Minutes of the Monetary Policy Meeting of the Monetary Policy Committee

Bank of Thailand

12 January 2011

Publication date: 26 January 2011

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 was volatile, appreciating relative to the US dollar on the back of capital inflows while depreciating in the beginning of 2011 due to sales of equity by foreign investors after better-than-expected US economic data. Going forward, investors are expected to give greater weight to recovery in major countries, resulting in greater two-way movement of the baht as opposed to continued appreciation pressure observed in the previous year. In addition, the yield curve shifted slightly upwards following the previous MPC meeting reflecting market pricing of an interest rate hike this meeting. The majority of market participants surveyed expected the current MPC meeting to result in a rise in the policy rate by 0.25 percentage points while some expected an overall rise of 0.50-1.00 percentage points in 2011.

International Economic Conditions

Risks to global economic growth have fallen. The **US economic recovery** continued to strengthen. A survey of economists indicated that the majority viewed that the US economy would grow faster than forecasted and that employment would improve although risks from house prices remained. Nevertheless, certain MPC members expressed concerns regarding the continually high rate of unemployment. The **European economy** stabilized although money markets remained volatile due to concerns over sovereign debt. However, core member countries, especially Germany, are projected to become drivers of growth. The **Japanese economy** still faced deflation while the appreciating yen may impede growth going forward. The **Asian economy** continued to grow on the back of domestic demand and exports destined to both within the region as well as new markets with high growth potential. Overall, the region is becoming less reliant on the G3 economies. However, the risk to inflation for the region as a whole increased significantly.

The uneven growth of advanced economies and emerging markets has led to varied monetary policy responses. Advanced economies pursued accommodative monetary policy to safeguard economic recovery while emerging markets tightened to maintain price stability and are expected to accelerate the pace of interest rate normalization in 2011. As a result, challenges for Asia going forward are likely to come from capital flow volatility and the appropriate pacing of monetary policy tightening.

Domestic Economic Conditions

Thai economic growth was projected to return to its long-term trend. The Thai economy continued to expand in Q4 of 2010 from the previous quarter in line with domestic and external demand. Going forward, growth will be supported by 1) <u>private consumption</u> expansion on the back of both agricultural and non-agricultural income, increase in the minimum wage, low unemployment and robust consumer confidence and 2) <u>private investment</u>, which despite some slowdown after accelerating in the prior period, should expand going forward due to favourable business confidence, high capacity utilization in many industries, and future investment plans to meet internal and external demand for goods in services and 3) <u>fiscal stimulus</u> from government income support programs for mostly low-income earners and government investment for both large projects and state enterprises which was expected to increase from the previous year.

Export growth in the previous year exceeded expectations and was expected to continue its growth trend into 2011 due to Chinese and ASEAN economic expansion as well as the rising trend in advanced orders. In addition, various research houses projected strong export growth in 2011 supported by a rising export prices (except for fisheries where there is low pricing power) which was expected to partly mitigate the adverse effects of baht appreciation. **Tourism** activity was solid and was expanded going forward.

In the **monetary sector**, private credit expanded well together with overall economic growth. The expansion in commercial bank credit was primarily due to demand from households. Corporate loans also increased and were projected to grow continuously in 2011. Commercial banks rapidly raised both deposit and loan rates following the policy rate hikes.

In regards to **price stability**, inflation pressure increased from the previous period. Headline inflation accelerated in line with the rise in wages while core inflation picked up due to the pass-through of production costs into goods prices, especially prepared food and seasonings and condiments. The MPC assessed that inflation pressure going forward has increased due to both cost-push and demand-pull factors. <u>Cost-push</u> factors include: 1) upward trend in oil and commodity prices on the back of global economic expansion; 2) increased pass-through from the Production Price Index (PPI) into Consumer Price Index (CPI) as authorities allowed price increases in many product categories; and 3) gradual pass-through of production costs to consumers as producers' ability to absorb such costs became more limited. <u>Demand-pull</u> factors include: 1) a diminishing output gap as output growth neared potential while producers have revised their inflation expectations upwards for some time. These factors would speed up price adjustment going forward. In addition, some MPC members expressed concerns over the possibility that inflation may breach its target this year.

Considerations for Monetary Policy

The MPC viewed that the **risk to inflation had increased relative to the risk to growth compared to the previous meeting.**

The global economic recovery strengthened compared to the previous meeting. The risk of a double dip recession in the US declined while Asia faced the challenge of rising prices, particularly those of commodities. **The Thai economy continued to return to its long-term growth trend.** The MPC viewed that domestic demand would become the principal driver of growth in the coming period. In addition, strong export performance pointed to Thailand's economic resilience in face of the baht appreciating in the previous period.

Inflationary pressure clearly increased due to rising oil and commodity prices, the return of the Thai economy to its long-term growth trend and pent-up pressure from delayed price adjustments. At the same time, increases in the minimum and civil service wages may boost consumption expenditures more than expected and lead to a rise in inflation expectations going forward.

Some MPC members were concerned that low real interest rates may foster financial imbalances, depress savings and lead to asset bubbles **in the future**.

MPC members were unanimous in seeing the need to maintain continuity in signaling rate normalization. Robust economic expansion together with significantly increased inflationary pressure led to some members discussing the possibility of a rate hike of 0.5 percentage points. Nevertheless, the majority of MPC members viewed that policy rate adjustment should be gradual while taking into account that the neutral rate depends on changing economic circumstances.

The MPC therefore decided unanimously (7 to 0) to raise the policy interest rate by 0.25 percentage points per annum, from 2.00 to 2.25 per cent per annum, effective immediately.

Monetary Policy Group

26 January 2011