

NESDB *Economic Outlook*

THAI ECONOMIC PERFORMANCE IN Q3/2004 AND OUTLOOK FOR 2004-2005

- ❑ Thai economy expanded by 6.0 percent in Q3, decelerated slightly from the average growth of 6.6 percent in H1. Nevertheless, the first 9 months registered quite a favorable growth of 6.4 percent, driven primarily by strong domestic demand and buoyant exports.
- ❑ Inflation rate rose to 3.3 percent in Q3 and averaged at 2.7 percent in the first 11 months, fueled by rising raw food prices, and transportation and communication cost.
- ❑ Q4 is likely to continue with a slowdown in economic growth, given the higher interest rate and strong base of Q4/2003. For the year, growth is likely to remain favorable at around 6.2 percent.
- ❑ 2005 growth is projected to be in the range of 5.5-6.5 percent, quite a satisfactory growth trajectory given such unfavorable factors as the world economic slowdown and rising crude oil price. Higher retail price of high-speed diesel after the price subsidy is phased out shall fuel inflation further. However, the impact of drought will be only minimal.

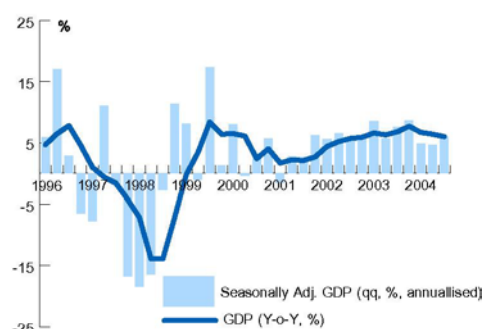
Office of the National Economic and Social Development Board (NESDB)

962 Krung Kasem Rd. Pomrab Bangkok 10100

www.nesdb.go.th

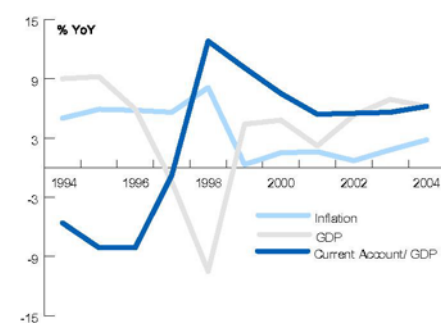
OVERVIEW

Thai economy expanded by 6.0 percent in Q3/2004.



Source: NESDB

In 2004, economic growth is projected to be 6.2 percent followed by 5.5-6.5 percent in 2005 while inflation is 2.7 percent in 2004 and 2.9-3.2 percent in 2005.



Source: BOT

Summary

The economy is projected to register a 6.2 percent expansion in 2004 and likely to decelerate to around 5.5-6.5 percent in 2005. The inflation rate in 2004 is likely to be at 2.7 percent before rising to 2.9-3.2 percent in 2005.

Following two consecutive quarters of strong growth averaging 6.6 percent, real GDP growth for Thailand continued to remain favorable at 6.0 percent in the third quarter of 2004. Growth was driven mainly by strong domestic demand and robust exports. Despite the agricultural output contraction, the rising prices of agricultural products support the farm income further this year. Manufacturing sector continued to record a comparable growth of Q2, and the first 9 months continued to record quite a strong growth of 8.5 percent, albeit lower than 10.2 percent in the same period of last year. Financial sector expanded by 11.6 percent as a result of stronger credit expansion and subsiding non-performing loans.

Private consumption and investment continued to adjust to a more sustainable level due to higher interest rate and rising oil prices. The expansion of 5.5 percent for private consumption and 14.6 percent for private investment in Q3 are slightly below the growth path of the last 4 quarters, and yet the average growth of the first 3 quarters is comparable to that in the same period of last year.

Higher crop prices and rising oil prices added more inflationary pressure, and the inflation rate surged to 3.3 percent in Q3 and remained at the same rate in October and November. Consumer prices index increased rapidly for food and non-food items. Despite the upward pressure on prices, the overall stability has been sustained, considering from current account surplus, ample international reserve level, stable exchange rate, and public debt status.

The most recent economic data, the October indicators, pointed to continued economic slowdown in the last quarter as the result of higher commodity prices and oil prices which are expected to continue.

The soft landing will be seen in private consumption and investment while export should continue to be strong both in terms of price and volume. However, signs of economic deceleration will emerge as the world economy moves into 2005 with less strength. The last quarter, therefore, is forecast to be moderate and the year 2004 shall conclude with an annual growth of 6.2 percent.

The Thai economy will enter 2005 with unfavorable environment of world economic slowdown, the need for currency adjustment and rebalancing of the US economy while oil price will remain high and interest rates in most developed economies will be raised gradually. Domestically, Thailand is also facing commodity prices and higher retail prices of diesel as the subsidy is gradually phased out. Given less favorable environment for growth as compared to 2004, The Thai economy in 2005 is projected to achieve a moderate growth in the range of 5.5-6.5 percent. The inflation rate will continue to rise and it is projected at 2.9-3.2 percent.

1. THAI ECONOMY IN Q3 AND THE YEAR 2004

1.1 World Economy in Q3 and 2004:

The global growth in the third quarter slowed down. The weakened growth can be seen in all major economies, including the US, Japan, EU and East Asia. The fall in purchasing power due to the rise in energy prices, together with a continuing depreciation of US dollar against Japanese Yen and Euro, led to the slowdown in Japanese and EU exports. In contrast, Asian exports continued to expand, which are partly accompanied by growing intra-regional trade and strong demand in electronic and telecommunication products.

World Economy (Y-O-Y growth rate, %)									
	2002	2003			2004			2004	2005
	Year	Q3	Q4	Year	Q1	Q2	Q3	Year	Year
World	3.0			3.9				4.6	3.8
US	1.9	3.5	4.4	3.0	5.0	4.8	4.0	4.4	3.5
EU-15	1.0	0.6	1.1	0.7	1.7	2.3	2.1		
EU-25 ^{1/}	1.1		1.2	1.0	1.8	2.4	2.1	2.3	2.3*
Euro Zone	0.8	0.4	0.7	0.5	1.4	2.1	1.8	1.9	1.9
Germany	0.1	-0.3	0.2	-0.1	1.5	1.9	1.3	1.6	1.5*
Japan	-0.4	1.9	3.1	2.4	5.9	4.2	3.9	4.4	2.3
Hong Kong	2.3	4.0	4.9	3.3	7.0	12.1	7.2	7.7	4.0
Singapore	2.2	1.7	4.9	1.1	7.5	12.5	7.5	8.8	4.4
South Korea	7.0	2.4	3.9	3.1	5.3	5.5	4.6	4.6	4.0
Taiwan	3.6	4.0	5.7	3.3	6.7	7.9	5.3	5.7	4.1
Indonesia	4.3	3.7	4.1	4.5	5.1	4.5	5.0	4.8	5.0
Philippines	4.4	4.8	5.0	4.5	6.5	6.6	6.3	6.1	4.2
Malaysia	4.1	5.2	6.6	5.2	7.8	8.8	6.8	7.1	6.3
Thai	5.4	6.6	7.8	6.8	6.7	6.4	6.0	6.2	5.5-6.5
China	8.0	9.6	9.9	9.1	9.8	9.6	9.1	9.3	8.0-8.5

Source: Government agencies, WEO (September 2004) and average from several sources.

1/ EU25 started 1 May 2004

The US economy grew by 4.0 percent in this quarter, lower than the 4.8 percent in the previous quarter. The annualized growth accelerated to 3.9 percent this quarter, up from 3.3 percent the preceding quarter but this is mainly due to the presidential election-campaign spendings. Weakening economy, rising oil prices and upturn of interest rate adversely affected private investment especially residential and commercial building which showed a marked slowdown. Nevertheless, growth rate of investment in equipment and software expanded well.

Private consumption expenditure remained strong which is mainly attributable to solid demand in motor vehicle and parts. Although the US economy slowed down, current account deficit and budget deficit has continued to deteriorate. The US trade deficit widened

in several major markets-including Canada, China and Japan.

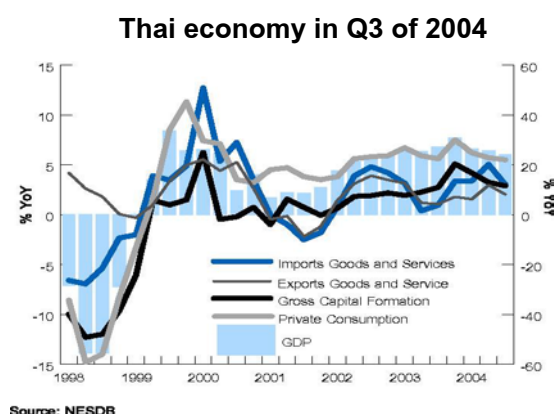
The Japanese economy grew by 3.9 percent, down from 4.2 percent in the previous quarter owing to the slowing down in private investment, both residential and non-residential investment, and the decline in public investment. Net export of goods and services became negative for the first time in eight quarters since export was slowing down sharply while import was still rising. Improving employment condition and higher wage have contributed to a rise in private consumption.

The EU-15 economic growth remained stable. Q3 GDP grew by 2.1 percent, close to 2.3 percent in the second quarter. The marked slowdown signs were observed in Germany, France and the UK. Unemployment rate was still at a high level. Inventories were built up. Euro appreciation against US dollar led to a slow down in EU exports and a rise in imports. European Central Bank decided to leave key interest rate unchanged at 2.0 percent since inflation pressure was still contained.

The Chinese economy. Signs of an economic slowdown in China became more noticeable in this quarter. The economy expanded by 9.1 percent in the third quarter, down from 9.8 percent and 9.6 percent in the first quarter and second quarter respectively. Construction in local area, production of steel and basic metal sectors which were the main target of macro-tightening policies, decelerated visibly. Private consumption and investment in equipment and machinery expanded steadily. International trade registered more surplus. In addition, People Bank of China raised central bank reference rate for the first time in nine years in order to cool down the economy and reduce the inflation pressure.

The Asian Economies ex Japan. The economic growths slowed down markedly in several countries, however, the growth rates were still at a relatively high level such as those of South Korea, Taiwan, Hong Kong, Singapore and Malaysia which grew 4.6, 5.3, 7.2, 7.5 and 6.8 percent respectively. In case of Singapore and Hong Kong, the growth rates were much lower than the growth rate of previous quarter. This is due to the low base in the second quarter of 2003, posed by the outbreak of SARs, that resulted in the very high growth rate in the second quarter of 2004. The expansion of this region's economy was driven by strong export and domestic demand, both consumption and investment

1.2 Thai Economy in Q3/ 2004



Thai economy in Q3/2004: In the third quarter, the economy expanded by 6.0 percent, slowing down from 6.6 percent growth rate in the first half of the year. The seasonally adjusted real GDP grew by 1.5 percent from the second quarter or equivalent to 6.3 percent annual rate, significantly higher than those 3.1 percent in the first and second quarter. Vulnerabilities of bird flu outbreak and the Southern unrest were only temporary effects and continued to be resolved. Domestic demand in the third quarter slowed down quite noticeably, while stock accumulation increased substantially. Meanwhile, final sales slowed down and registered 4.7 percent growth, much lower than 6.7 percent growth in 2003.

Domestic demand:

Both consumption and investment expenditures slowed down.

Household expenditure in Q3 increased by 5.5 percent, slowed down from 6.2 and 5.7 percent in the first and second quarter respectively. This was due to : (1) a slow pace in automobile expenditure growth (2) a continued increase in oil price (3) a social unrest in three southernmost provinces and (4) a revisit of bird flu outbreak. However, household expenditure still expanded at a considerably high rate because of positive factors such as increases in household and farm income and salary adjustment in both private and public sector.

Total investment expanded by 11.5 percent, lowered than 12.9 percent in the second quarter. Investment expansion was attributed to public and private investment. Private investment rose of 14.6 percent, slowed down from 16.2 percent in the first quarter. Public investment grew by 5.9 percent, mainly driven by investment in construction.

On the external side, export value increased by 25.4 percent, accelerating from that in the corresponding period last year due to a higher than expected rate of growth in the Asian economy and higher growth rates of Chinese and Japan economy. The accelerating growth in export value was a result of the strong increase in the value and volume of manufacturing exports. Value and volume of agricultural and fishery exports, especially frozen chicken and shrimp declined. High rates of growth in export value were seen in electronic and electrical appliances, passenger cars, and basic metals. Import value also expanded by 29.5 percent over the same quarter of previous year, mostly from fuel, raw material and capital goods import.

Trade balance and current account. In the third quarter of 2004, trade balance registered a surplus of 241 million US dollar compared to a surplus of 902 million US dollar as imports accelerated at the faster rate than exports. With the services and transfers account recorded a surplus of 1,231 million US dollar, the current account remained in

surplus by 1,472 million US dollar, compared with 1,810 million US dollar in the third quarter of 2003.

Production side:

Manufacturing continued to expand at a satisfactory pace but agriculture sector continued to contract.

Agriculture sector contract by 2.7 percent and registered negative growth for the third consecutive quarter with a significant decline in livestock and fishery products. On the other hand, manufacturing sector expanded at the same rate as last quarter's growth of 7.9 percent because food production slightly dropped whereas other manufacturing goods continued to expand. For production of vehicles and equipments, commercial car production dropped whereas passenger car production grew at a slower rate. Financial, construction, telecommunication and transportation and tourism sectors also expand rigidly

Employment conditions have improved. Employment in the third quarter rose from that in the corresponding period last year by 3.3 percent. Employment in non-agriculture expanded with a favourable expansion in transportation, construction, trade, and banking sector. On the other hand, the employment in agriculture sector was contracted continuously. The significant decline was found for all regions except for the South. The number of unemployed workers were 0.546 million in the third quarter. The unemployment rate was 1.49 percent, which is lower than the rate of 1.54 percent of the same period of last year.

Price levels

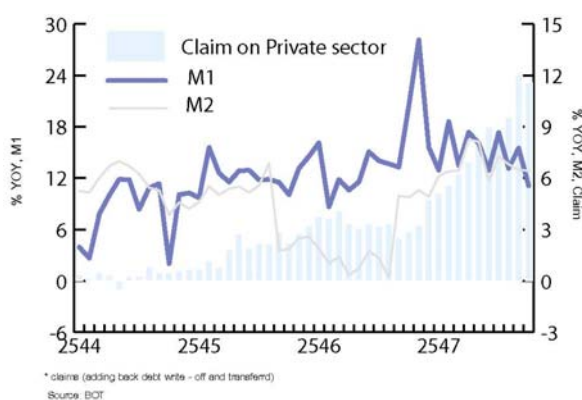
The consumer price index (CPI) rose by 3.3 percent, higher than the rate of 1.9 and 2.6 percent in the first and second quarter respectively. The increase in CPI owed mainly to the 4.5 percent increase in food prices in line with rising prices in vegetable fruit and eggs and milk products. In addition, non-food prices increased by 2.6 percent, mainly in energy, transportation and communication, and housing prices. The gasoline price index rose substantially by 12.9 percent, due to the adjustment in ceiling prices of Benzene 91 and 95 in line with rising world crude oil. Core CPI grew at 0.6 percent, higher than the rate of 0.4 percent in the second quarter. The first 9 months of this year showed an average headline inflation rate of 2.6 percent and core inflation rate of 0.6 percent.

The production price index (PPI) rose by 8.2 percent as a result of the 15.8 percent increase in mining product prices in line with the increase in crude oil, natural gas and condensate. For the PPI by the stage of processing, the PPI in the intermediate material sector rose by 14.4 percent compared with the rate of 11.1 percent rise in raw material sector, and 4.6 percent in the final goods sector.

Financial situation:

Credit continued to boost.

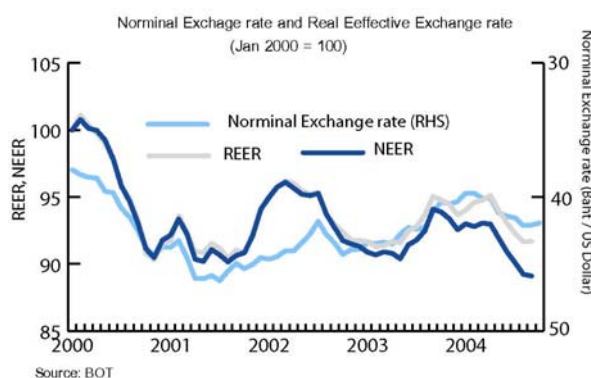
At the end of the third quarter of 2004, private sector credits (excluding IFCT credits after the merger with the Thai Military Bank and DBS Thai Danu Bank since September, 2004) rose by 6.8 percent compared to the same period of last year. The rate of credit expansion in the third quarter was comparable to the rate of 6.9 percent in the second quarter. As the commercial bank credit expanded at the faster rate than the deposit, the ratio of credits to deposits increased continuously from 94.1 percent in the second quarter to 96.4 percent in the third quarter. NPLs in the financial system in the third quarter accounted for 11.4 percent of total credits, slightly declined from the previous quarter's share. It is expected that BOT measure on provisional reserve for doubtful loan will render NPLs in the last quarter to decline.



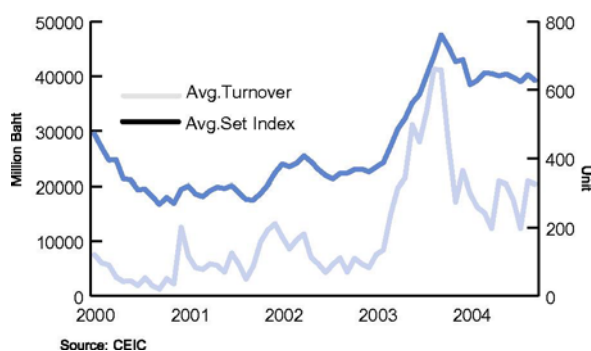
Interest rate The interbank rate increased as the Bank of Thailand increased 14-day repurchase rate from 1.25 percent to 1.5 percent in August. However, both the deposit and loan interest rates of the

commercial banks were kept unchanged from the previous quarter, partly because excess liquidity remained high.

Exchange Rate. In August, Thai baht depreciated from the previous month's average level due to the impact of rising oil prices and foreign investors' net sale position in the Thai equity market. However, Thai baht continued to appreciate since September as a result of a continued depreciation in dollar. In the third quarter of 2004, the baht moved in the range of 40.65 to 41.64 baht per US dollar, with the average of 41.25 baht per US dollar. The Real effective Exchange Rate was slightly weaker than the nominal rate.



Stock market. The Stock Exchange of Thailand (SET) index registered at 644.6 points at the end of the third quarter very close to 646.6 points in the second quarter of 2004. Average daily trading value in the stocked market decreased from 28,382 million baht in the first quarter and 19,070 million baht in the second quarter to 16,724 million baht in the third quarter. Factors that led to fluctuation of the index remained unchanged. These are the unrest in the south, oil price fluctuation, the revisited of the second avian flu outbreak.



Economic stability:

Economic stability remained favorable, which was reflected in the following factors

Fiscal position: Fiscal balance improved. In the fourth quarter of the fiscal year of 2003 (July-September), government revenue totaled 294.5 billion baht while government expenditure amounted to 304.5 billion baht, leading to a deficit in budgetary balance of 10,021 million baht. However, non-budgetary balance was in a surplus of 21,516 million baht, causing a surplus in treasury cash balance of 11,495 million baht.

For the fiscal stance at the end of fiscal year of 2004, the budgetary balance registered a deficit of 14,185 million baht and the non-budgetary balance was in deficit of 55,470 million baht. As a result, the fiscal position recorded a cash deficit of 69,655 million baht. However, government financed its deficit by issuing treasury bill and bonds amounted to 90,000 million baht. Therefore, cash balance after borrowing registered a surplus of 20,344.8 million baht, causing treasuring cash balance at the end of September 2004 to be 151.6 billion baht, a 20.3 billion baht increased from the beginning of fiscal year of 2004

Public Debt: At the end of August 2004, public debt stood at 2.98 trillion baht. It accounted for 46.23 percent of GDP, slightly increased from 45.42 percent of GDP at the end of the second quarter 2004. The increase in public debt was a result of government borrowing to finance its deficit and bond issuing for FIDF.

External debt declined from 8,033 million dollar to 7,961 million dollar. However, those in terms of baht increased from 328,452 million baht to 331,191 million baht due to the baht depreciation.

International reserves at the end of October 2004 was 46.2 billion dollar, equivalent to 3.3 times short-term external debts.

2. ECONOMIC FACTORS AND CONDITIONS IN 2005

2.1 World Economy in 2005 will continue to slow down from the latter half of 2004

(1) World Economic Outlook for 2004: In 2004, the world economy showed strong growth in the first half of the year, while it has slowed down since the third quarter, notably in major advanced economies such as the US, the EU, Japan, China and other Asian countries. This has been underpinned by rising oil prices, increased interest rates and tighter fiscal policy in order to ease pressures on prices and to create a stable economic environment. Amidst downside risks, global growth in the first three quarters remained solid. In the last quarter of this

year, however, the economy is likely to slow down in major economies, owing to high oil prices—notwithstanding gradually declining but not significantly. Correspondingly, the global growth is projected to satisfactorily grow at 4.6 percent in 2004, higher than that of 3.9 percent in 2003, led by stronger growth in the US, Japan, EU, Malaysia, Singapore and Hong Kong. This is attributed to continued implementation of low interest rate policy since 2002 which helped spur private consumption. Private investment also continued to expand well, accompanied by a corresponding improvement in business sentiments, low interest rate, strong pickup in electronics cycle in the US and a buoyant residential investment in response to higher demand for housing.

In the Asian countries, economic growth was mainly driven by robust domestic demand and, increasingly, strong export growth both in the case of exports across the region and exports to China, Japan and the US. The world trade volume in 2003 is expected to grow approximately by 10 percent and, accordingly, these increasing economic activities would create an opportunity for higher employment. Nevertheless, increasing labor productivity, higher investment in technology and corporate sector adjustment—to improve productivity and management—seem to make the unemployment rate, notably in the US, Japan and the EU, stand at high level.

In 2004, inflation rate in industrial and developed countries will reach 2.1 percent, slightly higher than 1.8 percent in 2003, amid rising oil prices and hikes in iron, copper and basic metals' prices, with growth rate of 35 and 17 percent, respectively. Inflation is still at manageable rate due to the following reasons (1) excess capacity remains high although it declined continuously. This creates intense competitive environment as well as high competition from China—a low-cost production base. (2) productivity improvement in several countries has eased inflationary pressures. Thus increase in interest rates can be gradually in a number of countries.

However, several countries tend to face with inflationary pressures which has turned up since the latter half of the year and is likely to continuously increase. For example, inflation rate in the US lifted up from 2.3 percent in the first half to 2.8 percent in the third quarter. It is also expected to increase to 3.4 percent in the last quarter resulting in the inflation rate of 2.7 percent for the whole year.

(2) World Economic Outlook for 2005: The world economy will remain vulnerable to significant risks including rising interest rates, high oil prices and balanced fiscal policy. Thus, the global growth is expected to slow down further from the latter half of 2004. GDP is projected to grow by 3.8 percent, due to the slowdown in major economies including the US, Japan, China and Asian countries which notably show a slowdown trend from the second half of 2004. The EU economy is likely to grow with almost the same rate of 2004. This is due to investment cycle which lagged those in the US, Japan and Asian countries, thus, growth momentum still remains generally strong and economic expansion will be well established in 2005. Nonetheless, slowdown trends in those major economies and China will put more constraints on exports from developing countries, particularly the Asian countries and, as a result, the Asian economies will not be able to expand at the significant rate as in 2003-2004 which is the highest growth in recent period.

Against this background, economic fundamentals in these Asian countries, to date, still remain favorable since some progress on structuring in both financial and real sector have become more apparent. Moreover, production factors used have been more productive and labor developments have also been persistently implemented. Meanwhile, the monetary and fiscal policies continue to gradually cool down the overheat economy. In addition more selective measures have been introduced, for example in the case of China, measures on credit extension in specific sector were adopted to cool down the overheating in investment particularly on construction, iron and basic metal manufacturing sectors. Solid economic fundamental, domestic demand stimulus as well as trade promotion within the region would help support Asian economies to grow significantly and move closely to the potential growth.

In 2005, it is expected that developing countries will have higher income and purchasing power, despite some slowdown in commodities prices. Rising demand for such commodities as steel, metal ores and aluminium will push up prices. Moreover, production in agricultural sector is likely to increase only marginally. Many countries also experienced drought which adversely affect production, while demand is still rising. Therefore, price levels will be increasing in 2005.

All in all, several forecasting agencies project that the slowdown of global economy in 2005 will not be severe and will expand by 3.8 percent with the inflation of 2.1 percent for developed countries and around 5.5 percent for other countries. Trade volume will increase by 8.0 percent. Federal fund rate will rise to 3.25 percent at the end of 2005, while official rates of the EU, Japan and UK will remain subdued at 2.0, 0.0 and 4.75 percent, respectively.

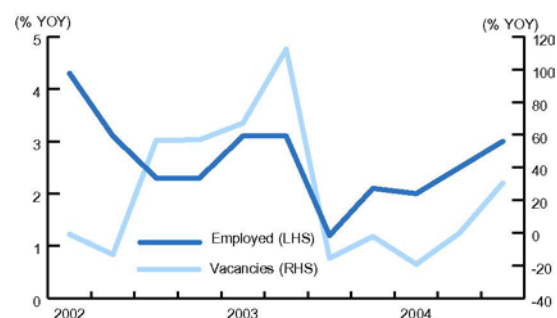
2.2 Key supporting factors for 2005

Several supporting factors for 2005 are the same as those for 2004, however, the factors are likely to weaken and the impacts on economic expansion of 2005 are considerably softer than 2004.

- (1) World economy continues to expand but at a lower rate than the growth rates in 2003-2004. The global economic expansion is still the supportive factor to export even though the export growth is unlikely to be strong as in 2004.
- (2) Supportive factors to private consumption consist of interest rate, which is still relatively low compared to higher growth of consumer prices¹ and household income which is likely to grow at a faster rate than the increase in the prices of consumer goods. As a result, real income will increase, and

lead to more spendings. Supportive factors to a higher real income are:

- Increase in employment while under-employment declines². In addition, a rise in job enrollment will create new job placement. For the first nine months of 2004, employment increased, on average, by 2.4 percent. Number of job vacancies increased by 30.5 percent at the end of September 2004.

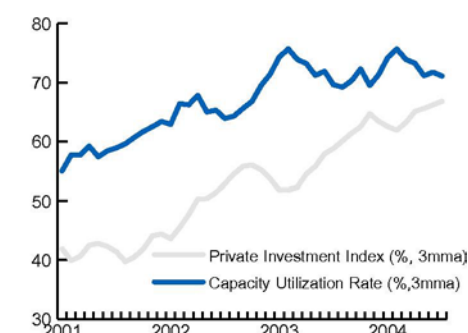


- A raise in government salaries in the latter half of 2004, together with additional living expense allowance for government permanent and temporary employees, will make average salary base of 2005 to be, higher than that of 2004. The government supporting scheme valued 3,700 million baht for permanent and temporary government employees was approved by the cabinet in October 6, 2004. In addition, private sector continued to raise wages and salaries that led to an increase in average wage.
- Tax measures which aimed to support social sector and low to middle income people will reduce tax burden and increase people's purchasing power. These measures was approved by the cabinet in October 26, 2004, including raising net income which will be exempted from personal income tax from 80,000 baht to 100,000 baht.
- By election law, the total spending in election campaign will be approximately 6,000 million baht.
- (3) Supportive investment climate remains. Supporting factors to private investment in 2005 consist of:

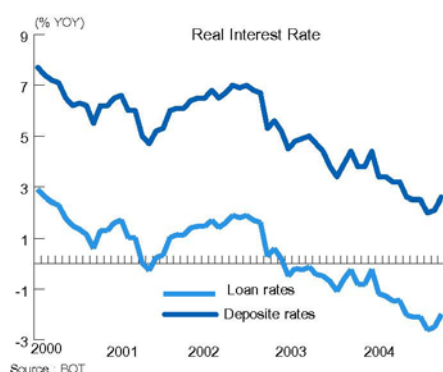
¹ Real interest rate remains low.

² Total working hours is less than 35 hours per week.

- Capacity utilization rate is likely to increase further and stay at the high level. For the first ten months of 2004, Capacity utilization rate equaled 77.2 percent, higher than 65.5 percent in 2003. Manufacturing sectors which recorded capacity utilization rate higher than 80 percents are motorcycle, zinc, tyre, commercial car, batteries, compressor, semiconductor and petro-chemical product. Since those sectors require large amount of investment, it is expected to be one of major driving force of private investment.
- Tax measures will provide incentive to expand investment in 2005. Under new tax scheme, corporate income tax rate for businesses which have registered capital not exceed 5 million baht is reduced. Tax rate applied for the first one million net profits decreased from 20 percent to 15 percent. However, tax rate for net profits exceed one million is kept unchanged. This tax cut will be effective on January 1, 2005. In addition, the cabinet agreed to extend maximum income not required to register in VAT system from 1.2 million baht per year to 1.8 million baht per year which will be effective in April 1, 2005.



- Real cost of borrowing remains at a low level since nominal interest rate is relatively low compared to rising commodity prices.



- Corporate profits continue to increase in 2004. For the first three quarters, corporate profits of registered companies rose by 39.5 percent compared to the same period of previous year.
- For the first ten months of 2004, the number of project approval by the Board of Investment rose by 51.5 percent, while the amount of investment increased by 69.1 percent. Rapid increase can be observed in export oriented project (80-100 percent) and in electronic and electrical product, chemical product, paper, plastic, machinery and transportation equipment and agricultural related activities. Foreign investment is likely to increase, especially investment from Japan. Total amount of project application surged by 59.6 percent compared to the same period previous year, reflecting the increasing trend in investment.
- Public consumption and public investment is expected to increase as a result of increasing investment in infrastructure and mega project. These investment plans are under 5-year-infrastructure development strategic plan and were approved by the cabinet in October 19, 2004. Total amount of investment plan is around 827,978 million baht and some projects are expected to begin by the end of 2005. In addition there will be extra government spending around 40,000 million baht as mid-year additional fund.

3. DOWNSIDE RISKS

3.1 External Factors

(1) The US policies on current account deficit and their effects on the world economic growth in 2005.

The US is facing with current account deficit and the government budget deficit at the same time. Together with continuously increasing current account deficit of around 5.7 percent of GDP in the third quarter, the government budget deficit has also increased and is equivalent to around 3.6 percent of GDP. These are among the factors causing some uncertainties on the US economy in investors' perspectives. The investors have become more reluctant to hold financial assets in the US dollars denomination, their portfolios are rebalanced toward more Euro, and thus put downward pressure on the US dollar. At the same time, some Asian central banks e.g. the south Korea and Japan have reduced their degree of intervention in the foreign exchange market. The Chinese authority also expands its band of exchange rate against the US dollar by 3 percent. The November 20th meeting among the ministers of finance and the governors of the central bank in 20 countries (Group 20), in Berlin. Also called for a more flexibility of the Asian currencies. Under such circumstances and pressures, the US dollar has depreciated more constantly since then. With these factors and uncertainties, investors are more concerned and not confident in the value of the US dollar, with some panics about tendencies for sudden drops. The speculation also led to more volatility. Given the weakening value of the US dollar, the exporting countries especially Asia of which the US is a major market is at disadvantages. These factors could aggravate the expected slowing-down of the world economy. Another factor needs to be taken into account is the oil price—remaining high, could push the world economic growth to slow down faster.

Nevertheless, it is assessed that it is likely that the US government would tighten monetary policy and increase the rate of interest. By the end of 2005, the Fed funds rate is expected to be at 3.25 percent. In this regards, the weaker US dollar and the higher rate of interest would reduce the US current account deficit. Noting that while the rate of interest in the US are likely to be higher than in the Asian economies, investors might consider that it is still profitable holding some financial assets in US dollars. For example, the Japanese domestic rate of interest is about 0 percent thus the US dollar assets would remain attractive for the Japanese.

(2) The oil price is still soaring and sensitive

The oil price is still high and fluctuates in response to many factors. The world economic growth, as well the Thai exports, would be negatively affected by this situation. Whereas the import value will accelerate by the higher crude-oil price, oil consumption will gradually slow down. This would decrease the positive trade balance. The consumer and the investors confidence are likely to be affected.

In the second half of 2004, the buoyant oil price reflected more than the fundamentals. The movement of the oil price in the past shows some psychological and technical factors, e.g. the speculations by Hedge funds. Some factors underlying the speculation are that (1) capacity margin with the ability to increase production within 1 month is only 0.5-1.0 mb/d. This would possibly cause the oil price 5 dollars/barrel higher (2) uncertainties in Iraq whose full capacity at 2.3 mb/d, would affect her export of oil (3) the OECD crude-oil stock is still low incomparable to a much higher oil demand. On November 12, the International Energy Agency predicted that the world oil demand will be 82.4 mb/d in 2004, which is the highest record in 24 years. This factor could raise oil price by 10 dollars/barrel, the so-called “inventory balance”.

At present, however, the crude oil price has a falling tendency until 2005. This is due to the fact that in December 2004 the US crude oil reserve is about 3.5 percent increasing from last year and that the OECD reserve is also increasing from the Gulf of Mexico platform recovery. The offshore

platform was preciously damaged by the hurricane Ivan in the Mexico Gulf.

As a result, the production was lower by 0.5 mb/d since September 16. However, the offshore platform has recovered and produced about 70 percent of the pre-disaster level since November. It is expected to return to full operation by the first quarter of 2005.

As well, the Russian government has a more concrete policy to remedy the problem of unpaid taxes owed to Yukos oil company. This would help alleviate the pressure on the World crude oil production.

Together with the weakening oil price, good economic fundamentals in many countries in the past few years would reduce the oil-price sensitivity of the world economy. The impact from the 2005 oil price would not be too severe and the world economic growth would land softly. Some of the good fundamentals which will help ease the impact of oil prices rising are:

- Positive current account and foreign reserve at the high level in many countries in Asia, especially, Japan and China.
- A continuously increase in the production efficiency would help soften the pressure on the inflation rate in many countries, especially, in the US. At the same time, the energy consumption is more efficient in many countries as well.
- In many countries, their central banks proceed more carefully on monetary policies and closely and prudently monitor the inflation movement than the past. This would help relieve the people's worrisome concerning inflation problem. In addition, in a high competition environment, the higher cost burden since 2004 could be shifted out to the consumer only gradually.
- The energy demand has a decreasing trend because of the world economic

situation. In 2005, the International Energy Agency (IEA) predicted the world total oil demand would increase by 1.8 percent (less than the 3.5 percent increase in 2004). This moderate increase would help lessen the pressure on the crude oil price.

- Oil exporting economies, like Middle-East countries and Russia, who gain a higher value of export earnings would also increase their spending. This would also help ease the oil-price impact on the world export.

3.2 Internal Factors

The domestic factors deterring economic expansion are: an increase in the rate of interest and inflation rate, an increase in the oil price after an abandon of the price ceiling, and impact of the epidemic of the Bird Flu on exports, as well as, a high growth rate of the first half of 2004 would provide a high base. Thus the economic growth in 2005 is expected to be slowing down.

(1) Increasing prices and rising interest rates

- Higher consumer prices and an increase in the rate of interest affect the household expenditure since the beginning of 2004. This is especially on the durables that are more sensitive to prices, income and interest rate than non-durables or semi-durables. Together with a lower consumers' confidence, the household's expenditure on metallic products machinery and tools at a constant price in the first 9 months increased by 14.4 percent (less than the 21.1 percent expansion in the first 9 months of 2003). Within this product group, the expenditure is explicitly lower in automobiles and tools (19.7 percent growth rate comparing to 38 percent in the first 9 months of 2003). The latest economic indicators in October reveals that the private expenditure is continuously slowing down.
- The consumer credit is slowing down since the beginning of this year. At the end of September 2004, this credit outstanding increased about 9.0 percent from last year during the same period (less than 14.3 percent expansion at the end of 2002 and 30.0 percent at the end of 2003).
- Although the relative interest rate is increasing, but at a slower rate than the

inflation. In other words, the real interest rate is not increasing. Nonetheless, the expectation on a higher rate of interest still persists. And this would cause people to be more careful on the debt creation and the demand on domestic and foreign products will expand slowly. The investment would be affected; especially in the situation that the business confidence is continuously decreasing since April and the confidence index is below 50. The index averaged 47.5 in the third quarter, as compared to 50.6 and 49.8 in the first and second quarters, respectively.

Nevertheless, in 2005, private investment is expected to expand but the growth rate will not be as high as in 2004. This is due to remaining good economic fundamentals, low cost of the borrowing in real term, and a capacity is increasing and presently it is close to the pre-crisis level. The private investment is also expected to expand in order to response to the market expansion in the medium-term. New investment would also be needed to improve the production technology.

(2) Bird Flu and its impact on frozen chicken exports

- In the first 10 months of 2004, the quantity and value of frozen chicken export declined by 91.2 and 91.3 percent, respectively, compared to the same period of last year. This is because Europe and Japan still prohibit the frozen chicken imports from Thailand. The continuous Bird Flu epidemic is one of the reasons that the importing markets are still strict on the imports and the need for factory inspection as well as ensuring prevention measures on the epidemic in the farm. All would increase the production cost to the producers.

(3) Abandoning of diesel oil price controls will raise production cost and prices.

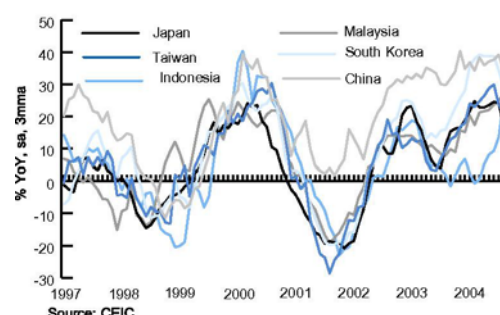
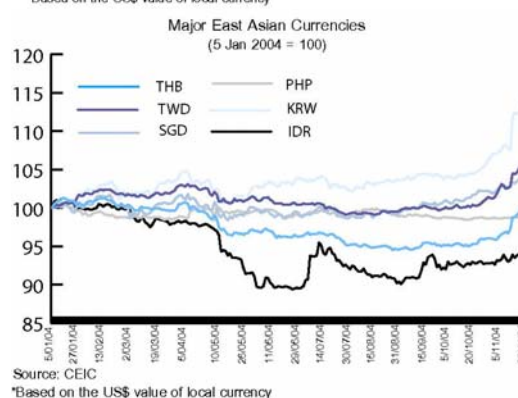
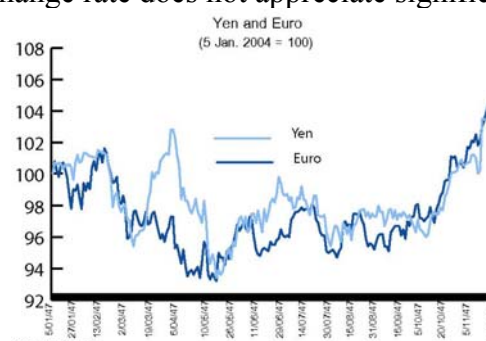
In case of average crude oil price (Oman quoted) in 2005 is 35 US dollar/bbl and government starts to reduce subsidies in the second quarter, this, as a result, will lift diesel oil price up to around 18 baht, according to its actual price. Hence, inflation will increase by around 0.7 percent which, as a consequence, will dampen purchasing power and household spending.

(4) Drought impacts

Loss from the drought is expected to be approximately 5,000 million baht in 2005.

(5) Appreciation of exchange rate

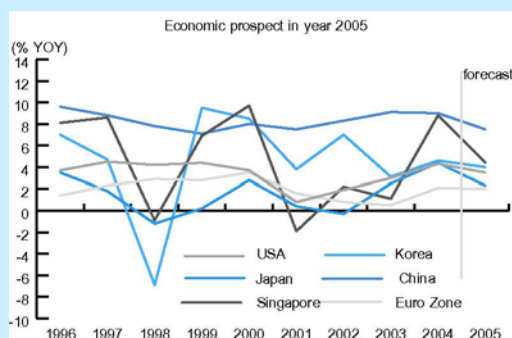
Effects of the appreciation of exchange rate on exports will be well contained. Since the adjustment have been consistent with other currencies in the region and real effective exchange rate does not appreciate significantly.



4. KEY ASSUMPTIONS FOR 2005 PROJECTION

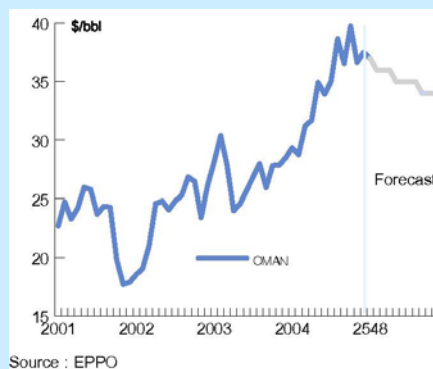
Key Assumptions for 2005 Projection

- (1) **The world economy** The world economy expanded by 4.6 percent in 2004, revised upward from 4.4 percent of the previous forecast in September. This is underpinned by upward-revision of the US, Chinese and Asian economies, given stronger-than-expected growth in the first three quarters of those economies. It is also projected a smaller growth in 2005, namely a 3.8 percent economic growth.



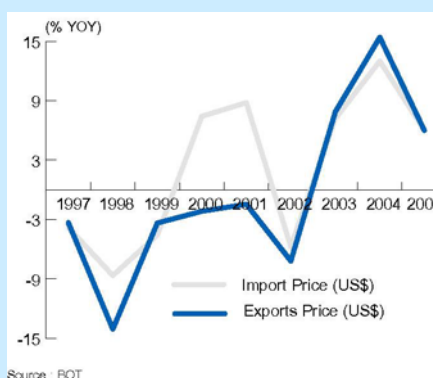
- (2) **The oil price** Oil price (Oman quoted) will average at 34.3 US dollar/bbl in 2004 and will slightly increase to 35.0 US dollar/bbl in 2005. The price is expected to remain at the current level in the first half of the year and will decline in the latter half. In 2005, production of both natural gas and crude oil will be totaled 83.0-84.0 million barrel per day, almost at the same level as demand for both items which is expected to be around 83.9 million barrel, up slightly from 82.4 million barrel in 2004. OPEC spare capacity that could produce additional oil within 1 month remains only 0.5-1.0 million barrel per day.

Meanwhile, the situation in Iraq remain fragile. These vulnerable situations in oil production will create more concerns over the market and will easily generate speculation..



Source : EPPO

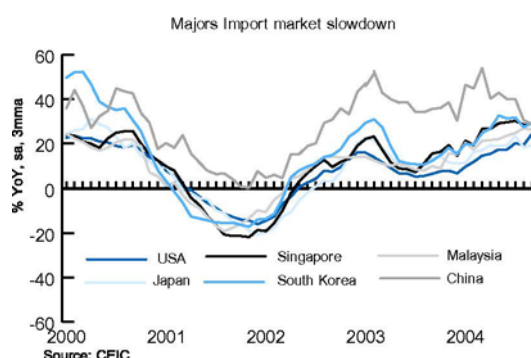
- (3) **Export and import prices.** Export prices in term of US dollar increased by 15.4 percent in 2003, while import prices rose by 13.0 percent. As a result of higher growth in export prices than that of import prices, Thailand gains in terms of trade. However, in 2005, it is expected to see slowdown in prices since demand tends to grow at lower rate. Average of both export and import prices in 2005 is projected to increase by 6.0 percent. With the same growth rate of both prices, thus, the Thailand will have no gain in terms of trade in 2005



Source : BOT

5. ECONOMIC OUTLOOK FOR 2004

For the first three quarters in 2004, Thai economy achieved an average growth rate of 6.6 percent; with an actual rate of 6.7, 6.4 and 6.0 percent in three consecutive quarters. The continued slowing down of growth was the result of: the household expenses which moved towards a stabilized level, the faster expansion of the imports of goods and services over the exports, the sluggish investment owing to the increasing oil price, the bird flu outbreak, the ongoing unrest in the Southern provinces. In October 2004, the data exhibited that the expenditure and investment continuously slowed down while the exports still grew satisfactorily. However, during the last quarter the global economy clearly signals a slower growth, which will consequently affect the Thai export. Together with the drought effect, Thai economy in the last quarter is anticipated to grow at softer rate, contributing to the average growth in 2004 of 6.2 percent with 2.7 percent inflation rate and 2.2 percent unemployment rate. The imports will increase faster than the exports, partly due to the rising oil price. As a result, the trade balances register a surplus of 111,700 million baht, smaller than that of 2003. However, together with an expectedly high surplus in services and transfer balances, the current account will be in surplus by over 295,900 million baht or equivalent to 6.2 percent of GDP.



6. ECONOMIC PROJECTION FOR 2005

Thai economy in 2005, under a sluggish world's economic conditions, is projected to expand within a range of 5.5 - 6.5 percent given an economic fundamental in 2004 including an increase in employment, a raised ceiling of wages and salary, a tax reduction, a steadily high oil price, as well as a certain amount of investment and public expense. Inflation rate, in consistent with an increase in diesel price, will approach a slight higher level of 2.9 - 3.2 percent. However, the exchange rate is expected to appreciate, which will help moderate a rise of consumer prices.

Economic Outlook by Components

Private Consumption Expenditure

Private consumption expenditure is projected to increase by 5.4 percent, slowing down from 6.0 percent in 2004. This is owing to rising oil prices and commodities prices, higher interest rates as well as deteriorated consumer confidence.

Private Investment

Private investment is expected to expand by 13.0 percent, lower than 14.9 percent in 2004. This slowdown trend shows an adjustment of private investment after enjoying high growth rates since 2000. In addition, this is a result of downward trend in expected demand from both domestic and

international markets. Rising oil price and increasing trend of interest rate will also delay some private investments.

Government Expenditure

Public investment at constant prices is projected to increase by 10.0 percent, higher than 6.6 percent in 2004. This is partly due to the infrastructure investment plan that is expected to start preceding some projects within 2005 and also some investment project from extra government budget of 40,000 million baht.

Government consumption expenditure at constant prices is projected to grow by 7.0 percent.

Export of goods and services

Export volume of goods is expected to grow by 5.8 percent, slightly lower than 7.1 percent in 2004, owing to global economic slowdown. However, export volume of services tends to increase significantly since the Tourism Authority of Thailand (TOT) has set a higher target for foreign tourists, namely at 11.5 percent growth and shall carry out measures in order to achieve that target.

Export of goods is projected to be 107.4 billion US dollars, rising by 11.8 percent or equivalent to 4,026.5 billion bahts, which accounted for 4.0 percent growth.

In sum, export of goods and services at constant prices is projected to grow by 6.4 percent.

Imports of goods and services

Import of goods is expected to be at 107.7 billion US dollars, increases by 15.5 percent. Import volume is projected to grow by 9.5 percent, slowing down from 12.7 percent growth in 2004. This is in line with the slowdown of private investment. Import price in term of US dollar is projected to increase by 6.0 percent, revised upward as a result of rising oil prices. In terms of baht, import value is projected to reach 4,039.7 billion

baht, increasing by 7.5 percent from 2004.

Import of services is expected to rise as a result of increasing expenditures of Thai residents abroad and expenses on freight and insurance services as well as high repatriation of investment income by foreign firms. Hence, import of goods and services at constant price in 2005 is expected to grow by 8.4 percent, higher than 12.3 percent in 2004.

Trade account and current account

Trade account is projected to register a marginal deficit of 13,000 million baht, or about 400 million US dollars, compared with a surplus of 111,700 million baht in 2004. This is a consequence of accelerating import volume growth. However, tourism condition is expected to improve after the Avian flu problem has been contained. Accordingly, this will result in the higher surplus in net service income than that of 2004. All in all, current account will record a surplus of about 8.7 billion US dollars or about 326.5 billion bahts, or equivalent to 4.6 percent of GDP.

Inflation

The headline inflation is expected to be in the range of 2.9-3.2 percent, higher than 2.7 percent in 2004. This is fueled by rising cost of raw materials, oil prices as well as wages and salaries. In addition, high growth of producer prices in 2004 will render increasing consumer price in 2005 and increasing prices mostly are those of foods and beverages and transportation items.

The low case of projection, namely 5.5 percent expansion, reflects downside risks of the negative factors being more severe than expected. In the worst-case scenario, the crude oil price from Oman could surge to 38-40 dollar per barrel and the world economy expands much slower than the projected 3.8 percent growth. Domestically, the disbursement rate is below the planned target. Under such conditions, consumption, investment, and export momentum would be weak. The economic growth will be close to the lower bound of the projected range. However, risk of hard landing is ruled out completely given a strong economic fundamental.

The high case is achievable given that and effective efforts are given to fulfill the following tasks designed as important policy guidelines.

(1) Planning for the right timing and phrasing of diesel price adjustment. Right timing for lifting the diesel prices ceiling is crucial for a smooth adjustment of the economy and stabilizing the prices. The government needs to plan for the adjustment after winter in the North atmosphere has passed so that the upward pressure on oil prices will not be too much to derail the correction process. Under such situation, it is expected the phasing of the increase of the diesel price will not exceed 3.7 baht per litre all together.

(2) Increasing the efficiency and transparency of government budget spending. The planned additional budget of 40 billion baht must be on time as planned for this year spending while ensuring transparency and efficiency of the spending.

The spending of the local administration and state-owned enterprises must be accelerated to support the growing economic activities at the grassroots and community levels.

(3) Avian influenza must be contained quickly to prevent further widespread while negotiating to expand the market for broiled and processed fowls.

(4) The unrest in the South must be resolved in a peaceful manner and as soon as possible to discourage further violence.

(5) The exchange rate policy should aim to manage the nominal exchange rate movement and prevent volatility so that the real effective exchange rate would not be too strong to jeopardize the competitiveness of the Thai products while taking into consideration the fact that the Chinese Yuan will be more flexible and to some extent will be determined by market mechanism.

Economic Projection of 2004

	Preliminary		Projection December 7, 2004	
	2002	2003	2004	2005
GDP (at current prices, Billion Baht)	5,446.0	5,930.4	6,523.4	7,130.1
GDP growth rate	5.3	6.9	6.2	5.5-6.5
(at constant prices, %)				
Investment (at constant prices, %)	6.5	11.9	12.7	12.2
Private (at constant prices, %)	13.4	17.5	14.9	13.0
Public (at constant prices, %)	-6.3	-0.8	6.6	10.0
Consumption (at constant prices, %)	4.8	5.8	5.9	5.6
Private (at constant prices, %)	5.3	6.4	6.0	5.4
Public (at constant prices, %)	1.8	2.0	5.0	7.0
Export volume of goods and services (Volume, %)	12.0	7.0	8.2	6.4
Export value of goods (Billion US dollar.)	66.1	78.4	96.0	107.4
Growth rate (%)	4.6	18.6	22.5	11.8
Growth rate (Volume, %)	12.0	9.5	7.1	5.8
Import Volume of goods and services (Volume, %)	13.7	7.7	12.3	8.4
Import value of goods (Billion US dollar)	63.4	74.2	93.3	107.7
Growth rate (%)	4.4	17.0	25.7	15.5
Growth rate (Volume, %)	13.3	9.7	12.7	9.5
Trade balance (Billion US dollar)	2.7	3.7	2.8	-0.4
Current Account (Billion US dollar)	7.0	8.0	10.1	8.7
Current Account to GDP (%)	5.5	5.2	6.2	4.6
Inflation (%)				
CPI	0.7	1.8	2.7	2.9-3.2
GDP Deflator	0.7	1.9	3.8	3.5

Source: Office of the National Economic and Social Development Board, December 7, 2004

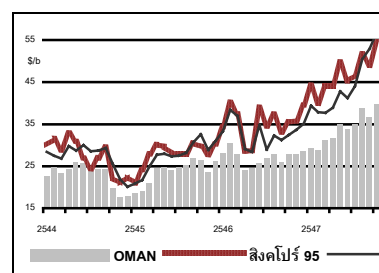
Analysis of abandoning of diesel price control

Office of the National Economic and Social Development Board analyses the impacts of higher diesel price on the Thai economy after the price ceiling is lifted, by taking into account possible effects on cost of production, price and spending. The analysis assumes the OMAN crude price at 35 USD per barrel. The gradual increase in diesel retail price is assumed to start in Q2/2005 and eventually the price will surge to around 18.0-18.30 baht/litre, meaning that the government subsidy of around 3.50-3.70 baht/litre will be removed. With the higher diesel price, the inflation will be up by 0.7 percent, which will dampen the private consumption by 0.6 percent and export volume by 0.42 percent. In sum, it will shed off around 1 percent of the real GDP growth, which have already been included in the current economic projection of NESDB.

1. Current price situation

In the first 11 months of 2004, OMAN crude price averaged at around 34.22 dollar per barrel, compared to 33.59 dollar of the DUBAI crude price.

Since January 10, 2004 upto present (December 3, 2004), the total amount of government subsidy is around 47,825.36 million baht with the average subsidy of 4.19 baht per litre or equivalent to 209.83 million baht per day. If the subsidy scheme is continued for the next year, the subsidy will be amounted to a little more than 90 billion baht, exceeding 1 percent of GDP.



2. Price outlook in 2005: price will remain high

Conditions/Factors affecting crude oil price	
Supply condition	Demand side
<ul style="list-style-type: none"> <input type="checkbox"/> The interruption to the oil production in the Mexico Gulf caused by the Hurricane Evan will return to normal by the first quarter of 2005. <input type="checkbox"/> The labour unrest and disputes in Niger Delta, Norway, Nigeria, and Brazil have been eased. <input type="checkbox"/> The problems of the Yukos owing a big amount of tax to the Russian government have been sorted out somewhat and the tension has been eased. <input type="checkbox"/> The 10 member countries of OPEC (excluding Iraq) are producing at 27.65 million barrel per day, higher than the quota agreed by the cartel. <input type="checkbox"/> Iraq itself has increased the production by 0.54 million barrel per day since October, making the present production level of 23 million barrel per day. <input type="checkbox"/> For the OPEC altogether, the spare capacity has been low, namely 0.5-1.0 million barrel per day while the situation in Iraq remain fragile. <input type="checkbox"/> In 2005, the supply of crude oil and natural gas is projected at 83.0-84.0 million barrel per day, higher than in 2004 	<ul style="list-style-type: none"> <input type="checkbox"/> Since November 2004, the stock of crude oil in the US has increased from the 2003 level by 3.5 percent. The building of the inventories so far has eased the upward pressure on price. In fact, the crude oil price declined very rapidly by a historical level of 3-4 dollar in one day. <input type="checkbox"/> In 2005 the demand for crude oil and natural gas is projected to increase to 83.9 million barrel per day from 82.4 million barrel per day in 2004. The increase of 1.8 percent is slightly lower than 3.8 percent expansion in 2004. <input type="checkbox"/> The demand for oil and gas is likely to slowdown in accordance with the world economic slowdown, especially the demand for oil and gas in China is expected to cool down. Moreover most countries have urged people to increase efficiency in energy consumption. <input type="checkbox"/> The oil inventories of OECD countries have been built up in 2004, but they are still at the low levels.

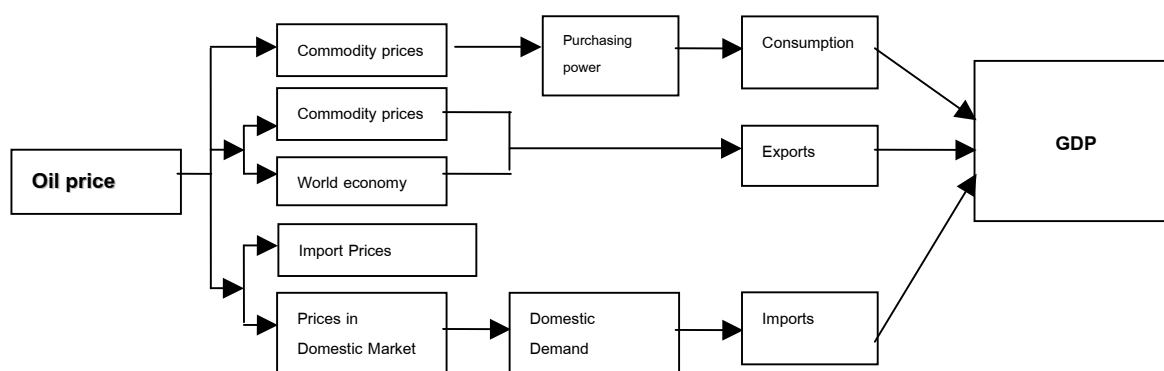
Psychological and technical factors

Price speculation by Hedge fund has been encouraged by exploiting the following three fundamental weaknesses of the oil market and production situation:

- (1) Low spare capacity of only 0.5-1.0 million barrel per day. This narrow capacity margin is estimated to increase crude oil price beyond the fundamental by 5 dollars.
- (2) The situation in Iraq remains fragile and uncertain. The interruption, if persist, would delay or hamper the export of around 2.3 million barrel per day.
- (3) The oil inventories of OECD countries remain relatively low, despite the recent build up, while the demand will continue to rise. As projected by the International Energy Agency on November 12, 2004, the demand for crude oil and natural gas of around 82.4 million barrel per day is the highest demand level in 24 years. This inventory balance is estimated to jump up the oil price by 10 dollar per barrel beyond the fundamental price level.

3. The impacts of rising diesel price after the price ceiling is lifted

3.1 The mechanism of oil price impacts on the economy



3.2 Impacts of removal of diesel price control on overall economy in 2005

Assumption	Removal of Diesel Price Ceiling		Subsidize 2 baht/litre
OMAN crude price (\$/bbl) ^{1/}	35.00	40.00	40.00
Weighted Retail Prices (baht/litre) ^{2/}	18.75	21.43	20.04
Benzene 95 Retail Price (baht/litre)	20.40	23.30	23.30
Benzene 91 Retail Price ((baht/litre)	19.65	22.40	22.40
HSD Retail Price (baht/litre) ^{3/}	18.30	20.85	18.85 ^{6/}
Subsidy removal (baht/litre)	3.41	6.26 ^{5/}	4.26 ^{6/}
Impact Assessment			
Overall economy in 2005	-1.02	-2.55 ^{5/}	-1.99 ^{6/}
Inflation (%)	0.69	1.32	0.94
Private Consumption (%)	-0.60	-1.14	-0.82
Export Volume (%) ^{4/}	-0.42	-1.41	-1.17

Note::

1. average price of Oman oil price
2. average price weighted by oil consumption in each items. Share of domestic oil consumption on Benzene 95, Benzene 91 and High-speed Diesel are 12.2, 18.2 and 69.6 respectively

3. on August 11, 2004, government has stabilized retail oil price of Diesel at 14.59 baht/litre
4. these are effects of rising oil price to relative price
5. This is the case of 35 dollar per barrel. If oil price increases from the base case (35 dollar per barrel) to 40 dollar per barrel, this is the total effects including effect on global economy which accounted for both effects through higher price in Thailand and effect of world oil price on trading partner's income.
6. This is the case of subsidize diesel price by 2 baht per litre.

4. Pros and Cons of Price Subsidy

Pros	Cons
<ul style="list-style-type: none"> ❑ Stabilizing the prices of goods and minimizing the impacts of sudden and huge increase in oil price and good prices to help preventing the economic instability and people from losing confidence, which could jeopardize the economy. ❑ The scheme would allow private sector to be prepared and adjusted to rising in production cost. Should the oil price rises are only temporary, the subsidy would be paid off to the government after the oil prices are normalized. 	<ul style="list-style-type: none"> ❑ The market mechanism is distorted should the oil price rises linger and the fundamental price increases to a higher level. The subsidy will become a big burden for the government and needs to be financed. The method for financing could distort the tax structure further in that the burden will not be borne by the consumers themselves. ❑ The price ceiling will not encourage private sector to realize the real cost of production and thus will not place enough effort to increase efficiency of energy consumption. This could become the government burden again in the future should the oil price fluctuate and rise.