Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

17 October 2012

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Members Present

Prasarn Trairatvorakul (Chairman and Governor), Pongpen Ruengvirayudh (Vice Chairman and Deputy Governor, Monetary Stability), Tongurai Limpiti (Deputy Governor, Corporate Support Services), Ampon Kittiampon, Narongchai Akrasanee, Siri Ganjarerndee and Aswin Kongsiri.

Financial Markets

Global financial market sentiment improved since the last meeting on the back of further progress toward the euro debt crisis resolution, as Germany's constitutional court had ruled in favour of German participation in the European Stability Mechanism (ESM). Further monetary policy easing by the Federal Reserve and European Central Bank also contributed positively to investor confidence, which led to more foreign capital inflows into Asian equity and bond markets and the appreciation of regional currencies including the Thai baht against the US dollar. However, pressure on the Thai Baht stemming from the third round of US quantitative easing (QE3) was expected to be more limited in comparison with QE1 and QE2 partly due to more attractive investment returns in other emerging markets, especially Latin America.

Short-term government bond yields edged up from the last meeting and stayed at a level close to the policy rate in the period leading up to this meeting, reflecting market expectation that the MPC would keep the policy rate unchanged. Medium- and long-term government bond yields were volatile, rising in tandem with higher US bond yields and greater-than-expected bond supply announced by the government, then edging lower on the back of capital inflows into the bond market.

The International Economy

The global economy remained weak despite some bright spot in the US economy with improvements in production, employment, and consumer confidence. QE3 was expected to play a limited role in stimulating the US economy as commercial banks' credit standard remained tight and the impact on the real estate sector, capital market and investment would take time to materialise given uncertainties pertaining to the fallout of the euro debt crisis and the US fiscal cliff. **The euro zone economy** remained in recession and was likely to weaken further due to challenges in policy implementation. The situation in Spain, in particular, could potentially deteriorate and undermine market confidence. Weak global demand had weighed more heavily on **Asian economies** than expected. Contraction of Asian exports to major economies persisted and could be compounded by China's economic slowdown. However, some regional economies continued to expand fairly well on account of robust domestic demand which helped to cushion somewhat the negative impact from the global economy.

Global inflationary pressure was subdued in line with weak global demand. A few central banks recently cut policy rates in response to the below-target inflation rates and more evident slowdown in domestic economy, but most central banks kept the policy rates unchanged.

The Domestic Economy

The MPC assessed the economic growth in the third quarter to be close to projection. Private consumption and investment continued to be the main growth drivers. Key supporting factors included high household income, favourable labour market conditions, strong consumer confidence, government stimulus measures such as the first-car tax rebate programme, as well as accommodative monetary conditions as evident from strong private credit expansion.

The MPC viewed that credit growth in the corporate sector was consistent with domestic investment cycle, and the expansion in mortgage loans was not yet a cause for concern, as commercial banks still maintained prudent credit standards and households' debt servicing abilities remained intact. However, the exceptionally high growth in non-mortgage loans should be closely monitored, with particular attention to be paid to low-income households, in order to guard against a potential build-up of financial imbalances.

In contrast with domestic demand performance, external demand was weaker than previously assessed, as reflected by more-than-expected contraction in exports and export production. Business sentiment in the export-oriented sector started to show sign of weakening, pointing to more sluggish investment in the export sector relative to the domestic sector in the period ahead. Leading indicators such as new export orders suggested that recovery in exports would be unlikely this year, although there might be some seasonal pickup in the last quarter.

Overall, the MPC assessed this year's economic growth to be close to the previous projection of 5.7 percent, but growth for 2013 was revised down to 4.6 percent from 5.0 percent. The revision was mainly due to the following reasons: (1) the global impact could spill over to private investment, which was already moderating as post-flood reconstruction and investment tapered off, and (2) government investment spending was likely to be partially delayed. However, it should be noted that additional spending under the government's 2.27 trillion baht infrastructure investment plan had not been incorporated into this projection. In the event that part of this plan could be rolled out within 2013, the economy would gain more traction and the growth outturn could be higher than the baseline projection. Private consumption was expected to grow steadily. Inflationary outlook was unchanged from the last meeting, with core inflation forecast remaining at 2.1 and 1.7 percent in 2012 and 2013, respectively.

Monetary Policy Considerations

All MPC members agreed that uncertainties surrounding the global economy remained high and the impact of global slowdown on regional economies was significant. Exports could be more negatively affected by weakening global demand in the period ahead, but Thai economy would continue to expand on the back of strong domestic demand under benign inflation outlook. However, members differed in their assessment of risks going forward and thus the need for policy easing.

Five members deemed a reduction of the policy rate by 0.25 percent per annum to be appropriate given that Thai exports and export production would deteriorate due to greater-than-expected slowdown in the Chinese and regional economies. Although domestic demand was helping to sustain the overall economic momentum, it might not be sufficient to cushion the impact of export slowdown going forward as the strength of private demand would be undermined by moderating private investment and expiring government stimulus, such as the tax rebate programme. Furthermore, significant acceleration of government spending appeared unlikely. Against this backdrop, a policy rate reduction at this meeting would act to shore up domestic demand and would also serve to signal firms to prepare for the possibly heightened risk of economic slowdown in the period ahead. Two members viewed that a reduction in interest rate differentials between Thailand and major economies would also help to slow down foreign capital inflows, although the effect was likely to be limited given that interest rate differential was shown by studies not to be the main driver of capital inflows, especially in comparison with market expectation of currency gain, global investor sentiment, and cross-country differentials in economic fundamentals and growth prospect.

Two members deemed that maintaining the policy rate at 3.00 percent per annum was justified on the basis that, despite high uncertainties besetting the global economy, signs of recovery had begun to emerge. Next year's global economic expansion was projected to be slightly higher than this year, and the probability of tail events had diminished thanks to additional policy measures undertaken by the G3 economies. Overall Thai economy continued to grow on a well-balanced path despite negative global impact, with domestic demand expanding firmly and inflation remaining within target. Moreover, in light of the already accommodative monetary conditions and high private credit growth, lower interest rates could induce risks to financial stability. Policy rate should therefore be put on hold, until there is greater clarity on the overall balance of risks to the economy.

The MPC therefore voted 5 to 2 to reduce the policy rate by 0.25 percent, from 3.00 percent to 2.75 percent per annum.

Monetary Policy Group
31 October 2012