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Performance and Prospect of the Thai Economy:
Current Risks and Ways to Overcome Middle Income Trap

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＜Summary＞

- Under the influence of the Asian currency and financial crisis, the Thai economy experienced a deep negative growth in two consecutive years of 1997-1998 and it was only in 2001 that it recovered the level it had reached before the crisis. The economy continued to grow strongly later but in 2009 it again had a negative growth due to the influence of global financial crisis. Since then, despite the damage of a heavy flooding and an adverse impact of political uncertainties caused by a coup in 2014, the economy has generally been on a recovery path until now, continuing to grow slowly.
- The current driving force of a recovery is the public investment and exports of goods and services. Private domestic demand remains weak in both household and corporate sectors.
- Thailand, which has been experiencing a relatively rapid aging of population, has now faced with the same problems as advance economies commonly have, i.e., a slow growth, low inflation trap.
- For the Thai economy to overcome the "middle income trap" and continue its steady growth in the medium-to-long term, it is necessary for the country to boldly address the problems of aging population, growing informal sector, and postponed structural reforms which constitute a bottleneck of the economy.
- External risk factors include global movements of anti-globalization and anti-free trade, deceleration of the Chinese economy and possible rapid outflow of capital from Thailand in response to a change in U.S. monetary policy. Political uncertainties constitute the top of

domestic risks. A state funeral is scheduled in October 2017 for the previous king of Thailand, and therefore the shift to civilian rule and a general election will most likely take place in 2018, but the situation is quite liquid.

1. Performance of the Thai economy

Positioning of Thailand in Asia

In terms of GDP, Thailand is the biggest country next to Indonesia among the ASEAN countries. In terms of per capita GDP, it ranks the fourth highest following Singapore, Brunei, and Malaysia, and stood at $5,900 in 2016 (IMF estimate), reaching the level of a middle income group.

Table 1: Main Economic Indicators for Major Asian Countries

		GDP 2016 ($ billions)	Population 2016 (millions)	GDP per capita 2016 ($)	Real Growth rate (annual average)				
					1980-89	1990-99	2000-2010	2011-2015	2016-2022
ASEAN	Brunei Darussalam	11	0.42	26,424	-0.2	2.1	1.5	-0.1	4.5
	Cambosia	19	16	1,230	6.5	6.2	8.1	7.2	6.7
	Indonesia	932	259	3,604	6.5	4.8	5.4	5.5	5.3
	Lao PDR	14	7	1,925	6.0	6.1	7.1	7.9	6.9
	Malaysia	296	32	9,360	5.9	7.2	5.0	5.3	4.7
	Myanmar	66	52	1,269	n.a.	8.4	10.7	7.3	7.4
	Philippines	305	104	2,924	2.0	2.8	4.7	5.9	6.9
	Sinagapore	297	6	52,961	7.8	7.3	6.2	4.1	2.5
	Thailanad	407	69	5,899	7.2	5.4	4.6	2.9	3.1
	Viet Nam	201	93	2,173	5.0	7.4	6.8	5.9	6.3
India		2,256	1,309	1,723	5.5	5.7	7.2	6.8	7.7
China		11,218	1,383	8,113	9.8	10.0	10.3	7.9	6.1
South Korea		1,411	51	27,539	8.8	7.1	4.8	3.0	2.9
Japan		4,939	127	38,917	4.4	1.6	0.9	1.0	0.8

(Notes) GDP data are available from 1985 for Brunei, from1987 for Cambosia, and from1997 for Myanmar. Data for 2016 and after are the forecasts of the IMF. The figures of average represent the average of the available years. (Source) IMF

Recovery continues at a slow pace

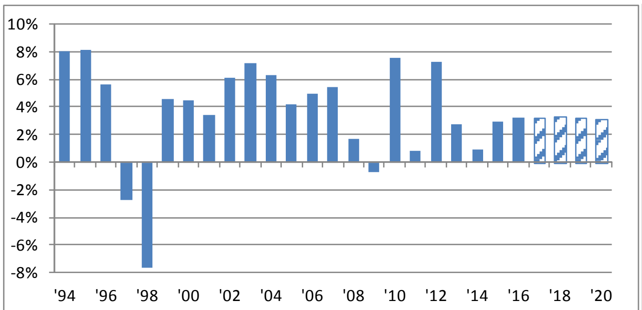
The Thai economy experienced a severe negative growth in two consecutive years of 1997 and 1998 influenced by the Asian currency crisis of 1997, and it was only in 2001 that it recovered the economic level it achieved before the crisis. The economy suffered from another negative growth in 2009 due to the influence of the global financial crisis after it had a strong recovery for some time. Since then, in spite of an adverse effect of heavy flooding in 2011 and political turmoil over the coup in 2014, the economy followed an upward trend to have a mild growth now. However, the growth rate in the 2010s pales a bit by comparison with other

ASEAN countries.

The driving force of the current recovery is the public investment and robust exports of goods and services. Although private consumption is solid, it is not strong enough to lead the economy. Corporate investment remains on a slow increase. The real GDP grew by 3.2% in 2016 (preliminary), exceeding the growth of 2.9% achieved in 2015.

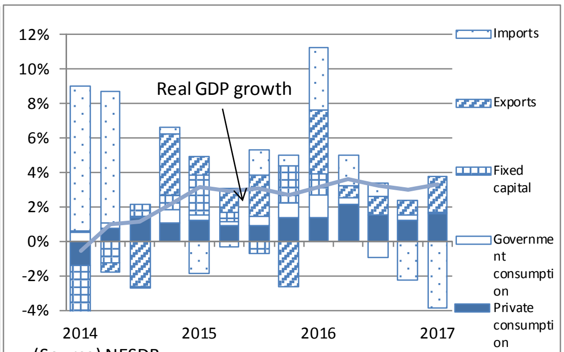
The IMF projects that the Thai economy will continue to grow at a modest rate led by the government expenditure centering on public infrastructure investment and exports of goods and services.

Chart 1 : Thailand: Real GDP Growth Rate
（Yearly data）



(Notes) Preliminary for 2015,2016. IMF forecast for 2017 and after.
(Sources) Office of the National Economic and Social Development Board (NESDB)、IMF

Chart 2:Contributions to the real GDP
（Quarterly Data, year on year）



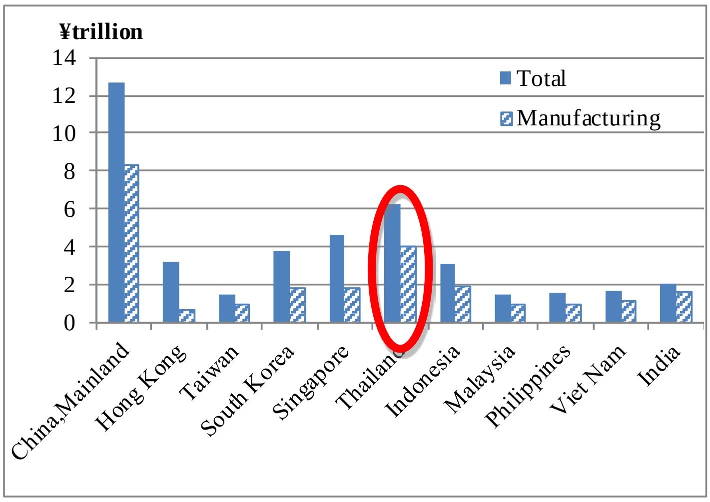
(Source) NESDB

Thailand, an important strategic base for the Japanese supply chains development

Since the time of its military ruling in the 1960s, the Thai government had promoted its industrialization of the economy by actively introducing foreign capital. Especially in the latter half of the 1980s, direct investment from Japan and Korea to Thailand looking for a production base with a lower cost of manufacturing increased sharply against the background of a depreciating dollar after the Plaza Accord, helping Thailand to make an export oriented economic development depending on the foreign capital. The government's active measures to attract foreign capital such as development of industrial complexes and tax breaks achieved successful outcome. Although Thailand often faced with political conflicts over the relationship with the military, it has kept a friendly position toward the foreign capital even in the political turmoil.

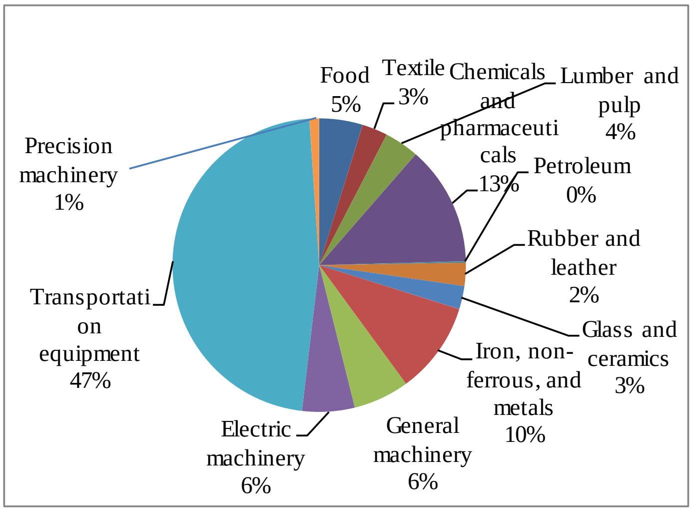
As of the end of 2016, out of ¥154 trillion of the Japanese foreign direct investment (FDI) outstanding, a little less than 30% was directed to the Asian region. Of which China had a predominantly high share of a little less than 30% and Thailand had a second largest share, amounting to about half of China. The Japanese FDI in Asia is characterized by its concentration in manufacturing, which is no exception in Thailand. By industry sector, the investment in transportation equipment accounted for almost half of the total. Other big sectors included chemicals and pharmaceuticals, iron, non-ferrous metals, electric machinery, and general machinery. Thus Thailand has become an important strategic base for the development of global supply chains by the Japanese companies. The statistics of Thailand, which disclose the recipient side of investment, also show a high share of the FDI from Japan (Chart 5).

Chart 3 : Japanese FDI to Asia
(Outstanding, end of 2016)



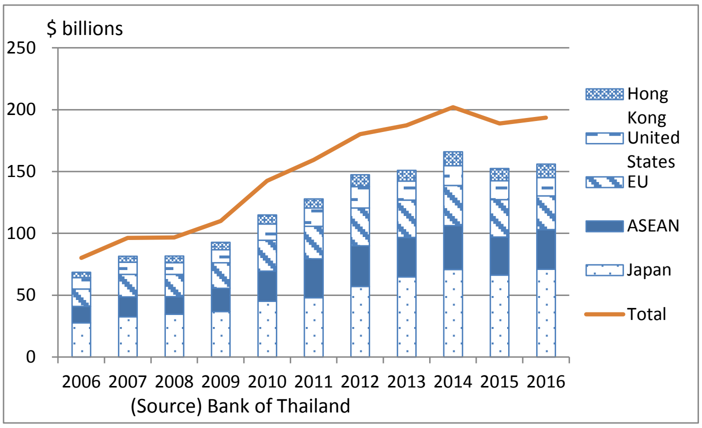
(Source) Japanese Ministry of Finance

Chart 4: FDI to Thailand by manufacturing sector
(Outstanding, end of 2016)



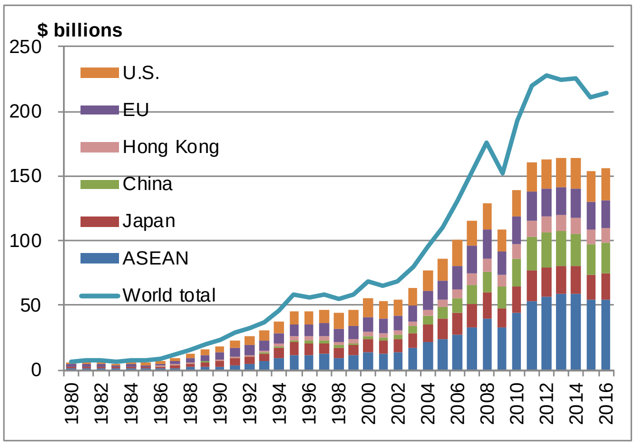
(Source) Japanese Ministry of Finance

Chart 5 : FDI to Thailand (outstanding, by investor country)



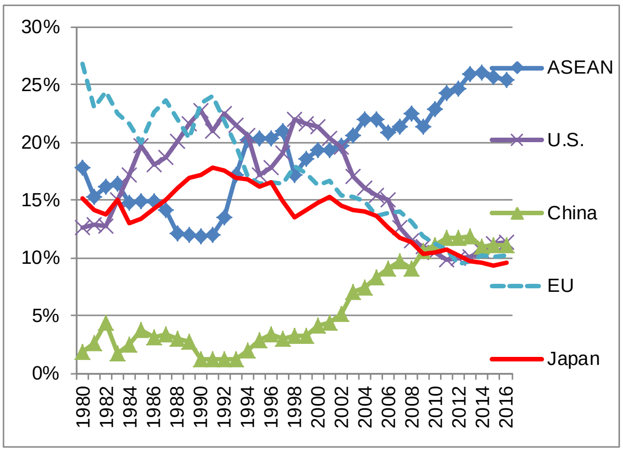
Through the incorporation of Thai manufacturing industry into the global supply chains, Thailand had seen a steady increase of exports. The shares of destination countries of the Thai exports show that until the 1980s Europe had a larger share in the destination but after the 1990s its share declined sharply. The share of Japan increased over the latter half of the 1980s to the first half of the 1990s, but it gradually decreased since, and instead the shares of China and intra-ASEAN trade increased. Since it joined the World Trade Organization (WTO) in 1994, China had rapidly promoted globalization of its economy. In the meanwhile, intra-ASEAN trade has been accelerated mainly reflecting strong growth in the neighborhood ASEAN countries as well as invigorated intra-regional direct investment[1], and in 2016 a quarter of exports was destined for intra-region countries.

Chart 6 : Exports by destination



(Note) ASEAN as a tradepartner means 9 members other than Thailand.
(Source) IMF

Chart 7 : Developments of Export Shares



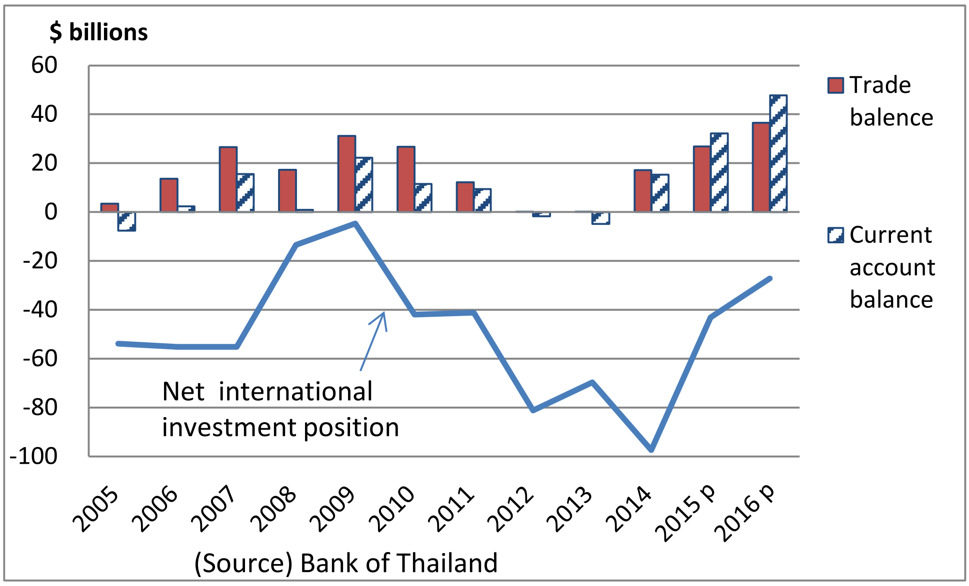
(Note) ASEAN as a tradepartner means 9 members other than Thailand.
(Source) IMF

The Balance of Payments Developments

Before the Asian crisis Thailand had a current account deficit as high as 8% of GDP, which led to an impetuous capital outflow. After the crisis, Thailand took tightening policies to slow the domestic demand and drastically decrease imports to promote an adjustment process on its balance of payments. Since then, although the trade balance has generally maintained a surplus, the trade surplus decreased significantly due to high oil price in 2012 and 2013. Since 2014 both trade surplus and current account surplus have been on an expansionary trend, recording a big surplus of $36.5 billion on the trade balance and $47.7 billion on the current account (9% and 12% of GDP, respectively) in 2016. As a result, deficit on net external investment position narrowed significantly. Thailand also has abundant foreign exchange reserves equivalent of 11 months' imports. Thus Thailand has little to worry about on its external front.

[1] Direct investment in the ASEAN region sharply increased since 2010. Both inward and outward investment increased mutually between Thailand and ASEAN4 (Indonesia, Malaysia, Philippines and Singapore). CLMV (Cambodia, Lao PDR, Myanmar and Vietnam) had an increased direct investment from Thailand. Responding to an increase of domestic minimum wages and labor shortage, more and more Thai companies have been expanding their business in CLMV which have lower labor costs.

Chart 8：Thailand; Balance of Payments and International Investment Position



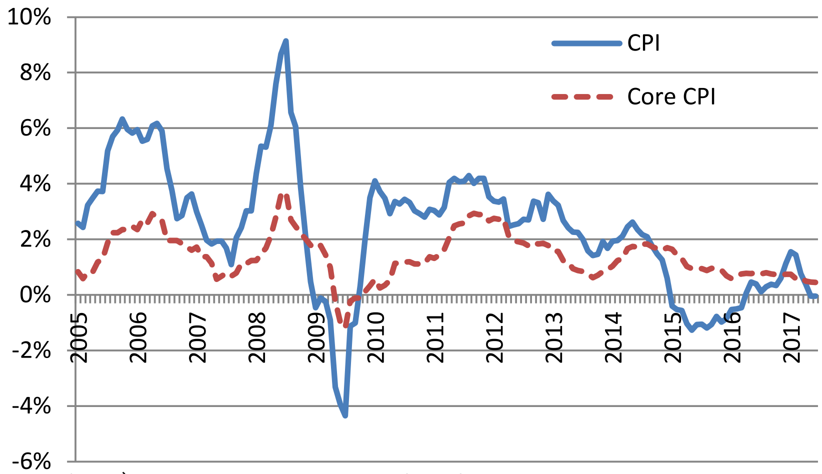
Employment and Inflation

Unemployment rate in Thailand rose sharply after the Asian financial crisis, recording over 5% in 1999. Then the rate continued to fall to reach 1.4% in 2007. Impact on the employment of a recession caused by the global financial crisis was rather small, with the rate hovering a little below 1% in 2010 to 2013. Although the rate started to rise moderately, the unemployment rate averaged 1.0% in 2016 and still remained at a historically low rate of 1.3% in March 2017. Despite this seemingly tight labor situation, the wage increase remained at a limited 1.8% on a yearly average in 2016. Against this background, disinflation on consumer price has continued (Chart 9).

Thailand has seen a flood of incoming workers from neighboring countries like Lao PDR, Cambodia, and Myanmar. Currently it is estimated that there are 1.35 million of legally admitted foreign workers and 4-5 million of illegal foreign workers in Thailand. In recent years, regulatory controls on foreign workers have been tightened and in June 2017 strengthened penalties were announced for both unauthorized foreign workers and their employers[2]. In the time ahead, there is a possibility that various industries including agriculture, food processing, food service, wholesale and retail, and construction will face a deepening labor shortage[3].

[2] In July 2017, it was announced the implementation of the penalties would be postponed by 180 days to start in January 2018.
[3] According to an estimate of the Bank of Ayudhaya Public Company Ltd., there is a risk that labor shortage and wage increases will drag down the GDP growth rate by 0.03-0.2% points.

Chart 9：Developments of Consumer Price Index (Yearly change)

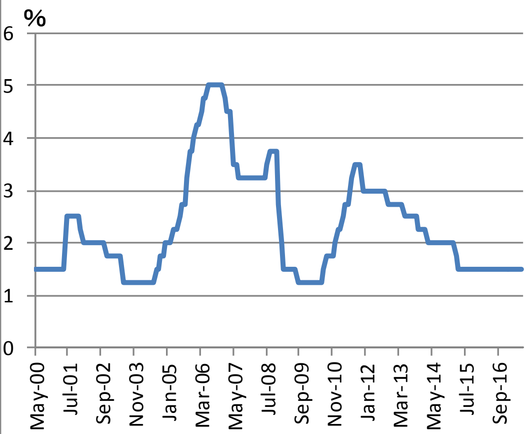


(Note) Core CPI means CPI except fresh foods and energy.
(Source) Ministry of Commerce Thailand

Monetary policies and foreign exchange rates

The Bank of Thailand, a central bank, had managed its monetary policies by making it a target for price stability to control the consumer price increase at 2.5% (±1.5%) on a yearly average[4]. The rise in consumer prices remained below the targeted range in the recent two consecutive years. It is attributed to the decline in the rise of food and energy prices, but a disinflationary trend is continuing even on the core inflation rate. Reflecting such price developments, policy rate has been kept at a low level of 1.5% since April 2015 (Chart 10).

Chart 10：Developments of Policy rate



(Source) Bank of Thailand

Chart 11：Foreign Exchange Rate Developments (Baht/dollar, end of month)

(Sourde) Thomson Reulter

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4 Thailand introduced in 2000 a flexible inflation target polity and has basically retained price stability. The current target range was decided at the cabinet meeting held in January 2015.

The foreign exchange rate of the baht against the dollar has been recovering in 2017 after it tended to fall since the tapering tantrum in May 2013 when the exchange markets had turmoil at the expected start of the U.S. tapering of its unconventionally easy monetary policy.

Financial sector

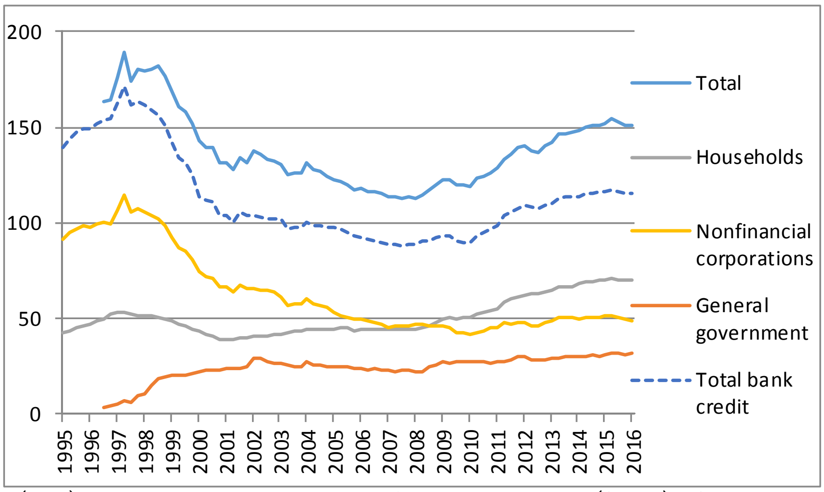
The credit provision of the Thai financial sector decreased in terms of GDP after the Asian crisis (Chart 12). Especially the credit extended to corporate sector sharply decreased to 50% of GDP from 100% of GDP reached before the crisis. On the other hand, credit to household sector, despite a decline immediately after the crisis, continued to increase into the 2000s, exceeding the credit to corporate sector at the end of the 2000s, reaching 70% of GDP.

Most of the credits to households consist of housing loans. Housing prices are rising in recent years (Chart 13), especially for condominiums in the urban areas. Although the increase in loans to households is slowing, it still exceeds the increase of income. As the households in agriculture, SMEs and low income households are likely to face difficulty in repayments hereafter, continued careful monitoring by the authorities will be required.

The non-performing loan rate (share in the total lending) of the banking sector in Thailand tended to decline until 2014, but recently it is moderately rising. It stood at 3.1% at the end of March 2017, although the level is still low from an historical point of view (Chart 14). The non-performing loan ratios are especially high in commerce (5.44%), manufacturing (4.83%) among corporates and credit card (4.09%), housing loans (3.23%) among households. However, at the same time the banks have the capital adequacy ratio (against risk weighted assets) of 17.8% and rate of allowance of bad and doubtful debts of 161.8%, with the financial risks considered to be limited.

Chart 12: Total credit by financial sector to non-financial Sectors in Thailand

（% of GDP）



(Note) Total bank credit equals to claims of the banking sector (Source) BIS

Chart 13: House price index

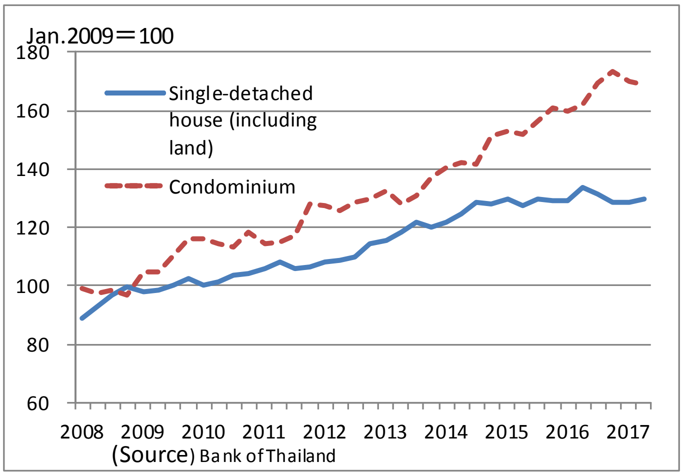
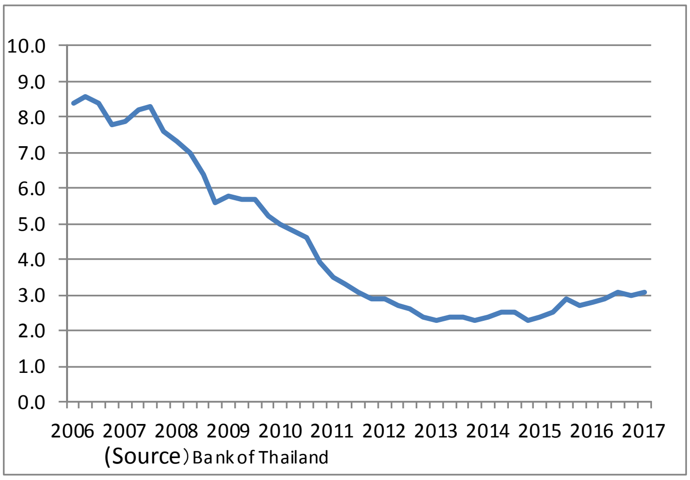


Chart 14: Non-performing loans Against total gross loans （%）



2. Challenges over the medium-to long run: Can Thailand overcome the "middle income trap"?

Following the NIEs (Hong Kong, Korea, Singapore and Taiwan), Thailand aims to join the group of advanced industrialized countries by overcoming the "middle income trap", but it is facing with various challenges. Thailand is one of the ASEAN countries which have the fastest population aging. Its productive age population hit the peak in 2013, showing the typical example of "Asia growing old before getting rich."[5] Slow growth, low inflation trap is an agenda common to advanced economies, but Thailand is already facing the same problem on one level or another.

In order to improve the potential growth, it is necessary for Thailand to take measures to tackle the labor shortage in the first place. They include enhancement of women's employment rate through improved childcare services, enhancement of employment of elder people through the raise of retirement age, facilitating migration of skilled foreign workers, improved quality of education and vocational training, and so on.

Further, it is necessary to increase capital investment and improve productivity. Among others, improvement of productivity through innovation is a pressing task. It will require the expansion of opportunity for private investment through advancement of public infrastructure investment, and revitalization of services industry through deregulation on participation of foreign capital and the like.

[5] On the population aging in Asia, please refer to "Asia, Growing Old before Getting Rich", in the IIMA International Financial Topics series. http://www.iima.or.jp/Docs/topics/2017/299_j.pdf

In this context, focusing on the "Sufficiency Economy Philosophy" [6], the Thai government emphasized in the 12th National Economic and Social Development Plan (October 2016-September 2021) their priorities on reduction of income gaps and poverty, improved competitiveness, improvement of natural environment and further improvement of confidence in Thailand in international society.

3. Risk factors

Among the risk factors Thailand faces, the external factors include global movement against globalization and trade liberalization, deceleration of the Chinese economy, abrupt and rapid capital outflow in response to the change of the U.S. monetary policy and the like. Domestic factor includes political uncertainties.

Movement of anti-globalization and anti-trade liberalization

Thailand has an open economy and currently it is growing largely led by external demand. The movement against globalization and trade liberalization that is rising mainly in the U.S. and Europe has generated a concern over the future of exports from Thailand. In fact, slowdown of the increase in the world trade is a matter for great concern to Thailand which has a high export dependency. It will give it a sense of relief that the extreme inclination to protectionism of the Trump administration seems to be halted in spite of initial concerns over his external policies at his inauguration. The Thai government is expected to come up with the policy measures, responding to the recommendations of the IMF and others, to correct excess dependency on exports and stimulate domestic demand. Therefore, it can be said the risk is small for the problem of protectionism to put a downward pressure on the Thai economy.

Deceleration of exports in line with the slowdown of the Chinese economy

As noted above, the share of China as a destination of Thailand exports has been rising to 10%, exceeding the Japanese share. Therefore, there remains a risk of export decrease in line with a sudden slowdown, if any, of the Chinese economy. It is true that there is a rise in the share of intra-ASEAN trade reflecting the growth of neighboring ASEAN countries and the launch of the ASEAN Economic Community (AEC), yet the sudden slowdown of the Chinese economy could be a big risk as the trade dependency on China is rising in ASEAN as a whole. According to an estimate of the IMF, slowdown of the Chinese real growth rate by 1% point will lower the real exports of Thailand by 0.7% point[7]. The impact is bigger on the Philippines

[6] It represents an economic philosophy that the former King Rama IX advocated at the end of the 1990s. It constitutes a basic philosophy in the 10th and 11th National Economic and Social Development Plans.
[7] By simple calculation, it will depress the Thai GDP by 0.4% point.

and Indonesia. According to the IMF Article IV Consultation report, however, the Chinese economy is expected to grow by 6.7% in 2017, and by 6.4% over the medium term (2017-2021), revised upward from 6.0% estimated in the 2016 report. So the risk of the slowdown of the Chinese economy itself can be considered to have receded.

Possible rapid capital outflow triggered by the change of the U.S. monetary policy

In the middle of 2013, speculation over the change of the U.S. monetary policy triggered capital outflow from many emerging economies, inviting the depreciation of their foreign exchange rates. There was some influence on Thailand, too (Chart 11). However, as was seen above, Thailand has an excessively high level of current account surplus and affluent foreign exchange reserves. The external risk can be seen small.

Political Development

From November to December 2013, there was a spate of big demonstrations against the government. The Yingluck administration dismissed the lower house in December and a general election was held in February 2014. The election was thrown into extreme confusion with suspension of voting in some electorates due to campaign obstructions. In March 2014 the constitutional court declared the election as invalid and sentenced in May the dismissal of 9 cabinet members including Prime Minister Yingluck. The military took power in a coup in May, and in July enacted the provisional constitution of 2014 in which the powerful authority of the National Council for Peace and Order (NCPO) of the military was incorporated on the assumption of the general election to be held in 2015. In August 2014, General Prayuth (Commander-in- Chief) was inaugurated as the 29th Prime Minister of Thailand.

In October 2016, King Bhumibol Adulyadej (Rama IX) passed away at the age of 88. He had reigned Thailand for 70 years, the longest reign in the Rattanakosin Era. He was so much loved and respected nationwide by the people that there was a concern over the confusion in respect of the royal succession, but after a period of mourning, the succession of Prince Vajiralongkorn to the throne was announced in December 2016.

Under the Prayuth interim administration, a road map was published for a restoration of democracy together with institution of a new constitution (initially the institution of a constitution and general election was scheduled in 2015). However, the institution of a new constitution had a very rough going. The second draft of the constitution which was proposed in 2016 was endorsed in a national referendum in August after some revisions, but it was further revised through the demise of the king and succession of the prince to the throne before it was finally enacted after the new king signed it on April 6 2017. It is estimated that the process from the institution of constitutions to the implementation of a general election will take about 16 months including preparations for elections as enactment of various related legislations is needed. Accordingly, it is highly likely that a general election will take place after the middle of 2018.

In the new constitution, a transitional provision for 5 years from the first general election was incorporated stipulating that the first members of the Senate will be appointed by the NCPO and if the selection of prime minister by the House of Representatives does not go smoothly, the Senate will join the selection process and can nominate the prime minister from other than the lower house members. Thus the strong influence of the military has been maintained.

Since the 1990s, Thailand has successfully promoted the correction of income disparity despite the widening tendency of it in many of the Asian countries[8]. However, the level of the disparity seen in terms of Gini coefficient is still high. Especially wide are the regional disparities between industrialized urban areas and rural areas (especially in the north and northeast regions) and the parties supported are also clearly divided between the Democratic Party that has many supporters in the urban areas and the Thai Rak Thai Party (TRT, former Thaksin fraction) that has a strong base in rural areas. Added by the influence of the military[9] to the confrontation of the two major political parties, the political situation in Thailand will continue to be unstable for some time to come.

[8] Some people see this is the result of the populist policies implemented by the Thaksin administration.

[9] The incumbent Prayuth administration inherits the populist policies directed to the rural areas that had been implemented under the Yingluck administration and this is regarded as aiming at increasing supporters of NPCO in the rural areas.

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