Economy: Thailand's Coup Fallout

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Economic signs in Bangkok are mixed, as the junta's policies chip away at investor confidence.

The first tangible signs are starting to emerge that, as expected, policies put in place after Thailand's military coup last year are having a negative effect on the country's economy, with both domestic and foreign investment declining and growth in consumer spending falling to 1.3 percent annually.

Although the economy expanded faster than expected, at 4.3 percent in the first quarter against a forecast 3.7 percent, the rise in gross domestic product was built largely on exports, which comprise 60 percent of the economy, and government spending.

The junta, which ousted former Prime Minister Thaksin Shinawatra in September 2006, has made a series of ill-considered economic moves, including halting the longstanding practice of using nominee firms to bypass the 49 percent foreign ownership restriction. The military-appointed government also instituted measures aimed at stemming speculative short-term capital inflows. The rules were designed to force overseas investors to deposit 30 percent of non-trade-related baht purchases worth more than US$20,000 with the central bank, interest-free for one year. If the money is withdrawn before 12 months, the Bank of Thailand keeps a third of it, which effectively raises transaction costs 10 percent.

Most of the moves by the government have been prompted by anger over the sale of Thaksin's family-owned telecommunications giant, Shin Corp, to Singapore government-run Temasek Holdings. The US$2 billion sale was largely tax free, meaning Thaksin's relatives enjoyed a huge windfall, but many Thais also saw it as a betrayal, since the company was viewed as a strategic asset that ended up in the hands of foreigners.

The uproar at the time helped lead to popular unrest against Thaksin and, eventually, his ouster. Now strictly enforcing the 49% ownership rule – Temasek controls about 96 percent of the company – could force Temasek to sell off Shin Corp at a huge loss. That may be fine for revenge purposes but redrawing the economic map in order to retaliate against one deal has earned considerable international criticism from foreign investors and cut into business confidence, which remains at an eight-year low, according to a report by Bloomberg.

One multinational executive in Hong Kong who exports consumer products from Thailand and other countries flatly said, "Thailand is over." While he isn't cutting back on his Thai operations, he isn't adding to them. Vietnam, he says, is a much more attractive country now for investment.

In a speech on June 7, Tarisa Watanagase, the Bank of Thailand governor, described Thailand's economy as being "in a key transitional period now," but said it could recover in the second half of the year if the general election is held as scheduled. In her speech, titled "Overall Picture of Economy and Approach to Supervising Financial Institutions," Tarisa conceded that private investment and consumption had declined to what she called a worrying level. However, she said, a state economic stimulus package, accelerated budget disbursement, continued interest rate cuts and mass transit construction would help boost economic growth.

Indeed, GDP growth was built partly on government consumption, which rose 11.2% in the first quarter, raising the share of government consumption to GDP to the highest level since 2002, an unhealthy replacement for private consumption, which was minus 0.3% for the first quarter of the year. Fixed investment was down by 1.8% over the previous quarter.

Most observers don't expect government policies to drive Thailand into the tank. Foreign reserves are high, the fiscal budget is close to balancing and debt levels remain low. As inflation eases, interest rates are also being cut. Rather, the country's economy and foreign investment are expected to return to growth levels that characterized the late period following the Asian financial crisis of 1997-1998.

The country also faces endemic problems including a lack of rail and other commercial transport and badly needed investment in infrastructure. Thailand is the least-energy efficient economy in Asia, even including the Philippines, and remains the country most exposed to oil-price shocks in the entire region. Net oil imports in 2006 amounted to about 9 percent of GDP, followed by the Philippines at 6 percent.

The coup, according to the investment bank CLSA, "could not have come at a worse time. Oil and commodities in general are expensive and, even with a US and China slowdown, are likely to remain so relative to five-year norms. Worse, the Foreign Business Ownership changes seem designed to lose Thailand its most-favored nation status among foreign investors at precisely the time that competition for FDI is becoming more and more intense."

Tarisa, the central bank governor, acknowledged that private investment would be crucial in replacing exports to stimulate the economy if the global economy slows as expected over the next few years. Key obstacles to private investment, she said, are a lack of confidence among private companies waiting for a clear picture of the election schedule, continuing amendments to economic laws, and implementation of major government mega-projects.

"We do not expect political uncertainty to decrease significantly over the next six months," ABN-AMRO analyst Dominique M Pierre Frecaut wrote in a recent report, saying that despite the dissolution of Thaksin's Thai Rak Thai party and the banning of Thaksin himself from politics, the party still retains a strong following in the countryside. "There is a risk that the dissolution of TRT could lead to its supporters feeling disenfranchised, which may not support a fast return to political normalcy."

Since many Thais believed the military had the King's support, the streets had been quite calm in the months after the coup. But protest numbers have swelled since the May 30 court verdict as ex-TRT lawmakers have jumped on board. Analysts expect the numbers to grow over the next few months as the referendum on the new constitution approaches.

Eventually Thailand's rulers must allow Thaksin's followers to join the political process, or long-term political instability looks certain to prevail. Regardless, the impact of the ongoing uncertainty on foreign direct investment will probably remain considerable.

P.S.

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