Summary of Keynote Address

"Thailand's Monetary Policy Challenge: How to Manage the Risks in a Changing Global Environment"

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SET Thailand Focus 2024: Adapting to a Changing World, 28 August 2024

Overall macroeconomic picture

- **At the time of last year's Thailand Focus (Aug-23), Thailand had undergone a period of steady disinflation (from peak of 8% down to about 0.8-0.9%) and the economic picture was one of slow but gradual recovery.**
- **In the fourth quarter of 2023, economic numbers turned out much poorer than expected.** GDP in Q4-23 contracted by 0.5% QoQ (seasonally adjusted). The main reason for the sharp drop-off was delayed fiscal budget disbursement (cumulative impact of delayed fiscal disbursement during Q4-23 – Q1-24 was about 0.8% of GDP), coupled with an unusually large rundown in stocks and a delayed export recovery. At the time, we expected these factors to be temporary, and that activity would bounce back in the first half of this year.
- **What happened in Q4-23 triggered a lot of the recent downgrading of forecasts, but the overall picture, as we saw Q1-24 and Q2-24 numbers came in, is that recovery remains intact albeit gradual going forward.** Looking ahead, momentum in the second half of 2024 is likely to taper off compared to the significant pick up in the first half. **Our latest (Jun-24) headline GDP growth forecast for the year is 2.6%, which is in line with other government agencies and most analysts out there.**
- **On the inflation front, inflation in Jul-24 came out at about 0.8%,** below our target range of 1% - 3%. We expect to see inflation slowly recovering and getting back within our target within the fourth quarter of this year. The forecast for the year is about 0.6%.
- The **primary objective of inflation targeting frameworks**, both in Thailand and elsewhere, **is not to achieve a particular or exact target, but to keep inflation and inflation expectations anchored into a low inflation regime**. If you look at surveys of inflation expectations and actual outturns, they remain intact.
- **Even though inflation is below target, we do not see any signs of a broad-based deflationary impact** on the economy. The decline in prices is concentrated in a limited number of product categories and we do not see a sharp slowdown or negative consumption growth.

Monetary Policy Response

- **Last Wednesday (21 Aug 2024), the monetary policy committee voted to hold the policy rate steady at 2.5%**, a 6-to-1 vote. Yes, the interest rate is at a decade-high in Thailand, but it is also among the lowest around the world. **In deciding monetary policy, the MPC will be outlook dependent rather than data dependent** and look at three things.
  (1) **Economic outlook**: The estimated headline GDP at about 2.6% this year and 3.0% next year is broadly in line with the long-term growth potential of around 3%. This is not a great number. **We would certainly like to see a higher long-term potential growth rate, but this can only**

happen if we undertake structural measures (investments and technological improvements) to increase productivity. Barring structural reforms, stimulus will only be short-lived and not sustainable.

(2) Inflation outlook: Headline inflation this year is likely to be around 0.6% and increase to 1+% (within target range) next year. **There are a lot of structural factors that contribute to Thailand's trend inflation being relatively lower than in other countries**, such as lower food inflation, which makes up a large part of our CPI basket, and lower services inflation. Nevertheless, **this does not indicate that a deflationary cycle is taking place**.

(3) Financial stability: It is a balancing act with several challenges and a big one is high household debt (90.8% of GDP as of Q1-24). **The problem is particularly difficult to address in Thailand** because the nature of household debt is quite different from other countries. Only one-third is mortgage debt backed by secure assets, while the rest are either hire-purchase or unsecured loans. **The way to sustainably get out of this problem is to increase income.** There is no silver bullet. It will take time to gradually reduce household debt to more sustainable level (international practice is about 80% of GDP, consistent with long-term macro and financial stability).

- Additionally, there are **two issues that are top of mind concerns for monetary policy** at this time: **uneven recovery** and **macro-financial linkages**.
  - **First, uneven recovery: Although the overall economy is gradually recovering, there is wide heterogeneity in the recovery which make people do not feel like it is happening.**
    - **By sector**, the **services sectors**, especially tourism-related ones, **are recovering quite well**, **while the recovery of manufacturing sectors is much slower**. A lot of the slow recovery is not just a result of a cyclical slowdown, but there are a lot of structural headwinds occurring at the same time, a lot of it relating to China. Exports of petrochemicals to China have dropped off because of China's increasing production capacity. At the same time, competition from Chinese exports is one of the reasons why we have not seen consumption growth translate into growth in manufacturing production.
    - **By income, we see a wide degree of unevenness as well.** A large share of the labor force is non-wage or daily workers and many are reliant on tourism. So, their incomes effectively dropped to zero during the COVID-19 lockdowns when we had effectively zero tourists. Although their incomes now have recovered back to where it was pre-COVID, there was still a big gap from when they had no income. On top of that, those people still had debt, so their debt burdens would increase.
  - **Second, macro-financial linkages:** This is an issue we tried to flag in the latest monetary policy statement.
    - **We are seeing signs of a deterioration in credit growth and credit quality, which is to be expected** following significant credit injection and forbearance measures taken during the pandemic. However, what we do not want to see is a negative feedback loop that affects the economic outlook going forward. That is, the deterioration in credit quality leads to

financial institutions less willing to lend because of higher credit risk, which leads to poorer macroeconomic outcomes and further deterioration in credit quality.

- **We do not expect to see an NPL cliff.** NPLs are tracking at about 2.8% of total loans. Given banks' buffers we do not expect this to translate into problems at the macro financial stability level, but the issue is the burden that borrowers will face.
- **Overall credit is still growing but there are certain pockets of particular concern, especially the SME segment where we see contraction in credit.** The best way to address this problem in a sustainable manner is to address the underlying problem of SMEs' high credit risk. We are very happy to see that the Ministry of Finance has supported our proposal to put in place a more flexible and effective credit guarantee facility to make sure that SMEs get access to credit.

- Keeping these things in mind, **the MPC stands ready to adjust policy in line with changing circumstances and will continue to be pragmatic and flexible.** We will be prudent and guided by hard-earned lessons that central banks have learned around the world, having gone through the past decade filled with unanticipated shocks and a lot of uncertainty. There is **a premium on running monetary policy in a resilient and robust manner**. This means:

  (1) **Policy should be robust** – appropriate for a wide range of possible outcomes – **rather than optimal** in a particular situation, **preserve optionality** and room to manoeuver in case things change, **and put a premium on preserving buffers**/policy space as we do not know where shocks will come from.

  (2) **Policy should not be an additional source of uncertainty. This means not to overreact to the latest data which can be noisy and not to do too much fine tuning.** That is why, when inflation spiked in 2022, we went for a gradual and measured approach to policy rate normalization (raised the policy rate by 25 basis points 8 times from Aug-22 to Sep-23 to 2.5%) because we saw that high inflation would be transitory and we did not want to disrupt the gradual recovery process. Similarly, we did not want to overreact to the slowdown in Q4-23 that was likely to be temporary and we see that a gradual recovery is taking place.

  (3) **Use complementary tools as part of an integrated policy mix:** The interest rate is a blunt tool for achieving multiple objectives and is just one element in a policy mix. It is important to complement this with other kinds of measures as part of an integrated policy framework, such as macroprudential policies, foreign exchange intervention, and financial measures (e.g. debt restructuring).

- To conclude, **I give my assurance that we remain flexible and practical. We are not wedded to any particular stance and stand ready to adjust as circumstances mandate.** It is important to recognize that policy response encompasses a wide range of measures as part of an integrated policy package and not just the interest rate. There are also financial and other measures that will help achieve the objectives that we set out.