



1. Overview

In 2010 Q2, the global economy continued to expand from the previous quarter. Asian economies, in particular, expanded robustly compared with economies in other regions, while industrialized countries such as the US and Japan only recovered gradually given a drag from elevated unemployment and contracting credits. Meanwhile, the sovereign debt crisis and concerns over the health of financial institutions in some European economies, especially those known as PIIGS, posed risks to the global economy and financial markets despite several concrete efforts to contain potential spillovers.

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

1. The recovery of the Thai economy appeared well maintained. In 2010 Q1, output expanded by 3.8 per cent quarter-on-quarter, driven by exports of goods and services that benefited from the global economic recovery. In addition, private investment, which had so far recovered sluggishly, started to expand more briskly as firms increased their production capacity in preparation for growing demand. Meanwhile, private consumption grew moderately, supported by a pick-up in hiring and an increase in farm income.

The pace of expansion slowed down somewhat in 2010 Q2, however, owing to (1) the adverse impact of the domestic political unrest on tourism and business sentiment and (2) the moderation in industrial production after having expanded strongly in the previous period. Yet, a rebound of the global recovery, together with several positive domestic factors such as rising farm

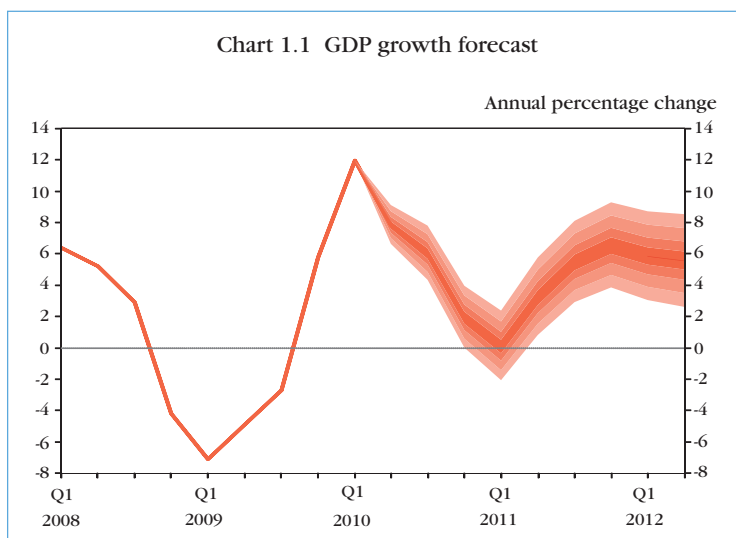
income, credit expansion and timely disbursement of public sector expenditure, remained supportive of the recovery of the Thai economy in this quarter and beyond.

Change from the previous period (Per cent)	2009	2009				2010
		Q1	Q2	Q3	Q4	Q1
Domestic demand ^{1/}	-2.4	-4.7	1.6	1.3	2.6	1.0
Private consumption	-1.1	-2.7	0.7	0.9	2.8	0.2
Private investment	-12.8	-12.9	1.9	4.5	2.8	6.1
Public expenditure	4.7	-2.6	4.7	-0.1	2.0	-1.1
Net exports of goods and services	23.4	103.7	-19.8	5.4	-1.9	7.2
Exports of goods and services	-12.7	-5.3	-3.7	5.9	7.6	6.0
Imports of goods and services	-21.8	-26.1	7.0	4.3	11.7	6.1
Gross domestic product	-2.2	-1.6	2.4	1.4	4.0	3.8


Note: ^{1/}Domestic demand excluding changes in stocks
Source: National Economic and Social Development Board

2. Looking ahead, the MPC deemed that a crucial downside risk to the Thai economy could come from the still-fragile recovery of major trading partners. High unemployment and contracting credits worked to restrain economic growth in G-3 countries. Furthermore, the sovereign debt problem in Europe and doubts over the health of European financial institutions—in particular, adequacy of bank capital—had the potential to disrupt economic activities in the region. Such adverse developments could affect Thai exports and have further repercussions on consumption and investment. In addition to the external risks, major risks on the domestic front included (1) the political tensions which, though eased to some degree, had yet to be fully resolved and (2) a prolonged and inconclusive resolution to the Map Ta Phut conflict. Overall, with the political uncertainty beginning to unravel, the MPC judged the upside and downside risks to economic growth roughly balanced.

After assessing the outlook for the global and domestic recovery in conjunction with the surrounding risks, the MPC anticipated that, given the robust economic expansion in the first half of 2010, this year the Thai economy would grow at a pace stronger than projected in the previous *Inflation Report*. Nevertheless, the average quarter-on-quarter growth momentum in the second half of the year would be somewhat more subdued than the first half which saw production and consumption accelerating strongly. For 2011, the MPC expected the Thai economy to continue to grow, on the back of robust economic fundamentals, at a rate close to the previous projection. In sum, output growth for 2010 and 2011 was expected to be in the range of 6.5-7.5 per cent and 3.0-5.0 per cent, respectively.



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

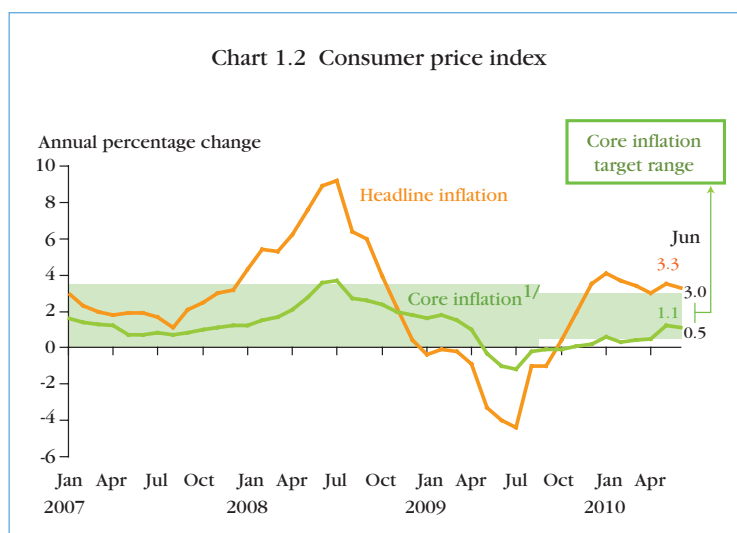


3. Overall macroeconomic and financial stability remained sound despite the domestic political problem in the first two months of 2010 Q2. This was confirmed by a continued improvement of corporate profits and household earnings, thanks to the rapid growth in exports and the ongoing labor market recovery. At the same time, financial institutions as a whole were healthy. Going forward, the MPC anticipated that the strength of the economic recovery, together with volatility in international financial markets possibly arising from concerns over the public debt problem in Europe, would have a significant implication on overall economic and financial stability. In addition, although there is currently no sign of macroeconomic imbalances induced by persistently low interest rates, the MPC deemed it necessary to closely monitor potential risks that might arise, particularly as the economy grows robustly.

Inflation outlook and monetary policy

Headline inflation slowed down to 3.3 per cent in 2010 Q2 from 3.8 per cent in the previous quarter, owing mainly to the moderation in domestic retail oil prices. Meanwhile, core inflation accelerated to 0.9 per cent from 0.4 per cent, returning to the target range of 0.5-3.0 percent. This development was indeed in line with the MPC's projection that core inflation would edge up because of two factors. First, the negative contribution to inflation from the government's tuition subsidy for pre-university students vanished in this quarter after the policy had been implemented for one year. Second, subsidy on water fees ended in April 2010.

The MPC expected price pressure to stay subdued in the short term as domestic firms were likely to delay price hikes given existing fragility in the global economic recovery, as a consequence of Europe's sovereign debt problem, and lingering domestic concerns. Nonetheless, price pressure was expected to gradually increase in subsequent periods from both higher costs of production and rising demand. The expected buildup in pressure was attributable to an upward trend of commodity prices in tandem with the global economic expansion, and also to a pick-up in domestic demand after political tensions had eased.

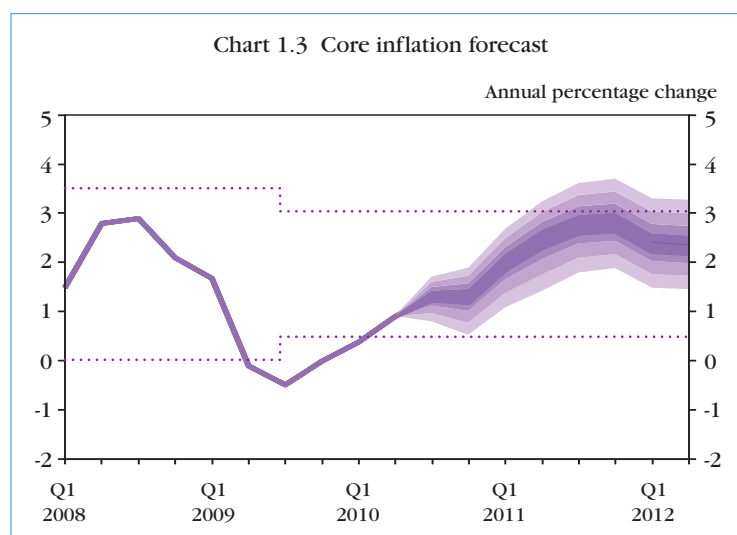


Note: ^{1/}Consumer price index excluding raw food and energy items
 Source: Trade and Economic Index Bureau, Ministry of Commerce


In accordance with the above view, the MPC projected both core and headline inflation for 2010 to be slightly lower than the previous estimates. For 2011, inflation projection was higher than previously estimated due to rising demand pressure as the recovery would move onto firmer ground, leading to a gradual narrowing of the output gap. At that juncture, it is likely that

producers would pass the rising costs of production onto consumers. Moreover, with the negative contribution to inflation from the government's cost-of-living subsidies disappearing next year, readings on inflation would edge up in 2011.

Major upside risks to inflation were seen to come from (1) higher-than-expected oil prices, potentially driven by a Gulf of Mexico hurricane and the Iran nuclear controversy, and (2) higher domestic farm prices caused by drought conditions. Meanwhile, key downside risks included (1) the global economic recovery that might lose steam owing to elevated unemployment in G-3 economies and the public debt crisis in some European countries, and (2) the possibility that the government would extend part of its subsidy measures. Consequently, the MPC projected headline inflation to be within the range of 2.5-3.8 per cent in 2010 and 2.5-4.5 per cent in 2011. Core inflation was projected to be within the range of 0.5-1.3 per cent in 2010 and 2.0-3.0 per cent in 2011.



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



With regard to recent monetary policy actions, at the 2 June 2010 meeting, the MPC judged that downside risks to growth had diminished, thereby lessening the need for exceptionally accommodative monetary policy. Nonetheless, there were still uncertainties surrounding the global economy, while the impact of domestic factors, particularly the political unrest, was still uncertain, causing consumer and investor confidence to remain fragile. Therefore, the MPC decided to leave the policy interest rate unchanged at 1.25 per cent per annum. However, with a preliminary assessment showing limited adverse impacts of the unrest on the overall economy by the time of the 14 July 2010 meeting, clearer signs of the ongoing recovery, and a favorable growth outlook going forward, the MPC decided to raise the policy interest rate by 0.25 per cent, from 1.25 to 1.50 per cent per annum, so as to bring the policy interest rate back towards normal levels.