Prasarn Trairatvorakul: Current topics of the economy and monetary policy of the Kingdom

Speech by Dr Prasarn Trairatvorakul, Governor of the Bank of Thailand, at the Japanese Chamber of Commerce Dinner Talk, Bangkok, 25 March 2013.

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Good evening,
Distinguished guests,
Ladies and Gentlemen,

I would like to thank the Japanese Chamber of Commerce (JCC) for inviting me to give a keynote speech at this special annual event. It is my honor to be back here again for the prominent institution that has its presence in Thailand over half a century, contributing to the development in trade and investment, as well as promoting Japan-Thailand friendship through cultural exchanges and technical support. For this special evening, I would like to reflect on recent developments in the global and Thai economy, and the challenges for monetary policy going forward.

First of all, let's look back to what happened last year. ***In 2012, Thailand faced a series of challenges from both domestic and external fronts.*** The global economy was subject to the main drag from the Euro debt crisis, while uncertainties remained on the recovery process of the US and Japan. These advanced countries faced a number of structural problems which would, of course, take time to resolve. However, it was encouraging to see the overall global economy continue on a gradual recovery path, with improving outlook particularly in the US and Japan, while China and Asia remained robust. The Chinese economy, in particular, was in a sweet spot with rebounding growth and low inflation, with room for further public investment. Asian economies also performed well mainly due to strong domestic demand.

Last year, the Thai economy grew robustly at a higher-than-expected rate of 6.4 percent. Even though the impact of the still weak global demand became more apparent in the latter half of the year, spillovers beyond merchandise exports and export-oriented manufacturing production were limited. Factors supporting domestic economy include private reconstruction investment after the flood, while domestic consumption was supported by favorable wage and employment condition as well as government stimulus measures. Inflation in 2012 remained low at 3 percent, while core inflation averaged at 2.1 percent which was well within the Bank of Thailand's target range.

This year we expect growth momentum for the Thai economy to continue, amidst remaining uncertainties in the global economy. The US has managed to avoid the so-called fiscal cliff, although uncertainties surrounding the sequestration process still remain. Structural reforms in the euro area continue slowly but on course. Japan also has an optimistic outlook, given a series of government stimulus measures to pull the country out of deflation. Improving outlook for the global economy should underpin a gradual recovery in export for Asian economies, including Thailand.

We have forecasted the GDP growth this year at 4.9 percent. However, given a stronger than-expected GDP growth in 2012, this forecast is likely to be revised up for the next release in April. Inflation is expected to remain low, with headline inflation around 2.8 percent. The second round minimum wage increase is unlikely to have significant impact on inflationary pressure, given that many firms are able to make necessary adjustments in reducing costs and increase productivity by shifting to more capital-intensive production.

Robust domestic demand should continue to be the major driver for Thai economy. Private consumption is backed by many supportive factors such as the first-car scheme from the previous year and cuts in personal income tax and accommodative monetary and fiscal policies. Private investment is also expected to expand well, given the crowding-in effects of public infrastructure investment projects. Export sector should pick up pace towards the latter half of this year on the back of moderate recovery in the global economy.

Nevertheless, ***there are still many challenges lying ahead for the Thai economy.*** The state of the global economy, while improving somewhat, remained fragile. And a firm recovery is still subject to risks and uncertainties. Domestically, although inflation seems to be benign, there is a possibility of rising inflation pressure from oil prices after global demand started to pick up gradually. Supply constraints, mainly from tight labor market, may also add on to wage-price inflation in the future. As a central bank, we always have to remain vigilant on price stability. Of more immediate concern; however, are potential threats to financial stability stemming from developments in asset prices as well as household indebtedness. Activities are increasingly active in the stock market and real estate market. We see more and more construction of condominium and residential houses in Bangkok, peripheral and major provinces around the country where prices of some of these projects have gone up rather fast. We also see household debt trending upward to over 70 percent of GDP. We will continue to be watchful and make sure that the situation does not get out of hand to threaten financial and economic stability.

Ladies and Gentlemen,

This leads us to the second part of my talk this evening.

Given recent economic and financial development I have mentioned, it is clear that, as monetary policy maker, the Bank of Thailand is faced with a challenge to strike the right balance between economic growth and macro-economic stability. It is not easy to determine appropriate policy, thus policy decision has always been made with careful considerations, taking into account all economic and stability aspects.

Last year, our main concern was about ensuring growth recovery from floods. Policy interest rate was cut twice with a view to providing an accommodative and conducive environment to growth. This helped accelerate recovery in the aftermath of the flood and support domestic demand in the face of global economic slowdown.

At the same time, the Bank of Thailand had to make sure that core inflation remains within target and concurrently, ensure macroeconomic and financial stability. There has been continuous effort to enhance stability surveillance over the years. Last year, the joint meeting between the Monetary Policy Committee and the Financial Institutions Policy Committee was first held with the purpose of sharing ideas from different perspectives. It set a stage for both committees to regularly monitor and exchange views on any systemic risk that might occur from the interconnectedness of economic and financial sectors and to form policy response, should further measures be necessary.

For this year, the Bank of Thailand will continue to make sure that overall economic conditions stay safe and sound. Yet, balancing among different policy objectives to reach the ultimate goal of macroeconomic stability is even more challenging this year, given the possible risk on financial stability while the global environment is still surrounded with uncertainties. In closing, I would like to outline the key challenges faced by the Bank of Thailand this year:

First, on <u>monetary policy</u>. Since the main goal of conducting monetary policy is to ensure sustainable economic growth, the MPC's decision-making has always based on the risk to economic growth, inflation, as well as financial stability. This year, the challenge would be striking the right balance between economic growth and financial stability as inflationary pressure is well contained in the short run. Given buoyant domestic spending, keeping the policy interest rate too low for too long could give incentive to private sectors to borrow more. Furthermore, low interest rate will encourage depositors to switch to invest in riskier asset which could lead to the problem of asset price bubble in the future. Therefore, it is important for us to take care of financial system stability as well when we conduct monetary policy. The Bank of Thailand has been closely monitoring the expansion of private sector's loans and assessing ability of debt repayment of the private sectors, especially the middle and the low income groups.

Second, on <u>exchange rate policy</u>, the main challenge is that the Thai baht has been on an appreciating trend due to various factors, including capital inflows surge into the region, structural change in the world economy, growth differential between advanced and emerging economies as well as accommodative monetary policy in advanced economies. Generally, allowing the exchange rate to be determined by the market can serve as an automatic stabilizer in the short-term and as an important price signal and catalyst for structural change in the long term. So, as the first line of defense, the exchange rate should be determined by market mechanism and from both the market and our own assessment, the Thai baht still remains broadly in line with economic fundamentals. However, the BOT stands ready to use policy instruments at our disposal to prevent and manage dysfunctional market conditions, excessive speculation or exchange rate overshooting.

It should be noted also that, the baht appreciation at this juncture provides an opportunity for businesses to upgrade their technology and productivity. Given scarce labor and increasing wages, productions in Thailand need to shift from labor intensive to a more capital intensive industries and thus more import of capital goods and machinery are made cheaper during this investment up-cycle.

Third, on <u>capital flows management</u>. In October 2012, the Bank of Thailand launched the Capital Account Liberalisation Master Plan. This Master Plan aims to facilitate Thai companies to diversify their investments abroad, especially in neighboring countries. This would encourage private companies to operate their businesses more efficiently by expanding their markets and production bases, which in turn will help strengthen their competitiveness. Facilitating outflows also helps capital flows to be more balanced. The Bank of Thailand, for instance, has removed the limit for Thai individuals' outward direct investment, raised the limit per investor, and eased regulations for transfers of foreign currencies to facilitate investment in foreign securities.

Recent surge of capital inflows to the region is likely to continue as long as advanced countries continue their extra-loose monetary policies and as long as the prospect of this region remains much more positive than advanced economies. There is no one-size-fits-all measure to deal with impact of short term capital inflows on the economy. The Bank of Thailand thus utilizes policy combinations, namely: allowing exchange rate adjustment as a first buffer; liberalising outward investments by residents; exercising exchange rate intervention to deal with excessive movements; and should circumstances deem necessary, the Bank of Thailand is prepared to consider appropriate measures in order to prevent serious impact on the economy.

Last but not least, other than the monetary policy, there is still a concern over the structural problem of the Thai economy in the medium and the long term. Given the tight labor market and increasing wage costs, we need to improve the country's infrastructure and productivity. This involves the upgrading of technology and innovation to move Thailand up the value chain. The well-being of workforce, as well as quality of education and training are also crucial to increase competitiveness ahead of the AEC integration. This cannot be done by only one party. Long-term coherent vision and concerted efforts among all agencies, both public and private, are needed.

Ladies and Gentlemen,

To close my remark this evening, I believe that the JCC will have a big role in shaping Thailand's future and I hope that with the long history of partnership between Japan and Thailand, we will continue our close cooperations in all aspects in the years to come.

Thank you.