

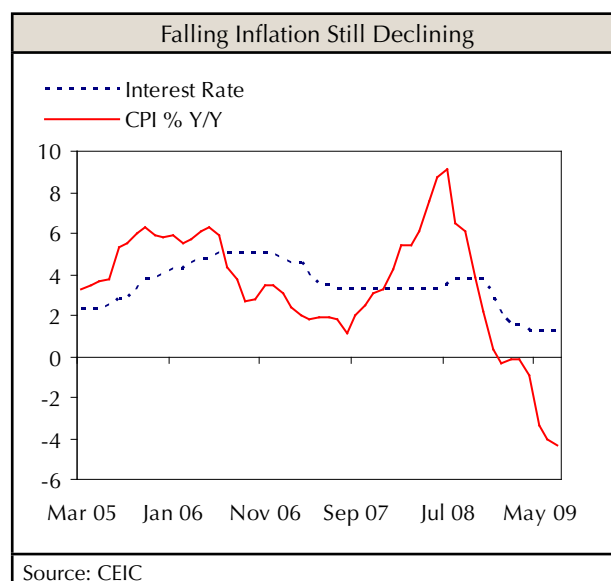
Thailand: Technical Recession Ends But Recovery Prospects Not Clear-Cut

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- Our expectation is for them to raise rates in the 2H of 2010, when the growth of the economy is on a more sustained path.
- Growing 2.3% q/q on a seasonally adjusted basis, the technical recession which began in the last quarter of 2008, has ended.
- A look at the key industries of the economy, however, still show weakness persisting.
- Exports, which make up more than 60% of GDP, also seem to be falling further, with no sign of recovery.
- Overall, we think Thailand's economy, like the rest of the global economy, looks to be on the recovery path. But the sustainability of the recovery pattern largely depends on whether the economy can stand on its own when the fiscal stimulus package runs out.

As expected, Thailand's central bank yesterday kept the benchmark one-day bond repurchase rate unchanged at 1.25%, in line with consensus estimates. The Bank of Thailand said the "current level of policy interest rate is appropriate and supportive of the economic recovery without generating any inflationary pressure". It did however caution that although the Thai economy had improved, there is still a "high degree of uncertainty about the sustainability of global economic recovery".

With Thailand's CPI still in a deflationary environment, there does not seem to be any impetus for the BoT to raise rates anytime this year. Our expectation is for them to raise rates in the 2H of 2010, when the growth of the economy is on a more sustained path. Indeed, even as Thailand climbed out of a technical recession in the 2Q, its recovery, which hinges on demand for exports coming back and whether it is able to wean off fiscal stimulus, still seems wobbly. Add to this, the domestic political issues which also continue to weigh on recovery prospects.

Growing 2.3% q/q on a seasonally adjusted basis, the technical recession which began in the last quarter of 2008, has ended in the 2Q, following in the footsteps of many other Asian countries. On year, the economy contracted 4.9%, less than the 7.1% decline in the 1Q. Headline numbers show the economy to have passed the worst of



its declines, helped largely by government spending which increased 5.9% from 3.6% in 1Q. Private consumption also seems fairly resilient, only dropping 2.3% from -2.5% in 1Q.

A look at the key industries of the economy, however, still show weakness persisting. Manufacturing - which made up about 40% of GDP last year, shrank 8.4% y/y, less than the -14.4% in 1Q. On a seasonally adjusted basis, the sector expanded 6.2%, after a 6.6% contraction in 1Q09. Similar to the previous quarter, the capital and technology industry (which includes machinery and motor vehicles manufacturing) saw the steepest drop of 34.9% y/y, but was still better than the previous quarter's -42.4%.

Although it looks likely that the manufacturing sector is past the worst of its slowdown, the quarters ahead may prove to be a tough and slow climb upwards. There does not seem to be a decisive uplift, since Thai exports are still shrinking. In fact, 2Q saw exports contracting more steeply, at -22.8%, compared to -17.9% in 1Q, with a decline in the export of electronics, vehicles and agricultural products. Exports, which make up more than 60% of GDP, also seem to be falling further, with no sign of recovery, with July's exports down 23.9% y/y, from -20.5% in Jun. With this in mind, our projection is for a slow improvement in the manufacturing sector. The 3Q could decline by around 6% y/y, before reversing to a marginal expansion in the 4Q at +1% y/y.

The other major component of GDP-services - which account for about 40% of GDP continue to decline on a whole-declined 2.6% y/y, similar to the previous quarter's 2.9% contraction. The sector was dampened somewhat by the slow recovery in the sales and repair of motor vehicles (2Q: -3.3% y/y, 1Q: -4% y/y) as well as hotels and restaurants, which were first hit by the closure of the airports last Dec, and now the H1N1 pandemic (2Q: -5.6% y/y, 1Q: -6% y/y). Tourists arrivals are also on the wane, declining more steeply in 2Q, at -16.5% y/y, compared to -15.8% in 1Q. As political issues in Thailand continuing to brew and dominate, tourism is bound to be affected.

Overall, we think Thailand's economy, like the rest of the global economy, looks to be on the recovery path. But the sustainability of the recovery pattern largely depends on whether the economy can stand on its own when the fiscal stimulus package runs out. We are still projecting 3Q to shrink over 3% before heading into some expansion of over 2% in the 4Q. For the full year, we are maintaining our forecast of -3.2%. The Thai state planning agency predicts that the economy would contract between 3.0% to 3.5% in 2009, revising its May forecast of a 2.5% to 3.5% contraction.

USD/THB

The THB has gained somewhat against the USD on improving risk appetite and some domestic stock market gains. But some political issues could weigh on the THB. For now now, the USD/THB pair looks range-bound, with some upside risks, due to still lingering uncertainty about the global recovery story. We are keeping to our projection for the THB to touch 33.0 by year end.

Growth Rates of Selected Sectors of Real GDP							
%	2008	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09
Agriculture	5.0	3.1	8.6	9.6	1.6	3.4	-2.7
Manufacturing	3.9	9.5	7.7	6.1	-6.7	-14.4	-8.4
Services	1.2	3.9	2.9	1.6	-3.6	-2.9	-2.6
GDP y/y%	2.6	6.0	5.3	3.9	-4.2	-7.1	-4.9
GDP q/q s/adj	2.6	1.1	0.3	0.5	-6.1	-1.8	2.3
Source: Office of the National Economic and Social Development Board							

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