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May 9, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Thailand - Staff Report for the 1986 Article IV Consultation
and First Review Under Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1986 Article IV consultation with Thailand and the first review under its stand-by arrangement. Draft decisions appear on pages 33-36.

This subject will be brought to the agenda for discussion on a date to be announced.

Mr. Aghevli (ext. 7177) or Ms. Schadler (ext. 7317) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

INTERNATIONAL MONETARY FUND

THAILAND

Staff Report for the 1986 Article IV Consultation
and First Review Under the Stand-By Arrangement

Prepared by the Asian, Exchange and Trade Relations, and
Fiscal Affairs Departments

(In consultation with the Legal and Treasurer's Departments)

Approved by P. R. Narvekar and Eduard Brau

May 8, 1986

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I. Introduction

Discussions for the 1986 Article IV consultation and first review of the stand-by arrangement with Thailand were held in Bangkok during January 14-February 3, and March 19-27, 1986. ^{1/} The staff representatives met with the Minister of Finance, the Governor of the Bank of Thailand, the Secretary-General of the National Economic and Social Development Board, and other government officials. The staff team consisted of Mr. Aghevli (Head, ASD), Mr. Heller (FAD), Ms. Schadler (ASD), Mr. Hansen (ETR), Mr. Barth (INS), Mr. Lav (World Bank), and as secretaries Mrs. Ellyn and Mrs. John (both ASD). Mr. Ganjarerndee, Advisor to Mr. Ismael, attended the meetings as an observer.

The Executive Board approved the stand-by arrangement for Thailand on June 14, 1985 (EBS/85/128, Supplement 2, June 18, 1985) for the period through March 31, 1987. The amount of the arrangement is SDR 400 million or 103 percent of quota (equivalent to a yearly access of 56 percent of quota), including SDR 206.3 million of borrowed resources. At the same time, a drawing under the compensatory financing facility (EBS/85/129, May 15, 1985) in the amount equivalent to SDR 185 million (48 percent of quota) was approved (Table 1).

Purchases under the stand-by arrangement were scheduled to occur in eight equal installments of SDR 50 million. Three purchases have been made; the first immediately following Board approval of the arrangement and the next two when the observance of respective performance criteria for end-June and end-September was confirmed (Table 2). However, the deficit of the central government for fiscal year 1984/85 (October-September) exceeded the program target, and the first review of the program, originally scheduled to be completed by December 31, 1985, was delayed owing to difficulties in reformulating fiscal targets for 1985/86. In addition, by the end of 1985, the ceiling on new external public debt commitments (a performance criterion) was exceeded. Consequently, the drawing scheduled for March 1986 on the basis of the observance of the December performance criteria, which included the completion of the first review, could not be made. The Government has now requested an extension of the stand-by arrangement through December 31, 1987 in order to allow sufficient time to undertake necessary adjustment measures within the program period. Under the prolonged arrangement, remaining purchases of SDR 250 million would be rephased, resulting in a reduction in the annual access rate to 40 percent of quota. Both the request for the extension and a description of the Government's economic program for 1986 and 1987 are contained in the

^{1/} Thailand continues to avail itself of the transitional arrangements of Article XIV; it maintains an exchange system that is free of restrictions on payments and transfers for current international transactions.

Table 1. Thailand: Fund Position During Period of Arrangement With
Rephasing of Purchases, April 1986-December 1987 ^{1/}

	Outstanding April 30, 1986	1986 April- June	1986 July- Sept.	Oct.- Dec.	1987
(In millions of SDRs)					
Transactions under tranche policies (net)		-14.6	6.4	6.9	6.7
Purchases		30.0	30.0	50.0	140.0
Ordinary resources		(15.0)	(15.0)	(25.0)	(63.4)
Borrowed resources		(15.0)	(15.0)	(25.0)	(76.6)
Repurchases		-44.6	-23.7	-43.1	-133.3
Ordinary resources		(-26.1)	(-16.5)	(-21.4)	(-92.1)
Borrowed resources		(-18.5)	(-7.2)	(-21.7)	(-41.2)
Transactions under special facilities (net) ^{2/}		-0.4	-30.6	-7.3	-29.2
Purchases		--	--	--	--
Repurchases		-0.4	-30.6	-7.3	-29.2
Total Fund credit outstand- ing (end-of-period)	847.5	832.5	808.3	807.9	785.4
Under tranche policies	587.1	572.5	578.9	585.8	592.5
Special facilities ^{2/}	260.3	259.9	229.3	222.0	192.8
(As percent of quota)					
Total Fund credit outstand- ing (end-of-period)	219.2	215.3	209.1	209.0	203.2
Under tranche policies	151.9	148.1	149.7	151.5	153.2
Special facilities ^{2/}	67.3	67.2	59.3	57.4	49.9

Source: International Monetary Fund.

^{1/} Numbers may not add up owing to rounding.

^{2/} Compensatory financing and buffer stock facilities.

Table 2. Thailand: Performance Under the Stand-by Arrangement
for the Period through December 1985 ^{1/}

	June 30		Sept. 30		Dec. 31	
	Ceiling	Actual	Ceiling	Actual	Ceiling	Actual
(In billions of baht)						
Domestic credit	696.8 (19.6)	666.6 (14.6)	732.1 (19.8)	674.3 (10.5)	766.2 (19.0)	705.8 ^{2/} (9.6)
Net credit to Government	156.0 (15.1)	149.7 (11.2)	161.0 (7.9)	149.7 (0.9)	165.5 (7.1)	164.9 ^{2/} (6.8)
Net foreign assets	15.5	32.9	17.0	37.5	22.8	32.7 ^{2/}
(In millions of U.S. dollars)						
New external public debt commitments	1,300	337 ^{3/}	1,300	1,140 ^{3/}	1,300	1,613 ^{3/}

Source: Data provided by the Thai authorities.

^{1/} Numbers in parentheses are year-on-year percentage changes.

^{2/} Domestic credit and net credit to the Government exclude \$300 million (B 8 billion) in government deposits that are the counterpart to borrowings undertaken by the Government in late 1985 to be used for refinancing during the first half of 1986. Net foreign assets also exclude the corresponding amount of foreign assets held by the Bank of Thailand.

^{3/} Excludes new commitments undertaken for refinancing of obligations falling due in 1986 and beyond. These amount to \$448 million as of end-June, \$513 million as of end-September, and \$799 million as of end-December.

attached letter from the Minister of Finance and the Governor of the Bank of Thailand, dated May 2, 1986.

As of April 30, 1986, Thailand's use of Fund credit under tranche policies stood at 151.9 percent of Thailand's quota of SDR 386.6 million; in addition, 67.3 percent of quota was outstanding under the compensatory financing and buffer stock facilities. Given large scheduled repurchases to the Fund, even with the full use of the present stand-by, Thailand's use of Fund credit would decline to 203.1 percent of quota by the end of the stand-by period. Thailand is not expected to encounter problems in meeting its planned repayments to the Fund. Information on Thailand's relations with the Fund is provided in Annex I.

II. Background to the Discussions

1. The adjustment problem and the program in 1985

During the late 1970s, a significant deterioration in the financial position of the public sector together with the adverse impact of the second round of oil price increases resulted in a sharp widening of the external current account deficit. By the early 1980s, it became apparent that the associated build up in external debt was unsustainable, and the correction of both the fiscal and external imbalances became an important focus of policy. In the ensuing years, however, adjustment efforts were stymied by adverse external developments--in particular, relatively sluggish external markets, and, between 1980 and 1982, a 20 percent deterioration in the terms of trade. There were also some slippages in the implementation of domestic policies in the wake of a slowdown in growth in 1982. Thus, by 1984, after several years of thwarted adjustment efforts, Thailand was still faced with a large current account deficit (equivalent to 5 percent of GDP) and a relatively heavy external debt burden (Table 3). In a renewed effort to correct this problem, the authorities, in late 1984, implemented a strong adjustment program supported by the present stand-by arrangement with the Fund.

The program for 1985 consisted of policy measures designed to enhance the competitiveness of the export sector, restrain domestic demand, and improve the public sector position. The baht was devalued by 15 percent in November 1984, and the long-standing practice of fixing the baht to the U.S. dollar was replaced by a basket peg; under the new exchange rate arrangement, the baht depreciated by a further 9 percent in real effective terms during 1985. To ensure the effectiveness of the devaluation and to restrain domestic demand, the authorities planned to contain credit expansion and maintain interest rates at a level adequate to encourage domestic savings and capital inflows. On the fiscal side, a package of tax measures was introduced in April 1985 to raise additional revenues equivalent to about 1 percent of GDP on an annual basis,

Table 3. Thailand: Selected Economic and Financial Indicators, 1983-86

	1983	1984	1985		1986
			Prog.	Est.	Proj.
National income, prices, and unemployment					
Real GDP (change in percent)	5.8	6.0	6.0	4.1	4.3
GDP deflator (change in percent)	3.4	1.5	7.0	2.6	3.3
CPI (period average, percent change)	3.7	0.9	7.0	2.4	2.2
Rate of unemployment (in percent)	1.9	2.2	2.2	2.3	2.4
Nominal GDP (billions of baht)	924.3	985.6	1,124.3	1,051.2	1,132.3
Balance of payments (bn. U.S. dollars)					
Exports, f.o.b.	6.3	7.3	8.1	7.1	7.6
Imports, c.i.f.	-10.2	-10.3	-10.7	-9.3	-9.5
Non-oil imports, c.i.f.	-7.7	-7.8	-8.3	-7.3	-7.9
Export volume (change in percent)	-9.6	21.9	11.5	4.9	5.4
Import volume (change in percent)	27.0	2.9	2.1	-5.4	5.5
Terms of trade (1980 = 100)	85	83	81	79	83
Current account deficit (-)	-2.9	-2.1	-1.7	-1.5	-1.2
Overall balance	-0.8	0.4	-0.2	0.2	0.2
Gross official reserves	2.5	2.7	2.6	2.7	2.8
(Months of current year's imports)	(2.9)	(3.1)	(2.9)	(3.5)	(3.6)
Central government ^{1/}					
Revenue and grants (change in percent)	17.3	9.3	15.2	8.6	5.5
Expenditure and net lending (change in percent)	5.7	6.7	11.3	15.9	3.8
Deficit (-, in billions of baht)	-38.1	-37.0	-35.0	-53.9	-53.2 ^{2/}
Money and credit (change in percent)					
Money (M2)	24.0	20.2	19.3	10.2	15.5
Domestic credit	25.6	17.1	19.0	9.6	14.2
Interest rate (end of period, one-year deposit rate)	12.5	12.5	...	11.0	9.5 ^{3/}
Velocity of broad money	-11.9	-11.3	-4.4	-3.2	-6.7
Exchange rates (end period, percent changes)					
Nominal effective exchange rate	1.8	-10.3	...	-9.7	...
Real effective exchange rate	3.0	-12.8	...	-8.8	...
(In percent of GDP)					
Central government (fiscal years) ^{1/}					
Revenue and grants	15.1	15.5	15.6	15.7	15.4
Expenditure and net lending	19.2	19.2	18.7	20.9	20.1
Deficit (-)	-4.1	-3.8	-3.1	-5.1	-4.7 ^{2/}
Domestic bank financing (in percent of total financing)	35.4	58.9	39.4	4.6	57.0
Foreign financing (in percent of total financing)	22.6	13.2	30.9	34.7	14.5
Public sector deficit (-)	-5.3	-5.0	-4.1	-6.3	-5.3 ^{2/}
Gross national savings ^{4/}	15.8	17.1	18.0	17.4	18.7
Gross domestic investment	23.0	22.1	22.0	21.2	21.5
External current account deficit (-)	-7.2	-5.1	-4.0	-3.8	-2.8
(In percent of exports of goods and services)					
External debt (including use of Fund credit)					
Debt service ratio	151	153	151	172	173
	23.2	24.0	25.7	27.4	27.0

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

^{1/} Fiscal year ending September 30.

^{2/} Staff projections assuming the implementation of adjustment measures.

^{3/} Actual, March 1986.

^{4/} Includes statistical discrepancy.

and the original budgetary allotments for expenditure in 1984/85 were cut by almost 2 percent; these measures were expected to result in a reduction of the central government deficit from 4 percent of GDP in 1983/84 to 3 percent in 1984/85. Continued expenditure restraint, as well as the full year effect of the tax increases, was expected to reduce the fiscal deficit to below 2 percent of GDP in 1985/86. In order to boost the financial position of state enterprises, tariffs of a number of enterprises were raised, and investment plans were scaled down or rephased.

The planned contraction of the fiscal deficit was consistent with the projected narrowing of the external current account deficit to 4 percent of GDP in 1985 and 3 percent of GDP in 1986 (Table 4). Capital inflows were projected to be somewhat lower than the peak reached in 1984, but sufficient to produce only a small overall payments deficit. Gross international reserves were therefore to fall by about \$100 million, leaving the import cover at just under three months. The planned adjustment of the current account was expected to substantially reduce the growth of external debt. The debt service ratio was to increase to about 26 percent in 1985, largely as a result of a bunching of repayments to the Fund, but to fall gradually thereafter. Based on the assumption of a moderate expansion of export markets, it was expected that the growth of both real GDP and investment would be sustained at about 6 percent. Despite restrictive financial policies, the devaluation of the baht was expected to push domestic inflation up to about 7 percent.

2. Developments in 1985

Economic performance during 1985 was severely strained by unexpectedly weak export markets, an 8 percent drop in export prices, and protectionism abroad. Notwithstanding these adverse circumstances, the external targets of the program were broadly met. The current account deficit narrowed significantly as a sizable shortfall in export earnings (equivalent to over 2 1/2 percent of GDP) was offset by an even larger shortfall in import payments. Exports benefited considerably from the substantial real depreciation of the baht, but the slowdown in export markets contained the growth in export volume to only 5 percent. With the drop in prices, export receipts fell by 3 1/2 percent, compared with a targeted increase of over 10 percent. The volume of imports declined by over 5 percent owing to the sluggishness of domestic demand and the dampening effect of the devaluation, while import prices fell by 4 percent. With broadly unchanged services and transfer accounts, the current account deficit fell to \$1.5 billion, equivalent to the program target of 4 percent of GDP.

Nonmonetary capital inflows were sufficient to fully finance the deficit on the current account. Public sector inflows were larger than projected in the program, as the Government increased its recourse to foreign borrowing to take advantage of attractive terms on external

Table 4. Thailand: Balance of Payments, 1983-87

(In millions of U.S. dollars)

	1983	1984	1985		1986	1987
			Program	Outcome	Projections	
Exports, f.o.b.	6,308	7,337	8,100	7,080	7,580	8,330
Volume (percent change)	(-9.6)	(21.9)	(11.5)	(4.9)	(5.4)	(5.5)
Unit value (percent change)	(1.2)	(-4.6)	(-1.1)	(-7.9)	(1.6)	(4.2)
Imports, c.i.f.	-10,187	-10,263	-10,700	-9,334	-9,470	-10,065
Volume (percent change)	(27.9)	(2.7)	(2.1)	(-5.4)	(5.5)	(4.8)
Unit value (percent change)	(-5.6)	(-2.0)	(2.2)	(-3.9)	(-3.8)	(1.4)
Trade balance	<u>-3,879</u>	<u>-2,926</u>	<u>-2,600</u>	<u>-2,254</u>	<u>-1,890</u>	<u>-1,735</u>
Services, net	<u>729</u>	<u>645</u>	<u>700</u>	<u>605</u>	<u>510</u>	<u>465</u>
Transfers, net	<u>277</u>	<u>171</u>	<u>200</u>	<u>165</u>	<u>170</u>	<u>170</u>
Current account balance	<u>-2,873</u>	<u>-2,110</u>	<u>-1,700</u>	<u>-1,484</u>	<u>-1,210</u>	<u>-1,100</u>
(Percent of GDP)	(-7.2)	(-5.0)	(-4.0)	(-3.8)	(-2.8)	(-2.4)
Nonmonetary capital movements, net	<u>1,496</u>	<u>2,470</u>	<u>1,500</u>	<u>1,525</u>	<u>1,410</u>	<u>1,315</u>
Medium- and long-term, net	<u>1,458</u>	<u>1,769</u>	<u>1,725</u>	<u>1,343</u>	<u>1,185</u>	<u>1,315</u>
Public sector	(799)	(732)	(875)	(996) 1/	(707)	(570)
Private sector	(659)	(1,037)	(850)	(347)	(478)	(745)
Short-term, net	38	701	-225	182	225	--
Errors and omissions	558	8	--	170	--	--
Overall balance	<u>-819</u>	<u>368</u>	<u>-200</u>	<u>211</u> 1/	<u>200</u>	<u>215</u>
Monetary movements	<u>819</u>	<u>-368</u>	<u>200</u>	<u>-211</u> 1/	<u>-200</u>	<u>-215</u>
Commercial banks (net)	<u>682</u>	<u>62</u>	<u>--</u>	<u>-469</u>	<u>--</u>	<u>--</u>
Monetary authorities	137	-430	200	258 1/	-200	-215
Fund resources	175	-114	130	226 2/	-100	-15
Gross official reserves	-38	-316	70	32 1/	-100	-200
Memorandum items:						
Gross official reserves	3,000	2,700	2,600	2,700 1/	2,800	3,000
(Months of imports)	(3.5)	(3.2)	(2.9)	(3.5)	(3.6)	(3.6)

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

1/ Excludes \$300 million borrowed by the Government in late 1985 to be used for refinancing in the first half of 1986.

2/ This figure includes the valuation adjustment in the amount of \$102 million arising from the depreciation of the dollar against the SDR.

loans. Private inflows, however, were lower than projected, owing to the slower growth of private sector activity. The overall payments position showed a surplus of \$200 million. More than twice this amount was absorbed by a reduction in net foreign liabilities of commercial banks, providing a welcome improvement in their external position. With net use of Fund resources of over \$100 million, and an increase in the value of outstanding Fund resources of about \$100 million arising from the depreciation of the U.S. dollar against the SDR, gross official reserves remained unchanged at \$2.7 billion. Owing to the drop in import payments, the import cover of reserves rose to 3 1/2 months. External debt rose by 11 percent, somewhat more than programmed in dollar terms owing to valuation changes of non-dollar denominated debt. The debt service ratio increased to 27 1/2 percent, reflecting both a bunching of repayments and the weakness of exports (Table 5).

The adverse external developments took a far greater toll on the attainment of domestic objectives. Given the leading role of exports in the economy, the weakness of export receipts depressed incomes and business sentiments so that private domestic demand stagnated; private consumption growth was down somewhat from 1984, and private investment plunged by more than 10 percent (Table 6). Thus, while growth in the agricultural sector remained strong, that in the nonagricultural sector, which is highly sensitive to both domestic and external demand, slumped. Consequently, real GDP growth slowed to 4 percent; although not unduly weak by international standards, this was as low a rate as any recorded in Thailand during the past two decades. Moreover, growth decelerated markedly during the year and has remained weak in the first half of 1986; rough estimates suggest that the rate of growth during the past 12 months has been significantly below 4 percent. Price performance, however, has been better than expected; consumer prices rose by about 2 percent, less than half the original estimate. Not only was inflation in trading partners lower than originally forecast, but also the sluggishness of domestic demand limited the extent to which the devaluation was passed through to domestic prices.

3. Policies during 1985

All the performance criteria relating to domestic credit, net credit to the Government, new external public debt commitments, and net foreign assets of the banking system were met through September. Both exchange rate and interest policies were also effectively conducted to help meet the program's objectives. However, there were serious slippages in meeting the fiscal targets of the program.

The deficit of the central government rose to 5 percent of GDP in 1984/85, compared with a program target of 3 percent of GDP (Table 7). The Government financed most of the overrun in the deficit by issuing bonds to the nonbank sector and by foreign borrowing; therefore, bank credit to the Government remained within the program ceilings throughout

Table 5. Thailand: External Debt, 1983-87

	1983	1984	1985 Est.	1986 Projections	1987
(In billions of U.S. dollars)					
Medium- and long-term debt	10.8	11.9	14.1 <u>1/</u>	15.1	16.3
Of which: Use of Fund credit <u>2/</u>	(1.0)	(0.9)	(1.1)	(1.0)	(1.0)
Short-term	3.2	3.7	3.2	3.4	3.4
Total external debt (end of period)	14.0	15.6	17.3 <u>1/</u>	18.5	19.7
Public debt (medium- and long-term, excluding IMF)	6.9	7.4	9.4 <u>1/</u>	10.2	10.9
Debt service payments					
Principal on medium- and long-term debt	1.1	1.3	1.5	1.6	1.5
Interest including on short-term debt	1.0	1.2	1.2	1.3	1.4
Total debt service	2.1	2.5	2.7	2.9	2.9
In percent of exports of goods and nonfactor services	23.2	24.0	27.4	27.0	24.8
(In percent)					
Growth rate of external debt	13.9	11.8	11.1	7.0	6.6
External debt (in percent of exports of goods and services)	155.0	153.2	172.4	173.3	169.3
Share of short-term debt in total debt	22.8	23.8	18.5	18.5	17.4
Gross international reserves/ short-term debt	78.1	72.7	84.3 <u>1/</u>	81.7	87.4

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

1/ External debt and gross international reserves exclude the \$300 million borrowed in late 1985 to be used for refinancing in the first half of 1986.

2/ Including Trust Fund loans.

Table 6. Thailand: Aggregate Demand and Supply
at 1972 Prices, 1983-86

(Annual percentage changes)

	1983	1984	1985 Est.	1986 Proj.
Private consumption	8.3	5.4	3.3	4.9
Private gross fixed investment	12.7	8.0	-10.3	5.6
Stockbuilding <u>1/</u>	0.8	-0.7	-0.4	0.7
Private domestic demand	10.2	4.9	0.3	6.0
Public expenditures	3.7	2.4	7.8	-2.0
Government consumption	2.2	0.7	1.3	-1.8
Public investment	6.7	5.5	10.8	-2.5
Domestic demand	8.8	5.0	1.2	4.4
Foreign balance <u>1/</u>	-5.6	3.5	2.2	0.3
Exports of goods and services	-4.5	18.0	4.3	5.1
Imports of goods and services	26.0	2.8	-5.6	5.2
Gross domestic product	5.8	6.0	4.1	4.3
Agriculture	3.7	4.1	3.8	2.3
Nonagriculture	6.5	6.6	4.2	4.9
Manufacturing	7.4	6.8	2.5	5.7

Source: Data provided by the Thai authorities.

1/ Percentage contribution to growth.

Table 7. Thailand: Central Government Position,
1982/83-1986/87

Fiscal Year	1982/83	1983/84	1984/85		1985/86 Proj. 1/	1986/87 Proj. 2/
			Program	Actual		

(In billions of baht)						
Expenditure and net lending	177.4	189.2	210.5	219.3	227.7	232.4
Expenditure	176.6	190.2	208.1	213.8	222.6	228.4
Interest payments 3/	22.2	24.8	32.2	30.7	36.0	40.7
Revenue and grants	139.4	152.3	175.5	165.4	174.5	190.4
Tax revenues	123.4	134.7	154.9	143.0	152.9	167.5
Deficit (-)	-38.1	-37.0	-35.0	-53.9	-53.2	-42.0
Financing (net)						
External	8.6	4.9	10.8	18.7	7.7	7.7
Domestic	29.5	32.1	24.2	35.2	45.5	34.3
Banking system	13.5	21.8	13.8	2.5	30.3	...
Nonbank sector	16.0	10.3	10.4	32.7	15.2	...

(As a percentage of calendar year GDP)						
Expenditure and net lending	19.2	19.2	18.7	20.9	20.1	19.0
Expenditure	19.1	19.3	18.5	20.3	19.7	18.7
Interest payments	2.4	2.5	2.9	2.9	3.2	3.3
Revenue and grants	15.1	15.5	15.6	15.7	15.4	15.6
Tax revenues	13.3	13.7	13.7	13.6	13.5	13.7
Deficit (-)	-4.1	-3.8	-3.1	-5.1	-4.7	-3.4
Memorandum item:						
Fiscal impulse	-2.2	-0.2	-0.9	0.7	-0.7	-1.5

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

1/ Estimates assume the tax and expenditure measures discussed in the text.

2/ Based on present budgetary estimates.

3/ Excludes interest payments made on behalf of nonfinancial public enterprises.

1985. ^{1/} In part, the overrun in the deficit resulted from weaker-than-expected economic growth and lower-than-expected inflation. Revenues and grants fell short of the program target in nominal terms, but, in terms of GDP, they still reached the target of about 15 1/2 percent of GDP. Expenditure and net lending, however, rose to the equivalent of nearly 21 percent of GDP, exceeding the program target by over 2 percentage points. Several factors were involved. First, the original budgetary allocations were based on a projected growth of nominal GDP of about 14 percent, more than twice the actual growth rate; the slowdown in GDP growth (and its effects on revenue) did not become apparent early enough to allow offsetting adjustments to be made. Second, because, at the projected inflation rate, budgetary allocations were perceived to be quite tight, ministries made efforts to increase the rate of disbursement and resorted more heavily than in the past to savings carried over from previous budgets. Finally, there was a substantial increase in net lending to state enterprises, mainly involving an on-lending of external borrowing in order to improve the terms on which state enterprises borrowed; insofar as this lending supplanted borrowing that would otherwise have been undertaken directly by state enterprises and involved minimal subsidization, it did not affect the overall public sector deficit.

The financial position of state enterprises also deteriorated in 1984/85 (Table 8). Much of this deterioration was expected and caused by the drain of resources from the Oil Fund, ^{2/} which resulted from the delay in adjusting domestic petroleum prices after the devaluation. Some further deterioration occurred mainly because of larger-than-expected capital expenditures.

As the growth of economic activity decelerated during 1985, the Bank of Thailand attempted to maintain a neutral stance of monetary policy. This effort reflected a balancing of the need to maintain sufficiently tight credit conditions to encourage an adequate level of capital inflows against the Bank of Thailand's desire to help support economic activity through the availability of credit and lower interest rates. Accordingly, the Bank of Thailand largely refrained from intervention in the money market--its principle means of influencing short-term monetary conditions--and allowed market forces to determine money market rates and bank liquidity. In this setting, the weakening pace of economic activity was the predominant influence on the monetary aggregates. The growth of broad money decelerated from 20 percent in 1984 to 10 percent in 1985 (Table 9). The growth of domestic credit also fell

^{1/} The increase in bond purchases by nonbanks reflected a variety of factors, including efforts by finance companies to strengthen their portfolios, large purchases by individuals, and purchases by the Government Savings Bank (which is not in the monetary accounts).

^{2/} The Oil Fund is a public entity used for stabilizing short-term fluctuations in prices of petroleum products.

Table 8. Thailand: Consolidated Financial Position of the State
Enterprise Sector, 1982/83-1985/86 ^{1/}

	1982/83	1983/84	1984/85		1985/86
			Program	Actual	Proj.
(In billions of baht)					
Gross fixed capital expenditure	30.6	33.0	34.8	37.0	38.6
Retained income	16.1	27.1	17.6	17.4	24.1
Overall deficit (-)	-14.5	-5.9	-17.2	-19.6	-14.5
External financing (net)	14.0	9.5	13.0	10.7	10.6
Domestic financing	0.5	-3.6	4.2	8.9	3.9
Bank	-3.8	-3.7	-0.7	-2.6	1.1
Nonbank	3.2	0.9	4.9	7.0	-1.9
(As percent of calendar year GDP)					
Gross fixed capital expenditure	3.3	3.3	3.1	3.5	3.4
Retained income	1.7	2.7	1.6	1.7	2.1
(Excluding the Oil Fund)	(1.3)	(2.3)	(2.1)	(1.8)	(2.1)
Overall deficit (-)	-1.6	-0.6	-1.5	-1.9	-1.3
(Excluding the Oil Fund)	(-2.0)	(-1.0)	(-1.2)	(-1.7)	(-1.3)

Source: Data provided by the Thai authorities.

^{1/} Program targets are not identical to those included in the original program paper owing to changes in definitions arising from improvements in the conceptual framework underlying the consolidation of state enterprises' accounts. Accounts are on an accrual basis.

Table 9. Thailand: Monetary Survey, 1983-86

	1983 Dec.	1984 Dec.	1985 Dec.	1986 Proj.
			Prog. Actual	
(In billions of baht)				
Net foreign assets	16.5	28.3	22.8	32.7 <u>1/</u> 38.0
Net domestic assets	434.7	514.2	624.5	564.8 <u>1/</u> 652.0
Domestic credit	549.7	643.9	766.2	705.8 <u>1/</u> 806.0
Central government (net)	(135.3)	(154.4)	(165.5)	(164.9) <u>1/</u> (189.5)
Private sector	(414.4)	(489.5)	(600.7)	(540.9) (616.5)
Other items (net)	-115.0	-129.7	-141.7	-140.9 -154.0
Broad money	451.2	542.5	647.3	597.6 690.0
(Percentage change)				
Net domestic assets	33.6	18.3	21.5	9.8 15.4
Domestic credit	25.6	17.1	19.0	9.6 14.2
Central government (net)	(8.7)	(14.1)	(7.2)	(6.8) (14.9)
Private sector	(32.4)	(18.1)	(22.7)	(10.5) (14.0)
Broad money	24.0	20.2	19.3	10.2 15.5

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

1/ Adjusted to exclude \$300 million borrowed by the Government in late 1985 to be used for refinancing in the first half of 1986.

sharply; not only was private demand sluggish, but the growth of credit to the Government also declined as the bulk of the Government's financing requirement was provided by the nonbank sector.

The liquidity position of banks was strongly affected by capital flows that fluctuated considerably during the year in response to changes in domestic credit demand and exchange rate expectations. In the first quarter of the year, large capital outflows that were related to uncertainty about the operation of the new basket peg and the appreciation of the U.S. dollar led to a severe tightening of liquidity conditions and a sharp increase in money market interest rates. With the depreciation of the dollar during the middle of the year, net capital inflows resumed and money market interest rates fell sharply. It was during this period that banks took the opportunity presented by the easing of their liquidity positions and slackening credit demand to reduce their net foreign liabilities. Toward the end of the year, the accelerated depreciation of the dollar against other major currencies resulted in a considerable appreciation of the baht against the dollar; speculation that this movement would be reversed gave rise to strong capital outflows that were eventually stemmed by a 2 percent devaluation of the baht in early December and the concomitant announcement that the baht/dollar rate would be kept more stable.

In recent years, the stickiness of domestic interest rates has been a major concern of the Bank of Thailand. Interest rates charged to prime customers have borne a close relationship to foreign rates adjusted for exchange rate expectations. However, those charged to smaller borrowers with limited access to foreign markets remained in the range of 17-19 percent during 1982-84, despite a substantial reduction in inflation and in foreign interest rates. The Bank of Thailand refrained from adjusting interest rate ceilings and instead strengthened market mechanisms in the hope that banks themselves would initiate cuts. Nevertheless, oligopolistic banking practices, together with banks' reluctance to risk losing deposit shares, prevented them from initiating any interest rate adjustments. Consequently, in mid-1985, as banks' liquidity positions eased and loan demand faltered, the Bank of Thailand reduced the official discount rates by 1-1 1/2 percentage points and exerted considerable moral suasion in order to bring about a 1-2 percentage point reduction in lending and deposit rates without lowering ceiling rates. Pressures for an interest rate adjustment again intensified at the end of the year when difficulties of several large borrowers raised concerns about the soundness of the banking system, but market rigidities prevented a self-initiated decline in bank rates. Consequently, the Bank of Thailand lowered ceilings on deposit and lending rates on two occasions during the first quarter of 1986. Actual deposit rates were reduced by a total of 1 1/2 percentage points, while lending rates were cut by 1 1/2-4 percentage points. During the second

of the two occasions, lending rates for priority and nonpriority sectors were unified. 1/

The weakness of some sectors of the economy and the high level of interest rates have severely strained the financial system during the past year. In order to better position the authorities to deal with any problems, banking laws were amended in 1985. The amendments have strengthened the supervisory authority of the Bank of Thailand and have provided for the establishment of a fund with resources to be contributed by both the Bank of Thailand and banks to support institutions facing liquidity problems. 2/ Through a program started in 1984, the Government remains actively involved in managing and providing financial assistance to a group of ailing finance companies. In addition, the Government recently revoked licenses of five finance companies that had been under investigation for improper management, but lifted controls on two others that had also been under strict surveillance.

Exchange rate policy has been effective in maintaining appropriate incentives for exporters and restraining import demand. Following the 15 percent devaluation of the baht in November 1984, the effective value of the baht depreciated further in both nominal and real terms during 1985 (Chart 1). The adoption of the basket peg, however, resulted in some market uncertainty and a related increase in the forward discount on the baht. To help stabilize the foreign exchange market, the authorities raised the weight of the dollar in the basket in conjunction with a 2 percent devaluation in December 1985. Since October 1984, the effective exchange rate of the baht has depreciated by over 25 percent in both nominal and real terms.

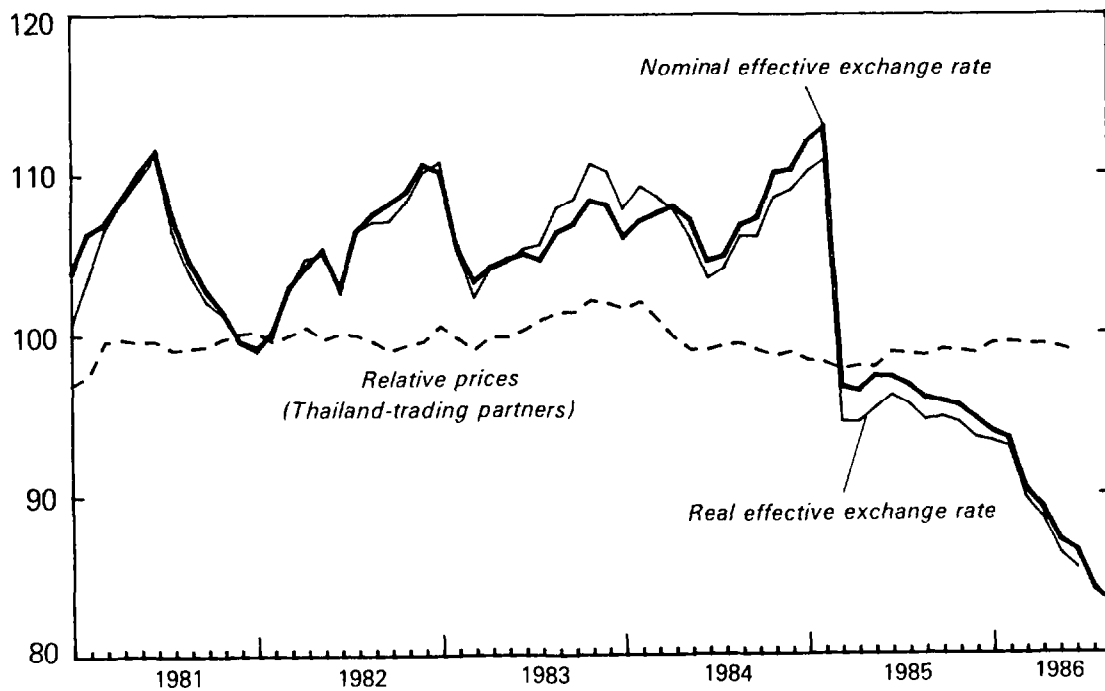
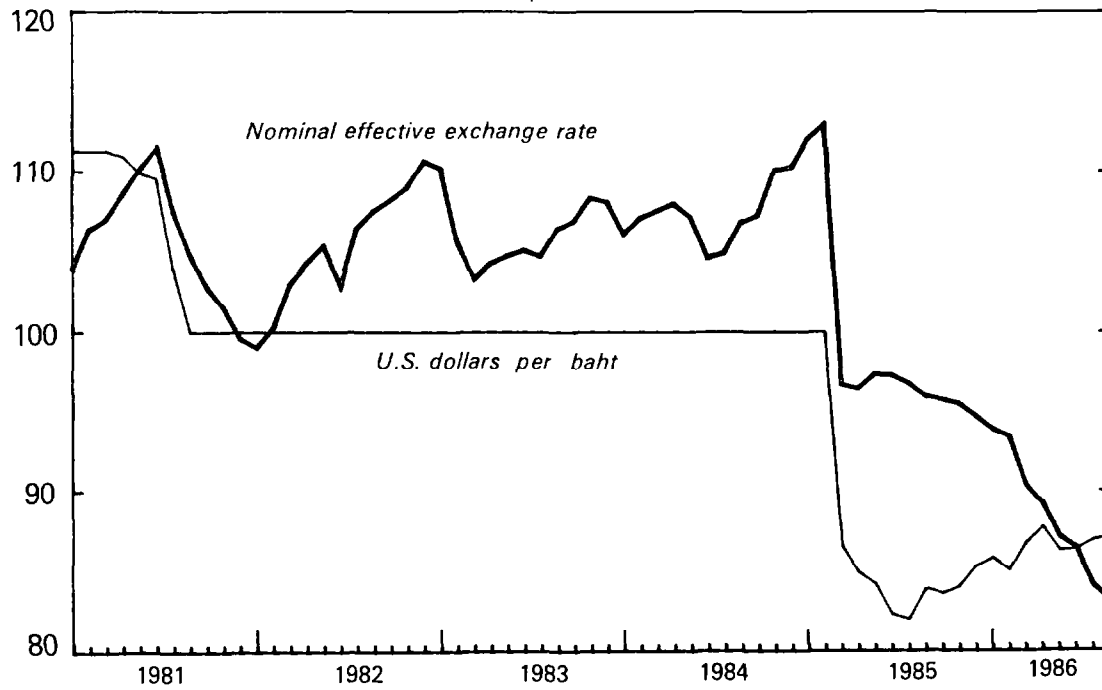
III. Policy Discussions and the Economic Program for 1986-87

The policy discussions focused on the strategy for reducing the fiscal deficit and on the appropriate pace of adjustment. The authorities believe that a reduction in the fiscal deficit is essential for achieving a sustainable current account position while making ample resources available for a rebound in private investment. They have stressed, however, that the pace of this adjustment must take due account of the state of the economy and the success to date in meeting the balance of payments objectives of the program. In this regard, the recent drop in oil prices together with somewhat more favorable prospects in export markets are likely to strengthen the growth of domestic

1/ The Bank of Thailand, however, maintained a facility for rediscounting bills of priority borrowers at below-market rates.

2/ So far, the Bank of Thailand has provided all the resources (B 1 billion) for this fund. The provision of these resources will affect the budget only indirectly through a reduction in the transfer of potential profits of the Bank of Thailand.

CHART 1
THAILAND
EXCHANGE RATE INDICES, 1981-86
(Q4, 1981=100)



Sources: IMF, IFS, and staff calculations.



activity, but mainly later in the year or in 1987. On the negative side, commodity prices are expected to remain low during 1986, and protectionist measures against some of Thailand's major export commodities have been intensified. Consequently, output growth appears to have remained weak during the first half of 1986 and is projected to strengthen only gradually during the second half; for the year as a whole, growth should be in the range of 4-4 1/2 percent. It is also expected that inflation will remain low and that external adjustment will proceed as envisaged in the original program.

Against this background, the authorities have proposed that the stand-by arrangement, which was originally scheduled to end in March 1987, be extended through December 1987. Under the proposed extension, the authorities would achieve a gradual reduction in the fiscal deficit without an undue sacrifice of economic growth. Specifically, given the present weakness of the economy, a small reduction in the deficit is planned for 1985/86, but a considerably larger adjustment is to take place in 1986/87 when growth is expected to pick up. Other policies will continue to be oriented toward supporting export growth and containing import demand.

1. Fiscal policy

The authorities are committed to containing the deficit of the central government to no more than B 53.2 billion in 1985/86--implying a reduction in the ratio of the deficit to GDP from 5.1 percent in 1984/85 to 4.7 percent in 1985/86. This reduction, which implies a negative fiscal impulse of over 1/2 percent of GDP, was considered to be consistent with an acceptable rate of growth. In view of the importance of achieving the fiscal target, a performance criterion on the overall deficit of the central government, which will be tested on an annual basis at the end of the fiscal year, has been introduced. The authorities have also established indicative quarterly targets for monitoring progress in reaching expenditure and revenue goals so that any slippages in budgetary performance can be observed and corrective actions can be taken in a timely fashion. The fiscal adjustment is to come about through strong efforts to restrain expenditure and through measures to increase revenues. More than half of the financing requirement is expected to be met by bank borrowing, an increase from the unusually low level in 1984/85.

On the basis of the full-year effect of measures put in place during 1985/86, the budget approved by the Cabinet for 1986/87 envisages a further reduction in the deficit to below 3 1/2 percent of GDP. The staff took the position that there should be an even stronger effort to reduce the fiscal deficit in 1986/87, particularly if the economic recovery gathers momentum more quickly than anticipated. The authorities accepted this view in principle, but pointed out the difficulty of undertaking more drastic actions when an election was expected within the next year. Nevertheless, they agreed to explore possibilities for

further improving the fiscal position in 1986/87, and, accordingly, the fiscal targets for the remainder of the program will be set at the time of the next review later this year. Furthermore, the authorities have decided to study the present structure of the tax system with a view to implementing a comprehensive tax reform before the end of the next fiscal year.

The budget for the current fiscal year was formulated to be restrictive. Noninterest outlays were budgeted to remain unchanged in real terms, while the nominal increase in total expenditure and net lending was limited to just over 5 percent. Nonetheless, in response to weaker-than-expected revenues during the first half of the fiscal year, budgetary allotments were cut, and planned net lending to state enterprises was reduced. Together, these measures will result in savings equivalent to 1 1/2 percent of total expenditure and net lending. Non-interest expenditure is projected to decline by about 1 percent in real terms. It is increasingly clear, however, that restraint of budgetary allotments can be effective in reducing cash outlays only if the Government is able to limit the potential for an offsetting acceleration in the rate of disbursements from current budgetary allocations or from unspent allocations from previous budgets. An important part of the program, therefore, is the Government's commitment to strengthening expenditure control by moderating the pace of disbursements on capital projects, limiting shifts of allocated expenditures across line items, and cutting back on the amount of savings from previous budgets available for use in the current fiscal year. In addition, the authorities are working, with technical assistance from the Fund, on methods to improve expenditure monitoring. The combination of the budgetary cutbacks and enhanced expenditure control is expected to reduce the ratio of expenditure and net lending to GDP from 21 percent in 1984/85 to 20 percent in 1985/86. A further cutback at least to 19 percent is envisaged for 1986/87.

Revenues during 1985/86 continue to be affected by the weakness of the economy, particularly in the nonagricultural sector. Owing to the prevalence of corporate losses and the low level of imports, the ratio of revenues to GDP is expected to decline slightly. In January, the Government introduced a comprehensive tax package designed principally to enhance the efficiency of the tax system, but also to generate a small amount of additional revenue. The package included an increase in the withholding tax on interest income in order to align it more closely with tax rates on other income, an increase in tax rates on sales of property, and a reduction in personal and corporate income tax rates. A tax amnesty was also offered to discourage tax evasion and enhance the efficiency of tax administration in the future. A particularly important element of the package was an increase in the ceilings on petroleum product excise taxes. With the recent decline in oil prices, which is expected to result in substantial savings on energy expenditure, there

is now additional scope for raising revenues. ^{1/} The authorities plan to retain about half of these savings for budgetary purposes. Specific taxes on petroleum products have been raised (effective April 29) to generate additional revenues of B 6 billion on an annual basis (1/2 percent of GDP). Moreover, the downward adjustment of energy prices will be limited in order to replenish the resources of the Oil Fund--which is included in the public sector accounts. The authorities have indicated that they will be flexible in determining the use of Oil Fund resources and that part of these resources could be transferred to the central government in the event that revenues fall short of targets.

The low elasticity of the tax system has been a problem in recent years and now poses a serious constraint to fiscal adjustment. New tax packages have had to be implemented almost every year to maintain the ratio of revenues to GDP. The Government is committed to raising the overall elasticity through a rationalization of the structure and administration of the tax system. To this end, the Government will undertake, with assistance from the Fund, a comprehensive study of the tax system, with particular focus on direct taxes. On the basis of this study, a package of measures is expected to be implemented in 1986/87.

2. State enterprise sector policies ^{2/}

As in recent years, the focus of efforts to strengthen the financial position of the state enterprises will be to raise operating profits and contain investments of a few key enterprises that have either experienced large losses or a significant weakening in their financial position. To this end, a long-standing government directive to increase telephone rates was implemented in March 1986. This, together with a rephasing of the investment program and increased use of private companies to complete line connections, is expected to reverse the recent slippage in the financial position of the Telephone Organization of Thailand. Also in the utilities sector, a phased increase in water rates that was recently completed has eliminated the losses previously sustained by the Provincial and Metropolitan Water Authorities.

There remains a need for measures to strengthen the financial position of some other enterprises. In particular, although enterprises in the electricity sector continue to show profits, their financial position has weakened in recent years; the recent decline in world oil prices has reduced operating costs in this sector and provided an opportunity to improve profits by limiting tariff reductions. The transportation sector continues to be afflicted by serious financial

^{1/} Every \$5.00 decline in international oil prices reduces expenditures on oil and oil products by about 1 percent of GDP.

^{2/} Specific measures affecting state enterprises are described in more detail in the accompanying paper on recent economic developments.

weaknesses and measures for addressing these problems are now under consideration. Specifically, despite an increase in bus fares in 1985, a large new investment program for the Bangkok Metropolitan Transport Authority (BMTA) has been postponed indefinitely until fares can be raised sufficiently to allow BMTA to contribute to the costs of the new investment. A railway fare increase to supplement that implemented in late 1985 is also under consideration. More generally, the Government is reviewing options for privatizing selected state enterprises. A number of small enterprises were sold to the private sector during the past year, and plans are being formulated for further sales and more extensive involvement of private companies in public sector activities.

The Government's capacity to monitor and control external borrowing through the National Debt Policy Committee and the State Enterprise Committee has been significantly strengthened during the past year. Conditions that must be met for state enterprises to be granted permission to borrow abroad for investment purposes have been standardized and borrowing ceilings have been closely adhered to. The resulting constraint on external borrowing has contributed importantly to containing state enterprise investment at about 3 1/2 percent of GDP.

The authorities have also introduced policies to prevent the accumulation of arrears of state enterprises to other state enterprises and to the Government. It is estimated that such arrears amounted to about 1/2 percent of GDP at the end of 1984/85. State enterprises have been instructed to develop plans for clearing these arrears, and certain government lending to enterprises has been earmarked for the repayment of arrears.

An important component of public sector investment during the remainder of the program period is the proposed Eastern Seaboard Development Program--a large-scale investment program for developing infrastructure and major industrial projects along the Gulf of Thailand. Despite a considerable scaling down and rephasing of original plans, the program remains the subject of heated controversy, and implementation has been delayed pending further study and additional financial support. The Government has now decided to proceed with the construction of a fertilizer plant, the financing for which has been partly provided by the International Finance Corporation. The construction of a port designed to service the fertilizer plant is still under study. The staff echoed concerns recently raised by the World Bank about the economic viability of this port. The authorities indicated that further progress on the port or any of the other infrastructure projects in the program will be contingent on clear evidence of their economic viability. In assessing the public investment program, the Government will continue to rely on assistance from the World Bank. 1/

1/ Information on Thailand's relations with the World Bank is provided in Annex II.

The overall position of the state enterprise sector will benefit from a reversal in Oil Fund outflows as a result of the drop in world oil prices. Together with the measures outlined above, this should result in a reduction in the overall deficit of the state enterprise sector from 2 percent of GDP in 1984/85 to just over 1 percent in 1985/86 and 1986/87.

3. Monetary policy

Monetary policy in 1986 aims to accommodate the expected pickup in credit demand, while ensuring that capital inflows are sufficient to finance the current account deficit. The growth of net domestic credit is expected to accelerate from about 10 percent in 1985, but it will be limited to below 14.2 percent (a performance criterion). With inflation expected to remain in the range of 2-3 percent, real credit growth should increase commensurately. Moreover, in order to ensure adequate credit to the private sector, the increase in net credit to the central government from the banking system (a performance criterion) will be limited to less than 25 percent of projected total credit expansion. The implied growth of credit to the private sector is 14 percent, compared with a growth of 10 1/2 percent in 1985.

The planned growth of credit for 1986 is consistent with the projected increase in broad money and a small increase in net foreign assets of the banking system. In recent years there has been a strong downward trend in the income velocity of money associated with the shift of financial assets into the banking system and the relatively rapid growth of the nonagricultural sector, which is the more monetized sector of the economy. Between 1980 and 1984, velocity declined at an average rate of over 8 percent per annum. During 1985, the decline in velocity slowed to 3 percent largely owing to the substantial slowdown in the growth of the nonagricultural sector. With the rebound in nonagricultural growth projected for 1986, velocity is expected to drop by almost 7 percent--more than in 1985 but still less than the trend decline during the previous few years. Consequently, with some acceleration in GDP growth and an unchanged rate of inflation, the growth of broad money in 1986 is expected to pick up to about 15 1/2 percent--13 percent in real terms. Credit policy has been formulated on the basis of this projection and the objective of ensuring a small overall payments surplus. The authorities recognize the uncertainties in these projections and will restrain credit expansion if the external objectives of the program are threatened by weaker-than-expected money demand. Net foreign assets of the banking system are targeted to increase by \$0.2 billion during 1986 (a performance criterion).

In the authorities' view, the decline in interest rates on both bank deposits and lending during the early part of 1986 has re-established an appropriate relationship between domestic and foreign interest rates and helped alleviate strains on the financial system. The authorities point to the more than 5 percentage point decline in

money market rates during the first quarter as further support for the appropriateness of the adjustments in ceiling rates. Nevertheless, they would like to see banks play a more active role in determining interest rates and will continue to explore means of enhancing the competitiveness and efficiency of the banking system with a view to reducing reliance on interest rate ceilings. In the meantime, the Government is mindful of the need to respond flexibly to any increase in foreign interest rates and to maintain interest rates at a level adequate to promote savings mobilization and the efficient allocation of financial resources.

4. External policies

The authorities remain committed to a flexible exchange rate policy aimed at providing adequate incentives for exports and containing the growth of imports. The more stable relationship of the baht with the U.S. dollar since late 1985 has been effective in preventing speculative capital outflows and, with the weakening trend of the dollar, in improving external competitiveness. The authorities realize that the new arrangement carries the danger of undermining competitiveness in the event of a reversal in trends in exchange rates between major currencies. If faced with such an event, they are prepared to act flexibly in order to ensure the achievement of external objectives.

In managing the external debt, the authorities are aware that Thailand's moderate recourse to commercial borrowing is an important factor contributing to its good credit standing in the international capital market. With the planned reduction in the public sector financing requirement, net external public borrowings are expected to decline from \$1.1 billion in 1985 to \$0.8 billion in each of the following two years. The ceiling on new commitments of public or publicly-guaranteed debt for maturities of one year or more has been set at \$1.2 billion for the current fiscal year and at \$0.7 billion for the first five months of 1986/87 (performance criteria). Because the maturity structure of public debt is not a problem, no subceiling on shorter-term maturities has been set. 1/ A large portion (\$0.5 billion) of total borrowings planned for 1985/86 was undertaken during the first three months of the fiscal year (October-December) because the Government took advantage of the availability of external funds on attractive terms; as a result, the external debt ceiling for end-1985 was exceeded. The growth of external debt is expected to decelerate sharply during the remainder of 1985/86.

1/ Out of total public external debt of \$9.4 billion at end-1985, borrowings with maturities of less than one year amounted to only \$0.1 billion; there were no borrowings with maturities of one to five years in 1985.

5. Structural policies

In line with the Government's efforts to strengthen export performance, the major emphasis of structural policies will continue to be improving incentives and efficiency in the export sector. These objectives have taken on added importance because of strains within some sectors caused by a sharp drop in commodity prices during the past year. In early 1986, a brief essay at a costly rice price support scheme was abandoned, and the Government implemented major reforms aimed at liberalizing conditions for rice exports; the premium on rice exports was removed and required stockholdings by exporters were virtually eliminated. These policy changes were long-standing recommendations of the World Bank. In the rubber sector, the premium on exports was cut in late 1985 in an effort to cushion the impact of falling rubber prices. Similarly, to combat the damaging effects of the slide in tin prices, the royalty on tin exports was cut. In other areas, measures are being carried out to promote the diversification of crops, in particular from tapioca and sugarcane to other cash crops with greater export potential. The Government has also taken steps to defuse problems related to debt service payments on borrowings in 1982 for a sugar price support scheme. Agricultural policies during 1986-87 will continue to rely primarily on market mechanisms for increasing production and improving the allocation of resources.

In a recent assessment of trade policy in Thailand, the World Bank concluded that the tariff structure continues to impose an undesirably high degree of protection. This has reduced both the efficiency of resource utilization and the effectiveness with which exporters can compete in world markets. Although there have been efforts to improve the tariff structure in recent years, revenue considerations have blocked any real gains in efficiency. Nevertheless, some progress has been made in reducing the effective rate of protection for the manufacturing sector (excluding agrobusiness) and, in particular, for the textile sector.

Price and wage policies are also keyed to market conditions. The price controls put in place immediately after the 1984 devaluation have been dismantled; long-standing price controls on only a few key products remain in effect. The Government remains committed to a restrained wage policy in order to both improve the competitiveness of domestic industry and deal with the increasingly serious unemployment problem. In view of the considerable slack in the labor market at present and the low rate of inflation, no general wage or salary increase is planned for 1986/87, and minimum wages will not be raised during 1986.

In the area of energy policy, the Government will continue to encourage domestic production and conservation. Domestic production of natural gas, gas condensate, crude oil, and lignite is expected to rise considerably during 1986. The Government will continue to grant incentives for investments that reduce pollution and conserve energy. A

substantial share of the savings from the recent decline in petroleum prices will go toward raising revenues of the central government and replenishing the Oil Fund. Remaining savings (less than half) will be passed on to the private sector through lower prices; prices of regular gasoline and kerosene were already reduced in February. One objective in price reductions is to restructure relative fuel prices so as to more closely align them with border prices and eliminate price distortions that have given rise to excessive diesel consumption.

IV. The Economic Outlook

1. Short-term prospects

The external setting is expected to improve during the remainder of the program period, although the effects of this improvement will probably only be felt late in 1986 and during 1987. Present world economic outlook forecasts indicate that the growth of Thailand's export markets should accelerate from about 3 percent in 1985 to almost 4 percent in 1986 and in 1987. Dollar interest rates are forecast to decline by 1 percentage point in 1986 and remain unchanged in 1987. Export unit values (in dollar terms) are projected to strengthen only slightly during 1986, but to rise by nearly 5 percent in 1987. The outlook for oil prices is, of course, subject to unusual uncertainty both because of external factors and questions about the extent to which contractual obligations will retard the transmittal of world oil price reductions to domestic prices; for the program forecasts it is assumed that the average world oil price will be \$18 per barrel in 1986 and \$17 per barrel in 1987. ^{1/} Finally, on the negative side, protectionism against Thai exports, particularly rice, textiles, tapioca, and certain less important manufactured products has been intensified in recent months and will affect export performance during the remainder of the program period.

In this setting, GDP growth should accelerate gradually, rising to about 4 1/2 percent in 1986 and 5 percent in 1987 (Table 10). The rebound in growth is expected to be fueled mainly by private demand--particularly private fixed investment, which after falling by 10 percent in 1985, is forecast to rise by 5 percent in 1986 and 8 percent in 1987. The implied increase in the share of private investment in GDP during the period should be matched by an increase in the share of private sector savings that is assumed to follow a projected 8 percent improvement in the terms of trade. The planned reduction in the ratio of the overall public sector deficit to GDP of about 1 percentage point in each year would therefore be consistent with a drop in the ratio of the current account deficit to GDP to 3 percent in 1986 and 2 1/2 percent in 1987.

^{1/} The average c.i.f. price Thailand pays for oil is about \$2 per barrel higher than the average world oil price.

Table 10. Thailand: Medium-Term Scenario, 1985-91

	1985	1986	1987	1988	1989	1990	1991
(In billions of U.S. dollars)							
Balance of payments							
Exports, f.o.b.	7.1	7.6	8.3	9.4	10.7	12.1	13.7
Imports, c.i.f.	-9.3	-9.5	-10.1	-11.1	-12.2	-13.4	-14.8
Current account	-1.5	-1.2	-1.1	-1.0	-0.9	-0.8	-0.7
(As percent of GDP)	(-3.8)	(-2.8)	(-2.4)	(-1.9)	(-1.6)	(-1.3)	(-0.9)
Capital account (net)	1.5	1.4	1.3	1.3	1.3	1.2	1.0
Gross external reserves	2.7	2.8	3.0	3.1	3.4	3.6	3.8
(In months of imports)	(3.5)	(3.6)	(3.6)	(3.4)	(3.3)	(3.2)	(3.1)
Debt profile							
External debt outstanding	17.3	18.5	19.7	20.8	21.7	22.5	23.1
(As percent of exports)	(172.4)	(173.3)	(169.3)	(159.2)	(149.1)	(138.1)	(126.8)
Debt service	2.7	2.9	2.9	3.0	3.5	3.7	4.0
Of which: debt service to IMF	(0.3)	(0.4)	(0.3)	(0.2)	(0.2)	(0.2)	(0.1)
Interest payments	1.2	1.3	1.4	1.5	1.6	1.6	1.7
Amortization payments	1.5	1.6	1.5	1.5	1.9	2.1	2.3
Debt service ratio (as percent of exports of goods and nonfactor services)	27.4	27.0	24.8	23.2	23.8	23.0	22.0
(Change in percent)							
Memorandum items:							
Real GDP	4.1	4.3	5.0	5.3	5.5	5.7	6.0
Export unit values (In U.S. dollar terms)	-7.9	1.6	4.2	5.3	5.3	5.3	5.3
Import unit values (In U.S. dollar terms)	-3.9	-3.8	1.4	4.8	4.8	4.8	4.8
Export market growth	3.3	3.6	3.6	5.5	5.5	5.5	5.5
Export volume	4.9	5.4	5.5	7.5	7.5	7.5	7.5
Import volume	-5.4	5.5	4.8	5.2	5.3	5.0	5.0
LIBOR (six-month rate in percent)	8.6	7.6	7.5	8.0	8.0	8.0	8.0
GDP deflator	2.5	3.3	3.3	4.8	4.8	4.8	4.8
(Percent of GDP)							
Gross domestic investment	21.2	21.5	21.8	22.0	22.0	22.0	22.0
Gross national savings	17.4	18.7	19.4	20.1	20.4	20.7	21.1

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

In 1986, the volume of merchandise exports is projected to continue to grow by about 5 percent. It is assumed that the small pickup in export market growth and lagged effects of the real depreciation of the baht should be largely offset by the impact of low commodity prices and increased protectionism abroad. There should be a rebound in the volume of merchandise imports reflecting the expected pickup in domestic demand and a diminution in the effects of the depreciation of the baht during 1985. With the projected improvement in the terms of trade and an unchanged position on the service and transfer account, the current account deficit should narrow from \$1.5 billion in 1985 to \$1.2 billion in 1986.

The openness of Thailand's financial markets and the volatility of capital inflows make any projections of capital movements tenuous. With this caveat in mind, it is projected that net inflows of nonmonetary capital will remain at about \$1.5 billion in 1986. Within this total, net public sector inflows are expected to decline somewhat, while net private inflows should rise owing to increased credit demand associated with a pickup in activity. The overall payments position should show a surplus of about \$200 million. Of this, about \$100 million will go toward net repayments to the Fund. Gross official reserves would then rise by \$100 million to \$2.8 billion, equivalent to about 3 1/2 months of imports, which the authorities consider to be an adequate level.

In 1987, export volume is expected to continue to grow by about 5 percent, while import volume growth should level off also at 5 percent. With the further improvement in the terms of trade, the current account deficit should fall to \$1.1 billion. Net capital inflows of about \$1.3 billion would leave the overall surplus at \$200 million, implying a further increase in gross official reserves to \$3 billion, equivalent to about 3 1/2 months of imports.

The projected improvement in the current account will permit a slowdown in the growth of external debt from about 11 percent in 1985 to 7 percent per annum during 1986-87 (Table 11). Consequently, the ratio of external debt to exports of goods and services will level off at about 170 percent. The debt service ratio should fall gradually from 27 1/2 percent in 1985 to 25 percent in 1987. Aside from a projected increase in short-term debt of \$0.2 billion in 1986, all of the new debt is in the medium- and long-term category. Consequently, the share of short-term debt in total is expected to fall from 19 percent in 1985 to 18 percent in 1986 and 17 percent in 1987.

2. Medium-term prospects

The staff has developed medium-term projections of the balance of payments for the period through 1991 (Tables 10 and 11). These projections, which are subject to the usual caveats, are broadly in line with those made by the Bank of Thailand. The underlying external assumptions are consistent with the world economic outlook exercise. On the

Table 11. Thailand: External Debt, 1985-91

	1985	1986	1987	1988	1989	1990	1991
(In billions of U.S. dollars)							
Total outstanding debt (disbursed)	17.3	18.5	19.7	20.8	21.7	22.5	23.1
Medium- and long-term	14.1	15.1	16.3	17.4	18.3	19.1	19.7
Public sector	10.5	11.2	11.9	12.5	12.8	12.9	12.9
Of which: IMF	(1.1)	(1.0)	(1.0)	(0.8)	(0.6)	(0.4)	(0.3)
Private sector	3.6	3.9	4.4	4.9	5.5	6.2	6.8
Short-term debt	3.2	3.4	3.4	3.4	3.4	3.4	3.4
Debt service payments <u>1/</u>	2.7	2.9	2.9	3.0	3.5	3.8	4.0
Repayment to IMF <u>2/</u>	0.2	0.3	0.2	0.2	0.2	0.2	0.1
(In percent)							
Growth rate of external debt	11.1	7.0	6.6	5.1	4.7	3.6	2.7
Debt service ratio <u>1/</u> <u>3/</u>	27.4	27.0	24.8	23.2	23.8	23.0	22.0
Debt outstanding as percent of exports of goods and nonfactor services	172.4	173.3	169.3	159.2	149.1	138.1	126.8

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

1/ Including interest on short-term debt.

2/ Including Trust Fund.

3/ In percent of exports of goods and nonfactor services.

domestic side, it is assumed that real GDP growth will rise gradually from 5 percent in 1987 to 6 percent in 1991; inflation is assumed to accelerate with higher foreign inflation, but to remain below 5 percent. With a projected pickup in market growth, a continuation of the past tendency for Thailand to gain market shares, and the maintenance of adequate incentives for exports, the growth in export volume is projected to increase to 7 1/2 percent a year. Such growth would more than offset a growth in import volume of about 5 percent. Under these assumptions, the current account would decline gradually from about 2 1/2 percent of GDP in 1987 to below 1 percent in 1991. Correspondingly, the growth of external debt would decelerate and the associated debt service ratio would fall to 22 percent in 1991. Gross international reserves are targeted to rise gradually, but the import cover would fall to three months.

The staff has also examined the sensitivity of these projections to a deterioration in external conditions. Specifically, the projections are redone under the assumptions that international interest rates are higher than in the baseline case by 1 percentage point, export volume growth is slower by 1 percentage point per annum, and international oil prices rise faster, by \$1 per barrel each year. The projections are done under two different policy scenarios. In the first, it is assumed that policies are designed to contain domestic demand and import growth so as to maintain the current account at the level in the baseline projections; the effect of the worse external conditions is felt entirely on the growth of economic activity. In the second, it is assumed that policies are designed to support domestic demand so as to maintain growth at the rate in the baseline projections; the effect of the worse external conditions is then channeled entirely into the outcome of the external accounts.

Taken individually, none of the changes in the assumptions has a severe effect on either growth or the external position. In the first policy setting, growth would weaken by less than 1 percentage point in each case. In the second policy setting, the ratio of the current account deficit to GDP would rise by less than 1 percentage point in each case. Also, the debt service ratio and the ratio of debt to exports would rise by less than 2 percentage points. However, the changes in assumptions taken together would have a severe effect on the economy. Specifically, in the first policy setting, growth would weaken to about 4 percent on average for the period 1987-91, compared with 5 1/2 percent in the baseline projection. In the second policy setting, by 1991, the current account as a proportion of GDP would be almost 2 percentage points higher compared with the baseline scenario, while the debt service ratio would be 3 percentage points higher, and debt as a proportion of exports 4 percentage points higher. The projections therefore underscore the downside risks in the medium-term projections and the necessity of continued strong adjustment policies.

V. Performance Criteria and the Phasing of Purchases

As amended, the arrangement will continue to include the following performance criteria: quarterly ceilings on domestic credit of the banking system, including subceilings on net credit to the central government; quarterly floors on net foreign assets of the banking system; a continuous ceiling on new commitments of public and publicly guaranteed external debt with maturities of one year and over; and the customary injunction regarding exchange and trade restrictions. In addition, the program contains a new performance criterion on the central government deficit for the fiscal year 1985/86 and two reviews with the Fund, to be completed prior to February 28, 1987 and July 31, 1987. Quantitative performance criteria will be set for the period through February 1987 at the time of completion of the present review (Table 12 and Table 1 in the Attachment). Performance criteria for the remaining period of the stand-by arrangement will be set at the time of the next review. In the course of the reviews, the staff will also discuss the progress made in achieving the program objectives.

Under the proposed extension of the arrangement, the remaining purchases of SDR 250 million will be phased in seven purchases. Five of the purchases, including the purchase scheduled to be made upon the completion of the present review, will be in the amount of SDR 30 million. The two purchases scheduled to be made on the basis of the observance of the performance criteria tested on September 30 of each year, which include the ceiling on the fiscal deficit, will be in the amount of SDR 50 million. Purchases after the first will be available every three months starting in September 1986 conditional on observance of the corresponding performance criteria; in addition, the March 1987 and September 1987 purchases will be conditional on the completion of the respective reviews. Total purchases will not exceed SDR 260 million (67.3 percent of quota) until the second review has been completed and will not exceed SDR 350 million (90.5 percent of quota) until the third review has been completed.

VI. Staff Appraisal

During the past year, the Thai economy suffered from an unusually severe deterioration in external conditions that weakened domestic growth and hampered the adjustment effort. The weakness of exports quickly depressed domestic demand, private investment plunged, and GDP growth fell substantially short of projections. The external targets of the program, however, were broadly met--testimony not only to the extent of the slowdown in the domestic economy, but also to the effectiveness of adjustment policies in supporting export growth, containing import demand, and attracting capital inflows. In the fiscal area, however, policy performance fell substantially short of program targets. Although the widening of the budget deficit provided support to the economy, particularly in the latter half of the year when the private

Table 12. Thailand: Quantitative Performance Criteria, 1985-87

	<u>Ceiling on Domestic credit</u>	<u>Ceiling on Net Credit to the Central Govt.</u>	<u>Floor on Net Foreign Assets</u>
	<u>(End of month; in billions of baht)</u>		
1985			
December	705.8	164.9	32.7
1986			
June	762.0	180.0	41.0
July	769.0	180.0	38.0
August	772.0	180.0	38.0
September	775.0	180.0	38.0
October	786.0	185.0	38.0
November	795.0	187.0	38.0
December	806.0	189.5	38.0
1987			
January	818.0	193.0	36.0
February	828.0	195.0	36.0

Ceilings on New Commitments of Public External Debt 1/

(In billions of U.S. dollars)

1985/86	1.2
October 1986- February 1987	0.7

Ceilings on Overall Deficit of the Central Government

(In billions of baht)

1985/86	53.2
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Sources: Data provided by the Thai authorities; and staff estimates.

1/ Public and publicly guaranteed debt with maturities of over one year.

sector was weak, it was a significant setback to attaining the program's fiscal objectives.

Determined efforts to improve the fiscal position are clearly needed in order to free resources for a strong revival of private investment while maintaining progress toward a sustainable external position. The pace of fiscal adjustment, however, should take account of the need to avoid undermining the incipient recovery of the economy. The favorable turn in external conditions in recent months should provide a fillip to domestic activity. In particular, the somewhat brighter outlook for export market growth as well as the impact of the oil price reduction on input costs and the profitability of industry should help revive private investment. The expected improvement in the terms of trade should stimulate private consumption and at the same time also provide scope for an increase in the private savings ratio. Nevertheless, the effects of these changes are likely to be seen only during the latter half of 1986 and during 1987. In the meantime, the economy will continue to feel the repercussions of low commodity prices and stepped-up protectionism against Thai exports.

In this setting, the staff supports the authorities' plan to undertake only a small reduction in the fiscal deficit during 1985/86 with the understanding that a much larger reduction will be implemented in 1986/87 when the economy is better positioned for a significant withdrawal of fiscal stimulus. The recent reduction in oil prices provides scope for substantially raising revenues of the central government. The authorities' commitment to retaining for budgetary purposes a substantial share of the savings associated with the decline in international oil prices is an important element in reaching revenue targets. Further measures, including transfers from the Oil Fund, are likely to be necessary to realize revenue targets. The authorities have also taken first steps toward strengthening expenditure control procedures, which have in the past proved inadequate for achieving planned cutbacks in spending. An important step in the process of overall fiscal control has been the establishment of quarterly targets for fiscal developments, which should help identify slippages early enough to take corrective actions and ensure realization of the fiscal target.

The 1986/87 budget approved by the Cabinet envisages a reduction in the fiscal deficit by over 1 percentage point to below 3 1/2 percent of GDP. The staff notes this effort to narrow the fiscal imbalance but believes that an even stronger effort is called for. The authorities' commitment to explore possibilities for reducing the deficit to a level below current projections, particularly if the economic recovery is stronger than expected, should lay the groundwork for setting specific fiscal targets for 1986/87 during the next review of the program. A major impediment to fiscal adjustment has been the low elasticity of the tax system. The staff therefore welcomes the authorities' intention to

undertake a study of the tax system, with particular focus on the efficiency and administration of direct taxes, and urges them to act quickly upon the recommendations of the study.

Developments in the state enterprise sector have been mixed. On the positive side, several tariff increases, which were implemented during the past year, have substantially improved the outlook for a few particularly problem-prone enterprises in the utilities sector. In addition, the Government's ability to control investment by state enterprises has been significantly strengthened by recent improvements in procedures for monitoring and approving external borrowing by enterprises. As a result, the projection for only a small real increase in investment outlays for the current year appears realistic. On the negative side, there remain weaknesses in a few key enterprises, especially in the transportation sector, where fare increases beyond those implemented in 1985 are necessary. More generally, the authorities need to persist with efforts to consolidate responsibilities for overseeing operations of state enterprises and for reviewing their investment programs. A remaining source of concern in the area of public investment is the proposed Eastern Seaboard Development Program. The staff is of the view that the risks entailed in such a large investment program are heightened during this period of considerable resource constraints. The authorities would be well advised to delay progress in implementing the program pending clear evidence of the economic viability of its components, particularly the infrastructure projects.

Developments in the financial sector during the past year have also been consistent with external adjustment. Domestic credit growth was restrained, albeit mainly as a result of slack demand; the baht was allowed to depreciate in order to help strengthen the external position; and interest rates were maintained at a level that attracted adequate capital inflows and promoted savings mobilization. For 1986, the staff supports the authorities' intention to adapt credit policy to accommodate the expected pickup in credit demand. Nonetheless, monetary developments must be monitored closely to ensure that credit policy remains consistent with the external targets. The authorities' commitment to managing the exchange rate so as to maintain external competitiveness will also help ensure the attainment of external objectives. The recent decline in interest rates is warranted by lower expected inflation and the drop in foreign interest rates; it has also provided needed relief from strains that threatened the financial sector. The longer-term health of the financial sector, however, depends critically on the authorities' success in strengthening market mechanisms in the determination of interest rates. Therefore, the staff urges the authorities to persevere with their efforts to reduce reliance on interest rate ceilings by enhancing the competitiveness and efficiency of the banking system. The staff also welcomes recent steps to strengthen the supervisory role of the Bank of Thailand and establish formal channels for dealing with weaknesses in financial institutions.

Significant progress has been made during the past year in addressing structural weaknesses in the economy. In particular, the Government has undertaken important liberalization measures to help support sectors seriously hurt by weak export markets. Most notable among these are reforms affecting rice, rubber, and tin exporters. The efforts to promote diversification of crop production have also been an appropriate response to weak export markets and protectionism abroad. The staff welcomes the authorities' intention to rely primarily on market-oriented approaches to deal with remaining weaknesses in the economy.

The Government's program of policies for 1986 balances the need for further adjustment of both the fiscal and the external positions with that of avoiding a precipitous withdrawal of fiscal support from an already weak economy. Admittedly, the slippage in the fiscal position last year is being reversed only to a limited extent in 1985/86; nevertheless, the external targets of the program will remain largely on track, and the domestic economy should begin to recover in a noninflationary environment. Under the proposed extension of the program period, it should be possible to regain the pace of fiscal adjustment envisaged in the original program and lay the foundations for sustained growth within the context of the stand-by arrangement.

It is recommended that the next Article IV consultation with Thailand be held on the standard 12-month cycle.

VII. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

1986 Consultation

1. The Fund takes this decision in concluding the 1986 Article XIV consultation with Thailand, in the light of the 1986 Article IV consultation with Thailand conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Thailand continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions.

Review Under the Stand-By Arrangement and Modification of the Stand-By Arrangement

1. Thailand has consulted with the Fund in accordance with paragraph 4 of the stand-by arrangement for Thailand (EBS/85/128, Supplement 2, 6/18/85) and paragraph 28 of the letter of May 15, 1985 from the Minister of Finance and the Governor of the Bank of Thailand attached thereto, and has requested an extension of the stand-by arrangement to December 31, 1987.

2. The letter dated May 2, 1986 of the Minister of Finance and the Governor of the Bank of Thailand and annexed Technical Memorandum shall be attached to the stand-by arrangement and the letter of May 15, 1985 and annexed Technical Memorandum shall be

read as supplemented and modified by the letter of May 2, 1986 and annexed memorandum.

3. Accordingly,

- (a) the period of the stand-by arrangement is extended to December 31, 1987;
- (b) purchases under the arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 150 million until May 31, 1986; the equivalent of SDR 180 million until September 10, 1986; the equivalent of SDR 210 million until December 10, 1986; the equivalent of SDR 260 million until March 10, 1987; the equivalent of SDR 290 million until June 10, 1987; the equivalent of SDR 320 million until September 10, 1987; and the equivalent of SDR 350 million until December 10, 1987.
- (c) Thailand will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Thailand's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota:
 - (i) during any period in which the data at the end of the related month indicate that the limit on domestic credit, the limit on net credit to the central government, the limit on net foreign

assets of the banking system or the limit on new external public debt commitments, as described in the annexed Technical Memorandum, is not observed; or

(ii) during any period after September 30, 1986, if the limit on the deficit of the central government described in the annexed Technical Memorandum, is not observed; or

(iii) during any period after February 28, 1987 and after June 30, 1987, respectively, until the reviews contemplated in paragraph 29 of the attached letter of May 2, 1986 have been completed and suitable performance criteria have been established for the remaining period of the arrangement, or, after such performance criteria have been established, while they are not being observed.

Thailand - Fund Relations
(As of April 30, 1986)

(Amounts in millions of SDRs,
unless otherwise indicated)

I. Membership Status

- (a) Date of membership: May 3, 1949
(b) Status: Article XIV

(A) Financial Relations

II. General Department (General Resources Account)

(a) Quota:	SDR 386.6 million	
	<u>Amount</u>	<u>Percent of quota</u>
(b) Total Fund holdings of currency:	1,205.27	311.76
(c) Fund credit	847.46	219.21
Of which: CFF	208.25	53.87
BSFF	52.09	13.47
Credit tranches	197.50	51.08
Enlarged access resources	389.62	100.78
(d) Reserve tranche position:	28.8	7.4
(e) Current operational budget:	--	--
(f) Lending to the Fund	None	

III. Current Stand-By or Extended Arrangement and Special Facilities

- (a) Current stand-by or extended arrangement:
- (i) Duration: June 1985-March 1987
 - (ii) Amount: SDR 400 million
 - (iii) Utilization: SDR 150 million
 - (iv) Undrawn balance: SDR 250 million
- (b) Previous stand-by arrangements during the last 10 years:
- (1) (i) Duration: July 1978-June 1979
 - (ii) Amount: SDR 45.25 million
 - (iii) Utilization: SDR 45.25 million
 - (iv) Undrawn balance: --
 - (2) (i) Duration: June 3, 1981-Nov. 17, 1982
 - (ii) Amount: SDR 814.5 million
 - (iii) Utilization: SDR 345.0 million
 - (iv) Undrawn balance: SDR 469.5 million

(3)	(i) Duration:	Nov. 17, 1982-Dec. 31, 1983
	(ii) Amount:	SDR 271.5 million
	(iii) Utilization:	SDR 271.5 million
	(iv) Undrawn balance:	--

(c)	Special facilities in the past two years: Compensatory financing facility:	SDR 185 million (June 1985)
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IV.	<u>SDR Department</u>	<u>Amount</u>	<u>Percent of allocation</u>
	(a) Net cumulative allocation:	84.65	100.0
	(b) Holdings:	22.43	26.50
	(c) Current designation plan:	Not incl.	--

V.	<u>Administered Accounts</u>	
	(a) Trust Fund loans:	
	(i) Disbursed:	130.95
	(ii) Outstanding:	79.32
	(b) SFF Subsidy Account	None

VI.	<u>Overdue Obligations to the Fund</u>	None
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(B) Nonfinancial Relations

VII. Exchange Rate Arrangement

Effective November 5, 1984, the exchange rate of the baht was changed from B 23.00 = US\$1 to B 27.00 = US\$1, representing a depreciation of 14.8 percent in terms of the U.S. dollar. Since then the value of the baht has been determined on the basis of a basket of currencies of major trading partners in line with domestic monetary and economic conditions. The exchange rate as of March 31, 1986 was B 26.470 = US\$1.

VIII. Last Article IV Consultation

The last Article IV consultation took place during January 3-29 and March 25-April 5, 1985. The Staff Report (EBS/85/128) was discussed by the Executive Board on June 14, 1985. It was proposed to hold the next Article IV consultation on the standard 12-month cycle. The following decisions were adopted:

1985 Consultation

1. The Fund takes this decision in concluding the 1985 Article XIV consultation with Thailand, in light of the 1985 Article IV consultation with Thailand conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Thailand continues to maintain an exchange system that is free of restrictions on payments and transfers on current international transactions.

Stand-By Arrangement

1. The Government of Thailand has requested a stand-by arrangement for the period June 14, 1985 to March 31, 1987 for an amount equivalent to SDR 400 million.

2. The Fund approves the stand-by arrangement attached to EBS/85/128, Supplement 2.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

IX. Technical Assistance:

Fiscal: Expert assistance in the field of tax administration, fiscal reporting, and public enterprise statistics.

Statistics: Assistance was provided by the Bureau of Statistics in the area of improving procedures for the compilation of data on nonfinancial state enterprises (see Annex III).

X. Resident Representative/Advisor: None

Thailand: Relations with the IBRD and IDA

(In millions of U.S. dollars)

	<u>IBRD</u>	<u>IDA</u>	<u>Total</u>
Total lending <u>1/</u>			
Agriculture	509	25	534
Irrigation	379	12	391
Education	127	55	182
Urban development	149	--	149
Industry	83	--	83
Transportation	585	--	585
Telecommunications	303	--	303
Power and energy	1,151	--	1,151
Population	--	33	33
Structural adjustment	325	--	325
Total	<u>3,611</u>	<u>125</u>	<u>3,736</u> <u>2/</u>
(Excluding cancellations)	(3,466)	(--)	(3,571)
Debt outstanding (including undisbursed) <u>1/</u>	<u>2,863</u>	<u>122</u>	<u>2,985</u>
Commitments for FY 1985	<u>153</u>	<u>--</u>	<u>153</u>

Technical assistance:

In addition to the usual range of technical advice provided in connection with its project and sector work, the IBRD has provided assistance in the drafting of the Fifth Development Plan and in improving budgetary procedures and planning for capital expenditures. In addition, technical assistance for a number of analytical studies and further work on program development are included in the Structural Adjustment Loan.

1/ As of March 31, 1986.

2/ Of which \$2,624 million has been disbursed.

Recent economic and sector reports: Economic Report, June 1982.
Transport Sector Review, May 1983.
Agricultural Taxes, Subsidies and
Prices Study, June 1983.
Labor Market and Employment Study,
November 1983.
Economic Report, August 1983.
Energy Assessment Report, October
1985

Structural Adjustment Loans: The Board of Directors approved a first loan for \$150 million for structural adjustment lending on March 15, 1982. The loan was fully disbursed on July 19, 1982. A second SAL for \$175.5 million was approved on March 31, 1983 and was fully disbursed on September 22, 1983. These loans were made in support of policy adjustments or development of policy programs in five broad areas with a view to: (1) promote agricultural growth and exports; (2) increase the export orientation of industry through a reform of industrial policies and investment promotion incentives; (3) provide a basis for efficient energy development and utilization through the preparation of a comprehensive energy sector program; (4) strengthen the fiscal planning and public sector resource mobilization efforts; and (5) foster the development of public institutions so as to use public resources more efficiently and provide an environment conducive to structural adjustment.

Thailand--Statistical Issues

1. Outstanding statistical issues

The 1985 Government Finance Statistics Yearbook contains data for the period 1975-84, with separate presentations for the consolidated central government, local government, and general government. Data reported for publication in International Financial Statistics (IFS) are fairly current but cover only the budgetary operations of the central government; the operations of the extrabudgetary agencies are excluded from the coverage of these data.

Considerable progress has been made in preparing consolidated data for the nonfinancial public sector, including general government and nonfinancial public enterprises. Following initial efforts to compile these data during the course of the Article IV consultation mission in January 1985, a staff member of the Bureau of Statistics visited Thailand in February/March 1985 for the purpose of providing assistance in developing procedures for the compilation of data on nonfinancial state enterprises. The main recommendations of the mission were that: (i) all government units use the same annual data on nonfinancial state enterprises, preferably those compiled by the Bank of Thailand; (ii) quarterly data currently collected by the Comptroller General's Office be shared with the Bank of Thailand, Fiscal Policy Office, and the Budget Bureau; and (iii) summary government finance data and consolidated data on the nonfinancial public sector be compiled on a quarterly basis for purposes of economic analysis and policymaking. The authorities have made substantial progress in implementing these recommendations.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Thailand in the April 1986 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Bank of Thailand, which during the past year have been provided on a timely basis.

Status of IFS Data

		<u>Latest Data in</u> <u>April 1986 IFS</u>
Real Sector	- National Accounts	1984
	- Prices	January 1986
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	December 1985
	- Financing	December 1985
	- Debt	November 1985
Monetary Accounts	- Monetary Authorities	December 1985
	- Deposit Money Banks	December 1985
	- Other Financial Institutions	Q2, 1985
External Sector	- Merchandise Trade: Value	November 1985
	Prices	November 1985
	- Balance of Payments	Q3, 1985
	- International Reserves	February 1986
	- Exchange Rates	February 1986

Thailand--Summary of Financial Program

	<u>1985</u>		<u>1986</u>	<u>1987</u>
	Proj.	Actual		
(In billions of U.S. dollars)				
I. <u>Targets</u>				
External current account	-1.7	-1.5	-1.2	-1.1
(In percent of GDP)	(-4.0)	(-3.8)	(-2.8)	(-2.4)
Overall payments position	-0.2	0.2	0.2	0.2
Gross official reserves	2.6	2.7	2.8	3.0
(Months of imports)	(2.9)	(3.5)	(3.6)	(3.6)
(Percentage change)				
Real GDP	6.0	4.1	4.3	5.0
CPI (period average)	7.0	2.4	2.2	2.5
II. <u>Assumptions</u>				
Export volume	11.5	4.9	5.4	5.5
Import volume	2.1	-5.4	5.5	4.8
Of which: Oil imports	-3.2	-9.8	2.8	2.0
Non-oil imports	3.8	-4.2	5.7	5.5
Terms of trade	-2.4	-4.8	5.1	3.0
Income velocity of broad money	-4.4	-3.2	-6.7	...

III. Principal Elements of the Program

1. Central government budget

a. The deficit of the central government for 1985/86, for which a performance criterion has been introduced, will not exceed B 53.2 billion (4.7 percent of GDP). For 1986/87, current budgetary projections indicate a reduction in the deficit to below 3 1/2 percent of GDP. The authorities are exploring all possible means for achieving a lower deficit.

b. Although the original budgetary allocations for 1985/86 were restrictive, cuts in these allocations and in net lending to public enterprises equivalent to 1 1/2 percent of total expenditure and net lending were made in early 1986. Also, the Government has undertaken to strengthen expenditure control by moderating the pace of disbursements on capital projects, prohibiting shifts of allocated expenditures across line items, and cutting back on the amount of savings from previous years' budgets available for use in the current fiscal year.

c. The Government adopted a tax package in January 1986, designed principally to enhance the efficiency of the tax system, but also to generate a small amount of additional revenue. The package included an increase in the withholding tax on interest income, an increase in tax rates on sales of property, a reduction in personal and corporate income tax rates, and an increase in the ceiling rate on petroleum product excise taxes. A tax amnesty was also offered to discourage tax evasion and enhance the efficiency of tax administration in the future. The Government is determined to retain for the budget half of the savings on oil and oil products resulting from the recent decline in world prices. To this end, excise taxes on petroleum products were raised to generate additional revenues of B 6 billion (1/2 percent of GDP) on an annual basis.

2. State enterprises

a. The downward adjustment of energy prices in response to the recent decline in world prices will be limited in order to replenish the resources of the Oil Fund. The authorities have indicated that they will be flexible in determining the use of Oil Fund resources and that part of these resources could be transferred to the central government in the event that revenues fall short of targets. In early 1986, telephone rates were increased in order to reverse the recent deterioration in the financial position of the Telephone Organization of Thailand. Increases in tariffs for enterprises in the transportation sector are under consideration.

b. The Government will further strengthen its procedures for monitoring the investment plans and operations of public enterprises. It will also review plans for large-scale public investment projects. Total investment outlays of public enterprises for 1986 will be contained to about 3 1/2 percent of GDP as in 1985.

3. Money and banking

a. Domestic credit of the banking system is subject to quarterly ceilings as a performance criterion. The expansion of domestic credit during 1986 will be limited to just over 14 percent.

b. Net credit of the banking system to the central government is subject to quarterly ceilings as a performance criterion. The expansion of net credit to the Government will be limited to less than 15 percent.

c. Official ceilings on interest rates will be adjusted if necessary in order to maintain interest rates at an adequate level to promote savings mobilization and the efficient allocation of financial resources.

4. External sector

a. The Government is committed to following a flexible exchange rate policy aimed at providing adequate incentives for exports and containing the growth of imports. The value of the baht will continue to be determined on the basis of a basket of currencies of trading partners and other considerations.

b. Net foreign assets of the banking system are subject to quarterly floors as a performance criterion. Net foreign assets will increase by at least B 5.3 billion (\$0.2 billion) during 1986.

c. As a performance criterion, new commitments of public and publicly guaranteed debt of more than one year maturity will be limited to \$1.2 billion in 1985/86 and \$0.7 billion during the first five months of 1986/87.

Bangkok, Thailand

May 2, 1986

Dear Mr. de Larosiere:

1. In its letter of May 15, 1985, the Government of Thailand described an adjustment program designed to strengthen Thailand's external position while sustaining growth and maintaining price stability. In support of this program, the Government requested a stand-by arrangement with the Fund in the amount equivalent to SDR 400 million, including access to the Fund's borrowed resources, for the period through March 31, 1987.

2. Given the unexpected weakening of external conditions and the resulting cyclical slowdown in the domestic economy, the pace of adjustment, particularly in the fiscal area, has been slower than envisaged. It is now apparent that a longer period will be required to achieve the desired reduction in the fiscal deficit without imposing an undue burden on the economy. Therefore, we would like to request an extension of the stand-by arrangement with the Fund to December 31, 1987.

The Adjustment Program in 1985

3. The Government's adjustment program was designed to reduce the external current account deficit from the equivalent of 5 percent of GDP in 1984 to 4 percent in 1985 and 3 percent in 1986. Growth was expected to remain at about 6 percent. The inflation rate was projected to rise to 7 percent, owing to the effects of the 15 percent devaluation of the baht in late 1984, but to drop to about 5 percent in 1986.

4. To achieve these objectives, a number of strong policy measures were implemented. Following the devaluation in November 1984, the long-standing practice of pegging the value of the baht to the dollar was abandoned for a basket peg. The flexibility afforded by this new arrangement permitted a further effective depreciation of 10 percent during 1985. The growth of credit was constrained by the weakness of demand. Credit policy was designed to provide scope to accommodate any pickup in credit demand without jeopardizing the inflation and the external objectives. To encourage domestic savings and capital inflows, interest rates were maintained quite high relative to both domestic inflation and foreign interest rates. In the area of fiscal policy, a package of measures was introduced in April 1985 to increase revenues, and expenditure allotments were cut. These measures were expected to reduce the central government budget deficit from 4 percent of GDP in fiscal year 1983/84 to 3 percent in 1984/85. To improve the financial position of public enterprises several measures, including tariff adjustments and a rephasing and rescaling of investment programs in several key sectors, were implemented during the year.

5. Despite considerably weaker-than-expected export markets, the external targets of the program were broadly met. Exports benefited considerably from the devaluation of the baht, but the slower-than-expected growth of export markets and a sharp decline in export prices resulted in a large drop in export receipts. The shortfall in exports was offset by an even larger shortfall in imports. Consequently, the current account deficit fell to the target of 4 percent of GDP. With capital inflows about as originally forecast, the overall position was also stronger than expected, allowing a welcome improvement in the net foreign asset position of commercial banks. Gross official international reserves remained unchanged, but the import cover rose to 3 1/2 months, also surpassing the program target. The growth of external debt was in line with projections, but the debt service ratio increased to 27 1/2 percent, largely reflecting the drop in exports.

6. The attainment of domestic objectives was largely thwarted by the adverse external developments. Given the leading role of exports in the economy, the weakness of export receipts resulted in a slowdown in the growth of domestic demand, a 20 percent drop in private investment, and a decline in GDP growth to 4 percent. Price performance, however, was better than expected as consumer prices rose by less than 3 percent; not only was inflation in trading partners lower than originally forecast but also the sluggishness of domestic demand limited the extent to which the devaluation was passed through to domestic prices.

7. In this setting, progress in reducing the fiscal deficit was severely hampered. With the lower-than-expected growth of incomes, nominal revenues fell short of the program estimate, although the revenue/GDP target was met. The expenditure/GDP ratio, however, exceeded the program target, largely because the slowdown of income growth did not become apparent early enough to allow offsetting adjustments to be made. While the larger-than-planned fiscal deficit represented a setback to the Government's medium-term fiscal adjustment, it did provide much needed support to the domestic economy.

The Adjustment Program for 1986 and 1987

8. The Government's adjustment program is designed to further reduce the external current account deficit to about 3 percent of GDP in 1986 and 2 1/2 percent of GDP in 1987. At the same time, the growth of GDP is expected to rise to 4 1/2 percent in 1986 and 5 percent in 1987. Consumer price inflation is projected to remain in the range of 2-3 percent in both years. The achievement of the current account target would allow a considerable further deceleration of external debt. The debt service ratio is expected to level off in 1986 and decline thereafter. The overall payments position is projected to show a surplus of about \$0.2 billion both in 1986 and 1987. This projection is consistent with the Government's objectives of maintaining gross international reserves equivalent to about 3 1/2 months of imports, which is considered to be an adequate level.

9. The Government is committed to reducing the fiscal imbalance, although it recognizes that the pace of adjustment must take due account of the state of the economy. Given the present weakness in the economy, a small reduction in the deficit is planned for 1985/86, but a considerably larger adjustment is to take place in 1986/87 when economic growth is expected to pick up. The deficit in 1985/86 will be reduced to B 53.2 billion (4.7 percent of GDP). In order to more closely monitor the progress in attaining the fiscal objective, the Government has developed quarterly targets against which budgetary performance can be measured.

10. On the expenditure side, the budget for the current fiscal year was formulated to be quite restrictive; with only a small increase in non-interest outlays, the implied increase in total expenditure and net lending was limited to just over 5 percent. Nonetheless, in response to weaker-than-expected revenues during the first half of the fiscal year, budgetary allotments have been cut by B 2.25 billion. The Government is also committed to controlling disbursements through cutbacks in carryovers and limiting shifts among line items. With these measures, non-interest expenditure will decline slightly in real terms. The Government has also reduced planned net lending to the public enterprises. The ratio of total expenditures and net lending to GDP is now expected to decline by nearly 1 percent of GDP.

11. On the revenue side, the Government introduced in January a comprehensive tax package designed principally to enhance the efficiency of the tax system but also to generate a small amount of additional revenue. The package included an increase in the withholding tax on interest income, an increase in tax rates on sales of property, and a reduction in personal and corporate income tax rates. A tax amnesty was offered which should enhance the efficiency of tax administration. A particularly important element of the package was a reform in the taxation of petroleum products that paved the way for a realignment of the structure of retail prices and increased the flexibility of the Government in raising taxes on petroleum products. With the recent drop in oil prices, the Government is now in a position to generate substantial additional revenue from oil taxes. The Government is determined to retain for budgetary purposes about half of the savings on petroleum and petroleum products. Specific taxes on energy have been raised to generate revenues of B 3 billion in 1985/86 and B 6 billion in 1986/87. The remainder of the savings will be shared between the Oil Fund and consumers.

12. The Government is committed to achieving a significant further improvement in the budgetary position in 1986/87. The budget approved by the Cabinet is formulated to reduce the deficit to B 42 billion, below 3 1/2 percent of GDP. The Government intends to explore, in consultation with the Fund, possibilities for improving upon this estimate. To this end, the Government will redouble its efforts to control expenditure and increase the ratio of revenue to GDP. On the

expenditure side, it is planned that noninterest spending and net lending to public enterprises will be reduced. Revenues will be boosted by the full year effect of the energy taxes implemented in 1985/86.

13. The Government is committed to strengthening the overall buoyancy of the revenue system through a rationalization of the structure and administration of the tax system. To this end, the Government intends to seek Fund assistance in undertaking a comprehensive study of the tax system, with particular focus on direct taxes. On the basis of this study, a package of measures is expected to be implemented in 1986/87 to enhance revenue collection capacity and to consolidate the fiscal position in the medium term.

14. The program also includes measures to strengthen the financial position of the state enterprise sector. In order to reverse the deterioration in recent years in the financial position of the Telephone Organization of Thailand, an increase in charges for calls was implemented in March. Also in the utilities sector, the phased increase in water rates that was recently completed has eliminated the losses previously sustained by the Provincial and Metropolitan Water Authorities. On the expenditure side, investment outlays of the state enterprise sector will be contained to B 39 billion in 1985/86.

15. The Government's capacity to monitor and control external borrowing through the National Debt Policy Committee and State Enterprise Committee has been significantly strengthened during the past year. An important element in this process has been the standardization of conditions that must be met for state enterprises to be granted permission to borrow abroad for investment purposes. The Government intends to introduce policies to reduce arrears of state enterprises to other state enterprises and to the Government. These measures, together with the substantial improvement in the financial position of the Oil Fund, should result in a reduction in the overall deficit of the state enterprise sector.

16. Further efforts to strengthen the state enterprise sector are planned for 1986/87. The Government will continue to restrain the growth of investment by state enterprises with the aim of containing such investment to B 42 billion in 1986/87. Plans for the Eastern Seaboard Development Program, which have been scaled down and rephased during the past year, remain under study. Further progress on any of the projects in the program, particularly the infrastructure investment on ports, will be contingent on clear evidence of its economic viability. In assessing the public investment program, the Government will continue to rely on assistance from the World Bank. On the revenue side the Government intends to formulate policies to reduce the losses of enterprises in the transportation sector and improve the profit position of enterprises in other sectors, in particular the energy sector.

17. The Government will seek to strengthen procedures for reviewing and monitoring the investment program and operations of state enterprises. This will require a centralization of responsibilities for reviewing the tariff policies of state enterprises and approving investment programs. The Government is also actively exploring possibilities for privatizing and for enhancing private participation in state enterprises.

18. Taken together, the measures outlined above are expected to reduce the overall public sector deficit in 1986 by the equivalent of about 1 percent of GDP. Such a reduction is sufficient to allow the projected improvement in the external current account deficit. For 1987, a further significant improvement in the overall public sector position, together with some rebound in the private savings rate, should allow the current account deficit to fall to 2 1/2 percent of GDP and the ratio of private investment to GDP to rise by more than 1 percentage point.

19. With the expected improvement in the financial position of the public sector, the external borrowing requirements of the public sector will decline during 1985/86. Accordingly, new commitments of public and publicly guaranteed loans with maturities of one year or more will be limited to \$1.2 billion in 1985/86. For the period October 1, 1986 to February 28, 1987 such commitments will be limited to \$0.7 billion.

20. Credit policy in 1986 will aim to provide sufficient liquidity to accommodate a pickup in credit demand while ensuring capital inflows sufficient to finance the current account deficit. To this end, the expansion of net domestic credit of the banking system will not exceed 14.2 percent during 1986. Credit policy will be closely monitored in light of external developments and, if necessary, credit expansion will be curtailed in order to meet the overall balance of payments target. The increase in net bank credit to the Central Government will be limited to B 24.6 billion, less than 25 percent of total credit expansion.

21. The Government believes that an efficient allocation of resources is best served by allowing interest rates to play an equilibrating role in domestic money and credit markets. It was hoped therefore that banks would take the initiative in reducing domestic deposit and lending rates in line with recent developments in domestic inflation and foreign interest rates. In the event, rigidities in the banking system prevented such an adjustment. Thus, in response to the flagging growth of the economy and increasingly apparent strains in the banking system, ceilings on deposit and loan rates were adjusted downward on two occasions during the first quarter of 1986. The Government is mindful of the need to respond flexibly to any increase in foreign interest rates and to maintain interest rates at an adequate level to promote savings mobilization and the efficient allocation of financial resources. The Government will continue to explore means of enhancing the competitiveness and efficiency of the banking system with a view to reducing reliance on interest rate ceilings.

22. The weakness of some sectors of the economy and the continuing high level of real interest rates have severely strained the financial system in recent years. To deal with these strains, the Government has amended banking laws to extend the regulatory powers of the Bank of Thailand and to provide resources to help support institutions facing liquidity shortages. The Government remains actively involved in the management of several ailing finance companies, although some companies that were under government control are now operating normally. The Government will continue to closely monitor developments in financial institutions and to deal expeditiously with any further difficulties.

23. The Government remains committed to following a flexible exchange rate policy aimed at providing adequate incentives for exports and containing the growth of imports. Recently, the more stable relationship of the baht with the U.S. dollar has been effective in preventing speculative capital outflows; with the weakening trend of the dollar it has also served to improve external competitiveness. Continued flexibility in managing the exchange rate will ensure that external objectives are not jeopardized by the pegging arrangement in the event of sudden or large reversals in trends in exchange rates between major currencies.

24. The Government will continue to pursue a restrained incomes policy. In view of the considerable slack in the labor market and expected low rate of inflation, minimum wage rates will be kept unchanged during 1986. No general wage or salary increase is planned for the public sector during 1985/86. Wages and salaries of civil servants and other employees of the public sector will be kept aligned with those in other sectors of the economy.

25. Structural policies will focus on enhancing the efficiency of industry and improving the performance of the agricultural sector. Industrial policy has been aimed mainly at promoting several key sectors mainly through tax incentives and improvements in industrial standards. The Government will continue to review effective rates of protection with the aim of reducing the level and achieving a more appropriate structure of effective protection. To help ease the impact of the recent collapse of the international tin market, the tin premium has been reduced, and other regulations on exporters have been liberalized.

26. The thrust of agricultural policy in recent years has been to raise incentives for production and exports and to diversify crop production. In early 1986, the Government substantially liberalized conditions for rice exports; the premium on rice exports was eliminated, and required stockholdings by exporters were reduced. During 1985, the premium on rubber exports was reduced substantially. Strong measures have been implemented to promote the diversification of crops, in particular from tapioca and sugarcane to other cash crops with greater export potential. Agricultural policies during 1986-87 will continue to rely primarily on market mechanisms for increasing production and improving the allocation of resources.

27. In the area of energy policy, the Government will continue to encourage domestic production and conservation. Domestic production of natural gas, gas condensate, crude oil, and lignite is expected to rise substantially during 1986. The Government will continue to grant incentives for investments that reduce pollution and conserve energy. With respect to petroleum prices, the Government intends to achieve an adequate level of petroleum product taxation, improve the structure of prices, and avoid any subsidization or cross-subsidization of petroleum products.

28. During the period of the stand-by arrangement, the Government of Thailand does not intend to introduce or modify any multiple currency practices; impose any new or intensify any existing restrictions on payments and transfers for current international transactions; enter into any bilateral payments arrangements with Fund members; or introduce any new or intensify any existing restrictions on imports for balance of payments reasons.

29. The annexed Technical Memorandum presents operational guidelines for the period to February 28, 1987. Thailand will conduct with the Fund two reviews to assess the progress made under the program; the first review will take place prior to February 28, 1987 and the second prior to July 31, 1987. In the context of the first review, it will reach understandings on appropriate policies and suitable performance criteria for the remaining period of the stand-by arrangement. The Government wishes to assure you at this time that these policies and performance criteria will be fully consistent with the objectives of the program.

30. The Government of Thailand believes that the policies and measures described in this letter are adequate to achieve the objectives of the program, but will take any additional measures that may become appropriate for this purpose. During the remaining period of the arrangement, the Government will periodically consult with the Fund, in accordance with the Fund's policies on such consultations, about the progress being made in the implementation of the program and any policy adaptations judged to be appropriate for the achievement of its objectives.

Sincerely yours,

Minister of Finance

Governor
Bank of Thailand

Mr. Jacques de Larosiere
The Managing Director
International Monetary Fund
Washington, D.C., 20431
U. S. A.

May 2, 1986

Thailand - Technical Memorandum

1. This Memorandum describes the performance criteria under the stand-by arrangement and sets the quantitative limits for these criteria for the period through February 28, 1987.

2. The performance criteria consist of:

(a) Ceilings on domestic credit of the banking system.

(b) Ceilings on net credit of the banking system to the central government.

(c) Floors on the net foreign assets of the banking system.

(d) Ceilings on external public debt commitments.

(e) A ceiling on the overall deficit of the central government.

(f) A review with the Fund to be completed prior to February 28, 1987.

(g) The observance of the commitment regarding the exchange and trade system that is stated in paragraph 28 of the letter of intent.

3. Domestic credit of the banking system is defined as the sum of net credit to the central government and credit to the private sector. The value of domestic credit on December 31, 1985 was B 705.8 billion.

4. Net credit to the central government is defined as the difference between the claims of the banking system on the central government and the deposits of the central government in the banking system excluding deposits against foreign exchange holdings for refinancing operations (these operations are described in paragraph 8). Claims on the central government include the issue of coins, and deposits of the central government include its holdings of currency. The value of net credit to the central government on December 31, 1985 was B 164.9 billion.

5. Credit to the private sector includes the gross value of all claims of the banking system on nonfinancial public enterprises, the local government sector, the business and household sector, and nonbank financial institutions. The value of credit to the private sector on December 31, 1985 was B 540.9 billion.

6. Net foreign assets are defined as the difference between the foreign assets and liabilities of the banking system. Foreign assets are defined to exclude holdings for refinancing purposes as described in paragraph 8. Foreign assets and liabilities of the monetary authorities denominated in currencies other than the U.S. dollar will be converted into U.S. dollars at the market rates of the respective currencies prevailing on December 31, 1985. Gold will be valued at a fixed accounting rate of \$327.0 per fine troy ounce; and the Bank of Thailand's SDR holdings and IMF position will be valued at the rate of \$1.09842 per SDR. The U.S. dollar value of foreign assets and liabilities of the Bank of Thailand will be converted into baht at the rate of B 26.625 per U.S. dollar. The baht value of the foreign assets and liabilities of the commercial banks will be multiplied by a conversion factor. The conversion factor for any month will be the ratio of the exchange rate of B 26.625 per U.S. dollar to the actual exchange rate used in the accounts of the Bank of Thailand in that month. The value of net foreign assets of the banking system on December 31, 1985 was B 32.7 billion.

7. The deficit of the central government (inclusive of the Farmers' Aid Fund and Rubber Replanting Aid Fund) is defined as total revenue and grants less total expenditure and net lending, classified on a Government Financial Statistics basis.

8. The ceiling on external public debt commitments covers all public and publicly guaranteed external debt commitments with an initial maturity of more than one year, including liabilities of all public enterprises except the Bank of Thailand. It excludes refinancing operations defined as those commitments for refinancing of obligations falling due in subsequent fiscal years. External liabilities in currencies other than the U.S. dollar will be converted into U.S. dollars at the market rates of the respective currencies prevailing on the day of commitment. The value of external public debt contracted or guaranteed by the Government on December 31, 1985 was \$12.61 billion.

9. Performance criteria relating to the credit ceilings, net foreign assets of the banking system, and external debt commitments will be tested on the last day of any month in each three-month period, at the option of the Thai authorities. These performance criteria must be met on the same date, and purchases under the stand-by arrangement must be made within three months of the test date chosen. The performance criteria on the deficit of the central government will be tested on September 30, 1986. During the period through February 28, 1987, domestic credit and net credit to the central government will not exceed the limits specified in the attached Table 1, and net foreign assets of the banking system will not fall below the limits specified in Table 1. The overall deficit of the central government for the fiscal year 1985/86 will not exceed B 53.2 billion. External public debt commitments during the fiscal year 1985/86 will not exceed \$1.2 billion. For the period October 1, 1986 to February 28, 1987 such commitments will not exceed \$0.7 billion.

10. The data in Table 1 and data on external debt commitments will be reported monthly to the Asian Department of the International Monetary Fund, not later than two months after the end of each month. Data on the overall fiscal deficit will be reported within two months of the end of the fiscal year. Information supporting these data will also be reported within two months after the end of each month. Other information necessary to assess financial and economic developments in Thailand will also be reported periodically at the request of the Asian Department of the International Monetary Fund.

Table 1. Thailand: Performance Criteria, 1985-87

(End of month; in billions of baht)

	Domestic credit	Net credit to the Central Government	Net foreign assets
1985			
December <u>1/</u>	705.8	164.9	32.7
1986			
June	762.0	180.0	41.0
July	769.0	180.0	38.0
August	772.0	180.0	38.0
September	775.0	180.0	38.0
October	786.0	185.0	38.0
November	795.0	187.0	38.0
December	806.0	189.5	38.0
1987			
January	818.0	193.0	36.0
February	828.0	195.0	36.0

1/ Actual data; not performance criteria.