Prasarn Trairatvorakul: Thailand's economic outlook in 2011

Opening remarks b Dr Prasarn Trairatvorakul, Governor of the Bank of Thailand, for the JSCCIB seminar titled "Thailand's investment environment – looking forward", Bangkok, 21 July 2011.

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Distinguished Speakers and Guests,

It is my honor and a pleasure to be here today, to give our distinguished audience an opening remark for this seminar, organized by the JSCCIB in cooperation with the JFCCT[1]. The theme, "Thailand's Investment Environment: Looking Forward" is most timely and is of everyone's interest. I am sure that the discussion and exchange of views and ideas presented throughout the day will be fruitful and beneficial to both public and private sector alike.

Before entering into a full-fledged panel discussion, I would like to give you, as an overture, an overview of Thailand's economic outlook in 2011, focusing on two parts. The first part will convey that ***2011 is the year of normalization in several aspects***, and the second part is to ***look beyond this ongoing normalization process and lays the basis for many challenges ahead***.

Ladies and gentlemen, over the past years, the Thai economy has been very resilient to numerous economic shocks, ranging from the oil price shock, natural disasters such as flood and drought, series of political uncertainties as well as the 2008 global financial crisis. Nevertheless, Thailand's average annual growth rate for the last decade registered at 4.4 percent which is within the range of our estimated potential growth. ***The Bank of Thailand expects economic growth for this year to return to this normal trend***, with moderate growth in the first half of the year and steady growth in the second half after the supply chain disruption unwound. This is the first aspect of returning to normalcy, or growth normalization, which is a feature of resilient economy.

Such economic expansion is on the back of sound external and domestic demand. On the external side, however, risks to the global economy have increased recently due to damages caused by Japan earthquake, a weaker-than-expected US economy and concerns over Euro area fiscal crisis. These developments will have to be monitored closely. As of now, we expect a slightly lower global growth prospect but this should not change Thailand's economic outlook to the extent that derails the economy from its present growth path.

In particular, ***Thailand's export remains robust. Supply chain disruption due to the Japan earthquake is proven to be limited and temporary***; limited in the sense that impacts are mostly felt in the production and exports of vehicles. Temporary in the sense that problems in Japan have been mitigated, at the same time, we see recovery in vehicle production for Thailand since late May.

[1] JSCCIB stands for the Joint Standing Committee on Commerce, Industry and Banking. JFCCT stands for the Joint Foreign Chambers of Commerce in Thailand.

As for the domestic side, high income and confidence are supporting domestic economy going forward. Domestic demand, both consumption and investment have been and continue to be strong as underpinned by a high level of farm income, high employment, and good consumer and business confidence, complemented by a favorable credit condition. Tighter resource utilization also reflected these vibrant economic activities. The seasonally-adjusted unemployment rate fell to the lowest record in April. Meanwhile, the capacity utilization rate is expected to accelerate in the second half of the year following the recovery in the vehicle sector.

Overall, the economic momentum in 2011 remains sound. Nevertheless, ***political stability remains a key factor to facilitate this ongoing momentum***. Having an orderly outcome of the election is one step, but the underlying conflict must continue to resolve in order to further boost confidence and business climate in the economy.

Given the current economic development, ***the Bank of Thailand is more concerned with inflation which is a common outcome in a good growth prospect environment***. Increases in inflationary pressure have become a worldwide phenomenon particularly among emerging market economies. Thailand is no exception. Both headline and core inflation are expected to edge up from last year despite the government's attempts to contain inflation through administrative price controls.

As such, the Bank of Thailand continues to gradually normalize the policy interest rate. ***At present, the policy rate is still deviated from the norm*** as the real policy rate remains negative at around –0.7 percent. Thus, ***interest rate normalization is another feature for the year 2011***. Last Wednesday rate hike marked the 8th increase in the policy rate to 3.25 percent. Many have asked at what level of interest rate the Bank of Thailand's target is. ***There is no definite answer to when the upward cycle of interest rate will end. Theoretically, a desirable interest rate path would be the path that leads economy to its potential output level without exerting excessive inflationary pressure on the economy***. However, this state is subjected to change with economic developments. Thus, the Monetary Policy Committee's decision must be based on their assessments of current economic development and outlook at each time of the meeting.

Having said that, even if inflation has been curbed and the economy is on its normal trend growth, Thailand should not be complacent with economic normalcy. ***We need to look beyond normalcy which is the second part of my focus today***. Moving the country forward will be more challenging than the past especially now when competition intensifies across the globe. Raising productivity will be the key objective of economic development in this regard.

Ladies and gentlemen, the current economic situation is comparable to the one in 2001 in the sense that the economy at both times has fully recovered from the crises, namely, the 2008 global crisis and the 1997 Asian crisis. However, in 2001, the Thai economy still operated at the level far below the potential level. At that time, stimulus policies which encouraged spending were suffice to lift the country demand to the level closer to the potential output. Thus, the economy prospered without exerting much pressure on inflation. The present situation, on a contrary, characterized by rising inflation, reflects that the economy's capacity is operating near the potential level. An expansionary fiscal policy is therefore no longer necessary. ***The situation today is not about bringing the economy to the potential level because we are already at it, but rather, it is about how to increase this potential level of output which has to be done by improving the country's productivity.***

Increasing productivity is a topic which has been discussed in many forums, nevertheless, let me stress again that to achieve such a goal, ***adequate investment in both physical capital and human capital are necessary***. In this regard, there are several challenges for all parties. For the new government, there will likely be three fundamental challenges.

First, the government must find the right balance between public consumption and investment. Over the last decade, government consumption has been gaining its share of the budget, while public investment growth was somewhat moderated. This does not bode well for productivity. Thailand's infrastructure continuously needs improvement in several areas, particularly logistics, irrigation and quality of education. These public investments will also influence private investment through the "crowding in effect" as public and private investment complement each other. Therefore, the government policies should be prioritized, be gradual and have specific target in their spending. Priority should be given to productivity enhancement project and spending should be selective and targeted to certain areas to ensure policy's effectiveness. At the same time, graduality of policies is necessary to minimize inflationary pressure and allow time for private sector to adjust.

Second, fiscal stance, like monetary policy, is also required to normalize in order to ensure fiscal discipline and sustainability. In a time of normal trend growth, there is a lesser need for a fiscal stimulus. Rising public debt, together with increasing contingent liabilities, may endanger fiscal sustainability in the long run. Reforms of the tax revenue collection and tax structure should be implemented along with rising expenditure to ensure a healthy balance sheet of the fiscal sector.

Third, political stability is a vital condition to the private sector for maintaining an investment-friendly environment. These three challenges, if prevail, will put Thailand forth into a competitive frontier.

Likewise, ***the private sector contribution is as equally important***. One immediate challenge which businesses face today is the problem of labor shortages. Under a strong baht environment, this is a great opportunity to import and invest in machinery and equipment which will upgrade Thailand towards a more capital-intensive country. The private sector can also help to improve labor quality through appropriate education and training, which is one way to help spread the benefits to workers as their productivities improve. ***As a long-term prospect, shifting input factor of production towards capital is more superior than using immigrant labor*** for three reasons. First, other than training, capital investment will improve labor productivity which will fully benefit Thai labor in a form of increases in real wage. Second, immigrant labor will likely worsen income inequality as wages for low-skilled worker will be suppressed. Third, a cutting-edge technology as well as modern machinery and equipment help facilitate R&D activities. Therefore, relying on immigrant labor is not a long-term solution for Thailand.

Promoting R&D investment is another key challenge for Thailand as current R&D spending is extremely low compared to our peers' and only accounted for about 0.2 percent of GDP. The public and private sector must work together to promote R&D investment which then lead to value creation for the economy. In addition, businesses could speed up the R&D process by seeking regional alliance opportunity with strategic partner who can provide complementary advantage to us in the area.

As for the Bank of Thailand, we continue to improve the efficiency, hence the productivity, of the financial sector through the Financial Sector Master Plan II. It aims to eliminate unnecessary regulatory burdens, increase competition and improve financial infrastructure as well as elevate financial literacy with sufficient consumer protection. ***The payment system is also being improved.*** The Imaged Cheque Clearing and Archive System or the ICAS, which allows physical cheques to be replaced by images in exchanges between commercial bank, is expected to be implemented within this year for the Bangkok and vicinity area and for the whole Kingdom at a later stage. This more efficient payment infrastructure will eventually make Thailand a "one-day cheque clearing country", which is a way to reduce financial cost of the private sector.

Ladies and gentlemen, ***all parties can help improving the country's productivity*** and let me now end my talk by stressing that our good economic fundamental and diversity make this country resilient to negative shocks. Returning to normalcy is one resilient feature but moving the country forward in a global competitive arena will be ever more a challenging task. A strong will alone is not enough, all parties, including Thai and foreign, public or private entity alike, must communicate, coordinate and take action in unity. I believe that with everyone's efforts, we can prevail with prosperity for all.

Thank you.