



# BANK OF THAILAND NEWS

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## **Interest rate policy and its impacts on the economy**

1. Since mid-1998, the Bank of Thailand has brought down **short-term interest rates in the repurchase market** and maintained the R/P 14-day at a current low level of 1.5 percent per annum in order to support a more broad-based economic recovery. The decline in the repurchase rates in turn induced commercial banks to reduce **MLR** from over 15 percent per annum to the current 7.75 percent per annum. Concurrently, however, commercial banks also reduced 3-month deposit rates from over 10 percent per annum to 3 percent per annum.
2. **Impacts on capital movements** The low interest rate policy in itself did not speed up capital outflows. Statistics on private sector's capital outflows show that **three quarters of the outflow was for foreign debt repayment**, which amounted to US\$8.58 billion, US\$15.15 billion, US\$15.94 billion, and US\$8.13 billion in 1997 (July-December, after the baht was floated), 1998, 1999, and the first 8 months of 2000, respectively.
3. **The consideration in foreign debt repayments depends on long term interest rates, not short term.** The data shows a regular pattern of repayment during the past 4 years; at monthly average rate of US\$1,430 million, US\$1,263 million, US\$1,328 million, and US\$1,016 million, respectively. Sources of refinancing for these debt repayments came in part from the issuance of fixed-coupon debt securities, and from floating rate bank loans.
4. **For the debtor that issues fixed coupon debt securities, the differential in long-term interest rates in Thailand and overseas is hardly significant as**

reflected in the rates for 10-year bonds in Thailand, US, and Euro. For those borrowing from commercial banks, the interest charged is floated against the MLR. Compared with LIBOR, **Thailand's MLR is still higher**. Therefore, debt repayment was not caused by the low interest rate policy, but due mainly to the risk-management strategy of individual debtors.

5. Domestic interest rates which are significantly lower than overseas are short-term rates such as 1-day R/P rate -- the wholesale money market rate -- which as of end-August 2000 was lower than the US overnight by 5.5 percent per annum. Whilst in the 3-month deposit rates, which is the market for the general depositors, Thailand's rate was lower than in the US by 3.375 percent per annum.
6. Despite the differential in short-term rates, the Bank of Thailand has regulations to prevent arbitrage activities from the interest differentials by setting the ratio of commercial banks net foreign assets to capital, and by controlling the amount of money a non-bank individual can take out of the country. Moreover, under the floating exchange rate regime, the risk from exchange rate volatility may nullify the gains from the interest differentials. Evidence shows that, during the past 4 years, capital outflows due to changes in foreign asset and liability positions of commercial banks and other private sectors were not significantly large.
7. Other items in the capital outflows are notably (a) foreign portfolio investment, and (b) commercial banks in Thailand delivering swap contract to the Bank of Thailand. Both factors have their own specific considerations.
8. **Impacts on private sector's consumption** The decline in deposit rates has reduced depositors' interest income, but at the same time, also lessened the burden of households which are servicing their debt. Moreover, borrowers which require consumer finance will have greater opportunity to take on the loan. During the period of decreasing interest rates, private sector's consumption did show continuous growth, as well as the rate of growth of sales of cars, motorcycles, and credits for general consumption.

9. **Impacts on private sector's investment and debt restructuring** The decrease in the interest rates on lending directly induced private sector's investment and accommodated the debt restructuring process as it helped reduce the cost of the project. For debtors whose repayment terms were extended by commercial banks, in the calculation of write downs and haircuts, commercial banks' debt write off will be lessened.
10. **Impacts on interbank interest spreads** In 2000 Q2, Thai commercial banks' effective interest spread was still low at 1.28 percent per annum. Banks' expenditure on operation and overhead typically accounts for 2-2.75 percent of total deposit.
11. **Future measures** Although actual interest received by commercial banks is still at a low level, it is recognised that MLR is still higher than deposit rates. The Bank of Thailand is therefore going to take steps to urge more competition among commercial banks to lead the process of lending rates competition, especially banks which had already transferred bad debts to AMCs. With improvement in credit expansion, competition for the market share of deposit will follow.

Other policies which the Bank of Thailand deems essential to support credit extension and debt restructuring include efficient credit information system, rapid court adjudication and negotiation process, and increased alternatives for savings, for instance, by increasing access for individuals to buy government bonds. The Bank of Thailand will further coordinate with other agencies involved to follow up on these measures.

**Bank of Thailand**  
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[Attachment](#)