Economics

DBS Focus

Thailand: External chill weighs on growth

Economics/Growth/Fiscal/Rates/Thailand

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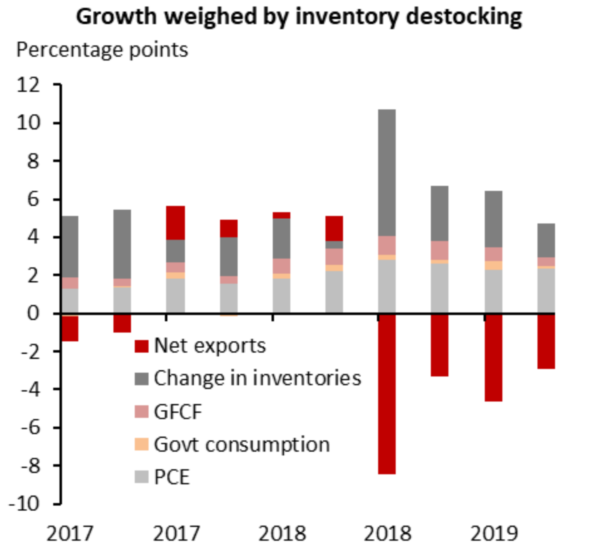
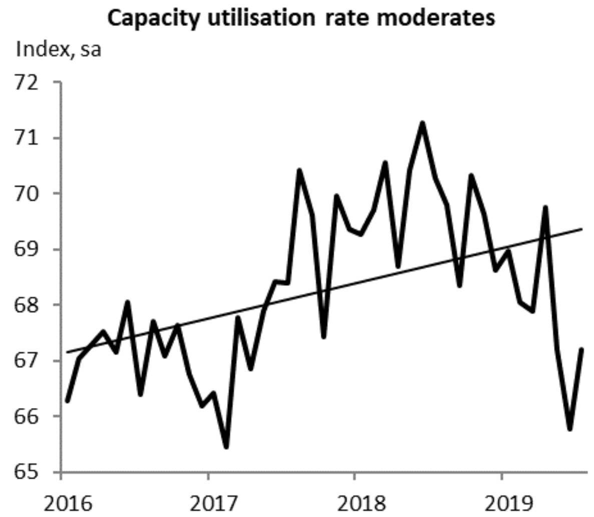
- *Exports-led uncertainty and inventory destocking is weighing on Thai growth*
- *Fiscal and monetary support is underway*
- *The government has announced a sizeable stimulus, with the BOT also onboard to tackle growth risk*
- *THB outperformance is a concern. Capital controls are not on the radar, with macroprudential measures likely*
- ***Implication for forecast**: We lower Thai GDP forecast to 3% vs 3.4% previously*
- ***Implication for investors**: Odds of a cut in 4Q are rising. For the USD/THB, the 30 handle is a key psychological level*

The Thai economy joined its regional peers in posting slower growth in first half of 2019. GDP growth slowed to 2.6% YoY in 1H, from 4.1% last year. Much of the correction, came from inventory destocking, as the component's contribution nearly halved from 2.9 percentage points in 4Q18-1Q19 to 1.7 ppt in 2Q.

Household consumption was resilient though public and private spending decelerated, affected by a delay in the formation of the government. Drought conditions have impacted farm output, while a delay in the passage of next fiscal year's Budget reined in public sector capex spending. On the services end, tourist arrivals moderated again after a stable 4Q.



Source: CEIC, DBS



Source: CEIC, DBS

Manufacturing activity decelerated due to subdued export conditions, with capacity utilisation rates easing since the start of the year (see chart above). The drag from net exports, however, moderated as slower exports was accompanied by weak imports.

All hands on the deck

The Bank of Thailand cut benchmark rates by 25bps in August, unwinding December's hike and taking the policy rate to within a striking distance from the global financial crisis low. Sharp slowdown in 2Q growth coupled with THB outperformance has perturbed the central bank, in midst of an already tough trade environment. The risk of missing the inflation target has also added to the cause of further easing. **Odds of another cut in 4Q has risen,** which will take the policy rate to 1.25% i.e. lows seen during the global financial crisis. Beyond 4Q, further cuts are unlikely in a hurry as the BOT seeks to balance the need for support with high household debt levels, constrained policy space and financial stability risks.

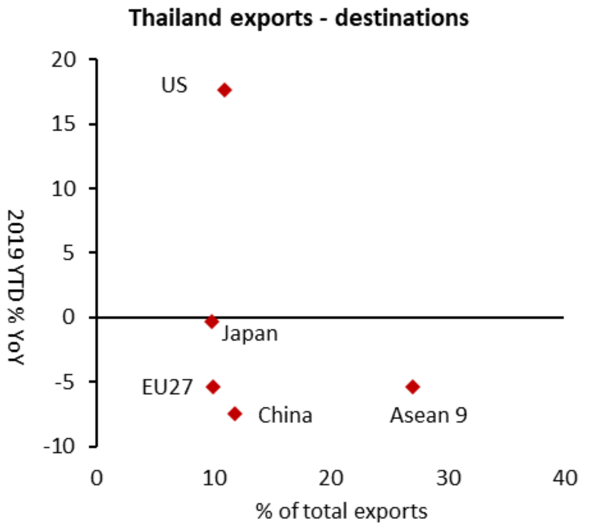
Non-rate measures till date have helped tame THB volatility but has done little to reverse its trend. It is, however, clear from the official rhetoric that draconian capital controls are not on the anvil. Instead, the BOT might prefer to continue down the line of macro prudential measures by way of relaxing norms on outflows, encourage Thai investments offshore etc. **This is particularly as the USDTHB approaches the psychologically crucial 30.0 level.** Intervention has yielded little result, with any aggressive approach on this end to attract the ire of the US Currency report review and reassessment of the GSP benefits.

As monetary policy nears historical lows, the government has also stepped into with stimulus measures. The Cabinet approved the THB316bn package last month, targeting a) households (increase in allowance for state welfare car holders etc.); b) farmers (attractive loan rates, cash handouts based on landholding etc.; c) tourism (domestic travel allowance, extension of visa waiver etc.); d) SMEs and businesses. This support is timely and is expected to help boost short-term consumption, while businesses are expected to avail of cheaper credit and tax deductions to step up capex spending. A timely rollout of the government's Budget will complement these efforts to ensure that the public sector draws in the private players. Fiscal costs will be kept under control as much of the spending is expected to be off balance sheet. A third is expected to be funded through the new budget and an already announced support scheme, while the rest will be via state banks and other borrowings. Hence this might translate into a marginal increase in the FY2020 Budget deficit target of 2.7% of GDP but keep within the fiscal framework.

2H stabilisation?

For rest of the year, growth is likely to feel the drag from a tougher global trade outlook, delay in the passage of the FY2020 Budget and weaker capex/manufacturing cycle.

In midst of a prolonged US-China trade skirmish and broader protectionist trade tendencies, Thai exports have fallen 3% between January and July 2019, down from 8% rise in 2018. Export breakdown shows that top eight sectors including electronics (-9%), auto (-3%) and agro products (-2.5%) have declined on the year. There is a silver lining in the destination-wise data, which shows that Thailand's exports to the US are up in double digits YTD, but this is offset by a fall in sales to other key markets i.e. China, Japan, ASEAN9 and the EU.



Source: CEIC, DBS

Washington and Beijing will hold the next trade negotiations in early October, but expectations for any breakthrough to reach a trade deal is low. Back during the late-July negotiations, the dispute escalated soon after and was followed by the US Treasury Department labelling China a currency manipulator in August and President Donald Trump announcing more tariffs on Chinese goods. This uncertainty will continue to weigh on the regional trade performance, while manufacturers pin hopes on short-term diversion benefits.

For Thailand, a tough trade backdrop is also accompanied by a delay in the Budget passage, implying that support from capex spending stands delayed by a quarter, to 4Q19 or early 2020. Nonetheless, some support is expected from fiscal stimulus measures, highlighted in the previous section, which might help ease the extent of slowdown in 2H.

Spill-over of weak trade activities onto domestic demand will be under watch, which in turn could impact consumption and employment conditions. Uncertainty over trade war developments (decision on auto tariffs and preferential treatment under the GSP framework) remain. **The evolving 1H trend prompts us to revise down Thailand's 2019 GDP forecast to 3.0% YoY, with downside risks, from 3.4% presently. This also moderates next year's growth to 3.2% vs the previous 3.5%.**

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).