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Inflation Report January 2010

Mr. Paiboon Kittisrikangwan, Assistant Governor, Bank of Thailand (BOT), announces that the Monetary Policy Committee (MPC) releases the January 2010 issue of the *Inflation Report* on 22 January 2010. The *Report* is issued to enhance public understanding of the BOT's policy stance, with the key details summarized as follows.

Recent developments in inflation and economic conditions

The Thai economy expanded in 2009 Q3 from the previous quarter, driven mainly by private investment and exports. With respect to 2009 Q4, the latest economic indicators suggest that the economy continues to improve owing to exports and private domestic demand, the latter of which expanded more than the MPC has anticipated, in line with more buoyant consumer and business sentiments. Overall in 2009, even though expected to contract on a year-on-year basis at a rate of 2.7 percent, the Thai economy appears to undergo a recovery that is more robust and broad-based.

The inflationary pressure in 2009 Q4 was contained as expected by the MPC. Core inflation rose only marginally from the previous quarter whereas headline inflation accelerated due primarily to the base effect of low oil prices during the global recession toward the end of 2008.

Economic growth and inflation projections

In the process of forecasting economic growth and inflation for the next eight quarters, the MPC had reviewed and revised the key assumptions used. The highlights can be summarized as follows.

1. The growth rates of trading partners' economies were revised upward slightly throughout the projection period in tandem with a clearer sign of recovery in the major industrialized and emerging market economies.
2. The Fed funds rate assumption was unchanged. The Fed is expected to start raising the policy rate from 0-0.25 to 0.25 per cent in the third quarter of 2010 and continue to raise the policy rate by 25 basis points each quarter afterward.
3. Regional currencies were assumed to appreciate against the US dollar throughout the projection periods at a faster pace compared to previous assumption, as a result of better economic growth prospects which would attract capital flows into the region.
4. Public spending was revised in fiscal year 2010 since portions of investment budget in the second stimulus package were reallocated to public transfers instead, reducing public investment and raising government consumption expenditure.
5. The Dubai oil price assumption was revised upward throughout the projection period, averaging at 81.3 and 87.5 US dollars per barrel in 2010 and 2011 respectively, in line with the assumption on global economic recovery and a continuing drop in the crude oil stock.
6. The assumption on agricultural prices in 2010 was revised downward throughout the projection period following lower-than-expected prices of fruits and vegetables, even

though prices of rice and flour rose due to low world supply caused by unfavorable weather.

7. The minimum wage in Bangkok and surrounding areas was revised upward throughout the projection period following the minimum wage committee's decision in December 2009 to raise the minimum wage from 203 to 206 baht per day. The MPC expect the minimum wage in 2011 to be slightly higher in line with the inflationary pressure and the economic recovery.

Under the above assumptions and the assumption that the domestic policy interest rate is at the present level over the next 8 quarters, the projected range for GDP growth in 2010 remains identical to the MPC's previous assessment. The Thai economy is expected to expand continuously into 2011, on the back of global economic recovery, growing domestic demand and accommodative monetary policy. Major risks to the outlook for growth include the fragility of the global economic recovery, a delay to the government's budget disbursement, and a delayed resolution to the Map Ta Phut case. Overall, the MPC views that the degree of uncertainty surrounding the growth projection remains high, with risks tilting toward the downside. As a result, economic growth is projected to be within the ranges of 3.3-5.3 per cent in 2010 and 2.8-4.8 per cent in 2011, with probabilities of 84.3 and 76.4 per cent, respectively.

The MPC views that the inflationary pressure should gradually build in line with improving domestic demand as well as higher oil and commodity prices, resulting from a global economic recovery. The extension of the government's subsidy measures toward the end of March 2010 would artificially suppress inflation as measured by the CPI to be lower than previously expected. The downside risk to inflation would dominate the upside risk, as demand could expand at a less brisk pace. Therefore, the fan charts for headline and core inflation are skewed slightly downwards for the entire forecasting horizon. Headline inflation is projected to average within the ranges of 3.0-5.0 per cent in 2010 and 2.0-4.0 per cent in 2011, with probabilities of 93.2 and 82.9 per cent, respectively. Meanwhile, core inflation is expected to be within the ranges of 1.3-2.3 per cent in 2010 and 1.8-2.8 per cent in 2011, with probabilities of 94.1 and 86.7 per cent, respectively.

Monetary policy stance in the last 3 months

Given the current assessment of economic conditions and outlook, the MPC judges that the global economy is exhibiting a clearer sign of recovery. Nevertheless, there remains uncertainty surrounding the global economic recovery, especially in the major industrialized countries, while the Asian economies are expected to recover at a faster pace, potentially bringing about more volatile capital flows between regions. Meanwhile, the Thai economy continues to expand in a variety of sectors, including private consumption for durable goods, farm income, tourist revenue, and exports. However, the major risk factors consist of fragile global economic recovery and delayed government's budget disbursement. Inflation is expected to move in line with higher oil and commodity prices, and an end to the government's subsidy measure. The MPC therefore decided to maintain the policy interest rate at 1.25 per cent per annum at the 2 December 2009 and 13 January 2010 meetings.

Bank of Thailand
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