Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

17 December 2014

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Members Present

Prasarn Trairatvorakul (Chairman), Pongpen Ruengvirayudh (Vice Chairman), Paiboon Kittisrikangwan, Jamlong Atikul, Porametee Vimolsiri, Veerathai Santiprabhob, and Sethaput Suthiwart-Narueput.

Monetary Policy Target for 2015

In 2012, the MPC proposed the switch of monetary policy target from core inflation to headline inflation as it would better reflect the cost of living and public inflation expectation. This in turn would help enhance the effectiveness of monetary policy in anchoring inflation expectation. On 17 September 2014, the MPC confirmed the suitability of headline inflation as monetary policy target and sought consultation with the Minister of Finance to set annual average headline inflation of 3.0 ± 1.5 percent as the target for 2015. With a mutual agreement, the monetary policy target would be submitted to the Cabinet for approval.

After the September meeting, however, the crude oil price trended down significantly as a result of weak global demand and expanding global oil supply, particularly from the US and other non-OPEC countries. Rather than opting for production cut to shore up falling oil price as in the past, OPEC countries decided to maintain their current level of crude oil production to preserve market share. The committee thus assessed that the global oil market had undergone a structural shift that would help limit the risk of oil price surge as seen during 2000-2011, and result in lower global inflationary pressure going forward. **The changing circumstance led the MPC to reconsider the appropriate level for the midpoint of the inflation target for 2015. The MPC would seek consultation on the adjusted midpoint with the Minister of Finance before submitting it to the Cabinet for approval. In practice, the monetary policy framework and deliberation would remain the same regardless of the choice of monetary policy target.**

The International Economy

The global economic recovery was weaker than previously assessed, and downside risks to growth in the euro area and Japan edged up. The US economy continued to expand on the back of private spending as a result of healthier balance sheets of the private sector and stronger labour market. Growth in **Asia (excluding China and Japan)** moderated somewhat, but sound economic fundamentals with improved labour markets and exports should provide an impetus for recovery going forward. **China's economy** slowed primarily from decelerated investment; however, government's measures should help sustain economic momentum, with economic reforms focused on long-term sustainability of growth. **The euro area economies** remained weak, with risks of a further slowdown, but the additional monetary and fiscal stimulus should lend some support to the economic recovery in the periods ahead. In **Japan,** economic growth was expected to rebound in the fourth quarter of 2014, while the Japanese yen depreciation would benefit exports. Looking ahead, Japan's economy should recover slowly given lingering domestic structural constraints.

Overall inflationary pressure diminished due to falling oil and commodity prices. **Most central banks kept their policy rates unchanged.** The People's Bank of China, however, lowered the policy rate in order to support economic growth and help reduce the costs of corporate and state enterprise borrowing.

The Financial Markets

The Thai baht weakened against the US dollar since the last meeting, in line with most major and regional currencies, due to stronger-than-expected US economic data and market expectation that the federal funds rate might increase sooner than previously anticipated. The Thai baht fluctuations remained moderate relative to those of regional peers. Nevertheless, global financial market volatilities increased in mid-December following a sharp fall in oil prices. It caused considerable currency depreciation in oil and commodity exporting countries, particularly Russia, and also weighed on global equity prices, including Thai equity indices.

Government bond yields declined following market expectation of a possible MPC's policy rate cut, more subdued inflation, and lower-than-expected government bond supply. Nevertheless, most market participants still expected the MPC to maintain the policy rate at this meeting, as reflected by relatively stable short-term interest rates and latest market opinion survey on policy rate action.

The MPC discussed the current Russian economic headwinds and possible repercussion on the Thai economy. The committee highlighted key risks to the Russian economy, as follows: (1) The downward trend in oil price could affect oil export revenues, Russia's main source of income; (2) Capital outflows and a considerable depreciation of the ruble could aggravate private sectors' debt-servicing abilities for foreign currency debt; and (3) The Russian central bank's drastic policy rate hike could exacerbate the economic slowdown. While the direct impact on Thailand was expected to be limited given the current level of trade linkages, the indirect impact through higher volatilities of both capital flows and exchange rates in emerging market economies could potentially pose risks to Thai financial markets. This and repercussion on the euro area, which has strong trade and financial linkages with Russia, warranted close monitoring.

The Thai Economy

In the third quarter of 2014, the Thai economy recovered gradually at a rate close to projection. Private consumption expanded from households' spending on non-durable goods and services. Private investment was higher than anticipated due to imports of equipments in the telecommunications and transportation sector. This helped offset lower-than-expected government spending, mainly as a result of low disbursement rate of state enterprises' investment budget, as well as a slightly-slower-than-expected recovery in exports of goods. In October, data pointed to a steady economic recovery.

However, improving economic conditions were in part attributed to transitory factors such as a boost from exports to the euro area ahead of Thailand's GSP tax privilege expiration and front-loading of government spending during the early period of 2015 fiscal year. **Overall, the committee expected the economic recovery to progress at a slow pace, with a projected growth rate of 0.8 percent for 2014.**

In 2015, the economy should continue to recover at a rate of 4.0 percent, below formerly assessed, largely due to lower fiscal spending, which would cause further delay in private investment, and softer global demand growth compared to previous projection. The adjustment in expected fiscal impetus took into account limited capacity in government's budget disbursement from recent track record. Expansion of private investment was adjusted downward accordingly, as most firms were expected to await greater clarity of public investment implementation. In addition, recovery in households' spending on durables would be slower than previously expected, owing in part to weakening farm income. Nevertheless, private consumption should be buoyed by gradually improving non-farm income, an increase in government officials' salaries and lower oil prices. Exports of goods were subjected to the more uncertain global economic outlook. Tourism was expected to turn more positive, but remained somewhat below the normal level.

Headline inflation trended downward in line with domestic retail oil prices, and was expected to remain subdued in some periods ahead along with global oil prices. Core inflation slightly decelerated from more subdued demand pressure as the economy was slow to recover. **Projection for inflation in 2015 was revised downward to 1.2 percent for both headline and core measures.**

Members actively discussed the prospects of fiscal stimulus in light of lower-than-expected public investment. Members broadly agreed that government agencies could further enhance the efficacy of budget disbursement, which if attained as originally planned should add more support to the economy. In this light, the committee would closely monitor the progress of fiscal spending going forward. Another issue of discussion was the impact on the Thai economy of global oil prices, which were projected to remain low for some periods. On balance, the economy should benefit from lower costs of production, but the already weak farm income might be worsened by a decline in agricultural commodities' prices such as those of rubber and sugarcane.

Monetary Policy Deliberation

The committee assessed that the Thai economy should continue to recover in 2015, albeit at a slower pace than previously projected. Monetary policy was not hindering the ongoing recovery, and was consistent with long-term financial stability objective. Going forward, members agreed that monetary policy should remain accommodative in order to reinforce the momentum of economic recovery. Another important factor would be for the government to ensure that the disbursement of public spending goes as planned.

Five members deemed maintaining the policy interest rate at 2.00 percent per annum as appropriate, with the following rationales:

(1) The current monetary policy stance was sufficiently accommodative and not holding back the recovery in 2015, while fiscal stimulus should be the thrust of a more steady recovery in the periods ahead.

(2) The degree of policy transmission might be weakened in the current environment of low interest rate. Further policy easing might have a limited impact on growth, while potentially creating unintended consequences on financial stability.

(3) The policy space should be preserved, particularly amid growing uncertainties in the global economy and financial markets.

Two members voted to reduce the policy interest rate by 0.25 percent per annum for the following reasons: (1) Monetary policy should be eased further in order to lend more support to a weaker-than-expected recovery, with growth staying below potential; (2) Higher downside risks to global economic recovery could undermine domestic economic growth, particularly at an early stage of recovery. A broad mix of policies should therefore be employed to strengthen the economy in preparation for external headwinds; and (3) Against the backdrop of low inflationary pressure, with a possibility of breaching the lower bound of the inflation target in 2015, monetary policy should play a greater role in supporting the economy and anchoring inflation.

The committee thus voted 5 to 2 to maintain the policy interest rate at 2.00 percent per annum.

Monetary Policy Group

31 December 2014