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BOT Press Release

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Monetary Policy Report, June 2021

The Bank of Thailand (BOT) released the June 2021 issue of the *Monetary Policy Report*. The *Report*, published quarterly, is aimed at enhancing public understanding of the Monetary Policy Committee's (MPC) policy stance and its assessment of Thailand's economic outlook. Details are summarized as follows.

Monetary Policy Conduct in the Second Quarter of 2021

At the meetings on May 5 and June 23, 2021, the Committee voted unanimously to maintain the policy rate at 0.50 percent. The Committee assessed that Thailand's economic recovery would be slower and more uneven compared with the previous assessment. The Thai economy was projected to expand by 1.8 in 2021 and 3.9 percent in 2022. The third wave of the COVID-19 outbreak would affect the recovery in foreign tourist figures and domestic demand. Labor markets became more fragile and might pick up more slowly than in the past, especially the services sector and among the self-employed. Additional fiscal support and strong merchandise export growth would only partially offset the impact from the third wave. Headline inflation rose temporarily in the second quarter of 2021 due mainly to supply-side factors. Meanwhile, rising inflation in advanced economies and supply constraints—including the shortage of manufacturing inputs as well as higher costs of transportation and raw materials—would have limited passthrough to domestic inflation. Medium-term inflation expectations remained well-anchored within the target range.

Key assumptions underpinning the latest economic forecasts were as follows. First, the third wave of COVID-19 in Thailand would be well contained by the beginning the fourth quarter of 2021. Second, at least 100 million vaccine doses would be procured and distributed within 2021 as planned, leading to the attainment of herd immunity by the first half of 2022. Third, additional fiscal stimulus would be forthcoming under the new Emergency Decree that authorized 500 billion baht of government borrowing. **However, the Thai economic outlook would still face significant uncertainties and downside risks,** including (1) prolonged outbreaks and virus mutations, both the existing and new variants, (2) smaller-than-expected government spending on economic relief and restoration, (3) further deterioration in business balance sheets from the new wave, especially those in the services sector, leading to widespread business closures and lay-offs, and (4) higher-than-expected impact of supply disruptions and higher shipping costs on Thailand's manufacturing and export sectors.

The Committee viewed that the most important issue facing the Thai economy at the present was the procurement and distribution of appropriate vaccines in an adequate and timely manner. Financial measures should be expedited, particularly the special loan facility and debt restructuring. These would provide more targeted assistance to the affected businesses and households than cutting the policy rate. The policy rate was already at a low level and cutting it might not lend much support to the economic recovery. The Committee thus voted to maintain the policy rate and would stand ready to use the limited policy space at the most effective timing. The Committee also viewed that all parties should swiftly push forward the implementation of various measures to support the economy, especially over the next six months where uncertainties would remain high.

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

1. Global Economy

The global economy continued to recover on the back of improving private consumption and services sector, especially in the U.S. after containment measures were relaxed and financial aids were granted to the low-income. Meanwhile, Asian exports exhibited strong growth. Looking ahead, Thailand's trading partner economies would continue to recover thanks to the abatement of the outbreak, the progress of vaccine distribution in many countries, as well as the additional fiscal stimulus measures and accomodative monetary policies supportive of the recovery. **The Committee expected trading partner economies to expand 6.0 percent in 2021 and 4.1 percent in 2022.** Nonetheless, downside risks to trading partners' growth increased. **New waves of infections and virus mutations could prompt governments to tighten containment measures again** and could also reduce vaccine efficacy. This would delay herd immunity attainment in each country and undermine consumer confidence. In addition, the global shortage of manufacturing inputs could be more severe and more protracted than expected.

Governments worldwide continued to implement monetary and fiscal measures to alleviate the impacts of the pandemic. The U.S. government announced measures to rebuild the U.S. economy over the longer term, namely, the 2.25 trillion U.S. dollars American Jobs Plan and the 1.8 trillion U.S. dollars American Families Plan. Central banks around the world continued to maintain accommodative monetary policy stances by keeping policy rates low and conducting quantitative easing. Nevertheless, the Federal Reserve and the Bank of England signaled potential shifts in monetary policy stances if economic growth remained robust and inflation returned to the target sustainably. Global financial conditions could therefore start tightening in the period ahead.

2. Financial Conditions and Financial Stability

Overall financial conditions in Thailand remained accommodative. Short-term interest rates in financial markets remained at low levels consistent with the policy rate. Medium- and long-term Thai government bond yields fell in tandem with the long-term U.S. treasury bond yields and higher foreign investors' demand for Thai government bonds. However, the new Emergency Decree authorizing 500 billion baht of government borrowing led to a slight increase in the long-term government bond yields due to an anticipation of greater bond supply . Benchmark lending rates of commercial banks remained low and new loan rates (NLR) declined particularly for larger-sized loans. On exchange rates, the baht against the U.S. dollar and the effective exchange rate continued to depreciate from the previous quarter due to (1) the third wave of COVID-19 outbreak in Thailand and (2) the stronger U.S. dollar driven by the signaling of the Federal Reserve of potential faster-than-expected policy rate hikes. Nevertheless, the

Committee would continue to closely monitor developments in the foreign exchange market and capital flows, while continuously expedite the new foreign exchange ecosystem in Thailand.

The Thai financial system remained vulnerable due to the impact of the third wave that delayed the recovery and increased uncertainties. Weak balance sheets and debt servicing capabilities of households and businesses were exacerbated by the third wave. In the period ahead, risks posed by the highly uncertain recovery and the pandemic would remain. Households and businesses would therefore need continued support from fiscal and financial measures to alleviate the impacts. Their balance sheets and debt servicing capabilities warranted close monitoring, especially during the phase-outs of support measures.

3. Economic and Inflation Outlook

The Thai economy was projected to expand 1.8 percent in 2021 due to the more prolonged and severe third wave that affected domestic spending and foreign tourist figures. Nevertheless, additional fiscal stimulus from the new Emergency Decree, clearer plans for vaccine procurement and distribution, as well as strong merchandise export growth on the back of trading partners' economies would help the Thai economy to avoid a sharp slowdown. **Growth would pick up and expand 3.9 percent in 2022** underpinned by continuing support from government measures. Furthermore, herd immunity in Thailand was expected to be attained within the first half of 2022, facilitating a gradual resumption in economic activities and increasing foreign tourist admissions in 2022.

Merchandise export value was expected to post solid gain at 17.3 percent in 2021 and 4.9 percent in 2022 following much stronger-than-expected outturns in the first quarter of 2021. Looking ahead, merchandise exports would see robust expansion in tandem with trading partners' economic growth. However, global supply constraints such as the shortage of freight containers, higher costs of transportation and raw materials, and the shortage of electronic components could have some impact on Thai merchandise exports going forward.

Exports of services would continue contracting and slowly recover. Foreign tourist figures were revised down to 0.7 million in 2021 and 10 million in 2022. This was on account of the new wave of the COVID-19 outbreak and virus mutations abroad and in Thailand, which prompted some countries to maintain international travel restrictions. Thailand would also be unable to relax quarantine requirements for travelers arriving from abroad.

The current account balance would record a deficit of 1.5 billion U.S. dollars in 2021 due to lower foreign tourist figures, as well as higher transport costs and oil prices. **For 2022, the current account surplus would be smaller than the previous assessment,** recording 12 billion U.S. dollars in line with a decline in tourism receipts due to lower foreign tourist figures.

Private consumption would gradually recover in the latter half of 2021. Despite being restrained in the first half of 2021 from the new outbreak and more stringent containment measures, private consumption was expected to gradually recover in the second half of the year thanks to additional government relief and stimulus measures. Progress in vaccine distribution would partly contribute to improving consumer confidence, leading to a recovery in tourism and services sector spending in 2022.

Private investment recovery would be sustained, growing 7.0 percent in 2021 and 6.0 percent in 2022 in line with the stronger export growth. The third-wave outbreak held back private investment somewhat during the first half of 2021 with investments in large infrastructure projects declining slightly. Despite that, private investment would pick up in the second half of 2021 driven by strong export growth and gradual upturn in private consumption.

The risks of the Thai economic outlook underperforming the baseline projection would be significant. First, protracted outbreaks and virus mutations from both the existing and new variants could reduce vaccine efficacy while prolonging and intensifying the pandemic. These could lead to a public health crisis, affect domestic spending and delay the re-opening plan to admit foreign tourists. Second, government spending on economic relief and restoration could be lower than expected if the projects under the new Emergency Decree faced approval delays or low disbursement rates. Third, balance sheets of businesses could be exacerbated by the new outbreak, especially those in the services sector leading to widespread business closures and lay-offs. Dismissed workers could be unemployed for extended periods and eventually give up finding jobs. Further deterioration in business and household balance sheets would thus impinge on economic activities and cause a rise in debt defaults. Fourth, supply disruption and higher shipping costs may have more impacts on Thailand's manufacturing and export sectors than expected.

Headline inflation was projected to be 1.2 percent in both 2021 and 2022. For 2021, inflationary pressure would rise on account of supply-side factors. Energy prices increased in tandem with the rise in global crude oil prices, although the government measure to reduce electricity bills temporarily eased some of the price pressures. For 2022, headline inflation would be higher than previously assessed as the effects of measures to reduce electricity bills dissipate. Headline inflation would remain within the target range throughout the forecast horizon. Core inflation was revised down to 0.2 percent in 2021 and 0.3 percent in 2022 given that demand-pull inflationary pressure would be subdued and recover more slowly following recurring outbreaks.

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