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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. Advanced economies and China were expected to grow at a slower pace in line with manufacturing production and exports owing to intensifying and expanding international trade tensions. The prolonged trade tensions began to affect consumption and investment confidence. **Asian economies** (excluding Japan and China) would grow moderately due to a fall in merchandise exports. Merchandise exports would contract in line with the global economy and trade volume that were affected by trade protectionism, the Japan–Korea dispute and a longer-than-expected down cycle of electronic products. Overall **monetary policy of trading partners** in both advanced and regional economies would be more accommodative to shore up the weakening economic outlook. The Federal Reserve (Fed) cut its policy rate in July 2019, and one additional rate cut was expected within this year. The European Central Bank (ECB), despite having kept its policy rate unchanged so far, began signaling more accommodative monetary policy stance. The ECB could cut its policy rate if economic growth weakened significantly and could also inject additional liquidity into the financial system through the third Targeted Longer-Term Refinancing Operations (TLTRO III). Monetary policy stance of regional central banks such as the Bank of Korea, Bank Indonesia, and the Reserve Bank of India became more accommodative. Moreover, the Reserve Bank of Australia and the Reserve Bank of New Zealand cut their policy rates as well.

The Committee assessed that trading partner economies and global trade volume would expand at a slower pace due to (1) trade protectionism that could be prolonged and intensified, after the US announced a prospective 10% tariff on 300 billion US dollars' worth of Chinese imports and designated China as a currency manipulator, and (2) increased risks of a no-deal Brexit. The Committee would thus closely monitor developments in advanced economies and China that could affect domestic demand, together with geopolitical risks that could become widespread. The Committee would consider potential impacts on the Thai economy through various linkages, as well as consider monetary policy stance of various countries that could affect capital flows and the Thai baht.

The Financial Markets

More accommodative monetary policy stance of advanced economy and regional central banks partially shored up sentiments in financial markets. In particular, the likelihood of the Fed and ECB policy rate cuts during the rest of this year increased. Nevertheless, concerns in global financial markets grew due to intensifying and expanding trade tensions, especially after the US announced additional tariffs on Chinese imports and designated China as a currency manipulator. Together with the weakening global economic outlook, these factors increased volatility in most asset prices and lowered risky asset prices. Regarding domestic financial markets, there were capital outflows from the short-term Thai government bond market following the Bank of Thailand's announcement of measures to enhance surveillance of short-term capital flows in July. Meanwhile, there were persistent capital inflows into long-term Thai government bond and equity markets due to (1) an increase in the weights of Thai assets in the MSCI indices and (2) an upgrade in Thailand's sovereign credit rating outlook by some credit rating agencies. Long-term Thai government bond yields declined in line with long-term US government bond yields as a result of more accommodative monetary policy stance.

On **exchange rates**, the measures to enhance surveillance of short-term capital flows limited in part the channels through which speculation on baht appreciation could occur. The volatility of the baht against the US dollar gradually subsided. The nominal effective exchange rate (NEER) depreciated slightly. Nonetheless, after the US announced tariffs on Chinese imports and designated China as a currency manipulator, investors sold off assets in Asia due to the region's high interconnectedness with China. Safe-haven asset prices rose, including the yen, gold, and the baht. In addition, Thailand faced a significant current account surplus. At the same time, gold trading activities by domestic investors put selling pressures on the US dollar. These factors caused the baht to strengthen against the US dollar and the NEER to appreciate since the previous meeting.

The Committee viewed that financial markets would remain highly uncertain going forward due to various factors, including (1) prolonged trade tensions which could intensify and broaden to other countries, (2) increased likelihood of a no-deal Brexit, and (3) monetary policy stance of advanced economy central banks, especially the Fed and the ECB, which could lead to more volatile asset prices and exchange rates. Furthermore, the Committee remained concerned about baht appreciation against trading partner currencies, which could affect the economy to a larger degree amid intensifying trade tensions. The Committee also noted that Thai assets remained supported by sound external fundamentals and that Thailand had low exposure to adverse impacts of trade protectionism compared with other countries. These factors could continue to pressure the baht in the period ahead. The Committee would therefore closely monitor developments of exchange rates and capital flows as well as assess the need of additional appropriate measures.

<u>Domestic Economic Conditions and Financial Stability</u>

The Thai economy would expand at a slower pace than previously estimated and below its potential. The slowdown was due to merchandise exports contraction that started to affect domestic demand. **Merchandise exports** were expected to contract more than the previous assessment due to the slowdown of trading partner economies and global trade volume owing to intensifying and expanding trade tensions as well as a longer-than-expected down cycle of electronic products. In addition, there was a sign that exports in the third quarter of this year would contract more than previously assessed. **Exports of services** would grow at a lower rate due to the global economic slowdown and the impact of baht appreciation on some tourist nationalities. **Private consumption** was expected to decelerate more than previously assessed on account of (1) declining non-farm income and employment, particularly overtime employment in the export-related manufacturing sectors, and (2) declining farm income caused by drought. Moreover, consumption would be restrained by elevated debt, while consumer confidence weakened. Nevertheless, government stimulus measures would support consumption in the period ahead to some extent. **Private investment** would expand at a slower pace, partly as a result of the continuing export contraction and moderating domestic demand while investment confidence softened. However, the relocation of production base to Thailand and public-private partnership projects for infrastructure investment would support investment going forward. **Public expenditure** would grow at a slower pace than previously assessed partly because of budget disbursement constraints as well as the expected delay in the enactment of the Annual Budget Expenditure Act, B.E. 2563 (A.D. 2020).

The Committee engaged in extensive discussion about the Thai economic outlook, particularly domestic demand which was showing signs of a slowdown. Moderating private investment and employment in export-related manufacturing sectors would weigh on consumption in the period ahead. The Committee thus saw the need to closely monitor (1) developments in the labor market especially temporary contract employees, non-farm and farm income, and household debt serviceability that could have implications for future consumption, and (2) the relocation of production base to Thailand, together with policy implementation by the new government, public expenditure, and the progress of major infrastructure investment that would have knock-on effects on future private investment. The Committee also noted that new government policies should be careful not to encourage additional household leverage that could aggravate household debt, which constituted a structural problem that had weighed on private consumption for some period.

The annual average of **headline inflation** was projected to be below the lower bound of the inflation target. Although fresh food inflation would be slightly higher than the previous projection in tandem with higher-than-expected fruit prices, the increase could not offset the decline in energy and core inflation. Energy inflation would weaken in line with lower-than-expected Dubai crude oil prices resulting from slower global economic growth. **Core inflation** would decrease on the back of subdued demand-pull inflationary pressures. Short-term and long-term **inflation expectations** remained close to the previous assessment. The Committee viewed that structural changes 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.

Financial system risks still posed vulnerabilities to financial stability. On **leverage**, household debt in the second quarter of this year continuously increased in line with credit expansion of commercial banks and non-bank financial institutions. Expansion in consumer loans, especially personal loans, for which lending standards became more lenient, warranted monitoring. The Bank of Thailand had worked with commercial banks to standardize debt service ratio (DSR) calculation in order to collate DSR data should additional measures intended to curb household debt become necessary in the future. Moreover, the share of households sensitive to negative income shocks had increased, which could weigh on household debt serviceability. Therefore, the channels through which negative income shocks could affect such households during an economic slowdown and drought conditions should be closely monitored. Meanwhile, corporate debt grew at a slower pace, especially small and medium enterprises (SMEs) in manufacturing and trade sectors. The non-performing loan (NPL) ratio of corporate debt was largely stable due to credit portfolio quality management. Regarding the **property sector**, after the implementation of the revised loan-to-value (LTV) measure, adjustments of households and commercial banks were in line with target. Speculation abated as reflected in (1) the slower growth of new mortgage loans, especially for high-rise units in the second quarter of this year, and (2) the decline in house prices consistent with real estate demand. Moreover, commercial banks' credit underwriting standards were tighter. The average LTV and repayment tenor declined while the loan-to-income (LTI) ratio was stable. Nevertheless, **search-for-yield behavior that led to underpricing of risks** still persisted in the prolonged low interest rate environment. This was reflected in expanding investments in high-yield mutual funds such as foreign investment funds (FIF), which posed concentration risks in some countries. The asset size of saving cooperatives subsided in line with moderating deposits and equities of members. Nevertheless, large corporates increased their fundraising in the prolonged low interest rate environment through the bond and loan markets.

The Committee viewed that the macroprudential measures previously implemented helped curb vulnerabilities in the financial system to some extent. The Committee would continuously monitor (1) the impacts of the revised LTV measure and the ensuing property sector developments, (2) adjustments of property developers and the oversupply situation, (3) the asset size of and the interconnectedness among saving cooperatives, and (4) fundraising by large corporates that might underprice risks. Moreover, the Committee viewed that household debt was a critical and urgent structural risk that would require a multi-dimensional resolution. Cooperation between various parties was needed to reduce leverage and to restructure existing debt. In this light, greater emphasis should be placed on borrowers' debt serviceability. The Committee thus directed a study of additional appropriate measures to curb potentially increased risks in the future.

<u>Monetary Policy Decision</u>

The Committee assessed that the Thai economy would expand at a lower rate than previously assessed due to contraction in merchandise exports that started to affect domestic demand. Headline inflation was projected to be below the lower bound of the inflation target. Overall financial conditions remained accommodative. Financial stability had already been taken care of to some extent, although there remained pockets of risks that warranted monitoring. Most Committee members judged that a more accommodative monetary policy stance would contribute to the continuation of economic growth and should support the rise of headline inflation toward target. **The Committee therefore voted 5 to 2 to cut the policy rate by 0.25 percentage point from 1.75 to 1.50 percent. Two members voted to maintain the policy rate at 1.75 percent.**

The Committee 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 and below potential. This would be mainly due to merchandise exports that contracted more than previously expected in tandem with the slowdown of trading partner economies and global trade volume as a result of intensifying and expanding trade tensions. Going forward, the situation could be aggravated and become prolonged. This would affect global trade volume and trading partners' demand more than previously assessed. Moreover, the tourism sector would grow at a slower pace in line with the global economic outlook, with some tourist nationalities affected by the baht appreciation. Furthermore, the impacts of merchandise export slowdown on domestic demand started to be seen. Private consumption and investment would decelerate due to (1) weakening household and business confidence, (2) contracting non-farm income and employment in export-oriented manufacturing sectors, (3) declining farm income which was partly affected by drought, and (4) restrained household purchasing power due to elevated household debt. Meanwhile, public expenditure would decelerate more than previously assessed as a result of budget disbursement constraints and the expected delay in the enactment of the Annual Budget Expenditure Act, B.E. 2563 (A.D. 2020).

The Committee viewed that the Thai economy would encounter heightened 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 prolonged and expanded, (2) a worse-than-expected growth outlook for advanced economies and China that could affect domestic demand, as well as the increased likelihood of no-deal Brexit and heightened geopolitical risks, and (3) more accommodative monetary policy stance of advanced economy and regional central banks. In addition, the Committee would continue to monitor policy implementation by the new government as well as public expenditure, together with the progress of major infrastructure investment and its knock-on effects on private investment, which could affect growth in the period ahead.

The Committee assessed that sustained exchange rate appreciation might result in greater effects on exports amid the slowdown in trading partner economies and heightened international competition. Signs of impacts on profits, debt serviceability, and overtime employment cuts began to be seen in some export-related sectors. If these impacts were broadened to other sectors, the purchasing power of households related to export firms and overall economic growth could be affected.

2) The annual average of headline inflation was projected to be below the lower bound of the inflation target due to (1) energy prices declining at a fast pace and (2) core inflation being lowest in nine years and projected to slow down in line with subdued demand-pull inflationary pressures. The slower core inflation outlook was partly reflected in weaker earnings and employment of low-income households. On the other hand, fresh food prices were expected to rise. The Committee viewed that inflation projection would face uncertainties from oil price fluctuations, weather and drought conditions, as well as policy uncertainty regarding the minimum wage increase this year. 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.

3) Some financial system risks which might pose vulnerabilities to future financial stability had been partly addressed by the implemented macroprudential measures. For instance, property sector risks abated after the implementation of the revised LTV measure. This was reflected by reduced real estate speculation and tightened commercial banks’ underwriting standards for mortgage loans. Moreover, banks would increase caution in extending loans during the economic downturn. **However, other financial stability risks had not improved and warranted continued monitoring.** These included high and rising household leverage as a result of loan expansion by commercial banks and non-bank financial institutions. In particular, more relaxed personal loan underwriting standards could encourage households to increase vulnerabilities. The Committee would also monitor worsening debt serviceability of SMEs, as indicated by elevated NPL and the rising trend of special mention loans (SM) amid economic slowdown. Another financial stability risk to be monitored was search-for-yield behavior in the prolonged low interest rate environment, which could lead to underpricing of risks, especially those related to the cooperatives system and leverage by large corporates.

Given the softening economic outlook and prolonged low interest rates, the Committee viewed that microprudential and macroprudential measures would need to play an increasing role in addressing financial stability risks. Greater emphasis should be placed on additional policies to resolve the structural household debt problem. Such polices included restructuring existing debt, standardizing DSR calculation, and establishing guidelines on responsible lending practice for financial institutions. The Committee would also consider approaches in addressing systemic risks posed by large corporates as well as direct a study of additional appropriate measures to curb potentially increased risks in the future.

The Committee engaged in extensive discussion regarding the necessity of the policy rate cut to 1.50 percent at this meeting. Most Committee members viewed that more accommodative monetary policy would foster the continuation of economic growth and the return of headline inflation to target in the context of heightened uncertainties mainly from external factors. This would give both public and private sectors time to adjust to the economic downturn. The adjustments included restructuring household debt and preserving business competitiveness. Meanwhile, public expenditure might not provide sufficient momentum for the economy due to budget disbursement constraints and the delay in the enactment of the Annual Budget Expenditure Act, B.E. 2563 (A.D. 2020). Moreover, most Committee members viewed that the policy rate cut at this meeting would reduce pressure on the Thai baht to some extent. The cut could also reduce the need for large policy rate cuts in the future, were the Thai economy to slow down more than expected due to the global economy. On the other hand, **two Committee members viewed that such a policy rate cut given the already accommodative monetary policy stance might not lend additional support to economic growth**, compared with potentially increased financial stability risks. The effects of the policy rate cut would be limited in offsetting negative impacts from external factors. Moreover, interest rates were not seen to be significant constraints for current private investment, and there was a need to build up policy space to cushion against possible risks in the future.

In the discussion of monetary policy outlook the Committee would monitor the developments of the outlook for growth, inflation, and financial stability, together with associated risks, especially the impacts of trade protectionism, as inputs for the formulation of appropriate monetary policy in the period ahead. Furthermore, **the Committee saw the need for policy coordination between related public and private organizations to support growth recovery and economic restructuring** given structural problems facing the Thai economy that could affect competitiveness and growth outlook going forward. The problems should be firmly addressed by all related parties.

Monetary Policy Group
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