BANK OF THAILAND

Unofficial Translation

April 7, 2023

Excellency,

No. BOT.MPD.(02) 247/2566 Statement pertaining to average headline inflation over the previous 12 months residing above the upper bound of the monetary policy target

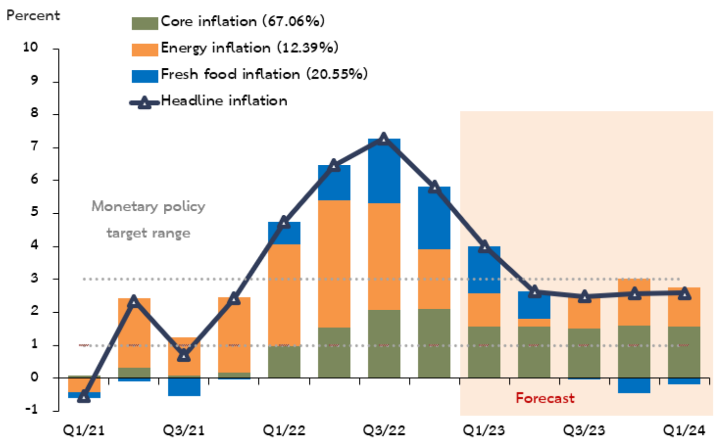
On November 30, 2022, the Minister of Finance and the Monetary Policy Committee (MPC) mutually reached the agreement to set the monetary policy target for price stability such that headline inflation is to reside within the range of 1 – 3 percent for both the medium-term horizon and for the year 2023. The agreement also designated the MPC to write an open letter to the Minister of Finance should 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 April 5, 2023, the Ministry of Commerce released the March 2023 data on headline inflation rate which came out to be 2.83 percent, leading to an average headline inflation rate over the previous 12 months (April 2022 - March 2023) of 5.86 percent—well above the current monetary policy target range. However, according to the MPC meeting on March 29, 2023, the MPC assessed that average headline inflation over the next 12 months (second quarter of 2023 - first quarter of 2024) would be 2.6 percent—residing within the target range. Pursuant to the aforementioned agreement, this open letter issued by the MPC shall outline (1) key drivers causing average headline inflation over the previous 12 months to breach the target range; (2) potential time frame for headline inflation to revert to the target; and (3) monetary policy actions taken to guide headline inflation back to the target within an appropriate time period. Details are as follows.

Key drivers that caused average headline inflation over the previous 12 months to reside above the monetary policy target range

Over the previous 12 months, average headline inflation resided above the upper bound of the target range mainly due to large cost-push shocks. The surge in global energy and commodity prices due to the Russia-Ukraine conflict led to **a significant increase in domestic energy prices**, resulting in elevated average energy inflation rate of 20.06 percent over the past 12 months. In addition, domestic **fresh food prices rose sharply** due to various factors. Most prominent was an increase in meat prices, especially pork whose prices rose due to supply contraction following the African swine flu outbreak at the beginning of 2022. Vegetable and fruit prices also increased as a result of their production being affected by fluctuations in weather conditions. Higher animal feed and fertilizer costs also added onto these price pressures, leading to average fresh food inflation rate of 7.74 percent over the past 12 months. **Meanwhile, demand-pull inflation pressures became a bit more evident in line with the recovering economic activities. This enabled businesses to better pass on higher costs to prices of goods and services, although the degree of such cost pass-through remained somewhat limited.** Such cost pass-through was most apparent in the prepared food category, leading to **average core inflation rate** over the past 12 months of 2.70 percent.

Figure 1: Contribution to Headline Inflation



Note: ( ) is weight in CPI basket

Source: Ministry of Commerce; Calculated and forecasted by Bank of Thailand in MPC meeting on 29 March 2023

<u>Potential time frame for headline inflation to revert to target</u>

On March 29, 2023, the MPC assessed that headline inflation had already passed its peak in the third quarter of 2022 and continued to decline as anticipated (Figure 1). The MPC expected that headline inflation would likely return to the target range in the second quarter of 2023, owing to the dissipation of the following supply-side pressures: (1) the decline in global energy and commodity prices, alongside high base effects from the previous year, and (2) the decline in fresh food prices due to the easing of animal feed and fertilizer costs. **Nevertheless, core inflation would likely remain elevated for some time** as the economic recovery might make it more conducive for businesses to pass on the higher input costs endured from earlier periods before easing off on such pass-through as cost pressures subsided. Overall, the reversion of headline inflation to target in the future was consistent with **medium-term inflation expectations which remained well-anchored within the target range.** This reflected the confidence of market participants that monetary policy would be able to maintain price stability over the medium term.

The MPC would continue to closely monitor the evolution of key risk factors to inflation. These include demand-side inflationary pressures that may materialize from the strong recovery in the tourism sector, potentially enabling higher- or faster-than-expected cost pass-through by businesses. In addition, the unwinding of government energy subsidy measures to ensure the stability of the Oil Fuel Fund and the Electricity Generating Authority of Thailand, who previously shouldered the burden of higher retail oil prices and electricity costs, would result in domestic energy prices declining at a slower pace compared to the decline in global energy prices. The MPC would continue to closely monitor and assess key risk factors to ensure that monetary policy actions would be implemented in an appropriate and timely manner.

Monetary policy actions taken to guide headline inflation back to the target within an appropriate time period

Under the monetary policy mandate of price stability, sustainable economic growth, and financial stability, the MPC viewed that the gradual and measured monetary policy normalization was still appropriate against the broad contour of **the Thai economic recovery being on track with some upside risks to inflation from demand-pull inflationary pressures.** However, the MPC would stand ready to adjust the size and timing of policy normalization should the growth and inflation outlook shift from the current assessment. **The MPC also supported the continuity of debt restructuring programs while asserting the importance of having in place other targeted and sustainable debt resolution measures for vulnerable groups.** These measures would help enhance financial stability and prevent it from hindering economic growth going forward. In addition, the MPC would closely monitor key factors affecting economic growth and inflation trends to ensure that monetary policy actions would lend proper support to the economic recovery while pursuing price and financial stability.

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 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 wished 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. Arkhom Termpittayapaisith
Minister of Finance
Bangkok