



**Monetary Policy Process and Implementation  
at the Bank of Thailand**

**Lecture 8**



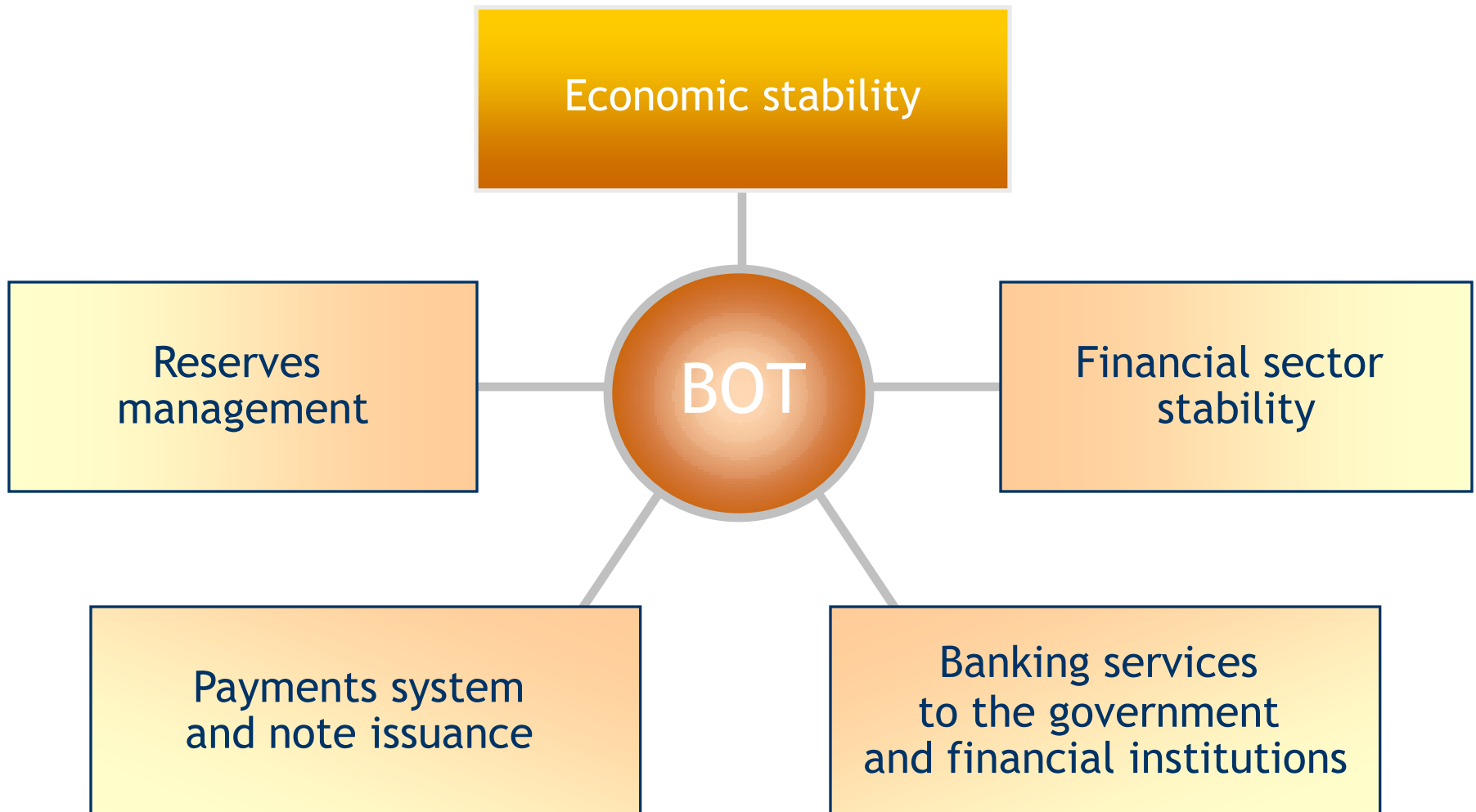
# Roadmap of Talk

- BOT's role in safeguarding economic stability
- Inflation targeting as a monetary policy framework
- Monetary Policy and its Transmission Mechanism
- Monetary Policy Decision-making Process





# BOT's Roles





## BOT uses monetary policy to maintain macroeconomic stability



- **Monetary policy cannot directly boost growth in the long-term**
- **Role of monetary policy in macroeconomic management:**
  - (1) Can be used to stimulate economic growth in the short-term to cushion a soft patch**
  - (2) Can be used to maintain price stability and thereby support sustainable growth in the long-term**



## BOT uses monetary policy to maintain macroeconomic stability

- Price stability refers to an environment where inflation is at a level that does not negatively affect households and businesses in their decision making
- Price stability preserves consumers' purchasing power
- Price stability supports national competitiveness
- Price stability encourages long-term consumption, production and investment planning
- Without price stability, an economy is likely to suffer from other stability concerns
- Central banks have limited ability to pursue objectives other than price stability and **long-term** sustainable growth



# Price stability is the major goal of monetary policy

Country	IT	Non-IT	Monetary Policy objective
US	✓	✓	Maximum employment, <b>stable prices</b> , and moderate long-term interest rates
UK	✓		Monetary stability ( <b>stable prices</b> and confidence in the currency) and financial stability
Euro area	✓		<b>Price stability</b>
Canada	✓		<b>Price stability</b>
Japan	✓	✓	<b>Price stability</b>
Sweden	✓		<b>Price stability</b>
Australia	✓		Stability of the currency of Australia; maintenance of full employment; and economic prosperity and welfare of the people...
NZ	✓		<b>Stability in the general level of prices</b>
Malaysia		✓	Monetary and financial system stability and fostering a sound and progressive financial sector, [for] sustained economic growth ...
Korea	✓		<b>Price stability</b>
Indonesia	✓		Stability in the rupiah, as reflected in the <b>inflation rate</b> and exchange rate
Philippines	✓		<b>Low and stable inflation</b>
Singapore		✓	Sustained <b>non-inflationary</b> economic growth
HK		✓	Currency stability

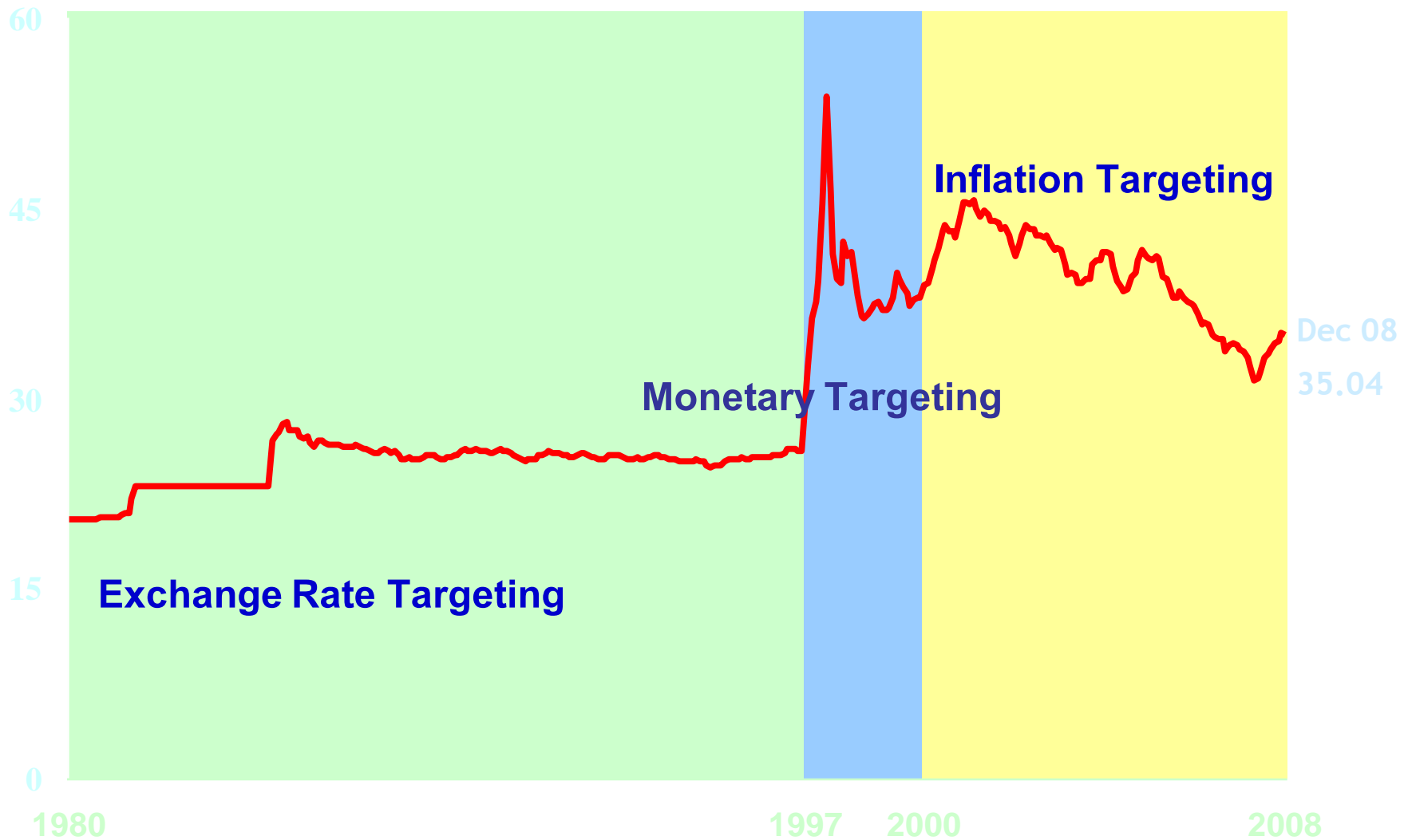


# **Inflation targeting as a monetary policy framework**



# Thailand's Monetary Policy Framework

Thai baht/US dollars





# Thailand's Current Monetary Policy Framework

- **Monetary policy focuses on achieving economic stability**
- **The current monetary policy framework is Inflation targeting which aims at maintaining inflation within the target range**
- **The target is to maintain core inflation within the range of 0.5-3 percent for each quarter**
- **The benefits of inflation targeting are (1) maintain purchasing power of households (2) maintain competitiveness (3) low and stable inflation will enable long-term business planning**
- **Acts as a nominal anchor for the economy (The Thai economy will have an average annual inflation rate not exceeding 3.5 percent)**



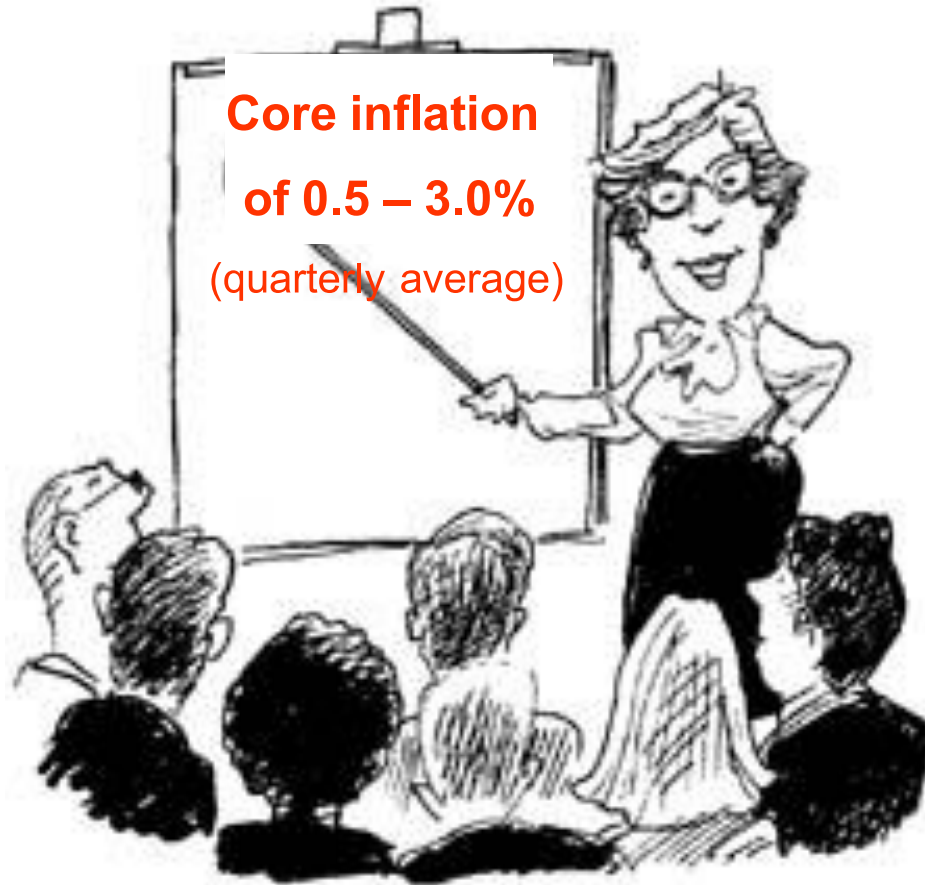
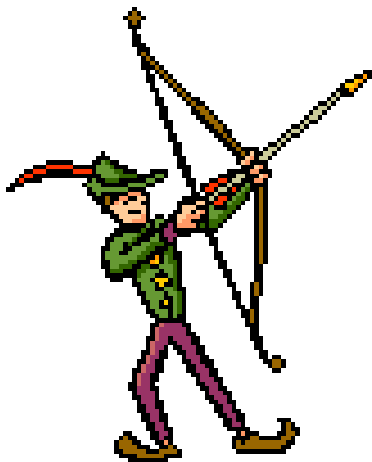
# Suitability in the Case of Thailand

- 1. Price stability is an important precondition for overall macroeconomic stability. Ultimately, it helps promote long-term growth.**
- 2. IT works well with a floating exchange rate.**
- 3. IT, more so than other monetary policy frameworks, encourages a systematic work process and transparency of the central bank.**



# Inflation Target

The current  
inflation target for  
BOT is ...





## Strengths of Inflation Targeting

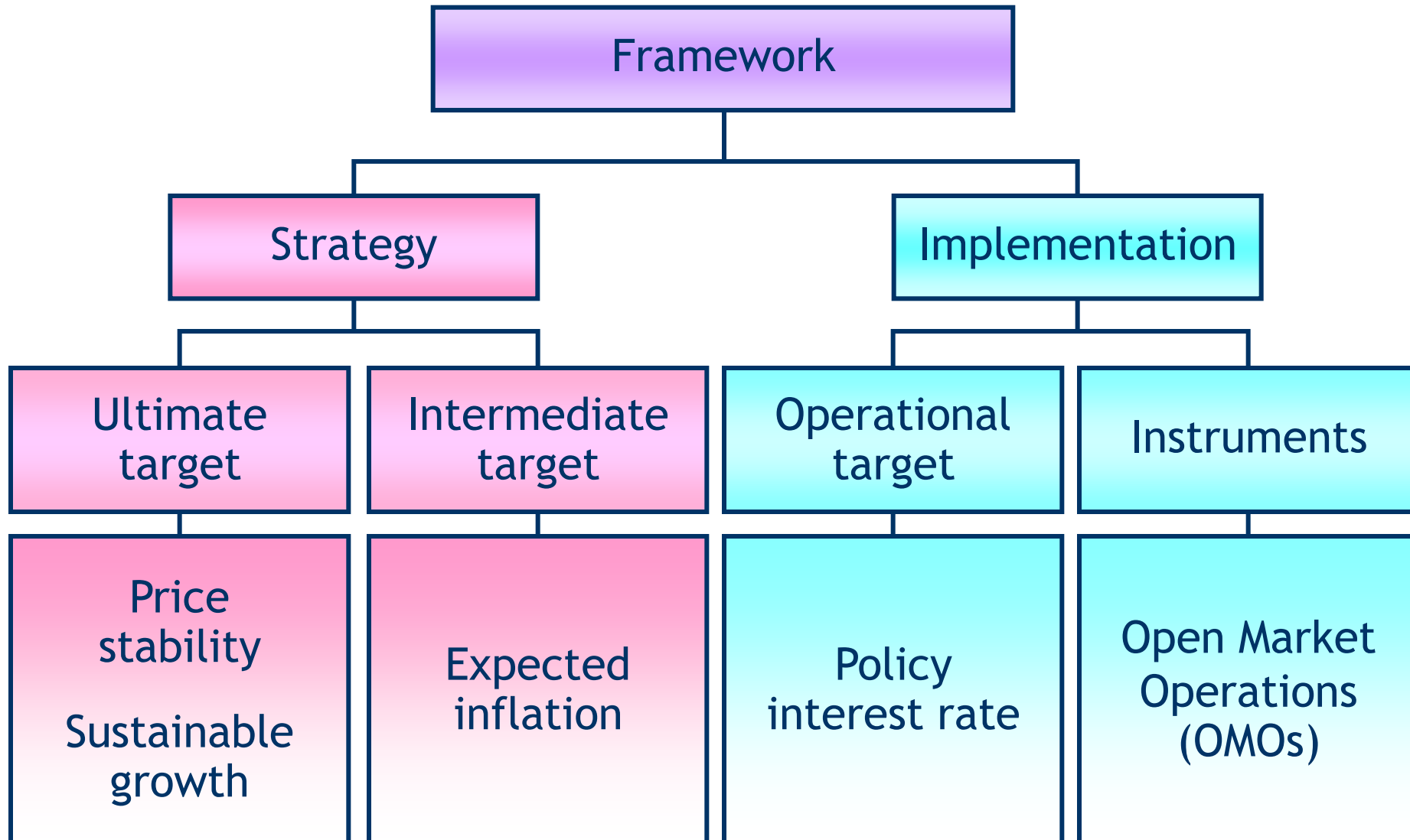
1. **Set a numerical inflation target and announce it to the public ahead of time**
2. **Emphasize transparency, especially the communication of timely and accurate information**
3. **Demand accountability from the central bank in case the inflation target cannot be delivered**
4. **Involve the development of forecasting tools**
5. **State clearly the policy interest rate to enhance the clarity of policy signal**


Transparency  
of the decision-  
making process  
and policy  
accountability  
help to build credibility  
of the central bank





# Inflation Targeting in Thailand





Does BOT's inflation targeting mean ignoring concerns over the growth momentum or asset prices?



No. **Thailand uses flexible inflation targeting**

In deliberating monetary policy, the Monetary Policy Committee (MPC) regularly monitors “**7 areas of potential imbalance**” other than inflation alone:

1. Current Account Deficit
2. Non-financial Corporation Performance
3. Household Debt
4. Public Debt
5. Real Estate/Housing Price
6. Financial Markets Volatility
7. Credit Growth/NPLs





# Monetary Policy Transmission Mechanism



# Monetary Transmission Mechanism

## Transmission Channels

**Central Bank**

S-T Interest  
Rate



OMO

**Interest Rate**

**Credit**

**Exchange Rate**

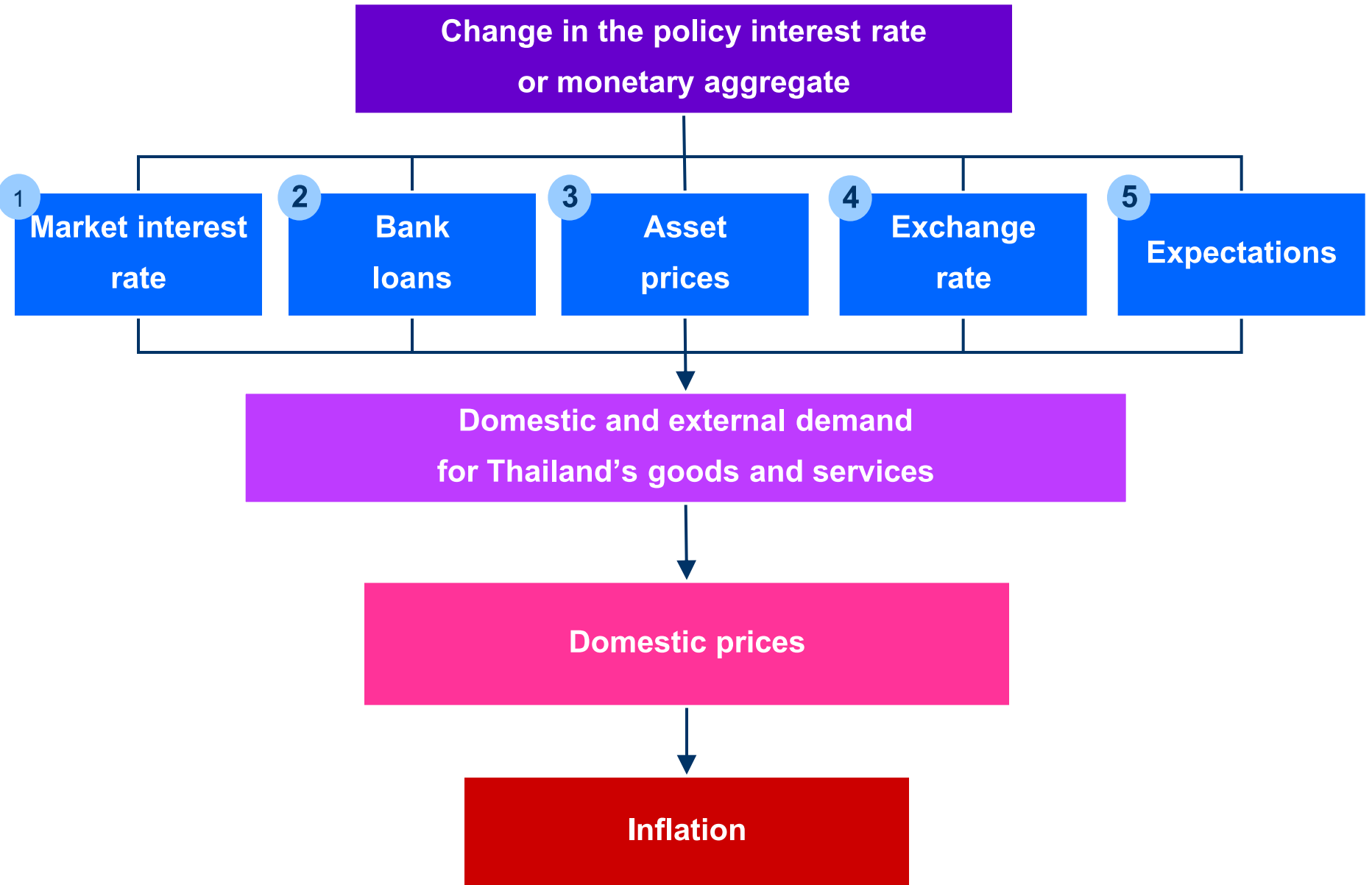
**Asset Price**



**Output  
and  
Inflation**



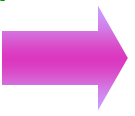
# Monetary Policy Transmission Mechanism



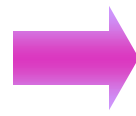


# 1. Interest rate channel

Expansionary monetary policy:  
(1) reduce policy rate  
or (2) Expand monetary base

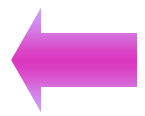


Money market  
interest rate  
decline

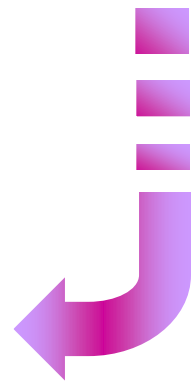


Cheaper cost of  
consumption  
and investment

Economic expansion,  
Higher price level



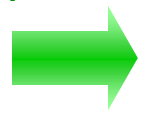
Higher  
demand for  
consumption  
and  
investment



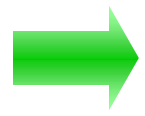


# 2. Credit channel

Expansionary monetary policy:  
(1) reduce policy rate  
or (2) Expand monetary base

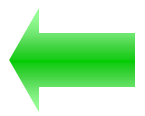


Money market  
interest rate  
decline



Lower debt  
burden of  
business sector  
Strengthen  
financial  
condition of  
business sector

Economic expansion,  
Higher price level



Bank willing to  
lend more





# 3. Asset price channel

Expansionary monetary policy:  
 (1) reduce policy rate  
 or (2) Expand monetary base



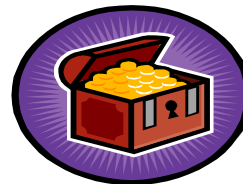
Money  
 market  
 interest rate  
 decline



People shift from  
 holding deposit  
 to investment in  
 assets

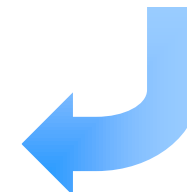
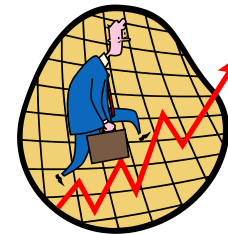
Better economic  
 condition  
 improve return  
 on assets

Economic expansion,  
 Higher price level



Asset price increase

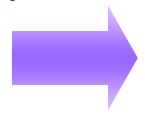
People become more  
 wealthy and purchase  
 more goods and service



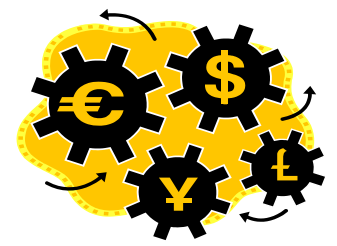


# 4. Exchange rate channel

Expansionary monetary policy:  
(1) reduce policy rate  
or (2) Expand monetary base

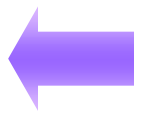


Lower interest  
rate differential  
Capital outflow



Baht weaker

Economic expansion,  
Higher price level

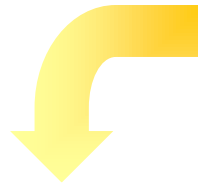


Increase export  
Reduce import





# 5. Expectation channel



Public expect for good economic growth prospect



Increase consumption and investment



Economic expansion,  
Higher price level

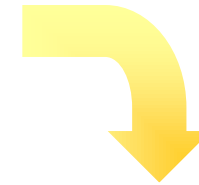


People worry of worsen than expected economic condition

Increase consumption and investment



Economic stagnant,  
Lower inflation





# Monetary Policy Transmission Mechanism

- Monetary policy transmission takes time, that is, its effect is not immediate. This is similar to a slow moving large oil vessel. Thus, policy making needs to be pre-emptive.
- That is, the **time lags** for the effect of monetary policy on the economy may be as long as 8 quarters
- The need to be pre-emptive requires the BOT to make forecasts of the economy



BOT

Monetary Policy

(4-8 quarters)

Economic

Stability



## Monetary Policy Implementation

- **BOT is responsible for maintaining money market liquidity at a level consistent with the policy interest rate set by the MPC**
- **Liquidity management is done through 3 main channels:**
  - 1. Reserve Requirement**
  - 2. Standing Facilities**
  - 3. Open Market Operations (OMOs)**



# Monetary Policy Decision-making Process



# Monetary Policy Decision-Making Process



MPC comprises of  
3 BOT officials and  
4 outside experts

Data



MPC meeting every 6 or 8 weeks

Assessment of economic  
conditions and outlook



MPC decision:  
Raise/Maintain/Lower policy rate



Press release



OMOs to maintain money market  
liquidity at a level consistent  
with the policy interest rate



*Monetary Policy Report*





## Assessment of economic conditions and outlook

- **The MPC fully recognizes that transparency in monetary policy increases its effectiveness.**
- **The MPC integrates the latest data in its economic assessments, specifically relating to inflation, internal and external economic conditions, various assumptions underlying the forecasts, and other issues the MPC considers important.**
- **This information should provide useful guidelines for private sector economic activities.**

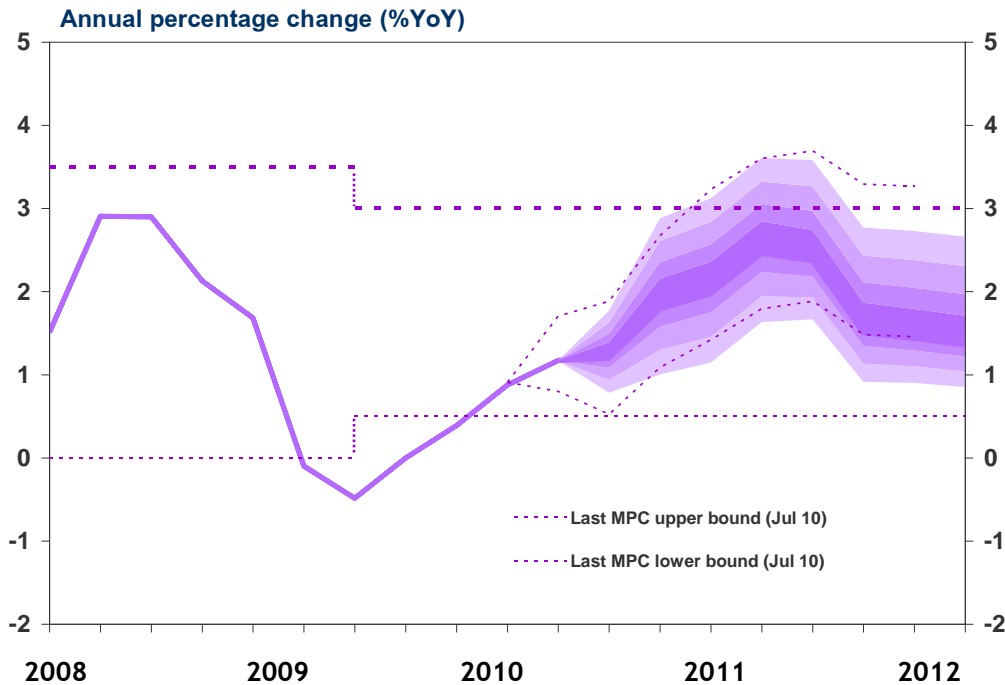


# Inflation and Growth Forecast



# Core Inflation Forecast

## Core Inflation Forecast



%YoY	2010	2011
<b>Core Inflation</b>	<b>0.5 – 1.3</b>	<b>2.0 – 3.0</b>
<i>(Jul 10)</i>	<i>(0.5 – 1.3)</i>	<i>(2.0 – 3.0)</i>

■ Risk factors going forward:

- Upward adjustment of minimum wage
- There remains some possibility that core inflation will exceed the upper bound of the target range in 2011

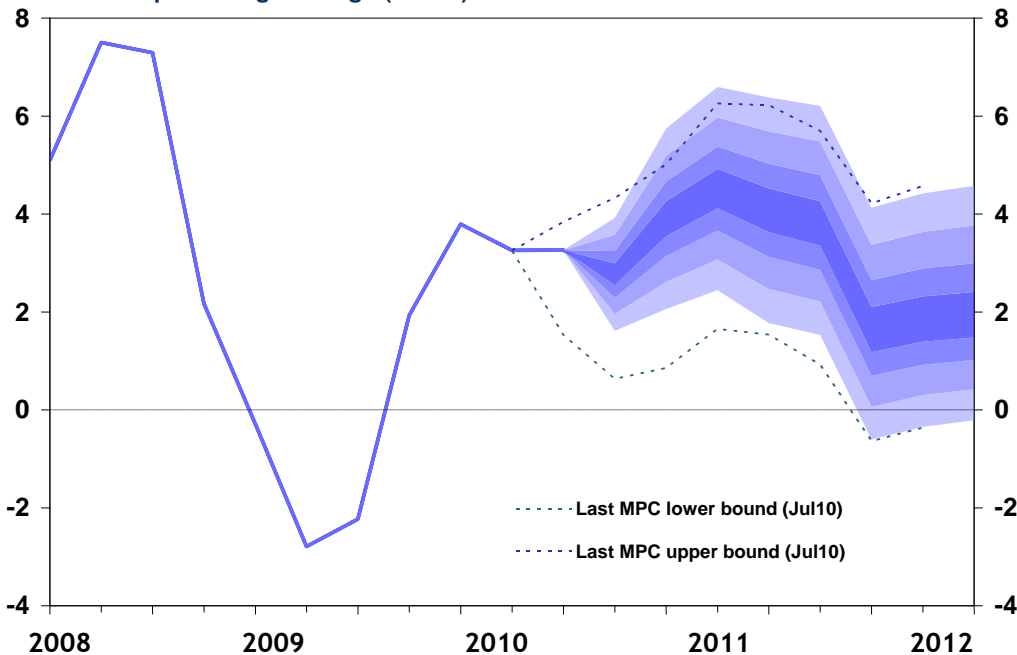
Remark: The fan chart covers 90 per cent of the probability distribution.



# Headline Inflation Forecast

## Headline Inflation Forecast

Annual percentage change (%YoY)



%YoY	2010	2011
Headline Inflation	2.8 – 3.8	3.0 – 5.0
(Jul 10)	(2.5 – 3.8 )	(2.5 – 4.5 )

### ■ Risk factors going forward:

- Oil prices in the global market
- Rising domestic farm prices due to unfavorable climate conditions
- Extension of the government's cost-of-living reduction measures

Remark: The fan chart covers 90 per cent of the probability distribution.



## Latest Forecast Summary (Oct 2010)

	2010	2011
<b>GDP Growth</b>	<b>7.3 – 8.0</b>	<b>3.0 – 5.0</b>
<i>(Jul 10)</i>	<i>(6.5 – 7.5)</i>	<i>(3.0 – 5.0)</i>
<b>Core Inflation</b>	<b>0.5 – 1.3</b>	<b>2.0 – 3.0</b>
<i>(Jul 10)</i>	<i>(0.5 – 1.3)</i>	<i>(2.0 – 3.0)</i>
<b>Headline Inflation</b>	<b>2.8 – 3.8</b>	<b>3.0 – 5.0</b>
<i>(Jul 10)</i>	<i>(2.5 – 3.8)</i>	<i>(2.5 – 4.5)</i>



# Exchange rate policy



# The BOT monitors two major types of exchange rates

- **Bilateral exchange rate, for example, Baht/US Dollar**
- **Nominal Effective Exchange Rate: NEER**
  - Calculated from Baht comparing to trade weight of currencies of important trading partners
- **Real Effective Exchange Rate: REER**
  - Calculated from NEER adjusting for relative price level, which will reflect the country's price competitiveness.
  - In the long run, REER depends on the productivity, but neither on the baht intervention nor on the monetary policy



## The role of the BOT in promoting exchange rate stability

- **Allowing exchange rate to move freely under market mechanism**
- **Standing ready to intervene in the foreign exchange market when the volatility of the exchange rate is at a level that the economy cannot tolerate.**
- **Maintaining national competitiveness, as measured through the Nominal Effective Exchange Rate (NEER), which comprises currencies of important trading partners.**

## Conclusion

- **BOT uses monetary policy to maintain price stability and thereby support sustainable growth in the long-term**
- **By integrating the latest data in economic assessments, the monetary policy stance is signaled through the policy interest rate**
- **BOT does not target a fixed level for the exchange rate, but has the role in managing excess volatility, in a manner consistent with the IT framework**

