

Thailand: Policy Rate Hiked 25 bps To 3.25%

Bank of Thailand again raised its 1 day repo rate by 25 bps to 3.25%, in line with market expectations. The need to dampen inflationary pressures is apparent, with headline inflation still high, at 4.1% y/y in June from May's 4.2%. Core CPI rose 2.6%, from the previous 2.5% y/y, near the upper end of the BoT target range of 0.5-3.0%.

Inflation looks likely to continue, on domestic demand stemming from strong private consumption and investment. Most of the economically expansionary policies, such as a rise in minimum wages, promised by the victorious Pheu Thai party are likely to kick in next year, and that should contribute to higher inflation in the coming months ahead. We are bringing forward our expectation of one more rate hike for this year from Oct to Aug in light of the present inflationary pressures in the economy, to bring the policy interest rates to 3.50% by end 2011. But with cost pressures not abating, and to pre-empt the inflationary potential from wage increases that will be building come next year, we think rates could go up to 3.75% by year end.

In its statement today, the BoT said inflation is likely to continue. "The extension of price administration and cost-of-living alleviation measures may slow the rise in measured inflation figures, but other measures such as the prospective increases in the minimum wage and fiscal spending amid continued economic growth will likely add to inflationary pressure and may result in heightened inflation expectations".

Impact on USD/THB

Our call is for the THB to strengthen moderately to 29.50/USD by year end, and also supported by more rate hikes in the coming months. But with possible political uncertainty still ahead, this could pose downside risks to the THB. We view THB appreciation as dependent on the ensuing political developments.