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NESDB *Economic Outlook*

THAI ECONOMIC PERFORMANCE IN Q2/2004 AND OUTLOOK FOR 2004-2005

- Thai economy in the second quarter of 2004 expanded at the rate of 6.3 percent, slightly slowed down from 6.6 percent in the first quarter due mainly to hampering factors in both production and expenditure sides.
- Inflation hiked up to 3.0 percent at the end of second quarter as a result of buoyant food prices and the pick up in other products' prices. However, internal and external economic stability remained favorable.
- Domestic and external constraints such as an increase in the interest rate by the Bank of Thailand and continued rise in oil price will render economic performance less buoyant in the latter half of 2004, and expected to record approximately growth of 6.0-6.5 percent for 2004.
- With limitations likely to continue next year, it is projected that Thai economy will grow by 5.5-6.5 percent in 2005.

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OVERVIEW

Summary

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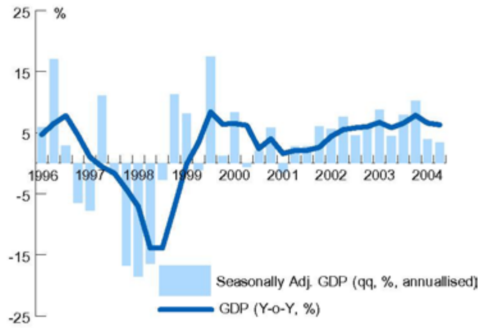
Thai economy expanded by 6.3 percent in Q2/2004.

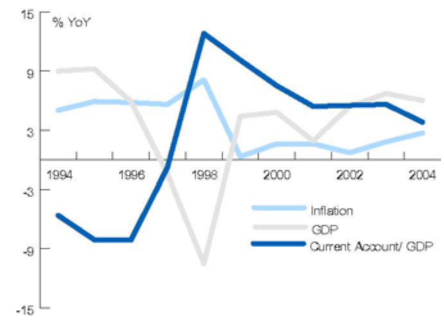


Source: NESDB

The Thai economy in the second quarter of 2004 expanded at the rate of 6.3 percent, slightly slowed down from 6.6 percent in the first quarter. Agricultural productions fell short of those in the corresponding period last year while manufacturing sector continued to expand, though at a slower pace. Nevertheless, favorable agricultural prices helped support a substantial rise in farm income. Commercial banks continued to extend more loans, but private consumption and investment showed signs of a slowdown from the expansion in previous quarter.

Surge in farm and oil prices fostered the acceleration of consumer price increases to 3.0 percent in June, driven by the rise of prices both in farm and non-farm products. However, economic stability remained favorable, as reflected in the strong current account balance, increasing international reserves, declining public debts, and stable exchange rate.

In 2004, economic growth is projected to be 6.0-6.5 percent with 2.7 percent inflation rate.



Source: BOT

In the latter half of the year, an increase in the interest rate conducted by the Bank of Thailand and the hike in oil prices will slow down private consumption and investment further. Thus, it is projected that the Thai economy in 2004 will expand by 6.0-6.5 percent.

In 2005 the world economy led by the US, Japan and China is likely to moderate. In addition, the Thai economy will encounter some domestic limitations which could restrain growth next year such as upward trend of interest rates in line with the increase in Fed Fund Rate and increasing inflation rate as well as rising diesel price as the subsidy will be phrased out in order to curb the future burden of the government Hence, it is projected that the Thai economy in 2005 will expand at the rate of 5.5-6.5 percent.

1. THAI ECONOMY IN Q2 AND THE YEAR 2004

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

	2002	2003			2004		
	Year	Q3	Q4	Year	Q1	Q2	Year
World	3.0			3.9			4.4
United States	1.9	3.5	4.4	3.0	5.0	4.7	4.4
EU-151/	1.0	0.6	1.0	0.7	1.6	2.2	2.3
Euro Zone	0.8	0.4	0.7	0.5	1.3	2.0	1.8
Germany	0.2	-0.3	0.0	-0.1	0.8	1.5	1.8
Japan	-0.4	1.9	3.1	2.7	5.9	4.4	4.0
Hong Kong	2.3	4.0	4.9	3.3	7.0	12.1	6.3
Singapore	2.2	1.7	4.9	1.1	7.5	13.0	7.6
South Korea	7.0	2.4	3.9	3.1	5.3	5.5	5.2
Taiwan	3.6	4.0	5.7	3.3	6.7	7.7	5.5
Indonesia	4.3	3.7	4.1	4.5	5.0	4.3	4.7
Philippines	4.4	4.8	5.0	4.5	6.4	6.2	4.8
Malaysia	4.1	5.2	6.6	5.2	7.6	8.0	6.6
Thailand	5.4	6.6	7.8	6.8	6.6	6.3	6.0-6.5
China	8.0	9.6	9.9	9.1	9.8	9.6	8.0

Source: Government agencies, and average from several sources.
1/ EU15

1.1 World Economy in Q2 and 2004:

The world's main economies including the US, China and Japan slowed down in the second quarter this year. This is mainly due to the monetary policy tightening, aimed to cool down the nearly overheated economic situation in these countries, which resulted in lower growth rates in the Japanese exports and private investment whereas the Japanese public investment growth has also receded. Nevertheless, growth rates of the Asian and EU economies rose from that in the first quarter due to domestic demands, which remained strong in most of these economies, and rapid strengthening in exports growth especially by Singapore, South Korea and Taiwan.

The US economy grew 4.7 percent this quarter compared with the 5.0 percent in the previous one. Signs of an economic slowdown became more noticeable once quarter on quarter comparison is considered, in that the second quarter expended by annualized rate of 2.4 percent from the first quarter which is lower than 4.5 percent in the first quarter. The slowdown was primarily due to rising oil price and interest rates which have led to slowdown in private consumption expenditures. However, the slowdown was partly due to the psychological effect, which once dissipated the consumption should grow better than the current rate of expansion. Promisingly, however, private investment in machinery, equipment and software remained strong. **The Japanese economy** grew by 4.4 percent, down from 5.9 percent in the first quarter owing to the slowing down in all demand components. The exports which increased by 14.2 percent in this quarter, however, remained an important driving force of the economy. Meanwhile private consumption and investment started to experience a more evident slowdown. Unemployment rate stands at around 5 percent while pressure on prices remains at bay.

The EU economy expanded by 2.2 percent in the second quarter, higher than 1.6 percent in the previous quarter. This is mainly supported by the strong recovery of exports, especially to the U.S., which also improve confidence in the economy and consumer spending

Unemployment problem, however, still persisted due to inelastic labor market as well as concern over the public welfare fund's ability to pay benefit in several European countries.

The Chinese economy registered a growth of 9.6 percent in the second quarter, followed the 9.8 percent growth in the first quarter. The main supporting factors for the Chinese economic growth were private consumption and exports. The Chinese government's measures to cool the economy appeared to have worked as the rate of investment slowed significantly from 43.0 percent in the first quarter to 29.0 percent in the second quarter. This noticeably signal a cooling down of the economy.

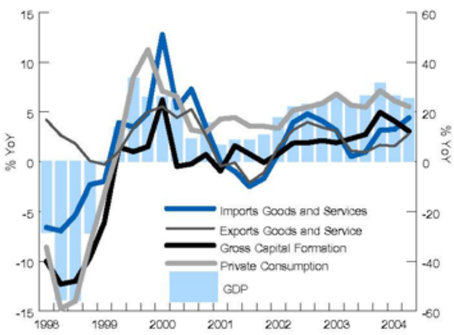
The Asian Economies ex Japan

Major economies in Asians continued to expand well in the second quarter, namely South Korea, Singapore, Hong Kong and Malaysia with the growth rate of 5.5, 13.0, 7.7, 12.1 and 8.0 percent respectively, higher than the rate of 5.3, 7.5, 6.7, 7.0 and 7.6 percent in the first quarter. Economic growth of Asian countries in this quarter were still broad-based through real sector and were supported by various expenditure sources in the economy.

Domestic demand, both consumption and investment, remained robust. Moreover, exports of these countries grew considerably, particularly exports to China, USA and among the region. Exporting industries beneficial to Asians includes electronic goods, telecommunication devices, chemicals and medicines showing increasing trend in this quarter.

1.2 Thai Economy in Q2/ 2004

Thai economy in Q2 of 2004



Source: NESDB

Source: NESDB

Thai economy in Q2/2004: Economy slowed down, but domestic demand remained to provide economic momentum. In Q2 Thai economy expanded by 6.3 percent, slower than 6.6 percent in Q1 and 7.8 percent in Q4 of 2003. The seasonally adjusted real GDP expanded by 2.9 percent from the first quarter, lower than 9.4, 10.2 and 3.2 percent in the past three quarters, although short-term uncertainties such as bird flu outbreak and social unrest in three most south provinces had already been resolved a great deal. In the second quarter domestic demand slowed down quite considerably while stock accumulation added positively to the real GDP growth. Moreover, moving average of stock accumulation increased noticeably. Meanwhile, final sales slowed down and registered 4.4 percent growth, lower than 5.0 percent growth in the first quarter and substantially below 5.7 and 7.0 percent in the last two quarters of 2003 when economic expansion reached the peak. This development signals that the Thai economy is moving into a slowing phase of economic cycle

Signs of economic slowdown reflected a regular adjustment of business cycle which has been dampened further by temporary impacts of increasing oil prices. These factors fueled faster and more severe slowdown than normal adjustment. When temporary negative factors dissipated, the economy will continue to expand well.

However, adjustment in business cycle suggested that the Thai economy surpassed the high growth period and already utilized existing excess capacity for a constant period of time. This fostered Thai economy to grow beyond its potentials without building so much inflationary pressure that economic stability affected. Nevertheless, as excess capacity is continually lowered, inflationary pressure started to rise. Temporary hike in oil price reinforced inflationary pressure further in addition to upward trend induced by current cycle. The economic slowdown in 2004, thus, was an adjustment to medium-term potential growth, tracking the business cycle; however, dampened further by temporary factors in which the government must find cushion to prevent excessive volatility.

Domestic demand remained to be key driving force to economic growth

Household expenditure at constant prices increased by 5.5 percent, slowed down from 6.1 percent in the first quarter because the price level began to rise. Increasing retail price ceiling of benzene 91 and 95 affected consumers' behavior; consumers became more cautious in spending. However, people's purchasing power still increased due to (1) major salary adjustment in April 1, 2004 (2) higher farm income and (3) expansion of commercial banks' consumer credits. Total investment expanded by 12.1 percent, lowered than 16.2 percent in the first quarter. Investment expansion attributed to private investment growth of 16.2 percent, slowed down from 17.8 percent in the first quarter. Private investment grew well in the areas of construction and machinery and equipment investment. Public investment was driven by investment of state-owned enterprises while public investment construction decreased. Government consumption at constant prices increased by 4.3 percent, lower than 8.2 percent in the first quarter.

On the external front, import volume of goods and services increased by 17.6 percent, accelerating from 12.9 percent expansion in the first quarter. Export volume of goods and services increased by 11.1 percent, accelerating from the first quarter as well due mainly to the larger number of inbound tourists relative to low base last year while export volume of goods did not increase significantly. Import volume of goods and services increasing at faster pace than that of exports resulted in negative net exports contribution and discouraged economic growth. However, average export prices increased more than that of import prices because of higher world farm prices particularly prices of grain and rubber as well as buoyant manufacturing prices. Therefore, Thailand gained from terms of trade in both goods and services. Trade and current account surplus, as a result, did not decline rapidly and remained to be positive factors to people's income and purchasing power as well as compensated impacts of rising oil price to some extent.

Production side

Agricultural sector diminished 7.5 percent for the second consecutive quarter due to drought and the continuing adverse effects of the avian flu. Output fell in 3 categories: (1) The major crops such as the second crops of rice, sugarcanes, cassava and corns (2) Fishery products especially the exported shrimps. This is because the anti-dumping inquiry by the US induced shrimp exporters to undergo most of their export activities in the first quarter. And (3) Livestock: There has been a decline in the output of poultry products especially chicken and chicken eggs. Rubber's output has improved but not quite caught up with the ever-increasing global demand. Nevertheless, rubber exports fell considerably in the first quarter as much of this year's planned exports, being induced by last year's historically high rubber price, were shifted over to last year, thus biting into this year's realized rubber stock.

Manufacturing sector expanded at an equal rate as last quarter's growth of 7.7 percent. Most sub-sectors still grew in parallel with the overall exports situation, except for food products which suffered the adverse consequences of the avian flu. However, the construction materials industry is starting to see upward changes in prices and shortages in certain items such as steel and cement which has recently undergone an increase in exports. **Most other sectors** grew reasonably well, in particular the tourist and services sectors which improved from last year low caused by the outbreak of SARS. As a result, this year's second quarter sees a rise in the number of tourists of 88.0 percent compared with last year.

The continuing economic upturn has contributed to a rise in total **employment**. The second quarter ends with a 4.7 percent increase in employment from that in the corresponding period last year. Employment both in the agricultural sector and non-agriculture continues to increase. Unemployment totals 0.813 million in the second sector which equals to 2.3 percent of the total labour force, compared with the 0.865 million figure which equals to 2.50 percent of the total labour force in 2003.

With regards to the goods prices, consumers prices averaged 2.6 percent higher than the 1.9 percent in the first quarter, which is mainly explained by the substantial increase of 5.0 percent in the food sector following a rise in prices of pork and meat due to a shift in demand from poultry items. Prices of vegetables, fruits and flour-related products including eggs have risen considerably. For products other than food and drinks, their prices increased by 1.2 percent which is higher than the 0.2 percent in the first quarter. This is due to effects from rising oil prices, despite the presence of domestic price controls. Together with the high input costs which continued to rise from last year, prices have been growing gradually, hence inducing prospects for a rise in inflation. Core inflation averaged 0.4 percent in the second quarter compared with the 0.1 percent in the first quarter as the inflationary pressure from oil price escalation began to take effects.

The first 8 months of this year saw an average headline inflation rate of 2.5 percent and core inflation rate of 0.3 percent.

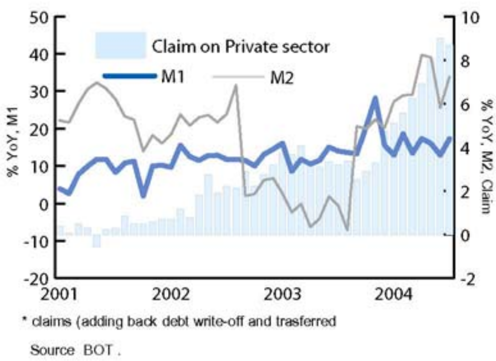
The producers' prices index (PPI) rose throughout the different production stages. The first 7 months of 2004 saw a rise in the PPI in the raw materials sector of 9.9 percent which was higher than the 6.0 percent in the intermediate products stage and substantially higher than the 3.2 percent in the final goods sector. As seen since the 2003, such structural changes imply that the extent of a shift in financial burden from the initial investment cost to consumers has not been substantial.

Financial situation:

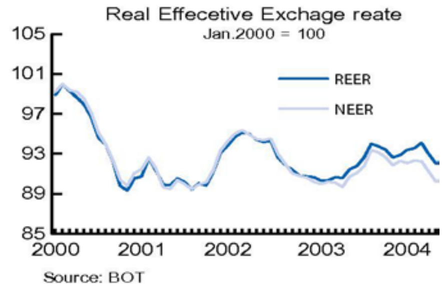
Continued credit expansion throughout the year.

At the end of the second quarter of 2004, credit outstanding increased by 6.9 percent compared to the same period of last year, and accelerated from the rate of 4.4 percent at the end of the first quarter. Credits continued to grow following the economic expansion, and thus, showed a faster growth rate than that of 3.7 percent of deposits at the end of the second quarter. The credit to deposit ratio at the end of June 2004 stood at 94.1, the highest ratio ever in the past three years. This pointed out that the liquidity in the banking system started to decline, though still at the high level. On the corporate side, some private firms used their net profits as another source of financing for their business on both investment and operation. In the second quarter of this year, initial public offering shares as one financing resort still increased in which some of them were the re-capitalization of listed companies. In the mean time, new issuance debentures declined by 4.6 percent.

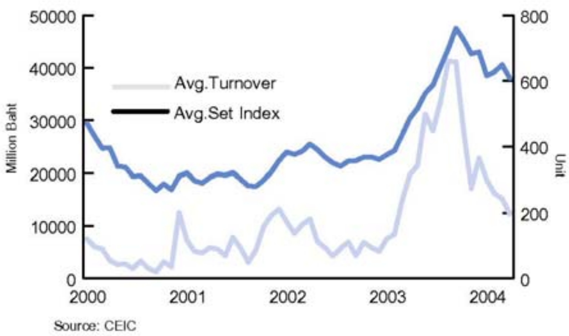
Overall, financial sector showed an improved performance. Valued added of the financial sector computed from the National Account System increased by 16.3 percent, accelerated from 11.7 percent in the first quarter. This was due to continued credit expansion. Nevertheless, the ratio of NPLs to total credit outstanding remained the same at the rate of 12.0 percent throughout the end of the second quarter, while lower than 15.7 percent at the end of the second quarter of 2003.



Meanwhile, Exchange rate depreciated in the second quarter, moving in the range of 39.04-40.94 baht/ US dollar, or averaged 40.22 baht/US dollar. This accounted for a depreciation rate of 2.6 percent compared to the first quarter, owing to appreciation of US dollar, rising oil prices and more securities selling by foreign investors. Meanwhile, consumer prices slightly increased, thus, the real effective exchange rate still kept depreciating.



Stock market remained steady. At the end of the second quarter, the SET index stood at 646.6, almost the same as 647.3 at the end of the first quarter. However, it is higher than 484.11 at the end of the second quarter of 2003. The average daily trading volume dropped from 28,729 million baht in the first quarter to 19,237 million baht in the second quarter, or decreased by 33.0 percent, whereas increased by 87.5 percent compared to the same period of previous year. On September 3, 2004, the SET index was 629.08 and topped the 16,882.2 million baht daily trading volume.



Economic stability:

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

- **Fiscal position improved.** In the third quarter of 2004, the fiscal balance was in a surplus of 84,650 million baht. At the end of the second quarter of 2004, the outstanding public debts totaled 2,932,228 million baht, or equivalent to 45.30 of

GDP. This comprises of the direct borrowing by the government (25.54 percent to GDP), state-owned non-financial institutions' debt (13.4 percent to GDP) and the Financial Institute Development Fund's debt (6.36 percent to GDP).

- International reserves remained high at 43.3 billion US dollar at the end of June, 2004, equivalent to 3.7 times of short-term debts.

At the micro level, there has been some improvements, for example, continued increase in corporate profits since the latter half of 2002. In the second quarter of 2004, corporate profits of listed companies rose by 16.2 percent, continued increase from 35.6 percent increase in the first quarter. Moreover, the decline in debt equity ratio from 4.42 at the end of 2003 to 4.21 at the end of March suggests healthier financial strength of corporate. Based on improved economic fundamentals, sovereign credit rating of Thailand has been raised by all credit rating agencies.

Credit Agency	Rating Change			Outlook Change		
	from	To	date	from	to	date
S&P	BBB	BBB+	08/04	Positive	Stable	08/04
Moody's	Baa3	Baa1	11/03	Positive	Stable	11/03
Fitch	BBB-	BBB	09/03	Positive	Stable	09/03
JCR	BBB	BBB+	11/02	Stable	Positive	11/03

* Sovereign Credit Rating: Foreign Currency-Long term

2. ECONOMIC FACTORS AND CONDITIONS IN 2004

2.1 Global Economic Trend in the second half and throughout the year 2004

In the second half, the global economy will expand further, but at a slower pace for most countries including particularly the US, Japan, China and other Asian economies. Average high growth in the first half will support a satisfactory performance of around 4.4 percent expansion for the year, higher than the 3.2 percent in 2003, led by strong growth prospects of the US and Japanese economies owing to the implementation of low-interest-rate policy and stimulus measures in sectoral level since 2002. Meanwhile Asian economies have benefited from buoyant world economic condition and the implementation of policies to strengthen domestic economy. In addition, trade with China and intra-regional trade is expected to expand well into the latter half, albeit a slight slowdown in growth.

Increased oil prices are likely to push inflation rate higher in large, emerging and developing economies than in the past year. However, it should be noted that the concerns over higher cost of production in the form of raw materials and intermediate products may be exaggerated due to the following reasons which may justify a gradual increase in consumer prices: (1) excess capacity remains high although it decreases continuously and competition is still intense, and (2) productivity improvement in several countries, which was partly encouraged by the need for reform during crisis and economic downturn. Hence, the increase in the interest rate is likely to be gradual. Moreover, the following two promising developments in major economies, which are the global growth engines, will be the important force to drive the global economy and keep economic momentum to prevent the global economy from hard landing: they are lowered unemployment rate and the continued rising in private investment.

(1)**The US economy** is likely to expand up to 4.4 percent in 2004, higher than 3.0 percent in 2003. Labour productivity in the US has continued to improve as a result of business effort in improving corporate performance and the benefit of successive investments in high-end ICT technology prior to economic downturn in 2001. This improvement helps ease the pressure on prices as the economy accelerates. In 2004, it is expected that inflation rate in the US will be around 2.5 percent, slightly higher than 2.3 percent in 2003. The average unemployment rate will come down from 5.7 percent in the early of 2004 to 5.5 percent by the end of this year.

However, the twin deficits, i.e. government budget in concurrent with current account deficits, remain an important fundamental problem of the US economy and will pressure the US dollar to depreciate.

(2) **The European Union** is likely to expand at the rate of 2.3 percent this year, increased from 0.7 percent in 2003. Inflation rate will be around 2.2 percent. Meanwhile the Euro Zone is likely to register a 1.7 percent economic growth. For this region the domestic demand has been strengthened as a result of buoyant export performance since the latter half of 2003. Industrial and consumer confidence indexes improve in tandem with the economic recovery. Steady unemployment rate is a good sign of the employment condition. However, the slowdown in the US economy and increased oil prices will be risk factors threatening the economic recovery of the European Union as a whole. Under the world economic slowdown scenario, it is more likely that the European Union will grow at the lower rate than what is currently expected.

(3) **The Japanese economy** started to slow down in the second quarter due to the slowdown in domestic demand and exports, after registering high growth in the first quarter spurred by rising demand from the US, Asia and China. The average growth in the first half of the year is around 5.7 percent. It is anticipated that investment and exports will moderate in the latter half as a result of the economic slowdown in the US, China and global economy. Therefore, the Japanese economy is expected to grow by 4.0 percent this year, yet considerable high while deflation still lingers. Average consumers' prices are expected to decline further, but at a lesser degree comparing to 2003, due mainly to higher demand for goods and services in 2004. However, there are risks associated with the Japanese economic outlook especially the structural problems which could impose limitation to country development in the latter stage. These include, for example, weak financial and corporate sectors, highly indebted public sector and persistent deflationary phenomena.

(4) **The Chinese economy** is expected to slow down more evidently in the latter half as a consequence of the government efforts to cool down the overheating economy especially in investment. The measures include, for example, increasing in reserved requirement ratios and applying more restricted rule to commercial banks' lending especially on over invested sectors such as real estate and iron production. However, the adjustment is likely to yield more effect on capital

goods than employment condition. Meanwhile urban and rural incomes have tendency to rise further, given that a favorable condition of commodity prices has continued. Foreign capital inflow to China is expected to continue while exports are expected to grow well into the latter half and next year despite the elimination of the export tax rebate. In the first half of this year, the overheating situation of the Chinese economy has gradually eased, as suggested by the slowdown in fixed asset investment. Yet, the first half of 2004 registered a robust growth of 9.7 percent, attributable to high growth in domestic spending and exports which helped compensating the slowdown in investment. Therefore, for 2004 it is expected that the Chinese economy will expand by 8.0 percent, clearly lower than 9.1 percent in 2003. Inflation will rise substantially as a consequence of higher oil prices and raw materials prices as well as more expensive food and consumer products, affected by heavy flood in China. Hence, it is likely that inflation rate will climb up to 4.4 percent, significantly higher than 1.2 percent in 2003.

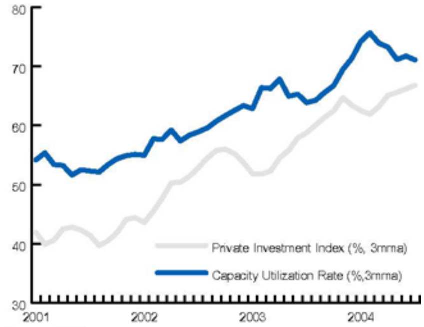
(5) **Asia ex Japan** expands well in the second quarter especially Singapore, Hong Kong, Taiwan and Malaysia, contributed by the buoyant exports in particular electronics and agricultural products to major markets. Further support came from increasing regional trade and trade with China. Together with the existence of domestic stimulus package such as the use of low-interest-rate policy as well as strong economic fundamentals, impacts of the surge in oil prices remain manageable. In fact, various economic agencies revised downward economic outlook in many countries such as Hong Kong, Singapore, Korea, Malaysia, Taiwan. Overall, Asia ex Japan is expected to grow by 6.6 percent, higher than 6.0 percent while inflation rate will be around 3.5 percent, substantially higher than 1.6 percent in 2003.

2.2 Key supporting factors for 2004

Supporting factors in the second half of this year are those already assessed since beginning of the year. However, their impacts are likely to weaken in the latter half. They are as follows:

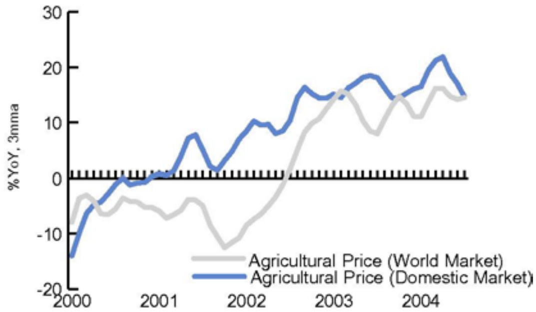
(1) Continued expansion of the global economy remains to be positive factor, but it is likely to slow down in the latter half

(2) Supportive factors to private investment consist of high and continued increase in capacity utilization, low real interest rate, albeit the rise in market interest rate, and improved corporate profitability although at slower pace.



Source: BOT

(3) Favorable factors backing household income are favorable commodity prices, improved corporate profitability, as well as gains in the terms of trade. This will in turn support household expenditure and partly offset the adverse impacts of a rise in oil prices.



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(4) Disbursement rate of government budget is expected to be higher towards the end of fiscal year. In addition, spending on new election campaigns will help boost up economic activities in the last quarter.

3. DOWNSIDE RISKS

Downside risks associated with the economic growth assessed as of September 6, 2004 are as follows:

3.1 External Factors

(1) The global economic slowdown in the latter half caused by the more tightening monetary policy and specific measures to cool down overheating economic conditions by controlling private credit especially in the US and China. The slowdown will hamper the Japanese exports. In addition, the slowdown of the global economy is dampened further by the rise in oil prices, which can potentially trigger economic downturn more severely than it otherwise would under the normal adjustment along the cycle.

However, NESDB assesses that, overall, the global economy is likely to grow at a quite satisfactory rate into the latter half of this year.

- Major economies such as the US, Japan, China and Asia continue to benefit from the use of low-interest-rate policy and the increase in government spending in the past two years. In addition, increased world trade volume since 2002 has triggered the rise in domestic demand in many countries particularly private investment, which has improved continually in the Asian economy.
- Although the interest rate rose, it remained to be at a low level and in fact real interest rate, which reflected true cost of borrowing, increased only slightly. In addition, for Asian economies including Thailand, private debt problems during the economic crisis have already been resolved to a great extent.
- Impact of oil price rise on the global economy in 2004 should not be severe because the oil price rises came at the time of strong economic fundamentals in many countries, judging by favorable current account standing of countries in Asia including Japan and China, and higher productivity. In addition, more prudent monitoring on price movement than in the past by the central banks somewhat raise people's concerns over inflation problem. Higher confidence level and strong economic performance in the US, Japan, China and Asia in the first half coupled with more efficient energy consumption also render the world less vulnerable to surges in oil prices than in the past.

  Nevertheless, NESDB believes that impact of oil price rise on the global economy will be more pronounced in 2005 which is likely to be a slowdown phase of the world economic cycle prompted by tightening monetary policy. It is expected that cost burden mounted in 2004 will be gradually passed on to consumers as prices in goods and services are adjusted upwards. This is likely to be the adjustment process as the excess capacity declines, employment condition improves, and pressure on labor wage surges.
- Oil-exporting countries such as Middle East countries and Russia tend to increase spending to stimulate the economy, which, in effect, partly alleviates the adverse impacts on the global exports.

(2) Rising crude oil price remains an important downside risk to the expansion of the global economy. The impacts on global economic situation in turn affect the Thai exports. As import value steps up due to rising crude oil price while oil consumption quantity decreases only slowly, current account position may be adversely affected. The adverse effects also include the deterioration of business and consumer confidence caused by the concern over the prospects of oil price movements.

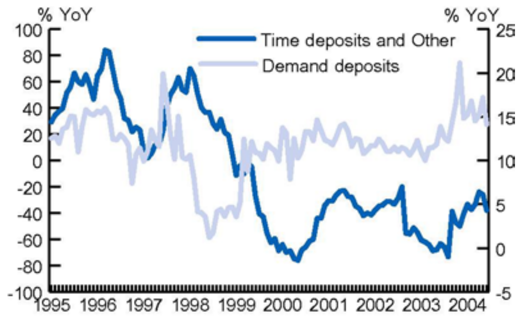
3.2 Internal Factors

In the previous press release, the ban on Thai export of frozen fowls and the anti-dumping investigation over the shrimp export to the US were potential limitations on Thai exports. The increase in price, pressured by higher labor wage, salary and rising oil prices, and rising prices of construction materials was also considered as risk factors for Thai export and economic activities in general. In addition, the unrest in three southernmost provinces was also included in the list of hampering factors.

Economic assessment this time points to the following limitations, which are more likely to be constraints to the economic performance in the latter half. They are rising interest rate and increasing prices of goods and services, and higher gasoline prices which potentially affects consumers' purchasing power. Moreover Thailand's country specific problems in exports, as well as large export base in the second half of last year are likely to impose constraints on high export growth. These factors will only slow down the economic performance but will not derail the growth path.

(1) Increasing prices and rising interest rates

- Effects of increased price level and rising interest rate have started to discourage household expenditure since the first half of this year and it is likely that the impact will be more pronounced in the second half especially spending on durable goods, which is more sensitive to price, income, and interest rate than non-durable and semi-durable goods. This is particularly the case when public confidence is being dampened and household saving is diminishing after a few year of consumption expansion financed by dis-saving. Expectation for a further rise in interest rates will also hurt household spending. In fact, household expenditure in metal products, machines and equipments at constant prices in the first half of 2004 already moderated. It increased by 14.2 percent from the same period of previous year, slowing down clearly from expansion rate of 24.4 and 18.8 percent in the first and second halves, respectively, of the previous year. In durable goods category, sales of automobiles and equipments expanded by 21.1 percent comparing to 43.2 and 30.2 percent in the first and second half of 2003.



Source: BOT

- Moreover, personal consumption loans have started to slow down since the beginning of this year. At the end of June 2004 personal consumption loan outstanding increased from the same period of last year by 8.2 percent, lower than 14.3 percent and 30.0 percent expansion at the end of 2002 and 2003 respectively.
- Although real interest rate will not increase substantially, impacts of rising interest rates on private investment in the short term may prevail via expectations on declining demand for goods and services in both domestic and foreign markets. Such expectations will somewhat affect investment incentives especially under the circumstance of declining business confidence since April 2004. In this regards, the confidence index had already fallen below 50, suggesting that majority of businesses being questioned is losing confidence in the economic situation. The index stood at 48.3 in July 2004. Besides, listed companies' profitability increased at a slower pace in the second quarter, i.e. 16.2 percent compared with 35.6 percent growth in the first quarter. However, it is expected that the slowdown in investment will not be substantial because investors remain optimistic in Thailand's strong fundamentals, and besides real cost of borrowing is still low. Most importantly, capacity utilization rose to pre-crisis level and, by the end of July 2004, capacity utilization was around 70.9 percent.

(2) Export problem

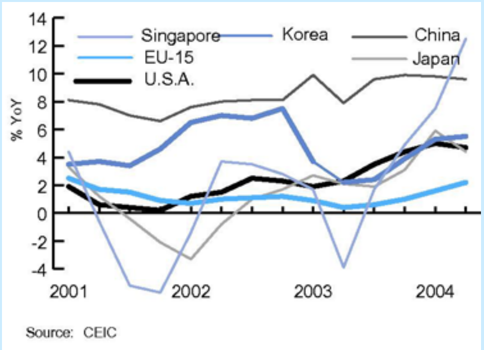
- Europe and Japan's ban on Thailand's frozen chicken export led to a decrease in both volume and value of frozen chicken exports by 88.0 and 86.8 percent in the first 7 months of 2004 comparing to the same period last year. Thus, it is expected that impacts on volume of frozen chicken exports will be worse than was anticipated in the previous assessment. However, value of frozen chicken exports throughout the year will be around 19,000 billion bahts as expected earlier.
- As a result of the US anti-dumping investigation on shrimp export, the Thai shrimp export to the US has been imposed with 5.56-10.25 percent import duty. This rate is higher than 6.08-9.35 percent imposed on Ecuador.
- Canned-food industry faced the problems of rising production cost and shortage of raw-material supply especially iron sheet. Moreover, canned tuna exporting industry experience problems of having Nutroflurance remain in the products and shortage of raw materials.

4. KEY ASSUMPTIONS FOR 2004 PROJECTION

Key Assumptions for 2004 Projection

(1) The world economy The world economy expanded by 4.4 percent, which is higher than the 3.9 percent used as an assumption for the world economic expansion in 2003 and equal to the June 7, 2004 forecast, despite a sharp hike in oil prices that occurred since the previous forecast. This is because there have been an upward re-adjustment in the first quarter's economic data of many countries and realized growth figures in the second quarter that were higher than predicted, which were due to a strengthening in domestic demand and sharp rise in exports – especially to Japan, the PRC and other Asian countries. Notably, the adverse effects of the oil price shocks have yet to show strength, while the economic slowdowns of the PRC and the US are expected to pursue a gradual pace without enduring the much feared hard landing.

- **The US monetary policy.** The US interest rate increase is likely to follow a moderate upward trend and it is one which takes flight from a very low starting point, unlike in 1995-1996 when interest rates increased by as much as 300 basis points over the period thus kicking start a dramatic adjustment process in the capital market.



- **The slowdown in Chinese economy** will not be a hard landing. Although over investment indicated the overheating conditions of Chinese economy but looking more closely into details, the government has started to gain stronger control over credit lending in sectors with large investment that are generating excess capacity, for instance the real estate development, iron, steels, aluminium and cement sectors. This remedy basically was measures to lower degree of overheating in some specific sectors. Impacts thus should be on capital goods rather than employment, which could potentially affect household expenditure in the great extent. Moreover, China's exports bold well and remains competitive especially in labor-intensive products in addition to rising farm prices. All of these supportive factors will help prevent Chinese economy from undergoing a hard landing and it should be noted that the Chinese government ensures that policies regarding increase in reserve requirement and limits on credit expansion to overheating sectors will remain unchanged.

(2) **The oil price** Assumption on Oman oil price is adjusted from 32.0 US dollar/bbl as of 7 June 2004 to 34.0 US dollar/bbl, and increases by 25.32 percent from the 2003 average price in accordance with a recent rise in crude oil price over the initially expected value. Production problems in Russia and Venezuela and speculations of oil prices in the futures market, which is derived from a psychological factor regarding the unrest in Iraq, are major causes of rises in oil prices. However, it is expected that oil price will decrease by the end of the year while demand for oil subsides as a result of the global economic slowdown. Oman reference crude oil price in the first 8 months was 32.93 US dollar/bbl and oil price is expected to remain stable around 37.40 US dollar/bbl in September, as in August. An increase in production quantity at the faster pace than that of consumption suggests that average oil price in the final quarter will be around 35.5 US dollar/bbl. Nevertheless, oil price reduction will not be substantial because there are some lingering problems in Iraq, which will obstruct oil production. In addition, countries in North America and Europe will consume more energy as they approach winter season, despite increased accumulation in commercial oil stocks in OECD countries.

Source : EPPO

(3) **The government will fix the diesel oil price** at current rate of 14.59 baht per liter until the end of this year to alleviate the impacts on economic conditions. Retail oil prices for benzene 91 and 95 are also expected to be at the current rates of 20.78 and 21.79 bahts for 2 more months although these retail prices are higher than the realized world market values and it is likely that retail prices will be adjusted closer to reality in accordance with lowered oil prices in the end of the year. Hence average prices for the whole of 2004 of diesel, and benzene 91 and 95 will be 14.59, 18.30 and 19.16 bahts per liter respectively..

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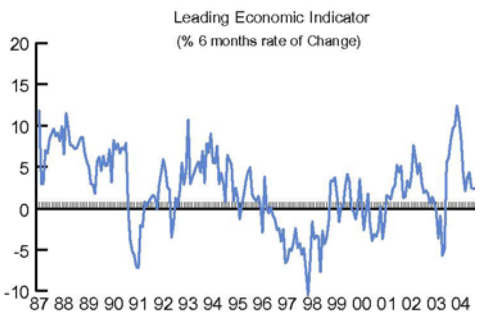
(4) **Export prices in term of US dollar** increases by 15.0 percent, higher than 14.0 percent growth estimated in the last press release. This is due to a rise in oil prices, which contributed to the high export prices in the first 7 months, and the agricultural product prices which declined more slowly than predicted. Export prices in every category including agriculture, electronics, manufacturing increased in the more rapid rate than in 2003. Average import prices in 2004 increased by 14 percent, higher than 11 percent in last projection. Upward trend in export and import prices showed that Thailand has opportunity to achieve gains in terms of trade, but the gains will be lower than that projected in June because oil prices had increased more rapidly than expected.

(5) **Thailand is banned from exporting frozen chicken until the end of 2004** while shrimp exports to the US were affected by heightening tariffs. This lowers Thailand's competitiveness relative to US producers and other competing countries which tariffs were levied at the lower rate such as Ecuador.

5. ECONOMIC OUTLOOK FOR 2004

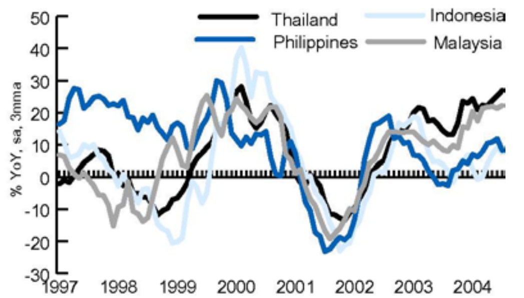
In this latest economic assessment, NESDB has revised downwards the 2004 economic projection of Thailand from 6.0-7.0 percent, released on June 6, 2004 to 6.0-6.5 percent. Meanwhile inflation is revised upwards from 2.5 percent to 2.7 percent. The downward revision of household expenditure and private investment following a slowdown trend in the latter half of the year mainly underlines this downward revision of GDP forecast. On the other hand, the net export of goods and services subtracted less from the GDP growth, as compared to the previous forecast. In overall, however, domestic demand remains the key driving force of the economy, while net exports of goods and services contributes negatively to the GDP growth, as imports grew faster than exports. The lower projected economic growth and higher projected inflation reflect the following factors and developments.



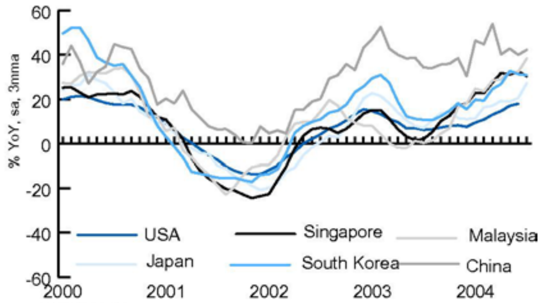
Source: NESDB

(1) The adjustment incorporated the most recent economic indicators up to July 2004. As the latest figures show, the Thai economy in the first half of the year expanded by 6.4 percent from the first half of 2003. The quarterly growth, being the year on year growth or quarter on quarter growth of seasonally adjusted series, showed a slowdown trend. Given that the the second quarter recovered from the Avian flu outbreaks, the smaller quarter on quarter growth of the second quarter confirms the slowing down of the economic activities. Moreover, the most recent economic data in July also point a slowdown trend.

- Seasonally adjusted export data suggested that export is peaking and slowing down is to be expected in the short run. This is in tandem with economic slowdown likely to be experienced more evidently by the world in general and by Thailand's major export markets in particular.



Source: CEIC



Source: CEIC

- Economic indicators in the first seven months of 2004 showed that household expenditure and private investment have slowed down and at the faster rate than projected earlier. This is partly due to escalating oil prices as well as rising commodity prices which adversely affected consumer confidence and inevitably dampened purchasing power. In addition, expectation on rising interest rates has somewhat caused consumers to be more cautious on their spending.

Source: NESDB

(2) Crude oil price in the world market and domestic retailed price have risen beyond expectation. Consumer prices have also been adjusted increasingly as a result despite a partial subsidy given to stabilize the Hi-Speed Diesel (HSD) price. Recently, the price control on Unleaded Gasoline (ULG Benzene 95/91) has been lifted and already led to rising retailed price and higher traveling cost. This development has, to some extent, squeezed higher traveling expenses out of the pocket and therefore dampened purchasing power of consumers.

(3) The Bank of Thailand raised the policy rate (RP14-days) earlier than expected. Earlier, most analysts expected to see the upward adjustments in the last quarter of 2004 as the earliest move by the Bank of Thailand.

Economic Outlook by Components

Private Consumption Expenditure

Private consumption expenditure is projected to increase by 5.6 percent, lower than 6.0 percent in the previous projection. This downward revision is due to a slowdown in consumption expenditures in the first half of the year, expected further impacts of higher oil prices and rising interest rates. In addition, the consumer confidence has deteriorated.

Private Investment

Private investment is expected to expand by 16.0 percent, revised downwards from 20.5 percent in the earlier projection. This was based upon recent data indicating a slowdown trend of private investment, falling business sentiment as well as downward trend in expected demand for goods both in domestic and foreign markets. Notwithstanding the slowdown in the fist half, overall private investment still performed well, underpinned by robust economic fundamental and rising capacity utilization.

Government Consumption

Public investment at constant prices is projected to increase by 7.0 percent, revised down from 10.0 percent. This is as a result of lower-than-expected disbursement from state enterprises and the government budget, particularly on construction expenditures. However, the disbursement rate of additional government budget is expected to accelerate as we move towards the end of the year. The disbursement of the additional salaries attached for specialization and management position is also expected to increase. Thus, government consumption expenditure at constant prices is projected to remain at 8.0 percent growth rate as earlier forecasted.

Export of goods and services

Export volume of goods is expected to grow by 6.0 percent, lower from the previous assessment of 7.5 percent, though the global economic growth was assumed to remain unchanged from the prior assessment. This downward revision is partly due to price impacts and the temporary ban of Thai chicken exports that lingered more slowly than initially expected, problem of shrimp export to US[1] and shortage of raw materials required for canned seafood exports. The rising export prices owing to higher oil price and increasing raw material costs could also render the Thai export less price competitive.

Nevertheless, service receipts tend to increase considerably, owing to higher number of foreign tourists coming to Thailand as the situation has returned to normal from the Avian flu epidemic. This is as a result of better confidence in domestic situation, strong global economy, as well as low base of tourist numbers in the second quarter of previous year in which the SARS outbreaks severely affected.

Export of goods is projected to be at 94.9 billion US dollars, rising by 21.0 percent or equivalent to 3,843.5 billion baths, which accounted for 18.4 percent growth. Export volume is expected to increase by 6.0 percent, while export price is projected to increase by 15.0 percent. Service receipts at constant prices of the whole year are projected to grow at 13.5 percent, compared to the contraction of 3.4 percent in 2003. **Overall, export of goods and services at constant prices is expected to expand by 7.3 percent.**

Imports of goods and services

Import of goods is expected to reach 93.2 billion US dollars, increased by 25.6 percent. Import volume is projected to grow by 11.6 percent, lower than earlier assessment due to a sign of slowdown in private investment. Import price is projected to increase by 14.0 percent, revised upwardly as a result of rising oil prices. In terms of bahts, import value will be about 3,744.6 billion baht, increasing by 21.9 percent from last year.

Import of services is expected to rise by 4.5. All in all, import of goods and services at constant price in 2004 is expected to grow by 10.5 percent, higher than 7.4 percent in 2003.

Trade account and current account

Trade account is projected to register a surplus of 1.7 billion US dollars, or about 68.9 billon bahts, markedly lower than a surplus of 4.2 billion US dollar or 174.4 billion baths in 2003. This is as a consequence of accelerated import volume growth. However, tourism sector is expected to improve after the Avian flu problem has been eased. Accordingly, this will result in the higher surplus in net service income than that of 2003. In sum, current account will record a surplus of about 6.0 billion US dollars or about 243 billion bahts, equivalent to 3.8 percent of GDP, significantly decline from 8 billion US dollars or 329.9 billion bahts, equal to 5.6 percent of GDP in 2003.

Inflation

The headline inflation is expected to be 2.7 percent, higher than previous projection of 2.5 percent. This is accompanied by rising cost of raw materials, oil prices and wages and salaries. Increasing price mostly are those of foods and beverages and transportation items. The price of non-food products, however, are likely to rise at the lower rate as a consequence of slight increase in housing rents and home furnishing product prices–highest-weighted item in non-food categories of the core inflation basket.

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[1] The US anti-dumping investigation on Thai shrimp export begun on July 29, 2004. The US government imposed AD duties on shrimp imports from Thailand ranging from 5.56-10.25 percent, while 0.0-67.8 percent for Brazil, 3.56-27.49 percent for India and 6.08-9.35 percent for Ecuador. In the cases of China and Vietnam, which have previously been considered, the rates are in the range of 12.11-93.13 percent and 7.67-112.81 percent respectively. To the less extent, these import duties are imposed temporarily for only 4 months starting officially from August, 2004. The final AD rates will be determined afterwards which are expected to be announced on December 17, 2004.

Economic Projection of 2004

	Preliminary		Projection of 2004		
	2002	2003	8.Mar	7 June	6 Sep[1/]
GDP (at current prices, Billion Baht)	5,451.9	5,938.9	6,484.1	6,473.4	6,455.6
GDP growth rate (at constant prices,%)	**5.4**	**6.7**	**7.0**	**6.0-7.0**	**6.0-6.5**
Investment (at constant prices, %)	6.5	11.7	16.0	17.7	13.8
Private (at constant prices, %)	13.2	17.9	19.0	20.5	16.0
Public (at constant prices, %)	-5.8	-2.3	8.0	10.0	7.0
Consumption (at constant prices, %)	4.6	5.6	5.7	6.4	5.9
Private (at constant prices, %)	4.9	6.3	6.0	6.2	5.6
Public (at constant prices, %)	2.5	1.1	4.0	8.0	8.0
Export volume of goods and services (Volume, %)	12.1	6.5	7.3	7.8	7.3
Export value of goods (Billion US dollar.)	66.1	78.4	90.2	95.3	94.9
Growth rate (%)	4.6	18.6	15.0	21.5	21.0
Growth rate (Volume, %)	12.2	8.8	8.0	7.5	6.0
Import Volume of goods and services (Volume, %)	13.6	7.4	9.2	12.8	10.5
Import value of goods (Billion US dollar)	63.4	74.2	87.6	92.8	93.2
Growth rate (%)	4.4	17.1	18.0	25.0	25.6
Growth rate (Volume, %)	13.1	8.8	10.0	14.0	11.6
Trade balance (Billion US dollar)	2.8	4.2	2.6	2.5	1.7
Current Account (Billion US dollar)	7.0	8.0	6.9	6.5	6.0
Current Account to GDP (%)	5.5	5.6	4.1	4.0	3.8
Inflation (%)					
CPI	0.7	1.8	2.2	2.5	2.7
GDP Deflator	0.7	2.1	2.2	2.5	2.7

Source: Office of the National Economic and Social Development Board, September 6, 2004

1/ Components of 6.0 percent projection

6. ECONOMIC OUTLOOK 2005

The Thai economic expansion in 2005 is expected to lie within the range of 5.5 to 6.5 percent bounds. This expected growth rate is moving closer to the medium-term potential growth of the Thai economy but nevertheless lower than the expansion rates seen in 2003 and 2004. The economy is likely to see a worsening in its exports situation due to the dampening of global economic growth next year. The expected slow down is also attributable to some contributing internal factors namely a rising inflation, a continued rise in the interest rates and the escalation of the diesel price arising from the expected abandoning of diesel price controls by the government - a necessary measure needed in order to induce a higher production efficiency and curb down market distortions.

With the exception of the rising oil prices, which resulted from pressure on the supply side, all of the above factors are typical signs of an economic cyclical variation. The Thai economy's expansion beyond its production capacity resulted in a lower unemployment rate which induces an upward pressure on the average nominal wage and a rise in demand for raw materials and other production inputs over the past 3 years, thus raising factor input prices and the overall production cost, reducing the previously existing excess production and consequentially boosting the overall inflation. As an important note, a prolonged negative real interest rates tend to overheat the economy and pose threat on economic stability. In an effort to maintain stability and prevent overheating of the economy, the Bank of Thailand began a gradual monetary tightening process on August 25 this year by raising the interest rate. In moving forward, monetary policy will be tightened further but gradually. The inflation forecast for 2005, nevertheless, is projected at 3 percent.

The upper-bound growth forecast of 6.5 percent abides on the strong prospects for Thai exports and high agricultural good prices: i.e. a better income prospect and basis for future expenditure growth, and an opening up of more borrowing opportunities and financial resources within the financial market which are needed to fuel a continued rise in private investment. The reasoning behind the latter requirement is that in order to go on investing more, internal funding resources will not be adequate and hence firms would need to rely more on external financing means. Nevertheless, the level of business activities needed to fuel the 5.5 to 6.5 percent economic expansion, which will involve an expansion in credit demand and capital requirement, is not likely to lead to liquidity constraint problems given the current level of liquidity supply of 500 – 600 billion baht within the economy. Therefore, dramatic contractionary monetary policy is not expected. The interest rate increases will therefore pursue a somewhat modest pace.

The current account surplus is likely to diminish since imports are still rising faster than exports. Should the current high crude oil prices persist, Thailand stands a good chance to lose the gains in terms of trade in 2005 and witness a dampened current account position. The surplus in the current account as ratio to GDP is forecast to stand at around 3 percent.

The 2005 economic policies should focus on providing the basis for continuation of growth in private investment and maintaining the suitable rate of expansion in private expenditure. These objectives can be achieved through the use of appropriate macroeconomic instruments to prevent an overheating of aggregate demand and maintain suitable balance between aggregate demand and supply capacity. On the other hand, policy implementers must ensure that the economy does not slow down too quickly. Importantly, special attention must be given on policies focused on improvement in the supply capacity and efficiency, including particularly the basic structural development, skill improvement, scientific and technological advancement, legal reform and modernization, and administrative efficiency at all levels.

Outlook of World Economy and Major Economies

	2003	2004	2005
1. World [1/]	2.2	3.4	2.3 ⇓
2. USA			
- Lehman Brothers	3.0	4.2	3.3 ⇓
- IMF	3.0	4.3	3.4 ⇓
- Bank of Montreal	3.0	4.4	3.7 ⇓
- HSBC	3.7	4.6	3.7 ⇓
3. Japan			
- Lehman Brothers	2.7	4.1	1.2 ⇓
- IMF	2.7	3.4	1.9 ⇓
- HSBC	2.5	4.3	2.4 ⇓
- UBS	2.5	4.5	2.0 ⇓
4. EURO ZONE			
- Lehman Brothers	0.5	1.7	1.7
- IMF	0.4	1.7	2.3 ⇑

[1/] 4 Major Regions, Lehman Brothers