Edited Minutes of the Monetary Policy Committee Meeting (No. 7/2017)

8 November 2017, Bank of Thailand

Publication Date: 22 November 2017

Members Present

Veerathai Santiprabhob (Chairman), Mathee Supapongse (Vice Chairman), Paiboon Kittisrikangwan, Porametee Vimolsiri, Sethaput Suthiwart-Narueput, Kanit Sangsubhan, and Subhak Siwaraka

The Global Economy

The global economy overall continued to recover while inflation still remained low. Thailand's trading partner economies continued expanding and largely unchanged from the previous projection, driven mainly by growth in advanced economies as well as rising corporate profits both in advanced economies and Asia. **Advanced economies** expanded on the back of improvements in consumer confidence and production. **China** expanded at a slightly faster pace than previously assessed but was projected to moderate due to ongoing economic structural reforms toward a domestic consumption-oriented economy, a slowdown in public infrastructure investment, and impacts of government measures on private investment in the property sector. **Asian economies** recorded slightly stronger growth than the previous assessment owing mainly to exports and production on the back of a recovery in advanced economies. Recent global events—such as the new Politburo Standing Committee in China, Japan's general election, the ECB's reduction in asset purchases, and the appointment of the new Fed chairman—would not significantly affect direction of economic and monetary policies of these countries. With regard to monetary policy, **most central banks maintained their accommodative stance** to support economic growth or foster a return of inflation to target. However, some central banks in advanced economies gradually raised policy rates given stronger economic growth and labor markets along with clearer signs of inflation rising toward the target.

The Committee noted that risks to global economic recovery became more balanced relative to the downward bias in the previous assessment. In particular, upside risks increased thanks to the higher probability of US tax stimulus policies, a faster pace of Chinese economic growth over the medium term, and clearer signs of a recovery of domestic demand in Asian economies, while geopolitical risks still warranted monitoring.

The Financial Markets

Overall sentiments in global financial markets remained sound on the back of the positive global economic outlook and gradual interest rate hikes of major advanced economies, although volatility heightened in some periods along with uncertainties from the appointment of the new Fed chairman and the progress in US tax reform. Capital inflows to emerging market economies slowed down in line with lower non-resident investment in Thailand's financial markets in both equities and short-term bonds, while non-resident investment in long-term bonds remained stable. With regard to exchange rates, the **baht remained stable against the US dollar** and was in line with regional currencies. **The Nominal Effective Exchange Rate (NEER) and the Real Effective Exchange Rate (REER)** appreciated somewhat due to the weakening of some major currencies. Meanwhile, short-term **government bond yields** remained below the policy rate as a result of reduced issuances of short-term BOT bonds and treasury bills. **The Stock Exchange of Thailand (SET) index** edged up in line with regional stock indices. This was partly driven by purchases by domestic institutional investors as concerns on political uncertainties had declined. In the period ahead, capital inflows to emerging market economies would continue to increase given improved economic growth. In addition, **the baht against the US dollar** might experience increased volatilities from external factors, especially uncertainties pertaining to the tax reform and stimulus economic policies in the US and monetary policy in advanced countries. Thus, the Committee would continue to closely monitor developments in the foreign exchange market.

Domestic Economic Conditions

The Thai economy was projected to gain further traction from the previous assessment driven by merchandise exports and improved private consumption. Merchandise exports expanded well and was projected to continue growth momentum on the back of stronger recovery in the global economy. This was in line with the global trade growth this year and the next that was projected to exceed the previous assessment. **Private investment** particularly in machinery and equipment continued to improve, as reflected in signs of increasing imported capital goods and domestic machinery sales across various industries. Nevertheless, private investment in the period ahead was projected to expand gradually due to overcapacity in some industries as well as delayed disbursement for some public investment projects. Meanwhile, **tourism** growth was in line with the previous assessment. **Private consumption** continued to pick up as purchasing power and consumer confidence improved. Nevertheless, such development was projected to be gradual as farm income had yet to recover due to low agricultural prices as well as purchasing power of non-agricultural, low-income groups that was not yet strong. Moreover, small and medium-sized enterprises (SMEs) might not fully benefit from the economic recovery due to structural problems such as increased competition from modern trade and e-commerce together with automation. **Public expenditure** remained an important growth driver but would likely slow down from the previous assessment due to delayed disbursement in capital expenditure.

Going forward, issues that could affect the economic momentum discussed by the Committee were as follows. First, regarding the **regulations on immigrant workers**, the situation improved continuously as most entrepreneurs could manage and resume business operations, although SMEs that were dependent on immigrant workers would potentially face higher labor costs. Meanwhile, consumption spending in areas concentrated with immigrant workers had yet to fully recover. Second, with regard to the **recent floods**, the impacts were mostly limited to residential and agricultural areas. Industrial areas were affected somewhat and already started to improve. Moreover, the Committee discussed **factors underlying the gradual recovery in private consumption despite clear signs of overall economic expansion**, attributing to subdued growth in household income and wages. This was caused in part by structural factors such as a changing employment pattern toward more part-time workers as well as a rising proportion of workers in the service sector, thereby resulting in low wage levels and little wage growth when compared with compensation in the manufacturing sector. Furthermore, the increased adoption of automation did not result in the propagation of macroeconomic expansion to increases in labor income or wages to the same extent as in the past. In addition to low wage growth, another reason for the gradual recovery in private consumption was the high level of household debt.

Headline and core inflation slightly increased and was in line with the previous assessment. Headline inflation picked up following an increase in fresh food and energy prices. However, given low demand-pull inflation pressures, signs of acceleration in prices of goods had yet to be seen. Moreover, a gradual pace of wage growth also limited cost-push inflation pressures. Looking forward, headline inflation was projected to slowly increase, given the recovery in domestic demand, higher oil prices, the excise tax increase, and the impacts of regulations on immigrant workers. Meanwhile, short- and medium-term inflation expectations slightly decreased possibly because of low headline inflation in the past and previous downward revisions in the inflation projection. Nevertheless, inflation expectations would likely pick up given an increase in inflation going forward. In addition, the Committee viewed that many central banks also faced with the challenge of low inflation and increased difficulty in predicting trend inflation due to structural changes, such as e-commerce, trade liberalization, and technological advances, which resulted in lower production costs. The Committee would continue to closely monitor inflation developments.

Growth in commercial bank loans expanded at a slow pace. Growth in business loans to large corporates and SMEs slowed down, which was partly due to debt repayment of large corporates as well as a shift toward more equity financing in the real estate and construction sectors. However, loans to businesses in the energy sector continued to expand, together with other sectors related to merchandise exports and tourism that witnessed increasing loan demand for working capital and fixed asset investment. Consumer loans expanded in all purposes. Loan approval rates increased in conjunction with higher consumer and business loan applications. However, corporate loan utilization rates slightly decelerated. With regard to credit quality, the non-performing loan (NPL) ratio started to stabilize except for SMEs in the commercial, industrial, and construction sectors. Meanwhile, the NPL ratio of consumer loans largely rose in mortgage loans. Nevertheless, financial institutions were able to maintain cushion against deterioration in credit quality. The Committee expressed concerns over NPLs of SMEs that would hardly decline despite macroeconomic improvements. This was because SMEs, particularly small businesses in commercial and construction sectors, were partly affected from structural problems in that current business models could not compete. Some Committee members noted that should NPLs in consumer loans, especially among low-income earners, were to increase, commercial banks might tighten credit standards further. These consumers might consequently resort to alternative financing sources such as saving cooperatives or non-banks, and such developments warranted close monitoring going forward.

Financial stability remained sound but there were pockets of risks that continued to warrant close monitoring. The ratio of household debt to GDP was projected to gradually decline, as seen in almost all loan purposes and especially in personal loans and auto leasing. Nevertheless, the ratio of household debt to household income remained largely stable given the recent decline in the ratio of household income to GDP. In addition, households' ability to cushion against financial shocks would likely decrease as indicated by the survey by the National Statistical Office this year where the ratio of household debt to financial assets increased especially for low-income earners. Meanwhile, leverage by other non-financial institutions relative to GDP remained stable in line with a gradual recovery in private consumption and private investment. Nevertheless, there remained risks pertaining debt serviceability of businesses, particularly SMEs, and low-income households. Regarding asset prices, housing prices including condominiums did not accelerate significantly. Meanwhile, the stock exchange index increased but the price-earnings ratio was largely unchanged from the historical average. Volatilities in Thailand's financial markets stood at a very low level possibly due in part to underpricing of risks, which could lead to increased volatility if market conditions were to turn out different from market expectations. Meanwhile, risks pertaining to the rollover of unrated bonds continued to ease as reflected in lower outstanding short-term unrated bonds. The **search-for-yield behavior in the prolonged low interest rate remained present**. First, foreign investment funds (FIFs) expanded continuously, although risks were limited as most funds invested in countries with investment-grade credit rating. Nevertheless, it was necessary to continue monitoring risks of concentrated investment in some particular countries. Second, some saving cooperatives reported strong growth in assets and deposits and in some instances where deposits grew faster than loans invested their surplus liquidity in riskier assets. The Committee viewed that pursuing policies which would strengthen supervision of saving cooperatives was highly critical. The Committee emphasized the need to monitor developments of search-for-yield behavior that could lead to underpricing of risks. Furthermore, some Committee members expressed concerns over the elevated ratio of debt to household income, which would impose persistent debt burden and affect household consumption.

Monetary Policy Decision

The Committee assessed Thailand's growth outlook to have improved further from the previous assessment mainly due to merchandise exports and tourism as well as continued domestic demand expansion. Headline inflation gradually rose as projected on account of increases in fresh food and energy prices, a recovery in domestic demand, an increase in excise tax, as well as impacts from regulations on immigrant workers that might increase overall wages. Meanwhile, financial conditions remained accommodative and conductive to economic growth as reflected in low corporate funding costs in the credit and bond markets. Financial stability remained sound but there were pockets of risks that might result in the build-up of vulnerability going forward. The Committee assessed the benefits and costs as well as trade-offs of policy alternatives and viewed that current accommodative monetary policy stance help support 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 policy decision. Their conclusions were as follow.

(1) Thailand's economic growth outlook gained further traction on the back of improved merchandise exports and tourism thanks to a stronger global economic recovery together with continued domestic demand expansion. Private investment indicators improved across various sectors, while private consumption continued to expand in line with improvements in household purchasing power and consumer confidence. However, the Committee viewed that the ongoing economic expansion did not fully extend to employment and earnings of low-income earners and SMEs. This was partly due to structural factors which monetary policy alone could not solve. Moreover, the baht appreciation in the recent period was in line with regional currencies, while NEER and REER remained largely unchanged. Overall, the Committee viewed that the degree of monetary policy accommodation should be maintained for some period to support a more robust domestic demand expansion.

(2) Headline inflation slightly increased following a rise in fresh food and energy prices and was expected to slowly edge up on the back of domestic demand recovery, an increase in excise tax, as well as impacts from regulations on immigrant workers. In addition, the Committee noted that recent below-target inflation was mainly due to supply-side and structural factors; further monetary policy accommodation therefore would not be appropriate and could result in the build-up of vulnerability in the financial system going forward. Moreover, under the Committee's assessment the decline in inflation expectations would not lead to deflation risks. This was because inflation was still expected to continue rising, prices of most goods and services did not fall, and consumption and investment continued to expand. Nevertheless, the Committee would continue to closely monitor the impacts of structural factors on developments of inflation going forward.

(3) Overall financial stability remained sound but there remained pockets of risks that might result in the build-up of vulnerabilities in the financial system going forward. These included in particular (1) a rising search-for-yield behavior in a prolonged low interest rate environment that might lead to underpricing of risks. This was partly reflected in increased investment in riskier assets, as seen in a continued expansion in foreign investment funds (FIFs), which were concentrated in some countries, and the leverage behavior of some saving cooperatives; (2) debt serviceability of households and SMEs that had yet to improve; and (3) other financial stability problems that might stem from regulatory gaps. In addition, some Committee members expressed concerns over the property sector given high competition amid oversupply. Nevertheless, the Committee saw the need to closely monitor financial stability developments as well as coordinate with financial regulatory authorities to implement measures in an appropriate manner.

In this light, the Committee assessed policy trade-offs and 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
22 November 2017