Edited Minutes of the Monetary Policy Committee Meeting (No. 3/2022)
2 and 8 June 2022, Bank of Thailand
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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

Thailand's trading partner economies were projected to slow down, with growth revised down from 3.6 percent to 3.4 percent for 2022, and from 3.2 percent to 3.1 percent for 2023. This moderation in growth was mainly due to tighter financial condition in the US and the EU as central banks accelerated the pace of policy normalization to tackle rising inflation. Meanwhile, Asian economies, particularly China, would continue to recover at the rate previously anticipated despite the zero-COVID measures imposed in major cities such as Shanghai and Beijing during the second quarter of 2022. The containment measures so far have been more relaxed in several areas, and the new COVID-19 cases have started to drop, which resulted in the gradual recovery of the manufacturing and transportation sectors. Furthermore, better-than-expected outturns in the first quarter of 2022 and the likelihood of additional stimulus measures by the Chinese authorities further suggested that the Chinese economy would expand in line with the previous projection. **Global inflation was expected to increase,** as energy and commodity prices would remain elevated for longer than expected. This was mainly due to the prolonged sanctions against Russia, which resulted in global supply shortage of raw materials.

Global financial markets were highly volatile due to concerns over rising inflation and monetary policy tightening in many countries, especially the aggressive rate hikes from the Federal Reserve in response to soaring inflation and tight labor market. Likewise, central banks in several other countries also signaled policy rate increases, particularly where economies have returned to pre-COVID levels and inflation has been above the central bank's target. As a result, government bond yields in many countries rose while risky assets prices fall. **For Thailand, short-term government bond yields increased in tandem with market expectations of policy rate hikes in Thailand,** while long-term government bond yields increased along with US Treasury bond yields. On the exchange rates, the Thai baht relative to the US dollar depreciated in line with regional currencies as the markets expected accelerating policy rate hikes in advanced economies. However, the relaxation of domestic containment measures and the better prospect of tourism with faster-than-expected border reopening since May helped to limit the depreciation of the baht. Key risk factors in the financial markets to be monitored included the pace of policy rate hikes by central banks in advanced economies and their impact on the global economy.

Domestic Economy

The Thai economy would continue to recover, expanding by 3.3 percent in 2022 and 4.2 percent in 2023. This would be driven by, first, the recovery in private consumption that would continue to gain strength, especially in the services sector, as reflected in the better-than-expected outturns in the first quarter of 2022. Going forward, pent-up demand from high-income households would help support consumption. Second, foreign tourist figures would increase due to the accelerated relaxation of border controls in Thailand and other countries, the removal of the Test & Go scheme since the beginning of May 2022, as well as further plans to discontinue Thailand Pass for foreign tourists in July 2022. Third, the labor market and household income showed signs of improvements as economic activities continued to recover in tandem with the easing of COVID-19 restrictions. The number of unemployment and underemployed workers has subsided and were close to pre-COVID levels; however, there remained a need to monitor whether labor who had left workforce during the COVID-19 would return to the labor market after the relaxation of containment measures.

The Thai economy in 2022 could expand faster than previously expected owing to stronger domestic demand and the recovery of tourism sector, while the impact of COVID-19 on economic recovery has been limited as expected. However, the Committee would monitor key risks that could affect the economic outlook. First, prices of energy and commodity, particularly chemical fertilizers, and animal feed, could remain elevated for longer than previously estimated due to prolonged sanctions against Russia. Therefore, cost pass-through to households and businesses must be monitored going forward. Second, the Chinese economy could slow down because of the implementation of zero-COVID measures, which could impact trading partner economies and Thailand's exports.

Headline inflation was expected to stay above the target range for the full year 2022. Inflation forecast for 2022 increased to 6.2 percent due to a prolonged surge in global oil prices and domestic oil prices, together with higher cost pass-through that have spread into broader ranges of products. The rises in inflation have been primarily caused by cost-push factors. However, prices in the core inflation basket such as condiments and cleaning products started to increase as well. As a result, several underlying inflation indicators have trended upward, including core inflation excluding rents and government measures, trimmed mean CPI[1], and sticky price CPI[2]. Inflation dynamics and cost pass-through thus warranted close monitoring in the period ahead. **However, headline inflation would gradually decrease and return to the target range in 2023** in the baseline scenario as energy prices were not expected to rise further and cost pass-through would gradually diminish. **Medium-term inflation expectations have not significantly increased and were anchored to the target range of 1-3 percent** despite a slight increase in short-term inflation expectations.

Upside risks to inflation increased stemming from, first, oil prices that could remain elevated for longer than expected as the surges in global crude oil prices could be prolonged, while domestic oil prices could increase in tandem with refined oil prices in Singapore and the gradual reduction in oil price subsidies by the government's Oil Fund. **Second, domestic cost pass-through could be broader and faster than expected** as businesses would be faced with simultaneous increases across various cost factors, including the impact of an increase in minimum wage that would gradually take off in 2023, and as businesses' ability to bear rising costs would diminish especially those with low profit margins. **Third, demand-pull inflation** could accelerate as economic recovery gained momentum.

[1] CPI after removing 10% of the CPI components with the highest and lowest price changes.

[2] CPI after removing CPI components with above average frequent price changes (4.8 times per month) and leave only with CPI components that change price relatively infrequently. Increase in sticky price CPI reflects that price adjustments have broadened into products that rarely see price changes, and the overall price tend to increase.

Discussions by the Committee

- **The Committee viewed that the Thai economy in 2022 could expand faster than the baseline projection** as a result of (1) domestic demand could be stronger than expected due to pent-up demand from high- and medium-income households, (2) foreign tourist arrivals that could improve more than expected following faster border reopening, and (3) the revival of income prospects for workers and businesses in the services sector following the recovery of tourism. **Nevertheless, the Thai economic outlook in 2023 remained uncertain.** Particularly, the risk of global growth slowdown led by advanced economies and China would impact Thailand's trading partner economies and exports going forward.

- **The Committee assessed that upside risks to inflation increased. First, uncertainty about oil prices remained high in the period ahead** as global crude oil prices could remain elevated for longer than expected as a consequence of prolonged sanctions against Russia, while oil-exporting countries might not significantly increase their production, and the demand for oil might pick up in tandem with global recovery. **Second, domestic cost pass-through could be higher and faster than expected** due to the simultaneous rises in costs for raw materials, energy, and labor costs. Increased price pressure has reflected in the increase in core inflation for broader ranges of products.

- **The Committee viewed that the balance of risks has shifted from the previous meeting, with risks to economic growth subsiding while risks to inflation increasing.** Thus, a very accommodative monetary policy will be less needed. Meanwhile, an emphasis should be placed on monetary policy being flexible and agile in order to move in a timely manner. The Committee also saw a need to build policy space to be able to address possible future risks.

- **The Committee viewed that monetary policy deliberation should strike an appropriate balance between supporting economic recovery, preserving price stability, and safeguarding the overall financial system stability**. The Committee came to an agreement on the following considerations.

  (1) High and elevated inflation would impede economic recovery. Rising inflation will lower the real incomes of businesses and households. Weakening purchasing power may undermine private consumption and economic recovery. Besides, persistently high inflation outturns could drive up inflation expectations, which may affect price- and wage-setting behavior of businesses and households. In the regime that inflation psychology has changed, it will become more challenging to bring inflation back to a low level.

  (2) With heightened inflationary risks, delaying the policy normalization could entail greater costs on the economy going forward. As the economy has started to recover and inflation is rising, maintaining the current accommodative monetary policy stance means greater loosening of monetary policy as the real policy rate declines. The additional monetary policy accommodation could exert upward pressure on demand-side inflation. Furthermore, in an adverse situation where inflation rises steadily to the point where inflation expectations of households and businesses become de-anchored, the policy rate will be forced to respond abruptly and aggressively to bring inflation down. Such a situation is undesirable because households and businesses would have to endure adverse impacts on their income, cost of living, and debt burden. Thus, policy normalization should be implemented at an appropriate timing and in a timely and gradual manner to avoid such tradeoff.

(3) A gradual normalization of the policy rate will allow the economy to adjust smoothly, limiting the negative side effects on the overall economy and financial system. The Thai economic recovery has been on track, and the continued expansion will lead to income recovery which will act as a buffer against rising debt services for households and businesses in the future. In fact, the increase in debt services from a gradual rise in interest rate will be significantly less than the increase in the costs of living and the costs of businesses stemmed from inflation. **Nevertheless, some vulnerable households and businesses—particularly the low-income group whose income have not fully recovered while debt burden remaining high—would be more sensitive to higher interest rates than the high-income group.** The Committee viewed that targeted measures, such as debt restructuring, should be implemented to assist the vulnerable groups. These measures should be adjusted appropriately to help ease the debt burden of the vulnerable groups through different channels including commercial banks or specialized financial institutions. This would prove to be more effective than using monetary policy which is considered a blunt tool.

Monetary policy decision

The Committee voted 4 to 3 to maintain the policy rate at 0.50 percent. Three members voted to raise the policy rate by 0.25 percentage points.

The Committee assessed that the Thai economy would continue to recover and tend to expand further than previously expected owing to strong domestic demand and the pickup in foreign tourists. Headline inflation would increase and remain elevated for longer than previously projected due to the increase in oil prices and higher cost pass-through. **The Committee deemed that a very accommodative monetary policy would be less needed going forward. Four members voted to maintain the policy rate in this meeting to ensure that the recovery would continue to gain traction as anticipated.** These four members would reassess the risks to growth and inflation going forward while emphasizing the need to communicate clearly to the public about the future course of monetary policy. **Three members viewed view that policy normalization is warranted in this meeting given the increased upside risks to both growth and inflation**. The balance of risks has shifted from the assessment in the last meeting. Economic recovery would be supported by stronger-than-expected pent-up demand and a pickup in foreign tourist arrivals. Meanwhile, the cost pass-through could be higher than initially anticipated, particularly pass-through of prices that affect core inflation. Since monetary policy would take time to have an impact on the overall economy and inflation, these three members deemed it appropriate to begin policy normalization in this meeting and to gradually increase in the policy rate going forward.

The Committee viewed that the baht has depreciated relative to the US dollar in line with regional currencies. 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 the exchange rate volatility.

The Committee emphasized the importance of targeted measures for vulnerable groups. The overall financial system remained resilient. Commercial banks had high levels of capital fund and loan loss provision. Liquidity in the financial system remained ample, although liquidity distribution still varied across economic sectors. Some groups of households and businesses remained vulnerable to rising living costs and production costs, as their incomes have not fully recovered while their debt burden remained high. The Committee deemed that debt restructuring in a sustainable manner to have broader impacts and be consistent with borrowers' long-term debt serviceability was still necessary, alongside a policy coordination with associated parties in preparing targeted measures for the vulnerable groups if needed.

Under the monetary policy framework with objectives of maintaining price stability, supporting sustainable and full-potential economic growth, and preserving financial stability, an appropriate monetary policy must aim at balancing the risks to each of these three objectives as they evolved, while considering the overall relationship and effectiveness of monetary policy together with other policy tools. **In this meeting, the Committee assessed that the economic recovery has continued to gain more traction, while the upside inflationary risks continued to increase. Thus, the Committee deemed that a very accommodative monetary policy would be less needed going forward. The Committee will assess the appropriate timing for a gradual policy normalization in accordance with the shift in the outlook and risks surrounding growth and inflation, taking into consideration the effectiveness of monetary policy over the medium term.**

Monetary Policy Group
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