Rabobank

Country report **THAILAND**

Summary

The unstable political and social situation remains the largest country risk for Thailand. While the situation has stabilized compared to the large-scale violent riots last year, uncertainty remains until the next general elections. The economy, on the other hand, is in very good shape since it is well-diversified and forecasted to grow by 5% yoy in 2011. A downside risk to this forecast, however, is the impact of the triple disaster in Japan. The fiscal position remains in healthy shape while the external position continues to improve.

Things to watch:

- The political/social situation in the run-up to the general elections
- The economic impact of the disaster in Japan

Author: **Ashwin Matabadal**
Country Risk Research
Economic Research Department
Rabobank Nederland

Contact details: P.O.Box 17100, 3500 HG Utrecht, The Netherlands
+31-(0)30-21- 61601
A.R.K.Matabadal@rn.rabobank.nl

Thailand

National facts			Social and governance indicators	rank / total
Type of government	Constitutional Monarchy		Human Development Index (rank)	92 / 169
Capital	Bangkok		Ease of doing business (rank)	19 / 183
Surface area (thousand sq km)	513,120		Economic freedom index (rank)	62 / 179
Population (millions)	66.3		Corruption perceptions index (rank)	78 / 178
Main languages	Thai		Press freedom index (rank)	153 / 178
			Gini index (income distribution)	42
Main religions	Buddhist (94%)		Population below $1.25 per day (PPP)	2%
	Muslim (5%)			
	Christian (1%)			
Head of State (King)	Bhumibol			
Head of Government (prime-minist	Abhisit Wetchachiwa			
Monetary unit	Baht (THB)			

Foreign trade	2009		
Main export partners (%)		*Main import partners (%)*	
US	11	Japan	19
China	11	China	13
Japan	10	US	6
Hong Kong	6	UAE	6

Economy		2010
Economic size	*bn USD*	*% world total*
Nominal GDP	319	0.51
Nominal GDP at PPP	587	0.79
Export value of goods and services	231	1.24
IMF quotum (in mln SDR)	41	0.02
Economic structure	*2010*	*5-year av.*
Real GDP growth	7.8	3.0
Agriculture (% of GDP)	12	11
Industry (% of GDP)	45	44
Services (% of GDP)	43	45
Standards of living	*USD*	*% world av.*
Nominal GDP per head	4724	48
Nominal GDP per head at PPP	8695	74
Real GDP per head	3113	39

Main export products (%)	
Machinery & mechanical appliances	14
Electrical apparatus for making or breaking	9
Electrical appliances	7
Vehicles, parts & accessories	8
Main import products (%)	
Fuel & lubricants	18
Minerals & metal products	12
Electronic parts	9
Industrial machinery, tools & parts	7
Openness of the economy	
Export value of G&S (% of GDP)	69
Import value of G&S (% of GDP)	59
Inward FDI (% of GDP)	1.9

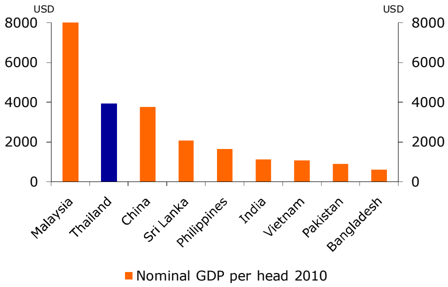
Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Economic structure and growth

Thailand's economy is better developed than those of its Asian neighbours, mostly reflected by a sound infrastructure and strong investment flows. Thailand's business friendly climate has made it a very attractive destination for foreign investment, as demonstrated by its high rank of 19 out of 183 countries in the World Bank's Ease of doing business index. The country has built up significant expertise in the automobile and electronics industry. Economic development has resulted in growing income levels; nominal GDP per capita stood at USD 4,724 in 2010, markedly higher than the income level of most other Asian countries. While one strong factor is that the economy is rather diverse, its weaknesses are its reliance on external demand and the fact that a large part of the population, 42%, still works in the agricultural sector. The economy is very open, as the combined value of exports and imports equals 128% of GDP. Since the export sector accounts for roughly three-quarters of GDP, the economy is very vulnerable to external demand shocks. Thailand's main export products are machinery, vehicles and electronics, while it main imports are goods to facilitate the industrial production of its export products. These include fuel, electronic parts, metal products and industrial machinery. Thailand's main trade partners are the US, China and Japan.

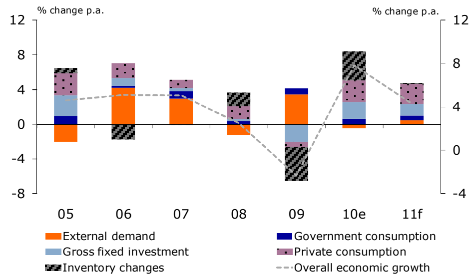
The Philippine economy is estimated to grow between 4-5% in 2011, which represents a slowdown from the 7.3% real GDP growth recorded in 2010. Gross fixed investments and private consumption will be the key contributors to GDP growth this year. Less stock-building and less pent-up demand mean growth will slow compared to last year.

Chart 1: Income level



Source: EIU

Chart 2: Growth performance



Source: EIU

A further downside risk to this growth forecast is the impact from the triple disaster in Japan. The electronics and automotive sectors might suffer from disruptions of supply from Japan for components of these products. Tourism could also be affected, as 10% of total number of visitors to Taiwan is from Japan.
The risks in the banking sector to monetary and financial stability are low. While the banking sector was not exposed to US sub-prime related debt obligations nor is a heavy investor in European sovereign debt, the ratio of non-performing loans did pick up slightly last year.

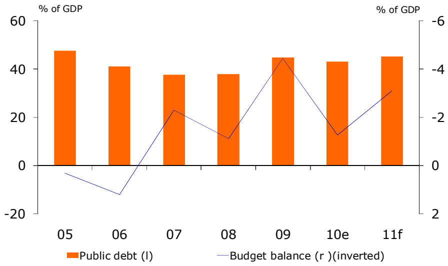
Political and social situation

Thailand has a history of political instability, as the Thai society remains deeply divided. The largest opposing forces are known as the rural poor "red shirts" and the mostly urban middle class and elite "yellow shirts". The political and social unrest has increased markedly since early 2006. In 2006, anti-government protests from the People's Alliance for Democracy (PAD), or "yellow shirts" forced the then PM Thaksin Shinawatra, head of the Thai Rak Thai Party (TRTP) to dissolve the parliament. Thaksin called for snap elections, which were boycotted by most major opposition parties. This led to a constitutional crisis and the constitutional court invalidated the election results. The court did order new elections in October, but these were cancelled as Thaksin was ousted via a judicial coup. The court also dissolved the TRTP after accusing it of election fraud. The general elections followed in December 2007 and were won by the People's Power Party (PPP), which was founded by several former members of the TRTP. This did not halt the turmoil, as the PAD started almost continuous protests after the PPP decided to amend the constitution in May 2008. PAD protesters seized Bangkok's international airport which forced it to close temporarily in December 2008. The protests ended after the constitutional court dissolved several parties of the PPP-led coalition. The PPP's successor, the Puea Thai Party (PTP), could not form a coalition government. This is where the incumbent government enters the stage, the Democrat Party (DP), led by Prime Minister Abhisit Vejjajiva. This is also when the "red shirts", the Thaksin supporters united under the United Front for Democracy Against Dictatorship (UDD) enter the stage. They have been protesting against Abhisit, as he was not elected democratically, and the UDD instantly demanded new elections. Their protests have been fierce; it led to the cancellation of the ASEAN summit in March 2009 and in April 2010 a two-month long protest rally was held in Bangkok which forced parliament members to flee government buildings and business and commercial districts to close temporarily. Hereafter, the government imposed an emergency rule which was lifted on December 31st, 2010. The government lifted the emergency rule as it felt the protests could be controlled. While indeed the protests so far this year have been relatively peaceful, the growing number of protesters reflects the deep divide in the Thai society.
Prime Minister Abhisit's term ends in December 2011, but he has partly conceded to the demands of the red shirts by stating he will hold early elections. The timing of the elections is not yet known,

but is likely to take place in 3Q2011.In this way Abhisit will have kept his promise not to cling to power while bringing forth the elections only for a couple of months.
The outcome of the general elections is also still uncertain. Both the large parties, the DP and the PTP, are unlikely to secure a parliamentary majority. Despite Abhisit's spending programs to support low-income groups, his elitist image and handling of the redshirt protests last year mean that the DP's support base will continue to be restricted to its traditional stronghold in the south and Bangkok's middle class. This will undermine the DP's potential to win a decisive election victory. Meanwhile, the factional splits within the pro-Thaksin bloc mean that the PTP is only a shadow of its former incarnations. As a result, Thailand's minor parties will play a crucial role in determining which of the two major parties forms the next government.
International relations remain tense with neighbor Cambodia. A long-standing dispute about the territory surrounding the Preah Vihaer Temple continues. Small, but violent clashes continue without any short-term resolution in sight.

Economic policy
The fiscal balance will worsen slightly in 2011 as government expenditures increase. The budget deficit will rise to 3.1% of GDP, up from 1.3% of GDP in 2010. The main drivers for the spending increase are free education until the age of 15, a national healthcare scheme over the medium term and rises in civil service wages. On the revenue side, several tax reforms are expected. A temporary tax break for foreign companies could be made permanent. Corporate tax rates are relatively high in Thailand, discouraging foreign investors, which go to Malaysia and Singapore instead. The resulting short-term revenue loss of lower corporate taxes could be offset in the future as more foreign companies find ground in Thailand. Also offsetting this potential loss would be the raise of the VAT and the introduction of property and inheritance taxes. Overall, the tax system is modern and efficient, but collection remains weak and tax evasion prevails. Further depressing government revenues is the lack of privatization of state enterprises, which has been on hold since 2006.
Despite this year's deterioration, overall public finances and fiscal discipline are in sound shape, since the country's fiscal policy has been historically conservative. After the 1997-98 Asian financial crisis, Thailand established a fiscal sustainability framework (see table 1) to promote fiscal discipline. While in fact this only is a set of legally non-binding guidelines, the government has adhered to these rather, except in 2009, as it had to introduce fiscal stimulus measures that year to counter the effects of the global financial crisis that year. In addition to this framework, two key legal frameworks aid in limiting fiscal spending. These are the Budgetary Act and the Public Debt management act, which stipulates the budget deficit must be financed by local currency borrowing and cannot exceed the sum of 20% of fiscal expenditure and 80% of principal bond repayment. Public debt is forecasted at 45% of GDP in 2011.
Contingent liabilities of the government exist from the banking sector in the form of a blanket guarantee of deposits equaling 74% of GDP. Other contingent liabilities, including guaranteed debt from state-owned enterprises, special financial institutions and autonomous government agencies, are low at 7% of GDP. The Bank of Thailand (BOT), the country's central bank, is expected to continue monetary tightening throughout 2011. The BOT has been raising interest rates since the summer of 2010 by steps of 25bps. The main policy rate, the repo rate, stood at 2% at the beginning of the year and has been hiked to 2.75% as of May. We expect more rate hikes, even though inflation has been moderate in the 3-4% range during the first five months of 2010. Tapping the monetary breaks is needed as the economy is growing at near-full capacity.

Chart 3: Public finances



Source: EIU

Table 1: Fiscal sustainability framework

Key Guidelines
· Public debt a /GDP ratio shall not exceed 50%
· Debt service in total budget shall not exceed 15%
· Investment spending to budget ratio must be at least 25%
· Achieve a balanced budget since FY05
A government's definition of public debt includes direct central government debt, non-financial state-owned enterprises' debt, FIDF liabilities, autonomous government agency debt and guaranteed debt of specialised financial institutions.

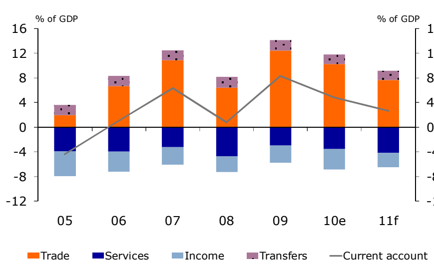
Source: Ministry of Finance and Public Debt Management Office Thailand

For example, capacity utilization rates in the automotive industry have recently approached pre-crisis levels. Also, a shortage of workers exists as unemployment is at a low of 1%. Both skilled and unskilled labour supply is insufficient.
Overall, the BOT's inflation management is sound and confidence in the domestic currency, the Thai baht (TBH), is strong, reflected by very low dollarization levels in the economy. Confidence is so strong that the TBH has markedly appreciated since March 2009, when the green shoots of the economic recovery began to appear. As economic growth prospects remain strong, a further appreciation of the TBH could hurt the export sector.

Balance of Payments

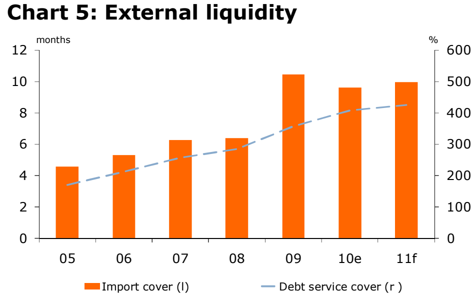
In 2010, the current account showed a surplus of 4.8% of GDP and for 2011 a surplus of 2.7% of GDP is estimated. The surplus can be almost fully attributed to the trade balance, which posted a 10.2% of GDP surplus in 2010. The trade balance has traditionally posted large surpluses as Thailand is a large net exporter. However, since Japan is a large trade partner, supply disruptions could hurt electronics exports. Export growth has been between 20-30% in the first four months of 2011, but could slow as the US economy appears to be slowing down. Import growth has slowed since the start of the year, likely due to reduced imports from Japan, and stood at 27.2% yoy in April. The deficit on the services balance of 3.5% of GDP in 2010 could increase this year as political turmoil keeps tourists at bay and the shortage of workers results in more employees of foreign companies entering and working in Thailand. The flows on the income and transfer balances will not change significantly this year.

Chart 4: Current account



Source: EIU

Chart 5: External liquidity



Source: EIU

External financing via the financial account is not needed, and the proposed lowering of corporate tax rates could result in stronger capital inflows. Continuous current account surpluses have led to a rapid accumulation of FX-reserves, which have quadrupled since 2005. At end-2011, FX-reserves are estimated at USD 211bn.

External position

Thailand has a sound external position and external financing difficulties are not expected. Foreign debt was low end-2010 at 27% of GDP. As the government mainly borrows domestically, the private sector is the largest external debtor. The part that the government does borrow externally is mostly facilitated by multilateral and bilateral entities such as the World Bank, Asian Development Bank and Japan International Cooperation Agency. The large stock of FX-reserves covers 9-10 months of imports and 407% of debt service, both very sound levels.

Thailand

Selection of economic indicators	2005	2006	2007	2008	2009	2010e	2011f
Key country risk indicators							
GDP (% real change pa)	4.6	5.1	5.0	2.5	-2.3	7.8	4.3
Consumer prices (average % change pa)	4.5	4.7	2.2	5.4	-0.9	3.3	3.8
Current account balance (% of GDP)	-4.3	1.1	6.3	0.8	8.3	4.8	2.7
Total foreign exchange reserves (mln USD)	50691	65291	85221	108661	135483	167530	211720
Economic growth							
GDP (% real change pa)	4.6	5.1	5.0	2.5	-2.3	7.8	4.3
Gross fixed investment (% real change pa)	10.5	3.9	1.5	1.2	-9.2	9.4	6.3
Private consumption (real % change pa)	4.6	3.2	1.8	2.9	-1.1	4.8	4.4
Government consumption (% real change pa)	11.3	2.2	9.8	3.2	7.5	6.0	6.3
Exports of G&S (% real change pa)	4.2	9.1	7.8	5.1	-12.5	14.7	7.7
Imports of G&S (% real change pa)	9.0	3.3	4.4	8.9	-21.5	21.5	9.4
Economic policy							
Budget balance (% of GDP)	0.3	1.2	-2.3	-1.1	-4.4	-1.3	-3.1
Public debt (% of GDP)	48	41	38	38	45	43	45
Money market interest rate (%)	2.6	4.6	3.8	3.3	1.2	1.3	2.3
M2 growth (% change pa)	6	8	6	9	7	11	10
Consumer prices (average % change pa)	4.5	4.7	2.2	5.4	-0.9	3.3	3.8
Exchange rate LCU to USD (average)	40.2	37.9	34.5	33.3	34.3	31.7	30.2
Recorded unemployment (%)	1.8	1.5	1.4	1.4	1.5	1.1	1.6
Balance of payments (mln USD)							
Current account balance	-7647	2316	15677	2210	21862	15420	9490
Trade balance	3387	13843	26762	17384	32691	32480	27260
Export value of goods and services	109369	127930	151240	175215	150712	194530	226280
Import value of goods and services	105981	114086	124478	157830	118022	162040	199020
Services balance	-6864	-8193	-8068	-12881	-7815	-11180	-14820
Income balance	-7172	-6703	-6954	-7060	-7500	-10830	-8290
Transfer balance	3004	3368	3939	4767	4485	4940	5340
Net direct investment flows	7554	8478	8309	4442	862	490	460
Net portfolio investment flows	4393	6233	-6556	-1387	-5464	9810	9890
Net debt flows	4398	2821	8222	995	3712	9710	5170
Other capital flows (negative is flight)	-6464	-4929	-5180	17293	6438	-1710	19580
Change in international reserves	2234	14919	20471	23553	27410	33710	44590
External position (mln USD)							
Total foreign debt	52749	56271	61738	64798	70304	81820	89380
Short-term debt	16014	17812	21640	24210	27272	33440	37390
Total debt service due, incl. short-term debt	29684	30779	33134	38197	37972	41140	49780
Total foreign exchange reserves	50691	65291	85221	108661	135483	167530	211720
International investment position	-53883	-56167	-53191	-10063	-4676	n.a.	n.a.
Total assets	92191	120929	163604	179730	219078	n.a.	n.a.
Total liabilities	146074	177096	216795	189793	223754	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	1.9	6.7	10.8	6.4	12.4	10.2	7.7
Current account balance (% of GDP)	-4.3	1.1	6.3	0.8	8.3	4.8	2.7
Inward FDI (% of GDP)	4.6	4.6	4.6	3.1	1.9	1.8	1.8
Foreign debt (% of GDP)	30	27	25	24	27	26	25
Foreign debt (% of XGSIT)	39	35	32	29	37	34	32
International investment position (% of GDP)	-30.6	-27.1	-21.5	-3.7	-1.8	n.a.	n.a.
Debt service ratio (% of XGSIT)	22	19	17	17	20	17	18
Interest service ratio incl. arrears (% of XGSIT)	1	1	1	1	1	1	1
FX-reserves import cover (months)	4.6	5.3	6.3	6.4	10.4	9.6	10.0
FX-reserves debt service cover (%)	171	212	257	284	357	407	425
Liquidity ratio	118	135	147	136	166	160	160

Source: EIU