BANK OF THAILAND

Thailand's Economic Conditions in 2013

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Year 2013 at a Glance and Outlook for 2014

In 2013, the Thai economy slowed down from the previous year, mostly owing to weakening domestic demand and sluggish recovery in exports of goods notwithstanding improvement in the global outlook. Only tourism registered robust growth throughout the year.

During the first half of the year, the economy expanded on the back of the government's measures to stimulate consumption along with supporting factors, including high employment, income, and confidence. At the same time, businesses continued to invest. The economy slowed down in the second half of the year due to contraction in domestic demand as government's stimulus measures expired. Delay in public investment and heightening economic and political uncertainties led to more cautious spending by households, postponement of investment projects by businesses, and tightening of credit standards by financial institutions. Meanwhile, exports of goods did not fully benefit from broad improvement in foreign demand, as the latter was concentrated in certain goods that were not Thailand's main export products. Some industries also faced production constraints. However, the robust tourism sector helped to underpin economic growth throughout the year.

Against the backdrop of slowing economy and highly uncertain outlook, the Monetary Policy Committee (MPC) assessed that there was room for additional easing to reduce risk to growth. Thus, the MPC decided to decrease the policy interest rate twice by a total of 0.50 percent at its meetings in May and November, 2013.

Overall economic stability was well maintained. Inflation continued to be low in line with global inflation thanks to moderating costs of factors of production such as oil and commodity prices. Inflation pass-through was also limited due to a slowdown in domestic demand despite a minimum wage hike to 300 baht nationwide at the beginning of the year and a gradual increase in prices of LPG for households towards the end of the year. In addition, financial position of businesses and financial institutions remained strong. Household debt, which increased markedly during the past two years, started to moderate, while government's fiscal position remained sound.

External stability was also well preserved. Although the current account registered a slight deficit for the second year in a row, it was due to net gold imports and repatriation of profits and dividends by foreign businesses. Overall capital account remained in surplus. Nonetheless, volatility in capital flows stemming from shifts in monetary policy of major advanced economies, together with domestic political tension, led to volatile and two-way movements of the baht exchange rate.

For 2014, the export sector was expected to play a more prominent role in supporting economic growth thanks to improvement in trading partners' economies. Meanwhile, recovery in domestic demand would hinge on the evolution of political situation. Continued political uncertainty could further dampen private confidence, thus prolonging moderation in consumption and investment. Public expenditure would likely be delayed further by continued political uncertainty. **Although, inflation was expected to edge up due to increased pass-through of LPG costs to prices of prepared food, overall inflation pressure remained benign.**

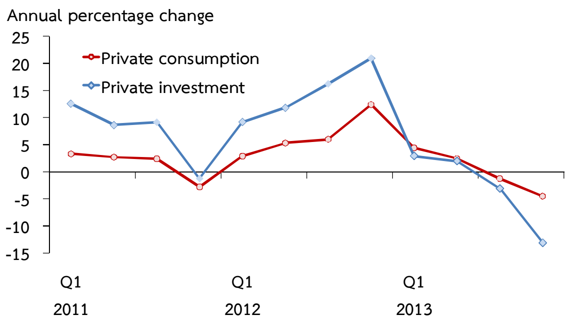
The Thai Economy in 2013

The Thai economy slowed down from the previous year mostly owing to weakness in domestic demand.

In 2013, the Thai economy expanded 2.9 percent, moderating from the previous year mostly owing to a slowdown in private spending. During the first half of the year, private consumption was an important driver of the economy. A combination of government's stimulus measures, most notably, the minimum wage hike, agricultural price subsidies, and the first-car tax rebate scheme, underpinned private consumption momentum. High employment along with steady income and confidence also supported household spending. The buoyant consumption environment provided incentives for businesses to invest to improve production efficiency. Manufacturing production, especially domestic-oriented industries continued to expand well.

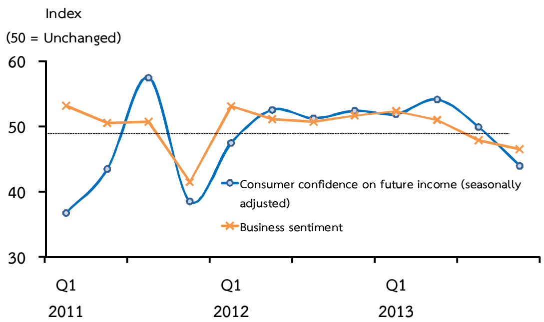
In the second half of the year, the expiration of the first-car tax rebate scheme and an escalating household debt burden, led to more cautious spending by households and tightening of credit standards by financial institutions. Such development coupled with a decrease in income from overtime employment and deteriorating confidence from heightening economic and political uncertainties, led to a contraction in consumption. At the same time, investment plummeted as businesses adopted a wait-and-see approach regarding the economic and political circumstance.

Private Consumption and Investment



Source: NESDB

Consumer Confidence and Business Sentiment

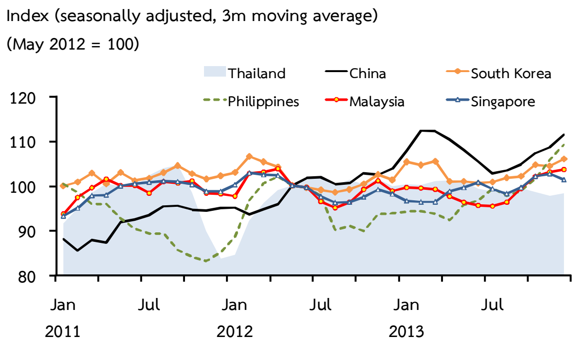


Sources: Bureau of Trade and Economic Indices, Ministry of Commerce, and Bank of Thailand

The benefits of global economic recovery on Thai exports of goods were limited as firms faced technological constraints and shortage of raw materials.

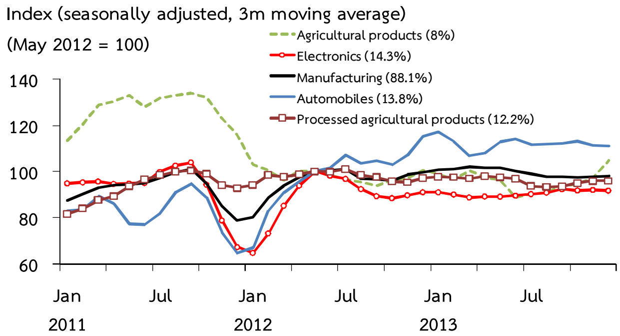
The recovery in major advanced economies during the second half of the year did not benefit Thailand's exports much because improving foreign demand was concentrated in goods that were not Thailand's main export products. For example, on the global scale there was a strong demand for tablets and smart phones, but due to their technological constraints, Thai firms were not able to cater to the changing consumers' preference. Moreover, exporters of processed agricultural products and fisheries faced shortages of raw materials following the ongoing shrimp disease outbreak. As a result, Thailand's export value in 2013 declined by 0.2 percent from the previous year. The sluggish recovery compared poorly to many countries in the region such as South Korea, Malaysia and the Philippines, whose exports had been improving visibly since 2013 Q3.

Exports of Asian Economies



Sources: CEIC and calculations by Bank of Thailand

Thai Export Value



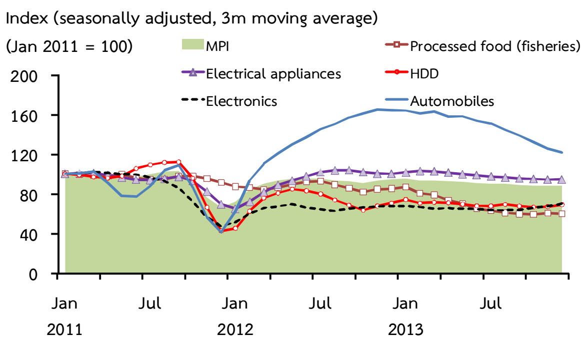
Note: ( ) shows percentage of total exports

Sources: Thailand Customs Department and calculations by Bank of Thailand

Manufacturing production was flat as a result of sluggish recovery in exports and moderation in domestic demand.

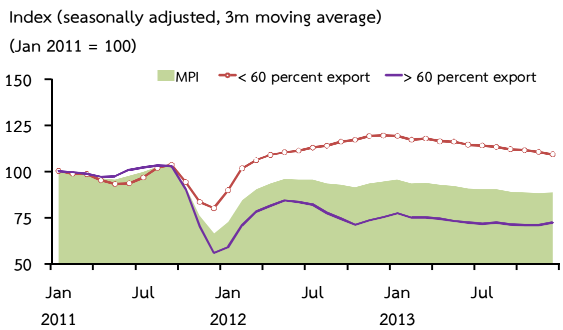
Manufacturing production was roughly unchanged from the previous year due to production constraints of export-oriented firms, including shortage of raw materials and technological limitation. At the same time, domestic-oriented firms were affected by a slowdown in domestic demand and the expiration of the government's stimulus measures during the second half of the year. In spite of this, some export-oriented industries showed signs of improvement towards the end of the year, in line with recovery in the global economy, particularly integrated circuits and parts and hard disk drive industries.

Manufacturing Production Index (MPI)



Source : Office of Industrial Economics

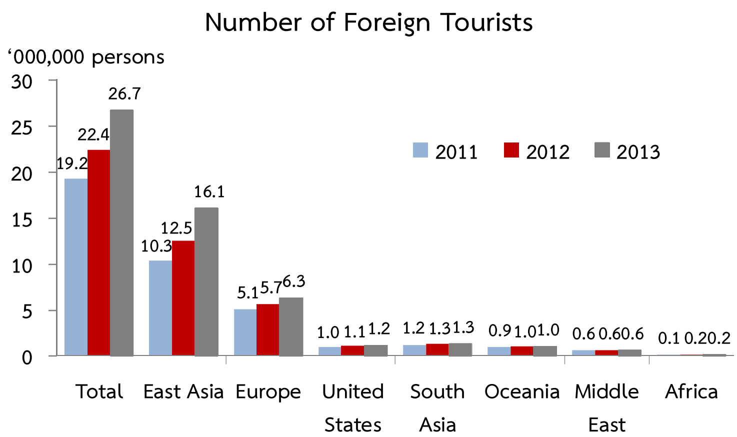
Manufacturing Production Index (MPI)



Source : Office of Industrial Economics

Tourism was the main engine of growth.

The buoyant tourism sector was an important engine of growth for the economy this year. The number of tourists rose across all regions, especially China, Russia and ASEAN countries. Altogether, a record of 26.7 million tourists was reached. Such development could be attributed to the fact that some tourists decided to change their travel destination to Thailand given rising tension between China and Japan and an increase in the number of low-cost airlines which helped improve convenience and reduce cost for travelers. However, some decline in the number of tourists was observed towards the end of the year, particularly those from China, following a change in China's tourism law to control sales of below-cost tour packages along with the impact of Thailand's political situation.



Source: Bank of Thailand

Monetary and fiscal policies were supportive of the economy during a slowdown in domestic demand.

Against uncertainties surrounding the global recovery and a slowdown in domestic demand, fiscal policy remained stimulative. In fiscal year 2013, a 300 billion baht budget deficit, equivalent to 2.5 percent of GDP, was announced. Nevertheless, the impact was less than the previous year's given low disbursement of public investment. In addition, the dissolution of parliament and political events towards the year-end caused some spending to be postponed. Moreover, parts of Water Management Projects which required a public hearing under the Administrative Court's order and the Infrastructural Development Act were also delayed.

On the monetary policy front, the MPC decided to decrease the policy interest rate twice by a total of 0.50 percent at the May and November meetings, causing the policy interest rate to stay at 2.25 percent per annum at the end of 2013. The decisions were deemed necessary to help reduce risk to growth in times of fragile private confidence following development in domestic political situation.

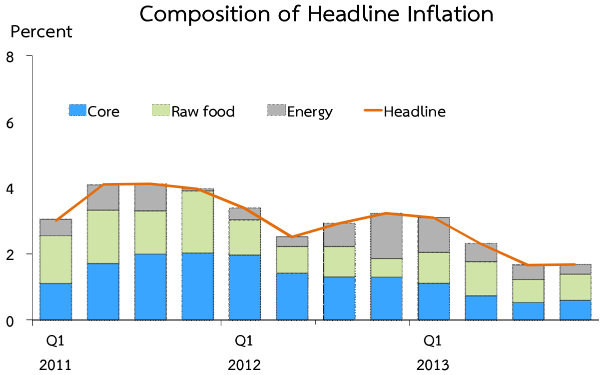
Private credits and savings moderated in tandem with the economy.

Overall, private credits continued to expand well despite some slowdown during the second half of the year in both corporate credits due to moderating private investment as well as consumer credits partly owing to a high level of household debt. Meanwhile, there was competition in deposit mobilization through introduction of special deposit products during the first half of the year given that low deposit interest rates had caused savers to switch to invest in other higher-return assets. However, competition in deposit mobilization cooled down in the latter part of the year in line with moderation in credit growth.

Overall economic stability was well maintained.

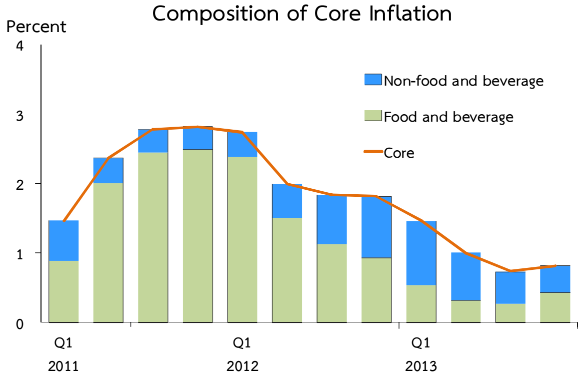
Headline and core inflation in 2013 averaged 2.18 and 1 percent, respectively. Headline inflation slowed down from the previous year in tandem with prices of energy and core inflation. Supply-side pressure remained low in line with trends in global oil and commodity prices. Although the second round minimum wage hike to 300 baht per day nationwide took effect on January 1, 2013, its impact was modest. Moreover, there was limited inflation pass-through from the gradual increase in LPG prices for households during 2013 Q4 to prices of prepared food owing to a slowdown in domestic demand.

Composition of Headline Inflation



Sources: Bureau of Trade and Economic Statistics, Ministry of Commerce, and calcula by Bank of Thailand

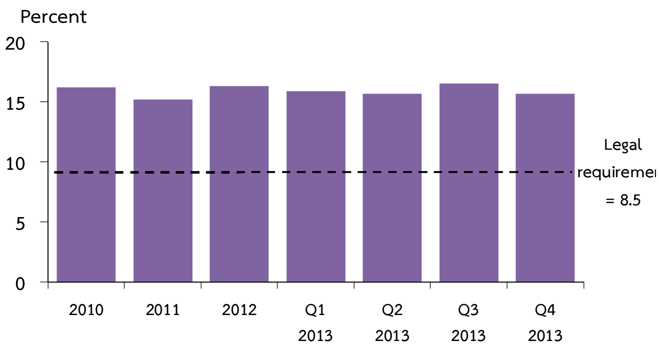
Composition of Core Inflation



Sources: Bureau of Trade and Economic Statistics, Ministry of Commerce, and calculations by Bank of Thailand

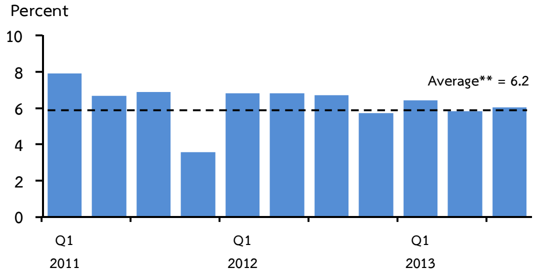
The financial institutions sector continued to be robust as reflected by a high capital adequacy (BIS) and healthy profits. The latter was attributed to debtors' strong financial conditions, particularly corporate debtors listed on the Stock Exchange of Thailand, as reflected by their high operating profit margins and liquidity positions. Nonetheless, financial institutions became more cautious in lending to households given that household debt continued to be elevated despite a slowdown in new loans from the previous year.

BIS Ratio of the Commercial Banking System



Source: Bank of Thailand

Operating Profit Margin of Non-financial Companies Listed on the Stock Exchange of Thailand*



Notes: * Median
** Average during 2003 Q3 – 2013 Q3
Sources: Stock Exchange of Thailand and calculations by Bank of Thailand

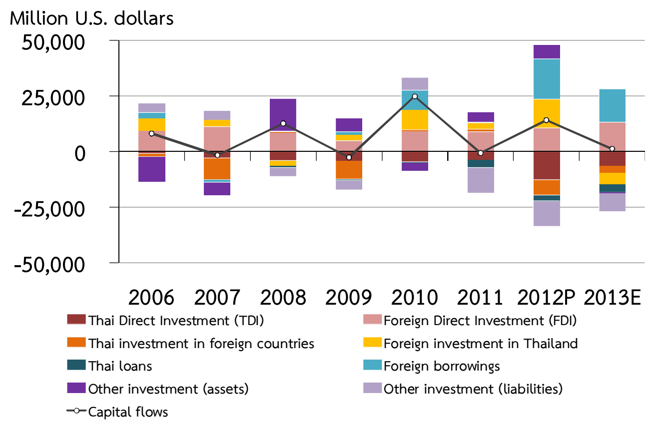
Government's fiscal position remained sound with the ratio of public debt to GDP lower than the threshold for fiscal sustainability of 60 percent of GDP. Nonetheless, the ratio of public debt to GDP rose from 43.7 percent in 2012 to 45.7 percent, with most of the increase coming from loans to finance public deficit and guarantees of Specialized Financial Institutions (SFIs), especially borrowings by the Bank for Agriculture and Agricultural Cooperatives (BAAC) to finance the rice pledging scheme.

Overall external stability was well maintained. Although a current account deficit of 2.8 billion U.S. dollars was recorded for the year, it did not reflect over spending since most of the deficit was a result of gold imports and repatriation of profits, income and dividends by foreign businesses, in particular, automobile companies whose profits had been notable in the previous year. In this regard, the current account excluding gold remained in surplus at 8.9 billion U.S. dollars.

The capital account registered a surplus of 1.2 billion U.S. dollars. During the first half of the year, there was massive amount of inflows into both the equity and bond markets, causing the baht to appreciate rapidly. Such inflows were caused by investors' higher demand for high-return baht denominated assets, following continuation of monetary easing by major advanced economies together with strong fundamentals of the Thai economy.

In the second half of the year, however, investors became weary of a potential wind-down of Quantitative Easing measures (QE tapering) by the Fed and heightened uncertainties regarding the Thai political situation towards the end of the year. As a result, investors started to sell off Thai assets which led to capital outflows from the equity market and caused the baht to depreciate continuously to the end of the year. As such, for the whole of 2013, there were net outflows from the Thai equity market. However, when these net outflows were combined with foreign direct investment and financial institutions' foreign currency denominated borrowings to support Thai businesses' direct investment abroad, a small surplus was recorded in the overall capital account.

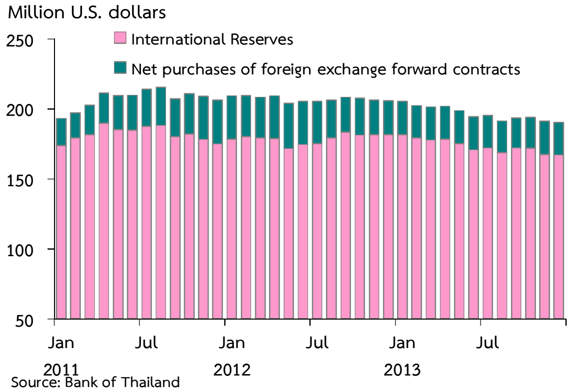
Capital Flows Classified by Type



Notes: P = Preliminary E = Estimate
Source: Bank of Thailand

Gross international reserves stood at 167.2 billion U.S. dollars at the end of December 2013, decreasing by 14.4 billion U.S. dollars from the end of the previous year. With the BOT's net purchases of foreign exchange forward contracts of 23 billion U.S. dollars, net international reserves registered at 190.2 billion U.S. dollars. Therefore, the ratios of international reserves to imports and international reserves to short-term external debt remained solid.

International Reserves



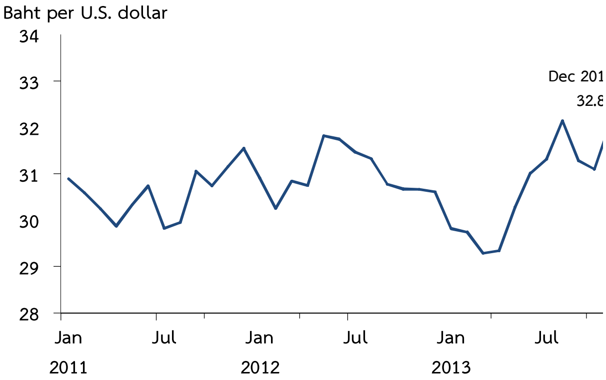
Source: Bank of Thailand

Indicators of External Stability

	International benchmark	2012	2013	2013			
				Q1	Q2	Q3	Q4
Current account (billion U.S. dollars)	n.a.	-1.5	-2.8	0.0	-7.2	-0.9	5.2
Current account ex. gold (billion U.S. dollars)	n.a.	4.2	8.9	6.2	-4.7	0.1	7.2
Indicators of liquidity position							
- International reserves to short-term external debt (ratio)	> 1	3.1	2.8	3.0	2.6	2.8	2.8
- International reserves to imports (month)	> 3-4 months	9.9	9.2	9.5	9.1	9.3	9.2
- Short-term external debt to total external debt (percent)	n.a.	44.5	43.2	43.5	45.8	44.2	43.2

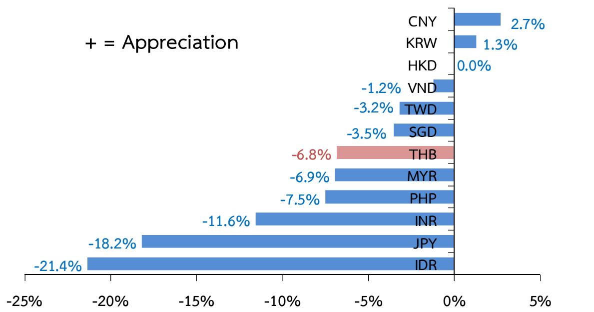
Volatility in capital flows led to a two-way movement in the baht **exchange rate**. In the beginning of the year, the baht strengthened relative to the U.S. dollar to reach a peak in March. Then, from mid-year onwards, the baht depreciated continuously to reach 32.86 baht per U.S. dollar at the end of the year. Compared with the end of the previous year, a depreciation of 6.8 percent was observed. However, relative to most regional currencies which also weakened as a result of capital reversals, the depreciation of the baht was moderate.

Exchange Rate



Source: Bank of Thailand

Movements of the Thai Baht and Regional Currencies Relative to the U.S. Dollar in 2013



Note: Calculated using exchange rates per U.S. dollar at the end of 2013 and 2012

Source: Bank of Thailand and Reuters

In 2014, the export sector would play a more prominent role in supporting economic growth while inflation was projected to increase from 2013.

The Thai economy in 2014 was expected to be driven by exports thanks to improvement in trading partners' economies, particularly major advanced economies whose recovery continued to gain traction. Meanwhile, recovery in domestic demand would hinge on the evolution of political situation. Continued political uncertainty would further dampen private confidence, thus prolonging moderation in consumption and investment. Public investment expenditure would also be delayed further by continued political uncertainty.

Overall inflationary pressure was expected to edge up from 2013. Headline and core inflation in 2014 were projected to rise from 2013 in tandem with uptrend cost pressure. The gradual increase of LPG prices for household use as a result of government policy would lead to greater pass-through of costs to prices of prepared food. Meanwhile, prices of other goods and services was expected to stabilize in line with prices of oil and other commodities as well as demand pressure.

Factors that could lead to accumulation of imbalances in the economy and hence required close monitoring are: 1) Volatility of capital flows as a result of major advanced economies' monetary policy implementation during times of abundant global liquidity, which could lead to fragile foreign investors' confidence; 2) higher risk to fiscal stability from rising public debt due to government spending to stimulate the economy in the short-term, especially spending related to quasi-fiscal activities conducted through SFIs as part of the rice pledging scheme along with subsidies on energy and other utilities. Such development could affect the country's credit rating, resulting in higher cost of finance and loss of competitiveness of the corporate sector; and 3) threats to overall economic and financial stability, especially household debt which remained elevated despite some moderation from the previous year.

In addition, various structural constraints represent a threat to sustainability of Thailand's economic growth. The most notable examples are labor shortage due to an increase in Thailand's aging population, low growth in labor productivity, and inability of businesses to upgrade technology to cater to the fast changing global demand in a timely manner. These issues would require time to address but their resolution would be crucial to uplift Thailand's competitiveness in the global arena.

ธนาคารแห่งประเทศไทย

Thailand's Economic Conditions in 2013

	2011	2012			2013		
	Year	H1	H2	Year	H1	H2	Year
(Annual percentage change, unless specified otherwise)							
Gross Domestic Product 1/	**0.1**	2.3	10.9	**6.5**	4.2	1.6	**2.9**
Demand (expenditure)							
Private consumption expenditure	**1.3**	4.1	9.2	**6.7**	3.4	-2.9	**0.2**
General government consumption expenditure	**1.1**	3.6	11.1	**7.5**	5.4	4.5	**4.9**
Gross fixed capital formation	**3.3**	7.7	18.9	**13.2**	5.2	-8.7	**-1.9**
- Private	**7.2**	10.5	18.5	**14.4**	2.4	-8.0	**-2.8**
- Public	**-8.7**	-2.7	20.4	**8.9**	17.0	-11.2	**1.3**
Exports of goods and services	**9.5**	-1.1	7.4	**3.1**	5.6	2.9	**4.2**
Imports of goods and services	**13.7**	6.5	6.0	**6.2**	6.3	-1.4	**2.3**
Supply (production)							
Agriculture	**4.1**	2.7	5.0	**3.8**	1.5	1.3	**1.4**
Manufacturing	**-4.3**	-0.8	15.7	**6.9**	1.9	-1.7	**0.1**
Construction	**-5.1**	3.9	11.7	**7.8**	7.6	-4.6	**1.2**
Services and others	**3.3**	4.8	8.3	**6.6**	6.2	4.5	**5.4**
Domestic stability							
Headline Consumer Price Index	**3.81**	2.95	3.08	**3.02**	2.70	1.68	**2.18**
Core Consumer Price Index (excluding raw food and energy)	**2.36**	2.37	1.83	**2.09**	1.23	0.78	**1.00**
Unemployment rate (percent)	**0.7**	0.8	0.5	**0.7**	0.7	0.7	**0.7**
Public debt (end of period, billion baht)	**4,298**	4,811	4,961	**4,961**	5,224	5,450	**5,450**
Share of GDP (end of period, percent)	**40.8**	43.9	43.7	**43.7**	44.5	45.7	**45.7**
External stability (billion U.S. dollars)							
Trade balance	**17.0**	1.4	4.6	**6.0**	-2.5	8.9	**6.4**
Current account balance	**4.1**	-2.8	1.4	**-1.5**	-7.1	4.3	**-2.8**
Capital account balance	**0.0**	0.1	0.1	**0.2**	0.1	0.1	**0.3**
Financial account balance	**-0.6**	5.5	8.7	**14.1**	9.0	-7.7	**1.2**
Balance of payments	**1.2**	-0.6	5.8	**5.3**	0.2	-5.2	**-5.0**
Gross international reserves (end of period)	**175.1**	174.7	181.6	**181.6**	170.8	167.2	**167.2**
External debt (end of period)	**104.3**	116.7	130.7	**130.7**	141.2	140.3	**140.3**
International reserves to short-term debt (percent)	**3.7**	**3.1**	**3.1**	**3.1**	2.6	2.8	**2.8**
External debt to GDP (percent)	**33.8**	35.6	38.0	**38.0**	39.4	38.3	**38.3**
External debt to export value (percent)	**47.0**	48.6	51.5	**51.5**	53.3	51.3	**51.3**
Short-term debt to external debt (percent)	**45.2**	48.0	44.5	**44.5**	45.8	43.2	**43.2**
Monetary statistics (end of period) (billion baht)							
Monetary base	**1,365.5**	1,330.3	1,497.8	**1,497.8**	1,386.1	1,582.1	**1,582.1**
Annual percentage change	**9.8**	8.7	9.7	**9.7**	4.2	5.6	**5.6**
Narrow money	**1,414.3**	1,452.8	1,598.3	**1,598.3**	1,519.7	1,662.3	**1,662.3**
Annual percentage change	**8.6**	8.7	13.0	**13.0**	4.6	4.0	**4.0**
Broad money	**13,559.9**	14,013.0	14,966.8	**14,966.8**	15,446.0	16,056.5	**16,056.5**
Annual percentage change	**15.1**	11.2	10.4	**10.4**	10.2	7.3	**7.3**
Financial institutions' deposits including bills of exchange 2/	**13,195.4**	13,783.7	14,656.5	**14,656.5**	15,214.1	15,757.7	**15,757.7**
Annual percentage change	**14.1**	11.5	11.1	**11.1**	10.4	7.5	**7.5**
Financial institutions' private credits 2/	**11,587.3**	12,396.4	13,359.0	**13,359.0**	13,989.9	14,691.8	**14,691.8**
Annual percentage change	**16.5**	16.1	15.3	**15.3**	12.9	10.0	**10.0**
Interest rates (end of period) (percent per annum)							
- Repurchase rate, one-day	**3.25**	3.00	2.75	**2.75**	2.50	2.25	**2.25**
- Overnight interbank rates (mode)	**3.15**	2.90	2.65	**2.65**	2.40	2.15	**2.15**
- Time deposit rate, one year 3/	**2.87**	2.86	2.46	**2.46**	2.40	2.23	**2.23**
- Prime rate (MLR) 3/	**7.25**	7.13	7.00	**7.00**	7.00	6.84	**6.84**
exchange rate (end of period) (baht per U.S. dollar)	**31.55**	31.75	30.61	**30.61**	31.02	32.86	**32.86**

Note: 1/ At constant prices

2/ Financial institutions consist of all deposit-taking institutions except the Bank of Thailand

3/ Average rate of four largest commercial banks

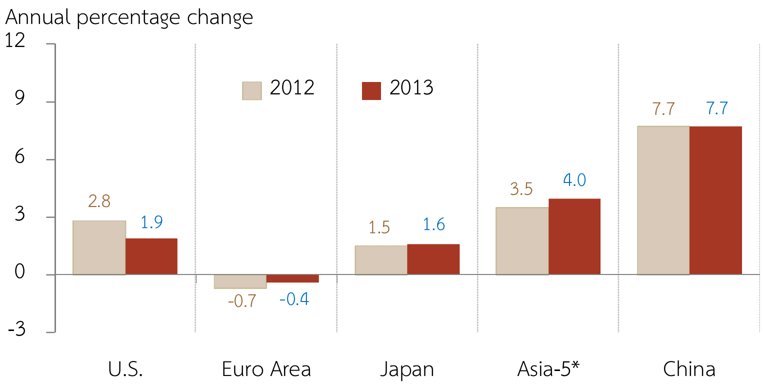
E = estimated data

Sources: Office of the National Economic and Social Development Board, Ministry of Commerce, National Statistical Office, Public Debt Management Office and Bank of Thailand

1. Global Economies

In 2013 the world economy improved from last year. Major industrialized economies, especially the U.S., posed stronger recovery, while the euro area emerged from the recession. The Japanese economy benefited from the government stimulus measures, and Asian and Chinese economies expanded following a continued growth in domestic demand.

Global Economic Growth in 2012 and 2013



Note: * GDP-PPP weighted average of five countries: Indonesia, the Philippines, South Korea, Taiwan, and Singapore

Source: Bureau of Economic Analysis (U.S. Department of Commerce), Cabinet Office of Japan, CEIC, Eurostat, and calculations by Bank of Thailand

Major industrialized economies (G3)

The U.S. economy recovered noticeably amidst uncertainties from monetary and fiscal policy direction.

In 2013, the U.S. economy grew by 1.9 percent, slowing down from 2.8 percent last year. At the beginning of the year, the slowdown was attributable to 1) tax increases, such as personal income and payroll taxes, which became effective since January and 2) the sequestration, which started to take effect in March. Government expenditure was therefore reduced, particularly in defense spending.

However, in the latter half of the year, the U.S. economy recovered thanks to continued improvement in economic fundamentals, especially in the labor and housing markets. This development benefited households' financial position and helped support consumption growth. Nevertheless, the U.S. economy still faced uncertainties from 1) sharp tightening in monetary conditions due to investor concerns on the tapering of quantitative easing during May prior to the Federal Reserve decision to reduce the amount of asset purchases from 85 to 75 billion US dollars per month in December 2013[1]; 2) the budget crisis which resulted in the 16-day partial government shutdown; and 3) risk of default due to restrictions on the public debt ceiling[2].

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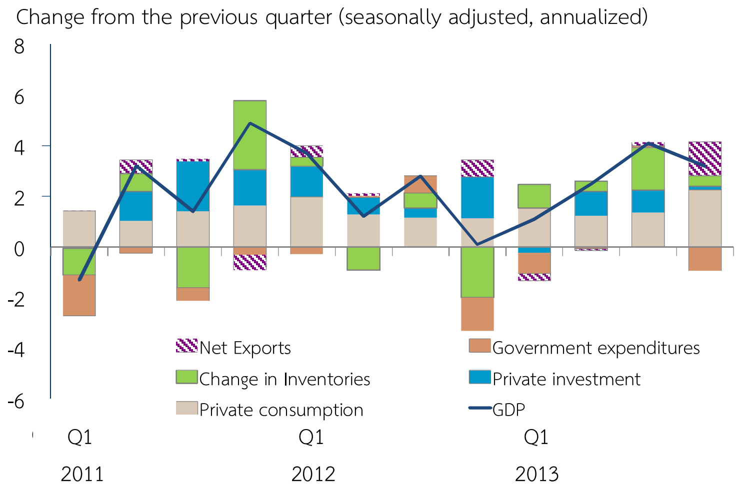
[1] At the meeting on December 17 – 18, 2013, the Federal Open Market Committee (FOMC) decided that it would (1) reduce asset purchases by 10 billion US dollars per month, resulting in a reduction in purchases of longer-term treasury securities and agency mortgage-backed securities to 40 billion US dollars per month and 35 billion US dollars per month respectively, which will go into effect in January 2014; and (2) maintain the federal funds rate at 0 – 0.25 percent per annum, given that the unemployment rate remained above 6.5 percent and the inflation does not exceed 2.5 percent. The FOMC also signaled that it would maintain the federal funds rate at this level even if the unemployment rate moved below 6.5 percent, especially if inflation continued to be below the 2 percent target.

[2] On October 17, 2013, the U.S. government agreed to extend the time period to pass the temporary budget and suspended enforcement of the requirements pertaining to the debt ceiling until January 17 and February 7, 2014, respectively.

The U.S. financial conditions in the periods ahead might tighten due to higher long-term interest rates. However, this should not halt economic growth because economic fundamentals continued to improve and the fiscal burden was diminishing[3].

Contribution to U.S. GDP Growth



Source: U.S. Department of Commerce

The euro area[4] emerged from the recession though individual recovery differed in pace and remained fragile.

Growth of euro area economies turned positive in 2013 Q2 after 6 consecutive quarters of contraction since 2011 Q4. Growth was driven mainly by domestic demand and exports of major economies, particularly Germany. Meanwhile, peripheral economies were still relatively weak as reflected by the low and uneven growth rates of credits to the corporate sector in each country.

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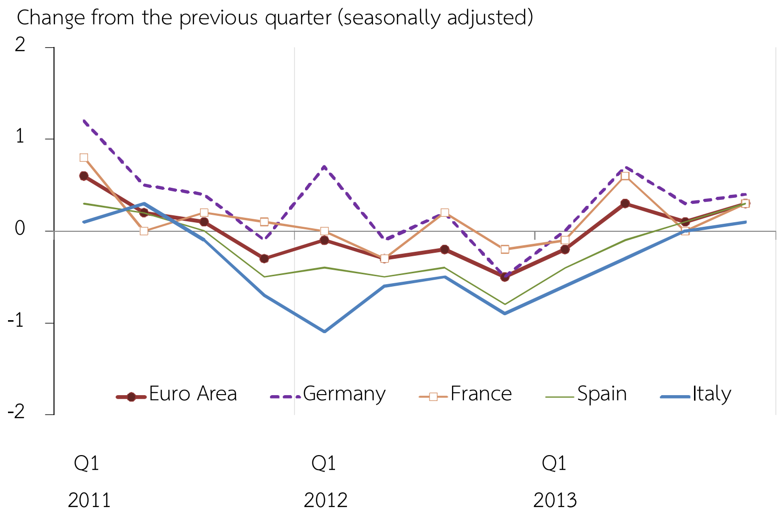
[3] On 18 December 2013, the U.S. Senate passed the Bipartisan Budget Act of 2013 for fiscal years 2014 and 2015 by eliminating some of the spending cuts of 2014 and 2015. This increased the federal government's budget allocation by 45 and 18 billion US dollars per year, respectively. Such cuts would be offset by (1) an increase in revenue, for example, from tourist fees and increase in pension contribution and (2) spending cuts on Medicare for a total of 85 billion US dollars over the next 10 years.

[4] The euro area comprises 17 countries using the euro currency. The economies of Germany, France, Italy, and Spain have 28, 21, 17, and 11 percent share of the total euro area's economy in 2013, respectively. Greece, Ireland, and Portugal combined made up 6 percent share.

In the latter half of the year, euro area economies gradually improved thanks to more buoyant business and consumer confidence which helped support production and private consumption. However, exports growth slowed down somewhat in line with external demand as Asian economies began to moderate. Besides, financial market volatility reflected uncertainties regarding the size of the Federal Reserve quantitative easing withdrawal. For the whole year, the euro area continued to contract by 0.4 percent, improving significantly from the 0.7 percent decline the year earlier.

In the periods ahead, euro area economies were expected to grow slowly. Nevertheless, recovery remained fragile due mainly to the record-high unemployment rates in many countries and the uneven growth among members, mirroring different levels of competitiveness. Important downside risks were: 1) the deleveraging process in both public and private sectors; 2) structural reforms in many countries that would take time, for example, efforts to improve labor market flexibility and enhance competitiveness; and 3) the ongoing contraction in corporate credits since the public debt crisis, would restrain recovery of the private sector.

Euro Area's GDP Growth



Source: Eurostat

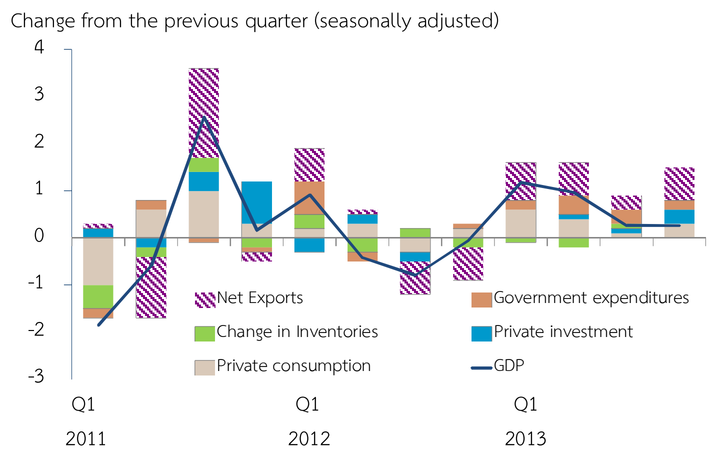
The Japanese economy gained momentum from the previous year. Growth was driven by government stimulus measures in 2013 H1, before moderating in the second half.

In 2013, the Japanese economy continued to expand, up 1.5 percent from the previous year. In the first half of the year, recovery was induced by government stimulus measures which spurred construction in areas affected by natural disasters and stronger confidence in the new government's stimulus package known as "Abenomics."[5] Exports also picked up in line with the weakening yen and more buoyant demand of trading partners.

In the second half of the year, the Japanese economy moderated due to the slowdown in private consumption after a strong expansion in prior periods following government measures. Exports were also affected by the slower growth of Asian trading partners. The moderation was despite the pick-up in private consumption ahead of the planned increase in consumption tax in April 2014 and improvement of exports to major trading partners, especially China and the U.S.

In the periods ahead, the Japanese economy would likely continue to expand despite some moderation due to the effects of increased consumption tax. Nonetheless, additional stimulus measures and improved exports owing to the weak yen and global economic recovery were expected to help cushion the impact of the tax increase.

Contribution to Japan's GDP Growth



Source: Cabinet Office of Japan

[5] The 3-arrow policy consists of: (1) monetary policy: the Bank of Japan announced Quantitative and Qualitative Easing: QE by increasing the asset purchases to pull the economy out of the recession and to achieve sustainable growth with stability; (2) fiscal stimulus measures; and (3) economic reforms i.e. "growth strategy".

Asian and Chinese economies expanded well on the back of strong domestic demand while exports of many countries recovered in tandem with expansion of major industrialized economies.

The Chinese economy continued to grow on the back of consumption and public infrastructure investment. Although production and investment in the manufacturing sector slowed down in the first half of 2013, reflecting the weak export growth and external demand, the overall economy expanded in the latter half of the year on account of recovery in exports and impact of government measures to expedite public investment.

Looking ahead, the Chinese economic growth was expected to continue, albeit at a slower pace. The government was committed to comprehensive economic and financial reforms to support long-term stability. Emphasis would be placed on consumption rather than investment which used to be the growth engine in the earlier period.

In 2013, the Asian economies excluding China expanded well thanks to domestic demand and the gradual recovery of exports following an upturn in demand of the major industrialized economies during the latter half of the year. Strong growth was observed for South Korea, Malaysia, and the Philippines which produced and exported a high share of electronic goods such as tablets and smart phones. The improved performance by the export sector also benefited production and investment in machinery and equipment of export-oriented producers. Indonesia's exports, however, remained weak as its commodities exports were affected by low global prices.

In 2014, it was expected that the momentum of Asian economies excluding China would be similar to last year's. Although Asian exports were improving in line with the global economic recovery, growth of ASEAN economies was expected to moderate due to slowing domestic demand. This was in part a result of government measures to maintain monetary, fiscal, and balance of payments stability. Moreover, ASEAN exports were yet to fully reap the benefit from the global economic rebound.

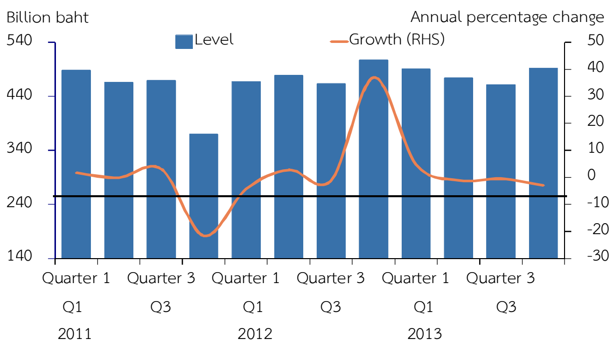
2. Supply Side

2.1 Manufacturing Sector

In 2013, the overall manufacturing production was unchanged from the previous year. Export-oriented manufacturing was unable to fully reap the benefits from the global economic recovery in the second half of the year.

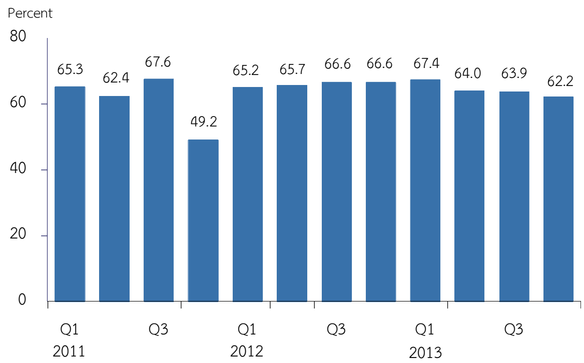
Manufacturing production was roughly unchanged from the previous year, gradually slowing down as a result of sluggish recovery in exports. Some export-oriented industries experienced production constraints, for example, the frozen shrimp industry which faced a disease outbreak and the hard disk drive industry which was affected by weakened global demand. The latter was due to the changes in consumers' preference toward tablets and smart phones instead of computers in which hard disk drives were the main components. Competitiveness of the apparel industry declined due to higher production cost. Meanwhile, production for domestic sales contracted, reflecting the moderation in domestic demand after accelerated spending earlier on post-flood reconstructions and temporary government stimulus measures, particularly the first-car buyer tax rebate scheme and electrical appliances coupons. The higher household debt burden also encouraged more cautious spending by consumers. However, some export-oriented industries showed signs of improvement towards the end of the year following recoveries of the major industrialized economies, especially integrated circuits and parts and hard disk drive industries.

Manufacturing Production at 1988 Price

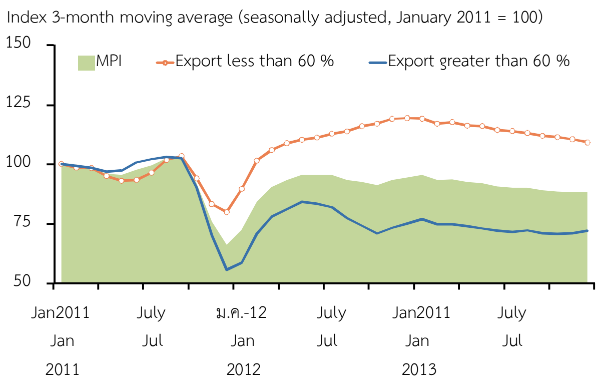


Source: Office of the National Economic and Social Development Board

Capacity Utilization: Manufacturing sector

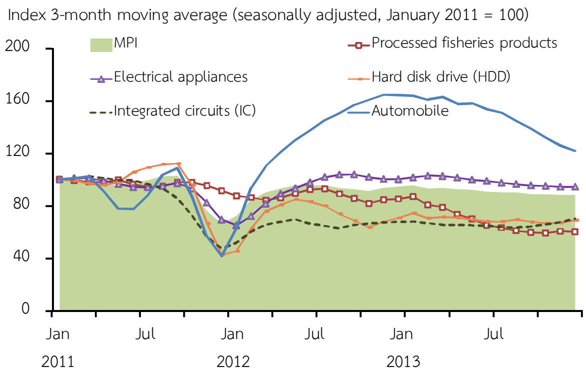


Manufacturing Production Index (MPI)



Source: Office of Industrial Economics

Manufacturing Production Index (MPI)



Source: Office of Industrial Economics

Key industries which experienced contraction were:

- Food and beverages production contracted due to the Early Mortality Syndrome (EMS) outbreak severely affecting the frozen shrimp industry. In addition, some frozen chicken factories of a major producer suspended production due to liquidity problem. Production of animal feed also declined in line with shrimp and chicken farming.

- Petroleum production contracted slightly owing mainly to a refinery closure for maintenance in the first half of the year. In the latter half, however, production increased partly reflecting the low-base effect in 2012 Q3 due to a partial closure of a refinery which had been damaged by a fire accident. In addition, oil producers raised production in line with the increase in car sales and to comply with the increase in oil reserve from 5 to 6 percent as stipulated by the Energy Policy and Planning Office which were effective since November.

- Electrical appliances production declined, especially in the second half of the year, on account of more cautious spending by consumers and restrained external demand, especially from the Middle East, Thailand's main export market, due to the political unrest.

- Hard disk drive production was affected by the change in consumers' preference toward high-technology equipment and new generation products such as Solid State Drive (SSD). However, production of hard disk drive showed signs of mild recovery owing to the increase in demand for a new game console, which came on sale in the last quarter of the year.

- Integrated circuit production was unable to fully reap the benefits from the increase in global demand for tablets and smart phones because Thai manufacturers had yet been able to produce parts for such products in sufficient quantities. However, in 2013 Q4, production rose to some extent thanks to the gradual improvement in global demand.

- Apparels: With higher production costs and weakening competitiveness, some manufacturers relocated their production bases to neighboring countries. Nonetheless, production recovered somewhat in the second half of the year thanks to an increase in demand from major trading partners along with orders for sports apparel in preparation for the 2014 World Cup.

Key industries which experienced expansion were:

- Automobile production totaled 2.46 million cars for the year, increasing slightly from the previous year. Automakers stepped up production at the beginning of the year to keep up with backlog order that resulted from government’s tax rebate scheme for first-time car buyers since end-2012. In the second half of the year, however, production gradually declined, as an increase in overseas orders failed to offset decline in domestic orders, after most cars under the first-car scheme had been delivered. Towards the end of the year, production was further constrained by adjustment of the production line by some automakers to prepare for new models. Since automobile production recorded an expansion for the year, other related industries such as rubber and rubber products also performed well, accordingly.

- Textile production expanded in line with exports of raw materials for garment industries in the neighboring countries, especially exports of fabrics to Vietnam and Laos.

- Construction materials and steel production expanded, but at a slower pace compared to the previous year, in line with construction businesses, real estate market conditions, and government infrastructure projects.

In 2014, manufacturing production was expected to expand, aided by export-oriented production, which was expected to improve in line with the global recovery. Nevertheless, export production would continue to face structural challenges since it could not effectively adapt to the change in global demand and technology. Production for domestic sales was expected to increase somewhat as private spending showed signs of a gradual improvement. However, consumers’ spending would be restrained, given accumulated debt levels and income shortfalls. Farm income could be affected by uncertainties regarding various agricultural pledging schemes. In addition, consumer and business sentiment could be dented further by the prolonged political situation.

Manufacturing Production Index

Industry (Annual percentage change)	Weight 2000	Relative Weight 2012	2012	2013	2013			
					Q1	Q2	Q3	Q4
Food and beverages	15.5	14.1	6.8	-6.7	-0.6	-3.9	-11.2	-12.0
Petroleum	10.4	8.6	8.5	-2.0	-9.3	-11.9	8.4	6.0
Textiles	7.3	2.1	-13.6	3.4	7.9	5.6	-1.3	1.8
Apparels	7.1	4.2	-10.7	-4.6	-14.4	-7.3	3.2	0.9
Hard disk drive	7.2	24.3	-16.2	-7.5	-7.3	-17.8	-1.0	-2.6
IC & Semiconductor	6.8	4.4	-21.2	-0.3	-0.6	-2.0	-2.1	3.5
Automobiles	5.4	15.8	73.1	1.4	47.4	11.9	-11.0	-26.1
Cement and construction	4.8	4.7	8.6	2.2	2.7	3.9	1.8	0.3
Chemicals	4.4	4.2	6.7	-0.9	-0.3	-0.4	-2.0	-0.8
Rubbers and plastics	4.0	3.0	2.6	2.5	2.4	2.4	1.2	4.0
Electrical appliances	3.7	4.9	11.7	-2.0	12.2	-3.7	-7.5	-8.4

Source: Office of Industrial Economics

2.2 Agricultural Sector

Agricultural output expanded due to the expansion of planting area while agricultural prices declined. Overall, farm income[1] rose slightly.

Agricultural output expanded by 0.6 percent for the year. Output of rubber and oil palm went up, owing to an increase in planting areas in response to higher price in the previous period. Livestock output increased on the back of production expansion to facilitate domestic and external demand, except shrimp output which declined due to disease outbreak. However, the situation began to improve towards the end of the year, with recovery in some farming areas. Rice output declined slightly, caused by unfavorable weather at the beginning of the year and the high-base effect in the previous year, owing to the efforts to offset damages from the flood at the end of 2011.

[1] Farm income does not include effects from government measures.

Annual percentage change	2012	2013				
		Year	Q1	Q2	Q3	Q4
Farm income	-5.6	0.3	-3.3	-0.8	-0.9	4.8
Agricultural output^{p}	4.5	0.6	1.1	-0.5	-2.9	3.0
Agricultural prices	-9.7	-0.3	-4.3	-0.4	2.1	1.8

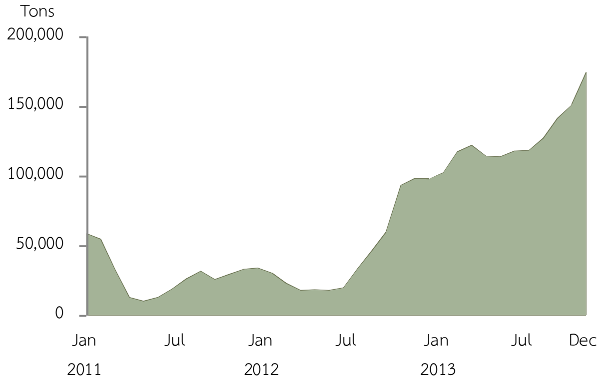
Note: Farm income does not include government transfers, which consist of price compensation under the income guarantee scheme and compensation for production costs for farmers affected by natural disasters.
p = Preliminary data for latest year
Source: Office of Agricultural Economics, calculations by the Bank of Thailand

Agricultural prices declined by 0.3 percent from last year. Prices of rice, rubber, and oil palm, whose production accounted for approximately 50 percent share of total output and the majority of farmers decreased by 5.4 percent all together. This reflected excess supply in the global market despite government measures to help cushion agricultural prices, such as the rice pledging scheme, the temporary waiving of export duty on rubber, and price intervention measures for oil palm.

Rice prices declined due to softer global demand as the major import countries such as Indonesia and the Philippines were able to increase domestic production in the previous year. Prices of rubber also declined because the major producers such as Thailand and Indonesia expanded planting areas while demand from China, a major importer, was not enough to shore up prices given its high inventory level. Oil palm prices decreased, owing to ample supply, particularly from Indonesia, the major producer. Meanwhile, soybean, a substitute of oil palm, experienced lower prices and increased output.

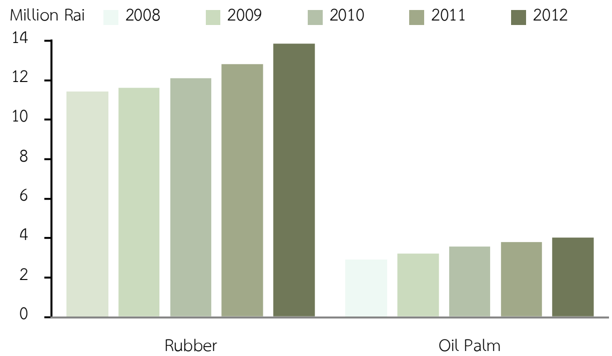
In 2013, farm income rose slightly due mainly to the increase in output.

China's Rubber Inventory



Source: Shanghai Futures Exchange

Farming Areas of Economic Crops



Source: Office of Agricultural Economics and calculations by Bank of Thailand

In 2014, agricultural output was expected to increase, particularly rubber and oil palm as plantation area had been increased in the past few years due to price incentives in line with stronger external demand. Meanwhile, rice output was expected to decline marginally from unfavorable prices and weather conditions.

Agricultural prices showed signs of declining trend, especially rice prices which were expected to decrease owing to good harvest in major importing countries causing softer global export demand. The impact from the rice pledging scheme in the beginning of 2014 would also depress prices, with uncertainty over the renewal of the scheme. Rubber prices were expected to stabilize as demand from China remained weak despite rising global economic recovery. This was attributable to the Chinese government's emphasis on economic stability; economic growth may not be as high as in the past. Furthermore, China's rubber inventory level remained high while output of other major producing countries increased. Nevertheless, it was expected that prices of oil and energy crops would rise due to higher demand for oil palm for biodiesel production, and for cassava for ethanol production.

With the uptrend of output and lower prices, overall farm income for 2014 was expected to stabilize from the previous year.

Thai Agricultural Prices

(Unit: Baht per ton)

	2012	2013	2013					
	Year	Year	H1	H2	Q1	Q2	Q3	Q4
Agricultural Price Index (2005 =100)	154.5	154.1	153.2	155.1	152.0	154.3	154.6	155.7
Δ%	-9.7	-0.3	-2.4	1.9	-4.3	-0.4	2.1	1.8
1. Crop Price Index (2005 =100)	169.8	160.3	162.3	158.3	162.7	161.8	159.2	157.3
Δ%	-9.7	-5.6	-6.2	-5.0	-7.1	-5.2	-3.9	-6.0
Hom Mali Paddy	15,103	15,582	15,826	15,339	15,878	15,774	15,676	15,002
Δ%	15.9	3.2	6.7	-0.2	5.9	7.6	2.8	-3.2
Paddy Class 1 (5%)	10,104	9,385	10,115	8,655	10,414	9,816	9,129	8,180
Δ%	11.2	-7.1	1.3	-15.3	7.0	-4.1	-11.2	-19.6
Rubber	89,974	74,755	78,280	71,230	81,020	75,540	71,243	71,217
Δ%	-29.4	-16.9	-22.0	-10.5	-21.0	-23.0	-11.1	-9.9
Maize	9,048	7,897	8,672	7,122	8,757	8,587	7,607	6,637
Δ%	10.3	-12.7	-1.8	-23.1	2.0	-5.4	-19.8	-26.7
Casava	2,016	2,130	2,152	2,108	2,080	2,223	2,143	2,073
Δ%	-14.5	5.7	11.9	0.0	6.1	17.8	4.0	-3.9
Oil palm	4,773	3,617	3,285	3,948	3,357	3,213	3,507	4,390
Δ%	-8.2	-24.2	-38.5	-6.1	-37.3	-39.6	-29.2	26.8
2. Livestock Price Index (2005 =100)	113.8	8.9	123.7	132.2	120.0	127.5	132.9	131.4
Δ%	-11.3	12.5	7.2	17.9	5.4	8.9	17.3	18.5
3. Fishery Price Index (2005 =100)	104.0	59.5	138.2	185.1	126.7	149.7	166.3	203.8
Δ%	-2.0	55.4	37.4	72.1	18.1	59.5	60.8	82.6

Note: Δ% indicates percentage change from the same period last year

Source: Office of Agricultural Economics

2.3 Tourism Sector

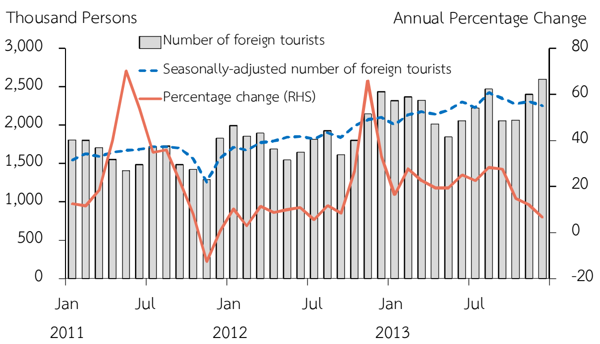
The tourism sector posted robust growth and was the main growth engine throughout the year.

The number of tourist arrivals reached a historical record of 26.7 million in 2013, rising by 19.6 percent from last year. Foreign tourists increased from all regions, notably from East Asia, especially China. With heightened political tension between China and Japan, some tourists chose Thailand as destination. Greater number of ASEAN tourists was in step with the increase in low-cost airlines which lowered the cost of travel. Russian tourists also continued to increase.

Tourism growth, however, slowed down in the last quarter of the year somewhat due to a number of factors including: 1) a decline in the number of group tourists from China after the Chinese government began to regulate below-cost tour packages in October, which drove up the cost for group tours. Nevertheless, the impact of this regulation was relatively small as more Chinese tourists chose to travel by themselves; and 2) political protests at the end of the year although the impact of which was moderate as travel advisory warnings applied to demonstration areas in Bangkok. Many airlines also increased direct and chartered flights to major tourist destinations in every region, facilitating tourists in adjusting travel itineraries and avoiding protest areas.

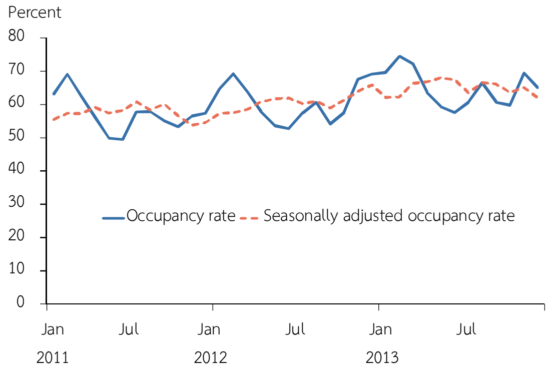
In 2014, the tourism sector was expected to expand at a slower pace, owing to the impact from the political situation which undermines the overall tourism environment, issuance of the Emergency Decree for State of Emergency, and China's new tourism laws. However, Thailand's tourism was expected to rebound rapidly once the political situation was resolved thanks to the sector's strengths and strong potentials. (details in Box: Tourism Sector Growing Strong Amidst Obstacles).

Number of Foreign Tourists



Source: Department of Tourism and Bank of Thailand

Occupancy Rate



Source: Bank of Thailand

Tourism Indicators

	2012	2013^{P}				
		Year	Q1	Q2	Q3	Q4
1. Number of foreign tourists (million persons)	22.4	26.7	7.0	5.9	6.8	7.1
Δ%	16.2	19.6	22.1	21.3	26.1	10.7
2. Tourism income (billion baht)	1,050.2	1,293.3	344.6	278.9	320.9	348.9
3. Occupancy rate (percent)	60.8	64.9	72.0	60.3	62.6	64.7

Note: P = Preliminary data

Δ% represents percentage change from the same period last year

Source: Department of Tourism and Bank of Thailand

Foreign Tourists Classified by Nationality

Country	Change (percent)		Share (percent)	
	2012	2013	2012	2013
East Asia	21.1	28.5	56.0	60.2
- Malaysia*	2.2	17.3	11.4	11.2
- China	61.9	68.8	12.5	17.6
- Japan	21.8	12.0	6.1	5.8
- Korea	15.6	11.5	5.2	4.9
- Laos*	9.4	13.3	4.4	4.1
- Singapore*	21.8	12.7	3.7	3.5
Europe	10.8	11.6	25.3	23.6
- Russia	24.9	31.9	5.9	6.5
- United Kingdom	3.3	3.8	3.9	3.4
The Americas	13.7	8.0	4.8	4.4
South Asia	11.1	4.6	5.8	5.0
- India	10.7	3.6	4.5	3.9
Oceania	12.1	-1.7	4.7	3.8
Middle East	0.7	3.6	2.7	2.3
Africa	12.8	5.5	0.7	0.6

Note: *Classification of region is according to Department of Tourism
Source: Department of Tourism

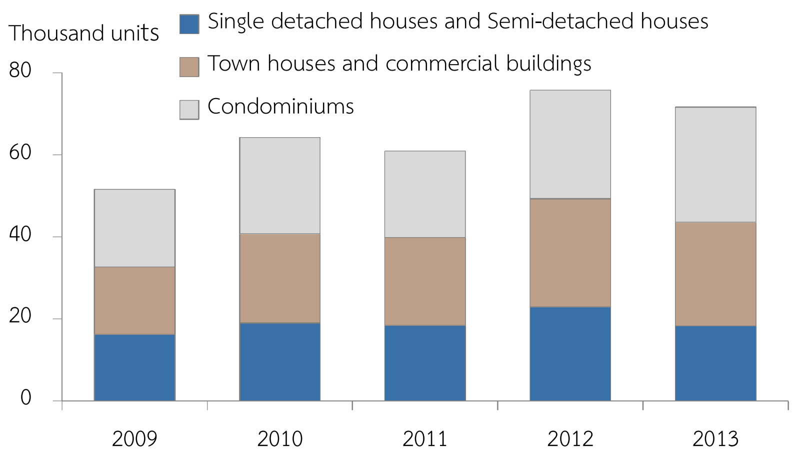
2.4 Real Estate Sector

The real estate market slowed down from the high growth last year. Demand weakened after earlier acceleration and more cautious behavior of buyers and financial institutions during the economic downturn. Property developers launched a number of new projects though most were located in high-demand areas.

In 2013, property demand decreased slightly as reflected by a decline in new mortgage loans. Reduction in demand was concentrated on single-detached houses due to buyers' concerns about the reoccurrence of floods. Meanwhile, demand for condominiums was close to the previous period. Moreover, buyers and financial institutions had become more cautious in borrowing and lending following the economic slowdown since the second quarter.

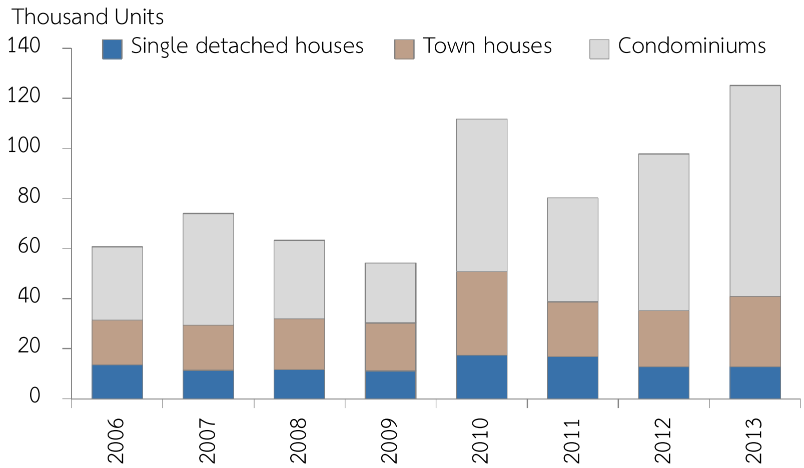
On the supply side, new residential projects, particularly condominiums, increased substantially from the previous year. Nevertheless, new launches were concentrated in high-demand areas, such as along the skytrain routes and major communities in outer suburban areas. The latter consisted mostly of projects with small, low-cost units. More low-rise residential projects, especially town houses, were on sale at the end of the year as property developers became less concerned about the floods at the sites with potential for housing projects.

New Mortgage Loans Classified by Housing Type



Source: Bank of Thailand

New Residential Projects In Bangkok and vicinities Classified by Housing Type



Note: Excluding duplexes, commercial buildings and other types of real estate

Source: Agency for Real Estate Affairs (AREA)

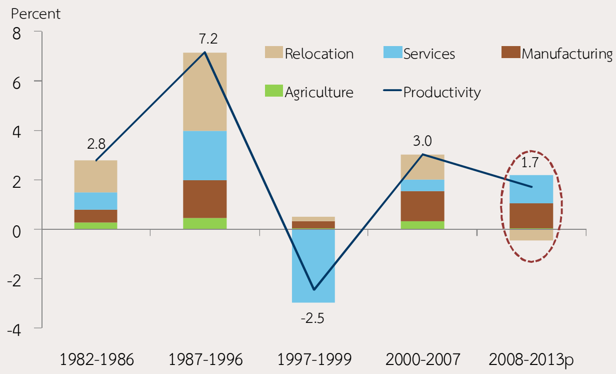
Supply Challenges to Thailand's Sustainable Growth Path

During the past decade, the Thai economy has been growing at a much slower pace compared to previous periods[1]. One of the major reasons is the structural limitations accumulated over the years that have never been effectively addressed. This had an impact on the country's gradual decline in competitiveness. Of note was the export performance in 2013 that recorded the first contraction in 12 years, excluding the 2009 world economic crisis. The major structural limitations are labor and production constraints.

1) Labor constraints

For many years, Thailand has experienced tight labor market conditions. Labor shortage is increasingly becoming an obstacle of doing business in every sector, in terms of both quantity and quality. Firstly, Thailand is now entering an aging population society due to the continued low fertility rate. The share of working population thus shows a decreasing trend. Secondly, labor productivity growth has slowed down compared to region countries. During 2000-2012, Thailand's productivity growth averaged at 2.5 percent per year, down from 6.8 percent during 1986-1996. This was in part explained by the relocation of labor from high-productivity manufacturing sectors to agriculture in line with the price incentives. In parallel, the private sector's capital accumulation moderated (details in Box: Labor Constraints on Economic Growth, Monetary Policy Report, July 2013). Finally, there is a labor-skill mismatch in the market due to misplaced social values and distorted wage incentives. For instance, there is a high demand for low-to medium-skilled labor with vocational training or less in the corporate sector, particularly the manufacturing sector. However, Thai students prefer to obtain a bachelor degree rather than a vocational one at the minimum. They also do not study in the fields that experience shortages, for example, engineering.

Labor Productivity Declined Due to Relocation to Agricultural Sector



Note: P= Latest data is preliminary
Source: Labor Conditions Survey, Office of the National Economic and Social Development Board, Bank of Thailand Symposium, 2008, "Uncertainty of Production Potentials and Monetary Policy Implementation," and calculations by the Bank of Thailand

Growth in Capital Accumulation to Labor

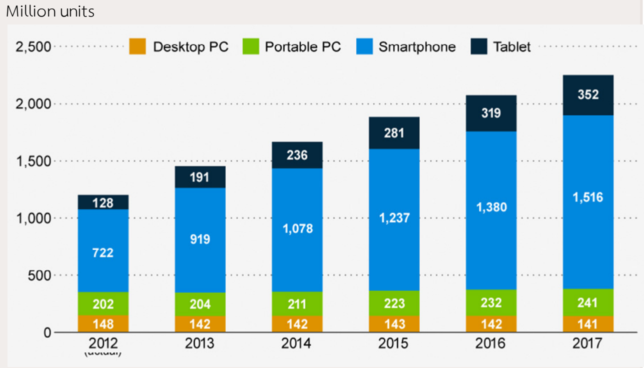
1987-1996	1997-1999	2000-2007	2008-2012
8.5%	3.9%	0.6%	1.6%

Source: Survey of Working Conditions for the Population by the National Statistical Office, Office of the National Economic and Social Development Board, and calculations by the Bank of Thailand

[1] The Thai economic growth averaged at 9.2 percent during 1986-1996 before slowing down to 4.2 percent during 2000-2012.

2) Production constraints

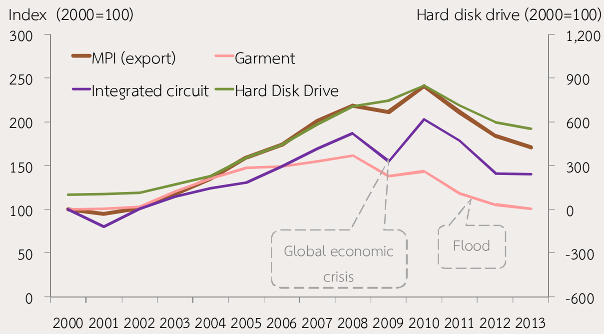
Projections for World Networking Devices



Source: Internet Data Center (IDC)

Thailand's production structure, especially production for exports, has been slow to adapt to the technological advancement and change in global demand. One notable example was the electronics industry which was unable to adapt its production line in step with the changing needs of customers whose preference shifted towards small, easy-to-carry devices like tablets and smart phones. These items do not have hard disk drive component and their required integrated circuits and parts are smaller in size than those commonly manufactured in Thailand. As there are only a handful of Thai manufacturers with capability for such devices, exports of electronic products could not fully benefit from the increase in demand following the world economic rebound. Meanwhile, global manufacturers are not interested in relocating the production base of such high-technology products to Thailand due to the country's lack of appropriate human resource, especially engineers, given the labor constraints highlighted above. Inaddition, Thailand possesses insufficient research and development and investment on production technology (details in Box: Production Structure Constraints on Thailand's Long-Term Growth, Monetary Policy Report, October 2013).

Manufacturing Production Index Declined Despite Global Economic Rebound

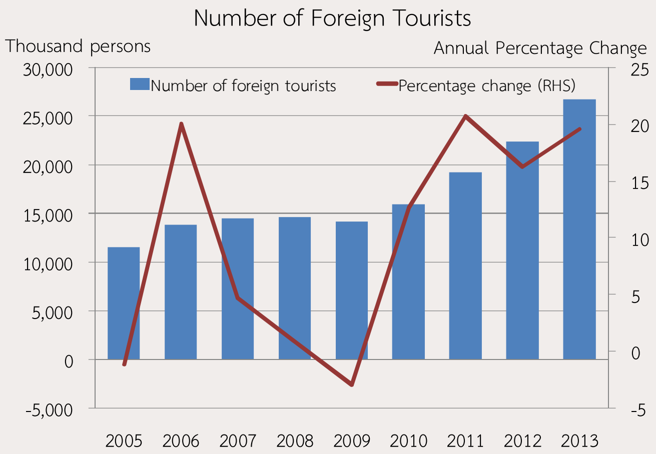


Source: Office of Industrial Economics

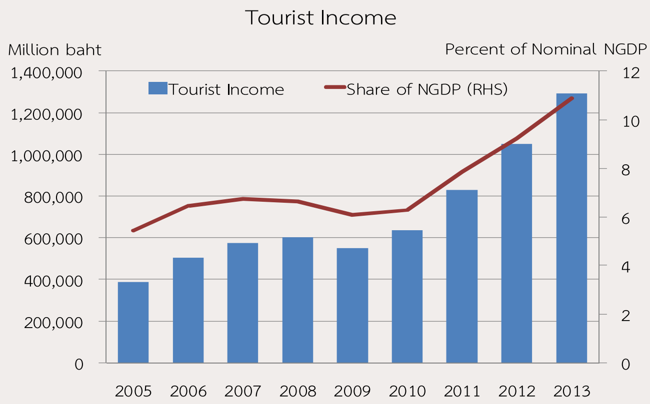
Such supply constraints have been long-standing problems which need to be comprehensively and urgently addressed as they are complex and time-consuming to overcome. Efforts are needed to prevent these constraints from undermining Thailand's competitiveness and production potentials. In this respect, the government should consider both short-term and long-term solutions, costs and benefits, and should opt for measures that would not have negative repercussions in the long-run. For example, efforts to increase the number of foreign workers without some control on certain types of work may alleviate labor shortage in the short-run but may reduce corporates' incentives to expand investment for long-term potentials. Therefore, a better solution may be measures which facilitate allocation of workers to high-productivity sectors while reducing measures with wage distortion effects. At the same time, the government should implement measures that would facilitate production restructuring in the private sector as an on-going process. For instance, measures should be formulated to support increased competition so as to create incentives for research and development investment and innovations to effectively meet the changing demand in the global market. These include tax measures with incentives for greater investment in order to enhance businesses' production potentials. To this end, Thailand's production structure in terms of labor, production, and product development would be able to progress in parallel in order to upgrade the country's potentials and global competitiveness.

Tourism Sector: Growing Strong Amidst Obstacles

In 2013, Thailand's tourism sector recorded robust growth and was a major driver for the economy throughout the year. This was amid the fragile global recovery, the impact from changing tourism regulations of China which played an increasing role in Thai tourism industry and the unfavorable domestic political situation toward the end of the year.



Source: Department of Tourism



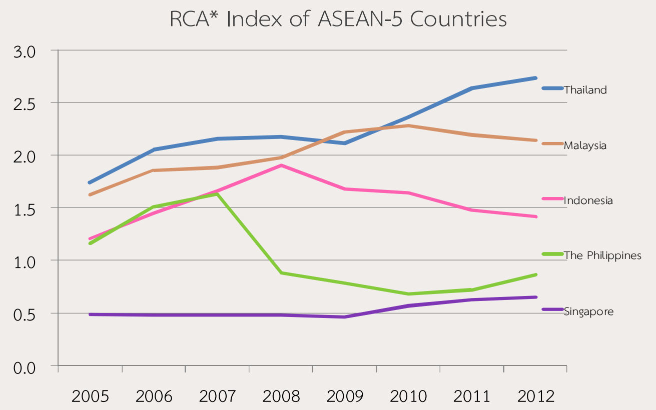
Source: Office of the National Economic and Social Development Board and Bank of Thailand

The tourism industry steadily gained importance for the Thai economy. Since 2010, the number of foreign tourists increased by leaps and bounds. There was also a notable structural change in foreign tourist composition, from European and American tourists to other groups, such as Chinese, Russians, and East Asians.

Nevertheless, the increase in the number of tourists from China and East Asia who typically have shorter stays did not result in a decrease in tourist income thanks to favorable economic performance of emerging market economies after the 2008 global crisis. These tourists thus possessed higher purchasing power and spent more per day. Moreover, the short stayover was compensated by the increased number of tourists. Fluctuations in tourism's seasonal adjustment were also eased as Chinese tourists, in particular, enjoy travelling all year-round, thereby enabling the industry to grow with more stability. Additionally, the hotel industry could in turn more effectively manage accommodation plans. Tourist income therefore enjoyed a consistent sharp rise in GDP share.

The continued expansion of the tourism sector reflected the strength of Thailand's competitiveness. Thailand's Revealed Comparative Advantage Index was consistently greater than 1 and showed an increasing trend. This means the growth of Thailand's tourism sector was above world average and was the highest compared with neighboring countries.

Thailand's unique position could be attributed to the value for money[1], culinary and cultural identity, friendliness, and abundant and diverse natural resources. It also has a geographical advantage as it is located at the center of ASEAN.



Note: *Revealed Comparative Advantage Index = Share of travel exports in total services exports, over the share of travel exports in world services exports.
Source : World Development Indicators, calculations by the Bank of Thailand

Future challenges and development

Despite Thailand's many strengths and high level of competitiveness, there remained several weaknesses, particularly the lack of an integrated transportation system, inadequate coverage of information and communication technology, labor shortage especially for tour guides, and public safety. Moreover, political stability continued to be a major factor which could hinder the tourism environment and the industry's growth potential. There were already a number of instances where foreign governments issued warnings to their tourists to review or suspend their travel plans into Thailand due to the political unrest.

Against this background, Thailand's tourism industry must remedy the remaining weaknesses as well as increase added value to this business. This would not only strengthen the industry's growth prospects, but also foster development to other sectors in the economy. For instance, there could be a backward linkgage to the agricultural sector which supplies raw materials to the food and hotel industry, as well as a forward linkage to other businesses with high value added, such as hospital services which has recently employed proactive marketing strategy overseas. As a result, this led to rapid growth in medical tourist business. Other businesses which could also benefit from such complementarity included the expanded routes of low-cost airlines in the region which would facilitate more travelling within ASEAN. The business in Information and communication technology also played a greater role due to the greater use of internet by foreign tourists in making travel and hotel reservations. Certain types of SMEs were on the rise including spa, aesthetic and souvenirs.

With these issues resolved, Thailand's competitiveness of the tourism industry would be greatly enhanced, enabling it to remain the growth engine for the country. This would offer concrete benefits not only in terms of economic growth, but also income distribution within the country.

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[1] Business liaison program between the Bank of Thailand and the business sector and ranking of tourism's competitiveness by 2013 World Economic Forum.

3. International Trade and Balance of Payments

Exports

Thailand's exports experienced a relatively slow recovery, unable to fully reap the benefit from the world economic rebound.

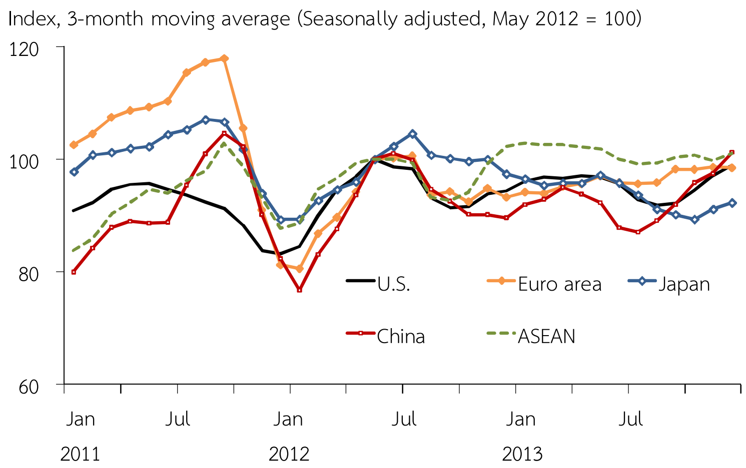
In 2013, export value contracted by 0.2 percent from the previous year. In the first half of the year, exports rose slightly from the same period last year, reflecting buoyant demand from Asia and the Middle East. In the latter half of the year, exports slowed down, especially for automobiles and electrical appliances. This was partly caused by the low-base effect of last year due to post-flood reconstructions at end-2011. However, exports to the major industrialized economies (G3) which is Thailand's main market continued to contract, consistent with exports of other countries in the region. Exports to China moderated during mid-year as China's exports were impacted by the weak global growth which brought down demand for raw materials and intermediate goods in the supply chain.

In the second half of the year, despite clearer signs of a G3 economic recovery, Thailand's exports continued to rebound slowly, unable to fully benefit from the G3 recovery, owing to the following factors:

- **Improving foreign demand was concentrated in certain products**

Despite recovery of the G3 economies, demand improved only for certain products, such as tablets and smart phones, in line with the change in consumers' preference toward these products instead of personal computers. This did not benefit Thailand's exports of electronic products as its production share of these electronic goods remained small. Although the demand for enterprise hard disk drive showed an increasing trend, overall exports of hard disk drive were unable to pick up. Moreover, towards the end of the year, demand from ASEAN started to weaken due to implementation of measures to safeguard economic stability, such as termination of oil subsidies, which affected their domestic economies.

Thailand's Major Export Destinations



Source: CEIC and calculations by Bank of Thailand

- **Supply constraints**

Exports of fishery and processed seafood contracted in line with shrimp exports, owing to the disease outbreak which were not fully resolved.

- **Decline of agricultural prices in the global market**

Rubber exports contracted on the back of global price decline as inventories in China, a major importer, remained high. On the other hand, exports of rice contracted in both price and quantity. The former had been on a downward trend since the beginning of the year in line with the increase in supply in the global market. The latter reflected the loss of competitiveness caused by the rice pledging scheme.

In the periods ahead, merchandise exports were expected to gradually gain momentum, in line with global demand recovery in 2014. Supply constraints in fishery output were expected to ease. However, Thai entrepreneurs would need to resolve the remaining structural issues so as to raise product quality as well as to develop new products. This would help ensure high demand for Thai exports and enable the country to compete with trading partners and other competitors in the global market in a sustainable manner.

Export Value Classified by Product

Annual percentage change (%YoY)	2012	2013	2013^P			
			Q1	Q2	$Q3^P$	$Q4^P$
Manufacturing products	6.1	1.8	7.7	-0.4	1.4	-1.1
Processed agricultural products	4.1	-2.6	-1.7	-3.1	-4.5	-0.9
Electronics	0.9	-0.7	2.3	-8.6	2.6	1.7
Automobiles	26.3	7.6	16.8	12.2	7.2	-3.9
Petroleum products	15.7	-1.3	-6.3	-19.4	9.6	11.8
Electrical appliances	2.2	2.3	13.4	-1.4	-0.8	-0.6
Metal products	21.2	-5.5	55.9	6.6	-21.0	-37.2
Apparels and Textiles	-12.0	3.6	1.3	6.8	4.2	2.2
Agricultural products	-23.1	0.0	3.2	-9.8	-0.2	5.9
Rice	-28.0	-4.6	8.6	-14.0	5.5	-14.0
Rubber	-31.1	-5.9	-8.7	-16.8	-11.1	13.8
Total Exports	3.1	-0.2	4.1	-1.9	-1.8	-1.0
Total Exports (excluding. gold)	2.8	1.3	6.9	-1.5	1.0	-0.9

Note: P = Preliminary data

Source: Ministry of Commerce and Bank of Thailand

Imports

Merchandise imports contracted in line with the slowdown in production, exports, and domestic demand.

In 2013, import value declined by 0.4 percent from the previous year in line with imports of raw materials and intermediate goods, especially non-oil and capital goods. This was consistent with the slowdown in manufacturing production and contraction in private investment after accelerating earlier for reconstructions due to the floods. Moreover, imports of automobile parts stabilized in line with automobile production as the benefit from the first-car tax rebate scheme gradually phased out. However, imports of consumer goods continued to expand, mainly attributable to imports of non-durable goods. Imports of durable goods rose slightly, reflecting a marked slowdown in private consumption from last year. Imports of gold increased considerably to reach a net total of 11.6 billion US dollars, following the continued downward adjustment in world prices. Gold demand for both consumption and investment therefore increased. Overall, imports excluding gold contracted by 1.6 percent.

Import Value Classified by Product

Annual percentage change (%YoY)	2012	2013	2013			
			Q1	Q2	Q3^{P}	Q4^{P}
Raw materials and intermediate goods	4.7	0.6	3.3	3.4	-2.6	-1.6
Fuel and lubricants	9.5	8.9	6.1	13.7	-3.0	19.4
Raw materials and non-fuel intermediate goods	2.4	-3.6	1.9	-2.1	-2.4	-11.4
Capital goods	25.4	-4.5	3.6	0.2	-6.1	-14.1
Consumer goods	13.6	3.6	9.6	6.4	-1.1	0.0
Non-durable goods	11.5	5.6	13.8	6.7	-2.1	4.7
Durable goods	17.7	0.1	2.2	5.9	0.9	-7.7
Other imports	0.8	6.5	42.6	2.5	11.3	-26.5
Automobile and parts	43.4	-6.2	32.8	2.4	-16.0	-31.6
Total imports	8.8	-0.4	8.5	1.0	-2.9	-7.6
Total imports (excluding. gold)	11.8	-1.6	4.6	1.0	-5.2	-6.5

Note: P = Preliminary data

Source: Ministry of Commerce and Bank of Thailand

Looking ahead, it was expected that imports would increase in line with the rebound in exports, consistent with demand in the world market. Domestic demand was also expected to increase, especially in the second half of 2014, in step with private consumption and investment, to be elaborated further in Chapter 4.

Current Account

The trade balance recorded a larger surplus than last year following the pickup in exports and the sharp drop in imports. Despite the high growth in tourist income, repatriations of profits, income and dividends by foreign businesses increased notably in line with their previous year performance, especially the automobile industry. As a result, the deficit of services, income, and transfer account was larger than the previous year's. With the decline in net inflow of indemnity transfer from insurance companies, the current account registered a deficit of 2,790 million US dollars, up from 1,470 million US dollars in the previous year. Nevertheless, the current account excluding gold showed a surplus of 8,854 million US dollars.

Financial Account and the Balance of Payments

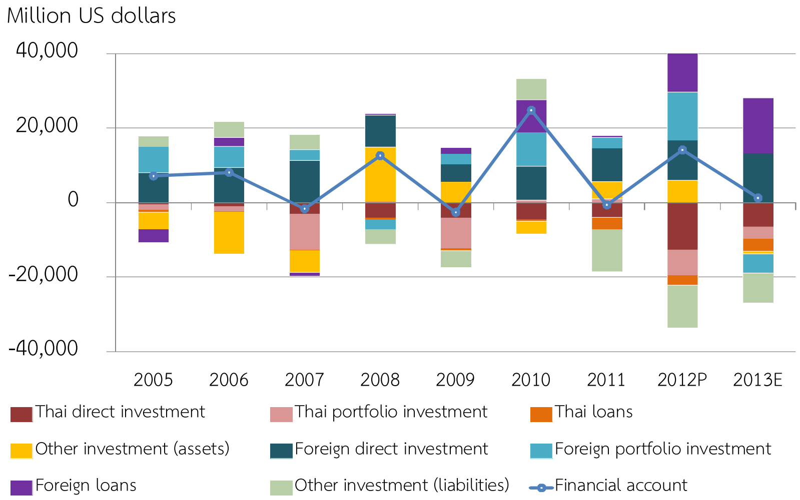
In 2013, the financial account registered a surplus with high volatility. This development mirrored the global monetary conditions, which had been affected by the Federal Reserve's monetary policy, and domestic political situation. Net capital inflow surged in 2013 H1 before reversing into net outflow in 2013 H2. With the current account in deficit, owing to the slow recovery of exports, and notable increases in gold imports and repatriations of profits and dividends, the balance of payments recorded a deficit for the year.

In 2013, the financial account recorded a net surplus of 1,236 million US dollars, declining substantially from 14,142 million US dollars in the previous year. This largely reflected the net outflow of foreign portfolio investment after the large influx a year earlier. At the same time, there was net inflow of short-term and long-term borrowings, including foreign direct investment, especially in financial institutions and insurance and automobile-related businesses.

The outflow of portfolio investment followed the same pattern of regional economies, with foreign investors selling both debt and equity securities. This was attributed to concerns on the tapering of the Federal Reserve's quantitative easing since May 2013. There were also effects of the domestic political situation towards year-end. These were in contrast to the first quarter when there was net inflow due to buoyant global liquidity that was influenced by accommodative monetary policies of major industrialized economies together with strong performance of the Thai economy. These inflows in turn caused the baht's strengthening at the beginning of the year. Additionally, Thailand's portfolio investment abroad was for both debts and equities and was diversified to new destinations. There were also other outflows such as trade finance of Thai importers, largely a repayment rather than credit to trading partners, in line with the moderating import growth.

The substantial decline in the financial account surplus and the increased deficit in the current account resulted in the balance of payment deficit of 5,049 million US dollars, compared with the surplus of 5,265 million U.S. dollars the year earlier.

Financial Flows Classified by Type



Note: P = Preliminary data E = Estimated data
Source: Bank of Thailand

Balance of Payment

(Unit: Million U.S. dollars)	2012[P]	2013[E]	Q1 2013	Q2 2013	Q3 2013	Q4 2013
Exports, f.o.b.	225,875	225,397	55,995	55,554	57,964	55,884
Δ% YoY	3.1	-0.2	4.1	-1.9	-1.8	-1.0
Imports, f.o.b.	219,860	219,042	57,566	56,510	52,931	52,036
Δ% YoY	8.8	-0.4	8.5	1.0	-2.9	-7.6
Trade balance	6,015	6,355	-1,571	-956	5,033	3,849
Trade balance minus gold	11,705	17,998	4,566	1,541	6,056	5,835
Net services, income and transfers	-7,485	-9,145	1,641	-6,213	-5,921	1,349
Current account	-1,470	-2,790	70	-7,169	-888	5,197
Current account minus gold	4,221	8,854	6,208	-4,672	135	7,183
Capital account	234	270	12	122	135	0
Financial account (net)	14,142	1,236	3,788	5,197	166	-7,915
Asset	-16,193	-13,751	-5,339	1,613	-1,405	-8,621
Thai direct investment	-12,652	-6,530	-2,505	-1,239	-1,599	-1,188
Thai portfolio investment	-6,960	-3,211	-1,466	504	942	-3,190
Thai loans	-2,634	-3,349	-940	-1,024	-127	-1,257
Other investments (assets)	6,054	-662	-428	3,372	-621	-2,986
Liabilities	30,335	14,987	9,126	3,584	1,571	706
Foreign direct investment	10,697	13,318	2,458	3,072	5,721	2,066
Foreign portfolio investment	12,948	-5,208	5,808	-5,105	-767	-5,144
Foreign loans	18,080	14,824	4,093	7,314	-2,214	5,631
Other investments (liabilities)	-11,390	-7,946	-3,232	-1,697	-1,170	-1,847
Net errors and omissions	-7,642	-3,766	-1,268	-592	-1,363	-543
Balance of payments	5,265	-5,049	2,602	-2,441	-1,950	-3,260

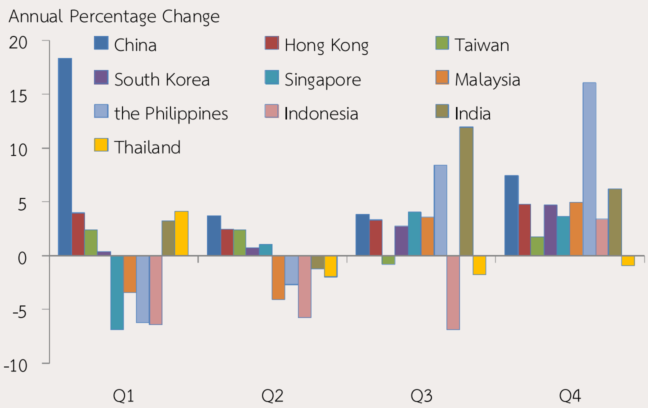
Note: P= Preliminary data E=Estimated data

Source: Bank of Thailand

Why Thailand's Exports Recovered Slower Than Those of Regional Economies?

After continued implementation of comprehensive crisis resolution measures, the major industrialized economies (G3) which experienced a prolonged period of low growth has begun to show clear signs of sustained recovery since the second half of 2013. This helped improve exports of trading partners, particularly East Asia and ASEAN, which relied heavily on exports to the G3. The current global economic recovery, however, resulted in an uneven pace of export recovery for the Asian economies. It was found that exports of North Asian economies, such as South Korea and China, including some ASEAN countries, such as Singapore, Malaysia, and the Philippines, were able to recover more rapidly than some others, including Indonesia and Thailand.

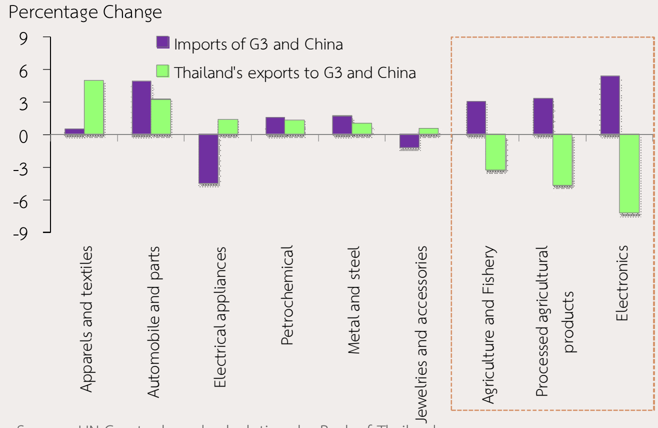
Comparison of Export Value Growth in 2013



Source : CEIC and Bank of Thailand, calculations by Bank of Thailand

The reasons for such an uneven pace of export recovery stemmed from both demand and supply factors. On the demand-side, there were the followings: 1) although demand recovery of the major industrialized economies gradually gained momentum, it was concentrated in consumption goods while demand for capital goods remained weak; 2) the change of consumers' preference from personal computers, which were ASEAN's main merchandise exports, to smart phones and tablets, which were major exports of East Asia; and 3) commodity prices in the global market remained relatively low as China, a major importer, was not expanding as strongly as in the past. Export value of commodities of each country, therefore, grew slowly. Supply-side factors included structural constraints in both labor and technology as well as export quota policy of some countries, for example, the export quota of minerals by Indonesia. Since these factors had different impacts on production and exports of each country, the pace of recovery from the global economic rebound was also uneven.

Comparison of Thailand's Exports to and Imports of Major Trading Partners during 2013 Q1 – Q3



Source : UN Comtrade and calculations by Bank of Thailand

With different structures of merchandise exports and levels of technology, Asian economies could be classified into two main groups: 1) Countries with high-technology production capacity, comprising East Asian economies and Singapore. Their exports included high share of electronic products, using modern technology. Therefore, their exports were able to recover more rapidly, with high growth performance, because they were able to meet the changing demand of consumers. 2) Other countries with medium-to low-technology production capacity export labor-intensive and commodity products. Recovery of exports under this group was gradual, with only moderate growth.

Despite having a relatively high share of electronic exports, Thailand belonged to the second group due to its medium-technology production capacity and technological constraints. Thus, export firms were unable to keep in step with the changing consumers' preferences, as detailed in Box "Supply-side Challenges to Thailand's Sustainable Growth Path." Moreover, there were additional factors that prevented Thailand from gaining full benefits from trading partners' recovery. These included: 1) the disease outbreak of shrimp since the end of 2012, which resulted in a contraction in the volume of fishery exports and shortage of raw materials in canned seafood industry, which was part of processed agricultural products; 2) the loss of price competitiveness for rice due to the government rice pledging scheme; and 3) the decline in commodity prices, especially sugar and rubber, which brought down the export value of agricultural and processed agricultural products. Nevertheless, certain groups of exports were able to expand in line with trading partners' demand, for instance, clothing and apparels, automobiles and parts, and petro-chemical products.

Against this background, in 2014 the Thai exports were expected to improve, consistent with the stronger global recovery. Products which were expected to perform well include automobiles and parts, electrical appliances, fishery and processed agricultural products. Furthermore, exports of electronic products were likely to rise in line with the U.S. economic recovery. As investment in information technology and hardware was expected to increase, some positive effects could be expected on Thailand's exports of hard disk drive.

Products With Growth Prospects in 2014

Product groups	Products	Supporting factors
Strong potentials	Vehicles and parts (12.8%)	Potentials for competition, investment expansion, and continued sales order
	Electrical appliances (5.0%)	Television sets were expected to benefit from increased demand during the 2014 World Cup
Supply constraints were expected to ease	Fishery products (1.2%)	The disease outbreak was expected to taper off. At present, the export volume showed prospects for a gradual recovery.
Demand was expected to increase	Electronics (14.4%)	Exports of hard disk drive were expected to grow somewhat in line with investment expansion in global information technology, especially the U.S. This would have positive impact on the demand for Personal Computers.
Prices were expected to improve	Processed agricultural products (12.5%)	Prices were expected to increase in line with global economic conditions.

Note: The numbers in ( ) means export weight in 2013

4. Domestic Demand

Domestic demand moderated significantly from the previous year. Though the economy benefited from strong domestic demand growth during 2013 H1, higher economic and political uncertainties prompted the private sector to become cautious in spending and investing during 2013 H2. Public investment also fell below average.

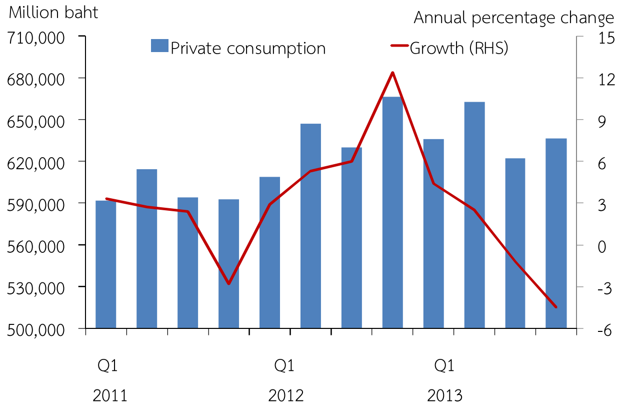
4.1 Private Consumption

Private consumption slowed down from the previous year as the impact of government stimulus, particularly the first-car tax rebate scheme, wore off. Consumers also became more cautious in their spending given an escalation of household debt burden.

Private consumption slowed down in 2013. In the first half of the year, the economy benefited from strong expansion in private consumption and it was an important growth driver of the economy, particularly consumption of durable goods namely automobiles. This resulted from continuous deliveries of back orders from the first-car tax rebate scheme and car dealers' ongoing sales promotion. Consumption of other consumer goods was supported by favorable income. Income in both the farm and non-farm sectors partly benefited from government measures, for example, the minimum wage hike to 300 baht nationwide on January 1, 2013, and the rice pledging scheme. Income also increased as a result of overtime, especially in the manufacturing sector. Employment conditions remained sound and credits continued to expand, particularly other personal loans and auto leasing.

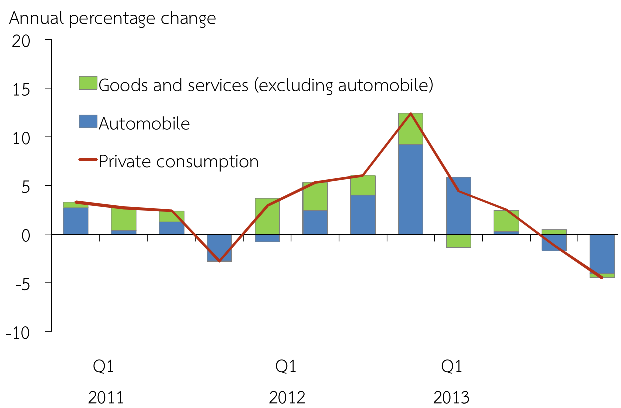
However, private consumption contracted during the second half of the year in line with a downward trend in consumption of durable goods. In particular, automobile sales slowed down due to completion of deliveries of back orders coupled with lack of new demand. Meanwhile, consumption of non-durable goods moderated as a result of 1) more cautious spending by households following acceleration in debt; 2) tightened credit standards for consumer loans; and 3) a slowdown in overtime income. Consumer confidence also deteriorated continuously due to the economic slowdown and the political situation towards the end of the year.

Private Consumption Expenditures at 1988 prices



Source: Office of the National Economic and Social Development Board

Composition of Private Consumption



Source: Office of the National Economic and Social Development Board

Consumer Confidence Index in Future Income (seasonally adjusted)

Source: Bureau of Trade and Economic Indices, Ministry of Commerce

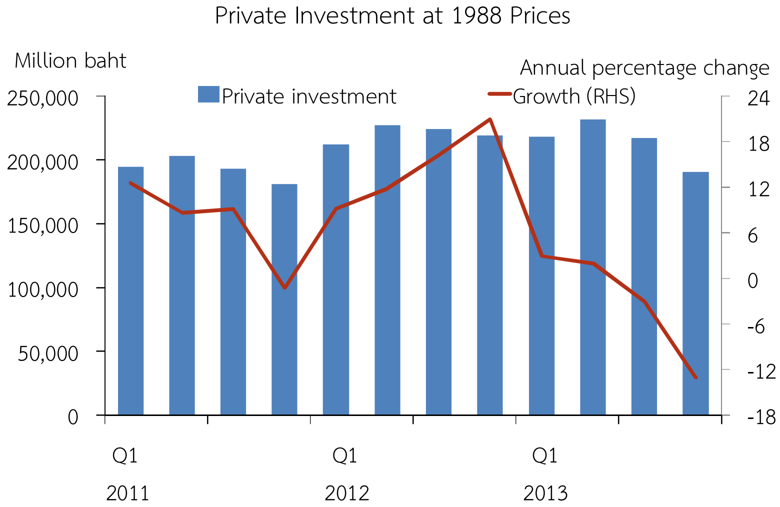
For 2014, it was projected that private consumption would grow by less than average due to the elevated household debt which continued to make households cautious in their spending. Consumption of non-durable goods would expand thanks to an increase in household income following improvement in exports on the back of the global recovery. Meanwhile, consumption of durable goods would continue to weigh on overall consumption in the periods ahead though a gradual improvement was expected to begin in the second half of the year.

4.2 Private Investment

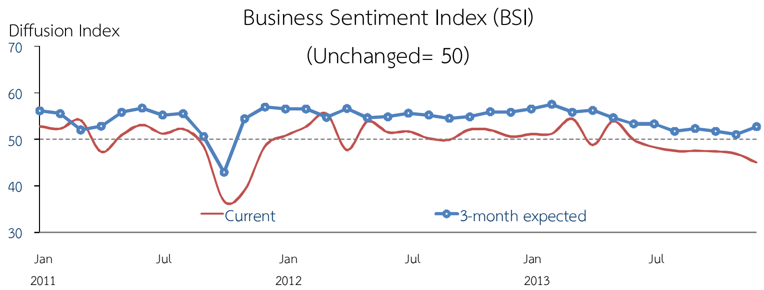
Private investment contracted slightly from the previous year after accelerating due to post-flood reconstructions and repairs. Some planned investment spending was also postponed owing to economic and political uncertainties.

Private investment expanded during the first half of the year. Investment in constructions increased in tandem with the strong expansion in the real estate sector while purchases of commercial cars continued to grow in line with deliveries of back orders from the first-car tax rebate scheme. During the second half, however, private investment contracted owing to accelerated imports of machineries and equipments for post-flood reconstructions and repairs in 2012, the slowdown in private consumption, and sluggish recovery in foreign orders. Additionally, business sentiment was also dampened by economic and political uncertainties, leading to delays in some productivity enhancing investment. Development in private investment was also mirrored by the slowdown of corporate credits. Overall, private investment in 2013 contracted slightly from the previous year, especially investment in machineries and equipments of the electronics, automobile, and metal and steel manufacturing sectors.

Investment in construction moderated in line with the postponement of construction activities as reflected by a survey of real-estate developers. This was due to rising household debt which caused commercial banks to hike up credit standards for consumer loans during the second half of the year.

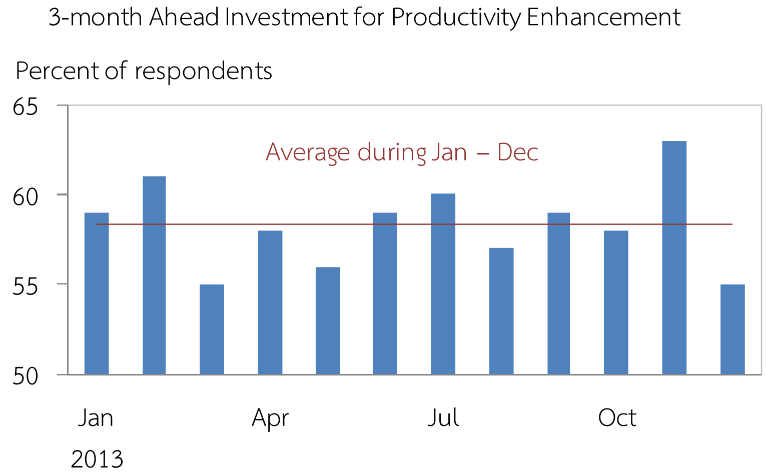


Source: Office of the National Economic and Social Development Board



Source: Bank of Thailand

Looking ahead in 2014, private investment was expected to recover gradually in line with improvement in exports and the support from continual recovery in private consumption in the latter part of the year. Some businesses were also expected to invest to enhance production efficiency and replace labor shortage. Financial factors were expected to be supportive of private investment, including low financing costs and strong financial conditions of businesses.



Source: Business Liaison Program, Bank of Thailand

Headwinds to growth of private investment included the followings: 1) constraints in the upgrade of production technology to allow firms to respond to the fast changing global demand more efficiently. The electronics sector, for example, still focused on producing Hard disk drive (HDD); 2) low growth in labor productivity and job skill mismatch. Moreover, some industries continued to require labor as production could not be done with machineries; and 3) rising uncertainties regarding the government's large infrastructure investment projects, which could affect investor confidence along with businesses' investment decisions, i.e. crowing-in effect.

4.3 Fiscal Sector

In 2013, the government's role in economic stimulus declined from the previous year owing to below-average disbursement rates and delays in non-budgetary spending. The escalating political situation towards the end of the year also caused some parts of pubic investment to be postponed.

In fiscal year 2013, the government announced a 300 billion baht budget deficit to stimulate the economy that was projected to be affected by fragilities in the global economy. The deficit was also expected to provide economic stimulus and fund various cost of living measures, for example, the rice pledging scheme and the reduction of excise tax on diesel oil. The government also planned to improve and develop the country's infrastructures through non-budgetary spending under the 2-trillion-baht Infrastructural Development Act and the 350-billion-baht Royal Decree on Investment Loan for Water Management and Future Development.

However, disbursement in 2013 was lower than anticipated. Only 2,171 billion baht was spent, equivalent to a disbursement rate of 90.5 percent. This was less than the average rate over the last five years of 93.1 percent mainly due to a shortfall in disbursement of capital expenditure. Although the government was able to frontload disbursement during 2013 H1, problems on procurement procedures and shortage of construction labor in 2013 H2 resulted in delays in disbursement of capital expenditure. Nonetheless, current expenditure was disbursed as usual. Of this, subsidies and transfers increased due to subsidies to the Bank for Agriculture and Agricultural Cooperatives (BAAC) for the rice pledging scheme, transfers to non-budgetary funds such as the health security fund and the village fund along with transfers to local government.

On the revenue side, collection totaled 2,571 billion baht which was 60.4 billion baht or 2.4 percent above projection. The higher-than-expected revenue collection mainly stemmed from excise taxes on automobiles, personal income tax and petroleum tax. Nonetheless, many tax items were below targets, in part due to the economic slowdown. For example, the value added tax was affected by the slowdown in consumption and reduction in imports. Meanwhile, corporate income tax was affected by the economic slowdown, the flood at the end of 2011, and reductions in the corporate income tax rate from 30 to 23 and 20 percent, respectively.

The continual fiscal spending to stimulate the economy led to an increase in public debt of approximately 500 billion baht from the end of fiscal year 2012. At the end of fiscal year 2013, outstanding public debt stood at 5,431 billion baht or 45.5 percent of GDP. Although the proportion of public debt to GDP remained lower than the threshold for fiscal sustainability of 60 percent of GDP, the increase in fiscal spending from both non-budgetary spending and expenditure under populist policies would cause overall public debt to rise and thus required close monitoring in the periods ahead.

In fiscal year 2014, the government planned to reduce the budget deficit to zero in 2017. The plan would be achieved through a budget deficit of 250 billion baht to help sustain economic growth and absorb potential impact from the global economic uncertainty. In the first quarter, fiscal spending was slightly affected by the dissolution of parliament on December 9, 2013 such that some disbursements, particularly capital expenditure were postponed. Moreover, some borrowings under the Royal Decree on Investment Loan for Water Management and Future Development and the Infrastructural Development Act, continued to be significantly delayed. The former also required a public hearing according to the Administrative Court's decision. Uncertainties also remained at the operational level owing to the current political deadlock.

Revenue collection in the first quarter of fiscal year 2014 was in line with projection. However, the ongoing political situation could dampen private sentiment and private spending along with revenue collection in the next periods.

Fiscal Position[1/]

(Unit: Billion baht)

Fiscal year

	2010	2011 P	2012 P	2013 P
Cash receipts from operating activities [2/]	1,708.6	1,892.0	1,980.6	2,157.6
(Annual percentage change)	(21.2%)	(10.7%)	(4.7%)	(8.9%)
Cash payments for operating activities[3/]	1,565.0	1,801.9	1,981.7	2,106.7
(Annual percentage change)	(-2.7%)	(15.1%)	(10.0%)	(6.3%)
Net cashflow from operating activities	143.7	90.2	-1.1	50.9
Net cashflow: investment in non-financial assets	147.0	201.4	229.6	268.4
Budget cash balance	-3.3	-111.3	-230.7	-217.5
Non-budget cash balance	-197.1	-48.7	-57.2	8.4
: of which Stimulus Package 2	-218.8	-61.1	-24.4	-7.5
Overall cash balance	-200.4	-159.9	-287.9	-209.1
Net incurrence of liabilities	345.1	241.9	335.4	244.3
Use of treasury cash balance	-144.7	-82.0	-47.5	-35.2
Treasury cash balance (end of period)	439.3	521.3	568.8	603.9

Notes: [1/] Data dissemination follows the standards prescribed by the International Monetary Fund's GFSM 2001

[2/] Revenue data in this table is on a cash basis, received from the Fiscal Policy Office

[3/] Excluding principle repayment

P = Preliminary data

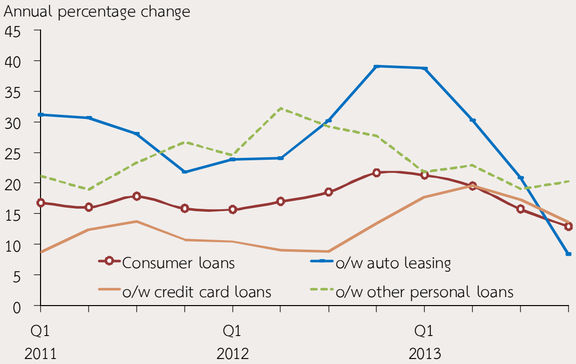
Sources: Fiscal Policy Office, Ministry of Finance, and Bank of Thailand

The Impact of Household Debt on Consumption

High growth in household debt since 2012 until the beginning of 2013 could be explained by post-flood spending on reconstructions and repairs along with government stimulus measures. In addition, low borrowing cost also facilitated debt financial consumption, particularly through consumer credits namely auto leasing and personal loans. Nonetheless, the highly accelerated spending and rising debt burden subsequently led to more cautious spending by households towards the second half of 2013. Looking ahead, households' purchasing power would be limited owing partly to higher indebtedness which would impair households' ability to deal with uncertainties in future income. This development would weigh on spending, giving rise to sub-par growth in future consumption.

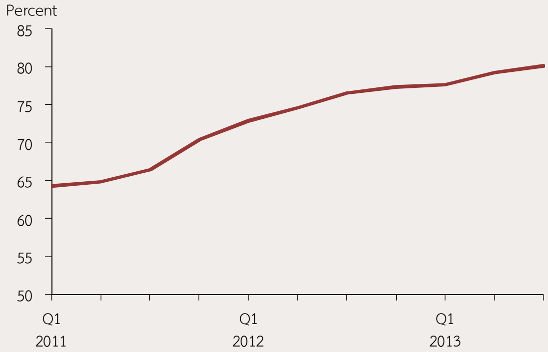
Consumption of durable goods, especially automobile, accelerated markedly during 2012 – 2013 Q1 due to pent-up demand from end-2011 during which factories and roads were damaged from the flood. A range of government stimulus measures such as the minimum wage hike, pledging schemes of various agricultural products, and the first-car tax rebate scheme, also lent support to durable consumption. Low borrowing cost also stimulated consumption through credits, leading to persistent growth in consumer loans such as auto leasing and personal loans including credit card loans. This was reflected by a significant growth in consumer loans of 18.2 percent in 2012. Moreover, the upward trend in the ratio of household debt to GDP in 2012 implied that growth of household debt had surpassed that of income.

Consumer Loans



Source: Bank of Thailand

Household Debt to GDP

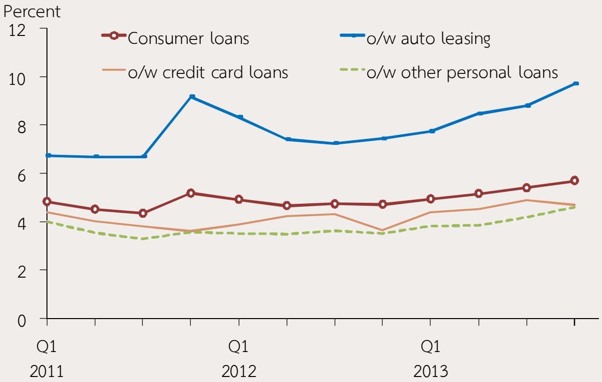


Sources: National Economic and Social Development Board and Bank of Thailand

The increase in household debt and debt service burden subsequently led to a slowdown in consumption of other durable goods such as electrical appliances and furniture since the end of 2012. As these goods were considered less necessary to livelihood compared to other consumer products, households thus postponed their purchases. Also, given their high values, consumers often preferred to purchase them through credit installments, which might lead to excessive debt burden. Nonetheless, towards the end of 2012, spending on non-durable goods, for example, food, beverage and clothing and apparels was not yet affected by accumulation of household debt. Consumption of non-durable goods thus expanded thanks to strong fundamentals including income and consumer confidence, along with accommodative monetary conditions.

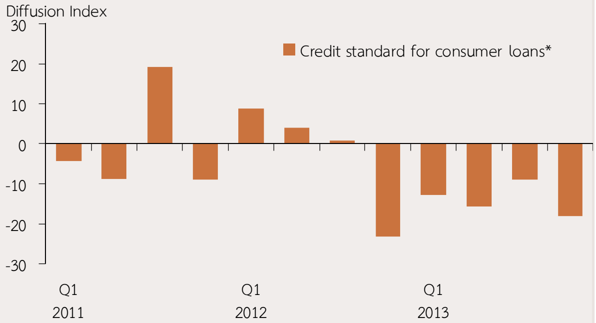
In 2013, households' purchasing power began to deteriorate due to accelerated spending in earlier periods, the gradual tapering off of government stimulus packages, and a decrease in overtime salaries which stemmed from manufacturing slowdown. Farm income was also affected by declining prices of rice and rubber. Therefore, debt servicing ability of some households, particularly low-income households, began to decline as reflected by an increase in delinquency ratio in 2013 H2.

Consumer Loans' Delinquency and NPL Ratio



Source: Bank of Thailand

Financial Institutions' Credit Standards



Note: Diffusion Index <0 means tightening compared to last quarter
=0 means unchanged
>0 means easing compared to last quarter
*Data on credit standard for consumer loans excluding Special Financial Institutions (SFIs)
Source: Bank of Thailand

Overspending which led to deterioration in debt servicing ability in prior periods began to affect household consumption significantly from the second half of 2013 onwards. As consumer confidence in the economy and income worsened consistently, households became more cautious in their spending and refrained from incurring new debt. Even households with acceptable debt servicing ability were facing constraints in borrowings as financial institutions tightened credit standards on consumer loans. Greater caution by all stakeholders thus led to a slowdown in household debt and household consumption towards the end of the year. Apart from the consistent decline in consumption of durable goods especially automobile, spending on non-durable goods also slowed down significantly, in particular when compared to other normal time periods. Nevertheless, the fact that every sectors of the economy adopted greater caution was a good sign that the economy would be able to adjust towards a sustainable growth path. Consumption would then result from higher purchasing power rather than overspending which reflected accumulation of imbalances in the economy.

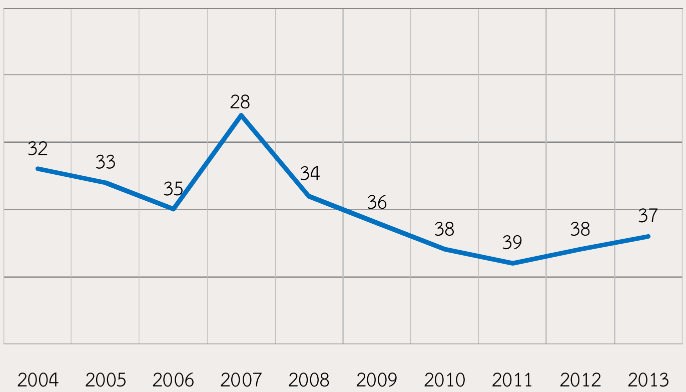
If households failed to align spending with debt burden, income and savings, the constraining effects of indebtedness would reduce households' ability to deal with uncertainties in future income. The effect would fall more heavily on low-income households with higher ratio of debt to income compared to other groups. Looking ahead, many risks to household income remained. While non-farm income would depend on future economic recovery, farm income would be subject to prices of major agricultural products such as rice and rubber which would continue to be volatile in line with global demand and supply. At the same time, subsidy programs for agricultural products lacked policy clarity. These uncertainties would affect consumer confidence, causing households to adopt even greater caution in their spending. This potential development would prolong a reversion of consumption towards its normal growth path in the periods ahead.

Thailand's Competitiveness and Opportunity in Attracting Foreign Investment

The upcoming ASEAN Economic Integration in 2015 would provide an opportunity for ASEAN countries to welcome foreign investment. The size of inflows into each country would differ depending on their relative attractiveness. Thus, an assessment of a country's competitiveness relative to its peers in terms of strengths and weaknesses was necessary. Identification of areas which could be further developed would uplift a country's competitiveness and attractiveness, making it ready to welcome investment and benefit from AEC in the coming years.

During the past five years, foreign direct investment in ASEAN as a proportion of global foreign direct investment rose steadily from 4 percent in 2009 to 8 percent in 2012. This was due in part to consistent growth in sizes of emerging market economies. ASEAN countries with the highest foreign direct investments included Singapore, Indonesia, Malaysia, Thailand and Vietnam, respectively. This trend reflected an increase in foreign direct investment in Thailand and regional countries though dispersion of investment destinations and types differed, depending on each country's ability to attract foreign funds.

Thailand's Competitiveness Ranking



Source: the World Economic Forum (WEF) The Global Competitiveness Report

Analysis of Thailand's competitiveness from the World Economic Forum (WEF)[1]'s survey of competitiveness revealed that over the past ten years, Thailand's competitiveness declined from rank 32 in 2004 to rank 37 at present. From the 2013-2014 surveys, it was found that while competitiveness improved by one rank from the previous year, Thailand's average score remained unchanged. Factors that contributed to an increase in Thailand's ranking were efficiency, especially in the product and labor markets, and innovation in terms of availability of technology and business expertise. However, factors regarding infrastructure and macroeconomic environment declined. Moreover, the most frequently cited business constraints were government related factors including corruption, political instability, policy uncertainty and operational inefficiency of government departments.

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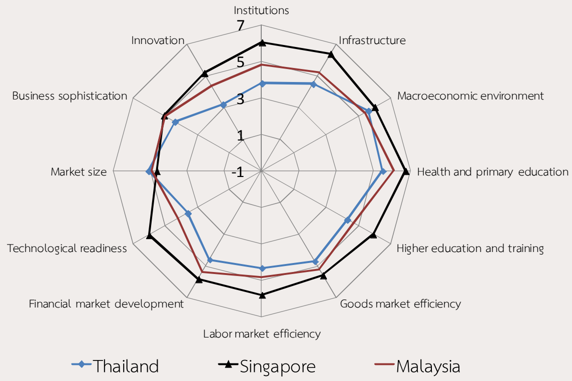
[1] Surveyed by World Economic Forum (WEF) in 2013-2014 in September, comprising 148 countries

Compared to other countries with higher proportion of foreign direct investment than Thailand, including Singapore, Indonesia and Malaysia, it was found that most foreign direct investment into Malaysia and Singapore went to high-technology manufacturing industries. This observation could be explained by Malaysia and Singapore's higher readiness compared to Thailand in various dimensions such as technology, public infrastructure, education, especially at university level, and innovation. Despite attaining a lower competitiveness ranking than Thailand, Indonesia showed remarkable improvement from rank 50 in 2012 to rank 38 in 2013 thanks to its strength in infrastructure, public management and innovation. These factors were considered important in foreign investors' investment decisions.

Comparison of Competitiveness Assessment among Singapore, Malaysia and Thailand



Source: WEF The Global Competitiveness Report, 2013-2014

For the group of Cambodia, Laos, Myanmar and Vietnam (CLMV), in spite of a lower proportion of foreign direct investment compared to Thailand, high growth was observed [2], especially in labor intensive industries such as mining and handicrafts. This observation could be explained by CLMV's competitiveness in terms of lower wage compared to other countries in ASEAN. Also, growth in these economies was likely to improve continually. These factors contributed to an increase in Vietnam's competitiveness ranking from 65 in 2012 to 59 in 2013 while Laos and Myanmar were included in the survey for the first time this year.

For Thailand to take advantages of AEC in attracting foreign investment, every sectors of the economy must join efforts in enhancing the country's competitiveness. Weaknesses needed to be turned to strengths in order to keep up with a front runner lilke Malaysia as well as to leave tailgaters like Indonesia and Vietnam behind. The followings could be done: 1) enhancing basic infrastructure, expanding mass transportation network and improving healthcare and education to uplift the quality of Thailand's human capital which would be key in future technological research and development; 2) undertaking institutional reform, for example, termination of corruption by strengthening auditing standards and increasing penalties for wrongdoers; and 3) restoring political stability to uplift investment climate. This could be achieved by ensuring social equality in terms of opportunity, income and participation for all Thais. If these weaknesses were addressed at the same time as

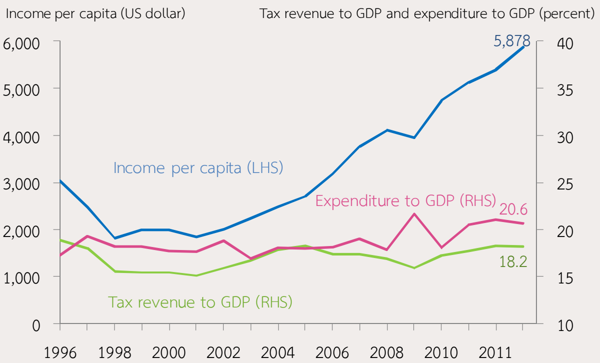
[2] Average growth in investment during 2009 – 2012 was as high as 20 percent per year.

improving macroeconommic environment and pursuing financial market development, AEC would be an important opportuninty for Thailand to achieve sustainable growth.

Structural Changes in the Fiscal Sector and Implications on the Economy

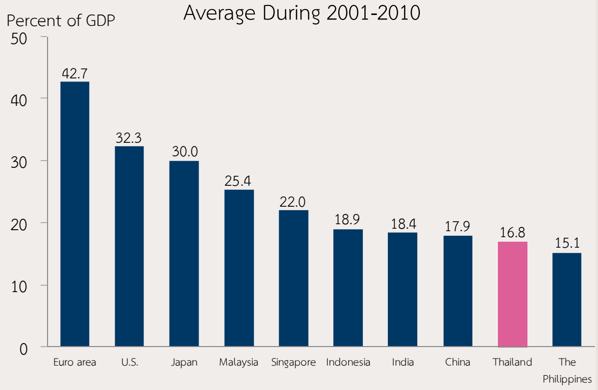
During the last decade, there were two important structural changes in Thailand's fiscal sector, 1) imbalance between revenue and expenditure with the latter growing greater than the former; and 2) increases in current expenditure and spending under populist policies while capital expenditure declined. These changes had implications on the overall economy in the previous periods. They would also remain important to economic development, going forward.

Thailand's Income and Expenditure to GDP



Source: Comptroller General's Department, Fiscal Policy Office, International Monetary Fund (IMF), Per Income per capital estimated by the IMF

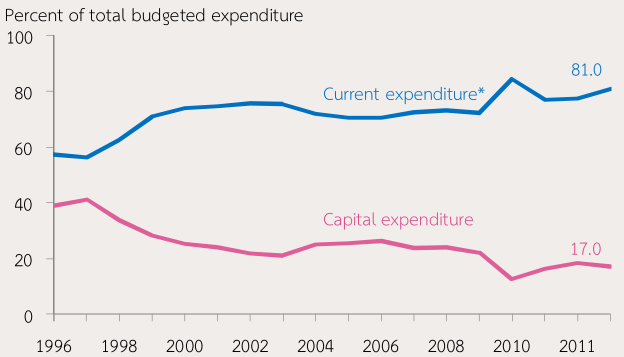
Country Comparison of Revenue Collection to GDP Average During 2001-2010



Sources: IMF and Bank of Thailand

Firstly, data on government revenue and expenditure over the last ten years showed that Thailand's income per capita increased from 2,500 U.S. dollars per person per year in 2004 to 6,000 U.S. dollars per person per year in 2013. However, nationwide revenue collection did not grow much. In fiscal year 2013, 2,157 billion baht of revenue was raised, equivalent to 18.2 percent of GDP. Over a longer horizon, average revenue collection during 2001 – 2010 stood at 16.8 percent of GDP, significantly less than levels observed in developed economies such as Singapore, Japan and the euro area where average revenue collection over the same period stood at 22 percent, 30 percent and 42.7 percent of GDP, respectively. Compared to other similar countries in the region such as Malaysia and Indonesia, Thailand's revenue collection ability was also underperformed.

Annual Current Expenditure and Capital Expenditure to Total Budgeted Expenditure



Sources: Ministry of Finance, compiled by Bank of Thailand

*Current expenditure excludes principle repayment and expenditure for replenishment of the treasury balance

Meanwhile, fiscal spending (including principle repayment and expenditure for replenishment of treasury account balance) in 2013 registered at 2,438 billion baht or 20.6 percent of GDP. Higher expenditure compared to revenue collection stemmed from acceleration in contingent liabilities which constituted a part of current expenditure. Examples included expenditure on benefits and education, which accounted for 45 percent of total budget, and spending under populist policies such as the first-car tax rebate scheme and pledging schemes of various agricultural products. Imbalance between government revenue and expenditure in part resulted in continuous needs to operate under budget deficit in previous years.

Secondly, the proportion of current expenditure rose from less than 60 percent in 1996 to 80 percent in 2013. The development partly stemmed from increases in benefits, for example, welfare benefits for elders, social security contributions, and national health security contributions. The increase in current expenditure caused the proportion of capital expenditure to reduce from 40 percent in 1996 to less than 20 percent in 2013, with a declining trend being observed over the last ten years.

Indicators of Thailand's Competitiveness

Global Competitiveness Index

	Rank (out of 148)	Score (1–7)
GCI 2013–2014	**37**	**4.5**
GCI 2012–2013 (out of 144)	38	4.5
GCI 2011–2012 (out of 142)	39	4.5
Basic requirements (40.0%)	**49**	**4.9**
Institutions	78	3.8
Infrastructure	47	4.5
Macroeconomic environment	31	5.6
Health and primary education	81	5.5
Efficiency enhancers (50.0%)	**40**	**4.4**
Higher education and training	66	4.3
Goods market efficiency	34	4.7
Labor market efficiency	62	4.3
Financial market development	32	4.6
Technological readiness	78	3.6
Market size	22	5.1
Innovation and sophistication factors (10.0%)	**52**	**3.8**
Business sophistication	40	4.4
Innovation	66	3.2

Source: Global Competitiveness Report 2013–2014

The low proportion of capital expenditure led to inadequate investment on economic development and competitiveness enhancement, particularly investment to improve infrastructure, innovation and technological readiness compared to other countries.[1]

In this connection, competitiveness enhancement remained key to resolving current constraints on the Thai economy, namely labor and production technology. Higher competitiveness would also help attract foreign investment and enable Thai exports to compete with trading partners in a sustainable manner as previously discussed in Boxes of Chapters 2 - 4.

[1] Source: World Economic Forum, Global Competitiveness Report 2013–2014

Fiscal Reforms

To address the above structural problems, tangible reforms on fiscal management would be crucial for the country's development in the next periods. Fiscal rules would need to be improved to ensure long-term economic sustainability in various dimensions.

On the expenditure side, steps that could be taken included: 1) determining an appropriate proportion of capital expenditure in each fiscal year and reducing unnecessary expenses; 2) reducing spending under populist policies that would not contribute to potential growth. Although these policies might lessen inequality, they would add to fiscal burden and interfere with the country's development in the long-term; 3) setting aside budget for principle repayment in each fiscal year to maintain fiscal discipline; and 4) considering establishing an independent organization to perform a similar task as the Congressional Budget Office (CBO) in the U.S. in analyzing and providing recommendations on government budget.

On the revenue side, the government should enhance efficiency in revenue collection. Analysis of other countries with similar economic structures to Thailand's revealed that revenue collection in these countries averaged at 22.9 percent of GDP[2]. This observation implied that Thailand could still increase the ability to raise government revenue by 5 percent. In this regard, the government could consider undertaking tax reforms, for example, improving standards in financial reporting of the business sector to expand the tax base or considering implementing a tax on land and buildings to increase revenue for local administration ,and reduce transfers from the central government.

[2] Source: Bank of Thailand Symposium, "Toward fiscal sustainability and long-term economic growth: what are the challenges ahead?", 2010

5. Monetary Conditions

5.1 Monetary Conditions and Exchange Rates

Monetary conditions were accommodative throughout the year.

Monetary policy in 2013 was consistently accommodative and supportive to growth against the backdrop of sluggish recovery in the global economy and higher threat to Thailand's economic outlook. Sources of risks included potential delays in public investment and the slowdown in domestic demand. The latter stemmed from both rising household debt and the political situation towards the end of the year. This development dampened consumer confidence and led some firms to postpone their investment to await greater economic and political clarity. The Monetary Policy Committee (MPC) thus reduced the policy rate twice by a total of 0.50 percent. The first policy rate reduction of 0.25 percent was on May 29, 2013, to help stimulate the economy after the lower-than-expected growth outturn in the first quarter. Then, the second policy rate decrease of another

0.25 percent was on November 27, 2013, to lessen risk to growth owing to the slow economic recovery amid more fragile private sentiment due to the political situation. The policy rate at the end of 2013 thus stood at 2.25 percent per annum.

Short-term money market rates and bond yields declined from the previous year in line with movement of the policy rate. At the end of 2013, the overnight interbank rate and the 1-month government bond yield stood at 2.15 and 2.30 percent per annum, respectively. Yields on medium to long-term government bonds were relatively volatile and moved upwards in tandem with yields on U.S. treasuries. This followed market expectation of a sooner-than-expected QE tapering by the Fed which resulted in asset sell-offs by foreign investors. At the end of the year, the 10-year government bond yield stood at 3.98 percent per annum, rising by 0.5 percent from the end-period last year.

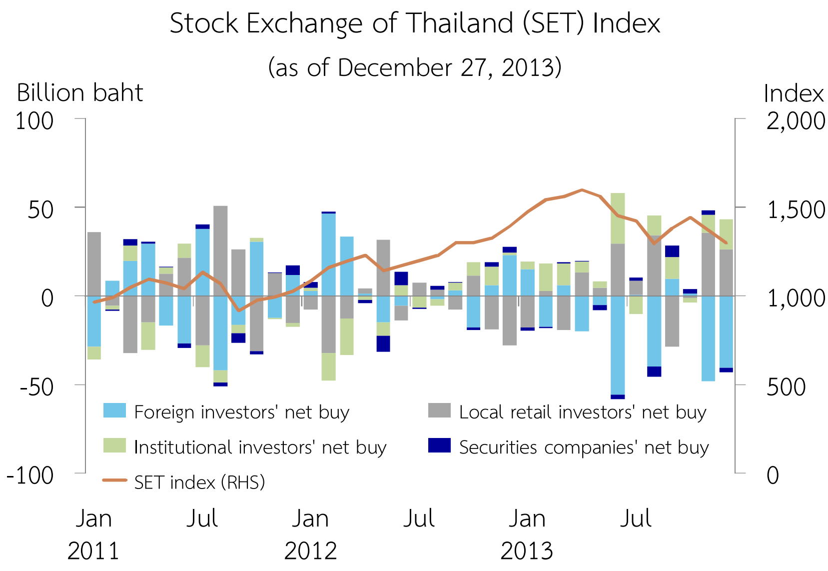
The policy rate cuts also led commercial banks to decrease interest rates on both deposits and loans in 2013. At the end of the year, the interest rates on the 12-month time deposit and the minimum lending rate (MLR) of the four largest commercial banks registered at 2.23 and 6.84 percent per annum, declining over the year from 2.46 and 7.00 percent per annum, respectively. Nonetheless, many commercial banks and Specialized Financial Institutions (SFIs) introduced new types of high-interest special deposit products in attempt to continually mobilize deposits in part to support the high demand for private credits.

Private credits continued to expand rigorously despite some moderation in 2013 H2 owing to the economic slowdown and the tightening of credit standards by financial institutions. Latest data at year-end showed that private credits grew by 10 percent, slowing down from 15.3 percent in 2012, owing to both corporate and consumer loans. The slowdown in corporate loans was consistent with private investment's trend while that in consumer loans was in part explained by a significant drop in auto leasing after completion of deliveries under the first-car tax rebate scheme. The elevated household debt also prompted financial institutions to tighten credit standards for consumer loans.

Deposits including bills of exchange (B/E) expanded by 7.5 percent at the end of 2013, slowing down from 11.1 percent at the end of 2012. This development stemmed from depositors' reallocation of funds to higher-return financial assets, for example, stocks and bonds. Subsequently, financial institutions continued to compete for deposits through high-interest special deposit products, especially during the first two quarters of the year to support the high demand for credits. However, competition for deposits cooled down during the second half of the year in line with financial institutions' plan to gradually reduce lending during the economic downturn.

The Stock Exchange of Thailand was affected firstly by uncertainties in the global financial markets and secondly by the political situation towards the end of the year.

In 2013, stock market conditions were volatile due to fluctuation of international capital flows which resulted from uncertainties in the global financial markets, risks to Thailand's and regional economies, and the political situation towards year-end. In the beginning of the year, the Stock Exchange of Thailand (SET) Index increased on the back of robust domestic economic conditions and the increase in global liquidity owing to monetary easing by major industrialized economies. Confidence in the global financial markets also improved on account of the resolution of the U.S. fiscal cliff. Subsequently, investors increased their holdings in emerging market assets and risky assets in search for higher yields. The SET index, therefore, increased steadily to reach a 19-year high of 1,643 points on May 21, 2013. Nevertheless, in the second half of the year, the SET index became more volatile due to market's speculation of a sooner-than-expected QE tapering by the Fed. This external factor along with the lower-than-expected domestic economic growth and heightened political tensions towards year-end, led to continuous sell-offs by foreign investors. From April to the end of the year, foreign investors' net sell amounted to 6.3 billion US dollars, causing the SET index to close at 1,299 points for the year, decreasing by 6.7 percent from the previous year. Market volatility also rose from 12.9 percent in 2012 to 19.6 percent this year.



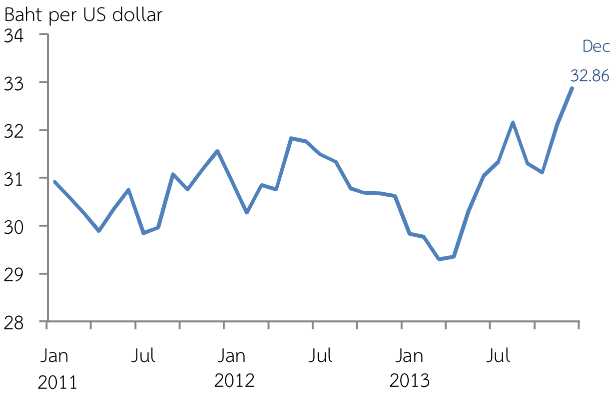
Source: Stock Exchange of Thailand

Both domestic and external factors resulted in volatility of the Thai baht against the US dollar.

The baht was quite volatile throughout 2013. From the beginning of the year up to April, the baht appreciated steadily, owing to capital inflows into both the stock and bond markets. These inflows mainly stemmed from monetary easing in major industrialized economies, coupled with Thailand's stronger economic fundamentals compared to other countries in the region. From May onwards, the baht weakened continually due to capital outflows as investors projected a sooner-than-expected QE tapering by the Fed given the signs of U.S. economic recovery. After the Fed announced in mid-December that QE tapering would begin in January 2014, the baht plunged along with regional currencies. This external development coupled with the greater-than-expected weakening of the domestic economy and the political situation at end-2013 caused the baht to close at 32.86 baht per US dollar, depreciating by 6.8 percent from the end of previous year.

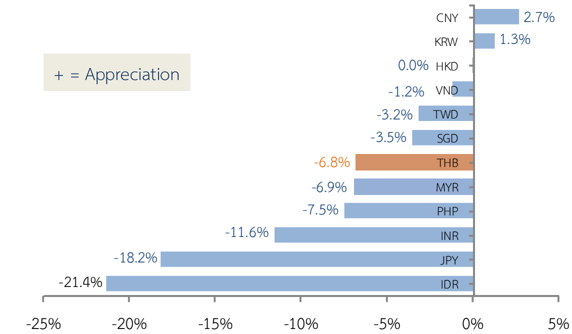
In December 2013, the Nominal Effective Exchange Rate (NEER) averaged at 102.95, depreciating slightly by 0.2 percent from the same period last year due to the depreciation of the Thai baht relative to the US dollar, the euro and the Chinese Yuan. Meanwhile, the Real Effective Exchange Rate (REER) averaged at 101.47 in the same month, depreciating by 3.2 percent from the same period last year owing to the weaker NEER and moderating inflation.

Exchange Rate



Source: Bank of Thailand

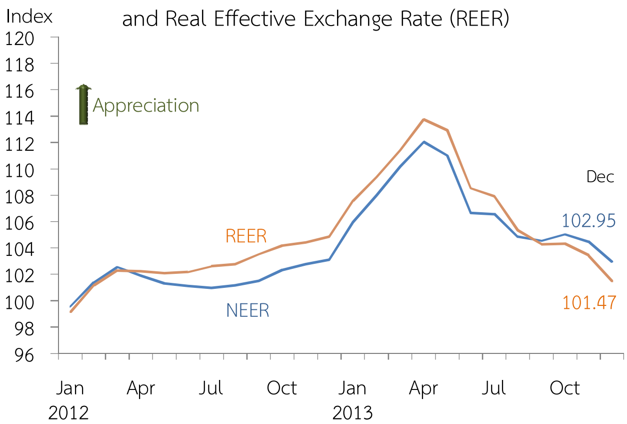
Movements of the Thai Baht and Regional Currencies Relative to the US Dollar in 2013



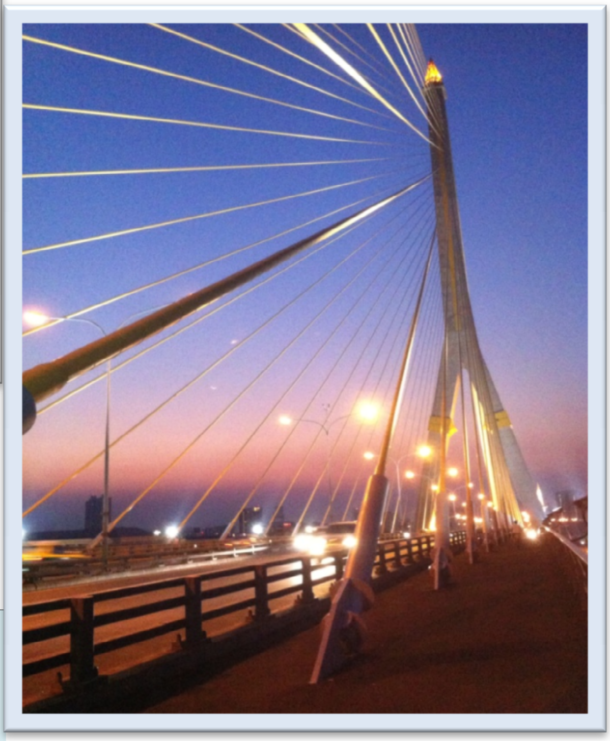
Note: End-2013 data calculated as a percentage change from end-2012

Sources: Bank of Thailand and Reuters

Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER)



Source: Bank of Thailand



6. Assessment of Thailand's Economic Stability

6.1 Internal Stability

Thailand's internal stability remained sound with low inflation and unemployment. Commercial banks and businesses' financial strength remained strong. The real estate sector cooled down. However, risk to fiscal stability heightened due to the government's quasi fiscal activities while stability of the household sector continued to be fragile.

6.1.1 Price Stability and Inflationary Pressure

Inflation remained low in line with overall production costs and little pass-through owing to the slowdown in domestic demand.

In 2013, headline and core inflation averaged 2.18 and 1.00 percent, respectively, slowing down continuously since the beginning of the year. Despite implementation of the second round minimum wage hike on January 1, 2013, pass-through of wage costs to prices of goods and services continued to be contained. The pass-through from steady increases of LPG price for the household sector during 2013 Q4 to prepared food prices was also limited. Thus, inflationary pressure was benign throughout the year. On the cost side, pressure was steady in line with prices of both oil and non-oil commodities, which tracked the slowly recovering global economy. On the demand side, pressure eased in tandem with the slowdown in domestic demand. In particular, household spending moderated in the second half of the year owing to the gradual wind-down of government stimulus packages and more cautious household spending which owed to rising indebtedness. As a result, increases in prices of goods and services by firms were rather limited.

Looking ahead in 2014, inflation was expected to edge up from 2013. Although demand pressure was likely to stabilize, cost pressure would rise from the gradual increase in LPG prices for household as a result of government policy.

Consumer Price Index
(Annual percentage change)

	2012	2013				
		Year	Q1	Q2	Q3	Q4
Consumer Price Index	3.02	2.18	3.09	2.32	1.67	1.68
- Core Consumer Price Index	2.09	1.00	1.47	1.00	0.74	0.82
- Raw food	4.40	5.54	6.08	6.60	4.48	5.04
- Energy	7.09	4.79	8.76	4.60	3.67	2.35
Producer Price Index	1.0	0.3	0.1	0.4	0.4	0.4

Source: Bureau of Trade and Economic Indices, Ministry of Commerce

6.1.2 Labor Market

The labor market continued to tighten. The nationwide minimum wage hike did not result in widespread lay-offs and thus the unemployment rate remained low.

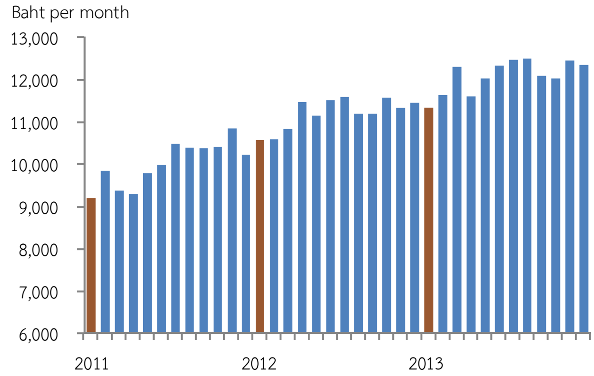
Overall employment was roughly unchanged from the previous year. In 2013 H1, employment in both agricultural and non-agricultural sectors increased, particularly in trade and construction, following expansion in the real estate market and construction of department stores in major cities. Employment in the manufacturing sector, at the same time, decreased slightly due to production adjustment by some firms to reduce labor costs following the minimum wage hike to 300 baht per day nationwide on January 1, 2013. Nevertheless, adjustment by firms did not lead to widespread lay-offs thanks to the high labor absorption capacity in other industries. This condition stemmed from the relatively tight labor market which led to high demand for labor. In 2013 H2, the slowdown in economic activities coupled with unattractive agricultural prices, particularly rice and rubber prices which had been declining substantially since the second quarter, led to slight decreases in employment and fewer overtime works in various manufacturing sectors. However, the average unemployment rate[1] in 2013 remained low.

Labor Market Indicators

Annual percentage change	2012	2013	2013			
			Q1	Q2	Q3	Q4
Employment	1.2	-0.1	1.3	0.9	-1.2	-1.3
Agriculture	3.7	-0.1	1.2	0.5	-1.7	-0.4
Non-agriculture	-0.3	-0.1	1.4	1.1	-0.8	-1.9
Manufacturing	1.8	0.8	1.1	-1.3	2.5	0.9
Others	-0.9	-0.3	1.5	1.8	-1.8	-2.6
Unemployment (thousand persons)	258.8	283.5	280.5	292.1	305.6	255.9
Unemployment rate (%)	0.7	0.7	0.7	0.7	0.8	0.6
Underemployment (thousand persons)	348.1	336.2	393.8	277.6	327.5	346.0
Underemployment rate (%)	0.9	0.9	1.0	0.7	0.8	0.9

Source: National Statistical Office

Average Earnings



Source: National Statistical Office

6.1.3 Government Sector

Risks to fiscal stability increased due to implementation of quasi-fiscal activities. This could lead to higher ratio of public debt to GDP in the next periods.

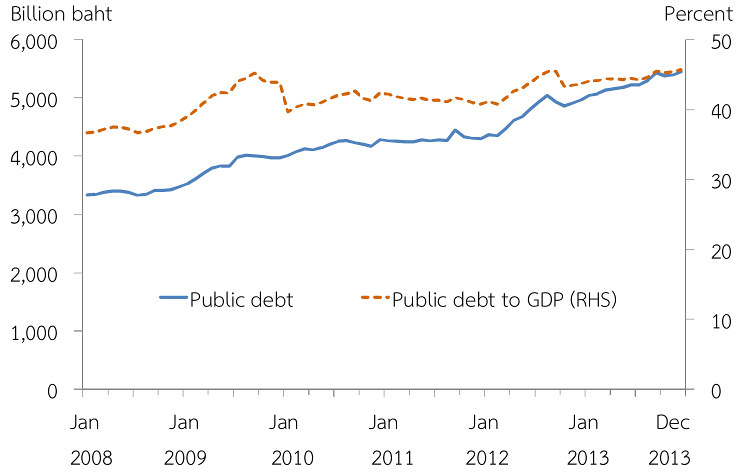
The ratio of public debt to GDP climbed from 43.7 percent at end-2012 to 45.7 percent at end-2013, remaining below the 60 percent threshold for fiscal sustainability. Most of the increase in public debt stemmed from loans to finance public deficit and guarantees of Specialized Financial Institutions (SFIs), especially the Bank for Agriculture and Agriculture Cooperatives (BAAC)'s

[1] The unemployment rate was low regardless of whether the narrow definition of unemployment (official unemployment) or the wide definition of unemployment (official unemployment including underemployment and seasonal unemployment) was used.

activities in the rice pledging scheme, reflecting higher risk from implementation of quasi-fiscal activities. These activities along with continuously rising spending under populist policies also caused the ratio of capital expenditure to overall government expenditure to drop below the set target of 25 percent.

Looking ahead, risk to fiscal stability would heighten owing to higher government expenditures associated with implementation of quasi-fiscal activities, while revenue collection was expected to moderate in line with the economic slowdown. The ratio of public debt to GDP was projected to rise from the current level, hence, required close monitoring. Moreover, possible delays in various investment projects and higher spending under populist policies could put a tighter squeeze on the allocation of budget on public investment to enhance the country's economic potential in the periods ahead.

Indicators of Government Sector Stability



Source: Pubic Debt Management Office (as of February 13, 2014)

6.1.4 Other Sectors

Stability of other sectors, namely the financial institutions and the corporate sectors, remained intact. Both domestic and external economic outlook were important variables that could affect debt servicing ability of the private sectors along with loan quality in the periods ahead.

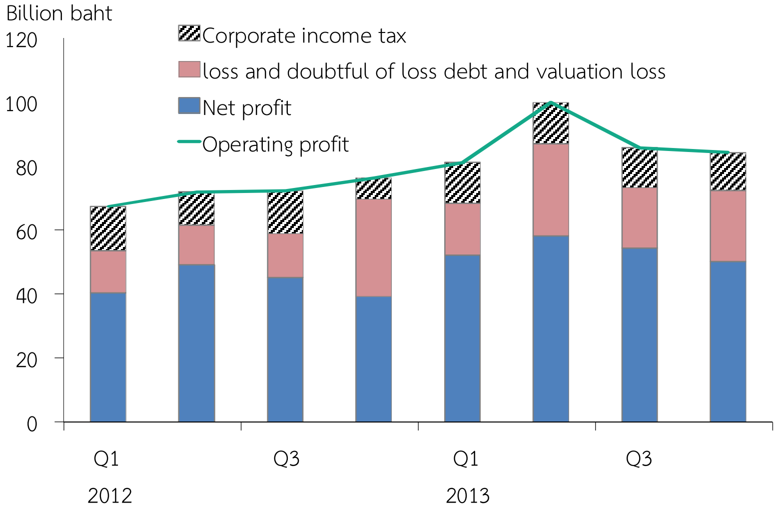
Financial institutions

Stability of the financial institutions sector was well maintained. Commercial banks continued to pose high profits, leading to high capital adequacy and provisioning for doubtful loans. The strong financial conditions would help absorb risk and volatility in the next periods.

In 2013, stability of the financial institutions sector was well maintained. Commercial banks recorded high profits in which the majority of revenue which accounted to 64 percent, continued to come from interest income. Meanwhile, the proportion of income from fees and charges increased modestly to 20 percent of total revenue, which partly stemmed from adjustment in business strategies to deal with stronger competition for deposits. With high profitability, commercial banks were able to allocate more capital to provisioning of doubtful loans to help absorb the potential impact from economic volatility. The capital adequacy ratio also increased steadily and was much higher than the legal requirement. Nonetheless, commercial banks' private credits grew by 11 percent, slowing down from the preceding year owing to the substantial slowdown in consumer credits. Meanwhile, credits to SMEs and credits to large corporates to finance outward investment expanded at a similar pace compared to the previous year which were in part reflective of the economic slowdown and expiration of government stimulus measures. Overall loan quality continued to be sound but some deterioration in consumer credits was noted. In this regard, the NPL ratio and the delinquency ratio of consumer credits increased marginally from 1.9 and 2.8 percent at end-2012 to 2.2 and 3.5 percent at end-2013, respectively.

Going forward, development in the global and domestic economies continued to warrant close monitoring as it could affect debt servicing ability of the private sector along with the quality of consumer credits and SME credits which tended to be quite susceptible to both domestic and external risks.

Commercial Banks' Net Profit, Operating Profit and Expenses



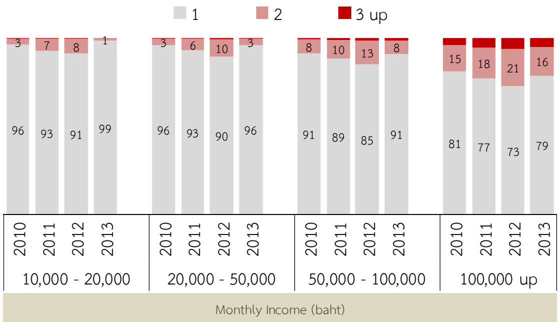
Source: Bank of Thailand

Corporate Sector (Non-Financial Institutions)

Stability of the corporate sector continued to improve from the previous year thanks to the real estate cool-down and high liquidity. Nonetheless, the household sector remained fragile as reflected by the high level of household debt to GDP.

1) The real estate sector cooled down slightly from the previous year with reduction in investment and speculative activities as reflected by a decline in the proportion of second and third home mortgages. Developers also implemented preventive measures, for example, increasing down payments and charging fees for name changes on reservation certificates. Additionally, financial institutions tightened credit standards for mortgage lending since 2013 Q2 owing to both the economic slowdown and the BOT's signaling of rising concern of real estate overheating. This development was reflected by the upward trend in the Debt Service Coverage Ratio (DSCR) during the second half of the year which averaged 4.7 percent compared with the average during 2008 – 2012 of 4.4 percent.

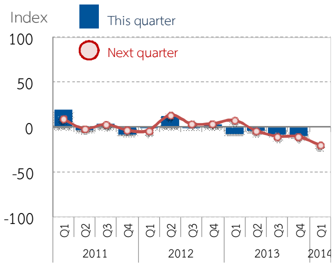
Commercial Banks' Mortgages Classified by Number of Properties Held by Borrowers*



Note: Mortgages for new and pre-owned properties from Jan 2008 – Dec 2013, calculated using a rolling window of 3 years and then comparing the number of borrowers in the third year of each window

Source: Bank of Thailand

Credit Standards for Mortgage Loans



Index:

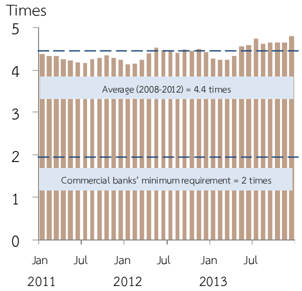
Index > 0 Easing

Index = 0 Unchanged

Index < 0 Tightening

Source: Bank of Thailand's Credit Conditions Survey

Debt Service Coverage Ratio



Note:

(1) DSCR = monthly income/monthly debt payment (principal and interest)

(2) Calculated for new mortgages in Bangkok and its vicinity

(3) 50th percentile (3-month moving average)

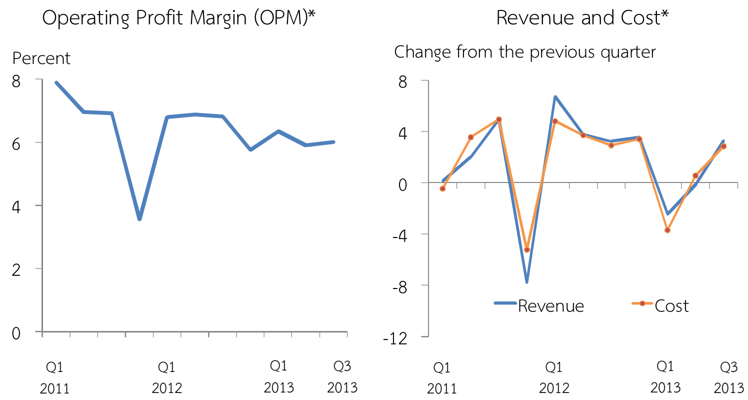
(4) Includes only debt services for new mortgages by commercial banks

Source: Bank of Thailand

2) Notwithstanding the impact from the global and economic slowdown, stability of the corporate sector continued to be evident. The corporate sector's net profit margin (NPM) during the first three quarters of the year stood at 6.1 percent, declining from 6.5 percent in 2012, mostly due to higher production costs. On the whole, however, the corporate sector still possessed high retained earnings from previous periods to help absorb risks associated with the economic outlook. Debt servicing ability and overall liquidity remained high as reflected by the high interest coverage ratio along with the current ratio which continued to be close to the average levels over the last ten years.

Looking ahead, important risks that could affect stability of the household, the real estate and the corporate sectors, particularly SMEs, included the economic slowdown and the ongoing political situation that could destabilize in confidence along with affecting income and debt servicing ability of these sectors.

Performance of the Corporate Sector



Note: * OPM = (Revenue – Cost of goods sold – Operating cost) / Revenue, Median

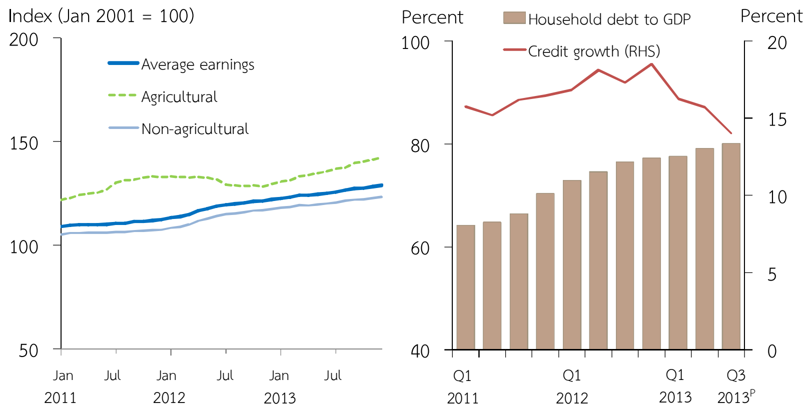
Sources: Stock Exchange of Thailand and calculations by Bank of Thailand

3) The household sector remained fragile as the ratio of household debt to GDP continued to be quite high. This development was caused by steeper growth in household debt compared to GDP. This was in part attributed by accommodative monetary condition and relatively strong competition in the market for consumer loans against the backdrop of a deeper-than-expected economic slowdown. Thus, the ratio of household debt increased from 77.3 percent at the end of 2012 to 80.1 percent at the end of 2013 Q3. In addition, households' debt servicing ability worsened as reflected by the NPL and delinquency ratio of consumer loans which steepened from 4.7 percent at the end of 2012 to 5.7 percent at the end of this year, mostly owing to deterioration in auto leasing loans.

Nevertheless, household debt by itself began to exhibit a decelerating trend. This was in part due to expiration of the first-car tax rebate scheme together with the gradual wind-down in spending for post-flood constructions and repairs. Households also became more cautious in their spending and accumulation of new debt, while financial institutions tightened credit standards. As a result, household debt at the end of 2013 Q2 and Q3 expanded from the same period last year by 15.7 and 14 percent, respectively, cooling down from 18.3 percent recorded at the end of 2012. In addition, favorable income and employment conditions continued to be supportive of the household sector stability as reflected by the increase in real average earnings of both agricultural and non-agricultural sectors and the low unemployment rate.

Indicators of Household Sector Stability

Household Income* Household Debt* to GDP



Note: *Seasonally adjusted real income (12-month moving average)
Sources: Office of Agricultural Economics, National Statistical Office, calculations by Bank of Thailand

Note: *Loans to households from financial institutions
Source: Bank of Thailand

6.2 External Stability

Thailand's overall external stability remained sound.

Although the current account had been in deficit for two consecutive years, deficit size was small and its source did not stem from over spending but rather from gold imports and profit repatriation by foreign companies. Even though the current account to GDP recorded a slightly larger deficit compared to 2012, if gold was excluded, it would remain in surplus.

Thailand's external debt edged up from the previous year owing mostly to long-term borrowings. These funds were used to finance outward investment by domestic corporates and to meet greater demand for domestic credits stemming from the government stimulus policies. In this regard, the ratio of short-term external debt to total external debt declined from the previous year.

International reserves decreased following measures to safeguard stability of the baht and to prevent balance of payments deficit. Gross reserves to import value thus declined from the previous year though it remained high compared to international benchmark.

External Stability Indicators

	International benchmark	2012	2013	2013			
				Q1	Q2	Q3	Q4
Indicators of debt servicing ability (percent)							
- Current account[1]/ to GDP	n.a.	-0.4	-0.6	0.0	-7.2	-0.9	5.5
- External debt to GDP[2/]	48-80 [3/]	38.0	38.3[E]	39.5	39.3	38.3	38.3[E]
- External debt to export value [1/ 2/]	132-220 [3/]	51.5	51.3[E]	53.3	53.3	51.5	51.3[E]
- Debt service ratio	< 20	4.2	4.0[E]	4.9	3.4	3.7	4.0[E]
Indicators of liquidity							
- Gross reserves to short-term external debt	> 1	3.1	2.8	3.0	2.6	2.8	2.8
- Gross reserves to import value (months)	> 3-4 months	9.9	9.2	9.5	9.1	9.3	9.2
- Short-term external debt to external debt (percent)	n.a.	44.5	43.2[E]	43.5	45.8	43.2	43.2[E]

Notes: [1/] Since October 2006, "Reinvested Earning" has been recorded as part of direct investment in the financial account and its contra entry recorded as "Investment Income" in the current account.

[2/] Using the averaged quarterly GDP for the last three years starting from the quarter considered

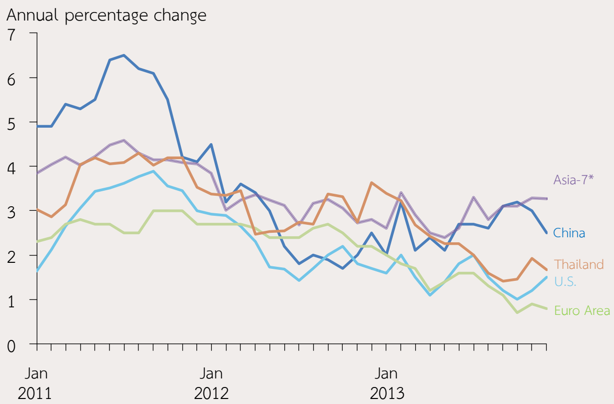
[3/] Benchmark for middle income countries, i.e. with GDP per capita of 756 – 9,265 US dollars per year

Source: Bank of Thailand

Global and Thai Inflation Development and Outlook

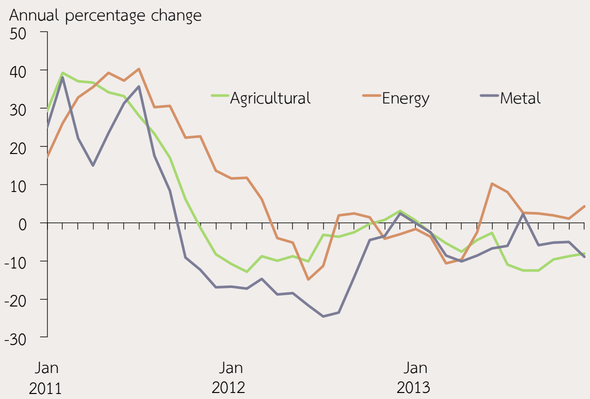
Since 2011, global inflation declined steadily in line with the declining trend in commodity prices amidst the slowly recovering global demand. In 2013, global oil and non-fuel commodity prices contracted by 3.9 percent and 1 percent, respectively. Declining cost pressure together with subdued demand pressure contributed to moderation of global inflation from 4 percent in 2012 to 3.8 percent this year with noticeable declines in major industrialized economies. Similarly, most Asian countries experienced low inflation except Indonesia and India where inflation accelerated towards year-end owing to the reduction of domestic oil price subsidies from governments.

Global Inflation



Note: *Average of Hong Kong, Indonesia, South Korea, Malaysia, the Philippines, Singapore and Taiwan
Source: CEIC, Eurostat, World Bank, Ministry of Commerce

Global Commodity Prices



Source : Consensus Forecast, December 2013

Global inflation

Inflation	2000-2010	2011	2012	2013
Global	4.0	4.8	4.0	3.8
Major industrialized economies	2.0	2.7	2.0	1.4
Developing economies	6.8	7.1	6.1	6.1

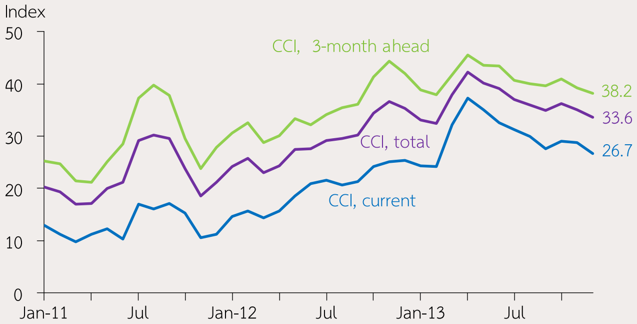
Source : International Monetary Fund, World Economic Outlook Database, January 2014

Thailand's inflation also slowed down steadily since 2012 before a sharp decline in 2013. Headline and core inflation averaged at 2.18 percent and 1.00 percent this year, moderating from 3.02 and 2.09 percent last year. Cost pressure, the largest determinant of Thailand's inflation,[1] caused inflation to slow down in line with developments in other countries. The following domestic factors also played their parts. 1) Lack of demand: The

[1] Cost pressure explains approximately 20-40 percent of Thailand's inflation dynamics. (Chotima Sitthichaiviset, Vararat Khemangkorn and Atipong Saikaew (2012). Inflation Dynamics and Monetary Policy. Bank of Thailand Discussion Paper)

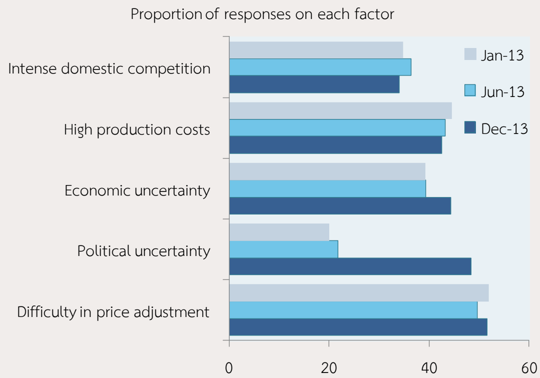
slowdown in domestic spending that resulted from expiration of government stimulus measures and rising household debt led consumers to become more cautious in their spending. Additionally, the fragile private sentiment which stemmed from the economic slowdown was dented further by the political situation towards the end of the year. Thus, demand pressure remained benign and led to minimal pass-through from costs to prices. 2) High competition in the corporate sector: the BOT's survey of business sentiment revealed that intense competition in the corporate sector coupled with difficulty in price adjustment were consistently cited as top business constraints throughout 2013.

Consumer Confidence Index



Index > 50 Improve or at a satisfactory level
Index = 50 No change or at an acceptable level
Index < 50 Deteriorate or at an unsatisfactory level
Sources : Bureau of Trade and Economic Indices, Ministry of Commerce and calculations by Bank of Thailand

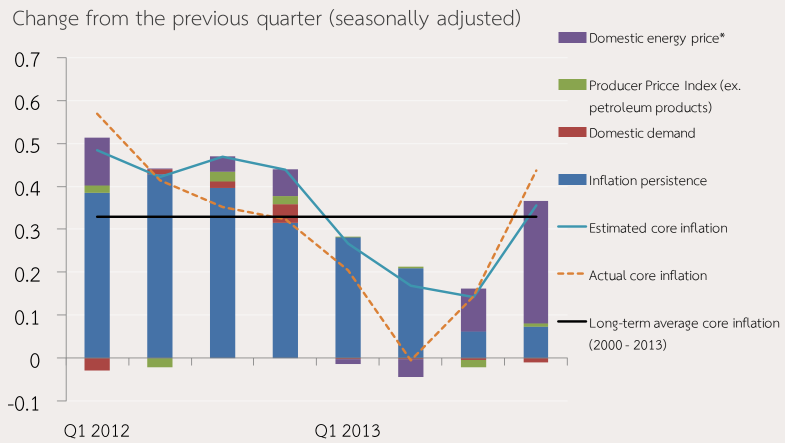
Top 5 Business Constraints



Source: Bank of Thailand's monthly survey of business sentiment

The second round minimum wage hike to 300 baht per day nationwide which was implemented at the beginning of 2013 resulted in increases in labor costs. However, pass-through to overall prices of goods and services were quite limited. Main causes of restriction on pass-through likely owed to intense competition in the corporate sector. Firms would risk losing market shares should they decide to raise prices. Moreover, some businesses chose to absorb cost increases given that they still possessed adequate profit margin and were able to make adjustments to reduce some costs. With regard to the steady increase in LPG prices for households which started in September 2013, some pass-through to prices of prepared food was noted though it was rather limited given the unfavorable economic environment.

Determinants of Core Inflation



Notes : *Domestic energy price includes oil and LPG price

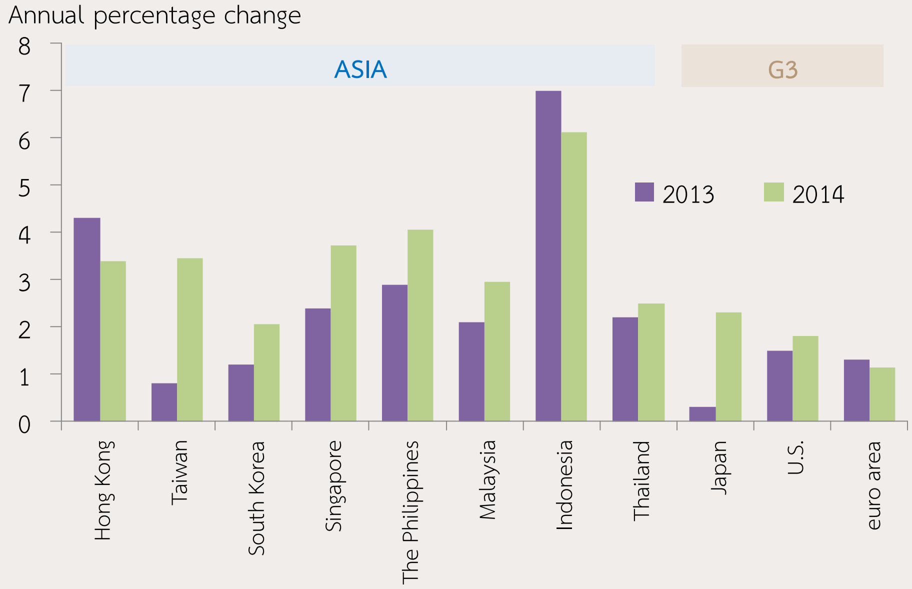
[1/] From regressing $\%\Delta Core\_no_t = f(\%\Delta Core\_no_{t-1}, \%\Delta Core\_no_{t-2}, \%\Delta Output\ gap_t, \%\Delta PPI\ excl.\ petro, \%\Delta Retail\ oil\ price_t, \%\Delta LPG\ price_t)$ using quarterly data during 1996Q1-2013Q4 with potential output calculated using hp trend

[2/] Core inflation excluding government measures

Concerning the role of the exchange rate on inflation, the baht's sharp appreciation from 2012 to the beginning of 2013 caused inflation to slow down to some extent due mainly to lower import price of oil. In the second half of the year, however, despite the baht depreciation, inflation rose only marginally since the government continued to maintain domestic oil prices especially diesel oil which was the main input for the transport and the manufacturing sectors. Moreover, price increases of other goods and services remained difficult owing to the softening domestic economy.

In 2014, global inflation was expected to increase from 2013, owing to firmer recovery in global demand. On the other hand, Thai inflation was likely to edge up largely from uptrend cost pressure, particularly the gradual increase of LPG prices for household. Other supply-side factors that may contribute to higher-than-expected inflation include abolishment of diesel price subsidy, psychological effect on price adjustments particularly prices of prepared food, gradual increases in administered prices.

Inflation Forecasts

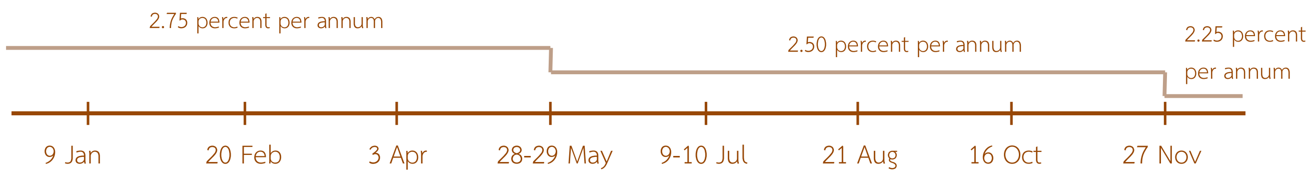


Source: Consensus Forecast, January 2014

7. Important Policies and Measures

Interest Rate Policy

Policy Interest Rate



Monetary Policy Committee (MPC) Meetings in 2013

Sources: BOT News No. 1/2013, 8/2013, 15/2013, 23/2013, 32/2013, 38/2013, 44/2013 และ 51/2013

❍ At the first three MPC meetings of the year on January 9, February 20, and April 3, 2013, the MPC decided to maintain the policy rate at 2.75 percent per annum. This level of policy rate was deemed accommodative enough to support continual economic growth against the backdrop of global economic uncertainty. Meanwhile, risks to financial stability remained from accelerated private credits, household debt and asset prices though inflation continued to be within the target.

❍ At the fourth MPC meeting on May 28-29, 2013, the MPC assessed that risk to growth increased following the substantially lower-than-expected outturn of 2013 Q1 GDP data. Additionally, a number of economic indicators began to trend downwards given the slower-than-expected global economic recovery and the domestic demand slowdown that followed accelerated spending during prior periods. Inflation, however, continued to be within the target. Thus, the MPC decided to reduce the policy rate by 0.25 percent to lend support to the economy.

❍ The MPC continued to maintain the policy rate at subsequent meetings as it was judged that accommodative monetary policy remained appropriate and necessary for Thailand's economic conditions, especially under global economic and financial uncertainties. At the last MPC meeting of the year on November 27, 2013, however, the MPC decided to reduce the policy rate by 0.25 percent to alleviate risk to growth which steepened due to more fragile private sentiment that stemmed from the political situation, given that growth in private credits was slowing down.

Money Market Measures

1. Transactions in Money Market

Measures	Main Points	Effective Date
Change in the regulation pertaining to sales and purchases of Bilateral Repo (BRP) and sales of BOT bonds to primary dealers	Regulations on Bilateral Repo (BRP) transactions were amended to require the use of the policy rate as reference for the interest rate. The change would furnish the BOT with appropriate monetary instrument for continuous conduct of long-term monetary operations. It would also enhance the effectiveness of liquidity management in the money market.	June 21, 2013

Source: BOT Circular No. FMD.(21) W.3/2556

2. Foreign Exchange Control

Measures	Main Points	Effective Date
1) Capital Account Liberalization Master Plan	BOT rules and regulations on capital outflows were eased as follows: (1) allowing individuals to directly invest abroad with no maximum amount limit; (2) allowing institutional and retail investors to invest in foreign instruments and derivatives including foreign currency denominated bonds issued and offered in Thailand with no maximum amount limit, subject to the allocation from the respective regulators /supervisors; and (3) allowing companies and individuals to open foreign currency deposit accounts with domestic financial institutions according to payment obligations abroad with no maximum amount limit on the account balance. The changes would enable domestic firms and savers to enhance efficiency in doing business as well as to diversify investment risk.	June 27, 2013
2) Taking bank notes out of the country	To encourage border trade, the Ministry of Finance increased the limit for taking bank notes out of the country for persons travelling to Vietnam, the Yunnan province of China and Thailand's bordering countries, from 500,000 baht to 2,000,000 baht. The BOT also issued a notification stipulating that persons taking more than 450,000 baht out of the country must declare the fund to the Customs Department.	November 14, 2013

Measures	Main Points	Effective Date
3) Conduct of businesses by authorized persons[1]	The BOT eased requirements on authorized persons as follows: (1) lifting the requirement on authorized persons to sell foreign bank notes purchased from customers to a commercial bank to allow greater convenience and flexibility; and (2) allowing domestic sole proprietorships or incorporated businesses that are either situated at border province or licensed by the Department of Tourism to conduct tourism business and situated in a designated province, to apply to become an authorized person. These changes would increase the flexibility in foreign exchange and payment services associated with border trade.	November 14, 2013

Sources: 1) BOT Circular No. FMD(21) W.69-70/2556 2) BOT Circular No. FMD(21) W.96-97/2556

Credit Measures

Measures	Main Points	Effective Date
1) Factoring business of commercial banks	The BOT authorized commercial banks to conduct unfunded factoring business which is when payment is not made to customers until the debt has fallen due and the debtor has defaulted on such debt. The BOT also revised supervisory rules and regulations to require factoring business of commercial banks to be based on risk and return consideration. Commercial banks must also strictly adhere to generally accepted accounting standards together with related regulations.	January 1, 2013

[1] An authorized person shall mean an individual who is authorized by the Minister of Finance to buy and/or sell foreign currencies and to buy back travelers' cheques

Measures	Main Points	Effective Date
2) Easing supervision of large exposure for high potential or financially strong corporate groups	Supervision of large exposure was eased for high potential or financially strong corporate groups to more accurately reflect risks faced by commercial banks. The capital add-on principle was applied in line with international standards to address greater importance of concentration risk. Starting on April 1, 2013, commercial banks must hold capital add-on for lending, investment, obligation or credit-like transaction that exceeds 25 percent of total capital. The late start was to allow commercial banks time to adjust. Thus, data on capital and capital add-on must be made public from the end of January 2015 onwards.	April 1, 2013

Sources: 1) BOT Circular No. FIPG (23) W.6/2556 2) BOT Circular No. FIPG(23) W.263/2556

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