Thailand

The economy slowed sharply in 2013 as domestic demand weakened and exports were sluggish. Political disruptions hurt the economy in the second half of last year and cloud the outlook for 2014. Growth is forecast to remain subdued before rebounding in 2015. Policy deficiencies have prompted calls to improve the design and implementation of public programs.

Economic performance

Political tensions weighed on the economy in the second half of 2013, dampening consumption, investment, and government spending. Slack domestic demand and sluggish exports confined GDP growth for the year to 2.9% (Figure 3.30.1). Growth in the fourth quarter, when political unrest intensified, decelerated to 0.6% year on year.

Private consumption edged up in the first half of 2013 but then fell, finally contributing just 0.1 percentage points of GDP growth for the year. In part, this reflected a base effect from 2012, when spending was stimulated by demand to replace household goods after severe floods late in the previous year, and by government flood relief payments. Also, the labor market softened in 2013, and falling prices for major crops hurt farm incomes. Sales of passenger cars dropped by 5.9% last year after a tax rebate expired for first-time buyers of domestically made automobiles. Consumer confidence weakened during the second half as political tensions worsened.

These tensions, together with a lackluster outlook for merchandise exports, weighed on fixed capital investment, which fell steeply in the second half and declined by 1.9% over the year. This result reflected mainly weakness in private investment, but public investment slowed when the government became distracted by political issues and hobbled by legal challenges. Fixed investment also came off a high base in 2012, when it was propelled by reconstruction and replacement after the floods. Total investment made a small contribution to GDP growth in 2013 because of an increase in inventories.

A sharp slowdown in import volumes contributed to higher net exports of goods and services, which added to GDP on the demand side for the first time in 4 years.

On the supply side, nearly all the growth in GDP was generated by services, while agriculture and industry barely contributed (Figure 3.30.2). Services got a boost from a 19.6% increase in tourist arrivals to 26.6 million in 2013, with the rate of increase ebbing in the fourth quarter as political strife worsened. Tourism contributed to 12.1% growth in hotel and restaurant business and solid expansion in transport and communications.

This chapter was written by Luxmon Attapich of the Thailand Resident Mission, ADB, Bangkok.
Manufacturing was flat in response to slack demand for exports and subdued domestic demand. The production of electronics fell by 6.2% and of electrical appliances by 3.3%. Automobile production, which had soared by 68.3% in 2012 on stimulation from the tax rebate after the floods, rose by only 0.1% in 2013. Construction increased by 1.2% for the year, with all gains in the first half followed by contraction in the second.

Agriculture and fisheries grew by a lackluster 1.4%, hit by a disease that cut shrimp production, a slight fall in the rice harvest, and a drop in cassava output. Increases were recorded for natural rubber, palm oil, and livestock.

Inflation abated from 3.6% at the end of 2012 to 1.4% in September 2013 before picking up a little (Figure 3.30.3). The year-average inflation rate at 2.2% was the lowest in 4 years. Lackluster domestic demand and soft world prices for oil and commodities helped ease inflationary pressures.

In the context of low inflation and weak economic growth, the Bank of Thailand, the central bank, lowered its policy interest rate by 50 basis points to 2.25% in 2013 (Figure 3.30.4). Money supply (M2) growth slowed to 7.3%, and growth in credit to the private sector eased to 12.4% as domestic demand weakened and banks became more stringent about lending.

Inadvertently, fiscal policy tightened in FY2013 (ended 30 September 2013) as legal challenges and political distractions frustrated the government’s pursuit of planned infrastructure projects. Only $261 million was disbursed from a $11.7 billion off-budget program to build water-management infrastructure. Tax breaks and relief payments to stimulate private consumption after the 2011 floods expired in 2012, though the program to boost farm incomes through government rice purchases continued into 2013. On the revenue side, collections exceeded the target by 2.7% in FY2013. Consequently, the fiscal deficit, including budget and off-budget items, halved to 2.0% of GDP from 4.1%.

In the external accounts, merchandise exports fell by 0.2% to $225.4 billion in 2013 as a result of tepid global demand, a decline in prices for some agricultural export commodities, and the shortfall in shrimp production. Exports of electronics declined by 0.7% and rice by 4.6%, deepening a 28% drop in rice export income in 2012. Shipments of autos and parts rose by 7.6%.

Imports fell by 0.4% to $219.0 billion, owing to weak demand domestically and for use in exports. Purchases of capital goods from abroad dropped by 4.5%, reflecting the decline in fixed investment. By contrast, imports of gold jumped by 21% to $15.0 billion, spurred by a lower global price.

Surpluses in trade in goods and services were more than offset by deficits in income and transfers, producing a current account deficit of $2.8 billion in 2013, equal to 0.7% of GDP (Figure 3.30.5). A big increase in repatriated profits and dividends, particularly by the auto industry, widened this deficit. Also, the current account surplus in 2012 was revised to a deficit of 0.4% of GDP. The capital and financial account recorded net inflows of $1.4 billion, off much larger inflows of $14.4 billion in 2012. Foreign direct investment rose to $12.8 billion, but portfolio investment showed net outflow of $7.6 billion in 2013.
The balance of payments fell into deficit by $5.0 billion, the first such deficit in 13 years.

International reserves dropped by $14.4 billion to $167.2 billion over 2013 but still maintained a strong position equal to 7.3 months of imports and 2.9 times short-term external debt. The Thai baht fluctuated widely against the US dollar, from B28.55 to B32.86. Over the year, it depreciated by 7.0% against the US dollar. The Stock Exchange of Thailand index fell by 6.7% over 2013.

Economic prospects

The outlook is subject to unusually high uncertainty. After antigovernment protests intensified in November 2013, the government dissolved the parliament in December and scheduled national elections for 2 February. However, disruptions to registration and voting in some areas meant the elections were not completed, leaving the administration in a caretaker role. Such status imposes restrictions on its ability to borrow, spend, or make policy decisions. The Constitutional Court later nullified the 2 February election.

Forecasts assume that government policy making will remain constrained through the first half of 2014. On this basis, economic growth is projected at a modest 2.9%, accelerating to 4.5% in 2015 provided that a stable government is formed this year (Figure 3.30.6).

Major public infrastructure programs had been expected to drive growth in 2014 and 2015: the $11.7 billion water-management projects to mitigate the country’s vulnerability to floods and $67 billion in proposed investments through 2020 to upgrade transport infrastructure using off-budget loans. The water-management projects are delayed by legal challenges, and the transport investment program was ruled in March 2014 unconstitutional as structured.

Some significant investments by state-owned enterprises, such as in telecommunications, were on hold in the first quarter of 2014, and many large private sector investments faced delays as the Board of Investment could not approve investment privileges under the caretaker government. Further, the budget for the fiscal year starting in October 2014 could suffer delayed approval.

The political deadlock has damaged consumer and business confidence (Figure 3.30.7). This has hurt private consumption, business activity, and investment. The tourism industry reported that tourist arrivals were virtually flat in January 2014 compared with a year earlier (Figure 3.30.8).

Private consumption faces additional headwinds from delays in government payments to farmers under the rice-pledging program and uncertainty about the program’s future. Moreover, high household debt weighs on borrowing for consumption. Household debt is the equivalent of 80.1% of GDP, and households spend on average 33.8% of monthly income repaying loans, according to a survey by the Bank of Thailand.

Illustrating the weakness in private consumption early this year, imports of consumer goods fell by 12% in January 2014 year on year and passenger car sales plunged by 60% in that month. A survey of small and medium-sized enterprises conducted by the Ministry of Industry
in January showed significant declines in sales in garments, leather products, and electrical appliances (Figure 3.30.9).

Subdued private investment will likely persist well into 2014. Investors are expected to be cautious, waiting for the new government’s policy direction. Imports of capital goods continued to fall in January 2014, and tax revenue from real estate transactions declined, providing further signs of subdued investment.

Consumption and investment are forecast to rebound in 2015, assuming the political situation improves. Low domestic interest rates will assist the investment revival, as will better international economic prospects.

External demand is expected to improve both this year and next. Major trading partners in the US and euro area will record stronger performances, countered to some degree by more sedate growth in the People’s Republic of China. The baht’s depreciation will help exports (Figure 3.30.10).

As noted, the government is constrained in pursuing its fiscal policy. The disbursement rate of budget funding fell in the first 3 months of FY2014. Disbursement on larger projects that require cabinet endorsement is difficult during the caretaker period. Only small amounts are likely to be spent this year on the water-management program. The fiscal deficit is projected to be similar to that of FY2013 at about 2% of GDP.

With such limits on fiscal policy, the Bank of Thailand set monetary policy to support the economy, reducing its policy rate by a further 25 basis points to 2.0% in March 2014. The central bank is expected to keep this rate through 2014, edging it up to more normal levels when growth rebounds and international interest rates move higher.

While the FY2015 budget may be delayed because of the political deadlock, the eventual formation of a new government should allow investment in infrastructure to step up in 2015, bolstering the economy next year.

Inflation is forecast to edge up to 2.4% this year because of the baht’s depreciation and the phased reduction in the subsidy on gas for household use. In February 2014, inflation quickened to 1.9% year on year as food prices rose. Stronger domestic demand in 2015 is seen lifting inflation slightly next year.

The current account is projected to record a small deficit in 2014 before turning into a surplus in 2015 as exports of goods and services gather momentum (Figure 3.30.11).

Downside risks to the outlook center on the political polarization that could cause political uncertainty to persist longer than currently expected. The unwinding of US monetary stimulus could prompt capital outflows and further baht depreciation, particularly if the domestic political tension drags on. Foreign investors were net sellers of Thai stocks and bonds in the first 2 months of this year. On the upside, GDP growth in 2014 could be significantly above the forecast if a stable government is formed sooner than expected.

Over the past 6 years, Thailand has suffered bouts of political unrest on top of the global financial crisis and severe flooding. Nevertheless, the economy maintains solid economic fundamentals that support its resilience, with high international reserves, relatively low inflation, a moderate amount of government and external debt, and a strong manufacturing base.
Policy challenge—policy design and implementation

Thailand has pursued a number of policies over recent years that absorbed considerable public funds only to produce dubious outcomes. Such policies included subsidies to consumers for fuel and to farmers for rice production, tax breaks for first-time purchases of cars, and a debt moratorium for borrowers from state-owned banks. In some years the policies provided useful counter-cyclical stimulus, but they were not well targeted to the most vulnerable groups in society, nor did they strengthen the economy’s long-term productive capacity.

The most controversial policy has been the rice-pledging program started in October 2011 to bolster rural incomes. Under this plan, the government tapped funding from a state-owned bank to buy rice from farmers at 40%–50% above the market price. It hoped to sell much of the rice on a rising world market. The program distorted the domestic rice market, reduced exports as other producers undercut Thai rice on the world market (Figure 3.30.12), pushed up domestic rice inventories to an estimated 18 million tons, and imposed losses on the government over 2 years that could exceed 2% of GDP. Further, it benefited mainly larger farmers with surplus rice to sell and reduced incentives for farmers to improve their productivity and reduce costs.

From late 2013, the government fell behind in payments to farmers. In February 2014, the program expired. Its future will be determined by the next administration.

Instead of unsustainable subsidies to farmers, government programs to address large rural–urban and regional income gaps could focus on greater public investment in rural infrastructure and social services (Figure 3.30.13). Direct cash transfers targeted to poor farmers, perhaps conditioned on school attendance to improve labor market opportunities for their children, also would promote inclusive and sustainable growth.

Deficiencies in rice pledging, and in other fiscal programs, have prompted calls to improve the design and implementation of public policies and for more rigorous analysis of their fiscal sustainability.

One proposal is for a nonpartisan agency, modeled on the Congressional Budget Office in the US, to project the potential cost, revenue, and other outcomes of legislation and fiscal proposals, with the aim of better informing parliamentary and public discussions. Wider public participation in and scrutiny of policy making would be useful, as would the strengthening of policy institutes and networks of nongovernment organizations.