Edited Minutes of the Monetary Policy Committee Meeting (No. 2/2017)

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Members Present

Veerathai Santiprabhob (Chairman), Mathee Supapongse (Vice Chairman), Paiboon Kittisrikangwan, Jamlong Atikul, Porametee Vimolsiri, Sethaput Suthiwart-Narueput, and Apichai Boontherawara

The Global Economy

The overall growth outlook for Thailand's trading partner economies improved. G3 economies continued to gain traction as reflected in manufacturing production and private consumption. The **US economy**, in particular, saw continued strengthening of labor market conditions towards full employment as well as a firmer recovery in investment. These developments led market participants to anticipate that the Federal Reserve (Fed) would continue to raise the federal funds rate this year. **Asian economies** continued to recover on the back of exports which benefited from the global demand recovery. Against this backdrop of continued improvements in the outlook for global growth and headline inflation in many countries, market participants came to expect that further monetary policy easing by most central banks might be less likely in the period ahead.

The global economic recovery still faced many risks. The Committee assessed that risks associated with the implementation of US economic policies increased from the previous meeting, particularly those regarding shifts in US investment and trade policies as well as the new administration's stance of foreign trade agreements and potential trade retaliations from US key trading partners. If such trade policies were to be carried out by the US, its trading partners including Thailand could be affected through both trade and confidence channels. Meanwhile, there remained risks stemming from financial stability concerns in China, political developments in Europe, and problems faced by the European banking sector. The Committee viewed that these risks were largely unchanged but would continue to monitor their development closely.

The Financial Markets

Financial markets remained highly volatile as market participants shifted their focus to monetary policy normalization by the Fed while US economic policies remained uncertain. Changes in market expectations of the Fed's monetary policy normalization path led to increased capital flow volatility in both emerging market bonds and equities, including those of Thailand. On the whole, the **baht appreciated against the US dollar** in line with movements of regional currencies. However, the extent of the baht's appreciation was greater than those of trading partner currencies, partly due to Thailand's relatively stronger external position as reflected particularly in the country's large current account surplus, and thus the **Nominal Effective Exchange Rate (NEER)** appreciated from the level seen at the prior meeting. Meanwhile, **Thai government bond yields** registered around the same levels as the previous meeting, and the **Stock Exchange of Thailand (SET) Index** was down slightly due to the fall in prices of energy stocks.

It was expected that capital flow and exchange rate volatilities would likely remain elevated in the period ahead, and that the baht could move in either direction, depending on the actual implementation of US fiscal stimulus as well as the anticipated pace of the Fed's monetary policy normalization. In addition, the Committee discussed the gradual relaxation of exchange controls that could help create more balanced capital flows. Moreover, in light of highly volatile capital flows, the use of market-based instruments might help reduce capital flow volatility to some extent, which would facilitate orderly exchange rate adjustments. At the same time, the private sector was encouraged to give more consideration to exchange rate risk management going forward.

Domestic Economic Conditions

Thailand's growth outlook improved, driven mainly by the continued expansion in external demand which led to a firmer recovery in **merchandise exports**. Meanwhile, **tourism** continued to recover and **public expenditure**, especially infrastructure investment, remained an important growth driver. On the other hand, domestic demand continued to recover at a gradual pace and did not gain much so far from the recovery of exports. **Private consumption** was supported by higher income and improved confidence but weighed down by household debt which remained elevated despite having leveled off. **Private investment** growth was still concentrated in export-related sectors, consistent with the expansion of business credit by commercial banks that also concentrated in these sectors.

The Committee assessed that the Thai economy would expand at a faster pace this year than previously projected. The growth forecast for 2017 was revised up from 3.2 percent to 3.4 percent on account of a better export outlook. **It was anticipated that the Thai economy would continue to expand** at 3.6 percent in 2018, driven by both exports and domestic spending. Notwithstanding, Thailand's economic growth would proceed amid a large degree of uncertainties on the external front, especially those pertaining to the direction of economic and trade policies of the US which the Committee would continue to monitor closely.

In the Committee's view, headline inflation was expected to gradually rise. Nevertheless, headline inflation might fluctuate in the near term due to the base effect of higher fresh food prices during the drought last year, and could face greater downside risks given that global oil prices might be lower than the current assessment due to higher than expected excess global oil supply. Meanwhile, demand-pull inflationary pressures remained low. In this light, the Committee **revised down the average headline and core inflation forecasts for 2017 slightly** to 1.2 percent and 0.7 percent respectively. **Headline and core inflation in 2018 was projected to continue trending upward**, averaging at 1.9 percent and 1.0 percent respectively, consistent with the projected increase in oil prices alongside the global economic recovery and the expected rise in demand-pull inflationary pressures as the Thai economy continues to expand. Going forward, the Committee anticipated headline inflation to gradually rise and return to the midpoint of the target, consistent with the public's medium-term inflation expectations that remained close to the midpoint of the target.

The Committee viewed that financial stability remained sound with sufficient cushion against economic and financial volatilities on both domestic and external fronts. However, there were pockets of risks that still warranted close monitoring such as the deterioration in the quality of loans extended to households and businesses, especially small-and-medium-sized enterprises (SMEs), as well as the search-for-yield behavior that might lead to underpricing of risks. On the development of risks related to recent defaults of unrated bonds issued by certain companies, the event appeared to have limited impacts on financial conditions, as most unrated bond issuers that did not default were still able to roll over their debt or to obtain financing from alternative sources. Costs of financing through unrated bonds also appeared to be more varied depending on the financial health of the issuers, which reflected increased market ability to distinguish risks across different issuers. Nevertheless, the Committee would continue to closely monitor developments of unrated bonds and other parts of the financial system for signs of risk underpricing.

The Policy Decision

In deliberating their policy decision, the Committee assessed that Thailand's growth outlook improved, and that headline inflation would continue to gradual rise and return to the midpoint of the target in the future period. However, the growth observed so far still had some vulnerabilities, and was concentrated largely in export-related economic activities which would remain subject to a large degree of risks. Headline inflation faced increased downside risks from developments in global oil prices, while demand-pull inflationary pressures also remained low. Overall financial conditions remained accommodative despite having tightened somewhat, partly because the baht appreciated against major trading partner currencies which might not be as beneficial to the economy as it could be. **Hence, the Committee decided to keep the policy rate unchanged at 1.50 percent at this meeting in order to maintain accommodative financial conditions which would facilitate the continuation of economic growth.**

Given that economic growth in the period ahead remained susceptible to risks, the Committee saw the need for concrete structural reforms that would uplift the competitiveness of Thai businesses and help cushion the impacts of adverse shocks to the economy. Additionally, although financial stability remained sound, some committee members viewed that imbalances in the financial system could continue to accumulate under the prolonged low interest rate environment. This was particularly seen in the recent increase in lending and borrowing through channels other than commercial banks and specialized financial institutions due partly to different regulatory standards across different types of financial institutions. In this regard, close coordination between regulatory bodies would be critical in closing such gaps as well as in monitoring and addressing risks in an appropriate and timely manner.

Going forward, the Committee concurred that sufficiently accommodative monetary policy remained necessary given that economic growth was still in the early stages and not yet broad-based. The Committee would stand ready to utilize an appropriate mix of available policy tools in order to support economic growth and ensure financial stability.

Monetary Policy Group
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