Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

5 September 2012

Publication Date: 19 September 2012

Members Present

Prasarn Trairatvorakul (Chairman and Governor), Suchada Kirakul (Vice Chairman and Deputy Governor, Monetary Stability), Tongurai Limpiti (Deputy Governor, Corporate Support Services), Ampon Kittiampon, and Narongchai Akrasanee.

Members Absent

Siri Ganjarerndee and Aswin Kongsiri.

Financial Markets

Stability of global financial markets improved since the last meeting on the back of positive outturns in key economic indicators in Germany and France, as well as better than expected US retail sales. The resultant strengthening of investor confidence led to a reallocation of investments towards higher-risk assets, and capital inflows into Asian equity and bond markets resumed. Against this backdrop, regional currencies, including the Thai baht, appreciated against the US dollar.

Short-term money market interest rates and government bond yields remained generally steady, reflecting overall market expectations that the MPC would keep the policy rate unchanged at this meeting, although some investors projected policy easing within this year.

The International Economy

Despite improvement in global financial markets, the global economy remained weak. US economic recovery proceeded at a gradual pace with consumption and investment expenditures remaining below normal levels. The impending expiration of fiscal stimulus measures posed a significant risk to the recovery. **The euro zone economy** entered recession and was projected to weaken further in the latter half of this year as a result of tighter government spending and markedly lower private sector confidence. In addition, the viability of the European Stability Mechanism (ESM) remained uncertain pending a ruling by Germany's constitutional court on the legality of German participation in the mechanism. Such implementation risks could delay the resolution of the euro zone debt crisis. **The impact of a weakening global economy on Chinese and Asian economies became more evident**, with export growth slowing down to a greater extent than anticipated. Nonetheless, in a number of countries including Malaysia, Indonesia, the Philippines and Thailand, growth in the latest quarter remained solid on the back of strong domestic demand.

Global inflationary pressure remained low. Despite some increase in prices of agricultural products due to unfavourable weather conditions, pass-through onto consumer prices was limited by weak global demand. Most central banks kept their policy rates unchanged, opting to wait for greater clarity on key developments that could significantly impact the global economic outlook. In some cases where domestic demand had clearly deteriorated, monetary policy was eased.

The Domestic Economy

The Thai economy in the second quarter expanded more than previously projected. Strong momentum in consumption and investment was likely to sustain a positive trend in domestic demand going forward. Key supporting factors included strong private sector confidence, favourable labour market conditions, higher household income, and accommodative monetary conditions, which was particularly evident from the robust expansion of credit. Government stimulus measures also continued to contribute positively to domestic growth, though disbursement on some projects, such as on investment slated under the Water Management Decree, had been partially delayed. **The impact of slowing global demand on Thai exports became more apparent**, with exports to major industrialised countries particularly affected. As a result, overall export growth in 2012 could turn out to be lower than that projected in the last meeting.

The MPC assessed that GDP growth for 2012 remained close to the previous forecast as robust expansion in private consumption and investment would help to cushion the impact of the weakening global economy on Thai exports. Nonetheless, economic growth in 2013 would likely be softer than previously projected given a more pronounced impact from the global economy as well as some delay in the disbursement of government stimulus measures. **Price pressure moderated in line with the weaker global economic outlook**, and inflation was forecasted to remain close to the midpoint of the target range going forward.

The MPC viewed that strong private credit expansion reflected a positive underlying momentum for domestic demand as well as strong willingness on the part of financial institutions to extend loans. Nonetheless, some members expressed concerns regarding the unusually high growth rate observed on certain types of credit, such as automobile loans, personal loans and a subset of real estate loans, which warranted close monitoring to guard against a potential build-up of financial imbalances.

<u>Monetary Policy Considerations</u>

All MPC members agreed that the balance of risks for the Thai economy was skewed more towards growth rather than inflation. While domestic demand remained robust, the impact of slowing global demand on Thai exports was expected to increase in the period ahead. Meanwhile, inflationary pressure remained moderate. In this context, further monetary policy easing could help to support economic activity. However, members differed in their assessment of the conditions that would warrant such an easing.

Two members viewed that a reduction of the policy rate by 0.25 percent per annum was justified given that**:** (1) Thai exports would become increasingly weighed down by the weakening global economy. Despite domestic demand remaining firm currently, support from fiscal stimulus measures would be more muted, while the temporary boost from flood-related private investment would wane going forward, and the positive contribution from the government's first-car tax rebate programme would run out in the near term; and (2) considering the time lag with which monetary policy actions transmit to the economy, a policy rate reduction at this meeting would act to shore up economic activity next year and would also serve to signal firms to prepare for possibly heightened risk in the period ahead.

Three members assessed that maintaining the policy rate at 3.0 percent per annum was appropriate on the basis that: (1) a policy rate reduction could not directly compensate for the adverse impact of weaker external demand on export. Meanwhile, domestic demand remained robust and sufficient to support economic growth; (2) monetary conditions remained accommodative and already supportive of economic activity with continued strong expansion in private credit. Given high growth rates in certain types of credit, close monitoring was warranted to guard against potential imbalances and a policy rate reduction may exacerbate such risks; and (3) the global economy remained susceptible to tail risks and it was important to preserve the room for monetary policy to act quickly should global economic conditions deteriorate rapidly.

The MPC therefore voted 3 to 2 to maintain the policy rate at 3.0 percent per annum. The MPC would remain vigilant in monitoring developments in the global economy, domestic demand conditions as well as private credit growth, and stood ready to take appropriate policy actions as warranted.

Monetary Policy Group
19 September 2012