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THAILAND

2012 ARTICLE IV CONSULTATION

June 2012

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2012 Article IV consultation with Thailand, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on February 24, 2012, with the officials of Thailand on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 12, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the IMF.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its April 27, 2012 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Thailand.

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THAILAND

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

April 12, 2012

KEY ISSUES

Context. Thailand is recovering from historic floods that inundated a large portion of the country, cost lives, destroyed physical capital, and halted production in the last quarter of 2011. Despite uncertainty about the evolution of the global economy, the Thai economy is expected to rebound sharply. The key challenge now is to rebuild the country, while maintaining macroeconomic stability and sowing the seeds for stronger and more wide-spread growth.

Outlook and risks. As reconstruction picks up and investment recovers, staff projects a V-shaped recovery with GDP growing by 5.5 percent in 2012 and 7.5 percent in 2013. Downside risks to the outlook are significant. The Thai economy remains vulnerable to weak growth in its trading partners. Domestically, political tensions and underperformance of government spending on reconstruction could adversely affect private investment.

The policy mix of monetary easing and fiscal stimulus will provide welcome support to domestic demand in the near term, but a gradual unwinding is called for over the medium term**.** The effectiveness and cost of fiscal measures should be carefully monitored to ensure that their income redistribution objectives are achieved in an efficient manner. Revenue-enhancing measures might be necessary to achieve these objectives while maintaining fiscal sustainability.

The financial sector remains sound but the governance of Specialized Financial Institutions needs to be improved.

Making growth more inclusive is a key priority of the authorities. Higher wages need to be accompanied by increases in productivity to avoid hurting competitiveness.

Approved By
Jerald Schiff and Dominique Desruelle

Discussions took place in Bangkok during February 13–24, 2012. The staff team comprised Messrs. Rumbaugh (head) and Yoshida, and Mmes. Yontcheva and Oner (all APD). Mr. Chia (OED) attended the concluding session and Mr. Poonpatpibul (OED) participated in key policy meetings.

CONTENTS

BOXES

APPENDIXES

INTRODUCTION

1. **Thailand is recovering from a very challenging year marked by natural disasters of historic magnitude.** First, the Japanese earthquake and tsunami affected manufacturing output via supply chain disruptions in 2011:Q1. Shortly after the economy recovered, massive floods brought the manufacturing sector to a standstill. Total losses are estimated at about 3 percent of GDP. On a yearly basis, GDP growth shrank from 7.8 percent in 2010 to a barely positive 0.1 percent in 2011. However, the Thai economy is expected to rebound sharply in 2012. Positive signs of a recovery are already under way with sharp improvements seen in high frequency indicators since December 2011. However, amidst uncertainty about the evolution of the global economy and the success of flood-prevention measures, downside risks to the outlook are significant.

2. **Public policies are targeting income redistribution and flood prevention.** A new government took office in August 2011 with policy priorities geared toward making income distribution more equal and rebalancing growth toward domestic consumption. In response to the devastating floods in 2011:Q4, the government added plans to invest in flood prevention and boost reconstruction-led recovery. In response to the floods and the weak external environment, the Bank of Thailand (BOT) halted its gradual normalization policy and lowered the policy rate twice by a cumulative 50 basis points in November 2011 and January 2012.

3. **Against this backdrop and amidst heightened uncertainty about the global outlook, the discussions focused on the challenge of rebuilding the economy in the near term, and restoring confidence while maintaining macroeconomic and fiscal stability and promoting inclusive growth.** The authorities and staff agreed that expansionary fiscal policies came at an opportune time to help offset weak world demand. However, beyond FY 2012, the authorities should gradually unwind the supportive policy stance and move to a medium-term consolidation path that is consistent with their commitment to fiscal sustainability. Staff advised that their commitment to maintain sound public finances could be usefully underpinned by formalizing the current operational medium-term fiscal guidelines. In addition, the effectiveness and fiscal cost of income redistribution policies, in particular the price interventions in the rice market, need to be carefully monitored while increases in labor productivity will be necessary to maintain competitiveness as the authorities gradually increase minimum wages. Similarly, the BOT’s accommodative stance is appropriately supporting the economy but normalization should resume once the recovery is under way.

ECONOMIC CONTEXT

A. Macroeconomic Developments: Recovering from Negative Shocks

4. **Thailand faced unprecedented adverse shocks in 2011.** In tandem with the region, Thailand promptly recovered from the global financial crisis and its growth performance remained robust till 2011:Q1. However, natural disasters pummeled the economy thereafter. First, the earthquake in Japan in March disrupted supply chains and slowed down production, albeit temporarily. Then, the country was inundated by massive floods that began in August and worsened in October–November, slowing the economy to a near halt (Figure 1). In the last quarter of 2011, output contracted by 10.75 percent (quarter-on-quarter), a larger contraction than ever recorded, bringing annual growth down to 0.1 percent. Manufacturing industries such as the automobile and electronics sectors were particularly badly affected (Box 1) but agriculture and tourism also suffered. Given the tightness of the labor market, unemployment remained subdued in spite of a drop in capacity utilization as enterprises kept employees on the payroll to avoid labor shortages in the recovery period. For the economy as a whole, the output gap which had closed earlier in 2011 turned negative again in 2011:Q4.

5. **The balance of payments surplus narrowed.** Flood-related supply-side bottlenecks and weaker external demand slowed exports down while the second half of 2011 saw some volatility in financial markets prompted by the global financial turmoil. Accordingly, the current account surplus declined to 3.4 percent of GDP compared to 4.1 percent in 2010 and the financial account moved to a deficit of 2 percent from a surplus of 7.5 percent of GDP leading to a modest increase in international reserves to 206 billion as of the end of 2011.

6. **The relatively high inflation in 2011 has slowed down.** Energy price hikes, flood-related food shortages and accommodative macroeconomic policy stances all played a role in keeping prices relatively high. Headline inflation was above 4 percent year on year (y/y) from April through November 2011, until falling in December to 3.5 percent as the flood-related supply shortages abated. Similarly, core inflation doubled from the previous year to almost 3 percent (y/y) over the same period, remaining close to the upper band of the BOT's inflation target until falling to 2.75 percent in December.

7. **The recovery is already under way** with sharp improvements seen in high frequency indicators since December 2011. Manufacturing output surged in December even though there are variations in the pace of recovery across industries. Confidence indicators almost reached their pre-flood levels even though concerns of renewed floods when the rainy season begins in June weigh on investor sentiment.

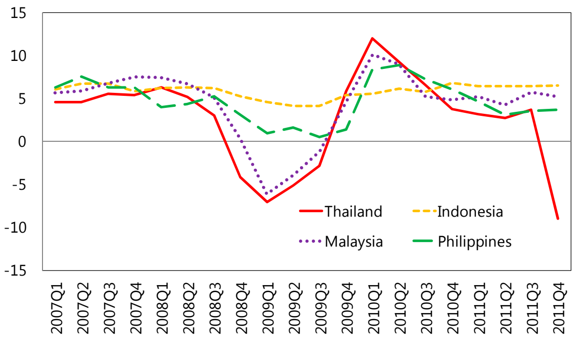
8. **Fiscal policy is supporting recovery.** In FY2011, general government revenue slightly increased by 0.3 percent of GDP from FY2010 (October–September), with increases in income and consumption taxes from the economic recovery more than offsetting the revenue loss from the diesel fuel excise tax cut that was in effect since April 2011. General

Figure 1. Thailand: Economy Hit by Shocks

Thailand's economic growth remained in line with the region until 2011…

GDP Growth

(Year-on-year percent change)

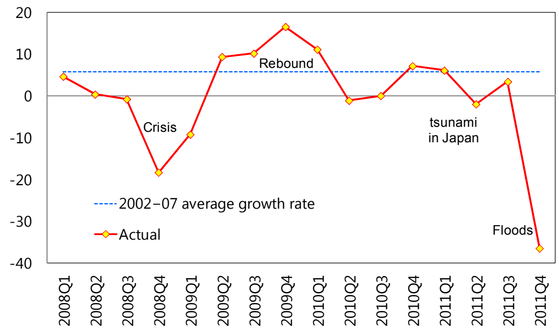


Source: CEIC Data Co. Ltd.

…when first the tsunami slowed production and then domestic floods brought the economy to a near halt

Real GDP Growth

(Seasonally adjusted annualized rate)

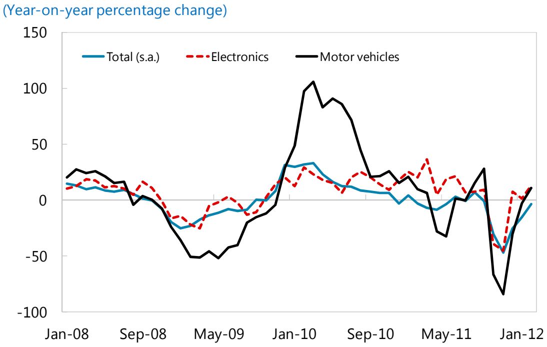


Sources: CEIC Data Co. Ltd; and IMF staff estimates.

Electronics and automotive industries were particularly hard hit…

Value-Added Production Index

(Year-on-year percentage change)

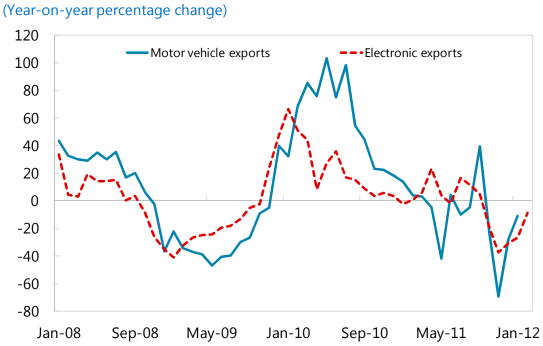


Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

….lowering exports of these sectors significantly.

Exports

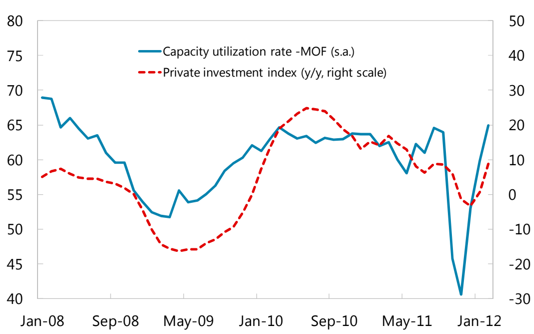
(Year-on-year percentage change)



Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

Capacity utilization fell to an all-time low in October–November but production restarted rapidly…

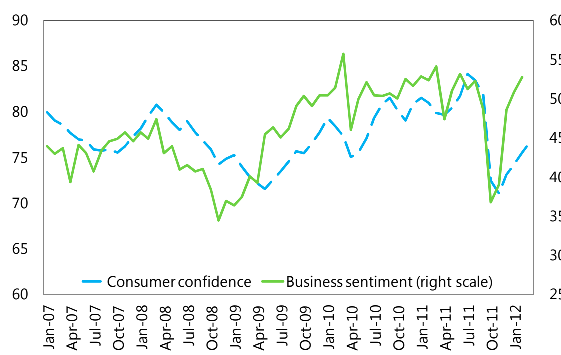
Capacity Utilization Rate and Private Investment Index



Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

…and confidence indicators have rebounded markedly.

Consumer Confidence and Business Sentiment Index



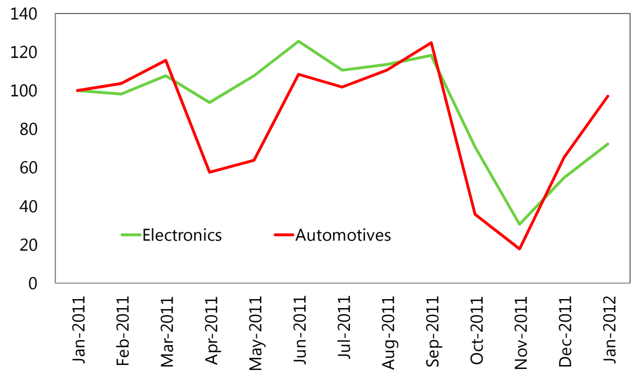
Source: CEIC Data Co. Ltd.

Box 1. Thailand: From Earthquake to Floods – A Challenging Year

As Japan is a key source of sophisticated intermediate and capital goods for Thailand (up to 92 percent for some components), Thailand was particularly affected by the March 2011 earthquake in Japan. The specialization and concentration of upstream manufacturers made substitution away from Japanese suppliers difficult in the short run and most Thai firms needed to temporarily scale back production. However, the bottle-neck impact was short-lived and production started catching up in June 2011.

From August through November 2011, Thailand experienced exceptionally severe inundations that significantly curtailed growth in the last quarter of 2011, bringing down annual GDP growth to 0.1 percent from 7.8 percent in 2010. About one-third of the country experienced flooding, including two key manufacturing provinces producing automobiles and electronic components. Seven industrial parks and 14,000 companies have been affected, and several major factories halted their production. Some global producers such as Honda and Sony reported disruptions to their global network. Agricultural output also fell with up to 7 million tons of rice having been destroyed (almost half of the expected Q4 harvest). So far, the flood-related damages are estimated to be around 3 percent of GDP. Manufacturing production picked up in December but the long-term consequences will depend on how rapidly the private sector can return to full capacity production and whether some businesses decide to relocate.

Manufacturing Production
(January 2011=100)



Sources: CEIC Data Co. Ltd; and IMF staff estimates.

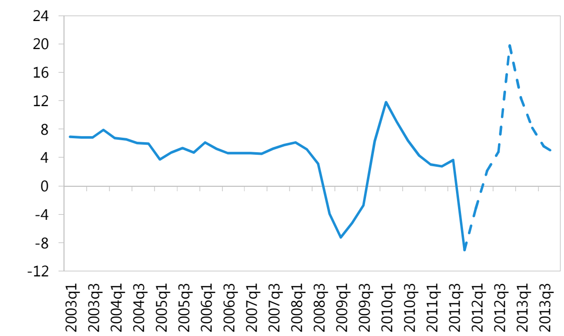
government expenditure grew by 1 percent of GDP from the previous year, due to an increase in current expenditure. As a result, the general government deficit in FY2011 widened to 1.6 percent of GDP from 0.8 percent of GDP in FY2010. The government elected in July 2011 adopted a set of policies aimed at boosting growth through higher consumption and income redistribution (see Paragraph 13). In addition, in response to the devastating floods, the government plans to invest in flood-prevention and provide soft loans to help households and firms in flood-affected areas.

B. Outlook: A V-shaped Recovery, Amidst Global Uncertainty

9. **Thailand's near-term economic outlook is promising.** Staff projects a V-shaped recovery with full recovery of the pre-flood production levels in the manufacturing and export sectors in the second half of 2012 with underlying growth expected to return to estimated potential thereafter. GDP is therefore projected to grow by 5.5 percent in 2012 and a further 7.5 percent in 2013 due to a large carryover effect from the strong recovery in the second half of 2012. Domestic demand is expected to be the driving force of growth in 2012 with investment increasing by 7 percent (y/y) partly due to reconstruction and flood-prevention efforts as well as consumption increasing by 5 percent, fuelled by the rise in the minimum wage. The trade balance is expected to show a deficit in 2012:H1, reflecting strong investment imports and soft world demand. Inflation should remain within the BOT's target band. With the output gap not projected to close until the

second half of the year, the large investment projects should not add excessive inflationary pressures. However, despite a reduction in global commodity prices (excluding oil), significant nominal wage increases, support for domestic rice prices, and the impact of higher oil prices, all represent upside risks for inflation.

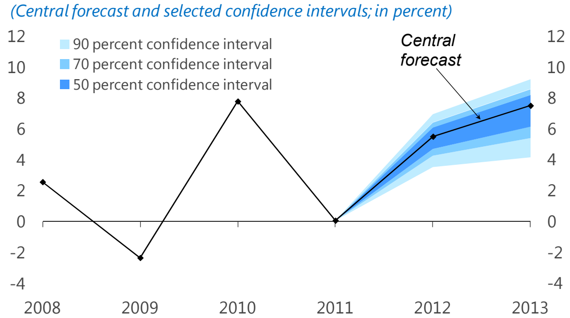
Real GDP
(Seasonally adjusted y/y growth)



Sources: CEIC Data Co. Ltd; and IMF staff estimates.

10. However, downside risks to the outlook are significant. On the external front, the Thai economy remains vulnerable to contagion from the turmoil in the euro area, and weak growth in its trading partners. As Thai banks are mostly domestically funded, the direct impact on the financial sector from a worsening of the euro-area sovereign crisis would be relatively limited. However, an increase in the global aversion to risk could lead to a sharp decline in stock markets. More importantly, a global downturn and an abrupt slowdown in China would hurt Thailand via lower export prospects. Domestically, political tensions and underperformance of public spending (in particular related to water management) could adversely affect business and consumer confidence, private investment, and economic growth (for more details, see Appendix I). If the minimum wage hike leads to a wage increase and labor productivity does not rise sufficiently, labor costs could rise to levels that erode competitiveness and weaken export growth. However, there are upside risks to the outlook as well: if the economic performance of advanced economies and key trading partners is better than expected, growth would be higher than under the baseline and inflationary pressures would return sooner than projected.

Thailand: GDP Growth
(Central forecast and selected confidence intervals; in percent)



Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

11. Over the medium term, potential growth remains constrained by supply side factors. Staff projects that potential output could rise from around 3.5 percent in 2011 to 5 percent over the medium term if infrastructure is improved and development potential in lagging regions can be tapped. While the fiscal stimulus plans may help jump start recovery and boost domestic consumption, these plans do not generally add to productive capacity, underscoring the importance of addressing supply-side factors going forward to support medium-term growth prospects.

Authorities' views

12. The authorities broadly agreed with staff's outlook but were somewhat more optimistic about domestic investment. The authorities shared staff's views on the global economic environment but were less worried about other downside risks as they expect flood-related investment would boost investors' confidence and prompt a strong recovery in private investment.

POLICY CHALLENGES

A. Optimizing Fiscal Policy for Growth

13. The authorities' near-term fiscal policy comprises both tax reductions and expenditure increases. On the revenue side, measures include introducing a tax break on first-time home and car buyers, and cutting the corporate income tax (CIT) rate over the next two years (from 30 percent to 23 percent in 2012, then to 20 percent in 2013) to help private companies deal with higher labor costs from increases in minimum wages of about 40 percent implemented on April 2, 2012. A previously adopted temporary reduction of the fuel excise tax has also been extended multiple times. On the expenditure side, the authorities increased the starting wage of civil servants, and granted a debt moratorium for some low-income households (see text table below). More recently, the flood-prevention investments include a B 350 billion (3 percent of GDP) off-budget package for infrastructure investments to be implemented over three years.

14. Staff estimates that the combined fiscal cost will be sizeable. On the revenue side, staff estimates that, at current compliance levels, the reduction in the CIT rate would reduce revenue by about 1.2 percent of GDP in 2012 and 1.8 percent of GDP in 2013 and thereafter. The fuel excise tax cut, if kept for a full year, would reduce revenue by another 1 percent of GDP. The tax refund for first time home and car buyers will erode income tax revenue by a further 0.2 percent of GDP beginning in FY2013. On the expenditure side, budgeted public investment is projected to increase in FY2012 to 3 percent of GDP (from 2.4 in the previous years) and is expected to be maintained in FY2013. This will be augmented with off-budget water management projects of B 350 billion (about 3 percent of GDP), to be carried out over FY2012–14. In addition, the rice price guarantee scheme could increase the public debt by 1 percent of GDP per year through government guarantees of state-owned enterprise (SOE) borrowing (see Box 2 for details on the rice price guarantee scheme). Under these assumptions and after taking into account expected efforts to rationalize spending, staff expects the general government deficit to widen from 1.6 percent of GDP in FY2011 to 3 percent of GDP in FY2012. The public sector deficit, which reflects the costs of the rice price guarantee scheme, is expected to widen from 2.4 percent to 4.4 percent of GDP over the same period. As the public debt level is still at a manageable 40 percent of GDP, the authorities are not expected to face any financing difficulties (Figure 2).

Fiscal Measures and Estimated Costs (% of GDP)

Policy	Estimated Cost
Lower corporate tax rate (from 30 percent to 23 percent)	1.2
Diesel fuel excise tax cut 1/	1.0
Rice price guarantee scheme	1.0
Tax refund for first time car buyer (beginning FY13)	0.2

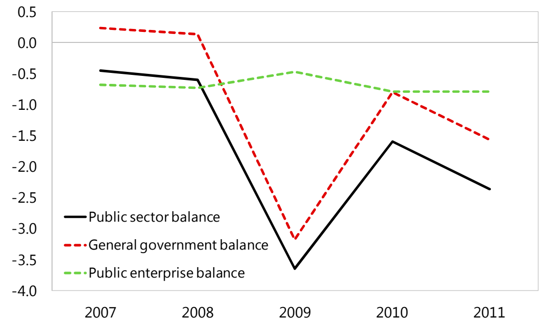
Source: IMF staff estimates.

1/ If the tax cut is phased out in the coming months, the impact in FY12 would be 0.7 percent of GDP.

Figure 2. Thailand: Public Finances

Fiscal balance worsened in 2009 and 2011, reflecting the responses to the global financial crisis and high energy prices.

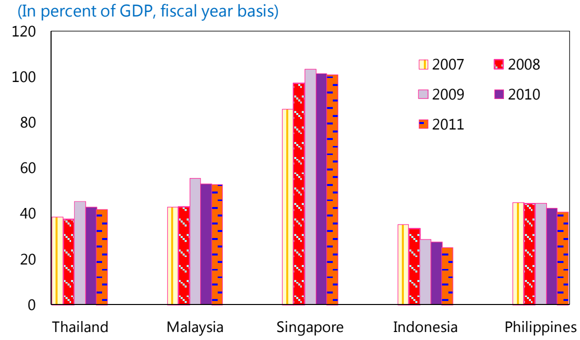
Fiscal Balance
(In percent of fiscal year GDP)



Sources: Ministry of Finance, Thailand; and IMF staff estimates.

...with higher public debt.

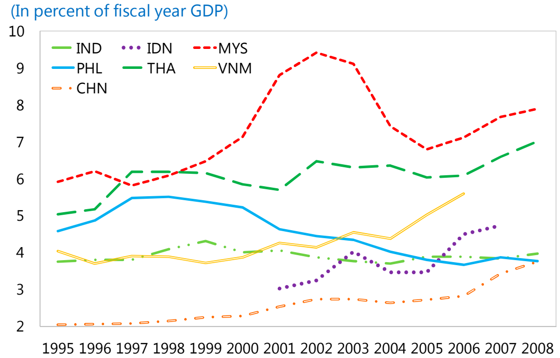
ASEAN–5: General Government Gross Debt
(In percent of GDP, fiscal year basis)



Sources: CEIC Data Co. Ltd; Bank of Thailand; IMF, *World Economic Outlook*; and IMF staff estimates.

Generating fiscal space is needed for achieving development goals....

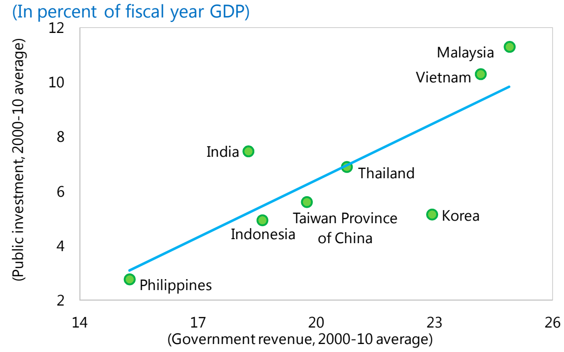
Public Spending on Education and Health
(In percent of fiscal year GDP)



Source: IMF staff estimates.

...and boosting Investment.

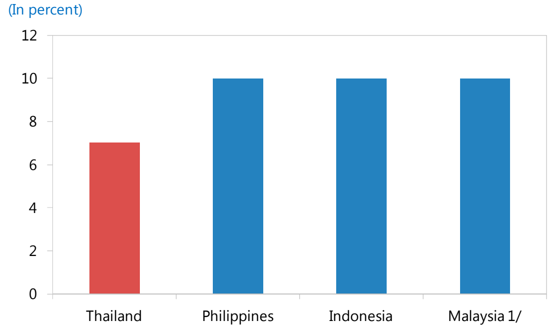
Link Between Government Revenue and Public Investment
(In percent of fiscal year GDP)



Sources: IMF, *World Economic Outlook*; and IMF staff estimates.

The VAT is lower than in neighboring countries.

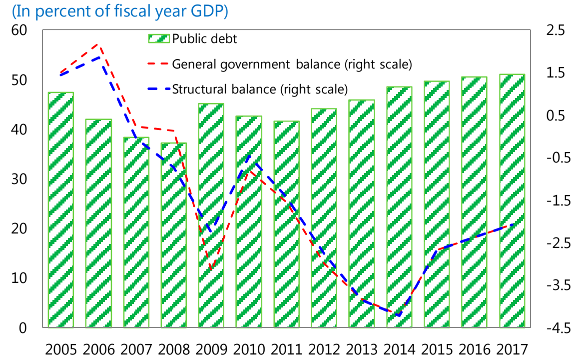
Value Added Tax Rates
(In percent)



Source: Asian Development Bank.
1/ Sales tax rate.

Based on current policies, no reduction in the public debt is in sight.

General Government Balance and Public Debt
(In percent of fiscal year GDP)



Sources: CEIC Data Co., Ltd.; and IMF staff estimates.

15. Implementation of expansionary measures requires careful management of fiscal space. Staff supports the authorities' plans to improve revenue collection and boost compliance through better use of information technology. However, more concrete measures may be needed to offset the impact of the tax cuts on revenues. To keep fiscal policy on a sustainable path, and given the pressing need to upgrade infrastructure to support future growth, fiscal space should be secured through containing current expenditures and enhancing revenue, rather than through reducing public investment. In particular, revenue-enhancing measures such as restoring fuel taxes, eliminating income tax credits, and reviewing the rate structure of excises and the VAT should be considered. In this light, staff welcomes the government's intention to reconsider cutting the CIT rate to 20 percent in 2013 if revenue underperforms in FY2012.

16. The cost, effectiveness, and composition of public expenditures should be carefully monitored. The fiscal stimulus comes at an opportune time to offset the impact of the weaker global outlook and help the reconstruction efforts. However, the effectiveness of the income redistribution policies, especially the rice price guarantee scheme (see Box 2), needs to be carefully monitored and changes implemented, if necessary, to contain fiscal costs. In addition, as growth ultimately hinges on the production capacity of the economy, spending should be more focused on growth-enhancing areas such as public investment. Expediting priority public investment will help restore market confidence and attract private investment. It will be particularly important to ensure that water management projects are implemented successfully to avoid a repetition of large-scale flooding in the future**.**

17. Moving away from fuel subsidies will be a very positive step, when implemented. While some energy prices are now gradually allowed to adjust to market prices, the diesel fuel excise tax cut has been extended repeatedly, most recently to end-April 2012. Such tax incentives should be allowed to expire as they are neither fiscally sustainable, nor efficient to cope with elevated global fuel prices**.** Because higher-income households consume a disproportionate share of energy, such untargeted measures are not efficient in terms of income distribution objectives either. The mission advised that the increase in minimum wages provides a good opportunity to fully restore the diesel excise tax.

18. Looking ahead, the medium-term fiscal outlook needs to be supported by specific policy plans. Though the cabinet approved a budget deficit for FY2013 of B 300 billion (2.7 percent of GDP), down from B 400 billion in FY2012, details are yet to be worked out. Assuming no major policy changes, staff projects that the general government deficit would decrease only in FY2015 as water management projects would be finished. The projected improvements in the budget balance over FY2015–17 are largely from projected improvements in revenue administration but are not sufficient to reverse the upward trend of public debt. While the debt level is still well below the authorities' official guideline of 60 percent of GDP, the perpetuation of current policies would gradually push the debt toward that ceiling. The debt sustainability analysis (DSA) shows that Thailand's public debt has switched from a downward trend to a modest upward one reaching 51 percent of GDP in 2017 (see Appendix II).

Box 2. Thailand: The Cost of Subsidizing Diesel and Guaranteeing the Rice Price

Diesel price subsidy and excise tax cut

Thailand established the Oil Fund after the first global oil shock in 1973 to protect domestic oil prices from swings in international prices. During low oil price periods, the Fund collects a levy and accumulates reserves that are then used to subsidize the retail price when the oil price rises above a certain level. In April 2011, after several months of high oil prices, the Fund's reserves were depleted and the government replaced the fuel subsidy provided by the Oil Fund with a temporary reduction in the excise tax so as to keep retail prices under B 30/liter. This excise tax reduction was meant to expire after a few months but has been prolonged several times. If this excise cut is maintained for an entire year, the revenue loss from the excise tax cut would be around 1 percent of GDP.

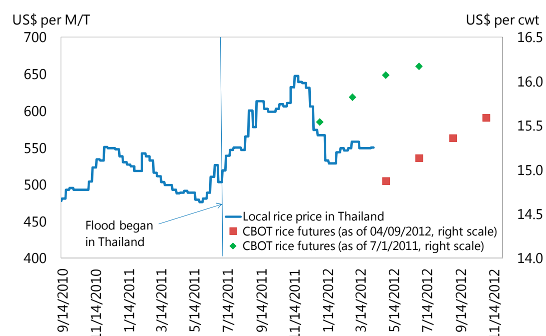
Rice price guarantee scheme

In October 2011, the government committed to buy rice from farmers at a price above the current market price, with the objective of improving farmers' income.

Mechanics of the program. The government guarantees to purchase rice at a set price. Farmers pre-register with the Ministry of Commerce to be allowed to deliver their rice to certified millers and public warehouses. Upon delivery of the rice, farmers obtain warehouse receipts specifying the rice quality and quantity. Farmers then use warehouse receipts as collateral to obtain a loan from the BAAC (the Bank for Agriculture and Agricultural Cooperatives, a specialized financial institution (SFI)). At the end of the rice season, farmers can either sell their crop on the market or to the government. In the latter case, the repayment of the loan becomes the responsibility of the government.

Fiscal cost. The fiscal cost of the program depends on developments in the world rice market. For the 2011–12 rice season, the government pledged to buy rice at B 15,000 per metric ton, which is 20 percent above the current international market price. If the pledge price remains 20 percent above the market and, assuming the amount of rice production is comparable to previous years, the cost of the program is estimated to be about 1 percent of GDP per year. If the gap between the pledged and market price widens, or the amount of pledged rice is larger than expected, the fiscal cost could be even higher. There will also likely be additional costs linked to storage and program management. The fiscal costs could be lower if the market price becomes higher relative to the pledge price, but so far the world rice price has not increased as India and Vietnam are increasing their supply and exports.

Rice Prices



Source: Bloomberg LP.

Structural issues and incentives. In addition to fiscal sustainability issues, there is a question as to what extent the program is effective as an income distribution policy. As the program is administratively cumbersome (e.g., farmers need to get certificates, and bring their paddy to mills) and involves a delay between rice delivery and loan disbursement , the smallest farmers tend to keep away from the program and sell their rice directly to millers at a lower price or keep it for subsistence purposes. Hence the program could end up mainly benefitting large-scale producers and middlemen. In addition, the complexity of the scheme can open arbitrage opportunities and create governance issues.

19. The credibility of fiscal policy would benefit from being set in a strengthened institutional framework. Currently, the government operates under a self-imposed (but not legally binding) medium-term fiscal target, which comprises ceilings on public debt and debt service.[1] A fiscal rule, comprising a public debt ceiling and a medium-term fiscal balance path consistent with those ceilings, as prescribed in the draft Public Finance Act, would add credibility to the government's commitment. A multi-year perspective would help establish a credible fiscal path that avoids unsustainable debt dynamics. For the fiscal rule to be practical, it should include an escape clause that would provide flexibility at times of exceptional shocks. Equally important is that the fiscal rule does not focus only on the narrowly defined central government budget, so that when extra spending is justified it can be fully reflected in the budget, without resorting to extra-budgetary expenditures, thus increasing both transparency and accountability. Recommendations of the 2009 fiscal Request on the Observation of Standards and Codes (ROSC), including comparison of budget figures to actual outturns in budget documents, more comprehensive coverage of extra-budgetary funds and public enterprises in public accounts, and including a statement of fiscal risks in budget documents, would help improve fiscal operations and accountability. It is also important to avoid recourse to the central bank for financing quasi-fiscal operations that could diminish its independence and impair its ability to achieve its inflation objectives.

[1] The government's medium-term fiscal target requires that the public debt does not exceed 60 percent of GDP and the debt service (principal and interest payment) does not exceed 15 percent of total expenditure.

20. In the discussions, staff argued that the authorities should plan on gradually unwinding the supportive policy stance. Acknowledging that the highly uncertain global outlook and the need to support domestic demand fully justify the stimulus stance now, staff recommended that demand-promoting policies should be phased out as the output gap closes, to allow the private sector to adapt and avoid inflationary pressures that would require a tighter monetary policy stance than otherwise. If the global economy were to deteriorate further, automatic stabilizers, plus additional stimulus measures, could be considered provided that a well-defined medium-term consolidation path is in place.

21. Over the longer term, public finances also are facing pressures from a rapidly aging population. The old-age dependency ratio of Thailand is already high among ASEAN-5 countries, and Thailand is expected to face a higher speed of aging compared to many other countries in the region. Health care spending is expected to rise by 1.1 percent of GDP in the next two decades, and public pension spending is projected to increase by 0.7 percent of GDP over the same period.[2] While the level of these age-related expenditures in Thailand is not particularly high by international standards, there is likely to be pressure for improving the coverage and quality of social protection as income per capita increases. It is thus important to ensure that health care and pension programs are resilient to the forthcoming demographic changes (Box 3).

[2] The slower pace of pension spending growth reflects the narrow coverage of the public pension plan.

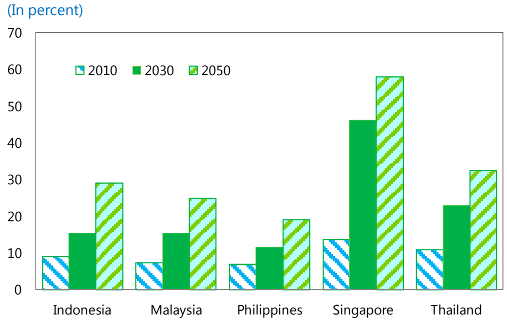
Box 3. Thailand: Economic and Fiscal Implications of Demographic Change

Thailand's population is aging relatively quickly—its old age dependency ratio is only second to Singapore within ASEAN-5 countries and expected to remain so for the decades to come. Within age-related spending, increases in healthcare spending are generally the most prominent due to cost increases from upgrades in available health services and lower productivity growth of services relative to other sectors of the economy.

Thailand has been successful in achieving universal coverage of healthcare without an excessive increase in public spending, partly due to relatively high economic growth during the period of coverage expansion. Based on the age distribution projected by the United Nations and the age profile of health spending consistent with the average for Organization for Economic Co-operation and Development (OECD) countries, public health spending in Thailand is estimated to increase from 2.8 percent of GDP in 2010 to 3.9 percent of GDP in 2030 (further details are provided in Appendix III).

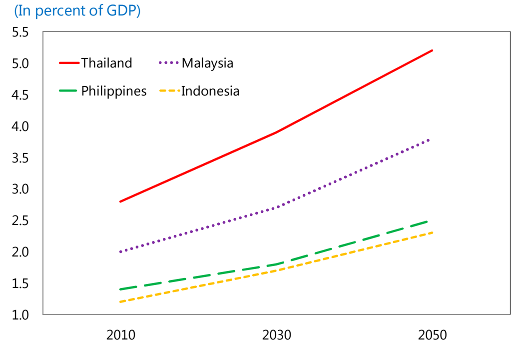
There are multiple ways of mitigating increases in public health expenditure, including through greater control over the range of publicly funded health services, more involvement of local governments in the program, and greater use of market mechanisms.[1] If savings from these reforms are not sufficient to contain the increase in health spending, deeper cuts in other spending areas or additional revenue sources may be needed. Potential source of additional revenue with a relatively low burden on the working age population include consumption taxes (VAT), property taxes, and excise taxes.

ASEAN–5: Old-Age Dependency Ratio
(In percent)



Source: United Nations, *World Population Prospects*.

Public Health Spending
(In percent of GDP)



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[1] According to a recent IMF paper, a one-unit increase in the index measuring involvement of local and regional governments in key health care decisions reduces growth in public health spending by about 0.30 percentage points of GDP (see "Macro-Fiscal Implications of Health Care Reforms in Advanced and Emerging Economies," IMF Policy Paper, 2010).

Authorities' views

22. The authorities were more optimistic about the fiscal costs of their policies but pledged to adopt countervailing measures if needed. Regarding the rice price guarantee scheme, the authorities indicated that they expect the international rice price to increase, thereby minimizing the fiscal costs of the policy. With respect to the CIT, they believe that a lower CIT rate will boost overall tax compliance, generating enough revenue to offset the loss from the lower tax rate. At the same time, the authorities showed their willingness to reconsider a further cut in the CIT rate to 20 percent in FY2013 if revenue underperforms. They also noted that it is desirable for an open economy like Thailand to have its corporate tax rates competitive with other countries, and to bring its energy price back in line with the international market price over the medium term.

23. The authorities reiterated their commitment to fiscal discipline, underpinned by the existing medium-term framework of ceilings on public debt and debt service. They also stressed the importance of maintaining public investment at a sufficient level to support private sector activities. They renewed their commitment to balancing the budget over the medium term.

24. The authorities agreed with the need to enhance fiscal discipline and transparency, along the lines of the 2009 fiscal ROSC recommendations. They informed staff that the draft Public Finance Act, which is expected to include provisions on the medium-term fiscal framework and fiscal transparency, is under preparation and is expected to be submitted to parliament in the future.

B. Supporting Stable Noninflationary Growth

25. The current monetary policy stance is accommodative. Monetary policy had been on a steady normalization path since July 2010 with the policy rate having been raised by a cumulative 225 bps. However, before a neutral stance could be reached, the weakening external environment and widespread floods led the BOT to first pause in October, and then lower the rate by a cumulative 50 bps in November 2011 and January 2012. Real rates are currently still negative and among the lowest in the region.

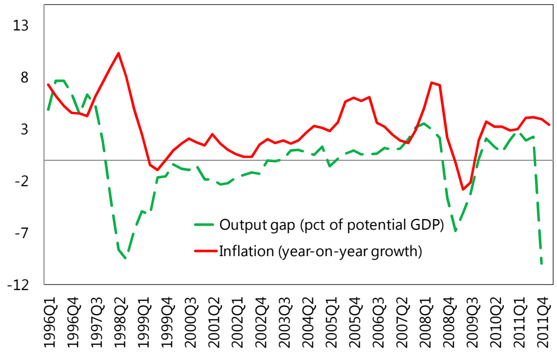
26. Even so, inflationary pressures appear muted. Inflationary pressures have been abating over the last few months due to both domestic and external factors, including low demand during the floods, and declining global commodity prices (see Figure 3). Going forward, base effects will keep inflation in the next year relatively low, and global food prices are expected to keep declining. The rice price guarantee scheme does not appear to be pushing up local rice prices yet. The planned infrastructure spending is large, but likely to be spread over the next two–three years and thereby will not add much to domestic demand pressures.

27. If upside risks materialize, inflationary pressures could return. While many commodity prices are subdued, the oil price has been rising and may rise further in the future. As for public policies, higher

Figure 3. Thailand: Balancing Inflationary Pressures

The large output gap due to the floods will ease inflationary pressures in the near term…

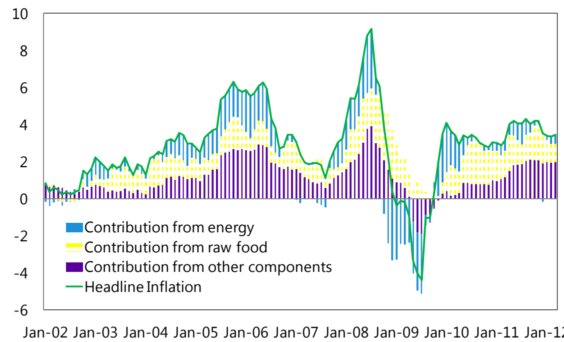
Output Gap and Inflation



Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

…but energy prices will add to headline inflation as subsidies are rolled back.

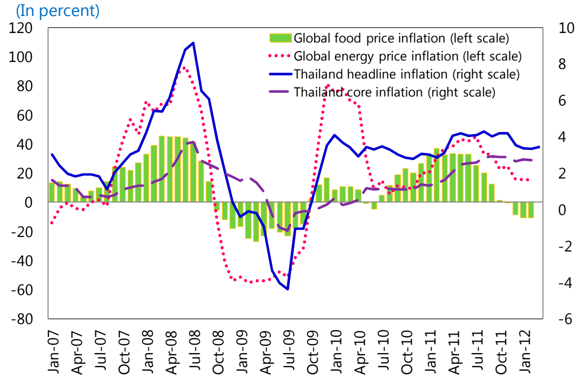
Contribution to Headline Inflation
(In percent)



Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

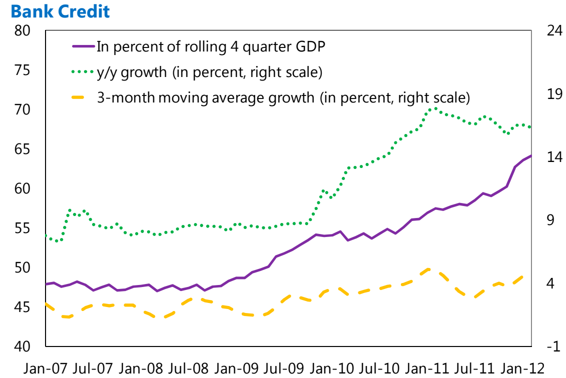
Commodity prices, which constitute a large share of CPI, have come down…

Thailand Inflation and Global Commodity Price Inflation
(In percent)



…while credit growth has settled at a rate consistent with underlying potential growth.

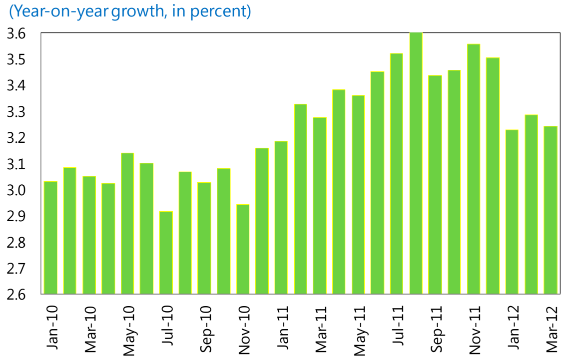
Bank Credit



Sources: CEIC Data Co. Ltd. and IMF staff estimates.

Inflation expectations came down in 2012 as supply scarcities eased.

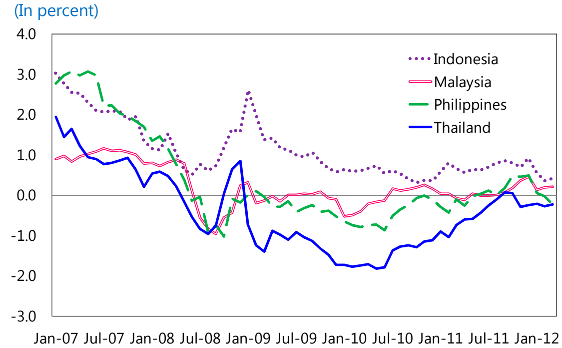
One-year Ahead Inflation Expectations
(Year-on-year growth, in percent)



Source: Consensus Economics.

BOT eased its policy rate back into negative territory in real terms.

ASEAN-4: Real Policy Rate
(In percent)



Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

minimum wages may have limited direct pass through to prices as the impact on companies would be offset by lower income tax rates, but could still boost consumption and lead to a stronger-than-anticipated wage-price spiral. The change in the rice price policy could also boost food prices and farm income more than in the baseline. A stronger-than-expected global economy would also add to inflationary pressures, both through higher export demand and through higher commodity prices.

28. Staff agreed that the BOT's accommodative monetary stance is appropriate at this juncture but underlined that once the recovery takes hold, resuming policy normalization would be warranted. With the output gap projected to close in the second half of the year, resuming normalizing policies will be needed to keep inflationary pressures in check. Monetary policy may need to adjust to inflationary pressures that could stem from fiscal policy, while continually gauging downside risks from a weaker global economy. If energy prices are allowed to gradually adjust to market levels, it will be crucial to maintain policy coordination to keep inflationary expectations well-anchored and contain second-round effects. Should downside risks to the central scenario materialize, the BOT could still support the economy by further reducing the policy rate and letting the exchange rate adjust.

Authorities' views

29. The BOT agreed with staff's recommendation to resume the normalization once recovery takes hold. Even though inflationary pressures have receded with the floods and declining commodity prices, they recognize that the wage and rice policies could pose inflationary risks, particularly if the economic recovery is stronger than expected. The BOT is determined to remain vigilant in setting its policy interest rate, aiming to offset excessive demand pressures if the government's deficit increases further or inflation expectations begin to rise. On the other hand, given the uncertainty of the global environment, the BOT is also ready to keep supporting the economy if domestic or global conditions warrant it.

C. Managing Capital Flows

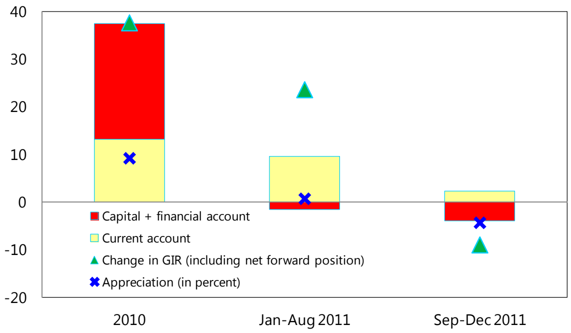
30. In line with other emerging markets, capital flows became markedly more volatile and are likely to remain so in the near future. Equity inflows were mostly flat over 2011, owing to the tightening monetary policy and the heightened risk aversion. Bond inflows, on the other hand, have been very large and volatile, reaching historic peaks at times and reversing during periods of heightened domestic or external uncertainty. Looking ahead, the relatively better outlook compared to advanced countries and attractive yield differentials are likely to keep channeling global liquidity toward emerging markets. At the same time, heightened global uncertainty is adding to the volatility in risk perceptions and is expected to cause intermittent stops in capital flows.

31. The BOT has been smoothing the exchange rate movements but the main challenge is to prepare economic agents to deal with higher volatility (Figure 4). The baht exchange rate remained largely unchanged against the dollar over 2011 as the BOT managed external flows in both directions but a relatively higher domestic inflation has appreciated the baht in real effective terms by 4 percent. With capital flows turning inward

Figure 4. Thailand: Flows, Intervention and Sterilization

BOT intervened heavily in response to large BOP surpluses the first half of 2011….

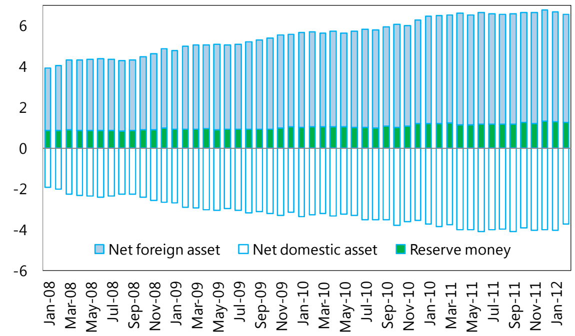
Balance of Payments, Reserve Accumulation and Baht Appreciation
(In billions U.S. dollars)



Sources: Haver Analytics; and IMF staff estimates.

…which were largely sterilized….

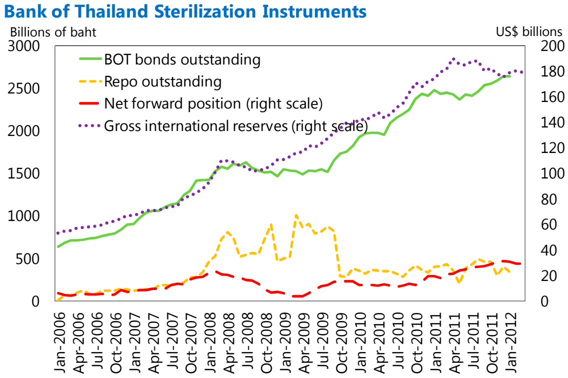
Bank of Thailand: Summary Balance Sheet
(In trillions of baht)



Sources: IMF, *Integrated Monetary Database*; and IMF staff estimates.

…with BOT bonds and repos with commercial banks.

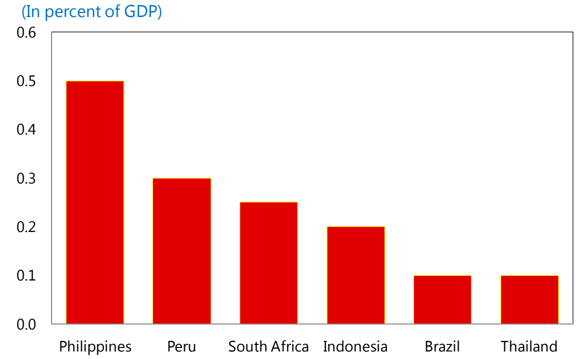
Bank of Thailand Sterilization Instruments



Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

Though the estimated sterilization cost is not large by international standards…….

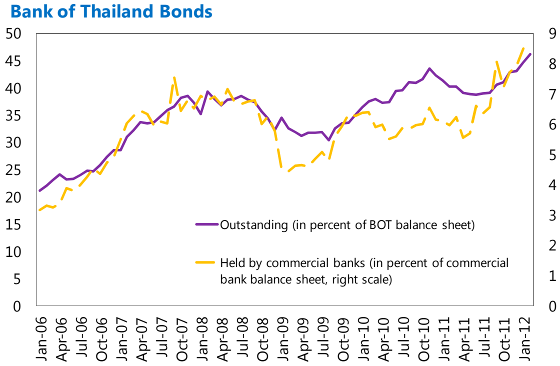
Marginal Sterilization Costs over 2010
(In percent of GDP)



Source: IMF staff estimates.

…these instruments burden the BOT balance sheet…

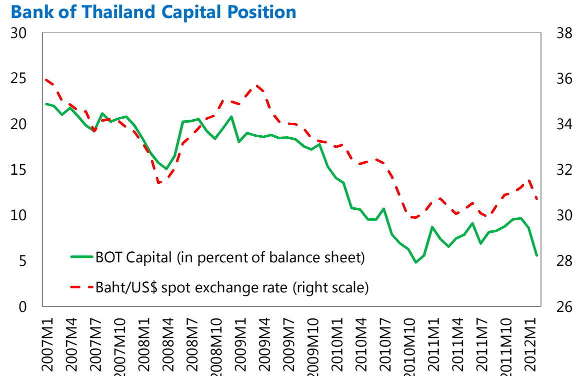
Bank of Thailand Bonds



Sources: Bank of Thailand; CEIC Data Co. Ltd.; and IMF staff estimates.

…and weaken its capital position.

Bank of Thailand Capital Position



Sources: IMF, IMD database; and IMF staff estimates.

once again in 2012, reserve accumulation also resumed, growing by $3 billion in the first two months. Staff argued that the main challenge is preparing economic agents as capital flow surges and volatility are structural in nature and smoothing measures may not have lasting effects. Given that large and volatile inflows may continue for a while, a sustainable strategy would include keeping a flexible exchange rate while encouraging wider use of hedging instruments and preventing large exchange rate risks from building up.

32. **Staff estimates that the exchange rate remains broadly in line with medium-term fundamentals**. Staff underlined that exports seem to have become more resilient to exchange rate flexibility (see Appendix IV). While point estimates range from a 9 percent undervaluation to a 7 percent overvaluation, some of these estimates are not statistically significant and the average of the estimates is a 3 percent undervaluation. In addition, the strengthening of regional supply chains has allowed the key export-oriented industries to become less sensitive to exchange rate movements. Hence, despite the steady appreciation of the Thai baht in real effective terms since 2005 (barring the global financial crisis), Thailand's world export share has increased during this period.

33. **Building higher foreign currency reserves is costly and has diminishing benefits**. At $210 billion (including the net forward position) as of end-March 2012, foreign currency reserves cover over 400 percent of short-term external debt, 11 months of future imports, 50 percent of broad money supply, and are above the level suggested by the IMF's new risk-weighted approach. Staff estimates that the monetary cost of the intervention and sterilization operations are not large at this time, amounting to about 0.1 percent of GDP in 2011 but these costs would accumulate over time.[3]

34. **With official reserves above all standard benchmarks and the exchange rate not overvalued, there is room for greater two-way flexibility of the baht**. Declining terms of trade, higher imports needed for building infrastructure and increasing outward investment by Thai residents are expected to diminish the balance of payments and current account surplus over time.[4] The balance is expected to remain positive, which will continue to exert appreciation pressures on the baht. Continued productivity gains in line with historical trends would also imply a stronger baht over the medium term.

Authorities' views

35. **The BOT intends to continue to allow flexibility in the exchange rate**. The authorities remain committed to keeping the baht in line with macroeconomic fundamentals and continue to encourage the private sector to enhance their risk management capabilities. They noted that they are committed to market-based liquidity management and view

[3] As the reserve currencies lose value against the baht, valuation losses are incurred on these reserves. Moreover, the instruments issued to sterilize the monetary impact of foreign exchange purchases cost more to the BOT than what is earned on international reserves.

[4] After relaxing restrictions on outward direct investment in 2010, the authorities introduced the Capital Account Liberalization Masterplan (CALM) in late 2011 to further liberalize outflows reducing the financial account surplus. Inward FDI has been very weak, likely reflecting investors' concerns of domestic political risks and the adequacy of infrastructure.

sterilization costs as limited in magnitude and offset by the benefits from smoothing excessive volatility.

36. Capital account liberalization will continue. With outward direct investment nearly fully liberalized, the authorities plan to move on to liberalizing portfolio flows, including by amending regulations to facilitate portfolio investments abroad. With these steps, the authorities aim to encourage investment by Thai residents abroad, going beyond the investment opportunities in the country and balancing the pressure on the baht from capital inflows. The authorities see capital account liberalization also as a necessary step toward the formation of stronger financial ties in line with the ASEAN Economic Community (AEC) integration agenda.

D. Maintaining and Strengthening Financial Sector Resilience

37. The banking sector was relatively unaffected by the stress events of 2011 and remains sound (Figure 5)**.** The BOT appropriately issued guidelines to deal with flood-affected customers, granting grace periods, and staff agrees that if the recovery unfolds as planned, underlying asset quality is expected to be relatively unaffected.[5] In general, asset performance has been steadily improving over recent years as banks keep healthy balance sheets including by selling their nonperforming loans (NPLs) to asset management companies. The BOT is encouraging banks to be forward-looking in determining their provisioning levels, so as to create a countercyclical buffer against shocks and those new requirements will further boost banks' resilience. Capital adequacy has been increasing in line with global initiatives. Given their low reliance on wholesale funding and few off-balance sheet commitments, banks are expected to easily meet Basel III's capital and liquidity requirements.

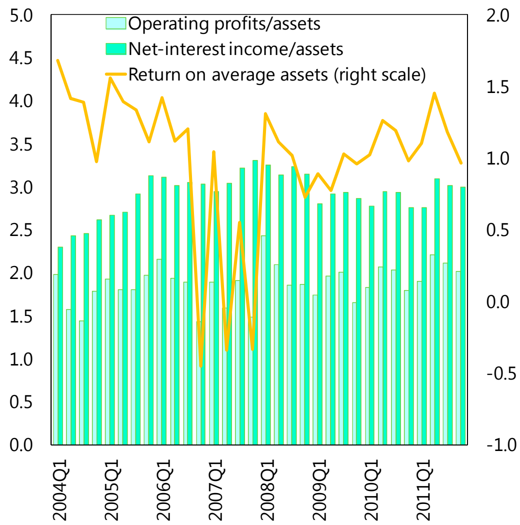
38. Recent initiatives related to financial sector and capital market development are encouraging. The authorities have made good progress in implementing their financial sector and capital markets development master plans, including by introducing a number of hedging instruments. The BOT issued guidelines for microfinance lending and have allowed the presence of foreign banks to gradually increase, with the goal of better financial access and injecting more competition into the system that would deepen markets. The reforms planned toward further liberalizing financial flows is a step toward regional integration and will help Thai investors expand their investment base beyond domestic opportunities. Some areas, however, could benefit from faster reform implementation. For example, innovations such as currency-futures would further deepen capital markets and allow for easier access to hedging instruments. In addition, Thailand got downgraded in February 2012 by the Financial Action Task Force (FATF) for not taking enough action to address deficiencies in its AML/CFT regime.

[5] In October 2011, the BOT issued guidelines temporarily allowing less stringent loan classifications thereby allowing banks to maintain the existing credit status of customers in flood-affected areas for 6 to 12 months. Measures banks could adopt included a grace period on principal and interest payments, a reduction in interest rates, and debt rescheduling.

Figure 5. Thailand: Banking Sector Developments

Bank profitability indicators remain stable.

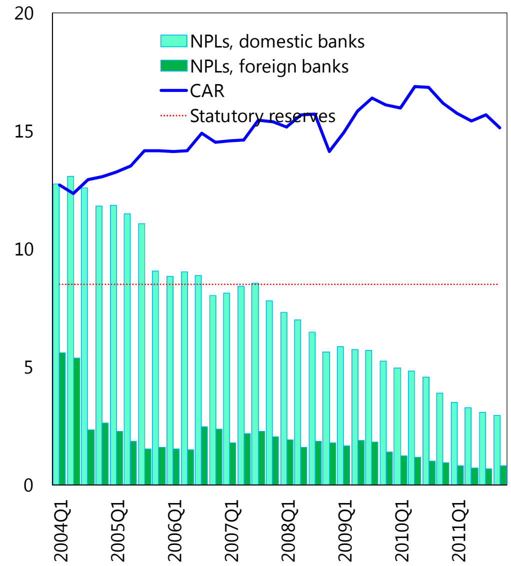
Commercial Banks Profitability 1/
(In percent, annualized)



Source: Bank of Thailand.
1/ Ratios are calculated based on the definitions suggested by the authorities.

Asset performance and capitalization ratios continue to improve.

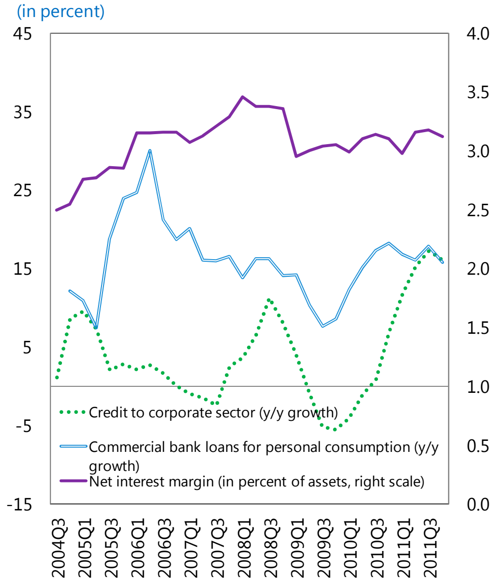
Gross NPLs and Banking System CAR
(In percent)



Sources: Bank of Thailand; and CEIC Data Co. Ltd.

Loan growth has picked up.

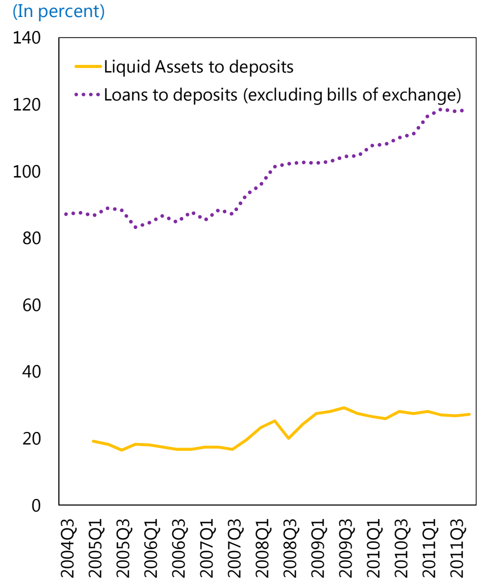
Interest Margin and Loans
(in percent)



Sources: Bank of Thailand; and CEIC Data Co. Ltd.

Bank liquidity remains adequate.

Liquidity Indicators
(In percent)



Sources: Bank of Thailand; and CEIC Data Co. Ltd.

39. While commercial banks are financially sound and stable, the performance of Specialized Financial Institutions (SFIs) is more problematic (Box 4). These institutions are involved in government lending operations and enjoy preferential treatment in terms of tax, accounting, auditing and regulatory requirements. SFIs are both owned and supervised by the Ministry of Finance (MOF). Having a different regulatory regime and according SFIs special privileges contribute to an unlevel playing field when SFIs activities overlap with those of commercial banks. Moreover, SFIs compare poorly with commercial banks in terms of banking soundness. They have higher levels of NPLs; they are less liquid and have significantly lower levels of capital. If standard prudential rules were applied to SFIs, some would need to be recapitalized. The recent World Bank Financial Sector Assessment Program (FSAP) module estimates such recapitalization needs at about 2 percent of GDP, mostly due to capital requirements for the BAAC. Since the SFIs are subject to different supervisory standards, the financial strength of these institutions could be weaker than suggested by the data, and the corresponding need for capital could be somewhat higher. In addition to past liabilities, some government plans, such as the rice price guarantee scheme and the debt moratorium for farmers, are to be implemented through SFIs and could deteriorate their balance sheets further.

40. Decisive progress should be made in reforming the SFIs. As SFIs are a growing part of the Thai financial system, it is crucial to continue the reform effort by clearly refocusing the SFIs' activity on their core mandate, and by applying bank supervision standards to those that are deposit-taking institutions. An external audit in line with best international accounting practices is an essential step to be able to assess and curtail potential fiscal contingent liabilities as well as financial risks. Payment of implicit or explicit subsidies out of the government's budget would also increase the transparency of public expenditures. The recent FSAP modular update on the SFIs conducted by the World Bank provides a comprehensive set of recommendations for improving their operations.

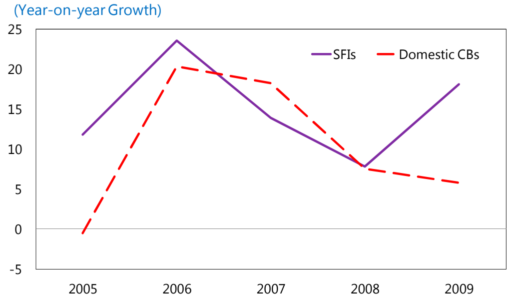
41. Continuing to develop strong financial safety nets is important. Starting July 2012, the fees banks used to pay to the Deposit Protection Agency (DPA) will be collected by the BOT and allocated to servicing the Financial Institutions Development Fund (FIDF) debt (public debt deriving from the settlement of the financial crisis in 1990s).[6] The reallocation of banks' contributions from the deposit guarantee system to the servicing of FIDF debt frees fiscal space in the near term, even though this does not reduce the overall interest burden for the public sector, but curtails the DPA's funding. Staff underlined that the authorities should ensure that the DPA has adequate resources, in line with best international practice.

[6] Under the new system, banks will start paying a levy both on their deposits and on their non-deposit liabilities such as bills of exchange (B/E). The fee will also be raised from 0.4 percent to 0.47 percent for deposits and 0.46 percent for non-deposit liabilities. The DPA will receive 0.01 percent in contributions (as opposed to 0.4 percent previously); the remaining 0.46 will be allocated to repaying FIDF debt.

Box 4. Thailand: Specialized Financial Institutions

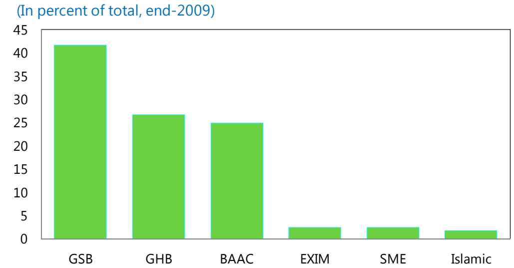
Thailand has eight specialized financial institutions (SFIs).[1] SFIs are government-owned, in most cases deposit-taking, financial institutions intended to implement the government's social and economic projects. They operate in various sectors of the economy ranging from agriculture to housing, SMEs, and trade financing. The three largest SFIs (Government Saving Bank (GSB), BAAC, and Government Housing Bank (GHB)) are deposit-taking institutions and account for more than 90 percent of the total assets of the SFI sector. Their share of financial sector assets has risen since the global crisis from 18 percent in 2008 to 22 percent in 2010, reflecting their proactive lending activity during the crisis period when revenues were scarce and commercial banks tightened their lending standards.

Loan Growth of Major Financial Institutions 1/
(Year-on-year Growth)



Sources: BankScope; and IMF staff estimates.
1/ Commercial banks and SFIs holding more than 90% of total assets in each sector.

Relative Size of the Specialized Government Credit Institutions 1/
(In percent of total, end-2009)

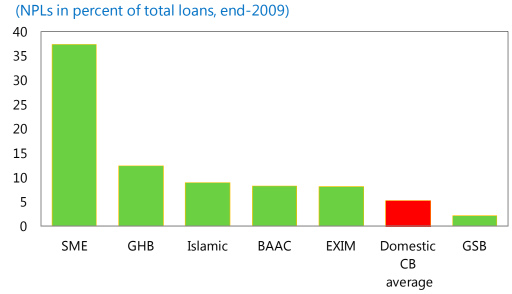


Sources: BankScope; and IMF staff estimates.
1/ Does not include SBCG and SMC due to lack of data; total combined assets of these two SFIs are less than 1 percent of total SFI assets.

SFIs benefit from a specific regulatory/supervisory regime and special privileges. The SFIs, including the deposit taking ones, which in practice operate alongside commercial banks, are regulated under separate SFI specific laws. While the MOF has delegated the authority to examine SFIs on an annual basis to the BOT, the overall supervision remains with the MOF. The BOT performs on- and off-site inspections of SFIs and reports its findings to the SFIs' board and the MOF, but it does not act as the legal supervisor and regulator and has no enforcement powers.

Loan performance at SFIs is weak, but their portfolio is growing. The government has indicated that major flood relief and reconstruction help could be channeled via SFIs, in particular the BAAC. Nonperforming loans are already significantly larger than for the average commercial bank and likely to rise. When bad loans are generated, SFIs lack the experience to manage and resolve the bad loan portfolio and are restricted in their ability to negotiate settlements.

Asset Quality 1/
(NPLs in percent of total loans, end-2009)



Sources: BankScope; CEIC Data Co. Ltd.; and IMF staff estimates.
1/ Does not include SBCG and SMC due to lack of data; total combined assets of these two SFIs are less than 1 percent of total SFI assets.

[1] The SFIs include the BAAC, the GSB, the GHB, the Export-Import Bank of Thailand (EXIM Bank), the Small- and Medium-Enterprise Development Bank of Thailand (SME Bank), the Secondary Mortgage Corporation (SMC), the Islamic Bank of Thailand, and the Small Business Credit Guarantee Corporation.

Authorities' views

42. The authorities are satisfied with the stability of the financial system. They pledged to move forward with the financial and capital market development master plans. The BOT expressed confidence that Thai banks are sufficiently capitalized and will overall not face any difficulties in complying with Basel III capital and liquidity requirements. The authorities expressed some concern about the impact of the FATF's downgrade on financial or trade flows, and concurred with the need to expedite the work on the existing draft AML/CFT legislation.

43. They emphasized that there are ample resources in the deposit protection agency. They underlined that the DPA has rapidly built resources since it was established in 2008 and consider its current size to be sufficient to fulfill likely needs, especially since the deposit insurance coverage will be reduced from B 50 million to B 1 million (per institution per depositor) in August 2012. In addition they underlined that full support from the government would be available, if necessary, to underpin the credibility of the deposit insurance system.

44. The need to reform the governance of the SFIs was acknowledged. They emphasized the usefulness of development banks in reaching low-income groups and minimized competition concerns in view of the fact that that SFIs operate in specific niche markets. However, they acknowledged the rapid growth of some SFIs and intend to refocus them on their core mandate. While noting that the quasi-fiscal liabilities remain relatively small, they will study the possibility to enhance the supervision of the deposit taking ones. They noted also that SFIs, which used to be exempt from the DPA levy, will now be subject to the same fee as commercial banks, a measure which should contribute to level the playing field.

E. Structural Issues: Raising Potential Growth and Reducing Income Inequalities across Regions

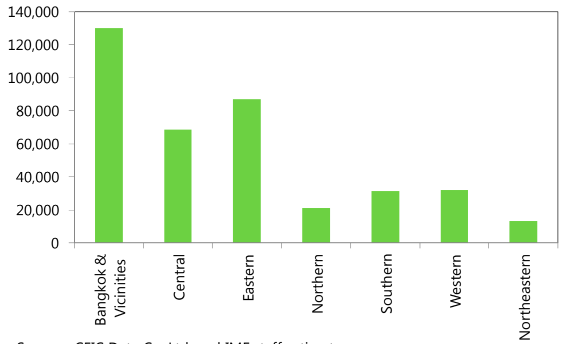
45. Discrepancies in regional income are large and growing. Average per capita GDP differs widely across regions; one-third of the population (located in Bangkok and in the Central and Eastern regions) contributes to two-thirds of national GDP. In addition, while there is a certain amount of income convergence within the core regions (Bangkok and the Central and Western regions), the poorer regions are staying behind. Per capita GDP is not only lower but is also growing slower than in core regions, thereby widening the income gap (see Appendix V). Lagging per capita output levels are associated with lower productivity, lower human capital, and less investments in physical capital (Figure 6).

46. Alleviating income inequality is at the heart of the government's policy. The authorities emphasized their objective of income redistribution through measures such as increases in the minimum wage and support for the rice price aiming at boosting income among poorer segments of the population.

Figure 6: Thailand: Regional Discrepancies

Large income disparities across regions…

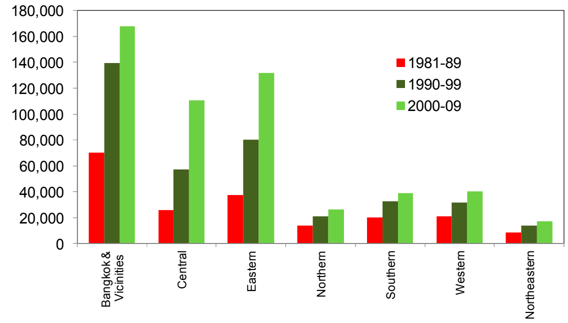
Thailand: Average Real GDP per Capita by Region, 1981–10
(In Thai baht)



Sources: CEIC Data Co. Ltd; and IMF staff estimates.

…have increased over the past three decades.

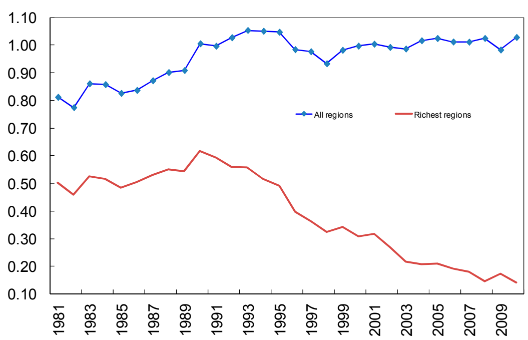
Thailand: Average Real GDP per Capita by Region
(In Thai baht)



Sources: CEIC Data Co. Ltd; and IMF staff estimates.

Mixed records in terms of economic convergence.

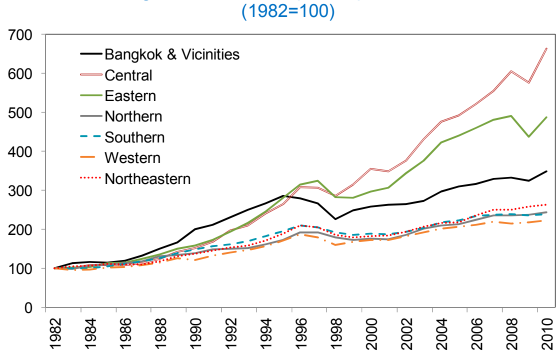
Real GDP Per Capita: Coefficient of Variation 1/



Sources: CEIC Data Co. Ltd; and IMF staff estimates.

The three poorest regions are also the slowest growing ones.

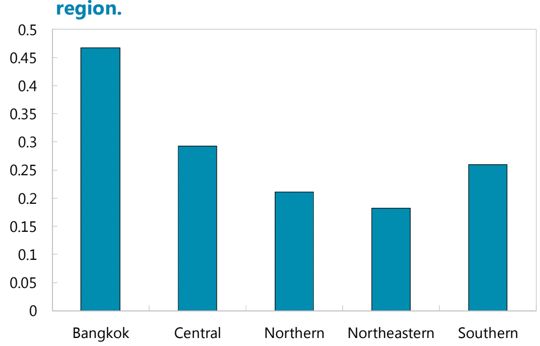
Regional Real GDP per Capita Growth
(1982=100)



Sources: CEIC Data Co. Ltd: and IMF staff estimates.

Disparities reflected in labor quality…

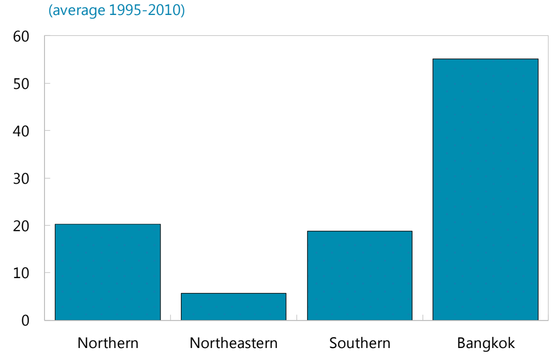
Share of skilled workers in the labor force by region.



Sources: CEIC Data Co. Ltd; and IMF staff estimates.

…and capital endowment.

Regional Share of New Investments
(average 1995-2010)



Sources: CEIC Data Co. Ltd; and IMF staff estimates.

47. In the discussions, staff welcomed the objective of making growth inclusive and underlined that tapping underdeveloped regions could be an appropriate option to increase potential growth. Staff recommends deepening capital through technology transfers, and improving the quality of the labor force to boost both growth rates and living standards in the peripheral regions. Enhanced public infrastructure combined with better conditions for the private sector could promote private investments while public expenditure could focus on developing labor skills.

48. Labor productivity needs to rise in tandem with wage increases to maintain competitiveness. Large increases in the minimum wages, if not matched by productivity increases, could worsen the competitiveness of the periphery regions, affect their attractiveness, and hamper private investment. Past country experiences show that labor productivity needs to rise significantly to keep regions competitive. As low-wage regions in the periphery are also regions with the lowest human capital, a comprehensive growth strategy would need to build capacity and reduce the stark differences in human and physical capital across regions.

***Authorities'* views**

49. The government argued that increases in the minimum wage and a higher rice price can start a virtuous growth cycle and boost domestic demand and growth as well as reduce social inequalities. The authorities believe that firms will try boosting productivity through capital investments if labor is more expensive, and do not expect this policy to cause unemployment given the overall shortage of labor. They indicated that they will adopt a gradual approach in implementing the minimum wage policy, to allow firms to adjust to the higher costs over time and reduce the risk of a surge in inflation.

STAFF APPRAISAL

50. Amidst uncertainty about the evolution of the global economy, the Thai economy is expected to rebound sharply from the impact of severe flooding in 2011. Staff expects GDP growth to rise from 0.1 percent in 2011 to 5.5 percent in 2012 and 7.5 percent in 2013 driven by a recovery in domestic demand and helped by supportive monetary conditions. Over the medium term, the estimated potential growth rate could increase from 3.5 to 5 percent if policies can successfully reduce supply-side constraints. Inflation is expected to remain within the target bands of the BOT.

51. Risks to the outlook remain significantly tilted to the downside and stem from both the global economy and domestic conditions. In line with other open economies in the region, Thailand is being affected by the sluggishness of the world economy and remains vulnerable to further shocks in its partner countries. At home, if there were renewed political tensions or underperformance of water management projects, this could adversely affect private investment and economic recovery.

52. In light of the anemic global outlook, the policy mix of monetary easing and fiscal stimulus will be providing welcome support to domestic demand in the near term but a gradual unwinding is called for over the medium term. The BOT's accommodative monetary stance is appropriate at this juncture, but the normalization policy should resume once recovery is achieved to keep inflationary expectations well anchored and contain credit growth. The fiscal stimulus is equally coming at an opportune time as the global outlook is highly uncertain and domestic demand needs to be supported. Beyond FY 2012, however, the authorities should gradually unwind the supportive policy stance and move to a medium-term consolidation path that is consistent with their commitment to fiscal sustainability.

53. In addition to flood-prevention investment and recovery-related expenditures, the new government strives to promote inclusive growth. The government's program aims at rebalancing income distribution through higher minimum wages and rice prices. Narrowing the income gap is a laudable objective, but it needs to be accompanied by higher labor productivity to maintain competitiveness. Hence, the gradual approach to implementing the minimum wage policy is appropriate. The rice price guarantee scheme may not benefit the farmers that are most in need and may impose potentially sizable costs, both explicit and implicit, to the budget. The cost and effectiveness of this policy should be carefully monitored.

54. The government's commitment to fiscal prudence is welcome but should be augmented with concrete measures. Given the pressing need to upgrade the infrastructure that are crucial for boosting trend growth, fiscal space should be secured through containing current expenditures and enhancing revenue, rather than through reducing public investment. Strengthening revenue administration through better use of information technology is appropriate to improve revenue collection and boost compliance. Revenue-enhancing measures such as eliminating income tax credits and reviewing the rate structure of excise taxes and VAT may also need to be added to the policy arsenal to maintain adequate public services and investment.

55. The resilience of fiscal policy would benefit from being set in a strengthened institutional framework. A fiscal rule, based on a public debt ceiling and a medium-term fiscal path consistent with that ceiling such as envisaged in the authorities' draft Public Finance Act, would add credibility to the government's commitment. A multi-year perspective would help establish a credible fiscal path that avoids unsustainable debt dynamics. The sustainability of fiscal policy would also be improved by more transparency and accountability of fiscal operations in line with the recommendations of the 2009 fiscal ROSC, including through comparison of budget figures to actual outturns in budget documents as well as more comprehensive coverage of extra-budgetary funds and public enterprises.

56. The banking sector remains sound and the measures to strengthen its resilience are commendable. Banks have weathered well the stress events in 2011 and the slowdown in economic activity. Looking ahead, the banking sector's activity is expected to pick up with the recovery, and banks' profit margins are likely to remain comfortable. The

BOT's guidelines for commercial banks to deal with flood-affected borrowers are appropriate and if the recovery unfolds as planned, asset quality is expected to be relatively unaffected. In addition, the new enhanced provisioning requirements will further boost the banks' resilience. The authorities should ensure that the deposit guarantee scheme has adequate resources, in line with best international practice.

57. Reforms to nonbank SFIs need to be pursued to limit fiscal risks. The decision to subject SFIs to a levy on their deposit base equivalent to what commercial banks pay is a welcome step toward leveling the playing field. As SFIs are a growing part of the Thai financial system, it is crucial to continue the reform effort by clearly refocusing their activity to their core mandate, and by applying more comprehensive bank supervision standards to deposit-taking ones. An external audit in line with best international accounting practices would help to assess and curtail potential fiscal contingent liabilities as well as financial risks.

58. Reforms planned for the financial sector, capital markets, and capital account liberalization are encouraging and welcome. The authorities have made good progress on their financial sector and capital markets development master plans, injecting more competition in the banking system, introducing a number of hedging instruments and deepening markets. The reforms planned toward further liberalizing financial flows is a step toward regional integration and will help Thai investors expand their investment base beyond domestic opportunities.

59. Addressing deficiencies identified by the FATF has gained urgency. The authorities need to amend the legislation to address the financing of terrorism issues identified in the action plan and to improve AML/CFT supervision of regulated entities as early as possible.

60. With trend growth expected to stay around 5 percent over the medium term, strong efforts to increase productivity would be needed to boost growth. Tapping underdeveloped regions, thereby spreading growth geographically across the nation would raise productive capacity. Staff recommends a comprehensive growth strategy that would build capacity including by investing in human and physical capital particularly in regions that do not have a direct access to trade routes.

61. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Table 1. Thailand: Selected Economic Indicators, 2009–13

Main exports (percent of total 2010): machinery and appliances (14.0), vehicles and parts (9.5)
GDP per capita (2011): US$5,113
Unemployment rate (2011): 0.4 percent
Poverty rate (2009): 8.1 percent
Net FDI (2010): US$1.4 billion
Population (2011): 67.6 million

				Projections	
	2009	2010	2011	2012	2013
Real GDP growth (percent)	-2.3	7.8	0.1	5.5	7.5
Inflation					
Headline CPI (period average, percent)	-0.8	3.3	3.8	3.9	3.3
Core CPI (period average, percent)	0.3	0.9	2.4	2.2	2.3
Saving and investment (percent of GDP)					
Gross domestic investment (excl. stocks)	24.1	24.7	26.2	27.7	28.8
Private	17.6	18.8	20.7	21.7	22.8
Public	6.5	5.9	5.5	6.0	6.0
Gross national saving	32.4	28.9	29.7	28.7	30.2
Private, including statistical discrepancy	29.6	23.8	26.0	25.9	28.2
Public	2.8	5.0	3.7	2.8	2.0
Foreign saving	-8.3	-4.1	-3.4	-1.0	-1.4
Fiscal accounts (percent of GDP) 1/					
Central government budgetary balance	-4.2	-2.6	-1.9	-2.8	-3.5
Revenue and grants	17.0	18.2	19.0	18.3	17.5
Expense and net acquisition of n.f. assets	21.2	20.8	20.9	21.1	21.0
General government balance 2/	-3.2	-0.8	-1.6	-3.0	-3.8
Public sector balance 3/	-3.6	-1.6	-2.4	-4.4	-5.6
Public sector debt	45.2	42.6	41.7	44.1	45.9
Monetary accounts (end-period, percent)					
Broad money growth	6.8	10.9	15.2	...	...
Narrow money growth	12.8	10.9	8.6	...	...
Private sector credit growth	2.5	12.3	16.7	...	...
Balance of payments (billions of U.S. dollars)					
Current account balance	21.9	13.2	11.9	3.8	5.8
(Percent of GDP)	8.3	4.1	3.4	1.0	1.4
Exports, f.o.b.	150.8	193.7	225.4	246.0	264.5
Growth rate (in dollar terms)	-13.9	28.4	16.4	9.2	7.5
Imports, f.o.b.	118.2	161.9	201.9	227.1	242.4
Growth rate (in dollar terms)	-25.1	37.0	24.7	12.5	6.7
Capital and financial account balance 4/	2.2	18.1	-10.7	7.3	7.6
Overall balance	-24.1	-31.3	-1.2	-4.1	-6.6
Gross official reserves (end-year; incl. net forward position)	154.1	191.7	206.3	212.7	222.4
(Months of following year's imports)	11.4	11.4	10.9	10.2	9.7
(Percent of maturing external debt)	360.1	342.9	484.5	476.7	477.4
Exchange rate (baht/U.S. dollar)	34.3	31.7	30.5	...	...
NEER appreciation (annual average)	-1.5	4.5	-1.6	...	...
REER appreciation (annual average)	-2.4	5.3	-0.9	...	...
External debt					
(In percent of GDP)	28.6	31.5	30.7	29.0	27.1
(In billions of U.S. dollars)	75.3	100.6	105.9	109.3	112.6
Public sector 5/	15.4	22.9	25.5	28.7	31.6
Private sector	59.9	77.6	80.4	80.6	81.0
Debt service ratio 6/	7.6	4.7	3.4	3.4	3.3
Memorandum items:					
Nominal GDP (In billions of baht)	9,042	10,105	10,539	11,449	12,714
(In billions U.S. dollars)	263.7	318.9	345.6	377.2	415.3

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

1/ On a fiscal year basis. The fiscal year ends on September 30.
2/ Includes budgetary central government, extrabudgetary funds, and local governments.
3/ Includes general government and nonfinancial public enterprises.
4/ Includes errors and omissions.
5/ Includes debt of state enterprises.
6/ Percent of exports of goods and services.

Table 2. Thailand: General Government Operations, 2007/08–2011/12

(In percent of fiscal year GDP, unless otherwise stated)

	2007/08	2008/09	2009/10	Est. 2010/11	IMF Proj. 2011/12
A. Central government (budgetary)					
1. Revenue	18.1	17.0	18.2	19.0	18.3
Taxes	16.0	14.9	15.8	16.9	15.9
Taxes on income, profits and capital gains	7.8	7.2	6.9	8.0	7.0
Taxes on goods and services	7.0	6.7	7.9	7.8	7.8
Taxes on international trade and transactions	1.1	0.9	0.9	0.9	1.0
Taxes not elsewhere classified	0.1	0.1	0.1	0.1	0.1
Grants	0.0	0.0	0.0	0.0	0.0
Other revenue	2.1	2.0	2.4	2.1	2.3
2. Total expenditure	18.7	21.2	20.8	20.9	21.1
Expense	17.3	19.2	18.4	18.5	18.1
Compensation of employees	6.4	7.2	7.6	6.7	7.6
Purchase/use of goods and services	3.7	5.1	4.9	5.1	4.4
Interest	1.2	1.1	1.3	1.9	0.8
Social benefits	0.9	1.3	0.4	0.1	0.9
Expense not elsewhere classified	5.1	4.5	4.3	4.7	4.4
Net acquisition of nonfinancial assets	1.4	2.0	2.4	2.4	3.0
3. Net lending/borrowing (budgetary) [=1-2]	-0.6	-4.2	-2.6	-1.9	-2.8
Net acquisition of financial assets	0.6	0.6	0.6	0.6	0.6
Net incurrence of liabilities	1.2	4.8	3.2	2.5	3.4
4. Nonbudgetary/loan expenditure 1/	0.0	0.2	2.4	0.5	0.8
5. Extrabudgetary balance	0.5	0.8	0.5	0.1	0.1
6. Social security balance	0.4	0.3	1.4	0.3	0.3
7. Net lending/borrowing (consolidated) [=3-4+5+6]	0.3	-3.4	-3.1	-2.0	-3.2
B. Local governments					
8. Revenue	3.7	3.8	3.5	3.3	3.3
9. Total expenditure	3.9	3.8	3.7	3.2	3.3
10. Net lending/borrowing	-0.2	-0.1	-0.2	0.1	0.0
C. General government					
Revenue	21.4	20.8	22.4	22.7	21.1
Taxes	17.3	16.7	17.5	18.6	17.4
Taxes on income, profits and capital gains	7.8	7.2	6.9	8.0	7.0
Taxes on goods and services	8.2	8.2	9.3	9.3	8.7
Taxes on international trade and transactions	1.1	0.9	0.9	0.9	1.0
Taxes not elsewhere classified	0.3	0.5	0.4	0.3	0.7
Social contributions	0.9	0.9	1.3	0.9	0.9
Grants	0.0	0.0	0.0	0.0	0.0
Other revenue	3.1	3.1	3.5	3.1	2.7
Total expenditure	21.2	24.0	23.2	24.2	24.1
Expense	18.7	20.8	19.8	20.8	20.2
Net acquisition of nonfinancial assets	2.5	3.2	3.5	3.4	3.9
Net lending/borrowing (consolidated)	0.1	-3.2	-0.8	-1.6	-3.0
Net acquisition of financial assets	0.8	2.2	1.7	1.6	0.6
Net incurrence of liabilities	0.7	5.4	2.5	3.1	3.6
D. Other					
Central government net lending/borrowing (budgetary)	-0.6	-4.2	-2.6	-1.9	-2.8
Central government net lending/borrowing (consolidated)	0.3	-3.4	-3.1	-2.0	-3.2
General government net lending/borrowing (consolidated)	0.1	-3.2	-0.8	-1.6	-3.0
Public enterprises balance	-0.7	-0.5	-0.8	-0.8	-1.4
Public sector balance	-0.6	-3.6	-1.6	-2.4	-4.4
Memorandum items:					
GDP (in billions of baht)	9,146	8,851	9,921	10,669	11,224
General government debt	23.6	29.2	29.3	29.4	31.3
General government debt and SOE guaranteed debt	29.9	35.5	34.7	34.4	36.6
Public debt 2/	37.3	45.2	42.6	41.7	44.1

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

1/ Expenditures related to Stimulus Package II, water management projects, and insurance fund undertaken outside the budget.
2/ Public debt includes any debt incurred by the central government, extrabudgetary funds or autonomous agencies, and state-owned enterprises. Special financial institutions' debt guaranteed by government is also included.

Table 3. Thailand: Balance of Payments, 2009–17 1/

(In billions of U.S. dollars, unless specified otherwise)

				Projection					
	2009	2010	2011	2012	2013	2014	2015	2016	2017
Current account balance	21.9	13.2	11.9	3.8	5.8	8.7	7.2	6.2	5.0
(In percent of GDP)	8.3	4.1	3.4	1.0	1.4	2.0	1.5	1.3	1.0
Trade balance	32.6	31.8	23.5	18.9	22.1	25.9	25.0	24.3	23.7
Exports, f.o.b.	150.8	193.7	225.4	246.0	264.5	282.7	299.7	318.3	338.2
(In percent of GDP)	57.2	60.7	65.2	65.2	63.6	64.0	64.0	64.3	64.7
Imports, f.o.b.	118.2	161.9	201.9	227.1	242.4	256.7	274.7	294.0	314.5
(In percent of GDP)	44.8	50.8	58.4	60.2	58.3	58.1	58.6	59.4	60.1
Of which: oil and oil products	24.8	31.9	43.0	50.1	51.6	50.4	49.8	50.2	51.4
Services	-6.4	-10.6	-9.9	-10.9	-11.5	-11.7	-12.1	-12.3	-12.4
Income and transfers	-4.3	-8.0	-1.7	-4.2	-4.8	-5.5	-5.7	-5.8	-6.2
Capital and financial account balance	2.5	-24.2	7.2	3.5	3.4	3.3	4.7	5.8	5.6
Foreign direct investment, net	-0.7	-4.2	2.4	2.7	3.5	4.0	4.7	5.2	5.1
Portfolio investment, net	5.5	-9.2	-3.4	-5.3	-5.4	-5.5	-5.0	-4.6	-4.7
Other investment, net	-1.1	-10.8	7.8	6.1	5.3	4.8	5.0	5.2	5.2
Errors and omissions	4.8	-6.1	-3.5	3.8	4.2	4.4	4.7	4.9	5.2
(In percent of GDP)	1.8	-1.9	-1.0	1.0	1.0	1.0	1.0	1.0	1.0
Overall balance	-24.1	-31.3	-1.2	-4.1	-6.6	-9.8	-7.2	-5.4	-4.6
Changes in official reserves (increase +)	24.1	31.3	1.2	4.1	6.6	9.8	7.2	5.4	4.6
Memorandum items:									
Gross official reserves (incl. net forward position, US$ billion)	154.1	191.7	206.3	212.7	222.4	236.5	249.8	262.8	275.6
(In months of following year's imports)	11.4	11.4	10.9	10.2	9.7	9.4	9.0	8.6	8.2
(In percent of short-term debt) 2/	360	343	484	477	477	486	491	493	592
Export growth	-13.9	28.4	16.4	9.2	7.5	6.9	6.0	6.2	6.3
Export volume growth	-14.2	17.7	10.2	9.2	7.4	7.0	6.5	6.1	6.1
Export unit value growth	0.3	9.1	5.6	-0.6	-0.3	-0.2	-0.4	0.1	0.4
Import growth	-25.1	37.0	24.7	12.5	6.7	5.9	7.0	7.0	7.0
Import volume growth	-23.2	26.8	13.2	11.1	7.7	7.6	8.2	7.6	7.2
Import unit value growth	-2.5	8.1	10.1	1.1	-0.8	-1.6	-1.2	-0.6	-0.1
Change in terms of trade	2.9	1.0	-4.0	-1.2	1.0	1.4	0.7	0.6	0.4
External debt/GDP	28.6	31.5	30.7	29.0	27.1	26.5	26.1	26.0	25.8
(In billions of U.S. dollars)	75.3	100.6	105.9	109.3	112.6	117.2	122.5	128.4	134.8
Debt service ratio 3/	7.6	4.7	3.4	3.4	3.3	3.0	2.7	2.5	2.7
GDP (US$ billion)	263.7	318.9	345.6	377.3	415.3	441.8	468.4	494.7	523.1

Sources: Based on data provided by the Thai authorities; and IMF staff estimates and projections.

1/ Balance of payments data are presented in accordance with BPM6 methodology, and therefore differ in some presentational aspects from data released by BOT.

2/ With remaining maturity of one year or less.

3/ In percent of exports of goods and services.

Table 4. Thailand: Monetary Survey, 2007–11

	December				
	2007	2008	2009	2010	2011
	(In billions of baht)				
Bank of Thailand					
Net foreign assets	2,951	3,872	4,525	5,082	5,441
Net domestic assets	-2,017	-2,833	-3,422	-3,839	-4,075
Of which : other items (net)	-1,389	-1,558	-1,580	-1,449	-1,484
Narrow money	1,000	1,041	1,175	1,302	1,414
Currency in circulation	720	752	844	937	1,036
Deposits at Depository Corporations	280	289	331	365	378
Reserve money	934	1,040	1,103	1,243	1,365
Monetary survey					
Net foreign assets	3,594	4,132	4,570	4,884	5,421
Net domestic assets	5,515	5,812	6,047	6,895	8,145
Domestic credit	8,884	9,566	10,014	11,015	12,753
Net credit to central government	132	203	292	155	203
Credit to nonfinancial public enterprises	348	325	366	372	392
Credit to financial corporations	574	519	625	668	699
Total credit to private sector	7,826	8,513	8,726	9,801	11,441
Credit to other nonfinancial corporations	3,775	4,135	3,847	4,132	4,838
Credit to other resident sector	4,051	4,378	4,879	5,669	6,603
Other items (net)	-3,369	-3,754	-3,967	-4,120	-4,609
Broad money	9,109	9,944	10,617	11,779	13,566
Currency	720	752	844	937	1,036
Transferable Deposits	280	289	331	365	378
Quasi money	8,110	8,903	9,442	10,476	12,152
Memorandum items:					
Broad money growth (y/y percent change)	6.3	9.2	6.8	10.9	15.2
Narrow money growth (y/y percent change)	9.7	4.1	12.8	10.9	8.6
Credit to private sector growth (y/y percent change)	4.8	8.8	2.5	12.3	16.7
Contribution to broad money growth	6.3	9.2	6.8	10.9	15.2
NFA	7.5	5.9	4.4	3.0	4.6
NDA	-1.3	3.3	2.4	8.0	10.6
Domestic credit	3.9	7.5	4.5	9.4	14.8

Sources: Bank of Thailand; and IMF staff calculations.

Table 5. Thailand: Financial Sector Indicators, 2005–11 1/

	2005	2006	2007	2008	2009	2010	2011	Latest observation
Capital adequacy								
Regulatory capital to risk-weighted assets	13.2	13.6	14.8	13.9	15.8	16.0	14.7	2011:Q4
Tier 1 capital to risk-weighted assets	9.9	10.7	11.9	10.7	11.7	11.8	10.9	2011:Q4
Asset quality								
Nonperforming loans to total loans	9.1	8.1	7.9	5.7	5.3	3.9	2.9	2011:Q4
Loan loss reserves to nonperforming loans	83.7	82.7	86.5	97.9	99.4	117.0	141.2	2011:Q4
Earnings and profitability								
Return on average assets (before tax and provisioning)	1.9	1.9	1.7	2.0	1.9	2.1	2.1	2011:Q4
Return on average assets (after tax)	1.4	0.8	0.1	1.0	1.0	1.2	1.2	2011:Q4
Return on equity (after tax)	14.2	8.5	1.2	10.3	9.5	10.9	12.0	2011:Q4
Non-interest income/total income	27.2	27.5	24.9	25.9	30.6	31.7	30.9	2011:Q4
Operating expenses/net interest income and dividend	72.4	78.4	80.9	74.5	81.8	80.2	76.7	2011:Q4
Liquidity								
Ratio of loans to deposits plus bills of exchange 2/	88.1	86.4	88.0	88.5	87.6	90.3	91.2	2011:Q4
Liquidity to deposits and borrowings ratio	18.2	16.7	19.6	24.2	27.4	27.4	27.2	2011:Q4
Sensitivity to market risk								
FX deposits (in percent of total deposits)	2.5	2.6	2.6	2.8	2.8	3.0	2.5	2011:Q4
FX loans to residents (in percent of total loans)	3.2	2.5	2.3	2.6	2.5	3.5	4.2	2011:Q4
Net open forex position (in percent of total capital)	2.5	1.6	3.0	1.9	4.1	2.7	2.1	2011:Q4
Memorandum items:								
Credit to private sector (percent change) 3/	8.0	4.5	4.8	8.8	2.5	12.3	16.7	2011:Q4
Nominal GDP (In US$ billion)	176.4	207.1	247.0	272.6	263.7	318.9	345.6	2011

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

1/ Data for locally incorporated banks and excludes retail banks, foreign branches and subsidiaries.
2/ Excludes interbank loans and deposits. Bills of exchange are CD-like instruments that are considered a stable source of bank funding.
3/ Includes all depository corporations.

Table 6. Thailand: Macroeconomic Framework, 2009–17

				Projections					
	2009	2010	2011	2012	2013	2014	2015	2016	2017
Real GDP growth (percent)	-2.3	7.8	0.1	5.5	7.5	4.5	4.6	4.8	5.0
Consumption	0.1	5.1	1.3	4.3	6.0	5.4	5.3	5.3	5.0
Gross fixed investment	-9.2	9.4	3.3	5.1	11.1	1.8	3.1	4.4	4.0
Headline CPI inflation (period average, percent)	-0.8	3.3	3.8	3.9	3.3	3.0	3.0	3.0	3.0
Core CPI inflation (period average, percent)	0.3	0.9	2.4	2.2	2.3	2.5	2.5	2.5	2.5
Saving and investment (percent of GDP)									
Gross domestic investment (excluding stocks)	24.1	24.7	26.2	27.7	28.8	28.1	27.7	27.7	27.6
Private	17.6	18.8	20.7	21.7	22.8	22.4	22.3	22.3	22.3
Public	6.5	5.9	5.5	6.0	6.0	5.8	5.4	5.4	5.3
Gross national saving	32.4	28.9	29.7	28.7	30.2	30.1	29.3	29.0	28.5
Private, including statistical discrepancy	29.6	23.8	26.0	25.9	28.2	28.2	27.2	26.6	26.2
Public	2.8	5.0	3.7	2.8	2.0	1.9	2.0	2.4	2.3
Foreign saving (- = current account surplus)	-8.3	-4.1	-3.4	-1.0	-1.4	-2.0	-1.5	-1.3	-1.0
Fiscal accounts (percent of GDP, fiscal year basis)									
Central government budgetary balance	-4.2	-2.6	-1.9	-2.8	-3.5	-3.1	-3.1	-2.7	-2.4
General government balance	-3.2	-0.8	-1.6	-3.0	-3.8	-4.2	-2.7	-2.4	-2.1
Revenue and grants	20.8	22.4	22.7	21.1	20.3	20.1	20.2	20.5	20.8
Expense and net acquisition of nonfinancial assets	24.0	23.2	24.2	24.1	24.2	24.3	22.9	22.9	22.9
Public sector balance	-3.6	-1.6	-2.4	-4.4	-5.6	-6.0	-4.5	-4.2	-3.9
Total public sector debt (end-period)	45.2	42.6	41.7	44.1	45.9	48.5	49.7	50.6	51.0
Balance of payments (billions of U.S. dollars)									
Exports, f.o.b.	150.8	193.7	225.4	246.0	264.5	282.7	299.7	318.3	338.2
(Volume growth)	-14.2	17.7	10.2	9.2	7.4	7.0	6.5	6.1	6.1
Imports, f.o.b.	118.2	161.9	201.9	227.1	242.4	256.7	274.7	294.0	314.5
(Volume growth)	-23.2	26.8	13.2	11.1	7.7	7.6	8.2	7.6	7.2
Trade balance	32.6	31.8	23.5	18.9	22.1	25.9	25.0	24.3	23.7
Services, income, and transfers	-10.7	-18.6	-11.6	-15.1	-16.3	-17.2	-17.8	-18.1	-18.7
Current account balance	21.9	13.2	11.9	3.8	5.8	8.7	7.2	6.2	5.0
(Percent of GDP)	8.3	4.1	3.4	1.0	1.4	2.0	1.5	1.3	1.0
Financial account balance 1/	2.2	18.1	-10.7	7.3	7.6	7.8	9.4	10.7	10.9
Overall balance	-24.1	-31.3	-1.2	-4.1	-6.6	-9.8	-7.2	-5.4	-4.6
Gross official reserves (including net forward position, US$ billions)	154.1	191.7	206.3	212.7	222.4	236.5	249.8	262.8	275.6
(Months of following year's imports of goods)	11.4	11.4	10.9	10.2	9.7	9.4	9.0	8.6	8.2
(Percent of short-term debt by remaining maturity)	360	343	484	477	477	486	491	493	592
External debt (percent of GDP)	28.6	31.5	30.7	29.0	27.1	26.5	26.1	26.0	25.8
Debt-service ratio (percent of exports of goods and nonfactor services)	7.6	4.7	3.4	3.4	3.3	3.0	2.7	2.5	2.7

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

1/ Includes errors and omissions.

Table 7. Thailand: Medium-Term Fiscal Scenario, 2008/09–2016/17 1/

(In percent of fiscal year GDP, unless otherwise stated)

			Est.	IMF Projection					
	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
A. Central government									
1. Revenue	17.0	18.2	19.0	18.3	17.5	17.3	17.4	17.7	18.0
Tax revenue	14.9	15.8	16.9	15.9	15.4	15.3	15.3	15.6	15.9
Taxes on income and profits	7.2	6.9	8.0	7.0	6.0	6.0	6.0	6.3	6.6
Taxes on goods and services	6.7	7.9	7.8	7.8	8.3	8.3	8.4	8.4	8.5
Taxes on international trade	0.9	0.9	0.9	1.0	0.9	0.8	0.8	0.7	0.7
Taxes not elsewhere classified	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social contributions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue	2.0	2.4	2.1	2.3	2.1	2.1	2.1	2.1	2.1
2. Total expenditure	21.2	20.8	20.9	21.1	21.0	20.4	20.5	20.4	20.4
Expense	19.2	18.4	18.5	18.1	18.0	18.0	18.0	18.0	17.9
Compensation of employees	7.2	7.6	6.7	7.6	7.5	7.5	7.5	7.5	7.5
Purchase/use of goods and services	5.1	4.9	5.1	4.4	4.3	4.2	4.1	4.1	4.0
Interest	1.1	1.3	1.9	0.8	0.9	1.0	1.1	1.1	1.2
Social benefits	1.3	0.4	0.1	0.9	0.9	0.9	0.9	0.9	0.9
Expense not elsewhere classified	4.5	4.3	4.7	4.4	4.4	4.4	4.4	4.4	4.4
Net acquisition of nonfinancial assets	2.0	2.4	2.4	3.0	3.0	2.4	2.4	2.4	2.4
3. Net lending/borrowing (budgetary)	-4.2	-2.6	-1.9	-2.8	-3.5	-3.1	-3.1	-2.7	-2.4
4. Nonbudgetary/loan expenditure 2/	0.2	2.4	0.5	0.8	0.8	1.6	0.0	0.0	0.0
5. Extrabudgetary balance	0.8	0.5	0.1	0.1	0.1	0.1	0.1	0.1	0.1
6. Social security balance	0.3	1.4	0.3	0.3	0.2	0.2	0.2	0.2	0.2
7. Net lending/borrowing (consolidated)	-3.4	-3.1	-2.0	-3.2	-4.0	-4.3	-2.8	-2.4	-2.1
B. Local government									
8. Revenue	3.8	3.5	3.3	3.3	3.3	3.3	3.3	3.3	3.3
9. Total expenditure	3.8	3.7	3.2	3.3	3.3	3.3	3.3	3.3	3.3
10. Net lending/borrowing	-0.1	-0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0
C. General government									
Revenue	20.8	22.4	22.7	21.1	20.3	20.1	20.2	20.5	20.8
Tax revenue	16.7	17.5	18.6	17.4	16.9	16.7	16.8	17.1	17.4
Taxes on income and profits	7.2	6.9	8.0	7.0	6.0	6.0	6.0	6.3	6.6
Taxes on goods and services	8.2	9.3	9.3	8.7	9.2	9.3	9.3	9.4	9.4
Taxes on international trade	0.9	0.9	0.9	1.0	0.9	0.8	0.8	0.7	0.7
Taxes not elsewhere classified	0.5	0.4	0.3	0.7	0.7	0.7	0.7	0.7	0.7
Social contributions	0.9	1.3	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue	3.1	3.5	3.1	2.7	2.5	2.5	2.5	2.5	2.5
Total expenditure	24.0	23.2	24.2	24.1	24.2	24.3	22.9	22.9	22.9
Expense	20.8	19.8	20.8	20.2	20.1	20.2	20.3	20.3	20.3
Compensation of employees	8.4	8.6	7.7	8.6	8.5	8.5	8.5	8.5	8.5
Purchase/use of goods and services	7.3	7.4	7.4	5.4	5.3	5.2	5.1	5.0	5.0
Interest	1.1	1.3	1.9	0.8	0.9	1.0	1.1	1.1	1.2
Social benefits	2.7	1.2	1.4	1.1	1.1	1.1	1.1	1.1	1.1
Expense not elsewhere classified	1.3	1.3	2.5	4.3	4.4	4.5	4.5	4.6	4.6
Net acquisition of nonfinancial assets	3.2	3.5	3.4	3.9	4.0	4.1	2.6	2.6	2.6
Net lending/borrowing (consolidated)	-3.2	-0.8	-1.6	-3.0	-3.8	-4.2	-2.7	-2.4	-2.1
Memorandum items:									
Central government net lending/borrowing (budgetary)	-4.2	-2.6	-1.9	-2.8	-3.5	-3.1	-3.1	-2.7	-2.4
Central government net lending/borrowing (consolidated)	-3.4	-3.1	-2.0	-3.2	-4.0	-4.3	-2.8	-2.4	-2.1
Local government net lending/borrowing	-0.1	-0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0
General government net lending/borrowing (consolidated)	-3.2	-0.8	-1.6	-3.0	-3.8	-4.2	-2.7	-2.4	-2.1
Public enterprise balance	-0.5	-0.8	-0.8	-1.4	-1.8	-1.8	-1.8	-1.8	-1.8
Public sector balance	-3.6	-1.6	-2.4	-4.4	-5.6	-6.0	-4.5	-4.2	-3.9
Public sector debt 3/	45.2	42.6	41.7	44.1	45.9	48.5	49.7	50.6	51.0
Central government	29.2	29.3	29.4	31.3	32.3	34.0	34.4	34.4	34.1
FIDF	1.1	0.6	0.3	0.0	0.0	0.0	0.0	0.0	0.0
NFPE	12.5	10.9	10.1	11.0	11.8	12.6	13.5	14.4	15.1
SFIs guaranteed debt, VF and EFPO	2.4	1.8	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Public sector consumption	15.0	15.1	14.0	14.3	14.1	14.0	14.0	13.9	13.8
Public sector investment 4/	5.4	7.1	6.3	7.2	7.2	7.4	5.8	5.8	5.8
General government	3.3	4.6	3.8	4.7	4.8	4.9	3.4	3.4	3.4
Public enterprises	2.1	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4

Source: IMF Staff estimates.

1/ The fiscal year runs from October 1 to September 30.
2/ Expenditures related to Stimulus Package II, water management projects and insurance fund undertaken outside the budget.
3/ Public debt includes any debt incurred by the central government, extrabudgetary funds or autonomous agencies, and state-owned enterprises.
Special financial institutions debt guaranteed by government is also included.
4/ Fiscal basis; differs from national account.

Appendix I: Thailand—Risk Assessment Matrix

Nature/ Source of Main Threats	Overall Level of Concern	
	Likelihood of Severe Realization of Threat in the Next 1-3 Years (high, medium, or low)	**Expected Impact if Threat is Realized** (high, medium, or low)
1. Intensification of the euro-zone crisis and global double-dip.	**Medium** • The euro-zone sovereign crisis is intensifying and could possibly lead to a global double-dip recession. • The global aversion to risk would increase.	**Medium** • Thai banks are mostly domestically funded so the direct impact would be relatively limited. • Nonetheless, an increase in the global aversion to risk could lead to a sharp decline in stock markets. • A global downturn would hurt Thailand via lower export prospects.
2. Underperformance of public spending	**Medium/High** • The government has devised an ambitious investment and recovery expenditures plan that could face implementation issues	**Medium/High** • Underperformance of public investment would adversely affect growth not only in the short run but also in the medium term as public investment is key to raising potential output.
3. Domestic political tensions	**Low/Medium** • In spite of the clear outcome of the general election held in 2011, the country remains politically divided and unrest could resume.	**High** • Political unrest would worsen the investment climate already hurt by the 2011 floods. • Consumer and business confidence would be damaged
4. Slower growth in China by 2 percentage points	**Low** • A tighter macroeconomic policy stance in China would slow growth further and affect regional growth.	**Medium** • If growth in China slows down more than expected, if would have a significant knock-on effect on Thailand.
5. Substantial and prolonged increase in oil prices	**Medium** • The international boycott of Iranian oil could put upward pressure on oil prices. • However, a considerable and prolonged increase in oil prices is not very likely given the weak global outlook.	**Medium** • A substantial and prolonged increase in oil prices would have a significant fiscal cost.
6. Resumption of capital inflows	**Medium** • Yield differentials could attract capital away from depressed advanced economies.	**Low** • Higher capital inflows put appreciation pressure on the currency. • Depending on the authorities' policy response, we can see different impacts; ○ Exchange rate appreciation could eventually hurt the export sector but past inflow episodes have shown that there is room for exchange rate flexibility. ○ Large inflows imply costly sterilization for the central bank and complicate the conduct of macroeconomic policy.

Appendix II: Thailand—Public and External Debt Sustainability

A. Public Debt Sustainability

1. Thailand's public debt is at a turning point from a downward trend to an upward one. In percent of GDP it has been on a downward trend except for a sharp increase in FY2009, but is expected to increase to 44 percent in FY2012. It is pushed up by 2 percentage points due to low GDP growth, lower government revenue from corporate income tax rate reduction and a fuel excise tax cut, as well as additional borrowing for water management projects and government guarantees for SOE borrowing to implement the rice price guarantee scheme. Announced revenue policy will further reduce government revenue until FY2014, and current expenditure will stay at around the level of FY2012. While public investment is expected to fall as water management projects come to completion in FY2014, the saving from this is not enough to offset the revenue loss. Under these assumptions, the public debt path would be on upward trend, with the ratio reaching 51 percent at the end of the projection period. Within the overall public debt, direct government debt would increase by 3 percentage points from FY2012 to FY2017, while the public enterprise debt would increase by 4 percentage points during the same period.

2. This profile is relatively resilient to interest rate shocks and exchange rate shocks. With the stable interest rates in the past and very little debt owed externally, shocks to interest and exchange rates make only modest differences to the medium-term forecast.

3. A more sizeable impact would come from shocks to the primary balance, or a combination shock. If the primary balance records an average deficit of 3 percent of GDP over the forecast horizon, instead of averaging 1.5 percent as assumed, then by 2017 the debt/GDP ratio would be 7 percentage points higher than in the baseline. A combined shock, in which the real interest rate, growth rate, and primary balance are permanently worse than under the baseline by one-quarter standard deviation, would also increase the debt/GDP ratio by 6 percentage points.

4. A contingent liabilities shock would generate a large deviation from the baseline. That is, if 10 percent of GDP in contingent liabilities are brought on budget in 2013, then even by 2017 the debt to GDP ratio would still remain 9 percentage points higher than in the baseline.

5. The most significant risk to the debt outlook comes from a potential slowdown in growth. Under the baseline scenario, growth is forecast to average around 5.5 percent over the medium term, 1 percentage point above the historical average. But the standard deviation of growth in Thailand is reasonably high. So, if growth proved lower than assumed by one-half a standard deviation, then the growth rate would average just 3.5 percent, and this in turn would push up the debt/GDP ratio by 10 percentage points.

6. While public debt levels are still modest and generally contained, these scenarios suggest proactive actions are needed for Thailand's public debt path to remain sustainable and resilient to shocks.

B. External Debt Sustainability

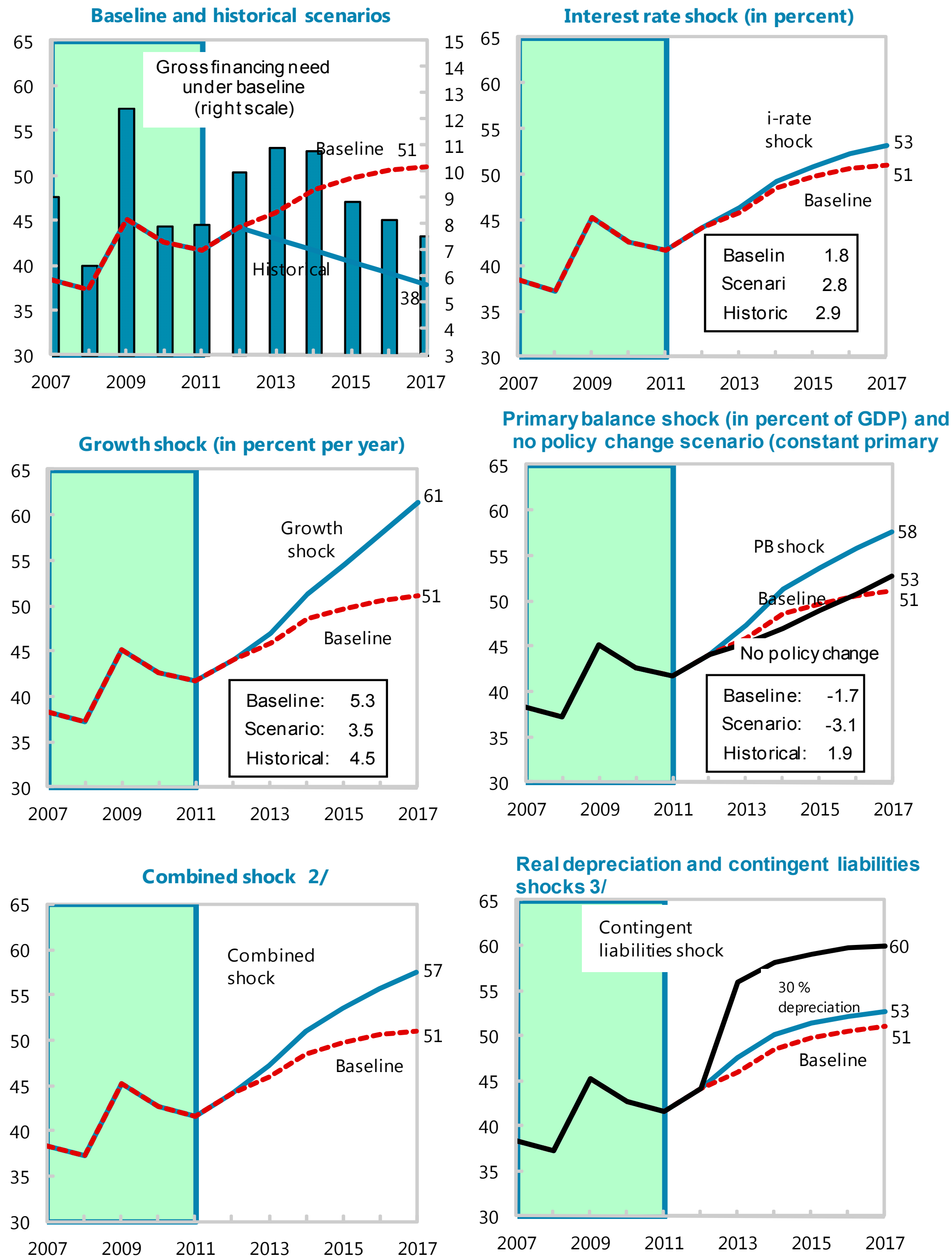
7. Thailand's external debt is projected to remain low and stable over the medium term. External debt amounted to $107 billion at the end of 2011 (28 percent of GDP), up by $6 billion (3.5 percent of GDP) from the previous year. The small increase over 2011 came from long-term general government borrowing, and the nonbank corporate and financial sectors. The increase also represented a lengthening of maturities, as short-term debt outstanding fell marginally and long-term debt rose. Going forward, Thailand's external debt is expected to first rise in 2012 to 32 percent of GDP, reflecting the financing needs of the government for the large scale infrastructure projects. Beyond 2012, external debt is projected to continue to rise, albeit at a slower pace than national income, thus declining from 32 percent back to 28 percent by 2017.

8. External debt trajectories appear broadly stable under macroeconomic shocks based on historical levels. The shock levels in the stress tests are based on 10-year historical standard deviations, and thus represent "plausible," rather than "extraordinary" permanent shocks (see Figure A2 for the shock values). Under such plausible scenarios, a slowdown in the economic growth rate or a rise in the external interest rate does not cause a large deviation in the external debt outlook for Thailand. A permanent one-half standard deviation shock to the non-interest current account balance has a relatively larger impact, raising external debt by 9 percentage points above the baseline by 2017 to 37 percent of GDP. Similarly, a combination of shocks such that the external interest rate, the non-interest current account balance, and economic growth all deviate from the baseline by a one-quarter standard deviation; external debt would rise by 6 percentage points from the baseline by the end of the medium term to 37 percent of GDP.

9. A large depreciation of the real exchange rate would have a larger impact on external debt. A real depreciation of 30 percent in 2012, which is equivalent to about a 34 percent nominal depreciation, would simultaneously raise the debt ratio by about 20 percentage points. However, this analysis excludes the adjustment that trade flows would have if such a depreciation were to occur, such as a sharp improvement in the current account that would—after the initial rise—bring the debt ratio back down significantly over the medium term.

10. Overall, Thailand's external debt remains stable under all reasonable stress scenarios.

Figure A1. Thailand: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of fiscal year GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2013, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table A1. Thailand: Public Sector Debt Sustainability Framework, 2007–17

(In percent of fiscal year GDP, unless otherwise indicated)

	Actual					Projections						
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Debt-stabilizing primary balance 9/
1 **Baseline: Public sector debt 1/**	38.3	37.3	45.2	42.6	41.7	**44.1**	**45.9**	**48.5**	**49.7**	**50.6**	**51.0**	**-1.4**
2 Change in public sector debt	-3.6	-1.1	8.0	-2.6	-1.0	2.4	1.8	2.6	1.2	0.9	0.5	
3 Identified debt-creating flows (4+7+12)	-3.5	-1.8	6.3	-2.4	-1.0	1.7	0.4	1.4	0.0	-0.3	-0.7	
4 Primary deficit	-1.5	-1.5	1.6	-0.7	-0.4	1.9	2.7	3.0	1.3	1.0	0.6	
5 Revenue and grants	23.6	23.0	22.5	24.1	24.3	22.7	22.0	21.8	21.8	22.1	22.4	
6 Primary (noninterest) expenditure	22.0	21.5	24.0	23.4	23.9	24.6	24.7	24.8	23.2	23.1	23.1	
7 Automatic debt dynamics 2/	-2.0	-1.8	3.5	-2.8	-0.5	-0.2	-2.3	-1.6	-1.3	-1.3	-1.3	
8 Contribution from interest rate/growth differential 3/	-1.1	-1.4	3.3	-2.6	-0.2	-0.2	-2.3	-1.6	-1.3	-1.3	-1.3	
9 Of which contribution from real interest rate	0.8	0.3	1.5	0.8	1.1	0.6	0.5	0.6	0.7	0.9	1.0	
10 Of which contribution from real GDP growth	-1.9	-1.7	1.8	-3.4	-1.3	-0.7	-2.8	-2.2	-2.1	-2.2	-2.3	
11 Contribution from exchange rate depreciation 4/	-0.9	-0.4	0.2	-0.2	-0.3	…	…	…	…	…	…	
12 Other identified debt-creating flows	0.1	1.5	1.2	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
13 Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
14 Recognition of implicit or contingent liabilities	0.1	1.5	1.2	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2–3) 5/	-0.2	0.7	1.7	-0.2	0.0	0.7	1.3	1.3	1.2	1.2	1.1	
Public sector debt-to-revenue ratio 1/	162.7	161.8	201.3	177.2	171.5	194.2	208.9	222.5	227.6	228.4	227.5	
Gross financing need 6/	9.0	6.4	12.4	7.9	8.0	10.0	10.9	10.8	8.8	8.2	7.5	
in billions of U.S. dollars	21.7	17.5	32.1	24.7	27.9	36.6	43.9	46.5	40.6	39.7	38.7	
Scenario with key variables at their historical averages 7/						**44.1**	**42.9**	**41.7**	**40.4**	**39.1**	**37.8**	**-0.7**
Scenario with no policy change (constant primary balance) in 2012–17						**44.1**	**45.3**	**46.9**	**48.9**	**50.8**	**52.7**	**-1.3**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.8	5.0	-4.8	8.4	3.4	1.8	7.0	5.2	4.6	4.8	5.0	
Average nominal interest rate on public debt (in percent) 8/	5.1	6.1	5.4	5.6	7.1	4.8	4.8	4.8	4.8	4.8	4.7	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.2	1.1	3.8	2.2	3.0	1.5	1.6	1.6	1.7	2.1	2.3	
Nominal appreciation (increase in U.S. dollar value of local currency, in percent)	13.8	6.9	-3.4	4.7	10.5	…	…	…	…	…	…	
Inflation rate (GDP deflator, in percent)	2.9	4.9	1.7	3.4	4.1	3.3	3.3	3.2	3.0	2.7	2.5	
Growth of real primary spending (deflated by GDP deflator, in percent)	13.0	2.5	6.3	5.5	5.5	5.0	7.2	5.6	-2.2	4.6	4.8	
Primary deficit	-1.5	-1.5	1.6	-0.7	-0.4	1.9	2.7	3.0	1.3	1.0	0.6	

1/ Public debt includes any debt incurred by the central government, extrabudgetary funds or autonomous agencies, and state-owned enterprises. Special financial institutions debt guaranteed by government is also included.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

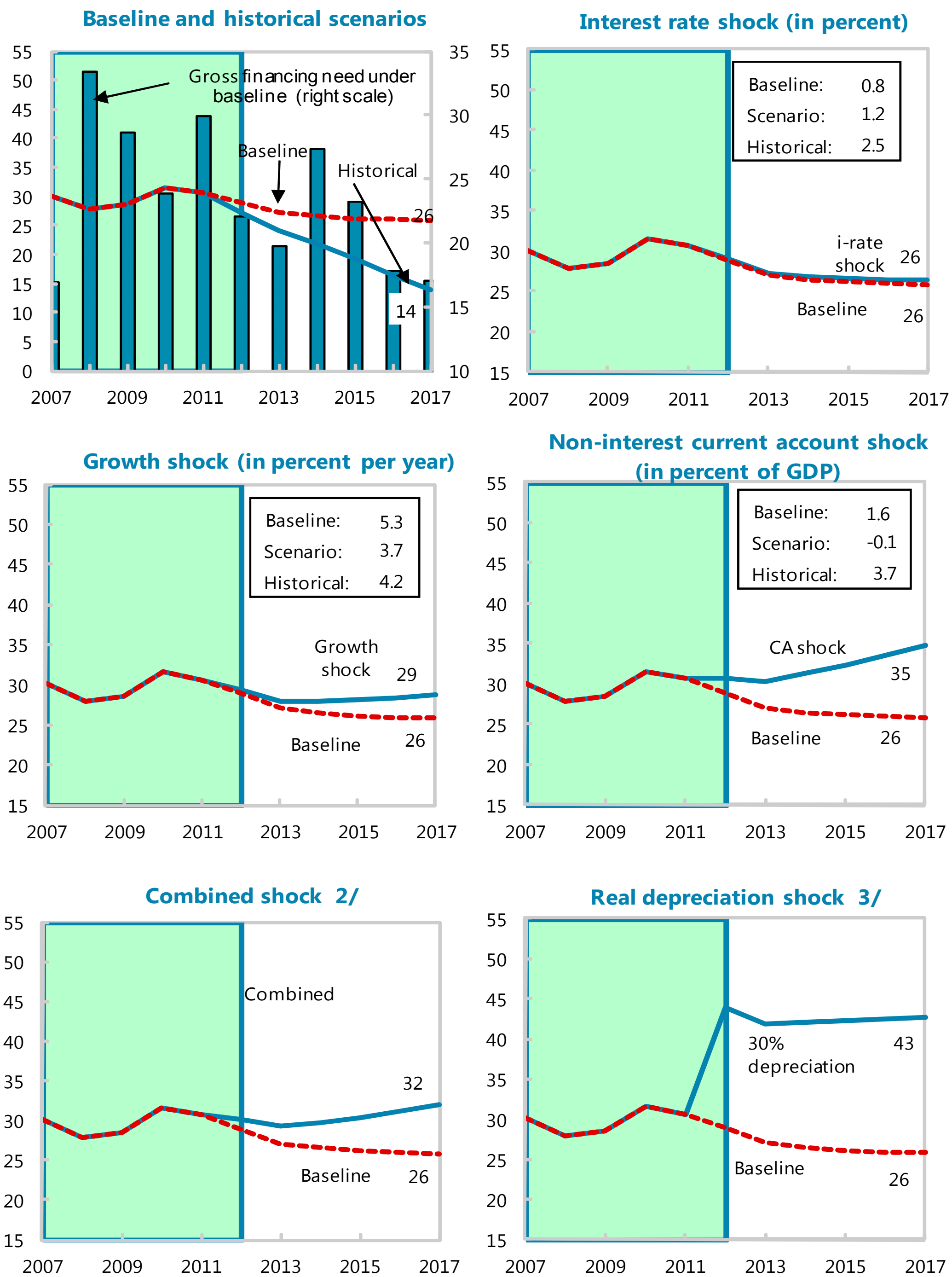
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure A2. Thailand: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data; and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2012.

Table A2. Thailand: External Debt Sustainability Framework, 2007–17

(In percent of GDP, unless otherwise indicated)

	Actual					Projections							
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017		Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	30.1	27.9	28.6	31.5	30.7	**29.0**	**27.1**	**26.5**	**26.1**	**26.0**	**25.8**		**-1.9**
2 Change in external debt	-3.7	-2.2	0.6	3.0	-0.9	-1.7	-1.9	-0.6	-0.4	-0.2	-0.2	0.0	
3 Identified external debt-creating flows (4+8+9)	-16.5	-4.3	-8.7	-11.5	-6.3	-3.5	-4.1	-3.8	-3.4	-3.1	-2.9	0.0	
4 Current account deficit, excluding interest payments	-7.1	-1.4	-8.7	-4.5	-3.8	-1.3	-1.7	-2.2	-1.6	-1.3	-1.3	1.9	
5 Deficit in balance of goods and services	-7.6	-1.6	-10.0	-6.7	-3.9	-2.1	-2.6	-3.2	-2.8	-2.4	-2.2		
6 Exports	73.4	76.4	68.6	71.5	77.0	77.4	76.2	77.1	77.9	79.1	80.4		
7 Imports	65.9	74.8	58.7	64.8	73.1	75.3	73.6	73.9	75.1	76.7	78.2		
8 Net non-debt creating capital inflows (negative)	-4.7	-0.7	-1.3	-2.4	-0.4	-0.9	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	
9 Automatic debt dynamics 1/	-4.7	-2.2	1.4	-4.6	-2.1	-1.3	-1.7	-1.0	-1.1	-1.1	-0.9	-1.2	
10 Contribution from nominal interest rate	0.8	0.6	0.4	0.4	0.4	0.2	0.3	0.2	0.1	0.1	0.4	0.4	
11 Contribution from real GDP growth	-1.4	-0.7	0.7	-1.8	0.0	-1.5	-2.0	-1.1	-1.2	-1.2	-1.2	-1.2	
12 Contribution from price and exchange rate changes 2/	-4.0	-2.1	0.3	-3.1	-2.4	...	...	...	...	...	...	-0.3	
13 Residual, including change in gross foreign assets (2–3) 3/	12.8	2.1	9.3	14.5	5.4	1.8	2.3	3.2	3.0	2.9	2.7	0.0	
External debt-to-exports ratio (in percent)	41.0	36.5	41.6	44.1	39.8	37.4	35.6	34.4	33.6	32.8	32.1		
Gross external financing need (in billions of U.S. dollars) 4/	58.9	81.6	58.3	62.8	94.7	87.3	74.2	75.2	80.8	86.3	92.2		
in percent of GDP	23.8	29.9	22.1	19.7	27.4	23.2	17.9	17.0	17.3	17.5	17.7		
Scenario with key variables at their historical averages 5/						**27.1**	**24.0**	**21.8**	**19.2**	**16.6**	**13.9**		**-1.3**
Key Macroeconomic Assumptions Underlying Baseline												For debt stabilization	
Real GDP growth (in percent)	5.0	2.6	-2.3	7.8	0.1	5.5	7.5	4.5	4.6	4.8	5.0	5.0	
GDP deflator in U.S. dollars (change in percent)	13.5	7.6	-0.9	12.2	8.3	3.4	2.4	1.7	1.4	0.8	0.7	1.4	
Nominal external interest rate (in percent)	2.7	2.1	1.5	1.6	1.3	0.9	1.0	0.8	0.4	0.3	1.5	1.5	
Growth of exports (U.S. dollar terms, in percent)	18.9	14.9	-13.1	26.0	16.8	9.8	8.3	7.7	7.1	7.3	7.4		
Growth of imports (U.S. dollar terms, in percent)	10.7	25.3	-24.1	33.7	22.2	12.5	7.6	6.8	7.8	7.8	7.8		
Current account balance, excluding interest payments	7.1	1.4	8.7	4.5	3.8	1.3	1.7	2.2	1.6	1.3	1.3		
Net non-debt creating capital inflows	4.7	0.7	1.3	2.4	0.4	0.9	0.7	0.7	0.7	0.7	0.7		

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in U.S. dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Appendix III: Thailand—Health Care Spending – Implications of Demographic Change[1]

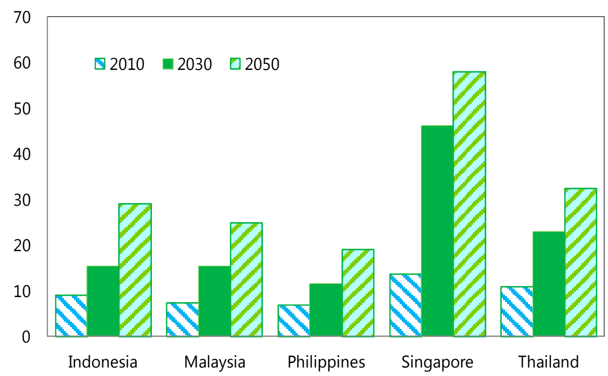
A. Why Demographic change matters for Thailand?

Thailand has a rapidly aging population – among ASEAN-5 countries, its old age dependency ratio is the second highest only after Singapore, and will remain so in 2050 (Figure 1). While the high dependency ratio reflects longer life expectancy thanks to improved nutrition and health conditions, an aging population generally means a higher fiscal burden to support the elderly with revenues from less dynamic economic activities. It is thus highly advisable for Thailand to prepare for the future increase in age-related spending.

B. Why Focus on Health Care Spending?

Two major items of age-related spending are pension benefits and health care spending. Increases in public expenditure on pensions are in general modest relative to that in health care spending, partly reflecting significant reforms that have already been accomplished in many countries. In the case of Thailand, pensions cover only 10 million members in the formal sector and 2 million civil servants, out of 60 million people. Though it was proposed to set up a national saving fund to extend persion benefits to those who are not covered by the current scheme, details of the scheme are still under consideration. Allowances for old age people, which could be characterised as pension benefits, are also at a low level (B 500 per month). Health care spending, in contrast, is subject to cost increase due to upgrades in available health services and lower productivity growth of services relative to other sectors of the economy.

ASEAN–5: Old-Age Dependency Ratio
(In percent)



Source: United Nations, *World Population Prospects*.

C. Overview of the Public Health Care System in Thailand

There are four main health care options in Thailand: i) the Universal Coverage Scheme (UCS); ii) the Civil Servants Medical Benefits Scheme (CSMBS); iii) the Social Security Scheme (SSS); and iv) private insurance. UCS and CSMBS are mainly financed by tax, and SSS is financed through compulsory 1.5 percent payroll contributions respectively by employers, employees, and the government. Private insurance is voluntary and entirely financed through private and employer contributions. By 2007, 98 percent of the population is estimated to be covered by formal insurance, completing the near universal coverage.

The experience of Thailand in achieving the universal coverage of health care is widely seen as a success. The proportion of people

[1] Prepared by Akihiko Yoshida.

facing catastrophic health expenditures has decreased from 5.4 percent in 2000 to 2.0 percent in 2006, which is estimated to have brought at least 1 million Thais out of poverty. And this was achieved without an excessive increase in public health spending (which increased from 1.9 percent of GDP in 2000 to 2.7 percent in 2007), partly due to relatively stable economic growth during this period.

D. Projections of Public Health Spending

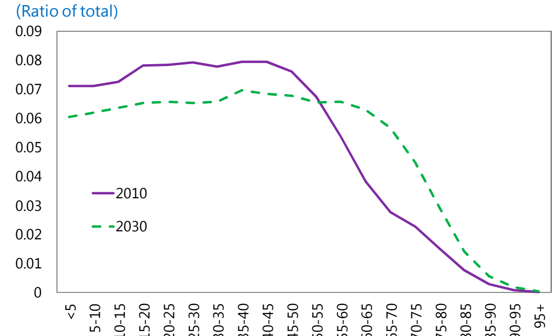
(1) Methodology

Generally, health care spending tends to rise as a share of GDP as countries develop. In addition, elderly people consume on average more health services than their younger counterparts. Non age-related increase in health spending as a share of GDP is known as excess cost growth (ECG). ECG is attributable to factors such as rising incomes, technological advances, and the relatively low productivity growth of services relative to other sectors of the economy (the Baumol effect). For Thailand, limited historical data on health care spending makes it difficult to estimate a country specific ECG. In this note, projections of future health care spending will be based on a common ECG of 1.0 percent, which is consistent with the average ECG observed for emerging economies (IMF, 2010). The projections incorporate spending profile by age group as well as expected changes in the age structure of the population.

(2) Baseline projections

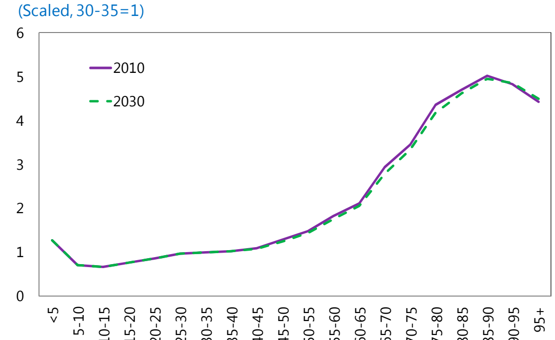
In Thailand, the share of the population older than age 60 is projected to increase from 12 percent in 2010 to 22 percent in 2030. The age profile of per capita public health spending in 2010 is assumed to be the same as the average for OECD countries, and to shift to the right by half a year every 10 years to reflect gains in longevity being spent in good health.

Thailand: Age Distribution of the Population
(Ratio of total)



Source: IMF staff estimates.

Thailand: Age Spending Profile
(Scaled, 30-35=1)



Source: IMF staff estimates.

Health Spending-Age profile and Age-distribution of the Population in Thailand

		<5	5-10	10-15	15-20	20-25	25-30	30-35	35-40	40-45	45-50	50-55	55-60	60-65	65-70	70-75	75-80	80-85	85-90	90-95	95+
W	2010	1.3	1.5	1.3	0.8	0.9	1.0	1.0	1.0	1.1	1.3	1.5	1.8	2.1	2.9	3.4	4.4	4.7	5.0	4.8	4.4
	2030 (mid-point)	1.3	1.4	1.3	0.8	0.9	1.0	1.0	1.0	1.1	1.2	1.4	1.8	2.1	2.8	3.3	4.2	4.6	4.9	4.9	4.5
P	2010	7.1	6.7	7.1	7.8	7.8	7.9	7.8	7.9	7.9	7.6	6.7	5.4	3.8	2.8	2.3	1.5	0.8	0.3	0.1	0.0
	2030	6.0	6.6	6.0	6.5	6.6	6.5	6.6	7.0	6.8	6.8	6.6	6.6	6.3	5.7	4.5	2.9	1.4	0.6	0.2	0.0

To illustrate the impact of aging, public health spending in 2030 (=PHE(2030)) can be described in the following formula:

PHE(2030) = PHE(2010) * [P(0-5, 2030)*W(0-5, 2030) + P(6-10, 2030)*W(6-10, 2030) + … + P(95+, 2030)*W(95+, 2030)] / [P(0-5, 2010)*W(0-5, 2010) + P(6-10, 2010)*W(6-10, 2010) + … + P(95+, 2010)*W(95+, 2010)]

where P(i, t) stands for the share of population of age i at time t, and W(i, t) stands for the ratio of per capita health spending of the population of age I to the per capita spending of the population age 30–35.

By using age profile of health spending and age distribution in the table above,

PHE(2030) = 2.8*(6*1.3 + 6.6*1.4 + … + 0*4.5)/(7.1*1.3 + 6.7*1.5 + … + 0*4.4) = 3.2

That is, demographic changes are expected to increase public health spending by 0.4 percentage points of GDP by 2030.

For non age-related increase in health care spending, we assume ECG of 1.0 percent per year, which reflects the average of emerging economies. Then, the public health care spending in 2030 can be depicted as:

PHE(2030) = PHE(2010)*((1+ECG)^(2030-2010)) = 3.4

The combined impact of demographic and nondemographic factors is larger than the sum of their individual effects due to the interaction between each of them. To take into account this combined impact, demographic effect (=0.6 percentage point of GDP increase in 20 years) needs to be annualized at 0.73 percent a year. Then the combined impact can be derived by the equation below:

PHE(2030) = PHE(2010)*((1 + annualized demographic impact + ECG)^(2030-2010))

= 2.8*(1+0.0073+0.01) ^20

= 3.9

Put in another way, public health spending in Thailand is estimated to increase by 1.1 percentage points of GDP by 2030. Out of this increase, 0.4 (38 percent) is due to pure demographic changes, 0.6 (54 percent) is due to excess cost growth (nondemographic changes), and the residual

(8 percent) is due to the interaction between the two factors.

(3) Calibration of projection results
The results of the above projection should be naturally interpreted with some margins. Here are some calibrations.

i) *Different scenario of demographic changes*
The baseline projections assume that the fertility rate will converge eventually toward a level of 1.85 children per woman. If we assume instead a fertility rate that is 0.5 children below the baseline, increase in health care spending in 2030 will be higher by 0.1 percentage points of GDP.

ii) *Differences in ECG*
If ECG turns out to be higher than the assumption in the baseline projection (1.5 instead of 1.0), public health spending in 2030 will be 4.3 percent of GDP. On the other hand, if ECG is lower at 0.5, public health spending in 2030 will remain relatively benign at 3.5 percent of GDP.

iii) *Expansion of public health benefits*
The baseline projections are based on the initial health care spending in 2010 taking into account gradual improvements in medical services provided over the period. If, instead of such gradual changes, the government decides to adopt a large expansion of the social health benefits, which could have a significant impact on the end result. For example, if the initial level of health spending is higher by 0.5 percent of GDP (as might result from the recent efforts by the government to scale up social welfare programs), the projected public health spending in 2030 will reach 4.7 percent of GDP.

E. Policy implication

(1) Measures to mitigate increase in health spending

How can policymakers prepare for the possible increase in health care spending? There are very limited, if any, policy tools to affect demographic changes. The types of reforms that would help improve performance of the health care system include the following:

i) *Greater control over the range of publicly funded services*
Greater control over physician numbers and hospital activities can be exerted, or more emphasis can be put on affordability when deciding on the publicly funded benefit package.

ii) *More involvement of local governments in policy decisions*
Local governments can be involved in a number of health policy decisions to exert more down-to-the-earth scrutiny.

iii) *Use of market mechanisms*
Greater freedom can be allowed for insurers to vary the scope, premium etc. for basic insurance packages and in negotiating with health providers. The degree of user choice over insurers can also be increased.

iv) *Budget caps*
Ultimately, budget caps can be introduced on spending for the entire health sector or specific health services.

(2) Possible source of financing for additional health spending

The level of government revenue and its structure varies a lot across countries, and theory provides little practical guidance on how best to finance increases in health spending. Empirical studies suggest, however, that broad-based consumption taxes and property taxes are less harmful to growth than income taxes.

Consumption taxes and property taxes are important potential sources of financing, especially in view of the relatively low rate of VAT and ongoing discussions over introduction of land taxes in Thailand. Relying on income taxes for financing the need would put a further burden on the working-age population as the old-age dependency ratio increases, holding back growth potential of the economy. Excise taxes and social contributions are less distortionary to growth, and could be explored as alternative sources of financing.

Appendix IV: Thailand—External Sustainability and Competitiveness Assessment[1]

A. External Sector Assessment

There is no sign of any major external imbalances for Thailand. The current account (CA) has room to decline from its current level given the large investment needs of the country, and projections based on current policy plans are in line with this assessment. Continuing to liberalize investment abroad would balance foreign capital inflows, and international reserves are more than adequate for supporting two-way flexibility of the baht while still providing scope for smoothing excessive volatility. External debt and net foreign asset (NFA) positions are stable (see Appendix 2 for a detailed assessment of external debt sustainability).

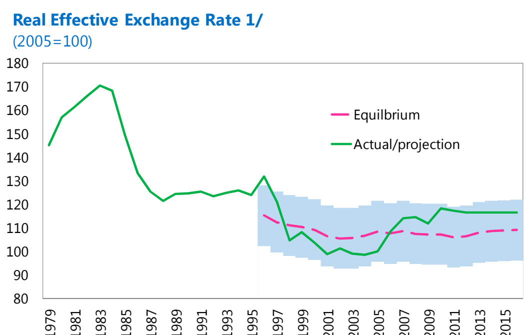
Thailand – Summary External Sector Assessment				
Current account(CA)	**Real exchange rate (RER)**	**Capital account: flows and measures**	**FX Intervention and Reserves**	**Foreign Asset/liability Position**
Thailand's CA has been quite volatile over the last decade, ranging from a 4¼ percent deficit to a 8¼ percent surplus, against the backdrop of a relatively stable trend real appreciation and volatile economic fundamentals. The CA surplus came down sharply from its peak in 2009 at 8¼ percent to 3 ½ percent in 2011 and is expected to decline further to about 1 percent over the medium term, as large investment projects raise imports and the baht continues to appreciate in real terms. Given Thailand's need for higher investment, a decline in the CA balance from its long-run average of 2½ percent by 3-5 percentage points is appropriate.	A number of methodologies suggest that the Thai baht is modestly (0–9 percent) below the equilibrium level (see Section B for details).	While capital flows to banks reflect mostly hedging activities of the trade sector and therefore follow the trade balance, portfolio flows are driven by global push factors as well as the relatively better fundamentals of the Thai economy compared to advanced economies. Portfolio inflows are expected to continue, though will increasingly be offset by outward investment as the authorities push forward with their financial account liberalization plans.	At 60 percent of GDP, over three times the IMF's composite metric and four times short-term external debt, Thailand's gross reserves are more than adequate. Thailand also has a large forward FX position (almost 10 percent of GDP at end-2011), which increased through 2011. Intervention has smoothed volatility but sterilization costs have increased. There is room for two-way flexibility, and no need for building higher reserves for precautionary purposes.	NFA had been rising steadily (in percent of GDP) from the large deficit it hit following the Asian crisis until 2010, when large inflows of direct and portfolio investment raised foreign liabilities and reversed NFA back down to -11 percent. NFA is expected to remain broadly stable as foreign assets rise in line with further liberalization and foreign liabilities rise with continued capital inflows.

[1] Prepared by Ceyda Oner. Based on the IMF's *World Economic Outlook*, April 2012.

B. Real Exchange Rate Assessment

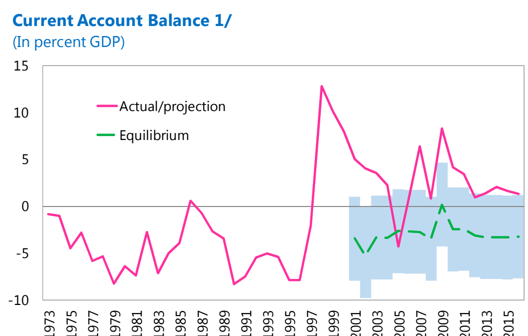
A combination of methodologies suggests that the Thai baht is between 0 to 9 percent below the equilibrium level. While point estimates range from a 9 percent undervalution to a 7 percent overvaluation, some of these estimates are not statistically significant. The average of point estimates is a 3 percent undervaluation.

- **Estimating an equilibrium real exchange rate**: Compared with an equilibrium level of the real exchange rate (RER) that is estimated from a set of economic fundamentals that include the terms of trade, relative productivity in the tradable versus nontradable sectors compared to trading partners, and government consumption relative to trading partners, Thailand's RER assessment has remained sufficiently close to equilibrium. The actual RER is within a 95 percent confidence interval of the estimated equilibrium RER in the past, and going forward, a change between -5 percent to 19 percent, with a mean of 7 percent, is estimated to be sufficient to maintain a path in line with economic fundamentals.



1/ The shaded area represents the 95 percent confidence internal of the equilibrium.

- **Estimating a current account norm**: A current account (CA) norm can be estimated from economic fundamentals and used to determine whether there is room for the RER or other policies to adjust so that the norm is attained over the medium term. Such a current account norm estimate is presented in the chart on the right, which is based on fundamentals such as dependency ratio, income growth relative to trading partners, fiscal positions vis-à-vis trading partners and net foreign assets. According to this estimate, the CA has been above the equilibrium level since 2006. Going forward, the CA is expected to decline mainly due to the large infrastructure investment projects that will require higher imports. Given this declining path, the CA is expected to approach the norm by the end of the medium term, though there is room for RER appreciation by ¼ to 18 percent, with a mean of 9 percent, to bring the CA within the confidence interval to equilibrium.

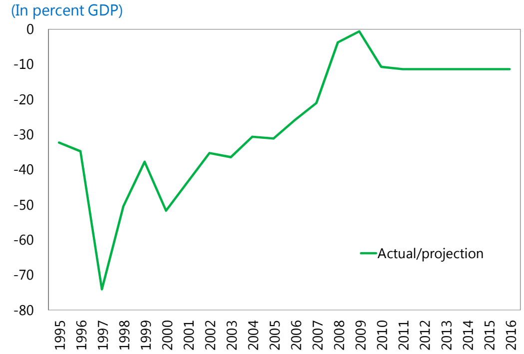


1/ The shaded area represents the 95 percent confidence interval of the equilibrium estimate.

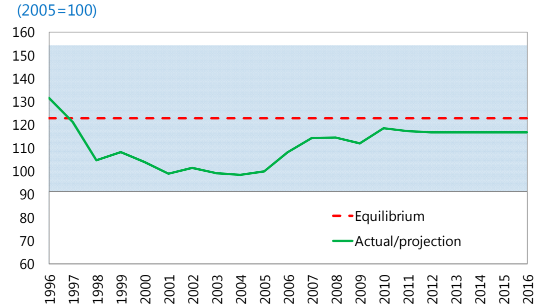
- **Maintaining stable NFA**: Another way to assess external sustainability is to compute the level of the current account that would stabilize the net foreign asset (NFA) position of the country at a certain level. In Thailand's case, the NFA position has steadily improved (in percent of GDP rather than in levels) from the deep negative territory it reached during the Asian crisis. After nearly turning positive in 2009, the NFA position declined back to -11½ percent in 2010 as large inflows of direct and portfolio investment raised foreign liabilities. Over the medium term, if the authorities push forward with their capital account liberalization plans, foreign assets may rise along with foreign liabilities as capital inflows to Thailand continue, which would also stabilize the NFA position. If the NFA level were to stabilize at the 2010 level of -11½ percent, the CA would need to be about -1 percent and a RER appreciation of about 5 could attain that range over the medium term.

- **Estimating a purchasing power parity-equilibrium**: A long-rum equilibrium RER can be estimated from using the purchasing power parity (PPP) theory. Based on this estimation, the RER path of Thailand has maintained a constant purchasing power relative to the rest of the world in statistical terms. A further 5 percent appreciation would attain the PPP level.

Net Foreign Assets
(In percent GDP)



Real Effective Exchange Rate – PPP Aproach 1/
(2005=100)



1/ The shaded area represents the 95 percent confidence internal of the PPP REER.

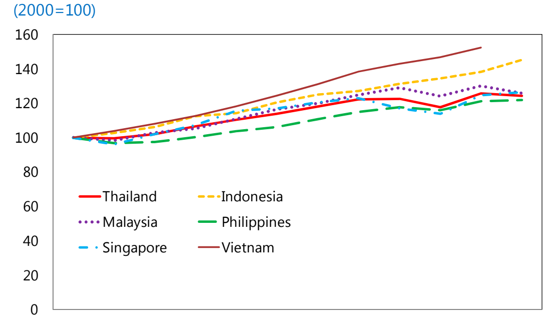
C. Competitiveness Indicators

Thailand's external competitiveness relative to the region remains broadly unchanged.

Labor productivity is relatively unchanged.

Labor productivity has steadily increased over the past decade until the global financial crisis. The drop in productivity experienced over 2009 because of the crisis was fully reversed in 2010. These changes have left Thailand's labor productivity relatively unchanged compared to other regional economies, although it fares poorly in an international comparison.

Selected ASEAN Economies: Output per Employed Person
(2000=100)

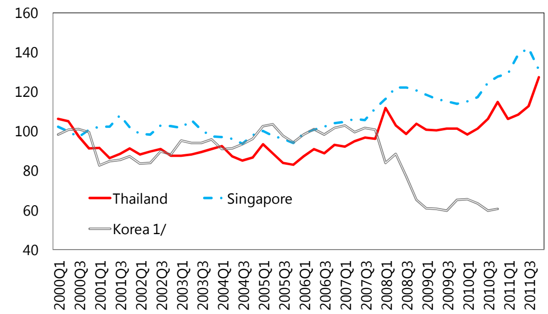


Source: Haver Analytics.

Unit labor costs (ULC) have risen but are in line with the region…

As labor productivity has been rising, wages have increased at a somewhat higher pace, raising unit labor costs gradually over the last few years. Comparable information on other countries is limited, but this rise in ULC appears to be in line with Singapore's, though unit labor costs have fallen sharply in Korea (adjusted for exchange and deflator changes).

PPP-Adjusted Real Unit Labor Costs 1/
(2000=100, s.a.)

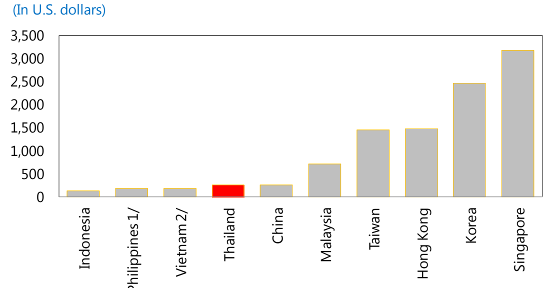


Sources: Haver Analytics and IMF staff estimates.
1/ Unit labor cost in mining and manufacturing.

…and wages are still low in Thailand.

Even though unit labor costs have risen, wages in Thailand are among the lowest in the region nonetheless, both in absolute and in purchasing power terms. While direct comparison of unit labor costs across countries is constrained by data limitations, this suggests that Thailand is still competitive.

Selected Asia: Average Wages in Manufacturing in 2010
(In U.S. dollars)

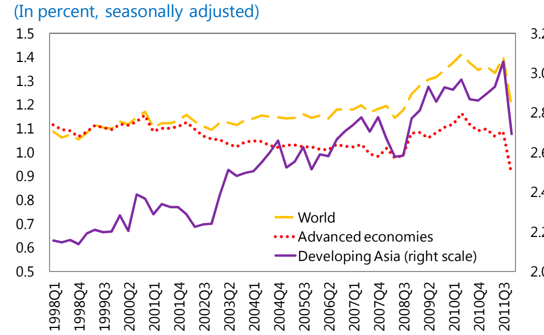


Sources: CEIC Data Co. Ltd; and IMF staff estimates.
1/ Estimated as average daily wages in the non-agricultural sectors times 20.
2/ As of 2009.

Thailand's exports have steadily gained market share during this time.

Thailand's exports have continued to steadily gain market share over the last decade, driven mainly by the vertical trade integration across Asian economies. (See IMF *Regional Economic Outlook: Asia and Pacific,* April 2011.) That this occurred in spite of the baht's considerable appreciation during the same period is not surprising: the forming of supply chains has meant that exports of these sectors are less sensitive to real exchange rate changes and depend more on foreign demand. Therefore one would expect a real appreciation to not necessarily lead to a loss of export shares.

Thailand: Export Market Shares
(In percent, seasonally adjusted)



Sources: IMF, *Direction of Trade database, Information Notice System*; and IMF staff estimates.

Appendix V: Regional Disparities in Thailand—When Average National Growth is not Enough

This analytical note examines income disparities and growth performances across regions in Thailand. It shows that the income gap between rich and poor regions is large by international standards and widening at the national level. However, while some regions are lagging behind, there are also successful convergence stories. Differences in labor quality and productivity as well as lower capital investment partly explain the disparities in terms of economic growth. Policies that boost the quality of labor and the level of investment would help boost the country's potential.

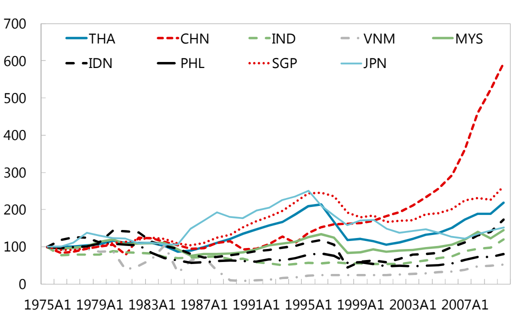
A. Introduction

1. **Over the past three decades, Thailand has enjoyed remarkable growth rates, making it one of the fastest growing economies.** While trend growth has slowed down since the Asian crisis, the Thai economy remains resilient as illustrated by its rapid bounce-back after the 2008 global financial crisis. Yet, regional income disparities remain substantial. The benefits of growth have been concentrated in Thailand's richer regions leaving some of the poorer ones lagging behind. As Thailand's poorest regions are also the most populous, the concern is that unless these regions catch up in terms of growth and income, a large proportion of the population will be left in poverty and that rising inequality could bring social, political, and economic difficulties. Moreover, boosting output growth in lagging regions could help raising trend growth at the national level. Some regions from the periphery have shown promising above-the-national-average growth rates which, if the patterns could be reproduced, would help promote more balanced growth.

B. Mixed Record in Terms of Economic Convergence

2. **Thailand's economy has been expanding at a robust pace over the last three decades.** In the pre-1997 period, the economy grew by an impressive average annual rate of GDP per capita of 7.5 percent. It slowed down in the aftermath of the crisis but remained roughly in line with other fast-growing emerging market economies.

Per Capita GDP: Cross-Country Growth rates



Sources: CEIC and IMF Staff estimates

3. **The disparity in economic conditions across Thai regions is large.** Thailand can be subdivided in seven administrative regions[1]

[1] Thailand is variably divided into different sets of regions, the most notable of which are the six-region grouping used in geographic studies (Northern, Northeastern, Western, Central, Eastern and Southern), (continued) and the four regions used in some administrative and statistical contexts. The four-region system includes the western and eastern regions within the central region. We consider Bangkok as a separate entity as well.

(including Bangkok) with large differences in economic activity, income, and population. The three richest regions accounts for 70 percent of total output but only 30 percent of the population while the most populous region (Northeastern) accounts also for a third of the country's population but its inhabitants share less than 10 percent of the country's income (see text table). The export-oriented manufacturing sector is concentrated in Bangkok and the central region, while the North and Northeastern regions are predominantly agricultural. The income disparities between regions are large by international standards. The ratio of per capita GDP between Bangkok and the Northeastern region was 9.6 on average over the 2000–09 period. By comparison, the ratio of the highest to the lowest regional per capita GDP was 8.65 in China (Fleisher, Li and Zhao, 2010), 4.5 in India (Purfield, 2006) and only 1.3 in the United States (Bureau of Statistics, current website).

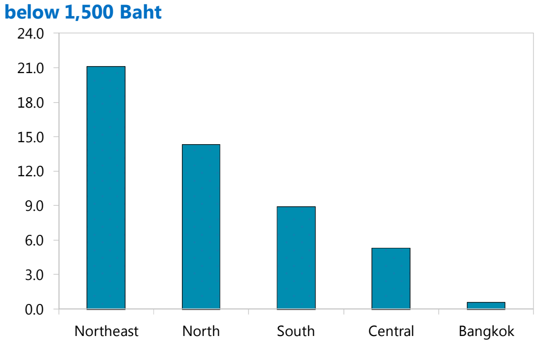
Regional Disparities (Population and Output)
2011

Region	Share of GDP	Share of Population
Bangkok	44.4	16.17
Central	10.1	4.68
Eastern	15.9	7.23
Northern	7.8	18.45
Southern	8.4	13.9
Western	3.6	5.78
Northeastern	9.8	33.8

Source: CEIC Data Co. Ltd and IMF Staff estimates.

4. Regional inequality is also associated with poverty. According to Thailand's household surveys,[2] poverty has continuously declined from around 33.8 percent in 1988 to 9.0 percent in 2008. (Bird and al., 2011). However, the aggregate poverty figure masks considerable differences in the incidence of poverty across regions. Poorer regions are unsurprisingly also the ones with the largest poverty incidence.[3] Very low rates of poverty are recorded in regions with high per capita incomes such as Bangkok and the Central region. The highest rates of poverty are recorded in the Northeast, and to a lesser extent in the Northern and Southern regions.

Percentage of Households with Monthly Income Per Capita below 1,500 Baht



Source: National Statistics Office, Thailand.

5. Evidence on economic convergence is mixed. At the national level, the gap in per capita income between the richer and the poorer states has widened over the past three decades. Except during the Asian crisis and the 2009 global financial crisis, the coefficient of variation[4] of regional GDP is increasing.[5] Per capita income in richer regions has grown almost three times faster than in the poorest

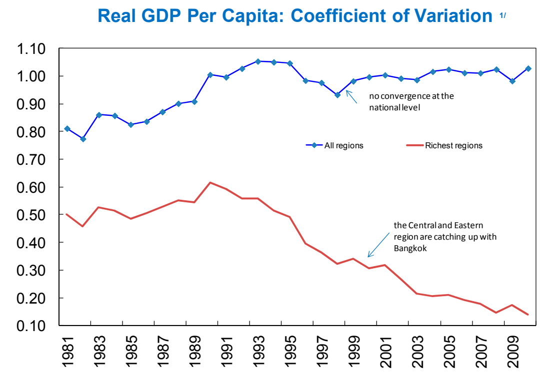
[2] Household surveys are conducted in Thailand every two years since 1988.

[3] Household surveys consistently show that the poor are overrepresented in the agriculture sector. Low-income families and poor families are heavily concentrated in agriculture, with almost 90 percent of the poor residing in rural areas.

[4] The coefficient of variation is calculated as the standard deviation of regional per capita GDP to the mean. An increase in the coefficient indicates a divergence between incomes.

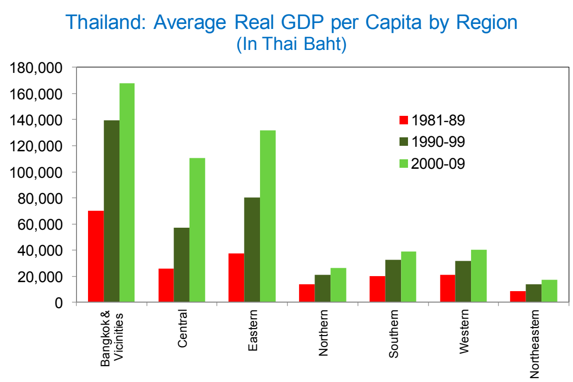
[5] The income convergence during crisis times is just the result of a larger but temporary income loss in Bangkok during the crisis as the region is more affected by international conditions.

regions indicating a *divergence* across regions at the national level. However, while there is no income convergence at the national level, we can see convergence among relatively more central regions. The central and eastern regions have grown faster than Bangkok since the beginning of the 1990's and their income is therefore catching up. Conversely, the four poorest regions not only have a lower GDP per capita but their growth rates are also lower than the national average thereby widening the gap.



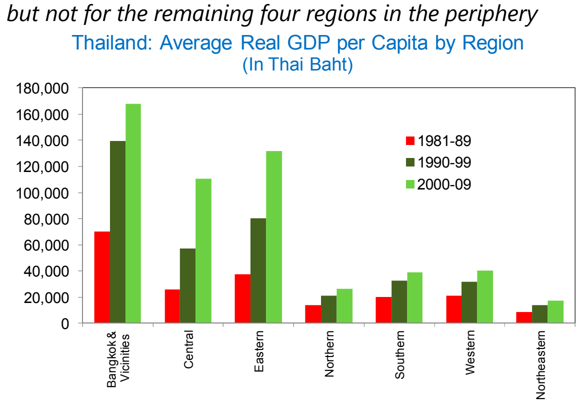
Sources: CEIC Data Co. Ltd; and IMF staff estimates.
1/ Calculated as the standard deviation of regional real per capita GDP to the mean.

Large initial income disparities...



Sources: CEIC Data Co. Ltd: and IMF staff estimates.

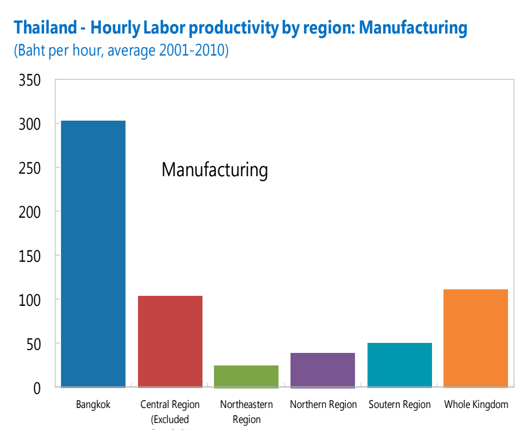
...have been narrowed in the central and eastern regions but not for the remaining four regions in the periphery



Sources: CEIC Data Co. Ltd: and IMF staff estimates.

C. Inequalities in Growth Factors

6. Lagging GDP per capita levels in the poorer regions are associated with lower productivity. While labor utilization rates are almost identical across the whole kingdom with full employment in all regions, there are stark differences in labor productivity. Labor productivity is markedly higher in Bangkok than in the rest of the country and the poorest regions have the lowest productivity rates. While differences in hourly productivity levels could reflect difference in the industry structures across regions, this discrepancy remains within each sector if we look at disaggregated sectoral data. For example, hourly manufacturing output is almost 12 times higher in Bangkok than in the northeastern region.

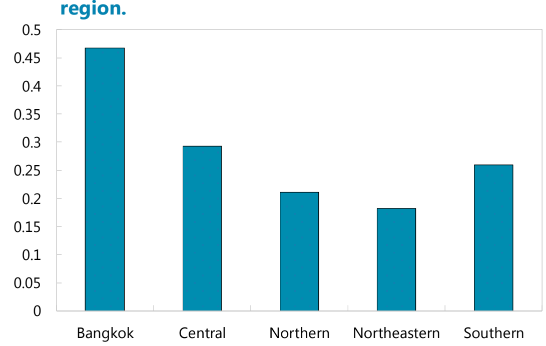


Sources: Bank of Thailand, IMF Staff calculations

7. The differences in productivity are mirrored by disparities in labor quality. The share of skilled workers in the labor force as defined by the share of workers with an education level of high school or higher follows a familiar regional pattern. The richer, faster-growing, more productive regions include a larger share of skilled workers. A trend reversal can be observed since 2002 with a faster recruitment of skilled workers in the Northern and Northeastern regions.

Large disparities of skills…

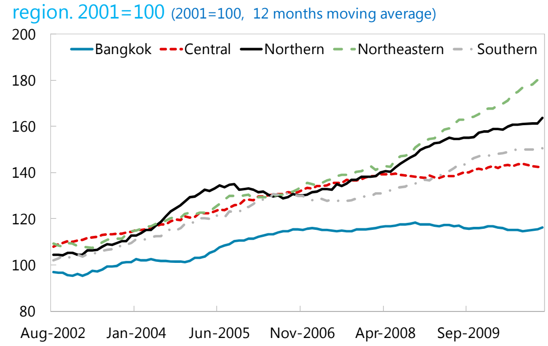
Share of skilled workers in the labor force by region.



Sources: CEIC Data Co. Ltd; and IMF staff estimates.

…that might start to get reversed.

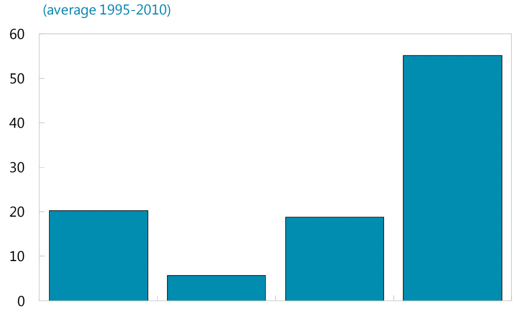
Evolution of the share of skilled workers in the labor force by region. 2001=100 (2001=100, 12 months moving average)



Sources: CEIC, IMF Staff calculations

8. Lagging regions receive less investment. Private capital accumulation (proxied by data on new investment permits delivered by the board of investment) is very unequal and reveals a strong preference for Bangkok. Over the 1995–2010 period, the Northeastern region has received about 10 times less private investment than Bangkok. This disparity is mirrored in the allocation of public infrastructure expenditure Bank of Thailand (BOT, 2011).

Regional Share of New Investments
(average 1995-2010)



Sources: CEIC Data Co. Ltd; and IMF staff estimates.

9. Geography and infrastructure are key factors explaining economic convergence. The central and eastern regions that are catching up with Bangkok benefit from the relative proximity to the capital and the strategic location on trade and export routes. Regions in the periphery are more difficult to access and benefit from less performing logistics and infrastructure.

D. Policies

10. Economic growth alone has been insufficient to promote economic convergence across all regions. Regions in the periphery are lagging behind in terms of growth rates and income. They don't benefit from the proximity to the capital and to trade and export routs, and infrastructure development is also lagging. Policies aiming to boost both growth rates and living standards in the peripheral regions need to supplement economic growth. Policies should target deepening capital through technology transfer, and improving the quality of the labor force. As poorer regions in the periphery are also regions with the lowest human capital and less physical investment, a comprehensive growth strategy would need to build capacity and reduce the stark differences in human and physical capital across regions. Enhanced public infrastructure combined with better conditions for the private sector could promote private investment while public expenditure could focus on developing labor skills.

INTERNATIONAL MONETARY FUND

THAILAND

April 12, 2012

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | Asia and Pacific Department

CONTENTS

ANNEX I. THAILAND—FUND RELATIONS

(As of March 31, 2012)

I. Membership Status: Joined 05/03/1949; Article VIII.

II. Article VIII Status: Thailand has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

III. General Resources Account:

	SDR Million	Percent Quota
Quota	1,440.50	100.00
Fund holdings of currency	1,009.07	70.05
Reserve position in Fund	431.43	29.95

IV. SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	970.27	100.00
Holdings	973.48	100.33

V. Outstanding Purchases and Loans:

None

VI. Latest Financial Arrangements:

In millions of SDR

Type	Approval Date	Expiration Date	Amount Approved	Amount Drawn
Stand-by	8/20/97	6/19/2000	2,900.00	2,500.00
Stand-By	6/14/85	12/31/86	400.00	260.00

VII. Projected Obligations to Fund (SDR million; based on existing use of resources and present holdings of SDRs):

	2013	2014	2015	2016
Principal				
Charges/interest	0.01	0.01	0.01	0.01
Total	**0.01**	**0.01**	**0.01**	**0.01**

VIII. Exchange Rate Arrangement:

After more than a decade when the baht was effectively pegged closely to the U.S. dollar through a basket of currencies, the exchange rate regime was changed on July 2, 1997. The exchange rate system is now a floating exchange rate regime with occasional central bank intervention.

IX. Last Article IV Consultation:

At the conclusion of the 2010 Article IV consultations, Executive Directors observed that Thailand has made a remarkable comeback from the effects of the global crisis and the period of domestic political turmoil. They welcomed the authorities' forceful policy response that enabled the export recovery to feed through into renewed domestic demand. They discussed the challenge of normalizing the policy stance, while ensuring that the recovery takes firm hold despite an uncertain global environment. They supported the government's plan to gradually scale back the fiscal stimulus and welcomed the Bank of Thailand's decision to start raising interest rates. Directors noted that, with the economy recovering rapidly, capital inflows could complicate policymaking. They broadly agreed that, in such circumstances, the exchange rate should be allowed to serve as a buffer. For the medium term, Directors supported the authorities' ambitious reform agenda aimed at strengthening infrastructure and developing the financial sector to help restore economic dynamism and raise growth potential. At the same time, they called for swift action to mitigate risks from government-owned specialized financial institutions by improving their risk assessment standards, strengthening supervision, and defining their role more clearly.

X. Recent Technical Assistance:

FAD: A fiscal ROSC mission took place in November 2008. A mission to provide assistance on integrating state-owned enterprises in fiscal accounts took place in November 2009.

LEG: Several LEG missions took place during 2009–11 to produce a national AML/CFT strategy for Thailand, as part of a three- to five-year strategic partnership to improve Thailand's AML/CFT regime.

MCM: Training missions on monitoring macrofinancial risks using a contingent claims approach took place in October 2009 and April 2010. A technical assistance (TA) mission on the development of an inflation targeting model took place in September 2011.

STA: A TA mission on government finance statistics took place in November 2009.

XI. Resident Representative: None

ANNEX II. THAILAND—BANK-FUND COLLABORATION

Thailand: JMAP Implementation Table

Title	Products	Provisional Timing of Missions	Delivery Date (tentative)
A. Mutual information on relevant work programs			
Bank work program	Thailand Economic Monitor (June and November 2011)		Published online in June and November 2011
	Public Finance Management Report		March 2012
	Revenue Policy Review		November 2010
	Thailand Development Report 2012 (Country Economic Memorandum)		June 2012
	Public Investment Management Review		December 2012
IMF work program	2012 Article IV mission	February 2012	Board discussion expected in April 2012
	2011 Staff Visit	February 2011	
Joint work program	Modular FSAP to assess the Specialized Financial Institutions of Thailand	Throughout 2011	Technical notes were completed in the fourth quarter of 2011
B. Request for work program inputs			
Fund request to Bank	Assessment of economic developments and structural policies	Semi-annual or more frequent	Ongoing
	Information sharing	Semi-annual or more frequent	Ongoing
Bank request to Fund	Assessment of macroeconomic developments and policies	Semi-annual or more frequent	Ongoing
	Information sharing	Semi-annual or more frequent	Ongoing

ANNEX III. THAILAND—RELATIONS WITH THE ASIAN DEVELOPMENT BANK[1]

(As of December 31, 2010)

Table 1. Cumulative AsDB lending to Thailand 1/
(In millions of U.S. dollars)

	Number of Loans	Amount of Loans	Percent
Agriculture and natural resources	9	409.21	6.86
Education	5	160.72	2.69
Energy	30	1,876.61	31.44
Finance	12	1,044.50	17.50
Health and social protection	1	500.0	8.34
Industry and trade	3	90.46	1.52
Public sector management	—	—	—
Transport and ICT	18	1,291.60	21.64
Water supply and other municipal infrastructure and services	9	595.00	9.97
Multisector	1	1.38	0.02
Total	88	5,969.48	100.00

1/ Includes three private sector loans.

Since joining the Asian Development Bank (AsDB), Thailand has received $5.97 billion for 88 loans as of the end of 2010. The greatest share of the loans (31.44 percent) have gone to the energy sector, followed by transport and communications (21.64 percent); finance (17.50 percent); and water supply, sanitation, and waste management (9.97 percent). The remaining loans have gone to support projects in health, education, agriculture and natural resources, and industry and trade. In recent years, technical assistance (TA) and knowledge sharing played a major role in Thailand's engagement with the AsDB. In total, $64.42 million has been provided for 165 TA projects covering a wide range of sectors and activities.[1]

[1]Based on information provided by AsDB staff.

A country partnership strategy (CPS), 2007–11 between the government and the AsDB was approved in 2007, and the government resumed borrowing from the AsDB in 2009, after a nine-year hiatus. The country operations business plan (COBP), 2011–13, reaffirmed that the core strategic areas of partnership in the existing CPS remain to promote long-term, sustainable economic growth and social development.

In 2010, AsDB supported government efforts to improve the environment for public–private partnerships (PPPs), with streamlined processes and guidelines, and better sector, legal, and regulatory frameworks for catalyzing investments in PPPs. In addition, AsDB provided Thailand with a Capital Market

Development Program Loan of $300 million, as well as TA to implement the capital market development master plan. For more details on projects with cofinancing, and on procurement contracts awarded to companies and consultants from Thailand see www.adb.org/Documents/Fact_Sheets/Thailand/cofinancing.asp and www.adb.org/Documents/Fact_Sheets/Thailand/procurement.asp.

ANNEX IV. THAILAND—STATISTICAL ISSUES

(As of March 2012)

I. Assessment of Data Adequacy for Surveillance	
General: Data provision is broadly adequate for surveillance. The authorities have continued to improve the quality and coverage of data, but dissemination of additional data would enhance the basis for macroeconomic policy analysis, particularly in the fiscal sector.	
National accounts: The national accounts are broadly in line with the 1968 SNA, but are in the process of being updated to the 1993 SNA. While data coverage and methodology have improved, statistical discrepancies can be reduced further. **Price statistics**: The Bank of Thailand (BOT) publishes monthly price statistics and quarterly inflation reports with sufficient coverage for surveillance.	
Government finance statistics: The authorities provide data to the Fund consistent with the *Government Finance Statistics Manual, 2001* (GFSM 2001). Data are contributed to both the *Government Finance Statistics Yearbook* and the *International Finance Statistics*. However, general government fiscal data are only provided annually and more timely publication is desirable. In addition, GFSM 2001-based data are not available for the state enterprises, so the public sector balance is imperfectly calculated in GFSM 2001-basis. Given the growing importance of state enterprises having timely data on their operations is desirable for more effective surveillance. General government debt, including an amortization schedule, is not available either, and is desirable for more effective surveillance.	
Monetary statistics: The authorities submit the Standardized Reporting Forms (SRFs) for monetary statistics on a timely basis.	
Balance of payments: The authorities started publishing balance of payments statistics under BPM6 in February 2012. The historical data goes back to 2005, and a longer historical time series is desirable for analysis. The methodology for compiling balance of payments data remains adequate, but the large errors and omissions, both under BPM5 and BPM6, point to weaknesses in data collection, including incomplete coverage of nonbank transactions in services trade. There is a long lag in the dissemination of IIP data, which is available only on an annual basis. The last observation available is 2010. Data on external debt and debt service have significantly improved since the introduction of a quarterly survey of private nonbank external debt. However, the breakdown of debt service along the lines of external debt stocks and an amortization schedule of external debt would allow for more effective surveillance.	
II. Data Standards and Quality	
Subscriber to the Special Data Dissemination Standard (SDDS) since 1996.	Data ROSC published in April 2006.

Thailand: Table of Common Indicators Required for Surveillance

As of March 27, 2012

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]	Memo Items: Data Quality – Methodological Soundness[7]	Memo Items: Data Quality – Accuracy and Reliability[8]
Exchange Rates	3/27/12	3/27/12	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	3/20/12	3/20/12	W	W	W		
Reserve/Base Money	3/20/12	3/20/12	W	W	W	O, O, LO, O	O, O, O, O, O
Broad Money	2/29/12	2/29/12	M	M	M		
Central Bank Balance Sheet	2/29/12	2/29/12	M	M	M		
Consolidated Balance Sheet of the Banking System	2/29/12	2/29/12	M	M	M		
Interest Rates[2]	3/27/12	3/27/12	D	D	D		
Consumer Price Index	2/29/12	2/29/12	M	M	M		
Revenue, Expenditure, Balance and Composition of Financing[3]– General Government[4]	3/31/11	3/31/11	A	A	A	O,LO,O,LO	LO, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	2/29/12	2/29/12	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2/29/12	2/29/12	M	M	M		
External Current Account Balance	2/29/12	2/29/12	M	M	M	O, LO,LO,LO	LO, O, O, O, LO
Exports and Imports of Goods and Services	2/29/12	2/29/12	M	M	M		
GDP/GNP	Q4 2011	2/23/12	Q	Q	Q	LO, LO, O, LO	O, O, LO, O, O
Gross External Debt	Q4 2011	2/23/12	Q	Q	Q		

[1]Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC (published on April 10, 2006 and based on the findings of the mission that took place during October 3–17, 2005) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
[8] Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment, and revision studies.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 12/48
FOR IMMEDIATE RELEASE
May 10, 2012

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2012 Article IV Consultation with Thailand

On April 27, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Thailand.[1]

Background

Thailand is recovering from a very challenging year marked by natural disasters of historic magnitude. First, the earthquake in Japan in March disrupted supply chains and slowed down production, albeit temporarily. Then, the country was inundated by massive floods that began in August and worsened in October–November, slowing the economy to a near halt. In the last quarter of 2011 output contracted by 10¾ percent (quarter-on-quarter), the largest quarterly contraction ever recorded, bringing annual growth down to 0.1 percent. Manufacturing industries such as the automobile and electronics sectors were particularly badly affected, but agriculture and tourism also suffered. Total losses are estimated at

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

about 3 percent of GDP. On a yearly basis, GDP growth shrank from 7.8 percent in 2010 to a barely positive 0.1 percent in 2011.

However, the Thai economy is expected to rebound sharply in 2012, partly owing to monetary easing and a large fiscal package. Positive signs of a recovery are already under way with sharp improvements seen in high frequency indicators since December 2011. Manufacturing output surged in December 2011 even though there are variations in the pace of recovery across industries. Confidence indicators have almost reached their pre-flood levels. As a result, GDP should grow by 5½ percent in 2012 and a further 7½ percent in 2013 due to a large carryover effect from the strong recovery in the second half of 2012. Domestic demand is expected to be the driving force of growth in 2012, partly due to reconstruction and flood-prevention efforts.

However, amidst uncertainty about the evolution of the global economy and the success of flood-prevention measures, downside risks to the outlook are significant. The Thai economy remains vulnerable to contagion from the turmoil in the euro area, and weak growth in its trading partners as well as to domestic political tensions, if they were to be renewed. If water management projects are not successful, that could also affect business and consumer confidence.

The policy response is targeting income redistribution and flood prevention. The government took office in August 2011 with policy priorities geared toward making income distribution more equal and rebalancing growth toward domestic consumption. Expansionary fiscal policies came at an opportune time to help offset weak world demand. In addition, in response to the 2011 devastating floods the government added plans to invest in flood-prevention and boost reconstruction-led recovery. Similarly, the Bank of Thailand halted its gradual normalization policy and lowered the policy rate twice by a cumulative 50 basis points in November 2011 and January 2012.

Executive Board Assessment

Executive Directors commended the Thai authorities for their policy response to last year's floods, which propelled the strong recovery underway. They noted that the short-term outlook is favorable, but significant downside risks stem from the unsettled global scenario, internal political uncertainties, and capacity constraints in the execution of public works.

Directors concurred that the main challenge for the period ahead is to complete reconstruction while maintaining macroeconomic stability and promoting inclusive growth.

Directors agreed that the current expansionary fiscal and monetary stances are appropriate in the context of weak world demand and muted inflationary pressures. Against this background, they supported the government's fiscal package and welcomed the Bank of Thailand's recent decisions to lower interest rates. Directors noted, however, that the authorities should unwind the supportive policy stance as the recovery takes hold and move to a medium-term consolidation path consistent with low inflation and fiscal sustainability. In particular, the authorities should stand ready to tighten monetary policy as the output gap closes.

Directors agreed that the authorities' commitment to fiscal prudence could be usefully underpinned by a formalization of current budgetary practices and targets, and looked forward to the adoption of the Public Finance Act. They also recommended improving transparency and accountability of fiscal operations in line with the recommendations of the 2009 review of fiscal standards and codes.

Directors supported the authorities' ambitious reform agenda aimed at promoting more inclusive growth. They observed that recent income redistribution policies, including the rice price support mechanism, need to be monitored and assessed with a view to containing fiscal costs and improve efficiency. In addition, minimum wage increases should be accompanied by measures boosting labor productivity to preserve competitiveness. In this context, Directors considered that technology transfers and investment in human capital and infrastructure, particularly in less developed regions, are needed to raise long-term growth. To create the fiscal space necessary to support these reforms, Directors saw scope for scaling back subsidies, eliminating income tax credits, and reviewing the rate structure for excise and value added taxes, while strengthening tax administration.

Directors noted that capital inflows have continued to be volatile and are likely to remain so in the near term. With high international reserves, more risk-aware economic agents, and increased availability of financial instruments to protect against volatility, Directors considered that there is room to increase exchange rate flexibility in both directions. They supported the authorities' plans to further relax gradually restrictions on capital outflow while ensuring that adequate safeguards are in place to protect against sudden reversals.

Directors welcomed the progress made in developing financial markets, which should facilitate private investment. They called for swift action to mitigate risks from government-owned specialized financial institutions by refocusing them on their core mandate, improving risk assessment standards and strengthening supervision, as suggested in the latest module of the Financial Sector Assessment Program. Directors also recommended continuing to develop strong financial safety nets and to address remaining weaknesses in the regulatory framework to combat money laundering and the financing of terrorism.

Thailand: Selected Economic Indicators, 2009–12

	2009	2010	2011	Proj. 2012
Real GDP growth (percent)	-2.3	7.8	0.1	5.5
Inflation				
Headline CPI (period average, percent)	-0.8	3.3	3.8	3.9
Core CPI (period average, percent)	0.3	0.9	2.4	2.2
Saving and investment (percent of GDP)				
Gross domestic investment (excluding stocks)	24.1	24.7	26.2	27.7
Of which: private	17.6	18.8	20.7	21.7
Gross national saving	32.4	28.9	29.7	28.7
Of which: private, including statistical discrepancy	29.6	23.8	26.0	25.9
Fiscal accounts (percent of GDP) 1/				
Central government budgetary balance	-4.2	-2.6	-1.9	-2.8
Revenue and grants	17.0	18.2	19.0	18.3
Expenditure and net lending	21.2	20.8	20.9	21.1
General government balance 2/	-3.2	-0.8	-1.6	-3.0
Public sector balance 3/	-3.6	-1.6	-2.4	-4.4
Public sector debt	45.2	42.6	41.7	44.1
Monetary accounts (end-period, percent change)				
Broad money growth	6.8	10.9	15.2	...
Private sector credit growth	2.5	12.3	16.7	...
Balance of payments (billions of U.S. dollars)				
Current account balance	21.9	13.2	11.9	3.8
(Percent of GDP)	8.3	4.1	3.4	1.0
Exports, f.o.b.	151	194	225	246
Growth rate (in dollar terms)	-13.9	28.4	16.4	9.2
Imports, f.o.b.	118	162	202	227
Growth rate (in dollar terms)	-25.1	37.0	24.7	12.5
Gross official reserves (end-year; incl. net forward position)	154.1	191.7	206.3	212.7
(Months of following year's imports)	11.4	11.4	10.9	10.2
Exchange rate (baht/U.S. dollar)	34.3	31.7	30.5	...
External debt (in percent of GDP)	28.6	31.5	30.7	29.0
Debt-service ratio 4/	7.6	4.7	3.4	3.4

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

1/ On a fiscal year basis. The fiscal year ends on September 30.

2/ Includes budgetary central government, extrabudgetary funds, and local governments.

3/ Includes general government and nonfinancial public enterprises.

4/ Percent of exports of goods and services.

Statement by Der Jiun Chia, Executive Director for Thailand
and Chaipat Poonpatpibul, Senior Advisor
April 27, 2012

1. On behalf of the Thai authorities, we would like to thank the IMF mission team for the 2012 Article IV Consultations following the unprecedented and devastating flood incident. The discussions during the Consultation, which focused on challenges in securing the recovery from the flood, enhancing macroeconomic stability amidst the elevated external risks and promoting inclusive growth, were timely and constructive. The authorities broadly concur with staff's assessment on the economic outlook and major thrusts of policy recommendations and would like to provide an update on the latest developments in Thailand as well as clarifications on some policy issues as follows:

Updates on the recovery and near-term economic outlook

2. Thailand was hit by a perfect storm in 2011. First came the supply disruption from the natural disaster in Japan in Q2, then the historic flood in Q4, and the global economic slowdown which led to substantial output loss and a near-zero growth in 2011. Notwithstanding these, the first quarter of 2012 Q1 saw a sharp rebound and the economy is expected to grow by slightly above 8 percent qoq.

3. Latest economic indicators including the private consumption index, the private investment index and farm income point to on-track recovery and activity is expected to normalize by Q3 2012 in all key areas of the economy. With sustained recovery in manufacturing production, particularly for automobile and electronics parts, exports have gradually resumed their pre-flood trend. Meanwhile, swift recovery in private consumption has been due to pent-up demand held back during the flood, favorable employment prospects, farm income and well as conducive monetary conditions. With continued improvement in confidence, a pickup in manufacturing production, and absence of significant delay in implementation of the fiscal stimulus measures, private investment, led by reconstruction and replacement spending is expected to sustain the growth momentum. Growth is projected to rebound to 5.7 percent in 2012 and resume a normal pace in 2013.

4. Notwithstanding these positive prospects, our authorities remain cautious. They are mindful of the pace and effectiveness of implementation of the fiscal stimulus measures and downside risks associated with weak demand from the advanced economies. The slowing demand from China could also weigh down on the prospects of Thai exports.

5. Inflation remained stable and well-anchored in 2012 Q1. Headline inflation stood at 3.4 percent in 2012 Q1 compared to 4.0 percent in 2011 Q4, driven mainly by the deceleration of fresh food price and core inflation amidst the acceleration of energy prices. Core inflation trended down slightly from 2.8 percent in the previous quarter to 2.7 percent in 2012 Q1 due to declining food and beverage prices. For the whole of 2012 and 2013, inflationary pressure is expected to pick up from sustained improvement in global growth prospect, cost pass-through from rising oil prices and the minimum wage increase. Private demand is also

expected to pick up from the return of production to its potential level in the latter half of 2012. The Thai authorities will closely monitor any price development and will act to ensure that inflation expectation is well anchored and inflation is within the target range.

Fiscal policy

6. On the fiscal policy front, our authorities welcome the detailed staff assessments and policy recommendations which stress the importance of maintaining fiscal discipline. With fiscal space, several revenue and expenditure measures as discussed in the Staff Report have been employed to lift the economy from a deep contraction and also helped enhance growth potential going forward. In this regard, positive progress has been made on several fronts. The 2012 fiscal year budget has recently been approved in February allowing for necessary spending plans to ensure on-track economic recovery. The water resource management decree has also been passed in March. The decree does not stipulate time constraint for spending but ensures prudence by mandating disbursement in accordance with specific approved projects. Meanwhile, given the near-term acceleration in oil prices, the diesel tax reduction scheme may be extended, subject to monthly assessment of the global oil price, so as not to forestall the economic recovery.

7. The draft Public Finance Act is in progress and notwithstanding the projected lower revenues, the fiscal sustainability framework is expected to remain intact. Nonetheless, the government continues to strive for medium-term fiscal balance through such initiatives as the establishment of infrastructure fund and the continuation of Public Private Partnership (PPP) investment scheme. The authorities recognize that the credibility of the fiscal policy framework could be strengthened further by making these rules legally binding. They also share the Fund's view that in addition to maintaining fiscal discipline and transparency, timeliness and effectiveness of spending should be closely monitored.

Monetary policy

8. The authorities view that the current monetary policy stance is appropriate for supporting a firm recovery as well as ensuring that inflation expectation is well-anchored. It is expected that core inflation this year would still be within the official target band of 0.5 to 3 percent notwithstanding potentially major upward risks such as the increase in minimum wage as well as demand pressure from infrastructure spending. However, once the economic situation returns to normalcy and the output gap closes, the policy rate would need to be gradually adjusted to its normal path to anchor inflation expectation. Decision on the policy rate would remain flexible and will be based on vigilant monitoring of the development of the aforementioned risks to inflation.

Capital flows and exchange rate

9. Thailand has witnessed volatile capital flows with periods of capital influx and bouts of rapid outflows during risk aversion periods in line with other regional emerging economies. To ensure more balanced two-way flows the authorities are pressing ahead with the Capital Account Liberalization Master Plan to gradually relax restrictions while maintaining flexibility and safeguards against excessive speculation.

10. The Thai baht has been gradually strengthening since the beginning of 2012 on perceptions of a strong recovery. Under the current managed float setting, the Thai baht is left to be determined by economic fundamentals whilst intervention would be made only to dampen excessive volatility. To date, the need for intervention has lessened as the private sector has been more prepared and capable of coping with exchange rate risks. They also have better understanding and greater experience in using hedging instruments. The Bank of Thailand (BOT), in partnership with commercial banks, will continue to promote awareness of SMEs on the importance of financial risk management.

11. Foreign reserves standing at 179.3 billion US dollars at the end of March 2012 are adequate to cushion against external shocks. The authorities are mindful of the cost of the intervention as well as the attendant reluctance of the private sector to adapt as they become more accustomed to a stable environment. In this regard, they maintain that foreign reserves are not a policy target and view that, with capital flows becoming more balanced in both directions, the pace of foreign reserve accumulation would likely ebb going forward.

Financial Sector

12. The banking sector recorded strong capital and profitability despite significant challenges from both the domestic front and the global financial crisis. The on-track implementation of the plan under the Financial Sector Master Plan II will continue to strengthen the financial system with an emphasis towards enhancing competition in response to changing financial and regulatory environments.

13. Significant part of financial inclusion is pursued through Specialized Financial Institutions (SFIs). These institutions are also used as instruments of the Government in implementing social and economic policies. The authorities are mindful that extensive recourse to SFIs could incur fiscal cost and will be closely monitoring their activities to ensure prudence and transparency as well as prevent the build-up of risks to the financial system. They have also instructed the SFIs to refocus on their core mandate and subjected them to the same levy as commercial banks in order to foster a more level playing field.

14. As for the capital market, the investor base has grown significantly under the Capital Market Development Master Plan partly due to increasing financial products in the market. Going forward, the introduction of new products, the liberalization for cross-border sales of capital market products in ASEAN and brokerage commission fee later this year will provide further

investment alternatives and greater tools for risk management as well as increase market depth.

15. The authorities have made progress in improving the AML/CFT compliance. While the necessary draft legislations are undergoing parliamentary approval process, AMLO itself is enhancing its efficiency and organizational structure to implement the new legislation when passed. Although the impact of the FATF's downgrade so far has been limited, the authorities will closely monitor the situation until completion of the legislative process.

Structural Policies

16. Our authorities are committed to strengthening medium- and long-term growth potentials and concurrently ensure that growth benefits are widely and more evenly distributed. In addition to the mega water management projects, large infrastructure projects funded by PPP such as mass-transit system expansion as well as transportation linkages with neighboring countries are proceeding on track. To foster progress on this front, the authorities are planning to streamline a PPP process and set up a one-stop service agency for PPP projects.

17. The authorities appreciate the study on discrepancies of income across regions in Thailand which underscored the need to alleviate income inequality during the next stages of economic development. The recent policies including the minimum wage increases across different regions and the rice price guarantee scheme have been adopted with income redistribution as one of the main objectives.

Final Remarks

18. The Thai authorities are committed to ensure normalization of economic activity from the severe flood period. They are mindful of key domestic and external risks and would therefore closely monitor these developments. At the same time, the authorities emphasize that a key priority for the medium- and long-term social and economic development is to pursue inclusive growth.

19. Finally, our authorities would like to thank the IMF mission team for their efforts in producing this comprehensive and thorough work on the recent economic and financial developments in Thailand. In addition, they would like to convey their appreciation for the topical analyses which are useful for near- and long-term policy making.