Minutes of the Monetary Policy Meeting of the Monetary Policy Committee

Bank of Thailand

19 October 2011

Publication date: 2 November 2011

Members Present

Prasarn Trairatvorakul (Chairman and Governor), Suchada Kirakul (Vice Chairman and Deputy Governor, Monetary Stability), Sorasit Soontornkes (Deputy Governor, Corporate Support Services), Ampon Kittiampon, Praipol Koomsup, Siri Ganjarerndee, Krirk-krai Jirapaet.

Financial Markets

Concerns over the euro area's sovereign debt problem and the global economic slowdown triggered a sharp increase in financial market volatility. The decline in confidence among international investors led them to curtail their holdings of risky assets including equities, commodities, and emerging market bonds. Stock market indices thus declined across the globe; the baht depreciated along with other regional currencies; and Thai government bond yields experienced substantial volatility. In addition, considerable uncertainty in global financial markets raised funding costs and led to tighter dollar liquidity in many countries, including Thailand. However, Thai baht money market rates and short-term government bond yields remained stable as most market participants anticipated that the MPC would maintain the policy rate at 3.50 percent per annum at this meeting.

The International Economy

The global economy continued to soften and downside risks increased since the last MPC meeting due to the lack of clear resolution of the euro area's debt crisis. The resulting loss of confidence prompted a surge in financial market volatility on concerns that spillovers onto the banking sector would become more severe, with negative ramifications on the euro area's growth outlook. **The US economy remained weak and fragile** with higher risk of falling into recession. Consumer confidence deteriorated to levels comparable to that of the 2008 crisis, while the recovery in the labour and housing markets remained protracted. Nonetheless, improvements in manufacturing production and the extension of tax incentives for employment could help to mitigate the risk of a US recession. **Economic expansion in Asia softened as export growth moderated in line with the global economic slowdown.** However, firm domestic demand, sustained growth in intra-regional trade, and government stimulus supported by available fiscal policy space should help to cushion growth of this region from a slowdown in the advanced economies. Meanwhile, despite a moderation in the price of commodities, including oil, **inflationary pressure in Asia remained elevated** as continued domestic demand growth facilitated the pass-through of higher costs into final prices.

The Domestic Economy

Economic growth in Thailand was expected to decelerate due to the weakening of the global economy and the impact of floods. Preliminary data for the third quarter indicated a rebound in economic activity as the negative repercussion of supply chain disruptions associated with the earthquake in Japan dissipated. However, economic growth in the last quarter of this year was likely to be much lower than previously anticipated because of (1) severe disruptions to economic activity from widespread flooding, particularly in the manufacturing sector, and (2) a moderation in export growth on the back of a softer world economy and a deceleration of commodity price increases. Nevertheless, reconstruction spending and government stimulus measures would provide support for domestic demand to pick up next year. Overall, the flood crisis was not expected to damage Thailand's long-term growth potential.

Members were concerned about the impact of the still-evolving flood situation, especially on production in key export sectors including rice, automobile, electronics and electrical appliances, as well as tourism, all of which were already feeling the effects of a weaker global economy. As a result, Thai export growth was expected to slow down, and members stressed the need to closely monitor the situation and continuously assess the impact on the Thai economy.

Inflationary pressure continued to be sustained by growth in domestic demand, though declines in input costs, such as moderated oil prices from a weaker global economy, as well as more stable inflation expectations would help to mitigate inflationary pressure in the periods ahead. Nonetheless, members assessed that upside risks to inflation remained from the anticipated pickup in public and private spending after flooding ends.

Monetary Policy Considerations

Six members decided to maintain the policy rate at 3.50 percent per annum on account of increased downside risks to growth from the global economic slowdown and the impact of floods, which had already brought about partial halt in some production sectors. However, the flood crisis was not expected to affect the economy's long-term potential, and reconstruction spending and government stimulus measures should provide support to domestic demand going forward. Meanwhile, flood-related shortages could push prices of some goods up temporarily. Although inflation remained high and warranted close monitoring, upside risks were limited. In this context, monetary policy could give higher weight to supporting the reconstruction of the economy. Maintaining the policy rate at the current level, which is still low and supportive of economic growth, was thus deemed appropriate. However, heightened uncertainty in the global economy and the ongoing flood crisis warranted continued close monitoring.

One member viewed that the risks from the global economy exceeded what was previously anticipated and the problem was likely to be protracted. Moreover, the flood damage appeared to be severe, while upward pressure on inflation did not rise significantly. As such, **a reduction of the policy rate by 0.25 percentage points** to better facilitate economic recovery was deemed appropriate.

The MPC thus decided to maintain the policy rate at 3.50 percent per annum and would remain vigilant in monitoring developments of risks and stand ready to take appropriate policy actions.

Monetary Policy Group
2 November 2011