BANK OF THAILAND

BOT Press Release

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No. 25/2012

Inflation Report May 2012

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

1. Economic Outlook

Last year's flood weighed on the Thai economy more severely than expected, with a sharp contraction in manufacturing production in nearly all industries. This brought down the annual growth for 2011 to 0.1 percent, much lower than 1.0 percent projected in the previous *Report*. Nevertheless, the MPC expects the economy to return normal faster than previously anticipated, thanks to domestic production and spending that gained traction early in Q1.

Post-flood recovery in **manufacturing production** was robust, as businesses started to resume production to meet domestic and global demand. Flood-hit businesses ramped up their reconstruction investment and sought production inputs from alternative suppliers to alleviate supply constraints, while unaffected businesses also stepped up their production. On the whole, the MPC assesses manufacturing production to return normal in late Q2. Recovery prospects are likely to remain well-supported by foreign orders, domestic consumer spending, as well as improved consumer and investor confidence. The MPC, however, will remain vigilant in monitoring the impact of the wage increase especially on SMEs and labor-intensive industries.

Meanwhile, private demand also picked up faster than expected. **Private consumption** is likely to return normal in Q1 as anticipated, but with stronger momentum this time due to damage replacement and high pent-up demand. Favorable income prospects, both for farm and non-farm sectors, will provide support for consumer spending going forward. Similarly, **private investment** is poised to outpace the previous forecast and return to normal conditions in Q1. The pick-up was mainly due to machinery and equipment investment, which reflected producers' efforts to resume operation quickly. **Government's policies and measures** will also be crucial in sustaining strong momentum in both consumption and investment over the period ahead.

On the external front, **Thailand's exports** are projected to resume their pre-flood trend in Q3, since some major industries including hard-disk drives and integrated circuits still face production problems and need more time to recover fully. The MPC assesses exports to recover gradually as global demand conditions improve, and to contribute more significantly to economic growth in 2013 along with domestic demand. Meanwhile, **imports** are projected to outpace exports especially in the first half of 2012 in line with the pick-up in consumption and investment, before moderating in the remaining period as domestic production returns normal.

2. Inflation Outlook

Inflation pressure is likely to build up going forward given rising cost pressure from oil prices and wages. Energy prices are likely to rise in line with global crude prices, which picked up early this year due to the conflict between Iran and Western nations that led to tightened crude supply. More pressure also arises from the reintroduction of the oil fund levy in mid-January. The minimum wage hike, on the other hand, may also pose an upside risk to inflation over the projection period. Meanwhile, fresh food prices should continue to decelerate after supply constraints during the flood eased, while commodity prices are likely to trend up gradually given market's concerns on the global economy.

The pass-through of costs to consumer prices is also likely to be greater amid the acceleration in private demand. In particular, both consumption and investment are bound to recover much faster than expected in the first half of this year, and should remain strong going forward given the increase in the minimum wage and government officials' salary. This is in line with the output gap that becomes narrower and is projected to close in 2012 Q3.

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 reflects last year's low base due to flood devastation and robust private demand in the first half of the year. The MPC then projects growth to sustain well into 2013, with exports contributing to growth more substantially along with domestic demand. On the whole, the MPC

Forecast Summary

%YoY	2011*	2012	2013
GDP Growth	0.1	6.0	5.8
		(4.9)	(5.6)
Headline Inflation	3.8	3.5	3.5
		(3.2)	(2.9)
Core Inflation	2.4	2.5	2.1
		(2.2)	(1.7)

Note: * Outturns
( ) Inflation Report January 2012
Sources: Office of the National Economic and Social Development Board and Bank of Thailand's projection

judges risks to growth to remain skewed to the downside mainly from the global economy. Nonetheless, downside risks and uncertainty are lower this time, thanks to swift recovery in private demand and production, as well as recent improvements on the euro area's debt crisis. Therefore, the fan chart for economic growth is skewed downward but to a lesser extent compared to the previous one, and is narrower throughout the forecast period.

The MPC also revises up its inflation forecasts in line with rising pressure from energy costs, and also private demand that picks up and will remain strong given the hike in the minimum wage and government officials' salary. The acceleration in demand will, also, allow a greater pass-through from costs to prices. The MPC judges upside risks to inflation to increase from various factors including global crude oil prices, the impact of the wage hike on production costs, the pass-through of cost burden, and inflation expectations. Accordingly, the fan charts for headline and core inflation are skewed to the upside and wider over the projection period.

4. Monetary Policy Outlook

In its last two meetings on March 21 and May 2, 2012, the MPC assessed global growth to remain slow but with lower downside risks. The U.S. economy improved with encouraging developments in the labor market and private sector confidence, while the euro zone economy entered a recession and still needed more time to resolve structural concerns. Nonetheless, core countries still rested upon solid fundamentals and started to show signs of improvement. Meanwhile, Thailand's post-flood recovery was faster than expected, as reflected in improved economic indicators across the board. Manufacturing production was anticipated to return normal in late 2012 Q2, while private consumption and investment picked up and would remain well-supported by stronger confidence and consumer spending, together with government stimulus and conducive financial conditions. Inflation pressure would persist over the period ahead due to elevated oil prices and the minimum wage increase. The pass-through of costs to consumer prices was also likely to be greater amid the pick-up in domestic demand.

The MPC assessed that the recent easing of monetary policy had helped shore up private sector confidence and supported a broad-based recovery. Furthermore, the MPC also deemed the current level of the policy rate to be appropriate in supporting a smooth recovery in economic activity to normal levels, while keeping inflation risks manageable. The MPC thus voted unanimously to hold the policy rate at 3.0 percent per annum in both meetings.

Bank of Thailand

May 11, 2012

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