Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

16 October 2013

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Members Present

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

Member Absent

Ampon Kittiampon

The International Economy

The global economy was expected to improve gradually into next year. G3 economies have shown signs of a continued improvement, notwithstanding elevated downside risks. Meanwhile, ASEAN economies expanded at a slower pace.

The US economy expanded at a moderate pace on the back of private consumption. Fiscal uncertainties continued to pose significant downside risks to growth. While economic impact from the government shutdown should be limited, failure to lift debt ceiling would materially undermine global financial and economic stability. Given uncertainties in fiscal outlook and tighter financial conditions, the Federal Open Market Committee (FOMC) decided to maintain the pace of asset purchases in their September meeting. In **the Euro area**, recovery was supported by better business confidence and lower structural fiscal deficits. **The Japanese economy** continued to expand in the second quarter, with growth outlook tempered somewhat by an introduction of consumption tax next year.

The Chinese economy continued to improve from exports, manufacturing production, and investment. **North Asia economies** similarly benefited from exports recovery, in line with global demand. In **ASEAN economies**, on the other hand, domestic demand has moderated. External stability risks edged up somewhat, especially for those with a high reliance on exports of goods using medium or lower technologies. Investors' greater focus on risks to external and fiscal stability exposed the region to fluctuations in cross-border capital flows and volatile global financial conditions. In response, policymakers in several countries adjusted their macroeconomic policies by raising policy rate, scaling back oil price subsidies, rectifying current account deficits, and providing domestic as well as US dollar liquidity. **Global inflationary pressure remained low** and most central banks kept the policy interest rates unchanged.

The committee saw failure to negotiate public debt resolution in the US as a key risk that could have implications for global financial market volatility going forward. In addition, an ongoing recovery of G3 economies remained dependent on unconventional policy support of central banks, which eventually will need to be withdrawn. The inevitable QE tapering by Federal Reserve could trigger another bout of capital flow volatility, and the committee will need to closely monitor the impact on confidence as well as the real economy.

The Financial Markets

Volatilities have picked up since the last meeting in major and regional currencies, as well as for money and fixed income markets, from uncertainties about the timing of QE tapering and US public debt problem. The US dollar initially appreciated, while regional currencies depreciated, during late August to early September, as better-than-expected US data heightened expectations of QE tapering. But the US dollar then depreciated from the latter half of September, after the FOMC decided to maintain the pace of asset purchase. Financial market concerns over US government's debt ceiling also contributed to the US dollar depreciation.

Yields to **regional government bonds** fluctuated in tandem with the US Treasury. Thai government yield curve steepened with the market expectations of imminent QE tapering. As the market adjusted its expectations in late September, the yield curve flattened in line with the resumption of demand from both foreign and domestic investors. The lower-than-expected government bond supply also contributed to a fall in medium- and long-term yields. Most market participants expected the MPC to maintain the policy interest rate at this meeting.

The MPC discussed policy measures adopted by countries in the region, citing in particular an ASEAN economy that was recently given a rating upgrade. The economy's fiscal and political stability was viewed as an important factor that has enabled the government to promote investment and successfully boost growth, which in turn improved tax collection and maintained a low cost of borrowing, thus creating a virtuous cycle.

The Thai Economy

The Thai economy grew less than previously assessed, but began to stabilize and showed signs of improvement in some sectors. Exports exhibited incipient signs of a broad-based recovery in most product and market segments in line with better global demand. Nevertheless, Thai exports may grow at a slower pace relative to certain Asian countries, such as South Korea and Taiwan, which have a larger share of high-tech exports. Technological and supply-side bottlenecks in some industries, such as hard disk drives, integrated circuits and textiles, may be constraining exporters' competitiveness in the world market. Domestic demand has shown signs of stabilizing. Private consumption grew primarily from non-durable goods, supported by favorable non-farm income. Private investment, particularly for construction, continued to expand. Looking ahead, private investment should continue to improve, underpinned by a gradual recovery of exports and ongoing businesses' investment plans, with most firms facing little financial constraints. Inflation edged lower in tandem with subdued production costs and domestic demand.

Accommodative financial conditions and expected global economic recovery should lend support to the Thai economy's gradual recovery. Key downside risks stemmed from a delay in fiscal disbursement especially for infrastructure projects as well as uncertain global recovery. The MPC consequently revised growth projections for 2013 and 2014 down from the previous assessment to 3.7 percent and 4.8 percent, respectively. Inflationary pressure edged lower from softening domestic demand.

One member viewed the slowdown in the economy to have stemmed primarily from the fragile state of the global economy and, to a lesser extent, less support from fiscal policy. Against this backdrop, monetary policy stance, in terms of the policy interest rate, credit growth, and exchange rate, has been appropriately supportive to the economy. The deceleration in credit growth has lessened financial stability risks, and has not been a constraint for growth momentum. In this environment, measures to stimulate demand in the short term may yield limited benefits, especially when the economy's potential growth may have been affected by supply-side constraints, and still fragile global economy. The committee agreed that public investment in large-scale infrastructure projects could play a key role in addressing both cyclical and structural challenges to the economy at this juncture. Current monetary policy remained accommodative, reflected by the still high private credit growth. The committee concurred that long-term structural constraints to growth could not be addressed by monetary policy.

The MPC discussed potential risks to Thailand's economic growth and financial stability, which warranted close monitoring as follows: (1) a delayed and lower-than-expected fiscal disbursement could weigh on economic momentum in the short run. A delay in large-scale public investment projects could also restrain potential growth in the periods ahead. Members viewed fiscal sustainability, consisting of a more balanced budget and greater emphasis on public investment, as a key factor to bolster market confidence; (2) the recent emergence of current account deficit could be explained in part by unusually high gold imports and repatriation of profits and dividends abroad. However, the deficit is likely to persist in the coming years due to higher imports of capital goods related to government infrastructure projects. Such deficit should not as yet be a cause for concern, as it is not driven by domestic overspending; and (3) private credit growth, while decelerating somewhat, remained on a high side, especially for household credits. The MPC saw the need to closely monitor the development of credits extended by both commercial banks and specialized financial institutions to ensure a smooth transition towards a more balanced financial condition, consistent with a sustained economic recovery.

Monetary Policy Deliberation

The MPC judged that the Thai economy has shown signs of stabilization and should recover gradually in the periods ahead. Fiscal policy was lending support to growth, notwithstanding some delay. The committee therefore deemed current accommodative monetary policy to be necessary in supporting the ongoing economic recovery, amidst high uncertainties in the global economic and financial conditions.

Six members viewed maintaining the policy rate at 2.50 percent as appropriate with the following rationales: (1) key risks to the Thai economy were volatilities in the global financial markets, in part related to uncertainties over the timing of QE tapering. Against this backdrop, maintaining the policy rate and monitoring the situation closely remained an appropriate strategy in safeguarding domestic financial stability; (2) the Thai economy was projected to recover at a gradual pace, subject to various constraints. Financial conditions remained sufficiently supportive, but needed close monitoring to ensure a sustained economic recovery; (3) the current policy rate was conducive to ongoing adjustments in credit growth towards a more sustainable level that is consistent with the real economy. However, the pace of new household credits and debt accumulation still posed risks and needed to be monitored. In light of current funding conditions in the banking sector, as well as continued uncertainties in the global financial markets, some members deemed it prudent to conserve policy space. One member saw limited effectiveness from monetary policy easing in compensating for lower fiscal stimulus at the current juncture. Instead, expediting public investment and introducing structural reform measures would bring about a more lasting benefit, by boosting long-term potential growth and providing more incentives for private investment.

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

A member was absent from this meeting.

Monetary Policy Group
30 October 2013