

Bandid Nijathaworn: Global markets outlook

Opening speech by Mr Bandid Nijathaworn, Deputy Governor of the Bank of Thailand, at the Global Markets Outlook Conference Series 2007, organised by Deutsche Bank, Bangkok, 8 January 2007.

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Thank you very much and good morning,

First, let me thank Deutsche Bank for inviting me to give the opening remark this morning. Last year, I was also honoured with the same opportunity, so I am very pleased to be back doing this again this year, addressing this important conference.

A lot of things have happened to both the global markets and to Thailand since the time we met last year. And compared to last year, to be speaking on the economy and the markets this year, I think, is much more challenging. At this time, although the mood in the markets is positive, I think considerable uncertainty still looms in the global economy to the extent that even the best of our analysts still do not seem to be coming to a common view on the key issues. For example, the pace of global slowdown and how much further would the US dollar need to adjust. But, this is, in essence, the nature of markets, and a variety of views will provide the markets with the needed latitude and balance for its continued growth and stability. So, I very much look forward to today's conference, and to the presentation on some of these issues, as well as on this year's outlook.

As for my part this morning, given the limitations of time, I want to share with you my thoughts on a few issues that I think will be important for the global economy and for Thailand this year. These are my own views on the global outlook and the implications for Thailand.

First, the global economy.

Conventional market view at this time is for the global economy to slow somewhat from last year, growing at about 4.9 percent compared to a growth of 5.1 percent last year. So, as the numbers suggest, the current view is for a moderate slowdown, reflecting for the most part a slower pace of expansion in the US. This is essentially a soft-landing scenario in the sense that the US will experience only a moderation in growth without major adverse impact on asset prices.

From Thailand's point of view, the slowing of global growth will have important implications for our export sector. Exports, particularly last year, have been the key driver of Thailand's performance. Therefore, for the economy to continue to maintain its momentum, it is important that we see in Thailand this year a stronger turnaround in domestic demand, especially in private sector investment.

For the global financial markets, I think three important implications are likely to emerge from this year's slower growth.

First, inflation is likely to be less of a policy concern across the major economies compared to last year. This means liquidity should continue to be ample as monetary policy in the major economies need to focus less on inflation. Ample global liquidity, therefore, will be a positive factor for financial markets this year.

Second, structurally, the US dollar may need to stay with its softening tone on account of the moderated US growth and the possible narrowing of interest rate differentials that used to benefit the US dollar. This is a conjecture consistent with the current market's fundamental view.

And third, because of ample liquidity, cross-border capital flows look to gain further momentum this year as international investors continue to search for yield and move further ahead on asset reallocation and diversification.

This last implication is important for the region, because it will mean continued flows of capital into Asia, putting pressure on the region's exchange rates and asset prices. Therefore, managing the macro implications of persistent capital inflows, as well as the risk of volatile and abrupt capital outflows, will be, in my view, an important policy challenge this year.

To me, the context underlying these implications relates very closely to the process of the unwinding of global imbalance. Such unwinding, as we know, requires a weaker path of the US dollar and higher US interest rates. A weaker US dollar is something that we have been seeing. As for interest rates,

going forward, it is not yet certain whether the US long rates would need to rise in order to facilitate the financing of the US current account deficit. This would depend essentially on the relative ease with which the US deficit can be financed. So, I think we need to watch these developments closely because financial markets can adjust much more rapidly than the real side of the economy.

Turning to the Thai economy.

Last year, the economy showed considerable resilience, notwithstanding many adverse shocks affecting it, especially the higher oil price and political uncertainties at home. Growth, estimated at about 5 percent last year by the market, is satisfactory while the second round effects of the oil price increase on inflation were well contained. Overall, the economy's fundamentals remain sound with economic stability intact.

Last year, monetary policy in Thailand was focused on limiting the second round effects of the oil price increase on inflation. That focus I think was well met. Policy rate has been held steady from midyear last year, and since then, inflation pressure looks to be moderating. Latest data show a further consolidation of inflation in December. So, under the current softening trend, barring no surprises on the oil price, there is also a possibility that, in Thailand too, inflation could be less of a policy concern this year. Under this scenario, therefore, there could be greater room for monetary policy to aim for a balance between growth and inflation.

I noted earlier that, to ensure continued momentum of expansion, what we need to see in Thailand this year is a stronger turnaround in domestic demand, especially in private sector investment. This is, in a way, the most important must-have macro development for Thailand this year.

Financial environment supporting private sector investment, I think, is very positive and conducive this year, with lower oil prices, easing domestic inflation, ample liquidity, and a more stable interest rate environment. But to substantially lift investment, what we need to see in Thailand is a continued improvement in business sentiment and confidence. Here, therefore, lies an important issue for policy. On this, I am quite confident that the ongoing efforts by the Government to promote growth with stability will successfully lead to continued improvements in business sentiment and confidence, which will be positive for our investment going forward.

I want to end my brief remarks this morning with a few year for our domestic banks and financial firms as they continue to support the economy while preparing for a number of important regulatory changes that are set to take place this year.

Beginning this month, Basel II will be launched in the G7 economies. For Thailand, this means we will have less than two years to prepare for our own eventual adoption of Basel II, which has been slated for end 2008. At this time, most banks in Thailand have already decided on using the standardized approach for the calculation of minimum capital. And to prepare for Basel II, we will be asking our banks to begin reporting their capital under the new standardized approach from the third quarter of this year onwards, in parallel with the usual calculation under Basel I. This, I think, will be an important exercise for our banks before we formally begin Basel II at the end of next year.

This year will also see financial firms in Thailand adopting the IAS39 accounting rules for the valuation of collaterals, which will affect their loan provisioning. We will see the Bank of Thailand implementing consolidated supervision, and we will see the whole financial system going through a formal FSAP assessment with the IMF. All these will happen this year, and all these will be positive developments for our financial system.

So, 2007 should be another active and positive year for the global markets and for Thailand. But given the uncertainties that still loom in the global markets, I think maybe we should move to meet the optimism and the challenge of this year cautiously. But this is the words coming from a central bank, which probably and usually sounds too careful. So, I guess now you may want to hear something different from Michael Spencer and his team. So, on this note, let me end my brief remarks and wish you all a successful conference.

Again I want to thank Deutsche Bank for the invitation, and a happy new year to all of you.

Thank you.