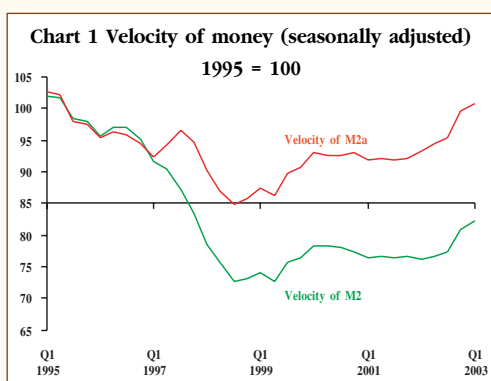


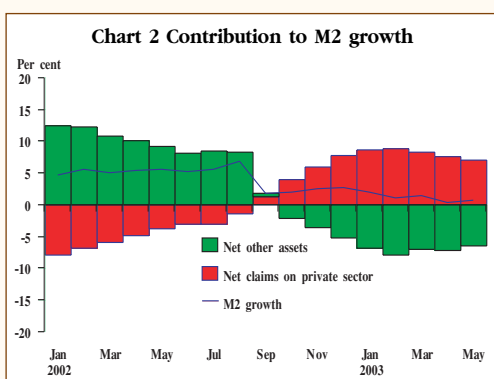
Monetary base, money supply, and the Bank of Thailand's monetary policy

In general, the growth of monetary base and money supply is expected to be in line with output expansion. In recent periods, however, monetary base growth outpaced that of money supply noticeably. Monetary base grew quickly at 13.7 and 12.4 per cent in 2002 and 2003 Q1, respectively, in line with output expansion, while money supply (M2a) expanded only by 2.4 and 1.5 per cent over the same period. These developments pose interesting issues as follows:

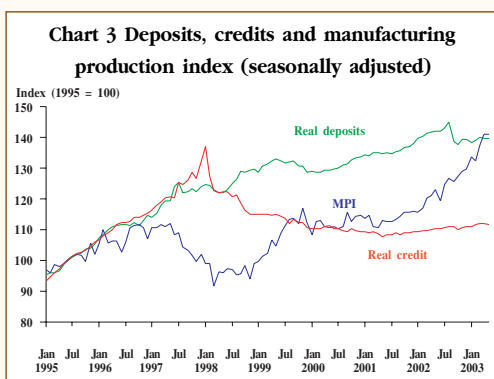


1. Rise in Velocity of Money

Fast output expansion that outpaced money supply growth raised the velocity of money, reflecting the ability of the economy to grow with less dependence on money supply expansion. An examination on the sources of money supply revealed that, although commercial banks' claims on private sector expanded, its growth was not as fast as that of the Manufacturing Price Index (MPI).



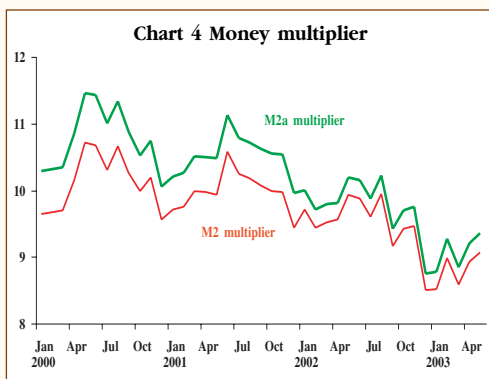
Economic expansion especially in the manufacturing sector that became less dependent on commercial bank credits, reflected not only the shift towards issuance of debt instruments, but also indicated inefficiencies in the banking system with regard to money creation process. Commercial bank credits were unable to grow in line with the deposits and output expansions. Besides, the lack of alternative investment opportunities led to a continued reliance on the banking system for investment returns.



The higher growth of deposits compared to the growth of claims on private sectors created high liquidity in the banking system and put pressure on commercial banks to adapt their operations. In the recent years, commercial banks still concentrated on reducing interest payments, as interest receipts, although continued to improve, had not yet proven to be the main source of profits. The recent rounds of interest rate reduction by commercial banks helped cut down their deposit costs in line with net interest margin (NIM), and stabilized

Source: Bank of Thailand

the spread between interest receipts and interest payments. Stable interest spread, in turn, helped improve commercial banks performance continuously.

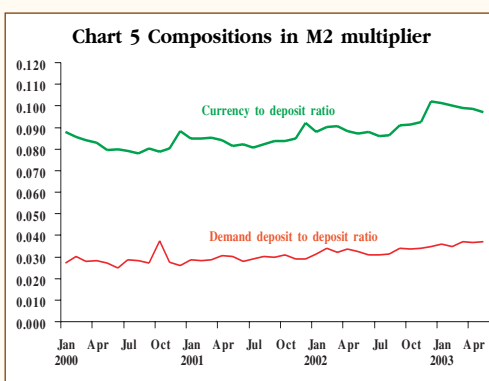


2. Fall in Money Multiplier

The outpacing of monetary base growth over that of money supply also led to a fall in the money multiplier. Aside from the banking system's inefficient role in the money creation process, other causes of the fall in the money multiplier were the following:

1. The change in savers' asset holding structure through the switch from deposits at the commercial bank to bonds, especially the FIDF saving bonds issued in the second half of 2002. The switch from deposits to the FIDF saving bonds resulted in an immediate drop of money supply, but had no impact on monetary base.

2. The rise in currency to deposit ratio, responding to more use of cash in the economy was partly due to the rapid growth in the economy at the grass root level that relied mainly on cash transactions.



Source: Bank of Thailand

3. The BOT's Monetary Policy Stance

In recent years, consumer spending rose in line with output expansion, as reflected by acceleration in GDP and the Private Consumption Index (PCI). Monetary base thus grew in line with more currency held by the public. The BOT, therefore, injected liquidity responding to public spending demand and real demand of the economy.

The outpacing of monetary base over money supply did not mean that the BOT had tried to inject more liquidity to stimulate growth. Instead, it reflected the changes in the relationship between money supply and economic activities. Future analyses would thus need to consider money supply in a broader definition.

Changes in monetary base were due mainly to changes in demand factors. Under the inflation targeting framework, the BOT is responsible for keeping the policy rate, i.e. the 14-day repurchase rate, at the level set by the MPC. As such, the BOT has to forecast the use of monetary base that changes mainly in response to public demand via cash withdrawal from the banking system. In absorbing or injecting liquidity, the BOT, which sets the policy rate, is thus the party that pursues net transactions in the money market in order to keep demand for and supply of liquidity in line with both the policy rate and the inflation target.