Thailand

Better than expected net export performance is helping offset sluggishness of consumption and investment caused by political uncertainties, thus keeping the GDP growth projection for 2007 at 4.0%. The soft domestic activity has, though, prompted a downward revision in the inflation forecast. Domestic demand is expected to pick up in 2008, if consumer and business confidence returns after elections for a new government. The GDP growth projection for next year remains at 5.0%.

Updated assessment

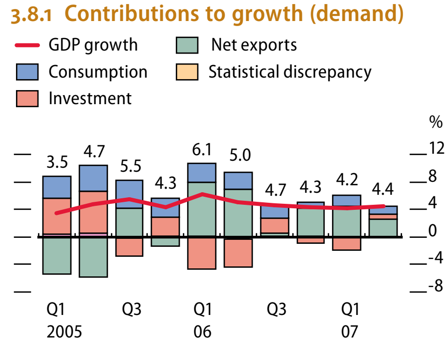
The economy grew by 4.3% in the first half of 2007. Net exports were the driving force (Figure 3.8.1), as domestic demand weakened due to disruptions in the political environment and a lack of clarity about economic policy direction. (An interim Government was installed after a military coup in September 2006, and national elections are planned for December this year.) Private consumption, hurt by weakness in consumer confidence (Figure 3.8.2), expanded modestly by 1.1% in the first half. Unsettled politics also hurt gross fixed investment, which fell by 0.6%, with private fixed investment down by 1.5% (Figure 3.8.3).

The interim Government accelerated its spending to buttress domestic demand: almost 70% of annual state-owned enterprise investment was disbursed in the first 6 months of FY2007 (ending 30 September 2007). Domestic demand is expected to remain weak for the rest of 2007. Private consumption is seen growing by 2%, around the same range as projected in *Asian Development Outlook 2007* (*ADO 2007*) earlier this year, but forecast growth in total fixed investment is revised down to 2% from 5%. Taking into account stronger than expected net exports, the projection for full-year GDP growth is maintained at 4.0%, the lowest rate in 6 years.

On the production side, agriculture grew by 6.2% in the first half, accelerating from a year earlier, on an increase in sugarcane and cassava production. But growth in industry and services combined slipped to 4.2%, reflecting slowdowns in light industries, high-technology industries, and hotels and restaurants.

The external side performed better than anticipated, with exports stronger and imports weaker than forecast in *ADO 2007*. Merchandise exports grew by 18.4% in the first half of 2007 (Figure 3.8.4): agriculture's were up by 15.6%, partly a result of higher rice prices, and industry's by 19.1%, led by electrical appliances, automobile parts, and construction materials. Shipments to India and Eastern Europe, relatively small but increasingly important markets for Thailand, recorded particularly strong growth as these economies accelerated. In the second half, export growth is likely to ease, partly because the baht has continued to appreciate, which is damping orders for some exports, and in July, export growth decelerated sharply to 6.2%. A decision by the United States (US) in June to reduce preferential treatment for some imports from Thailand,

3.8.1 Contributions to growth (demand)



Source: National Economic and Social Development Board, available: http://www.nesdb.go.th, downloaded 3 September 2007.

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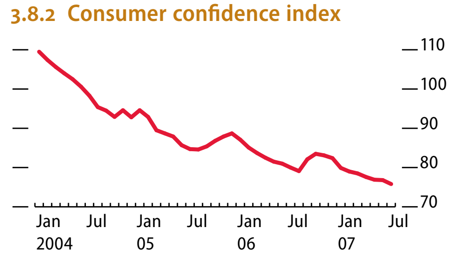
3.8.2 Consumer confidence index



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

Source: Center for Economic and Business Forecasting, University of Thai Chamber of Commerce, available: http://www.utcc.ac.th, downloaded 25 August 2007.

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including gems and jewelry, should have a fairly limited impact on exports. For all this year, total exports are projected to grow by 12.5%.

Imports in January–June rose at the modest rate of 6.4%, affected by the slack domestic demand. Capital goods imports barely grew (by 0.3%), reflecting weak investment (stemming from shakier business confidence), and fuel imports fell by 3.4%. Imports could pick up modestly in the second half, given depletion of inventories of imported materials and the firmer exchange rate.

The solid first-half export performance, combined with weak imports, generated a merchandise trade surplus of $5.1 billion, a sharp turnaround from a deficit of $1.9 billion a year earlier. Net income from tourism, transportation, and remittances was also strong. Together these moved the current account into surplus, at $6.2 billion, compared with a deficit of $1.6 billion in the first half of 2006. The full-year figures for the trade surplus and net income are projected to be stronger than forecast in *ADO 2007*. Drawing these strands together, the projection for the current account surplus for 2007 is revised up to 3.0% of GDP, from 1.3%.

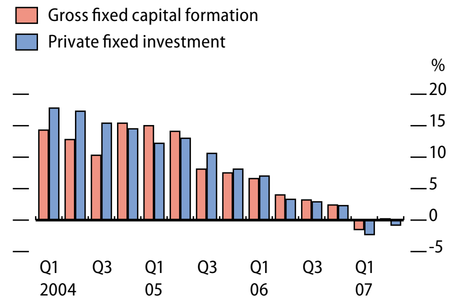
The rising current account surplus and a surge in private capital inflows into the Thai stock market boosted foreign exchange reserves to $72.1 billion in July 2007, equivalent to 3.8 times short-term external debt and to 6 months of imports. The higher foreign reserves also reflect central bank sales of baht to moderate the currency's appreciation. Even so, the baht appreciated by 4.8% against the US dollar by late August from end-2006. The Stock Exchange of Thailand index of share prices rose by 20% over those 8 months.

Controls introduced in December 2006 to curb capital inflows and to slow currency appreciation were gradually eased, although a 30% non-interest-bearing reserve requirement on unhedged external borrowing and foreign purchases of Thai debt securities remains in place (stock market investments are exempted). In July 2007, the interim Government relaxed rules on Thai residents' foreign investment and foreign currency holdings. Also, the Finance Ministry aims to refinance $3.2 billion in foreign debt held by the Government and state-owned enterprises to help reduce upward pressure on the baht by increasing demand for foreign currency to repay external creditors.

Soft domestic demand has weakened inflation pressures: average consumer price inflation was only 2.0% in the first 8 months of 2007. In August, year-on-year inflation slowed to 1.1% (Figure 3.8.5), with core inflation (i.e., excluding volatile food and energy), at just 0.7%. Such figures allowed the Bank of Thailand scope to lower its policy interest rate by 175 basis points to 3.25% between January and August. Inflation is likely to remain low over the rest of this year, assisted by currency appreciation (cushioning rising oil prices), and softer than expected domestic demand (limiting firms' ability to raise prices). For all 2007, inflation is forecast at 2.0%, revised down from 2.5% in *ADO 2007*.

On the fiscal side, the Government targeted a budget deficit equivalent to 1.7% of GDP in FY2007. Government consumption spending looks set to rise by 11%, helping bolster domestic demand. As for the public infrastructure program, which projected investment of as much as $42 billion on a variety of major projects in 2005–2009, the interim Government had aimed to make progress this year on expanding mass

3.8.3 Fixed investment growth



Source: National Economic and Social Development Board, available: http://www.nesdb.go.th, downloaded 3 September 2007.

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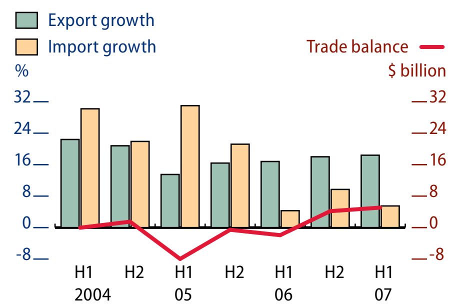
3.8.4 Trade indicators



Source: Bank of Thailand, available: http://www.bot.or.th, downloaded 31 August 2007.

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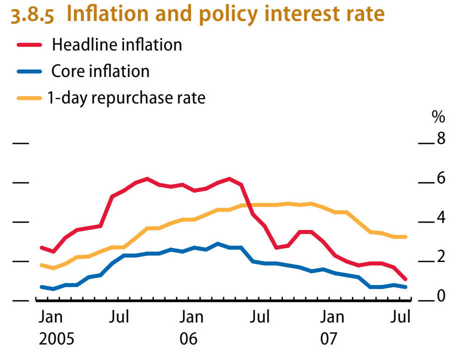
3.8.5 Inflation and policy interest rate



Note: Core inflation excludes fresh food and energy items.

Source: Bank of Thailand, available: http://www.bot.or.th, downloaded 3 September 2007.

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transit rail lines for Bangkok—a significant part of the program—but contract bidding was postponed. Some projects, such as investment in energy, water resources, and low-cost housing, have gone ahead over the past couple of years, but others have faced delays.

Prospects

The outlook for 2008 assumes that national elections are held in December this year as planned and that an elected government pursues a credible economic program. In that case, consumer and business confidence would likely revive. Private investment would pick up, supported by the reduction in interest rates this year and fairly high capacity utilization (75% in July). A new government would likely continue with the public infrastructure program: energy, water, and health projects are already in the FY2008 budget. The question is how quickly it could start building the mass transit lines.

This year's appreciation of the baht is likely to crimp growth of some exports in 2008, especially those with low levels of imported content, as well as agricultural products and clothing. However, export growth is still expected to achieve the level foreseen in *ADO 2007*. Imports will pick up as companies rebuild inventories and domestic demand starts to revive. On this basis, the forecast for GDP growth next year is maintained at 5.0% (Figure 3.8.6). Inflation is projected to edge up to 2.5% on average—an unchanged forecast from *ADO 2007* (Figure 3.8.7)—as firmer domestic demand paves the way for price increases.

Moderating export and strengthening import growth would result in a trade surplus lower next year than this year, but still considerably higher than that forecast in *ADO 2007*. The current account is now seen posting a small surplus (0.5% of GDP), as opposed to a deficit (of 0.7%) in *ADO 2007*.

For FY2008, the Government has approved a budget with a deficit of B165 billion, or 1.8% of GDP. The total public-investment budget will increase by 8% relative to FY2007, with additional allocations for the mass transit system, energy, and the petrochemical industry. The aim of this expansionary fiscal policy is to stimulate domestic demand. The incoming government will have the fiscal space to further raise public investment if required, as public debt at end-May 2007 stood at 38.2% of GDP, well within a self-imposed 50% ceiling under the fiscal sustainability framework.

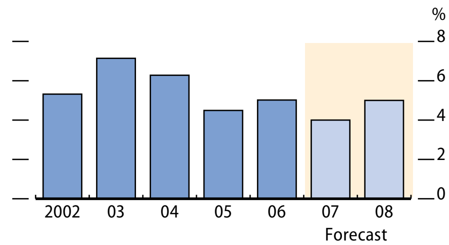
The main risk to this outlook involves a continuation of policy uncertainty into 2008, if the newly elected government cannot quickly implement a sound program for the economy. Further weakness in domestic demand would make the economy susceptible to any unexpected reduction in external demand, the main element underpinning growth so far in 2007.

3.8.1 Selected economic indicators (%)

	2007		2008	
	ADO 2007	*Update*	*ADO 2007*	*Update*
GDP growth	4.0	4.0	5.0	5.0
Inflation	2.5	2.0	2.5	2.5
Current acct. bal. (share of GDP)	1.3	3.0	-0.7	0.5

Source: Staff estimates.

3.8.6 GDP growth



Sources: National Economic and Social Development Board, available: http://www.nesdb.go.th, downloaded 3 September 2007; staff estimates.

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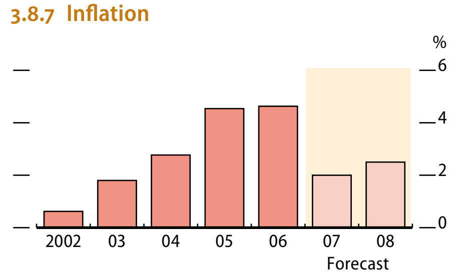
3.8.7 Inflation



Sources: Bureau of Trade and Economic Indices, available: http://www.price.moc.go.th/web4_e/cpi/index.asp, downloaded 31 August 2007; staff estimates.

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