

Turmoil in Thailand: impacts on economy and insights from the ground

On the 22 January the Thai government declared a State of emergency in the capital Bangkok in response to antigovernment protests that currently are going on in the city.

On the same day the Central Bank Monetary Policy Committee decided to maintain the policy interest rate at 2,25% per annum, even though there was the possibility of another rate cut after the first one occurred the previous November.

The street protests have worsened during the month and the government decided to call a snap general election, scheduled for 2 February. The opposition has already announced that they're going to boycott the elections. This means that political deadlock and protests are unlikely to end with the elections.

Reasons for the protests. Thailand has always been characterized by political instability (18 coups have occurred since 1932) and the population is divided into two main factions: i) the *red shirts* (mainly rural voters) that support the government and the prime minister Yingluck Shinawatra, leader of the Pheu Thai Party and sister of Thaksin Shinawatra (former prime minister currently in self-exile in Dubai, ousted by the military in a 2006 coup); ii) the *yellow shirts*, lead by the opposition Democratic Party, loyalist and close to the Thailand elite and the army.

Riots began last November, when the government proposed an amnesty bill that would have allowed Thaksin Shinawatra (found guilty on corruption charges) to return to the country. The yellow shirts claimed that Thaksin is using his sister Yingluck as a proxy to continue running his political and business empire from abroad, and gathered in the street asking for the prime minister's resignation. Protests were originally peaceful but violence has escalated recently: a Thai anti-government protest leader was shot and killed in Bangkok on Sunday 26th of January, as demonstrators blocked early voting in many areas of the capital ahead of the disputed election next week. However the demonstrations are not spreading through the country and remain in the capital Bangkok.

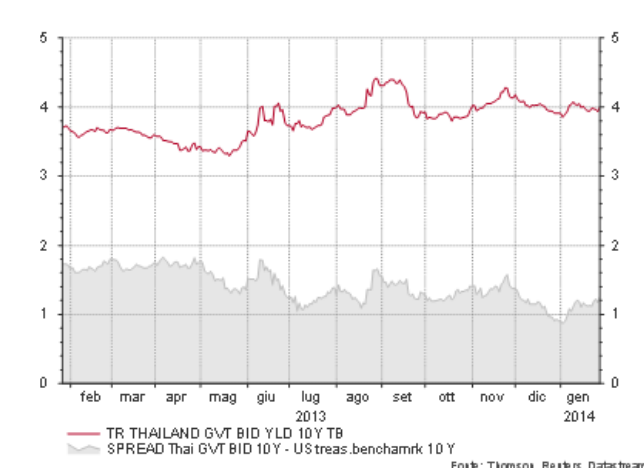
Impact on the economy. Thailand's macroeconomic fundamentals are still positive: a contained inflation, a small fiscal deficit and a strong position in foreign currency reserves. Nevertheless GDP growth is slowing (third-quarter real GDP growth declined to 2,7% y/y from 5,4% in the first quarter¹) because of a decrease in tourist arrivals, a weak external demand and the expiry of some domestic stimulus programs that were taken in 2012. Prolonged or escalating protests could also undermine investor confidence, affecting both local and foreign investments, and exacerbate delayed public infrastructure investment.

The Central Bank surprisingly cut the interest rate in November 2013 by 25 b.p., trying to boost economic growth. As a consequence of growing protests and flagging economic prospects, another cut was expected on the 22 January, but the Monetary Policy Committee members voted four-to-three against the decision, leaving interest rates at 2,25% because the Bank of Thailand considers "...the current stance of monetary policy to be accommodative and appropriately supportive of economic recovery...the Monetary Policy Committee will closely monitor developments of the Thai economy and stand ready to take appropriate actions as warranted²".

Financial market reactions. Government bond 10-year yields rose very slightly in November and the spread against the US treasury benchmark is still low (122 b.p.), while the stock exchange was more affected, with the SET index losing 9% between November 2013 - January 2014.

The exchange rate movement needs to be strictly monitored: the Thai baht dropped to its lowest level in almost four years and political instability could put pressure on the exchange rate. Further depreciation could undermine investor confidence, leading to a decrease in foreign capital inflows, deterring foreign direct investments and, accordingly, future economic growth prospects.

Thai government 10y bond yields



Source: Datastream Thomson Reuters

Exchange rate (USD/Thai Bath)



Source: Datastream Thomson Reuters

Insights from the ground. After a two-year period of political stability, Thailand faced a 2013 full of turbulence especially during the last quarter. People who live and do business in Thailand, especially in Bangkok, are quite used to demonstrations and disorder. During the recent crisis in 2008, the People's Alliance for Democracy (PAD) staged a disruptive demonstration in Bangkok causing the closure of the international airport, which hosts 14.5 million tourists each year. All flights to and from Thailand's main airport were suspended for two weeks. Protests turned inner Bangkok into a war zone in 2010. Although more than 90 people died in another protracted bout of political unrest, foreign direct investment jumped 88% that year, the stock market surged 41% and the economy bounded ahead by 7,8%. This time, however, the protests have already lasted for three months and have disrupted government operations.

It's important to consider that Thailand is the biggest car market in Southeast Asia as well as a regional production and export base for top manufacturers such as Toyota, Nissan Motor and Ford Motor. Furthermore, some foreign companies such as Honda Motor which overcame catastrophic flooding in 2011 still have a positive outlook going beyond 2014. "New potential investors may be spooked by the political woes," said Pitak Pruttisarikorn, its executive vice-president. "For Honda, we have been in Thailand for more than 50 years and we are still confident in Thailand's long-term outlook." It is likely political instability will prevent investment flow this year. "Foreign direct investment probably totaled almost \$13 billion in 2013 but could drop to less than \$8 billion in 2014 even if tension eased and investors returned in the second half", said Pimonwan Mahujchariyawong, an economist at Kasikorn Research Center in Bangkok. Toyota, the largest car manufacturer in Thailand, may reconsider investing up to 20 billion baht (\$609 million) in the country, and could even cut production, if the current political crisis goes on longer (as the head of the Japanese automaker's local unit said on Monday).

Banks, institutions and corporate representatives based in Bangkok confirmed that the protests have been mostly limited to well-defined zones (downtown), the city's markets, malls, administrative offices and temples remain open. The elevated rail system as well as the subway and taxis are working as usual and capacity has increased to cope with demand from commuters and tourists (thousands of tourists are expected from China, Taiwan and Hong Kong during the lunar new year holiday that starts this week). Companies are manufacturing their goods as usual in industrial zones far from downtown Bangkok and the protest sites. The two factions, the *red shirts* and the *yellow shirts*, have not yet clashed face to face because the Government has managed to keep them under relative control.

Some countries, including the United States, Malaysia, Australia and the Philippines, have issued travel alerts for Thailand due to fears of political instability. The Minister of Tourism and Sports said recently that arrivals will fall by half to 1 million this month (the revenue loss could amount to 22,5 billion baht or \$685 million). People are still visiting other parts of Thailand. Bookings to Thai destinations including Chiang Mai in the north, as well as beach resorts including Koh Samui and Phuket have helped offset a decline in demand in Bangkok.

The main effect of the political crisis in the short term could be the six to twelve month delay of public infrastructure investment. The huge amount of public investments was one of the key points in the Government's latest 10 year plan. The total spending plan was around 2 trillion baht (almost \$62 billion) to upgrade various infrastructure: 43% for high-speed trains linking Southeast Asia to China, 25% for Bangkok metro/subway, 14% for road upgrades, 14% for train (non-high-speed) upgrades, 2% for marine ports as well as 2% for cargo stations and custom houses at borders. The previous Thai government had a goal to reduce logistic costs per GDP by 2% (currently at 15,2%) and gradually shift the transport model from road to rail. The only project which is currently carried out by the government is the train (non-high-speed) upgrade. The high-speed train project was also attractive for various Italian construction companies. ICE has recently cancelled a workshop focused on high-speed trains in Thailand.

The slowdown of GDP growth in the last months of 2013 is much more related to the decline of Thai exports (-0,02% comparing Jan-Oct 2013 with Jan-Oct 2012) than to the political instability of the country. The main drop is attributed to the exports of agro-industrial products (-4,7% y/y) as well as mining and fuel products (-6,03% y/y). The trade flows from Thailand to Japan have decreased approximately 6% as of October 2013 in comparison to the same period in 2012³.

Sunday 02 February is a crucial date for Thailand. Although the anti-government protesters are boycotting Sunday's poll, saying reforms are needed before the vote, the Government is remaining firm with the election date. If elections proceed there are widespread fears that tensions could escalate.

¹ Source Moody's.

² Monetary Policy Committee's Decision n° 2/2014, 22nd January 2014.

³ All data provided by Thai Ministry of Finance (Information and communication technology center with cooperation of the customs department).