Thailand - worst flooding in 50 years

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Thailand is suffering with the worst flooding in 50 years, which has already displaced over 2 million people, killing nearly 300. There is no sign of let up and the country is bracing itself for worse. While 30 of Thailand's 77 provinces have been severely affected, Bangkok is now bracing itself, as floods from over-spilling dams in the north of the country are expected to affect the city in the coming days. 15% of farmland is affected and evacuation centres around the country are being set up. The government has started to bolster Bangkok's flood defences.

Source: theaustralian.com.au

Thai businesses are being seriously affected - the central province of Ayutthaya, a large industrial centre has suffered markedly. Honda Motor and Hanna Microelectronics are amongst more than the 300 out of 2150 business units that have been closed in the province. Nikon, Canon and Siam Cement have plants closed. Food processing and other important sectors, such as tourism, will no doubt take a knock. As such, we can expect to see forecasts for overall economic activity to fall while the country struggles to cope (estimates vary wildly, but it has been estimated that approximately 1% will be shaved of headline GDP). There will, however, be an economic swing once the floods abate, with companies working hard to complete unfilled orders.

It is also likely that the flooding will have an inflationary impact on prices. Food prices were expected to fall in the latest inflation print, but the food component of the consumer basket remained surprisingly high. With the damage that has been done to rice crops, where Thailand is the world's largest exporter, we can expect food prices to remain at elevated levels for the time being and the increased rice prices will have implications in other regional countries, with rice being a high weight in local baskets. We would however, expect the Bank of Thailand to keep monetary policy loose, with the Bank remaining focused on overall economic growth. Although there will no doubt be a strong relief effort, we do not believe there will be any material increase in the current government debt stock, to finance the efforts. Here we are not concerned, as our emerging market local currency bond strategy is currently underweight Thai Government Bonds. If the situation worsens we may even see a slight further weakening of the baht. We will however, not know the full extent of the damage in Bangkok until waters that have breached dams in the north of the country arrive later in the week. For our fixed income strategy, we will remain allocated to countries that offer a better potential risk adjusted return.

REXITER

Despite the large and yet unknown impact of the flooding, the Thai stock market has risen recently (in line with other Asian markets due to the improvement in global sentiment on hopes for resolution on the Greek debt and European bank crisis). In both our GEM and Asian equity portfolios we are overweight Thailand and, importantly, our holdings should be unaffected directly by the floods. In both strategies we hold Banpu which is a coal stock with nearly all its assets outside of Thailand (primarily Indonesia) and a bank. The impact is mostly on industrial companies, particularly multinational subsidiaries and specifically auto related businesses. Overall the impact though could be felt through a dip in GDP due to a manufacturing slowdown and a reduction in tourism, but only for a limited period. We don't see this as having any long term impact.

We believe that post the election earlier this year the political background is more stable than it has been for some time however, there remains the issue of the succession to the elderly King. We forecast GDP growth of approximately 3% this year and next, a current account and trade surplus, regardless of the impact in the loss of production in the auto sector. Although we may see a shock to the price of food, inflationary pressures should continue to ease from about 4% this year to under 3% next year. The equity market currently trades on a Price Earnings Ratio multiple of 10x and even though we forecast earnings growth of only 12% this year and 5% next year (much lower than consensus of 20.5% this year and 13% next year) we still see decent upside in the equity market, despite the fact that it has been one of the better performers since the 2008 crisis. Besides, perhaps more importantly for banks and property companies, the government approved Thailand's corporate tax rate to be cut from 30% to 23% this week, which will be effective from the start of 2012. This will have a positive uplift for profit growth, which perhaps also explains the recent rise in valuations in these sectors.