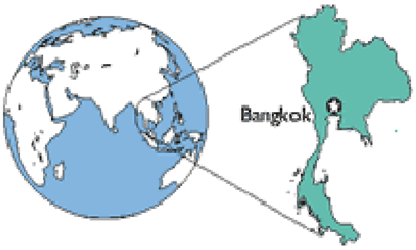
COUNTRY REVIEW
Update
Thailand



21 June 2010

ANALYST: Dr. Manfred Stamer

EULER HERMES COUNTRY RISK GRADE: B

Country Risk Grades are on a scale of AA, A, BB, B, C, D
where AA is the lowest and D the highest risk.

BACKGROUND

The political environment in Thailand has been fragile since 2006 when months-long demonstrations of the urban middle class (operating under the name People's Alliance for Democracy, PAD) against the government of then Prime Minister Thaksin culminated in a bloodless coup and 15 months of military rule until end-2007. These events deepened the division in the Thai society between the urban middle class and the rural poor which have been mostly supporters of Thaksin.

The majority of the rural poor helped elect a pro-Thaksin government at end-2007 which, however, was ousted a year later by the Constitutional Court after new PAD anti-government protests lasting for about five months, including and eight-day siege of major Thai airports. The PAD protesters are also known as yellow-shirts.

The opposition Democratic Party under the new PM Abhisit took over at end-2008, but was also soon faced with mounting anti-government protests, this time by the rural Thaksin supporters who rallied under the name United Front of Democracy Against Dictatorship (UDD). The red-shirt protestors of the UDD intensified their rallies in March/April 2009. The situation escalated when the UDD besieged government buildings (as did the PAD in 2008) and PM Abhisit subsequently announced a state of emergency and called the army to restore order. Violence erupted and left at least two dead and more than a hundred injured. On the morning of 14 April 2009, the anti-government protest had dispersed and peace returned to the streets for the time being.

RECENT EVENTS

Large-scale anti-government protests resumed in Bangkok on 12 March 2010. The red-shirt protestors of the UDD—mostly from the poor north and north east with many supporters of ousted PM Thaksin Shinawatra—claimed, among other things, that PM Abhisit's government did not have a popular mandate and called for an immediate dissolution of parliament and fresh elections. The protests intensified at first in early April and resulted in violence on 10 April, when a failed military crackdown on the protesters left 25 dead and hundreds injured.

In early May 2010, PM Abhisit outlined a reconciliation plan and offered to hold early elections in November, in a fresh attempt to end the protests peacefully. However, negotiations between the two sides collapsed as the protesters sought to attach conditions to their agreement to the plan. The conditions were unacceptable for PM Abhisit and he withdrew his offer.

The situation deteriorated sharply on 13 May, as the army reinforced attempts to seal off the main protesters' encampment in central Bangkok. Clashes culminated into the worst political violence in nearly two decades. Foreign embassies and businesses in or close to the area were closed for security reasons. The government extended an earlier state of emergency declaration to a total of 22 out of 76 provinces—mostly in and around Bangkok and the protesters' heartlands in the north and north east. On 19 May, the army stormed the barricaded encampment and most protest leaders surrendered. After another day of heavy violence—including rioting and arson attacks by some hard-line protesters—the protest had largely dispersed. By the end of May, order was restored in Bangkok and most businesses had resumed.

On 2 June 2010, PM Abhisit survived a no-confidence vote over the handling of the crisis.

ANALYSIS

Politics

The almost 10 weeks protests from mid-March to mid-May 2010 were headline-catching, initially because of their scale and persistence and then because of the heavy violence. In effect, the latest protests were a continuation of four years of political turmoil and uncertainty, though the death toll of 88 make them one of Thailands worst periods of political violence in decades.

The ongoing political crisis has to be considered as intensified for now; and a return to political normalcy and stability in Thailand is a long way off anyway. This is because there is no obvious resolution to the underlying problem which has become an entrenched political struggle between the two sides of the now deeply divided society. Hence expect continued political instability.

However, recently often-heard talk of Thailand being on the brink of civil war appears far-fetched or premature. A civil war is unlikely as long as military discipline is retained. The latest escalation of the political crisis affected only some very specific areas of Bangkok and was far away from conflicts seen in countries like Sri Lanka and Nepal in recent years. Despite some access to small weapons and financing on the side of the protesters, there is no large-scale armed and organised rebel body that would be capable of launching a sustained military campaign against the army.

In the short term, PM Abhisit appears to have maintained the backing of the royal palace and the security forces, which is important in Thailand. Although Abhisit is still talking of reconciliation, his administration appears intent on proceeding with a policy of suppression (protest leaders are charged with terrorism; opposition media remains shut down). Parliamentary elections are due by end-2011 at the latest, but early elections are still possible. However, the polarisation of Thai politics appears now such that the losing side is unlikely to accept the result.

Another source of uncertainty is the reportedly poor health of Thailand's highly revered King Bhumibol Adulyadej, who has always had an important role as a strong stabilising force during previous crises, but who has not intervened during this crisis. The eventual passing away of King Bhumibol could create a vacuum as his son and designated heir, crown prince Maha Vajiralongkorn, is widely unpopular and unlikely to fully inherit his moral and political authority.

Economy

After four consecutive quarters of contraction, **real GDP rebounded to yr/yr growth of 5.8% in Q4 2009 and 12% in Q1 2010**, though partly due to **base effects**. On a qtr/qtr, seasonally-adjusted basis real GDP shrank 1.5% in Q1 2009, but grew 2.1% in Q2, 1.7% in Q3, 3.6% in Q4 and 3.8% in Q1 2010.

In Q2 2010, GDP is likely to contract qtr/qtr as as the political turmoil has dented consumer confidence and business confidence as well as tourist arrivals. Both the political and economic **outlooks are highly uncertain for H2 2010**. Assuming that political instability fades back to the level of 2006-2009, when the economy still grew at a reasonable pace, **GDP may expand by about 4% in calendar 2010**, after shrinking by 2.3% in 2009.

Public finances are still solid, even though fiscal stimulus in the wake of the global economic crisis has increased the fiscal deficit to about 3.5% of GDP in 2009 and a forecast 4.5% in 2010. Public debt grew to 45% of GDP in 2009, however, 86% thereof was domestically issued debt.

Average **inflation** was -0.8% in 2009 as consumer prices declined in the first nine months, before inflation picked up to 3.5% in December, driven by recovering domestic demand and rising global oil prices. Inflation rose further to 4.1% in January 2010 but has since eased to 3.5% in May and should remain in check for the rest of the year.

The **exchange rate** of the Thai baht (THB) appears largely unaffected by the crisis so far. After appreciating by 3.8% against the USD in 2009, the THB has gained a further 3% year-to-date (21 June) and has been surprisingly stable during the protest period from mid-March to mid-May 2010.

Equity prices at the **Bangkok SET** have been volatile this year. The SET stood at 734 at end-2009 and at 733 on 12 March 2010 (start of protests), reached a recent high of 813 on 7 April, then fell to a recent low of 721 on 25 May (short after end of protests), and has recovered to 806 on 21 June.

FX reserves are ample and have continued to rise despite the ongoing political instability. At USD140bn in May 2010, reserves were up 3.4% from end-2009 and 133% from September 2006, the point of time of the military coup that ousted former prime minister Thaksin. Current FX reserves cover more than nine months of imports and four times all external debt payments falling due in 2010 – quite excellent ratios among all emerging economies.

The external position remains favourable. The **current account** recorded a 7.7% of GDP surplus in 2009 and is forecast to post another surplus of 3% or so in 2010. **Total external debt** is comparatively low at about 26% of GDP or 37% of export earnings.

Dr. Manfred Stamer **Hamburg: +49 (0)40 8834 3607**