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Members Present

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

The Global Economy

Trading partner economies would expand at a slower pace due to the coronavirus outbreak despite having exhibited more stabilizing growth previously. Advanced economies would grow moderately due to weakened manufacturing production. This was reflected in rising business inventory and declining employment in the manufacturing sector. Meanwhile, employment in the services sector and private consumption indicators showed some signs of improvement. **China and Asian economies** exhibited stabilizing growth, particularly in the manufacturing sector, as reflected in declining business inventory as well as increasing orders for intermediate and capital goods. Moreover, growth stabilization was supported by a sustained recovery of the electronics cycle on the back of 5G technology and improving business confidence after the US and China reached an agreement on the phase one trade deal. However, the coronavirus outbreak posed higher risks to short-term economic growth. This situation remained highly uncertain and could be prolonged and thus warranted close monitoring. **Monetary policy of trading partners** would continue to be accommodative following series of policy rate cuts last year. In January 2020, the People's Bank of China (PBOC) reduced the reserve requirement ratio (RRR) to provide more liquidity to the financial system, and Bank Negara Malaysia (BNM) cut the policy rate further to foster economic growth.

The Committee assessed that there was a probability of trading partner's economic growth being lower than the previous assessment due mainly to (1) the coronavirus outbreak that could widely spread to other countries and their impacts could extend from private consumption and tourism to manufacturing sector and international trade, (2) high uncertainties of trade protectionist measures regarding the further actions of the US and China following the phase one trade deal, which warranted monitoring as it could affect international trade and trade negotiation going forward, (3) uncertainties pertaining to trade deal after Brexit, and (4) geopolitical risks that could be intensified and prolonged, particularly recurring protests in several countries. The Committee thus saw a need to monitor developments in the trading partner economies, together with the risks mentioned above, and closely evaluate their impacts on the Thai economy that could occur through various linkages.

The Financial Markets

Despite a slightly improved confidence following the agreement between the US and China over the phase one trade deal, there were rising concerns in the global financial markets over the short term owing to the coronavirus outbreak. The outbreak caused most of asset prices in the global financial market to fall and become more volatile. Regarding the Thai financial market, short-term government bond yields declined partly due to higher demand. Long-term government bond yields continued to decline in tandem with concerns in the global financial market and the Thai economic outlook, especially by a further delay in the enactment of the Annual Budget Expenditure Act, B.E. 2563 (A.D. 2020). Meanwhile, non-resident capital flows recorded net outflows from both the equity and short-term bond markets.

On exchange rates, **although the Thai baht depreciated somewhat, it remained potentially inconsistent with economic fundamentals.** Over the intermeeting period, the baht depreciated against the US dollar. The baht also depreciated against regional currencies as reflected by a decline in nominal effective exchange rate (NEER) despite its high level compared with the past. The recent baht depreciation was due to investors' concerns over the softening outlook for the Thai economy from domestic and external factors, as well as the Bank of Thailand's relaxation of foreign exchange regulations to facilitate capital outflows. The investors started to view that the baht could depreciate after a substantial appreciation last year. Meanwhile, a divergence in the trends of the baht and prices of gold, which was a safe-haven asset, was more prominent especially during the coronavirus outbreak period. This reflected a diminishing safe-haven status of baht-denominated assets from the investors' perspective.

The Committee viewed that the financial markets would remain highly uncertain going forward due to various factors including the coronavirus outbreak, risks that the trade protectionism could reintensify and be further widespread, geopolitical risks, and Thai economic slowdown. These factors could cause volatilities in Thai asset prices and exchange rates. The Committee thus saw a need to continue to closely monitor developments of exchange rates and capital flows.

<u>Domestic Economic Conditions and Financial Stability</u>

The Thai economy in 2020 would expand at a much lower rate than the previous forecast and much further below its potential due to the coronavirus outbreak, the delayed enactment of the Annual Budget Expenditure Act, and the drought, all of which would affect a large number of related businesses and employment. **Exports of services** would be much lower than the previous forecast following a significant drop in tourist figures and tourism receipts mainly due to the Chinese government's prohibition on Chinese outbound group tours after the outbreak of coronavirus. **Merchandise exports** would decline in line with trading partner economies and potential impacts of regional supply chain disruptions due to a temporary production halt in China such as electronics and automotive industries. **Public expenditure** would grow at a lower rate than previously assessed due to a further delay with increased uncertainty in the enactment of the Annual Budget Expenditure Act. **Private consumption** would expand at a lower rate than previously assessed in tandem with more restrained household income in service, agricultural, and manufacturing sectors. The household income was negatively affected by the coronavirus outbreak, declining exports, the more-severe-than-expected drought, and elevated household debt. **Private investment** was expected to slow down. Business confidence was affected by the delay in the Annual Budget Expenditure Act. Financial institutions became more cautious in extending business loans amid economic slowdown with additional pressures from a slowdown in private consumption and tourism.

The Committee engaged in an extensive discussion regarding major risk factors to the Thai economy and an assessment of the impacts of those risks in each scenario through various linkages. Such major risk factors included, **first, the coronavirus outbreak** that remained highly uncertain as it could become rapidly widespread and prolonged. This would in turn pose larger-than-expected impact on the Thai economy, particularly for businesses and employment in tourism sector. In addition, there was a risk that Chinese group tours could be prohibited to travel abroad much longer. In case the outbreak were to be well-contained, and the recovery in tourist figures would still take time. Furthermore, the Committee viewed that Wuhan was a major transport hub and manufacturing center for some industries such as steel, automotive, and electronics. Factory shutdowns in Wuhan and nearby cities since Chinese New Year holiday could lead to supply chain disruption and could have knock-on effects on the recovery of electronics cycle and Thai export sector. **Second, the further-delayed-than-expected enactment of the Annual Budget Expenditure Act** would affect operations and liquidity of relevant businesses, especially construction companies. **Third, the drought** that could be more severe than expected would affect purchasing power of agricultural households. The Committee thus saw a need to closely monitor developments of the abovementioned risk factors which remained highly uncertain and to assess the impacts on the Thai economy through each channel.

The annual averages of headline inflation in 2020 and 2021 were projected to be lower than the lower bound of the inflation target throughout the forecast horizon due to moderating core inflation following subdued demand-pull inflationary pressures. In addition, energy prices were projected to be lower than expected owing to declining oil demand as a result of the coronavirus outbreak, while fresh food prices were expected to increase slightly due to the drought. **Core and headline inflations remained subject to downside risks** in line with risks to the economy.

There were more vulnerabilities in the financial system due to the slowing economy which led to negative income shocks for both businesses and household. Risks in the period ahead increased owing to the coronavirus outbreak, the delayed government spending, and the intensifying drought. Major risks were as follows.

(1) Debt serviceability where medium-sized SMEs were found to have deteriorating loan quality in addition to small-sized SMEs which had been highly vulnerable owing to existing structural problems. Meanwhile, the impacts on businesses that relied on Chinese demand and tourism sector warranted close monitoring. Regarding household debt, the household debt-to-GDP ratio remained elevated and would continue to edge up as a result of the economic slowdown as well as credit card and personal loan growth where household increasingly resorted to collateralized personal loans for liquidity.

(2) Search-for-yield behavior that led to underpricing of risks still persisted in the lower-for-longer interest rate environment. Large corporates increasingly shifted their funding to the bond market instead of bank loans during the low interest rate environment, with commercial banks becoming cautious in extending loans. As a result, both corporates and investors could underprice risks. Regarding saving cooperatives, assets held by a large saving cooperative, who served as an intermediary for taking deposits and extending loans, grew at a higher rate as its deposit rates were higher than those of commercial banks and those deposits were invested more in financial assets.

(3) Risks in the property sector decreased despite a need to continue monitoring the oversupply. The speculation in the property sector would abate. Financial institutions extended mortgage loans with tighter credit standard. Some developers adjusted by delaying new project launches, but some still launched new projects. Hence, oversupply and time-to-go still rose. Moreover, some developers mainly relied on bond market for funds. These developers' remaining credit lines with commercial banks were also limited. Thus, there was a need to monitor rollover risks especially for non-investment grade or unrated bonds. Meanwhile, the recent implementation of monetary and fiscal measures would help reduce the oversupply in the property sector to some extent. Such measures were the reduction of transfer fees and mortgage registration fees for new housing units under three million baht, a 50,000-baht cash rebate program for homebuyers (the Baan Dee Mee Down scheme), and the relaxation of the loan-to-value (LTV) measure by the Bank of Thailand.[1]

The Committee viewed that the previously implemented macroprudential measures helped curb vulnerabilities in the financial system to some extent. The Committee saw a need to continue monitoring and assessing the impacts of LTV measure on the property sector, financing by large corporates that might underprice risks, and risks associated with the large saving cooperative who served as an intermediary for taking deposits and extending loans. Moreover, the Committee viewed that household debt was a critical and urgent risk that would require a multi-dimensional resolution. Cooperation between various parties was needed to reduce leverage and to restructure existing debt. In this light, greater emphasis should be placed on borrowers' debt serviceability and adequate residual income to cover their costs of living. The Committee thus directed an exploration of debt to service ratio (DSR) data to examine the impacts of the abovementioned risks and to study holistic measures to address the household debt problem.

Monetary Policy Decision

The Committee assessed that the Thai economy would expand at a slower rate in 2020 than previous projection and much further below its potential. Headline inflation would be below the lower bound of the inflation target throughout the forecast horizon. Financial stability became more vulnerable due to the modest growth outlook. In this situation, there was an urgent need to coordinate monetary and fiscal measures. The Committee viewed that a more accommodative monetary policy stance would alleviate the negative impacts. A more accommodative monetary policy would also support liquidity provision and debt restructuring for businesses and households severely affected from these negative impacts that should be urgently implemented and materialized. **The Committee therefore voted unanimously to cut the policy rate by 0.25 percentage point from 1.25 to 1.00 percent.** In this regard, some Committee members viewed that extra accommodative monetary policy at this juncture would be appropriate to support the Thai economic growth and to facilitate the rise of headline inflation toward the target range amid downside risks and heightened uncertainties arising from both external and domestic factors. However, the need for extra accommodative monetary policy would gradually reduce going forward should the developments of the economic outlook continue to gain traction, impacts resulting from aforementioned uncertainties turn out to be less than expected, and headline inflation trajectory become consistent with the inflation target. In their policy deliberation, the Committee discussed key considerations underpinning the policy decision. Their conclusions were as follows.

1) The Thai economy would expand at a much lower rate in 2020 than the previous forecast and much further below its potential due to the coronavirus outbreak, the delay in the Annual Budget Expenditure Act, and the drought that would affect a large number of related businesses and employment. Tourist figures were expected to reduce from the previous forecast.

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[1] The Bank of Thailand amended the regulation of mortgage lending (LTV measures) on January 20, 2020

Exports of goods would decline in line with trading partner economies and the potential impacts of regional supply chain disruptions. Regarding domestic demand, the public expenditure would grow at a slower rate owing to the delayed enactment of the Annual Budget Expenditure Act, which remained subject to high uncertainty. Furthermore, private consumption would be restrained by moderating household income in the services, agricultural, and manufacturing sectors as well as by elevated household debt, which would deteriorate households' capability to withstand negative income shocks compared to the past that labors could move from adversely affected sectors to more resilient sector, or could borrow to cover liquidity shortage.

The Committee viewed that the Thai economy would encounter uncertainties from both external and domestic factors going forward, including (1) the coronavirus outbreak that could intensify and be prolonged which would consequently affect the manufacturing sector and exports, particularly as a result of further delayed recovery of the electronics cycle, (2) uncertain trade tensions and geopolitical risks that could dampen the economic outlook of trading partners, (3) uncertainties pertaining to public expenditure that might not provide sufficient support for the economy, including the progress of important public-private partnership infrastructure investment projects and their knock-on effects on private investment, (4) risks from drought which might be more severe than expected and affect agricultural output and farm income, as well as increasing costs of water supply management in some areas, and (5) lower-than-expected private consumption due to a decline in household income and employment.

The Committee remained concerned that the baht might not be consistent with economic fundamentals as the baht continuously appreciated against trading partner currencies last year, and would likely remain volatile despite the recent depreciation compared with trading partner currencies. The Committee thus saw the need to closely monitor developments of exchange rates and capital flows amid high external uncertainties as well as the effectiveness of the relaxation of foreign exchange regulations to encourage capital outflows, which were previously implemented by the Bank of Thailand and related public organizations. Such relaxations include allowing exporters to keep more foreign currency proceeds overseas, allowing retail investors to invest in foreign securities directly and allowing life insurance companies to invest more in foreign securities. The Committee encouraged the Bank of Thailand to consider implementing additional measures alongside efforts to stimulate investment and imports to reduce large current account surplus.

2) Headline inflation would be below the lower bound of the inflation target in 2019 and 2020 due to moderating core inflation following subdued demand-pull inflationary pressures in tandem with an economic outlook, lower-than-expected energy prices owing to declined oil demand as a result of the coronavirus outbreak. However, fresh food prices were expected to increase slightly due to the drought. The Committee viewed that inflation projection would face uncertainties form oil price fluctuations and weather conditions. Furthermore, the medium-term inflation expectations were unaffected by the new inflation target specifying headline inflation within the range of 1-3 percent as it was well-anchored at around 2 percent.

3) Some financial system risks had been partly addressed by the implemented macroprudential measures. For instance, property sector risks abated after the implementation of the revised loan-to-value (LTV) measure. This was reflected by moderation in speculation and adjustments of developers. **However, there were more vulnerabilities in the financial system, especially related**

to debt servicing capability of households and SMEs due to the prospect of economic slowdown. Moreover, other financial stability risks had yet to improve and thus warranted continued monitoring. First, the household debt remained at a high level, partly due to structural problems stemming from households' leveraging behavior and financial institutions' business practice. Second, search-for-yield behavior in the prolonged low interest rate environment could lead to underpricing of risks, especially by large corporates and saving cooperatives. Third, the property sector remained oversupplied in some areas. The Committee viewed that the policy interest rate, along with microprudential and macroprudential measures, should be combined at the appropriate timing to ensure financial stability.

The Committee engaged in extensive discussion regarding the necessity of the policy rate cut to 1.00 percent at this meeting and viewed that both external and domestic uncertainties remained high and were expected to pose significant impacts on economic growth, headline inflation, as well as financial stability associated with debt servicing capability of households and SMEs in particular. Moreover, such risks occurred simultaneously. The Committee thus viewed that the policy rate cut in this meeting was timely and appropriate without a need to wait until these risks became fully materialized and thus more difficult to cope with.

The Committee viewed that the policy rate cut in this meeting might not lend much additional support to economic growth but would rather reduce the debt burden and support liquidity provision. Monetary policy accommodation would need to be pursued in combination with other targeted monetary and fiscal measures in order to effectively alleviate the impacts from negative shocks. Such measures that were needed to urgently implement included **(1) liquidity provision measures** that financial institutions assisted clients who were affected by the coronavirus outbreak, such as principal repayment suspension, interest reduction and additional loan provision, and **(2) debt restructuring measure,** such as pre-emptive debt restructuring for SMEs to enhance their debt servicing capability and to keep their businesses operating, as well as the third phase of debt clinic.

In the period ahead, the Committee would be data-dependent by closely monitoring the economic growth, inflation, and financial stability, together with other associated risks, especially the coronavirus outbreak, the delay in the Annual Budget Expenditure Act, and the drought, in deliberating monetary policy going forward. The Committee would stand ready to use policy tools as appropriate. Furthermore, **the Committee saw the need for policy coordination between related public and private organizations to support an economic recovery and to restructure the economy**, given structural problems facing the Thai economy that could affect competitiveness and growth outlook going forward. The problems should be firmly addressed by all related parties.

Monetary Policy Group
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