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Country Risk Monitor

THAILAND

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In a nutshell

- Thailand's solid external buffers support the country's macroeconomic strength. In spite of weaker global demand, the current account (CA) surplus improved further to 8.1% of gross domestic product (GDP) in 2015 (2014: 3.8%), as higher tourist arrivals and lower import demand helped offset the generally weak goods exports. Thailand's external debt, meanwhile, remains relatively low by regional standards, standing at 35.7% of GDP in 1H2016 (2015: 32.3%). More importantly, its foreign exchange reserves are ample by global benchmarks, with the ratio to short-term external debt at 2.9 times in 1H2016 (2015: 3.0 times).

- Thailand's generally healthy public finance and modest debt level are also its key strengths. The general government fiscal position has remained broadly balanced since the Global Financial Crisis (GFC) in 2009, and has fluctuated between a small deficit and surplus (2015: 0.1% of GDP, 2014: -0.8% of GDP), providing additional space for the authorities to jumpstart the economy over the near to medium term. That also reflects prudent fiscal management by the authorities, despite repeated episodes of political instability in recent years. Thailand's public sector debt, meanwhile, moderated to 42.9% of GDP in July 2016 (2015: 44.4%) and is well below its self-imposed debt ceiling of 60% of GDP. It ranks favourably when compared to its regional peers.

- Notwithstanding the favourable attributes, Thailand's array of structural challenges continue to challenge its macroeconomic strength. As a result, the economy has hardly recovered to its pre-GFC level, with growth averaging at just 3.7% in the six years since 2010 (pre-GFC: 5.0%). In spite of its status as an upper middle-income nation, Thailand's income growth continued to lag its regional peers. On a purchasing power parity (PPP) basis, its GDP per capita rose by an average 4.8% per annum in the post-GFC period, vis-à-vis the Association of Southeast Asian Nations' (ASEAN) average of 5.6%. The rapidly aging population in recent years further complicates its effort to escape the middle-income trap. The growth of the working-age population dropped to an average of 0.2% over the last three years (early 2000s: 1.0%), while the old-age dependency ratio climbed to 12.7% in the five years since 2010 (early 2000s: 9.1%). The decline in economic competitiveness, stubbornly weak global demand, combined with the emergence of low-cost manufacturing rivals such as Vietnam and Philippines are among other long-term challenges for the economy.

- While Thailand's current political environment has remained relatively stable, the overall situation is still somewhat uncertain. Thailand's population is deeply polarised between the royalist urban elites (yellow shirts) and the mainly rural poor (red shirts). There have been a dozen military coups and bouts of political violence over the past eight decades, which undermine its institutional strength. In spite of the approval of the military-backed constitution through the public referendum in August 2016, the recent passing of the highly revered King Bhumibol Adulyadej in mid-October 2016 may result in continued political uncertainty in the foreseeable future. Not surprisingly, Thailand scored relatively poorly in both the World Bank's Worldwide Governance Indicators and Transparency International's Corruption Perception Index relative its regional peers.

Table 1: Selected economic indicators

	2010	2011	2012	2013	2014	2015
Real GDP growth (% y-o-y)	7.5	0.8	7.2	2.7	0.8	2.8
Inflation rate (% y-o-y)	3.3	3.8	3.0	2.2	1.9	-0.9
Unemployment rate (%)	1.0	0.7	0.7	0.7	0.8	0.9
Current account balance (% GDP)	2.9	2.5	-0.4	-1.1	3.8	8.1
External debt (% GDP)	33.0	31.5	35.4	35.8	34.8	32.3
Foreign exchange reserves (USD billion)	172.1	175.1	181.6	167.3	157.1	156.5
General government balance (% GDP)*	-1.3	0.0	-0.9	0.5	-0.8	0.1
- of which: central government (% GDP)*	-1.1	-0.5	-1.3	-0.7	-2.0	-1.3
Public debt (% GDP)	39.6	38.0	40.2	42.2	42.8	44.4
- of which: central government (% GDP)	27.8	27.3	28.5	29.7	30.1	32.6

Source: BoT, MoF, CEIC, MARC Economic Research.
*Note: * = Fiscal year end-September*

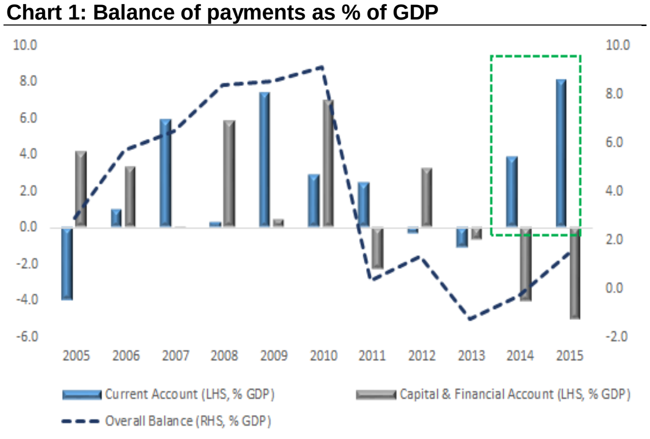
Key Strengths

Solid external buffers

Thailand's solid external buffers as evidenced by its huge CA surplus, ample foreign exchange reserves and low external borrowings support the country's macroeconomic strength. In spite of weaker global demand, the CA surplus improved further to 8.1% of GDP in 2015, an increase by 4.3 percentage points from the preceding year (2014: 3.8%). That reversed the cyclical deficits of 1.1% and 0.4% of GDP in 2013 and 2012 respectively. The sharp decline in global crude oil prices, lower import demand, as well as higher tourist arrivals have effectively helped offset the generally weak goods exports. In local currency terms, gross goods exports and imports contracted by 1.2% and 6.3% respectively in 2015, while in USD dollar terms, they shrank by 5.7% and 10.5% respectively. Accordingly, the goods and services balance almost doubled from a year earlier to a record high of THB1.5 trillion in 2015. The latest data showed that CA surpluses have continued to grow, averaging at 12.6% of the country's output in 1H2016, thanks to the rebound in gross merchandise exports (1H2016: +6.9%, 1H2015: -3.9%) and a continued contraction in inbound shipments (1H2016: -2.4%, 1H2015: -6.7%).

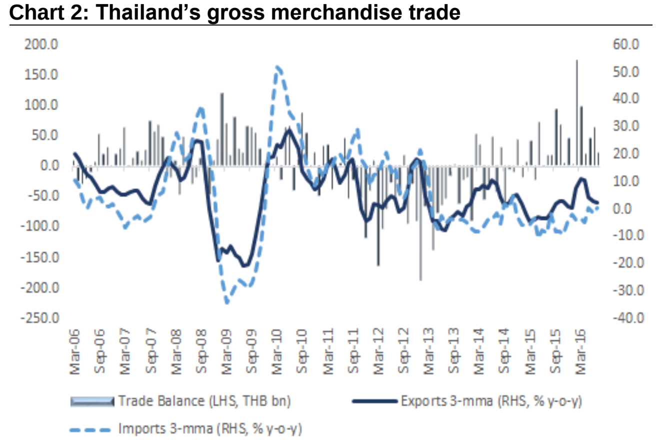
On the other hand, the capital and financial account recorded a larger deficit, equivalent to 5.0% of GDP in 2015 from 4.1% of GDP in the preceding year. That reflects higher capital outflows during the year amid a shift in investor sentiment globally. Specifically, net outflows of portfolio investments jumped to THB613.1 billion during the year, from THB392.5 billion in 2014. Meanwhile, the direct investment account registered a net outflow of THB124.3 billion in 2015, a more than sixfold increase from THB18.7 billion in the preceding year, largely due to higher outward investments by residents following the new policies to liberalise outflows and diversify investment opportunities. Notwithstanding this, portfolio inflow appears to have resumed in 2016, amounting to THB41.5 billion in 1H2016 (2H2015: -THB314.4 billion), while outflow of direct investments more than doubled to THB298.3 billion from THB123.9 billion in 2H2015. Accordingly, its foreign exchange reserves which have declined since early 2013 have started to rebound, climbing by THB24.0 billion in the first nine months of 2016 to THB180.5 billion, recouping the THB25.2 billion loss in the three years through to 2015.

Chart 1: Balance of payments as % of GDP



Source: CEIC, MARC Economic Research

Chart 2: Thailand's gross merchandise trade



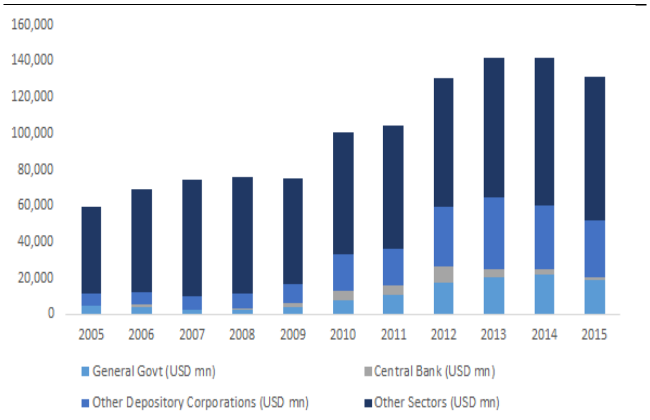
Source: CEIC, MARC Economic Research

Thailand's external debt, which has remained relatively low by regional standards, further supported its strong external balance sheet. As of 1H2016, total foreign borrowings stood at 35.7% of GDP, an increase by 3.4 percentage points from the end of 2015, but sharply lower than its peak of 72.9% of GDP in 1999. In value terms, that represents a 3.0% rise from a year earlier in 1H2016 amid the pickup in short-term debt, which climbed by 7.5% during the same period (2015: -7.6%) and accounted for 42.5% of total offshore borrowings. On the other hand, its long-term external debt, which represents 57.5% of total external debt, extended its decline for a fifth consecutive quarter, albeit at a slower pace of 0.1% during the same period (2015: -7.0%). In particular, the bulk of external borrowings was from non-depository corporation private sectors (representing 60% of total external debt), of which nearly half were short term in maturity. Such borrowings rose by 4.0% in 1H2016, offsetting the continued decline in borrowings by depository corporations (1H2016: -3.0%, 2015: -10.4%).

From a different perspective, however, the increase in CA surplus in recent years reflects the lack of investment activities, on the back of continued political uncertainty. Foreign direct investment, for instance, remains tepid, with a net inflow of THB120 billion in the first seven months of 2016. This represents only about 40% of total inflows in 2015 (THB305.3 billion, 2014: THB161.3 billion), and a far cry from the average inflow of THB360 billion registered between 2010 and 2013. Looking ahead, MARC is of the view that CA surpluses will narrow slightly over the medium term, following the recovery in domestic demand, the execution of long-delayed public infrastructure projects and the stabilisation in global commodity prices.

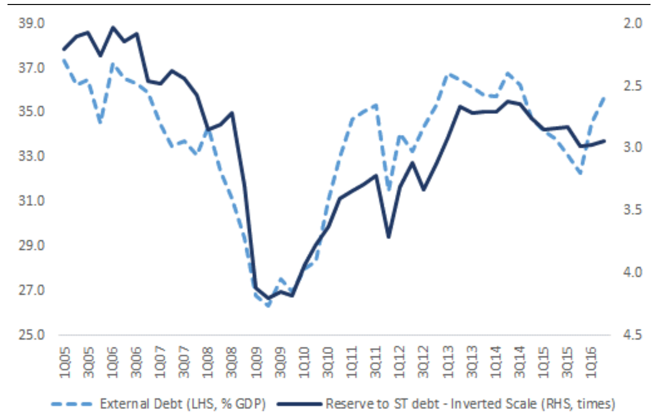
On external debt, although there could be a slight pickup in the near term, it will remain relatively low vis-à-vis its regional peers. This will likely keep the risks of a liquidity crisis minimal, in our view. In addition, foreign exchange reserves remain ample by global benchmarks, with the ratio to short-term external debt at 2.9 times in 1H2016 (2015: 3.0 times), which is sufficient to finance about 13.4 months of imports (2015: 10.6 months). Its flexible exchange rate regime also complements its strong external balance sheet position, and acts as the first line of defence against external shocks, according to the International Monetary Fund (IMF).

Chart 3: External debt by sector



Source: CEIC, MARC Economic Research

Chart 4: External debt as % GDP and reserves to short-term external debt



Source: CEIC, MARC Economic Research

Healthy public finance and modest debt level

Thailand's generally healthy public finance and modest debt level relative to its regional peers further underpinned the country's macroeconomic fundamentals. At the consolidated level, the general government fiscal position has remained broadly balanced since the GFC in 2009. Against this backdrop, we are of the view that Thailand's fiscal stability will provide additional fiscal space for the authorities to jumpstart the economy over the near to medium term. Such a situation also reflects prudent fiscal management by the authorities, despite repeated episodes of political instability in recent years.

In the latest fiscal year ended September 2015 (FY2015), the general government balance returned to a surplus equivalent to 0.1% of GDP, following a deficit of 0.8% of GDP in the preceding year. Thanks to a rebound in revenue, alongside with the decline in government outlays, the fiscal balance improved to a surplus of THB18.0 billion in FY2015. The 8.0% jump in revenue, as compared to a 1.5% decline in the preceding year, was largely attributed to higher tax takes during the year on the back of a mild recovery of the domestic economy. The tax takes, which accounted for nearly 80% of total general government revenue, rose 6.7% (FY2014: -4.5%). Other receipts also contributed to the higher revenue during the year, rising 14.2% in FY2015, almost double the previous year's 7.6% increase. From a regional perspective, Thailand's general government revenue fared better in terms of its ratio to the national output, averaging at 21.6% of GDP in the six years since 2010, vis-à-vis ASEAN-5's average of 19.4% of GDP during the same period.

On the expenditure side, a large reduction was seen in the subsidies component, in line with the government's commitment to rationalise non-productive subsidy programmes. Total subsidies effectively dropped to a cyclical low of 6.0% of total government outlays as compared to its peak of 8.0% in 2011. Compared with the preceding year, total subsidies plunged 23.2% in FY2015 due largely to, among other things, fuel subsidy reform and the replacement of the rice pledging scheme with a more targeted scheme. That has partially mitigated the 4.5% rise in compensation of employees, which was the biggest component of general government expenditure (FY2015: 35.5%, FY2014: 33.9%). Accordingly, total expenses declined 0.1% in FY2015, as compared to a 4.5% increase in the preceding year. Over the past six years, the general government expenditure averaged at 18.9% of GDP, well below the regional's average of 21.2% of GDP.

At the central government level, the overall fiscal balance remained in the red for a seventh consecutive year through to FY2015, averaging at 1.3% of GDP versus a surplus of 0.9% of GDP in the six years prior to FY2009. The central government balance, however, improved slightly in FY2015, with the overall deficit narrowing to 1.3% of GDP from its cyclical peak of 2.0% of GDP in the preceding year. The improvement can be attributed to the 8.7% jump in revenue collections, which was the strongest pace since 2010, reversing the 3.5% drop registered in FY2014. The central government expenditure, meanwhile, rose marginally by 1.0% in FY2015, as compared to an average 8.1% increase in the five years through to FY2014. It is worth noting that the central government expenditure growth remained on a downward trend since FY2010, reflecting the government's commitment to fiscal consolidation, despite the uncertainties on the domestic and external fronts.

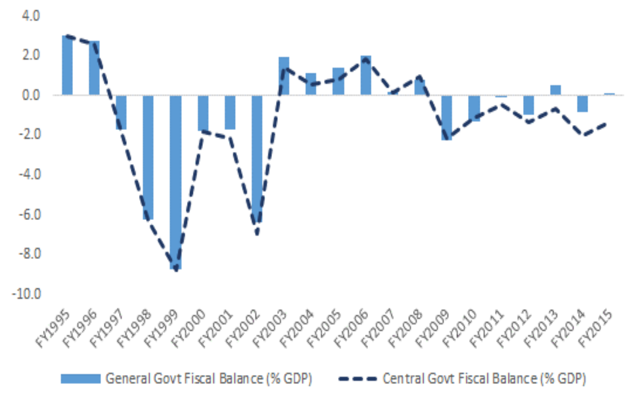
Thailand's public sector debt, meanwhile, remained modest as compared to its regional peers. The latest data showed that total public debt has moderated slightly to 42.9% of GDP in July 2016 from the recent peak of 44.4% of GDP at end of 2015, well below its self-imposed debt ceiling of 60% of GDP. The central government accounted for nearly three quarters of total public debt, most of which were long term in nature (97.5%) and sourced domestically (97.9%). The remainder, meanwhile, were borrowings from non-financial state enterprises and special financial institutions. About 60% of these were directly guaranteed by the central government. As of end-July 2016, total central government debt stood at 31.7% of GDP, down by 0.9 percentage points from the end of last year. Total government-guaranteed debt, meanwhile, declined to 6.7% of GDP from 7.0% of GDP as at end-2015.

Going forward, MARC expects Thailand's overall fiscal position to weaken slightly, in view of the authorities' commitment to implement a moderately expansionary fiscal stance in order to reignite the economy. Specifically, the general government fiscal balance is expected to turn into a small deficit in the near term following the implementation of long-delayed large infrastructure investment projects and tax reforms, which could help boost domestic demand and lift up future potential growth. We view positively the government's short-term stimulus measures to support farmers and small and medium enterprises as part of the temporary relief measures amid severe weather conditions and low commodity prices. In the long term, however, the government should introduce more productive measures to prevent dependency on the low-productivity agricultural sector. In addition, there is also a need for the government to build sufficient fiscal buffers amid a rapidly aging population and other structural challenges that may constrain future growth. In relation to this, the proposed Fiscal Responsibility Law, which is currently under consideration by the Council of State, is expected to improve governance and enhance the management of public resources going forward.

MARC is also of the view that Thailand's debt level will continue to remain broadly lower than its regional peers and that the authorities will maintain prudent debt management over the medium term. Moreover, the overall public debt service capacity remains below 15% of expenditure (Jan-July 2016: 6.7%, 2015:

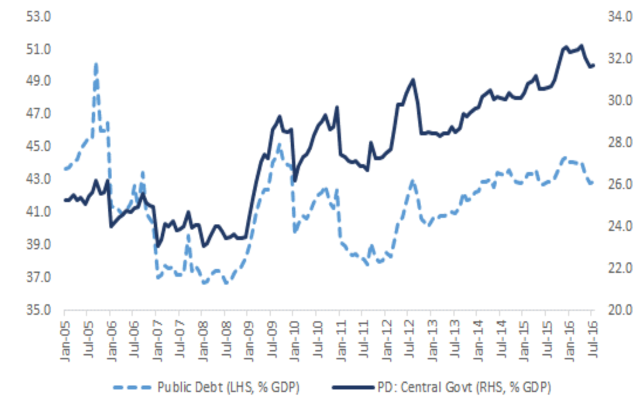
6.2%), lower than the level stipulated under Thailand's public finance framework, and has in fact fallen below 10% since 2011.

Chart 5: General and central government fiscal balance



Source: MoF, MARC Economic Research

Chart 6: Public debt and central government debt



Source: CEIC, MARC Economic Research

Major Challenges

Structural challenges hinder potential growth

Thailand's array of structural issues continue to challenge its macroeconomic strength, hence hindering its economic potential. As a result, the economy has hardly recovered to its pre-GFC level as economic growth remains subdued. In the six years through to 2015, the economy grew at an average rate of 3.7%, as compared to 5.0% in the six years prior to 2009. In particular, real GDP growth between 2013 and 2015 averaged at just 2.1%, dragged down by severe weather conditions, continued political uncertainty and delays in long-needed structural reforms. According to the IMF, Thailand's potential growth slowed to 3.0% in the past five years since 2010, compared with the 5.0% pace in the mid-2000s, due largely to the sharp fall in total factor productivity (TFP) growth and low employment growth. This reflects slow reallocation of labour from low-productivity agriculture to more productive sectors and continued decline in foreign direct investments (FDI) in the manufacturing sector.

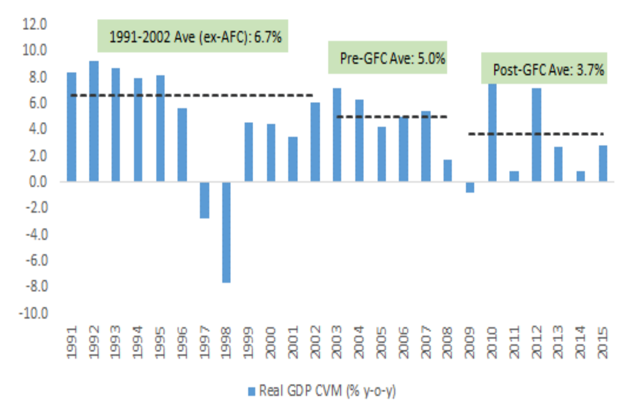
ASEAN's second-largest economy, Thailand is categorised as an upper middle-income nation. However, its income growth continued to lag its regional peers. On a PPP basis, its GDP per capita rose by an average 4.8% in the six years since 2010, down from 6.9% recorded in the six-year pre-GFC period. While the general slowdown was in tandem with the regional trend, the recent growth pace lagged most of its ASEAN peers which averaged at 5.6% in the post-GFC period. In addition, the rapidly aging population further complicates its task to escape the middle-income trap. The growth of the working-age population dropped to an average of 0.2% over the last three years as compared to an average 1% in the early 2000s, reflecting slower labour supply growth. The old-age dependency ratio (the percentage of people aged 65 and above relative to the working age population) almost doubled to as high as 13.8% in 2015, from 7.2% in the mid-1990s. It is also worth noting that the child age population (aged 0-14 years) has been declining for 17 consecutive years and at a faster pace in the post-GFC period (post-GFC: -1.4%, pre-GFC: -1.0%), which may constrain future potential growth.

The decline in economic competitiveness in recent years is also proving to be one of the challenges for the country. As an export-dependent economy, the relatively strong local currency compared to its regional peers continued to hurt exporters. Moreover, the emergence of low-cost manufacturing rivals such as Vietnam and Philippines, combined with stubbornly weak global demand, were among other long-term challenges for the economy. The World Economic Forum's Global Competitiveness Report shows that Thailand's competitiveness position among 138 countries has deteriorated from 28th place in 2007-08 to

39th in 2011-12 before recovering slightly to 34th in 2016-17 (2015-16: 32nd place). The deterioration reflects lack of business sophistication and innovation, alongside generally poor institutional settings amid continued political instability. While the latest 2017 World Bank Doing Business Report placed Thailand at 46th place, unchanged from the previous year, the overall Distance to Frontier Score (DTF) declined from a peak of 75.99 in 2014 to 72.53 in 2017.

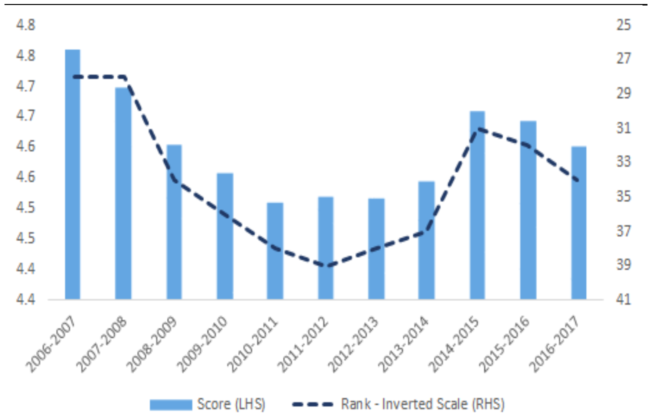
Going forward, we foresee Thailand's economic recovery to remain modest, supported by the execution of public infrastructure projects and continued progress in structural reforms. Although the current progress on structural reforms are commendable (the government has laid out its first 20-year National Strategy to achieve sustainable development, reforms on state-owned enterprises, special financial institutions, taxes, and the pension system), the downside risk to the outlook remains, especially if the authorities delay some of the economic and structural reforms following another round of political instability and further deferment in the road to democracy. In addition, weaker-than-expected global growth, together with China's slower-than-expected economy, will continue to be a major obstacle for the country going forward. Therefore, there is a strong need for the economy to enhance its competitiveness via deeper trade integration with neighbouring economies to further reinvigorate exports.

Chart 7: Thailand's real GDP growth



Source: CEIC, MARC Economic Research

Chart 8: World Economic Forum's Global Competitiveness Index



Source: WEF, MARC Economic Research

Ongoing political uncertainty undermines institutional setting

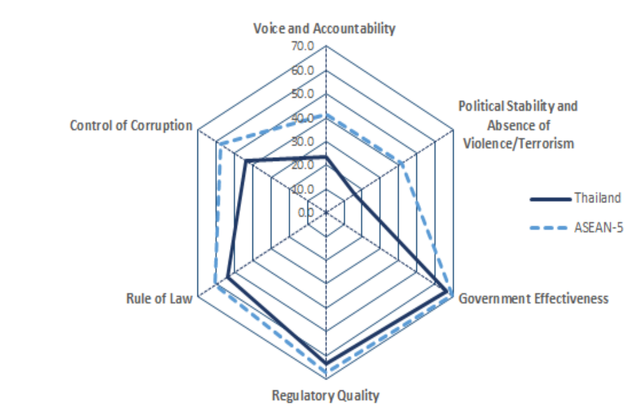
While Thailand's current political environment has remained relatively stable, the overall situation is still somewhat uncertain. Thailand's population is deeply polarised between the royalist urban elite, commonly known as the "yellow shirts", and the mainly rural poor, known as the "red shirts". There have been a dozen military coups and bouts of political violence over the past eight decades, with the latest two occurring in just over the last ten years. The country has been under military rule since a 2014 coup which successfully restored order and ended months of political tension that led to the ouster of former Prime Minister Yingluck Shinawatra. Even now, overall social order remains fragile as past economic development has failed to bridge the income gap between the rural and urban areas.

With the passing of the highly revered King Bhumibol Adulyadej in mid-October 2016, Thailand's political uncertainties will likely prevail in the foreseeable future. This is in spite of the recent approval of the military-backed constitution through a public referendum in August 2016, which marked the country's 20th constitution since 1932 and the fifth in the past decade. The death of the 88-year old-monarch marked the loss of a stabilising influence in the nation's political landscape which had helped reunite the country after being shaken by 10 coups during his seven-decade reign. While the referendum has provided a clearer picture on the road to democracy, the proposed election in late 2017 may be postponed again if political tensions re-escalate. This is particularly true if political leaders feel less restraint to challenge the military rule once the lengthy mourning period ends. In contrast with the highly revered late King Bhumibol, his successor, the Crown Prince Maha Vajiralongkorn, is reported to be unpopular and may struggle to enjoy the same level of respect from both sides of the political divide. All these may take a toll on an already weak investment climate in Thailand and put a brake on the recovery that has slowly gathered pace.

The repeated episodes of political instability have dampened the nation's institutional strength. This is reflected in its ranking in the World Bank's Worldwide Governance Indicators, which has continued to trail its regional peers. Thailand did very poorly in the *Political Stability and Absence of Violence/Terrorism* spectrum, with a percentile ranking of 15.7th in 2015, as compared to ASEAN-5's average of 41.8th place and sharply lower than its peak of 63.3rd registered in 1998. In addition, Thailand's freedom of public expression and media independence have effectively been curbed, particularly during military rule. As a result, its percentile ranking in the *Voice and Accountability* sub-indicator has deteriorated from 63.5th place in 2000 to as low as 23.6th in 2015. Corruption, meanwhile, remains a pertinent issue for Thailand, with a high number of cases involving politicians and high-ranking public officials over the past few years. Not surprisingly, Transparency International placed Thailand at 76th place out of 168 countries in its 2015 Corruption Perception Index, with public officials and civil servants, political parties, and police among the institutions perceived by the public to be most affected by corruption.

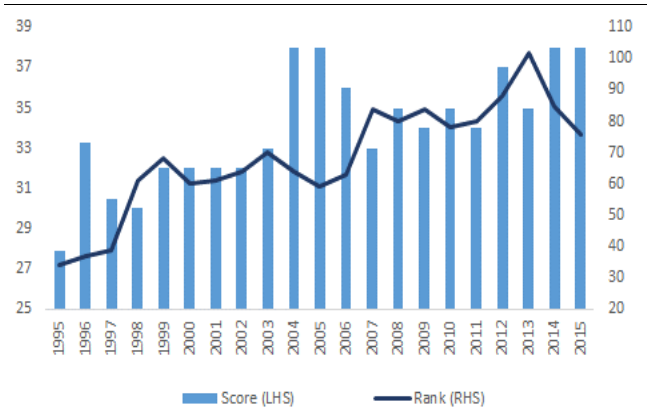
Going forward, while MARC is of the view that Thailand's political landscape will remain relatively stable in the near term, there is deep uncertainty over the future direction of the political landscape, and consequently of the economy. Crown Prince Maha Vajiralongkorn has requested a delay in taking the throne, although the military-led Prime Minister Prayuth Chan-Ocha has ensured that the general election that is slated for late 2017 would not be deferred following the king's death. Notwithstanding this, while we foresee the overall situation to remain calm in the near future, risks remain tilted to the downside. Meanwhile, we foresee no material change in Thailand's ranking in major global indices in the near to medium term, unless there are significant structural reforms in the economy.

Chart 9: Worldwide Governance Indicators 2016



Source: World Bank, MARC Economic Research

Chart 10: Transparency International Corruption Perception Index



Source: Transparency International, MARC Economic Research
Note: Scores prior to 2012 were adjusted to reflect the recent change in methodology

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