Minutes of the Monetary Policy Meeting of the Monetary Policy Committee

Bank of Thailand

9 March 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

The Thai baht, relative to the US dollar, saw greater two-way movement. Recently, the baht appreciated gradually after depreciating in the second half of January as the Thai Stock Exchange Index fell over concerns regarding sovereign debt problems in Europe and political unrest in the Middle East. **The Euro and most regional currencies strengthened** after central banks signaled their intention to tighten monetary policy to fight inflation. The US dollar continued to depreciate due to confirmations that the second round of quantitative easing would continue as scheduled despite improvements in employment. The short end and middle of the **yield curve** shifted upward as the market priced in future rate hikes by the MPC. The shift was consistent with a survey of market participants which indicated expectations of a 0.25 percentage point hike this meeting.

International Economic Conditions

Risks to inflation have increased due to record-high food prices and the surge in oil prices amid unrest in the Middle East. Nevertheless, the supply shock, particularly high oil prices, was expected to have a limited impact on economic expansion due to (1) increased global resiliency to oil price shocks as oil dependency had fallen as reflected in lower oil expenditure to GDP ratio, (2) real oil prices were currently lower than its peak in 2008 and (3) many Asian economies maintain price controls or provide subsidies as fiscal room remained.

Some MPC members raised concerns about the impact of the surge in oil and commodity prices on the global recovery. However, MPC members noted that the oil price spike would likely be temporary and would not remain excessively high for an extended period since political unrest in the Middle East was not expected to become widespread to the extent that might threaten oil supply networks and global inventory. Also, OPEC excess capacity remained high and could offset any reduction in production by countries experiencing unrest. In addition, the recent upward trend in oil prices reflected underlying global demand due to economic expansion, particularly in the emerging markets. The MPC members therefore assessed that the surge in oil and commodity prices would probably not impede continued global economic recovery.

Although risks to inflation have increased, **the global economy maintained its recovery momentum** as reflected by improvements in the global Purchasing Managers' Index, particularly in the G3 economies where recovery had become more evident. The **US economy** showed continued expansion on the back of improved production, consumption, and employment. Credit market conditions have improved but recovery of the real estate market may take time. The **Euro area** continued to expand, driven by the performance of core member countries. However, signs of inflation risk have emerged. The **Japanese economy** remained fragile due to high unemployment and deflation. **Asian economies** grew continuously from domestic and external demand amid increased inflationary pressure, prompting monetary policy normalization and reduced fiscal stimulus in 2011. The **Chinese economy** expanded well despite continued monetary tightening.

Domestic Economic Conditions

The Thai economy continued to expand in Q4 of 2010 and January 2011 on the back of domestic demand, in particular, **consumption and investment**, as well as **exports**, which was expected to remain an engine of growth going forward. In addition, the real impact of fiscal stimulus on consumption and investment in FY2011 increased from the supplementary budget and aid disbursement following natural disaster in the beginning of the year. Meanwhile, **imports** expanded well. Going forward, the Thai economy would likely retain its growth momentum from rising farm income on the back of world commodity prices as well as higher non-farm income. The impact of high oil prices would therefore not have a significant impact on continued economic expansion. Additional supporting factors included (1) the fact that the current oil shock was not as severe compared to previous shocks, (2) the Thai economy's lower oil dependency (3) and diesel price administration. Nevertheless, some MPC members commented that the Thai economy's substitution away from oil toward alternative energy sources may eventually lead to the gradual lifting of government price administration of alternative energy, which could result in higher inflationary pressure.

In the **monetary sector**, private credit growth continued to accelerate. Corporate loans exceeded its pre-crisis level while household loans grew in line with improved consumer confidence. Automobile leasing loans also grew. Loan quality remained satisfactory. In addition, increased demand for loans and rising costs led to increased competition to attract funding. Lastly, commercial banks were more responsive in adjusting their benchmark interest rates in line with the policy rate compared to the previous MPC meeting.

In regard to **price stability**, inflationary pressure increased and became more evident compared to the previous meeting as a result of economic expansion and the upward adjustment in inflation expectations following the spike in global oil and commodity prices. Nevertheless, the extension of government cost-of-living relief measures by four months would delay, if only partly, pressure on core inflation. Some MPC members noted that due to price administration, measured inflation figures may not sufficiently reflect actual inflationary pressure. In addition, increased input costs could adversely affect farm income which had served as a driver of growth.

Monetary Policy Considerations

The MPC assessed that the surge in oil and commodity prices resulted in increased inflationary pressure but would not impede continued growth of the global and Thai economies going forward.

Inflationary pressure clearly increased. The surge in oil and commodity prices amid robust domestic demand resulted in increased inflation expectations and an acceleration in core inflation. If oil prices remain persistently high beyond projections and the output gap closed in the second half of 2011 as expected, inflation expectations could rise even further.

Some MPC members noted that increased fiscal stimulus following elections could result in an overheating economy beyond projections. In such an environment, accelerated inflationary pressure may lead to faster pass-through from increased production costs to overall inflation and possibly weaken the anchoring of inflation expectations. With higher inflationary pressure amid robust demand, the economy should have no problems adjusting to an interest rate hike of 0.5 percentage point. Nevertheless, the majority of MPC members judged that gradual adjustment in the policy rate would build monetary policy credibility while not disrupting financial markets. In the event that greater-than-expected inflationary pressure arises, monetary policy stance could be adjusted as necessary, including possibly the use of alternative policy measures as commented by some members. However, other members stressed that alternative policy measures cannot substitute for the interest rate as the main instrument of monetary policy in targeting price stability.

Following discussion, MPC members were unanimous in maintaining gradual rate hikes to signal continuity in monetary policy normalization. The hike was deemed to be sufficient in keeping domestic demand from fueling price pressure as well as in keeping financial imbalances at bay. Nevertheless, MPC members emphasized the need to **closely monitor developments in inflationary pressure going forward.**

The MPC therefore decided unanimously (7 to 0) to raise the policy interest rate by 0.25 percentage point, from 2.25 to 2.50 per cent per annum, effective immediately.

Monetary Policy Group

23 March 2011