Thailand

Exports drove moderate economic growth in 2007, with consumption and investment curbed by political uncertainties at home. An elected Government took office in January 2008, a development that is expected to assist in reviving domestic demand and so offset a likely weakening of exports this year. The Government has lifted capital controls and outlined policies to stimulate the economy and invest in large infrastructure projects. Growth is projected to edge higher in 2008–2009. Inflation, low last year, is now accelerating.

Economic performance

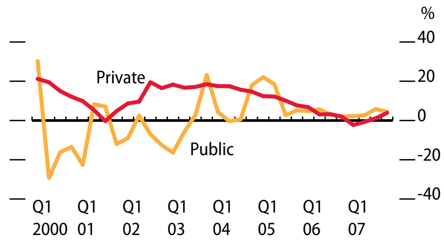
With consumption and investment weakened by lack of certainty on the political front, the economy grew by 4.8% in 2007, or nearly 1 percentage point below the average for the 5 years 2002–2006. Domestic demand contributed less than 2 percentage points to GDP growth while net exports contributed 3 percentage points. After 2 years of political instability, which included a military coup in September 2006 followed by an interim administration, an elected government took office in January 2008 in a six-party coalition.

Concerns about political issues and associated lack of clarity on economic policy eroded consumption and investment spending for much of 2006 and 2007. At half 2006's low rate, private consumption grew by just 1.4% in 2007, despite stronger farm incomes due to higher prices of agricultural products and increases in salaries for government and state-enterprise employees. Spending on items other than food grew by a meager 0.8%. The consumer confidence index fell until November.

Regarding investment, total gross fixed capital formation in 2007 grew by 1.4%, a sharp slowdown from a year earlier. Private fixed investment contracted in the first half, then started to improve in the second (Figure 3.29.1) to record 0.5% growth for the year as a whole. The pickup later in the year was the result of some improvement in investor confidence that the political uncertainties would be resolved. GDP growth lifted in the second half of 2007 (Figure 3.29.2) Public investment in FY2007 (ended 30 September 2007) was up by 4.0% from the previous fiscal year, even though there was no major investment under the large public infrastructure program drawn up in 2004, which called for capital outlays of as much as $42 billion in 2005–2009.

From the supply side, industry was the fastest-growing sector and made the strongest contribution (2.5 percentage points of total GDP growth). Manufacturing output increased by 5.8%, driven by export-oriented industries including integrated circuits, hard disk drives, air conditioners, and vehicles. In contrast, some domestic market-oriented

3.29.1 Fixed investment growth



Source: National Economic and Social Development Board, available: http://www.nesdb.go.th, downloaded 13 March 2008.
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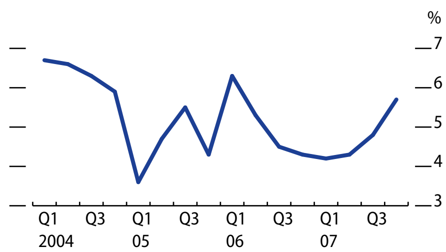
3.29.2 Quarterly GDP growth



Source: National Economic and Social Development Board.
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industries reported lower production, namely cement and motorcycles. Construction grew by 2.7%, mainly reflecting an expansion of public sector projects. Growth in services was pulled back by a weakening in tourism arrivals. Agriculture had a reasonable year, with good output gains in cassava and palm oil, as well as in fisheries.

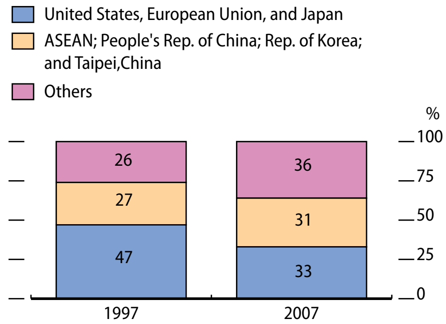
External trade made the major contribution to growth: merchandise exports climbed by 18.1% in nominal United States (US) dollar terms, while merchandise imports increased at just half that rate. All export categories performed well, notably electronics, vehicles, petroleum products, metal products, plastic products, and jewelry. Exports of agricultural products, including palm oil, rice, and natural rubber, also rose, boosted by high world commodity prices. The strong export performance was attributable in part to gains in fast-growing markets in eastern Europe, Middle East, People's Republic of China, and India (Figure 3.29.3). Thai producers have come under pressure from sluggish domestic demand and a slowdown in exports to the US to push harder in new markets, and seem to have been aided by Thailand's free-trade agreements. For example, exports of automobiles and parts to Australia surged after their bilateral agreement came into effect in 2005 (Figure 3.29.4).

The soft domestic demand kept import growth to moderate levels, until later in the year when it started to pick up (Figure 3.29.5) as private investment firmed. Demand for imported raw materials and intermediate goods rose in line with the strong export performance. A large trade surplus of almost $12 billion contributed to a current account surplus of about $15 billion, or 6.1% of GDP in 2007. Foreign exchange reserves increased by $20 billion to $85.1 billion at year-end, equivalent to 3.9 times short-term foreign debt and 6.2 months of imports. This also reflected accumulation of foreign exchange by the Bank of Thailand as it sold baht to limit the currency's appreciation. Still, the currency strengthened by a nominal 6.3% against US dollar in 2007, and its nominal effective exchange rate rose by 1.4% (Figure 3.29.6).

Weakness in domestic demand had another effect: it kept inflation low until the fourth quarter, when it quickened to 2.9%, propelled by higher prices for fuel and cooking gas (subsidies on cooking gas were ended in early December 2007). Food prices also picked up, in line with the global trend. For all 2007, inflation averaged 2.3%, about half the rate of the 2 previous years, paving the way for the central bank to reduce its policy interest rate by 175 basis points to 3.25% in January–July, in an effort to stimulate domestic demand. But with domestic demand (and inflation) gathering pace later in the year, the central bank left the policy rate steady after July. The interim administration, having accelerated spending to bolster domestic demand, recorded a budget deficit of 1.8% of GDP in FY2007. Total public debt fell to 38.0% of GDP at end-2007 from 40.5% a year earlier.

Employment rose by 1.6% to 36.2 million, and the unemployment rate averaged 1.4%, down from 1.5% in 2006, continuing the downward trend of the past 10 years.

3.29.3 Export share



Source: Bank of Thailand.

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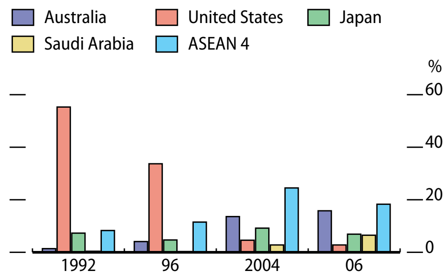
3.29.4 Export share for automobiles



Source: Ministry of Finance.

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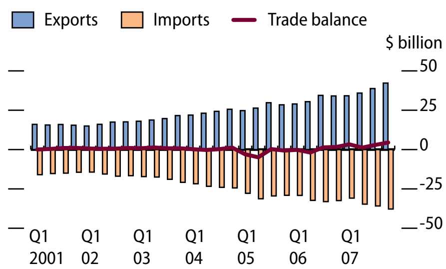
3.29.5 Trade indicators



Source: Bank of Thailand.

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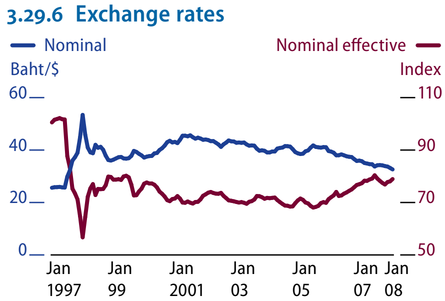
3.29.6 Exchange rates



Source: Bank of Thailand.

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Economic prospects

The projections for 2008 and 2009 assume that the coalition Government will be stable and will implement the major policies outlined so far, which should underpin an improvement in consumer and business confidence. The Government has indicated that it will revive or revitalize some policies similar to those followed during 2001–2005, aimed largely at assisting poorer communities and small enterprises. One is the village fund program (put on hold during the interim administration), which provided a revolving fund of B1 million (now about $31,250) for each village for lending to local people. It was successful in boosting consumption at the village level, although it is not clear that the money was always spent for productive purposes. The new Government plans to revive these village funds, and upgrade well-managed ones into village banks. Another program that was suspended and could be revived involves funding for communities for projects to generate sustainable revenues, develop community assets, and preserve the environment.

The One Village-One Product policy was continued during the interim administration but with only low priority. It assists small enterprises that add value to natural resource products such as silk and food. The People's Bank, which provides low-income people with access to banking, also looks set to get more attention. The Government will retain the universal health care program, which provides a useful safety net but is underfunded.

These policies would boost demand at the community level in the near term. Longer-term issues are to show that they are fiscally sustainable and can operate in a transparent way that enables public funds to be monitored.

As for public investment, the Government has reprioritized the large infrastructure investment program. Tenders for three new train routes in Bangkok will be called in 2008 as part of a $22.2 billion plan to develop nine new mass transit rail lines for the city. The Government will draw B520 billion (US$15.0 billion) from its budget in 2008–2013 to help fund the rail projects. Speeding up public investment in infrastructure is likely to provide a boost to related private sector industries, including construction and real estate, mainly after 2008.

Early indications show domestic demand continuing to improve in 2008. The index of consumer confidence rose in January 2008 (Figure 3.29.7) and the private consumption index increased by 8.5% that month from a year earlier. A sharp rise in imports of capital goods in January (excluding aircraft, ships, and trains) indicated a rise in private investment. In March, the Government introduced a policy package designed to stimulate consumption and investment, including tax breaks for individuals and for small and medium firms, and a reduction in taxes and fees for property transfers.

Given these policies and plans, faster growth is forecast for both consumption and investment, public and private. Stronger domestic demand is expected to offset a slowdown in exports, supporting a GDP growth forecast of 5.0% in 2008 and 5.2% in 2009 (Figure 3.29.8)

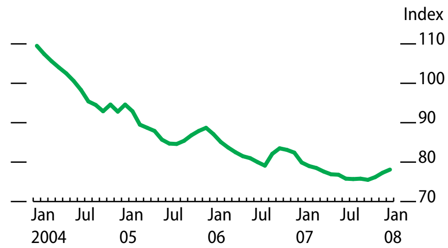
Private consumption will be buttressed by increases in minimum wages (January 2008) and in wages for the public sector, including state enterprises (October 2007) and the more recent tax breaks for individuals. The impact of last year's interest rate reductions will help.

3.29.1 Selected economic indicators

	2008	2009
GDP growth	5.0	5.2
Inflation	4.0	3.5
Current account balance (% of GDP)	3.0	1.0

Source: Staff estimates.

3.29.7 Consumer confidence index



Note: A reading of less than 100 denotes deteriorating confidence.

Source: Center for Economic and Business Forecasting.

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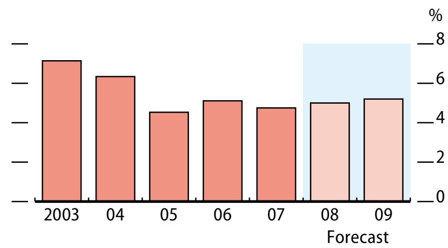
3.29.8 GDP growth



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

Click here for figure data

Private investment is forecast to expand by at least 5% in 2008, from a low base last year. High levels of capacity utilization at end-2007 (Figure 3.29.9) will induce investment. Capacity utilization rates were high in chemicals (100%), petroleum products (94%), electronic products (92%), and beverages (87%). Moreover, foreign direct investment approvals last year rose by 63% in value terms, a sign that FDI inflows will be robust in the forecast period.

Merchandise export growth is projected to slow because of the downturn in industrial-country markets, but still to increase by about 11% in 2008 and 10% in 2009. Exports appear to be more resilient (Figure 3.29.10) now that the markets are more diversified. The diversification extends beyond expansion in new markets. For example, exports denominated in currencies other than US dollars have increased from about 8% in 1996 to 19% in 2007. This has helped reduce the impact of the baht's appreciation. Export products, too, are more widely based than in the past, marking Thailand's shift away from labor-intensive items over the past decade. The top exports last year were computers and parts, automobiles and parts, and electrical circuits.

Merchandise imports are forecast to accelerate, prompted by the revival of domestic demand, rising by 14% this year and 15% in 2009. The current account surplus is projected to shrink to about 3% of GDP in 2008 and to 1% in 2009 as the trade surplus falls (Figure 3.29.11).

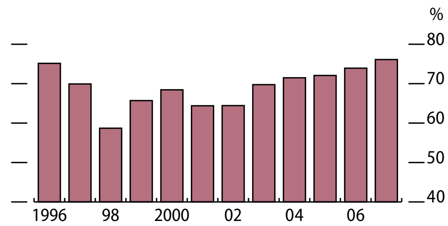
Inflation quickened to 5.4% in February 2008, the highest level in 20 months, indicating negative real interest rates (the policy interest rate is 3.25%) and an easing of monetary policy. Rising prices for oil and food are underpinning inflation. Price pressures are forecast to moderate during the year, leaving the average inflation rate at 4.0% for 2008, easing to 3.5% in 2009 (Figure 3.29.12). Inflation is limiting the possibility of further interest rates cuts to support economic growth.

The budget for FY2008 projects a wider deficit of 1.8% of GDP and disbursements of capital expenditures in the first 4 months of this fiscal year were stepped up sharply from the year-earlier rate. Given that the public debt is well below the government-imposed limit of 50% of GDP, the authorities are likely to consider additional public spending this year and next to stimulate growth. Tax concessions announced this year will erode public revenues, though collections of indirect taxes will rise if consumption picks up as forecast.

The central bank in March 2008 lifted capital controls (imposed in December 2006) by removing the 30% non-interest-bearing reserve requirement on many types of capital inflows. That restriction had been aimed at curbing a surge in capital inflows (Figure 3.29.13) and slowing currency appreciation. Following a plunge in stock prices in the immediate aftermath of the imposition of capital controls, the authorities exempted stock market inflows, and continued to roll back the restrictions over the course of 2007. In response to exporters' concerns that the lifting of the controls would add upward pressure on the baht (because of higher capital inflows), the Government stated that it would refinance its own foreign currency debt and ease restrictions on foreign investment by Thais.

Development of the domestic capital markets is one of the new Government's policies. It has announced tax concessions for companies to

3.29.9 Industrial capacity utilization



Source: Bank of Thailand.
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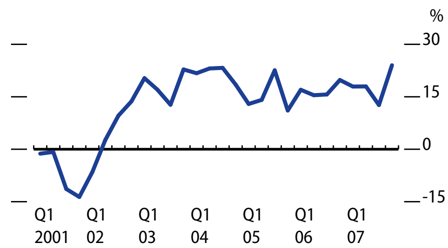
3.29.10 Export growth



Source: Bank of Thailand.
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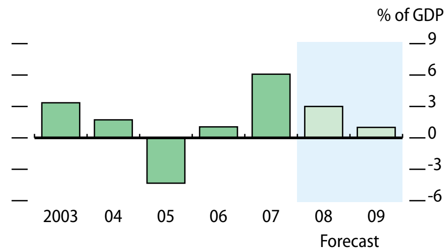
3.29.11 Current account balance



Sources: Bank of Thailand; staff estimates.
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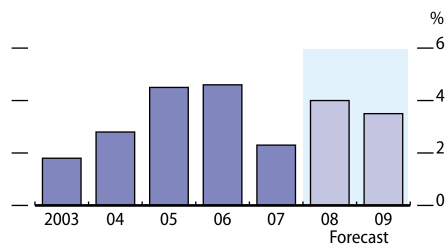
3.29.12 Inflation

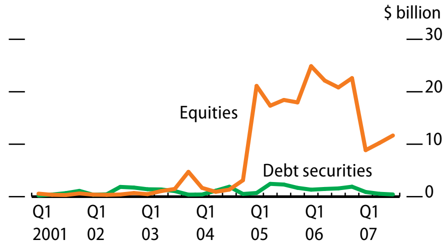


Sources: Bank of Thailand; staff estimates.
Click here for figure data

list on the stock exchange, tax incentives for investment in life insurance and long-term equity funds, and stated that it will increase the role of domestic capital markets in financing the large infrastructure projects. However, privatization of state assets, which would benefit equity market development, does not appear to be a government priority.

Risks to the forecasts come from within and outside the country. Higher than expected global oil prices are a particular risk because the economy is more sensitive to oil prices than most others in Asia. A deeper global economic slowdown than the baseline forecast would damage the outlook for exports and for externally oriented services such as finance and tourism. Domestically, there are risks that the large public investment projects could face further delays, and that political stresses could reemerge.

3.29.13 Capital inflows



Source: Bank of Thailand.
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Development challenges

Given that foreign investor sentiment was dented by some of the policies and proposals of the interim administration, the new Government faces the challenge of rebuilding confidence. It has gone some way with the ending of capital controls. A proposed amendment to the Foreign Business Act that would tighten controls on foreign ownership of Thai companies remains a concern to international businesses and it might be shelved. Also to be resolved are proposed changes to retail laws that would hamper foreign retailers' expansion.

The baht appreciated by about 7% against the US dollar in the first 12 weeks of 2008 and has strengthened by 24% since end-2005. The Government's stance on currency appreciation has yet to become clear. Continued market intervention to support the US dollar against the baht is one option. Gross foreign reserves, including forward contracts, totaled $106.7 billion at end-2007, with much of the rise of $32 billion over the year reflecting market intervention by the central bank. However, this buying of foreign exchange has a cost: the central bank needs to counterbalance inflows with new bond issues to prevent excessive growth in the money supply that could fan inflation.

A longer-term challenge is the aging population. The population dependency ratio, defined as the ratio of the number of elderly to the number of working age people, is projected to rise from 23.5% in 2006 to nearly 69% by 2050. Such changes imply a reduction in income per capita and a heavy fiscal burden on the public old-age pension and health care programs. Currently, Thailand has a social insurance program that includes an old-age pension administered by the Social Security Office. The pension plan is a mandatory, defined-benefit system for employees in the formal sector of the economy. Workers and employers contribute 3% of wages each and the Government contributes an amount equal to 1% of wages.

However, it is projected that the pension system will not have adequate funding to pay the full promised retirement benefits by 2046, leaving the Government to fill a widening financial gap or to reduce the pension payouts and push many older people into poverty. Increasing the retirement age from 55 to 60 and raising contribution rates would help in the medium term. Adding mandatory privately managed pensions in order to supplement the public system could be a longer-term solution.