BANK OF THAILAND

Unofficial Translation

February 9, 2024

Excellency,

No. BOT.MPD.(02) 106/2567 Statement pertaining to average headline inflation over the previous 12 months residing below the lower bound of the monetary policy target

On November 23, 2023, the Minister of Finance and the Monetary Policy Committee (MPC) mutually reached the agreement to set the monetary policy target for price stability such that headline inflation is to reside within the range of 1 – 3 percent for both the medium-term horizon and for the year 2024. The agreement also designated the MPC to write an open letter to the Minister of Finance should average headline inflation over the previous 12 months or a forecast of average headline inflation over the next 12 months breach the target range.

On February 5, 2024, the Ministry of Commerce released January 2024 data on the headline inflation rate of -1.1 percent, leading headline inflation over the previous 12 months (February 2023 - January 2024) to average at 0.7 percent — which is slightly below the inflation target range. Pursuant to the aforementioned agreement, this open letter issued by the MPC shall outline (1) key drivers causing average headline inflation over the previous 12 months to breach the lower bound of the target; (2) potential time frame for headline inflation to revert to the target; and (3) monetary policy actions taken to guide headline inflation back to the target within an appropriate time period. Details are as follows.

Key drivers that caused average headline inflation over the previous 12 months to fall below the lower bound of the monetary policy target range

Average headline inflation over the previous 12 months resided below the lower bound of the monetary policy target range due to temporary factors. In large part, this stems from government energy subsidy measures that aimed to lower the cost of living for households by reducing electricity costs and domestic retail oil prices through the Oil Fuel Fund and excise tax cuts. Without such aforementioned subsidy measures, average headline inflation over the previous 12 months would have resided within the monetary target range at 1.6 percent. Additionally, **average headline inflation remained low from subsiding cost-push pressures and the high base in the previous year.** Due to the decline in domestic retail oil prices from global oil price developments alongside aforementioned energy subsidy measures, **energy inflation** during the past 12 months averaged at -1.8 percent, which is substantially lower from the average of 24.4 percent over the previous 12 months (February 2022 – January 2023). Moreover, **average fresh food inflation** over the previous 12 months stood at a low of 1.6

percent, owing to the reduction in meat prices, especially pork, whose prices declined from a continuous increase in supply. **On the demand side, demand-pull inflation pressures increased slightly in line with the economic recovery**, leading to an **average core inflation rate** over the past 12 months of 1.1 percent.

<u>Potential time frame for headline inflation to revert to target</u>

The MPC assessed that the trajectory for headline inflation would gradually increase and should return and move within its target range during the second half of 2024. This outlook for inflation hinges upon the following supply-side developments: (1) the rise in energy prices from the possible unwinding of government energy subsidy measures, and (2) the surge in fresh food prices from seasonal summer effects, which will be compounded to some extent this year by El Niño. **Nevertheless, core inflation would likely remain stable** in line with the growth in domestic demand. Overall, the outlook for headline inflation which is expected to gradually increase is consistent with **measures of medium-term inflation expectations that have remained well-anchored within target range.** According to the survey of professional forecasters by Asia Pacific Consensus Economics in October 2023 and from financial market data in December 2023, five-year-ahead inflation expectations stood at 1.8 and 2.1 percent respectively. This reflects the confidence of market participants that monetary policy would be able to maintain price stability over the medium term.

The MPC would continue to closely monitor the evolution of key risk factors to inflation. These include (1) the increase in global energy prices and shipping freight rates, stemming from the uncertainty of Middle East geopolitical tensions, (2) lower fresh food prices from the impact of El Niño that may not materialize as expected due to volatile weather conditions, and (3) uncertainty regarding the continuity of government energy subsidy measures.

<u>Monetary policy actions taken to guide headline inflation back to the target within an appropriate time period</u>

Under the monetary policy mandate of price stability, sustainable economic growth, and financial stability, the Committee will continue to take into account all key factors while making monetary policy decisions, including developments in medium-term trends. Gradual and measured policy normalization over the past period have helped keep the economic recovery intact, and prevented broad-based and persistent inflation by limiting the occurrence of second-round effects from cost-push shocks. In addition, policy normalization helped safeguard financial stability by limiting the buildup of financial imbalances that otherwise could arise under a low-for-long interest rate environment, as well as helped preserve policy space to withstand uncertain shocks in the future.

The Committee recognized the impact of higher interest rates on vulnerable groups, particularly small businesses and highly indebted households. Sustainable debt solutions, particularly measures requiring financial institutions to provide targeted debt restructuring such as the "Responsible Lending" initiative, are therefore strongly encouraged. Employing such sustainable debt solutions would help reduce the debt burden of fragile borrowers, enhance financial stability, as well as prevent debt from hindering the economic recovery going forward. The MPC would closely assess cyclical and structural factors affecting economic growth and inflation outlooks and stands ready to deliberate appropriate monetary policy actions to ensure sustainable economic growth through maintaining price stability and safeguarding financial stability.

According to the latest Memorandum of Understanding between the MPC and the Minister of Finance, the MPC will write an open letter to the Minister of Finance again six months from now, should average headline inflation over the past 12 months or a forecast of average headline inflation in the next 12 months at that time breach the monetary policy target. In addition, to enhance the transparency and clarity of communication to the general public, the MPC wishes to publish this letter on the Bank of Thailand's website.

Yours sincerely,

(Mr. Sethaput Suthiwartnarueput)
Governor
Chairman of the Monetary Policy Committee

The Honorable Mr. Srettha Thavisin
Minister of Finance
Bangkok