

## 1. Overview

The global economy continued to recover in 2009 Q4. The recovery was especially robust in the Asian economies, supported by strong expansion in production, consumption, exports, as well as a pickup in asset prices. There have been more capital inflows into the region as a result. The industrialized economies also continued to see gradual recovery, with accumulative effects from monetary and fiscal policies lending support to private consumption and investment particularly during the second half of the year. Nonetheless, the recovery of major industrialized economies remains fragile. Elevated unemployment rates continue to pressure both the US and the euro area, while problems in the banking sector are yet unresolved and are constraining the commercial banks' ability to extend credits. In addition, recent events in Dubai, Vietnam, Greece, and Venezuela have raised the volatility in the global financial market.

Over the past three months, the Monetary Policy Committee (MPC) views that

1. The Thai economy has shown a continuous sign of recovery, expanding by 1.3 per cent in 2009 Q3 over the previous quarter. The pace of expansion is somewhat slower than in the second quarter, in which the economy grew quarter-on-quarter by 2.2 per cent partly owing to a one-time upward adjustment in restocking production. The recovery during the third quarter was aided by (1) an exports growth of 5.2 per cent from the previous quarter, the first expansion in 2009, which spurred growth in the export-reliant

Change from the previous period (Per cent)	2008	2008		2009		
		Q3	Q4	Q1	Q2	Q3
<b>Domestic demand <sup>1/</sup></b>	2.5	0.6	-0.1	-4.9	1.6	1.2
Private consumption	2.7	0.5	0.0	-2.8	0.6	1.0
Private investment	3.2	0.0	-4.9	-12.9	1.6	3.7
Public expenditure	1.0	1.9	5.1	-3.6	4.9	-0.3
<b>Net exports of goods and services</b>	-6.5	-20.3	-32.2	122.5	-25.3	8.8
Exports of goods and services	5.1	-3.1	-10.6	-6.4	-3.5	5.2
Imports of goods and services	8.5	1.3	-4.7	-28.2	8.0	2.0
<b>Gross domestic product</b>	2.5	-0.6	-4.8	-1.5	2.2	1.3

Note: <sup>1/</sup>Domestic demand excludes changes in stocks

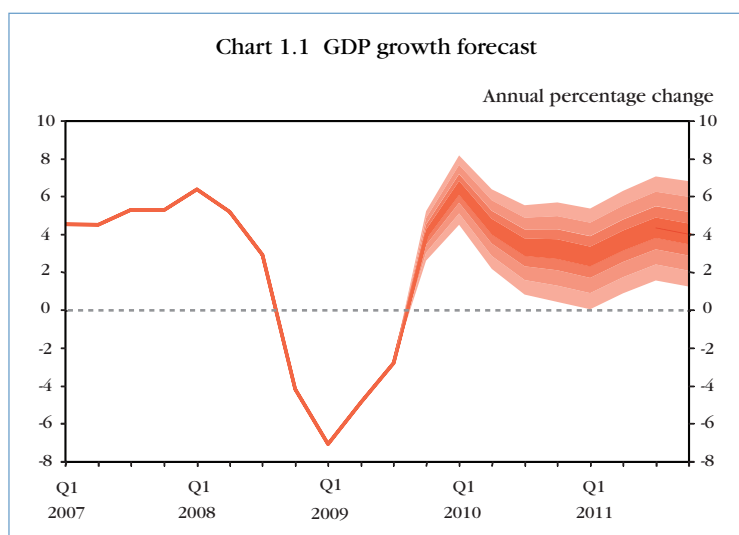
Source: National Economic and Social Development Board

industries such as electronics and hard disk drives and tourism, (2) an increase in the disbursement rate of government spending by 21.1 per cent compared to the same quarter in the previous year, encompassing both the regular budget and investment projects such as road building and water supply provision in the rural areas, and (3) an expansion of private consumption by 1.0 per cent compared to 0.6 per cent in the previous quarter, especially in the durable goods category whose strong rebound was in line with improving consumer confidence.

The data over the first two months of 2009 Q4 reaffirm the continuity of the Thai economy's ongoing recovery. This pickup in activity, beginning in 2009 Q2, was initially concentrated within the export-reliant sectors such as electronics, hard disk drives, and electrical appliances, but has now spanned the domestically driven sectors such as automobiles, beverages, and petrochemical industry. Additionally, tourism and agricultural incomes have risen, while unemployment

rate has fallen to a more normal level of 1.1 per cent in October. The evidently more broad-based economic expansion has been accompanied by upswings in manufacturing production, capacity utilization, exports, and private consumption. The improvement in private investment, while more gradual, was steady.

2. In the period ahead, the MPC continues to view the following factors as major downside risks to growth: (1) the possibility of a delay in the global economic recovery, as the stimulus effects from fiscal policies fade in industrialized economies, while private spending is constrained by high unemployment rates and limited availability of credits, (2) a slower disbursement rate of government expenditure, which could potentially disrupt the momentum of economic recovery, and (3) the prolonged delay in the resolution of the suspension of investment projects in the Map Ta Phut area, Rayong, with direct consequences in terms of production and investment foregone within the area as well as broader



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

repercussions on business confidence, employment, related industries, and ultimately financial institutions through higher non-performing loans.

After assessing the outlook for global economic recovery together with the risks surrounding the outlook, the MPC expects the expansion of the Thai economy to continue in the period ahead. The contraction for the entire 2009 will be slightly smaller than estimated in the previous *Inflation Report*, whereas for 2010 and 2011, the MPC expects robust expansion in public consumption, private consumption, and exports. Private investment is projected to be more subdued than otherwise in 2010 due to the problem in Map Ta Phut, but should be firmer in 2011. Overall, the MPC has projected growth over the next eight quarters to be 3.3-5.3 per cent for 2010 and 2.8-4.8 per cent for 2011. The risks remain skewed to the downside throughout the forecast horizon.

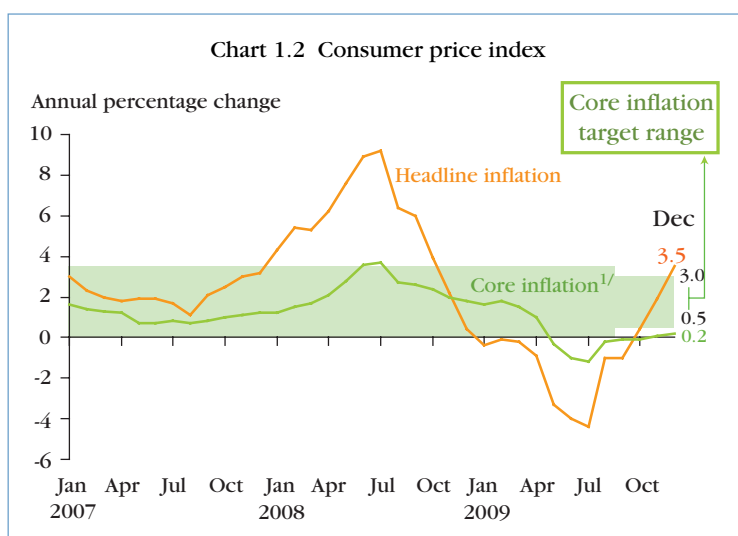
3. In the second half of 2009, the overall economic and financial stability improved in line with firmer global and domestic demand recovery. Corporate and household earnings as well as loans quality have strengthened, with corporate profitability and ability to service debts rising toward the pre-crisis levels. Notably, credits have begun to climb in November, possibly marking the end of commercial banks' deleveraging process. The latest incoming information reveals that (1) private credits extended by commercial banks began to rise in November, after dropping continuously since early 2009, (2) the outstanding household credits in all categories have risen above the pre-crisis levels, and (3) senior loan officers reported in the 2009 Q4 survey that on average they

expected both the demand and supply of credits to pick up in 2010 Q1 for both corporate and household sectors.

4. International financial markets remained frail as reflected by the debt repayment delay by Dubai World and the sovereign credit downgrades in a number of European countries. While contagion risks to the domestic financial system are remote, the indirect impacts via the sustainability of the global economic recovery looking ahead can be more material, and will be closely monitored by the MPC.

### *Inflation outlook and monetary policy*

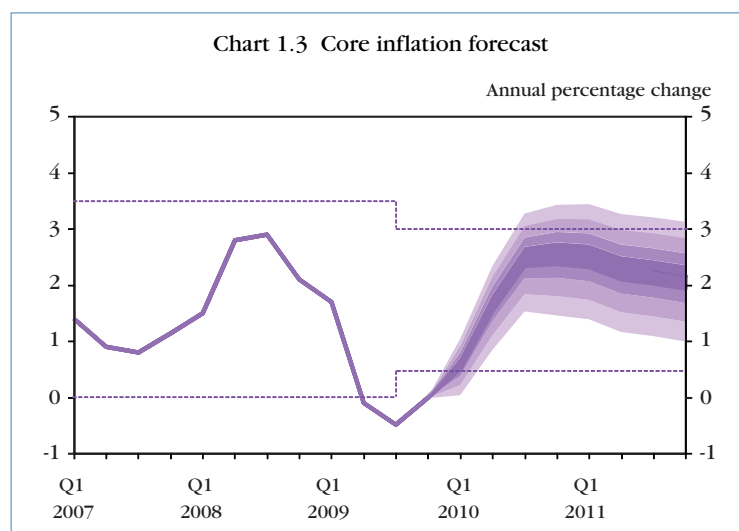
Inflation in 2009 Q4 was in line with what the MPC had anticipated, with headline inflation registering at 1.9 per cent, after being negative since 2009 Q1. The energy-related items were the major contributing factor, rising by 20.1 per cent compared to a contraction of 13.2 per cent in the previous quarter due to a low base of domestic retail oil price during the last quarter of 2008.




Note: <sup>1/</sup>Consumer price index excluding raw food and energy items  
 Source: Trade and Economic Index Bureau, Ministry of Commerce

The demand pressure on inflation remains subdued however, with core inflation rising marginally above the negative territory to register at 0.1 per cent in 2009 Q4. Excluding the artificial effects from the government subsidy measures, core inflation would have been higher and close to the lower end of the inflation target range of 0.5-3.0 per cent.

In terms of outlook, the MPC views that headline and core inflation in 2010 are likely to be lower than previously projected, owing to (1) the extension of government subsidy measures toward the end of March 2010, (2) a downward revision of agricultural prices for 2010, and (3) a continuation of energy price control measures by the Ministry of Energy until August 2010. In 2011, headline and core inflation are expected to increase slightly from lower bases in the previous year, due to stronger demand pressure and a continued pickup in oil and agricultural prices. Accordingly the MPC has revised the projection for inflation slightly. Headline



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



inflation is expected to be within 3.0-5.0 per cent in 2010 and 2.0-4.0 per cent in 2011. Core inflation is projected to be within 1.3-2.3 per cent in 2010 and 1.8-2.8 per cent in 2011.

Core inflation, the MPC's policy target, should return to the target range from 2010 Q1 onwards, and is expected to rise throughout 2010 before moderating subsequently.

After a complete assessment of the outlook for growth and inflation over the next eight quarters, taking into account the prospects for global and Thai economic recovery as well as the extent of fiscal impetus, the MPC decided to leave policy interest rate unchanged at 1.25 per cent per annum on 2 December 2009 and 13 January 2010. The MPC deems the current stance of monetary policy to be conducive to an ongoing economic recovery, and should aid private spending to build sufficient momentum to serve as the main engine for growth, especially as the impetus from fiscal policy wanes in the period ahead.

## *Inflation target for 2010*

On 22 December 2009, the Cabinet approved the 2010 inflation target as quarterly average core inflation within the range of 0.5-3.0 per cent per annum, the same as in 2009. This target was jointly proposed by the Minister of Finance and the MPC in accordance with the Bank of Thailand Act, as amended by the Bank of Thailand Act (No.4) B.E. 2551, which stipulates that the MPC works together with the Minister of Finance to determine the inflation target for the following year and propose the mutually agreed target to the Cabinet for approval by the end of the year.

Accordingly, the MPC reassesses the suitability of the inflation target<sup>1/</sup> for the Thai economy each year. The proposal for maintaining the same target as in 2009 is based on the following considerations.

1) The main objective of most central banks, including the BOT, is to maintain long-term price stability, i.e., to ensure low and stable inflation. Price stability helps promote an economic environment conducive to private sector consumption and investment decisions, which in turn support sustainable economic growth.

2) In general, the inflation target should not be adjusted frequently. Because each announced target is important to the anchoring of the public's inflation expectations over the medium to long term, the continuity of the inflation target enhances the effectiveness of the anchoring of the public's inflation expectations which in turn aids the maintenance of price stability.

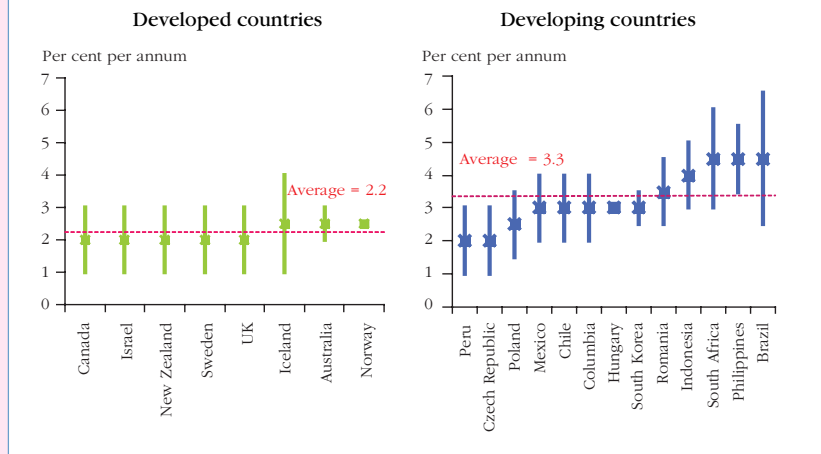
For this reason, most inflation-targeting countries, including the UK, Canada, and Australia do not adjust their inflation targets frequently. Only a few countries that experienced high inflation at the beginning of the adoption of the inflation targeting framework, such as Indonesia and the Philippines, adjusted their targets downward each year in order to bring the rate of inflation down to the appropriate level for the economy.

3) Reasons for continuing to use core inflation as the policy target are as follows. First, core inflation reflects demand-side pressure well which is consistent with the objective of monetary policy which aims at taking care of demand-side pressure. Second, core inflation still reflects inflation trend in the long run as reflected by the fact that the average core inflation rate over the long run is close to that of headline inflation. Finally, because core inflation has been used as a policy target since the adoption of the inflation targeting regime, it is now well understood by and familiar to the public. This facilitates policy

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<sup>1/</sup> For further details, see "Setting an appropriate inflation target." box article in the January 2009 *Inflation Report*.

**Chart 1 Inflation target adopted by of other inflation targeting countries for 2010 other than Thailand**



Source: Bank of Thailand

communication and enhances the effectiveness in guiding the public's inflation expectations.

4) Range targeting, as used in the present, provides flexibility for the conduct of monetary policy. By allowing room for core inflation to move within the target range, it gives leeway for monetary policy to take care of other stability objectives, including the ongoing recovery of the Thai economy in 2010.

5) The proposed inflation target range is designed to help maintain price competitiveness of Thai exports as it is in line with trading partner inflation:

- Inflation targeting countries. The average inflation target adopted by developed countries for 2010 is 2.2 per cent while that of developing countries is 3.3 per cent (Chart 1).

- Non-inflation targeting countries. A number of Thailand's important trading partners also have price stability as their monetary policy objective even though they do not practice inflation targeting. From 2000 to November 2009, the inflation rates in these countries<sup>2/</sup> averaged at 2.3 per cent.

In sum, given the rationales above, the use of quarterly average core inflation within the range of 0.5-3.0 per cent per annum as the target for 2010 will work to support the ongoing economic recovery in the short run and will be conducive to stable and sustained economic growth in the long run.

<sup>2/</sup> The countries in this group are the US, Japan, China, Hong Kong, Taiwan, Singapore, Malaysia, Vietnam, Denmark, and India.