Economy

BHANUPONG NIDHIPRABHA

HISTORICAL OVERVIEW

Between 1961 and 1990 the Thai economy expanded at an average annual rate of 7.2%. Per capita gross national income more than quadrupled over the same period. The growth rate was remarkable, as there was no threat of spiralling inflation, even though during this time the country experienced two oil price shocks, which led to brief periods of double-digit inflation. Price stability was maintained throughout this period, owing to fiscal discipline and the rapid development of financial institutions. A conservative budgetary policy created fiscal sustainability and enabled successive Governments to implement trade liberalization. Public debt was cut from a record high of 36% of gross domestic product (GDP) in 1986 to just 17% in 1990. Since the Thai currency, the baht, was pegged to the US dollar, it created a more stable environment for international trade. However, there were two significant devaluations of the currency: of 8.7% in 1981 and 14.9% in 1984. The devaluations were successful: the trade deficit was transformed into a surplus as a result of a more realistic exchange rate.

In 1984 Thailand adopted a peg of the baht to a basket of currencies of the countries with which it did most trade, with different weightings, in order to minimize exchange rate fluctuations. However, the gradual overvaluation of the baht precipitated the Asian financial crisis in 1997. Output contracted by 10% in 1998, but Thailand was able to export its way out of recession, taking advantage of the healthy global economy outside Asia. Between 1991 and 2005 Thailand engaged in trade reform and opened up its financial sector, allowing the country to enjoy a high-growth trajectory, riding the waves of global economic expansion.

Then came a military coup in September 2006 (see *History*), which shook business sentiment and consumer confidence. Constant political turmoil and violence, including a curfew in the capital, Bangkok, and a shutdown of its international airport in November 2008, destabilized the Government and exacerbated pessimistic economic expectations. The Thai economy began to experience a deceleration of economic growth below its potential path of expansion. In January 2014 the 'yellow shirts' anti-Government group staged a campaign to 'shut down' Bangkok. Consumption and investment growth slowed, in particular, after another military coup in May that year. Foreign direct investment (FDI) dwindled and was diverted to neighbouring countries with greater political stability.

Almost three years after the 2014 coup, a new Constitution was promulgated in April 2017, and a national election was held in March 2019. A new coalition Government was formed, after being elected by a narrow majority in the National Assembly. However, the Government is led by Prime Minister Gen. Prayuth Chan-ocha, who had also headed the military junta that had ruled the country since the 2014 coup. In July 2020 six government ministers resigned, owing to internal fighting within the coalition parties. The Prime Minister reorganized his team of economic ministers in August to pacify disgruntled members of coalition parties and give new hope to the public, after six years of disappointing economic management by the previous incumbents. However, the resignation of the newly appointed Minister of Finance, Predee Daochai, in early September, after less than a month in office, threatened to undermine both public and investor confidence.

The Government is facing insurmountable economic and social problems. The road to Thailand's economic recovery will be even more challenging because of the global coronavirus disease (COVID-19) pandemic. The Government will not be able to cope with external shocks easily, given the poor level of governance in Thailand and the generally poor quality of its institutions.

THE ECONOMY DURING THE COVID-19 PANDEMIC

The Thai economy has been on a low growth path since 2006. It exhibits increased volatility, caused by fluctuations of internal and external demands. When trade tensions between the USA and the People's Republic of China from 2018 dampened demand for Thailand's exports (see *The USA–China Trade War and its Effects on Thailand*), the economy did not enter recession, owing to the booming tourism industry. However, when COVID-19 hit in early 2020, tourism ceased. Travel restrictions and a lockdown imposed to curb the spread of the virus brought about a severe decline in domestic consumption and a shrinking services sector.

GDP declined for the first time since 2014 in the first quarter of 2020, by 2.0% on a year-on-year basis. In the second quarter GDP contracted by 12.2%, the sharpest decrease since the 12.5% decline recorded in the second quarter of 1998, when Thailand endured the Asian financial crisis. As measured by the manufacturing production index, industrial output in the second quarter of 2020 declined by 19.9% on a year-on-year basis. This situation is different from that in 1998, however: the financial sector is more robust, while the baht remains strong. None the less, since all growth engines have been shut down, the economy will experience a deep recession in 2020.

The USA is the largest market for Thailand's exports, so the 9.1% year-on-year contraction in second-quarter output registered in the USA suggests that external demand will be unlikely to rebound. Despite the early recovery of the Chinese economy in the second quarter, other key trading partners also suffered from the impact of lockdowns in the second quarter. Japan and Singapore experienced year-on-year declines of 9.9% and 13.2%, respectively. There would be no hope for a rapid, 'V-shaped' recovery such as Thailand experienced in 2010 after the global financial crisis, when the strong recovery of China and India propelled Thailand's exports.

The contraction in the second quarter was expected to be the deepest of 2020, as Thailand lifted its lockdown on business activities on 1 July. Consumer confidence and industrial production should gradually return to normal levels in the second half of 2020, provided there is no second wave of the virus in the country. With increased spending on economic activity anticipated in the second half of the year, in June the Bank of Thailand (the central bank) forecast that GDP would shrink by 8.1% in 2020.

THE CHINA FACTOR

Thailand's business cycle is broadly synchronized with that of China, as China's import demands largely dictate the growth of Thailand's exports. When investment and consumption do not sufficiently expand, exports are the remaining driver of growth.

China is the top destination of Thailand's exports, receiving 11.8% of its total exports in 2019. If Hong Kong is included, the overall share of China's exports in that year amounted to 16.6%. The 1.6% contraction in GDP recorded in China in the first half of 2020 over the same period of 2019 will have severe implications for international trade, possibly prompting a significant global economic slowdown and even a recession in developed economies.

When growth in China decelerates, its declining demand for commodities depresses the prices of Thailand's exports of food and agricultural raw materials, chiefly rice, oil palm kernels, maize, cassava and rubber. With weak agricultural export prices, the value of Thailand's exports in 2019 declined by 2%. Although agrarian exports represent only about 10% of Thailand's total exports, farm income is essential for the population in rural areas, where more than 40% of the labour force work in the agricultural sector. When farm incomes are depressed, so is the demand for manufactured products. Domestic sales of motorcycles and pick-up trucks tend to be sluggish when commodity prices are not favourable for farmers. Thus, China's slowdown adversely affects both the agricultural and non-agricultural sectors in Thailand.

There is a longer-term impact of China's slowdown, which fuels worries about the global recession. Because of the wide trade network that links China's vast manufacturing base to supply chains in Asia, Thailand's exports of intermediate inputs are similarly affected by a production cut in China. Whether it is China's 'new normal' growth policy (aimed at achieving slower but more sustainable rates of growth) or a desire to rebalance the economy, Thailand's synchronized business cycle with China inevitably pushes Thailand's economic activity to move in line with China's. While the USA and Japan were in recession at mid-2020, China was the first country that was recovering from the impact of the COVID-19 pandemic. However, China's recovery would not be sufficient to pull Thailand out of recession.

During a period of low demand from domestic consumption and sluggish exports in the past five years in Thailand, the tourism industry has provided a cushion for the economy, allowing the country to achieve a positive overall economic growth rate—albeit lower than those of other member states in the Association of Southeast Asian Nations (ASEAN). Tourist arrivals from China are by far the largest group of visitors to Thailand (comprising 11.0m. of total arrivals of 39.8m. in 2019), and their average spending is the highest among international tourists. One of the challenges to Thailand's tourism industry is to sustain the growing number of Chinese tourists, who are sensitive to safety and security issues, as well as the exchange rate between the baht and the Chinese currency, the renminbi.

Since 2018 the People's Bank of China (the Chinese central bank) has reduced commercial banks' reserve requirement ratio six times in order to provide more liquidity to credit markets to support small firms during an economic slowdown. The cash Reserve Ratio remained unchanged at 12.50% in August 2020, while the benchmark one-year loan prime interest rate was held steady at 3.85% for the fourth straight month. This indicates that the Chinese economy is recovering from the shock caused by the COVID-19 crisis. However, providing liquidity to markets may not resuscitate investor confidence as long as consumer confidence remains low. There are consequences for Thailand from China's loose monetary policy in terms of the exchange rate. While the renminbi depreciated against the US dollar in 2019, the baht appreciated against the dollar, implying that a strong baht relative to the renminbi would be a deterrent to Thailand's exports to China. Exchange rate-sensitive Chinese tourists would find Thailand less attractive than neighbouring countries whose currencies are depreciating against the renminbi.

THE USA–CHINA TRADE WAR AND ITS EFFECTS ON THAILAND

The trade imbalance between the USA and China has been a thorny issue for more than a decade. China has been accused of being a currency manipulator, despite the trend of renminbi appreciation. When the USA announced 25% tariffs on US $250,000m. worth of goods from China (imposed between mid-2018 and mid-2019), the Chinese Government retaliated by announcing similar tariffs on $110,000m. of US products. When the USA imposed tariffs on imports from China, there was an opportunity for Thailand to replace Chinese products in the US market. Similarly, when China retaliated by raising the tariff on US products, it was possible that Thailand could replace US products in the Chinese market. However, the possibility of Thai goods substituting Chinese goods is limited to some commodities. More importantly, when global trade volumes shrink, Thailand will suffer from China's slowdown. Furthermore, the indirect effect of the trade war slowed growth in Thailand's major export markets in Japan and ASEAN member states. Because China is a major importer of global commodities, a slowdown in its growth, whether from China's 'new normal' growth policy or negative effects from tariffs imposed by the Administration of US President Donald Trump, can exert an enormous influence on global commodities prices and the demand for goods from the rest of the world.

One of the factors that has contributed to China's slowdown is the US–Chinese trade war. Thailand and other ASEAN countries that supply intermediate products to China have been directly affected by reduced imports from China, bearing the brunt of the trade war.

Moreover, a slowdown in economic activity in Singapore and Malaysia implies that their demand for imports of Thai products has declined significantly. The Singaporean economy has been hit more severely by the US–Chinese trade dispute because of its heavy dependence on external trade, with Thailand hurt to a lesser extent because of its lower degree of external exposure than Singapore. Owing to the COVID-19 crisis, Singapore was expected to experience its steepest GDP contraction on record of a projected 6% in 2020. However, the Thai economy was forecast to contract more because of the reduction in exports and income shortfall from the tourism industry.

There have been instances of foreign manufacturing firms relocating from China to countries in South-East Asia to exploit the benefits of US preferential customs treatment. Myanmar and other low-wage countries such as Bangladesh could benefit significantly from such FDI. Furthermore, Thailand may attract FDI from US firms as they seek to avoid tariffs imposed by China.

Although the Republic of Korea (South Korea) and Taiwan have benefited from the US–Chinese trade war by replacing China's exports of semiconductors, Thailand cannot do so, owing to its lack of capability to match the production of skilled labour existing in both those countries. For their part, Bangladesh and Viet Nam can benefit from replacing Chinese textile and garment exports, but Thailand cannot replace Chinese products because of its relatively high wages. As a result, Thailand will not be able to seize the opportunity of replacing Chinese products in the US market. Similarly, Thailand cannot replace US products in the Chinese market, where tariff walls are raised against them. To make matters worse, an excess supply of US soybeans, resulting from the higher tariffs recently imposed by China, has flooded the Thai market and depressed domestic grain prices. Furthermore, China's excess supply of steel has been diverted from the US market, hurting Thailand's steel producers.

Thailand's trade exposure to the USA is much lower than its exposure to China and Japan. Sluggish economic activity in China and Japan suggests that both countries' overall imports will decline sharply, as rising global protectionism increases pressure on capital expenditure. Unless domestic demand in both countries remains healthy, their imports from Thailand will fall, adversely affecting Thailand's near-term growth potential.

A small number of export industries in Thailand have benefited from the US–Chinese trade dispute. Wood and leather products and shoes are some of the Thai products that can replace Chinese products in the US market and US products in the Chinese market. However, these gains are minuscule when compared with the decline in total exports.

In the first half of 2020 Thai exports declined by 7.1% on a year-on-year basis, while imports fell by 12.6%. There was a trade surplus of US $10,700m. If a second wave of COVID-19 infections cannot be contained in various parts of the world, and if the baht remains close to an exchange rate of 30 baht to the US dollar, Thailand's exports could decline by 15% in 2020. In such a situation, GDP could contract by 10% rather than by the 8.1% predicted by the Bank of Thailand.

BAHT APPRECIATION

According to the International Monetary Fund's external sector report in July 2019, the US dollar is overvalued by 6%–12%, based on near-term economic fundamentals, while the Japanese yen, the euro and the renminbi are broadly in line with their fundamentals. Unless structural changes take place in China and the USA, the dollar will need to depreciate to address the issue of large US trade deficits with other countries. The USA's strong dollar policy may soon be replaced by a weak dollar policy. If that is the case in the longer term, the baht will appreciate against the dollar, and the baht could well appreciate to the point of breaking the psychological barrier of

30 baht to the dollar, unless the Bank of Thailand keeps on buying dollars.

Thailand's high current account surplus and ample foreign exchange reserves make the baht attractive as a safe asset, while other regional currencies are depreciating. Capital inflows further strengthen the baht, thereby hurting Thai exporters. Even if the interest rate in Thailand remains relatively low compared with other countries, there would still be an incentive for international investors to hold a long position in the baht. Furthermore, the expected appreciation of the baht attracts more capital inflows.

The Bank of Thailand has attempted to rein in capital inflows by reducing the issuance of short-term baht bonds, lowering the maximum amount that a non-resident investor can hold from 300m. baht to 200m. baht per person, and tightening the report requirements from non-residents' holding of debt securities. However, this provides an opportunity for foreign investors to invest in the baht. As a result, the Bank of Thailand is unlikely to succeed in preventing the baht from appreciating. The Bank of Thailand's policy of curbing capital inflows by reducing the amount of bonds issued could in fact temporarily weaken the baht.

Imposing capital controls to rein in the baht would probably be the last resort as a policy option, and could be almost impossible to achieve. The Bank of Thailand has learned valuable lessons from the experience in 2006, when the local stock market crashed the day after capital control measures had been announced. The Bank of Thailand had to renege on its capital control measures on the following day by excluding portfolio investment from the list of sectors where capital controls were imposed. Capital control measures tend to be ineffective and costly. At best, they can change the maturity composition of flows of capital, but not the total amount of the flows, as long as there is a possibility to make a profit from arbitrage. The situation in 2019 was the opposite of the pre-crisis circumstances of July 1997. At that time, the baht was overvalued, and there were speculative attacks on the baht, as the economy was weak and inconsistent with its fundamentals. Capital outflows led to daily declines in international reserves owing to speculative attacks in the so-called 'battle of the baht' between the Bank of Thailand and hedge funds, which speculated on the baht falling in value significantly. Ironically, the baht, the epicentre of the 1997 Asian financial crisis, had become the region's safest bet currency by late 2019. While the Indian rupee and the South Korean won had weakened by almost 3% since the beginning of that year, the baht was likely to remain strong as long as Thailand's current account registered a large surplus and international reserves remained on an upward trend. Although Taiwan and South Korea also tend to record a current account surplus, these two countries have been hardest hit by the US–Chinese trade war. Thailand is not so directly affected by the supply chain consequences of the trade war. When Thailand's exports decline, its imports also decline, as imported intermediate and capital goods fall accordingly—this is a notable feature of Thailand's current account balance. A strong Thai economy generates a current account deficit, while a weak economy leads to a current account surplus. The baht will continue to be strong as long as the economy enjoys a surplus on the balance of payments.

When the Bank of Thailand cut the policy rate by 25 basis points in August 2019, to 1.5%, the baht immediately declined to 30.9 baht to the US dollar from 30.75 baht. It rebounded to 30.8 baht by the end of the day, however. Because other central banks in Asia had also cut their key policy rates, and much earlier and more frequently, the conclusion is that the Bank of Thailand's interest rate changes are always too little and too late to affect the market. It cannot be denied that the flexible inflation-targeting policy of the central bank encompasses the exchange rate, in addition to the conventional variables, namely output growth and the inflation rate. It can also be inferred that the central bank yielded to pressure from the Government to cut the rate to spur the sagging economy in line with the fiscal stimulus policies of the new administration. Further reductions in the policy rate were effected in November and the first half of 2020 (see *Monetary Policy*.

Between June and August 2020 the baht appreciated by 4% against the US dollar, swinging from the worst to the best performer in Asian currencies. This rising trend will continue as long as there is no significant change in monetary policy. The Bank of Thailand denies that it has intervened in the foreign exchange market to gain trade competitiveness.

A DEEP RECESSION

During the economic boom in the early 1990s the economy was driven by exports and investment. Thailand was able to engineer a rapid recovery after the Asian financial crisis of 1997–98, owing to export growth and baht depreciation. Exports stalled during the global financial crisis in 2008–09, but China's economic recovery eventually supported Thailand's exports. As Thailand has suffered from political instability and two military coups since 2006, the Thai economy has expanded below its potential during this period. Private spending growth has slowed significantly. As private consumption expenditure accounts for some 60% of total output, a slowdown in consumer spending led to dismal GDP growth. When the Chinese economy began to slow, Thailand's export growth engine decelerated dramatically. Because private consumption and investment are related, as consumer spending fell, owing to pessimistic public sentiment, private investment growth became sluggish.

According to the Bank of Thailand, the state of emergency, night-time curfew and business closures imposed by the Government from March 2020 to curb the spread of COVID-19 may cost the country 3,000,000m. baht. However, the Government has been gradually easing the lockdown in several stages. By May almost all businesses were permitted to operate under the 'new normal' conditions. The travel ban on international flights into Thailand, imposed on 4 April, was partially lifted from 1 July for some passengers, including Thai nationals and those with a valid work permit. Despite the contraction in output during the first half of 2020, imports declined more than the reduction in exports, leading to a current account surplus—a natural characteristic of the Thai economy. The current account tends to be more in deficit during periods of output expansion and more in surplus during a downturn. However, the pandemic has caused a deficit in the services balance; therefore, the current account surplus is narrower as a percentage of GDP.

In the second quarter of 2020 GDP contracted by 12.2% over the same period of 2019—the steepest drop in 22 years since the Asian financial crisis in 1998. GDP growth had already slowed from 4.2% in 2018 to 2.4% in 2019. The primary cause of this slowdown was the fall in the value of exports in 2019, by 3.3%. Private and public investment grew by only 2.8% and 0.2%, respectively, in that year. Similarly, government consumption decelerated from 2.6% to 1.4%. Political uncertainties and instability prevented the Government from stimulating the economy to compensate for the reduction in private expenditure.

The Office of the National Economic and Social Development Council predicted that GDP per capita in 2020 would be US $7,175. It forecast that private investment would collapse by 10.2%, and private consumption would shrink by 3.1%, while public consumption and investment would increase by 3.6% and 8.6%, respectively. Since the share of government expenditure in GDP is only one-third that of private spending, fiscal stimulus would not sufficiently spur output growth.

The Government faces a great challenge to lift the economy out of the middle-income trap. It would take longer than two decades for Thailand to reach an income level of US $14,000 per capita if GDP growth could continuously be maintained at 3% without disruption. Unless there is institutional reform in the country, the economy will remain in the middle-income trap. The reforms must change the existing legal infrastructure and improve bureaucratic capacity to foster growth, enhance investor sentiment and promote consumer confidence.

THE STOCK MARKET

The stock market index is a prime indicator of future economic activity. Expectations of future performance are essential for the decision-making process in financial and physical investment. The expectations reflect psychological and fundamental factors. As Thailand's capital market has been integrated into global financial markets, it has been exposed to external shocks, which transmit booms and busts to the Thai economy periodically. Expectations about the future direction of the economy, or business confidence and sentiment, affect stock market liquidity. The wealth effect from the stock market alters decision-making in consumption and investment expenditure. There is a linkage between the real and financial sectors. Monetary expansion enhances liquidity in the stock market, thereby stimulating private investment and consumption. A rise in private expenditure increases the level of output and raises output expectations, which in turn enhance physical and financial capital deepening.

Thailand's stock market broadly moves in line with the US financial markets. Negative results of the tensions arising from the US–Chinese trade war affect stock markets around the world. However, there are times when local conditions lead the Stock Exchange of Thailand index to deviate from global trends. Domestic factors include political uncertainties, natural disasters and terrorist attacks. Indeed, Thailand's high exposure to international capital markets can bring both benefits and costs, in line with fluctuations in the global business cycle. Stabilizing the economy requires the skills of managing capital flows and exchange rate management by the central bank.

In the first half of 2020 the market capitalization of the Stock Exchange of Thailand fell by 13.8%, to 14,600,000m. baht. Foreign investors, institutional investors and brokerage firms are net sellers in the stock market, while retail investors are net buyers.

Various factors are contributing to the poor performance of the Thai stock market. In addition to having the highest price-to-earnings ratio in South-East Asia, the USA–China tensions and domestic political uncertainties were limiting the market's performance in 2020. It is expected that the net profit of the listed companies on the Stock Exchange of Thailand will drop by 50% as a result of lockdown measures, which have depressed domestic consumption. Moreover, the lingering effect of a resurgence of COVID-19 infections in many countries and the end of stimulus packages could further reduce the profits of listed companies. The Stock Exchange of Thailand index has tended to be more volatile than other markets in the region, owing to the impact of domestic political unrest and the sporadic emergence of local infections outside state quarantine. If ongoing conflict between pro-royalists and the Free People anti-Government movement intensifies, stock prices could plunge further due to fear sentiment.

MONETARY POLICY

More often than not the Government is not satisfied about the way that the Bank of Thailand handles the exchange rate and interest rate policy. If the interest rate is too high, and the baht is too strong to stimulate the economy, the Government wants the Bank of Thailand to rein in the strong baht and reduce interest rates. The central bank has to consider the side effects of the weak baht on inflation, household debts and asset speculation. The Government set up a new economic policy committee in early 2019 to combat the economic downturn. The fiscal and monetary committee includes policymakers from the central bank and the finance, commerce and industry ministries. The Government has denied that it is interfering with the operation of monetary authorities, arguing that the country needs co-ordination and flows of information among policymakers.

None the less, the threat to the central bank's independence remains. Empirical evidence in several countries indicates that central bank independence is the key factor determining economic stability. It is not a good sign of a country's economic performance if the government attempts to interfere with the operation of the central bank. The independence of the central bank, which includes policy, operation and institutional governance, must be maintained.

After reducing the key interest rate to 1.25% in November 2019 in view of declining exports, the central bank cut the rate three more times in the first half of 2020 with the aim of mitigating the economic effects of COVID-19, to a record low of 0.5% by mid-May. It seemed unlikely at August that it would cut the rate by a further 25 basis points or adopt a zero interest rate policy, as economic activity had entered the recovery stage. The central bank might introduce an unconventional monetary policy, such as quantitative easing or twisting the yield curve to reduce the long-term interest rate. The newly appointed Governor of the Bank of Thailand, Sethaput Suthiwart-Narueput, who was due to take office in October, and Predee Daochai's successor as Minister of Finance (yet to be designated at mid-September) will have to devise appropriate monetary and fiscal policy measures to navigate the economy through this turbulent time.

FISCAL STIMULUS

Thailand's fiscal structure has been the cornerstone of the country's fiscal sustainability. The ratio of public debt to GDP is relatively low compared with other countries, owing to fiscal discipline built into taxation and budgetary laws. During economic upturns tax revenues grow more quickly than public expenditure. During economic slumps tax revenues decline while expenditure does not fall by as much. As a result, the fiscal budget is more likely to be in surplus during boom years and more likely to be in deficit during a recession. The system of fiscal automatic stabilizers helps the country to manage public debt very well. There are rules of fiscal sustainability, which put a limit on government spending and its ability to create debt to finance the budget deficit. The ratio of public debt to GDP is capped at 60%. Thailand's fiscal policy has been conservative because public expenditure is constrained by tax capacity. The conservative budgetary laws provide ample space for the Government to use fiscal stimulus when facing external shocks. Nevertheless, this conservative fiscal policy has led to a lost opportunity to use budgetary spending for long-term growth through infrastructure development. As a result, the country has forsaken future potential growth for fiscal stability. In this sense, Thailand suffers from a fear of borrowing and creating debt to realize its growth potential.

The level of public debt is not as important as how the Government deploys its budget. If budget funds are allocated to defence and current spending in order to please the military and the electorate, then a high level of public debt would be detrimental to the economy. Empirical evidence suggests that the expansionary impact of current spending on output is weak, if not zero. Military spending can lead to negative output growth. However, if the budget deficit is geared towards infrastructure spending, the deficit itself can be self-financed, as it generates future income streams for the Government.

The Fiscal Responsibility Act (2018) stipulates that populist spending cannot exceed 30% of annual budget expenditure. The motivation behind the Act is to prevent politicians from using off-budget borrowing to finance populist projects. It appears that it cannot avoid such programmes initiated in the name of fiscal stimulus during the economic downturn.

Successive Governments have run a budget deficit since 2007. The ratio of debt obligations in total annual budget spending increased to 8.7% in 2018/19. This level is still below the 15% ceiling under the Fiscal Responsibility Act. It is expected that the ratio will increase to 10.9% in 2023. The ratio of public debt to GDP is expected to rise from 43.5% in 2019 to 48.8% of GDP in 2023—much lower than the ceiling of debt to GDP of 60%. The Fiscal Responsibility Act imposes a maximum level of debt servicing at 15% of the total budget and a 5% maximum level of foreign debt servicing for exports. These are the fiscal prudential rules that the Government can meet without difficulty.

However, the Government has consistently failed to raise the share of capital spending in the total budget to above 25%. In the annual budgets for the fiscal years 2018/19–2022/23, capital spending will amount, on average, to 22.3% of the total budget. Debt obligations as a share of total revenue in 2019/20 were forecast at 29.6%, rising to 32.5% in 2022/23. This indicates that budgetary space is shrinking, as the Fiscal Responsibility Act stipulates that the public deficit must not exceed 35% of estimated revenue. Foreign debt servicing was expected to be just 3.7% of GDP in the 2019/20 budget.

The Ministry of Finance has estimated that the primary deficit will be eradicated within six years, and that the total budget, including interest and principal payments, will be balanced by 2030. Typically, the Government tends to paint a rosy picture about the outcome of fiscal stimulus measures. The danger is that once welfare programmes have been established for the sake of economic stimulus, it is difficult to curtail spending once the economy is on a recovery path. It implies that the future liabilities of the Government will increase as a result of these welfare programmes for the poor.

Government revenues are procyclical. Because of the slowdown in GDP growth the proportion of revenue to GDP has been declining. It reached 15.2% in 2018/19 and will fall further in 2019/20, which is desirable as the revenue acts like an automatic stabilizer. The corporate income tax rate has been cut to 20% from 30%. The Government provided additional tax deductions for personal income tax and property taxes to mitigate the impact of COVID-19. However, only 7% of the labour force pay income taxes. Most tax revenues are derived from consumption-based taxation; personal income taxes amount to some 12.3% of total tax revenues.

In January 2020 the Government approved a budget for the fiscal year 2020/21 of 3,300,000m. baht. The Ministry of Defence was allocated 223,000m. baht. To revive the economy after the impact of COVID-19, the Government issued a royal decree to borrow 1,000,000m. baht. In August the Government agreed a loan of US $1,500m. from the Asian Development Bank, to be repaid in two tranches, with the initial $500m. carrying a term of 10 years. The loan has a three-year grace period, but the Government must disburse it by the end of June 2021. As a result of the massive borrowing from internal and external sources, public debt to GDP was forecast to rise from 44.8% in June 2020 to 57%, nearly hitting the maximum ceiling under the Fiscal Responsibility Act.

There is also an issue with the expansionary effects of fiscal stimulus. Falling exports, the US–Chinese trade dispute and low prices for agricultural output have dampened business confidence. Fiscal policy will not work well during this period of uncertainties, which will reduce spending by consumers and investors because of their low expectations of future income streams. Fiscal stimulus packages have a more powerful effect on income during a period of favourable business sentiment and strong consumer confidence. As long as the stability of the coalition Government remains a persistent issue, Thailand's economic problems will intertwine with political risk and limit the multiplier effect of government spending.

UNEMPLOYMENT, WAGE FLEXIBILITY AND DEFLATION

During the Asian financial crisis in 1997–98 unemployment increased considerably. The Thai economy did not suffer from hysteresis of the recession. The unemployment rate did not lag behind the economic recovery. The flexibility of the wage rate mitigates the impact of output contraction. Wage cuts give incentives for employers to slow down lay-offs. Employees in the services sector take a holiday without pay, while employers hope for economic recovery.

Thailand is a country with a long history of price stability. Only during the oil price shocks did the inflation rate exceed 10%, but those were episodes of aberrant circumstances, in 1973–74 and 1979. There has never been spiralling inflation in Thailand, unlike in some other emerging economies. Because successive Thai Governments have seldom financed budget deficits by borrowing from the central bank, monetary expansion caused by printing money has rarely been an issue. After staying on a low-growth trajectory since 2006, the Thai economy has not experienced pressure from domestic and external demand. Furthermore, as the global economy has entered an era of slowing growth, while oil prices remain low, inflation in Thailand remains subdued. The headline Consumer Price Index (CPI) increased by 0.7% in 2019, while the core CPI (excluding food and energy prices) rose by just 0.5%. Low inflation reduces the urgent need to adjust the nominal wage rate, as the real wage rate has not been affected by inflation. However, low inflation does not imply low real wages. Moreover, low inflation does not encourage healthy corporate profits and business expansion.

Between January and August 2020 Thailand experienced price deflation; the headline CPI declined by 1.0% compared with the same period of the previous year, while the core CPI increased marginally, by 0.3%. The headline CPI began to decrease in March, the first contraction in almost three years. The most significant decline in 11 years, of 3.4%, was in May, when the full impact of the lockdown was felt.

Thailand is suffering from a shortage of skilled labour, which leads to higher real wages. Labour-intensive industry has lost competitiveness, owing to the high cost of labour. The textile and garments industry is experiencing a shortage of labour and high wages, resulting in falling export market share.

In the past decade shortages of labour have become increasingly severe for labour-intensive industries. There are about 3m. registered foreign workers from neighbouring countries, where wages are lower than Thailand's. The minimum wage in major provinces is 325 baht per day, and less than that in areas where the cost of living is lower.

According to the National Economic and Social Development Council, in a report published in May 2020, up to 8.4m. workers in Thailand were at risk of losing their jobs in 2020 because of the impact of COVID-19, particularly on the tourism industry. This figure included 2.5m. in the tourism sector, 1.5m. in the industrial sector, and 4.4m. in other services sectors. However, the Council anticipated an overall rate of unemployment of 3%–4% for 2020, with no more than 2m. people unemployed, as the pandemic came under control and economic activities resumed.

AGRICULTURE

Changing weather patterns have increased the incidence of droughts and floods, disrupting the regular supply of grains. In 2019 the Thai agricultural sector suffered from low rainfall, and cyclical movements in the global business cycle affected demand for agricultural raw materials. Imbalances in supply and demand for agricultural commodities lead to booms and busts of primary products. Because of the lagged responses of agricultural production, this resultant excess supply and demand have forced successive Governments to intervene regularly to stabilize farm incomes through price support mechanisms and various commercial schemes, such as imposing an import ban on agricultural products from abroad.

Rural poverty and rising debts among farmers have provided successive Governments with an excuse to intervene in the agricultural sector, enhancing the opportunity to please voters and appease the poor. Large budgets are allocated to agricultural subsidies, at the expense of long-term investment in agricultural infrastructure. The various grants have created a 'trap' for the workforce in the countryside, keeping rural workers inside the agricultural sector and delaying the mass shift of labour from the primary sectors to the modern and industrialized sectors. During the course of Thailand's economic development the shares of output and employment in agriculture have been consistently higher than in other countries at the same level of income. Maintaining unrealistically high prices for farm output keeps rural workers inside the agricultural sector.

When the Chinese economy slows down, demand for commodities in that country declines considerably. As a result, commodity prices are steadily decreasing. To shore up prices, the Thai Government allocated 17,000m. baht in the 2019/20 budget to a crop guarantee programme. The targeted crops included rice, rubber and oil palm. It has now become standard policy for the Government to subsidize farmers, either by guaranteeing prices or income or by other means.

Thai politicians employ farm subsidies to help farmers and gain popularity. In turn, farmers exert pressure on the Government to keep providing subsidies through regular street protests. Farm subsidies are expensive and ineffective in the long term. A better way to solve rural poverty would be to enhance farm productivity by intensifying public investment in agriculture. The aim must be on reducing the labour productivity gap between the agricultural and non-agricultural sectors.

Because of their close linkages, a boom in the manufacturing sector leads to high economic activity in the services sector, and vice versa. The challenge is that the agricultural sector has only a loose relationship with other industries. The agricultural sector can become more productive and efficient by reducing distortions in the farming sector, which would expedite the shift of labour to the services and industrial sectors.

The strong baht, a decline in paddy output caused by drought, and weakening global demand for rice, due to the COVID-19 pandemic, were expected to reduce Thailand's exports of rice to just 6.6m. metric tons in 2020—the lowest level in 20 years. Moreover, at the end of July the price of Thai white rice was US $460 per ton, while similar rice from India was $370 per ton. Thailand cannot compete with India's non-basmati rice, demand for which is rising rapidly in Africa, and when both the quantity and price of rice fall simultaneously, farm income will be reduced considerably. To mitigate rice farmers' plight, within three months after the lockdown began in March 2020 the Government transferred 100,100m. baht to 7.7m. farmers suffering from the impact of COVID-19. In addition, during the period of weak global commodity demand the Government allocated 14,100m. baht for price guarantee programmes for maize, tapioca and rubber. The only difference from the previous Government is that the present Government limits the quantity of guaranteed produce to prevent a budget overrun. None the less, this market intervention by the Government will be very costly in the long run because the measures do not address the root causes of the problem, which are low farm productivity and oversupply of farm products induced by unrealistic farm prices.

MANUFACTURING

Export capability determines the growth of manufacturing output. The determinant of export capability is the level of FDI in a particular industry. In the past three decades the Thai economy has been propelled by the rapid growth of manufactured exports. There were 18 years of double-digit export growth from 1986–2011, averaging 20.5% per year. Thailand's exports collapsed in 2009 after the onset of the global financial crisis, but rebounded sharply in 2010. Thailand's export growth slowed significantly in 2011 and 2012. From 2013 to 2016 Thailand's exports experienced negative growth. The global recession and China's slowdown contributed to the dismal export performance, but a supply factor also played a part. The dwindling level of FDI, caused by Thailand's political turmoil and poor business sentiment, diminished export capability and competitiveness. The demise of Thailand's export-orientated industries can be attributed to the country's inability to attract FDI inflows. Industries that could secure continuous flows of FDI remained competitive, but those that could not progressively retreated from the global market.

The booms and busts of Thailand's manufactured export industries depend on whether the industry can attract inflows of the right type of FDI. The main strength of Thailand's export-orientated industries lies in labour productivity and 'export upgrading'. With imported technology and a spillover effect for local industries, FDI can lead to sophisticated industrial production. However, if inflows of FDI decline or cease to be attracted to Thailand, it can be difficult for the country to maintain competitiveness, as the country is squeezed out by countries with a lower wage rate and countries with high wages but more advanced technology. It is not surprising that Thailand does not have well-known national brands of manufactured export products. Thailand will remain stuck in the middle-income trap until investment in human capital bears the fruit of innovation by creating domestic higher-value-added products.

The failure of Thailand's textile and garment industries to compete globally is evident in its shrinking share of output, exports and labour employment. However, some industries can sustain growth and maintain competitiveness, owing to the ability to attract FDI. The automobile industry's exports have grown faster than the expansion of global trade volumes. The processed food industry, which has a comparative advantage, owing to abundant agricultural food resources, faces constant challenges that always disrupt the steady growth path either from supply or demand sides. Electronic and electrical equipment exports are sensitive to global trade fluctuations, and rapid changes in technology and demand patterns could prevent the industry from maintaining a steady growth path.

The level of income elasticity in demand for industrial products is also important during periods of volatile global trade fluctuations. Thailand's exports to Japan and China are sensitive to the business cycle. The spectacular growth of Thai exports occurred when the Japanese and Chinese markets expanded rapidly. In other words, the character of Thailand's export products is crucial in terms of resilience during a business downturn. Furthermore, if export goods can be differentiated from those of competitors in terms of superior quality and safety standards, manufactured with cost advantages, and create sufficient product and market diversification, sales of them will have a better chance of surviving a global recession and will rebound quickly when the global economy recovers.

The industrial capacity utilization index in Thailand declined from 67.8 in March 2020 to 51.3 in April, but had rebounded, to 56.0, by July, in response to a gradual easing of the lockdown measures imposed to curb the spread of COVID-19. However, some industries benefited from the lockdown, as sales of their products increased when people spent time at home. Industrial production rose in response to demand for products such as animal feed, electrical appliances (microwaves and refrigerators), canned seafood and dairy products. Non-durables consumption was expanding in mid-2020 as people returned to regular spending; demand for durable goods remained sluggish. Purchases of the former cannot be postponed, while the latter can be delayed because of lower permanent income and uncertainties. Total car sales have been declining continuously since 2019, falling by 38% year on year in the first half of 2020.

The COVID-19 outbreak dampened consumer confidence and reduced purchasing power. The local infection rate peaked in March 2020. Some companies had to cease operations temporarily from April to mid-May, as both domestic and foreign demand declined sharply. At the end of July Thailand ranked first out of 184 countries in the Global COVID-19 Recovery Index (developed by a consulting company from Malaysia, PEMANDU Associates, in collaboration with that country's Ministry of Science, Technology and Innovation and Sunway Group), based on its success in halting the spread of the pandemic. If there is no recurrence of infections, manufacturing capacity is expected to increase gradually with domestic demand. However, if infection rates remain high in the major export markets, it is unlikely that the manufacturing sector's capacity utilization will return to the pre-pandemic level.

HOUSEHOLD DEBTS, THE PROPERTY SECTOR AND THE BANKING SECTOR

When an economy is in recession, the recovery will take longer if there is a high level of household debt. Consumers will have to service their debts before resuming their usual pattern of spending. Thailand has the highest level of household debt of any country in Asia, amounting to 80.1% of GDP in March 2020. The debt ratio is on an upward trend and rose rapidly during the economic slowdown, as consumers tended to maintain consumption patterns by borrowing. A high level of household debt also complicates monetary policy management. The central bank is reluctant to cut interest rates to stimulate the economy, as reducing the interest rate can exacerbate debt and poverty as households take on more loans (as debt is cheaper to repay).

The Bank of Thailand has come up with policy guidance to commercial banks to limit borrowers' debt service ratio (DSR) at 70% of a monthly income up to 30,000 baht. The DSR regulation has directed the attention of financial institutions to monitor customers' ability to service debt rather than the value of their lending collateral. Lending for mortgage loans and the purchase of automobiles focuses on high deposits rather than the borrowers' debt-servicing capability. However, the new prudential DSR strategy has a downside risk, as it can thwart economic recovery if private consumption is held back by loan limits. Furthermore, if access to the formal credit market is denied to low-income families, they could be driven to informal money markets, which would negate the primary objective of the DSR guidelines.

It is estimated that by the end of 2020 there could be around 100,000 vacant condominium units in Thailand. It will take more than two years to unload these unsold units. Foreign buyers, of whom 60%–70% were Chinese, accounted for around 15% of condominium purchases in 2019. Developers postponed new projects in response to the global COVID-19 pandemic in 2020, and some slashed condominium prices by more than 30%. Despite the low cost of borrowing, it is unlikely that the property sector will recover to its previous level by 2021. High unemployment and job insecurity will dampen the demand for housing. There is a possibility that Chinese buyers might return, but it is not going to happen until an effective vaccine for COVID-19 can be found.

The performance of the financial sector reflects the health of the economy. Household debts rise during a downturn, causing non-performing assets in the financial sector. In the first half of 2020 the aggregate net profits of commercial banks dropped by 27% compared with the corresponding period in 2019. The decline resulted from higher provision for bad debts. The Bank of Thailand's stricter expected loan loss provisions were responsible for the considerable reduction in net profits. Only two small banks experienced a rise in net profits in the first half of 2020. Because of the export shortfalls, the Export-Import Bank of Thailand experienced a sharp rise in non-performing loans (NPLs) from 4.6% of total outstanding loans at the end of 2019 to 6.4% in June 2020. However, NPLs for commercial banks increased marginally, to 3.09% of total lending at the end of June. With mounting economic problems, commercial banks' loans rose by 5% year on year in the first half of 2020 because large companies required loans owing to tight liquidity and a volatile bond market.

TOURISM

In a study published in July 2020, the United Nations Conference on Trade and Development estimated that if Thailand's lockdown measures lasted for eight months, tourism revenues would fall by US $47,000m. The longer the lockdown period, the more economic damage the pandemic would inflict on the country. It seems that there is a trade-off between economic wealth and human health. For Thailand, the early lockdown caused a severe economic impact, but infection and death rates remained remarkably low at mid-2020. Nevertheless, even if domestic tourism can be revived, international tourism has been almost totally suspended. Domestic tourism can never offset the loss of foreign tourists, as long as restrictions imposed by other countries remain in place. In July 2020 the Tourism Council of Thailand warned that more than 30% of tourism-related enterprises had left the market, and more businesses will exit if there is no increase in the number of tourists.

The tourism sector employed around 4m. workers before the outbreak of COVID-19. In August 2020 the Tourism Authority of Thailand noted that, with no revenue in the preceding six months, unemployment in the tourism sector could grow to 2.5m. because businesses could not bear more losses. In the Authority's worst-case scenario, Thailand could earn only 742,000m. baht in tourism revenue in 2020—a fall of 75% from the 3,010,000m. baht achieved in 2019—followed by 675,000m. baht in 2021.

According to the Thai Hotels Association, up to 600,000 jobs were lost in the first half of 2020 in the hotel industry, which employed 1.5m. people before the pandemic. Despite the easing of the lockdown, by early August only 50% of hotels had reopened because international travel restrictions remained in place. Hotel operators were burdened by massive debts for the investments that they made before the outbreak, amounting to around 700,000m. baht. This problem in the tourism sector compounds the issue of NPLs that is affecting the commercial banks. Without the suspension of principal and interest payments, many hotel operators will go bankrupt.

To mitigate the collapse in revenue from international tourism, the Government promoted domestic tourism. The 'Moral Support' campaign, worth 2,400m. baht, which was approved in June 2020, was to allow 1.2m. health volunteers and officials of sub-district hospitals to travel, with a budget of 2,000 baht per tourist. This was part of a wider package proposed by the Ministry of Tourism and Sports, worth 22,400m. baht, offering subsidized travel, accommodation and catering. Foreign medical tourists, film crews, exhibitors and members of Thailand Elite (a government visa programme for affluent foreign visitors) were permitted entry to Thailand from August, although planned bilateral travel 'bubble' arrangements with low-risk nations were postponed that month owing to renewed outbreaks in some countries being considered for the scheme. Also proposed was a 'Safe and Sealed' scheme aimed at long-stay tourists, who would be tested on arrival for COVID-19 and required to quarantine for 14 days at a designated resort, during which time they could travel within 1 km of their hotel, before being tested again.

CONCLUSION

This essay has highlighted the critical external factors that shape the performance of the Thai economy. There are structural weaknesses that preclude Thailand from achieving its potential growth path. The exchange rate policy has been the cornerstone of Thailand's economic success and failure. More recently, the slowdown in global growth, the ripple effects from the US–Chinese trade war and the repercussions of the global COVID-19 pandemic have hampered Thailand's economic activity, with a particularly severe impact on the tourism industry. Meanwhile, subdued consumer confidence and political uncertainties have adversely affected the mood of investors, and the efficacy of fiscal stimulus has been impaired by an unstable coalition Government. The road to sustainable recovery and long-term growth will be steep if not impossible to navigate unless the rule of law and legal infrastructure can be upheld to a high standard.

It seemed unlikely at mid-2020 that the economy would regain the pre-pandemic output level within the following three years. The pace of recovery would largely depend on the return to normality of international travel and the absence of political upheaval and uncertainties.