Prasarn Trairatvorakul: Thailand – assessment of recent economic performance and challenges for the period ahead

Keynote address by Dr Prasarn Trairatvorakul, Governor of the Bank of Thailand, at the Institute of International Finance Asia CEO Summit, Bangkok, 14 March 2012.

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Distinguished speakers,

Ladies and gentlemen.

Let me begin by thanking our hosts – the IIF and Bangkok Bank, for inviting me to speak before you at this occasion. It is a pleasure to participate in this unique forum that brings together so many experts from both the private and public sides of the international financial community. I would also like to congratulate the IIF for your proud 30th Anniversary. My designated topic for today is on Thailand's recent economic performance and challenges for the period ahead. In this audience, I think it is safe to presume that most of you are familiar with recent economic developments so I will be brief in this respect and focus most of my remarks on challenges going forward.

So let me start by offering a recap on the events of 2011 up to now. ***The main theme during most of last year was maintaining growth momentum while keeping stability in check***. As the economy gained traction, the balance of risks began to shift away from growth and towards inflation. As a result, monetary policy was dedicated to normalizing interest rates. Then the table was turned. Threats to the global outlook began to intensify, driven primarily by the euro sovereign debt crisis and signs of continued fragility in the US economic recovery. Domestically, the devastating floods in the fourth quarter of last year caused severe disruptions to our agricultural and manufacturing industries in affected areas. With upside risks to inflation deemed to be contained, the Monetary Policy Committee (MPC) agreed that there was room to address the heightened risk to growth and the policy rate was reduced by a total of 50 basis points over two meetings.

The current rate of 3.00 percent was judged to be accommodative for domestic recovery as well as supportive of long-term economic stability.

This is the story up to now. While the overall environment is improving, one cannot afford to be complacent. The events over the past few years has reminded us that things that seem under control can get out of hand very quickly. So, let me take you farther down the road of 2012–2013. ***I would like to focus on two key issues. The first concerns future challenges facing Thailand. The second then addresses the Bank of Thailand (BOT)'s policy focus, going forward***.

First, on the challenges.

On the external front, uncertainties surrounding the global recovery remain substantial. Major advanced economies are still grappling with structural weaknesses in their economies. Most prominent is the substantial debt-overhang. In the euro area, this is mainly in the form of sovereign debt. In the US, the problem lies primarily with private sector debt. While the US is more advanced in the de-leveraging process, the debt-overhang will be a drag on growth in both regions well into 2012. Dealing with such deep-rooted problems require tough, unpopular, actions at the fundamental level. A critical challenge is in justifying these actions to an increasingly skeptical public. Thus the implementation of the required policies is just as hard, if not harder, than coming up with the solution. ***The political risks involved in all this is a key source of uncertainty that we must be mindful of.***

While global financial markets in recent months appear to be coping better with this nagging uncertainty, we are definitely not out of the woods. ***And the risks are much compounded***

given the limited room for additional monetary and fiscal stimulus remaining in the advanced economies.

Looking closer to home, the rising contribution of Asia to the global economy is reassuring. Despite the slowdown in exports on the back of a softer global economy, domestic demand in many Asian economies remains robust. The expanding role of China and ASEAN's commitment towards economic integration will offer vast economic opportunities for the region. However, as will be discussed later, taking advantage of such opportunities will neither be automatic nor easy. ***The key challenge for Thailand is to make sure that we harness the opportunities and incentives generated by this process to achieve fundamental restructuring of our economy and raise our potential growth.***

On that note, let me turn to the domestic challenges. This year, Thailand must stay focused on ensuring post-flood recovery and restoring confidence. The damage of the floods was severe. Economic activity contracted by 9 percent year-on-year in the final quarter of last year and the economy barely grew over the year as a whole. However, the impact of a one-time shock of this kind will likely be temporary and there is no doubt that Thailand will recover strongly. Indeed, notwithstanding some slight delays associated with the need to import machinery and the processing of insurance payouts, the recovery process is well under way. We expect that growth will rebound to 4.9 percent in 2012 (figure from MPC January Meeting), boosted mainly by post-flood spending of both the private and public sectors. In 2013, momentum is expected to pick up, resulting in an expansion of 5.6 percent.

This optimistic outlook reflects key fundamental strengths in Thailand's economy. First, Thailand's human capital remains intact and strong, ready to support business expansion. ***Second***, the corporate sector continues to enjoy healthy balance sheets from accumulated savings and profits. This strong financial position will enable future investment and restoration. ***Third***, Thailand's financial sector is well positioned to provide the financing necessary to facilitate the investment cycle. Although the new Financial Institutions Development Fund (FIDF) fee will detract from banks' bottom line, the impact should be marginal and manageable. ***Finally***, Thailand is well positioned geographically to serve as a supply-chain hub for many industries, and stands to gain from the expanding set of opportunities created by a growing and more integrated Asian economy.

Thailand's underlying strength places us in a position to reap the substantial benefits from such regional expansion and integration. However, realizing these benefits will be a challenge and requires considerable adjustments. The key task is to ensure the necessary structural reforms to enhance Thailand's international competitiveness. Factors of production will need to be relocated from sunset to sunrise sectors. The quality of our human capital should be continuously strengthened to handle broadened and more complex activities as well as competition. Logistics and basic infrastructure need to be upgraded to support increased flows of goods and services. Government policies, rules, regulations and the legal framework must be improved and updated to facilitate all of this. ***In a world with so much uncertainty, what is certain is that we cannot simply make-do with the status quo. Lifting our growth potential requires vigorous change and transformation in what we do and how we do it***.

Ladies and gentlemen,

As the familiar French proverb – "Rome was not built in a day" goes; these structural challenges cannot possibly be addressed in the short-term. Successful implementation of this reform agenda requires a medium- to long-term perspective. The public sector will play a critical role in this. This brings me to the final part of my address, the BOT's policy focus going forward.

Starting with monetary policy, the primary aim at the current juncture is to strike the right balance between accommodating domestic recovery while ensuring stability in the long-term. As mentioned earlier, recent monetary policy actions were geared towards temporarily addressing risks to growth. In the context of a sharp contraction in economic activity from the floods, moderating inflationary risks, and pronounced headwinds from the global economy, the MPC judged this to be most appropriate. Such policy actions have helped to shore up confidence and hasten the recovery process. ***However, with clearer signs of a pickup in economic activity and the recent rise in global oil prices, upside risks to inflation has become more elevated***. It is unlikely though that inflation would accelerate to the extent that would threaten economic stability. Nonetheless, monetary policy will remain watchful as the pick-up in public and private spending and cost-side pressure stemming from various government stimulus packages may add extra inflationary pressure in the period ahead.

From a longer-term perspective, let me reiterate our commitment to the inflation targeting framework. Since its adoption over 10 years ago, this framework has endowed monetary policy with a degree of flexibility and credibility that has proved extremely valuable. Especially through trying times with high levels of uncertainty, the framework has imparted a degree of stability by helping to anchor public expectations of monetary policy. In delivering our primary mandate of macroeconomic stability, inflation targeting will continue to be a central pillar.

At a more structural level, the BOT can also act as a catalyst to help enhance competitiveness and augment economic adaptability. One key avenue is through fostering financial sector development. Here, the main thrust of our policy focus will be to enhance the effectiveness of the financial sector in serving as intermediaries of capital through further liberalization. The aim is to achieve improvements in four key dimensions. They are: (1) greater financial innovation and expansion of available financial instruments; (2) broader choice of services to suit households and firms' needs; (3) lower costs of such services; and (4) improvement in financial access.

Starting with the banking sector, which plays the most prominent role in our financial system, we will be taking steps to enhance competition. In the spirit of progressive liberalization under the ASEAN Economic Community (AEC), Thailand's formula for the banking sector will be guided by the second Financial Sector Master Plan. This year, we enter the second phase of this plan, which would allow existing foreign bank branches and subsidiaries up to a maximum of 20 branches and 20 off-premise ATMs. New service providers may be allowed under a restricted license to close any remaining gaps in the system. In the final phase in 2014, additional new licenses may also be considered.

Complementing this push will be efforts to boost financial market development through a more streamlined capital account and foreign exchange regulatory regime. This is part of a broader Capital Account Liberalization Master Plan aimed at facilitating and encouraging more outward investment by Thai residents in foreign assets.

At the same time, we are mindful that financial sector development cannot be sustained without adequate attention to risk management. I should briefly mention here that we are moving steadily forward with Basel III implementation. The overall implication of this new regime is a shift in bank capital structure that should result in greater resilience to liquidity shocks and less pro-cyclicality. ***From a macro-prudential perspective, the new regime implies more pre-emptive policy actions and a greater mix of policy options***. In this respect, there is a balance to be achieved. On the one hand, tighter regulatory structure and more active use of macroprudential policies may imply higher costs for banks. On the other hand, these costs, some of which can be offset through efficiency gains, represent a price worth paying for a safer and more stable financial system.

In terms of implementation, the BOT is currently finalizing the national standards and time-frame for adoption. The Thai banking sector can expect the first draft of the Basel III capital regulatory framework and liquidity risk management guidelines to be available later this month, with an industry hearing in the second quarter to gather feedback. Ongoing monitoring will be supplemented by the conduct of a Quantitative Impact Study semi-annually. This is to address any unintended consequences and maintain on-going communication and feedback with the industry.

Ladies and gentlemen,

Let me conclude by stressing that the BOT has a significant contribution to make in helping Thailand upgrade competitiveness and achieve long-term macroeconomic and financial stability. However, we cannot do this alone. ***A common vision and strong commitment among all stakeholders are necessary pre-conditions when it comes to long-term structural reforms***. Rest assured that the BOT is committed to push forward the national agenda on reforms, particularly on issues involving the public sector, to ensure that our economic system attains greater efficiency.

Thank you for your attention.