

2. Inflation and Economic Conditions

Inflation trends

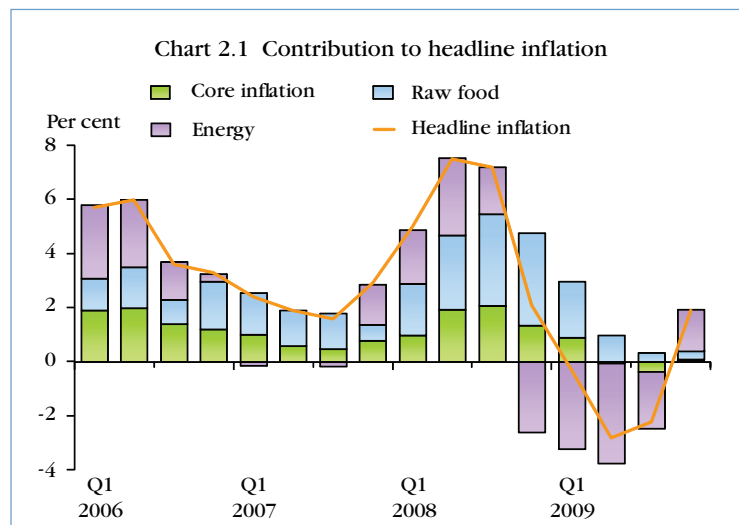
In 2009 Q4, headline inflation turned positive at 1.9 per cent after a continued contraction since 2009 Q1. The turnaround was mainly attributable to the low base effect from domestic retail oil prices during the same period of the previous year when the Dubai oil price fell sharply from an average of 95.9 US dollars per barrel in September 2008 to 40.5 US dollars per barrel in December 2008 as a result of the global financial crisis.

Core inflation in 2009 Q4 also turned positive at 0.1 per cent, after slipping into negative territory in 2009 Q2. The turnaround was due to a pickup in domestic demand in tandem with the economic recovery despite the negative contribution of the government's cost-of-living reduction measures and the 15-year free-of-charge education program. Excluding the effects of these government's measures, core inflation would be higher, up to around the lower bound of the inflation target range of 0.5-3.0 per cent per annum.

In 2009 Q4, headline inflation and core inflation turned positive at 1.9 and 0.1, respectively.

Unit: Per cent	2008	2009	2009			
			Q1	Q2	Q3	Q4
Percentage change from the previous year (%Δyoy)						
- Headline consumer price index	5.5	-0.9	-0.3	-2.8	-2.2	1.9
• Core consumer price index	2.4	0.3	1.7	-0.1	-0.5	0.1
• Raw food	15.3	5.6	11.4	6.3	2.8	2.6
• Energy	8.0	-13.1	-25.8	-24.4	-13.2	20.1
- Producer price index	12.4	-3.8	-3.5	-7.0	-10.2	6.7
Percentage change from the previous quarter (%Δqoq)						
- Headline consumer price index	-	-	-0.8	1.6	0.5	0.7
• Core consumer price index	-	-	0.1	-0.1	-0.1	0.2
• Raw food	-	-	-2.1	3.0	-0.7	2.4
• Energy	-	-	-2.4	14.5	6.9	0.7
- Producer price index	-	-	-2.4	5.0	-1.1	5.3

Source: Trade and Economic Index Bureau, Ministry of Commerce



Source: Trade and Economic Index Bureau, Ministry of Commerce

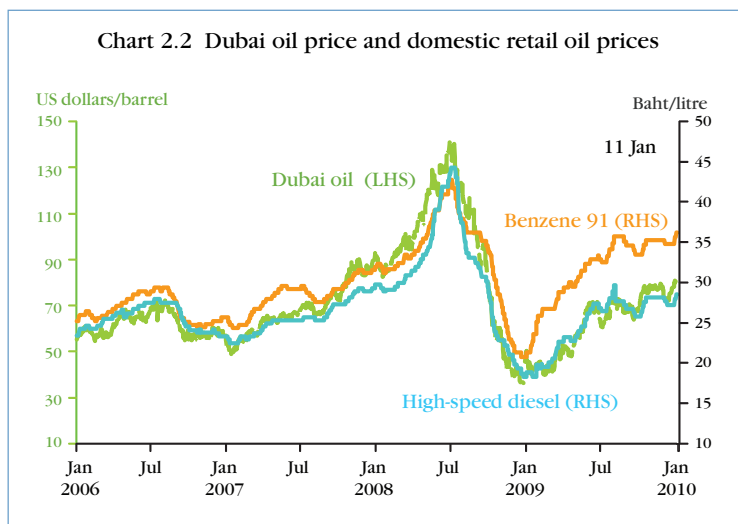
Domestic retail oil prices increased from the previous quarter in tandem with global oil prices.

An inspection of CPI components reveals that in the year to 2009 Q4 the growth rate of energy prices registered at 20.1 per cent compared to -13.2 per cent in the previous quarter due to the base effect from the falling oil prices in the same period of the previous year, as the Dubai oil price in this quarter averaged at 75.4 US dollars per barrel, up only slightly from 67.8 US dollars per barrel in the previous quarter. On the other hand, the growth rate of raw food prices registered at 2.6 per cent, decelerating slightly from the previous quarter owing to the favourable weather condition that caused the supply of vegetables and fruits to increase.

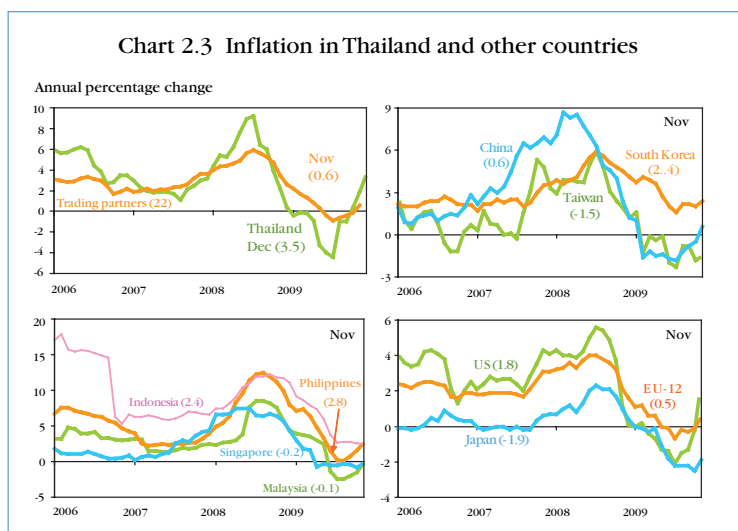
The growth rate of the Producer Price Index (PPI) in 2009 Q4 turned positive to 6.7 per cent, after a continued contraction since 2009 Q1. This was attributable to increases in prices of raw material for agricultural, mining, and manufacturing production compared to the previous quarter in tandem with world prices on top of the low base effect from the previous year.

The fall in oil and commodity prices in the same period of the previous year was the main factor causing inflation rates in most countries to move in the same direction. Inflation became less negative in countries such as Japan, Singapore, and Malaysia, while turning positive in the US, the Euro area, and China. For regional countries such as Indonesia and the Philippines whose inflation was still positive after a sharp decline during the middle of the year, inflation has either leveled off or accelerated.

Foreign inflation rates moved in a similar direction to Thailand's inflation.



Source: PTT Public Company Limited



Source: Various official sources and Bloomberg

Aggregate demand in 2009 Q3^{1/}

In 2009 Q3, the Thai economy continued to recover gradually with a growth rate of 1.3 per cent.

In 2009 Q3, the Thai economy continued to recover gradually with a quarter-on-quarter growth rate of 1.3 per cent, decelerating from 2.2 per cent in the previous quarter. The recovery was supported by two main factors, namely the expansion in net exports as a result of global recovery, and the high level of public spending. In addition, accommodative monetary policy was supportive to the improvement of private consumption.

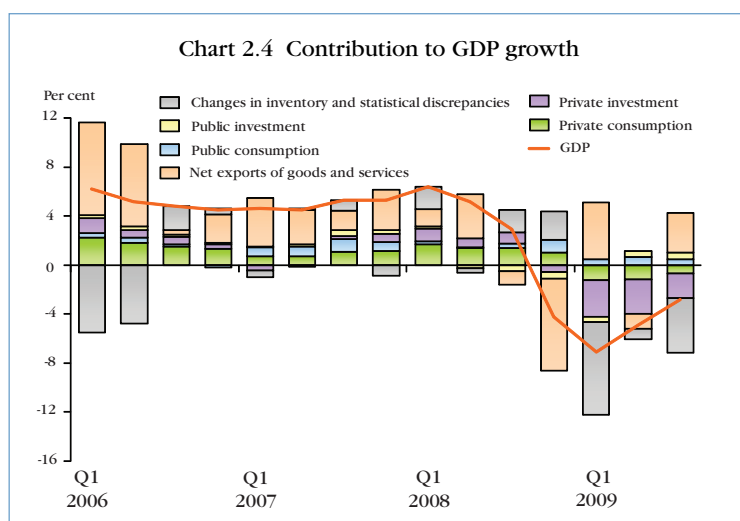
Change from previous quarter (seasonally adjusted, per cent)	2008				2009		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
GDP	1.6	-0.2	-0.6	-4.8	-1.5	2.2	1.3
Domestic demand	1.9	-1.0	0.6	-0.1	-4.9	1.6	1.2
Private consumption	2.2	-0.6	0.5	0.0	-2.8	0.6	1.0
Private investment	1.9	-0.5	0.0	-4.9	-12.9	1.6	3.7
Public consumption	2.1	-0.7	3.4	9.5	-5.8	1.2	0.4
Public investment	-0.9	-6.6	-0.8	-2.7	0.7	11.8	-1.3
Exports of goods and services	2.0	2.8	-3.1	-10.6	-6.4	-3.5	5.2
Imports of goods and services	4.4	0.9	1.3	-4.7	-28.2	8.0	2.0

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

External demand was one of the key drivers of the recovery in this quarter. Exports of goods and services expanded for the first time on a seasonally-adjusted, quarter-on-quarter basis at 5.2 per cent which translated into a lower year-on-year contraction of 15.0 per cent, compared to a contraction of 21.7 per cent in

^{1/} Data used to analyze aggregate demand in 2009 Q3 were obtained from the NESDB. Economic indicators used for analyze 2009 Q3 and the outlook for 2009 Q4 were obtained from the BOT, except for the Consumer Confidence Index, which was compiled by the University of the Thai Chamber of Commerce, and data on government expenditure, which originated from the Comptroller General's Department and were compiled by the Fiscal Policy Office.

the previous quarter. This was due to good performances in the manufacturing sector including electronics and vehicles as a result of the global economic recovery. Exports of gold also increased due to rising world gold prices. Regarding exports of services, tourism revenue improved because of the increase in the number of foreign tourists.



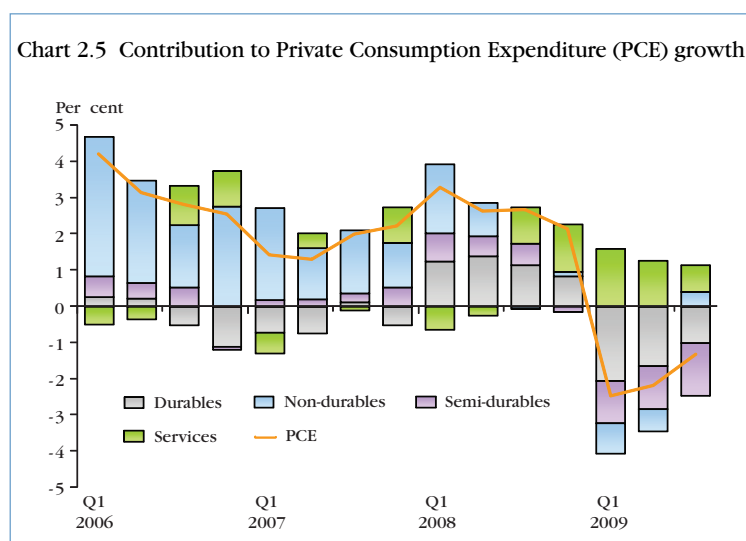
Source: National Economic and Social Development Board

Imports of goods and services picked up slightly this quarter with a lower year-on-year contraction of 23.8 per cent after a contraction of 25.6 per cent in the second quarter. The improvement was broad-based and resulted from the recovery in domestic consumption and production. However, imports of services contracted, after a slight expansion in the previous quarter, owing mainly to the promotion of domestic travel.

Government expenditure still provided some stimulus to the economy. The budget disbursement for this quarter expanded by 21.1 per cent. This reflected the increases in both current and capital expenditures

Government expenditure still provided some stimulus to the economy, albeit at a slower pace.

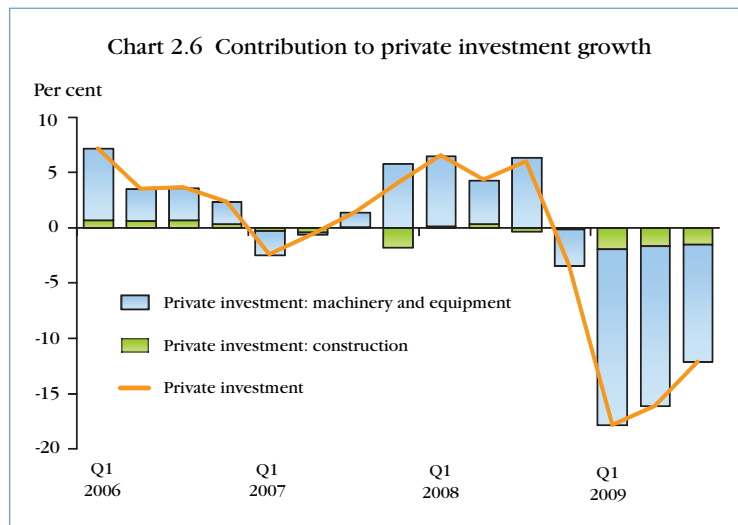
at 4.7 per cent and 8.0 per cent respectively. However, these rates were slightly below the previous quarter's counterparts. In addition, the increase in public investment mostly resulted from ongoing projects such as irrigation and road construction, and not yet from the second stimulus package (SP2).



Source: National Economic and Social Development Board

Private consumption picked up more strongly than in the previous quarter due to stronger confidence and low interest rates.

Private consumption in 2009 Q3 continued to improve across all components, displaying a growth rate of 1.0 per cent from the previous quarter compared to 0.6 per cent in the 2009 Q2. On a year-on-year basis, private consumption displayed a lower contraction rate of 1.3 per cent due to increases in consumption of food and durable goods as reflected by higher passenger car sales spurred by sales promotion and low interest rates. In addition, increasing consumer confidence, as reflected by the rise of the Consumer Confidence Index (CCI) from 72.0 in the previous quarter to 74.5, also played a part in the expansion of private consumption.



Source: National Economic and Social Development Board

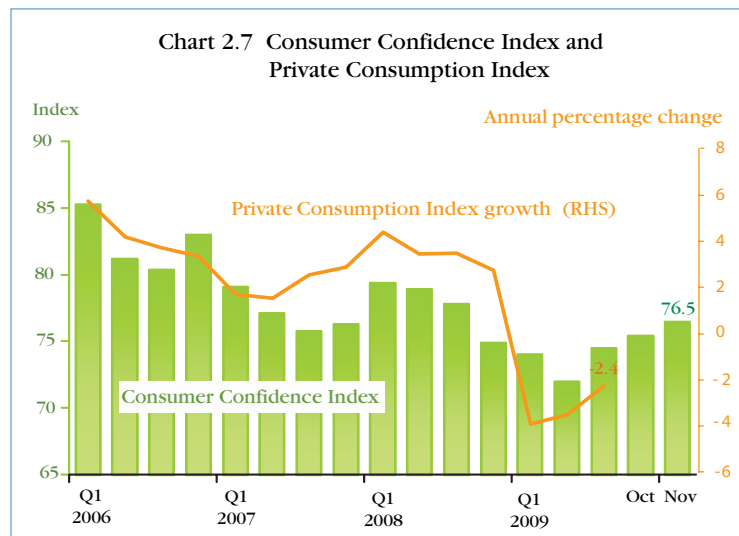
Private investment expanded gradually on the quarter-on-quarter basis, up from 1.6 per cent in the second quarter to 3.7 per cent this quarter, as investment in machinery and equipment continued to improve in line with rising exports performances. These developments coincided with rising capacity utilization rate since 2009 Q1. Meanwhile, construction of small projects also increased as a result of low financial costs and raw material prices. However, construction of projects remained subdued and would be contingent on stronger business confidence.

Private investment improved but still remained at a very low level compared to last year.

Outlook for aggregate demand in 2009 Q4

Overall, aggregate demand in 2009 Q4 was expected to continue to expand from the previous quarter with exports and government spending being the main supporting factors. However, the pace of recovery remained moderate as exports and private investment were still below the pre-crisis levels.

The Thai economy continued to recover in terms of exports, tourism, and government spending.



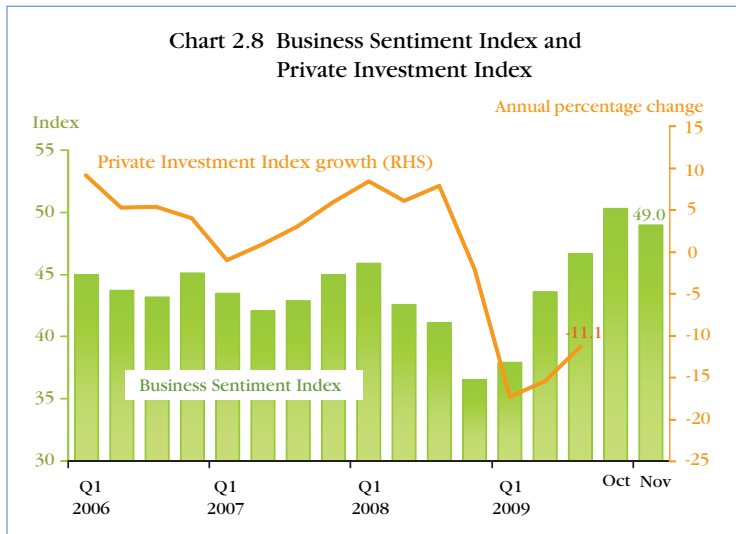
Source: The University of the Thai Chamber of Commerce and Bank of Thailand

Prospects for private consumption continued to improve but remained subject to risks.

In the first two months of 2009 Q4, the Private Consumption Index (PCI), compiled by the Bank of Thailand, pointed towards a higher level of private consumption. The PCI expanded by 1.5 per cent from the same period last year, registering a positive growth for the first time since 2008 Q4. Improvements in the PCI were broad-based with noticeable increases in car sales and imports of consumer goods. This positive outlook for private consumption was in line with an improvement in the Consumer Confidence Index which rose to 76.0 from an average of 74.5 in the previous quarter.

The pace of private investment recovery remained gradual, leaving investment at a lower level than last year.

The Private Investment Index (PII) during the first two months of this quarter contracted by 8.5 per cent, a slower pace relative to 11.1 per cent in the previous quarter. This was due to higher investment in machinery and equipment following an increase in imports of capital goods, domestic machinery sales, and domestic commercial car sales. Investment in construction remained subdued, but started to show some signs of



Source: Bank of Thailand

recovery as reflected by an improvement in domestic cement sales. This recovery of private investment was in line with higher capacity utilization as well as the continued pick up in investor confidence as reflected by the Business Sentiment Index (BSI) which rose to 49.7, up from 46.7 in the previous quarter.

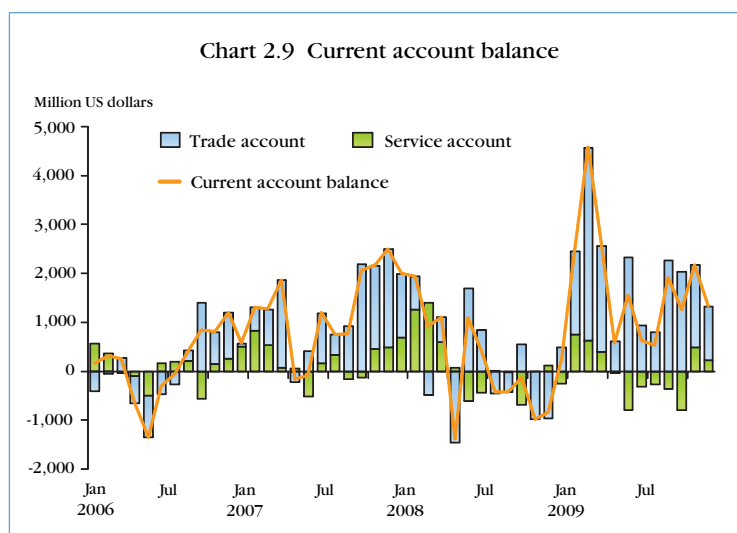
Going forward, the government's mega-projects investment and residential construction along the mass transit routes will contribute to the recovery of private investment.

Government expenditure in the first two months of 2009 Q4 expanded on average by 7.4 per cent from the same period last year on the back of higher current expenditure. The accumulated disbursement rate stood at 14.6 per cent at the end of November, higher than 12.6 per cent in the same period last year. This reflected the government's continual effort to stimulate the economy.

Government expenditure expanded from last year following higher current expenditure.

Export volume improved while imports contracted at a slower rate.

On the external front, both the value and the quantity of exports in October and November 2009 increased from the previous quarter with a year-on-year growth rate of 6.2 per cent and 0.5 per cent, respectively. This was due partly to the low base effect as well as improving world demand, which resulted in improving export performance especially in high-technology products such as electronics, electrical appliances, and vehicles. In addition, service income also trended upward due to better tourist receipts as Thailand's major tourism markets such as China, Hong Kong, and Taiwan, had recovered.



In comparison to the previous quarter, the value and the quantity of imports during the first two months of this quarter contracted at a slower rate of 10.7 per cent and 14.7 per cent, respectively. The lower contraction rates were attributable to improvements in both prices and quantities of imports across all items. Imports of consumer goods expanded buoyantly especially electrical appliance while imports of capital

goods picked up mainly from the electrical machinery item. Moreover, imports of raw material and intermediate goods also increased from higher imports of iron products, chemicals and electronics parts, while imports of vehicles and parts also picked up in line with the recovery of the car industry.

As export values trended higher while imports still contracted, the trade balance was expected to continue to be in surplus in the fourth quarter. Meanwhile, services income and transfers were also expected to record a surplus, causing the current account to remain in surplus.

Production and supply in 2009 Q3 ^{1/}

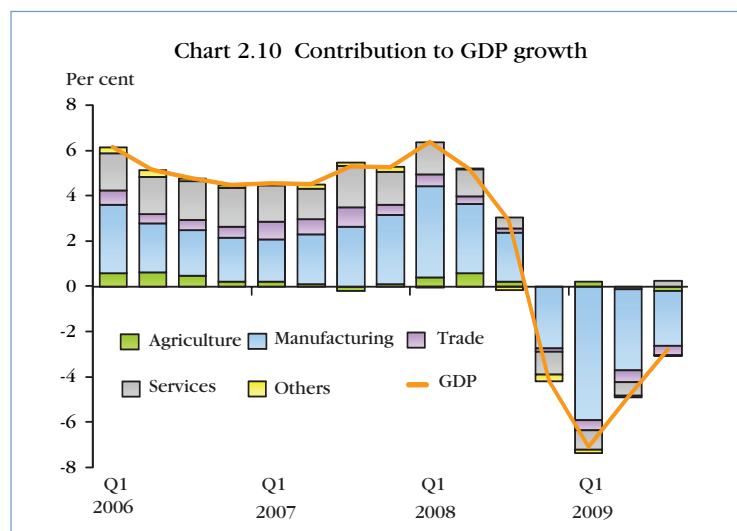
In 2009 Q3, production and supply continued to recover from the previous quarter as the manufacturing and the services sectors improved in tandem with improving external demand. In addition, the construction sector continued to expand as the budget disbursement was accelerated. However, the agricultural sector continued to shrink due to lower crop prices and a high base in the previous year.

Manufacturing production in this quarter contracted by 5.9 per cent, improving from the contraction of 8.7 per cent in the previous quarter and 14.4 per cent in the first quarter. The recovery was evident in many sectors such as electronics, which depended on external demand, chemical products,

In 2009 Q3, production and supply continued to recover from the previous quarter.

Manufacturing production recovered further in many industries including electronics, chemical products and motor vehicle.

^{1/}Data used to analyze aggregate demand in 2009 Q3 were obtained from the NESDB. Economic indicators used to analyze 2009 Q3 and the outlook for 2009 Q4 were computed by the BOT, except for the Consumer Confidence Index, which was produced by the University of the Thai Chamber of Commerce, and data on government expenditure, which originated from the Comptroller General's Department and were compiled by the Fiscal Policy Office.



Source: National Economic and Social Development Board

which relied on both domestic and external demand, and petroleum, which relied on domestic demand.

The services sector recovered as tourism improved and construction benefited from government spending.

The services sector grew by 0.8 per cent after shrinking for three consecutive quarters, owing to the improvement in hotels and restaurants which benefited from the increase in the number of tourists. Moreover, transport and communication also picked up due to a higher number of air passengers. As for the construction sector, it continued to do well because of the expedited budget disbursement, expanding investment by state owned enterprises and condominium construction along the mass transit routes.

Agricultural output continued to shrink due to a base effect.

Agricultural output in this quarter shrank by 2.5 per cent compared to a contraction of 1.3 per cent in the previous quarter. The reduction was a result of a drop in crop production which adjusted to the decrease in prices. In addition, there was also a base effect since production last year was exceptionally high. Nevertheless, livestock and fishery managed to expand due to the recovery of both domestic and external demand.

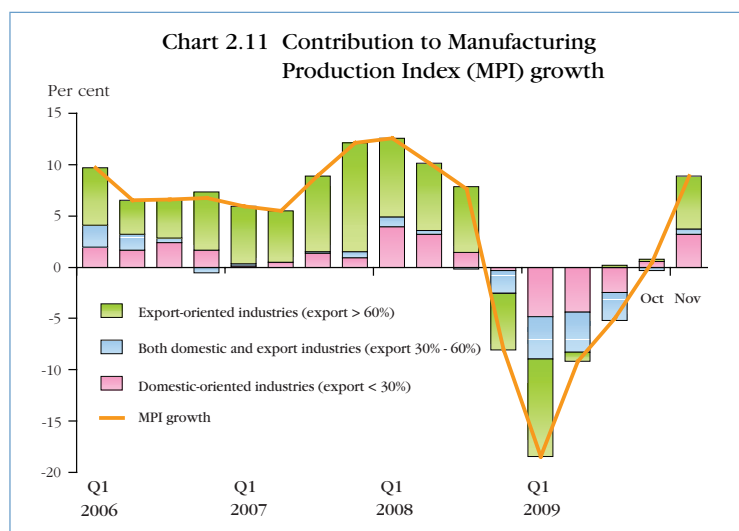
A firmer recovery in the non-agricultural sector caused employment in this sector to expand by 4.0 per cent. This positive development was observed across all subsectors. Nonetheless, non-agricultural employment in this quarter fell by 1.9 per cent after growing in the past three quarters. This was due to the ongoing contraction in the agricultural sector.

Outlook for production and supply in 2009 Q4

The outlook for production and supply in 2009 Q4 improved in line with demand. The manufacturing sector was expected to expand well. A similar outlook applied to tourism. Meanwhile, agriculture was expected to experience decelerated contraction.

Manufacturing production in 2009 Q4 was expected to further improve as the Manufacturing Production Index (MPI) continued to expand in both October and November. Export-oriented production showed improvement as demand for integrated circuits

Manufacturing production showed a continued improving trend for both export-oriented and domestic-oriented industries.



Source: Bank of Thailand

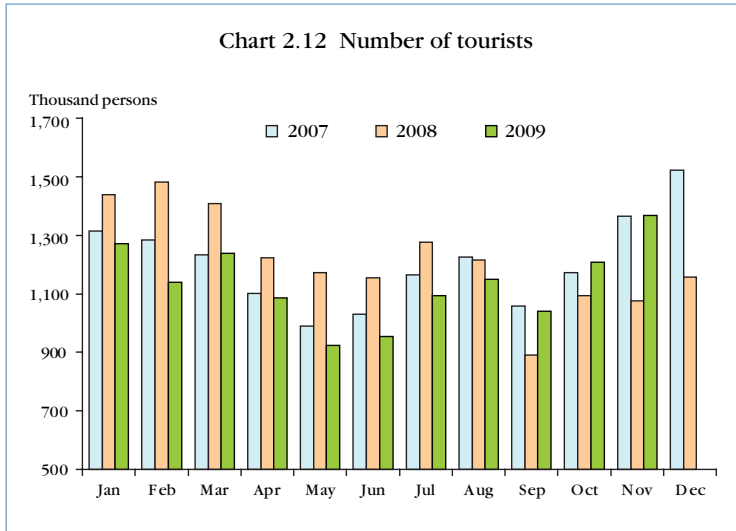
and televisions continued to increase. Likewise, domestic-oriented production grew as there was more demand for beverages, petroleum, and vehicles. Low interest rates and rising farm income also contributed to higher demand, particularly for vehicles.

Production of major crops contracted on average by 0.8 per cent during the first two months of 2009 Q4. The contraction was due to the reduction in production of rice, cassava, and palm oil which resulted from poor weather and pest outbreak. Nevertheless, the pace of contraction decelerated.

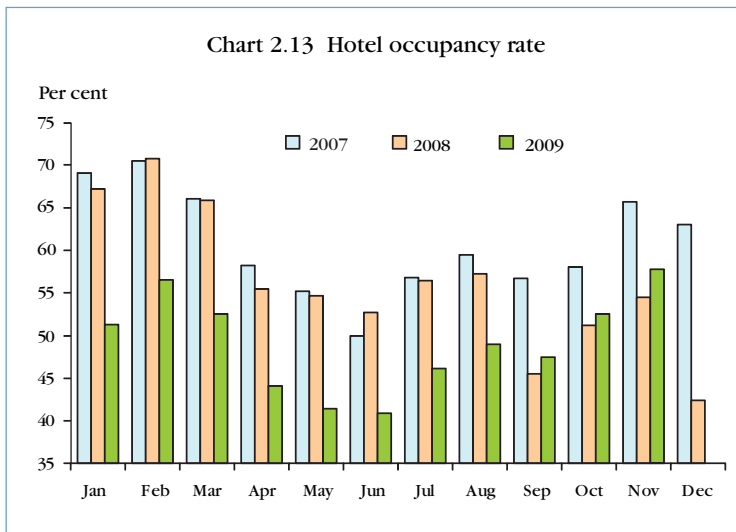
Prices of major crops fell by 0.8 per cent from last year but expanded by 12.8 per cent from the previous quarter. The growth was attributable to the improvement in prices of rubber, rice, and cassava which benefited from a decrease in harvests both domestically and abroad whereas demand was still on the rise. The improvement in production and prices of main crops led to rising farm income, bolstering farmer's consumption going forward.

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

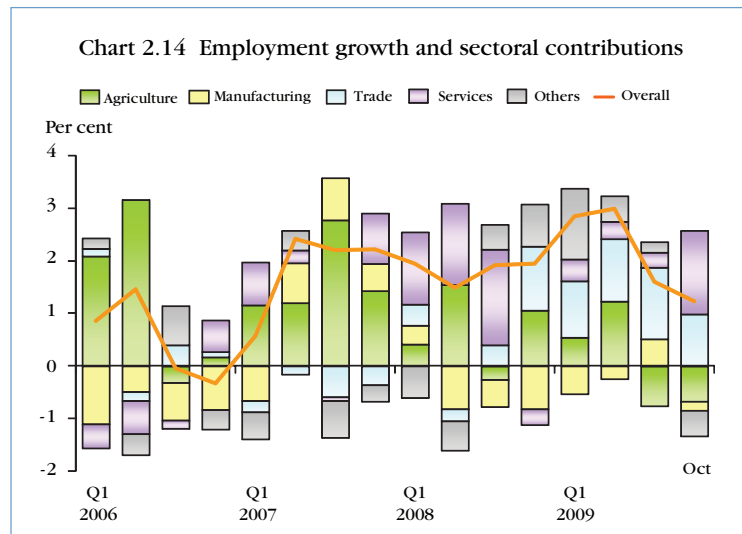
During the first two months of 2009 Q4, tourism adjusted upward as depicted by the number of tourists that increased on average by 18.7 per cent from the same period last year. This high growth was due to a low base last year, economic recovery in tourist home countries, especially in Asia, and the higher number of European tourists. Consequently, the average occupancy rate rose to 55.0 per cent from 52.8 per cent in the same period last year.



Source: Tourism Authority of Thailand and Bank of Thailand



Source: Tourism Authority of Thailand and Bank of Thailand



Source: National Statistical Office

Labour market condition remained sound as the unemployment rate in October fell to 1.1 per cent following the increase in employment in trade and services sectors. The improvement in the labour market was consistent with further reduction in the number of people claiming unemployment benefits.

Fiscal position and its implications for macroeconomic stability

The current global economic crisis necessitates several countries to use fiscal policy to shore up and stimulate their economies. This practice has created both explicit and implicit risks to fiscal position and can adversely affect investor confidence and country creditworthiness, which have implications for costs of borrowing and ultimately macroeconomic stability.^{1/}

In Thailand, public sector expenditure has played an important role in boosting the economy by partly compensating for the contraction in exports, private consumption, and private investment. In fiscal year 2009 the government ran a cash deficit of 4.8 per cent of GDP (which was above the budget deficit of 3.9 per cent of GDP), bringing the public debt to GDP ratio up from 37.2 per cent at the end of fiscal year 2008 to 45.9 per cent at the end of fiscal year 2009. Although the economy is improving in fiscal year 2010, the recovery is only gradual and still fragile. The government thus continues to run a budget deficit of 3.7 per cent of GDP as fiscal stimulus is deemed to be necessary.

However, both shrinking public sector expenditure following a shortfall in revenues and increasing contingent expenditure and social welfare expenditure reduce the budget for investment sharply. As a result, the government has decided to borrow further by enacting special bills^{2/} to make possible public investment in accordance with the “Strong Thailand 2012 Project,” the stimulus package over 2010-2012. It is also expected that the government will continue to run budget deficits for some time in the future to keep output expansion at a rate close to the potential growth rate. Consequently, if the government fails to restructure its public spending – by cutting back current expenditure and transfers – public debt is expected to rise above 60 per cent of GDP, the threshold level suggested by the Ministry of Finance’s medium-term fiscal sustainability framework. Moreover, if implicit contingent liabilities of quasi-fiscal activities become actual losses, the actual debt burden of the government will turn out to be higher.

Prolonged fiscal deficits and rising public debt have become issues of concern among academics and investors. The main question is whether they adversely affect a nation’s creditworthiness and costs of borrowing. Greece, for

^{1/} Fiscal position is one of the seven aspects of the economy the Bank of Thailand closely monitors and conducts analyses on. The other institutions and market conditions that have important implications for macro stability are firms, households, financial institutions, international trade and capital flows, real estate markets, and financial markets.

^{2/} The Emergency Decree Empowering the Ministry of Finance to Borrow for Economic Restructuring and Strengthening, B.E. 2009, and the Act Empowering the Ministry of Finance to Borrow for Economic Restructuring B.E. ...

Chart 1 Ratio of government debt to GDP

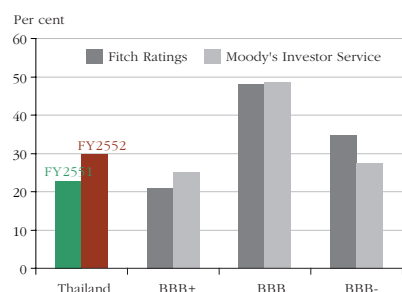
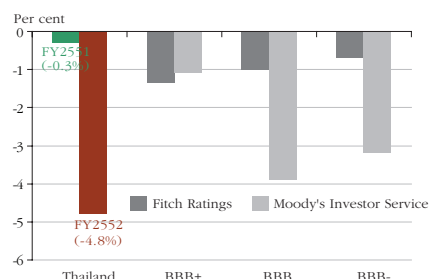


Chart 2 Ratio of government balance to GDP



Note: Thailand is at present rated Baa1 (equivalent to BBB+) according to Moody's Investor service and BBB according to Fitch Ratings.

Source: Fitch Ratings and Moody's Investors

example, was downgraded in 2009 in light of its fiscal deficits as much as 12.7 per cent of GDP and public debt that reached 112.6 per cent of GDP. Such an elevated debt level and massive budget deficits pose risks to debt service ability, risk premiums, and long-term bond yields of any country facing a similar problem.

Credit rating agencies do not usually have debt thresholds when determining creditworthiness of a country. Instead, one important criterion that they use is debt affordability – a ratio of interest payments to government revenues. Currently, the debt affordability indicator for Thailand stands at 8 per cent. It is possible that this ratio will approach the 14 per cent benchmark used by Moody's Investors Service. One reason is the uptrend in interest payments. Another is a low level of government revenues, as the collection rate in Thailand is quite low at 16 per cent of GDP, about half of that in advanced economies.

Maintaining fiscal discipline by keeping fiscal position at an appropriate level is a challenge to policymakers. Going forward, the conduct of fiscal policy will be under tighter constraints. First, both current and long-term contingent expenditures have been rising. This will depress public investment earmarked for infrastructure development, which has an implication for the nation's competitiveness. Second, to raise capital expenditure the government can either decrease current expenditure or increase government revenues by reforming the tax system and enhancing the effectiveness of revenue collection. For this reason, when the economy heads towards full recovery it is important that the government reduces its impetus and instead works to support private sector investment.