Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

21 August 2013

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Members Present

Prasarn Trairatvorakul (Chairman), Pongpen Ruengvirayudh (Vice Chairman), Tongurai Limpiti, Ampon Kittiampon, Siri Ganjarerndee, Narongchai Akrasanee, and Aswin Kongsiri.

The Financial Markets

The US dollar depreciated against major currencies, as uncertainties about the timing of the Federal Reserve's QE tapering continued, while euro area and Japanese economies showed signs of improvement. The US dollar appreciated against regional currencies, from financial market concerns over risks to regional economic growth, following a slowdown in Chinese and other Asian economies, with deteriorating fundamentals in some countries. Thai baht was volatile and depreciated following the release of lower-than-expected second-quarter GDP. The short-term outlook for Thai baht would largely hinge on (1) economic outlook of major countries, as well as China and regional economies and (2) the timing of Fed's QE tapering.

Money market rates remained stable while government bond yield curve steepened. Short-term yields edged lower following increased demand from both domestic and foreign investors, while medium- and long-term yields rose in tandem with the US Treasury bond yields. Most market participants expected the MPC to maintain the policy interest rate at this meeting.

The MPC discussed recent rise in financial market volatility in the region, particularly Indonesia, India, and Malaysia. The market was concerned about current account deficits in the first two economies and fiscal sustainability in the latter. Relatively high share of non-resident holdings of Malaysian bonds heightened the economy's exposure to capital flow and exchange rate volatility, despite otherwise sound economic fundamentals.

The International Economy

The global economy continued to improve gradually. The US economy expanded on the back of manufacturing and housing sectors, while healthier balance sheets of the private sector should help support an ongoing economic recovery. **The euro area economies** continued to stabilize, supported by improvement in manufacturing sector. Growth resumed for the euro area in the second quarter, the first expansion since the third quarter of 2011. Nonetheless, recovery continued to be weighed by financial health of both real and financial sectors. **The Japanese economy** expanded at a gradual pace, due to government's economic stimulus policies. **The Chinese economy** moderated in the second quarter, though recent indicators pointed to some improvement. Public and private investment should lend support to growth going forward, and downside risks to growth have decreased since the previous meeting. **In Asia,** domestic demand slowed down while exports generally remained weak, notwithstanding tentative signs of recovery in exports for some countries. **Global inflationary pressure remained low** and most central banks kept the policy interest rates unchanged.

The Thai Economy

GDP Q2 2013 was broadly in line with the MPC's expectation of an economic slowdown in the short term. Domestic demand and exports were expected to recover gradually, although supply-side constraints could restrain potential growth and limit benefits from prospective global recovery. Private consumption of durable goods and automobiles continued to decelerate, as adjustment from waning government's first car tax rebate measure took longer than expected. Some increase in delinquencies and tightening of credit standards for consumer loans could add to a drag on durable goods consumption. Recovery in exports has not taken hold, while supply-side constraints in some industries are constraining exporters' competitiveness in the world market, with repercussion on domestic investment. Fiscal policy remained supportive of growth, though room for additional stimulus was limited in short term.

The MPC projected the Thai economy in 2013 and 2014 to expand less than previous assessment, from longer-than-expected moderation in private consumption and exports, coupled with a risk of delay in planned government stimulus. Nevertheless, the overall pace of economic slowdown so far was close to the committee's previous assessment. The economy continued to benefit from accommodative financial conditions, which would lend support to economic momentum to some extent. Inflationary pressure eased from softening domestic demand and subdued production costs, with lower-than-expected headline and core inflation in July.

Some members expressed concerns over the impact of potential default in automobile loans, which could adversely affect prices of second-hand cars, values of collaterals, and potentially the lenders. While prices of second-hand cars have recently fallen noticeably, members noted that second-hand car loans still accounted for a small share of automobile loans. A significant portion of first-car loans has also been extended to car dealers rather than consumers, thus limiting wider impact. While agreeing that the risk was not systemic, the MPC members saw the need to broaden surveillance to cover additional segments of credit markets. For instance, lightly-regulated car-for-cash loans have allowed easy access to finance based only on registration certificates, while saving cooperatives which have extended substantial loans to civil servants, were not under the central bank's regulatory domain.

The MPC discussed the likely impact of global market volatility on the Thai economy after the start of QE tapering. Some members identified two important determinants of asset allocation to emerging markets, namely (1) Fed communication regarding the speed, procedure, and strategy in winding down large-scale asset purchase program, and (2) underlying economic fundamentals in individual emerging economies, which may also have market implications including in Thailand. Other members emphasized exchange rate expectation as the key driver of capital outflows from emerging markets in recent months, as economic fundamentals usually changed too slowly to justify large swings in market sentiments. Moreover, some foreign investors may be inclined to consider Asian markets collectively as a group, with little discrimination based on fundamentals. Members agreed that a close monitoring of capital flow developments was warranted. One member noted in addition that volatile exchange rate may put upward pressure on inflation in the periods head.

Monetary Policy Deliberation

The MPC judged that The Thai economy continued to soften in the second quarter, broadly in line with the committee's previous assessment, from moderating domestic demand and exports. **The MPC deemed the current accommodative monetary policy to be necessary and appropriate in supporting an economic expansion.**

Six members viewed maintaining the policy rate at 2.50 percent per annum as justified, after weighing the likely effectiveness of further monetary easing against the costs. Key rationales are as follows: (1) private consumption moderated owing in part to higher household debt burden and advanced consumption of future income. Further easing of monetary policy may thus have only marginal impact on consumption, but could instead lead to a build-up of financial imbalances; (2) the recovery of Thai exports and private investment mainly hinged upon the global economy, which has already shown signs of gradual improvement; (3) against the backdrop of uncertain global financial conditions and capital flow volatility, further monetary easing might add to market uncertainties, with potentially adverse effect on private sector's confidence; (4) given an already prolonged period of negative real deposit rates, a cut in policy rate could further discourage saving, with implications for investment and potential growth in the longer term; and (5) the Thai economic slowdown may owe partly to supply-side constraints. Without pressing ahead with structural reforms to enhance the economy's potential growth, monetary policy easing would yield only limited payoffs.

One member deemed a reduction of the policy rate by 0.25 percent per annum as appropriate to support the continuity of growth next year, mainly through boosting labour income and helping reduce household debt burden. Given the time lags involved in monetary policy transmission to the real economy, a policy rate reduction would have a limited impact on growth this year. In addition, under the current circumstance, domestic interest rates were not a primary factor affecting capital flows, allowing the policy rate to be lowered.

The MPC thus voted 6 to 1 to maintain the policy rate at 2.50 percent per annum.

Monetary Policy Group
4 September 2013