BANK OF THAILAND

Unofficial Translation

August 30, 2024

Excellency,

No. BOT.MPD.(02) 600/2567 Statement pertaining to average headline inflation over the previous 12 months residing below the lower bound of the monetary policy target

On November 23, 2023, 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 2024. 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 August 7, 2024, the Ministry of Commerce released July 2024 data on the headline inflation rate at 0.8 percent, leading headline inflation over the previous 12 months (August 2023 - July 2024) to average at 0.0 percent, which is below the inflation 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 lower bound of the target; (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 breach the lower bound of the monetary policy target range

Average headline inflation over the previous 12 months resided below the lower bound of the monetary policy target range in large part due to temporary factors from the energy sector. The decline in global oil prices alongside domestic government energy subsidy measures that aimed to help alleviate the high cost of living for households by subsidizing electricity costs and reducing domestic retail oil prices through the Oil Fuel Fund and excise tax cuts put downward pressure on energy prices. As a result, **energy inflation** during the past 12 months averaged at -0.6 percent, which is substantially lower than the average of the previous 12 months (August 2022 – July 2023) at 7.5 percent. Without aforementioned government subsidy measures, average headline inflation over the previous 12 months would have resided at 1.0 percent. Moreover, **fresh food prices** have been influenced by various supply-side factors, particularly increases in pork supply that has led to consistently low meat prices. As a result, average fresh food inflation over the previous 12 months stood at -1.0 percent. As for **core**

inflation, the average level over the past 12 months was 0.5 percent. **Despite inflation being low however, it has not been a hindrance to the economic recovery and does not reflect weak purchasing power of households.** This is because the reduction in the prices of goods and services has not been broad-based and private consumption has seen robust growth at an average rate of 6.5% over the past year (Q3 2023 – Q2 2024).

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

The MPC assessed that headline inflation will return to and move within the target range during the fourth quarter of 2024 due to: (1) the rise in domestic energy prices from the possible unwinding of government subsidy measures on diesel prices, and (2) supply-side pressures that have kept fresh food prices low are expected to ease. In the meantime, **core inflation is projected to gradually increase** in line with the economic recovery. Overall, the outlook for headline inflation which is expected to return to the target range in the near term, aligns with **measures of medium-term inflation expectations that have remained well-anchored within the target range.** According to the survey of professional forecasters by Asia Pacific Consensus Economics in April 2024 and from financial market data in August 2024, five-year-ahead inflation expectations stood at 1.7 and 2.0 percent respectively. This reflects the credibility that market participants have towards monetary policy in maintaining price stability over the medium term.

The MPC would continue to closely monitor the evolution of key risk factors to inflation. These include (1) uncertainty that pertains to Middle East geopolitical tensions that may lead to an increase in global energy prices and freight rates, (2) potential changes in government subsidy measures that could impact domestic energy prices, and (3) climate variability that may affect fresh food prices.

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

Under the monetary policy mandate of price stability, sustainable economic growth, and financial stability, the MPC viewed that **the current policy rate was consistent with the improving growth and inflation outlook, while fostering macro-financial stability in the longer term.** The committee deemed that the Thai economy continued to expand, driven mainly by tourism and domestic demand. Meanwhile, headline inflation is anticipated to gradually return to its medium-term trend. Additionally, the current level of the policy interest rate is supportive of ongoing debt deleveraging, which could reduce risks to macrofinancial stability and support long-term economic growth.

Despite economic growth remaining intact, the MPC recognizes that some sectors still face problems that need to be addressed. Household debt remains high while some SMEs still face difficulties in credit access. Therefore, **safeguarding macro-financial stability requires a mix of policy tools aside from the policy interest rate to address problems faced by different groups in a well-targeted manner without causing unintended consequences to other segments of the economy.** These include financial measures that aim to address structural impediments in the financial sector, including debt restructuring measures for debtors that face repayment difficulties, as well as requirements for banks to lend in accordance to the debt repayment ability of borrowers. The MPC would continue to closely assess cyclical and structural factors that may impact the outlook for economic growth and inflation, and stands ready to deliberate appropriate monetary policy actions to ensure sustainable economic growth through maintaining price stability and safeguarding 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 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