BANK OF THAILAND

Unofficial Translation

April 1, 2025

Excellency,

No. BOT. 2347/2568 Statement pertaining to average headline inflation over the previous 12 months residing below the lower bound of the monetary policy target

On December 16, 2024, the Minister of Finance and the Monetary Policy Committee (MPC) mutually reached the agreement to set the monetary policy target for price stability such that headline inflation is to reside within the range of 1 – 3 percent for both the medium-term horizon and for the year 2025. The agreement also designated the MPC to write an open letter to the Minister of Finance should either average headline inflation over the previous 12 months or a forecast of average headline inflation over the next 12 months breach the target range.

On February 6, 2025, the Ministry of Commerce released the January 2025 headline inflation outturn of 1.3 percent, leading headline inflation over the previous 12 months (February 2024 – January 2025) to average at 0.6 percent, which is below the inflation target range. Pursuant to the aforementioned agreement, this open letter issued by the MPC shall outline (1) how monetary policy aims to maintain price stability under the flexible inflation targeting framework; (2) key drivers causing average headline inflation to breach the lower bound of the target and inflation outlook; and (3) implications of low inflation for the macroeconomy.

(1) Monetary policy under the flexible inflation targeting framework

The Bank of Thailand conducts monetary policy to maintain price stability, foster economic growth and ensure financial stability. Price stability, meaning low and stable inflation, serves as the fundamental pillar of economic well-being in the medium term, as it protects purchasing power of households and facilitates investment. **To maintain price stability, the Bank of Thailand conducts monetary policy under the flexible inflation targeting framework (FIT) with a medium-term inflation target of 1-3 percent.** This means that, while monetary policy aims to keep inflation within this range over the medium-term horizon, inflation need not always reside within the target range given that temporary deviations are possible owing to external shocks and economic cycles.

The FIT framework is well-suited for maintaining price stability in the context of Thailand's economy given its characteristics of being a small open economy with heavy reliance on energy imports, as well as having a high proportion of food consumption. These structural factors make Thailand's headline inflation particularly susceptible to external and supply-side shocks, such as fluctuations in global oil prices and changes in weather-related conditions. Monetary policy has limited influence over such volatile supply-side shocks that lead to relative price changes in specific sectors, but plays a more critical role in managing inflation as driven by demand shocks or shifts in inflation expectations that can lead to more broad-based and sustained changes in prices. To this end, the range-based and medium-term orientation of the inflation target under the FIT framework provides monetary policy with the flexibility to look-through short-term fluctuations from supply-side shocks, which helps prevent frequent or excessive adjustments in the interest rates that could otherwise lead to financial instability or unintended consequences for the macroeconomy.

The flexibility of the FIT framework allows monetary policy to maintain price stability while safeguarding macro-financial stability. By keeping inflation low and stable in the medium-term, policymakers can also support economic growth in line with the economy's potential — a goal that is aligned with the Directive Principles of State Policy — while simultaneously managing financial stability risks. Towards determining the appropriate policy interest rate, monetary policy must strike a careful balance between short-term and long-term risks to macro-financial stability. **Recently, monetary policy has prioritized risks to economic growth, leading to an interest rate cut in the Monetary Policy Committee (MPC) meeting on February 26, 2025.** The decision was based on the following key considerations: (1) weaker-than-expected economic growth prospects with rising uncertainties; (2) reduced financial stability risks, reflected by ongoing household debt deleveraging, amidst tighter financial conditions and slower credit growth; and (3) sustained price stability, with inflation remaining near the lower bound of the target range and long-term inflation expectations well-anchored.

Integrating interest rate policy with other policy tools can enhance the effectiveness of monetary policy while minimizing undesirable side effects. The MPC recognizes that certain sectors of the Thai economy continue to face significant challenges, including high household debt levels and limited credit access for SMEs due to heightened credit risks. **To address these concerns, the MPC supports targeted policies for vulnerable groups and structural reforms that foster an investment-friendly environment and encourages sustainable economic growth.** This includes supporting the Bank of Thailand's initiatives such as debt restructuring and sustainable debt resolutions for vulnerable groups, as well as the "Khun Soo, Rao Chuay" program - a collaborative effort between the government, the private sector and the Bank of Thailand which aims to provide assistance to individual borrowers and SMEs.

(2) Key drivers causing average headline inflation to breach the lower bound of the target and the outlook for headline inflation

Average headline inflation over the previous 12 months remained below the lower bound of the monetary policy target range, primarily due to supply-side factors in energy and fresh food sectors. The decline in global oil prices, coupled with domestic government energy subsidies, exerted downward pressure on energy costs. These subsidy measures included reducing domestic retail oil prices through the Oil Fuel Fund and implementing excise tax cuts, as well as subsidizing electricity costs. As a result, price changes in the **energy sector** during the past 12 months averaged at merely 1.0 percent. Without these government measures, this figure would have been higher at 4.9 percent, raising overall headline inflation averaged over the previous 12 months to 1.1 percent. For the **fresh food** sector, price changes over the previous 12 months averaged at a low level of 0.4 percent due to increases in pork supply and relatively stable vegetable prices from the previous year. Low price pressures in both energy and fresh food sectors helped contain cost pass-through to other goods and services, contributing to a core inflation rate of 0.6 percent over the past 12 months.

Recently, headline inflation gradually increased in the past few months due to (1) the low base effect of last year's energy prices due to global oil price developments and government energy subsidy measures, and (2) the easing of supply-side pressures that have kept fresh food prices low. Consequently, **headline inflation has returned to its target range during December 2024 – February 2025**. Looking ahead, inflation is expected to remain near the lower bound of the inflation target range, although it may occasionally dip below the target range during certain periods. These temporary deviations are primarily driven by supply-side factors, including downward pressures from intensified competition from cheap imported goods from China.

(3) Implications of low inflation for the macroeconomy

The MPC assesses that low inflation in Thailand recently, as well as its outlook in the near future, does not act as a hindrance to economic growth due the following reasons:

(1) Low inflation does not pose risks to price stability since low inflation in Thailand is primarily driven by temporary supply-side rather than demand-side factors. These include global oil price developments and government energy subsidy measures, as well as favorable weather conditions for agricultural production. In addition, headline inflation has already returned to its target range while medium-term inflation expectations remain well-anchored. According to the Survey of Professional Forecasters by Asia Pacific Consensus Economics in October 2024 and from financial market data in December 2024, five-year-ahead inflation expectations both stood at 1.8 percent, reflecting confidence towards monetary policy in maintaining price stability over the medium term.

(2) Low inflation is not a sign of deflation, as prices of goods and services have not broadly declined. During this period, over three-quarters of the items in the inflation basket have either increased or remained unchanged. Furthermore, private consumption expanded at an average rate of 4.4% in 2024, which indicates robust demand growth.

(3) Low inflation does not hinder competition and investment as factors that have contributed to low private sector investment growth are not due to low inflation but rather a lack of incentives for the private sector to expand production capacity. The manufacturing sector in Thailand faces structural challenges from the competition of foreign goods, particularly from China in industries such as electronics, petrochemicals, rubber and plastics, and electric vehicles (EVs). Meanwhile, low and stable inflation has helped keep funding costs through the bond market at low levels for both the government and private sector. It has also helped in maintaining price competitiveness for businesses by preventing rapid increases in production costs and through the real exchange rate.

Furthermore, low inflation in the recent past has helped alleviate the cost of living for households after many goods have seen significant price increases during the post-COVID period. Essential items such as energy and food, including meat, vegetable oil, and fuel remain about 20 percent higher than pre-COVID levels.

Going forward, the MPC will continue to assess the implications of inflation for the economy to ensure that headline inflation does not become excessively high or low for sustained periods, which could impact economic growth and the conducive environment for competition and investment. The MPC will continue to closely monitor the development of various risks to inform appropriate monetary policy actions. Key risks include potential decline in energy prices due to lower-than-expected global economic growth and volatile weather conditions that may affect fresh food prices.

According to the latest Memorandum of Understanding between the MPC and the Minister of Finance, the MPC will write an open letter to the Minister of Finance again six months from now, should either average headline inflation over the past 12 months or a forecast of average headline inflation in the next 12 months at that time breach the monetary policy target. In addition, to enhance the transparency and clarity of communication to the general public, the MPC wishes to publish this letter on the Bank of Thailand’s website.

Yours sincerely,

(Mr. Sethaput Suthiwartnarueput)
Governor
Chairman of the Monetary Policy Committee

The Honorable Mr. Pichai Chunhavachai
Minister of Finance
Bangkok