Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

17 September 2014

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Members Present

Prasarn Trairatvorakul (Chairman), Pongpen Ruengvirayudh (Vice Chairman), Paiboon Kittisrikangwan, Siri Ganjarerndee, and Aswin Kongsiri.

Members Absent

Narongchai Akrasanee, and Arkhom Termpittayapaisith.

Monetary Policy Target for 2015

The MPC recognized the merits for adopting headline inflation as the new policy target. A consultation with the Minister of Finance should proceed, with a consent on a target range of 3.0 ± 1.5 percent for the year 2015 on an annual average basis. After a mutual agreement has been reached, the proposal would be sent to the Cabinet for approval.

The following rationales were discussed.

(1) Headline inflation could be easily understood by the public and would better reflect the cost of living. The new target would promote central bank communication and the anchoring of inflation expectation.

(2) The central target of 3.0% should be appropriate. It is broadly in line with the targets of the trading partners, and thus should help maintain Thailand's competitiveness. The level is consistent with average long-term inflation expectations, and comparable to the previous mid-point for core inflation target.

(3) Economic conditions next year were expected to be favorable for the transition. Inflationary pressure should remain subdued, amid moderate global commodity prices. Inflation should remain within the proposed target range even after taking into account the energy price restructuring planned by the government.

The Financial Markets

Since the previous meeting, the Thai baht has been stable, moving in line with other regional currencies. The baht strengthened in early August on the back of improved fundamentals of Asian economies and reduced geopolitical tensions. Since then, the baht has been depreciating, driven by broad US dollar strength, owing to stronger US data and the Federal Reserve's (Fed) signal of an earlier rate hike. Greater policy divergence among major central banks led to a sharp appreciation of the US dollar, though the baht and other regional currencies depreciated relatively modestly, thanks to stronger fundamentals. **The government bond yields moved in**

a narrow range. Short-term yields were stable, while medium-term yields declined somewhat from greater foreign investors' demand, as the prospect for recovery became more apparent. Long-term yields rose slightly due to profit-taking, after falling to a low level previously.

Market participants expected no policy rate change at this meeting, deeming the current monetary policy stance to be already supportive of economic recovery for the remainder of the year, and expecting inflation to be contained. **However, a few participants saw the possibility of gradual rate normalization next year, as the recovery should start to gain traction.**

The International Economy

The global economy continued to recover gradually but was characterized by greater growth differentials. **The US economy** continued to expand, and the market expected the first Fed funds rate hike in the second half of 2015. Meanwhile, **the euro area** experienced weaker growth in the second quarter of 2014, weighed down by geopolitical tension and temporary weather-related factors. After a significant contraction in the second quarter**, the Japanese economy** should recover gradually, on the back of stimulus measures and stronger exports. Outlook for **China** remained unchanged from the previous assessment, with the continuing attempt to maintain a balance between longer-term reforms and short-term support to the economy. Growth in **Asian economies** should remain stable, as the cyclical improvement in the electronics exports helped offset domestic demand deceleration.

Global inflationary pressure remained subdued and most central banks continued to maintain policy rates. The European Central Bank, however, lowered the policy interest rate to address the risks of deflation. The Bank of Korea also cut the policy rate, in order to shore up domestic demand. The central bank of the Philippines, meanwhile, raised the policy rate to contain inflationary pressure.

The Thai Economy

Private confidence improved, and domestic economic activities have begun to recover thanks to more stable political environment. July readings showed improved private sentiments and spending, due in part to government support to household purchasing power, healthy non-farm income, as well as more active public spending. However, structural impediments and weak agricultural prices have affected exports by more than previously assessed, weighing on the recovery. Tourism would take time to recover to normalcy. Inflation edged down from the prices of raw food and energy, as well as the phasing out of pass-through from LPG costs to prepared food prices.

The committee maintained growth projection for 2014 at around 1.5 percent, as the improvement in domestic demand should offset weaker-than-expected recovery in exports of goods and services over the year. **However, growth projection for 2015 was revised down to around 4.8 percent,** to reflect slower recovery in exports and tourism. Inflationary pressure was revised down from lower cost pressure. Inflation expectations remained stable.

In the committee's view, the overall financial stability has improved following the political resolution that has shored up private confidence and led to clearer prospects for government's economic policy. Corporate bond issuance and demand for credit picked up for some business sectors. Real estate sector saw some rebound in activities, after a previous slowdown. Meanwhile, household debt has begun to stabilize as a percentage of GDP, as new debt slowed and household income rose modestly.

There was a view among members that a prolonged period of low interest rates could discourage household savings and induce investment in riskier assets. Some members expressed concerns over supply side limitations that may impede exports of goods going forward, necessitating concerted efforts from all stakeholders to address the problem.

Monetary Policy Deliberation

The MPC judged that the economic recovery was at an early stage, driven primarily by private consumption and public spending. Meanwhile, exports would recover slowly and it would take time for fiscal policy to bear more material effects on growth. **Monetary policy should therefore be sufficiently accommodative to support the ongoing economic recovery, while at the same time consistent with the safeguarding of long-term financial stability**, against the backdrop of contained inflationary pressure and stable financial system.

Five members viewed maintaining the policy rate as appropriate with the following rationales:

(1) Given that a broad-based recovery has not taken hold, the current degree of monetary accommodation was needed to support and sustain economic recovery.

(2) Prevailing financial conditions remained sufficiently accommodative and supportive of economic recovery, which should pick up pace in the second half of this year. Fiscal policy should also lend further impetus to growth going forward. Broad economic reform agenda under the current government should bring about tangible results in due course, and should help bolster long-term potential growth.

(3) Maintaining the policy rate was appropriate amidst currently stable financial markets and capital flows.

The MPC thus voted unanimously to maintain the policy rate at 2.00 percent per annum.

Monetary Policy Group

1 October 2014