# Thailand

SEB MERCHANT BANKING – COUNTRY RISK ANALYSIS April 20, 2016

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*Restoration of political calm at least on the surface has paved the way for modest economic recovery. The ruling military leaders have announced a referendum over a new constitution followed by elections in 2017, by which it aims to achieve a political modus vivendi with a semblance of democratic forms while remaining the ultimate arbiter.*

## Country Risk Analysis

**Modest recovery:** Last year the economy regained some strengths as economic activity expanded 2,8%, still shy, though, of its former vigor as investors remained on the sidelines waiting for political signals and delayed government infrastructure projects. With recent months’ clarification on both issues, we expect growth to pick up to 3% in the current year with some upside potential for coming years. The external sector should stay strong with a current account surplus and large reserves.

**Financial policies back on a steady path**: The military junta has reduced the fiscal deficit left over by the previous government which was voted into office in 2011 on a populist ticket. That has facilitated looser monetary policies to counter negative effects on demand from ongoing deflation. Structural reforms have mostly remained in the dead-water but could receive an impetus from the new large infrastructure projects which will require private participation and financing.

**Political calm yet to be tested**: Since the coup in 2014, political turmoil has subsided and the junta has taken the risk to present a new constitution for referendum set to next August. That document leaves the military as the ultimate arbiter despite restoration of democratic forms including general elections in 2017. Future parliaments and civilian governments will be under checks and balances which may facilitate a break with Thailand’s recent history of fractious politics ending in military coups. But this may also come at costs to civilian society and the maturing of the political environment which could provoke protest and new political unrest.

**Royal transition**: Overarching Thailand’s political conundrum is the issue of royal transition which could intensify political polarization should it take place in coming years. The new constitution will keep the military anointed Senate for five years securing the military’s power for at least that period.

**Steady outlook with caveats**: The outlook is reasonably steady with slightly accelerating growth for the rest of the decade. But risk are mainly on the downside including regional financial turbulence from a possible hard landing in China, domestic political unrest and an overleveraged economy that could put the banking system to a test. Despite these risks external sovereign ratings have remained stable on a relatively high level due to strong fiscal metrics. Some rating agencies also argue that Thailand has proved reasonably resilient to shocks since it last buckled under the Asian crisis in 1997. Without discounting these points of view we note that country risk is not only a question of the sovereign’s repayment capacity and that a negative outlook to the country is still warranted reflecting the threat that the risk noted above may be on the rise.

## *Recent economic developments*

*Last year the economy regained some strengths as economic activity expanded 2,8%, still shy, though, of its former vigor as investors remained on the sidelines waiting for political signals and delayed government infrastructure projects. With recent months' clarification on both issues, we expect growth to pick up to 3% in the current year. The external sector is set to remain strong with a current account surplus and large reserves covering almost one year's worth of import payments.*

**A modest recovery**: Last year, following very weak growth in 2014 at only 0,8% due to political uncertainty including a military coup, the economy staged a recovery of 2,8% growth. That was much less, though, than first expected as investors remained on the sidelines deterred by continued political tensions, weak external demand and excess capacity in industry, while drought held back incomes in Thailand's important agricultural sector. However, in late 2015 public sector investments picked up sharply to meet year end deadlines for budget dispersions while a continuing tourist boom helped bolster consumer sentiment underpinned by new tax and subsidy incentives.

**Good start to the current year**: These trends mainly continued into the first months of the current year. The government has launched a new large scale investment program and the tourism boom goes on unabated with arrivals in January-February breaking new records up some 15% year-on-year. (yoy). That should support further acceleration of growth to around 3% for the full year, still shy of Thailand's estimated growth potential of 3,5% pa. As a result, the official unemployment rate should remain low at less than 1% corroborated by continued declines in the underemployment rate. Although indicating a rather tight labor market this has yet to present evidence of rapid wage growth which decelerated to only 1,4% yoy in January. Price pressure also remained extremely subdued with growth of the overall consumer price index for January in slightly negative territory for the 13th consecutive month. That was despite serious drought for agriculture because of sales from excessive government food stocks.

**External current account surpluses continue at record levels**: In 2014, the current account balance turned into a surplus for the first time since the Global Financial crisis (GFC) in 2009. Last year, that rose further to $32bn, about 8%/GDP, despite very weak manufacturing exports which, nevertheless, was more than compensated by terms of trade improvements related to energy and raw materials and the growth of inward tourism. The latter continues to benefit strongly from rising travel preferences of Chinese households. Even the terror bombing of the Erewan shrine in last August, a popular tourist destination in Bangkok, had only a short term negative effect on arrivals.

**The capital account in rising deficit**: The balance on the capital account, by contrast, ended in a larger deficit in 2015. That reflected net inflows of foreign direct investments (FDI) turning sharply negative, meaning that outflows by Thai investors exceeded inflows of foreign investors and /or that foreign investors withdrew part of their investments from earlier years. Repayment of loans from abroad, mainly by Thai corporates, sped up as well as did sales from foreign holdings of shares in the local stock and bond markets. As a result of these transactions and some outright capital flight, the balance of payment -- the sum of the current account and capital account balances -- turned slightly negative in 2015. The Bank of Thailand, BoT – (central bank), reportedly met this situation with sales from reserves which dropped $6bn to $151bn – about 40%/GDP -- by the end of the year, still sufficient to pay for 11 months of imports. With these and other foreign assets including in private hands exceeding total external debt at about 35%/GDP Thailand's net international investment position remained robust.

### *Policies*

*The military Junta since May 2014 has reined in a growing fiscal deficit and other government profligacy left over by the previous government which was voted into office in 2011 on a rather populist ticket. This has helped reduce the budget deficit to less than 2,3% of GDP despite weak growth while limiting the rise in the government debt ratio within 35%/GDP. Monetary policies, by contrast, loosened further in 2015 as the BoT cut policy rates to counter negative effects on demand from ongoing deflation. Structural reforms, by contrast, have mostly remained in the dead-water but could receive an impetus now related in part to the recently announced mega project program. The full effect of this program on government balances remains to be seen, however.*

**Correction of the fiscal balance**: Last year the fiscal balance relative to GDP rose slightly from 2,1% to 2,3% but including the structural surplus on the social benefit budget the deficit was only 0,8%/GDP. That was despite lower than expected expenditures because of under-execution of the government investment program. For the current fiscal year which started in October (FY2015/16) the deficit is likely to grow to an estimated 2,8%/GDP after the government introduced a minor stimulus program including cheap loans for SMEs and households' car and property purchases. It also made permanent the temporary corporate tax cut from 30% to 20% of profits first introduced by its predecessor in the hope of reviving private investment demand. As a result of the higher deficit, the government debt ratio will this year increase slightly to 35% excluding debt of non-financial public enterprises which potentially raises the government debt level to estimated 60%/GDP. That is a more comprehensive debt measure, however, than presented by many peers.

**Government mega-projects**: Recently the government announced large scale infrastructure plans worth about $50bn to be implemented over the 2016-2023 period. Such a program was also launched by its predecessor but then delayed as a result of subsequent political turbulence. The new program differs in important aspects. A major part of it appears now to be dominated by the construction of a high speed train from the northern part of the country to the capital. Although, that will connect the more populous parts of Thailand, the northern parts are also among the poorest and largely dominated by agriculture. That does not indicate solid underlying domestic demand for this kind of expensive transport. In return, it may fit into Chinese plans to integrate the region.

**Monetary policy easing has limited effect on credit growth**. Last year credit extension continued moderate growth at an annual rate of 4,6%. That was despite two more cuts in the policy rate of BoT in the early part of the year to only 1,5% pa, still keeping the real rate at a relatively high 2,5% pa. This proved too high for many would-be investors in a climate of continued uncertainty about the future of the economy, not least against the backdrop of the central bank's own inflation target of 2,5%±1,5pp. That said the rate cuts seem to have prevented the exchange rate from overshooting in real effective terms which may have been a secondary objective for the bank.

**Banks remain healthy but high leverage could become a concern:** The Thai banking system is large with total assets at 180%/GDP. Out of this about one half is related to household debt which has nearly doubled since GFC much due to cheap loans for car purchases and other durables by previous governments with the aim to stimulate domestic demand. Many of these loans are now going sour and end up as non-performing loans (NPL) in banks' loan books. Together with so-called "special mention loans", i.e. loans still being serviced but after restructuring to ease the repayment burden of the debtors, the total of bad loans is now exceeding 5% and that does not yet include liabilities to banks of the large steel mill, Sahaviriya Industries. This went bankrupt in last October -- the largest Thai corporate default since the

Asian crisis in 1997. Banks have now become more cautious and raised lending standards but are still in a reasonable good shape with strong capitalization of more than 13% on average. That should provide a robust buffer against the trouble seen so far.

**Structural policies - time to wipe off the dust**: While structural reforms have remained mainly on the back-burner in recent years due to political uncertainties, some progress has still been made. First the expensive rice program of the previous government was terminated after having allegedly cost the budget some 5% of GDP over three years. After that, the new administration under the military junta overhauled government fuel subsidies. Plans are now mulled to speed up corporatization of state owned enterprises with a view to their eventual privatization. Hopefully, the government will also complete the process of transferring all supervision of state controlled banks to the BoT as recommended by the IMF. That should help them avoid being abused for political ends as are allegations regarding the Agricultural bank over its role in the now terminated rice program.

## *Politics*

Since the military coup in May 2014, the new rulers, often referred to as the "junta" even in domestic media, has struggled to consolidate its power and bring order to political chaos. This has resulted in some allegations of human right violations, but not overwhelmingly so. That said it is also clear that the rules of democracy have been severely violated and it is likely that the military does not see a role for itself in running the day-today affairs of its country for any length of period.

As political calm, or at least a semblance of calm, was restored last year, the new rulers have been busy finding a constitutional formula that would justify the coup and preserve a place for the military as the ultimate arbiter of political developments. Last September it presented a draft constitution but then apparently withdrew it after it produced a storm of protest from all side if the polity and civil society. A new attempt presented in the following January, will now be voted on in a referendum set to next August.

A crucial question on that ticket is whether to accept that the upper house of Parliament, the Senate, should be allowed to vote together with the lower house in selecting the prime minister. The distinction is important because the 250 Senate members will now be anointed by the military and could heavily influence the outcome of any voting in the more democratically lower house 500 members. It is being mused that the whole set-up is to make weak coalition governments in the future thereby facilitating "divide and rule" by the ultimate arbiter.

It has not been made clear what will happen in case the referendum turns down the draft constitution but the military appears to take all precautions to achieve their desired result. The bill on the referendum provides criminal penalties for attempts to "influence" the vote. Moreover, debates on the constitution must be preapproved by the junta.

To grant the draft constitution some merits it may be argued that it imposes so many checks and balances on politicians and the Parliament that it should be possible to stop Thailand's decades long cycle of fractious politics followed by military coups. But then again it also introduces a cloudy concept of "emergency situations" where the military at its discretion can resume all powers from an elected government. The proof will be in the eating. Will the new constitution be used to the benefit of the established political Bangkok elite and further suppress the opposition around the previous government and its charismatic movement leader, Dr. Thaksin? The former was always seen as having the sympathy of the armed forces. In such a case there is limited hope that the reintroduction of elections and civilian rule will help overcome the deep polarization of politics and the society at large.

Overarching Thailand's political conundrum is the question of the royal transition. Some observers warn that this event could intensify the underlying political polarization and make it increasingly difficult for the military to control developments. Perhaps as a safeguard, the new constitution keeps the military anointed Senate for five years going forward securing the army's power for at least that period.

## *Outlook*

For the current year most observers agree that growth should accelerate somewhat to about 3%. That is 0,5pp lower than projected by the government but higher than more conservative estimates including of one of the rating agencies which sees only 2,5% growth in 2016. Next year and to the end of the decade will probably produce slightly higher growth at almost 3,5% per year with the external balance remaining strong in an environment of predictable economic development. Thailand may not fully live up to its potential in this period but neither will it crash for economic/financial reasons alone. Since the Asian crisis the economy has a track record of resilience to shocks over nearly two decades.

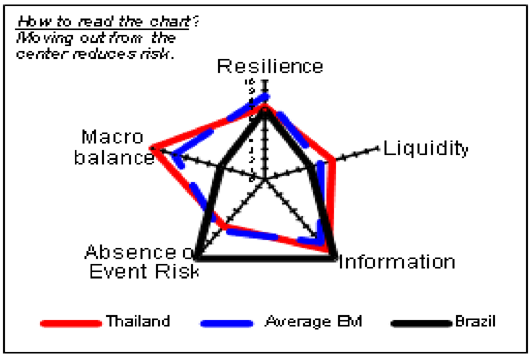
Downside risks to this scenario, however, are palpable.

- With 11% share of exports China is Thailand's greatest export destination and a hard landing in that country could reduce Thailand's average growth for the rest of the decade by at least 0,3% not enough to produce a crisis but to exacerbate other negative shocks should they occur. [1]New political turmoil could make it difficult to implement the government investment plans, while deterring also private investors. That could intensify problems for banks against a background of high household leverage.

- Faster than expected US monetary tightening may spell global market turbulence and renewed investor flight from emerging markets, possibly raising financing costs for many leveraged Thai corporates in particular those with external credits.

- Thais are ageing and the dependency ratio is about to rise potentially presenting new challenges to economic policies and social cohesion.

| **Key statistics** | **2016** |
|---|---|
| GDP/capita ($) | 5628 |
| GDP (change) | 3.0% |
| Inflation | 0.6% |
| Curr. Account balance/GDP | 7.5% |
| Reserves/imports (months) | 11 |
| Budget balance/GDP | - |
| Central gov. debt/GDP | 34% |




**External ratings:**
Fitch: BBB+
Moody's: Baa1
S&P: BBB+

**Peers:**
Brazil
Spain
India

**Graph:** The risk profile of Thailand is about at par with the average emerging market country on resilience and macro balance but better on liquidity. Event risk is higher than average and is now combined with also higher information risk.

[1] (Conf. our analysis in "Indonesia, September 2015" on www.seb.se/mb.)

| **Key data:** | **2011** | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** |
|---|---|---|---|---|---|---|---|---|
| GDP (mill.US$) | 371 | 397 | 420 | 404 | 396 | 384 | 402 | 427 |
| GDP/capita (US$) | 5536 | 5911 | 6224 | 5966 | 5821 | 5628 | 5887 | 6247 |
| GDP (real change) | 0.8% | 7.2% | 2.7% | 0.8% | 2.8% | 3.0% | 3.4% | 3.4% |
| Investments/GDP | 25% | 26% | 25% | 24% | 25% | 26% | 26% | 26% |
| Budget balance/GDP | -0.2% | -3.4% | -2.1% | -2.2% | -2.3% | -2.5% | -2.7% | -2.9% |
| Govt debt/GDP (*) | 27% | 28% | 29% | 30% | 31% | 34% | 35% | 33% |
| CPI inflation (%) | 3.8% | 3.0% | 2.2% | 1.9% | -0.9% | 0.6% | 2.1% | 1.8% |
| Money demand (%) | 7.2% | 20.9% | 13.9% | 4.8% | 5.4% | 1.4% | 2.6% | 3.4% |
| Stock prices (yearly avg.) | 66961 | 67234 | 67511 | 67768 | 67981 | 68153 | 68297 | 68417 |
| Interest rates | 3.1% | 3.1% | 2.7% | 2.2% | 1.8% | 1.5% | 2.0% | 2.7% |
| Exch. Rate ($) | 30.49 | 31.08 | 30.73 | 32.48 | 34.25 | 36.57 | 36.82 | 36.49 |
| Trade/GDP (%) | 114% | 112% | 106% | 105% | 98% | 97% | 97% | 98% |
| Oil price (Brent) | $111 | $112 | $109 | $99 | $52 | $32 | $40 | $49 |
| **Millions US $** | | | | | | | | |
| Export of goods | 219.1 | 225.7 | 225.4 | 224.8 | 212.1 | 204.7 | 211.6 | 225.5 |
| Imports of goods | 202.1 | 219.1 | 218.7 | 200.2 | 177.5 | 167.8 | 178.3 | 193.9 |
| Other: | 8.9 | -1.5 | -5.2 | 15.4 | 31.8 | 28.9 | 25.2 | 21.8 |
| Current account | **8.9** | **-1.5** | **-5.2** | **15.4** | **31.8** | **28.9** | **25.3** | **21.8** |
| (% of GDP) | 2.4% | -0.4% | -1.2% | 3.8% | 8.0% | 7.5% | 6.3% | 5.1% |
| FDI | -4.7 | -1.4 | 3.8 | -0.6 | -2.6 | -3.6 | -3.5 | -3.9 |
| Loan repayments | -8.8 | -13.3 | -11.1 | -12.9 | -18.3 | -25.6 | -31.1 | -35.3 |
| Net other capital flows | 25.6 | 14.0 | 6.3 | -9.9 | -16.7 | 3.3 | 18.1 | 27.0 |
| Balance of payments | **21.0** | **-2.2** | **-6.1** | **-8.0** | **-5.9** | **3.0** | **8.7** | **9.6** |
| Reserves (yearly avg.) | 173.7 | 171.5 | 165.4 | 157.4 | 151.6 | 154.6 | 163.3 | 172.9 |
| Total debt (yearly avg.) | 109.8 | 122.0 | 140.9 | 142.2 | 135.2 | 139.0 | 147.7 | 158.9 |
| o/w short term debt | 54.9 | 56.7 | 62.6 | 59.5 | 54.7 | 59.9 | 63.5 | 68.1 |

(*) Central government only

*Source: OEF (Oxford Economic Forecasting) and SEB estimates.*

| **Rating history** | | | | | |
|---|---|---|---|---|---|
| Fitch (eoy) | BBB | BBB | BBB+ | BBB+ | BBB+ |
| Moody's (eoy) | Baa1 | Baa1 | Baa1 | Baa1 | Baa1 |

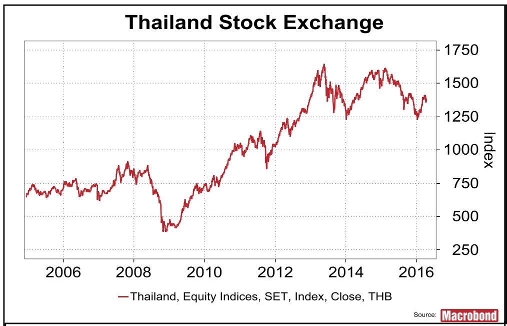
**Type of government:**

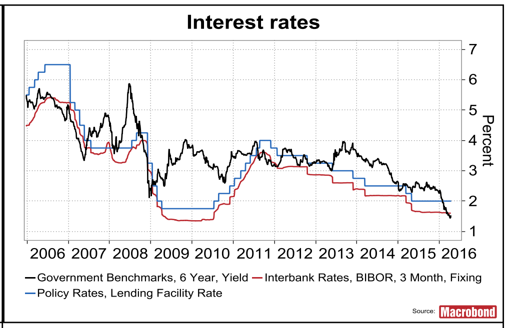
Next elections July 2015

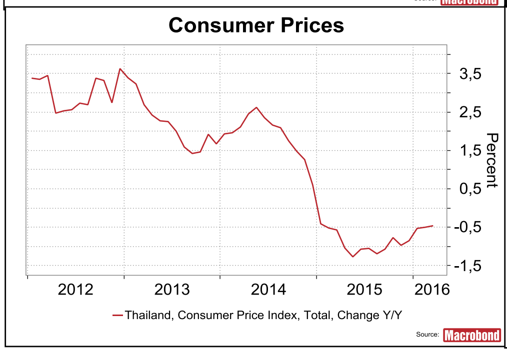
**Other:**

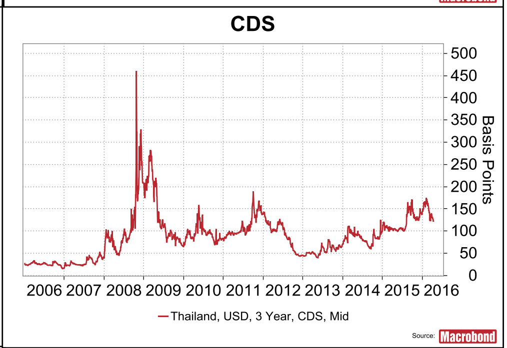
Latest PC deal None

Recent IMF programs Stand-by 1997



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