Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

9 January 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 global financial market sentiment improved after the US "fiscal cliff" was averted. Consequently, most major currencies appreciated against the US dollar except the yen which depreciated due to expectation that the newly elected government would implement additional monetary stimulus measures. Meanwhile, both equity and bond inflows into the region accelerated on the back of improving global economic outlook. The Thai Baht strengthened rapidly following the fiscal cliff agreement, but overall movement remained in line with regional trend.

Short-term money market rates stabilised close to the policy interest rate, reflecting market expectation that the MPC would hold the policy interest rate at this meeting. Government bond yields of all maturities edged higher after the last meeting, in line with investors' improving assessment of economic outlook.

The International Economy

The global economy overall continued to recover gradually, with signs of improving outlook from the previous meeting. **The US economy** gained more traction from sustained improvement in the labour and housing markets as well as businesses' greater willingness to resume investment after the resolution of fiscal policy impasse. Nonetheless, uncertainties arising from debt ceiling and sequestration which need to be finalised by February 2013 remained key risks to the economy and could affect short-term confidence. **The Chinese and most Asian economies** continued to expand well with domestic demand being the main growth driver. Nonetheless, there was a view that a potential escalation of the territorial dispute between China and Japan might pose a risk to the region's growth momentum. **The eurozone economies** continued to be in recession, but were projected to recover gradually this year led by core members' economies particularly Germany. Progress in the resolution to Greece's sovereign debt problem also helped reduce the tail risks significantly. **The Japanese economy**

remained weak, both in terms of exports and domestic demand, while the new government's stimulus policies were expected to have only a limited impact in accelerating the economic recovery.

Inflationary pressure in many parts of the world remained subdued. Most central banks consequently decided to keep their policy interest rates unchanged after easing previously, while awaiting greater clarity on the domestic and international developments.

<u>The Domestic Economy</u>

The economy expanded in the fourth quarter by more than previously assessed largely from stronger-than-expected domestic demand, on the back of both private consumption and investment. In addition to fundamental factors, the outlook for domestic demand is further supported by greater subscriptions to the first-car tax rebate program and accelerating production by car manufacturers, as well as a personal income tax cut in 2013. **Exports have probably passed their trough**, with incipient signs of a recovery emerging across major export goods and markets, consistent with higher exports elsewhere in the region. Meanwhile growth in the service and tourism sectors remained robust, supported in part by strong tourist arrivals.

The overall impact of the first minimum wage hike on businesses' profit margins, employment, and product prices has not been significant, mainly due to 1) adjustment efforts made by firms including substituting machinery for labour, 2) the currently tight labour market, and flexible labour movements, and 3) highly competitive goods market, which limited the scope for price increases. **Although, based on these considerations, the effect of the second minimum wage increase was expected to be similarly limited,** the MPC would nevertheless monitor the situation closely.

The MPC judged that growth momentum in the fourth quarter was stronger than expected and domestic demand outlook should continue to be strong, supported by a number of favourable factors. As a result, growth projections for 2012 and 2013 have been revised upward to 5.9 percent and 4.9 percent, respectively. In line with an expected gradual recovery of the global economy, the export sector should lend more support to growth in the latter half of 2013 alongside domestic demand. While tail risk has declined significantly, overall downside risks to the global economy still outweigh the upside risks. **Inflation pressure was expected to remain subdued, similar to the previous meeting.**

<u>Monetary Policy Considerations</u>

The MPC agreed that the accommodative monetary policy stance throughout 2012 had played a significant role in supporting post-flood recovery and helped cushion the Thai economy from the global economic headwinds. Given that the global economic recovery was still ongoing with lingering uncertainties, and inflation was expected to stay within the target range, **an accommodative monetary policy stance remained appropriate in supporting an ongoing economic expansion.**

Key conclusions reached during policy consideration were as follows:

1) **The overall global economy showed signs of stabilization** led by improving prospects in the US and China, while Asian economies expanded on the back of strong domestic demand. Although the eurozone debt crisis and the US fiscal cliff remained major hurdles to global economic recovery, tail risks have declined significantly thanks to progress in policy resolution.

2) **The Thai economy continued to expand, supported by robust private consumption and investment as well as fiscal stimulus measures,** which were expected to help sustain growth momentum up to the first half of 2013. Exports showed incipient signs of a broad-based recovery in most product and market segments.

3) **The current monetary conditions remained sufficiently accommodative to mitigate global economic risks**, with real interest rates continuing to be in negative territory, and private credits expanding robustly. However, the high pace of credit growth, particularly for certain types of household loans, could raise household debt and lead to a build-up of financial imbalances.

The MPC thus voted unanimously to maintain the policy rate at 2.75 percent per annum.

Some members noted that although the current policy rate was appropriate for the prevailing macroeconomic conditions, there was a need to remain vigilant regarding risks to economic outlook and financial stability. In particular, persistently high credit growth, rising household debt, volatile capital flows in the midst of continued monetary policy easing in major economies, and growing public debt could potentially undermine financial stability going forward.

Monetary Policy Group

23 January 2013