MNI Bank of Thailand Preview – September 2022

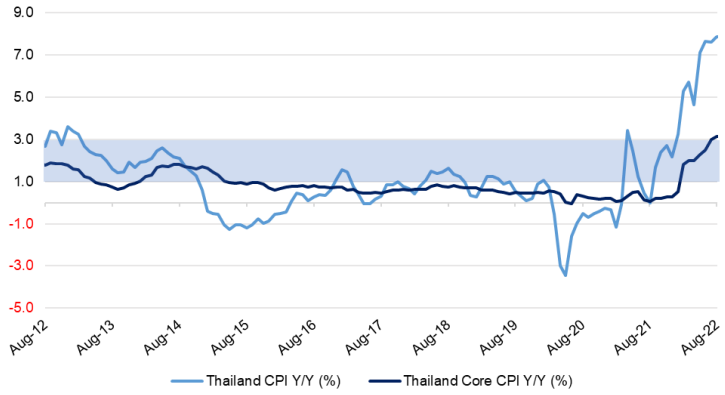
Announcement Date: Wednesday, 28 September 2022

Announcement Time: 08:00 BST/14:00 ICT

Link To Statement: https://tinyurl.com/BoTMonPolDecisions

MNI Point of View: Under Pressure To Turn More Hawkish

The Bank of Thailand was a latecomer to the global tightening party, only inaugurating its current rate-hike cycle last month. The Committee voted 6-1 to raise the policy rate by 25bp, with the sole dissenter calling for a 50bp move. We believe that the decision will be finely balanced between another 25bp rate rise and a front-loaded 50bp hike. The BoT's reluctance to start tightening monetary conditions leaves it significantly behind the curve, with inflation running too hot to handle and the baht printing multi-year lows.

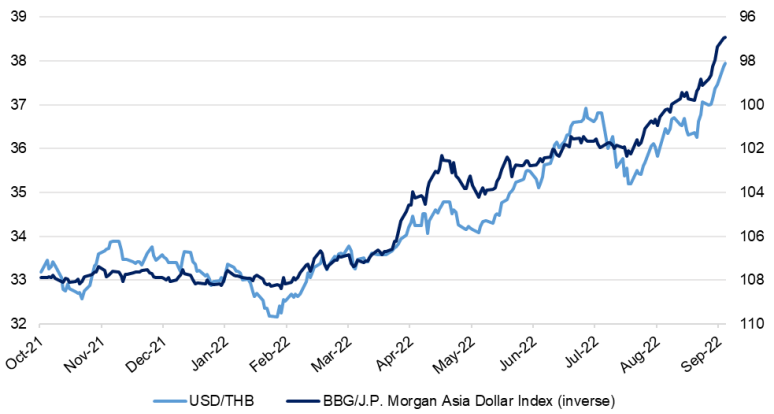


The shaded region represents the BoT's inflation target range.

The case for another rate lift-off is clear, with inflation soaring further beyond the BoT's +1.0%-3.0% Y/Y tolerance band. Annual CPI growth quickened to +7.86% in August, which was the fastest pace since 2008. While the headline reading narrowly missed consensus forecast, breakdown data flashed a warning sign on building domestic price pressures, as core CPI inflation breached the upper end of the target range. The impending minimum wage hike, which will take effect on October 1, risks adding fuel to demand-pull pressures and disanchoring inflation expectations.

Rapid depreciation in the baht's exchange rate accentuates imported inflation, complicating the BoT's task of bringing inflation under control. The baht has shed ~11.8% versus the greenback this year, with USD/THB trading at levels not seen since 2006. Thailand's weak external trade position (customs trade deficit widened to 9-year wides last month) amplify headwinds for the THB. While officials stressed that baht weakness is in line with regional trend, recent comments signalled a sense of concern with the rapid pace of currency depreciation.

While the government's obscure communique on FX markets frustrates attempts to draw any detailed conclusions, but it seemed clear that the authorities are growing uncomfortable with the rapid, one-sided move in the baht. Acting Prime Minister Prawit was forced to walk back his calls for measures to prop up the baht and reaffirm commitment to BoT independence after he cited THB35 to the dollar as his preferred exchange rate level. Still, the fact that he made such explicit remarks and a further assurance from Finance Minister Arkhom that the central bank is closely monitoring FX markets suggest uneasiness about the recent baht moves.



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There is less clarity on any shifts in the central bank's attitude, with little in the way of fresh comments crossing the wires recently. In his latest address earlier this month, Governor Sethaput reiterated that the Committee prefers to tighten policy in gradual and measured steps. The central bank's desire to protect fragile economic recovery coupled with Thailand's traditionally high levels of household debt raise barriers to more aggressive policy tightening and will factor into the Committee's deliberations.

Still, with hawkish drumbeat from the Fed growing only louder, pressure is piling on Thai policymakers to take a more aggressive approach to withdrawing stimulus. The baht's plunge and broadening domestic price pressures strengthen the case for a double-barrel rate hike this week, despite familiar concerns about the trajectory of economic recovery. We see a 50/50 chance that the BoT will hike its key policy rate by 50bp this week, with members facing a difficult task of navigating highly uncertain environment.

Bank of Thailand August Monetary Policy Statement:

The Committee voted 6 to 1 to raise the policy rate by 0.25 percentage point from 0.50 to 0.75 percent, effective immediately. One member voted to raise the policy rate by 0.50 percentage point.

Economic recovery has continued to strengthen. The Thai economy is expected to return to the pre-COVID level by the end of this year and will continue to gain traction. Headline inflation will remain at a high level for some time. The Committee assesses that the extraordinarily accommodative monetary policy undertaken in response to the COVID-19 pandemic has become less needed. Most members thus voted to raise the policy rate by 0.25 percentage point at this meeting. One member voted to raise the policy rate by 0.50 percentage point to reduce the risk of having to increase the policy rate aggressively later and views that such a rate increase will not significantly affect the economic recovery.

The Thai economy is projected to continue recovering with strong momentum. This is attributable to a larger-than-expected number of foreign tourist arrivals following the relaxation of international travel restrictions and improved travel sentiments. In addition, private consumption would continue to recover in line with improvements in labor market conditions and household incomes. Although the risk of global slowdown has heightened, the impact on the Thai economy would be limited. Nonetheless, there remains a need to monitor risks to the growth outlook in the period ahead, especially the impact of rising living costs on private consumption.

Headline inflation will remain at a high level throughout 2022, largely unchanged from the previous forecast, before gradually falling into the target range in 2023 as the supply-side inflationary pressures subside. Meanwhile, medium-term inflation expectations have not increased significantly. Going forward, the inflation outlook is still subject to upside risks, including potentially higher and faster cost pass-through to core inflation. The Committee will continue to closely monitor inflation dynamics, cost pass-through, and inflation expectations.

Overall financial system remains resilient. Commercial banks have high levels of capital fund and loan loss provision. Liquidity in the financial system remains ample, although liquidity distribution still varies across economic sectors. Debt serviceability of households and businesses has improved in line with the economic recovery. However, there are certain vulnerable groups, particularly some SMEs that have yet to fully recover as well as low-income households that are sensitive to the rising living costs. The Committee views that financial institutions should continue to press ahead with debt restructuring and deems it important to have targeted measures and sustainable solutions in place for vulnerable groups.

Overall financial conditions remain accommodative but with high volatility. The baht has depreciated against the US dollar mainly due to the strengthening of the US dollar following concerns about the global economic slowdown and the Fed tightening. The Committee will closely monitor developments and volatilities in financial and exchange rate markets.

Under the monetary policy framework with objectives of maintaining price stability, supporting sustainable and full-potential economic growth, and preserving financial stability, the Committee judges that the Thai economic recovery will continue to gain traction, and thus the extraordinarily accommodative monetary policy will become less needed. The Committee views that the policy rate should be normalized to the level that is consistent with sustainable growth in the long term. Monetary policy normalization should be done in a gradual and measured manner consistent with the growth and inflation outlook in the period ahead.

Click here to access the edited minutes of the meeting.

Sell-side comments:

ANZ (+50bp): The odds have shifted in favour of the Bank of Thailand (BoT) accelerating its pace of rate hikes. We are thus pencilling a 50bp hike at its upcoming meeting. There was one monetary policy member who voted in favour of a 50bp hike rather than the typical 25bp at the last meeting in August, and the case for an outsized move has continued to build. A more hawkish than expected US Fed is putting significant pressure on the THB amid widening rate differentials; the spread between Thailand's policy rate and the FFR is currently more than four standard deviations below the five-year average, which is higher than regional peers. Furthermore, the BoT only has two more scheduled MPC meetings this year (28 September and 30 November); if it continues to move in increments of 25bps, rate differentials will widen further and the central bank could risk being perceived as the standout regional laggard and intensify downward pressure on the THB. Notably, there are growing concerns about THB weakness within the government too, and its associated implications for inflation and financial stability. Overall, we now expect a faster and deeper rate-hiking cycle, which in turn signals more headwinds to growth. We have pencilled in a terminal policy rate of 2.50% by Q2 2023 (previously 2.25% by Q3 2023).

Barclays (+25bp): We expect the BoT to continue its measured and gradual hiking cycle and increase the policy rate by 25bp. We expect the MPC to sound more concerned on the currency's sharp depreciation, given the government has also been publicly voicing concerns.

DBS (+25bp): The BOT will meet this week, and there will be much for policymakers to consider in the areas of growth, inflation, and currency spill-overs. We expect the policy rate to be raised by 25bps to 1%, largely in line with consensus. However, we do not rule out a bigger increase of 50bps given the flurry of aggressive moves in the ASEAN region in the previous week, partly to shield currency weakness vs the US dollar. Recent communication from the BOT Governor Sethaput has been for a 'gradual and measured' policy rate normalisation. Rising and upside inflationary pressures in headline and core figures justify higher interest rates to anchor inflation expectations. A gradual approach has been guided given that Thailand's quarterly real GDP figure has yet to return to pre-COVID level, even though its economic recovery from the pandemic and growth is gaining traction on a tourism upturn. Moreover, there are still vulnerable pockets such as in low-income households and small businesses, while the global external demand outlook is looking dicey. Recent news has seen Thai policymakers focus their attention on currency movements as the Thai baht hit a 16-year low vs the USD. That said, the BOT might see the baht's movements to be in line with regional currency performance and driven by USD strength. Sethaput mentioned in a previous Bloomberg interview in August that exchange rate pass-through to Thai inflation is extremely low. The finance minister said last week that the central bank had reported some capital outflows but those were not substantial. Thailand has instead seen portfolio inflows so far this year. Our Taylor rule model showed that the BOT did not usually deal with currency volatility through its policy rate. An unexpected large interest rate hike to curb FX weakness would therefore likely reflect a change in thinking regarding the impact of a weaker currency to inflation and other economic areas. A bigger hike could also take place should the BOT assess higher risks of second round inflation effects, as seen from the rare 50bps hikes in 2005.

Goldman Sachs (+50bp): We now expect the Bank of Thailand (BoT) to hike policy rates by 50bp at its upcoming meeting (from our earlier forecast of a 25bp hike), raising the policy rate to 1.25% (from 0.75%, currently). The central bank is likely to revise up its 2022 tourism and growth forecasts. We're forecasting tourism and GDP growth at 10mn and 3.5% this year, compared to BoT at 6mn/3.3%. We see risks to BoT's 2022 headline inflation forecast as balanced – global commodity prices including energy have fallen more than BoT expected. However, core inflation has surprised to the upside. In 2023, we continue to forecast upside risks to BoT inflation forecasts – as inflation outturns could be higher and stickier-than-expected given stronger demand-pull price pressures as tourism rebounds, higher business-cost pass-through, and higher food and energy prices. With GDP growth likely to rebound as tourism picks up and supply-side constraints ease, elevated headline inflation, upside risks to core inflation, the need to rebuild policy buffers amid still highly accommodative policy settings, aggressive global monetary policy responses, and currency weakness, we now expect the BoT to hike policy rates by 50bp this week, hiking thereafter in 25bp increments at subsequent meetings until the policy rate reaches a terminal rate of 2.5% in Q2 next year. While we see the risk around the BoT meeting this week as skewed towards the dovish side (i.e. a smaller hike of 25bp), in the medium term we see risks to our policy rate forecasts as skewed to the upside, especially in terms of the speed at which we get to our terminal rate forecasts, should BoT decide to rebuild policy buffers at a faster pace and/or core inflation continue to surprise to the upside as demand rebounds.

Morgan Stanley (+25bp): We expect BoT to raise the policy rate by 25bps at the upcoming meeting, consistent with the Governor's recent guidance that increase in policy rate is necessary to keep pace with rising inflation.

Indeed, the latest August inflation print continued to stay elevated with headline inflation coming in at a 14-year high 7.9%Y (vs. 7.6%Y in July) along with further pickup in core CPI (3.1%Y vs.3.0%Y in July). Looking ahead, we expect BoT to raise rates in 25bp increments at each of the two subsequent meetings, for a cumulative increase of 100bps in this normalization cycle. There have also been concerns that baht depreciation and weaker current account balance could prompt BoT to undertake more aggressive rate hikes in order to mitigate the pass-through of FX depreciation on imported inflation. However, we think disruptive tightening is unlikely for a few reasons, The year-to-date depreciation of baht has not been more significant than regional peers. Core CPI at 3.1% YoY in Aug-22is only marginally above the 1-3% target range, suggesting that inflation pressure is still more supply-side rather than demand-side, and the still-nascent recovery is also likely something policymakers would keep in mind. Indeed, recall that unlike other central banks, which began to lift off on policy rate after the economy had returned to pre-Covid GDP levels or above, BoT lifted off on policy rate even before GDP has got back to pre-Covid GDP levels. At a terminal policy rate of 1.5%, real policy rate is likely still below neutral.

Pantheon (+25bp): We expect the MPC to follow up its first 25bp last month with another one this week, taking the policy rate to 1.00%. This likely will be the last hike this year, as inflation will have fallen sharply by the November meeting.

Scotiabank (+25bp): A second quarter-point rate hike is expected to lift the benchmark rate to 1%. August inflation climbed to 7.9% y/y and core CPI accelerated to 3.2% for the highest reading since 2008.

UOB (+25bp): BOT is of the view that given expectation of sustained growth recovery and higher inflation expectations ahead, the policy rate should start being normalized. Hence, we keep our view for another 25bps rate hike to 1.00% in Sep, and to stay there for the rest of 2022, before possibly resuming hikes in 2023.

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