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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

Thailand's trading partner economies continued to gain further traction in line with the previous assessment. **Advanced economies** continued to expand mainly on the back of private consumption and improved economic fundamentals, especially the US economy which was growing above potential. However, consumption in the euro area recovered somewhat slower than expected. **China and Asian economies** continued to grow at a slower pace as previously assessed, driven by private consumption and exports. **Inflation in trading partner economies** increased in line with the previous assessment mainly on the back of rising energy prices. Inflation in the US rose as the economy grew above potential, while inflation in the Asian countries gradually increased as the economy approached potential. With regard to **monetary policy of trading partners**, the Federal Reserve (Fed) was expected to raise the policy rate two more times by the end of 2018, while the European Central Bank (ECB) and the Bank of Japan (BOJ) were expected to maintain their monetary policy accommodation for some time. Some central banks in the region such as Indonesia and the Philippines raised the policy rate in order to safeguard external stability and contain inflation. **The Committee assessed that risks to trading partners' growth tilted more toward the downside** due mainly to uncertainties pertaining to US trade protectionism measures and retaliatory measures by US trading partners as the situation recently intensified. Although such risks had yet to impact real sector activities including international trades, private investment, and inflation, the Committee deemed it necessary to monitor further developments regarding US trade protectionism including how businesses would adapt to the situation. Meanwhile, future monetary policy actions of various central banks could lead to further tightening of global financial conditions and thus must also be monitored given its implications for economic growth as well as confidence among domestic and foreign investors.

The Financial Markets

Over the recent period, concerns over US trade protectionism had limited impact on the global financial markets but led to a sharp depreciation of Asian currencies, especially the Chinese yuan and currencies of countries highly connected with China. In the early stage, rising concerns over trade protectionism prompted investors to be more cautious in investing in risky assets as reflected in a rapid decline in global stock market indices at the end of June, before rebounding thereafter as capital outflows from regional bond and equity markets slowed down. On exchange rates, the US dollar appreciated against other currencies due to monetary policy normalization by the Fed and possible inflation pickup in the US from higher import tariffs as a result of US trade protectionism measures. This could result in a faster-than-expected pace of rate hikes in the US. Meanwhile, the appreciation of the US dollar also led to the depreciation of Asian currencies. **The baht depreciated against the US dollar and underwent volatile movements in line with other regional currencies** due to concerns over trade protectionism and demand for US dollar by some Thai firms for overseas investment in the recent period. **Short-term Thai government bond yields rose** due to increased government bond issuance as well as declining demand for short-term government bonds by foreign investors. Nevertheless, such increase in short-term government bond yields was limited because higher yields also caused Thai investors to start switching from their investment in foreign investment funds (FIF) to short-term Thai government bonds. Meanwhile, **long-term Thai government bond yields fell** due to increased concerns over US trade protectionism and higher demand by foreign investors for some series of government bonds due to adjustment in the proportion of investment in Thai government bonds following changes in benchmark bonds included in the global bond index.

The Committee viewed that the global financial markets remain highly uncertain in the period ahead due to factors such as (1) directions of monetary policy in advanced economies and (2) trade protectionism that could further intensify and affect the global economy as well as capital flows, which would then put pressure on asset prices and exchange rates particularly in emerging markets with vulnerable economic fundamentals and high interconnectedness with China and Europe. **The Committee thus viewed it necessary to monitor such situations and their implications for exchange rates and bond yields, as well as impacts on the economy.**

Domestic Economic Conditions and Financial Stability

The Thai economy continued to gain further traction, driven by both external and domestic demand. Following a temporary slowdown in the first quarter of 2018, the **value of merchandise exports** later registered higher growth in terms of both quantities and prices as a result of improved external demand and rising crude oil prices, respectively. Meanwhile, the impacts of US trade protectionism measures were so far limited to some products such as washing machines and solar cells, which constituted a small share of total exports value. Going forward, additional relocation of production base to Thailand, for some industries such as hard disk drives, would continue to lend further support to merchandise exports. **Private consumption** continued to expand in almost all categories mainly on the back of spending by middle- to high-income households as well as improving consumer confidence. Factors underpinning the private consumption outlook also showed gradual improvements overall as reflected by (1) improved and more broad-based employment in manufacturing, services, and agricultural sectors; (2) farm income which continued to see gradual improvements thanks to higher agricultural output; and (3) the implementation of additional government stimulus policies. **Private investment** was projected to continue expanding in line with improving business sentiment, especially investment in machinery and equipment. This was reflected in imports of capital goods by export- and energy-related businesses. The outlook for private investment was further supported by greater certainty regarding the prospects of public investment projects with further progress on projects under the Eastern Economic Corridor (EEC) and the Public-Private Partnership schemes. Nevertheless, their progress must still be monitored going forward. **Public expenditure** remained a driver of growth. Government consumption growth was largely stable, while public investment was expected to grow at a slower pace due to problems related to budget disbursement capabilities as well as potential delays in some state-owned enterprise (SOE) investment projects. In addition, **exports of services** was projected to continue growing but at a slower pace than previously assessed mainly due to the Phuket tour boat sinking incident. The incident might affect tourist arrivals, especially Chinese tourists, and could also lead to lower income for tourism-related businesses, as some businesses adapted to the situation by offering discounts to bolster sales. In order to assess the impact from the incident in terms of magnitude and duration, it was deemed necessary to monitor further developments and how affected businesses would adapt to the situation.

Headline inflation in June and July 2018 increased albeit at a slightly lower rate than previously assessed on account of a larger-than-expected decline in fresh food prices given higher output, especially prices of vegetable, fruits, and meat. Meanwhile, energy prices continued to rise in tandem with global oil prices. **Core inflation** edged up slightly higher than previously assessed mainly on the back of increases in prices of prepared food and house rent, while prices of other items remained largely stable. Looking ahead, headline inflation was projected to slowly rise as demand pressure gradually builds up and as oil prices increase. The annual average headline inflation was expected to be within target, although downside risks remained as fresh food prices could fluctuate sharply depending on weather conditions and agricultural output. Meanwhile, core inflation might also be more persistent than in the past even though the economy was growing at full potential. This could be attributed to structural factors that affected pricing power such as the expansion of e-commerce, heightened price competition, and upgrades to production efficiency which reduced costs of production. In this light, the Committee saw the need to further study the impact of these structural changes on prices, including how technological development affected input costs and productivity, due to its implications for the inflation outlook. Nevertheless, **overall public's inflation expectations** remained largely stable.

The Committee engaged in extensive discussion regarding Thailand's growth outlook especially on momentum of domestic demand which was subject to challenges arising from structural changes that affected wage setting; low inflation; and elevated household debt. The Committee assessed that the pass-through of benefits from economic growth to the labor market became more evident as reflected in the more broad-based increase in non-agricultural hiring, while agricultural employment remained high. Nevertheless, the average wage had yet to clearly increase. The average wage growth in Thailand had remained low for many years especially when compared with other regional countries. This could partly be explained by structural factors in the Thai labor market such as (1) high degree of labor mobility, which allowed labor shortages in one sector to be alleviated by labor from another sector as well as by migrant workers, that resulted in limited upward pressure on wages; (2) greater adoption of automation in place of labor in the production process; and (3) low inflation which limited wage increases especially for low-income workers. Meanwhile, elevated household debt remained a drag on purchasing power. **As such, the Committee deemed it necessary to closely monitor developments on these fronts given that they might affect household purchasing power in the period ahead.**

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 consumer loans. Loans extended to businesses with smaller credit lines increased in some areas, while consumer loans expanded in all loan purposes, especially auto loans which continued to pick up as prior debt burden from the first-car scheme gradually receded. With regard to **credit quality**, the non-performing loan (NPL) ratio was stable. However, the NPL ratio of SMEs remained high. Meanwhile the NPL ratio of consumer loans was largely unchanged, except for mortgage loans which increased. The Committee viewed that these developments reflected continued improvements in economic growth. The Committee also deemed it necessary to closely monitor growth in loans extended to small businesses and households as well as the credit quality of SME loans with small credit lines and mortgage loans.

Financial stability remained sound overall but there remained risks that might pose vulnerabilities to financial stability going forward. Regarding **leverage**, the seasonally adjusted household debt-to-GDP ratio remained unchanged in the first quarter of 2018, while non-financial corporate debt-to-GDP ratio continued to decline. In addition, it appeared that businesses switched their funding from debt issuance more toward commercial bank loans. Meanwhile, there remained the need to monitor the accumulation of new household borrowing which might delay the deleveraging process, and also debt serviceability of SMEs affected by structural changes. With regard to **asset prices**, volatility of the Stock Exchange of Thailand (SET) index remained high but decreased somewhat as investor confidence improved. In addition, further tightening of financial conditions in the period ahead could lead to higher funding costs through bond issuance for businesses and could affect their ability to rollover debt. For the **real estate sector**, the house price index continued to rise, although it did not pick up significantly. Meanwhile, commercial banks competed in extending mortgage loans with higher credit risks. This was reflected in a rising share of new mortgage loans with the loan-to-value (LTV) ratio exceeding 90 percent as well as the increasing loan-to-income (LTI) ratio. Moreover, the quality of mortgage loans still deteriorated, as indicated by the higher NPL ratio. The overall situation regarding the oversupply of new condominiums improved somewhat as the amount of time required for businesses to unload the stock of condominiums declined partly due to developers' deferred opening of new projects. Nevertheless, it is necessary to consider additional indicators to monitor developers' adjustment such as ownership transfers and oversupply in certain areas in order to assess the situation in the property market. The Committee thus deemed it necessary to closely monitor competition in the mortgage loan market as well as the oversupply of condominiums in certain areas and the existing stock of old condominiums. **The search-for-yield behavior** remained present in the prolonged low interest rate environment. This was evident in the persistently high asset growth among saving cooperatives whereby some large saving cooperatives became increasingly reliant on borrowing, in tandem with accelerated lending growth. Meanwhile, the search for yield in other areas was not of concern. Mutual funds continued to grow with increased investment in fixed-income funds, whereas investment in foreign investment funds (FIF) slowed down. Some Committee members also discussed the need for macroprudential measures to address and prevent risks that could not self-correct through market mechanism such as growing assets of saving cooperatives, competition in the mortgage loan market, and debt serviceability of SMEs and households.

Monetary Policy Decision

The Committee assessed that the Thai economy continued to gain further traction, driven by merchandise exports and tourism in tandem with global economic growth, and by stronger momentum from domestic demand. The outlook for headline inflation was largely unchanged from the previous assessment with the annual average expected to be within target. However, downside risks remained from sharp fluctuations in fresh food prices. Meanwhile, core inflation was expected to edge up slightly higher as demand pressure would gradually build up. Overall financial conditions were accommodative and conducive to economic growth. Financial stability remained sound overall. The Committee viewed that in the context where (1) the economy is growing at potential and (2) inflation became less responsive to economic growth due partly to structural factors, with the annual average inflation expected to be within target, it would be important to monitor the build-up of vulnerabilities in the financial system, which could be reflected in underpricing of risks and competition in the mortgage loan market.

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. Merchandise exports were expected to achieve higher growth than previously assessed partly due to the relocation of production base to Thailand for some industries. Private consumption was projected to continue expanding but overall purchasing power was still recovering at a gradual pace due to elevated household debt. Private investment continued to expand with additional support from greater certainty regarding the prospects of public investment projects, although their progress must still be monitored going forward.

The Committee viewed that, going forward, potential impacts of both external and domestic risks on Thailand's economic growth and capital flow volatility continued to warrant close monitoring. Such risks included (1) directions of monetary policy in advanced economies; (2) US trade protectionism and retaliatory measures from its trading partners, which would affect global trade and Thai exports; and (3) lower-than-expected tourism growth as a result of the Phuket tour boat sinking incident. In this light, some Committee members viewed that current growth momentum still warranted monitoring, and thus **the current level of monetary policy accommodation would support a more robust growth in domestic demand.**

(2) The outlook for headline inflation was largely unchanged from the previous assessment, but downside risks remained as fresh food prices could fluctuate sharply depending on weather conditions and agricultural output. Core inflation was projected to edge up slightly as demand-pull inflationary pressure would gradually build up. The public's inflation expectations were largely unchanged. In addition, structural changes such as the expansion of e-commerce, heightened price competition, and upgrades to production efficiency which reduced costs of production might result in more persistent inflation than in the past even though the economy was growing at full potential. **In this regard, the Committee viewed that current accommodative monetary policy allowed the headline inflation trajectory to be consistent with the inflation target.**

(3) Financial stability remained sound overall but there were some pockets of risk areas that had yet to show signs of improvements and might pose vulnerabilities to financial stability going forward, especially as economic growth strengthened. Such risks included those pertaining to (1) the property market where businesses continued to raise funds despite the oversupply of condominiums in certain areas, while financial institutions engaged in competition by extending mortgage loans with increased credit risks; (2) debt accumulation among households in which the debt-to-income ratio had yet to indicate clear signs of deleveraging, while the prolonged low interest rate environment might encourage further debt accumulation thus impeding the deleveraging process. Some Committee members viewed that persistently high household debts and impaired debt serviceability of SMEs might have an impact on economic growth over the long run; (3) the search-for-yield behavior under the prolonged low interest rate environment which could lead to the underpricing of risks, especially among saving cooperatives whose assets continued to grow at a high rate. In addition, some large saving cooperatives had become increasingly reliant on borrowing in tandem with accelerated lending growth. **In the context of prolonged low interest rate and varying degrees in financial regulations, the Committee viewed that macroprudential measures alone would not be sufficient in preventing potential risks in the financial system. Thus, monetary policy must be conducted with caution as to not contribute to further build-up of financial vulnerabilities.**

Against this backdrop, the Committee viewed that the current monetary policy accommodation played a part in supporting economic growth, especially in sustaining domestic demand, and allowed the headline inflation trajectory to be consistent with the inflation target. **The Committee thus voted 6 to 1 to keep the policy rate unchanged at 1.50 percent. One member voted to raise the policy rate by 0.25 percentage point to 1.75 percent** with a view that the economic recovery was sufficiently robust and that the prolonged monetary accommodation might induce households and businesses to underestimate potential changes to financial conditions. The member thus voted to raise the policy rate at this meeting in order to curb financial stability risks that could affect the sustainability of economic growth over the longer term and to start building policy space.

In addition 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. The Committee would continue to closely monitor the outlook of economic growth and inflation, as well as risks especially on the external front.

Monetary Policy Group
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