WORLD BANK GROUP

THAILAND ECONOMIC MONITOR

BUILDING A RESILIENT FUTURE: COPING WITH DROUGHTS AND FLOODS

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EXECUTIVE SUMMARY

Recent Developments

Economic growth rebounded in 2023 Q1 by 4.5 percent due to domestic demand and tourism but still trailed behind peers due to external challenges. Economic reopening and the authorities' measures to mitigate cost-of-living pressures supported the recovery. Tourism arrivals reached 70 percent of the pre-pandemic level in April, surpassing Indonesia and the Philippines following the reopening of China but remained below the global average. However, because of the economy's heavy reliance on tourism and trade, the recovery only surpassed pre-pandemic levels in 2023 Q1 (Figure ES 1) and lagged that of its ASEAN peers, most of which returned to pre-pandemic levels by late 2021. Thailand experienced a sharp contraction in goods exports growth in 2022 Q4, similar to ASEAN peers as global demand slowed (Figure ES 2).

The current account returned to surplus in line with the recovery of the tourism sector and falling oil prices. The current account surplus reached 3.0 percent of GDP in Q1 2023, its highest in more than two years, after turning positive in the previous quarter, supported by both goods and a trade surplus. The financial account in Q4 2022 was positive for the first time in three quarter as foreign direct investments continued to increase and portfolio accounts turned positive. The increased portfolio inflows were boosted by stronger confidence over Thailand's economic outlook post-China reopening. The Real Effective Exchange Rate (REER) appreciated by 4.1 percent in the last quarter of 2022 on the positive current account and improved investor confidence about Thailand's economic outlook but depreciated slightly in 2023 Q1 amid concerns over Fed tightening. International reserves remained ample at 47 percent of GDP, the highest among Emerging Asian economies, covering 10 months of imports.

Inflation has peaked and fallen back into the central bank's target range but underlying price pressures persist. Headline inflation slowed to 2.7 percent in April, having remained within the target range of 1-3 percent for the third consecutive month amid declines in core and raw food inflation (Figure ES 3). The government continued to impose caps on other energy prices, including electricity and cooking gas, which also helped contain inflation pressure. Core inflation declined, reaching 1.8 percent, but remained higher than its pre-pandemic average of 0.7 percent over 2016-2019. While market-based forward-looking measures of inflation expectations remain well-anchored at around 2.4 percent, continued monitoring of pass-through from producer prices to consumer prices will be necessary to determine whether core inflation will persist. The central bank has stayed the course on gradual monetary normalization to contain still-elevated core inflation while supporting the economic recovery.

Fiscal responses to high energy price have supported the recovery but slowed the path to consolidation, while a long political transition may slow public investment. The central government's deficit narrowed in first half of FY23 (Oct 2022- Mar 2023) to 6.7 percent of GDP from 9.6 percent the same period last year. A smaller deficit reflected the falling government expenditures to 22.8 percent of GDP, down from 25.8 percent last year as spending need for COVID relief waned. However extended cost-of-living support measures through social benefits, subsidies, and price controls have constrained fiscal consolidation and maintained fiscal deficit at above the 2019 pre-pandemic level. Despite recent economic recovery, revenue collection has remained relatively low at 15.8 percent in the same period. Public debt rose to 61.2 percent of GDP at the end of March 2023, 20 percentage points higher than the pre-pandemic period, and remained sustainable. Continued price controls applied to energy and public transport helped contain cost of living pressures, but such controls tend to be an inefficient method of redistributing income, are often regressive in their impact and may delay efficient reallocation of resources and distort the inflation process, thereby complicating monetary policy.

The financial system remains stable overall, although risks associated with high levels of household debt remain. Capital and liquidity buffers at commercial banks remain well above regulatory requirements, with profitability rising. Indicators of asset quality continued to improve. Gross non-performing loan (NPL) ratio declined to 2.8 percent as of 2022 Q4, comparable to regional peers and reflects the continued support of banks for their borrowers through debt restructuring and loan profile management. However, the continued relaxation of loan classification norms to support borrowers may mask further deterioration of balance sheets and lead to an increase in NPLs. Special mention loans stood at 6.1 percent of total loans, though lower than the peak of 7.7 percent during pandemic, remains significantly higher than the pre-pandemic levels of 2.8 percent in December 2019. High household debt– at 85.7 percent of GDP as of 2022 Q4 – stands well above major ASEAN economies and is comparable to advanced economies. The composition of household debt in Thailand warrants particular attention due to the large share of uncollateralized lending.

Labor market conditions have improved due to the recovery of sectors related to tourism--trade and hospitality. Employment in trade and hospitality continued to trend up supported by a strong rebound in tourism. Manufacturing employment remained relatively stable, despite a decline in manufacturing exports for two consecutive quarters. The unemployment rate stood at 1.1 percent, down from 1.5 percent in the same quarter last year and almost returning to its pre-pandemic level at 1.0 percent in Q1 2020. The underemployment rate stood at 8.4 percent of the labor force in Q1 2023, falling to below the pre-pandemic level of 9.5 percent in Q1 2020. Poverty is expected to have declined in 2022, underpinned by the labor market recovery.

Outlook and Risks

The recovery momentum will strengthen in 2023 supported by tourism recovery before slowing due to global headwinds. Growth is projected to accelerate from 2.6 percent in 2022 to 3.9 percent in 2023 (Table ES 1), 0.3 percentage points higher than expected in April 2023 mainly due to tourism recovery and stronger-than-expected demand from China. However, goods exports is projected to contract due to weakening demand in major advanced economies. After rebounding in 2022 following domestic reopening, private consumption growth will slow but remain solid, supported by the ongoing recovery, with improved labor market and strong pent-up tourism demand from China. Public investment will remain weak due to the long transition towards a new government. Growth in 2024 and 2025 are expected to expand at 3.6 percent and 3.4 percent, respectively, with tourism and private consumption remaining the major drivers as external demand weakened. Long-term potential growth is estimated at 3.0 percent, slower than 3.6 percent estimated over 2010-2019.

The current account balance is expected to reverse from its deficit of the past two years and return to positive territory in 2023 at 2.5 percent of GDP due to both goods and services trade. Although the goods export outlook remains weak, the lower import bill amid easing global oil prices will contribute to a stronger trade surplus. The tourism sector recovery and the normalization of shipping costs will also support the current account surplus.

Headline inflation is projected to moderate to 2.0 percent in 2023, below most emerging markets amid easing global energy prices, price caps and below-potential growth. The deceleration in inflation from 6.1 percent in 2022 the previous year, reflects the lowered energy price inflation, which is projected to fall from 25 percent in 2022 to just 1.9 percent, as well as below-potential growth until 2025. Brent crude oil prices are forecasted to average USD 84 per barrel in 2023 amid weaker global demand. Continued caps on energy prices, including electricity and cooking gas, are expected to remain until Q3 2023 and will help contain inflation pressure in the rest of year. However, underlying price pressures persist as core inflation remains higher than its pre-pandemic average. Continued price controls applied to energy and public transport helped contain cost of living pressures, but such controls tend to be a costly method of redistributing income, are often regressive in their impact and may delay efficient reallocation of resources and distort the inflation process, thereby complicating monetary policy.

Public debt is projected to peak at slightly above 60 percent in the medium term. Over the medium term, public debt is projected to remain sustainable as the narrowing fiscal deficit and recovering output would contribute to a gradually declining debt to GDP ratio. Largely denominated in local currency, Thailand's debt is also resilient to foreign currency risk.

Despite recent resurgent growth, the output level is unlikely to return to the pre-pandemic path and is expected to remain below its potential level from 2023 to 2025. This path could be dampened further by the difficult external environment and possible re-escalation of energy prices. Delays in government formation may set back public investment. Structural challenges, such as an aging population, climate change, low capital investment accumulation, declining export competitiveness, and high household debt, may further limit potential growth (Figure ES 5). The EAP region, including Thailand, is exposed to climate risks, particularly floods and droughts, in part because of the high density of population and economic activity along the coasts (see part 2 on *Coping with Floods and Droughts*). Unlike many other emerging markets, Thailand still has the fiscal space to meet rising spending needs associated with aging and climate change if expenditure and revenue reforms are undertaken (Figure ES 6) (see WB *Thailand Public Revenue and Spending Assessment* 2023).

Coping with Floods and Droughts in Thailand

Thailand, like many ASEAN economies, is already acutely vulnerable to floods and droughts. In recent decades, Thailand has been subjected to frequent floods and droughts. Thailand currently ranks ninth globally in the INFORM index of risks from floods, below Vietnam, Myanmar and Cambodia. The 2011 floods caused 680 deaths, affected nearly 13 million people, and resulted in damages and losses to the economy worth an estimated THB 1.43 trillion (USD 46.5 billion), equivalent to 12.6 per cent of GDP. UNDRR (2020) estimates the average annual losses related to flooding at USD 2.6 billion. Bangkok and the export industries around it remain especially vulnerable to flooding, despite the introduction of flood control measures. Thailand also frequently suffers from droughts resulting from shortage of rainfall, reduced flow in surface and sub-surface rivers, and poor land management practices (Figure ES 4). The entire country was affected by severe droughts in 1979, 1994, and 1999; the north-eastern region, which has the highest poverty rates, is particularly vulnerable to drought.

Climate change will increase the frequency and intensity of floods in the coming decades. Changes in weather patterns resulting from climate change are increasing the impacts of floods. Although there remains considerable uncertainty in the modelling, current projections suggest that there will be an increase in the annual precipitation rates in Thailand. Moreover, the increases in rainfall are predicted to occur during the wet season, suggesting an increase in susceptibility to flooding. In 2017, rainfall anomalies exceeded those of 2011. Without climate adaptation measures, the potential impacts of another 1-in-50-year flood event similar to the one in 2011 could double.

Climate change will also increase the intensity and frequency of future droughts. The average from a combination of future climate projections suggests that average daily temperatures in Thailand could increase by 1.8°C by 2050. Although total precipitation is expected to increase, there will be more dry days outside the wet season, leading to an increase in the frequency and severity of future droughts. Thailand will be susceptible to El Niño-related droughts and the frequency of 'severe meteorological droughts' will increase substantially after 2050 in high emission scenarios. Higher average temperatures will exacerbate the effects, as will rising sea levels and saline incursion.

The public costs of floods and droughts are already substantial and will grow in the future. The Thai government lost an estimated 3.7 percent of tax revenues in 2011 and 2.6 percent of revenues in 2012 because of floods. The public sector faced THB 141 billion of losses to property and an estimated reconstruction bill of THB 388 billion (3.4 percent of GDP). In 2019, it was reported that the government provided THB 25 billion (0.15 percent of GDP) to farmers to compensate directly for damage to crops from drought and flooding. Further measures to support affected farmers were also announced with a cost of THB 60 billion (0.36 percent of GDP). Future costs to the government in providing compensation (mainly to farmers) are expected to increase over time.

The macroeconomic costs of floods will grow; a 1-in-50 year flood (i.e. the 2011 floods) in 2030 would cost more than 10 percent of GDP in lost production. As climate change increases the severity and frequency of floods, the economic costs will also grow. If floods cover wider areas, more businesses will be forced to reduce production during the flood and recovery period. Businesses that are not directly affected by the floods may still be forced to reduce production because of supply-chain problems. Loss of income could also have further demand-side effects on the economy. Overall, the effects of a 1-in-50 year flood is likely to be a loss of 10 percent of production. If supply chains are unable to adapt, the impact could be a 15 percent loss of production. Businesses can therefore offset some of the effects of floods by maintaining supply-chain flexibility. However, impacts will remain substantial without centralized adaptation measures.

Progress has been made to better cope with floods and droughts but certain challenges remain. Since the establishment of the Office of the National Water Resources (ONWR), the coordination of the different entities involved in flood and drought management has substantially improved and ONWR has increasingly supported the planning of flood and drought mitigation measures. However, several other recommendations of the Post Disaster Needs Assessment of the 2011 floods still have not been addressed. The institutional and legal reform process started in 2017 with the enactment of the Water Resources Act (2018) is incomplete and the institutional landscape remains fragmented as each institution has protected its traditional mandate that it has spearheaded. Furthermore, the different ministries, departments and agencies often face funding and staffing challenges with resulting implications on fulfilling their mandate, provision of services as well as proper operation and maintenance of aging infrastructure.

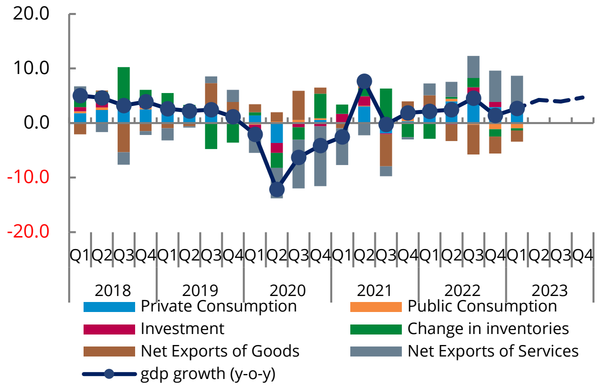
Robust cost-benefit assessments are needed to identify and prioritize suitable flood and drought prevention measures. This is especially important for the provinces which are most vulnerable to the risk of such events, including the Greater Bangkok area which accounts for a significant part of the population and economy. Measures should include both infrastructure investments and softer ones, such as effective early warning and community-based adaptation systems.

An integrated comprehensive framework is needed for climate adaptation. The four key points highlighted in *An EPIC Response: Innovative Governance for Flood and Drought Risk Management* (Browder et al., 2020) include: i) an enabling environment, ii) prioritized risk mitigation planning, iii) investment in water resources infrastructure, and iv) controlling land and water use. The latest advancements to improve water use efficiency, promote a circular economy, and integrate nature-based solutions can also significantly contribute to enhancing resilience to floods and droughts.

Recent Developments and Medium-Term Outlook

Figure ES 1: Thailand's recovery picked up due to private consumption and tourism while…

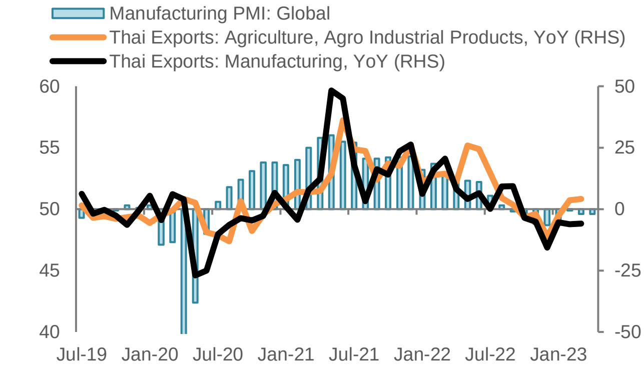
(Percentage-point contribution to real GDP growth, year-on-year)



Source: NESDC.
Note: Change in inventories include statistical discrepancies.

Figure ES 2:…weak global demand weighed on goods exports.

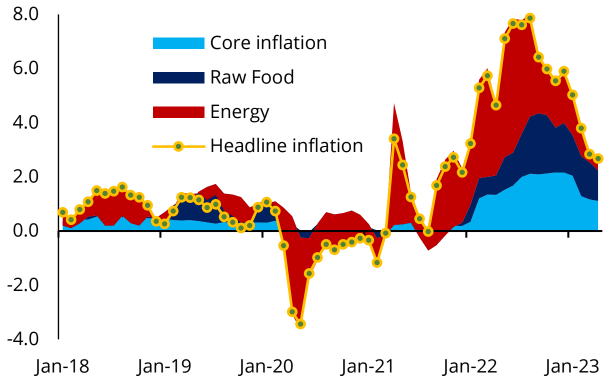
(left: diffusion index; right: Percent year-on-year)



Source: CEIC; World Bank staff calculations.

Figure ES 3: Headline inflation declined after peaking last August but core inflation remained elevated.

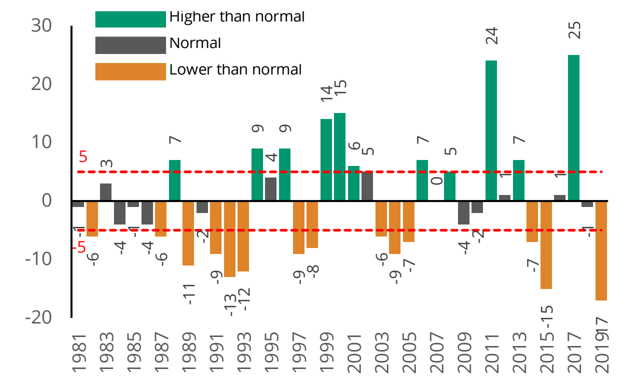
(Contribution to headline inflation, % change y-o-y)



Source: CEIC; World Bank staff calculations.

Figure ES 4: Rainfall anomalies in Thailand are rising (1981-2019).

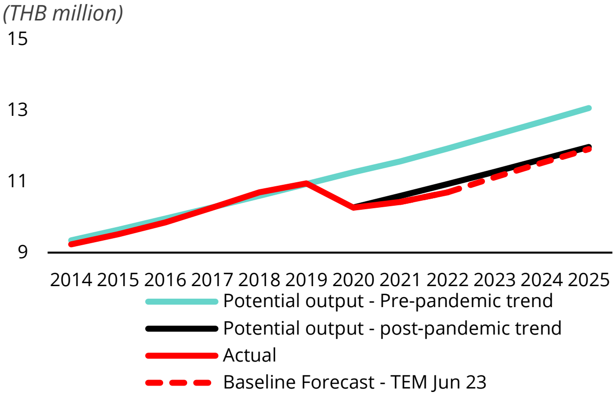
(Percentage of rainfall anomalies in Thailand, mm.)



Source: HII, 2019: Thailand Water Situation 2019 (ThaiWater.net)

Figure ES 5: Weak global demand, aging and climate change weigh on the outlook.

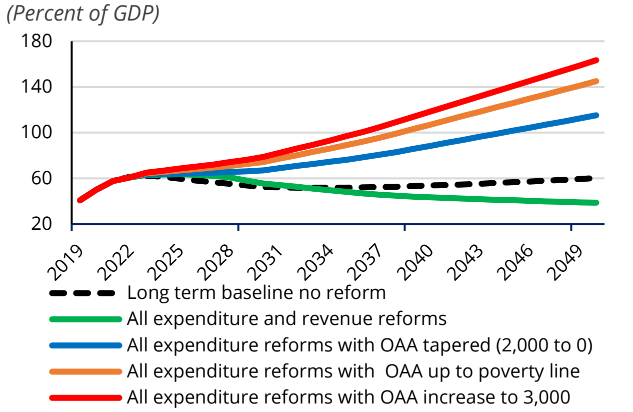
(THB million)



Source: Haver Analytics; World Bank staff projections

Figure ES 6: Spending needs related to aging and climate adaptation can be met under fiscal reforms.

(Percent of GDP)



Source: Ministry of Finance, Public Debt Management Office; World Bank staff projections.

Table ES 1: Macroeconomic Indicators

	2020	2021	2022	2023f	2024f	2025f
Real GDP Growth Rate (at constant market prices)	-6.1	1.5	2.6	3.9	3.6	3.4
Private Consumption	-0.8	0.6	6.3	3.8	3.4	3.0
Government Consumption	1.4	3.7	0.2	-2.6	1.1	2.5
Gross Fixed Capital Investment	-4.8	3.1	2.3	2.1	2.1	3.7
Exports of Goods and Services[1]	-19.7	11.1	6.8	7.3	6.4	4.3
Imports of Goods and Services	-13.9	17.8	4.1	1.5	4.2	4.0
Real GDP Growth Rate (at constant factor prices)						
Agriculture	-2.9	2.6	0.5	1.4	2.0	2.2
Industry	-5.1	6.0	-1.0	0.7	2.8	3.6
Services	-5.6	-0.5	4.9	6.4	4.6	3.7
Inflation (Consumer Price Index)	-0.8	1.2	6.1	2.0	1.9	1.3
Current Account Balance (% of GDP)	4.2	-2.1	-3.5	2.5	4.4	4.9
Fiscal Balance (General Government, % of GDP)	-4.7	-7.0	-4.5	-2.1	-1.9	-1.9
Debt (% of GDP)	50.2	57.8	59.7	59.0	58.5	58.7

Note: 1/ Exports of goods and services accounted for 69.4 percent of GDP in 2022**.** See more details in the outlook section.
***Source*:** NESDC; World Bank staff calculations.

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