

Labour Market Conditions and Inflationary Pressure

In previous issues of the *Inflation Report*, the analysis on price pressures focused on the reasoning behind low inflation. The current situation however, is changing with the recent continuous rise in commodity and oil prices as well as the expanding world economy, causing the rising inflationary trend in many countries, including that in Thailand. The latest data showed that headline inflation in June 2004 accelerated to 3 per cent, up from 0.6 and 1.8 per cent in 2002 and 2003, respectively. Core inflation remained low, although rising slightly from 0.1 per cent in 2003 to 0.5 per cent in June 2004, reflecting that price pressures from demand were not yet high enough for producers to pass on to consumers. Nevertheless, as the economy continues to expand and

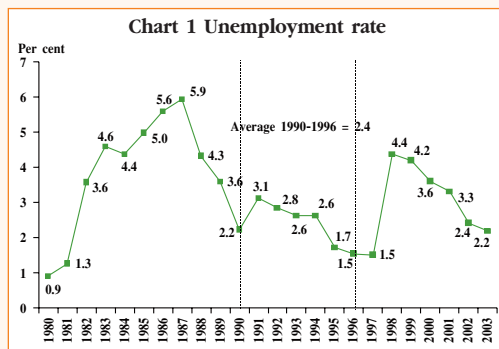
investments increase, demand for labour will also rise. A tightening labour market will exert pressure on wages while rising income will lead to demand-side pressure. Thus, an upward wage adjustment is an important factor that can cause higher headline and core inflation.

Labour market indicators

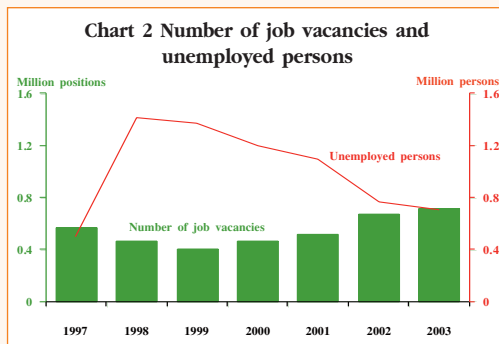
The downward trend in the unemployment rate, which is approaching the lowest level in 20 years, indicates a tightening labour market. During the economic crisis, the average unemployment rate in 1998 was 4.4 per cent, while last year's figure fell to a low of 2.2 per cent. Increasing demand for labour induced the difference between the number of job vacancies and that of unemployed workers to decline continuously.

According to 2 rounds of surveys conducted by the Economic/Business Information Exchange Programme between the Bank of Thailand and the Business Sector, 42 per cent of 45 firms within the Bangkok Metropolitan Area and perimeter provinces view that the labour market is tightening, especially that in the construction and real estate sectors, which lack skilled workers and contractors, as well as that in the food industry. In addition, some firms in the automobile and electrical appliances sector also indicate a shortage of engineers.

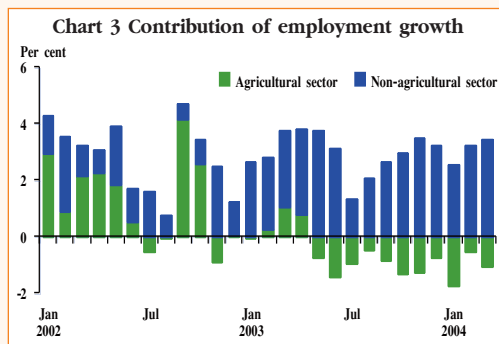
The tightening labour market is not only occurring in the Bangkok Metropolitan Area and perimeter provinces. From surveys conducted by Bank of Thailand regional offices, many real estate developers in the northern region consider that the labour market is tightening, in particular that for skilled-labour. In



Source: National Statistical Office (NSO)



Source: National Statistical Office (NSO) and Department of Employment

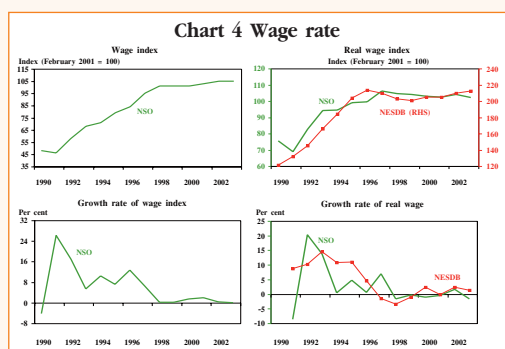


Source: National Statistical Office (NSO)

the southern and northeastern regions there is a shortage of general labour in the manufacturing sector. This finding is in line with data released by the National Statistical Office (NSO) that the increasing labour demand is primarily concentrated in the manufacturing sector, whereas in the agricultural sector there still exists excess labour. In other words, the tightening of the labour market is localized in that for skilled-labour.

Pressure on wages and inflation

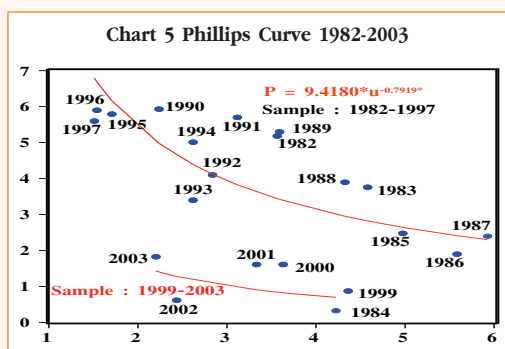
Even though the labour market is tightening, pressure on wages is not yet apparent. According to the NSO, nominal wages have continuously been moving downwards with hardly any change in 2002 and 2003 and did not respond to the acceleration in inflation, thereby causing the rate of increase of real wages to be negative.



Source: National Statistical Office (NSO) and National Economic and Social Development Board (NESDB)

Note that, although data from the National Economic and Social Development Board suggests that real wages rose by 1.3 per cent in 2003, which is higher than NSO's estimation, it still reflects that nominal wages have grown slower than the inflation rate.

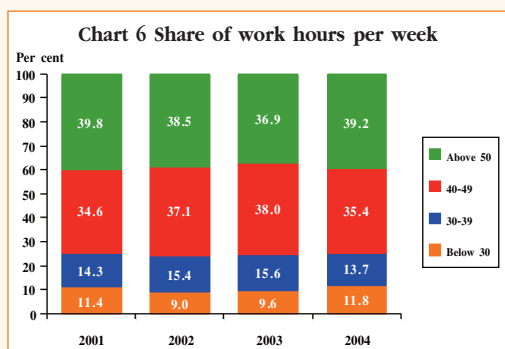
Although the unemployment rate has recently been low, it has not caused inflationary pressure as in the past. The Phillips curve, which depicts the inverse relationship between inflation and unemployment, shows that the slope during 1999-2003 is flatter than that during 1982-1997. This weakening of the relationship may be explained by non-wage adjustments, namely working overtime and student employment (as evident in the rising ratio of the number of persons working fewer than 30 hours per week and those working more than 50 hours per week), additional employee benefits, employment of non-residents, and the substitution of machinery for labour. Although the effect of labour market tightening on wages has not been perceivable, if non-wage adjustments should become inaccessible, wage increases could ensue.



*Statistically significant at 5%

Source: Bank of Thailand estimates

The MPC viewed that increasing price pressure, resulting from either production costs or wages, might cause inflation expectation to increase, leading to higher private spending and rising prices of government administered or closely supervised commodities. Consequently, price stickiness, as currently experiencing, will gradually disappear. If this should be the case, the inverse relationship between inflation and unemployment would become more apparent than in the past. The MPC thus deemed it necessary to closely monitor factors that may cause inflationary pressure.



Source: National Statistical Office (NSO)