

Tarisa Watanagase: Prospects and challenges for the Thai economy in 2010

Dinner talk by Dr Tarisa Watanagase, Governor of the Bank of Thailand, at the British Chamber of Commerce, Bangkok, 30 November 2009.

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Distinguished Guests, Ladies and Gentlemen,

First of all, I would like to thank the British Chamber of Commerce for inviting me to be here tonight. It is my pleasure to join you once again at this prominent annual gathering.

Last year we had a fruitful discussion on “What determines the future of the Thai economy”. If you may recall, I imparted on the audience some words of wisdom for all policymakers, which is to smooth short-term pain, and to achieve long-term gain. Last year’s speech took care of the latter part, in which the key message was a call for collective efforts to raise the economy’s potential output in order to achieve sustainable long-run prosperity. We, however, did not spend much time on the former part as we were yet to witness the complete fallout from the collapse of Lehman Brothers.

Today, we all know that our get-together last September was at the onset of the greatest economic contraction over the last 60 years. The collapse of Lehman Brothers on Sep 15, 2008 created a gigantic shockwave in the world financial markets with its ripples subsequently evolving into an economic tsunami that wiped out so much economic well-being all over the world. Its consequences are still being felt today and the focus of policymakers has, therefore, shifted to the immediate task of giving the economy a quick resuscitation and lifting it out of the short-term slump.

After the crisis, foreign direct investments from the eurozone have dropped significantly. However, despite the weakness back home, the UK’s net FDI to Thailand still managed to register a positive number of approximately 48 million USD for the first three quarters of 2009. It is, therefore, to our mutual benefit for the BCCT to have a good understanding of the outlook and challenges for the Thai economy from a policymaking standpoint. This will be the mission of my speech today and I would like to proceed in the following sequence: **First**, I would like to start by giving you an update on the current economic development; **second**, I would attempt to draw an outlook for the Thai economy for the year 2010; and **third**, I will outline the key challenges that await the Thai economy going forward.

Ladies and Gentlemen,

As you all know, the Thai economy was hard-hit by a sharp drop in the external demand caused by this global financial crisis. The spillovers from the large decline in exports were far-reaching and affected all sectors of the domestic economy, with the manufacturing sector being hardest hit. Consequently, sentiment turned gloomy as more workers started to lose their jobs. To make matter worse, the escalation of internal political tensions adversely affected private consumption and investment.

With the timely implementation of accommodative fiscal and monetary policies, the world economy has seen a quicker turnaround than originally expected. The most recent economic data indicate that the world economy has stabilized. This was shown by the fact that the recession has ended in several countries with positive quarter-on-quarter growths from the second quarter onward. More importantly, financial institutions that were the origins of the crisis have appeared to become much more stable, though not yet returned to normal. This was reflected by indexes measuring concerns on liquidity and credit risks in the financial

market such as the 3-month Libor spread and the external debt market spread which have continued to adjust downward.

For Thailand, the green shoots started to emerge in the second quarter, owing primarily to a pick-up in the world's demand, large government's stimulus packages, accommodative monetary policy and strong economic fundamentals. The recovery of the world economy has augured well for Thai exports as the sector has turned into an expansion of 5.3 percent in the third quarter. As a result, the manufacturing sector in the same quarter grew by 2.6 percent, while the capacity utilization rate rose from a low of 54.8 in the first quarter to reach 62.4 percent at the end of the third quarter.

In addition, domestic demand has also been boosted by accommodative monetary policy and a rise in public spending, causing private consumption and investment to grow at 1.0 percent and 3.7 percent respectively in the third quarter. As a result, the overall GDP growth for the quarter came in at 1.3 percent on a quarter-on-quarter basis.

Ladies and Gentlemen,

In 2010, the Thai economy is expected to stay on the course of a gradual recovery due to two important factors. First, the continued world recovery, and second the fiscal stimulus. Let me go into each of these briefly.

First, the IMF and market consensus expect the world economy to return to positive growth next year, owing primarily to monetary and fiscal policies of the industrialized economies that are expected to remain accommodative. Emerging market economies including Asia are expected to rebound faster and stronger than developed economies. This is because Asia's financial sectors were not directly affected by the current crisis. Brighter prospect for the global economy next year means our export sector can continue to be our main growth engine going forward.

Secondly, the government spending under SP2 or the Strong Thai scheme will also continue to support the nascent recovery. As we are all aware, we cannot indefinitely rely on fiscal stimulus to keep the economy going so it is our hope that public spending will eventually crowd in private demand so that the recovery will continue after the stimulus tapers off.

Now let me turn to the risks associated with this outlook. Despite several good signals, the recovery of the world economy is still subject to a number of downside risks. In particular, the fact that unemployment rates remain high despite the pick-up in economic activities has led many people to worry that this might be a "jobless recovery". This high unemployment, if prolonged, could have a deep and lasting impact on both consumption and the potential growth of the US economy. Moreover, consumption in the US will be adversely affected by the decline in household wealth as well as the increase in personal saving rate.

Other issues which may exert downward force on the world recovery include the high level of public debt which may put upward pressure on long-term interest rates and the US and other advanced countries' financial sectors which are still weak and may not be able to support the recovery of the economy.

On the domestic front, the downside risk comes from the ability of the government to swiftly execute the SP2 investment projects. In other words, the disbursement may not proceed as expected due to the lack of capacity to effectively implement many projects simultaneously. More importantly, political unrests which affect the stability of the coalition government may distract, disrupt, or in the worst case, discontinue the disbursement process.

Taking both upside and downside risks into consideration, the Bank of Thailand's Monetary Policy Committee assessed that the Thai economy is expected to recover gradually, supported by better global economic outlook and accommodative monetary and fiscal policies. Meanwhile, the inflationary pressure continues to be subdued for the time being. The MPC, therefore, decided to maintain the policy interest rate at 1.25 percent per year

during the most recent meeting. At the same time, the BOT is expecting that the Thai economy will return to a positive growth of 3.3–5.3 percent in 2010.

Ladies and Gentlemen,

I believe we have a consensus that the worst of the global economic crisis is already behind us. At this juncture, policymakers and businesses are starting to look beyond the crisis and gauging what lies ahead. At the Bank of Thailand, we envisage the following three challenges for the post-crisis era.

First, the outlook for Thai export market will not be as good as the pre-crisis period. This is because the global financial crisis is likely to reduce both the purchasing power and the potential growth of Thailand's major trading partners, especially the industrialized economies. Moreover, as the unemployment rates continue to increase in the G3 countries, protectionist sentiment may be intensified in an attempt to protect jobs at home.

It is a common knowledge that, since the 1997 financial crisis, Thailand has relied on exports as our primary engine of growth. This dependency is expected to continue for quite some time as our domestic demand is not large enough to substitute the purchasing power from abroad. Therefore, exporters need to be more adaptive, while policymakers need to ensure supportive policies. Having said that, it does not mean we will abandon our efforts in rebalancing our growth engine more towards domestic demand going forward. This can also be done as the balance sheet of the private sector is still in good shape.

Now I would like to turn to our **second challenge**: As the world economic recovery begins to find more solid footing, the exit from the unconventional measures and the return of monetary policy towards the normal level becomes an increasingly important issue. Israel, Australia and Norway are already leading the way. However, it is a great challenge for policymakers to exercise an exit strategy with appropriate pace and time so as to ensure that the exit does not create unwarranted impacts on the economic recovery. On the one hand, a premature exit can derail the recovery. On the other, a delayed exit can lead to rising inflation and asset price bubbles. On top of this, the coordination of exit policy among countries is also important. For instance, the removal of deposit guarantees should be simultaneously implemented in order to avoid a disruption which may be caused by the shifting of deposits from a country that has lifted the guarantee to another country that has not.

On balance, it is expected that emerging economies including Asia are likely to recover first as our economic fundamentals remain sound and the banking system is in a position to support economic recovery. As a result, interest rates in emerging market economies are expected to be raised faster than the industrialized countries. These interest rate and growth differentials against the backdrop of ample global liquidity are breeding the carry-trade behaviour with the USD as the funding currency this time.

This leads us to our **third challenge**, which is how to prevent the surge in capital inflows from creating unwarranted instabilities such as excessive volatility in the currency market and asset price bubbles. In response to this challenge, we are beginning to see some countries such as Hong Kong, Korea, Singapore and China tightening their prudential standards to cool down speculative pressure in the real estate sector. In addition, Brazil has recently imposed measure to slow down the inflows of fund into its stock market.

In the case of Thailand, net capital flows have turned positive in July and continued to remain so, causing the Thai baht to strengthen as the current account is also in surplus. Nevertheless, the Thai baht has been moving in line with other regional currencies and the Bank of Thailand remains vigilant in ensuring this continues to be the case. In order to make capital flows more balanced, we are in the process of furthering the liberalization of capital outflows. This would also increase the flexibility of our businesses in financial management.

As for the issue of asset price bubbles, while the signs of accelerating asset prices observed in many countries in Asia are not so apparent in Thailand at this time, the risk is not

neglected. As a matter of prudence, the Bank of Thailand will continue to closely monitor asset prices to ensure financial stability prevails in the long term.

Ladies and Gentlemen,

I would like to conclude my speech tonight by reiterating that the economic recovery in Thailand is expected to continue going forward. Nevertheless, the risk of an aftershock is not negligible due to fragile global and domestic environment. Hence, businesses and policymakers alike need to remain vigilant, but at the same time, should not be overcome by unreasonable fear. One important factor that will help speed up the process of recovery is the return of investment and trade within the country. With our economic resilience and strong economic fundamentals, I would like to assure you that Thailand remains a lucrative place to invest.

Despite this difficult time, the BCCT has always been a great supporter of our investment programs, an example of which is your *Thailand Means Business 2008* report which is very relevant in terms of attracting new or re-investment from British businesses. I hope that this long relationship will continue to be as good as ever or even better in the coming years.

Thank you.