

# Thailand Macro Flash

## Higher Risk Premia Prompts MPC Rate Cut of 25bp to 2.25%

- **Amid political turmoil, MPC surprises with a 25bp rate cut to 2.25% (survey: 2.5%/Citi: 2.5%)** — In a vote of 6-1, the MPC's unexpected decision to trim its policy rate was prompted by the macro impact of the recent political turmoil in our view, at a time when private spending has turned lethargic and strong export recovery remained elusive. In the MPC's press release after the meeting, policymakers viewed the economy 'expanding at a slower pace than previously assessed, with greater downside risks compared with the last meeting'. While the MPC's latest action could provide some relief to market and investor sentiment, the rate cut would not replace the impact of public investments likely to be delayed by political developments. The unexpected cut comes at a time when 10yr govt bond yields drifted up to recent high of 4.26% in yesterday's session from 4% early in the month. Neither did 3Q GDP data nor BoT's HH debt concerns weigh heavily on the MPC's decision. Tech recession risk ended with 3Q GDP up 1.3%QoQ SA while 3Q durable goods consumption (transport equipment) rose by 0.46%QoQ SA.
- **Prospective rate easing likely dependent on risk premia and upcoming economic indicators** — In its press release, MPC noted 'higher downside risks to growth stemming from delay in government investments and fragile private confidence, which could be compounded by ongoing political situation'. Risk premia and upcoming indicators would determine MPC decisions to ease. **After the unexpected cut, we now expect MPC to cut by another 25bp to 2% in its next scheduled policy rate meeting on January 22nd as delays in approval and implementation of public investments would run to 1Q14** (assuming Parliamentary approval in Dec-Jan, opposition would probably petition the Court to decide on the legal basis/constitutionality of the Bt2tn public investments program) with strong export recovery still elusive. **Since we are assuming GDP's slow pace (+0.5%YoY) hitting bottom in 4Q13 with mild gains slated for next year, MPC's accommodative bias would probably prevail for much of 2014 and thus sustain an overnight rate at 2%.** A firmer public investment outlook and strong export recovery, if it happens in 2H14, comprise the caveat.
- **Market implications** — The THB would bear the brunt of MPC's surprise rate cut, potential rate easing in 1Q14 and sustained accommodative rate bias until risk premia ease and the macro outlook is on a firmer footing. Potential rate cut in 1Q14 implies mild upside risk to our THB forecast of 32 that assumed a policy rate steady at 2.5%. On the local bond side, the rate easing outlook would help anchor the front end of the local bond curve amid risk premia, Fed tapering risk results in UST yields drifting up, and a weak THB aggravated by portfolio exit risk. However the long end of the curve would remain vulnerable to upside risk mainly because of structural fiscal weakness embodied by a rising public investment debt to GDP ratio. As public investments rise while lacking sharp cuts in populist programs, the long yields likely locked in at 4%-4.5% would not benefit from the low policy rate setting.

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- In its press release, the MPC noted 'the global economy continued to recover, led by expansion in the major economies, particularly the US'. While there's 'high uncertainty in the outlook for US monetary and fiscal policies', this appears to be counter balanced by an 'expanding Chinese economy well across all sectors, while the regional economies continued to grow gradually'. The MPC cited that exports of the North Asian economies, including China, recovered at a more robust pace than those of ASEAN exports.
- The MPC was bearish on onshore growth prospects, noting that the 'Thai economy in the 3Q13 was weaker than expected from both private and public spending'. The macro backdrop continued to miss export recovery. On prospects, policymakers sense 'higher downside risks to growth stemming from delay in government investment and fragile private confidence, which could be compounded by ongoing political situation'. The MPC also expects 'exports might not benefit fully from prospective global economic recovery'. With subdued inflation pressures, decelerating private credits, including moderating HH credit growth, the MPC deemed economic and financial conditions were appropriate for rate action to mitigate heightened downside risks to growth.

## Appendix A-1

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