Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

22 January 2014

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Members Present

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

The Financial Markets

The Thai baht depreciated since the last meeting, owing to the scaling down of asset purchase by the Federal Reserve (Fed) and domestic political situation. Following the Fed's announcement in December and as the financial market shifted forward their anticipation of QE tapering, the baht depreciated in line with other regional currencies. Volatility subsequently picked up as domestic political situation intensified toward the end of 2013, and the baht depreciated against regional currencies. In 2014, the baht has stabilized within a narrow range, supported by long-term foreign investment flows and lower-than-expected US employment data. **The government bond yields decreased since the last meeting**, mainly driven by domestic factors. First, the ongoing political unrest has led to an expectation of a reduction in the policy rate at this meeting. In addition, the new issuance of government bonds related to the 2-trillion -baht public investment was expected to be further delayed after parliament dissolution. Since the beginning of 2014, non-residents have reduced their holdings of Thai debt securities, particularly long-dated ones.

In their discussion of financial market developments, several members noted the relative stability of the Thai financial markets, and their resilience against both domestic and external shocks. This may have owed in part to advanced anticipation of QE tapering, as well as a stabilizing role of long-term investment inflows during the intervening period. Nevertheless, current domestic political situation and global financial market developments kept short-term uncertainties elevated, and market sentiments could change swiftly, warranting close monitoring. The policy framework in place remained appropriate in countervailing these risks.

The International Economy

The global economy continued to improve, led by the major economies. **The US economy** expanded faster than expected, driven mainly by private consumption and investment, particularly in residential sector. Fiscal drag waned after the Congress passed the bill that allowed higher 2014 and 2015 budgets for the central government, while monetary policy was expected to be accommodative for an extended period. **The euro area economies** continued to grow on the back of manufacturing and exports of core member economies, together with gradually improving private confidence. Nevertheless, tight fiscal policies and slow progress in financial sector resolution would continue to impede economic recovery. **The Japanese economy** decelerated, but the manufacturing sector provided growth momentum on the back of accelerating private consumption before a consumption tax hike due in April. Exports should improve in tandem with trading partners' growth and yen depreciation. **The Chinese economy** continued to recover, buoyed by trading partners' more robust recovery, but the real estate sector and local government debts continued to pose risks to the economy. **The Asian economies** overall expanded well, with firmer export recovery in North Asia compared with that of Southeast Asian counterparts. The global inflationary pressure remained generally subdued, and most central banks have kept their policy rates unchanged.

The committee agreed that the global economic outlook has improved, though several risks in major economies should be monitored: (1) Deleveraging process in the euro area has not completed and there has been limited progress in the resolution of fiscal and financial sector issues. Bank lending rates in crisis-affected countries such as Spain and Italy were still significantly higher than their peers', while fiscal policy stances continued to tighten. Financial conditions were easing in some countries, but would take time to fully transmit to the real economy; (2) In China, financial stability risks stemmed from fragile real estate sector and large shadow banking debt relative to GDP, which has not been subject to rigorous regulation; and (3) An increase in consumption tax rates in Japan might weigh on domestic demand, a key growth engine, with potential effects on sentiments that were harder to assess.

The Thai Economy

Growth of the Thai economy in the fourth quarter of and for 2013 as a whole was expected to be lower than previous assessment, owing to a downward revision to both private consumption and investment. Exports has improved in most market segments and products, but could not compensate for a slowdown in domestic demand. Tourism has begun to see some impact from the political situation. Looking ahead, exports of goods should gradually improve in line with a moderate recovery in major economies. Nevertheless, private consumption would take longer to recover, due to more subdued consumer confidence and farm income. Private investment has been further delayed, amid uncertainties regarding economic recovery and political situation. Public spending and investment have been similarly postponed. Tourism could be more affected by prolonged political situation, but should quickly recover once the situation stabilizes.

The Thai economy in 2014 was projected to expand less than previously assessed, with prolonged political situation posing further downside risks to private and public spending as well as tourism. **The committee therefore revised growth projection for 2014 down, from around 4 percent to around 3 percent.** Inflationary pressure overall remained subdued in line with domestic demand and world crude oil prices.

The committee agreed that the downside risks to growth have increased substantially. Some members noted that any benefits of global growth pickup this year on Thai exports and tourism could be restrained by the ongoing political situation. Growth impact could be more pronounced if a prolonged unrest were to cause a switch of export orders to other countries, with potential knock-on effect on domestic spending. Members also discussed the degree to which the recent baht depreciation may have helped support the export sector by increasing their income in local currency. Many members saw the benefit of stable exchange rates amid currently uncertain economic environment and fragile private confidence.

Monetary Policy Deliberation

The MPC judged that the Thai economy was expanding at a slower pace than previously assessed, with greater downside risks stemming from the ongoing political uncertainties. During the policy discussion, the committee evaluated: **(1) The need to maintain accommodative monetary policy given the current economic backdrop; (2) The effectiveness of further monetary policy easing, against potential costs and risks; and (3) The appropriate timing for additional monetary policy easing amid the prevailing high degree of uncertainties.** The committee agreed on the need to maintain accommodative monetary policy in order to support the ongoing economic recovery. The majority deemed the underlying economic fundamentals to be robust, which should help the economy weather short-term risks from political uncertainties. Meanwhile, safeguarding financial stability remains a cornerstone for economic recovery in the period ahead.

Four members voted to maintain the policy rate at 2.25 percent per annum, with the following rationales: (1) **Monetary policy stance remained accommodative and appropriately supportive of economic recovery**, as reflected by ample liquidity in the financial system and negative real policy rate; (2) **Further easing of monetary policy was unlikely to provide a meaningful boost to private consumption and investment at the current juncture**, given that political uncertainties were the main headwind to domestic demand at present. Instead, effectiveness of a policy easing could be confined to providing a temporary lift to asset prices; (3) Given still fluid political developments, **there was a case for conserving the policy space and awaiting clearer economic assessment before considering further action;** and (4) Against the backdrop of higher global financial market volatility stemming from QE tapering and market concerns about the emerging markets, **financial stability should be given a high priority in monetary policy consideration,** as it would provide a foundation for a sustainable recovery in the period ahead.

Three members voted to reduce the policy rate by 0.25 percent from 2.25 percent to 2.00 percent per annum, as they saw a greater role for monetary policy in shoring up private confidence and supporting the economy, given noticeably higher downside risks to growth. These members deemed the risks associated with additional easing to be contained, as the inflationary pressure was subdued while financial stability risks were also manageable, as reflected by (1) decelerating private credit growth in line with economic slowdown; and (2) high level of international reserves to cushion potential capital outflows, while long-run demand for emerging market assets should still remain. Consequently, a greater weight could be put on supporting economic growth.

The MPC thus voted 4 to 3 to maintain the policy rate at 2.25 percent per annum. The MPC will closely monitor evolving developments, and stand ready to implement appropriate policy as warranted.

Monetary Policy Group
5 February 2014