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THAILAND ECONOMIC MONITOR

FISCAL POLICY FOR A RESILIENT AND EQUITABLE FUTURE

December 2022

Executive Summary

WORLD BANK GROUP

EXECUTIVE SUMMARY

Recent Developments

The economy has shown resilience to recent global shocks thus far, with output surpassing its pre-pandemic level in 2022 Q3, earlier than expected but trailing behind peers. Economic growth accelerated to 4.5 percent in the third quarter fueled by resurgent private consumption and strong tourism inflows.[1] Economic reopening in May and the authorities' measures to mitigate cost-of-living pressures have supported the recovery. Tourism arrivals reached 45 percent of the pre-pandemic level in September, surpassing Indonesia and the Philippines. Because of its heavy reliance on tourism, Thailand's economic recovery, however, lagged that of its ASEAN peers, most of which returned to pre-pandemic levels by late 2021. In addition, exports of goods remained a drag on growth in contrast to many peers who benefitted from stronger good export growth in the first half of this year. Most recently, Thailand experienced a sharp slowdown in goods exports growth, also observed it its ASEAN peers and consistent with the contraction in global manufacturing Purchasing Manager Index (PMI).

Despite higher revenue from tourism, the current account deficit remained wide in 2022 Q3. This was due to a combination of structurally large net oil imports and a cyclical deterioration in the goods trade balance. Merchandise exports continued to slow while the fuel import bill remained high. As a result, the current account deficit reached 5.7 percent of GDP in 2022 Q3. The portfolio account continued to show net inflows in the first half of 2022, driven by inflows to equities, reflecting ongoing economic recovery and improved confidence. This partly offset weakness of the goods trade balance. The real effective exchange rate continued to depreciate. International reserves have notably declined from 13 to 9 months' worth of imports. External buffers against external shocks have therefore declined but remained sizable.

Price pressures have remained elevated and broadened to core inflation. Despite easing slightly due to lower global energy prices, headline inflation remained high at 6.0 percent in October, above the Bank of Thailand's target range of 1-3 percent, and the second highest among major ASEAN economies. Despite price controls applied to energy and public transport, core inflation (excluding raw food and energy) has increased steadily since the beginning of 2022, and reached 3.2 percent in October, its highest rate in 14 years, indicating rising risk of second-round inflation amid recovering domestic demand. While forward-looking measures of inflation expectations remain well-anchored at around 2 percent, continued monitoring will be necessary to determine whether the pick-up in inflation is temporary or more permanent. The central bank has embarked on gradual monetary normalization amid heightened inflation risks as the economic recovery gained traction.

Fiscal measures aimed at mitigating the cost-of-living shock have supported economic activity but contributed to the slowdown in fiscal consolidation. The central government's fiscal deficit narrowed to 5.6 percent of GDP in 2022 Q3 but remained larger than before the pandemic. The government largely maintained proactive fiscal policy to support the recovery and to mitigate the rising cost-of-living pressures. Total public spending declined to 23.4 percent of GDP in FY22 due to lower spending on the Covid-19 related relief measures. However, it remained well-above the pre-pandemic level due to measures to mitigate impact of rising energy subsidies, including cash transfers and subsidies on diesel and cooking gas prices estimated at around 3 percent of GDP. Central government's fiscal revenue remained unchanged at 17.8 percent of GDP Public debt rose to 60.7 percent of GDP at the end of FY22, almost 20 percentage points higher compared to its pre-COVID level. Price controls applied to energy and public transport continued to help 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 increased levels of household and corporate debt have not been resolved. Capital and liquidity buffers at commercial banks

remain well above the regulatory requirements, with profitability stabilizing. Indicators of asset quality show some improvement. Nonperforming loans to total gross loans decreased to 2.8 percent in 2022 Q3. Other forward-looking indicators such as special-mention loans have improved. Nevertheless, as a proportion of total loans to SMEs, NPLs remained high at 7.4 percent as of 2022 Q3, well above their pre-COVID levels of 4.5-5 percent. The central bank has extended the SME soft loan facility until end-2022, while several businesses have started their debt restructuring through asset warehousing programs. However, protracted forbearance measures, some only expiring at the end of 2023, may continue to mask vulnerabilities in asset quality. High household debt levels – at above 90 percent of GDP as of 2022 Q1 – and corporate debt – at 87 percent of GDP, both well above major ASEAN economies, may amplify shocks from tightening financial conditions. Small and medium enterprises (SMEs) are particularly exposed.

Outlook and Risks

Severe global headwinds are projected to weigh on the recovery momentum in 2023, testing Thailand's resilience. Output is projected to expand by 3.4 percent in 2022, at a faster rate than 2.9 percent projected in June (*Thailand Economic Monitor* June 2022). Growth in 2023, however, has been revised down to 3.6 percent by 0.7 percentage point, compared to the June forecast, with tourism and investment becoming the major drivers of growth. Investment growth is projected to accelerate helped by robust foreign direct investment inflows and accelerated disbursements of public investment projects. Goods trade and manufacturing investment will slow reflecting the impact of the global economic slowdown. The lingering negative output gap is expected to close by 2024. Long-term potential growth rate is estimated at 3.0 percent, slower than 3.6 percent observed over the past decade. Private consumption growth is also projected to moderate in 2023 to 4 percent as the reopening boost fades. Employment is expected to return to pre-pandemic level and will continue to support consumer spending

The current account balance is expected to reverse from its deep deficit in the past 2 years and return to positive territory in 2023. The improvement will be driven by the tourism rebound alongside declining global shipping costs. However, the goods trade balance is expected to deteriorate as goods export growth is projected to turn negative for the first time in 3 years due to the weakening global demand, while the cost of energy imports is likely to remain higher than prior to the war in Ukraine. The positive outlook on the current account and economic recovery will strengthen investor sentiment and support appreciation of the Thai baht.

Price pressures are expected to remain elevated with headline inflation staying above the Bank of Thailand's target in the first half of 2023 before moderating. Headline inflation is projected at 6.0 percent in 2022—the highest level in 24 years, driven mainly by higher fuel and transportation costs, raw food and prepared food prices. Headline inflation is projected to decelerate to 3.2 percent in 2023 as global crude oil and food prices moderate but will remain above the Bank of Thailand's target range throughout the first half of 2023. Core inflation (excluding raw food and energy) is likely to remain elevated at 2.4 percent in 2023, with ongoing cost pass-through to the prices of some consumer staples and services, coupled with rising demand fueled by a strengthening labor market and higher minimum wage. However, over the medium term, second-round pressures on prices are expected to remain contained, similar to regional peers, due to existing price administration and subsidies as well as a lingering output gap.

Public debt is projected to peak at 60.7 percent of GDP in FY 22. 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 shielded from the currently depreciating baht.

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

Additional shocks, including a prolonged period of high energy prices, may increase inequality or further erode fiscal space unless more targeted social assistance spending is introduced. The pandemic and energy crisis have highlighted the vulnerability of certain segments of society and the importance of social assistance. At the same time, the recent rise in public debt levels and lagging recovery have made it harder to reconcile the pressures to keep social support and subsidy measures – as the fiscal cost of subsidy continues to rise – with the need for fiscal consolidation. The fiscal cost of energy subsidies could be significantly larger if the global energy supply shock is prolonged. To manage these competing pressures and create additional space to address future shocks, more targeted cost-effective social assistance spending, a rebalancing of expenditure towards public investment, and further effort on revenue mobilization will be necessary.

Labor market conditions have improved, but the phasing out of COVID-19 relief measures and the rising cost of living may slow down poverty reduction. The official unemployment rate declined to 1.2 percent in 2022 Q3 close to its pre-pandemic level of 1.0 percent. Average wages grew by 5.4 percent in 2022 Q2 but lagged the rising cost of living. Most COVID-19 relief measures and stimulus packages, which helped support the income of poor families and drove the official poverty rate down to 6.3 percent in 2021, have been discontinued or soon will. This may lead to the persistence of poverty at 6 percent or above in 2022, particularly if the economy does not grow as predicted and tourists' arrival is less than expected due to global recession.

Fiscal Policy for a More Equitable Future

Prior to the COVID-19 pandemic, Thailand has made remarkable progress in reducing poverty; income inequality has also declined but is still high. Between 1990 and 2019, the national poverty rate fell from 58 to 6.3 percent, and the international poverty rate (measured at $5.5 a day in 2011 PPP) declined from 65 to 6.2 percent. From 2015 onwards, only Malaysia had a lower poverty rate than Thailand in the upper-middle income country (UMIC) group. Thailand has also achieved important reductions in inequality, but it is still high. With an income Gini coefficient of 43.3 percent in 2019, Thailand ranked as the 13th most unequal out of 63 countries for which income Gini coefficients are available, and first in East Asia and the Pacific (EAP). In terms of consumption inequality, Thailand performed better. With a consumption Gini coefficient of 35.0 percent in 2019, it ranked 45th out of 72 countries with available consumption Gini coefficients, but it continues to rank higher than half of countries in EAP. Inequality can undermine progress in human capital accumulation and tends to reduce the pace and sustainability of growth and poverty reduction.

Fiscal policy serves as an important tool to reduce poverty and inequality. This was well illustrated by how Thailand's social assistance response to COVID-19 crisis helped to offset loss of income and poverty increase. Without this assistance, poverty would have reached 8.1 percent in 2021 (27 percent higher than observed levels), while inequality would have been over 4 percent higher than its current level. Fiscal policy can affect short-term poverty and inequality through the immediate effect of taxes, transfers, and subsidies on households' income, and can promote growth and poverty reduction in the long term through spending on health, education and infrastructure.

Pre-pandemic, the impact of Thailand's fiscal system on poverty and inequality reduction was higher than in peer countries. Households pay taxes and benefit from direct cash transfers from social assistance programs. They also receive non-cash benefits from public spending on health and education. In 2019, households in the poorest groups received more benefits than they paid taxes; the poorest 10 percent of people's incomes increased by 10 percent in cash terms through fiscal policy, rising to 70 percent when non-cash health and education are included (the next poorest 10 percent saw a net 2 percent increase in cash incomes and 45 percent when non-cash benefits are included). At the same time, the richest 10 percent paid more taxes than they received in benefits, contributing a net 13 percent of their income. This progressive pattern of Thailand's fiscal system helped to reduce inequality and to a lesser extent poverty. Inequality is most commonly measured with the Gini Index, which ranges from 0 percent (complete equality) to 100

percent (complete inequality). In Thailand the Gini Index falls from 37.5 percent based on market incomes only to 28.6 percent after accounting for taxes, cash transfers and in-kind benefits— indicating that fiscal policy reduced inequality by 8.9 percentage points in 2019. The impact of taxes and cash transfers on inequality reduction is lower than the impact of in-kind spending on health and education, suggesting that in-kind spending is a more important source of redistribution in Thailand. Poverty based on market income (at $5.5 a day in 2011) is estimated at 9 percent, falls to 6.2 percent after accounting for direct taxes and cash transfers but increases to 8.1 percent when adding indirect taxes. In sum, fiscal policy reduced poverty by 0.9 points through cash transfers, with the burden of indirect taxation on the poor partly offsetting the impact of social assistance benefits. In the international context, the impact of fiscal policy on inequality is 22nd - best out of 58 countries with available data, and 13th-best out of 24 UMICs. While the impact of fiscal policy on poverty is relatively low, it is 15th-best out of 56 countries with comparable data and 7th highest among UMICs.

However, Thailand's social spending is low by international standards, as is tax revenue collection. While social spending does help reduce poverty and inequality in Thailand, overall levels are low. At the same time, overall spending is constrained by low total tax revenue collection, particularly low value-added tax (VAT) collection. The fiscal demands of responding to the COVID-19 crisis have increased pressure on fiscal policy. Designing the policy mix that supports an inclusive recovery, accelerates poverty and inequality reduction, and protects households against ongoing and future shocks in a narrowed fiscal space is very challenging. Fiscal policy can focus on increasing the efficiency of social spending by improving targeting of social assistance transfers. Policies can also focus on increasing spending on critical public services for human development and long-term growth and raise revenue for this additional spending in a progressive manner. Reforms to increase tax revenues should minimize negative impacts on vulnerable households and should be accompanied by targeted measures to protect their income.

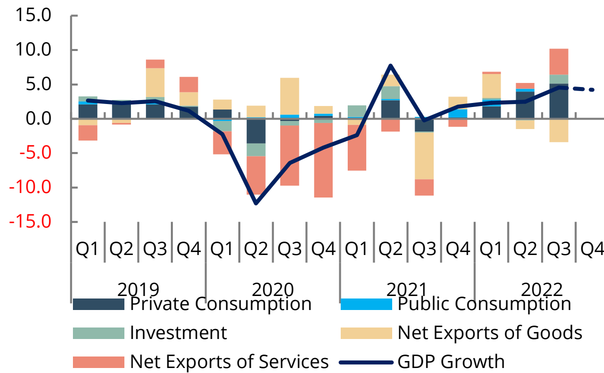
Thailand's relatively low tax revenue collection contributes to underinvestment in pro-poor spending. Pre-COVID tax revenues were around 16 percent of GDP, below UMIC and non-OCED HIC averages and only half that of the OECD average. Moreover, it relies more on indirect taxes which are less progressive than direct taxes, with PIT accounting for 1.7 percent of GDP, compared to the UMIC average of 2.8 percent. While Thailand's PIT is very progressive with most revenue coming from richer households, it contributes only a quarter as much revenue as VAT and excises. Consequently, Thailand both collects less total revenue than other countries and has a less progressive mix.

Short-term reforms to VAT and social assistance could result in a net increase of tax revenues and significant reductions in poverty and inequality. An increase in the base VAT rate from 7 percent to 10 percent with a removal of preferential rates and exemptions could increase tax revenues by as much as THB 245 billion. These VAT reforms would increase poverty by 1.5 points. However, the negative impact on the poor would need to be offset by social assistance reforms. A tapered increase of the Old Age Allowance (OAA) to between THB 2000 and THB 500 per month for elderly people (60 and above) in the lowest two income quintiles would reduce poverty by 2.1 points and inequality by 1.2 points and would cost THB 71 billion. An increase of Social Welfare Card (SWC) transfers to THB 699 per capita per month with better targeting to the lowest income quintile would reduce poverty by 2.9 points and inequality by 1.2 points and would cost THB 73 billion. The reforms of OAA combined with SWC and VAT reforms would raise tax revenues by THB 100 billion while reducing poverty by 3.6 points and inequality by 2.6 points.

Recent Developments and Near-Term Outlook

Figure ES 1: Thailand's recovery has strengthened as private consumption and services picked up following reopening...

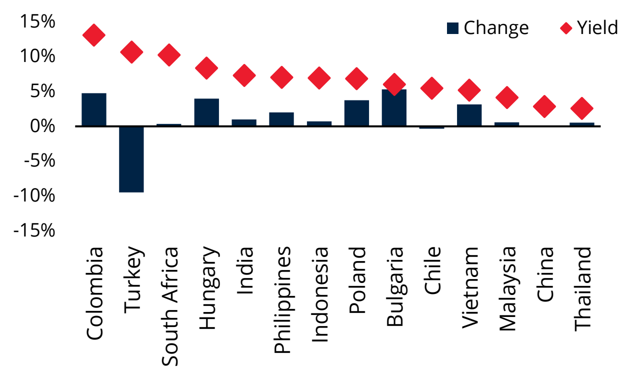
(Percentage-point contribution to real GDP growth, year-on-year)



Source: NESDC.
Note: Change in inventories explain the difference between other components and total GDP growth.

Figure ES 2: ...and has shown resilience amid recent global economic uncertainty.

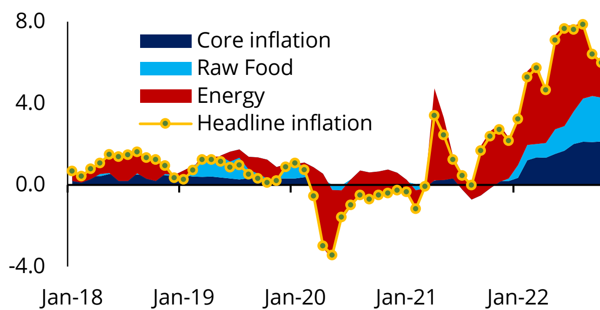
(10-year bond yield, % change y-o-y)



Source: Bloomberg; Haver Analytics.

Figure ES 3: Price pressures remain elevated with rising core inflation and cost of living.

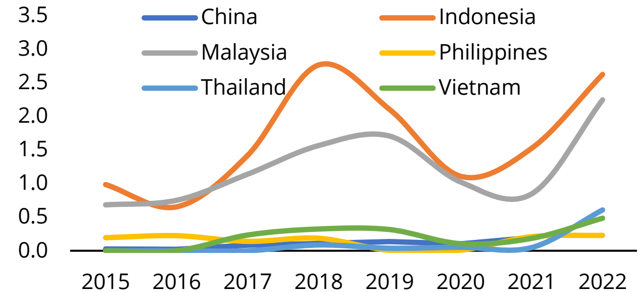
(Contribution to headline inflation, % change y-o-y)



Source: CEIC; World Bank staff calculations.

Figure ES 4: Thai authorities and regional peers have responded with fuel subsidies to mitigate cost-of-living pressures.

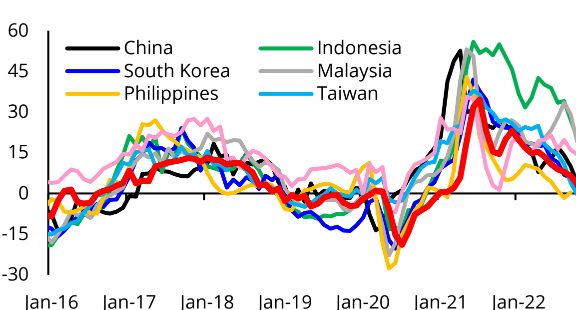
(Percent of GDP)



Source: International Monetary Fund 2015–21 and World Bank staff estimates for 2022. ***Note:*** *estimation* as of July for 2022.

Figure ES 5: A goods exports growth slowdown has already begun to weigh on the outlook...

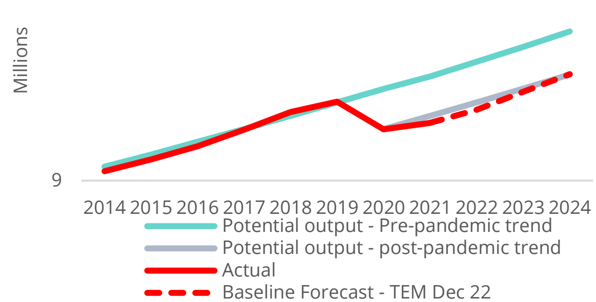
(Percent year-on-year, 3 months moving average)



Source: Haver Analytics; World Bank staff projections.

Figure ES 6: ...and delay the economy's return to potential output levels to mid-2024.

(Index, 2019 = 100)



Source: World Bank staff projections.

Table ES 1: Macroeconomic Indicators

	2019	2020	2021	2022f	2023f	2024f
Real GDP Growth Rate (at constant market prices)	2.2	-6.2	1.5	3.4	3.6	3.7
Private Consumption	4.0	-1.0	0.3	6.0	4.0	3.3
Government Consumption	1.6	1.4	3.2	-0.9	-1.0	1.4
Gross Fixed Capital Investment	2.0	-4.8	3.4	2.3	4.5	3.7
Exports of Goods and Services	-3.0	-19.7	10.4	10.0	4.6	5.8
Imports of Goods and Services	-5.2	-14.1	17.9	8.6	3.2	4.1
Real GDP Growth Rate (at constant factor prices)						
Agriculture	-0.5	-3.2	1.3	2.0	2.2	2.2
Industry	-0.7	-5.3	3.4	1.7	2.7	3.5
Services	4.2	-5.8	0.5	4.6	4.4	3.8
Inflation (Consumer Price Index)	0.7	-0.8	1.2	6.2	3.2	1.2
Current Account Balance (% of GDP)	7.0	4.2	-2.1	-2.6	0.1	2.3
Fiscal Balance (General Government, % of GDP)	0.4	-4.5	-6.9	-5.5	-2.6	-1.5
Debt (% of GDP)	40.9	50.2	57.7	61.0	60.2	59.2

Source: NESDC; World Bank staff calculations.

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