Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

27 November 2013

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Members Present

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

The Financial Markets

Market expectations of the unwinding of the Federal Reserve's quantitative easing (QE) were the main drivers of major and regional currencies. The US dollar appreciated since the last meeting, as financial markets shifted forward their anticipation of QE tapering, following more optimistic statement by the Federal Open Market Committee (FOMC) in October, and better-than-expected labour market data. As a result, **regional currencies and the Thai baht depreciated against the US dollar.** Domestic political situation and weaker-than-expected Thai economic data also triggered capital outflows from the equity and bond markets especially in November, and contributed to the baht depreciation.

Government bond yield curve fluctuated with global market sentiments. Yields initially rose in tandem with the US Treasury, thanks to market expectations of early QE tapering. However, the depreciation of Thai baht in November may have precipitated some selling of short-dated bonds by foreign investors. Most market participants expected the Monetary Policy Committee (MPC) to maintain the policy interest rate at this meeting, and to start normalizing the policy interest rate in the latter half of next year, consistent with economic recovery.

Some members saw the need to closely monitor the potential implications of gold exports and imports for current account deficits and Thai baht. Although the headline deficit might have contributed to some foreign investors' concerns about external stability, current account balance remained in surplus after excluding exports and imports of gold. Members agreed that greater communication regarding this issue would be beneficial.

The International Economy

The global economy continued to recover, led by the major economies, and was projected to grow at a firmer pace next year. The US economy grew more robustly than expected in the third quarter of this year, owing to a temporary boost from inventory accumulation. Healthier balance sheets of households and financial institutions should help sustain domestic demand and economic recovery in the periods ahead. Nonetheless, uncertainties about fiscal policy and the timing of Fed's QE tapering would continue to weigh on global financial market sentiments. **The euro area economies** grew at a gradual pace from domestic demand in core member economies and improving exports, but political situation and fragile balance sheets of financial institutions continued to impede the recovery. **The Japanese economy** moderated in the third quarter of this year from contraction in exports and softening private consumption. Looking ahead, support from domestic demand and government's economic stimulus policies should continue to provide growth momentum. **The Chinese economy** expanded well across all sectors, albeit at a slower pace relative to previous years, given the government's greater focus on long-term sustainability of economic growth. **The Asian economies** continued to grow at a moderate pace. Exports of the North Asian economies recovered at a more robust pace than those of ASEAN peers. Given the North Asian products' technological advantages and greater supply chain integration, these economies were able to benefit more from higher demand from the major and Chinese economies. Countries with twin deficit problem remained subject to higher risk of capital outflows compared to other countries.

Global inflationary pressure remained low, and most central banks have consequently kept policy interest rates unchanged since the last meeting. However, in India and Indonesia the policy interest rates were raised in response to elevated inflationary pressure and widening current account deficits; while in the euro area economies the policy interest rate was lowered in response to the economic slowdown amidst subdued inflationary pressure.

In their discussion, the MPC noted that (1) China's economic reforms as set out in the Third Plenum, especially the liberalization of exchange rate (linked in part to Yuan greater convertibility), interest rates, and capital account, could have significant implications for the Thai economy, thus warranted close monitoring; and (2) Structural problems remained in China and Japan. China's major challenges were to create higher value-added products, reduce income inequality and rein in shadow banking activities. In Japan, high social welfare spending and public debt, together with low labour productivity, could restrain Japanese economic growth in the periods ahead.

The Thai Economy

The Thai economy expanded less than expected in the third quarter of 2013 from both private and public spending. Recovery in exports of goods has not gained traction, though tourism continued to grow well. The outlook for private consumption was projected to be more subdued than previously assessed, with higher household debt burden holding back consumption of non-essential goods amidst lower consumer confidence. Private investment has not recovered, as some businesses awaited clearer signs of private demand recovery as well as implementation of public investment in infrastructural projects. Exports should gradually improve in line with a moderate pickup in external demand, but benefits would be curbed by limitations in competitiveness and lower technological advantage of the export industry. Core and headline inflation rates edged up in October in tandem with prices of food and beverages, but inflationary pressure overall remained low.

The economy was projected to grow at a slower pace than previously assessed. Growth was subject to greater downside risks, stemming from further delay in public investment, fragile private confidence which might be compounded by the ongoing political situation, and the uncertain timing of QE tapering which continued to weigh on investors' confidence. **The committee therefore revised growth projection down from 3.7 to around 3 percent in 2013, which has not taken into account possible additional effects from the political situation. Projection for 2014 was also revised downward from 4.8 to around 4 percent.** Inflationary pressure remained benign in line with economic outlook.

Concerns over financial stability risks have lessened, as private credits, including to households, continued to decelerate. Financial conditions, nevertheless, remained conducive to economic recovery, reflected in part by financial institutions' willingness to lend and continued demand for loans. Overall credit quality remained healthy, though households' debt servicing abilities have shown some signs of deteriorating. Financial institutions have tightened credit standards, particularly for individual borrowers, to strengthen their credit risk management. Real estate market has cooled from the beginning of this year, in line with lower risk appetite from both buyers and developers.

The committee agreed that clear growth drivers were lacking, and there were several factors impeding an economic recovery, including a high level of household indebtedness, a decline in export competitiveness, and higher downside risks to growth. Economic expansion in 2014 should be driven in part by a technical rebound in private demand from a low base this year, together with a gradual recovery in exports in line with the global economic outlook subject to structural constraints. Given this backdrop, macroeconomic policies should remain supportive of economic recovery, particularly through expediting public investment. The committee saw lower risks to financial stability, as credit growth continued to adjust towards a more sustainable level that was consistent with the real economic activity, after expanding at a high pace throughout the past few years. Nevertheless, debt servicing abilities might deteriorate further during periods of economic slowdown, and warranted monitoring.

Monetary Policy Deliberation

The MPC judged that the Thai economy should expand at a slower pace than previously assessed with greater downside risks compared with the last meeting, with household credit growth moderating somewhat. **The majority of the committee saw further room to ease monetary policy in order to mitigate downside risks and support an economic recovery**, given benign inflation outlook.

Six members viewed a reduction of the policy rate by 0.25 percent per annum as appropriate with the following rationales: (1) Downside risks to growth outlook have increased, and it would take time before the economy could resume growing at a normal pace. Domestic demand remained weak while recovery in exports has not gained traction despite improving global recovery, owing to structural factors. Some members saw a possibility of slower-than-expected global economic recovery. Moreover, domestic political situation could further dent sentiments, potentially affecting private spending and tourism, as well as causing further delay to public spending and investment; (2) Inflation edged up slightly following a gradual increase in LPG price but remained low and close to the lower bound of the target range. Inflation thus was not an immediate threat; (3) Risks to financial stability decreased somewhat, reflected by decelerating private credit growth amid economic slowdown. There were signs of adjustment in risk appetite for both lenders and borrowers, with financial institutions becoming more stringent in approving loans. Nevertheless, the MPC deemed it prudent to closely monitor the impact of reducing policy rate on financial stability developments.

Some members noted that while there was room for monetary policy easing at the current juncture, the policy effectiveness in compensating for lower fiscal stimulus would be limited.

One member deemed maintaining the policy rate at 2.50 percent to be sufficiently accommodative as the Thai economy should be able to resume its normal growth next year. Risks to financial stability remained, while inflation was kept subdued partly due to government measures. Furthermore, a prolonged period of very accommodative monetary policy could discourage private savings in the long run.

The MPC thus voted 6 to 1 to reduce the policy rate by 0.25 percent, from 2.50 to 2.25 percent per annum.

Monetary Policy Group
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