

3. MACROECONOMIC ENVIRONMENT AND ACCESS TO FINANCE

67. The first section of this chapter examines the macroeconomic environment. Section two then examines issues related to the cost of, and access to, finance for enterprises.

THE MACROECONOMIC ENVIRONMENT

68. In PICS 2004, the managers of one third of all enterprises surveyed mentioned macroeconomic instability and economic policy uncertainty as major or severe obstacles to doing business in Thailand. In the PICS 2007, this number almost doubled to reach close to two-thirds of enterprises. This serious worsening of perceptions is probably due to changes in global economic environment and an effect of the political instability which Thailand experienced in 2006 and 2007. More than a third of firms perceived it as one of the three top constraints to their business and investment decisions. To determine whether the perceptions of managers are justified by the objective economic situation or are simply the result of pessimistic business sentiments, this section examines key aspects of the macroeconomic environment in Thailand.

69. Both external and domestic factors have adversely affected the macroeconomic environment in 2006 and 2007. These include (i) the rapid increase in the price of oil and other commodities since 2005,³⁸ (ii) the rapid appreciation of the Thai baht since 2006 as the US dollar weakened and Thailand's current account surplus increased,³⁹ (iii) the increase in interest rates,⁴⁰ (iv) a rise in inflation growth since 2006, (v) the slowdown in the world economy and, especially, in the United States which is Thailand's major export destination, and (vi) the significant slowdown in the growth of domestic household consumption since 2005 (to only 1.4 percent in 2007, the lowest growth since 1999). Insufficient demand is the top constraint to capacity utilization - 70 percent of firms perceived it as a constraint in PICS 2007, increased from 40 percent in PICS 2004.

70. High oil price, Baht appreciation and high raw material price were reported by more than half of the enterprises as main factors that have adversely affected their investment decisions in the last two years (see Figure 17). More than 70 percent of

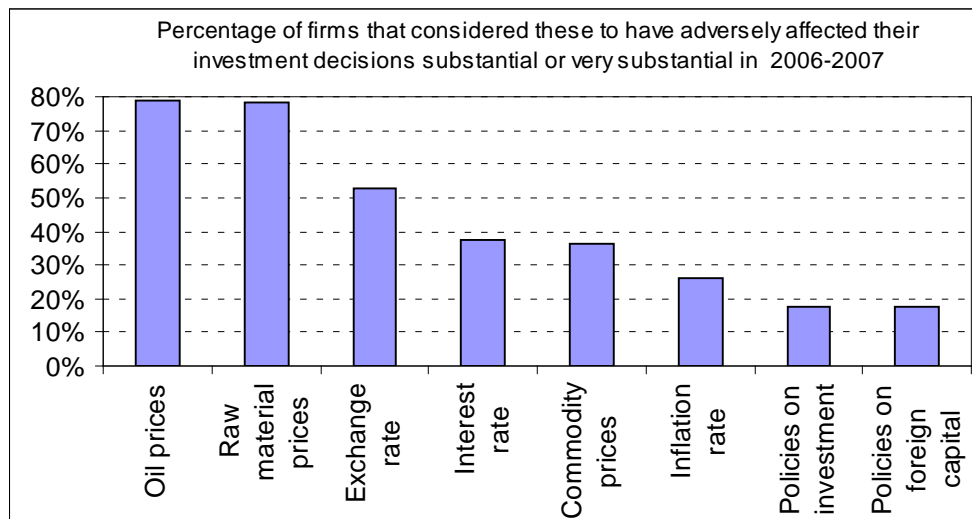
³⁸ World crude oil prices have rapidly increased since 2005. The Thai government lifted the subsidies on benzene in 2005 and on diesel in 2006, to make retail gasoline prices reflect world prices.

³⁹ The Baht's real effective exchange rate appreciated by 15.5 percent between 2005 and 2007.

⁴⁰ The minimum lending rates (MLR) rose from 5.95 percent in 2005 to 7.53 percent in 2006 and 7.21 percent in 2007. With rising inflation in the last quarter of 2007, firms had anticipated a future rise in the lending rates.

exporting firms said that the appreciating baht had adversely affected their investment decisions. Many of these are large enterprises and are in the food processing, textile, garments, and electrical appliance industries. More than a third of firms cited high interest rates and commodity prices as a major concern. The highest share of firms concerned about the rising commodity prices are in the food processing, machinery and equipment, and automotive part industries because commodities account for a large share of the inputs to their production.⁴¹ Inflation was a major concern for one-fourth of the firms, particularly those in the garments industry, electrical appliance, and rubber and plastic industries, in which at least half of the firms sell domestically.⁴² A higher inflation rate in Thailand would mean a lower purchasing power and could reduce the domestic demand for their products, especially when it is very price elastic.

Figure 17. Percentage of Firms that Considered Particular Macroeconomic and Policy Factors to Have Adversely Affected their Business and Investment Decisions



Source: PICS 2007

71. The Baht appreciated significantly against US dollar in the recent years (Figure 18). The exchange rate went from 44 Baht to a US dollar in January 2002 to 32 Baht in May 2008. The producer price index (PPI)⁴³ increased from 120 percent in January 2005 to 165 percent in May 2008 reflecting the fact that the inflation rate is partly linked to the appreciation of the Thai Baht (Figure 19).

⁴¹ Raw agriculture products are major input for the food processing industry; steel for the machinery and equipment; and rubber for the tire industry which is a large share of the automotive industry in Thailand.

⁴² Half of the firms in the garment industry sell mainly in the Thai market (they export less than 10 percent of total production) and more than 60 percent of firms in the electrical appliance and rubber and plastic industries sell mainly in the Thai market.

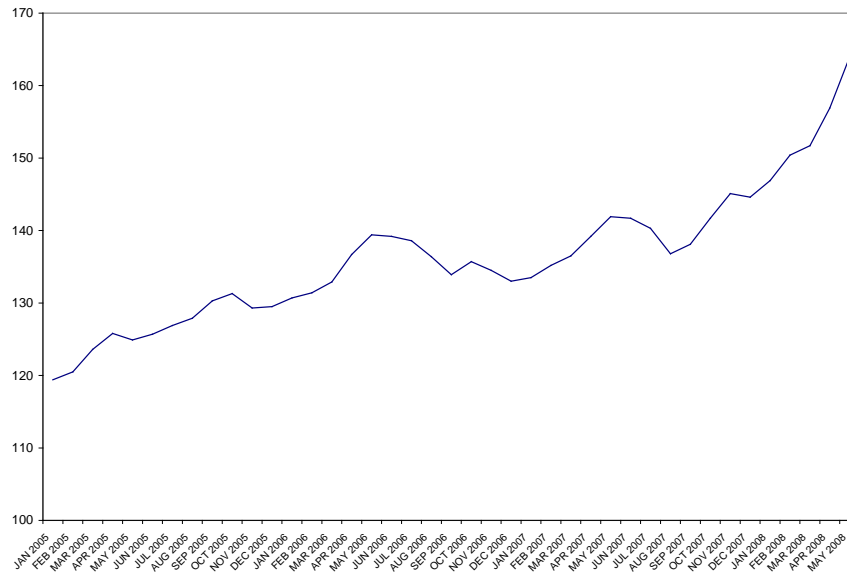
⁴³ The base year for PPI is 2000.

Figure 18. Baht/US\$ Exchange Rate: 2002-2008



Source: Bank of Thailand

Figure 19. Producer Price Index, 2005-2008



Source: Bank of Thailand

72. How did enterprises cope with this macroeconomic situation? Some 25 percent of the enterprises reported that they did not take any particular measures. The remainder, however, reported that they took some measures to cope with macroeconomic risks. Large firms and exporters—many of which are in the food processing, auto-parts, and electronic component industries—were more active in coping with changes in the

macroeconomic environment. The measures they took include finding new suppliers, securing long term contracts, using financial hedging instruments, pricing in a different currency and investing abroad and improving productivity. Small and medium-sized, many of which are in the electrical appliance, machinery and equipment, textile, and garments industries, took measures to a much lesser extent. In fact, more than one-fourth of small and medium-sized firms had not taken any measures to cope with the macroeconomic risks. We now discuss the measures undertaken by enterprises below.

73. Some 40 percent of the firms found new suppliers and/or engaged in long-term contracts. In trying to reduce their cost, one-third or more of firms of all sizes have found new suppliers who sold at a lower price or are more reliable. This is particularly true for exporting firms and for firms in the automotive parts and in the rubber and plastics industries. By doing so, this would have in part promoted suppliers who have a higher productivity and are more efficient producers. One-fourth of firms tried to lock in their input and product prices through the use of long-term contracts. Large firms have used this tool more than the smaller firms as they have a greater bargaining power with both suppliers and purchasers.

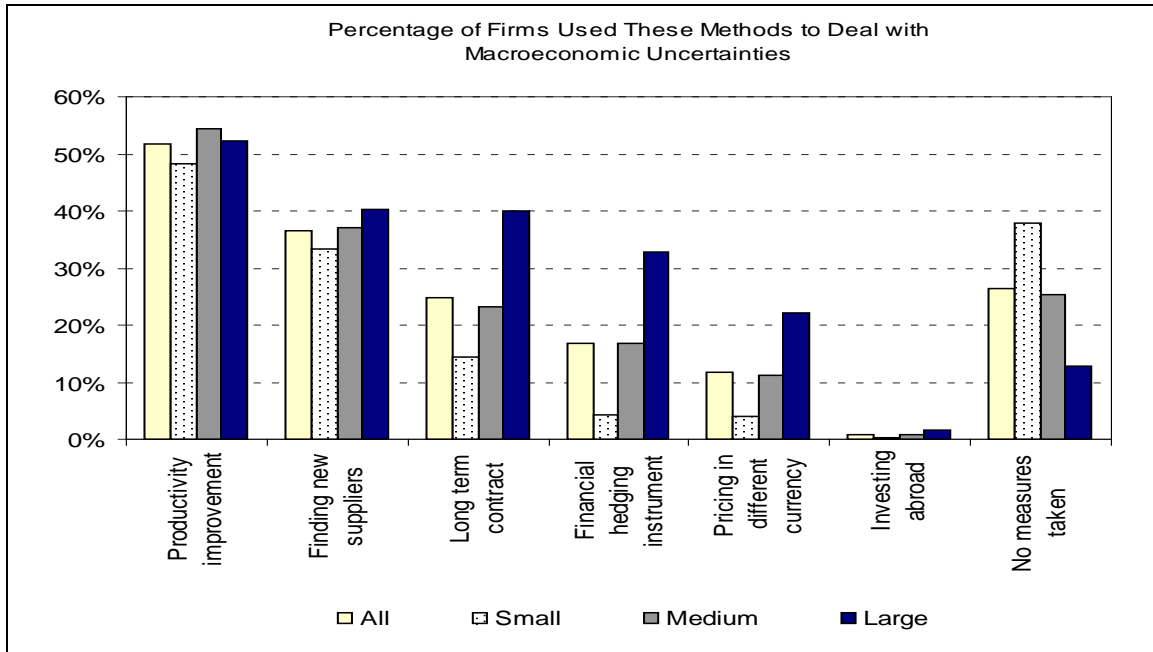
74. The use of financial instruments to hedge against fluctuations in the exchange rate and volatility in input prices was however limited. Financial hedging instruments were used by 17 percent of firms even though more than half of all firms reported that exchange rate fluctuations and volatile commodity prices adversely affected their investment decisions. Only 29 percent of exporting firms used financial hedging instrument even though more than 70 percent of them expressed concerns about exchange rate fluctuations. Financial hedging instruments were used more often by larger rather than smaller enterprises – 33, 17 and 4 percent for large, medium and small firms use hedging instruments, respectively. This may be the result of lack of knowledge of the use of hedging instruments in smaller firms or because they find them unnecessary.

75. Pricing exports in a different currency is difficult for Thai exporters. As exports are usually priced in US dollars, the appreciation of the baht against the US dollar, which has been more rapid than against other major currencies such as the Euro and the Yen, has greatly reduced the export receipts of firms. Since most Thai exporting firms are price takers, it has not been easy to increase prices or shift the pricing to a different currency. With a greater bargaining power with purchasers, a higher share of large firms was able to price their exports in a different currency as compared to smaller firms. Even so, only one fourth of large exporting firms priced their exports in a different currency as compared to one-fifth of medium and small exporting firms.

76. Investing abroad has not been an option for most Thai enterprises. Less than 1 percent of firms surveyed made investments abroad as a means of coping with the global and domestic macroeconomic uncertainties (see Figure 20). A larger share of large and exporting firms, especially those in the electronics and automotive part industries, invested abroad compared to other types of firms. But still, those that have done so represent only four percent of firms in the electronic component industry and 1.8 percent in the auto part industries.

77. One of the possible answers to the question “what measures did you take to cope with macroeconomic risks?” was “increasing productivity,” presumably through product and/or process improvements. More than half firms reported that they did.

Figure 20. Methods Reported by Firm Managers to Cope with Macroeconomic Risks (Percentage of Firms)

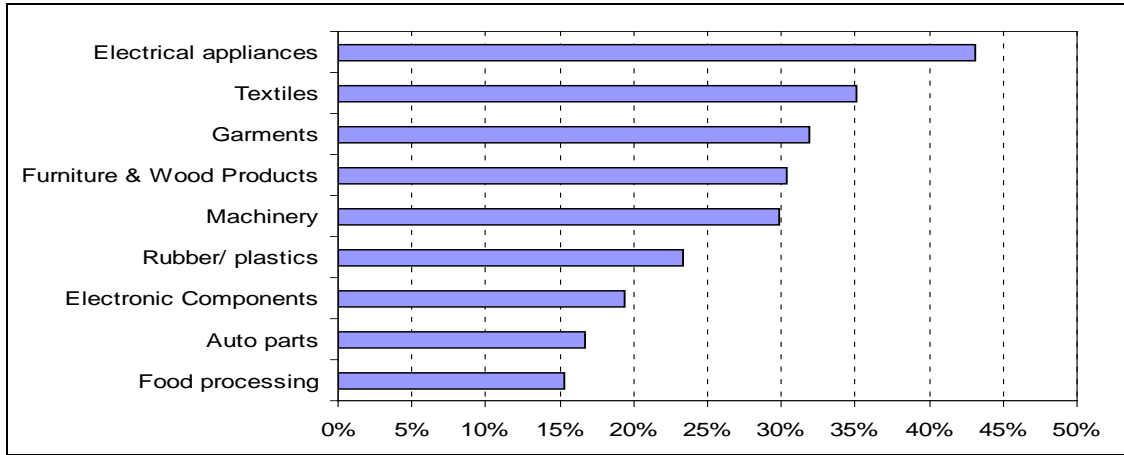


Source: PICS 2007

78. A large number of firms, particularly smaller ones, did not take any measure to cope with the macroeconomic instability. Even though 70 percent of firms expressed that these were major or severe obstacles to their business and investments, one-fourth of firms surveyed reported that they did not take any coping measure, many of which are in the electrical appliance, textile and garments industries (Figure 21).

79. In the electrical appliance industry, which is mainly made up of small, domestic firms, more than 40 percent of companies reported that they did not undertake any coping actions. This corresponds to the high proportion of firms in that industry that cited the lack the knowledge to do so. In the textile and garment industries, which were mainly made up of medium-sized firms, around one-fourth of them did not have the knowledge to undertake the measures. This was reflected in one-third of firms not undertaking any measure, while the firms undertook the measures represented only a small share of firms in the industry. In industries in which relatively few firms reported lack of knowledge about such measures, the share of firms taking actions to mitigate risks was comparatively large. These are firms in industries such as the automotive parts and the electronic component industries, which are mostly made up of large firms.

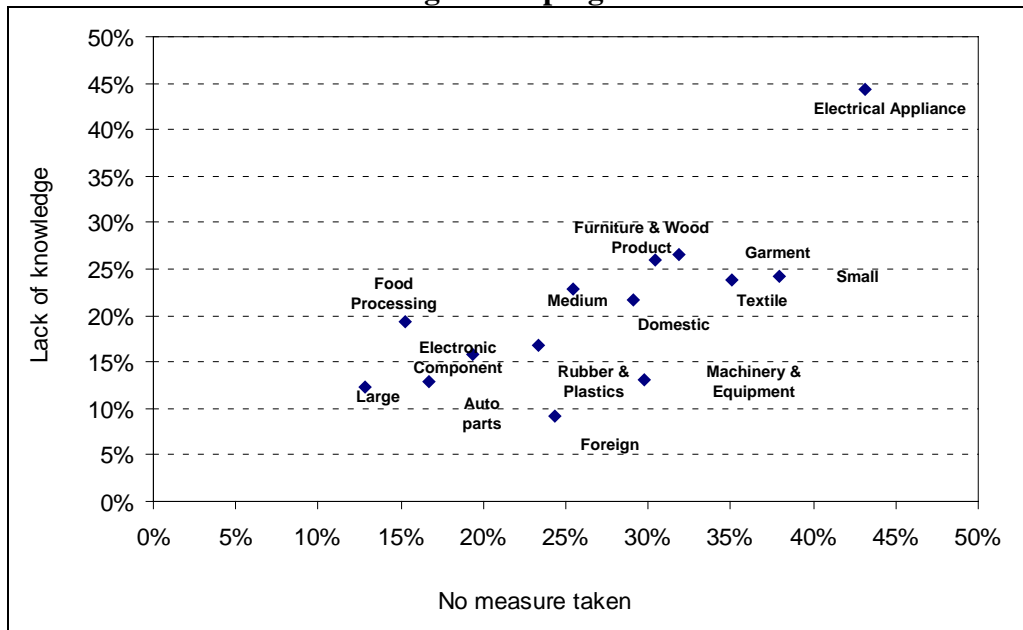
Figure 21. Percentage of Firms that Did Not Take Active Measures to Cope with Macroeconomic Risks, by Industry (Percent)



Source: PICS 2007

80. One of the main reasons for firms not actively undertaking measures to cope with the macroeconomic risks is that firms lack the knowledge to do so. One-fifth of firms did not take risk-mitigating measures because they lacked the knowledge. This was particularly true for the smaller and medium-sized firms which are mostly domestically-owned.

Figure 22. Percentage of Firms that Reported Not Taking any Measure vs. Lack of Knowledge on Coping Measures



Source: PICS 2007

81. Political instability—i.e., the parliamentary dissolution in April 2006 followed by the military coup in September—as well as economic policy uncertainty have affected business sentiments and investment decisions. The political situation led to the perception that changes in certain key policy areas, especially those relating to foreign investments, were in the offing. The proposed amendment of the Foreign Business Act and the capital inflow policies are two examples of the uncertainties of economic policy surrounding investment policies.⁴⁴ One-fifth of firms reported that the uncertainty had adversely affected their investment decisions. This is particularly the case for large firms, exporting firms, and foreign firms that are likely to have a higher share of foreign shareholders and higher reliance on foreign capital compared to smaller, non-exporting and domestic firms. These have hurt investor sentiments. Firms tend to delay their investment decisions as the macroeconomic environment was volatile and efficient coping measures are not always available. There is evidence that applications for investment promotions at the Board of Investment (BOI) have increased (Figure 23), which would seem to imply that investors are still optimistic about the future. On the other hand, the decline of business sentiment was reflected in the Bank of Thailand’s business sentiment index survey and in PICS 2007 (Figure 24). The evidence is not black and white.

Figure 23. BOI Approvals of Applications (Billion Thai Baht)

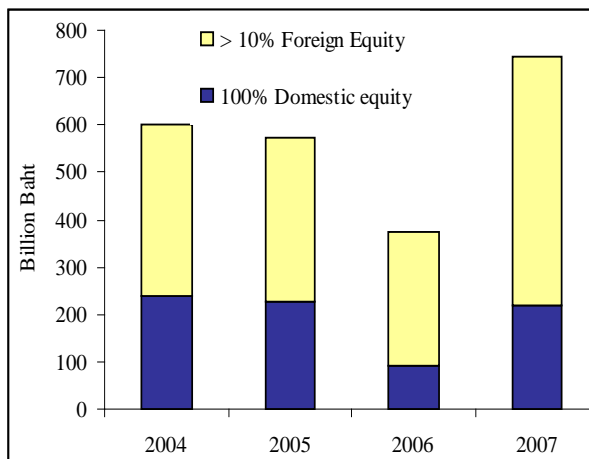
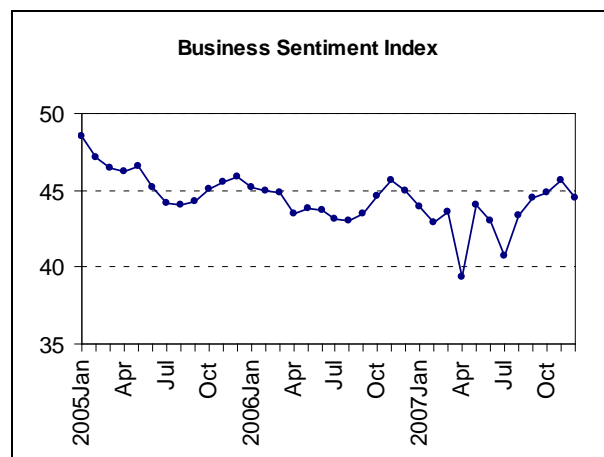


Figure 24. Change in Business Sentiment (Index)

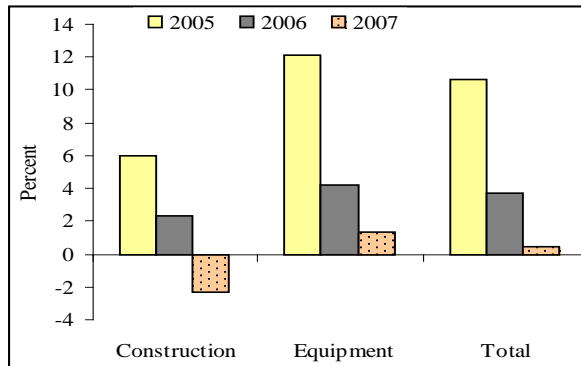


82. Manufacturing production has continued to expand at the rate of 5-6 percent while private investment growth experienced a disproportionate fall from 10.6 percent in 2005 to 0.5 percent in 2007 (see Figure 25 and Figure 26). Overall capacity utilization in the industrial sector increased. Should demand pick up in the near future, supply constraints may result from insufficient capacity. To avoid such vulnerabilities, stimulating

⁴⁴ In December 2006, a 30 percent unremunerated reserve requirement on capital inflows was announced and proposed amendments of the Foreign Business Act to increase restrictions on foreign investments were tabled in early 2007. The unremunerated reserve requirement on capital inflows was fully lifted in March 2008. The amendments of the Foreign Business Act are still not approved.

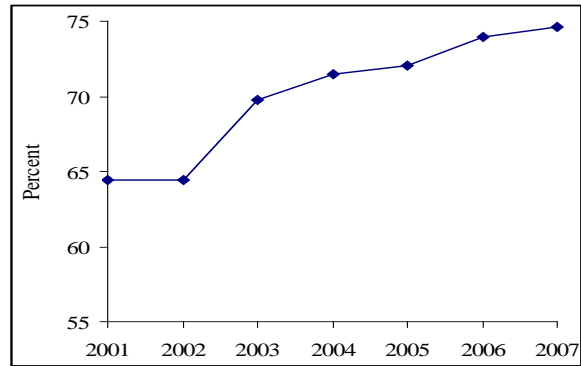
investment growth by optimizing the business climate would be helpful for the Thai economy.

Figure 25. Growth of Real Private Investment (Percent)



Source: NESDB

Figure 26. Industrial Capacity Utilization (Percent)



Source: BOT

ACCESS TO FINANCE

83. An efficient and well-functioning financial system is important to channel funds to the most productive users and allocate risks to those who can best bear them, thus boosting economic growth and improving opportunities. Indicators of access to finance barriers are found to be negatively correlated with the actual use of financial services.⁴⁵ From an international perspective barriers to loan services in Thailand are relatively low (see table 2). There is no minimum amount restriction on loan applications, which is important for small and medium enterprises. Fees associated with business loan amount to about 0.55% of GDP per capita in Thailand—which compares favorably with Indonesia (0.9%) but not with Korea (0.29%) or Japan (0%). In Thailand, loan applications can be submitted in bank headquarters or branches only, while in countries with more advanced financial sectors, they can often be submitted in non-branch outlets, electronically, or by phone.

⁴⁵ See World Bank (2007), *Finance for All: Policies and Pitfalls in Expanding Access*

Table 2. Barriers to Lending Services – International Comparison ⁴⁶

	Minimum amount business loan (% of GDP per capita)	Fees associated with business loan (% of GDP per capita)
Thailand	0	0.55
Indonesia	0	0.9
Korea	16.99	0.29
Japan	30.98	0
sample median	55.28	1.26

Source: Beck, Demirguc-Kunt, and Martinez Peira (2007)

84. More firms perceived access to credit and the high cost of finance as obstacles to doing business in 2007 than in 2004. Inadequate access to credit was reported by more than 15 percent of firms in PICS 2007 as one of the top three constraints to their operations and investment. This was not the case in PICS 2004. The proportion of firms that perceived access to domestic credit a major or severe constraint increased from 14 percent to 22 percent.⁴⁷ The proportion of firms that reported the high cost of financing is one of the major or severe constraints to doing business increased from 15 percent to 35 percent. The 2007 results compared less favorably to the East Asia average where 19 percent of firms report access to finance and 20 percent report cost of finance a major or severe constraint.⁴⁸

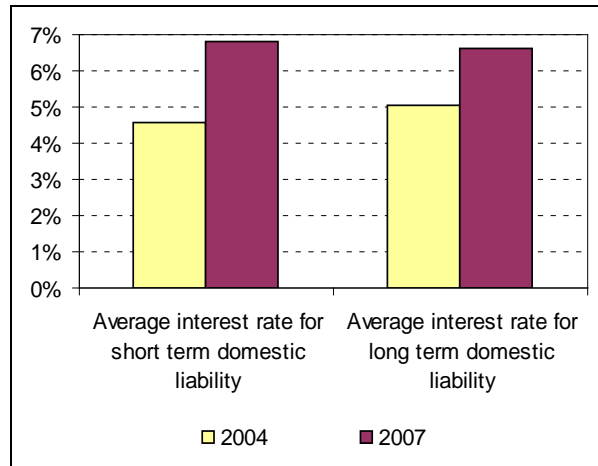
85. Interest rates for short-term domestic loans have risen by 2.2 percentage-points for firms on average, while those for long-term domestic loans rose by 1.5 percentage points (Figure 27). Minimum lending rate increased from about 5.6 percent in the mid 2005 to 7.8 percent in mid 2006; and it remained around that level until it declined to 7 percent in mid 2007 (Figure 28). The higher collateral value required for commercial loans also limit firms' financing. The value of collateral required as a share of the total bank loan value has increased from 83.5 percent to 122 percent or 38 percentage-points.

⁴⁶ There are 71 countries in the sample. See <http://econo.worldbank.org/programs/finance>. The comparator countries are chosen from East Asia based on the data availability. Minimum amount business loan is the smallest amount of loan banks make to business. Fees business loan are the fees associated with business loans. Minimum loan amount and fees are expressed as a share of gross domestic product per capita (GDPPC).

⁴⁷ Firms' perception on access to foreign credit is not reported here due to the limited number of observation.

⁴⁸ Source: World Bank (2007), Finance for all: policies and pitfalls in expanding access.

Figure 27. Interest Rates Faced by Firms, 2004 and 2007

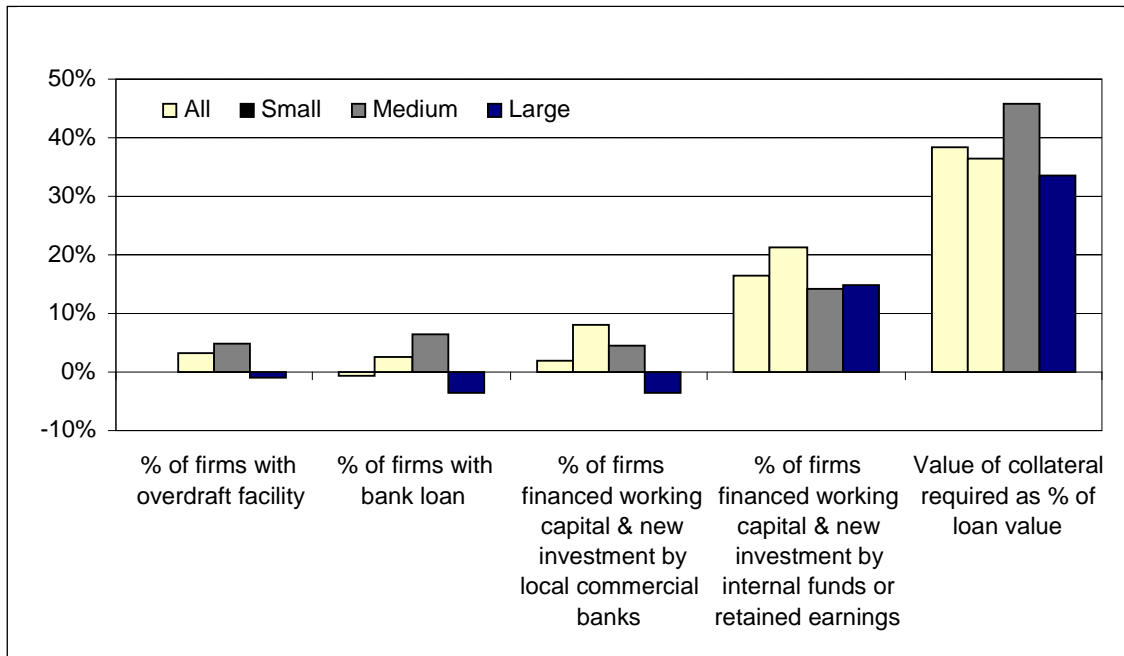


Source: PICS 2004 and 2007

Figure 28. Average Minimum Lending Rate, 2005-2008

86. The high interest rate and collateral requirement resulted in a lower share of firms financing their working capital through commercial bank loans, while the share of firms that financed their new investments by commercial bank loans increased by only 5 percent. Large firms, in particular, have reduced their borrowing from commercial bank for both their working capital and new investments. Instead, an increasing share of firms has financed their working capital and new investments through internal funds or retained earnings (Figure 29). This may imply limitations to the available investment capital compared to the amounts that could be borrowed from commercial banks, thus constraining business improvements and expansion.

Figure 29. Access to Finance, 2004 and 2007 (Difference in Percent)



Source: PICS 2004 and 2007

87. This was reflected by the declining trend of loan growth in Thailand since 2004 (Figure 30). After peaking at 14 percent (or 10 percent for manufacturing sector) in mid 2004, with fluctuation, it dropped to 0 percent (or -2 percent for manufacturing sector) in the third quarter of 2007. This declining growth of loan may partly explain the declining growth of private investment. No clear trend is discernible from changes that took place in more recent months.

Figure 30. Growth of Lending, 2004-2008

