

Economic Performance in Q2/2005 and Outlook for 2005

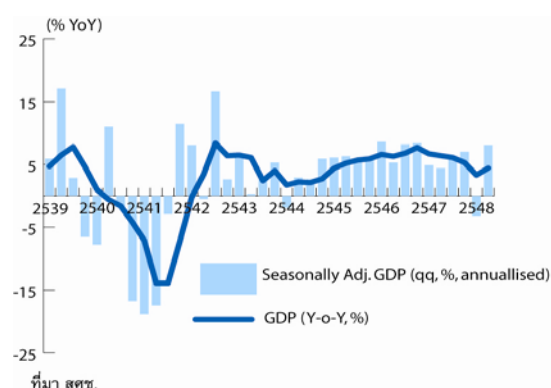
ECONOMIC OUTLOOK

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- Thai economy appears to have bottomed out in the first quarter of 2005, and real GDP growth picked up to 4.4 percent in the second quarter, higher than 3.3 percent in the first quarter. The turnaround was underpinned by a number of factors including the alleviated drought impacts on agricultural products, the pickup in the tourism sector as well as increasing industrial production following improvements in exports, particularly in food and electronics products.
- In all, the economy grew by 3.9 percent in the first half of 2005, exceeding market expectation, notwithstanding the negative effects from oil price surges, a drought situation, Tsunami impacts, and unrest in 3 southernmost provinces.
- The economy is expected to improve in the second half due to continued exports expansion, the further recovery of the tourism sector, and the government economic stabilization measures for the latter half of the year.
- In 2005, the annual growth is projected in the range of 3.8-4.3 percent with 4.0-4.4 percent inflation, current account deficit of 1.9-2.4 percent to GDP and average unemployment rate of 2.1 percent.

OVERVIEW

Thai economy appears to have bottomed out in the first quarter of 2005



In 2005, economic growth is projected to be in a range of 3.8-4.3 percent while pressure on inflation and current account is increasing due to surges in oil price.



Key Themes of 2005

- In the second quarter of 2005, Thai economy grew by 4.4 percent, higher than 3.3 percent in the first quarter. This is underpinned by a number of factors including the alleviated drought impacts on agricultural products, the pickup in the tourism sector and increasing industrial production following improvements in exports, particularly in food and electronics products.
- In all, the economy grew by 3.9 percent in the first half of 2005, exceeding market expectation, notwithstanding the negative effects from higher oil price, a drought situation, Tsunami impacts and unrest in 3 southernmost provinces.
- Inflationary pressures continued to increase. In the first half of the year, inflation rate averaged at 3.3 percent, and reaching 2.8 percent in the first quarter and up to 3.7 percent in the second quarter. Producer prices and consumer prices in non-food items which significantly climbed up since the latter half of 2004 have passed-through the effect of oil prices to core inflation—the monetary policy target. In the first half of 2005, core inflation stood at 0.9 percent, rising from 0.6 percent in the second half of 2004 to 0.7 and 1.1 percent in the first and second quarter of 2005.
- Exports continued to perform well, especially in shrimps and fowls as problems have been eased. In addition, electronics exports recovery was seen in the high exports of computer and components. This is supported by the seemingly turnaround in the world electronics cycle, reflected in the picking up of book to bill ratio of world electronics goods. Export value in US dollar term increased by 12.4 percent in the first half of the year.
- Imports growth, however, has surpassed that of exports. With high growth rate of 42 percent of crude oil price, imports of fuel items increased by 80 percent in the first half

and shared 18 percent of total imports. Production activities, both export-oriented and domestic-oriented industries, still expanded well. It was then expected that some raw materials' prices, particularly iron and gold, would increase further, imports of raw materials, thus, rose substantially by 31 percent in the expectation of high prices. Moreover, in line with investment momentum, imports of capital goods grew by 20.2 percent. In sum, import value increased by 31.2 percent in the first half, with 28.5 and 33.7 percent in the first and the second quarter respectively.

- Trade balance registered a deficit of 8,464 million US dollar or around 209.9 billion baht in the first half of 2005.
- Tourism sector has recovered from the Tsunami. Tourism revenue remained a contributing factor for services, income and transfers account surplus. In the second quarter of 2005, the number of foreign tourists increased by 1.9 percent, recovering evidently compared with a negative growth rate of 9.2 percent in the first quarter. In the first half, tourism account recorded a surplus of 2,413 million US dollar, whereas income account¹ registered a deficit of 1,723 million US dollar, due to high profit and dividend remittances by foreign investors. As a result, net services, income and transfers account registered a surplus of only 2,255 million US dollar which could not offset the trade account deficit. Therefore, current account registered a total deficit of 6,207 million US dollar following a deficit of 1,500 million US dollar in the first quarter and a deficit of 4,710 million US dollar in the second quarter.
- The economy is expected to improve in the second half of 2005 due to (1) continued exports expansion, particularly in food, electronics, rubber and other household goods such as soap and cosmetics products (2) effective imports management which

would help decelerating imports (3) the recovery of the tourism sector which results in continued surplus in service account.

- In addition, the government economic stabilization measures will support continued economic expansion and stability in the latter half of the year. Key measures include accelerating government budget disbursement, allocating budget under SML schemes, raising minimum wages and salaries, promoting the use of NGV, floating domestic diesel price and establishing the Fix it centers² for 2,000 villages pilot project which will help extend lifespan of machineries and tools and thus reducing imports.
- In 2005, the annual growth is projected in the range of 3.8-4.3 percent with 4.0-4.4 percent inflation, current account deficit of 1.9-2.4 percent to GDP and average unemployment rate of 2.1 percent.

¹ Net income of Thai employees working aboard, profit and returns on investment and interest payment.

² With the center, expenditure of the people both in the farm sector and outside can be reduced, while their tools and machinery have a longer lifespan through good maintenance and repairing services; also farmers and non-farmers are more informed about the effective use of machine tools.

1. ECONOMIC PERFORMANCE IN Q2/2005: GREW BY 4.4 PERCENT

World Economy
(Y-O-Y growth rate, %)

	2545	2546	2547				2547	2548		2548	2548
			Q1	Q2	Q3	Q4	Year	Q1	Q2	June	Sept
World	3.0	4.0					4.7			3.4	3.2
US	1.9	3.0	5.0	4.8	4.0	3.9	4.4	3.6	3.6	3.6	3.4
EU-15	1.0	0.7	1.8	2.3	2.1	1.8	2.2	1.5	1.3		
EU-25 ^{1/}	1.1	1.0	1.9	2.4	2.2	1.9	2.3	1.6	1.3	2.0	2.0
Euro Zone	0.8	0.5	1.5	2.1	1.8	1.5	2.0	1.4	1.2	1.1	1.1
Japan	-0.3	1.4	4.5	3.2	2.6	0.6	2.7	1.3	1.4	0.8	0.8
Hong Kong	2.3	3.3	7.0	12.1	6.8	7.1	8.1	6.2	6.8	4.0	4.8
Singapore	3.2	1.4	7.9	12.3	7.2	6.5	8.4	2.7	5.2	4.0	3.5
South Korea	7.0	3.1	5.3	5.5	4.7	3.3	4.7	2.7	3.3	4.0	3.3
Taiwan	3.6	3.3	6.7	7.9	5.3	3.3	5.7	2.5	3.0	4.0	3.8
Indonesia	4.4	4.9	4.4	4.4	5.1	6.7	5.1	6.2	5.5	5.5	5.5
Philippines	4.4	4.5	6.5	6.6	6.3	5.4	6.1	4.6	4.8	4.7	4.5
Malaysia	4.1	5.2	7.8	8.2	6.7	5.8	7.1	5.8	4.1	6.0	5.0
China	8.3	9.3	9.8	9.6	9.1	9.5	9.4	9.4	9.6	8.5	9.0

Source: Government agencies, WEO (April 2005) and average from several sources.

1.1 World economy: grew at a slightly faster pace than in the first quarter but at a slower pace than in 2004

The world economy in the second quarter is on a steady trend. The economic growth of **South East Asia and US** has been steady as private consumption and investment contributed to economic growth. **The Japanese economy** continued to recover, supported by improved domestic demand, both private consumption and investment. **The European economy** remain subdued. For the Asian economy, **Indonesia and Malaysia economy** showed a sign of slowdown, caused by the moderate growth in private consumption and the reduction/abolishment of fuel subsidies. **The Chinese economy** enjoys a robust growth of 9.6 percent in line with a strong expansion in fixed investment and manufacturing. **The NIEs economy** (including Singapore Hong Kong, South Korea and Taiwan) grew at a faster rate. Hong Kong has benefited from the strong growth in the Chinese economy and Singapore has benefited from a rising trend in oil export. In sum, the world economy grew at slightly more than the growth rate in the first quarter but at a slower pace than 2004.

The second quarter is the period where major countries experienced worsen trade deficits or a moderating trade balance surplus as a result of a slowdown in export and a surge value of import, contributed primarily by petroleum. In the second quarter of 2005, the US trade deficit sunk to the lowest level in the past ten year at 186.3 billion dollar. This is underpinned by soaring imports even though the export showed sign of recovery. On the other hand, China and Singapore registered rising trade surplus from high growth in export values and Singapore's export grew faster from oil price hike

In all, world inflation was not at a considerably high level, even though crude prices increased significantly. This has been such a case in developed countries due to mainly to productivity improvement, intense competition of low price products from China and India as well as other Asian economies, and in part to the economic slowdown.

Trade Balance in Selected Countries
(Billion U.S. dollars)

	2004				2004	2005	
	Q1	Q2	Q3	Q4	Year	Q1	Q2
The U.S.	-139.3	-162.4	-178.6	-185.2	-665.4	-169.8	-186.3
Japan	33.2	34.1	32.4	32.5	132.2	26.2	24.8
Singapore	3.34	3.81	4.08	4.87	16.10	3.35	3.99
S.Korea	6.5	8.71	6.93	7.25	29.38	6.27	6.25
Indonesia	4.84	6.04	7.06	7.13	25.06	6.3	5.91
Philippines	-0.54	-0.61	-0.11	0.65	-0.62	0.12	-1.39
Malaysia	5.05	4.78	5.98	5.42	21.22	6.58	6.01
China	-8.4	1.7	11.5	28.1	32.8	16.6	23.3

Source: CEIC

Inflation Rate in Selected Countries
(%, y-o-y)

	2003	2004	2004				2005	
	Year	Year	Q1	Q2	Q3	Q4	Q1	Q2
The U.S.	2.3	2.7	1.8	2.9	2.7	3.3	3.0	2.9
EU-15	1.95	1.95	1.63	2.07	2.0	2.11	1.93	2.05
Japan	-0.25	0.00	-0.1	-0.31	-0.1	0.51	-0.2	-0.1
Singapore	0.49	1.67	1.23	1.89	1.91	1.66	0.26	0.06
S.Korea	3.5	3.5	3.25	3.41	4.33	3.37	3.15	2.98
Indonesia	6.8	6.1	4.8	6.4	6.7	6.3	7.8	7.6
Philippines	3.5	6.0	4.1	4.7	6.9	8.1	8.5	8.2
Malaysia	1.1	1.4	0.9	1.2	1.4	2.1	2.5	3.0
China	1.2	3.9	2.8	4.4	5.3	3.2	2.8	1.7

Source: CEIC

Concurrently, excess capacity in the world market also helps ease pressure on inflation. Meanwhile South East Asia countries who just abandoned oil price subsidization face higher pressure on prices.

Inflation in the EU slightly marked up from 1.9 percent in the first quarter to 2.1 percent in the second quarter, slightly exceeding the target rate of 2.0 percent of the EU central bank. This was accompanied by higher prices of oil, housing and transportation. Inflation in South Korea, the US and China continued to slow down, remaining at 3.0, 2.9 and 1.7 percent respectively, owing to a slowdown in agricultural prices in South Korea, housing prices in the US and food prices in China. In cases of Japan and Singapore, headline inflation remained low at -0.1 and 0.06 percent respectively, owing to the slowdown of public utilities prices in Japan and housing prices in Singapore.

However, headline inflation stayed high in Indonesia in which inflation rate in the second quarter was 7.6 percent, according to rising prices in foods, oil and transportation. In the Philippines, inflation rate was 8.2 percent since oil and service prices remained at high level. Meanwhile, inflation in Malaysia speeded up from 2.5 percent in the first quarter to 3.0 percent in the second quarter after abandoning oil price subsidization in May.

1.2 The Economic Performance in Q2/2005 and in the first half of 2005.

- **The Thai economy expanded by 4.4 percent** in the second quarter, slightly accelerating from 3.3 percent growth in the first quarter. Compared with the first quarter, GDP grew by 2.0 percent (%qoq) from the first quarter (annualized rate of 8.1 percent). Economic growth has reached the bottom in the first quarter and is expected to accelerate in the latter half as the impact of drought on agricultural production has been mitigated. Tourism is on the rising trend as number of tourists started to pick up. The manufacturing production expanded at a faster rate as the export condition improved, especially in food and electronics industry.

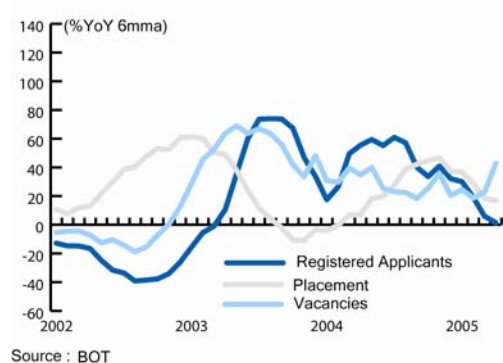
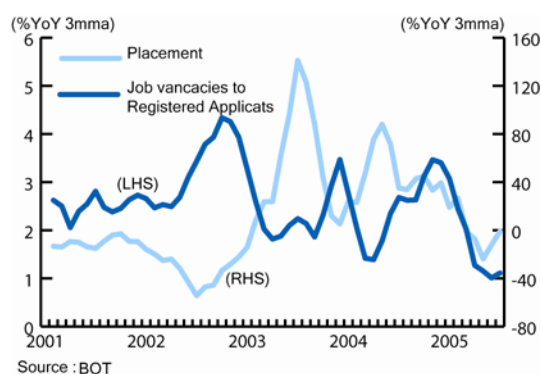
	2004			2005		
	Year	H1	H2	Q1	Q2	H1
Agriculture	-3.9	-3.7	-4.0	-7.9	-2.3	-5.4
Non-agriculture	7.2	7.7	6.8	4.6	5.0	4.8
Industry	8.4	8.8	8.0	3.5	6.4	5.0
Hotel and restaurants	12.2	13.6	10.9	-2.0	2.9	0.5
(No.of foreign tourists)	16.5	28.2	7.6	-9.2	1.9	-4.1
Services and Others	6.0	6.5	5.5	7.4	4.1	5.0
GDP	6.1	6.6	5.7	3.3	4.4	3.9

Source: NESDB

- **Overall, the economy expanded by 3.9 percent** in the first half of 2005, better than expectation from the forecasts by various research houses although the economy is affected by the sharp increase in oil price (The Dubai price averaged at 31.4 U.S. dollars per barrel in the first half of 2003. It increased to 44.6 U.S. dollars per barrel in the first half of 2004). Moreover, drought, Tsunami, and the unrest in the three southern provinces are negative factors to the economy.
- **Domestic demand was the main contribution of economic growth in the first half of 2005.** Particularly, the private consumption and investment continued to expand at a satisfactory rate since the first quarter. Private consumption and investment grew by 4.6 percent and 11.7 percent respectively in the first quarter. In the second quarter, the private consumption and investment increased steadily by 4.7 and 12.3 percent respectively. The public investment and consumption increased by 24.4 and 12.5 percent respectively in the first half.
- **Export has shown vital signs of recovery.** The problem of shrimp and chicken exports has been mitigated. The average F.O.B. price per kilograms of ribbed smoked sheet No. 3 was 69.85 and 66.72 Baht in July and August respectively, increasing from the same month last year by 32.8 and 29.2 percent respectively. Electronics sector exports are also expected to improve, particularly in computer and parts. In the first half of 2005 the value of total export in dollar term grew by 12.4 percent.
- **Import accelerated at the faster rate than exports**, leading to a rising deficit in the trade balance. Import value grew substantially by 31.2 percent, mostly from raw material, fuels and capital goods. The import of intermediate and raw materials for export goods production and domestic demand expanded by 31 percent. Import of capital goods increased by 20.2 percent in tandem with the continuing expansion of investment. Import of fuel surged by 80 percent due to a higher oil price. Trade balance registered a deficit of 3.2 billion dollar in the first quarter and experienced a rising deficit to 5.2 billion dollar in the second quarter, accumulating to 8.5 billion dollar in the first half of 2005.
- **In the second quarter, the services, net income and transfers account recorded a surplus of 2,225 million US dollars;** however, it could not offset the sizable trade deficits. The surplus was mostly from tourism revenue although the net income account registered a rising deficits as the remittance of operating profit of the private sector increased. The travel account registered a surplus of 2,413 million dollar whereas the net income account recorded a

deficit of 1,723 million dollar as the remittance of operating profits/return on investment of continued to increase by 39.6 percent from second quarter of 2004 to 2,539 million dollar.

- In the first half of 2005, the current account recorded a deficit of 6.2 billion dollar with the deficit of 1,500 billion dollar in the first quarter and rose to 4,710 billion dollar in the second quarter.
- **Production expanded at a faster rate in many sectors**, particularly in manufacturing sector. Manufacturing sector expanded by 6.4 percent, accelerating from 3.5 percent in the previous quarter. The acceleration was due to growth in the production of food and beverage, electronics and electrical appliances, and iron and steel following increased external and domestic demand. However, part of the increase in iron and steel productions was an accumulation in inventory. In the second quarter, **capacity utilization rate** of the manufacturing sector averaged at 70.6 per cent.
- **Employment conditions.** According to the labor force survey in June 2005, total labor force comprised of 35.05 million persons. The number of employment reached 35.88 million. The number of employment persons was 0.7 million persons, which was equivalent to 2.0 percent unemployment rate. The Northeast Region had the highest unemployment rate (2.7%). The unemployment rate in the central, southern, and northern region was 1.6, 1.5, and 1.3 respectively. Out of the total employment of 35.05 million persons, the employment in agricultural sector was 13.37 million, with a reduction of 71,000 persons. Employment in non-agriculture was 21.68 million persons, with an increase of 83,000 persons. In total, the number of employment increased by 12,000 persons, with a favorable expansion in hotel and restaurants, transportation, and real estate activities.



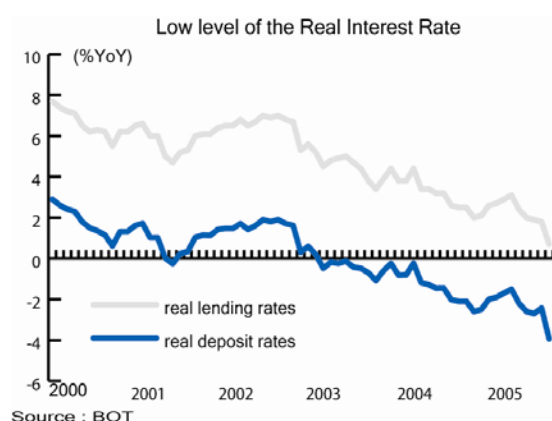
of job vacancies is approximately half of registered applicants, indicating that the unemployment rate will be on a steady trend. According to the statistics of job vacancies, registered applicants, and job placements, although registered applicants outpaced job vacancies, job placements slightly increased, reflecting the mismatch between labor demand and qualification of available labor.

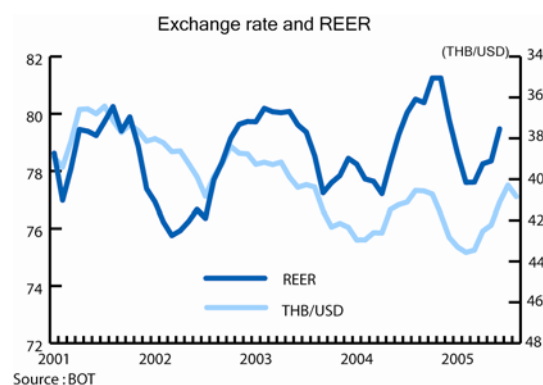
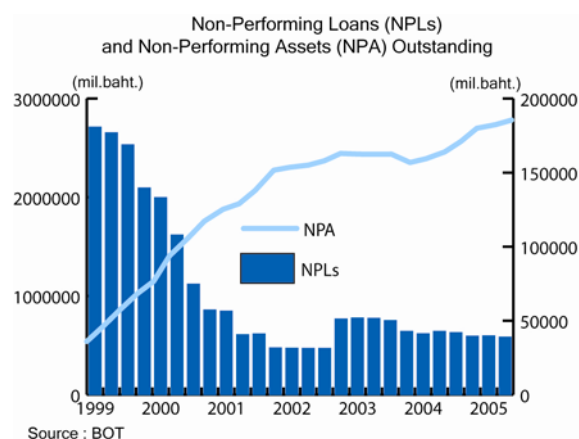
- **Financial situation:** increasing interest rate and declining excess liquidity

Interest rate in the money market is on an upward trend, and declining excess liquidity, credit expansion rate of commercial banks started to slow down.

In the second quarter of 2005, the excess liquidity in the commercial banks system declined. This helped the monetary transmission mechanism from the 14 day repurchase rate to market loan rate and the deposit rate to be more effective. As can be seen, five major commercial banks gradually lifted their loan and deposit rate of interests. However, a more rapid increase in the inflation rate than the interest rates has left the real interest rate in the negative zone and, to some extent, continued to stimulate the expenditure and the investment but not as strong and attractive as in 2004-2005. The expectation of higher interest rate somewhat helped mobilize savings and make people more cautious of credit borrowing. The financial institutions themselves shall be more careful in carrying out risk assessments during the upward trend of interest rate and the economic slowdown. As of June private credit outstanding of commercial banks increased by 5.2 percent, slowed down from 7.2 percent at the end of 2004.

On the corporate side, they have resorted more to the capital market to finance their business by offering more shares to public and issuing more debt instruments in the primary market. In this second quarter of





2005, initial public offering shares in the primary market increased by 36.5 percent, and corporate bonds issued in the primary market increased by 56.1 percent.

At the end of this second quarter, NPLs remained high at 10.33 percent of total credit outstanding in the financial system. Non-performing assets (NPAs) of commercial banks have also increased continuously and could be costly for banks.

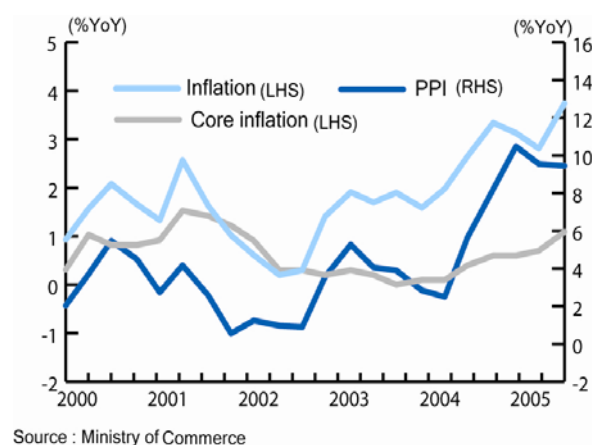
Stock market underperformed in the second quarter as compared to the first quarter, both in terms of trading volume and stock index. The stock index decreased to 675.50 points at the end of second quarter, lower than 681.49 at the end of the first quarter.

Weaker baht throughout the second quarter, as it moved between 39.18-41.27 baht/USD and averaged 40.04 baht/USD— weaker from the first quarter by 3.8 percent. The depreciation was due to worsening current account deficit, the concern over the economic slowdown and the net selling of foreign investors in the Thai stock market throughout April and May. Also, the state enterprises and oil importing companies demanded more US dollars following the higher oil price. The real effective exchange rate-- computed by comparing the baht to other currencies and adjusted by the relative domestic prices between countries, is, however, weaker by 0.4 percent in the first half of 2005. This was a likely factor which contributed 0.3 percent to the export volume in particular in electronic products which are price-elastic.

Recently, however, the baht turned stronger after the Chinese Yuan currency system had moved to a more flexible regime on July 21.

Fiscal Position in the first eight month of the fiscal year (October 2004-May 2005), budgetary balance registered a deficit

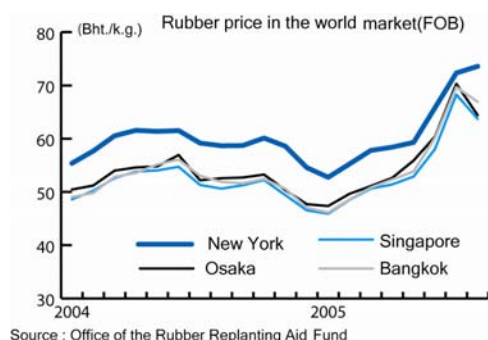
of 149,040 million baht, leading to a deficit in treasury cash balance of 106,347 million baht. **Public Debt** at the end of June 2005 stood at 3.21 trillion baht or equivalent to 44.62 percent of GDP, slightly increased from 3.13 trillion baht or 43.52 percent of GDP at the end of March 2005.



Headline inflation in the first half stood at 3.3 percent. It rose by 2.8 percent in the first quarter and surged to 3.7 percent in the second quarter. In the month of July, during which government controls on retail diesel prices were lifted, the **Consumer Price Index (CPI)** rose by 5.3 per cent year-on-year, and accelerated to 5.6 percent in April. High import prices and production price indexed induced a second round effect to core inflation, which is a target of monetary policy. **Core** inflation was at 0.6 percent in the first quarter. It accelerated to 1.2, 1.9, and 2.3 in the second quarter, July, and August respectively.

International reserves at the end of June 2005 were 48.352 billion dollar, equivalent to 3.4 times short-term external debts.

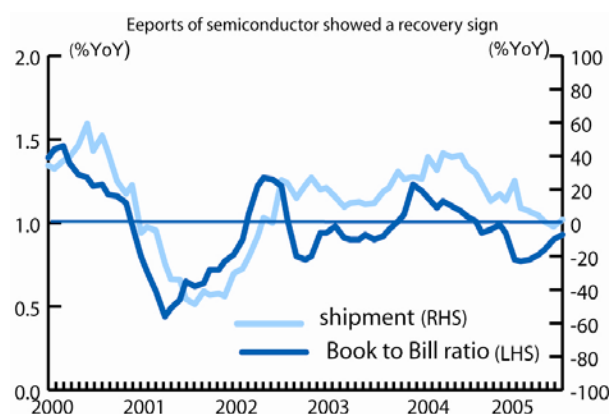
2. Economic Projection for 2005: 3.8-4.3 percent GDP growth, 4.0-4.4 percent headline inflation, and 1.9-2.4 percent current account deficit to GDP



Goods with a Favorable Export Trend in the Second Half

(%YoY)	2004			2005			
	Year	H1	H2	Q1	Q2	Jun	Jul
Rubber	23.1	24.0	22.1	-2.1	-6.7	-10.3	1.0
Frozen shrimp	-6.4	-8.9	-4.5	-12.1	32.6	42.4	66.5
Cooked/broiled chicken	36.9	8.2	63.2	89.2	38.7	33.0	32.0
Electronics	11.3	12.6	5.8	5.7	11.9	16.5	16.3
- Computer	13.6	10.6	13.5	21.2	35.2	41.4	23.6
- Integrated circuits	7.6	24.8	-9.2	-10.8	-3.7	5.2	27.1
Cosmetics soap and skin care products	16.0	14.1	17.4	18.2	23.5	45.3	30.7
Pharmaceutical products/ Medical tools	15.7	13.4	17.9	9.8	17.4	17.3	26.6

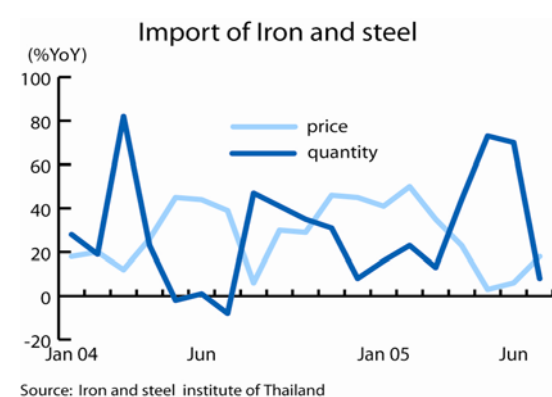
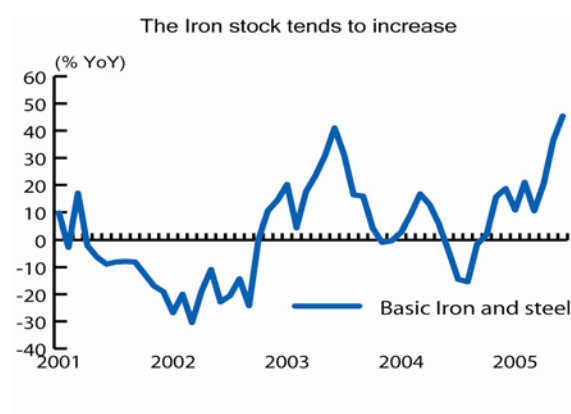
Source: Ministry of Commerce



Thai economy is expected to improve in the latter half of 2005: Economic growth has bottomed out in the first quarter and is expected to accelerate in the latter half. Positive factors expected to support the economic growth in the second half are as follows.

• Favorable conditions for exports

- 1) **Cooked/broiled chicken** was certified by the South Korea, Russia, and the European Union (EU). In addition, its export to EU has increased due to the bird flu outbreak in Brazil.
- 2) **Shrimp exports** is expected to increase after the European Union (EU) has agreed to temporarily bring down tariffs on shrimp exports from all countries, including Thailand under the Generalized System of Preferences (GSP). Import tariffs will drop from 12 percent to 4.2 percent for fresh Thai shrimp, and from 20 per cent to 7 per cent for prepared shrimp-without quota. This measure will apply retroactively from August 1 and run until December 31 before the new GSP scheme will then become effective on January 1, next year.
- 3) **Prices of agricultural export** are growing significantly. For example, the average rubber price per kilograms of ribbed smoked sheet No. 3 (F.O.B.) was 69.85 and 66.72 Baht in July and August respectively, increasing from the same month last year by 32.8 and 29.2 percent respectively.
- 4) **Electronic exports have shown an improving sign**, as the most recent months have seen increases in export of computer and parts.
- 5) **Other exports** specifically in the categories of household appliances, soap and cosmetics show a rising trend.



- Efficient management of imports** contributed to a moderate growth in imports. The three major import items that rose sharply in the first half were crude oil, steel, and gold, which accounted for 25 percent of total import value. These items are expected to ease in the latter half as the business has already planned to import crude oil during August to December 2005 of the amount not more than 850,000 Barrel per day.. From the manifest of clear plan, the volume of steel import during August to December will be not more than 1.3 million tons per month and the volume of gold import will be approximately at 6-7 ton per month. In addition, the high level of inventory indicates that the value of import will increase at a slower rate in the latter half of 2005. The latest figure shows that July import value grew by 22.4 per cent, slowing down from 31.4 per cent in the first half of the year.
- The recovery of tourisms has been on an increasing trend and the service account surplus is expected to continue.** In the first half of 2005, tourisms performed better and a further improvement is expected in the latter half because of government measures to stimulate tourisms. Travel industry showed signs of recovery as both the passenger and chartered airlines, starting with the Korean market are returning to Phuket, during August to November, the high season for Korean tourists. Many promotional measures in France, Singapore and Russian markets initiated by the Tourism Authority of Thailand (TAT) will also facilitate the recovery. In addition a

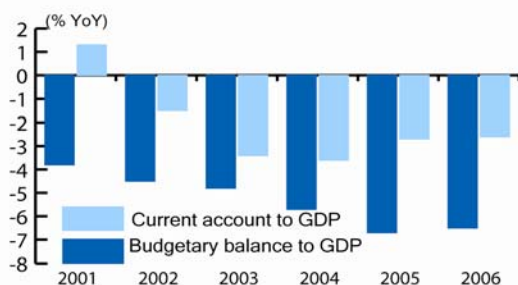
memorandum of understanding had been signed between TAT, the federation of Japan Tourism association and 13 travel agencies in Tokyo to attract more tourists from Japan from 1.1 million to 1.4 million, or 300,000 tourists increase within this year.

- **Economic Stimulus package is likely to support economic growth and stability in the latter half of the year.** Major measures are (1) an acceleration of government budget disbursement process (2) SML Fund to improve the capabilities of villages and rural communities. (3) a rise in labor wage, minimum wage and civil servants' salaries and (4) promoting more usage of NGV as an alternative source of energy, floating diesel price and establishing "Fix It Centers" across 2000 villages, which will extend lifespan of machinery tools and thus help reduce import expenses.

However, there remain downward risks that could affect the performance of Thai economy in the latter half of 2005. They are as follows:

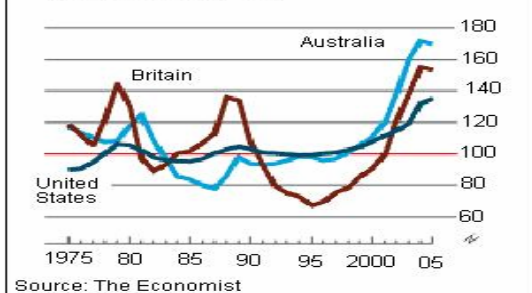
- **A slowdown in world economy** The problems of current account and budget deficits in US, and housing bubbles particularly in USA, Australia, and UK pose risks to the adjustments that could have taken place in the form of large and abrupt change in exchange rate and interest rate. This would inevitably and eventually harm Thai exports. In addition, in the Asia region, there are concerns on Indonesian economy as a result of high oil price and the increase in budgetary expenditures on fuel subsidies. Moreover, the incremental impact of the slowdown in US, Europe, and Japan to Asian economy remains a risk factor since these 3 markets are the major export markets of Asia-ex Japan.
- **A hike in Crude oil price** particularly after the Hurricane Katrina damaged pipelines in the Gulf of Mexico, refineries, and ports which affect the oil

High current account deficits and budget deficits in USA

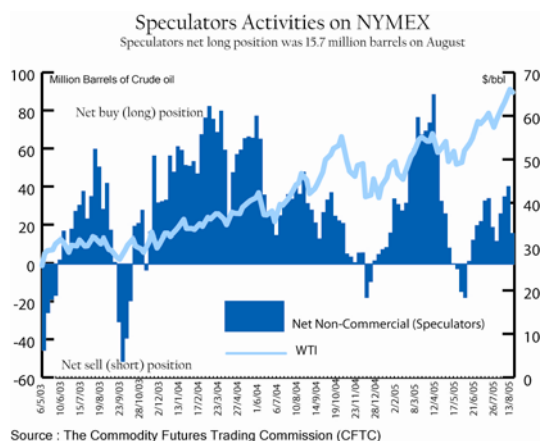


Source: Office of Management and Budget, USA

Ratio of house prices to rents
1975-2000 average=100

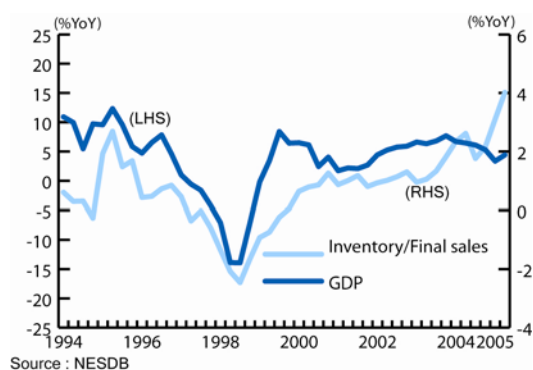
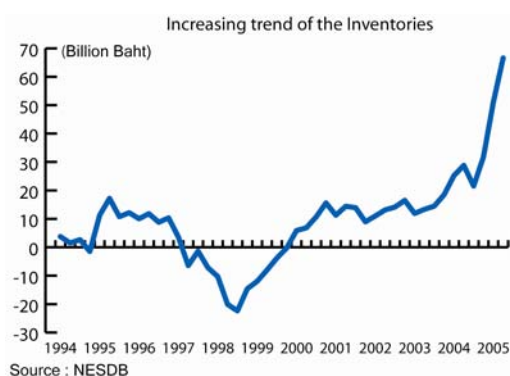


Source: The Economist



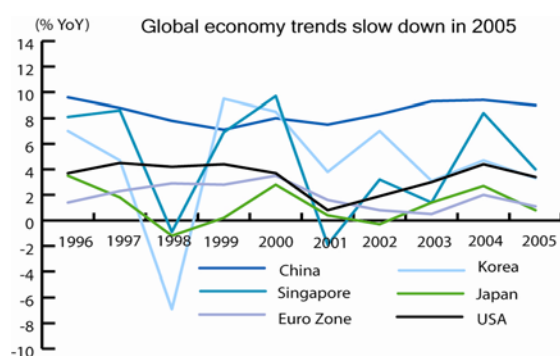
transportation, even though the US government has offered to lend oil reserves from Strategic Petroleum Reserve to 8 refineries. In addition, the price of crude oil at the end of this year will depend on the cool weather in North America and Europe. However the net long position in the future market slowed down since the second quarter of 2005. This indicates that the crude oil price is approaching the maximum level, encouraging hedge funds to reduce net long position. Together with the slowdown in the world economy which would calm down the oil demand, the oil price is not expected to increase very significantly from the current level.

- **An increase in Interest rate during the latter half of 2005** will reduce the impulse of the interest rate on consumption and investment from that in the first half.
- **Drought** remains a negative factor throughout this year and may affect not only agricultural production, particularly, rice, cassava, and sugar cane but also the industry in the Eastern Seaboard and the tourism industry in Pattaya and Phuket. As of 30 August 2005, the level of usable water to the storage capacity in the large 30 reservoirs across the country was averaged at 29.0 percent, a continued decline compared with 45.9 percent and 35.3 percent in 2003 and 2004 respectively. For the current situation, some reservoirs namely, Kra-seaw and Nong-Pla-lai have already used the so-called “dead storage” reserve water.
- **Accumulation in inventory** was registered at 191,771 million baht, equivalent to 5.6 percent to GDP in the first half of the year. Parts of the stock building in raw materials would help to moderate import in the latter half of the year. However, the increase in the stock of finished goods and semi finished goods (which is expected to be 40 percent of total inventory accumulation) would soften the expansion of production activity, compared to the pace of the domestic and external spending which is expected to recover in the latter half of the year.



2.1 Key Assumptions for 2005 Projection

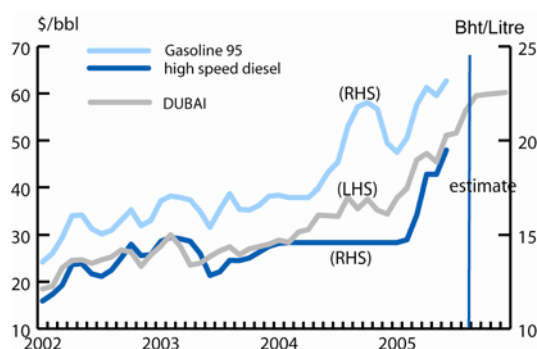
Upward revision of Dubai oil prices from 44 to 51 US dollar per barrel and downward revision of world growth from 3.4 percent to 3.2 percent.



- (1) **World economic growth: the world economy in 2005 is projected to expand by 3.2 percent, slowing down from 4.7 percent in 2004.** The assumption is revised downward from 3.4 percent to 3.2 percent. This downward adjustment was a result of the downward revisions of major economies which predominantly drive the world growth. The US economic growth is revised from 3.6 to 3.4 percent in 2005, the Japanese economy remains the same level of 0.8 percent growth and the EU economy also remains at 1.1 percent. The projection of Asia-ex Japan economies, including Singapore, South Korea, Thai, Malaysia and the Philippines, is also revised down. These downward revisions are supported by the most recent data in the first half of 2005 when most economies expanded at lower rate than that of market expectation since oil price is much higher than earlier expected. The slowdown of US economy significantly affected other economies as well as their export performances. However, the forecasted growth rate of China is revised up from 8.5 percent to 9.0 percent, due to high expansion rate of 9.5 percent in the first half of the year.

- (2) **Crude oil prices: Dubai price is assumed to be 51 US dollar per barrel, revised upward from previous forecast of 44 US dollar per barrel.**

The September projection adjusted Dubai oil price in 2005 to 51 US dollar per barrel, up from average price of 49 US



World oil prices (\$/bbl)

	OMAN	DUBAI	BRENT
2004 Year	34.33	33.65	38.09
Q1	29.75	29.45	31.65
Q2	33.49	33.30	35.31
Q3	36.75	36.30	41.29
Q4	37.29	35.52	44.11
2005 Q1	42.50	41.27	47.68
Q2	48.85	47.89	52.30
July	53.46	51.54	57.80
Aug	57.52	56.60	63.93

Source: The Ministry of Energy

dollar per barrel in 2004 and revised upward from 44 US.³ dollar per barrel in the previous forecast, due primarily to rapid increase in oil price. In the first 8 months of the year, the Dubai price was averaged at 46.91 US dollar per barrel, compared with 32.42 US dollar per barrel in the same period last year. Rapid increase in oil price had become more evident in June with average level of 51.08 US dollar per barrel and spiked to 51.54 and 56.42 US dollar per barrel in July and August respectively. This trend has been boosted by continued rising in global demand while production capacity remains tight.

Dubai price is expected to be 59.5 US dollar per barrel in September and will slightly increase to an average level of 60 dollar per barrel in the forth quarter during the winter time in the North pole when demand for heating oil will increase. Meanwhile, there are also some concerns that there could be a supply shortage of both crude oil and petroleum products. Recently, oil production platforms and refineries in the US were also shut down as a result of Hurricane Katrina, whose path directly hit many production facilities in the Gulf of Mexico as well as many refineries in Louisiana and major refinery in Mississippi. As a result, the US has to import petroleum products from Asia. Moreover, European Commission may consider raising oil reserves in order to avoid the shortfall in oil supply in the future. Crude oil export from Iraq in August declined 900,000 barrel per day from the export level of 1.49 million barrel per day.

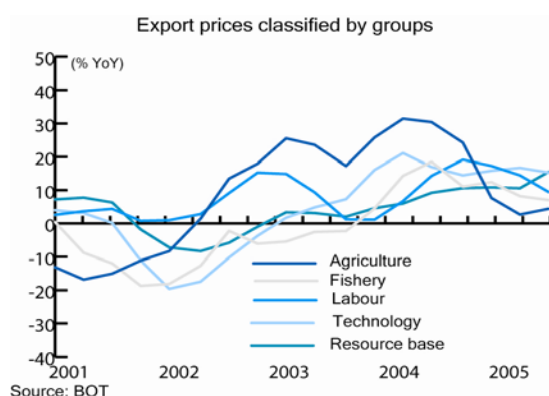
In the previous forecast, due primarily to rapid increase in oil price. In the first 8 months of the year, the Dubai price was

³ The Dubai oil prices assumption on June's projection was specified from real oil price data of five months average level at 43.2 US dollar per barrel. Oil prices climbed up to 45-46 US dollar per barrel during June 1-2, right before the press release on June 6. Thus, if oil prices remain at 45-46 US dollar, average oil price in 2005 would be around 44 US dollar per barrel.

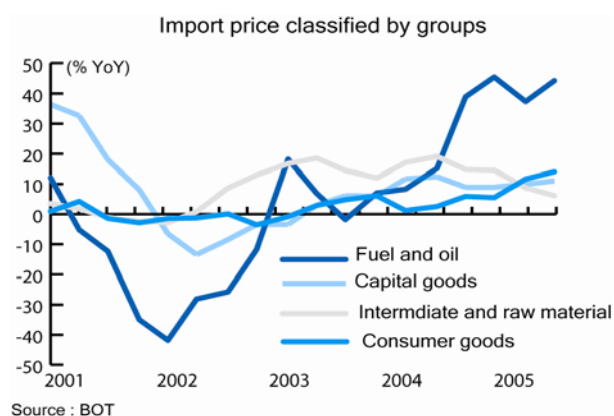
averaged at 46.91 US dollar per barrel, compared with 32.42 US dollar per barrel in the same period last year. Rapid increase in oil price had become more evident in June with average level of 51.08 US dollar per barrel and spiked to 51.54 and 56.42 US dollar per barrel in July and August respectively. This trend has been boosted by continued rising in global demand while production capacity remains tight. Dubai price is expected to be 59.5 US dollar per barrel in September and will slightly increase to an average level of 60 dollar per barrel in the forth quarter during the winter time in the North pole when demand for heating oil will increase. Meanwhile, there are also some concerns that there could be a supply shortage of both crude oil and petroleum products. Recently, oil production platforms and refineries in the US were also shut down as a result of Hurricane Katrina, whose path took it directly over many production facilities in the Gulf of Mexico as well as many refineries in Louisiana and major refinery in Mississippi. As a result, the US has to import petroleum products from Asia. Moreover, European Commission may consider raising oil reserves in order to avoid the shortfall in oil supply in the future. Crude oil export from Iraq in August declined 900,000 barrel per day from the export level of 1.49 million barrel per day.

Currently, Brent oil prices in the future market stood at 67 US dollar per barrel, in the last quarter of 2005. Normally, average Brent prices will be about 6-7 USD higher than Dubai prices.

- (3) **Export and import prices:** in this projection, export prices in US dollar term remain the same increasing rate of 11.0 percent as in previous projection. Average export prices in the first 7 months rose by 13.1 percent. The export prices of resource-based products, namely wood furniture, cement and sugar as well as agricultural products has shown an



increasing trend, particularly price of rubber and rice due to rising world demand. However, manufacturing products both labor-intensive and hi-technology continued to slow down since the beginning of the second quarter resulting from global demand slowdown as well as higher competition from China and India. Consequently, with a continued global slowdown and intense competition, manufacturing products price is not expected to increase much in the last 5 months of this year. However, prices of agricultural and resource-based products will significantly increase, in particular rubber prices that will continue to rise in line with increasing synthetic rubber prices due to higher cost of oil price.



In terms of import price in US dollar term, the average price in 2005 is projected to increase by 16.0 percent, higher than 10.0 percent assumed in the previous forecast. In the first 7 months, average import price soared by 15.5 percent due to rising crude oil and fuel prices of 41.2 percent growth, import prices of capital goods and consumer goods of 10.9 and 17.6 percent respectively. In contrary, the price of raw materials import started to slow down. Monthly data also suggests that import prices of all items, except raw materials, increase at faster rate as a result of elevated oil prices cost.

Therefore, in 2005 Thai economy's term of trade will deteriorate for the first time ever since 2002, which will pose negative income effect for the country. The worsening in the comparative prices between export and import will become major factor that forces Thailand into the trade account deficit.

2.2 Revision of Economic Projection for 2005

(1) According to above conditions, NESDB has revised the economic projection downward from 4.5-5.5 percent released on June 6, 2005 to 3.8-4.3 percent. Concomitantly, inflation rate is projected to be 4.0-4.4 percent, higher than previous forecast of 3.6 percent, due mainly to a surge in oil price, increasing crop price—affected from the drought and slight currency depreciation that, in turn, could possibly put pressure on commodity prices. Current account is expected to register a total deficit of 3,200-4,100 million US dollars, equivalent to 1.9-2.4 percent of GDP. This downward adjustment was mainly a result of: (1) Downward revision of world economy which affected export sector. (2) Higher oil prices both crude oil and domestic retail price than earlier expected of about 10 US dollar per barrel which induced acceleration in commodity prices and thus affected purchasing power of consumers. In addition, trade deficit will be worsening than earlier anticipated. (3) More severe impacts of water shortage and more widespread effect than expected and (4) Slower-than-expected pace of tourism recovery in the South. Thus, the projection of tourist number in 2005 has been reduced to 12 million people, down from 12.37 million.

(2) The revision of 2005 economic projection was as follows;

- Export of goods and services is revised down from growth rate of 5.2 percent to 3.4 percent following downward adjustment of export of goods from 4.7 percent to 3.5 percent as a result of downward revision of world growth and slower-than-expected recovery pace of tourism affected from the Tsunami.
- Private consumption is revised down from 4.6 percent to 4.3 percent due to higher-than-expected rising in oil prices and commodity prices. Also, multiplier effect is smaller in line with downward revision of exports.

Nevertheless, private consumption expansion is still considered favorable since real income seems to increase in the second half of the year. This is owing to (1) increasing trend of employment (2) rise in minimum wage and salaries in real terms since salaries of government officials, SOEs and minimum wage exceed the inflation rate. (3) uptrend of farm income due to rising agricultural product prices, especially rubber and palms (4) increasing dividends from corporate profits of listed companies in 2004.

- Private investment is adjusted downwardly from 10.6 percent to 10.0 percent in tandem with expected slowdown in domestic demand and exports.

Supportive factors for investment are the same as in the first half including increasing capacity utilization rate, higher corporate profits, upward projection in product sales, low real interest rate and more investment in the medium term for large companies.

- Import of goods and services is revised down from 9.0 percent to 8.1 percent following downward adjustment of import of goods from 10.0 percent to 9.0 percent. This is in line with increasing sign of economic slowdown and a higher trend of inventories rundown in the second half which will aggravate imports to slow down from the first half of the year.

However, the assumption on import prices have been adjusted upward according to July indicator which shows continued expansion at higher-than-expected rate as well as higher oil prices. Therefore, in 2005 Thai economy's term of trade will decline.

- Economic stability is expected to remain favorable. Unemployment rate is expected to be 2.1 percent. International reserves remain ample and short-term external debts subdue. Public debts to GDP decline and exchange rate move within narrow band. However, the

economy is expected to experience more pressure on inflation and current account deficit given that the oil prices continue to enjoy the rise.

2.3 The High Case Scenario of 4.3 Percent Growth

Thai economy in 2005 could achieve 4.3 percent growth if export accelerates to reach the target of 19-20 percent growth rate in the last 5 months of the year, or increase export value from the trend case of around 14,300 million baht or 360 million US dollar. The trend line projection of export in the second half is 18 percent. The efforts would be primarily focused on exports of agricultural products, in particular rubber, shrimp, fowls, rice and canned seafood as well as manufacturing products in household goods, namely soap and cosmetics.

2.4 The Low Case Scenario of 3.8 percent growth

The low case scenario of 3.8 percent growth in 2005 is conditional upon the worst possible assumptions of Dubai oil prices up to 70 US dollar per barrel in the last 4 months, which will result in average level of 55 US dollar per barrel for 2005. These inevitably push inflation up to 4.4 percent. However, the chance of Dubai price to rise to that level at the end of the year is expected to be extremely rare. This is because the slowdown in global economic growth will somewhat ease pressure on the demand side.

However, some domestic factors could render economic growth to be lower than 4 percent such as the recovery condition in tourism sector and impacts of water shortage that continue to linger throughout the year and is also likely to become more severe and have widespread effects through various sectors including agriculture, manufacturing and tourism in some provinces.

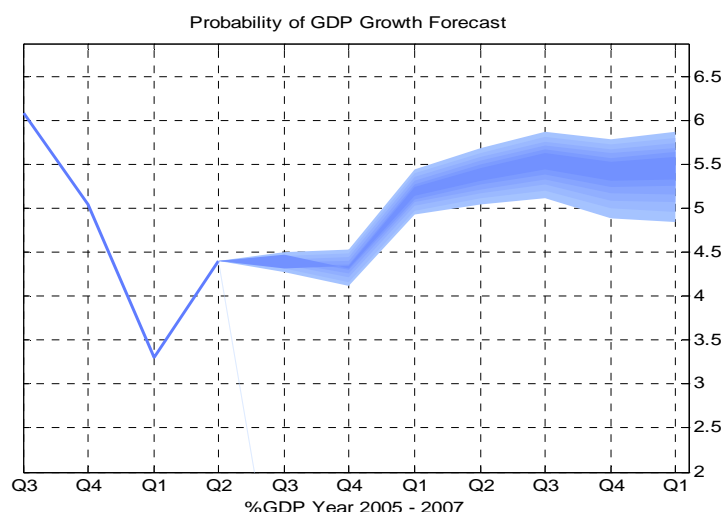
3. PROBABILITY OF VARIOUS GROWTH PROJECTION SCENARIOS

Oil prices have been very responsive to the technical and psychological factors, especially when it affects demands and production conditions; hence, the likelihood of an average price turning to be higher or lower than 51 dollars per barrel is assessed to be equal. Occurring incidents have shown to be both negative and positive triggers to the oil price; for example, sluggish growth in demands, or increasing in accumulative stocks, etc. Likewise, the global economy could possibly grow at more or less than 3.2 percent, with the U.S. economy is the key variable in the equation. However, the slow-recovering tourism and drought severity would probably cause an unfavorable result in the economy, thus pose downside risks to the economic outlook.

Therefore, probability distribution of the 2005 economic growth is skewed towards the lower half of the forecast range of 3.8-4.3 percent. That said the probability distribution of the 2005 economic outlook is asymmetric. NESDB assesses that the probability of the 2005 economic growth falling into the 3.8-4.3 percent range is approximately 84 percent.

Probability of various growth projection scenarios

Probability	Percent
Pr. {<3.8%}	10%
Pr. {3.8%– 4.3%}	84%
Pr. {>4.3%}	6%



Economic Projection of 2005

	Preliminary		Projection 2005		
	2003	2004	Mar 7	Jun 6	Sep 5
GDP (at current prices: Bil.Bht)	5,930.4	6,576.8	7,198.8	7,195.0	7,142.4
GDP Growth (at constant prices, %)	6.9	6.1	5.5 - 6.5	4.5-5.5	3.8-4.3
Investment (at constant prices, %)	11.9	14.4	15.6	11.9	11.0
Private (at constant prices, %)	17.5	15.3	15.7	10.6	9.5
Public (at constant prices, %)	-0.8	11.7	15.3	15.3	15.3
Consumption (at constant prices, %)	5.8	5.4	5.7	5.1	4.9
Private (at constant prices, %)	6.4	5.6	5.3	4.6	4.3
Public (at constant prices, %)	2.0	4.1	8.6	8.6	8.6
Export volume of goods&services (Volume, %)	7.0	7.8	5.9	5.2	3.8
Export value of goods (Bil.USD)	78.1	96.1	110.3	111.1	110.5
Growth rate (%)	18.2	23.0	14.8	15.7	15.0
Growth rate (Volume, %)	9.5	7.0	5.5	4.7	4.0
Import volume of goods&services (Volume, %)	7.7	12.1	9.4	9.0	8.3
Import value of goods (Bil.USD)	74.3	94.4	113.4	116.1	118.2
Growth rate (%)	17.4	26.9	20.2	23.0	25.2
Growth rate (Volume, %)	9.7	12.1	10.2	10.0	9.2
Trade balance (Bil.USD)	3.8	1.7	-3.2	-4.9	-7.7
Current account balance (Bil.USD)	8.0	7.3	1.9	0.1	-3.2
Current account to GDP (%)	5.6	4.5	1.0	0.1	-1.9
Inflation (%)					
CPI	1.8	2.7	3.1	3.6	4.1
GDP Deflator	1.9	4.6	3.6	4.4	4.5

Source: Office of the National Economic and Social Development Board, September 5, 2005

