Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

13 June 2012

Publication Date: 27 June 2012

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

Developments in the eurozone economy weighed heavily on investor confidence, prompting a flight to safety, which pushed yields on US, Japanese, and German government bonds to historical lows. The Thai baht depreciated in line with regional currencies, with much of the pressure stemming from outflows from the equity market, which fell in tandem with regional bourses.

The Thai money market was largely unaffected by the stress in global financial markets. Domestic liquidity, as well as those in the foreign exchange market, was sufficient and volatility in the swap market remained contained, albeit at slightly elevated levels. Short-term money market interest rates stabilized in line with the policy interest rate, reflecting market expectations that the MPC would keep the policy rate unchanged at this meeting. More volatility was seen for government bond yields in the medium and long-term maturities as investors grappled with heightened uncertainty in the global economy.

The International Economy

Risks to the global economy increased relative to the previous meeting as doubts about the ability of Greece to remain in the eurozone grew and the Spanish economy became increasingly affected by the growing fragility of its banking system. As a result, the contraction in **the eurozone economy** was likely to be more protracted than previously anticipated, with greater potential repercussions on the global economy. The US economy, in particular, would be susceptible given its close link with the eurozone economy and the still fragile state of its recovery, as reflected in latest signs of weaknesses in the labor market. While strong domestic consumption and consumer confidence continued to form the foundation of the recovery, the potential drag to economic activity from the anticipated expiration of fiscal stimulus measures was a source for concern. Economic growth in Asia moderated and the rebound in exports was expected to soften in line with the slowdown in China and the global economy. On the positive side, robust domestic demand and remaining fiscal and monetary policy space would help to cushion the impact of weaker global economic growth on Asia to some extent.

Global price pressure moderated as oil and commodity prices fell on the back of a weaker global economic outlook. **Most central banks kept policy interest rates unchanged**, opting to wait for greater clarity on the global economic outlook and preserving the room to act should the situation in the eurozone economy deteriorate markedly.

The Domestic Economy

The Thai economy recovered faster than expected in the first quarter. The recovery in the manufacturing sector was swift with production back almost to pre-flood levels, driven in part by the pressing need for inventory buildup. Restoration spending and capacity expansion fueled a robust pickup in private investment, while private consumption growth continued to be buoyed by a strong labor market, increased farm income and higher consumer confidence. Government spending also picked up following the implementation of the Budget Act. At the same time, monetary conditions remained accommodative, with credit continuing to expand rapidly. Although much of the supply constraints had been addressed, exports were weighed down by weakening external demand, particularly from Europe.

The Thai economy continued to gain traction from the recovery in production and domestic demand. Despite the much stronger outturn in the first quarter, economic growth for 2012 was expected to remain at 6.0 percent. This reflected a weaker outlook for the remainder of the year as export growth was revised downwards in light of the worsening global economic outlook. Moreover, government spending was expected to be lower than previously projected. Risks to the outlook also increased from uncertainties surrounding the global economy. In particular, should the situation in the eurozone economy deteriorate markedly, Thai exports would be affected directly as well as indirectly through the contraction in exports of other countries, such as China, and the resulting drag on the economic recovery could be substantial.

Inflationary pressure persisted, albeit at a more moderate level relative to the previous meeting as production costs eased. Oil and commodity prices fell against the backdrop of a softer global economic outlook. Nonetheless, robust domestic demand kept the degree of pass-through of costs to final goods prices elevated. Notably, the price of processed food, a staple item for Thai consumers, continued to rise, while inflation expectations remained elevated compared to historical levels partly due to the recent minimum wage hike and the anticipated energy price structure reform.

Monetary Policy Considerations

The MPC assessed that the balance of risks for the Thai economy was skewed towards growth rather than inflation, primarily reflecting heightened global economic uncertainties. The most likely scenario involved a drawn out crisis in the eurozone economy given the weak state of public finances in several countries, fragilities in the banking system, and persistently high unemployment. Solving such deep-rooted problems would take time. Meanwhile, with confidence fragile and sentiment weak, a number of factors, especially on the political front, could trigger a rapid worsening of the situation.

Given the shift in the balance of risks, the MPC considered whether there was a need for monetary policy to be eased further. Key issues raised in discussion were as follows.

(1) Although risks to the global economy had heightened, its impact on the Thai economy had not changed materially, with domestic economic activity remaining strong and on course to return to potential by the end of this year. Some recent moderation in price pressure notwithstanding, the strength of the economic recovery continued to put pressure on inflation, which was projected to remain higher than the mid-point of the policy target. A few members noted that shortages of raw material and labor were constraining some sectors and, in the context of the elevated inflation expectations, would drive pass-through of costs to final goods and services prices in the period ahead.

(2) Monetary conditions remained accommodative and commensurate with the needs of the economy. Private loan growth was robust and low long-term real interest rates were supportive of investment spending. Some members viewed that funding costs were not a key obstacle for businesses at this point, especially when compared to constraints from limited availability of labor and raw material.

(3) Given the risk that the global economy may deteriorate substantially, it was important to preserve room for interest rate policy to act by waiting for greater clarity on continuing developments abroad.

The MPC thus voted unanimously to maintain the policy rate at 3.00 percent per annum at this meeting and would remain vigilant in monitoring global economic developments and stand ready to take appropriate policy action as warranted.

The Joint Meeting between MPC and FIPC

The MPC deemed that safeguarding financial stability involved an integrated view of key areas, including financial institutions, financial markets, and macro-economy, all of which are highly interlinked. The effectiveness of the surveillance framework for systemic risks would benefit from regular joint sessions between the Monetary Policy Committee (MPC) and the Financial Institutions Policy Committee (FIPC) to share information, assess important risks to financial stability, and discuss appropriate and possibly coordinated policy options. The meetings will take place at least twice a year or as necessary, and the first joint meeting would be held on June 18, 2012.

Monetary Policy Group

27 June 2012