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Monetary Policy Report December 2014

Mr. Mathee Supapongse, Assistant Governor of the Bank of Thailand (BOT) and Secretary of the Monetary Policy Committee (MPC), released the December 2014 issue of the *Monetary Policy Report*. The *Report*, published quarterly, is aimed at enhancing public understanding of the MPC's policy stance and its assessment of Thailand's economic outlook, with main details summarized as follows.

1. Economic Outlook

The Thai economy is expected to recover steadily but at a slower pace than previous forecast due to a weaker outlook of both domestic demand and exports. On the domestic side, **consumption** is expected to gradually recover on the back of improving non-farm income and employment, as well as lower oil prices. However, durable consumption, especially automobile purchases, is still impeded by high household debt and depressed farm income. In addition, **government spending**, particularly on investment projects, is likely to be lower than previously anticipated. This is due to project reviews and examinations for transparency issues, implementation capacity that does not expand fast enough to meet increased budgets, and labor scarcity in the construction sector. The prospect of public investment shortfall and slow recovery of domestic demand in turn have weighed down on **investment** decisions of most private businesses. An exception is the telecommunication industry which ramped up investment in H2/2014 to meet increasing demand for hi-speed internet and 3G network. On the external side, **merchandise exports** are likely to grow at a lower rate due to weaker trading partners' demand. Notwithstanding steady growth in the US, lower-than-expected growth of the Euro area economies, Japan, and China has caused exports of Asia and Thailand to slow. Additionally, domestic production limitations and depressed commodity prices would continue to affect Thai exports in the period ahead. For **export of services,** the rebound of Chinese tourists, whose confidence in Thailand's political situation resumed quickly, has contributed to a steady recovery. Tourism will also receive additional benefit from lower fuel prices in the period ahead. Nevertheless, the recovery will be restrained by European and Russian tourists due to their weak economies, and the fact that some tourists remain concerned about the Thai political situation.

Inflation declined considerably due mainly to lower cost pressure. Global oil price has decreased substantially and is expected to stay low throughout the forecast period due to increasing non-OPEC supply, especially the US's shale oil production, while OPEC is holding production steady to maintain market share. Meanwhile, world oil demand has been weak as a result of slow global economic recovery. Low global oil price will push Thai inflation, which has been on a downward trend since the end of 2014, lower further for quite some time. However, government policy on retail energy price restructuring and a weaker Thai baht have offset the impact of global oil price on inflation to some extent. At the same time, demand pressure is lower than previously expected in accordance with slower economic recovery, as reflected by the output gap that is likely to remain open throughout the forecast period as well as lower inflation expectations.

2. Projection for Growth and Inflation

In light of the economic assessment above, **the MPC lowered growth projections for both 2014 and 2015, and assessed that risks are balanced throughout the forecast period.** Downside risk comes from possibility of slower-than-expected global economic recovery and thus exports, and low farm income making a greater impact on consumption than expected. Upside risk stems from higher government disbursement than expected leading to more confidence in government policy and higher investment than expected. The growth fan chart is therefore evenly distributed over the forecast period. **Core inflation forecast was revised down slightly for 2015. While headline inflation forecasts were revised down for the entire forecast period. Risks are balanced** between upside price pressure from possible OPEC cut of oil production raising prices and downside price pressure from an extended slump in global growth reducing oil and commodity prices. Therefore, the fan charts for both headline and core inflation are evenly distributed over the forecast period.

Forecast Summary			
Percent per year	2013*	2014	2015
GDP Growth	2.9	0.8 (1.5)	4.0 (4.8)
Headline Inflation	2.2	1.9 (2.2)	1.2 (2.1)
Core Inflation	1.0	1.6 (1.6)	1.2 (1.3)

Note: * actual data ( ) MPR September 2014
Source: NESDB, MOC, and forecasts from BOT

3. Monetary Policy Deliberation

The MPC deemed the current degree of monetary policy accommodation to be supportive of the expected steady economic recovery and consistent with long-term financial stability objectives. In the November 5, 2014 meeting, the MPC evaluated the export sector to be on a slower recovery path due to supply-side limitations and assessed slow recovery in domestic demand, including lower-than-expected government spending. Nonetheless, sustained growth was expected in 2015. The MPC therefore voted 6 to 1 to maintain the policy rate at 2.00 percent per annum. In the December 17, 2014 meeting, the MPC continued to assess a sustained growth. However growth projection in 2015 was lowered as constraints to government spending became more apparent, causing the private sector to delay investment. Additionally, exports became exposed to greater risk from slower global recovery. On the other hand, the MPC judged that low inflation forecasts are not a concern because they come mainly from lower energy costs. Also, risks to financial stability from an extended period of low interest rates are contained. The MPC thus voted 5 to 2 to hold the policy rate at 2.00 percent per annum. **Going forward, the MPC members shared the view that monetary policy should remain accommodative in order to reinforce the momentum of economic recovery. Another important factor would be for government to expedite spending as planned.**

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