

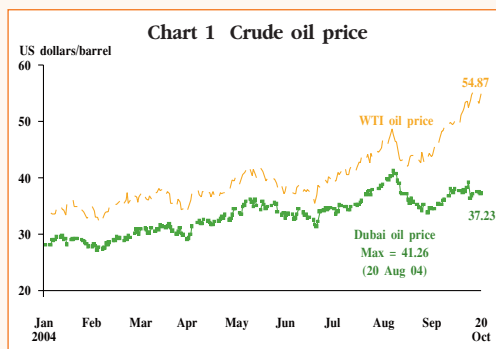
Impact of Oil Prices on the Thai Economy

World crude oil prices continued to rise with the West Texas Intermediate (WTI) crude oil price moving above 50 US dollars per barrel in October 2004. Meanwhile, the Dubai oil price used in the assumption for economic growth and inflation forecasting, rose to a high of 41.26 US dollars per barrel on 20 August 2004. Factors contributing to the rise in crude oil prices in recent periods include:

(1) Fundamental factor: World economic recovery since 2002 rendered higher demand for crude oil. In particular, China, the world's second largest oil importer after the US, imported around 40 per cent more crude oil than in the previous year. World oil supply, on the other hand, tightened as oil producers had previously increased oil production to match demand, as a result, spare capacity was reduced.

(2) Psychological factor: Market concerns regarding insufficient supply of oil from several world events such as the production halt of Yukos (Russian's largest oil producer) due to financial difficulties from high back tax collection, the explosions of oil pipelines in Iraq, and the ongoing terrorism situation in the Middle East, had psychological impacts on the market and contributed to high oil prices.

(3) Technical factor: The technical factor is mainly due to oil price speculation by hedge funds in the oil market. Trade records of the WTI crude oil price in the NYMEX market, the largest oil future market of the Commodity Future Trading Commission (CFTC), found that during January-August 2004, speculators had net long positions of 71.5 million barrels compared to net short positions of 2.4 million barrels in the same period last year.



Source: PTT Public Company Limited

Assessment of the oil price impact from the macroeconomic model

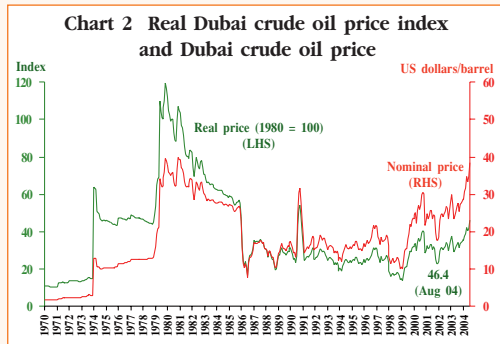
Rising oil prices in recent periods resulted in an upward trend of world inflation. Although the world economy continued to grow strongly in 2004 H1, analysts assessed that risks of world economic slowdown due to rising oil prices would be plausible and thus adjusted downwards their economic growth forecasts for 2005. The impact of oil prices on growth, however, is expected to be small compared to the previous 2 oil crises. The assessment of high oil price impacts on output growth and inflation by BOT's macroeconomic model under the assumption of floating domestic benzene and diesel retail prices from 2004 Q4 and April 2005, respectively, are as follows:

- **Impact on economic growth:** The overall negative impact on economic growth is minimal, averaging around 0.3 per cent in 2004 and 2005.
- **Impact on headline inflation:** In 2005, headline inflation would increase significantly, and could be as high as 4-5 per cent if the Dubai crude oil price rises to 40-50 US dollars per barrel with floating domestic retail prices.
- **Impact on core inflation:** Rising oil prices will put accelerating pressure on core inflation in 2005. However, it will remain within the target range of 0-3.5 per cent.
- **Impact on the current account:** The current account would remain in surplus around 4-6 billion US dollars in 2004 but would decline in 2005 to around 1-2 billion US dollars, depending on adjustments in the import volume.

Reasons for the lower oil price impact on economic growth compared to that in the past

The Thai economy has been relatively lightly affected by recent surges in oil prices compared to the 1979-1980 oil crisis due to several reasons:

(1) The current crude oil price index in real terms^{1/} is significantly lower than that during 1979-1980. Current real Dubai crude oil price stands at 46.4. If the current crude oil price index in real terms was to equal to that of the highest level in November 1979, Dubai crude oil prices would have to reach 99.2.



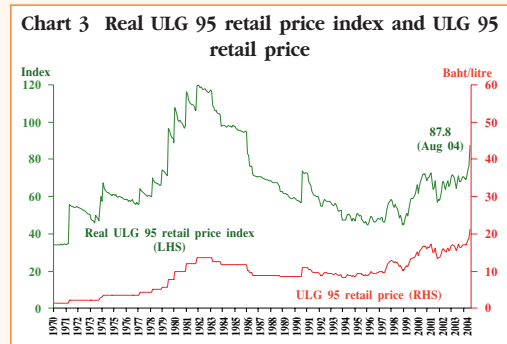
Source: PTT Public Company Limited, International Monetary Fund and Bank of Thailand

Currently, the highest benzene retail price is recorded at 22.39 baht per litre, lower than 29.73 baht per litre which is today's price equivalent to the highest oil price^{2/} in January 1982. Nevertheless, due to the current exchange rate of 41 baht per US dollar compared with 20-27 baht per dollar in the 1980's, the current benzene retail price in real terms is not much lower than that during the oil crisis when compared to the crude oil price case.

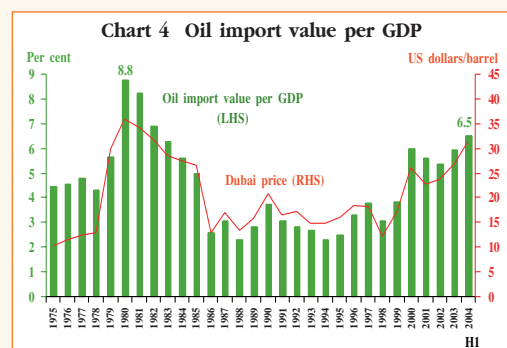
(2) Nowadays, Thailand's oil dependency has lessened significantly compared to the previous oil crisis period as domestically found natural gas has been used as a substitute. The ratio of oil consumption to total energy consumption in 2003 stood at 45.8 per cent compared with 80.5 per cent in 1983. Although the ratio of oil import value to GDP has risen with the economic recovery and rising oil prices, the ratio in 2004 H1 stood at 6.5 per cent of GDP, lower than 8.8 per cent experienced during the second oil crisis during 1979-1980.

(3) Real income per capita is presently much higher than that during 1979-1980, and high enough that the rise in retail oil prices in real terms did not slow down Thai consumption and investment significantly compared to the oil crisis period. Therefore, the Thai economic growth was not greatly affected by rising oil prices.

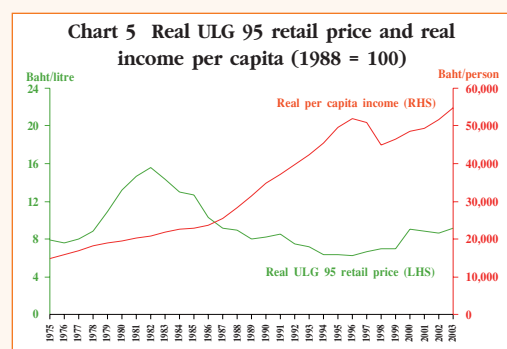
The MPC deemed that there are several risk factors that may cause oil prices to remain high going forward. Oil conservation is therefore necessary to minimize the impact of rising oil prices on economic stability, both inflation and the current account balance, which could cause economic vulnerabilities and hamper sustainable economic growth. Thus the government's initiative to float benzene prices to reflect market mechanisms and the expected increase of diesel prices early next year is one of the best strategies to conserve oil.



Source: PTT Public Company Limited and Bank of Thailand



Source: Energy Policy and Planning Office, National Economic and Social Development Board and Bank of Thailand



Source: PTT Public Company Limited, National Economic and Social Development Board and Bank of Thailand

^{1/} Dubai oil price adjusted by the US consumer price index, with base year 1980 = 100

^{2/} Retail benzene 95 oil price adjusted by the Thai consumer price index, with base year 1980 = 100