Thailand's Economic Prospects and Challenges[1]

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Thailand has been severely hit by the global downturn. GDP is estimated to have contracted by approximately 3% in 2009, with growth year-on-year only resuming in the fourth quarter. Although the manufacturing sector accounts for roughly 40% of Thai GDP, its performance was responsible for 75% of the GDP decline, mostly in the export-oriented sectors (especially the automobile and electrical and electronic goods sectors). Production plunged in the fourth quarter of 2008 and the first quarter of 2009, amidst one of Thailand's worst export collapses since 1957. Private investment fell by 16.9% in the first half of 2009 in response to heightened risk perception from banks and investors. Finally, the fall in agricultural commodity prices (which affected rural incomes) and consumer confidence added to an adverse labor market caused private consumption to contract by an estimated 1.1% year-on-year in 2009[2].

The economy seems to be on a path to recovery. The Economist Intelligence Unit (EIU) predicts that GDP will grow by 3.2% and 4.1% in 2010 and 2011, respectively. Production has recovered, led by the manufacturing sector on the back of renewed demand for Thai exports in China and advanced economies. Manufacturing output is expected to expand by 5-6% in 2010 with the stabilization of external demand, and the construction sector seems to have recovered. Since the second quarter of 2009, there has been a narrowing of the year-on-year fall in private consumption, which is expected to grow moderately in 2010 and more strongly in 2011. The government's two stimulus packages[3] have injected funds into the economy, and one of these, the TKK, scheduled to run until 2012, should help provide momentum in the forecast period provided funds are disbursed and used as planned.

However, observers caution that Thailand may need long-term changes to respond to its new economic environment. In particular, in light of the fact that demand in developed countries is unlikely to regain its pre-crisis dynamism in the short- to mid-term, observers have advocated deeper regional integration. Moreover, export-based manufacturing largely performs assembly functions with little technology transfers from outside investors, and a shift towards industrial activities that add more value to production has been recommended.

Although the situation is calmer than that of April 2009, political instability persists. During the latest round of protests, which began on March 13th, United Front for Democracy Against

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[1] Thibaut Muzart, Management Systems International, under ME/TS's Alliances, Analyses, and Program Support (AAPS) buy-in to EGAT's Business Growth Initiative. The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

[2] About 40% of the Thai workforce is employed in the agricultural sector.

[3] SP1 (focused on stimulating consumption) and the Thai Kem Kaeng Program (the TKK, focused on transfers to sub-governments, agriculture, education, construction and equipment; and scheduled to run until 2012).

Dictatorship (UDD, anti-government) protesters shut down parts of Bangkok, where they poured blood from thousands of sympathizers in front of the prime minister's residence[4]. On March 23, 2010 the Internal Security Act, which gives security forces the power to impose curfews and set up checkpoints, was extended for another week. Tens of thousands of anti-government protesters remain in the capital where they are planning additional rallies to obtain the resignation of the prime minister, whom they accuse of being in power illegitimately and only serving the interests of the elite and the monarchy. At this point in time, it is considered unlikely that the prime minister will call an early election, or that the UDD will back down any time soon. Although both sides seem to be mindful to avoid a recurrence of the violent confrontations of April 2009, there is no telling if, or when, calm will return. Some speculate that the army may intervene again soon[5] to restore stability and protect what it perceives as key institutions under threat, notably the monarchy. The current troubles add to the economy's difficulties by increasing the risk perceptions of investors and causing financial losses due to physical destruction and the interruption of economic activity.

Although exports fell substantially in 2009, the current account remained in surplus due to a faster drop in imports. Imports decreased owing to the slump in consumption and investment as well as lower global commodity prices. As a result, 2009 recorded an estimated current account surplus of 6.7% of GDP equivalent. In 2010-2011, the current account surplus is expected to average 4.3% of GDP equivalent as trade volumes rise, although with a restrained export performance relative to before the crisis due to an expected sluggish demand growth for Thai exports in high-income countries. The fact that Thailand's main exports have so far recovered unsteadily supports this prognosis.

The Bank of Thailand (BoT, the central bank) has kept its policy interest rate unchanged (at 1.25%) since April 2009. This stance was reiterated at the BoT's last meeting (January 13 2010), as although growth and the CPI are on the rise, private investment remains weak. Moreover, the BoT considers that core inflation[6] (at 0.6% year-on-year in January) is still well below the upper boundary of the official target range, and it fears that raising interest rates prematurely could cause inflows of foreign capital and the beginning of an asset bubble. It is likely, however, that the BoT will raise the policy rate sometime in 2010.

The BoT has intervened in the currency market to moderate the appreciation of the Baht, caused by large current accounts. This intervention has necessitated the accumulation of large amounts of foreign exchange reserves, which in turn have required the bank to sell securities to absorb some of the additional liquidity injected into the domestic market. These sterilization

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[4] The prime minister (Abhisit Vejjajiva) had retreated to (and still resides in) the army's 11th infantry battalion headquarters in the north of Bangkok.

[5] There have been 18 attempted coups by the Thai military since 1932. The latest resulted in the ouster of Prime Minister Thaksin Sinawatra in 2006, a vast proportion of protesters consider that he represented the interests of voters.

6 Core inflation excludes fuel and food prices

measures are sustainable as long as inflation remains low. However, should inflation rise and the bank tighten its monetary policy, the resulting hike in interest rates could cause capital inflows that would strengthen the Baht and make related central bank interventions more expensive.

The Baht has continued to appreciate against the US Dollar into January. This has caused some observers to speculate that Thailand would impose capital controls, while others estimate that the BoT might continue to eliminate some constraints on overseas investments (which it has done to some extent in early February). The Baht is expected to appreciate against the US Dollar by 5.1% in 2010 and by an additional 1.1% in 2011.

The 2009 price level declined year-on-year until October due to the drop in commodity prices since mid-2008 and the contraction of the economy. However, because of higher food and energy prices the headline CPI has risen steadily since October 2009 to reach 4.1% in January 2010, in spite of government initiatives to reduce the prices of transport and education. Prices are expected to increase by 2-3% in 2010 and 2% in 2011, as demand returns and international commodity prices continue to rise.

The 2009 budget deficit is estimated at 5.6% of GDP equivalent, but is forecasted to be narrower in 2010 and 2011 (at 3.4% and 3.7% of GDP equivalent, respectively). The government has ramped up spending since the second quarter of 2009, when public investment was up by 8% year-on-year. Public investment increased further in the third quarter, by 12% year-on-year, and is estimated to have been higher in the fourth quarter year-on-year compared to 2008. However, the government will aim to reduce budgetary spending overall in FY2009/2010 (October-September), which will not be affected by the implementation of the TKK, which is largely financed through borrowing. The combination of reduced budgetary spending and TKK disbursements will cause public investment to rise only slightly in 2010.

Thai Banks weathered the crisis relatively well. Thai banks remained profitable, with Capital Adequacy Ratios (CAR) exceeding the mandatory requirement of 8.5% by almost 100% at the end of August 2009 despite the crisis. Non-performing loans, which were expected to rise dramatically, only showed a modest increase in 2009. The relatively healthy banking system helped cushion the effects of the crisis and hastened the pace of recovery.

However, risks in the banking sector remain real, due to a large extent to government mechanisms to increase lending. The possibility that some loans might be of a lower quality in the short- to medium-term remains real and calls for close monitoring. This is especially true given the government’s response to the fall in credit allocations in the first quarter of 2009. Its initiatives, a loan guarantee mechanism and higher lending targets for specialized financial institutions (SFIs), have raised concerns that program objectives might weigh excessively in lending decisions.

Thai companies have responded quickly to the crisis. Thai companies were severely hit by the crisis in the last quarter of 2008, when the unexpected drop in orders caused interest coverage ratios and profit margins to plummet. Earnings before interest, tax, depreciation and amortization (EBITDA) plunged by 70% and Return on Equity (ROE) and Return on Assets (ROA) were at their lowest since 1999. However, aggressive cost cuts quickly implemented as a response protected companies' balance sheets and facilitated the resumption of supply chains in 2009.

The number of firms going out of business in 2009 was relatively low and seems to have bottomed out. The number of Thai firms declined by 2% in 2009 on a net basis, with the biggest number of exiting firms recorded in May. However, new entrants have been increasing gradually and exponentially on average in 2009. This relatively optimistic picture should nevertheless not obscure the fact that on balance, small-and- medium enterprises (SMEs, which make up about 99% of all Thai companies) fared worse than other companies.

Although the impact of the crisis was strongest in the capital-intensive manufacturing sector, the crisis-caused collapse in commodity prices affected poverty rates the most. The crisis primarily affected the manufacturing sector, which is capital intensive. The sector only makes up 14% of total employment, and only 3.2% manufacturing jobs were lost in 2009. However, more than 40% of Thais work in agriculture, and the decline in commodity prices caused by the crisis had an adverse impact on employment in the sector. The role of a safety net played by the sector (as well by the informal sector) made this worse by increasing labor competition and depressing prices as laid off workers turned to the agricultural sector.

The developments in the agriculture sector mean that poverty is estimated to have increased in 2009. The reduction in incomes in the agriculture sector and the accompanying decline in overall consumption, combined with the usually high correlation between poverty and consumption, indicate a possible increase in poverty in 2009 by as much as ½-1 percentage point%. The impact of the government's first stimulus package on poverty reduction is unclear at this point. However, the TKK includes transfers and subsidies to local communities and farmers, which could help improve outcomes in the agriculture sector.

Observers have remarked that raising GDP growth levels would require improvements related to poverty and inequality in order to raise domestic demand. These could include better access to safety nets for vulnerable groups, to enable them to invest their savings and be more willing to take on higher risk, better paying economic activities, thereby raising overall consumption and investment levels. Productivity improvements in all three sectors through removing constraints to growth have also been mentioned as potential means of raising growth levels.

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