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Thailand Flood – Effects and Opportunities

Executive Summary

Effects:

- Manufacturing and agriculture sectors are disrupted, and tourism sector is at risk as flood continues into the peak season.
- Flood disrupted agriculture and manufacturing sectors, which amount to almost half of the total employment in Thailand, affecting workforce and causing temporary unemployment.
- Decline in consumer and business sentiments may affect consumption and investment if prolonged decrease is observed.

Recovery and Opportunities:

- Pause in rate hike and possible decrease in rate should help put downward pressure in baht and help exporters in recovery.
- Reconstruction budget should help to lift spending and presents opportunities for the construction sector. Insurance claims can act as additional source of capital to aid manufacturers in their recovery.
- Decline in crop supply due to Southeast Asia weather problems may prop up crop prices and benefit unaffected farmers that can produce healthy crops.

Introduction

In our previous report on Thailand, we highlighted that the implementation of Pheu Thai Party's policy was a key to Thailand's success. Positive factors underpinning Thailand's growth include good growth momentum in consumption and investment, and the recovery of manufacturing sector from the supply disruption due to Japan's earthquake and tsunami. However, we noted that risks surrounding Thailand include the existing inflationary pressure that may increase further 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.

What we did not expect was the ongoing flood in Thailand, which is one of the worst in 50 years, and may amount to as much as 120 billion baht of damage as mentioned by the Governor Prasarn Trairatvorakul. As the flood damaged crops and factories, threatening to slow Thailand's economy, we aim to discuss effects and opportunities that may arise.

Effects of the Flood

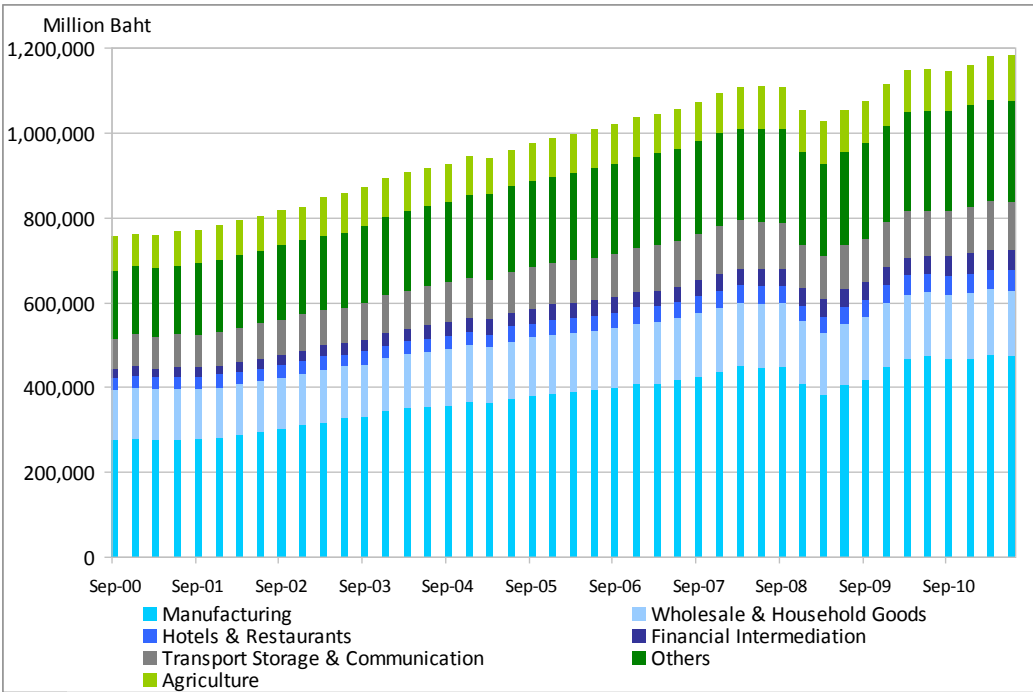
The ongoing and worst flood in five decades has serious implications for the infrastructure, people and economy of Thailand. Manufacturing and agriculture sectors are most affected by the flood, and tourism may be hampered. The people of Thailand not only face disruptions of their daily lives, but also temporary unemployment as farms are damaged and factories are closed. Lastly, the disaster also dampened both consumer and business confidence which, if prolonged, may decrease consumptions and investments.



Manufacturing, Agriculture and Tourism Sectors Affected

Floodwaters that spread across 61 of the country's 77 provinces since late July have damaged 14 percent of the nation's rice farms and closed more than 1,000 factories, as highlighted by the government and reported by Bloomberg on 20 Oct. Companies such as Western Digital Corp, Honda Motors Co and Canon Inc are affected by the closure of factories as they rely on Thailand factories for supplies. The overall economy is likely to experience a slowdown in growth as manufacturing and agriculture account for almost half of Thailand's GDP (Chart 1). Estimated damage may amount to 1.0-1.7% of GDP according to Thailand Deputy Prime Minister/Commerce Minister Kittirat Na Ranong.

Chart 1: Thailand GDP By Industry



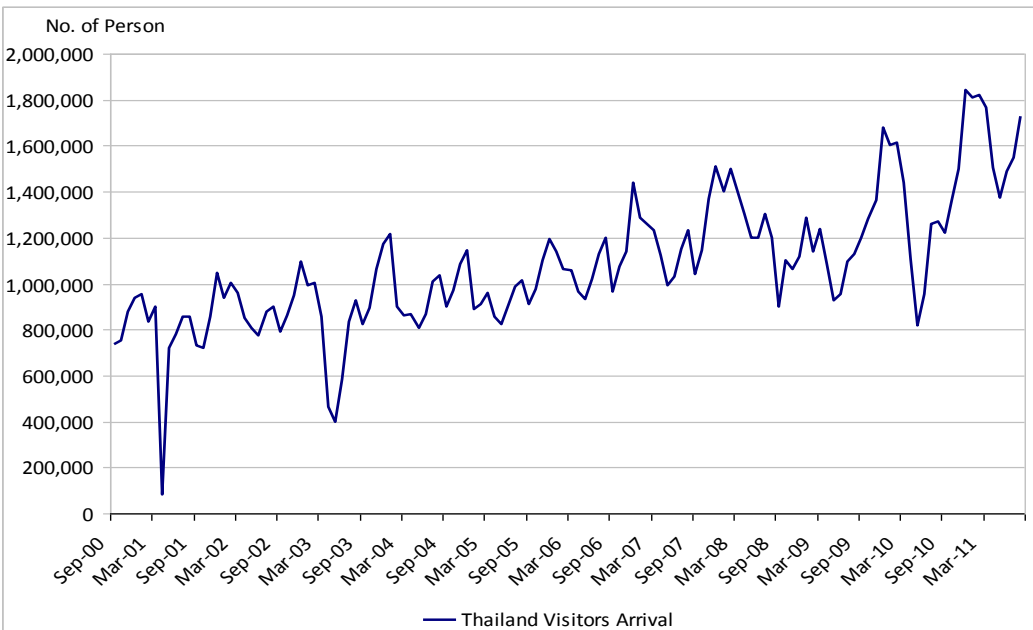
Manufacturing and agriculture accounts for almost half of Thailand's GDP. Estimated damage may amount to 1.0-1.7% of GDP.

Source: Bloomberg, as of 17 Oct 2011

Aside from manufacturing and agriculture, the tourism sector is likely to be affected as well. Thailand visitors arrival tends to peak in the November/December holiday season (Chart 2), and could fall short of expectations as the flood persists. In 2010, a total of 15.9 million tourists came to Thailand, of which 20.9 percent was accounted for by November and December. Prime Minister Yingluck Shinawatra highlighted on 14 Oct that Phuket, Krabi, Pattaya and Koh Samui, Thailand's biggest tourist draw cards, have thus far escaped the flood and efforts to improve flood defenses around Bangkok will help the capital avoid widespread damage. However, as the rain continues, Bangkok appears to be increasingly at risk as Yingluck restated that floodwaters throughout the capital may reach more than one metre. As the flood continues into the peak of tourist season, revenue from tourism, which accounts for about 7 percent of nation's GDP, according to former Prime Minister Abhisit Vejjajiva, could be hampered and the target of 19 million tourist arrival this year may be difficult to meet.



Chart 2: Tourism Sector At Risk



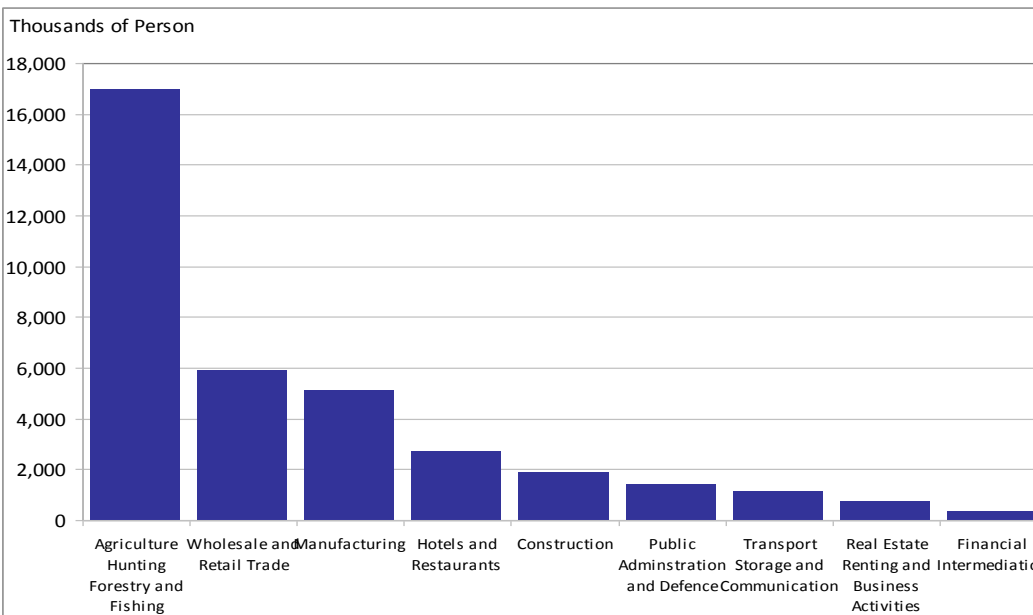
Tourism typically peak in Nov/Dec period, and is at risk as flood continues into the peak season.

Source: Bloomberg, as of 17 Oct 2011

Workforce Affected

Agriculture and manufacturing account for 54.7 percent of employment and flood damages have caused disruptions to the workforce. According to the Labor Ministry, the flood has affected 14,254 factories and businesses, leaving 664,567 workers at risk of losing jobs. The implications might be more severe if overseas companies slow investment or move operations to neighboring countries. However, the effect should be mitigated if Thailand bolsters its infrastructure and strengthens flood defenses at its industrial estates, said Commerce Minister Kittiratt.

Chart 3: Thailand Employed Workers by Industry



Agriculture and manufacturing sector accounts for almost half of Thailand's workforce.

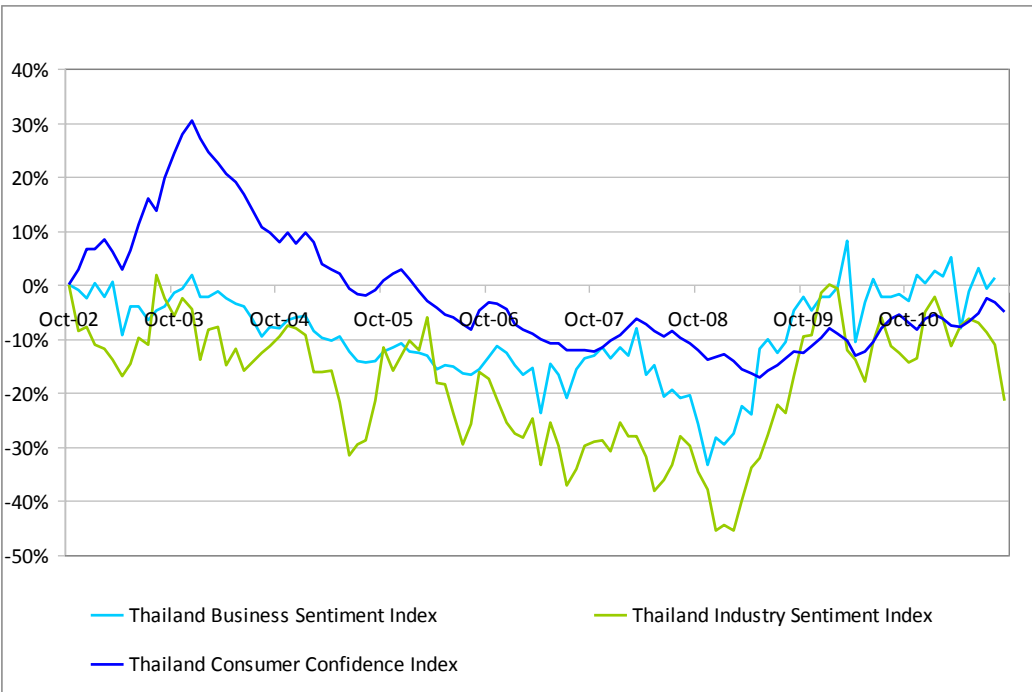
Source: Bloomberg, as of 17 Oct 2011



Sentiments May Dampen Further

Prolonged flood and job disruption could also affect business and consumer sentiments negatively in the coming months. Thailand Consumer Confidence Index fell in September to 81.8, down from 83.4 in August and lowest in the past four months. The Thailand Industry Sentiment Index also fell to 90.7 points in September from 102.5 in August, hitting a 26-month low, due to the flooding in the North that resulted in reduced sales and production. Coupled with weaker global economic growth and the ongoing Europe debt crisis, the flood may further dampen business and consumer sentiments, hurting consumption and investment.

Chart 5: Sentiments Dampened



Thailand consumer and industry sentiments are leveling off and could pose risks to consumption and investment should there be prolonged declines.

Source: Bloomberg, as of 17 Oct 2011

The Future Is Not Entirely Bleak

While the flood is likely to cause adverse effects for the economy, employment and sentiments, we feel that the future is not entirely bleak and opportunities may arise as well. Firstly, unchanged policy rate should help to limit price of baht and aid recoveries of exporters. Secondly, recovery should be aided by the reconstruction budget and insurance claims. Lastly, we foresee potential opportunities in Thailand construction companies and unaffected rice exporters.

The Monetary Policy Committee (MPC) voted on 19 Oct to keep interest rates constant for the first time this year, noting the severity of the flood and its adverse effects on economic growth in the remaining of the year. The committee has also promised to be ready to ‘take appropriate policy actions’ as they monitor development in risks of flood, which is not over yet. This may limit the value of baht, and should help elevate some pressure off exporters in the medium term as they recover from the disruptions.



In addition, reconstruction spending could be a support for the economy as Yingluck said on 17 Oct that the amount may be more than 100 billion baht. So far, Thailand's Cabinet has approved a request to widen this year's budget deficit by 50 billion baht to 400 billion baht because of the costs associated with the nation's flood. In addition, the Finance Minister also mentioned the likelihood of widening the deficit to 500 billion baht to finance road, dam and infrastructure construction, which could boost domestic purchasing power. Therefore, as highlighted by MPC in their latest statement, "reconstruction spending would provide support for domestic demand to gradually pick up in the periods ahead."

On top of the reconstruction budget, insurance claims of manufacturers should also aid in their recovery. The secretary-general of the Office of Insurance Commission highlighted that the insurance coverage of the seven affected industrial estates amounts to about 457 billion baht, as reported by Bloomberg. The bulk of the insurance claims, approximately 70 percent, is likely to be borne by Japanese property and casualty insurers, as estimated by Deutsche Securities Inc and reported by Bloomberg. While the final details of insurance claims has yet to be announced, we believe it will be an additional source of capital to aid manufacturers' recovery.

Lastly, other unaffected rice exporters should benefit from possible increase in crop prices as Thailand's supply gets disrupted. Thailand is the world's top rice exporter and while it may be too early to assess the total damage, the Commerce Ministry has cut its estimate of main rice crop to 21 million tonnes from 25 million because of flooding. According to the UN Food & Agriculture Organization, about 12.5 percent of rice farmland in Thailand has been damaged, along with 6 percent in the Philippines, 12 percent in Cambodia, 7.5 percent in Laos and 0.4 percent in Vietnam, as storms hit the region since September, as reported by Bloomberg on 21 Oct. Given the extent of supply disruption, crop prices may increase and benefit unaffected farmers in return.

Conclusion

The effects of the Thailand flood are mostly felt in the manufacturing and agriculture sector, affecting employment and sentiments. Tourism is also likely to be hampered as the flood continues into the peak of tourist season and approaches inner Bangkok. However, the pause in rate hike and possibility of reduction in rates should help to limit price of baht and aid exporters in their recovery. Opportunities arise in construction companies as the reconstruction budget may support domestic spending and economy. Lastly, as shortages of crops are observed in various parts of Southeast Asia, unaffected farmers should benefit from potential increase in grains prices.

Reconstruction budget likely to support domestic demand.

Insurance claims could be additional source of capital to aid manufacturers' recovery.

Crop disruption in Southeast Asia likely to prop up crop prices, benefiting farmers unaffected by the weather disruptions.



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