

## 6. Conclusion

The Thai economy contracted in 2011 Q2 from the preceding quarter mainly due to a slowdown in exports. The drag in exports owed largely to the automobile industry, which was gravely affected by supply disruption following natural disasters in Japan. Nonetheless, other merchandise exports and the tourism sector continued to expand. Private-sector investment and consumption moderated, partly owing to lower spending on durable goods, notably automobiles. Public investment also dropped in line with actual disbursement of both central and local governments.

Looking ahead, the MPC projects economic growth to resume in 2011 Q3 thanks to strong exports, tourism, and private investment. Government consumption and investment are also likely to play a crucial role in supporting domestic growth, in tandem with budget disbursement that picked up late in the fiscal year. However, the MPC revises down its annual growth forecast for 2011 due to the widespread floods, which is likely to affect agricultural and manufacturing production significantly in 2011 Q4 before subsiding next year once recovery is underway. Heightened global risks, particularly due to the euro area's sovereign debt concern, will also continue to weigh on Thailand's growth outlook. The delay in progresses made so far toward resolution of the debt crisis, and its ramifications on the banking sector and the real economy of core countries such as France, Italy, and Spain are likely to result in further fiscal consolidation in these

countries and hamper the ongoing recovery in the U.S. and Japan. Meanwhile, the MPC expects inflation pressures to remain elevated in 2011 in line with high input costs and inflation expectations, as well as the likely pick-up in fresh food prices due to the floods.

With regard to recent monetary policy decisions, the MPC judged on August 24, 2011 that Thailand's growth momentum remained strong in spite of heightened risks to growth, particularly those coming from the external front. On the other hand, domestic price pressures persisted and would result in rising inflation expectations and higher upside risks to inflation going forward. The MPC, therefore, decided with a 5-2 vote to raise the policy interest rate by 0.25 percent from 3.25 to 3.50 percent, with two votes in favor of keeping the policy rate unchanged. In its subsequent meeting on October 19, 2011, the MPC viewed that the global economic outlook had deteriorated markedly as a result of the euro area's sovereign debt problem and the fragile recovery in the U.S. Despite Thailand's continued growth this period, the MPC noted recent signs of a slowdown in exports, and also the fact that the impact of the floods on the broader economy was still evolving. Meanwhile, inflation pressures remained high due to continued expansion of domestic demand, while inflation expectations started to stabilize. Overall, the MPC deemed the current level of policy rate to be appropriate in addressing upcoming inflation pressures and supporting economic adjustments amid heightened risks from the global economy. The MPC thus voted 6 to 1 to hold the policy rate unchanged at 3.50 percent, with one vote in favor of a 0.25 percent decrease.

## *Business Liason Report*

*As of September 30, 2011*

### **Overall summary**

Overall business activity expanded from the previous quarter following favorable domestic and foreign demand according to the Economic/Business Information Exchange Program between the Bank of Thailand and 316 firms nationwide in 2011 Q3<sup>1/</sup>. Exports of goods and services continued to expand. In particular, vehicle production grew significantly to fulfill the backlog of orders incurred during the supply chain disruption. Domestic consumption and investment remained strong. Looking ahead, industrial production and exports are expected to be affected by the widespread floods but the impact would be temporary. Meanwhile, the downside risk on export growth from the slowdown in the U.S. and the euro area economies increased. Labor shortages and difficulty in price adjustments also remained constraints to businesses.

- **Consumption** remained favorable although consumption in flooded areas from the end of the quarter onward was adversely affected. Factors underlying the consumption growth momentum remained strong. For example, farm income remained high while wages and work hours in the manufacturing sector increased. In addition, financial support from bank and non-bank financial institutions, sale promotion schemes and the government's stimulus package helped maintained the growth momentum for consumption to smooth over the temporary slowdown due to the floods.
- **Real estate** activity slowed down from the previous quarter as developers and home buyers adopted a wait-and-see attitude pending the government's real estate stimulus measure. As a result, the number of newly launched housing projects declined. Most newly launched projects were townhouses. Going forward, developers expect to increase house prices during the rest of this year and next year due to higher costs of land, rising prices of raw material, and wage hikes.
- **Tourism** activity expanded continuously in every region of the country. Asian tourists, especially those from China, India, and ASEAN, increased notably. In contrast, tourists from the U.S. and Europe declined due to economic slowdown in their respective regions. Domestic tourism expanded owing to the expansion of the Meeting, Incentive, Convention, and Exhibition (MICE) activities and promotion schemes. However, accommodation prices were not adjusted upward due to high competition.
- **Production and exports** increased on the back of favorable domestic and foreign demand. Order books from Asian countries such as China, ASEAN, and the Middle East remained healthy. Order books from Japan also increased following its economic recovery. In contrast, order books from the U.S. and Europe declined due to higher downside risk to economic growth. Vehicle production expanded significantly in order to meet the backlog of orders incurred during the supply chain disruption following the Japan crisis. Consequently, tire and auto-parts industries expanded. The hard disk drive industry expanded this quarter as final demand from China increased. Electrical appliances, particularly televisions and air-conditioners, expanded well in line with domestic and external demand for new models. However, going forward, production and exports are expected to decline temporarily due to the widespread floods.

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<sup>1/</sup> Including responses from the Business Sentiment Survey (about 700 business firms per month).

- **Investment** expanded from the previous quarter. Businesses invested in order to replace obsolete machinery, expand production capacity, and substitute for labor. Given tightening capacity utilization, the vehicle and parts industry ramped up its investment in order to expand production capacity and upgrade technology to accommodate production of new car models. Regarding the wholesale and retail sectors, investment plans for new warehouses and branches were undertaken. In addition, hotels renovated their conference and functional rooms in order to attract more MICE customers. Going forward, businesses anticipated that both public and private investment would expand following increased investment demand for machinery, plants, and the restoration of buildings damaged by the floods as well as government investment in mega-projects.
- **Employment** remained strong in line with economic expansion. In this quarter, workers migrated from the non-agricultural sector into the agricultural sector due to the growing season. As a result, businesses experienced labor shortages. In anticipation of the 300 baht minimum income policy and higher production costs, firms adjusted themselves by increasing labor productivity, outsourcing some parts of production process, basing remuneration on output, substituting machinery for labor, and converting benefits into wages. In addition, some businesses (e.g. garment, processed food, handicraft, electrical appliance) considered other options such as relocating production to neighbor countries and downsizing.
- **Production costs.** Domestic oil price decreased in this quarter due to the cessation of the oil fund contribution fee. However, raw material prices and overall production costs, especially for agricultural products (e.g. sugar, rubber, rice, pork), remained high. Thus, businesses, particularly food businesses, steadily raised their prices. Nevertheless, price adjustment proved difficult because of intense competition and price controls. As a result, the increase in consumer prices has not compensated for the rise in production costs.
- **Corporate and household credit** continued to grow. As for corporate credit, loans for fixed investment and working capital grew well for both large corporates and SMEs, especially in the manufacturing and trading sectors. Household loans also expanded in line with consumption. Auto loans accelerated after delivery of vehicles returned to normal. Moreover, high farm income continued to support demand for vehicles.
- **Business constraints and risks.** Businesses continued to be constrained by labor shortages and difficulties in price adjustment amid rising production costs. Going forward, businesses expressed greater concerns over how the Thai economy would fare given the slowdown of the U.S. and euro area economies as well as the supply shortage due to the floods.