Minutes of the Monetary Policy Meeting of the Monetary Policy Committee

Bank of Thailand

25 January 2012

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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, Siri Ganjarerndee, Narongchai Akrasanee, and Aswin Kongsiri.

Financial Markets

The lack of a clear resolution to the euro zone's sovereign debt problem has resulted in further declines in investor confidence and continued volatility in financial markets. Nevertheless, central bank liquidity injection along with increased preparedness of the private sector to deal with eventual outcomes has helped calm market sentiment. The recent credit ratings downgrade of several economies in the euro zone pressured markets only temporarily and to a lesser extent than expected. US dollar liquidity in global financial markets eased slightly.

The Thai baht depreciated against the US dollar and other regional currencies as a result of a slowdown in Thai exports due to the recent floods and capital outflow on the back of elevated concern about the global economy, which increased desired holdings of US dollar assets. Money market interest rates and short-term government bond yields tended downward, reflecting the market's expectation of a reduction in the policy rate in this MPC meeting.

The International Economy

The global economic outlook has weakened further with the euro area facing the risk of a prolonged recession. The conjunction of tighter credit markets, limited fiscal policy space, and credit rating downgrades of several euro economies and the European Financial Stability Facility (EFSF) has complicated the resolution to the region's sovereign debt problem. On the other hand, the US economy showed signs of improvement with continued expansion in employment and stronger consumer confidence. However, limited fiscal policy space, continued weakness in the housing market together with the impact from the euro zone's debt crisis would constrain economic growth in the periods ahead to remain below potential.

Meanwhile, the repercussions of the euro zone's problem on Asia became more evident through trade-related channels, while its impact on the financial sector remained contained. The softening global economy contributed to a moderation in the prices of food and various commodities, leading to lower global inflationary pressure.

The Domestic Economy

The impact of the floods on the Thai economy was greater than previously anticipated, leading to a sharp contraction in economic activity in the last quarter of 2011. Although the recovery process in the manufacturing sector has already begun, the restoration of production to normal capacity is expected to be more prolonged than previously assessed. The delay reflects the greater severity of damages, which would take more time to repair and also require more extensive replacement of machineries, as well as the drawn-out damage assessment process in claiming insurance payouts. Exports decelerated on the back of flood-induced supply chain disruption and the softening global economy. Nonetheless, improving consumer confidence, government stimulus measures, and accommodative monetary conditions would help support the revival of private consumption.

Short-term inflationary pressure declined, reflecting a more prolonged recovery in domestic demand and reduction in production costs from lower non-oil commodity prices, in line with the softer trend in global inflation. Nonetheless, upside risks to inflation remained from the possibility of higher oil prices resulting from unrest in the Middle East, as well as changes in the excise tax on oil and a higher contribution rate to the oil fund. In addition, higher wages and government stimulus measures would add to upward inflationary pressure as economic activity returns to normal in the second half of 2012.

Monetary Policy Considerations

The MPC assessed that the downside risks to growth has increased due to protracted weaknesses in the global economy as well as a post-flood recovery process of the Thai economy that will be more drawn out than expected. With upside risks to inflation contained, monetary policy could be eased further to help accelerate the return of economic activity to normal levels, especially as private sector confidence, albeit improving, continues to be fragile. The MPC therefore voted unanimously to reduce the policy rate by 0.25 percent, from 3.25 percent to 3.00 percent per annum.

The MPC noted that rapidly increasing market share of specialized financial institutions (SFIs) relative to commercial banks may have stemmed from an unlevel playing field in the banking system, especially in deposit mobilization where the SFIs have a clear cost advantage. In this circumstance, commercial banks' ability to adjust their interest rates in line with official policy rate may have been limited. Thus, monetary policy's support to economic restoration efforts through lower cost of funds for the private sector has also been limited. The MPC stressed the importance of policy coordination from all relevant authorities in resolving this structural problem in the banking system.

Monetary Policy Group

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