

# Thailand 4.0 (...and the IMF Article IV)

Ana Corbacho  
IMF Mission Chief for Thailand  
September 25, 2017  
Tokyo

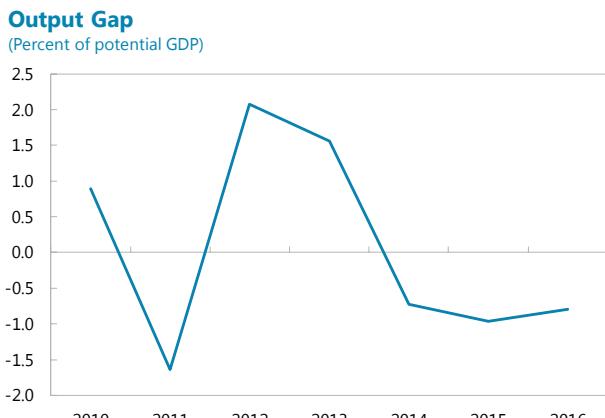
## Thailand 4.0—Government's vision

Transform Thailand into a value-added and innovation-driven economy  
from commodities to innovative products;  
from production-based to service-based;  
...by creating an environment for investment and growth into the future

But relying on some old ways: target industries; tax incentives

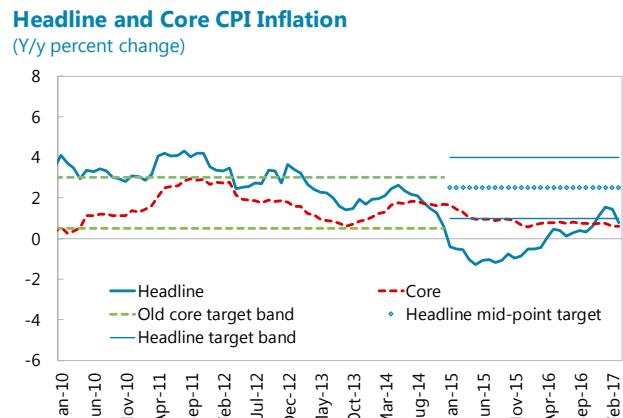
# Context—Cyclically-weak emerging market...

## Persistent (small) negative output gap



Source: IMF staff calculations.

## Inflation below target band

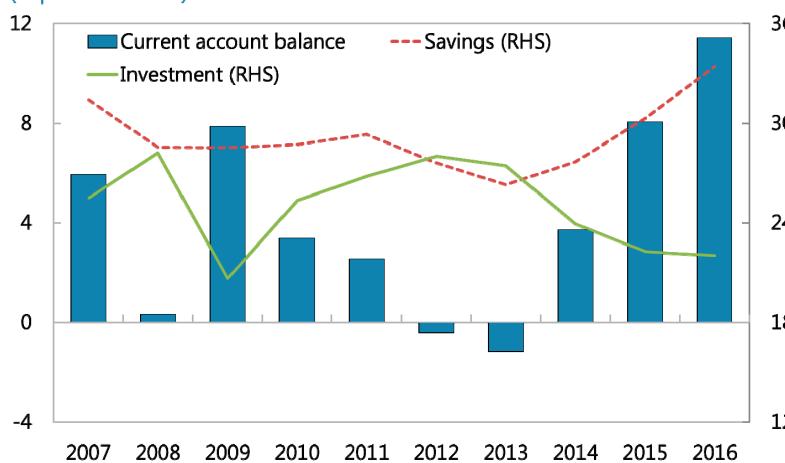


Sources: CEIC Data Co. Ltd.; and IMF staff calculations.

...that is saving too much, investing too little

## Current Account Balance, Savings and Investment

(In percent of GDP)



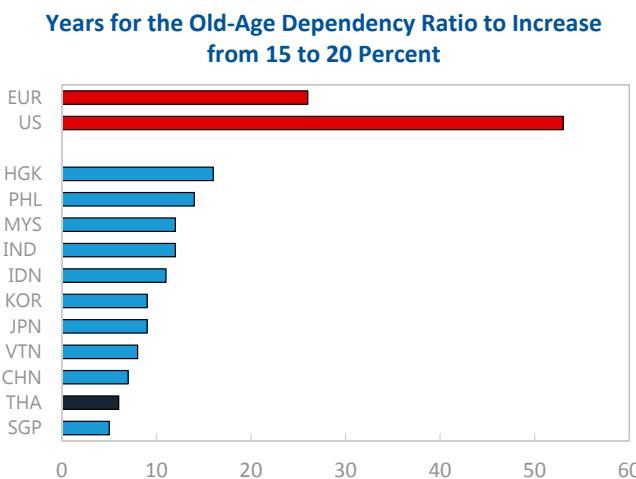
Sources: CEIC Data Co. Ltd.; and IMF staff calculations.

## Political transition

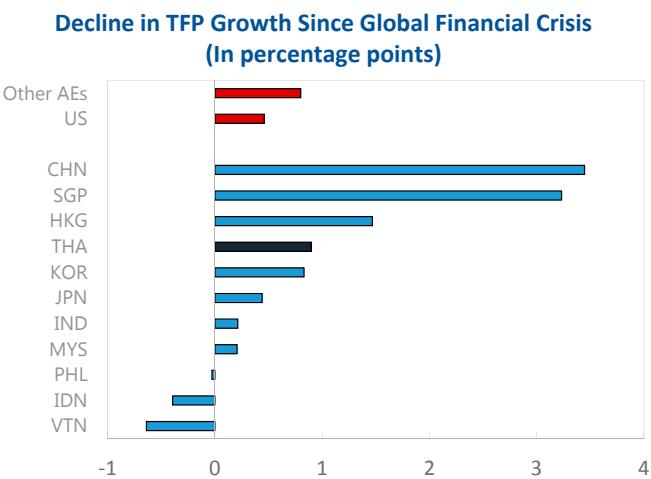
- 2014: Military regime
- 2016: Royal Succession
- 2017: Constitution endorsed
- 2018: General elections

# ...and faces long-term challenges today

## Rapid Population Aging



## Slowdown in Productivity



## Where is Thailand heading?

- Strong exports and tourism are supporting growth, but investment has been disappointing—large infrastructure projects taking time
- Inflation is projected to undershoot the target band in 2017 and reach the lower end of the band (1 percent) only by end-2018
- Excessive current account is expected to persist into the medium term

➤ Near-term growth is holding up, but downside risks dominate

Global financial volatility  
A turn to inward-looking policies  
Hard landing in China

Entrenched low inflation  
Household debt overhang  
Political uncertainty

# Thailand Article IV—IMF staff advice

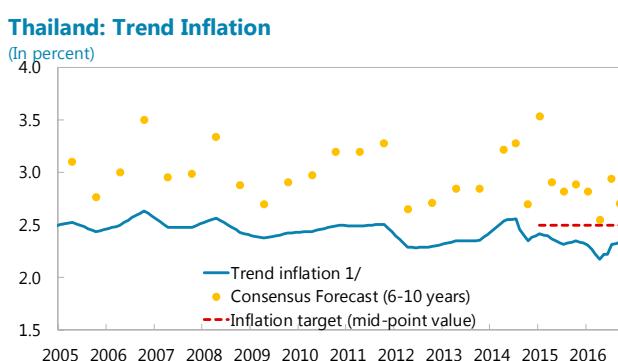
Avoid a low-inflation, low-growth trap through an expansionary policy mix and structural reforms:

- 1) Monetary policy easing and enhanced communication should steer inflation back to target
- 2) Macroprudential policy and regulatory reform can address emerging pockets of financial fragility
- 3) Existing fiscal space should be used to remove infrastructure bottlenecks within a sustainable, medium-term framework
- 4) Concerted reforms should foster inclusive and sustained growth

➤ Reduce the excessive current account through a growth-driven process, boosting real incomes

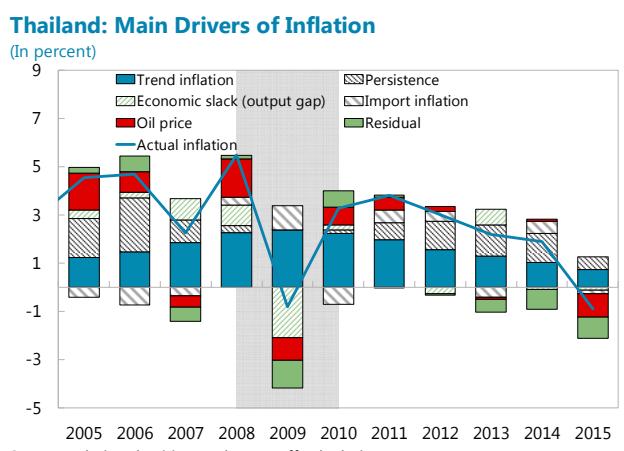
1) Monetary easing and enhanced communication to steer inflation back to target

## ***Trend inflation below target since 2015***



1/ Trend inflation estimates, from Garcia and Poon (forthcoming), are based on actual inflation dynamics and long-term survey inflation expectations, following Chan, J., Clark, T., and Koop, G., 2015, "A New Model of Inflation, Trend Inflation, and Long-Run Inflation Expectations," FRB of Cleveland Working Paper No. 15-20.

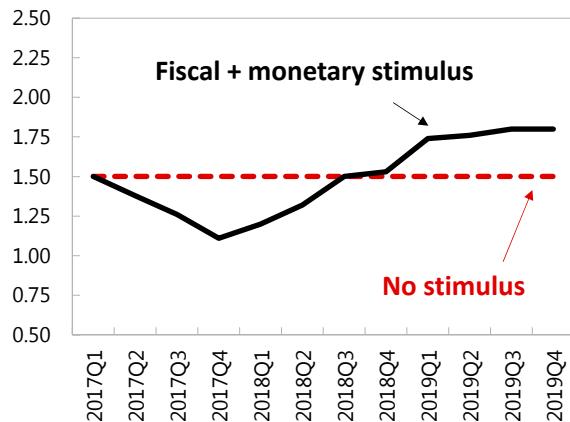
## ***Inflation dynamics less forward-looking***



Monetary policy alone is not enough—reinforce fiscal stimulus and expectations channel

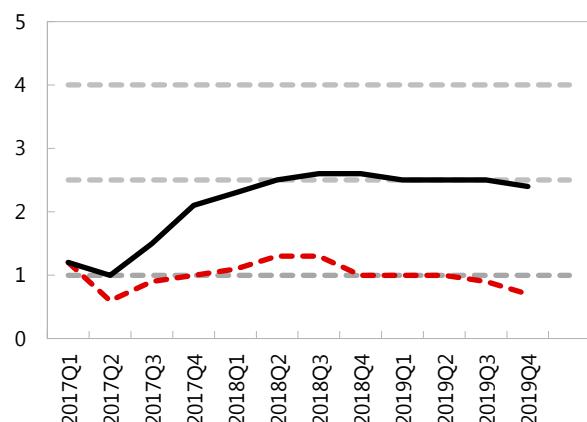
#### Policy Rate

(Percent)



#### Headline Inflation and Target Band

(Percent)



2) Macroprudential policy and regulatory reform to address pockets of financial fragility

#### Assessment of risks

- Financial stability risks contained
- Pockets of fragility
  - ✓ High household debt—legacy from past rapid credit growth
  - ✓ Housing prices—fast appreciation in Bangkok condominium area
  - ✓ Regulatory arbitrage—shift in risks to shadow banking

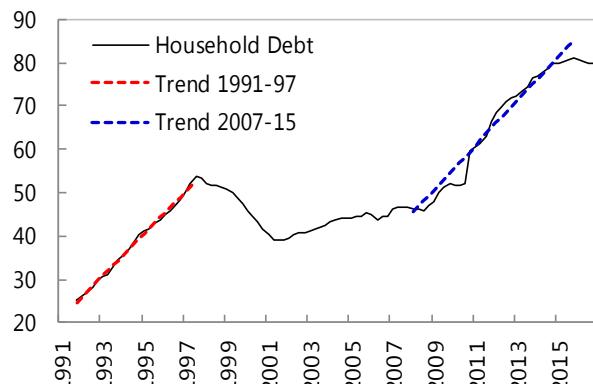
## 2) Macroprudential policy and regulatory reform to address pockets of financial fragility

### Assessment of risks

- Financial stability risks contained
- Pockets of fragility
  - ✓ **High household debt—legacy from past rapid credit growth**
  - ✓ **Housing prices—fast appreciation in Bangkok condominium area**
  - ✓ **Regulatory arbitrage—shift in risks to shadow banking**

### Household Debt, 1991-2016

(Percent of GDP)



Sources: Authorities' data; BIS; and IMF staff calculations.

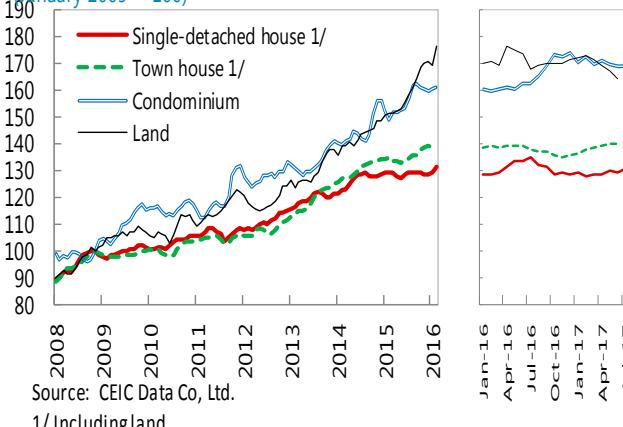
## 2) Macroprudential policy and regulatory reform to address pockets of financial fragility

### Assessment of risks

- Financial stability risks contained
- Pockets of fragility
  - ✓ **High household debt—legacy from past rapid credit growth**
  - ✓ **Housing prices—fast appreciation in Bangkok condominium area**
  - ✓ **Regulatory arbitrage—shift in risks to shadow banking**

### Thailand: Real House Price Indices

(January 2009 = 100)

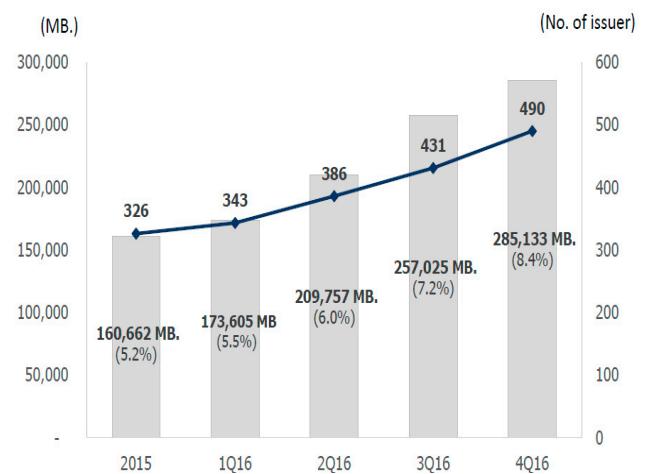


## 2) Macroprudential policy and regulatory reform to address pockets of financial fragility

### Assessment of risks

- Financial stability risks contained
- Pockets of fragility
  - ✓ High household debt—legacy from past rapid credit growth
  - ✓ Housing prices—fast appreciation in Bangkok condominium area
  - ✓ Regulatory arbitrage—shift in risks to shadow banking

### Thailand: Unrated Corporate Bonds



## 2) Macroprudential policy and regulatory reform to address pockets of financial fragility

### Assessment of risks

- Financial stability risks contained
- Pockets of fragility
  - ✓ High household debt—legacy from past rapid credit growth
  - ✓ Housing prices—fast appreciation in Bangkok condominium area
  - ✓ Regulatory arbitrage—shift in risks to shadow banking

### Advice

- Monetary easing increases risks?
- Targeted action
  - ✓ Time-varying MPMs for riskier households
  - ✓ Tighter LTV; DTI for segments of real estate market
  - ✓ Regulatory reform for consistent risk pricing across banks and nonbanks

### 3) Existing fiscal space should be used for infrastructure within a sustainable MT framework

#### Does Thailand have Fiscal Space?

##### On the positive side:

The overall fiscal balance of the public sector has been close to zero in recent years suggesting a good track record of fiscal discipline.

The current cost of debt financing is low but likely to increase in the medium term. Now is the time for debt financing at fixed rates for new debt issuance.

Public debt and gross financing needs paths are below standard vulnerability benchmarks and below the Cabinet debt ceiling of 60 percent of GDP.

##### On the negative side:

Quasifiscal activities by some SOEs are not properly tracked or reported. Risks of contingent liabilities are hard to quantify with the available information.

Age-related spending is projected to increase steadily for demographic reasons, threatening fiscal sustainability beyond the medium term.

**Bottom line:** Thailand has some fiscal space that should be used wisely.

### 3) Existing fiscal space should be used for infrastructure within a sustainable MT framework

#### Does Thailand have Fiscal Space?

##### On the positive side:

The overall fiscal balance of the public sector has been close to zero in recent years suggesting a good track record of fiscal discipline.

The current cost of debt financing is low but likely to increase in the medium term. Now is the time for debt financing at fixed rates for new debt issuance.

Public debt and gross financing needs paths are below standard vulnerability benchmarks and below the Cabinet debt ceiling of 60 percent of GDP.

##### On the negative side:

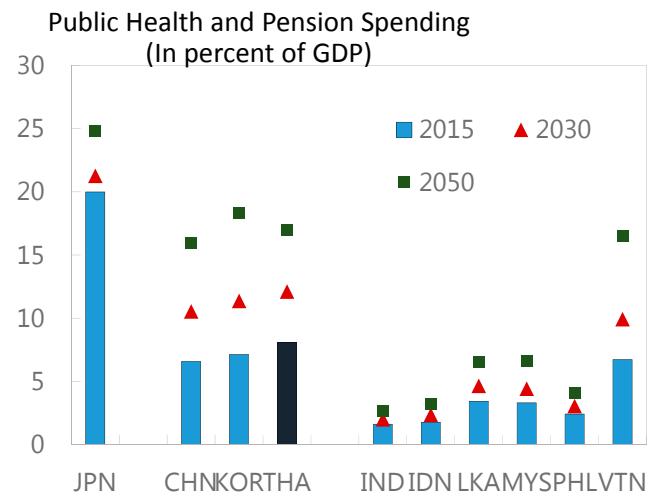
Quasifiscal activities by some SOEs are not properly tracked or reported. Risks of contingent liabilities are hard to quantify with the available information.

Age-related spending is projected to increase steadily for demographic reasons, threatening fiscal sustainability beyond the medium term.

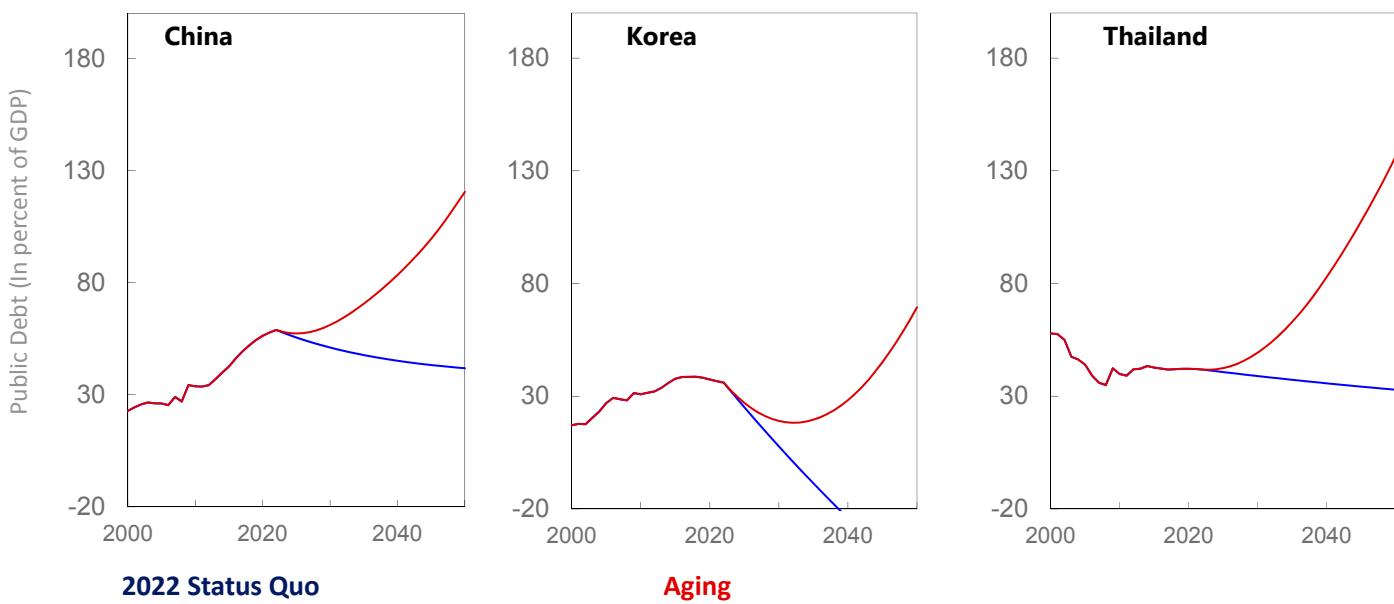
**Bottom line:** Thailand has some fiscal space that should be used wisely.

# Public health and pension spending is set to rise due to rapid aging

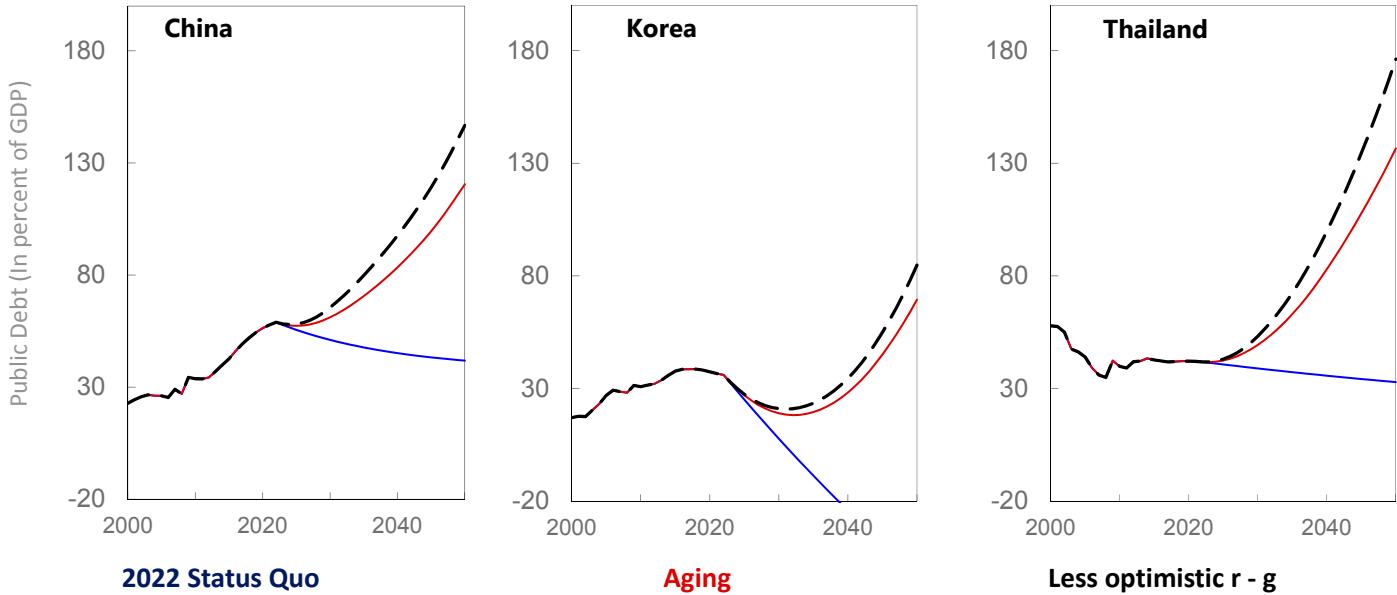
- The increase in spending is driven primarily by demographics (changes in the old-dependency ratio)
- Aging will also lower labor force participation and potential growth



Left unchecked, age-related spending is a threat to long-term fiscal sustainability



# A less favorable interest rate-growth differential adds further risk



## 3) Existing fiscal space should be used for infrastructure within a sustainable MT framework

### Does Thailand have Fiscal Space?

#### On the positive side:

The overall fiscal balance of the public sector has been close to zero in recent years suggesting a good track record of fiscal discipline.

The current cost of debt financing is low but likely to increase in the medium term. Now is the time for debt financing at fixed rates for new debt issuance.

Public debt and gross financing needs paths are below standard vulnerability benchmarks and below the Cabinet debt ceiling of 60 percent of GDP.

#### On the negative side:

Quasifiscal activities by some SOEs are not properly tracked or reported. Risks of contingent liabilities are hard to quantify with the available information.

Age-related spending is projected to increase steadily for demographic reasons, threatening fiscal sustainability beyond the medium term.

**Bottom line:** Thailand has some fiscal space that should be used wisely.

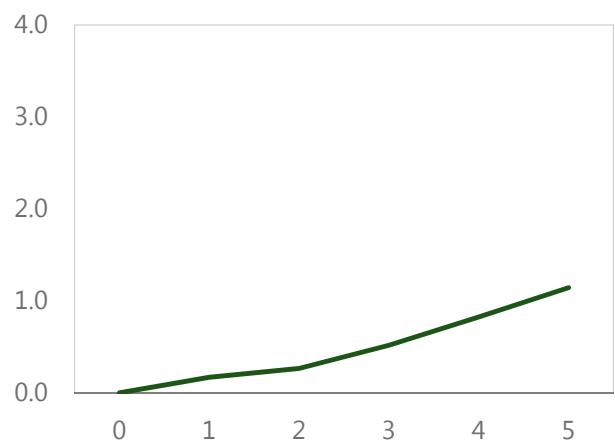
# A simulation with fiscal and monetary policy

- Asia Module of the Flexible System of Global Models
  - 16 countries for Asia; 8 blocks for the RoW
- Households (liquidity-constrained, saving); firms
- Fiscal policy plays a key role in the economy
  - Infrastructure investment and consumption
  - Transfers (general and targeted)
  - Taxes (VAT, PIT, CIT)
- Monetary policy generally follows inflation targeting

## Thailand: Infrastructure push under different financing and monetary policy

- In the baseline, monetary policy reacts to the infrastructure push, crowding out private demand

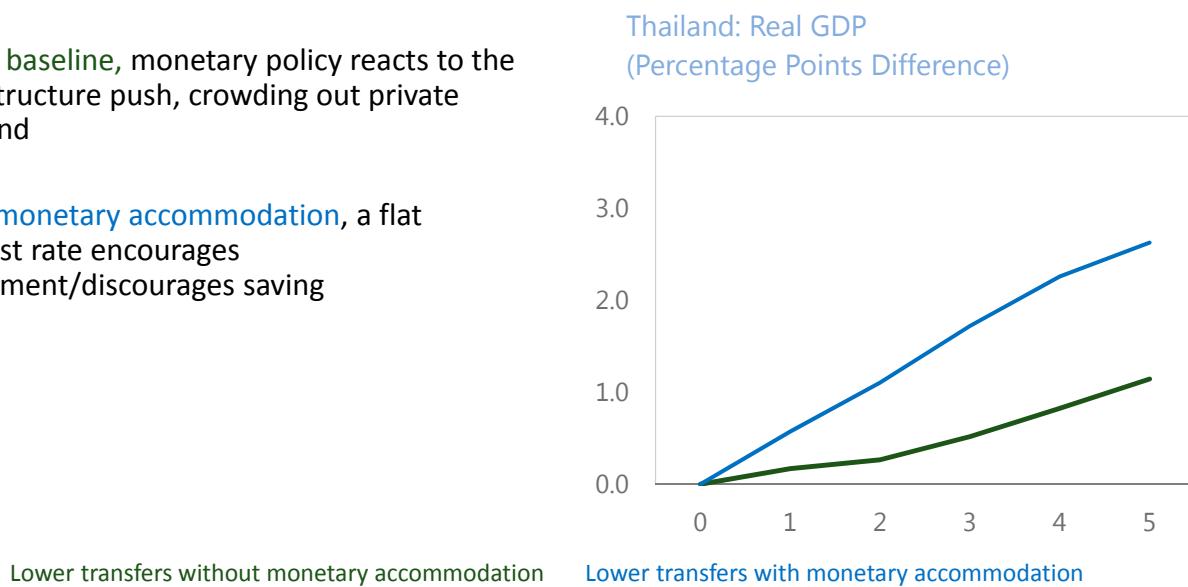
Thailand: Real GDP  
(Percentage Points Difference)



Lower transfers without monetary accommodation

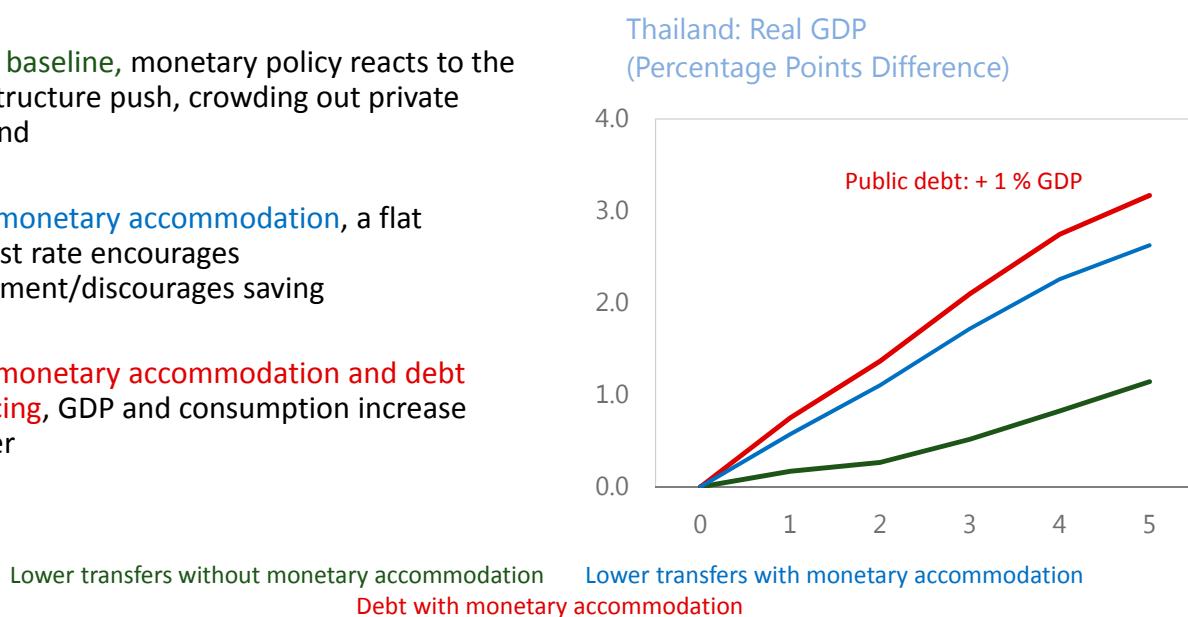
# Thailand: Infrastructure push under different financing and monetary policy

- In the baseline, monetary policy reacts to the infrastructure push, crowding out private demand
- With monetary accommodation, a flat interest rate encourages investment/discourages saving



# Thailand: Infrastructure push under different financing and monetary policy

- In the baseline, monetary policy reacts to the infrastructure push, crowding out private demand
- With monetary accommodation, a flat interest rate encourages investment/discourages saving
- With monetary accommodation and debt financing, GDP and consumption increase further



# To reap higher growth dividends, critical elements must be in place

- Simulation results hold if risk premium is contained
- More broadly, critical pillars are:

Quality projects that address country-specific gaps

Credible fiscal anchors that look long term

Inclusive and sustainable Social Security Reform

- Structural reforms in healthcare
- Automatic adjustment mechanisms in pension
- **Better coverage and benefits—revenue mobilization**

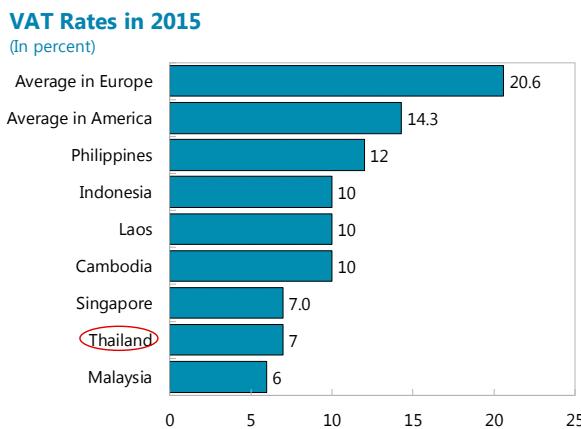
## Pension reform to address design issues and population aging

### Pension Reform Challenges

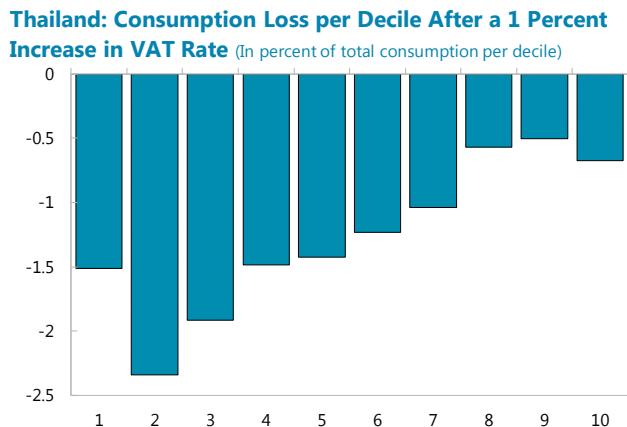
|                            |  |
|----------------------------|--|
| <i>Harmonization</i>       | The pension system is fragmented in regimes for public, (formal) private, and informal employees.                    |
| <i>Sustainability</i>      | The retirement age, 55, and the contribution rate, 6 percent, are low.   |
| <i>Coverage</i>            | Over 60 percent of the working-age population is not covered by a formal pension.                                    |
| <i>Adequacy</i>            | The average replacement rate for private sector workers (19 percent) is too low.                                     |
| <i>Fairness</i>            | Pensions for civil servants are much more generous, with higher replacement ratios, than for private sector workers. |
| <i>Poverty Alleviation</i> | The old-age allowance (minimum pension for those without a formal pension) is low and untargeted.                    |

# How should revenue be mobilized?

## Increase the low VAT rate



## Compensate low-income households



## 4) Concerted reforms to foster inclusive, sustained growth

- Mitigate demographic drag
- Support capital accumulation
- Increase TFP

- Close gender gap in LFP
- Increase retirement age
- Facilitate skilled migration
- Reform education

- Upgrade infrastructure
- Relax limits to foreign equity stakes
- Facilitate PPPs
- Adopt best practices in doing business

- Eliminate untargeted subsidies (agriculture)
- Revamp competition law
- Restructure SOEs
- Reduce tax distortions (incentives for target sectors)

Robust mechanism to identify and compensate vulnerable households

- Reduce the excessive current account through a growth-driven process

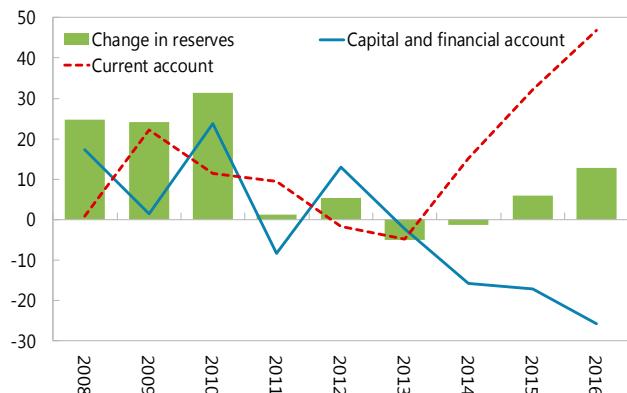
## Substantially stronger external position

### Thailand: EBA Estimates and Staff Adjustments

|                                     |            |
|-------------------------------------|------------|
| Actual current account (CA)         | 11.4       |
| <b>EBA CA estimates</b>             |            |
| Cyclical adjustment                 | 0.3        |
| Cyclically adjusted CA              | 11.1       |
| CA norm                             | 1.1        |
| CA gap                              | 10.0       |
| Policy gap                          | 2.3        |
| Unexplained residual                | 7.6        |
| <b>Staff-adjusted estimates</b>     |            |
| Cyclical and transitory adjustments | [3.0, 7.0] |
| Terms of trade                      | [1.0, 1.5] |
| Tourism                             | [1.0, 1.5] |
| Political uncertainty               | [1.0, 4.0] |
| CA gap                              | [3.0, 7.0] |
| REER gap (elasticity 0.6)           | [-11, -6]  |

## Two-sided intervention; but reserves ↑

### Current Account, Capital and Financial Account, and Reserves (In billions of U.S. dollars)

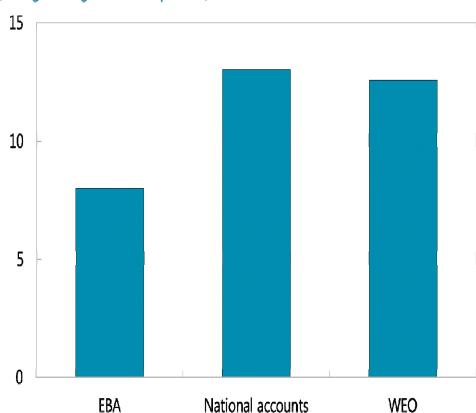


Sources: CEIC Data Company Ltd.; and IMF staff calculations.

EBA: Staff's adjustments of cyclical/transitory factors helped interpret part of the unexplained residual

### Thailand: Terms of Trade

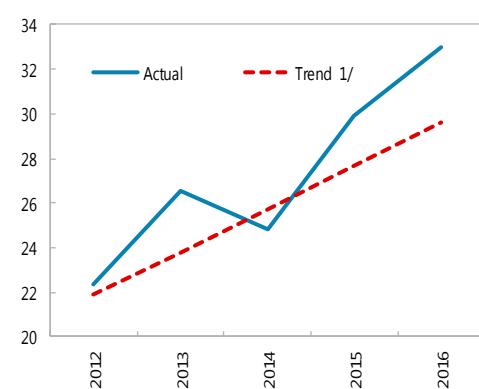
(Change during 2013-16; in percent)



Source: IMF staff calculations.

### Thailand: Tourist Arrivals

(In millions of persons)

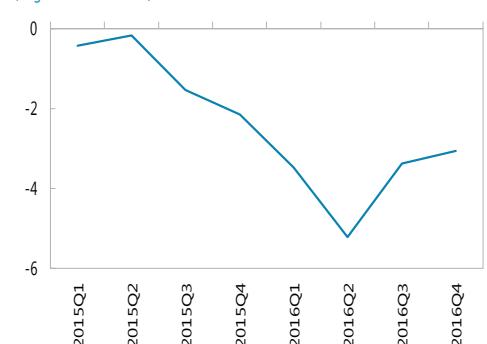


Sources: Authorities; and IMF staff calculations.

1/ Trend calculated using an HP filter since the mid-1990s.

### Impact of Political Uncertainty on Private Investment 1/

(Regression coefficient)

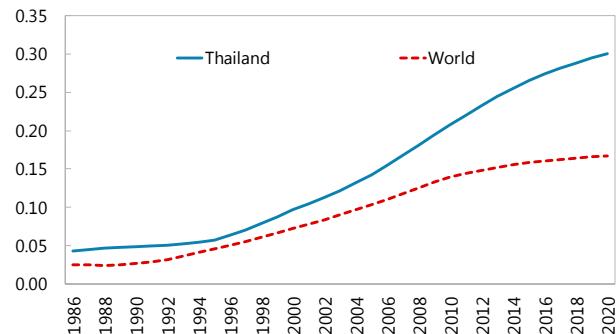


Source: IMF staff estimates.

1/ Rolling regression of private investment (percent of GDP) on the inverse of ICRG index (measuring political uncertainty), controlling for external demand.

# Demographic factors are expected to increase the CA norm in coming years

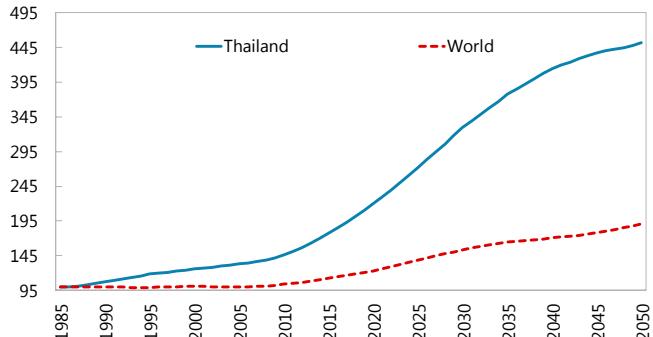
## Aging Speed 1/ (Projected change in old-age dependency ratio)



Source: IMF staff calculations.

1/ Projected change in old age dependency ratio in 20 years, relative to current level.  
World refers to other EBA countries.

## Old-Age Dependency Ratio 1/ (Index; 1985=100)



Source: IMF staff calculations.

1/ Population aged over 65 divided by population between 30 and 64 years old.

## Final remarks

- Thailand's economy is on a recovery path. Exports and tourism are engines of growth, but domestic demand (investment) and inflation are too weak
- Monetary policy should focus on returning inflation to target, while macroprudential policies address systemic risks
- Fiscal policy expected to do a lot. Infrastructure stimulus must be balanced against the fiscal cost of the rapid demographic transition
- Structural reforms are the only true long-term solution

➤ Domestic and external rebalancing through inclusive growth