



BANK OF THAILAND

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Monetary Policy Report, March 2018

Mr. Jaturong Jantarangs, Assistant Governor of the Bank of Thailand (BOT) and Secretary of the Monetary Policy Committee (MPC), released the March 2018 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.

Monetary Policy Conduct in the First Quarter of 2018

The Committee assessed that the Thai economy continued to gain further traction, driven by improved growth in exports and tourism in tandem with the global economy and domestic demand. In addition, private consumption would continue to gradually increase. Headline inflation would trend up albeit at a slightly slower pace than previously assessed due to large supply of meat, vegetables, and fruits in the market which led to a decline in prices. The increase in the buildup of risks to financial stability from a prolonged low interest rate environment in certain pockets still warranted close monitoring. Against this backdrop, **the Committee had to weigh various factors in formulating the most appropriate course of monetary policy in order to attain the objectives of sustainable economic growth and price stability while preserving financial stability. The Committee voted unanimously and later 6 to 1 to keep the policy rate unchanged at 1.50 percent at the meetings on February 14 and March 28, 2018 respectively.** In deliberating their decision, the Committee judged that accommodative monetary policy stance would still be necessary to support a more robust growth in domestic demand which would foster the return of headline inflation to target. Moreover, the Committee viewed that the policy rate at 1.50 percent remained appropriate in that it would facilitate sufficiently accommodative financial conditions, as reflected in low real interest rates and continued improvements in private sector financing through commercial banks and financial markets. One committee voted to raise the policy rate by 0.25 percentage point to 1.75 percent at the meeting on March 28, 2018 as the unusually low interest rates for a prolonged period might prompt households and businesses to underestimate risks to potential changes in financial conditions in the future. Furthermore, a gradual, timely reduction in monetary policy accommodation would not hinder economic growth or price stability. It would instead help alleviate risks to financial stability in the future and facilitate a smooth process of monetary policy normalization.

Looking ahead, the Committee deemed that monetary policy accommodation should be maintained for some time to support a more robust economic growth and foster the gradual return of headline inflation toward the medium-term target. The Committee would stand ready to utilize available policy tools to facilitate the return of headline inflation to target in an appropriate time, while seeking to achieve sustainable economic growth and maintaining financial stability.

Assessments of the Economic and Inflation Outlooks as the Basis for Policy Formulation

1. Global Economy

The global economy was projected to continue expanding and remained a driver of Thai exports in the period ahead. Advanced economies would expand further due mainly to consumption and exports. Moreover, the U.S. would exhibit a higher growth than previously expected on account of the U.S. tax reform policy, a strong labor market, and improved consumer confidence. The euro area would also record a stronger growth than the previous assessment on the back of exports and domestic demand. In addition, accommodative financial conditions, improved private sector confidence, and a gradual recovery in the labor market conditions would continue to support growth going forward. Japan would see growth across all economic sectors with private consumption expected to rise from robust consumer confidence and improved labor market conditions. The Chinese economy was expected to gain further traction despite some slowdown, consistent with its economic growth target for 2018 and the government's economic reforms. Meanwhile, other Asian economies would continue expanding following robust growth in exports across various product categories which would underpin employment and household consumption in the period ahead. **The Committee therefore revised up the growth forecast for Thailand's trading partners from 3.5 percent to 3.7 percent in 2018.** However, there remained certain risks that warranted monitoring including (1) an increase in import tariffs by the U.S. which might lead to retaliatory measures by major economies which could cause a direct impact on trade volume and an indirect impact on prices as well as productions in global supply chains, (2) uncertainties surrounding other U.S. economic policies such as infrastructure investment policy, and (3) geopolitical risks that could intensify and undermine the economy and financial markets.

Most central banks maintained accommodative monetary policy stance. Nonetheless, some central banks gradually reduced the degree of monetary policy accommodation following improvements in economic and inflation outlooks. The Federal Reserve (Fed) raised its policy rate in March 2018 as the market expected, while the European Central Bank (ECB) adjusted its forward guidance, reflecting the possibility of a sooner-than-expected reduction in the degree of monetary policy accommodation in the future. Moreover, a number of central banks in Asia started to signal a monetary policy normalization in the period ahead given improved economic growth and a slow rise in inflation.

2. Financial Conditions and Financial Stability

Financial conditions remained accommodative. The market correction which resulted in lower asset prices in the global financial market did not have a significant effect on Thailand's financial markets. Short-term bond yields remained below the policy rate due to a decreased supply of short-term bonds and an increased demand from foreign investors. Medium- and long-term bond yields declined at the beginning of the year owing to higher demand from both Thai and foreign investors. Subsequently, the yields gradually edged up in line with U.S. government bond yields, albeit remaining low due to following reasons. First, net supply of Thai government bonds was low as a number of bonds reached their

maturities during the first quarter of the year. Second, Thai government bond yields were more attractive relative to other regional countries and thus continued to attract foreign investors into Thai bond markets. Third, Thailand's inflation expectations remained low. Meanwhile, interest rates on new loans (NLR) remained at low levels, reflecting accommodative financial conditions. Overall private credit expanded on the back of both corporate and household sectors. In particular, SME loan growth improved across various sectors, reflecting a more broad-based economic recovery. Furthermore, business financing through bond and equity markets continued to increase. Meanwhile, household loans expanded in all categories, particularly auto leasing. With regard to exchange rates, the baht appreciated against the U.S. dollar from the previous quarter due to the weakening of the U.S. dollar. Such appreciation was in line with movements of most regional currencies, but the pace of appreciation varied depending on country-specific factors. The real effective exchange rate (REER) somewhat appreciated consistent with improving economic fundamentals.

Financial stability remained sound but there remained pockets of risks that warranted monitoring. These included, first, some sign of accelerating household debt while debt serviceability of some households continued to deteriorate. Second, some SMEs which continued to incur losses would see deterioration in their abilities to service debt and cushion against economic volatilities. Third, the search-for-yield behavior persisted given a prolonged low interest rate environment which could lead to underpricing of risks. Such behaviour included, for instance, a large expansion of foreign investment funds (FIF) with high concentration in some countries. Moreover, assets and deposits surged among savings cooperatives despite some slowdown after the revised regulations to upgrade supervision practices. Fourth, there was also an oversupply of property in certain price ranges and areas. This was particularly the case for condominiums with price below three million baht whose supply continued to rise.

3. Economic and inflation outlook

The Thai economy was projected to continue expanding and record 4.1 percent growth in 2018 and 2019, higher than previously estimated in the previous Monetary Policy Report. The upward revision was on account of a continued improvement in merchandise exports and tourism, thanks to robust growth of trading partners and a gradual expansion in private spending, which would be partly supported by government measures aimed at improving the well-being of low-income households.

Merchandise exports continued to expand across various product categories and almost all export destinations. The value of merchandise exports in 2018 was revised to grow by 7.0 percent, up from 4.0 percent assessed in the previous quarter, in tandem with economic expansion of trading partners. Such improvement was observed particularly among exports of electronics, auto parts, and processed agricultural products. Electronics exports would see growth especially in electronic components related to the Internet of Things (IoT) and electronic parts used in automobile. Nonetheless, the increase in import tariffs by the U.S. was expected to have a limited impact on Thai exports in the short term as only a small share of Thai products in total Thai exports would be subject to these new tariffs.

However, downside risks to export growth increased as retaliatory measures could impact major trading partners' growth, especially through supply chains, thereby weighing on international trade and Thai exports in the period ahead. Moreover, export prices, especially for commodities and oil-related products, would likely trend up in line with oil prices. Meanwhile, import value would also rise following increased demand for raw materials and intermediate goods consistent with the improved growth and higher oil prices.

Exports of services in 2018 were expected to expand in line with continued improvement in tourism. The projection of the number of foreign tourists was revised up to 37.6 million in 2018, up from the previous forecast of 37.3 million. The upgrade was on account of a steady growth in the number of Chinese tourists, both group and independent tourists. In addition, Indian tourists would likely increase in the period ahead after the Indian authority granted Thai airlines additional capacity entitlements under bilateral air services agreements since March 2018. However, Thailand still faced capacity constraints in accommodating the rising number of tourists in the main airport, although such constraints were somewhat lessened in recent periods with increasing roles of local airports operated by the Department of Airports and the Ministry of Defense, especially Krabi, Suratthani, and U-tapao Airports, in facilitating international flights.

Private consumption would gradually expand in the period ahead, supported by income among non-agricultural households with medium-to-high income. In addition, signs of improvement in earnings of low-income households began to be observed as employment picked up in export-related businesses and the tourism sector. On the other hand, household income in some agricultural sectors was projected to slow down in line with agricultural prices. Nevertheless, overall household purchasing power gradually improved. This was partly a result of structural changes in the labor market such as adoption of automation in place of human labor in the production process as well as a decline in agricultural prices which made farming unattractive. Hence, these led to greater migration of workers out of the manufacturing and agricultural sectors to the services sector. Nevertheless, some workers might earn less as they migrated to certain parts of the services sector with relatively lower wages. Moreover, elevated household debt underlined the fact that workers still needed to earmark part of their income for debt repayment. Nonetheless, government measures aimed at improving the well-being of the low-income households—such as the social welfare card project (second phase) and the community enterprise development project—would partly help raise private consumption in the period ahead.

Public spending remained a driver of economic growth on the back of expansion in public consumption and investment. However, public expenditure was lower than previously estimated because the impact from the Public Procurement and Supplies Management Act, B.E. 2560 on government disbursement was larger and longer than expected. In particular, disbursement by certain state agencies, especially local governments, was significantly affected, where those agencies would need some times to adjust. Meanwhile, most investment projects of state-owned enterprises (SOEs) were not affected by

the new law, but some projects were postponed due to delays in contract signing and problems in accessing construction sites.

Private investment would continue to improve, consistent with growth of exports and private consumption. Such improvement was partly reflected by a rising demand for business credits and accelerated value of investment application submitted to the Board of Investment at the end of 2017. Moreover, investment incentives offered by the government would play an important role in driving private investment, particularly through public-private partnership, government infrastructure investment projects, and the Eastern Economic Corridor (EEC) initiative whose prospects became more certain. Therefore, this would help promote business confidence and also attract foreign investment.

Headline inflation remained low due to supply-side factors but was expected to slowly rise. In recent periods, headline inflation stabilized at a lower level than previously estimated. This was owing to a contraction in fresh food prices following declined prices of meat, vegetables and fruits, stemming from a large supply in the market. Going forward, headline inflation would slowly rise as cost-push inflationary pressures increased at a slower pace given that fresh food prices were projected to remain low, while the impact from minimum wages increases in 2018 on inflation was largely limited. Moreover, demand-pull inflationary pressures remained close to the previous estimate. **The Committee therefore projected headline inflation to average 1.0 and 1.2 percent in 2018 and 2019 respectively, while core inflation was projected to average 0.7 and 0.8 percent in 2018 and 2019 respectively.**

Risks to the growth projection were expected to tilt to the downside. The Thai economy would face greater risks from the U.S. foreign trade policy and retaliatory measures from major economies. As a result, this might weigh on trading partners' growth to a larger extent than previously assessed, despite some improvements in geopolitical risks related to the Korean Peninsula. Moreover, domestic risks included a larger-than-expected impact from the Public Procurement and Supplies Management Act on public expenditure, and a lower-than-expected domestic spending as improvement in purchasing power was not yet sufficiently broad-based. However, on the upside, there were possibilities that the growth outcome might be higher than the baseline projection given a better-than-expected growth outlook of Thailand's trading partners with supporting factors including the U.S. tax reform, Chinese government measures which could soften its economic slowdown, better-than-expected Asian exports, as well as government infrastructure investment which could stimulate a higher private investment than the baseline projection. **Risks to the inflation projection were also assessed to tilt to the downside** consistent with risks to the growth forecast.

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