**Edited Minutes of the Monetary Policy Committee Meeting (No. 6/2017)**

**27 September 2017, Bank of Thailand**

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## Members Present

Veerathai Santiprabhob (Chairman), Mathee Supapongse (Vice Chairman), Paiboon Kittisrikangwan, Jamlong Atikul, Sethaput Suthiwart-Narueput, and Apichai Boontherawara

## Member Absent

Porametee Vimolsiri

## The Global Economy

**The growth outlook of Thailand's trading partners improved further from the previous meeting.** The **US** was projected to continue expanding on account of private consumption and investment, which began to be more broad-based, together with stronger labor market conditions. The hurricanes would have a negative impact on the US economy only for a short period of time, while the government shutdown and debt default were less likely to occur. **Japan** expanded on the back of continued growth in consumption as reflected in improvement in consumer confidence. Regarding the **euro area**, labor market conditions improved, while most member countries recorded higher growth than long-term averages. Accommodative financial conditions and improved consumer confidence would support a growth momentum going forward. **China** expanded at a slower pace owing mainly to softer investment by state-owned enterprises. Looking ahead, investment in certain sectors, particularly real estate, would likely slow down following more stringent measures to safeguard financial stability. **Asian economies** continued to recover thanks to exports which benefited from growing external demand from major advanced economies and greater imports from China. These would support manufacturing growth, especially in electronic goods, in the region in the period ahead, underpinned by domestic demand as consumer confidence picked up. **With regard to monetary policy, most central banks maintained their accommodative stance given the low inflation environment.** However, some central banks with relatively high policy interest rates cut their policy rates to boost economic growth momentum. Meanwhile, the Federal Reserve (Fed) remained on the path of monetary policy normalization, with a high possibility that the Fed would hike the federal funds rate one more time this year and commence its balance sheet reduction in October in a gradual manner in order to reduce any possible impacts on the financial markets.

**The Committee assessed that risks to the growth outlook of Thailand's trading partners remained despite decreasing somewhat** given a delayed implementation of the US foreign trade policy. However, global geopolitical risks heightened slightly from tensions in the Korean Peninsula and the responses by major advanced economies.

## The Financial Markets

**Overall sentiments in global financial markets improved** on the back of a stronger global economic recovery and a gradual rise in the policy rates of major advanced economies. Nevertheless, asset prices experienced volatile movements in some periods resulting from conflicts in the Korean Peninsula and political issues in the US, which led to negative investor sentiments on the US dollar. **Combined with accommodative global financial conditions, such developments resulted in continued capital inflows to regional securities markets,** which caused appreciation of most regional currencies. The **baht appreciated against the US dollar** from the previous meeting due to the weakening of the US dollar and Thailand's large current account surplus given continued improvement in income from merchandise exports and tourism. Nevertheless, the baht appreciation was in line with regional currencies so the baht's movement relative to those of trading partners was mostly unchanged. This was reflected in the **Nominal Effective Exchange Rate (NEER)** and the **Real Effective Exchange Rate (REER)** that remained largely stable. Looking ahead, exchange rates might experience higher volatilities due to uncertainties on the external front, such as uncertainties pertaining to US economic policies and monetary policy conducts of major advanced economies, which might affect business adjustments. The Committee would thus continue to closely monitor developments of capital flows and in the foreign exchange markets. Furthermore, the private sector was encouraged to give more consideration to exchange rate risk management which included the use of foreign exchange hedging instruments or invoicing in local currencies to reduce the possible impact from volatilities of the US dollar.

With regard to the bond market, **long-term government bond yields** decreased owing to higher foreign demand. **Short-term yields** picked up somewhat from selling pressures from domestic investors as they adjusted their portfolios to invest in higher yielding assets. However, short-term yields were still lower than the policy rate as a result of the reduction in the issuances of short-term BOT bonds and an absence of Treasury bill issuances at the end of the fiscal year. With regard to the stock market, the **Stock Exchange of Thailand (SET) Index** edged up in line with improved global sentiments and as domestic political uncertainties subsided.

**Domestic Economic Conditions**

**The Thai economy was projected to gain further traction** driven by external sectors. **Merchandise exports** continued to expand both in terms of volume and prices as a result of strong growth among Thailand's trading partners and global trade expansion. Meanwhile, **tourism** recorded stronger growth thanks to regional economic expansion and the increasing number of Chinese tourists. Domestic demand continued to recover and started to be more broad-based. **Private consumption** exhibited stronger expansion in the services and durable goods categories and would likely improve further driven by non-agricultural households' spending and improved consumer confidence. Nevertheless, such improvement was projected to be gradual as purchasing power of low-income and agricultural households was not sufficiently strong. **Private investment** recovered at a gradual pace. Investment in machinery and equipment was observed across various businesses. The total investment value of project applications also increased given better investment sentiments that were consistent with improvements in external sectors and private consumption. However, some businesses still delayed their investment as there was still excess production capacity, and they were also awaiting greater clarity in the government's policies, especially those regarding investment on infrastructure projects. **Public expenditure** remained an important growth driver but would likely slow down due to prior accelerated disbursement in the previous period. Some government agencies were also constrained by disbursement efficiency. Meanwhile, the promulgation of the Public Procurement and Supplies Management Act B.E. 2560 might result in slight delays in the disbursement of some state agencies during the initial phase, particularly local administrative organizations that had not previously operated under this system.

**Going forward, the Committee assessed that the Thai economy would expand further,** recording 3.8 percent in 2017 and 2018, which was higher than previous projection at 3.5 and 3.7 percent, respectively. The upward revision was due to a better-than-expected growth in the second quarter, coupled with continued improvements in merchandise and services exports attributable to a better growth outlook of Thailand's trading partners, increasing pre-orders from abroad, and improved consumer sentiments across various businesses. Moreover, fiscal impetus remained and would continue to drive private investment going forward, in terms of both public investment expenditure and the promulgation on the Eastern Special Economic Zone Act, which would help boost business confidence as well as attract greater foreign investment. **Nevertheless, uncertainties surrounding the growth forecast declined given stronger economic growth of Thailand's trading partners, but upside risks remained dominated by downside risks**, namely, external risks that might affect trading partners as well as domestic risks pertaining to household purchasing power that did not yet sufficiently recover. Moreover, regulations on immigrant workers might restrain economic activities in the short run, while public expenditure might slow down from the impact of the promulgation of the Public Procurement Act during the initial phase.

**The Committee continued to monitor developments of certain factors that could affect the overall growth and inflation outlook.** First, regarding the **impacts from regulations on immigrant workers**, the numbers of immigrant worker registrations in small and medium-sized enterprises (SMEs)—in particular, hotels and restaurants, constructions, and trade—were still low despite the delay in enforcement until the end of this year. These sectors might thus face risks of labor shortages in the period ahead. However, impacts in agricultural and household sectors were judged to be less, as most of immigrant workers in these sectors had already registered. Meanwhile, employment of immigrant workers in manufacturing and services sectors of large businesses might not be much affected since these sectors mostly employed legal workers, but labor costs would likely increase. The Committee would therefore closely monitor the impacts of these regulations especially on the private consumption outlook, as some immigrant workers had left the country, and the impacts on the inflation outlook due to a possible wage rise as labor market tightened. Second, regarding **sectoral economic improvement** recently observed, economic expansion remained concentrated in medium- and large-sized firms in export-related businesses that recorded improvements in production and employment. In addition, there were signs of inventory accumulation after much decumulation in the previous period. Nevertheless, wages and employment in other sectors, such as those in domestic-oriented and agricultural businesses, did not reflect a strong recovery in domestic demand. Non-agricultural employment picked up only in middle- to high-income groups. Meanwhile, employment in a low-income group had yet to fully recover, which was partly due to the increasing adoption of automation in businesses.

**Headline inflation in August 2017** picked up driven mainly by an increase in energy prices, although fresh food prices continued to decline. Meanwhile, **core inflation** remained stable at a low level in line with low demand-pull inflationary pressures, which were in part attributable to (1) economic expansion that was not yet broad-based and (2) pass-through from lower fresh food and liquefied petroleum gas (LPG) prices to prepared food prices. According to the Committee's assessment of the impact of supply-side factors on the inflation outlook, falling prices of fresh food and LPG partly caused prices of food items in the core inflation basket to stabilize at the low level. Overall non-food components in core inflation also remained largely unchanged, given that businesses continued to increase sales promotion as domestic demand improved only gradually. Moreover, structural changes, including increasing roles of modern trade, e-commerce, and globalization, helped facilitate consumers to compare prices and enhanced competitions among entrepreneurs. Technological advancements also led to lower costs of production which partly resulted in headline inflation rising at a slower pace than in the past. Looking ahead, headline inflation was projected to rise albeit more gradually compared with the previous assessment, weighed on by the decline in fresh food prices as a result of higher output of vegetable and fruits amid favorable weather conditions. Meanwhile, demand-pull inflationary pressures remained low and would be subject to structural changes. Nevertheless, headline inflation was projected to slowly rise on the back of domestic demand recovery and an increase in excise tax, together with impacts from regulations on immigrant workers that might affect wages in the period ahead. **The Committee therefore revised down headline inflation projection for 2017 and 2018** to 0.6 and 1.2 percent, respectively, while **maintaining the forecast of core inflation for 2017 and 2018** at 0.6 and 0.9 percent, respectively. In addition, **risks to the inflation outlook were judged to be balanced**. The downside risks remained given that economic growth might be lower than expected, while the upside risks to inflation could stem from (1) regulations on immigrant workers that might result in a tightening labor market and increasing wages and (2) an increase in excise tax. Meanwhile, the public's **inflation expectations** remained close to the midpoint of the target. The Committee would closely monitor inflation developments and continue to communicate with public to anchor public's inflation expectations within the target band going forward.

**Growth in commercial bank loans increased but was concentrated only in some businesses.** Business loans extended to large corporates remained largely stable, while loans extended to SMEs gradually expanded but were rather concentrated in manufacturing, real estate, and public utility sectors. Meanwhile, consumer loan expansion was observed in all loan purposes. The approval rate rose in tandem with higher loan demand from both consumers and businesses, while the credit utilization rate remained stable overall. Regarding the **quality of consumer loans**, the non-performing loans (NPL) ratio increased at a slower pace. However, the NPL ratio of housing loans continued to rise. As for the **quality of business loans**, NPLs of large businesses remained stable while those of SMEs—particularly smaller businesses in commercial, construction, and industrial sectors—picked up, reflecting an economic recovery that was not yet broad-based. This was partly because such businesses confronted competitiveness challenges arising from constraints on adaptation to economic structural changes such as the increasing roles of technology in business operations. Nevertheless, NPLs of SMEs in export-oriented industries decelerated somewhat in line with export expansion. However, the Committee expressed concerns over the high level of NPLs that would remained elevated in the short run. This was because NPLs were highly concentrated in some businesses such as large businesses in certain industries with NPLs unlikely to decline, while NPLs of smaller businesses in the commercial sector continued to rise. Thus, the Committee saw the need to closely monitor developments of NPLs going forward.

**Monetary Policy Decision**

The Committee assessed that the Thai economy would grow at a faster pace than the previous assessment on account of merchandise exports and tourism, while domestic demand continued to recover and began to be more broad-based. Headline inflation was softer than previously projected mainly because of supply-side factors, but was expected to slowly rise given domestic demand recovery, an increase in excise tax, as well as impacts from regulations on immigrant workers that might result in wage increases. In addition, overall financial conditions remained accommodative and conducive to economic growth. Thus, the Committee viewed that current monetary policy accommodation helped support the economic growth and foster the return of headline inflation to target, although this might take some time.

**In their policy deliberation, the Committee discussed key considerations underpinning the policy decision.** Their conclusions were as follow.

**(1) Thailand's growth outlook was expected to gain further traction driven mainly by external factors, while the strength of domestic demand recovery must be monitored.** The Committee viewed that a stronger global trade recovery and a continued improvement in income of Thailand's trading partners would be important drivers to support the continuation of growth in merchandise exports and tourism, while these sectors would unlikely be affected significantly by the baht appreciation. Moreover, the baht appreciation in the recent period was in line with regional currencies, and Thailand's low inflation relative to those of trading partners resulted in only a slight appreciation of the REER since the beginning of the year. With regard to domestic demand, the ongoing expansion began to be more broad-based. However, increased economic activities were still concentrated in export-related and large businesses and had not yet lead to stronger income and purchasing power, especially those of low-income households. Meanwhile, SMEs still confronted competitiveness challenges. Nevertheless, the Committee viewed that a policy mix between macroeconomic policy and more targeted measures as well as structural economic reforms was necessary in dealing with uneven economic expansion. Meanwhile, monetary policy played its role in fostering sufficiently accommodative financial conditions which were conducive to the continuation of economic growth and orderly adjustments of the private sector.

**(2) Headline inflation was softer than previously assessed due mainly to supply-side factors but was expected to slowly rise.** The Committee viewed that headline inflation was expected to edge up in 2018 following a domestic demand recovery and an increase in excise tax. Nevertheless, inflation would rise at a slower pace than in the past due to structural factors. These included the increasing role of modern trade and e-commerce, together with competition in global trade. Thus, the Committee would closely monitor the implications of structural changes for inflation dynamics and the monetary policy conduct. Moreover, some Committee members noted that the effect of a policy rate cut to increase inflationary pressures and foster a swifter return of headline inflation to target would be limited, as low inflation was caused by supply-side and structural factors. Financial conditions remained accommodative for extended periods and did not pose any difficulties on investment according to entrepreneurs. Moreover, debt accumulated by low-income households remained elevated and might limit their abilities to additionally leverage despite falling borrowing costs. Lower interest rates might also induce medium- to high-income households, which mostly hold bank deposits, to enhance return by investing in riskier assets instead of increasing consumption. Furthermore, lower interest rates might weigh on purchasing power and consumption of elderly people relying on savings and interest incomes from savings deposits.

**(3) Financial stability remained sound overall but there remained pockets of risks that might result in the buildup of vulnerabilities in the financial system going forward which continued to warrant close monitoring.** These included in particular a rising search-for-yield behavior in a low interest rate environment, together with other financial stability problems especially those stemming from regulatory gaps. Nevertheless, the Committee viewed that developments in monitoring processes and analyses on financial stability were essential for monetary policy formulation under flexible inflation targeting, which required careful considerations on economic and financial risks, while striking a right balance overall between economic growth, inflation, and financial stability.

**In this light, the Committee unanimously voted to keep the policy rate unchanged at 1.50 percent at this meeting. The Committee concurred on the need to maintain accommodative monetary policy stance and would stand ready to utilize available policy tools to support the continuation of economic growth while preserving financial stability.**

Monetary Policy Group
11 October 2017