Edited Minutes of the Monetary Policy Committee Meeting (No. 7/2021)
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Members Present

Sethaput Suthiwartnarueput (Chairman), Mathee Supapongse (Vice Chairman), Vachira Arromdee, Kanit Sangsubhan, Rapee Sucharitakul, Somchai Jitsuchon, and Subhak Siwaraksa

The Global Economy and Financial Markets

The pace of global economic recovery decelerated. Growth in advanced economies (AEs) slowed down after substantial expansion earlier as some countries re-imposed containment measures in response to surges in new cases under the 'live with COVID-19' policy. Meanwhile, the recovery in Asian economies improved thanks to significant progress in vaccination and subsequently the relaxation of containment measures. Nevertheless, the global economy would remain subject to the risk of rising global energy prices, particularly prices of natural gas and coal, during the recovery phase that led to higher crude oil prices. The global energy prices were expected to gradually decrease in line with the decline in energy demand after the end of winter and the projected increase in oil supply from OPEC Plus and the US next year. In addition, the global economy would still face the risk from prolonged global supply disruptions, including shortages of containers and semiconductors.

Volatilities in the global financial markets increased due to gradual normalization of monetary policy in AEs in light of economic recovery. The Federal Reserve announced the tapering of bond purchases. Meanwhile, some emerging market (EM) central banks started normalizing monetary policy, particularly Latin American countries due to high inflation. Although government bond yields rose, EM risky asset prices also increased owing to the economic recovery underpinned by the improved pandemic situation. Global investors returned to EM bond and equity markets, resulting in appreciation of regional currencies. Meanwhile, **the baht exhibited more volatile movements than its regional peers** due mainly to domestic factors, namely the relaxation of containment measures and the plan to re-open to foreign tourists. **Looking ahead, the global financial markets would remain highly volatile.** There would be a risk of central banks in AEs adopting a faster pace of monetary policy normalization to cope with elevated inflation. This would amplify the policy divergence given that monetary policy stance in several EMs remained accommodative to support the economic recovery.

Domestic Economy

The Thai economy would expand in 2021 and 2022 at a pace close to the projection in the September meeting on the back of domestic spending that gradually recovered following the relaxation of containment measures. The floods in October had limited impact on the overall economy, with the government providing some relief measures for affected farmers. Looking ahead, the improvements in outbreak situation and the vaccine rollout reaching the government's target of 70 percent by the end of this year would help mitigate risks to the economy and allow Thailand to re-open sooner. Foreign tourist figures were expected to gradually recover as short-haul Asian travelers who make up most of the tourist figures were still subject to quarantine requirements after leaving Thailand. Moreover, Chinese tourists still faced a ban on outbound travel. As such, foreign tourist figures were expected to remain close to the previous projection at 0.15 million and 6 million in 2021 and 2022 respectively. Meanwhile, fiscal support would taper following the substantial stimulus earlier and a projected slowdown in state-owned enterprise investment. Merchandise exports would decelerate in tandem with trading partner economies. Meanwhile, the labor market improved on the back of higher income of workers in the services sector and the self-employed in line with economic activities. Workers also started to return to provinces with industrial estates such as Nakhon Ratchasima, Rayong, and Chachoengsao.

Headline inflation would increase temporarily owing to supply-side factors, particularly energy prices which would likely decline by early next year. The cost pass-through of global energy prices was limited due to following reasons. First, the Oil Fund helped manage domestic energy prices by subsidizing diesel and LPG prices. Moreover, the fuel tariff electricity charge rate (Ft rate) was under regulation. The global energy prices were expected to decline after the first quarter of 2022 due to the end of winter and the increase of oil supply from major producers. Second, rising costs for businesses in tandem with global commodity prices due to global supply disruption were expected to have limited pass-through to consumer prices. This is because purchasing power was recovering slowly, thus lowering ability of firms to increase prices and forcing them to absorb the higher costs. Meanwhile, only 7 percent of the CPI basket was affected by the impacts of global supply disruption. Third, higher inflation was a result of relative price changes from some goods such as oil prices, rather than a broad-based price increase, reflecting subdued demand-side inflationary pressures. Looking ahead, headline inflation would remain within the target, with upside risks including the elevated global energy prices persisting longer than expected and global supply constraints becoming more prolonged. Meanwhile, inflation expectations remained anchored within the target. One-year-ahead inflation expectations based on a survey of businesses was 1.9 percent as of October 2021, lower than the October headline inflation outturn of 2.4 percent. A measure of expected inflation over the five-year period that begins five years from today based on a survey of professional forecasters was 1.8 percent, which remained anchored within the medium-term target of 1–3 percent.

Going forward, the recovery of the Thai economy would remain fragile and subject to uncertainties as follows. First, the outbreak situation following the re-opening of the country could affect the recovery and employment, which going forward would vary across businesses and geographical areas. A survey of domestic businesses revealed that manufacturing, retail, and restaurants would recover faster than hotels and transport of passengers. Second, the momentum of fiscal support could decelerate after the phase-out of existing measures. Third, higher costs could pass through to consumer prices, as producers might raise prices if the higher global prices of energy persisted longer than anticipated, if global supply disruption became more prolonged than expected, or if costs of various inputs increased simultaneously.

Discussions by the Committee

- **The Committee assessed that** headline inflation would increase temporarily in accordance with projected global energy prices. However, there remained a risk of the elevated global energy prices persisting longer than expected. Thus, inflation dynamics warranted close monitoring. Some MPC members expressed concerns that global energy prices could remain persistently high. This could happen in several instances such as (1) if global energy demand rebounded in line with the global economic recovery, (2) if global energy supply increased by less than expected as a result of insufficient investment in oil drilling rigs, and (3) if there were energy transitions in many countries toward lower greenhouse gas emissions. Should the surge of global energy prices last longer than anticipated, domestic energy prices would be affected as the Oil Fund would have limited capacity. If the prices of energy used as basic factors of production such as diesel, natural gas, and electricity were to increase, there would be knock-on effects on prices of other goods and services. Inflation expectations of consumers and businesses could subsequently rise. The Committee would closely monitor the outlook of global energy prices as well as other factors that could affect inflation dynamics.
- **The Committee viewed that an important issue for the Thai economy was to ensure the sustained recovery** as the economy would still be subject to several risks such as (1) recurrent outbreaks after the country's re-opening, especially with rising demand for foreign workers that could induce illegal entrance to Thailand, (2) the momentum of fiscal support, and (3) the pass-through of global energy prices. Economic recovery could be hampered if the high prices of natural gas and oil persisted longer than expected. The Committee would continue to closely monitor and reassess risks to the economy.
- **The Committee assessed that recovery in the period ahead would be uneven across sectors.** Despite recent signs of improvement, the uneven recovery could lead to a more fragile labor market. This was reflected in the number of employees in the social security system who applied for unemployment benefits which remained high. The number of unemployed along with underemployed workers was estimated to reach approximately 3.4 million persons by the end of 2021. Thus, **government measures to address the uneven recovery and the labor market should be more targeted. The measures should also focus on restructuring the Thai economy to be compatible with the new context** to reduce long-term economic scars after the outbreak subsided.
- **The Committee viewed fiscal policy as the main driver** to provide relief and to support economic recovery. Although the momentum of fiscal support would decline somewhat after the phase-out of government measures, there would be further fiscal support from the increase of the public debt ceiling to 70 percent of GDP. This would allow the government to implement additional measures if necessary. **Going forward, fiscal measures should support the economic recovery in a targeted manner, while the balance between emergency assistance and subsequent economic rehabilitation could be reassessed to shift the focus to creating incomes as well as promoting investment to enhance long-term potential growth.**

- **Monetary policy contributed to continued accommodative financial conditions,** with ample liquidity in the financial system and low financing costs. **Financial and credit measures continued to make progress,** but credit risks remained a challenge to liquidity distribution, particularly to SMEs and households. The special loan facility for businesses helped in part alleviate the problem. In addition, **the Committee deemed that financial institutions should accelerate debt restructuring in a sustainable manner** through the scheme launched on September 3, 2021, to have broader impacts and be consistent with borrowers' long-term debt serviceability.
- **The Committee viewed that the baht exhibited more volatile movements due to domestic factors, namely the relaxation of the containment measures and the earlier-than-expected re-opening of the country. Going forward, external risk factors warranted monitoring, particularly monetary policy divergence,** as they could have implications on capital flows, exchange rates, and domestic bond yields. The Committee assessed that exchange rate volatility could have adverse impacts on businesses during the recovery phase. Nonetheless, Thai businesses—mostly large corporations—carried out more foreign exchange hedging transactions recently, with exporters' hedging ratio increasing from 25 percent at the beginning of the year to 35 percent as of October 2021. Additionally, overall hedging costs declined, though small businesses faced higher costs than large corporations. Therefore, the Committee would closely monitor developments in both global and domestic financial markets, and encourage businesses, especially SMEs, to hedge against risks from exchange rate volatility.

<u>Monetary Policy Decision</u>

The Committee voted unanimously to maintain the policy rate at 0.50 percent to support the economic recovery which remained highly uncertain.

The Committee assessed that the Thai economy had bottomed out in the third quarter of 2021 and would expand at a pace close to the previous projection for 2021 and 2022 on the back of domestic spending that gradually recovered following the relaxation of containment measures, partially offsetting the adverse impact of higher global energy prices. Meanwhile, downside risks receded on account of the accelerated vaccination progress. However, the fragile recovery would remain subject to uncertainties. Looking ahead, fiscal support might taper following the substantial stimulus earlier. Merchandise exports would decelerate in tandem with growth in trading partner economies. **The Committee viewed that the continued accommodative monetary policy would help support overall economic growth, and thus voted to maintain the policy rate. In addition, the ongoing financial and fiscal measures, with the focus on rebuilding and enhancing potential growth would play an important part in bolstering the robust recovery of income.**

The baht relative to the US dollar exhibited more volatile movements owing to monetary policy in advanced economies and uncertainties in the Thai economic recovery outlook. The Committee would closely monitor developments in both global and domestic financial markets, and continue to expedite the new foreign exchange ecosystem, particularly through supporting SMEs in hedging against risks from exchange rate volatility.

The Committee viewed that the government measures and policy coordination among government agencies would be critical to support the economic recovery. Public health measures should strike a balance between containing the outbreak and supporting the recovery of economic activities, particularly after the re-opening of the country. Fiscal measures should facilitate the economic recovery by focusing on generating income and expediting measures to rebuild and enhance potential growth. Monetary policy should contribute to continued accommodative financial conditions overall. Financial and credit measures should be expedited to distribute liquidity to the affected groups in a targeted manner and help reduce debt burden. In addition, financial institutions should accelerate debt restructuring in a sustainable manner.

Under the monetary policy framework with objectives of maintaining price stability, supporting sustainable and full-potential economic growth, and preserving financial stability, **the Committee continued to put emphasis on supporting the economic recovery.** In addition, the Committee would monitor key factors affecting the economic outlook, namely the outbreak situation following the re-opening of the country, the adequacy of fiscal, financial, and credit measures, and the global energy price pass-through. The Committee would stand ready to use additional appropriate monetary policy tools if necessary.

Monetary Policy Group
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