



BANK OF THAILAND NEWS

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Inflation Report January 2003

Mr. Bandid Nijathaworn, Assistant Governor of the Monetary Policy Group, Bank of Thailand, announced that the Monetary Policy Committee (MPC) released the January 2003 issue of the *Inflation Report* on 31 January 2003. The *Report* was 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

Preliminary data indicated that the Thai economy expanded at a solid rate in 2002 Q4, due to a boost in both production and private sector spending. Exports accelerated in both quantity and value. Robust economic growth in 2002 Q4 was thus expected. Core inflation was low, averaging 0.2 per cent in 2002 Q4 or 0.4 per cent for the year 2002.

External stability remained strong. In 2002, the current account recorded a surplus of 7.6 billion US dollars. External debt fell to 59.6 billion US dollars at end-November, while international reserves stood at 38.9 billion US dollars at end-year.

Nevertheless, there remained risks to the Thai economy, particularly from tensions in the Middle East that the MPC assessed would heighten world crude oil prices in the short term, coupled with the uncertain prospects for global economic recovery.

Monetary policy stance in the last 3 months

In the 19 November 2002 meeting, the MPC deemed that external uncertainties continued to exist, with clearer signs of a fragile US economic recovery. To cushion the economy from the potential repercussions of the uncertain world economic environment as well as strengthen Thailand's growth in 2003, the MPC thus decided to reduce the 14-day repurchase rate by 25 basis points to 1.75 per cent per annum.

In the meetings on 12 December 2002 and 20 January 2003, the MPC viewed that the Thai economy grew favourably in 2002. However, uncertainties surrounding the tensions in the Middle East could have an impact on the Thai economy. Core inflation in the 8 quarters ahead was expected to remain low and within the target range. The MPC therefore decided to maintain the 14-day repurchase rate at 1.75 per cent per annum. Nevertheless, the MPC would continue to closely monitor developments in the world economic situation.

Economic growth and inflation projections

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

1) Trading partners' economies grew at a slower rate than previously assessed, especially European countries that continued to exhibit weak economic performance.

2) Although an improvement in the US economy was expected during the second half of 2003, there remained uncertainties regarding the US-Iraq conflict. The MPC therefore anticipated that the Fed would continue to adopt a lax monetary policy stance. The Fed was expected to keep the Fed funds rate at the current level of 1.25 per cent per annum until 2003 Q3 before raising the rate when the economy showed clearer signs of recovery.

3) The MPC viewed that crude oil prices would start to decline after 2003 Q1, based on these supporting factors: (1) a brief war between the US and Iraq; (2) large excess oil production capacity and high global crude oil supply; and (3) agreement by OPEC members to increase oil production by 1.5 million barrels per day to compensate for the reduction in oil production during

the strike in Venezuela. The MPC used the assumption that Dubai crude oil price would increase in 2003 Q1, averaging 26 US dollars per barrel, before falling to an average of 23 US dollars per barrel for the rest of the forecast period.

4) In August 2002, the Cabinet decided to postpone the hike in value added tax (VAT) until 30 September 2003. However, the MPC used the assumption that the VAT rate would remain at 7 per cent throughout the forecast period, in view of a stronger fiscal position in 2002 that was expected to improve further in 2003. Moreover, the US-Iraq conflict could affect Thailand's economic recovery, which would induce the government to consider further delaying the VAT hike.

5) The 14-day repurchase rate remained at 1.75 per cent per annum throughout the forecast period.

The Thai economy expanded 5.8 per cent in 2002 Q3 over the same period the previous year. Preliminary data also indicated continued growth in 2002 Q4. As a result, the MPC assessed that in 2002 the Thai economy would grow around 5 per cent, providing a firm basis for future economic growth. Furthermore, the MPC adjusted upward the GDP growth forecast for 2003 to 3.5-4.5 per cent, to reflect the improving economic trend as well as uncertainties surrounding the US-Iraq conflict. The probability of economic growth staying within the 3.5-4.5 per cent range was 77 per cent. In 2004, Thailand's GDP was expected to grow 3.5-5 per cent with a probability of 80 per cent.

Core inflation outlook

The MPC anticipated that both core and headline inflation would be lower than was forecasted in the previous *Report*, owing to the assumption that the VAT hike would be delayed. Both core and headline inflation were expected to average around 0.5-1.5 per cent in 2003 and 1-2 per cent in 2004. Core inflation was expected to remain low and within the target range of 0-3.5 per cent, facilitating the maintenance of an accommodative monetary policy stance to support economic growth.

Bank of Thailand

31 January 2003