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TOGETHER WE CAN TRANSFORM THAILAND

THAILAND ECONOMIC MONITOR

LIVING WITH COVID IN A DIGITAL WORLD

December 2021

Executive Summary

WORLD BANK GROUP

EXECUTIVE SUMMARY

Recent Developments

A major surge in COVID-19 cases severely slowed economic activity in Thailand during Q3 of 2021, but a recovery is now underway. The Thai economy contracted by 0.3 percent year-on-year in Q3, and seasonally adjusted output fell by 1.1 percent from Q2 following modest growth in the first half of the year. Thailand's year-on-year contraction in Q3 was the third deepest among regional peers, after Vietnam (-6.2 percent) and Malaysia (-4.5 percent), while the Philippines and Indonesia registered strong growth.[1] Private consumption declined, and the consumption of durable goods was particularly weak. External demand also softened, and global supply-chain and logistics issues disrupted exports and imports of productive inputs. However, recent indicators suggest that activity rebounded in September and October, as the number of new COVID cases per day fell from a peak of over 20,000 in mid-August to an average of fewer than 8,000 by mid-November. Containment measures have been eased, and mobility now exceeds pre-pandemic levels. Meanwhile, indicators of private consumption, consumer confidence, and business sentiment have all ticked upward. Progress on vaccinations has accelerated since August, and the government is now on track to achieve its target of vaccinating 70 percent of the population by the end of the year.

The economy is expected to grow by 1.0 percent in 2021, unchanged from our previous projection published in October. This forecast reflects the persistent weakness in private consumption due to COVID-19 and the expectation that tourist arrivals will remain negligible through to the end of 2021 despite the recent reopening of international borders. On the other hand, goods exports have supported growth amid resurgent global demand, and investment is expected to increase rapidly. Cash transfers, public health initiatives, economic recovery programs, and other forms of fiscal support have helped shore up private demand while supporting consumption among vulnerable households and attenuating the impact of the crisis on poverty.

The current account remained firmly in deficit through the first three quarters of 2021. The goods trade balance continued to show a large surplus of 7.0 percent of GDP in Q3, but the services trade deficit widened from 3.1 percent of GDP in 2020 to 7.2 percent of GDP in the first half of 2021, largely reflecting the collapse of tourism receipts and rising freight costs. The combination of a widening current-account deficit and net outflows on the capital and financial accounts has caused the nominal and real effective exchange rates to depreciate since the end of 2020. However, improved investor confidence has spurred a modest appreciation since the end of September 2021. While international reserves have declined since the beginning of the year, they remain ample at around 10 months of imports and four times the level of short-term external debt.

While the headline inflation rate has risen, core inflation has remained contained, and the Bank of Thailand has maintained the policy rate at 0.5 percent to support the recovery. After dipping to zero in August, the headline inflation rate rose to 2.4 percent in October 2021, due largely to supply-side factors such as rising global oil prices and the impact of flooding on fresh-food prices. However, the core inflation rate remained low at 0.2 percent, and the surge in headline inflation is expected to be temporary due to a large negative output gap (estimated at around 5 percent of potential output)

[1] Growth rates are expressed in year-on-year terms unless otherwise indicated.

combined with well-anchored inflationary expectations. Thailand's experience contrasts with those of other emerging markets, such as the Philippines, Brazil, and Turkey, which are facing elevated inflationary pressures.

The financial system remains stable overall, but asset-quality indicators have deteriorated, and risks associated with increased levels of corporate and household debt remain significant. Capital and liquidity buffers at commercial banks remain well above regulatory requirements, and profitability has stabilized following a significant decline in 2020. However, forward-looking indicators of asset quality have deteriorated. By end-June 2021, the share of nonperforming loans (NPLs) had risen to 3.2 percent of total gross loans, and several of the financial-sector assistance measures introduced by the government may mask underlying vulnerabilities in loan quality. Risks associated with high levels of household debt—which had reached almost 90 percent of GDP at end-June 2021—may be exacerbated by a temporary easing of loan-to-value limits for mortgage lending, with borrowers able to borrow up to 100 percent of a house's value until the end of 2022. Financial weaknesses among small and medium enterprises (SMEs) also continue to pose risks. The NPL ratio among SMEs remained above 7 percent through the first three quarters of 2021, well above pre-COVID levels of 4.5-5.0 percent. The central bank has extended the SME soft-loan facility until the end of 2022, while several businesses have entered debt restructuring through asset-warehousing programs.

The central government fiscal deficit widened to 8.7 percent of GDP in FY21 due to further increases in pandemic-response spending, while public debt increased to 58.2 percent of GDP. As a share of GDP, revenue collection for the full year FY2021 was broadly in line with the last two years at 17.7 percent. On the other hand, spending rose to 26.4 percent of GDP, up from 23.5 percent in FY20 and an average of 20 percent in the three years FY17-FY19. Of the 1.5 trillion baht (9.3 percent of GDP) approved in off-budget borrowing to fund COVID-19 response, government disbursed THB 680 billion (4.2 percent of GDP) in FY2021, more than double the THB 300 billion disbursed in FY2020. The remainder is expected to be disbursed in FY2022. Almost all of the amount disbursed to date has been in the form of relief measures (recurrent spending) rather than capital spending, reflecting the impact of the second and third waves of COVID-19, which set back the timeline for economic recovery and extended the need for household relief beyond what was originally planned.

The poverty rate is estimated to have stabilized in 2021, but a recent phone survey indicates that the pandemic has had a particularly severe impact on vulnerable groups. After rising from 6.2 percent in 2019 to 6.4 percent in 2020, the poverty rate at the upper middle-income poverty line of 5.5 dollars a day (2011 PPP) has remained broadly unchanged in 2021. While an estimated 160,000 people have fallen into poverty since the onset of the pandemic, a comprehensive social and economic response effort has helped contain the increase in the poverty rate. In the absence of government intervention, the poverty rate would now be an estimated 1 percentage point higher, implying that the response effort prevented 700,000 people from falling into poverty. A rapid phone survey of 2,000 adults between April and June 2021 showed that over 80 percent of all households—and an even larger share of low-income households—benefitted from the government's emergency assistance programs. Nevertheless, 60 percent of low-income households reported running out of food. Reported coping mechanisms included reducing food and nonfood consumption, relying on government assistance, tapping savings, engaging in additional income-generating activities, and returning to agriculture in the face of rising urban unemployment.

Outlook and Risks

Economic activity is expected to return to pre-pandemic levels by end-2022, with continued progress on vaccinations and the resumption of tourist arrivals supporting the recovery. The GDP growth rate is projected to accelerate to 3.9 percent in 2022 and reach 4.3 percent in 2023, driven by a recovering service sector. If the current pace of vaccinations (about 750,000 per day) is maintained, and in the absence of a further resurgence of COVID-19, domestic consumer confidence and international tourist confidence are expected to strengthen. Given these conditions, private consumption is projected to expand by just under 4 percent per year in 2022 and 2023, up from an estimated 1 percent in 2021. The number of international tourists is projected to rise to almost 7 million in 2022, with a sharp increase in the second half of the year, before increasing further to around 20 million arrivals in 2023—still just half the 2019 level. Tourism is expected to contribute 2 percentage points to GDP growth in 2022 and 4 percentage points in 2023. The contribution of goods exports to GDP growth in 2022 is projected to be smaller than in 2021, reflecting softening global demand. Fiscal support is also expected to moderate, as most of the COVID response measures will have already been implemented.

Inflation is expected to remain contained, with a substantial output gap persisting in 2021 and 2022. GDP is estimated to remain below potential in 2021 and 2022. The headline inflation rate is projected to remain low in 2022 and gradually rise to 1.3 percent in 2023, reflecting subdued domestic demand and a limited pass-through effect from global oil prices. Consumer-price inflation is unlikely to see a significant surge, with administered prices accounting for approximately one-third of the Consumer Price Index basket. Monetary policy is projected to remain accommodative to support the recovery, with the policy rate remaining unchanged at 0.50 percent in 2022.

While public debt is expected to increase, risks to fiscal sustainability remain manageable. As a result of the government's COVID-19 relief and recovery spending, the public debt stock is projected to peak at almost 62 percent of GDP in 2022, below the debt ceiling, which was recently raised from 60 to 70 percent of GDP. This debt trajectory remains consistent with medium-term fiscal sustainability under a range of scenarios for GDP growth rates, interest rates, and primary deficits over the next few years. Fiscal risks are also mitigated by the fact that the debt stock is largely denominated in local currency and by the availability of sufficient domestic liquidity to accommodate the government's refinancing needs.

Risks to growth are skewed to the downside, as several uncertain variables cloud the outlook. The global trajectory of the pandemic remains unpredictable, and the probability of future waves of COVID-19 within Thailand will depend on continued progress with the vaccination rollout, the effectiveness of vaccines against new strains of the coronavirus, the ongoing implementation of other preventive and testing/tracing measures, and the sustained reopening of international borders. There is also significant uncertainty around how international tourism demand will evolve over the medium term, even if vaccination thresholds are met and COVID-19 cases are controlled, and supply disruptions and logistical bottlenecks could impede the ability of Thai firms to fully benefit from the recovery of global trade. Nevertheless, there is upside potential for a more robust external recovery to bolster trade and investment by creating new opportunities in the market for digitally delivered services that underpin many of the most sophisticated global value chains, as well as expanding global demand for Thailand's current range of exports.

The pandemic shock is expected to inflict lasting scars on productivity and socioeconomic development in Thailand. A decline in capital investment in 2020 diminished potential output, exacerbating the adverse effects of demographic aging and slow factor reallocation. Job losses and school closures will have some longer-term impacts on human capital accumulation, although in contrast to other countries, the substantial government response has helped to prevent large-scale losses in human capital. But firm closures and employee separations are likely to have contributed to the erosion of valuable intangible assets, such as management and technical know-how, employee skills, and workplace networks and relationships. Although investment began to recover in 2021 and is projected to continue increasing through 2022, a simultaneous rise in the levels of corporate and household debt could pose longer-term risks, including risks to the financial sector once existing forbearance measures expire. On the other hand, a deferral of productive investments due to weakened firm balance sheets would reduce potential output over the medium term. To reduce the potential for pandemic-related scarring and address underlying structural challenges, additional interventions are needed. In this context, investing in the digitalization of economic activity offers a valuable opportunity to raise both supply and demand in the short term, while permanently increasing potential output via productivity gains and reduced market frictions.

Building Back Better by Boosting the Digital Economy

The adoption of digital technologies has the potential to support Thailand's post-pandemic recovery while enhancing its competitiveness over the longer term. Pandemic-related mobility restrictions and precautionary behaviors increased the use of digital production technologies and the consumption of digital services. The uptake of digital technologies has bolstered commerce and productivity by more efficiently connecting firms—especially new entrants—to global networks. Digital commerce is an especially important outlet for SMEs in Thailand, as it reduces transaction costs and allows entrepreneurs to reach new markets. In addition, innovative financial technologies can expand access to financing among smaller firms that might otherwise be capital constrained. While the Thai government has already shown a strong commitment to advancing the digital agenda under the banner of industry 4.0, more can be done to develop digital services and the digitalization of businesses.

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Efforts to boost competition and ensure a level playing field are necessary to promote market contestability and increase the interoperability of digital systems. The Thai market for digital services is highly concentrated, with e-commerce dominated by just two large firms. To lower barriers to entry, digital regulations should be simplified and redesigned to encourage the participation of smaller firms. Moreover, recent mergers have revealed opportunities for closer regulatory oversight. At the same time, a lack of interoperability between electronic payment systems constrains the dynamism of the digital services market. Pro-competition regulation is needed to reduce the potential for abuse of market power and encourage interoperability across digital platforms, while mechanisms to promote transparency and expand access to business data could help spur innovation and facilitate the entry of new firms. In addition, expanding provisions to prevent spectrum hoarding would increase the quality of broadband services.

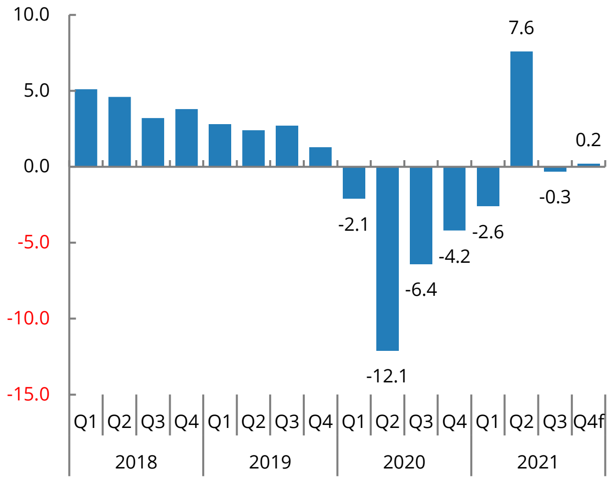
The availability of digital skills, as well as complementary managerial and organizational capabilities, is vital to support digital transformation. Such skills are in high demand, but supply is inadequate, and employer-employee mismatches result in a suboptimal allocation of existing skills. For instance, the private sector requires employees trained in information management, user experience design, integrated systems technology, cloud computing, and the internet of things, but these subjects have not been sufficiently incorporated into the education curriculum. Greater input from the private sector on curriculum design could help align training with employer demand, while enhanced market information and job-placement services could ameliorate skills mismatches. Finally, upskilling and reskilling existing workers could bolster the supply of workforce skills and reduce unemployment.

Expanding access to innovation financing can ease constraints on the adoption of new business models and the uptake of digital technologies, especially by SMEs. Currently, regional venture capital (VC) funds and angel investors have only a limited presence in the Thai market, which deprives startups from regional market experience and customers, access to know-how and networks. Government grants for promoting innovation tend to target small firms, and to exclude mid-sized firms beyond seed stage. The 2020 Bank of Thailand survey revealed that the high costs of technology, a lack of reliable financial statements, and narrow margins all compromised the ability of smaller firms to obtain financing. Peer-to-peer lending and crowdfunding platforms present an opportunity to ease these constraints. A unified legal framework and collateral registry would help strengthen the secured-transactions regime, and the credit-reporting system could be expanded to cover more firms. Finally, a well-formulated policy for open banking would help promote competition and growth of financing for innovation.

Recent Developments and Near-Term Outlook

Figure ES 1: In Q3 2021, the spread of the Delta variant set back Thailand's incipient recovery…

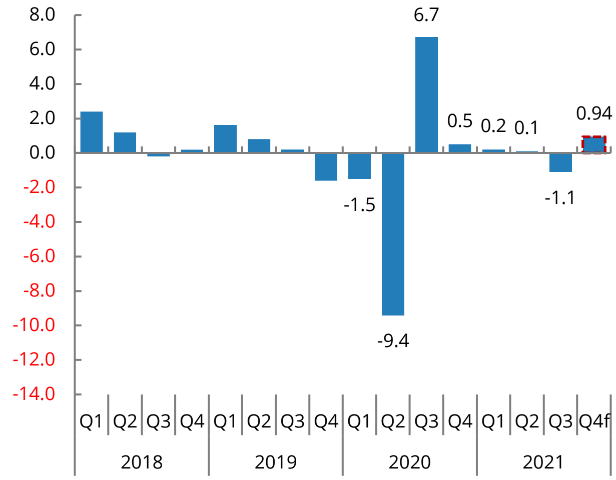
(% change, year-on-year)



Source: NESDC
Note: f is forecasted value

Figure ES 2: …disrupting the country' already weak quarterly growth momentum.

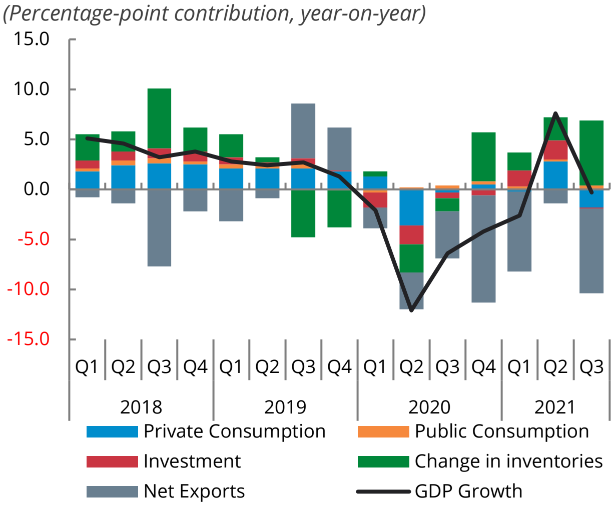
(% change, quarter-on-quarter, seasonally adjusted)



Source: NESDC
Note: f is forecasted value

Figure ES 3: Weak domestic demand and softening global demand dragged down growth in Q3…

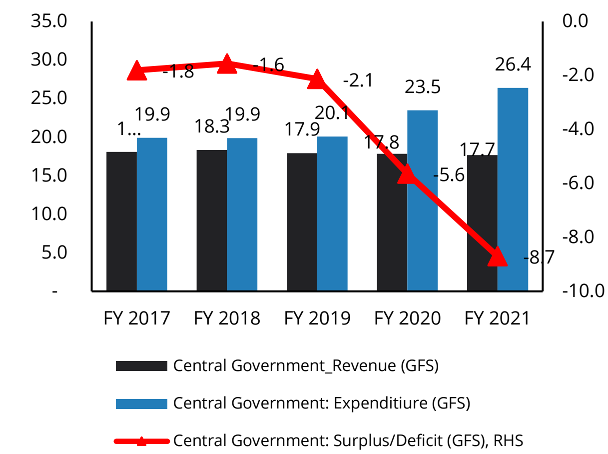
(Percentage-point contribution, year-on-year)



Source: NESDC; World Bank staff calculations

Figure ES 4: …while the pandemic response effort significantly widened the central government deficit.

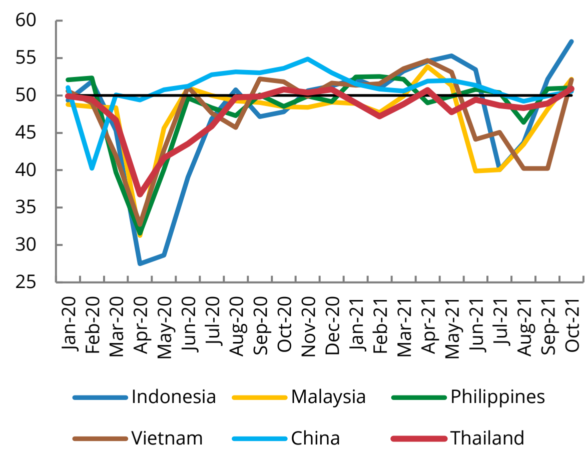
(*Percent of GDP)*



Source: Fiscal Policy Office, Ministry of Finance

Figure ES 5: Recent measures show a rebound in the manufacturing sector…

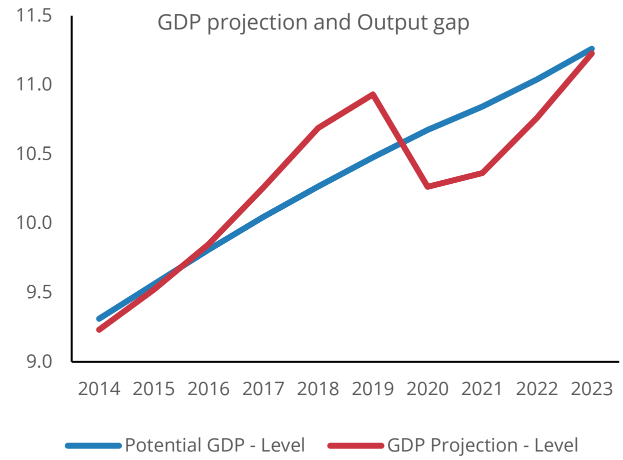
(purchasing manager's index: 50+ shows expansion)



Source: World Bank East Asia and Pacific Update October 2021; Haver Analytics

Figure ES 6: …but the recovery is expected to be protracted, with a negative output gap until 2023.

(THB trillion)



Source: World Bank staff calculations

Table ES 1: Macroeconomic Indicators

	2019	2020	2021f	2022f	2023f
Real GDP Growth Rate (at constant market prices)	2.3	-6.1	1.0	3.9	4.3
Private Consumption	4.0	-1.0	1.0	3.8	3.9
Government Consumption	1.7	0.9	2.5	2.0	-2.2
Gross Fixed Capital Investment	2.0	-4.8	5.6	6.0	3.6
Exports of Goods and Services	-3.0	-19.4	8.5	10.8	8.9
Imports of Goods and Services	-5.2	-13.3	16.6	6.3	6.7
Real GDP Growth Rate (at constant factor prices)					
Agriculture	-0.6	-3.4	1.1	3.8	4.2
Industry	0.1	-5.3	1.4	1.3	1.2
Services	4.5	-6.9	8.8	4.8	3.9
Inflation (Consumer Price Index)	0.71	-0.85	1.1	1.4	1.3
Current Account Balance (% of GDP)	7.0	3.2	-3.4	0.5	2.3
Fiscal Balance (% of GDP)	-2.1	-5.6	-7.8	-4.5	-1.0
Debt (% of GDP)	41.0	49.4	58.8	62.2	61.6

Source: NESDC; World Bank staff calculations

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