

Inflation Report

January 2010

The *Inflation Report* is prepared quarterly by staff of the Bank of Thailand with the approval of the Monetary Policy Committee (MPC). It serves two purposes: (1) to provide a clear forward-looking framework for economic and inflation forecasting to assist the MPC in making monetary policy decisions and (2) to give the MPC an opportunity to present the explanation for their decisions on various policy issues to the public.

Although individual MPC members may have differing opinions regarding the assumptions on which the forecasts are based, as a group they are in agreement with the forecasts on the outlook for inflation and output as well as the risk factors involved as illustrated in the fan charts.

The Monetary Policy Committee:

Mrs. Tarisa	Watanagase	Chairman
Mr. Bandid	Nijathaworn	Vice Chairman
Mrs. Atchana	Waiquamdee	Member
Mr. Ampon	Kittiampon	Member
Mr. Praipol	Koomsup	Member
Mr. Siri	Ganjarende	Member
Mr. Krirk-krai	Jirapaet	Member



Thailand Monetary Policy Strategy

Monetary Policy Formulation

- The Monetary Policy Committee (MPC) sets monetary policy in order to attain price stability conducive to sustainable economic growth. The MPC also monitors factors contributing to external stability and financial imbalances.

The Monetary Policy Instrument

- The MPC utilizes the 1-day bilateral repurchase transaction rate as the key policy rate to signal the monetary policy stance.

The Target

- The MPC uses core inflation (excluding raw food and energy) as its policy target with the range of 0.5-3.0 per cent (quarterly average). In the event that the target is missed, the MPC is required to explain the reasons thereof to the public.

Forecasting Tools

- To assist the MPC in making monetary policy decisions, the Bank of Thailand has developed a macroeconomic model to forecast economic conditions and inflation outlook. The model is also employed to evaluate the impact of various factors on the economy and to offer guidelines for appropriate monetary policy responses.

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1. Overview

The global economy continued to recover in 2009 Q4. The recovery was especially robust in the Asian economies, supported by strong expansion in production, consumption, exports, as well as a pickup in asset prices. There have been more capital inflows into the region as a result. The industrialized economies also continued to see gradual recovery, with accumulative effects from monetary and fiscal policies lending support to private consumption and investment particularly during the second half of the year. Nonetheless, the recovery of major industrialized economies remains fragile. Elevated unemployment rates continue to pressure both the US and the euro area, while problems in the banking sector are yet unresolved and are constraining the commercial banks' ability to extend credits. In addition, recent events in Dubai, Vietnam, Greece, and Venezuela have raised the volatility in the global financial market.

Over the past three months, the Monetary Policy Committee (MPC) views that

1. The Thai economy has shown a continuous sign of recovery, expanding by 1.3 per cent in 2009 Q3 over the previous quarter. The pace of expansion is somewhat slower than in the second quarter, in which the economy grew quarter-on-quarter by 2.2 per cent partly owing to a one-time upward adjustment in restocking production. The recovery during the third quarter was aided by (1) an exports growth of 5.2 per cent from the previous quarter, the first expansion in 2009, which spurred growth in the export-reliant

Change from the previous period (Per cent)	2008	2008		2009		
		Q3	Q4	Q1	Q2	Q3
Domestic demand ^{1/}	2.5	0.6	-0.1	-4.9	1.6	1.2
Private consumption	2.7	0.5	0.0	-2.8	0.6	1.0
Private investment	3.2	0.0	-4.9	-12.9	1.6	3.7
Public expenditure	1.0	1.9	5.1	-3.6	4.9	-0.3
Net exports of goods and services	-6.5	-20.3	-32.2	122.5	-25.3	8.8
Exports of goods and services	5.1	-3.1	-10.6	-6.4	-3.5	5.2
Imports of goods and services	8.5	1.3	-4.7	-28.2	8.0	2.0
Gross domestic product	2.5	-0.6	-4.8	-1.5	2.2	1.3

Note: ^{1/}Domestic demand excludes changes in stocks

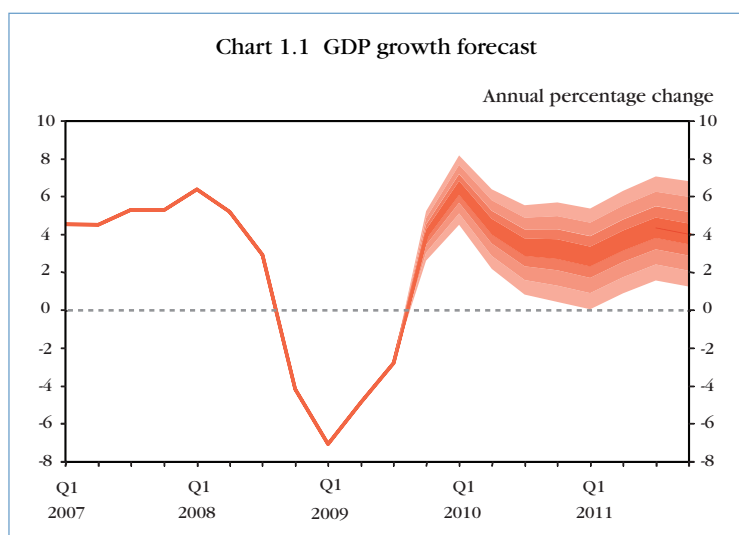
Source: National Economic and Social Development Board

industries such as electronics and hard disk drives and tourism, (2) an increase in the disbursement rate of government spending by 21.1 per cent compared to the same quarter in the previous year, encompassing both the regular budget and investment projects such as road building and water supply provision in the rural areas, and (3) an expansion of private consumption by 1.0 per cent compared to 0.6 per cent in the previous quarter, especially in the durable goods category whose strong rebound was in line with improving consumer confidence.


The data over the first two months of 2009 Q4 reaffirm the continuity of the Thai economy's ongoing recovery. This pickup in activity, beginning in 2009 Q2, was initially concentrated within the export-reliant sectors such as electronics, hard disk drives, and electrical appliances, but has now spanned the domestically driven sectors such as automobiles, beverages, and petrochemical industry. Additionally, tourism and agricultural incomes have risen, while unemployment

rate has fallen to a more normal level of 1.1 per cent in October. The evidently more broad-based economic expansion has been accompanied by upswings in manufacturing production, capacity utilization, exports, and private consumption. The improvement in private investment, while more gradual, was steady.

2. In the period ahead, the MPC continues to view the following factors as major downside risks to growth: (1) the possibility of a delay in the global economic recovery, as the stimulus effects from fiscal policies fade in industrialized economies, while private spending is constrained by high unemployment rates and limited availability of credits, (2) a slower disbursement rate of government expenditure, which could potentially disrupt the momentum of economic recovery, and (3) the prolonged delay in the resolution of the suspension of investment projects in the Map Ta Phut area, Rayong, with direct consequences in terms of production and investment foregone within the area as well as broader



Note: The fan chart covers 90 per cent of the probability distribution



repercussions on business confidence, employment, related industries, and ultimately financial institutions through higher non-performing loans.

After assessing the outlook for global economic recovery together with the risks surrounding the outlook, the MPC expects the expansion of the Thai economy to continue in the period ahead. The contraction for the entire 2009 will be slightly smaller than estimated in the previous *Inflation Report*, whereas for 2010 and 2011, the MPC expects robust expansion in public consumption, private consumption, and exports. Private investment is projected to be more subdued than otherwise in 2010 due to the problem in Map Ta Phut, but should be firmer in 2011. Overall, the MPC has projected growth over the next eight quarters to be 3.3-5.3 per cent for 2010 and 2.8-4.8 per cent for 2011. The risks remain skewed to the downside throughout the forecast horizon.

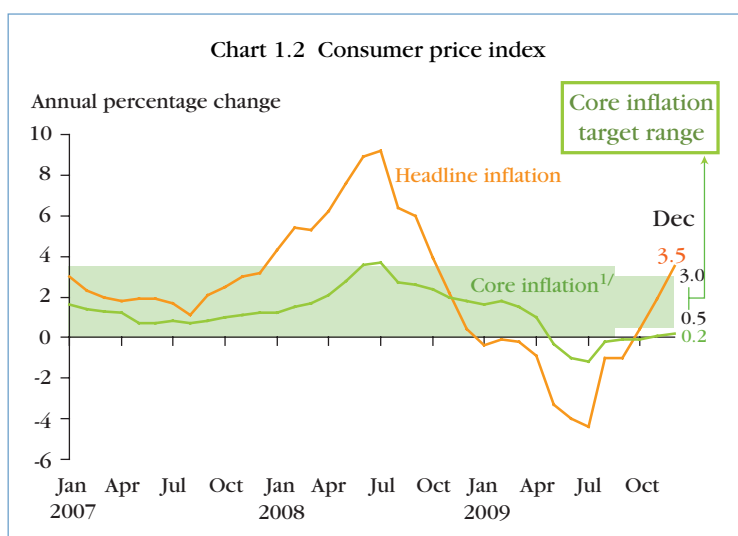
3. In the second half of 2009, the overall economic and financial stability improved in line with firmer global and domestic demand recovery. Corporate and household earnings as well as loans quality have strengthened, with corporate profitability and ability to service debts rising toward the pre-crisis levels. Notably, credits have begun to climb in November, possibly marking the end of commercial banks' deleveraging process. The latest incoming information reveals that (1) private credits extended by commercial banks began to rise in November, after dropping continuously since early 2009, (2) the outstanding household credits in all categories have risen above the pre-crisis levels, and (3) senior loan officers reported in the 2009 Q4 survey that on average they

expected both the demand and supply of credits to pick up in 2010 Q1 for both corporate and household sectors.

4. International financial markets remained frail as reflected by the debt repayment delay by Dubai World and the sovereign credit downgrades in a number of European countries. While contagion risks to the domestic financial system are remote, the indirect impacts via the sustainability of the global economic recovery looking ahead can be more material, and will be closely monitored by the MPC.

Inflation outlook and monetary policy

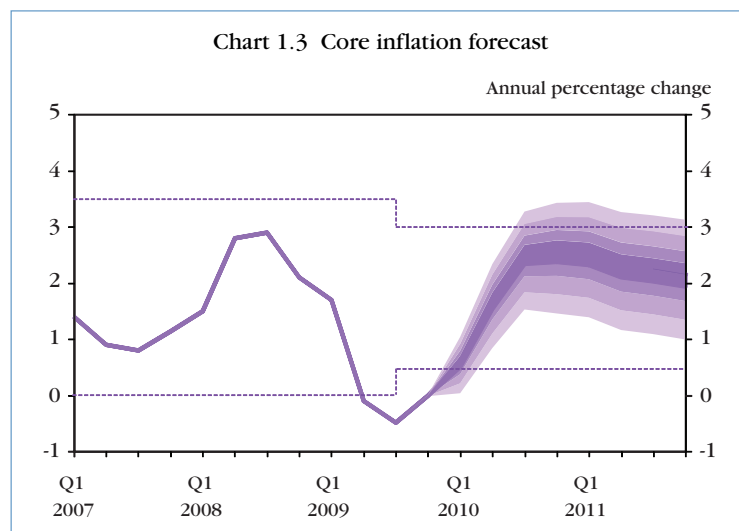
Inflation in 2009 Q4 was in line with what the MPC had anticipated, with headline inflation registering at 1.9 per cent, after being negative since 2009 Q1. The energy-related items were the major contributing factor, rising by 20.1 per cent compared to a contraction of 13.2 per cent in the previous quarter due to a low base of domestic retail oil price during the last quarter of 2008.




Note: ^{1/}Consumer price index excluding raw food and energy items
 Source: Trade and Economic Index Bureau, Ministry of Commerce

The demand pressure on inflation remains subdued however, with core inflation rising marginally above the negative territory to register at 0.1 per cent in 2009 Q4. Excluding the artificial effects from the government subsidy measures, core inflation would have been higher and close to the lower end of the inflation target range of 0.5-3.0 per cent.

In terms of outlook, the MPC views that headline and core inflation in 2010 are likely to be lower than previously projected, owing to (1) the extension of government subsidy measures toward the end of March 2010, (2) a downward revision of agricultural prices for 2010, and (3) a continuation of energy price control measures by the Ministry of Energy until August 2010. In 2011, headline and core inflation are expected to increase slightly from lower bases in the previous year, due to stronger demand pressure and a continued pickup in oil and agricultural prices. Accordingly the MPC has revised the projection for inflation slightly. Headline



Note: The fan chart covers 90 per cent of the probability distribution



inflation is expected to be within 3.0-5.0 per cent in 2010 and 2.0-4.0 per cent in 2011. Core inflation is projected to be within 1.3-2.3 per cent in 2010 and 1.8-2.8 per cent in 2011.

Core inflation, the MPC's policy target, should return to the target range from 2010 Q1 onwards, and is expected to rise throughout 2010 before moderating subsequently.

After a complete assessment of the outlook for growth and inflation over the next eight quarters, taking into account the prospects for global and Thai economic recovery as well as the extent of fiscal impetus, the MPC decided to leave policy interest rate unchanged at 1.25 per cent per annum on 2 December 2009 and 13 January 2010. The MPC deems the current stance of monetary policy to be conducive to an ongoing economic recovery, and should aid private spending to build sufficient momentum to serve as the main engine for growth, especially as the impetus from fiscal policy wanes in the period ahead.

Inflation target for 2010

On 22 December 2009, the Cabinet approved the 2010 inflation target as quarterly average core inflation within the range of 0.5-3.0 per cent per annum, the same as in 2009. This target was jointly proposed by the Minister of Finance and the MPC in accordance with the Bank of Thailand Act, as amended by the Bank of Thailand Act (No.4) B.E. 2551, which stipulates that the MPC works together with the Minister of Finance to determine the inflation target for the following year and propose the mutually agreed target to the Cabinet for approval by the end of the year.

Accordingly, the MPC reassesses the suitability of the inflation target^{1/} for the Thai economy each year. The proposal for maintaining the same target as in 2009 is based on the following considerations.

1) The main objective of most central banks, including the BOT, is to maintain long-term price stability, i.e., to ensure low and stable inflation. Price stability helps promote an economic environment conducive to private sector consumption and investment decisions, which in turn support sustainable economic growth.

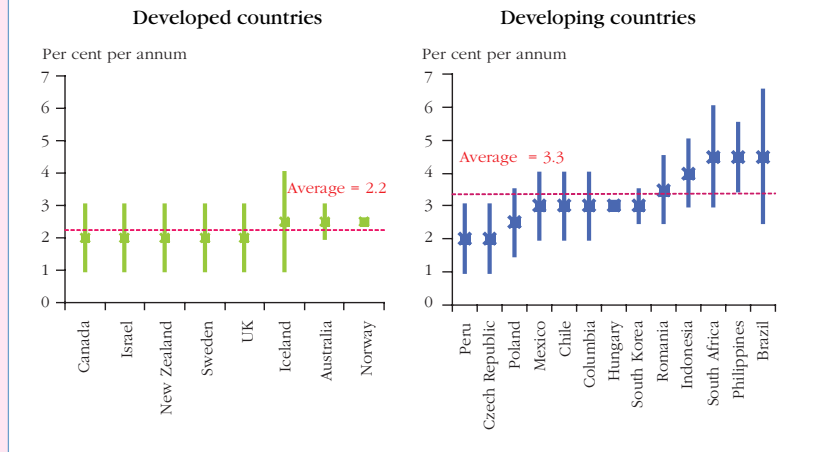
2) In general, the inflation target should not be adjusted frequently. Because each announced target is important to the anchoring of the public's inflation expectations over the medium to long term, the continuity of the inflation target enhances the effectiveness of the anchoring of the public's inflation expectations which in turn aids the maintenance of price stability.

For this reason, most inflation-targeting countries, including the UK, Canada, and Australia do not adjust their inflation targets frequently. Only a few countries that experienced high inflation at the beginning of the adoption of the inflation targeting framework, such as Indonesia and the Philippines, adjusted their targets downward each year in order to bring the rate of inflation down to the appropriate level for the economy.

3) Reasons for continuing to use core inflation as the policy target are as follows. First, core inflation reflects demand-side pressure well which is consistent with the objective of monetary policy which aims at taking care of demand-side pressure. Second, core inflation still reflects inflation trend in the long run as reflected by the fact that the average core inflation rate over the long run is close to that of headline inflation. Finally, because core inflation has been used as a policy target since the adoption of the inflation targeting regime, it is now well understood by and familiar to the public. This facilitates policy

^{1/} For further details, see "Setting an appropriate inflation target." box article in the January 2009 *Inflation Report*.

Chart 1 Inflation target adopted by of other inflation targeting countries for 2010 other than Thailand



Source: Bank of Thailand

communication and enhances the effectiveness in guiding the public's inflation expectations.

4) Range targeting, as used in the present, provides flexibility for the conduct of monetary policy. By allowing room for core inflation to move within the target range, it gives leeway for monetary policy to take care of other stability objectives, including the ongoing recovery of the Thai economy in 2010.

5) The proposed inflation target range is designed to help maintain price competitiveness of Thai exports as it is in line with trading partner inflation:

- Inflation targeting countries. The average inflation target adopted by developed countries for 2010 is 2.2 per cent while that of developing countries is 3.3 per cent (Chart 1).

- Non-inflation targeting countries. A number of Thailand's important trading partners also have price stability as their monetary policy objective even though they do not practice inflation targeting. From 2000 to November 2009, the inflation rates in these countries^{2/} averaged at 2.3 per cent.

In sum, given the rationales above, the use of quarterly average core inflation within the range of 0.5-3.0 per cent per annum as the target for 2010 will work to support the ongoing economic recovery in the short run and will be conducive to stable and sustained economic growth in the long run.

^{2/} The countries in this group are the US, Japan, China, Hong Kong, Taiwan, Singapore, Malaysia, Vietnam, Denmark, and India.

2. Inflation and Economic Conditions

Inflation trends

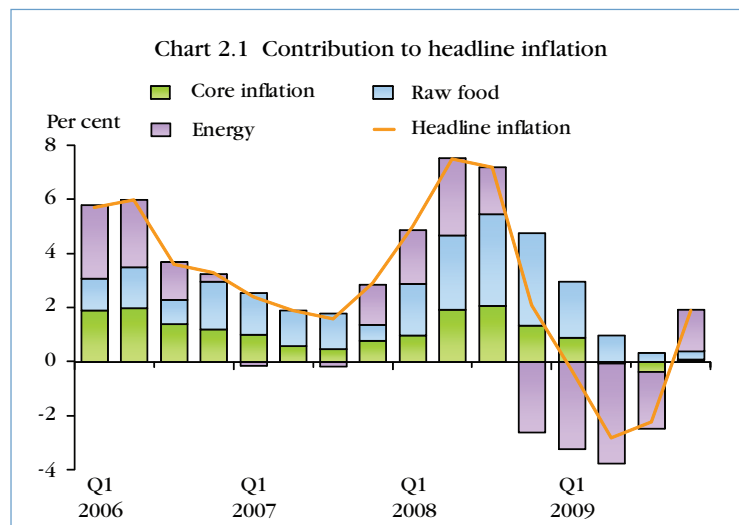
In 2009 Q4, headline inflation turned positive at 1.9 per cent after a continued contraction since 2009 Q1. The turnaround was mainly attributable to the low base effect from domestic retail oil prices during the same period of the previous year when the Dubai oil price fell sharply from an average of 95.9 US dollars per barrel in September 2008 to 40.5 US dollars per barrel in December 2008 as a result of the global financial crisis.

Core inflation in 2009 Q4 also turned positive at 0.1 per cent, after slipping into negative territory in 2009 Q2. The turnaround was due to a pickup in domestic demand in tandem with the economic recovery despite the negative contribution of the government's cost-of-living reduction measures and the 15-year free-of-charge education program. Excluding the effects of these government's measures, core inflation would be higher, up to around the lower bound of the inflation target range of 0.5-3.0 per cent per annum.

In 2009 Q4, headline inflation and core inflation turned positive at 1.9 and 0.1, respectively.

Unit: Per cent	2008	2009	2009			
			Q1	Q2	Q3	Q4
Percentage change from the previous year (%Δyoy)						
- Headline consumer price index	5.5	-0.9	-0.3	-2.8	-2.2	1.9
• Core consumer price index	2.4	0.3	1.7	-0.1	-0.5	0.1
• Raw food	15.3	5.6	11.4	6.3	2.8	2.6
• Energy	8.0	-13.1	-25.8	-24.4	-13.2	20.1
- Producer price index	12.4	-3.8	-3.5	-7.0	-10.2	6.7
Percentage change from the previous quarter (%Δqoq)						
- Headline consumer price index	-	-	-0.8	1.6	0.5	0.7
• Core consumer price index	-	-	0.1	-0.1	-0.1	0.2
• Raw food	-	-	-2.1	3.0	-0.7	2.4
• Energy	-	-	-2.4	14.5	6.9	0.7
- Producer price index	-	-	-2.4	5.0	-1.1	5.3

Source: Trade and Economic Index Bureau, Ministry of Commerce



Source: Trade and Economic Index Bureau, Ministry of Commerce

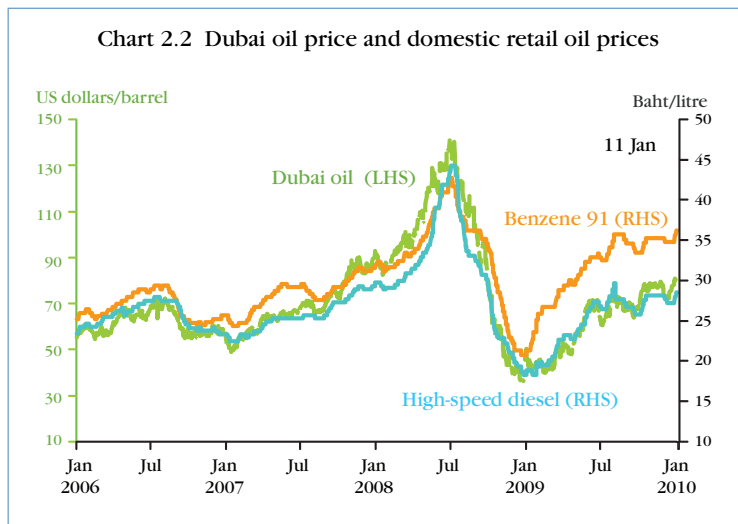
Domestic retail oil prices increased from the previous quarter in tandem with global oil prices.

An inspection of CPI components reveals that in the year to 2009 Q4 the growth rate of energy prices registered at 20.1 per cent compared to -13.2 per cent in the previous quarter due to the base effect from the falling oil prices in the same period of the previous year, as the Dubai oil price in this quarter averaged at 75.4 US dollars per barrel, up only slightly from 67.8 US dollars per barrel in the previous quarter. On the other hand, the growth rate of raw food prices registered at 2.6 per cent, decelerating slightly from the previous quarter owing to the favourable weather condition that caused the supply of vegetables and fruits to increase.

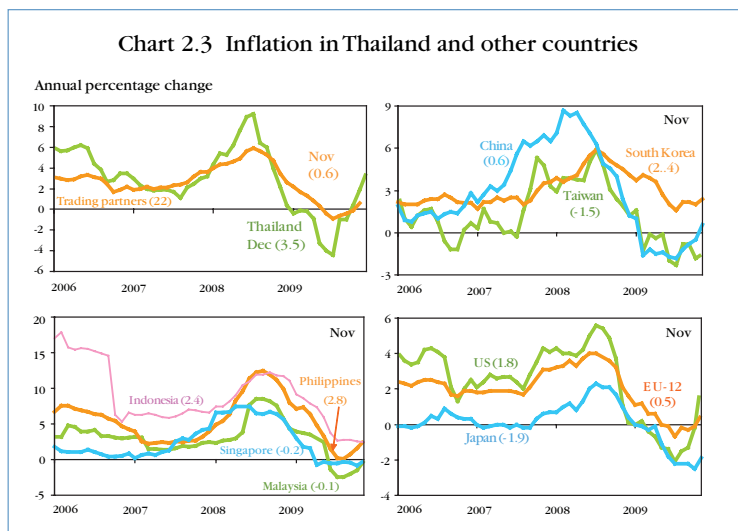
The growth rate of the Producer Price Index (PPI) in 2009 Q4 turned positive to 6.7 per cent, after a continued contraction since 2009 Q1. This was attributable to increases in prices of raw material for agricultural, mining, and manufacturing production compared to the previous quarter in tandem with world prices on top of the low base effect from the previous year.

The fall in oil and commodity prices in the same period of the previous year was the main factor causing inflation rates in most countries to move in the same direction. Inflation became less negative in countries such as Japan, Singapore, and Malaysia, while turning positive in the US, the Euro area, and China. For regional countries such as Indonesia and the Philippines whose inflation was still positive after a sharp decline during the middle of the year, inflation has either leveled off or accelerated.

Foreign inflation rates moved in a similar direction to Thailand's inflation.



Source: PTT Public Company Limited



Source: Various official sources and Bloomberg

Aggregate demand in 2009 Q3^{1/}

In 2009 Q3, the Thai economy continued to recover gradually with a growth rate of 1.3 per cent.

In 2009 Q3, the Thai economy continued to recover gradually with a quarter-on-quarter growth rate of 1.3 per cent, decelerating from 2.2 per cent in the previous quarter. The recovery was supported by two main factors, namely the expansion in net exports as a result of global recovery, and the high level of public spending. In addition, accommodative monetary policy was supportive to the improvement of private consumption.

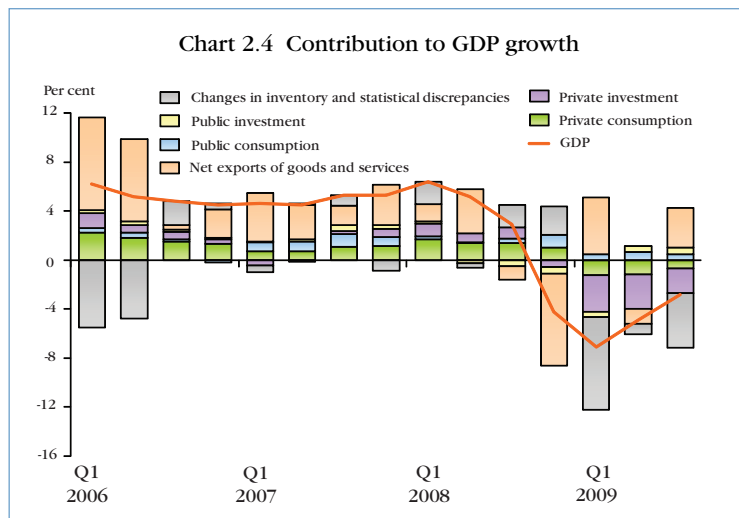
Change from previous quarter (seasonally adjusted, per cent)	2008				2009		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
GDP	1.6	-0.2	-0.6	-4.8	-1.5	2.2	1.3
Domestic demand	1.9	-1.0	0.6	-0.1	-4.9	1.6	1.2
Private consumption	2.2	-0.6	0.5	0.0	-2.8	0.6	1.0
Private investment	1.9	-0.5	0.0	-4.9	-12.9	1.6	3.7
Public consumption	2.1	-0.7	3.4	9.5	-5.8	1.2	0.4
Public investment	-0.9	-6.6	-0.8	-2.7	0.7	11.8	-1.3
Exports of goods and services	2.0	2.8	-3.1	-10.6	-6.4	-3.5	5.2
Imports of goods and services	4.4	0.9	1.3	-4.7	-28.2	8.0	2.0

Source: National Economic and Social Development Board, calculations by Bank of Thailand staff

External demand was one of the key drivers of the recovery in this quarter. Exports of goods and services expanded for the first time on a seasonally-adjusted, quarter-on-quarter basis at 5.2 per cent which translated into a lower year-on-year contraction of 15.0 per cent, compared to a contraction of 21.7 per cent in

^{1/} Data used to analyze aggregate demand in 2009 Q3 were obtained from the NESDB. Economic indicators used for analyze 2009 Q3 and the outlook for 2009 Q4 were obtained from the BOT, except for the Consumer Confidence Index, which was compiled by the University of the Thai Chamber of Commerce, and data on government expenditure, which originated from the Comptroller General's Department and were compiled by the Fiscal Policy Office.

the previous quarter. This was due to good performances in the manufacturing sector including electronics and vehicles as a result of the global economic recovery. Exports of gold also increased due to rising world gold prices. Regarding exports of services, tourism revenue improved because of the increase in the number of foreign tourists.



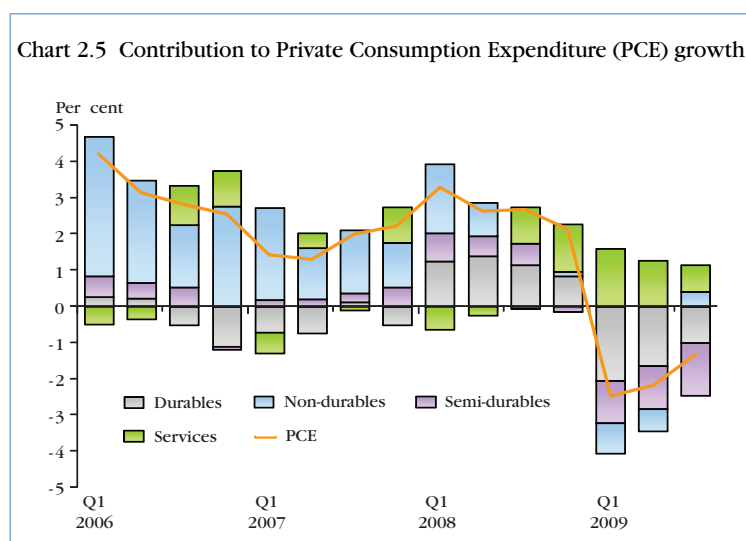
Source: National Economic and Social Development Board

Imports of goods and services picked up slightly this quarter with a lower year-on-year contraction of 23.8 per cent after a contraction of 25.6 per cent in the second quarter. The improvement was broad-based and resulted from the recovery in domestic consumption and production. However, imports of services contracted, after a slight expansion in the previous quarter, owing mainly to the promotion of domestic travel.

Government expenditure still provided some stimulus to the economy. The budget disbursement for this quarter expanded by 21.1 per cent. This reflected the increases in both current and capital expenditures

Government expenditure still provided some stimulus to the economy, albeit at a slower pace.

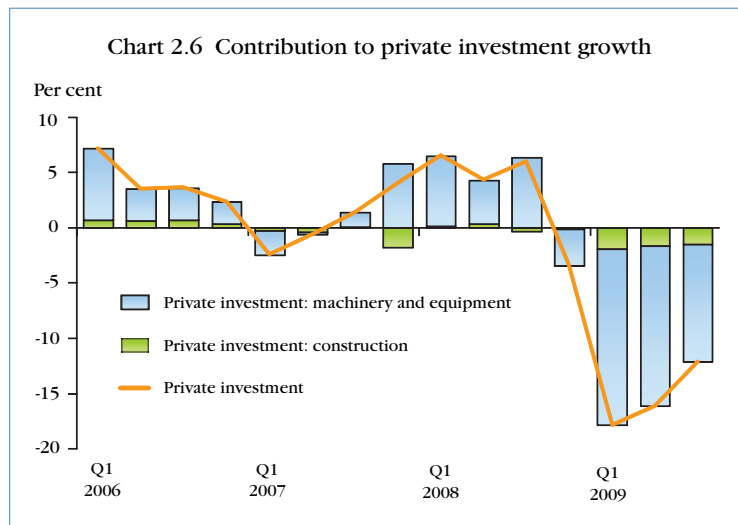
at 4.7 per cent and 8.0 per cent respectively. However, these rates were slightly below the previous quarter's counterparts. In addition, the increase in public investment mostly resulted from ongoing projects such as irrigation and road construction, and not yet from the second stimulus package (SP2).



Source: National Economic and Social Development Board

Private consumption picked up more strongly than in the previous quarter due to stronger confidence and low interest rates.

Private consumption in 2009 Q3 continued to improve across all components, displaying a growth rate of 1.0 per cent from the previous quarter compared to 0.6 per cent in the 2009 Q2. On a year-on-year basis, private consumption displayed a lower contraction rate of 1.3 per cent due to increases in consumption of food and durable goods as reflected by higher passenger car sales spurred by sales promotion and low interest rates. In addition, increasing consumer confidence, as reflected by the rise of the Consumer Confidence Index (CCI) from 72.0 in the previous quarter to 74.5, also played a part in the expansion of private consumption.



Source: National Economic and Social Development Board

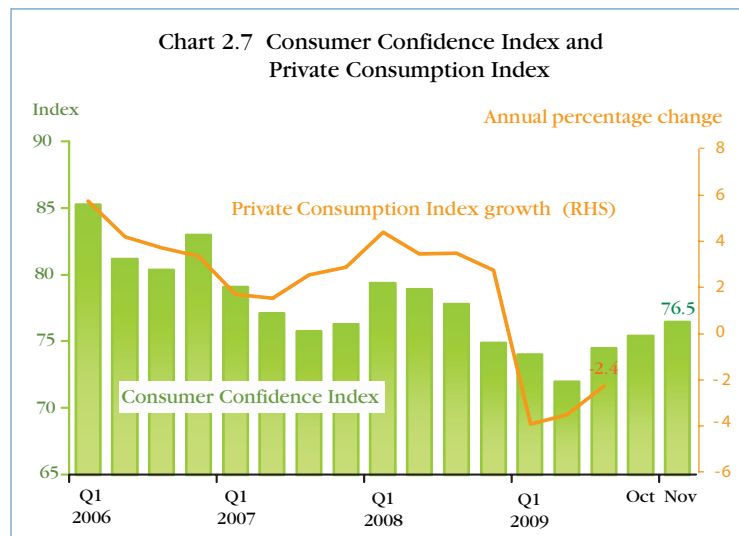
Private investment expanded gradually on the quarter-on-quarter basis, up from 1.6 per cent in the second quarter to 3.7 per cent this quarter, as investment in machinery and equipment continued to improve in line with rising exports performances. These developments coincided with rising capacity utilization rate since 2009 Q1. Meanwhile, construction of small projects also increased as a result of low financial costs and raw material prices. However, construction of projects remained subdued and would be contingent on stronger business confidence.

Private investment improved but still remained at a very low level compared to last year.

Outlook for aggregate demand in 2009 Q4

Overall, aggregate demand in 2009 Q4 was expected to continue to expand from the previous quarter with exports and government spending being the main supporting factors. However, the pace of recovery remained moderate as exports and private investment were still below the pre-crisis levels.

The Thai economy continued to recover in terms of exports, tourism, and government spending.



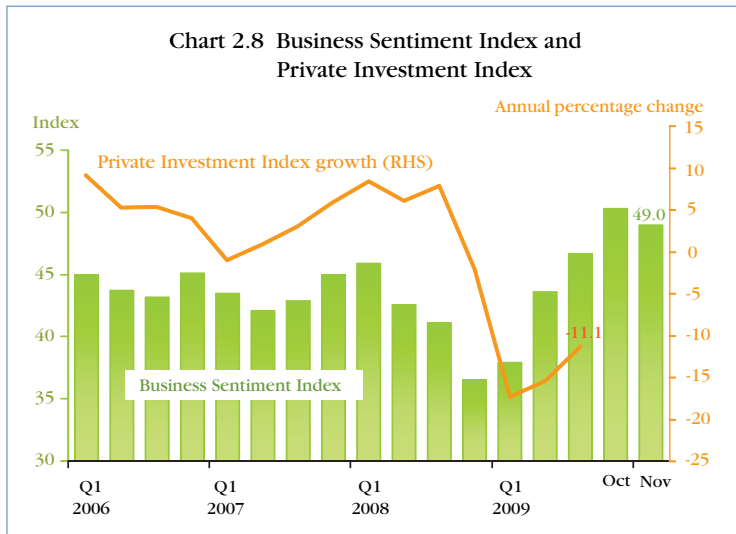
Source: The University of the Thai Chamber of Commerce and Bank of Thailand

Prospects for private consumption continued to improve but remained subject to risks.

In the first two months of 2009 Q4, the Private Consumption Index (PCI), compiled by the Bank of Thailand, pointed towards a higher level of private consumption. The PCI expanded by 1.5 per cent from the same period last year, registering a positive growth for the first time since 2008 Q4. Improvements in the PCI were broad-based with noticeable increases in car sales and imports of consumer goods. This positive outlook for private consumption was in line with an improvement in the Consumer Confidence Index which rose to 76.0 from an average of 74.5 in the previous quarter.

The pace of private investment recovery remained gradual, leaving investment at a lower level than last year.

The Private Investment Index (PII) during the first two months of this quarter contracted by 8.5 per cent, a slower pace relative to 11.1 per cent in the previous quarter. This was due to higher investment in machinery and equipment following an increase in imports of capital goods, domestic machinery sales, and domestic commercial car sales. Investment in construction remained subdued, but started to show some signs of



Source: Bank of Thailand

recovery as reflected by an improvement in domestic cement sales. This recovery of private investment was in line with higher capacity utilization as well as the continued pick up in investor confidence as reflected by the Business Sentiment Index (BSI) which rose to 49.7, up from 46.7 in the previous quarter.

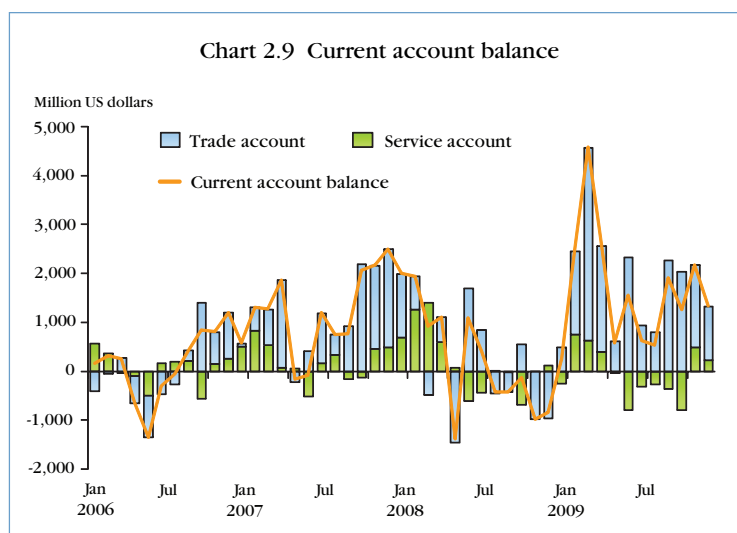
Going forward, the government's mega-projects investment and residential construction along the mass transit routes will contribute to the recovery of private investment.

Government expenditure in the first two months of 2009 Q4 expanded on average by 7.4 per cent from the same period last year on the back of higher current expenditure. The accumulated disbursement rate stood at 14.6 per cent at the end of November, higher than 12.6 per cent in the same period last year. This reflected the government's continual effort to stimulate the economy.

Government expenditure expanded from last year following higher current expenditure.

Export volume improved while imports contracted at a slower rate.

On the external front, both the value and the quantity of exports in October and November 2009 increased from the previous quarter with a year-on-year growth rate of 6.2 per cent and 0.5 per cent, respectively. This was due partly to the low base effect as well as improving world demand, which resulted in improving export performance especially in high-technology products such as electronics, electrical appliances, and vehicles. In addition, service income also trended upward due to better tourist receipts as Thailand's major tourism markets such as China, Hong Kong, and Taiwan, had recovered.



In comparison to the previous quarter, the value and the quantity of imports during the first two months of this quarter contracted at a slower rate of 10.7 per cent and 14.7 per cent, respectively. The lower contraction rates were attributable to improvements in both prices and quantities of imports across all items. Imports of consumer goods expanded buoyantly especially electrical appliance while imports of capital

goods picked up mainly from the electrical machinery item. Moreover, imports of raw material and intermediate goods also increased from higher imports of iron products, chemicals and electronics parts, while imports of vehicles and parts also picked up in line with the recovery of the car industry.

As export values trended higher while imports still contracted, the trade balance was expected to continue to be in surplus in the fourth quarter. Meanwhile, services income and transfers were also expected to record a surplus, causing the current account to remain in surplus.

Production and supply in 2009 Q3 ^{1/}

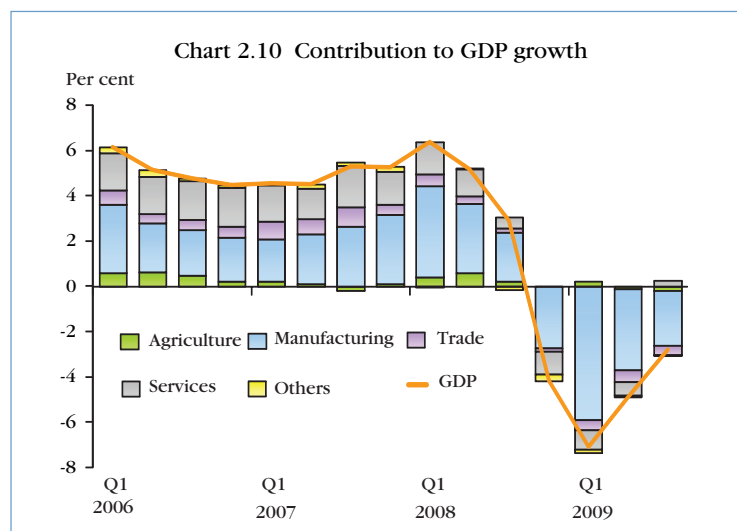
In 2009 Q3, production and supply continued to recover from the previous quarter as the manufacturing and the services sectors improved in tandem with improving external demand. In addition, the construction sector continued to expand as the budget disbursement was accelerated. However, the agricultural sector continued to shrink due to lower crop prices and a high base in the previous year.

Manufacturing production in this quarter contracted by 5.9 per cent, improving from the contraction of 8.7 per cent in the previous quarter and 14.4 per cent in the first quarter. The recovery was evident in many sectors such as electronics, which depended on external demand, chemical products,

In 2009 Q3, production and supply continued to recover from the previous quarter.

Manufacturing production recovered further in many industries including electronics, chemical products and motor vehicle.

^{1/} Data used to analyze aggregate demand in 2009 Q3 were obtained from the NESDB. Economic indicators used to analyze 2009 Q3 and the outlook for 2009 Q4 were computed by the BOT, except for the Consumer Confidence Index, which was produced by the University of the Thai Chamber of Commerce, and data on government expenditure, which originated from the Comptroller General's Department and were compiled by the Fiscal Policy Office.



Source: National Economic and Social Development Board

which relied on both domestic and external demand, and petroleum, which relied on domestic demand.

The services sector recovered as tourism improved and construction benefited from government spending.

The services sector grew by 0.8 per cent after shrinking for three consecutive quarters, owing to the improvement in hotels and restaurants which benefited from the increase in the number of tourists. Moreover, transport and communication also picked up due to a higher number of air passengers. As for the construction sector, it continued to do well because of the expedited budget disbursement, expanding investment by state owned enterprises and condominium construction along the mass transit routes.

Agricultural output continued to shrink due to a base effect.

Agricultural output in this quarter shrank by 2.5 per cent compared to a contraction of 1.3 per cent in the previous quarter. The reduction was a result of a drop in crop production which adjusted to the decrease in prices. In addition, there was also a base effect since production last year was exceptionally high. Nevertheless, livestock and fishery managed to expand due to the recovery of both domestic and external demand.

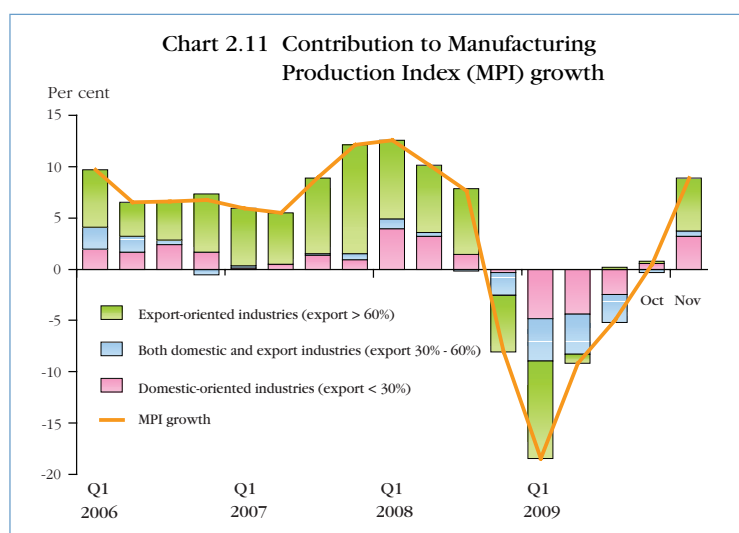
A firmer recovery in the non-agricultural sector caused employment in this sector to expand by 4.0 per cent. This positive development was observed across all subsectors. Nonetheless, non-agricultural employment in this quarter fell by 1.9 per cent after growing in the past three quarters. This was due to the ongoing contraction in the agricultural sector.

Outlook for production and supply in 2009 Q4

The outlook for production and supply in 2009 Q4 improved in line with demand. The manufacturing sector was expected to expand well. A similar outlook applied to tourism. Meanwhile, agriculture was expected to experience decelerated contraction.

Manufacturing production in 2009 Q4 was expected to further improve as the Manufacturing Production Index (MPI) continued to expand in both October and November. Export-oriented production showed improvement as demand for integrated circuits

Manufacturing production showed a continued improving trend for both export-oriented and domestic-oriented industries.



Source: Bank of Thailand

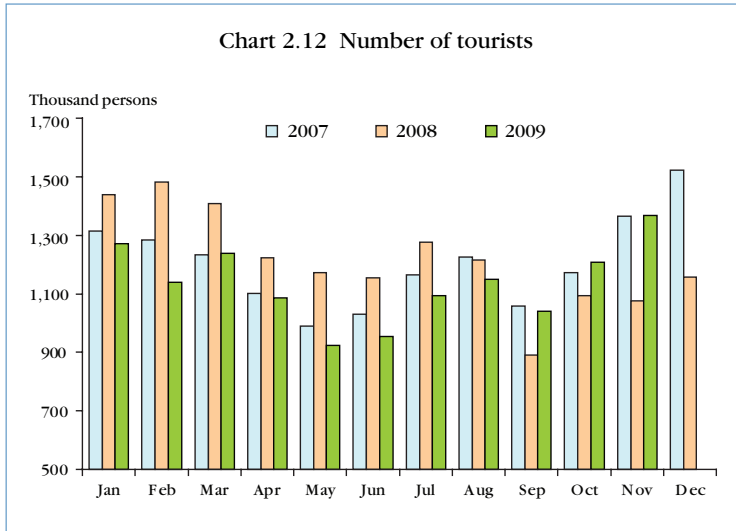
and televisions continued to increase. Likewise, domestic-oriented production grew as there was more demand for beverages, petroleum, and vehicles. Low interest rates and rising farm income also contributed to higher demand, particularly for vehicles.

Production of major crops contracted on average by 0.8 per cent during the first two months of 2009 Q4. The contraction was due to the reduction in production of rice, cassava, and palm oil which resulted from poor weather and pest outbreak. Nevertheless, the pace of contraction decelerated.

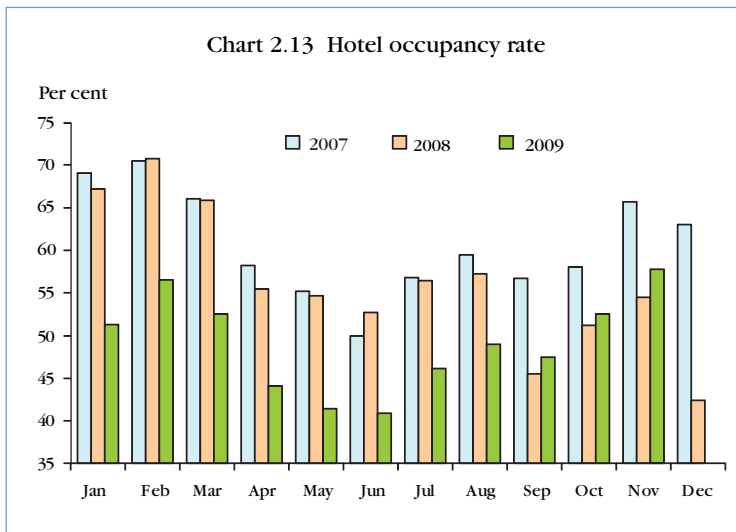
Prices of major crops fell by 0.8 per cent from last year but expanded by 12.8 per cent from the previous quarter. The growth was attributable to the improvement in prices of rubber, rice, and cassava which benefited from a decrease in harvests both domestically and abroad whereas demand was still on the rise. The improvement in production and prices of main crops led to rising farm income, bolstering farmer's consumption going forward.

Tourism continued to improve due to economic recovery in major tourist home countries.

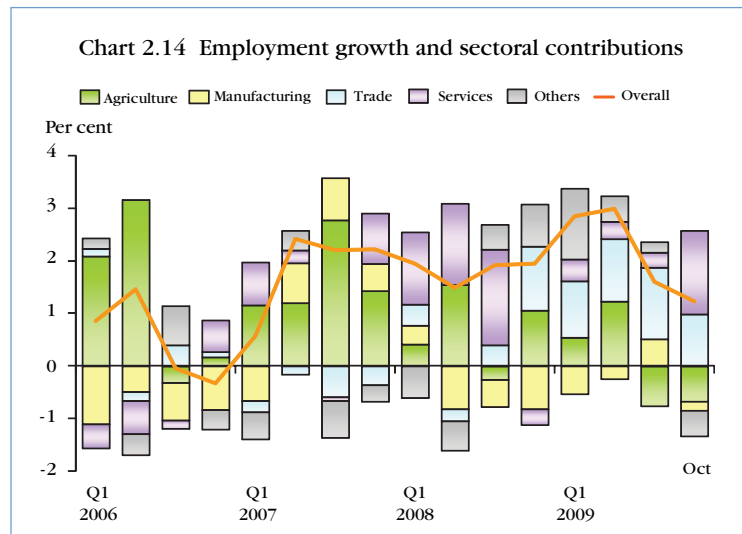
During the first two months of 2009 Q4, tourism adjusted upward as depicted by the number of tourists that increased on average by 18.7 per cent from the same period last year. This high growth was due to a low base last year, economic recovery in tourist home countries, especially in Asia, and the higher number of European tourists. Consequently, the average occupancy rate rose to 55.0 per cent from 52.8 per cent in the same period last year.



Source: Tourism Authority of Thailand and Bank of Thailand



Source: Tourism Authority of Thailand and Bank of Thailand



Source: National Statistical Office

Labour market condition remained sound as the unemployment rate in October fell to 1.1 per cent following the increase in employment in trade and services sectors. The improvement in the labour market was consistent with further reduction in the number of people claiming unemployment benefits.

Fiscal position and its implications for macroeconomic stability

The current global economic crisis necessitates several countries to use fiscal policy to shore up and stimulate their economies. This practice has created both explicit and implicit risks to fiscal position and can adversely affect investor confidence and country creditworthiness, which have implications for costs of borrowing and ultimately macroeconomic stability.^{1/}

In Thailand, public sector expenditure has played an important role in boosting the economy by partly compensating for the contraction in exports, private consumption, and private investment. In fiscal year 2009 the government ran a cash deficit of 4.8 per cent of GDP (which was above the budget deficit of 3.9 per cent of GDP), bringing the public debt to GDP ratio up from 37.2 per cent at the end of fiscal year 2008 to 45.9 per cent at the end of fiscal year 2009. Although the economy is improving in fiscal year 2010, the recovery is only gradual and still fragile. The government thus continues to run a budget deficit of 3.7 per cent of GDP as fiscal stimulus is deemed to be necessary.

However, both shrinking public sector expenditure following a shortfall in revenues and increasing contingent expenditure and social welfare expenditure reduce the budget for investment sharply. As a result, the government has decided to borrow further by enacting special bills^{2/} to make possible public investment in accordance with the “Strong Thailand 2012 Project,” the stimulus package over 2010-2012. It is also expected that the government will continue to run budget deficits for some time in the future to keep output expansion at a rate close to the potential growth rate. Consequently, if the government fails to restructure its public spending – by cutting back current expenditure and transfers – public debt is expected to rise above 60 per cent of GDP, the threshold level suggested by the Ministry of Finance’s medium-term fiscal sustainability framework. Moreover, if implicit contingent liabilities of quasi-fiscal activities become actual losses, the actual debt burden of the government will turn out to be higher.

Prolonged fiscal deficits and rising public debt have become issues of concern among academics and investors. The main question is whether they adversely affect a nation’s creditworthiness and costs of borrowing. Greece, for

^{1/} Fiscal position is one of the seven aspects of the economy the Bank of Thailand closely monitors and conducts analyses on. The other institutions and market conditions that have important implications for macro stability are firms, households, financial institutions, international trade and capital flows, real estate markets, and financial markets.

^{2/} The Emergency Decree Empowering the Ministry of Finance to Borrow for Economic Restructuring and Strengthening, B.E. 2009, and the Act Empowering the Ministry of Finance to Borrow for Economic Restructuring B.E. ...

Chart 1 Ratio of government debt to GDP

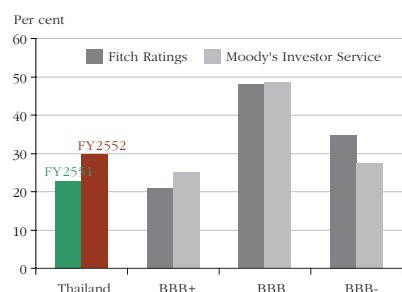
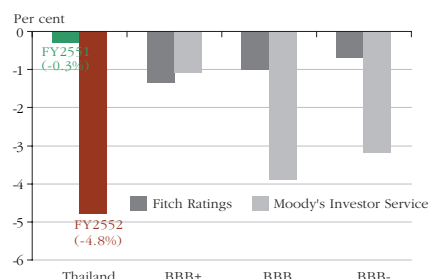


Chart 2 Ratio of government balance to GDP



Note: Thailand is at present rated Baa1 (equivalent to BBB+) according to Moody's Investor service and BBB according to Fitch Ratings.

Source: Fitch Ratings and Moody's Investors

example, was downgraded in 2009 in light of its fiscal deficits as much as 12.7 per cent of GDP and public debt that reached 112.6 per cent of GDP. Such an elevated debt level and massive budget deficits pose risks to debt service ability, risk premiums, and long-term bond yields of any country facing a similar problem.

Credit rating agencies do not usually have debt thresholds when determining creditworthiness of a country. Instead, one important criterion that they use is debt affordability – a ratio of interest payments to government revenues. Currently, the debt affordability indicator for Thailand stands at 8 per cent. It is possible that this ratio will approach the 14 per cent benchmark used by Moody's Investors Service. One reason is the uptrend in interest payments. Another is a low level of government revenues, as the collection rate in Thailand is quite low at 16 per cent of GDP, about half of that in advanced economies.

Maintaining fiscal discipline by keeping fiscal position at an appropriate level is a challenge to policymakers. Going forward, the conduct of fiscal policy will be under tighter constraints. First, both current and long-term contingent expenditures have been rising. This will depress public investment earmarked for infrastructure development, which has an implication for the nation's competitiveness. Second, to raise capital expenditure the government can either decrease current expenditure or increase government revenues by reforming the tax system and enhancing the effectiveness of revenue collection. For this reason, when the economy heads towards full recovery it is important that the government reduces its impetus and instead works to support private sector investment.

3. Monetary Conditions and the Exchange Rates

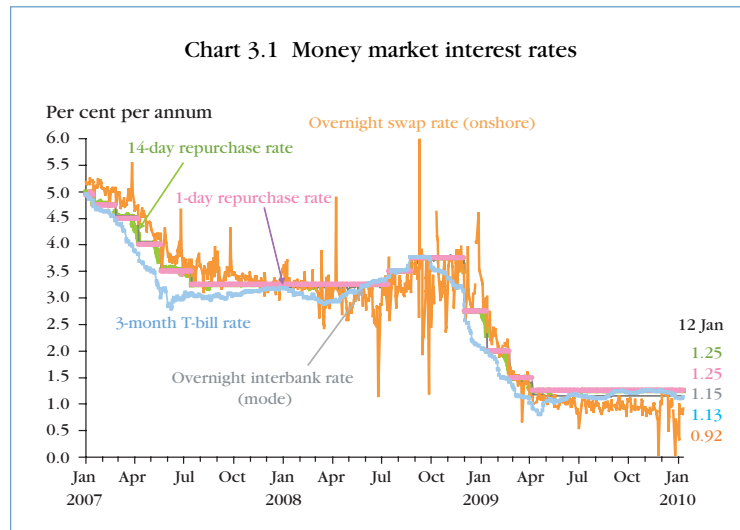
Following the release of the previous *Report*, the MPC convened in the meetings on 2 December 2009 and 13 January 2010, and currently holds a collective judgment that the global economy continues to improve. However, risks to economic recovery in the period ahead remain, especially for the major industrialized economies. The Asian economies are likely to recover sooner, giving rise to policy differentials which may lead to more volatile capital flows going forward. The Thai economy continues to recover, supported by improvements in domestic and foreign order books, business sentiment, farm income, employment conditions as well as the tourism sector. The MPC judges that the economic recovery is likely to continue at a gradual pace, with some need for policy support. The rise of inflation in December owed mainly to oil prices, but the overall demand pressure on inflation remains low. The MPC's view is that inflation is likely to be higher this year, due to effects from oil prices, the end of the government's subsidy measures, and the firmer economic recovery. The MPC will continue to closely monitor inflation and economic developments. In both the December and January meetings, the MPC thus decided to maintain the policy interest rate at 1.25 per cent per annum.

Money market conditions

Money market

In 2009 Q4, short-term money market interest rates for both collateralized and uncollateralized

Short-term money market rates remained unchanged in line with the policy interest rate.

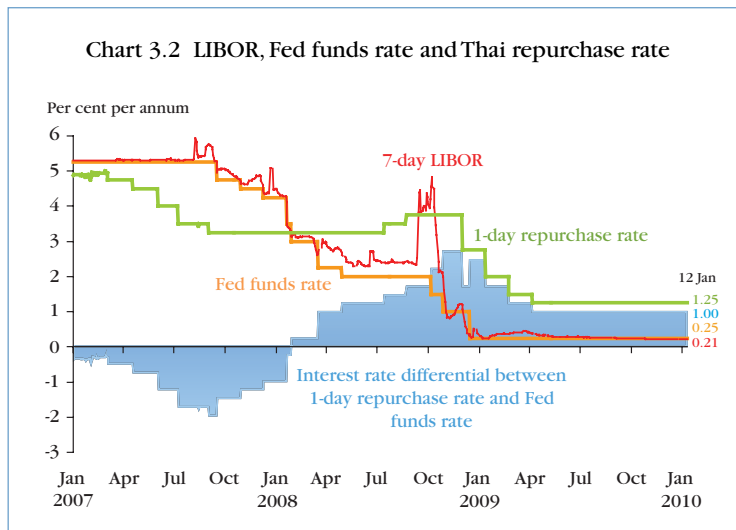


Source: Bank of Thailand

lending in the Thai baht were broadly consistent with the policy interest rate. The 1-day repurchase rate and the overnight interbank rate averaged over the quarter at 1.25 and 1.15 per cent per annum respectively, close to the averages in the previous quarter, following the MPC's decisions to maintain the policy interest rate.

The overnight swap rate, which represents the cost of borrowing the Thai baht using the US dollar as collateral, was lower than the policy interest rate throughout the quarter. This was due to the fact that there was demand for US dollars by foreign investment funds as well as exporters seeking to hedge their foreign exchange exposure. The onshore overnight swap rate declined from the average of 0.97 per cent per annum in the previous quarter to the current average of 0.81 per cent per annum.

As of the end of 2009 Q4, the difference between the Thai and the US policy interest rates remained unchanged at 1.0 per cent per annum, following the decisions in both Thailand and the US to maintain policy interest rates at 1.25 and 0.0-0.25 per cent per annum respectively.

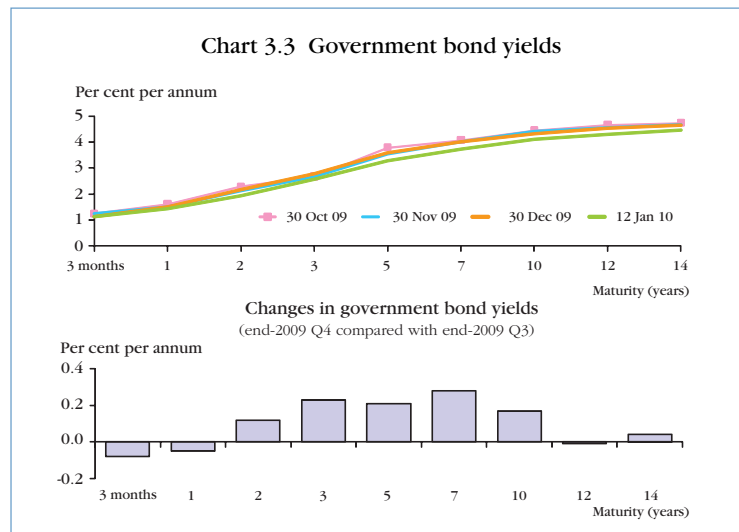


Source: Bank of Thailand

Bond market

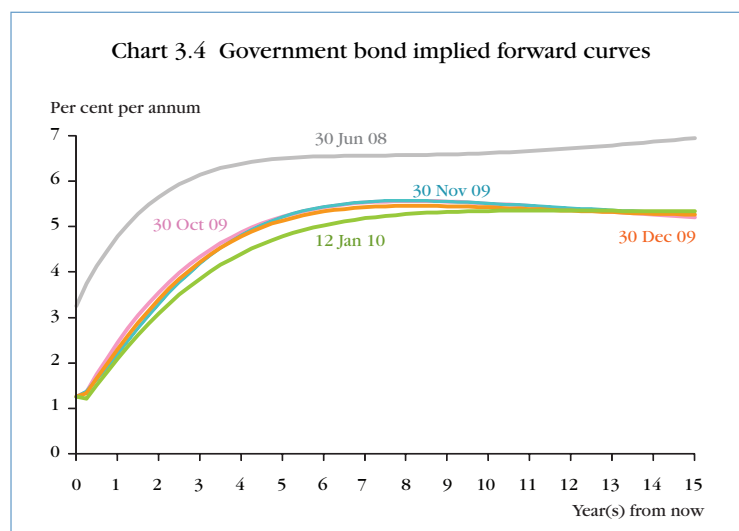
Government bond yields in 2009 Q4 increased slightly from the previous quarter. During the early part of the quarter, government bond yields increased continually, especially in the middle part of the yield curve. The upward adjustment reflected a more buoyant confidence given positive developments of the global and Thai economies, with the SET index also making a new high for the year. In addition, some central banks such as the Reserve Bank of Australia and Norges Bank adjusted their policy interest rates upward sooner than the market had previously anticipated, weighing on the international and Thai bond markets. Nevertheless, towards the middle of the quarter, investor confidence was dented by concerns over the sustainability of the global and Thai economic recovery as well as ongoing domestic political uncertainty. The resulting pickup in demand for government bonds pushed the government bond yields down somewhat.

The yields on government bonds, especially with medium-term maturities, increased slightly following a more upbeat confidence in the outlook for the global and Thai economies.



Source: Bank of Thailand

The short end of the implied forward curve shifted upwards slightly, as investors priced in a higher chance of an increase in the policy interest rate in the next 1-2 years. Meanwhile, the long end of the implied forward curve did not change significantly from the third quarter, suggesting that long-term inflation expectations remained well anchored.

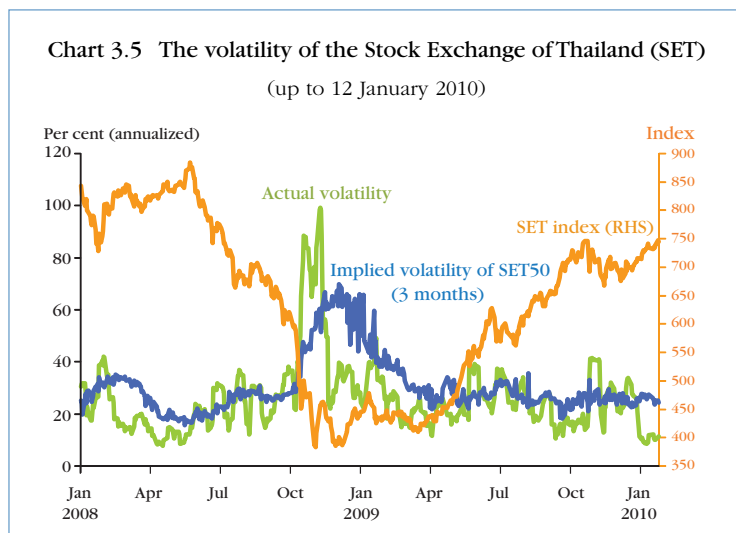


Source: Bank of Thailand

Equity market

In 2009 Q4, the SET Index was relatively stable after a rapid climb in the previous quarter. In November, the index was under some pressure due to (1) the political uncertainty, (2) the Dubai World debt postponement and (3) the suspension of investment projects in the Map Ta Phut industrial area. Nevertheless, the SET index adjusted upward in December, supported by some easing in the concerns and year-end demand from Long Term Equity Funds (LTFs) and Retirement Mutual Funds (RMFs).

In 2009 Q4, the SET regained some stability after climbing rapidly in the previous quarter.



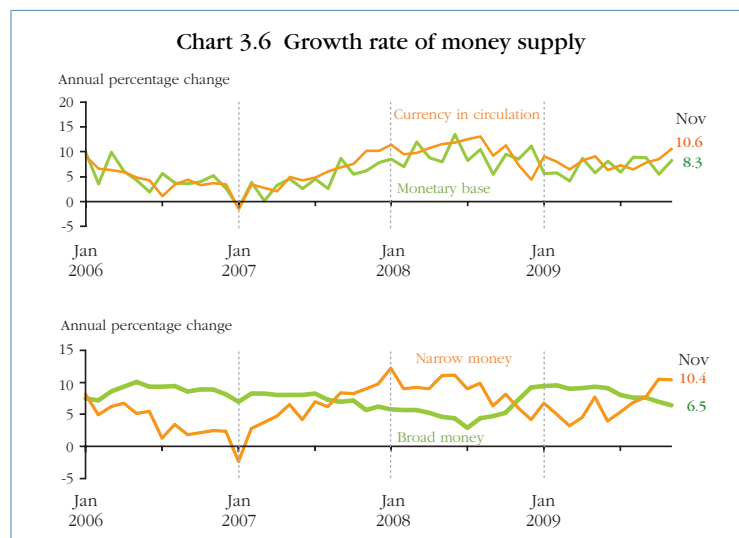
Source: Stock Exchange of Thailand, calculations by the Bank of Thailand

Going forward, the SET index volatility is expected to remain moderate, reflected by a low 3-month implied volatility of the SET 50 index.

Monetary base and money supply

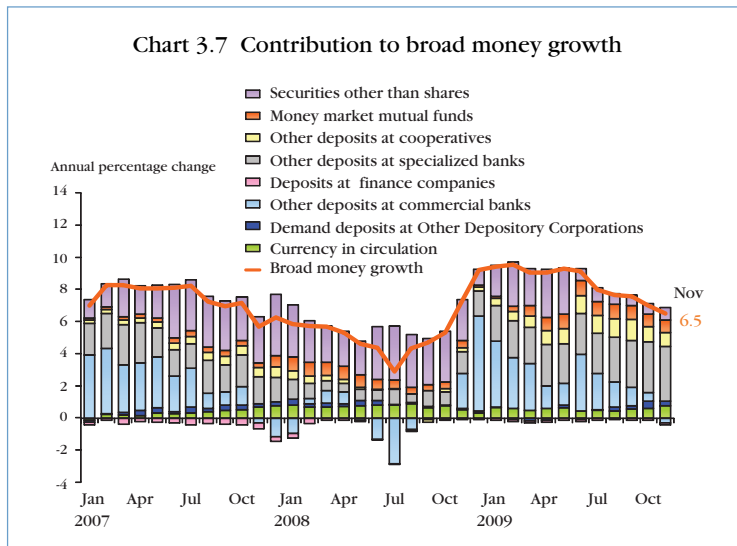
Monetary base expanded in line with economic activities, while broad money grew at a slower pace, owing to a high base effect last year.

In October and November 2009, the monetary base picked up its pace to expand from the same quarter last year by an average of 7.0 per cent, following an increase in private expenditure and economic activities.



Source: Bank of Thailand

Broad money expanded at an average rate of 6.7 per cent during the October-November period, a deceleration from 2009 Q3 in which broad money grew by 7.7 per cent on average. The deceleration owed mainly to a high base effect last year, which saw a significant shift to safe and low-duration assets such as deposits with financial institutions. On the other hand, broad money outstanding continued to increase from the previous month, particularly the deposits with specialized financial institutions (SFIs) which rose as a result of the mobilization of deposits in accordance with the government's policy to accommodate more credit expansion in the period ahead.



The banking system

Following the MPC's decision to hold the policy interest rate unchanged at 1.25 per cent per annum since the end of 2009 Q2, most commercial banks had maintained their reference rates for lending throughout the last two quarters of 2009. In some exceptional instances, several big commercial banks lowered their reference rates^{1/} for 3-to-12-month time deposits with an amount less than 3 million baht in order to offset earlier increases. These moves were however largely motivated by the banks' internal liquidity and cost management strategies rather than their views about the likely path of future policy interest rates. Overall, the average 3-, 6- and 12-month time deposit rates of the four largest commercial banks at the end of the quarter stood at 0.70 per cent per annum.

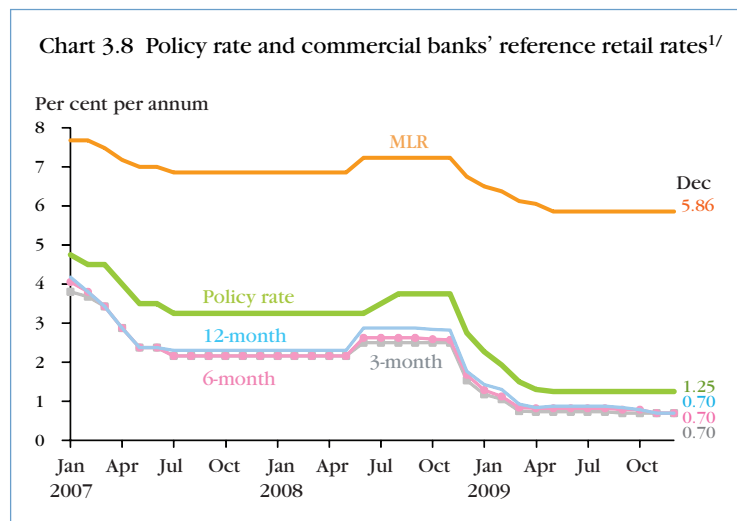
Commercial banks' deposit rates dropped slightly after a previous pickup, while MLR remained unchanged.

^{1/} The average between minimum and maximum rates of the four largest commercial banks.

Unit: Per cent per annum	2007	2008		2009				
	Dec	Sep	Dec	Mar	Jun	Sep	Nov	Dec
Policy rate	3.25	3.75	2.75	1.50	1.25	1.25	1.25	1.25
Average reference retail rates of the 4 largest banks								
Savings	0.75	0.75	0.75	0.50	0.50	0.50	0.50	0.50
3-month	2.16	2.50	1.54	0.75	0.73	0.70	0.70	0.70
6-month	2.16	2.63	1.68	0.84	0.82	0.79	0.70	0.70
12-month	2.31	2.88	1.78	0.94	0.88	0.84	0.70	0.70
24-month	2.50	3.59	2.50	1.25	1.44	1.44	1.44	1.44
MLR	6.87	7.25	6.75	6.13	5.86	5.86	5.86	5.86

Note: ^{1/} Policy rate is the rate at end-period; Reference retail rates are the average of minimum and maximum rates.

Source: Bank of Thailand



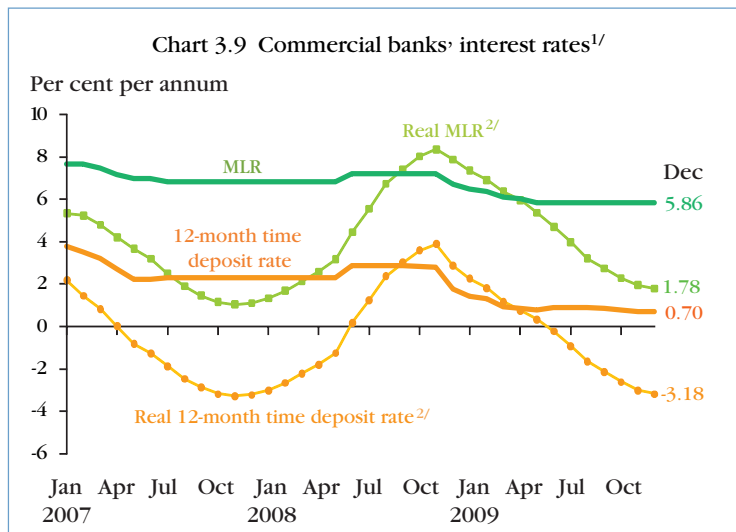
Note: ^{1/} Average rate of the 4 largest commercial banks at end-period and the average of minimum and maximum

Source: Bank of Thailand

Meanwhile, the minimum lending rates (MLR) of the four largest commercial banks remained unchanged on average at 5.86 per cent per annum. The real MLR^{2/} and the real 12-month time deposit rate^{3/} dropped to

Note: ^{2/} Real MLR = MLR - average forecasted inflation 12 months ahead

^{3/} Real 12-month deposit rate = 12-month deposit rate - average forecasted inflation 12 months ahead



Note: ^{1/} Average rate of the 4 largest commercial banks
^{2/} Real interest rates are calculated from the compounded interest rate formula
Source: Bank of Thailand

1.78 and -3.18 per cent per annum respectively at the end of the quarter, on account of a pickup in projected inflation over the next 12 months.

Deposits of Other Depository Corporations (ODCs)^{4/} in October and November expanded on average at a decelerating rate of 7.1 per cent from the same period last year. The deceleration followed a strong surge in ODC deposits last year due to heightened risk aversion during the global financial crisis, which induced investors to shift investment away from higher-yielding assets. However, when compared to the end of the third quarter, the outstanding ODC deposits as of the end of November grew by a robust amount of 260 billion baht. The pickup was due to the mobilization of deposits by both SFIs, in accordance with the

Deposits of ODCs decelerated from the previous quarter but expanded noticeably compared to the previous month.

^{4/} Other Depository Corporations consist of domestically registered commercial banks, branches of foreign banks, international banking facilities, finance companies, Specialized Financial Institution (including Government Savings Bank, Government Housing Banks, Bank of Agriculture and Agricultural Cooperatives, Export-Import Bank of Thailand, Small and Medium Enterprise Development Bank of Thailand, Islamic Bank of Thailand), saving cooperatives, and money market mutual funds.

Chart 3.10 Other Depository Corporations' deposits and private credits

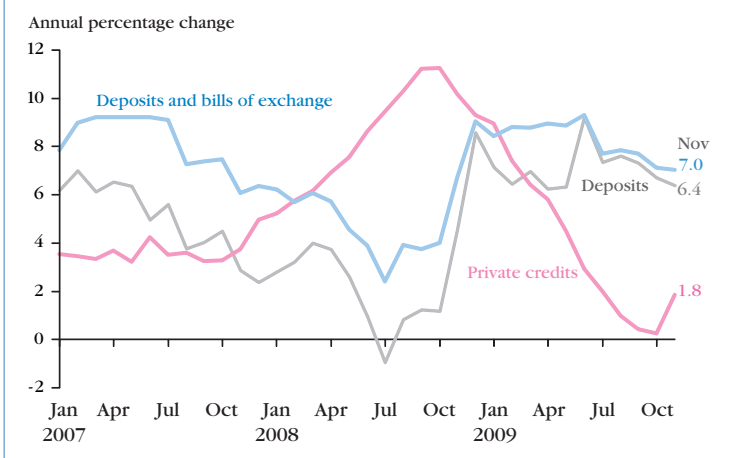
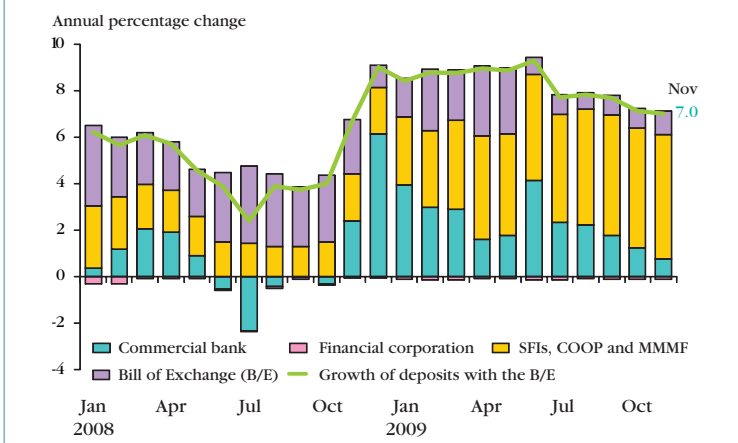


Chart 3.11 Deposits of Other Depository Corporations by financial institutions (with B/E)



Source: Bank of Thailand

government's policy, and commercial banks in anticipation of greater credit expansion going forward especially in personal consumption loans. Additionally, a number of Bank of Thailand and government saving bonds had reached their maturities.

Private credits, especially those extended to the household sector, accelerated.

Private credits of ODCs in October decelerated from the previous quarter, growing at an average rate of 0.2 per cent per annum from the same period last year. However, private credits in November grew at an accelerating rate of 1.8 per cent per annum, largely

Chart 3.12 Other Depository Corporations' private credits by types of debtors

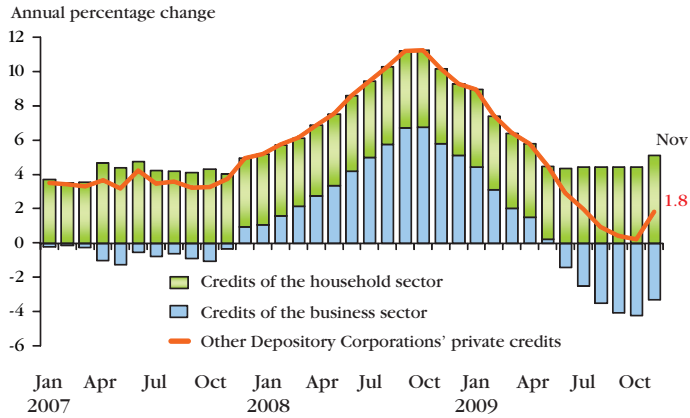


Chart 3.13 Other Depository Corporations' private credits by types of creditors

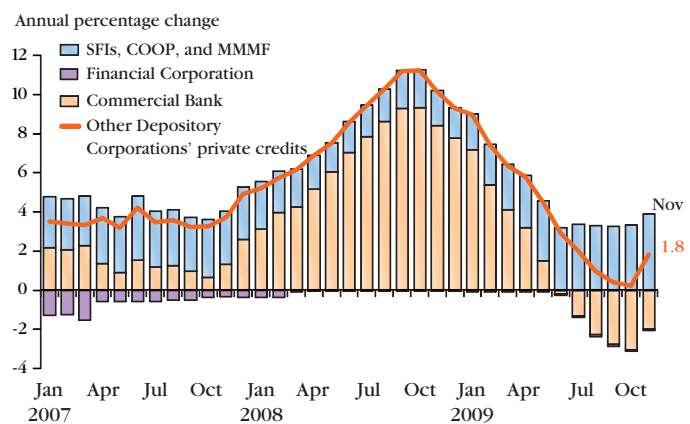
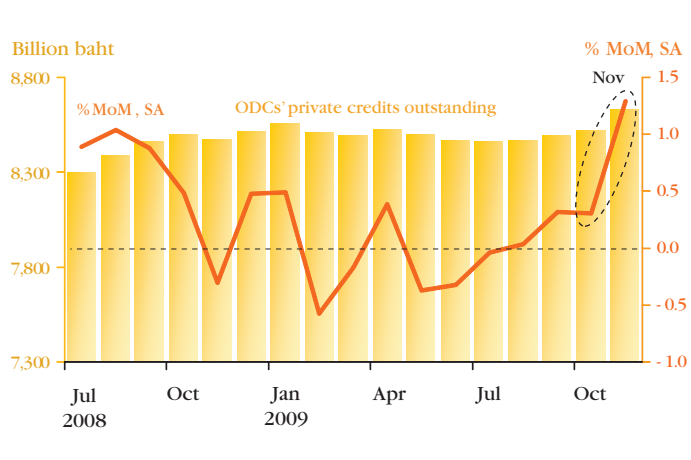
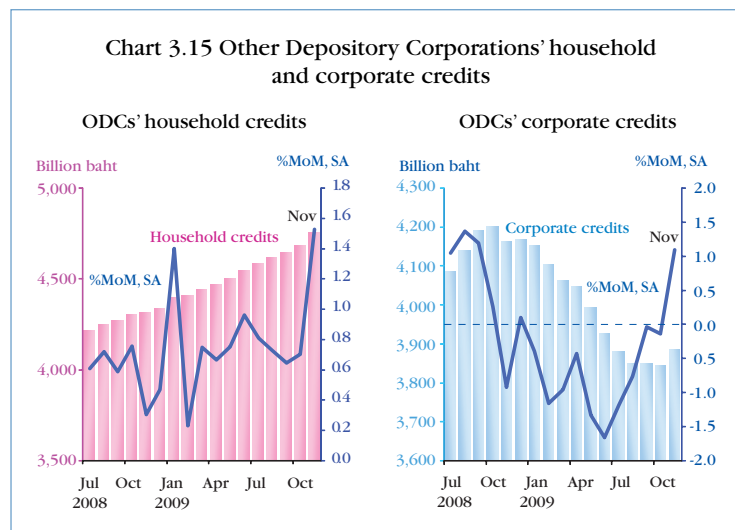


Chart 3.14 Other Depository Corporations' private credits



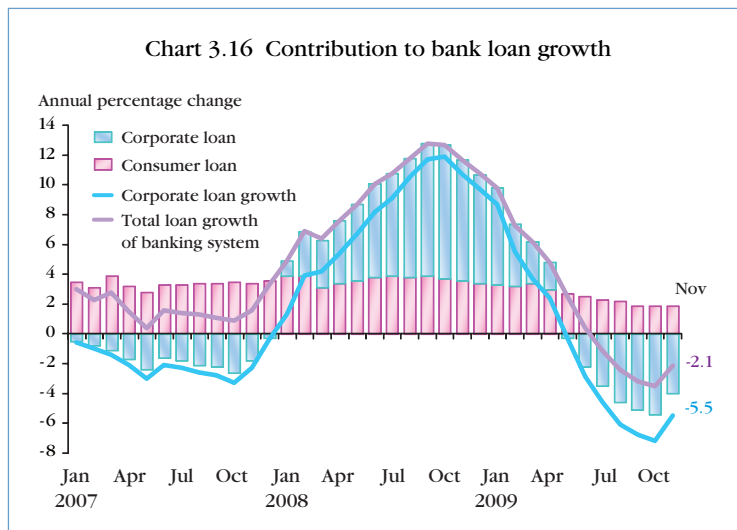
Source: Bank of Thailand



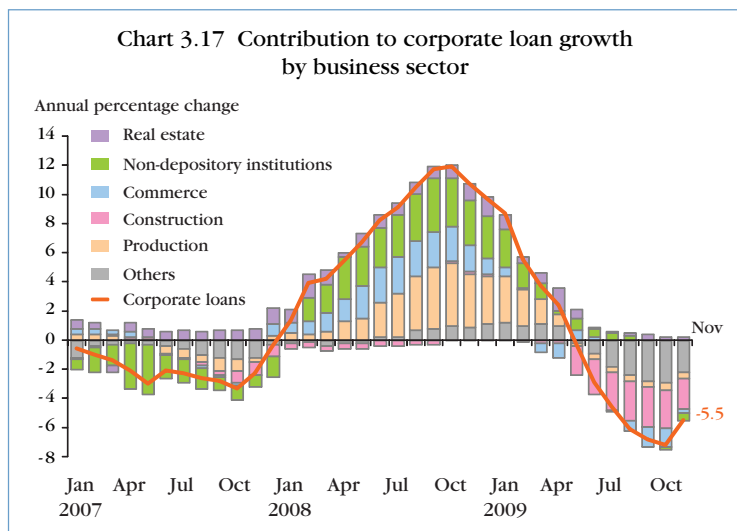
Source: Bank of Thailand

attributable to household credit extension. Notably, the SFIs continued to expand credits in accordance with the government's policy, especially to the housing sector which was deemed to be less risky compared to corporate credits due to its collateralized nature. Meanwhile, corporate credits in November expanded from the previous month for the first time in 11 months, partly because of rising demand for credits in view of an ongoing economic recovery.

Commercial banks' private credits in October and November 2009 shrank by 7.2 and 5.5 per cent respectively from the same period last year. The deceleration of the contraction in November was mainly attributable to some improvements in corporate credits, especially for hire-purchase and public-utility credits such as electricity production. Meanwhile, household credits, especially for housing and vehicles, continued to expand.



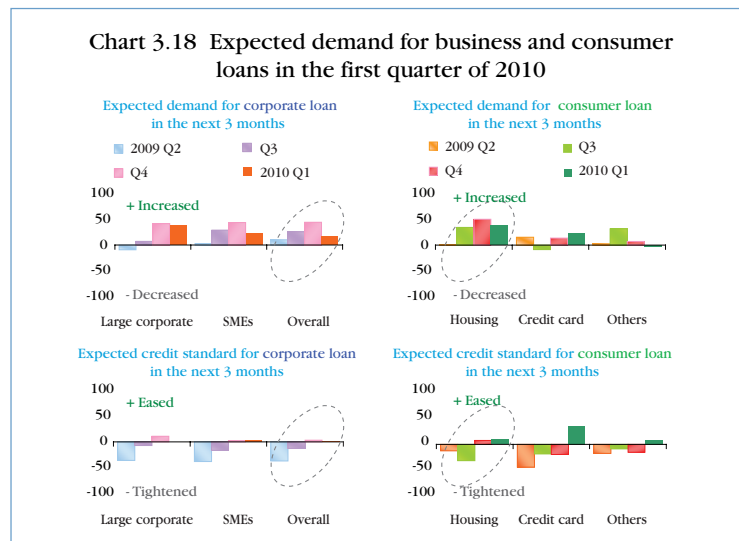
Source: Bank of Thailand



Source: Bank of Thailand

The credit outlook for 2010 Q1, according to the Senior Loan Officer Survey, is expected to benefit from higher demand for credits from household and business sectors, particularly in housing credits, as well as a continued easing in credit standards set by financial institutions in tandem with the economic recovery. However, the overall growth rate of credits is likely to decelerate from the previous quarter.

Demand for credits is expected to increase both for business and household credits, while credit standards set by financial institutions will likely ease further.



Source: Senior Loan Officer Survey conducted in the 4th quarter of 2009

Exchange rates

The Thai baht continued to appreciate against the US dollar from the previous quarter.

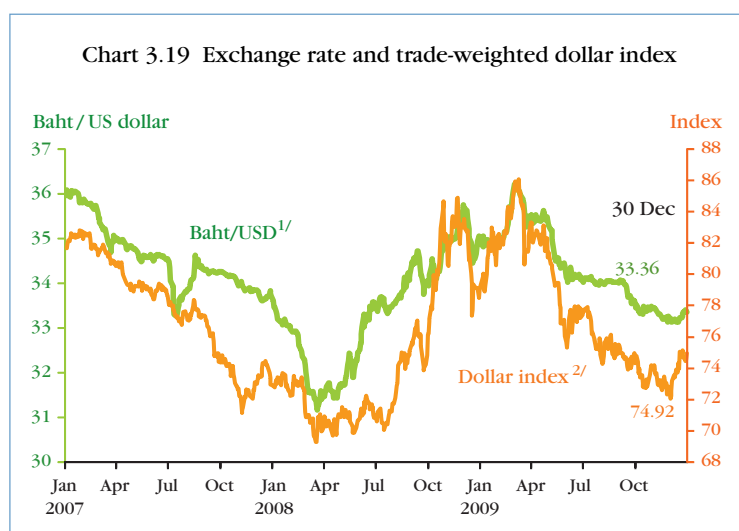
In 2009 Q4, the baht appreciated 2.0 percent from the previous quarter's average to 33.31 baht per US dollar. The appreciation of the baht in the earlier part of the quarter largely resulted from the US dollar selling by foreign investors who sought to reduce their US dollar exposure, as well as commercial banks and exporters amidst concerns of continued baht strength.

The major factors contributing to the depreciation of the US dollar during the first two months of the quarter were (1) the rising appetite for risky assets as investors grew more confident in the economic recovery, (2) the action by the Reserve Bank of Australia (RBA) to raise its policy interest rate earlier than expected during the beginning of the quarter, (3) a string of positive economic releases in the US, Japan and euro area, as well as strong corporate earning announcements, (4) news about continued foreign reserves diversification away from the US dollar, and (5) the expectation that

the Federal Reserve would maintain the policy interest rate (Fed funds rate) at a low level for an extended period.

However, towards the end of November, concerns regarding the possible default of Dubai World on its debt disrupted the stock markets worldwide and induced a safe haven flight to the US dollar. This reversal led to a temporary depreciation of the Thai baht and other regional currencies, which was short-lived due to their limited exposure to Dubai World. Moreover, the concerns were alleviated after the UAE had provided the liquidity assistance to the affected commercial banks in Dubai.

Towards the end of the quarter, the Thai baht weakened once again, owing to year-end demand for US dollars by foreign investors and financial institutions in preparation for the long holiday. Moreover, the recent better-than-expected US economic data also led the market to price in an earlier Fed funds rate hike.

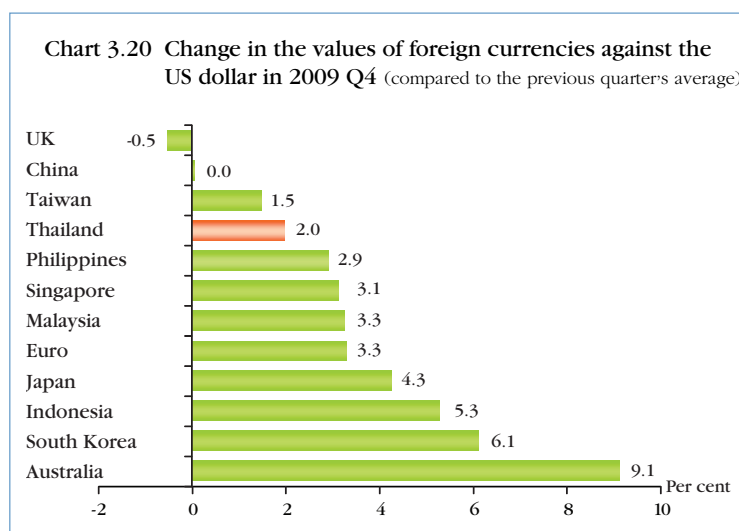


Sources: ^{1/} Bank of Thailand
^{2/} Bloomberg

Most currencies appreciated against the US dollar amidst a resumption of risk appetite.

Other major and regional currencies also appreciated against the US dollar in 2009 Q4, due to the aforementioned surge in risk appetite. The gain was largest for the Australian dollar, which was supported by a comparatively positive outlook for recovery in Australia as well as a brisker pace of policy normalization. The Korean won also appreciated markedly, due to a positive trade balance, improved economic data, and an expectation that the Bank of Korea may raise the policy rate sooner than expected. The pound sterling was volatile, with some short-term upswings in response to positive economic releases, but overall depreciated from the previous quarter from the worries on the country's fiscal deficit, its fragile economic recovery, and concerns about the impact of Dubai World's default on British commercial banks.

Similarly, the euro and the yen rose against the US dollar from the previous quarter's average. The yen was initially under pressure early in the quarter from greater demand for risky assets, but strengthened subsequently as investors turned to the US dollar as a

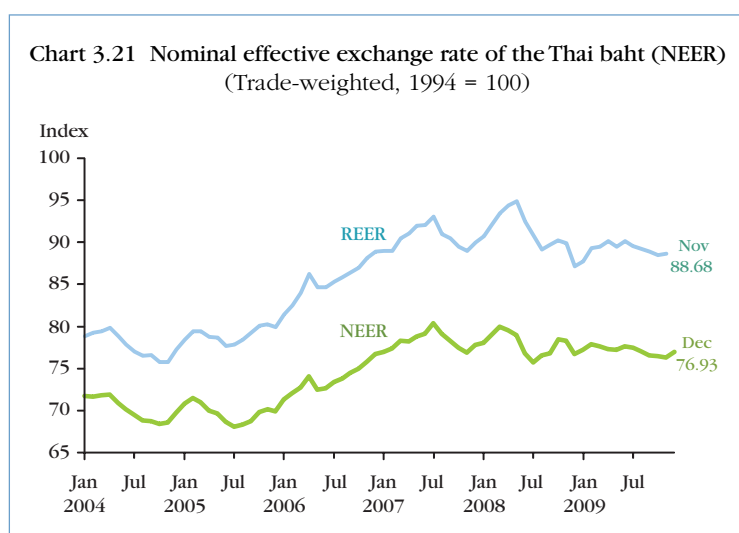


Source: Bank of Thailand

funding currency. Strong Japanese economic data and a bout of risk aversion from the Dubai World problems also contributed to an appreciation in the yen. The euro also appreciated against the US dollar, benefiting from an improvement in economic data as well as the demand by various central banks seeking to diversify their foreign reserves.

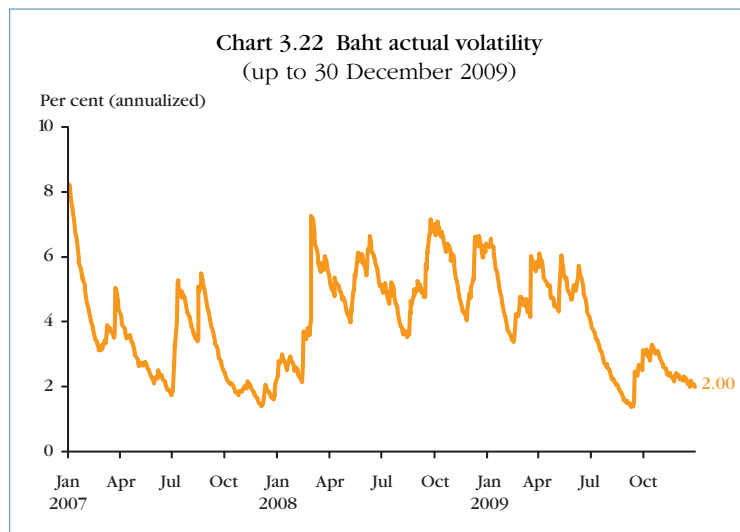
The appreciation of the baht against the dollar was comparatively subdued relative to many other currencies, causing the nominal effective exchange rate (NEER)^{2/} to weaken slightly by 0.57 per cent from the previous quarter's average.

The real effective exchange rate (REER), calculated by deflating the NEER by relative inflation rates to reflect the country's price competitiveness, also trended downwards in line with the NEER depreciation. On average, the REER declined from the previous quarter's average by 0.77 per cent in the first two months of 2009 Q4.



Source: Bank of Thailand

^{2/} The Thai baht NEER is calculated as a weighted average of bilateral exchange rates between the baht and major trading partners' currencies.



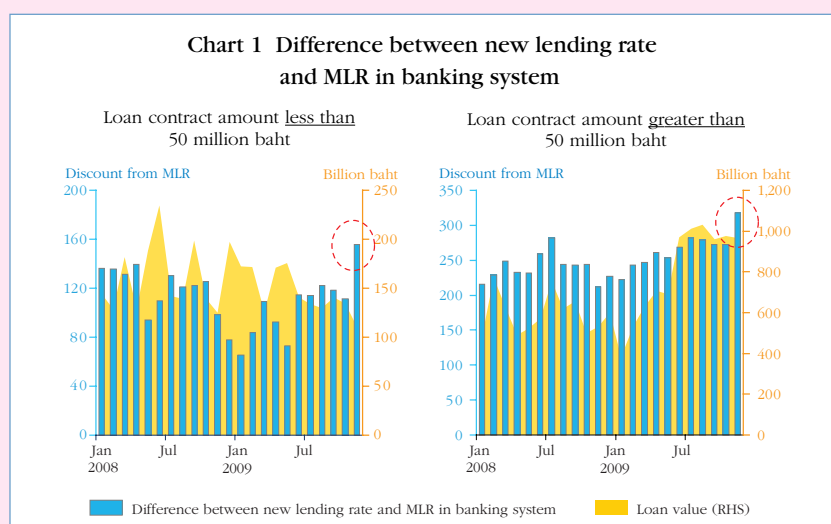
Source: Bank of Thailand

The average volatility of the Thai baht vis-à-vis the US dollar in 2009 Q4 increased from the previous quarter, stemming from relatively active foreign exchange transactions by foreign investors, commercial banks and exporters seeking to reduce their US dollar holding. Towards the quarter end, the pressures from the demand and supply sides were more balanced, and the baht consequently moved within a narrow range with subdued volatility.

The role of banks in sustaining the economic recovery

The rapid eruption of the global financial crisis in the last quarter of 2008 has extensively affected both the global and Thai economies, leading to the deterioration in demand for exports as well as business and consumer confidence. As a result, there had been a drastic decline in credit outstanding of financial institutions since the start of 2008, induced by (1) heightened risk aversion of financial institutions and consequently a drop in loan supply, and (2) weakened demand for loans during the economic slowdown. Nevertheless, the November data suggest that there have been positive developments in the credit market, signaling tentative signs that the banks' deleveraging process may have come to an end:

1. The private credits provided by commercial banks expanded from the previous month in a wide range of sectors, including the business loans that had been falling since the beginning of the year. Household credits also continued to grow, with outstanding household credits in all categories already reaching their pre-crisis levels.



Source: Bank of Thailand

2. Despite leaving the reference loan rates unchanged since mid-2009, some commercial banks had recently been lending at a discount (as shown in chart 1), implying a higher degree of price competition in the loan market.

3. According to the latest survey taken in 2009 Q4, most senior loan officers were of the view that the demand for both business and household loans would continue to grow into the first quarter of 2010. They also expected the credit standards to be eased significantly.

4. Liquidity in the commercial bank system remains ample and sufficient to accommodate the expansion of demand for credits looking ahead.

Another encouraging development in the credit market has been the sign of competition among commercial banks to attract deposits. As most commercial banks did not anticipate an imminent increase in the policy interest rate, they opted against adjusting the deposit rates and instead focused on non-price competition strategies, such as offering special saving products. The small and medium-sized banks were looking to mobilize funds in order to accommodate greater credit expansion expected in the periods ahead, while larger banks engaged in competition mainly to maintain the existing deposit base. SFIs have also launched campaigns to mobilize funds to meet greater credit extension expected as a result of the government policy. Nonetheless, the overall degree of competition in the deposit market remains moderate.

The aforementioned developments point towards an increase in the private demand for loans, and a more accommodative outlook in credit supply. With credit standards continuing to ease and banks charging effective lending rates with greater discount, the noticeable expansion of credit growth in November should have sufficient momentum to continue expanding going forward. Therefore, it is likely that the commercial banks' deleveraging process has come to an end, and the banking system should serve as an important engine for a self-sustaining economic recovery the period ahead.

4. Financial Stability Conditions and Outlook

Thailand's financial stability conditions improved in 2009 H2 in tandem with the recovery of the world economy and domestic demand which boosted corporate performance, household income, and credit quality of financial institutions. Nevertheless, the global financial markets remained highly volatile, particularly in the fourth quarter after the Dubai World's debt postponement and credit downgrades of several countries. Although these events have had limited impacts on Thailand's financial stability, they may indirectly affect the length and the strength of the global economic recovery in the period ahead.

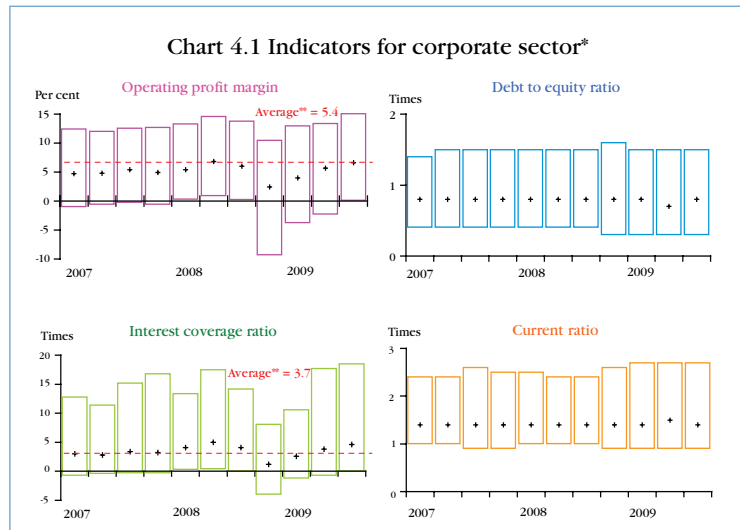
Non-financial corporate sector

In 2009 Q3, the performance of most non-financial companies listed on the Stock Exchange of Thailand continued to improve in tandem with the pickup in the global economy and domestic demand. Corporate profitability and ability to service debt were sound, as reflected by the rebound in operating profit margins and interest coverage ratios which roughly returned to the pre-crisis levels.

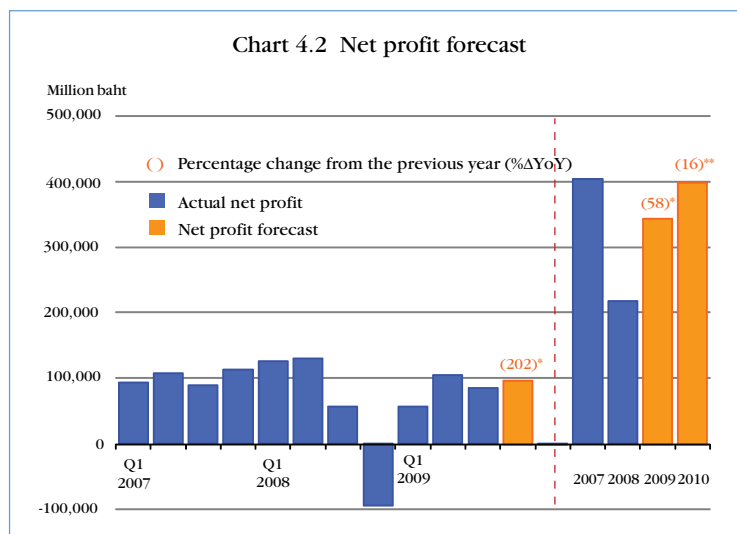
Going forward, risks to corporate sector stability are expected to subside further according to the Security Analyst Association (SAA) Consensus which showed average net profit growth of non-financial listed companies of 202 and 16 percent in 2009 Q4 and 2010, respectively, on the back of the global and domestic economic recovery. Nevertheless, it should be noted

In 2009 Q3, production and supply continued to recover from the previous quarter.

Major risk factors to corporate sector stability in the medium term are the sustainability of the global economic recovery, the Map Ta Phut problem, oil prices and the political unrest.



Note: * Each bar depicts an interquartile range, where upper and lower bounds represent the 25th and 75th percentiles, respectively. The symbol + indicates the median.
 **Average 1997 Q1 - 2009 Q3
 Source: Stock Exchange of Thailand, calculations by Bank of Thailand staff



Note: *December 2009 estimates
 **September 2009 estimates
 Source: Stock Exchange of Thailand and Securities Analysis Association, calculations by Bank of Thailand staff

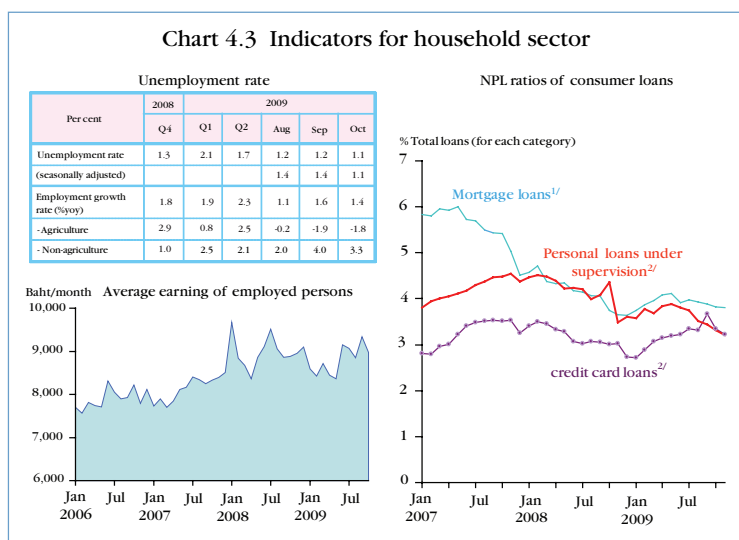
that the recovery of the world economy remains fragile, as observed for instance by the postponement of Dubai World's debt repayment and the downgrades of sovereign credit rating of countries with excessive public debt burden such as Greece, Spain, and Mexico.

The fragile global recovery together with domestic issues such as the suspension of investment projects in the Map Ta Phut industrial area, the political uncertainty, and the increasing oil price trend present major risk factors to the stability of the corporate sector in the period ahead.

Household sector

Risks to household's income and employment continued to decrease as reflected by the October 2009 labour market data which showed a decline in the seasonally-adjusted unemployment rate from 1.4 per cent over the previous two months to 1.1 per cent. Meanwhile, both non-agriculture employment and average earnings of employed persons continued on an upward trend in line with the increase in labour demand associated with the economic rebound.

Risks to household employment decreased on the rebound of the labour market.



Source: National Statistical Office

Note: ^{1/} Commercial bank's loans
^{2/} Total loans from commercial banks and non-banks

Source: Bank of Thailand

Households' ability to service debt improved.

The improvement in household income helped increase households' ability to service debt, as reflected by the decline in the NPL and the delinquency (one to three months past due) ratios of mortgage and credit card loans. Going forward, the MPC judges that the outlook for household sector stability is largely conditional on the economic recovery. In addition, households' ability to service debt may also be affected by the expected higher costs of living.

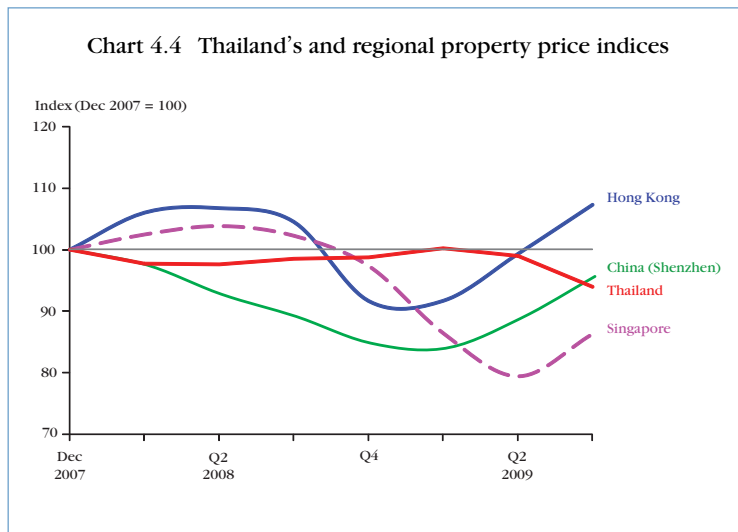
Real estate sector

Risk of a bubble in the real estate sector remains low.

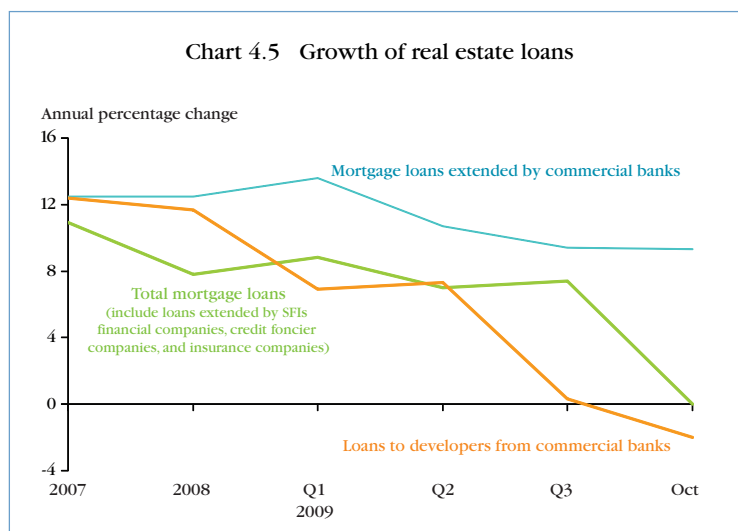
Real estate sales in 2009 Q4 increased significantly due to improved consumer confidence following the economic recovery and the government measures to stimulate the real estate sector - most notably tax reduction for home buyers in 2009 and reduction of fee and special business taxes, scheduled to expire in March 2010 - which provided tax incentives for consumers to speed up their residential property purchases. Nevertheless, the MPC judges that the increased housing demand was driven by fundamentals, with limited speculation, if any^{1/}.

On the supply side, housing supply expanded in line with demand as developers accelerated the completion of their real estate projects before the expiration of the tax incentives. Another impetus for developers was a brighter prospect of the economy which brought about the relaunch of several pending projects that had been postponed in 2009 H1.

^{1/} Consistent with views of developers according to the survey of Business Information Exchange program between the Bank of Thailand and businesses.



Source: CEIC and REIC, calculations by Bank of Thailand staff



Source: Bank of Thailand

Overall, the MPC's assessment is that the likelihood of a bubble in the Thai property sector remains low. While house prices in several regional countries had started to move back to their pre-crisis levels, Thailand's housing price index still drifted downward. Furthermore, cautious credit extension by financial institutions means one less factor fuelling bubbles. Nevertheless, the protracted period of eased monetary condition and the economic upswing may increase the likelihood of the emergence of a property market bubble.

Nevertheless, the protracted period of eased monetary condition and the firming economic recovery pose risks to asset price bubbles in the period ahead.

Financial institutions

The commercial banking system's operating performance and capital position remained sound.

The latest operating performance data showed that the financial health of the banking sector remained sound. Net profits of the Thai banking system in 2009 Q3 totalled 23.5 billion baht, up 26.4 per cent from the previous quarter owing primarily to a decrease in provisioning following the economic recovery. Meanwhile, Thai banks' capital position remained strong, as reflected by the BIS ratio in November 2009 at 16.2 per cent, up further from the 2009 Q2 and well above the minimum requirement of 8.5 per cent. All of these should help the Thai banking sector to withstand various shocks in the future. As for the Dubai World debt postponement, the direct impact has been minimal as the system's lending and investment exposure to the Dubai World Group is very limited. Still, there may be some indirect

**Table 4.1 Thai Bank's Financial Soundness Indicators
(at the end of 2009 Q3^{1/})**

Key indicators (%)	2008			2009		
	Q2	Q3	Q4	Q1	Q2	Q3
1. Capital adequacy						
1.1 Regulatory capital to risk-weighted assets (8.50) ^{2/}	15.0	15.3	13.9	14.7	15.6	16.1
1.2 Regulatory tier 1 capital to risk-weighted assets (4.25) ^{2/}	11.5	11.9	10.7	11.1	11.5	12.1
2. Asset quality						
2.1 Non-performing loans to total loans	7.01	6.5	5.7	5.9	5.8	5.7
3. Earning and profitability						
3.1 Return on assets (ROA)	1.2	1.2	1.0	0.9	0.9	1.0
3.2 Interest margin ^{3/} to gross income ^{4/}	72.1	73.9	74.1	70.9	69.5	69.2
3.3 Non-interest expenses to gross income	52.2	53.5	55.2	58.0	55.8	55.5
4. Liquidity						
4.1 Liquid assets ^{5/} to total assets	20.4	18.7	17.9	18.9	19.3	18.6
4.2 Liquid assets to short-term liabilities ^{6/}	27.4	24.4	23.6	24.8	25.5	24.8
Number of banks	14	14	14	14	14	14

Note: ^{1/} Based on "Peer Group" data

^{2/} Minimum regulatory capital to risk-weighted assets

^{3/} Interest margin = Interest income and dividend - Interest expenses

^{4/} Gross income = Interest margin + Non-interest income

^{5/} Liquid assets = Cash and deposits + Securities purchased under resale agreements + Investment in securities (net)

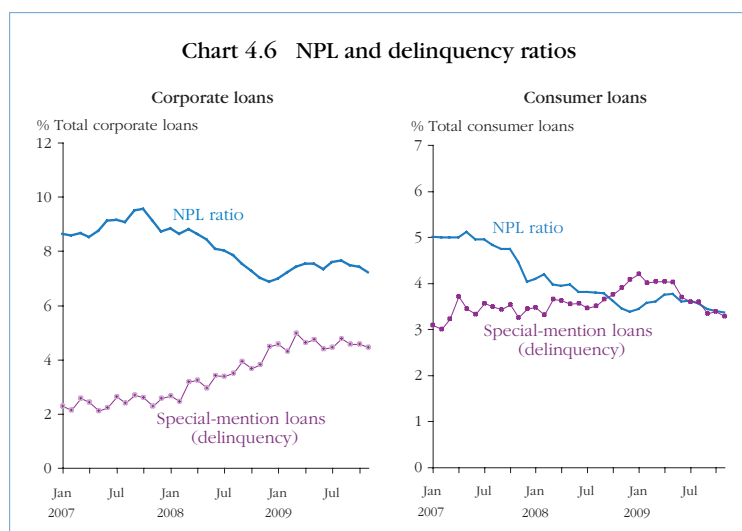
^{6/} Short-term liabilities = Deposits (Liability side)

Source: Bank of Thailand

impacts from loans to firms with investment and business activities in Dubai which the MPC will continue to monitor closely.

During the past few months, Thai banks' credit quality showed continuous improvement as observed by the declining NPL ratios of both corporate and household loans. Defaults as proxied by the ratio of special-mention loans (one to three month past due) to total loans also decreased. However, the MPC still has some concerns on the pace and the sustainability of the economic recovery which could have serious implications for financial stability conditions. In particular, the suspension of investment projects in the Map Ta Phut industrial area may affect construction activities and other related industries. Although the preliminary assessment showed that its direct impact is limited, the Map Ta Phut incidence may indirectly affect confidence and threaten the sustainability of the economic recovery.

Credit risk of Thai banks began to decline as a result of improvements in economic condition.

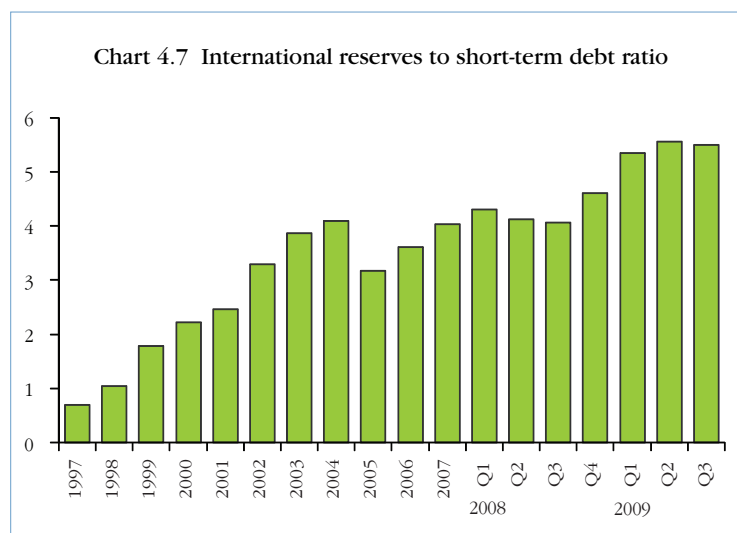


Source: Bank of Thailand


External sector

External stability remained strong.

Thailand's external stability remained strong, as reflected by a high level of international reserves. As of October 2009, the ratio of reserves to short-term debt stood at 5.4 which should help cushion fluctuations in capital flows to a certain extent. Nevertheless, the MPC will continue to monitor capital flows developments closely, for up to now the global financial market remains volatile as evidenced by the disorderly adjustments in the foreign exchange and the stock markets in response to Dubai World's debt postponement and the credit downgrades of countries with weak fiscal positions which reflect the vulnerability in the global financial markets.



Source: Bank of Thailand




In summary, even though the recent economic recovery appears more concrete and supportive to overall financial stability conditions, the MPC deems that the ongoing global economic recovery remains fragile while the domestic recovery is still subject to several risk factors which have to be monitored closely. Furthermore, concerns over the acceleration of asset prices during the economic upturn is an area in which the MPC regards seriously and will step up the surveillance efforts going forward.

5. Economic Growth and Inflation Outlook

Although contracting on a year-on-year basis as the MPC had previously expected, the Thai economy in 2009 Q3, driven by exports, consumption, and investment, grew from the previous quarter. This forward momentum was well maintained throughout 2009 Q4 supported by public consumption and exports, which worked to shore up private consumption and private investment. Such a pickup in economic activity was also reflected in improvements in consumer confidence and business sentiment indices. Meanwhile, imports accelerated following a rebound in exports and domestic demand. Overall economic activity was expanding in the last quarter of the year at a pace slightly stronger than expected, thereby bringing the growth rate for the entire year, albeit negative, close to the upper bound of the previous forecast range.

The MPC judges that the Thai economy will continue to expand in 2010 on the back of a sustained global recovery. Exports, private consumption, and private investment are expected to grow even though fiscal stimulus will moderate somewhat. The MPC expects the economy to carry momentum into 2011 because of rising private consumption, exports, and private investment – the last of which is conditional on the resumption of industrial projects in Map Ta Phut.

Inflation pressures are expected to rise going forward owing importantly to a firming in domestic demand and a rise in oil and commodity prices that is in line with the global recovery. However, an extension of government measures to alleviate the costs of living



to the end of 2010 Q1 works to lower readings on inflation this year from the forecasts given in the previous *Report*.

In what follows, economic projections for the next eight quarters, based on the Bank of Thailand macroeconomic model, forecast assumptions carefully reviewed by the MPC, and the MPC's off-model judgment, are presented in the form of fan charts. The fan charts reflect uncertainty associated with a range of events and are constructed conditioning on the assumption that the policy interest rate remains at the current level of 1.25 per cent per annum from 2010 Q1 to 2011 Q4. This policy rate assumption is consistent with the decisions in the MPC meetings on 2 December 2009 and on 13 January 2010 to keep the rate unchanged at 1.25 per cent per annum.

Forecast assumptions

In forming economic and inflation forecasts for the next eight quarters, the MPC uses the most plausible baseline assumptions on various exogenous factors such as economic and financial conditions in foreign economies, world commodity prices, and government spending. These assumptions are summarized below.

International economic and financial conditions

Signs of recovery in major industrial and emerging market economies have become increasingly evident. Private consumption and industrial production improved in 2009 Q3 and appeared poised to continue into 2009 Q4. Such an expansion of economic activity

occurred earlier than previously anticipated. Consequently, the MPC revises up growth projections of trading partner economies over the entire forecast period.

The US economy contracted by 2.6 per cent year on year in 2009 Q3. Indicators for financial markets, real estate activity, and private consumption pointed to earlier and clearer signs of recovering than previously anticipated as a result of fiscal and monetary policy accommodation. Although labour market conditions improved faster than expected, the unemployment rate remains elevated and will likely take time before reverting to the long-term trend. The MPC thus revises up growth projection of the US economy over the entire projection period and judges that the economy will recover only gradually, starting from the first quarter of 2010, and expand at a pace below the long-term potential growth rate.

At the meeting on 16 December 2009, the Federal Open Market Committee (FOMC) kept the target range for the Fed funds rate of 0 to 0.25 per cent. The FOMC also decided to purchase as much Treasury securities, agency debt, and mortgage-backed securities as it previously announced. Nevertheless, the FOMC would gradually slow down the purchases of 1.25 trillion US dollars of mortgage-backed securities and 175 billion US dollars of agency debt.

Even though latest economic indicators showed clearer and faster improvements than previously assessed, there remain risks to economic growth. The MPC projects that the Fed will maintain the funds rate at 0-0.25 per cent until 2010 Q2 and will raise the policy rate to 0.25 per cent in 2010 Q3, and subsequently

With the US economy showing clearer signs of recovering, the MPC revises up the growth projection of the US throughout the forecast period.

The MPC projects that the Fed will begin to tighten monetary policy gradually toward the end of 2010.

increase it by 0.25 per cent in each quarter until reaching 1.5 per cent in 2011 Q4.

The MPC revises up over the whole forecast period the growth projection for the Euro area.

The Euro area economy contracted by 4.1 percent in 2009 Q3 year on year, shrinking less than the previous forecast. Together with latest economic indicators for exports, business sentiment, and consumer confidence that have improved noticeably, the MPC consequently revises up the growth projection of the Euro area over the forecast horizon. It is expected that growth will turn positive in 2010 Q1 on a year-on-year basis – faster than anticipated in the previous *Report*. Nevertheless, the recovery is likely to be only gradual owing to elevated unemployment as in the case of the US.

The MPC revises up slightly the output growth projection for Japan throughout the forecast period.

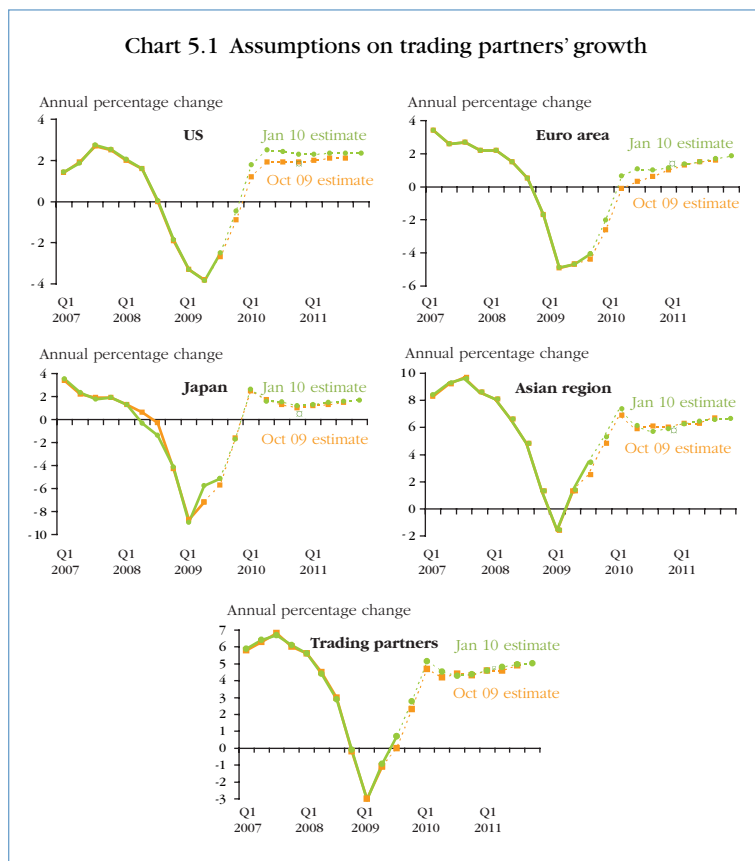
The Japanese economy contracted by 5.1 per cent year on year in 2009 Q3, less than previously expected. Latest economic indicators, including those for industrial production and exports, also started to gain some traction. In the fourth quarter, however, production appeared to have slowed from its rapid pace. This, together with deflation prospects as a result of subdued confidence and weak employment, prompted the government to introduce additional stimulus to boost consumption. In light of the fiscal impetus, the MPC thus slightly revises up the growth projection of the Japanese economy over the entire forecast period and expects growth to resume in the first quarter of 2010.

The MPC revises up slightly the output growth projection for East Asian economies throughout the forecast period.

Economic activities in **Asian economies** increased owing importantly to improvements in exports and domestic demand. The pace of expansion was slightly faster in 2009 Q3 than previously anticipated. Even though growth in 2010 and 2011 is not likely to attain

the pre-crisis pace given a fragile global demand, economic indicators show signs of further improvement going forward. The MPC thus revises up the growth projection of Asian economies throughout the forecast horizon.

Overall, the MPC projects that trading partner economies will grow at a rate slightly higher than anticipated in the previous *Report* throughout 2010 and 2011.

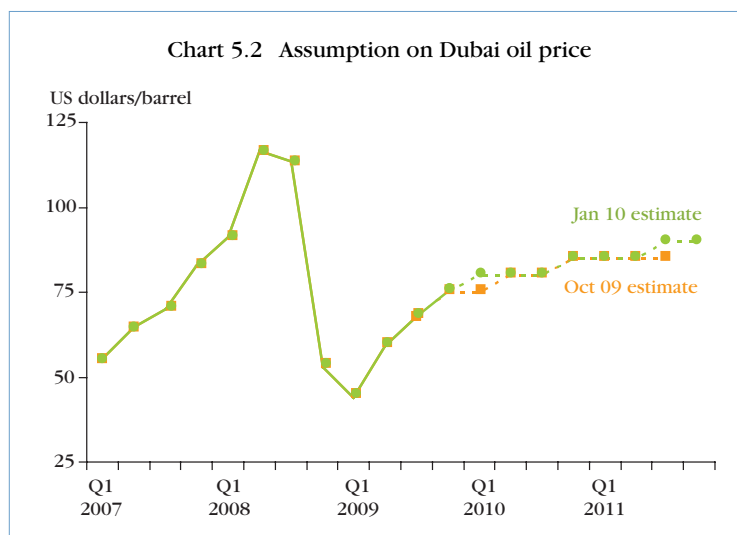


Regional currencies are projected to appreciate vis-à-vis the US dollar. Given increasing global risk appetite and flows of capital into the region, particularly into stock markets, as a result of better prospects of the global economy, the MPC projects that regional currencies will appreciate throughout the forecast horizon faster than previously anticipated.

World commodity prices

The MPC revises up the projection on the Dubai oil price for 2010 and 2011.

The MPC projects global demand for crude oil in 2010 and 2011 to increase slightly from the previous projection in accordance with the global economic recovery as well as a continuous decline in the crude stock. Consequently, the projection for the Dubai oil price is revised up, averaging at 81.3 and 87.5 US dollars per barrel in 2010 and 2011, respectively.



Source: Bank of Thailand projection

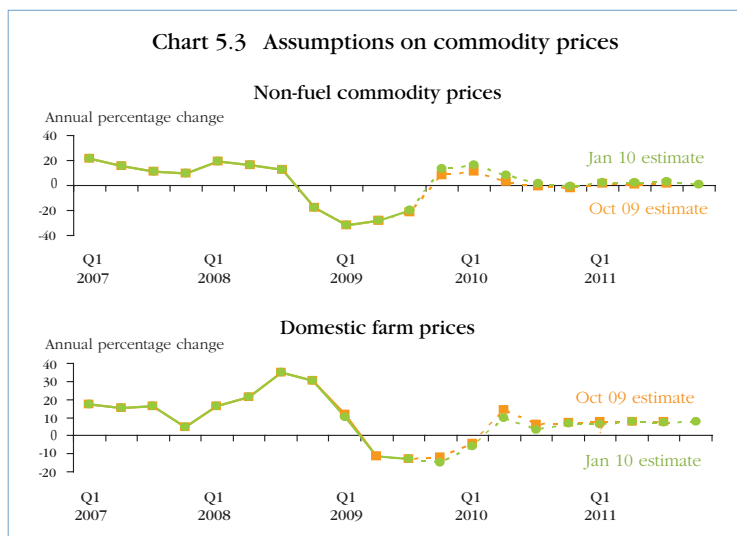
Non-fuel commodity prices are projected to be higher than previously expected.

With regard to non-fuel commodity prices in 2010, the MPC revises up the previous projection given a recent uptrend in metal and food prices. Non-fuel

commodity prices are expected to edge up slightly in 2011.

Domestic farm prices in 2010 are revised down, as lower-than-expected prices of fruits and vegetables more than offset rising prices of rice and flour following a weather-induced decline in world supply of rice. Nonetheless, farm prices will likely rise in 2011 on account of a pickup in global demand ahead.

Domestic farm prices projection is revised down.



Source: Bank of Thailand projection

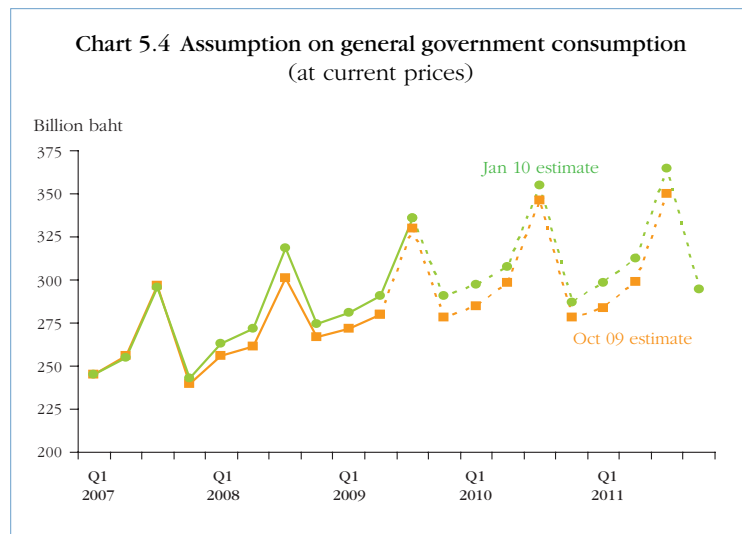
Fiscal Expenditure

The MPC projects government consumption expenditure in fiscal year 2010 to be 1,250.2 billion baht, higher than previously projected, as parts of outlays for investment in the second stimulus package are now earmarked for consumption expenditure. This budget reclassification in effect reduces public investment outlays in fiscal year 2011 to 622.4 billion baht – lower than expected – 358.9 billion of which is designated as central government investment and 263.5 billion as state-owned enterprise investment.

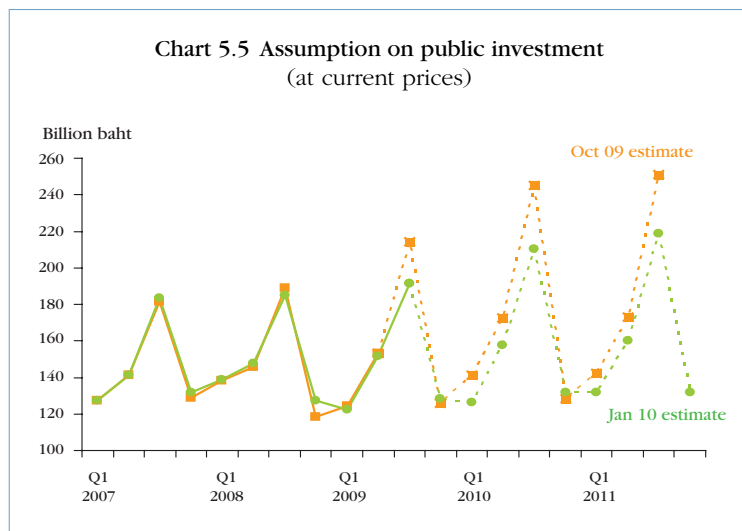
The MPC projects general government consumption and investment over fiscal year 2010 to be 1,250.2 and 622.4 billion baht, respectively.

Public consumption and investment for fiscal year 2011 are estimated at 1,263.0 and 642.5 billion baht, respectively.

For fiscal year 2011, the MPC estimates that government consumption expenditure will total 1,263.0 billion baht while public investment outlays will come to 642.5 billion baht. The latter consists of central government investment worth 401.4 billion baht and state-owned enterprise investment worth 241.1 billion baht.



Source: Bank of Thailand projection



Source: Bank of Thailand projection

Minimum wages

The MPC revises up the assumption on this year's daily minimum wage for the Bangkok Metropolitan Area from 203 baht to 206 baht in line with the new minimum wage recently set by the Central Wage Committee in December 2009. In addition, the minimum wage for 2011 is revised up slightly on account of the uptrend in inflation and a pickup in economic activity.

The MPC slightly revises up the minimum wage forecast assumption over the entire forecast horizon.


Inventory accumulation

The MPC judges that inventory will slowly accumulate following an economic recovery, turning the contribution to GDP growth to positive in both 2010 and 2011 after being negative throughout 2009.

Output and inflation projections

Output projection

The Thai economy expanded in 2009 Q4 at a pace faster than previously expected, driven mainly by exports as well as private and public domestic demand. Imports also accelerated during this period. The sustained recovery is primarily due to recovering global demand, rising domestic farm income following higher agricultural prices, improved employment conditions, and accommodative interest rate, all of which bolstered consumer confidence. While private investment still contracted in 2009 Q4 year on year, the pace of contraction slowed down owing to improved business sentiment. Meanwhile, although the effects of fiscal stimulus ebbed somewhat compared with the same period of the previous year, the acceleration in



disbursement of funds still enabled the public sector to provide a forward momentum to the economy. Overall, in 2009 the Thai economy is expected to contract from the previous year by 2.7 per cent owing importantly to the global recession, which led to contractions in almost all GDP components except government consumption and public investment that still expanded and acted as an engine of growth in 2009.

Under the assumption that the policy interest rate remains unchanged at 1.25 per cent over the next eight quarters, together with clearer signs of recovery, increasing domestic demand, and accommodative monetary policy, the MPC projects GDP growth for 2010 to be close to the previous projection. However, a tenuous global economic recovery, a holdup in investment activities in Map Ta Phut, and a possible delay in government budget disbursement represent the major risks to output growth. Economic activity is expected to be well maintained in 2011, driven by private consumption and exports, despite the waning effects of fiscal stimulus. At the same time private investment is expected to resume a stronger pace of expansion, provided that the Map Ta Phut injunction is resolved.

Details of forecasts of GDP components are as follows.

Private consumption will grow in 2010 at a faster rate than previously estimated and will carry momentum into 2011.

Private consumption will grow in 2010 slightly more than the previous estimate in accordance with improved employment prospects and stronger consumer confidence. Moreover, government transfers to households, which are part of the fiscal stimulus package, and accommodative monetary policy will also

lend support to consumption growth in this year and the next.

Private investment is poised to rise at a more solid pace in 2010 compared with the previous year and relative to the previous forecast. This is in line with a recovery in the export sector, a gradual rise in industrial capacity utilization, improvement in business sentiment following better prospects of economic recovery, and low levels of interest rates.

Private investment continues to recover in 2010 and 2011.

Government spending should provide a softened stimulus in 2010, as parts of the funds previously earmarked for public investment in the second stimulus package have now been reclassified as public consumption expenditure and transfers to municipal authorities (which do not necessarily result in immediate outlays). Nonetheless, the total direct government outlays are likely to rise in 2011 in line with an increase in revenues following economic recovery.

Impetus from fiscal policy is reduced in 2010 but expected to be stronger in 2011.

Exports of goods and services will continue to grow in 2010 and 2011 as a result of recovering overseas demand. Both exports of goods – in particular, electronics and automobiles and parts – and the tourism industry will continue to recover.

Exports of goods and services will expand in 2010 and 2011 at a higher rate than the pre-crisis period.

Imports of goods and services will expand at a solid pace in 2010 and 2011 in tandem with a pickup in exports and private domestic demand. However, rising oil and non-fuel commodity prices will work to soften the pace to some extent in 2011.

Imports of goods and services will accelerate in 2010 and 2011.

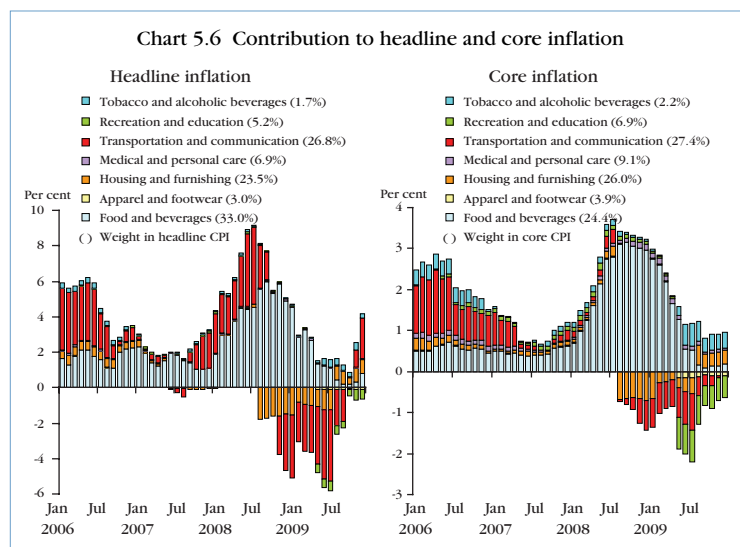
With imports accelerating more sharply than exports in 2010 and 2011, the MPC projects the current account surplus (including reinvested earnings) to decline slightly from the level seen in 2009.

Inflation projection

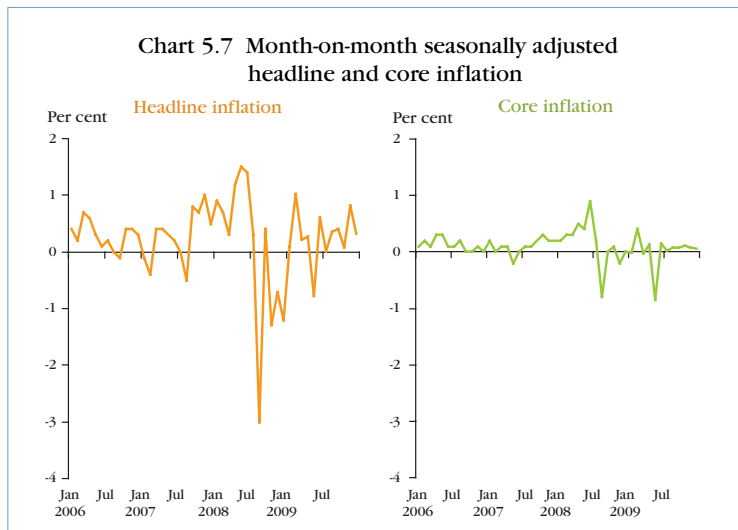
Headline and core inflation outturns for 2009 Q4 were as anticipated. While core inflation rose slightly from the previous quarter, headline inflation jumped owing importantly to a surge in crude oil prices and also in line with a rise in core inflation.

Core and headline inflation will be lower than the previous projection throughout the entire forecast horizon.

Readings on core and headline inflation in 2010 will be somewhat lower than previously projected. The extension of the government's cost-of-living reduction measures until the end of March 2010 and of the Ministry of Energy's fuel price administration until August 2010, together with lower-than-expected agricultural prices, contribute to a decline in inflation. Core and headline inflation will rise slightly in 2011 in conjunction with increasing domestic demand and higher oil and agricultural prices following a global economic recovery. However, inflation pressures will be reduced partly by the appreciation of the baht against the US dollar that is in line with movements in regional currencies.



Source: Trade and Economic Index Bureau, Ministry of Commerce, calculation by the Bank of Thailand



Source: Calculations by the Bank of Thailand

Assessment of risks

The MPC judges that output and inflation projections based on the above forecast assumptions and the constant interest rate assumption are most likely. However, there remain risks which can bring about deviations from the baseline projection. Important risk factors are as follows.

Risk factors in the output projection

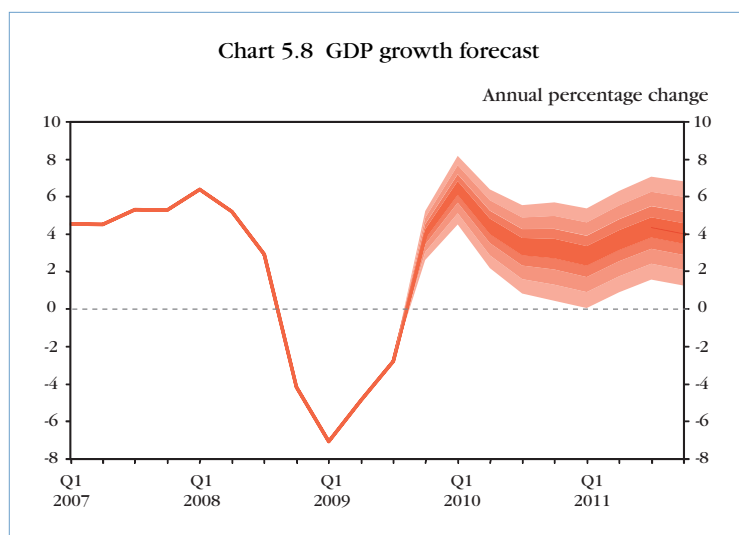
A major external risk factor that can affect output expansion is a delayed recovery of trading partner economies as the effects of fiscal stimulus in the US and Europe start to wane, while demand has yet to fully recover as a result of elevated unemployment. A sluggish global recovery will affect Thai exports which in turn have repercussions for domestic consumption and investment.

Domestic adverse risk factors are twofold. A possible delay to budget disbursement has the potential to reduce impetus behind the ongoing

economic recovery. In addition, a prolonged resolution of the Map Ta Phut suspension not only affects investment and production activities of industrial projects in the area but also indirectly puts a strain on broader investor sentiment, employment, related industries, as well as macroeconomic and financial stability.

An important upside risk to the baseline forecast is that trading partner economies may recover faster than expected given continuous and effective stimulus measures in various countries, which will help Thai exports to expand more briskly than expected.

The fan chart for GDP growth is skewed downward but to a lesser extent relative to the previous Report.



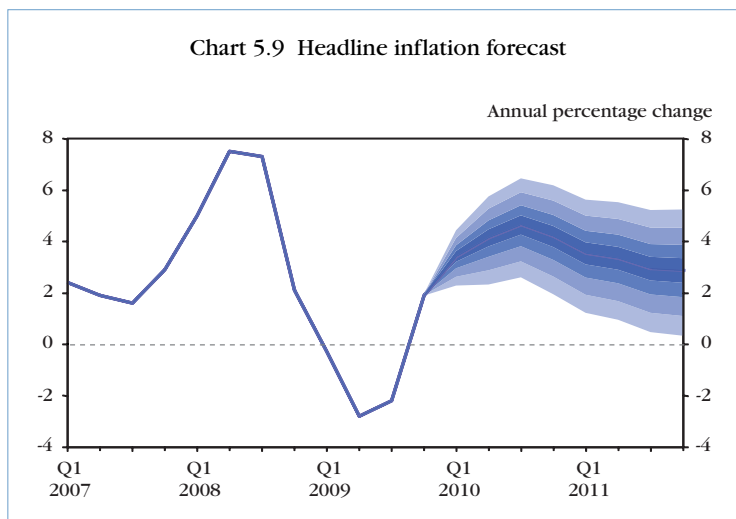
Note: The fan chart covers 90 per cent of the probability distribution

Overall, the MPC judges that uncertainty surrounding the forecasts remains high. Although the balance of risks is tilted to the downside, compared with the forecast in the previous *Report*, negative risks have now moderated. Consequently, over the entire forecast horizon, the fan chart for economic growth is skewed downward but to a lesser extent relative to the previous forecast.

Risk factors in the inflation projection

A major risk factor that can cause inflation to deviate from the baseline projection is oil prices. In a high case the MPC assumes that the Dubai oil price, when averaged over the forecast horizon, will be above the base case scenario by half a standard deviation of implied volatilities reflected in prices of traded option contracts, corresponding to 92.5 and 105.6 US dollars per barrel for 2010 and 2011, respectively. The low-case oil price is below the base case by half a standard deviation, amounting to 70.0 and 69.4 US dollars per barrel in 2010 and 2011, respectively.

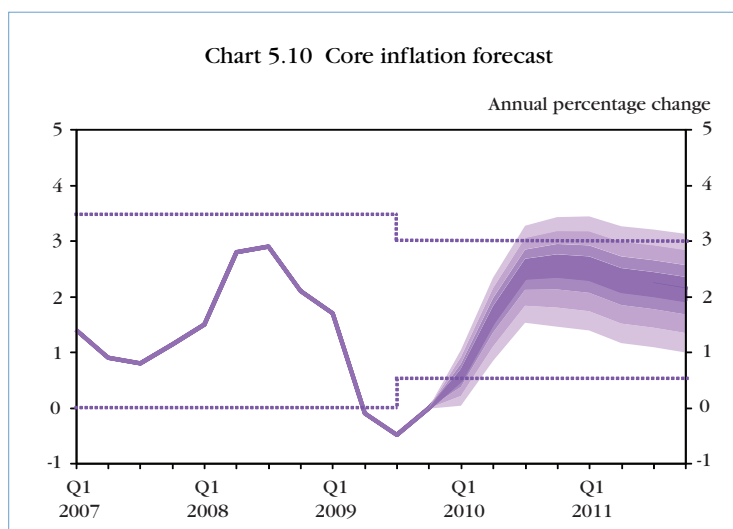
Other factors that may cause inflation to be below the baseline projection include a further extension of certain cost-of-living subsidies beyond March 2010, which will depress readings on CPI inflation in 2010. In addition, demand pressures may be held down during the nascent stage of economic recovery.



Note: The fan chart covers 90 per cent of the probability distribution

The fan charts for headline and core inflation are skewed downward slightly throughout the projection period.

Chart 5.10 Core inflation forecast



Note: The fan chart covers 90 per cent of the probability distribution

Overall, the MPC judges that the downside risks to inflation dominate the upside risks. The fan charts for headline and core inflation thus are skewed downward over the entire forecast horizon and are consistent with the fan chart for output growth.

Table 5.1 Probability distribution of GDP forecast

Unit %	2009	2010				2011			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
> 8	0	7	0	0	0	0	0	1	1
7 - 8	0	22	1	0	0	0	1	4	3
6 - 7	0	34	7	2	2	2	5	10	8
5 - 6	8	25	21	8	8	6	13	19	16
4 - 5	38	10	30	19	17	14	21	23	22
3 - 4	40	2	24	27	24	22	24	21	22
2 - 3	12	0	12	23	22	24	19	13	16
1 - 2	1	0	4	14	15	18	11	6	8
0 - 1	0	0	1	5	7	10	4	2	3
(-1) - 0	0	0	0	1	3	4	1	0	1
< (-1)	0	0	0	0	1	1	0	0	0

With regard to the probability distribution of the forecast for each of the two years, which is obtained by averaging the fan chart's darkest forecast ranges over the four quarters, the MPC projects output growth to be in the ranges of 3.3-5.3 per cent, unchanged from the previous *Report*, with probability of 84.3 per cent. For 2011, output growth is projected be in the range of 2.8-4.8 per cent, with probability of 76.4 per cent.

Output growth for 2010 and 2011 is projected to be in the ranges of 3.3-5.3 and 2.8-4.8 per cent, respectively.

Headline inflation in 2010 is projected to average within the range of 3.0-5.0 per cent, lower than the previous *Report's* projection of 3.5-5.5 per cent, with probability of 93.2 per cent. In 2011 headline inflation is to average within the range of 2.0-4.0 per cent with probability of 82.9 per cent.

Headline inflation for 2010 and 2011 is projected to be in the ranges of 3.0-5.0 and 2.0-4.0 per cent, respectively.

Unit %	2010				2011			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
> 7	0	0	2	1	0	0	0	0
6 - 7	0	3	9	5	2	2	1	1
5 - 6	1	15	25	17	9	8	5	5
4 - 5	16	34	32	29	22	19	15	14
3 - 4	54	31	22	26	29	28	25	24
2 - 3	27	14	8	15	22	24	26	25
1 - 2	3	3	2	5	11	13	17	18
0 - 1	0	0	0	1	3	5	8	9
< 0	0	0	0	0	1	1	3	3

The MPC assesses core inflation in 2010 to be in the range of 1.3-2.3 per cent, slightly lower than the previous projection, with probability of 94.1 per cent. For 2011 core inflation is projected to average within the range of 1.8-2.8 per cent with probability of 86.7 per cent.

Core inflation for 2010 and 2011 is projected to be in the ranges of 1.3-2.3 and 1.8-2.8 per cent, respectively.

Unit %	2010				2011			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
> 3.5	0	0	2	4	4	2	2	1
3.0 - 3.5	0	0	12	15	14	9	8	6
2.5 - 3.0	0	2	32	30	28	23	21	19
2.0 - 2.5	0	18	32	28	28	30	30	29
1.5 - 2.0	0	40	17	16	17	22	23	25
1.0 - 1.5	7	29	5	6	6	10	12	14
0.5 - 1.0	51	10	1	1	2	3	4	5
0.0 - 0.5	38	1	0	0	0	1	1	1
< 0.0	5	0	0	0	0	0	0	0

Forecasts by research houses

Forecasts of output growth for 2010 from various research houses average at 3.7 per cent, higher than the previous average forecast. For 2011, the Thai economy is expected to expand at 4.7 per cent.

	(13 Oct 09) ^{1/}		(12 Jan 10) ^{2/}	
	2009	2010	2010	2011
Capital Nomura	-3.7	3.5	3.0	5.0
Kasikorn Research	-3.7	3.0	3.0	4.0
Standard Chartered	-3.5	2.8	2.8	4.5
ING	-3.5	4.0	4.0	5.0
Citigroup	-4.6	2.7	4.2	5.0
DBS Bank	-3.2	4.0	4.2	4.4
HSBC	-2.8	4.5	4.6	4.7
Average	-3.6	3.5	3.7	4.7
NESDB	(-3.5)-(-3.0) ^{3/}	n.a.	(3.0)-(4.0) ^{4/}	n.a.

^{1/} Data by Reuters; calculation of average figures by the Bank of Thailand.

^{2/} Data and calculation of average figures by the Bank of Thailand.

^{3/} Estimated on 24 August 2009 when GDP figures for 2009 Q2 were released.

^{4/} Estimated on 23 November 2009 when GDP figures for 2009 Q3 were released

Headline inflation for 2010 is projected to be 2.9 per cent, higher than the previous average forecast at 2.7 percent. Projected headline inflation for 2011 is 3.1 per cent.

Table 5.5 Headline inflation forecasts by various research houses				
	(13 Oct 09) ^{1/}		(12 Jan 10) ^{2/}	
	2009	2010	2010	2011
Capital Nomura	-0.9	2.7	2.7	3.3
Kasikorn Research	-0.8	4.0	3.5	3.3
Standard Chartered	0.2	3.2	3.2	3.7
ING	-1.1	1.5	2.5	3.0
Citigroup	-0.9	2.7	2.5	3.5
DBS Bank	-1.1	2.1	2.9	1.5
HSBC	-1.0	2.6	3.0	3.3
Average	-0.8	2.7	2.9	3.1
NESDB	(-1.0)-(-0.5) ^{3/}	n.a.	(2.5)-(3.5) ^{4/}	n.a.

^{1/} Data by Reuters; calculation of average figures by the Bank of Thailand.

^{2/} Data and calculation of average figures by the Bank of Thailand.


^{3/} Estimated on 24 August 2009 when GDP figures for 2009 Q2 were released.

^{4/} Estimated on 23 November 2009 when GDP figures for 2009 Q3 were released.

6. Conclusion

The Thai economy shows signs of continued expansion since 2009 Q3 on the back of (1) the stronger-than-anticipated global recovery and (2) continued support from both monetary and fiscal policies. The recovery is becoming increasingly broad-based, spanning the export-driven manufacturing sectors such as electronics and hard disk drives, as well as the domestic-oriented industries such as automobiles, beverages, and petrochemicals. In addition, tourism revenue improves while farm income edges up in line with world crop prices. The recovery of the real sector has lent support to the labour market, pushing employment near the pre-crisis level, which in turn helps shore up consumer confidence and provide a boost to private spending in durable goods such as automobiles and motorcycles. In general, recent encouraging developments point towards a clearer prospect for an economic recovery going forward.

The MPC expects the Thai economy to continue to expand. The Thai economy in 2009 would contract less than anticipated in the previous *Report*, while the economic growth in 2010 and 2011 is likely to be close to the previous projection. Price pressures should rise slightly, in tandem with the economic recovery, but core inflation will continue to be within the target range. The MPC judges that the policy interest rate of 1.25 per cent per annum is currently appropriate and will continue to aid the process of economic recovery.



Therefore, the MPC decided to maintain the policy interest rate at 1.25 per cent per annum at the meetings on 2 December 2009 and on 13 January 2010.

Nevertheless, the recovery of the Thai economy is still in an early stage and fragility remains. Three important risk factors are: (1) the potentially delayed recovery in the trading partners' economies, (2) the inability of the government to disburse the budget as promptly as planned, and (3) the uncertainty surrounding the problems in the Map Ta Phut area, which could adversely affect business sentiments and interrupt the rebound of private investment. Going forward, the key challenge to policymakers therefore will be to promote a sustainable recovery and to foster a swift rebound in private consumption and investment before the role of government stimulus recedes. The MPC will continue to monitor closely the uncertainty surrounding both domestic and external economic conditions.

*Report: “Economic/Business Information Exchange Programme
between the Bank of Thailand and the Business Sector”*

As of 30 December 2009

Overall summary

From the Economic/Business Information Exchange Programme between the Bank of Thailand and 200 business firms throughout the country during 2009 Q4^{1/}, it was revealed that overall business conditions improved from the previous quarter, on the back of higher production due to increased order books from both domestic and foreign markets. Private consumption improved noticeably, reflected by increased consumption expenditures on durable goods. Meanwhile, private investment was mostly concentrated in machinery replacement and efficiency improvement. Looking ahead, businesses perceived that overall business conditions would continue to improve in line with the global economic recovery. Fiscal stimulus packages would continue to play an active role in supporting the economy. Nonetheless, uncertainties in economic conditions, difficulties in price adjustments, and domestic political instability remained risk factors to the economic recovery.

- **Private Consumption.** Private consumption showed clearer signs of recovery relative to the previous quarter, stemming from an increase in personal consumption expenditures in durable goods, e.g., cars and electrical appliances. Among supporting factors were improved income and consumer confidence, a better overall prospect of the economic recovery, and marketing promotions, such as Motor Exposition, and launches of new car models. Consumption of necessity goods also continued to expand from the previous quarter.
- **Private Investment.** Private investment increased continuously from the previous quarter, partly from the rebound of the electronics industry as well as the vehicles and parts industry. The largest contribution to investment was concentrated in machinery replacement and efficiency improvement rather than in capacity expansion. The new investment decision was largely based on the outlook for demand, current capacity utilization, and the breakeven point. In the period ahead, risks to private investment recovery include those affecting production costs, continuity of new orders, the resolution of problems in the Map Ta Phut area, and domestic political instability.
- **Production and Exports.** Production and exports improved from the previous quarter, owing to an increase in order books from both domestic and foreign markets. The improvement was largely driven by final demand rather than inventory build-up. Fiscal stimulus packages in many countries, especially in the emerging markets, as well as a seasonal pickup in demand during year-end contributed to the production expansion. Consequently, this led to an increase in the capacity utilization rate in export-oriented industries, e.g., electronics and electrical appliances in 2009 Q4.
- **Employment.** Employment conditions remained stable compared to the previous quarter, as shown by unchanged numbers of employed persons and average overtime working hours. Wage rate was stable and close to the pre-crisis level. Some industries, such as electronics, vehicles and construction, reported shortages of skilled labour, with some migrating to other sectors such as agricultural and services.
- **Costs and Prices.** Businesses incurred higher production costs, given rises in commodity and oil prices following the global economic recovery. Despite higher cost pressure, an increased competition among businesses kept the overall price level unchanged, compared to the previous quarter, resulting in a decline in profit margins for businesses.
- **Credit Conditions.** Corporate demand for credit, from both large corporations and SMEs, increased slightly from the previous quarter, owing to the economic recovery and fiscal stimulus packages. In addition, most of the businesses reported that they had sufficient access to credits from financial institutions. Meanwhile, the credit standards for corporate loans remained unchanged from the previous quarter. It was notable that an expansion of overall private credits in this quarter was due mainly to the household sector, especially from mortgage and car leasing credits.
- **Business Constraints and Risk Factors.** Uncertainties in economic conditions, difficulties in price adjustments resulting from high competition in both domestic and foreign markets, and domestic political instability which could potentially interrupt the continuity of government stimulus package, remained the key business concerns and risk factors to the economic recovery in the period ahead.

^{1/} Including responses from the business sentiment survey (about 520 business firms per month).