Edited Minutes of the Monetary Policy Committee Meeting (No. 2/2023)
24 and 29 March 2023, Bank of Thailand
Publication Date: 12 April 2023

Members Present

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

The Global Economy and Financial Markets

Trading partner economies were projected to grow 2.5 and 2.9 percent in 2023 and 2024, respectively. Advanced economies (AEs) should continue to improve led by the service sector. China's reopening should lend support to its economy, improving activities in manufacturing, service, and real estate sectors. Asian economies, which recently experienced an export downturn, were expected to recover in line with China and the global economy. **However, the global economic outlook grew more uncertain** from persistently high inflation and tighter global financial conditions following episodes of banking stresses in some AEs. Depending on how these developments unfold, there could be implications for monetary policy and the global economy.

Uncertainty about the Fed and ECB's monetary policy outlook kept volatilities in global financial markets high. Contributing to this uncertainty were persistently high inflation and increased financial stability risks from banking stresses in some AEs during March 2023. As a result, bond yields in most countries declined, while risky asset prices fell along with increased capital outflows from emerging market economies. However, the impact from these banking stresses on the Thai financial system so far had not been significant, as the Thai financial institutions and corporations had limited linkages with the troubled banks and risky assets. Moreover, Thai financial institutions continued to maintain high levels of capital. Nonetheless, the Committee would closely monitor the global financial developments and assess any potential impact on the Thai economy and financial system.

Thailand's overall financial conditions remained accommodative. Thai bond yields declined slightly in tandem with US Treasury yields. Financial conditions tightened somewhat from higher private sector funding costs, in line with the higher policy interest rate. On balance, financial conditions remained supportive of fund mobilization by the private sector and ongoing recovery, as bank lending and corporate bond issuances continued expanding. **The baht fluctuated against the US dollar,** driven by the Fed's uncertain policy outlook and increased financial market volatility induced by banking stresses in AEs.

Domestic Economy

The Thai economy was expected to continue expanding, driven mainly by recovery in the tourism sector, which should, in turn, boost labor income and private consumption. Growth projection for 2023 and 2024 was 3.6 and 3.8 percent, respectively, supported by several factors. First, the tourism sector continued to recover robustly, with the number of foreign tourists picking up across most source countries. Tourist arrivals were expected to reach 28 million and 35 million for 2023 and 2024, respectively, an upward revision from the January assessment of 25.5 million in 2023 and 34 million in 2024. Second, improving employment and labor income, especially for the service and self-employed sectors which benefited from tourism recovery, should help support private consumption. Third, merchandise exports started to rebound after contracting in the last quarter of 2022 and should gather momentum in the second half of 2023 consistent with trading partners' growth. Nevertheless, certain merchandise exports could recover more slowly than others, including electronics whose global demand was undergoing a cyclical downturn, and petrochemical which was affected by China's dual circulation strategy. **Overall, the risk to Thai economic growth was tilted to the upside** from the number of foreign tourist and their spending which could exceed expectations. The Committee, however, noted the downside risks from highly uncertain global financial and economic outlook.

Headline inflation would likely return to the target range by mid-2023 and was projected to average 2.9 percent in 2023 and 2.4 percent in 2024. Supply-side inflationary pressures should continue to gradually dissipate in line with smaller increases in domestic electricity and diesel prices. **Core inflation was projected to remain at a high level for some time**, averaging 2.4 percent in 2023 before declining to 2.0 percent in 2024. Underlying inflation indicators had begun to turn downward, though still hovered at high levels. **There remained a risk of inflation staying elevated for longer than expected**, as firms could pass on higher costs absorbed in the past and demand-side pressures could pick up with the recovery gaining traction. The Committee would therefore continue to closely monitor risks to inflation.

Highlighted discussions by the Committee

- **The Committee saw increased risks to the global economy and financial system.** Persistently high inflation and tighter financial conditions induced by banking stresses in some AEs could have implications for monetary policy and economic outlook. Measures taken by authorities had helped assuage these concerns to some extent and, to date, the real and financial spillover impact to Thailand had been limited. The situations nonetheless remained fluid and uncertain. The Committee would thus closely monitor the developments and continuously assess potential impact on Thailand's economy and financial system.

- **The Committee expected the Thai economy to continue expanding.** In most members' assessment, there were upside risks to growth in 2023 from stronger-than-expected tourist arrivals and associated boost to labor income and domestic demand. Merchandise exports could similarly recover faster than expected, especially if banking stresses in AEs were contained and left limited broader impact on the global economy. Nonetheless, the Committee would monitor the global outlook given increased downside risks.

- **In the Committee's view, upside risks to inflation remained** given a potential increase in pass-through of costs absorbed in the past. Some production costs were still persistently high, in part as increased contribution to the Oil Fuel Fund capped downward adjustments in the domestic energy prices. Businesses could moreover raise prices of goods and services in anticipation of rising households' purchasing power and stronger economic recovery. The Committee discussed the possibility of inflation staying elevated longer than historically the case, owing to the same structural changes impinging on the global inflation. These included technology transformation, deglobalization and green transition. The Committee agreed to closely monitor firms' pricing behavior and demand-side inflationary pressures, as well as potential changes in inflation dynamics which could affect medium-term inflation expectations.

- **The Committee remained concerned over the financial positions of the vulnerable groups,** especially SMEs and low-income households. Despite the recovery observed, labor income in some sectors remained below the pre-Covid levels and insufficient to cover increased expenses and debt servicing costs. The Committee deemed it important to still have in place financial support measures, particularly debt restructuring, with a comprehensive coverage for vulnerable households to resolve their debt problems in a sustainable and targeted manner.

- **The Committee agreed on a continued policy normalization to lessen the risk of inflation staying persistently above the target range.** Although inflation had recently declined, there remained upside risks from higher cost pass-through and demand-side inflationary pressures. Persistently high inflation, in turn, might affect price-setting behavior and inflation expectations. The Committee viewed a gradual and measured policy normalization as an appropriate strategy for tackling inflation and supporting the economic recovery with remaining vulnerable businesses and households. The Committee also discussed the potential role of low real interest rates in engendering a build-up of economic imbalance, posing risks to long-term financial stability. The appropriate level of real interest rates would be one relevant consideration for monetary policy deliberation looking ahead.

Monetary policy decision

The Committee voted unanimously to raise the policy rate by 0.25 percentage point from 1.50 to 1.75 percent.

The Committee expected the Thai economy to continue expanding, driven mainly by tourism and private consumption. Exports of goods were recovering and expected to gain strength in the second half of this year. **Headline inflation would likely return to the target range by mid-2023, but with upside risks** from higher cost pass-through and demand pressures following the economic recovery. Meanwhile, **overall financial system remained resilient** but developments in the financial markets and the banking stresses in AEs must be monitored. As some SMEs and households remained fragile, debt restructuring should be pressed ahead, and the Committee deemed it important to have in place targeted measures and sustainable debt resolutions for vulnerable groups.

Under the prevailing monetary policy framework, the Committee would seek to maintain price stability, support sustainable growth in line with potential, and preserve financial stability. In view of these objectives, the Committee judged the broad contour of economic recovery to be on track. However, risks to inflation from demand-side pressures must be monitored. **The Committee thus decided to increase the policy interest rate to normalize the monetary policy stance in a gradual and measured manner toward a level consistent with long-term sustainable growth. The Committee would be prepared to adjust the size and timing of policy normalization should the evolving growth and inflation outlook differ from the current assessment.**

Monetary Policy Group
12 April 2023