BANK OF THAILAND NEWS
Communications and Relations Office, Management Assistance Department
Tel. 0-2283-5016-7 FAX 0-2281-5648 www.bot.or.th

No. 13/2006

Inflation Report April 2006

Mr. Bandid Nijathaworn, Deputy Governor (Monetary Stability), Bank of Thailand (BOT) announced that the Monetary Policy Committee (MPC) released the April 2006 issue of the *Inflation Report* on 26 April 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 2005 Q4 the Thai economy expanded by 4.7 per cent, moderating from a 5.4 per cent growth in 2005 Q3 as a result of a slowdown in private consumption and net export. For the whole of 2005, the economy grew by 4.5 per cent as forecasted in the previous *Inflation Report*. Moreover, recent indicators for 2006 Q1 still showed a slowdown in private consumption and investment due to adjustments in response to higher goods prices and production costs. Nevertheless, expansions in the global economy should drive exports and would act as the main engine of growth, going forward.

Overall economic stability remained in good condition. Headline inflation for 2006 Q1 averaged at 5.7 per cent per annum, slowing down from 6.0 per cent per annum in 2005 Q4, reflecting a slowdown in the over-the-year growth of world crude oil prices. Meanwhile, core inflation increased slightly growing by 2.6 per cent per annum in 2006 Q1, up slightly from 2.4 per cent per annum in 2005 Q4. Nevertheless, the continuous increase in the 14-day repurchase rate coupled with the speed-up of monetary policy transmission through the commercial bank interest rate channel helped alleviate some pressure on inflation. In any case, there remained risks of more volatile and higher oil prices, which could exert pressure on inflation going forward. Financial stability also remained in good condition for all sectors including corporate, households and financial institutions. However, risks to economic stability could rise due to various factors namely oil prices which remained high, increases in interest rates, and global imbalances which could result in volatile flows of capital and affect stability in the financial markets.

External stability was satisfactory where latest indicators in 2006 Q1 indicated a notable acceleration in exports from the previous quarter. Meanwhile, imports slowed down partly due to an unusually high base last year where there was an increase in many import items. As a result, the trade balance improved from 2005 Q4. Moreover, net services, income and transfers continued to improve following an increase in tourist income and as a result, the current account stood in good condition. External liquidity was also satisfactory, where the ratio of international reserves to short-term external debt remained higher than 3.

Economic growth and inflation projections

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

1. Dubai oil price assumptions adjusted higher than the previous *Inflation Report* for the entire projection period, averaging at 61.5 and 63.0 US dollars per barrel in 2006 and 2007, respectively. The adjustment was in line with the continued expansion in world demand for crude oil while supply outlook improved only slightly and geopolitical risk in some oil producing countries remained.

2. Non-fuel commodity prices and world farm prices were revised up for the first part of the projection period before trending down towards the same path in the latter part.

3. The increase in the fed funds rate was expected to end in 2006 Q2 at 5.00 per cent per annum, 25 basis points higher than the assumption used in the previous *Inflation Report*.

4. Trading partner economies adjusted higher following economic expansion in the euro area, Japan and other Asian economies where the average growth accelerated from the previous assumption, especially in the first part of the projection period.

5. The impact of the delay in the formation of the new government on the budgeting process and some investment projects that need to go through an international bidding process resulted in a downward revision in public investment assumptions for fiscal years 2006 and 2007. The assumption on government consumption for fiscal year 2006 remained unchanged as the same disbursement rate assumption was used. However, the assumption on government consumption for fiscal year 2007 was expected to decline from the figure used in the previous *Inflation Report*.

As for risks to the economy going forward, the positive risk included a faster than expected budgeting process. On the other hand, negative risks included a possible increase in world oil prices, business sentiment, which could continue to decline, and the strengthening of regional currencies as a result of continued capital inflows into emerging countries.

The MPC thus assessed that the Thai economy in 2006 and 2007 would expand at approximately 4.25 – 5.25 and 4.5 – 6.0 per cent with 87 and 83 per cent probabilities, respectively.

Possible upward pressure on inflation in the following periods could come from higher world oil prices and price adjustments of goods and services that have not yet been increased. On the other hand, downward pressure on inflation could come from domestic demand, which may slow down, and possible baht appreciation. The MPC thus projected headline inflation for 2006 and 2007 to be around 4.0 – 5.0 and 2.0 - 3.5 per cent, respectively. Meanwhile, core inflation for 2006 and 2007 should average around 2.0 - 3.0 per cent.

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 8 March 2006, the MPC viewed that the growth momentum should carry on going forward, being supported by a positive outlook on exports in accordance with favourable global economic trends. Nevertheless, the risk that core inflation could exceed the target range in the next periods while real interest rates that still remained negative prompted the MPC to raise the 14-day repurchase rate from 4.25 to 4.50 per cent per annum.

2. In the Monetary Policy Committee's meeting on 10 April 2006, the MPC viewed that the economy still expanded satisfactorily. Nevertheless, although headline inflation in 2006 Q1 averaged lower than the previous quarter while core inflation remained relatively stable and was expected to decline in the latter half of this year, real deposit rates were still negative. Thus the MPC decided to raise the 14-day repurchase rate from 4.50 to 4.75 per cent per annum.

Bank of Thailand
26 April 2006

For further information: Surach Tanboon Tel. 0 2283 6185
e-mail: SurachT@bot.or.th