Prasarn Trairatvorakul: Perspectives on Thailand's economy

Speech by Dr Prasarn Trairatvorakul, Governor of the Bank of Thailand, at the Global Macro Conference, Hong Kong, 27 January 2015.

* * *

Distinguished guests, ladies and gentlemen,

It is a pleasure for me to share with you my perspectives on Thailand's economy in these times of growing concerns about global financial markets and economic recovery. I would like to thank Goldman Sachs for arranging this platform for policymakers like us (the Bank of Thailand), senior global leaders and investors to exchange information and ideas. And, it is very important, at this juncture, to foster constructive dialogues between policymakers and industry specialists.

I would like to first share with you my thoughts on Thailand's recent economic development and the direction in which I see the Thai economy is heading.

Update on economic activity

Last year marked a bumpy ride for Thailand's economy. In the first half of the year, the economy was stagnant due to a combination of low domestic demand and external challenges. In the second half of the year, clarity of political situation boosted private sector's confidence, which in turn encouraged a turnaround in private consumption and a pick-up of private investment in some sectors, such as telecommunication. With the resumption of a functioning government, public spending resumed somewhat, although not as much as we had hoped. Throughout the year, low interest rates made the overall financial condition an accommodating factor. Despite occasional challenges, the financial and the real sectors remained resilient. We are currently awaiting the official figure, but project that the economy in the second half of 2014 to have grown by 1.7%, which translates into an annual growth of 0.8% for 2014. ***(Slide 1)***

Prospect for 2015 and projections

As for 2015, we project that the Thai economy will continue to recover at an annual growth rate of 4%. Let me briefly highlight a few key points underlying this projection.

First, we anticipate that the growth momentum is carried forward from last year's second half. The economy should show stronger signs of recovery. Private consumption, investment and government spending will be the main drivers of growth. Lower oil prices certainly have also given consumers a hand in the recovery process. Exports are also expected to grow, but at a slower pace than we have seen in the past.

Second, our estimate of exports is conservative. We project *merchandise exports* to grow mere 1% this year compared to 3–4 % expected by the market. Demand growth from our trading partners is still slowly recovering, especially in the euro zone and Japan. While the US economy is picking up its growth momentum, the risk of global growth and lower commodity prices has undermined many Asian countries' exports including ours. With regard to *exports of services*, particularly the tourism sector, things are however somewhat brighter. With tentative signs of improvement, we project tourism to grow approximately 10% compared to last year.

Third, there are critical assumptions in this projection, which hinges on government spending. As we all know, there are many uncertainties when dealing with an assumption of political nature. And, for this year in particular, our forecast team had a hard time making fiscal assumptions. On the one hand, the government is trying to accelerate budget disbursement and push through infrastructure projects. On the other hand, the country is undergoing structural reforms in many areas. Some on-going reform processes, such as those related to fighting corruption[1], cannot help but delay government spending and investment. This is *dynamism* of the current reform period. Some measures incur *"short-term pain"* but are necessary to create *"long-term gains"*. ***(Slide 2)***

Underlying fundamentals and medium-term outlook

Ladies and gentlemen,

Despite headwinds and disappointing growth last year, the underlying fundamentals that have been attracting investors to Thailand are still in place. The country's overall economic stability remains sound against a backdrop of low unemployment, well-anchored inflation and a strong current account position. ***(Slide 3)***

Thanks to the painful lessons of the crisis back in 1997 and the adjustment thereafter, the main sectors in the economy (be it banks, corporate, households or government) have also kept their leverage in check. The banking and corporate sector had undergone a dramatic change and now possesses a fairly healthy structure. NPLs of the banking sector dropped from 43% during the crisis, to 2.3% in 2014, while debt-to-equity ratio in the corporate sector declined from 5.1 in 1997 to 1.3 in 2014.[2] As for the household sector, even though the level of debt had risen somewhat in the recent years, approximately 85% of GDP last year, the decelerating growth provides us a relief. The transparent and prudent macroeconomic policy frameworks, used for both fiscal and monetary policy, also command trust from investors and the public. For these reasons, the reputable credit agencies have still reaffirmed their positive assessment of the Thai economy.

Indeed, the recent economic conditions have underscored the importance of preserving sound macroeconomic fundamentals in order to create resilience in the face of unexpected shocks. Domestically, the recent economic slowdown has put some small businesses and indebted households under financial strains. Loan quality has deteriorated somewhat, with NPL increasing slightly as a result, but these risks have been contained to specific sectors. The banking system and corporate sector remain strong and have coped with the slowdown well, owing to their improved risk management policies.

Externally, like many emerging markets, Thailand faced a couple episodes of capital flow volatility in recent years. The economy, however, has withstood these challenges reasonably well. For instance, during the "Taper Tantrum" in May 2013 and our own political unrest towards the end of 2013, Thai baht had swung by more than 10 percent in a year, fluctuating from 30 baht per US dollar to 28 and back to close to 33 baht. Despite this volatility, market reactions (in terms of outflows) have been relatively dampened. Foreign participation in the Thai bond market decreased from a peak of 13 percent to the current level of around 10 percent of total outstanding public sector bond. The strong local institutional investor base was able to pick up from where foreigners left. Despite foreigners exiting the Thai bond market, total portfolio outflows last year (2014) amounted to a mere 1 percent of our international reserves.

A flexible exchange rate, a relatively balanced external position and a modest external exposure, altogether acting as *the first line of defence*, contributed to the success. The Bank of Thailand is also equipped with comprehensive policy tools, along with ample international reserves, that can be used as a backstop to deal with disruptive capital flows and to

[1] Examples of anti-corruption measures are 1) the ***Construction Sector Transparency Initiative*** (CosT) which promotes transparency in state enterprise projects and 2) ***Integrity Pacts*** which oversee purchase plans of government and state enterprise projects. Among the big projects already implemented are 1) Suvarnabhumi Airport Phase II 2) the Blue Line metro extension, and 3) Bangkok NGV bus purchase plan.

[2] Total corporate debt / total corporate equity.

safeguard financial stability. In fact, these are our *multiple lines of defence* available at our disposal.

Ladies and gentlemen,

We, should not be under the illusion, however, that good fundamentals can be taken for granted. In fact, the slowdown of economic growth in the recent years pinpoints to structural problems, holding back the economy. Chief among these are supply bottlenecks such as a shortage of labour and public infrastructure, eroding competitiveness and productivity, and corruption. If not properly addressed, these could restrain the country's growth potential in the medium term.

The good news is that ongoing developments in Thailand are constructive. The current reform agenda holds promises for moving the country forward. The National Reform Committee, along with other task forces, has been founded to push forward much-needed measures. ***(Slide 4)*** The Bank of Thailand is currently involved in the reform of state-owned enterprises, as this sector includes 8 State-Owned Financial Institutions (SFIs), whose asset size accounts for approximately a quarter of total assets in the Thai banking system. Starting from this year, we at the Bank of Thailand are appointed to be a *"regulator"* for such financial institutions, whilst the Ministry of Finance remains a *"policy-maker"* and an *"owner"*. This is one of the reform attempts to clearly separate the roles among those involved, in order to avoid potential conflict of interests and to ensure that SFIs are subject to a proper supervision akin to that of commercial banks. ***(Slide 5)***

While the reform efforts are welcome developments, to what extent reform plans will be put into action remains to be seen. One of the main challenges will be keeping the reform momentum going, as certain reforms may take years to complete. I think of sustainable reforms as running a marathon. You have to keep going steadily, slowly but surely. It's not sprinting as fast as you can for 100 meters until the finish line. If you told me today to run a full marathon tomorrow, I could not make it. But, if you gave me time to prepare and get fit, I would be in the run.

Monetary policy

Let me now devote the last few minutes of my talk to update you about our monetary policy.

Throughout the last couple of years, the Monetary Policy Committee has maintained an accommodative policy stance to support the economy. Mindful of downside risks to growth, the Committee carefully adjusted the degree of policy accommodation to ensure sufficient support to domestic demand and to shore up confidence. Since May 2013, the policy rate was cut three times, as lower risks to domestic financial stability and subdued inflation opened room for monetary easing. Nonetheless, since the interest rate has been low for a prolonged period, we continue to be vigilant in monitoring any risks to financial stability. ***(Slide 6)***

Ladies and Gentlemen

This year marks the 15th anniversary of Bank of Thailand's adopting of the "flexible inflation targeting' monetary policy framework. Thus far, this framework has served us well and resulted in a satisfactory record of price stability, which is a remarkable improvement from previous decades. ***(Slide 7)*** The headline inflation rates were on average 2.6% since 2000 under inflation-targeting, while they were more than 4% prior to that (15 years during 1985–1999). Equally important is that, inflation targeting has helped restore credibility and has brought transparency to the monetary policy deliberation process.

To continue improving communication with the public, the Committee has decided to change the inflation target from core inflation to headline inflation starting this year. The new headline inflation target of 2.5 ± 1.5 percent aims to better reflect the cost of living and public inflation expectations. In practice, however, the monetary policy framework and deliberations will remain the same, irrespective of the choice of the target.

Conclusion

Allow me to conclude,

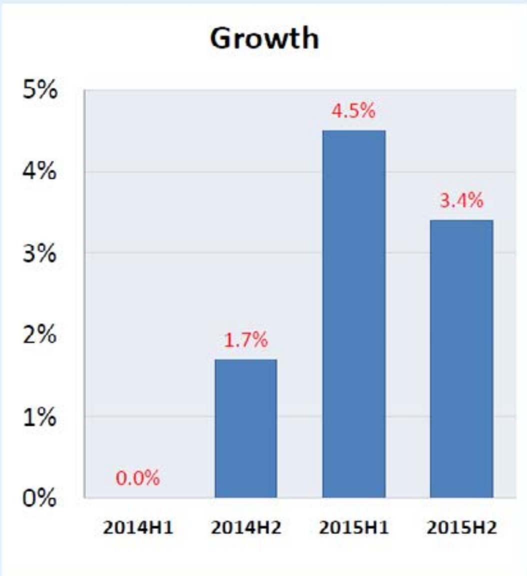
Key takeaway of my talk is that the growth outlook for this year is more positive than last year's growth. Due to the Thai economy's strong fundamentals and resilience, we remain optimistic about the near future. But, it is important to see through much-needed reforms, which would strengthen the country's foundation for the medium and long term.

Thank you very much!

Slide 1

BANK OF THAILAND

Recent Economic Development



YoY%	2014	2015
GDP Growth	0.8	4.0
Core Inflation	1.6	1.2
Headline Inflation	1.9	1.2

2

Slide 2

BANK OF THAILAND

Dynamism During the Reform Process

Government **pushing** infrastructure and investment projects

Anti-corruption measures **delaying** government spending and investment

Slide 3

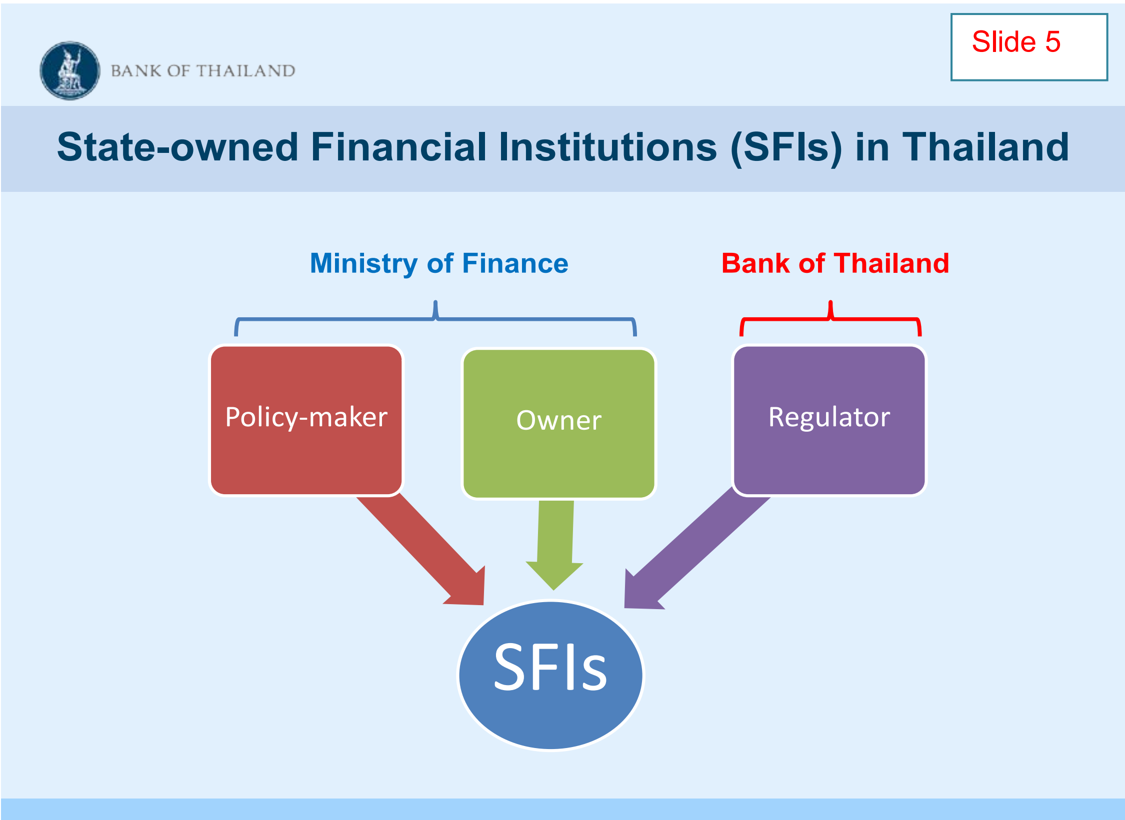
BANK OF THAILAND

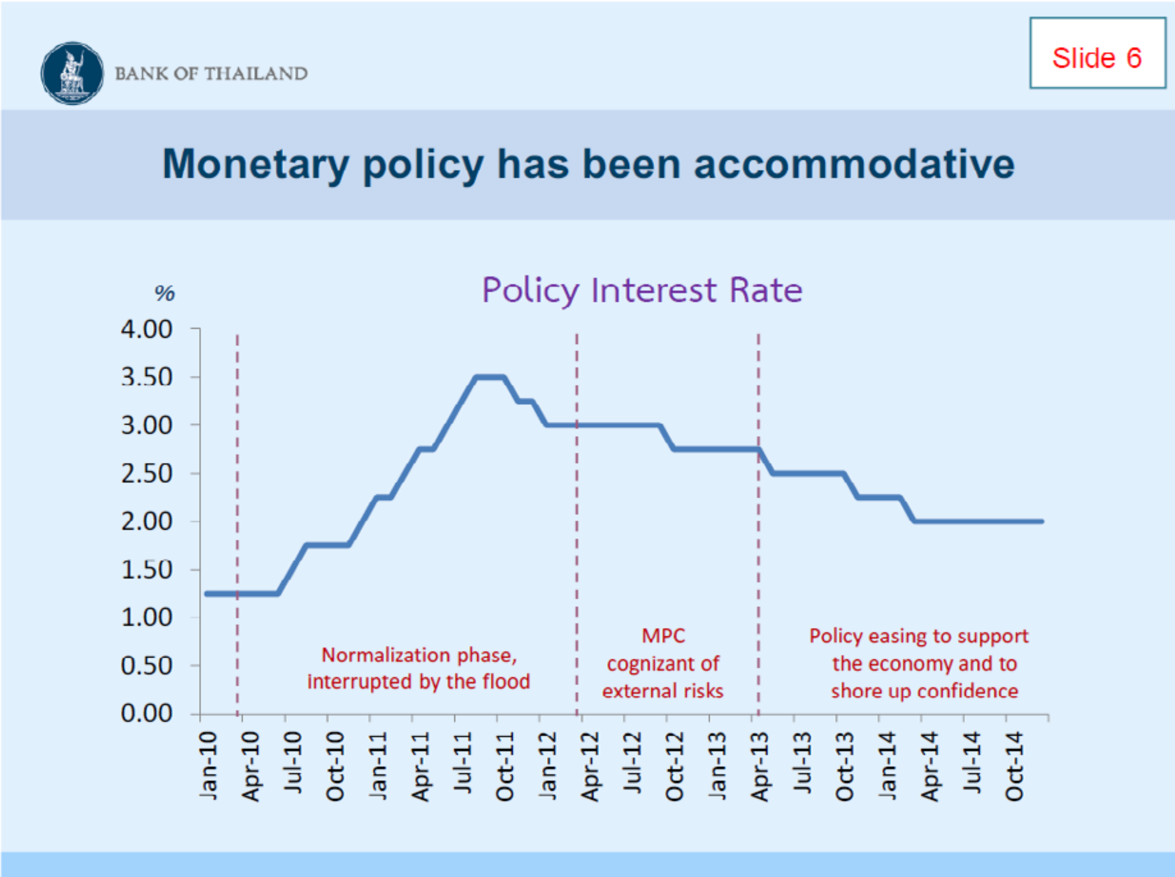
Thailand Profile

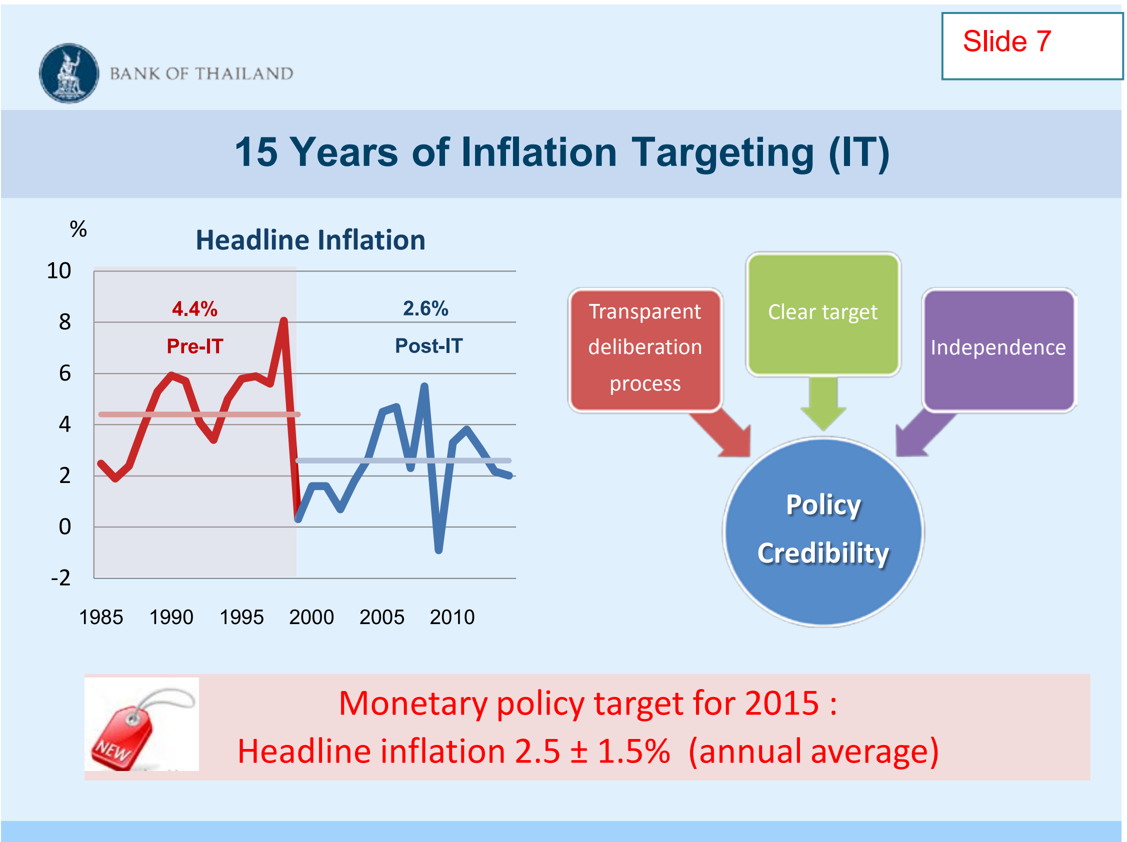
	1997	2005	2014[E]
Inflation	5.6%	4.5%	1.9%
Current Account *(Billion USD)*	9.3	-7.6	8.6
NPL *(% of total loan)*	42.9%	10%	2.3%
D/E Ratio of corporate sector	5.1	1.3	1.3
Household Debt *(% of GDP)*	n/a	54%	85%
Public Debt *(% of GDP)*	42%	51%	46%

Note: 2014 numbers as estimated; NPL as of Q2, 1998


Slide 4
BANK OF THAILAND
Reform Efforts: National Reform Council
EQUALITY
DECENTRALIZATION
ANTI-CORRUPTION
INTRA-REGIONAL COMPLEMENTARITY
reform


Slide 5
BANK OF THAILAND
State-owned Financial Institutions (SFIs) in Thailand
Ministry of Finance
Bank of Thailand
Policy-maker
Owner
Regulator
SFIs


BANK OF THAILAND
Slide 6
Monetary policy has been accommodative
Policy Interest Rate
%
4.00
3.50
3.00
2.50
2.00
1.50
1.00
0.50
0.00
Normalization phase, interrupted by the flood
MPC cognizant of external risks
Policy easing to support the economy and to shore up confidence
Jan-10
Apr-10
Jul-10
Oct-10
Jan-11
Apr-11
Jul-11
Oct-11
Jan-12
Apr-12
Jul-12
Oct-12
Jan-13
Apr-13
Jul-13
Oct-13
Jan-14
Apr-14
Jul-14
Oct-14


BANK OF THAILAND
Slide 7
15 Years of Inflation Targeting (IT)
Headline Inflation
%
10
8
6
4
2
0
-2
4.4%
Pre-IT
2.6%
Post-IT
1985
1990
1995
2000
2005
2010
Transparent deliberation process
Clear target
Independence
Policy Credibility
NEW
Monetary policy target for 2015 :
Headline inflation 2.5 ± 1.5% (annual average)