Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

25 July 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

Global economic uncertainty continued to dampen investor confidence, fueling demand for safe-haven assets and pushing government bond yields in major economies to exceptionally low levels. In contrast, bond yields in crisis-affected eurozone economies edged higher. Capital flows to emerging economies were volatile, as they were sensitive to shifting investor sentiment. As a result, volatility in regional equity and bond markets increased, while regional currencies including the Thai baht depreciated against major currencies such as the US dollar and the Japanese yen.

Heightened volatility in global financial markets did not significantly affect the Thai financial market, with both domestic and foreign currency liquidity remaining sufficient. Although foreign currency liquidity tightened in some periods as concerns over global economic conditions intensified, overall market adjustment was orderly. **Money market rates and short-term bond yields stabilized in line with the policy rate, reflecting market expectations that the MPC would keep the policy rate unchanged in this meeting.** Driven by a strong post-flood economic recovery, foreign investment in equity and bond markets increased, pushing medium- and long-term government bond yields lower.

International Economy

Risks to the global economy increased relative to the previous meeting reflecting: (1) the high degree of uncertainty surrounding the European sovereign debt crisis which was likely to be protracted given deep underlying structural problems whose resolution would encounter numerous practical challenges. For example, parliamentary approval from every member country would be needed before the single supervisory mechanism can be established. **(2) The fragile recovery of the U.S. economy,** as reflected by lower than expected employment and consumption figures, and uncertainty over whether or not key fiscal stimulus measures scheduled to expire at the end of this year would be extended.

The slowing global economy weighed on Asian and Chinese exports, which were anticipated to be weaker than previously assessed. Some MPC members viewed the moderation in export growth as suggestive of Asia's limited capacity to act as the main driving force for the global economy going forward.

As global price pressure softened in line with weaker global demand, a few central banks, such as in South Korea, China, as well as the eurozone, **eased policy** with a view to containing downside risks to growth.

The Domestic Economy

The Thai economy continued to recover from the floods and the level of activity had returned to normal. Domestic demand was supported by accommodative financial conditions, strong private credit growth, good employment opportunities and government stimulus measures. These factors should continue to sustain private consumption and investment expenditures going forward. Nonetheless, a few MPC members viewed that constraints on the supply of key inputs, particularly shortages of labour in some industries, would limit growth of the country's production capacity in the long run.

While the MPC projected economic growth to be close to potential with continued expansion of domestic demand, the slowdown in the global economy would detract from Thai export growth to a greater extent than previously anticipated. Relative to the previous meeting, export growth for 2012 was revised downward from 8.3 percent to 7 percent, while projected GDP growth was lowered from 6.0 percent to 5.7 percent in 2012 and from 5.4 percent to 5.0 percent in 2013. **Price pressure moderated in tandem with the softer economic outlook**, and inflation was projected to return to the mid-point of the target sooner than previously assessed.

The MPC deliberated on the recent rapid growth in private credit. While a major driving factor was attributed to credit extension by government specialised financial institutions, commercial bank loans had also expanded at a fairly high rate. This was viewed as reflective of the upcycle in private investment, as well as accommodative loan supply conditions. Although there were currently no clear signs of excessive credit growth, with the level of non-performing loans still at a low level, the committee would continue to closely monitor the expansion of loans by both commercial banks and specialised financial institutions.

Monetary Policy Considerations

The MPC viewed that the outlook for global economic growth had weakened with heightened risks compared to the previous assessment, and anticipated that the impact on Asian and Thai economies would become more evident in the period ahead. Meanwhile, domestic demand expanded close to potential and inflationary pressure subsided. **With the balance of risks skewed more towards growth rather than inflation, monetary policy could play a role in supporting economic activity if necessary.** However, members differed somewhat in their assessment of the balance of risks.

Two members viewed that a reduction of the policy rate by 0.25 percent per annum was warranted as the weakening global economy could act as a drag on the Thai economy through its larger than expected impact on the export sector. Moreover, there was the risk that the support from fiscal stimulus measures could be delayed and their impact more muted than currently assumed. Further easing of monetary policy at an early stage would thus help to shore up confidence and sustain private investment growth.

Five members assessed that the current policy rate of 3.0 percent per annum was appropriate, viewing the prevailing macroeconomic policy mix as suitably supportive of domestic economic growth and already providing a degree of cushioning against global economic risks. This assessment was supported by an overall economic picture in which growth was close to potential, inflation projected to remain within target, and monetary conditions accommodative with low real interest rates and robust credit growth. In addition, given the structural nature of the problems besetting the global economy, comprehensive solution would take time. As such, the option for monetary stimulus should be retained until there was greater clarity on the impact of the global economy on Thai economy.

The MPC therefore voted 5 to 2 to maintain the policy rate at 3 percent per annum. The MPC would remain vigilant in monitoring developments in the global economy and domestic demand conditions, and stood ready to take appropriate policy actions.

Monetary Policy Group
8 August 2012