Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

12 March 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 stabilized and appreciated slightly on the back of (1) peaceful general election on February 2nd and more stable political situation; (2) depreciation of the US dollar following weaker-than-expected data; and (3) improved sentiments on emerging markets and Asian economies. Capital inflows to Thailand started to resume in March, especially the equity market which saw positive net inflows. **The government bond yields declined,** driven by higher demand from domestic institutional investors and lower expected issuance of government bonds owing to delayed public investment. Most market participants expected the MPC to reduce the policy interest rate at this meeting, citing economic slowdown and subdued inflationary pressure. The MPC's decision to hold the policy rate in the last meeting, while unanticipated by the market, led to little adjustments in the foreign exchange market. Money market rates ticked up marginally.

In the committee's view, the global financial markets have been less volatile since the last meeting. Credit rating agencies' affirmation of a stable outlook for Thailand had a positive impact on foreign investors' sentiments. Nevertheless, some members saw the need to monitor risk factors, including political situation and household debt, which might weigh on economic growth and credit outlook going forward. Nominal effective exchange rate (NEER) for the Thai baht appreciated slightly on improving current account balance but remained supportive of growth.

The International Economy

The global economy continued to recover, led by the major economies. **The US economy** expanded steadily, despite slowdown in the housing sector from higher mortgage rates. Softer recent indicators owed partly to a temporary cold weather, and should not materially affect the recovery path. At its latest meeting, the FOMC maintained the pace of asset purchase reduction and reiterated its intention to keep policy rate low for some period. **The euro area economies** continued to grow while deflation risks remained low. **In Japan,** domestic demand accelerated before the introduction of consumption tax hike, resulting in a pickup in production and imports. Consumption should decelerate after the tax hike takes effect in April. **The Chinese economy** continued to expand, but investment moderated due partly to policy reforms in local government and financial sectors. **In Asia**, exports improved in tandem with a recovery in major economies while domestic demand held up well. Nevertheless, domestic demand in ASEAN economies was weighed by slowing private investment and public spending.

Exchange rates of emerging market economies recovered from the previous drop triggered by QE tapering, partly due to credible policy responses in countries such as India, Malaysia, Indonesia, and Brazil. Global inflationary pressure remained subdued, notwithstanding somewhat higher inflation in Asia. Most central banks have kept their policy rates unchanged given steady improvement in domestic demand.

The committee noted that risks related to local government debts and shadow banking issues in China were difficult to analyze precisely given data limitations. Assessments of these risks by private analysts also varied. The committee nevertheless acknowledged the importance of the Chinese government's structural reform efforts towards greater reliance on market forces. These should yield long-term benefits, although there might be some costs to growth in the short run.

The Thai Economy

Growth in the fourth quarter of 2013 was close to the previous projection, with some improvements in exports helping offset lower-than-expected domestic demand. The latest indicators pointed to weaker economic momentum, as domestic demand continued to be soft and the effect of political situation on tourism became more apparent. Meanwhile, exports continued to recover steadily. Risks from a prolonged political uncertainty remained, and could subject private sentiments to further retrenchment, affecting consumption. Households' purchasing power was already made fragile by lower farm income and high household indebtedness. Private investment was subject to further delay, amid rising political and economic uncertainties, and uncertain outlook for public investment. Tourism was expected to feel more impact from political uncertainty, particularly for tourist arrivals from Asia. Exports, especially of consumption goods to the major economies, should improve with the global recovery, and serve as the main growth driver in the periods ahead. Inflation continued to edge up, as energy cost was passed through to prices of prepared food.

Looking ahead, the Thai economy was projected to grow less than previously expected as a result of weaker domestic demand, despite expected improvement in exports. **The committee revised their growth projection down from around 3 percent to 2.7 percent for 2014, and 4.8 percent for 2015**. Inflation was projected to increase in tandem with expected pass-through of LPG costs to prices of prepared food, but demand pressure on prices remained low.

Financial stability issues were discussed, with respect to the resiliency of various economic sectors to withstand the economic slowdown. Corporate and real estate sectors' financial positions remained healthy. Households' debt-servicing abilities deteriorated somewhat from previously accumulated fragility, potentially weighing on their spending outlook. Financial conditions overall remained accommodative, as reflected by generally low financing costs and banks' loan targets which remained consistent with nominal GDP growth. Improving efficiency of public finance management, on both the revenue and expenditure sides, remained a long-term challenge to fiscal sustainability.

Members agreed that the ongoing political uncertainty posed a key downside risk to growth, through delayed government spending and deteriorating private sector confidence, with potential repercussions on private consumption and investment. Nevertheless, exports should continue to recover gradually in line with the global economy.

The committee noted several issues that warranted monitoring in the periods ahead, against the backdrop of ongoing economic slowdown: (1) Liquidity and debt-servicing abilities of businesses, especially small- and medium-sized ones, could deteriorate. Alleviating these risks somewhat are commercial banks' efforts to strengthen their risk management. Corporate funding costs overall also remained low and were generally not an obstacle for businesses; (2) Government tax revenue this year could fall short of target. Structurally, government's revenue collection was also significantly lower compared with those of developed countries; (3) A prolonged period of economic slowdown might hinder the corporate sector's efficiency and competitiveness. These longer-term implications should be taken into account alongside the assessment of cyclical developments.

Monetary Policy Deliberation

The MPC judged that downside risks to growth have risen in the wake of prolonged political uncertainties. In their discussion, the committee evaluated **the need and effectiveness of further monetary policy easing to cushion the economy in the short term, against potential costs to financial and price stability. The majority saw further room to ease monetary policy, in order to mitigate downside risks and lend more support to the economy, as well as to ensure continuous financial accommodation.** A policy easing was also justified by subdued inflationary pressure and lower financial stability risks, reflected in part by decelerating private credit growth and more stable global financial market.

Four members viewed a reduction of the policy rate by 0.25 percent per annum as appropriate with the following rationales: (1) Monetary policy should play a greater role in supporting the economy, given higher downside risks to growth stemming from the ongoing political situation, and still fragile domestic demand and exports which would take time to recover; (2) Even though core inflation has edged up following an increase in prepared food price, it remained low and close to the midpoint of the target range. Given subdued domestic demand and stable world crude oil prices, inflation was not an immediate threat; (3) Improved global financial market sentiments helped contain capital flows and exchange rate risks; and (4) Further monetary policy easing could help reduce financial burden of those sectors more exposed to economic slowdown, such as small and medium enterprises and households.

Three members voted for maintaining the policy rate at 2.25 percent for the following reasons: (1) The current monetary policy stance was deemed adequately accommodative and supportive of economic recovery; (2) Maintaining the policy rate was consistent with the committee's inflation forecast, amid rising core inflation; (3) Global financial market conditions remained sensitive to the shift in monetary policy in the US; and (4) The main headwinds to growth were political uncertainties, and not financial in nature. Further monetary policy easing would likely have a limited impact on growth at the current juncture. Monetary policy space should thus be conserved, until such time as it would be more effective in supporting the economic recovery.

The MPC thus voted 4 to 3 to reduce the policy rate by 0.25 percent, from 2.25 to 2.00 percent per annum.

Monetary Policy Group
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