



BANK OF THAILAND NEWS

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Inflation Report July 2002

Mr. Bandid Nijathaworn, Assistant Governor of the Monetary Policy Group, Bank of Thailand (BOT), announced that the Monetary Policy Committee (MPC) released the July 2002 issue of the *Inflation Report* on 31 July 2002. The *Report* was issued to create a public understanding of the BOT's policy stance, with the key details summarized as follows.

Recent developments in inflation and economic conditions

Preliminary data indicated a Thai economic recovery in 2002 Q2, a continuation from 2002 Q1, due to expansion in both production and spending. Production expanded in various sectors, while spending growth was due primarily to private investment. The construction sector expanded noticeably owing to low domestic interest rates and the government's measures to rehabilitate property markets. Without pressures either from the demand or supply side, core inflation should remain within target for the next 8 quarters.

Certain risks, however, remained. Volatility in the world stock markets could affect the US economy, which would make the recovery prospects of Thai trading partners' economies more uncertain and dampen Thai export. Accounting for 60 percent of the GDP, any slowdown in export could hinder the Thai economic recovery in future periods.

Monetary policy stance in the last 3 months

In the meetings on 3 June and 22 July 2002, the MPC viewed that a continuation of stimulus measures from the authorities was necessary, especially if the world economic outlook remained weak. However, the improved functioning of the credit system and clear resolutions to the Financial Institutions Development Fund (FIDF) problems were important advances in the financial sector in the past 3 months that could help financial institutions perform their role as intermediaries more effectively. The reduction of the FIDF's role as the major borrower in short-term money markets would allow commercial banks to manage their liquidity more efficiently

and respond to changes in the policy rate more promptly. The MPC thus deemed recent cuts in the interest rate as adequate signals of the BOT's monetary policy stance, and agreed to maintain the 14-day repurchase rate at 2 per cent per annum.

Economic growth and inflation projections

Compared to the assumptions used in the previous projection 3 months earlier, the MPC deemed that:

1) Trading partners' economies, especially Japan and other Asian countries, improved in 2002 Q1, creating better growth prospects. This development prompted the MPC to adjust upward the assumption on trading partners' growth from the previous *Report*.

2) There were heightened risks associated with the economic recovery process underway in the US. Consequently, the MPC used the assumption that the Fed would maintain a lax monetary policy stance. However, the low interest rate environment would likely lead to increasing consumer purchases of and investment in housing and real estate, leading to rising real estate prices, and eventually putting pressure on inflation in the future. Therefore, the MPC used the assumption that the Fed funds rate would be raised, but the Fed's action would be postponed to 2003 Q1 instead of 2002 Q3 as assumed earlier. The speed and size of the rate increase was assumed to be slower and less drastic than previously anticipated, and would be done in 25-basis-point increments until the Fed funds rate reached 3 per cent per annum in 2003 Q4.

3) The rising trend in the world economy together with continued tensions in the Middle East could raise oil prices. This assessment was incorporated in the previous assumption on Dubai crude oil price. As a result, the new assumption was close to the previous one with a slight upward adjustment to an average of 23 US dollars per barrel in the second half of 2002. The MPC used the assumption that Dubai crude oil price would remain at 22 US dollars per barrel from 2003 onwards, the same as in the previous *Report*.

4) The assumption on public expenditures for fiscal year 2002 remained unchanged from last *Report*. However, the assumption that the disbursement rate was to decrease slightly from 90 per cent to 88.9 per cent coupled with the actual disbursement rate in the first half of 2002 implied a smaller injection of funds into the economy in the second half of 2002. The MPC maintained the assumption on public expenditures for fiscal year 2003 in accordance with the budget bill. It also maintained the assumption on the disbursement rate as previously assumed, with a budget deficit of 3.6 per cent of GDP, smaller than that of fiscal year 2002.

5) The 14-day repurchase rate remained at 2 per cent per annum throughout the forecast period.

The latest data from the NESDB indicated that the Thai economy expanded at the high rate of 3.9 per cent in 2002 Q1 over the same period the previous year. The acceleration in the growth rate improved consumption and investment trends, putting the economy on the same path as that projected in the previous *Report*. Domestic demand would continue to drive economic expansion, consistent with a number of economic indicators that pointed to signs of improvement. The rising world economic trend, on the other hand, should improve Thailand's export performance. The MPC, therefore, deemed that the Thai economy could expand at the rate that was announced by the NESDB in June with high probability. Nevertheless, heightened risks associated with the world economic recovery prompted the MPC to revise the economic forecasts for 2002 and 2003 to an average of 3-4 per cent with 87 and 66 per cent probability, respectively.

Core inflation outlook

The MPC expected core inflation to remain low. Although world crude oil and commodity prices increased, a stronger baht relative to the US dollar caused import prices in baht terms to decline, thereby restraining the cost pressure. Meanwhile domestic demand, while rising, did not exert pressure on the price level, owing largely to excess production capacity in the economy. The MPC deemed that core inflation would average only 0.5-1 per cent in 2002 before rising to 0.5-1.5 per cent in 2003, and would continue to rise into 2003 but would remain within the target range for the 8 quarters ahead. Low inflation would continue to be supportive of an easy monetary policy stance.

Bank of Thailand

31 July 2002