

Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

9-10 July 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 appreciated against most major and regional currencies due to market anticipation that the Federal Reserve (Fed) could wind down its quantitative easing (QE) programme sooner, as signs of US economic recovery have become more evident, particularly in the labour market. Slowing Chinese and emerging market economies also triggered capital outflows from emerging markets, including Thailand. Thus, the Thai baht and regional currencies depreciated against the US dollar rapidly in the first half of June, before subsequently stabilizing as outflows moderated. Volatility of the baht increased, but remained relatively low compared with other regional currencies.

Government bond yield curve steepened. Short-term yields edged lower following the MPC's decision to reduce the policy interest rate at the previous meeting. Medium- and long-term yields rose following market's expectations of Fed's QE tapering, which led to increased selling of Thai bonds by foreign investors. However, subsequently more subdued outflows and lower-than-expected government bond issuance announcement for the third quarter helped lower yields to some extent. Most market participants expected the MPC to keep the policy interest rate unchanged at this meeting.

The MPC discussed potential impact of QE tapering on overall financial markets: (1) steepening government bond yield curves in many countries were partly attributable to decreased demand for long-term bonds as investors sought to reduce long-term interest rate risk exposure. The Thai bond market was also affected, as it has normally been sensitive to external factors; (2) Emerging Asia and Latin America may experience outflows, following significant surges in capital inflows previously. Despite the difficulties in predicting the effects of shifting risk appetite on capital flows, some members noted that financial markets may have overreacted to Fed's signals of QE tapering in the short run. The members pointed out that the Fed's intention to wind down its QE programme is conditional on more evident and sustained US economic improvement, which may have been misinterpreted by some market participants as a committed timeframe; and (3) rising long-term interest rates may have played some part in delaying the public sector's new bond issuance. However, the corporate sector continued to

issue its new bonds as planned. The MPC will closely monitor developments in financial markets and implications for private sector's financing conditions in the periods ahead.

The International Economy

Overall global economic growth moderated since the last meeting. While downside risks to growth in advanced economies have decreased, they have edged up in the Chinese and Asian economies. However, global growth is expected to improve gradually in the latter half of this year. The US economy grew at a slower pace in the second quarter of this year from softening private consumption following income tax increases. Nevertheless, improving underlying economic fundamentals, particularly in the labour and housing markets, should help support domestic demand and economic recovery in the periods ahead. **The euro area economies** remained weak but exhibited incipient signs of stabilization on the back of improved private sector confidence and production in core member economies, particularly Germany. **In Japan,** economic stimulus policies started to have more evident impact on private consumption, production, and exports. **The Chinese economy** moderated primarily from exports and investment, though domestic demand should be an important driver of growth going forward on the back of high employment, favourable household and corporate income, and government measures to support investment. However, China's economic growth is expected to be less buoyant than in previous years, as the government has signaled its intention to place greater emphasis on sustainability of economic growth. **The Asian economies** continued to expand on domestic demand, but weaker exports, linked in part to China's slowdown, resulted in a more subdued growth compared to the last meeting. Firmer recovery of advanced economies in 2014 should benefit Asian exports in the periods ahead.

Global inflationary pressure remained low, partly from softening commodity prices. Most central banks have consequently kept policy interest rates unchanged since the last meeting.

The MPC saw the need to monitor developments in China closely, including: (1) the ongoing high credit growth in China arising from shadow banking activities, which, if not addressed by appropriate measures, could undermine financial stability; (2) the potential impact of China's slowdown on Thai exports and tourism, given a high share of Thai exports to China and the large number of Chinese tourists. One member noted in addition that a prerequisite to a robust economic recovery is the strength of balance sheets of households, businesses, financial institutions as well as governments. Current balance sheet conditions in both the US and the euro area remained fragile however, thus risks of a more protracted recovery path could not be ruled out.

The Thai Economy

Growth of the Thai economy moderated from a slowdown in both domestic demand and exports. Softer private consumption, particularly of durable goods, was an adjustment from the

previous extraordinary growth. Consumers exercised more caution partly as a result of rising debt burden at a time when the impact of government consumption stimulus measures dissipated. Exports decelerated from supply constraints as well as a slowdown in exports to China since the first quarter of 2013. Meanwhile the gradual US recovery has not resulted in higher export demand. Slowing domestic and external demand in turn led to delay in parts of private investment. Nevertheless, businesses' investment plans to raise capital intensity remained, with most firms facing no financial constraints. Thus, private investment should resume as planned once demand improves. Economic fundamentals such as low unemployment, high non-farm income, as well as accommodative monetary conditions, remained supportive of growth.

The MPC revised growth projection for 2013 down from the previous assessment to 4.2 percent, as a result of a slowdown in domestic demand and exports, and delay in government investment plans especially in water and flood management projects. Inflationary pressure eased further from softening domestic demand and lower production costs, from both oil and commodity prices. Risks to financial stability warrant continued close monitoring, as private credit growth and household debt, though decelerating somewhat, remained on a high side.

Some MPC members noted that better performance of Thai exports relative to many countries in the region, may owe partly to increasing product diversification. Some members expressed a view that long-run potential growth may be adversely affected not only by a slowdown in private investment, but also supply-side issues such as labour shortages and challenges to improving productivity and creating higher value-added products. The supply constraints cannot be resolved by monetary policy easing or demand stimulus measures, but instead require structural reforms. Members saw the need to closely monitor developments of the global economy and public investment outlook, both of which remained key risks to Thai economy in the periods ahead.

The MPC deemed the decisions by most commercial banks to keep both deposit and lending rates broadly unchanged despite the policy rate cut on 29 May 2013, as essentially due to concerns about liquidity outlook amid intensified competition in deposit market. Key factors responsible for banks' desire to retain their deposit bases included: (1) commercial banks' ongoing plans to expand lending, (2) government's need to raise funds for large-scale infrastructure projects through Specialised Financial Institutions (SFIs), and (3) uneven liquidity distribution and different business strategies among commercial banks. Given high level of competition in both credit and deposit markets, commercial banks were reluctant to lower their interest rates.

Monetary Policy Deliberation

The MPC judges that the Thai economy was in transition from the previous extraordinary growth induced by government stimulus measures, and thus should resume its normal growth

path in the periods ahead, supported by sound underlying fundamentals such as high employment and income. The outlook for global growth points towards a gradual recovery, though fragility remains. **The current monetary policy stance remains sufficiently accommodative and supportive of a recovery to normal growth path.**

Key conclusions reached during policy discussion are as follows:

(1) The global economy expanded less than previous assessment due mainly to China's economic slowdown which weighed on Asian exports including Thailand, despite some improvement in the US and Japanese economies. Some members pointed out that several organizations, including the International Monetary Fund (IMF) had revised down their growth forecasts.

(2) Growth of the Thai economy moderated from domestic demand and exports, partly as a result of rising debt burden coupled with waning government consumption stimulus measures. Weak domestic and external demand in turn caused a delay in private investment. The latest downward revision of growth projection is due to weaker-than-expected GDP outturn in the first quarter and the recent softening of economic indicators. The MPC already took the moderating trend of growth into account when it decided to lower the policy rate in the previous meeting.

(3) Monetary and fiscal policies remain sufficiently accommodative to support growth recovery as reflected in continued credit expansion and fiscal deficit, with financial institutions competing actively to mobilize funds and extend more credits.

(4) Risks to financial stability warrant continued close monitoring. Notwithstanding a slight moderation, credit growth remained high. In particular, the rising trend of household debt burden, if continues, could add to overall financial imbalances.

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

The MPC agreed that risks stemming from financial market and capital flow volatility, with potential implications for exchange rate and financial stability, warrant a continued close monitoring.

Monetary Policy Group
24 July 2013