

M R Chatu Mongol Sonakul: Thailand - where we are now and what we are trying to do

Speech by Mr M R Chatu Mongol Sonakul, Governor of the Bank of Thailand, at the Asia Society Southern California Centre, on 3 October 2000.

* * *

President of the Asia Society of Southern California, distinguished guests, ladies and gentlemen,

Two years ago this month, I came to speak to this Society. It was to tell you how Thailand was getting along, what we were going to do and to solicit your support as friends of Thailand.

Those of you who were present might recall the things I said we were going to do. They were very rudimentary as far as central banking goes, and that the economic and financial numbers then, whilst improving, were not necessarily a basis around which a good future could be built.

The numbers are in many ways now better and we have gone on to do all the things which I said we would do and develop the more sophisticated mechanisms of central banking, such that we are far in advance of our indications two years ago. It is usually a happy occasion when one could report that one has done more than what one has set out to do. But I am not really a happy man today. The economy is still fragile, and there are vast areas left to be mapped out and implemented.

The one thing that one can say about the Thailand of old is that we really did underestimate the problems we were in and the structural changes needed to put us back to the forefront of international competition.

Let me recall that two years ago, we were going through a negative growth of 10.7%, and inflation of 8.1%. The short-term three months fixed deposit rate at that time was 8.25%, and the minimum lending rate was 15.8%, having peaked at over 20% earlier in the year. The only good news at that time seems to have been the large current account surplus of around 10 billion dollars, which would help stabilize the baht dollar exchange rate as well as repay our huge debts, which had reached an unbearable level now known to be US\$ 105 billion or over 100% of GDP at the particular point of time that I was making the statement to this august body in 1998.

At that time, I indicated that in my mind, our problem was structural, and that to solve and put Thailand back on the growth path, we must make structural changes, rather than just pumping money back in. Now, I am even more convinced that I was right and we have indeed pursued that path of restructuring and rediscovering ourselves. Let me elaborate a little.

Prominent but unnoticed by many Thailand-watchers was our being invited and joining as shareholders of the BIS, properly known as the Bank for International Settlements. Although this was not a major decision for us, it was a very prominent confirmation of our status in the world economy. BIS has less than 50 shareholders and is really an elite clique of the leading central banks. That it has decided to invite us to become shareholders was in recognition of the status that Thailand now has in the financial and economic market place of the world.

That the BIS last week decided to buy back all its privately held shares, becoming purely a central bank for central banks is of course a reinforcement of this development.

Another achievement of our own doing, this time towards transparency is that we are now qualified in the Special Data Dissemination Standard of the IMF, the 21st country to do so in May this year. This set of data is a guarantee whereby a country delivers enough information in a timely manner, such that international investors have a reasonable chance of evaluating its performance and prospects.

Many leading countries are still unable to qualify, because they have things that they wish not to be shown to the public, whereas we have taken the road that what cannot be shown in public perhaps

should not be done. We therefore participated also in the international reserves template both voting for it, and qualifying in the first group of countries to do so that have subscribed to the SDDS.

In terms of positioning ourselves for future participation in world activity, in the first half of this year, we announced the International Investment Position to replace the old foreign debt data. Although statistically it was a partial IIP, since our legal system does not yet allow us to collect our foreign investments data in a timely manner, it allows investors to know our investments abroad systematically for the first time, a sine qua non if one were to borrow substantially from the world community. One has to know what investments one has offsetting it as well.

In announcing the IIP, we thoroughly examined the foreign debt and put in a new complete data collection system even though it would show that we owed 20.5 billion dollars more than what we had previously announced. Our IIP was announced with a foreign debt of 105 billion dollars for 1997, clearly underlining the bad performance of the economy in that year. It is now reduced to 88 billion dollars, a level compared to the present GNP, which is quite acceptable, although still difficult to manage and must be watched with careful attention.

A decision was also made again in the spirit of transparency and sensibility to show these data to Moody Investor Services who thereupon upgraded us to investment grade.

To make future growth sustainable and high, after a long, arduous preparation over a year and a half, we went into the inflation targeting system, with an inflation band of 0-3.5%. The ceiling, being the average in the last decade of our 22 competitor countries, reflects our determination to be internationally competitive with them for the years to come.

Our inflation targeting model, although linear-quadratic, shows the zone or banding features by exhibiting a fan-shaped prediction both for the GDP and inflation. The Inflation Report that we issue at the end of each quarter shows an advanced feature in that it gives a sensitivity analysis around a band of exchange rate and a range of oil prices, something countries more advanced than us have hitherto been unwilling to enter into. But as I have said, we are trying to be transparent and trying to get our people and investors to be able to act as accurately as possible and to form a view as to what the future of the economy might look like.

We believe entirely that the better the estimates, the lower will be the costs one puts or has to put for taking the risk of investing in the economy and that, in the long run, the country will be more competitive using less resources to produce the same goods other countries are producing.

For this reason, we are constantly trying to improve our techniques. Next February we are hosting a select meeting of econometricians in inflation targeting model-making, and we will see if after that we could make our model into a linear zone-quadratic model, which would be more consistent with a target band than the present model which is really better fitted to a point target.

The link back between inflation targeting and forex stability is, however, more nebulous and we have therefore fortified it with technical changes in the trading system designed to keep exchange rates more stable again basically through transparency.

In my statement two years ago, I said we had set up a money market committee to oversee our operations in the money markets as well as forex, including swaps, forwards, options, and such likes. This we have now developed into a very good domestic monitoring vehicle, and the control of offshore baht will be fortified next week with our reissuing of forex declaration forms, which reflect the reality of the market condition today. The old forex forms allowed us to know the purpose of forex transactions only of 40% of total transactions, since it was issued some 20 years ago, when 60% of today's transactions were unknown or insignificant in the system.

Although this in itself is not designed to limit or restrict forex flows, we believe the increased transparency will make the system less prone to speculation especially as we are one of the few central banks that have decided to keep supervisory powers within the central bank. This option makes the bank harder to manage but supervision is a very effective tool against speculators.

On a more micro side, we have been putting good governance into our financial institutions. By good governance, we mean transparency, competitiveness and good internal management. Bank directors

are now required to have no more than three directorships in other limited liability institutions so that they can spend enough time running the bank. Of the 70 people who did not qualify, 50 have now complied and we are working on arranging for the rest to be compliant as soon as possible using the traditional amicable Asian way of trying to change things.

We are also working on getting the major shareholders not to vote for independent directors so that minority shareholders are better represented on the board. One government bank has done this and the new private commercial bank to be set up at the end of this year has agreed to do so. Seeing that it could be done or how it could be done, we expect the remaining private commercial banks to follow suit in next year's annual shareholders' meeting or at other relevant times.

Audit committees are now a requirement and many banks have nomination and compensation committees to reduce the power of the major shareholders in the management of the bank. Nearly all banks have risk management committees or at least asset and liability management committees, which is preferable to having no risk management at all.

In the area of transparency, commercial banks since August this year have had to announce at the end of each month their NPL level, penalties and fines imposed by the authorities and the related lending. Public and stakeholders' opinions are thereby used to augment the new supervision and examination process we are installing with the help of the OCC and the FDIC.

In terms of bad banks, I expect that by the time I get back, or soon after I get back, the disposal of all intervened banks will be complete. In terms of bad clients, since on the afternoon I left for the Annual Meetings of the World Bank and IMF, the contract for the transfer into the government-run Asset Management Company of some 12 billion dollars of assets was signed and the Cabinet had also approved the covered asset pool arrangement for another intervened bank for a further 5 billion dollars. I expect that the NPL at the end of this year will be in the teens - a quite manageable level compared to the high of 48% at the beginning of the year.

On the average, banks are now back into the positive spread, actually of 1.28% last month, which is low by traditional standards and still not profitable but still over half of the spread that we expect banks to be operating in under the new competitive and transparent conditions that we will see in the future.

In this respect, banks are now allowed to close branches freely and also are free to decide opening and closing hours. We are working on the rules on the free opening of branches, being quite far ahead in this, and we expect to announce it, certainly within the next two to three months, whereby lending conditions tied to branch opening are probably going to be removed.

This initiative is undertaken under the concept that banking services coverage is now adequate and we need not force banks any longer to do things for social reasons. Competition between service providers will probably lead to better results than government directed banking.

We have now also agreed on the rules for internet banking, defined as the traditional counter service banking using e-commerce technology. Our idea is simple in that what could be done over the counter will be allowed over the internet. The similarity in service even goes so far as that we will not allow pro-active selling in the internet but that it must be passive in the same way that we require that selling of non-banking services over bank counters must be passive.

In terms of e-commerce, what that means is that logos of non-bank service suppliers in the bank's web must not be on the main page. Transactions with the suppliers must be done by transferring into the supplier's web rather than on the bank's web services and, of course, the bank's client, must log in. The banks may not push their services onto their clients' computers.

A lot of our advisors asked why banks cannot behave in the way of best interest to the bank, doing whatever they wish. This, of course, applies to many other things that we do not allow banks to do and the answer really is that we still wish to see "banks doing other services", rather than "other businesses also offering banking services". This is because banks are critical organs of an economy and they should be separately supervised and examined such that they are safer than other activities which might be allowed to fail more easily.

Virtual banking, defined as banking without counter services, is still not allowed. The only thing that we have decided in this new and expanding area of the economy is that if the e-commerce service takes deposits, a banking license must be sought before the services could be offered.

But like many things in life, it is not where you are, but how fast you are going, how fast you are catching up that is more important, and in this respect we are working assiduously to formulate the new rules so that we can join the leaders in the change to the New Economy - new rules with the reliability that is always so necessary in any kind of good banking.

In summary on our financial institutions' developments, they are going ahead very fast and they will have good rules to perform to, but I must admit we are coming from way off, and have a long way to go before we are competitive in our own country let alone abroad.

Ladies and gentlemen,

So far I have talked at some length about the macroeconomy, good governance and developments in our financial institutions. Even if all the things I have outlined about Thailand were to happen, many people think that the economy would still be prone to instability unless the central bank is also revitalized. I am inclined to agree with them.

For some reasons not yet identifiable, and that worries me because a good change normally only can happen when the problems have been clearly identified. But in any case, there were signs that the Bank of Thailand somehow has been sidetracked into the crony capitalism of the rest of the economy, a development whose job it is of the central bank to try and prevent.

It was obvious therefore that the Bank of Thailand had to be restructured into an organization that would be effective and neutral. Extensive work was therefore done employing re-engineering concepts using consultants as necessary.

The six management levels have now been reduced to two, with people of different capabilities at the second tier depending on the importance of their work.

At the operating level, there are also only two levels. At the top is the head of the business groups, again of different job sizes. The next level is four kinds of work units reporting in a hierarchy or directly reporting to the head of business groups depending on the best way the work can be undertaken.

This is in place of the previous system where there were six management levels and only one level of operation, which made for lengthy approval processes and inadequate delineation of responsibility.

Personnel systems have also been totally redesigned with career development, performance and potential evaluation, as well as succession and replacement plans being already effective or soon to be implemented. A cornerstone of this may well be that at certain levels promotion is by examination rather than selection allowing capability to be a key determinant rather than just the traditional ability to get on well with people, primarily young superiors.

In the more difficult areas of manpower, recruitment and pay structure, work has just begun or will begin early next year as this requires that the restructure of organization and work processes be rather complete. The restructure has still to be extended into a fully bank-wide process, whereas at present re-engineering of work processes and organization has begun at only four of the 25 businesses groups.

Pay schedule will also have to be redesigned and here probably lies the biggest single difficulty, as in the lower-ranking jobs under the present scale, some people are paid five times more than another doing the same job. As this has been the system for a very extended length of time, one ends up with a lot of people being paid a lot and doing very little. As such, people don't move on in jobs or move out of jobs if they are not competent as might happen with a proper pay system.

However, a problem identified is halfway solved as the saying goes. And I am happy to note that outsiders and stakeholders who have had to work with the Bank of Thailand lately are very receptive to the change and are saying much nicer things about us and our work. I also sense that the staff are seeing that things are better and will probably give enough support to the restructure.

Ladies and gentlemen,

To get back to the topic of the economy: two years ago I said that we would reduce interest rates as the basic strategy for saving the country. This we have done and now the 14-day RP, the monetary instrument we use to transmit monetary policy to the general economy, is at only 1.5%. The lowest lending rate is 7.5% - what a difference from when I talked to you two years ago.

The currency is now at around 42 baht to the dollar, which some people consider weak. Yet when compared to the 22 competitor countries, it has not much depreciated in the last two years.

Exports being our only area of sunshine, we have to make sure that the increasing exports are maintained until such time that investment or consumption is taking place normally and this can only be done with a low interest rate and a competitively priced baht.

For this reason, it is our belief that the low short-term interest rate, coupled with the long-term interest rate of the same level as the EU and the US, is a correct strategy that we will try to maintain.

Inflation is still low, around 2% headline and less than 1% core. This looks like a good level of economic numbers to nurse and nurture an economy that is still weak and recovering with a capacity utilization of only 54%.

Astute investors will I think see all this and invest in the country just as they did two years ago when I lowered interest rate from the very high and unbearable level to the low level of today, against many contradictory advice from people who should know better.

Whilst nursing the economy though, let me emphasize that we intend to put in mechanisms to improve the sustainability of growth and stability, some of which occurrence I have outlined in this speech, and others we are working on as we learn more and more about the economy and improve the accuracy and speed of our data collection and dissemination system.

Ladies and gentlemen. In ending my statement let me recall that I began by stating that we still have plenty of problems. At least we are no longer underestimating them.

We have especially uncertain government with general elections coming up very fast. We have not effected the management change in our financial institution needed for the organization truly to absorb modern technologies.

The Bank of Thailand Act as well as the Financial Institutions Act have not yet been passed by Parliament. The latter was designed to facilitate change to financial institutions. The former was to make the Bank of Thailand independent or some degree of it depending on what will get through Parliament in the end.

There are different opinions on this - on what the Parliament will want, on what the government wants, and on what the Bank of Thailand wants. But among central bankers, it is well known that the independence needed to execute a sensible monetary policy cannot just be legislated.

It must be earned.

This I think we have done to no small degree, so I'm not unhappy about this most important area of central banking.

Let me, therefore end my statement on this rather hopeful note.