

Thailand Watch

One more hike

Hiking against falling inflation—four reasons why

The Bank of Thailand (BoT) sounded resolutely hawkish at the Monetary Policy Forum. Despite a sharp slowdown of [headline inflation \(see report\)](#), the BoT still sent a strong signal of more rate hikes to come. We see four reasons as to why: (1) an optimistic economic outlook, (2) concerns over sticky core inflation, (3) the risk of financial instability build-up from 'too low' interest rates, (4) the desire to lift real rates into positive territory.

BoT remained positive on growth outlook

The BoT portrayed an optimistic view of the Thai economic growth outlook in 2H23. In the latest BoT forecast in May, the Thai economy was expected to grow 3.6% in 2023 (3.8% in 2024), with private consumption, exports, and tourist arrivals all revised upward from the previous forecast. The BoT also saw further upside to this growth estimate, citing tourism recovery and fiscal stimulus.

Concerns over sticky core inflation

At the meeting, a great amount of emphasis was placed on rationalizing inflation risks despite the recent drop in inflation figures. The BoT acknowledged the slowing momentum of headline inflation but continued to be concerned about the stickiness of core inflation, especially food in core and core services (excl. rent) that remains above historical averages. The BoT was more concerned on future inflationary pressures that could arise from increases in cost pass-through as the economic recovery gains pace.

The need to normalize to a positive real interest rate

For the first time, the BoT spent time communicating more directly about the 'terminal rate' and the 'neutral interest rate' with the public. While not giving out the exact level of the terminal rate for this cycle, the BoT stated clearly that the 'real' policy interest rate should land in positive territory as the economy normalizes. It also pointed out that the current real interest rate is hovering around 0%, and the policy rate needs to be lifted further to be consistent with a positive long-term neutral rate.

Financial stability risk from low-for-long interest rates

Another reason supporting the hawkish stance of the MPC is the belief that an interest rate level that is deemed 'too low' would give rise to financial stability risks. In the latest meeting minutes, the MPC reasoned that "a sufficiently high real interest rate would guard against search-for-yield behavior and excessive financial risk-taking, thus fostering long-term financial stability." Building policy space, as reportedly quoting Deputy Governor and MPC member Mathee Supapong, was as another reason to justify a further rate hike.

One more hike and no more

For all these reasons, we maintain our call that the MPC will raise rates to the terminal rate of 2.25% in August. We believe that the MPC would follow with a long pause thereafter, as downside risks will only get stronger and outweigh inflation concerns. In addition, we also believe that actual inflation will continue to come down faster and stay lower than the BoT's current estimates, in our view making the monetary policy stance as implied by the real policy interest rate, too tightened than the MPC desires.

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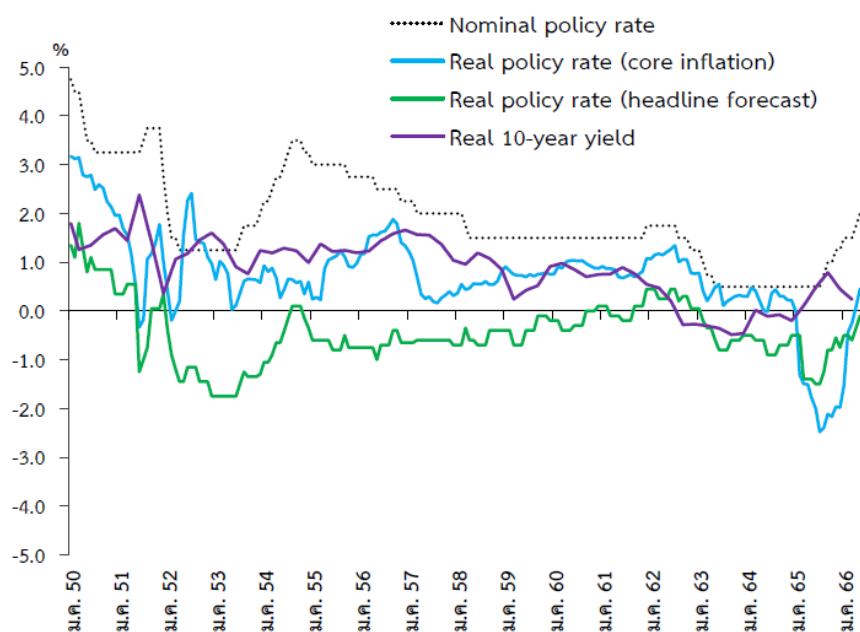
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Exhibit 1: Current real rates remain at about 0%

The BoT's measure of "real interest rates"



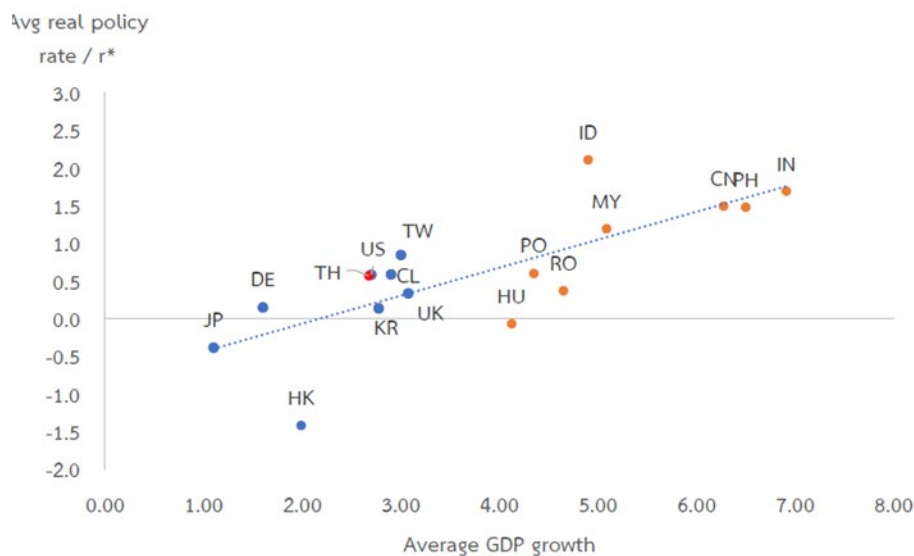
หมายเหตุ: Real 10-year yield คำนวณโดย Term structure model

Source: Bank of Thailand

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Exhibit 2: According to the BoT, Thailand's neutral "real" policy rate should be at zero

Average real policy rate and average GDP growth rate



Source: Bank of Thailand

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