Edited Minutes of the Monetary Policy Committee Meeting (No. 2/2022)
25 and 30 March 2022, Bank of Thailand
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Members Present

Sethaput Suthiwartnarueput (Chairman), Mathee Supapongse (Vice Chairman), Vachira Arromdee, Kanit Sangsubhan, Rapee Sucharitakul, Somchai Jitsuchon, and Subhak Siwaraksa

The Global Economy and Financial Markets

Thailand's trading partner economies were projected to slow down, with growth for this year revised down from 4.0 percent to 3.6 percent. This was due to the impacts of sanctions against Russia. The sanctions resulted in higher energy and commodity prices, which worsened global supply disruption and led to rising inflation in most countries. However, as the Russian economy accounted only for 2 percent of the world economy, the direct impacts on the global economy were limited, with the exception of Europe which had strong economic linkages with Russia and Ukraine. Asian economies would recover at a slower pace due to higher energy prices which weighed on growth through higher living costs and production costs, but the impact would be limited. Regarding the COVID-19 outbreak, the situation was improving in many countries and the impact of the Omicron outbreak on economic activities would be less than in previous waves.

Global financial markets were highly volatile due to the Russia-Ukraine conflict. The Thai financial markets moved in line with global markets. Long-term Thai government bond yields rose in tandem with US Treasury yields. Meanwhile, short-term and medium-term Thai government bond yields remained steady, consistent with the Thai policy rate. **On the exchange rates, the Thai baht relative to the US dollar remained volatile.** In the early part of the first quarter of this year, the Thai baht had appreciated, mainly driven by the prospect of a tourism sector recovery. The baht then depreciated due to concerns over the Russia-Ukraine conflict and expectations of policy rate hikes in advanced economies. However, the impacts on the Thai financial markets were largely muted thanks to strong external stability, reflected in a high level of international reserves and low external debt. **In the period ahead, financial markets' volatilities could increase.** Key risk factors included (1) prolonged sanctions against Russia, which would push up energy prices and costs in the long run, and (2) faster-than-expected policy rate hikes by major central banks, particularly the Federal Reserve, in response to rising inflationary pressures.

Domestic Economy

The Thai economy would continue to recover, expanding by 3.2 percent in 2022 and 4.4 percent in 2023. This would be driven mainly by improving domestic demand as well as a resurgence in foreign tourist arrivals, which were expected to reach 19 million in 2023. Meanwhile, negative shocks in recent periods have had a limited impact on the recovery prospect. **The effects of sanctions against Russia would not derail the overall economic recovery path.** The direct impacts on the Thai economy were limited since the value of exports to Russia in 2021 was only 0.4 percent of total exports and Russian tourists accounted for only 4 percent of total foreign tourists before the pandemic. However, the main impact on the Thai economy would be the indirect spillover effects on energy and commodity prices. These would result in higher costs of goods and living expenses, a dampened domestic purchasing power, as well as a slowdown in external demand. **The impact of the Omicron outbreak on economic activities was expected to be more contained than previous waves.** The public health system could still accommodate COVID-19 cases, and thus no stringent containment measures were expected.

Downside risks to short-term growth increased. First, there could be prolonged shortages of raw materials in certain industries. In particular, commodities mostly produced by Russia and Ukraine could face more severe shortages, including pig iron, chemical fertilizers, wheat, and minerals used in the manufacture of automobiles and electronics. Second, households and businesses could be affected by higher living costs and higher production costs, particularly the vulnerable groups. Non-farm income was still below the pre-pandemic level. Furthermore, the ability of businesses in certain sectors to absorb rising costs had diminished, particularly those with large shares of fuel and commodities in their cost structure, including transportation, petroleum and chemicals, and construction.

Headline inflation for the full year 2022 was expected to exceed the target range, reaching 4.9 percent, driven primarily by rising energy prices and the pass-through of food prices. Inflation could exceed 5 percent in the second and third quarters, mainly attributed to the low-base effect of crude oil prices and government assistance measures in 2021. Such effect would subside by the fourth quarter of 2022. **Headline inflation in 2023 was expected to decrease to 1.7 percent and return to the target range.** This would be owing in part to the assessment that the rises in energy and food prices would not persist, and the global shortage of raw materials and commodities would ease. **However, upside inflationary risks increased** from (1) higher-than-expected oil prices if the Russia-Ukraine war and the sanctions against Russia exerted greater-than-assessed impacts on global oil supplies, and (2) higher-than-expected cost pass-through to consumer prices, both directly and indirectly due to rising production costs and transportation costs. **Nevertheless, inflation pass-through to wage rises was assessed to be limited** due to a fragile recovery in the labor market and an uneven recovery across industries. Employment remained lower than the pre-pandemic level and might recover more slowly than in past crises.

Overall, the Committee assessed that the rise in inflation was mainly due to cost-push price pressures. Even though the proportion of domestic goods and services with significant price increases picked up, this remained concentrated in energy- and food-related product groups. (In the Consumer Price Index basket, the proportion of goods and services with significant price increases rose from 9 percent in January 2022 to 13 percent in February 2022). **Demand-pull inflationary pressures remained subdued given that income had just begun to recover. Medium-term inflation expectations remained anchored within the target range** and were not sensitive to short-term price changes.

<u>**Discussions by the Committee**</u>

- **The Committee assessed that the Thai economy was not characterized by stagflation. The economy would continue to expand in 2022 and 2023** on the back of improving domestic demand and tourism. The overall recovery path would not be derailed by the Omicron outbreak and sanctions against Russia. Despite the Omicron's high transmissibility, its mild symptoms helped shore up sentiment which lessened the impact on economic activities. Moreover, sanctions against Russia would have a limited direct impact on the Thai economy. **On inflation, the recent increase was**

driven by supply-side factors that were expected to alleviate gradually. Headline inflation would decline and return to the target range in early 2023. Therefore, the Thai economic outlook did not meet the criteria for stagflation, which referred to an episode of a very low or negative growth together with continuously rising inflation.

- **The Committee expressed concerns that the escalation of the Russia-Ukraine war might lead to global geopolitical tensions that pose uncertainties in the future.** These would aggravate global supply chains that had yet to resume their pre-pandemic functioning or would reshape global trade and investment into blocs (deglobalization). Moreover, global supply chains and businesses' investment decisions could be affected in the long run.
- **The Committee judged that the rise in Thailand's inflation was in a different context from that of major economies, especially the US.** The Thai economy was in a different stage of the business cycle compared with the US. For Thailand, the economy had just begun to recover and demand-pulled inflationary pressures remained subdued. For the US, the economy was expanding robustly. There were both cost-push and demand-pull inflationary pressures. The rise in private consumption and wages contributed to broad-based and persistent increases in prices. The Federal Reserve would therefore accelerate the pace of rate hikes to temper inflation arising partly from demand-pull factors.
- **The Committee noted that medium-term inflation expectations remained anchored within the target range**. This reflected confidence that monetary policy would continue to preserve medium-term price stability, similar to the 2008 episode. During that period, Thailand's headline inflation rose to 5.5 percent in tandem with the rise in global oil prices which peaked at 140 US dollars per barrel. However, Thailand's medium-term inflation expectations only displayed small increases. By contrast, Latin American economies which had a long history of grappling with hyperinflation saw medium-term inflation expectations rising in tandem with short-term inflation. In addition, Thailand had mechanisms to stabilize domestic prices, including the Oil Fuel Fund. **Nevertheless, the Committee considered that inflation dynamics would need to be closely monitored**, including the dispersion and persistence of price increases, cost pass-through from producer to consumer prices, demand-pull inflationary pressures, and wage pressures, together with inflation expectations based on surveys and those implied from various sources. This would ensure that medium-term inflation expectations would be consistent with the monetary policy target.
- **The Committee viewed that the overall financial system remained stable. Some households and businesses, however, were more vulnerable as a result of higher living expenses and production costs**, particularly low-income households and SMEs whose incomes were to fully recover and debt remained high. This situation could affect private consumption and debt servicing capability going forward. The Committee deemed that measures contributing to sustainable debt restructuring should be expedited to mitigate financial stability risks and prevent a drag on medium-term economic growth.

<u>**Monetary policy decision**</u>

The Committee voted unanimously to maintain the policy rate at 0.50 percent to help facilitate a sustained economic recovery.

The Committee assessed that the Thai economic recovery would remain intact in 2022 and 2023, despite impacts from sanctions against Russia which led to higher energy and commodity prices as well as a slowdown in external demand. Average inflation for the full year 2022 would exceed the target range but was expected to decline and return to target in early 2023 with energy and food prices stabilizing. **The Committee assessed those recent increases in inflation stemmed primarily from cost-push factors, while demand-pull inflationary pressures remained subdued. The Committee thus voted to maintain the policy rate at this meeting to help facilitate a sustained economic recovery.**

The Committee viewed that the baht had depreciated relative to the US dollar due to concerns over the Russia-Ukraine war and the expectation of monetary policy normalization in advanced economies. The Committee would therefore closely monitor developments in both global and domestic financial markets, and continue to expedite the new foreign exchange ecosystem, particularly through supporting SMEs in hedging against risks from exchange rate volatility.

The Committee viewed that government measures and policy coordination among government agencies would be critical to support the economic recovery amid heightened uncertainties. Fiscal measures should support the economic recovery in a targeted manner, with a focus on generating income and alleviating living expenses for vulnerable groups. Monetary policy should contribute to continued accommodative financial conditions overall. Financial and credit measures had helped distribute liquidity and reduce debt burden, especially for those whose incomes had not yet fully recovered. In addition, financial institutions should accelerate debt restructuring in a sustainable manner to have broader impacts and be consistent with borrowers' long-term debt serviceability, thereby preventing a drag on medium-term economic growth.

Under the monetary policy framework with objectives of maintaining price stability, supporting sustainable and full-potential economic growth, and preserving financial stability, **the Committee continued to put emphasis on supporting the economic recovery**. In addition, the Committee would monitor key factors affecting the economic and inflation outlook, namely, global energy and commodity prices, higher cost pass-through, and geopolitical risks that could elevate and pose uncertainties in the period ahead. The Committee would stand ready to use appropriate monetary policy tools if necessary.

In the medium term, the Committee viewed that appropriate monetary policy should consider trade-offs between the objectives of price stability, economic growth, and financial stability in light of the changing outlook and risks. This should be deliberated in conjunction with the overall assessment of the interaction of monetary policy and other policy tools, as well as their effectiveness. At the current juncture, accommodative monetary policy reflected the assessment that risks and uncertainties to the economic growth continued to outweigh risks and uncertainties to other policy objectives. In the period ahead when the robust economic recovery resumed and the associated risks subsided, the Committee should re-assess the balance of risks between the policy objectives to reflect the evolving situation, taking into account medium-term policy impact and effectiveness.

Monetary Policy Group
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