Development of the Monetary Policy Framework in Thailand

The Bank of Thailand Act, B.E. 2485 (1942) was enacted in 1942 during the Second World War. The BOT Act specified a mandate for the Bank of Thailand to conduct the business of central banking, with various functions as specified by the Royal Decree Regulating the Affairs of the Bank of Thailand added subsequently. The Act did not make any clear statement about monetary policy but it gave power to the Court of Directors to set the Bank Rate which was the interest rate under the Bank's lender-of-last-resort facility. It also empowered the Bank to buy and sell debt instruments and foreign exchange and to extend credits to financial institutions against eligible collateral. These transactions would not be carried out with a view for profit. Therefore, although monetary policy objectives were not explicitly stipulated in the Bank of Thailand Act, in practice the Bank has always regarded the maintenance of monetary and financial stability as its primary goal, both of which are necessary in achieving sustainable economic growth over the long run.

The development of the monetary policy framework in Thailand can be divided into 3 periods.

1. Pegged exchange rate regime (Second World War - June 1997): This regime was first adopted after the Second World War. The value of the baht was initially either pegged to gold, a major currency, or to a basket of currencies. The basket regime was adopted from November 1984 until June 1997. During this period, the Exchange Equalization Fund (EEF) would announce and defend the value of the baht against the U.S. dollar daily. Given the environment at the time, a fixed exchange rate was deemed to be the best monetary policy regime which would support long term economic growth.

2. Monetary targeting regime (July 1997 - May 2000): After the adoption of the floating exchange rate system on 2 July 1997, Thailand received financial assistance from the International Monetary Fund (IMF). While the IMF program, a monetary targeting regime was adopted. Under this regime, the Bank targeted domestic money supply using the financial programming approach in order to ensure macroeconomic consistency as well as to reach the ultimate objectives of sustainable growth and price stability. The Bank would set the daily and quarterly monetary base targets, on which its daily liquidity management was based. Daily liquidity management was essentially aimed to ensure against excessive volatility in interest rates and liquidity in the financial system.

3. Flexible inflation targeting regime (23 May 2000- present): After the IMF program, the Bank made an extensive reappraisal of both the domestic and the external environment and concluded that the targeting of money supply would be less effective than the targeting of inflation. The main cause for change was that the relationship between money supply and output growth became less stable over time, particularly since the financial crisis.

With the exit from the IMF program, it became necessary for authorities to identify a new policy anchor which would be appropriate for Thailand. The Bank of Thailand announced the adoption of flexible inflation targeting in May 2000, with a main objective of maintaining price stability. Given the institutional reforms required for an flexible inflation targeting framework to operate successfully, it was envisaged that flexible inflation targeting would help rebuild confidence and credibility of the central bank and monetary, going forward.

Under the flexible inflation targeting framework the Monetary Policy Board (MPB) was first appointed on 5 April 2000 and vested with the power to decide monetary policy by the Governor. The MPB, with 9 members, comprised distinguished external experts

and the top management of the Bank. The MPB had the authority to set the direction of monetary policy with price stability as the overriding objective, and also to refine the flexible inflation targeting framework to suit the Thai economy. At present, however, the

Monetary Policy Council, comprising 7 members - 3 from the Bank of Thailand and 4 external members - is responsible for deciding on the direction of monetary policy.

The new Bank of Thailand Act, B.E. 2551 (2008) was enacted on 3 March 2008. The new BOT Act clearly states the Bank of Thailand's objectives and responsibilities as the nation's central bank, in maintaining monetary stability, stability of the financial system, and stability of the payments system.

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