APAC Economic Comment
Thailand: Autos give growth a lift

Economics

Thailand

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Better than expected growth reduces the case for lower rates near term

In May we took the view that BoT policy rates would be cut 50bps by end year 2016. We now adjust that view to look for only one 25bp cut by year end, with policy rates on hold in 2017. Better than expected H1 real GDP growth leads us to revise our full year Thai GDP forecast to 3.1% (from 2.8%), reducing the case for policy easing.

Autos give a lift to Q2 growth

Real GDP growth surprised on the upside in Q1 and Q2, reaching 3.5% yoy in Q2 2016. The upward surprise in Q1 was a jump in government outlays and acceleration in tourist arrivals. Both subsequently diminished, as we expected, in the second quarter. However, car sales contributed to a jump in consumer spending and manufacturing activity in Q2. Consumption accelerated to 3.8% yoy, the fastest pace since Q1 2013, thereby supporting GDP growth in against a slowdown in government consumption, investment and exports. Car production, meanwhile, helped manufacturing activity generate the acceleration in four quarter GDP growth from an output perspective (Figures 1-3). The Statistics Agency suggested the increased auto activity was due to new car launches and the ongoing incentive promotion campaign.

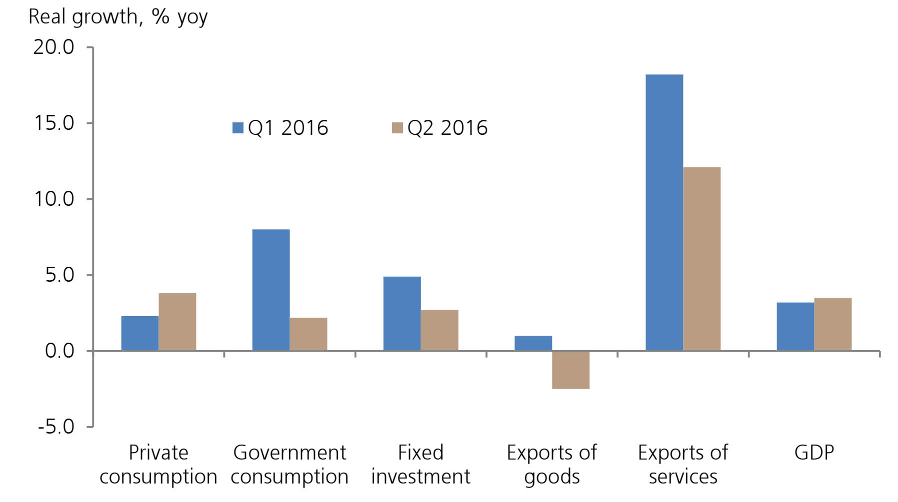
Is the credit cycle recovering?

The strength of auto demand in Q2 – linked to new car launches – may well prove temporary. However, auto demand bears watching because autos purchases are often financed by credit and a sustained acceleration in car sales might suggest Thailand is less hindered by the mature credit cycle than we assume. Unfortunately the ongoing slowdown in household credit does not suggest an improvement in the credit cycle as yet (Figure 6). For now, we assume the jump in car sales will be partially reversed in Q3.

Reduced case for BoT easing – we now look for only one 25bp cut by year end.

Back in May we forecast lower BoT policy rates for four reasons: (i) that official real GDP growth forecasts would be cut below 3%; (ii) that the credit cycle would depress inflation; (iii) that peer central banks would ease policy and (iv) a willingness to weaken the baht. Since May, inflation has been depressed - headline inflation was 0.1% in July and ex-food & energy inflation 0.7% in July. Peer central banks (e.g. BoK, BI, BNM, RBA, RBNZ) have eased policy and the US Fed indicated its willingness to be patient post the UK's EU 'Leave' vote. Meanwhile, in the August policy statement, the BoT voiced concern about baht strength. However, GDP growth did not slow as we expected and official forecasts for 2016 remain in the 3-3.5% range. We do still expect Thai growth to slow in coming quarters because of the mature credit cycle and fading impulses from fiscal policy, tourism and car sales. Weakness in Chinese and European demand are another source of downside risk but could be partially offset by better US growth and a reduced drought related drag on agri output. The strength of growth in H1 brings our full year real GDP forecast back up to 3.1% (from 2.8%). The forecast features slower growth in H2 2016 and our 2017 growth forecast is unchanged at 2.5%. It follows that the case for easing policy near term is reduced but not removed due to the weakness we expect going into 2017 – we now look for only one 25bp BOT policy rate cut at year end. Thereafter we expect policy rates will be left on hold in 2017. Previously we thought the 50bps of cuts in late 2016 would be reversed by end 2017 due to the pressure of higher US interest rates (Figure 7).

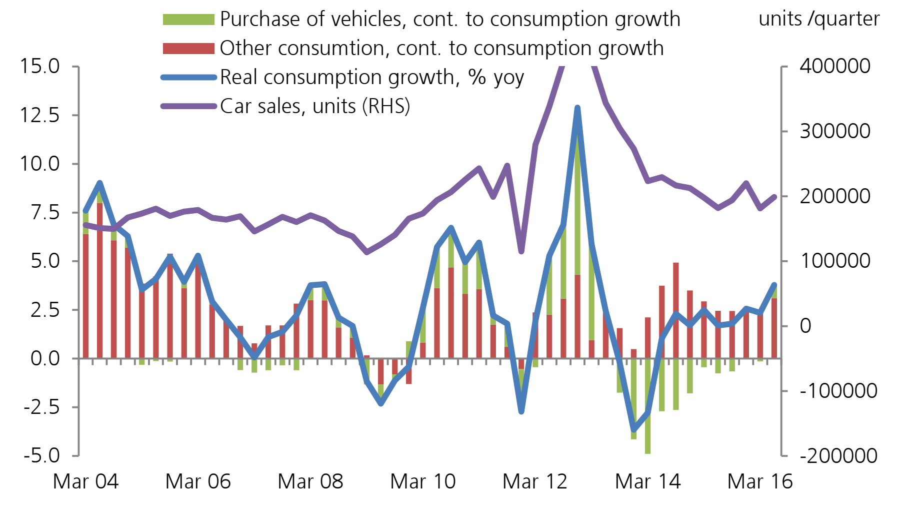
Figure 1: An isolated acceleration in consumption in Q2 2016



Source: UBS, Haver, CEIC

Real GDP growth accelerated to a 3-year high of 3.5% in Q2 2016. The acceleration can be attributed to a jump in consumption.

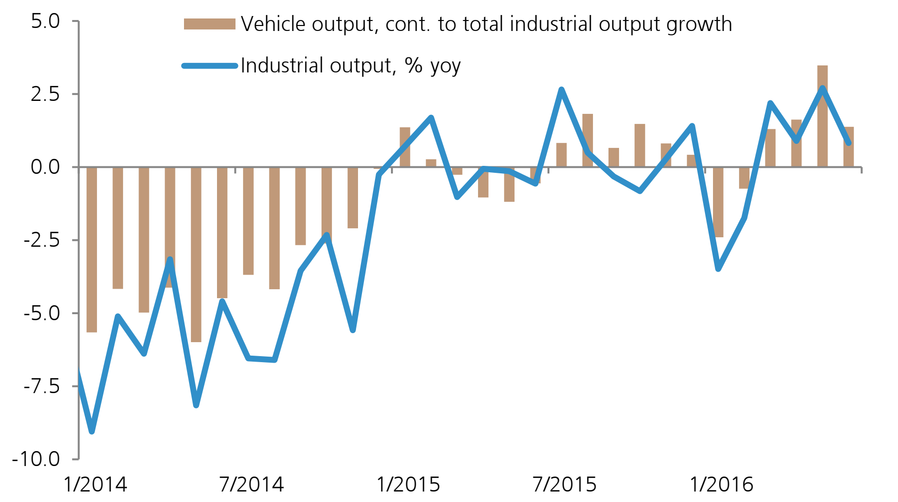
Figure 2: Autos help consumption pick up



Source: UBS, Haver, CEIC

Car sales account for only 6% of consumption but explain more than half the acceleration in consumption growth. Car sales were lifted by new car launches and an ongoing incentive campaign according to the Statistical Agency (NESDB). As such, the rise in car sales could prove temporary.

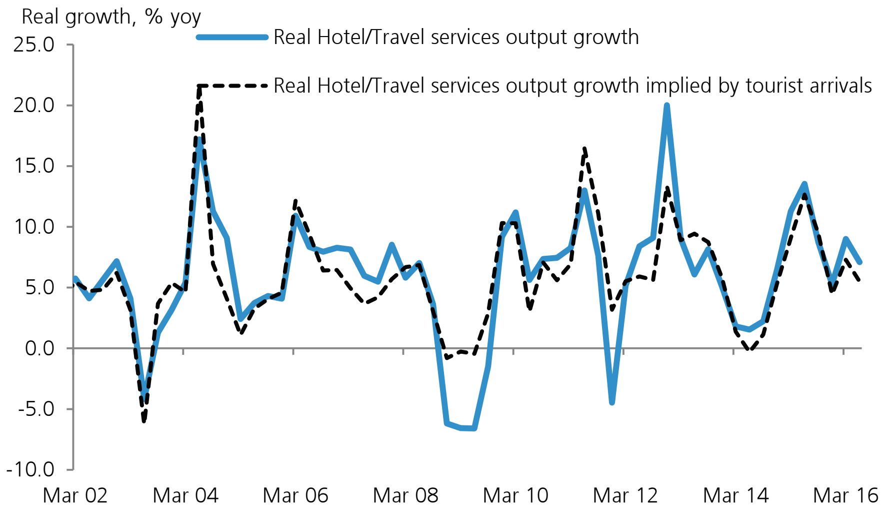
Figure 3: Car production also drove manufacturing



Source: UBS, Haver, CEIC

Motor vehicle production accounts for 18% of manufacturing, which in turn accounts for 27% of GDP. The rise in car production explained the rise in Q2 GDP from an output perspective. However, the pace of car and total production slowed in June after the strength in May – consistent with a temporary lift from autos to economic activity.

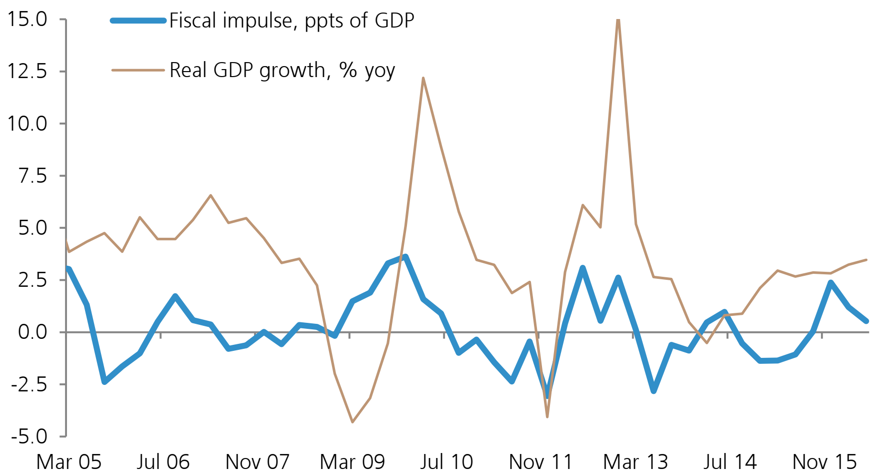
Figure 4: Tourism growth could slow further



Source: UBS, Haver, CEIC Note: implied series based on simple linear regression based on tourist arrivals

Tourism has been a strong driver of the hotel/restaurant and communications/transport sectors (12% of GDP). Growth was fading anyway; tourism arrivals growth of 6.6% yoy in June was less than half that of Q1. The tragic bomb blasts in tourism districts on 11-12 August will unfortunately probably depress growth further in Q3. We note that the Tourism Authority of Thailand estimates a loss of under 0.1% of GDP via reduced bookings and also that Thailand's tourism sector has bounced back before.

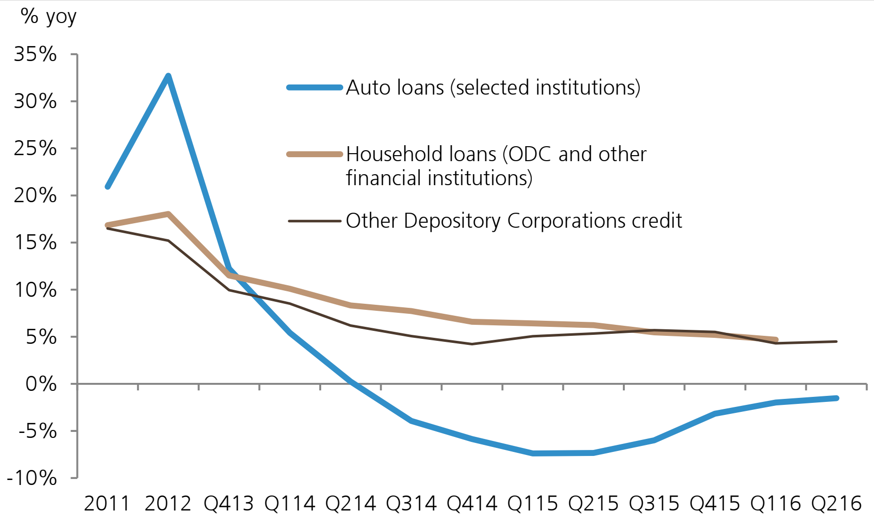
Figure 5: Fiscal impulse fading



Source: UBS, Haver, CEIC

Government consumption and investment contributed significantly to Thai GDP growth in Q4 2015 and Q1 2016. Our measure of the fiscal impulse – the acceleration in the four quarter change of central government debt – suggests the support for growth is fading. That is consistent with the slower public investment and government consumption growth evidenced by Q2 GDP.

Figure 6: Could an improving auto sector herald an improved credit cycle?



Source: UBS, Haver, CEIC, Corporate Results

Temporary supports for growth abating are one driver, but the key underpinning of our slower growth view remains that the mature credit cycle in Thailand (and ASEAN) will keep growth relatively subdued. Accelerating car sales are a test of that view since autos tend to be financed with credit. Could accelerating car sales be a sign that the credit cycle is turning? We shall watch this space.

Figure 7: Key UBS Forecasts

	2015	2016E (old fcst)	2017E (old fcst)
Real GDP growth, % yoy	2.8	3.1(2.8)	2.5
CPI inflation, % yoy	-0.9	0.4	1.7
BoT repo rate, %	1.50	1.25(1.00)	1.25(1.50)

Source: UBS Estimates

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