

THAILAND

Real GDP in Thailand is projected to grow at 5.0 percent in 2008, up from 4.8 percent growth in 2007 – making it the only larger economy in East Asia where growth is expected to accelerate this year. The key reason is the economic bounce expected from a return to democracy and the election of a new government late in 2007. Last year's better-than-expected growth was due to buoyant export performance throughout the year even as domestic consumption and investment declined amidst the uncertain political environment and sudden shifts in policy. But this year, the opposite is likely. The new government announced a set of economic policies and measures – including higher levels of public investment – which are expected to boost domestic demand by reviving confidence and stimulating private investment and consumption. The balance of trade, on the other hand, is likely to contribute less to real GDP growth than last year, in part because rising aggregate demand will boost import growth while exports will be constrained by an appreciating Thai baht and the slowdown in major export markets. Inflation, although rising, is projected to remain within the target range set by the Bank of Thailand, so interest rates are expected to remain low and supportive of private investment. Most of the risks to this forecast are on the downside, but these should be muted (barring some unforeseen event) as the government has the fiscal and macroeconomic space to respond to negative external shocks.

Private investment should recover after its slump last year. Private investment growth in 2007 was a mere 0.5 percent (in real terms), the lowest since 2000. Foreign direct investment fell to US\$21 billion, well below its post-crisis peak of US\$32 billion. Capacity utilization reached 75 percent in 2007, the highest since the crisis, and in many industries, it exceeded 80 percent. Several policy changes took their toll on investor confidence, including the introduction of unremunerated reserve requirements on capital inflows and the proposed amendments to the Foreign Business Act that would increase restrictions on foreign investments. The new government announced measures to boost public and private investment. Growth in public investment is expected to more than double this year, as implementation is expected to resume on public mega-infrastructure investment projects such as the mass transit lines in Bangkok and the dual track rail system. To boost private investment, the new government removed the 30 percent unremunerated reserve requirement for capital inflows and has introduced tax cuts for firms listed in the stock exchange and on property transactions. Several large firms announced plans to increase investment in plant and equipment that had been put on hold last year. Real private investment growth is expected to increase to 10 percent this year.

The external current account may weaken slightly in 2008, as the global downturn slows exports and robust domestic demand stimulates imports. Growth in exports of goods and services is expected to slow from around 18 percent to 13 percent (in US dollars) due to sluggish demand in Thailand's key export markets, although intra-regional trade will mitigate some of the slowdown. The appreciation of the baht could also play a role.¹ Growth in exports of services, especially tourism, is also expected to slow as high fuel prices and sluggish income growth in industrial countries dampens international travel globally. Imports on the other

¹ Thailand's key exports (such as integrated circuits and computers) have high import content, and so the exchange rate appreciation is likely to be of limited consequence. Those exports with low or no import content for which the appreciation would matter more (such as canned fruits and furniture) represent only a small share in total exports.

hand are expected to rise as higher investment and consumption increases demand for imported consumer, intermediate, and capital goods.

Inflation is on the rise, driven by fuel and food prices. Headline inflation was only 2.6 percent in 2007 compared to 4.7 percent in 2006. But inflation began to rise in the fourth quarter of 2007, reaching 4.3 and 5.6 percent in January and February 2008 respectively despite an appreciating Thai baht and price controls on more than 200 products. Higher prices for meat, vegetables, fruit and fuel were the key contributors.

The rise in agricultural prices has meant higher incomes for the rural population and has somewhat helped the rural poor. Around forty percent of the population and of the poor are engaged in agriculture. The rise in agricultural prices since 2004 has raised farm incomes by more than 15 percent annually. Farm incomes are estimated to have climbed by another 22 percent in January this year. From 2004 to 2006, Thailand's poverty headcount fell by almost 2 percentage points (over 1 million people) with most of the reduction occurring in rural areas. This trend is expected to have continued in 2007 and early 2008. But there is evidence that the urban poor, as well as the rural poor engaged in fishing and other non-farm activities have been adversely affected.

Should conditions for the poor worsen – perhaps because of a deteriorating international economic environment, a disappointing private investment response, or further increases in the relative price of food and energy – Thailand has adequate fiscal and macroeconomic space to stimulate the economy. Foreign reserves have climbed to over \$90 billion, some four times short term external debt, and public debt currently stands a relatively comfortable 37.5 percent of GDP. The Government has signaled its intention to use some of this space by announcing two stimulus packages – one lowering taxes and the other increasing pro-poor expenditures – totaling 0.6 percent of GDP. This would raise the projected 2008 budget deficit from 1.8 percent of GDP to around 2 percent.² Finally, while there is some room for monetary easing, the recent rise in inflation warrants some caution going forward.

² The tax package includes a higher deductible for personal income taxes, a reduction in corporate income tax rates, increased tax deduction on machines and equipment for investment purpose, and reduced property sales transaction fees. The expenditure package includes a direct transfer to grassroots communities of roughly Bt20 billion this year.