Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

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Members Present

Veerathai Santiprabhob (Chairman), Mathee Supapongse (Vice Chairman), Paiboon Kittisrikangwan, Jamlong Atikul, Porametee Vimolsiri, Sethaput Suthiwart-Narueput, and Apichai Boontherawara.

The Global Economy

The global economy gradually recovered at a pace close to the assessment at the previous meeting, while the divergence in economic growth prospects of advanced and emerging market economies became more apparent. The advanced economies showed more signs of recovery, especially **the US economy** which continued to be supported by improvements in the labor market and domestic consumption, adding to market expectations that the FOMC would raise the policy rate at its December meeting. However, the Committee viewed that the FOMC's rate hike should be gradual in nature so as to support economic recovery amid subdued inflation. **The euro-area economy** improved mainly on the back of private consumption. Nevertheless, muted investment and close-to-zero inflation prompted additional monetary easing by the European Central Bank. **The Japanese economy** rebounded in the third quarter as private consumption and investment picked up. Meanwhile, **the Chinese economy** continued to decelerate, putting downward pressure on global commodity prices. The slowdown also had repercussions on **other Asian economies** (excluding Japan), particularly those with strong trade linkage with China.

Looking ahead, the Committee viewed that Asian economies, including Thailand, would continue to face risks stemming from China's economic restructuring which led to a decline in Chinese imports of goods. Meanwhile, the negative impact from China could not be fully offset by the benefits from a recovery in the advanced economies as they also relied less on imports. In addition, **geopolitical risks might escalate** following the Paris terrorist attacks, adding to uncertainty over the euro area's economic recovery and possibly dampening global tourism, at least temporarily.

The Financial Markets

Over the intermeeting period, financial market developments remained centered around the market expectation over the timing of the FOMC's rate hike. As it became apparent that the FOMC would raise the policy rate in December, following better-than-expected economic data and constant communication by the FOMC members regarding the monetary policy stance, foreign investors cut back on their holdings of emerging market assets, including those of Thailand's. Volatility in the financial markets consequently picked up and **the baht weakened against the US dollar**. However, **the Nominal Effective Exchange Rate (NEER) remained relatively stable** as the baht's movements were largely in line with those of regional currencies.

In the Committee's assessment, volatility in the financial markets could potentially rise as a result of monetary policy divergence among advanced economies. Nevertheless, the Fed funds rate lift-off was likely to have limited impact on domestic financial markets under a gradual normalization path. Although capital outflows could depress domestic stock prices somewhat and put upward pressure on domestic bond yields, resulting in higher financing costs, the Committee judged that such development would not significantly weigh on the currently accommodative monetary conditions since Thailand's external stability remained sound, as reflected by the country's persistent current account surplus, low external debt to GDP ratio, and ample international reserves.

<u>The Thai Economy</u>

From the third quarter to October 2015, the Thai economy recovered gradually, yet unevenly across sectors, at a pace close to the assessment at the previous meeting as it continued to receive support from high disbursement of public expenditure, an expansion in private consumption of necessity goods and services, and an improving number of tourist arrivals, especially from China. Meanwhile, merchandise exports continued to contract because of a cyclical slowdown in Thailand's major trading partners, shifting global trade structure, and structural limitations which weighed on the country's competitiveness. Consumer spending on durable goods remained low, and commercial banks' credits to business and household decelerated, due partly to prudent lending standard as credit risk increased. **On the whole, growth projection for 2015 was revised to 2.8 percent, a slightly higher rate than the September assessment at 2.7 percent.**

Growth projection for 2016 was lowered slightly to 3.5 percent from the September assessment at 3.7 percent as a projected increase in private consumption and public expenditure could not compensate for a downward revision of export growth due to a slower-than-expected economic recovery of Thailand's major trading partners. In addition, both the upside and downside risks around the baseline projection increased. The key downside risk was an even slower recovery of Thailand's major trading partners, especially China and Asian countries. The key upside risk was the faster-than-expected expansion in public investment, which might additionally crowd in more private investment than currently assessed. Nonetheless, in the Committee's assessment, overall risks to growth remained skewed to the downside.

Inflationary pressure declined slightly from the previous meeting due mainly to a fall in global oil prices, causing headline inflation to stay in negative territory, probably into the first half of 2016. **Headline inflation projection for 2016 was therefore revised down to 0.8 percent owing to lower cost pressure, while the projection for 2015 remained unchanged at -0.9 percent. The projections of core inflation for 2015 and 2016 were revised up slightly to 1.1 and 0.9 percent, respectively**, as a continued expansion in household spending already allowed businesses to adjust prices of certain products and services upward, while there was also the impending increase in excise tax rate on vehicles next year.

The Committee assessed that deflationary risks remained contained as demand continued to expand and core inflation was still positive, with the prices of most non-energy items stable or trending upwards. In addition, the public's medium-term inflation expectations stayed close to the inflation target.

Monetary Policy Deliberation

The Committee voted unanimously to maintain the policy rate at 1.50 percent per annum at this meeting. In their deliberation, members judged that monetary policy remained accommodative, as monetary conditions and the exchange rate were still conducive to the economic recovery. Meanwhile, growth and inflation outlook did not change materially from the previous meeting. Moreover, the Committee were in agreement that monetary policy at this juncture should give due weight to maintaining financial market stability, as volatility in the financial markets could potentially rise due to monetary policy divergence among advanced economies. Some members were of the view that further reduction in the policy rate was likely to have a marginal effect on the economic recovery, while fiscal stimulus would lend more support in the periods ahead. Moreover, the policy rate should be kept on hold to preserve the policy space for future use, if needed, as uncertainties, especially around the global development, were expected to remain high.

Going forward, the Committee judged that monetary policy should continue to be sufficiently accommodative in order to support the ongoing economic recovery. The Committee will continue to closely monitor downside risks to growth, particularly those stemming from a slowing global economy and uncertainty in the global financial markets. Moreover, in a prolonged period of low interest rates, most members saw the need to monitor risks to economic and financial stability, which might arise from search for yield behavior. The Committee stands ready to utilize an appropriate mix of available policy tools in order to support the economic recovery, while ensuring financial stability.

Monetary Policy Target for 2016

The Committee discussed and confirmed the suitability of setting the annual average of headline inflation at 2.5 ± 1.5 percent as the monetary policy target for 2016 and the medium-term target, as it was considered to be consistent with the country's economic fundamentals and close to those of Thailand's trading peers, thereby preserving price competitiveness of Thai merchandise exports. Moreover, this particular target had been effective in anchoring inflation expectations of the public. In designating it as the medium-term target, the Committee reflected upon the transmission time lag of monetary policy to the economy and inflation rate, with an aim to facilitate efficient planning of consumption and investment by businesses and households.

The Committee would seek consultation on the target with the Minister of Finance before submitting it to the Cabinet for approval.

Monetary Policy Group
30 December 2015