Prasarn Trairatvorakul: Recent challenges and the way forward

Speech by Dr Prasarn Trairatvorakul, Governor of the Bank of Thailand, at the Japanese Chamber of Commerce Dinner Talk, Bangkok, 22 March 2012.

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Good evening,

Distinguished guests,

Ladies and Gentlemen,

I would like to thank the Japanese Chamber of Commerce for inviting me to speak again at this special annual event. Each of these years has brought us yet more economic surprises and challenges. In 2010, the world economy grew surprisingly fast and the Thai economy promptly rode on the wave of global recovery. Then last year, the European sovereign debt problem erupted and depressed the global economic environment, while at home both of our economies were badly hit by devastating natural disasters that took a heavy human and economic toll.

In Thailand, the damage from the floods was indeed severe. Output loss was estimated to be around 3.2 percent of GDP and economic activity contracted sharply by 9 percent year-on-year in the last quarter of 2011. Manufacturing and agricultural outputs as well as exports were severely dented. The automobile industry, which was just recovering from the supply chain disruptions following the earthquake and tsunami in Japan, was hit especially hard.

But as you are well aware, shocks from natural disasters are temporary in nature. They tend to be followed by rapid resumption of economic activity as things get back on track, as was the case with Japan in the aftermath of the earthquake. From a medium term perspective, therefore, such events cause less economic dislocation than disruptions that reflect inherent structural weaknesses in the economy. Even temporary shocks, however, do often expose deeper shortcomings if they are sizeable enough. ***In Thailand's case, water management and crisis response systems have been shown to be inadequate. The government has rightly given high priority in addressing these gaps over the medium term.***

But in the immediate future, there is no question that Thailand will rebound quickly and strongly from the recent setback caused by the floods. I also believe that the country's underlying economic strengths will continue to support dynamic growth going forward and allow our economy to weather the global economic headwinds. In my remarks this evening, I would like to ***first highlight Thailand's fundamental strengths that underpin this positive outlook***. Then I will move on to discuss ***the role of the Bank of Thailand (BOT) in further strengthening economic resiliency and enhancing competitiveness***.

Before I delve into the key themes of my talk today, let me briefly touch upon the ***challenges that we are now facing on the external front***. With the ever closer integration of global markets for goods, services, and finance, it becomes harder to separate domestic economic prospects from the international context. This backdrop is presently quite challenging. Continuing strains in the Euro area and fragilities in major advanced economies elsewhere make for a highly uncertain global economy. Without bold actions, economic as well as political ones, the potential for Europe to be swept into a downward spiral of collapsing confidence and stagnant growth looms large. This grim possibility will remain a drag on the global economic backdrop and hence a key risk factor for the Thai economy in the foreseeable future.

While the potential impact on Thailand through financial channel appears limited due to low direct exposure of the Thai financial institutions to the European financial system, the impact through trade could be significant. This reflects Thailand's strong trade tie with Europe, which accounts for around 10 percent of our total exports. Fortunately, any such slowdown in Thai exports can be cushioned to some degree. A key reason is Thailand's shift towards more intra-regional trade within Asia, as well as our success in diversifying into alternative export markets more generally.

Against this backdrop of continuing headwinds from abroad, I believe that Thailand is poised for a sustained upward growth trend. ***Despite the floods, our long-term growth trajectory remains intact.*** We project that economic growth will rebound to 5.7 percent in 2012 driven mainly by strong domestic demand. Fiscal spending through flood-relief and stimulus measures will play a supportive role. The latest economic data show private consumption already recovering swiftly. Business confidence has also rebounded strongly and investment is projected to regain a firm footing by the third quarter of this year. The economy is expected to gather momentum and return to its potential from the second half of this year onwards.

This positive outlook is attributable to a number of key fundamental strengths in the Thai economy. First, corporate sector balance sheets remain healthy, thanks to robust savings and profitability. Net profit of Thai listed firms in 2011 was forecasted to continue rising strongly despite damages inflicted by the floods. This will enable firms to rebuild and invest. ***Second***, our banking sector is sound with a strong capital base. This reflects sustained profitability, good risk management and rigorous supervision. Latest information from our loan officer survey indicates banks' continued willingness to lend. This will greatly facilitate a quick recovery in economic activity.

Third, Thailand's human resources and know-how provides a solid foundation for businesses to flourish and expand. A strong human capital base constitutes one of Thailand's main comparative advantages. And this remains fully intact. ***Finally***, a key element of the nation's fundamental strengths that I would like to underscore is Thailand's geographic advantage to benefit from the promising growth in Asia. The rise of China and the ASEAN Economic Community or AEC provide enormous opportunities for businesses operating in Thailand to expand and prosper as the regional markets and productions become more integrated. The complex supply network and infrastructure that have long been established in Thailand, especially in the automotive and electronics industries, serves as a unique platform for international investors to obtain a critical foothold in the region.

I believe that these existing solid fundamentals that I have just outlined will help Thailand emerge strongly from the economic setback we recently experienced. However, in a constantly shifting global landscape, we policymakers cannot be complacent with the status quo. ***A lot remains to be done to guarantee the continued strength of our economy.***

The key impetus falls on structural reforms that lift Thailand's international competitiveness. This will not only enable Thailand to reap the full benefits of the emerging trend of regional integration, but also ensure sustainable growth in the long run. Considerable adjustment and transformation of our economy will be required. Bottlenecks to businesses due to structural rigidities will need to be removed. Factors of production will have to be upgraded and reallocated to activities that offer the most promising way forward. Government policies and laws will have to be updated and changed to best facilitate such structural adjustments, all the while making sure that the burden of adjustment on those who stand to lose is bearable. As should be apparent, ***these challenges cannot possibly be completely met in the short-term and will require long-term commitment from both the public and private sectors.***

The BOT's role in meeting these challenges is, first and foremost, to ***deliver on our mandate of ensuring macroeconomic stability***. A stable macroeconomic environment will not only foster business-friendly climate and make the process of structural adjustment easier, but it is also a key prerequisite for long-term sustainable growth. In this regard, I believe that our ***Flexible Inflation Targeting framework will continue to serve us well.*** This conclusion is based not solely on Thailand's favorable experience with the framework, but also echoes the experiences of many other central banks around the world. Supplementing this framework with macroprudential measures should help to further strengthen our ability to deliver long-term economic and financial stability.

While the current monetary framework gives priority to inflation, the BOT gives a balanced consideration to economic growth and financial stability as well. ***In the face of severe disruption to economic activity from the floods, elevated risks and uncertainties from the global economy, and moderating inflationary pressure, monetary policy has recently shifted toward addressing risks to economic growth.*** This is reflected in the two consecutive reductions in the policy rate in the last two meetings before yesterday. These actions have helped to shore up confidence and accelerate the return of economic activity to normal levels.

At this juncture, upside risks to inflation have begun to increase. Externally, geopolitical problems in the Middle East have pushed global oil prices up strongly. Domestically, post-flood pickup in public and private spending is adding to demand pressure. In addition, various government measures, including the reduction in the oil subsidy and a hike in the minimum wage, may also boost prices in the short term. ***As I understand, the minimum wage increase is one of the chief concerns for many of you here.*** We very much recognize the potential risks involved and our utmost priority is to limit harmful second-round effects of this shock. In doing so, this should help to limit the impact on businesses.

Apart from serving as an anchor for macroeconomic stability, ***the BOT can also work to promote Thailand's competitiveness and adaptability***. We will continue to pay particular attention to policies that facilitate businesses in adjusting to a competitive environment. For example, the BOT is formulating a Capital Account Liberalization Master Plan to enable more flexibility in managing cross-border investments and to achieve greater balance of capital flows. Foreign exchange regulations would also be streamlined to help reduce the cost for the private sector in cross-border transactions as well as to deepen and broaden domestic financial markets.

More directly, the BOT can strive to ***enhance the effectiveness of the financial sector in serving as an efficient intermediary that is able to meet private sector demands at reasonable costs***. Improvements can be achieved in four dimensions. ***First***, encourage financial innovation and the expansion of available financial instruments. ***Second***, broaden the choice available to firms and households in terms of financial services. ***Third***, reduce the cost of these financial services. **And lastly**, improve access to them. The second Financial Master Plan is an example of BOT's efforts aimed at pushing the financial sector in this direction.

To conclude, I wish to reiterate that with its solid economic foundations, ***Thailand is poised for a strong recovery and is well-positioned to benefit from the rise of Asia***. The BOT strives to be an active player in the broader push by the public sector to upgrade our economy's potential. Most immediate is to make sure that we deliver on our mandate of macroeconomic and financial stability. At the same time, the BOT aims to undertake steps, or act as a catalyst for the necessary changes, that will serve to achieve a more competitive Thai economy.

Let me close my remarks tonight by thanking the Japanese Chamber of Commerce and the Japanese business community in Thailand for your commitment to our country. We have been inspired by how you have dealt with the daunting adversity caused by the earthquake in your country. And we have been deeply touched by your support and steadfastness as we recover from the floods. I hope that the long history of friendship and strong business tie between Japan and Thailand will blossom further into the future for the mutual benefit of both our nations.

Thank you.