Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

21 March 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

Market confidence improved following significant progress in debt restructuring for Greece and long-term liquidity provision by the European Central Bank. Improved market sentiment prompted a resumption of capital inflows into regional equity and bond markets, contributing to the appreciation of most regional currencies including the Thai baht. Some MPC members viewed that while the euro zone's debt crisis may have abated, structural problems underlying the crisis remained unresolved. Thus, the possibility that the crisis may escalate again remained a key risk to the global economic outlook. This was reflected by continued market unease about sovereign debt problem in other countries, such as Spain and Portugal.

Volatility of the Thai baht picked up recently, particularly from late February to early March, driven by fluctuations in the US dollar, surges in capital flows in tandem with shifting market sentiment, and flood-related insurance payouts. The MPC noted improvements in Thai firms' ability to adjust to the baht volatility.

Money market interest rates and short-term government bond yields stabilized around 3 percent per annum, reflecting market expectations that the MPC might keep the policy rate unchanged at this meeting. Medium and long-term government bond yields increased in tandem with higher US treasuries' yields on the back of an improved economic outlook and an anticipated pickup in inflationary pressure. The expected rise in government bond supply associated with flood-related spending also contributed to higher bond yields.

The International Economy

The global economy continued to grow at a slow pace but with lower downside risk as reflected in positive signals from a number of economic indicators. The US economic outlook became more positive in light of improvements in the labor market, both in manufacturing and service sectors, as well as higher business and consumer confidence. **The euro zone economy** entered into a recession, though the contraction probably might not be as severe or prolonged as earlier feared, given that the debt crisis had abated somewhat and the German economy remained robust with relatively low unemployment, low private sector debt, and continued improvement in business confidence. **Economic growth in Asia**

softened slightly in line with recent moderation in exports. Going forward, however, export outlook was positive as the shortage of parts caused by flooding in Thailand had abated and the US economy continued to recover. Latest figures indicated further improvements in new export orders in Taiwan, Korea, China, and Singapore, especially for electronic goods, which formed the bulk of exports from Asia.

Inflationary pressure increased from rising global oil prices as a result of tensions in the Middle East, and slightly higher commodity prices. Nonetheless, the MPC judged that the pressure would not be as severe as in 2008, since the conflict was expected to be contained and unlikely to result in war. It was also noted that oil price increases driven by supply factors typically do not persist for very long, compared with those resulting from higher demand.

Against the backdrop of a more positive global economic outlook and higher risks to inflation, most central banks decided to keep the stance of policy unchanged. The exceptions were due to country-specific reasons, such as the Philippines where monetary policy was eased in light of a decline in inflationary pressure on account of domestic factors.

The Domestic Economy

The economic recovery in Thailand gained traction with consumption and private investment accelerating faster than previously anticipated. The payment of insurance claims may be delayed in a number of cases due to the drawn-out assessment process and a shortage of manpower to verify claims. However, this did not impede business investment since most flood-affected firms had a number of funding sources: own funds, financial support from parent companies abroad, credit from commercial banks, and interim payments from insurance companies. Nevertheless, the purchase and installation of machinery for some companies that rely on advanced technologies may take longer. Overall the MPC anticipated most economic activities to return to normal by the second quarter of this year. The main exception was the manufacturing sector, where normal production levels were expected to resume in the third quarter, paving the way for a steady recovery in exports.

Accommodative monetary policy and government stimulus measures continued to underpin economic growth. The government's budget disbursement on water management projects was expected to take place at a faster pace than previously forecasted as some projects had already been approved in March. The Thai economy was projected to grow by 5.7 percent in 2012 driven primarily by domestic demand from both the private and public sectors, while external demand was expected to play a larger role in the latter half of this year as the anticipated recovery in the global economy takes hold and exports return to their normal levels. Overall, recent improvements in the global economy had reduced downside risks to Thailand's economic growth.

Inflationary pressure and their expectations were projected to remain stable in the short-run, but there are upside risks stemming from rising global oil prices, a pick-up in domestic demand in the latter half of this year, and government stimulus measures, especially the minimum wage hike which comes into effect in April 2012. On the other hand, the postponement of the reinstatement of the oil excise tax would help lessen the effect of rising global oil prices on domestic inflation.

Monetary Policy Considerations

The MPC assessed that the reduction in the policy rate over the last two meetings had helped to shore up the Thai economy, with good momentum evident in all major components. In light of lower risks from the global economy, further easing of monetary policy was not needed. Nevertheless, the structural problems underlying the sovereign debt crisis in the euro zone had not been directly addressed and could flare up again. With the recovery of the Thai economy only just beginning and considering potential implementation delays in government stimulus measures, an accommodative monetary policy stance was deemed appropriate in supporting economic growth in the period ahead.

At the same time, risks to inflation became more elevated mainly from global oil prices and progressively more pronounced demand pressure as the Thai economy moves closer to potential, implying a possible pickup in inflationary pressure in the latter half of this year. Although this price trend was in line with the earlier assessment and the level remained manageable, more caution was warranted. A few members expressed their concern that inflationary risks may rise further from domestic factors, such as the unprecedented hike in the minimum wage, as well as external developments including the enormous injection of liquidity by central banks of advanced economies. These were important risk factors that the MPC would monitor closely.

The MPC deemed the current level of the policy rate to be appropriate in supporting economic recovery 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 3.00 percent per annum.

Monetary Policy Target for 2012

In regard to the monetary policy target for 2012, the MPC viewed that the proposal to adopt headline inflation (annual average headline inflation of 3.0 ± 1.5 percent per annum) as a monetary policy target remained appropriate. In the long run, this would help enhance the effectiveness of monetary policy communication and strengthen the anchoring of inflation expectations. The Ministry of Finance and related agencies, after discussing the matter in accordance with the cabinet resolution, agreed in principle on the adoption of the new target, but suggested the postponement of the change. This was due to a number of special factors this year, such as a sharp rise in global oil prices from international geopolitical tensions and reform of the structure of domestic energy prices, which may result in undue volatility of headline inflation.

In order to ensure a smooth transition, the MPC agreed to postpone the adoption of the new monetary policy target to a more appropriate time and retained the current target (quarterly average core inflation of 0.5 – 3.0 percent) for this year. The MPC would continue to monitor both core and headline inflation as usual, and communicate its policy deliberations in terms of both measures with increasing emphasis on the headline inflation to foster public understanding from this point forward.

In terms of oil price developments, the MPC would continue to monitor their impact on headline inflation and the transmission to core inflation. Recently, the pressure had indeed increased, resulting in a slight upward revision to the inflation forecast. In any case, the focus of monetary policy would be on addressing potential second round effects from demand pressure and developments in inflation expectations, regardless of whether headline or core inflation was used as the policy target.

Monetary Policy Group

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