



Summary

Political risk remains elevated in Thailand, which struggles with the deep social divide between the elitist 'yellow shirts' and the rural poor 'red shirts'. Moreover, King Bhumibol, who is seen as key in maintaining the country's fragile stability, is in ill-health. Despite the heightened tensions, Thailand's economy has been able to function rather well in the past years. Still, the risk of a perfect (political) storm is clearly present in Thailand. A return of ousted Prime Minister Thaksin Shinawatra, the death of King Bhumibol and/or growing public discontent if the government handles another natural disaster poorly (like the 2011 floods) could lead to large scale protests again. This turmoil could seriously disrupt business and government activity. Moreover, military intervention in the political situation cannot be excluded. Meanwhile, the economy is recovering from the floods in 2011, which hit the agricultural sector as well as the industrial hart of Thailand. Economic growth dropped to 0.1% in 2011 as a result, but is expected to recover to 6% this year. The global outlook and tense political situation, however, pose downside risks to the Thai economy.

Things to watch:

- Rising tension between Red and Yellow shirts (including the potential return of ex-PM Thaksin)
- Succession risk if King Bhumibol passes away
- Economic recovery from the 2011 floods

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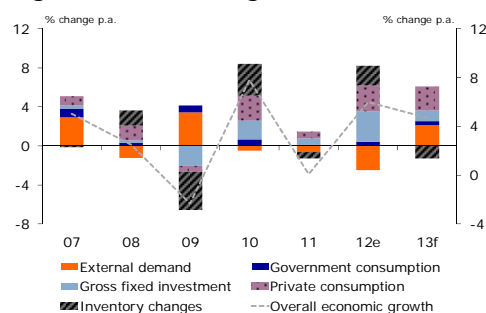
Thailand			
National facts		Social and governance indicators rank / total	
Type of government	Constitutional monarchy	Human Development Index (rank)	103 / 187
Capital	Bangkok	Ease of doing business (rank)	17 / 183
Surface area (thousand sq km)	513,120	Economic freedom index (rank)	60 / 179
Population (millions)	67.6	Corruption perceptions index (rank)	80 / 183
Main languages	Thai	Press freedom index (rank)	137 / 178
Main religions	Buddhist (94%) Muslim (5%) Christian (1%)	Gini index (income distribution)	42.45
Head of State (King)	Bhumibol Adulyadej	Population below \$1.25 per day (PPP)	0%
Head of Government (prime-minister)	Yingluck Shinawatra	Foreign trade 2010	
Monetary unit	Baht (THB)	<i>Main export partners (%)</i>	<i>Main import partners (%)</i>
		China 11	Japan 21
		Japan 10	China 13
		US 10	US 5
		Hong Kong 7	UAE 6
Economy 2011		<i>Main export products (%)</i> 2011	
<i>Economic size</i> bn USD % world total		<i>Main import products (%)</i>	
Nominal GDP	346 0.50	Machinery & mechanical appliances	37
Nominal GDP at PPP	602 0.76	Vehicles, parts & accessoires	10
Export value of goods and services	267 1.21	Electrical apparatus for making or breaking	13
IMF quatum (in mln SDR)	41 0.02	Electrical appliances	13
<i>Economic structure</i> 2011 5-year av.		<i>Main import products (%)</i>	
Real GDP growth	0.1 3.6	Fuel & lubricants	33
Agriculture (% of GDP)	13 11	Minerals & metal products	19
Industry (% of GDP)	43 44	Electronic parts	17
Services (% of GDP)	44 44	Industrial machinery, tools & parts	10
<i>Standards of living</i> USD % world av.		<i>Openness of the economy</i>	
Nominal GDP per head	5068 47	Export value of G&S (% of GDP)	71
Nominal GDP per head at PPP	8823 71	Import value of G&S (% of GDP)	65
Real GDP per head	3084 38	Inward FDI (% of GDP)	3.0

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Economic challenges from within...

Economic growth was expected to be between 4% and 5% in 2011, but growth was depressed by the earthquake and tsunami in Japan, which triggered supply chain disruptions in the first quarter of 2011, and the worst floods in decades, which hit Thailand in the second half of 2011. As a result, real GDP growth dropped from a very strong 7.8% in 2010 to a meager 0.1% in 2011. The floods started in August and first hit the agricultural sector in the north and east, before moving down to the industrial hart of Thailand and on to Bangkok in the south. Industrial production plunged in the fourth quarter as a result, because several large factories and many small-scale workshops had to close down during that period.

Figure 1: Economic growth



Source: EIU

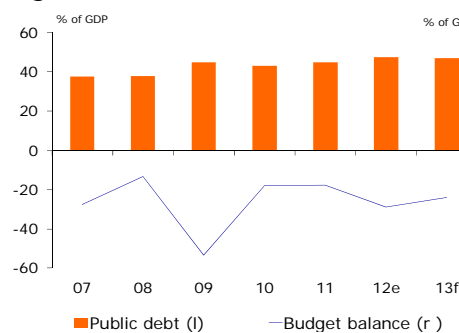
Figure 2: Industrial production



Source: EIU

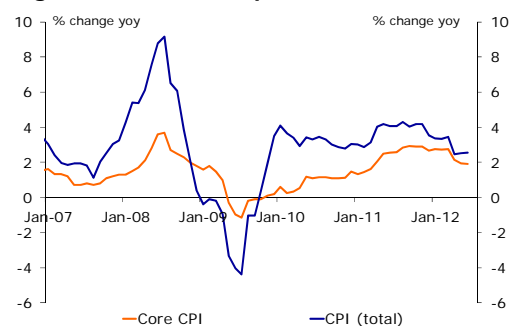
Economic growth declined by 10.8% quarter-on-quarter in the fourth quarter of 2011, which is a sharper contraction than witnessed during either the 08/09 financial crisis or the 1998 Asian crisis. Moreover, being a major production hub in Asia, the floods led to supply chain disruptions that, among others, adversely affected the car parts and electronics sectors globally. As physical damage had to be repaired, industrial production is not expected to be fully up and running again until 2H2012. The agricultural sector is not expected to perform well in 2012 either, with droughts hitting several provinces in the spring of this year. Still, on the back of post-flood investments and additional government spending, the economy is expected to recover strongly this year and grow at around 6%. Domestic consumption is supported by the increase in minimum wages as per April 2012 in Bangkok and 6 provinces. The rest of the country will see a similar increase in 2013. Economic growth in 2013 will be supported by this rise in minimum wages as well as the carryover effect of an expected strong performance of the industrial sector in 2H2012. The global outlook and tense political situation, however, pose severe downside risks to the Thai economy (see next sections).

Figure 3: Fiscal situation



Source: EIU

Figure 4: Consumer price inflation



Source: Ecwin

The flood response of Prime Minister Yingluck's administration, which was only installed in August 2011, was generally regarded as below par. A cabinet reshuffle, promises to improve disaster management and a minimum price for rice were announced to repair the loss of public support. The rice scheme focuses on buying a certain amount of rice by the government at a fixed price, which is well above market prices. The fiscal deficit is expected to increase from 1.5% of GDP in 2011 to around 3% of GDP in 2012 on the back of investment in flood prevention, soft loans for affected households and the rice program. Public debt is expected to rise in line with the wider fiscal deficit to 48% of GDP by the end of this year, from 45% of GDP in 2011. While the rapid rise of public debt in the past years (10pp increase between 2008 and 2012) is something to keep a close eye on, the current level is still acceptable and in line with regional peers such as Malaysia and the Philippines.

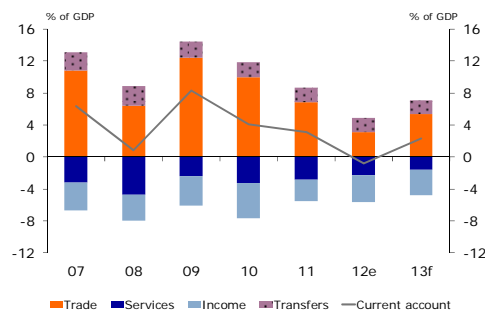
... and economic challenges from abroad.

Being an open economy, Thailand is sensitive to the weakening global economic outlook. The primary export and import partners are China, Japan and the US. So, the impact of an escalation of the eurozone should be less severe than in several other emerging markets. Moreover, the banking sector is largely funded domestically. Still, Thailand is not immune. The domestic stock exchange, currency and investment flows are sensitive to change in global risk appetite, although the Thai bath and stock exchange have been remarkably resilient so far compared to other emerging markets. Foreign direct investment is expected to recover this year after investors postponed

decisions during the floods last year, but inward portfolio flows are expected to decline this year compared to last year.

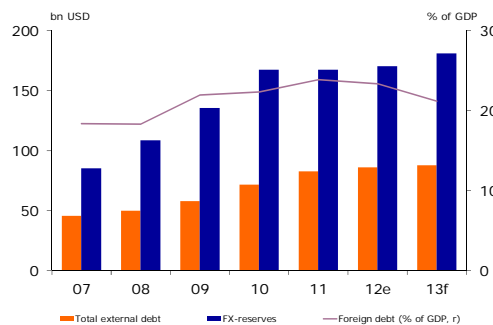
The current account balance is expected to slip into negative territory this year, on the back of sluggish domestic production and weak external demand. The current account will likely show only a small deficit at around 1% of GDP in 2012, but this is a substantial worsening from 2009, when the current account surplus stood at 8.3% of GDP. With the recovery of export production, the current account balance is expected to become positive again in 2013. Overall, the external position of Thailand remains comfortable. External debt is about 23% of GDP, while at USD 170bn the foreign exchange reserves are almost twice as large as total foreign debt. The import cover is expected to amount to almost 8 months by the end of 2012, while the liquidity ratio will amount to a healthy 141%.

Figure 5: Current account balance



Source: EIU

Figure 6: External debt



Source: EIU

Thailand faces political tensions, ...

Political risk remains elevated in Thailand, which struggles with the deep social divide between the established elite and urban middle class, generally called the ‘yellow shirts’, and the poor rural and urban workers, the ‘red shirts’. Moreover, king Bhumibol, who is seen as key in maintaining the country’s fragile stability and national cohesion, is in ill-health. Finally, a failed bomb attack in February of this year and on-going tension with Cambodia and Malaysia over respectively a temple complex and border dispute draw attention to security issues. Despite the heightened political and social tensions, Thailand’s economy has been able to function rather well in the past years. The tourism sector has been surprisingly resilient and the violence and protests generally affect only some areas in the business districts and areas with government buildings. Still, the risk of a perfect storm is certainly present in Thailand. A return of ousted Prime Minister Thaksin Shinawatra, the death of King Bhumibol and/or growing public discontent if the government handles another natural disaster poorly (like the 2011 floods) could lead to large scale protests again. . This turmoil could seriously disrupt business and government activity. Moreover, military intervention in the political situation cannot be excluded.

During the period 2006-2010¹, the political situation of Thailand was characterized by regular turmoil and protests, a bloodless military coup that ousted then-Prime Minister Thaksin Shinawatra and court rulings, which dissolved several parties. It is a reflection of the long-seated, and still present, division in Thailand between the red and yellow shirts. The rural-oriented red shirts are in majority, but the elitists yellow shirts have the backing of the bureaucracy and military. While tension rose markedly in 2006, it was not the first time that the power struggle between the

¹ See Rabobank Country Risk Report Thailand of June 2011 for more information on this period.

traditional elite and the generally poor rural majority escalated – and will likely not be the last. Protests have subsided since early 2011, but the deep divide continues to simmer and defines the political situation in Thailand.

The general elections of July 2011 brought a landslide victory to the red shirt-oriented Puea Thai Party (PTP) of Yingluck Shinawatra, the sister of ousted premier Thaksin Shinawatra. This suggested a return of Thaksinomics, a populist stance on economic policy with a focus on the rural population. Although the PTP has a majority in the parliament, it formed a coalition with four smaller parties. As the opposition, which is dominated by the Democrat Party (PD), and the military accepted the PTP victory, the short-term political stability of Thailand improved. However, Prime Minister Yingluck has the impossible task to manage very conflicting expectations. Firstly, the rural poor expect to see improvements in their situation and keep food prices low, as promised in the populist election campaign. The 2011 floods added decent disaster management to the public's wish list. Second, the pro-Thaksin United Front for Democracy Against Dictatorship (UDD), the protest movement that put Yingluck in the driving seat, expects a return of Thaksin. This would require an amnesty to allow him to end his self-imposed exile, which Thaksin chooses to avoid a sentence for corruption. His passport, that had been taken away earlier and was one of the major obstacles for return, was given back to Thaksin late-2011, much to the disliking of the opposition parties. Third, the opposition expects Yingluck to stay within their preferred policy lines. Foremost, this means that Thaksin does not return to Thailand and that policies are not too populist. In fact, if given the chance, the PD, the opposition party that governed from 2008 to 2011, would like to return to power. Living up to these expectations will be difficult in itself, but are complicated by the fact that Yingluck faces economic challenges internally (after the 2011 floods) and externally (slowing global demand).

Despite the difficult balancing act, the government of Yingluck is still in charge. However, the first cracks are showing. In February 2012, Yingluck reshuffled her cabinet following public discontent about the government's performance during the 2011 floods. The reshuffle came only five months after Yingluck's cabinet, which includes many technocrats, was formed. The overhaul aims to boost the popularity of Yingluck and her party, but also introduces allies of Thaksin. Moreover, the returning of Thaksin's passport caused a rift and increases tension between the red and yellow shirts again. Also, the discussion on amending the constitution is firing up tension between the two camps. Finally, the PD has already launched several court cases to overturn new laws and has formed a shadow cabinet. In the past, several Thaksin-backed parties have been banned by the high court and the PD and other opposition parties seem to aim for that again. If history repeats itself, there is a good chance that Yingluck's cabinet won't make it until the next elections – while winning the elections of 2001, 2005 and 2007, parties supported by Thaksin never lasted until the end of their term. Overall, political and social tensions in Thailand are expected to remain elevated in the coming period. Key things to watch are the possible amnesty for and return of Thaksin; the amendment of the 2007 military-drafted constitution; court rulings on the legitimacy of the ruling PTP; public satisfaction with economic developments and disaster management.

... **succession risk and security issues.**

While Thailand is a constitutional monarchy, King Bhumibol has considerable informal political power. During his reign of more than 60 years, Bhumibol has become immensely popular and is therefore key to Thailand's national identity. Unfortunately, King Bhumibol was hospitalized in September 2009 and has rarely left the hospital since. Bhumibol's son, Crown Prince Maha Vajiralongkorn, is heir apparent to the throne. However, he is not very popular and unlikely to fill

his father's position as a moral authority. His sister, Princess Maha Chakri Sirindhorn, has more supporters and could constitutionally succeed her father, but this is controversial. Therefore, the death of King Bhumibol could lead to an increased power struggle between the different political parties with the military and bureaucracy playing an important role on the background.

Next, Thailand also faces several security issues. First, Thailand has rather complicated relations with several of its neighboring countries. With Cambodia, there is a long-standing dispute over the Preah Vihea temple, which led to military clashes in April/May 2011 that killed several soldiers. Since the PTP came in charge the tensions has decreased. Both sides recognize that the countries have more to gain from cooperation than from conflict. With Malaysia, the occasional violence at the border in southern Thailand (in three provinces with a Muslim majority) causes tensions. But in general, the common desire to further development keeps both countries on the same page. With Myanmar, the diplomatic relations are often at odds, as the military of Myanmar crosses the Thai border to chase ethnic militants. However, Thailand has considerable economic ties with Myanmar and aims to increase its presence to tap into the natural resources. Finally, there was the botched bomb attack in February 2012. Terrorists from Iran allegedly wanted to attack Israeli diplomats, but the home-made bombs exploded early when the police tried to arrest the men. While the authorities tried to downplay the failed attack, 14 countries still issued a travel warning in response to the incident. Luckily, the important tourism sector tends to be very resilient.

Thailand							
Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
<i>Key country risk indicators</i>							
GDP (% real change pa)	5.0	2.5	-2.3	7.8	0.1	6.0	4.7
Consumer prices (average % change pa)	2.2	5.4	-0.9	3.3	3.8	3.5	3.6
Current account balance (% of GDP)	6.3	0.8	8.3	4.1	3.1	-0.8	2.3
Total foreign exchange reserves (mln USD)	85221	108661	135483	167530	167389	170370	181260
<i>Economic growth</i>							
GDP (% real change pa)	5.0	2.5	-2.3	7.8	0.1	6.0	4.7
Gross fixed investment (% real change pa)	1.5	1.2	-9.2	9.4	3.3	14.5	4.6
Private consumption (real % change pa)	1.8	2.9	-1.1	4.8	1.3	5.1	4.9
Government consumption (% real change pa)	9.8	3.2	7.5	6.4	1.1	4.0	4.4
Exports of G&S (% real change pa)	7.8	5.1	-12.5	14.7	9.5	3.3	6.6
Imports of G&S (% real change pa)	4.4	8.9	-21.5	21.5	13.7	8.4	4.5
<i>Economic policy</i>							
Budget balance (% of GDP)	-2.3	-1.1	-4.4	-1.5	-1.5	-2.4	-2.0
Public debt (% of GDP)	38	38	45	43	45	48	47
Money market interest rate (%)	3.8	3.3	1.2	1.3	2.8	3.2	3.8
M2 growth (% change pa)	6	9	7	11	15	14	9
Consumer prices (average % change pa)	2.2	5.4	-0.9	3.3	3.8	3.5	3.6
Exchange rate LCU to USD (average)	34.5	33.3	34.3	31.7	30.5	31.0	30.7
Recorded unemployment (%)	1.4	1.4	1.5	1.0	0.7	0.9	1.0
<i>Balance of payments (mln USD)</i>							
Current account balance	15677	2210	21890	13098	10685	-3020	9490
Trade balance	26631	17393	32608	31678	23503	11280	22140
Export value of goods	151240	175215	150788	193610	225366	222170	244480
Import value of goods	124610	157819	118181	161934	201863	210890	222340
Services balance	-7938	-12891	-6382	-10548	-9871	-8530	-6850
Income balance	-8588	-8958	-9705	-14060	-9312	-12360	-13010
Transfer balance	5573	6665	5372	6031	6365	6580	7210
Net direct investment flows	8312	4444	681	4156	-1086	7420	4280
Net portfolio investment flows	-6553	-1397	-5211	7418	4065	1910	2690
Net debt flows	-1862	-1283	5952	12367	9170	3780	3550
Other capital flows (negative is flight)	4898	19579	4098	-3328	-19839	-7040	-9420
Change in international reserves	20471	23553	27410	33711	2995	3050	10590
<i>External position (mln USD)</i>							
Total foreign debt	45306	49839	57886	71263	82523	85930	87730
Short-term debt	18295	19189	27010	38472	41221	40960	41360
Total debt service due, incl. short-term debt	40036	35302	31616	38298	49283	55240	56480
Total foreign exchange reserves	85221	108661	135483	167530	167389	170370	181260
International investment position	-53191	-10063	-1714	-36319	n.a.	n.a.	n.a.
Total assets	163604	179730	219099	264611	n.a.	n.a.	n.a.
Total liabilities	216795	189793	220813	300930	n.a.	n.a.	n.a.
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Trade balance (% of GDP)	10.8	6.4	12.4	9.9	6.8	3.1	5.3
Current account balance (% of GDP)	6.3	0.8	8.3	4.1	3.1	-0.8	2.3
Inward FDI (% of GDP)	4.6	3.1	1.8	3.0	2.8	3.3	2.4
Foreign debt (% of GDP)	18	18	22	22	24	23	21
Foreign debt (% of XGSIT)	23	22	30	29	29	30	28
International investment position (% of GDP)	-21.5	-3.7	-0.6	-11.4	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	21	16	16	16	17	20	18
Interest service ratio incl. arrears (% of XGSIT)	1	1	1	1	1	1	1
FX-reserves import cover (months)	6.3	6.4	10.5	9.7	7.9	7.7	7.8
FX-reserves debt service cover (%)	213	308	429	437	340	308	321
Liquidity ratio	142	138	171	160	148	141	145

Source: EIU

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