Thailand

Policy stimulus supported a strong recovery last year after severe flooding devastated the economy in late 2011. While domestic demand rebounded in 2012, exports weakened on soft global demand and flood-related disruptions to manufacturing. GDP growth is seen moderating toward trend, with inflation forecast to remain modest. The country faces critical challenges in equity, public investment, and governance.

Economic performance

The economy rebounded last year from flooding that swamped industrial estates, farmland, and parts of the capital Bangkok in late 2011. GDP rose by 6.4% in 2012 compared with just 0.1% in the previous year (Figure 3.30.1).

Private consumption increased by 6.6% to contribute about half of total GDP growth. Consumption was stimulated by demand to replace household items after the floods and by several government policies. These included increases in minimum wages by up to 40% in seven provinces and in public service salaries, a tax rebate to first-time buyers of domestically made cars, which some 1.2 million car buyers took advantage of, tax breaks for first-time buyers of houses, and a government decision to buy unmilled rice from farmers at prices well above international levels.

Growth in employment and wages supported consumption, as average wages rose by 11.8% and employment by 1.2%. The unemployment rate fell to just 0.5% by year-end.

Fixed capital investment rose by 13.3%, propelled by the reconstruction of flood-damaged factories, houses, and other infrastructure and the replacement of capital equipment. Public construction was spurred by the building of mass rapid transit projects in Bangkok and mobile telecommunications networks.

However, external demand weakened last year due to sagging economic growth in major markets and disruption to export-oriented manufacturing caused by the floods. Net exports of goods and services acted as a drag on GDP growth.

Some manufacturers were able to return to full production relatively quickly, particularly those targeting the domestic market, but others—including makers of computers, hard drives, and semiconductors—took several months to rebuild and replace equipment. These industries also faced sluggish export demand.

Car and truck production jumped by 72%, reflecting the low base caused by the 2011 floods and additional demand stimulated by the rebate for first-car buyers. Manufacturing production rose by 7.0%,
and the industry sector as a whole contributed 3.4 percentage points to GDP growth, the biggest sector contribution from the supply side (Figure 3.30.2).

The service sector grew by 5.8% and was also an important source of GDP growth. A 16% rise in tourist arrivals, to 22.3 million, contributed to 8.8% growth in the hotels and restaurants subsector. Financial services grew by 6.6%, with insurance benefiting from buoyant auto sales.

Agricultural output increased by 3.1% with higher output of rice, cassava, natural rubber, and oil palm.

Food price inflation eased and fuel prices were fairly stable. Despite picking up in the fourth quarter because of an increase in electricity tariffs and higher excise taxes on alcohol and tobacco, inflation for 2012 was the lowest in 3 years (Figure 3.30.3).

The Bank of Thailand, the central bank, lowered its policy interest rate to 3.0% to assist economic recovery after the floods, and reduced the rate again in October 2012 to 2.75%, slightly below the inflation rate (Figure 3.30.4). Lending interest rates declined, and commercial bank lending expanded by 13.7% in 2012, with a 21.6% surge in consumer loans.

Fiscal policy also stimulated the economy. The fiscal deficit widened to 4.1% of GDP in FY2012 (ended 30 September 2012) from 1.3% in FY2011. About 90% of planned spending was disbursed, though this fell to 66% for the capital budget owing to delays in approving the FY2012 budget after a change of government in August 2011 and shortages of construction materials after the floods. The wider deficit reflects new government subsidies and tax breaks to support households, farmers, and businesses, including a cut in the corporate tax rate to 23% in 2012.

Moreover, considerable spending was funded off-budget. Parliament approved an emergency decree allowing the government to borrow the equivalent of $11.7 billion by June 2013 to be spent over several years on water management projects. About $100 million of this was spent in 2012.

Merchandise exports rose by just 3.2% in US dollars last year. The value of rice exports shrank by 28% because the subsidy on the domestic purchase price pushed Thai rice prices well above international levels. Exports of automobiles increased by 26%, but those of electronic products edged up by just 0.9%.

Imports outpaced exports, rising by 7.8% in US dollars, in part a result of capital equipment purchased to replace that damaged by the floods. Consequently, the trade surplus shrank by half to $8.3 billion (Figure 3.30.5). Insurance payouts after the floods contributed to a narrowing in the services trade deficit, but the sharply lower trade surplus meant the current account surplus fell to 0.7% of GDP.

The capital and financial account recorded a substantial surplus, largely because of net portfolio inflows and loans to businesses. The overall balance of payments remained in surplus, and gross international reserves rose by 3.7% to $181.6 billion, cover for 10 months of imports.

Higher capital inflows contributed to 6% appreciation of the Thai baht against the US dollar in 2012. The central bank indicated it would further liberalize outward foreign direct and portfolio investment, partly to take pressure off the baht. The Stock Exchange of Thailand index of share prices climbed by 35.8% over last year, and yields on government bonds generally declined. Housing prices showed modest gains.
Economic prospects

After the rebound in 2012, economic growth is expected to moderate to about 5% this year and next (Figure 3.30.6), the pace seen in the 3 years leading up to the global financial crisis. Projections assume the government follows through with large public investments it plans in water management and transport infrastructure during the forecast period.

Private consumption will continue to benefit from a tight labor market and the minimum wage increases, which were extended throughout the country from January 2013. A study by the Thailand Development Research Institute found that last year’s 40% increase in minimum wages in seven provinces did not cause significant layoffs.

Despite concerns that the rice price subsidies may not be the most cost-effective option for raising rural incomes, the government extended the rice-purchase program into 2013. However, the impact of flood-relief payments and low-interest loans offered in 2011 will fade during 2013 and beyond. The tax break for first-time house buyers is scheduled to end in May 2013, while the incentive for first-time car buyers expired at the end of 2012. While consumer confidence rose in February to its highest level in 18 months (Figure 3.30.7), growth in private consumption is unlikely to match that in 2012.

Growth in private investment will also moderate as post-flood reconstruction winds down, though investment is likely to remain robust. Cement sales were strong early this year, suggesting that construction remains buoyant. The Board of Investments approved investment incentives for 2,262 planned projects valued at $330 million in 2012, double the value of the previous year. Business sentiment generally was high early in 2013 (Figure 3.30.7) and lending rates relatively low.

Government investment is expected to contribute more to economic growth, with public investment projected to rise by 12.5% this year. The water management program should gather momentum from the second half of 2013, with $1.3 billion projected to be spent this year. The fiscal deficit, including budget and off-budget spending, is projected to widen to 4.8% of GDP in FY2013.

Early in 2013 the central bank noted positive signs for continued economic growth, pointing to increases in indexes of consumption and investment, buoyant tourism, and an uptrend in exports in January.

Modest inflation—slightly above 3%—is projected for the forecast period (Figure 3.30.8). The government has extended a tax exemption on diesel fuel into 2013 and is expected to maintain controls on a range of consumer items. Global prices of oil and other commodities look likely to remain broadly stable. Rising domestic wages are anticipated to have a modest impact on inflation, which averaged 3.1% in the first 3 months of this year.

Monetary policy is expected to remain accommodative to growth for some time in light of low inflation and strong capital inflows. Higher government borrowing for public investment will likely drain some excess liquidity from the banking system. The monetary authorities have indicated they stand ready to take macroprudential measures to manage
rising household debt if consumer lending continues at the high rate seen in 2012. The baht appreciated by 4.5% against the US dollar in the first 3 months of 2013 (Figure 3.30.9).

Stronger economic growth in some major export markets, including the People’s Republic of China (PRC), and pickup in world trade indicate that growth in merchandise exports will quicken to about 10% in 2013, and step up again in 2014. Manufacturing industries’ return to full production will support the increase in exports. Imports are forecast to increase by 11% this year, accelerating in 2014 when the government starts the new transport infrastructure projects. The current account is expected to record small surpluses (Figure 3.30.10).

Risks to this outlook include the challenges discussed below, potential significant delays affecting infrastructure projects, and capital inflows that maintain upward pressure on the baht, damaging the competitiveness of exports. Failure to address weaknesses in education is a longer-term risk to economic development.

The government is incurring substantial losses from its purchases of rice from farmers at prices above the international market. Thai rice inventories were estimated at 15 million tons early in 2013 as overseas buyers turned to lower-priced rice from India and Viet Nam (Figure 3.30.11). Losses could exceed the equivalent of 1% of GDP annually.

Policy challenges—equity, public investment, and governance

Thailand faces several critical policy challenges. One is inequality, which undermines social and political stability with associated risks to investor confidence. Inequality is reflected in large rural–urban and regional gaps in incomes and access to social and economic services (Figure 3.30.12). Such structural problems are unlikely to be resolved by ad hoc measures to boost incomes through subsidies and tax concessions. More effective targeting of public investment in social and physical infrastructure will be important to address these concerns.

A second issue is inadequate public investment, which dents the country’s competitiveness. Public investment as a ratio to GDP has declined over many years (Figure 3.30.13). The World Economic Forum ranks Thailand 38th of 144 countries in its Global Competitiveness Report 2012–2013. However, Thailand’s ranking sinks to 46th for infrastructure and lower still for railway, port, and telephone components of infrastructure. Also of concern is the country’s lowly ranking on basic education, at 89th, and on adoption of technology, at 84th. A separate World Bank benchmark that measures the performance of logistics ranked Thailand 38th of 155 countries in 2012, below the PRC and Malaysia.

Public investment is needed in transport infrastructure to reduce logistics costs and in water management infrastructure to mitigate the social and economic impacts of climate change and flooding. Increased investment in social infrastructure is needed to ensure equitable improvements in skills and social capital that will boost creativity and productivity to generate sustained gains in living standards.
Mobilizing and effectively managing resources to ensure more equitable, efficient, and effective delivery of public services is one of Thailand’s most pressing challenges. The government lacked resources for public investment following the 1997 Asian financial crisis. More recently, political instability has interrupted the planning and implementation of large public investment projects. Moreover, the government prioritized spending on fast-disbursing stimulus programs when the economy slumped during the global financial crisis in 2008–2009 and after the extreme flooding in 2011. Large public finance allocations were directed at incentives for first-time buyers of cars, pay rises for the public service, tax cuts for companies, popular measures such as the diesel fuel subsidy, and subsidized rice purchases from farmers.

The government is now beginning to address declines in public investment with significant multiyear programs for water management ($11.7 billion) and transport infrastructure (as much as $67 billion), funded off-budget. However, considerable uncertainty surrounds the pace of implementation.

Investment in transport infrastructure aims to reduce logistics costs by 2 percentage points, from about 15% of total production costs. Most of the investment in transport will go to rail networks to improve transport links within Thailand and to neighboring countries. The water management projects are designed to mitigate the social and economic impact of flooding and better manage water resources.

While the commitment to increased public investment is a positive development, off-budget programs have the disadvantage of compromising transparency. Instead, increases in budget funding for public investment could be generated by broadening the tax base or phasing out the economic stimulus programs. The government could also consider amending the Public Debt Management Act to raise borrowing limits while maintaining its fiscal sustainability framework to keep public debt below 50% of GDP.

This leads to a third challenge: the need to improve public sector management and accountability, and to fight corruption. This will become increasingly important as public investment expenditure rises.