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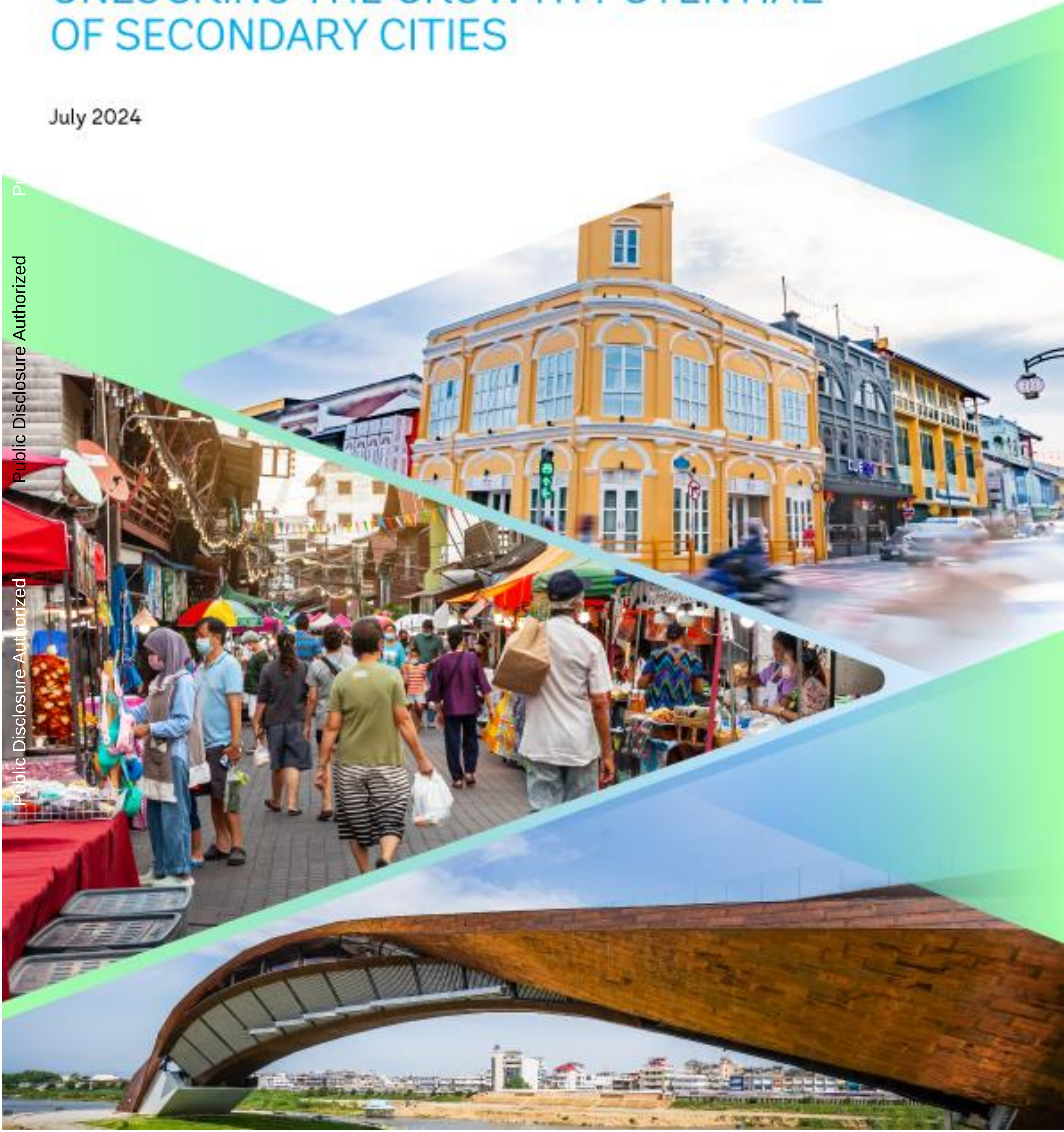
WORLD BANK GROUP

THAILAND ECONOMIC MONITOR

UNLOCKING THE GROWTH POTENTIAL OF SECONDARY CITIES

July 2024



EXECUTIVE SUMMARY

Recent Developments

The economic recovery faltered due to global and domestic headwinds as growth fell to 1.5 percent year-on-year in 2024 Q1, (Figure ES 1)**.** Goods exports and manufacturing contracted by 2.0 percent and 3.0 percent[1], respectively, due to weak external demand. Internally, budget delays resulted in public investment and public consumption contracting by 27.7 and 2.1 percent, respectively. Tourism and private consumption, supported by cost-of-living measures, continued to expand. However, Thailand's tourism arrivals showed signs of losing momentum: arrivals reached only 86 percent of pre-pandemic levels in March as the recovery in global services trade neared completion; Chinese arrivals remained significantly below pre-pandemic levels (58.2 percent). The budget delay combined with the exposure to tourism and trade caused the Thai economy's post-pandemic recovery to lag further behind peers such as Malaysia and Philippines (Figure ES 2).

The current account remained positive at 2.2 percent of GDP in Q1 2024 but underlying weaknesses persist. Despite a goods trade surplus, goods exports contracted by 9.5 percent, in line with weak manufacturing. The financial account balance registered a deficit for the first half of this year, amid exchange rate depreciation, net FDI outflow and net foreign portfolio outflow. Meanwhile, the Real Effective Exchange Rate (REER) depreciated by 2.5 percent, one of the largest in the region. This depreciation was linked to the US dollar appreciation, uncertainty within local markets regarding new fiscal stimulus measures, and the persistent vulnerability of the current account balance.

Inflation has turned positive but remained the lowest among emerging markets due to energy subsidies and a weak recovery. After seven months in negative territory, headline inflation turned positive due to the partial withdrawal of energy subsidies and elevated food prices (Figure ES 3). In April, the government lifted the ceiling on retail diesel prices. However, subsidized electricity prices, including the reduced price for low-income households, were kept unchanged. Core inflation (excludes energy and raw food) remained weak at 0.4 percent, below its pre-pandemic average of 0.7 percent over 2016-2019, due to lower-than-expected prepared food prices and the delayed closing of the output gap. More price pressures may emerge if electricity price subsidies are further reduced and global energy prices surge. The central bank maintained its neutral policy rate but risks of underlying price pressures obscured by price controls and the potential impact of the large Digital Wallet universal cash transfer on growth and inflation complicates monetary policy.

The financial system remained stable amid improving but weak profitability, although risks associated with high levels of household debt persist. Capital and liquidity buffers at commercial banks remained well above regulatory requirements, with profitability rising. Indicators of asset quality continued to improve. Non-performing loan (NPL) ratio remained low at 2.8 percent as of Q2 2024. Profitability stood below pre-pandemic levels with return on assets at 1.2 percent and return on equity at 8.9 percent but continued to improve. Household debt stood at elevated level even compared to advanced economies (91.6 percent of GDP as of Q4 2023) and the highest among ASEAN peers. The composition of household debt in Thailand warrants attention due to the large share of uncollateralized lending (44 percent of GDP). Higher interest rates could strain households' ability to service debt.

The fiscal stance has become less expansionary as capital spending lapsed due to the delayed budget. The FY24 budget of THB 3.48 trillion (18.9 percent of GDP, cash basis) took effect in late April, after a seven-month delay. In the first half of FY24 (October 2023 - March 2024), the central government's fiscal deficit (GFS basis) declined to 3.5 percent of GDP, a notable decline from the 7.1 percent in the same period last year. The general government structural balance in FY23-24 showed a smaller deficit due to less expansionary policies, mirroring trends among ASEAN peers as governments prioritized fiscal consolidation in the wake of the pandemic. However, Thailand's decline was more pronounced than that of its ASEAN peers, due to delays in FY24 budget approval, which led to minimal capital spending (0.04 percent of GDP) and moderated recurrent spending.

Poverty declined in 2022 due to the labor market recovery. Per capita household consumption showed an 8.1 percent growth between 2021 and 2022 as the unemployment rate declined and average wages rose. Certain stimulus programs, such as the half-half initiative, and social assistance programs like the state welfare card and old age allowance, provided support to low-income households. With the rise in household income and consumption, the national poverty rate fell from 6.3 percent in 2021 to 5.4 percent in 2022. The decline in poverty was slightly more pronounced in urban areas compared to rural ones, decreasing from 5.2 percent to 4.2 percent in urban areas and from 7.8 percent to 7.1 percent in rural areas between 2021 and 2022.

Outlook and Risks

The economy is projected to recover in 2024 supported by sustained private consumption as well as tourism and goods exports recovery. Growth is projected to accelerate from 1.9 percent in 2023 to 2.4 percent in 2024 (Table ES 1). Private consumption and tourism will be key drivers but their pace will slow. Goods exports are expected to rebound due to favorable global trade (Figure ES 4). Tourism is projected to return to pre-pandemic levels in mid-2025, set back by the slowdown of the Chinese economy. The planned Digital Wallet[2] is not yet included in the baseline but could potentially boost near-term growth further if implemented. Potential growth for 2023-30 is estimated at 2.7 percent, 0.5 percentage points lower when compared to the previous decades due to aging and subdued productivity growth. This slowdown is also observed among regional peers, as the average potential growth in the East Asia and Pacific (EAP) region is projected to average 4.8 percent over the remainder of this decade (down from 6.2 percent in the decade to 2021).[3]

The current account balance will moderate in 2024 and support external stability but remain below pre-pandemic levels. The current account surplus will moderate from 1.4 percent of GDP in 2023 to 1.0 percent of GDP in 2024, driven by weaker-than-expected goods export in Q1 and a net services trade deficit due to supply disruptions in the Red Sea despite recovering tourism revenue.

Headline inflation is projected to slow to a regional low of 0.7 percent in 2024, below the central bank's target range, due to the moderation in food and energy prices and a negative output gap. This decline is attributed to lower-than-expected food prices energy prices and core inflation despite the partial withdrawal of energy subsidies. Food prices and core inflation are expected to increase.

Public debt is projected to rise to 64.6 percent in FY25. The fiscal deficit is projected to increase to 3.6 percent of GDP as budget execution normalizes and fiscal stimulus measures aimed at boosting consumption are implemented, in line with the government's medium-term fiscal framework. While public debt is projected to remain sustainable (Figure ES 5), the pressure for higher social spending and public investments in human capital due to aging is rising. Thailand currently still has the room to raise tax revenue and maintain fiscal sustainability while meeting both spending pressures and investment needs (WB Thailand *Public Spending and Revenue Assessment* 2023).

Thailand faces the mounting challenge of reconciling fiscal sustainability and short-term stimulus. The government projected that public debt will rise to 68.6 percent of GDP by 2028 as spending needs rise.[4] Pro-growth consumption-stimulating measures such as the Digital Wallet have added to this pressure. To enhance fiscal resilience amid rising spending needs, Thailand can start by focusing on more targeted social assistance and transfers to effectively support vulnerable households and poverty alleviation. In addition, Thailand has room to raise tax revenue, promote equity, create fiscal space and accelerate investment. In the long-term, potential growth could be lifted through fiscal reforms to unleash multiple growth poles across the country; implementing public infrastructure investments can connect and empower lagging regions,

[1] Growth terms are in year-on-year terms, unless specified otherwise.

[2] The government is waiting for BAAC's estimates of financial and management costs before seeking approval from the Council of State regarding financing from the BAAC, a state-owned bank. Once there is certainty about how the scheme will be implemented, the scheme would be included in World Bank baseline projections.

[3] World Bank Global Economic Prospects, June 2023

[4] Medium-Term Fiscal Framework, Fiscal Policy Office, May 28, 2024.

crowd in private investment and support structural transformation (Figure ES 6; see Chapter 2 on Secondary Cities).

Building Tomorrow: Infrastructure Finance for Thailand's Secondary Cities

Thailand's urbanization has been heavily focused on Bangkok. Bangkok is one of the most primate cities[5] in the world. Bangkok's strategic geographic position within Southeast Asia, coupled with its comparatively developed infrastructure and transportation networks, has fostered economic growth and activities within the city and surrounding areas. At the same time, Bangkok has become ever more congested, and the inefficiencies and problems related to that congestion are becoming more expensive and harder to overcome. The 2011 floods also highlighted Thailand's economic vulnerability due to the concentration of critical industries in Bangkok. Climate change will further strain Bangkok's infrastructure and the nation's economy, emphasizing the need for a more diversified economic base.

A portfolio of places is needed for economic growth. The World Bank's 2009 *World Development Report* (WDR) advised policymakers to see their role as "prudent managers of a portfolio of places." One city cannot do it all. Different types of cities serve different functions, with large cities like Bangkok providing world-class levels of services for business and government, while medium size cities may be better suited for manufacturing. Many of Thailand's secondary cities are already regional centers of economic activity, with a diverse array of industries and sectors. These cities are vitally important in their regions, and they have the potential to be much stronger contributors to a balanced national economy.

Recently, per capita GDP growth in Thailand's secondary cities has been nearly 15 times higher than in Bangkok. While Bangkok's economy seems to be mature and potentially saturated, these cities have been growing their productivity faster than their populations. With appropriate investments in infrastructure, human capital, and institutional capacity; and with adjustments to the intergovernmental framework, a number of these cities have the potential to further enhance Thailand's productivity, spur its economic growth, and bolster its global competitiveness. Within their respective regions, these urban centers can prospects for individuals and businesses alike, while contributing to the mitigation of poverty in surrounding rural areas.

Thailand's secondary cities are overly dependent on nationally raised revenues. Because they have little control over their own spatial planning, infrastructure development, and fiscal policies, these cities depend heavily on transfers from the national budget to support the required infrastructure development, and this keeps them from realizing their economic potential. While substantial capital investment is necessary, they do not need to rely on national resources. If local governments have greater authority over urban planning, infrastructure development, and access to long-term financing mechanisms—complemented by robust fiscal instruments such as property taxes, income tax piggybacking, and user charges—these cities could effectively chart their own economic growth trajectories.

Cities need robust revenue instruments to thrive. These instruments could include a property tax with more local control or surcharges on national income taxes. Additionally, fees and charges for urban services need to be reassessed, as they currently fall short of supporting the infrastructure necessary for a modern economy. Thailand's cities do not have the authority to set their own property tax rates or tax base. This lack of control impairs the adequacy and reliability of local taxation, starving cities of the revenues they need for operations and investment. If greater autonomy and reliability in property taxes proves difficult in the Thai context, an alternative could be a "piggyback" local tax which relies on the national personal income tax collection system. Empowering local authorities to implement fair and reasonable taxes, in consultation with their communities, would be an important first step in ensuring fiscal sustainability.

Cities with adequate and reliable revenues can access capital for infrastructure development. Municipal borrowing and public-private partnerships (PPPs) are proven ways for cities to secure capital for

[5] Primary cities and primate cities are related concepts in urban geography. Bangkok is both primary and primate. A primary city is the largest and most important city in a country or region, while a primate city is disproportionately large compared to other cities in the country, dominating the country's urban system economically, culturally, and politically. See discussion of Bangkok's primacy in Box 4 of Part 2.

infrastructure investment, allowing citizens and firms to benefit from modern services while they pay for them. Wherever there are reliable and adequate revenue streams, cities can leverage these to secure infrastructure and pay for it over time. Cities across the world use these tools and are able to attract significant capital to finance local infrastructure.

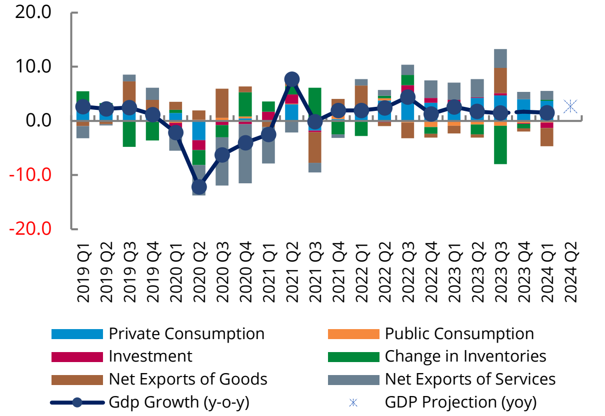
Empowering Thailand's secondary cities would be a significant paradigm shift. The possibilities that we suggest in this chapter cannot be realized through marginal adjustments to existing policies. An intergovernmental fiscal policy that puts more responsibility and accountability on local government, and frees communities to plan their own futures, would require systemic change. The planning authority, fiscal instruments, and long-term financing powers of local government would all need to change, as would requirements for local government transparency, consultation, participation, and downward ac-countability. The model could be what the European Union calls the principle of subsidiarity: governance decisions should be taken at the lowest practical level of government, and as close to the citizen as possible – so that if a matter can be handled by local government, it should be.

A paradigm shift of this magnitude could not occur overnight. If the decision to empower local governments were made in principle, it would still necessitate years of capacity-building and experiential learning. Local Administrative Organizations (LAOs) would need to cultivate expertise in consistently assessing community needs, designing projects to address these needs, and securing financing for implementation. The transition would require legislative and institutional reforms to grant LAOs increased authority while ensuring greater accountability. It would require local planning processes that are responsive and adaptable to market demands for land, housing, labor, and transportation. The challenge lies not just in the decision itself, but in the complex, multi-faceted implementation process that would follow.

Recent Developments and Medium-Term Outlook

Figure ES 1: The Thai economy slowed due to the contraction in government consumption and total investment

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

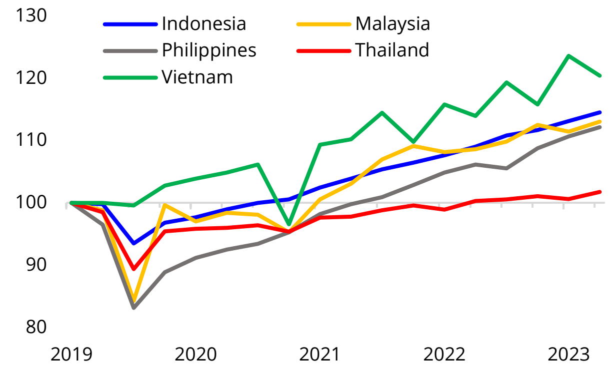


Source: NESDC.

Note: Change in inventories include statistical discrepancies; 2023 Q4 is estimated.

Figure ES 2: …Thailand's post-pandemic recovery lagged behind ASEAN peers

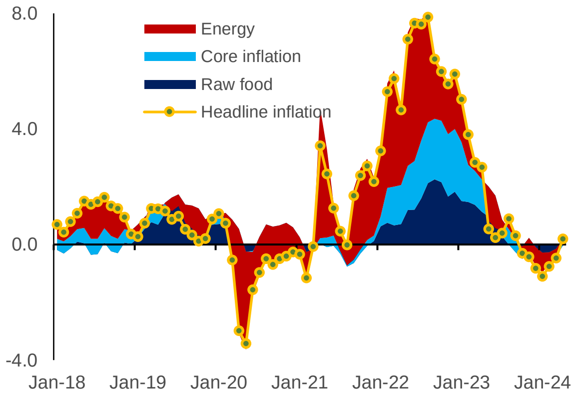
(GDP Index, seasonally adjusted, Q4 2019 = 100)



Source: CEIC; World Bank staff calculations.

Figure ES 3: Headline inflation turned positive due to cost-of-living measures and easing global prices

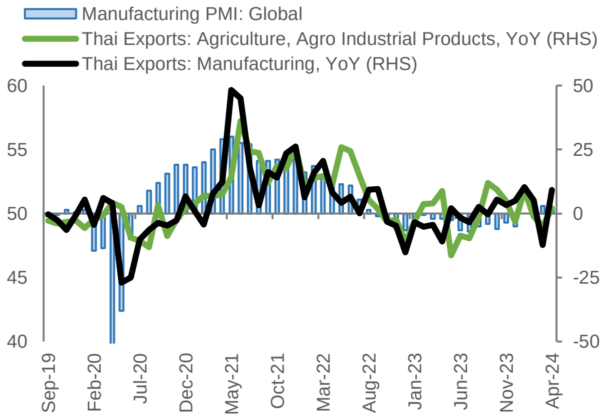
(Contribution to headline inflation, % change y-o-y)



Source: CEIC; World Bank staff calculations.

Figure ES 4: Indicators point to an ongoing recovery in goods exports

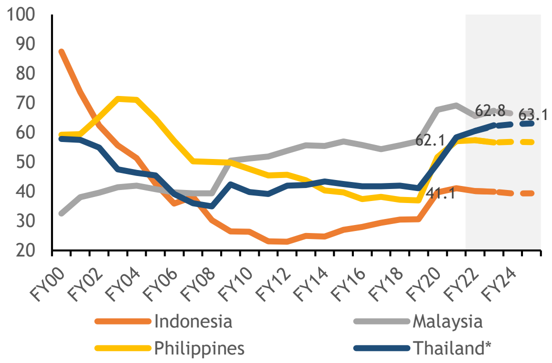
(left: diffusion index; right: Percent year-on-year)



Source: Haver Analytics; CEIC; World Bank staff calculations.

Figure ES 5: Public debt is projected to rise but remains sustainable

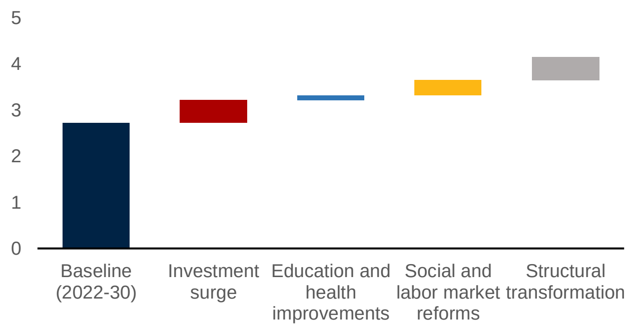
(Percent of GDP)



Source: CEIC***;*** World Bank staff projections.

Figure ES 6: The growth potential could be uplifted by investments including in secondary cities

(Potential growth, illustrative reform scenario, percentage points)



Source: *Thailand SCD;* World Bank staff projections.

Table ES 1: Macroeconomic Indicators

	2020	2021	2022	2023	2024f	2025f
Real GDP Growth Rate (at constant market prices)	**-6.1**	**1.6**	**2.5**	**1.9**	**2.4**	**2.8**
Private Consumption	-0.8	0.6	6.2	7.1	3.6	2.6
Government Consumption	1.4	3.7	0.1	-4.6	1.2	2.6
Gross Fixed Capital Investment	-4.7	3.1	2.3	1.2	2.1	2.8
Exports of Goods and Services[1]	-19.7	11.1	6.1	2.1	4.7	3.5
Imports of Goods and Services	-13.9	17.8	3.6	-2.3	4.0	3.4
Real GDP Growth Rate (at constant factor prices)						
Agriculture	-2.7	2.5	1.4	2.0	1.5	2.0
Industry	-4.9	6.0	3.6	-2.3	1.2	2.7
Services	-5.7	-0.3	3.1	4.3	3.2	2.9
Inflation (Consumer Price Index)	**-0.8**	**1.2**	**6.1**	**1.2**	**0.7**	**1.1**
Current Account Balance (% of GDP)	**4.2**	**-2.0**	**-3.2**	**1.4**	**1.0**	**3.3**
Fiscal Balance (General Government, % of GDP)	**-4.5**	**-6.7**	**-4.4**	**-2.0**	**-1.3**	**-3.6**
Debt (% of GDP)	**50.1**	**57.7**	**59.7**	**62.1**	**63.4**	**64.6**

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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