Prasarn Trairatvorakul: Bank of Thailand's policy direction in 2011

Speech by Dr Prasarn Trairatvorakul, Governor of the Bank of Thailand, at the Bank of Thailand, Bangkok, 26 January 2011.

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With retrospect, the year 2010 testified to the strength and resilience of the Thai economy. Economic activity was able to continue uninterrupted, despite various unfavourable shocks such as political unrest, volatile capital flows, flood, and delayed economic recovery in some advanced economies. Policy measures, both monetary and fiscal, had been supporting factors. The economy expanded by as much as 8 per cent in 2010 as a result.

Given the strong growth momentum and solid economic fundamentals, the Thai economic growth is expected to expand at 3–5 per cent this year. This pace of growth is consistent with the long-term potential growth of the economy, and is an indication that the economic activity has returned to its normal, more balanced state. This is in contrast with the catching up episode last year, characterized by extraordinary growth rate.

As the economy operates closer to its potential, the demand pressure on prices will begin to accumulate, and consequently inflation is projected to be higher than those registered in the last couple of years. The rising costs, stemming largely from commodity prices, can further add to upward pressure on prices. Upside risks to inflation should return to focus this year, while the downside risks to growth should continue to abate. Meanwhile, many risk factors of the previous year may continue to pose threat. For example, episodes of volatile capital flows may return, while the economy's long-term competitiveness remains in need of improvement.

Policy objectives in 2011

The Bank of Thailand envisages two economic policy objectives this year: (1) to safeguard macroeconomic stability, and (2) to continue strengthening underlying fundamentals of the economy. Both objectives should be interpreted in the broad sense, for example, macroeconomic stability entails price stability, financial stability, as well as fiscal sustainability. Likewise, strong economic fundamentals encapsulate resilient private sector, efficient public sector, and sound banking sector among others. Given these broad goals, the Bank of Thailand and everyone all have parts to play. The government, for example, is in charge of ensuring a sustainable fiscal position in the long-term, and an efficient disbursement of budget so as to best strengthen the economy.

Monetary policy

Maintaining economic balance is key to the making of monetary policy, as it is one of the most important pre-requisites of macroeconomic stability. In practice, this means that as the economic activity returns to normalcy, monetary policy stance must similarly be normalized. Failure to do so will add undue pressure on inflation, ultimately posing risks to macroeconomic stability. Thus this year, the monetary policy committee (MPC) will need to continue normalizing monetary policy.

The amount and pacing of policy interest rate adjustments this year will be consistent with the outlook for growth and inflation as well as the surrounding risks. As always, the policy decisions will be grounded on informed and prudent deliberation by the MPC, with an aim of keeping core inflation within the target band as mandated by law. Because many shocks, both of temporary and structural nature, cannot be foreseen, it is difficult to say beforehand what level of policy interest rate should be appropriate for this year. However, sustained negative real interest rates are usually not consistent with fostering economic balance.

Timely adjustments in policy interest rate will help keep inflation pressure in check, which in turn lead to low and sustainable borrowing costs in the long run.

The Bank of Thailand has taken steps to enhance the transparency of Monetary policy making, by announcing the MPC voting result together with the statement for the first time early this month. The first minutes of the meeting has also been released this morning. It is hoped that these information will help businesses and households understand the rationales behind the MPC policy decisions, and enable them to make better and more informed economic decisions.

Exchange rate policy

The Bank of Thailand adheres to our policy framework, where exchange rate is not a policy instrument and hence is market-determined. However, recognizing the risks of high volatility in capital movements looking ahead, the Bank of Thailand has followed a three-part approach.

The first is to develop a systematic capital flows master plan, with sequencing appropriate for the development of the Thai economy and the evolving international financial market. Part of this plan is to relax regulations that hinder Thai residents from investing abroad, in order to foster more balanced capital flows.

Secondly, the Bank of Thailand will encourage the use of appropriate financial hedging instruments, in order to strengthen the risk management capability of the private sector, especially the small and medium-sized businesses. Given the possibility of more volatility in the financial market looking ahead including the exchange rate, those businesses with sufficient hedging capacity will be able to absorb shocks better.

In preparation for any extreme event with respect to capital flow’s volatility that may pose risks to the economic stability as a whole, the Bank of Thailand has prepared various options of regulating capital flows, with varying degrees of control. This constitutes the third plan. These three-pronged plans should ensure that the Thai economy has enough resilience and safeguard to meet challenges of capital flows.

Financial institutions policy

Effective implementation of monetary policy requires a strong system of financial intermediaries. An important characteristic of strong financial institutions is the ability to recognize and adapt swiftly to changes in the financial environment, domestic and abroad. For example, the ongoing process of economic and financial globalization will bring about ever closer interconnectedness and more volatility that will continue to challenge businesses and financial institutions. Meanwhile, the advent of modern financial tools, while enhancing the risk management capability for businesses, can also bring about closer and more complex integration between the capital market, the money market as well as the insurance industry. On the other hand, from the perspectives of consumers themselves, greater demand for funds and financial services is often constrained by limited financial access.

The appropriate course of policy on financial institutions must take into consideration challenges posed by these trends of changes. In this context, the Bank of Thailand sees three policy priorities going forward: (1) to preserve the soundness of the financial institution system, (2) to enhance the efficiency of financial intermediation, and (3) to place emphasis on consumer protection.

The soundness of financial institutions is the major foundation of macroeconomic stability. Currently, financial institutions are in top conditions, with NPL ratio last year as low as 3.6 despite credit expansion of 11.3 per cent. Banks’ capital is also much higher than recommended international standards. This strong soundness must be preserved. The Bank of Thailand will continue to apply micro-prudential approach to the regulation of financial institutions, to ensure that financial institutions put in place appropriate risk management framework, are prudent in extending credits, and maintain sufficient level of capital according to new international standards such as the Basel III guideline.

The recent global economic crisis highlights the importance of extending the coverage of supervision to foster the soundness of system as a whole, in addition to individual institutions. “Systemic risk”, in particular, can pose serious threat to macroeconomic stability at large. The Bank of Thailand has taken steps to guard against the potential development of such risk, by establishing macro-surveillance framework that provides early warning about areas that may be under threat. In practice, Thailand is also among the first countries to implement “macro-prudential policy”, the application of supervisory and regulatory policy in pursuit of system-wide financial stability.

The second policy priority is to continue enhancing the efficiency of financial intermediation. The Bank of Thailand will encourage a more widespread provision of hedging instruments and will seek to improve financial access especially for small and medium-sized businesses and retail customers. In addition, for businesses, people and government agencies to receive fast, safe and efficient payment services, the Bank of Thailand will work with all related parties to promote electronic payments such as using money transfer instead of cheque usage and using debit card instead of cash payment, which would reduce payment costs and allow government and businesses to manage cash more efficiently. The goal is to ensure that all parts of the economy benefit from the strong and stable financial system, an aspect of what constitutes an “inclusive growth”.

The third and last policy element is consumer protection. Consumers of financial services have the rights to good quality of services and fair protection. The Bank of Thailand encourages financial institutions to disclose all relevant information, including fees, to consumers before providing services to them. Financial institutions should also educate their customers, and provide financial services that are suitable both in terms of business and risk management capability of the customers, followed by dedicated after-sales services. Improvements along these lines will further strengthen growth inclusiveness.

Other policies

The Bank of Thailand will also seek to strengthen the economy through its other functions. In managing international reserves, the Bank of Thailand advocates further diversification by expanding the investment asset universe, as permitted by the new royal decree. The Bank of Thailand also supports a speedy repayment of outstanding FIDF debt, based on the principles of monetary policy independence and long-term fiscal discipline.

While monetary and financial stability certainly provide a favourable backdrop, the economy cannot prosper on the back of these alone. The nation’s competitiveness, in particular, needs to be strengthened and improved further. The private sector should continue to place greater emphasis on innovation and seek to compete on the basis of quality rather than prices. The public sector, meanwhile, must ensure that a sufficient part of budget is set aside for infrastructure investment on a sustained basis, which will help improve the productivity and benefit all parts of the economy in the long run. Joint efforts by all sides are needed to achieve our common goals of macroeconomic stability and economic strength and prosperity.