Thailand

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Thailand is growing financially ever more robust but exhibit lower than desirable growth rates due to deepening income gaps and political uncertainty. In the medium term, creditworthiness is quite strong but the longer term the country could end up in a middle income trap..

Country Risk Analysis

Stronger than expected growth: Last year, the economy surprised on the upside growing 3,9% up from 3,2% the year before driven mainly by merchandise exports and booming tourism. Domestic demand, by contrast, in particular investments, remained weak held back by slow implementation of government infrastructure projects but also sluggish private investments in response to political uncertainty. As a result, the savings-investment imbalance -- the current account surplus -- rose to 11%/GDP, helping maintain reserves worth more than 10 months of imports.. For the current year, the government forecasts 4% growth on the back of new megaprojects.. They include the Eastern Economic Corridor with investment worth 18%/GDP over 5 years..

Accommodative economic policies: With low inflation and a strong exchange rate, monetary policies have remained accommodative but stable in contrast to more expansive fiscal policies. In 2017, the budget deficit rose to 2,8%/GDP due to weaker than expected tax revenues. Such shortfalls are set to grow provided more effective project implementation. But with moderate debt at only 42%/GDP including guarantees, the government is in a good position to finance such deficits. Thai banks remain robust representing moderate contingent liabilities..

Malfunctioning trickle-down effect? Consumer demand has continued to suffer from weak growth of household purchasing power. Economic expansion increasingly benefits a minority of the workers, i.e. employees of foreign owned companies. That is in contrast to those employed in domestic oriented SMEs representing 80% of urban workers. As a result, overall unemployment remains low but that masks a shift in employment from higher productivity sectors with higher wages including the main export industries to lower valued services in particular tourism. As such wage fueled price pressure remains low.

Unsettled political situation. Investors are reportedly increasingly worried about the political situation. Since taking power in a coup four years ago, the military junta has promised to re-establish democracy, but also repeatedly pushed prospects of new elections into the future. Last November, elections promised for 2018 were once again pushed back into 2019. In return, the generals last year successfully oversaw a peaceful royal transition and promulgation of a new constitution although one that is designed to keep the military's hold on power.

Outlook: The short to medium term outlook for Thailand is reasonably strong underpinned by solid finances and the generals' grip over political activity with or without new elections. In the longer term, more inclusive growth will be needed for higher productivity and to offset adverse demographic developments. The stable outlook of the external sovereign ratings may appear well argued.at least within a medium term horizon.

Recent economic developments

The momentum from the positive economic development observed last year appears to continue into the current year with the exception of a few worrying signals.

Higher than expected growth: Last year the economy performed better than fist projected with growth reaching almost 4%. That was much supported by the global economy, important for an export oriented nation like Thailand. Merchandise exports were up 9,7% and tourism arrivals surged to 36mn, up 9% year-on-year (yoy). Nevertheless, the recovery was quite narrow. Consumption rose only 3% and private investments remained almost flat, up less than 2%. The latter was much due to slow implementation of government infrastructure projects, including airport developments and a long planned expansion of the rapid mass transit system in Bangkok. Private Thai investors have a tendency to look to government capital expenditure as a signal of the future business environment. In return, new car sales shot up by 18% as households had finished paying off their five year "first-buyer car loan" scheme launched by the previous government in 2011-2012.

Steady growth set to continue:. Steady growth is set to continue and was recently hiked to 4,1% by the Bank of Thailand (BoT) -- the country's central bank. It should also become more broad-based.. While exports should continue strong, albeit with rising downside risks, the government has made firm commitments to speed up its infrastructure program. The largest of these – the Eastern Economic Corridor -- passed Parliament last February and should give a fiscal boost worth some 1-2% of GDP already in the current year. That scenario comes with a few qualifications, though. First of all, global protectionism could derail into uncontrolled escalation with steeper than so far expected slowdown for China.. China is almost at par with the US as trading partner for Thai exporters, receiving more than 11% of their shipments by value. That could have repercussions on public sector project implementations with ripple effects on private investment demand. In addition, investors could take a step back should the promised elections next year intensify political tensions or e postponed yet another time. That said, the latter worries may appear somewhat overstated at least for the time being.

The tourism sector: The tourism sector in Thailand is growing rapidly on rising demand from both domestic and foreign households. Last year it attracted 36mn foreign persons and for the current year the government expects another 2-3% growth thanks to new air-routes from Turkey, ASEAN and most importantly China which accounts for a quarter of all arrivals. That forecast could prove too timid: In the first 2 months of the current year, arrivals were 15% greater than in the same period of 2017. Tourism now counts for 13% of all economic activity in Thailand and 19% of all export revenues.

Buoyant labor market but weak income growth: Last year employment growth outpaced the growth in the working age population. That, however, did not translate into a concomitant growth in household incomes due to uneven sectoral employment growth. Automation and other parts of new business models prompted large corporates to reduce hiring. That forced many job-seekers to find other employment opportunities including in the tourism sector. However, in that and other services sectors wages are traditionally lower causing the shift to negatively impact average household incomes. As a result, greater economic activity did not translate into price pressure and inflation stayed below the central bank's lower boundary of 1%. For the current year, by contrast, higher excise taxes and spill-over effects from abroad could change that picture. Surveys show inflation expectations rising closer to 2% in a 12 months perspective.

Exceptional current account surplus and reserve growth. The current account surplus in 2017 at almost 11%/GDP is set to moderate for the current year but still stay close to a formidable 10%/GDP. That reflects continued strong merchandise exports and growing tourism activities but even stronger growth in imports including investment goods, machinery and equipment. Such deliveries began to expand already in 2017 and are now likely to continue into the current year along with the government's ambitious infrastructure plans. On the capital account, the most remarkable feature remained the continued deepening of the net FDI account after having turned negative in 2016.. That was in part the result of eased restrictions on capital outflows with the objective to stem the impact on the exchange rate from the foreign exchange surplus.caused by trade flows. Such outflows to the tune of $10bn. – 3%/GDP, were still insufficient to balance the foreign exchange market prompting the central bank to buy dollars in order to damp volatility in the exchange rate. As a result, reserves rose $30bn. to nearly $200bn preserving an import coverage of more than 10 months.

Policies

Last year's relatively accommodative fiscal stance is set to loosen further in the current year provided the government succeeds in pushing out budgeted money for its mega projects. That stimulus would be damped should the central bank be pressed to hike interest rates more than necessary to match US policies. But more importantly, failing in this endeavor, the government would risk sending a clearly negative signal to many investors.about the future course of financial policies. .

Widening fiscal deficit:: In 2017, the fiscal deficit widened slightly to 3%/GDP mainly due to an unexpected drop in tax revenues to less than 19%/GDP. The deficit would have ended higher still but for severe delays in the implementation of budgeted capital expenditures. The latter was mainly the result of weak project management and administration, but also inclement weather in particular toward the end of the year causing planned construction works to slow. In the current fiscal year, FY18, ending in September 2018, the shortfall will rise further. The budget plans for massive investments in transport and other infrastructure amounting to THB362bn—about 2,5%/GDP. Although much of that should attract private co-financing it will also require government resources. To that end the budget plans to raise additional revenues including hiked excise taxes on fuel, tobacco, alcohol and soft drinks, mitigating the budget shortfall to 4,2%/GDP but still up 1,2%/GDP on the year before. Nevertheless, the financing is not expected to yield any major challenges but should be accomplished with relative ease including issuance of bonds.

Market sentiment remains overall stable. Investors have so far been happy to buy these bonds as most of them are denominated in the local currency or otherwise hedged. Outright debt is moderate at only 33%/GDP even though this rises to 46% when including explicit guarantees for state owned enterprises (SOE). It also helps that Thailand has a strong external position. As a result, investors are demanding a moderate premium of about 1pp. over US Treasuries. However, like several other emerging markets Thailand is vulnerable to sudden changes in market sentiment as witnessed by the turbulence that erupted in the local exchange market during the heated tax debate in Washington last fall. In a medium term scenario there is also a danger that investors could turn against the government should they see a threat to fiscal policy prudence. For the current year, however, continued fiscal implementation failure is probably the main risk to investor sentiment.. In that respect it is noted that government capital expenditure reportedly fell clearly behind plans in Q1 growing only 13%, below targeted growth of 21%.

Stable monetary policies: The Bank of Thailand (BoT), the country's central bank, has kept its policy rate stable at 1.5%pa against a background of well-behaved consumer price inflation within or slightly below the target range of 2.5±1.5% per year. Last year, core inflation was even lower at 0.8% largely been driven by supply side factors. The central bank appears cognizant that monetary policies are hardly apt to address such inflation factors, but given the bank's own concerns about rising speculative developments among parts of the public, one could have expected the bank to more explicitly mull a possible tightening.. Such speculative developments included rapid growth of investment funds targeting the growth of financial sectors in a few selected countries, When that did not happen, the bank may have been worried such tightening could have fueled excessive appreciation of the exchange rate. Through 2017, that rate strengthened 4% in real effective terms. and over the last 12 month period the Thai baht has strengthened further. As noted above and to the same effect of stemming further appreciation, last year the bank also eased restrictions on private FDI outflows..

Structural policies: Overall Thailand ranks high in most surveys gauging investor perceptions of the country's business climate. The World Bank's own *Doing business* ranked Thailand at 26th place for SMEs in 2017 among 190 countries. That was up from 48th place in 2016 reflecting improvements such as reduced time to start a business to 27 days. That said, to enforce a contract was still at a high 460 days.. But the sticking point for investors is above all the lack of adequate infrastructure in various parts of the country

Thailand's main problem in implementation of government capital expenditure projects, is a slow and ineffective bureaucracy. This has become more pronounced over the recent decade. In the words of a recent World Bank report, *since the Asian crisis focus has been on financial sustainability and inflation w*ith reduced focus on administration. In the event, *government institutions became fragmented and unable to fully implement large projects and reforms* with the result that overall economic growth trailed ending at 3% before last year's partial recovery. More specifically, government investment management is hampered by unclear roles of various agencies, including the Comptrollers General Department, the National Anticorruption Commission etc.

Addressing such problems the Parliament last February passed a bill allowing the government to go ahead with its new project, the Eastern Economic Corridor (EEC) which plans to spend $45bn. on trade links and tourism infrastructure over the next five years subject to private co-financing. The bill will enable investors to avail of tax breaks, rent land for 99 years and benefit from relaxed visa procedures. The bill forms a part of a 20-year National Strategy to be presented Parliament in mid-FY18. The EEC also includes a more controversial plan to construct a high speed train from Bangkok to Nong Khai at the border with Laos where it supposedly will meet a planned Chinese counterpart under China's *One belt one road* international project.

The EEC should go a long way to address investor concerns but still leaving a more fundamental problem, namely the mismatch between demand for and supply of skilled labor. This is often blamed for Thailand's lackluster investment growth not least among SMEs and which has slowly undermined economic performance. The SME sector is of vital importance dominating 80% of urban employment. To its credit, the government is in the process of establishing local computer centers around the country including for the training of youngsters in new technology.

Financial sector

Well capitalized banks: In the two decades since the Asian crisis in 1997-98 banks have consolidated and strengthened their financial position. With 18,5% capital to risk weighted assets (CAR) banks are in a good position to face another downturn in their operating environment. However, except for the last couple of years, banks have also expanded fast and together with other financial institutions grown to almost 1,5 times nominal GDP, apparently an outlier and more than two times larger than peers according to one rating agency. That has now combined with weak loan growth of only 3% in 2017 and growing non-performing loans (NPL).

Increasing bad loans: At 3% of banks' total loan books – rising to almost 6% when so-called "special mention loans" are included -- the overall level of NPLs is still relatively low. Main problem areas are segments within the SME sector and retail loans including for autos and mortgages. Household debt is also high at almost 80%/GDP and has continued to rise in particular for low income borrowers. So far the rise is quite slow and manageable in view of banks' ample provisioning for bad loans. Despite overall accommodative financial conditions reflected in low policy rates and gradually declining lending rates, banks have remained cautious about credit extension to potential problem sectors according to the latest Credit Condition Survey conducted by the BoT in late 2017.

Other sources of financing: Other parts of the financial system include corporate bonds which expanded at a hefty rate of14% yoy in 2017Q3. Funding from the equity market also increased markedly.

Politics

Unsettled political situation: Investors are reportedly becoming more worried about the political situation. Since taking power in a coup four years ago, the military junta has promised to re-establish democracy, but also repeatedly pushed prospects of new elections into the future. Last November, elections promised for 2018 were once again pushed back into 2019. Underling tensions could be a reason for this hesitancy. The opposition Pheu Thai Party has already registered for next elections. It has won all elections since 2001 under its present or previous names before the military ousted it in 2014 together with its PM and her cabinet. In the absence of reliable political polls, it is hard to say how much support it can still garner from its former grass-root movement. But during the court case against the ousted PM, Ms. Yungiluck, last fall, the opposition managed to organize a rally in her support despite continued martial law.

New constitution and royal transition. In return, the generals can be credited with the prevailing calm during the royal transition when the new King, Maha Vajiralongkorn ascended the throne after his father had passed away – ending the longest living royal reign in modern history. Last year, the generals also successfully oversaw a referendum and the promulgation of a new constitution although one that is designed to keep their hold on power after elections

Outlook

Recovery set to continue: The economic recovery of last year and signs of the momentum continuing into the current year and longer has helped dispel doubts about Thailand's economic future. In 2018, growth is estimated to stay on a 4% expansion rate buoyed by

- import demand from trading partners
- new regional airline routes facilitating more tourist arrivals
- stronger investment demand on the back of government led infrastructure projects and rising capital utilization in industries.
- Private consumption and fiscal stimuli including a new social welfare project

The momentum should continue into 2019 with a slight moderation to the growth rate to 3,8% according to projections by the World Bank. This scenario comes with well-known qualifications, including a possible sharper than expected slowdown in China, one of Thailand's main export destinations, and growing international protectionism that could shave off some 0,5pp. from annual Thai growth according to estimates by Oxford Economics, a consultancy. Domestic political developments represent also a wild card that may severely discourage would-be investors and prompt turbulence in financial markets in a worst case scenario.

Does this solve Thailand's growth conundrum? Thailand's growth potential has been revised down to less than 3% a year over the next ten-years period, down from 3,3% in the previous period. That is on undeniable demographic factors such as the projected decline of working age share of the total population beginning in 2020, but also slightly weaker capital formation and total productivity growth..

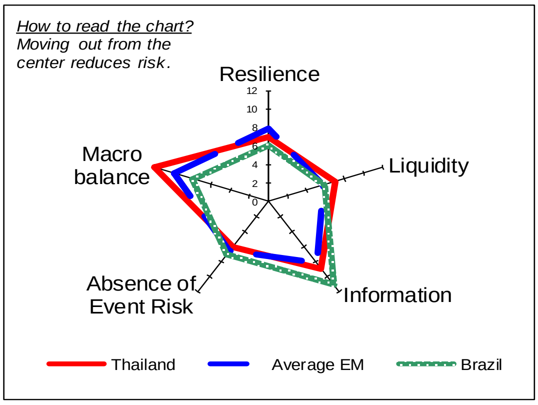
What can be done about weak underlying growth? Apart from the obvious answers of increasing the participation rate including among women and elder workers while encouraging more productive investments, two areas stick out for further consideration:

- Could Thailand's current business model be made more efficient?
- Should Thailand be happy with its existing comparative advantages or rather try to develop such into new areas?

The first is a question about the apparent lack of "trickle down" effect in the labor market. The foreign invested export sector has continued to be successful but experts point out that automation has made it increasingly less labor intensive. That may have increased productivity and wages for those remaining but has also begun to crowd out workers into less productive parts of the economy characterized by lower wages, including the tourism sector.

In the hypothetical absence of that sector which clearly represents a national comparative advantage, could the alternative have been more labor supply to the industrial SME sector enhancing its growth prospects and its ability to integrate with the large export corporates eventually producing a stronger trickle down effect? This report has no ambitions of pursuing answers to these issues but only points out that a country with a comparative advantage in an activity that presents limited productivity growth might be better off to rather develop new comparative advantages even though the rewards may not show up immediately?

Key statistics	2018
GDP/capita ($)	7524
GDP (change)	3,2%
Inflation	1,2%
Curr. Account balance/GDP	10,4%
Reserves/imports (months)	9
Budget balance/GDP	-4,2%
Central gov. debt/GDP	33%



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. 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	2020
GDP (mill.US$)	398	421	407	402	412	456	521	548	562
GDP/capita (US$)	5858	6169	5951	5849	5978	6600	7524	7901	8100
GDP (real change)	7,2%	2,7%	1,0%	3,0%	3,3%	3,9%	3,2%	3,0%	3,0%
Investments/GDP	26%	25%	24%	25%	25%	24%	24%	24%	25%
Budget balance/GDP	-3,4%	-2,1%	-2,2%	-2,2%	-2,8%	-3,0%	-4,2%	-4,2%	-4,3%
Govt debt/GDP (*)	28%	29%	30%	30%	31%	31%	33%	35%	36%
CPI inflation (%)	3,0%	2,2%	1,9%	-0,9%	0,2%	0,7%	1,2%	1,7%	1,7%
Money demand (%)	20,9%	13,9%	4,8%	5,4%	3,2%	3,6%	6,7%	6,8%	5,3%
Stock prices (yearly avg.)	67884	68179	68449	68684	68883	69051	69193	69316	69423
Interest rates	3,1%	2,7%	2,2%	1,8%	1,6%	1,6%	1,6%	2,2%	2,9%
Exch. Rate ($)	31,08	30,73	32,48	34,25	35,30	33,94	31,23	31,14	31,76
Trade/GDP (%)	114%	108%	107%	100%	95%	96%	97%	98%	100%
Oil price (Brent)	$112	$109	$99	$52	$44	$54	$67	$65	$66
Millions US $									
Export of goods	227,7	227,5	226,6	214,0	214,3	235,1	265,0	283,6	294,5
Imports of goods	227,6	227,4	209,4	187,2	177,7	203,2	237,4	254,9	268,5
Other:	-1,7	-4,9	15,2	32,1	48,2	49,2	53,9	58,8	58,7
Current account	**-1,7**	**-4,9**	**15,2**	**32,1**	**48,2**	**49,3**	**53,9**	**58,9**	**58,7**
(% of GDP)	-0,4%	-1,2%	3,7%	8,0%	11,7%	10,8%	10,4%	10,7%	10,4%
FDI	-1,4	3,8	-0,8	3,9	-10,3	-11,1	-12,7	-12,6	-13,0
Loan repayments	-13,3	-11,1	-12,9	-17,3	-12,3	-11,8	-22,9	-35,2	-42,0
Net other capital flows	14,2	6,0	-9,5	-24,6	-6,8	-10,8	15,0	6,7	13,9
Balance of payments	**-2,2**	**-6,1**	**-8,0**	**-5,9**	**18,8**	**15,5**	**33,2**	**17,7**	**17,6**
Reserves (yearly avg.)	171,5	165,4	157,4	151,6	170,3	185,8	219,0	236,8	254,4
Total debt (yearly avg.)	122,0	140,9	144,1	135,9	139,1	143,9	158,4	171,2	184,1
o/w short term debt	56,7	62,6	61,0	54,4	58,6	58,0	66,4	74,8	83,1

(*) 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

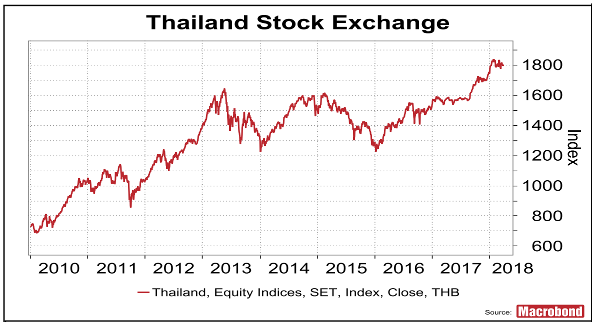
Type of government:

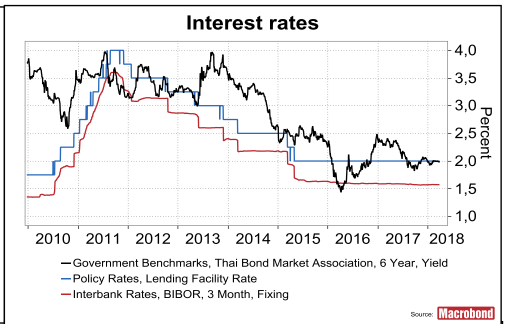
Next elections   Likely early 2019

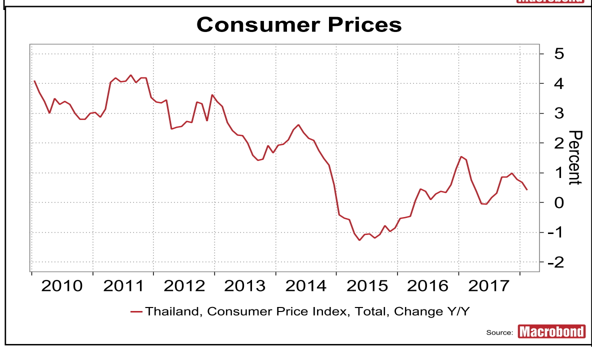
Other:

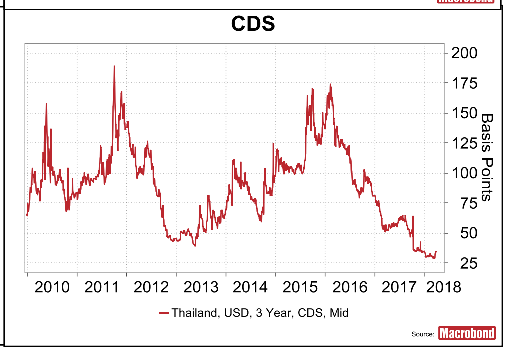
Latest PC deal   None

Recent IMF programs   Stand-by 1997









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