ARTICLE FOR THE EDGE

THAILAND: IS IT OVER ITS BAD PATCH?

Thailand has endured more than 12 years of successive political crises and economic stresses. In recent months, the news flow appears to have brightened a tad, raising the hopes that Thailand might finally be coming out of its long dark patch. There is growing evidence that the current cyclical recovery can be sustained, so the near term outlook seems to be better. Encouragingly, there are also some signs that Thailand could be in a position to improve its longer-term prospects as well. Much will hinge on how potential political and other pitfalls are resolved. We assess all these dimensions of Thailand's future below.

Cyclical outlook: green shoots of recovery now taking firm root

Most observers agree with official forecasts that economic growth can accelerate this year to around 3.8% from 3.2% last year and 2.9% in 2015. What gives us confidence that this uptick can be sustained is the multiple sources of growth in play:

- Recovery in global demand boosting exports: Thailand's openness and diversified export base enables it to ride this wave of expanding global demand. OECD lead indicators suggest that the major developed and developing economies will enjoy slightly above trend growth in the next year or so, a good sign that the recovery in Thai exports has legs.

- Tourism powers ahead: Thailand remains such a magnet for tourists that even terrorist incidents such as the bombing of the Erawan shrine so popular with tourists cannot undermine it. As the global economic recovery spreads, there has been a broad-based recovery in tourists from countries as varied as the US, France and Russia. After a correction induced by a crackdown on tourist scams, the growth of Chinese tourists (27% of total international visitors) is also resuming.

- Consumer demand gathering momentum as one-off negatives fade away: Higher crop yields following the end of the drought and recovering commodity prices have given farmers more disposable income. With good rains in 2017 bolstering water tables, crops will probably flourish and further boost farm incomes. Moreover, the ending of the five-year period in which participants in the first-time car buyer scheme could not sell their vehicles has lapsed, allowing about 1.12 million people to now sell their cars and purchase new ones. In addition, the government had cracked down on moneylending in the informal sector and piloted initiatives to convert informal debt to formal debt. While this initially hurt consumption, this short-term pain has now given way to a long-term gain as loans made in the formal sector tend to carry lower interest rates and greater regulatory scrutiny, putting borrowers in a more secure position.

- Public investment spurs growth as well: Furthermore, large-scale public infrastructure projects are in progress. While some of the projects that the government has promised have yet to take off, a large number of small-scale projects are already underway, supporting investment. Private investment, however, has disappointed significantly.

Long-term: hopes are rising for better growth

A defining trait of the current government, for all its warts and flaws, is that it has taken the time to chart a 20-year plan that will be passed into law before this government ends its term. There are several aspects to this carefully thought out plan, including an ambitious plan to transform its eastern region and to step up cross-border trade with its neighbours.

One major initiative is the government's plan to develop an Eastern Economic Corridor (EEC), which builds on the country's successful Eastern Seaboard initiative that helped to power Thailand's economic boom of the late 1980s and early 1990s. The EEC initiative comprises a series of mega infrastructure projects costing USD43 billion over the next five years. A double-track rail link among the three seaports of Laem Chabang, Map Ta Phut and Sittahip and a motorway from Map Ta Phut to Dawei port in Myanmar will substantially improve connectivity, while potentially cutting out the seaborne journey for trade flows around the Straits of Malacca. Ports at Laem Chabang, Sattahip and Mab Ta Phut will also be greatly expanded. There is also a bold plan to expand the U-Tapao airport – opening a second passenger terminal and runway to boost its passenger capacity from 800,000 currently to 3 million and transforming U-Tapao into a hub for aviation maintenance, repair and overhaul, air cargo, and logistics. The EEC aims to promote Thailand as a production base for technology-intensive industries and could add up to 0.5% to the economy's potential growth rate.

The other major initiative is for Thailand to further leverage on the growth of its neighbours – Cambodia, Laos, Myanmar and Vietnam (CLMV). Thailand could be a big winner as this region, with a population of 160 million enjoys rapid growth. Thai products are considered as "premium" ones in these growing markets and Thai firms are already increasing their footprint in the region. Border Special Economic Zones have been set up to further facilitate trade and investment flows into these economies, with attendant benefits accruing to Thai border cities such as Khon Kaen, Chiang Mai, Chiang Rai and Ubon Ratchathani, among others. Cross-border trade has turned in remarkable results, increasing by 10-fold over the past two years.

As the CLMV region grows and Thailand firms its foothold in these fast-growing economies, Thailand can also derive some growth impetus from its neighbours. Bangkok will consequently be the hub of the region – medical services, tourism, logistics and even finance. There are plans for the Thai Baht to be used as the currency of choice in the region. A case in point: Laos issued its fifth Thai Baht-denominated bond in November 2016.

But for this to take off, private investment has to recover

There are several reasons why the next few years should see a gradual recovery in private investment:

- First, the prolonged export slowdown up to late-2016 resulted in excess capacity and inventories that deterred investment for capacity expansion. However, as the current export upturn continues, production capacity will increasingly be utilised and excess inventories run down. That should spur investment.

- Second, as the government's ambitious infrastructure plan is finally rolled out, private investment is likely to be "crowded in" as projects are approved and implemented and construction works get off the ground.

- Third, private investment has clearly been hurt by the political storms of the past decade. As we explain below, greater political certainty is likely and this should also help raise the willingness of companies to invest for the future.

Once these drags on private investment are eased, there is good reason to expect investment to rise. Thailand has stayed high on global rankings for foreign direct investment (FDI). For example, Thailand ranks 19th worldwide in the AT Kearney FDI Confidence Index which found good opportunities in Thailand in areas such as transport infrastructure and the technology sector. Discussions with companies that have recently made large investments in Thailand suggest that Thailand remains highly competitive, underpinned by a good infrastructure of expressways, rail links, ports and airports; a critical mass of activities in globally competitive manufacturing clusters around the Eastern Seaboard; attractive government incentives; and the chance to use Thailand as a base to access the CLMV region.

What about an ageing population?

Thailand's labour force, by some measures, has already peaked and will gradually decline from now on, subtracting from the economy's potential growth. Moreover, an ageing society will create a host of associated problems including a drag on fiscal resources stemming from increased demands for social expenditures and the need to ensure retirement adequacy among the elderly folks.

Demographics will certainly limit Thailand's growth potential compared to countries such as Indonesia, the Philippines, Vietnam and Malaysia. However, with the right policies, Thailand can still sustain growth of around 4% a year if it uses sensible fiscal policies to address the costs of ageing and if it works hard at boosting total factor productivity:

On the first issue, Thailand has considerable fiscal space as the public debt-to-GDP ratio stands at a relatively low 45% currently and could easily be bumped to 55% over time to address the drag on growth from ageing.

The key then is for Thailand to improve on its performance in total factor productivity. The good news is that there is considerable scope for such gains:

- There is huge potential for gains in agricultural productivity, given existing inefficiencies in the small-plot farming that dominates Thailand. The shift to large-scale farming by combining existing small plots and employing machinery to do the heavy lifting will spur productivity in the farm sector. A pilot project to test the impact of large scale farming showed a 10% fall in unit costs of production, suggesting that there is indeed considerable scope for efficiency gains.

- Improvements in the public sector will also help: Thailand still suffers from a large amount of red tape - deregulation and improving government processes can also help improve efficiency. The crackdown on corruption has also helped to boost public sector efficiency according to surveys.

- The substantial improvements in transport connectivity should also help reduce costs and boost productivity.

Finally, there remains a skills gap that needs to be resolved in order for the economy to progress up the value chain. The education system in Thailand will need to be revamped. However, Thailand is also helped by being a magnet for foreign skilled and unskilled workers, which could help offset some of the drags of an ageing society.

Better political prospects could help as well

The key to sustainable political stability will be a return to constitutional rule. The cremation of the beloved late King Bhumibol is expected in October which will be followed by the formal coronation of King Vajiralongkorn. That will then pave the way for elections. It is encouraging that the electoral timeline has now become clearer after many delays: elections will probably be held in by late 2018.

For now, it appears that a sufficient proportion of the Thai people are ready to accept that, while unelected, the current government is reforming the country and building a solid foundation for future progress. It also helps that, after a plodding start, the military government has proven to be good stewards of the economy. Many business people and middle class folks even welcome the hard-nosed clean-ups of excesses that are the hallmark of this government, in stark contrast to past governments. This influential segment of the population credits the military government with developing a well thought out economic development plan focused on Thailand 4.0 which entails a concerted push for the digital economy centred on innovation, productivity and high value-added activities.

Bottom line: Growth to be led by the EEC and cross border trade

The economy should grow at close to 4% in the medium term. Should public sector infrastructure projects crowd in private investment, Thailand's growth impetus will be even stronger. In the long run, we expect the EEC and border SEZs to be new engines of growth. That said, structural challenges such as the ageing society and skills gap must be addressed swiftly.

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