Bandid Nijathaworn: Update on the Thai economy

Luncheon address by Mr Bandid Nijathaworn, Deputy Governor of the Bank of Thailand, at the Rotary Club of Bangkok South (RCBS), Bangkok, 20 November 2009.

* * *

Good afternoon,

First, let me thank the Rotary Club of Bangkok South (RCBS) for the invitation, and especially I want to thank Peter Williams for a very warm introduction. It is an honor to be speaking to you today, and my topic this afternoon is updating on the Thai economy.

As you are all aware, this year has been an exceptionally challenging year economically, not just for Thailand but also for most other economies. This year the global financial crisis, which has been with us since August 2007, continues to impart negative impact on economic activities, employment, and access to financing worldwide. The good news is that things are looking up. There are better news coming from the advanced economies, suggesting that economic situations are improving and financial markets are stabilizing. In Asia and the Pacific, signs of recovery are also strong and lead those in the rest of the world. On the homefront, recent economic data for Thailand are also more positive and indicate that the economy is slowly returning to growth after a sharp contraction we saw late last year and in the first quarter of this year. My talk today is to update you on the recent economic and financial developments, and to share with you our assessment of the prospect for next year, including the challenge for policy.

Let me begin first with the global economy.

Recent economic data, especially of the last few months, point to a picture of greater stabilization and more consistent signs of recovery in the global economy. The severity of the early economic contractions has eased while the levels of economic activities are gaining traction on a worldwide basis. In most major economies, final demand is showing signs of strengthening along with improvements in consumer confidence and business sentiment. More importantly, although the financial system in the advanced economies has not returned to normalcy, financial conditions have improved markedly with lower market volatility, reduced risk premia, and the unfreezing of interbank and other short-term funding markets. These positive developments have led to a view that the worst of the global crisis is now behind us, and forecasts of economic growth have been revised upwards for this year and next year.

On the financial front, reflecting these recent developments, appetite for risky assets has returned, leading to a resurgence of capital flows to emerging markets and strong rallies in equity markets especially in Asia. And for economies that the prospects for recovery look most certain, policy interest rates have started to increase to return policy accommodation to a more normal level, as is the case of Australia and Norway.

In the Bank of Thailand’s Monetary Policy Committee meeting held last month, the committee also shared the view that the global economy is returning to growth with the main impetus being the policy stimulus and a turn in the inventory cycle. Looking ahead, prospect for the recovery to continue into next year appears strong given the policy room that exists in the advanced economies to support growth. Nonetheless, it also needs to be said that downside risks to recovery remain, as uncertainty that can hold back the recovery momentum remains large.

In the case of the advanced economies, the key uncertainties include: ***first***, the high rates of unemployment which could stifle the momentum of consumer spending and private demand – the US unemployment rate in October was 10.2 percent; ***second***, the large fiscal debt positions which could heighten investor’s concern on fiscal sustainability and put upward pressure on long-term interest rates; and third, problems in the advanced economies' banking systems that could act as a drag on growth because of limited credit availability.

These are the uncertainties in the advanced economies that could mark down the pace of global recovery going forward. Moreover, high and rising oil prices could also act as a deterrent to economic recovery worldwide. Therefore, notwithstanding the consensus on the next year's return to growth, there remains a risk that global economic recovery going forward could be choppy and sluggish.

Turning to Thailand, although the Thai banking sector is resilient and has been largely immune to the global financial turmoil, the impact of the crisis on Thailand has been quite hard owing to the economy's high dependency on exports. As noted earlier, economic activities contracted sharply in the fourth quarter of last year and in the first quarter of this year, but the situation started to stabilize from the second quarter onward as economic activities began to show signs of improvement consistent with the developments observed elsewhere. Latest data for September point to continued improvements in economic activities, both in private consumption and investment, reflecting largely the benefits that domestic demand has gained from fiscal stimulus and supportive monetary policy. Exports in September contracted by 8.3 percent year on year, much lower than the contractions of 17.9 and 25.7 percents of the previous two months. On the output side, recovery in domestic demand has been met by stronger activities in production. Index of manufacturing production rose by 0.4 percent year on year in September, while the rate of capacity utilization in manufacturing increased to 64.7 percent.

On economic and financial stability, economic stability remains intact in Thailand with strong external positions marked by continued current account surpluses, high level of international reserves, and a low and stable external debt. As for inflation, the emerging signs of recovery have not put pressure on domestic prices. CPI inflation remains subdued at a rate of 0.4 percent year on year in October, reflecting the sizable output gap and well-anchored inflation expectations. On the financial stability front, the banking sector remains resilient with healthy balance sheets and the lending capacity largely preserved. And notwithstanding the strong resurgence of capital flows, the risk of asset price bubble, either in equity or in housing, for now remains low given the slow growth of bank credit and the more subdued initial conditions. The situation on asset prices, however, warrants a close monitoring as credit conditions can change quickly given the ample domestic liquidity.

In sum, the Thai economy is now in a process of recovery. The economy is poised to return to positive growth next year. At this time, however, the momentum of private sector demand is still not robust with the momentum largely mirroring the support from policy. Economic and financial stability, on the other hand, is intact with subdued inflation and a resilient banking sector. Therefore, given weak private sector demand, the Monetary Policy Committee is of the view that policy support remains needed as a firm recovery is yet to be established. It was in this context that the policy interest rate was kept unchanged at 1.25 percent in the last Monetary Policy Committee meeting in October.

Next, let me share with you our assessment of the outlook for the economy and policy. The assessment I am sharing was made by the Monetary Policy Committee in its meeting in October and is now available in our latest Inflation Report that has just been published. The key point is that, with the ongoing recovery, the Thai economy is set to return to positive growth next year, supported by improvements in the global economy and continued policy stimulus to support private sector demand. A key part of the policy stimulus is the expansionary fiscal policy of which a fiscal deficit equivalent to 3.9 percent of GDP is set for the 2010/2011 fiscal year. Stronger momentum in exports, continued policy stimulus, and a recovery in private sector demand are expected to lift real GDP growth to a range of 3.3 to 5.3 percent in 2010.

As the economy returns to growth, a return of domestic inflation is also expected next year on the back of a rebound in economic activities and the rise in oil prices. Inflation next year, while rising, is forecasted to be within our policy target of 0.5-3.0 percent for core inflation. Again, developments on the inflation front is not without uncertainty. With growth, pressure on prices could return quickly, not to mention the added pressure to inflation that could be coming from the oil price and from the spillovers of the possible rises in asset price linked to persistent capital inflows. Hence, the challenge for monetary policy next year will be to help foster a sustained economic recovery while maintaining price and financial stability. The latter will call for a careful assessment of the inflation risk and the recovery strength so that the calibration of monetary policy going forward will be well-timed and consistent with the objective of maintaining growth with price and financial stability.

Also, developments on the growth outlook next year are not without risk. An overarching risk is that the global economic recovery could stall. This could occur given the many headwinds and uncertainties that remain in the global economy as I already noted. Next, the second area of risk is the possible effects on business sentiment and consumer confidence at home from our own domestic political situations which could stifle the recovery in private sector demand. If this was to happen, the benefits that we expected to have from fiscal policy stimulus to lead a rebound in private sector spending would be weakened, rendering a missed opportunity for public sector spending to ignite the needed rebound in private investment. And finally, a resurgence of strong capital flows to Asia and a return of asset price inflation could pose a risk to financial stability and complicates further the conduct of monetary policy. The Bank of Thailand is mindful of these risks and is alert to their possible impacts on the economy.

I hope I have given you a clear enough picture of what can be expected next year in terms of the economic outlook and the challenge for policy. After two years of market stress and decline in economic activities, we can now cautiously look forward to a return to growth. Looking back, the last two years have also been an important testing time for Thailand as the impact from the global financial crisis has been large and quite unprecedented. As it turns out, the economy has been able to weather the impact of the global crisis quite adequately. This is to say, while the decline in output was unavoidable, economic and financial stability was maintained, the banking sector remained resilient, and the economy was able to adjust to the impact of the turmoil in an orderly manner, with output growth now recovering.

In my view, these things were of no accidents. Instead, they manifest a number of inherent qualities embedded in the Thai economic system that have contributed to the relative resilience of the economy. Such qualities include: ***first***, a strong and resilient banking sector resulted from good risk management practices by financial institutions and careful supervision by financial regulators at home; ***second***, a disciplined conduct of macroeconomic policy that emphasizes prudent fiscal and monetary frameworks with a clear focus on maintaining growth with price and financial stabilities; and ***third***, the promotion of economic flexibility as a mechanism for the economy and the private sector to adjust to macroeconomic shocks. To me, these qualities are of no accidents. They are our investment returns from past economic restructuring and reforms that were put in place, and they are the qualities that we need to preserve and to further expand upon by continuing with economic restructuring and reform.

I probably have used up my allotted time. I hope the talk has been useful, and again I want to thank the Rotary Club of Bangkok South for the invitation. Thank you.