BANK OF THAILAND

BOT Press Release

Communications and Relations Office, Corporate Communications Department
Tel. +66 2283 5016-7 Fax. +66 2283 6969 www.bot.or.th

No. 1/2019

Monetary Policy Report, December 2018

The Bank of Thailand (BOT) released the December 2018 issue of the *Monetary Policy Report*. The *Report*, published quarterly, is aimed at enhancing public understanding of the Monetary Policy Committee (MPC)'s policy stance and its assessment of Thailand's economic outlook. Details are summarized as follows.

Monetary Policy Conduct in the Fourth Quarter of 2018

In the Committee's view, the Thai economy continued gaining traction and expanded at the level consistent with its potential. Headline and core inflation were projected to be broadly in line with the previous assessment. Financial stability remained sound overall, but it was deemed necessary to monitor risks that might lead to the build-up of vulnerabilities in the financial system. **The Committee weighed various factors in determining the most appropriate course of monetary policy and voted 4 to 3 at the meeting on November 14, 2018 to maintain the policy rate at 1.50 percent and voted 5 to 2 at the meeting on December 19, 2018 to raise the policy rate by 0.25 percentage point to 1.75 percent.** At the latest meeting, most Committee members viewed the continuity of economic expansion sufficiently strong. The need for currently extra accommodative monetary policy as in the previous period had thus reduced and the policy rate should be raised to curb financial stability risks and to start building policy space. Moreover, the policy rate at 1.75 percent would still be conducive to continuous economic growth. Nonetheless, two members viewed that risks and uncertainties on the external front heightened and could affect Thailand's economic growth in the period ahead and thus saw the need to assess the clarity of such impacts on the sustainability of domestic growth momentum. In addition, the implemented macroprudential measures had addressed certain risks to financial stability to some extent.

Looking ahead, the Thai economy was projected to continue to gain traction despite the slowdown in external demand. The Committee viewed that accommodative monetary policy would remain appropriate in the period ahead. The policy rate increase would be gradual and not in a continuous manner as in the past. The Committee would thus closely monitor developments of economic growth, inflation, and financial stability, together with associated risks, in deliberating appropriate monetary policy in the period ahead.

Assessment of the Economic and Financial Outlook as the Basis for Policy Formulation

1. Global Economy

The global economy was expected to expand at a slower rate due to lower-than-expected outturns in several countries during the third quarter of 2018. However, most Thailand's trading partners would still operate above potential. While there was additional momentum from the U.S. economy due to greater fiscal stimulus expected to take effect in 2019, growth momentum from other countries would slow down because domestic demand was affected by tightening financial conditions, less fiscal stimulus, as well as uncertainties regarding the U.S. trade protectionism measures and political issues in the euro area. **The Committee thus revised down the growth projection of Thailand's trading partners to 3.6 and 3.4 percent in 2018 and 2019, respectively. The projections would be subject to increased downside risks** mainly due to an increased likelihood of the no-deal Brexit. Other risks that warranted monitoring included uncertainties pertaining to the trade protectionism measures, geopolitical risks, and China's financial stability concerns.

Most central banks started to reduce the degree of accommodative monetary policy. The U.S. Federal Reserve (Fed) still gradually normalized its monetary policy. The European Central Bank (ECB) would end new bond purchases at the end of 2018 as announced, but would roll over matured bonds and was expected to maintain its interest rate until the second half of 2019. The Bank of Japan would likely maintain their short-term and long-term target rates for some time. On the other hand, some regional central banks raised their policy rates in the fourth quarter of 2018, for instance, the Bangko Sentral ng Pilipinas, Bank Indonesia, and the Bank of Korea. Looking ahead, other countries in the region were expected to gradually normalize their monetary policy to be consistent with the economic growth outlook and to preserve price and financial stability.

Emerging markets (EMs) experienced capital outflows, as investors viewed the prospect of the Fed's rate hikes to be more certain and there were concerns over intensifying trade protectionism measures by the U.S. and heightened political uncertainties in Europe. Nonetheless, capital flows partly returned to EMs after such concerns somewhat alleviated. Looking ahead, global financial markets would likely remain highly volatile. EM capital flows could fluctuate given uncertainties surrounding the Fed's future rate hikes, possibly intensifying trade protectionism measures after the announcement of temporary suspension of new tariffs, and uncertainties pertaining to Brexit negotiations which warranted close monitoring.

2. Financial Conditions and Financial Stability

Thailand's financial conditions remained accommodative, although overall government bond yields increased at the beginning of the fourth quarter before falling afterwards. This is due to greater demand from foreign investors, the lower-than-expected outturns of Thailand's economic figures in the third quarter, and investors' concerns over uncertainties on the external front. The new loan rate remained at a low level. Private credit expanded in both business and household sectors. Businesses continued to seek funding through both debt and equity instruments. The Thai baht depreciated against the U.S. dollar from the end of the previous quarter due to investors' concerns over uncertainties on the external front. The baht depreciated at a larger extent as compared with other regional currencies. This was due partly to some corrections after previously appreciated faster than other regional currencies. The real effective exchange rate (REER) depreciated.

Financial stability remained sound but there remained pockets of risks that warranted monitoring. These included, first, the search-for-yield behavior, in particular by saving cooperatives and large corporates, which persisted in the prolonged low interest rate environment and could lead to underpricing of risks. Second, the property sector was subject to accumulated vulnerabilities in the mortgage loan market and oversupply in the real estate market. The markets would likely adjust to the implemented revision in the macroprudential measure on mortgage loans during the period prior to the effective date. Housing demand would likely rise as a consequence of accelerated purchasing of mortgage loan borrowers for second or more homes and the developers would adopt more proactive marketing strategy. Third, despite household debt slowly declining, it remained at a relatively high level and the debt serviceability of some groups of households and small corporates continued to deteriorate.

3. Economic and Inflation Outlook

The Thai economy was projected to record slower growth at 4.2 and 4.0 percent in 2018 and 2019, respectively, lower than the projection in the previous *Monetary Policy Report*. Growth drivers stemming from external demand were expected to moderate as merchandise and services export growth would be lower than expected. Meanwhile, domestic demand would remain a key growth driver, especially on the back of sustained private consumption growth.

Merchandise exports were expected to slow down in tandem with global demand. This was partly due to export prices which would decline following a fall in crude oil prices and a temporary factor pertaining to natural disasters in Thailand's trading partners. The value of merchandise exports was projected to grow at lower rates of 7.0 and 3.8 percent in 2018 and 2019, respectively. The downward revisions were owing to impacts of the U.S. trade protectionism measures on global trade volume and Thailand's trading partner economies. Nonetheless, the redirected orders and the relocation of production base from China to Thailand would be supporting factors in the period ahead. Under the Committee's assessment, although concerns over trade protectionism measures alleviated in the short term, there remained uncertainties which could put pressures on the international trade and investment. This would both directly and indirectly affect Thai exports. Thus, it was deemed necessary to closely monitor developments of trade negotiations.

Exports of services were projected to exhibit slower growth due to a gradual recovery in Chinese tourist figures. The projected number of foreign tourists was revised down to 38 and 40 million for 2018 and 2019, respectively. This was owing to a large contraction in Chinese tourist arrivals following more severe and longer-than-expected impacts of the Phuket tour boat sinking incident, coupled with additional effects of Chinese economic slowdown and the renminbi depreciation. However, signs of improvement in Chinese tourists were observed after the government promptly enhanced safety standards in the tourism sector and put in place marketing incentives such as the free visa-on-arrival.

Private consumption was expected to continue expansion in almost all categories, particularly for durable and semi-durable goods. Growth would be partly supported by the waning effect of the first-car scheme, more broad-based growth of non-farm income, and continued improvements in employment in major sectors, as well as support from government policies. However, private consumption growth was expected to moderate somewhat in the period ahead due to the high-base effect of durable goods consumption in 2018. Moreover, elevated household debt would cause households to allocate part of their income for debt repayment. Structural changes in the labor market would limit wage increases. These factors would restrain purchasing power in the period ahead.

The government would help drive the economy despite some slowdown in public spending compared with the previous assessment. Delays in public investment were expected in some projects. Central government investments were revised down due to the delayed approval of land expropriation expenses for the Bang Yai–Kanchanaburi motorway project. Moreover, delays in drafting the master plans under the National Strategy prompted government agencies to defer obligation of funds for some projects. For state-owned enterprises, investments were revised down due to the deferment of the second phase of the dual-track rail project which was during the process of project priority review. Government consumption growth was projected to be in line with the previous assessment.

Private investment growth projections were largely unchanged, but would gradually improve mainly on the back of machinery and equipment investment. Drivers would come from upgrades to production efficiency and capacity expansion as well as the relocation of production base to Thailand. Such factors would compensate for the moderating investment trend owing to investor concerns over trade protectionism measures as well as delays in public investment. Additional supporting factors for the investment outlook were (1) special measures by the Board of Investment (BOI) to boost investment and (2) the public-private partnership (PPP) in infrastructure investment projects in the Eastern Economic Corridor (EEC). Progress of such investment projects would be monitored going forward.

The inflation outlook was expected to be in line with the previous assessment. Headline inflation was projected to be slightly lower than the previous assessment due to lower crude oil prices despite some offset by higher fuel adjustment surcharge (Ft). Core inflation was expected to slightly increase due to higher bus fares and gradually improving demand-pull inflationary pressures. **The Committee thus projected headline inflation to be 1.1 and 1.0 percent for 2018 and 2019, respectively, and core inflation to be 0.7 and 0.9 percent for 2018 and 2019, respectively.**

Risks to the growth projection were expected to tilt more downward, mainly due to external factors as the probability of no-deal Brexit heightened. Moreover, the possibility that the Thai economy would underperform the baseline forecast could be due to (1) impacts of the U.S. trade protectionism measures, (2) lower-than-expected growth of trading partners, (3) slower-than-expected growth of private consumption due to an uneven distribution of domestic purchasing power recovery, especially for farm income, and (4) lower-than-expected public expenditure due to constraints in budget disbursement and project execution. On the other hand, the possibility that the Thai economy would outperform the baseline forecast could be due to (1) less-than-expected Chinese economic slowdown, and (2) possibly higher-than-expected domestic spending due to infrastructure investment and PPP projects as well as government measures to help stimulate private consumption. Meanwhile, **risks to the forecasts of headline and core inflation were expected to tilt more downward** in line with increased downside risks to growth projections and to oil prices.

Bank of Thailand
2 January 2019

For further information: Monetary Policy Strategy Division
Tel. 0 2283 6186, 0 2356 7872
E-mail: MPStrategyDiv@bot.or.th