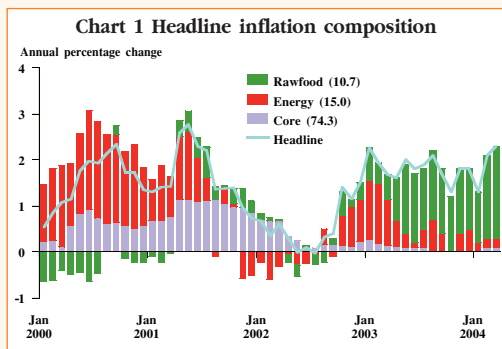
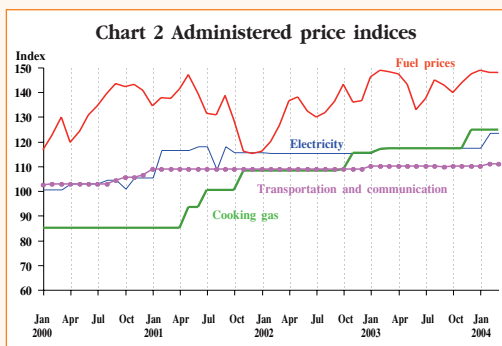


Price Pressure and Inflation Trend

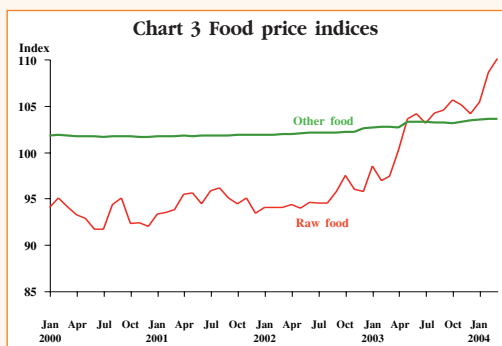
Given the clear sign of world economic recovery, the continuous rise in commodity and oil prices resulted in a higher inflationary trend in many countries. Notably, China, which has been exporting lower-priced goods, is now experiencing rising cost pressure as well as accelerating inflation. In 2004, price pressure in Thailand is most likely to be upward owing to increases in prices abroad and a growing domestic demand, with which producers could pass their rising costs on to consumers. Nevertheless, core inflation, which is the monetary policy target, has remained low and close to zero for more than one and a half years, although headline inflation rose to average around 2 per cent per annum in 2003, reflecting the stickiness in the upward price adjustments of goods in the core CPI basket.



Source: Trade and Economic Index Bureau, Ministry of Commerce



Source: Trade and Economic Index Bureau, Ministry of Commerce



Source: Trade and Economic Index Bureau, Ministry of Commerce

Short-term core inflation trend

Owing to declining housing rent, core inflation turned negative in January 2004, the first time ever since the consumption price index has been compiled. Examining the components of headline inflation from 2002 Q4, the rise in headline inflation was due to alternative rises in raw food and energy prices. Meanwhile, core inflation hardly moved and has remained near zero, although rising raw food and energy prices should have led to rising prices of other items in the core CPI basket.

With regard to **energy** prices, although world crude oil prices have been rising, prices of energy-related goods and services, such as cooking gas, electricity and transportation have remained almost unchanged over the past year. One reason explaining the stickiness in the upward adjustment of energy prices is the government's measure to stabilize domestic retail oil prices. Crude oil prices thus need to adjust upwards continuously for some period before affecting prices of goods and services administered by the government. Notably, cooking gas, electricity and transportation charges have gradually adjusted upwards towards the end of 2003 and early 2004. Going forward, if oil prices remain at this high level, administered prices are expected to rise further, especially electricity and water utility charges during mid-2004.

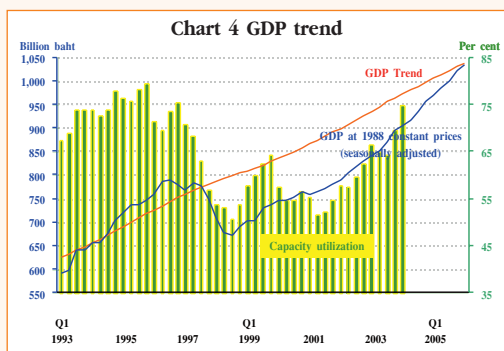
As for **food** prices, it is worth noting that despite rising raw food prices, the prices of ready-to-eat and semi ready-to-eat food have risen only marginally. Other food prices have also changed only slightly since 2000.

The relatively slow pass-through of increases in raw food and energy prices meant the increases were not enough to counter-balance the impact of

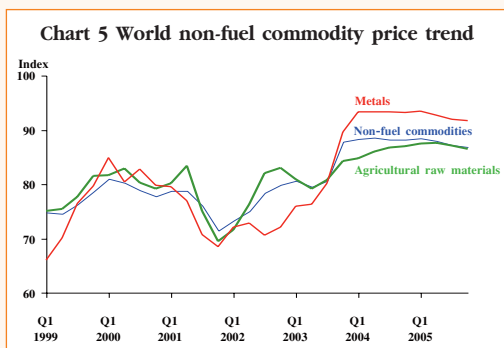
declining housing rent, which accounted for 24 per cent of the core CPI basket, causing core inflation to remain low. Nevertheless, prices of goods and services related to raw food and energy have started to adjust upwards, while the decline in housing rent has moderated. Core inflation should thus rise and should be non-negative throughout 2004.

The long-term core inflation trend

Going forward, 3 main factors indicating price pressure include:



Source: Bank of Thailand estimates



Source: IMF

(1) Demand-side pressure (or domestic demand) reflected by the narrowing output gap, in line with rising capacity utilization, which will put upward pressure on prices going forward.

(2) Cost pressure from raw material inputs such as world crude oil, farm, and world commodity prices. According to IMF's estimation, prices of the aforementioned raw material inputs will remain high for the next 2 years due to the acceleration in world demand, particularly that of China. Although China is one of the top 5 world producers of steel, producing 220.12 million metric tons or a 21.2 per cent increase in 2003, China's import value of steel in February 2004 accelerated to 1,884.3 million US dollars, or a 50 per cent rise year-on-year.

(3) Global competition and profit-maintenance capability of domestic businesses. BOT's business sentiment survey suggested that fierce competition in the domestic market was the most important business obstacle since early-2003 and was also the reason forcing businesses to compete by

lowering sale prices and accepting lower profit margin. However, surveys during late 2003 and early 2004 found that production costs have become the second most important obstacle compared to its prior minimal significance. This indicates that business operators may be in a situation where they will have to raise prices albeit the present fierce competition.

In conclusion, increasing raw food and energy prices caused headline inflation and production cost to rise over the previous period, and to be on the upward trend going forward. Core inflation, however, was insignificantly affected by these price changes. One reason explaining the stickiness of core inflation is that prices of fundamental necessity services, such as utility and public transportation, have been administered by the government. Another reason is that the highly competitive market caused firms to accept lower profit margin. Nevertheless, as production costs and aggregate demand continue to rise, the authority may allow prices of administered goods and services to adjust upwards. Meanwhile, entrepreneurs can, to some extent, pass on the rising cost to consumers. Prices of goods in the core inflation basket will thus eventually pick up on a rising trend.

In analyzing price pressures to conduct monetary policy, the MPC deemed important to also monitor other price movements together with core inflation.