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Article

Thailand: The low growth, low inflation trap seems entrenched

The Bank of Thailand keeps monetary policy on hold.

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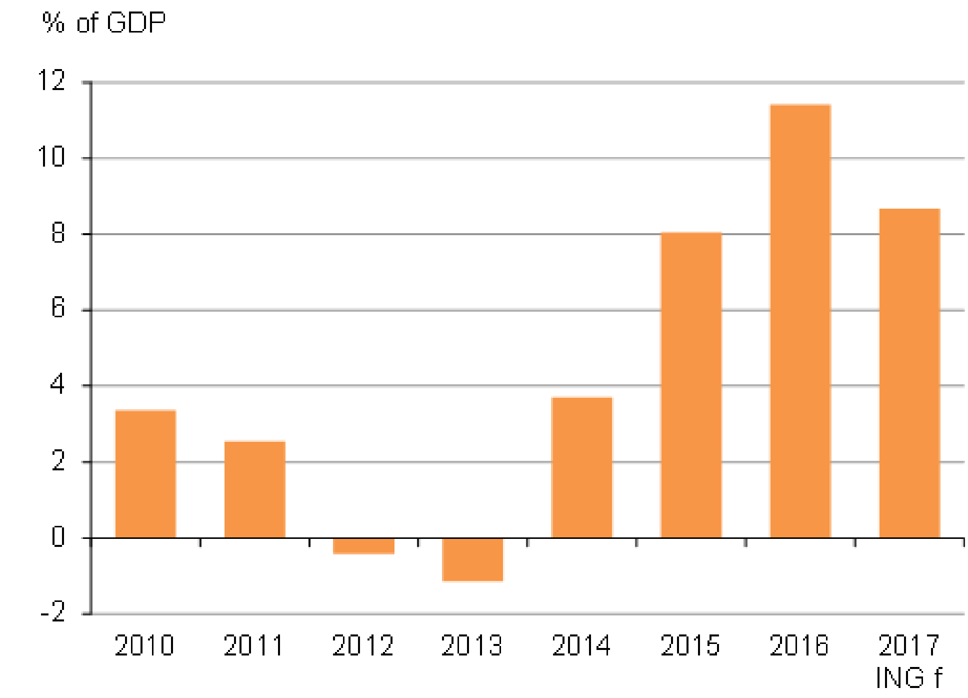
BoT keeps policy on hold

As widely expected, the Bank of Thailand Monetary Policy Board decided to keep the monetary policy on hold at their latest meeting. We were an outlier in the Bloomberg poll for our forecast of a 25bp policy rate cut to 1.25%, while all other forecasters expected no change. We were wrong, but the central bank was also under pressure from the government to cut rates, as the stronger Thai Bhat THB) threatens exports and tourism proceeds, the main sources of Thailand's economic strength this year. However, that isn't the only argument for easing.

The IMF noted in its 2017 Article IV Consultation published in May that "*Thailand's policy space and ample buffers can be deployed to minimize the risk of a low-inflation, low-growth trap*" and "*…recommended monetary policy easing together with enhanced communication to improve the balance of risks and steer inflation back to the target*". We think the low-growth, low-inflation trap appears entrenched and the economy needs some policy accommodation to overcome that. There is not much evidence of stimulus coming from the fiscal side, despite increases in extra-budgetary spending on infrastructure development.

A surge in the current account surplus

% of GDP



Percentage of GDP

Source: ING, Bloomberg

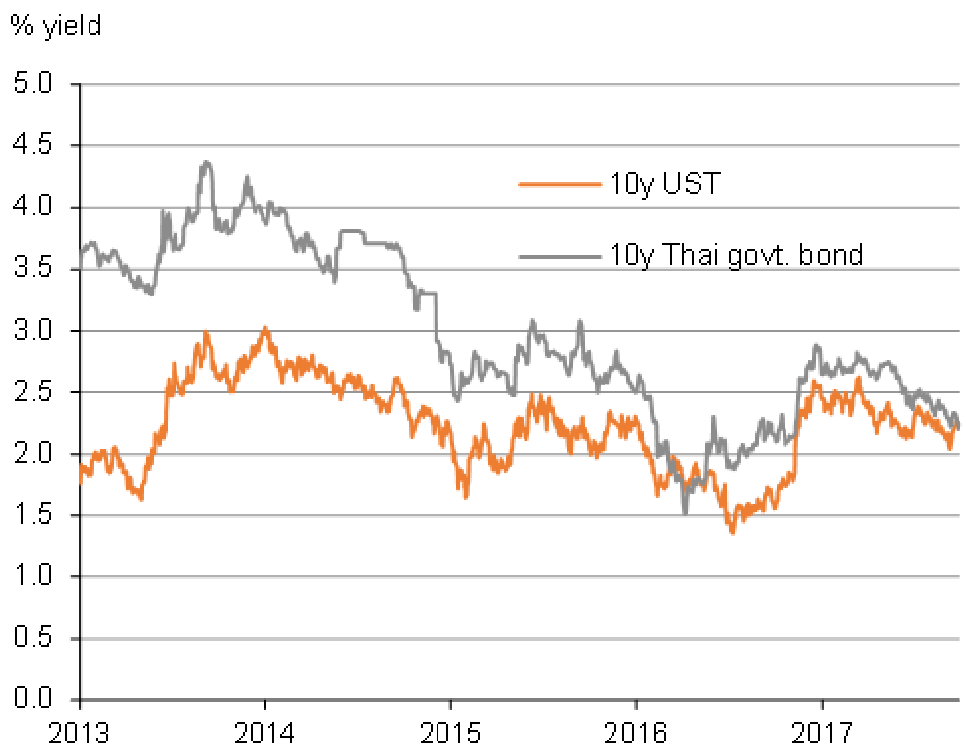
Growing economic imbalances

Instead, we see greater evidence of economic imbalance. A significant step up in the current account balance, from a 1.2% of GDP deficit in 2013 to a 3.7% surplus in 2014 and further to 8.1% and 11.4% GDP surpluses in subsequent two years, is more a result of persistent weak domestic spending and a plunge in commodity prices than the result of strong external demand / competitiveness. Another sign of imbalance is Thai government bond yields trading through their US counterpart (latest 10y yield at 2.20% vs. 2.22% for UST).

Are investors treating Thai government bonds as a safe-haven against the global risk, or have USTs lost their lustre as the ultimate safe haven asset? Highly unlikely. A question in a Bloomberg story yesterday, "*why a developing nation with a credit rating seven levels lower than the US at Moody's Investor Services has similar borrowing costs is down to the deluge of money flooding into emerging-market debt*", seems appropriate. However, the answer in the same story citing large current account surplus attracting investment flows to position for appreciating currency seems less convincing. We believe the re-pricing of the THB for large external surpluses has run its course. We forecast the current surplus to narrow to under 9% of GDP in 2017.

Thai bond yield trading close to UST yield

% yield



Source: ING, Bloomberg

Future hopes

Despite a modest pick-up in GDP growth to 3.5% in the first half of 2017 from 3.2% in all of 2016, underlying economic fundamentals remain weak. All the boost to growth came from inventories even as manufacturing growth remained anaemic despite an acceleration in exports.

> De-stocking will be a drag on future output.

CPI inflation remains close to zero and below the BoT's 1-4% policy target. Our full-year 2017 growth and inflation forecasts are 3.5% and 0.5% respectively (cons: 3.5% and 0.7%). We agree there is not much room for policy rates to go lower if the BoT needs to preserve policy space for the future. The low in the policy rate was 1.25% during the 2008-09 Global Financial Crisis and the benefits of one 25bp rate cut may not be significant. This means the government also will need to loosen the fiscal strings to stimulate the economy.

Hopes are pinned on accelerated public spending once a year-long mourning period ends after the cremation of the late King HM Bhumibol Adulyadej on October 26. We continue to forecast a 25bp BoT policy rate cut before the end of the year. We think part of the spike in USD/THB since yesterday is anxiety about the BoT easing, which is unlikely to go away despite today's on-hold decision. The spike has the pair trading near our 33.3 year-end forecast, which we now revise higher to 33.50 (spot: 33.3, cons: 33.4).

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