Edited Minutes of the Monetary Policy Committee Meeting (No. 4/2023)
27 July and 2 August 2023, Bank of Thailand
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Members Attending

Sethaput Suthiwartnarueput (Chairman), Mathee Supapongse (Vice Chairman), Roong Mallikamas, Paiboon Kittisrikangwan, Rapee Sucharitakul, Somchai Jitsuchon, and Subhak Siwaraksa

The Global Economy and Financial Markets

Trading partner economies continued to track the recovery path. The US economic outlook continued to improve from the services sector and strengthening employment as well as private consumption. Meanwhile, the Chinese economy softened more than expected in the second quarter, pointing to more sluggish recoveries in other Asian economies than previously anticipated, especially as Chinese manufacturing inventories remained high. Asian exports should nonetheless rebound in the fourth quarter this year, lifted by an expected global electronic cycle recovery.

Sentiments in the global financial markets were buoyed by slowing global inflation following lower energy prices and better US economic outlook. Investors expected the Federal Reserve to slow the pace of monetary policy tightening, leading to increased risky asset prices and capital flows into some regional countries.

Domestic financial conditions became less accommodative but remained supportive of fund mobilization by the private sector and the ongoing economic recovery. The private sector continued to raise funds through the credit markets despite increased financing costs consistent with the policy rate. In the second quarter of 2023, total corporate funding grew 2.8% over the previous year, driven by a 12.8% expansion in corporate bonds, while business loans contracted 1.1%. The contraction of business loans partly reflected a normalization of lending activity after an uninterrupted credit expansion throughout the COVID-19 crisis aided by extraordinary financial measures. **The baht fluctuated against the US dollar,** initially depreciating due to weak Chinese economic outturns before appreciating in line with regional currencies amid expectations of slower tightening in US monetary policy. Major risks looking ahead included the US monetary policy stance, Chinese economic momentum, and domestic political uncertainties.

Domestic Economy

The Thai economy should continue to expand, driven mainly by tourism and private consumption, while softening merchandise exports were expected to improve. Several factors would lend support to the recovery: **(1) the tourism sector** should continue to benefit from a growing foreign tourist number, in line with the previous projections of 29 and 35.5 million for 2023 and 2024, respectively. The fewer-than-expected tourists from China to date have been offset by arrivals from other jurisdictions. **(2) private consumption** should continue to be robust, driven primarily by spending of medium- and high-income consumers. Improving employment and labor income, notably in the services and self-employed sectors, should continue to lend support, as in the second quarter of 2023 when real non-farm labor income expanded 2.4% over the previous quarter. **Merchandise exports** were projected to contract slightly this year, weighed by subdued Chinese demand, global electronic cycle, and a severe El Niño episode. However, merchandise exports should gradually pick up in the second half of this year, including those of air conditioners to the US and Europe given hotter climate, agro-manufacturing products to ASEAN, and electronics due to rising global demand for automotive semiconductors from ASEAN. **Public consumption and investment** were projected to decline from the previous year because of the delayed budgeting process but should rebound in 2024. Looking forward, risks to growth outlook include potential delays in exports due to slower global economic recovery, domestic political uncertainties, and a more severe El Niño episode.

Headline inflation declined but should revert and stabilize within the target range. The recent fall in inflation could be attributed to a high base last year, cost-of-living subsidies, and lower energy prices, including electricity charges in line with natural gas prices and domestic retail oil prices. But as the influence of these temporary factors dissipate in the second half of 2023, headline inflation should rebound. Meanwhile, El Niño was likely to exert a meaningful upward pressure on raw food prices – the expected Oceanic Niño Index (ONI) for the fourth quarter of 2023 was revised up from 1.1 to 1.9, indicating a more severe El Niño episode (albeit not as severe as in 2014 when ONI reached 2.6). **Core inflation edged lower but should stabilize at a higher level than in the past.** Falling food-in-core as well as services excluding housing rent inflation, together with lower cost pass-through by businesses, explained recent moderation in core inflation. At the same time, underlying inflation indicators continued to hover above historical averages, while persistently high global food prices shaped the prospects for Thai food inflation. Upside risks to inflation remained from higher food costs amid a more severe El Niño episode, which could accelerate cost pass-through in the context of sustained economic expansion.

<u>Highlights of Committee Discussion</u>

- **The Committee deemed the economic and inflation outlook to be broadly similar to the previous assessment.** Recent moderation in growth and inflation were expected to be short-lived. The outlook for growth was one of a sustained economic recovery, with downside risks from uncertain global demand and domestic political situation. Headline inflation slowed in near term from energy prices, cost-of-living subsidies, and high base last year. Inflation should, however, rebound in the second half of this year with upside risks from higher food prices amid a more severe El Niño episode.

- **The Committee saw substantial uncertainties surrounding the outlook, particularly pertaining to global economic recovery, domestic political developments, and severity of El Niño episode.** Uncertain demand particularly from China would directly weigh on Thailand and the region given the tight trade linkages – China and ASEAN accounted for almost 40 percent of Thai goods exports. Domestic political developments could generate different shocks. On the one hand, a delayed formation of government could affect sentiments, with repercussion for private consumption and investment as well as tourism. On the other hand, the new government could introduce public spending and policies that expose growth and inflation to upside risks. For inflation, a particularly severe El Niño episode could drive up raw food prices including the costs of livestock feed. In the context of higher input costs and continuing economic expansion, a resurgence of cost pass-through by businesses remained a possibility.

- **The Committee assessed financial conditions to be less accommodative but still supportive of fund mobilization by the private sector and the ongoing economic recovery. The Committee remained concerned over the financial positions of vulnerable households and businesses, and supported holistic and sustainable debt resolution.** This would include further debt restructuring, as well as responsible lending measures to address persistent debt problems. Targeted measures such as these would likely be more effective and create less side effects than using the policy interest rate, a blunt instrument with much stronger and far-reaching effects on the macroeconomy.

- **The Committee agreed that monetary policy should give due consideration to macro-financial stability in the longer term.** A low-for-long interest rate could contribute to a build-up of financial fragilities, for example in the form of elevated household debt and more widespread search-for-yield behavior leading to underpricing of risks in borrowing and investment activities. Over time, these developments would leave the business and financial sectors more fragile and vulnerable to shocks, hindering sustainable growth. Monetary policy should thus give due weight to longer-term macro-financial stability and guard against the build-up of financial imbalances by internalizing the undesirable side effects of a low-for-long interest rate environment.

- **The Committee expressed concerns over structural problems hampering potential growth of the economy**. The Thai labor income share trended downward from 60 percent to 50 percent during the last 20 years, with the majority of employment being in lower-productivity agricultural and services sectors. Declining labor income share could weaken private consumption and potential growth, with monetary policy implications. Addressing these structural problems would require supply-side policies to enhance labor productivity.

- **In the Committee's view, a higher policy rate would help preserve the policy space in light of highly uncertain outlook.** A higher interest rate would add buffer to monetary policy and the financial system, enhancing the capability to respond to negative shocks. This buffer has been limited in the recent history, due to succession of adverse shocks depleting the available policy space. The present context of sustained economic expansion should provide an opportunity for building up policy space in readiness for uncertainties looking forward.

- **The Committee noted that the current policy rate was approaching the level consistent with longer-term macro-financial stability.** The Committee expected the Thai economy to continue expanding toward its potential level. Headline inflation should stabilize within the target range, but upside risks remained. Monetary policy should keep inflation sustainably within the target range and foster longer-term macro-financial stability.

- **In deliberating further policy rate increases, the Committee would evaluate the stance of monetary policy in relation to economic and inflation outlook, also taking into account associated risk assessments and uncertainties.** It would be important to look through transient forces contaminating incoming data and focus on the medium-term economic outlook (outlook rather than recent data dependent). In doing so, monetary policy would be playing its appropriate stabilizing role, and not unduly adding or amplifying shocks to the economy.

<u>Monetary Policy Decision</u>

The Committee voted unanimously to raise the policy rate by 0.25 percentage point from 2.00 to 2.25 percent.

The Committee judges the economy to expand toward the potential level driven mainly by tourism and private consumption, while merchandise exports contracted in the short term, but should pick up looking ahead as the global economic activity gathers momentum. **Inflation declined, but core inflation should stabilize at a higher level than in the past.** Upside inflationary risks stem from uncertainty in forthcoming government economic policy and more-severe-than-expected El Niño episode. **Overall financial conditions became less accommodative** but remain supportive of fund mobilization by the private sector and the ongoing economic recovery. **The overall financial system remains resilient.** Credit quality might deteriorate for some fragile SMEs and households with impaired debt serviceability. The Committee supports the continuation of debt restructuring measures as well as targeted measures and sustainable debt resolution for vulnerable groups, particularly responsible lending measures.

Under the prevailing monetary policy framework, the Committee seeks to maintain price stability, support sustainable growth in line with potential, and preserve financial stability. In the context of continuing economic expansion and narrowing slack, monetary policy should keep inflation sustainably within the target range and foster longer-term macro-financial stability by preempting the build-up of financial imbalances that could arise in a low-for-long interest rate environment. A higher policy rate would also help preserve the policy space in light of the highly uncertain outlook. **The Committee therefore voted to raise the policy rate by 0.25 percentage point at this meeting. In deliberating further policy rate increases looking ahead, the Committee will take into account economic and inflation outlook as well as associated risk assessments.**

Monetary Policy Group
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