

# Thailand

Drought, higher world oil prices, and the December 2004 tsunami were a drag on growth in 2005. Inflation rose while the trade and current accounts switched into deficit. The economy is projected to perform somewhat better in 2006, mainly on account of sustained growth in exports and some stimulus from disbursements for large infrastructure investments. These investments will increasingly become a driver of growth in 2007 and beyond.

## Economic performance

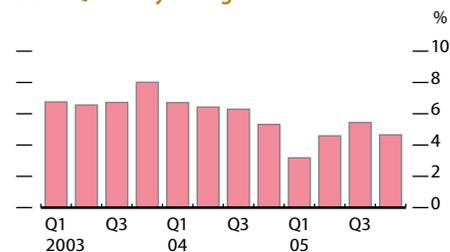
Economic growth slowed to 4.5% in 2005, the lowest rate since 2001. (Growth had averaged 6.2% over 2002–2004.) Still, the performance is notable because several adverse factors affected the economy in the first half of the year (Figure 2.28.1). The tsunami of 26 December 2004 battered the tourism industry in the southwest of the country; a severe drought affected output from agriculture (still an important export sector); sporadic political unrest continued in the southern provinces; and perhaps more important than all of these factors, high oil prices hurt the economy, which is particularly sensitive to them.

As the year advanced, growth picked up with a strong recovery in agriculture and tourism and a healthy expansion of exports, as manufactured goods, including electronics, and agricultural products benefited from high external demand. Second-half gross domestic product (GDP) growth at 5.0% was about 1 percentage point higher than in the first half. On the demand side, higher energy prices and rising interest rates damped private consumption and investment. Consumption remained the major contributor to GDP growth, adding 3.4 percentage points; investment contributed 2.9 percentage points; but a contraction in net exports subtracted 2.1 percentage points (Figure 2.28.2).

With rapidly rising retail oil prices pushing up power and transport prices and with increases in wages, consumer inflation in 2005 rose to 4.5% from 2.8% in 2004, the highest rate in 7 years. Year-on-year inflation peaked at 6.2% in October, subsequently declining to 5.8% in December. Fuel subsidies, which had been introduced in January 2004, were gradually removed over the first half of 2005 and completely abolished in July, in one of the major government policy initiatives of the year. In total, however, the subsidies still cost the Government the equivalent of \$2.3 billion in 2004–2005. When the subsidy on diesel prices was eliminated in July, its price immediately jumped by 16%. Over the year, retail prices of diesel and gasoline rose by 57% and 33%, respectively.

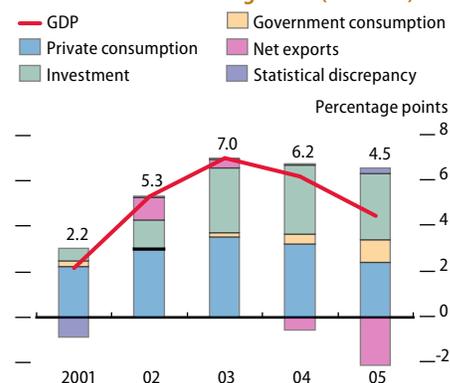
Oil-price increases percolated to other prices. Core inflation (excluding food and energy) accelerated but remained comparatively subdued at 1.6% in 2005. Concerns about rising inflationary pressures and an interest rate differential with the United States prompted the Bank

2.28.1 Quarterly GDP growth



Source: National Economic and Social Development Board, available: [http://www.nesdb.go.th/econSocial/macro/nad/1\\_qgdp/data2\\_04/menu.html](http://www.nesdb.go.th/econSocial/macro/nad/1_qgdp/data2_04/menu.html), downloaded 2 February 2006.

2.28.2 Contributions to growth (demand)



Source: National Economic and Social Development Board, available: [http://www.nesdb.go.th/econSocial/macro/nad/1\\_qgdp/data2\\_04/menu.html](http://www.nesdb.go.th/econSocial/macro/nad/1_qgdp/data2_04/menu.html), downloaded 2 February 2006.

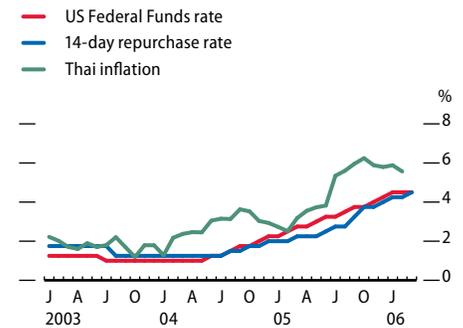
of Thailand to lift its 14-day repurchase interest rate in stages to 4.0% by December, and then to 4.5% by March 2006 (Figure 2.28.3).

The fiscal position remained strong in FY2005 (ended 30 September 2005). Revenue collection expanded by 13.3% from 2004, as collection of corporate income tax and value-added tax continued to rise. In spite of a midyear supplementary budget of baht (B) 50 billion, government spending was kept within the original budget target. Overall, the budget showed a small surplus of 0.1% of GDP, similar to that in 2004 (Figure 2.28.4). The Government initiated a huge \$42 billion megaprojects investment program to improve physical and social infrastructure, covering the period 2005–2009, an amount equivalent to about 5% of GDP each year. The program targets substantial investments in transport projects (including urban mass-transit systems), water resources development, energy, low-cost housing, and health and education (Figure 2.28.5). While some expenditures on the program were made under the 2005 budget, they did not significantly affect government outlays. The program's impact will be felt mainly from 2007. The authorities continued to repay some of the more expensive external debt in 2005, and by year-end total public debt stood at a comfortable 44% of GDP, below the Government's self-imposed ceiling of 50%.

A major positive factor in 2005 was the export performance. Agricultural exports improved as higher farm prices and favorable weather conditions in the last 3 quarters of the year lifted crop production. Meat and fisheries were also beneficiaries of increased export demand. Manufacturing exports of high-technology products (mainly electronics), automobiles, chemicals, plastics, and rubber all expanded robustly. Merchandise exports rose by 15.0%. However, as a result of the rising cost of oil imports and buoyant demand for capital goods—as capacity utilization rose after a long period of low business investment in manufacturing—total imports increased by 26.0%. After 7 years of surpluses, the trade balance swung into deficit in 2005 and, for the first time since the 1997–98 Asian crisis, the current account balance was in deficit, by \$3.7 billion, or 2.1% of GDP. Strong capital inflows ensured a comfortable overall balance-of-payments outcome. Together with a narrowing of the interest rate differential with US dollar rates, these inflows caused the baht to strengthen toward the end of the year. International reserves rose to a high \$52.1 billion, nearly twice their level of 1997.

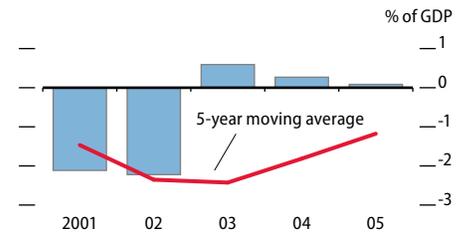
The Government had hoped that new listings of major companies would give a boost to the stock market in 2005. However, an initial public offering of the shares in EGAT, the state electricity generation authority, was suspended in November by the supreme administrative court on the grounds that the issue may violate the constitution. The Government wanted to raise about \$800 million by selling 25% of the shares in EGAT. Moreover, Thai Beverage, a major privately owned liquor company, postponed a listing in Thailand because of opposition from antialcohol groups, proposing instead to list in Singapore. It had planned an initial public offering in Thailand, valued at up to \$1 billion. Even with these setbacks, strengthening the capital markets remains a priority for the Government. A capital market development master plan, finalized in January 2006, includes measures to increase the supply of high-quality

### 2.28.3 Inflation and interest rates



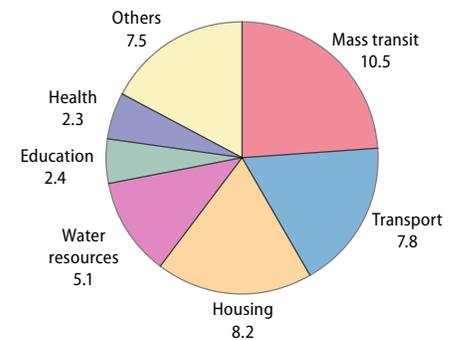
Sources: Bank of Thailand, available: [http://www.bot.or.th/bothomepage/index/index\\_e.asp](http://www.bot.or.th/bothomepage/index/index_e.asp), downloaded 14 March 2006; Datastream, downloaded 18 March 2006.

### 2.28.4 Budget balance



Source: Bank of Thailand, available: <http://www.bot.or.th/bothomepage/databank/EconData/EconFinance/index02e.htm>, downloaded 2 February 2006.

### 2.28.5 Megaprojects investment plan for 2005–2009, by category (\$ billion)



Source: Fiscal Policy Office, Ministry of Finance.

stocks, encourage participation of institutional investors in the stock market, and strengthen domestic securities companies.

## Economic outlook

### Prospects for 2006 and 2007

Continued high oil prices will hold back growth of consumption expenditure in 2006 and, to some extent, in 2007. Concerns about the impact of rising costs on core inflation—in part resulting from the pass-through of higher oil prices—are likely to lead the Bank of Thailand to continue raising interest rates in 2006. This will slow spending on, among other things, automobiles, household goods, and housing. The forecasts also assume that an increase in spending on the megaprojects program will become a key driver of growth. Consequently, both private and public investment will induce stronger growth in the economy.

While there is a consensus in Thailand that the proposed megaprojects program is required to sustain long-term growth, perhaps with some modifications, there was considerable uncertainty in the first quarter of 2006 as to the speed and magnitude of its implementation. Political uncertainties and a call by the Government for a more open and wider international bidding process for constituent projects will delay the start of some activities scheduled for this year. But a progressive acceleration of expenditures is assumed in the baseline from 2007. Megaprojects investment could contribute 0.5–0.7 of a percentage point to GDP growth each year from 2007, taking into account direct and multiplier effects. In addition to direct spending on the projects, the investment will encourage capacity expansion in cement, steel, and construction materials and subsequent creation of new jobs. This year, perhaps half of the original allocation of about \$7 billion for the megaprojects will be invested, mainly by state enterprises such as EGAT, PTT (the state petroleum company), State Railway of Thailand, National Housing Authority, and Thai Airways International. This slow start is not expected to affect the economy much in 2006, but if delays and uncertainties continue into 2007 and beyond, the baseline outlook for growth, investment, and capital market development would be significantly eroded.

GDP is forecast to grow by about 4.7% in 2006, slightly above last year (Figure 2.28.6). The leading drivers will be a moderate pickup in public investment, somewhat better performance in agriculture, robust exports, and a continuing revival of the tourism industry from the setback of the tsunami. Agriculture's contribution depends on whether it will be affected by drought again—in early 2006, there were signs of drought in some parts of the country. Yet the sector may now be better prepared to cope because the Ministry of Agriculture started improving the irrigation system last year.

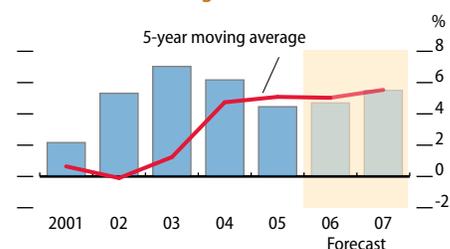
Although the contribution of consumption expenditure to growth is likely to moderate in both 2006 and 2007, private investment should remain relatively robust as capacity utilization continues to increase. In 2007, spending on the megaprojects program should support some further acceleration in growth to the 5.0–6.0% range.

#### 2.28.1 Selected economic indicators

	2006	2007
GDP growth	4.7	5.5
Inflation	4.0	3.0
Current account balance (% of GDP)	-2.5	-2.5

Source: Staff estimates.

#### 2.28.6 Annual GDP growth



Sources: National Economic and Social Development Board, available: [http://www.nesdb.go.th/econSocial/macro/nad/1\\_qgdp/data2\\_04/menu.html](http://www.nesdb.go.th/econSocial/macro/nad/1_qgdp/data2_04/menu.html), downloaded 2 February 2006; staff estimates.

Export growth is forecast at 15.3% for this year, about the same as in 2005. Electronics, computer peripherals and parts, automobiles, and agricultural products are projected to show significant export gains in 2006, with some leveling-off possible in 2007. Exports of services, essentially tourism, will continue to strengthen over the next 2 years. Import growth is projected to slow to 15.0%, since in 2005 imports of oil, capital equipment, and gold for the jewelry industry all surged, and this rate of increase will likely moderate in 2006. Elimination of fuel subsidies in 2005 and some energy-saving measures will curb growth in oil imports. The trade deficit is expected to widen (Figure 2.28.7). The current account deficit is likely to be \$4.6 billion–4.9 billion (or 2.5% of GDP) in both years (Figure 2.28.8).

Inflationary pressure is expected to ebb. The moderate tightening of monetary policy should slow consumer spending, which could also be affected by political uncertainty. In addition, the Ministry of Commerce enforced stringent price controls on a range of consumer goods in early 2006. Oil prices are projected to rise more moderately. In view of these factors, the inflation rate for 2006 is forecast at 4.0%, decelerating further to about 3.0% in 2007 (Figure 2.28.9).

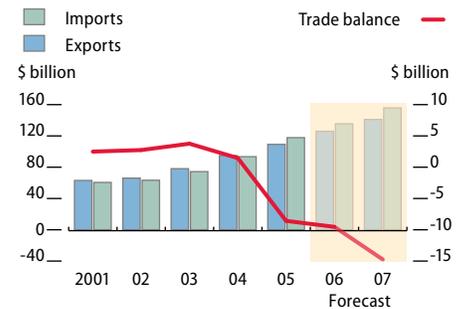
The fiscal position is expected to remain comfortable, with the Government targeting a balanced budget in FY2006 and FY2007. During the first quarter of FY2006, revenue collection exceeded target by 10.3%. There is room for an additional budget during the year if economic growth fails to meet expectations. As public infrastructure investment increases in 2007, additional funding will be needed from domestic and international sources. The extent of resources required from the public sector will depend in large part on the Government's success in attracting private sector participation to the megaprojects.

### Medium-term outlook

The outlook is for continued relatively robust economic growth in the 5–6% range. This medium-term performance will depend in part on raising the economy's productivity and competitiveness by pushing through with the megaprojects—which should, for example, reduce transport bottlenecks—and by making advances in structural reforms. These include privatization of state enterprises and development of the capital markets.

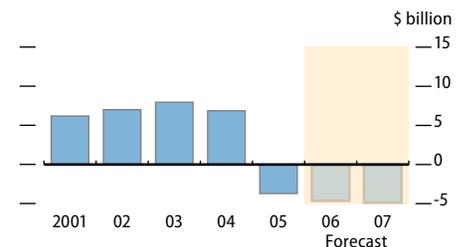
Given the very large amounts of money involved over an extended period, the financing of the megaprojects program needs to be structured so as to avoid jeopardizing fiscal and external stability. The Government has said it will ensure that public debt does not exceed 50% of GDP, debt servicing stays below 16% of public spending, and the budget is in balance. The current account is likely to remain in deficit by 2–3% of GDP over the medium term, which would not be a concern provided that the megaprojects help lift the economy to a higher growth path. Private equity will be required to reduce the pressure on public finances. Foreign participation could be encouraged through public-private partnerships. The investment in physical infrastructure is receiving the most attention, which may underplay the need to improve human resources. A study by the World Bank on the investment climate found that human resource constraints are significant in Thailand. Skills shortages cost firms, on average, the equivalent of 15% of sales.

### 2.28.7 Trade indicators



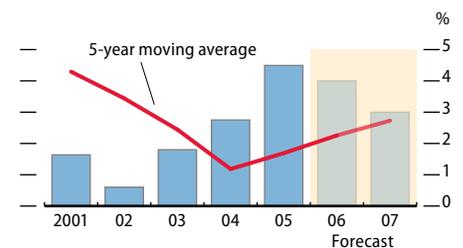
Source: Bank of Thailand, available: <http://www.bot.or.th/bothomepage/databank/EconData/EconFinance/index03e.htm>, downloaded 2 February 2006.

### 2.28.8 Current account balance



Source: Bank of Thailand, available: <http://www.bot.or.th/bothomepage/databank/EconData/EconFinance/index03e.htm>, downloaded 2 February 2006.

### 2.28.9 Inflation



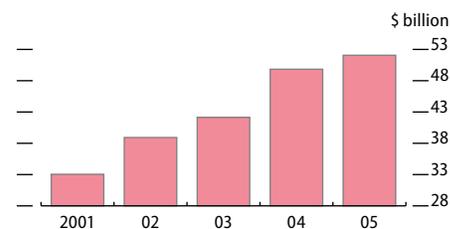
Sources: Bank of Thailand, available: <http://www.bot.or.th/bothomepage/databank/EconData/EconFinance/index04e.htm>, downloaded 2 February 2006; staff estimates.

In addition to increased public investment, the Government has embarked on an effort to lift private investment by offering tax incentives for reinvestment for a period of 3 years from this year, and incentives for companies to add value to output, such as by processing agricultural produce. The Government's dual-track development policy emphasizes both domestic demand and exports. Domestic demand is to be boosted by continued substantial spending on rural programs with a high multiplier effect, such as village development programs. In FY2005, over 30,000 villages received a total of B9.4 billion, and the budgeted amount for FY2006 has been raised to B19 billion.

Putting the privatization program back on track will be important for several reasons, including developing the capital markets, assisting the funding of infrastructure investment, and enhancing investor confidence. After the 1997–98 crisis, Thailand embarked on the privatization program as one of its structural reforms. Privatization of state enterprises was promoted both to improve their efficiency and their access to funding, and as a way to reduce the financial obligations of the Government. A privatization master plan was drafted and several committees formed to oversee, implement, and audit the sale process. Major enterprises privatized and listed include PTT and AOT (the airport authority). However, the program became bogged down by protests from employees and consumer groups as well as concerns over regulatory deficiencies and the transparency of the share offerings. The court decision on the EGAT share offering raised another obstacle.

In the near term, risks to the outlook arise from the uncertainties over the timing of the megaproject investments. As discussed, significant delays to the program would affect economic prospects. The financing of the large investments is also unclear at this time. Although the country's economic fundamentals are strong—with a healthy fiscal situation, robust export growth, and a comfortable level of external reserves (Figure 2.28.10)—prolonged political uncertainty would erode investor and consumer confidence. The possibility of renewed sociopolitical tensions in the southern provinces represent a further risk. Continued high petroleum prices could pose a particular problem because the economy is one of the most sensitive in Southeast Asia to them. The elimination of fuel subsidies in 2005 was one step to reduce consumption of imported oil. The Government has taken another step by promoting alternative energy sources, such as bio-diesel and natural gas for vehicles. It has reduced excise taxes on these alternatives, and is converting official cars and taxis so they can use them. This program has had some success.

2.28.10 Gross international reserves



Source: Bank of Thailand, available: <http://www.bot.or.th/bothomepage/databank/EconData/EconFinance/index03e.htm>, downloaded 2 February 2006.