Edited Minutes of the Monetary Policy Committee Meeting (No. 1/2019)
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Members Present

Veerathai Santiprabhob (Chairman), Mathee Supapongse (Vice Chairman), Paiboon Kittisrikangwan, Sethaput Suthiwart-Narueput, Subhak Siwaraksa, and Somchai Jitsuchon

Member Absent

Kanit Sangsubhan

The Global Economy

Trading partner economies would expand at a slower pace, particularly **advanced economies**, as economic and political uncertainties affected private sector confidence and economic activities. The US economy was temporarily affected by the extended government shutdown. However, the US would continue to grow with support from a strong labor market in the period ahead. **Chinese and Asian economies** would expand at a slower pace after exports accelerated in the earlier period due to concerns over trade protectionism measures between the US and China. The Chinese economy showed some signs of weakening domestic demand. The overall **monetary policy of trading partners** would be less tightening. The Federal Reserve (Fed) was expected to delay its next policy rate hike to the third quarter of 2019. The European Central Bank (ECB) would raise its policy rate at the earliest possible period in the second half of 2019. Meanwhile, the Bank of Japan (BOJ) was expected to continue its accommodative monetary policy stance. Other regional central banks were also expected to keep their monetary policy stance unchanged. Nevertheless, Bank Indonesia (BI) would likely further hike the policy rate in 2019 to preserve external stability.

The Committee viewed that trading partner economies would probably grow slower than previously assessed due to the US government shutdown, uncertainties regarding Brexit negotiations, and possibly prolonged trade tensions between the US and China despite easing temporarily. There remained risks surrounding the Chinese economy and financial stability, notwithstanding government measures to support growth including tax reduction for businesses and households, a lower reserve requirement ratio, and some financial stability measures to curb debt in the economy recently. The Committee thus saw a need to closely monitor developments of these factors through qualitative data, such as business and consumer confidence surveys, in conjunction with quantitative data, such as labor market information, to assess the momentum of trading partner economies in the period ahead.

The Financial Markets

Concerns in the global financial markets temporarily abated after the Fed communicated a more gradual policy rate normalization. Meanwhile, investor concerns over trade protectionism measures between the US and China subsided. Risks of a no-deal Brexit also declined. Foreign investors consequently increased their portfolio investment in stock markets of emerging market economies. Nevertheless, Thailand registered net outflows of foreign portfolio investment since the beginning of this year as the Thai bond market experienced net sell-off by foreign investors. On exchange rates, the baht strengthened against the US dollar mainly due to the weakened US dollar. The movement of the Thai baht was in line with those of emerging markets and regional currencies. The nominal effective exchange rate (NEER) index appreciated due to Thailand's strong external stability, which was partly reflected by the sustained current account surplus. Despite a decline in global financial market volatility in the near term, uncertainties would remain going forward, especially those related to the global growth slowdown and the impact of trade protectionism measures between the US and China.

The Committee viewed that global financial markets would remain highly uncertain in the period ahead due primarily to (1) monetary policy direction of advanced economies, (2) trade protectionism measures between the US and China, and (3) Brexit and political situation in the euro zone that could intensify and affect the global economy and cross-border capital flows, in turn exerting pressures on asset prices and exchange rates. The Committee would thus continue to closely monitor developments in the global financial markets and exchange rates, as well as their impacts on the Thai economy.

Domestic Economic Conditions

The Thai economy was expected to continue gaining traction on the back of domestic demand despite a slowdown in external demand. The **value of merchandise exports** would expand at a slower pace due to the global trade slowdown, trade protectionism measures between the US and China that affected trading partner economies, and the down cycle of electronic products. Going forward, the value of merchandise exports was expected to grow at a slower pace but would later accelerate during the second half of 2019 partly owing to redirected orders of some industries from China to Thailand. Moreover, the European Union delisted Thailand from the illegal, unreported, and unregulated fishing (IUU) yellow-card status, which would support an increase in fishery exports. **Exports of services** were expected to improve particularly on the back of the recovery in Chinese tourist figures whose growth turned positive for the first time in December 2018 after the tour boat sinking incident in Phuket last year. The recovery in the number of Chinese tourists was faster than expected due partly to the extension of the visa on arrival fee waiver until the end of April 2019. However, tourism receipts would improve slightly as, after the Phuket incident, businesses offered discount packages to attract tourists. **Private consumption** was expected to continue expanding across all product categories due to various factors, including (1) improvement in incomes of both agricultural and non-agricultural households and (2) a more broad-based increase in household incomes across income groups and regions due in part to additional supports from government measures. Nevertheless, elevated household debt would still weigh on private consumption. **Private investment** was expected to expand thanks to public-private partnership (PPP) infrastructure investment projects and the relocation of production base in some industries to Thailand. **Public expenditure** was projected to expand at a lower rate than previously assessed due to (1) actual disbursement being temporarily affected by government agencies that needed to undertake project reviews to comply with the master plans under the National Strategy, (2) lower-than-expected government budget for current and capital expenditures, and (3) delayed progress on public infrastructure investment projects.

The Committee engaged in extensive discussion regarding the outlook for the Thai economy in the face of external and domestic uncertainties. Over the recent period, the Thai economy continued to expand on the back of domestic demand, especially private consumption that was continually driven by an improvement in the labor market across almost all sectors, together with a gradual, more broad-based increase in household income. However, elevated household debt would be a drag on private consumption going forward. Moreover, durable consumption was expected to grow at a slower pace—in particular, spending on automobiles that had earlier accelerated, as going forward financial institutions would likely tighten credit standards for auto-leasing loans due to deteriorating loan quality. The Committee would thus closely monitor the strength of private consumption. Private investment continued to expand. However, the Committee saw a need to closely monitor progress on major infrastructure investment projects that could affect the momentum of private investment, especially given uncertainties that might arise after the formation of the new government. Meanwhile, risks to the exports of goods tilted to the downside due to trade protectionism measures between the US and China that would be prolonged despite easing in the near term. In addition, although the situation of air pollution exceeding a safe level at present had yet to show a clear impact, this could affect tourism going forward if unresolved.

In the period ahead, risks to headline inflation tilted to the downside due to fluctuations in energy and fresh food prices. Meanwhile, core inflation was expected to rise slowly due to gradual improvement in demand-pull inflationary pressures. Nonetheless, structural changes partly contributed to a more persistent inflation than in the past. Such changes included the expansion of e-commerce, rising price competition, and technological development which reduced costs of production.

Some pockets of risks in the financial system might pose vulnerabilities to financial stability in the future. With regard to **leverage**, the seasonally-adjusted household debt to GDP ratio slightly increased in the third quarter of 2018. The seasonally-adjusted private nonfinancial corporate debt-to-GDP ratio edged up somewhat due to borrowing of property and hotel businesses. Regarding loan quality, the Committee would monitor the non-performing loan (NPL) ratio of mortgage loans that remained at a high level, while the NPL ratio of auto-leasing loans was expected to rise. With regard to **asset prices**, recent volatilities of the SET index decreased in tandem with global financial markets. The price-earnings ratio (P/E ratio) remained slightly lower than the historical average. Borrowing costs of corporates in the bond market for certain credit-rating groups continued to increase. The Committee hence would monitor debt rollovers, particularly in the case of companies issuing bonds with low credit rating or unrated bonds that were mostly in the real estate sector. With regard to the **property sector**, demand for real estate, particularly foreign demand, continued to expand. Meanwhile, developers continuously raised funds through commercial bank loans and corporate bonds. Regarding mortgage loans, the share of new mortgage loans with high loan-to-income (LTI) ratios was still rising. Moreover, the debt-to-service ratio (DSR) of low-income households was at a high level. The **search-for-yield behavior** remained present in the prolonged low interest rate environment, as reflected in the high growth in equity investment of saving cooperatives, together with certain large saving cooperatives increasingly mobilizing deposits and in turn lending to other cooperatives. This increased interdependence posed further build-up of risks within the cooperatives system. Meanwhile, investment in mutual funds grew at a slower pace, which was in part due to a decline in fixed income funds since the previous year. The Committee would pay close attention to the interconnectedness of individual risks, focusing on an integrated and forward-looking risk assessment in order to address and prevent financial imbalances, which included elevated household debts, property sector risks, the expansion of saving cooperatives' assets, and acceleration in borrowing by large corporates that might underprice risks.

Monetary Policy Decision

The Committee assessed that the Thai economy continued to gain traction on the back of domestic demand despite a slowdown in external demand. Headline inflation was restrained by lower energy prices, while downside risks increased from fluctuations in energy and fresh food prices. Core inflation edged up in line with the previous assessment. Overall financial conditions remained accommodative and conducive to economic growth. However, there were risks to financial stability in the future that warranted close monitoring. Most Committee members viewed that current accommodative monetary policy stance had contributed to the continuation of economic growth and was appropriate given the inflation target. Most Committee members also judged that pockets of financial stability risks had been addressed to a certain extent by the implemented macroprudential measures and the policy rate hike in the previous meeting. Thus, most members voted to keep the policy rate unchanged. Meanwhile, two Committee members assessed that the economy continued to expand at the level around its potential, and that the overall financial conditions would remain accommodative and conducive to economic growth despite an additional 0.25 percentage point increase in the policy rate. Moreover, increasing the policy rate would reduce financial stability risks and help to build up policy space.

In their policy deliberation, the Committee discussed key considerations underpinning the policy decision. Their conclusions were as follows.

1) The Thai economy continued to gain traction. Despite a moderating growth in merchandise exports attributable to global trade slowdown and the impact of trade protectionism measures between the US and China, service exports improved in line with the faster-than-expected recovery in the number of Chinese tourists. Domestic demand continued to increase, particularly on account of private consumption which was driven by increasingly broad-based improvement in farm and non-farm incomes as well as additional supports from government measures. Private investment was expected to expand due to the relocation of production base to Thailand, PPP infrastructure investment projects, and foreign direct investment in some industries. Nonetheless, public expenditure expanded at a lower rate than the previous assessment.

The Committee viewed that the economy would continue to expand at the level around its potential, but would experience increased uncertainties from external and domestic factors that could affect economic growth in the period ahead. These uncertainties included in particular (1) trade protectionism measures between the US and China that could be prolonged and affect trading partner economies and consequently Thailand's merchandise exports, (2) a worsening outlook for Chinese economic growth, and (3) the progress on infrastructure investment projects that could have important consequence for private investment.

2) Headline inflation was restrained by lower energy prices. Moreover, downside risks increased owing to fluctuations in energy and fresh food prices. The Committee would thus closely monitor factors that could affect crude oil prices, including those relating to the financial markets and oil supply, particularly from the Middle Eastern countries. The Committee would also closely monitor factors that could increase fresh food prices, such as increasing external demand due to livestock diseases abroad and the delisting of Thailand from the IUU list. Meanwhile, core inflation edged up due to a gradual increase in demand-pull inflationary pressure and improving economic conditions. **The Committee viewed that current accommodative monetary policy had allowed headline inflation trajectory to be consistent with the inflation target.** Nevertheless, structural changes such as the impacts from the expansion of e-commerce, rising price competition, and productivity upgrades which reduced production costs all could cause inflation to rise at a slower pace than in the past despite the continued expansion of the Thai economy.

3) There were pockets of risks in the financial system that might pose vulnerabilities to financial stability in the future. First, household leverage increased, particularly from auto-leasing and personal loans, while credit quality of mortgage loans and auto-leasing loans continued to decline due in part to more relaxed credit underwriting standards. Second, search-for-yield behavior in the prolonged low interest rate environment could lead to underpricing of risks. For example, the assets of saving cooperatives continued to grow. Large saving cooperatives also played a greater role in the cooperatives system by extending more loans to other saving cooperatives. Meanwhile, large corporates accelerated their fundraising in the prolonged low interest rate environment, representing a larger share of the bond market and commercial bank loans. Third, risks in the real estate sector remained, including significant foreign demand for Thai properties, competition in the mortgage loan market, and the oversupply of property in some areas. Moreover, real estate developers continued to increase their funding through commercial bank loans and bonds.

The Committee viewed that accumulation of vulnerabilities in the financial system had been addressed to some extent by the implementation of macroprudential measures as well as the policy rate hike in the previous meeting. Nevertheless, the Committee would closely monitor developments in the mortgage loan market, adjustments in the property sector, growth in assets of saving cooperatives, as well as leverage by households and large corporates that might be subject to underpricing of risks. The Committee viewed that there would be a need to study the appropriate macroprudential measures for Thailand to prevent the future risk build-ups. Most Committee members agreed that the impacts of the implemented macroprudential measures and the policy rate hike needed to be monitored for a certain period. However, two Committee members assessed that a rate hike in this meeting would complement the use of macroprudential measures in order to reduce financial stability risks.

The Committee discussed monetary policy transmission after the policy rate hike. The money market rates, short-term government bond yields, and deposit rates of some financial institutions began to rise in line with the policy rate. With liquidity in the banking system sufficient to support loan growth in the period ahead, most lending rates were largely unchanged. Real interest rates edged up but remained at low levels. The private sector continued to raise funds, while corporate and consumer loans expanded.

In addition, **the Committee discussed the monetary policy outlook** and judged that accommodative policy would remain appropriate in the period ahead. Policy rate increase would be gradual and follow a data-dependent approach, with a careful assessment of the outlook for growth, inflation, and financial stability, together with associated risks, in deliberating appropriate monetary policy in the period ahead.

Monetary Policy Group
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