



# BANK OF THAILAND NEWS

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## Inflation Report July 2011

Mr. Paiboon Kittisrikangwan, Assistant Governor, Bank of Thailand (BOT), announced that the Monetary Policy Committee (MPC) released the July 2011 issue of the *Inflation Report* on July 22, 2011. The *Report* was published 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 3.0 percent in 2011 Q1 over the same period last year, slightly dampened from the previous quarter partly owing to the effect of last year's high base. However, on a quarterly basis, the economy posted a robust 2.0 percent growth, relatively high in Thailand's historical standard, mainly driven by strong exports and rising contribution from private-sector demand. Preliminary indicators in April and May then suggested a potential drag in exports as supply disruption due to natural disasters in Japan continued to weigh on Thailand's manufacturing, especially for the automobile sector, and this would dampen investment to some extent. Despite the pressures, the forward momentum would likely sustain in the second quarter on the back of strong private consumption, further boosted by fiscal stimulus mainly through the government's consumption spending.

Inflation pressures picked up in 2011 Q2 as the MPC had anticipated. Core inflation edged higher from prices of food and beverages, which surged in line with rising costs of fresh food as well as seasonings and condiments. In addition, rising demand from robust domestic growth also pressured core inflation to the upside. Headline readings accelerated as well in all components, with fresh food prices surging due to rising costs and unfavorable weather and energy prices edging higher with the global oil prices.

### Economic growth and inflation projections

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

1. **Demand for Thai exports** remains unchanged throughout the projection period. The MPC expects softer-than-expected outturns in 2011 for the U.S. and Japan, while anticipating the opposite for the euro area and Asia. Trading partners' demand will then gain momentum in 2012 as previously assumed.
2. The **U.S. federal funds rate** is expected to rise in 2012 Q2, a one-quarter delay from the previous assumption, in line with the protracted recovery in the U.S.
3. **Regional currencies** will appreciate against the U.S. dollar slightly more throughout the forecast period following the second quarter's outturns and strengthened growth prospects in Asia.

4. **Direct government spending** is revised throughout the forecast period. For fiscal year 2011, government consumption rises with the upward revision in disbursement, whereas investment spending drops with the actual disbursement that turned out lower than expected. For fiscal year 2012, consumption spending declines due to lower carry-over from the preceding year, with no significant revision in public investment.
5. The **Dubai oil price** outlook remains largely unchanged, with the price pressured by both rising global demand and supply constraints due to political tensions in the Middle East and North Africa. The crude price is projected to average at 108.1 U.S. dollars per barrel in 2011, slightly up from the previous assumption of 107.7 U.S. dollars per barrel due to the second quarter's high outturns. The projection then stays unchanged in 2012 at 110 U.S. dollars per barrel.
6. **Non-fuel commodity prices** are revised down in 2011 due to lower-than-expected outturns in April and May, particularly for food and metal prices. Going forward, prices of metals will likely edge higher with elevated oil prices and sustained global growth, with further support from the firmer recovery of the Japanese economy anticipated in the second half of this year. Non-fuel commodity prices will then grow robustly in 2012 in line with the continued global growth.
7. **Domestic agricultural prices** are revised down as the April-May outturns indicated a drop in prices of vegetables and fruits, as fresh produce increased due to favorable weather. The price assumption then rises in 2012 in line with the rebound in prices of vegetables and fruits.
8. The **daily minimum wage** assumption stays unchanged at 215 baht in 2011 before rising to 240 baht in 2012, up from the previous assumption of 226 baht. The upward revision owes partly to higher remuneration for workers' social and recreational expenses. This assumption does not reflect the new government's plan to increase minimum wage, as the plan still needs approval from the National Wage Committee and the detail on the implementation has not been finalized.

Given the key assumptions above, the MPC projects a sustained growth for the Thai economy in the second half of 2011. Export momentum will likely resume its strong uptrend thanks to robust emerging market demand as well as the gradual recovery in developed economies. The firmer-than-expected rebound of the Japanese economy, in particular, will benefit Thailand's exports and support investment. At the same time, private consumption will continue to edge higher given the favorable prospects for both farm income and employment. Growth will then become more balanced and sustained in 2012 thanks to robust domestic and external demand, with fiscal impetus also stepping up its role in supporting the private sector and domestic growth overall. Accordingly, the MPC maintains its growth projection for 2011 and 2012 at 4.1 and 4.2 percent, respectively, under the baseline scenario.

Meanwhile, inflation pressures are anticipated to pick up during the second half of 2011 due to greater pass-through of cost burden to consumers and rising demand pressures. The government, however, has extended its cost-of-living subsidy measures beyond the scheduled termination at the end of the second quarter. As a result, core inflation is less likely to rise above the target range and will subside slightly in 2012, while staying below headline figures that will gain from persistently high fresh food and energy prices. Therefore, under the baseline scenario, the MPC projects core inflation to be 2.4 percent in 2011 and 2.3 percent in 2012. Headline inflation is forecast to be 3.9 and 3.2 percent in 2011 and 2012, respectively.

The MPC takes note of major risk factors that may cause growth to deviate from the baseline projection. On the whole, the MPC views upside risks to growth to outweigh downside ones. The new government's stimulus package will likely boost short-term domestic growth, despite the added risks to trading partners' and global growth. Accordingly, the fan chart for economic growth is wider and skewed more to the upside compared with the previous one.

With regard to inflation, the MPC views upside risks to dominate downside ones. This outlook owes mainly to the new government's economic policy and minimum wage raise, and also the possibility that the global oil and commodity prices may turn out higher than expected. Reflecting these risks, the fan charts for headline and core inflation are skewed upward throughout the projection period.

### Monetary policy stance in the last 3 months

In the meeting on June 1, 2011, the MPC assessed the Thai economy to grow robustly in the first quarter thanks to strong momentum in agricultural production and exports, with solid economic fundamentals to support growth over the period ahead. Meanwhile, price pressures picked up more sharply than anticipated. Sustained growth in private spending allowed greater pass-through from rising costs to consumer prices, thus raising the probability of core inflation exceeding the target range. Accordingly, the MPC decided unanimously to raise the policy rate by 0.25 percent, from 2.75 to 3.00 percent. Then in its subsequent meeting on July 13, 2011, the MPC viewed domestic growth to sustain well in the second quarter on the back of robust domestic and external demand. Supply disruption, particularly for parts used in the automobile industry, eased sooner than expected, which could lead to a firmer rebound in the manufacturing sector during the second half of the year. Going forward, consumption and investment momentum would continue to strengthen with added support from higher fiscal stimulus. On the other hand, the MPC anticipated inflation to remain elevated. While the rise in inflation might be somewhat delayed due to the extension of cost-of-living subsidy measures, the new government's plan on minimum wage raise and spending boost could pressure prices and inflation expectations upward. Given the upside risks to inflation amid robust demand, the MPC deemed it appropriate to continue its rate normalization to maintain overall economic stability and contain inflation expectations. The MPC, therefore, decided unanimously to raise the policy rate further by 0.25 percent, from 3.00 to 3.25 percent.

Bank of Thailand

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