Thailand—Update

Yield Movements

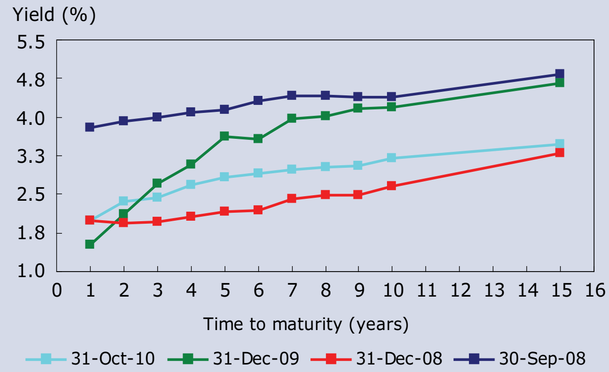
Thai government bond yields fell for most maturities between end-December 2009 and end-October 2010 **(Figure 1)**. Yields for 1- and 2-year maturities rose 46 and 25 basis points, respectively, while yields fell for all other maturities, resulting in a flattening of the curve. Specifically, yields for 3- and 4-year bonds declined 28 and 39 basis points, respectively. Yields fell by more than 100 basis points along the rest of the curve, with the 15-year tenor declining the most (120 basis points). The yield spread between 2- and 10-year maturities narrowed to 84 basis points in end-October from a spread of 207 basis points at end-December.

The flattening of the yield curve reflected increased foreign investor demand in Thai bonds, which prompted the Thai government to take stronger measures to tame appreciation of the baht. The Thai government's recent moves include imposing a 15% withholding tax on foreign investors and relaxing regulations on foreign exchange transactions. Meanwhile, the Bank of Thailand (BOT) held its 1-day repurchase rate at 1.75% on 20 October, while raising concerns over a faltering global recovery. The BOT declined to increase rates further in October after two consecutive monthly rate hikes in July and August.

Thailand's consumer price inflation slowed for the third straight month in October to 2.8% year-on-year (y-o-y), from 3.0% and 3.3% in September and August, respectively. Government subsidies helped contain price pressures, but floods in October seem to have caused a modest increase in food prices. The BOT projects inflation to fall within 2.5%–3.8% in 2010 and 2.5%–4.5% in 2011.

Thailand's gross domestic product (GDP) slowed to 6.7% y-o-y in 3Q10, after expanding 9.1% y-o-y in 2Q10. Growth in the Thai economy is expected to drop further in 4Q10 due to the strengthening baht, fluctuating oil prices, and the impact of flooding on agricultural output. Thailand's GDP is expected to grow 7.3%–8.0% in 2010, according to BOT, and 3.0%–5.0% in 2011.

Figure 1: Thailand's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

Size and Composition

The size of Thailand's total local currency (LCY) bond market expanded 14.2% y-o-y to reach THB6.6 trillion (USD217 billion) in 3Q10, lower than the 18.4% y-o-y growth recorded in 2Q10 **(Table 1)**. Total LCY bonds outstanding rose 2.5% quarter-on-quarter (q-o-q) and 1.1% month-on-month (m-o-m).

The outstanding stock of government bonds was up 17.3% y-o-y at end-September for a total of THB5.3 trillion (USD176 billion). BOT bonds had the highest growth rate among all categories of government bonds at 36.3% y-o-y for a total of THB2.3 trillion, followed by treasury bonds, which posted growth of 9.1% y-o-y to reach a total of THB2.6 trillion. State-owned enterprise and other bonds, however, declined 5.2% y-o-y to THB503.0 billion.

Central government bonds retained a dominant share of total bonds outstanding (49% as of end-September) as the central government continued to issue 28-, 91-, and 182-day treasury bills. The government also issued 3-, 4-, 5-, 7-, and

Table 1: Size and Composition of the LCY Bond Market in Thailand

	Amount (billion)								Growth Rate (%)						
	Jun-10		Jul-10		Aug-10		Sep-10		Jun-10		Jul-10	Aug-10	Sep-10		
	THB	USD	THB	USD	THB	USD	THB	USD	y-o-y	q-o-q	m-o-m	m-o-m	y-o-y	q-o-q	m-o-m
Total	6,419.0	198.0	6,499.7	201.5	6,506.0	208.1	6,576.6	216.8	18.4	3.9	1.3	0.1	14.2	2.5	1.1
Government	5,177.5	159.7	5,256.2	162.9	5,274.5	168.7	5,349.8	176.4	21.0	4.3	1.5	0.3	17.3	3.3	1.4
Treasury Bonds	2,566.7	79.2	2,593.9	80.4	2,567.7	82.1	2,596.7	85.6	14.5	3.9	1.1	(1.0)	9.1	1.2	1.1
Central Bank Bonds	2,096.8	64.7	2,151.2	66.7	2,196.8	70.3	2,250.2	74.2	37.8	6.3	2.6	2.1	36.3	7.3	2.4
State-Owned Enterprise & Other Bonds	514.0	15.9	511.2	15.8	510.0	16.3	502.9	16.6	(0.4)	(1.3)	(0.6)	(0.2)	(5.2)	(2.2)	(1.4)
Corporate	1,241.4	38.3	1,243.5	38.5	1,231.5	39.4	1,226.8	40.4	9.0	2.3	0.2	(1.0)	2.6	(1.2)	(0.4)

LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY–USD rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
Source: Bank of Thailand and Bloomberg LP.

12-year loan and savings bonds in 3Q10. In July, THB3.5 million in 3-year savings bonds were issued for sale to retail investors.

Since July, the Thai government has issued THB57.0 billion of loan bonds to finance the budget deficit. The expected budget deficit for fiscal year 2010 (ending 30 September) narrowed to 3.8% of GDP, compared with 4.3% in fiscal year 2009.

New issuance of government bonds in 3Q10 reached THB2.8 trillion, with BOT accounting for 90% of the total. State-owned enterprises such as Government Housing Bank, Bangkok Mass Transit Authority, State Railway of Thailand, and Provincial Waterworks Authority issued THB14.2 billion in bonds, with maturities ranging between 5 and 15 years.

Meanwhile, the Thai government is planning to issue the longest-dated security ever in Thailand—a 50-year government bond. The bond issue will likely take place in 1Q11 and will be targeted to institutional investors. Proceeds will help cover the budget deficit and a portion will be used to refinance existing government debt. Currently, the longest-dated bond issued in Thailand is the 30-year government bond.

Corporate bonds outstanding stood at THB1.2 trillion (USD40.4 billion) as of end-September, up 2.6% y-o-y. Total corporate bonds outstanding declined on both a q-o-q and m-o-m basis by 1.2% and 0.4%, respectively. New issuance in 3Q10 reached THB224.0 billion, which represented declines of 8.9% y-o-y and 18.5% q-o-q. Notable THB-denominated corporate bond issues for the quarter included Toyota Leasing's THB4.0 billion of 3-year bonds and Mahboonkrong's THB3.0 billion of 3-year bonds.

In August, the Thai Finance Ministry granted approval to three firms from the Republic of Korea to issue a total of THB14.0 billion of bonds in the Thai market before the end of 2010. Industrial Bank of Korea and Korea Development Bank have each been granted permission to issue

THB5.0 billion, while Korea Water Resources Corp. has been approved to issue THB4.0 billion.

In October, the Finance Ministry approved three more foreign entities to issue THB-denominated bonds before 31 March 2011. Central American Bank for Economic Integration (CABEI), ING Bank, and the Export–Import Bank of Korea (KEXIM) have been approved to issue bonds of THB4.0 million, THB10.0 million, and THB8.0 million, respectively. Also in October, Thailand's second-largest property developer Pruksa Real Estate sold a total of THB5.0 billion of 3- and 5-year bonds.

The following corporations have bond issues in the pipeline for 4Q10:

(i) Thailand's largest energy firm PTT will sell THB20.0 billion worth of bonds.

(ii) Leading coal miner Banpu PCL plans to raise up to THB20.0 billion to purchase Australia's Centennial Coal.

(iii) PTT Chemical plans to raise THB3.0 billion to repay project investments.

The top 30 corporate issuers in Thailand at end-September were mainly from the industrial and financial sectors, and together represented 75% of total LCY corporate bonds outstanding **(Table 2)**. PTT PCL ranked first as the top LCY and foreign currency (FCY) corporate issuer, with total bonds outstanding of THB179.2 billion and USD1.2 billion, respectively.

In July, PTT Exploration and Production became the first Thai issuer to sell bonds in the international market in 3 years. The firm issued USD500 million worth of 5-year bonds with a coupon of 4.152%. Asian investors bought 69% of the bonds, Europeans took 11%, and offshore investors from the United States (US) purchased 20%. Prior to July, the last Thai corporate bond issuance in the international market—USD350 million worth of 7-year bonds—was conducted by True Move in July 2007.

Table 2: Top 30 Corporate Issuer, September 2010

Top 30 Corporate Issuers	Outstanding Amount		
	LCY Bonds (THB billion)	**LCY Bonds** (USD billion)	**FCY Bonds** (USD billion)
PTT PCL	179.2	5.9	1.2
Siam Cement PCL	110.0	3.6	—
Bank Ayudhya Public Ltd	63.2	2.1	—
Krung Thai Bank PCL	53.4	1.8	0.2
PTT Exporation and Product PCL	49.0	1.6	0.5
Thai Airways International PCL	36.8	1.2	—
Toyota Leasing Thailand	29.5	1.0	—
Charoen Pokphand Foods	26.2	0.9	—
Kasikorn Bank PCL	25.1	0.8	0.2
Dad SPV Company Ltd	24.0	0.8	—
Thai Oil PCL	20.8	0.7	0.4
PTT Chemical PCL	40.2	1.3	0.3
Siam Commercial Bank Co	20.0	0.7	
Krung Thai Card PCL	19.5	0.6	—
Advanced Info Service	19.5	0.6	—
Thanachart Bank PCL	18.0	0.6	—
TMB Bank PCL	17.3	0.6	0.02
Bangkok Expressway PCL	15.1	0.5	—
Glow Energy PCL	15.0	0.5	—
PTT Aromatics and Refining	15.0	0.5	—
Quality Houses Public Co	15.0	0.5	—
Ayudhya Capital Auto Lease	14.7	0.5	—
True Corporation PCL	13.8	0.5	—
Thanachart Capital PCL	13.5	0.4	—
Bangkok Mass Transit System	12.0	0.4	—
Kiatnakin Bank PCL	11.9	0.4	—
Central Pattana Public	11.7	0.4	—
Land & Houses Public Co	11.0	0.4	—
Minor International PCL	10.4	0.3	—
Siam City Bank PCL	10.0	0.3	—
Total Top 30 Corporate Issuers	**920.8**	**30.4**	**2.7**
Total Corporate Bonds Outstanding	**1,231.5**	**40.6**	
Top 30 as % of Total Corporate	**75%**	**75%**	

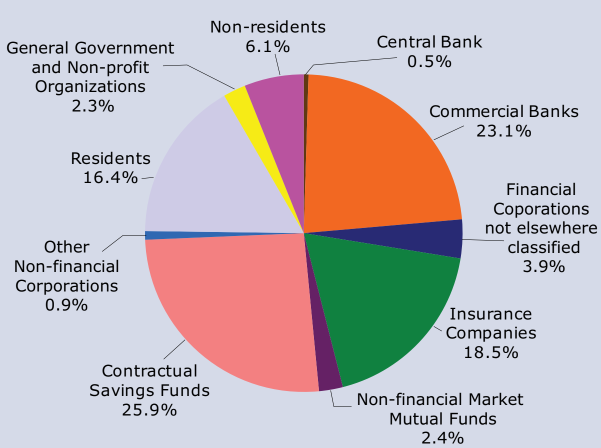
— = not applicable, FCY = foreign currency, LCY = local currency.
Source: Bloomberg LP.

Investor Profile

At the end of September, contractual savings funds were the largest holder of Thai government bonds with a total amount of THB671.8 billion and a share of 26.0% **(Figure 2)**. Commercial banks were the second largest holder of government bonds with a 23.1% share, followed by insurance companies (18.5%), residents (16.4%), and non-residents (6.1%). Financial corporations "not elsewhere classified" held 3.9% of all Thai government bonds, non-financial market mutual funds had 2.4%, and general government and non-profit organizations had a 2.3% share. Finally, other non-financial corporations held a 0.9% share while the central bank had a 0.5% share.

Foreign holdings of Thai government bonds stood at THB157.5 billion at the end of September, an increase of about 45% since the end of June. Foreign investors increasingly sought safe haven in Thai bonds as low returns in the developed world are pushing many Asian currencies higher. As a result of foreign fund inflows, the Thai baht strengthened to a 13-year high of 30.33 against the US dollar at the end of September.

Figure 2: LCY Government Bonds Investor Profile, September 2010



LCY = local currency.
Source: Bank of Thailand.

In response, the BOT relaxed foreign exchange regulations on 5 October and has imposed a 15% tax on interest and capital gains earned by foreign investors from Thai bonds.

Rating Changes

On 28 October, Moody's upgraded the outlook for Thailand's long-term FCY and LCY government bond ratings to stable from negative **(Table 3)**. According to Moody's, the decision for the outlook change was based on Thailand's "robust economic recovery" and the "stabilization of government finances despite continuing domestic political turmoil."

Table 3: Selected Sovereign Ratings and Outlook for Thailand

	Moody's	S&P	Fitch
Sovereign FCY LT Ratings	Baa1	BBB+	BBB
Outlook	stable	negative	stable

FCY = foreign currency, LT = long term.
Source: Rating Agencies.

Policy, Institutional, and Regulatory Developments

Finance Ministry Relaxes Capital Outflow Controls

In September, the Finance Ministry of Thailand announced regulatory changes to promote foreign investment and capital outflows in an effort to slow the appreciation of the baht, which has gained about 8% against the US dollar year-to-date due to capital inflows and a steady trade surplus. The five new regulatory measures include (i) allowing Thai firms to invest and lend without limit to affiliate companies abroad; (ii) allowing Thai firms to lend up to USD50 million per year to non-affiliated companies abroad; (iii) increasing the foreign property investment cap from USD5 million to USD10 million; (iv) increasing the maximum FCY deposits held by Thai individuals and companies from USD100,000 and USD300,000, respectively, to USD500,000 for both; and (v) increasing mandatory repatriation of export earnings from USD20,000 to USD50,000.

Thai Cabinet Approves a 15% Tax on Bonds

The Thai government has approved the imposition of a 15% tax on interest and capital gains earned by foreign investors from Thai bonds in an effort to slow foreign currency inflows and ease the baht's appreciation. Effective 13 October, foreign investors trading government, central bank, or state enterprise bonds were required to pay a withholding tax of 15%. Meanwhile, the Customs Department is considering waiving import tariffs on machinery that cannot be produced in Thailand as the government wants to help exporters and small and medium-sized enterprises (SMEs) improve their productivity. State banks—Krung Thai Bank, Small and Medium Enterprise Development Bank of Thailand, Islamic Bank of Thailand, and Export–Import Bank of Thailand—are offering forward contracts to protect SMEs against volatility in the exchange rate. The Government Savings Bank provides SMEs a credit line of up to THB5.0 billion. Also, the Revenue Department is planning to offer local companies additional tax breaks for asset depreciation. According to the Ministry of Finance, about 10,000 SMEs need assistance as a result of the baht's recent appreciation.

BOT Relaxes Regulations on Foreign Exchange Transactions

The BOT issued measures relaxing foreign exchange regulations to increase the flexibility of Thai businesses in managing foreign exchange risks. Effective 12 October, Thai exporters were permitted to transfer FCY deposits to counterparties in Thailand for payment of goods and services, with the limit on foreign exchange transactions being increased to USD50,000 from USD20,000. Also, Thai businesses undertaking direct investment or lending abroad of USD10 million or more per year are now required to notify the BOT.