Thailand

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Ongoing general elections are facing Thailand's oft-cited impressive resilience with its toughest test in many years. That could mean more unstable politics with the capacity to deter investors from participating in the government's new infrastructure investment program but if managed well could also be the beginning of a new era leading the country out of the middle income trap.

Country Risk Analysis

Growth upholds well: Despite the turbulence in global financial markets in 2018 the economy still achieved 4,2% rate of expansion, slightly higher than in 2017 driven mainly by domestic demand. Private consumption continued strong reflecting robust labor market and household income growth, while investors were buoyed by the start to long awaited government investment projects. Despite growing activity price pressure remained muted rising to just within the central bank's target range 1-4% annualized consumer price inflation. That helped support competitiveness to offset some of the effects of currency appreciation, which otherwise weakened the external balance although from a strong level of more than 7% of GDP.

Latest: Final election results. May 7 the Electoral Commission announced the results of the March 24 general elections. The final count showed the coalition of 11 opposition parties had lost 10 seats in the national assembly compared with initial results in late March mainly due to last minute changes to the electoral law. The main opposition party, the Pheu Thai still came out as the largest with 136 seats, 21 more than the main pro-junta party, but its coalition could now rely on only 245 seats, 6 short of a majority in the 500 seat lower house. The 250-seat Senate - upper house - is dominated by pro-junta representatives having already been anointed by the Junta, The senate is not involved in the formation of government, however, only the PM.

Steady policies: Financial policies have remained steady although government's infrastructure projects could now widen the budget deficit to more than 3%/GDP, still well within the targets set by the new Fiscal Responsibility Act, though. As domestic investment opportunities become more attractive, large net capital outflows in the form of direct investments will narrow, supporting further growth of central bank reserves which at 10 months of import cover are already at a very high level.

Politics – the remaining challenge: After having been delayed several times, the military junta that took power in a coup five years ago, eventually decided to hold new general elections although according to a new Constitution that still largely safeguards the junta's dominance over Thai politics. The official count will be announced early next month (May 9), but the opposition has already declared victory based on preliminary results. It is now extremely important that political tensions do not boil over into new strife.

Thailand's outlook looks reasonably good based on strong sovereign metrics and a relatively robust banking system underpinned by a competitive export industry. household leverage has now started to decline from a peak of 75%/GDP. In addition to domestic politics, risks to the future include

- a sharp slowdown in China, Thailand's main export market
- more delays to the government's infrastructure program
- rapid aging and shrinking of its working age population beginning in the current year.

The rating agencies have remained on the sidelines in recent years well within investment grade for the sovereign, but with an eye on underling political tensions. Their cautious optimism is also relevant for country risk.

Recent economic developments

The economy on an even keel: Last year the economy started on a strong note but was mid-year hit by investor concern over threats to global trade before regaining its strength toward year-end. Overall economic expansion ended at 4.2%, slightly higher than in 2017 and this time driven mainly by domestic demand. Private consumption continued strong growing more than 5% yoy (year-on -year) reflecting a robust labor market and household income growth. Investors were also buoyed by the kick-start to government-led investment projects intended to raise the country's future production capacity. Construction companies have been piling up inventories of machinery and building materials in anticipation of such plans hitting the road in coming months.

Investment demand spearheading growth: Improving investor sentiment and already high capacity utilization in industry points to continued solid investment demand in the current year. That might nevertheless reach no higher than 4% growth yoy as uncertainty about the global outlook including China continues to weigh on the mood among export companies – the main investor group in Thailand.

Muted price pressure: As a result of steady but unspectacular growth price pressure is likely to remain well tamed in 2019. Last year the CPI (Consumer price index) rose slightly to 1,1% annualized just within the central bank's target range and this year projections are for another 1.2%. That could be lower should the Baht appreciate at the same rate as last year, that is at almost 5% in US dollar terms, or should climatic conditions continue as favorably as in 2018 producing bumper harvest and suppressed food prices. Unemployment, in return remains incredible low at less than 1% of the total labor force, although it is unclear how that counts for underemployment in rural areas.

Net exports exerting a drag: Already in January export volumes were down by almost 5% yoy largely due to reduced demand from China -- Thailand's main export market with a share of 12% of total exports. That said, following the recent signing of a trade bilateral trade agreement there is a new potential for Thai exports to China to expand. The agreement is aimed at lifting mutual trade between the two countries to $140bn by 2021. In the meantime Thai imports are growing fast in line with expanding investment demand causing the trade surplus to drop and leaving the estimated current account surplus for 2019 in a strong position of 6,4%/GDP one percentage (pp) down from last year's end result and 5pp down from a record 11%/GDP in 2017.

Soaring tourism demand: Recent years' record current account balances were much helped by the rising trade in services, including inbound tourism. Despite being struck by a tragic disaster last summer when a Thai ferry capsized killing 140 tourists on board mainly Chinese nationals, the sector still saw arrivals rise by almost 9% yoy in the three first quarters of last year. In an attempt to help the sector recover, the government recently slashed all fees on visa-on-arrival for tourists from 20 countries, including China. As a result arrival numbers are expected to go even higher in the current year.

Large capital outflows: Despite new domestic investment opportunities recent years' capital outflows, in particular in the form of FDI (foreign direct investments), are likely to continue into the current year. The turnaround from net inflows to net outflows started in 2013. That was one year before the coup that brought the present junta to power. The net outflows have remained high often exceeding $10bn a year reflecting Thailand's history of high savings ratios but also new uncertainty arising from domestic politics. Combined with other net capital outflows this has stemmed the rise in central bank reserves. Last year they remained virtually flat at about $200bn. equivalent to some 10 months of import cover or three times greater than short term debt.

Economic policies

Rising budget deficit caused by government investment plans: The budget deficit of the fiscal year ending September 2018 (FY2018) ticked in lower than expected at 2,5%/GDP. For the current year, and for several years going forward, by contrast, the shortfall is likely to rise to accommodate the government's infrastructure plans estimated at THB3.3trillion – about $100bn. – for the next five years up to 2024. In the current fiscal year the budget will see capital outlays soar by 20% and the budget deficit widen to 3,4%/GDP.

Easy financing: The higher budget shortfall is not expected to scare many investors, though. For one thing, more than 20% of the additional capital spending in the current year should be financed as PPP projects. Also, as in previous years, large scale domestic savings provides a reliable source of local financing. The latter has helped keep the share of foreign holdings of government debt down to a minimum of around 2%. In addition, the government recently passed a fiscal responsibility law with explicit rules to cap all government debt below 60%/GDP, much above its present level of 42%/GDP (34% excluding guarantees) while the law bans the foreign share of it to rise above 10%.

Accommodative monetary policies: Last December, the Bank of Thailand (BoT) – central bank – hiked its policy rate by 25bsp to 1,75%pa, its first move in eleven years. The stated motivation was to prevent financial stability risks but also to rebuild its policy rate should monetary stimuli again be called for in the future. The small rise in consumer price inflation to just within the lower bound of the central bank's target rate of 1%-4% a year, was hardly a concern although growing house prices in the metro Bangkok area could have been. Financial leverage among households grew rapidly under the previous government's financial stimulus policies (2010-13) and is presently still standing at 75%/GDP up from 50%/GDP in 2009.

Loan growth: New BoT restrictions on auto financing and house loans including tighter mortgage regulations was implemented from the beginning of the current month with the objective to damp new loan growth. This comes on the heel of a period of loose mortgage underwriting standards which had brought LTV (loan to value ratio) up to 80%, the lowest among regional peers. That is in contrast to loan demand from large corporates which is expected to expand further as government led investment projects are soon to come on-stream. In general, most observers agree that effective monetary policy over recent years has contributed to macroeconomic stability and a sound financial system. Strong finances have also helped insulate Thailand when turbulence in global financial markets hit other EM countries as witnessed by the episode about a year ago. Unlike several of Thailand's regional peers, BoT was able to ride out that storm with limited interventions that calmed market rather than aggravating the situation further.

Reasonably strong banks: Thai banks have used recent years to bolster their balances sheets and are today described as adequately capitalized with improving quality of their loan books. Oft-cited cited concerns are related to still high but gradually declining leverage among banks' household clients.

Politics:

New general elections: As expected, 2019 has turned out as a year of make-it-or-break-it as regards Thai politics. Since the junta took power in a relatively undramatic coup in 2014, its promise of new democratic elections has been deferred several times for various reasons. The passing of the widely respected King, HE

Aduljadej Bhumibol, who had reined for 70 years was one of the most important ones. Eventually, elections took place last March without disruptions or so far major allegations of election fraud although that may still come after official election results are declared by the Election Commission -- appointed by the junta -- on May 9. The opposition has been quick to declare victory, claiming a majority including coalition partners in the house of representatives of 255 out of 500 seats. However, to be able to elect the prime minister, it will also need a strong minority count in the senate which is dominated by members appointed by the junta.

End or beginning to political strife? The elections were held according to the new constitution written by the junta and in the view of many observers with the sole intention to secure the military's continued dominance over politics. That could mean more years of relatively mild political suppression but also more political turbulence as the opposition is unlikely to remain silent when more democratic rights and freedoms of expression are reintroduced. The position of the new king is also highly relevant. Before the coup and the passing of his father it was speculated that he maintained a strong relationship to the exiled opposition leader, Thaksin Shinawatra. Also the manner in which he forced his sister to step down from opposition politics a few months ago has given rise to speculations that The new King he may still entertain such a relationship.

Outlook:

Steady as she goes: On a short to medium horizon expectations are for Thailand to stay on the path staked out in recent years of overall external and internal balances, low inflation and reasonable but not spectacular growth around 3% a year due to threats of intensifying global trade frictions. The financial system will remain sound with only legacy problems – high household leverage – the main issue still causing some concerns several years after their gestation.

However, such a scenario comes with several caveats:

Eastern Economic Corridor: A new government may reallocate resources thereby raising threats to the expeditious implementation of the present government's large-scale infrastructure program –. Although this program has been codified into law it can likely still be slowed prompting fears among investors of the authorities' willingness to see it through.

More political turbulence: Since last fall domestic and foreign investors have begun to flock back to Thailand, not only to take part in government projects but also other attractive developments. However, they can easily be deterred should the global economy experience a sharper downturn than presently expected.

Rapid ageing: According to demographic trends, 2019 marks the first year Thailand's working age population starts to decline at a quickening rate reaching more than half a percentage point a year by the middle of the next decade. Unless the trickle-down effect has taken on more dynamism by then, consumer demand may see a relatively lackluster development as more income creation non-proportionally benefits the already richest part of society, i.e. households with the lowest propensity to consume, providing business people declining incentives to invest in the domestic economy.

Sharp slowdown in China: It is generally recognized that China has passed its prime and is soon to face the ills of many advanced countries but at a clearly more premature stage. The working age population has begun to decline with spill-over effects on private consumption. Next year economic expansion could be poised for continued drop leaving annual growth rates at about 3% according to private projections before the middle of the next decade. That could reshape the global economy with probably the most severe repercussions on countries most dependent on regional trade like Thailand -- an open economy with total trade (export + imports) equal to annual GDP. Even though China's share of Thai exports, not counting services, is moderate at 12% of total export earnings, our calculations on the Oxford Economics Global Model shows such a slowdown in China cutting Thailand's export growth by a full percentage point while leaving the total economy relatively unaffected (Conf. Box 2) a possible sign of the export sector's ability to quickly adjust to the rerouting of global and in particular regional trade.

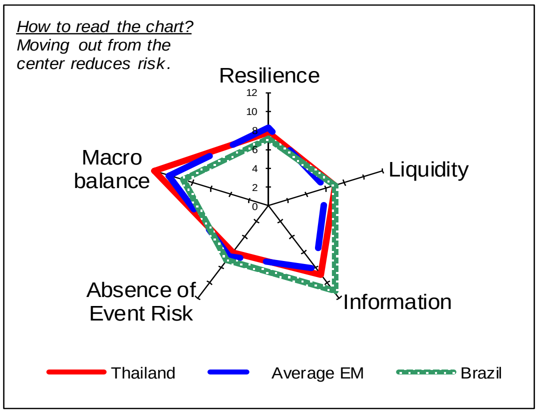
Box 2	Sharp slowdown in China 2019-23 Deviation (pp) from base line	
	GDP	Exports
China	-1,51%	0,15%
Japan	-0,10%	-0,65%
Hong Kong	-0,65%	-0,98%
Taiwan	-0,59%	-0,97%
Indonesia	-0,04%	-0,54%
Thaland	-0,04%	-1,14%

Overall, it seems to us that the economy is capable of adapting to new realities, meaning focus is now on the political challenges and the country's way back to a more inclusive democracy.

Ratings:

The main rating agencies have remained on the sidelines in recent years since the junta took over in 2015 as the strengthening of economic and financial metrics have outweighed the risk of political turbulence for the sovereign. We believe that is also relevant to country risk.

Key statistics	**2019**
GDP/capita ($)	7707
GDP (change)	3,4%
Inflation	1,2%
Curr. Account balance/GDP	6,4%
Reserves/imports (months)	10
Budget balance/GDP	-3,0%
Central gov. debt/GDP	34%



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.

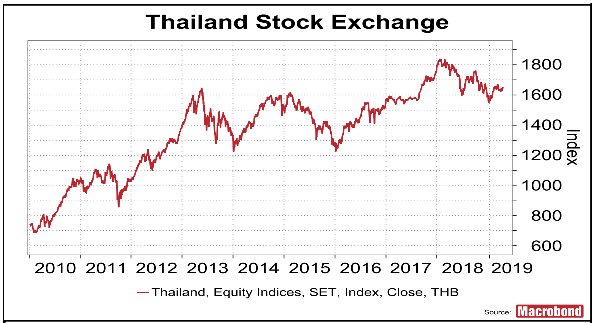
Key data:	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
GDP (mill.US$)	421	407	402	412	456	507	534	567	603
GDP/capita (US$)	6169	5951	5849	5978	6601	7330	7707	8171	8674
GDP (real change)	2,7%	1,0%	3,0%	3,3%	3,9%	4,2%	3,4%	3,3%	2,9%
Investments/GDP	25%	24%	25%	25%	24%	24%	24%	24%	24%
Budget balance/GDP	-2,1%	-2,2%	-2,2%	-2,8%	-3,0%	-2,6%	-3,0%	-3,3%	-3,5%
Govt debt/GDP (*)	29%	30%	30%	31%	32%	33%	34%	34%	35%
CPI inflation (%)	2,2%	1,9%	-0,9%	0,2%	0,7%	1,1%	1,2%	1,7%	1,9%
Money demand (%)	13,9%	4,8%	5,4%	3,2%	3,6%	6,5%	6,2%	6,4%	5,4%
Stock prices (yearly avg.)	68179	68449	68684	68883	69051	69193			
Interest rates	2,7%	2,2%	1,8%	1,6%	1,6%	1,6%	2,0%	2,5%	2,9%
Exch. Rate ($)	30,73	32,48	34,25	35,30	33,94	32,31	32,06	31,67	31,27
Trade/GDP (%)	108%	107%	100%	95%	96%	96%	94%	95%	95%
Oil price (Brent)	$109	$99	$52	$44	$54	$71	$61	$66	$67
Millions US $									
Export of goods	227,5	226,6	214,0	214,3	235,3	253,8	263,0	278,9	295,2
Imports of goods	227,4	209,4	187,2	177,7	201,1	231,2	239,9	257,7	275,1
Other:	-4,9	15,2	32,1	48,2	50,2	37,5	34,1	32,8	35,5
Current account	**-4,9**	**15,2**	**32,1**	**48,2**	**50,2**	**37,5**	**34,1**	**32,8**	**35,5**
(% of GDP)	-1,2%	3,7%	8,0%	11,7%	11,0%	7,4%	6,4%	5,8%	5,9%
FDI	3,8	-0,8	3,9	-10,6	-10,6	-7,8	-9,0	-11,2	-13,1
Loan repayments	-11,1	-12,9	-17,3	-12,3	-13,0	-14,9	-18,1	-22,8	-27,6
Net other capital flows	6,0	-9,5	-24,6	-6,6	-11,1	1,2	-5,0	13,7	50,8
Balance of payments	**-6,1**	**-8,0**	**-5,9**	**18,8**	**15,5**	**15,9**	**2,1**	**12,6**	**45,5**
Reserves (yearly avg.)	165,4	157,4	151,6	170,3	185,8	201,7	203,8	216,4	261,9
Total debt (yearly avg.)	140,9	144,1	135,9	139,1	146,5	157,9	169,4	183,2	197,0
o/w short term debt	62,6	61,0	54,4	58,6	61,4	67,2	74,8	83,1	92,0

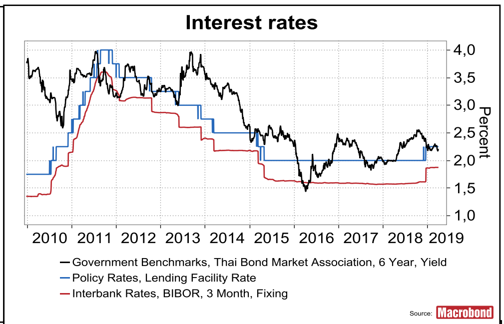
(*) Central government only

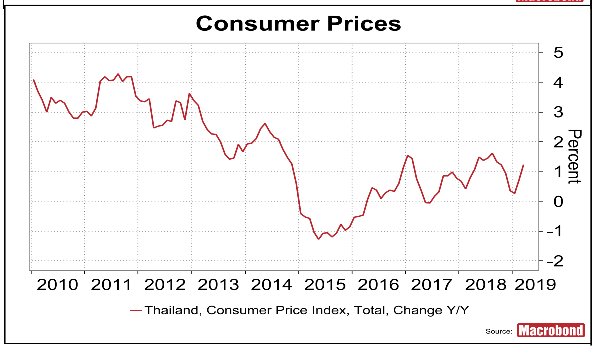
Source: OEF (Oxford Economic Forecasting) and SEB estimates.

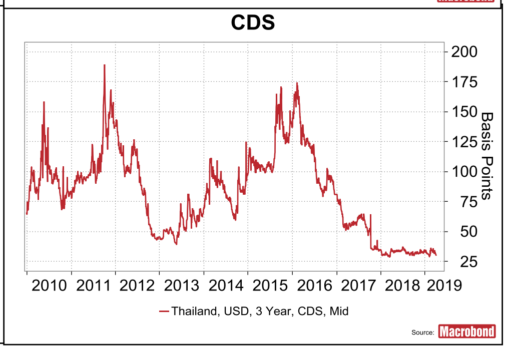
Rating history					
Fitch (eoy)	BBB	BBB	BBB+	BBB+	BBB+
Moody's (eoy)	Baa1	Baa1	Baa1	Baa1	Baa1

Type of government:	
Next elections	2023
Other:	
Latest PC deal	None
Recent IMF programs	Stand-by 1997









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