



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. 52/2007

Inflation Report October 2007

Mrs. Suchada Kirakul, Assistant Governor, Monetary Policy Group, Bank of Thailand (BOT) announced that the Monetary Policy Committee (MPC) released the October 2007 issue of the *Inflation Report* on 19 October 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

In 2007 Q2, the Thai economy expanded by 4.4 percent year-on-year, accelerating modestly from the first quarter with exports serving as the main engine of growth for the economy together with public spending. Meanwhile, private consumption and investment remained subdued. Overall, the Thai economy expanded by 4.3 percent year-on-year during the first half of this year, slowing down from the previous year which recorded a growth rate of 5.0 percent year-on-year.

Latest economic indicators in July and August showed that domestic demand was gradually improving owing to greater political clarity, continued fiscal stimulus, low inflation which helped maintain consumers' purchasing power, as well as an accommodative monetary policy. This signaled that domestic demand should have a greater contribution to economic growth going forward while exports would slow down in line with trading partners' economic growth.

With regard to economic stability, inflationary pressure continued to decline in 2007 Q3, as a result of retail oil prices which remained below last year's levels despite higher world oil prices, partly owing to a stronger baht. In addition, pressure from raw food prices was mild. This coupled with limited adjustments in the prices of goods and services under subdued demand conditions resulted in 1.6 percent headline inflation and 0.8 percent core inflation, respectively.

The economic slowdown did not significantly affect the balance sheets of corporates and households although corporate profitability declined and the delinquency rates of households in the low to middle income groups rose slightly. Nevertheless, there were signs of behavioral adjustments, for example, consumers began to exercise more caution in their spending. Meanwhile, although financial institutions continued to perform well and their overall stability was not a concern, an increase in non-performing loans could become a source of fragility and should be monitored.

External stability as a whole was also satisfactory. The trade balance and current account registered smaller surpluses in 2007 Q2 compared with the previous quarter, owing to an acceleration in imports. As for 2007 Q3, even though exports were likely to slow down and imports were expected to accelerate further, the trade balance was still expected to register a sizable surplus. Given that the net services, income and transfers balance was expected to record a small level of deficit, the current account balance should continue to record a fairly large surplus.

Economic growth and inflation projections

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

1. The Dubai oil price assumption in 2007 Q4 was adjusted upwards to reflect temporary supply-side risks. As a result, the Dubai oil price assumptions were revised to 64.6 and 65.0 US dollars per barrel in 2007 and 2008, respectively. Meanwhile, the domestic retail petroleum price index¹ was assumed to average at 294.6 and 293.8 in 2007 and 2008, respectively, also rising from the previous assumptions in line with the direction of world oil prices.

2. Assumptions on the direction of world farm and non-fuel commodity prices were revised upwards in line with the projections of the International Monetary Fund.

3. The fed funds rate was expected to adjust lower in 2007 Q4 to stabilize at the rate of 4.50 percent per annum until the end of the projection period. Such revision was due to the problems in the US subprime market.

4. The growth rate of Thailand's trading partners' economies in 2007 was expected to be largely the same, but that of 2008 was revised downwards slightly due to the problems in the US subprime market. While the growth rates of the US, Japan and the euro area were expected to be lower, assumptions on the growth of Asian economies remained the same despite some impact from the problems in the US subprime market given the stronger-than-expected momentum during the previous period.

5. Regional exchange rates were assumed to appreciate by less than the previous assumptions.

6. The assumption on government consumption in fiscal year 2007 was revised downwards due to lower-than-expected central government's current expenditure. However, the assumption for fiscal year 2008 remained the same. Meanwhile, the assumption on public investments was revised downwards in 2007 due to a lower-than-expected disbursement of carry-over expenditures. The assumption for fiscal year 2008 was also adjusted downwards in line with lower forecasts of state-owned enterprises' investments.

Looking ahead, 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 that could be influenced by many factors, a lower-than-expected trading partners' economic growth due to the problems in the US subprime market, a stronger-than-expected appreciation in the baht, and lower-than-targeted budget disbursement rates. Meanwhile, risks that could cause the economy to expand higher than the baseline projections included a faster-than-expected recovery in consumer and business sentiments and a stronger-than-expected impact of low interest rates on decisions to consume and invest once uncertainties were resolved. The MPC thus assessed that in 2007 the Thai economy would expand by around 4.3 – 4.8 percent with 92.2 percent probability and by around 4.5 – 6 percent, similar to the range previously projected, with 91.7 percent probability in 2008.

Possible upward price pressures that might cause inflation to be higher than the baseline projections could come from prices of oil and farm produces, an upward adjustment of cooking gas (LPG) prices, increases in cigarette and alcohol excise tax ceilings as well as subsequent

¹ 1996 = 100. The index comprises benzene oil, diesel oil, LPG gas, fuel oil and kerosene, with the weights of 19.3, 46.8, 8.3, 25.4, and 0.2, respectively.

upward price adjustments following a recovery in domestic demand given that producers had to bear higher production costs for quite sometime already. Meanwhile, a slower-than-expected recovery in domestic demand, an appreciating trend in the baht and price administration measures by the Ministry of Commerce could cause inflation to be lower than the baseline projections.

The MPC thus projected that headline inflation would average around 1.8 – 2.3 percent with 98.2 percent probability in 2007 and around 1.5 – 2.8 percent with 86.9 percent probability in 2008, up from the previous forecasts. At the same time, core inflation should average around 0.8 – 1.3 percent with 100 percent probability in 2007 and around 1 – 2 percent with 92.9 percent probability in 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 29 August 2007, the MPC viewed that domestic demand began to show signs of improvements while the slowdown in exports did not affect the overall economy. Meanwhile, inflation remained low. Overall, given that risks to growth and inflation did not change from the previous assessment, the MPC thus decided to maintain the policy rate at 3.25 percent per annum. The MPC also viewed that the impact of the problems in the US subprime market on the global economic and financial system would need to be closely monitored.

2. In the Monetary Policy Committee's meeting on 10 October 2007, the MPC viewed that domestic demand showed signs of a continued and gradual improvement, while exports still expanded well despite an expected deceleration in growth during the latter half of this year. Meanwhile, the impact of the problems in the US subprime market on the Thai economy had been limited. Nevertheless, these problems were likely to be protracted and should be monitored closely. In addition, inflation continued to be low. Although price pressures rose since the previous meeting, core inflation was expected to remain within the target range during the next 8 quarters. The MPC thus decided to maintain the policy rate at 3.25 percent per annum.

Bank of Thailand
19 October 2007

For further information: Vararat Khemangkorn Tel. 0 2356 7876 e-mail: Vararatk@bot.or.th