Edited Minutes of the Monetary Policy Committee Meeting (No. 4/2022)
5 and 10 August 2022, Bank of Thailand
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Members Present

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

The Global Economy and Financial Markets

Thailand's trading partner economies were projected to expand at a slower pace than previously assessed with growing concerns over looming recession in some countries. However, it was unlikely that the global economy would face a sharp slowdown. The US and EU economies were expected to slow down due to rising inflation and tighter financial conditions as central banks accelerated the pace of policy normalization. Global inflation would remain elevated in line with high energy and commodity prices, given that Russia continued to cut down natural gas supply to Europe and oil production by OPEC+ countries would likely fall below the target. The Chinese economy was projected to slow down due to its strict zero-COVID policy and fragile real estate sector. The Asian economy excluding China would continue to hold up with growth at around the same rate as previously assessed, since the impact of global slowdown would be offset by stronger domestic demand as the economy was in its early recovery phase.

Global financial markets were volatile mainly due to the aggressive rate hikes in response to soaring inflation in many countries as well as concerns over recession. As a result, the US dollar had strengthened, and bond prices had increased, while prices of risky assets had fallen. Given the recession concerns, investors expected the Federal Reserve and European Central Bank to slow down the pace of their interest rate hikes and might even have to cut the interest rates in 2023. **The Thai bond market had become more stabilized as investors had clearer views on normalization path of Thai monetary policy.** Short-term government bond yields had increased in line with rate hike expectation. Long-term government bond yields had declined in tandem with US Treasury yields. The baht depreciated against the US dollar in line with most currencies. This was mainly attributable to aggressive rate hikes from the Federal Reserve and concerns over US economic recession. As such, investors were more cautious toward risky assets including emerging market assets and currencies. Nonetheless, Thailand's portfolio flow movements were in tandem with other regional countries. Looking ahead, the financial markets would still be subject to high uncertainty. Key risk factors included monetary policy tightening by major central banks as well as inflationary pressures and growth outlook especially in advanced economies, as these would have implications on monetary policy conduct of central banks in the period ahead.

Domestic Economy

The Thai economy would continue to recover and return to the pre-COVID level by the end of 2022. The main drivers included, first, the number of foreign tourist arrivals that had continued to increase and would be larger than expected. This was in tandem with growing travel demand and the relaxation of international travel restrictions in Thailand and abroad. Second, the recovery in private consumption would be stronger than expected especially for service consumption. This was consistent with the recovery in the tourism sector and continuous improvement in labor market conditions, as reflected in declining numbers of unemployment and underemployment as well as increasing non-farm incomes across all income groups. Third, merchandise exports in 2022 would be higher than expected both in terms of value and volume. This was owing to a smaller-than-expected impact of China's containment measures on the Thai exporting sector, as well as gradual easing of supply chain disruptions. Merchandise exports in 2023 were expected to slow down in line with the growth outlook of Thailand's trading partners. Going forward, some sectors would experience a rapid recovery, especially tourism-related businesses such as hotels, restaurants, and commerce. As such, these businesses in some areas might face temporary labor shortages. There was also a need to monitor the growth outlook of Thailand's trading partners as this could affect Thai exports, especially in 2023.

Headline inflation would remain at a high level throughout 2022, largely unchanged from the previous forecast. Headline inflation was expected to exceed the target range through the end of 2022. Price increases had been observed across a larger number of products but were still contained within food and energy categories. This was mainly due to direct cost pass-through of higher raw material and energy prices including meat, electricity charges, and liquefied petroleum gas. Cost pass-through to core inflation, especially to prepared-food prices, turned out to be greater than expected. As a result, short-term inflation expectations had edged up in line with rising living and production costs that households and businesses were facing. However, medium-term inflation expectations had not increased significantly and remained anchored within the target range of 1-3 percent. **Headline inflation would gradually decline into the target range in 2023.** This was attributable to subsiding supply-side inflationary pressures, given that energy and domestic retail oil prices would not increase further and that pork and palm oil prices would also fall.

The inflation outlook would still subject to upside risks. Businesses could pass on more costs to consumers at a faster pace as they face simultaneous price increases in various inputs. In addition, demand-pull inflation could pick up as the economic recovery started to gain pace. At the same time, these upside risks would be partially offset by a potential decline in energy prices resulting from global economic slowdown. **The Committee viewed that the risk of wage-price spiral would not be a major concern for Thailand compared to other countries** because the labor market structure in Thailand differed from other countries in many aspects. First, the ratio of non-farm workers, or those who earn wages, in Thailand stood at 44 percent and was lower than the counterparts in advanced economies at 85-90 percent. Second, workers in Thailand could move across sectors quite easily. Migrant workers, the self-employed, and workers who had left workforce during the COVID-19 pandemic could switch to work in the non-farm sector, although there might be some reluctance at first as workers might perceive the revenue stream to be unstable and not sufficient to cover urban living costs. Third, Thai workers have low bargaining power, and there is no wage indexation in Thailand. Going forward, upward pressures on wages and prices should be limited as the labor market would take some time to fully recover. The seasonally adjusted unemployment rate was 1.4 percent in the second quarter of 2022, higher than the pre-COVID level at 1.0 percent. In addition, according to information obtained from business contacts, some firms would be restrained from raising prices further. This was because they had already adjusted their prices and wages, while others might choose to bear increased labor costs given that demand had not fully recovered.

<u>Discussions by the Committee</u>

- **The Committee had confidence that the economic recovery would continue to gain traction on the back of improving foreign tourist figures while the global economic slowdown would have a limited impact on the Thai economy.** The number of foreign tourist arrivals would primarily depend on the relaxation of international travel restrictions and the implementation of tourism promotion policy. These two factors would matter more than the economic growth of travelers' country. Private consumption would continue to recover as well. Recovery in tourism would lead to improvement in incomes of businesses and workers in the tourism-related service sector which would in turn drive private consumption in the period ahead. However, there remained a need to monitor risks arising from higher production and living costs which could affect the Thai economic recovery. In addition, geopolitical risks could cause significant impacts, although the possibility of such risks to materialize was low.

- **The Committee viewed that inflation risks were still substantial, mainly from the cost pass-through.** Even though headline inflation would gradually fall due to declining energy and domestic retail oil prices following the global economic slowdown, cost pass-through to core inflation would persist for some time. This was owing to, first, concurrent price increases across various inputs. Second, changing production and global trade structures resulted from the COVID-19 pandemic and geopolitical tensions could affect future inflation dynamics. This had been factored in into the core inflation forecast for 2023 which was higher than historical average. The Committee assessed that such cost pass-through would not lead to entrenched inflation. Going forward, upside risks to the inflation outlook could increase if rising short-term inflation expectations affect cost pass-through and price setting of businesses. **The Committee would thus closely monitor potentially higher and faster cost pass-through as well as inflation dynamics and inflation expectations.**

- **The Committee noted that potential labor shortage could affect the economic recovery and create upward pressures on wages in some business sectors.** Workers who had left workforce during the COVID-19 pandemic might have difficulty returning to the labor force owing to a lack of clarity on the upcoming relaxation of containment measures, high uncertainty surrounding their income prospects, as well as a lack of resources to start a new job. Furthermore, as e-commerce is growing rapidly, many workers have decided to become freelancers or work in delivery service companies since earnings from such jobs are higher than the minimum wages. This could create additional pressures on wages. The minimum wage increase and changing structure of the Thai labor market should thus be monitored going forward.
- **The Committee viewed that gradual rate hikes were consistent with the growth and inflation outlook.** The Committee viewed that the economic recovery would continue to strengthen. Holding the policy rate at an extraordinarily low level to alleviate the COVID-19 impact had thus become less needed. Meanwhile, headline inflation would remain at a high level for some time. Cost pass-through, especially to items in the core inflation basket, must be monitored. Nonetheless, the recent rise in inflation was assessed to be mainly due to cost-push factors. The Committee viewed that the policy rate should be normalized to the level that is consistent with sustainable growth in the long term, and that monetary policy normalization should be done in a gradual and

measured manner consistent with the growth and inflation outlook in the period ahead.

- **The Committee viewed that gradual reduction of monetary policy accommodation coupled with having targeted measures in place to support vulnerable groups would be appropriate for Thailand's uneven recovery across sectors.** The economic recovery in the period ahead would help improve debt serviceability of businesses and households. However, some groups would remain vulnerable, including some SMEs in sectors that have yet to fully recover, low-income households that are sensitive to the rising living costs, and unsecured loan borrowers. Financial institutions should continue to press ahead with debt restructuring to address debt problems in a sustainable manner for vulnerable groups. Considered as a blunt tool, monetary policy may not be an effective policy tool for those vulnerable groups. Maintaining the policy rate at a low level for an extended period could also create financial stability risks in the long run.

<u>**Monetary policy decision**</u>

The Committee voted 6 to 1 to raise the policy rate by 0.25 percentage point from 0.50 to 0.75 percent. One member voted to raise the policy rate by 0.50 percentage point.

The Committee viewed that the Thai economic recovery had continued to strengthen. Main drivers were from the higher-than-expected number of foreign tourist arrivals and improving private consumption in line with an improvement in the labor market conditions and household incomes. The economy was expected to return to the pre-COVID level by the end of this year and would continue to gain traction. Headline inflation would remain at a high level for some time before gradually falling into the target range in 2023 as the supply-side inflationary pressures subside. However, risks to the inflation outlook remained elevated. The Committee assessed that the extraordinarily accommodative monetary policy undertaken in response to the COVID-19 pandemic had become less needed. **Most members voted to raise the policy rate by 0.25 percentage point at this meeting.** This gradual policy rate hike would help facilitate a sustained economic recovery without creating upward pressures on inflation. **One member voted to raise the policy rate by 0.50 percentage point.** Such a rate increase was deemed not to significantly affect the economic recovery and would reduce the risk of having to increase the policy rate aggressively later. Another reason was to build up policy space to prepare for any future uncertainty.

The Committee deemed it important to have targeted measures and sustainable debt solutions in place for vulnerable groups. The Committee assessed that overall financial system remained resilient. Commercial banks had high levels of capital fund and loan loss provision. Liquidity in the financial system remained ample, although liquidity distribution still varied across economic sectors. Debt serviceability of households and businesses had improved in line with the economic recovery. However, there were certain vulnerable groups, particularly some SMEs that had yet to fully recover as well as low-income households that were sensitive to the rising living costs. Financial institutions should thus continue to press ahead with debt restructuring.

The Committee viewed that overall financial conditions remained accommodative but with high volatility. The baht had depreciated against the US dollar mainly due to the strengthening of the US dollar following concerns about the global economic slowdown and the Fed tightening. The Committee will closely monitor developments and volatilities in financial and exchange rate markets.

Under the monetary policy framework with objectives of maintaining price stability, supporting sustainable and full-potential economic growth, and preserving financial stability, **the Committee judged that the Thai economic recovery would continue to gain traction, and thus the extraordinarily accommodative monetary policy would become less needed. The Committee viewed that the policy rate should be normalized to the level that is consistent with sustainable growth in the long term. Monetary policy normalization should be done in a gradual and measured manner consistent with the growth and inflation outlook in the period ahead.**

Monetary Policy Group
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