BANK OF THAILAND NEWS
Communications and Relations Office, Management Assistance Department
Tel. 0-2283-5016-7 FAX 0-2281-5648 www.bot.or.th

No. 107/2000

A further clarification of interest rate policy

In response to the criticism that the acceleration in debt repayment has been due to the low interest rate policy. We would like to clarify that in fact the level of debt repayment has been steady over the past 4 years. We would also like to confirm that the relevant domestic credit condition will not be affected by low interest rate policy for the following reasons:

1. In the fixed exchange rate system, when there is a change in capital movement BOT needs to intervene in the foreing exchange market, resulting in a full increase or decrease of domestic money supply. That is in the case of capital inflows, money supply will increase. In the case of capital ouflows, the supply will be reduced.

2. However, in the managed floating exchange rate system, BOT intervenes in the foreing exchange market only to a limited extent. The change in the level of capital movement will not affect the level of domestic money supply as much as under the fixed exchange rate regime. Moreover, under the managed floating exchange rate system, BOT could increase the level of money supply to an appropriate level without relying on capital inflows. Therefore, an increase in external debt repayment does not aggravate the domestic credit situation. There is also substantial excess liquidity in the money market at the moment.

3. In response to the proposal that BOT should have raised interest rates to discourage debt repayment, we would like to clarify that raising short-term interest rate in the repurchase market only indirectly affect long-term interest rate. This is because long-term rate depends more imporatantly on inflation and the amount of government bond issued. The change in BOT policy regarding interest rate, therefore, will not directly influence the debt repayment situation.

4. We believe that the increase in debt repayment has a clear advantage in alleviating the debt burden of small private businesses who are vulnerable to the volatility of exchange rate. The acceleration in debt repayment, therefore, will help these businesses and contribute to the overall debt reduction of the Thai economy. Thailand's short-term external debt is now reduced to 19 percent of GDP in July 2000, as compared to 35 percent at the end of 1997. Total external debt is now at 69 percent of GDP, as compared to the international standard of low-indebted country of 48 percent.

5. If BOT raise interest rate too early while the economy is still recovering, the tight monetary policy would reduce domestic investment, consumption and expenditure. The increase in domestic demand is what Thailand needed at the moment in order to maintain the process of economy recovery. An increase in interest rate will affect foreing investors' confidence and hence put extra burden on the external debt ridden Thai companies.

In conclusion, we would like to assure you that the increase in external debt repayment will not affect domestic liquidity and credit condition. The proposal to raise interest rate to discourage debt repayment is therefore not appropriate given the current economic circumstance.

Bank of Thailand

27 September 2000