**Edited Minutes of the Monetary Policy Committee Meeting (No. 8/2017)**

**20 December 2017, Bank of Thailand**

**Publication Date: 3 January 2018**

## Members Present

Veerathai Santiprabhob (Chairman), Paiboon Kittisrikangwan, Porametee Vimolsiri, Sethaput Suthiwart-Narueput, Kanit Sangsubhan, and Subhak Siwaraka

## Member Absent

Mathee Supapongse (Vice Chairman)

## The Global Economy

**The global economy was growing well overall.** Thailand's trading partners continued to expand with improved and more broad-based growth compared with the previous assessment, driven primarily by consumption and manufacturing production in advanced economies as well as Asian exports. **Advanced economies** saw robust growth, especially in consumption and manufacturing production, and were supported by improved consumer confidence and labor market conditions. Private investment showed clearer recovery signs as business confidence improved alongside strong earnings. **Asian economies and China** grew faster than previously assessed mainly on the back of exports. In the period ahead, Asian export growth might slow down somewhat following this year's acceleration but would still be sustained by growth in advanced economies and demand for electronic goods. **Inflation in trading partner economies** was increasing gradually thanks to the recovery in oil and fresh food prices, with signs of core inflation picking up in advanced economies. It was also expected that demand-pull inflationary pressures would increase further going forward as advanced economies edged closer to potential. **Most trading partners' central banks maintained accommodative monetary policy stance**, although some central banks in both advanced economies and Asia began raising policy rates as the economic recovery firmed and inflation approached their respective targets. Against such backdrop, **the Committee viewed that risks to global economic growth were balanced** as opposed to the previous assessment where downside risks outweighed upside risks. In particular, this was due to the increased likelihood that Thailand's trading partners would achieve faster-than-expected growth as a result of the strong investment outlook in advanced economies as well as additional stimulus measures implemented in China. Meanwhile, downside risks remained largely unchanged. Risks pertaining to US economic and foreign trade policies as well as geopolitics continued to warrant monitoring going forward.

## The Financial Markets

**Sentiments in Asian financial markets improved** due to a more positive growth outlook in many economies, potential policy rate hikes as communicated by some central banks in the region, and lower perceived risks of emerging Asian assets. Meanwhile, the US dollar was negatively affected by uncertainties on the US tax reform and a more gradual monetary policy normalization of the Federal Reserve (Fed). **These developments resulted in continued capital inflows into regional financial markets, although the size of inflows into the Thai bond market was smaller relative to regional peers.** Meanwhile, foreign investors reduced their investment in Thai stocks partly because companies listed on the Stock Exchange of

Thailand (SET) did not benefit from the global economic recovery to the same extent as those listed on regional markets. Nevertheless, the **SET Index** still edged up because of purchases by domestic investors. **Short-term bond yields in Thailand** remained below the policy rate. **On exchange rates, the baht's movement relative to those of trading partner currencies was largely unchanged from the previous meeting.** The **Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER)** appreciated slightly in line with Thailand's improving economic fundamentals. In the period ahead, exchange rates might undergo volatile movements as a result of external factors especially uncertainties pertaining to the US tax reform as well as the conduct of fiscal and monetary policies in advanced economies. Hence, the Committee would continue to closely monitor developments in the foreign exchange markets going forward.

**The Committee discussed the risk of possible price corrections in US stock and bond markets**. The Committee noted that recent upticks in US stock indices stemmed from more optimistic views regarding the ongoing deregulation policy that would lower operational costs for businesses, together with expectations regarding the outcome of the tax reform bill. Nevertheless, the Committee viewed that recent investment decisions in financial markets were mostly driven by short-term factors such as economic outturns compared with market expectations, rather than by medium-term fundamentals such as monetary policy normalization by the Fed or fiscal deficits that would result from the tax reform. Hence, if investors were to put more weight toward these medium-term factors in their investment decisions, it could lead to significant corrections in US government bond yields, thereby posing a risk to financing conditions for businesses in the period ahead.

## Domestic Economic Conditions

**The Thai economy gained further traction** driven by growth in the external sectors as well as the gradual recovery in domestic demand. **The value of merchandise exports** continued to expand in both quantity and price terms as the global economic recovery strengthened. **Tourism** also grew given the higher tourist numbers in almost all nationality groups. In particular, the number of Chinese tourists became higher than that seen prior to the implementation of measures to curb illegal tour operators and was made up of the visitors with higher spending per head. Regarding the ongoing domestic demand recovery, **private consumption** continued to expand albeit at a gradual pace given that improvements in income growth were not yet sufficiently broad-based. While spending on durable goods was growing driven by improved purchasing power of non-agricultural households with higher income, the underlying strength of consumption growth remained soft as income of some non-agricultural households, especially those with lower income, was affected by decreased hiring. Farm income was gradually improving, although some households were affected by declining agricultural prices. Meanwhile, household debt remained high and household confidence with regard to future income had yet to show clear improvements. **Private investment** picked up at a gradual pace as reflected in outlays for machinery and equipment, as especially reflected by imports of capital goods and sales of commercial vehicles. Nevertheless, investment in construction slowed down somewhat. In the period ahead, private investment was projected to continue expanding with support from growing exports and consumption, together with government policies especially infrastructure investment and the Eastern Economic Corridor (EEC) projects. **Public expenditure** remained an important growth driver but might slow down somewhat from delayed disbursement for investment spending. In particular, public investment was projected to decline due to (1) the downward revision of the supplementary budget for fiscal year 2017 earmarked for carry-over expenditure and (2) the postponement of some state-owned enterprise (SOE) investment plans.

**The Committee projected that the Thai economy would achieve a faster growth rate than the previous assessment**. The growth forecast for 2017 was revised to 3.9 percent, up from 3.8 percent on account of the better-than-expected third quarter outturn, according to which improved merchandise exports thanks to stronger trading partners' growth offset the lower-than-expected growth in public expenditure and domestic demand. **The Thai economy was projected to continue expanding in 2018** with the growth forecast also revised up to 3.9 percent from 3.8 percent. The upward revision was mainly on account of stronger-than-expected growth in the external sectors, while domestic demand would likely expand at a slightly slower pace than previously assessed due to temporary postponement of some infrastructure investment projects. On the whole, the Thai economy remained on a steady growth path. **Risks to the growth projection were deemed balanced given increased upside risks from the stronger growth among trading partner economies**. Other upside risks included domestic factors, namely public infrastructure investments and spending of funds accumulated by local administrative organizations that could be implemented faster than expected. Nevertheless, there remained downside risks stemming from the external front, such as US economic and foreign trade policies as well as geopolitical risks, and domestically from private demand that might not be as strong as expected should the recovery in purchasing power still not broaden out.

**The Committee also engaged in an extensive discussion on the various factors that could affect Thailand's growth outlook.** First, export growth would be expected to decelerate in 2018. This was due to a potential slowdown in global trade and oil prices after having picked up strongly in earlier periods as well as the high base due to this year's export expansion. In addition, the positive effects of special factors, such as the relocation of production base for electronics and electrical appliances to Thailand and the inventory buildup within the electronics industry, were expected to dissipate. Nevertheless, the monthly average value of exports for 2018 would likely be higher compared with previous years. Some Committee members meanwhile viewed that export growth could be stronger than expected due to trading partners' growth. Second, the slowdown in public expenditure in 2017 was in part attributed to temporary limitations in accessing construction sites during inclement weather conditions. Nevertheless, public investment was expected to pick up given the increased budget allocation for investment spending and given SOEs showing readiness for undertaking investment projects. Some Committee members also expected that the crowding-in effects of public investment on private investment might be larger than expected, especially those related to the EEC projects. Third, while the Thai economy overall was gaining traction, growth had yet to trickle down sufficiently and in a more broad-based manner to employment and household income. This was reflected by the decline in employment within non-agricultural sectors, especially the low-paid daily hire employees in manufacturing and construction and the self-employed commercial business owners. This was in part a result of structural factors such as the adoption of automation by businesses, aging population, and competitiveness issues faced by Thai firms. Some Committee members viewed that such development was partly cyclical in nature and thus employment conditions should improve as economic growth continued. Nonetheless, the Committee viewed that employment and household income remained issues that must be monitored closely going forward.

**Headline inflation edged higher in November 2017** mainly as a result of rising energy prices. **Core inflation** rose slightly due to the excise tax hike on tobacco as well as the termination of free public bus and train services. Demand-pull inflationary pressures picked up somewhat but overall remained low, as economic growth was not yet broad-based and labor income had yet to fully recover. Structural changes also contributed to more persistent inflation than in the past. Meanwhile, the public's **inflation expectations** appeared to stabilize after inflation outturns improved. **The Committee revised up the headline inflation forecast for 2017** to an annual average of 0.7 percent on account of higher-than-expected gains in fresh food and oil prices in the third quarter, while the core inflation forecast remained close to previous assessment. The **headline inflation and core inflation projections for 2018** were revised down to annual averages of 1.1 and 0.8 percent, respectively. This downward revision was due to the fact that the impacts of the excise tax increase and the termination of free public bus and train services were smaller than expected. **Risks to inflation projections were deemed balanced** in line with the balance of risks to current growth forecasts. On the upside, inflation might turn out higher than forecast should crude oil prices pick up further with global growth. On the downside, inflation might turn out lower than forecast if economic growth turned out below expectations.

**Growth in commercial bank loans remained low overall** partly due to debt repayment by large corporates as well as the switch to bond and equity financing by businesses in manufacturing, real estate, and construction sectors. Nevertheless, loans extended to small-to-medium enterprises (SMEs) picked up and broadened to a broader range of businesses, which reflected ongoing economic growth. Consumer loans also expanded in all purposes. In addition, increases in loan applications and loan utilization reflected growing demand for business and consumer loans, although commercial banks remained cautious in approving consumer loans. With regard to **credit quality**, the non-performing loan (NPL) ratio remained stable overall, except for consumer loans which rose across all loan purposes especially housing loans. NPLs of SMEs started to decline for those in export-related sectors, which were growing well recently, but were still on the rise for those in commerce, construction, and agro-manufacturing. The Committee still expressed concerns regarding credit quality of SMEs that were unable to adjust to the improved economic conditions sufficiently fast. In particular, some SMEs were affected by structural problems, namely the inability to adjust their current business models in order to maintain competitiveness. This was especially the case for retail businesses. Some Committee members viewed that rising NPLs of SMEs might partly be a result of the debt write-off process which could take time given the lengthy legal processes when involving a large amount of collateral.

## Monetary Policy Decision

The Committee assessed the Thai economy to have gained further traction and would likely achieve faster growth than in the previous assessment, driven by growth in the external sectors as well as a gradual recovery in domestic demand. Nevertheless, factors underpinning private consumption remained soft. Headline inflation was still rising at a gradual pace as previously assessed, but the inflation forecasts were revised down slightly mainly because the effects of the excise tax hike and the termination of free public bus and train services were smaller than expected, both of which were non-demand factors. Overall financial conditions remained accommodative and conducive to economic growth as reflected by low funding costs for businesses through both credit and bond markets. Financial stability remained sound but there were pockets of risks that warranted close monitoring as they might result in the build-up of financial vulnerabilities going forward. The Committee considered the benefits and costs 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, the Committee discussed key considerations underpinning policy decision.** Their conclusions were as follows.

**(1) While the Thai economy gained further traction, it was still below potential and thus inflationary pressures remained subdued.** Although the macroeconomic outlook was clearly improving, with signs of SMEs in many sectors beginning to gain benefits, the factors underpinning domestic demand, especially employment conditions, remained soft. Together with the effects of elevated household debt, these factors resulted in relatively low demand-pull inflationary pressures at present. In this regard, the Committee viewed that an accommodative monetary policy stance was still necessary to foster stronger domestic demand going forward.

**(2) Financial stability remained sound overall. However, there remained pockets of risks that might result in the build-up of vulnerabilities in the financial system going forward**, for example, underpricing of risks that stemmed from the search-for-yield in the prolonged low interest rate environment. In particular, there appeared to be signs of risk underpriced on a broad scale including growing household debt, issuance of unrated bonds, investments in non-core business activities by large corporates, and rapid growth of foreign investment funds (FIFs). While these risks were still benign, the Committee saw the need to closely monitor their developments going forward. In addition, some Committee members viewed that risks to financial stability had receded somewhat after the implementation of targeted measures and regulatory upgrade by supervisory authorities over the recent periods. Specifically, these were the implementation of enhanced regulations on credit card and personal loans, revised regulations on the issuances and sales of debt securities, and an enhanced legal framework and supervisory processes for savings cooperatives.

**In this light, the Committee assessed policy trade-offs and unanimously voted 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
3 January 2018