



January 5, 2021

Excellency,

No. BOT.MPD.(02) 7/2564 Statement pertaining to the average headline inflation in the past 12 months residing below the lower bound of the monetary policy target

On December 9, 2020, the Minister of Finance and the Monetary Policy Committee (MPC) mutually agreed to set the monetary policy target for price stability such that the headline inflation is to reside within the range of 1.0 – 3.0 percent for both the medium-term horizon and for the year 2021. The agreement also designated the MPC to write an open letter to the Minister of Finance should the average headline inflation in the past 12 months or a forecast of the average headline inflation over the next 12 months breach the target range.

On January 5, 2021, the Ministry of Commerce issued a statement indicating that the December 2020 headline inflation stood at -0.27 percent. This resulted in a below-the-target average inflation rate of -0.85 percent in the past 12 months (January 2020-December 2020). Abiding by the above Memorandum, this open letter by the MPC shall outline (1) reasons for the headline inflation residing below the lower bound of the target; (2) the time horizon as to when the headline inflation is expected to fall within the target range; and (3) monetary policy actions taken to guide the headline inflation back to the target range at an appropriate time. Details are as follows.

Reasons for the average headline inflation in the past 12 months residing below the target

The supply-side factor, notably the decline in energy prices, was the main cause of the 2020 annual average headline inflation residing below the monetary policy target. This was driven by the collapse in oil demand owing to the COVID-19 outbreak. In addition, in the second quarter of 2020, the government also implemented measures to lower the cost of living for households by reducing electricity and liquefied petroleum gas (LPG) prices. These factors led to the average energy inflation in the past 12 months falling by 8.87 percent from the previous year to -11.55 percent. At the same time, fresh food inflation continued to expand at 1.72 percent from the previous year. **Meanwhile, the low demand-pull inflationary pressures stemming from a slow recovery of the Thai economy after the COVID-19 pandemic also dampened the core inflation**, averaging just 0.29 percent in the past 12 months. This was in part due to the restrictive measures implemented to contain the spread of the virus, leading to the reduction of employment as well as household income, and eventually to the deterioration in consumer purchasing power and consumer confidence. In addition to the subdued demand, businesses employing lower price strategies to boost household spending also contributed to the persistently low inflation.

Nevertheless, the ongoing negative headline inflation since March 2020 does not indicate that Thailand is facing a deflation when evaluated under four important criteria. First, overall prices of goods and services have not exhibited persistent contraction. The headline inflation was projected to rise and reach the target in the middle of 2021. Second,

prices of goods and services have not faced broad-based contraction. Prices of around 70 percent of goods and services in the inflation basket have increased or otherwise remained stable. **Third, the medium-term headline inflation expectations remained anchored within the target.** According to the recent survey of professional forecasters in October 2020, the five-year-ahead headline inflation expectation stood at 1.7 percent, reflecting the public view that the current negative inflation rate is a temporary phenomenon. **Fourth, the demand for goods and services as well as the level of employment should not become persistently subdued** after the relaxation of the restrictive measures to contain COVID-19. The MPC would closely monitor the new development on consumption and investment trends, income, employment, and business confidence. The MPC would also continue to communicate with the public regarding the inflation outlook and the potential deflationary risk, should there be any.

The expected time horizon for the headline inflation to revert back to the target

The MPC anticipated that the headline inflation would be within the target range in the middle of 2021, following the inflationary pressures from the demand side as a result of the sustained monetary and fiscal policy accommodation and the recovery of household purchasing power after the COVID-19 situation was well-controlled. At the same time, supply-side inflationary pressures would pick up following the improvement of fresh food and energy prices that were expected to recover along with the commodity prices. **Nevertheless, the MPC acknowledged that there would still be a high level of uncertainty surrounding the inflation dynamics going forward,** notably the changes in the global economic environment due to the COVID-19 outbreak, trade tensions, and geopolitical risks which could impact the global supply chains and commodity prices. Furthermore, some structural changes accelerated by the COVID-19 pandemic have also created additional disinflationary pressures, especially from the altered producer and consumer behaviors. These behaviors include (1) a rapid expansion of e-commerce businesses during the COVID-19 containment period and (2) a more-intensive use of automation in the production process to reduce the contagion risk among workers and to lower the production cost. These structural changes could serve as potential causes for the headline inflation to deviate from the baseline projection in the future.

Monetary policy actions taken to guide the headline inflation back to the target within an appropriate time horizon

Due to the high level of uncertainty and risks surrounding the recovery path, the MPC's current main objective was to support the economic recovery. The MPC aimed at promoting sustainable economic growth while also seeking to ensure that the medium-term price stability and financial stability objectives were met. The demand-pull inflationary pressures following the economic recovery would be the main factor supporting the reversion of the headline inflation back to the target within an appropriate time horizon. The MPC's recent actions are discussed below.

In the second half of 2020, the Thai economy gradually recovered under the continuous supporting measures to alleviate the negative impact of COVID-19 outbreak on the

economy, including fiscal, monetary, and credit measures. After three policy rate cuts in the first half of 2020, the MPC voted to maintain the policy rate at 0.5 percent over the second half of the year in order to continuously provide the accommodative financial conditions needed to dampen the impact of the COVID-19 outbreak and to guide the headline inflation back to the target. **Furthermore, the MPC also encouraged the Bank of Thailand (BOT) to implement other measures to assist borrowers affected by the COVID-19 pandemic** by using a more proactive and more targeted approach. The BOT therefore had moved from applying general measures to most borrowers to implementing more targeted ones which would be tailor-made to the needs of individual borrowers, in addition to the Phase II measures which gave retail borrowers who were affected by the COVID-19 pandemic some assistance through debt restructuring. Furthermore, **the MPC also supported the BOT in implementing measures regarding the development of the new Thai FX ecosystem** in order to address structural problems in the foreign exchange market, which would in turn support the long term stability of the financial system.

Looking ahead, the MPC viewed that the fiscal, financial and credit measures must be closely coordinated and implemented in a timely manner in order to effectively accelerate the anticipated economic recovery. In particular, the fiscal measures would play a leading role in supporting the economic recovery. Meanwhile, the accommodative monetary policy should be maintained for some period of time to bolster the economic expansion and the return of the headline inflation to the target. Going forward, the MPC will continue to closely monitor the economic development and stand ready to take further monetary policy actions if necessary to support the economic growth and preserve the country's financial stability.

According to the latest Memorandum of Understanding between the MPC and the Minister of Finance, the MPC will write an open letter to the Minister again six months from now, if at that time the average headline inflation over the past 12 months or the forecast of the average headline inflation in the next 12 months remains outside the target range. In addition, to enhance the transparency and clarity of BOT's communication to the general public, the MPC wishes to publish this letter on the BOT's website.

Yours sincerely,

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Governor
Chairman of the Monetary Policy Committee

The Honorable Mr. Arkhom Termpittayapaisith
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Bangkok