Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

3 April 2013

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Members Present

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

Members Absent

Aswin Kongsiri (due to obligations abroad)

<u>The Financial Markets</u>

Global financial market sentiment weakened slightly since the last meeting from political uncertainty in Italy, financial crisis in Cyprus and soft economic releases in the euro area. Most major and regional currencies depreciated against the US dollar as a result. Better US economic indicators raised expectations that the Federal Reserve (Fed) could start winding down its quantitative easing (QE) sooner than the market previously assessed, lending further support to the US dollar. The Thai baht exchange rate was relatively close to the level prevailing at the previous meeting. However, the baht appreciated notably toward the end of March, boosted by Thailand's credit rating upgrade by Fitch and more stable economic and political environment relative to other economies in the region. The baht subsequently corrected and stabilized due to higher demand for the US dollar from domestic businesses.

Short-term money market rates remained close to the policy rate. Government bond yields declined, driven by lower-than-expected bond supply as well as subdued global market sentiment amid further financial turmoil in the euro area. Short-term yields edged up from the last meeting before trending lower following an increase in investor demand. Most market participants expected the MPC to keep the policy interest rate unchanged at this meeting.

The MPC discussed the potential drivers of recent capital inflow and baht appreciation, including the misperception by some market participants that the Bank of Thailand (BoT) had ruled out strong policy responses. The MPC, however, was satisfied that the BoT's current exchange rate management framework already entailed systematic steps of policy responses, with specific measures ready to be implemented if and when warranted by the circumstances.

The International Economy

The global economy has shown signs of gradual improvement with similar momentum compared to the previous meeting. The US economy has improved, evidenced by a number of better-than-expected key economic indicators including housing and labor markets. Relatively firm domestic demand should help offset the drag from fiscal sequestration to some extent. However, the issues of debt ceiling and further need for fiscal consolidation remained major risks to US economy and should be closely monitored. **The euro area economies** remained weak and contracted by more than expected. Financial crisis in Cyprus and particularly the government's decision to bail in depositors have undermined financial market confidence, raising tail risks to the global economy. **The Japanese economy** exhibited incipient signs of improvement in the manufacturing sector, while private sector confidence and inflation expectations were boosted by more concrete plans for further stimulus measures. **The Chinese and Asian economies** have expanded in line with the MPC's previous assessment, on account of robust domestic demand and improving prospects of exports. Several countries announced measures to cool the real estate sector after a recent acceleration in real estate prices.

Global inflationary pressure remained low. Most central banks kept the policy rates unchanged; while in India and Vietnam the policy rates were lowered in response to evident slowdown in these economies.

The MPC assessed the US economic recovery to be gradual with risks remaining, a view broadly similar to the Fed's assessment. However, the committee also noted that the assumptions regarding US and global growth used by the BoT staff for forecasting purposes were generally more conservative than market consensus.

The Thai Economy

The Thai economy was assessed to have moderated toward a normal trend in the first quarter of 2013, mainly due to the slowdown in domestic demand after accelerating faster than expected in the previous quarter. Looking ahead, domestic demand should continue to be a key engine for economic growth, with private consumption holding up and private investment remaining on an upward trend backed by businesses' shifts toward greater capital intensity given rising labor costs. The overall domestic demand momentum should therefore continue, supported by favorable household income, high employment, as well as accommodative monetary conditions.

Fiscal stimulus, through public investment in flood management and the two-trillion-baht infrastructure projects should provide support to growth in the latter half of this year and lend further impetus to private investment. **Thus, the MPC adjusted growth projections for 2013 and 2014 slightly upward to 5.1 percent and 5.0 percent, respectively.** Meanwhile exports should recover slowly in tandem with the global economic conditions, reflected by forward-looking indicators including export orders. Japanese yen depreciation has not significantly affected Thai exports, which have closely been integrated into the Japanese supply chain, thus indirectly benefiting from yen depreciation through increased exports of intermediate goods to Japan. In addition, the cost of imports from Japan, mainly capital and intermediate goods, would also decrease. Thai exports are also not in direct competition with Japanese goods due to largely different products. Inflationary pressure may edge up going forward due to supply constraints, higher labor costs, and greater cost pass-through given entrepreneurs' diminishing ability to hold down prices.

Some members noted that the planned increase in government spending could add to inflationary pressure and risks to fiscal sustainability in the periods ahead. On the other hand, some members deemed it necessary to monitor the sustainability of domestic demand momentum and whether disbursement of government expenditures would fall short of target.

Risks to financial stability warranted close monitoring, including from (1) the ongoing high household credit growth which could adversely impact households' debt service ability, particularly for the low-income group; (2) stock market volatility and signs of increased speculation in small-capitalization stocks by individual investors; and (3) continued buoyancy in real estate activities, reflected by a growing number of newly launched residential projects, especially in major regional provinces, with incipient signs of speculation.

The MPC agreed that, if exacerbated, these conditions could lead to a build-up of financial imbalances and undermine the economy's ability to absorb shocks. The MPC therefore saw a need to remain vigilant over these financial stability risks, and be prepared to implement appropriate measures as necessary.

Monetary Policy Considerations

The MPC agreed that balance of risks to the Thai economy remained skewed toward financial stability rather than growth. Nonetheless, members differed in their assessment of the impact of policy rate changes in preventing a buildup of economic imbalances stemming from accelerating domestic asset prices and capital inflows as follows.

Five members deemed maintaining the policy rate at 2.75 percent per annum as justified, with varying rationales. The majority of these members judged that: (1) the global economic recovery path remained close to the previous meeting, despite an increase in tail risks from banking sector problems in the euro area; (2) the Thai economy moderated after accelerating in the previous quarter, but growth momentum is expected to be sustained on the back of sound economic fundamentals; (3) planned public expenditures should add to the overall economic momentum in the periods ahead, but the continuity of private consumption and investment momentum warranted monitoring. Against the backdrop of ongoing risks to financial stability and the current policy rate that was already supportive of economic growth, maintaining the policy rate to wait for greater clarity on near-term momentum was an appropriate policy. Meanwhile, one of the five members assessed the Thai economy to be moderating, after post-flood recovery reaching its peak in the third and fourth quarters of 2012. The potential causes of slowdown included the fragile state of the global economy and a softening in domestic demand, as reflected by almost all economic indicators in January and February. Nonetheless, this member saw a need to carefully assess incoming economic data in the months ahead to ascertain whether the slowdown in domestic demand and exports during the first two months were temporary or persistent. Until there is greater clarity, maintaining the policy rate at 2.75 percent was therefore deemed appropriate.

One member viewed reducing the policy rate by 0.25 percent as appropriate given that: (1) both global and Thai economic indicators, particularly exports, have continued to deteriorate since the last meeting, while core and headline inflation rates trended downward; (2) capital inflows remained abnormally high and could pose significant risks to the Thai economy; (3) exchange rate volatility has intensified and baht appreciation has begun to have an evident impact on exports. A policy rate reduction of 0.25 percent was therefore deemed necessary. In addition, other complementary measures such as macro-prudential policy should be considered in order to safeguard the Thai economy against these risks.

The MPC thus voted 5 to 1 to maintain the policy rate at 2.75 percent per annum. The MPC will remain vigilant in monitoring global and domestic economic developments and stands ready to take appropriate policy action as warranted.

Monetary Policy Group
17 April 2013