Edited Minutes of the Monetary Policy Committee Meeting (No. 4/2019)
26 June 2019, Bank of Thailand
Publication Date: 10 July 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. Advanced economies grew at a slower pace than expected due to (1) a decline in manufacturing sector and investor confidence as a result of intensified trade tensions and (2) a moderating sign of private consumption owing partly to diminished employment in both manufacturing and service sectors in some advanced economies, as well as a decrease in wages in some European countries. The **Chinese economy** would grow moderately attributable to the manufacturing sector, exports, and investment that were affected by the US trade protectionist measures. However, the economy would not slow down considerably owing to government stimulus measures to stimulate growth. **Asian economies** (excluding Japan and China) would also moderate due mainly to export contraction in tandem with global trade volume. Private consumption would continue to expand on the back of strong labor markets and economic stimulus measures, even though high household debt as a share of GDP in various countries would put a pressure on consumption going forward. Overall **monetary policy of trading partners** was expected to be more accommodative in both advanced and regional economies. The Federal Reserve (Fed) would likely cut its policy rate once in 2019 with an additional cut in 2020. The European Central Bank (ECB) would likely keep its policy rate unchanged until the first half of 2020 and would probably cut the policy rate in the case of deteriorating growth prospects. In addition, the ECB launched the new series of liquidity injection into the financial system through the third Targeted Longer-Term Refinancing Operations (TLTROs III). Some regional central banks, such as the Bangko Sentral ng Pilipinas and Bank Negara Malaysia, as well as the Reserve Bank of Australia cut their policy rates. Meanwhile, other central banks, such as the Bank of Korea and Bank Indonesia, kept their policy rates unchanged.

The Committee assessed that there was a higher probability of trading partners' economic growth being lower than the baseline due mainly to (1) trade protectionist measures that could be prolonged and expanded to other countries such as Mexico, India, and Europe, (2) risks of a no-deal Brexit, and (3) rising geopolitical risks, especially in the Middle East. The Committee viewed that there would be a high probability of prolonged and hard-to-predict trade conflicts between the US and China due partly to upcoming US presidential election next year. Thus, the Committee saw a need to closely monitor (1) developments in trading partner economies together with the aforementioned risks in order to evaluate their impacts on the Thai economy that could occur through various macroeconomic linkages, and (2) other countries' monetary policy stances that could have implications on capital flows and the Thai baht.

The Financial Markets

Concerns in the global financial markets grew in response to intensified trade tensions, especially between the US and China. However, the concerns abated after some central banks signaled more dovish monetary policy stance. Consequently, investors shifted to invest more in risky assets. Trade protectionist measures between the US and China, which would be prolonged and could expand to other countries such as Mexico, India, and Europe, caused overall prices of risky assets to drop temporarily. Moreover, market expectations on various central banks' monetary policy would be more dovish. The latest Federal Open Market Committee (FOMC) statement and interviews of some members signaled a higher probability of a policy rate cut this year. As a result, foreign investors' concerns eased and reallocated their investment to emerging market assets. Overall prices of risky assets continued to increase. Long-term Thai government bond yields declined in line with those of advanced economies, while foreign and domestic investors continued to invest more in Thai long-term bonds.

On exchange rates, the Thai baht appreciated against the US dollar at a somewhat fast pace due to several factors. On the external front, factors included (1) Fed's accommodative monetary policy stance, resulting in US dollar depreciation, and (2) trade protectionism that caused investors to invest more in safe haven assets including those in Thailand. On the domestic front, factors included (1) a greater clarity pertaining to political developments and (2) an increase in the weights of Thailand's assets in the MSCI and JP Morgan indices. These factors attracted more equity as well as both short- and long-term bond inflows to Thailand. Another factor contributing to pressures on the baht was gold trading by Thai investors to earn profits when gold prices rose. Meanwhile, the baht appreciated faster than regional currencies. The nominal effective exchange rate (NEER) continued to appreciate.

The Committee viewed that financial markets would remain highly uncertain going forward due to various factors, which included (1) the global economic slowdown, (2) trade protectionism, and (3) prolonged and uncertain developments of the Brexit. These could cause asset prices and exchange rates to fluctuate. The Committee viewed that the somewhat rapid appreciation of the baht might not be consistent with economic fundamentals and could negatively affect economic growth going forward. Given moderating economic prospects, current economic data from various sectors reflected that the Thai economy would be more sensitive to currency appreciation. The labor market showed some signs of vulnerabilities, especially in the export-related manufacturing sector and the tourism sector. The Committee, therefore, saw a need to closely monitor developments of exchange rates, capital flows, as well as impacts on the economy through various channels, especially employment. The Committee deemed it necessary to prepare short-term capital inflow management measures ready to be implemented at an appropriate time, as well as to continue relaxing more capital outflow regulations to encourage a greater flow of outward portfolio investment by residents.

Domestic Economic Conditions

The Thai economy was expected to expand at a slower pace than previously assessed due mainly to exports of goods and services. **Merchandise exports** would expand at a significantly slower pace than the previous assessment due to the slowdown of trading partner economies and global trade volume after trade tensions, particularly between the US and China, intensified as well as a down cycle of electronic products. However, merchandise exports were expected to improve later in the second half of this year due partly to redirected orders and the relocation of production base to Thailand. Nonetheless, the recovery during the second half of this year coudld not turn export growth positive this year. **Exports of services** would likely grow at a slower pace due mainly to a decrease in Chinese tourist figures as a result of China's economic slowdown, the Chinese government policies to promote domestic tourism, and changing destinations of Chinese tourists to other regional countries following increased tourism competition. **Private consumption**, especially durable goods consumption, would continue expanding on the back of government stimulus measures through tax deduction and an increase in government transfers to support low-income earners through the social welfare card. Nevertheless, private consumption would be restrained by elevated household debt, particularly among low-income households, and some signs of moderation in non-farm earnings and employment in the export-related manufacturing sector. In any case, the labor market had been adjusted over the previous year. Some low-income workers increasingly shifted from the manufacturing sector, which affected by a decline in exports, toward the service and trade sectors. **Private investment** was also projected to expand at a slower pace in line with the export outlook and softening investment confidence. Nevertheless, investment in the manufacturing sector would likely expand going forward, reflected by growing imports of capital goods in the machinery category. The relocation of production base to Thailand and public-private partnership infrastructure investment projects (PPP) would support private investment going forward. **Public expenditure** would likely grow at a slower pace than previously assessed due to (1) the expected delay in the enactment of the Annual Expenditure Budget Act, B.E. 2563 (A.D. 2020), which would affect capital disbursement for new projects, and (2) delays in some state-owned enterprise investment projects.

The Committee expected that the Thai economy would expand at a lower rate in 2019 and 2020 than the previous assessment due mainly to exports of goods and services. Growth was projected to be 3.3 percent in 2019 and 3.7 percent in 2020, which were lower than the previous assessment of 3.8 percent and 3.9 percent, respectively. **There were possibilities that growth could be lower than the baseline projection** include (1) trade protectionism that could be intensified and would affect global trade volume and subsequently Thailand's merchandise exports more than expected, (2) lower-than-expected trading partners' economic growth due to several uncertainties such as trade protectionist measures that could be intensified, consequences of a no-deal Brexit, Chinese economic and financial stability problems, and geopolitical risks, (3) a delay in forming the new government, which would affect budget disbursement and government policy implementation, and (4) lower-than-expected growth of Chinese tourist figures. Nevertheless, **there were possibilities that the Thai economy would expand at a higher rate than the baseline projection** owing to (1) higher-than-expected trading partners' economic growth in case of additional support from government stimulus measures or in case of alleviated uncertainties and (2) higher-than-expected domestic demand arising from public investment in infrastructure, PPP projects, quick acceleration of private investment following greater political clarity, as well as additional government measures to support private spending.

The Committee engaged in an extensive discussion regarding global economic and domestic uncertainties, particularly **trade protectionist measures between the US and China** that could be prolonged and intensified in the period ahead. This would affect the Thai economy in three aspects. First, the weakening of **the global economy and global trade** would result in growing concerns of businesses and impinge upon merchandise exports, tourism, and investment in Thailand. Second, on **trade diversion**, Thai exports that were part of the supply chain of Chinese exports to the US would be adversely affected. On the other hand, some Thai exporters would benefit by substituting Chinese products exported to the US. However, some Chinese products previously exported to the US market could be dumped into Thailand, which in any case accounted for a small proportion of Thailand's total imports of goods. Third, on **investment diversion**, there could be a relocation of production base of foreign businesses to ASEAN countries including Thailand in order to substitute the production in China. **The Committee saw a need to monitor the outcome of trade negotiation between the US and China, the Chinese economic outlook, Brexit developments, and direction of new government policies**, which could affect the continuation of public and private investment projects as well as risks to financial stability and medium-term fiscal position.

The annual headline inflation was projected to remain close to the lower bound of the inflation target, with fresh food prices expected to increase relative to the previous meeting. Meanwhile, **core inflation would be mostly in line with the previous projection.** The Committee assessed that pressures from energy prices remained broadly unchanged from the previous assessment. The oil production cut by the Organization of the Petroleum Exporting Countries (OPEC) and an increase in geopolitical risks in Middle East would compensate for the decrease in demand in tandem with the global economic slowdown. Fresh food prices were projected to rise due especially to a less severe pork oversupply and an increase in external demand from China and regional countries affected by the swine disease outbreaks. The Committee thus projected **headline inflation** at 1.0 percent in 2019 and 2020. Meanwhile, **core inflation** was projected to gradually increase in line with domestic demand at 0.7 and 0.9 percent in 2019 and 2020, respectively. Core inflation projection was revised down somewhat as a result of softer domestic demand. **There would remain a probability of headline and core inflation being lower than the baseline** in line with risks to the economic projection.

Monetary Policy Decision

The Committee assessed that the Thai economy would expand at a lower rate than previously assessed due mainly to exports of goods and services, while private consumption was expected to continue expanding. Headline inflation was projected to be close to 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, particularly a rise in household debt and the nonperforming loan (NPL) ratio. In addition, external and domestic uncertainties would remain high in the period ahead. **The Committee therefore unanimously voted to keep the policy rate unchanged at this meeting and discussed key considerations underpinning the policy decision. Their conclusions were as follows.**

1) The Thai economy was expected to expand at a slower pace than previously assessed due mainly to exports of goods and services. Merchandise exports would grow at a significantly slower pace than previous assessment due to the slowdown of trading partner economies and global trade volume. The slowdown was affected by intensifying trade protectionist measures, particularly between the US and China. However, Thai exports were affected to a lesser extent compared with those of other regional countries due to a smaller portion of Thai exports integrated into the Chinese supply chain and more diversified exports products. Tourism would grow moderately due mainly to the number of Chinese tourists. Regarding domestic demand, private consumption was expected to continue expanding but would be restrained by elevated household debt as well as signs of moderation in earnings and employment in the export-related manufacturing sector. Private investment was projected to slowdown. However, the relocation of production base to Thailand and the PPP infrastructure projects would support investment going forward. Meanwhile, public expenditure would decelerate more than previously estimated due mainly to the expected delay in the enactment of the Annual Budget Expenditure Act, B.E. 2563 (A.D. 2020).

The Committee viewed that the Thai economic growth would encounter uncertainties mainly from the external front that could affect the growth prospect going forward**.** These uncertainties included, in particular, (1) trade protectionism that could be intensified and prolonged which would subsequently cause global trade volume to expand at a slower pace than expected and affect Thailand's merchandise exports and (2) a worse-than-expected growth outlook for advanced economies and China that could affect domestic demand, especially in case of economic and financial stability concerns, no-deal Brexit, and geopolitical risks. Key domestic uncertainties included (1) a delayed formation of the new government which could affect the continuity of budget disbursements and (2) new government policies such as minimum wage and welfare policies. The Committee thus saw the need to closely monitor developments in the labor market as well as the quality of credits extended to economic sectors that would be affected by trade protectionism and the economic slowdown.

2) Some pockets of risks in the financial system might pose vulnerabilities to financial stability in the future. First, high and rising household leverage, as especially reflected in auto leasing and mortgage loans, would elevate the household debt-to-GDP ratio. Meanwhile, the NPL ratio of auto loans, driven especially by new-entry NPLs, was poised to increase continuously. This was due partly to (1) more lenient credit underwriting standards over the recent periods as a result of heightened competition from increasing participation of non-bank financial institutions and (2) a decrease in farm income and household income in the provinces. Moreover, there would be a need to monitor deteriorating debt serviceability of SMEs, especially in the trading sector where the new-entry NPL rate remained high. This reflected structural problems of some groups of small enterprises that could not adapt to changes. Second, search-for-yield behavior in the prolonged low interest rate environment could lead to underpricing of risks that were related to the cooperatives system and leverage by large corporates. Third, risks in the real estate sector remained, especially the oversupply of property in some areas as well as the decline in foreign demand in response to the global economic slowdown that could affect property destocking.

The Committee viewed that macroprudential measures already implemented helped curb accumulation of vulnerabilities in the financial system to some extent. However,

safeguarding financial stability in the period ahead would remain necessary and could be done through a combination of tools, including the appropriate policy interest rate, macroprudential measures, and microprudential measures. Regarding the current context, more emphasis should be placed on debt serviceability of borrowers since credit supervision by categories could not resolve the household debt problem. Therefore, **the Committee deemed it necessary to monitor the impacts of the implemented macroprudential measures and to examine further appropriate macroprudential measures to prevent systemic risks more effectively.**

3) The annual headline inflation would be largely unchanged compared with the previous assessment and would remain close to the lower bound of the inflation target. Core inflation was projected to be in line with the previous assessment. The Committee viewed that there remained risks to inflation in the period ahead due to fluctuations in oil prices, weather and drought conditions, as well as uncertainty in the minimum wage policy that could be raised this year. **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. This posed implications for the future appropriate inflation target. The Committee viewed that the inflation target could be reviewed in accordance with inflation dynamic and the changing context. Thus, the inflation target could become more flexible and be in a more forward-looking manner, together with maintaining stability of medium-term inflation expectations.

In addition, the Committee discussed monetary policy outlook and viewed that the economy would expand at a slower pace due mainly to momentum of external demand. However, the Thai economy would grow around its potential going forward. Meanwhile, there remained risks to financial stability that must be continually monitored, as well as high uncertainties arising from both external and domestic factors in the future. The current accommodative monetary policy would, therefore, remain appropriate. However, the Committee would monitor the developments of the outlook for growth, inflation, financial stability, and exchange rate, together with associated risks, especially the impacts of international trade protectionism, in deliberating appropriate monetary policy in the period ahead.

Monetary Policy Group
10 July 2019