Tarisa Watanagase: Current topics of the economy and monetary policy of the Kingdom

Dinner talk by Dr Tarisa Watanagase, Governor of the Bank of Thailand, to the Japanese Chamber of Commerce, Bangkok, 24 March 2010.

*   *   *

Good Evening,

Ladies and Gentlemen,

First of all, I would like to thank the Japanese Chamber of Commerce for the invitation to speak again at this annual event. It is indeed a great pleasure to be back here for the institution that has, for a long time, been playing a key role in promoting a closer cooperation and better understanding between the Thai authorities and the Japanese business community in Thailand.

Tonight, I would like to focus my remarks on three issues. The ***first*** is Thailand's current economic conditions and outlook. The ***second*** is the key challenges for policymakers going forward. And the ***third*** is the Kingdom's policies to ensure a sustained growth recovery along with price and financial stability.

Many of you may recall that my speech here last year took place during the most testing time for both the global economy and policymakers. In the western economies at the core of the crisis, the financial and real sectors have been severely impacted. And for Thailand, it was the first time in ten years that the Thai economy registered negative growth, as the collapse in global demand led to a sharp contraction in the Thai exports.

Fortunately, the global economy has now turned the corner and recovery has continued to gain stronger momentum. The latest figures have indicated the better-than-expected recovery of the global economy and financial markets due to the large, timely and broad-based economic stimulus measures that have been implemented to combat the crisis.

In most countries, manufacturing production and trade have improved, while rebounding consumer and business confidence has helped boost the private demand. As for the financial system, de-leveraging and the tightening of credit underwriting standards have moderated. Banks have gradually rebuilt their strength and become less dependent on the support from government facilities.

Ladies and Gentlemen,

Let me turn to the case of Thailand. Our successful navigation of the Thai economy through the crisis can be credited to two key factors. The first is our strong economic fundamentals including the resilient financial system as a consequence of intensive and continuous reforms since the 1997 Asian crisis and the second is the timely implementation of both monetary and fiscal stimulus measures.

You may remember that, the Bank of Thailand has reacted decisively and preemptively by lowering the policy interest rate by 250 basis points to a historically low level of 1.25 percent, while the Thai government launched massive stimulus packages and other measures to help relieve households' cost of living through the difficult time.

As a result of these policies and the revival of the global economy, our GDP data for the fourth quarter of 2009 shows solid growth and momentum, growing 5.8 percent year-on-year and 3.6 percent quarter-on-quarter, one of the highest in the region and the world. The latest data for January also shows continuation of a broad-based economic recovery in all sectors.

- Our manufacturing production index rose at 28.6 percent;
- Exports grew at 31.4 percent;
- Private consumption expanded at 4.7 percent;
- Number of inbound tourists are now exceeding 1.6 million for the second consecutive months; and
- Farm income has improved noticeably from mid-2009.

All of these have been instrumental in reducing the unemployment rate of our economy from the peak of 2.4 percent during the crisis to a near historic low level of 0.9 percent, with some sectors such as electronics and automobile industries now starting to experience labor shortages.

These are exactly the picture of the economy that we are hoping and looking for: growth that is based on confidence of consumers and investors that feel secure enough about their jobs and business prospects. So much so that it leads to the renewal of consumption and investment activities, especially the consumption of durable products such as cars, refrigerators, and televisions as well as the purchase of new home and new investment projects.

Going forward, the prospect of the Thai economy remains robust. The momentum of the recovery is expected to continue into both 2010 and 2011. Our latest economic projection as of January 2010 suggests an economic expansion of 3.3–5.3 per cent in 2010 and 2.8–4.4 per cent in 2011, with an increasing role of private investment replacing government expenditure, which will gradually subside since the need for continued fiscal stimulus wanes as the economic growth becomes self-sustaining.

Here, I would like to point out that this projection is due for a revision in April. With the stronger-than-expected performance in the last quarter of 2009, it is highly likely that these numbers will be revised upward.

Ladies and Gentlemen,

Having pointed out a fairly positive outlook, I will now turn to the second topic of my talk: the key challenges going forward and I must quickly add that looking ahead there are both external and domestic uncertainties. Policymakers therefore will have to be watchful and well-prepared to implement appropriate policy to ensure continued growth momentum amidst these challenges.

First, the global economic recovery, particularly those of the industrialized economies, remains fragile and subject to downside risks. In spite of the higher-than-expected growth in the fourth quarter of 2009, the US economy is still beset by high unemployment, continued deleveraging, and weak financial institutions. All of these will have dampening effects on domestic demand, especially consumer spending – the main growth driver for the US economy. At the same time, concerns on the Eurozone's sizable fiscal deficits especially those of the peripheral economies may trigger another round of confidence problems.

Furthermore, the exit policy especially of the major economies could spill additional risks to the ongoing global recovery. Their timing and speed will be crucial. The action that is either too early when the economy is not sufficiently robust, or too late when inflationary pressure and/or economic imbalances have already been formed will have important implication on recovery, price and financial stability.

Second, emerging economies, Thailand included, face the challenge of sizeable and volatile flows of capital due to their better growth prospect and sooner policy normalization vis-à-vis G3 countries. These flows could lead to volatility in foreign exchange markets and might potentially create financial imbalances. From the data thus far, we have seen sizable inflow of capital into some of the Asian countries such as Korea, Taiwan, India, and China since the second half of 2009. And in the last couple weeks, this money started to flow into Thailand.

Third on domestic front, as you are well aware, Thailand also faces two major uncertainties: the problem of Map Ta Phut and the on-going political unrest.

I believe the “Map Ta Phut” problem is of the most interest to Japanese investors, and therefore I would like to say a few words. At present, the authorities have put all efforts to achieve the resolution of the problem, given its implications on the country’s future investment prospect, industrial practice, and economic recovery. So far, the processes of the EIA, HIA, and public hearing processes have been formalized and the government is now in the process of establishing independent agencies which will be responsible for evaluating all of the proposed investment projects. It will take some more time, but progresses are being steadily made.

In my view, the “Map Ta Phut” problem is only a temporary hiccup in Thailand’s long record of investment-friendly climate and rapid industrial development. It can be seen as part of a growing pain that developing countries such as Thailand experienced as it becomes more developed. On the positive side, it should provide opportunity to forge a closer coordination among related parties and establish a clear process in achieving sustainability of industrial development.

As for the second issue, I think, it is too early at this point to put out an exact estimate of its negative impact on the recovery process.

Should the problem takes time to resolve itself, the negative impact on the economy will become more visible especially on the tourist industry and private consumption. These, together with the severe drought that we have been experiencing thus far, may somewhat dampen the robust economic momentum that we carry forward from the fourth quarter of last year.

Ladies and Gentlemen,

I would like to turn to my last topic: Thailand’s economic policies going forward, starting with our monetary policy strategies in 2010.

In the last few months, we have seen slight upward price movement with both headline and core inflation rates turning positive since the fourth quarter of last year. Currently, headline and core inflation for February 2010 are at 3.7 and 0.3 per cent respectively. The turnaround was due to a combination of the base effects from oil prices and the pick-up in domestic demand.

Looking ahead, with the firming economic recovery, inflationary pressure is expected to increase further, with core inflation forecasted to surpass the midpoint of our target range of 0.5–3.0 percent by the end of the year.

Thus, it is clear that in the near term, policymakers need to perform a delicate balancing act that would at the same time ensure a continued growth momentum, the anchoring of inflationary expectations, and the containment of potential financial imbalances.

In light of the solid fourth-quarter GDP figures and January’s economic indicators, the current extraordinary accommodative monetary policy stance will be of less need for the Thai economy. Furthermore, an over-extended period of low interest rates can lead to heightened inflation expectations or financial imbalances such as asset price bubbles, as this crisis has vividly demonstrated in many countries.

To this end, the timing of monetary policy normalization will be important so that it will not jeopardize economic recovery particularly as private investment has yet to pick up enough pace. Thus, I would like to assure you that, we will put our best effort in considering its timing carefully.

As for dealing with consequences of capital inflows, we see the current managed float exchange rate regime as appropriate and beneficial to the Thai economy. We will continue to let the level of exchange rate be determined by market forces, but make sure that it is not too volatile to the extent that it will be too difficult for the private sector to adjust to.

And to give the private sector greater flexibility to manage foreign exchange risks, last month we further relaxed restrictions on Thai direct investment abroad and on the unwinding of foreign exchange hedges. These moves, which are parts of our ongoing capital account liberalization plan, will also make our capital flows situation more balanced, by facilitating two-way foreign exchange flows.

On the fiscal front, you will agree that fiscal policy is one of the key instruments to support the economy during the difficult times when private sector growth engines have been impaired. However, the stimulus packages that the government announced last year, have been done on the assumption that Thailand will face the most severe global recession in the last 60 years. But as it turned out, the global crisis was not as severe as thought. Given that our economy is on the robust recovery path, the need for stimulus may be less. And the government should also find the way to normalize the fiscal policy stance at an appropriate time.

Here, the latest development on sovereign debt crises in Europe underscores the importance of the restoration of our fiscal discipline. If there are no changes in our policy, the ratio of public debt to GDP will increase to over 60 percent by 2012. This will not only leave little room for the government to use more fiscal stimulus should there be a new crisis in the region or in the global economy but it could also put Thailand in the spotlight of the foreign investors who have become much more sensitive to the issue of fiscal sustainability.

This is why we have to rethink the stance of our fiscal policy once the short-term political and economic uncertainties fade away. Furthermore, to ensure fiscal sustainability over the medium to longer term, Thailand will need fiscal reforms that include:

- Continued fiscal consolidation;
- Broadening of our tax bases;
- Reforms to increase the efficiency and equality of the tax system; and
- Greater allocation of public spending toward investment expenditures.

Indeed, the government realizes the need for fiscal consolidation and reforms. With the better-than-expected tax revenues, thanks to the solid economic recovery, the budget deficit for this fiscal year and the extent of public debt will probably be lower than originally expected. The government has also taken initiatives to work on some reform measures such as the introduction of property taxes. These are commendable initiatives that remain to be seen whether will be successfully implemented.

Ladies and Gentlemen,

Looking forward, Thailand has no other choices but to embrace the force of globalization. This means that we have to continue to integrate our economy to the global economy and world financial markets. And a closer cooperation with economies in the region would then be a vital factor that will help strengthen the overall recovery and enhance the potential of Thailand in the global stage.

This is why we continue to engage in free trade agreements both on a bilateral and multilateral basis, for example, the ASEAN Free Trade Agreement (or AFTA) that should facilitate intra-regional trade and technological development. And at the same time, we also need to prepare ourselves for the coming volatilities in the flow of capital. As of noon today, our ***Chiang Mai Initiative Multilaterization (CMIM)*** will be in effect to provide the swap lines of foreign exchange liquidity for the ASEAN+3 countries during periods of liquidity or balance of payments distress.

I am certain that these closer integration and cooperation will be critical for our success together as a region in new global economy after the crisis and Thailand is looking forward to working with the Asian communities and especially with Japan, one of Thailand's closest friends and economic partners, in achieving our potential.

Thank you for your attention.