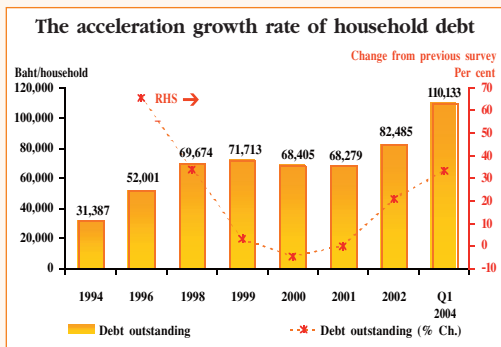
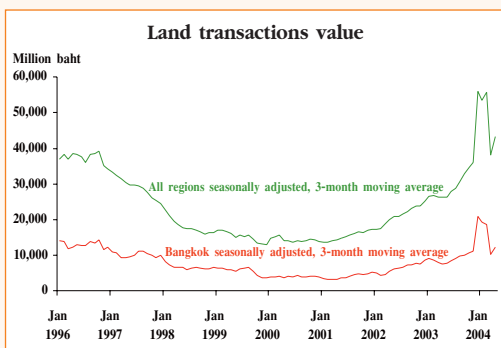


Macroeconomic Vulnerabilities Assessment

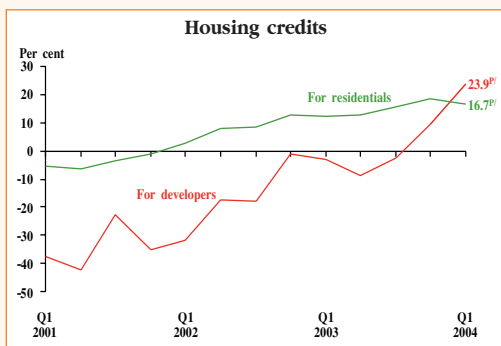
During the economic up-cycle, in addition to monitoring inflationary pressure, the main objective of maintaining economic stability, financial imbalances should also be monitored. Financial imbalances that may occur during an economic up-cycle could induce economic vulnerabilities and hamper sustainable economic growth, which in turn could lead to drastic economic adjustments going forward. Against the aforementioned risks, the MPC assessed macroeconomic vulnerabilities to include: (1) household debt (2) the real estate sector (3) external stability (4) credit and performance of commercial banks, and money supply (5) business performances (6) Thai stock market and (7) fiscal position and public debt. Since the beginning of 2004, the MPC has released



Source: National Statistical Office (preliminary data for Q1 2004)



Source: Department of Lands and Bank of Thailand estimates



^{P/}= Preliminary data

Source: Bank of Thailand

reports on these vulnerabilities and has emphasized in the MPC press conference of the need to monitor those vulnerabilities. Recently, in the 21 July 2004 meeting, the MPC considered it important to monitor indicators of potential financial imbalances, particularly in household debt and the real estate sector.

The latest survey of the National Statistical Office (NSO) indicated that **household debt** continued to increase. Factors driving up household debt include economic recovery, improvements in consumer confidence, the low interest rate environment, government economic stimulus measures and an increase in household credit extension by financial institutions. Preliminary figures for 2004 Q1 by the NSO found that total debt per household increased by 33.5 per cent from the average in 2002.

Going forward, the **real estate sector** should continue to expand well. During the first four months of 2004, the real estate sector grew favourably despite the termination of the property tax reduction measure at the end of 2003. The land transactions value grew year-on-year by 48.7 per cent during the first four months of 2004. The average land price appraisal which increased by 14.4 per cent implied that the volume of land transactions expanded by 30 per cent. In addition, housing credits, especially credits for developers, increased substantially consistent with the expansion of permitted construction areas. During the aforementioned period, both new real estate projects, especially luxurious condominiums in central Bangkok, and new developers entering into the market expanded well. The Bank of Thailand has thus closely monitored credit expansion, in particular, the continuous credit extension to developers following the increase in demand.

The remaining five indicators which do not yet indicate financial imbalance include:

- **External stability** which remained strong in 2004 Q1. International reserves continued to rise, standing at 43.0 billion US dollars at the end of March 2004, while external debt declined to 52.3 billion US dollars at the end of January 2004. As a result, external debt was at 40 per cent of GDP and the international reserves to short-term debt ratio stood at 3.8, reflecting sound external stability and the Thai economy's capability to withstand external volatilities. Although current external risks remained low, the acceleration of imports together with demands for investment from both public and private sectors to accommodate future economic expansion would lead to a decline in the trade and current account surplus in the short-term but could turn to deficit in the medium-term.
- **Credit and performance of commercial banks, and money supply:** performance of the entire banking system remained strong. Commercial bank credit has been on the upward trend since the beginning of 2003 with operations improving continuously. As of 2004 Q1, operating profits of commercial banks rose to 30.91 billion baht, reflecting an increase in effective interest rate spreads of commercial banks. The surge in profits were partly due to the redemption of SLIPs and CAPs, enabling commercial banks to partially lower interest payments. Although the acceleration of commercial bank credits will contribute to a rise in money supply, signs of financial imbalance are still unclear. When compared to GDP growth, the growth rate of commercial bank credits was lower than that of the overall economy. Nonetheless, if private investment continues to accelerate in future periods, credit expansions should be closely monitored, particularly in housing credits and personal consumption credits.
- **Corporate performance** improved during the first quarter of 2004, with high levels of liquidity, as a result the cash to short-term debt ratio rose continuously. In addition, some corporations gradually issued new common stocks during 2004 Q2. This helped them to strengthen their potential operations without incurring a large expenditure burden. Currently, there are 2 sectors showing an upward investment trend. One is the manufacturing sector, which continues to invest in fixed assets. The other is the real estate sector, where funding from external loans and the issuance of securities has accelerated since the second half of 2003.
- **The Thai stock market** was sluggish in 2004 Q2 due to the continuous rise in oil prices and investors' concerns regarding the upward adjustment of the fed funds rate. However, after the FOMC announced the increase in the fed funds rate by 25 basis points as the market expected, the credit upgrades of Thai commercial banks by Standard & Poor and the expectation of strong operating performance for listed companies in 2004 Q2 attracted foreign investors to re-invest in the Thai stock market. Despite the relatively gloomy conditions in the secondary market in the first half of 2004, listed companies continued to issue new common stocks in the primary market. The total value of initial public offering was approximately 18.3 billion baht, compared with 21.1 billion baht for the year 2003.
- **Fiscal position:** Thailand's public debt continuously declined due to improved debt management and fiscal discipline. With the purpose of achieving fiscal sustainability, the government established the following targets: to maintain public debt at not more than 50 per cent of GDP; to contain government debt at not more than 15 per cent of budgeted expenditures; to achieve a balanced budget for fiscal year 2005 and to retain investment expenditure at not less than 25 per cent of budgeted expenditures. Nonetheless, the risks of fiscal position going forward may occur due to credit expansion extended by specialised financial institutions in line with government policies, mega projects, and the Decentralization Act.