

Thailand

The economy has been hurt by political uncertainty, higher oil prices, and rising interest rates, prompting a downward revision to the 2006 growth forecast from April's *Asian Development Outlook 2006* (ADO 2006). With a caretaker government in place for much of the first half of this year, the budget for the fiscal year starting October 2006 cannot be approved, which will reduce government spending and investment in 2007. Consequently, some of the megaprojects planned by the Government will be delayed. Consumer spending will also soften. The GDP growth projection for 2007 is therefore downgraded sharply to about 4% from 5.5% in ADO 2006.

Updated assessment

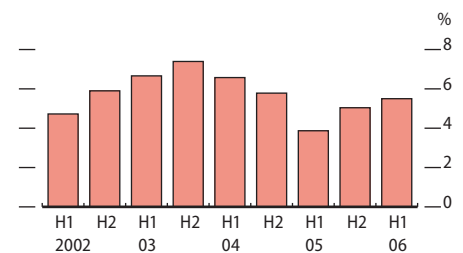
Robust growth of 5.5% was recorded for the first half of 2006, due mainly to a good performance by agriculture and exports (Figure 2.8.1). This growth rate was also favorably influenced by the comparison with early 2005, when the economy was hit by drought and the effects of the December 2004 tsunami. Agricultural production rose significantly by around 7% in January–June 2006 year on year as major crops benefited from improved weather and higher farm-product prices. Manufacturing production also increased by about 7%, with higher levels of growth recorded in office and electrical machinery, motor vehicles, and textiles, spurred mainly by stronger exports.

On the demand side, household consumption expenditure expanded by 4.1% in the first quarter, stimulated by rising farm incomes and an increase in minimum wages in January. After the first quarter, concerns about higher oil prices, inflation, and rising interest rates damped consumer spending. So did political uncertainties—Thailand has been under a caretaker government since results of elections held in April were annulled. New elections are scheduled for October. Meanwhile, consumer confidence has steadily slipped (Figure 2.8.2).

Also affected by the political situation, growth in private investment slowed to 5.4% in the first 6 months, less than half the rate of a year earlier. The slowing of private investment (despite relatively high capacity utilization) is a concern for the country's medium-term prospects. The lack of a government that can take longer-term decisions has also affected public investment, slowed policy implementation, and delayed some infrastructure projects. For example, construction of three new subway lines for Bangkok was scheduled to start early in 2006, but the political impasse has delayed crucial decisions and none of the \$4.3 billion earmarked for the lines will be spent this year.

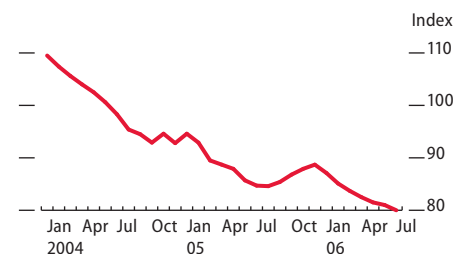
Exports were a bright spot, however, and in net terms were the main

2.8.1 GDP growth



Source: National Economic and Social Development Board, available: <http://www.nesdb.go.th>, downloaded 17 June 2006.

2.8.2 Consumer confidence



Note: A reading of less than 100 marks deteriorating consumer confidence.

Source: Center for Economic and Business Forecasting, University of the Thai Chamber of Commerce, available: <http://www.utcc.ac.th>, downloaded 25 August 2006.

driver of growth in the first quarter of the year (Figure 2.8.3), and will likely remain so over the full 12 months. But the slowdown in consumer spending and investment has led to a downward revision in the GDP growth forecast to 4.2%, from 4.7% in *ADO 2006*.

Merchandise exports climbed by 17.1% in the first 6 months of 2006 from a year earlier, and are expected to grow by 14% over the full year. Merchandise imports, in contrast, slowed to grow by just 4.2% over the period (Figure 2.8.4) and will be lower than expected in 2006 because of weakening domestic demand. The import slowdown stemmed partly from a decline in the import volume of fuel (the elimination of fuel subsidies in 2005 curbing demand), and of vehicles and vehicle parts. Despite strong exports and slowing import growth, the trade balance for the first 6 months remained in deficit. The current account is expected to register a small deficit for 2006, now projected to be about 0.5% of GDP instead of 2.5% forecast in *ADO 2006*. The baht (B) appreciated by 4.8% against the US dollar in the first half of 2006 from the second half of 2005, in line with movements among several other Asian currencies.

Inflation has been stronger than expected in *ADO 2006*, driven by higher oil and food prices. The consumer price index rose at an average rate of 5.9% in January–June 2006, with core inflation at 2.7%. The Government is gradually allowing increases in the prices of 26 essential goods and 150 other consumer items and construction materials that it controls, to offset rising production costs caused by expensive oil.

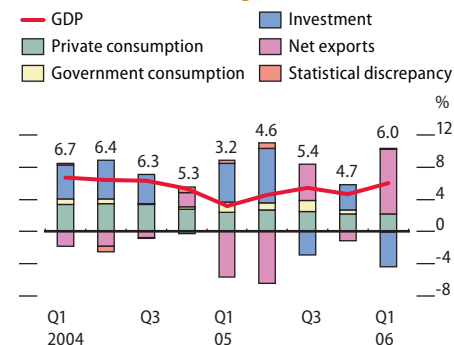
To lean against inflation, the central bank raised its policy interest rate four times in the first half of 2006, to 5.0% (Figure 2.8.5). The Bank of Thailand's Monetary Policy Committee said in a July statement, after leaving the 14-day repo rate unchanged that month, that softening economic growth, too, will help relieve pressure on inflation. The rate of increase in the consumer price index slowed to 4.4% in July, largely a result of the slowdown in consumer demand and a high-base effect in July 2005 when Thailand abolished fuel subsidies. For all of 2006, the inflation forecast is 4.5%, up from 4.0% in *ADO 2006*, principally due to continued high oil prices and increases in wages and interest rates, all of which are feeding into production costs.

The fiscal position remains strong, with the overall budget likely to be in balance in the fiscal year ending 30 September 2006. Total public debt as of end-June 2006 stood at 42.1% of GDP, well below the Government's self-imposed limit of 50%.

Prospects

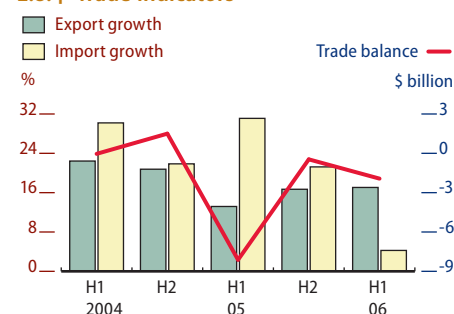
The unsettled political situation has delayed approval of the FY2007 budget as well as some large public infrastructure investments. Moreover, the Government originally set spending for FY2007 at B1.48 trillion, based on expectations of economic growth of 5–6%. With growth now likely much lower, the revenue forecast for FY2007 is probably too optimistic. Therefore, in addition to being delayed, the budget for FY2007 will likely involve a lower level of spending than originally planned. Public investment could also be significantly lower than earlier projected. Combined with high oil prices and inflation, this will have an adverse effect on short-term growth prospects.

2.8.3 Contributions to growth (demand)



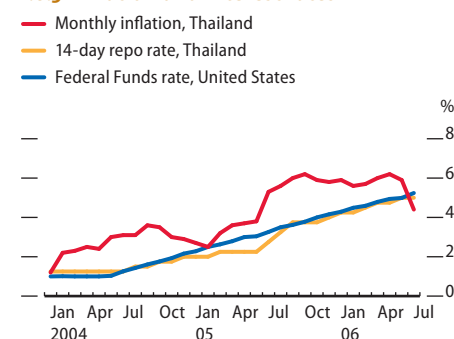
Source: National Economic and Social Development Board, available: <http://www.nesdb.go.th>, downloaded 17 June 2006.

2.8.4 Trade indicators



Source: Bank of Thailand, available: <http://www.bot.or.th>, downloaded 4 August 2006.

2.8.5 Inflation and interest rates



Sources: Bank of Thailand, available: <http://www.bot.or.th>; Bureau of Trade and Economic Indices, Ministry of Commerce, available: <http://www.indexpr.moc.go.th>; Federal Reserve Board, available: <http://www.federalreserve.gov>, downloaded 1 August 2006.

Major new government spending cannot be initiated until a new budget is approved, which is unlikely before January or February 2007. Even when a new government is elected, it may focus on rebuilding its political base rather than on economic matters. (Thailand's major political parties have said that, if elected, they would work to amend the constitution and aim then to hold new elections after 12–18 months.) This is likely to result in delays in disbursements of the \$42 billion planned for infrastructure megaprojects, most of which had been targeted for 2007–2009. The investment in megaprojects was originally expected to contribute about 0.7 percentage points to GDP growth each year from 2007, and this will not now be fully realized. (Some of the megaproject investments are not, though, affected by political uncertainties as they have already been approved and accounted for in the 2006 budget. For example, many housing and energy projects will go ahead as planned.) As the lack of certainty will also curtail private investment, the 2007 baseline assumption for growth in total investment is revised down to 6.0% from 9.0%.

Further eroding growth prospects in 2007, private consumption will continue to slow due to upward adjustments to prices, though this deceleration will be offset a little by reductions in personal income taxes effective August 2006. Exports should continue to be the main engine of economic growth as the generally robust outlook for trading partners, together with favorable prices for export crops, supports the export sector and partly offsets weakening domestic demand. Within the overall export picture though, the slowdown in the US economy and in global electronics demand will have some impact. For the full year, export growth of around 14% is projected, down 1.3 percentage points from the April forecast. Against this background, the GDP forecast for 2007 is revised to 4.0% or a touch higher, from 5.5% in *ADO 2006* (Figure 2.8.6).

High oil prices will keep the current account in deficit in 2007, at about 2% of GDP (Figure 2.8.7). Delays in capital expenditure disbursements and softer consumer spending will help bring down inflation by about 1 percentage point to 3.5%—though this is still above *ADO 2006*'s 3.0%, partly because of higher than expected increases in farm incomes this year (Figure 2.8.8).

In policy areas, the political hiatus has set back the privatization of state-owned enterprises. An initial public offering of shares in EGAT, the state electricity generation authority, was suspended in November 2005 by the supreme administrative court. This ruling, and the political logjam, has stymied the privatization process. Even with a new government in place, the privatization process will have to be revised as a result of the court decision, and this could take some time. Overall, the economic forecasts have a greater than usual degree of uncertainty, since it is unclear that economic policies pursued in recent years will be continued.

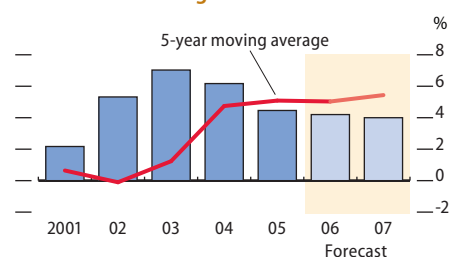
The extended political uncertainty and subsequent delays in decision making and investment have led to a downward revision of the medium-term growth projection, to 4–4.5% in the next 3 years, compared with 5–6% in *ADO 2006*, though the end of this period could see a pickup in GDP growth, based on restored political stability and the solid fiscal position.

2.8.1 Selected economic indicators, %

	2006		2007	
	<i>ADO 2006</i>	<i>Update</i>	<i>ADO 2006</i>	<i>Update</i>
GDP growth	4.7	4.2	5.5	4.0
Inflation	4.0	4.5	3.0	3.5
Current acct. bal. (share of GDP)	-2.5	-0.5	-2.5	-2.0

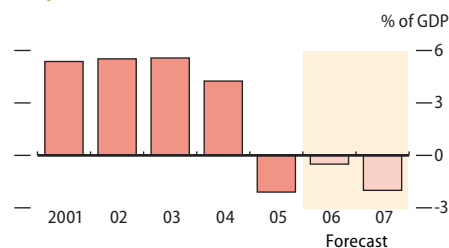
Source: Staff estimates.

2.8.6 Annual GDP growth



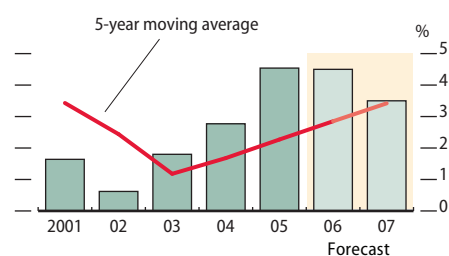
Sources: National Economic and Social Development Board, available: <http://www.nesdb.go.th>, downloaded 17 June 2006; staff estimates.

2.8.7 Current account balance



Sources: Bank of Thailand, available: <http://www.bot.or.th>, downloaded 3 August 2006; staff estimates.

2.8.8 Annual inflation



Sources: National Economic and Social Development Board, available: <http://www.nesdb.go.th>, downloaded 1 August 2006; staff estimates.