Economy

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HISTORICAL OVERVIEW

Between 1961 and 1990 the Thai economy expanded at an average annual rate of 7.2%. Per caput 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, 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. Consumption and investment growth slowed, in particular, after another military coup in May 2014. 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 new Government is likely to prove unstable, even with the continuation in office of Prime Minister Gen. Prayuth Chan-ocha, who had also headed the military junta that had ruled the country since the 2014 coup. The road to Thailand's economic recovery will be even more challenging. 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 CHINA FACTOR

Thailand's business cycle is broadly synchronized with that of the People's Republic 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 11.9% of its total exports in 2018. If Hong Kong is included, the overall share of China's exports in that year amounted to 16.9%. China's GDP growth slowed to 6.3% in the second quarter of 2019 and may slow further in the second half of the year, to about 6.0%, if the US–Chinese trade war remains unresolved. A growth rate of 6.0% would be the lowest in China in three decades and would 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, growth in the value of Thailand's exports in 2019 was expected to be flat. 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 works 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. At August 2019 China's motor vehicle production had declined for 12 consecutive months, suggesting that the manufacturing sector did not expect a sales recovery any time soon. 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.

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 10.5m. of total arrivals of 38.3m. in 2018), 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, and more cuts were expected before the end of 2019; 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 has depreciated against the US dollar in 2019, the baht has 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 expansionary fiscal policy conducted by China in the aftermath of the global financial crisis in 2008–09 resulted in the Thai economy contracting rapidly, but staging an equally dramatic recovery. Massive tax cuts of about US $290,000m. announced by China in early 2019 to stimulate the economy were expected to produce an expansionary effect by 2020. Furthermore, bonds worth 2,150,000m. renminbi issued by provincial Chinese Governments to fund infrastructure construction may have some effect on preventing China's GDP growth from falling lower than the country's minimum growth target of 6%. ASEAN member states cannot count on China's rapid recovery, owing to more muted economic growth in that country in recent years. There will be no spectacular rapid recovery as in 2009, owing to the slowdown in China and political and economic uncertainties in the USA and Europe.

With the prospect of a protracted trade war between the USA and China lasting well into 2020, the renminbi is likely to fall further against the US dollar. The depreciation of the Chinese currency is being used to counter threatened US tariffs, as a way to keep Chinese exports competitive. As China's currency weakens to below 7.0 renminbi to the dollar, the baht is likely to appreciate against the renminbi and further reduce the value of Thailand's exports of goods and services to China.

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. If trade negotiations between the two countries failed in late 2019, the USA was set to impose an additional 10% tariff on almost every Chinese-made good sold in the USA by the end of that year.

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 is slowing 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.

In 2018 Thailand's combined exports to the USA and China (including Hong Kong) constituted 28.0% of its total exports. 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 will be hit more severely because of its heavy dependence on external trade. Thailand will be hurt to a lesser extent because of its lower degree of external exposure than Singapore.

Viet Nam is the largest importer of Thailand's products among ASEAN members, with a 5.1% share of Thailand's exports in 2018. Viet Nam's exports to the USA have increased significantly since the onset of the US–Chinese trade dispute. However, this situation may change following Viet Nam's inclusion in the USA's watchlist of currency manipulators in May 2019.

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 are benefiting 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.

Japan is the third largest importer of Thai products, with a 9.9% market share in 2018. Japan has been adversely affected by the trade war through falling exports, lower confidence among its manufacturers and China's slowdown. Japan's exports fell by 6.7% year on year in June 2019, the seventh consecutive month of contraction. While Japan's exports to the USA increased by 4.8% year on year in the first half of 2019, its exports to China declined by 10.1%. 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.

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 30 baht to the dollar psychological barrier, unless the Bank of Thailand (the central bank) 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.

From 2015 to July 2019 the Bank of Thailand maintained the policy interest rate at 1.75%, while other central banks in the region reduced their policy rates. The interest rate gap has grown, prompting more capital inflows. In 2018 there were some US $60m. of capital outflows. However, in the first six months of 2019 there were about $3,000m. of capital inflows into Thailand's stock and bond markets. With widening interest gaps, there have been higher capital inflows, particularly in July 2019, when Moody's Investors Service and Fitch Ratings raised Thailand's credit ratings outlook from stable to positive. Appreciating by 8% year on year in July 2019, the baht became the top performing currency in emerging markets. In an attempt to slow the appreciation of the currency, the Bank of Thailand regularly intervenes in the foreign exchange markets. Consequently, international reserves increased to $218,000m. at the end of July.

By late 2019 the Bank of Thailand was facing a policy dilemma. The exchange rate matters for the survival of small and medium-sized exporters. The tourism industry is also affected by baht appreciation. Maintaining a weaker baht would help exporters and the tourism industry, but Thailand would run the risk of accusations from the US Government of being a currency manipulator. If the policy interest rate is cut to reduce capital inflows, there could also be a risk of fuelling a domestic property bubble.

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 effective 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. Meanwhile, exports declined owing to the overvalued baht, while the global economy expanded. In 2019, by contrast, the baht was strong and undervalued as the global economy slowed.

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.

DISMAL GDP GROWTH

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 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 amounts to 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.

The Asian Development Bank forecasts that Thailand's GDP growth in 2019 will be 3.5%, owing to a sharp slowdown in exports. This growth forecast is the third lowest behind Brunei Darussalam and Singapore among the 10 ASEAN countries. In June the Bank of Thailand revised down its GDP growth forecast to 3.3% from its forecast of 3.8% in April.

Because of lower production of cars, rubber products and petroleum, the manufacturing production index declined by 5.5% year on year in June 2019. Industrial capacity utilization was recorded at 65.3%, indicating the postponement of new capital spending in the private sector. In the first quarter of 2019 the economy grew by 2.8% year on year—the slowest rate in more than four years. Exports contracted by 4.2% in the second quarter, following a fall of 4.0% in the first quarter. The downturn in the electronic business cycle and a decline in international oil prices are among the factors contributing to the continued dramatic decline of Thailand's exports.

The lacklustre economic activity is due in part to weak consumer spending. In particular, a contraction in expenditure on consumer durable goods, which fell in June 2019 for the first time since December 2017. It is a worrying situation, as consumer spending depends fundamentally on consumer confidence, which in turn depends on expected income. Political uncertainty after the national election in March 2019 and the subsequent formation of a coalition Government did not improve the sagging sentiment of consumers and investors. As private consumption spending is the largest part of aggregate spending, so flagging growth in this part of the economy weighs on GDP growth. Furthermore, weak consumer spending delays capital investment by the private sector. Consequently, the GDP growth rate in 2020 will also be low, given the imminent economic slowdown (or even recession) in the USA.

A notable indicator of economic sluggishness is captured by activity in the insurance sector. In the first half of 2019 insurance premiums declined by 6% year on year. This was the first decline in 15 years. The fall can be attributed to some regulatory changes, such as new accounting standards and the risk-based capital II framework, but the primary factor is the economic slowdown, which has caused a decline in renewals and new premiums. Furthermore, the prolonged period of low interest rates has made endowment insurance policies prone to higher financial risks.

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. The news of the USA threatening to impose a tariff of 10% on US $300,000m. of Chinese products from September 2019, on top of tariffs of 25% already imposed on $250,000m. worth of Chinese goods, sent global stock prices into decline in early August. Foreign investors, institutional investors and brokerage firms reacted similarly by offloading shares. However, for international investors, baht appreciation gives them more incentives to hold Thai stocks and baht bonds. Massive capital inflows into local bond markets kept the baht strong, despite bad news from global markets. Thailand's sovereign credit outlook was upgraded to a positive outlook by several international credit rating agencies in July, although the outlook depends on the success of the policy stimulus package of the new Government.

After China was denounced by the US Department of the Treasury as a currency manipulator in August 2019, the Thai bond yield curve became flatter, owing to capital inflows to Thailand's long-term government bond market. It was the first time that the long-term bond rate had fallen below that of the Bank of Thailand's key policy rate of 1.5%, to which level it was cut on 7 August, from 1.75%. The fear of global recession caused by the release of weak economic data on Germany and China, accentuated by the inverted yield in US Treasury bills, resulted in an approximately 800-point (3%) decline in the USA's Dow Jones Industrial Average index on 14 August. The Stock Exchange of Thailand index recorded a third straight day of falls in the same week, in line with the Dow Jones index.

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.

MONETARY POLICY

In recent years the Bank of Thailand has largely resisted interest rate cuts, but the central banks of India, South Korea, Indonesia and the Philippines have implemented reductions, even while the US Federal Reserve has held rates steady. These economies have experienced slowing GDP growth, and their central banks have adopted an accommodative monetary policy. The Bank of Thailand argued that cutting the interest rate would not prevent baht appreciation, and pointed out that its key policy rate is the lowest in the region. In July 2019 the Bank of Korea cut its base rate by 25 basis points, to 1.5%. The Bank of Thailand was not able to resist the global easing trend, in particular when the Federal Reserve cut the federal funds rate at the end of July from 2.25% to 2.0% (to sustain growth in the US economy). This was the first such cut in the USA in more than a decade, and it prompted the Bank of Thailand to follow suit in the following week, when its monetary policy committee voted by five to two to cut the policy rate from 1.75% to 1.5%. There were no significant capital outflows from Thailand, and the baht remained strong in September, even though the historical positive interest gap turned negative. As has normally been the case, the Bank of Thailand did too little too late to change its policy course. In mid-2019, when inflation was below 1%, and the economy was expected to grow at only just above 3%, monetary policy could have been eased earlier in order to support economic growth.

Within a week after the key policy rate cut, Thai commercial banks followed suit by reducing the minimum lending rate for retail customers, although the prime lending rate for corporations remained unchanged. The evidence suggests that the monetary policy conducted during the downturn is not as effective as during the upturn. With the credit crunch, the central bank may be able to push the market rate higher, but the ability to reduce the market interest rate during a recession is limited. Commercial banks are more concerned with heightened risks during periods of economic uncertainty. The prime lending rate in the USA is closely related to the federal funds rate. Unlike the Federal Reserve, the Bank of Thailand cannot effectively dictate the lending rate of commercial banks, because the link between money markets and credit markets is not that strong. The loose connection between short-term and long-term capital markets stems from the less sophisticated development of financial institutions.

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.

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%. As the level of public debt at June 2019 was 41.3% of GDP, the country has sufficient fiscal space to deal with a recession.

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 3,200,000m. baht budget for 2019/20 proposed in August 2019 increased by 200,000m. baht from the 2018/19 budget. The Government anticipated a deficit of 469,000m. baht in 2019/20. The enlarged deficit is appropriate to spur growth during an economic slowdown. The fiscal year begins on 1 October, but the 2019/20 fiscal budget will take effect only in January 2020. The first reading of the draft bill was scheduled to take place in October 2019. If the cabinet wants to alter the budget framework to fulfil election promises, the actual disbursement of funds will be further delayed because the fiscal framework will have to be reconsidered by four macroeconomic policy institutions: the Bank of Thailand, the

Ministry of Finance, the National Economic and Social Development Council and the Bureau of the Budget.

The political parties that formed the new Government that took office in July 2019 made various pledges during the election campaign, many of which were 'pork barrel' policies designed to win votes. These include monthly allowances of 1,000 baht for the elderly, 3,000 baht for pregnant women and 2,000 baht for children until the age of six, as well as a 10,000 baht one-off allowance for newborn babies. These programmes would require an additional 300,000m. baht. The four macroeconomic policy institutions would not be comfortable with these kind of transfer payments. The delay in forming a new government after the March 2019 election will have a significant effect on output growth in the last quarter of that year.

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% debt ceiling under the Fiscal Sustainability 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 Sustainability 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 budget for the fiscal years 2018/19–2022/23, capital spending will amount, on average, to 22.3% of the annual budget. Debt obligations as a share of total revenue in 2019/20 were forecast at 29.6%, rising to 29.6% 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.

Current spending in 2019/20 (which comprised 74.7% of the 3,200,000m. baht total budget) increased by 5.3% from 2,200,000m. baht in 2018/19. It was estimated that revenue collection in 2019/20 would increase by 7.1% from fiscal year 2018/19, although the budget deficit would increase by 4.3%. The investment budget represents 20.5% of the total budget, which is still below the 25% minimum requirement for sustainable growth. Actual disbursements from the budget will only begin by February 2020—four months behind schedule. The fiscal drag from the delay in spending will put a limit on the growth of the economy in 2019.

The Ministry of Finance has estimated that the primary deficit will be eradicated within six years, and 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.

There is also an issue with the expansionary effects of fiscal stimulus. By July 2019 business sentiment had declined to its lowest level in 18 months. 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.

WAGE PRESSURES, DESPITE SUBDUED INFLATION

Thailand is a country with a long history of price stability. Only during the oil price shocks did inflation rise to above 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 demands. Furthermore, as the global economy has entered an era of slowing growth, while oil prices remain low, inflation in Thailand remains subdued. Headline inflation in the first seven months in 2019 averaged 0.9%, while core inflation was just 0.6%. 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.

There were some 38.6m. people of working age in Thailand in 2018, including 12.8m. agricultural workers and 6.2m. in the manufacturing sector. Because of a declining birth rate, the average age of Thais is increasing rapidly. Consequently, Thai society is now facing the adverse consequences of an ageing society. The number of people who are 65 years and older has doubled over the past two decades, and owing to better health care, Thais live 4.4 years more on average than they did 50 years ago—average life expectancy at birth in 2017 was 75.5 years, according to the World Bank.

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. If the new Government insists on fulfilling its policy pledges to increase the minimum wage, the rise in the wage rate would exacerbate the loss in competitiveness and deter FDI. At the provincial level, there are tripartite wage committees that decide the minimum wage rate. Public sector, private sector and labour representatives decide the appropriate level of the daily minimum wage by considering the cost of living, as well as exports, investment, inflation and workers' skills.

In 2018 the national daily minimum wage was raised to 330 baht in some areas. That was the first rise since 2013. About 4m. people live on the minimum wage. However, raising the minimum wage was a policy agenda of some of the parties in the coalition Government. Because of the fragile economy, the promise of an increase in the minimum wage might not be fulfilled. The business sector opposes a wage hike. The last increase, in 2013, was blamed for Thailand's loss of competitiveness, the relocation of factories and the diversion of FDI to neighbouring countries.

There is also a suggestion to set a flat minimum wage rate nationwide. If it comes into effect, there would be considerable differences in the real wage rate between different regions, thereby causing more distortion in the structure of real wage rates. When the economy is fragile, amid falling exports and lower consumer spending, small and medium-sized firms, which cannot upskill workers, would suffer from an increase in the minimum wage.

AGRICULTURE

Changing weather patterns have increased the incidence of droughts and floods, disrupting the regular supply of grains. In 2019 the Thai agricultural sector was suffering 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 has allocated 17,000m. baht in the 2019/20 budget to a crop guarantee programme. The targeted crops include 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.

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, 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-oriented 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-oriented 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.

HOUSEHOLD DEBTS, THE PROPERTY SECTOR AND FINANCIAL INSTITUTIONS

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 78.8% of GDP in March 2019. 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.

Excessive expansion of credit for the purchase of housing is the root cause of all property bubbles. The central bank can prevent housing bubbles by controlling the issuance of mortgages. In April 2019 the Bank of Thailand imposed a new limit on the loan-to-value (LTV) ratio for mortgage businesses, allowing 90% loans for first-time buyers and 80% and 70% loans for second- and third-time buyers, respectively. The new measures have cooled speculative demand for property and reduced mortgage lending by 2.4% in April–June year on year, following a surge of 28% in the first quarter of 2019. After the stricter LTV rule was applied, the issuance of second and third mortgages declined, indicating falling speculative demand for high-rise apartments. However, the slowdown in lending cannot be attributed fully to the new regulations, as demand in the property market has been decreasing, owing to the fear of a global recession among domestic and foreign buyers. As a result of China's slowing economic activity, the demand for residential properties among Chinese customers declined in early 2019, when the Chinese Government restricted capital outflows. There is now a cap on overseas investment by Chinese nationals, set at US $50,000 per year. In recent years Chinese demand for apartments in Thailand has represented about 20% of the Thai market. The baht's appreciation against the renminbi in 2019 has made Thai properties less attractive to Chinese buyers, and housing demand has cooled generally because of weak sentiment and the fear of recession. Furthermore, the possibility of a crash in the property sector cannot be ruled out, if demand fails to keep up with rising new supply.

It will be interesting to see if stricter macro-prudential measures can reduce the level of non-performing loans (NPL), while not inadvertently reducing genuine demand for housing. In June 2019 the net level of NPLs of commercial banks in Thailand was only 1.5% of total loans, while gross NPLs stood at 3.1%. There was a marginal decline in the value of non-performing assets of commercial banks between 93,100m. baht in December 2018 to 92,500m. baht at the end of June 2019. In conclusion, the financial sector's soundness, supported by high liquidity, profitability and capital adequacy, remains intact since the onset of the global growth slowdown. The strengthened rules and prudential regulations implemented after the financial crisis in 1997 have borne the fruits of a broadly resilient financial sector.

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 and the ripple effects from the US–Chinese trade war have hampered Thailand's economic activity, and growth in the tourism industry has decelerated considerably. 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.