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Members Present

Veerathai Santiprabhob (Chairman), Mathee Supapongse (Vice Chairman), Paiboon Kittisrikangwan, Sethaput Suthiwart-Narueput, Kanit Sangsubhan, Subhak Siwaraksa, and Somchai Jitsuchon

The Global Economy

Trading partner economies would continue to slow down due to the impacts of uncertainties arising from international trade tensions despite some signs of improvement in the short term. Advanced economies were expected to moderate due to exports, production, and investment. Meanwhile, the services industry would remain a key sector supporting the economy. Private consumption would be supported by rising wages and tightening labor markets. **China** would expand at a slower pace, prompting the authorities to launch monetary and fiscal stimulus measures to help shore up the economy. While these measures were in a smaller scale than those in the past, they were designed to be more targeted and taken into account financial stability consideration. **Asian economies** (excluding Japan and China) would also moderate in line with production, exports, and a prolonged downturn in the electronic cycle. In coordination with monetary policy, fiscal policy would support Asian economies by increasingly focusing on infrastructure investment. **Monetary policy of trading partners** in both advanced and regional economies would loosen further. The Federal Reserve (Fed) additionally cut its policy rate in October 2019 as insurance against potential adverse impacts on the economic and inflation outlook from uncertainties pertaining to the global economy and trade tensions. The European Central Bank (ECB) kept their accommodative monetary policy stance and would start its new Asset Purchase Program (APP) in November 2019. Many regional central banks such as the Reserve Bank of India, the Bank of Korea, Bank Indonesia, and the Reserve Bank of Australia also cut policy rates further in October.

The Committee assessed that there was a probability of trading partner economies and global trade volume growing at a slower pace than the baseline projection due to (1) the global economic slowdown, (2) potentially prolonged trade protectionism through both tariff and non-tariff measures that would impinge on services sector employment in advanced economies, and (3) heightened geopolitical risks. The Committee noted that Thailand's trading partner economies would not show a clear sign of improvement next year, although the global economy would gain traction due to the economic recovery in Latin America and Russia, as both were not Thailand's major trading partners. Monetary policy space in various countries would be more limited. Policy rates would be lower for longer. However, there were still policy space for fiscal policy, especially in Asia, which would be an important tool for stimulating the economy in the period ahead.

Moreover, risks of global financial stability would heighten in the medium to long term due to the lower for longer environment caused by accommodative monetary policy of advanced economies. Investors would search for higher yields by investing in riskier assets, which could lead to underpricing of risks. There was higher risk accumulation in non-bank financial institutions due to less regulation. The Committee thus saw a need to closely monitor (1) development of trading partner economies, (2) other countries' monetary and fiscal policies, and (3) risks pertaining to economy and financial stability in order to assess their impacts on the Thai economy that could occur through various macroeconomic linkages.

The Financial Markets

Concerns in the global financial markets abated thanks to positive progress on trade negotiations between the US and China in the first stage of the partial US–China trade agreement. The deal included (1) postponement of US tariff hikes on some Chinese products, (2) removal of designation of China as currency manipulator, and (3) China's pledge to increase imports of some agricultural products from the US. In addition, Brexit negotiation made some progress after a three-month extension until 31 January 2020. Prices of most risky assets increased owing to the risk-on sentiments after the first phrase of trade deal between US and China had some progress. Long-term US government bond yields rose in tandem with global financial market conditions. However, long-term Thai government bond yields only slightly increased due to domestic investors' demand for long-term bonds.

On exchange rates, **the Thai baht appreciated against the US dollar since the previous meeting** in line with regional currencies and emerging market risky asset prices. Movements of the baht somewhat diverged from those of the yen and gold prices due to risk-on sentiments following better prospects in trade negotiations between the US and China as well as Brexit negotiation. The nominal effective exchange rate (NEER) appreciated since the previous meeting.

The Committee viewed that financial markets would remain highly uncertain going forward due to various factors, including uncertainties pertaining to trade negotiations between the US and China, Brexit, and the global economic slowdown. These factors could cause volatilities in asset prices and exchange rates. Moreover, monetary policy stance of advanced economies would be an important factor affecting confidence in global financial markets going forward. The Committee remained concerned about baht appreciation against trading partner currencies given the economy continued to slow down, as heightened external uncertainties could cause the Thai economy to be more sensitive to greater currency appreciation. This would be an additional pressure on the softening employment and domestic demand, particularly in export-related manufacturing and services sectors. **The Committee supported the Bank of Thailand in relaxing regulations in order to facilitate capital outflows and help promote balanced cross-border flows, which could lessen pressure on the baht as well as facilitate foreign exchange risk management of the private sector.** In addition the Committee saw the need for the Bank of Thailand to (1) closely monitor developments of exchange rates, capital flows, and impacts on the economy through various channels and (2) to review the effectiveness of the implemented capital outflow relaxation measures every three months and consider implementing additional measures at an appropriate timing if necessary. These additional measures included those under the Bank of Thailand's authority and those required collaboration with other private and public organizations, particularly efforts to stimulate investment to reduce the large current account surplus. Such investment projects, including those requiring imported capital goods, would help boost the economy during the global economic slowdown. These investment projects would also enhance growth potential of the Thai economy and restructure the economy to keep up with changes especially in digital technology.

Domestic Economic Conditions and Financial Stability

The Thai economy would expand at a lower rate than previous projection and further below its potential due to the contraction in merchandise exports that increasingly affected the labor market. **Merchandise exports** would contract more significantly and would recover at a slower pace than the previous assessment due to (1) the slowdown in trading partner economies and global trade as a result of trade tensions and (2) indirect impacts of increasing Chinese merchandise exports redirected to the region. **Exports of services** would moderate. Tourism expenditure declined following the global economic slowdown. **Private consumption** was expected to slow down despite supports from fiscal stimulus. This was due to moderated household income and a sharp fall in employment, particularly in export-related manufacturing sectors, as well as elevated household debt. Looking ahead, private consumption would encounter downward risks regarding a broad-based decline in non-agricultural employment and a decline in agricultural output due to the low dam water levels. **Private investment** would grow at a lower rate than previously assessed in tandem with merchandise exports and domestic demand. However, greater clarity of public-private partnership projects for infrastructure investment and the relocation of production base to Thailand would support investment going forward. **Public expenditure** would expand at a lower rate than the previous assessment due partly to delay in the state-owned enterprise investment projects and a reduction in state-owned enterprise investment budgets for fiscal year 2020.

The Committee assessed that there remained possibilities that the Thai economy could expand at a slower pace. These included key merchandise exports such as (1) automotive and auto parts that would be affected by the global economic slowdown and within-industry changes such as automation as well as a growing trend of electronic vehicle with less parts needed, causing lower demand for workers and (2) electronic goods that would face with a slower-than-expected recovery of the global electronic cycle. Moreover, some Thai entrepreneurs might gain less benefit from the upcycle due to technological changes. Regarding domestic demand, the Committee concerned over the fast decline in employment in both agricultural and non-agricultural sectors in a broad-based manner that would continue to decline further following the slowdown in the economic outlook and impacts of drought next year. The Committee thus saw a need to closely monitor developments in the labor market and debt servicing capability of households.

The annual averages of headline inflation in 2019 and 2020 were projected to be lower than the previous projection and below the lower bound of the inflation target due to lower-than-expected energy prices in tandem with the global economic slowdown as well as a sooner-than-expected return to the normal level of crude oil production in Saudi Arabia after the attack on production plants. **Core inflation** was expected to increase at a lower rate than expected owing to processed food prices, where the pass-through of fresh food prices to processed food prices was limited. This partly reflected low demand-pull inflationary pressures. Nevertheless, long-term **inflation expectations** slightly increased from the previous period, while short-term inflation expectations were largely unchanged.

Financial system risks still posed vulnerabilities to financial stability. The financial cycle that remained above trend could reflect some vulnerabilities. However, the financial cycle was expected to moderate in the period ahead. On **leverage**, loan quality of SMEs continued to deteriorate. This was attributed to the worsening loan quality of medium-sized SMEs in addition to that of small-sized SMEs which were highly vulnerable owing to existing structural problems. Meanwhile, loan quality of some corporates affected by trade tensions also worsened. Regarding household debt, the household debt-to-GDP ratio remained elevated and would continue to edge up as a result of the economic slowdown as well as loan expansion by commercial banks and non-bank financial institutions, especially credit card and personal loans. Households increasingly resorted to collateralized personal loans for liquidity, part of which could be for business purposes. In addition, the share of households sensitive to negative income shocks increased, and the Committee would thus monitor these households during the economic downturn. In order to curb household debt problems going forward, the Bank of Thailand worked with commercial banks to establish guidelines on responsible lending and standardize debt service ratio (DSR) calculation in order to collate DSR data in case additional measures intended to curb household debt would become necessary in the future. **Search-for-yield behavior that led to underpricing of risks** still persisted in the prolonged low interest rate environment. Large corporates increasingly turned to the bond market for funds instead of commercial banks during the low interest rate environment, with banks becoming cautious in extending loans. Some high-yield bonds and perpetual bonds were found to be bought by individuals who might underprice risks. Growth of saving cooperative assets subsided following moderation in deposits and their members' equities. Regarding the **property sector**, after the implementation of the revised loan-to-value (LTV) measure, households and commercial banks changed their behavior as intended. Speculation abated as reflected in (1) the slower growth of new condominium loans for the second and subsequent contracts, (2) the tightened credit underwriting standards, and (3) the decline in condominium prices due to softened demand. Prices of single houses and townhouses were largely unchanged. Property developers adjusted by delaying new project launches. Meanwhile, the government's reduction of transfer fees and mortgage registration fees to 0.01 percent for new housing units under three million baht effective 2 November 2019 was expected to help reduce the oversupply in the property sector to some extent.

The Committee viewed that the macroprudential measures previously implemented helped curb vulnerabilities in the financial system to some extent. The Committee saw a need to continuously monitor and assess the impacts of LTV measure on the property sector. There also was a need to monitor financing by large corporates that might underprice risks and risks associated with large saving cooperatives that were highly financially interconnected. Moreover, the Committee viewed that household debt was a critical and urgent structural risk that would require a multi-dimensional resolution. Cooperation between various parties was needed to reduce leverage and to restructure existing debt. In this light, greater emphasis should be placed on borrowers' debt servicing capability. The Committee thus directed a study of additional appropriate measures to curb potentially increased risks in the future.

Monetary Policy Decision

The Committee assessed that the Thai economy would expand at a lower rate than previously assessed and further below its potential due to the contraction in merchandise exports that increasingly affected employment and domestic demand. Headline inflation would be below the lower bound of the inflation target. Overall financial conditions were accommodative. Real interest rates and government bond yields remained low. Liquidity in the financial system remained ample. Meanwhile, the baht continued to appreciate. Financial stability had already been taken care of to some extent, but there remained pockets of risks that warranted continued monitoring. Most Committee members judged that a more accommodative monetary policy stance would contribute to the continuation of economic growth and should support the rise of headline inflation toward target. **The Committee therefore voted 5 to 2 to cut the policy rate by 0.25 percentage point from 1.50 to 1.25 percent. Two members voted to maintain the policy rate at 1.50 percent. The Committee discussed key considerations underpinning the policy decision. Their conclusions were as follows.**

1) The Thai economy was expected to expand at a lower rate than previously assessed and further below its potential. Merchandise exports contracted more than the previous assessment and were projected to recover at a slower pace. Employment would decline significantly in both agricultural and non-agricultural sectors. Public expenditure would grow at a lower rate than previously estimated. **The Committee viewed that the Thai economy would encounter higher risks from both external and internal factors** including (1) uncertain trade tensions and prolonged downturn in the electronic cycle, (2) the weakening outlook of trading partners' economies, especially China and Asia, together with intensifying geopolitical risks, (3) more accommodative monetary policy stance in advanced and regional economies, (4) uncertainties pertaining to public expenditure and the progress on public-private partnership infrastructure investment and the consequent impact on private investment, (5) more-than-expected slowdown in private consumption as a result of declining employment and income, and (6) risks from drought next year which could affect agricultural output and farm income.

The Committee assessed that continued exchange rate appreciation affected exports and the overall economy. The impacts could be seen from business profits and liquidity, a sharp reduction in employment in export-related manufacturing sectors, signs of slowdown in domestic demand and deteriorated debt servicing capability in the sectors related to export contraction. The Committee thus saw the need to closely monitor exchange rate and its impacts on the economy.

2) Headline inflation would be below the lower bound of the inflation target in 2019 and 2020 due to lower-than-expected energy prices in line with the global economic slowdown and with quicker-than-expected recovery in Saudi Arabia oil production. In addition, core inflation was expected to be lower than the previous estimate owing to subdued demand-pull inflationary pressures. In the period ahead, the Committee viewed that inflation projection would face uncertainties from oil price fluctuations and weather conditions. Moreover, structural changes such as impacts from the expansion of e-commerce, heightened price competition, and productivity upgrades which reduced production costs could cause inflation to rise at a slower pace than in the past.

3) Some financial system risks which had been partly addressed by the implemented macroprudential measures. For instance, property sector risks abated after the implementation of the loan-to-value (LTV) measure. Moreover, banks were more cautious in extending loans during the economic slowdown. **However, other financial stability risks had not improved and warranted continued monitoring.** First, debt servicing capability of households and SMEs could be worsened amid economic slowdown, particularly in the case of additional income shocks, while elevated household debt could build up vulnerabilities in the household sector. Second, search-for-yield behavior in the prolonged low interest rate environment could lead to underpricing of risks, especially by large corporates and saving cooperatives. Third, the property sector remained oversupplied in some areas.

Given the softening economic outlook and prolonged low interest rates, the Committee viewed that microprudential and macroprudential measures would need to play an increasing role in addressing financial stability risks. The Committee supported the Bank of Thailand to work with other organizations in order to push forward household and SME debt resolutions. Such resolutions included debt restructuring and the debt clinic, together with putting into practice guidelines for responsible lending and for building financial discipline and promoting household savings. The Committee saw a need to continue monitoring impacts of the implemented measures and study additional appropriate measures to curb potentially increased risks in the future.

The Committee engaged in extensive discussion regarding the necessity of the policy rate cut to 1.25 percent at this meeting. Most Committee members viewed that more accommodative monetary policy would support economic growth during the slowdown as well as the rise of headline inflation toward target in the context of heightened uncertainties mainly from external factors. This would give both public and private sectors time to adjust to the economic downturn. The adjustments included restructuring household and corporate debt such as (1) broadening the scope of the debt clinic to include more debtors and (2) restructuring SMEs debt to enhance their debt servicing capability as well as to keep their businesses operating. Moreover, the policy rate cut could also facilitate fiscal policy to support the economy. In addition, most Committee members viewed that the policy rate cut together with the relaxation of capital outflow regulations would reduce pressure on the baht to some extent. Nevertheless, **two Committee members viewed that a policy rate cut given the already accommodative monetary policy stance might not lend additional support to economic growth** compared with potentially increased financial stability risks, which could pose adverse effect on economic growth in the long run. In addition, the effect of a policy rate cut on reducing pressure on the baht could be limited as baht appreciation was driven mainly by inflows from current account surplus and foreign direct investment. Furthermore, there remained a need to preserve the limited policy space for coping with potentially heightened risks in the future.

In the discussion of the monetary policy outlook the Committee would be data-dependent by closely monitoring the developments of the outlook for growth, inflation, and financial stability, together with associated risks in deliberating monetary policy going forward. The Committee would stand ready to use policy tools as appropriate. Furthermore, **the Committee saw the need for policy coordination between related public and private organizations to support growth recovery and economic restructuring** given structural problems facing the Thai economy that could affect competitiveness and growth outlook going forward. The problems should be firmly addressed by all related parties.

Monetary Policy Group
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