2. Inflation and Economic Conditions

Inflation trend

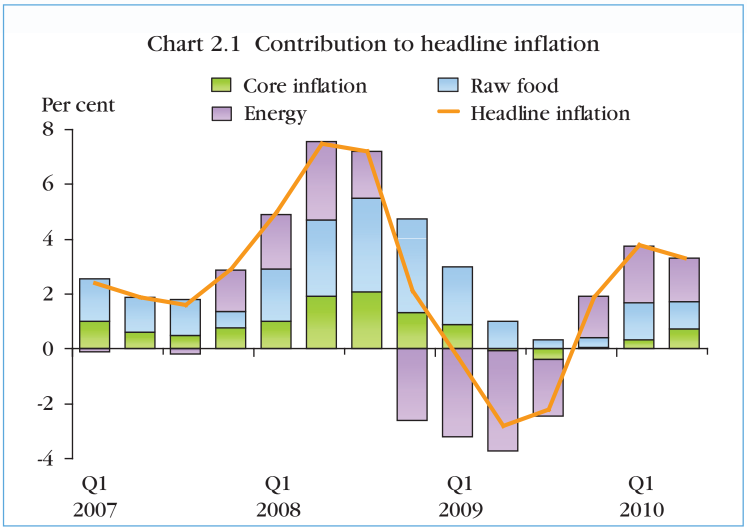
In 2010 Q2, headline inflation fell to 3.3 per cent from 3.8 per cent in the previous quarter, due to the slowdown in gasoline prices this year together with a high base last year as a result of an increase in excise taxes on gasoline and rising world market prices of crude oil. Nevertheless, this quarter saw an extensive rise in fresh food prices over the previous quarter as variable weather conditions diminished supply. At the same time, core inflation rose from 0.4 per cent in the previous quarter to 0.9 per cent, back within the target range of 0.5-3.0 per cent per annum. The surge in core inflation was in accordance with the MPC's expectations given that a negative contribution from the 15-year free education program had disappeared after one year in effect. Another positive contributor to core inflation was the termination of the government's subsidy on water charges in April 2010, which returned associated consumer expenditures to pre-policy levels.

In 2010 Q2, headline inflation and core inflation stood at 3.3 and 0.9 per cent, respectively.

Table 2.1 Quarterly inflation

Unit: Per cent	2008	2009	2009		2010	
			Q3	Q4	Q1	Q2
Percentage change from the previous year (%Δyoy)						
- Headline consumer price index	5.5	-0.9	-2.2	1.9	3.8	3.3
• Core consumer price index	2.4	0.3	-0.5	0.1	0.4	0.9
• Raw food	15.3	5.6	2.8	2.6	8.2	9.2
• Energy	8.0	-13.1	-13.2	20.1	26.4	10.9
- Producer price index	12.4	-3.8	-10.2	6.8	12.0	9.3
Percentage change from the previous quarter (%Δqoq)						
- Headline consumer price index	-	-	0.5	0.7	1.0	1.0
• Core consumer price index	-	-	-0.1	0.2	0.4	0.4
• Raw food	-	-	-0.7	2.4	3.3	4.0
• Energy	-	-	6.9	0.7	2.6	0.5
- Producer price index	-	-	-1.1	5.3	2.4	2.5

Source: Trade and Economic Index Bureau, Ministry of Commerce



Source: Trade and Economic Index Bureau, Ministry of Commerce

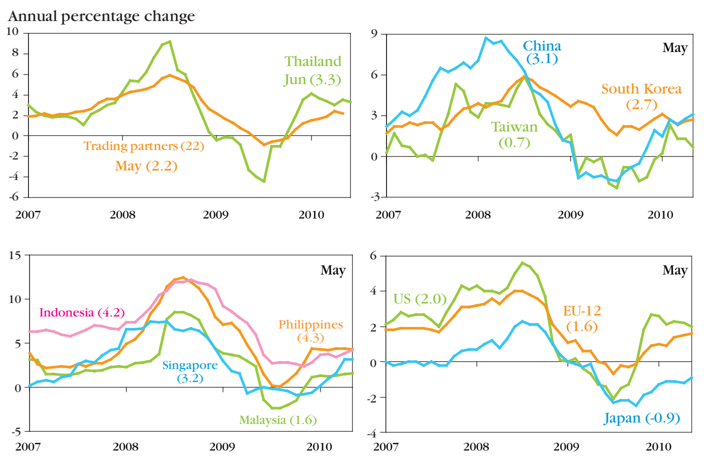
In the core consumer basket, prices of goods and services other than those affected by the government's cost-of-living alleviation measures remained mostly stable, reflecting the still limited pass-through of production costs which had risen somewhat during the earlier period. The limited pass-through could be attributed to (1) the recent moderation in cost of production pressure as seen by PPI inflation, which fell to 9.3 per cent from 12.0 per cent last quarter following the moderation of commodity prices in the world market amid concerns over sovereign debt in Europe, (2) the political unrest that affected consumer confidence and thus firms' price setting, and (3) the government's request to firms to maintain their current prices until the end of the third quarter of this year. Given improved profits during the first quarter as a result of the economic recovery, most firms were able to accommodate the government's request.

As a consequence of the aforementioned factors, the MPC anticipated low inflationary pressures in the short run. However, over the longer run, both cost-pushed and demand-pulled price pressures were expected to gradually increase. Commodity prices were projected to climb in line with global economic growth, while domestic demand was anticipated to improve after the resolution of the political turmoil. If domestic demand were to strengthen by the end of the third quarter, coinciding with the end of the cooperation period during which firms agreed to maintain their current prices, production cost pass-through to consumers would become more pronounced. This view was supported by the Bank of Thailand's business surveys which indicated that the proportion of firms with plans to raise prices in the next three months did not fall below that of the last quarter.

Foreign inflation rose moderately from the previous quarter in line with the continued global economic recovery.

Most foreign inflation rates showed slight acceleration compared with the previous quarter, as a result of the recovery of the world economy coupled with the low base of commodity prices last year. An exception was Europe, where inflation remained sluggish due to the sovereign debt crises in some countries.

Chart 2.2 Inflation in Thailand and other countries



Source: Various official sources and Bloomberg

Aggregate demand in 2010 Q1 and the outlook for 2010 Q2 [1/]

Thailand's economic growth was likely to moderate in 2010 Q2, following the exceptional expansion in 2010 Q1.

In 2010 Q1, Thailand's economy expanded by 3.8 per cent quarter-on-quarter, driven largely by buoyant exports of goods and services. Meanwhile, accelerated economic activities helped boost private investment, while private consumption and public spending stayed comparable with the previous quarter. Following an exceptional rate of expansion in 2010 Q1, overall economic growth was likely to moderate in 2010 Q2, in part because political unrest took a toll on tourism income. Other sectors, however, seemed poised to carry on expansion.

Table 2.2 GDP growth rate

Change from previous quarter (seasonally adjusted, per cent)	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
GDP	-0.7	-4.9	-1.6	2.4	1.4	4.0	3.8
Domestic demand	0.4	-0.3	-4.7	1.6	1.3	2.6	1.0
Private consumption	0.4	-0.1	-2.7	0.7	0.9	2.8	0.2
Private investment	-0.4	-5.1	-12.9	1.9	4.5	2.8	6.1
Government consumption	3.7	6.7	-3.4	1.0	0.7	7.2	-1.7
Public investment	-2.9	1.6	-1.3	11.6	-1.6	-6.8	-0.1
Exports of goods and services	-2.7	-11.9	-5.3	-3.7	5.9	7.6	6.0
Imports of goods and services	2.3	-7.6	-26.1	7.0	4.3	11.7	6.1

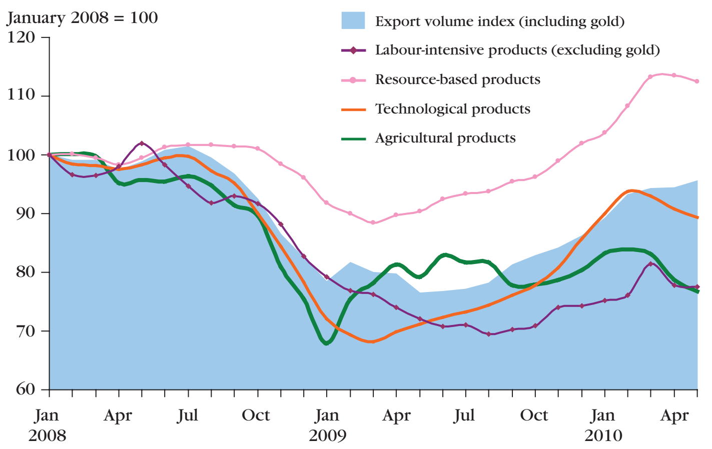
Source: National Economic and Social Development Board, calculations by Bank of Thailand

[1/] Data used to analyze aggregate demand in 2010 Q1 came from the NESDB. Economic indicators used for the analysis of 2010 Q1 and the outlook for 2010 Q2 were obtained from the Bank of Thailand, except for the data on government expenditures which came from the Comptroller General's Department and were compiled by the Fiscal Policy Office.

Looking at each component of GDP in 2010 Q1, exports of goods and services expanded strongly at 6.0 per cent quarter-on-quarter on the back of a good global recovery. Expansion was seen in nearly all categories of exported goods, including important items such as electronics and resource-based products. Meanwhile, exports of services continued to recover, as reflected by the growing number of foreign tourists despite the escalating political tensions towards the end of March. Unfortunately, the political situation deteriorated in 2010 Q2 and by then could not avoid having a severe bearing on the number of tourists and exports of services at large. Nonetheless, exports of goods did not seem to be much affected, as confirmed by strong growth rates in both April and May as well as a favourable trend for June.

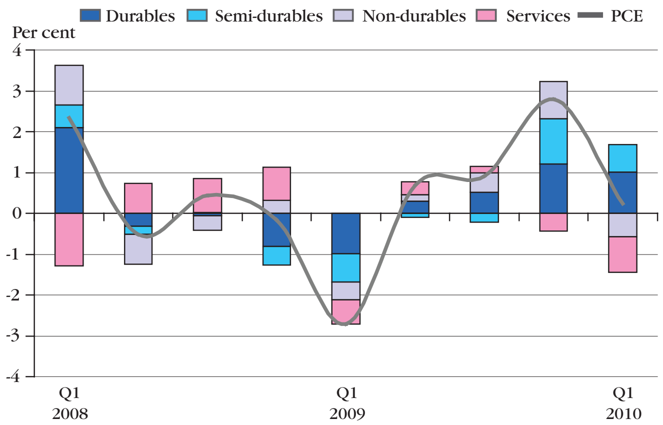
Exports drove the high GDP growth rate in 2010 Q1. While exports of goods remained buoyant in 2010 Q2, exports of services suffered from the political unrest.

Chart 2.3 Export volume index classified by products



Source: Bank of Thailand

Chart 2.4 Contribution to private consumption expenditure (PCE) growth (qoq, sa)

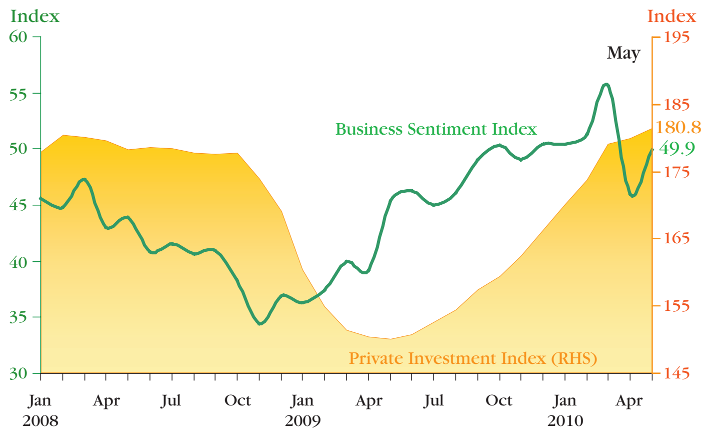


Source: National Economic and Social Development Board and calculations by Bank of Thailand

In 2010 Q1, durable and semi-durable consumption grew at a rate close to that of the preceding quarter. Further growth in private consumption was likely in 2010 Q2.

Private consumption expanded by 0.2 per cent quarter-on-quarter in 2010 Q1. While durable and semi-durable goods grew at a rate close to that in the previous quarter with support from strong sales of automobiles and electronics, non-durable goods and services contracted slightly. In 2010 Q2, despite the political turmoil, household spending was likely to carry on expansion as overall employment conditions improved, farm income rose, and household credits continued to grow.

Chart 2.5 Business Sentiment Index and Private Investment Index



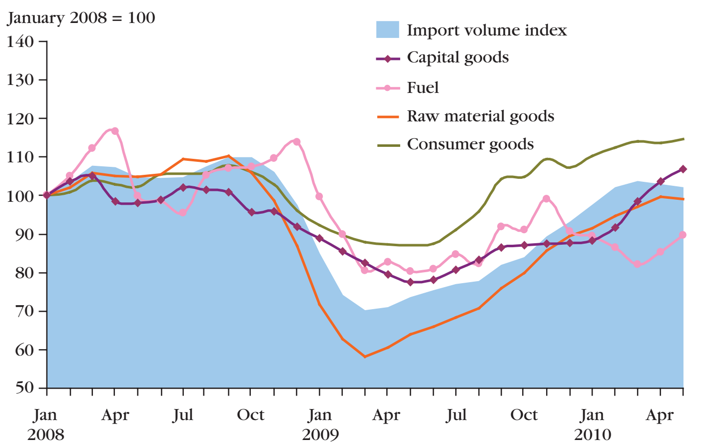
Source: Bank of Thailand

Private investment registered a high quarter-on-quarter growth rate of 6.1 per cent in 2010 Q1, up from 2.8 per cent in the preceding quarter. With that, private investment level surpassed the pre-crisis benchmark. The pick-up in investment activities was associated with capacity expansion in export-oriented as well as domestically oriented production sectors, in particular the electronics, electrical appliances, and automobile industries that saw notable machinery imports during this quarter. Additionally, investment in construction accelerated in tandem with growing residential and commercial construction along the elevated rail network and an increase in large-scale public investment projects.

Private investment surpassed the pre-crisis level in 2010 Q1 and continued to expand in Q2.

In 2010 Q2, investment was expected to expand further in line with rising global demand. Although business confidence was affected by the political turmoil in April, it was already rebounding by late May. The fast recovery of business confidence would contribute positively to the continued expansion of private investment.

Chart 2.6 Import volume index classified by products

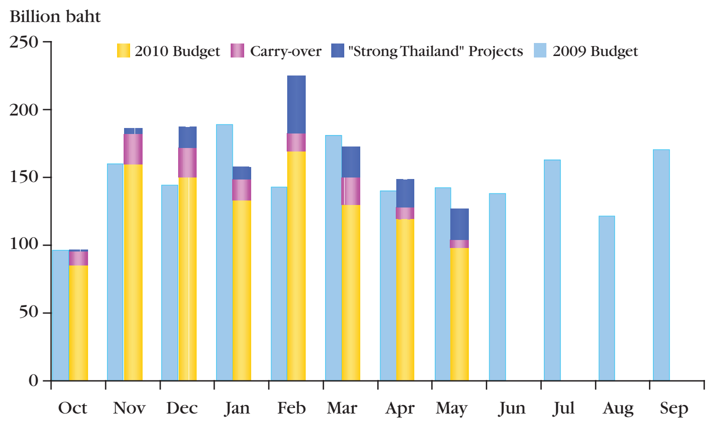


Source: Bank of Thailand

Imports grew briskly in 2010 Q1. Excluding gold, imports continued to expand in 2010 Q2 along with favourable prospects for exports and the economic recovery.

The sustained recovery of exports, consumption and investment brought along an increase in imports of goods and services, which grew by 6.1 per cent quarter-on-quarter in 2010 Q1. In particular, imports of raw materials and intermediate products expanded well, while imports of capital goods accelerated, notably in electrical and industrial machinery. Imports of services, however, declined slightly from a drop in outbound tourist spending. In 2010 Q2, imports excluding gold continued to expand, supported by favorable prospects for exports and the overall economic recovery.

Chart 2.7 Disbursement of government budget



Note: Excluding principal repayments and replenishments of the treasury reserve.
Source: The Comptroller General's Department, Ministry of Finance

Public spending remained supportive of overall economic growth as the accumulated budget disbursement rate stayed high.

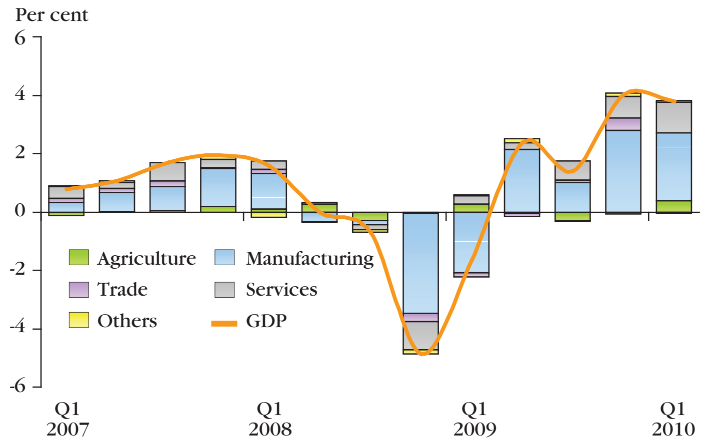
Public spending contracted by 1.1 percent quarter-on-quarter in 2010 Q1, largely due to the decline in public consumption. Nonetheless, budget disbursement remained at a high level, expanding by 6.9 per cent year-on-year. Moreover, the accumulated budget disbursement rate from the beginning of the fiscal year up to May stood at 63.8 per cent, exceeding that of the previous fiscal year, while the total value of "Strong Thailand" Projects approved for procurement reached 86.4 per cent of the total package by end- June 2010.

Production and supply in 2010 Q1 and the outlook for 2010 Q2 [2/]

In 2010 Q1, production and supply recovered in line with demand, with the quarter-on-quarter growth contributions from manufacturing, services and agriculture at 2.3, 1.1 and 0.4 percentage points, respectively. The recovery significantly raised the degree of resource utilization in the economy, as seen from the tightened labour market and the increase in manufacturing capacity utilization. Even though production growth in 2010 Q2 was likely to moderate from the first quarter, economic activities were expected to remain at high levels. Thus, resource utilization was likely to stay tight, while prices of agricultural products and farm income continued to be on an increasing trend, adding pressure on inflation down the road.

In 2010 Q1, production and supply recovered well in line with strengthening demand. Some contraction in the service sector was expected for 2010 Q2, but the rest of the economy was likely to continue expanding.

Chart 2.8 Contribution to GDP growth (qoq, sa)

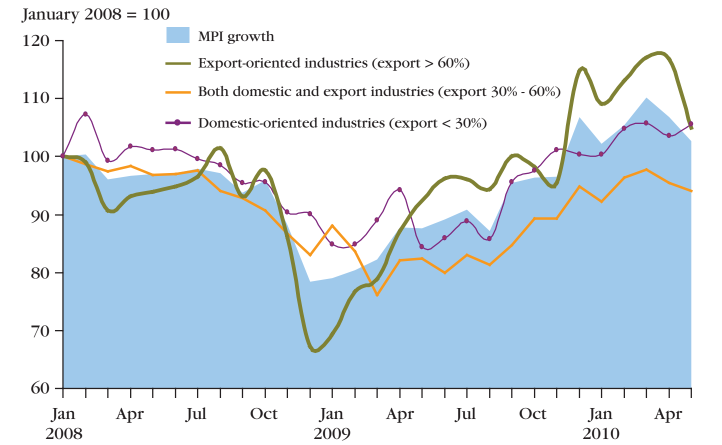


Source: National Economic and Social Development Board

[2/] Data used to analyze aggregate supply in 2010 Q1 came from the NESDB. Economic indicators used for the analysis of 2010 Q1 and the outlook for 2010 Q2 were compiled by the Bank of Thailand, except data on the number of tourists and the occupancy rate which were in part compiled by the Tourism Authority of Thailand. Data on the labour market were obtained from the NSO.

Manufacturing production in 2010 Q1 expanded by 5.7 per cent quarter-on-quarter, decelerating from the growth rate of 7.1 per cent in the previous quarter. Nonetheless, production expanded well in the export and export-related sectors, including electronics, electrical appliances and steel.

Chart 2.9 Manufacturing Production Index (MPI, sa) classified by market



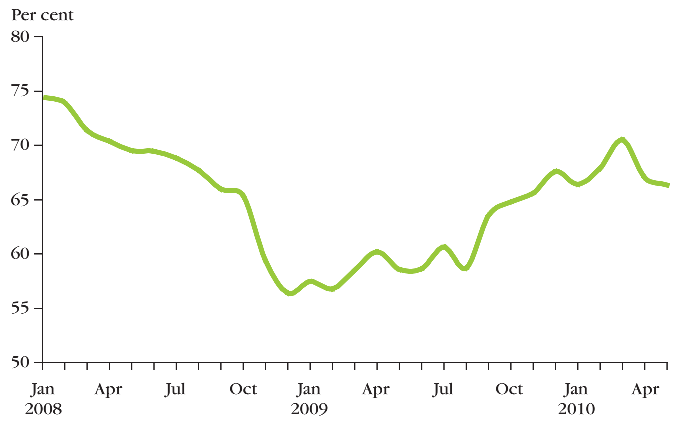
Source: Bank of Thailand

In 2010 Q2, manufacturing output decelerated in tandem with the production of export-oriented goods and goods for both domestic and foreign markets.

In 2010 Q2, manufacturing production maintained favourable growth prospects. Nonetheless, the quarter-on-quarter expansion was likely to slow down from previous quarters, in part because export-oriented industries had previously expanded at exceptional rates while curfew that was temporarily imposed during this quarter also had some effect on night-shift production. In particular, production of automobiles, electrical appliances such as televisions and air conditioners, and electronics, especially hard disk drives, was likely to slow down. In addition, textile production was expected to moderate due to a shortage of raw materials.

The expected moderation in industrial production was in line with the decline in manufacturing capacity utilization. In May 2010, the seasonally adjusted capacity utilization rate stood at 66.0 per cent, down from the monthly average of 68.4 per cent in 2010 Q1. Nonetheless, the rate was still considered high in comparison with previous periods, especially during the recent global economic crisis.

Chart 2.10 Capacity utilization rate (sa)



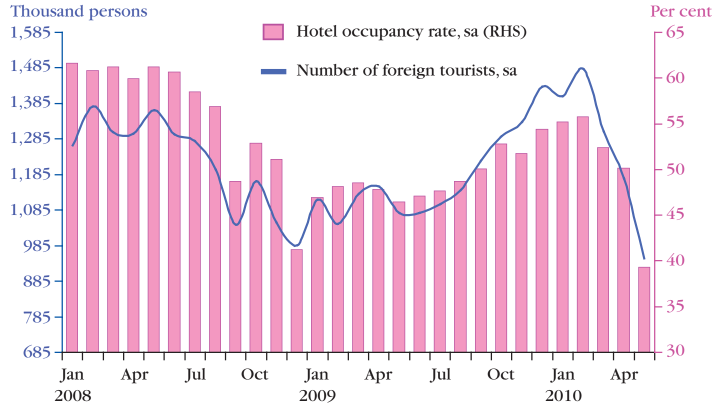
Source: Bank of Thailand

The service sector recovered well in 2010 Q1, expanding by 3.2 per cent quarter-on-quarter. This owed partly to the expansion of the hotel and restaurant sector in line with the recuperation of the tourism industry, as reflected by the number of foreign tourists which grew by 2.8 per cent quarter-on-quarter as their home economies recovered. However, the MPC noted that Thailand's tourism market was shifting away from G-3 countries towards Asia, following a faster recovery of the latter. Meanwhile, the continued expansion in manufacturing production brought along growth in the utilities sector, including water, natural gas and particularly electricity which constituted the largest share of the sector.

The effect of the political turmoil on the tourism industry was less than generally expected.

The political unrest which took place between March and May 2010 had a negative impact on the tourism industry, but not to the extent feared by the general public. In April and May, the seasonally adjusted number of foreign tourists contracted by 24 per cent from the previous quarter, while the seasonally adjusted hotel occupancy rate fell from 54.4 per cent in 2010 Q1 to 39.3 per cent in May 2010. The gravity of the impact was less than the MPC's preliminary assessment due in part to the adaptive nature of foreign tourists who, for example, changed travel plans to fly directly to the South instead of stopping over in Bangkok. As a result, the number of tourists visiting the South continued to rise during those months. Nonetheless, the service sector in 2010 Q2 as a whole was expected to slow down from the previous quarter.

Chart 2.11 Number of foreign tourists (sa) and hotel occupancy rate (sa)



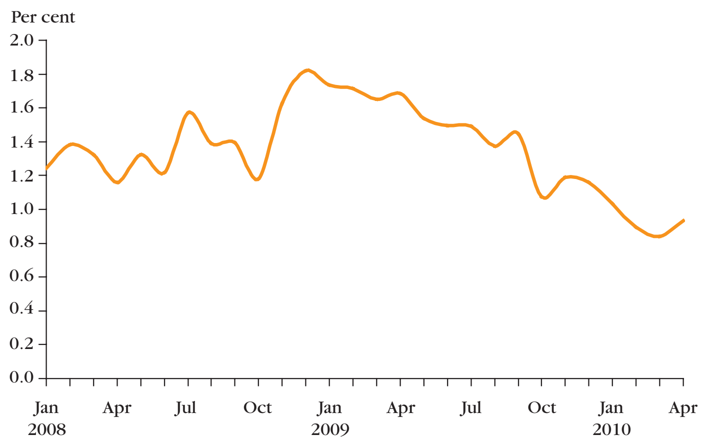
Source: Tourism Authority of Thailand and Bank of Thailand

Agricultural output grew modestly at 0.5 per cent quarter-on-quarter in 2010 Q1, following a contraction of 4.2 per cent in the preceding quarter. Although production of cassava, sugar cane, rice and maize for animal feeds dropped as a result of droughts and pest outbreaks, production of rubber and palm oil expanded quite well. Fishery also expanded, due mainly to the increase in shrimp export. Meanwhile, crop prices rose on the back of favourable global economic recovery. The price increase was the key factor behind the continued expansion of farm income in this quarter.

Farm income continued to rise on the back of both production expansion and favourable crop prices.

In 2010 Q2, agricultural production was likely to stay comparable with the previous quarter. Although farmers continued to suffer from droughts and pest outbreaks, agricultural output was boosted by the expansion in plantation area for rubber and palm oil as well as by the delay in second-crop rice harvest to this quarter. Farm income was expected to rise further from the price factor, following the global economic recovery and supply shortage of some agricultural products.

Chart 2.12 Unemployment rate (sa)



Source: National Statistical Office, calculations by Bank of Thailand

Tightened labour market could add pressure on inflation down the road.

The broad-based expansion in production caused employment to rise, while signs of labour shortage became increasingly evident in certain areas such as in the garment industry. Employment in April 2010 expanded by 0.5 per cent year-on-year, with growth seen in agriculture, construction as well as manufacturing workforce. Accordingly, the seasonally adjusted unemployment rate stood at just 0.9 per cent in April 2010. The recruitment difficulty index in May 2010 was at 43.8, staying below the neutral condition of 50 and thus indicating that businesses were likely to continue facing labour shortage, a condition which could subsequently translate into more inflationary pressure in the future.

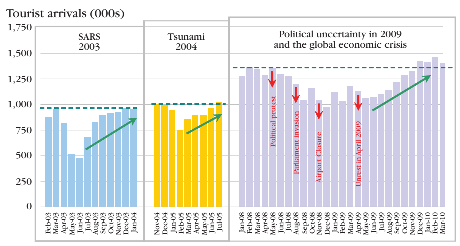
Tourism: significance to the Thai economy and outlook for the second half of 2010

Tourism is one of the sectors that bring in substantial foreign income, accounting for as much as 40 per cent of the service receipts in the current account and approximately 6 per cent of Thailand's GDP. The industry also maintains extensive linkages with other sectors. According to the Input-Output Model[1/], one baht spent by foreign tourists translates on average into an increase in manufacturing production by 1.86 baht and an increase in national income by 0.8 baht. One explanation for these relatively large multipliers is the size of employment in the tourism sector. Directly linked to the tourism industry, hotels and restaurants alone employ 6.4 per cent of the country's labour force. In addition, tourism-related employment extends to transportation, tour guiding, retail sales, souvenir production, and recreation.

Historical experience reveals that, although the tourism sector is highly susceptible to shocks, it usually recovers quickly. Some common findings gathered from recent incidents, namely the SARS outbreak in 2003, the December 2004 Tsunami, and the episode of domestic political uncertainties and global financial crisis in 2008-2009, are summarized as follows.

(1) Inbound tourism was quick to recover, with the rebound to normal levels taking no more than two quarters regardless of the magnitude and duration of the shock. During the SARS outbreak, the number of tourists in May 2003 dropped by as much as 50.5 per cent year-on-year. The Tsunami, however, was a brief incident and only affected tourism in the southern parts of the country. Political uncertainties and the global financial crisis that began towards the end of 2008, on the other hand, were more prolonged, causing the number of foreign tourists to contract year-on-year for 13 consecutive months. Nevertheless, in all these cases the number of foreign tourists managed to bounce back rapidly once the shocks had ended. Econometric analysis also confirms that the impacts of pandemic outbreaks, natural disasters and political unrest on the number of foreign tourists were small in comparison with the effect of changes in foreign tourists' own incomes.

Chart 1 Past recovery of inbound tourism



Source: Tourism Authority of Thailand and Office of Tourism Development

Coefficient values from the error correction model

Short-run model (Adjusted R-Squared = 0.34)

Variable	Coefficient	t-statistic
Δ LOG(TPGDP_SA(-6))	2.76	(2.25)**
Δ LOG(PCRUDE_SA(-3))	-0.20	(-2.38)**
Δ LOG(B$_SA(-9))	1.23	(2.32)**
DUMMY_SARS	-0.13	(-3.26)*
DUMMY_TSUNAMI	-0.21	(-2.81)*
DUMMY_POLITICAL	-0.15	(-4.21)*
ECM_NTOURIST (-1)	-0.34	(-2.81)**

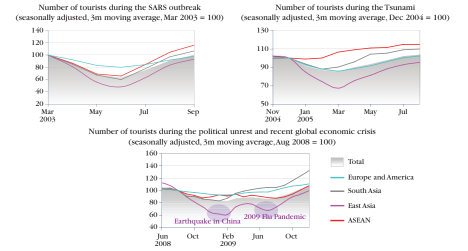
Long-run model (Adjusted R-Squared = 0.87)

Variable	Coefficient	t-statistic
Constant Term	0.95	(1.80)***
LOG(TPGDP_SA)	1.26	(11.30)*
DUMMY_SARS	-0.23	(-5.92)*
DUMMY_TSUNAMI	-0.19	(-3.35)*
DUMMY_POLITICAL	-0.15	(-4.93)*
AR(1)	0.56	(6.87)*

Note: Results are based on monthly data from January 2000 to April 2010
NTOURIST denotes number of foreign tourist arrivals
TPGDP denotes gross domestic product of major tourism markets for Thailand, calculated as an index and weighted by the proportion of the number of tourists by country
P_CRUDE denotes crude oil price (Dubai price)
B$ denotes exchange rate (baht/dollar)
SA denotes seasonally adjusted
Dummy variables include: DUMMY_SARS for periods with SARS outbreak; DUMMY_TSUNAMI for the period with Tsunami; and DUMMY_POLITICAL for periods with political unrest
*, ** and *** indicate statistical significance at 0.01, 0.05 and 0.10, respectively

[1/] Using the 2000 Input-Output Table compiled by the NESDB, the output and income multipliers for the hotel, restaurant and transportation industries were found to be 1.86 and 0.8, respectively.

Chart 2 Past recovery of inbound tourism by region



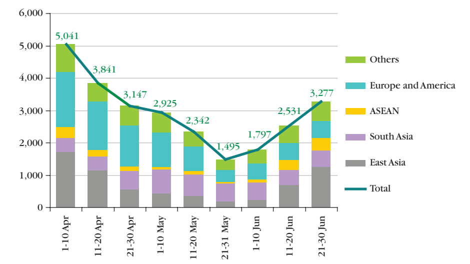
Source: Tourism Authority of Thailand and Office of Tourism Development

(2) The decline in the number of tourists from East Asia, namely China, Hong Kong, Korea, Taiwan and Japan, had a large impact on the tourism industry as a whole. This can be explained by the fact that tourists from those countries account for 30 per cent of total inbound tourists, and they tend to be more sensitive to negative shocks. **Nevertheless, the duration of their recovery did not differ from other groups'**. East Asian tourists are more flexible in terms of trip arrangement, requiring only 1-3 months of advance arrangement due to shorter travel distances, compared with tourists from Europe and America who require 3-6 months of planning.

An outlook for inbound tourism

Going forward, the number of foreign tourists travelling to Thailand is expected to increase in tandem with the global economic recovery. Previously, domestic political unrest and the European sovereign debt crisis that could weigh on the pace of the European economic recovery, along with seasonal factors, caused a sharp drop in foreign tourists in May 2010. At the time, the MPC projected the tourism industry to be significantly affected throughout the rest of the year.

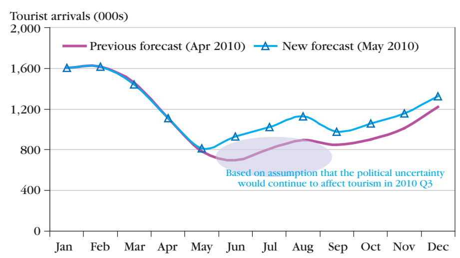
Chart 3 Average number of ATTA's clients per day



Source: Association of Thai Travel Agents (ATTA)

Several countries, however, have since retracted their travel advisory in view of the improved political situation. As a result, foreign tourists have regained confidence in Thailand, and a rise in the average number of tourists per day[2/] was already observed in June, with the rebound coming mostly from Asian tourists, in particular those from China, Hong Kong and ASEAN countries, reflecting a swift recovery just as in the past.

Chart 4 Forecast of foreign tourist arrivals in 2010



Source: Bank of Thailand

Barring negative factors which could dent tourists' confidence, the number of foreign tourists is expected to improve steadily in 2010 H2, returning to normal levels by the year-end peak season. For the whole year, the number of tourists in 2010 is likely to be close to the 2009 level. However, competitive pricing to attract tourists is another factor that can cause a decline in total tourism receipts in 2010 relative to the previous year.

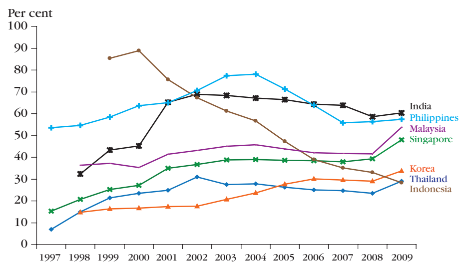
[2/] Based on the number of clients of the Association of Thai Travel Agents (ATTA) travelling through Suvarnabhumi Airport between April and June 2010.

Resolving the sovereign debt problem

The sovereign debt crisis in some European countries such as Greece reflects a structural problem which has persisted for many years, as current expenditure on public welfare programs have outpaced government revenues. The problem was intensified by the recent global economic crisis which saw increased spending by governments to ameliorate the impact of the global slump.

The European debt crisis has triggered stakeholders to pay more attention to the level of public debt in Thailand. At present, Thailand's public debt is at a satisfactory level of 42.2 per cent of GDP (as of end-April 2010), with direct government borrowing of only 28.5 per cent of GDP. Moreover, the ratio of foreign liability to total public debt has declined dramatically from 30.0 per cent at end-fiscal year 2000 to 8.7 per cent in the current fiscal year, while short-term liability to total public has fallen from 19.0 per cent to 6.1 percent over that same period.

Chart 1 Public debt to GDP



Source: IMD World Competitiveness, May 2010

Table 1 Public debt and fiscal balance to GDP in 2009

	Public debt (% of GDP)	Fiscal balance (% of GDP)
U.S.A.	83.0	-11.0
Japan[1/]	192.9	-7.2
Euro area	86.3	-6.3
Germany[2/]	76.2	-3.3
France	86.3	-7.6
Greece	119.0	-13.5
Ireland	70.3	-14.3
Italy	128.8	-5.2
Portugal	87.0	-9.4
Spain	62.6	-11.2
Thailand	45.2	-3.9

Note : [1/] Including debt of the Japan Railway Settlement Corporation and the National Forest Special Account from 1998 onwards.
[2/] Including debt of the Inherited Debt Fund from 1995 onwards.

Source: OECD Economic Outlook, Public Debt Management Office and Bank of Thailand

In comparison with OECD countries, Thailand maintains modest levels of public debt and budget deficit relative to GDP. Even though the ratios are somewhat above the pre-Asian crisis levels, Thailand has been able to reduce public debt from 90.0 per cent of GDP in 2000 to 28.3 per cent of GDP by the end of fiscal year 2009, in line with the performance of other crisis-hit Asian countries like Korea, Singapore, Malaysia and the Philippines, with Indonesia being the only exception. Thus, overall risks in managing public debt remain low in Thailand.

Nevertheless, public debt as a share of GDP is just one among many indicators of the Medium-term Fiscal Sustainability Framework. That many countries, including the EU and Thailand, try to keep their public debt below the international benchmark of 60 per cent of GDP is not necessarily sufficient for fiscal sustainability in the longer term. Governments need to lower their fiscal deficits in order to bring the ratio of public debt to GDP down in the future.

For Thailand, although there are no signs of an emerging public debt crisis at this time, issues regarding fiscal sustainability still warrant attention, especially in light of a number of limitations in the fiscal structure. In particular, average revenue growth of 8.0 per cent per year is well below the average growth rate of 15.0 per cent per year for committed expenditure and social welfare outlays. As it becomes increasingly difficult for the government to attain a balanced budget, public debt as a percentage of GDP will eventually increase, risks to fiscal sustainability in the medium term.

In addition, the present expenditure structure lacks flexibility as current expenditure and transfers make up as much as 80 per cent of total expenditure with the ratio deteriorating in accordance with the aging demographic structure. Meanwhile, interest payments may also trend upwards given a larger amount of total borrowing and higher risk premiums associated with higher debt. Eventually, funds for investment in infrastructure projects and the maintenance of national competitiveness may be crowded out. That in turn will weigh on Thailand's potential growth and add even more limitations to the expansion of government revenue.

On the financing side, the present structure of long-term domestic saving and a thin capital market also limit the government's ability to find alternative funding sources. Japan, in contrast, has a very high saving rate; therefore, domestic savings can be used as an important financing source for the government despite Japan's public debt approximately doubling the size of its GDP.

To rein in risks to fiscal sustainability down the road, the government should plan to achieve balanced budgets within the next 5-10 years. In order to do so, concrete guidelines for fiscal consolidation must be in place, including a reform of the tax system and the revenue structure, as tax collection now stands at only 17 per cent of GDP– just half of that in developed countries– with only a sixth of the workforce in the tax base. In addition, the government should avoid measures relating to populist policies, such as cost-of-living subsidy measures which have already been terminated by many countries, including the G-20. On the contrary, more attention should be given to capital expenditure, especially investment in basic infrastructure. Some projects, however, may require a change in funding schemes towards greater participation of users with the ability to pay. Public-private partnerships (PPPs) should also be promoted to relieve the burden of the government as well as to enhance the effectiveness of investment.