

## Thailand: Policy Rate Stays At 3.5%

Bank of Thailand kept the benchmark interest rate steady at 3.50%, in line with market expectations. Inflationary pressures have eased slightly, with headline inflation at 4.0% y/y in Sep, from 4.3% in Aug. Core CPI continued to climb to 2.92% from 2.85%.

The adverse impact from the severe flooding has added to the already moderating growth in Thailand, with BoT estimates of the damage wrought by the floods at around 1.0-1.7% of GDP. The BoT thus looks likely to hold the policy interest rate at 3.5% for the rest of the year, given that the economy is headed for a slowdown. The MPC voted 6 to 1 to maintain policy interest rate at 3.50%, while one voted for a 0.25% cut. We might be downgrading our full-year GDP growth forecast of 4.0%, depending on how protracted the floods are, and looking at the final tally of the damage to the economy. We project rate hikes to likely resume again in the 2H of next year to end 2012 at 3.75%, where monetary policy might resume its focus again on inflationary pressures, and the economy picks up.

Looking at the months ahead, domestic inflationary pressures are likely to continue, with the increase in rice prices, and more so after damage to agriculture arising from the flood, with annual output projected to be affected by at least 3 mn tones. The rise in minimum daily wage to THB300 in Bangkok and six other provinces were approved, which should also add to domestic inflation.

In its statement today, the BoT noted the significant deterioration in the external economy emanating from the Eurozone debt problems, while US data signaled a "fragile recovery". But the BoT was more upbeat on domestic and regional growth mitigating the fallout from the external environment. "Firm domestic demand and available fiscal policy space should help to cushion growth and trade within the region from the impact of a slowdown in advanced economies." While aware of the impact of the floods on GDP, the BoT stated that "reconstruction spending would provide support for domestic demand to gradually pick up in the periods ahead."

### Impact on USD/THB

The slowdown in the domestic economy from weak external demand as well as the flooding might see the THB weakened. The pause in rate hikes is another dampener on the domestic currency. But overriding these factors is the volatile external environment owing to the still unresolved Eurozone debt crisis. Risk appetite could still quickly swing back to risk-off mode, despite some strength seen recently in the Asian currencies. We are maintaining our call for THB to weaken slightly to 31.50/USD by year end.