Edited Minutes of the Monetary Policy Committee Meeting (No.5/2021)
4 August 2021, Bank of Thailand
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Members Present

Sethaput Suthiwartnarueput (Chairman), Mathee Supapongse (Vice Chairman), Paiboon Kittisrikangwan, Rapee Sucharitakul, Somchai Jitsuchon, and Subhak Siwaraksa

Member Absent

Kanit Sangsubhan

The Global Economy and Financial Markets

While the global economy would continue to recover, growth divergence between major advanced economies and Asian economies would be more apparent. Major advanced economies would continue to recover thanks to the significant progress of COVID-19 vaccination. Meanwhile, economic activities in Asian economies were affected by the more severe outbreak and virus mutations in several countries. In the period ahead, the global economic recovery would remain highly uncertain as the outbreak could become more severe due to virus mutations, particularly in countries with slow vaccination progress and limited access to effective vaccines.

Concerns in the global financial markets heightened due to the COVID-19 outbreak situation, which became more severe in several countries, especially in emerging markets with low vaccination rates. This led to risk-off sentiments among investors and a decline in the holdings of risky assets such as equities and an increase in the holdings of safe assets such as government bonds. The Thai financial markets moved in line with other regional markets with a decline in Thai stock market index and government bond yields. On exchange rates, the Thai baht and the nominal effective exchange rate (NEER) depreciated since the previous meeting. The baht depreciated against the US dollar more than regional currencies due to an intensified COVID-19 outbreak situation and the outlook of slow economic recovery in Thailand.

Looking ahead, volatility in the global financial markets would remain high and could weigh on the Thai financial markets. Significant risks included the COVID-19 outbreak situation, which remained highly uncertain and could intensify in many countries, and the US fiscal and monetary policy outlook. In particular, should the US economy continue to recover and inflation continue to rise, the Federal Reserve might tighten the monetary policy faster than market expected.

Domestic Economy and Financial Stability

The Thai economy would expand at a much slower rate due to stricter COVID- 19 containment measures, which would impinge on economic activities and domestic demand. The Committee assessed that the Thai economy was projected to expand by 0.7 and 3.7 percent in 2021 and 2022 respectively. This would be significantly lower than the June projection owing to private consumption which was greatly affected this year and foreign tourist figures which were expected to be significantly lower next year. The labor market would be more fragile, particularly the services sector and the self- employed, which experienced income losses. Nevertheless, key growth drivers going forward were as follows. First, public expenditure would be higher thanks to the new Emergency Decree authorizing a 500 billion baht borrowing which would somewhat shore up household purchasing power and mitigate impacts from the latest wave of the outbreak. Second, merchandise exports were expected to register a strong growth on the back of external demand recovery of trading partners, although some manufacturing and export sectors would experience supply constraints. Headwinds included, for example, reduced working hours in the manufacturing sector after the government imposed stricter containment measures as well as global shortages of containers and raw materials, particularly electronic parts. **Headline inflation would remain unchanged,** while core inflation would still be subdued owing to weak domestic demand. Medium-term inflation expectations remained anchored within the target.

There remain significant downside risks to the economic outlook. First, the outbreak situation in Thailand and other countries could become more severe. This was due particularly to virus mutations which could reduce vaccine efficacy. Slow vaccination progress could also lead to a more prolonged and severe public health crisis. Second, financial positions of businesses, especially the services sector, that became more vulnerable could lead to widespread business closures and lay-offs. Third, supply constraints, especially owing to factory outbreaks and temporary shortages of raw materials, could become more severe and prolonged, thus affecting the manufacturing and export sectors more than expected. Such constraints were expected to alleviate in the first half of 2022**.**

The financial system would be more vulnerable. The latest wave of the outbreak aggravated income and the already fragile financial positions of households and businesses, thereby increasing the likelihood of debt at risk. Nevertheless, financial positions of financial institutions remained robust and could accommodate deteriorating credit quality in the future. Therefore, the impacts from the aforementioned risks on overall financial stability would still be limited.

<u>Discussions by the Committee</u>

The Committee discussed risks to the Thai economy due to the impacts of potentially more severe and prolonged outbreak, measures that should be urgently implemented, as well as monetary policy and financial measures. The details were as followed.

- **The Committee assessed that the impacts of the COVID-19 outbreak on the Thai economy were larger than the previous assessment, and there remained significant downside risks that the outbreak could become more severe and prolonged than expected.** Vaccine distribution which would take some time could cause the numbers of new and critical cases to increase continuously and exceed the health system capacity. Containment measures that could become stricter and prolonged would further dampen economic activities. Meanwhile, business and consumer confidence could fall significantly in line with declining income. This would in turn affect the consumption outlook. The prolonged outbreak resulted in a more uneven recovery across different sectors, a more fragile labor market, and potential long- term scarring effects especially on employment in the services sector and among self- employed workers whose working hours began to decline. More workers also migrated back to their home provinces. In addition, the labor market was expected to recover slowly as reflected by the rising number of the long-term unemployed and newly-graduated unemployed as well as persons outside the labor force.

- **The Committee viewed that the most important issue for the Thai economy at present was to accelerate containment of the outbreak and prevention of the spread, especially the procurement and distribution of effective vaccines in a timely manner.** This would help reduce the infections to the level compatible with the health system capacity and allow for the relaxation of the containment measures. This would contribute to a gradual pickup in economic activities. **Fiscal measures** should help alleviate the adverse impacts and support the economy by more actively addressing unemployment and vulnerabilities in the business sector in an adequate and timely manner. The public debt-to-GDP ratio could rise and exceed 60 percent. Nonetheless, this would not pose a significant risk to fiscal sustainability if the budget were to be spent efficiently towards shoring up the economy that was facing high risks in the short run and supporting economic restructuring to raise potential growth. Subsequently, the public debt-to-GDP ratio could fall in the long run. **Monetary policy** must contribute to continued accommodative financial conditions. The baht recently depreciated and thus did not hinder the economic recovery. Government bond yields and commercial bank lending rates remained low. However, ample liquidity was not distributed to the affected businesses and households. **Financial and credit measures** should thus be adjusted quickly to enhance effectiveness and to have broader impacts. Although the special loan facility had helped facilitate access to credits for SMEs and the two-month loan payment holiday helped ease debt burden somewhat, the latest wave of the outbreak would likely be prolonged and have larger impacts on the economy than expected. Thus, liquidity distribution should be expedited and financial institutions should effectively help reduce debt burden for borrowers by, for instance, applying debt restructuring methods that were consistent with long-term borrowers' debt serviceability. Furthermore, the Committee viewed that there should be additional measures that were designed to incentivize less affected households and businesses with high savings to increase spending and stimulate domestic demand going forward.
- **The Committee extensively discussed the effectiveness of monetary policy transmission in the current situation, the net benefits of the policy rate reduction to the economy, as well as various policy options. The Committee agreed that financial measures could help those who were affected by the COVID-19 outbreak in a more targeted manner than the policy rate reduction.** The Committee viewed that, first, the important issue at present would be the distribution of the ample liquidity in the banking system to businesses and households with high credit risks. Second, the slowdown in economic activities was a consequence of disease containment. Meanwhile, overall financial conditions remained accommodative and helped financial institutions to provide support for borrowers through various ongoing financial measures. Third, financial measures, particularly the special soft loan facility that helped alleviate liquidity constraints for the affected groups and debt restructuring which helped address elevated debt problems, would be more effective

and targeted than the reduction in the policy rate which was a blunt instrument. Despite the broad-based impacts, the policy rate cut would only marginally reduce debt burden for vulnerable groups. **Nonetheless, some members viewed that the policy rate cut at this meeting would be a preemptive action against the potential economic slowdown in the period ahead.** They assessed that the previously implemented financial and fiscal measures might have some limitations and remain inadequate. Meanwhile, monetary policy would take some time before the impacts reached the economy. They thus voted to cut the policy rate at this meeting, although the policy rate was deemed less targeted and effective than other financial and fiscal measures, to mitigate heightening risks in the period ahead.

Monetary Policy Decision

The Committee voted 4 to 2 to maintain the policy rate at 0.50 percent. Two members voted to cut the policy rate by 0.25 percentage point. One MPC member was unable to attend the meeting.

The Committee assessed that the Thai economy in 2021 would be affected by the COVID-19 outbreak more than expected with significant downside risks. The most important issue for the Thai economy at present was to accelerate containment of the outbreak and distribution of vaccines to restore confidence and support the recovery in economic activities and income. Fiscal and financial measures must be expedited to assist affected groups in a more targeted and timely manner in line with the situation. The Committee viewed that risks to the economic outlook remained high. The support must be provided by accelerating the distribution of liquidity and debt burden reduction for those who were affected. **Most members viewed that financial measures would be more effective than a further reduction in the policy rate which was already low and thus voted to maintain the policy rate. Nevertheless, two members voted for a policy rate reduction as a supplement to other measures in shoring up the economy and mitigate heightened risks in the period ahead.**

The Committee would continue to monitor developments in foreign exchange markets and capital flows. The baht exhibited more volatile movement and could depreciate more than regional currencies owing to domestic factors. The Committee would thus closely monitor developments in both global and domestic financial markets to maintain exchange rate stability and ensure that the exchange rate would not hinder business adjustments. The Committee would also continuously expedite the new foreign exchange ecosystem to improve the structure of the Thai foreign exchange markets over the medium term. The Committee viewed that by encouraging Thai institutional investors to increase their portfolio investments abroad, it would facilitate capital outflows and improve the balance between capital inflows and outflows.

The Committee viewed that the government measures and policy coordination among government agencies would be critical to support the economic recovery. Public health measures should aim at accelerating the procurement and distribution of effective vaccines to prevent the outbreak from being prolonged. Fiscal measures should help alleviate the adverse impacts and support the economy by more actively addressing vulnerabilities in the labor market and business sector in an adequate and timely manner. Monetary policy must contribute to continued accommodative financial conditions overall. Financial and credit measures should be adjusted in a timely manner to enhance effectiveness, thereby expediting the distribution of liquidity to the affected groups in a targeted manner and help reduce debt burden. Such measures included the special loan facility, asset warehousing scheme, and other measures by specialized financial institutions (SFIs). In addition, financial institutions should accelerate debt restructuring to have broader impacts and be consistent with borrowers' long-term debt serviceability.

Under the monetary policy framework with the objectives of maintaining price stability, supporting sustainable and full-potential economic growth, and preserving financial stability, **the Committee continued to put emphasis on supporting the economic recovery.** In addition, the Committee would monitor key factors affecting the economic outlook, namely the distribution and efficacy of vaccines, the outbreak situation in Thailand and abroad, as well as the adequacy of fiscal, financial, and credit measures. The Committee would stand ready to use additional appropriate monetary policy tools if necessary.

Monetary Policy Group

18 August 2021

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Key issues from the MPC meeting No.5/2021

4 August 2021

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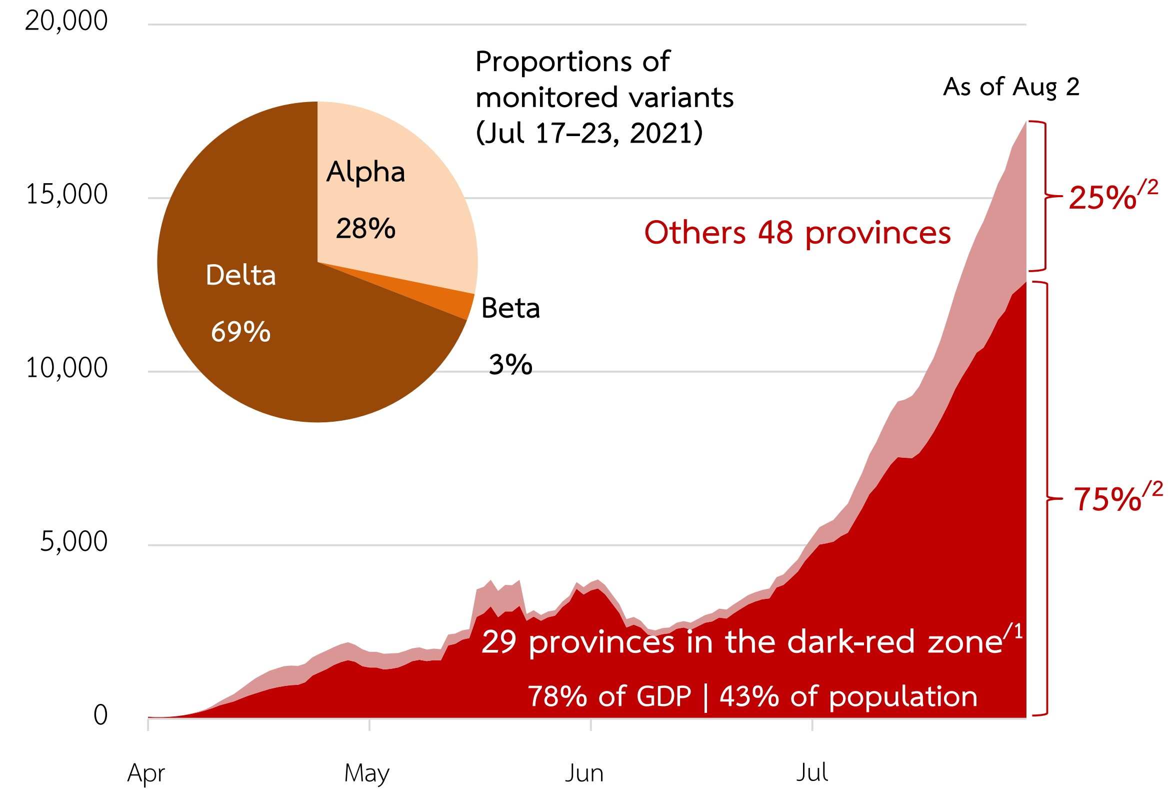
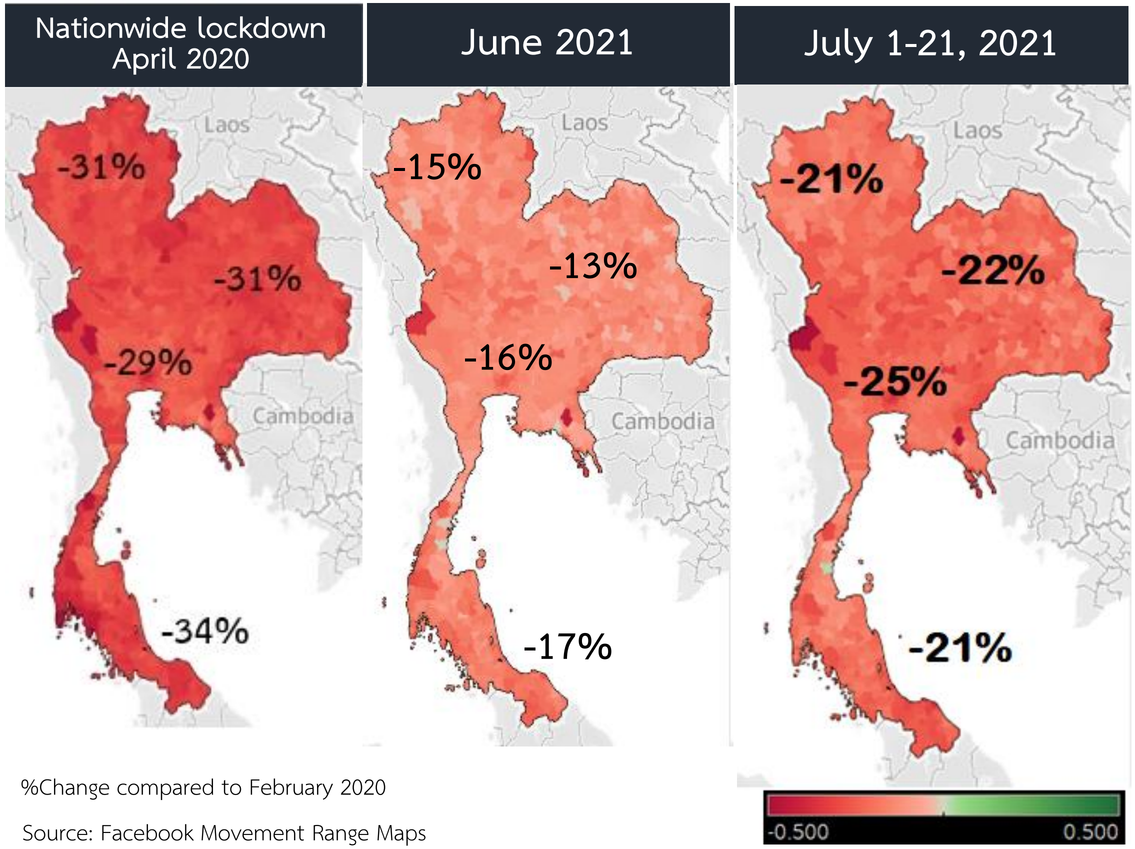
The worsening COVID-19 situation caused increasingly larger impacts on economic activities.

Number of new infections accelerated across regions and was higher than previously assessed. Most cases were from Delta variant with more severe symptoms.



The recent outbreak led to tighter containment measures, resulting in lower economic activities in all regions.



%Change compared to February 2020

Source: Facebook Movement Range Maps

[1] 29 provinces included Bangkok, Chachoengsao, Chonburi, Nakhon Pathom, Nonthaburi, Narathiwat, Pathum Thani, Pattani, Ayutthaya, Yala, Songkhla, Samut Prakan, Samut Sakhon, Kanchanaburi, Tak, Nakhon Ratchasima, Prachuap Khiri Khan, Prachinburi, Phetchaburi, Phetchabun, Rayong, Ratchaburi, Lopburi, Sing Buri, Samut Songkhram, Saraburi, Suphan Buri and Ang Thong

[2] Proportion of cumulative infections in the last 14 days

Source: Department of Disease Control, Department of Medical Sciences

The labor market was severely affected by the 3rd wave outbreak in Q2/21. The impacts would be more pronounced going forward given the potentially more severe and prolonged outbreak

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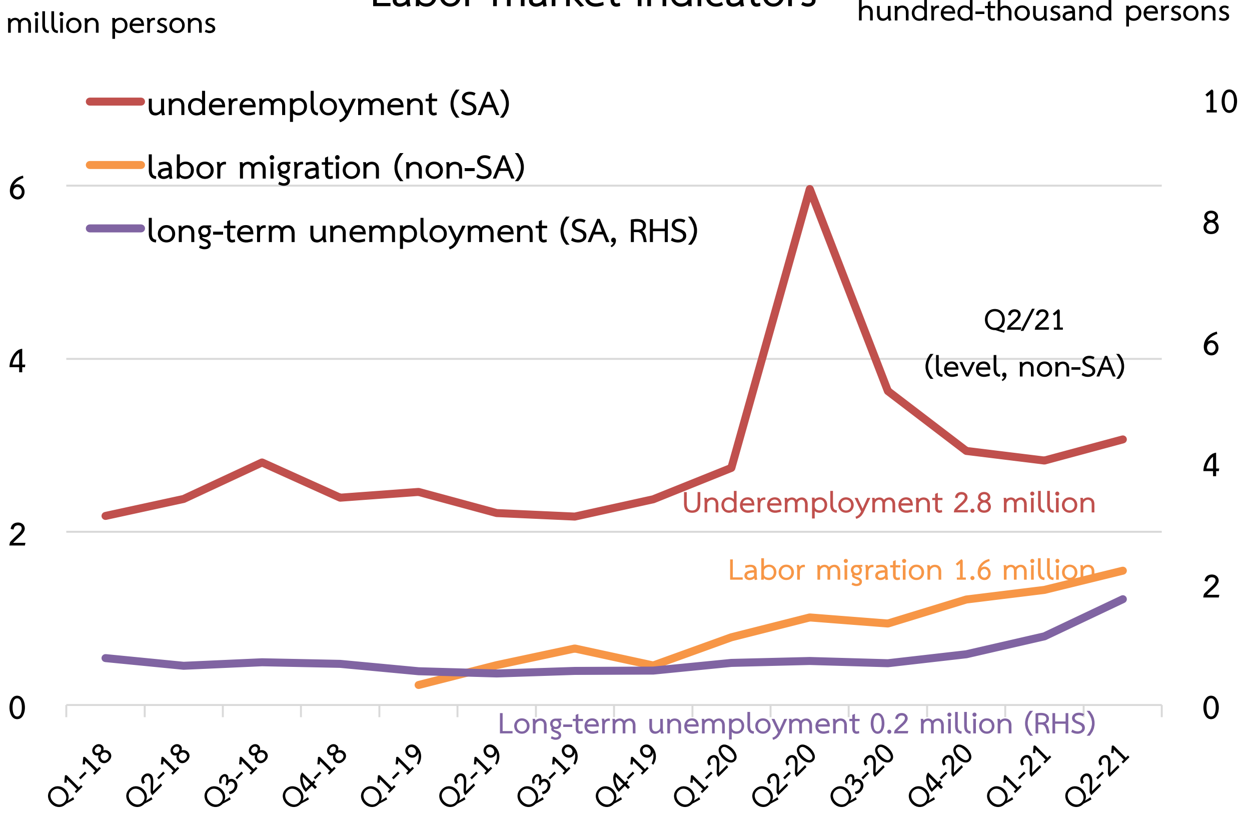
The 3rd wave outbreak resulted in a more fragile labor market: (1) a rise in underemployment for the first time in a year, (2) an increase in labor migration back to their home provinces, and (3) an acceleration of long-term unemployment.

Labor market indicators

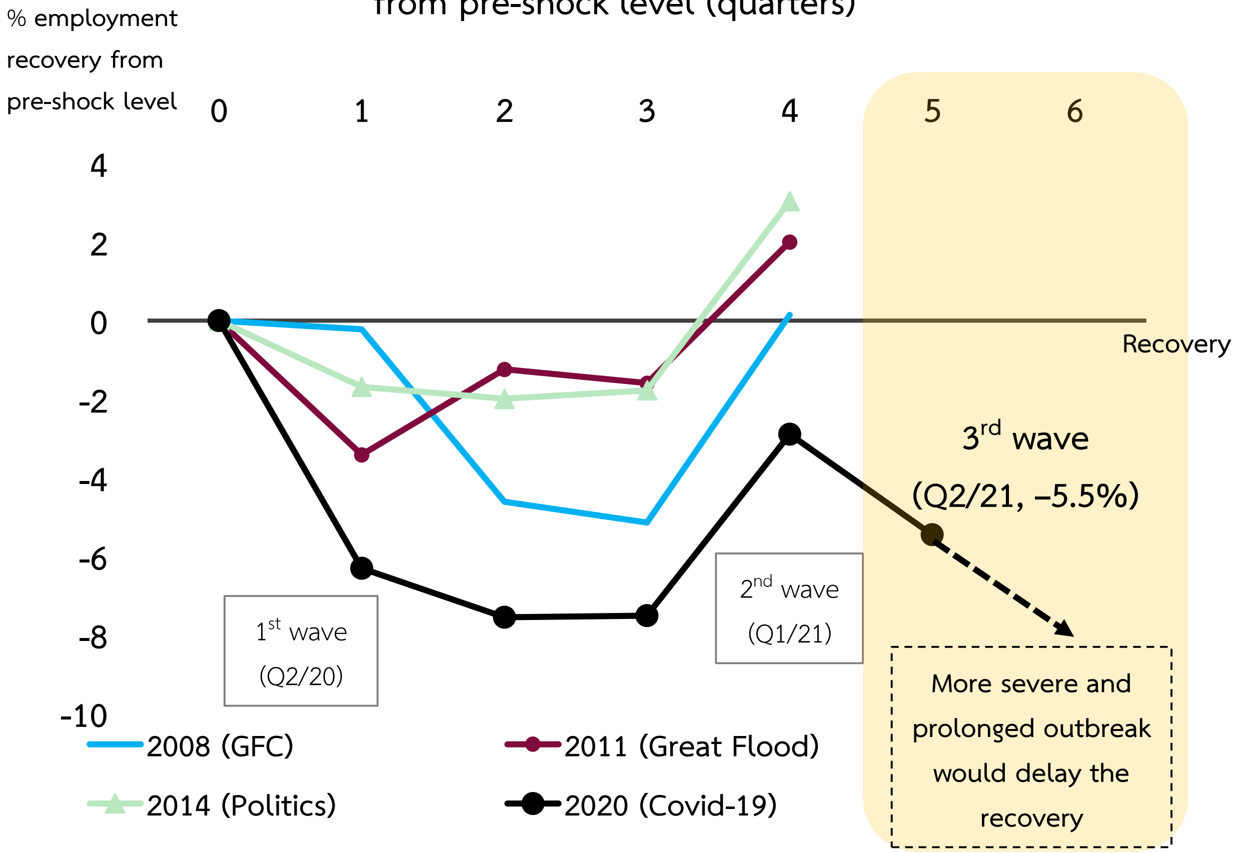


Note: Long-term unemployment refers to unemployment for longer than 1 year
SA = seasonally adjusted, non-SA = non-seasonally adjusted

Source: The Labor Force Survey by the National Statistical Office of Thailand and True Corporation, calculations by BOT

Employment recovery would be W-shaped and slower than the past.

Duration of recovery in private non-farm employment* from pre-shock level (quarters)



Note: * Calculated from a sample of 11.4 million private sector employees outside the agricultural and construction sectors (30% of labor force)

Source: The Labor Force Survey by the National Statistical Office of Thailand, calculations by BOT

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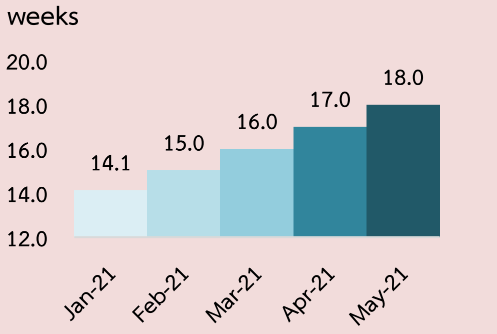
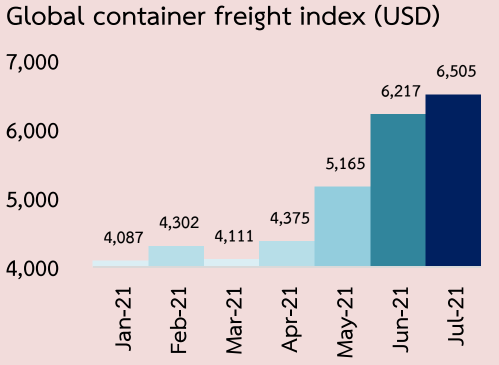
The outbreak began to have some impacts on domestic supply chain and might affect production and exports of some products in addition to existing supply-side issues

Supply chain disruption	Domestic		Foreign	
	Outbreak in factories	Production suspension for the night shift	Semiconductor lead time	Container cost
Recent Development	• Some factories have to **temporarily suspend production.** • Outbreak in suppliers' factories **impacted deliveries of raw materials.** • Production capacity was affected, **resulting in delay in product deliveries.**	• Curfew **led to lower working hours per day.** • Production capacity was affected, **resulting in delay in product deliveries.**	 Average lead time for advance order of semiconductor would likely increase to 18 weeks, reflecting worsening chipset shortages.	 Freight costs continued to rise, reflecting a container shortage problem which would affect costs and capacity of exporters.
Affected products (%weight in MPI)	Auto and auto parts (13.8), Electrical appliances (3.8), Food (16.4), Rubber gloves (0.3), Processed rubber (3.4)	Auto and auto parts (13.8), Food (16.4)	Auto and auto parts (13.8), Electrical appliances (3.8)	Broad-based, especially Food (16.4)
Expected period of supply alleviation (In comparision to MPC Jun 21)	Early Q4-21 when outbreak expected to be contained		Q2-22 (⟷)	Q1-22 (⟷)

Source: Information from entrepreneurs, Bloomberg, https://fbx.freightos.com/

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In the period ahead, significant risks to the economy included domestic outbreak and vaccine development, which could affect the re-opening plans to foreign tourists throughout the forecast horizon

Significant issues to be monitored

- Domestic outbreak situation
- Vaccine development including both efficacy and distribution
- Containment measures and re-opening plans to foreign tourists

- The outbreak situation, especially owing to virus mutation, in other countries
- Supply disruption which could affect merchandise exports
- Continuity of public measures including both fiscal and financial measures to support businesses

Scenarios	Baseline		Baseline minus	
	2021	2022	2021	2022
The outbreak situation	To be contained gradually relax containment measures in early Q4/21		To be prolonged relax containment measures at the end of Q4/21	
No quarantine for foreign tourists	Q2/22		Q3/22	
No. of foreign tourists (million persons)	0.15	6.0	0.1	2.0

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In the baseline, the economy would grow significantly slower than the previous projection

GDP growth (%YoY)	2021	2022
Jun-21 forecast	1.8	3.9
Headwind		
Lower-than-expected Q2/21 economic indicators	-0.2	0.2
Impacts of more prolonged and severe COVID-19 outbreak	-1.1	0.6
Delayed reopening and lower confidence among foreign tourists	-0.3	-1.3
Tailwind		
Additional government measures	0.4	0.3
Better-than-expected export outlook	0.1	-
Total change from the previous forecast	-1.1	-0.2
Aug-21 forecast	0.7	3.7