BANK OF THAILAND
BOT Press Release
Communications and Relations Office, Corporate Communications Department
Tel. 0-2283-5016-7 Fax. 0-2281-5648 www.bot.or.th

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Inflation Report January 2012

Mr. Paiboon Kittisrikangwan, Assistant Governor Bank of Thailand (BOT), announced that the Monetary Policy Committee (MPC) released the January 2012 issue of the *Inflation Report*. The *Report* was published to enhance public understanding of the BOT's policy stance, with the key details summarized as follows.

1. Economic Outlook

The impact of the recent flood on the Thai economy was more severe than previously assessed. Manufacturing production, in particular, suffered both directly from activity halt and also indirectly through disruption in supply chain and transportation. Production problems coupled with a continuing drag on exports due to weak global demand led to a sharp contraction of the Thai economy in 2011 Q4, bringing down the annual growth for 2011 to 1.0 percent from 7.8 percent in the previous year.

Recovery has already begun as the flood receded last December. Economic activity is projected to finally return to its pre-flood level in 2012 Q3, with domestic strength helping to cushion some weakness in exports due to global demand slowdown. The MPC anticipates **private consumption** to stage an early comeback in Q1 thanks to support from damage replacement, pent-up demand especially in automobiles and electrical appliances, along with favorable income and employment prospects. Meanwhile, **private investment** and the **manufacturing sector** will gradually return to normal conditions in Q3, a 1-2 month delay from the previous assessment because of: (1) severe damage to machines, which forces firms to import some of them anew instead of repairing; (2) businesses' delayed investment in anticipation of the government's comprehensive plan on water management and flood prevention; and (3) insurance companies' delay in damage assessment and compensation payment. Looking ahead, a sustained recovery in private demand may hinge on **government**'s direct spending and additional stimulus measures, with a prime focus on concrete water management scheme to rebuild investor confidence. Given conducive financial conditions, the **banking sector** will also play an important role in extending credits to households and businesses to aid recovery.

Meanwhile, Thailand's **exports** are likely to decelerate from last year and to resume their pre-flood trend in Q3 in line with delayed recovery in the manufacturing sector and softer global demand. This time, the MPC revises down its assumption on trading partners' economic growth, taken into account the likely recession in the euro area and Asia's slower growth due to weaker exports. Growth prospects in the U.S., however, strengthen relative to the previous assessment. With exports and manufacturing production yet to recover fully, **imports** are likely to slow down in the near term, before regaining some traction during the first half of this year with machine replacement and merchandise imported to compensate shortfall in production caused by the flood.

2. Inflation Outlook

Inflation is likely to subside during the first half of 2012, as demand pressure softens with delayed recovery in the private sector. Fresh food prices also start to decelerate after the flood situation eased, while the rice pledging program does not pressure rice and food prices as expected due to the low quantity of rice pledged under the program. Nevertheless, energy prices may edge higher with the oil fund levy and the reintroduction of the excise tax on fuel. Elevated crude oil price due to the conflict between Iran and Western nations may also add more pressure temporarily.

Inflation pressure could build up during the second half of the year, roughly tracking the pre-flood trend. The anticipated pick-up in private demand and the closing of output gap will allow for a greater pass-through of cost increases to consumers. Additionally, production costs are likely to rise, as the impact of the minimum wage hike and energy-related measures becomes more evident. More pressure could also arise from heavy public spending on water management projects coming underway. Heightened domestic pressure, however, would be largely offset by the slowdown in global crude and commodity prices due to weak global demand.

3. Projection for Growth and Inflation

In light of the assessment above, the MPC projects economic growth in 2012 to be higher than the previous forecast under the baseline scenario. The upward revision partly reflects last year's low base due to the severe flood damage, though offset to some degree by the delayed recovery in manufacturing production. The MPC then projects growth momentum to sustain well into 2013. Relative to the baseline projection, the MPC judges risks to growth projection to be skewed to the downside, mainly due to heightened risks and uncertainty from abroad. Accordingly, the fan chart for economic growth is skewed to the downside and wider throughout the forecast period.

Forecast Summary

%YoY	2011	2012	2013
GDP Growth	1.0	4.9	5.6
	(2.6)	(4.1)	
Headline Inflation	3.8*	3.2	2.9
	(3.8)	(3.5)	
Core Inflation	2.4*	2.2	1.7
	(2.4)	(2.5)	

Note: * Outturns
( ) Inflation Report October 2011
Source: National Economic and Social Development Board and Bank of Thailand's projection

On the other hand, the MPC revises down its inflation projection for both 2012 and 2013 in line with subdued inflation pressure. During the second half of this year, domestic pressure is likely to pick up with demand recovery and the impact of stimulus measures, but will be offset by softened global oil and commodity prices. Inflation could continue to trend lower to normal levels in 2013, as the impact from government measures diminishes. The MPC judges downside and upside risks to inflation projection to be broadly equal, as reflected in balanced fan charts for headline and core inflation over the projection period.

4. Monetary Policy Outlook

The MPC decided to reduce the policy interest rate in its last two meetings to support flood recovery. In its meeting on November 30, 2011, the MPC viewed the global economic outlook to deteriorate. The euro area was more likely to fall into a recession, while recovery in the U.S. remained somewhat fragile. On the domestic front, the impact of the flood on manufacturing production, exports, and private sentiment turned out to be more severe than expected. While inflation pressure persisted due to the impact of stimulus measures and the anticipated pick-up in private demand, upside risks to inflation were assessed to be limited. The MPC, accordingly, viewed that monetary policy could provide further support to domestic recovery, and thus voted 5 to 2 to reduce the policy rate by 0.25 percent, from 3.50 to 3.25 percent, with 2 votes in favor of a 0.50 percent reduction.

Then in its subsequent meeting on January 25, 2012, the MPC viewed that the global economy had weakened further, with the euro area likely to enter a recession. Despite some signs of improvements, economic growth in the U.S. remained constrained over the period ahead. On the other hand, the flood's impact on the broader economy was greater than assessed previously. Recovery was also projected to be delayed, with manufacturing production returning to normal by 2012 Q3. With limited inflation risks and headwinds from the global economy, the MPC voted unanimously to reduce the policy rate by 0.25 percent, from 3.25 to 3.00 percent, with an aim to help accelerate the return of economic activity to normal levels.

Bank of Thailand
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For further information: Bodin Civilize Tel. 0 2356 7876 E-mail: bodinc@bot.or.th