

## 1. Overview

In the first half of 2007, Thailand's economic growth registered an average rate of 4.3 per cent year-on-year, a moderation from 5.0 per cent growth in 2006. This was in line with the assessment of the Monetary Policy Committee (MPC) in the previous *Inflation Report*. Considering the components of economic growth, domestic demand slowed down by more than expected. The slowdown was particularly apparent in private investment, which contracted year-on-year in both quarters as a result of various sources of uncertainty in the economy, including uncertainty in government economic policies. In addition, growth of private consumption was weaker than expected, given that continued fragile consumer confidence had a negative impact on the purchase of durable goods. On the other hand, exports expanded by more than previously projected, partly due to a stronger global economic environment than was previously anticipated by the MPC. In addition, most exporters were able to adjust their operations and sales strategies in finding new export markets, thus cushioning the impact of the appreciation of the baht on overall export performance. Export growth therefore helped to compensate for the slowdown in private demand and was an important driver of economic growth throughout the first half of the year, while the acceleration of government spending also helped stimulate economic growth compared to end-2006.

Unit: % $\Delta$ yoy	2006	2006			2007	
		Q2	Q3	Q4	Q1	Q2
<b>Domestic demand<sup>1/</sup></b>	<b>3.4</b>	<b>3.8</b>	<b>3.1</b>	<b>1.8</b>	<b>1.5</b>	1.3
Private consumption	3.1	3.3	2.8	2.5	1.3	0.9
Private investment	3.9	3.3	2.9	2.3	-2.3	-0.8
Public expenditure	3.4	5.7	4.3	-4.2	11.1	7.4
<b>Net exports of goods and services</b>	<b>46.9</b>	<b>147.0</b>	<b>3.1</b>	<b>30.4</b>	<b>32.9</b>	<b>22.6</b>
Exports of goods and services	8.6	9.0	4.7	7.0	6.9	6.7
Imports of goods and services	1.6	-1.7	5.2	1.0	-0.2	3.7
<b>Gross domestic product</b>	<b>5.0</b>	<b>5.0</b>	<b>4.7</b>	<b>4.3</b>	<b>4.2</b>	<b>4.4</b>

Note: % $\Delta$ yoy = percentage change from the previous year

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

Source: National Economic and Social Development Board

In spite of the lower than expected growth in private spending in the first half of the year, latest economic indicators in 2007 Q3 showed signs of a gradual but continued recovery in both the private consumption and private investment indices. Factors supporting the recovery included greater clarity in the political direction following the referendum on the new Constitution, and an acceleration of public spending which helped to stimulate economic activity. In addition, low inflation helped to preserve consumers' purchasing power, while monetary policy continued its easing cycle. Fragile confidence remained a negative factor that kept the recovery at a gradual pace. The MPC therefore assessed that the recovery of private consumption and investment would continue, but was likely to expand at a slower than previously expected pace for the rest of the year, compared to the previous *Report*. However, the recovery would strengthen and become more apparent in 2008, following the general election scheduled for the end of this year and increased political certainty.

While private domestic demand recovered gradually, government spending played a role in supporting overall economic growth. External demand was expected to expand robustly as previously anticipated, but on a gradually moderating trend in line with the expected slowdown in the global economy. The baht was expected to continue to appreciate in line with regional currencies. Increased concerns in the US subprime market since the end of 2007 Q2 would be an important risk to US economic growth going forward, but so far had not affected trading partners' growth in 2007. In addition, the readiness of central banks in many countries to pause their tightening stance of monetary policy to lighten the impact from the subprime problems further cushioned the impact on world growth in 2008. The export trend, along with a slow down in Thai imports given the slowdown in private domestic spending, was likely to lead to higher than previously expected growth in net exports.

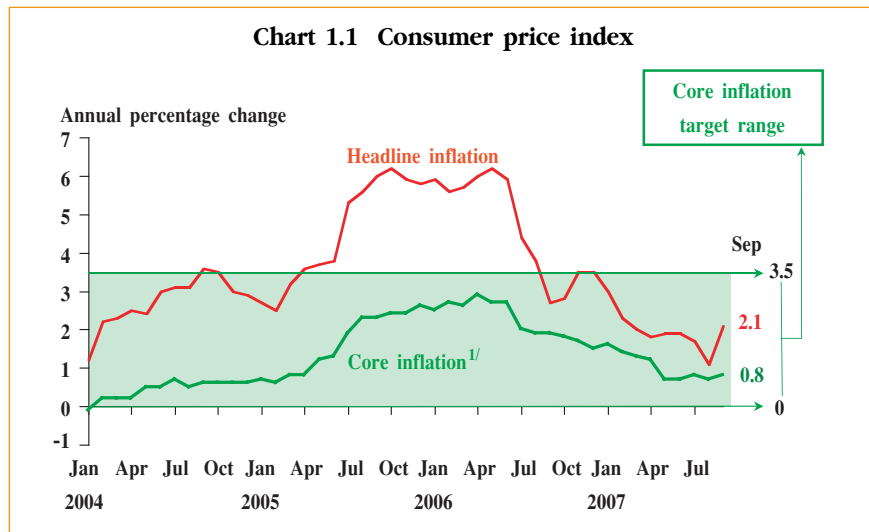
The assessment of economic conditions and initial forecasts led the MPC to maintain its growth projections for 2007 and 2008 for the baseline scenario. However, the MPC viewed that going forward, there were increased uncertainties from the previous forecast as a result of continued concerns that problems in the subprime market could be more widespread. Therefore, the fan chart for economic growth in 2008

became wider, compared to the previous *Report*, reflecting this increase in uncertainty. The fan chart for growth was also skewed downwards throughout the forecast range, reflecting negative risks from concerns in the US subprime market. However, the forecast remained within the previous forecast range of 4.5-6.0 per cent in 2008. As for 2007, the MPC narrowed the forecast range to 4.3-4.8 per cent to reflect actual data from the first half of the year.

The slowdown in economic activity in the previous period had no significant impact on the balance sheets of firms and households. However, the corporate sector's ability to make profits declined, while households' ability to service their debts worsened somewhat. At the same time there were signs that households began to adjust their behaviour, such as practicing greater caution in their spending habits, making the overall situation less of a concern. As for the banking sector, credits to the corporate sector continued to contract year-on-year, particularly credits for investment purposes, in line with the downtrend in investment in previous periods. Credits to the household sector grew at a satisfactory pace, however, and continued to drive overall credit growth. In any case, the overall moderation in credit extension did not have any significant impact on the balance sheets of commercial banks. Commercial bank reserves remained at a high level compared to international standards, and the ability to earn profits remained robust. However, there were signs that non-performing loans would increase and would need to be monitored going forward.

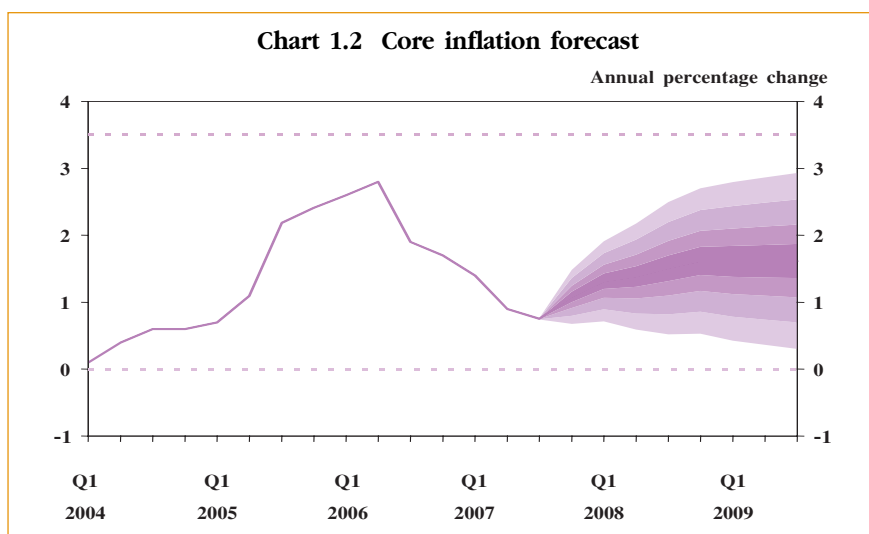
### ***Inflationary outlook and monetary policy***

Over the previous periods, inflation moderated in line with the MPC's forecasts, even though inflation in 2007 Q3 decelerated by more than the MPC expected, as a result of the slow recovery in domestic demand which led to limited room for price increases. Price increases were initially expected to be more widespread, given the lifting of the 8<sup>th</sup> statement of the Administrative Reform Council under the Democratic System on 6 April 2007, which had earlier prohibited the increase in prices for all goods and services. In addition, in the months of July and August 2007, price pressures from higher global oil prices were subdued, owing partly to the stronger baht.



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

Going forward, pressures to inflation from the supply side were likely to rise, both from oil and commodity prices, as well as from the proposed increase in the price of cooking gas (LPG) and the ceiling of excise tax on cigarettes and alcohol. At the same time, demand side pressures remained minimal, given that recovery of domestic demand was at an early stage. The MPC therefore assessed that the forecast for core inflation would not change significantly from the previous *Report*, while the upside and downside risks to growth were quite balanced both in 2007 and 2008. The forecast range for average core inflation in



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

2007 was narrowed down to 0.8-1.3 per cent, given actual data up to 2007 Q3, while the forecast for 2008 was unchanged at 1-2 per cent. There were increased risks to headline inflation, however, from supply side factors. The forecast range for average headline inflation in 2008 was therefore increased to 1.5-2.8 per cent, but was narrowed down for 2007 to 1.8-2.3 per cent given actual data up to 2007 Q3.

Compared to the previous period, risks to inflation increased slightly but remained at a low level, while risks to growth remained. But given that there had been considerable accommodation of monetary policy since early 2007, along with continued signs of recovery in domestic private demand, as well as continued uncertainty with regards to concerns in the US subprime market which would need to be monitored closely going forward, the MPC decided to maintain the policy interest rates at 3.25 per cent per annum at both MPC meetings on 29 August and 10 October 2007.