Edited Minutes of the Monetary Policy Committee Meeting (No. 4/2018)

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Members Present

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

Member Absent

Kanit Sangsubhan

The Global Economy

Thailand's trading partner economies continued to gain further traction since the previous meeting. **Advanced economies** were expected to expand mainly on the back of private consumption. Although consumption was somewhat dampened by unusually cold weather, robust labor markets and strong consumer confidence were key supporting factors for growth in advanced economies. However, confidence in the euro area temporarily declined due to political developments in Italy and Spain. Meanwhile, the US continued to be driven by fiscal stimulus. **China and Asian economies** continued to grow driven by exports and consumption thanks to strong global demand and increased commodity prices. Nevertheless, the rise in oil prices had a small impact on consumption given government measures to mitigate the adverse impact in many countries. **Headline inflation in trading partner economies** accelerated in line with oil prices, while inflation expectations and core inflation were largely unchanged. Nonetheless, global inflation remained subdued, partly as a result of structural factors such as lower labor productivity growth and expansion of e-commerce. With regard to **monetary policy in trading partners**, the Federal Reserve (Fed) raised the federal funds rate in June 2018 and was expected to raise the policy rate a total of four times this year instead of three, following a positive outlook of the US economy and inflation. On the contrary, the European Central Bank (ECB) maintained its monetary policy accommodation, but announced its intention to end the bond purchases as well as outlined its policy normalization path in the period ahead. However, some central banks in the region such as Indonesia and the Philippines raised the policy rate in order to curb volatilities in the financial markets. **The Committee assessed that downside risks to economic growth of trading partners increased** given US trade protectionism measures and retaliatory measures by US trading partners, which were increasingly intensified and unlikely to be resolved in the near future. The Committee would thus continue to closely monitor developments of trade policies and negotiations as they could have stronger impacts than anticipated on the expansion of trading partner economies and global trade volume in 2019.

The Financial Markets

Global financial markets experienced greater volatilities given monetary policy divergence in advanced economies. The US dollar appreciated against almost all currencies as the Fed was expected to raise the federal funds rate sooner than market expectations. On the other hand, the ECB would likely keep its policy rate unchanged at least until the summer of next year, which would be longer than market expectations. In addition, latest euro area economic data came out softer than anticipated. Meanwhile, the market became increasingly concerned about trade protectionism. These developments prompted investors to continually reduce their holdings of risky assets including investments in emerging market economies, particularly countries with vulnerable economic fundamentals such as Argentina and Turkey. **The baht depreciated against the US dollar in light of the dollar's strength against most currencies.** The baht also weakened against trading partner currencies, partly because some regional currencies had depreciated in the prior period. In addition, some central banks already began to gradually raise the policy rate, which helped slow down the pace of depreciation to some extent. **Overall Thai government bond yields picked up slightly since the previous meeting. Short- and medium-term Thai government bond yields rose** due to (1) recent economic and inflation outturns which were better than expected and (2) an increase in short-term bond issuances by the Bank of Thailand and the Ministry of Finance. Foreign investors continued to sell off emerging market short-term bonds. **Long-term Thai government bond yields fell** in line with US government bond yields and due to a higher demand from foreign investors following improved confidence about the Thai economy. **Looking ahead, the baht would likely experience volatile movements** due to (1) uncertainties pertaining to the conduct of monetary, fiscal, and trade policies in advanced economies together with retaliatory measures, (2) geopolitical risks, (3) increased emerging market risks as perceived by investors, and (4) the outlook of oil prices. The Committee would closely monitor these developments and their potential impacts on exchange rates and the economy going forward.

The Committee viewed that the impact from rising bond yields in recent periods on financing costs of the private sector through the bond market was still limited. In addition, overall corporate financing through financial institutions and the bond market did not slow down. However, at this current juncture where global interest rates were on an upward cycle, global financial conditions would tighten and pose risks to domestic financial conditions. The Committee would thus closely monitor such development and its impact on corporate financing. Moreover, some Committee members viewed that, although Thailand's sound external stability contributed to limited risks of capital outflows induced by interest rate differentials between Thailand and foreign countries, it was deemed necessary to closely monitor capital flows by both Thai and foreign investors.

Domestic Economic Conditions

The Thai economy continued to gain further traction driven by improvements in both domestic and external demand. The **value of merchandise exports** improved from the previous assessment mainly on the back of rising global crude oil prices, while export volume would expand at a slightly better pace than previously estimated. However, there were still risks from the impact of US trade protectionism measures, particularly from US tariffs on imported cars and auto parts. Meanwhile, the **value of imports** increased in line with prices of crude oil and other industrial products, as well as improvements in export volume and domestic demand. **Exports of services** continued to grow in line with the number of tourists and increased utilization of regional airports. Moreover, domestic demand gained additional momentum. In particular, **private consumption** continued to expand at a faster rate than previously assessed especially on account of spending by medium- and high-income households. However, elevated household debt and the economic expansion that had yet to fully extend to household income and employment in a broad-based manner held down household consumption to some extent. Furthermore, **private investment** would continue expanding in construction as well as machinery and equipment. Private investment would also gain additional support from public investment projects, whose prospects became more certain following developments with regard to the Eastern Economic Corridor (EEC) initiative and the Public-Private Partnership (PPP) scheme. In the Committee's view, if investment in the EEC was to progress as planned, private-sector investment would then achieve a higher growth rate. **Public expenditure** remained a driver of economic growth, although public consumption growth was lower than the previous assessment. This was due to the change in government budget structure for fiscal year 2019, with a larger share of capital budget compared with the previous announcement. Meanwhile, some of public investment projects intended for 2018 were postponed, especially investment projects of state-owned enterprises (SOEs) that faced operational difficulties resulting in delayed disbursement such as the second phase of the Suvarnabhumi Airport Development Project (1st contract) and the Bang Pakong Power Plant Project. With regard to public investment in 2019, it was expected to rise given a larger share of capital budget and the double track railway project (Denchai–Chiang Khong), which became certain.

The Committee assessed that the Thai economy would continue expanding and achieve a higher growth than the previous assessment. The Committee therefore revised up the growth forecast for 2018 to 4.4 percent, up from 4.1 percent. The revision was on account of merchandise exports and tourism, which improved in line with global economic expansion, and increased domestic demand momentum. In 2019, the economy would record a 4.2 percent growth, up from 4.1 percent. The slightly softer growth next year compared with this year was in line with global growth moderation. Nevertheless, there were still possibilities that the Thai economy would exhibit a higher growth than the baseline projection. These were attributable to growth of trading partners which might be stronger than previously expected, given a continued improvement in the US economy, additional economic measures from the Chinese government that could soften China's economic slowdown, and public expenditure on both investment in infrastructure projects and measures to support private sector spending that might be higher than anticipated. However, **risks to the growth forecast tilted more toward the downside** with possibilities that growth outturns could be lower than the baseline projection mainly due to external factors. These included (1) US trade protectionism measures and possible retaliatory measures by US trading partners, as well as stronger competition from trade diversion, which might have a larger-than-anticipated impact on Thai exports and rising competition in domestic markets, and (2) a lower-than-expected growth of Thailand's trading partners if geopolitical conflicts were to occur. There were also some downside risks from domestic factors including (1) a lower-than-expected consumption as domestic purchasing power had yet to increase broadly, and (2) the impact from the enforcement of the Public Procurement and Supplies Management Act, B.E. 2560 which might lead to longer-than-expected delays in budget disbursement of government agencies.

The Committee engaged in extensive discussion regarding Thailand's growth outlook in the period ahead and on various factors that might result in different growth outturns from the previous forecast. Apart from external risks which could potentially affect Thai exports, the Committee viewed that public investment projects and PPP projects would have a significant impact on Thailand's economic growth. The success of such investments would thus be highly important going forward. Furthermore, some Committee members noted that benefits from the improvement in economic expansion were not yet broad-based. This was partly a result of structural changes in the labor market such as adoption of automation in place of labor in production processes, changes in demand for labor skills, and low global agricultural prices that were unlikely to improve. Thus, private consumption in the period ahead might not grow at a high rate as in the past.

Headline inflation rose at a faster pace than previously forecasted toward target in April and May 2018 mainly on the back of acceleration in domestic oil prices in line with global prices, while fresh food prices increased slower than previously anticipated. **Core inflation** increased slightly mainly due to supply-side pressures—in particular, a gradual rise in fresh food and liquefied petroleum gas (LPG) prices. Demand-pull inflationary pressures remained low but would likely improve, as reflected in a slight increase in prices of some products in the core inflation basket such as personal care products. Meanwhile, **overall public's inflation expectations** remained largely stable. Nevertheless, the Committee expected headline inflation to rise at a slightly faster pace than previously assessed owing to a rise in oil prices and some improvement in demand-pull pressures. The Committee thus revised up the **headline inflation forecast for 2018** to 1.1 percent, up from 1.0 percent, and projected **headline inflation for 2019** to be 1.2 percent. **Core inflation for 2018** was projected to remain close to the previous assessment at 0.7 percent, while core inflation would rise to 0.9 percent in 2019, up from 0.8 percent. This was owing to a slight increase in demand-pull inflationary pressures. Nevertheless, **risks to the inflation forecast tilted to the downside** consistent with risks to the growth forecast.

Commercial bank loans continued to expand in almost all loan purposes, especially loans extended to small and medium-sized enterprises (SMEs) with relatively large credit lines, and continued to grow across almost all types of businesses. SME loans with smaller credit lines, however, increased only moderately. Meanwhile, consumer loans expanded in all loan purposes, particularly auto loans. With regard to **credit quality**, the overall non-performing loan (NPL) ratio edged up slightly, especially NPLs of SMEs with small credit lines. However, NPLs of overall consumer loans remained stable, except NPLs of mortgage loans which continued to increase. The Committee viewed that these developments reflected a stronger economic expansion. However, debt serviceability of small SMEs must still be monitored, given relatively high default rates and a relatively large number of debtors in the commercial bank system.

Monetary Policy Decision

The Committee assessed that the Thai economy continued to gain further traction and would grow at a higher rate than previously projected, with additional momentum from both domestic and external demand. Headline inflation would rise at a slightly higher pace than the previous assessment, while core inflation was projected to rise slowly. Overall financial conditions were accommodative and conducive to economic growth. Financial stability remained sound overall, but it was deemed necessary to monitor pockets of risks that might lead to the build-up of vulnerabilities in the financial system in the future.

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

(1) The Thai economy overall continued to gain further traction, driven by merchandise exports and tourism which continued to improve in tandem with global growth, and by a stronger momentum from domestic demand, especially from private consumption. However, household debt and structural changes, such as declining working-age population in the labor market and an adoption of automation in place of labor in production processes, resulted in the economic expansion that had yet to benefit overall household income and employment. In the Committee's view, these issues should be addressed through various structural reform policies. Private investment was expected to continue expanding with additional support from public investment projects whose prospects became more certain, although their progress in the period ahead must be monitored. Meanwhile, public expenditure remained a driver of growth, although there were risks of more-than-expected delay in disbursement. The Committee would thus continue to monitor external risks, especially risks related to US foreign trade policies and retaliatory measures by US trading partners as well as geopolitical risks. Moreover, some Committee members saw the need to monitor sectoral growth in order to assess sustainability of aggregate expansion. **The Committee viewed that the current accommodative monetary policy remained necessary to help support the continuation of growth of domestic demand.**

(2) Headline inflation was projected to gradually trend up at a slightly faster pace than previously assessed toward target mainly on the back of an acceleration in oil prices. Core inflation was projected to edge up slightly given gradual build-up in demand-pull inflationary pressures, while the public's inflation expectations were largely unchanged. Therefore, the Committee viewed that **accommodative monetary policy should facilitate headline inflation to remain within target in a sustainable manner**. However, the Committee viewed that uncertainties regarding highly volatile fresh food prices remained an important factor. In addition, structural changes, such as expansion of e-commerce and rising price competition that led to changes in inflation dynamics, might contribute to a more persistent inflation than in the past, despite the continued improvement in an economic growth. Therefore, the Committee saw the need to study the impact of such factors on inflation dynamics in further details, as this could have significant implications on the future setting of the inflation target.

(3) Financial stability remained sound overall but there remained pockets of risks that might result in the build-up of vulnerabilities in the financial system. Such risks included (1) the search-for-yield behavior that could lead to underpricing of risks, (2) a continued increase in assets and deposits of saving cooperatives despite slowing down somewhat compared with the previous period due to more stringent regulations, (3) debt serviceability of households and SMEs, and (4) the property market where businesses continued to increase their investment and financial institutions engaged in competition by extending mortgage loans with higher credit risks. The Committee viewed that the policy interest rate was a preventive tool against these risks from further developing and affecting broad financial stability, and that it should be used in conjunction with macroprudential measures to preserve financial stability.

The Committee viewed that the current monetary policy accommodation helped in part support economic growth and sustain headline inflation within target. **Most Committee members voted to keep the policy rate unchanged at 1.50 percent. However, one Committee member voted to raise the policy rate by 0.25 percentage point to 1.75 percent** with the view that the economic recovery was sufficiently robust and inflation was expected to remain within target throughout the projection period. Moreover, the member viewed that the prolonged monetary accommodation might induce households and businesses to underestimate potential changes to financial conditions and thus voted to raise the policy rate at this meeting in order to start building policy space.

In this light, the Committee voted 5 to 1 to keep the policy rate unchanged at 1.50 percent at this meeting and viewed that accommodative monetary policy remained an important factor to sustain domestic demand growth and facilitate a gradual rise in headline inflation toward target in a sustainable manner. Nevertheless, the Committee discussed conditions and appropriate timing to begin normalizing monetary policy in the future. The Committee viewed that, should economic expansion continue and inflation move more firmly within target, the need for currently extra accommodative monetary policy would start to be reduced, and that the need for a policy rate increase in order to build policy space in the future would be increasing.

Monetary Policy Group
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