MACROHIVE PROFESSIONAL

Macro Hive Pro: EM Under the Spotlight – Thailand Finally Poised for Recovery

(Caroline Grady, caroline.grady@macrohive.com, 25 November 2022)

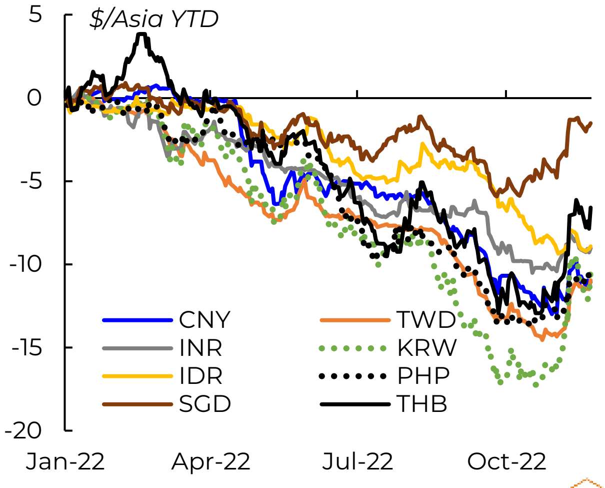
Summary

- Thailand has seen one of the slowest recoveries in Asia with output only just back at the pre-Covid peak. That the full tourism reopening is only a few months old is one reason; underperformance on exports is another.
- The slow growth recovery and Thailand's high level of household debt – and skew towards short-term debt – has meant the BOT's hiking cycle has been the slowest globally despite the significant acceleration in inflation.
- And with the most negative real rates in Asia and a C/A on track for the largest deficit since 2005, a sustained THB rally has yet to materialise.
- We see scope for THB outperformance ahead with both C/A and capital account flows set to improve. Tourism and the broader recovery are finally gathering pace. Meanwhile, BOT rate hikes will continue and the widening gap with the Fed slow, albeit not reverse. The negative growth impulse from slower global trade is also less than for others in Asia.

C/A and Capital Account Flows at a Turning Point

Thailand's tourism recovery was expected to support growth, see the C/A flip back into surplus and allow the central bank to continue to raise the policy rate. But the recovery has been decidedly slow, in both tourism- and non-tourism-related sectors. A sustained baht recovery has failed to materialise. However, THB has rallied by more than other currencies in Asia over the past month and, YTD, is now the best performing after SGD, reflecting several policy shifts by MAS (Chart 1). With several factors aligning to support C/A and capital account flows, we think the recent THB rally can finally be sustained.

Chart 1: THB Finally Outperforming Other Asian Currencies (ex SGD)



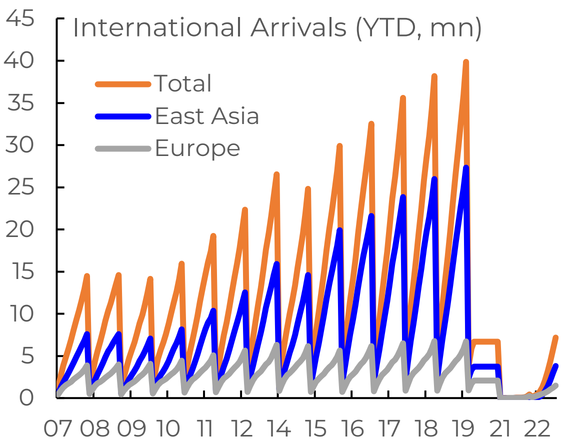
Source: Macro Hive, Bloomberg

Tourism Recovery Just Getting Underway: Thailand only fully re-opened to international travellers on 1 October. Partial re-opening came earlier with requirements on vaccination and testing. But this was initially only in parts of the country, and an earlier Thailand pass registration scheme meant numbers were limited. YTD visitor numbers are still down 77% versus October 2019 levels at just over 7mn (the government targets 10mn arrivals for the year, versus 40mn in 2019). This sharply contrasts Turkey, where arrivals are almost back at the 2019 peak (Charts 2 and 3).

Alongside a later re-opening compared with Turkey, Thailand's tourism recovery remains constrained by the ongoing absence of visitors from China. Versus the 27% share from China in October 2019 (with Malaysia the next highest at 11.5%), China now accounts for just 2.5% of visitors. For Turkey, Germany, Russia and the UK are the top sources of arrivals.

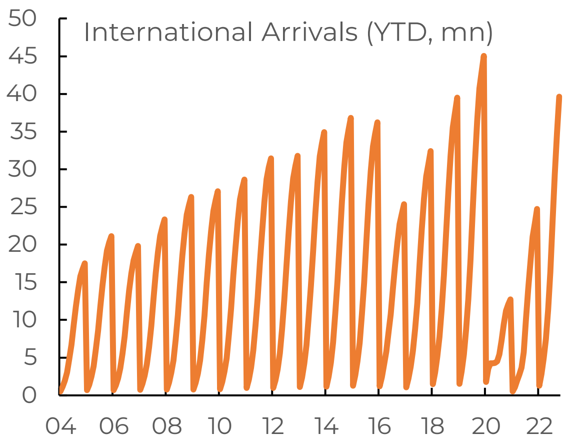
Small steps by China to reduce quarantine requirements could mean visitor numbers accelerate slightly. But with China's Covid cases at an all-time high and renewed lockdowns in place, normalisation of Chinese outbound tourism remains some way off. But even without China, visitor numbers should continue to climb. [Departures] from Bangkok airport are up 85.8% YTD, and the government is targeting a significant increase in arrivals through 2023.

Chart 2: Thailand's Tourism Recovery Has Yet to Take Off



Source: *Macro Hive, Macrobond*

Chart 3: While Turkey's Tourist Arrivals Almost Back at 2019 Peak



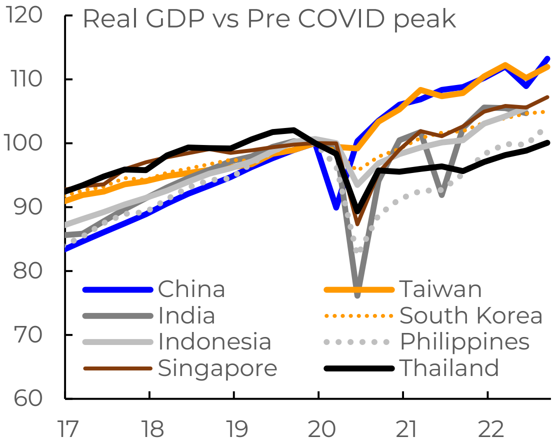
Source: *Macro Hive, Macrobond*

Leaving More Scope for a Growth Catch-Up: Tourism-related services have been a significant drag on Thailand's recovery. Versus a 2019 base, the tourism sector remains 15-20% down and, in BOT projections, is not expected to return to pre-Covid levels of output by end 2023. Ongoing improvement should nevertheless support domestic momentum and incomes. The rebound in manufacturing and non-tourism services has also been sluggish. Barring one strong quarter in Q4 2021, which partly reflected a rebound from a deep contraction the quarter earlier, industry growth has remained subdued.

Some of this subdued growth recovery also reflects a fairly sluggish export performance versus others in the region. Thai exports have averaged just 13.7% over the past year (and 18.3% in 2021) versus an average of 21.7% for the Philippines, Indonesia, Malaysia and Singapore over the past year and 28.1% in 2021. But this also means that the negative growth impulse from slowing global trade is less for Thailand than others in the region.

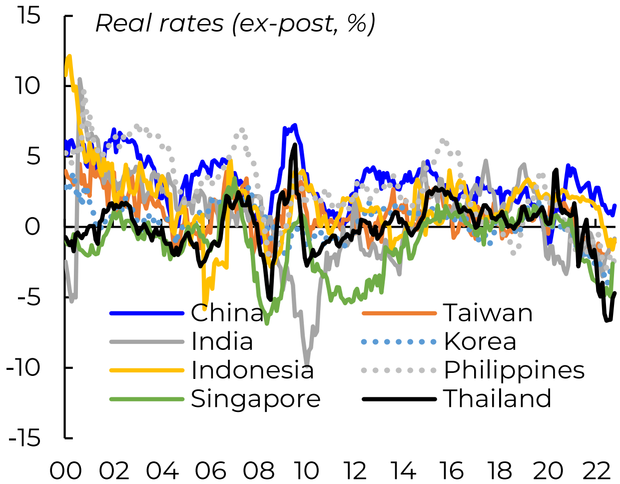
Overall, Thailand's recovery has been the slowest across Asia with the 1.2% QoQ expansion in Q3 only now bringing Thailand back to pre-Covid levels of output (Chart 4). This nevertheless leaves greater scope for a growth catch-up than elsewhere.

Chart 4: Thailand's Recovery the Slowest in Asia



Source: Macro Hive, Macrobond

Chart 5: And Ex-Post Real Rates the Lowest



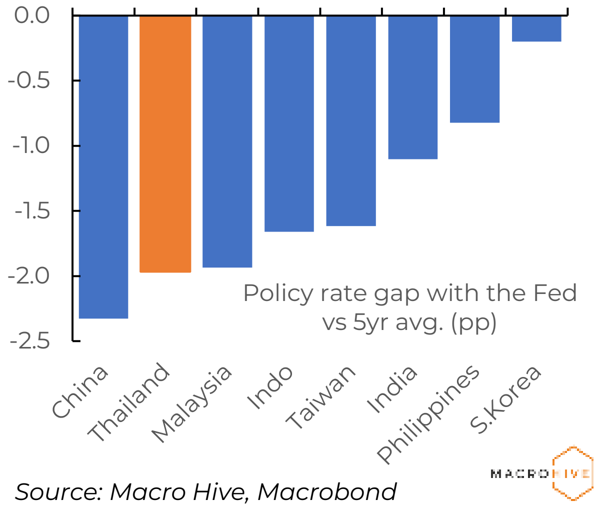
Source: Macro Hive, Macrobond

BOT Rate Hikes Should Continue, Gap With the Fed to Narrow: Sluggish domestic demand has left a dovish BOT. With just two 25bp rate hikes so far, Thailand's tightening cycle has been the slowest globally. While a few EM central banks have cut rates this year (namely Russia, Turkey and China) and the BOJ has remained ultra-accommodative, Thailand still sticks out given the acceleration in inflation.

With CPI at 5.98% YoY and the policy rate at 1.0%, Thailand's ex-post real policy rates are the lowest in Asia (Chart 5). In addition, the rate gap with the Fed is now the largest in Asia after China, versus a five-year average (Chart 6). This has meant an additional headwind for THB with non-resident bond flows negative YTD. Equity inflows have nevertheless provided an offset with close to $5.5bn in inflows so far (Chart 7).

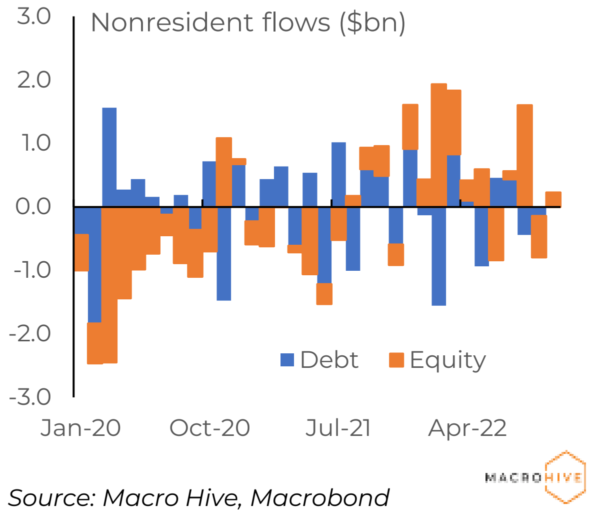
Slower Fed hikes from here and continued BOT hikes as confidence in the recovery increases should relieve pressure on bond flows. And with other central banks in the region nearing an end to their hiking cycles (BOK and to a lesser extent the RBI), the BOT should also become less of an outlier on rates.

Chart 6: Thailand's Rate Gap With the Fed the Largest in Asia, After China



Source: Macro Hive, Macrobond

Chart 7: Equity Inflows Offsetting Bond Outflows YTD



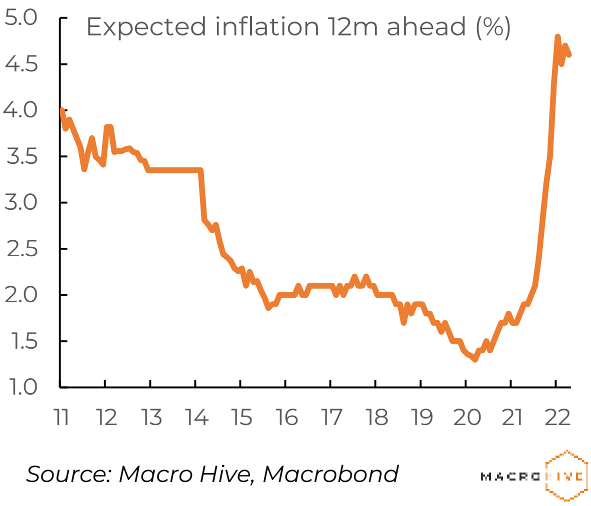
Source: Macro Hive, Macrobond

Acceleration from the current 25bp pace is unlikely, but we see continuation of hikes with another 100bps or so in the pipeline.

High Household Debt Will Not Impede Tighter Policy: That Thailand has one of the highest household debt levels in EM also explains the cautious approach by the BOT. Both Hong Kong and South Korea have a higher share of household debt, but the composition in Thailand is unfavourable. This reflects an unusually high share of household borrowing via credit card debt and unsecured personal loans, which are more short term and with higher interest rates.

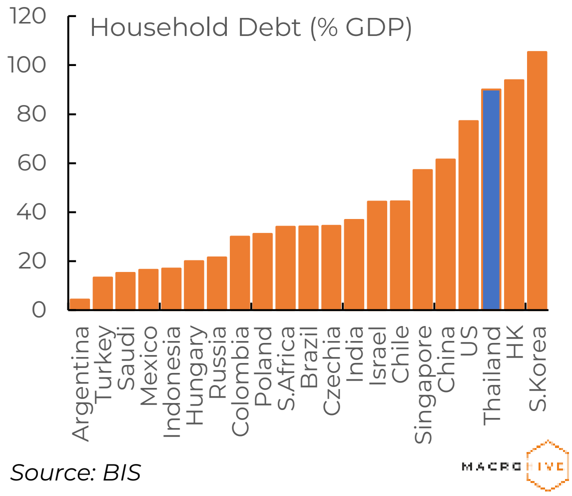
The BOT therefore face a balancing act between supporting an incipient recovery and returning inflation to the 1-3% target range. The BOT see medium-term inflation expectations as anchored within a range, but this is not the case for one-year ahead expectations within the business sentiment survey. At 4.6% in October, this is down from the 4.7% high a month earlier but not yet a sustained downward move.

Chart 8: BOT Balancing the Need to Anchor Inflation Expectations



Source: Macro Hive, Macrobond

Chart 9: And Stalling the Recovery With Higher Debt Servicing Costs



Source: BIS

Improved C/A and Capital Flows to Support THB: With the incipient tourism recovery, Thailand's 3.9% of GDP C/A deficit through Q3 is the worst external position since 2005. The 8.0% of GDP services deficit is an unprecedented swing from the 4.5% surplus in 2019. And as this has come at a time of relatively subdued exports and rising oil imports, the trade surplus has also narrowed from earlier highs.

But with travel receipts rising from Q4, the C/A improvement should finally take hold. A C/A returning towards surplus and less pressure on the capital account from bond outflows leave us constructive on the baht. Thailand's expected C/A improvement also contrasts the export-led deterioration already evident across much of the rest of the region. And the outperformance of THB versus the rest of Asia over the past month should continue.