Prasarn Trairatvorakul: Outlook for Thailand at a time of economic uncertainty

Speech by Dr Prasarn Trairatvorakul, Governor of the Bank of Thailand, at the Thomson Reuters Forum, Bangkok, 21 February 2012.

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Distinguished guests, Ladies and Gentlemen,

It is my pleasure to be the keynote speaker at this Thomson Reuters forum. This is a special opportunity for me to share my views on the “Outlook for Thailand at a Time of Economic Uncertainty.” At the outset, I would like to highlight that the Thai economic outlook for 2012 is likely to be strong in terms of projected GDP growth while pressure on inflation should be well- contained. Having said that, I know that all of you, especially those in financial markets, are well aware that in today’s fast-paced world we cannot be complacent. Positive outlooks, such as the one I just described, may change quickly. Today, my speech will focus on laying out the challenges, my assessment of the challenges, and our policy options going forward.

First, let us turn to the challenges.

Last year 2011 was a year of regaining poise and balance for monetary policy. One year ago, the global recovery had started to gain traction. Capital flows had begun to stabilize and became less uni-directional. The balance of risks had started to shift away from growth to inflation. As a result, the Bank of Thailand (BOT), and indeed, the majority of central banks in the region, normalized interest rates throughout most of the year. But that was one year ago. And one year can be a long time. Therefore, the need to focus on ensuring macroeconomic stability can never be taken for granted.

This year Thailand faces challenges from both within and without. On the internal front, the main challenge is the flood – more specifically, how to ensure domestic recovery and restoration after the flood. The extent of the damage inflicted by the flood in the last quarter of 2011 was larger than expected and disrupted agricultural and manufacturing supply-chains in the flooded areas. As a result, the economy grew by 0.1 percent in 2011. The economy is projected to rebound in 2012, growing by 4.9 percent, boosted by private and public spending for post-flood restoration. In 2013, economic growth is projected to gather momentum, expanding by 5.6 percent.

The Bank of Thailand is confident that the economy continues to be supported by strong fundamentals. Let me give you a few examples. Inflation expectations remain anchored. Healthy corporate balance sheet from past savings and profits will allow firms to rebuild and re-invest. Corporate lending remains high despite some headwinds to the banking sector. These headwinds include the effect of the flood and global uncertainty on the macroeconomic outlook and on loan quality, as we have seen some pressure on the delinquency rate. The new FIDF fee will also have some effect on banks’ bottom line. Nevertheless, the Thai banking system will be able to handle these challenges given a strong capital base as a result of continued profitability in the past ten years, a good risk management system, and strong risk-based supervision. Therefore, Thailand’s key fundamentals remain resilient in the face of these challenges. Most importantly, human resources and know-how remain intact. History shows that no matter how severe the natural disaster, roads can always be rebuilt and buildings restored in a relatively brief span of time should the human spirit remain, as it does in Thailand.

The growth rates I have mentioned for 2012 and 2013 are consistent with the medium-term trend, as strong fundamentals mean that Thailand’s long-term growth trajectory remains intact despite the flood and volatile external environment. ***An important reason for this is***

that Thailand is well positioned geographically to reap the benefits of growth in Asia. The rise of China and the ASEAN Economic Community (AEC) provide enormous growth opportunities from economic integration. For sure, there will be more competition. But our research shows that trade gains will be substantial, from both inside and outside the region. However, there is a catch. To reap these gains, the Thai economy will have to undergo structural adjustment, that is, the flow of labor and capital from sunset to sunrise sectors. The exact form of adjustment is uncertain, as it depends on global developments. However, what is quite certain is that the size of structural change required will be large, comparable to what Thailand experienced during the economic liberalization of the 1980s and 90s. This change, almost by definition, will not be easy. If Thailand overcomes this hurdle, it will benefit from exporting more goods, possibly more hi-tech, to the region while becoming part of the regional supply chain and enjoying a greater range of imports.

But while the domestic outlook appears positive, the global environment remains uncertain. The lingering euro debt crisis and fragile US recovery continue to weigh on global growth. Why? Current technical solutions do not address deep-rooted long-term problems. As a result, resolution has been delayed, adding to uncertainty. Moreover, the longer the delay, the more interest rates and fiscal stimulus in both the US and euro area will be pushed to new limits. The tightened policy space means that new shocks will be hard to manage and could derail the ongoing recovery. In my view, it appears that the global economy currently lacks the clear leadership especially in regards to getting the advanced economies out of the woods. Countries which had previously provided the leadership for global macroeconomic management through, for example, the International Monetary Fund, are now caught in the dilemma of solving their own economic problems versus choosing policy options for the greater good of the global economy. This is a separate issue deserving of its own discussion.

Let me now turn to the policy options going forward, particularly from the perspective of BOT.

Ladies and Gentlemen,

As the global environment remains uncertain and without global economic leadership, it is even more important than before that the BOT policy strikes the right balance between accommodating the domestic recovery while ensuring stability in the long-term. Currently, monetary policy has shifted toward addressing domestic and global challenges to growth. The combination of domestic and external events has contributed to the MPC's decision to lower the policy rate. On the domestic front, the key factor was the flood—its economic impact proved to be larger than expected. At the same time, domestic inflationary risks look to moderate. On the external front, risks to global economic growth increased due to the fragile US recovery and the lingering euro debt problem. While the policy rate has come down due to risks to growth, the MPC also has its eye firmly fixed on long-term macroeconomic stability. As such, the MPC views current interest rates as supportive of long-term economic stability.

I would also like to say that in response to the challenging global landscape BOT will undertake policy actions that will serve to anchor long-term macroeconomic stability, enhance Thailand's competitiveness, and augment economic adaptability. Here I want to stress that the BOT has consistently adhered to the principle of conducting policy that ensures long-term sustainable growth.

On augmenting economic adaptability, the BOT will ensure that the exchange rate moves broadly in line with the underlying economic fundamentals while its volatility is manageable by Thai businesses. In the long run, we view a flexible exchange rate regime as the most effective buffer for capital flow volatility. In this context, a more balanced capital account is an important supporting factor. To this end, the BOT is currently formulating a Capital Account Liberalization Master Plan. This plan seeks to promote Thai investment abroad and streamline foreign exchange regulation, thereby increasing economic adaptability and promoting greater awareness and capability for the private sector's foreign exchange risk management, which relate directly to the businesses of many of you present here.

In addition to maintaining stability, BOT can also enhance competitiveness by ensuring financial institutions' role as effective intermediaries of capital, thereby improving financial access and inclusive growth. In this regard, I like to mention that we have launched the Financial Consumer Protection Center to boost financial literacy.

Clearly, a more competitive financial sector will support the process of structural change I discussed before. The second Financial Sector Master Plan, which takes into account major global developments such as regional integration and global regulatory reform, will further this vision of a modern financial sector landscape. In designing such a landscape, many key policy issues will need to be explored in depth. These issues include a regulatory framework that promotes financial sector development without compromising financial sector stability, the optimal adoption of international standards for bank supervision, a level-playing field among different domestic financial players, and the competitiveness of the Thai financial system in the ASEAN context of Qualified ASEAN banks, and so on.

Ladies and Gentlemen,

I believe that the efforts put forth by the BOT will fulfill the objective of enhancing competitiveness and ensuring long-term macroeconomic and financial stability. However, we cannot do this alone, especially in a world of global economic uncertainty, domestic challenges and diminishing fiscal room. A common vision among all stakeholders is necessary for policy coordination. The advanced economies that are now experiencing public debt crisis offer valuable lessons for emerging countries as well as Thailand where planned fiscal spending will add to fiscal debt. I believe that at this crucial juncture, many countries, Thailand included, still have time to manage possible future fiscal stresses. Austerity by means of cutting public spending is one conventional way to achieve fiscal consolidation. However, most emerging and developing countries still require essential infrastructure investment to unleash their own growth potential. Austerity without growth would be futile. Therefore, what is needed is constructive fiscal consolidation rather than dogmatic austerity programs. Prudential cuts can be combined with infrastructure spending to raise competitiveness levels and ensure sustainable long-term growth.

Rest assured that the BOT will do everything possible to create a stable long-term economic environment in which businesses can prosper. Thank you.