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Monetary Policy Report, March 2020

The Bank of Thailand (BOT) released the March 2020 issue of the *Monetary Policy Report*. The *Report*, published quarterly, is aimed at enhancing public understanding of the Monetary Policy Committee (MPC)'s policy stance and its assessment of Thailand's economic outlook. Details are summarized as follows.

Monetary Policy Conduct in the First Quarter of 2020

At the meeting on February 5, 2020, the Committee voted unanimously to cut the policy rate by 0.25 percentage point from 1.25 to 1.00 percent. The Committee assessed that the Thai economy would expand at a much lower rate than the previous forecast and much further below its potential due to the coronavirus (COVID-19) outbreak, the delayed Annual Budget Expenditure Act, and the drought. In this situation, there was an urgent need to coordinate financial and fiscal measures, as well as to support liquidity provision and debt restructuring for businesses and households. **Later on March 20, 2020, the Committee held a special meeting and voted unanimously to cut the policy rate by 0.25 percentage point from 1.00 to 0.75 percent, effective on March 23, 2020.** This was because the impact of the COVID-19 outbreak in the period ahead would be more severe than previously expected, which would severely affect the Thai economy. The outbreak also raised concerns among global financial markets and affected liquidity of Thai financial markets. **At the meeting on March 25, 2020, the Committee voted 4 to 2 to maintain the policy rate at 0.75 percent. Two members voted to cut the policy rate by 0.25 percentage point**, while one MPC member did not vote[1]. The Committee viewed that the economic and inflation outlook remained consistent with the assessment at the special meeting. Most members would wait to assess the adjustment in the financial markets as well as additional reduction in interest rates by financial institutions. Most members deemed it appropriate to preserve policy space. Meanwhile, all members viewed that the government's announced relief measures and the loan repayment measures to assist borrowers affected by the COVID-19 were more targeted in addressing the problems. However, two members voted to cut the policy rate by 0.25 percentage point, as the extra accommodative monetary policy would in their view be commensurate with the significant economic contraction.

Looking ahead, the Committee would stand ready to use additional policy tools in an appropriate and timely manner. Such tools included the policy rate and other financial measures that would help enhance the policy rate transmission as well as loan extension by financial institutions to reach the target groups.

[1] The MPC member attended the meeting through video conference to consider the economic outlook, financial stability, and the appropriate monetary policy formulation but did not vote.

Assessment of the Economic and Financial Outlook as the Basis for Policy Formulation

1. Global Economy

The global economy was projected to slow down significantly as the COVID-19 pandemic severely affected tourism, manufacturing, and exporting sectors, as well as private consumption. The outbreak also led to excessive volatility in the global financial markets. Major advanced economies were expected to enter into a recession in 2020. **The Committee thus revised down economic growth projections for Thailand's trading partners to 0.2 percent in 2020 and 2.0 percent in 2021.** Nonetheless, **risks that trading partner economies would underperform the baseline projection increased.** Such risks included, for example, the COVID-19 outbreak which could become more severe and prolonged than expected, and financial stability risks which could deteriorate in many countries. On the other hand, there were possibilities that trading partners' economic growth would outperform the baseline projection owing to a faster-than-expected ending of the outbreak due to a successful development of vaccines or medicines, or larger-than-expected effects of financial and fiscal measures in many countries in stimulating the economy.

Governments and central banks in various countries worldwide promptly released measures to alleviate the impact of the COVID-19 outbreak. Such measures included greater government spending and extra accommodative monetary policy in conjunction with measures to safeguard financial stability and provide liquidity to financial markets. The Federal Reserve (Fed) held two unscheduled meetings in March 2020 and decided to cut the policy rate to a range of 0.00-0.25 percent and announced to purchase Treasury and agency mortgage-backed securities as much as needed to support the well-functioning of the financial markets. Meanwhile, the European Central Bank (ECB) and the Bank of Japan (BOJ) maintained negative policy rates and announced additional liquidity measures. Regional central banks eased their monetary policy further and also introduced measures to ensure stability of the financial markets following sustained capital outflows.

2. Financial Conditions and Financial Stability

Thai financial markets encountered volatilities similar to global financial markets. In March, investors' concerns over the COVID-19 pandemic increased, causing Thai government bond yields to rise rapidly across all tenors. **However, BOT measures helped improve stability of the financial markets. These measures included government bond purchases, the policy rate cut at the special meeting, and measures to stabilize the Thai financial markets.** As a result, government bond yields declined and overall financial conditions became more accommodative, partly reflected in the decreased lending rates.Meanwhile, overall corporate financing remained mostly unchanged. Financial institutions became more tightened in extending loans in line with economic conditions. Therefore, the BOT, together with related agencies, continued to implement measures to assist borrowers affected by the outbreak. These measures included both liquidity provision and debt restructuring. With regard to exchange rates, the baht against the U.S. dollar and the real effect exchange rate (REER) index depreciated considerably from the previous quarter.

The financial system faced greater risks from the short-term impact of the COVID-19 outbreak, although stability of financial institutions, external, and fiscal sectors, remained robust. Further risks that warranted monitoring were as follows. First, some investors rushed to redeem their investment units in daily fixed income funds, which were open for daily redemption, especially the funds investing in foreign assets. Some mutual funds therefore sold off their government bonds, thereby impacting liquidity and the functioning of the financial markets. Second, corporate bonds default risks increased in tandem with economic conditions, triggering knock-on effects to other related parties in the financial system, including cross-default and some saving cooperatives with corporate bond holdings. Third, ability to manage liquidity and debt servicing ability of households and businesses deteriorated. This could impact decisions to extend loans of financial institutions and in turn affect economic activities, resulting in a negative feedback loop. Fourth, oversupply in the real estate market was expected to rise due to falling demand for housing.

3. Economic and Inflation Outlook

The economy would contract significantly, expanding at a much lower rate than the assessment in the previous *Monetary Policy Report*. The Thai economy was expected to contract 5.3 percent in 2020 but would recover and expand 3.0 percent in 2021. The economy would remain at a level below its potential throughout the forecast horizon. This was mainly owing to the severe impact of the COVID-19 outbreak. In addition, farm income would be depressed by the drought, while public expenditure would experience a larger impact than previously assessed due to the delayed enactment of the Annual Budget Expenditure Act, B.E. 2563 (A.D. 2020). Nevertheless, government's implemented measures would be the key mechanism to alleviate the impact on the economy despite being unable to offset a significant contraction in aggregate demand.

Assumptions underlying the economic projection in this *Report* include (1) the COVID-19 outbreak in Thailand would be contained within the second quarter of 2020 according to the Ministry of Health estimate, and (2) the projection took into account financial and fiscal measures implemented before March 25, 2020, not including any measures thereafter.

The value of Thai merchandise exports in 2020 would markedly shrink both in terms of volume and prices. Export volume would be affected by the COVID-19 outbreak, which resulted in a significant demand slowdown of trading partner economies and supply chain disruptions. Meanwhile, export prices would significantly decline in line with crude oil prices. However, the value of merchandise exports was expected to expand slightly in 2021 once the spread of COVID-19 subsided. Nevertheless, **the Committee assessed that the value of merchandise exports would contract 8.8 percent in 2020, before expanding slightly at 0.2 percent in 2021.**

Exports of services was expected to severely contract as the COVID-19 outbreak led to travel restrictions that affected foreign tourist figures of all nationalities. Moreover, there would also be an impact on tourist spending per head. However, the number of foreign tourists was expected to gradually improve in the second half of 2020. Nevertheless, tourists would start to travel once the vaccines for the coronavirus were to be widely distributed. **The number of foreign tourists was projected to be 15.0 and 20.0 million in 2020 and 2021, respectively.**

The current account balance was projected to register a surplus of 19.4 and 19.2 billion U.S. dollars in 2020 and 2021, respectively. The services balance was revised from being in surplus to deficit, as tourist receipts declined considerably in line with the decline in the number of tourists and spending per head. Meanwhile, the trade balance was expected to record a larger surplus due to a large contraction in imports value. Import volume contracted in line with imports of raw materials, intermediate and capital goods, while import prices declined in tandem with global crude oil prices.

Private consumption was expected to contract in 2020, which was the first contraction since 2009. Suspension of a wide range of economic activities affected consumption in the services and away-from-home spending categories. Meanwhile, farm income was expected to decline due to a more-severe-than-expected impact of the drought. However, government measures to alleviate the impact of the COVID-19 outbreak would partly help relieve the impact on private consumption to a certain level.

Private investment was projected to contract in 2020 in line with both domestic and external demand. **However, private investment was expected to improve in 2021** thanks to a gradual recovery in exports, the PPP projects in infrastructure investment projects that had been postponed, as well as a greater clarity pertaining to investment in the 5G network following the auction in the first quarter of 2020.

Public expenditure, both consumption and investment, was expected to expand and would be a key driver of the Thai economy. However, although government agencies adjusted the procurement process for a faster disbursement, this could not offset the impact of the delayed enactment of the Annual Budget Expenditure Act in the previous period. SOE investment was revised down in line with project postponement and a lower fiscal budget on transportation projects. Meanwhile, the first and second packages of government measures to mitigate the impact of the COVID-19 outbreak, totaling 464 billion baht or 2.8 percent of GDP (excluding tax relief measures worth approximately 260 billion baht or 1.5 percent of GDP), were mostly measures on credit and transfers. This was expected to directly cushion private consumption and investment, not through public consumption and investment.

Headline inflation would be negative due to the sharp decline in crude oil and energy prices. Core inflation was expected to be negative as well in line with a large decrease in demand-pull inflationary pressures. Headline inflation was projected to be negative at -1.0 percent in 2020, before gradually increasing to 0.3 percent in 2021 consistent with the gradual economic recovery outlook. However, headline inflation would remain below the inflation target.

Economic and inflation projections were highly uncertain and mainly depended on the situation of the COVID-19 spread and the success of the containment measures. Risks to the projections tilted downward. The possibilities that the Thai economy would underperform the baseline projection would be due to the following factors. First, the global economy could enter into a recession should the outbreak become more severe and prolonged than expected, exerting additional adverse impacts on Thailand's merchandise exports. Second, global financial stability risks might affect the Thai economy in the medium term. Third, Thailand's tourism might not recover in the second half of 2020 if the outbreak in Thailand and other countries could not be contained within the second quarter of 2020. Fourth, the government might need to implement stricter measures to control the outbreak, which might cause some businesses to shut down operations or significantly reduce employment. Fifth, more-severe-than-expected impact of the drought could affect farm income. However, **there were possibilities that the Thai economy would outperform the baseline projection** due to (1) a faster-than-expected development of vaccines and medicines for the COVID-19, (2) better-than-expected impacts of additional government's stimulus measures and measures to assist borrowers, and (3) a higher-than-expected domestic demand as a result of public infrastructure investment and PPP projects, which might incentivize the private sector to invest more and faster. Moreover, **there remained downside risks to headline and core inflation projections** in line with risks to crude oil prices and the economic growth projection.

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