

Thai economic outlook 2018

Riding the wave of global recovery

January 30, 2018

Executive Summary

The global economy expanded strongly in 2017 and is expected to put on an even better performance in 2018 (Exhibit 1). The strong growth in 2018 is forecast to be synchronous for most of the main economic actors, and therefore supportive of global trade. After years of subdued growth, global investment started to recover in 3Q16 and picked up strongly in 2017. Leading indicators such as the Purchasing Managers Index (PMI) suggest this trend is likely to continue in 2018 and 2019 (Exhibit 2). As a result, global growth will be underpinned by strong investment growth in both developed and emerging markets.

Against such a backdrop, our estimates for Thai GDP growth in 2017 and 2018 are 3.9% and 4.2%. The solid headline GDP number has been driven by a robust tourism sector and much-better-than-expected goods exports since 4Q16. The early stages of the ongoing digital revolution have provided for a revival in our electronics sector that is likely to be sustained for an extended period.

While the Thai economy benefited from a strong external sector, domestic demand has remained subdued. Export recovery has yet to translate into either a material increase in CAPEX or a pronounced rebound in private consumption. Domestic demand continues to face underlying structural challenges such as labour shortages and wealth and income inequality.

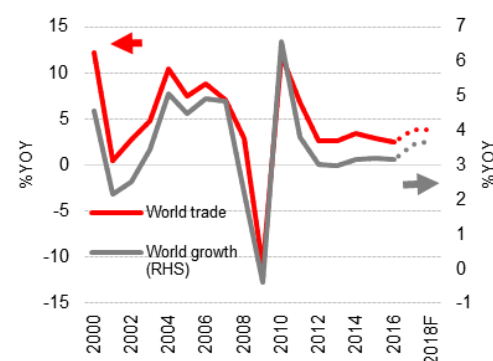
The current government is undertaking a massive upgrade to our infrastructure—especially the Eastern Economic Corridor (EEC) project—that will significantly increase public investment and boost private sector sentiment. That, in turn, should provide a much-needed lift in private investment.

Given higher oil prices and firmer domestic activity, Thailand's current account in 2018 is likely to moderate from 2017, but remain well in surplus. We see headline inflation rising to 1.7% this year, while core inflation edges slightly higher to 0.7%. Given the combination of a strong external sector and still-loose global monetary conditions, we expect the baht to average around 30 THB/USD in 2018. Under these circumstances, we expect the Bank of Thailand to leave its policy interest rate unchanged for the next two years.

Exhibit 3: Thailand Macroeconomic Forecasts

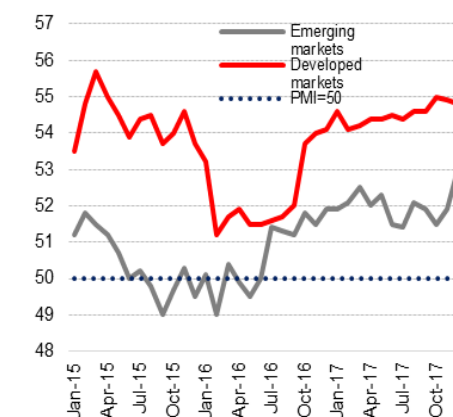
		BBL		Consensus	
		2017E	2018F	2017E	2018F
Real GDP growth	%YoY	3.9	4.2	4.0	4.0
Private consumption	%YoY	3.2	3.2	3.2	3.1
Private investment	%YoY	2	3	1.9	3.3
Public consumption	%YoY	2.2	2.5	2.1	2.3
Public investment	%YoY	1.5	9	1.7	10.2
Exports of goods (nominal)	%YoY	9.9	4.5	9.3	4.6
Imports of goods (nominal)	%YoY	14.7	9	13.5	7.4
Current account	USD billion	48	38	46.9	39.9
CPI	%YoY	0.7	1.7	0.7	1.3
Exchange rate	THB/USD	33.9	30		
Policy rate	%	1.5	1.5		

Exhibit 1: Global GDP and trade growth



Source: World Bank, IMF

Exhibit 2: Global PMI



Source: Bloomberg

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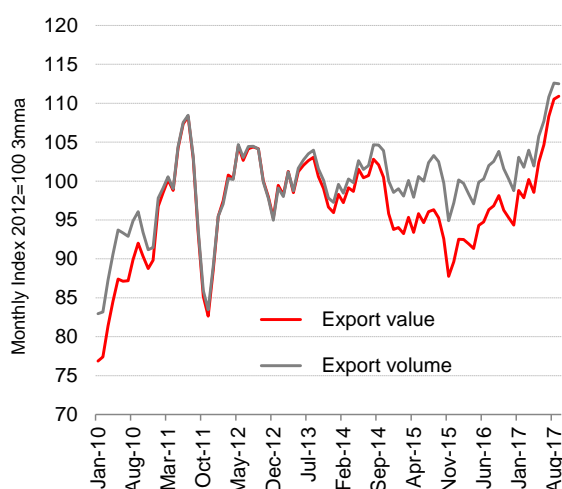
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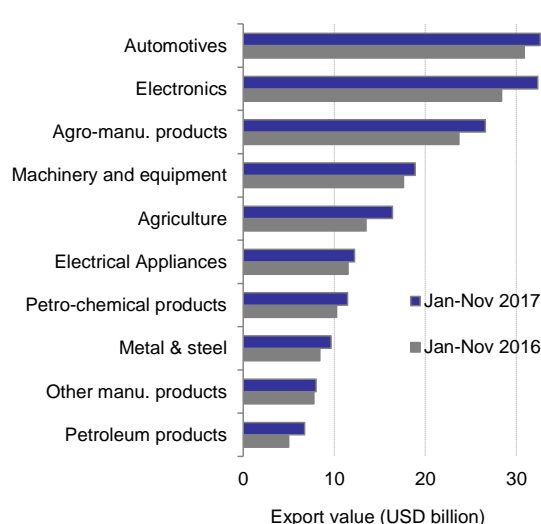
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Exhibit 4: Export Value and Volume Indices



Source: Bank of Thailand

Exhibit 5: Top Ten Exports



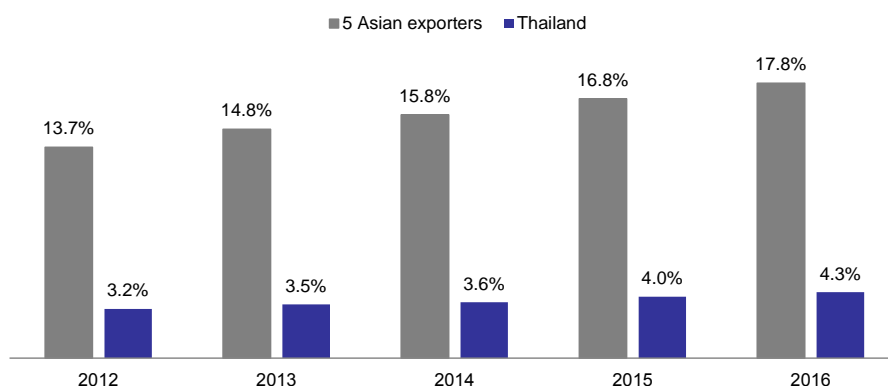
Source: Bank of Thailand

Exports continue to expand solidly

Amid global recovery, exports will continue to be the main driver of growth. After a low base in 2016, exports of goods registered growth of 9.9% in 2017—the highest in 6 years—to USD237 billion. This was largely driven by the increase in export volume (Exhibit 4). Leading the pack were exports of automotive vehicles and parts, electronics, agro-manufacturing and agricultural products, machinery and equipment, and petrochemical products, which together account for 70% of total exports (Exhibit 5).

Digital revolution provides extra tailwinds for exports of electronics-related products. As we are in the early stages of a new profusion of digital technology—from AI to cloud computing and the Internet of Things—the current CAPEX cycle is likely to be longer than the historical maximum of 9 quarters.

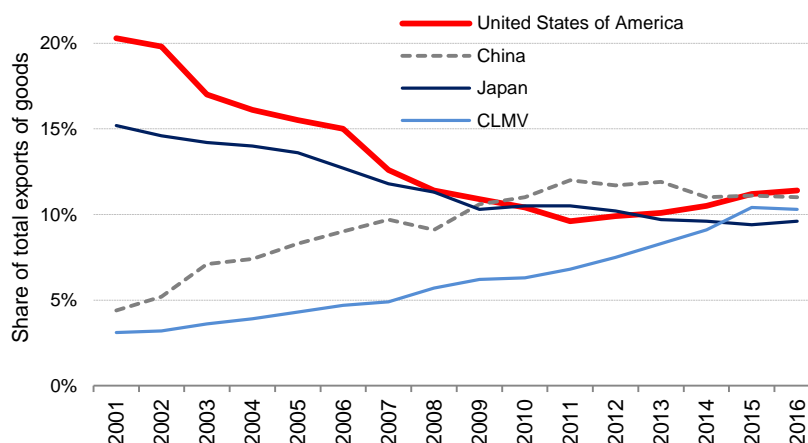
Exhibit 6: The Share of Microchip Exports to Total Exports



Source: International Trade Center

Digital wave starts to change Thailand's electronics export composition. Within the 14% growth in electronics exports from 2016 to 2017, IoT-related components such as microchips have gained more prominence. For Thailand, the share of microchip exports in total exports quickly increased from 3.2% in 2012 to 4.3% as of 2016. This is in line with the record of five Asian exporters—South Korea, Taiwan, Singapore, Malaysia and Thailand—whose microchip exports have risen from 13.7% of total exports in 2012 to 17.8% in 2016 (Exhibit 6). (The 2017 figure is approximately 20%.) Meanwhile, the share of exports of computers and parts, which used to be the main export item, has declined from 7.3% to 5.9% over the past 5 years.

Exhibit 7: Thailand's Top Export Destinations

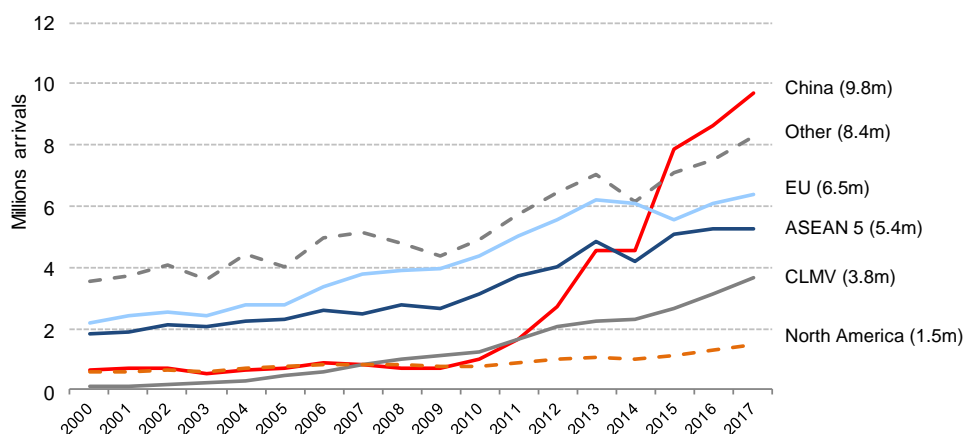


Source: International Trade Center

Demand from the fast-growing CLMV has boosted Thai exports over the past decade. The share of Thai exports to the Cambodia, Laos, Myanmar, Vietnam region rivals those to Japan, to China, and to the US (Exhibit 7). The top exports to CLMV include petrochemical products, automotive vehicles and parts, and electrical appliances.

That said, growth in goods exports will likely decelerate in 2018 from the 9.9% achieved in 2017. With the previously mentioned supporting factors, **we still expect 2018 goods exports to rise by 4.5% in value.** Nevertheless, we believe that export growth will likely be slowing over the next few years, as the growth of trading partners' GDP and world trade are projected to stabilize.

Exhibit 8: Tourist Arrivals

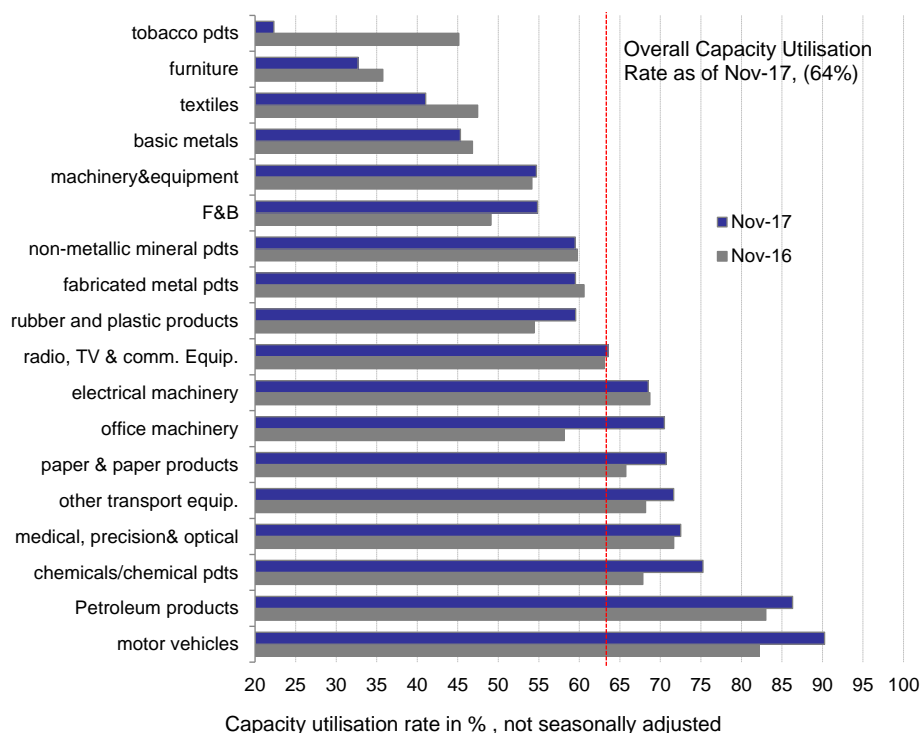


Sources: CEIC, Ministry of Tourism and Sports

Tourism

Thailand continues to be the most popular tourist destination in the world. In 2017 the number of tourist arrivals surpassed the 35 million mark, and in 2018 the number is forecast to reach 37 million. The number of Chinese tourists has picked up significantly over the past decade; they current occupy the top spot (Exhibit 8). However, the strong tourism sector only benefits some provinces, such as Bangkok, Chonburi, Phuket, Chiang Mai and Surat Thani. The record number of visitors are putting an enormous strain on many Thai airports, prompting urgent investment to expand airport capacity. The government is also planning to enhance connectivity between the three major airports—Suvarnabhumi, Don Muang and U-Tapao—via high speed train links.

Exhibit 9: Capacity Utilisation Rates across Industries

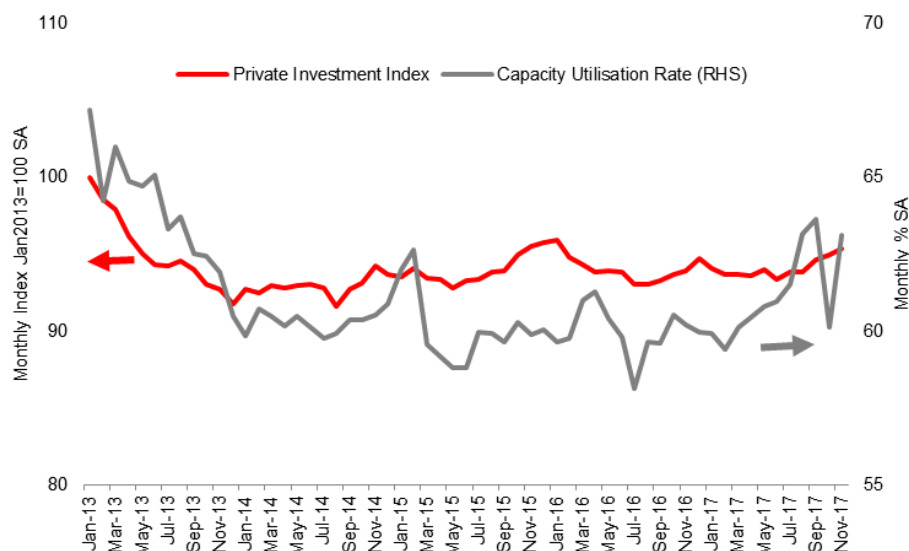


Source: Office of Industrial Economics

Private investment growth to gain more solid footing, albeit gradually

Spillover from exports to private investment is evidenced by an increase in capacity utilisation within export-oriented sectors in 2017 (Exhibit 9). Among them are motor vehicles and petroleum products, whose capacity utilisation reached record highs around 90%. Similarly, capacity utilisation in the electronic components sector has increased to 64% from an average of 59% during the 2014-2016 world trade slowdown.

Exhibit 10: Private Investment Index and Capacity Utilisation Rate



Source: Bank of Thailand, Office of Industrial Economics

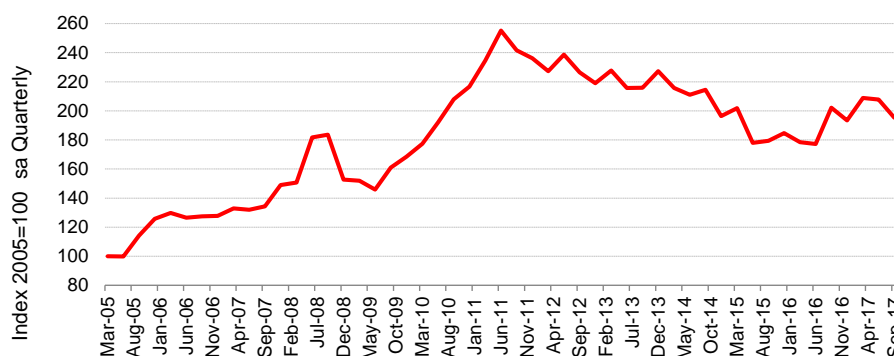
Other sectors—such as chemical products, other transport equipment, paper products, and office machinery—have also exhibited significant increases in capacity utilisation. **As a result, the overall capacity utilisation has, for the first time in 4 years, risen from around 59% to 62% (Exhibit 10).**

Our clients' activities suggest that rapid changes in technology and business models are prompting firms to invest in order to stay competitive. Some industries need to upgrade to keep up with the new technology. In the automotive industry, firms in international supply chains need to move towards production of parts for hybrid and electric vehicles. Some need to invest in R&D to move beyond price competition as the e-commerce trend disrupts distribution channels, while others may even need to transition away from troubled industries such as textiles, publishing, and entertainment into new industries.

However, the export recovery has yet to translate into a significant acceleration in investment. Spillover from exports have been limited because SMEs, which comprise over 90% of businesses in Thailand, only account for 25% of total export value. Meanwhile, a prolonged period of sluggish domestic demand has, together with competition from e-commerce, squeezed SMEs' margins in recent years, making it harder for them to initiate another round of investment. Finally, labour shortages across various sectors have hindered business expansion.

Thus, we project 2018 private investment to grow at 3%, in line with the consensus.

Exhibit 11: Farm Income Index (seasonally adjusted)



Note: Farm income index calculated from agricultural price index times agricultural production index

Source: Office of Agricultural Economics

Weak farm income and elevated household debt have proven to be a drag on private consumption

We expect consumption to recover only mildly, rising by 3.2% in 2018, despite signs of strength in durables, services, imports of consumer goods, and auto sales. In our view, private consumption growth will remain subdued due to the underlying structural problems of income and wealth inequality, as reflected in the disparity in household income and elevated household debt.

Weak farm income has depressed the consumption of one-third of the population

Since the agricultural sector employs around one-third of the total workforce, farm income has significant implications for overall private consumption. Despite the recent 10.3% recovery from the 2015-2016 trough, farm income's prolonged downward trend since 2011 has severely dented farm households' spending power, as they generally have no other major sources of income. Moreover, volatile movements in agricultural prices generate a great deal of uncertainty over the level of farm income. A recent Bank of Thailand study shows that farm income volatility reduces farmers' willingness to consume (Exhibit 11).

Exhibit 12: Government's Measures

Measures for Low-Income Earners

Measures	Budget	Details	Period
1. Welfare Smart Card	THB41.94 billion/year	<ul style="list-style-type: none"> - Coverage: 11.67 million people - Benefits: <ul style="list-style-type: none"> - THB500/month subsidy for bus/ sky train tickets - THB500/month subsidy for Transport Company's bus tickets - THB500/month subsidy for train tickets - THB45/quarter discount for cooking gas purchases - Monthly allowance for necessity good purchases at designated stores: <ul style="list-style-type: none"> THB300 for those who earn less than THB 30,000/year THB300 for those who earn THB30,000-THB100,000/year 	Since Oct 2017
2. Welfare Smart Card's Additional Benefits	THB35.67 billion	<ul style="list-style-type: none"> - Coverage: Welfare smart card holders - Benefits: <ul style="list-style-type: none"> - Additional monthly allowance for those who register for designated job-training programs: <ul style="list-style-type: none"> THB200 for those who earn less than THB 30,000/year THB100 for those who earn THB30,000-THB100,000/year - Eligibility for designated soft loans programs 	Approved by the Cabinet
3. Housing for Low-Income Earners	THB248 million	<ul style="list-style-type: none"> - 494 rooms in Samut Sakhon, Chiang Mai, and Nakhon Sawan for low-income earners to rent at low rates - Eligible households: Those who earn THB16,501-THB24,700/month in Bangkok and THB9,501-THB14,600/month in other provinces 	Approved by the Cabinet
4. New Year's Gifts		<ul style="list-style-type: none"> - 1,000-baht cash rebate for good customers of Government Housing Bank - THB2 million/person soft loans from Government Housing Bank - Cash back equivalent to 30% of the 2018 interest payment for customers of Bank of Agriculture and Agricultural Cooperatives 	Jan-Dec 2018

Measures for Farmers

	Budget	Details	Period
5. Assistance Program for Rice Farmers	THB80.77 billion	<ul style="list-style-type: none"> - THB47.27 billion subsidy for harvesting costs (THB1,200/rai for up to 10 rai per farmer or for up to THB12,000 per household) - THB21 billion soft loan program for rice storage - THB12.5 billion soft loan program for rice quality improvement 	Nov 2017-Mar 2018 Nov 2017-Feb 2018 Nov 2017-June 2018
6. Farm Subsidy	THB1.7 billion	<ul style="list-style-type: none"> - 2,000 baht/rai subsidy for not growing second crop rice (for up to 15 rai per farmer) 	Approved by the Cabinet
7. Interest Payment Subsidy for Rubber Buyers	THB600 million	<ul style="list-style-type: none"> - Interest payment subsidy (equivalent to 3% interest rate) for loans to entrepreneurs who purchase rubber from farmers (under the THB20,000 soft loan program) 	2018

Measures for Income Redistribution

	Budget	Details	Period
8. Tax Deduction for Visiting "2nd -Tier" Tourist Destinations		<ul style="list-style-type: none"> - Tax deduction of up to THB15,000/person for purchases of tour packages, accommodation, transport, food or buying local products in 55 provinces listed as "2nd -tier" tourist destinations 	Jan-Dec 2018

Source: Various News Sources

Elevated household debt significantly reduced disposable income

Despite the decline in the household-debt-to-GDP ratio from a peak of 81.2% in 2015Q4 to the current level of 78.3%, total household debt continued to climb to THB11 trillion. This enormous debt level covers more than half of all households, and the majority of the debt is for consumption. This partly reflects households' usage of zero-percent-interest installment schemes, which prompted the Bank of Thailand to announce limits on credit card issuance to low-income consumers in 2017. More importantly, this debt is part of the vicious cycle arising from the structural inequality problem. The 2015 household survey revealed that the average income of the wealthiest 20% of households is 10 times that of the poorest 20%, who are unable to make ends meet. Further, there remains the serious problem of unofficial debt, which is not accounted for in the formal statistics. As a result, the growing debt service burden has led to significant shrinkage in disposable income.

Realizing these challenges, the government has put in place measures to address the immediate needs of farm households and low-income households (Exhibit 12). Moreover, the problem of inequality is one of the major focuses of the national reform plan, which is scheduled to launch in early 2018. Nevertheless, the impacts of these policies will take time to bear fruit.

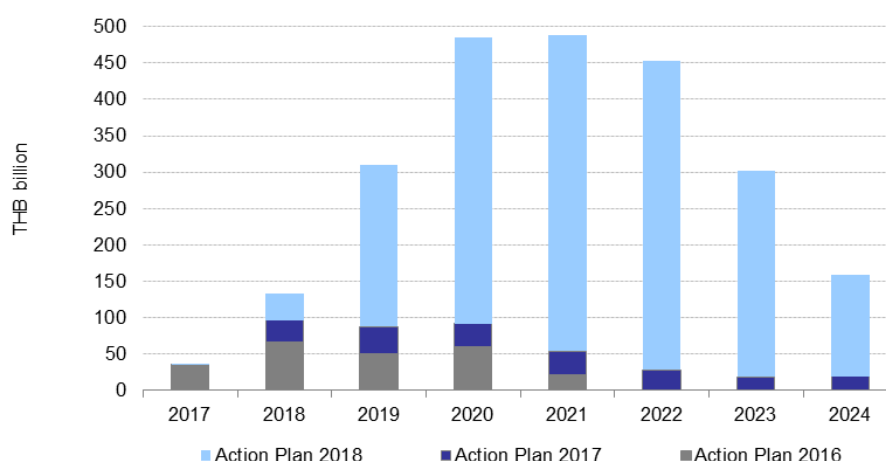
Exhibit 13: Upcoming Infrastructure Projects

Upcoming Infrastructure Projects (THB656.9 billion)

	Value (THB billion)	Expected completion time
1. Infrastructure projects under construction (THB171 billion)		
1.1 Orange line mass transit system (Thailand Cultural Center-Min Buri)	110.1	2023
1.2 Dual-track railway (Jira-Khon Kaen)	26.0	2019
1.3 Motorway (Pattaya-Map Ta Phut)	20.2	2019
1.4 Regional airport development	7.9	2019
1.5 Intermodal facility at Chiang Khong	2.4	2019
1.6 Railway container depo at Laem Chabang Port (phase 1)	2.0	2018
1.7 Harbor development project at Laem Chabang Port	1.9	2018
1.8 Common ticket system	0.8	2018
2. Infrastructure projects ready for construction (THB384 billion)		
2.1 Mass transit system		
Pink line (Khae Rai-Min Buri)	53.5	2020
Yellow line (Lad Phrao-Samrong)	51.9	2020
2.2 Dual-track railway		
Prachuap Khiri Khan-Chumphon, Nakhon Pathom-Hua Hin, HuaHin-Prachuap Khiri Khan	42.9	2021
Map Kabao-Jira	30.9	2021
Lop Buri-Paknampho	22.7	2021
2.3 Bangkok-Nakhon Ratchasima high-speed rail	179.4	2021
2.4 Improvement of baggage carousel system at Suvarnabhumi Airport	3.3	2019
3. Infrastructure projects during the procurement stage (THB101.2 billion)		
3.1 Expressway		
Rama III Road-Dao Khanong-Western Outer Ring Road	31.2	2021
Northern Route (N2) and East-West corridor	17.6	2020
3.2 Red line mass transit system	50.1	2022
3.3 Public bus procurement and stations	2.3	2018

Source: Ministry of Transport, Office of Transport and Traffic Policy and Planning

Exhibit 14: Disbursement Schedule of Infrastructure Projects



Sources: Ministry of Transport, Office of Transport and Traffic Policy and Planning

Government investment set to accelerate before the general election

We see government investment accelerating in 2018 as more infrastructure projects are set to take off. Government capital expenditure in the fiscal year to September 2018 is budgeted at THB622 billion, up 15% from FY2017, and around 20% of the planned allocation has already been disbursed. Currently eight projects with a total value of THB171 billion are already under construction, and contracts for seven projects with a total value of THB385 billion have already been signed, so construction should begin later this year. These include the yellow and pink lines of the sky train public-private partnership (PPP) projects, three dual track railways, and the China-Thailand high speed rail from Bangkok to Nong Kai in the northeast (Exhibit 13). The schedule of disbursements for the projects under the Transport Ministry's 2016-2018 action plans is shown above (Exhibit 14).

We expect activity of contractors and subcontractors to intensify. Further, there is an obligation under the loan draw-down process to begin construction within a year of the signing of the contract, so we see only a limited chance of delays. Currently, we are seeing more usage of working capital by contractors to buy equipment and pay their suppliers, as well as more loan requests from subcontractors.

We expect the implementation of these projects to accelerate, but only gradually. Despite the government's intention to ensure that its investment disbursement rate will not be lower than 75%, the average disbursement rate for 2012-2017 was only 69%. Infrastructure projects also face two major challenges—land acquisition, and similar to other sectors, labour shortages. Overall, our view is that public investment will increase by 9% in 2018, in line with the consensus (Exhibit 14).

Exhibit 15: EEC Infrastructure Projects

The 2018 Schedule of EEC Infrastructure Projects

						
	Priority Projects	High-speed train Bangkok-Rayong	U-Tapao Airport	MRO Centre	Map Ta Phut Port (Phase III)	Laem Chabang Port (Phase III)
Terms of Reference		Feb	Feb	Mar	Mar	Aug
Private Partner Selection		Jul	Jul	May	Sep	Nov
Contract Signing		Sep	Sep	Sep	Nov	Dec
Completion		2023	2023	2021	2024	2025
Project Value* (THB billion)		237	215	10	11	150

* As of Dec 2017

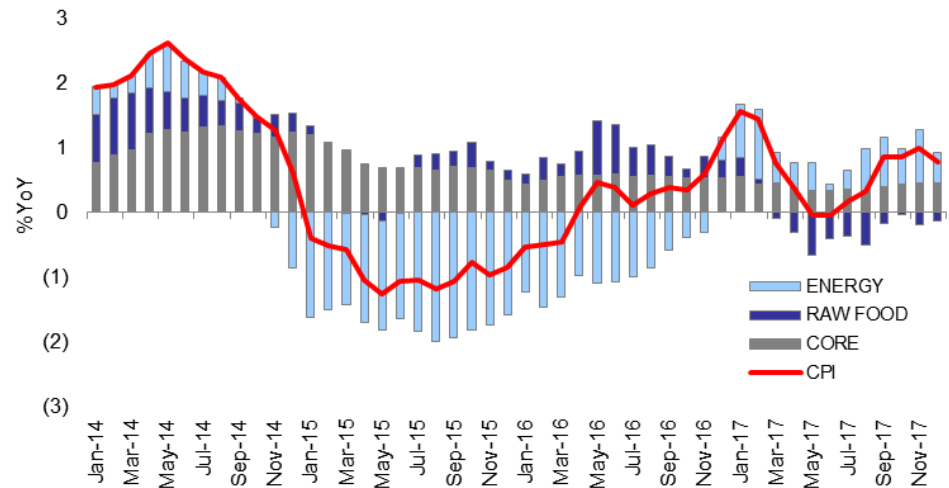
Source: EEC office

Nevertheless, we are very bullish about the Eastern Economic Corridor (EEC) project, which will boost both public and private investment. To attract international investors, the EEC office has launched a new set of PPP laws and bylaws to bring them in line with international standards. The terms of reference for five key infrastructure projects—the U-Tapao Airport, its aircraft Maintenance, Repair and Overhaul (MRO) Center, the Bangkok-Rayong high-speed rail, and the Laem Chabang and Map Ta Phut Ports (Phase III)—will be released in 1H18 with the aim of signing PPP contracts for the projects towards the end of 2018 (Exhibit 15). This means that actual investment should take place from 2019 onwards.

Current account surplus to moderate in 2018

We project the current account surplus in 2018 to be around USD38 billion, down slightly from last year due to the impact of higher oil prices and rising CAPEX, especially by export-oriented firms and the construction sector, which will lead to higher imports of machinery, equipment and raw materials, and consequently a lower trade surplus.

Exhibit 16: Headline inflation higher, but core inflation remains subdued

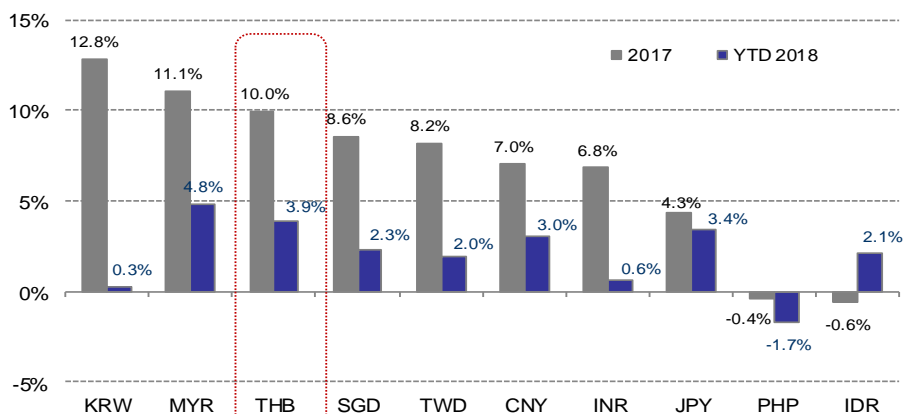


Source: Office of Agricultural Economics

Inflation to rise to 1.7%, still well below the 2.5% target

We see inflation trending higher, due primarily to higher energy prices, especially oil prices. To some extent, firmer domestic demand will also nudge core inflation higher. Our forecast is for core inflation to rise to 0.7% in 2018 from 0.55% in 2017, and for headline inflation to rise to 1.7% in 2018 from 0.7% in 2017 (Exhibit 16).

Exhibit 17: Currency Movements



Source: Bloomberg, *YTD as of 25Jan2018

Thai baht likely to continue its appreciation

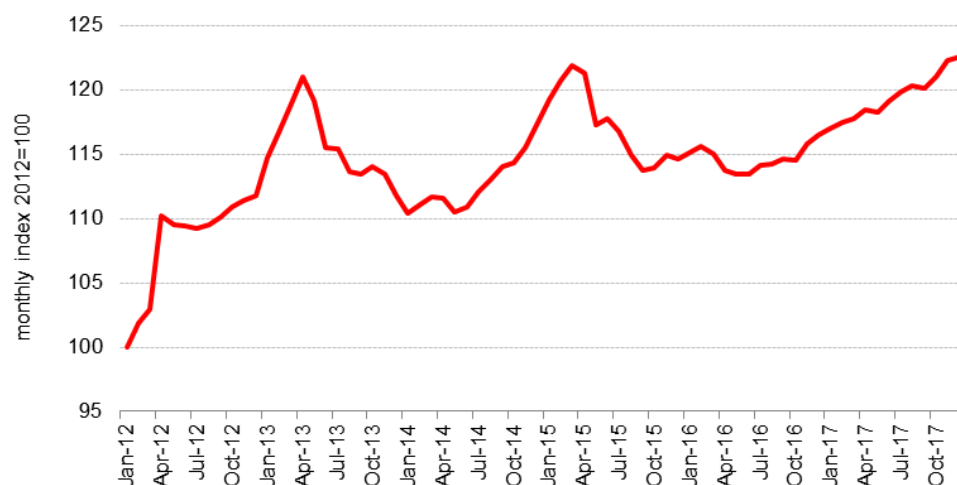
The Thai baht is likely to continue to appreciate in 2018 but to a lesser degree than in 2017. Buoyed by another massive current account surplus in 2017 and strong tourism receipts, the Thai baht appreciated by 10%, the third strongest in the region (Exhibit 17). The Thai baht rose sharply despite attempts to slow the appreciation by the Bank of Thailand (FX reserves, including net forward position, rose to USD239.3 billion at year-end 2017 from USD202.7 billion at the beginning of 2017). As of 25 January 2018, the Thai baht had risen by 3.9%, the second strongest after the Malaysian ringgit.

Based on internal surveys, our customers, especially Japanese clients, listed the rapid appreciation of the baht as one of the most pressing issues for businesses in Thailand in 2017.

However, they had no plans to relocate as Thailand remains the most important link of their supply chain in the ASEAN Economic Community.

In 2018 we expect the Thai baht to average around 30 THB/USD, as positive factors in the recent past continue to persist this year. Other analysts have mentioned the possibility of a capital-flow reversal, resulting in a rapid depreciation of baht. We don't see that materializing in our baseline scenario, because even though the Fed is set to normalize its balance sheet and raise the fed funds rate in 2018, this has already been priced in. Further, other major central banks, like the ECB and the BOJ, will continue to inject liquidity into the global financial system. As such, there will be a net injection of liquidity despite the Fed's planned quantitative tightening. This supports our baseline scenario, which envisages global capital continuing to flow into emerging markets.

Exhibit 18: Nominal Effective Exchange Rate (NEER)



Source: Bank of Thailand

Monetary Policy: on hold for the next two years.

Despite better GDP growth, growth is uneven—domestic demand has yet to catch up with a strong external sector. Headline inflation, while higher, has failed to reach the target of 2.50% since the new inflation target was introduced in 2015. Therefore, we believe the Bank of Thailand will be in no hurry to tighten monetary policy.

The Thai baht's appreciation is once again a source of concern for the current administration. The baht's nominal effective exchange rate (NEER) is currently higher than the level reached just prior to the taper tantrum in 2013 after which the baht depreciated sharply along with most emerging market currencies (Exhibit 18). In 2015, when the NEER once again rose above 120, the Bank of Thailand (BOT) announced further capital account liberalization measures to encourage capital outflows. Currently, the NEER's elevated levels are once again starting to unnerve the private sector, which may prompt the BOT to take action.

By holding the policy rate, the BOT can—in addition to supporting domestic demand—ease the pressure on the Thai baht while other central banks in the region are poised to raise interest rates in response to rising inflation. **Our baseline view is for the BOT to be on hold for the next two years.**

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