

## **Edited Minutes of the Monetary Policy Committee Meeting**

**Bank of Thailand**

**11 May 2016**

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### **Members Present**

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

### **The Global Economy**

In the first quarter of 2016, the global economy recovered at a pace slightly slower than assessed in the previous meeting, as growth momentum in the G3 economies weakened in line with consumption spending. Going forward, however, the pace of the global economic recovery was still expected to remain close to the previous projection. Key support would come from continued improvements in the **U.S. economy**, given the ongoing recovery in the labor market, while both the manufacturing and services sectors were likely to resume positive trajectory. At the same time, the **Japanese economy** gained support from accommodative monetary policy, coupled with government spending on reconstruction projects following the earthquake which had affected manufacturing activities and private consumption in the earlier period. With regard to **China**, government measures led to some economic improvements in the near term, but elevated corporate debt and overcapacity in the industrial sector continued to pose downside risks to the long-term outlook.

**The balance of risks to the global economy remained tilted to the downside**, given the risks surrounding China's economy and financial markets as well as monetary policy divergence among advanced economies. In addition, uncertainty regarding the Brexit referendum results could add to global financial market volatility and weigh on the **euro area** recovery through trade and investment channels. The Committee would pay close attention to future developments of China's corporate defaults and the effectiveness of policy responses from the Chinese authorities, since these issues could have implications on financial stability in China and regional countries.

### **The Financial Markets**

**Overall confidence in the financial markets improved**, as crude oil prices rebounded and investors' concerns over the Chinese financial markets eased somewhat in the near term. With the anticipation of gradual policy rate increases by the U.S. Federal Reserve, investors continued to increase holdings of emerging market financial assets including those of Thailand. This resulted in an increase in **Thai equity market indices** and an appreciation of **the baht against the U.S. dollar** in line with regional currencies. The **Nominal Effective Exchange Rate (NEER)**, however, depreciated due to a rapid appreciation in the Japanese yen. **Thai government bond yields**, especially at the long end of the yield curve, continued to edge lower mainly due to strong demand from domestic investors, causing the yield curve to flatten substantially from the beginning of the year. This helped lower financing costs and made domestic monetary conditions more accommodative. Nevertheless, some

Committee members expressed concerns regarding low global bond yields that could potentially reflect underpricing of risks. In addition, a possible snapback in global bond yields, which could raise Thai bond yields as well, could have adverse impacts on the corporate sector. These issues warranted close monitoring in the period ahead.

**Going forward, monetary policy divergence could still contribute to heightened volatility in international capital flows and exchange rates.** However, Thailand's strong external positions at present could help support investors' confidence.

### **Domestic Economic Conditions**

**The Thai economy continued to recover gradually**, supported by effective disbursement of the fiscal budget as well as tourism that expanded more than anticipated on the back of a broad-based increase in the number of foreign visitors. Nevertheless, merchandise export volume, after excluding gold, still contracted from the same period last year due to the slowdown in trading partners' economies and prevailing structural problems. Overall private investment remained low, with capacity expansion seen only in certain industries such as telecommunications and renewable electricity generation. Subdued investment caused imported capital goods and raw materials, together with commercial bank credit growth, to be on the decline. The modest credit growth was also due partly to the expiration of the government soft loan program. Private consumption showed signs of weakening partly because the drought had affected purchasing power of agricultural households. Meanwhile, non-farm employment was able to provide less cushion than in the past, as demand for labor in the manufacturing sector declined in line with the softening of economic activity.

**The Thai economy was estimated to expand in 2016 at a rate close to the assessment in the previous meeting.** Tourism, projected to grow briskly, would compensate for the more-than-expected slowdown in private consumption and investment. In the period ahead, despite a return to normal rainfall pattern from mid-year onward, the Committee expected the impacts of drought on the financial health of agricultural households to persist for some time. One reason was the loss of income that caused some agricultural households to incur more debt. Another was a potential deterioration in soil fertility following severe dry season. Private consumption would thus continue to be weighed down going forward. **Overall, risks to the recovery were judged to be skewed more to the downside compared with the previous assessment.** The Committee would monitor domestic demand closely in order to ascertain the economic momentum amid the fragile global recovery.

**Headline inflation turned positive** in April due to an increase in oil prices coupled with acceleration in fresh food prices. The latter was, nevertheless, considered to be a temporary result of the unusually hot weather. Meanwhile, demand-side inflationary pressure remained low, as reflected by subdued core inflation which was consistent with a gradual economic recovery. **Going forward, the Committee projected headline inflation to gradually rise in line with the previous assessment**, although the inflation outlook could be affected by uncertainties in global oil prices and softening domestic demand.

**Overall risks to financial stability rose slightly** on the back of search-for-yield behavior and weakened debt service ability of both agricultural households and SMEs amid a delayed economic recovery. The deterioration in debt service ability was reflected by rising non-performing loan (NPL) ratios, especially in the categories of SME loans and credit card loans. In addition, some Committee members noted that the currently low financing costs of large

corporations, which resulted from banks competing for financially secured borrowers and a rapid increase in investors' demand for private debenture, could reflect underpricing of risks. As such, the Committee would monitor and assess these developments closely.

### **The Policy Decision**

**The Committee voted unanimously to maintain the policy rate at 1.50 percent at this meeting.** In deliberating monetary policy, the Committee judged that the Thai economy would continue to expand at a rate close to the previous assessment but face greater downside risks on the domestic front. Moreover, the strengthening of the baht against some trading partner currencies during some recent periods might not be as conducive to the economic recovery as it could be. Nonetheless, overall monetary conditions eased further thanks to the low levels of bond yields and prior reduction in commercial bank lending rates, which were deemed conducive to overall economic recovery. Consequently, the Committee decided to keep the policy rate unchanged at this meeting. The Committee also saw the need to preserve the policy space should the ongoing economic recovery become affected by negative risk factors such as a further delay in the global recovery, a prolonged weakness in domestic consumption, or political uncertainties that could dent public and private investments. Meanwhile, risks to financial stability from the search-for-yield behavior, as well as other long-term imbalances that could accumulate under the prolonged low interest rate environment, continued to warrant close monitoring. In addition, some Committee members judged that monetary policy easing would provide limited support to the economy and inflation, as the current slowdown of the Thai economy was partly due to global and domestic structural problems. Besides, the reduction in commercial bank lending rates had already eased monetary conditions.

**Looking ahead, the Committee concurred that monetary policy should remain sufficiently accommodative.** The Committee would stand ready to utilize an appropriate mix of available policy tools in order to ensure that monetary conditions are conducive to the economic recovery, while safeguarding financial stability.

Monetary Policy Group  
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