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Members Present

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The Global Economy

Thailand's trading partner economies continued to expand but would grow at a slower pace going forward. This was attributable to global trade volume that would likely be affected by trade protectionism and tightening financial conditions in several economies. **Advanced economies** were expected to continue expanding, particularly the US economy which was supported by a robust labor market, income tax cuts, and strong consumer confidence. Euro area and Japan economies were supported by accommodative financial conditions and strong labor markets, although growth momentum was slower by political issues in the euro area and natural disasters in Japan during the second quarter as well as impacts from trade protectionism. **China and Asian economies** would continue expanding at a slightly slower pace due in part to trade protectionism and tightening financial conditions. Nevertheless, the Chinese government implemented measures, such as infrastructure investment as well as tax reduction, to alleviate burden of household and business sectors in order to support growth. Meanwhile, Asian economies were driven by domestic demand and exports. **Inflation in trading partner economies** increased mainly on the back of rising energy prices, while inflation expectations were largely unchanged. With regard to **monetary policy of trading partners**, the Federal Reserve (Fed) continued with its tightening cycle as previously assessed, while the Bank of Japan (BOJ) and the European Central Bank (ECB) were expected to keep their accommodative monetary policy stance for some time. The Bangko Sentral ng Pilipinas increased the policy rate to stabilize inflation, while Bank Indonesia raised the rate to curb financial market volatilities.

The Committee assessed that risks to trading partners' growth were largely unchanged and would remain tilted to the downside due mainly to uncertainties pertaining to US trade protectionism and retaliatory measures by US trading partners that could be intensified, as well as geopolitical risks that could cause volatilities in financial and commodity markets, especially oil prices. In this regard, the Committee saw the need to monitor developments regarding US trade protectionism and retaliatory measures by major trading partners, especially impacts of trade diversion on the manufacturing sector and the labor market in Thailand.

The Financial Markets

Concerns over US trade protectionism and vulnerable economic fundamentals of some emerging markets posed downward pressures on their asset prices and exchange rates, with the impacts differing depending on economic fundamentals. Nevertheless, several emerging market central banks started implementing policies to support exchange rate stability and raising policy interest rates. Meanwhile, foreign investors reallocated investments from vulnerable emerging markets to economies with relatively stronger external stability that included Thailand. This resulted in capital inflows to the Thai bond market toward the end of August. However, overall Thai government bond yields rose due partly to domestic factors such as the second quarter growth outturn which was higher than market expectations. On exchange rates, Asian currencies, particularly the South Korean won and the New Taiwan dollar, weakened relatively less than those of vulnerable emerging market economies thanks to relatively sound external stability. Meanwhile, the Thai baht appreciated against regional currencies.

The Committee viewed that the global financial markets remained highly uncertain in the period ahead due to factors such as (1) directions of monetary policy in advanced economies, (2) trade protectionism that could be further intensified, and (3) investors' concerns over economic vulnerability in emerging markets that could affect the global economy and capital flows and put pressure on asset prices as well as exchange rates. **Thus, the Committee would continue to closely monitor these developments going forward.**

Domestic Economic Conditions

The Thai economy continued to expand driven by both domestic and external demand. The **value of merchandise exports** was projected to expand at a slower pace in line with trading partners' growth and global trade prospects. In addition, the impacts of trade protectionism measures by the US and China were expected to be more pronounced next year. Nevertheless, relocation of production base to Thailand for some industries such as hard disk drives could partly lend support to and alleviate trade protectionism impacts on merchandise exports. **Exports of services** continued to expand on the back of a higher number of foreign tourists as well as a lower-than-expected adverse impact of the Phuket tour boat sinking incident. The number of Chinese tourists already started to recover in various areas; meanwhile, some tourists decided to postpone their travel plans to 2019 instead of cancelling them. In addition, the openings of new airline routes as well as capacity management by both airlines and airports would likely enhance tourism carrying capacity. The **value of imports** was projected to grow at a slower pace in tandem with exports but would be supported by improvements in private consumption. Growth momentum of domestic demand increased, particularly **private consumption** that continued to expand greater than previously assessed. This was attributable to continuous improvements in incomes and consumer confidence—particularly increases in earnings of low-income non-agricultural households in almost all sectors as well as increases in incomes of agricultural households thanks to increased supply of farm output—together with supports from government policies such as the first and second phases of the social welfare card scheme, the community enterprise development project, and the agricultural reform project. However, purchasing power improved only gradually due to elevated household debt and structural changes in the labor market such as (1) a high degree of labor mobility that allowed labor shortage in one sector to be alleviated by labor from another sector and (2) greater adoption of automation in place of labor in the production processes. These contributed to limited upward wage pressures. **Private investment** was expected to continue expanding in line with private consumption and capital outlays arising from production relocation to Thailand of some export-oriented industries. Moreover, growth prospects of private investment would be supported by continuous progresses in public infrastructure investment, the Eastern Economic Corridor (EEC), and the

Public-Private Partnership schemes. Regarding **public expenditure**, government consumption expenditure, particularly compensation of civil servants, was projected to increase at a slower pace given policy to replace vacant job positions with contract workers. Meanwhile, public investment continued to expand, despite construction problems in some central government projects and delays in some state-owned enterprise projects owing to operational difficulties including project revisions, funding reviews, and bidding process delays.

The Thai economy was projected to achieve the same growth rates as in the previous assessment at 4.4 percent and 4.2 percent in 2018 and 2019, respectively. The growth projection was mainly on the back of further improvements in private expenditure, both consumption and investment, as well as the faster-than-expected recovery after the Phuket boat incident, with the overall tourism growth momentum remaining intact. Meanwhile, merchandise exports were projected to grow in 2018 at a higher rate than expected but growth would be slightly lower in 2019 due to trade protectionism. Public expenditure would expand at a lower rate than expected this year, partly because some investment projects were postponed to 2019.

Risks to the growth forecast remained tilted to the downside albeit to a lesser extent compared with the previous projection. This resulted from a higher likelihood that the economy would exhibit a stronger growth than the baseline projection, particularly attributable to domestic demand which could expand more than projected, given possible further announcement of infrastructure investments and government measures to support private expenditure. Moreover, there were possibilities that trading partners' growth could be stronger than expected. The US economy would be supported by tax reform, while the Chinese economic slowdown could be less than expected. However, there remained possibilities that growth of the Thai economy would be lower than the baseline projection due mainly to external factors. Although impacts of the 200 billion dollar worth of tariff that the US imposed on China's exports were partially included in the baseline projection, there remained uncertainties pertaining to US trade protectionism and retaliatory measures that could be further announced. Additional downside risks included lower-than-expected growth of Thailand's trading partners that could arise if geopolitical conflicts and economic problems in emerging markets were to occur. In addition, there remained downside risks pertaining to domestic factors such as lower-than-expected private consumption as domestic purchasing power improved gradually.

The Committee assessed economic expansion to have become more broad-based. Private consumption and investment continued to improve supported by non-agricultural employment across every major sector, with agricultural employment remaining strong, and by the gradual improvement in earnings of low-income non-agricultural households. This would lend support to the Thai economy amid uncertainties pertaining to US trade protectionism that could be further announced as well as possible retaliatory measures from major trading partners. In this light, some Committee members noted that improvements in private consumption were partly supported by government measures, which were temporary, while elevated household debt as well as structural factors in the labor market remained a drag on consumption growth. As such, some Committee members deemed it necessary to monitor developments of purchasing power in the period ahead. Nevertheless, the Committee viewed that efficiency in budget disbursement and success of public investment projects as well as the Public-Private Partnership investment projects would be key factors to the economic growth going forward.

Headline inflation rose in August 2018 on account of fresh food prices falling only slightly, given damages to agricultural supply caused by heavy rainfall and given a less severe meat oversupply problem. **Core inflation** lingered at a low rate on account of prepared food prices, which were in turn affected by a decline in fresh food prices. Demand-pull inflationary pressures remained gradually increasing. **Overall public's inflation expectations** remained largely stable. Nevertheless, the Committee assessed that **headline inflation would increase in line with the previous assessment**, and thus maintained the projection of headline inflation for 2018 at 1.1 percent as the decline in fresh food prices was expected to be compensated by higher energy prices. However, headline inflation forecast for 2019 was revised down from 1.2 percent to 1.1 percent as increases in fresh food prices would likely be less than expected. This was partly attributable to technological development that induced higher productivity with lowering costs. **Core inflation was expected to rise in line with the previous assessment**, with the core inflation projection for 2018 maintained at 0.7 percent. However, the core inflation projection for 2019 was slightly revised down from 0.9 percent to 0.8 percent due mainly to prepared food prices. In addition, core inflation could be more persistent than in the past even though the economy was growing at full potential. This could be attributed to structural factors such as the expansion of e-commerce and heightened price competition. **Risks to the inflation forecast tilted to the downside** consistent with risks to the growth forecast and on the back of fresh food prices that could be lower than expected.

Monetary Policy Decision

The Committee assessed that the Thai economy continued to gain traction, with domestic demand and exports gaining further momentum. The annual average of headline inflation was expected to rise slowly in line with the previous assessment. However, downside risks still came from volatile fresh food and oil prices. Meanwhile, core inflation was projected to edge up at a slightly, albeit at a slower pace than previously assessed, mainly on the back of the gradual build-up of demand-pull inflationary pressures. Overall financial conditions were accommodative and conductive to economic growth. Financial stability remained sound overall. The Committee viewed that structural factors partly contributed to inflation becoming less responsive to economic growth despite the economy growing at potential. Meanwhile the Committee noted that it would be important to monitor the build-up of financial system vulnerabilities that could be seen in underestimation of potential changes in financial conditions, especially competition in the mortgage market that led to looser credit standards. 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. There was an increasing share of mortgage loans extended to borrowers for a second or more homes with credit standards deteriorating. Furthermore, the share of non-performing loans in mortgage loans increased. Meanwhile, the oversupply of condominiums in certain areas remained high.

In their policy deliberation, the Committee voted 5 to 2 to keep the policy rate unchanged at 1.50 percent. Two members voted to raise the policy rate by 0.25 percentage point to 1.75 percent. The Committee discussed key considerations underpinning policy decision. Their conclusions were as follows.

(1) The Thai economy continued to gain traction, with growth starting to become more broad-based as seen in several economic sectors. This was supported by a favorable domestic demand expansion on the back of improvement in income and consumer confidence as well as a broad-based increase in employment. Private investment continued to expand with additional support from government projects that became more concrete. Merchandise exports were expected to expand albeit at a slightly slower pace given the impact of trade protectionism. The Committee viewed that the Thai economy still encountered risks arising from possible additional announcement of US trade protectionism and retaliatory measures from US trading partners, which could affect supply chains in Asia and could result in trade diversion. Moreover, the Committee noted that appreciation of the baht relative to those of trading partner currencies could affect business competitiveness.

Most Committee members viewed that the current accommodative monetary policy stance remained necessary to support the continuation of robust economic growth. The strength of private consumption and progress on public investment must be monitored going forward. Meanwhile, **some members viewed that the economy was sufficiently robust and expanded above potential.** Moreover, they viewed that monetary policy was exceptionally accommodative for a prolonged period, as reflected in the policy rate that was in the down cycle since 2011 and remained at a low level for the longest period compared with other instances in the past. Therefore, they viewed that a gradual reduction in accommodative monetary policy toward a normal level would not affect economic growth. Instead, it would reduce financial stability risks, and this would be conducive to sustainable economic growth in the long term.

(2) Headline inflation was expected to rise gradually. However, downside risks remained as fresh food prices could be highly volatile depending on weather conditions and agricultural output. Meanwhile, core inflation was projected to slightly edge up given the gradual build-up of demand-pull inflationary pressures. Structural changes such as the expansion of e-commerce, heightened price competition, and productivity upgrades that reduced production costs could result in more persistent inflation than in the past even though the economy was growing at full potential. **The Committee viewed that current accommodative monetary policy had allowed the headline inflation trajectory to be consistent with the inflation target**. The Committee viewed that a prolonged period of low inflation was due mainly to supply-side factors and structural changes despite the economy continuing to expand. As such, some Committee members viewed that maintaining the current level of monetary policy accommodation would not accelerate inflation.

(3) Financial stability remained sound overall but there were some pockets of risks that had yet to show signs of improvements and might pose vulnerabilities to financial stability going forward. In the Committee's view the financial system showed signs of increased vulnerability in the property sector, where financial institutions competed in extending mortgage loans, willing to bear higher risks and resulting in loosening credit standards. In this regard, the risks that the Committee would monitor closely included (1) household debt accumulation which had yet to show clear signs of deleveraging, while the prolonged low interest rate environment and low rates of return could affect savings going forward and (2) other types of search-for-yield behavior in the prolonged low interest rate environment which could lead to underpricing of risks. For example, savings cooperatives continued to provide high returns to members, resulting in high growth of their assets that could pressure them to search for higher returns. Likewise, in the prolonged low interest rate environment the issuance of corporate bonds was concentrated among large corporations, which tended to invest more in non-core businesses and overseas businesses. This would pose greater risks to business operations.

Most Committee members viewed that financial stability risks remained manageable. Some risks might be self-correctable through market mechanism. Others could not be corrected through market mechanism, and thus macroprudential measures could be applied in order to address and prevent pockets of risks in some economic sectors. **However, some Committee members concerned that vulnerabilities might begin to build up in the financial system** that potentially affect sustainable economic growth in the long term. They viewed that vulnerabilities started to become widespread due partly to the prolonged low interest rate environment, which would induce households and businesses to underestimate potential changes in financial conditions. Consequently, relying only on macroprudential measures would not be sufficiently effective.

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 the target, the need for currently extra accommodative monetary policy would start to be gradually reduced, and the need for a policy rate increase in order to build up policy space in the future would be increasing. The Committee's evaluation of the appropriate conditions would be data dependent, including careful assessment of the outlook of economic growth and inflation, as well as risks especially on the external front.

Monetary Policy Group
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