Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

11 March 2015

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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.

The International Economy

The global economy recovered at a slower pace than previously assessed due mainly to slowdowns in China and Asia. China's growth slowed as a result of decelerating private investment and ongoing economic reforms, which aimed at containing financial stability risks and lifting the country's long-term growth potential. Consequently, China lowered its growth target for 2015. Growth in **other Asian economies** also weakened from lower commodity prices and subdued exports and private investment, in part as a result of the slowdown in China. **Japan's economy** continued to grow slowly with a weak recovery in private sector demand. Meanwhile, **the euro area economies** improved slightly on the back of exports and private consumption, which benefited from falling oil prices. Nonetheless, uncertainty surrounding the ongoing negotiation over the bailout program for Greece warranted close monitoring. As for **the US**, growth was entrenched as reflected in the better-than-expected outturns of economic data, especially in the labour market, prompting market expectation that the Fed could raise the policy rate as early as June 2015. However, given low inflationary pressure thanks to subdued global oil and commodity prices, **many central banks decided to reduce their policy rates** on the back of disappointing economic growth figures, including the central banks of Australia, India, Indonesia, and China.

The Financial Markets

The Thai baht slightly strengthened against the US dollar and other major trading partners' currencies over the intermeeting period, leading **to an appreciation of the Nominal Effective Exchange Rate (NEER).** Despite higher short-term volatility of the Thai baht as a result of hefty capital inflows in some periods, for example in the form of foreign investment in an infrastructure fund, the MPC viewed the stronger baht in recent periods as largely attributable to fundamental flows, particularly the current account surpluses and foreign direct investment, while portfolio investment flows were quite balanced overall. Nonetheless, the committee saw the need to closely monitor movements of the Thai baht and its impact on the Thai economy going forward.

Since the last meeting, Thai government bond yields rose and moved broadly in line with US Treasury yields. On the whole, bond yield volatility increased somewhat as investors were concerned about the uncertainty surrounding Greece's bailout negotiation. **Most market participants anticipated the MPC to hold the policy rate at this meeting.**

In line with the committee's assessment at the last meeting, there were no significant capital inflows to Thailand as a result of the ECB's latest asset purchase program. In the periods ahead, capital inflows to Asia were expected to be limited as European investors generally prefer to allocate funds to financial markets in advanced economies. However, developments in global financial markets, particularly the implementation of monetary policy in major economies and its potential impact on capital flows and exchange rate volatility, warranted close monitoring going forward.

The Thai Economy

In the fourth quarter of 2014, the Thai economy continued to recover modestly, with the momentum of private consumption and investment being softer than expected due in part to weaker private sector confidence and less-than-expected public investment. Economic data in January 2015 were largely comparable to December 2014, indicating a slow economic recovery. **In the periods ahead, the economy was projected to recover at a slower pace than formerly assessed mainly due to softer domestic demand.** Households were expected to remain cautious on spending, partly because their confidence on future income prospects had weakened. At the same time, firms were likely to delay investment, awaiting signs of a more solid recovery in domestic and external demand as well as progress on public investment. Exports of goods looked to recover at a rate close to the previous projection, but with higher downside risks from a slowdown in trading partners' economies, notably China. Meanwhile, tourism should improve steadily, partially offsetting the weaker domestic demand. **Overall, growth projection for 2015 was revised downward from the previous meeting to 3.8 percent, while growth projection for 2016 was revised slightly upward to 3.9 percent.**

In the first two months of 2015, headline inflation declined and turned negative due to falling global oil prices. Nonetheless, the prices of most goods and services continued to rise, as reflected by positive core inflation. Looking ahead, inflationary pressure was forecasted to remain at a low level, close to the committee's previous assessment, in tandem with low energy prices and slow economic recovery. **In 2015, headline inflation and core inflation were projected to register at 0.2 and 1.2 percent, respectively, while the projections for 2016 were 2.2 and 1.2 percent, respectively.**

MPC members discussed the development of key factors affecting the economic recovery. Weaker consumer confidence with respect to income outlook might further delay the recovery in private consumption. Furthermore, private investment incentives remained muted, in part due to excess capacity in many industries and the fact that some businesses continued to wait for evident implementation of public investment. Despite the recent pickup, exports of goods might be somewhat affected by the baht's appreciation against trading partners' currencies. Against this backdrop, members deliberated on the trajectories of growth and inflation under different policy rate paths, taking into account the various channels of policy transmission to real activity. In addition, the committee expressed concerns over the potential negative impact arising from an extended period of slow economic recovery and weak private sector confidence. Notably, the country's long-term competitiveness might deteriorate with delays in private investment to enhance productivity.

Monetary Policy Deliberation

The MPC judged that the outlook of the Thai economic recovery was weaker than previously assessed and fiscal stimulus would take time to materialize. Meanwhile, private sector confidence had deteriorated, and headline inflation was expected to remain low for a certain period of time. The committee discussed and considered **the effectiveness and potential costs of further monetary policy easing to lend more support to the economy under a prolonged period of low domestic interest rate environment.** Although overall financial stability remained sound, the potential risk build-up associated with search-for-yield behaviour warranted continued monitoring.

Four members viewed a reduction of the policy rate by 0.25 percent per annum as appropriate, with the following rationale:

(1) Monetary policy should be eased further to mitigate downside risks and provide more support to the economic recovery, as well as to help shore up private sector confidence. A weaker-than-expected recovery, with growth staying below potential for a sustained period of time, could further dent sentiments, with repercussion on economic momentum in the periods ahead.

(2) Monetary policy easing could help reduce financial burden for indebted businesses which were adversely affected by the economic slowdown.

(3) Risks to financial stability were contained, with equity price surges confined to small capitalization stocks and a recent stock market correction. In addition, the expansion of new household debt had already been tempered following more prudent behaviours of both borrowers and lenders.

(4) A reduction in the policy rate would in part help maintain monetary policy credibility given that headline inflation was likely to breach the lower bound of the target band for some periods ahead.

Three members voted to maintain the policy rate at 2.00 percent per annum, with the following rationale:

(1) Current monetary policy stance was deemed adequately accommodative and supportive of the economic recovery. Fiscal stimulus, especially the implementation of planned public investment, should be a key growth driver at this juncture. In addition, further monetary policy easing would likely have a limited impact on growth given that private consumption had been restrained by elevated household debt burden and businesses had postponed new investment due to long implementation lag of public investment and excess capacity in several industries.

(2) Further monetary policy easing could create more financial imbalances, for instance via increased household indebtedness. This, in turn, could affect financial stability and depress national savings level in the long run.

(3) Against the backdrop of higher uncertainties in the global economy and financial markets, policy space should be preserved as a shock absorber, to be used when more necessary and in time of more effective policy transmission.

(4) Headline inflation breached the lower bound of the inflation target band mainly as a result of positive supply shocks associated with falling global oil prices. Moreover, the inflation figure was expected to return to the target band in the period ahead, and hence should not pose concerns on monetary policy credibility.

The MPC thus voted 4 to 3 to reduce the policy rate by 0.25 percent, from 2.00 to 1.75 percent per annum. The committee deemed **policy coordination and concerted efforts from both public and private stakeholders necessary in supporting the economic recovery.** Going forward, the MPC will closely monitor developments of the Thai economy and will pursue appropriate policy to sustain the ongoing economic recovery, as well as to maintain financial stability in the long term.

Monetary Policy Group
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