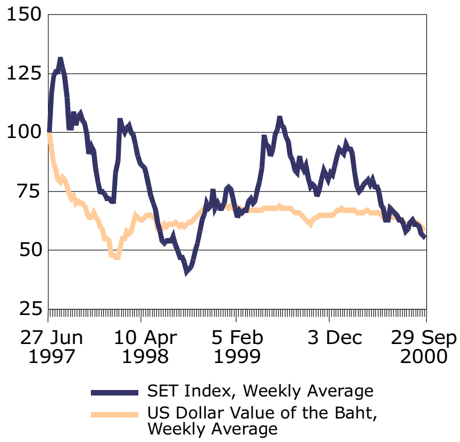
Thailand Update

Asset Markets

Figure 1: **Exchange Rate and Stock Price Indexes**
(last week of 1997June=100)



Source: ARIC Indicators.

The baht has depreciated significantly.

As of end-September 2000, the baht had depreciated by 11 percent since the beginning of the year (Figure 1). The baht's weakness can be attributed mainly to the rise in US interest rates and uncertainties about the pace of economic recovery in the region. Concerns about the timing and outcome of the forthcoming general election, including worries that reforms may be delayed or cancelled, may have also contributed to the decline.

The stock market has also posted substantial losses this year.

Equity values have fallen steadily in 2000. By end-September 2000, the Stock Exchange of Thailand (SET) Index had declined by 42 percent since the beginning of the year. Also the turnover has been relatively thin. The major factors that adversely affected the stock market were the hike in US interest rates, reduced investment weight for Thailand in the MSCI Indexes, continuing concerns over the performance of financial institutions (despite a return to profitability by some), the pace of corporate restructuring, and political uncertainties.

But a better sovereign credit rating by Moody's should help boost investors' confidence.

On 21 June, Moody's raised its rating of Thailand's foreign currency long-term bonds and notes (to Baa3 from Ba1) and foreign-currency bank deposits (to Ba1 from B1), citing an improved balance-of-payments performance. An upgraded credit rating should somewhat help restore confidence among foreign investors.

The worst is over in property markets, but oversupply remains.

Bangkok's office property market remains sluggish due to the supply overhang. But the worst is probably over. The office vacancy rate has declined for five consecutive quarters since early

1999 (Table 1), with many businesses still looking to relocate into newer and better offices in the central business districts. Rentals of Grade A office space have started picking up due to the strong take-up in this segment of the market. However, office vacancy rates are still high compared to other crisis-affected countries. The rate stood at 34 percent in the second quarter of 2000.

Table 1: **Office Property Vacancy Rates in Bangkok** (%)

	98Q2	98Q3	98Q4	99Q1	99Q2	99Q3	99Q4	00Q1	00Q2
Office Property	28.2	28.7	29.7	43.1	42.2	40.3	38.9	36.3	34.0

Source: Jones Lang LaSalle, *Asia Pacific Property Digest,* various issues.

Real Sector

Economic recovery is continuing.

Thailand's rebound from its worst recession in 30 years has continued in 2000. First half GDP growth was 5.9 percent year-on-year. The Government's growth target of 4.5-5.5 percent for the whole of 2000 appears now within easy reach.

Table 2: **GDP Growth and Projections** (%)

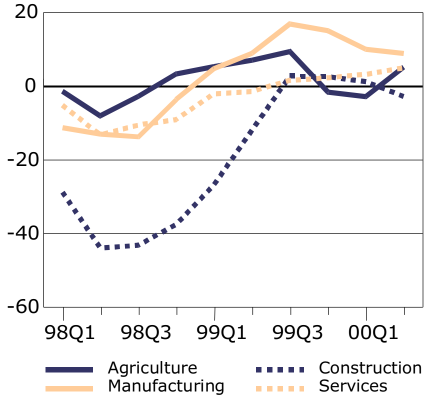
	1997	1998	1999	2000	2001
Official[1]	-1.7	-10.2	4.2	4.5-5.5	4.0-6.0
ADB[2]	—	—	—	4.5	4.6
IMF[3]	—	—	—	5.0	5.0
World Bank[4]	—	—	—	4.5	4.5
Consensus Economics[5]	—	—	—	5.1	4.7

[1]Bank of Thailand, *Inflation Report*, July 2000.
[2]ADB, *Asian Development Outlook 2000 Update*, September 2000.
[3]IMF, *World Economic Outlook*, September 2000.
[4]World Bank, *East Asia's Recovery: Gathering Force—An Update*, 18 September 2000.
[5]Consensus Economics Inc., *Asia Pacific Consensus Forecasts,* September 2000.

The manufacturing sector is still leading GDP growth.

Manufacturing continues to drive output growth, although this has taken place at a slower rate than during the second half of 1999, partly because it is measured from a higher base (Figure 2). The recovery of manufacturing production has been broad based. Output of vehicles, related parts and accessories, elec-

Figure 2: **Sectoral GDP Growth**
(y-o-y, %)

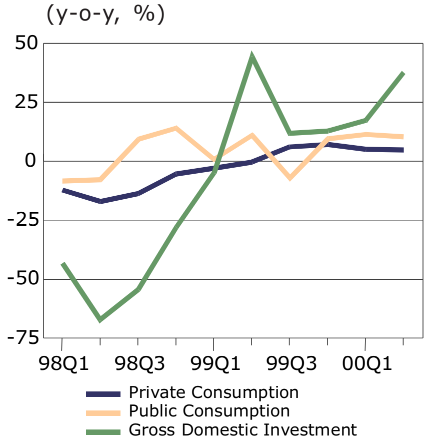


Source: ARIC Indicators.

tronics, and iron and steel production have all expanded in response to the increased demand in the export sector and related industries. Nevertheless, capacity utilization rates have remained below normal levels. After a sizable contraction in the first quarter, the agricultural sector rebounded strongly in the second quarter as weather conditions improved and higher crop prices induced farmers to produce more. To help revive the property market, the Government from 1999 introduced a series of measures, including a reduction in real estate transfer fees, provision of long-term fixed rate credit, and an expanded role for the National Housing Authority in purchasing and completing unfinished housing projects. These have had some impact on the construction sector, which stopped contracting from the third quarter of 1999 and posted modest growth until the first quarter of 2000. In the second quarter, however, the sector contracted again, reflecting underlying conditions in the property market.

Domestic demand has turned.

Figure 3: **Growth of GDP Expenditure Components**
(y-o-y, %)



Source: ARIC Indicators.

Domestic demand has turned in 2000. Public consumption expanded by more than 10 percent in the first two quarters (Figure 3), as the Government continued with its measures to stimulate growth. Private consumption grew at a more moderate pace—at 5.1 percent in the first quarter and 4.8 percent in the second quarter. Despite the Government's measures—including a reduction in value-added and personal income tax rates, and cuts in taxes on petroleum products—declining farm income and cautious consumer sentiment have kept private consumption growth in check. In contrast, gross domestic investment continued to expand strongly, especially in the second quarter of 2000. Investment growth, due mainly to changes in stocks rather than increased fixed investment, has been propelled by strong exports and a recovery in domestic demand.

Fiscal and Monetary Developments

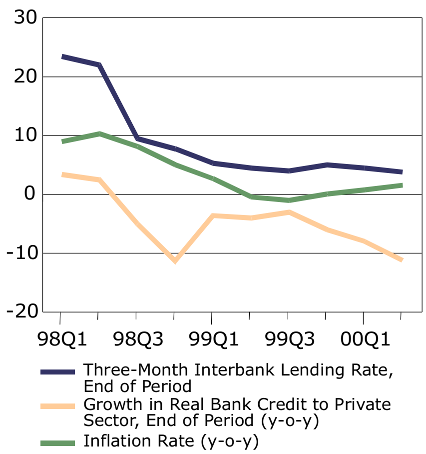
Fiscal deficits continue to support recovery.

In 1999, fiscal policy played an important role in stimulating the economy. Many of the deficit spending measures were directed at stimulating private demand and helping to alleviate the adverse social effects of the crisis. A projected budget deficit of about 4.1 percent of GDP in fiscal year 2000 is expected to further stimulate domestic demand and support economic growth.

But central Government debt has climbed.

Central Government debt has increased sharply in the past three years, from 6.3 percent of GDP in 1997 to 14.5 percent in 1998, 21.1 percent in 1999, and 21.4 percent in the second quarter of 2000. While Government debt has increased and will need to be carefully managed, Thailand's public debt dynamics are currently sustainable.

Figure 4: **Short-Term Interest Rate, Real Bank Credit Growth, and Inflation Rate** (%)



Source: ARIC Indicators.

Inflation remains subdued.

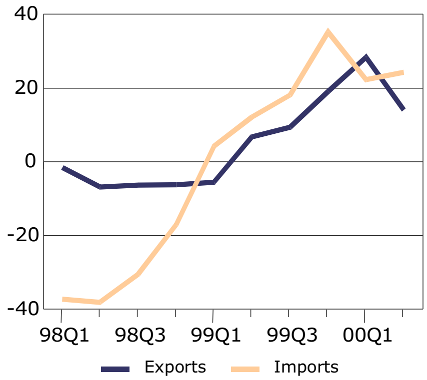
In 1999, consumer price inflation averaged only 0.3 percent, the lowest rate since Thailand started compiling the index more than 50 years ago. Low inflation has allowed nominal interest rates to remain well below their precrisis levels. However, in the second quarter of this year, inflation rose to 1.6 percent, measured year-on-year (Figure 4). Increases in oil prices and the depreciation of the baht contributed to the rise. Baht interest rates have now come off their earlier lows following increases in US dollar interest rates and potential inflationary threats. The Bank of Thailand has recently adopted an explicit inflation targeting system, setting the initial core inflation target quite wide at 0-3.5 percent. The 14-day repo rate will be used to manage variations in liquidity.

Balance of Payments

Although import growth is outpacing export growth, the current account remains in surplus.

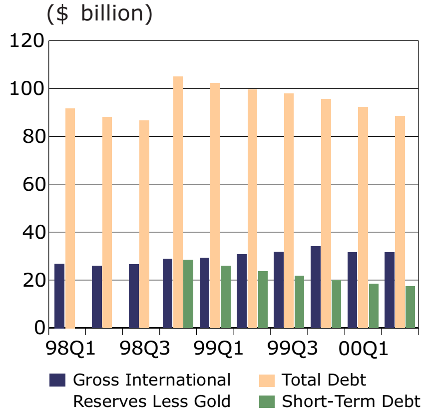
Merchandise exports (in dollars) grew by 20.9 percent (y-o-y) in the first half of 2000 (Figure 5). Meanwhile, import values rose at a higher rate of 23.4 percent, boosted by a recovery in domestic demand and higher international oil prices. The country’s trade surplus in the second quarter narrowed slightly over its corresponding figure in 1999. The trade surplus, combined with rising revenues from tourism in the service and transfer account, led to a current account surplus of $4.7 billion in the first half of 2000.

Figure 5: **Growth of Merchandise Exports and Imports** (y-o-y, %)



Source: ARIC Indicators.

Figure 6: **International Reserves and External Debt** ($ billion)



Source: ARIC Indicators.

Capital outflows offset a larger current account surplus.

Net capital outflows remain sizable. External debt repayments of commercial banks, especially by the Bangkok International Banking Facility, underpinned the capital account deficit. As a result, the balance of payments registered a deficit of $2.5 billion in the first half of 2000. International reserves, meanwhile, declined by $2.85 billion in the first seven months of 2000 to $31.9 billion (Figure 6). Nevertheless, they remain at a comfortable level (about 5.9 months of imports), and provide ample cover for short-term debt.

Total external debt declined and its profile improved.

The private sector's repayment of short-term foreign loans led to an improvement in the maturity structure of the country's external debt. The ratio of short-term debt to total debt fell to 19 percent at end-July 2000, compared to 20.9 percent and 27.1 percent at the end of 1999 and 1998, respectively. Despite an increase in public sector external debt, total external debt continued to decline, decreasing from $95.6 billion at the end of 1999 to $86.1 billion at end-July 2000.

Financial and Corporate Sector Developments

Financial conditions are slowly improving.

The Thai economy has rebounded from the economic crisis but sustaining recovery still depends on continued progress in financial and corporate restructuring. NPLs in the financial system fell to 31.2 percent of total outstanding loans[1] or B1.59 trillion ($39.5 billion) in August 2000 from 39 percent at the end of 1999. The reduction in NPLs largely reflects the progress of corporate debt restructuring and their removal and transfer to newly established AMCs. Profitability is now

[1] 30.9 percent if new international banking facilities and credit foncier companies are included.

returning to some commercial banks. The private sector raised B52.6 billion in the first quarter of 2000 through direct financing from the domestic bond market. In the first quarter of 2000, private bond issuance registered a total of B75.3 billion, of which B55.4 billion were nonfinancial corporate bonds.

Despite these improvements, credit from the banking sector remains tight, with the overall stock of the private sector declining. In part, this reflects provisioning, and the transfer of NPLs to AMCs. But, in part, it also reflects a reluctance to lend in a context of weak bank balance sheets. Credit availability from other sources does, however, seem to be improving. As loans are restructured, firms are more willing to extend trade credit to their customers. This has helped small- and medium-sized enterprises (SMEs). For larger corporates, the debt market is now providing an important source of finance.

Measures were introduced to promote stock market development.

To buoy up the Thai stock market and improve its competitive edge, the Securities and Exchange Commission and SET have introduced measures to increase both the demand for and supply of quality stocks. These measures include (i) expediting public offerings of listed and nonlisted stocks of large state-owned enterprises (SOEs), (ii) expediting the launch of derivatives as risk management instruments, (iii) reducing the trading cost of Internet-related securities and listing fees for listed companies, and (iv) introducing new hedging instruments. In addition, to attract international investors who are unable to invest in the Thai Trust Funds, the issuance of Non-Voting Depository Receipts has been allowed as an option. These measures will contribute to the development of the Thai stock market in the medium and long term. Some intermediate impacts will also be felt, especially as the result of large-size SOE listings and share offerings, promotion of Internet trading, and reductions in commission fees.

Prospects and Policy Issues

GDP growth is back on track and likely to grow more than 5 percent this year.

The latest Consensus Economics (September 2000) projections suggest that GDP could grow by 5.1 percent in 2000. The generally positive outlook is based on the presumption of continued growth of exports, recovery of investment, and further progress in financial and corporate restructuring. However, risks remain. A high level of public debt, recalcitrant debtors, rising oil prices, slower than anticipated privatization, and the uncertainty created over the timing and outcome of the pending election could all blunt growth. Concerns are increasing that further reforms may be delayed or cancelled and that the most difficult restructuring cases are yet to come. Nevertheless, 2000 should see further consolidation of the recovery process. Consensus Economics projects a slowdown in growth to 4.7 percent in 2001.

Growth may help fiscal balances.

Deficit spending measures have helped to kick-start recovery in Thailand. A substantial deficit is again programmed for 2000-2001 to sustain economic growth until private investment and consumption have gathered more momentum. It is anticipated that, as growth accelerates, fiscal revenues will grow. In a low interest rate environment, this will help the Government reduce the budget deficit and bring down debt.

Slow financial restructuring could hamper recovery.

Even though the Thai economy has shown overall improvement, the recovery is not yet broad based. Farm incomes are falling, many SMEs are struggling, and there is still a substantial amount of debt to be resolved. The pace of bank and corporate restructuring will have a crucial influence on getting credit flowing again and putting growth on a faster track. Although NPLs have of late shown an encouraging decline, they remain high. A 25 percent NPL ratio has been set as the target for year-end 2000. One concern is that the most problematic cases are yet to be resolved. There is also a growing number of cases that will be referred by CDRAC for legal settlement.

Confidence in the legal framework for insolvency is vital for speedy corporate restructuring.

Although there has been some progress in corporate debt restructuring, settlements are concentrated on large firms. Medium and small loans and their underlying assets are being restructured slowly, and markets for distressed assets are not clearing. The corporate restructuring completion ratio is high for services and export sectors and relatively low for the real estate (including construction) and manufacturing sectors.

Despite new bankruptcy laws and promised further legal reforms, creditors appear to be not yet sufficiently empowered. The framework for insolvency is still biased in favor of debtors and the costs of pursuing bankruptcy actions are high. Nevertheless, the headline ruling on the case of Thai Petrochemical Industry in mid-March 2000 signals the bankruptcy courts' willingness to back creditors (Box G). Debtors and creditors now have a better understanding of the bankruptcy law and are more confident about legal protection. More debtors are filing petitions to protect their businesses. Steps are needed to ease congestion in bankruptcy courts and to redress the features of the bankruptcy law that still seem to work against creditors.

Box G: **Bankruptcy Law Reform—The Landmark TPI Insolvency Case**

The financial crisis has highlighted the need for an overhaul of Thailand's insolvency framework; to this end, the Government has designated reform of bankruptcy laws a priority.

Thailand's old insolvency framework allowed only for "liquidation" when resolving credit disputes through the courts. The revised bankruptcy law, enacted in 1999, introduces a second mechanism, "reorganization," modeled on the US's Chapter 11.

The purpose of the new mechanism is to prevent viable businesses that suffer liquidity problems from being driven to bankruptcy. Under this framework, either a creditor or debtor can petition for protection under reorganization supervised by the courts. The petition will activate a moratorium to prevent secured and unsecured creditors from pursuing their claims or filing a bankruptcy petition. If the court is satisfied that the debtor is insolvent but has the potential to be rehabilitated, it may order reorganization. If the reorganization fails to help the business, the court could then declare the business bankrupt and order liquidation under the bankruptcy law.

The revised law provides weak protection for creditors, as the test for insolvency uses the balance sheet criteria, namely, "liabilities exceed assets," as opposed to the more appropriate criteria of "ability to pay when the debt falls due." If a company can prove that the value of its assets exceeds liabilities, even if its cash flow cannot service current debts, it may not be ruled to be insolvent. The bias against creditors under the existing insolvency system has often been cited as one of the reasons for the slow progress of bank and corporate restructuring in Thailand.

However, a ruling on the Thai Petrochemical Industry (TPI) Plc insolvency case in March this year was hailed as a landmark in financial and corporate reform in Thailand. TPI had been negotiating with creditors, led by Bangkok Bank, to restructure outstanding debt of about B120 billion ($3 billion). In January 2000, Bangkok Bank filed a reorganization petition at the Central Bankruptcy Court, which TPI contested the following month, arguing that it was not insolvent because the value of its assets exceeded liabilities. The court, however, ruled in favor of the petitioning creditors that as TPI could not service its debts, it was, in effect, insolvent.

This positive development is expected to encourage more insolvent companies to proceed with formal insolvency and help create the kind of business culture that is needed in corporate Thailand. However, the insolvency test is still at the court's discretion and the TPI case should not be regarded as a legal precedent for defining insolvency under the more appropriate "ability to pay" criteria. Further reforms to the insolvency system will be required.

Sources: *Thailand Economic Monitor*, World Bank, June 2000; and Comment: Thai Bankruptcy Court Decision on TPI—Implication for Thai Banks, Fitch IBCA Ratings, 15 March 2000.

Thailand: Selected ARIC Indicators

	1996	1997	1998	1999	98Q1	98Q2	98Q3	98Q4	99Q1	99Q2	99Q3	99Q4	00Q1	00Q2
Output and Prices														
GDP Growth (%)	5.9	-1.7	-10.2	4.2	-7.5	-13.7	-12.8	-6.8	0.2	2.5	7.8	6.5	5.3	6.6
Private Consumption Expenditure Growth (%)	6.8	-1.1	-12.3	2.4	-12.3	-17.1	-13.7	-5.4	-2.9	-0.3	6.1	7.1	5.1	4.8
Public Consumption Expenditure Growth (%)	9.5	-0.9	1.9	2.8	-8.4	-7.8	9.2	14.0	0.8	11.0	-7.1	9.6	11.4	10.4
Gross Domestic Investment Growth (%)	6.8	-23.1	-49.3	12.6	-43.2	-67.3	-54.3	-28.0	-4.9	44.3	11.9	12.9	17.3	37.6
Agricultural Sector Growth (%)	3.8	0.6	-1.3	4.0	-1.3	-8.0	-2.7	3.4	5.4	7.1	9.4	-1.6	-2.8	5.2
Manufacturing Sector Growth (%)	6.7	0.8	-10.5	11.3	-11.2	-13.0	-13.7	-3.6	4.7	9.0	16.9	15.1	10.1	9.0
Construction Sector Growth (%)	7.2	-26.7	-38.8	-8.7	-28.7	-43.9	-43.1	-37.4	-26.7	-11.8	2.8	2.6	1.3	-2.8
Services Sector Growth (%)	5.3	-1.4	-9.5	0.1	-5.2	-13.1	-10.5	-9.0	-2.0	-1.4	1.6	2.4	3.3	5.0
Exports of Goods and Services Growth (%)	-5.5	8.4	6.7	9.6	15.0	8.9	5.7	-1.2	-0.6	4.5	13.9	20.4	21.1	15.2
Imports of Goods and Services Growth (%)	-0.5	-11.4	-22.3	16.7	-27.1	-28.4	-21.9	-10.1	-2.8	22.0	20.1	26.3	45.1	16.0
Inflation Rate (%)	5.8	5.6	8.1	0.3	9.0	10.3	8.1	5.0	2.7	-0.4	-1.0	0.1	0.8	1.6
Unemployment Rate (%)	1.1	0.9	4.4	4.2	4.6	5.0	3.4	4.5	5.2	5.3	3.0	3.3	4.3	4.2
Monetary and Fiscal Accounts														
Growth of Broad Money, M2 (%)[1]	12.6	16.5	9.7	5.4	15.7	13.8	12.7	9.7	8.6	6.2	3.4	5.4	4.1	. . .
Three-Month Interbank Lending Rate (%)[1]	. . .	26.0	7.8	5.0	23.5	22.0	9.5	7.8	5.3	4.5	4.0	5.0	4.5	3.8
Growth in Real Bank Credit to Private Sector (%)[1]	9.4	13.6	-11.3	-6.0	3.4	2.5	-5.0	-11.3	-3.6	-4.0	-3.0	-6.0	-8.0	-11.2
NPL Ratio of the Financial System[1]	. . .	. . .	45.0	38.9	. . .	32.7	39.7	45.0	47.0	47.4	44.7	38.9	37.3	32.0
NPL Ratio of the Commercial Banking System[1]	. . .	. . .	42.9	38.6	. . .	31.0	37.9	42.9	46.2	46.5	43.9	38.6	36.9	31.8
Average Stock Price Index	1,167.9	597.8	353.9	421.1	473.1	361.5	246.0	335.0	357.1	461.8	450.5	415.0	432.7	358.2
Central Government Fiscal Balance as % of GDP	0.9	-0.3	-2.8	-3.3	0.0	0.6	-8.5	-3.4	0.0	-4.2	-4.1	-4.9	-1.5	. . .
Central Government Debt as % of GDP[1]	. . .	6.3	14.5	21.1	5.4	9.1	10.2	14.5	18.5	19.6	20.6	21.1	20.7	21.4
Government Expenditure on Education (% of Total)	22.2	23.9	25.2	25.1	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
Government Expenditure on Health (% of Total)	6.9	7.3	7.8	7.3	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
External Account, Debt, and Exchange Rates														
Growth of Merchandise Exports ($ fob, %)	-1.3	3.4	-5.7	7.7	-1.5	-6.8	-6.3	-6.2	-5.5	6.8	9.4	19.1	28.4	14.0
Growth of Merchandise Imports ($ cif, %)	2.2	-15.2	-30.1	17.5	-37.3	-38.1	-30.5	-17.1	4.2	12.1	18.2	35.3	22.3	24.4
Current Account Balance as % of GDP	-8.1	-1.9	12.5	8.9	16.0	10.1	12.3	11.8	10.4	8.5	8.9	7.7	. . .	. . .
Net Foreign Direct Investment ($ Billion)	. . .	3.3	7.4	5.9	2.2	2.5	1.4	1.2	1.0	1.9	1.2	1.8	0.8	0.7
Net Portfolio Investment ($ Billion)	. . .	4.4	0.4	0.4	0.5	-0.1	-0.1	0.0	-0.1	0.1	0.2	0.2	0.3	0.2
Gross International Reserves Less Gold ($ Billion)[1]	37.7	26.2	28.8	34.1	26.9	25.8	26.6	28.8	29.2	30.7	31.6	34.1	31.6	31.5
Total External Debt as % of GDP[1]	59.8	70.3	93.1	76.9	67.3	73.9	78.3	93.1	85.9	82.1	78.6	76.9	73.6	69.6
Short-Term Debt as % of Gross International Reserves[1]	. . .	146.3	98.7	58.6	. . .	. . .	. . .	98.7	88.0	76.8	68.7	58.6	58.4	55.7
Short-Term Debt as % of Total Debt[1]	. . .	. . .	27.1	20.9	. . .	. . .	. . .	27.1	25.1	23.7	22.2	20.9	20.0	19.8
Real Effective Exchange Rate (1995=100)[2]	109.2	102.4	90.0	93.5	77.3	92.5	93.5	96.8	97.3	97.5	91.9	87.4	92.0	89.3
Average Exchange Rate (Local Currency to $)	25.3	31.4	41.4	37.8	47.1	40.3	41.1	37.0	37.1	37.2	38.3	38.8	37.7	38.7

Note: All growth rates are on a year-on-year basis.
. . . = not available.
[1] End of period.
[2] Trade weighted using wholesale price index for trading partners and consumer price index for the home country.
Sources: Data on output and prices, merchandise exports and imports, nonperforming loan ratios of the financial and commercial banking system, central government debt, total and short-term external debts, net foreign direct and portfolio investments, and government expenditure on education and health are from national sources. Data on M2, real bank credit to private sector, central government fiscal balance, current account balance, and gross international reserves are from the International Monetary Fund, *International Financial Statistics*. Data on interbank lending rate, average stock price index, and average exchange rate are from Bloomberg LP. Real effective exchange rates are based on ARIC calculations.