

THAILAND

MACROECONOMIC UPDATE

KEY DEVELOPMENTS

- *Recovery is on track but it remains fragile.* The economy has continued to expand in 2000 (in Q1 2000, real GDP grew by 5.1 percent). Exports remain the main driver of growth. Private investment has shown some signs of improvement, in selected export oriented industries. The increased market volatility, the increase in oil prices, and the uncertainty arising from forthcoming elections, may have adversely affected consumer confidence. On balance, Thailand is expected to grow by 4-5 percent in 2000. The downside risks to the potential growth scenario include a further fall in the market confidence arising from a slow down in the implementation of the structural reform program as the Government gets distracted by the elections, and export growth losing some of its vigor in the third and fourth quarter with the possible *soft landing* of the US economy.
- *While market volatility has increased, it is unlikely to lead to a turmoil.* Since January 2000, the Stock Exchange of Thailand index has lost 36 percent of its value, and it remains volatile, in part reflecting market discontent with the pace of reforms and political uncertainty. The Baht has depreciated by 7.7 percent. These adjustments, however, do not point towards a new crisis as the balance of payments situation remains comfortable.
- *The pace and quality of the financial and corporate reform continue to be the major constraint to the full cementing of the recovery.* NPLs still represent 32 percent of total credit (see the Financial Sector Update) and the total credit value of cases that have failed the CDRAC process and require legal action is a growing concern (see the Corporate Sector Update). Moreover, successful debt restructuring is often limited to rescheduling. Thus, despite high levels of liquidity in the financial sector credit flows have not recovered. Going forward, this could jeopardize the financing of new investments in sectors that are currently running close to full capacity (e.g., integrated circuits, tires, an paper products).
- *Thailand external position remains comfortable.* While exports slowed down in Q2 2000, performance continues to be solid (15 percent growth). Despite the fast growth of imports (26 percent in Q2 2000), the current account remains positive and is able to compensate for weakness in the capital account resulting from accelerated debt repayments. FDI remains stable and will likely remain above the pre-crisis level of 2 percent of GDP. Thus, international reserves are likely to remain above USD 30 billion, comfortably covering short term external debt
- *Fiscal policy continues to support the recovery.* The overall public deficit for year 2000 could approximate 7 percent. Given the slow pace of recovery in domestic demand, the government has delayed the normalization of the value added tax (from April 2001 to October 2001). The targeted overall fiscal deficit for year 2001 is thus close to 6 percent.
- *While public debt has increased, and will pose challenges in the future, it is manageable.* Public debt has reached 55 percent of GDP not including additional US\$ 800-1,200 billion of expected losses from FIDF. However, provided that growth does not slow down below 4 percent and real interest rates do not shoot up, public debt can be reduced below 40 percent of GDP by year 2010 with fiscal consolidation in the medium term.
- *Monetary policy continues to be accommodating.* Given a still frail real economy, and inflation expected to remain low (2-3 percent) despite the increase in oil prices, BOT has maintained an accommodative monetary policy. The inflationary impact of oil price increases is likely to be neutralized by increases in productivity growth, low industrial capacity utilization, and wage increases which remain modest given the still relatively high unemployment rate.
- *Total factor productivity (TFP) and the quality of the labor force are trending-up.* TFP, which began to decline well before the crisis, is now trended upwards. The manufacturing sector has witnessed a significant turnaround in productivity. It is difficult to estimate the extent to which the productivity growth is structural or cyclical, although there is some evidence that the structural reform program has begun to pay dividends.
- *The social impacts of the crisis are still being felt.* The latest Socioeconomic Survey shows that poverty incidence in 1999 reached 16 percent. Given a poverty/growth elasticity of 1.3 and a GDP growth rate of 5 percent, poverty incidence could go back to pre-crisis levels by year 2003/2004 (see the Social Sector Update).

Growth and its key drivers

After a sharp contraction in 1998, real GDP is estimated to have grown by 4.2 percent in 1999 and is expected to grow by 4-5 percent in 2000. A major downside risk to the growth scenario is the observed slowdown in manufacturing production (particularly for domestic oriented industries) which reflects weak domestic demand. Despite government interventions (subsidies and prices controls) to minimize the impact of higher energy prices, these may also be contributing to a downward adjustment of aggregate supply. Signs of this slowdown are given by the downward trend in the manufacture production index during the last 6 months and the fall in industrial capacity utilization which in July stood at 55 percent. Thus, it is likely that GDP growth rates in Q3 and Q4 2000 would be below those observed in the first two quarters.

Figure 1: The economy may be slowing down

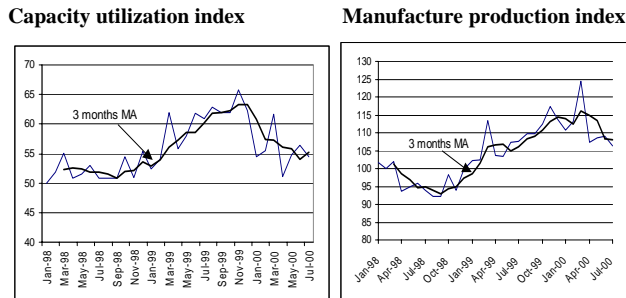


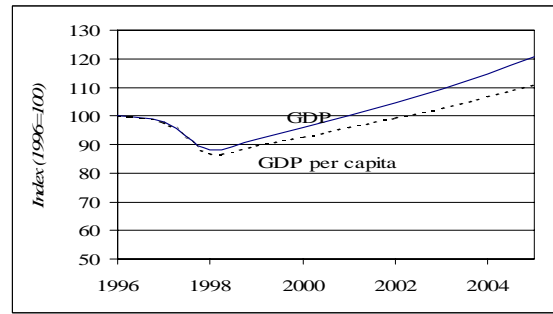
Table 1: Contributions to Growth (Baseline case)

	Growth	Contributions to growth
Real GDP growth (%)	4.5	4.5
Private consumption	6.4	3.4
Public consumption	4.9	0.46
GDFI	8.04	1.37
Public total investment	4.5	0.43
Private total investment	11.0	1.22
Exports	11.0	6.33
Imports	17.0	-7.54

Source: Staff calculations

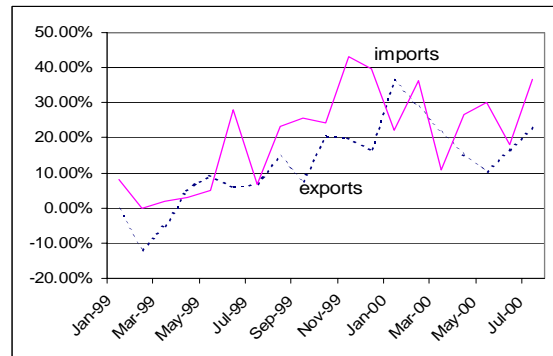
Exports continue to be the key driver of the recovery. In 1999, exports grew by close to 9 percent, and are expected to grow by 11 percent in 2000 contributing 6 percentage points to economic growth. During Q1 2000 monthly exports (in dollars) were growing at an average of 30 percent (y-o-y). While in the second quarter exports growth slowed down, performance continues to be remarkable. The expansion of exports, however, has concentrated in the manufacturing, mining and re-export sectors. Agricultural exports have been left behind due to weather problems and depressed prices for agricultural products.

Figure 2: Per capita Income will reach pre-crisis levels by the end of year 2002/2003



The dependency of the recovery on foreign demand creates an important down-side risk. Thirty six percent of Thai exports go to NAFTA and Japan. Therefore, a slowdown of the United States economy or the lack of full recovery in Japan could slowdown economic growth. The effect of high energy prices and a global slow down in the third and fourth quarters and next year may also have adverse effects on Thai exports. Some estimates suggest, for instance, that if growth in the world economy falls below 3 percent, economic growth in Thailand could be reduced by 1 to 2 percentage points.

Figure 3: Exports and imports growth



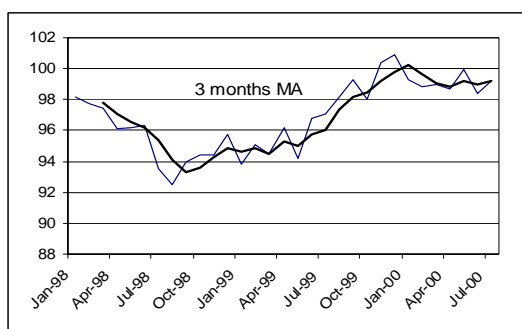
The rapid growth of imports suggests that recovery may be broadening. After growing by 21.3 percent in 1999, imports are expected to grow by 17 percent in year 2000. While initially growth was mainly due to consumers goods, imports of raw materials and capital goods are now the major drivers.

External balance remains comfortable. Despite the fast growth of imports, the resource balance remains positive and has compensated for some weakness in the capital account resulting from accelerated debt repayments following the increase in interest rates in the United States. While there is evidence that FDI is slowing down in sectors such as real estate, financial intermediation, and construction, as foreign investors are exhausting extraordinary opportunities, in sectors such as services and trade trends are stable and could peak up. Overall, it is likely that in the medium term FDI flows will be above the pre-crisis level of 2 per-

cent of GDP. Given a flexible exchange rate regime, the surplus on the trade balance, and improved prospects for the tourism industry, it is expected that gross official reserves will remain above US\$ 30 billion, enough to cover comfortably current cash in circulation.

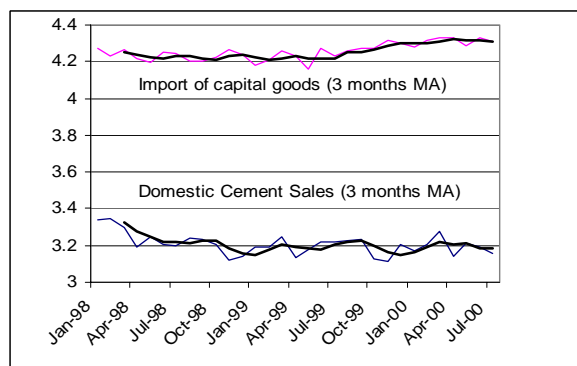
Private consumption may be slowing down. In 1999 private consumption grew by 3.5 percent, recovering from the sharp contraction in 1998 (-12.3 percent). During Q1 2000 consumption grew by 5 percent. This recovery is broadly consistent with the return of consumers confidence, reflected in an increase in the propensity to consume, as well as the recovery in aggregate disposable income resulting from rising wages and higher levels of employment. More recently, however, consumer confidence may have weakened, as indicated by the private consumption index. Given observed growth rates of indicators such as car sales and the VAT tax, which are highly correlated with quarterly consumption, it is, however, unlikely that the growth rate of consumption in year 2000 will be below 5 percent.

Figure 4: The consumption index is flattening



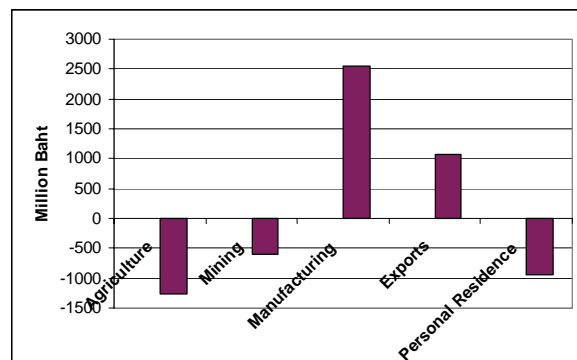
Private investment remains fragile but observed levels are sufficient to sustain growth rates of 4-5.5 percent during the next two or three years. In 1999, total investment reached 20.4 percent of GDP, an increase of 12 percent from 1998 (in 1996, 1997 and 1998 total investment as a share of GDP was respectively 43 percent, 34 percent and 19 percent). Since January 1999, indicators such as cement sales and BOI approvals have remained mostly flat. However, historically, BOI only represents a small share of total investment (less than 3 percent of GDP). Other indicators such as imports of capital goods, which constitute a better proxy for aggregate investment, are trending up, suggesting that investment is recovering. Total investment in the economy is expected to grow by close to 8 percent this year (this trend is also supported by an increase in SOE investment).

Figure 5: Investment seems to be recovering



The major obstacle to investment growth is the high level of NPLs, and the slow pace of financial and corporate sector restructuring, which make banks reluctant to lend. During the first 7 months of year 2000 total credit has continued to contract at an average of 5 percent (y-o-y). The cutbacks, however, do not affect all sectors in the same way. For instance, in the manufacturing and export sectors, since December 1999, total credit has been increasing at an average of Baht 2.5 and 1 billion per month respectively. In contrast, in the agricultural sector, total credit has been decreasing at an average of Baht 1.2 billion per month. A pro-active management of financial and corporate sector restructuring continues to be essential for re-viving business investments particularly in the case of SMEs.

Figure 6: Average monthly change in credit between December 1999 and May 2000



Source: BOT

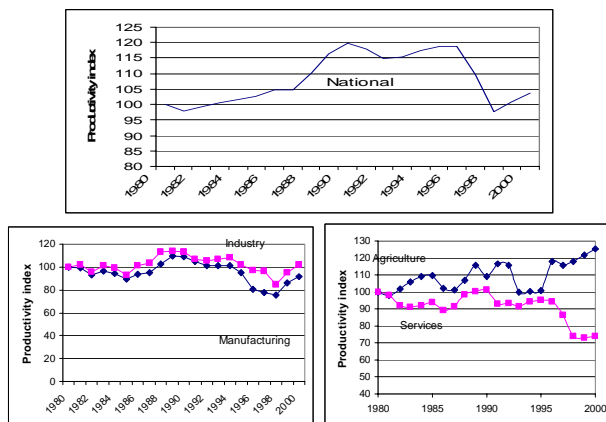
Sectoral performance

While the recovery is still unbalanced. Not all sectors have recovered in the same way. Initially the recovery was driven by the manufacturing sector, in particular outward oriented industries (the sector grew by 9.5 percent in Q1 2000 with sub-sectors such as electronics and computers growing by over 15 percent). Gradually other sectors have started to expand. For instance, the construction sector, badly hit by the crisis (this sector contracted by 8.7 percent in 1999), grew by 1.1 percent in Q1 2000, mainly as a re-

sult of an increase in private construction. Nonetheless, the financial and agricultural sectors continued to display a poor performance in Q1 2000, contracting by 4.3 percent and 1.5 percent respectively. The poor performance of the agricultural sector, however, is not crisis related but responds to weather problems that affected the production of shrimp and high oil prices which raised production costs in fisheries.

Prospects are encouraging given the turnaround in productivity growth. TFP growth slowed down since 1990, becoming negative around 1996, and collapsing with the onset of the financial crisis. However, since 1999, TFP appears to have started to grow again in all sectors, particularly manufacturing. New calculations show that in the medium term TFP growth in industry, agriculture, and the service sector could reach 6 percent, 3 percent and 1.4 percent respectively. At the national level TFP could be expected to grow at close to 3 percent, provided that the government continues to make progress in the implementation of its agenda to renew competitiveness.

Figure 7: Total factor productivity is growing

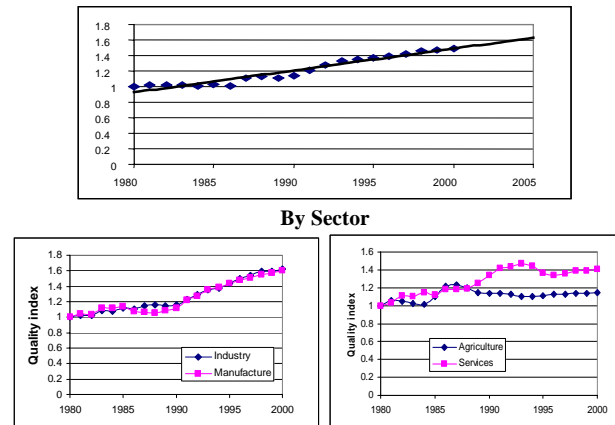


Source: Authors calculations.

The productivity of the labor force has been improving as the share of educated workers increases. In the medium term, labor productivity is expected to grow by 1.7 percent per year. Growth will be driven predominantly by the manufacturing sector (2 percent). In the services and agricultural sectors labor productivity growth is estimated at 1 percent and 0.3 percent respectively, although there is significant upside potential in the services sector.

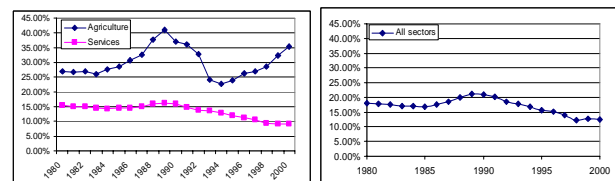
Returns to capital have stabilized in all sectors. The rate of return to capital, which had been falling in all sectors since 1990, appears to be stabilizing. In the agricultural sector the rate of return to capital has been growing aggressively since 1994, in part reflecting Thailand's comparative advantage in the sector.

Figure 8: Labor productivity is increasing (1980=1) National



Source: Authors calculations.

Figure 9: Returns to capital have stabilized

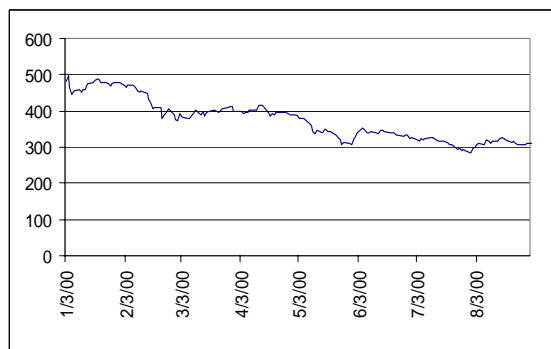


Source: Authors calculations.

The stock market remains volatile but it is not perceived as a major threat to the recovery. Since January, the SET has lost 36 percent of its value. Initially, prices dropped as foreign investors cut their positions on Thai stocks (in January and February, foreign investors were net sellers of close to US\$ 280 million). In part adjustments in portfolios were introduced to reflect the lower weighting of the SET in the MSCI, after the inclusion of the Malaysian and Taiwanese stock markets in the benchmark, and given expectations of rising US interest rates, which make US bonds more attractive. Nonetheless, the adjustments may also be reflecting uncertainties in the Thai economy arising from (a) the forthcoming elections and the possible change in the Government, (b) the slow pace of financial and corporate restructuring.

As a response, the SEC and SET are devising reforms to enhance the competitive edge of the Thai stock market in response to globalization. Their proposal has four major components: (1) merging the foreign board with the main board to increase flexibility for foreign investors; (2) allowing for dual or multiple listings; (3) allowing securities companies to invest overseas; and (4) introducing new hedging instruments. The new Derivatives Act, which would introduce these reforms, is expected to go to the Parliament in July.

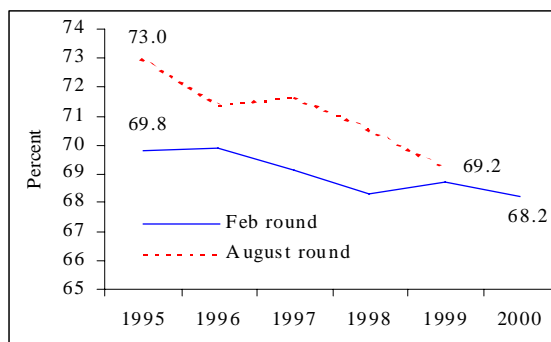
Figure 10: Stock market remains volatile



Labor markets

Employment is growing in all sectors except agriculture. The Labor Force Surveys (LFS) for August and November 1999 showed that while the unemployment rate had begun to fall, employment was contracting and the share of the labor force working less than 20 and 30 hours per week was increasing. The falling unemployment rate was simply due to the fact that since 1989 the participation rate (the share of the labor force in the population over 13 years of age) had been falling at an average rate of 1.4 percent per year. The latest round (February 2000) of the LFS confirms its long-run downward trend. However, the survey also shows that for the first time since the crisis, employment has expanded in all sectors except agriculture. Indeed, between 1999 and 2000 approximately 500 thousand new workers were employed thus reducing the February unemployment rate from 5.4 percent in 1999 to 4.8 percent in 2000 (data on the average number of hours worked is not yet available).

Figure 11: Participation rate has continued to fall

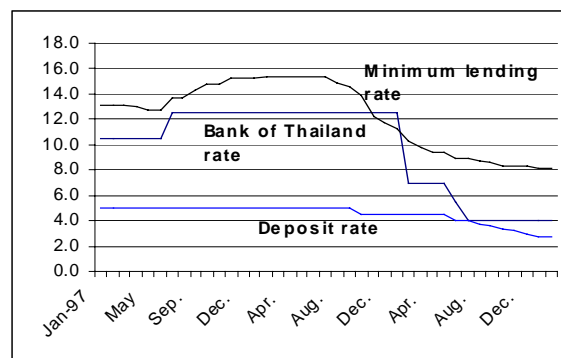


The fact that employment in the construction sector is expanding (as well as output, see Section on Sectoral Performance) is encouraging. Indeed, in the past, the construction sector constituted a safety net for agricultural workers during the non-harvesting season. Despite the observed recovery, however, claiming that the construction sector is ready to resume this role would be premature. Government safety net programs remain important.

Macroeconomic policy

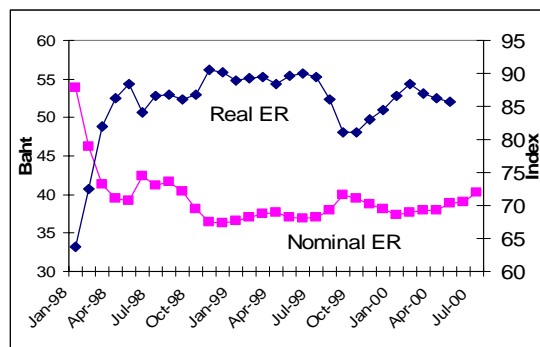
Monetary policy remains accommodative. The BOT has opted for low interest rates. This policy seems appropriate given the still frail situation of the financial sector and a much improved external position. In particular, short term external debt has decreased dramatically, falling from 65 percent of exports prior to the crisis to 27 percent to date.

Figure 12: Real interest rates have decreased



The effect of the nominal depreciation on exports and imports, depends on the dynamics of the domestic inflation rate relative to the inflation rate of major commercial partners. For instance, the 4.2 percent nominal depreciation of the exchange rate observed between January and May, was accompanied by an appreciation of the real exchange rate of 1 percent. Basically, the observed nominal depreciation was not sufficient to maintain the competitiveness of Thai exports given relatively higher domestic prices. The macroeconomic model developed by BOT suggests that, for each percentage point difference between the growth rate of the goods and services exports price index and the consumer price index in the United States, the growth rate of exports could be reduced by 0.4 percentage points.

Nominal exchange rate depreciation is healthy



Given steady reductions in uncertainties over the past one and a half year, the authorities contend that the case for stabilizing expectations by maintaining the Baht in a relatively tight range has become less compelling. They have also clarified that they do not intend to tighten existing capital controls. Looking forward, fluctuations in the ex-

change rate will be tolerated as long as they are consistent with the announced inflation target.

Inflation is not a risk. High oil prices, and a shrinking output gap, over time, could add inflationary pressures. Nonetheless, given low commodity prices and low capacity utilization, forecasts suggest that inflation in year 2000 will be below 3 percent. Important progress has been observed in the implementation of the framework for inflation targeting. The Monetary Policy Board has initiated bi-monthly meetings and has tentatively set a medium-term target for the inflation rate of 3.5 percent.

Fiscal policy continues to support the recovery. The overall public sector deficit (including interest cost of financial sector restructuring) for year FY00 is projected to be around 7 percent of GDP and is expected to contribute around 1 percentage point to economic growth. The deficit for January-March 2000 has been in line with the target (in March the budgetary deficit amounted to Bt 4.9 billion). However, there is a downside risk of a shortfall in the overall deficit during the second half of this fiscal year. In July, government revenues increased by 5.9 percent (y-o-y) while expenditures increased only by 0.8 percent. The MOF has appropriately decided to postpone raising the VAT tax (from 7 percent to 10 percent) until October 2001 (the original target was April 2001).

While the public debt has increased and will need to be carefully managed, it is sustainable, provided the growth momentum is maintained and the reform program is on track. As of March 2000, Thailand's public debt had increased to close to 55 percent of 1999 GDP according to the Royal Thai Government estimates (including Bt 500 billion issued to cover FIDF debt and additional 776 billion of currently outstanding FIDF liabilities). While existing FIDF liabilities are included in March 2000 public debt figure, only current and future net losses will impact the central government budget. MOF and BOT estimates place these losses in the range of Bt 800-1,200 billion.

Table 2: Public debt as of March 2000

	Baht Billion
Central Government debt	983.2
Guaranteed SOE debt	698.4
Non-Guaranteed SOE debt	139.2
FIDF outstanding liabilities (a)	776.8
Total public sector debt	2,597

Source: Ministry of Finance
(a) as of December 1999

Table 3: Public debt dynamics is sustainable

Target for the total public sector debt to GDP ratio by year 2010 (%)	Primary Balance (as % of GDP) required to stabilize debt.			
	g-r=-1%	g-r=0%	g-r=1%	g-r=2%
60	0.18	-0.82	-1.78	-2.7
50	1.8	0.84	-0.07	-0.96
40	3.43	2.51	1.63	0.78

i is real interest rate, and g is real GDP growth

Calculations assume a seignorage revenue of 1 percent of GDP equal to the average for the period 1980-1995. Seignorage revenue is defined as (Base money/GDP)*Nominal GDP growth

Source: Staff calculations

Table 3 shows the size of the primary fiscal balance that the Government will need to generate to stabilize the public-debt-to-GDP ratio, under different assumptions on the gap between the real GDP growth rate (g) and the real interest (r) paid on debt. Even under a worst case scenario, assuming that the fiscal cost of financial sector restructuring turns out to be higher than currently projected, with public debt peaking at 65 percent of GDP, debt dynamics is sustainable. For instance, to reduce the debt/GDP ratio to 50 percent by year 2010, under the assumption that the real interest rate exceed growth by 1 percentage point, Thailand would need to generate a primary surplus of 1.8 percent. The fiscalization path for additional FIDF losses could be set to keep the debt service/budget ratio close to 10 percent while ensuring that capital expenditures targets are met.

POLICY IMPLEMENTATION AND ASSESSMENT

Going forward, the quality of recovery in 2000 will depend on several factors including:

- A pro-active management of financial and corporate sector restructuring
- Macroeconomic policies continuing to be supportive of the recovery process
- Safety net and fiscal stimulus measures to ensure that domestic demand effects contribute to recovery and poverty alleviation
- Sustaining the structural reform process to ensure improvements in efficiency and TFP growth.

BANK INSTRUMENTS

Public Sector Reform Loan (PSRL). The PSRL of US\$400 million is a programmatic structural adjustment loan (PSAL). This loan will support Thailand's program to improve public sector management through: 1) improved performance-based resource management, 2) better service delivery, and 3) greater accountability and transparency.

Thailand intends to achieve these objectives by implementing specific action plans in the five areas of (i) expenditure management, (ii) human resources management, (iii)

revenue management, (iv) decentralization, and (v) cross-government accountability and transparency.

Comprehensive Development Partnership. The World Bank Group has initiated discussion with the Government of Thailand to prepare a Country Development Partnership on Competitiveness (CDPC). The CDPC is a non-lending instrument that would support the modernization of institutions and policies to promote a competitive business environment that rewards innovation, investments in human capital, the adoption of new technologies and the rational use of natural resources .

Economic Management Assistance Project (EMAP). The EMAP is a US\$15 million technical assistance loan which started in 1997 and ends in February 2001. The main objectives of the EMAP are as follows: 1) streamlining economic management which includes macroeconomic analysis, public resource management, and administrative renewal, 2) reforming public enterprises, and 3) strengthening industrial competitiveness.

Social and Structural Review (SSR). The SSR is an analytical work underpinning adjustment lending of the World Bank to Thailand. It collects the central messages of the on-going policy dialogue with the Thai authorities regarding short and medium term reform. The SSR covers relevant issues on economic growth, poverty alleviation, financial sector reform, private sector development, environmental challenges, debt management and public sector reform.

Advisory services: The Bank is supporting Thailand's reform program with advisory services. Short policy notes and informal workshops are increasingly becoming instruments of policy dialogue. The Bank also publishes the Economic Monitor which reports on the issues and challenges facing the real economy, financial and corporate restructuring, corporate governance, public sector reform, legal reform, privatization and SOE reform, social safety nets and labor markets, and medium term competitiveness issues.

FINANCIAL SECTOR UPDATE

CURRENT DEVELOPMENTS

Headline non-performing loans (NPLs) are falling slowly (see Figure 1). NPLs in the commercial banks, finance companies and credit fonciers peaked at Baht 2.73 trillion, or 47.7 percent of total loans in May 1999, and have since declined to Baht 1.62 trillion, or 32 percent of total loans in June 2000. If NPLs transferred to bank-owned AMCs are included, headline NPLs as of June would have been Baht 1.75 trillion, or 35 percent of total loans.

The following observations can be made about the dynamics of NPLs over time: (1) While new NPLs are entering into the system, the amount of new NPLs has trended down. (2) The reported magnitude of NPL re-entry has been small at only 0.3 percent of total loans per month, but the general quality of restructuring is questionable. To avoid more provisions for loan losses, banks are rescheduling NPLs (term extension with grace periods) instead of restructuring them at market rates such that repayments can be supported by the borrower's underlying cash flow. (3) 46 percent of total NPL reduction results from debt restructuring. Debt restructuring activity usually accelerates at the end of each accounting period (June and December). (4) Economic recovery accounted for 10 percent of the decline in NPLs. (5) Write-offs have become the second largest contributor to the drop of headline NPLs (21 percent). (6) 10 percent of the NPL reduction came from transfers to asset management corporations (AMCs). Transfers of NPLs to banks' AMC subsidiaries do not resolve the NPLs, but only transfer the management of the accounts to a different organizational unit.

The first straight sale by a Thai bank of a large proportion of its NPLs to third parties has occurred. DBS Thai Danu Bank (DTDB) recently agreed to sell 77 percent of its remaining NPLs (Baht 39.7 billion as of June 2000) to third parties at a deep discount. Proceeds will amount to Baht 9.25 billion, which represents a 70 percent discount from the Baht 30.6 billion outstanding principal balance (OPB). The loans sold include Baht 9 billion of retail loans and Baht 21.6 billion of corporate loans. The retail loans and the corporate loans will be sold at a discount of approximately 50 percent and 78 percent respectively. The average discount of both the retail and corporate loans will approximately be 70 percent.

Private Asset Management Companies (AMCs) have not progressed as expected. Since the removal of tax disincentives in October 1999, the BOT has approved the establishment of eight AMC subsidiaries by seven banks and one finance company, and is reviewing the application for

the set up of four more. However, only one private bank has established a wholly owned AMC and transferred NPLs at fair value. Those loans are managed by third party professionals. Because other private banks are under-provisioned and are capital constrained, their proposed transfers of NPLs to AMC subsidiaries have not been at fair market value. This has resulted in a deadlock with auditors, who will not recognize the transfer. This has stalled the implementation of private AMCs. Total transfers to private AMCs have been only Baht 304.5 billion.

The SEC has identified a roadmap to enhance valuation standards, certification requirements and methods. Appraisal of loan collateral is crucial to determine losses in the financial system since current prudential rules calculate provisions for loan losses net of collateral value. Sampling of appraisals in bank credit files shows that most are done by the cost method, without regard to future income potential. Key weaknesses in the valuation industry include: (1) few number of appraisers experienced with best practice, (2) valuation techniques and certification requirements are below international standards and (3) little supervision and regulation. Currently there are two sets of appraisal standards and code of conduct set by two local associations. Quality control of the profession is weak and there is no penalty in case of non-compliance. The SEC is contemplating a project to develop Thai standards based on international standards.

The Bank of Thailand (BOT) will allow hybrid debt capital instruments as upper Tier-2 capital. This modification should enable Thai banks to have greater flexibility in managing their capital. As provisioning erodes Thai banks' tier-1 capital, the amount of subordinated debt which qualifies as tier-2 capital proportionately declines since lower tier-2 capital cannot exceed the limit of 50 percent of tier-1 capital. In case of hybrid debt capital recently approved by the BOT, the total amount issued can be counted as tier-2 capital. Key features of upper tier-2 capital are that issuers have the option to defer payment of interest and principal on certain circumstances, and such debts must be able to absorb losses (junior to lower tier-2 capital). Such instruments must not be redeemable without the prior consent of the regulators. Upper tier-2, however, is suitable for banks with sufficient core capital and earnings, which may not be the case for some Thai banks. The total capital requirement will remain unchanged at 8.5 percent of risk assets, 50 percent of which must be tier-1 capital.

The Government will split the largest state bank (KTB) into a good bank and an AMC, which will be wholly owned by the FIDF. This will allow the management to focus on the good bank. KTB expects to complete the transfers of its Baht 537 billion NPLs to an AMC by September. Transfer pricing of NPLs are set such that KTB's capital position becomes adequate, but uncovered losses have been transferred to the AMC. After the transfers, its

management expects KTB's NPLs to drop to Baht 140 billion (16 percent of total loans) and its capital is projected to be 9.56 percent. Third party managers will be selected by the FIDF's board to manage the AMC.

Bangkok Metropolitan Bank (BMB) will be privatized while the resolution for Siam City Bank (SCIB) has not been finalized. The most likely case is that bad assets of SCIB (Baht 230 billion) will be transferred to the government-owned AMC, which was set up as a bidder of last resort for the FRA's auctions. The remaining good assets of SCIB may be merged into Bankthai (BT), which was established by mergers of several failed institutions. The government may separate BT into a good bank and a bad bank as well.

The SEC has issued its medium-term strategy to boost competitiveness of Thai capital market. Its strategy focuses on six areas: equity market, bond market, futures market, securities industry, fund management industry, and investors. Its strategies for the equity market include: (1) improve the quality and quantity of supply; (2) stimulate demand by encouraging contractual savings in the country; and (3) restructure the stock exchange (SET). Its strategies for the bond market include: enhancement of the primary market activities by improving flexibility in bond issuance, encouraging new instruments and enforcing credit ratings for new issues. The investor base should be expanded, and infrastructure for the secondary market will be developed further. Standards and practices of both the securities and mutual fund industries should be improved, clients should be well protected, and supervision will be improved to ensure the stability. In order to set up the domestic futures market, the SEC plans to develop the necessary legal framework and infrastructure.

Domestic bond issuance slowed in 1H 2000. From January-June 2000, issuance amounted to Baht 229 billion, which was about 29 percent of the 1999 total (Baht 795 billion). Bond issuance by the central government in the first half was Baht 31 billion, as compared to Baht 333 billion in 1999. However government bond issues should continue to lead activity in the primary bond market due to fiscalization of FIDF's losses over the next five years. The authorities have estimated FIDF's losses between Baht 800-1,200 billion. The amount of corporate bonds issued in the first half of 2000 has also declined substantially following the SEC's new requirement that all debentures must be rated after April 2000.

The BOT is reviewing a pricing scheme to promote the wider use of a more efficient and lower-risk electronic payment system. The payment system in Thailand has undergone substantial technological development in the past decade. However, it is still paper-based (cash and checks) and relatively high cost. For example, actual costs of using and clearing checks significantly exceed fees and are subsidized by other payment channels. There are many

challenges facing the BOT in the development a new pricing scheme to encourage migration into electronic payments. While increasing fees for using checks may encourage corporat to switch to electronic payments, retail customers do not have similar access. An unintended result may be more cash payments. Accessibility by all non-bank financial institutions (as well as foreign banks) is also an issue going forward. Thai banks have legacy systems which slow the transition to electronic payments.

Achievement to Date

Crisis management was effective; the macro economy has stabilized. Failed finance companies were liquidated, failed banks were sold, and now FIDF-owned asset management companies, managed by professional third parties under incentive arrangements, hold promise for resolution of debts in state banks.

A market-led approach to financial sector and corporate debt restructuring has attracted about Baht 314 billion of private tier-1 capital into the private banks since the crisis broke. This has reduced the cost to the taxpayer for the guarantee of depositor's funds in financial institutions. Total capital raising by financial institutions from January 1998 to June 2000 amount Baht 900 billion. This enables them to meet the provisioning rules under the forbearance program (stepped up until the end of year 2000). Still more is needed to absorb the full losses of NPLs.

The infrastructure for the bond market has been improved and the authorities are increasing capacity to manage public debt. The MOF established the Domestic Bond Market Committee to build a domestic bond market, with a primary focus on the government securities market. The Public Debt Management Office (PDMO) has been established to manage government debt. The office has already pulled existing resources from the Fiscal Policy Office and the Comptroller General Office. A road map for strengthening the office is being developed, including asset liability management, a resource plan and an information technology development plan.

Supervision regime is being strengthened. The Draft "Financial Institution Law" was approved by Cabinet and the Council of State in Q1 2000. The BOT is reengineering its supervision function, with the assistance of a management consultant and professional supervisors from the US. Risk-focused supervision is replacing transaction testing.

Issues and Areas to Watch

Reduction in NPLs is expected to slowdown as Bt1.1 trillion are headed for the courts. Easier cases have been restructured by banks. The remaining cases are believed to be more complex, difficult to resolve and reflect deeper losses. The informal platform for out-of-court restructur-

ing of large syndicated loans may end if Corporate Debt Restructuring Advisory Committee (CDRAC) winds down its operations next year. Moreover as of June 2000, Bt1.1 trillion in CDRAC's portfolio were not resolved on a voluntary basis by the deadline, and will have to be resolved in court, where there are capacity constraints and time consuming processes. Given current completion and filing rates, it may take the courts approximately six to seven years to reach judgements on that backlog. After judgements are received, the auction of the collateral and resolution of the claim may take another two years.

DTDB's loan sale has set a benchmark price for NPLs of other Thai banks. DTDB's recent sale of its NPLs is more recent than the FRA auctions of assets from the failed finance companies, and its portfolio should be more similar to NPLs of other banks. But prices were similar to prices achieved by the FRA. DTDB sought bids for its NPLs a year ago, but did not sell the loans at that time. According to management, prices offered in last year's bid were not substantially different from prices offered in the recent loan sale. The positive market reaction to the sale suggests that DTDB's strategy is sound, and that on a net present value basis, the legal process for debt collection of NPLs is prohibitively expensive.

While banks will meet the year-end 2000 provisioning requirements set by the regulator, the banking system remains capital constrained. Thai banks have raised Baht 844 billion tier-1 capital of which Baht 314 billion came from private investors. Although significant unrealized losses remain on the balance sheets of some banks, regulatory forbearance allows banks to delay loss recognition such that banks are not forced to recapitalize quickly and sufficiently. Explicit forbearance, which includes the phase-in of provisions over time, will cease at end 2000. However implicit forbearance, which is less transparent, will continue after 2000. Implicit forbearance allows banks to provision for loan losses net of collateral value, which is mostly property. Collateral value appears overstated due to the weakness in the profession, practices and standards of property valuation in Thailand. In addition, quality control on the reclassification of restructured NPLs appears weak. Capital constraints in the banking system, together with a weak legal regime for collection, are slowing the pace and quality of loan restructuring.

The Government's program, which provides public capital as a last resort to private banks, will expire early next year. The government established a public recapitalization program in August 1998 to provide public funds to recapitalize private financial institutions on a matching basis with private capital. Banks view the scheme as a last resort because they fear that it will bring government interference in management, even after 1999 amendments to the scheme. To date only 23 percent or Baht 70.5 billion has been utilized by private banks. The scheme is set to expire in March 2001 and the Ministry of Finance is considering

whether to let it expire or amend the law so that funds can be used for other purposes.

The SET has been under-performing some other stock markets in the region. Foreign investors have been net sellers in the SET (see Figure 2). Thai stock market turnover hit a record low in July. The allocation of Thai stock market in several benchmark indices, which are used to measure the performance of international institutional investors, was revised down according to comparative levels of market capitalization. The result is that portfolio investors allocate less of their funds to Thai stocks.

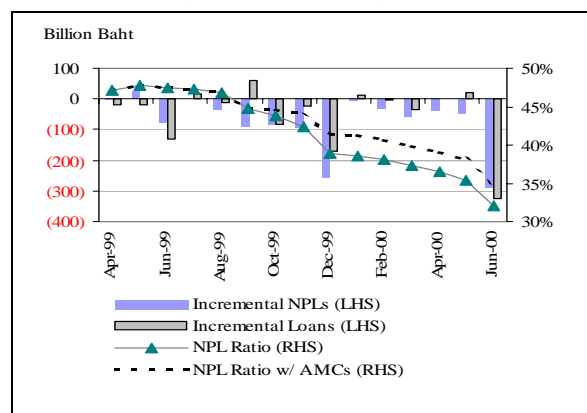
The challenge ahead is to attract private capital to invest in Thai banks to cover losses and provide a platform for new lending, once capacity utilization picks up. Otherwise, the taxpayers will pay for remaining losses. A change in the incentives would give investors confidence that banks (and borrowers) can more expeditiously resolve outstanding NPLs, would stimulate the secondary markets for loans and collateral, and would more equitably distribute the losses among taxpayers, borrowers and lenders.

Instruments for the Financial Sector

- *Technical assistance lending:* Financial Sector Implementation Assistance Project (\$15m, FY98).
- *Structural adjustment lending:* Finance Companies Restructuring Loan (\$350m, 12/97); Economic & Financial Adjustment Loan I (\$400m, 7/98); EFAL II (\$600m, 3/99).
- *Trust Funds support:* Japanese PHRD grant (\$1.2m, 2/98); World Bank Institutional Development Fund (\$0.3m, 2/98); European ASEM grant (\$0.74m, 10/98); Japanese PHRD II (\$2.4m, 7/99).
- *Essential Technical Assistance Programs:* technical assistance (\$1.6 m annually) funded under SFO's internal budget.
- *Country Development Partnership for Competitiveness (CDPC):* CDPC will carry forward financial sector reform

Appendix:

Figure 1: Declining NPL



Source: Bank of Thailand

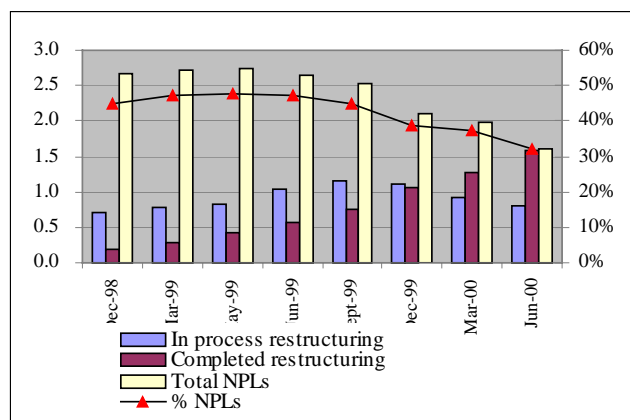
Table 1: Changes in NPLs

	4Q 99	1Q 00	2Q 00	Total	Break down
Increase in NPLs	170	138	114	422	100%
New NPLs	137	100	66	304	72%
Reentry NPLs	33	38	47	118	28%
NPL Reduction	606	236	491	1,333	100%
Debt Restructuring	259	150	208	616	46%
Reclassified as performing loans	70	34	35	140	10%
Others (principal repayment, sell-offs, etc.)	68	45	40	154	12%
Transfer to AMCs	140	0	0	140	10%
Write off	70	6	207	283	21%

Source: Bank of Thailand

CORPORATE SECTOR UPDATE

Figure 13. Progress corporate debt restructuring



Source: The Bank of Thailand

CURRENT ASSESSMENT

While the pace of restructuring has been steady and entry of new non-performing loans has slowed, the level of non-performing loans remains high. Restructuring has brought down non-performing loans from the peak of 47.7 percent in May 1999 to 38.6 percent in January 2000 and to 32.1 percent at the end of June 2000. Overall, restructuring is still concentrated in large viable firms; there is relatively little progress with less viable borrowers.

- Between January and June 2000, corporate debt restructured averaged Baht 77 billion (\$1.93 billion) per month, with a cumulative total of Baht 1.59 trillion (\$39.7 billion). Debt restructuring proceeded at an average pace of Baht 74 billion (\$1.85 billion) per month in 1999 and reached a cumulative total of Baht 1.07 trillion (\$26 billion) by end 1999. The increase was significant as compared to 1998, when restructuring averaged Baht 11 billion (\$275 million) per month and the cumulative total restructuring of slightly over Baht 100 billion (\$2.5 billion).
- The entry of new non-performing loans slowed in the first and second quarter of 2000. As a result, NPLs which peaked at 47.7 percent of total credit in May 1999 began to decline. By June 2000, NPLs had declined to Baht 1.62 trillion (\$40.5 billion), 16 percent below the of Baht 2.73 trillion (\$71.8 billion). The decline was also aided by the transfer of NPLs to AMCs.
- Baht 1.59 trillion (\$39.7 billion) of loans restructured (approximately 58 percent of peak NPLs) as of June 2000 suggests that NPLs of the financial system should have been more than halved since the peak

level observed in May 1999. However, NPLs have only declined by Baht 1.14 trillion (\$28.5 billion) or 41.8 percent from the peak level including NPLs that were transferred to AMCs. There are three factors which explain the discrepancy between the reduction in NPLs and the completed restructuring amount: (1) new NPLs continue to enter into the system; (2) some restructured NPLs have turned non-performing again (re-entry); and (3) restructured loans include proactive restructuring of near NPLs (those which were not previously classified as NPLs.)

- The non-FDI corporate sector continues to show anemic recovery, and some sectors are still in decline. Commercial bank lending has yet to rebound.
- Because recovery and restructuring has been slow, approximately 88 percent of remaining NPLs are at least twelve months past due. Between January 1999 and March 2000, loans over 12-months past due grew by over 60 percent in Thai commercial banks (including the impact of absorption of failed institutions). Since recovery rates from distressed debt are often inversely correlated with time, the growing proportion of long-term NPLs implies declining recovery rates.

Voluntary informal workouts of small cases continue at a steady, slow pace. The Bank of Thailand's Corporate Debt Restructuring Advisory Committee (CDRAC) Program is beginning to add to restructuring volumes since cases are beginning to reach deadlines. However, the process is resulting in both agreements and failures, which will have to be resolved in the courts. The legal filings in the Civil Court and the Central Bankruptcy Court appear to have picked up since January.

The Corporate Debt Restructuring Advisory Committee (CDRAC) monitors the restructuring of both corporate and small-medium-sized loans. A total of 9,582 target cases with the credit exposure of Baht 2.59 trillion is under the auspices of CDRAC. To date, Baht 1.01 trillion or 39 percent of total credit exposure has been restructured.

- Initially, CDRAC monitored 702 large corporate "target debtors". Since October 1999 an additional 2,039 target cases were added, increasing the number of cases to 2,734 (Baht 2.29 trillion). Of the total corporate target cases, 2,124 firms signed the *Debtor Creditor Agreement (DCA)*. Unlike most of the regional variants of the London Rules, CDRAC requires that a plan be confirmed on its second vote, within 6-8 months. At the end of July, 40.8 percent (credit exposure of Baht 935 billion) of the corporate target cases were restructured, while 45.3 percent (credit exposure over Baht 1.03 trillion) have failed to settle and are reverting to the courts. The total

credit value which has failed the CDRAC process and proceeded to legal action is a growing concern; it exceeds the amount of completed restructuring. The increasing court filings may further delay debt restructuring if there are delays in the court processes and decisions.

- In addition to the large corporate cases, CDRAC is also responsible for 6,841 small-medium-sized loans, which represents credit exposure of Baht 295 billion. To date, restructuring of this target group has produced a 25.9 percent completion rate, which remains slow.

Table 1 Status of CDRAC Target Cases (Corporate and SMEs) As of July 31, 2000

<i>Stage</i>	<i>No. Cases</i>	<i>Out-standing Credit (million baht)</i>	<i>Share of Out-standing</i>
Completed, signed and documented restructuring deals	4,538	818,451	
Deals in Process of Signing and Legal Documentation	147	192,534	
Total Completed Cases	4,685	1,010,985	39 %
Cases in Debt Restructuring Process	1,519	244,108	9 %
Cases failed to reach agreement: CDRAC advises legal action	1,692	405,064	
Cases in which the courts have accepted filing petitions	1,626	768,854	
Unsuccessful cases in Process of Legal Action	3,318	1,173,918	46%
Cases recovered to normal status without restructuring	60	159,662	6%
Total	9,582	2,588,673	100 %

Source: Bank of Thailand Office of Corporate Debt Restructuring

Court-supervised resolution of NPLs has been slow in 1999, but the volume of court filings for business reorganization and liquidation appears to have picked up since January 2000.

- Through December 1999 the Central Bankruptcy Court has received 37 business reorganization petitions (value over Baht 362 billion) and 441 liquidation petitions (value under Baht 11 billion), of which 416 were smaller liquidation cases. Since January, the volume of court filings in both categories has increased significantly. Between January through March, 14 reorganization petitions (value over Baht 169 billion) were filed with the court, and the number of filings increased to 65 petitions (value over Baht 418 billion) at the end of June. Liquidation petitions have also increased during the first six months of year 2000, 224 petitions were filed (value over Baht 17 billion) at the end of June. Court officials felt that the debtors and creditors have a better understanding of the bankruptcy law and process, and are more confi-

dent in the legal protection under the court system. While still slow, debtors are increasingly filing petitions to protect their businesses as out-of-court negotiations with creditors proved futile.

Table 2 Progress of central bankruptcy court business reorganization and liquidation

(as of Ju 30, 2000)

<i>Type of Filing</i>	<i>Volume</i>	<i>Jun-Dec 1999</i>	<i>Jan-Mar 2000</i>	<i>Apr-Jun 2000</i>	<i>Jan-Jun '00 Total</i>
Business Re-organization	Cases	37	14	51	65
	Mill Bt	362,841	169,938	248,226	418,164
Liquidation	Cases	441	167	224	391
	Mill Bt	10,500	10,707	17,845	28,552

Source: Central Bankruptcy Court of Thailand

POLICY IMPLEMENTATION AND ASSESSMENT

In addition to measures to stimulate the economy and re-capitalize banks, the Government's strategy toward the corporate debt problem has been three fold:

1. to strengthen the *legal framework for recovery* of non-performing debt through an improved Bankruptcy Act and amendments to the Code of Civil Procedure designed to accelerate enforcement of security interests;
2. to provide a *mechanism for voluntary, out-of-court settlements* with institutional support through the Bank of Thailand; and
3. to provide *incentives for firms and banks to restructure debt* through tax policy and regulations.

Legal Framework for Insolvency. Prior to 1998, a court-supervised rehabilitation was not possible under Thai law. Bankruptcy was used strictly for winding down companies, and was used rarely for large corporate cases. Bankruptcy cases were heard in the civil courts, which had a very slow non-continuous hearings schedule. Thailand created a rehabilitation law in 1998, provided technical improvements to it in 1999, and created a specialized Central Bankruptcy Court and Business Reorganization Office. These amendments were intended to lead to greater use of formal reorganization as a restructuring vehicle, a mechanism for confirming voluntary settlements, and as a restructuring incentive.

Through December 1999, banks did not appear to be filing petitions for bankruptcy liquidation or rehabilitation in numbers commensurate with the magnitude of distress – this has undermined the potential leverage created by the amendments. In November and December 1999, the Court received one reorganization petition per week, which is an

increase from the previous pace of 1.5 -2 petitions per month. The 37 petitions received are still a minor fraction of the nearly 400,000 non-performing debtors. The reasons for the low utilization are several:

- *Uncertainty over proving insolvency.* The law includes a wide range of causes for presuming insolvency, including a "liquidity" test, which are rebuttable by the debtor. Judges have discretion, and have been trying to judge whether assets exceed liabilities, instead of whether the debtor has the ability to meet its obligations as they fall due.
 - *Uncertainty over naming the planner and therefore controlling the bankruptcy.* Intended to provide balance, the law includes an option for creditors to form a 2/3 majority to override the planner if nominated by the debtor. This makes creditor filings less likely, unless they have conferred with other creditors to assure a 2/3 vote to control the planner appointment.
 - *Allocation of power and limitations of planner.* The Thai law transfers to the planner, whether debtor or creditor appointed, an extraordinary degree of control over both operational management and developing the turnaround plan. It is possible that the resulting turnaround plan transfers all equity to creditors. This makes debtor filings unlikely, unless the debtor has obtained the consent of a critical mass of creditors to control the planner appointment process. Furthermore, there are several problems with the planner position - no clear indemnification or separation from director liability, and unclear remuneration rules if the plan is not approved.
 - *Non-legal reasons.* First, as a large portion of distressed debt owed to Thai banks is secured, bankruptcy reorganization may not provide a value-maximizing solution. Second, Thai firms are undercapitalized to such a large extent (i.e., if assets were discounted to market values and the discount was also applied to equity) that large creditors are *de facto* owners. These creditors may not see a bankruptcy which has the potential to crystallize an immediate and large loss as value-maximizing. Thirdly, long-standing ties and formal equity relationships between creditors and debtors may further inhibit filings.
 - *The amendment to the Code of Civil Procedures on default was passed into law in March 2000.* The amendment eliminates a frequent delay tactic by enabling judges to issue a judgement in favor of the plaintiff if the defendant fails to appear for a hearing. However, since the enactment of the new default procedures, creditors have reported increasing delays in the civil court process for enforcing security interests,
- and in the execution of the auction of the collateral in the market.

Voluntary Framework for Corporate Debt Restructuring.

- The Corporate Debt Restructuring Advisory Committee (CDRAC) was established by the Governor of the Bank of Thailand to monitor progress in target cases and accelerate their restructuring. With the support of the Thai Bankers' Association, Foreign Banks' Association, Association of Finance Companies and Federation of Thai Industries, Board of Trade of Thailand, CDRAC created three civil contracts: Debtor Creditor Agreement (DCA), Intercreditor Agreements (ICA), and the Simplified Agreement (SA) for small-medium-sized loans. Signatories agree to adhere to a process with defined procedures for case entry, information sharing, negotiations, and 75 percent majority voting approval. It includes options for CDRAC-arranged mediation, as well as intercreditor arbitration, which has since been cancelled by CDRAC due to lack of capacity and human resources. The agreements empower the Bank of Thailand to enforce compliance by creditors through warnings and substantial monetary damages, and creditor enforcement of debtor compliance through court filings. Court filings are required if a workout process ends in failure.
- *The voluntary agreements under CDRAC will expire at the end of December 2000.* The crucial issue is what will happen to the incomplete cases at the end of the year when the voluntary agreements under the CDRAC process expires. The Bank of Thailand expects that most of the work-in-process cases at that time will be the small-medium-sized loans. The BoT is also considering two options, either to wind down the CDRAC process such that the unfinished cases will have to be resolved through the courts, or to extend the voluntary agreements and allow the Office of CDRAC to continue to facilitate debt restructuring until the voluntary process is completed. If the BoT winds down the CDRAC process, it is expected that the court filings, especially in the Civil Court, will dramatically increase during the first quarter of 2001, and further backlog will certainly occur. The court will need to increase capacity and streamline the processes for both judgements and post-judgement auctions in order to bring timely resolutions to the pending cases. The more likely scenario is the extension of the voluntary agreements under the auspices of CDRAC and BoT, the process of which is likely to continue until mid-2001. Under this scenario, the potential failure of the CDRAC process still remains, and the failed cases will have to be resolved in court. The most effective means to accelerate resolution of

cases under CDRAC is then the most crucial consideration of the BoT in the immediate future.

- *Capital adequacy continues to constrain restructuring.* Thai banks are not required by their regulators to fully provision against recognized loan losses until end-2000, and are only required to provision net of collateral values on secured loans. As provisioning needs increased through new entry of NPLs and the aging of NPLs into higher-provision categories, banks have restructured extremely conservatively and slowly. As a result, (1) debt reduction is rarely a part of settlements, and extension of maturities, interest rate reductions, and new capital injected by the debtor or new investor are typical outcomes; (2) banks have been reluctant to use available legal options to force corporations to address their operational and financial condition, as doing so would crystallize a more immediate and potentially larger loss and (3) only viable sectors have been addressed.
- *State-owned banks face unique obstacles.* While Thai private commercial banks have 1.8 times the outstanding credit of state-owned banks, private banks have restructured 3.3 times the number of cases. To facilitate more rapid progress, the Bank of Thailand will soon issue the “Principles and Guidelines for Debt Restructuring by State Banks”, which aim to reduce the potential for legal liability. The State Enterprise Employees Act provides for criminal liability on the part of employees who accept a loss on behalf of the state, even if it was a reasonable write-off accepted in a debt restructuring.
- *CDRAC needs to take a more active role in contentious cases, supported by appropriately skilled personnel. Administrative sanctions should support and be coordinated with CDRAC.* Over time, the firms approaching CDRAC for assistance are likely to be in less viable sectors or smaller. CDRAC's successful restructuring will require more resources devoted to analysis and business restructuring. The resources made available through existing loans and grants should be deployed immediately.
- *Excess capacity in several sectors not being addressed.* In a restructuring environment characterized by low capitalization and weak legal implementation, sectors which do not promise a high recovery rate on restructuring will pose an overwhelming challenge. Long-term NPLs (those over 12 months past due) in Thai banks increased rapidly in critical sectors. From October 1999 through March 2000, loans over 12 months past due increased over 75 percent in manufacturing, over 120 percent in real estate, and over 150 percent in construction. At the end of March 2000, NPLs as a percentage to outstanding loans are

concentrated in the real estate, services, and import sectors (Table 3).

- *Few, if any, mergers between distressed firms have occurred.* The merger process in Thailand is time consuming and onerous, requiring six months notice period during which creditors may object to the merger or demand immediate payment. The Civil and Commercial Codes and the Public Limited Companies Act require that the two merged entities lose legal status before creating a new legal entity out of the two independent units. In addition, although the Government has extended numerous tax incentives to induce mergers such as the waiver of tax on non-cash mergers, the actual transactions are few in number. The primary obstacle to the mergers is the inability to carry net losses forward into the new entity.
- *Creditor-driven removal of capacity is by and large not occurring.* Even where firms have negative equity and whose petitions are likely to be accepted by the bankruptcy court, creditors have in general not filed petitions. As a result, assets are not clearing.

Table 3. NPLs in Key Sectors, March 2000

Critical Sectors	(Billion baht)			NPL % of Loans
	Out-standing Loans	12 Months Past Due	3-12 Months Past Due	
Manufacturing	1,563	430	80	33%
Wholesale & Retail Trade	806	276	43	40%
Imports	202	84	11	47%
Exports	157	50	13	40%
Services	417	167	29	47%
Real Estate	550	315	35	64%
Construction	230	93	12	46%

Source: Bank of Thailand

Real Estate Sector. The recovery of the real estate market value in Thailand is largely driven by property type: residential or commercial. Currently, the market condition is considered poor; there is both excess supply and shortage of demand for both types of properties. Property values have been either stabilizing or falling depending on location. Based on the electricity meter statistics from the Metropolitan Electricity Authority (MEA), which measures vacancies in the Bangkok Metropolitan Area (BMA), there is 47 percent vacancy rate of all properties.

Completion rates for debt restructuring are low in the real estate sector. Property sector restructuring includes substantial asset redeployment, for which the court process is very slow. In addition, most loans involve multi-creditors and/or syndicated lenders which increases the complexity and time in restructuring. Finally, the lack of legal action has kept assets from distressed owners out of the market.

During the last quarter of 1999, Land and House, Plc., the largest real estate developer in Thailand successfully restructured its Baht 20 billion debt and raised Baht 2.5 billion capital through public offering. In March 2000 Sansiri Plc., another large real estate developer also successfully restructured its Bht 14 billion debt and brought in a foreign strategic partner. The market viewed these developments positively. As mortgage interest rates have fallen in recent months, the outlook for the sector improvement is favorable.

Steel Industry. Over-supply of steel products continues to persist due to declining construction activity. The demand for steel is sluggish and may not recover for some time. There are several large-scale steel producers, most with sizeable, multi-creditors, foreign currency debts. Restructuring of steel firms is happening mostly through CDRAC, and the progress is slow. In some cases, negotiations with creditors have been ongoing for over two years without resolution. Recently merger discussions were restarted which may ultimately reduce the number of producers. Currently, the top four producers (SCC, NTS, BSI, and Nam Heng Steel) are negotiating a merger, and an MOU is expected to be signed by late 2000. To this end, the government is considering incentives to the merger that would prevent foreign take-over of the companies.

The medium-term agenda: Rebuilding Competitiveness. It is unlikely that growth will be reestablished on the basis of debt-financed investment in fixed assets in the near future. A medium-term growth strategy will depend on enhancing total factor productivity growth. This will require sharpening the impact of public sector investments in skills and technology, addressing tariff structures and investment incentives and implementing the ongoing programs in the financial and corporate sectors.

Strengthening Corporate Governance. The most critical factor input for the recovery of distressed firms is decisive management focused on creating value for all stakeholders. This includes strategies which limit non-core or low-contribution investments, find highest value use for assets, maximizing cashflow to enhance share value, and reduce the cost of capital by seeking outside equity investors where necessary. This often requires change in management.

BANK INSTRUMENTS

Policy support for corporate restructuring was provided under EFAL I and II adjustment loans and the IMF structural adjustment program. The Thai authorities, with Bank support, are now developing a third tranche work program. The Country Development Partnership for Competitiveness (CDPC) will include a policy program completing the financial and corporate sector reforms, and a new reform program to support competitiveness. A number of techni-

cal assistance projects have been provided by the Bank in support of the corporate reforms, funded primarily by ASEM Trust Fund and PHRD grants. This includes training programs provided to bank and finance company workout departments, seminars provided to corporate sector managers in operational restructuring, automated monitoring and project management database system provided to the Bank of Thailand, assistance to the development of guidelines for restructuring among state-owned banks, tax and legal standardized documentation support for restructuring, pilot mediation programs provided through CDRAC, the development of Thailand Institute of Directors to enhance the corporate governance of listed firms, and the development of regulations for the Thai Trade Competition Commission.

Adjustment Operations. The emphasis of CDPC is competitiveness, including the trade and competition policy, technology, logistics, financial and legal requirements for Thailand to enhance the ability of its corporate sector to enhance value-added exports.

Trust Funds. (i) PHRD: Corporate restructuring component of Miyazawa Special Contribution. \$0.7 million. (ii) PHRD: Corporate Revival (\$0.2 million) (iii) ASEM: Revival of the Corporate Sector. \$0.75 million.

Coordination with IMF, ADB and Bilateral Donors. Coordination with the IMF is well established, with Bank staff joining or review Fund assessment missions and holding regular consultations. A joint review of insolvency legislation is planned with ADB, IMF and IFC.

SOCIAL SECTOR UPDATE

KEY SOCIAL INDICATORS

	Latest data (date)	Previous Period (date)
Human Development	1997-98	1994-95
Primary enrollment rate (gross) ¹	91.4	91.0
Male	93.1	92.3
Female	90.0	89.0
Secondary enrollment rate (gross) ¹	60.3	60.0
Male	58.0	58.4
Female	63.0	61.0
Tertiary enrollment rate ¹	21.0	19.3
Male	19.0	18.0
Female	23.1	21.0
Infant mortality rate ²	26.1 (1995-96)	34.5 (1991)
Poverty and Income Distribution³	1999	1996
National Headcount Index	15.9	11.4
Urban Headcount Index	1.3	1.6
Urban/rural Headcount Index (sanitary districts)	8.8	5.8
Rural Headcount Index	21.5	14.9
Gini Index	0.533	0.515
Allocation⁴	(Billion Baht)	(Billion Baht)
	FY00	FY99
Public Health	65.7	62.5
As percentage of Total Budget	7.6 %	7.6%
Education	222.4	209.9
As percentage of Total Budget	25.9%	25.3%
Social and Public Welfare	93.7	98.7
As percentage of Total Budget	10.9%	12.0%
Labor Market	February 2000	February 1999
Unemployment rate (%) ⁵	4.3	5.2
Female	4.6	5.5
Participation rate (%) ⁶	68.1	68.9
Female	59.4	60.0
Male	76.9	77.5
Strike incidents/workers involved during year	2/290 (1999) ⁷	2/685 (1998)

- Office of the National Education Commission.
- NESDB/ADB, "Health and Nutrition in Thailand", Volume 3, Number 3: July 1999. Estimates obtained from the Survey of Population Change.
- National Statistics Office Socio-Economic Survey. NESDB/ADB, "Poverty and Inequality During the Economic Crisis in Thailand", Volume 3, Number 1: January 1999.
- Bureau of Budget, Sectoral budget classification.
- National Statistics Office Labor Force Survey.
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- Bank of Thailand, Key economic indicators, November 30, 1999.

CURRENT DEVELOPMENTS

Poverty

The effects of the crisis on poverty continue to be felt. Latest and preliminary data indicate that the poverty headcount index increased from 11.4 percent in 1996 to 15.9 percent in 1999.

The increase in poverty has been distributed unevenly throughout the country. While poverty incidence rose between 1996 and 1999 in the country as a whole, it actually declined in the municipal areas (inner urban) from 1.6 percent to 1.3 percent. In the sanitary areas (outer urban), poverty incidence increased from 5.8 percent to 8.8 percent, while it jumped from 14.9 percent to 21.5 percent in the villages (rural areas). Likewise, between 1996 and 1999, the incidence of poverty declined in the North and Bangkok vicinity, while it increased in the Northeast, South, and Central Regions. The Northeast experienced the largest increase in poverty incidence during this period -- from 19.4 percent in 1996 to 30.8 percent in 1999.

Poverty is concentrated among certain population groups. Households headed by farmers, the elderly (aged 70 and over), and people with less-than-primary schooling are particularly vulnerable to poverty. Children under the age of 17 years, accounting for 38 percent of the total poor, are at a much greater risk of poverty than adults.

Labor Markets

Flexible labor markets minimized the impact of the crisis. During the economic crisis, the flexibility of Thailand's labor markets helped lessen the impacts of the economic downturn. Wages and the number of hours worked adjusted downwards, thus containing the unemployment rate which increased from close to 1 percent in 1996/1997 to 3.4 percent in 1998 (August round).

The impact of the crisis was more severe among low-wage workers. Low-wage workers (usually young, less educated workers) were more likely to lose their jobs and suffer pay cuts than their high-wage counterparts, and were also less likely to be reached by government interventions. About 1.8 million workers with primary and less-than-primary education lost their jobs, and the aggregate wage earnings of this group fell by 13-20 percent during the crisis.

Government interventions were crucial to minimize welfare losses. The single most important government initiative was employment generation through public spending, financed largely by external sources. The Miyazawa Program provided employment to the equivalent of 319,182 person years (3.5 million people employed for an average of 18 days each). The World Bank's Social Investment Program also supported the Government's job-creation

programs. These programs likely contributed to the 14 percent drop in unemployment from August 1998 to August 1999 – Thailand's first year-on-year decline in unemployment since the onset of the crisis.

Comparative data from other crisis-affected countries indicate that Thailand weathered the crisis much better than did Korea or Indonesia. Thailand's decline in wage labor earnings was less than that of GDP, while the decline in wage labor earnings in Korea and Indonesia were nearly three times as large as the GDP decline. This suggests that Thai labor markets have generally worked well to cushion the effects of the crisis. Wage flexibility of labor markets and quantity flexibility of farm employment have both played a critical role in spreading the impact more evenly among workers and preventing massive open unemployment.

However, many of the labor-protection programs in place in Thailand have very small population coverage. In addition, because of implementation and enforcement problems, these programs are biased in favor of formal-sector employees, who tend to be better-off than informal-sector employees. As such, low-wage and disadvantaged workers who most need protection during economic downturns fall beyond the purview of these programs.

The challenge for the future will be to maintain the labor flexibility that served Thailand well during the economic crisis, but at the same time ensure that poor and underprivileged workers who typically bear the brunt of economic downturns, are better protected from consumption shocks.

AIDS Vaccine Trials

Thailand's first large-scale anti-AIDS vaccine trial has mobilized 2,500 volunteers to test the effectiveness of the vaccine over a three-year period. All the volunteers have received their first shots of the vaccine. The volunteers are either recovered intravenous heroin users or rehabilitating addicts on methadone treatment and will receive a total of seven doses of the injection. None are HIV-positive. Half the volunteers will receive the candidate vaccine while the other half will receive a placebo. Blood from the volunteers will be taken for tests two weeks after every shot they receive. The vaccine, Aidsvax, is the second candidate vaccine of VaxGen Incorporation which is currently under a large-scale trial. The trial in Thailand is the first of its kind because it was especially designed for the country.

The study is being monitored with the collaboration of the Bangkok Metropolitan Administration, Mahidol University's Faculty of Tropical Medicine, the Thai Government, The Center for Disease Control (CDC) of the US, and VaxGen Incorporation.

Population and Housing Census 2000

Preliminary results from the 2000 Census show that on April 1, 2000, Thailand had a population of 60,606,947. Out of this population 29,844,870 were males and 30,762,077 were females. Thailand is the fourth largest country in Southeast Asia in terms of population size. Indonesia is the largest (209 million), followed by Vietnam (79 million) and the Philippines (74 million). The annual population growth rate at the time of the 1990 Census was 1.96, the annual growth rate is now 1.05. Regional comparisons reveals that 34.2 percent of the population live in the Northeast, 23.3 percent in the Central and 18.8 percent in the North.

AREAS TO WATCH

The prolonged lag in social recovery behind economic growth shows no signs of sudden improvement. Such lags are expected, but the combined effects of weak agricultural commodity prices, slow recovery in consumption, and very low levels of construction activity have held back the demand for labor and may prolong wage and employment stagnation.

As part of the Government's decentralization plan, the Bureau of the Budget (BOB) intends to devolve funds to the Tambon Administrative (TAO) level. During its planning process the BOB has been consulting with the Social Fund Office in order to determine how to introduce participatory planning processes in conjunction with the allocation of funds. The BOB hopes to borrow from the successful pioneering work of the Social Fund.

There is an intensifying debate on the issue of rural poverty, as evidenced by the increasing protests by the Assembly of the Poor. While the protests began with dams and other development projects like Pak Mun, the broadening of the protests to include a much larger group of people, discussing a much wider range of issues, points to a deeper problem -- poverty, particularly in the Northeast.

BANK INSTRUMENTS

Social Investment Project. By end August 2000, disbursements from the World Bank total US\$168.5 million or 55.97 percent of the loan amount. Significant progress has been achieved in the creation of employment opportunities through the implementation of small-scale civil works (weirs, foreground dredging, rural roads and school renovation).

Since the Social Investment Fund, a SIP component, was launched on September 9, 1998, a total of 2,687 sub-projects have been approved with a total budget of Bt2,805 million (approximately \$71.9 million). The subprojects cover 76 provinces of the country with over 7 million

beneficiaries. The SIF is widely recognized in Thailand as a major element of the Government's crisis alleviation strategy. The Social Fund Office has managed to mobilize a large number of volunteers all over the country, including individuals from the NGO community, government civil servants, academics, physicians, teachers, and religious leaders help prepare, review, screen, and implement projects. The SIF has become a social movement, promoting lasting goals of community self-reliance and cooperation, mutual learning and continuous development, and the strengthening and stabilizing of society through community networks.

Social Protection Program Partnership. The World Bank is forging a partnership with the Ministry of Labor and Social Welfare to promote a Social Protection Program. The key elements of this program include: (i) occupational health and safety; (ii) job information, placement and counseling services; (iii) strengthening the role of CSOs in

provision of informal safety net services; and (iv) labor market data and policy analysis.

The fourth issue of the *Thailand Social Monitor* entitled "Thai Workers and the Crisis" was disseminated in July 2000. Future issues will focus on AIDS and Poverty.

Ongoing initiatives on AIDS. Country dialogue on AIDS vaccines included a consultative meeting in May 1999 between the Bank's AIDS Vaccine Task Force and donors, health ministry policymakers, pharmaceutical companies, NGOs, and the national Technical Subcommittee on AIDS Vaccines. A forthcoming Brief on Thailand's Response to AIDS will focus on the lessons learned from the Thai experience that are applicable to the rest of the region and on strategic priorities in the response to AIDS in Thailand now. The paper will serve as a basis for discussion with government, NGOs, donors, and UN agencies and will suggest actions for the UN Theme Group to assist Thailand over the next 12 months.

- Macroeconomic Update was prepared by David Robalino (EACTF)
- Financial Sector Update was prepared by Thomas Rose (FRO)
- Corporate Sector Update was prepared by Tanatat Puttasuwan, EACTF and Arvind Gupta, EASPS
- Social Sector Update was prepared by Maryam Salim and Christopher Chaberlin (EACTF)

THAILAND ECONOMIC INDICATORS

	1997	1998	1999e	2000e	1998	1999	2000Ja			
	Year	Year	Year	Year	Q3	Q4	Q1	Q2	Q3	n
Output, Employment and Prices										
GDP (% change previous year)		-1.3	-9.4	4.0	4.5	-12.5	-5.0	0.9	3.3	7.7
	97.3	107.2	96.5			92.8		106.0	104.6	109.0
(% change, previous year)		-0.5	-10.0	12.6		-9.5	-3.6	4.8	10.5	17.5
Unemployment Rate (%) 1/		1.9	4.0	3.5		..	..	..	..	..
Real Wage Growth (%) 1/		..				..	..	..	..
Consumer price index (% change, previous year)		5.6	8.1	0.3	2.5-3.0	7.0	4.3	1.6	-1.2	-0.8
										0.2
Public Sector										
Government balance (% GDP) 2/		-0.32	-2.80	-6.6	-7.0	-8.56	-3.34	-0.01	-4.14	-4.12
Public sector debt (% GDP) 3/		27.0	40.0	50.0	66.0		..			
Domestic		6.0	14.0	29.0	45.0					
Foreign		21.0	21.0	21.0	21.0					
Foreign Trade, BOP and External Debt										
Trade balance (million\$US) 4/		-4,626	12,232	8,900		3,146	3,359	2,671	2,119	2,400
Exports of goods, (\$millionUS)		56,721	52,873	56,785		13,258	13,415	12,692	13,684	14,702
(% change, previous year)		3.8	-6.8	7.4	9.6	-8.7	-9.9	-4.2	5.7	10.9
Imports of goods, (\$millionUS)		61,347	40,641	=47,834		10,112	10,056	10,021	11,565	12,330
(% change, previous year)		-13.4	-33.8	17.1	19.0	-34.2	-18.9	-1.0	11.7	21.9
Current account balance (\$millionUS)		-3,112	14,290	11,300		3,409	3,861	3,439	2,554	2,796
(percent GDP)		-2.0	12.7	9.0		12.6	11.7	11.0	8.6	9.2
Foreign Direct Investment (million US\$)		3,733.0	7,131.0			1,432.0	1,025.0	1,025.0	2,210.0	1,153
Total external debt (million \$US)		93,416	86,160			86,792	86,160	83,865	80,655	78,734
(% GDP)		60.8	76.8	61.3	53.0	..	..	..	..	..
Short-term debt (million \$US)		34,258.0	23523.0			26,193.6	23,522.7	20,521.0	17,566.7	15,688
Debt service ratio (% exports of g&s)		15.6	20.3	20.4	18	24.2	19.3	21.5	19.0	
Reserves, including gold (\$US billion)		27.0	29.5	34		27.3	29.5	29.9	31.4	32.4
(months of imports of goods and services)		4.7	7.3	8.7		6.9	7.6	7.5	7.2	
Financial Markets										
Domestic credit (% change, previous year)		30.1	-3.3	-3.5		3.6	-3.3	0.8	-4.8	-4.9
Short-term interest rate /5		10.8	6.0			8.0	6.0	5.0	4.8	4.4
Exchange rate (end-period)		31.4	41.4	37.5		39.2	36.9	37.7	36.9	41.4
Real effective exchange rate (1990=100 and + = appn)		75.5	88.8	88.06		87.8	88.8	87.8	89.9	82.3
(% change, previous year)		-29.9	17.6	0.2		2.8	17.6	0.3	3.2	-2.5
Stock market index (Dec 1996=100)		44.8	42.8	74.2		30.7	42.8	42.3	62.7	54.9
Memo: GDP in million US\$		153,711.8	112,257.7			27,241.04	33,018.9	31,831.4	29,702.8	..

2/ Central Government (CY Year)

4/ In Million US \$