

Prasarn Trairatvorakul: Navigating through volatility with long-term focus

Speech by Dr Prasarn Trairatvorakul, Governor of the Bank of Thailand, at the Association of International Banks (AIB) Dinner Speaker Series, Bangkok, 29 July 2013.

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Excellencies, distinguished guests, ladies and gentlemen,

I would like to thank the Association of International Banks for inviting me to give a talk this evening. It is my honor and pleasure to be here for the prominent institution that has its presence in Thailand since 1996. The association's work and efforts have contributed significantly towards the strength of the Thai banking system as well as economic prosperity here in this country. For this special evening, I would like to share with you my views on the recent economic and financial challenges, as well as the Bank of Thailand's role in safeguarding economic and financial stability.

Navigating through volatility

Over the past few years, we have gone through many economic surprises. Last year alone the Thai economy had to face several challenges, both inside and outside Thailand – recovering from the devastating floods and coping with fragile global economy. And just a few months ago we only just started talking about a pick-up in global growth, driven mainly by robust demand in emerging markets. Today, circumstances have changed, and we are facing with unexpected slowdown in emerging markets as well as the prospect of Fed QE tapering.

As far as global economic environment is concerned, I think we are going to see a lot more surprises. The world, in my view, is now obsessed with just a few things. I would like to highlight them in turn.

First, the prospect of QE tapering is having wide implications for financial markets. We have already seen a sell-off of emerging market debts and equities, and a reversal of foreign capital flows that had rushed into the region earlier this year. With uncertainty in the amount of global liquidity provided by major central banks like the Fed, we will likely see more volatile capital flows, exchange rate and commodity prices going forward.

Second, financial markets are watching closely Abe's plan to revive the Japanese economy. Its effectiveness, especially of its third-arrowed plan of structural reform, will be significant for global outlook and the degree of risk aversion in general. If the third arrow has failed before it even properly began, the economic momentum running by the previous arrows – monetary and fiscal stimulus – would be weakened.

Third, signs of Chinese economy and emerging markets slowdown have already started to affect world growth. With prolonged recovery in G3 countries, the last hope for global recovery seems fading. China's aim to tame its real estate boom and inflation resulted in the economy slowing more quickly than initially hoped. So the slowdown of China will undoubtedly be a key risk to the global economy.

Consequences for the Thai economy

Along with weaker global outlook, the Thai economy this year started out with much moderation. Growth in the first quarter has been subdued as domestic spending, both private consumption and investment is weaker-than-expected. Part of this pullback may have been a natural reversion to a more normal pace of growth after an unusually strong expansion last

year. At the same time, on the external side, a drag on the overall Thailand's trading partners' growth continues to weigh on Thai exports.

Going forward, however, many of the supporting factors remain in place. High level of employment and strong private sector confidence should provide an enabling environment for growth. Fiscal stimulus related to large-scale infrastructure investment should also begin to phase in from the latter part of this year. This would potentially generate a positive crowding-in effects on private spending. For this, I would expect the economy to return to its normal path in the third and fourth quarter of this year.

Apart from slower growth, a potential threat to financial stability has increased, stemming from development in household indebtedness. Currently, household debt is rising to over 70 percent of GDP. International evidence suggests that a prolonged period of rapid credit growth could lead to a build-up of financial imbalances, worsen households' debt servicing ability and loan quality, as well as sow a seed for asset price bubbles.

The need for long-term focus

Ladies and gentlemen,

Having said all of the above, I may seem to paint the picture that the Thai economy is slowing down recently, largely as a result of weaker global growth. But I would like to point out that the Thai economy has not just slowed down recently. In fact, it has been growing slower for more than a decade, both in terms of quantity and quality of growth. Without enough quantity and quality of growth, we will not be able to grow sustainably and it will be a long way until Thailand can get out of the middle-income trap. The problem is that we are now caught in the middle- unable to compete with either low- or high-income countries. If this trend continues, it will prevent us from reaping the full benefits of future economic integration.

Part of this may stem from structural changes in Thailand's endowment. Labor is now scarce, increasingly mismatched and becoming more expensive. So, labor-intensive driven growth strategy is no longer applicable to Thailand. It is important that we create new sources of growth. To achieve this goal, an improvement in technology, education and labor productivity via higher investment in physical and human capital are needed.

Another thing I would like to note is that, as in most developing economies, economic development is often associated with rising income inequality and social exclusion. Thailand is no exemption. In fact, the economy has been growing unevenly. But growth without inclusiveness is not sustainable, because it can lead to deterioration of social solidarity, political uncertainty and finally affect economic growth. Thailand's economic development should, therefore, properly address the issue of equitable growth going forward.

The Bank of Thailand's role

Ladies and gentlemen,

This leads us to the second part of my talk this evening. Although short-term volatility has often caught us by surprise, there is a pressing need to consider longer-term issues. And to support long-term perspective, the Bank of Thailand has set economic and financial environment to support such goal.

The Bank of Thailand always attempts to strike the right balance between economic growth and macroeconomic stability. Monetary policy decision via interest rate setting has always been made while taking into consideration growth, inflation and financial stability dimensions. However, there are limitations that monetary policy cannot achieve. A single instrument, namely, the policy interest rate cannot target multiple objectives such as price stability, financial imbalances, exchange rate and capital flow simultaneously. The policy choices inevitably involve trade-offs between different objectives. Policymakers will have to weigh carefully the costs and benefits of a policy decision.

Although exchange rate is not the Bank of Thailand's main policy tool, or an intermediate policy target, sharp exchange rate volatility can have significant impact on exporters and small businesses with less capacity to adjust. The Bank of Thailand, therefore, constantly monitors the impact of baht movement on the overall economy and stands ready to use policy instruments to prevent and manage dysfunctional market conditions and excessive speculation. Nevertheless, in the long-run, exchange rate should be determined by market mechanism and serve as an important price signal and catalyst for structural changes. Despite more exchange rate volatility ahead, we could seize this opportunity to strengthen the fundamentals of the economy and reap long-term benefits that are likely to be greater than short-term costs of adjustment.

For the banking sector, having a competitive and efficient banking sector is of extreme importance in the world where competition is borderless. For this, the Bank of Thailand is ready to provide an enabling environment for the Thai financial sector. Today, the Bank of Thailand has embarked on several important measures to enhance efficiency, strength and access of the Thai banking system.

New banking licenses were granted, including new subsidiary license for foreign commercial banks who want to operate their businesses in Thailand. This should further increase competition, thereby raising the efficiency of the financial system. In addition, the Bank of Thailand has liberalized the opening of branches of Thai banks to allow them more flexibility in managing branch network and reducing costs. Further financial liberalization to facilitate regional integration is also considered. The ASEAN central banks are negotiating the common standard of Qualified ASEAN Banks (QABs). This will allow awarded banks to operate on a region-wide basis. And along with more liberalization, the Bank of Thailand has ensured that financial institutions are stable. So even though the Thai banking sector is already well-equipped with capital and sound positioning, the Bank of Thailand has strengthened their capital bases earlier this year, following Basel III, and in line with international standard.

As we already know, the payment and settlement systems are the backbone of the modern economy. In this regard, the Bank of Thailand has laid down financial market infrastructure to facilitate business operations. This year the Imaged Cheque Clearing and Archive System (ICAS) coverage will be expanded across the country to speed up the provincial cheque collection and clearing. This will help promote a more efficient payment system, enabling fast, safe, and secure financial transactions. The Bank of Thailand also encourages the use of electronic payment by coordinating with relevant parties to build infrastructure to facilitate this process.

Concluding remarks

Ladies and gentlemen,

Despite many roles that the Bank of Thailand plays in ensuring economic and financial stability, I would like to say that the Bank of Thailand's policy alone cannot ensure sustainable economic growth. Given Thailand's structural shortcomings, there is the need to improve Thailand's infrastructure and productivity, by improving technology and innovation. The well-being workforce and quality of education and training are also crucial to increasing competitiveness. For this, long-term coherent vision and concerted efforts among all stakeholders, both public and private, are needed.

Let me close by leaving you with some final thoughts.

Thailand is now challenged by both external and internal risks. These are not necessarily unfavorable, as they also come with opportunities to urge us to prepare ourselves collectively to cope with uncertainty in the global economy. In an increasingly volatile world, we must do more. Our efforts should not be just about coping with short-term fluctuations, but also about laying long-term foundation for Thailand's future. That requires a forward-looking plan of

action by all stakeholders. The Bank of Thailand, for our part, will continue to ensure a stable financial and economic environment, so that businesses can continue to thrive and individuals can enjoy better standards of living on a sustainable basis.

Thank you and wish you all an enjoyable evening.