

## **M R Chatu Mongol Sonakul: Bank of Thailand's review of major economic events in Thailand during the past year**

A Statement by M R Chatu Mongol Sonakul, Governor of the Bank of Thailand, on Thailand's Economic and Monetary Conditions: Bank of Thailand's Public Report, 27 December 2000.<sup>1</sup>

\* \* \*

Ladies and gentlemen,

On the occasion of the New Year, the Bank of Thailand as one of the main national institutions would like to take this opportunity to review some of the major economic events during the year. We would also like to review the work that the Bank of Thailand has carried out in terms of economic policies and internal restructuring. This would also be a good opportunity to raise a number of issues, which the private sector may find important for consideration in the next year.

In the past year, the Thai economy has continued to expand. However, the growth rate was more moderate than anticipated. Economic recovery was not broad-based, and there remain pockets of fragility. In the second half of the year, with the adverse effect of increased oil prices, consumer and investor sentiment deteriorated, leading to deceleration in domestic spending.

As a result, inventories of finished products rose by 22 % from the same period of last year. At the same time stocks of finished products, which averaged around 15 days of sales last year, rose to 17 days of sales this year. Sectors that saw large increases in stocks were canned seafood, beverages, and automobiles. Consequently, the capacity utilisation rate of the industrial sector remained at 56 % on average for the year.

Capacity utilisation rate did not expand significantly was due to the fact that many manufacturing industries for domestic market were affected by the deceleration in domestic expenditure which led a number of industries to operate at less than half of total capacity namely beverages, automobiles, and iron & steel products.

Another reasons being that those export-manufacturing industries which have performed well have been expanding their capacities. For example, the electronics industry, where the capacity in the integrated-circuit sector has increased by 65 % since 1997.

With excess capacity prevailing, demand for new investment has been low, thus reducing the role of investment in propelling economic recovery. Moreover, some firms halted operations temporarily as the result of debt problems, adding to excess capacity in the system.

This year, the recovery has been propelled mainly by export. Industries geared to export markets expanded by 22 % on average, while industries selling to domestic markets contracted by 7.5 %.

Exports which saw high growth rates were in the hi-tech manufacturing products group, the export value of which rose by 30 %. This group comprises such products as integrated circuits, electrical appliances, automobiles and computers. In addition, firms that have upgraded product quality and competitiveness in labour intensive industries such as garments have also recorded buoyant exports.

Such development pointed to an adjustment in the right direction. The industrial base has shifted from reliance on cheap labour towards an industrial structure, which relies more on high quality workforce. As a result, labour productivity will increase which will lead to an increase in per capita income, something that we should not discourage.

However, some export industries have little backward linkages with other sectors in the country, and rely on high import contents. As a result, the expansion in export has not contributed significantly to the overall economic recovery.

Import was affected by the increase in oil prices, causing the trade surplus to decline to US\$4.6 billion. In addition, the volatility in the world financial system caused the exchange rate of Thailand along with that of other regional currencies to be under periodic pressure, depreciating vis-à-vis the major currencies, which, in turn, affected investors' sentiment from time to time.

---

<sup>1</sup> This is an English language translation from the original version in Thai . For reference please refer to the Thai version.

However, Thailand's international financial position has strengthened significantly, as external debt declined by US\$11.7 billion during the first nine months, while international reserves stood at US\$32.5 billion, providing more than two-fold coverage for short-term external debt.

In the past year, commercial banks have continued to remain cautious in new lending. Commercial bank credits expanded by 1.8% if loans transferred to AMCs and debt write-offs were added back. Businesses continue to have problems mobilising capital linked to the remaining risk in the business sector, the question of discipline of borrowers, and the need for prospective borrowers to adapt to the more sophisticated credit requirements of commercial banks. These factors restricted the expansion of commercial bank credits.

On a positive note, the ability to maintain macroeconomic stability resulting from low inflation, has enabled monetary policy to remain accommodative and helped reduce the financial burden on businesses up to a certain level.

Although in the year 2000 the economy grew less than forecasted, we have, however, managed to make considerable progress in tackling a number of important problems arising from the 1997 crisis, and some of these are bearing fruit.

On financial institutions, overall financial position of the Thai banking industry has improved markedly. A number of banks are now showing profits while interest spread has improved to 1.57 by the third quarter.

Commercial bank external debt has also declined substantially. More than 78 % of bank's existing foreign liabilities have been new borrowings incurred after July 1997. This shows that Thai banks have no difficulties in raising funds abroad.

All banks are expected to meet full 100 % loss provision requirement by end of the year as required by the Bank of Thailand. In the last three years some B890 billion has been raised as new bank capital, raising the BIS capital-adequacy ratio to 11.95 % for the industry. This is relatively high by the minimum standard, and will allow Thai banks to meet any provision in the future, as well as supporting credit expansion.

Non-performing loans, which peaked at 47.7 % of total credit, have now been reduced to 22.5 % of total credit at end-October.

A total of B1.1 trillion of NPL have been restructured, while a further B1 trillion of NPL is either in, or is in the process of being submitted to court, with resolutions that need to be accelerated. The remaining portion, B600 billion, of un-restructured debt consists mainly of loans to small and medium enterprises (SMEs), as well as consumer and mortgage loans.

To speed up the restructuring of the last portion, especially the SMEs, the Bank of Thailand has set up a scheme of debt restructuring and new lending for SMEs with NPL problems but have viable business prospects. This scheme is made possible through a credit guarantee by the Small Industry Credit Insurance Corp. When the scheme was first introduced, there were some minor problems relating to the requirement for additional personal guarantee. This issue has now been resolved. It is hoped that the scheme will help SMEs in returning to a state of normalcy.

In addition, the Bank of Thailand has encouraged financial institutions to separate their non-performing assets either to be sold or transferred to asset management companies. In all, 14 asset management companies have been approved, and approximately B579 billion worth of assets have been transferred as of end-October. With all these measures in place, we expect further progress in the resolution of the NPL problem next year.

With regard to the intervened banks, two have been sold to new investors. The remaining two are in the process of identifying new potential partners which are most likely to be finalised next year.

As for the existing Thai banks, the policy framework emphasised by the government is to encourage mergers, such as in the case of Bank Thai, which will help to preserve Thai-owned financial institutions. In this regard, in the case of those banks which have already been sold, the authorities have imposed the condition that they remain listed in the local stock market. And even in the case of the financial institutions which have switched to foreign investors, and for which permission for exiting the local stock market has been granted, the move to exit the stock market has been halted.

As for the financial obligation of the FIDF, there is now a clear solution to the problem. The Ministry of Finance will provide a guarantee for the FIDF bonds to the amount equivalent to the loss incurred by FIDF in the first year and for the estimated losses in the following years. The preliminary amount of the

losses is currently estimated at B880 billion, with the first lot of government guaranteed FIDF bonds expected to be issued in the first quarter of next year.

With a clear framework for resolving the FIDF problem in place, the next important piece of work is to move toward setting up a Deposit Insurance Agency to formally replace the current blanket deposit insurance by the government that will need to be phased out at an appropriate time. Such an establishment will ensure a level playing field among the banks in Thailand.

What I have said so far is a review of the progress we have made in resolving the financial problems arising from the crisis of 1997. At this juncture it is fair to say that the Thai banking system is now in a sound position to move forward on its own strength.

**An important question is how can we be sure that, in spite of all the efforts that have been put to resolving the financial problem arising since 1997, a similar situation will not emerge in the future? What are the preventions?**

The best prevention is that macroeconomic management must aim to avoid the boom and bust cycle, as the burst of the bubble, as had happened, brought a heavy toll on the economy and society. What we must do is to strive for a steady-state growth path.

Another important means of prevention is to ensure that banks have a good management system, are transparent, and most importantly, that there is an effective and efficient supervision system that meets international standards.

The Bank of Thailand has made substantial progress on the latter point. We have encouraged banks to become more transparent in providing the public with more timely and transparent information on bank management, especially information relating to non-performing loans, lending to related parties, and violation of the Bank of Thailand's regulations as well as the fines incurred.

In addition, we have encouraged banks to give greater importance to and abide by the best principles of corporate governance by limiting the number of outside directorships which the bank directors or bank senior executives may hold to not more than three, as well as not being an authorised director.

Before the announcement made on this issue by the Bank of Thailand on 17 September 1999, there were a total of 82 bank directors holding more than 3 outside directorships. The number has now reduced to 22, and should be finally phased out.

To reduce the risk of economic bubbles and the consequence to financial institutions, the Bank of Thailand plans to reduce the reliance of the private sector on bank credits, from a share of 77 % of the total sources of funds, presently, to 55 % in the next 10 years.

This requires that Thailand must have strong markets for debt instruments and equities. Thus, the development of the bond market is among the major tasks the Bank of Thailand has undertaken during the year, as it will provide the infrastructure for the conduct of monetary policy through open market operation, as well as enhancing the country's long-term economic development. During the course of this year, more than B200 billion worth of corporate debentures were issued by private corporations and state enterprises, some of which have a maturity of up to 20 years. The issuance of such debentures has helped reduce the cost in mobilising long-term capital.

In developing the bond primary market, in co-operation with the Ministry of Finance, benchmark interest rates were finally set up. In developing a secondary market, the Bank of Thailand has changed the status of bank counterparties to the Primary Dealers in June 2000. This was in order to facilitate the implementation of monetary policy, to provide liquidity in the secondary market and to participate in the bidding of government and state enterprise bonds in the primary market, as well as to undertake non-competitive bidding. Moreover, when any bonds are in high demand, there will be an issuance of the bonds to ensure adequate liquidity in the market.

In addition, by the end of next year, the Bank of Thailand will introduce BAHTNET II, which is the large value payments system that meets international standards and will serve both domestic and overseas financial institutions. The system will provide a facility to serve the transaction of debt instruments for which the Bank of Thailand is the registrar. The pricing of this service will also be more market oriented.

The Bank of Thailand also plans to improve convenience of the general public by standardising the width of all bank notes, and to introduce chemically treated paper to promote hygiene and lengthen the life span of the notes in circulation.

Ladies and gentlemen,

The most important factor for preventing the recurrence of the financial crisis is to put in place a framework of financial institution supervision in which the business sectors and the public place confidence.

From the first of January next year, the Bank of Thailand will introduce a new financial institution supervision framework which is risk-based supervision, focusing on the risk management system of the financial institutions.

Under this new system, the responsibility of the supervisor in charge of each institution will be clearly set out in order to ensure direct accountability. Their work will be supplemented by on-site inspection, where the supervisor will work with internal supervisor (off-site) of the Bank of Thailand and external auditors of the financial institutions.

In order to promote transparency and to ensure that the financial institutions being examined understand the purpose of the visit, a formal audit program will be sent out to inform the financial institutions prior to the visits. The annual bank supervisor's on-site visit plan requires that each institution be visited at least once a year.

The process of bank examination will be timelier. Moreover, to ensure that the quality of the assessment of each financial institution is of the same standard and to ensure transparency in the process, the supervision report will be submitted to the Financial Institution Development Committee, which comprises the Heads of all Supervisor Teams.

The Bank of Thailand's management will meet with the Board of Directors of the financial institution to present the findings of the supervision report, and there will be a close monitoring and follow up on the directives given, as well as the points raised in the supervision report.

To put in place this new supervision framework, the Court of Directors of the Bank of Thailand has approved the new structure of the Supervision Group due to be effective on the first of January 2001. Under the new organisational structure, there will be a clear separation of the three lines of work, namely supervision, examination, and research and analysis. This will provide for checks and balances within the system as well as serve to develop depth in supervision work.

Moreover, a new Department of Risk Supervision and Department of Information Technology Supervision will also be set up, which will help ensure that the supervision process will be more proactive and forward looking, focusing on strategic as well as management risk.

It is quite pleasing that the work, which has been undertaken, has begun to bear fruit, and we will have by the end this year a strengthened financial institution system.

Ladies and gentlemen,

The economic crisis, which occurred in 1997, caused the Bank of Thailand to review its role and task as the central bank of the country.

This review pointed to a number of weaknesses in the Bank of Thailand's work in the past. As a result, the Bank has embarked on a comprehensive restructuring and modernisation programme aimed at improving the works of the Bank of Thailand to best serve the roles and responsibilities as a central bank.

The strategy focused on 4 aspects, namely organisational structure and work process, human resource management, decision making process, and database and information technology.

The Bank of Thailand started the restructuring programme at the beginning of 1999 with the revamping of the management levels. Emphasis was placed on shorter lines of command, which facilitate fast and effective problem solving.

The organisation is divided into five main business groups; namely, monetary stability, financial institution stability, corporate support services, financial institution rehabilitation and strategic capabilities. Objectives, roles, and responsibilities of each group are clearly stipulated.

In 1999, the modernisation programme put the main emphasis on improving the work process. Those completed included: Data Management Group - a centralisation of data collection that were originally performed by many departments within the Bank; introduction of the use of information technology for the dissemination of information for public use through the Bank of Thailand's web site; Financial

Markets Operations Group - to develop working efficiency by increasing skills in risk management and the modernisation of the trading room; another group which has been completed under the programme was the Supervision Group.

On personnel development, most of the Bank of Thailand's staff lacked systematic development. In the past year, therefore, heavy investment was put on staff training by doubling the budget for this purpose. Moreover, staffs with high potential were assigned job training in outstanding private sector companies in order to increase their vision and experience and to understand how the private sector works.

A job evaluation system has been applied to each position in order to put the right man on the right job. Most importantly, we have introduced performance evaluation and individual development plans in accordance with international standards.

Next year, the Bank of Thailand will start a new salary structure to be consistent with job evaluation, and to set out a clear work target and plan for each group.

The most important change that occurs has been the improvement in the decision-making process. Today, all Bank of Thailand policies have been made on the basis of sound principles and reasoning that can be explained clearly to the public.

The decision-making process now evolves around decision-making by a committee rather than relying on individuals as in the past. In some of the committees, well-qualified individuals from outside the Bank of Thailand have been invited to be members. Between each committee, emphasis has been put on the ability to communicate and exchange information.

The change in this decision making process has resulted in the implementation of policies based on collective decision-making, accuracy and up to date information, most importantly, the co-ordination between the committees has helped reduce policy inconsistency.

On monetary policy, following the change to a floating exchange rate system, there was a need for a new monetary policy framework. On this issue, the Bank of Thailand believes that the Inflation Targeting framework, which is being used today, is very appropriate to the present conditions and is well suited for Thai economic and monetary structures. Keeping inflation at a low level is an important pre-condition in maintaining economic stability of the country in the long run. Most importantly, under this framework, the Bank of Thailand must set clear monetary policy targets, be transparent in its decision-making, and accountable for its policies. The Bank of Thailand Monetary Policy Board announces its decision every six weeks, and so far has published two Inflation Reports.

At present, the new monetary policy framework has been accepted at a certain level. More importantly, for it to be highly successful and efficient, the Bank of Thailand must be independent in implementing its policies.

On this issue, the draft of the new Bank of Thailand Act has stipulated this condition. Even though there is a need to review the draft in order to make it more effective, the Bank of Thailand strongly endorses the importance of this Act because it will provide for an up to date framework for the development of the Thai monetary system in the future.

In data dissemination, the Bank of Thailand has improved the process of data collection and dissemination to ensure that they are complete, correct, and expeditiously published, such as the improvement of the M3 data, the report on buying-selling of foreign currency especially the forms F.T. 3 and F.T. 4, as well as random checks on the correctness of the report.

At this point, we would like to note that the purpose of this random check is not to emphasise the use of penalties but to create awareness amongst the financial institutions the importance of data reporting to the Bank of Thailand, so that the Bank of Thailand can have an up to date database for policy decision-making.

On the external data, for the first time there has been a survey and announcement of the International Investment Position (IIP), in order to correctly monitor foreign currency exposure of the Thai economic system. Also, Thailand is the 21st country ranking in the world, in compliance with the International Monetary Fund's Special Data Dissemination Standard (SDDS). Moreover, the dissemination of the Bank of Thailand's data to the public has been improved through the access to information through the web site and the use of the Interactive Voice Response.

The various improvements to the Bank of Thailand have also started to show results. In this regard, the Bank of Thailand was invited by the Bank for International Settlements (BIS) to hold shares with other prominent central banks in the world.

But the work does not end here. The improvement within the Bank of Thailand must continue to ensure the Bank is an organisation which is ready to learn and develop itself as well as being the main economic organisation with accepted international working standards. More importantly, it is necessary to have an ability to maintain monetary and financial institution stability effectively and have the confidence of the public.

In 2001, we projected the economy to grow at around 4 %, a similar rate compared to this year.

In the first half, economic activity is projected to be somewhat stabilised. However, given a cleared economic and political environment, higher growth is anticipated in the second half of the year.

Following the adoption of an accommodative monetary policy stance by the Bank of Thailand to foster economic growth, which has enabled a continued downward adjustment of market interest rates, domestic spending is expected to pick up next year, as there is usually a lag of 1 – 1.5 years before monetary policy will result in increased spending.

As for Thailand's international financial position, even though exports will not be as buoyant as this year due to a less favourable external environment and imports will continue to increase in line with the economic recovery, the current account will continue to record a surplus in the year 2001, though of a smaller amount.

Although the Thai economy will continue to expand, there are a number of important issues to be taken into consideration:

#### **The first issue: The US economic slowdown**

External risks will be increased as the US economy is expected to slow in the coming year. How much should we be concerned about this, given that the USA is a major industrial country and the major export market for Asian countries? The degree of Thailand's exposure to the US market can be considered moderate, as exports to the US market constitutes about 21% of Thailand's total exports. Major export goods include textiles, electrical appliances, electrical parts and integrated circuits.

Over the years, the structure of Thai exports has diversified considerably in terms of both markets and goods, thus reducing over dependence on any particular market or goods. It is expected that this diversified structure and the enhanced price competitiveness will help cushion any adverse effects on Thai exports caused by the US economic slowdown.

#### **The second issue: Restoring public confidence**

Given that exports will slow down, economic recovery will have to rely more on domestic demand which in turn depends on the recovery of purchasing power. However, at present, private sector spending has been affected by the decline of consumer and investor confidence, leading to a situation where those with purchasing power are cautious in their spending.

This confidence has to be restored. Those who are able to invest have to begin investing. But a good starting point to restore confidence is to have a clear economic policy framework which can be realised only by having people electing good citizens to run the government. If the people are confident in their government and in the policies of that government, then confidence in the economy will be restored speedily.

#### **The third issue: Fiscal policies for economic growth**

Fiscal policies will play an important role in the process of economic recovery next year. At present, government spending amounts to a fifth of GDP, which is not considered as a high level. But for other countries, people are used to the system which the government plays a major role. Government deficit at a level which is conducive to economic recovery should therefore be readily understood and accepted.

Therefore, fiscal policies must play a more important role in stimulating the economy, but should maintain a balance between economic stimulation and long-term fiscal discipline.

#### **The fourth issue: Monetary policy**

On monetary policy implementation, the Bank of Thailand's view is that the Thai economy at present and in the near future continues to need low level of interest rate rather than a high level. The Bank will continue to support this need as it is deemed possible, under the Inflation Targeting framework.

As for the exchange rate, the stability of the baht has improved, due to measures that have been implemented. The Bank of Thailand will continue to closely monitor international capital flows and exchange rate movements in order to ensure timely policy responses to different circumstances.

In the area of international reserves, the Bank of Thailand has set a plan to repay loans. However, given our relatively modest reserves, it might be appropriate to consider using new interest incomes that will accrue from these reserves to repay loans. This may be deemed a better alternative than to keep on accumulating reserves, whilst taking on new borrowings to repay existing debts.

What I have said so far should help make it clear that, in spite of increasing global risks in the next year, we remain in a position to be able to steer our economy towards another year of satisfactory rate of economic expansion.

As for the economic problems that remain to be solved, this should not be a cause for much concern, as we have already prepared the appropriate policy framework and strategy to address them. It is only for the newly formed government to give importance to these policy frameworks, as well as to pay attention to the following three areas that are critical to the long-term survival of the Thai economy:

1. Thailand needs to modernise its industrial base and requires government initiatives to introduce improvements in areas of management and production technology. Education and labour skill developments also need to be given top priority, along with research and development of Thai products. These will enable Thailand's productive sector to serve as the main engine for economic growth in the future.
2. The prevailing social and economic problems at present partly reflect the lack of integrity in public and private sector management. The Bank of Thailand urges the introduction into the national agenda the specification for implementation of good governance at all levels. In the long run, this will serve to reduce risks to future social and economic developments.
3. The authorities must develop a financial infrastructure that can support a balanced development benefiting capital formation, liquidity management and risk protection on business and income in all business sectors namely agricultural, industrial and service sectors. We need to develop markets for financial products that are necessary to complete the structure of Thailand's financial market. We also need to promote the use of financial instruments, such as derivatives. The Bank of Thailand will have an important role to play in overseeing the provision of such financial services.

Ladies and gentlemen,

At the end of the Second-stage expressway at the Rama IX exit there is a large billboard. In it there is a Chinese saying. It reads in Chinese "bu dan xin jin bu huan man zhi dan xin mei yan jin bu." It translates into Thai "Do not be afraid to walk slowly. Be afraid to stand still." Let me end by stating that the Thai economy is ready. But readiness can not stand still forever. Let me end my speech by paraphrasing this saying. If Thailand were not to have a second wave, a second crisis: "Do not be afraid to walk fast". Thank you for listening.