



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. 18 /2010

Inflation Report April 2010

Mr. Paiboon Kittisrikangwan, Assistant Governor, Bank of Thailand (BOT), announced that the Monetary Policy Committee (MPC) released the April 2010 issue of the *Inflation Report* on 29 April 2010. 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 in 2009 Q4 continued to show robust signs of recovery, registering its third consecutive quarter-on-quarter growth and expanding year-on-year for the first time of the year. The recovery was driven primarily by exports and private domestic demand. Latest economic indicators in 2010 Q1 – including the strong expansion in the Manufacturing Production Index (MPI), the high level of industrial capacity utilization, and increases in both consumer and business sentiments – pointed to the continuation of the recovery process with exports and private demand still driving the economy.

Meanwhile, inflationary pressure edged up from the previous quarter. Core inflation accelerated slightly following the economic recovery but remained below the lower bound of the policy target range, reflecting the impact of the government's cost-of-living reduction measures. Headline inflation accelerated more noticeably due to the pick-up in raw food and domestic retail oil prices.

Economic growth and inflation projections

In forming economic and inflation forecasts for the next eight quarters, the MPC revised the key assumptions from those used three months earlier, as follows:

1. The growth rate of trading partners' economies is revised upward throughout the projection period, in line with the indication from the recent data that the recovery of industrialized and emerging market economies is stronger than previously assessed.
2. The Fed funds rate assumption is the same as the one used in the previous report.
3. Regional currencies are assumed to appreciate slightly more against the US dollar throughout the projection period, as a result of strengthening growth prospects in Asia together with the continuation of capital flows into the region due to increasing global risk appetite.
4. While overall direct government spending in fiscal year 2010 remains close to the previous assumption, a greater portion of total spending is allocated to consumption while investment spending is trimmed down following actual disbursement in the first quarter of fiscal year 2010. For fiscal year 2011, direct government spending is higher than previously assumed in line with the expansion of the budget, resulting in higher consumption spending. On the other hand, investment spending is revised downward,

given the government's cancellation of the bill that would authorize the Ministry of Finance to raise 400 billion baht of loans to finance economic stimulus projects.

5. The Dubai oil price remains close to the previous assumption, as the fundamentals determining the oil price did not change since the previous *Report*. There is only a slight downward revision of oil price in 2010 Q1, following the actual data. As a result, the Dubai oil price averages at 80.2 and 87.5 USD per barrel in 2010 and 2011, respectively.
6. Agricultural prices are revised upward in 2010, following the view that prices of meats, vegetables and eggs are likely trend up due to unfavorable climate conditions. The prices will then slow down in 2011 due to the high base effect. Similarly, non-fuel commodity prices are revised upward in 2010, in line with the global economic recovery. The MPC expects a subsequent slowdown of non-fuel commodity prices in 2011, in line with the IMF forecast that prices of agricultural products will drop substantially from the preceding year.
7. The minimum wage assumption remains unchanged throughout the projection period, staying at 206 baht per day throughout 2010 and rising slightly in 2011 in line with the economic recovery and higher inflation going forward.

Under the above assumptions and the assumption that the domestic policy interest rate stays at the present level of 1.25 per cent per annum over the next 8 quarters, the MPC assesses that the Thai economy will pose stronger annual growth rates in both 2010 and 2011. The upward revision is, to a large extent, attributable to the high expansion in 2009 Q4, the high expected growth in 2010 Q1 as suggested by both supply- and demand-side indicators, and a stronger prospect for goods exports over the next 8 quarters reflecting the more robust global recovery. Furthermore, accommodative monetary and fiscal policies are likely to continue supporting the economic recovery. However, political conditions will exert significant, adverse impacts on the economy. The inflow of tourists in the last three quarters of 2010 will be heavily reduced as a result. At the same time, private spending will be constrained by the inability of certain economic activities to operate normally and deteriorations in consumer and investor sentiments. The MPC expects economic activities to revert to normal conditions in 2011.

With regards to inflationary pressure, the MPC assesses that core inflation in 2010 will be slightly lower than previously projected due to the extension of the government's cost-of-living reduction measures by three months. Headline inflation will remain close to the previous projection, however, as suppressed core inflation will be offset by rising domestic farm prices. In 2011, inflation will edge up and become higher than previously projected as a result of rising demand-side pressure following the economic recovery, which will facilitate a gradual pass-through of production costs to retail prices.

The MPC also takes note of risk factors that can cause the economy to deviate from the baseline projection. On the whole, the MPC assesses that negative risks to economic growth will outweigh positive risks throughout the projection horizon, mainly due to internal risk factors. Prolonged and more intense political conditions will affect tourism revenue, private sentiments, as well as the effectiveness of public spending. Moreover, if prolonged, the resolution of the Map Ta Phut suspension will have direct impacts on the affected projects' revenue and overall investment of the country. On the external front, the most important risk factor is a delayed global recovery. On the whole, the fan chart for economic growth skews downward and widens

compared to the previous projection for the entire horizon, reflecting higher risks and uncertainties. This gives the projection of economic growth in the ranges of 4.3-5.8 per cent in 2010 and 3.0-5.0 per cent in 2011, with probability of 75.7 and 74.5 per cent, respectively.

As for core inflation projection, the MPC views that the downside risks will dominate the upside risks, as demand may expand at a slower pace. Therefore, the fan chart for core inflation skews downwards for the entire projection horizon in line with the fan chart of the GDP growth. However, the fan chart for headline inflation is balanced throughout the projection period, since the supply-induced upside risks will be offset by the demand-induced downside risks. Therefore, the MPC projects headline inflation to average within the ranges of 3.3-4.8 per cent in 2010 and 2.3-4.3 per cent in 2011, with probability of 92.0 and 84.9 per cent, respectively. Meanwhile, core inflation is expected to be within the ranges of 1.0-2.0 per cent in 2010 and 2.0-3.0 per cent in 2011, with probability of 98.7 and 87.8 per cent, respectively.

Monetary policy stance in the last 3 months

From the assessment of economic conditions and outlook above, the MPC views that the Thai economy has been expanding from 2009 Q4 onwards following the global recovery, improved private sector sentiments, and solid economic foundations. Inflation will gradually rise over the periods ahead in tandem with the economic expansion and rising costs of raw materials. Nevertheless, higher uncertainty surrounding domestic political conditions is the important risk factor affecting sentiment, tourism, consumption and investment. The MPC will closely monitor its impact on the economy, and therefore decided to maintain the policy interest rate at 1.25 per cent per annum at the 10 March 2010 and 21 April 2010 meetings.

Bank of Thailand

29 April 2010

For further information: Kritchaya Janjaroen Tel. 0 2356 7876 e-mail: kritchap@bot.or.th