

Edited Minutes of the Monetary Policy Committee Meeting

Bank of Thailand

3 August 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 slower pace than assessed in the previous meeting. This was mainly due to the result of the British referendum (Brexit) that negatively impacted confidence in and stability of global financial markets and consequently economic activities going forward. **European economies**, in particular, would be directly affected by Brexit through trade linkages and weakened private sector confidence. Meanwhile, the recovery of the **US economy** might be moderated by the recent appreciation of the US dollar, which led to market expectations that the Federal Reserve would postpone further hikes in the federal funds rate. At the same time, the Bank of Japan might ease monetary policy further to lend additional support to the slowing **Japanese economy**, which was in part a result of the appreciation of the yen that could affect profitability and repatriation of profits of Japanese businesses overseas. Overall, the slower recovery of G3 economies, combined with more fragile investor confidence from uncertainties in the global economy, contributed to a slower growth outlook for **China and other Asian economies** compared with the previous assessment.

Risks to the global economic recovery increased. The Committee assessed that, while Brexit might not have much impact on the global economic recovery in the short run, **uncertainties in the aftermath of Brexit**, especially over trade and investment negotiations between the UK and the EU, would have significant implications on international trade and global growth in the long run. Furthermore, **concerns over the European financial sector** warranted close monitoring, as it could impact financial stability in Europe and consequently Asia through financial market volatility and liquidity. **Financial stability risks in China**, especially those pertaining to real estate prices and shadow banking, also warranted continued monitoring. In addition, **political developments**, such as the future stability of the EU and the US presidential election, could affect confidence and the economic outlook of Thailand's trading partners going forward.

The Financial Markets

Volatility in financial markets heightened after the June meeting in light of Brexit. Subsequently, investors increased holdings of safe-haven assets, which contributed to the US dollar's strength, higher gold prices, and declines in government bond yields of major advanced economies. **During the run-up to the August meeting, however, market concerns over Brexit eased, but there remained expectations that major central banks would maintain very accommodative monetary policy for longer than previously expected ('low for longer').** This led to increased capital flows into emerging markets including Thailand. As a result, the **Stock Exchange of Thailand (SET) index** picked up. Meanwhile, the **Thai baht**

appreciated against the US dollar, moving in the same direction as other regional currencies. As the baht strengthened against certain major currencies and in some periods appreciated by more than other regional currencies, the **Nominal Effective Exchange Rate (NEER)** rose. **Thai government bond yields**, on the contrary, were largely unchanged as the increase in foreign demand was offset by additional issuance.

The Committee expected capital flow and exchange rate volatility to persist in the period ahead. Major contributing factors included monetary policy uncertainties in major advanced economies, which could have broad-based impacts on emerging market economies including Thailand, and fragile sentiment in global financial markets under the low-for-longer environment.

Domestic Economic Conditions

The Thai economy continued to recover at a gradual pace, mainly driven by effective disbursement of the fiscal budget as expected and a steady expansion in the tourism sector. Private consumption increased on the back of improvements in income and confidence of agricultural households after the drought subsided. However, merchandise exports continued to contract on account of weak demand from Asian economies, shifting global trade structure, and declining competitiveness in some product categories. As such, there was excess production capacity in the manufacturing sector, and hence overall private investment remained low despite some expansion in certain business sectors. This was consistent with total corporate financing that continued to expand but at a lower rate compared with the historical average and was still highly concentrated in larger firms. Furthermore, some businesses still faced limitations in obtaining credits partly due to cautious lending by financial institutions against the current backdrop of gradual economic recovery.

The Committee projected the Thai economy to expand at a rate close to the previous assessment but with greater downside risks from increased uncertainties in the global economy. As a result, tourism, a major growth driver, could be softer than expected, and merchandise exports could contract further. In addition, the Committee viewed that the extended period of subdued exports could negatively affect employment in some industries, while the ability of the service sector and other industries to provide employment cushion might be more limited should the economic recovery be slower than expected. This posed rising concerns over income growth and the strength of private consumption, particularly for non-agricultural households. Hence, the Committee would closely monitor employment conditions in the period ahead.

Core inflation in July remained stable from the previous month, reflecting a subdued demand-pull inflationary pressure. **Headline inflation softened slightly** on account of fresh food prices, but continued to be on an upward trajectory towards the target band in line with the gradual economic recovery. Nonetheless, the **timing of the return to the target band**, which would depend mainly on global oil price movements, could be slightly pushed back from the previous assessment due to weaker-than-expected energy prices.

Overall financial stability was not deemed to be a concern. However, risks arising from the prolonged low interest rate environment continued to warrant close monitoring, particularly the search for yield in unrated bonds that could lead to underpricing of risks. In addition, there remained signs of weakened debt serviceability among SMEs and households, as reflected in rising non-performing loan (NPL) ratios over recent periods.

The Policy Decision

In deliberating their policy decision, the Committee assessed that the economy continued to expand at a rate close to the previous projection, despite facing greater downside risks in the period ahead. Headline inflation was still projected to return to the target band. Meanwhile, monetary conditions remained accommodative and conducive to the economic recovery, as reflected in low real interest rates and a continued expansion in total corporate financing and household credits, although certain businesses faced limitations in obtaining credits. **Hence, the Committee voted unanimously to maintain the policy rate at 1.50 percent at this meeting.** Nevertheless, the recent appreciation of the baht might not be beneficial to the ongoing economic recovery. The Committee would therefore continue to closely monitor developments in the global economy as well as the exchange rate and monetary conditions in Thailand.

The Committee affirmed the need to preserve policy space given considerable external uncertainties, particularly the fragile global economic recovery and uncertainties in the monetary policy directions of major advanced economies. While these factors were unlikely to have discernible impact on the Thai economy in the short run, they could significantly hinder the recovery of Thailand's trading partner economies and consequently the Thai economy in the period ahead. As such, the Committee viewed it essential to preserve policy space to cushion potential impact should these risks materialize. In addition, most Committee members viewed that monetary policy decisions should give due consideration to a potential increase in risk accumulation due to the search-for-yield behavior in the prolonged low interest rate environment.

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

17 August 2016