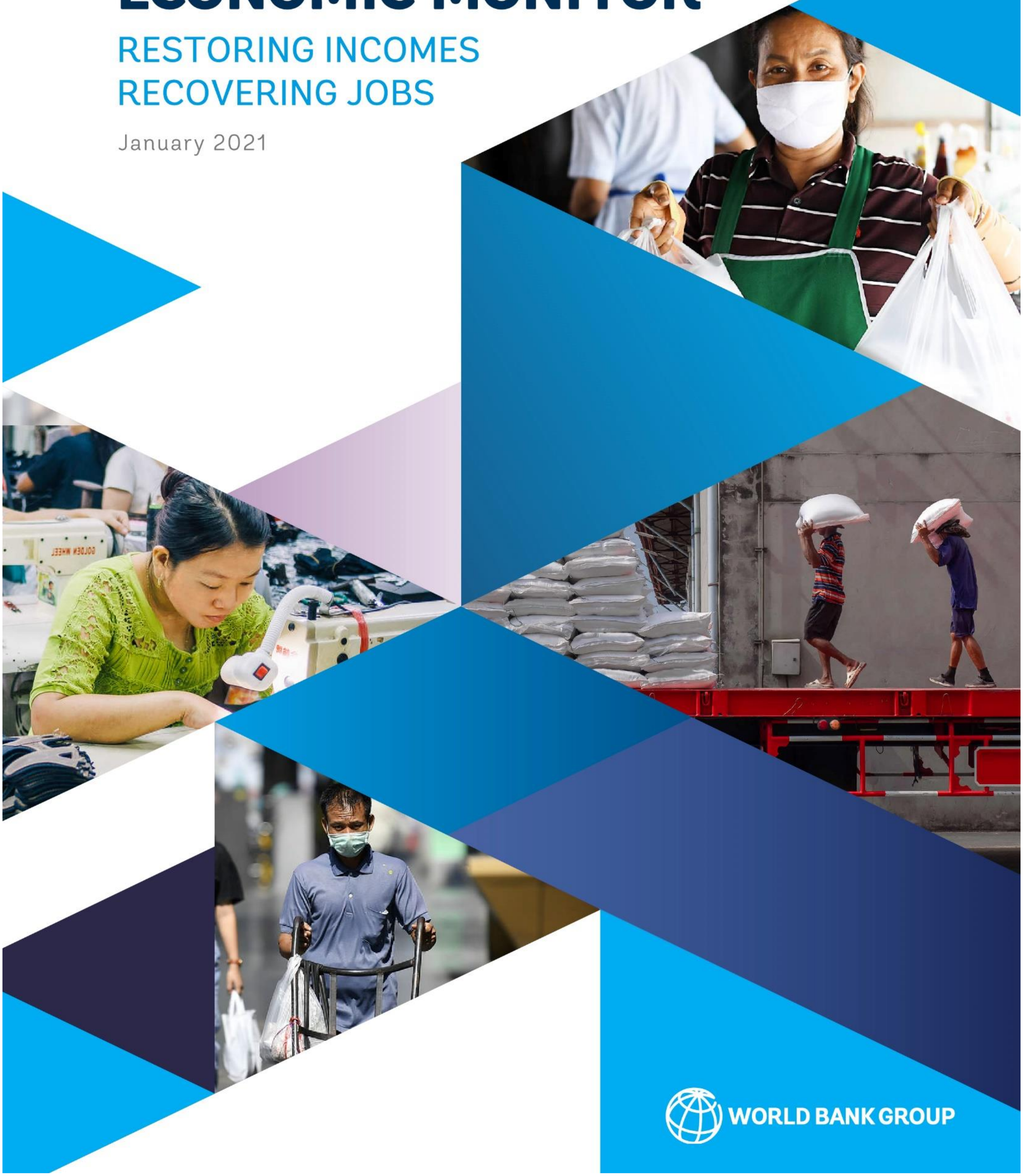
TOGETHER WE CAN TRANSFORM THAILAND

THAILAND ECONOMIC MONITOR

RESTORING INCOMES RECOVERING JOBS

January 2021



WORLD BANK GROUP

EXECUTIVE SUMMARY

Recent Developments

COVID-19 has severely affected the Thai economy, which was already weakening even prior to the global outbreak. US-China trade tensions, domestic political uncertainty and the ongoing drought caused growth to slow in 2019 and early 2020. While the spread of COVID-19 was successfully contained within Thailand's borders for most of 2020, the economic impact has been pronounced. Weak global demand, a near cessation of international tourist arrivals, and domestic mobility restrictions have depressed goods and services exports and private consumption. Private investment has also declined amid continued uncertainty around the medium-term outlook for exports and growth.

While signs of improvement have emerged in the most recent national accounts data, the second surge in COVID-19 cases is likely to constrain the recovery in the near-term. The economy contracted by 6.4 percent (yoy) in 2020 Q3, a smaller fall than the 12.1 percent contraction in Q2. Services exports remained very weak, but an easing of mobility restrictions and government stimulus provided some support, as did an agricultural sector slowly recovering from drought. Nevertheless, the economy is expected to have shrunk by 6.5 percent in 2020. This is an upward revision from the 2020 forecast in October, reflecting the stronger-than-expected Q3 performance and Thailand's success in containing COVID-19 throughout most of the year. Core price inflation resumed in Q3 (after prices declined in the previous quarter) reflecting increased domestic demand and the expiration of discounts on electricity and water bills. However, the second wave of COVID-19 – which began in December – and the associated renewal of domestic restrictions is likely to have a negative impact on consumer spending in early 2021.

The current account surplus has narrowed sharply, but net inflows on the financial account supported the Thai baht and reserves coverage remains strong. The current account surplus fell to 0.6 percent of GDP in 2020 Q2 (from 6.6 percent in the previous quarter) due to the large contraction of tourism receipts. On the other hand, financial inflows associated with the sale of foreign assets and the repatriation of deposits held abroad have supported the local currency. Nevertheless, the baht has appreciated only modestly compared with the currencies of other countries in the region as of the end of the second quarter. In the fourth quarter, the baht has resumed the appreciation trend due to the depreciation of the US dollar.

Despite global volatility in financial markets, Thailand's financial system remains stable, though there are pockets of vulnerability. Significant liquidity and capital buffers and high rates of regulatory compliance have meant that the financial sector has so far been able to weather the pandemic shock. However, increased corporate vulnerabilities and elevated levels of household debt pose significant risks, particularly if the economic recovery is slower than expected and debt service obligations become harder to bear. Household debt in Thailand is the second highest in East Asia (at 80.2 percent of GDP in March 2020). Though non-performing loans (NPLs) were stable at 3.1 percent of total loans at end-June 2020, they remain at a relatively high level. NPLs are particularly high for SMEs and could increase in the future if SMEs struggle to service loans provided in response to COVID-19 or adapt to the eventual withdrawal of financial support measures such as deferred loan payments.

With low inflation and a slowing economy, the Bank of Thailand maintained the policy rate at 0.5 percent to support economic recovery. The BOT also implemented a series of measures to support financial stability and ensure that adequate liquidity is available to banks and non-financial corporates. This included the establishment of a Corporate Bond Stabilization Fund (BSF) to provide bridge financing of up to 400 billion baht as a liquidity backstop for firms with bonds maturing during 2020.

The implementation of measures to provide soft loans to SMEs - as part of the overall pandemic response package - has proved challenging. SMEs account for over 40 percent of GDP and around 80 percent of private sector employment, but many have limited access to finance. As part of the government's approved fiscal and financial response to COVID-19 (equivalent to around 13 percent of GDP), the Bank of Thailand on-lent 500 billion baht (around 3 percent of GDP) to commercial banks to fund a dedicated SME lending program. But the disbursement of soft loans to SMEs has fallen below expectations while overall credit growth to SMEs has slowed. The government has more recently revised some of these programs to expand coverage, address credit risk issues, and extend the time frame.

The fiscal deficit widened sharply as the government ramped up spending to mitigate the economic impacts of the virus on households and firms. Revenue declined in FY2020 (year ended September) due to the impact of COVID-19 on trade and economic activity, and policy measures including a temporary reduction in withholding tax and expanded payroll tax deductions for SMEs. Spending rose, mainly due to the roll-out of pandemic relief measures. As a result, the budgetary central government deficit expanded to 5.9 percent of GDP in FY2020, from 2.3 percent of GDP in FY2019. The deficit was financed by domestic borrowing. As a result, public debt rose sharply to 49.4 percent of GDP in September 2020, its highest level since the early 2000s.

Progress has been made in implementing fiscal measures to support the most vulnerable. The fiscal response has centered on authorized borrowing of up to 1 trillion baht (about 6 percent of GDP) to fund cash transfers, the medical response, and economic and social rehabilitation (e.g. job-creating public works), in the aftermath of COVID-19. Of the 555 billion baht authorized to be spent on cash transfers for households, farmers, and entrepreneurs, around 300 billion baht has been disbursed. Despite some implementation challenges, the government has acted quickly to leverage existing social assistance mechanisms and set up new large-scale cash transfer programs to cover vulnerable individuals who would not otherwise have been covered. Overall, Thailand has performed relatively well compared to its peers in the region in terms of the scale, speed, and targeting of its response.

Outlook and Risks

The economy is expected to recover gradually over the next two years, but the outlook remains highly uncertain. Growth is projected to rebound to 4.0 percent in 2021 and pick up further to 4.7 percent in 2022, at which point output will return to its pre-pandemic 2019 level. Nevertheless, compared with our pre-COVID-19 (January 2020) projections, economic output is projected to be almost 8 percent lower per year (on average) between 2020 and 2022. In the first quarter of 2021, domestic demand will be adversely affected by the recent resurgence of COVID-19. But assuming that this outbreak is successfully contained, and vaccine distribution proceeds as planned, domestic activity is expected to recover through the remainder of the year as domestic mobility returns to pre-pandemic levels consumer and business confidence improves, and fiscal policy remains supportive. External demand will recover more slowly, reflecting only a modest recovery in global goods trade and an increase in foreign tourist arrivals from mid-2021 onwards, when borders are assumed to gradually reopen. In the absence of mitigating policy responses, the effects of the pandemic on investment, human capital accumulation, and productivity may also have longer-run impacts on potential output.

With COVID-19 cases still surging globally, risks to the outlook are skewed to the downside. The recovery could be slow and start-stop in nature if the Government is forced to reimpose stringent lockdowns, if progress on developing and distributing a vaccine is slower than anticipated, or if global activity remains weaker than expected. Relatedly, the recovery of the tourism sector will be dependent on when international borders reopen, and whether hesitation to travel internationally persists, as well as the success of efforts to promote domestic tourism as a substitute, all of which remain uncertain. Negative impacts on potential output would be exacerbated if these downside risks are realized, and financial vulnerabilities associated with SME and household balance sheets may be exposed. In such a downside scenario, growth could drop further to 2.4 percent in 2021.

Besides COVID-19, several other sources of domestic and external risk exist. Prolonged political unrest could undermine consumer and business confidence, hindering the economic recovery. It will also distract attention from the critical policy reforms needed to support recovery and bolster long-term growth, such as those outlined below. The premature removal of fiscal and financial relief could stymie Thailand's recovery, even if the pandemic is successfully controlled in the coming months. A resumption of trade tensions and/or supply chain disruptions would stall the recovery of the external sector, although recently signed and pending trade agreements could provide some support.

Thailand's Labor Market: Challenges and Policy Responses to Drive a Jobs Recovery

The labor market faced several challenges prior to the pandemic. COVID-19 struck a labor market already suffering from weaknesses, including lackluster job creation, a prevalence of low-quality jobs and informal employment, declining labor force participation, and a rapidly aging workforce. The movement of workers into higher-productivity sectors has stalled in recent years, and COVID-19 is likely to have reinforced some of the trends inhibiting the movement of workers into higher productivity jobs.

As a result of the pandemic, hours worked fell sharply and people resorted to agricultural employment as a safety net, likely increasing hardship for many households. The official unemployment rate doubled from 1.0 percent in the first quarter of 2020 to 2.0 percent in the second quarter, the highest level since 2009, with a particularly large increase for young people. By the second quarter of 2020 there were 700,000 fewer jobs in aggregate than a year earlier, and 340,000 fewer than the previous quarter. Employment losses were widespread across sectors, but a large proportion of workers who lost their jobs in other sectors seem to have moved into the low-productivity agricultural sector, which gained more than 700,000 jobs between the first and second quarters, an atypically large gain even for a sector that generally grows at that time of year. Hours worked fell by 5.7 percent for men and 7.2 percent for women between the first and second quarters of 2020, reflecting a spike in zero-hour workers and an increase in workers working fewer than 40 hours a week. The reduction in hours worked and other labor market adjustments resulted in a decline of private sector average monthly wages of 5.4 percent in the agriculture sector and 1.9 percent outside of it. These income losses likely created economic hardship for many households. Recent projections indicate that an additional 1.5 million people may have entered poverty in 2020 due to the economic impacts of COVID-19, based on a poverty line of US$5.50 (2011 PPP) per day.

Some of these employment impacts moderated toward the end of 2020. The labor force participation rate increased in the third quarter and employers added nearly 850,000 jobs resulting in year-on-year job growth of more than 1 percent. This continued in the first two months of the fourth quarter. Still, the unemployment rate remained elevated toward the end of 2020, hours worked have not fully recovered, and employment in several sectors including manufacturing remains lower than a year ago.

Thailand's rapidly aging population will cause the supply of labor to decline, exacerbating labor market challenges over the longer-term. Following a fast drop in fertility rates and improvement in life expectancy, population aging is occurring quickly in Thailand, and at a relatively low-income level compared to other aging countries. The number of years for the share of the 65-plus population to increase from 7 percent of the population to 14 percent, a measure often used to gauge the speed of population aging, was 115 years and 69 years in high-income France and the United States, respectively, but is only projected to take 20 years in Thailand. The working age share of the population is projected to decline from 71 percent of the population in 2020 to 66 percent in 2030 and 56 percent in 2060. Without changes in policy and behavior that improve the supply of labor and enhance productivity, this would imply a mechanical decrease in growth in income per capita, due to the smaller number of people working relative to the total population, and a decline in savings available for investment. Projections of the potential impact suggest that, absent any adjustments, changes in demographics will decrease average annual growth in GDP per capita by 0.86 percent in the 2020s. Population aging will therefore exacerbate the negative effects of low labor productivity (as reflected in the prevalence of low-quality jobs) and declining labor force participation on national income.

Productivity improvements and increases in the labor force participation of older people and women can counterbalance the negative growth effects of an aging population. Advancements in automation, digitization and other technologies may create opportunities for fewer workers to produce more and for firms to participate in new global value chains while reviving capital investments needed to raise Thailand's long-term growth trajectory. Increasing health and education levels and changes to the nature of work mean that there is also scope for labor force participation to increase.

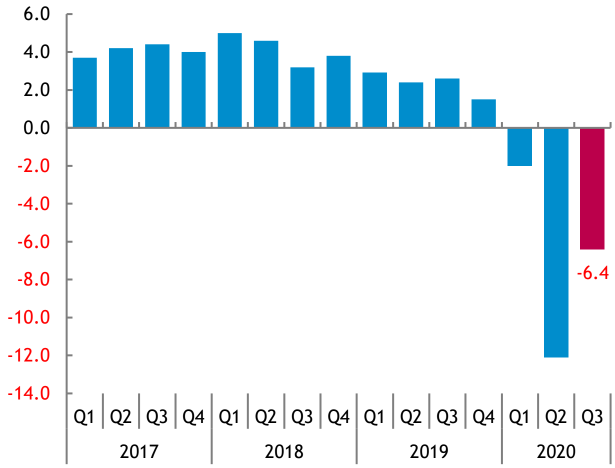
Policy options are available to counter the effects of population aging, several of which would also help promote a sustainable recovery from COVID-19. A resurgence of the COVID-19 outbreak in Thailand could require a renewed focus on employment retention policies like wage subsidies and job creation policies like public works that could help make up for reduced working hours. As Thailand recovers from the COVID-19 outbreak, upskilling and reskilling programs can be combined with financial support to help displaced workers get back to work. Training programs can target workers from sectors severely impacted by the outbreak (e.g. tourism) and provide training in strategic sectors likely to grow in the near and medium term (e.g. the care sector). Training can be provided in soft skills like teamwork and interpersonal communication, which are increasingly demanded by employers, and in entrepreneurship skills to help generate self-employment. Training can be linked to subsidies provided in the form of vouchers that finance training and act as a wage subsidy to promote demand or in the form of start-up support for self-employment. These programs should be followed by longer-term efforts to strengthen the workforce development system, including by developing an advanced labor market information system, to enhance linkages with the private sector and ensure that education and training matches the needs of employers. This will help ensure that workers acquire the sophisticated technical skills, the digital skills, and the soft (e.g. interpersonal, critical thinking) skills that will be increasingly demanded as Industry 4.0 takes hold in Thailand. Population aging also creates opportunities to increase employment in the care sector, particularly in the evolving market for aged care, which will require both lower skilled workers and highly trained specialists and highly trained specialists.

Barriers to the increased participation of women and older people can also be addressed. Female labor force participation can be increased by improving the accessibility and lowering the cost of childcare, making parental leave more generous, and bolstering old age social assistance programs. The working lives of older people can be extended by promoting flexible work arrangements and potentially increasing the retirement age, including through age or longevity indexing, that is, tying the retirement age to life expectancy at retirement age. These initiatives will need to be undertaken with the fiscal costs in mind. Some involve minimal government action, such as disseminating good practices on flexible working arrangements for older workers. Others, however, imply a more significant fiscal cost. In these cases, careful evaluation of the effectiveness of these programs is important, likely through pilots to help determine what works. The effectiveness of existing schemes, such as tax incentives to promote the hiring of older workers, should be evaluated to ensure they are achieving desired objectives. Where ineffective, savings from these programs can be redirected. While costly, action is necessary to ensure that Thailand is able to recover quickly from the COVID-19 outbreak and to counteract the long-term negative implications of population aging on growth.

Recent Developments in Charts

Figure ES 1: The Thai economy contracted less in 2020 Q3 than Q2

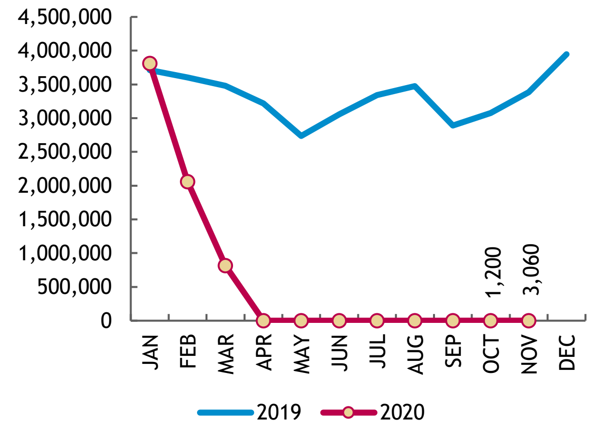
(% change, year-on-year)



Source: NESDC

Figure ES 2: … while foreign tourism arrivals ceased since April 2020

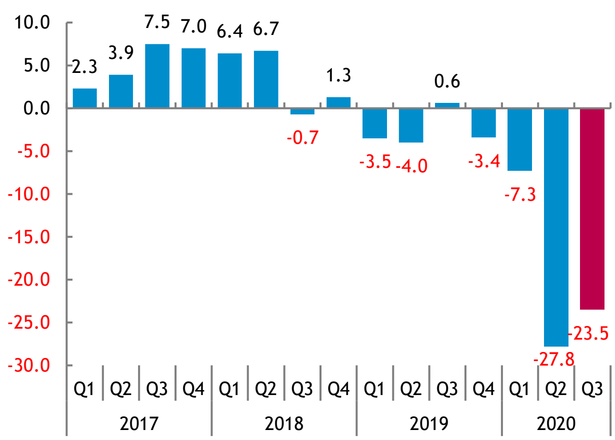
(People)



Source: Ministry of Tourism and Sports

Figure ES 3: Exports of goods and services are still massively contracting, with tourism hit hard by foreign travel restrictions

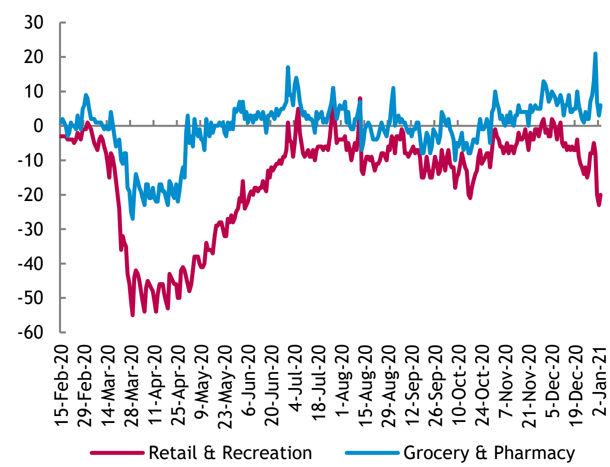
(% change, value, year-on-year)



Source: NESDC

Figure ES 4: Mobility improved after the easing of restrictions in mid-2020, as reflected by increased private consumption, but worsened again in response to the second wave

(Change in visits relative to baseline)



Source: Google Community Report

Note: Grocery & Pharmacy represents mobility trends for places like grocery markets, food warehouses, farmers markets, specialty food shops, drug stores, and pharmacies. Retail & Recreation represents mobility trends for places like restaurants, cafes, shopping centers, theme parks, museums, libraries, and movie theaters

Table ES 1: Macroeconomic indicators

	2018	2019	2020f	2021f	2022f
Real GDP Growth Rate (at constant market prices)	4.1	2.4	-6.5	4.0	4.7
Private Consumption	4.6	4.5	-1.3	3.6	4.2
Government Consumption	1.8	-1.7	2.3	2.3	2.0
Gross Fixed Capital Investment	5.4	3.3	-4.4	1.5	2.1
Exports of Goods and Services	3.3	-2.6	-18.5	6.0	6.6
Imports of Goods and Services	8.3	-4.4	-15.3	4.5	4.7
Real GDP Growth Rate (at constant factor prices)	4.2	2.4	-6.4	4.1	4.7
Agriculture	5.0	2.0	-3.9	2.2	2.2
Industry	2.7	2.6	-6.9	4.0	4.5
Services	5.0	2.3	-8.0	4.3	5.0
Inflation (Consumer Price Index)	1.1	1.1	-0.9	1.0	1.3
Current Account Balance (% of GDP)	6.5	5.0	0.8	2.2	3.8
Fiscal Balance (% of GDP)	-2.0	-2.3	-5.9	-6.5	-3.1
Debt (% of GDP)	42.0	41.1	49.4	54.4	55.4

Source: NESDC; World Bank staff calculations

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