



# BANK OF THAILAND NEWS

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## **Inflation Report April 2007**

Mr. Mathee Supapongse, Director, Monetary Policy Department, Bank of Thailand (BOT) announced that the Monetary Policy Committee (MPC) released the April 2007 issue of the *Inflation Report* on 24 April 2007. 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 by 4.2 percent year-on-year in 2006 Q4, slowing down from 4.7 percent in 2006 Q3, mainly due to a slowdown in private consumption and investment which had decelerated by more than the MPC's expectation. Meanwhile, exports of goods and services still expanded well and acted as the main engine of growth. For the whole year, the Thai economy was able to grow at a rate of 5.0 percent, slightly lower than the rate projected in the previous *Report*.

In 2007 Q1, latest economic indicators continued to reflect a softening trend in domestic demand owing to consumer and business sentiments which remained fragile as a result of various uncertainties. Subsequently, the recovery of domestic demand would be delayed. Nevertheless, an acceleration in public expenditure and a more accommodative monetary policy would help support domestic demand to a certain extent. Moreover, exports of goods and services should continue to expand satisfactorily.

With regard to economic stability, inflationary pressure continued to decline in line with the assessment in the previous *Report*, as a result of lower oil prices compared to the same period last year and decelerating raw food prices after the impact from last year's floods had subsided. As a result, headline and core inflation in 2007 Q1 averaged at 2.4 and 1.4 percent, respectively.

The economic slowdown coupled with higher financing costs did not significantly affect the overall economic and financial stability. The performance of financial institutions and credit quality remained sound, partly reflecting a more cautious spending behaviour of households. Nevertheless, households' delinquency rate increased somewhat and corporate profitability declined slightly especially among **under-performing** firms.

Overall external stability was also satisfactory. The current account continued to be in surplus during 2006 H2, as the trade balance improved owing to good exports performance while the net services, income and transfers balance returned to surplus. As a result, the current account for the whole year was in surplus, compared with a sizable deficit recorded in the previous year. As for 2007 Q1, the current account balance was expected to record a high surplus as a result of a

satisfactory expansion in exports and a marked deceleration in imports along with domestic demand. This high current account surplus **exerted further pressure** on the appreciating baht.

### Economic growth and inflation projections

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

1. The Dubai oil price assumptions were adjusted upward for the entire projection period, averaging at 58.8 and 58.0 US dollars per barrel in 2007 and 2008, respectively. This adjustment was in line with intensifying international political tensions, an increase in the planned strategic petroleum reserve of the US, closures of some refineries for maintenance, and a reduction in production capacity of non-OPEC oil producing countries.

2. Assumptions on the direction of world farm prices and non-fuel commodity prices were adjusted upward. Nevertheless, they remained on a declining trend, in line with the projections of the International Monetary Fund.

3. The fed funds rate was expected to decline by 25 basis points to stand at 5.00 percent per annum in 2007 Q3, in order to stimulate the US economy, and would remain at that level until the end of the projection period.

4. The growth rate of Thailand's trading partners' economies in 2007-2008 was expected to be higher as a result of an upward revision for the Asian economies as well as the Euro area, which would help compensate for the slowdown in the US economy.

5. Regional exchange rates remained on a similar appreciation trend as in the previous *Report*.

6. For fiscal years 2007-2008, the assumption on government consumption was revised upward while that of public investments was revised downward slightly.

Risks that could cause the economy to expand lower than the baseline projections included higher-than-expected world oil prices owing to uncertainties in the supply of oil, a stronger-than-expected appreciation in the baht, and a softer-than-expected external demand should the US economy slow down by more than the baseline assumption. Meanwhile, risks that could cause the economy to expand higher than the baseline projections included an improvement in consumer and business sentiments following the authorities' measures to stimulate the economy, including a more accommodative monetary policy stance and a stronger boost from the fiscal side in line with the government's plan to accelerate budget disbursement.

The MPC thus assessed that in 2007 the Thai economy would expand by around 3.8 – 4.8 percent with 94.3 percent probability and by around 4.3 – 5.8 percent with 90.8 percent probability in 2008.

Possible upward pressures on inflation in the future periods could come from an acceleration in the prices of oil and farm produces as well as upward price adjustments of administered goods and services by the Ministry of Commerce. Meanwhile, weak domestic demand and an appreciation in the baht could bring inflation below the baseline projection. The MPC thus projected that headline inflation would average around 1.5 – 2.5 percent in 2007 and be within a wider projection range of 1 – 2.5 percent for 2008. At the same time, core inflation should average around 1 – 2 percent in both 2007 and 2008.

### Monetary policy stance in the last 3 months

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

1. In the Monetary Policy Committee's meeting on 28 February 2007, the MPC viewed that latest economic indicators for 2006 Q4 and January 2007 reflected a continued slowdown in domestic demand. At the same time, inflationary pressure subsided. The MPC thus assessed that going forward, risks to growth would be higher than risks to inflation and decided to lower the policy rate from 4.75 percent per annum to 4.50 percent per annum.

2. In the Monetary Policy Committee's meeting on 11 April 2007, the MPC viewed that domestic demand slowed down by more than previously projected, both in consumption and investment. Meanwhile, inflation continued to decline. The MPC thus decided to lower the policy rate from 4.50 percent per annum to 4.00 percent per annum. Regarding this decision, the MPC assessed that inflationary pressure would remain low such that core inflation would stay within the target range for the next 8 quarters. As a result, monetary policy could be more accommodative to support growth without increasing inflationary risks.

Bank of Thailand

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