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IMF Executive Board Concludes 2010 Article IV Consultation with Thailand

On September 17, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Thailand.¹

Background

The Thai economy has been coming through two severe tests. The first test came when global trade collapsed following Lehman's failure in September 2008. This collapse had profound consequences for one of the world's most open economies, where exports account for more than 60 percent of GDP. By the first quarter of 2009, output had fallen by 7 percent year-on-year. Then, just as the economy was beginning to recover from this shock, politics intervened. In March 2010, a large political protest started in Bangkok, which stretched on until the end of May, periodically leading to outbreaks of violence. As a result, tourist arrivals, which generate about 6 percent of GDP, plunged. Confidence indicators fell, and households again reacted by slowing their consumption.

Yet the economy was able to absorb these blows—and stage a remarkable comeback. The recovery began in the second quarter of 2009, narrowly and tentatively. By the first quarter of 2010, it had progressed to the point where GDP had essentially regained its previous peak. The political turmoil then set the recovery back, but again the economy rebounded. Tourism quickly began to recover, while private consumption rapidly resumed its upward trend. Most significantly, the rebound in investment continued at a robust pace, never flagging, even during the protest period. Therefore, by the third quarter of 2010, it seemed that a sustainable recovery

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

was taking hold. International reserves have been climbing, surpassing US\$160 billion by September 2010, and the real effective exchange rate has regained its pre-crisis peak reached in 2008.

A key factor behind this rapid recovery was the revival in global trade, starting in early 2009. This revival sparked a surge in Thailand's exports, even as imports remained depressed, pushing the current account from near balance into a 7¾ percent of GDP surplus in 2009. Vigorous export demand continued into 2010, and exporters were able to fill these orders, even during the political disturbances, because the industrial estates and ports were located far from the protest zone.

Another factor behind Thailand's recovery was its policy response, one of the most forceful in the region. Years of fiscal prudence and credible monetary management (reinforced by an inflation targeting framework) provided ample space for decisive action. The Bank of Thailand cut its policy rate by 250 basis points to a historically low level of 1¼ percent. Meanwhile, the government swiftly introduced a sequence of stimulus packages. The first package focused squarely on putting spending power in the hands of the population, partly through direct cash transfers, partly by waiving charges, such as the cost of electricity, for the poor. The second package expanded spending to include investment projects, particularly on infrastructure. Together, they imparted an estimated stimulus of 3 percent of GDP in the two fiscal years since 2007/2008.²

The most fundamental explanation for Thailand's rapid recovery, however, lies in its sound economic framework. The country entered the global crisis from a position of financial strength, on all sides—bank, corporate, and public. So, when the stress arrived, these sectors were able to withstand the blow, and once the overseas orders came back, they were ready to resume production. As this happened, the impetus quickly fed through to domestic demand, in stark contrast to some advanced countries, where households and financial institutions were beset by balance sheet problems.

Over the short term, Thailand should benefit from some further economic normalization, which will buoy growth over the next few quarters. As a result, growth this year should reach 7½ percent and 4 percent in 2011, with low inflation. However, downside risks remain: slowing growth in advanced countries could undermine the global recovery, while political uncertainty could weigh on domestic demand.

With the economy recovering, the authorities are starting to normalize the policy stance. After two years of fiscal stimulus, disbursements from the off-budget second stimulus package are scheduled to fall by nearly 2 percent of GDP next fiscal year, as the special bond funding authority nears exhaustion. But part of the stimulus measures will be transferred to the regular budget, reducing the estimated withdrawal to a manageable 1 percent of GDP. The overall public sector deficit should also fall by the same amount, to a projected 3½ percent of GDP.

² Thailand's fiscal year runs from October 1 through September 30.

Meanwhile, the Bank of Thailand has initiated the normalization process, raising interest rates by 50 basis points to 1.75 percent in July-August.

Executive Board Assessment

Executive Directors observed that Thailand has made a remarkable comeback from the effects of the global crisis and the period of domestic political turmoil. Directors attributed this achievement to the authorities' forceful policy response, the revival of export demand, and sound economic fundamentals that have enabled the export recovery to feed through into renewed domestic demand. They noted that notwithstanding the current economic strength, the authorities face important challenges of nurturing the recovery into a sustained expansion and restoring the economy's dynamism.

Directors agreed that the immediate challenge is to normalize the policy stance, while ensuring that the recovery takes firm hold despite an uncertain global environment. In this context, they generally supported the government's plan to gradually scale back the fiscal stimulus and welcomed the Bank of Thailand's decision to start raising interest rates from their exceptionally low levels, as well as its intention to phase in further adjustments as evidence accumulates that the recovery is becoming entrenched.

Directors noted that, with the economy recovering rapidly, capital inflows could complicate policymaking. They broadly agreed that, in such circumstances, the exchange rate should be allowed to serve as a buffer. Most Directors also agreed that, should sustained inflows threaten to create asset bubbles, consideration could be given to introducing prudential measures and further liberalizing capital outflows.

For the medium term, Directors supported the authorities' ambitious reform agenda aimed at strengthening infrastructure and developing the financial sector to help restore economic dynamism and raise growth potential. Noting the limited budgetary resources to support reforms, Directors saw scope for reprioritizing expenditures, scaling back subsidies, widening the tax base and bringing the VAT rate back in line with regional peers. Directors also underscored the need to further improve implementation capacity for public investment.

Directors welcomed the authorities' plans to further develop financial markets and ease the financing constraints that have held back investment. They called for swift action to mitigate risks from government-owned specialized financial institutions by improving their risk assessment standards, strengthening supervision, and defining their role more clearly. Directors also recommended a gradual further opening of the financial system to foreign competition.

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Thailand: Selected Economic Indicators, 2006–10

	2006	2007	2008	2009	Proj. 2010
Real GDP growth (percent)	5.1	4.9	2.5	-2.2	7.5
Inflation					
Headline CPI (period average, percent)	4.7	2.3	5.5	-0.9	3.0
Core CPI (period average, percent)	2.3	1.1	2.4	0.3	1.0
Saving and investment (percent of GDP)					
Gross domestic investment (excluding stocks)	28.1	26.4	27.4	24.4	26.1
<i>Of which: private</i>	21.1	19.5	20.8	17.9	18.0
Gross national saving	29.2	32.7	27.8	32.1	29.7
<i>Of which: private, including statistical discrepancy</i>	21.2	26.1	22.3	30.0	26.5
Fiscal accounts (percent of FY GDP) 1/					
Central government net lending/borrowing (budgetary)	-0.3	-1.4	-0.6	-4.2	-1.1
Revenue	18.6	17.9	18.1	17.0	17.8
Total expense	18.8	19.3	18.7	21.2	18.9
General government net lending/borrowing (consolidated) 2/	2.2	0.2	0.1	-3.2	-2.7
Public sector balance 3/	1.6	-0.5	-0.6	-3.6	-4.5
Public sector debt	43.5	39.5	37.3	45.2	45.5
Monetary accounts (end-period, percent change)					
Broad money growth	8.2	6.3	9.2	6.8	...
Private sector credit growth	4.5	4.8	8.8	2.5	...
Balance of payments (billions of U.S. dollars)					
Current account balance	2.3	15.7	1.2	20.3	11.0
(Percent of GDP)	1.1	6.3	0.4	7.7	3.6
Exports, f.o.b.	128	151	175	151	180
Growth rate (in dollar terms)	17.0	18.2	15.9	-14.0	19.6
Imports, c.i.f.	127	138	176	131	171
Growth rate (in dollar terms)	7.9	9.1	26.8	-25.2	29.9
Gross official reserves (end-year)	67.0	87.5	111.0	138.4	154.5
(Months of following year's imports)	5.8	6.0	10.1	9.7	9.9
Exchange rate (baht/U.S. dollar, period average)	37.9	34.5	33.3	34.3	...
External debt (in percent of GDP)					
Debt-service ratio 4/	11.4	11.8	7.1	6.7	2.2

Sources: Data provided by the Thai authorities; and IMF staff estimates.

1/ The fiscal year begins on October 1.

2/ Includes budgetary central government, off-budget government spending (second stimulus package), extrabudgetary funds, and local governments.

3/ Fund staff estimate. Includes general government and nonfinancial public enterprises.

4/ Percent of exports of goods and services.