Edited Minutes of the Monetary Policy Committee Meeting (No. 2/2018)

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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 partners performed as previously assessed. **Advanced economies were expected to grow steadily,** driven primarily by manufacturing production and improved consumer confidence. **China and Asian economies showed sustained growth**, mainly on the back of exports, manufacturing production, and increased consumer confidence. Meanwhile, China's economy experienced some deceleration due to slower economic activity over the Chinese New Year holiday. Global financial conditions remained accommodative as overall government bond yields were still lower than historical averages despite some spike during market correction. **Inflation in trading partner economies was increasing gradually,** with US inflation likely to rise toward target. Inflation in the euro area and Japan remained low, while inflation in most Asian economies was within the target range. **Most trading partner central banks maintained accommodative monetary policy stance to support economic expansion and gradual rise in inflation.** Some Asian central banks could delay policy rate hikes relative to the previous assessment given moderate expansion in the domestic economy.

The Committee viewed that, despite a decline in geopolitical risks, the balance of risks to global economic growth was skewed to the downside due mainly to risks associated with US economic and foreign trade policies as well as possible retaliation from US trading partners. According to the Committee's preliminary assessment the latest US safeguard measures, such as the tariffs on steel and aluminum, would have a limited direct impact on the US and trading partner economies in the short term. However, indirect impacts warranted monitoring going forward. For instance, trade protectionism in certain goods might result in accelerated US inflation, which might affect monetary policy decision of the Federal Reserve (Fed) and the volatility in global financial markets. There might also be impacts on international supply chains as well as on Thai exports. Furthermore, Thai domestic businesses could face increased competition if trade partners of the US diverted their exports to Thailand.

The Financial Markets

Overall sentiments in global financial markets improved, but heightened asset prices volatility caused risk-off sentiments among investors amid developments in US trade policies and the US monetary policy outlook. After market correction, US Treasury yields stabilized while global equity indices gained slightly. Moreover, foreign investors started to sell off assets in some regional bond and stock markets. Meanwhile, the baht experienced heightened volatility and appreciated against the US dollar since the previous meeting in the same direction as most regional currencies. However, the pace of appreciation varied in accordance with country-specific factors. **Thai government bond yields did not materially change. Rising US Treasury yields had limited effects on Thai government bond yields and**

financing costs through corporate bonds, as reflected in the modest outflows from the Thai bond market. US dollar liquidity tightened in some instances but did not cause significant movements in global financial markets. Overall, private financing costs remained low. **Looking ahead, the baht would likely undergo volatile movements due mainly to uncertainties pertaining to the conduct of monetary, fiscal, and trade policies in advanced economies.** The Committee would thus continue to monitor closely developments in the foreign exchange markets. **The Committee noted that, if excess liquidity in the global financial system were to significantly decline in the period ahead, less accommodative monetary policy stance in advanced economies could have a stronger impact on the global financial markets than previously.** This could in turn affect dollar liquidity in Thai financial markets and potentially raise financing costs in the Thai bond market.

<u>**Domestic Economic Conditions**</u>

The Thai economy as a whole continued to gain further traction and was expected to achieve higher growth than the previous assessment due particularly to continued improvements in merchandise exports and tourism driven by stronger global economic growth. **Merchandise exports** continued to improve both in terms of quantity and prices. **Tourism** expanded further due to a higher-than-expected number of Chinese tourists, together with Indian tourists which were projected to pick up further after the increased capacity entitlements under bilateral air services agreements. Furthermore, capacity constraints in the main airport were somewhat eased by the use of local airports. With regard to domestic demand, **private consumption** improved only gradually as household income in some agricultural sectors was affected by a decline in agricultural prices. Meanwhile, income among non-agricultural low-income households was largely unchanged due partly to migration of workers from the manufacturing sector to the services sector, which yielded relatively lower productivity. Meanwhile, household debt remained elevated. Nevertheless, income among non-agricultural households with medium-to-high income picked up further in line with improvements in the overall economic growth, which partly contributed to continued expansion of services and durable goods consumption. **Private investment** continued to improve particularly in machinery and equipment in line with increased capacity utilization among various industries such as automobiles, chemicals, and construction materials. Going forward, the increasing value of investment applications submitted to the Board of Investment, and investment incentives offered by the government particularly infrastructure investment as well as the Eastern Economic Corridor (EEC) initiative would sustain private investment going forward. **Public expenditure** remained a growth driver while there were risks from lower and delayed budget disbursement compared with the previous assessment. This was due in part to the promulgation of the Public Procurement and Supplies Management Act, B.E. 2560 which might cause government and related agencies to take longer time than expected to be accustomed as well as construction delay in some government investment projects such as certain motorways and the mass rapid transit projects.

The Committee projected that the Thai economy would continue to gain further traction and achieve higher growth than the previous assessment. The growth forecast for 2018 was revised to 4.1 percent, up from 3.9 percent, with continued growth momentum at 4.1 percent in 2019. The upward revision was mainly on account of continued improvements in merchandise exports and tourism thanks to stronger trading partners' growth. Meanwhile, private expenditure gradually expanded, which would be partly supported by the government measures aimed at improving the well-being of low-income households. Nevertheless, **risks to the growth projection tilted to the downside** due importantly to risks pertaining to (1) US economic and foreign trade policies as well as retaliatory measures from trading partners of the US that could affect Thailand's export momentum, (2) budget disbursement by the government that could turn out lower and further delayed than the previous assessment—in particular, budget disbursement by local authorities, and (3) private demand that might not be as strong as expected should the recovery in purchasing power still not sufficiently broaden. Nevertheless, there were upside risks that could induce higher-than-expected economic growth. These included (1) trading partners' growth which might be stronger than previously expected given benefits from the US tax reform, (2) additional economic measures from the Chinese government that could soften China's economic slowdown, and (3) domestic infrastructure investment that might induce higher private investment than the previous assessment.

The Committee engaged in extensive discussion on various factors that could affect Thailand's growth outlook. First, while overall export growth was expected to be steady due particularly to stronger global economic expansion, it was subject to heightened volatility in exchange rates driven by external factors. Second, private consumption was not sufficiently strong, attributable to household income in some agricultural sectors that were affected by lower agricultural prices as well as declines in hours worked observed in daily workers outside the agricultural sector and monthly workers in services and construction sectors. Meanwhile, the unemployment rate started to rise owing to structural factors as reflected in newly graduated students taking longer time in seeking jobs. Nevertheless, improvements in employment were still concentrated in some manufacturing and services sectors related to tourism, reflecting economic growth that had yet to fully transmit in a broad-based manner. In addition, household debt remained elevated. **These problems need to be tackled by further implementation of structural policies.**

Headline inflation edged down in February 2018 owing to a decline in fresh food prices, following increased output, and a slowdown in energy price increases. **Core inflation** slightly increased due particularly to higher prices of housing rents and personal goods. Nevertheless, headline inflation was projected to gradually rise on account of domestic demand recovery and higher oil prices relative to the previous year. Demand-pull inflationary pressures remained low and were subject to structural changes that caused inflation to rise more slowly than in the past. Meanwhile, the **public's short-term inflation expectations** appeared to be more stable. **The Committee slightly revised down the headline inflation forecast for 2018** to 1.0 percent and projected **headline inflation for 2019** to rise to 1.2 percent. This was owing to lower fresh food prices following falling pork prices stemming from a large supply in the market as well as lower fruit prices given high agricultural output amid favorable weather. **The core inflation forecast for 2018 was slightly revised down**, averaging 0.7 percent this year, while the **forecast for 2019** was expected to be an annual average of 0.8 percent, given the gradual improvements in domestic demand that did not lead to the acceleration in the domestic price level. **Risks to the inflation projection tilted to the downside** consistent with the risks to economic projection.

Commercial bank loans grew at a similar pace as the end of last year. A broad range of businesses saw an expansion especially in consumer loans on the back of auto leasing. Loans extended to small-to-medium enterprises (SMEs) picked up and in some regions spread across a broader range of businesses, especially manufacturing, construction, and services sectors, thanks to overall economic expansion. Business loans to large corporates contracted due partly to debt repayment and a shift toward bond and equity financing. With regard to **credit quality**, the overall non-performing loan (NPL) ratio remained stable, given the sluggish improvement in NPL of SME and consumer loans across all loan purposes, reflecting economic expansion that was not yet sufficiently broad-based. NPL of some SMEs decreased slightly, especially in exports and services sectors, in line with economic recovery. Nevertheless, the Committee would closely monitor development of NPL of SMEs, as partially reflecting a more broad-based benefits of continued economic recovery.

Monetary Policy Decision

The Committee assessed that the Thai economy would gain further traction and achieve stronger growth than the previous assessment, driven by external sectors as well as the gradual improvement in domestic demand. Nevertheless, developments in domestic demand still warranted close monitoring. Headline inflation was projected to gradually rise albeit at a slightly slower pace than the previous assessment. Overall financial conditions remained accommodative and conducive to economic growth as reflected in low levels of real interest rates. 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 impacts 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, six Committee members voted to maintain the policy rate at 1.50 percent. Their conclusions of key considerations were as follows.

(1) The overall Thai economy gained further traction and achieve stronger growth, with domestic demand improving but not sufficiently strong. Economic growth was mainly driven by external demand from both merchandise and services exports and began to widen out to more related sectors. However, improvements in private investment were still concentrated in the sectors related to exports and tourism. Moreover, private consumption continued to expand at a gradual pace, achieving lower growth than the overall economic expansion. This was because (1) household income of those in the agricultural sector and those with lower income in the non-agricultural sector had yet to recover, (2) household debt among low-income earners remained elevated, and (3) the labor market was not sufficiently strong and was affected by structural problems. As a result, purchasing power of low-income households was not sufficiently strong. Most Committee members viewed that private consumption would thus have to be monitored for some time. **Overall, the Committee viewed that the current level of monetary policy accommodation was still necessary to foster stronger domestic demand.**

(2) Headline inflation gradually trended up on the back of recovery in domestic demand and oil prices despite a greater-than-expected decline in fresh food prices that contributed to a slightly slower increase in headline inflation than the previous assessment. Core inflation rose slowly as domestic demand recovered at a gradual pace. Nevertheless, the Committee assessed that the slower-than-expected increase in headline inflation did not reflect deflation risks as decline in headline inflation was mainly attributable to supply-side factors. In addition, the public's inflation expectations remained close to the target, and the economy continued to expand. However, the Committee would continue to closely monitor inflation developments going forward. **In their view, the current level of monetary policy accommodation would foster the return of headline inflation to target, although the process could take some time.**

(3) Financial stability remained sound overall, but there were pockets of risks that might lead to the build-up of vulnerabilities in the financial system. The Committee noted signs of improvements in some financial stability risks as reflected in, for instance, lower NPLs seen in some businesses and some regions. Nevertheless, the Committee was still concerned about the search-for-yield behavior that could lead to underpricing of risks, debt serviceability of households and SMEs, developments in saving cooperatives, and a real estate oversupply along the mass rapid transit routes as well as new openings of high-end condominiums and mixed-used real estate projects in the coming years.

One Committee member voted to raise the policy rate by 0.25 percentage point to 1.75 percent. In deliberating the decision, the member viewed that prolonged monetary accommodation would induce households and businesses to underestimate potential changes in financial conditions, while **gradually reducing monetary policy accommodation in a timely manner would not hinder economic growth or price stability but would rather reduce financial stability risks in the future as well as facilitate monetary policy normalization in an orderly manner.**

In this light, the Committee assessed policy trade-offs and voted 6 to 1 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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