Strategy - Thailand

Client feedback on our strategy

Equity Strategy

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Equity Strategy
ASEAN | Thailand

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AOT: Airports of Thailand
SCB: Siam Commercial Bank
OSP: Osothsapha
GFC: Global Financial Crisis

Meetings and calls with local and foreign investors

Following the release of our bullish strategy report (see here), we held a series of meetings with local funds and conducted several voice and video calls with overseas investors. Here, we provide feedback from them and answers to FAQs.

Reminder of our views

As a reminder, we have argued that Thailand will enter a 2-3 year cyclical upturn around mid-year. Although we do not see upside drivers for 1H24, the Bank of Thailand (BOT) rate cuts should act as a catalyst from 2H24, and earnings should help maintain the rally into 2025-26. We believe that cyclical factors explain most of the current weak earnings and economic weakness and that the cyclical headwinds will turn to tailwinds from 2H24 onwards. We expect EPS CAGR of 12%-15% during 2023-2026.

Foreign clients generally in agreement

The foreign investors we spoke with generally liked our thesis. Some were already thinking that Thailand could be an interesting catch-up story, while others who had not been monitoring the market closely found the narrative appealing. All the foreign investors we spoke with agreed that 1H did not appear to have strong catalysts but that the market would perform well once catalysts appeared.

The main pushback came from some of our stock picks. Some clients asked why our tourism analyst, Chatri Phrawphraikul, prefers hotels to AOT. They liked AOT's higher liquidity and viewed it as a purer play on the Thai tourism recovery. Some investors also expressed surprise that our banks analyst, Bay Tuntisrisuk, likes SCB. Bay has argued that SCB was the big bank most likely to raise its dividend payout. The investors we spoke with did not favor Thai banks in general due to weak short-term and long-term prospects. We note, however, that our conversations occurred before SCB did indeed announce an increase in dividend payout which came as a surprise.

Domestic clients more cautious

Domestic funds seemed more cautious. One investor expressed concerns over Thailand's structural challenges. Another worries that high household debt will short-circuit a recovery. Several domestic investors asked if a delay in Fed rate cuts would also put the BOT on hold. Others saw a risk that the tourism rebound has plateaued and that tourist expenditures have structurally declined. We did not get the impression that local funds expect significant downside, but there seemed to be a lack of confidence that positive catalysts would appear. On stocks, we did not hear significant pushback on SCB or hotels from local clients, but some asked why our beverages analyst likes OSP.

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FAQ #1: Will rate cuts be delayed?

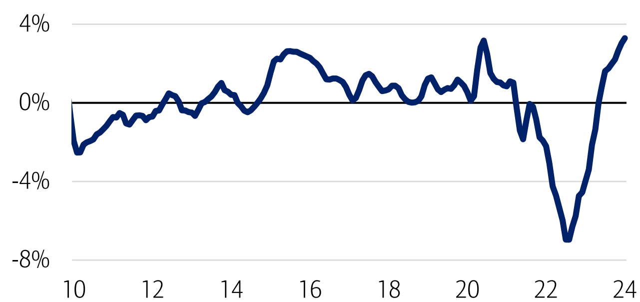
Now we will address some of the frequently asked questions we have encountered in our conversations with investors.

The first is whether BOT will in fact cut rates in June. Our economist, Pipat Luengnaruemitchai, forecasts that the rate cuts will happen no later than June.

We expect early rate cuts as the Thailand economy is strong. Real rates are currently at a post-GFC high and are in restrictive territory based on Pipat's calculations (Exhibit 1). Inflation is notably low (Exhibit 2). While household debt level is still high, it has already eased from the peak levels (Exhibit 3).

We do not consider the Fed an obstacle to early rate cuts in Thailand. We believe that the current account matters more for the Baht than foreign exchange rate differentials. We also do not consider weak Baht necessarily as a problem for Thailand. It has very low unhedged foreign currency debt, and as an export and tourism-dependent economy, cheap Baht should help economic growth.

Exhibit 1: Real BOT rate
In restrictive territory



Source: Bank of Thailand, Ministry of Commerce, Kiatnakin Phatra Securities
Note: real rate is defined by the difference between policy rate and last 3m average headline inflation

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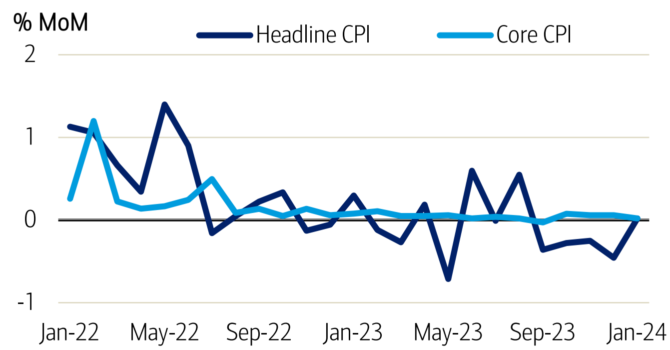
Exhibit 2: CPI inflation
Inflation too low



Source: Ministry of Commerce

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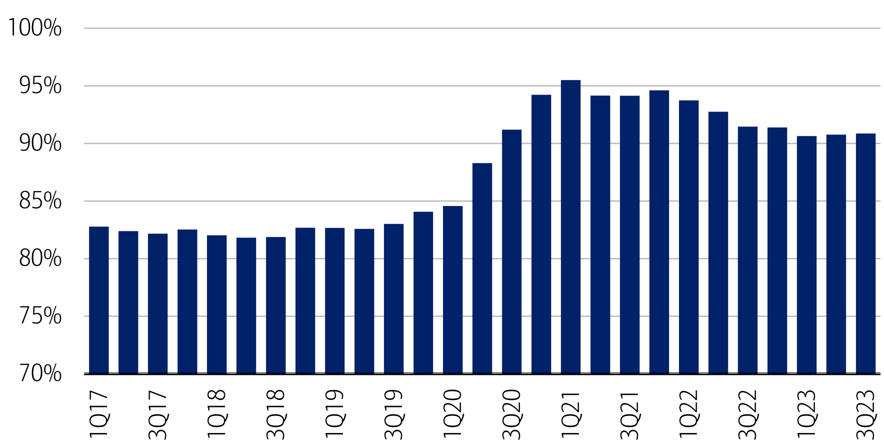
Exhibit 3: Household debt to GDP
Already well off peaks



Source: Bank of Thailand

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FAQ #2: Will high household debt prevent recovery?

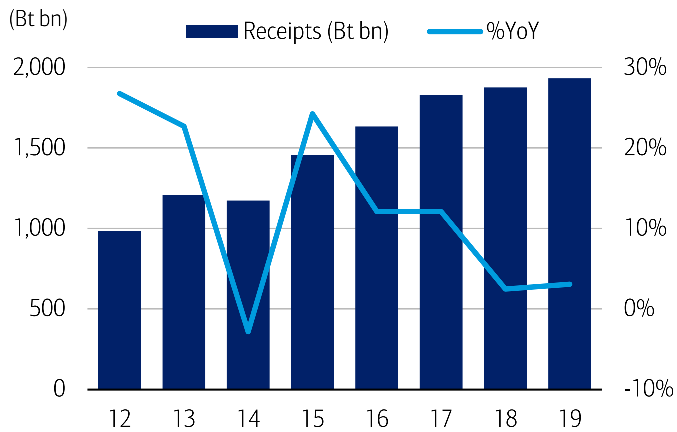
High household debt—now at 91% of GDP—certainly concerns us from a long-term perspective. However, it should form a cyclical tailwind when the rates are cut. When rates fall, stocks with high debt levels typically outperform companies with low debts. We believe the same can apply to an entire market.

FAQ #3: Will tourism recover to pre-Covid levels?

There seem to be two separate but related concerns regarding tourism. First is that spending per head is permanently impaired. The second less commonly expressed fear is that Chinese tourism is permanently impaired, and arrivals will not get back to the pre-Covid levels in the foreseeable future.

On the longer-term growth prospects for tourism, we see real cause for concern. Even before Covid, growth in tourism receipts was slowing, largely due to a fall in spending/head (Exhibit 4 and Exhibit 5).

Exhibit 4: Tourism receipts
Growth already slowing before Covid



Source: Ministry of Tourism and Sport

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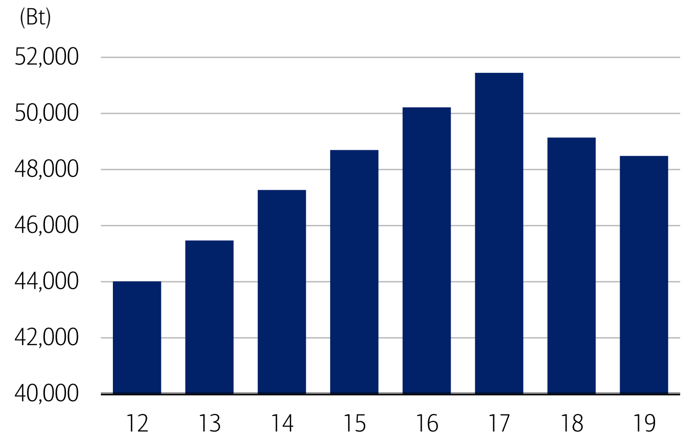
Exhibit 5: Tourist spending/capita
Thailand increasingly becoming a mass-market destination from mid/high-end tourists



Source: Ministry of Tourism and Sport

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In part, we attribute the 2018-19 weakness to the cyclical slowdown in global and Asian GDP growth resulting from the China-US trade conflict. However, we think a part of the slowdown reflects a shift in arrivals from higher-income to lower-income tourists. Over the past two decades, Thailand has been gradually becoming a destination for mass-market tourists from mid/high-end tourists and that has changed the mix of arrivals.

As a result, we are not optimistic about a long-term growth in revenues from tourism. We expect sub-5% annual growth in revenues from tourism for the next 5-10 years.

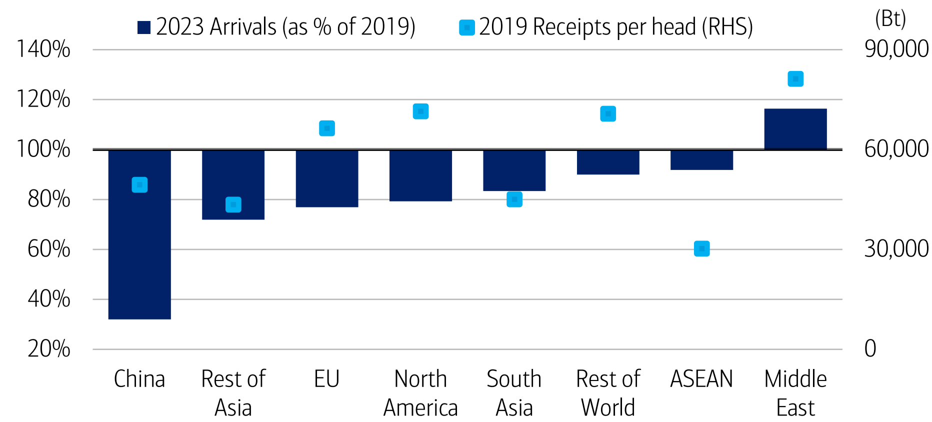
That said, we see several mitigating factors.

First, for AOT (though not hotels or the broader economy) what matters most is the number of heads passing through gates, not the spend/head. Arrivals are doing better than spend/head.

Second, we believe there is still ample room for fairly rapid catch-up growth in receipts on a 1-2 year view as pre-Covid travel patterns are restored.

Third, if we examine the 2023 numbers we find encouraging signs on spending. Due to the late reopening of China, the post-Covid period has seen a big—but likely temporary—change in the mix of nationalities. Lower-income markets in Asean and South Asia are taking a much bigger share than before Covid, while China's contribution is lower (Exhibit 6). We expect the mix to normalize as Chinese tourism ramps up.

Exhibit 6: Low-spending Asean tourists have surged while Chinese have lagged
Changes in mix explain much of lower receipts/head at present



Source: Ministry of Tourism and Sport

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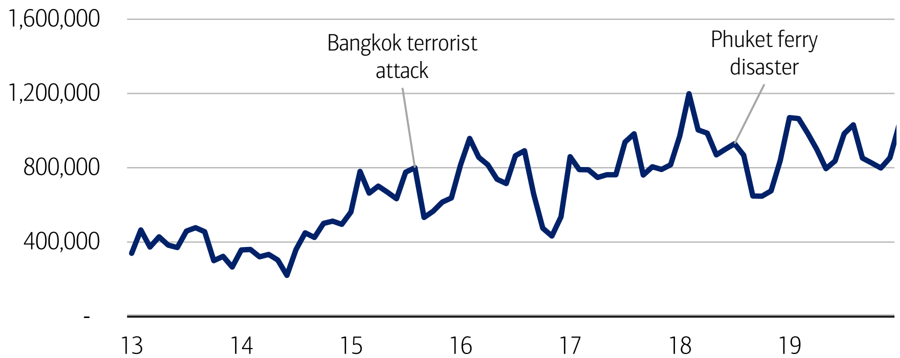
We lack the data to quantify how much the change in mix explains lower overall spend/head, and it likely accounts for most of the fall. Much of the remainder, we think, is due to the weak global economy, particularly in Europe and China.

Regarding arrivals, we believe that Thailand has room for strong growth for the next 1 to 2 years.

The current shortfall is primarily due to slow normalization of Chinese arrivals. China opened its borders only about a year ago. Because most people plan their international trips 6-12 months in advance, there should be a lag in normalization.

A possible easing in security concerns could also bolster the number of arrivals to Thailand. Bank of America's China tourism analyst has found that mainlanders' travel to Emerging Markets in general has lagged trips to Developed Markets since the pandemic due to security concerns, and that may have contributed to weakness in tourism in Thailan (China Tourism monthly (Dec) – Solid domestic travel during New Year holiday: see note). There have been several events in Thailand that caused security concerns in the past that resulted in declines in tourism, but history tells us that the damages from security concerns appear to be generally short-lived. (Exhibit 7).

Exhibit 7: China tourist arrivals
Unit: Number of people



Source: Ministry of Tourism and Sport

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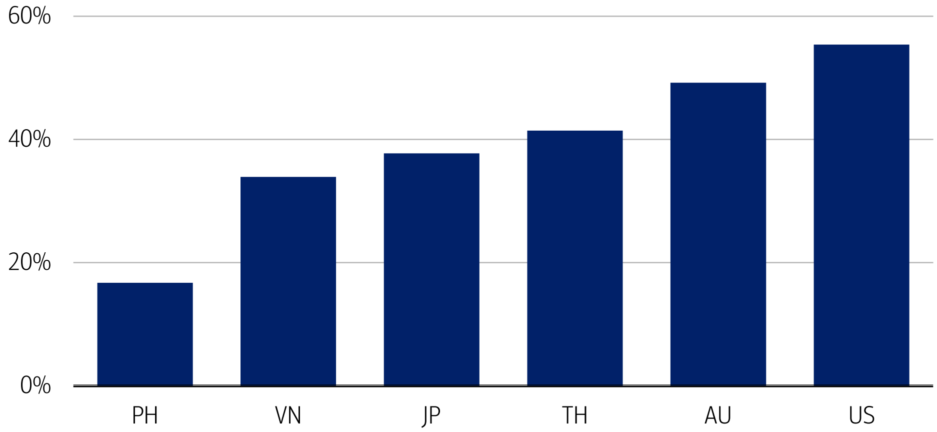
We expect that the latest event concerning Thailand's security will follow a similar pattern, with substantial potential upside from normalization. Chinese arrivals to Asean Emerging Markets in 4Q23 were 17-41% of the pre-Covid benchmark compared to 38-55% for Chinese arrivals to developed markets, such as the US, Japan and Australia (Exhibit 8). Were security concerns to dissipate over the course of this year, we expect Chinese arrivals to rapidly grow to the levels comparable to that of the developed markets.

Exhibit 8: 4Q23 Chinese tourist arrivals as % of 4Q19 levels by destination

Security concerns have slowed travel to Emerging Markets



Source: National Official Sources Note: PH-The Philippines, VN- Vietnam, JP-Japan, TH-Thaniland, AU-Australia

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FAQ #4: Will structural challenges overwhelm a cyclical upturn?

From a longer-term perspective, we take Thailand's structural challenges very seriously. Thailand's demographics are similar to China's, and the population is shrinking. The educational system is poor, and the work force lacks skills to support a move to higher value-added industries like semiconductors. Key industries are overconcentrated. Technological changes are disrupting two core industries—hard disk drives and ICE autos. These structural challenges make us cautious on Thailand from a long-term view of 5-10 years.

That said, we think that cyclical factors, such as recovery in tourism and rate cuts, will overwhelm structural issues for the 2-3 year term. We have calculated that cyclical factors explain at least 70-80% of the current shortfall in GDP and earnings relative to pre-Covid trends. We identify four cyclical headwinds at present: a lagged tourism recovery, high real interest rates, the eight-month delay in the government's budget, and weak exports. We believe that the first three headwinds will start reversing by 2H and that the fourth—weak exports—will start turning next year when our economists forecast a recovery in the global economy.

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