Edited Minutes of the Monetary Policy Committee Meeting (No. 1/2018)

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Members Present

Veerathai Santiprabhob (Chairman), Mathee Supapongse (Vice Chairman), Paiboon Kittisrikangwan, Porametee Vimolsiri, Sethaput Suthiwart-Narueput, Kanit Sangsubhan, and Subhak Siwaraksa

The Global Economy

The global economy overall continued to expand. Thailand's trading partner economies recorded stronger growth than the previous assessment, mainly on the back of consumption and employment in advanced economies as well as manufacturing production and exports in China and the Asian region. **Advanced economies saw robust growth**, with the US economy expected to gain additional growth momentum from the US tax reform. The euro area and Japanese economies would continue expanding given improvements in domestic demand and exports. Meanwhile, **China's economy** was expected to expand at a slower pace due to the government's structural economic reforms through excess capacity reduction and a tighter regulation on funding through banks and shadow banks. **Asian economies** would gain further traction on account of domestic demand that was partly driven by the public sector. Meanwhile, exports were expected to expand well given increasing demand for electronic goods, and some countries would further benefit from an increase in commodity prices. In addition, Asia's exports would gain in part from the improved US growth outlook following the tax reform. Nevertheless, the impact from the US safeguard measures on certain products exported from Thailand was expected to be largely limited. **Inflation in trading partner economies was increasing gradually** thanks to oil and fresh food prices. In advanced economies, particularly the US, inflation would likely trend up toward target, while in most Asian economies inflation was within the target. **Most trading partner central banks maintained accommodative monetary policy stance**, although some central banks in both advanced economies and Asia began raising policy rates given the firmer economic recovery underpinned by domestic demand and the acceleration of inflation toward target. Against such backdrop, **the Committee projected that risks to economic growth of trading partners were largely balanced**, where risks surrounding US economic and foreign trade policies as well as geopolitics continued to warrant monitoring going forward. In addition, the Committee saw the need to monitor other factors that could affect inflation expectations in the US, such as the outlook for fiscal deficits as well as oil prices, as these might influence the pace of the federal funds rate increases.

The Financial Markets

Global asset prices declined as risk-off sentiments were prevalent among investors in early February. While overall sentiments in the global financial markets had been sound in the prior period, with sustained capital inflows to emerging markets as well as the expectations of gradual monetary policy normalization by the Federal Reserve (Fed), in February investors expected a faster pace of the federal funds rate increases than previously assessed as reflected in a pickup in the 10-year US treasury yields. Consequently, investors gradually sold risky assets, resulting in a decline in global asset prices, an appreciation of the US dollar, and capital outflows from some countries in the region. With regard to the bond and foreign exchange markets, **Thai government bond yields, unlike the US treasury counterparts, fell** as demand from both foreign and domestic investors outgrew the supply of government bonds. Meanwhile, **the baht experienced rising volatilities**. In January, the Thai currency appreciated against the US dollar as the latter weakened, with the baht appreciating at a faster pace than many regional currencies partly due to a large current account surplus and accelerated capital inflows to the bond market. However, the baht weakened against the US dollar in February as the dollar strengthened. **Looking ahead, the baht would likely experience volatile movements** mainly due to uncertainties pertaining to monetary and fiscal policies in advanced economies. The Committee would closely monitor exchange rate developments as well as potential impacts on the economy going forward.

The Committee viewed that recent capital inflows to Thailand were partly due to improved sentiments of foreign investors regarding Thailand's economic outlook and sound external positions. These were reflected in the large current account surplus, low external debt, foreign exchange reserves at a high level, and low volatility of the baht. In addition, the Committee also noted that **Thailand's large current account surplus partly reflected structural changes in both global and Thai economies.** These included (1) a surplus in the services balance attributed to net tourism receipts following the Chinese government's policy supporting Chinese outbound travels, (2) a surplus in the trade balance due to a decline in the value of imports on account of a significant fall in oil prices since late 2014, and (3) the low level of domestic investment. In addition, **the large current account surplus was partly due to a rising surplus in the services balance compared with the trade balance surplus**. The current account surplus was expected to sustain for some period. Consequently, policy coordination from various parties was necessary for capital flows to become more balanced, such as (1) expediting public investment to be undertaken as planned, especially investment by state-owned enterprises (SOEs) that involved imported raw materials and (2) supporting individual and institutional investors with a significant amount of savings to effectively invest abroad without unnecessary regulatory limitations. These efforts would help in part alleviate pressures on the baht.

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

The Thai economy gained further traction and saw robust growth, driven by improved growth in the external sectors and a gradual improvement in domestic demand. Merchandise exports improved both in terms of quantity thanks to a stronger growth of trading partners than previously assessed, and in terms of prices on the back of rising global crude oil prices. **Tourism** continued to expand. With regard to domestic demand, private spending was further driven by improved merchandise exports that increasingly lifted household income as well as government measures that were directly aimed at boosting private spending. **Private consumption** continued to expand, particularly on durable goods, driven by non-agricultural households with higher income. Moreover, consumption would also be supported by public spending thanks to the fiscal 2018 supplementary budget, in particular the social welfare card project (second phase) and the community enterprise development project, which would help increase purchasing power of low-income households going forward. **Private investment** continued to grow in line with the improved growth outlook, with additional support from the Eastern Economic Corridor (EEC) initiative. The prospect of this initiative became more certain after the approval of the EEC bill by the National Legislative Assembly on 8 February 2018. **Public expenditure** remained an important growth driver given the higher-than-expected budget for fiscal 2019 endorsed by the cabinet with a larger-than-expected share of current expenditure. This would consequently inject more money into the economy in the short run as current expenditure disbursement was more efficient than investment disbursement. Nonetheless, public investment slowed down somewhat in the recent period as a result of the postponement of some SOE investment plans, together with the enforcement of the Public Procurement and Supplies Management Act, B.E. 2560, which might cause government and related agencies to take time initially to adjust. However, public investment was expected to resume growth going forward.

While the Committee viewed that the Thai economy was growing well, with improvement in incomes beginning to be observed among non-agricultural low-income households, the strength of domestic demand going forward was still subject to several factors. A somewhat gradual improvement in household purchasing power was partly a result of structural changes in the labor market, such as adoption of automation in place of human labor in the production process as well as a decline in agricultural prices which made farming unattractive. These led to greater migration out of the manufacturing and agricultural sectors to the services sector. Nevertheless, those workers migrating from manufacturing to services might earn less because of the relatively low productivity and wages in the latter sector. Moreover, elevated household debt underlined the fact that workers still needed to earmark part of their income for debt repayment. In solving such structural problems, the Committee viewed that agricultural and labor reform measures would be more effective than monetary policy, and the Committee would continue to closely monitor the continuity of growth in private consumption, especially after the impact of government measures from the supplementary budget for fiscal 2018 dissipated.

Headline inflation dropped slightly in January 2018 owing to a slowdown in energy price increases after having accelerated in the previous period. Core inflation stabilized at a low level. Looking ahead, headline inflation was expected to gradually trend up toward target on account of domestic demand recovery and higher oil prices than in the previous year. Meanwhile, the impact of the minimum wage increases on the overall wage was expected to be limited. Demand-pull inflationary pressures remained low as domestic demand was not sufficiently strong, labor income grew at a slow pace, and businesses faced limitations in price adjustments due to rising competition. Moreover, the Committee viewed that structural changes, such as technological development and an expansion of e-commerce, would cause inflation to rise more slowly than in the past. Meanwhile, the public's inflation expectations appeared to be more stable given recent improvements in inflation outturns. Some Committee members viewed that low demand-pull inflationary pressures reflected economic growth that was still in the initial stage of expansion and could improve from the current level. In their views, there remained productive resources that had yet to be fully utilized such as significant underemployment among Bachelor's degree graduates as well as many available spaces in industrial estates which could accommodate more investment.

Growth in commercial bank loans accelerated toward the end of 2017. Loans extended to small-to-medium enterprises (SMEs) increased across a broader range of businesses such as manufacturing, real estate, services, and commerce. Such increases also broadened across wider geographical areas, which reflected a greater positive spillover of overall economic growth to SMEs. Meanwhile, loans extended to large corporates were still concentrated in industrial estates and provinces in the eastern region. Consumer loans expanded in all purposes, particularly auto loans. With regard to credit quality, **the overall non-performing**

loan (NPL) ratio remained stable, except for (1) the NPL ratio for business loans that declined thanks to a gradual recovery of SMEs in various businesses consistent with improving economic growth and (2) the NPL ratio for consumer loans which declined because of end-of-year consumer loan portfolio management. Nevertheless, issues to be monitored remained, including debt serviceability of certain small businesses, such as retail businesses in commerce, and the increasing NPLs of mortgage loans. The Committee pointed that this was partly a result of a competition in mortgage loans extension by commercial banks in the past 2–3 years, including the unusually low interest rates offered during the initial phase of the contract, which caused difficulties in debt serviceability for some customers after that period ended. Moreover, commercial banks were more cautious in extending loans to low-income households in the recent period by targeting at lending to medium-income households with regular income flows who were perceived to have low risks. This resulted in fewer loans extended to low-income households, and therefore the NPL ratio of this group remained high. Meanwhile, loans extended by specialized financial institutions (SFIs) and non-banks were projected to rise. Most of these loans were extended to farmers whose financial positions were fragile and could thus face difficulties in debt repayment.

Financial stability remained sound overall but there remained pockets of risks that warranted monitoring. The ratio of household debt to GDP declined at a slower pace in the third quarter of 2017 relative to the previous period owing to an acceleration in consumer loans. Household debt serviceability thus remained an issue to be monitored, particularly among low-income households whose debt as a proportion of financial assets was higher than other income groups and was projected to rise. Meanwhile, the ratio of non-financial corporate debt to GDP declined; nonetheless, debt serviceability of SMEs, especially those affected by economic structural changes and changes in business models, should be monitored. In any case, financial institutions remained cautious in extending loans to both businesses and households but were more stringent in auto leasing as demand for loans increased. Regarding asset prices, the overall house price index increased at a slow pace except high-end condominiums. However, expansion in mortgage loans did not accelerate significantly relative to the past, and demand for high-end condominiums mainly came from high-income households and foreign customers. Meanwhile, the Stock Exchange of Thailand (SET) index rose in line with equity prices of large corporates due to improved business performance given the positive economic outlook. The price-earnings ratio (P/E ratio) was thus largely unchanged. Volatilities in Thailand's financial markets were still at a low level, which reflected risk appetite of investors. **The search-for-yield behavior in the prolonged low interest rate environment remained present** as reflected in the continued investment in mutual funds during the end of 2017, during which investment in daily fixed income funds accelerated in contrast to investment in foreign investment funds (FIFs) that slowed down due to rising costs of foreign exchange hedging. Meanwhile, overall growth in asset sizes of saving cooperatives slowed down relative to the previous period. However, given that deposit growth outpaced loan growth, saving cooperatives consequently increased their investment in long-term assets in search of higher yields. In addition, the private sector resumed the issuances of unrated bonds in the fourth quarter of 2017, but most of these bonds were short-term debts issued by large real-estate companies with sound financial positions.

The Committee noted that the pace of deleveraging had slowed down and suggested analyzing household debt by income groups and loan purposes in order to fully understand and consequently formulate appropriate policies. Furthermore, the Committee viewed that land prices in the central business district were relatively high, which prompted real-estate companies to develop high-end condominiums. The success of those projects would thus depend on understanding the property market and the ability to meet the needs of high-income and foreign customers. However, tightening global financial conditions might dampen demand from foreign customers. In addition, some Committee members noted that, while mixed-use development projects became increasingly popular, there remained significant demand for office spaces relative to demand for spaces for commercial use. Overall, the Committee saw the need to monitor developments in the property market, especially projects with weak financial positions that might rely on funding through unrated bonds.

Monetary Policy Decision

The Committee assessed that the Thai economy would gain further traction and would see robust growth, driven by external sectors as well as the gradual improvement in domestic demand. Headline inflation was projected to rise at a gradual pace. Overall financial conditions remained accommodative and conducive to economic growth. Financial stability remained sound overall, but there were pockets of risks that might lead to the build-up of vulnerabilities in the financial system going forward. The Committee considered the benefits and costs of policy alternatives and viewed that the current accommodative monetary policy stance remained conducive to the continuation of economic growth and should foster the return of headline inflation to target, although the process could take some time.

In their policy deliberation, the Committee discussed key considerations underpinning policy decision. Their conclusions were as follows.

(1) The overall Thai economy gained further traction, with domestic demand improving but not sufficiently strong. Economic growth was mainly driven by external demand from both merchandise exports and tourism and began to broaden out to wider economic sectors. However, private consumption still gradually expanded as agricultural prices declined, household debts remained high, and the labor market had yet to fully recover. As a result, purchasing power of low-income households was not sufficiently strong. Private consumption would thus have to be monitored going forward, particularly after the effects of this year's government measures dissipated. Moreover, with the saving-investment gap, investment still had the potential to expand further. Some Committee members viewed that Thailand's economic expansion was still at the initial stage and facing structural changes in various aspects. Overall, the Committee viewed that an accommodative monetary policy stance was still necessary for some period to foster stronger domestic demand going forward.

(2) Headline inflation gradually trended up toward target mainly on the back of supply-side factor such as an increase in oil prices. Meanwhile, the effect of the minimum wage increases on the overall wage was largely limited. Demand-pull inflationary pressures remained low. The Committee viewed that supply-side and structural factors at present might result in a lower impact of demand-pull pressures on inflation—for instance, rising business competition given e-commerce resulted in difficulties in price adjustments. The Committee would thus continue to closely monitor inflation developments going forward.

(3) Financial stability remained sound overall. There remained pockets of risks, though largely benign, that warranted monitoring as they might result in the build-up of vulnerabilities in the financial system going forward. Such risks included (1) underpricing of risks that stemmed from the search-for-yield behavior in the prolonged low interest rate environment, (2) debt serviceability of low-income households and SMEs that were largely affected by structural economic changes and changes in business models, (3) new openings of high-end condominiums and mixed-use development projects, and (4) developments in saving cooperatives under the enhanced supervisory framework.

In this light, the Committee assessed policy trade-offs and unanimously voted to keep the policy rate unchanged at 1.50 percent at this meeting. The Committee concurred on the need to maintain accommodative monetary policy stance and would stand ready to utilize available policy tools to support the continuation of economic growth while preserving financial stability.

Monetary Policy Group
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