

BOT sees no benefit from dropping rates

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Governor sends a strong signal that no change in interest rates is likely soon

Keeping the policy rate at its current level at its next meeting would mean the central bank is running with the tide, not against it, Bank of Thailand Governor Prasarn Trairatvora-kul has indicated.

Speaking at The Nation Exclusive Insights for CEOs on "Baht Watch 2013", he explained why the interest rate cannot be lowered - telling the 32 guests a lower interest rate wouldn't stabilise the baht or help the country in the long term.

Starting with an overview of the global foreign exchange market, which is influenced by quantitative easing by developed economies, he explained the "impossible trinity" (also known as the 'trilemma') - interest rate autonomy, capital mobility and exchange rate stability.

Striving for public trust after the disastrous 1997 financial crisis, the Bank of Thailand puts interest rate autonomy as a priority.

In this scenario, as Thailand draws more capital to finance domestic economic expansion, there is restriction on capital inflow. That means exchange rates would be a victim, to move in line with changes in capital flows.

"We can't have them all," the central banker told the CEOs during the event at the Dusit Thani Hotel last Friday.

The governor also sent a strong signal that the situation would not be changed soon. Resisting the urge for a switch from inflation targeting to exchange rate targeting, he insisted the interest rate had proved it could control the monetary condition well, while exchange rate instruments posed a problem of controllability. Performing well in reducing output and inflation volatility, the interest rate policy in Thailand provided adequate flexibility in economic and financial stability.

"We acknowledge the government's concern that the baht appreciation will impact the country's exports. Anyway, we cannot rely on only one strategic tool to solve two particular problems. We need to trade off," Prasarn said.

"We (the Bank of Thailand), however, agree to undertake further discussion with the government to integrate our tools together in solving the country's financial and economic problems in the future," he said.

Prasarn gave the example of 1997 when the BOT tried to fully pursue all three objectives - interest rate autonomy, free capital mobility, and exchange rate stability - which proved to be the central bank's worst failure.

He said the BOT currently employed interest rates as the main policy instrument based on three criteria for appropriate monetary policy instruments, which are the ability to control monetary policy conditions and to mitigate the impact from the economic cycle to ensure growth and inflation stability.

It was flexible in responding to shocks, and could be used in combination with other policy tools.

Interest rates appear to be a more appropriate instrument in the Thai context under the 'flexible inflation targeting' regime. Interest rates had proved to be able to control monetary conditions well, while the exchange rate instrument was limited in controllability.

Bank of Thailand research supported this, he said. Foreign capital was flowing into Thailand mainly because of investor confidence (15 per cent), expected baht appreciation (15 per cent), economic conditions (11 per cent) and implied dollar/ baht volatility (10 per cent).

The weight of interest rate differential is only 3 per cent as well as inflation (3 per cent).

In another scenario, among 12 economies in Asia, Thai real rates are the third lowest by 0.64 per cent, higher than only those of Singapore (4.02 per cent) and Hong Kong (3.27 per cent). To the governor, the interest rate is already low, being at the point that encourages speculation in some sectors, particularly the stock market and condominiums, as real interest rates have been in negative territory for some time.

Prasarn said that the too-low interest rate environment was likely to be a source of financial imbalance build-up as it induces domestic investors to shift their investments into more risky assets.

He said the Thai baht was currently fairly valued from the market's view. However, current concerns, which may affect financial stability and private consumption in the future, are the rise of credit and household debt, especially auto and personal loans.