Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

14 September 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 Boontherawara

The Global Economy

Thailand's trading partner economies were projected to recover at a pace close to the previous assessment. The **US economy** continued to recover, mainly driven by private consumption, which led the market to expect another hike in the federal funds rate by the end of this year. The recovery of **European economies** remained weak, but continued monetary policy easing by the European Central Bank was likely to help sustain economic growth. The **Japanese economy**, supported by government stimulus measures, was expected to continue expanding at a gradual pace. However, the appreciation of the yen due to its perceived safe haven status might not be conducive to the ongoing recovery. With regard to **China and other Asian economies**, growth was driven by additional government stimulus measures, together with improvements in exports of some countries such as Taiwan and Hong Kong, thanks to increased demand for high-technology goods in the global markets.

Risks to the global economic recovery were largely unchanged from the previous assessment. Key risks included greater uncertainties in the aftermath of Brexit, especially over trade and investment negotiations between the UK and the EU that could take longer than expected and would depend largely on political developments in Europe. Moreover, the upcoming US presidential election and financial stability concerns in Europe and China continued to warrant close monitoring, as they could affect investors' confidence and financial market volatility going forward.

The Financial Markets

Volatility in the financial markets receded after the previous meeting as investors' concerns over Brexit somewhat subsided. Meanwhile, additional monetary policy easing by major central banks prompted investors to increase holdings of emerging market assets, including those of Thailand. As a result, in August the **baht appreciated against the US dollar**, in the same direction with regional currencies. However, later in September the baht and regional currencies depreciated vis-à-vis the US dollar, as an increase in the federal funds rate by the end of this year became more likely. Altogether, over the course of the inter-meeting period, the baht appreciated only slightly against the US dollar. Given the baht's strength relative to major currencies and most regional currencies, the **Nominal Effective Exchange Rate (NEER)** appreciated somewhat, with periodic volatility due to movements of the Japanese yen. In the meantime, **Thai government bond yields** rose overall, while the **Stock Exchange of Thailand (SET) Index** declined due to selling pressure from domestic institutional investors despite net purchases by foreign investors.

The Committee anticipated that major central banks would maintain very accommodative monetary policy for a longer period of time ('low for longer'), which could amount to additional capital inflows into emerging markets including Thailand. However, uncertainty regarding the timing of, or policy measures to be used for, further monetary easing could contribute to capital flow and exchange rate volatility in the period ahead. Hence, the Committee would continue to monitor global financial market developments closely as they might impact the stability of Thailand's financial markets going forward.

Domestic Economic Conditions

The Thai economy recorded higher-than-expected growth in the second quarter on the back of a strong expansion in private consumption, partly as a result of temporary factors including the launches of new car models, promotional campaigns, and government stimulus measures during the holiday period. Meanwhile, public spending and tourism continued to be the key growth drivers. Nonetheless, merchandise exports and industrial production contracted due to the slowdown in Asian economies and structural problems facing the Thai economy. In this connection, private investment remained low and mostly concentrated in some business sectors—for instance, the service sector, especially hotel and retail sale businesses. In addition, subdued private investment contributed to the slowdown in credit expansion by commercial banks over the recent period. With these observations the Committee agreed that, while the ongoing economic recovery required accommodative monetary policy, reform policies to uplift Thailand's productivity and competitiveness, especially in the export sector, would be more important.

The Committee expected the Thai economy to grow at a slightly faster rate in 2016 than the previous assessment on account of better-than-expected private consumption outturn in the second quarter. Nonetheless, the economy was expected to slow down slightly in the latter half of the year. Growth momentum from private consumption showed signs of moderation, following the acceleration in the earlier period, due to already softened earnings in the manufacturing sector and fragile private confidence. In addition, the number of foreign tourists was expected to be more modest compared with the previous projection in light of the government's attempt to curb zero-dollar tours. **Consequently, the Committee revised the growth forecast for 2016 to 3.2 percent.** Meanwhile, the Committee maintained the growth forecast for 2017 at 3.2 percent. Public investment was projected to increase further with the ongoing support from measures to accelerate government investment, which would help offset the contraction in exports and subdued private investment. **Overall, the Committee projected that the Thai economy would continue to recover, but risks to growth remained tilted to the downside** owing to both domestic and external factors, especially the more fragile global recovery following Brexit and political developments abroad. Furthermore, shifts in the global trade structure and structural limitations that affect Thailand's competitiveness might cause some of Thailand's export products to be unable to reap the full benefits of the global economic recovery in the period ahead.

Headline inflation increased slightly in August on account of fresh food prices, while core inflation remained stable at low levels in line with the gradual recovery in demand. **The Committee expected headline inflation to return to the target band within 2016 as previously assessed**, with headline inflation averaging at 0.3 percent in 2016 due to this year's low oil prices and 2.0 percent in 2017 thanks to the expected recovery of global oil prices as well as the base effect. Core inflation in 2016 and 2017 was projected to remain at 0.8 percent and 1.0 percent, respectively.

Overall financial stability remained sound but certain pockets of risks warranted monitoring. These included the search-for-yield behavior under the prolonged low interest rate environment, especially household investment in higher-risk financial assets, and declining credit quality in some business sectors amid gradual economic recovery. The latter was particularly pertinent to small-and-medium-sized enterprises (SMEs), which financial institutions remained cautious in extending credit to.

The Policy Decision

The Committee judged that the policy rate should be kept on hold at 1.50 percent at this meeting. Under the Committee's assessment, the Thai economy continued to recover as expected although growth was still limited to some sectors, and the recovery still faced greater uncertainties on both domestic and external fronts. In addition, headline inflation was likely to return to the target band within the latter half of this year in line with the previous assessment. Monetary conditions remained accommodative and conducive to the economic recovery, as reflected in low real interest rates and bond yields, while the slowdown in credit expansion by commercial banks was in part attributed to demand-side factors. Nonetheless, the baht appreciated against key trading partner currencies which, in the Committee's view, might not be beneficial to Thailand's ongoing economic recovery.

The Committee affirmed the need to preserve policy space given that the Thai economy would be faced with greater uncertainties in the period ahead. These included, in particular, the fragile global economic recovery and uncertainty in the monetary policy directions of major advanced economies, which could significantly affect the recovery of Thailand's trading partners and the continuity of Thailand's growth momentum. The Committee thus viewed it essential to preserve policy space to cushion potential impact should these risks materialize. In addition, **the Committee would continue to closely monitor financial stability risks, including the search-for-yield behavior and declines in credit quality**.

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 support the economic recovery and ensure financial stability.

Monetary Policy Group

28 September 2016