



BANK OF THAILAND NEWS

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Inflation Report July 2005

Ms. Atchana Waiquamdee, Assistant Governor, Monetary Policy Group, Bank of Thailand (BOT) announced that the Monetary Policy Committee (MPC) released the July 2005 issue of the Inflation Report on 28 July 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 during the first 5 months of 2005 moderated as a result of higher oil prices, the tsunami in the 6 southern provinces along the Andaman coast, the drought, ongoing unrest in the southern provinces, and the slowdown in the world economy. Consequently, domestic demand and exports decelerated.

Forces straining economic stability had become more apparent. Inflation during the second quarter accelerated from the previous quarter with headline and core inflation averaging at 3.7 and 1.1 per cent, respectively, due to increases in domestic retail oil prices. Meanwhile, the current account during the first 5 months of 2005 recorded a deficit of 4.7 billion US dollars due to the excessively high import value of capital goods, fuel, and raw materials while exports stagnated. The MPC thus projected that it was highly probable for the current account to show a deficit this year.

Economic growth and inflation projections

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

1. The Dubai crude oil price was adjusted upwards from the previous assumption due to the continued surge in prices which rose higher than previously assumed.

Assumptions on domestic retail oil prices also increased coinciding with the rise in the Dubai crude oil price and the floating of retail diesel prices beginning 2005 Q3.

2. The fed funds rate adjusted upwards but at a slower pace than previously assumed.

3. Trading partner economies adjusted slightly lower due to the effects of higher oil prices.

4. The assumption on government consumption was revised upwards due to reduced appropriations of revenues to the Local Administrative Organization (LAO) and to the rise in civil servants salaries. Assumptions on public capital expenditures were increased mainly due to higher state enterprise expenditures which corresponded to the higher disbursement rate and public investment spending for Mega Projects.

5. The assumption on the average nation-wide minimum wage rate was revised up corresponding to the Wage Committee of the Ministry of Labour.

After assessing the continued severity of negative factors on the economy, particularly high oil prices and the slow down in economic stimulus in the first quarter, economic growth in 2005 and 2006 were assumed to be lower than previously projected. An assessment of various risks to the economy in the following periods included the positive risk of government stimulus measures from higher disbursement rates, whereas negative risks consisted of volatile oil prices that could be higher than assumed and could slow down trading partner economies, as well as lower consumer and investor confidence. The MPC thus assessed that the Thai economy in 2005 would expand at a slower pace than previously projected at around 3.5-4.5 per cent. For 2006, the economy was expected to expand at approximately 4.5-6.0 per cent.

The MPC projected that the economy would improve in the second half of 2005 from the revival of the tourism industry, the alleviation of the drought problem, and improvements in the export sector. Furthermore, fiscal stimulus measures including economic stimulus measures in the short run and investments in Mega Projects would both support continued economic growth.

Pressure on inflation in the following periods should increase due to higher input costs from oil and the trend of higher disbursements by the government to stimulate growth. Thus, if some of the administered price measures were lifted, various production costs would increase including wages. The MPC thus projected that headline inflation for 2005 would accelerate to average around 4.0-4.5 per cent from an average of 2.7 per cent in 2004. Furthermore, if oil prices continued to rise, the probability of headline inflation trending downwards would be unlikely. Headline inflation for 2006 was thus projected to average at 3.5-4.5 per cent, higher than that projected in the previous Report. Core inflation

should average at 1-2 percent in 2005 and converge closer to headline inflation to average around 2-3 percent in 2006. For the quarterly average, there were some possibilities that core inflation would fall outside of the target range of 0-3.5 per cent per year in the latter part of the projection period.

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 9 June 2005, the MPC viewed that the economy expanded reasonably well amidst the many negative factors such as higher oil prices, the tsunami, and unrest in the southern provinces. Meanwhile, risks to higher inflation also increased. Therefore, to promote economic stability and sustainable growth in the long run, the MPC decided to raise the 14-day repurchase rate from 2.25 per cent per annum to 2.50 per cent per annum.

2. In the Monetary Policy Committee's meeting on 20 July 2005, the MPC viewed that higher oil prices affected economic stability, causing the current account to register a larger deficit, while core and headline inflation accelerated. There probability of core inflation exceeding the target range also became greater. As a result, the policy rate should remain on an upward trend to keep core inflation under control and support sustainable growth in the long term. The MPC therefore decided to raise the 14-day repurchase rate by another 25 basis points from 2.50 per cent per annum to 2.75 per cent per annum.

Bank of Thailand

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