Minutes of the Monetary Policy Meeting of the Monetary Policy Committee

Bank of Thailand

20 April 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.

The International Economy

The global economy continued to expand and was expected to maintain its momentum. The Japan crisis and the resulting disruption in the regional supply network would somewhat affect the Asian economy but leave the overall global growth momentum intact. The US economic expansion would be driven by private consumption and production going forward. The gradual recovery of the euro area economy would continue despite remaining risks from sovereign debt. Meanwhile, the Asian economy expanded robustly.

Inflation risk clearly increased in many countries amid continued economic expansion as well as the rise in oil and commodity prices due to geopolitical developments in the Middle East and natural disaster. Inflation in the US picked up while actual inflation and inflation expectations rose visibly in the euro area. In Asia, inflationary pressure continued to build, leading to further increases in interest rates across the region. The European Central Bank (ECB) notably raised its policy rate for the first time since the global financial crisis in the face of persistent inflationary pressure. Members noted that the ECB hiked rates in response to oil prices and the risk of second-round inflation despite remaining economic fragilities.

The Domestic Economy

The Thai economy expanded well in the first quarter of this year from both internal and external demand. The economic impact of the recent flood was small. Going forward, the growth momentum would be sustained by the following factors: (1) expanding private consumption supported by strong farm income; (2) rising private investment due to the need to expand production capacity as reflected by accelerated corporate credit growth; (3) government spending; and (4) continued export expansion to meet demand from both developed and emerging markets as recovery takes hold. The Japan crisis was expected to result in a temporary supply disruption in certain manufacturing and export sectors. The electronics sector would be able to manage the disruption by using alternative supply sources. Nonetheless, the automobiles sector would slow somewhat in the short-run due to its dependence on technologically advanced parts from Japan before picking up after the supply disruption is resolved. **Some members expressed concerns over the severity of the impact of the Japan crisis on the production network, but assessed that it would not weigh on the overall growth momentum of the Thai economy.**

Inflationary pressure increased due to: (1) oil and commodity prices which continued to rise amid strong economic expansion; (2) the lifting of government price administration for various goods which facilitates the pass-through from production costs to goods prices as reflected in rising inflation expectations; and (3) the postponement of the lifting of the diesel price control may lead to an increase in pent-up price pressure and pose an upside risk to inflation going forward especially if oil prices rise by more than anticipated when the control is lifted.

Financial Markets

Transmission from the policy rate to commercial bank rates continued to be effective. Many commercial banks raised both lending and deposit rates following the rate hike from the previous MPC meeting (9 March 2011). **Regarding interest rate expectations prior to this meeting,** a rise along the short and medium-term parts of the yield curve showed that the market had priced in a rate hike. This was consistent with survey results in which all market participants expected a rate hike of 0.25 percentage points.

Robust economic growth contributed to increased capital inflows into the equity and bond markets especially in bonds with maturities of less than one year. Other economies in the region also experienced increased capital inflows. **The baht and other currencies (except the Japanese yen) appreciated relative to the US dollar** as investors sought non-US assets due to growth differentials and widening interest rate gaps given expectations that the Federal Reserve would hold its policy rate until the end of the year. **The euro strengthened** following the ECB rate hike. **The Japanese yen weakened** continuously due to carry trade transactions following temporary appreciation after the earthquake.

Monetary Policy

Members emphasized the impact of two recent major events--the Japan crisis and persistently high oil prices--on the balance of risks to growth and inflation.

For six members, mounting inflationary pressure remained the primary risk and continued to warrant a rate hike of 0.25 percentage points. The Japan crisis posed a downside risk to the Thai economy but its impact was expected to be temporary. On the risk to inflation, those members viewed that inflation pressure had become more apparent and remained the key risk as reflected in rising inflation expectations amid the economic upturn. In such an environment, pass-through from production costs to goods prices may intensify and add to inflationary pressure. As a result, rate normalization should continue given low real interest rates that currently prevail.

Some members noted that exchange-rate appreciation could mitigate some of the pressure exerted by high global oil and commodity prices on inflation expectations; however, the effectiveness of the exchange rate in anchoring inflation expectations was considered to be limited compared to the interest rate tool.

For one member, the crisis in Japan called for an interest rate pause. In light of the risk that the Japan crisis could become more drawn-out than expected, a rate pause would give the MPC more time to fully assess the situation. However, going forward, rate normalization should be maintained.

The MPC therefore decided to raise the policy interest rate by 0.25 percentage points, from 2.50 to 2.75 per cent per annum, effective immediately.

Members discussed the neutral rate that will mark the end of the normalization cycle. The level of the neutral rate varies according to the economic outlook at each point in time and is thus difficult to pin down precisely. Nevertheless, current negative real interest rates amid output gap closure reflect accommodative monetary policy.

The MPC decided to release the point estimates of both the baseline forecasts for GDP and inflation in the *Inflation Report* to replace previously published range estimates. The fan charts remain. These changes have the following benefits: (1) allow the public to better interpret changes in the forecasts, particularly in instances where the forecast range does not change; (2) provide better indication regarding the direction of monetary policy; and (3) further improve communication by the MPC following the publication of its edited minutes.

Monetary Policy Group

4 May 2011