Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

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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 economic recovery was projected to continue at a rate close to the last meeting's assessment. Nevertheless, downside risks increased, particularly from a weak economic recovery in the euro area which could be further affected by domestic political uncertainties and intensifying international conflicts. Outlook for other major economies was broadly in line with the committee's previous evaluation. The Japanese economy expanded at a low pace due to a gradual recovery in private consumption and investment. Economic activities in China continued to moderate due in part to economic reform policies to contain financial stability risks. Meanwhile, the US economic recovery strengthened thanks to improving economic fundamentals. **Going forward, key factors influencing the global economic outlook included** (1) movements in global oil and commodity prices which would affect individual economies differently; (2) development in geopolitical situations; and (3) the timing of the Federal Reserve's policy rate normalization and global financial market volatilities that might follow.

Inflation continued to decline and turned negative in some countries, particularly those highly connected to the euro area economies and were faced with higher deflation risks. This prompted certain central banks to ease monetary policy. However, most central banks in the region maintained the policy interest rates.

The Financial Markets

Since the beginning of 2015, **major currencies fluctuated** amid heightened uncertainty in the global economic outlook due in part to more intense geopolitical conflicts and unexpected monetary policy actions by some major central banks. Important events included the European Central Bank (ECB)'s announcement of a larger-than-expected asset purchase program and the Swiss National Bank's lifting of the exchange rate floor. Movements of regional currencies diverged, depending on the impact of oil prices on respective economies. **The Thai baht slightly appreciated against the US dollar**, consistent with other regional currencies whose economies benefited from falling oil prices. By contrast, the currencies of net oil-exporting countries in the region depreciated.

The Thai government bond yields fell as there was higher demand from both foreign and domestic investors. The movement in yields was influenced, in part, by the development in the US Treasury market, as well as a lower-than-expected inflation outturn in December 2014. Regarding monetary policy outlook, most market participants expected the committee to maintain the policy interest rate at this meeting.

Members actively discussed the prospects of capital flows to the regional and Thai financial markets following the ECB's expanded asset purchase program and policy easing by some central banks. In the view of some members, Thai economic fundamentals, particularly a surplus in the current account from falling oil prices, might be a factor attracting capital inflows in the periods ahead. Nevertheless, the low level of Thai government bond yields might somewhat discourage the inflows. In addition, the magnitude of the overall impact would depend on the level of liquidity in the global financial markets as well as investors' risk appetite. Up to the date of this meeting, the effect on the Thai financial markets was not evident, but the development, particularly in the exchange rate market, warranted close monitoring in the periods ahead.

The Thai Economy

In the fourth quarter of 2014, the Thai economy recovered gradually at a pace close to the previous projection, with slower-than-expected expansion in domestic demand being offset by an improvement in the exports of goods and services. Public spending rose modestly from the previous period, though the magnitude of fiscal stimulus remained smaller than anticipated. Looking ahead, the economy would benefit from lower global oil prices via (1) improving trade balance, despite the fact that the prices of certain exports items might fall in line with global oil prices; (2) higher household purchasing power, as the costs of living eased, corresponding with a decline in headline inflation; and (3) reduced costs of production which, in turn, should be translated into higher corporate profits. This, however, might not lead to additional investment in the near term, as spare production capacity should remain in many industries. In 2015, nevertheless, private investment was expected to pick up from last year as firms which had already obtained investment incentives from the Board of Investment should gradually carry out their investment plans. Greater clarity of public investment projects was also expected to help drive the growth momentum of private investment in the periods ahead.

Headline inflation declined in line with global oil prices, and was expected to slip into negative territory in the first half of 2015. This, however, was not considered deflation for the following reasons. (1) The decline in the price level was not broad-based, as the prices of non-energy items still increased in tandem with the recovery in domestic demand. (2) The decline in global oil prices was expected to be a temporary phenomenon and the trend should reverse in the second half of this year. (3) Inflation expectation remained close to the central target of headline inflation.

The committee expressed concerns over downside risks to the recovery and followed up on the progress of public spending disbursement, particularly the investment expenditure which was critical in adding impetus to the recovery. Moreover, the committee discussed extensively the impact of exchange rate movements on the economy. On the one hand, some members took the view that the changing nature of the global supply chain had resulted in more intense price competition, as it gave the customers more bargaining power. On the other hand, other members argued that, in many industries, switching manufacturers within the supply chain could be complicated by the need to meet specific production standards and also deterred by the long-established trading partnership. Overall, members were in agreement that dynamic technological and productivity improvements would enable Thai exports to better respond to changing global demand, and therefore would truly reinforce the competitiveness of the exports sector in the long-run.

Monetary Policy Deliberation

In the committee's assessment, the Thai economy should continue to recover in 2015 at a rate close to the previous projection. Although core inflation remained relatively close to the previous assessment, headline inflation declined more than previously assessed, due mainly to a more-than-expected drop in crude oil prices. In addition, risks of capital inflows heightened following the easing of monetary policy in several countries.

Against this backdrop, the committee discussed: **(1) The impact on the domestic economy and inflation of higher downside risks to the global economy, falling oil prices, easing monetary policy in several countries, capital flows and exchange rate movements; (2) The need for additional support from monetary policy given that monetary conditions had recently become less accommodative; and (3) The conduct of monetary policy in the environment where headline inflation was expected to breach the lower bound of the target band.**

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 did not hinder the ongoing economic recovery**, while public investment spending would be more effective in shoring up business confidence and thus ensuring a more steady recovery in the periods ahead. **Moreover, an additional reduction in the policy rate was unlikely to provide a meaningful boost to the economic recovery at the current juncture.** According to the business sentiment survey, most firms did not consider the interest rate level an impediment to their current business operations.

(2) Despite the possibility of breaching the lower bound of the inflation target band**, the recent decline in headline inflation was a result of positive supply shocks, which should help support the economic recovery.** This should not raise concerns as in the case of deflation caused by aggregate demand contraction. In fact, there was no evidence suggesting that the public expected a sustained decline in the general price level, which could lead to delays in consumption and investment.

(3) Against the backdrop of higher global financial market volatility, **monetary policy should give more consideration to financial stability objectives.**

Two members viewed a reduction of the policy rate by 0.25 percent per annum as appropriate in lending more support to economic recovery in light of higher risks from global economy and financial markets and the long implementation lag of fiscal stimulus. Their rationales are as follows:

(1) The ongoing decline and the expected negative headline inflation in the periods ahead would effectively result in rising real interest rates. Monetary policy should thus ease further to help avert the tightening of the overall monetary conditions.

(2) Monetary policy developments in several countries might lead to more capital flows into Thailand and add pressure on the Thai Baht, affecting the still fragile economy recovery.

(3) The 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.

The committee thus voted 5 to 2 to maintain the policy interest rate at 2.00 percent per annum. Going forward, members agreed that monetary policy should remain accommodative in order to ensure a steady recovery of the economy. The MPC would closely monitor economic and financial development, and stand ready to implement appropriate policy as warranted.

Open letter explaining the movement of headline inflation in January 2015 below the lower bound of the target band

Headline inflation had fallen steadily and was expected to become negative in January 2015. Although this would not officially breach the inflation target which was set in the form of average annual headline inflation, the MPC decided to communicate with the public by issuing an open letter to the Ministry of Finance in order to show commitment to the monetary policy framework and to help anchor public expectation of future inflation. The open letter would convey the committee's view as follows:

(1) **The negative rate of headline inflation would not be a signal of a deflationary environment** since the decline in the price level was not broad-based, as reflected in stable and positive core inflation. In addition, medium-term inflation expectations remained close to the inflation target, suggesting that the public viewed the current negative inflation rate as a temporary phenomenon.

(2) **The current accommodative monetary policy stance would foster the ongoing economic recovery** and therefore should, in part, help lift headline inflation back within the target band by the end of 2015.

Monetary Policy Group

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