Edited Minutes of the Monetary Policy Committee Meeting (No. 6/2019)
25 September 2019, Bank of Thailand
Publication Date: 9 October 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. Advanced economies were expected to grow at a slower pace in line with exports, production, and investment that were affected by escalating international trade tensions. Private consumption would remain an important growth driver thanks to employment in the services sector. **China** would also grow at a slower pace, held down mainly by exports as a result of intensifying trade tensions. However, the Chinese government announced additional monetary and fiscal stimulus measures, which would help shore up the Chinese economy. **Asian economies** (excluding Japan and China) would grow moderately in tandem with production, exports, and a prolonged downturn in the electronic cycle. **Overall monetary policy of trading partners** in both advanced and regional economies would be more accommodative. The Federal Reserve (Fed) reduced its policy rate in September 2019, and another policy rate cut was expected within this year. The policy rate reduction was regarded as an insurance against potential impacts on the economic and inflation outlook from uncertainties in the global economy and international trade tensions. The European Central Bank (ECB) announced a package of monetary easing measures in September. The package included a key interest rate cut, a new round of the Asset Purchasing Program (APP), and an extended liquidity injection into the financial system through the third Targeted Longer-Term Refinancing Operations (TLTRO III). Some regional central banks such as the Reserve Bank of India, the Bangko Sentral ng Pilipinas and Bank Indonesia additionally cut their policy rates. Meanwhile, other regional central banks still held their policy rates with tendency to cut by the end of this year.

The Committee assessed that there was a higher probability of trading partners' economic growth being lower than the baseline projection due especially to (1) economic slowdown and trade tensions that could be prolonged and intensified and thus would affect employment in the services sector in advanced economies and (2) a potential no-deal Brexit and geopolitical risks in some countries. The Committee also noted that most of fiscal stimulus measures in advanced economies and China were mainly for supporting domestic demand. Therefore, these measures could contribute limitedly to the global economic recovery in the period ahead. The Committee thus saw a need to closely monitor (1) developments in global demand and trading partner economies together with the aforementioned risks in order to assess their impacts on the Thai economy through various linkages and (2) other countries' monetary policy stances that could have implications on capital flows and the Thai baht.

The Financial Markets

The global financial markets became volatile in tandem with developments of trade tensions between the US and China, Brexit, and geopolitical risks. Safe-haven asset prices increased in August in line with rising volatility in the global financial markets due to risk-off sentiments after the US and China announced additional retaliatory tariff and non-tariff measures. Meanwhile, the likelihood of a no-deal Brexit heightened. However, trade tensions and the no-deal Brexit risk somewhat abated in September due to (1) delays in new tariff hikes between the US and China and (2) better prospects of a Brexit extension. In addition, continuation of more accommodative monetary policy in advanced economies positively contributed to risk-on sentiment for investors to reinvest in risky assets, resulting in a gradual increase in risky asset prices. Regarding domestic financial markets, the policy rate cut in the previous meeting contributed to a decrease in short-term Thai government bond yields. Meanwhile, long-term Thai government bond yields quickly declined in line with the US counterpart in tandem with the global financial markets conditions.

On exchange rates, **the Thai baht appreciated against the US dollar since the previous meeting** despite baht depreciation in August after the policy rate cut. The movement of the baht was mainly driven by factors pertaining to global financial markets, especially after the US and China announced new tariff hikes. As a result, the baht appreciated in line with the Japanese yen and gold prices, which were safe-haven assets. In September, the baht continued to appreciate in line with risky asset prices of emerging markets economies. This was a result of improvement in trade negotiations between the US and China as well as Brexit negotiations.

The Committee viewed that financial market would remain highly uncertain going forward due to various factors, including prolonged trade tensions, Brexit negotiations, and the global economic slowdown. These factors could cause volatility in asset prices and exchange rates. Moreover, monetary policy stance of advanced economies would be an important factor affecting confidence in the global financial markets going forward. The Committee remained concerned about baht appreciation against trading partner currencies given the economic slowdown prospects, as the economy could be more sensitive to greater currency appreciation. This would be an additional pressure on the softening domestic demand, particularly exported-related manufacturing and services sectors. The Committee thus saw the need to closely monitor developments of exchange rates, capital flows, and impacts on the economy through various channels, as well as consider implementing additional measures at an appropriate timing if necessary. The additional measures included (1) those under the Bank of Thailand’s authority, such as continued relaxation of capital outflow regulations to encourage Thai residents to increase their portfolio investment abroad, and (2) those required collaboration with other organizations, including efforts to stimulate investment to reduce the elevated current account surplus.

<u>Domestic Economic Conditions</u>

The Thai economy would expand at a lower rate than the previous projection and below its potential. The slowdown was due to contracted merchandise exports that started to affect domestic demand. **Exports of goods** were expected to contract more than the previous assessment because of the slowdown in trading partner economies and global trade due to intensifying trade tensions and a prolonged downturn in the electronic cycle. **Exports of services** would slow down consistent with the global economy. **Private consumption** was weighed down by (1) a decline in household income and employment in various industries, especially in export-related manufacturing sectors and in the agricultural sector partly hit by natural disasters and (2) elevated household debt. Nevertheless, government stimulus measures would support private consumption this year to expand as previously assessed.

Private investment would grow at a lower rate than the previous assessment, partly owing to exports contraction and weakening domestic demand. 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 moderately due partly to delay in the state-owned enterprise investment projects. However, government consumption would increase due to the budget restructure with an increase in the share of current expenditure for fiscal year 2020.

The Committee expected the Thai economy in 2019 and 2020 to expand at a lower rate than estimated in June 2019 mainly due to merchandise exports contraction which started to affect domestic demand. The economic growth was projected to be 2.8 percent in 2019 and would increase to 3.3 percent in 2020, which was lower than the previous projection at 3.3 and 3.7 percent, respectively. **Risks to the economic projection were slightly tilted more to the downside** due to the following factors. First, lower-than-expected trading partners' economic growth owing to various uncertainties could affect Thai merchandise exports. These uncertainties included further intensified trade tensions and their impacts on global trade volume, a longer downturn in electronic cycle, Brexit negotiations, and geopolitical risks in some countries. Second, domestic demand could be lower than expected owing to uncertainties pertaining to government policy implementation, delays in public-private partnerships infrastructure investment projects, and a further weakening of household purchasing power following worsening impacts on employment in export-related sectors as well as from natural disasters. 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 stimulus policies or alleviated trade tensions in the period ahead resulting in a faster-than-expected recovery of the electronic cycle and (2) higher-than-expected domestic demand in case of faster-than-expected developments in infrastructure investment projects and private investment, including the case of additional fiscal stimulus measures.

The Committee engaged in an extensive discussion regarding the economic outlook and its implications for the appropriate policy mix going forward. The Committee noted that domestic demand would be affected by (1) uncertainties pertaining to approval and implementation of key public-private infrastructure investment projects and (2) elevated household debt and declining household employment and income that could affect consumption prospects. The Committee viewed that comprehensive understanding of different characteristics among households, such as those with different financial positions, those with high debt and fragilities, and those without financial disciplines, were needed to design targeted and appropriate solutions to the household debt problem.

The annual average of headline inflation in 2019 was projected to be lower than the previous projection and below the lower bound of the inflation target due to (1) lower-than-expected energy prices owing to the global economic slowdown despite a transient increase in crude oil price following the attacks of oil facilities in Saudi Arabia and (2) **the annual average of core inflation in 2019 would decline** owing to prices of processed food, housing rent, and personal care products, partly reflecting subdued demand-pull inflationary pressures. Nonetheless, **the annual average of headline inflation in 2020 was expected to return to the target** in line with gradual economic recovery and prospects of minimum wage increases. **The Committee thus revised down projection of headline inflation in 2019** from 1.0 percent to 0.8 percent and **kept the projection for 2020** at 1.0 percent. **There would**

remain a likelihood of headline and core inflation being lower than the baseline projection in line with risks to the economic projection.

<u>Monetary Policy Decision</u>

The Committee assessed that the Thai economy would expand at a lower rate than previously projected due to contraction in exports that affected domestic demand. Headline inflation in 2019 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 continued monitoring. The Committee viewed that developments of the economic outlook, inflation, and financial stability remained close to the assessment in the previous meeting. Moreover, accommodative monetary policy stance since the policy rate cut in August would contribute to the continuation of economic growth and should support the rise of headline inflation toward target in 2020. **The Committee therefore voted unanimously to maintain the policy rate at 1.50 percent at this meeting. 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 previously projected and below its potential due to (1) the contraction in merchandise exports in line with the slowdown in trading partner economies and global trade volume as a result of intensifying trade tensions and (2) a prolonged downturn in the electronic cycle. Regarding domestic demand, private consumption would slow down despite supports from fiscal stimulus measures. This was due to manufacturing sectors and employment that were affected by contraction in exports, natural disasters, and elevated household debt. Private investment would be moderating in line with exports. However, the relocation of production base to Thailand as well as public-private partnership projects for infrastructure investment would contribute to the momentum in the period ahead. Public expenditure would expand at a lower rate than previously assessed due partly to delay in state-owned enterprise investment projects.

The Committee viewed that the Thai economy would encounter heightened uncertainties mainly from the external front that could affect the growth prospects going forward. These uncertainties included, in particular, (1) trade tensions that could be prolonged and expanded, (2) a worse-than-expected growth outlook of advanced economies that could affect domestic demand as well as the increased likelihood of no-deal Brexit and heightened geopolitical risks, and (3) monetary policy stance of advanced economy and regional central banks that could continue to be more accommodative. In addition, the Committee would still monitor policy implementation by the government, such as impacts of fiscal stimulus measures and minimum wage increase policy, together with the progress of major infrastructure investment and its knock-on effects on private investment that could affect the growth outlook in the period ahead.

The Committee assessed that sustained exchange rate appreciation could result in greater effects on exports and the overall economy amid the slowdown in trading partner economies and increased international competition. Signs of impacts on profits and liquidity, debt servicing capability, and reduction of overtime employment began to be observed in export-related manufacturing sectors. The Committee thus saw the need to monitor the aforementioned private sector adjustment. If these impacts were broadened, the purchasing power of households related to exports as well as the overall economic growth could be affected going forward.

2) Headline inflation in 2019 was projected to be below the lower bound of the inflation target due to lower-than-expected energy prices in tandem with the global economic slowdown. In addition, core inflation was expected to moderate owing to subdued demand-pull inflationary pressures. Nevertheless, the Committee viewed that headline inflation would gradually increase toward the target in 2020 in line with the growth outlook and prospects of minimum wage increases. In the period ahead, the Committee viewed that inflation projection would face uncertainties from oil price fluctuations and weather conditions. Moreover, 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 loan-to-value (LTV) measure. Moreover, banks tended to be more cautious in extending loans during the economic slowdown. **However, other financial stability risks had not improved and warranted continued monitoring.** First, high and rising household leverage could accumulate vulnerabilities in the household sector. The Bank of Thailand would therefore monitor debt service ratio (DSR) data in accordance with the standardized calculation methodology agreed by the Bank of Thailand and financial institutions, which would start to report DSR data in the fourth quarter of 2019. The Committee would monitor worsening debt servicing capability of households and SMEs amid economic slowdown that could affect their incomes. Second, the Committee would monitor the search-for-yield behavior in the prolonged low interest rate environment, which could lead to underpricing of risks, especially activities of saving cooperatives and leverage by large corporates. Third, the Committee would monitor risks in the real estate sector, especially the oversupply situation in some areas. This was due partly to a decline in foreign demand in response to the global economic slowdown, which could affect residential property inventories.

Given the softening economic outlook and prolonged low interest rates, the Committee viewed that microprudential and macroprudential measures should be appropriately combined and more targeted to address financial stability risks. Moreover, the Bank of Thailand would cooperate with other related organizations in order to push forward household and SME debt resolutions. Such resolutions included debt restructuring and the debt clinic, together with putting into practice guidelines for responsible lending and for building financial discipline and promoting household savings. 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 an extensive discussion regarding monetary policy transmission after the policy rate cut. Money market rates, short-term government bond yields, and benchmark lending rates of various financial institutions gradually decreased in line with the policy rate. Meanwhile, most deposit rates remained unchanged. Real interest rates remained at a low level despite a slight increase due to declining inflation expectations. These allowed financing by the private sector to continue expanding. **In addition, the Committee saw the need to preserve policy space in order to cushion against possible risks in the future and deemed it necessary to monitor the impacts of the policy rate cut and fiscal stimulus measures on the economy.** Meanwhile, some Committee members viewed that, given the already accommodative monetary policy stance, the policy rate cut might not lend significant additional support to economic growth, compared with potentially increased financial stability risks.

In the discussion of the monetary policy outlook the Committee would be data-dependent by closely monitoring the developments of the outlook for growth, inflation, and financial stability, together with associated risks, especially the impacts from trade tensions, in deliberating appropriate monetary policy going forward. The Committee would stand ready to use policy tools as appropriate. 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
9 October 2019