Edited Minutes of the Monetary Policy Committee Meeting (No. 3/2019)
8 May 2019, Bank of Thailand
Publication Date: 22 May 2019

Members Present

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

The Global Economy

Trading partner economies would expand at a slower pace than the previous assessment despite signs of improvements, particularly in the US and China, in the short term. **Advanced economies** grew at a slower pace due to country-specific factors such as the gradually fading benefit of the US fiscal stimulus, the impact of Japan's consumption tax increase in October 2019, the effect of the new emission standards on automobile production, and political uncertainties in the euro area. Furthermore, a high level of business inventory following a weakening domestic demand and exports would restrain and cause production to recover slowly. In addition, the slow increase in global trade volume could affect employment in the manufacturing sector. However, overall employment remained sound, especially in the services sector. The **Chinese economy** would expand at a slower pace, but the growth rate would not decline considerably owing to government measures to support growth. Investment and retail sales showed signs of improvement in the first quarter of 2019. **Asian economies** (excluding Japan and China) would expand at a slower pace in line with global trade volume. The overall **monetary policy of trading partners** would be more accommodative both in advanced and regional economies. The Federal Reserve was expected to hold its policy rate through the end of 2019. The European Central Bank would likely pursue an accommodative monetary policy for an extended period. For regional central banks, the Reserve Bank of India and Bank Negara Malaysia lowered their policy rates. Bank Indonesia and the Bangko Sentral ng Pilipinas were expected to cut their policy rates this year. Accommodative monetary policy and supportive fiscal measures would foster trading partner economies going forward.

The Committee assessed that downside risks to trading partners' economic growth exhibited a positive development, particularly a higher-than-expected expansion of the Chinese economy, as well as a lower risk of the no-deal Brexit. However, other risks that still warranted monitoring included the outcome of trade negotiations between the US and China, together with the US import tariffs on automobiles and parts which would have implications on Thailand's production, employment and exports going forward. The Committee saw a need to closely monitor developments in trading partner economies together with the aforementioned risks and to assess their impacts on the Thai economy that could occur through various macroeconomic linkages.

The Financial Markets

Concerns in global financial markets temporarily abated, resulting in an increase in overall prices of risky assets. This was due to (1) recent higher-than-expected economic outturns in the US and China, (2) a more accommodative stance regarding monetary policy communications of central banks in major economies and Asia, and (3) easing concerns over trade negotiations between the US and China given positive developments since the beginning of this year. In addition, positive signs in global financial markets encouraged foreign investors to invest in assets of emerging market economies (EMs), particularly those with high yields. Nevertheless, **investors remained cautious to invest in Thai assets partly due to domestic political uncertainties.** Thus, Thailand registered net foreign portfolio outflows from both the government bond and equity markets since the beginning of this year. Moreover, concerns in global financial markets intensified once again after the US announced plans to raise additional tariffs on imported goods from China, resulting in heightened volatility in global financial markets. On exchange rates, the Thai baht depreciated slightly against the US dollar since the previous meeting. The movement of the Thai baht was in line with regional currencies, causing the nominal effective exchange rate (NEER) to be largely unchanged. Meanwhile, corporate bond yields in secondary markets slightly declined, partly due to an increase in bond holdings by domestic investors given expectations of a more dovish hike in the policy rate.

The Committee viewed that financial markets would remain highly uncertain going forward due primarily to (1) Thailand's political uncertainties, (2) an unsettled outcome of trade negotiations between the US and China, and (3) the global economic slowdown. These uncertainties could pressure asset prices and exchanges rates. The Committee would thus continue to closely monitor domestic uncertainties, developments in global financial markets and exchange rates, as well as their impacts on the Thai economy.

Domestic Economic Conditions

The Thai economy was expected to expand at a lower rate than the previous assessment mainly due to merchandise exports and investment. **Merchandise exports** would grow at a lower rate due to the slowdown of the global economy and global trade, as well as the impact of trade protectionist measures between the US and China. **Private investment** was projected to expand at a slower pace as some investors postponed their investment plans to assess clarity of government policy and the continuation of public investment projects. Nevertheless, investment in the manufacturing sector would likely expand, as reflected in growing imports of capital goods in the manufacturing machinery category. Meanwhile, **public expenditure** would likely grow at a slower rate than the previous assessment due to (1) government investment that could be affected by delayed enactment of the Annual Expenditure Budget Act for fiscal year 2020 and (2) delay in some state-owned enterprise investment projects. However, the Thai economy would continue to gain traction driven by **private consumption** which was expected to continue expanding, supported especially by non-farm income and government measures. Nonetheless, private consumption was restrained by elevated household debt and a leveling off in overall employment, with signs of moderation seen in the construction and export-related manufacturing sectors. **Exports of services** would continue to expand partly attributable to the benefit from the extended exemption of the visa on arrival fee until the end of October 2019, which would offset a decline in the number of foreign tourists in some areas due to the recent air pollution problem.

The Committee engaged in extensive discussions regarding global economic and domestic uncertainties, particularly trade protectionist measures between the US and China that could intensify in the period ahead. This would affect the Thai economy in three aspects. First, the weakening of the global economy and global trade would impinge upon merchandise exports, tourism, and investment in Thailand. Second, Thai exports that were part of the supply chain of Chinese exports to the US would experience a negative impact. On the other hand, some Thai exporters would benefit by substituting Chinese products exported to the US. Third, there could be a relocation of production base of foreign businesses to ASEAN countries including Thailand. In any case, the Committee assessed that trade protectionist measures between the US and China were a significant risk and remained highly uncertain, and deemed it necessary to closely monitor developments with a more comprehensive analysis of the impacts. Furthermore, the dumping of Chinese goods to the third countries including Thailand also warranted monitoring. Regarding domestic uncertainties, the Committee assessed that **the Thai economy was subject to heightened political uncertainties**, which could have implications for economic growth, including a direct effect on government spending in the period ahead and an indirect effect on private consumption and investor confidence. In addition, **risks from drought,** which could intensify and extend to wider areas, could weigh on purchasing power of farmers and sustainability of private consumption going forward.

Headline inflation was projected to remain close to the lower bound of the inflation target following a rise in energy prices in line with the outlook of global crude oil prices. This could offset a lower-than-expected increase in fresh food prices. Meanwhile, **core inflation** remained broadly unchanged from the previous estimate and was expected to increase slowly on account of a gradual improvement of demand-pull inflationary pressures. Furthermore, structural changes, such as impacts from the expansion of e-commerce, intensified price competition, and lower production costs from higher production efficiency, could cause inflation to rise at a slower pace than in the past. Moreover, **short-term inflation expectations** slightly increased, while **long-term inflation expectations** were largely unchanged.

Some pockets of risks in the financial system might pose vulnerabilities to financial stability in the future. Regarding **leverage**, the seasonally-adjusted household debt-to-GDP ratio slightly increased in the fourth quarter of 2018. This was mainly on account of an accelerated extension of auto-related loans, both auto loans and auto refinancing (“car for cash”), by commercial banks and auto-leasing companies. Looking ahead, sustained and elevated household debt as a share of GDP could pose more sensitivity of some household groups to negative income shocks, which could weigh on debt serviceability in the future. Meanwhile, the seasonally-adjusted private non-financial corporation debt-to-GDP ratio rose somewhat due to increased borrowings from financial institutions and bond issuances. Meanwhile, the quality of household loans must be monitored, particularly auto-related loans with the non-performing loan (NPL) ratio continuing to rise. In addition, deteriorating loan quality of small and medium enterprises (SMEs), especially in commercial, construction and services sectors, must also be monitored. Regarding the **property sector**, there were some adjustments prior to the implementation of the revised loan-to-value (LTV) ratio measure, resulting in a largely stable house price index. Regarding demand for real estate, a number of new mortgage loan approvals increased for both low-rise houses and condominium. This was reflected in the rising share of (1) new mortgage loans with the LTV ratio above 90 percent and (2) loans with value exceeding collateral value. Similarly, the rising share of new mortgage loans with high loan-to-income (LTI) ratios and long repayment periods reflected an acceleration of ownership transfers before the implementation of revised LTV measure. On the supply side, the revised LTV measure moderated overall property sales. Real estate developers thus launched sales promotion for completed condominium projects as well as delayed opening new projects. However, there was a need to monitor foreign property demand that might continue to decline following the global economic slowdown and domestic uncertainties. The **search-for-yield behavior** remained present in the prolonged low interest rate environment, as reflected in the continued expansion of investment in risky assets of households, both mutual funds and saving cooperatives. Despite a stabilizing growth of mutual funds overall, foreign investment funds (FIF) continued to grow and were concentrated in certain countries. Meanwhile, despite some slowdown in the investment of saving cooperatives, there was an increase in the interconnectedness within the system of saving cooperatives. This was particularly the case for large saving cooperatives that engaged in an intermediary role by taking deposits and lending to other cooperatives. Such behavior reflected that households might underprice risks. Looking ahead, if deficit saving cooperatives were to face credit risk given high NPLs, this could subsequently trigger capital losses to large and surplus saving cooperatives in the future.

The Committee engaged in extensive discussions regarding measures to address and prevent pockets of risks that could pose vulnerability to financial stability. These risks included, in particular, elevated household debt, growing assets and greater interconnectedness within the system of saving cooperatives, adjustments of risks in the property sector after the implementation of the revised LTV measure, as well as leverage by large corporates that might underprice risks. In the following period, **the Committee viewed that there remained a need to address financial stability risks through a combination of tools.** These included (1) the appropriate policy interest rate, (2) microprudential measures such as strengthening credit standards of financial institutions, and (3) macroprudential measures which should place greater emphasis on debt serviceability of borrowers. There were also additional measures including facilitating debt settlement of unsecured personal loans under specified conditions ("debt clinic"), enhancing financial literacy and discipline of the public, as well as supporting relevant supervisory authorities to push forward the implementation of an upgraded supervisory standard for saving cooperatives in accordance with the Cooperatives Act (No.3) B.E. 2562 in order to ensure stability of the cooperatives system.

Monetary Policy Decision

The Committee assessed that the Thai economy would expand at a slower pace than previously assessed owing to merchandise exports and investment, while domestic consumption was expected to continue expanding. Inflation was projected to be consistent with the lower bound of the inflation target. Overall financial conditions remained accommodative and conducive to economic growth. However, there were risks to financial stability that warranted close monitoring. In addition, global economic and domestic uncertainties would remain high in the period ahead. **The Committee therefore unanimously voted to keep the policy rate unchanged at this meeting in order to assess the clarity of impacts from such uncertainties. In their policy deliberation, the Committee discussed key considerations underpinning the policy decision. Their conclusions were as follows.**

1) The Thai economy was expected to expand at a lower rate than the previous assessment owing to merchandise exports and investment. Merchandise exports would grow at a slower pace than previously assessed due to the global economic slowdown, a down cycle of electronic products, as well as impacts from trade protectionist measures between the US and China. Private investment was expected to expand at a slower pace, as some investors delayed their investment in order to assess (1) clarity pertaining to policy prospects after the formation of the new government and (2) the continuation of public investment projects. Public expenditure would grow at a slower pace than previously assessed, partly due to delay in public investment projects. Meanwhile, private consumption was expected to continue expanding but was restrained by elevated household debt and employment in construction as well as manufacturing sectors that started to moderate.

The Committee viewed that the Thai economy would experience increased global economic and domestic uncertainties that could affect economic growth in the period ahead. These uncertainties included, in particular, (1) trade protectionist measures between the US and China that could intensify and subsequently affect trading partner economies and Thailand's merchandise exports, as well as the outlook of major advanced economies and China which could impinge on domestic demand, (2) political uncertainties that could affect investment in significant infrastructure projects and could have knock-on effects on private investment, (3) drought that might pose a larger impact than expected, and (4) employment in the export-related manufacturing sector which might slow down and weigh on overall income. This could lead to a larger-than-expected impact on private consumption.

2) There were pockets of risks in the financial system that could pose vulnerabilities to financial stability in the future. First, household leverages increased, driven particularly by auto-related loans, both auto loans and car for cash. Meanwhile, the NPLs of auto loans continued to rise, partly as a result of more lenient credit underwriting standards in the previous periods led by increased competition from non-bank financial institutions. Moreover, deteriorating debt serviceability of SMEs must be monitored. Second, search-for-yield behavior in the prolonged low interest rate environment could lead to underpricing of risks, particularly of which related to the cooperatives system and leverage by large corporates. Third, risks in the real estate sector remained, especially an oversupply of property in some areas.

The Committee viewed that the implemented macroprudential measures in the previous period helped curb accumulation of vulnerabilities in the financial system to some extent. However, an appropriate level of the policy interest rate would still be necessary to preserve financial stability in the period ahead. Implemented macroprudential and microprudential measures could only address risks associated with some categories of loans and financial institutions under the Bank of Thailand's supervision. These measures would also be effective only for new loans. Therefore, **the Committee deemed it necessary to continue monitoring the impacts of the implemented macroprudential measures and to examine further appropriate macroprudential measures to prevent systemic risks more effectively.**

3) Headline inflation was projected to be consistent with the lower bound of the inflation target. The increase in energy prices since the previous meeting could offset a lower-than-expected increase in fresh food prices. Nevertheless, there remained upside risks to fresh food prices in the period ahead due to drought. The Committee would thus monitor factors that could affect crude oil and fresh food prices, particularly a potentially intensified drought. Meanwhile, core inflation would remain broadly unchanged from the previous projection. **The Committee viewed that current accommodative monetary policy allowed headline inflation trajectory to be consistent with the inflation target.** Nevertheless, structural changes, such as impacts from the expansion of e-commerce, heightened price competition, and productivity upgrades which reduced production costs, could cause inflation to rise at a slower pace than in the past.

At this meeting, the Committee discussed a framework for incorporating financial stability consideration in monetary policy formulation. The Committee saw the need to develop comprehensive financial stability indicators, including a financial cycle indicator that was related to downside risks to medium-term economic growth. Moreover, the Committee viewed that it was necessary to analyze and assess risks to financial stability in various dimensions, including the interconnectedness in the financial system, forward-looking assessment and scenario planning, as well as analysis on buffer capacity in each sector. In this light, the Committee deemed it necessary for the staff to continue developing indicators and an analytical framework in order to support monetary policy formulation in a more systematic manner going forward.

In addition, **the Committee discussed monetary policy outlook** and judged that, for the current meeting, the Committee would need to wait and assess the clarity of various factors due to heightened global economic and domestic uncertainties. Therefore, current accommodative policy would remain appropriate. Going forward, further policy rate adjustment 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
22 May 2019