Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

2 May 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.

Monetary Policy Target for 2012

On April 17, 2012, the Cabinet approved the monetary policy target for 2012 proposed by the Ministry of Finance to maintain the target range for quarterly average core inflation of 0.5–3.0 percent per annum, which was deemed appropriate given the current economic situation.

Financial Markets

Market confidence improved temporarily before declining from concern over sovereign debt problems in Spain and Italy. Major currencies strengthened as investors once again turned to safe-haven assets. **The bilateral Thai baht exchange rate remained roughly unchanged from the previous meeting, with lower volatility in line with regional currencies**. This was attributable to more balanced capital flows, partly due to an increase in demand for US dollars by gold and oil importers.

Short-term money market interest rates stabilized in line with the policy rate, reflecting market expectations that the MPC would keep the policy rate unchanged at this meeting. Meanwhile, the Bangkok Interbank Offer Rate (BIBOR) of maturity greater than 3 months increased in tandem with higher short-term government bond yields, reflecting market expectations that the policy rate might be adjusted upward in the next 3 – 6 months.

The International Economy

The global economy continued to grow at a gradual pace with improving signs of recovery in the major economies. US economic outlook improved on the back of positive developments in the labor market and income prospects, as well as stronger private sector confidence. Meanwhile, **the eurozone economy** entered a recession and it would take time for the structural problems to be resolved. Nevertheless, the MPC assessed that the overall eurozone economy might suffer less severe contraction than previously thought, based on more positive leading indicators in manufacturing and export sectors in core countries. Although problems in Spain might affect market confidence somewhat, it was anticipated that they could be contained by the Spanish and European authorities. **Economic growth in Asia** softened in line with moderation in exports. Nonetheless, a gradual pickup in exports towards the end of the second quarter was expected following an increase in new export orders, particularly for exports of intermediate goods and electronic parts to China. This was in line with the anticipated strengthening of the global economic recovery in the latter half of this year. Some MPC members expressed concern over growing political uncertainties in both Europe and Asia, which could hinder the resolution process for sovereign debt in Europe and remained a risk factor to Asia's economic recovery.

Global inflation remained stable relative to the previous meeting, though pressure from an elevated oil price level persisted. The MPC noted that the extraordinary easing of monetary policy by major industrial economies could be one of the factors adding to higher global inflationary pressure in the periods ahead. Most central banks kept policy interest rates unchanged opting to wait for greater clarity on the outlook for global economic recovery and inflation.

The Domestic Economy

The recovery of the Thai economy in the first quarter was faster than expected. Production of most flood-affected manufacturing firms has returned to pre-flood levels while some of those unaffected has accelerated their production. On the whole, manufacturing production was projected to return to normal levels by the end of the second quarter this year, earlier than the third quarter projected previously. Private consumption and investment accelerated as supply shortages eased, consumer and business confidence strengthened, and domestic purchasing power increased due to favorable income conditions in both farm and non-farm sectors. Exports were expected to rebound sooner than previously assessed in tandem with the recovery of manufacturing production and the anticipated pickup in global demand. Government stimulus measures and accommodative monetary conditions would continue to support sustained economic recovery going forward. In light of the broad-based recovery, which has been faster than expected with good momentum evident in all components, the MPC adjusted GDP growth projection for 2012 upward to 6.0 percent from 5.7 percent in the previous meeting.

Inflation slowed down in April partly as a result of the high base of the previous year and the reduction of some fresh food prices back to their normal levels. The moderation in inflationary pressure was expected to be temporary given that several items in the CPI basket, such as electricity charge and public transportation fare, are in the process of upward price adjustment. Moreover, elevated oil prices and the minimum wage hike in the context of a strong pickup in domestic demand, as well as heightened public concern over the rising cost of living, could add to higher inflation expectations. This, in turn, could result in a greater pass-through of higher costs to prices of goods and services. The MPC deemed it too early to assess the full impact of the minimum wage hike on inflation at this point, and would continue to monitor and appraise the effect as more information becomes available.

The MPC suggested that communication regarding the role of monetary policy in tackling inflationary risks should be enhanced to foster a common understanding with the public. Emphasis should be placed, in particular, on the importance of demand management and anchoring inflation expectations in attaining price stability. Regardless of the immediate cause of inflation pressure in the short-term, its persistence and impact on overall price stability in the long run hinges on the credibility of monetary policy.

Monetary Policy Considerations

The MPC assessed that the recent easing of monetary policy has helped to shore up private sector confidence and contributed to a broad-based recovery which has been faster than expected. The global economic outlook appeared more positive, particularly with respect to major economies, while the sovereign debt crisis in the eurozone was not expected to deteriorate much further. However, **the recovery of global economy remains fragile amidst high uncertainties** especially regarding the lingering structural problems in the eurozone economy which would take time to resolve. This continues to be a risk factor for Thailand's economic recovery. Some members viewed that the faster-than-expected recovery of the Thai economy in the first quarter was partly due to the acceleration in production as well as private consumption and investment as part of flood-related replacement and restoration spending, which could moderate in the following quarters. It was thus important to closely monitor incoming information to obtain a clear bearing on the strength of the economic recovery going forward.

Although inflation might have moderated in April and remained within a manageable level, upside risks to inflation continued to persist. Thus, it is necessary to closely monitor factors that could affect the dynamics of inflationary process, especially public concern over the rising cost of living which could fuel inflation expectations in the periods ahead.

In weighing the balance of risks, **the MPC deemed the current policy interest rate to be appropriate in supporting a sustained recovery of economic activity to normal levels in the face of remaining risks in the global economy while still consistent with keeping inflation within target. The MPC, therefore, voted unanimously to maintain the policy rate at 3.0 percent per annum.** The MPC would remain vigilant in monitoring developments of the key risk factors and stands ready to take appropriate policy action in response to material shifts in the balance of risks.

The MPC discussed the appropriateness of policy rate renormalization in the upcoming periods. The recent temporary easing of monetary policy was aimed at preventing deterioration in domestic demand, especially weaker business confidence, from aggravating the impact of the flood on the economy. Given that economic recovery has gained traction with robust momentum going forward amidst sustained rise in private sector confidence, the need for current exceptional policy accommodation should continue to decline. Meanwhile, the rise in inflationary pressure reinforced the need to renormalize the policy rate at an appropriate time.

Monetary Policy Group

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