

# Thailand

Renewed political uncertainties and rising inflation have undercut consumption and investment in 2008. GDP growth slowed in the second quarter and will likely trend lower in the rest of the year, while inflation accelerated in July to a more than 10-year high. The authorities have undertaken several policy measures: cuts in some taxes and utility charges, extra funding for villages and small businesses, and interest rate increases. Growth is projected at about 5% this year, subject to strong downside risks. Assuming that political tensions recede, growth in 2009 is forecast at around 5% (a downward revision from April). Inflation forecasts are revised up for both years.

## Updated assessment

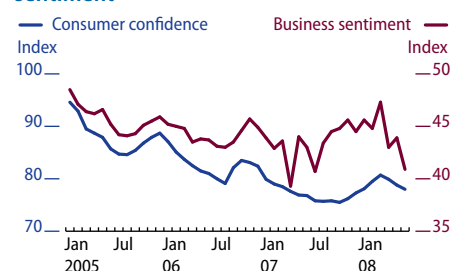
Continuing an uptrend from the second half of 2007, economic growth picked up to 6.1% in the first quarter of 2008. Early this year, an elected government took over from an interim administration that had been installed after the military coup in September 2006. However, the Government soon faced legal and political challenges, which renewed political uncertainties and undermined effective policy implementation. These political tensions, together with a surge in inflation, damaged consumer and business confidence in the second quarter (Figure 3.9.1), when economic growth slowed to 5.3% (Figure 3.9.2).

Growth in private consumption spending slowed from 2.6% in the first quarter to 2.4% in the second. Government consumption spending in real terms contracted in both quarters. Consequently, total consumption contributed just 1.2 percentage points to total GDP growth of 5.7% in the first half. Total investment contributed significantly to GDP growth in the 6 months, but mainly reflected rising inventories. Indeed, growth in fixed capital formation slowed from 5.4% in the first quarter to 1.9% in the second, when private fixed investment growth eased and public fixed investment fell (Figure 3.9.3), in part a result of the political situation. Fixed investment added less than 1 percentage point to GDP growth. Net exports also added to the overall expansion, but by much less than in 2007.

Industry grew by 7.9% in the first half and made the biggest production-side contribution to GDP growth, of about two thirds. Manufacturing grew by 9.0% in the 6 months, driven by export-oriented industries including electronic products, computers, televisions, and air conditioners. Public construction investment fell in the first half from high levels of a year earlier, and private construction recorded meager growth.

Services grew by just 3.5% from a year earlier to contribute 1.5 percentage points to GDP growth. Wholesale and retail trading showed a slight rise and some public services, such as education and health, contracted. High prices for agricultural products caused farmers

**3.9.1 Consumer confidence and business sentiment**

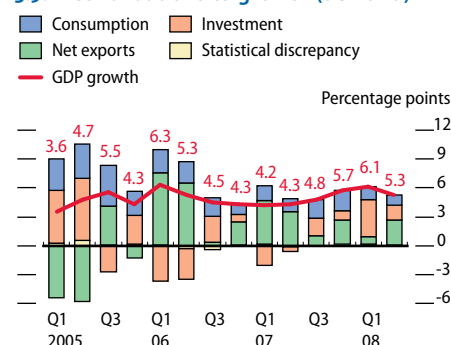


Note: A reading of less than 100 for consumer confidence and less than 50 for business sentiment denotes a deterioration.

Sources: Center for Economic and Business Forecasting; Bank of Thailand, available: <http://www.bot.or.th>, downloaded 29 July 2008.

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**3.9.2 Contributions to growth (demand)**



Source: National Economic and Social Development Board, available: <http://www.nesdb.go.th>, downloaded 27 August 2008.

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to increase output of rice, sugarcane, palm oil, and livestock, leading to a 4.9% lift in overall agricultural production in the first half. Agriculture contributed 0.4 percentage points to GDP growth.

Merchandise exports in United States (US) dollars rose by a stronger than expected 24.7% in the first half of the year, to \$86.5 billion. Agricultural exports jumped by about 55% in value terms, mainly owing to higher exports of rice (up by 135%) and natural rubber (32%). High-technology exports rose by about 19%, led by gains in computers and computer parts. This robust export performance was helped by rapid increases of about 32% in shipments to nontraditional markets, particularly People's Republic of China, India, Middle East, Eastern Europe, and the bigger Southeast Asian economies. By contrast, exports to traditional markets—US, European Union, and Japan—rose by about 10%. The proportion of exports going to traditional markets has fallen to only 35%.

Merchandise imports rose much faster than exports, by 32% to \$86.1 billion, inflated by higher prices for imported oil and industrial inputs. The value of imported oil rose by about 60%, although its volume increased by 6%. Energy efficiency has improved in recent years as oil prices have increased and there has been a shift to greater use of gasoline-ethanol mix, biodiesel, and natural gas. Imports of industrial inputs such as chemicals and plastics materials for the robust export industries grew significantly by value.

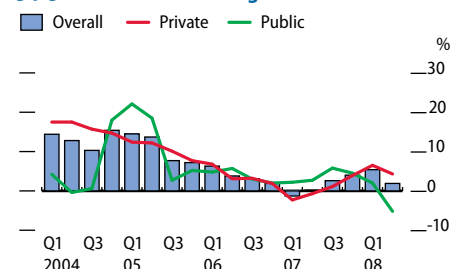
The sharper rise in imports than exports cut the trade surplus to \$316 million in the first half, from \$4.1 billion in the prior-year period, and the current account surplus fell to \$2.8 billion from \$5.9 billion (Figure 3.9.4). Foreign exchange reserves of \$102 billion in July 2008 were equivalent to 7.5 months of imports of goods and services.

Inflation accelerated during the first half to average 6.3%, jumping to an 11-year high of 9.2% in July, before easing in August (Figure 3.9.5). The main causes were higher prices for energy (fuel and natural gas), which rose by about 20% in the 6 months, and food and beverages, which were up by about 9%. Higher production expenses, reflecting cost hikes for metals and many other industrial inputs, were passed on to consumers, so that core inflation (excluding food and energy) accelerated to 3.7% by July, above the Bank of Thailand's target of 0–3.5%. The baht appreciated early in the year against the US dollar, assisted by a lifting of the capital controls that were imposed in December 2006. Subsequently though, it softened along with some other Asian currencies on concerns about a deteriorating global economic outlook. At end-August 2008, the baht had depreciated by 1.2% against the US dollar from the start of 2008 (Figure 3.9.6).

After core inflation breached the Bank of Thailand's target rate in June, the central bank raised its policy interest rate (the 1-day repo rate) in July and August, by 25 basis points each time, to 3.75% (Figure 3.9.7). That still keeps it below the inflation rate.

The Government took other steps to contain inflation. It released rice from stockpiles at low prices and temporarily reinstated a small subsidy on diesel between March and July. The authorities also pressed oil refineries to reduce refinery margins on diesel, to be in effect from June to November this year. A broader inflation-relief package was implemented in August, to last for 6 months. It includes a reduction of excise tax on

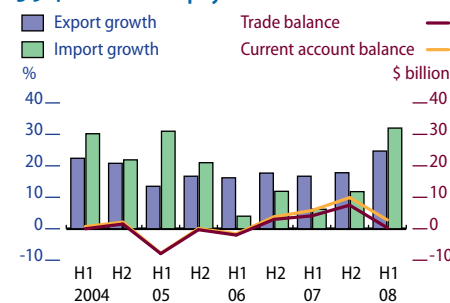
### 3.9.3 Fixed investment growth



Source: National Economic and Social Development Board, available: <http://www.nesdb.go.th>, downloaded 27 August 2008.

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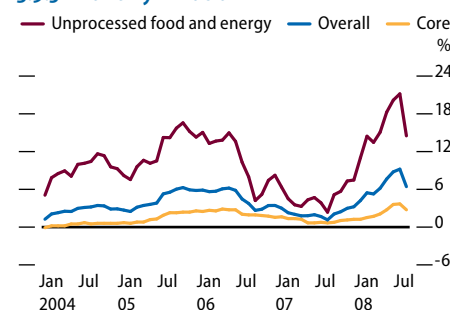
### 3.9.4 Balance-of-payments indicators



Source: Bank of Thailand, available: <http://www.bot.or.th>, downloaded 2 September 2008.

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### 3.9.5 Monthly inflation



Sources: CEIC Data Company Ltd.; Bureau of Trade and Economic Indices, available: [http://www.price.moc.go.th/web4\\_e/cpi/index.asp](http://www.price.moc.go.th/web4_e/cpi/index.asp); both downloaded 2 September 2008.

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gasoline-ethanol mix and diesel, free electricity and water supply for poor households, free rides on selected public buses in Bangkok, and free third-class train travel on some routes. The package will cost the Government about \$1.4 billion.

Despite these and other commitments, the budget deficit in FY2008 (ended 30 September 2008) is projected at slightly below the deficit of 1.8% of GDP recorded in FY2007. Revenue growth is expected to be slightly stronger than budgeted.

## Prospects

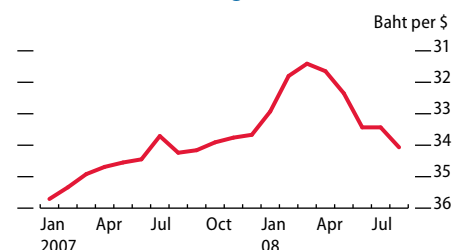
Several generally moderate fiscal measures have been implemented to spur the economy in the first 8 months of 2008. A package announced in March and costing the equivalent of \$1.2 billion contained tax breaks for individuals and for small and medium firms. A second package includes a 3-year debt moratorium for about 300,000 farmers, low interest rate loans from the Government Savings Bank for small businesses, and additional funding for the Government Housing Bank. As expected, the new Government injected more funds into programs started several years ago to assist development and generate employment in villages. It distributed about \$41 million to 5,800 villages in April for community development projects and \$26.6 million to 900 villages in August for lending to villagers.

These measures, and an easing in inflation from midyear levels, should have some positive impact in the second half of 2008. However, economic growth is forecast to slow toward 4.0% in that period, crimped by political tensions that worsened in August. Antigovernment demonstrations disrupted transportation and sparked clashes that led the Government to declare a state of emergency in Bangkok that was in force for 12 days in early September. This prompted some countries to advise their nationals against nonessential travel to Thailand, hurting the tourism industry. The rising political tensions further dented investor sentiment—the index of stock prices fell by 27% between late May and mid-September (Figure 3.9.8). Export growth is expected to soften in the second half because of the weaker global trade environment. Taking into account the stronger than expected 5.7% economic expansion in the first half, full-year growth is projected at about 5% (Figure 3.9.9), subject to strong downside risks because of the highly uncertain political context.

The surge in imports caused by higher prices for oil and other commodities has cut into the trade surplus this year, and services income will be hurt by lower than expected tourist arrivals in the second half, contributing to an expected reduction in the current account surplus to 1.0% of GDP, which is a revision from the 3.0% given in *Asian Development Outlook 2008* (ADO 2008). The steps taken to curb the cost of fuel, utilities, and public transportation helped slow inflation to 6.4% in August (a decline in fuel prices that month had a significant impact). Inflation for all 2008 is forecast to average 7.0%, revised up from 4.0% in ADO 2008 because of the higher than expected price pressures that built up in the first half.

The outlook for 2009 assumes that political tensions attenuate and that the policy environment improves. That would pave the

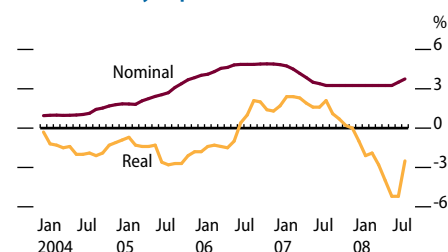
### 3.9.6 Nominal exchange rate



Source: International Monetary Fund, *International Financial Statistics* online, downloaded 2 September 2008.

[Click here for figure data](#)

### 3.9.7 One-day repo rate



Sources: CEIC Data Company Ltd.; Bureau of Trade and Economic Indices, available: [http://www.price.moc.go.th/web4\\_e/cpi/index.asp](http://www.price.moc.go.th/web4_e/cpi/index.asp); both downloaded 2 September 2008.

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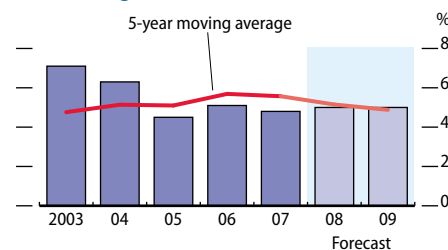
### 3.9.8 SET index



Source: CEIC Data Company Ltd., downloaded 11 September 2008.

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### 3.9.9 GDP growth



Sources: National Economic and Social Development Board, available: <http://www.nesdb.go.th/>, downloaded 27 August 2008; staff estimates.

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way for a pickup in consumer and business sentiment and allow the implementation of some of the large public infrastructure projects planned by past administrations, but delayed in the past 2 years by political issues. (Specifically, two new mass transit rail lines for Bangkok, which are a significant part of the infrastructure program, are expected to start construction in 2009.) An expansionary budget with a deficit target of 2.4% of GDP has been approved for FY2009, and the forecasts assume that public spending will increase next year.

Private consumption and investment are expected to strengthen, although not to the degree forecast in *ADO 2008*, mainly owing to higher inflation and interest rates. Public consumption and investment spending are likely to rise, supported by the infrastructure projects and the budget spending plans. Export growth will lose momentum as a result of lackluster world trade and modest growth in global nonfuel commodity prices, while import growth might not slow by the same degree, given the need to import equipment for the expected public investment programs. Drawing these strands together, the *Update* lowers the growth projection for next year to 5.0%, although this forecast (as 2008's) is subject to substantial downside risks. The current account is forecast to move into deficit, equivalent to about 0.5% of GDP (Figure 3.9.10) (a surplus was expected previously).

Inflation is forecast to ease to 5.5% next year (Figure 3.9.11) as global prices for oil and other raw materials decline or grow more moderately than in 2008. Also, the Government is expected to implement measures to suppress price increases for low-income earners, as it has done this year. Such inflation would still be well above the average of 3.2% in 2003–2007.

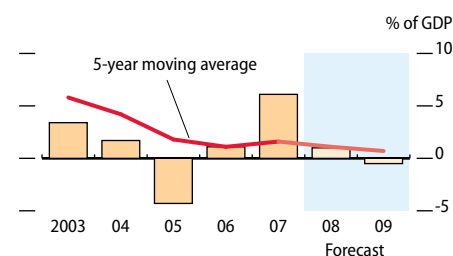
The main risks to this outlook are in the political arena. If wrangling that started in 2006 drags into a fourth year, the impact on the economy would most likely intensify, substantially eroding already weak business and consumer sentiment and resulting in lower than forecast economic growth. Extended disruptions to the economy and to policy making could have implications for the country risk premium (including bond spreads and credit ratings). The Government faces several legal challenges that could lead to an early national election in the forecast period. That would likely create an economic policy vacuum for some months that could further delay the large public infrastructure projects and undermine investment. In that event, weaker than expected domestic demand could be expected to damp import growth, and the current account outcome would be better than the baseline forecast. The inflation outlook is conditioned on volatile international factors, as well as the implementation of domestic inflation-relief measures and the value of the baht.

### 3.9.1 Selected economic indicators (%)

|                                      | 2008            |               | 2009            |               |
|--------------------------------------|-----------------|---------------|-----------------|---------------|
|                                      | <i>ADO 2008</i> | <i>Update</i> | <i>ADO 2008</i> | <i>Update</i> |
| GDP growth                           | 5.0             | 5.0           | 5.2             | 5.0           |
| Inflation                            | 4.0             | 7.0           | 3.5             | 5.5           |
| Current acct. bal.<br>(share of GDP) | 3.0             | 1.0           | 1.0             | -0.5          |

Source: Staff estimates.

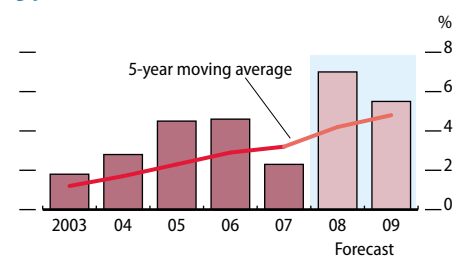
### 3.9.10 Current account balance



Sources: Bank of Thailand, available: <http://www.bot.or.th>, downloaded 2 September 2008; staff estimates.

[Click here for figure data](#)

### 3.9.11 Inflation



Sources: Bank of Thailand, available: <http://www.bot.or.th>, downloaded 2 September 2008; staff estimates.

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