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Implementation of Pheu Thai Party Policy – Key to Thailand's Success

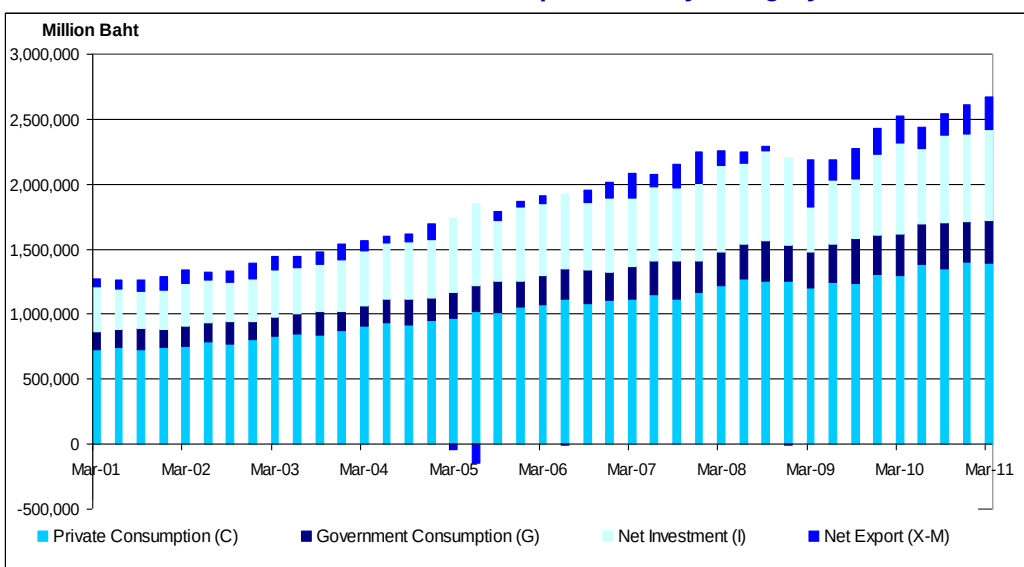
Executive Summary

- Bright spot in private consumption to be supported by rising wage and low unemployment.
- Private and foreign direct investment injections remain supportive for the economy.
- Easing of headwinds in the manufacturing sector as supply chain disruptions from Japan natural disaster likely to recover.
- Inflation remains the significant risk in Thailand, especially if wage increase and fiscal spending are implemented too rapidly.
- Higher inflation warrants the need for further monetary tightening which may attract capital inflows and drive up the value of Baht, affecting the competitiveness of Thai exports and tourism sector.

Introduction

Thailand has a history of political tension between the yellow and red shirts that are opposed to and supporters of former Thai leader Thaksin Shinawatra and his allies respectively. The first massive street protest started in Bangkok in 2006 and took place again in 2008, 2009 and 2010. In the recent Thailand general election on 3rd July 2011, the Pheu Thai Party won a majority of 265 seats in Parliament out of 500, and the SET Index gained 4.7 percent the next day. This article aims to discuss the economic outlook and key risks that surround Thailand as the political party takes over.

Chart 1: Thailand GDP Expenditure by Category



Private Consumption makes up the majority of Thailand's GDP expenditure and has a relatively stable growth trend over the past 10 years.

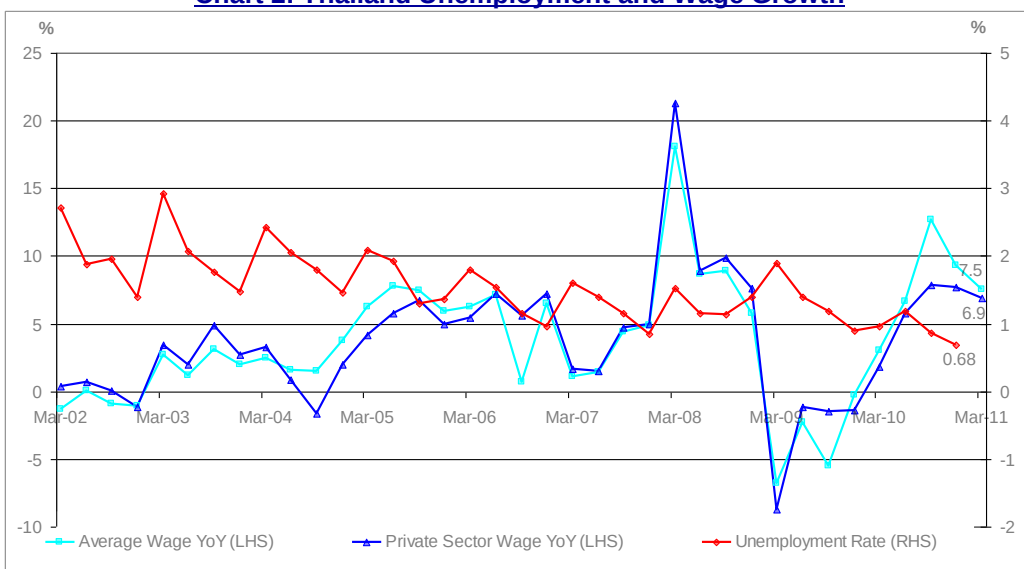
Source: Bloomberg, as of 5 Jul 2011



Bright Spot in Private Consumption

Private consumption contributes almost 52.2 percent of the overall Thailand GDP according to the latest 1Q2011 figures. (Chart 1) The Private Consumption Index increased 5.1 percent year-on-year in May 2011, and has been growing steadily since Nov 2009, driven mainly by rising wage and improving employment situation. As noted in Chart 2, average and private sector wage have registered positive growth for the past five quarters and unemployment is at the lowest level in the past 10 years. Moving forward, we foresee rising wage and low unemployment to continue to boost spending power and private consumption in Thailand.

Chart 2: Thailand Unemployment and Wage Growth



Source: Bloomberg, as of 5 Jul 2011

On top of rising wage and the low unemployment rate, the Pheu Thai Party has pledged to lift minimum wage by about 40 percent to 300 Baht per day, and up to 1000 Baht by 2020. Theoretically, increase in minimum wage should boost consumption power and private consumption in Thailand further. However, we feel that the pace at which the Pheu Thai Party implements them is vital to the success, as rapid minimum wage hike might fuel inflation or staunch manufacturing growth, bringing more harm than benefit to Thailand's economy.

Investment Injections Remain Supportive for the Economy

Investment is important for an economy as it leads to future output and growth. The Private Investment Index in Thailand expanded 11.1 percent in May 2011 and has been growing since Jan 2010. Foreign direct investment, on the other hand, remained positive for three consecutive months and registered 460 million USD in Apr 2011. Investment is affected by political situation to a certain extent, as both type of investments typically drop as political unrest occurs. (Chart 3) Thailand's army led the coup which removed Mr Thaksin from power in 2006, but the military leaders had agreed not to get involved in the election result as reported by Bloomberg, reducing chances of another army-led riot. With lessened risk of another country-wide riot, we foresee private and foreign direct investment to remain stable and supportive for future economic growth in Thailand.

Private consumption grew 5.1 percent in May 2011, supported by rising wage and low unemployment.

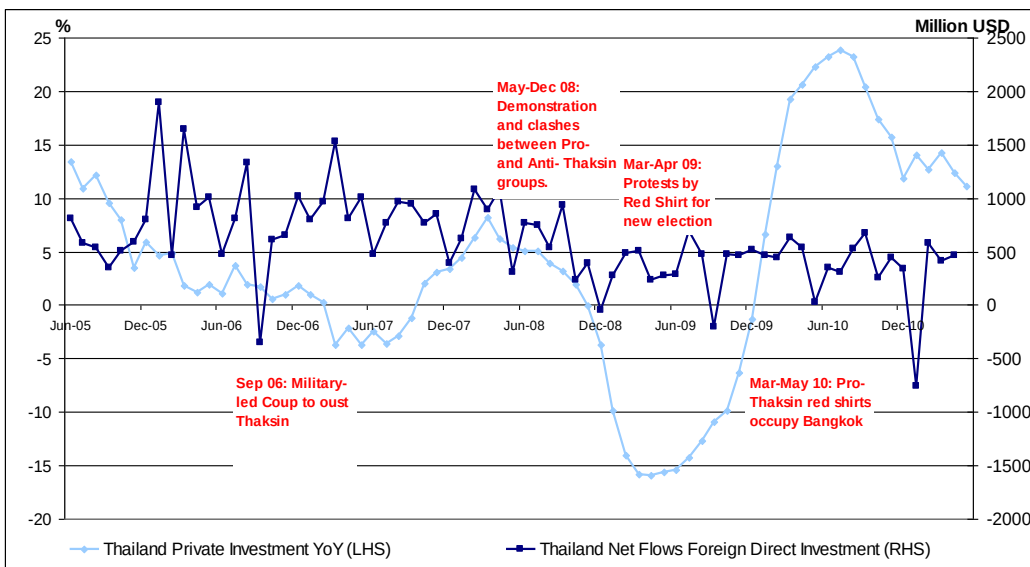
Wage rate in Thailand has been growing for the past 5 quarters and unemployment is at the lowest level in the past 10 years.

Pheu Thai Party has pledged to lift minimum wage by about 40 percent, further supporting private consumption. (if policies are implemented gradually)





Chart 3: Private and Foreign Direct Investment



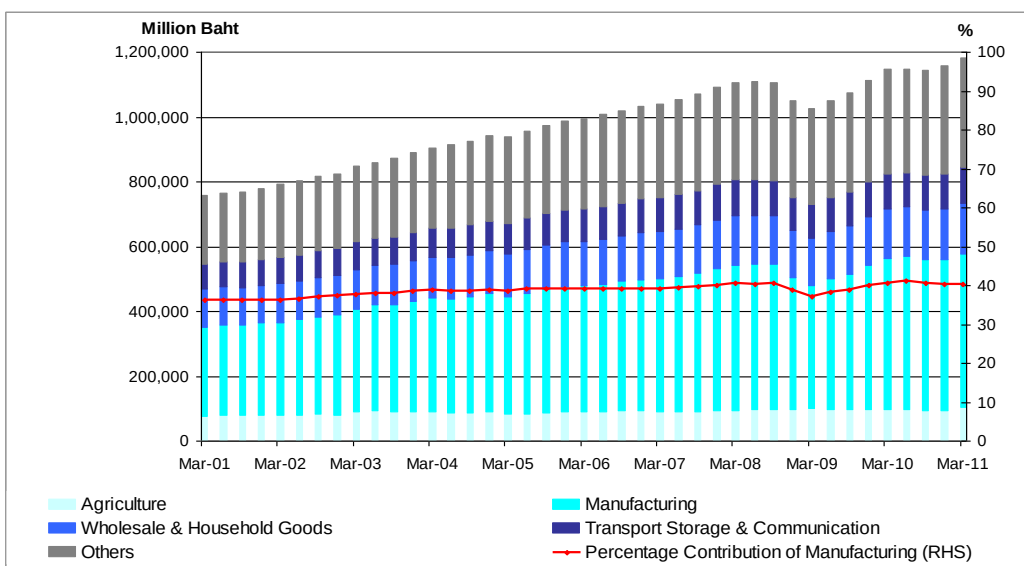
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Source: Bloomberg, as of 5 Jul 2011

Easing of Headwinds in the Manufacturing Sector

In terms of sectors, Thailand's GDP is mainly supported by manufacturing, which contributed an average of 38.7 percent to Thailand's GDP over the past 10 years. (Chart 4) Aside from the decline during the 2008-09 financial crisis, Thailand's manufacturing industry and overall GDP have witnessed stable upward trend over the same period.

Chart 4: Thailand Seasonally-Adj GDP (By Industry)



Manufacturing has contributed an average of 38.7 percent to Thailand's GDP over the past 10 years and witnessed relatively stable upward trend.

Source: Bloomberg, as of 5 Jul 2011





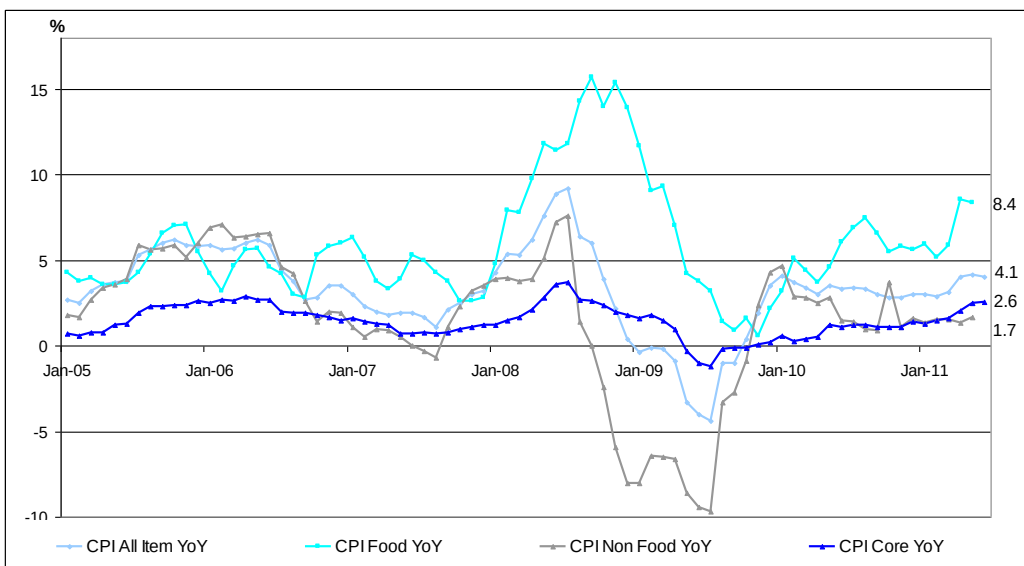
In the latest figure as of May 2011, the Manufacturing Production Index dropped 3.9 percent year-on-year, but improved 7.6 percent from April. Manufacturing was partly affected by the natural disaster in Japan, which caused supply disruption and impacted the automobile productions negatively. In addition, garment and textile production decreased as customers postpone orders as they assess the prices of raw materials, as mentioned by Bank of Thailand. Moving forward, we foresee the automobile production to improve from its post-crisis level and contribute positively to the manufacturing industry, as the entire electronics industry is expected to recover from the disaster by the end of third quarter according to IHS iSuppli research.

As mentioned previously, one policy that the Pheu Thai Party has proposed is the increase in minimum wage hike of approximately 40 percent. The wage hike, if not implemented gradually and in line with productivity of the workers, might add cost and impact the manufacturing sector adversely. Therefore, we reiterate that the pace and method of implementation for the minimum wage policy is vital to the continued growth in manufacturing, in our opinion.

Inflation Remains as a Significant Risk in Thailand

Thailand's consumer price was up 4.1 percent in June from the previous year. (Chart 5) This is lower than the 4.19 percent in May and most Asia countries such as China and India. Among the components, food prices grew at the fastest pace of 8.4 percent, higher than 1.7 percent for non-food and 2.6 for core items (excluding food and energy). Although Thailand's inflation is lower than most Asia counterparts, we expect inflationary pressure to remain or increase, mainly on the back of possible wage-price spiral and increased spending.

Chart 5: Thailand CPI YoY



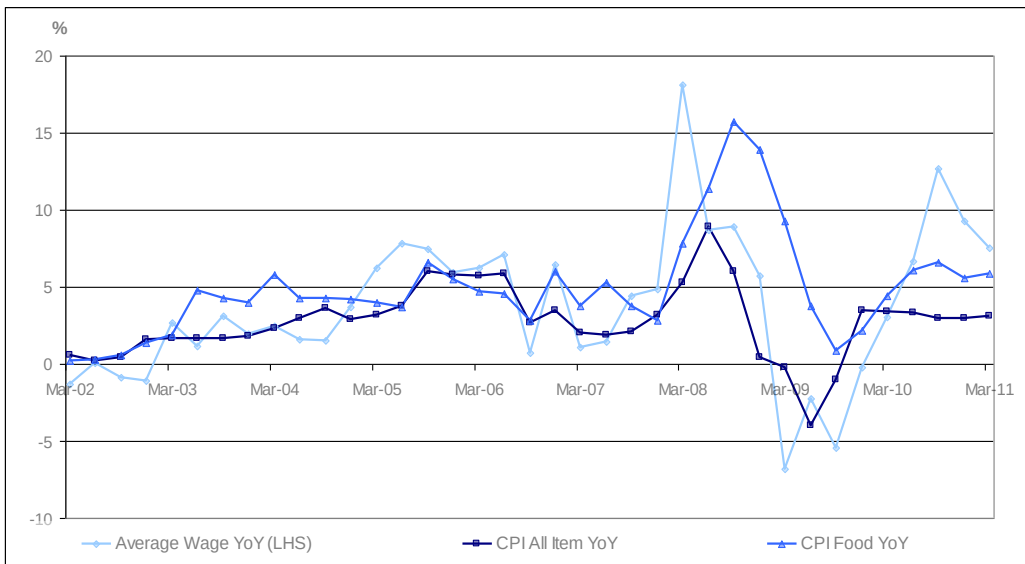
Thailand's consumer price was up 4.1 percent in June year-on-year, lower than the 4.19 percent in May and most Asia countries.

Source: Bloomberg, as of 5 Jul 2011



Historically, there is a positive relationship between wage and inflation and the Pheu Thai Party has pledged to increase minimum wage as part of its policy to reduce poverty. (Chart 6) Wage increase tends to increase people's purchasing power, and this might lead to higher inflation if the existing amount of goods available for sale cannot adjust in time to meet the increase in demand. Therefore, the pace of wage increase implementation is likely to affect future inflation, as rapid wage increase might lead to further inflationary pressure in Thailand.

Chart 6: Wage Growth and CPI



Wage growth and inflation demonstrates positive relationship.

Source: Bloomberg, as of 5 Jul 2011

Risk of a Stronger Baht May Hurt Exporters and Tourism

Aside from wage increases, the Pheu Thai Party has also proposed other policies such as free tablet computers for primary school students and building high-speed trains, all of which are expected to lead to further fiscal spending and possibly higher inflation pressure. Depending on the pace at which these policies are carried out, further monetary tightening by the Bank of Thailand may be required in order to curb inflation. The Bank of Thailand has hiked its benchmark interest rate five times this year to 3.25 percent and signaled more increases are likely to tame inflation. Further monetary tightening and high yields may attract more capital inflows, driving up the value of the Baht and affecting the competitiveness of Thailand exports and possibly the tourism sector as well.



Conclusion

Fundamentally, we feel that Thailand has good growth momentum in terms of both private consumption, private and foreign investments, and recovering manufacturing sector. In addition, Thailand's year-on-year inflation of 4.1 percent is lower than most of its Asia counterparts such as China and India. However, the key risks lie in possible increased inflationary pressure from the fiscal spending promised by the Pheu Thai Party, slowing of manufacturing due to higher wages and tighter monetary policy which could strengthen Baht and hurt exporters and the tourism sector.

Overall, we are slightly positive on Thailand based on the fundamental growth story and the government injection of money which could boost growth and the Thailand economy. However, we note that should there be any miscalculation in the pace and method of implementation of proposed policy, the wage increase which should boost private consumption might lead to slowing of the manufacturing; and fiscal spending which should lead to economic growth might lead to higher inflation that requires monetary tightening. In conclusion, while the growth momentum of Thailand should continue on the back of strong private consumption and recovering manufacturing sector, Pheu Thai Party's pace and implementation of the proposed policies is a key determining factor of the success of Thailand.



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