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Inflation Report October 2012

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

Thailand's growth momentum is poised to soften for the rest of this year, with exports suffering from weak global demand more than expected. However, overall strength in domestic demand will help sustain near-potential economic growth in the period ahead.

Private demand starts to moderate to its normal trend, as near-term factors fueling first half's pick-up disappeared. Private investment decelerates to normal conditions after post-flood reconstruction tapered off, as reflected in weak readings in Q3 in machinery and equipment investment as well as imports of capital goods. But going forward, investment prospects remain sound thanks to (1) businesses' confidence and commitment to long-term plans; and (2) foreign investors' continued investment demand given Thailand's strengths in infrastructure, skilled labor, and well-established supply chains especially for automobiles and parts. **At the same time, private consumption is also expected to moderate for the rest of the year**, since most pent-up demand has already been fulfilled. However, consumption will likely remain firm and help sustain growth in the period ahead, given the continued impact from government's stimulus measures, favorable income prospects, as well as interest rate and credit conditions that remain supportive.

The impact of global demand weakness on exports has also become more evident. Manufacturing exports have been the hardest hit, especially for electronic products and electrical appliances where foreign orders started to decline. Additionally, agricultural exports are likely to remain contracted, partly due to rice exports, which suffered from high rice prices driven up by the rice mortgage scheme. Over the period ahead, the MPC expects export weakness to pass on to production, sentiment, and private spending more visibly. On the other hand, **merchandise imports appear to drop** mainly from imports of raw materials, intermediate goods, and capital goods, reflecting dissipated reconstruction investment.

The global economy, given its weak prospects and uncertainty, continues to be the major risk to the Thai economy. Growth momentum in the euro area and the U.S. remains weak and recovery is poised to take time, while the impact of sluggish global demand on Asian economies is likely to be more than assessed. Despite some positive impact on near-term sentiment, recent monetary policy easing in Europe and the U.S. is unlikely to change the deteriorated global growth outlook. Additional risks from domestic factors, though not as important as those from the external front, arise from uncertainty regarding government's spending on long-term water management and infrastructure projects.

2. Inflation Outlook

Inflation pressure is viewed to soften from the previous assessment. Demand pressure subsides with domestic growth that is likely to lose some momentum due to global economic slowdown and post-flood reconstruction that dissipated earlier than expected. However, some demand pressure still remains given near-potential growth projected in the period ahead. **Cost pressure also softens** partly from next year's softer-than-expected global oil prices due to weaker global demand. But overall, the MPC projects global oil prices to stay close to the present level, supported by supply concerns including tensions in the Middle East and low OPEC spare capacity. Other costs including prices of non-fuel commodities and fresh food remain benign.

The MPC also revises its assumption that the government would postpone the reintroduction of fuel excise taxes over the projection period to help cushion energy and transportation costs, compared to the previous assumption that the taxes would start in early 2013. This change in assumption drives down next year's headline forecast considerably.

3. Projection for Growth and Inflation

Forecast Summary

Percent	2011*	2012	2013
GDP growth	0.1	5.7 (5.7)	4.6 (5.0)
Headline inflation	3.8	3.0 (2.9)	2.8 (3.4)
Core inflation	2.4	2.1 (2.2)	1.7 (1.9)

Note: * Outturn
( ) Inflation Report July 2012
Source : Office of the National Economic and Social Development Board and calculation by Bank of Thailand

The MPC maintains its growth forecast for 2012 at 5.7 percent, assessing that domestic demand strength will help offset the impact from the global economy to some degree. **For 2013, growth is projected to continue but at a pace slower than assessed earlier.** This owes largely to (1) the global economy that is weaker this time and affects exports and domestic demand more evidently; and (2) delayed disbursement under government's water management plan. Looking ahead, the MPC views downside risks from the global economy to persist and dominate upside ones. The fan chart for growth is thus skewed downward throughout the forecast period.

The MPC revises down next year's inflation forecasts in line with the new assumption that fuel excise taxes would be postponed over the projection period, as well as softer global oil prices. The MPC assesses overall risks to inflation to remain weighed to the downside, mainly from heightened risks to domestic growth due to global economic concerns. Accordingly, the fan charts for headline and core inflation are skewed downward over the projection period.

4. Monetary Policy Outlook

In its meeting on September 5, 2012, the MPC assessed overall risks to the global economy to remain elevated. Recovery in the U.S. continued to be tepid, while euro area's economy had entered recession and was projected to weaken further in the latter half of the year. The impact of weaker global demand on Chinese and Asian economies also became more apparent. On the other hand, the Thai economy grew faster than expected in Q2, with consumption and investment momentum projected to gain traction, while inflation pressure moderated and inflation forecasts stayed within the target range. The MPC viewed the impact of slower global demand on the Thai economy to have increased to some extent. However, domestic demand remained firm and current monetary conditions were accommodative enough to support continued economic expansion. The MPC thus voted 3 to 2 to maintain the policy rate at 3.00 percent per annum, with two votes in favor of a 0.25 percent decrease. Two members were unable to attend this meeting due to obligations abroad.

In its subsequent meeting on October 17, 2012, the MPC viewed the global economy to remain weak, although monetary policy easing in major economies helped support market sentiment and economic indicators in the U.S. improved somewhat. Going forward, fiscal risks in the U.S. and challenges in resolving euro area's debt crisis still posed significant risks to the global economy. Meanwhile, the Thai economy continued to expand in Q3. Domestic spending and investment continued to grow, but at a moderated pace since post-flood reconstruction had tapered off. Softened global demand also impacted exports and related production more apparently, and global economic uncertainty could hamper export recovery in the period ahead. In addition, inflation pressure stabilized at an acceptable level. With upside risks to inflation contained, the majority of the MPC deemed that monetary policy easing was warranted to shore up domestic demand in the period ahead and ward off the potential impact from the global economy, which remained weak and fragile. The MPC, therefore, voted 5 to 2 to reduce the policy rate by 0.25 percent, from 3.00 to 2.75 percent per annum. Two members voted to hold the policy rate at 3.00 percent per annum, deeming current growth momentum to be adequate and that further policy action could wait for greater clarity in the economic outlook.

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