DO WE NEED TO BE AFRAID OF FLOOD-INDUCED INFLATION?

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THE LATEST INFLATION DATA, released last Thursday by the Ministry of Commerce, showed that Thai inflation remained elevated in November. This should come as no surprise, as the ongoing flood crisis has played a part in temporarily driving up prices.

The headline consumer price index (CPI) held steady at 4.19 per cent higher than the same period last year, on the back of an upswing in food-price inflation, which recently hit peak growth of 10.21 per cent (the highest growth rate over the past 34 months). These food prices were driven up by flood-related shortages and higher logistic costs. Growth in non-food prices, on the contrary, continues to decelerate, rising a mere 0.54 per cent.

Measured over the same period last year and setting aside volatile raw food and energy prices, core inflation hovered at 2.90 per cent - well within the Bank of Thailand's policy target range of 0.5 to 3 per cent. Although the impact of the flooding on inflation is real and already evident, flood-induced inflationary pressure going forward is not as daunting as some may assume. The effect will not only be limited, but also temporary, for these reasons.

Firstly, the impact of the flooding on prices is not broad-based across the country, but concentrated in certain areas, mostly the Central provinces, and affecting certain goods, especially vegetables and fruits, which normally have short production cycles of one to four months. As such, price hikes are likely to swiftly revert to their long-term levels. According, pass-through of rising input costs to final prepared food prices is expected to be subdued.

Secondly, some affected goods, such as construction materials and cleaning products, command only small weights in the CPI basket, amounting to less than 3 per cent. Their price increases due to the post-flood restoration demand, therefore, will not shake overall price stability.

Thirdly, most flood-affected goods prices - such as those of rice, meats, poultry and dairy products - are being monitored and administered by the Commerce Ministry. Some products such as eggs and instant noodles have been important to relieve domestic shortages. These government measures can partially moderate the effect of the supply shock.

Inflation risks not associated with the flooding are not particularly threatening, either. On the one hand, upside risks are expected from the upcoming demand-pull pressure stemming from the restoration of the private sector's confidence and potential government stimulus policies. These demands, however, are not yet of a great concern, as they do not reflect higher purchasing power, thus the risk of a second-round effect. On the other hand, downside risks seem to be more apparent as a result of the worsening global economic prospects. This would help tame some of the demand-pull pressure as well as contribute to decelerating trends of global oil and commodity prices, which in turn will lessen pressure on the cost side. Additionally, the steady 12-month-ahead inflation and cost expectations (as of October) indicate that expectations are quite well anchored.

Overall, after assessing both the upside and downside inflation risks, it can be reasonably anticipated that inflationary pressure will persist, but will be well contained. This is in line with the Monetary Policy Committee's latest assessment that the inflation risk is outweighed by the risk to growth and there was room to implement a more accommodating monetary policy to shore up confidence, as well as to support economic recovery and investment. Consequently, a 25-basis-point policy rate cut - the first in two years - was decided upon, bringing the rate down to 3.25 per cent per annum.

(The views expressed are the author's own).

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