Minutes of the Monetary Policy Meeting of the Monetary Policy Committee

Bank of Thailand

24 August 2011

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Members Present

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

Financial Markets

Market volatility increased in tandem with heightened risks in global financial markets, especially on concerns over the US credit rating downgrade and debt ceiling problems. The resulting risk aversion weakened the Thai baht, reversing appreciation pressures in July. Looking ahead, the baht was expected to resume its appreciation path as portfolio inflows were expected to resume once global financial markets stabilize and in light of the continued strong economic fundamentals of Asia and Thailand. Since the beginning of August, the medium- to long-term yields on government bonds declined sharply, owing partly to a drop in US government bond yields and partly to portfolio shift towards longer maturities by foreign investors. Meanwhile, money market rates and short-term government bond yields increased as the market priced in a policy rate hike. This was consistent with survey results which indicated that most market participants anticipated a rate hike of 0.25 percentage points at this meeting.

The International Economy

Members assessed that risks to growth of advanced economies (G3) had increased. The US economy will likely grow at a modest rate for longer than expected, causing the market to perceive higher risk of another recession. Nevertheless, factors that will help support growth and lower such risk include (1) higher consumer spending driven by lower oil prices and the recovery in the automobile sector after supply disruptions ended; (2) stronger financial conditions of businesses and households compared to the 2008 crisis; (3) continued expansion in exports; and (4) the ongoing accommodative monetary policy stance. Meanwhile, the impact from the US credit rating downgrade had been limited but may still affect risk premium for private financing in the periods ahead. **The euro area** expanded more slowly than expected as a result of higher inflation and the end of stimulus packages in some member countries. Economic growth was expected to moderate given the planned fiscal consolidation. However, robust exports and employment conditions in core member countries, especially Germany, should help support the euro area growth overall. **The Japanese economy continued to recover** from reconstruction expenditures despite the credit rating downgrade. **Growth in other parts of Asia showed some moderation** with higher risks to exports to advanced economies. Nevertheless, intra-regional trade, particularly rising exports to China, strong domestic demand reflected in high growth of retail sales and credit in many economies, as well as large fiscal and monetary policy space, should help cushion such increased risks. However, **inflationary pressures remained elevated in many Asian economies including Thailand**.

The Domestic Economy

The Thai economy expanded during the first half of the year, supported by both domestic and external demand, despite the slowdown in the second quarter owing to the impact of the disaster in Japan**. The main growth engines in the latter half of this year are domestic demand and a recovery in manufacturing production** following the end of the supply disruptions in the automobile sector. Private consumption and investment was expected to expand in line with good prospects for both farm and non-farm income, improved confidence, expansion in credit, and rising investment trend in the automobile, electronics and electrical appliance industries.

Members expressed concerns about the impact of the slowdown in advanced economies on the export sector. However, such impact can be partly cushioned by (1) exporters' diversification to markets in Asia and other emerging market economies; (2) continued expansion in exports of agricultural and resource-based products to advanced economies; and (3) ongoing stimulus from public consumption and investment. In this regard, members deemed it necessary to closely monitor developments in the global economy and their impact on the Thai economy.

Inflationary pressures remained high with core inflation trending upwards from strong domestic demand and the continued pass-through of higher costs to prepared food. The MPC assessed that although inflation should moderate during the latter part of the year due to a cut in the Oil Fund levies, upside risks in the periods thereafter remained significant owing to (1) the closing output gap; (2) inflation expectations which remained high; and (3) government's stimulus package such as increase in minimum wage and rice pledging scheme that may cause inflation expectations to increase.

Monetary Policy Considerations

All members agreed that short-term policy goal of interest rate normalization remained appropriate in order to address inflationary pressure and preserve financial stability. Members also agreed that risks to growth had increased as a result of global economic slowdown, and that risks to inflation had also increased. However, ***members differ somewhat on the weight assigned to such risks*.**

Two members assessed that the risk of a global recession and consequential impact on the Thai economy was material enough to justify pausing the policy rate increase at this meeting in order to assess the extent of the slowdown in advanced economies given their limited policy space to support growth. Moreover, although **domestic inflation remained high**, short-run inflationary pressures from the government's stimulus package may not be material given the implementation time lag and only a small disbursement was expected in the second half of the year. Should it become clearer at the next meeting that the global economy does not enter a recessionary period and the Thai economy continues to expand well, policy interest rate can still be raised then.

Five members viewed that the continuation of the policy rate hike by another 0.25 percentage points was appropriate. They assessed that despite **higher risks to Thailand's economic prospects** due to the slowdown in advanced economies, there are factors that should mitigate the risk of a global recession of the magnitude experienced in the recent crisis. Moreover, intra-regional trade and domestic demand in Asia, including Thailand, would continue to support the growth momentum. Meanwhile, **upward risk to domestic inflation increased significantly** and may continue into future periods. While the government’s stimulus package may help cushion risks to growth from the advanced economies, it could increase upward pressure on inflation and inflation expectations. Thus, continued interest rate normalization was deemed necessary to address future risks to inflation given the time lag in the transmission mechanism. Members also assessed that since real interest rates were still negative, gradual increase in the policy interest rate would signal policy continuity towards normalization and facilitate a smooth adjustment for the economy.

The MPC decided with a 5-2 vote to raise the policy interest rate by 0.25 percentage points, from 3.25 to 3.50 percent per annum, to contain inflationary pressures and inflation expectations in the periods ahead. However, the MPC will closely monitor and assess **developments in the global economy and the government’s spending plans**, and stands ready to take necessary action to ensure sustainable growth for the Thai economy.

Monetary Policy Group
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