BANK OF THAILAND

BOT Press Release

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Monetary Policy Report, September 2019

The Bank of Thailand (BOT) released the September 2019 issue of the *Monetary Policy Report*. The *Report*, published quarterly, is aimed at enhancing public understanding of the Monetary Policy Committee (MPC)'s policy stance and its assessment of Thailand's economic outlook. Details are summarized as follows.

Monetary Policy Conduct in the Third Quarter of 2019

The Thai economy was expected to expand at a lower rate than previously assessed and below potential due to a decline in exports which affected domestic demand. Headline inflation in 2019 was projected to be lower than previously assessed and below the lower bound of the inflation target due to lower-than-expected energy prices and core inflation. However, inflation was expected to rise toward the target next year. Meanwhile, there remained risks in the financial system that might pose vulnerabilities to financial stability in the future. **The Committee voted 5 to 2 to cut the policy rate by 0.25 percentage point from 1.75 to 1.50 percent at the meeting on August 7, 2019 and voted unanimously to maintain the policy rate at 1.50 percent at the meeting on September 25, 2019.** At the most recent meeting, the Committee viewed that accommodative monetary policy stance should support the rise of headline inflation toward target, and would contribute to the continuation of economic growth amid heightened risks mainly from the external front. Nevertheless, the Committee remained concerned about baht appreciation against trading partner currencies, which could affect the economy to a larger degree amid heightened external risks. The Committee thus saw the need to closely monitor developments of exchange rates and capital flows, and would consider implementing additional measures at an appropriate timing if necessary. With regard to addressing financial stability risks, given softening economic outlook and prolonged low interest rates in the period ahead, the Committee viewed that microprudential and macroprudential measures should be appropriately combined and targeted.

Looking ahead, the Committee would be data-dependent by closely monitoring the developments of the outlook for growth, inflation, and financial stability, together with associated risks, especially the impacts from trade tensions, in deliberating appropriate monetary policy going forward. The Committee would stand ready to use policy tools as appropriate. Nevertheless, the Thai economy continued to face structural problems, which would affect competitiveness and growth outlook going forward. This should be firmly addressed by all related parties.

Assessment of the Economic and Financial Outlook as the Basis for Policy Formulation

1. Global Economy

The global economy was expected to expand at a slower pace due to intensifying trade tensions between the U.S. and China weighing on production, exports, and private investment. However, private consumption continued to be an important driver, underpinned by robust employment, while more accommodative monetary policy stance and additional government stimulus measures would support growth of advanced economies in the period ahead. **The Committee thus revised down growth projection of Thailand's trading partner economies to 2.8 percent in 2019 and 2.7 percent in 2020. Nonetheless, the probability of trading partner economies underperforming the baseline projection remained** due to (1) uncertainties from prolonged trade tensions, which could undermine consumption and investment outlook, (2) uncertainties pertaining to the recovery of electronics cycle and exports, as well as (3) additional geopolitical risks which could increase volatility in the financial and commodity markets.

Many central banks cut their policy rates, the majority of them shifting toward more dovish stance to shore up the economy. The Federal Reserve (Fed) cut its policy rate again in September 2019 to 1.75 – 2.00 percent. Another policy rate cut was expected by the end of this year with another cut in 2020. The European Central Bank (ECB) announced a package of additional monetary policy easing measures in September. The Bank of Japan (BOJ) would likely ease monetary policy further should the economy experience a significant slowdown. Other regional central banks, including the Reserve Bank of Australia (RBA), Bank of Korea (BOK), the Reserve Bank of India (RBI), Bangko Sentral ng Pilipinas (BSP) and Bank Indonesia (BI) lowered their policy rates to support weakening economic and inflation outlook.

Emerging markets (EMs) continued to experience volatile capital flows. Capital outflows from EMs occurred due to (1) investor concerns about the Fed's monetary policy stance being less dovish than the markets anticipated, (2) intensifying trade tensions, (3) heightening geopolitical risks, as well as (4) more accommodative monetary policy of many EM central banks, including Thailand. However, capital flows returned to EMs at the end of the third quarter after concerns over trade tensions alleviated and advanced economy central banks shifted towards a more dovish monetary policy stance.

2. Financial Conditions and Financial Stability

Thailand's overall financial conditions remained accommodative as reflected by the real policy rate that remained at a low level relative to those of other EMs. Interest rates in Thailand's financial markets, including short-term government bond yields, corporate bond yields, and some commercial banks' lending rates declined in tandem with the policy rate cut. However, long-term government bond yields abruptly fell due to both internal and external factors. Overall financing activities continued to expand from the previous quarter. However, private credit exhibited slower growth mainly due to business loans extended to manufacturing, trade, and service sectors. Credit extended to households moderated, especially mortgage and auto leasing loans. The baht appreciated against the U.S. dollar from the end of the previous quarter on account of concerns over global economic slowdown as well as intensifying and prolonged trade tensions. In particular, after the U.S. announced additional tariffs on Chinese imports and designated China as a currency manipulator, safe-haven asset prices rose such as gold, and the Japanese yen and Thai baht strengthened. The real effective exchange rate (REER) index also appreciated from the last quarter.

There remained risks in the financial system that could pose vulnerabilities to financial stability in the future. However, some risks abated due to the implementation of targeted prudential measures and the economic slowdown. For instance, risks in the real estate sector had been partly addressed through the revised loan-to-value (LTV) measure, as reflected by (1) more tightening lending standards among financial institutions, especially for loans extended to the same purchaser acquiring the second and subsequent residential units, (2) subdued speculation in the property market, (3) lower residential prices encouraging affordability of some real demand, and (4) subsequent adjustments by real estate developers to cope with softening demand. **On the other hand, some risks had not improved**, including (1) weakening ability of households and SMEs to cope with negative income shocks, (2) rising risks of oversupply in the real estate market following domestic and foreign demand slowdown, and (3) the search-for-yield behavior which could lead to underpricing of risks, particularly among saving cooperatives and large corporates.

3. Economic and Inflation Outlook

The Thai economy was expected to expand at a slower pace at 2.8 and 3.3 percent in 2019 and 2020, respectively, which would be lower than the previous assessment in the *Monetary Policy Report* and below potential. This was due to a slowdown in both external and domestic demand. Merchandise and services exports were expected to exhibit slower growth than previously assessed due to further slowdown in global trade volume and trading partner economies. In addition, merchandise exports contraction began to impact private consumption and private investment. Meanwhile, public expenditure would grow at a slower rate owing partly to delays in state-owned enterprise investment projects. The annual average of headline inflation was projected to be lower, particularly in 2019 due to falling energy prices and slower core inflation in line with demand-pull pressures. Nonetheless, headline inflation was projected to increase toward the inflation target in 2020 in line with the economic outlook and cost-push inflationary pressures from the prospects of minimum wage increase.

The value of merchandise exports in 2019 was expected to contract, mainly due to the decline in export volume following intensifying and prolonged trade tensions. Export prices were projected to fall in line with global crude oil prices. In the period ahead, merchandise exports would recover thanks to the relocation of production base to Thailand in previous periods. Moreover, the U.S. would import more categories of Thai exports to substitute Chinese imports.

Exports of services were projected to decelerate consistent with the outlook of most foreign tourist nationalities and lower spending per head amid the global economic slowdown. However, government measures to boost tourism through extending the exemption of visa-on-arrival (VOA) fees from the end of October 2019 to April 2020 would attract more foreign tourists.

Private consumption was expected to be weighed down by weakened purchasing power. This was due to greater impacts of exports on employment and working hours in export-related manufacturing sectors. Farm income was projected to decline next year from the high base effect of agricultural prices due to natural disasters this year. In addition, elevated household debt may exert additional pressures on consumption, especially when household income were restrained. Despite all these, consumption would be shored up in the near term by government economic stimulus measures during the second half of 2019.

Private investment would expand at a lower rate than previously assessed in line with export contraction and domestic demand slowdown. However, government stimulus measures would bolster private investment to some extent. Looking ahead, private investment would benefit from additional relocation of production base to Thailand as businesses seek to avoid the impact of intensifying and prolonged trade tensions. Moreover, investor confidence was expected to pick up due to continued infrastructure investment in the Eastern Economic Corridor (EEC) as well as the public-private partnership (PPP) projects.

Public spending would support economic growth to a lesser extent than previously assessed due to delays in state-owned enterprise investment projects. In addition, there was a change in budget structure of the Annual Budget Expenditure Act B.E. 2563 (A.D. 2020) that led to a smaller proportion of capital expenditure and a larger proportion of current expenditure. Public investment would subsequently decelerate, while government consumption would increase in 2020.

Headline inflation was projected to be lower than the previous projection and below the inflation target in 2019 at 0.8 percent due to lower-than-expected outturns of energy prices and core inflation between June and August 2019. Core inflation would also soften in line with demand-pull inflationary pressures. Energy prices were projected to decline in tandem with global crude oil prices, although fresh food prices were expected to rise in the short term which would support headline inflation to some extent. Nevertheless, **the Committee assessed that headline inflation would increase toward the target in 2020 at 1.0 percent. Core inflation was projected to increase from 0.6 percent in 2019 to 0.9 percent in 2020 in line with the growth outlook and cost-push pressures from the prospects of minimum wage increase next year.**

The growth and inflation projections were subject to greater downside risks than the assessment in the previous ***Monetary Policy Report*** mainly due to external risks. **The possibilities that the Thai economy would underperform the baseline projection** would be due to (1) slower-than-expected trading partner economies and global trade volume as a result of intensifying trade tensions, impinging on Thai merchandise exports more than expected, (2) higher-than-expected increase in crude oil prices due to intensifying tensions in the Middle East, (3) potential implementation delay in government policy and discontinuity from the previous government, and (4) larger-than-expected household income shocks impinging on private consumption. On the other hand, **there were possibilities that the Thai economy would outperform the baseline projection attributable to** (1) higher-than-projected growth of trading partner economies if there were additional government stimulus measures, improvements in trade tensions, and faster-than-expected recovery in the electronics cycle, and (2) higher-than-expected domestic demand as a result of public infrastructure investment and PPP projects, which may boost private investment, as well as the potential implementation of additional government stimulus measures. **Downside risks to headline and core inflation projections remained**, in line with risks to the growth projection.

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