

2006-45  
Dec. 25, 2006

## Thailand (Kingdom of)

Foreign LT: **A-/Stable**, Local LT: **A+/Stable** (Affirmed on November 20, 2006)

### <Rating Perspective>

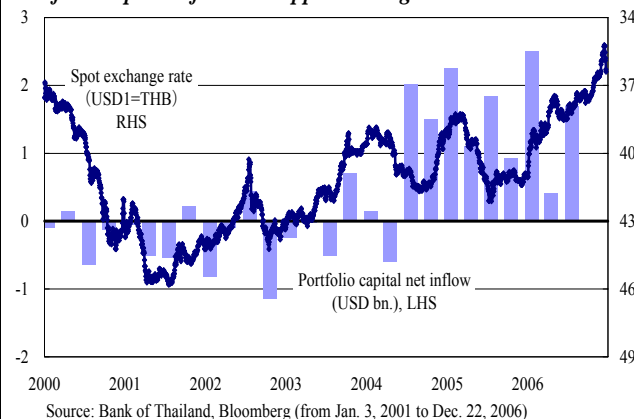
#### Positive Factors

- Solid external position.
- Gradually recovering corporate and banking sectors.

#### Negative Factors

- Relatively vulnerable government fiscal position due to significant, albeit gradually decreasing, debt and substantial contingent liabilities.

*Portfolio capital inflow and appreciating THB*



### <Update: from September to November, 2006>

#### Positive Factors

- Despite a military coup, financial market remained largely stable. THB/USD regained in the Asian morning on Sept. 20 some of the ground lost in offshore markets right after the coup.
- FY2007 budget of THB1.52 trillion was approved by the cabinet. (Oct. 17)
- Martial law was lifted in 41 provinces including Bangkok, while it remains in effect in 35 provinces in deep south, north and northeast regions. (Nov. 28)
- CPI inflation remained low at 3.5% y/y in November. (Dec. 1)
- Q3 real GDP growth was steady at 4.7% y/y compared with 5.0% in the previous period (Dec. 4)

#### Negative Factors

- Thailand's military and police force seized power in Bangkok albeit in a peaceful manner (Sep. 19)
- SET index (closing) plunged 15%, recording its steepest daily drop since 1990, prompted by introduction of 30% unremunerated reserve requirement (URR) on foreign investment. (Dec. 19)

## <Outlook and Points to Watch>

### *Policy misstep has no immediate implications on credit ratings*

#### (1) Equity markets plunged at currency rule

On Dec. 19, SET index closed at 622.1, down 15% from the previous day, recording a largest daily drop since 1990. The sell-off by foreign investors were triggered by an introduction of 30% unremunerated reserve requirement (URR) on foreign investment in securities and other assets, which was announced by the central bank in the evening of the previous day and became effective on the following day. The measures were draconian, requiring 30% URR for investment over a year, and additional 10% principle deduction for investment for less than a year. After seeing a chaotic stock market development, the financial minister announced in the evening that foreign equity investment will be exempted from the URR, while bond investment and loans remain under URR requirement, a dramatic U-turn just one day after the introduction of the measure.

JCR thinks that the policy misstep which precipitated a collapse of equity markets has no immediate implications on credit ratings of Thai government, though it may increase a mid-term funding cost for Thai entities by limiting a liquidity previously provided from offshore. External balance sheet of Thailand remains strong and thus resilient to external shocks, with international reserves net of forward position on December 8, 2006 at USD73.4 billion, comfortably covering gross external debts of both public and private sector.

## (2) What was behind recent THB strength?

Right after the military coup in September, there were substantial capital inflows to Thai equity which seemed relatively cheap (in P/E terms). Investors' perceptions that the coup will lead to political stability, that interest rate will go down amid moderating inflationary pressures, and that the economy will be stimulated by start of a part of infrastructure investment ("mega-projects"), seemingly accelerated the inflows. Together with mild current account surplus and relatively stable net FDI inflow, the equity inflow placed upward pressures on THB. Starting from mid-October, market participants saw large capital inflows to bonds denominated in THB, putting further upward pressures on THB. It seemed that relatively high yield (albeit close to that of USD) as an Asian investable credit, and better liquidity than other regional currencies made THB an attractive investment. The bond investments seemed to aim at foreign exchange gain, and to some extent capital gain in views of interest rate cut in the near future, rather than yield.

## (3) BoT tried to restrain a heavy capital inflow to THB bonds

In order to contain surges in capital inflows to THB bonds, which was the main culprit of rapid THB appreciation, BoT introduced various measures in early November and in early December. They prohibited some transactions by banks with non-residents, such as sale of THB denominated bill of exchange (B/E), and repo, and tightened controls on foreign exchange forward transactions. While BoT indicated that there could be additional measures in case of need, most market participants expected somewhat moderate measures such as liberalization of domestic investors' foreign investments. Thus, draconian measures that cover all the portfolio investments took the investors by surprise, leading to a rapid sell-off in the equity markets. JCR thinks it likely that the measure initially covered equity investment because BoT thought that the capital flowed into equity will easily switch into bonds, if not regulated. After equity investment was exempted from the measure, special equity investment accounts for non-resident were created so that to close the above mentioned loop-hole.

## (4) Was strong THB really a treat to Thai economy?

Apparent from the comment from secretary general of SEC that he was not told about the control, the measure seemed to be introduced without due considerations and coordination with relevant institutions. Foreign investors' confidence in the economic team, which had been perceived to be highly knowledgeable about market economy, seems to be somewhat dented by the incident. In addition, JCR is not fully convinced that appreciating THB will create a considerable negative impact on Thai economy. Biggest components of Thai exports are manufactured goods with high import contents, which are less sensitive to THB fluctuations. Despite rapid appreciation of THB since the beginning of the year (16% against USD), merchandise exports recorded a robust growth to date (custom export grew 17% y/y for Jan. – Nov. period).

JCR suspects that the measure might be intended to protect certain sectors of economy rather than economy as a whole. Sectors vulnerable to THB appreciation may include labor intensive manufacturers and some agricultural producers. JCR is worried that current interim government, which was not directly elected by voters, could be more easily influenced by certain sectors than the previous one.

If the central bank or the government will make another serious misstep in the near future, it will severely erode confidence among both foreign and domestic investors. While there remains considerable near-term uncertainty about capital flow to Asian financial markets, oil price development, and US economy, it will be crucial for them to act in a predictable manner paying close attentions to financial markets developments.

### Thailand: Main Economic Indicators

		1999	2000	2001	2002	2003	2004	2005	2006f	2007f
Real GDP Growth y/y	(%)	4.4	4.8	2.2	5.3	7.1	6.3	4.5	4.6	4.5
Unemployment Rate	(%)	3.0	2.4	2.6	1.8	1.5	1.5	1.7	1.6	2.1
CPI Inflation y/y	(%)	0.2	1.7	1.6	0.7	1.8	2.7	4.5	5.3	4.5
Lending Rate	(%)	9.0	7.8	7.3	6.9	5.9	5.5	5.8	7.3	6.7
Central Gov. Balance/GDP (GFS basis)	(%)	-9.0	-1.9	-2.2	-7.2	1.5	0.6	0.3	-0.2	-0.1
Gross Gen. Gov. Debts/GDP (incl: FIDF)	(%)	31.9	38.5	38.7	38.4	40.2	35.9	36.5	35.0	36.0
Exports of Goods & Services	(US\$ bn)	71.4	81.8	76.1	81.5	93.9	114.0	129.8	151.0	163.0
Imports of Goods & Services	(US\$ bn)	56.3	71.7	69.1	73.7	85.1	107.3	133.7	145.5	159.0
Current Account Balance/GDP	(%)	10.1	7.6	5.4	5.5	5.6	4.2	-2.1	1.0	1.5
International Reserves(excl: gold)	(US\$ bn)	34.1	32.0	32.4	38.0	41.1	48.7	50.7	53.0	57.0
Import Cover	(month)	7.3	5.4	5.6	6.2	5.8	5.4	4.6	4.4	4.3
Net External Debts/GDP	(%)	36.8	24.8	15.2	4.6	-4.2	-8.2	-9.2	-12.0	-13.5
Intl. Reserves/S-T External Debts	(%)	1.8	2.2	2.5	3.3	3.9	4.1	3.3	4.2	4.4
Net External Debts/Exports	(%)	63.2	37.2	23.0	7.2	-6.4	-11.6	-12.6	-16.2	-18.0
Debt Service Ratio	(%)	21.8	16.3	25.4	23.2	15.6	10.6	9.5	8.6	7.5
Exchange Rate (period average)	(US\$1=)	37.8	40.1	44.4	43.0	41.5	40.2	40.2	38.0	36.0

Source : Bank of Thailand, Ministry of Finance, NESDB, IMF, World Bank, JCR estimates and forecasts