
Country Report

Thailand

Thailand at a glance: 2007-08

OVERVIEW

Thailand's political outlook remains highly uncertain following the military coup in September 2006. The armed forces continue to struggle to restore national unity, and supporters of the ousted prime minister, Thaksin Shinawatra, are becoming more vocal in their opposition to military rule. The military-appointed prime minister, Surayud Chulanont, a retired general, has suggested that a general election could take place in November 2007, but there are concerns over potential delays, and the prospects for the post-transition period remain unclear. Surayud has adopted a "sufficiency" model of economic management, but his government is now planning expansionary measures to stimulate the economy, which remains weak. Inflation will ease from the highs of 2006. The current account will drop into deficit in 2008.

Key changes from last month

Political outlook

- Despite being formally indicted on charges of corruption and abuse of power in mid-June, Thaksin has announced that he does not intend to return to the country to defend himself until after the next election. If he does return while the military is still in power, this would probably prove to be a major flashpoint.

Economic policy outlook

- Reflecting its efforts to provide some fiscal stimulus, the interim government recently approved an increase in budgetary expenditure for 2007/08 (October-September) compared with that originally programmed, so that total spending is now set to rise by around 6% on planned spending in 2006/07.

Economic forecast

- Thailand's export revenue (in US dollar terms) continues to grow at a rapid pace, increasing by nearly 19% year on year in January-May, according to preliminary data from the Ministry of Commerce, whereas the import bill rose by only 4.4% during the same period. The Economist Intelligence Unit has therefore revised up its forecast for the current-account surplus this year to the equivalent of 2.3% of GDP (from 1.3% previously).

July 2007

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The Economist Intelligence Unit

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Electronic delivery

This publication can be viewed by subscribing online at www.store.eiu.com

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ISSN 1356-4056

Symbols for tables

"n/a" means not available; "--" means not applicable

Printed and distributed by Patersons Dartford, Questor Trade Park, 151 Avery Way, Dartford, Kent DA1 1JS, UK.

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Thailand

July 2007

Summary

Outlook for 2007-08 Thailand's political outlook remains highly uncertain following the military coup in September 2006. The military continues to struggle to restore national unity, and supporters of the ousted prime minister, Thaksin Shinawatra, are becoming more vocal in their opposition to military rule. The military-appointed prime minister, Surayud Chulanont, a retired general, has suggested that a general election could take place in November 2007, but there are concerns over potential delays, and the prospects for the post-transition period remain unclear. Surayud has adopted a "sufficiency" model of economic management, but his government is now planning expansionary measures to stimulate the economy, which remains weak. Inflation will ease from the highs of 2006. The current account will drop into deficit in 2008.

The political scene The Constitution Tribunal has found the Thai Rak Thai (TRT) party guilty of electoral fraud and has ordered that it be dissolved. The party's 111 executive members have also been barred from politics for five years. The acting leader of the now defunct TRT, Chaturon Chaisang, has vowed to relaunch the party under the same name. The first draft of a new constitution, which must be promulgated before an election can take place, has been completed. Thaksin has been formally charged with abuse of power and has had his assets frozen. Rallies by his supporters have grown, causing the military junta some concern. The government has approved a new security bill, while the Muslim insurgency in the southernmost provinces continues unabated.

Economic policy The government has sought to stimulate growth, and the Bank of Thailand (the central bank) has sharply cut its policy interest rate in an attempt to spur on the economy. The government has approved plans to restrict future privatisations. A trade agreement with Japan has been signed, but the US has put Thailand on its Priority Watch List for intellectual property rights infringements.

The domestic economy Real GDP grew by 4.3% year on year in the first quarter of 2007, with a strong external sector offsetting weak domestic demand growth. Employment has remained buoyant, but confidence continues to deteriorate. Inflation remains low, and the baht has made further gains against the US dollar.

Foreign trade and payments The trade surplus widened sharply in the first four months of 2007, but import growth picked up pace in April. The current account recorded a record surplus in the first quarter, pushing up foreign reserves even further.

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Political structure

Official name	Kingdom of Thailand	
Form of state	Constitutional monarchy	
The executive	Under an interim constitution that came into effect on October 1st 2006, the military council, known as the Council for National Security (CNS), appoints the prime minister, who is then free to form a Council of Ministers (the cabinet)	
Head of state	King Bhumibol Adulyadej	
National legislature	Under the interim constitution, a 250-member National Legislative Assembly acts as the legislature. Assembly members are appointed by the king and drawn from all regions of the country	
National elections	The CNS has pledged to hold a general election by the end of 2007 after a new permanent constitution has been promulgated	
National government	In the September 19th 2006 coup the military ousted the Thai Rak Thai caretaker government, which was led by Thaksin Shinawatra. The CNS maintains a firm grip on power under the interim constitution, and on October 1st it appointed a retired general, Surayud Chulanont, as prime minister to head the planned year-long transitional government	
Main political organisations	The main political parties include Thai Rak Thai (TRT), the Democrat Party (DP), Chart Thai (CT) and Mahachon	
	Prime minister	Surayud Chulanont
	Deputy prime ministers	Kosit Panpiemras Paibool Watanasiritham
Key ministers	Agriculture & co-operatives	Theera Sutabu
	Commerce	Krirkkrai Jirapet
	Defence	Boonrawd Somtat
	Education	Wijit Srisa-arn
	Energy	Piyasvasti Amranand
	Finance	Chalongphob Sussangkarn
	Foreign affairs	Nitya Pibulsongkram
	Industry	Kosit Panpiemras
	Information technology & communications	Sitthichai Pokai-udom
	Interior	Aree Wong-araya
	Justice	Charnchai Likitjitta
	Labour & social welfare	Apai Chanthanajulaka
	Natural resources & environment	Kasem Santiwong na Ayudhaya
	Public health	Mongkol na Songkhla
	Science & technology	Yongyuth Yuthawongse
	Social development & human services	Paibool Watanasiritham
	Tourism & sport	Suwit Yodmanee
	Transport & communications	Thira Haocharoen
Central bank governor	Tarisa Watanagase	

Economic structure

Annual indicators

	2002 ^a	2003 ^a	2004 ^a	2005 ^a	2006 ^a
GDP at market prices (Bt bn)	5,451	5,917	6,490	7,088	7,816
GDP (US\$ bn)	126.9	142.6	161.3	176.2	206.3
Real GDP growth (%)	5.3	7.1	6.3	4.5	5.0
Consumer price inflation (av; %)	0.5	1.8	2.8	4.5	4.6
Population (m)	63.5	64.0	65.1	65.5 ^b	66.0 ^b
Exports of goods fob (US\$ m)	66,089	78,084	94,979	109,200	128,213
Imports of goods fob (US\$ m)	-57,009	-66,909	-84,194	-105,995	-113,400
Current-account balance (US\$ m)	4,691	4,772	2,759	-7,857	3,231
Foreign-exchange reserves excl gold (US\$ m)	38,046	41,077	48,664	50,691	65,291
Total external debt (US\$ bn)	59.4	51.8	51.2	52.3	59.9 ^b
Debt-service ratio, paid (%)	22.9	15.3	10.5	14.5	8.7 ^b
Exchange rate (av) Bt:US\$	42.96	41.48	40.22	40.22	37.88

^a Actual. ^b Economist Intelligence Unit estimates.

Main origins of gross domestic product 2006	% of total	Components of gross domestic product 2006	% of total
Agriculture, forestry & fishing	10.7	Private consumption	56.1
Industry	44.6	Government consumption	11.6
Construction	3.1	Gross fixed investment	28.6
Manufacturing	35.1	Change in inventories	-0.7
Services	44.7	Exports of goods & services	73.7
		Imports of goods & services	-69.8

Principal exports 2006	US\$ m	Principal imports 2006	US\$ m
Machinery & mechanical appliances	20,268	Raw materials & intermediates	51,901
Electrical apparatus for circuits	13,980	Capital goods	33,106
Electrical appliances	10,041	Fuel & lubricants	25,403
Vehicle parts & accessories	9,740	Consumer goods	9,564

Main destinations of exports 2006	% of total	Main origins of imports 2006	% of total
US	15.0	Japan	20.4
Japan	12.7	China	10.6
China	9.0	US	6.7
Singapore	6.4	Malaysia	6.6
Hong Kong	5.5	UAE	5.6

Quarterly indicators

	2005			2006			2007	
	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr
Central government finance (Bt bn)								
Revenue	416.5	404.8	270.9	312.7	439.4	411.1	304.9	318.3
Expenditure	337.7	360.8	376.2	351.6	329.7	397.5	308.0	438.4
Net lending/borrowing ^a	78.8	43.9	-105.3	-38.9	109.6	13.6	-3.2	-120.1
Output								
GDP at constant 1988 prices (Bt m)	927.7	943.9	1,020.9	1,017.6	974.6	988.1	1,064.3	1,060.9
GDP at constant 1988 prices (% change, year on year)	4.7	5.5	4.3	6.1	5.0	4.7	4.3	4.3
Manufacturing index (2000=100)	153.0	156.7	160.3	167.0	163.0	167.0	171.1	177.1
Manufacturing index (% change, year on year)	11.4	11.5	7.2	9.7	6.6	6.6	6.8	6.0
Prices								
Consumer prices (2002=100)	108.3	111.2	111.7	112.2	114.8	115.2	115.4	114.9
Consumer prices (% change, year on year)	3.7	5.6	6.0	5.7	6.0	3.6	3.3	2.5
Producer prices (2000=100)	125.5	128.4	130.0	131.7	138.4	136.3	134.4	135.1
Producer prices (% change, year on year)	9.5	9.4	8.2	8.7	10.3	6.2	3.4	2.6
Financial indicators								
Exchange rate Bt:US\$ (av)	40.04	41.29	40.99	39.29	38.07	37.64	36.53	35.54
Exchange rate Bt:US\$ (end-period)	41.27	40.96	41.03	38.80	38.19	37.49	36.00	34.97
Deposit rate (av; %)	1.33	2.25	2.92	3.83	4.50	4.67	4.75	4.25
Discount rate (end-period; %)	4.00	4.75	5.50	6.00	6.50	6.50	6.50	5.00
Lending rate (av; %)	5.50	5.83	6.33	6.92	7.50	7.50	7.50	7.50
M1 (end-period; Bt bn) ^b	813.7	838.9	898.9	889.8	856.1	852.9	916.2	924.9
M1 (% change, year on year)	8.1	8.8	7.8	6.4	5.2	1.7	1.9	3.9
M2 (end-period; Bt bn) ^b	7,351	7,549	7,737	8,016	8,041	8,146	8,219	8,406
M2 (% change, year on year)	4.2	4.9	6.3	8.7	9.4	7.9	6.2	4.9
Stockmarket index (SET; end-period; Apr 30th 1975=100)	675.5	723.2	713.7	733.3	678.1	686.1	679.8	673.7
Stockmarket index (% change, year on year)	4.5	12.2	6.8	7.6	0.4	-5.1	-4.7	-8.1
Sectoral trends, production (% change, year on year)								
Textiles	1.3	1.0	2.4	7.4	5.2	0.0	-3.3	-1.5
Vehicles	3.5	12.1	8.6	14.5	8.4	3.1	-4.5	-6.4
Integrated circuits	-1.8	31.5	45.9	26.9	30.9	25.3	9.9	5.5
Petroleum products	2.1	3.7	-9.0	3.4	0.9	0.4	5.1	-1.0
Rice	-10.5	3.4	5.2	5.4	23.3	3.6	-2.8	-9.7
Rubber	-7.8	3.5	-1.0	5.8	-2.0	3.9	3.8	2.4
Foreign trade (Bt bn)								
Exports fob	1,046.4	1,243.9	1,177.4	1,171.6	1,182.0	1,325.6	1,267.2	1,241.6
Imports cif	-1,246.2	-1,221.4	-1,197.5	-1,197.0	-1,253.4	-1,272.9	-1,148.3	-1,099.8
Trade balance	-199.8	22.5	-20.1	-25.4	-71.3	52.7	118.9	141.9
Balance of payments (US\$ m)								
Merchandise trade balance fob-fob	-1,778	3,148	2,130	2,739	1,527	4,749	5,798	n/a
Services balance	-2,111	-1,976	-1,591	-1,598	-2,014	-2,339	-1,978	n/a
Income balance	-2,273	-1,816	-1,493	-1,383	-2,557	-1,973	-1,114	n/a
Net transfer payments	751	743	805	851	848	806	869	n/a
Current-account balance	-5,411	99	-149	609	-2,196	1,243	3,575	n/a
Reserves excl gold (end-period)	47,185	48,527	50,691	53,709	56,424	59,997	65,291	69,101

^a Excluding net acquisition of non-financial assets. ^b Bank of Thailand.

Sources: Bank of Thailand, *Monthly Bulletin*; IMF, *International Financial Statistics*.

Outlook for 2007-08

Political outlook

Domestic politics Thailand could have a new democratically elected government in place by the end of the year, bringing to an end the country's recent period of unprecedented political turmoil. However, such a benign outcome is by no means assured, and there remains the potential for further political upheaval over the next six months. Supporters of the Thai Rak Thai (TRT) party have rallied peacefully in support of the ousted prime minister, Thaksin Shinawatra, in recent months, even after the party was ordered to be dissolved after being found guilty of electoral fraud on May 30th. However, tensions are building. In the event that the elections are delayed beyond November-December this year, or that former TRT members are prevented from forming a new political party, the momentum of opposition could grow rapidly, with the military having to confront pro-democracy activists as well as disgruntled TRT supporters. If the military were then to seek to assert its full authority, it would raise the risk of serious clashes between demonstrators and the armed forces.

There are other potential flashpoints, not least the possibility that Thaksin might return to the country to defend himself against charges of corruption and abuse of power. The Council for National Security (CNS), which is made up of the coup leaders, has stated that Thaksin could return to the country and that his safety would be guaranteed. However, in late June Thaksin's legal adviser, Noppadon Pattama, announced that Thaksin would not return from self-imposed exile in the UK until after the election, saying that the former prime minister believed that the justice system had been compromised and that he would not in fact be safe. In mid-June Thaksin and his wife, Potjaman, were formally indicted on corruption charges relating to a controversial land purchase in 2003, and investigations into a number of other cases are coming to an end. The military-appointed investigative authorities have also frozen Thaksin's assets, amounting to around US\$1.5bn.

Although the CNS is confident that it can contain potentially volatile pro-Thaksin rallies, the military continues to struggle to maintain the confidence of those who welcomed its intervention last year. When ousting the Thaksin administration, the junta abrogated the 1997 constitution and pledged to introduce a new charter that would be more effective in protecting the public against a corrupt and excessively powerful government. This new constitution, which is still being drafted, is set to go to a public referendum in August. Failure to secure majority support for it could undermine the military's perceived legitimacy, and would inevitably scupper its plans to return power to a democratically elected government by the end of the year.

If an election does go ahead before the end of the year (the military now plans to hold elections on November 25th), the Democrat Party (DP) would most likely secure sufficient support to lead the next government, with its leader, Abhisit Vejjajiva, taking the helm. However, the party will struggle to improve on its recent poor electoral performances in the north and north-east.

Die-hard TRT supporters in these areas will be keen to back any TRT remnants contesting the ballot under a new banner. In the absence of this option, they are likely to switch their support back to other small and medium-sized parties, such as Chart Thai. Thailand therefore appears to be on course to revert back to the days of unwieldy, and potentially unstable, coalition governments.

In focus

The constitutional reform process

The Council for National Security (CNS), which led the coup that ousted the government of Thaksin Shinawatra in September 2006, has made good progress in overseeing the drafting of a new constitution, but it has attracted criticism for its decision to disregard the 1997 constitution, which was widely regarded as the country's best ever. There are also concerns that the CNS has exerted excessive influence over the drafting process—it hand-picked ten people to join the 35-member Constitution Drafting Committee (CDC), with the other 25 members being selected from the ranks of the 100-member Constitutional Drafting Assembly (CDA).

The new constitution, the first draft of which was completed in late April, will place greater controls on future prime ministers and will reduce the role of elected lawmakers in the political system. This is unsurprising, given that the coup in September last year was largely a reaction to the perceived excessive power of Thaksin and his alleged abuses of it. Although the most controversial constitutional change proposed—to make the prime minister an appointee, not an elected lawmaker—has been scrapped, the draft has been widely criticised for lacking the spirit of democracy and for placing excessive power in the hands of the judiciary. The military-backed administration wants to prevent Thai politics from again becoming as one-sided as it did under Thaksin's dominance, but its plans for achieving this seem to suggest that stronger "checks and balances" on the executive may come at the expense of Thailand's democracy.

After completing its first draft of the new constitution, the CDC handed the document to a number of organisations, including the CNS, the national parliament and the CDA, and these bodies are set to review the draft and propose amendments. The initial draft includes new provisions to limit any prime minister to two four-year terms in office, and to reduce the percentage of lawmakers needed to initiate no-confidence motions against an incumbent prime minister. The final version is now scheduled to be made public in July, with a national referendum planned for mid-August. Pro-democracy activists opposed to the coup have launched a campaign calling on voters to reject the new draft constitution. However, if the new constitution is not approved in the referendum, or if the CDA fails to finalise the charter in time, the military-approved interim charter empowers the cabinet and the CNS to select and amend a previous charter for promulgation within 30 days.

International relations In the immediate future Thailand's relations with the US are set to be harmed more by commercial disputes than by the US government's concerns about the military's grip on power in Thailand. In late April the US Trade Representative Office placed Thailand on its Priority Watch List of countries to be monitored for their lack of protection of intellectual property rights. The move was partly in response to the recent decisions by Thailand's Ministry of Public Health to impose compulsory licensing to override patents on a number of drugs made by US pharmaceutical firms. The US government, however, will maintain pressure on the CNS and the interim government to adhere to their reform pledges to restore democracy by the end of 2007. If there are signs of slippage in the schedule for a return to civilian rule, relations could turn frosty—Thailand's status as a "major non-NATO ally" of the US, which was granted in late 2003, is already under threat. Thailand's relations with most of its fellow members of the Association of South-East Asian Nations (ASEAN) have not been seriously affected by the coup, with the group maintaining its principle of non-interference in the domestic affairs of member states.

Economic policy outlook

Policy trends Despite the efforts of the administration led by the military-appointed prime minister, Surayud Chulanont, to promote a "sufficiency" economic management model, the government appears set to resort to popular measures to boost the economy. In May the government launched a Bt44bn (US\$1.3bn) stimulus programme, with new loans being distributed by state-owned banks to low-income workers and small and medium-sized enterprises. The interim government has also tinkered with the tax system to stimulate spending and investment, particularly in the housing market. However, the Surayud administration will be keen to differentiate its brand of stimulus measures from those of its predecessor. For example, although its recently launched "happy living" scheme is similar to the Thaksin administration's village fund, under which small loans were offered to villagers, the interim government has stressed that funds would be made available only for "productive" projects. It is likely that the next government, which could be in place by early 2008, will also seek to prop up the economy with some mildly stimulatory fiscal measures.

Fiscal policy Spending by the interim government grew by a rapid 34% year on year in January-March. Spending was slow in October-December last year, owing to the delayed passage of the budget for fiscal year 2006/07 (October-March). In 2006/07 as a whole the interim government is planning to run a small deficit of Bt146bn, equivalent to around 1.7% of GDP (based on official GDP projections). There is little risk that the interim government will greatly overspend (particularly given its policy of economic sufficiency), but budget revenue is set to fall below target, owing to the fact that economic growth is likely to turn out weaker than projected. The interim government recently approved a higher budget than initially planned for 2007/08, with total spending now set to rise by around 6% compared with planned spending in 2006/07.

Monetary policy The Bank of Thailand (BOT, the central bank) has loosened monetary policy considerably in the past few months. It cut its policy interest rate, the one-day repurchase (repo) rate, from around 5% in January to 3.5% in late May—at the most recent meeting of the bank’s monetary policy committee (MPC), on May 23rd, the bank cut the one-day repo rate by 50 basis points, following a similar cut in April and two earlier cuts of 25 basis points each. In its minutes from the meeting in May, the MPC indicated that it considered the current rate to be appropriate in terms of supporting the economy while also ensuring that inflation remained under control. However, the BOT has scope to cut rates further this year—domestic demand still requires stimulus, and both headline and core inflation are set to remain low for the foreseeable future. The Economist Intelligence Unit also expects the Federal Reserve (the US central bank) to lower its policy rate in the third quarter of this year, after having kept it on hold since June 2006. This will encourage Thailand to continue cutting rates. However, the BOT is concerned about the potential for spikes in crude oil prices, and during the remainder of 2007 it is unlikely to be as aggressive in cutting rates as it has been in recent months.

Economic forecast

International assumptions

International assumptions summary

(% unless otherwise indicated)

	2005	2006	2007	2008
Real GDP growth				
World	4.8	5.3	4.8	4.6
OECD	2.6	3.2	2.5	2.6
China	10.4	10.7	10.3	9.2
EU27	1.8	3.0	2.7	2.4
Exchange rates				
¥:US\$	110.1	116.2	117.9	106.3
US\$:€	1.25	1.26	1.36	1.38
SDR:US\$	0.68	0.68	0.65	0.64
Financial indicators				
¥ 3-month Gensaki rate	0.00	0.28	0.66	1.47
US\$ 3-month commercial paper rate	3.38	5.03	5.13	5.13
Commodity prices				
Oil (Brent; US\$/b)	54.7	65.3	65.0	60.3
Gold (US\$/troy oz)	445.0	604.5	652.5	642.5
Food, feedstuffs & beverages (% change in US\$ terms)	-0.5	16.1	10.6	-0.2
Industrial raw materials (% change in US\$ terms)	10.2	49.9	6.3	-14.2

Note. Regional GDP growth rates weighted using purchasing power parity exchange rates.

Despite an economic slowdown in the US, we forecast that the world economy will expand by an annual average rate of 4.7% in 2007-08 (measured using purchasing power parity weights). Thailand's ability to expand its export earnings will nevertheless be hampered by the relatively slow pace of GDP growth in the US and the EU, in addition to the current strength of the baht against the US dollar. However, consumer demand continues to drive growth in Japan, and growth in China will remain buoyant. Global crude oil prices will drop back in 2007-08, but the decline in 2007 is now forecast to be minimal on

an annual average basis. Oil prices will fall more sharply in 2008, and this will contribute to falling retail fuel prices and easing inflation in Thailand. Global prices for some of Thailand's main export commodities, such as rice and rubber, will remain strong over the next two years.

Economic growth **Gross domestic product by expenditure**

(Bt bn at constant 1988 prices where series are indicated; otherwise % change year on year)

	2005 ^a	2006 ^a	2007 ^b	2008 ^b
Private consumption	2,103.3	2,169.2	2,227.2	2,337.3
	4.3	3.1	2.7	4.9
Public consumption	351.8	363.8	408.7	443.6
	13.7	3.4	12.4	8.5
Gross fixed investment	906.5	942.9	955.7	1,005.1
	11.1	4.0	1.4	5.2
Final domestic demand	3,361.6	3,475.8	3,591.6	3,786.0
	7.0	3.4	3.3	5.4
Stockbuilding	68.3	-38.2	-14.2	40.0
	0.4 ^c	-2.8 ^c	0.6 ^c	1.3 ^c
Total domestic demand	3,429.9	3,437.6	3,577.4	3,826.0
	7.3	0.2	4.1	6.9
Exports of goods & services	2,557.5	2,777.0	2,943.8	3,107.0
	4.3	8.6	6.0	5.5
Imports of goods & services	2,162.3	2,196.3	2,310.5	2,526.2
	9.3	1.6	5.2	9.3
Foreign balance	395.2	580.7	633.2	580.8
	-2.1 ^c	4.8 ^c	1.3 ^c	-1.2 ^c
GDP	3,851.3	4,044.6	4,214.6	4,422.8
	4.5	5.0	4.2	4.9

^a Actual. ^b Economist Intelligence Unit forecasts. ^c Contribution to real GDP growth (as a percentage of real GDP in previous year).

Real GDP growth will slip to 4.2% in 2007, from 5% in 2006. According to preliminary data for the first quarter of 2007, GDP growth stood at 4.3% year on year during the three-month period, with a strong net exports position offsetting weak private consumption and investment. During the remainder of the year the domestic economy is likely to improve on its first-quarter performance, but the export sector will struggle to maintain its growth momentum owing to the emerging weaknesses in the economies of some of Thailand's major trading partners, notably the US. This slowdown in export growth, combined with a pick-up in import demand (as firms rebuild their inventories, and as public consumption and investment spending rises), will mean that net exports make a negative contribution to GDP growth in 2008.

In terms of the domestic economy, falling interest rates and easing inflation could provide some stimulus to consumption and investment, but confidence will remain weak until the political scene stabilises and the military returns power to a democratically elected government. Based on the assumption that this will happen in early 2008, domestic demand growth is forecast to pick up next year, offsetting the negative impact on growth that the deteriorating net exports position will have. Although private consumption and investment growth will remain fairly weak this year, public investment growth is set to accelerate, boosted by the interim government's efforts to move ahead with a

number of infrastructure development projects. Public consumption growth will pick up quickly this year, owing to the fact that funds allocated in the delayed 2006/07 budget started to be disbursed only in January 2007.

Inflation Consumer price inflation will ease in 2007-08 from the annual average of 4.6% recorded in 2006. Year-on-year inflation dropped to a three-year low of 1.8% in April 2007, and picked up only slightly, to 1.9%, in May. The easing in inflation primarily reflects relatively stable food prices, and, barring further serious bouts of bad weather, food price inflation will slow in 2007-08. Despite the overall downward trend in global crude oil prices, retail fuel prices in Thailand have picked up again, rising by about 13% between January and June, and we therefore expect inflation to accelerate slightly in the second half of 2007, so that over the year as a whole inflation will average 2.6%. However, as global crude oil prices fall in 2008 the upward trend in local retail fuel prices will be reversed, contributing to a drop in annual average inflation in that year.

Exchange rates The baht has remained strong against the US dollar in recent months, with the local interbank rate standing at Bt34.5:US\$1 in late June 2007. (The gap between local and offshore rates has remained wide, owing to the effect of the capital controls introduced in late 2006—the offshore rate stood at Bt32.5:US\$1 in late June.) The strength of the baht in recent months has reflected the large current-account surplus, in addition to the continued general weakness of the US currency. However, given that the current account is set to deteriorate over the next year or so, the baht is likely first to level off and then to fall steadily. Although there does not appear to be a strong correlation between movements in the baht and the spread between local and international interest rates, the downward trend in local interest rates will contribute to this depreciation.

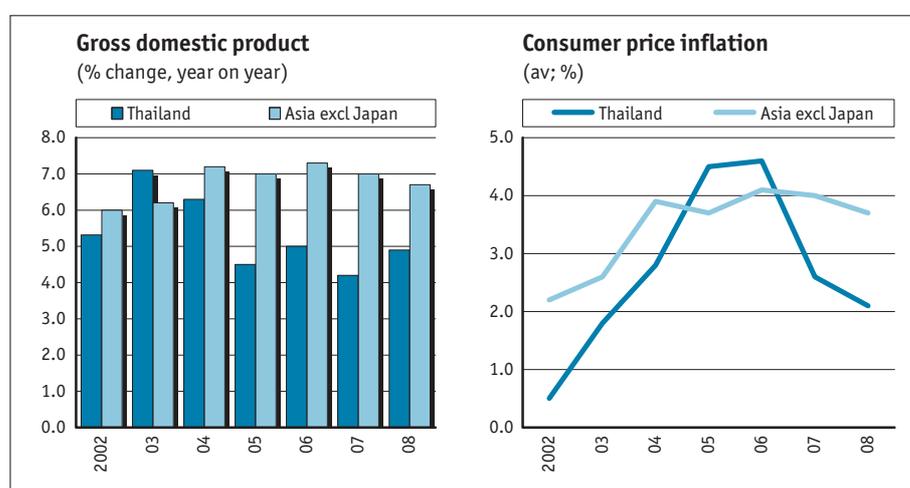
External sector Thailand's export revenue (in US dollars) continues to grow at a rapid pace, increasing by nearly 19% year on year in January-May, according to preliminary data from the Ministry of Commerce, while the import bill rose by only 4.4% during the same period. The pace of export growth, however, is set to slow later this year and into 2008, a trend in line with our forecast of relatively weak external demand. Although import demand overall remains soft, the pace of growth is picking up, and will be boosted by higher government spending in the second half of this year. In 2008 import demand will also be strengthened by improving confidence on the part of investors and consumers (assuming that a parliamentary election goes ahead as planned in late 2007). Reflecting these trends and the forecast for a steady expansion in the combined deficit on the services and income accounts, the current account will move from a surplus equivalent to around 2.3% of GDP in 2007 to a deficit of 1.5% of GDP in 2008.

Forecast summary

(% unless otherwise indicated)

	2005 ^a	2006 ^a	2007 ^b	2008 ^b
Real GDP growth	4.5	5.0	4.2	4.9
Gross agricultural production growth	-3.2	4.8	3.5	3.0
Unemployment rate (av)	1.8	1.5	1.7	1.6
Consumer price inflation (av)	4.5	4.6	2.6	2.1
Short-term interbank rate	5.8	7.4	6.6	6.4
Government balance (% of GDP)	0.2	1.1	-1.9	-2.1
Exports of goods fob (US\$ bn)	109.2	128.2	140.0	150.7
Imports of goods fob (US\$ bn)	-106.0	-113.4	-122.1	-141.1
Current-account balance (US\$ bn)	-7.9	3.2	5.6	-3.7
Current-account balance (% of GDP)	-4.5	1.6	2.3	-1.5
External debt (year-end; US\$ bn)	52.3	59.9 ^c	58.3	59.6
Exchange rate Bt:US\$ (av)	40.2	37.9	34.9	35.2
Exchange rate Bt:¥100 (av)	36.5	32.6	29.6	33.2
Exchange rate Bt:€ (year-end)	48.4	47.6	49.1	47.6
Exchange rate Bt:SDR (year-end)	58.6	54.2	54.7	54.9

^a Actual. ^b Economist Intelligence Unit forecasts. ^c Economist Intelligence Unit estimates.



The political scene

The TRT is found guilty of electoral fraud and dissolved

On May 30th, in a highly charged atmosphere, the country's largest political party, Thai Rak Thai (TRT), which was founded by the ousted prime minister, Thaksin Shinawatra, was ordered to be dissolved after being found guilty of electoral fraud by the Constitution Tribunal. In addition to dissolving the party, the tribunal, which the Council for National Security (CNS, the military junta) set up in the wake of the coup, also punished the TRT's 111 executive members, banning them from politics for five years. The party's executive committee comprises Thaksin and many of the country's political heavyweights. Even those members who had jumped ship from the TRT since the coup, intending to revitalise their political careers under a different banner, were punished.

The case against the TRT related to its tactics during the April 2006 parliamentary elections and the following by-elections, which were boycotted by the

main opposition Democrat Party (DP) and a host of other parties. The TRT was accused of paying two smaller parties, Pattana Chart Thai and Phaendin Thai, to contest seats in constituencies in which it was unlikely that a TRT candidate running alone would gain sufficient votes for the poll result to be valid. (Thai electoral law requires candidates in uncontested seats to win at least 20% of the vote.) On these charges the TRT was found guilty, with the judges remarking that the TRT's offences had been "very dangerous to democracy". The two smaller parties were also dissolved. The DP faced a number of charges, including those of paying two other small parties to claim that they were bankrolled by the TRT to contest the election, but the tribunal acquitted the DP of all charges.

The Constitution Tribunal judges defended the legal case for their verdicts in long statements on May 30th, but the outcome was undoubtedly heavily politicised. Before the ruling, TRT officials had suggested that the military had already influenced the verdict against their party. DP officials, while proclaiming their innocence, had implied that the charges against their party were fabricated, and therefore that the purpose of a guilty verdict, had such a decision been handed down, would have been to balance the rulings against the TRT in an effort to prevent a major backlash from TRT supporters. (In a curious development soon after the May 30th verdict, the CNS chairman, General Sonthi Boonyaratkalin, floated the idea of offering an amnesty to the TRT executives. Following intense criticism of such a plan, however, he has since backtracked.)

The tribunal judges had a number of alternative scenarios to consider when reaching their verdicts. A decision to acquit both leading parties, although in effect maintaining the status quo, would have led to accusations of judicial weakness and would probably have eroded further the military's perceived legitimacy since its ouster of the Thaksin government. At the other extreme, if the tribunal had found both parties guilty and banned all their executive members from politics for five years, it would have created even more serious political turmoil, rendering the next election a farce, as 160 or so of the country's leading political players would have been prevented from taking part. In turn, the resulting political vacuum would have raised serious concerns over the potential for the military to hold on to power indefinitely. The final outcome, which leaves the DP intact, at least ensures that a viable government can be formed when fresh elections are eventually held. There had been speculation that the tribunal was set to dissolve the TRT but would punish only those party members who had played a direct role in the electoral fraud. However, such a verdict would have enabled many of the TRT's core members to regroup under a new banner and contest the next election, an outcome that would have been unpalatable for the CNS and anti-Thaksin groups.

Chaturon aims to relaunch the TRT

The decision to dissolve the TRT and ban its executives from politics for five years dramatically alters the political landscape. Although the TRT had partly disintegrated in the wake of the coup, as some large factions left the party with the intention of re-establishing themselves as political entities in their own right, the party was still the most popular in the country, claiming 14m supporters. Moreover, there are still 200 or so TRT members who held seats in

the previous parliament and have not been banned from politics. They could yet play a role in reviving the party with leading players, such as Thaksin and the acting party leader, Chaturon Chaisang, pulling the strings behind the scenes. After the verdict against his party was delivered, Chaturon said that he would fight on and would offer the party's supporters ways to "go forward together". He also vowed to set up a new party under the same name.

However, Chaturon and other members of the defunct TRT are prevented, at least for the time being, from forming new political parties. On June 5th the cabinet lifted the ban on political activities by existing parties, but it did not move to lift the suspension on the registration of new political parties. (Following the coup in September last year, the military's Announcement 15 prohibited party-political activity and the registration of new parties.) In late June the National Legislative Assembly (NLA) accepted a government-sponsored bill to lift the ban on registering new political parties but delayed giving the measure its formal approval, instead deciding to set up a panel to consider the proposed changes. Chaturon has criticised the delays in revoking the ban, and has accused the junta of attempting to prevent former TRT members from regrouping and preparing for the next election.

A new election date is set, putting pressure on the CDA

In an apparent attempt to reassure those worried about the potential for the military to prolong its grip on power, on June 20th the military-appointed interim prime minister, Surayud Chulanont, announced that the next election could go ahead on November 25th, earlier than the previously proposed dates of December 16th or 23rd. The revised election timetable, however, remains dependent on the successful passage of a new constitution, which is now set to go to a public referendum on August 19th. In order for the referendum to be held on time, the Constitution Drafting Assembly (CDA), the body responsible for overseeing the drafting process, will need to finalise the draft charter by early July.

In mid-April the 35-member Constitution Drafting Committee (CDC) released its first draft of a new constitution, formally presenting it to the 100-member CDA and another 12 bodies, including the CNS, the interim government, the NLA, the Supreme Court and the National Commission to Counter Corruption. Initial public reaction to the draft was fairly negative, with the document being widely criticised for lacking the spirit of democracy and placing too much power in the hands of the judiciary. However, the CDC avoided including what would have been the most controversial constitutional change, that of making the prime minister an appointee, not an elected legislator. In the first draft, the CDC called for the House of Representatives (the lower house of parliament) to be reduced to 400 members from the current 500, and for the Senate (the upper house) be reduced to 160 members, from 200 at present. (Both chambers are currently suspended, but will be recalled following the next general election.)

Reflecting the underlying fear among those drafting the new constitution of future prime ministers being in a position of excessive power, they have approved plans to place greater controls on future heads of government. The initial draft includes new provisions to limit any prime minister to two four-year terms of office, and to reduce the percentage of lawmakers needed to

initiate no-confidence motions against the prime minister. In late June the CDA voted in favour of plans to lower the threshold for the tabling of a censure motion against the prime minister to only one-fifth of members of parliament (MPs), down from two-fifths in the previous constitution. The tabling of censure motions against cabinet ministers would require the backing of only one-sixth of MPs, down from one-fifth.

Based on the deliberations of the members of the CDA, the final version of the constitution could be very different from the initial draft. In June CDA members voted in favour of a new structure for the Senate, according to which the upper house would comprise 150 members, of whom 76 (one for each of the nation's provinces) would be elected and 74 appointed. The CDC's secretary general, Somkid Lertpaithoon, stated that such a mixture of elected and appointed members would ensure that the Senate was balanced and neutral. A seven-member selection committee (comprising heads of independent judicial and state administration bodies) would choose the 74 appointed senators, whose main roles would be largely unchanged from those stipulated in the old constitution. Under the new charter, senators would still have the task of scrutinising legislation, monitoring the government's performance and appointing members of independent state agencies. CDA members also voted against the plan to reduce the number of lower house MPs to 400. Instead, they voted in favour of a 480-member lower house, with 400 MPs from constituencies (as before) and 80 party-list members (down from 100 under the old constitution).

Another major amendment to the initial draft of the new constitution is likely to come in the form of the removal of an article permitting the establishment of a national crisis council. According to the initial draft, such a council would be given the responsibility of acting in the event of a political impasse in which all other state mechanisms have failed to solve a national problem. It would comprise the prime minister, the opposition leader, the speakers of the Senate and the House of Representatives, the presidents of the Supreme Court and the Supreme Administrative Court, and the heads of independent public organisations. Following widespread opposition to the proposal, mainly on the grounds that it would be dangerous to give such power to a small group of people and because of the inability to agree on the definition of a "crisis", in mid-May the CDC agreed to omit the proposed article.

The authorities get tough with Thaksin

Nine months after the coup, the authorities have finally started to make strenuous efforts to bring Thaksin to justice for his alleged abuse of power. Soon after the party that he founded was ordered to be dissolved and he was banned from politics for five years, Thaksin suffered further setbacks. On June 11th the Assets Examination Committee (AEC) ordered the freezing of 21 bank accounts belonging to him, his wife, Potjaman, two of their children and other relatives. The funds in the accounts totalled around Bt52bn (nearly US\$1.5bn). Under a military order, the AEC has the authority to freeze assets of state officials suspected of corruption. The AEC decided to go ahead and freeze Thaksin's assets (mainly related to the controversial Bt73bn sale of his family's stake in the country's largest telecommunications company, Shin Corp, in January 2006) on the basis that it claims to have found sufficient evidence that

Thaksin was involved in five cases of malfeasance and six cases of abuse of power in order to “obtain unusual wealth”.

By late June the AEC had forwarded to the public prosecutor only one case of Thaksin’s alleged corruption, relating to a land purchase by his wife. On June 21st the prosecutor formally indicted Thaksin and Potjaman on corruption charges relating to the case. The prosecutor handed the indictment to the Supreme Court’s Political Crime Section, alleging violations of the National Counter Corruption Act and the Criminal Procedures Act. The land purchase in question took place in 2003, when Potjaman purchased a 33-rai (52,800-sq-metre) plot in Bangkok for Bt772m (equivalent now to around US\$20m). The land was sold (via auction) by the Financial Institutions Development Fund, which was set up following the 1997-98 Asian financial crisis to rehabilitate financial institutions. Thaksin stands accused of having abused his power in his position of authority overseeing the FIDF and its finances, enabling his wife to secure a deal at a bargain price. He is also accused of being in violation of the anti-graft law, which prohibits state officials and their spouses from conducting business with state agencies.

In total the AEC is working on 13 cases against Thaksin and his close associates. Other state investigative agencies looking into the family’s financial activities include the Department of Special Investigation (DSI). In late June the DSI ordered that Thaksin, Potjaman and Thaksin’s sister-in-law, Bussaba Damapong, should face charges of concealing their total shareholdings in a property company, SC Asset, prior to the listing of shares in the firm on the Stock Exchange of Thailand in 2003.

Pro-Thaksin rallies build as Thaksin asserts his innocence

Thaksin, who remains in self-imposed exile in the UK, continues to deny any wrongdoing during his terms in office, and in a pre-recorded video address on June 15th stated that he would fight all charges against him. During his address, which was broadcast to supporters in Sanam Luang, a park in the centre of the capital, Bangkok, that has played host to a number of political rallies over the past year or so, Thaksin reiterated that he would not return to take a political role but would strive to protect his dignity. He has also continued to move ahead with his plans to buy an English football club, Manchester City, in a controversial deal that has raised questions back in Thailand over the source of his funds.

Over the past few months Thaksin’s supporters have been eager to demonstrate their full backing for the ousted prime minister, and they have become increasingly vocal in registering their opposition to the military junta. The ousted prime minister’s address on June 15th attracted more than 10,000 people to Sanam Luang, and other rallies in his support have at times brought together up to 20,000. To date the rallies have generally been peaceful, and although not matching the size of the anti-Thaksin demonstrations in early 2006, they have proved to be a major source of concern for the military. In the run-up to the May 30th tribunal report, the military played up the prospects that TRT supporters would revolt if the verdict did not go their way—around 13,000 soldiers and police were mobilised around the country that day, and together

with the government the CNS warned that a state of emergency would be imposed if the security situation deteriorated.

The pro-Thaksin satellite television station, People's Television (PTV), continues to be one of the leading organisers of rallies in support of Thaksin and against the coup leaders. In early June a mix of pro-Thaksin and "pro-democracy" groups formed the Democratic Alliance Against Dictatorship (DAAD), which has been holding protests on a daily basis. In the mould of the People's Alliance for Democracy (PAD), the group that led the anti-Thaksin demonstrations in early 2006, this new alliance is intent on galvanising popular support to force the prevailing government out of office. Groups on opposite sides of the political divide have been interpreting events differently. The military and anti-Thaksin groups have played down the effectiveness of these rallies, saying that the numbers are relatively small and that they are losing momentum. General Sonthi has also said that the anti-coup protestors will not bring down the government or the CNS, claiming that there are only 2,000 "hard-core" protestors, with the others, mostly from the north-east of the country, being paid to attend recent rallies. DAAD leaders, however, continue to claim that they are attracting more and more people, and that their protest outside the army headquarters on June 23rd was a major success.

A new security bill is approved

The military-appointed government has moved to shore up the powers of the Internal Security Operations Command (ISOC), approving amendments to the National Security Act on June 19th that ostensibly enable ISOC to handle "new forms" of threats to the country. The revised act covers domestic and international terrorism, and according to Surayud the changes mean that the government will no longer need to rely on the imposition of a state of emergency during times of crisis. Government officials have denied that the revisions are intended to give greater power to General Sonthi, who is currently the director of ISOC, and they have downplayed concerns that the revisions are being introduced to counter activity by those opposed to the CNS. The proposed revisions to the act will need to be approved by the Council of State before being forwarded to the NLA.

The revised act may go some way towards improving the military's capacity to contain the violent insurgency in the Muslim-dominated southernmost provinces. To date, the armed forces have had little success. Although in recent months there has been no repeat of the widespread co-ordinated bombing campaign that was carried out on February 18th this year, small-scale shootings, bombings and arson remain an almost daily occurrence in the provinces of Yala, Pattani, and Narathiwat, while Songkhla province is also suffering regular outbreaks of violence. The military currently has around 30,000 troops in the troubled region, some of whom patrol government school campuses and are used to protect teachers and students travelling to and from schools. Schools have been a regular target for arson attacks, and a number of teachers have been killed by insurgents who are opposed to the teaching of Thai Buddhist values. In May and June the military suffered two deadly incidents, when a combined total of 19 soldiers were ambushed and killed.

Although Surayud conceded in June that the violence was unlikely to be resolved by the end of the year and that it was in fact escalating, the defence minister, Boonrawd Somtas, struck an overoptimistic tone when he recently claimed that the insurgents were on their “last legs” and were making a final effort to claim international recognition for their cause. Boonrawd was speaking during an official trip to Malaysia in June to discuss security operations with his Malaysian counterparts.

Economic policy

The government is eager to stimulate growth

After pledging to adhere to a “sufficiency” philosophy (centring on moderation) in its management of the economy, the administration led by the interim prime minister, Surayud Chulanont, has in recent months implemented some stimulatory measures in an attempt to boost economic growth. In May the government launched a Bt44bn (US\$1.3bn) loan package for low-income earners and small and medium-sized enterprises (SMEs). Four state-owned specialised banks are involved in the scheme—the Government Savings Bank, the Bank for Agriculture and Agricultural Co-operatives, the Government Housing Bank and the SME Bank—and, together with general loan targets for the year, the four banks aim to extend a total of Bt466bn in fresh credit. The finance minister, Chalongphob Sussangkarn, stated that the additional loans would help to strengthen the grass-roots economy and would indirectly benefit the economy as a whole.

The loans will be disbursed to low-income earners for new homes, business development, community projects and education, while SMEs can borrow for machinery purchases or to expand their operations. As with the populist policies implemented by the administration led by the ousted former prime minister, Thaksin Shinawatra, which relied heavily on financing by state-owned banks, there are concerns that if robust risk-assessment practices are not adhered to, these new loans could turn sour and the government could be called upon to absorb banks' losses.

In addition to prompting state-owned banks to increase lending, the government is pushing ahead with direct fiscal stimulus. In early June the cabinet approved a budget of Bt1.66trn (US\$47.4bn) for fiscal year 2007/08 (October-September). This planned expenditure is up from the Bt1.64trn initially approved in March. For 2007/08 the government is now targeting a budget deficit of Bt165.5bn, equal to around 1.8% of GDP (based on the government's assumption that the economy will grow by around 5% over the fiscal year). For the current fiscal year the government is targeting a deficit of Bt146bn, with expenditure set at Bt1.56trn.

In the first seven months of the current fiscal year total revenue rose by 5.1% to Bt735.1bn, while expenditure increased by 5.4% to Bt873.8bn, according to preliminary data published by the Ministry of Finance. Thus, the deficit for this period reached Bt138.7bn, up from Bt129.3 in the year-earlier period. Owing to the delayed passage of the budget for 2006/07 (the budget was not passed until January), expenditure was particularly high in February-April, with ministries and government agencies making up for the slow pace of spending in the

preceding months. Spending in February, for example, surged to Bt200.7bn—up from a monthly average spend of around Bt100bn in October-January, and 75% more than the amount spent in February 2006.

The government has also sought to boost spending by tinkering with the tax system to reduce the overall burden on households. However, changes in this respect have been limited. In late May the finance ministry announced that taxpayers would be entitled to claim deductions up to Bt100,000 (around US\$2,860) per year against interest payments on home mortgages. Prior to this change, the maximum deduction was Bt50,000. Chalongphob stated that although the change would cost the government Bt2.5bn-4bn in forgone tax revenue, the higher permitted tax deduction would help to stimulate the property market.

The BOT cuts its repo rate sharply

The Bank of Thailand (BOT, the central bank) has aggressively cut its policy interest rate, the one-day repo rate, in recent months. It cut the rate by 0.5 percentage points in April, from 4.5% to 4%, and by the same amount again, from 4% to 3.5%, in May. The BOT had already lowered its policy rate on two occasions earlier in the year, by 25 basis points on both occasions. Its current accommodative monetary policy stance is clearly appropriate given the state of the economy. Thailand's ongoing political turmoil has had a damaging effect on domestic demand, with economic activity hampered by sliding investor and consumer confidence. During the most recent meeting of the BOT's Monetary Policy Committee, on May 23rd, the central bank authorities stated that the latest 50-basis-point cut brought the policy rate to a level that was appropriate to support the economy while also ensuring that inflation remained in check.

Economic policy indicators

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exchange rate (av; Bt:US\$)												
2004	39.05	39.05	39.40	39.40	40.50	40.80	40.90	41.50	41.40	41.30	40.30	39.18
2005	38.71	38.44	38.55	39.48	39.78	40.87	41.71	41.15	41.01	40.86	41.07	41.03
2006	39.58	39.35	38.93	37.95	37.97	38.3	37.96	37.59	37.38	37.30	36.50	35.78
2007	35.93	35.69	35.02	34.89								
3-month money market rate (%)												
2004	1.02	1.05	1.04	1.00	1.00	1.02	1.07	1.13	1.45	1.52	1.66	1.79
2005	1.89	1.88	1.93	2.05	2.19	2.35	2.53	2.68	3.07	3.37	3.67	3.80
2006	3.97	4.14	4.31	4.56	4.61	4.76	4.88	4.87	4.88	4.95	4.93	4.85
2007	4.84	4.73	4.48	4.17								
Money supply (M2), % change year on year												
2004	6.5	6.6	6.6	8.2	7.4	6.6	7.7	7.2	7.3	7.3	6.3	5.7
2005	5.5	5.7	4.8	3.6	3.6	4.2	3.8	4.5	4.9	4.6	5.4	6.3
2006	7.7	7.3	8.7	9.5	10.2	9.4	9.3	9.4	7.9	8.2	8.0	6.2
2007	5.1	6.0	4.9	5.0								
Central government budget balance (Bt bn)												
2004	-0.7	-0.4	-1.3	-17.5	-5.2	63.3	-17.1	-1.3	26.0	-31.9	-15.1	2.5
2005	-9.7	15.1	-8.2	3.0	6.3	69.5	-2.9	-13.7	60.5	-40.9	-33.7	-30.7
2006	-5.8	-13.7	-19.4	14.8	129.5	-34.7	-17.6	87.4	-56.2	10.3	-9.0	-4.5
2007	8.2	-95.1	-33.1	-15.5								

Sources: Bank of Thailand; IMF, *International Financial Statistics*; Ministry of Finance.

Although the BOT has indicated that it is no longer overly concerned about the current strength of the baht, it has yet to remove completely the capital controls that it introduced in December 2006 to stem the appreciation of the currency. Since mid-March the watered-down Unremunerated Reserve Requirement (URR) has affected only non-residents purchasing baht for investment in bonds, Treasury bills and debentures. (The URR is the proportion of affected foreign funds bought into Thailand or exchanged against the baht that must be placed with the BOT). In late March the IMF acknowledged the policy dilemma facing Thailand's monetary authorities, but warned that capital controls were at best a short-term device to contain volatility and would be costly in the long run. The BOT holds a similar view, and in recent speeches the bank's governor, Tarisa Watanagase, has reiterated the standpoint that the URR is a temporary measure, which the BOT was obliged to introduce in order to break the momentum of appreciation in the baht despite the adverse effect that it had on investor confidence.

The government plans to restrict future privatisations

The government has moved to prevent certain state-owned enterprises (SOEs) from being privatised. On June 19th the cabinet approved a proposed law that would prohibit the sale of state entities operating utilities and public infrastructure. The law would mean that shares in the state electricity utility, EGAT, could not be held by the private sector. The previous government led by Thaksin failed in its efforts to launch an initial public offering (IPO) of shares in EGAT in late 2005. The planned sell-off did not prove popular domestically, and was eventually halted after the Supreme Administrative Court ruled that the two executive decrees underpinning the IPO had been illegal.

Other firms that cannot be sold off to private interests include those whose businesses are deemed harmful to public health (such as the Thailand Tobacco Monopoly) and those that could cause social problems (such as the Government Lottery Office). The proposed law also outlines procedures for the government to follow when privatising SOEs and listing shares on the stockmarket. In addition, it sets out the requirements for new bodies to be set up to regulate newly privatised entities. The law still has to be approved by the Council of State, the government's legal advisory body, before being passed to the National Legislative Assembly (NLA).

Around the same time that the Surayud administration approved the draft law governing privatisation, the Constitution Drafting Assembly (CDA) was debating constitutional provisions for the sale of state assets. Although no CDA member raised any definite objection to the concept of privatisation, there was agreement that the process should be more transparent and that basic public utilities should be prevented from becoming private monopolies "to the detriment of the state". Despite some calls for the new constitution to give parliament the final say in approving future privatisations, a vote on the matter did not take place, and according to the current draft of the constitution the executive retains the authority to approve any such moves.

In addition to approving the draft law on privatisation, the administration has also pushed ahead with plans to amend the Foreign Business Act (FBA). The cabinet approved the Ministry of Commerce's revised version of the proposed

amendments to the FBA in April, the first proposal having been unveiled in January to stinging criticism from foreign investors. The revised version is in some areas more stringent than the initial version, increasing the fines and possible prison terms for violators. However, under the revised version, foreign businesses currently in violation of the law would have three years to adjust to the new regulations, rather than two as initially proposed. The amendments to the FBA are aimed at removing ambiguities (stemming from the use of nominee shareholders and preferential shareholder voting rights) about whether a firm is a foreign or a Thai entity. In late April the NLA voted in favour of amending the FBA based on the commerce ministry's revised draft, rather than adopting the more liberal version drafted by an NLA subcommittee. Foreign chambers of commerce continue to express concerns about the impact that the proposed revisions could have on foreign investment.

Economic links strengthen with Japan but not the US

The Surayud government is following its predecessor in pushing ahead with plans to reach free-trade agreements (FTAs) with major trading partners. On April 3rd, during his official visit to Japan, Surayud and his Japanese counterpart, Shinzo Abe, finally signed the Japan-Thailand Economic Partnership Agreement (JTEPA). (The JTEPA was initially agreed in late 2005, but the dissolution of Thailand's parliament in February 2006 forced the signing to be postponed.) The government is also now in the process of negotiating new tariff reductions with India as part of an effort to conclude a bilateral FTA with that country. The two sides signed a partial FTA in 2003 that featured the lowering of tariffs on 82 product lines.

Recent developments in trade and investment ties with the US, however, suggest that there is unlikely to be any rapid progress towards completing negotiations for a Thai-US free-trade deal when talks eventually resume. (Negotiations over the FTA stalled in early 2006 at the onset of the political crisis in Thailand, and the US has not been keen to continue until a democratically elected government has been installed.) In May this year the US placed Thailand on its Priority Watch List for countries failing to protect US corporate intellectual property rights (IPR). Thailand became one of only 12 countries on the priority list, the others including China, India, Russia and Argentina. The US based its decision to downgrade Thailand's status on the assertion that Thailand had violated IPR in many areas, and that the breach of copyrights and patents on medicines had been rampant. According to the US International Intellectual Property Alliance, US businesses selling copyrighted products and services lost US\$368m in Thailand in 2006, up from US\$355m in 2005 and US\$184m in 2004.

The US appears to have been spurred into taking action after Thailand's Ministry of Health took the controversial step of issuing compulsory licences to allow the circumvention of patents on pharmaceuticals produced by US firms. In January the ministry issued compulsory licences for an HIV/AIDS treatment, Kaletra, which is manufactured by Abbott Laboratories of the US. Prior to this, in late 2006 the government issued its first ever compulsory licence for generic copies of another AIDS drug, Sustiva (efavirenz), which is produced by another US firm, Merck. In addition to these AIDS treatments, the government has also issued compulsory licences for a blood-thinning drug, Plavix, produced by

Sanofi-Aventis of France and the US's Bristol Myers Squibb. The government has justified its move to utilise a World Trade Organisation (WTO) rule to override patents (by manufacturing or importing generics) on the basis that the AIDS problem is a public health crisis. However, its position on the issuance of compulsory licences for Plavix is more controversial—this is the first time that a patent for a heart disease treatment has been overridden under the WTO compulsory-licence rule.

The domestic economy

Economic trends

GDP growth is buoyed by strong net exports

Thailand's economy grew by 4.3% year on year in real terms in the first quarter of 2007, a respectable pace of growth given the country's ongoing political turmoil. However, the headline GDP growth figure, which was unchanged from that recorded in the fourth quarter of 2006, masks serious weaknesses in the domestic economy, and were it not for Thailand's robust export sector the economy would be close to recession.

Despite the recent strength of the Thai baht and signs of a global economic slowdown, led by the US economy, Thai exporters have been recording impressive rates of growth in recent quarters. In the first quarter of 2007 goods exports rose by 8.5% year on year (in real GDP terms), down slightly from the quarterly average of 9.2% recorded in 2006. Services exports contracted by 1.4% year on year, owing in part to slow growth in the tourism sector, with some cancellations recorded in January following the deadly bombings in the capital, Bangkok, on December 31st 2006. Nevertheless, total goods and services exports rose by 6.5% year on year. The positive net contribution to GDP growth from the external sector in the first quarter, at 4.4 percentage points, was buoyed by the contraction in imports. In the first quarter imports of good and services fell by 0.3% year on year, as goods imports growth of 0.1% was offset by a 1.8% contraction in services imports.

The performance of the domestic economy stands in stark contrast to that of Thailand's external economy. In the first quarter of 2007 domestic demand growth (comprising both public and private consumption and investment) slowed for the seventh consecutive quarter, posting year-on-year growth of only 1.6%. The political turmoil that the country continues to experience has clearly taken its toll on consumer and business confidence. Private consumption grew by only 1.3% year on year in the first quarter, while private investment decreased by 2.4% year on year, the first such contraction in five years.

The public sector helped to offset the impact of the private sector's unwillingness to spend. Government consumption spending rose by 11.2% year on year in the first quarter of 2007. This was an unsurprising outcome, given that spending in the first quarter of fiscal year 2006/07 (October-September) was held up by the delay in implementing the annual budget—the budget was only approved in time for spending to proceed as planned in January this year.

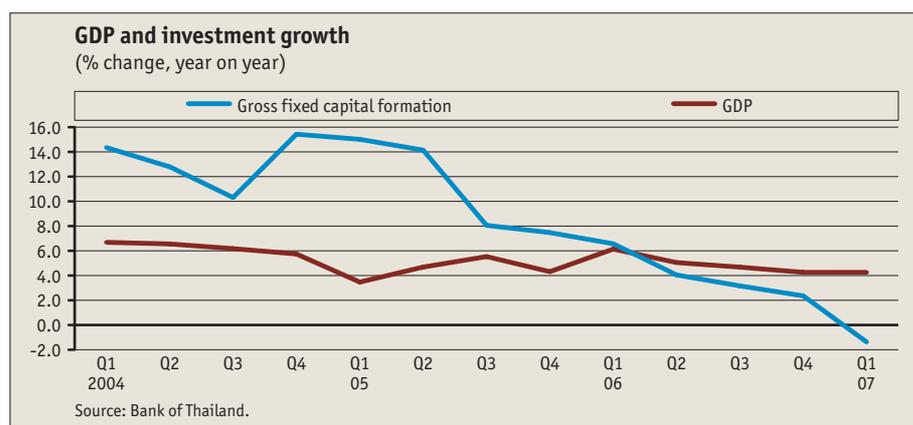
Public-sector investment spending, however, was still fairly weak in the first quarter of 2007, growing by only 2.1% year on year.

Expenditure on gross domestic product

(% change, year on year; constant 1988 prices)

	2005	2006			2007	
	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr
Private consumption	3.7	3.9	3.3	2.8	2.5	1.3
Public consumption	10.4	7.4	5.7	4.3	-4.2	11.2
Fixed investment	7.5	6.6	4.0	3.2	2.4	-1.4
Exports of goods & services	4.6	14.4	9.0	4.7	7.0	6.5
Imports of goods & services	8.7	1.9	-1.7	5.2	1.0	-0.3
GDP	4.3	6.1	5.0	4.7	4.3	4.3

Source: Bank of Thailand.



Changes in inventories continue to have a major impact on overall GDP growth figures. In the first quarter inventories contracted sharply again on a year-on-year basis, pulling the headline GDP growth figure down by 1.6 percentage points. It is of little surprise that firms are willing to run down their stocks rather than expand production capacity, given the current political uncertainty and the weakness of consumer and business confidence. However, the rapid pace of contraction in inventories also reflects the surge in external demand in recent months, as the sharp expansion in exports has not yet been reflected in manufacturing growth.

Manufacturing growth slows

On a quarter-on-quarter seasonally adjusted basis, manufacturing grew by only 0.4% in the first quarter of 2007, the slowest pace of growth in two years. On a year-on-year basis manufacturing growth was only 4.7%, down from a quarterly average of around 6% in 2006. Growth in light industries, such as food and beverages and textiles, grew by 5.4%, up from growth of 4% in 2006 as a whole. However, growth in output of raw materials stood at only 0.9% year on year, down from 2.4% in the whole of 2006, while growth in capital goods slowed to 6.2% in the first quarter, from an average of 10% in 2006.

Agriculture (including forestry and fishing) rebounded in the first quarter of this year, growing by 4.3% year on year, after registering growth of only 1.9% in the fourth quarter of 2006. This positive performance was owing to reasonably

favourable weather conditions and higher yields of major crops, such as rubber, cassava, sugarcane and palm oil. The construction sector was fairly subdued, with year-on-year growth of only 0.2%, as a contraction in private-sector activity was offset by a pick-up in public-sector construction work. Services growth was generally weak, with wholesale and retail trade growing by just 2.3% year on year and financial intermediation growth of just 1.4%. However, hotels and restaurants and transport and communications posted reasonably strong growth rates, of 5.4% and 6.7% respectively.

Gross domestic product by selected industry

(% change, year on year; constant 1998 prices)

	2005	2006	2 Qtr	3 Qtr	4 Qtr	2007
	4 Qtr	1 Qtr				1 Qtr
Agriculture	-0.8	7.6	7.1	4.0	1.9	4.3
Manufacturing	5.2	7.6	5.7	5.5	5.7	4.7
Electricity, gas & water	0.8	3.9	3.5	6.6	6.6	4.0
Construction	3.9	5.0	5.3	5.1	4.0	0.2
Wholesale & retail trade	4.3	3.7	2.3	2.3	2.4	2.3
Financial intermediation	4.9	4.0	3.4	2.4	1.7	1.4
Hotels & restaurants	4.5	15.8	11.0	7.9	8.1	5.4

Source: Bank of Thailand.

Employment remains strong, but confidence weakens

Employment levels remain fairly high, despite the slowing economy. In January-April the average number of people in formal employment reached 35.4m, up by 1.8% compared with the year-earlier period. The rate of unemployment during this period stood at 1.6%, down from 1.9% in the year-earlier period. Employment in agriculture remained fairly stable in the first four months of 2007, at an average of around 12.4m workers. Although down from the highs of around 15.6m in the busy harvesting period in the final two months of 2006, employment in agricultural in January-April 2007 was up by nearly 2% year on year. The expansion in employment in non-agricultural sectors in January-April also stood at around 2%. Manufacturing employment rose by around 0.8% year on year to around 6.2m, while the number of construction workers (formally employed) reached 2.5m, up by 2.9%. In January-April there was relatively high year-on-year employment growth in public administration and defence (7.9%), hotels and restaurants (5.6%) and real estate (3.3%).

Although employment remains buoyant, the ongoing political turmoil continues to have a damaging effect on consumer confidence, according to a widely reported consumer confidence index produced by the University of the Thai Chamber of Commerce. In the first quarter of 2007 the index averaged 79.1 points, down from 83 in the fourth quarter of last year. (The index covers a range from zero to 200, with scores above the 100-point mark reflecting a general feeling of confidence.) Business confidence has also weakened further, according to the Business Sentiment Index (BSI) compiled by the Bank of Thailand (BOT, the central bank). In April the BSI stood at 39.3 points, down from 43.6 points in March and 45 in December last year (the index ranges from zero to 100 points, with a score below 50 indicating that business sentiment has worsened). The deterioration in business confidence, according to the BOT's survey, reflects a host of concerns, most notably those related to the ongoing political uncertainty, the slowdown in general business activity, low

consumer confidence and the strength of the baht, which has eroded export-competitiveness. However, the “expected” BSI, an indicator of sentiment over the following three months, is improving, owing to the expectation of falling interest rates and lower production costs.

Private consumption and investment indicators

(% change, year on year)

	2006		2007			
	Nov	Dec	Jan	Feb	Mar	Apr
Private consumption						
Passenger car sales (volume)	-6.1	-15.8	-10.0	-18.6	-18.6	-17.2
Motorcycle sales (volume)	-26.0	-16.8	-17.9	-14.7	-34.4	-33.3
Consumer goods imports (at 2000 prices)	5.4	9.7	4.6	11.3	1.1	15.7
Value-added tax receipts (gross)	6.2	3.0	5.6	3.6	0.8	5.9
Private investment						
Capital goods imports (at 2000 prices)	0.1	-8.3	-6.5	2.9	-7.9	2.8
Cement sales (volume)	4.3	6.9	-0.5	-4.6	-3.8	-11.0
Commercial car sales (volume)	-9.9	20.7	-27.7	-18.1	-13.9	-3.0

Source: Bank of Thailand.

Despite the downturn in business confidence, data on investment applications and approvals from the Board of Investment (BoI, a state agency that offers promotional privileges for investors) suggest that both local and foreign firms are still keen to invest. In January-April this year the BoI received 451 project applications with a total investment value of Bt155.5bn (US\$4.5bn), up from 374 project applications worth Bt92bn in the year-earlier period. Applications from foreign investors rose by 7% year on year in terms of the number of projects and 24% in terms of investment value.

Inflation remains low

Consumer price inflation picked up slightly in May, rising to 1.9% year on year, from 1.8% in April. After averaging 4.7% in 2006, inflation eased steadily to 2.4% in the first quarter of 2007, before slowing further in April—a trend that was generally in line with the slowdown in domestic demand and easing supply-side pressures. During the first five months of 2007 year-on-year inflation averaged around 2.2%.

Prices for food and beverages continue to rise at a relatively rapid pace compared with prices for other goods and services. In January-May prices for food and beverages increased by 4.5% year on year, pushed up mainly by soaring prices for vegetables and fruit. Average year-on-year inflation in the non-food and beverages categories in the consumer price index stood at only 0.8%, down sharply from an annual average of 4.6% in 2006. In the transport and communication category of the consumer price index, prices rose by only 0.9% year on year in January-May, a steep drop from the average annual increase of 9.1% recorded in 2006. This trend reflects the general downward trend in global crude oil prices, which has contributed to lower retail fuel prices. Prices for clothing and footwear remained practically unchanged in January-May compared with the year-earlier period, while prices in the housing

and furnishing category rose by 0.7%, those in the personal and medical care category increased by 1.2% and those in recreation and education rose by 1.1%.

Core inflation, which excludes volatile food and fuel prices, slowed to only 0.8% year on year in May, its lowest level since early 2005. During the first five months of the year core inflation eased steadily, dropping to an average of 1.3%, compared with 2.3% in the whole of 2006. Core inflation therefore remains within the 0-3.5% band targeted by the central bank.

Producer price inflation has slowed sharply, dropping to only 1.8% year on year in May, and an average of 2.3% in January-May, well down from its average rate of 7% in 2006 as a whole. Although producer prices for agricultural products are rising rapidly (they were up by 13.7% year on year in January-May), this has been offset by falling prices for petroleum products and only slight increases in prices for most manufactured products.

Price indices

(% change, year on year)

	2005			2006				2007	
	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	Apr-May
Consumer price index	3.7	5.6	6.0	5.7	6.0	3.6	3.3	2.4	1.9
Core consumer price index ^a	1.1	2.2	2.4	2.6	2.8	1.9	1.7	1.4	1.0
Producer price index	9.5	9.4	8.2	8.7	10.3	6.2	3.4	2.6	1.8

^a Excludes raw food and energy items from the consumer price index basket.

Source: Bank of Thailand.

The baht makes further gains against the US dollar

Despite the BOT's efforts to stem the appreciation of the baht against the US dollar, the Thai currency has continued to strengthen. In mid-June the interbank onshore rate stood at around Bt34.6:US\$1, a year-on-year appreciation of nearly 10% and up from around Bt36:US\$1 in January. (Since the BOT imposed controls on capital flows in late 2006, onshore and offshore rates have diverged, with the offshore rate appreciating much faster, reaching around Bt32.8:US\$1 in mid-June.)

The baht is now at its highest level since August 1998, shortly after the BOT floated the currency. Although its current strength appears rather surprising given the slowing economy and the ongoing political uncertainty affecting the country, it has been held up both by Thailand's strong current-account position and by inflows of capital. Moreover, local exporters continue to sell their US dollar holdings in the expectation that the central bank will lift its capital controls—a move that could cause the baht to appreciate further.

Although the baht's strength against the US dollar is in part a product of the general weakness of the US currency, the baht has also been rising sharply against the yen in recent months, reaching Bt28:¥100 in mid-June, representing a year-on-year appreciation of 20%. The baht continued to gain ground against the euro too, albeit at a much slower pace; in mid-June it was trading at around Bt46.3:€1, up by around 5% year on year. The baht has also been strong against the currencies of most of Thailand's regional competitors. It was up by around 6% year on year in May against the Singapore dollar, by 5% against the renminbi and by 10% against the Vietnamese dong.



Manufacturing

Disk drive manufacturers shine

Manufacturing output growth remains fairly steady, with year-on-year growth standing at 6.2% in January-April, down from 7.4% in the whole of 2006, according to the BOT's manufacturing production index (MPI). Some sectors, however, have recorded impressive growth. Output of electronic products, which have a weighting of 13.6% in the MPI, jumped by 22% year on year in January-April, following growth of 23.7% in 2006 as a whole. This expansion was largely the result of robust growth in the manufacturing of hard-disk drives (HDDs). In January-April total output of HDDs reached 58.2m units, a year-on-year expansion of 31%. Offsetting this growth, output of integrated circuits dropped by 8.6% to 4.1bn pieces. Production of computer keyboards and monitors remained on a downward trend, but the number of printers produced rose by 22% to 6.1m.

Manufacturing production

(% change, year on year)

	2006				2007	
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	Apr
Food	5.1	9.2	10.0	8.4	7.2	12.0
Beverages (incl alcohol)	15.3	3.3	26.2	14.0	8.2	9.7
Tobacco	-30.8	-15.3	4.4	-7.1	20.8	52.6
Textiles	7.4	5.2	0.0	-2.0	-1.1	1.8
Petroleum products	3.5	0.9	0.3	5.1	-1.1	3.3
Construction materials	3.4	7.6	7.7	4.0	-1.8	4.7
Iron & steel products	-12.1	4.8	0.2	-5.9	5.5	-11.5
Vehicles & equipment	14.5	8.4	3.1	-4.5	-6.4	-8.4
Electronic products	24.7	19.7	23.3	26.6	22.2	19.3
Electrical appliances	1.2	-9.1	-12.8	-10.9	-0.3	4.3
Setting jewellery	-0.2	1.9	-1.6	-1.5	-2.2	-4.0
Total incl others	9.6	6.6	6.6	6.9	6.0	6.7

Source: Bank of Thailand.

Manufacturers of electrical appliances have failed to boost growth markedly, with output rising by only 0.8% year on year in January-April. Output of

television sets, fans and refrigerators all fell on a year-on-year basis during this period, but there was solid growth in the number of airconditioning units produced. In January-April total output of airconditioners reached nearly 960,000, up from around 780,000 in the year-earlier period.

Carmakers slow down, but an eco-car project moves forward

Vehicle output remains on a downward trend, with manufacturers scaling back their plans in view of weak domestic demand and the prospect of a slowdown in demand growth in most overseas markets. In January-April car output plunged by 8% year on year to 87,253 units, while that of commercial vehicles (mainly light trucks) dropped by 1.7% to 289,362 units. There was also a sharp drop in motorcycle manufacturing, with the number of units produced falling by 24% year on year. Domestic sales volumes remain weak. In January-April total sales of cars and commercial vehicles fell by 16% year on year, following a drop of 3% in 2006, primarily owing to weak consumer confidence in the face of intense political uncertainty.

In an attempt to boost the automotive industry while also shoring up overall investment, Thailand has finally moved forward with a long-delayed plan to become a regional hub for the production of "eco-cars", which are characterised by affordable prices, low exhaust emissions and high fuel economy. In November last year the BoI gave initial approval for tax incentives for producers of eco-cars meeting certain standards of fuel efficiency, exhaust emissions and safety. The BoI finalised these incentives on June 15th, shortly after the government had approved a preferential excise tax rate of 17% for eco-cars (excise tax rates are in the range of 30-50% for standard cars). The industry minister, Kosit Panpiemras, who chaired the BoI board meeting on the issue, stated that eco-car manufacturers would enjoy a maximum eight-year exemption from corporate income tax payments and machinery import duties, irrespective of the location of their production bases in the country. Carmakers now have six months to submit their plans for eco-car production to the BoI. If they do move ahead with plans to set up eco-car operations in Thailand, production will not commence for at least another two years, as the new tax regime will not come into effect until October 2009.

The JTEPA provides hope for the garment sector

Thailand's garment and textile manufacturers are rapidly losing their competitive edge to their low-cost rivals in the region, primarily China and Vietnam. In view of the slow growth in demand for Thai-made garments in major export markets, output remained practically unchanged year on year at 1.6bn pieces in January-April 2007, while output of synthetic fibres dropped by 17% to around 220,000 tonnes. The Japan-Thailand Economic Partnership Agreement (JTEPA), which was signed in April and is set to come into effect in the near future, could provide a massive boost to the struggling garment and textile sector. Under the agreement, Japan will lower its import tariffs on Thai textiles and garments from 12% to zero from October 2007. Special projects promoting joint investment are reportedly being planned, and Rachane Potjanasutorn, the director-general of the Ministry of Commerce's Department of Export Promotion, believes that Japanese investors will expand their operations in the country in order to export to Japan and other markets. In order to qualify for zero tariffs, garment exporters must use fabrics from

Thailand, Japan or other ASEAN countries, and must cut and sew these fabrics in Thailand.

Agriculture

Output growth rebounds, but rice production falls

After suffering from severe flooding in the final quarter of 2006, the agricultural sector rebounded in the first four months of 2007, with the BOT's crop production index rising by 6.2% year on year. Although paddy rice production contracted by 6.9% year on year in January-April, dropping to 5.3m tonnes, overall output of grains and food rose by 4.1%, with solid output growth for vegetables, fruit, cassava and sugarcane. The production of oils (mainly from palm fruit, coconut and soybean) rose strongly in January-April, expanding by 20.8% year on year, while the output of coffee beans jumped by 26% year on year. The rubber sector also performed reasonably well, with output growing by nearly 5% to 942,000 tonnes.

Despite the downturn in paddy production, the government is optimistic that rice production and exports will increase this year, with an export target set at 8.5m tonnes (up from around 7.4m tonnes in 2006), ensuring that the country remains the world's leading rice exporter.

Shrimp farmers are having a tough time

Although shrimp farmers have enjoyed a sharp expansion in exports, operating conditions are becoming increasingly difficult owing to falling prices and problems in exporting to important markets. In the first four months of the year the exported volume of fresh and frozen shrimp rose by 17% year on year to around 50,000 tonnes, with revenue jumping by 22% to US\$320m. However, according to the Thai Marine Shrimp Farmers Association, local prices have dropped sharply in recent months, and local shrimp farmers have cut output volumes by 20% in response. According to the association's president, Surapol Pratuangtum, market prices have now dropped below operating costs. The drop in local prices is a result of oversupply and the strength of the baht against the US dollar.

Other problems faced by local shrimp farmers relate to the requirement that exporters post a continuous bond on shrimp exports to the US under regulations imposed on countries accused of dumping. This burden has resulted in tight liquidity conditions for exporters. Exports to Australia (the sixth-largest market for Thailand's shrimp exporters) are also set to suffer under the Australian government's plans to impose stringent restrictions on imports of shrimps. Although the ostensible reason for the move is the need to control disease, Thai farmers have suggested that the measure is in fact designed to protect Australia's local shrimpers.

Infrastructure

Nuclear energy plans are raised

The interim government is keen to reduce the country's dependence on natural gas as a fuel for its power stations, as gas accounts for around 70% of electricity production at present. However, it has struggled to gain popular approval for its long-term Power Development Plan (PDP)—a public hearing on the proposed 15-

year PDP (for 2007-21) had to be postponed in February this year owing to public protests. Nevertheless, the government is pushing ahead with the plan, which gained the approval of the National Energy Policy Council in April. Based on the assumption that power demand will grow by an average of just under 6% a year in 2007-11, 6% a year in 2012-16 and 5.5% a year in 2017-21, the government has determined that Thailand needs to increase its electricity-generating capacity by around 32,300 mw over the 15-year period.

In June the state-owned electricity generator, EGAT, said that it planned to invest US\$6bn in building the country's first nuclear power plant, coming on stream in 2020 and producing 4,000 mw of electricity. The energy minister, Piyasvasti Amranand, justified the move on the basis that Thailand needed to develop nuclear energy so as to have an alternative power source and to meet rising demand for electricity. He said that the action plan for nuclear energy development would be completed by the end of 2007, and that this would be followed by seven years of project preparations and six years of construction. Environmentalists have criticised the plan for being expensive and dangerous. However, with the country already heavily reliant on natural gas to fuel power stations and widespread local opposition to the construction of coal-fired power plants, the government claims that it has few choices left. It remains to be seen how successful EGAT will be in running a public-relations campaign to head off mass local opposition to its plans to build a nuclear generator.

The government pushes ahead with mass-transit projects

The interim administration is determined to make some tangible progress with plans to develop transport infrastructure in the capital, Bangkok, before its period in power expires (possibly before the end of the year). In June the government was making an all-out effort to persuade the Japan Bank for International Co-operation (JBIC) to speed up its lending approval process, to enable it to move ahead with plans to hold a bidding contest for potential constructors for one mass-transit route in Bangkok, the so-called Purple Line. The government is hoping to call for bids in early September for the 23-km route, the construction of which could cost around Bt45bn. Bids could then be submitted by mid-December. The government is also hoping to make solid progress with another route, the 15-km section of the Red Line, before the end of the year. It is planning to call for bids in July and to select a contractor by November, with construction work potentially commencing in early 2008. Despite debate earlier this year between government ministers over which routes to push ahead with, five new routes remain under consideration. Tentative plans by the Mass Rapid Transit Authority of Thailand for three of these routes (the Purple, Red and Blue lines) suggest that services on these new routes will not begin until 2010 at the earliest.

Financial and other services

Bank lending growth slows

The banking sector has been fairly inactive in recent months in terms of issuing consumer loans. In the first five months of the year total outstanding loans increased by Bt33.8bn to just over Bt4trn (US\$115bn), an increase of around 0.8%. This trend reflects the impact of the downturn in the local economy on demand for new loans, and also banks' heightened concerns over the potential

for loans to turn bad. Although Bank Thai, a state-owned commercial bank, recently announced that it had reduced its minimum monthly income level for loan applicants to Bt10,000 (US\$285), from Bt15,000 before, it has maintained a strong focus on ensuring borrowers' creditworthiness: the bank's loan approval rate has dropped to 30-35%, from around 40-45% last year.

Commercial banks have recorded a slight upturn in non-performing loans (NPLs) in recent months. At the end of April total NPLs as a percentage of total outstanding loans stood at nearly 4.6%, up from just under 4.5% at end-2006. (Since December last year commercial banks have been permitted to report a net NPL figure that is lower than the gross figure, based on loan-loss reserves.)

TMB Bank remains troubled

TMB Bank (formerly known as the Thai Military Bank) remains troubled, having failed in recent months to shore up its capital base after making a net loss of Bt12.3bn (around US\$357m) last year. The bank has been trying to raise Bt35bn in order to meet loan-loss provisioning requirements and also to support expansion plans, and its board members are hoping to complete a recapitalisation plan by September this year. But the plans stalled in March this year, and the deputy finance minister, Sommai Phasee, who was the bank's chairman until he took up a position in the government, has since called for the bank's chief executive, Subhak Siwaraksa, and other senior managers to resign. The Ministry of Finance holds a 31% stake in TMB Bank, with the military holding a small percentage. Singapore's DBS Bank, which holds a 16% stake in the bank, supports a management change, but has reportedly stated that it will accept a dilution of its shares if such a change is not made. In June the Bank of Thailand (the central bank) ordered TMB Bank not to make its next interest payment of US\$7.5m for its US\$200m hybrid tier-one securities due in July. The bank has been keen to make the payment, but under the terms of the bond issue it is not obliged to do so if it posted a loss in the previous accounting period. Although the missed payment is not technically a default, it is likely to affect the bank's credibility.

Tourist arrivals pick up

The tourism sector remains strong, having recovered fully from the devastating impact of the December 2004 tsunami. According to data from the Tourism Authority of Thailand (TAT), the number of foreign tourists visiting the country in the first quarter of 2007 reached nearly 3.8m, up by 4.4% year on year. This followed strong growth in 2006, when the number of foreign tourists reached 13.8m, representing a year-on-year increase of 20%. The performance in the first quarter of 2007 was affected by the bombings in Bangkok on December 31st last year, with arrivals increasing by only 2% year on year in January. During the first quarter hotel occupancy rates averaged 69.2%, down slightly from 69.8% in the year-earlier period.

The Ministry of Tourism's focus remains on attracting high-end tourists, and the tourism minister, Suvit Yodmanee, said in April that his ministry would focus on the quality rather than the quantity of visitors. In April the government approved in principle an additional budget of Bt500m (US\$14.5m) for TAT's promotional activities. The funds will be used to target tourists from Japan, South Korea and Singapore—arrivals from these countries dropped by 7%, 3% and 16% respectively on a year-on-year basis in the first quarter.

THAI is told to lease planes rather than buying them

The national airline, Thai Airways International (THAI), recorded a 4.7% year-on-year rise in the number of passengers carried in October 2006-April 2007 (the first seven months of the company's operating year). The airline has nevertheless suffered some setbacks in recent months. As part of a compensation package between THAI and the EU's Airbus aerospace group following delays in delivering Airbus's A-380 planes, THAI had been planning to buy eight Airbus A-330 planes. However, in June the government rejected the airline's plans, instead ordering THAI to lease the planes over a ten-year period. The increase in fleet size is intended to facilitate the company's plans to expand its regional operations.

Domestically, the national airline is facing strong competition from low-cost carriers, including a subsidiary, Nok Air, in which it holds a 39% stake. In June THAI executives held talks with the National Legislative Assembly's Transport Committee on how THAI could increase its influence over Nok Air, which has been accused of undermining its parent company's interests. THAI is considering increasing its stake in Nok Air to 51%, and has also indicated that it may revive plans to set up another "no-frills" airline.

Foreign trade and payments

The trade surplus rises as exports boom

Despite signs of weakness in some of Thailand's main export markets, export revenue growth remained strong in the first four months of 2007, with total export revenue rising to US\$45.7bn, up by around 18% year on year. In March export revenue soared to a record monthly high of US\$13.1bn. By contrast, growth in imports has been sluggish. In January-April the import bill stood at US\$41.1bn, up by only 3.7% year on year. The merchandise trade balance (fob-cif) therefore posted a healthy surplus of US\$4.6bn in January-April, compared with a deficit of nearly US\$1bn in the year-earlier period.

Exports of high-technology manufactures remain buoyant, rising by 18% year on year to US\$40bn in the first four months of the year. Exports of integrated circuits and parts recorded particularly impressive growth, jumping by 27% to US\$2.6bn, while growth in exports of computers and parts slowed slightly to 6% year on year, but still posted revenue of US\$4.6bn. Exports of electrical appliances (such as airconditioners, televisions and refrigerators) performed well in January-April, rising by 18% year on year to US\$3.6bn. Despite falling domestic sales, vehicle manufacturers continue to enjoy rising export values. In January-April the total value of exports of vehicles, parts and accessories increased by 28% year on year to US\$3.9bn.

Thailand's exports of labour-intensive manufactures remain weak compared with exports of high-tech products. In March and April exports of labour-intensive manufactures dropped by around 7% year on year. However, owing to a particularly strong performance in February, the total for the first four months of the year reached US\$3.7bn, making for a year-on-year increase of 4.2%. Garments and textiles make up a large proportion of the country's labour-intensive manufactured goods, and in January-April these exports rose in value by only 1.4% year on year. With exports of garments alone plummeting by 7%

year on year, it is clear that Thailand's manufacturers are struggling to compete with their low-cost rivals in China, India, Vietnam and even Cambodia.

The agriculture sector has continued to post strong growth in exports. In January-April agricultural exports jumped by 16% year on year to US\$3.5bn, most of this total being accounted for by rubber and rice. Although rubber export volumes dropped slightly, revenue expanded by 6% to US\$1.7bn in line with higher received prices. Higher prices also contributed to much of the 18% year-on-year rise in the value of rice exports, to US\$873m.

Exports of selected commodities

(US\$ m unless otherwise indicated)

	2006				2007	
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	Apr
Manufactured products	25,713	27,171	30,508	29,989	30,601	9,520
Machinery	4,670	4,697	5,274	5,627	5,109	1,534
Vehicles & parts	2,391	2,325	2,557	2,769	3,032	866
Electrical appliances	2,352	2,488	2,499	2,401	2,758	892
Integrated circuits & parts	1,599	1,717	1,875	1,839	2,008	609
Textiles	1,362	1,332	1,471	1,399	1,316	387
Agricultural products	2,348	2,282	2,818	2,777	2,676	848
Fishery products	466	525	657	586	561	176
Mineral products	542	604	629	605	601	159
Total incl others	29,559	30,998	35,061	34,332	34,826	10,875

Source: Bank of Thailand, *Quarterly Bulletin*.

Although total export revenue growth remained in double digits in the first four months of the year, exports to the US were particularly weak, rising by only 1.8% year on year to US\$5.9bn. Fortunately for Thai exporters, demand was still strong in most other major markets. Exports to Japan, for example, rose by 16% year on year to US\$5.8bn, while exports to the EU increased by 25% to US\$6.7bn. Demand for Thai products also grew rapidly in China (up by 24% to US\$4.1bn) and Australia (up 45% to US\$1.8bn). Regional demand has also picked up, with Thailand's exports to fellow members of the Association of South-East Asian Nations (ASEAN) growing by 15% year on year in January-April to US\$9.4bn. There was particularly strong growth in exports to Indonesia, Malaysia and the Philippines, whereas exports to Singapore (Thailand's largest export market in ASEAN) contracted slightly.

Import growth picks up from recent lows

In the first four months of 2007 there was fairly strong growth in imports of consumer goods and also of raw materials and intermediate goods, but this was partly offset by a contraction in imports of capital goods and a drop in the value of crude oil imports. Reflecting weak domestic investment growth, imports of capital goods contracted by 3% year on year to US\$10.7bn. Although imports of electrical machinery and parts rose by 32% to US\$3.9bn, imports of industrial machinery, tools and parts fell by 24% to US\$2.9bn. Part of the reason for the contraction in capital goods imports was the drop in the value of aircraft imported during the first four months of the year, to US\$177m, from US\$555m in the year-earlier period. Weak consumer spending growth in early 2007 was not reflected in import trends—in January-April imports of consumer goods rose by nearly 10% to US\$3.3bn. Imports of non-durable consumer goods rose by about

9% year on year to US\$1.8bn, while imports of durables rose by 11% to US\$1.5bn, driven mainly by imports of electrical appliances and parts. Imports of raw materials and intermediate goods increased by 16% year on year in January-April, rising to US\$18.5bn, owing to strong growth in purchases of electronics parts, metals and chemicals. Reflecting the general downward trend in global prices for crude oil, the value of crude oil imports dropped by 10% year on year in January-April to US\$5.5bn.

Imports of selected commodities

(US\$ m unless otherwise indicated)

	2006				2007	
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	Apr
Consumer non-durables	1,271	1,315	1,399	1,421	1,338	475
Food & beverages	498	504	536	646	449	168
Consumer durables	983	1,085	1,105	986	1,075	407
Electrical appliances	448	517	490	391	515	136
Raw materials & intermediate goods	12,083	13,328	13,641	12,850	13,936	4,602
Capital goods	8,413	8,401	8,437	7,852	7,857	2,804
Electrical machinery	2,238	2,292	2,362	2,138	2,903	991
Industrial machinery	2,788	3,084	2,932	2,710	2,073	813
Computer components	1,038	1,048	1,127	997	1,039	315
Vehicles & parts	916	906	926	940	935	253
Fuel & lubricant	5,514	6,531	6,990	6,009	4,756	1,763
Total incl others	29,966	32,623	33,393	30,866	30,555	10,619

Source: Bank of Thailand, *Quarterly Bulletin*.

The current account records a record quarterly surplus

The current account bulged to a record quarterly surplus of US\$5.5bn in the first quarter of 2007, owing primarily to the substantial surplus of US\$4.1bn recorded on the merchandise trade account. There was also a healthy surplus on the services account in the first quarter of the year, of US\$1.5bn, compared with a quarterly average of US\$1.2bn in 2006. (The BOT's accounting method for goods and services imports in the balance of payments differs from that of the IMF.) Services receipts rose by 15% year on year to US\$6.9bn, with travel services soaring by 22% to US\$4bn, while services payments jumped by 16% year on year to US\$5.4bn. The deficit on the income account stood at US\$1.1bn in the first quarter of this year. Inflows of investment income climbed to US\$1.1bn, up only slightly compared with inflows in the preceding quarter but rising sharply from only US\$614m in the year-earlier period. However, income payments reached US\$2.6bn in the first quarter, up slightly from the fourth quarter last year and from US\$2.3bn in the year-earlier period. Around US\$1.1bn in income payments were recorded as reinvested earnings. The transfers surplus remained buoyant, reaching US\$939m in the first quarter of this year—a record high, and up from a quarterly average of US\$844m recorded in 2006.

In the first quarter of this year the capital and financial account recorded its first deficit in three years. Although net foreign direct investment, which includes earnings reinvested by foreign investors, soared to US\$3.4bn, the capital and financial account recorded an overall deficit of US\$2.3bn. There was a net outflow of portfolio investment, to the tune of US\$1.1bn, the largest since the fourth quarter of 2002 and a sharp reversal compared with an average quarterly inflow of US\$1.1bn in 2006. Purchases of foreign equity and debt

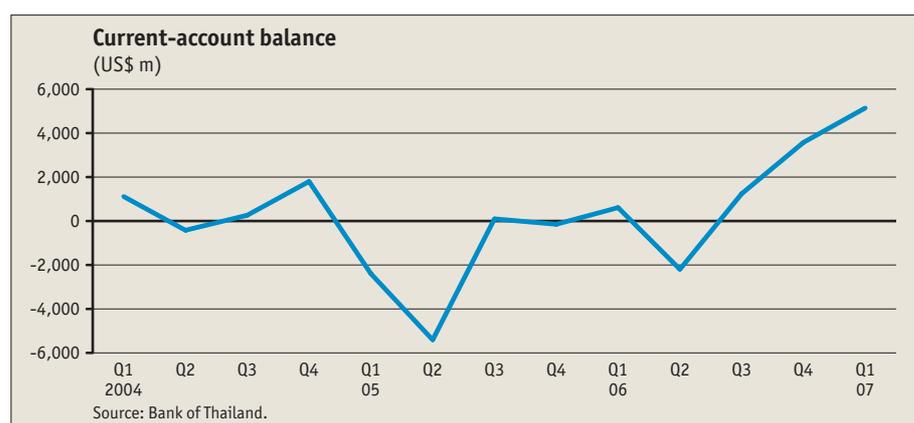
securities by Thai-based investors rose to US\$1.6bn in the first quarter, up from a quarterly average of around US\$430m in 2006, while net flows into equity securities of US\$1.1bn were partly offset by the negative net position of flows into debt securities (of US\$519m). The overall balance of payments (including errors and omissions of US\$140m) in the first quarter recorded a surplus of nearly US\$3.3bn, pushing Thailand's international reserves position up to US\$70.9bn at the end of the quarter, from US\$70bn at end-2006 and US\$52bn at end-2005.

Balance of payments

(US\$ bn unless otherwise indicated)

	2005	2006				2007
	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr
Merchandise exports fob	28,391	29,091	30,592	34,555	33,981	34,460
Merchandise imports cif	-29,154	-29,316	-32,297	-33,105	-31,258	-30,332
Trade balance	-763	-224	-1,705	1,450	2,723	4,127
Services balance	1,301	1,368	1,121	855	1,038	1,487
Income balance	-1,492	-1,387	-2,466	-1,861	-1,045	-1,101
Current transfers balance	805	852	848	806	866	939
Current-account balance	-149	609	-2,201	1,250	3,582	5,453
Capital & financial account balance	2,399	2,925	2,961	2,635	345	-2,273

Source: Bank of Thailand, *Quarterly Bulletin*.



External debt rises slightly

Thailand's gross external debt position picked up slightly in the first quarter of 2007, reaching US\$60.4bn, up from US\$60bn at the end of 2006. General government debt continues to fall, dropping to US\$3.2bn at end-March; all of this borrowing is on a long-term basis. The external debt stock held by state enterprises remains fairly stable, standing at US\$8.9bn at end-March. However, the private sector's holdings of both short- and long-term debt continue to increase. At the end of March the private sector owed a total of US\$25.1bn in long-term debt. Although up only slightly since the end of the previous quarter, the outstanding stock of debt was higher than the level of US\$21.5bn at the end of March 2006. Similarly, private-sector short-term debt jumped from US\$13.9bn at end-March 2006 to US\$16.7bn at end-March 2007. Around 60% of this short-term debt comprised trade credits, while just under 20% consisted of intra-company lending.