Thailand

Strong exports drove a pickup in economic growth last year, since domestic demand was damped by several factors including rising interest rates and inflation in the first half, flooding, and political uncertainties for much of the year. Inflationary pressures eased in the second half, paving the way for the central bank to start lowering rates early in 2007. Economic growth is projected to slow this year, and the outlook for next year depends heavily on elections actually being held and on the incoming government providing a clear and credible economic program.

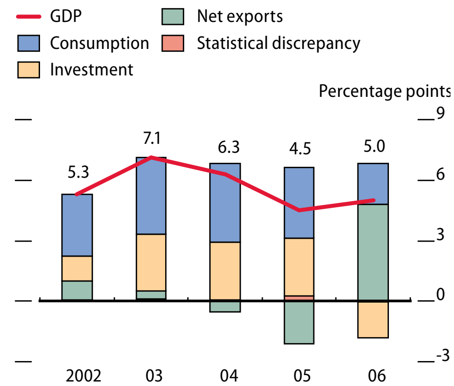
Economic performance

Economic growth picked up by a half percentage point to 5.0% in 2006, though that still left it nearly 1 percentage point below the 2002–2005 average. Driven by strong exports and a slowing in imports, net exports of goods and services contributed nearly all the overall GDP expansion (Figure 2.28.1). Domestic demand weakened, hurt by the rise in global oil prices, inflation and rising interest rates, flooding, and most important, political uncertainty throughout most of the year. Results of elections held in April were annulled, and a caretaker government took office pending new polling in October. However, in September, after a coup, the military took over the administration, suspended the 1997 constitution, and installed an interim government. A new constitution is being drafted, on which a referendum will be held, and national elections are planned before the end of this year.

Growth stepped down over 2006 from 6.1% on a year-on-year basis in the first quarter to 4.2% in the fourth (Figure 2.28.2), mainly as a result of heightened political uncertainty and of flooding in the northern and central regions, which affected farm incomes. The index of consumer confidence declined from the second quarter. For the year, private consumption growth decelerated to 3.1%. Fixed investment growth slowed to 4.0% as firms waited for political and policy positions to become clear. In addition, most of the large public infrastructure investments planned by the previous government were delayed.

This program targeted investment of as much as $42 billion over 2005–2009 on physical and social infrastructure. The interim government did not scrap the program, but has been reviewing it and changing the priorities. This delayed some projects, in particular new mass transit rail lines for Bangkok. A few projects under the program were implemented through the 2006 budget, including construction of power plants and gas pipelines, improvement of water supply systems, and provision of low-cost housing. Investments under the infrastructure program are now expected to be extended well beyond 2010, which is a more realistic schedule than originally planned given the size and complexity of the investments. Investment overall was a drag on GDP growth in 2006 for the first time since 1998, subtracting 1.8 percentage points.

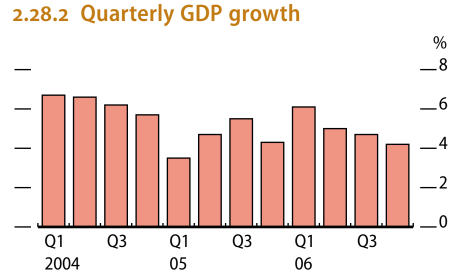
2.28.1 Contributions to growth (demand)



Source: National Economic and Social Development Board, available: http://www.nesdb.go.th, downloaded 9 March 2007.

Click here for figure data

2.28.2 Quarterly GDP growth



Source: National Economic and Social Development Board, available: http://www.nesdb.go.th, downloaded 8 March 2007.

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Average inflation in 2006 accelerated to 4.6%, the highest rate in 7 years. The elimination of fuel subsidies in July 2005 pushed up inflation over the next 12 months. As world oil prices eased and the impact of the elimination of the fuel subsidies faded, price pressures subsided (Figure 2.28.3). To lean against inflation, the Bank of Thailand, which follows an inflation targeting policy, had hoisted its policy interest rate seven times between early 2005 and July 2006. As inflation pressures then diminished, the central bank kept the policy rate steady until early 2007, when it cut its benchmark in January and again in February, to 4.7% (Figure 2.28.4), in a context of moderating inflationary pressures and weakening economic growth.

Merchandise exports grew by a nominal 17.4% as a result of strong external markets and high prices for export commodities, including natural rubber and rice. Import growth, in contrast, pulled back sharply to 7.0%, reflecting weakness in both consumption and investment demand. This saw the trade balance switch to a surplus of $2.2 billion, from a deficit of $8.5 billion a year earlier. The services balance was in surplus by $4.3 billion, supported by a recovery in tourism from the impact of the December 2004 tsunami (tourism receipts rose by nearly 30% in 2006).

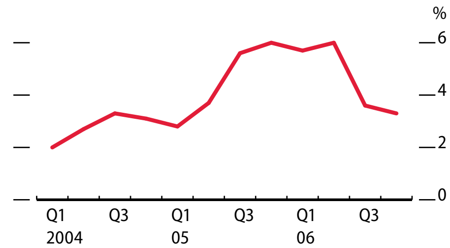
The current account surplus amounted to $3.2 billion, or 1.6% of GDP, turning around from a $7.9 billion deficit in 2005. The return to a current account surplus, together with large inflows of equity portfolio investment and a surge in foreign purchases of domestic debt securities, boosted official foreign exchange reserves to a record $65.1 billion in December (Figure 2.28.5), partly reflecting Bank of Thailand intervention to stem rapid appreciation of the baht.

The current account surplus, allied with significant capital inflows, put strong upward pressure on the baht: it averaged B37.9/$1 in 2006, compared with B40.2/$1 a year earlier, and it hit a 9-year high of B35.1/$1 in mid-December (Figure 2.28.6). On 18 December the monetary authorities, aiming to curb capital inflows and slow currency appreciation, announced controls, in the form of a 30% noninterest-bearing reserve requirement on many capital inflows. If the reserve-associated funds are withdrawn from Thailand within 1 year, only two thirds of the reserve will be released, equivalent to a tax of 10%.

That decision prompted, on 19 December, a plunge in the stock market. The Bank of Thailand that day stated it would exempt inflows into the stock market from the reserve requirement. In the following weeks it further rolled back the restrictions and indicated that controls would eventually be lifted.

Despite the controls, the baht ended 2006 strongly, at B36.05/$1. The clampdown on capital inflows, in addition to shaking the stock market, exacerbated concerns about the broader investment climate. It also led to the baht trading at different levels onshore and offshore. Thai banks could sell US dollars for baht only in the offshore market, and importers had to pay for imports in US dollars. This limited the supply of baht offshore, causing it to appreciate by as much as B2/$1 against its onshore value. The gap may encourage speculators to arbitrage by buying dollars offshore and selling them onshore.

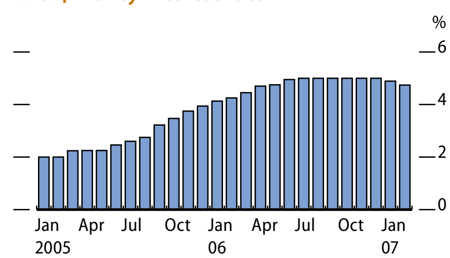
2.28.3 Quarterly inflation



Source: Bureau of Trade and Economic Indices, available: http://www.price.moc.go.th, downloaded 30 January 2007.

Click here for figure data

2.28.4 Policy interest rate



Source: Bank of Thailand, available: http://www.bot.or.th, downloaded 17 March 2007.

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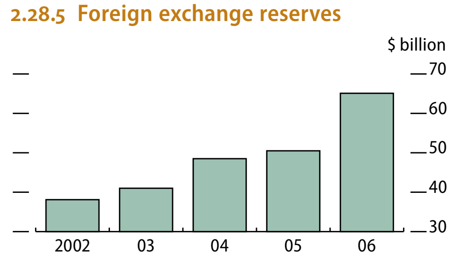
2.28.5 Foreign exchange reserves



Source: Bank of Thailand, available: http://www.bot.or.th, downloaded 16 March 2007.

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Economic prospects

The projections for 2007 and 2008 assume that national elections will take place not later than the fourth quarter of this year. With an elected government in place, if it quickly adopts a credible economic program, business and consumer confidence should start to pick up, which would revive domestic demand in 2008. The incoming government will need to carefully prioritize and accelerate infrastructure investment, which has lagged in recent years and contributed to an erosion of industrial competitiveness.

Net exports look likely to play a smaller role in driving economic growth over the next 2 years, with domestic demand picking up some of the slack. Export growth will ease in 2007 from the fast pace of recent years, based on expectations of a softer global economy and on baht appreciation. Exports in nominal terms are projected to grow by about 7.9% in 2007, with exports of manufactures in particular curbed by the appreciation.

Imports will accelerate somewhat as companies rebuild inventories, though sluggish domestic demand is likely to keep import growth to about 8%. Imports should rise faster after the elections, when both private and public investment is expected to revive. The trade balance this year is forecast to notch up a surplus of $2.3 billion, but that will shrink in 2008. The current account is projected to record a surplus of 1.3% of GDP this year, but move into deficit in 2008 (Figure 2.28.7).

Retail sales data late in 2006 showed a slowdown of private consumption, already suggesting weakness heading into 2007. Subsequent bombings in Bangkok, which killed seven people during the new year's celebration, helped bring down consumer confidence to a 5-month low in January, and it remained weak in February.

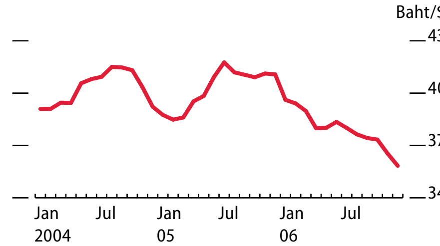
Government consumption spending in 2007 is expected to rise significantly as a result of a decision to accelerate budget disbursements and because of the elections. Hence, total consumption is projected to grow by about 4% in 2007, up slightly from 3.2% in 2006.

Private investment is likely to be modest owing to the political uncertainties and dented foreign investor sentiment, though it will no doubt strengthen in 2008 if confidence in the economy comes back. Public investment will pick up in 2007 and gain pace in 2008 as the Government moves ahead with some infrastructure investments. Contract bidding for new mass transit rail lines was expected to start in May 2007. Five lines have been approved, but construction will probably start on only two this year. Growth in fixed investment in 2007 is projected at 5%, accelerating to 8% in 2008. The mixed outlook on the demand side suggests that GDP growth in 2007 will fall to around 4%, before rising to 5% in 2008 (again, if confidence returns).

The budget for FY2007 (ending 30 September 2007) projects a deficit of B142.6 billion, equivalent to 1.7% of GDP. However, revenue collection could again fall short of the target if economic growth is weaker than the official projection of 4.5–5.5% (set in late 2006). The budget deficit will raise public debt to about 41% of GDP this year, though still well within a 50% ceiling under the Government's fiscal sustainability framework.

Average inflation this year and next is forecast to decelerate to 2.5%, from 4.6% in 2006, in large part a result of lower international oil prices

2.28.6 Exchange rate



Source: Bank of Thailand, available: http://www.bot.or.th, downloaded 22 February 2007.

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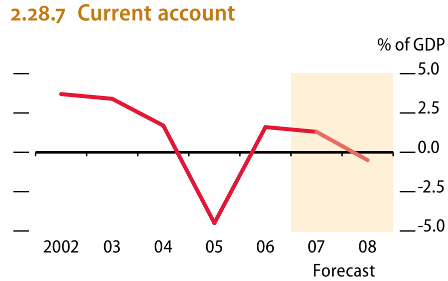
2.28.1 Selected economic indicators

	2007	2008
GDP growth	4.0	5.0
Inflation	2.5	2.5
Current account balance (% of GDP)	1.3	-0.7

Source: Staff estimates.

2.28.7 Current account



Sources: Bank of Thailand, available: http://www.bot.or.th, downloaded 16 March 2007; staff estimates.

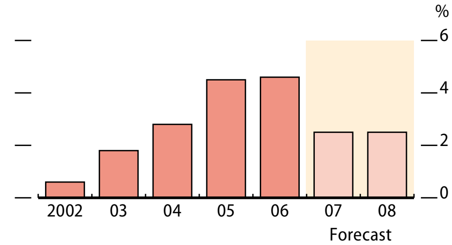
Click here for figure data

(Figure 2.28.8). This could pave the way for further reductions in the policy interest rate.

Thailand's ambitions to become a financial center have been hurt by the imposition of capital controls, the political turmoil, and a halt to privatization of state-owned companies. A capital market plan adopted early in 2006 set a target to double the size of the domestic bond market by 2010. The plan also called for more privatization to broaden the equity market. However, privatization has been on hold since a late-2005 decision by the supreme administrative court that a share offering by EGAT, the state power generating company, may violate the constitution, and no privatization is expected until a new government is elected. The interim government plans to pursue reforms in the financial sector this year with amendments to the Bank of Thailand Act, the Securities and Exchange Act, and the Insurance Act. These amendments aim to free the three regulatory bodies from political interference.

Domestic risks for the economy stem mainly from political uncertainties. A delay in returning to an elected government would most likely lead to public agitation, which would worsen consumer and investor sentiment. Alternatively, an elected government seen to be weak and without a clear economic program would also prolong uncertainty, and result in continued low growth. Violent outbreaks in southern provinces so far have had limited impact on the national economy. Finally, more cases of avian flu were reported in Thailand early in 2007. This disease has the potential to damage the economy because Thailand is a major exporter of poultry products.

2.28.8 Inflation



Sources: Bureau of Trade and Economic Indices, available: http://www.price.moc.go.th, downloaded 30 January 2007; staff estimates.

Click here for figure data

Development challenges

The political and policy uncertainties generated over the past year need to be resolved if faster growth is to be achieved. In addition to the capital controls, followed by backtracking on those measures, the Government put forward amendments to foreign investment regulations that jolted international companies. The amendments, which were intended to clarify rules on the use of local nominees by foreign-invested companies, mainly affect the services sector. Changes proposed would cause some foreign investors to reduce their shareholdings and limit their voting rights.

Moreover, the Government is advocating the concept of a "sufficiency economy," which underpins the formulation of the 10th National Economic and Social Development Plan (2007–2011). The concept centers on the idea of building economic resilience to outside shocks, keeping investment and household debt within sustainable levels, and ensuring inclusive growth. The Government has given assurances that the sufficiency economy philosophy does not mean backing away from market principles or from welcoming foreign investment. However, many international businesspeople have expressed misgivings about the concept, worried that it may presage a more inward-looking stance.