Thailand Watch

A tale of two halves

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GEM Economics
Asia | Thailand

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Growth revision

We have revised downward our 2024 growth forecast from 3.7% to 2.6%, as we no longer assume the government's proposed Digital Wallet in our base case. If implemented, the policy would provide some upside to our forecast. We also fine-tuned our forecast to reflect weak manufacturing production and lower tourism revenues. We have revised our inflation forecast down to 0.8% for 2024 and 0.9% for 2025.

Two rate cuts in 2024

We reiterate our call for two 25bp rate cuts in 2024 beginning in June and another cut in 2025. We argue that the monetary policy stance may prove to be more tightening than previously thought. The lower inflation expectations imply higher real interest rates. At the same time, the lower potential growth may result in lower neutral rates. A weaker growth outlook would call for even deeper cuts.

A tale of two halves

We expect the economic recovery to remain sluggish in 1H24, given the significant impact from the budget delay, before picking up pace in 2H24, as the budget disbursement normalizes and the expected rate cuts provide needed policy easing.

Digital wallet not in the base case

Given the uncertainty surrounding the Digital Wallet policy, we no longer assume the full-scale digital wallet policy in our base case. We think there are three key options: (i) pushing it through, (ii) scaling it down and putting it in the 2025 budget, or (iii) scrapping the program altogether. The policy, if implemented, would be an upside to our forecast.

Manufacturing decline: cyclical vs structural

Thailand's manufacturing sector has been contracting over the past five quarters following a strong rebound after the Covid19 outbreak. We think there are two key issues at play. On the one hand, the manufacturing contraction could be a cyclical response to the inventory cycle given weak exports and the strong buildup in inventory. On the other hand, it could be a sign of structural decline in some of the industries.

Another Kodak moment?

Hard-disk drive (HDD) is one of Thailand's largest exporting industries. Thailand has been the largest producer of HDD, with more than 50% of global production capacity. In 2023, HDD exports and production fell as much as 40%. While this could be a response to the cyclical inventory cycle, the structural shift that is expected to continue with technological changes which will present stronger headwinds to Thailand's HDD exports.

Lower tourist spending

We expect tourism recovery to be the key drivers for growth in 2024, with the forecast of 35.1mn arrivals in 2024 and 38.8mn in 2025. We expect the change in spending behavior to still weigh on total tourism revenue compared to the pre-Covid19 trend.

Refer to important disclosures on page 8 to 9.

A tale of two halves

We have revised downward our 2024 growth forecast from 3.7% to 2.6%, as we no longer assume the Digital Wallet policy in our base case. We also fine-tuned our forecast to reflect weak manufacturing production amid rising inventory and lower tourism revenues. We revised our inflation forecast down to 0.8% for 2024 and 0.9% for 2025 and reiterate our call for two 25bp rate cuts, starting in June.

Exhibit 1: We revised 2024E growth to 2.6%, as we remove the digital wallet policy from our base case
Key economic forecast (%)

		Previous Forecast		Current Forecast	
%YoY	2023	2024E		2024E	2025E
		with digital wallet	without digital wallet		
Real GDP	1.9	3.7	2.9	2.6	2.8
Private Consumption	7.1	4.6		2.8	3.0
Govt Consumption	-4.6	1.5		1.3	1.8
Gross Fixed Capital Formation	1.2	3.0		1.9	2.0
Private	3.2	3.0		2.0	2.0
Public	-4.6	3.0		3.1	2.0
Exports of Goods	-2.8	2.0		1.8	2.5
Export of Services	38.3	19.5		22.7	6.6
Import of Goods	-3.8	3.0		3.5	2.3
Import of Services	4.3	7.4		5.9	1.9
Current Account (US$ bn)	7.9	11.7		4.5	10.1
as % of GDP	1.5	2.1		0.8	1.7
Headline CPI	1.6	1.7		0.8	0.9
Policy Rate	2.50	2.5	2.3	2.0	1.75
Tourist Arrivals (Mn persons)	28.7	35.2		35.2	38.8

Source: Kiatnakin Phatra Securities estimates

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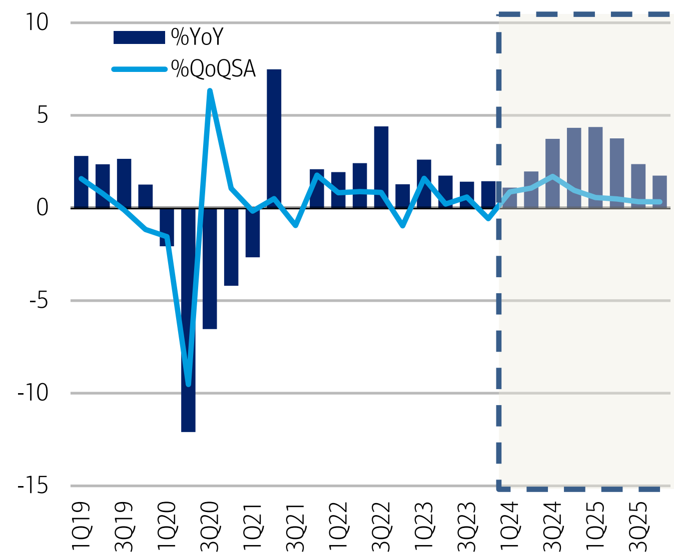
Exhibit 2: Growth is expected to remain sluggish in 1H24 before picking up pace in 2H24
Real GDP growth, actual and forecast (%)



Source: Kiatnakin Phatra Securities estimates

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A tale of two halves

We expect economic recovery to remain sluggish in 1H24 before picking up pace in 2H24, as the budget disbursement normalizes and the expected rate cuts provide needed policy easing.

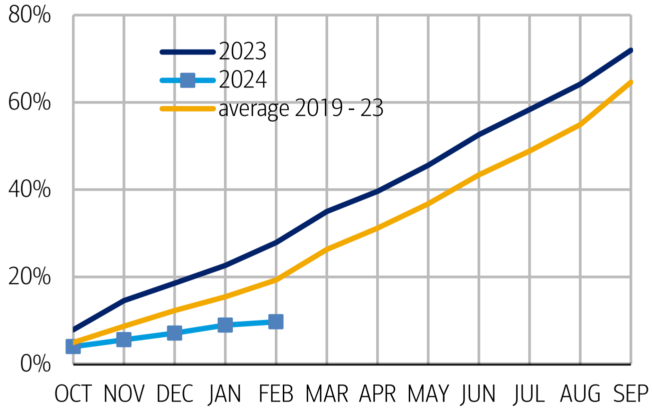
The budget delay

As highlighted in the [4Q23 GDP report](), the economic recovery was dragged by the significant delay of the disbursement of public investment projects as parliamentary approval of the Budget Bill is delayed. The disbursement on public investment expenditure fell as much as 50% in 4Q23. Public investment in GDP fell as much as 20% YoY and 12% QoQSA (quarter-on-quarter seasonally adjusted).

The Budget Bill is not expected to be passed until April and the disbursements may not resume until May. We expect the normalization in disbursements to provide some boost to public investment expenditure and the construction sector in 2H24. However, due to capacity constraints, some of the delayed budget may not be executed within the current budget year, which ends in September. Some of the delayed budget would be carried into the next fiscal year.

Exhibit 3: Public investment disbursements fell as much as 50% YoY as the Budget Bill is delayed

Cumulative disbursements of fiscal capital expenditure (% of the total capital expenditure budget)



Source: Ministry of Finance, Kiatnakin Phatra Securities

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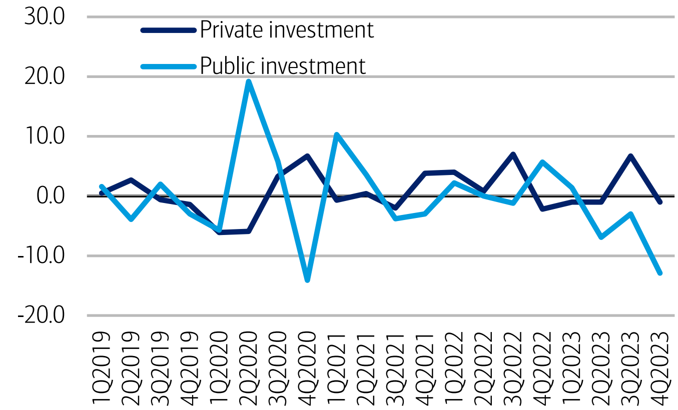
Exhibit 4: Public investment in GDP fell 12% QoQSA and 20% YoY in 4Q23

Public and private investment growth (%QoQSA)



Source: NESDC, Kiatnakin Phatra Securities

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Cyclical vs structural

We are also expecting some cyclical recovery in exports, given the inventory cycle and improvements in regional exports. However, as highlighted below, apart from the cyclical recovery, we believe Thailand is facing challenging structural headwinds in its competitiveness. Several industries are in a structural decline because of technological changes, competition from excess capacity in China, and inability to maintain their competitiveness.

Risks to the outlook

The key risks to the growth outlook remain tilted to the downside, including weaker-than-expected global trade and economic recovery, a rise in commodity prices due to geopolitical conflicts, the slower-than-expected Chinese economic and tourism recovery, and weaker-than-expected domestic demand due to slow income recovery and high household debt burden.

First rate cut in June

We reiterate our call for two 25bp rate cuts this year beginning in June and another cut in 2025. We argue that the monetary policy stance at the current level of the policy rate may prove to be more tightening than previously thought. The lower inflation expectations imply higher real interest rates. At the same time, the lower potential growth may result in lower neutral rates, which would call for a lower policy rate to re-calibrate the policy stance.

While the lower potential growth trend and weaker cyclical economic recovery would call for rate cuts, the Monetary Policy Committee (MPC) has been hawkish and still deemed the current policy rate to be consistent with the forward-looking outlook. The sustained tight monetary policy stance would prove to be too restrictive, adding pressure on the weak domestic demand.

Digital Wallet—No longer in the base case

Given the uncertainty surrounding the Digital Wallet policy, we no longer assume the full-scale digital wallet policy (Bt500bn handouts) in our base case. The National Anti-Corruption Commission (NACC) has recently sent its formal recommendations to the government, highlighting the risk of policy corruption, the risk of violating the Constitution and the fiscal discipline law, the risk that the policy may be inconsistent with the promises pledged during the election campaign, as well as the financial burden on the country.

More recently, the Digital Wallet Policy Committee reconvened without a clear path forward. With the pushback and objections, the Committee concluded with more subcommittees to look into potential corruption issues and to receive more feedback and opinions. While the prime minister insisted that the government would push the policy forward, it remains unclear whether the government has full support from its coalition and government officials.

We think the report and the government's reluctance to push the policy forward signal a rising chance that the policy may not pass as intended. We think there are three key options:

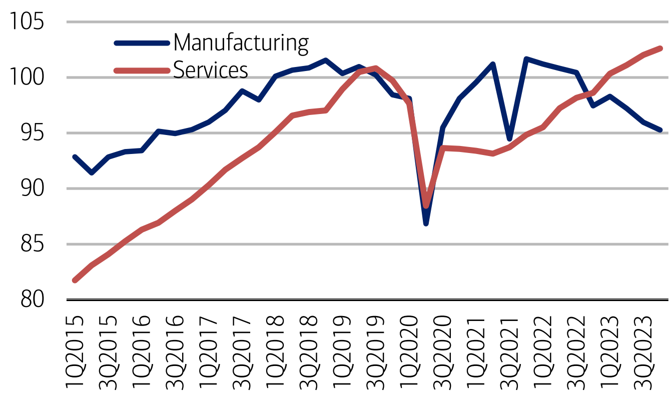
- Keep pushing the Bt500bn borrowing bill through parliament (or pass it as an Emergency Decree), with the risk that it may be challenged in the Constitutional Court or by the Election Commission. Given that it needs parliamentary approval, the policy may be delayed until at least July. If this is the case, we would still expect a fiscal multiplier of about 0.2-0.3x and GDP impact of about 0.8%. However, the negative impact from the financing side, including the tightening in liquidity in the banking system, a rising bond yield and weaker baht are expected.
- Delay the project, include it in the 2025 budget without the borrowing bill, and start the program in October as the new fiscal year starts. Given the budget constraint, the size of the program may need to be scaled down by at least half. As it would not be funded entirely by new deficits, the incremental economic impact would be less, depending on the financing options and targeted recipient groups.
- Scrap the program altogether. This option also carries a risk that the Election Commission might question whether the Pheu Thai Party fulfilled its pledges during the campaign.

Manufacturing sector at risk

Thailand's manufacturing sector has been contracting over the past five quarters after a strong rebound after the Covid19 outbreak. The Manufacturing Production Index (MPI) fell as much as 6% YoY in December 2023 and the manufacturing sector in GDP fell 2.4% YoY in 4Q23.

We think there are two key issues at play. On the one hand, the manufacturing contraction could be a cyclical response to the inventory cycle given weak exports last year and the strong buildup in inventory. On the other hand, it could be a sign of structural decline in some of the industries. Overall, we anticipate the continued weak manufacturing production to weigh on the Thai growth outlook in the longer term.

Exhibit 5: Manufacturing has been on a decline, while services have led the recovery
Growth of value added from manufacturing and services sector in the GDP



Source: NESDC, Kiatnakin Phatra Securities

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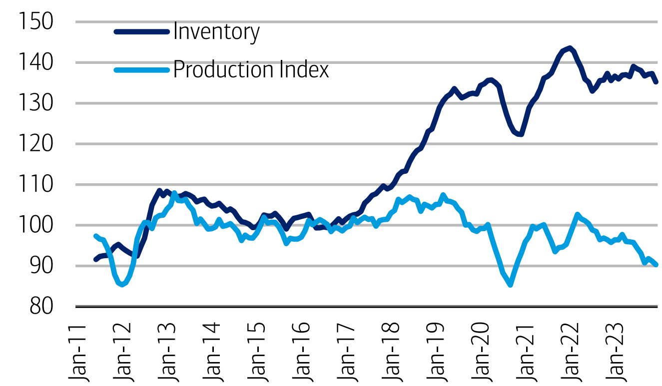
Exhibit 6: Manufacturing production has been declining as inventory has built up
Manufacturing production and inventory index



Source: Office of Industrial Economics, Kiatnakin Phatra Securities

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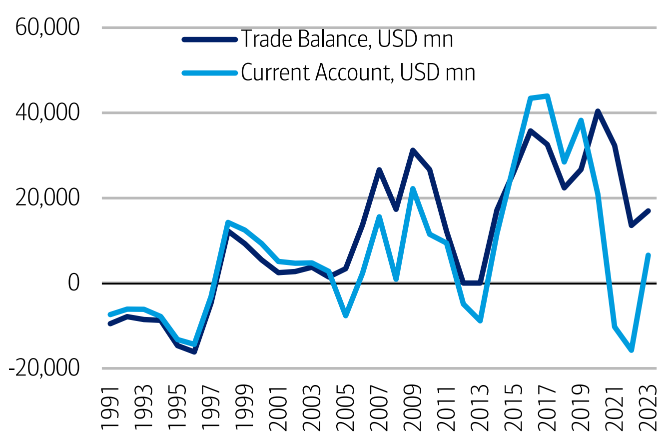
Cyclical recovery

The unusually high inventory levels have led to a production slowdown last year. Thai manufacturing's inventory levels have remained above average in December 2023 at approximately +1 standard deviation (SD). Specifically, in the auto sector, inventory levels in 4Q23 are approximately +2.4 SD compared to historical averages. However, as local demand and exports improve and inventory declines, production is expected to recover.

Competitiveness issues

However, Thailand is facing several structural changes to its competitiveness. While exports have so far held up well and net exports remain in surpluses, there are signs of deterioration of competitiveness in several products, particularly concerning technological shifts and increased competition from abroad, notably China. Notably, we note a structural decline in the production of various products, including HDDs, textiles, vehicles, and fabricated metal products.

Exhibit 8: The current account has recovered as tourism returned and the trade balance remained in surplus, but we foresee risks ahead
Trade balance and the current account balance (USD mn)



Source: BoT, Kiatnakin Phatra Securities

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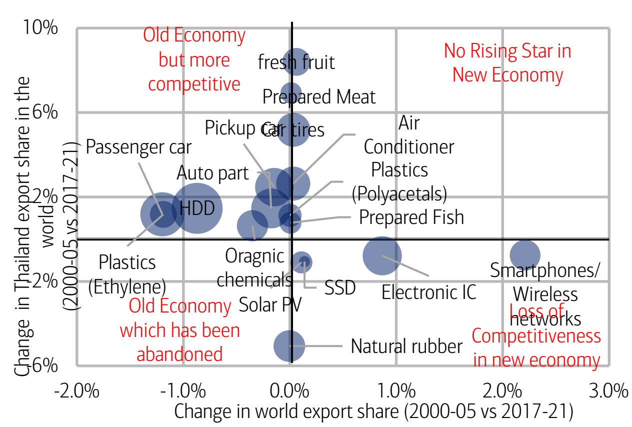
Exhibit 9: Thailand is gaining market share in old economy sectors and losing market share in new economy sectors
Changes in Thailand's export share and changes in world export market share, between 2000-05 vs 2017-21, by industry



Source: UNComTrade, Kiatnakin Phatra Securities

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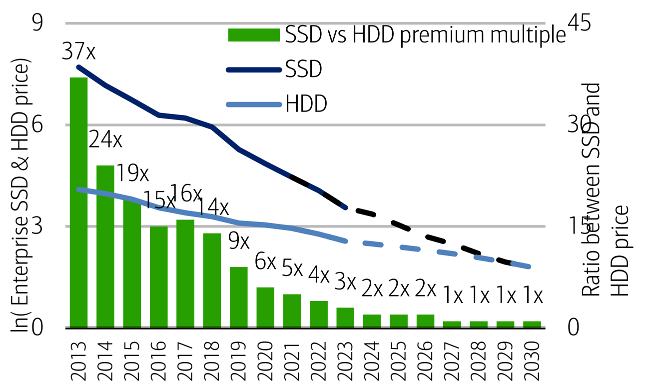
Another Kodak Moment?

We highlighted in our earlier report that Thailand's Internal Combustion Engine (ICE) vehicles are at risk of facing the so-called "Kodak Moment" where the market leader could lose its status as the market, technology, and competition shift.

Another potential case is the HDD industry. HDD is one of Thailand's largest exporting industries. Thailand has been the largest producer of HDD, with more than 50% of global production capacity. As the industry was consolidated in 2017, production capacity was relocated from Malaysia and China to Thailand. While the demand for retail users was shifted to solid state drives (SSD), the rising demand from data centers and cloud services continued to sustain exports and production. However, as the cost difference between HDD and SSD narrows, the shift is expected to continue.

In 2023, HDD exports and production fell as much as 40%. While this could be a response to the cyclical inventory cycle and some of the production could still recover in the short term, the structural shift that is expected to continue with the technological changes will eventually present stronger headwinds to Thailand's HDD exports.

Exhibit 9: The cost difference between HDD and SSD has narrowed and is expected to narrow further
Difference in cost between HDD and SSD



Source: Wikibon 2021

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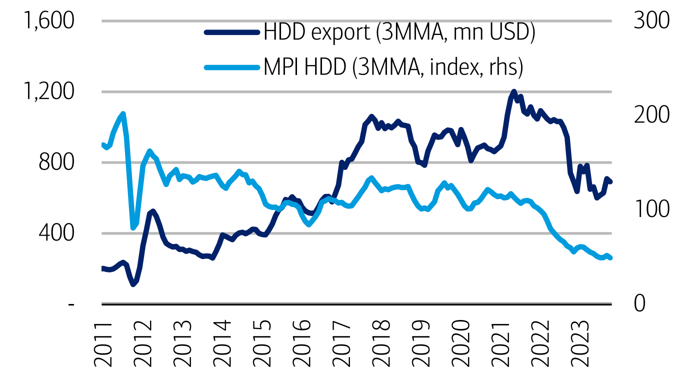
Exhibit 10: Production and exports of HDD rose in 2017 as production was consolidated, but fell sharply over the past year
Export value of HDD (US$ million per month) and manufacturing production index (MPI) of HDD



Source: Ministry of Commerce, Ministry of Industry

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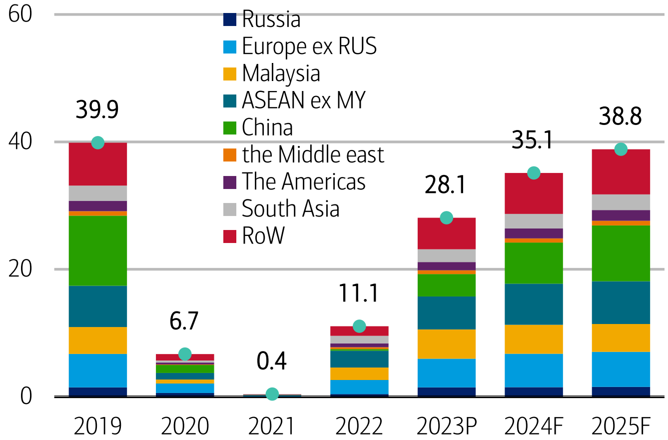
Lower tourism revenue

We expect tourism recovery to be one of the key drivers for growth in 2024, with the forecast of 35.1mn arrivals in 2024 (88.1% of the pre-COVID level) and 38.8mn in 2025 (97.4% of the pre-COVID level). Chinese tourists remain the key risk to the forecast. While we expect the number of tourists from other countries to recover to the pre-COVID level this year, we only expect Chinese tourists to recover to 60% of the pre-COVID level (6.5mn) from 32% last year and to 80% next year (8.8mn).

However, we note that the official estimate of spending per head in 2023 is 5% lower than the pre-COVID level, both because of the change in the composition of incoming tourists and a lower spending pattern, with ASEAN (Association of Southeast Asian Nation) tourists gaining greater share compared to the pre-COVID structure. We expect average spending per head to gradually improve as the tourism composition normalizes. However, the change in spending behavior may still weigh on total tourism revenue compared to the pre-COVID19 trend.

Exhibit 11: Foreign tourists are expected to a key driver for growth
The number of foreign tourists, by country of origin



Source: Ministry of Tourism and Sports, KKPS

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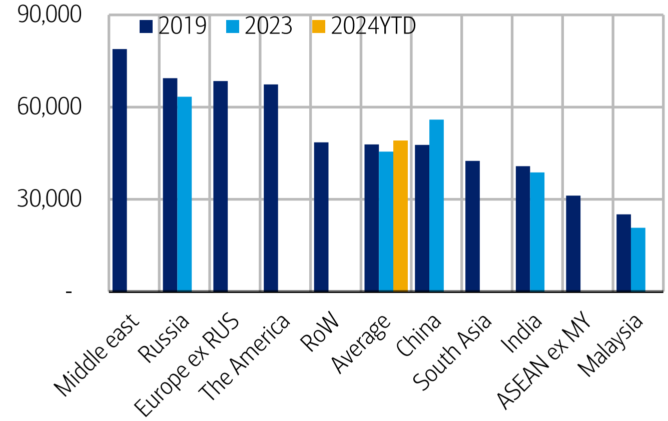
Exhibit 12: Early estimates of average spending per head is lower than the 2019 level, while Chinese tourists spend more
Estimate of spending per head by country



Source: Ministry of Tourism and Sports, KKPS

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