Thailand

Analyst: Rolf Danielsen. Tel : +46 8 763 83 92. E-mail : rolf.danielsen@seb.se

The passing of King Adulyadej after a reign of 70 years, has occurred without creating any disruptive events and the crowning of his son is expected to take place before year end. That will be followed by general elections to reinstall civil government lost in the military coup of 2013. Thailand is now in dire need of political stability to boost private investments and consumption.

Country Risk Analysis

Modest recovery continues: In 2016, notwithstanding severe drought for agriculture followed by three months mourning after the King's death in October, the economy managed to grow above expectations at 3,2%. That was much supported by public investments in infrastructure and exports of services, including tourism. For the current year the same forces will lift growth to 3,4% underpinned also by household demand for durables. Only private investments will remain anemic held back by overcapacity in industry and continued political uncertainty.

External balances set to remain very strong: The current account surplus of 2016 reached a record high at nearly 12%/GDP. That will slightly moderate in the current year, but still post a very respectable 10%/GDP. Despite slowing demand from China exports should continue strong but is now being outpaced by imports judged by trade developments so far in the current year. As a result reserves will grow further from $68bn – 11 months of import cover, at last year-end.

Financial policies: So far financial policies have remained accommodative, but the government seems bent on giving its eight years infrastructure program from 2015 a stronger boost to the tune of 1% of GDP primarily financed by government owned enterprises. As such the official budget deficit will remain within some 3%/GDP. With inflation below the lower boundary of the central bank's 1-4% target monetary policies are also set to remain lax with policy rates at 1,5% for more than two years.

New royal regime: The ongoing transition has so far been smooth strengthening expectations of a final conclusion as the new King is crowned after the cremation of his father toward the end of the year. That should put to rest any rumor-mill of infighting in the back-stages between the new King and his potential adversaries. The new King asserted his will by demanding changes to the draft constitution of the military junta before this was promulgated by Parliament in last April.

Outlook remains cautiously optimistic: A successful completion of the royal transition and a political transition to a civil government should revive investment demand and maintain growth close to potential. That, however, is not very impressive for a country on the cusp of growing into a more advanced economy. Thailand needs to open up for domestic and foreign competition to promote high skilled services before negative demographic trends strike over coming decades.

Ratings: External ratings have remained stable over the last year except for a downgrade by one of the agencies of sovereign local currency debt for technical reasons. The same stability seems reasonable also for country risk.

Recent economic developments

The modest quickening of activities in 2016 continues into the current year as growth picks up to an estimated 3.4% on the back of government led infrastructure projects and slightly more buoyant consumer demand. Private investments, by contrast, are more likely to remain on the sidelines pending clarification to political uncertainties. Weak domestic demand helps keep the current account in a strong surplus of almost 10%/GDP.

Modest recovery continues: Last year, the economy accelerated slightly to a rate of 3,2% growth somewhat above expectations. That happened despite severe drought for agriculture in the first half of the year followed by an official one month mourning period after the passing of King Bhumibol Adulyadej in October which, however, many enterprises extended to the end of last year. So far into the current year it appears that growth will continue accelerating to 3,4% spearheaded by a more vigorous implementation of the government's eight-year infrastructure plan and further underpinned by more household spending including for automobiles. In last April, sales of such rose by more than 15% year-on-year (yoy). The infrastructure plan envisages an extra $6bn. almost 2%/GDP spent on new railways, roads, ports, airports and other logistics and transportation. Private investments, by contrast, may remain sluggish, probably growing by less than 2%. That may seem puzzling against a background of buoyant business sentiment but low capacity utilization in industry holds back demand for new production equipment while investors remain cautious about the political situation.

Subdued prices and unemployment: Last April, price pressure eased further to only 0,4% growth (yoy) in the consumer price index (CPI) dropping 0,4pp (percentage point) from the previous months. As such it remained well below the lower boundary of the central bank's self-imposed target of annual price growth within 1% - 4%. The low result for April reflected low prices for foodstuff and energy, the more volatile elements of the consumer basket. The labor market remained calm with unemployment hovering around 1%, which, however, is likely to hide more substantial underemployment including in rural districts.

Buoyant exports continue: In the current year, exports are estimated to expand by more than 4%, doubling the rate of growth from 2016, on the back of rising demand for electronics in more developed countries and despite the likely slowing of China's import demand. However, growing exports will be outpaced by even faster imports which were up by 6% yoy already in the first three months of the current year. Last year, Chinese arrivals were hit by the Thai government's ban on so called "zero dollar tours" where everything was prepaid from China and left little demand for Thai goods and services. The effect of that could linger into the current year, although sharply rising demand from Russia will continue to offset the worst damage to the Thai tourism industry. Hotel occupancy is already up to 70% after a shallow slump last year. Services exports occupy an important place in that picture as tourism continue to grow, no longer only by Chinese tourism but increasingly also from rising demand from other regional countries..

… but is overtaken by imports. Already in the first three months of the current year, decent merchandise export growth of 2,7% yoy was outpaced by even faster import growth of 6%. For the whole year expectations are for exports to grow by 4% and imports by 5%. The expanding import bill is to some extent the base-year response to higher oil prices which hit a low in early 2016, but also reflects ramped up demand for raw materials and intermediate goods probably indicating the pre-positioning of industries should domestic demand pick up toward the end of the year including for the government's infrastructure projects.

External balances set to remain strong: As a result of faster import growth, the current account balance is set to suffer slightly but still remain in a very strong surplus of 10%/GDP -- $42bn -- down from almost 12%/GDP of the year before. As in 2016, capital transactions will eat into the current account surplus and shave off some $38bn. to leave the central bank with $4bn. to build reserves to $71bn, still enough to maintain an import cover of more than 10 months. The dominating net capital outflows mainly reflect the saving surplus of corporates which has so far been reluctant to place this in fixed inland investments. Thailand's total external debt mainly of its private debtors mounts to $133bn. – 31%/GDP -- and is significantly dwarfed by its assets of $182bn. It is estimated that $15bn. falls due as regular amortization in the current year, although that does not seem to include originally short term debt of $59bn. [1]

Policies

Overall accommodative financial policies are set to continue in 2017 with the end result much dependent on the government's ability to implement its ambitious and multiyear infrastructure program. The aim of this is to strengthen competitiveness of Thai industries, but it is warned that in the longer term it may fail to achieve that objective without an upgrade to the country's services sector.

Budget deficit contained within 3%/GDP: The budget deficit for the current fiscal year running up to next September is estimated at about 3% of GDP when excluding the surplus of the government's social budget. Including that cuts the deficit to less than 1%/GDP, mainly reflecting the price of the government's continued subsidy for rice farmers. Despite the fiscal stimulus as the government ramps up its multiyear infrastructure program, the budget deficit is still estimated to shrink by some 0,4pp from last year's fallout of 2,9%/GDP, but stay about unchanged including also the aggregate deficits of the non-financial public enterprises (NFPE) estimated at 1%/GDP in 2017 up from less than half that in 2016.

Still low government debt: The moderate budget deficit will help to contain Thailand's sovereign debt ratio relative to GDP at a relatively low level around 31% of which almost all is denominated in the local currency and only 6% held by foreigners including bi-laterals and multi-laterals. The debt ratio is likely to remain relatively stable to the end of the decade. That is in part because of the low government financial participation in the infrastructure program limited to 5%. Going further into the future, by contrast, projections show the debt ratio rising when including also possible contingent liabilities as the government's own NFPEs will contribute with 75% of the total financing to the infrastructure program.

Monetary policies could ease further: The main policy rate has remained unchanged at 1,5%pa since early 2015. In view of continued weak price pressure, the IMF last year recommended further easing of monetary policies which seems even more relevant today taking into account also Thailand's strong external position and strong exchange rate. By the same token, monetary easing would also fight the present low inflation environment becoming entrenched in a manner that may impinge on future growth prospects.

Baht under upward pressure: The central bank has overall followed a policy of benign neglect of the currency and in recent year acted in a limited manner mainly to stem a too rapid rise. In the first few months of the current year the Baht was

[1] Thailand Research: On a Path of Gradual Recovery, Institute of International Finance, Washington March 2017

under upward pressure and appreciated by 2,5% against a a strong dollar. In view of the current account surplus it may be argued that the exchange rate is still undervalued.

Structural policies – Thailand's Achilles' heel: The government's multi-year infrastructure program launched in 2015 and expected completed in 2022 will this year receive a further boost as implementation appears already to be on its way at least at a higher speed than in earlier years. The program aims at spending $56bn over eight years, including railways, roads, ports, airports, water resource management, broad band internet and mass transit in Bangkok. The objective is to remove bottlenecks, particularly in the transportation network, thereby strengthening competitiveness for domestic and foreign owned companies. Financing will be shared among the central government, government owned enterprises and banks as noted above with a 20% share from private sources in the balance. In addition, the government plans to establish economic zones to promote 10 key forward looking industries including "next generation" cars, smart electronics, medical and wellness tourism, agriculture and biotechnology.

Banks remain sound: Observers commend banks for steady profits and high capitalization of 18,5% despite recent years soft credit growth reflecting a more buoyant bond market for corporates and retail deleveraging. Lending to households in particular from specialized state owned banks rose sharply at the beginning of the decade on the back of government programs of subsidized loans to first time car and house buyers and also for loans to small and medium sized rural enterprises. Since then credit growth has stabilized but at an elevated level of 80%/GDP total outstanding many households and small businesses including farmers have now started to pay back their bank loans. To some extent, growth of bad loans in lending books have begun to eat into banks' balances and earnings, although the level of non-performing loans (NPL) is still on a moderate level at less than 3%. That said, though, banks are now facing a tougher operating environment with increasing competitions from other financial markets that may erode their relatively ample interest margin of 5,5pp going forward.

Politics

Long lasting junta: The present military junta, a term frequently uses by itself, has been in power since it staged a coup in 2013 against the constitutionally elected government of Yungiluck Thaksin, the sister of former PM Thaksin who was ousted in 2006 by the military himself. This four years period is the longest in modern Thai political life between a coup and return to civilian power, and expectations are that it will endure at least for another year. Few observers doubt that it is in firm control of the situation in Bangkok and other main cities and has avoided the kind of violence that marred several other coups in the past. It has also presided over the extraordinary if not unexpected event of a royal transition which so far has occurred in a smooth manner by all appearances.

The new King: The Crown Prince, Maha Vajrialongkorn (1952), son of King Bhumibol Adulyadeij (1927-2016), was proclaimed king in December 2016, two months after his father's passing. He takes over a more polarized country than his father did without the latter's proven ability to unite in times of political turmoil. He has so far not been seen often at public occasions and rather delegated presentations to his popular sister, princess Sirindhorn. He has been seen as less frugal than his father and is rumored to have plans of building a new palace for himself. He has also surprised by apparently interfering with the appointments to the highest seats of the two competing branches of Thai Buddhism.

The draft constitution. The referendum of last August approved a new Constitution prepared by the military rulers with a majority of 59% in a turnout of at least 55%. This included certain clauses that significantly curbed the powers of the monarchy. The new King requested the old version of the Constitution be restored thereby canceling the provision that the head of the privy council should automatically assume the power of the regent in the interim period after the passing of a king until a new ascended the throne. King Vajiralonkorn has yet to be crowned after the cremation of his father expected next October. The new King also asked for the abrogation of a clause that appointed a replacement in the absence of the monarch from Thailand (e.g. during travel abroad). As importantly, he asked for the restoration of the monarch's right to veto any cabinet decision and to dismiss a government unilaterally -- provisions that the junta quietly removed from the 2016 draft charter.

Speculations but few direct signs of infighting: Such acts, both the proposed changes to the Constitution curbing the power of the monarchy at a time this could be expected to soon undergo a transition, and the subsequent restoration of the original texts, could prompt speculations about infighting. However, after the draft was promulgated by the sitting Parliament in last April, any conflict should have been put to rest at least for the near term. So far suffice to say that infighting if any has been held behind tightly closed doors. Provided the new King is crowned as planned shortly after the cremation of his father, the transition must be regarded as a smooth one.

New elections: Thereafter, the government is bound to hold general elections, expected clearly before the end early 2018, to prepare for a civilian government with a prime minister to be elected by a new national assembly of 500 members and a senate of 250 members. Although the latter will also consists of many members directly appointed by the military, election of the other MPs could still provide a test to political stability.

The opposition: Since coming to power, the military rulers have closed some 7000 web-sites, including most of the opposition sites. As a result it is now difficult to read the power of the latter, the so-called "red shirts", which have remained stalwart supporters of former PM Thaksin Shinawatra, ousted in a coup in 2006 and now living in self-imposed exile abroad. Provided that the present political calm represents the true underlying picture and is carried through without major disruptions or renewed violence, investors are likely to take a sigh of relief. At the same time they will remain wary that the new monarch faces a steep learning curve and that efforts of others to curb his powers, perhaps with the intention to modernize the regime, could return in the future. A case in point often noted in this context is the immense value of the properties that formally belongs to the monarchy in Thailand. Thailand is no different from other countries and riches could always be a bone of contention. (Box 1)

Box 1: The Crown Property Bureau: The CBR administers the wealth of the monarch. Like the Privy Council its trustees are appointed by the King but the bureau is chaired by the Ministry of Finance. As might be expected it is the largest land owner in Thailand and is also known to have important business interests including a decisive stake in one of the country's largest commercial banks.
In 2010, Forbes valued the CPB's holdings at £$30bn, but as CPB is not required to disclose its assets the lack of transparency is a frequent point of protest for various anti-establishment groups.

Recurring violence: It has been noted that terrorism and violence have been on the rise in recent months in Bangkok and other cities with tens of casualties among innocent bystanders. It has yet to be firmly established if any of these have been politically motivated although the military rulers have been quick to blame alleged "terrorist networks" often a code word used for Thaksin supporters.

Outlook

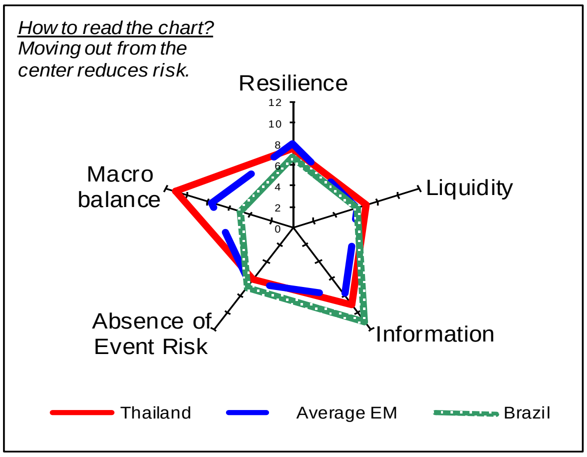
Steady growth but still underperforming: Despite steady growth since 2016 and expected for the current year and until the end of the decade, observers generally note that Thailand is under-performing its true potential. 3% growth is less than others achieved in the same situation, i.e. on the cusp of entry to a more developed economy. Shifting governments have given the clear impression of understanding the situation but have also been hamstrung by the unstable political climate.

What is holding Thailand back? Thailand performed well up to the late 2000s, but has since showed a clearly less fortuitous development of which the more challenging global environment cannot explain all. This has coincided with rising domestic political turmoil which has ended in two long lasting coups against elected governments, the latest coup still ongoing.

In need of a higher skilled services sector: As important, however, is the fact that Thailand seems to be missing a vital development. That is of laying the basis for a more high-skilled services sector including engineering, finance, management consulting, accounting and legal. This has proved key to others taking the leap into a more sophisticated business climate where innovation and other advances eventually become domesticated from their foreign origins. Unfortunately, Thailand has for the last decade continued along a development model that has outlived its role in a country with more than $17000/capita in PPP terms. Many of the noted professions are strictly regulated for the country's own citizens, and even more so for foreigners and could now be holding back potential growth.

Before going grey: This comes on top of other underlying challenges such as a growing dependency ratio as the population begins to age faster than peers. The future of the country is therefore not without question marks that may restrain its credit grading if remaining unaddressed.

Key statistics	**2017**
GDP/capita ($)	6378
GDP (change)	3.3%
Inflation	1.0%
Curr. Account balance/GDP	10.0%
Reserves/imports (months)	11
Budget balance/GDP	-2.5%
Central gov. debt/GDP	31%



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

Peers:
China
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.

Key data:	2012	2013	2014	2015	2016	2017	2018	2019
GDP (mill.US$)	398	421	407	400	407	436	457	487
GDP/capita (US$)	5915	6233	5998	5879	5970	6378	6676	7113
GDP (real change)	7.2%	2.7%	0.9%	2.9%	3.2%	3.3%	3.3%	3.1%
Investments/GDP	26%	25%	24%	25%	25%	25%	25%	25%
Budget balance/GDP	-3.4%	-2.1%	-2.2%	-2.2%	-2.9%	-2.5%	-2.9%	-2.8%
Govt debt/GDP (*)	28%	29%	30%	31%	31%	31%	31%	32%
CPI inflation (%)	3.0%	2.2%	1.9%	-0.9%	0.2%	1.0%	1.9%	2.1%
Money demand (%)	20.9%	13.9%	4.8%	5.4%	3.2%	4.8%	6.6%	5.3%
Stock prices (yearly avg.)	67234	67512	67768	67982	68153	68298	68417	68514
Interest rates	3.1%	2.7%	2.2%	1.8%	1.6%	1.7%	2.4%	3.2%
Exch. Rate ($)	31.08	30.73	32.48	34.25	35.30	34.78	34.98	34.51
Trade/GDP (%)	115%	108%	107%	100%	96%	97%	98%	98%
Oil price (Brent)	$112	$109	$99	$52	$44	$52	$52	$59
Millions US $								
Export of goods	227.7	227.5	226.7	214.1	214.1	230.1	243.3	256.0
Imports of goods	227.6	227.4	209.4	187.2	178.4	191.5	203.2	222.9
Other:	-1.6	-4.8	15.1	32.1	46.8	43.6	47.6	41.9
Current account	**-1.6**	**-4.8**	**15.1**	**32.1**	**46.8**	**43.7**	**47.6**	**41.9**
(% of GDP)	-0.4%	-1.2%	3.7%	8.0%	11.5%	10.0%	10.4%	8.6%
FDI	-1.4	3.8	-0.8	4.0	-10.5	-5.9	-5.6	-5.7
Loan repayments	-13.3	-11.1	-12.9	-17.3	-21.5	-28.5	-34.8	-39.3
Net other capital flows	14.1	6.0	-9.4	-24.7	3.9	-1.5	5.5	16.1
Balance of payments	**-2.2**	**-6.1**	**-8.0**	**-5.9**	**18.8**	**7.7**	**12.7**	**13.1**
Reserves (yearly avg.)	171.5	165.4	157.4	151.6	170.3	178.0	190.7	203.9
Total debt (yearly avg.)	122.0	140.9	144.1	136.5	138.3	143.3	154.2	166.6
o/w short term debt	56.7	62.6	61.0	54.7	57.1	61.8	68.5	75.3

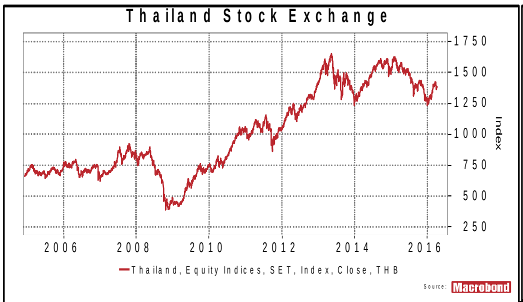
(*) Central government only

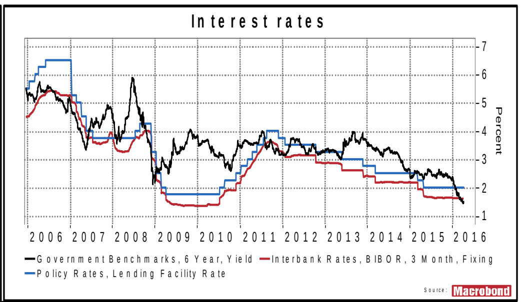
Source: OEF (Oxford Economic Forecasting) and SEB estimates.

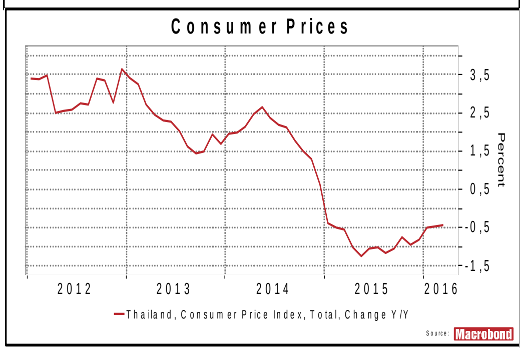
Rating history					
Fitch (eoy)	BBB	BBB	BBB+	BBB+	BBB+
Moody's (eoy)	Baa1	Baa1	Baa1	Baa1	Baa1

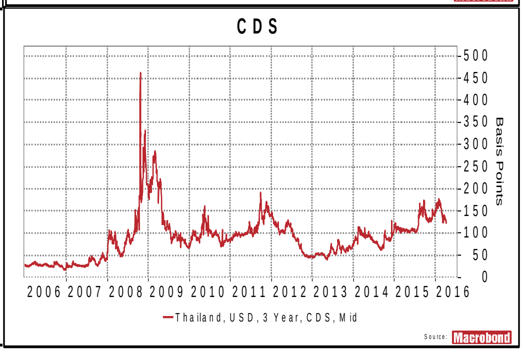
Type of government:

Next elections	Likely early 2018
Other:	
Latest PC deal	None
Recent IMF programs	Stand-by 1997









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