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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 slow down, with growth revised down from 3.4 percent in 2022 and 3.1 percent in 2023 to 2.9 and 2.6 percent, respectively. The downward revision was to reflect the slower growth in advanced economies due to elevated inflation and the accelerated pace of policy normalization by several central banks. The EU economy has faced additional inflationary pressures from high energy prices as a result of the prolonged conflict with Russia. Meanwhile, Asian economies would decelerate in response to weaker global demand. China would grow at a slower rate given additional impacts on domestic demand following the strict zero-COVID policy imposed in many cities as well as protracted stress in the real estate sector.

Global financial markets were volatile, driven by concerns over soaring inflation and restrictive monetary policy by several central banks. Most central banks placed more emphasis on tackling rising inflation which led to faster pace of rate hikes. Given the Fed's aggressive rate hikes as well as investors' concerns over the global slowdown, the US dollar had thus strengthened rapidly relative to all other currencies. Government bond yields had also risen in most countries while risky asset prices had fallen. **The Thai government bond yields gradually increased,** with short-term government bond yields rising in line with the Thai policy rate. Meanwhile, long-term government bond yields increased in tandem with US Treasury yields. **On exchange rates, the baht continued to depreciate against the US dollar due to the strengthening of the US dollar, but was still in line with regional currencies.** The magnitude of the baht depreciation was moderate compared with regional peers, while there had not been any unusual movements in capital flows. Looking ahead, the financial markets would still be subject to high uncertainty. Key risk factors included inflationary pressures, monetary policy tightening by major central banks, as well as the global growth outlook.

Domestic Economy

The Thai economy would continue to recover at 3.3 percent in 2022 and 3.8 percent in 2023, down from 3.3 percent and 4.2 percent previously projected. This was due to, first, the number of foreign tourists that had continued to increase more than expected, with the number of tourist arrivals in 2022 being revised up to 9.5 million from 6 million thanks to growing travel demand and the relaxation of international travel restrictions. The number of tourist arrivals in 2023 was also raised to 21 million from 19 million, with most of them being Asian ex-China tourists. Second, private consumption would continue to recover especially service consumption, which had returned to the pre-pandemic level on the back of the recovery in the tourism sector. In addition, the labor market continued to improve with the recovery more evenly distributed. The unemployment rate fell to 1.4 percent and the total labor income increased across all groups. Meanwhile, non-farm income was expected to grow 14 percent in 2022 and 6 percent in 2023, rebounding from the contraction of 18 percent in

2020. Self-employed workers' income, which had been recovering slowly, would also increase by 33 percent in 2022 and 9 percent in 2023. Third, merchandise exports would expand as expected in 2022 owing to concerns over the food crisis and easing of electronic parts shortages. Nevertheless, the growth of merchandise exports could decelerate in 2023 given a slowdown in global demand in tandem with trading partners' economic growth outlook.

Headline inflation in 2022 would remain largely unchanged from the previous forecast and was expected to gradually decline in line with global oil and commodity prices. Headline inflation was expected to be at 6.3 percent in 2022 due to elevated energy and fresh food prices as well as a gradual increase in cost pass-through, as reflected in the core inflation rising to 2.6 percent on the back of food-related products prices. The increase in headline inflation was mainly driven by cost-push inflation, while signs of demand-pull inflation were not yet observed as the Thai economy was still in the recovery stage. Short-term inflation expectations started to fall, while medium-term inflation expectations remained anchored within the target range of 1-3 percent. Headline inflation would gradually decline into the target range in 2023 when it was expected to be at 2.6 percent on account of decreasing energy and domestic retail oil prices. Meanwhile, core inflation was expected to fall to 2.4 percent in 2023 as cost pressures would subside. However, it would remain at a level exceeding the historical average.

The inflation forecast had taken into account both upside and downside risks comprehensively. The baseline assessment has already incorporated, to a certain extent, factors that could give rise to inflation remaining elevated for a prolonged period of time. As such, the risks to the baseline inflation forecast were largely symmetric. On the one hand, **inflation could be higher than the baseline projection due to several factors.** First, cost pass-through could increase if businesses were to face rising cost pressure from multiple sources simultaneously. The Thai baht depreciation would also be monitored as it could exert additional pressures on businesses' import prices. Moreover, demand-pull inflation could pick up in the period ahead as the economic recovery started to gain pace. Second, energy-related government relief measures, such as excise tax reduction or electricity bill subsidy, could end earlier or be less than expected. Third, labor market conditions could tighten as wages rise in some sectors and areas that had faced labor shortages. Although there have not been signs of a broad-based wage increase, risks from tight labor market conditions should be monitored in the period ahead, especially in some labor-intensive industries. On the other hand, **inflation could also be lower than the baseline projection** if energy prices were to decline more than the baseline assessment due to falling demand as a result of the global slowdown.

<u>**Discussions by the Committee**</u>

- **The Committee assessed that the economic recovery would continue to gain traction mainly on the back of tourism and domestic consumption. Global economic slowdown would have an impact on merchandise exports but would not derail the overall economic recovery.** Inbound tourism could recover more strongly than expected thanks to further relaxation of international travel restrictions and Thailand's tourism promotion policy. Also, tourism recovery should be relatively insusceptible to global recession as the recent inbound foreign tourist arrivals were mostly short-haul and premium travelers whose decisions to travel were not significantly affected by the economic conditions in their countries. Meanwhile, private consumption was expected to continue recovering in a more broad-based manner, supported by the income improvement that had spread into the services sector and low-income households. As a result, this would be an important driver of private consumption in the period ahead. However, some members perceived that the global slowdown would be a risk that could affect Thai merchandise exports more than expected and would continue to closely monitor the outlook of global and trading partner economies.

- **The Committee viewed that inflation risks remained high and must be closely monitored, especially for core inflation.** This was reflected in the rise in several categories of prices in core inflation due to higher and more widespread cost pass-through. Businesses could pass on costs further in the face of simultaneous price increases from multiple sources, such as raw material prices, oil prices, and wages. Such pass-through could affect inflation expectations and thus should be monitored along with inflation dynamics and inflation expectations in the period ahead.

- **The Committee noted that potential labor shortages in some recovering labor-intensive businesses, such as hotels, restaurants, and construction, could create upward pressures on wages and limit the recovery in such businesses.** Workers who had previously relocated still faced difficulty returning to the labor force, such as a lack of resources to start a new job in economic zones. Additionally, some Thai workers had switched to self-employed jobs with better pay in line with growth of e-commerce sector, which could cause labor shortages and wage pressures to continue for some time. Developments in the labor market and wage increases should thus be monitored in the period ahead. Meanwhile, the increase in minimum wage in October 2022 had a limited impact on overall wages as most workers already earned more than the minimum wage. The knock-on effect on higher wages was hence limited.

- **The Committee viewed that the depreciation of the baht against the US dollar had been rapid and continuous due to the strengthening of the US dollar but was still in line with regional currencies.** The nominal effective exchange rate (NEER) had only depreciated by around 2 percent since the start of 2022, indicating that the baht movements were in line with those of trading partner currencies and thus did not affect Thailand's competitiveness. Also, there had not been any unusual capital flow movements, with Thailand's capital flows still registering net inflows since the start of 2022. Moreover, **Thailand's external stability remained resilient and would be able to accommodate volatilities in capital flows**. Thailand's international reserves were ranked the 12th-highest worldwide and amounted to more than 3 times the short-term external debt. Meanwhile, Thailand's external debt was low at only 38 percent of GDP. Moreover, the recovery in the tourism sector would help reduce the current account deficit and curb depreciation pressure in the period ahead. **Nevertheless, the Committee was concerned that the rapid depreciation of the baht could create additional cost pressures for businesses and would accelerate more cost pass-through. This would in turn affect inflation and therefore developments in the foreign exchange market should be closely monitored, especially in the period of heightened volatilities.**

- **The Committee deemed that gradual and measured policy normalization remained an appropriate stance of monetary policy and would be ready to adjust the size and timing of policy normalization should the growth and inflation outlook shift from the**

current assessment. The gradual policy normalization was consistent with the current growth and inflation outlook due to the followings:

(1) The economic recovery continued to gain traction and was more broad-based, both in terms of business sectors, especially services, and in terms of income distribution. As a result, the Thai economy was ready to accommodate a gradual normalization to the level that would be consistent with sustainable growth in the long term.

(2) Headline inflation was close to the previous assessment, driven mainly by supply-side and global factors which would subside in the period ahead. **Meanwhile, the risks to core inflation increased, mainly due to cost pass-through. Nonetheless, demand-pull inflationary pressures were still limited as the Thai economy was still in the early stage of recovery**. Moreover, the wage-price spiral risks remained limited as non-farm workers, or those who earn wages, accounted for only 44 percent of total workers in Thailand, compared to 85-92 percent in the United States, Germany, and the UK. Thailand's labor supply was also more elastic than that of other countries. Workers in Thailand could move quite easily across sectors in response to changing demand in different situations.

(3) There remained vulnerabilities in some businesses and households, especially SMEs in some sectors that had yet to fully recover and low-income households that were sensitive to the rising living costs who would be affected by aggressive policy rate hikes and could in turn derail the recovery. The Committee thus viewed that a gradual policy normalization should be done in conjunction with targeted measures and sustainable debt solutions to support vulnerable groups.

Notwithstanding, **should the growth and inflation outlook shift from the current assessment, the Committee would be ready to adjust the size and timing of policy normalization accordingly.** For example, if the economy could recover faster than expected or inflation could persistently rise from demand-pull pressures, the Committee could consider raising the policy rate by more than 0.25 percentage point. On the other hand, the Committee could consider temporarily halting the hikes to await clarity should more uncertainties ensue in the period ahead, such as if the global economy were to slow down by more than currently assessed.

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

The Committee voted unanimously to raise the policy rate by 0.25 percentage point from 0.75 to 1.00 percent.

The Committee viewed that the Thai economic recovery would continue to gain traction, mainly driven by tourism and private consumption. The tourism sector recovered better than expected from the continued increase in the number of foreign tourist arrivals. Moreover, the economic recovery was more broad-based, both in terms of business sectors, especially services, and in terms of income distribution. Headline inflation remained at a high level as cost pass-through had increased in recent periods, despite declining global oil prices and subsiding supply chain bottlenecks. Core inflation increased mainly due to higher cost pass-through. Nonetheless, demand-pull inflationary pressures were still limited as the Thai economy was still in the recovery stage, while signs of a broad-based wage increase were not yet observed. However, there remained a need to closely monitor risks to inflation. **The overall growth and inflation outlook remained largely unchanged from the previous**

assessment. The Committee deemed that gradual and measured policy normalization remained an appropriate course for monetary policy and thus voted to raise the policy rate by 0.25 percentage point at this meeting.

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 and loan loss provision. Debt serviceability of households and businesses had improved in line with the economic recovery. However, SMEs in some sectors had yet to fully recover and some low-income households 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. Real interest rates remained negative and overall funding costs were still conducive for business financing, although government bond yields gradually increased in line with the outlook of policy normalization. The depreciation of the baht against the US dollar was rapid and continuous due to the strengthening of the US dollar but was still in line with regional currencies. **The Committee would continue to closely monitor developments in the financial and exchange rate markets, especially in the period of heightened volatilities.**

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 economy would continue to recover but with increased inflation risks. The policy rate should be normalized in a gradual and measured manner to the level that would be consistent with sustainable growth in the long term. The Committee would be ready to adjust the size and timing of policy normalization should the growth and inflation outlook shift from the current assessment.**

Monetary Policy Group
12 October 2022