BANK OF THAILAND

BOT Press Release

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Inflation Report July 2012

Mr. Paiboon Kittisrikangwan, Assistant Governor Bank of Thailand (BOT), announced that the Monetary Policy Committee (MPC) released the July 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

Post-flood recovery has been robust in the first half of the year. However, growth momentum is likely to be weaker than expected in the second half, as the global economy weakens and private demand starts to decelerate after picking up earlier in the year.

Production constraints due to the flood continue to ease, with overall production constraints largely dissipated in late Q2. The MPC assesses recovery in flood-hit industries to be satisfactory. Production of automobiles and electrical appliances has returned to full capacity, but still falls short of high pent-up demand. For hard-disk drives, while production also resumes to normal conditions, production figured were affected by weak global demand. On the other hand, the integrated circuit industry is expected to recover fully in Q4, as some producers still wait for new machines to be imported and installed. Growth of the production sector should be sustained going forward, despite some challenges from labor shortage and protracted global slowdown.

Meanwhile, private demand has rebounded to pre-flood levels. **Private investment** has been growing favorably on the back of reconstruction investment in the first half of the year, but is likely to subside as most reconstruction demand wanes off in Q3. Nonetheless, investors' positive sentiment and commitment to long-term plans will lend support to investment growth going forward. On the other hand, **private consumption** continues to benefit from pent-up demand especially for automobiles. Some deceleration is expected from the second half onward, but overall momentum should be supported by favorable income prospects, continued fiscal stimulus, and conducive monetary conditions.

On the external front, **export** recovery remains weighed by global demand conditions. Merchandise exports will be weaker than previously assessed, as manufacturing exports suffer from sluggish global demand and agricultural exports are negatively affected by contraction in rice exports. However, exports of services should remain resilient thanks to the tourism sector. Meanwhile, **imports** are projected to decelerate in the second half of the year, in line with diminishing reconstruction needs and weaker prospects of merchandise exports.

The global economy, given its weak outlook and heightened risks, continues to be the major source of downside risks to economic growth. While progresses made on the sovereign debt crisis help calm the marketplace temporarily, worries on global growth prospects seem to escalate along with additional signs of slowdown in industrialized and emerging market economies. Some central banks have also eased their monetary policy further to contain downside risks to growth. This time, the MPC continues to revise down its growth projection for Thailand's trading partners. The euro economy is viewed to remain in recession in 2012, before starting to recover gradually next year. At the same time, economic momentum in the U.S. and Asia will subside throughout the projection period.

2. Inflation Outlook

Inflation pressure is likely to soften relative to the previous assessment. While economic growth has picked up firmly and is close to potential in Q2, demand pressure is viewed to abate as economic momentum decelerates in the second half of the year.

Cost-side pressure also lessens with the recent decline in global oil and commodity prices. Going forward, the MPC assesses pressure coming from oil prices to be rather limited. Heightened concerns on global growth will continue to weigh on global oil prices, while the impact of Iran's tension on crude supply may be more benign than assessed. Also, domestic retail oil prices are likely to be steady this year, given government's policy in administering the prices. At the same time, commodity prices are projected to recover gradually in line with oil prices, while fresh food prices are likely to fall in the near-term given abundant supply.

3. Projection for Growth and Inflation

The MPC revises down growth projection in 2012, assessing the negative impact of slowdown in the second half to outweigh the positive impact of robust recovery in the first half. The MPC also lowers its growth forecast for 2013, given the continued slowdown from the previous year's second half and the base effect due to post-flood surge in the previous year's first half. On the whole, the MPC judges downside risks and uncertainty from the global economy to increase this time. Thus, the fan chart for economic growth is skewed downward to a greater degree compared to the previous one, and is wider throughout the forecast period.

Forecast Summary

%YoY	2011*	2012	2013
GDP Growth	0.1	5.7	5.0
		(6.0)	(5.8)
Headline Inflation	3.8	2.9	3.4
		(3.5)	(3.5)
Core Inflation	2.4	2.2	1.9
		(2.5)	(2.1)

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

The MPC also revises down its inflation forecasts in line with demand pressure that softens with weaker growth momentum in the second half, and also cost pressure that subsides with the recent decline in global and oil commodity prices. The MPC judges risks to be skewed to the downside mainly from: (1) heightened risks to domestic growth due to global economic concerns; and (2) risks to global oil prices that become balanced as the impact of Iran's conflict on crude supply is likely to be more benign than assessed. Accordingly, the fan charts for headline and core inflation are skewed downward over the projection period.

4. Monetary Policy Outlook

In its meeting on June 13, 2012, the MPC judged risks to the global economy to increase relative to the previous meeting, mainly from uncertainty about Greece's future in the euro area and banking problems in Spain. Meanwhile, the Thai economy recovered from the flood faster than expected in the first quarter, but exports might weaken further in case that the euro area crisis intensifies. Inflation pressure moderated with global oil and commodity prices, but would remain in the period ahead from robust domestic demand. On the whole, the MPC assessed the balance of risks to be skewed toward growth, rather than inflation, and deemed it appropriate to maintain an accommodative policy stance to support domestic recovery and help cushion risks from the global economy. The MPC thus voted unanimously to maintain the policy rate at 3.0 percent.

In its subsequent meeting on July 25, 2012, the MPC viewed risks to the global economy to escalate, given dampened recovery in the U.S. and delayed resolution of structural concerns in the euro area. In this context, some central banks started to ease their monetary policy further to contain downside risks to growth. The Thai economy, on the other hand, continued to recover and was close to potential. Domestic demand growth remained firm, while exports might be affected by the global economy more than assessed. Meanwhile, inflation pressure moderated and projected inflation was within the target range. The MPC, accordingly, voted 5 to 2 to maintain the policy rate at 3.0 percent, with two votes in favor of a 0.25 percent decrease. The majority viewed the current policy stance to be accommodative enough to support domestic growth and help cushion global economic risks to some degree. The MPC would closely monitor future developments and stand ready to take appropriate action as warranted.

Bank of Thailand

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