



BANK OF THAILAND NEWS

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Inflation Report January 2005

Ms. Atchana Waiquamdee, Assistant Governor, Monetary Policy Group, Bank of Thailand (BOT), announced that the Monetary Policy Committee (MPC) released the January 2005 issue of the *Inflation Report* on 28 January 2005. 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

The Thai economy expanded at a satisfactory rate during the first 11 months of 2004 supported by growth in exports and domestic spending, as well as government stimulus measures. With regard to the tsunami disaster, the MPC assessed that the impact on the Thai economy would not be substantial.

Overall economic stability remained strong, with headline inflation averaging 2.7 per cent in 2004 and should trend downwards following the decline in oil prices and the stronger baht. Meanwhile, core inflation averaged 0.4 per cent in 2004. External stability remained robust with the current account recording a surplus in 2004 and should continue into 2005.

Economic growth and inflation projections

Compared to the assumptions used in the projection 3 months earlier:

- 1) The assumption on fed funds rate was gradually adjusted upwards, higher than the previous assumption by approximately 25 basis points throughout the projection period.
- 2) Dubai crude oil prices was adjusted downwards from the previous assessment due to the decline in world oil prices, but remained high. This in turn led the MPC to lower domestic retail oil price assumptions compared to that assumed previously.
- 3) Trading partner economies expanded at a rate similar to that previously assumed.

The MPC assessed that in 2004 the Thai economy would expand around 6.2 per cent, within the previously projected range. For 2005, without the tsunami disaster, the aforementioned assumptions would increase the GDP projection by 0.2 per cent compared to the previous projection. The tsunami

disaster, however, was expected to have a negative impact of 0.5 per cent, as a result, the Thai economy was projected to be lower than the previous projection by 0.3 per cent. For 2006, output growth should remain strong following the assumptions on trading partner economies which remained stable, the tourism situation which should return back to normal and lower than previously assumed Dubai crude oil prices.

Risks to the economy going forward included additional government stimulus measures, the rising trend in world oil prices, lower-than-expected growth in trading partner economies, prolonged unrest in the southern provinces and unaccounted loss due to the natural disaster. The MPC thus assessed that in 2005, the Thai economy would grow slightly lower than previously projected at 5.25-6.25 per cent, with probability around 84 per cent. As for 2006, the Thai economy was expected to grow between 5.5-7 per cent with probability around 80 per cent.

With regard to the inflation trend, the MPC assessed that headline inflation in 2005 and 2006 would be lower than previously forecasted following The MPC thus expected headline inflation in 2005 and 2006 to be around 2.5-3.5 and 1.5-2.5 per cent per annum, respectively. For core inflation in 2005 and 2006, it was expected to average around 1-2 and 1.5-2.5 per cent, respectively.

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 Monetary Policy Committee's meeting on 15 December 2004, the MPC viewed that the Thai economy expanded at a satisfactory rate. Although recent economic data showed moderate expansion in domestic spending, growth momentum remained strong in other sectors, especially exports. The MPC assessed that lower oil prices and the appreciation of the Thai baht should help alleviate the inflationary pressure from that previously projected. External stability remained robust, with the current account expected to be in surplus this year and the next. Although short-term inflationary pressure from lower oil prices and the stronger baht had declined, the situation could be temporary. To maintain economic stability in light of continued economic growth, the MPC thus deemed that interest rates should adjust upwards going forward as the currently low interest rate

environment could pose risk of accelerating inflation and undermine sustainable growth. The MPC thus decided to raise the 14-day repurchase rate by 25 basis points, from 1.75 to 2 per cent per annum.

2. In the Monetary Policy Committee's meeting on 19 January 2005, the MPC viewed that the Thai economy expanded at a satisfactory rate, supported by growth in exports and domestic spending. Nevertheless, the MPC was of the view that consumer spending could be dampened by the tsunami disaster and the resultant decline in tourism receipts, although these negative effects should be offset, to some degree, by greater investment and public spending. With respect to inflation going forward, price pressure remains but with a declining trend following lower oil prices and the appreciation of the Thai baht. Nevertheless, the MPC was of the view that sustained negative real deposit rates may discourage domestic saving and raise household debt. As such, the currently low interest rate level should be gradually returned to neutral going forward. Nevertheless, the potential impact on the Thai economy from the occurrence of the natural disaster, volatility in currency markets, and continued high oil prices, remained uncertain and the MPC agreed that it was important to wait for a clearer picture to develop. The MPC therefore decided to maintain the 14-day repurchase at 2 per cent per annum.

Bank of Thailand

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