

## 2. Inflation and Economic Conditions

### *Inflation trends*

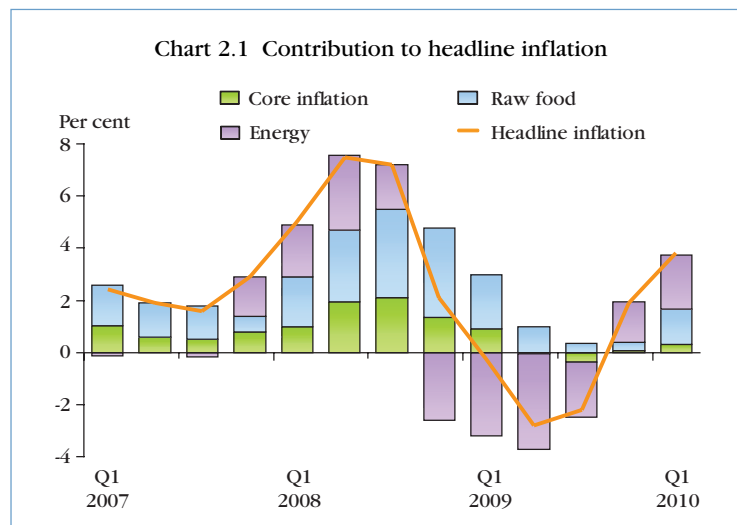
In 2010 Q1, headline inflation registered at 3.8 per cent, accelerating from 1.9 per cent in the previous quarter. At 0.4 per cent, core inflation also accelerated from 0.1 per cent in the previous quarter, but remained below the lower bound of the policy target range of 0.5-3.0 per cent per annum as a result of the effects from the government's cost-of-living reduction measures and the 15-year free-of-charge education programme. Excluding these measures, core inflation would continue to be within the target range with a gradually increasing trend in tandem with the continued economic recovery.

*In 2010 Q1, headline inflation and core inflation accelerated to 3.8 and 0.4 per cent, respectively.*

The acceleration of headline inflation in 2010 Q1 was attributable to increases in (1) raw food prices, as the severe hot weather caused the supply of vegetables, fruits as well as meats to decrease, and (2) energy prices, as domestic retail oil prices increased from the same period last year when the global financial crisis was still

Unit: Per cent	2008	2009	2009			2010
			Q2	Q3	Q4	Q1
<b>Percentage change from the previous year (%Δyoy)</b>						
- Headline consumer price index	5.5	-0.9	-2.8	-2.2	1.9	3.8
• Core consumer price index	2.4	0.3	-0.1	-0.5	0.1	0.4
• Raw food	15.3	5.6	6.3	2.8	2.6	8.2
• Energy	8.0	-13.1	-24.4	-13.2	20.1	26.4
- Producer price index	12.4	-3.8	-7.0	-10.2	6.8	12.0
<b>Percentage change from the previous quarter (%Δqoq)</b>						
- Headline consumer price index	-	-	1.6	0.5	0.7	1.0
• Core consumer price index	-	-	-0.1	-0.1	0.2	0.4
• Raw food	-	-	3.0	-0.7	2.4	3.3
• Energy	-	-	14.5	6.9	0.7	2.6
- Producer price index	-	-	5.0	-1.1	5.3	2.4

Source: Trade and Economic Index Bureau, Ministry of Commerce



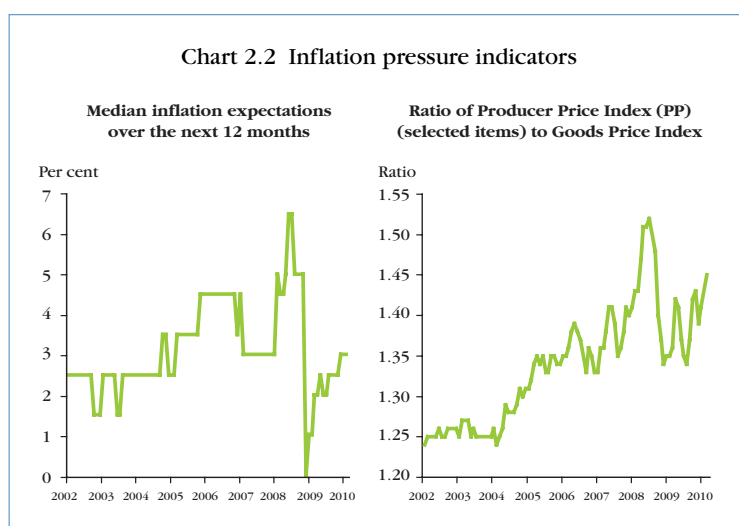
Source: Trade and Economic Index Bureau, Ministry of Commerce

unresolved. On the other hand, inflation pressure from the demand side remained subdued, as reflected by the slight acceleration of core inflation. Nevertheless, demand-side pressure became more pronounced compared to the previous quarters when inflation was determined primarily by the supply side.

Going forward, supply-side pressure from rising costs of production is expected to increase further as the ratio of the CPI-related Producer Price Index (an index constructed from PPI components that relate to those in the CPI) to the CPI-Goods index<sup>1/</sup> has risen in several consecutive months. The increase in this ratio indicated that producers were facing margin squeezes from continued increases in the prices of raw materials which may force them to adjust their selling prices upward in the period ahead. Consistent with this

<sup>1/</sup> This ratio reflects the relationship between producer prices and consumer prices better than the ratio of the overall PPI to the overall CPI which have different basket compositions. The overall CPI basket comprises goods and services while those of the overall PPI comprises only prices of goods, some unrelated to goods in the CPI. For further details of both indices, see [www.price.moc.go.th](http://www.price.moc.go.th).

tendency, the BOT's business sentiment survey revealed that around 20 per cent of businesses planned to increase their prices in the next three months, up from an average of 10 per cent in the previous year, and that the median 12-month-ahead inflation expectations rose from 2.5 per cent during August to November 2009 to 3.0 per cent during December 2009 to February 2010. All these suggest that, as the Thai economy continues to improve in the period ahead, producers will be able to pass on higher costs to consumers more easily.



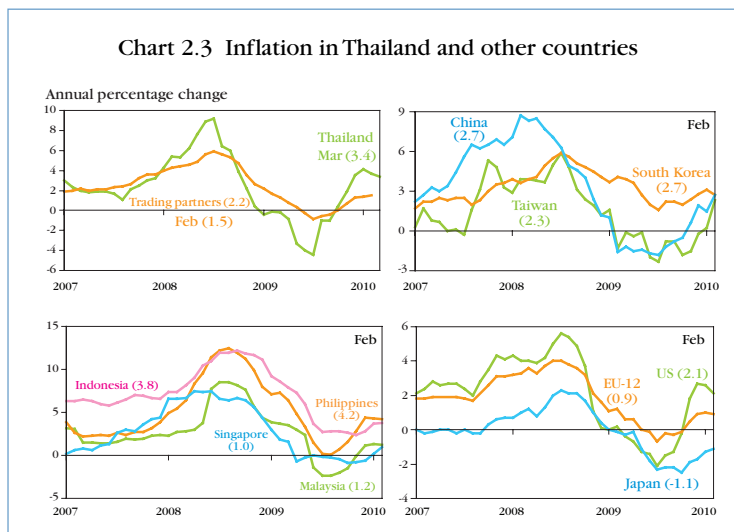
Source: Bank of Thailand's report on Business Sentiment Index

Source: Ministry of Commerce, calculations by Bank of Thailand

Foreign inflation also showed an upward trend similar to Thailand's. Except Japan, all countries experienced the return to continued positive inflation rates, as world oil and commodity prices increased in tandem with improving global demand associated with the firmer global economic recovery.

*Foreign inflation increased in tandem with world oil and commodity prices.*

Chart 2.3 Inflation in Thailand and other countries



Source: Various official sources and Bloomberg

### Aggregate demand in 2009 Q4 and the outlook in 2010 Q1<sup>2/</sup>

*Economic growth accelerated in 2009 Q4 and the growth momentum was poised to continue in 2010 Q1.*

The Thai economy in 2009 Q4 grew the fastest in 10 years at 3.6 per cent (qoq, sa), accelerating from 1.7 per cent in the previous quarter. This was a result of a strong pickup in external demand, supported by a robust recovery in domestic expenditures. The growth momentum is set to continue in 2010 Q1.

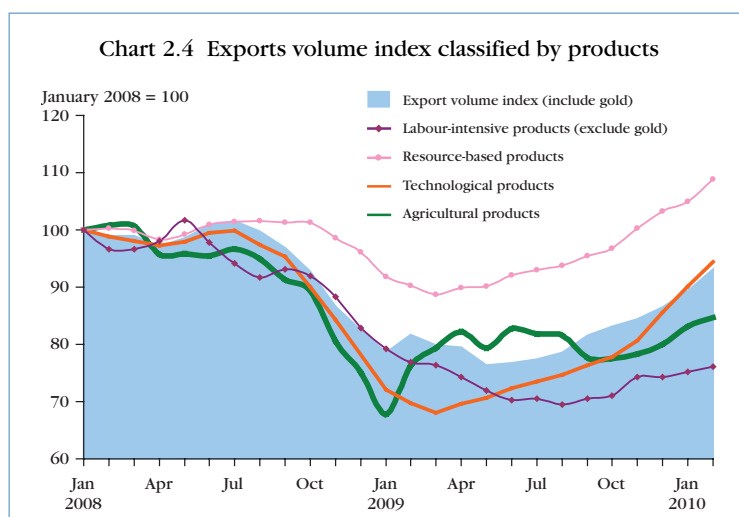
*Exports of goods and services were the main driving force in 2009 Q4. Exports are expected to expand further in 2010 Q1.*

The recovery of the world economy was the key factor underpinning the strong pick-up in external demand. Exports of goods and services expanded 7.9 per cent (qoq, sa) in 2009 Q4, up from 6.1 per cent recorded in the previous quarter. The expansion was observed in almost all categories, especially electronics and resource-based products. In terms of export

<sup>2/</sup> Data used to analyze aggregate demand in 2009 Q4 were obtained from the NESDB. Economic indicators used for analyze 2009 Q4 and the outlook for 2010 Q1 were obtained from the BOT, except for data on government expenditure, which originated from the Comptroller General's Department and were compiled by the Fiscal Policy Office.

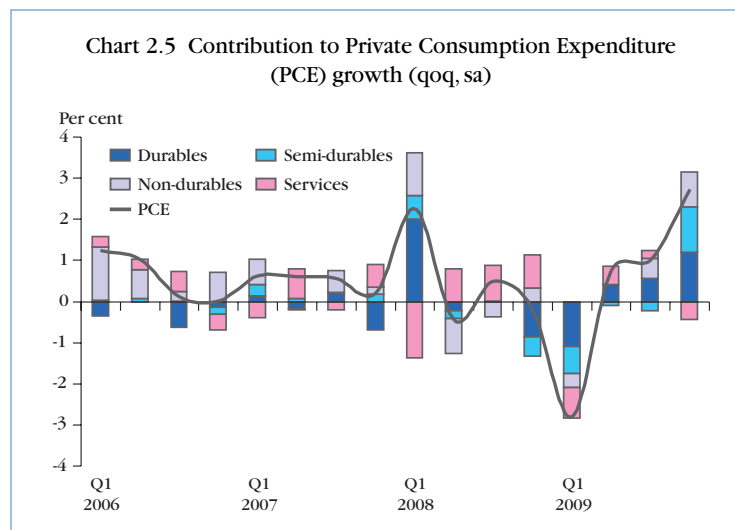
Table 2.2 GDP growth rate							
Change from previous quarter (seasonally adjusted, per cent)	2008			2009			
	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	-0.2	-0.5	-5.0	-1.5	2.1	1.7	3.6
Domestic demand	-0.9	0.7	-0.5	-4.7	1.7	1.3	2.7
Private consumption	-0.5	0.5	-0.2	-2.8	0.8	1.0	2.7
Private investment	-0.3	0.1	-5.4	-12.7	1.9	3.8	3.2
Government consumption	-0.8	3.9	6.9	-3.8	1.0	0.9	7.3
Public investment	-6.6	-1.4	-1.1	-0.2	11.7	-2.0	-7.4
Exports of goods and services	2.8	-2.5	-11.7	-5.9	-3.4	6.1	7.9
Imports of goods and services	1.0	2.6	-7.5	-27.0	8.0	4.6	11.6

Source: National Economic and Social Development Board, calculations by Bank of Thailand



Source: Bank of Thailand

destinations, exports of goods to Asian markets continued to perform well. Exports of services also improved as the number of foreign tourists rose above the pre-crisis level. Since the crisis, Asian tourists have been growing faster than tourists from other regions. Exports of goods and services in 2010 Q1 are expected to continue its growth momentum although the political situation during the latter half of March may have some negative effects on tourist receipts.



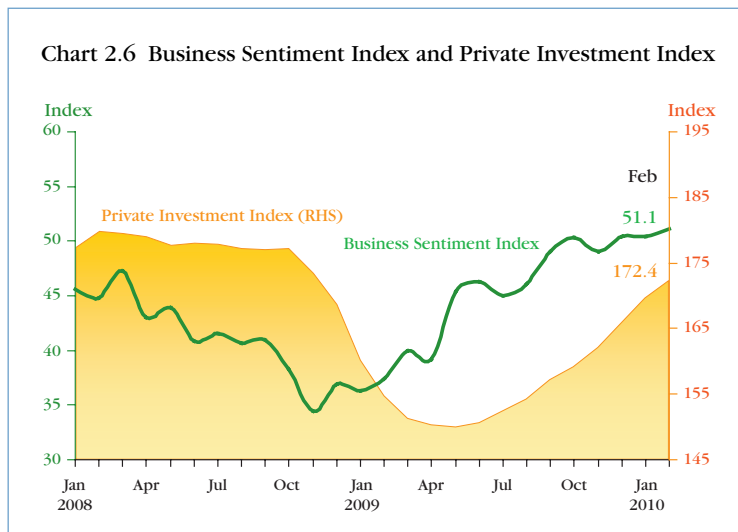
Source: National Economic and Social Development Board and calculations by Bank of Thailand

*Private consumption surpassed the pre-crisis level in 2009 Q4.*

Having improved continuously since 2009 Q2, private consumption surpassed the pre-crisis level in 2009 Q4. The expansion spread across almost all consumption categories, particularly durable goods which benefited from strong growth in sales of vehicles and electrical appliances. In addition, semi-durable and non-durable goods continued to grow at a reasonable rate. This increase in household expenditure was supported by better employment conditions and higher farm income. As a result, consumer confidence has increased. All these factors, together with exceptionally low interest rates and robust household credit expansion, should continue to support private consumption in 2010 Q1.

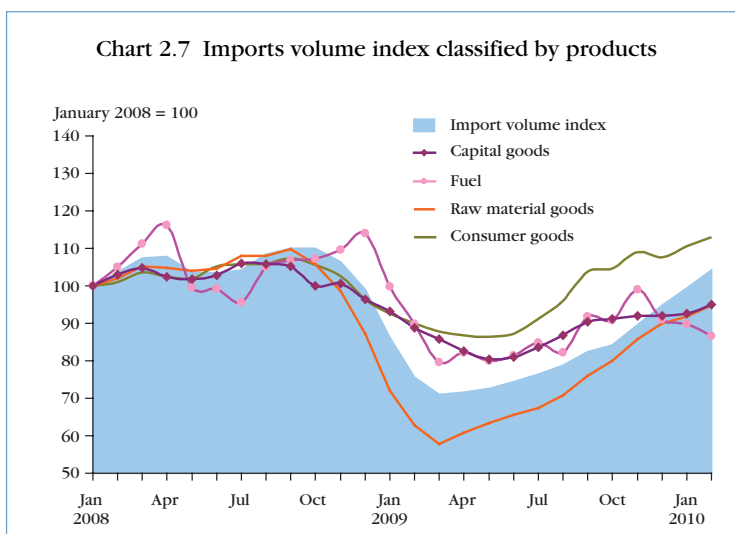
*Private investment continued to recover in 2009 Q4 with expectations for further expansion in 2010 Q1.*

Private investment continued to recover, growing 3.2 per cent (qoq, sa) in 2009 Q4, after expanding 3.8 per cent in the previous quarter. This was due to improving economic conditions and the expansion in exports. In particular, export-oriented industries with high capacity utilization had invested in



Source: The University of the Thai Chamber of Commerce and Bank of Thailand

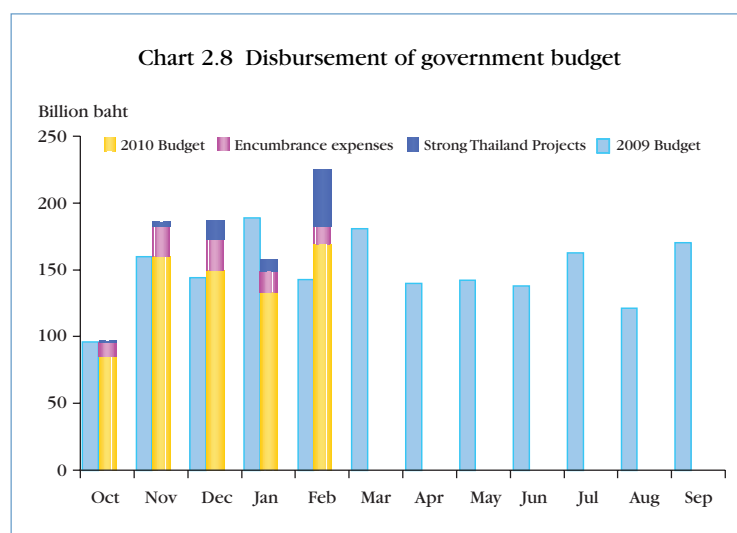
machinery and equipment. In addition, investment in residential and commercial construction also grew as a result of tax incentives which were scheduled to end in March 2010. Moreover, improving business sentiment provided another supporting factor for investment. Owing to this recovery momentum, private investment in 2010 Q1 is expected to expand further despite political uncertainties and rising costs of production that partially undermine investment sentiment.



Source: Bank of Thailand

*Strong recovery in domestic and external demand resulted in a surge in imports.*

Strong recovery in domestic and external demand resulted in a surge in import growth from 4.6 per cent (qoq, sa) in 2009 Q3 to 11.0 per cent in 2009 Q4. This development was observed in almost all major goods items, namely imports of raw materials such as car parts, imports of consumer goods which had returned to the pre-crisis levels, and imports of capital goods which improved in tandem with investment. Going forward, imports of goods and services in 2010 Q1 are expected to continue with this trend.



Note: The expenditure excludes principle repayments and replenishment of treasury reserve.  
Source: The Comptroller General's Department, Ministry of Finance

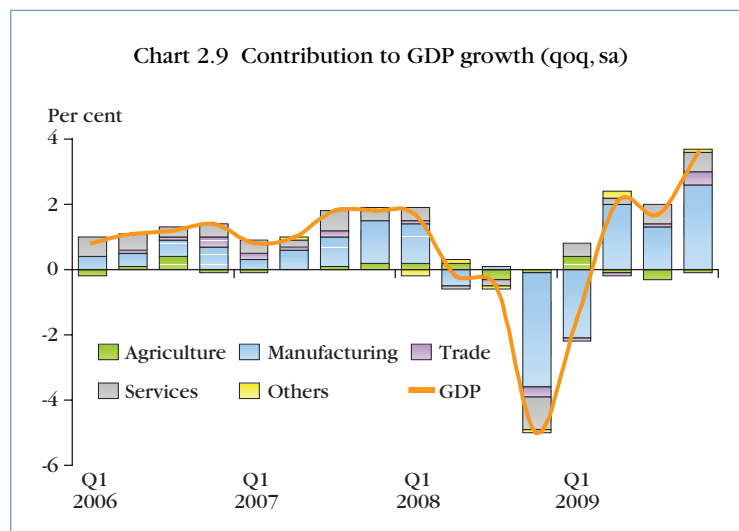
*Government spending continued to help stimulate the economy in 2009 Q4.*

Government spending continued to help stimulate the economy in 2009 Q4. Total budget disbursement was 9.3 per cent higher than that of the same period last year. The increase came mostly from expansion in government consumption while public investment only played a small role. Going forward, government spending is expected to continue providing further stimulation as there has been a good progress in the implementation of the Strong Thailand projects in the first two months of 2010.

## *Production and supply in 2009 Q4 and the outlook in 2010 Q1<sup>3/</sup>*

Production and supply in 2009 Q4 recuperated well in line with the demand recovery. The manufacturing sector contributed 2.6 percentage points to the overall quarterly growth (qoq, sa) while the trade and the services sectors together contributed 1.0 percentage point. As for the agricultural sector, rising prices of agricultural goods helped sustain farmers' income despite shrinking agricultural output. All these factors led to higher usage of factors of production as reflected by the tightened labor market and the capacity utilization rate that returned to near the pre-crisis level. For 2010 Q1, production and supply are expected to continue its improving trend which will result in further tightening of the factor markets. At the same time,

*Production and supply recuperated well in line with the demand in 2009 Q4 and showed steady improving trend in 2010 Q1.*

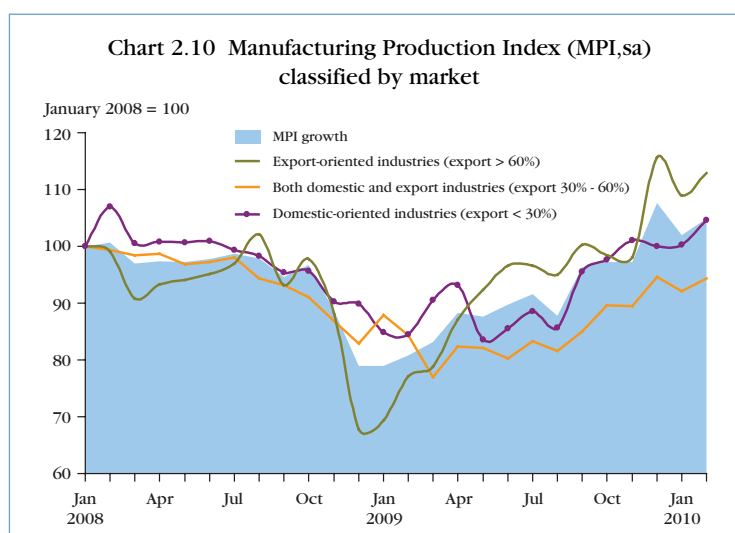


Source: National Economic and Social Development Board

<sup>3/</sup> Data used to analyze aggregate supply in 2009 Q4 were obtained from the NESDB. Economic indicators used to analyze 2009 Q4 and the outlook for 2010 Q1 were computed by the BOT, except data on the number of tourists and occupancy rate which were in part compiled by the Tourism Authority of Thailand. Data on the labour market was obtained from the NSO.

rising trend of agricultural prices will put pressure on inflation going forward.

Manufacturing production in 2009 Q4 grew 6.7 per cent (qoq, sa), up from 3.3 per cent in the previous quarter. The improvement was observed in all sectors, namely export-oriented industries especially electronics and electrical appliances, domestic-oriented industries such as food, beverages and passenger cars, and industries which rely on both domestic and export markets, in particular commercial cars.

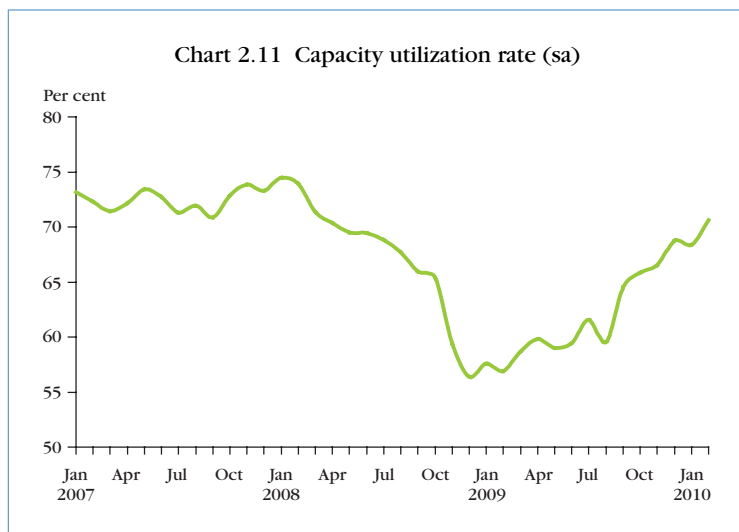


Source: Bank of Thailand

For 2010 Q1, manufacturing production is expected to grow further although the pace (qoq, sa) is expected to moderate due to the base effect. Nevertheless, high technology products such as electronics, vehicles, and electrical appliances are expected to continue to perform well.

The recovery in the manufacturing sector has been in line with the rise in capacity utilization since 2009 Q1. Latest data in February 2010 revealed that the

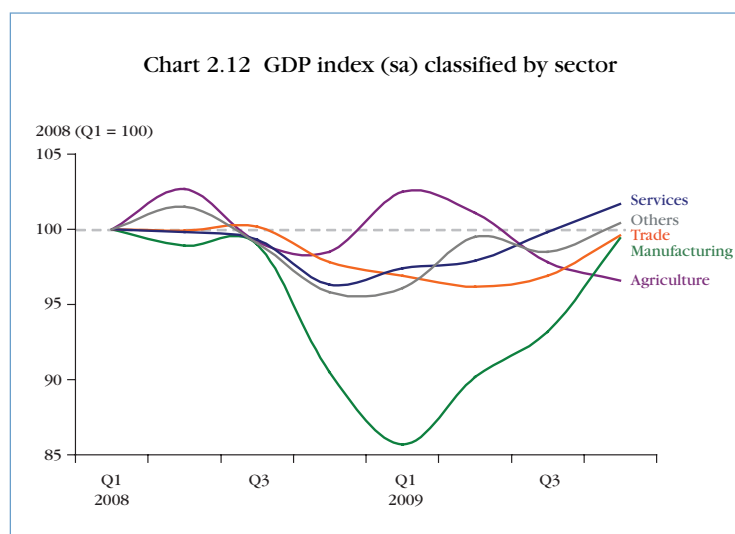
seasonally-adjusted capacity utilization rate stood at 70.6 per cent, close to the pre-crisis average of 72.4 per cent in 2008.



Source: Bank of Thailand

In 2009 Q4, the services sector continued to recover and expanded above the pre-crisis level with the growth rate of 1.9 per cent (qoq, sa), to which hotel and restaurants contributed 1.1 percentage points. Moreover, the growth in the number of tourists surged from 5.6 per cent (qoq, sa) in the previous quarter to 16.7 per cent in line with improved global economic conditions. Nonetheless, the structure of tourist receipts had moved away from the G3 countries towards Asian countries. Furthermore, transportation services expanded well owing to the recovery of both exports and tourism.

*The services sector surpassed the pre-crisis level due to the recovery in tourism and transportation services.*



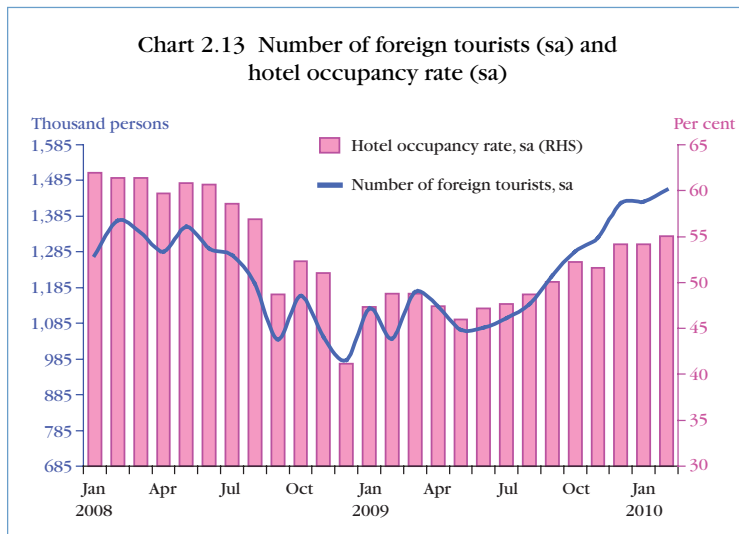
Source: National Economic and Social Development Board

*In 2010 Q1, services continued to grow though the political unrest might have some negative effects.*

Despite the political unrest that took place late in the quarter, the services sector is expected to expand well in 2010 Q1, thanks to the strong showing of data in the first two month. The average of the seasonally-adjusted number of tourists for the first two months of the quarter grew by 7.4 per cent from the previous quarter's average, while the seasonally-adjusted occupancy rate also increased from 52.7 per cent in 2009 Q4 to 55.0 per cent in February 2010. However, the political unrest is expected to affect tourism in 2010 Q2, and the MPC will continue to monitor and assess these impacts closely.

*Agricultural output contracted in 2009 Q4, but was expected to expand in 2010 Q1, while farm income increased continuously.*

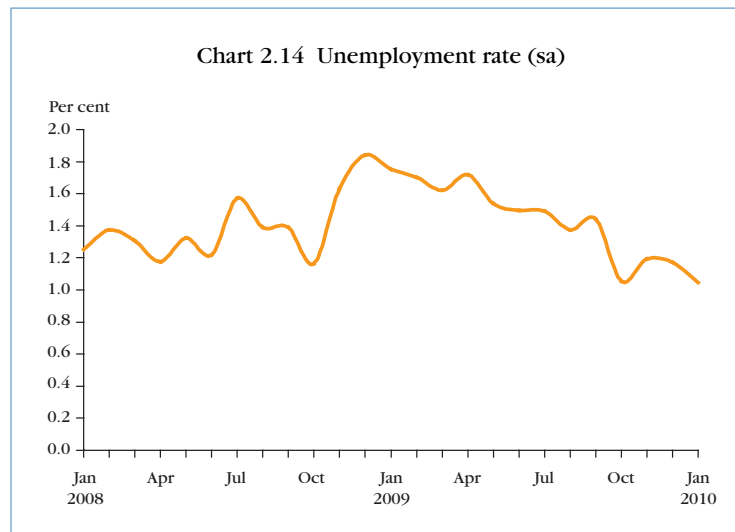
Agricultural output fell by 1.3 per cent (qoq, sa) in 2009 Q4, deteriorating further from a contraction of 3.3 per cent in the previous quarter. This was due to the flood in the southern region which affected production of rubber and the pest outbreak which affected rice and cassava. Nevertheless, fishery output managed to accelerate from the previous quarter on the back of strong shrimp exports. Prices of several crop



Source: Tourism Authority of Thailand and Bank of Thailand

especially in sugar cane, rubber and cassava also accelerated from the previous quarter which gave a boost to rising farm income.

Agricultural output in 2010 Q1 is expected to expand from the previous quarter. Despite the impact of the pest outbreak and the drought, production of major crops in January and February displayed a seasonal-adjusted, month-on-month growth rate of 0.7 and 1.5 per cent, respectively due mainly to increasing plantation area of rubber and palm oil in several regions. Nevertheless, production shortage in many crops caused major crop prices to accelerate continuously, leading to higher farm income which is expected to support private consumption and economic recovery going forward.



Source: National Statistical Office, calculations by Bank of Thailand

*Tourism continued to improve due to economic recovery in major tourist home countries.*

A firmer recovery outlook in several sectors was a foundation for the continuous expansion in employment growth with some industries starting to show signs of labour shortage. The year-on-year employment growth accelerated from 1.5 per cent at the end of 2009 to 2.3 per cent in January 2010 while the seasonally-adjusted unemployment rate continue trending downward to 1.0 per cent, the lowest level since the beginning of data collection. The seasonally-adjusted underemployment rate also fell to 1.2 per cent. Other labour market indicators such as the ratio of vacancy to unemployment and the recruitment difficulty index also pointed towards a tighter labour market condition. These developments might be another factor adding to inflationary pressure in the period ahead.