

Thailand

Devastating floods disrupted manufacturing and other industries in the second half of 2011, leaving the economy virtually flat over the 12 months. This year, reconstruction and policy stimulus will spark a rebound in growth, despite sluggish exports, and inflation, which quickened in 2011, is forecast to moderate. Rebuilding factories and infrastructure, as well as investor confidence, will be a major task during the forecast period.

Economic performance

Widespread flooding in August–November 2011, the worst in more than 50 years, devastated the economy. The floods across central and northern Thailand disrupted industries, including agriculture, construction, transport, and retailing, for months. The economy contracted by 9.0% year on year in the fourth quarter (Figure 3.30.1), leaving GDP for the year just 0.1% higher than in 2010.

Manufacturing slumped by 21.8% in the fourth quarter when the floods submerged factories making automobiles, hard-disk drives, electrical appliances, semiconductors, and textiles. As Thailand is the world's 12th biggest automobile maker and accounts for 25% of global hard-disk drives, the factory closures caused economic dislocation far beyond its borders.

Earlier in the year, the Japanese earthquake and tsunami had caused supply shortages for the Thai auto and hard-disk drive industries, reducing output. For the whole year, overall manufacturing production fell by 4.3%.

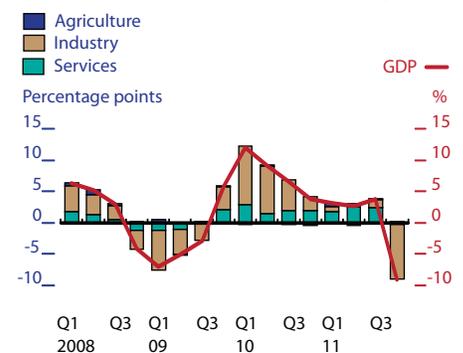
Construction was also hit on two fronts—public projects were delayed by national elections and a change of government in July 2011, and private activity was curtailed during the flooding. Total construction activity for the year fell by 5.1%.

Services contracted in the fourth quarter, largely because of the floods, although grew by 3.8% over the whole year and were the main contributor to the marginal rise in GDP in 2011. Tourist arrivals fell by 4.7% in October–December (but still rose by 17.9% to 18.8 million in 2011 from 2010, a year in which arrivals fell because of 2 months of violent demonstrations).

Flooding reduced agricultural yields in the second half, though for the full year farm output increased by 3.8% owing to a rebound in the first half from a weak prior-year performance.

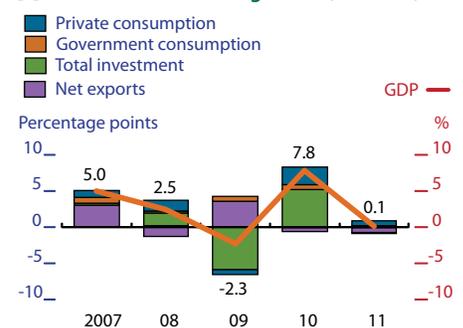
Private consumption was subdued in 2011 (Figure 3.30.2), in part a result of the floods, which dented consumer confidence and lowered incomes in affected areas. Farm incomes were hurt in the second half,

3.30.1 Contributions to growth (supply)



Source: National Economic and Social Development Board. <http://www.nesdb.go.th> (accessed 20 March 2012).

3.30.2 Contributions to growth (demand)



Source: National Economic and Social Development Board. <http://www.nesdb.go.th> (accessed 20 March 2012).

both by the impact of flooding and lower prices for some agricultural commodities. Rising inflation contributed to weakness in private consumption, which grew by just 1.3% in 2011.

Government consumption was similarly sluggish. The government that took office in August 2011 reviewed and adjusted the budget for the fiscal year starting October 2011 (FY2012), which held up some spending.

Private fixed investment, robust for most of 2011, suffered when the floods hit, but still rose by 7.2% for the year. Public investment, by contrast, fell by 8.7% owing to a combination of the floods, postponement of decisions on public works during the election period, and the delay in completing the FY2012 budget.

Growth in merchandise exports slowed to 16.4% in US dollar terms from 28.4% in 2010. The inundation of many export-oriented factories cut merchandise exports by nearly 5.2% in the fourth quarter (Figure 3.30.3). Rice exports turned down late in the year because of the impact of floods and a new government policy to pay higher prices to farmers for rice, reducing its competitiveness in export markets.

Closure of factories during the floods and supply disruptions from March 2011's earthquake in Japan cut import growth to 24.7%, despite much higher prices for imported oil. The surplus in goods trade fell, but the deficit in services narrowed slightly, reflecting higher receipts from tourism and insurance (from flood claims). That left a current account surplus equivalent to 3.4% of GDP, a decline of about a half percentage point from the previous year.

The capital and financial account recorded a net outflow of \$7.2 billion, the effect of an increase in outward direct investment and withdrawal of portfolio investment from emerging markets in the second half of last year. Foreign direct investment into Thailand fell by 13% to \$8.4 billion in 2011. Outward direct investment nearly doubled to \$10.8 billion, in part a result of relaxed regulations on Thai investment abroad. Gross international reserves edged up by 1.7% to \$175.1 billion, cover for 10 months of imports.

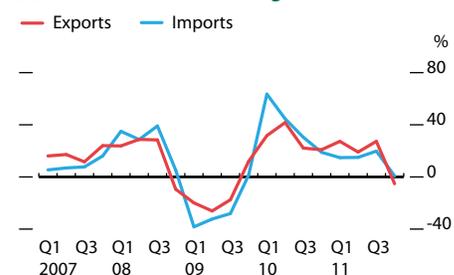
Higher oil prices and flood-induced disruptions to supplies of food and other consumer goods lifted average inflation to 3.8% in 2011. The pace of food price inflation reached a 3-year high of 10.2% in November (Figure 3.30.4).

In response to upward pressure on prices and inflation expectations, the Bank of Thailand raised its policy interest rate six times in the first 8 months of the year, to 3.5%. It then reversed course when the flooding hit, the economy contracted, and the global economic outlook deteriorated, lowering the policy rate in November and again in January 2012, to 3.0% (Figure 3.30.5). Commercial bank lending slowed toward end-2011, though still rose by 14.9% for the year. The baht depreciated by 3.9% on average against the US dollar during 2011.

The fiscal deficit narrowed to 1.5% of GDP in FY2011 and public debt declined to 40.3% of GDP. Spending on the Thai Khem Kaeng (Strong Thailand) infrastructure program fell short of target (about 86% of its budgeted funding was disbursed).

To support farmers, the new government committed to purchase unmilled rice at B15,000 (\$500) a ton from October 2011—well above the market price—and budgeted B400 billion (\$13.2 billion) in FY2012 for this

3.30.3 Merchandise trade growth



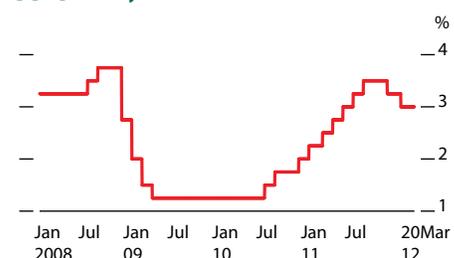
Source: Bank of Thailand. <http://www.bot.or.th> (accessed 28 March 2012).

3.30.4 Monthly inflation



Sources: CEIC Data Company; Bureau of Trade and Economic Indices. <http://www.price.moc.go.th> (both accessed 20 March 2012).

3.30.5 Policy interest rate



Source: Bloomberg (accessed 20 March 2012).

purpose. The policy drove up both the domestic price of this staple food and the price set by Thai exporters.

Overseas buyers were not, however, prepared to pay the higher prices, at a time that rice exporters in Cambodia, India, Myanmar, and Viet Nam were eager to sell, so that Thai rice exports fell by 29% in the first 2 months of 2012 from the prior-year period. The government, facing heavy costs as rice inventories build, is seeking bilateral government sales. It has had some success with Indonesia, which agreed to buy 1 million tons of milled rice annually over 5 years.

Economic prospects

Reconstruction of flood-damaged areas and substantial policy stimulus will drive a rebound in economic growth in 2012, despite the torpid global outlook. GDP growth is expected to recover from last year's marginal 0.1% to 5.5% through the forecast period (Figure 3.30.6).

Private consumption growth will be underpinned by a tight labor market, civil service salary increases in January 2012, and a 40% boost in minimum wages in April. The government has also introduced incentives for first-time buyers of houses (tax breaks) and automobiles (cash rebates). Consequently, consumer confidence has started to pick up (Figure 3.30.7) after plunging during the floods.

Sales of consumer durables are getting a lift from the replacement of household appliances and furniture damaged during the inundations. Automobile sales, which had slumped by 62% year on year in the worst month, November, rebounded in January and February this year.

Investment will benefit from extensive private and public reconstruction work in flood-hit areas coupled with replacement of capital equipment. Small and medium-sized businesses affected by the floods have access to a \$10 billion low-interest loan program set up by the Bank of Thailand.

In signs of recovery, the industrial capacity utilization rate recovered to 62.3% in February, well up from 40.1% at its lowest point in November 2011 (Figure 3.30.8), and indexes for private consumption and private investment surpassed preflood levels. Tourist arrivals rose by 5.2% year on year in the first 2 months of 2012.

Half the factories flooded in 2011 had resumed full production by the end of February, but some are not expected to get back to that until the second or third quarters.

Fiscal and monetary policies have been set to spur growth. Flood-relief measures rolled out in the last quarter of 2011 included a debt moratorium and low-interest loans for farmers and low-income households; payments of B5,000 (\$165) for households affected by the floods plus B20,000 (\$645) for house repairs; and tax exemptions for businesses that invest in new production facilities. Businesses get a cut in the corporate income tax rate to 23% this year and 20% in 2013, from 30% in 2011.

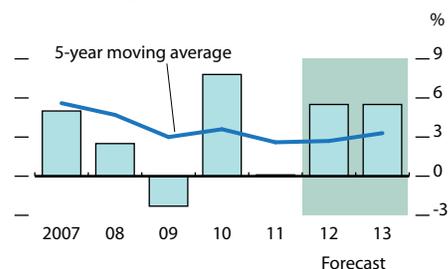
In addition to budget outlays, the authorities will spend large amounts off budget on reconstruction and flood prevention. Parliament approved an emergency decree allowing the government to borrow the equivalent of \$11.3 billion by June 2013 for flood prevention and water management projects over the next few years.

3.30.1 Selected economic indicators (%)

	2012	2013
GDP growth	5.5	5.5
Inflation	3.4	3.3
Current account balance (share of GDP)	0.5	-0.5

Source: ADB estimates.

3.30.6 GDP growth



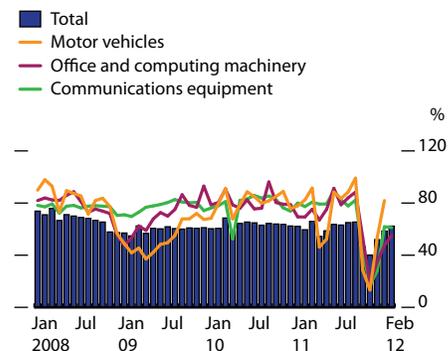
Source: Asian Development Outlook database.

3.30.7 Confidence indicators



Sources: Center for Economic and Business Forecasting; Bank of Thailand. <http://www.bot.or.th> (both accessed 20 March 2012).

3.30.8 Capacity utilization rate



Source: Bank of Thailand. <http://www.bot.or.th> (accessed 9 March 2012).

To pave the way for this borrowing, the government shifted responsibility for paying interest on about \$46 billion of the debt of the Financial Institutions Development Fund from its budget to the Bank of Thailand, effective September 2013. That debt was issued during the late 1990s' Asian financial crisis to recapitalize Thai banks.

Further, the government set up a \$1.6 billion disaster insurance fund to help households and businesses buy insurance (premiums charged by reinsurers rose sharply after the floods), and it outlined an ambitious infrastructure program including roads and railways that could cost up to \$70 billion over 5–10 years. (Similar infrastructure initiatives by previous administrations have seen projects delayed or rolled over into later programs.)

The ramping up of spending to deal with the impact of the floods is expected to raise the fiscal deficit of the central government, including budget and off-budget spending, to about 5% of GDP in FY2012, before the gap narrows as GDP grows. Monetary policy is accommodative, with the policy interest rate at 3.0%, below inflation.

Recovery in manufacturing and agriculture will support growth in merchandise exports this year, despite sluggish world trade and uncertainties over Thai rice exports. Merchandise exports are projected to increase by 15.0%. Imports will increase faster than exports, by about 23.0% in 2012, reflecting purchases of capital equipment for reconstruction and robust consumer spending. The current account will likely slip into deficit next year, equivalent to about 0.5% of GDP (Figure 3.30.9).

Net foreign inflows into Thai bonds totaled B50 billion in the first 2 months of 2012, and the Thai Bond Market Association predicts a 20% increase for this year as international investors seek higher yields.

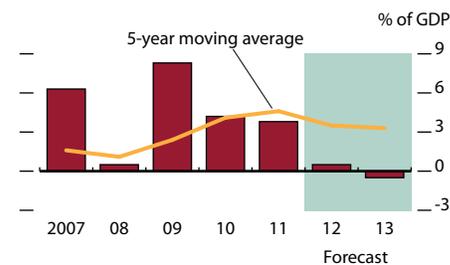
Food price inflation has receded, along with the floods. Nevertheless, upward pressure on prices will come from stronger domestic demand, rising minimum wages, heavy government spending, and a planned reintroduction of excise tax on diesel fuel. Inflation is forecast to average 3.4% in 2012 and 3.3% in 2013 (Figure 3.30.10).

Government borrowing to fund water management projects is projected to lift the public debt to 48.6% of GDP this year and 50.4% in 2013 (Figure 3.30.11). While these levels are manageable, the large outlays planned on infrastructure, coupled with cuts in corporate taxes and diminishing revenue from import taxes owing to trade agreements, suggest the debt may continue to rise without new revenue sources such as a broader personal income tax base or an environmental tax.

The anticipated rebound in growth this year depends on the government reconstructing flood-damaged infrastructure and making a significant start on longer-term projects involving flood-prevention and water management. Funding is allocated for this work, but the government's ability to implement projects poses a risk: the rate of disbursement of the capital budget has fallen to under 60% in recent years.

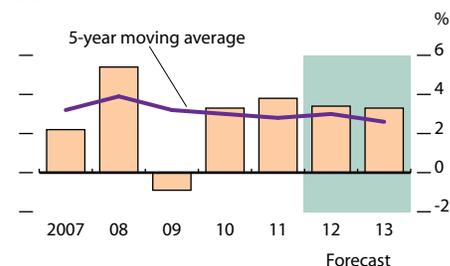
Other risks to the outlook include a deeper than assumed recession in the eurozone—the market for nearly 10% of Thai exports and source of about 27% of its tourists. Higher than projected global oil prices are also a downside risk. Flooding and drought are a perennial threat.

3.30.9 Current account balance



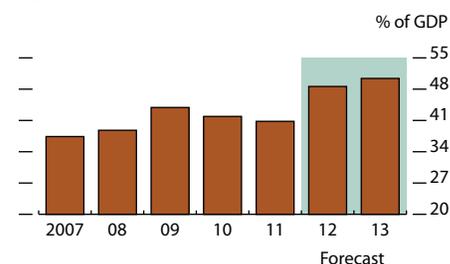
Source: Asian Development Outlook database.

3.30.10 Annual inflation



Source: Asian Development Outlook database.

3.30.11 Public debt



Source: Ministry of Finance. <http://www.mof.go.th> (accessed 29 March 2012).

Policy challenge—after the deluge

The expansion of industrial zones, often on former low-lying farm land, has increased chances that heavy floods will have a really severe impact on the economy, as in 2011.

Resulting prolonged closures of factories and extensive damage to a broad range of businesses (Figure 3.30.12) also raises the risk that foreign firms could become reluctant to expand manufacturing and warehousing in Thailand. Maintaining investor confidence depends on rebuilding flood-damaged infrastructure promptly, carrying out flood prevention and mitigation projects, and establishing a better institutional structure to handle crises.

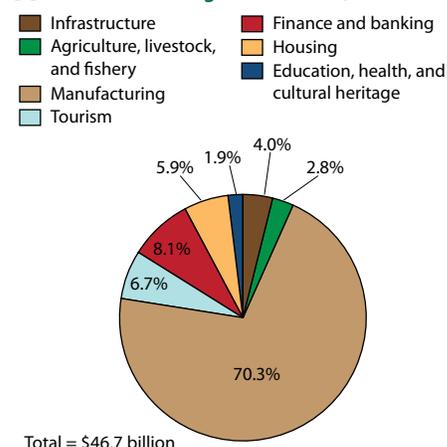
By January 2012, the government had approved a master plan for water management that, among other things, covers upgrading warning systems, flood protection and management infrastructure, and a central agency for water resource management.

Further, the cabinet cleared 246 flood management projects costing B24.8 billion (\$818.5 million) during the first quarter of this year. These projects include raising highway levels in flood-prone areas and building dikes and drainage systems. Line agencies are scrambling to get as many projects as possible completed or under way before the next wet season. Officials are identifying land to be set aside as floodways.

Thailand's ability to assuage investor sentiment will also depend on the replacement infrastructure being better able to manage the impact of prolonged heavy rainfall and floods than the former structures.

Moreover, although reconstruction must be pursued quickly, it will be important to address longer-term water management issues as well, and to ensure that water-related projects in one region take into account their impact on other regions. For example, Bangkok and surrounding industrial areas at the lower reaches of the Chao Phraya river basin depend on good water management in the basin's upper reaches to prevent floods that later affect the heavily populated lower regions.

3.30.12 Flood damages and losses, 2011



Sources: Department of Disaster Prevention and Mitigation; Ministry of Finance.