

Lecture 12: Monetary Policy in Thailand

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March 16, 2012

Outline

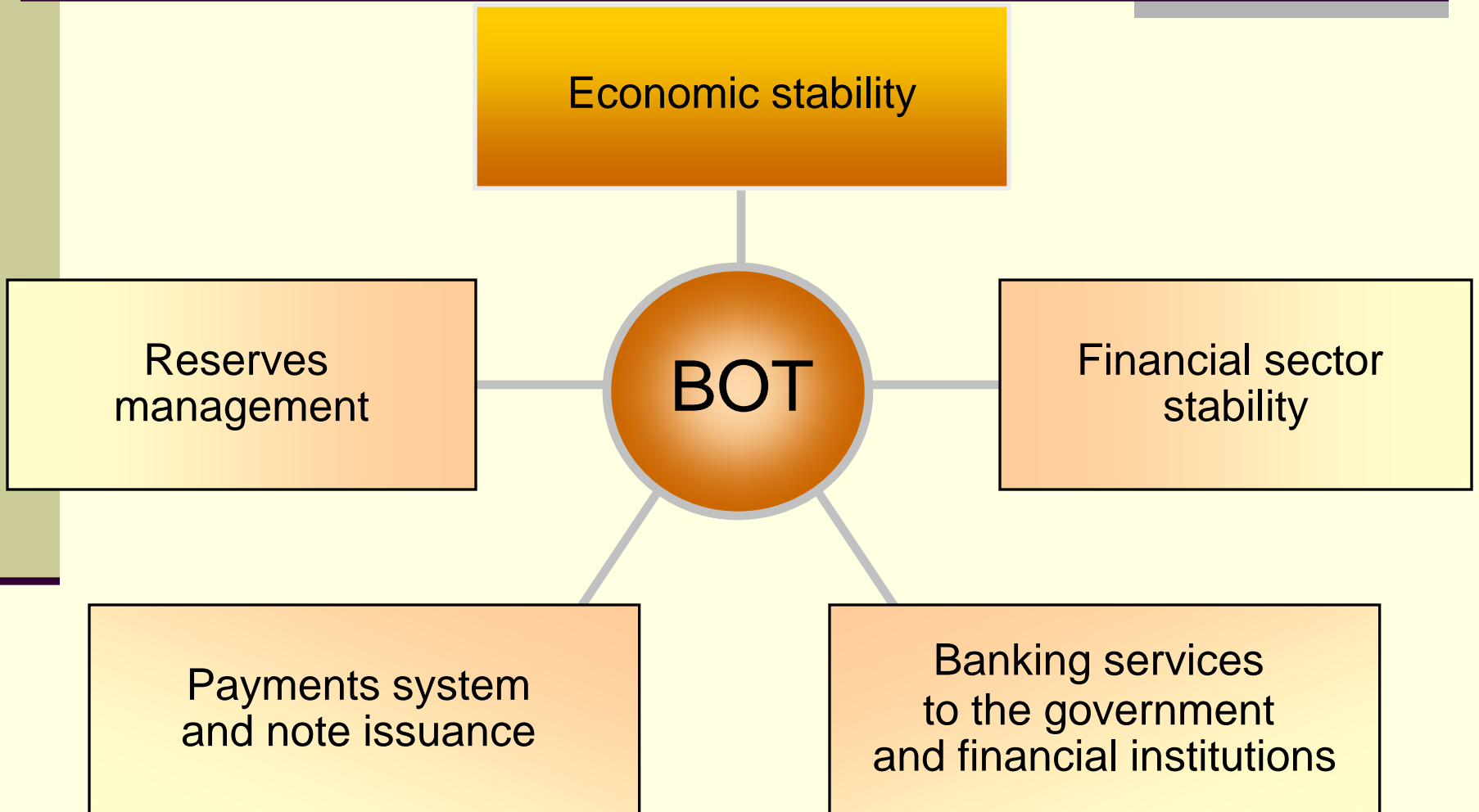
- **BOT's role in safeguarding economic stability**
- **Inflation targeting as a monetary policy framework**
- **Recent MPC decision, Inflation and Growth Forecast**





BOT's role in safeguarding economic stability

BOT's Roles



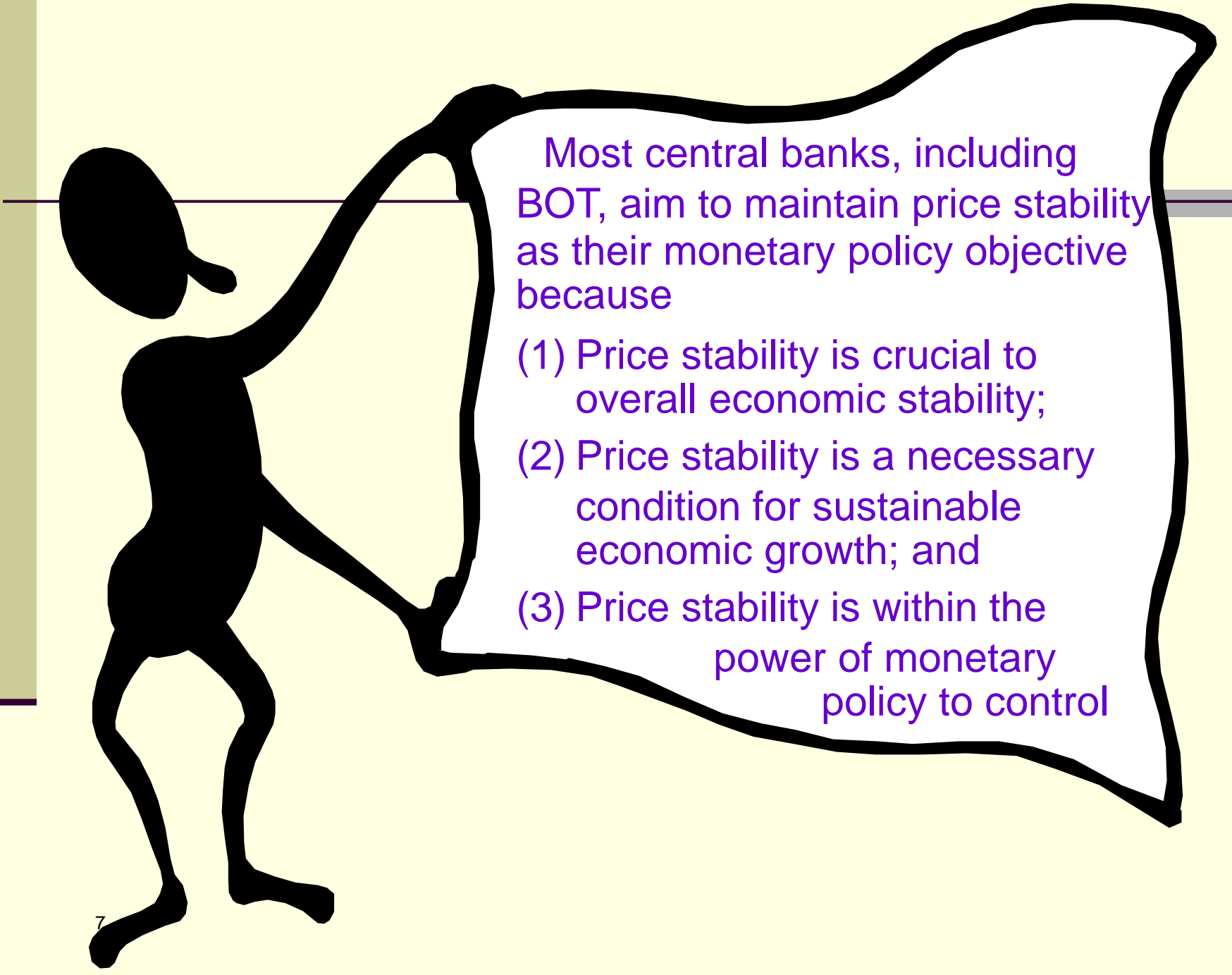
BOT uses monetary policy to maintain macroeconomic stability



- **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**

Most central banks aim to maintain price stability as their monetary policy objective

Country	Inflation Targeter	Price stability mandate	Secondary objective: Economic growth
Australia	✓	✓	✓
Brazil	✓	✓	
Canada	✓	✓	✓
Euro Area		✓	
Hong Kong	Currency Board	✓	
India		✓	
Indonesia	✓	✓	
Japan	✓ (from Feb 12)	✓	
Korea	✓	✓	
Malaysia		✓	✓
Mexico	✓	✓	
New Zealand	✓	✓	
Philippines	✓	✓	
Singapore	Exchange rate targeting	✓	✓
Sweden	✓	✓	
Thailand	✓	✓	✓
UK	✓	✓	✓
US (dual mandate)	Just do it	✓	✓



Most central banks, including BOT, aim to maintain price stability as their monetary policy objective because

- (1) Price stability is crucial to overall economic stability;
- (2) Price stability is a necessary condition for sustainable economic growth; and
- (3) Price stability is within the power of monetary policy to control



Inflation targeting as a monetary policy framework

Inflation Targeting

An inflation-targeting (IT)

Central bank announces inflation as the target of monetary policy and changes the policy interest rate to keep inflation at the specified target.

Key aspects of IT are systematic monetary policy process and transparent communication with the public.

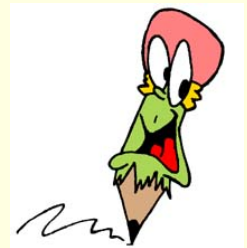
IT was first introduced in NZ in 1990 and has gained increasing popularity since.



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



Potential Drawbacks of Inflation Targeting

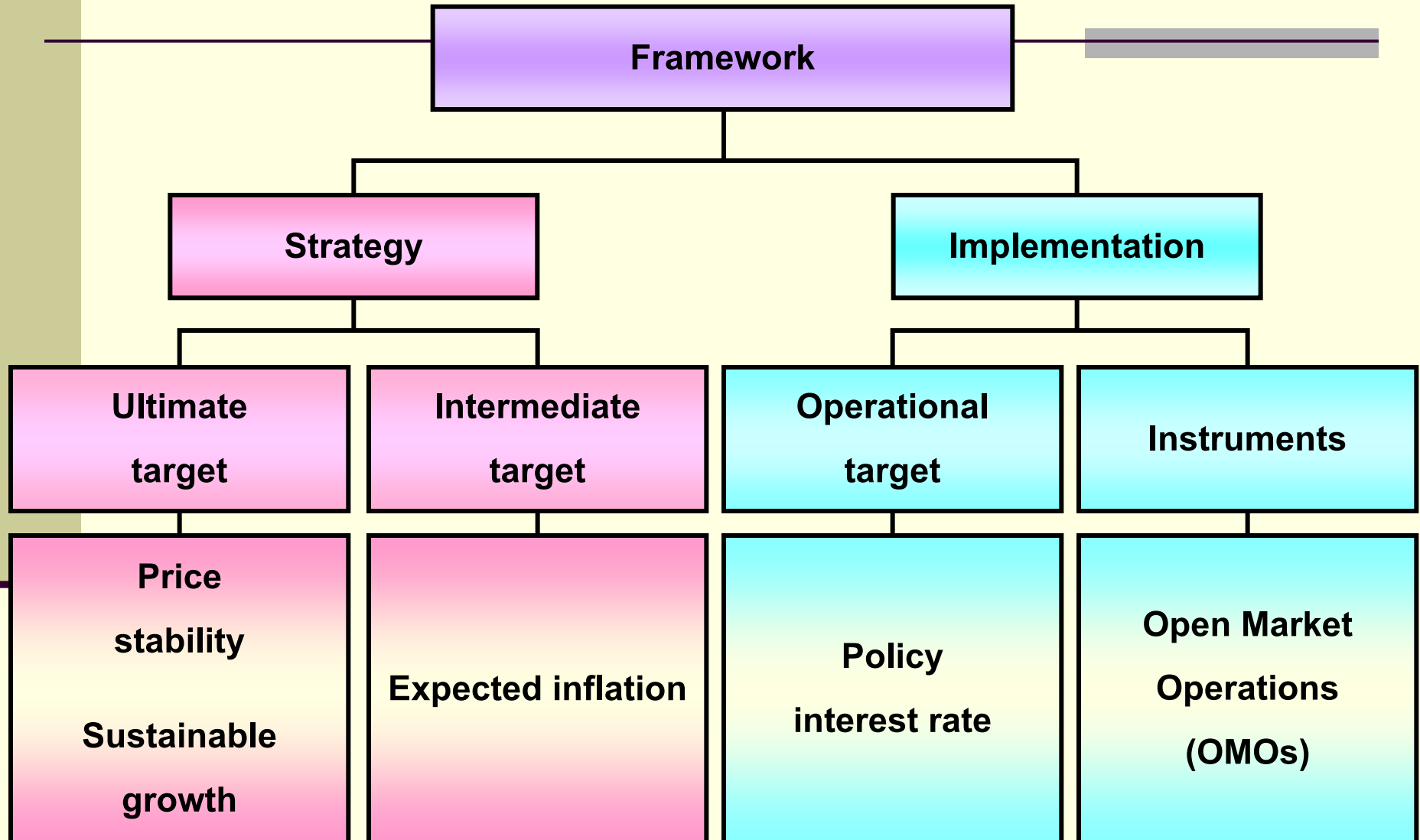


- 1. Long policy transmission lag to the stated target requires forecasting capability and pre-emptive policy moves**
- 2. Focus on inflation alone may induce short-term volatility of output**

Suitability in the Case of Thailand

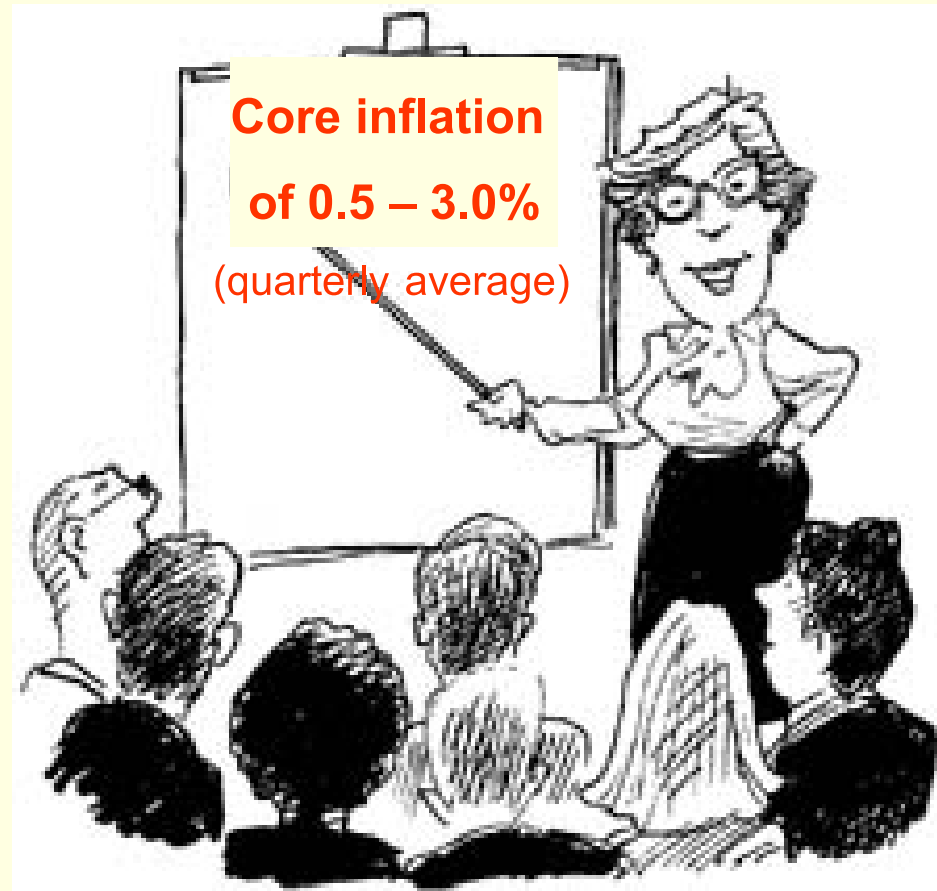
1. Price stability is an important precondition for overall macroeconomic stability. Ultimately, it helps promote long-term growth.
2. IT works well with a floating exchange rate.
3. IT, more so than other monetary policy frameworks, encourages a systematic work process and transparency of the central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

Inflation Targeting in Thailand

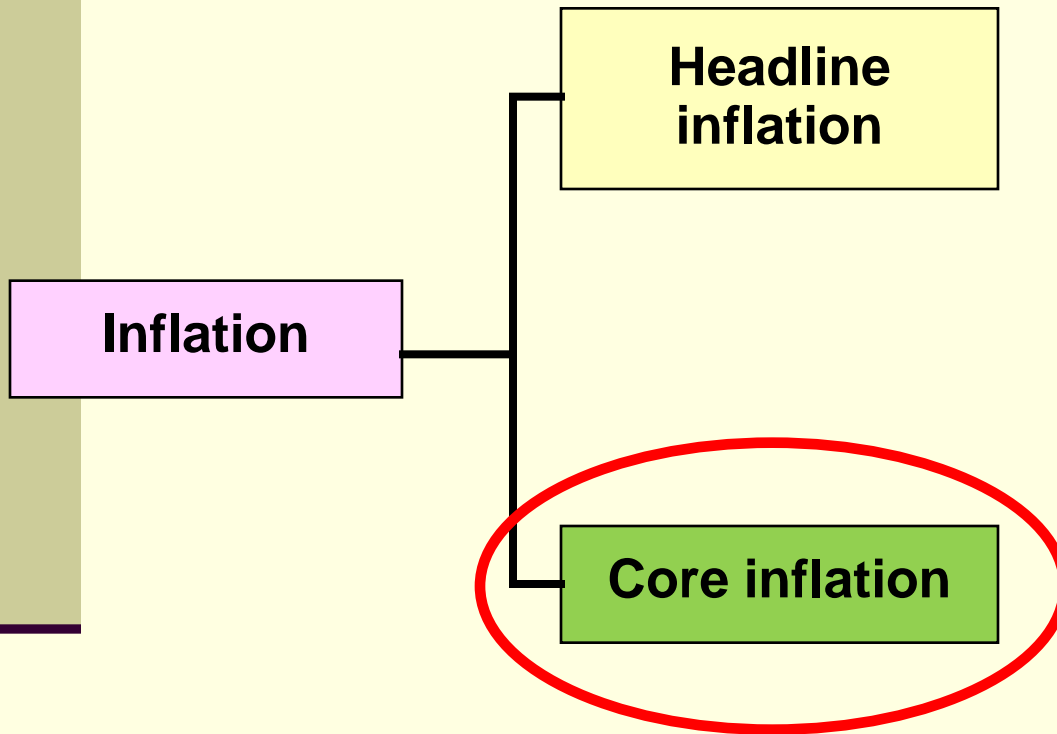


Inflation Target

The current
inflation target for
BOT is ...



Intermediate Target: Core Inflation

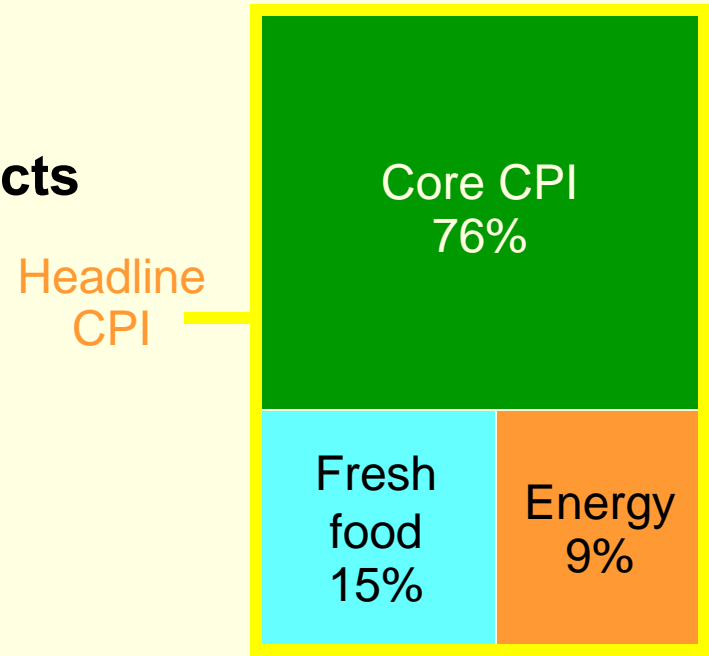


- A subset of headline inflation
- Focuses on inflation in the long-term so that monetary policy does not have to react to external pressure such as oil and farm prices

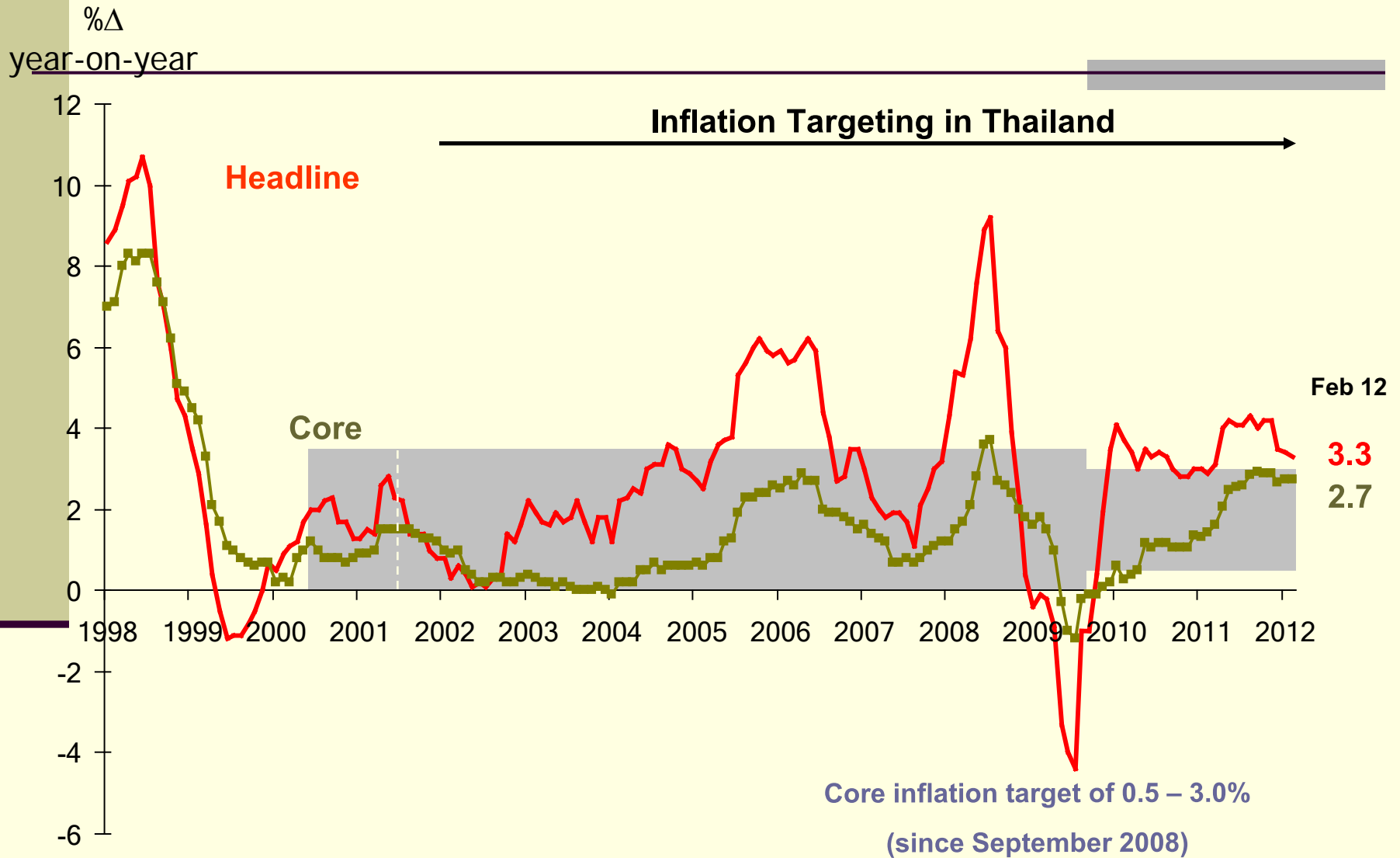
Thailand's Core Inflation Measure

Core inflation is the change in Core CPI, which is Headline CPI excluding fresh food and energy items (roughly 24% of the CPI basket):

- Rice, flour and flour products
- Meat, poultry and fishery products
- Vegetables and fruits
- Eggs and dairy products
- Gasoline
- Electricity and cooking gas



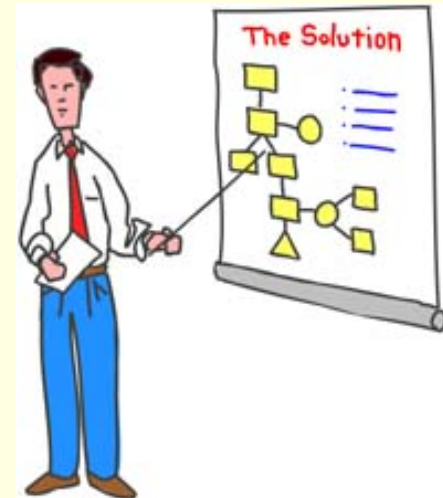
Headline and Core Inflation



Monetary Policy and the Real Economy

**Monetary policy affects the real economy through
5 main channels:**

- 1. Interest rate channel**
- 2. Credit channel**
- 3. Asset price channel**
- 4. Exchange rate channel**
- 5. Expectations channel**



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

Policy Signaling

- **The MPC signals policy through the 1-day repurchase rate while letting other money market rates move according to market conditions.**
- **Having only one policy interest rate helps enhance the policy signal.**



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 Process

Data



MPC comprises of
3 BOT officials and
4 outside experts

MPC meeting every 6 or 8 weeks

Assessment of economic
conditions and outlook



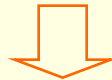
MPC decision:
Raise/Maintain/Lower policy rate



Press release



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



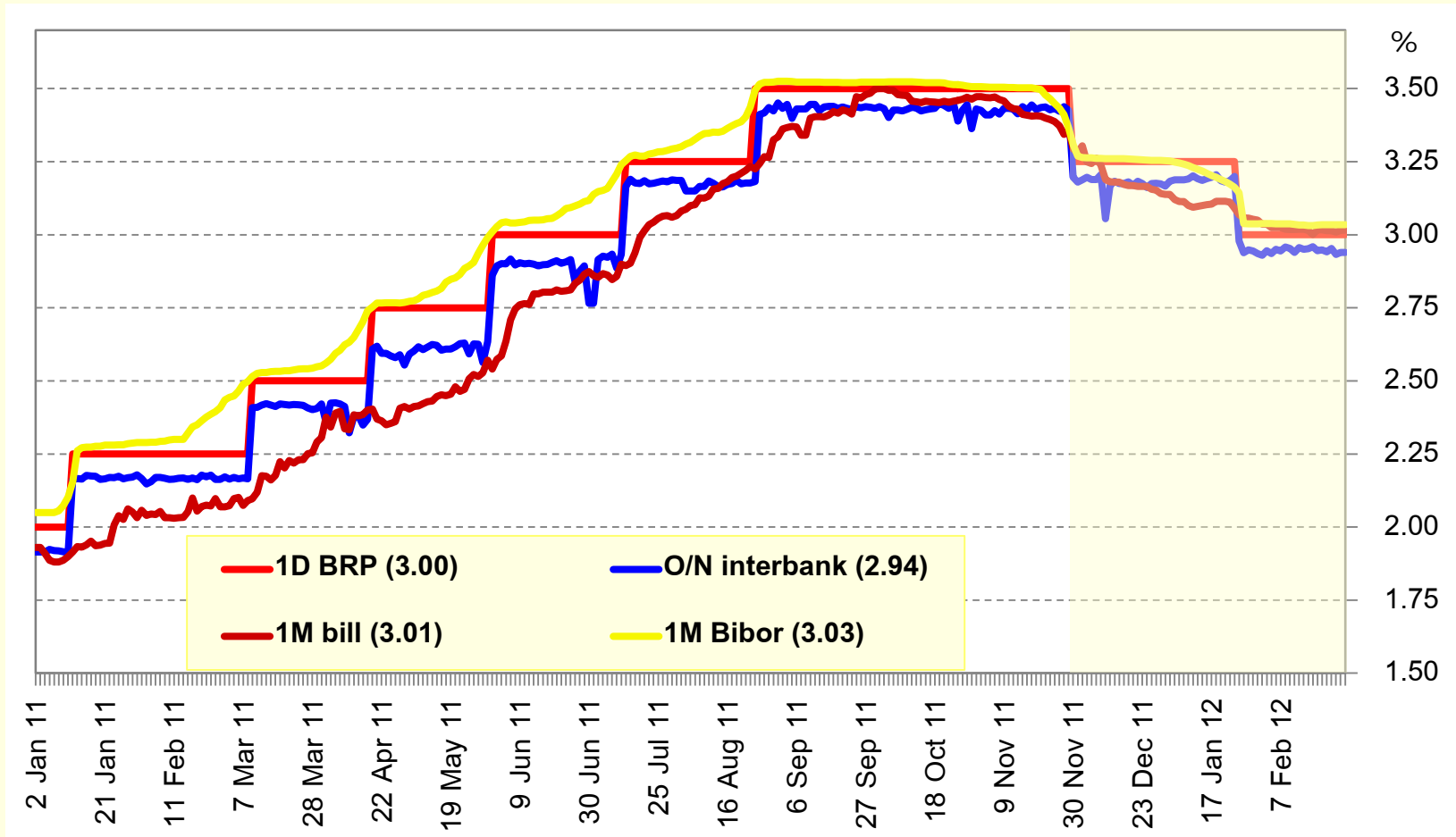
Inflation Report



Recent MPC decision, Inflation and Growth Forecast*

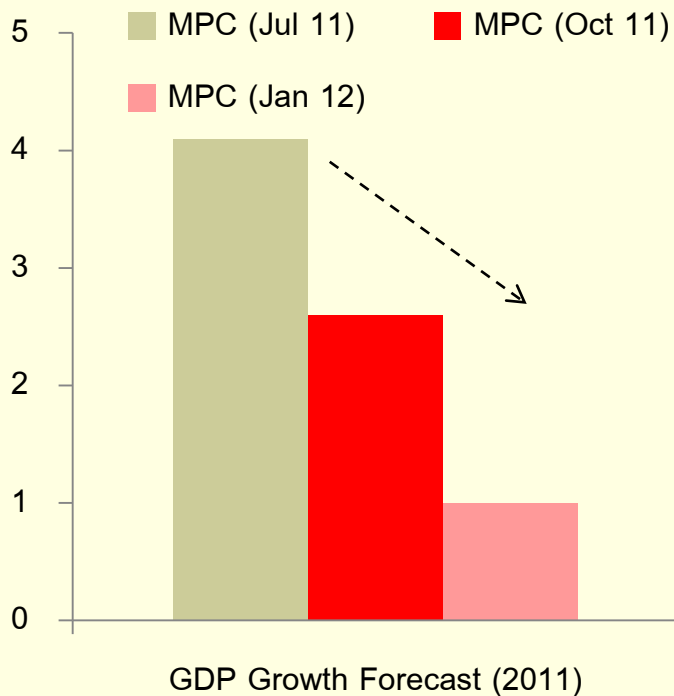
***from Inflation Report (Bank of Thailand) Jan 12**

The Monetary Policy Committee (MPC) started easing monetary policy in December 2011 after continued monetary policy tightening.

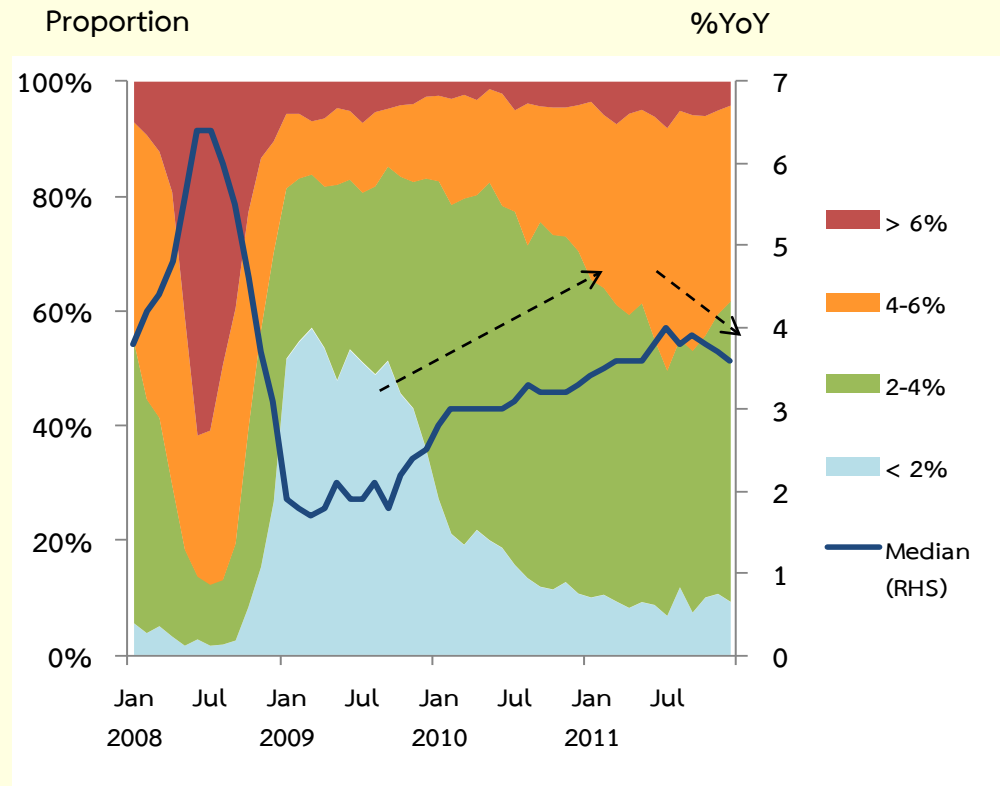


Easing decisions were driven mainly by heightened risks to growth, which appeared to outweigh risks to inflation.

MPC GDP growth forecasts



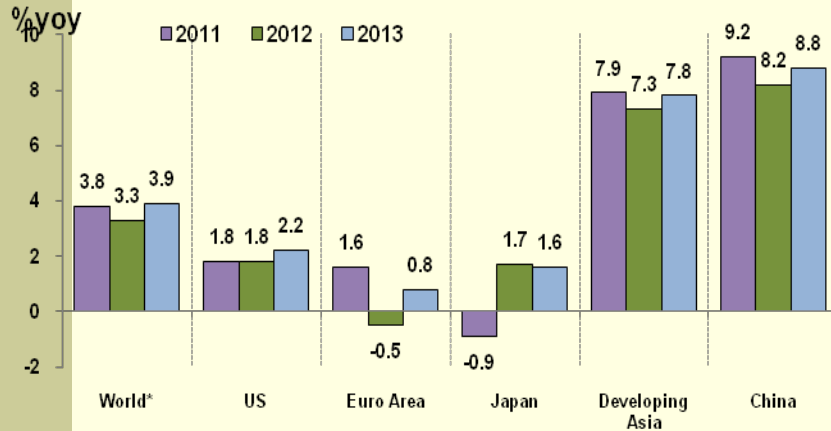
Inflation Expectations over the next 12 months



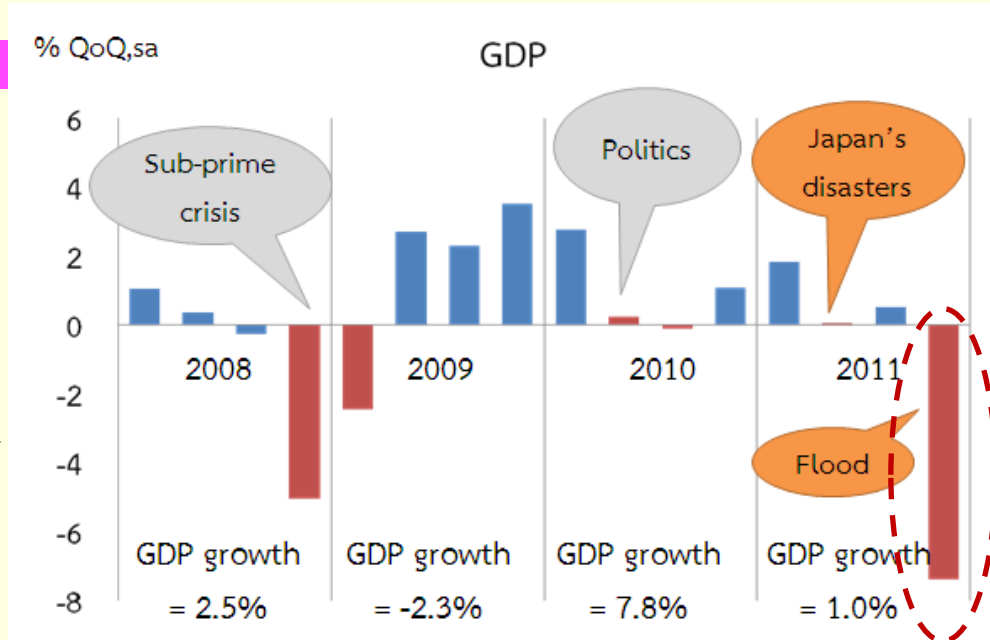
Source: BSI Survey as of December 2011, Bank of Thailand

While weak global outlook played an important role, greater-than-expected economic impact of the flood led to a significant revision in GDP growth forecasts.

IMF GDP Forecasts



Source: IMF's World Economic Outlook, 13 January 2012
 Note: * Composed of 184 countries and weighted by GDP valued at purchasing power parities (PPPs) for years 2003-2005



Note: GDP growth for 2011Q4 and 2011 are Bank of Thailand's projections (as of Jan 12)

Estimated impact of the flood was 3.1% of GDP (as of Jan 12), the highest in the history* due to substantial damage in the manufacturing sector.

According to reports from flood-hit areas:

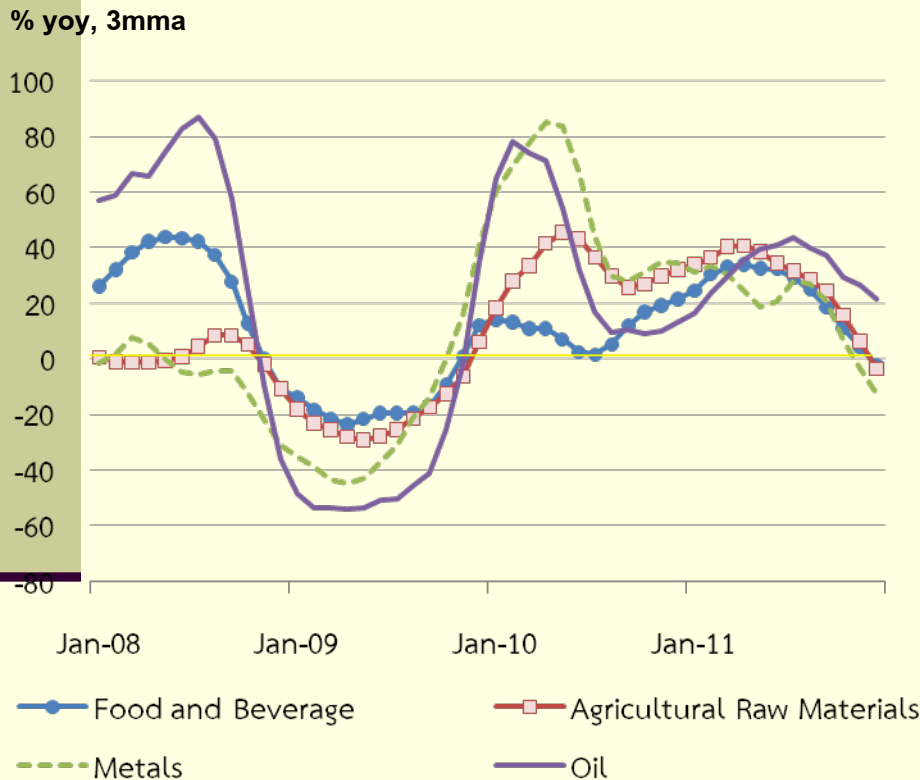
- Major production bases are severely impacted, particularly for the automobile and HDD industries, causing severe disruption in supply chains
- Further delay is likely given firms' need to purchase new machines, coupled with insurance companies' delay in claim payout



Note: * The impact of the flood was previously estimated to be 2.1% of GDP in November 2011

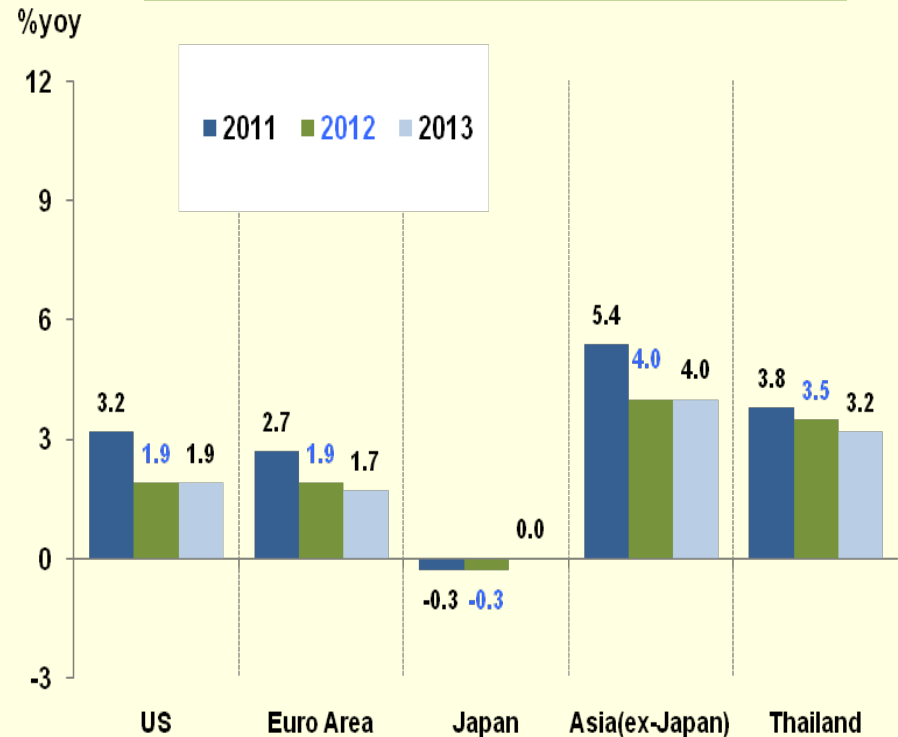
At the time, global inflation subsided as commodity prices decelerated.

World commodity prices



Source: IMF

Consensus Inflation Forecasts (Jan 12)



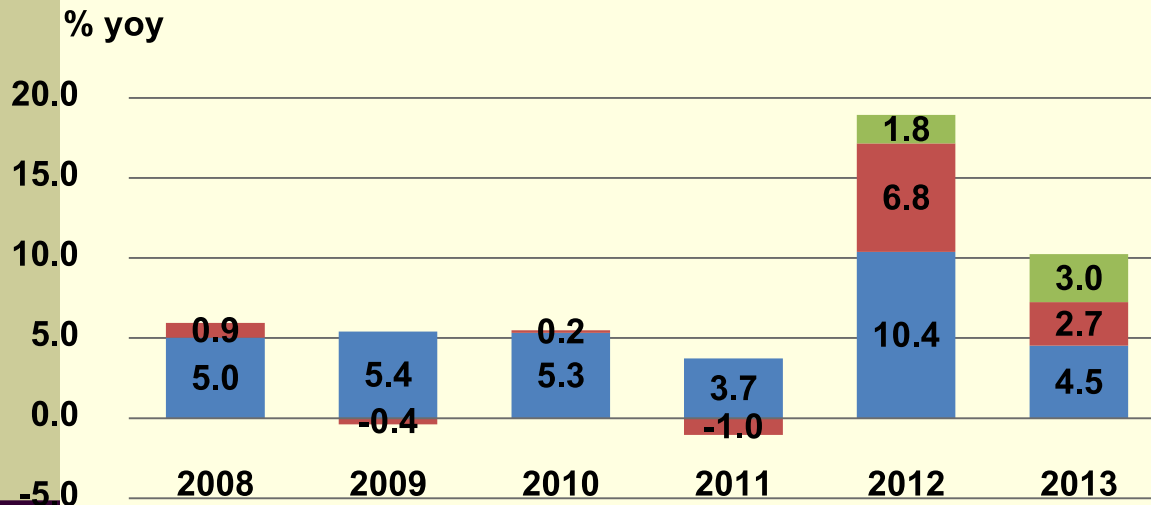
Source: Consensus forecasts (survey date) as of 9 January 2012

Growth outlook for 2012

- The Thai economy in 2012 will recover from the flood on the back of domestic demand, while external demand is likely to soften with global growth prospects
 - Economic activity is projected to return to normal condition in 2012 Q3
 - Economic recovery will be supported by reconstruction and replacement spending, improved investors' confidence, quick rebound on private consumption, and fiscal stimulus

Fiscal stimulus will play a crucial role on economic recovery in 2012

Contribution to public direct expenditure



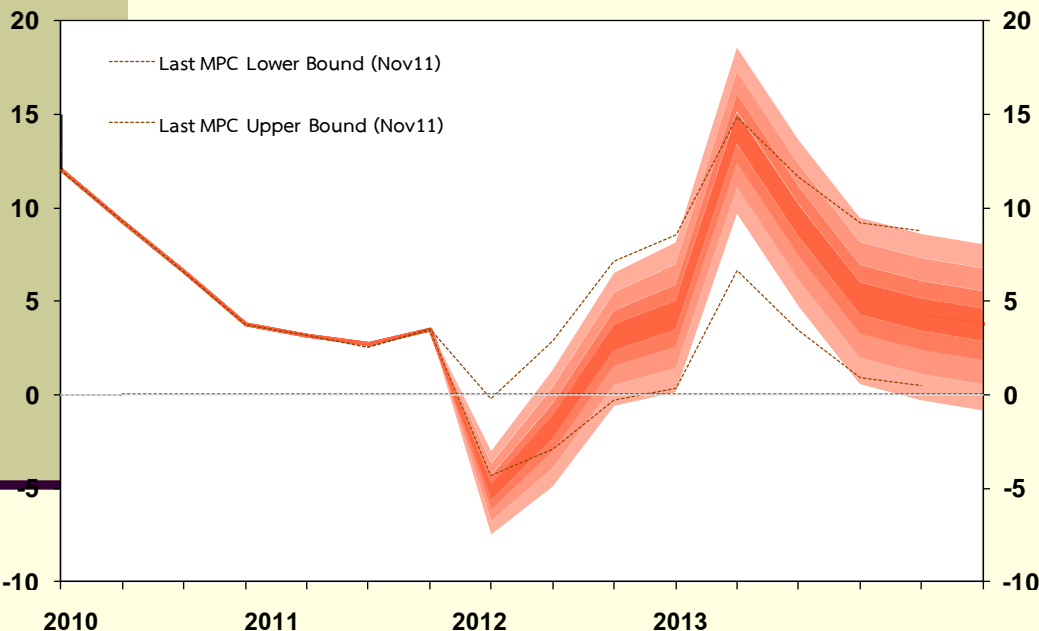
- 400 billion baht budget deficit in the fiscal year 2012
- Water management scheme over 3 years (350 billion baht)
- State enterprises' investment

■ Government consumption
 ■ Public investment
■ Water management

GDP growth forecast

- Under the baseline scenario, the Thai economy is likely to grow at a low rate in 2011 due to the severe impact of the flood. The economy is then projected to rebound in 2012, as domestic demand picks up with reconstruction efforts, before external demand steps up its contribution in 2013.

Annual percentage change (%YoY)



%YoY	2011	2012	2013
GDP Growth	1.0	4.9	5.6

Downside risks to GDP growth outweigh upside ones. Thus, the fan chart is skewed downward throughout the projection period.

Downside risk:

- Slower growth in trading partners' demand

Upside risk:

- Greater-than-expected public spending

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

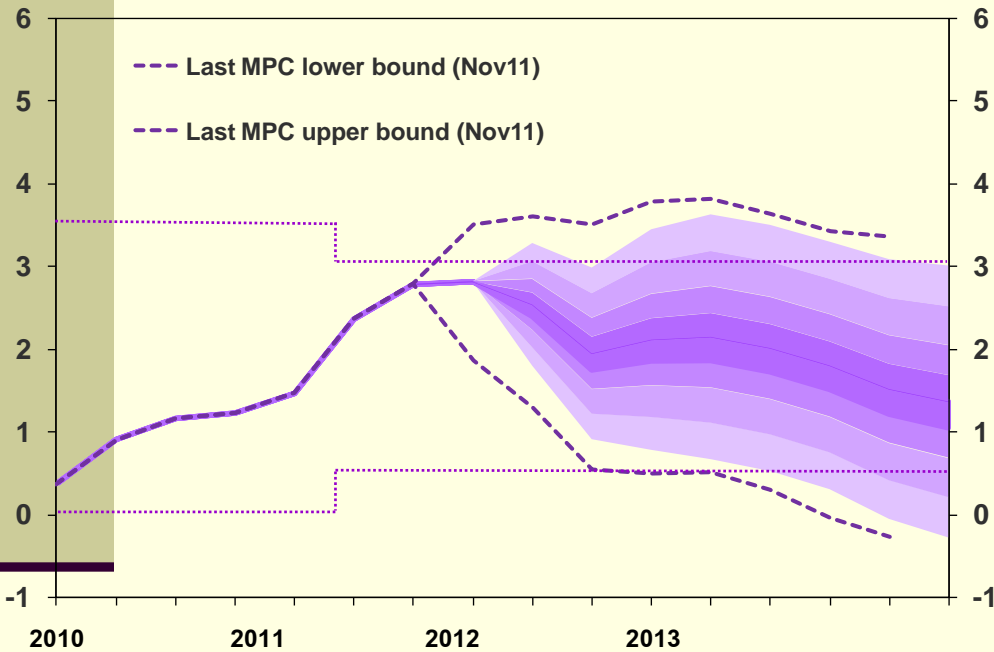
Inflation is likely to subside, gradually trending lower to a more normal level in 2013

- Demand pressure moderates due to the delay in economic recovery
- Production costs decline with the slowdown in commodity prices, in line with global inflation and growth prospects
- Inflation expectations of private sector fall to some extent
- However, inflation forecasts are revised down only slightly, given the impact of government measures such as the increase in minimum wage and civil servants' salary, rice pledging program, and energy-related measures

Core inflation forecast

- Under the baseline scenario, core inflation is likely to subside in 2012 with lower demand pressure due to delayed recovery, and will continue to trend lower to a more normal level in 2013.

Annual percentage change (%YoY)



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

%YoY	2011	2012	2013
Core Inflation	2.4*	2.2	1.7

*Outturns

Downside and upside risks are broadly equal.
Thus, the fan chart is balanced throughout the projection period.

Downside risks:

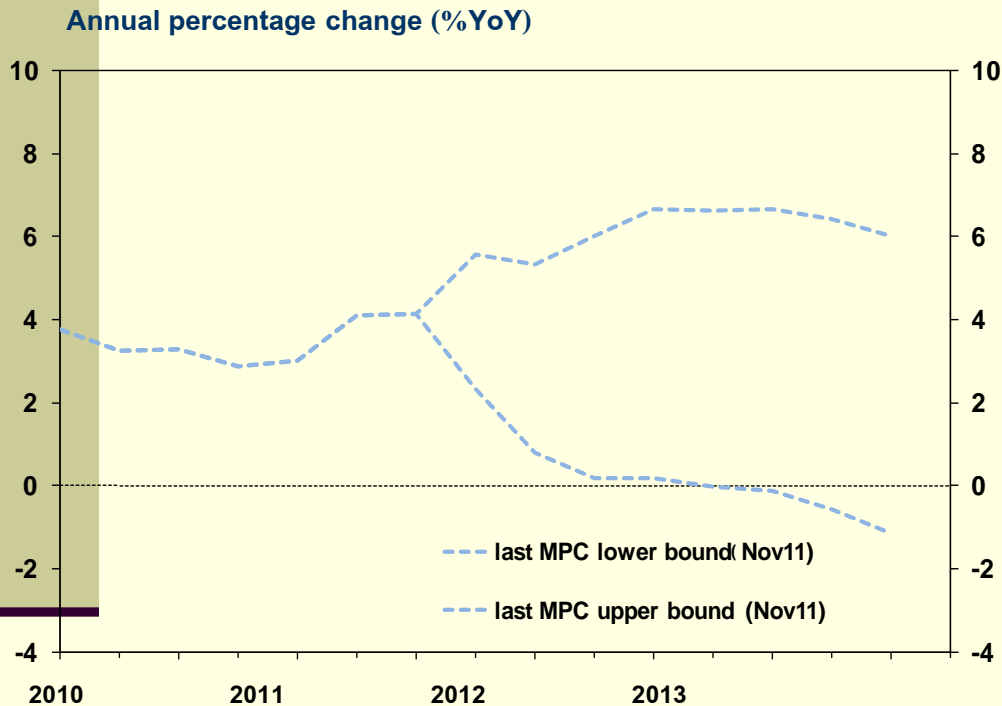
- Softer oil and commodity prices in the world market
- Weak demand pressure in case of slowdown in trading partners' growth

Upside risks:

- Greater pass-through of production costs to consumers during recovery
- Accelerated spending and rising inflation expectations due to government measures

Headline inflation forecast

- Under baseline scenario, headline inflation is likely to subside in 2012 with lower demand pressure and decelerated commodity prices, and will continue to trend lower to a more normal level in 2013.



%YoY	2011	2012	2013
Headline Inflation	3.8*	3.2	2.9

*Outturns

Downside and upside risks are broadly equal. Thus, the fan chart is balanced throughout the projection period.

Downside risk:

- Lower demand pressure if economic growth turns out lower than expected

Upside risks:

- Elevated crude oil price due to the conflict in the Middle East
- Accelerated spending and rising inflation expectations due to government measures

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

Key developments to monitor for monetary policy going forward

■ Externally

- Euro area's ability to come up with solutions for the ongoing debt crisis, in order to avoid a severe recession and limit contagion effects on core countries and the global economy at large

■ Domestically

- Government policies and implementation plans regarding water management, which will help restore confidence and support economic recovery going forward