FOR INFORMATION

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To: Members of the Executive Board

From: The Secretary

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***If the authorities consent to the publication of this assessment, it may be published by the AIIB.**

Thailand—Assessment Letter for the Asian Infrastructure Investment Bank

June 2, 2020

I. Recent Developments, Outlook, and Risks[1]

Recent Developments

1. **Thailand's economy has been extensively affected by the Covid-19 pandemic through its impact on tourism (a fifth of GDP) and global value chains during 2020**. Following the Covid-19 shock, economic activity contracted by 2.2 percent quarter on quarter in Q1:2020, largely driven by a collapse in services, mostly in tourism. Tourist arrivals declined by 35 percent quarter on quarter, while investment and exports of goods also declined steeply.

2. **Financial markets have been subject to volatility, for the most part following global trends around the Covid-19 pandemic**. The baht in 2020 depreciated against the U.S. dollar by 7.4 percent, one of the largest in Asia. Yield curves significantly steepened in early March. The stock market registered some of the largest losses in the region with a significant increase in volatility. U.S. dollar funding pressures also increased in late March. Approximately US$6.5 billion in capital flowed from Thai bond and equity markets by mid-April as foreign investors moved into global safe havens, before slowing substantially. Volatility declined in May but remains elevated.

3. **Following aggressive containment measures, signs of "flattening of the infection curve" have emerged and Thailand has begun lifting some restrictions**. A state of emergency, instituted on March 26 through May 31, is likely to be extended through June 30 as per the National Security Council's recommendation.[2] Subsequently, the government has also announced clear and strict guidelines for each of the 77 provinces to loosen restrictions and reopen only after registering 14 consecutive days of zero new infections. The first stages for easing containment measures started on May 3, by opening low-risk businesses including markets, small eateries, small retail outlets, and exercise facilities. The government is evaluating the situation regularly determining whether to further ease restrictions or, reimpose restrictions if there is a spike in new infections.

Outlook and Risks[3]

4. **The impact from the Covid-19 pandemic has taken a large toll on the economy and adds to the impact from severe drought, delays in fiscal budget execution, and weak domestic demand conditions**. Real GDP is projected to contract by 6.7 percent in 2020, reflecting sharp declines in tourism and related services, exports of goods, and private consumption and investment.

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[1] Thailand was experiencing an economic slowdown even before the Covid-19 pandemic. Please see IMF Country Report No. 19/309.

[2] Under the decree, foreigners are banned from entering the country except for shippers, diplomats, drivers, pilots, foreigners with work permits, and others permitted by the Prime Minister. A nationwide curfew is in place from 23:00 and 04:00 until further notice, international commercial flights are banned until end June and a 14 day mandatory state quarantine is in imposed on all travelers entering Thailand, mostly Thai national returnees.

[3] The assessment's macro forecast is based on staff's April 2020 WEO. Given the uncertainty and fast-moving developments on Covid-19, these forecasts could be further refined in late June/July 2020.

Imports are also expected to contract and, therefore, the current account surplus is expected to remain sizable—at over 5 percent of GDP. A partial GDP growth rebound is expected in 2021 of around 6.1 percent, driven primarily by the external environment.

5. **The current account surplus is expected to decline in 2020, with large shocks to services and the trade balance**. The projected narrowing of the current account surplus to 5.2 percent of GDP in 2020 is due mainly to the contraction in tourism inflows, while the trade balance is on net expected to widen as lower export earnings from GVC disruptions and weak external demand are offset by compressed imports from weaker consumption and investment and lower intermediate goods and fuel imports. FX reserves remain well above reserve adequacy metrics, the NIIP position is small and stable, and external debt is assessed as sustainable with limited vulnerabilities.

6. **The uncertainty on the outlook is greater than usual, with risks tilted to the downside**. The main risk is a prolonged Covid-19 outbreak—including a potential second wave—and associated disruptions, which could further depress tourism, upend global supply chains, drive commodity price volatility, and strain liquidity for highly leveraged households and firms, raising solvency risks. Further disruptions to trade from renewed protectionist measures and policy uncertainty could also weigh on export growth. On the domestic front, delays in coordinating an adequate fiscal response to the Covid-19 outbreak could hamper mitigation/containment efforts, resulting in even lower growth; and private domestic demand could fail to pick up owing to a prolonged household debt overhang. Policy action could be further inhibited if fragilities were to increase in the coalition government. The adapting of tourism to a post-pandemic 'new normal' is an added challenge. Upside risks include reallocation of some of China's production to Thailand and other countries in the region in response to U.S.-China trade tensions.

II. Policy Response

Staff supports the authorities' multi-pronged, policy package of monetary, fiscal and financial policies to manage risks from the outbreak and protect households, businesses, and the financial system. The authorities should stand ready to provide additional stimulus by frontloading growth-promoting and clean infrastructure investment, providing better-targeted economic support to individuals and businesses for a longer period, and providing additional liquidity support as needed.

Fiscal Policy

7. **In response to Covid-19, the government has approved exceptional fiscal measures to be implemented on a temporary basis**. The measures include: i) health-related spending; ii) assistance for workers, farmers, and entrepreneurs affected by Covid-19 (including THB 5,000 per month per worker for three months to 14 million non-farm workers outside the social security system and 10 million farmers); iii) support for individuals and businesses through soft loans from Specialized Financial Institutions and the Social Security Office, and tax relief; and (iv) lower water and electricity bills, and employees' and employers' social security contributions. Although the measures above sum up to more than 9 percent of GDP, the expected fiscal stimulus in 2020 stemming from these measures is projected to be moderate, as some are financed within the original budget, others consist of loans, and not all may be implemented this fiscal year. Additional fiscal stimulus, to focus on growth-promoting infrastructure push and greening the recovery from 2021,

including through cleaner and more resilient infrastructure investment and appropriate carbon pricing, is likely to be needed.

8. **Thailand has some fiscal space**. Public debt is assessed to be sustainable, with a projected increase from 41 to 48 percent of GDP during 2020−21, based on announced fiscal measures, (below the 60 percent ceiling in the fiscal responsibility law-FRL). Debt stabilizes thereafter, assuming that the fiscal stimulus is unwound as the economy recovers in 2021. Thailand has strong access to credit markets, with low financing cost, supported by ample external buffers. Growth-promoting measures that focus on cleaner and more resilient public investment will lift up medium-term growth and minimize the risks of pushing public debt closer to (or even above) the 60 percent ceiling in the FRL. A low share of FX-denominated public debt and long average term to maturity (above 12 years) significantly mitigate the impact from exchange rate and interest rate shocks. Over the medium and long term, additional fiscal revenue mobilization will be needed to address expenditure pressures from population aging.

Monetary Policy

9. **The Bank of Thailand (BOT) has responded appropriately by easing monetary policy and intervening to maintain orderly market conditions while allowing exchange rate flexibility**. The policy rate was reduced by 75 basis points from 1.25 percent to 0.5 percent over three monetary policy committee (MPC) decisions in February, March and May. Additional measures implemented by the BOT are described in the IMF's Thailand policy tracker (COVID-19 Policy Tracker). In the May 2020 MPC decision, the BOT expressed concern that the baht seemed to be appreciating once again. This might lead to foreign exchange intervention by the BOT, were it to perceive market conditions as disorderly during any further appreciation.

10. **Given the magnitude of the shock, the BOT should be prepared to implement further monetary policy easing and additional liquidity support**. However, as the policy rate is approaching its effective lower bound, such policy space is extremely limited, at most 50 basis points. Unconventional policy options could be considered in the event of a more protracted pandemic and as needed.

Financial Sector

11. **The weakening outlook and large economic disruptions from the crisis will add to financial vulnerabilities**. While financial vulnerabilities so far appear to be contained, household indebtedness is relatively high and there were signs of weaknesses in some corporates and SMEs before the crisis. The 2019 FSAP stress tests showed that the financial sector can remain both sufficiently liquid and solvent in the face of shocks on the magnitude and length of the Asian Financial Crisis. But the current Covid-19 crisis has resulted in (and could result in further) sudden and unexpected shocks that affect the economy directly as well as the financial system calling for close monitoring to prevent an adverse macro-financial feedback loop.

12. **Measures have been taken to support stability in the financial sector by providing liquidity and backstopping certain segments of the financial markets**. Details of these measures are also described in the IMF policy tracker for Thailand (COVID-19 Policy Tracker). The BOT has undertaken these measures in a timely fashion and have helped stabilize Thai financial markets.

Moreover, the BOT has indicated a willingness to intervene as necessary and to do so with other agencies.

Structural Reforms

13. **Structural reforms are key to address long-standing internal and external imbalances and secure a solid recovery**. Where possible, structural reforms should be part of the immediate containment and recovery packages. Important reforms include improving the efficiency of public investment, addressing challenges from population aging, strengthening social safety nets, raising productivity in an increasingly informal economy and improving labor market policies, augmenting worker skills and facilitating re-employment. Supportive policies are needed to foster firm dynamism and reduce excess leverage to create an environment more conducive to innovation and facilitate resource reallocation. The focus on short-term needs to contain the pandemic could be complemented with broader efforts to promote long-term sustainable green growth as a basis for "greening the recovery."

IMF Relations

14. Thailand is on a standard 12-month Article IV consultation cycle. The 2019 Article IV consultation was concluded by the IMF's Executive Board on September 30, 2019. As the Fund's capacity development (CD) work pivots to crisis-related priorities, staff is prepared for the possibility of a virtual CD delivery and stands ready to support the authorities' crisis management efforts through the use of remote "CD on demand" and consistent with surveillance priorities.

Table 1. Thailand: Selected Economic Indicators

Population (2019): 69.1 million — Per capita GDP (2019): US$7,871
Quota (current): SDR 3,211.9 millions — Poverty rate (2014): 10.5 percent
Main products and exports: Electronics, machinery, appliances, vehicles and parts
Key export markets: China, U.S., Japan, ASEAN

	2016	2017	2018	2019	Proj. 2020	Proj. 2021
Output						
Real GDP growth (%)	3.4	4.1	4.2	2.4	-6.7	6.1
Prices						
Inflation (%)	0.2	0.7	1.1	0.7	-1.1	0.6
General government finances						
Revenue (% GDP)	21.9	21.1	21.4	21.0	20.3	20.8
Expenditure (% GDP)	21.3	21.5	21.4	21.8	23.7	22.5
Fiscal balance (% GDP)	0.6	-0.4	0.1	-0.8	-3.4	-1.7
Public debt (% GDP)	41.7	41.8	42.0	41.1	48.1	48.9
Money and credit						
Broad money (% change)	4.2	5.0	4.7	3.7	...	...
Credit to the private sector (% change)	4.2	4.6	5.8	2.5	...	...
3-month treasury bill interest rate (%)	1.4	1.3	1.3	1.6	...	...
Balance of payments						
Current account (% GDP)	10.5	9.6	5.6	6.9	5.2	5.6
Reserves (months imports)	11.8	12.6	13.3	16.7	15.0	14.0
External debt (% GDP)	32.0	34.0	32.1	31.7	35.7	34.9
Exchange rate						
REER (% change)	-2.9	3.2	3.0	5.6	...	...

Source: IMF staff estimates.