Edited Minutes of the Monetary Policy Committee Meeting (No. 3/2018)
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Members Present

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

Member Absent

Paiboon Kittisrikangwan

The Global Economy

Thailand's trading partner economies continued to grow in line with the previous assessment. **Advanced economies** were expected to expand mainly on the back of private consumption as employment and consumer confidence continued to improve. Although consumption was somewhat dampened by unfavorable weather conditions, it was expected to gain traction in the period ahead. **China and Asian economies** showed sustained growth driven primarily by exports thanks to strong global demand. **Inflation in trading partner economies**, especially in advanced economies, was increasing on the back of energy prices. Meanwhile, inflation in emerging market economies remained subdued. **The Committee viewed that downside risks to economic growth of trading partners due mainly to risks associated with US economic and foreign trade policies as well as possible retaliation from US trading partners were mostly unchanged from the previous assessment**. Geopolitical risks remained largely unchanged, as tension declined in the Korean Peninsula but escalated in the Middle East. According to the Committee's preliminary assessment, US foreign trade policies and possible retaliation from US trading partners would have a limited impact on the Thai economy and trading partners, with the impact varying across product groups. Nevertheless, the impact on supply chains and Thai businesses would be complex and difficult to assess. The Committee would thus continue to closely monitor developments of trade policies and negotiations as they could have stronger impacts than anticipated. Moreover, there might also be a significant impact on private sector confidence about investment, foreign trade, and financial market conditions.

The Financial Markets

Investors in global financial markets maintained a cautious stance. Despite having declined from earlier this year, asset price volatility remained high compared with last year, causing global financial markets to continue to be sensitive. This is attributable to (1) the 10-year US Treasury yield now exceeding 3 percent, a four-year high, thanks to increased US inflation expectations and stronger US economic performance relative to other countries especially Europe, (2) uncertainties surrounding US trade policies, and (3) geopolitical risks. These factors led to US dollar appreciation and risk-off sentiments among investors, particularly toward investments in risky assets and emerging markets. As a result, investors began a sell-off in these bond and stock markets. Countries with vulnerable economic fundamentals, such as Argentina, Turkey, and Indonesia, were significantly affected by capital outflows. Meanwhile, the baht depreciated against the US dollar, in the same direction as most regional currencies, in light of the US dollar's movements and seasonal outflows from Thailand due to the repatriation of foreign investors' dividends during the second quarter of the year. Thus, volatility of the baht increased. However, the currency's movements relative to those of trading partner currencies in the previous period were largely unchanged. **Short-term Thai government bond yields rose** due to selling pressures from foreign investors and an increase in government and Bank of Thailand bills issuance. **Long-term Thai government bond yields slightly edged up** as their US counterparts increased. Nevertheless, long-term Thai government bond yields did not materially change given the bond supply and the low inflation outlook. **Looking ahead, the baht would likely experience volatile movements** mainly due to uncertainties pertaining to the conduct of monetary and fiscal policies in advanced economies as well as geopolitical risks and oil prices. The Committee would closely monitor these developments and their potential impacts on exchange rates and the economy going forward.

The Committee viewed that risks associated with uncertainties pertaining to US trade policies could affect global trade and financial markets more than market participants anticipated both in terms of asset prices and investor confidence. The Committee also noted that **there were signs of tightening global financial conditions—in particular, the acceleration in US Treasury yields at a pace that induced risk-off sentiments among investors—after financial conditions remained highly accommodative for a prolonged period.** This might pose a risk that liquidity in the global financial markets going forward might tighten at a faster pace than observed in the past two years.

<u>Domestic Economic Conditions and Financial Stability</u>

The Thai economy gained further traction and recorded higher growth than previously assessed driven by expansion in the external sector and a gradual improvement in domestic demand. The **value of merchandise exports** improved both in terms of quantity thanks to robust growth in external demand and in terms of prices on the back of rising global crude oil prices. **Exports of services** continued to expand in line with the number of tourists partly due to (1) the launch of direct flight routes from Chinese secondary cities to Thailand and (2) airlines working to accommodate more tourists despite airport capacity constraints. Meanwhile, domestic demand increasingly played a significant role in supporting economic growth. **Private consumption** gradually expanded, driven primarily by middle- and high-income households, and employment showed signs of improvement. Furthermore, **private investment** growth was projected to rise due to developments pertaining to the Eastern Economic Corridor (EEC) initiative and the Public-Private Partnership (PPP) scheme, after the cabinet approved the high-speed rail project linking three main airports, which helped boost investor confidence. Despite some delays in budget disbursement, **public expenditure** continued to lend support to economic growth as the supplementary budget for fiscal year 2018 had a larger share of direct public expenditure than previously assessed. Meanwhile, the effects of the enforcement of the Public Procurement and Supplies Management Act, B.E. 2560 gradually alleviated as expected.

The Committee engaged in extensive discussion and viewed that the positive spillovers of overall economic expansion to the labor market and private consumption remained limited to export-related sectors, while the strength of income growth among agricultural and low-income households still warranted close monitoring going forward. The increase in non-agricultural household income was concentrated in the middle- and high-income households, which supported growth in durable goods consumption. Meanwhile, low-income households still lived on stagnant earnings, with elevated household debt remaining a drag on consumption. For agricultural households, although agricultural output expanded, purchasing power started to improve only in product groups that experienced higher prices, such as jasmine rice and cassava. Regarding the labor market, which acted as a key channel for overall macroeconomic growth to trickle down to household spending at the micro level, there were structural challenges in the labor market such as automation in the production processes, limited skill flexibility that constrained mobility across industries, and job search by graduates that increasingly took longer time. **The Committee viewed that such problems must be tackled by structural policies** in order for labor skills and incomes to improve and better align with a fast-changing economy with respect to technology, business models, and demography.

Headline inflation gradually rose in March and April 2018 as previously assessed thanks to the continued increase in energy prices. However, domestic oil prices were partially subsidized by a reduction in the refining cost premium as well as reduced contribution to the Energy Conservation Promotion Fund maintained by the Committee on Energy Policy Administration. Fresh food prices remained low due to high agricultural output thanks to favorable weather. **Core inflation increased slightly** on the back of higher housing rents. Looking ahead, headline inflation was expected to slowly trend up on account of gradual expansion of domestic demand and rising oil prices. However, demand-pull inflationary pressures remained low, resulting in a slow increase in core inflation. In addition, structural changes such as technological developments, an expansion of e-commerce, and heightened price competition, would cause inflation to rise more slowly than in the past. Nevertheless, **long-term inflation expectations saw a slight increase.**

Commercial bank loans continued to expand in line with economic growth, especially large loans extended to small and medium-sized enterprises (SMEs) which increased across a broader range of businesses. Smaller SME loans, however, remained largely unchanged. Meanwhile, large corporates continued to make significant amounts of loan repayments. Nevertheless, loans extended to large corporates expanded in certain businesses, in particular real estate where financing increased through loans, bonds, and equities. Consumer loans expanded in all purposes, particularly auto loans. With regard to **credit quality**, the overall non-performing loan (NPL) ratio remained stable from the previous quarter. However, NPLs of some SMEs warranted monitoring, despite credit quality of SMEs loans starting to improve in a broad range of businesses in line with overall economic growth as reflected in a decline in migration rates of normal loans to special-mentioned and non-performing loans. Going forward, credit quality of consumer loans still warranted monitoring as NPLs continued to rise across all purposes except auto loans. Furthermore, commercial banks began to raise more deposits to prepare for economic growth in the period ahead as well as an interest rate upcycle.

Financial stability remained sound overall but there remained pockets of risks that might lead to a build-up of vulnerability in financial system going forward. Regarding **leverage**, the seasonally adjusted ratio of household debt to GDP continued to decline gradually albeit remaining at a high level in the fourth quarter of 2017. Debt serviceability of households remained an issue to be monitored, particularly among low-income households with high proportion of debt to financial assets. The ratio of non-financial corporate debt to GDP remained unchanged but corporate financing through long-term debt increased, which were mostly investment grade in financial, real estate, and food sectors. In any case, financial institutions remained cautious in extending loans to both businesses and households and were more stringent in SME loans and auto leasing. Regarding **asset prices**, volatilities of the Stock Exchange of Thailand (SET) index increased somewhat in line with global financial conditions, with the price-earnings ratio (P/E ratio) largely unchanged. The overall house price index continued to rise albeit at a slow pace. Property owners increased their financing through commercial banks and the bond market, reflecting continued investment. Meanwhile, commercial banks competed more on providing mortgage loans within the middle-to-high price range consistent with the increase in the loan-to-value ratio (LTV). **The search-for-yield behavior in the prolonged low interest rate environment remained present** as reflected in (1) an accelerated expansion of daily fixed income funds despite a slowdown of foreign investment funds (FIFs) for some time and (2) continued high growth in deposit and portfolio investment of saving cooperatives despite slowing down somewhat compared with the previous period due to more stringent regulations.

The Committee extensively discussed the issue of household debt and viewed that, in general, economic recovery in other countries such as the US and South Korea would take place in conjunction with significant deleveraging. However, that Thailand's elevated household debt declined at a slower pace partly reflected some structural problems that had yet to be fully resolved. In addition, some Committee members noted that the duration of consumer loans in Thailand was shorter on average compared with other countries. A longer loan's term potentially would lead to lower monthly interest expenses and consequently would allow for higher disposable income available to households. Furthermore, some Committee members viewed that certain financial stability risks were self-correctable, while some other risks might warrant regulatory measures such as credit card and personal loan measures, which the Bank of Thailand already implemented in order to tackle household debt problems last year.

Monetary Policy Decision

The Committee assessed that the Thai economy continued to gain further traction and would grow at a higher rate than previously projected, driven by both the external sector and gradual improvements in domestic demand. Headline inflation was projected to gradually rise in line with the previous assessment. Overall financial conditions were accommodative and conducive to economic growth. Financial stability remained sound overall, but it was deemed necessary to monitor pockets of risks that might lead to the build-up of vulnerabilities in the financial system. The Committee considered the benefits and costs of policy alternatives and viewed that the current accommodative monetary policy stance remained conducive to the continuation of economic growth and should support the rise of headline inflation to target in a sustainable manner, although the process could take some time.

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

(1) The Thai economy overall gained further traction, with domestic demand improving but not yet sufficiently strong in a broad-based manner. Growth continued to be driven by the external sector. Merchandise exports and the number of tourists continued to grow and started to trickle down to employment of related businesses. Private consumption, particularly on durable goods, steadily expanded. However, improved purchasing power had yet to fully extend to all economic sectors. The increase in farm income following higher agricultural output was a result of the low base. Earnings of low-income households remained fragile and dependent on government subsidies. Furthermore, household debt still weighed on private consumption and structural changes were taking place in the labor market. Private investment continued to improve in line with robust business confidence but was still contingent on budget public sector disbursement and investment going forward. Meanwhile, there remained risks on the external front especially uncertainties surrounding US foreign trade policies and retaliatory measures from major economies. **Overall, the Committee viewed that growth development still warranted monitoring for some period. Accommodative monetary policy thus remained necessary to support more broad-based and stronger domestic demand.**

(2) Headline inflation gradually trended up in line with the previous assessment on the back of fuel prices following a continued increase in global oil prices. Meanwhile, fresh food prices remained low. Core inflation slowly rose on account of a gradual improvement in domestic demand and an increase in the public's inflation expectations. The Committee viewed that upward pressures on inflation in the period ahead might be lower than in the past, as wage increases had only limited effects on inflation, oil prices increases were partly compensated by subsidies, and increases in agricultural prices became less likely due to expansion in the agricultural land base worldwide. Moreover, firms were still profitable overall and able to cope with higher production costs without the need to pass on to consumers. The Committee would continue to closely monitor inflation developments going forward and viewed that the **current accommodative monetary policy should support headline inflation to rise toward target in a sustainable manner, although the process might take some time.**

(3) Financial stability remained sound overall but there remained pockets of risks that might result in the build-up of vulnerabilities in the financial system. Such risks included (1) the search-for-yield behavior especially in the prolonged low interest rate environment that could lead to underpricing of risks, (2) developments in saving cooperatives, (3) debt serviceability of households and SMEs, and (4) the property market in which businesses and financial institutions continued to invest and increasingly engaged in competition. Some Committee members viewed that macroprudential measures were appropriate for mitigating risks to financial stability. While others viewed that, as the policy interest rate would partly help prevent these risks from further developing and broadly affecting financial stability, it was thus an indispensable tool in preserving financial stability alongside macroprudential measures, as it would enhance effectiveness in safeguarding overall 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
30 May 2018