BANK OF THAILAND

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Monetary Policy Report, March 2017

Mr. Jaturong Jantarangs, Assistant Governor of the Bank of Thailand (BOT) and Secretary of the Monetary Policy Committee (MPC), released the March 2017 issue of the *Monetary Policy Report*. The *Report*, published quarterly, is aimed at enhancing public understanding of the MPC's policy stance and its assessment of Thailand's economic outlook. Details are summarized as follows.

1. Global Economy

Advanced economies continued to recover. This was particularly the case for the U.S. economy where labor market conditions strengthened with investment poised to increase. The euro area economies gained traction through domestic consumption, while the Japanese economy continued to recover at a gradual pace. The Chinese economy was expected to slow down as a result of the ongoing economic reforms; however, the economic recovery in other Asian economies was expected to continue, driven by exports, especially those of electronic goods which benefited from the technological upcycle and the uptrend of Internet of Things (IoT) products. Overall, **trading partner growth was revised upward**. While there were greater upside risks compared with the previous assessment in the case that U.S. economic stimulus measures would turn out to be more effective than expected, **the balance of risks to the trading partner growth forecast remained skewed downward**. This was due to U.S. trade policies, which involved potentially greater risks and uncertainties than the previous assessment. Meanwhile, risks concerning financial stability in China, political uncertainties in Europe, and problems faced by the European banking sector were judged to be unchanged from the previous assessment.

Most central banks continued their accommodative monetary policy, although policy accommodation was expected to phase down due to improvements in the global economic and inflation outlook. Despite the future direction becoming clearer, there remained uncertainty surrounding the timing and pace of U.S. monetary policy normalization. There was also considerable uncertainty about the U.S. administration's economic policies. These uncertainties were important in determining investors' expectations. Consequently, volatilities in global financial markets were to be expected on the back of increased uncertainties, potentially resulting in volatile capital flows both into and out of emerging markets.

Oil prices were projected to decline in the near term before trending upward later in line with the OPEC's agreement to cut production and the global economic recovery. However, taking into account uncertainty over the OPEC's compliance and the possibility of a swift response of the global oil supply to higher prices, the Monetary Policy Committee revised the projection of the Dubai oil price down to 52.3 dollars per barrel in 2017. The oil price was projected to rise to 54.8 dollars per barrel in 2018.

2. Recent Economic Developments

The Thai economy in the fourth quarter of 2016 continued to recover on the back of private consumption and public spending as well as the rebound in merchandise exports. Meanwhile, **headline inflation over the first two months of 2017 continued to rise relative to the rate seen at the end of last year**, due largely to higher energy prices. Meanwhile, core inflation slowed down slightly.

Financial conditions remained accommodative. Long-term government bond yields rose due to external factors while short- and medium-term government bond yields increased only slightly. Business loans showed signs of higher growth, especially working capital loans extended to exporters and agriculture-related commercial businesses. Household loans slowed down in most categories. This was particularly the case for growth in credit card loans that significantly declined after having accelerated due to government stimulus measures during the end of last year. Meanwhile, the baht against the U.S. dollar appreciated in the same direction as regional currencies due to the weakening of the U.S. dollar, as market participants viewed details of U.S. economic stimulus policies still unclear. **Financial stability remained sound overall.** The defaults of bills of exchange (B/E) issued by unrated companies since the end of last year had a limited impact on the financial system and did not affect overall corporate bond issuance.

3. Economic Outlook

In the period ahead Thailand's economic recovery was expected to gain further traction from 2016. The economy was projected to record growth of 3.4 percent and 3.6 percent in 2017 and 2018, respectively.

Export growth showed a steady recovery as seen in many products. The value of merchandise exports was projected to expand by 2.2 percent in 2017 led by (1) electronics products due to the increased popularity of smartphones and IoT devices, (2) electrical appliances that benefitted from improved external demand, and (3) the relocation of manufacturing sites to Thailand of products such as vehicle tires and solar cells. Moreover, export prices of commodities and petroleum-related products were forecast to trend upward along with crude oil prices.

Exports of services experienced a quick recovery and were projected to continue expanding after the impact of measures to curb illegal tour operators subsided. In addition, the extension of visa fee reduction/exemption as well as the Chinese government's restriction on sales of tour packages to South Korea were likely to bring in more Chinese tourists to Thailand. Therefore, the Committee revised up the projection of the number of foreign tourists to 34.5 million in 2017.

Public spending remained an important driver of growth and was expected to record a higher figure than the previous assessment despite a delay in parts of the dual-track railway project due to the revision in the government's procurement processes. This upgraded public spending projection was attributable to clearer investment plans under the Pracharat project, the higher-than-expected fiscal budget for fiscal year 2018, and the faster-than-expected budget disbursement for telecommunications infrastructure upgrade.

Private consumption was expected to continue recovering. Key supporting factors are (1) improvements in farm income due to higher rubber prices and higher rice output, (2) a positive income outlook for households in the service sector, and (3) some increase in purchasing power following the gradual completion of loan repayments under the first-car scheme. However, overall income and employment might have not yet benefitted clearly from the recovery in merchandise exports, as the exports improvements were largely concentrated in the sectors which relied more on capital rather than labor for production.

Private investment showed signs of recovery in some sectors such as telecommunications, electronics, and alternative energy. Although investment might not gain much from the recovery in private consumption and merchandise exports at this stage, as there remained excess production capacity, private investment was expected, going forward, to pick up once consumption and exports growth become firmer.

Headline inflation was projected to gradually rise and approach the midpoint of the target due to the phasing out of the base effect from last year's lower oil prices as well as increased demand pressure from the economic recovery. Nevertheless, headline inflation might fluctuate in the near term due to the base effects of higher fresh food prices during the drought last year. At the same time, downside risks increased, attributable to global oil prices that faced downward pressures due to uncertainties pertaining to global oil supply. **Headline inflation was projected to average at 1.2 and 1.9 percent in 2017 and 2018, respectively.**

The balance of risks to growth and inflation forecasts tilted towards the downside and to a greater extent compared with the previous assessment. This was on account of (1) uncertainty surrounding the U.S. foreign trade policies that could undermine exports and (2) financial stability concerns in China that could slow down China's economic growth further. Nonetheless, there remained a possibility that the Thai economy would grow at a faster rate than the baseline projection if public investment were to crowd in further private investment and if U.S. economic stimulus policies turned out to be more effective than expected.

4. Monetary Policy Deliberation

In the Monetary Policy Committee meetings on 8 February and 29 March 2017, the Committee unanimously voted to keep the policy rate on hold at 1.50 percent. In deliberating their policy decision, the Committee considered that the growth outlook improved and that the economy would expand at a faster pace than the previous assessment. This was on account of a steady recovery in exports and a quick turnaround in tourism. However, the positive spillovers from improvements in exports to employment and income remained limited. Private consumption and private investment, however, continued to recover at a gradual pace. Meanwhile, headline inflation had reached the lower bound of the target and was expected to gradually rise despite a downward revision to the forecasts due to lower inflation outturns and the recent decline in oil prices.

Overall financial conditions remained accommodative. Total corporate financing increased mainly for those businesses with robust recoveries. Meanwhile, the increase in long-term bond yields had a limited impact on financing costs because Thai businesses mainly issued short- and medium-term debt. The baht appreciated somewhat against major trading partners' currencies over the recent period, partly due to Thailand's relatively strong external position. In the period ahead, capital flows and exchange rates would continue to experience heightened volatility, and thus proper foreign exchange risk management on the part of the private sector would become increasingly important.

Financial stability remained sound. However, there remained pockets of risks that warranted close monitoring such as the deterioration in debt serviceability of SMEs and households, yieldseeking behavior that might lead to underpricing of risks, and shadow banking activities together with other risks that potentially remained unnoticed. Moreover, the prolonged period of low interest rates amid the rise in long-term bond yields might induce some businesses to rely more on issuance of short-term bonds which could pose a risk if there were maturity mismatches between assets and liabilities. In addition, collaboration among relevant regulatory agencies would play a greater role in reducing vulnerability buildups in Thailand's financial system.

Monetary policy should remain accommodative until the economy achieved a broader and firmer growth which would facilitate the return of inflation to the midpoint of the target, especially given that there remained uncertainties on the external front particularly those pertaining to the fragile global economic recovery and the U.S. foreign trade policies that might undermine export recovery. The Committee would stand ready to utilize an appropriate mix of available policy tools in order to ensure that monetary conditions remained conducive to the continuation of economic growth while ensuring financial stability.

Bank of Thailand

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