



# BANK OF THAILAND NEWS

Communications and Relations Office, Management Assistance Department

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## **Inflation Report January 2006**

Ms. Atchana Waiquamdee, Assistant Governor, Monetary Policy Group, Bank of Thailand (BOT) announced that the Monetary Policy Committee (MPC) released the January 2006 issue of the *Inflation Report* on 30 January 2006. 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**

During the first 11 months of 2005 the Thai economy grew at a satisfactory rate amidst several unfavourable conditions since the beginning of the year, particularly in 2005 Q3 which grew robustly at 5.3 per cent year-on-year. In 2005 Q4, recent indicators indicated a slowdown in private investment due to higher production costs and a similar growth rate for private consumption as that in the previous quarter, moderating however from 2005 Q2 due partly to accelerating prices. The growth momentum should carry on going forward, supported by a positive outlook on exports and private investment.

Overall economic stability remained in good condition. For internal stability, headline and core inflation for 2005 stood at 4.5 and 1.6 per cent per annum accelerating from 2.7 and 0.4 per cent per annum in 2004, respectively. The acceleration in world crude oil prices since mid-2005 imposed supply-side pressure on inflation while continual economic expansion caused demand-side pressure, as a result, the inflation rate rose substantially during the second half of 2005. However, towards the end of 2005, headline inflation began to decline following the fall in world crude oil prices and close price monitoring by authorities. Lower world crude oil prices made upward price adjustments of goods apart from those of energy and raw food unjustified, as a result, core inflation remained steady towards the end of 2005. External stability improved, as the current account turned around from being in deficit throughout the first half of 2005 to being in surplus since July.

### **Economic growth and inflation projections**

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

1. Dubai oil price assumptions remained the same as previously assumed, averaging at 57.50 and 56.25 dollars per barrel in 2006 and 2007, respectively. Although oil prices declined during the beginning of 2005 Q4, upward pressure on prices remained. Meanwhile, assumptions on domestic retail oil prices were adjusted slightly lower than previously assumed due to a reduction in the marketing margin.

2. The fed funds rate remained in an upward trend, higher than the previous assumption by 25 basis points. This upward trend, however, was expected to end in 2006 Q2.

3. Trading partner economies adjusted slightly higher following economic expansion in the euro area, Japan and other Asian economies.

4. The assumption on government consumption was revised up for fiscal years 2006 and 2007 from that previously assumed due to higher disbursement rate assumptions in line with government measures to expedite disbursements. On the other hand, the assumption on

public investment for fiscal years 2006 and 2007 was revised down due to the expected decline in the carry-over budget as disbursements had already been expedited in fiscal year 2005 and the revision of investment plans for the rail-based mass transit system.

As for risks to the economy going forward, negative risks included possible increases of oil prices above baseline assumptions, which could slow down trading partners' economic growth, and the strengthening of regional currencies given the prospect of the fed funds rate entering the final stage of the tightening process. If the baht happened to gain strength against other regional currencies, price competitiveness of Thai exports could be affected. On the other hand, the positive risk included possible improvements in investor confidence. The MPC thus assessed that the Thai economy in 2005 would expand around 4.5 per cent. For 2006, the economy was expected to expand at approximately 4.75-5.75 per cent with 81 per cent probability, in line with NESDB's latest forecast. For 2007, the economy was expected to expand around 4.5-6.0 per cent.

Upward pressure on inflation in the following periods included higher world oil prices and pent-up price pressure on goods and services. On the other hand, downward pressure on inflation could come from baht appreciation and slower economic growth. The MPC thus projected headline inflation for 2006 and 2007 to be around 3.5-5.0 and 2.0-3.5 per cent with probabilities of 96 and 83 per cent, respectively. Meanwhile, core inflation for 2006 and 2007 should average around 2.0-3.0 and 2.0-3.5 per cent with probabilities of 99 and 94 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 14 December 2005, the MPC viewed that the need to adjust the policy rate at a fast pace had diminished due to the deceleration of the inflation rate in November 2005 from the previous month and lower negative risks from high oil prices. As a result, the risk of core inflation exceeding the target range declined from the previous meeting. In addition, as the pace of policy rate increments had already been sufficiently brisk, the MPC therefore decided to raise the 14-day repurchase rate by only 25 basis points from 3.75 to 4.00 per cent per annum.

2. In the Monetary Policy Committee's meeting on 18 January 2006, the MPC decided to raise the 14-day repurchase rate from 4.00 to 4.25 per cent per annum. The MPC viewed that the Thai economy still had momentum for continued expansion while headline inflation had begun to moderate. Nevertheless, price pressure remained while real interest rates were still negative, which could cause the private saving rate to fall below the appropriate level. Against this background, the MPC judged that the policy interest rate should be raised again to keep future core inflation within the target.

Bank of Thailand  
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