Bank of Thailand's Monetary Policy: Navigating towards Sustained Growth
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Ladies and gentlemen,

It is my pleasure to be addressing you this morning. I will take this opportunity to speak to you about Thailand's economic outlook and monetary policy at this important time. But before I move on, I would like to first thank the Stock Exchange of Thailand for hosting this event, and all participants for your interest in the Thai economy and the Thai capital market.

This is an important time, not only for the global economy, but also for the Thai economy. After five years of sub-par growth rates, Thailand has managed to restore economic growth to its potential. As the economy moves from a recovery phase towards an expansionary phase, the role of macroeconomic policy needs to evolve accordingly. What used to be a stimulative tool will eventually have to transition into a support on which the economy could grow on a sustainable basis. Furthermore, we need to step up structural reform policy to address long-term challenges.

Ladies and gentlemen,

The turning point of macroeconomic policy stance is not a straightforward one. Imagine yourself on a road trip with a group of friends. You were driving, and one of your friends asked you, "When will we make a turn?" If you have a GPS navigator or open up Google Maps, you might be able to say with precision, "In 2.5 kilometers." When talking about a policy course, the answer might be, "In the next two or three quarters, if things go according to plan."

In real life, we policymakers do not have the luxury of having a GPS navigator, not to mention the fact that this said turn could be moved closer or further away without giving any warnings in this volatile world. What we do have, however, are indicators we observe from our surroundings, and indicators of road conditions and possible storms ahead of us. Similarly, the MPC considers a number of factors when formulating a policy decision—not only the current state of such factors, but also their longer-run trends and expectations of risk scenarios going forward. For a small open economy in an increasingly volatile world, MPC's decisions will have to be data dependent.

In my address to you this morning, I will share with you the factors that the MPC considers when making policy decisions. Since the main objective of a flexible inflation targeting framework is to attain sustainable economic growth while preserving price and financial stability, I am going to take inflation, growth, and financial stability each in turn.

Ladies and gentlemen,

The first factor that the MPC takes into consideration is inflation. Since 2015, the Bank of Thailand has set a medium-term headline inflation target at 2.5 percent with a band of one to four percent. After running below the target for the past three years, inflation is finally back within the target range, albeit around the lower end, with headline inflation this year and the next forecasted at 1.1 and 1.2 percent, respectively. Some of the factors that have contributed to low inflation are transient, including large fluctuations in oil and agricultural prices. Nonetheless, core inflation, which is designed to look past these short-term fluctuations has also been low as well, averaging only 0.7 percent year-to-date.

For policymakers and economists, stubbornly low inflation against the backdrop of the improving economy is quite perplexing. While core inflation is expected to edge up further given a build-up in demand-pull inflationary pressures, many structural changes warrant monitoring as they might contribute to lower levels of inflation than in the past. This is an ongoing area of research by central banks around the world, as low inflation is not Thailand-only problem, but seems to be shared by a number of countries. Many studies—including Bank of Thailand's own—find that there are several factors that would have impacts on long-term inflation dynamic. Aging population which implies more saving, manufacturing automation that drives the cost of production down, and online platforms that take away pricing power of traditional merchants are some of the few issues that have contributed and will continue to contribute to the low inflation in the long run.

For central banks, concerns over inflation deviation from target is not symmetric; we would be more concerned if there is any indication that inflation will cross the *upper* bound of the target range. As long as the economy continues to expand close to its potential, with no indication of deflation expectation, and low inflation can be attributed to structural factors, central banks need to strike an appropriate balance between trying to achieve the midpoint of the target range and other policy objectives. By relaxing monetary policy further or maintaining extremely accommodative monetary policy stance to achieve the inflation target would risk unintended consequences of overstimulating the economy and excessive risk-taking behavior in the financial system.

Having covered inflation, I will now turn to growth. In the first half of 2018, Thailand's GDP grew at 4.8 percent—the strongest two-quarter performance in five years. The solid growth number slightly beat our expectations back in June when we revised our 2018 GDP growth forecast from 4.1 percent to 4.4 percent. This information, along with other developments in the domestic and global economy, will be one of the key inputs for our next forecast round in September.

While these numbers are in themselves impressive, what I think worth even more mentioning are the sources of growth. For the past few years, Thailand's growth was filled with imbalances, creating the so-called "two-speed economy." On the high-speed track, exports of goods and services had been expanding robustly in tandem with improved external demand, consistently contributing over half of the GDP growth. The benefits from these growths, however, were felt mostly by those associated with the export sector—especially large exporters—leaving behind the low-speed domestic demand track. Private investment's gradual growth was also concentrated only within the export sector, while private consumption growth registered well below historical average as strong export growth and pickup in manufacturing did not lead to higher employment and higher household income. Excess production capacity in certain manufacturing sectors and a movement towards automation in manufacturing processes were some of the reasons often cited for this disconnect. In addition, a high level of household debt constrained private consumption growth as households had to use additional income to service their debt obligations rather than spending on goods and services.

More recently, even though the imbalances still exist, we started to observe a change in this trend. We begin to see a more broad-based growth in exports, reaching beyond large exporters. We also begin to see steady growth in private consumption and private investment, making the strong growth performance in the first half of 2018 even more meaningful. Along with the recovery in private consumption and private investment was the pick-up in loan growth, particularly consumer and SME loans. On the labor market front, we see continuous improvement in manufacturing employment, reversing a multi-year decline trend. These are encouraging signs that the benefits from export growth has spilled over to other sectors. As we move into the second half of this year and the next, even more spillovers are expected from various public infrastructure projects that we have heard about earlier this morning.

Certainly, there are risks to this growth outlook, both external and domestic. Recent developments in the trade war between the United States and China, development of the financial conditions in vulnerable emerging market countries, as well as the recovery of tourism in the Southern region after the Phuket boat accident are some of the major risks discussed by the MPC. While monetary policy decisions will need to take these risks into account in supporting the economy towards a more robust growth, solving the two-speed economy requires solutions beyond the scope of monetary policy. Structural challenges that caused this two-speed economy require more precision tools like fiscal programs that could accurately target the specific sectors in need of support. Promoting education and skills reform could help address the change in labor market landscape mentioned earlier. As another example, creating an environment that stimulates innovation will be the key for boosting productivity and lifting Thailand onto a higher long-term growth path.

The third factor that the MPC considers when deliberating its policy is financial stability. The prolonged period of global low interest rate environment leads to another potential concern: search-for-yield that leads to underpricing of risks. It should be noted that search-for-yield is not uncommon and is all well and good if investors are well-informed and manage their risks accordingly. However, we cannot deny that some investors are underpricing the associated risks. Debt accumulation among households;

large expansion of foreign investment funds with high concentration in some emerging economies; saving cooperatives' growing asset base; maturity mismatch of corporate borrowers; and rapid growth of unrated bonds are some examples of the issues the Bank of Thailand has been monitoring over the years. More recently, we also notice an upward trend in mortgage loans to homebuyers who search for rental yield, driven partly by high LTV ratio for mortgage loans offered by fierce competition in the financial sector. Furthermore, mortgage NPLs, especially among second and third home buyers, have continued to rise. On the regulatory side, the Bank of Thailand continues to monitor warning signs of financial stability risks and address them accordingly. For example, last year, we tightened credit card regulations as well as uncollateralized personal loan limits to mitigate household debt problems. It is also our view that collaborations between various regulatory bodies and market participants are increasingly important for effective risk monitoring and assessment, together with appropriate measures to manage risks that might arise in the future.

With regards to the extent to which financial stability conditions should be incorporated into monetary policy decision, one prominent view is that financial stability should be addressed mainly by macroprudential tools, and that, if effectively deployed, macroprudential tools can free up monetary policy to focus on price and output stabilization objectives. While this might hold true in some advanced economies, operationalizing macroprudential tools in practice—especially in emerging markets—has proved challenging. Limited experiences and complex interactions among various policy tools make calibrating macroprudential measures extremely difficult, not to mention the risk that these tools might inadvertently push some activities outside of the regulatory umbrella into shadow banking. My view, therefore, is that macroprudential tools are complements, rather than substitutes, for the broader monetary policy stance.

Ladies and gentlemen,

The three factors I have mentioned—inflationary pressure, growth, and financial stability—are factors that the MPC consistently looks at when deliberating monetary policy's transition under the flexible inflation targeting framework. But before I make my concluding remarks, I would like to mention that when we are confident that economic growth is close to its potential and inflation will remain within our target range, the MPC can take a longer view. And this is when policy space should be taken into consideration.

Two considerations are at play. First, history has taught us that a period of prolonged economic expansion comes with asset price bubbles and market correction and recession. A gradual, anticipated, movement in the policy rate reduces the risk and the size of such outcome. Second, through the most recent economic downturn, our policy rate has been lowered to 1.5 percent, a quarter percentage point above the historic low level of 1.25 percent implemented in 2009 immediately after the peak of the Global Financial Crisis. This was done with the aim to stimulate economic recovery. We now have limited "monetary policy space" to act should unexpected adverse economic conditions emerge. In very much the same way that our foreign reserve build-up in times of capital inflow allows us room to conduct a diverging monetary policy and smooth out sudden capital outflows as we have seen these past months, building up some policy space for the future should be a prudent consideration.

Ladies and gentlemen,

With the ample external buffers we have built up, Thailand so far has the autonomy to deliberate our own monetary policy. I have outlined for you the main factors that the MPC considers: inflation, growth, and financial stability. We expect this year's headline inflation to be in the target range, albeit around the lower end. In the longer run, however, structural changes and their effects on inflation dynamics will need to be taken into consideration when deciding an appropriate monetary policy framework. Concerns over the economic recovery have lessened over the last few quarters as the economy has made a clearer recovery with a more balanced growth. Nonetheless, certain risks to the growth outlook remains, and monetary policy still plays a role in supporting a more robust growth in domestic demand. In this light, most MPC members in the last meeting viewed that current growth momentum still warranted monitoring and monetary policy should continue to be accommodative for some time. However, we are mindful that ultra accommodative monetary policy stance could lead to unintended consequences. The prolonged period of very low interest rates has a side effect that it could undermine long-term financial stability. Therefore, we have been monitoring developments of search-for-yield and underpricing of risk behaviors in various sectors. Let me emphasize once again that MPC's decisions are data dependent. Economic and financial developments, their trends, and risk factors have been and will continue to be weighted carefully by the MPC. I am certain we will be able to navigate the Thai economy towards sustained growth in this increasingly volatile global landscape.

Thank you very much for your attention.