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Country Risk Monitor

THAILAND

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In a nutshell

- Thailand has benefitted from sturdy external finances that have underpinned the country's macroeconomic fundamentals. The surplus in its current account (CA) of the balance of payments is large by regional standards, reaching as high as 11.7% of gross domestic product (GDP) in 2016 (2015: 8.1% of GDP). Thailand's low external debt has also solidified the country's external finances. As of end-2016, total external borrowings stood at 32.5% of GDP, sharply below its peak of 72.9% of GDP in 1999. Most importantly, its foreign exchange reserves remained ample, with the ratio to short-term external debt rising further to 3.3 times as at end-2016 (end-2015: 3.0 times). This has kept the economy resilient in the face of heightened external headwinds and volatile global capital flows.

- Thailand's sound fiscal management, along with a relatively modest public debt level also support the country's macroeconomic fundamentals. In spite of the moderately expansionary fiscal stance it has adopted, the latest fiscal year ended September 2016 (FY2016) saw the surplus in the general government balance increase by 0.4 percentage point to 0.5% of GDP. Thailand's public debt, meanwhile, has been broadly stable, declining to 41.2% of GDP in 2016, well below its debt ceiling of 60% of GDP. It should be noted, though, that while MARC feels Thailand has considerable fiscal space to kick-start the economy, it should be utilised wisely by prioritising long-delayed structural reforms and public infrastructure investments.

- The country's array of structural challenges, however, weigh on the country's economic potential. Its economic growth, in particular, trails its regional peers and has hardly recovered to its pre-Global Financial Crisis (GFC) level. As a result, Thailand is somewhat stuck in the so-called middle-income trap, with an ageing demographic profile further complicating the issue. The working-age population growth has been subdued, averaging at a mere 0.5% pace in the seven years through to 2016, while the decline in child-age population (aged 0-14 years) is constraining future labour supply growth. Moreover, eroding economic competitiveness also reflects Thailand's ongoing structural challenges. Not surprisingly, its ranking in the World Economic Forum's Global Competitiveness Index has been deteriorating, from as high as 28th between 2006 and 2008, to 34th in 2016-17. While the government has laid out its short- to long-term plan to restructure the economy, the overall progress is still subject to execution risk.

- Thailand's political environment, while having remained relatively stable under military rule, is still subject to a certain degree of uncertainty, undermining the nation's institutional setting and dampening investment sentiment. The population, comprising the royalist urban elite and the mainly rural poor, remains deeply polarised. Over the past eight decades, Thailand has endured dozens of military coups and bouts of political contestation, with the latest two occurring in the last ten years. Royal endorsement of the new constitution in April 2017 has somewhat paved the way for the country to return to civilian rule. Nevertheless, further delays in the road to democracy, if they materialise, will undermine an already weak investment climate and put a brake on the authorities' ambition to reform the economy. Not surprisingly, Thailand scored relatively poorly in both the World Bank's Worldwide Governance Indicators and Transparency International's Corruption Perception Index relative to its regional peers.

Table 1: Selected economic indicators

	2011	2012	2013	2014	2015	2016
Real GDP growth (% y-o-y)	0.8	7.2	2.7	0.9	2.9	3.2
Inflation rate (% y-o-y)	3.8	3.0	2.2	1.9	-0.9	0.2
Unemployment rate (%)	0.7	0.7	0.7	0.8	0.9	1.0
Current account balance (% GDP)	2.6	-0.4	-1.0	3.8	8.1	11.7
External debt (% GDP)	31.5	35.4	35.8	34.8	32.3	32.5
Foreign exchange reserves (USD billion)	175.1	181.6	167.2	157.1	156.5	171.9
General government balance (% GDP)*	0.0	-0.9	0.5	-0.8	0.1	0.5
- of which: central government (% GDP)*	-0.5	-1.3	-0.7	-2.0	-1.3	-0.8
Public debt (% GDP)	38.0	40.1	42.2	42.6	43.9	41.2
- of which: central government (% GDP)	27.3	28.5	29.6	30.0	32.3	31.0

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

Key Strengths

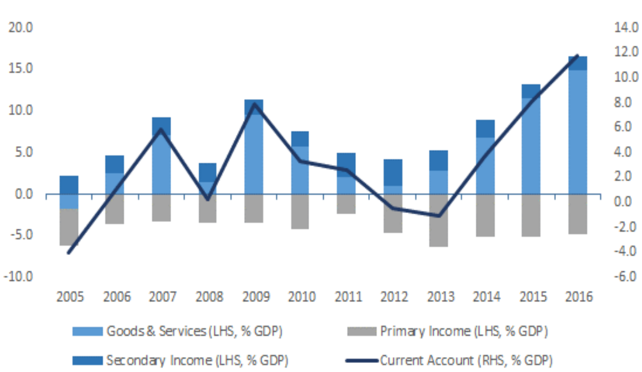
Relatively sturdy external finances

Thailand has benefitted from sturdy external finances that have underpinned the country's macroeconomic fundamentals. Its CA surpluses, while having remained volatile, are large by regional standards. Further complementing its solid external buffers are low external borrowings and ample foreign exchange reserves. These have kept the economy resilient in the face of heightened external headwinds and volatile global capital flows.

After two consecutive years of cyclical deficits in 2012-2013 (average: -0.7% of GDP), the CA surplus started to widen, reaching as high as 11.7% of GDP in 2016. This represented an increase of a whopping 3.7 percentage points from a year earlier, led by the recovery in the exports sector, alongside continued import compression amid a low oil price environment. Total gross goods exports, grew 4.5% during the year, following a 1.2% contraction in 2015. In addition, a robust tourism sector contributed positively to the build-up in CA surplus in recent years. As such, the goods and services balance rose to a new high of THB2.1 trillion in 2016, an increase of 35.5% from a year earlier.

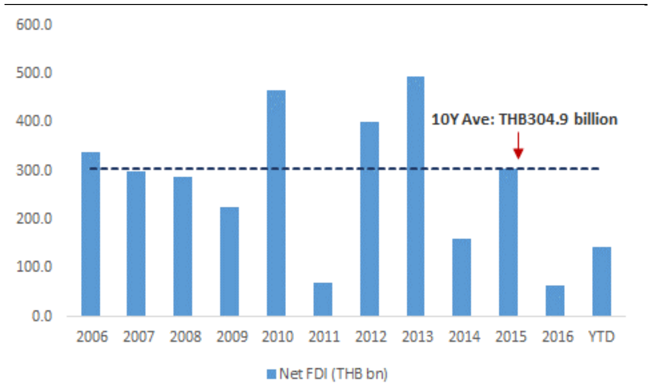
The deficit in the capital and financial account (CFA), on the other hand, widened to 6.5% of GDP in 2016, up by 2.1 percentage points from the preceding year. Unlike the rest of the region, Thailand's net portfolio outflows appeared to have stabilised despite episodes of volatile global capital flows. From a high of THB569.3 billion in 2015, net outflows of portfolio capital slowed to THB101.2 billion, the least since the country experienced the last net portfolio inflows in 2012. One notable point is that net direct investment registered massive amounts of outflows, totalling THB442.1 billion in 2016, compared to inflows of THB131.0 billion in the preceding year. This can be attributed chiefly to the outward direct investment by local entities following the liberalisation of financial accounts by the authorities. In addition, foreign direct investments (FDI) have been largely subdued amid continued political uncertainty, with net FDI inflow standing at a record low of THB63.0 billion in 2016, sharply down from its 10-year average of THB304.9 billion. Meanwhile, continued outflows of other investments also contributed to the widening of the CFA deficits, doubling to THB399.1 billion in 2016 from THB189.6 billion in 2015.

Chart 1: Current account balance as % GDP



Source: CEIC, MARC Economic Research

Chart 2: Net FDI



Source: CEIC, MARC Economic Research

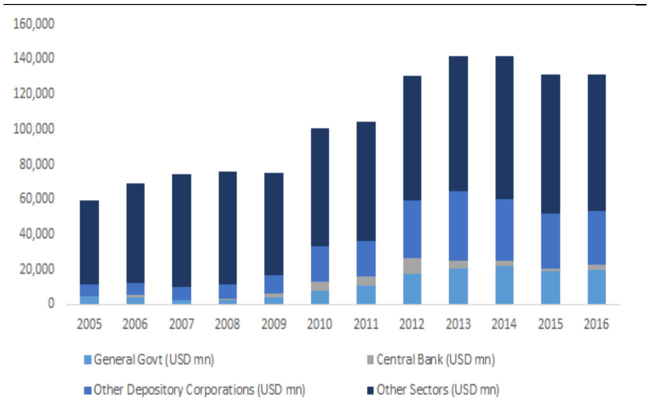
Thailand's low external debt relative to that of its regional peers solidified the country's external finances. As of end-2016, total external borrowings stood at 32.5% of GDP, sharply below its peak of 72.9% of GDP in 1999. While it was a tad higher than the preceding year's 32.3% of GDP, in value terms, total external debt has actually declined for a third consecutive year, albeit at a lesser pace of 0.1% in 2016 (2015: -7.3%). Much of the decline was due to the drop in longer tenure borrowings by 0.4% during the year (2015: -7.0%), while short-term debt rebounded slightly to grow 0.5% after contracting in the preceding two-year period (2015: -7.6%). Notwithstanding this, the maturity profile of the borrowings remained fairly manageable, with the short-term portion hovering around 40% of total external debt over the past three years.

On a different perspective, however, the high level of CA surplus in recent years reflects tepid private domestic demand due largely to unfavourable political conditions. Private investment growth, while having picked up slightly to 0.4% in 2016 after three consecutive years of contractions, remained well below its long-term trend of 8.4% and its average growth of 12.7% between 2010-2012. Meanwhile, an inadequate social safety net and a rapidly ageing population have also induced higher precautionary savings that led to the build-up in CA surpluses.

MARC anticipates Thailand's CA balance to moderate over the near to medium term, taking its cue from the recovery in domestic demand and the execution of long-delayed public infrastructure projects as well as the stability in global commodity prices. Indeed, the continued expansion in gross goods exports of 6.0% in 1H2017 (1H2016: 7.1%) has been offset by a 12.9% jump in inbound shipments (1H2016: -2.4%), largely in response to the slight pickup in commodity prices and a recovery in domestic demand. The CA balance, as a result, eased slightly but has remained large at 10.9% of GDP in 1H2017 (1H2016: 13.2% of GDP).

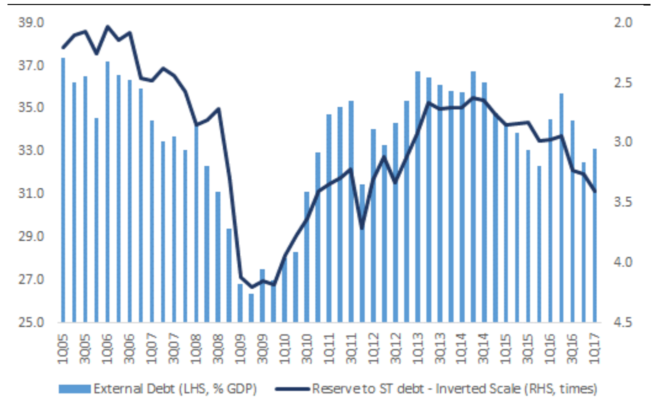
MARC is of the view that Thailand's external debt will remain relatively low compared to that of its peers over the foreseeable future, hence keeping the risk of a liquidity crisis minimal. It is worth noting that two decades on, Thailand has learnt its lesson from relying heavily on foreign borrowings that led to the collapse of its economy during the Asian Financial Crisis. Evidently, its foreign exchange reserves have remained ample, with the ratio to short-term external debt rising further to 3.3 times as at end-2016 (2015: 3.0 times), comfortably above the global benchmark of 1.0 time. Meanwhile, its flexible exchange rate regime also complements its strong external position and enhances its resiliency against exogenous shocks.

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

Sound fiscal management and modest debt level

Thailand's sound fiscal management with a relatively modest public debt level support the country's macroeconomic fundamentals. In spite of a series of political instability, the government continued to maintain its consolidated fiscal position at a respectable level relative to its ASEAN peers. Over the past five years, the consolidated general government fiscal balance stood at an average of -0.1% of GDP compared to that of its regional peers of -2.0% of GDP. From a technical perspective, Thailand has considerable fiscal space as opposed to its peers, enabling it to reignite the economy over the near to medium term.

Indeed, the latest fiscal year ended September 2016 (FY2016) saw surpluses in the general government balance increase by 0.4 percentage points to 0.5% of GDP. This was in spite of the moderately expansionary fiscal stance it adopted as evidenced by a significant 7.6% jump in total outlays during the year, the most since FY2013 (FY2015: -0.1%). That said, the widening in fiscal surplus can be attributed chiefly to lower spending on investment of non-financial assets, dropping 33.0% from a year earlier. Total revenue, on the other hand, increased by a mere 2.6% (FY2015: 8.0%) due to generally lower economic activities and some tax breaks to stimulate domestic consumption. Accordingly, tax revenue, which accounted for nearly 80% of total revenue, rose by only 1.5% in FY2016, compared to the 6.7% increase in the preceding year.

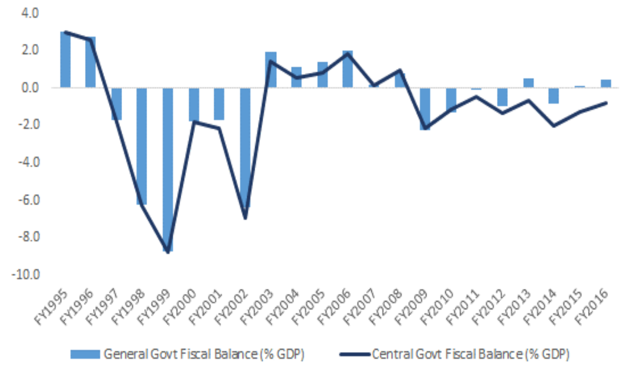
A similar performance was observed at the central government level, with total expenditure growth accelerating to 6.7% (FY2015: 1.0%) while revenue expansion was much slower at 2.3% (FY2015: 8.7%). Nevertheless, the overall balance continued to rise, thanks to a drop in expenditure meant for the investment of non-financial assets. As a result, the central government fiscal deficit improved to a low of 0.8% of GDP, down from its recent high of 2.0% of GDP in FY2014 (FY2015: -1.3% of GDP). From a regional perspective, it is worth noting that Thailand's general government revenue fared better than that of its peers, averaging at 21.9% of GDP over the past five fiscal years, vis-à-vis the ASEAN-5's average of 19.2% of GDP.

Thailand has demonstrated a good grip on debt management as evidenced by its modest public debt level. After peaking at 49.0% of GDP in mid-2005, total public debt has been broadly stable, hovering at less than 45.0% of GDP since then. As of end-2016, total public debt declined to 41.2% of GDP (2015: 43.9% of GDP), well below its debt ceiling of 60.0% of GDP as stipulated in the Fiscal Sustainability Framework. Of the total public debt, central government comprised 75.3% of the total or equivalent to 31.0% of GDP, most of which were long-term in maturity. Most importantly, 97.8% of total central government debt were sourced domestically, safeguarding it from foreign currency risks. The remainder of public debt were borrowings from non-financial state enterprises and special financial institutions, of which 60% of these were directly guaranteed by the central government. That said, total government-guaranteed debt remained at a manageable level of 6.2% of GDP in 2016, 0.8 percentage points lower than a year earlier.

Over the near to medium term, MARC foresees Thailand's overall fiscal metrics will weaken slightly, taking into account the authorities' strong commitment to restructure the economy. While we think that Thailand has considerable fiscal space to kick-start the economy, prioritising long-delayed structural reforms and public infrastructure investments would be the government's key task. This in turn will help crowd in private investment and boost domestic demand, which will be vital for future potential growth. Over the longer term, however, the government will be challenged by rising fiscal burden amid a rapidly ageing population. In this regard, the enactment of the Fiscal Responsibility Law is expected to help improve governance and enhance the management of public resources going forward.

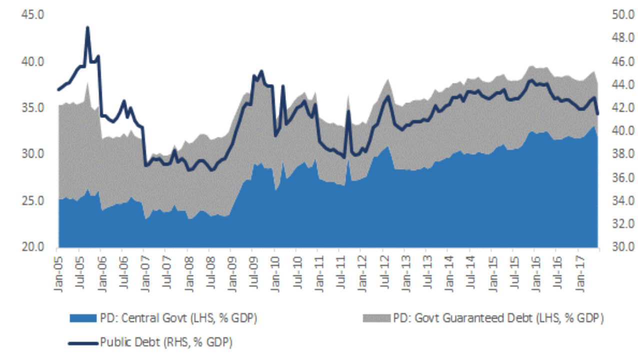
MARC expects Thailand's public debt to trend upward over the foreseeable future, as about two-thirds of its mega-infrastructure projects will be funded by public entities. Notwithstanding this, we believe the authorities will maintain prudent debt management such that the overall debt level remains broadly lower than that of its regional peers and well below the debt ceiling. Moreover, Thailand's debt affordability will remain favourable, underpinned by low interest payments and steady revenue flows. Notably, total debt service ratio has been broadly below the 15% of expenditure limit capped by Thailand's public finance framework (2016: 6.4%, 2015: 6.2%), and has in fact fallen below 10% since 2012.

Chart 5: General and central government fiscal balance



Source: MoF, MARC Economic Research

Chart 6: Total public debt, central government debt and government-guaranteed debt as % GDP



Source: CEIC, MARC Economic Research

Major Challenges

Structural challenges weigh on economic potential

Thailand's array of structural challenges has weighed on the country's economic potential. The economy, while continuing to chalk up positive growth, has trailed that of its regional peers and has hardly recovered to its pre-GFC level. It grew at an average 3.6% over the past seven years, down from a 5.1% pace recorded in the seven-year period prior to the GFC. Against regional economies, Thailand's economic growth lagged its peers by a whopping 1.7 percentage points in the seven years through to 2016, compared to only 0.5 percentage point prior to the GFC. Other than unfavourable external conditions, severe weather conditions, bouts of political unrest and delays in long-needed structural reforms also contributed to the declining growth trend. Not surprisingly, the International Monetary Fund (IMF) estimates that Thailand's potential growth has declined from over 4.0% in the early millennium to about 3.0% recently, attributed to the decline in labour contribution related to an ageing demographic and stagnant capital formation.

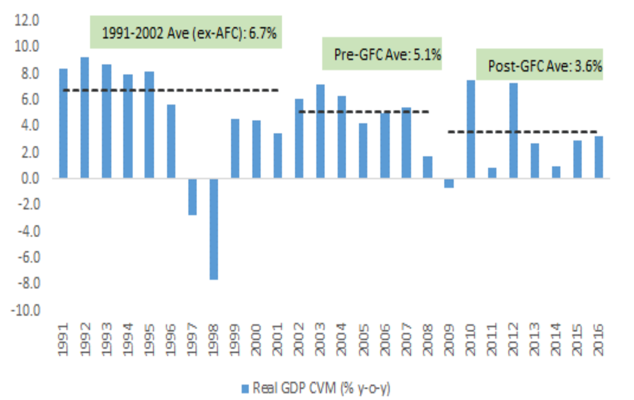
As an upper-middle income nation, Thailand is somewhat stuck in the so-called middle-income trap. Per capita income growth, as measured by GDP per capita on a purchasing power parity (PPP) basis, grew by an average of 4.8% since 2010, sharply lower than the 6.9% pace recorded prior to the GFC, and well below the ASEAN-5's average of 5.5%. Moreover, the rapidly ageing demographic profile complicates the country's task to escape the middle-income trap. In particular, the working-age population growth has been subdued, averaging at a mere 0.5% pace in the seven years through to 2016, compared to an average 1.5% in the late 1990s. Also worth mentioning is the population of children (aged 0-14 years), which has been declining in 20 of the past 21 years (post-GFC: -1.4%, pre-GFC: -1.0%), further constraining future labour supply growth. Not surprisingly, the old-age dependency ratio doubled in just two decades, from 7.2% in mid-1990s to 14.4% in 2016.

Eroding economic competitiveness also reflects the country's ongoing structural challenges. The relatively strong local currency vis-à-vis its regional peers continued to undermine export-oriented industries. Meanwhile, the fast emergence of neighbouring low-cost manufacturing rivals, combined with a lack of domestic high-skilled labour have caused the economy to remain in doldrums. Accordingly, its ranking in the World Economic Forum's Global Competitiveness Index has been deteriorating, from as high as 28th place between 2006 and 2008 to 39th in 2011-12, before recovering slightly to 34th in 2016-17. Weak governance, insufficient capacity to innovate, an inadequately educated workforce and infrastructure bottlenecks were among the most problematic factors for doing business in the country. Similarly, while Thailand's World Bank Ease of Doing Business ranking was unchanged at 46th out of 190 economies, its overall Distance to Frontier Score (DTF) shrank from a peak of 75.99 in 2014 to 72.53 in 2017.

As an open economy, the pace of monetary policy normalisation by advanced economies, weaker-than-expected growth of its major trading partners, and rising trade protectionism by the United States (US) remain the country's short-term external downside risks. In this regard, there is a strong need for the economy to enhance its competitiveness via deeper economic integration with neighbouring economies to further reinvigorate exports and investment. It is also vital for the country to upskill its labour force and promote a higher level of research and development to counter its demographic challenges and transform itself to become an innovation-driven economy as envisaged in the Thailand 4.0 strategy.

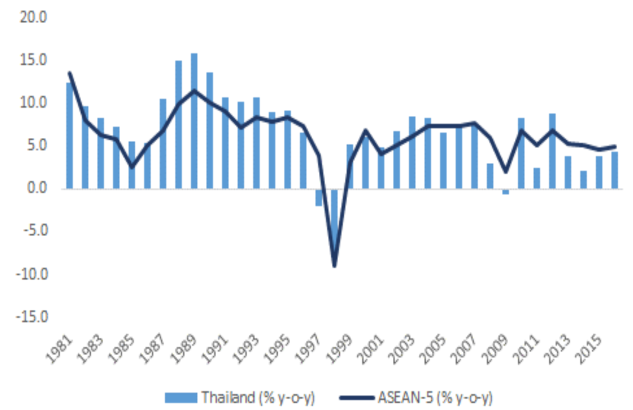
While the government has laid out its 20-year National Strategy and Thailand 4.0 Economic Policy to overcome its structural challenges, the overall progress is still subject to execution risk. This is specifically true if political tensions re-escalate, which would cause further delays in its long-needed structural reforms as evidenced in the past. Notwithstanding these challenges, MARC expects Thailand's economy to continue to recover at a moderate pace, backed by speedier implementation of public infrastructure projects, further progress in structural reforms and a stronger global economic recovery. Positively, the economy continued its upward momentum, growing 3.7% in 2Q2017, the strongest since 1Q2013, and bringing its half-year growth rate to 3.5% (2016: 3.2%).

Chart 7: Thailand's real GDP growth



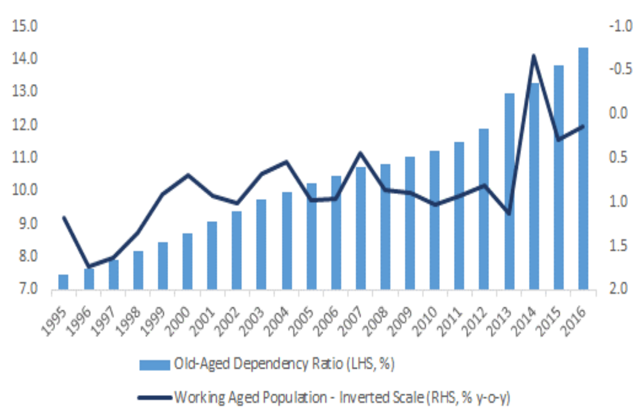
Source: CEIC, MARC Economic Research

Chart 8: Thailand's income per capita growth versus the ASEAN-5, on a PPP basis



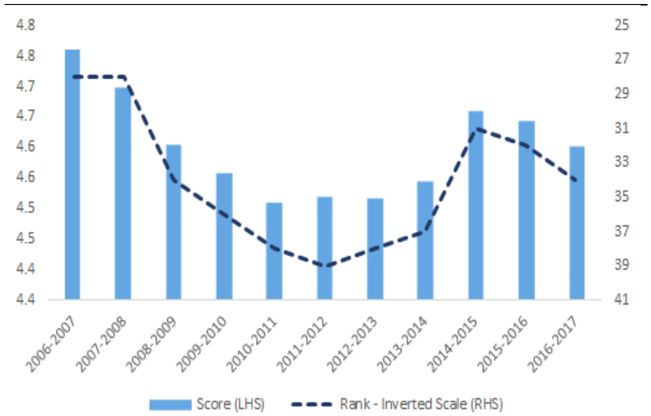
Source: IMF, MARC Economic Research

Chart 9: Working-age population growth and old-age dependency ratio



Source: CEIC, MARC Economic Research

Chart 10: World Economic Forum's Global Competitiveness Index



Source: WEF, MARC Economic Research

Prolonged political uncertainty undermines institutional framework

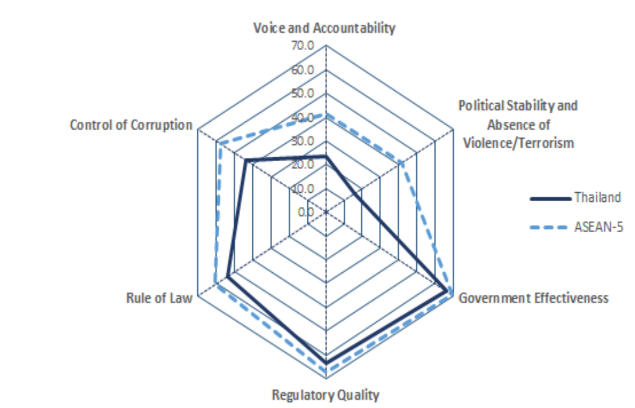
Thailand's political environment, while having remained relatively stable under military rule, is still subject to a certain degree of uncertainty. In particular, the population, comprising the royalist urban elite and the mainly rural poor, remains deeply polarised. This reflects fragile social order as past economic developments failed to bridge the income gap between the rural and urban areas. Over the past eight decades, Thailand has endured dozens of military coups and bouts of political contestation, with the latest two occurring in the last ten years.

Nevertheless, royal endorsement of the new constitution in April 2017 has somewhat paved the way for the country to return to civilian rule. This was in spite of a further deferment of its general election which is now slated for mid- or late-2018, rather than this year as previously envisaged, partly attributed to the one-year official mourning period for the late king as well as the need to ensure a smooth transition for his successor Maha Vajiralongkorn. To recap, this marked the third deferment by the junta government – first in 2016 and then again in 2017 – and in terms of timeline remains inconclusive.

It is worth mentioning that Thailand's prolonged political uncertainty has taken a toll on the nation's institutional setting and dampened investment sentiment. FDI inflows and private investment growth, for instance, have been largely subdued, as investors remained wary about the political prospects. Meanwhile, its poor ranking in the World Bank's Worldwide Governance Indicators (WGI) vis-à-vis its regional peers reflects its longstanding institutional weakness. Across all spectrums of the WGI, Thailand lagged its ASEAN-5 peers most in the *Political Stability and Absence of Violence/Terrorism* sub-indicator, with its percentile ranking consistently below 20th over the past decade versus the ASEAN-5's average of 37.7th place. In addition, media freedom and public expression have effectively been curbed, particularly through greater usage of lese-majeste laws since the junta took power. As a result, its percentile ranking in the *Voice and Accountability* sub-indicator deteriorated from 63.5th place in 2000 to as low as 23.6th in 2015. Similarly, corruption remains a veritable concern for the country, with its ranking in the latest Transparency International's Corruption Perception Index falling drastically by 25 positions to 101st place out of 176 countries in 2016. The agency cited that government repression, lack of independent oversight, and the deterioration of rights have been the main factors that eroded public confidence in the country.

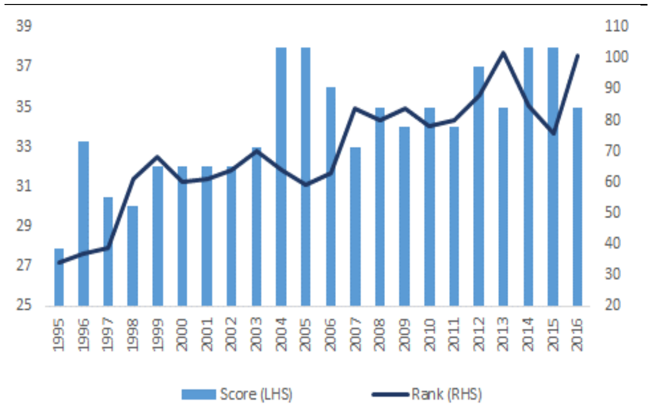
On the whole, MARC feels that Thailand's political landscape would be subject to some degree of uncertainty. In spite of the general promise made by the current military government to hold a general election in 2018, further delays in the road to democracy, if they materialise, will undermine an already weak investment climate and put a brake on the authorities' ambition to reform the economy. As such, 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 11: Worldwide Governance Indicators 2016



Source: World Bank, MARC Economic Research

Chart 12: Transparency International's 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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