

# Thailand

## Summary

**M**acroeconomic indicators are worse than were projected in *ADO 2005*, with high energy prices a major culprit: GDP growth of 4.0% or slightly higher is now forecast for 2005, revised down sharply from the earlier forecast of 5.6%; inflation has accelerated faster than envisaged; and the trade and current account balances have deteriorated much more than anticipated, and will likely record deficits for the year.

In contrast, the fiscal situation has been stronger than projected, allowing the Government to introduce a supplementary budget. Subsidies on diesel fuel were eliminated midyear, which will ease any future budgetary pressures and moderate oil import growth, which has been the major cause of the deteriorating trade position. Accelerated public spending, particularly on a “mega-projects” infrastructure program over the next few years, will help momentum pick up, though there is a risk that the program could strain fiscal and external balances. Growth is expected to rebound in 2006, as some of the factors that constrained it this year recede and investment in the mega-projects program accelerates.

## Updated assessment

The weaker GDP performance is a result of several factors: higher world oil prices, which possibly cut 2005 growth by 0.5–1.0 percentage point from the *ADO 2005* forecast; a drought that ran through the first half of 2005; and a larger than expected impact on tourism from the Indian Ocean tsunami in December 2004. Continued political unrest in three southern provinces and a new outbreak of avian flu have also taken their

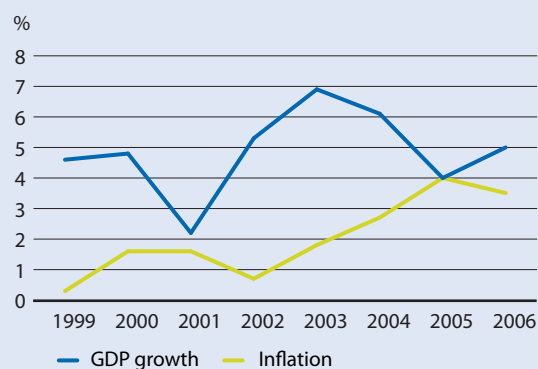
toll. The net result was that first-quarter growth of 3.3% was the lowest since 2001. The economy regained some momentum in the second quarter, with GDP expanding by 4.4%. This reflected a pickup in tourism and industrial production, but there was some deterioration in consumer confidence and business sentiment. Over the first half, the economy expanded by 3.9%, compared with 6.1% in all of 2004.

On the supply side, the agriculture sector contracted by 5.4% during the first half, largely due to the drought, while other sectors in total expanded by 4.8%. Except for public services, which benefited from increased government spending, growth in all subsectors slowed significantly, and tourism-related subsectors even registered a contraction because visitor arrivals fell after the tsunami. For the full year, GDP growth—now estimated at 4.0% or a touch better—is likely to be concentrated in export-oriented manufacturing, as well as in construction and services.

On the demand side, private consumption slowed in the first half of 2005 as uncertain prospects for income growth, rising fuel prices, and higher interest rates hurt purchases of durable goods. Household debt rose to an estimated 55–60% of income. In response, some controls were introduced to check excessive lending to more vulnerable income groups that could be hit by higher interest rates in the future. Growth of private investment in the first half decelerated to 11.7%, from 13.0% in 2004, and for 2005 as a whole will probably expand at around 10%.

To support growth, the Government accelerated the disbursement of public funds. An economic stimulus package was introduced in July. Its main ingredients were: a 5% salary rise

**Figure 2.8 GDP growth and inflation, Thailand, 1999–2006**



Sources: National Economic and Social Development Board; staff estimates.

for civil servants; a higher minimum daily wage; an increase in pensions; an additional allocation of B20 billion for a village fund; and tax breaks for firms offering more benefits for low-income workers. Many of these measures had already been planned and were brought forward. The stimulus package is likely to push up wage costs and add to the cost impact of the ending of diesel subsidies in July. Overall, both public consumption and investment are expected to contribute to growth in 2005.

The unemployment rate was estimated at a modest 2.2% at the end of April. The increase in minimum wages may reduce demand for labor later in the year, but could also boost consumer spending. Inflation rose sharply in the first 7 months of 2005, mainly as a result of steeper prices for various food products and for transportation. The CPI rose by an average 3.6% in the first 7 months of the year. In July (after the diesel subsidy was ended), the CPI jumped by 5.3% from the year-earlier level.

Higher wage costs and the pass-through of higher diesel prices will maintain inflationary pressures in the second half. For all of 2005, consumer inflation is expected to average 4.0%, revised up from the 3.5% forecast in *ADO 2005*, and higher than the 2.7% of 2004 (Figure 2.8).

Core inflation, excluding food and energy prices, also accelerated, which prompted the Bank of Thailand to raise its benchmark 14-day repo rate by 25 basis points in July to 2.75%, the sixth increase since August 2004. Monetary policy will

most likely continue to tighten over the remainder of 2005, but overall the policy stance will remain accommodative unless inflation accelerates further.

On the fiscal front, gross revenues for the first 9 months of FY2005 (which will end on 30 September 2005) exceeded the target by 6.5%. Stronger revenues allowed the Government to introduce a supplementary budget of B50 billion in the second quarter, aimed at supporting economic growth. As financing for many of the measures in the economic stimulus package had already been factored into the original FY2005 budget, any additional impact on the fiscal position was limited. The July ending by the Government of diesel subsidies, which had cost it B92 billion over 18 months, should help ease any budgetary pressures. The budget for FY2005 is expected to remain in balance or show a small surplus.

The performance of the external sector in the first half of 2005 was mixed: merchandise exports grew by 12.5%, faster than projected, but imports surged by 32.5%, much more rapidly than anticipated, mainly because of higher prices for imported oil. In May, for example, the value of crude oil imports more than doubled from a year earlier. Both the trade and current accounts deteriorated markedly, posting the first large deficits since the Asian financial crisis. The trade deficit for the first 6 months widened to \$8.5 billion, while the current account posted a \$6.2 billion deficit. The overall balance of payments recorded a much reduced surplus, estimated at \$330 million up to midyear. International reserves remained comfortable at \$48 billion at 30 June, or more than four times the level of short-term debt.

The export outlook for the second half of 2005 is more positive. Partly, this is because the supply of agricultural exports has increased as the drought eased. The baht is now also weaker than during the first half. Moreover, the elimination of fuel subsidies and fuel conservation measures should moderate import growth, and imports of items, including steel and gold, are expected to increase at a slower rate because of an earlier buildup in inventories. Consequently, the trade and current accounts could be in surplus in the second half. For the full year, the current account is expected to record a deficit of 2.4% of GDP.

**Table 2.8 Selected economic indicators, Thailand, 2005–2006, %**

Item	2005		2006	
	ADO 2005	Update	ADO 2005	Update
GDP growth	5.6	4.0	5.8	5.0
Inflation (CPI)	3.5	4.0	3.0	3.5
Current account/GDP	2.3	-2.4	1.3	-2.5

Source: Staff estimates.

## Prospects

The medium-term economic outlook hinges on developments in the domestic economy and on the outlook for international oil prices. The Government has initiated a huge \$42 billion megaprojects public investment program over 2005–2009 that will likely spur growth in the short term and raise potential output further out. The investment will be made mainly in transportation projects, including a mass-transit system, in water resources development, and in housing. Expenditure on the projects will start in 2006, and about 80% of total program spending is targeted for 2007–2009. If the program advances as scheduled, it is expected to provide a direct boost to GDP of about 0.7 percentage point a year. The indirect impact through the multiplier effect could be significant, too.

The Government is also expected to continue spending on its social and rural programs. Domestic demand, supported by public investment demand, will assist economic growth over the next few years. GDP growth is expected to strengthen to 5.0% in 2006. Exports are forecast to increase moderately in 2006. Imports will be boosted by spending on the megaprojects, offset to some extent by the impact on oil imports resulting from the elimination of subsidies and fuel conservation measures. A current account deficit of 2.5% of GDP is forecast for 2006.

Inflation is expected to ease to 3.5–4.0% in 2006 as the impact of the elimination of fuel subsidies and wage increases wanes, and as the supply of agricultural products improves.

Although countercyclical spending is warranted, the authorities need to watch that they do not unduly heighten macroeconomic risks for the sake of maintaining high economic growth. If economic growth does not pick up, the Government would come under pressure from the public to raise social spending and cancel bad loans in rural areas, at a time when its tax revenues would be eroded, significantly tightening its fiscal position.

The Government, though, has set itself strict rules for the fiscal sustainability of the megaprojects program, namely that the budget is to remain balanced, debt servicing is to stay below 15% of public spending, and public debt is not to exceed 50% of GDP. Financing for the program is to tap the budget for about 39% and SOEs for 13%. Another 24% will come from domestic loans, 18% from external loans, and 6% from other sources, including private investment. The budget for FY2006 is estimated at B1.36 trillion, up 8.8% on the FY2005 budget. About 25% of expenditures will be targeted at capital spending. The megaprojects require substantial imports of capital equipment, and there is a risk this could seriously widen the current account deficit.

Uncertainty over the future path of global oil prices makes Thailand's economic outlook difficult to predict, because the economy is one of the more susceptible in Southeast Asia to slower economic growth if higher oil prices endure (see Part 3). However, the Government's decision to eliminate fuel subsidies puts the budget in a better position to withstand any further rises in oil prices. In the private sector, a potential problem lies in the increasing level of household debt, which, at a time of rising domestic interest rates, could pose renewed risks for the financial system.