Edited Minutes of the Monetary Policy Committee Meeting (Special Meeting)
20 March 2020, Bank of Thailand
Publication Date: 8 April 2020

Members Present

Veerathai Santiprabhob (Chairman), Mathee Supapongse (Vice Chairman), Paiboon Kittisrikangwan, Sethaput Suthiwart-Narueput, Kanit Sangsubhan, Subhak Siwaraksa, and Somchai Jitsuchon

Since the Monetary Policy Committee (MPC) meeting in February 2020, the coronavirus (COVID-19) outbreak continued to worsen and deteriorated rapidly. The outbreak raised concerns in global financial markets and affected liquidity in Thai financial markets during the week prior to the scheduled meeting around the end of March. **The Committee thus held a special meeting on 20 March 2020 to assess the rapidly changing outbreak situation and its impacts on the economic outlook and the functioning of financial markets, particularly during the week prior to the special meeting, to consider necessary measures in a timely manner.**

The Global Economy

Trading partner economies would experience a significant slowdown due mainly to the prolonged and intensified COVID-19 outbreak. Advanced economies, especially the euro area, Japan, and the US, would likely enter recession. Manufacturing production and exports were affected by supply chain disruptions. Consumption and tourism significantly weakened, leading to substantial declines in employment and consumer confidence. **China and Asian economies** would exhibit much slower growth despite some improvements in China's economic activities after the COVID-19 outbreak started to abate. However, the spread of COVID-19 to various countries in Asia caused significant slowdown in Asian economic activities. Nevertheless, **public sectors in various countries worldwide announced financial and fiscal measures to alleviate the impacts. In particular, central banks stepped up efforts to increase monetary policy accommodation**. For example, the Federal Reserve (Fed), Bank of England (BOE), Reserve Bank of Australia (RBA), Bank of Korea (BOK), and Bank Negara Malaysia (BNM) reduced their policy rates to support the economies. The People's Bank of China (PBOC) lowered the reserve requirement ratio (RRR). Moreover, many countries implemented other additional measures concurrently such as financial assistance for households or SMEs and wage subsidy schemes.

The Committee assessed that there was a likelihood of trading partners' economic growth being lower than the baseline assessment due to the COVID-19 situation that could become more severe and widespread to other countries, together with other risks including financial system vulnerabilities in many countries, geopolitical risks, risks pertaining to trade protectionism that remained highly uncertain, as well as uncertainties regarding trade deal after Brexit. The Committee thus saw a need to closely monitor those risks, especially the COVID-19 as it could significantly impact the Thai economy through various channels including tourism, manufacturing, and merchandise exports. In addition, capital flows and financial markets volatilities also warranted close monitoring.

<u>The Financial Markets</u>

Concerns in global financial markets heightened from the COVID-19 spread outside China, which became more severe and affected the functioning of global and Thai financial markets. This was reflected in the sharp rise in the VIX index since late February. Risk-off sentiments among investors led to a steady decline in the holding of risky assets, both equities and bonds. Investors accelerated selling of equities in the middle of March, resulting in sharp plummets of stock market indices in advanced economies which frequently triggered circuit breakers. Meanwhile, investors sold off US government bonds in exchange for cash that was perceived as less risky. Prices on US government bonds fell while yields rose quickly. The sharp surge in demand for US dollars in global financial markets resulted in a dollar liquidity squeeze, reflected in a more negative cross currency basis. Moreover, foreign investors also reduced holdings of emerging market assets, affecting Thai equity and bond markets.

On exchange rates, the baht weakened against trading partner currencies, especially major currencies, and exhibited volatile movements. The baht depreciated against the US dollar since the February meeting and also depreciated against regional currencies as reflected in the continuous decline in the nominal effective exchange rate (NEER) since the beginning of this year. This was due to investor concerns about the outlook of Thai economy caused by both external and domestic factors, especially the COVID-19 outbreak which became more severe and widespread. Meanwhile, the baht moved in line with other currencies affected by the outbreak.

In the bond market, the Thai government bond yields were volatile. Short-term Thai government bond yields declined in line with the policy rate cut at the February meeting. Long-term Thai government bond yields fell in line with the US counterpart. Nevertheless, after the COVID-19 spread triggered risk-off sentiments in global financial markets, foreign investors continually reduced their investments in both short- and long-term Thai government bonds. Moreover, some Thai investors rushed to redeem their investment units in daily fixed income funds, which allowed for daily redemption, especially the funds investing in foreign assets. Some mutual funds therefore sold off government bonds in order to have enough cash to return to unitholders. Consequently, Thai government bond yields in some tenors rose rapidly and affected the liquidity and functioning of financial markets. This was reflected in the abnormally high bid-ask spreads throughout the week prior to the special meeting. The Bank of Thailand therefore provided liquidity through a large amount of government bond purchases to alleviate the impacts.

The Committee viewed that the financial markets would remain highly uncertain in the period ahead, primarily depending on the duration and severity of the COVID-19 situation. The Committee would therefore closely monitor the situation and its implications on capital flows and financial markets. The Committee also asked the Bank of Thailand to ensure sufficient liquidity as well as the well-functioning and stability of the financial markets. The Committee viewed that recent liquidity strains in the Thai financial markets, especially the bond markets, were partly due to tighter liquidity in global financial markets, despite overall stability of the Thai financial system. If the liquidity tightening extended to corporate bond markets, the real sector could be affected. The Committee therefore deemed it necessary for related organizations to prepare preventive measures to address liquidity strains in financial markets from further intensifying and affecting overall financial system stability.

Domestic Economic Conditions and Financial Stability

The Thai economy would likely contract significantly in 2020 due mainly to the COVID-19 outbreak which affected external demand and domestic economic activities. Exports of services would severely contract because of the deterioration in both tourist figures and tourism receipts after the outbreak became more severe and travel bans were announced. **Merchandise exports** would markedly decline in line with the significant slowdown of trading partners' economies, where some countries would enter recession. Merchandise exports would also be affected by supply chain disruptions. Benefits arising from increased demand in some product categories could not be offset by these headwinds. The significant slowdown in external demand and supply chain disruptions in many countries would lead to reduction in domestic economic activities. These would widely affect business and household incomes and consequently result in shrinking domestic demand. **Private consumption** would fall, as already seen in the decline in away-from-home expenditure, in line with both farm and non-farm incomes and the limited financial cushion for necessary expenses. Agricultural households would be affected by the drought whose impact turned out more severe than expected. Furthermore, elevated household debt would still weigh on private consumption in the period ahead. **Private investment** would experience a downturn owing to domestic and external demand. Some businesses expressed weakened confidence, leading to slowing down or postponing investment. Nevertheless, infrastructure investment, including public-private partnership projects, would support private investment going forward. **Public expenditure** would expand, albeit at a slower pace than the previous assessment from the impacts of the delayed Annual Budget Expenditure Act. **For 2021, the Thai economy was expected to recover** if (1) the virus spread abated, (2) fiscal measures could sustain economic activities, alleviate the adverse impacts, and assist various groups affected by the outbreak, and (3) financial institutions' assistance measures to borrowers could help relieve the impacts of the outbreak.

The Committee engaged in extensive discussions regarding factors contributing to the Thai economic recovery in the period ahead amid heightening risks and assessed the impacts of risks under each scenario. The key risks were as follows. First, the current COVID-19 outbreak could become more severe and widespread. The Committee saw that the outbreak in the period ahead would be difficult to forecast accurately under potentially different outcomes. For example, despite some countries having successfully contained the outbreak, the outbreak could spread to other countries or re-emerge in the previously contained countries. Under each scenario, the impacts on tourism and economic activities would be different. For Thailand, if the outbreak could be contained within the second quarter of 2020 according to the Ministry of Public Health estimates, tourist figures might recover somewhat during the second half of this year. **Second, regarding shock absorption capacity and the global recovery outlook**, the global economy would likely enter into a recession given that the COVID-19 outbreak affected behavior and lifestyle of the population. Meanwhile, the speed of the global economic recovery in the period ahead depended on many factors, including the intensity and duration of the outbreak at home and abroad, vaccine development, along with the capacity of the economy to adapt and to absorb shocks. Under each scenario, the exports of goods and services would be affected through lower trading partners' incomes and supply chain disruptions in many countries. **Third, domestic financial and fiscal measures** would be key mechanisms to alleviate the impacts on the economy and assist various groups affected by the COVID-19 outbreak. After the number of confirmed cases in Thailand rose, various parties including the government, the Bank of Thailand, related agencies, and financial institutions announced some relief measures such as measures to boost liquidity and reduce debt burden. The Committee viewed that such measures were appropriate. However, since the outbreak would remain highly uncertain in the period ahead, financial and fiscal measures needed to be coordinated proactively as well as expanded to assist the affected groups in an adequate, comprehensive, and timely manner to sustain the economy.

The Committee viewed that the Thai economy would face elevated risks going forward. Significant external risks therefore warranted close monitoring. These included the COVID-19 spread and containment, the impacts on the global economic outlook which may result in severe recessions, and relief and stimulus measures of each country. Further risks that warranted close monitoring included the spread of the virus in Thailand, the policies and measures to assist affected groups, financial institution assistance to borrowers, together with the impact of drought on the economy that could be more severe than expected. These factors would have implications on the economic recovery and the long-term potential of the Thai economy.

The annual average of headline inflation would be below the target throughout the forecast horizon. Headline inflation would be negative in 2020 owing to falling energy prices in line with subdued energy demand mainly because of the COVID-19 outbreak. **Core inflation** would decrease on the back of falling demand-pull inflationary pressures, while the increase in fresh food prices would have limited impacts. For 2021, headline inflation would increase somewhat given the low-base effect of energy prices in 2020. However, this could not offset the continuous decline in core inflation. **Headline and core inflation would be subject to downside risks** in line with risks to the economy and crude oil prices.

The financial system remained sound overall, but vulnerabilities increased in some pockets given the sharp economic contraction that potentially led to income shocks, falling asset prices and tighter financial conditions. This could lead to worsening debt servicing capability and higher corporate bond rollover risks. Nonetheless, the Thai banking system remained healthy with high levels of capital fund and loan loss provision to withstand deteriorating loan quality. In addition, external stability remained robust, indicated by ample international reserves.

The Committee discussed the increased complexity of the interconnectedness within the financial system, together with efforts to ring-fence risks seen in some areas to prevent negative spillovers. The Committee saw that risks in the corporate bond markets might be transmitted to corporate bond holders and to some saving cooperatives that had high proportion of vulnerable corporate bonds in their portfolios. The Committee thus supported the establishment of the Corporate Bond Liquidity Stabilization Fund (BSF) and deemed it necessary for related organizations to prepare readily available measures to prevent the liquidity strain in financial markets from spreading further and affecting overall financial system stability.

Monetary Policy Decision

The Committee viewed that the COVID-19 spread in the period ahead would be more severe than expected and the situation would take some time before returning to normal. As a result, the Thai economy would markedly contract in 2020. The headline inflation was projected to be negative this year and below the lower bound of the target throughout the forecast horizon. Financial stability became more vulnerable due to the weakened growth outlook in the near term. Moreover, the outbreak caused concerns among global financial markets and affected liquidity and the functioning of Thai financial markets despite overall stability of the financial system. **The Committee viewed that prompt policy action prior to the scheduled meeting would help alleviate the impacts on the Thai economy and financial markets in a timely manner amid the rapid changes in the outbreak situation. The Committee thus voted unanimously to cut the policy rate by 0.25 percentage point from 1.00 to 0.75 percent effective on 23 March 2020.** The policy rate cut would reduce interest burdens of affected borrowers, alleviate liquidity strain in the financial markets, mitigate the impacts on the economy, and would also reinforce fiscal measures already implemented and forthcoming.

The Committee viewed that the policy rate cut in the previous and today's meetings would benefit the economy if financial institutions took active roles in addressing liquidity problems of borrowers, especially SMEs and households, as well as accelerating debt restructuring to have noticeable and meaningful impacts. The Committee urged the Bank of Thailand to closely monitor each financial institution's assistance to borrowers. **The Committee also saw a need to have measures to enhance liquidity in the financial markets which was likely to be tightening.** The Committee thus supported the Bank of Thailand, in collaboration with related organizations, to consider implementing other measures in addition to government bond purchases to support and sustain liquidity in the financial markets to ensure stability and the well-functioning of the financial markets.

Monetary Policy Group
8 April 2020