

August 7, 2019

Bank of Thailand reverses course and delivers a surprise 25 bps cut

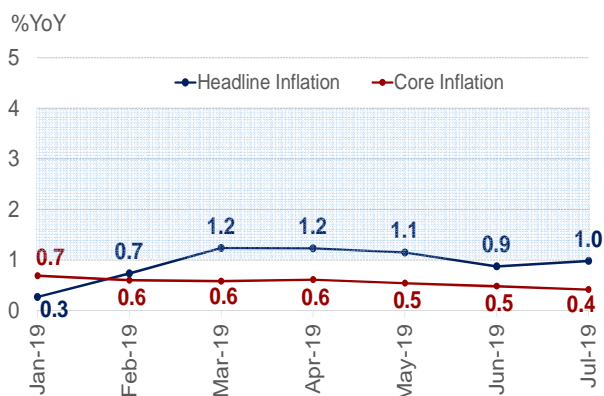
- **On Aug 7th, the MPC voted 5-2 to lower its policy rate to 1.50% from 1.75%.** The Bank of Thailand finally reverses its course and delivers the first rate cut in 2019, not long after its last interest increase of 25 bps in December 2018. This has taken the markets by surprise as the BOT had not communicated its abrupt about-turn on its monetary policy stance. Based on the Bloomberg survey, almost all economists anticipated no change in the policy rate today.
- **As we reiterated before, the policy rate cut was only a matter of when – not if.** We assessed that the overall economic conditions had deteriorated rapidly since the beginning of the year, and therefore warranted a lower policy rate (see *below for our last report on the MPC decision on June 27th*). And, as the Federal Reserve lowered its policy rate on July 31st, this paved the way to make it easier for the Bank of Thailand to follow suit. Further, today the Reserve Bank of India, and the Reserve Bank of New Zealand also delivered a larger-than-expected rate cut which pointed to the general stance of dovishness amidst the increasingly gloomy global backdrop.
- **The BOT stance has become decidedly much more dovish.** According to the MPC statement, they expect to see a lower GDP growth rate than the previous projection (2019 GDP of 3.3%) and below the potential GDP growth rate, and the inflation rate is likely to miss the inflation target (between 1-4%). More worryingly, the core inflation has weakened over 2019, indicating a softened domestic economic activity (**Chart 1**). In addition, the MPC voices its concerns over the impacts of the strong Thai baht on tourism and exports, especially given the relative strength of the Thai baht against other currencies (**Chart 2 and 3**). Worsening economic outlook, as well as the impacts of the drought, played an important role in tipping the scale for some of the MPC members as they opted for a lower policy rate. In our view, we expect to see a disappointing figure of Thailand's Q2 GDP release on August 19th,
- **We expect this to be a series of policy rate cuts, rather than a one-off.** The BOT should deliver further rate cuts to support the economy, weaken the Thai baht and lift the inflation rate back to target. But the question is how low the BOT can go in this series, as they reiterated the need to preserve the policy space? The historic low policy interest rate is 1.25% which most believe that is the line in the sand drawn by the BOT (**Chart 4**). **However, I think, given the weak economic outlook, the BOT will likely have to bring down its policy rate well past the 1.25% mark.**
- **Last but not least, the interesting question is whether the Minimum Loan Rate (MLR) charged by the Thai commercial banks will also move lower?** Following the last BOT rate hike at the December 2018 meeting, the MLRs did not increase with the policy rate, but instead remained unchanged. The last time commercial banks lowered their MLRs in tandem occurred in Q2 2016, despite no policy change from the BOT. **I expect to see lower MLR across all banks to match the move by the BOT.**

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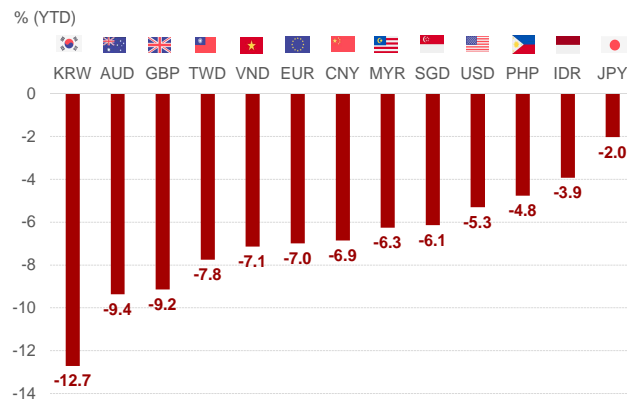
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Chart 1: Headline and Core Inflation



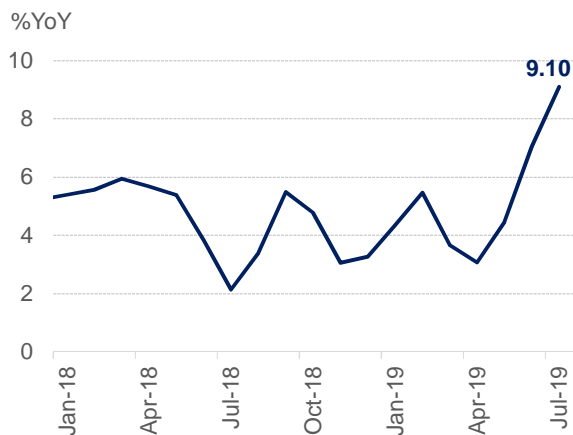
Source: Ministry of Commerce

Chart 2: Other Currencies' Movement Against the Thai Baht (YTD)



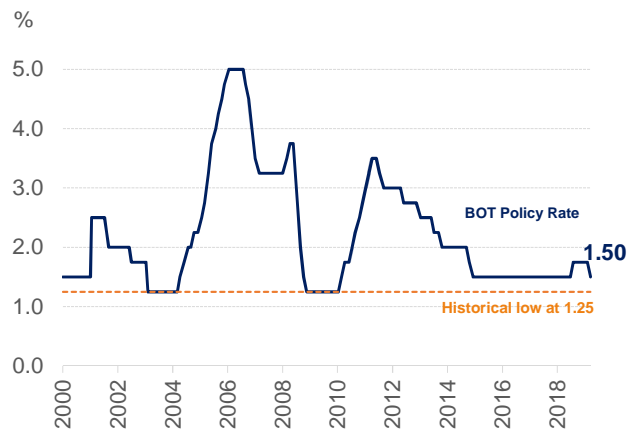
Source: Bloomberg

Chart 3: Nominal Effective Exchange Rate



Source: Bank of Thailand

Chart 4: Bank of Thailand Policy Rate



Source: Bank of Thailand

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