



## **BANK OF THAILAND NEWS**

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### **Inflation Report July 2001**

Ms. Atchana Waiquamdee, Senior Director, Monetary Policy Group, the Bank of Thailand, as the Secretary of the Monetary Policy Committee (MPC), announced that the MPC released the July 2001 issue of the *Inflation Report* on 26 July 2001. The *Report* intends to increase public understanding of the Bank of Thailand's monetary policy stance. A summary of key issues is as follows:

#### **Recent developments in inflation and economic conditions**

During the first half of 2001, aggregate demand weakened as a result of softer domestic and external demand. The slowdown in major trading partners' economies would unavoidably affect Thai export. Overall industrial production expanded at a more moderate pace, especially in export-oriented sectors. The slowdown in private consumption and private investment also reflected low consumer confidence. Hence, the MPC assessed that weak external conditions would dampen Thai economic growth this year. Although core inflation was rising, it should stay within the 0-3.5 per cent target range. Core inflation stood at 1.3 per cent in the first half of 2001 compared to the same period last year.

#### **Inflation and GDP growth forecasts**

Compared to the assumptions underlying forecasts in the previous *Report*, the MPC viewed that:

1. The outlook for US economic recovery remained unclear while the euro area and Japanese economies exhibited clearer signs of a downturn. As a consequence, the Asian economies slowed down more than expected in the previous *Report*. The MPC thus adjusted the assumptions on economic growth of trading partners downward.

2. Although the Federal Reserve already cut its interest rates 6 times since the beginning of the year, from 6.5 per cent to 3.75 per cent on 27 June 2001, the risk of sustained economic weakness remained. The MPC thus used the assumption that the Fed funds rate would be lowered by another 0.25 percentage point in the third quarter of 2001 and remaining at 3.5 per cent for the next 8 forecast quarters.
3. Conditions in the crude oil market during the second quarter of 2001 were close to expected. The MPC thus used the same assumption as in the previous *Report*, with the Dubai crude oil price staying between 22-26 US dollars per barrel in the second half of 2001 and between 20-24 US dollars per barrel in 2002.
4. The MPC used a weaker assumption on world farm price compared to the previous forecast. World farm price was expected to move downward in the years 2001 and 2002 in response to the sluggish global economy, before turning positive in the first half of 2003.
5. Considering the government's stimulus measures such as village funds and farmers' debt moratorium, this *Report* assumed total government expenditure of around 900 billion baht for fiscal year 2001, equivalent to 90.5 per cent disbursement rate. Expenditure in fiscal year 2002 was expected to be around 981 billion baht, equivalent to a disbursement rate of 91 per cent, which indicated that the fiscal stimulus would be bolstered in 2002 when compared to 2001.
6. The MPC used the assumption that the value added tax (VAT) rate hike from 7 per cent to 10 per cent would take place in the fourth quarter of 2002. This followed the resolution from the cabinet meeting on 12 June 2001 that called for an extension of a 7 per cent VAT rate to 30 September 2002.

### **GDP growth projection**

Recent economic conditions followed a downward trend due to the risks of weakening domestic and external demand. Nonetheless, the government's economic stimulus measures, the mitigation of the misalignment in interest rate and financial market structures, and the push for commercial banks' credit extension should contribute to stronger domestic demand and faster economic growth in 2002. This growth should accelerate further if external conditions were more favourable than this year.

The MPC expected GDP in 2001 to grow close to the National Economic and Social Development Board's estimate of 2-3 per cent. For the years 2002-2003, the MPC viewed that output growth should pick up to 4-6 per cent in each quarter, with the highest probability.

#### Inflation outlook

Core inflation in 2001 was expected to be between 1.5-2 per cent, as risks to inflation were not yet evident. In 2002, core inflation should increase to around 2-3 per cent, consistent with the economic recovery trend.

#### Monetary policy stance

The MPC deemed that the decision to raise the 14-day repurchase rate from 1.5 per cent per annum to 2.5 per cent per annum since 8 June 2001 was sufficient to correct the misalignment in the structure of short-term interest rates. Although the correction induced some volatility in the bond market and affected private sector financing, the effects were expected to be temporary.

In the meeting on 12 July 2001, the MPC thus decided to maintain the 14-day repurchase rate at 2.5 per cent per annum to achieve price stability, with consideration for external stability, in support of further economic recovery.

The sixth issue of the *Report* will be released by the BOT at the end of October 2001.

Bank of Thailand

26 July 2001