Edited Minutes of the Monetary Policy Committee Meeting (No. 4/2024)
16 and 21 August 2024, Bank of Thailand
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Members Attending

Sethaput Suthiwartnarueput (Chairman), Alisara Mahasandana (Vice Chairman), Roong Mallikamas, Paiboon Kittisrikangwan, Rapee Sucharitakul, Roongrote Rangsiyopash, and Santitarn Sathirathai

The Global Economy and Financial Markets

Trading partner economies were projected to expand, supported mainly by the service sector; the manufacturing sector, meanwhile, should continue its recovery trajectory despite some recent slowdown. The U.S. economy continued to expand primarily due to personal consumption expenditures, although signs of a slowdown emerged in the labor market, with worse-than-expected job growth and unemployment rate in July. The Chinese economy was anticipated to decelerate, partly due to prolonged issues in the real estate sector, which continued to weigh on domestic demand. Meanwhile, Asian manufacturing and merchandise exports started to improve in line with the recovery of the global electronics cycle. Nonetheless, the global economic outlook remained uncertain due to lingering geopolitical risks in the Middle East.

Asset prices in global financial markets have been volatile due to concerns about the U.S. economic slowdown and the anticipation of interest rate cuts by major central banks. Market participants expected more rate cuts from the Federal Reserve this year, which led to the depreciation of the U.S. dollar, a decline in U.S. bond yields, and increased capital inflows into regional bond markets. The Thai baht appreciated against the U.S. dollar, while Thai bond yields declined in line with U.S. government bonds.

Domestic Demand

The Thai economy was projected to expand in line with previous assessments, primarily supported by (1) a robust expansion in the tourism sector, reflecting an increase in foreign tourists, and (2) continued expansion in private consumption, albeit at a more moderate pace following a period of strong growth. Meanwhile, merchandise exports and manufacturing activities were expected to recover gradually. Private investment contracted in the second quarter, consistent with the observed decline in business confidence.

However, the economy has recovered unevenly across sectors. Sectors that recovered well and continued to grow robustly included tourism and most service industries, such as trade and utilities, which collectively accounted for approximately 60% of GDP and 44% of the labor force. In contrast, **sectors that have yet to fully recover**, representing 40% of GDP and 56% of the labor force, included: (1) sectors that have recovered slowly but saw easing cyclical impediments, such as electronics exports as well as real estate and the related construction industry, which had been affected by delayed government disbursements; and (2) sectors that have recovered slowly and continued to face both structural and cyclical pressures, such as (2.1) automotive-related businesses, which contracted due to a faster-than-expected transition to electric vehicles (EVs), weakening domestic and external demand, and tighter credit conditions for hire-purchase loans by financial institutions, and (2.2) businesses facing competition from Chinese imported goods, such as electrical appliances, apparel, and furnishings, whose growth was likely to remain subdued. Going forward, **it is crucial to monitor private investment and consumption**, which could be affected by declining investor and consumer confidences, coupled with sluggish income recovery and financial vulnerability of certain households.

Headline inflation was expected to gradually return to the target range by the end of 2024. The inflation rate was expected to decline relative to previous assessments due to (1) agricultural prices likely remaining subdued as favorable weather conditions boosted production, and (2) structural factors preventing large increases in energy and raw food prices compared to the past. Additionally, heightened competition from imported goods, particularly lower-priced Chinese imports with increasing volumes. These contributed to a lower trend in core inflation. Looking ahead, it remains crucial to monitor potential extensions of government subsidies currently supporting energy prices.

Overall financial conditions tightened somewhat. Private sector funding costs via commercial banks and the bond market remained relatively stable. **However, financial conditions for SMEs and certain households tightened**, as reflected by the slowdown in credit growth and the deterioration in credit quality, particularly for household loans. This was partly due to the deterioration in debt repayment capacity of vulnerable households, stemming from slow income recovery. In addition, the decline in credit quality could also be attributed to borrowers who had previously been under financial measures implemented since COVID-19 but their debt repayment capacity had not improved. However, it was assessed that the proportion of non-performing loans would not increase sharply. Total outstanding loans for businesses remained roughly unchanged, but loans in the automotive and electronics sectors declined partly due to structural factors, while SME loans contracted due to rising credit risks.

Highlights of Committee Discussion

- **The Committee expected the Thai economy to expand as projected**. The economic growth was anticipated to be more balanced, with contributions from both domestic demand and external factors. However, **the committee expressed concerns about certain sectors of the economy**, particularly: (1) private consumption whose momentum could be lower-than-expected from several factors, such as slower labor income recovery especially in the manufacturing and self-employed groups, declining consumer confidence in middle- to low-income households, and deteriorating credit quality for certain households; and (2) firms in the merchandise exports and manufacturing sectors that recovered slowly and could face ongoing pressures from structural headwinds and deteriorating competitiveness. This, in turn, could affect private investment and **have implications for long-term potential growth.**
- **The Committee assessed headline inflation to gradually return to the target range by the end of 2024** and expected it to stabilize near the lower bound of the target range. This was partly due to structural factors such as low exchange rate pass-through and a flexible labor market which allows self-employed and migrant workers

to more easily re-enter jobs in non-agricultural sectors, resulting in limited impact of economic expansion on wage increases. Moreover, the continuous rise in imports of Chinese goods has been an additional structural factor. However, the current low inflation did not indicate signs of deflation and could partly alleviate the rise in the cost of living, particularly for low-income households who had experienced higher inflation rates compared to other households in preceding periods. This is due to the lower-income household's consumption basket containing a higher proportion of food items, as well as the tendency for price adjustments of cheaper goods to increase at a higher rate than those of expensive goods within the same product category. The committee deemed that the inflation target range of 1 to 3 percent has effectively anchored medium-term inflation expectations and has been sufficiently flexible to accommodate supply-side fluctuations, such as the recent rise in global energy prices. The inflation target also helped lower inflation persistence and allow the shocks to quickly dissipate in such scenarios. Going forward, the Thai economy would face more relative price changes from supply-side fluctuations and structural factors. A flexible inflation target range, therefore, would play a crucial role in maintaining medium-term price stability.

- **The Committee recognized the interlinkages between the macroeconomic and financial sectors**. Household credit quality has deteriorated particularly in housing and hire-purchase loans. Additionally, there were signs of credit quality deterioration extending from low-income to higher-income households. The Committee expressed the importance of monitoring the impacts of credit quality, which could lead financial institutions to tighten overall lending standards. This tightening could affect borrowing costs and overall credit growth, which in turn could impact economic activities through private investment and consumption, potentially further affecting credit quality. Thus, it is crucial to vigilantly guard against possible adverse feedback loop between the macroeconomic and financial sectors.

- **Most Committee members deemed that the current policy interest rate was consistent with the economy converging to its potential as well as conducive to safeguarding macro-financial stability.** Their rationales were as follows: (1) the Thai economy was likely to expand as projected, and (2) household debt remained high, necessitating continued debt deleveraging. **The committee would closely monitor the impact of the deterioration in credit quality on aggregate financial conditions and the economy, as well as the implications for monetary policy going forward**. **Meanwhile, one member voted to cut the policy interest rate** for the following reasons: (1) to align with the lower potential growth as structural headwinds had become more apparent; (2) to help alleviate the borrowers' burden somewhat, particularly for low-income households and SMEs facing limitations and unable to adjust due to structural challenges; and (3) due to concerns that the vulnerable groups might expand.

Monetary Policy Decision

The Committee voted 6 to 1 to maintain the policy rate at 2.50 percent. One MPC member voted to cut the policy rate by 0.25 percentage point.

In the Committee's judgment, the Thai economy should continue to expand as projected, driven by tourism and domestic demand, while overall exports should continue to gradually recover. Nonetheless, certain export sectors remained pressured by structural headwinds and declining competitiveness. The economy has recovered unevenly across sectors, with labor income in manufacturing and self-employed groups improving more slowly than other groups. **Inflation was expected to decline relative to previously assessment**, with headline inflation anticipated to return to the target range by the end of 2024. **Overall financial conditions tightened somewhat.** The Committee deemed that it was essential to monitor the impacts of deterioration in credit quality on borrowing costs and overall credit growth, as well as the implications for economic activities. The Committee recognized the challenges SMEs are facing in accessing credit, therefore supported measures to resolve these issues, such as credit guarantee schemes. In addition, the Committee supported the Bank of Thailand's policy of debt restructuring through financial institutions, a targeted measure that partly facilitates household debt deleveraging.

The prevailing monetary policy framework seeked to maintain price stability, support sustainable growth, and preserve financial stability. **Most Committee members deemed that the current policy rate remained consistent with the economic growth and inflation outlook, while fostering macro-financial stability in the longer term. The Committee would closely monitor macroeconomic and financial developments, as well as the interlinkages between them,** and would take into account growth and inflation outlooks in deliberating monetary policy going forward.

Monetary Policy Group

4 September 2024