Tarisa Watanagase: Enhancing Thailand's resiliency against economic turbulence

Address by Dr Tarisa Watanagase, Governor of the Bank of Thailand, at the 4th Annual Euromoney Thailand Investment Forum: The Economic Perspective, Bangkok, 6 July 2010.

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Prime Minister,

Distinguished Speakers and Guests,

Ladies and Gentlemen,

First of all, I would like to thank Euromoney for the invitation to speak to this gathering of prominent members of public and business sectors. I welcome this opportunity to share with you some thoughts on Thailand's economic and policy issues at this very challenging juncture.

As we all know, the Thai economy has been through one of the most turbulent periods due to the global impact from the US sub-prime crisis and the European debt crisis. Despite the difficult external environment compounded by political problem and weak sentiments at home, it is clear that the Thai economy has been able to cope with shocks quite well. Thus far, what the economy experienced has been a mere cyclical downturn, in tandem with the contraction of global demand.

The good news is that ***nothing about our economy amplified the impact of these external and domestic shocks and I call that economic resiliency***. Unfortunately, the less good news is that a small open economy like Thailand will be prone to more shocks, especially through international trade and financial market linkages. So, we need to accept this fact and make ourselves as resilient as possible to ride the waves.

Against this background, my talk today will focus on three parts. First, I wish to discuss the progress of Thailand's economic recovery and the importance of starting policy normalization. Second, I will highlight the four key strengths underlying our economic resiliency – the strengths which we can continue to improve. Third, I will focus on the medium-term issues that we must work to enhance so that the economy will become more resilient to external developments and increasing volatility.

This time last year, we were highly uncertain as to when the global economy would bottom out, and whether there was danger of a double dip in the recovery. Today, we have already witnessed robust growth rates in Thailand and other Asian economies, starting the fourth quarter of 2009. This has been achieved notwithstanding the gradual recovery of the G3 economies, and financial market volatility following the European debt problem.

Looking back at the downturn, fiscal spending played a very important role in cushioning and boosting up the economy. While external demand was still weak, we saw the surge in public sector spending to jump start the economy and avoid a potential downward spiral in domestic demand. But, once global economy is back on a recovery track, our exports have started to grow strongly, in particular, in electronics, electrical appliances, and vehicles. In fact, our export sector has already recovered to the pre-crisis level.

As the growth momentum gained strength, domestic consumption started to pick up. Overall, the conditions for recovery look favorable enough and there is general optimism that the Thai economy looks set on a continuous growth path. That said, a key weak pocket in the current recovery process appears to be the domestic investment climate but even that should get better as the external environment is improving.

Unfortunately, the political unrest during April–May had somewhat set back the recovery process. Most activities slowed down during May on a month on month basis. The tourism sector, in particular, was hit hard. In May, the number of foreign tourist arrivals in Thailand declined by 11.8 percent year-on-year. Correspondingly, hotel occupancy rate fell to 34.9 percent, mainly from a significant drop in Bangkok and the central region. Nevertheless, the impact was rather confined. The occupancy rate in the southern region remained intact at 45.5 percent, higher than the last 5-year average of 42.9 percent.

On the whole, we expect that the second quarter GDP growth would be less buoyant than that of the first quarter. Nevertheless, economic data during April–May came out better than expected, reflecting the ongoing momentum of the Thai economic recovery led by exports. In fact, the export value in May continued to expand by 42.5 percent year-on-year in line with favorable expansions in all export categories and markets.

Ladies and Gentlemen,

Despite headwind from both external and domestic factors, it is now important to embark on policy normalization, both fiscal and monetary policies. ***As the Thai economy is getting stronger, returning fiscal and monetary policies gradually to pre-crisis normal levels will not obstruct the recovery path***. Rather, it is essential to enhance our economic resiliency and save the policy space for the medium term.

For our ***monetary policy***, it has been extra-eased for quite some time and there is less need now. Although the domestic inflationary pressure has been kept in check and we have not observed asset price bubbles at this time, the central bank is well aware of the risks associated with the interest rates that are kept too low for too long. The crisis in the United States was a clear demonstration of how this can lead to a build up of bubbles. And, once bubbles burst, the cost to the economy is devastating. Central banks always face a tough decision, whether and when to take away the punch bowl before the party gets going. That said, we will put our best effort in considering the timing of interest rate increase carefully.

On the ***fiscal policy***, normalization is also important. As the economic recovery strengthens, actual revenue collection has already surpassed the target by as much as 2.9 percent of GDP, and fiscal deficit has started to shrink. However, as several new spending plans to enhance social distribution and build new infrastructure appear to be in the pipeline, the fiscal policy challenge is how best to preserve adequate fiscal policy space for future cyclical and structural spending needs. The financial market turmoil due to weak confidence following the European debt problem is a costly lesson learnt on the importance of fiscal sustainability, an issue which will be closely watched by the investor.

Let me turn now to the second part of my talk. As economic turbulence would be more prevalent going forward, ***we need to maintain the strengths that have thus far helped make Thailand's economy resilient***. These are prudent risk management by key sectors of the economy as well as prudent policies.

First of all, ***the Thai economy has an overall moderate risk exposure***. Our government and private sector were right not to build up too much risk exposure. This did not happen by chance but out of everyone's recognition of risks associated with high debt burden. Over time, private sector's debt-to-equity ratio has come down significantly, now at 0.7, from around 3 folds during the 1997 crisis. Our banking sector, despite ample liquidity, was very cautious and had a minimal exposure to CDO-related assets at the onset of the US sub-prime crisis. The banks were wise not to follow the bandwagon in search for high yields abroad, which in turn helped protect their balance sheet strengths.

Second, the key economic sectors have sufficient insurance against risks. Our household sector was not excessively leveraged while the corporate sector has always maintained healthy retained earnings, although in part reflecting unfavorable domestic investment climate.

As for the banking system, we have built up sufficient bank capital, partly benefited from our prudent risk management. Our supervision developments have also come a long way. With intensive and continuous legal and regulatory reforms since the 1997 Asian crisis, our financial system is now resilient and in a good position to support growth. On this note, let me also say that the Bank of Thailand holds regular meetings with representatives from both Thai and Foreign Banks Associations, as well as meetings with their top management to discuss current issues and policy implications. This dialogue helps us to continuously strengthen risk management such that the financial system will remain in a strong position to serve the real economy efficiently.

Third, thanks partly to export diversification over the years, Thai export is now recovering strongly despite a considerable shock to trades. A decade ago, Thailand relied mostly on G3 countries as our export market, but now, ASEAN market as well as BRIC (i.e., Brazil, Russia, India, and China) and other new destinations are emerging strongly and help diversify risk from the G3 countries. We also did not get much impact from the European debt crisis since our exports to PIIGS countries (i.e., Portugal, Ireland, Italy, Greece, and Spain) account for only 1.8 percent of total exports.

Despite an impressive export growth now, Thailand needs to become more resilient against greater competition by an increasing number of emerging markets. Thailand is somewhat in an awkward position currently, being left behind by the NICs, and being caught up by countries like China and Vietnam, to name a few. ***It is therefore important to extend efforts beyond market diversification to promoting higher value along the production chain, a task that both the private sector and the Government have a role to play. Especially with the rising FTAs as well as other regional integration and cooperation, notably among ASEAN, we must work to make sure that Thai producers and exporters can fully utilize the benefits from these arrangements.***

Fourth, prudent policy has obviously shielded us from the contagion of external developments so far. In addition to the importance of fiscal discipline and debt sustainability which I have already highlighted, I would like to stress that ***monetary policy has not and should not be used as an instrument to boost short-term growth. However, it can help cushion the economy against growth contraction in the short run, while ensuring stability in the long run***. In this past crisis, the adverse effect led us to a series of aggressive rate cuts during December 2008 to April 2009 in order to help shore up the economy. The rate cuts were timely and turned out to be effective, in view of the momentum of economic recovery achieved.

Regarding the framework of monetary policy, I should stress that the Bank of Thailand's policy framework has always emphasized, not only monetary stability, but also financial stability. We have also developed over the years and have been equipped with a broader and more in-depth surveillance that now covers household, financial, and real estate sectors. This is important for early detection of imbalances and enables preemptive policy action to prevent costly bursting of bubbles. Importantly, the process of monetary policy decision itself has been institutionalized, and independent from political influence. I therefore have no concern today whether who will become the next governor since a good system for policy decision making is already in place.

Going forward, one of the important policy challenges facing us is the sizeable and volatile capital that flows to emerging economies, including Thailand. This is due to their better growth prospect and earlier policy normalization vis-à-vis G3 countries. Apart from the policy measure to try to shield ourselves from the adverse impact, the private sector also needs to remain vigilant about risk by not building up excessive risk exposure and by employing more risk protection tools as well.

I turn now to the third part of my presentation that is what we can possibly do more to enhance Thailand's resiliency over the medium term. On this issue, I would like to reiterate briefly what I said earlier in my annual statement regarding the urgency to elevate Thailand's fundamental strength to cope with the changing structure of the global economy. Specifically, there are three issues that should be considered priorities.

First, in light of the changing global financial landscape and regulatory environment, continuing to strengthen the financial system is an important agenda for both the authorities and the financial sector. ***The financial system must remain focused on risk management, as well as be competitive and responsive to customers' demand for access, and more variety of products and services.*** Such a financial system is necessary to efficiently support and grow with the economy.

Second, given the changing structure of the Thai population, ***fiscal reform is vital to address the ageing society. At the moment, only one-sixth of the labor force is in the tax base.*** Tax revenue thus accounts for only 16 percent of GDP, half of that of developed countries. So improving the tax restructure is one of the priorities to be addressed to enhance fiscal sustainability as well as overall social welfare of the country.

Third, we need to continue to elevate Thailand's competitiveness by enhancing our productivity, both in industries and agriculture. Productivity gain in agriculture, which accounts for the majority of population, in particular, will also help increase farm income and reduce poverty. Improvement in productivity, of course, involves a whole range of issues from more effective training, education, investment in research and development, to infrastructure investment – all of which require long-term commitment of both the public and private sectors.

Ladies and Gentlemen,

I am pleased to say that these medium-term priorities are well-recognized by both the authorities and the private sector. The Second Financial Sector Master Plan and the First Capital Market Master Plan have already been announced. The Government is working on tax reforms and a few infrastructure projects have been decided upon, some of which already launched. Although at an early stage, and it may take some time before these tasks of longer-term nature will start to bear fruits, I believe that Thailand is set on the right course of economic progress.

Indeed, the private sector continues to see favorable investment opportunities in Thailand. ***Despite current uncertainties, the expected Business Sentiment Index (BSI) has improved in recent months, boding well for further investment going forward. Our discussions with several domestic and foreign chambers of commerce also confirmed similar positive sentiment and confidence in Thailand's strength by long-term investors.*** This positive opinion has also been evidenced by a stable level of BOI investment privilege applications similar to last year's. For our part, the Bank of Thailand has recently amended our regulations (effective June 11, 2010) to allow multinational corporations to set up treasury-center operations to facilitate more efficient financing flows in Thai baht and foreign currencies.

To conclude my remark today, I would like to reiterate that, with resilient economic fundamentals, the prospect of the Thai economy remains robust in the medium term. I believe that going forward gradual policy normalization of fiscal and monetary policies will enhance our economic resiliency and provide more policy space for the future.

In closing, I would like to wish all of you successful and fruitful discussions during this two-day conference. I hope that the speakers and participants will reflect upon what Thailand has done right and what we can do more for the Thai economy. In particular, I believe it is equally important for the private sector, as much as the public sector, to play the role in strengthening Thailand's long-term economic fundamentals, especially the priority areas I mentioned. Having done some of the right things does not mean that we can be complacent, since the economic challenges will not get any easier in the current and future global environment.

Thank you.