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Monetary Policy Report, March 2019

The Bank of Thailand (BOT) released the March 2019 issue of the *Monetary Policy Report*. The *Report*, published quarterly, is aimed at enhancing public understanding of the Monetary Policy Committee (MPC)'s policy stance and its assessment of Thailand's economic outlook. Details are summarized as follows.

Monetary Policy Conduct in the First Quarter of 2019

In the Committee's view, the Thai economy was expected to expand around its potential, on the back of domestic demand, despite at a slower pace than previously assessed due to a slowdown in external demand. Headline inflation was projected to be in line with the previous forecast. Core inflation would be slightly lower than previously assessed while still gradually trending up. However, there were pockets of risks in the financial system that might pose vulnerabilities to financial stability in the future. **The Committee weighed various factors in determining the most appropriate course of monetary policy and voted 4 to 2 at the meeting on February 6, 2019 to maintain the policy rate at 1.75 percent with one committee member absent. At the meeting on March 20, 2019, the Committee unanimously voted to maintain the policy rate at 1.75 percent.** The Committee viewed that the current accommodative monetary policy stance contributed to the continuation of economic growth and was appropriate given the inflation target. In addition, given heightened global and domestic uncertainties in the current period, the Committee thus voted to keep the policy rate unchanged to assess the clarity of impacts from such uncertainties. Furthermore, there remained a need to address risks to financial stability through a combination of tools, including an appropriate policy rate as well as microprudential and macroprudential measures.

Looking ahead, the policy rate increase would be gradual and follow a data-dependent approach. The Committee would closely monitor developments of economic growth, inflation, and financial stability, together with associated risks, in deliberating appropriate monetary policy in the period ahead.

Assessment of the Economic and Financial Outlook as the Basis for Policy Formulation

1. Global Economy

The global economy was expected to expand at a slower rate, but still close to its potential. Private consumption of most trading partner economies continued to expand, consistent with strong labor market conditions and government support in some countries. Nonetheless, economic outturns in the fourth quarter of 2018 and developments in the first quarter of 2019 reflected that economic growth was below expectations in many economies. This was due to the impact from global trade slowdown as well as country-specific factors. Such factors included a temporary impact from the U.S. government shutdown, hampered confidence in Europe following prolonged political issues, and uncertainties surrounding trade protectionist measures between the U.S. and China. **The Committee thus revised down the growth**

projection of Thailand's trading partner economies to be 3.2 percent for both 2019 and 2020. However, there remained possibilities that growth in the trading partner economies would underperform the baseline projection due to uncertainties pertaining to trade negotiations between the U.S. and China as well as Brexit negotiations. Other risks that still warranted monitoring included uncertainties regarding the impact of trade protectionist measures on the global value chain, geopolitical risks, and China's financial stability concerns.

Most central banks maintained their monetary policy stance and followed a data-dependent approach, while some central banks started to signal a dovish stance toward policy normalization. The U.S. Federal Reserve (Fed) was expected to raise the policy rate once in 2019[1] from the previous anticipation of two rate hikes. The European Central Bank (ECB) ended new bond purchases at the end of 2018 according to its announced plan but continued rolling over matured bonds. The ECB was expected to keep the policy rate on hold throughout 2019 and implement a plan to increase liquidity in the financial system through targeted longer-term refinancing operations (TLTROs). Meanwhile, the Bank of Japan (BOJ) would maintain both short- and long-term interest rate targets for some period. Many central banks in the region, including the Bangko Sentral ng Pilipinas and Bank Indonesia, maintained their policy rates after having continuously raised the rate in 2018. Other central banks such as the Bank of Korea, Bank Negara Malaysia, and the Reserve Bank of Australia kept their policy rates on hold due to the outlook of economic slowdown, declining inflation, and uncertainties on trade protectionist measures.

Emerging markets (EMs) experienced capital inflows after risks in the global financial market declined. This was due to the Fed's dovish stance regarding the monetary policy communications, improvements in trade negotiations between the U.S. and China, as well as lower risks of the no-deal Brexit during the beginning of the year. However, geopolitical risks affected investor confidence in certain periods. Looking ahead, the global financial market would remain highly volatile. International capital flows both into and out of EMs could fluctuate depending on monetary policy directions of advanced economies, prolonged uncertainties pertaining to U.S.-China trade protectionist measures, uncertainties regarding Brexit negotiations, political developments in the euro area as well as geopolitical risks.

2. Financial Conditions and Financial Stability

Thailand's financial conditions remained accommodative. The new loan rate remained stable at a low level despite the gradual increase of short-term government bond yields in line with the policy rate. Meanwhile, medium- and long-term government bond yields fluctuated due to both domestic and external factors. Private credit expansion continued in both business and household sectors. Business sectors continued to raise fund through both bond and equity markets. The Thai baht appreciated against the U.S. dollar at the beginning of the quarter, consistent with other regional currencies, due to (1) a weaker U.S. dollar after the Fed's dovish stance regarding the monetary policy communications, (2) a lower possibility of the no-deal Brexit during the beginning of the year, and (3) improvements in U.S.-China trade negotiations. The baht appreciated to a larger extent as compared with other regional currencies given Thailand's large current account surplus and investors associating the baht with low risks. In late February 2019, the baht depreciated against the U.S. dollar due to better-than-expected outturns of some U.S.

[1] This was an assessment as of 19 March 2019 before the Federal Open Market Committee (FOMC) meeting at 20 March 2019, with the tone of the statement dovish than the market expected.

economic figures. Moreover, investors were concerned about geopolitical risks between the U.S. and North Korea as well as the general election in Thailand. Meanwhile, the real effective exchange rate (REER) appreciated.

There were some risks in the financial system that could pose vulnerabilities to financial stability in the future. These risks included (1) an accumulation of household debt especially for auto and mortgage loans, (2) the search-for-yield behavior which persisted in the low interest rate environment and could lead to underpricing of risks, particularly among saving cooperatives and large corporates, and (3) risks in the property sector including uncertainties regarding Chinese demand for Thai condominiums. There remained a need to monitor adjustments in the property market and mortgage loans after the revised macroprudential measure on mortgage loans were to be effective in April 2019.

3. Economic and Inflation Outlook

The Thai economy was projected to register slower growth at 3.8 and 3.9 percent in 2019 and 2020, respectively, down from the projection in the previous *Monetary Policy Report*. Growth drivers stemming from external demand were expected to moderate following the slowdown in trading partner economies and global trade volume. Merchandise and services export growth was thus expected to slow down. Meanwhile, domestic demand would remain a key growth driver.

Merchandise exports were expected to slow down in line with global demand. Export volume was projected to moderate in tandem with the outlook of trading partner economies and global trade volume. Looking ahead, Thailand's merchandise exports would be supported by the relocation of production base in some industries to Thailand, redirected orders from China to Thailand, and 5G technology-related infrastructure investment plans in many countries, which would benefit Thailand's exports of electronics parts in the period ahead.

Exports of services were projected to exhibit slower growth mainly due to lower spending per head, despite a higher-than-expected number of foreign tourists. The global economic slowdown could lead to lower spending per head, especially for Chinese tourists, and a shorter trip duration of European tourists. The projected number of foreign tourist arrivals was revised up to 40.4 and 42.0 million for 2019 and 2020, respectively. The upward revision was on the back of tourist confidence on improvements in Thailand's safety standards and the extended exemption of visa-on-arrival (VOA) fees until the end of April 2019.

Private consumption was expected to be well maintained despite some moderation in durable goods which had accelerated significantly in 2018. Supporting factors included a continued improvement in household income for both farm and non-farm households, improved consumer confidence, and support from government policies. However, elevated household debt would weigh on consumption. In addition, the adoption of automation in place of labor in the production process and inflation remaining at a low level would limit pressures on employers to increase wages, thus resulting in a gradual improvement in household purchasing power.

Private investment, particularly investment in machinery and equipment, would continue to expand. Supporting factors included expansion in production capacity and the relocation of production base to Thailand for hard-disk drives and other industries affected by the trade protectionist measures between the U.S. and China, which would lend support to Thai exports going forward. In addition, the private sector was expected to invest further in public-private partnership (PPP) investment projects.

Public spending would continue to drive the economy, especially investment on transportation infrastructure including the dual-track railway and mass rapid transit projects. Nevertheless, public investment was projected to grow at a slower pace than previously assessed due to delays in some state-owned enterprises' infrastructure investment projects and changes in the investment structure of some PPP projects to allow for greater investment by the private sector. Moreover, the budget allocation for replenishment of the treasury account balance for fiscal year 2020 was higher than expected, resulting in lower composition of capital and current expenditures.

Inflation was expected to trend up consistent with the previous assessment. Fresh food prices were expected to rise on account of an intensified drought and would offset some decline in core inflation following the softening in economic activity. However, demand-pull inflationary pressures would subsequently slowly rise reflecting a gradual closing of the output gap in the period ahead. **Thus, the Committee projected headline inflation to average 1.0 and 1.1 percent for 2019 and 2020, respectively, and core inflation to average 0.8 and 0.9 percent for 2019 and 2020, respectively.**

The growth projection was subject to downside risks due to (1) lower-than-expected trading partner economic growth following such as more intensified trade protectionist measures between the U.S. and China, uncertainties regarding Brexit negotiation, the U.S. import tariffs on automobiles and parts, and geopolitical risks; and (2) lower-than-expected private investment due to political uncertainties. However, **there was a possibility that the Thai economy would outperform the baseline projection** due to (1) less-than-expected slowdown of the Chinese economy due to government economic stimulus measures; (2) higher-than-expected domestic demand as a result of (2.1) sooner-than-expected implementation of government infrastructure investment projects, PPP projects, and private investment, (2.2) a quick dissolving of political uncertainty, and (3) additional government measures to support private spending. Meanwhile, **risks to the forecasts of headline and core inflation were expected to tilt downward** in line with increased downside risks to growth projections.

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