



BANK OF THAILAND NEWS

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Inflation Report July 2004

Ms. Atchana Waiquamdee, Assistant Governor, Monetary Policy Group, Bank of Thailand (BOT), announced that the Monetary Policy Committee (MPC) released the July 2004 issue of the Inflation Report on 29 July 2004. 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

Although the Thai economy slowed down from a growth rate of 7.8 per cent in 2003 Q4 to 6.5 per cent in 2004 Q1 due to impacts from the avian flu and drought effects on the agricultural sector, improved economic fundamentals, especially private investment, remained the main factor for strong economic growth. Preliminary data for the first five months of 2004 indicated that the Thai economy would continue to expand driven by domestic spending and exports, in particular private investment and accommodative monetary policy.

Overall economic stability remained strong despite the rise in headline and core inflation by 2.6 and 0.4 per cent, respectively, in 2004 Q1, accelerating from the previous quarter. The headline and core inflation trend could rise further following higher cost of production and demand, in particular the increasing trend of international inflation and higher oil prices. External stability remained strong although the current account surplus declined due to the acceleration in imports. International reserves remained high, with foreign debt declining.

Economic growth and inflation projections

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

- 1) On 30 June 2004, the fed funds rate was increased to 1.25 per cent per annum, as a result, the MPC adjusted the fed funds rate assumption upwards throughout the forecasting period.
- 2) Crude oil prices rose substantially from the previous assessment despite OPEC's decision to increase the production quota. Due to uncertainties pertaining to the situation in the Middle East and terrorist attacks in many countries, the oil price trend was expected to adjust upwards in 2004. However, due to the continuation of the measure to stabilize domestic retail oil prices, the retail oil price was assumed to remain at the current level throughout the forecasting period.
- 3) During the first half of 2004, world commodity prices, including world farm prices and non-fuel commodity prices, increased from the previous assessment, but would slow down in 2005 following improvements in supply.
- 4) Trading partners' economies in 2004 improved from the previous assessment, especially Japan and Asian region economies.

Due to changes in the aforementioned assumptions together with risks regarding world commodity prices, trading partners' economies, direction of monetary policies in other countries, the reoccurrence of the avian flu and additional government measures to boost the economy, the MPC assessed that in 2004, the Thai economy would grow at 6.0-7.0 per cent with probability around 89 per cent, lower than previously projected. For 2005, the Thai economy was expected to expand 6.0 – 7.5 per cent, with probability of around 87 per cent.

With regard to the inflation trend, the MPC assessed risks which could put pressure on prices going forward to include the increase in world commodity prices, the rising inflation trend in Asian region countries as well as the tightening labour market. The MPC thus expected headline inflation in 2004 and 2005 to accelerate to 2.0-3.0 and 1.5-2.5 per cent per annum, respectively. Due to the lag in transmission from headline to core inflation, core inflation was expected to average at 0.0-1.0 and 1.0-2.0 per cent, respectively, in 2004 and 2005, the same as previously projected.

Monetary policy stance in the last 3 months

In order to determine the appropriate monetary policy stance going forward, the MPC discussed various important issues as follows:

1. In the 9 June 2004 meeting, the MPC viewed that the Thai economy continued to expand favourably despite the slight moderation in growth to 6.5 per cent in 2004 Q1. Improved economic fundamentals, in particular private investment, should help the economy to withstand negative influences and should help facilitate economic expansion going forward. Although current inflation remained low, inflation going forward could accelerate and thus render a close monitoring of inflationary pressures. For the time being, the current monetary policy was deemed appropriate given current conditions. As a result, the MPC decided to maintain the 14-day repurchase rate at 1.25 per cent per annum.

2. In the latest meeting on 21 July 2004, the MPC viewed that although inflationary pressure increased from both oil and farm prices, the Thai economy continued to expand during the first five months of the year, driven by domestic spending, in particular private investment, and the accommodative monetary policy. In addition to taking care of price stability, the main objective of monetary policy, the MPC considered it important to monitor indicators of potential financial imbalances, namely imbalances in the real estate sector and household debts, which could affect Thai economy growth going forward.

The MPC viewed that there would be less need for an accommodative monetary policy than at present and would stand ready to adjust the interest rate upwards once inflation showed a clearer sign of acceleration or the buildup of financial imbalances became more apparent. However, given the uncertainty of risks, the MPC decided to maintain the 14-day repurchase rate at 1.25 per cent per annum for the time being.

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