Bandid Nijathaworn: Thailand's economic outlook – an update

Speech by Mr Bandid Nijathaworn, Member of the Board of the Bank of Thailand, at the Australian-Thai Chamber of Commerce dinner talk, Bangkok, 14 July 2010.

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First, let me thank the Australian-Thai Chamber of Commerce for the invitation. This year has been a particularly challenging year for Thailand, on account of both developments in the global economy and the political situations at home. So, what I want to do today is to give you an update on Thailand's economic outlook, particularly to see what these challenges have meant for the Thai economy, as well as for the outlook going forward.

A keyword this year is "uncertainty". As you well know, the market does not like uncertainty because it raises risk and costs. For the global economy, this year has been an exceptionally "complicated" year because of the two major uncertainties that have contributed to an unusual degree of volatility in global financial markets.

The ***first*** is uncertainty surrounding the strength of global economic recovery which has been weighed down by the high levels of unemployment and slow bank-lending growth in the advanced economies, as well as prospect for higher long-term interest rates in the major economies linked to the financing of public sector deficits. This is the first uncertainty.

The ***second*** uncertainty is policy. For the advanced economies, it is the uncertainty about the timing of exit policy, and whether the commitment to fiscal consolidation by the major economies can be sustained given the adverse implications for growth. For emerging markets, there is uncertainty about the policy approach that emerging markets will use to manage large capital inflows particularly in Asia. This involves the policy choice between exchange rate management, monetary policy, and the use of macro-prudential and capital control.

In my view, uncertainty about policy has been of most concern for financial markets, resulting in increased volatility and a constant shift in investor sentiment between risk aversion and risk appetite. As for Thailand, in addition to the global uncertainties, we also have our own home-grown uncertainty linked to domestic political developments, which have added another dimension of risk to economic recovery and to the prospect of Thailand's growth in the longer-term.

How has the Thai economy performed so far amidst all this risk and challenges?

Today, an important decision was made by the Bank of Thailand's Monetary Policy Committee to begin a process of policy normalization by raising the policy interest rate by 25 basis points to 1.50 percent. The decision represents the first increase in fifteen months since the policy rate was reduced cumulatively by 2.5 percentage points to cushion the economy from the global recession. But more importantly, it also marks an important turning point in our assessment of the economy's growth and inflation outlook, taking into account the impact of the political situation. I want to share with you this assessment, which can be summarized in three main points.

First, economic recovery in the first half of this year is firm, and the momentum is likely to continue in the second half, supported by global economic recovery, accommodative fiscal and monetary policies, as well as the strong momentum of recovery itself. As for the impact of the political turmoil, April and May data clearly suggests that the impact is limited and the collateral consequences will be felt largely in the tourism sector which will take a bit longer to recover. For the whole of this year, we are expecting growth to be higher than the range of 4.3–5.8 percent that we had forecasted earlier in April. So, similar to other economies in the region, Thailand should recover firmly this year, and the recovery momentum should carry forward into the next year.

Second, with the economy recovering well, inflationary pressure is set to increase going forward, reflecting the impact of stronger domestic spending and also higher commodity and raw material prices in global markets. Also, going forward, pressure on asset prices will become more evident on account of continued capital inflows into the region. Therefore, with pressure on prices edging up and the recovery momentum looking firm, the move to begin policy rate normalization is a logical one for maintaining economic and financial stability. So, the decision today is not a surprise for financial markets, rather it is a decision that is long-overdue.

The ***third*** point is the risk to growth. For the most part, we still see developments in the global economy as a key downside risk to Thailand's growth this year. A key risk at this time is the strength of global recovery in the second-half of the year, given a more limited room in the advanced economies for using fiscal stimulus to drive growth because of concern over longer-term fiscal sustainability and the risk of eroding inflation expectations. Another issue is the possible spillover of concerns over sovereign debt onto the European banking sector. Domestically, the drought situation seems to have improved substantially after a bout of plentiful rainfall country-wide. Finally, we have risks relating to how Thailand's political situation will evolve going forward. This is an issue which remains a known-unknown to most Thais.

For this evening, I have been asked to dwell a bit more into the interactions between politics and the economy in the context of what has been happening in Thailand. Without getting too much off track, let me end my remark with three personal observations on this point.

First, it is clear that politics does affect the economy and its performance. The channels of impact come largely through: (1) disruption to normal businesses from unsettling political events as we have seen in the last two years; (2) its effects on the country's image internationally which negatively effects our international sectors such as tourism and exports; and (3) its impact on investor confidence due to the perception of political instability. These are the short-term impacts or shocks, that once they happen, the economy will need to adjust to.

My ***second*** observation is that the Thai economy so far has been resilient in adjusting to such shocks. As I noted, the impact on the economy from the April and May political events seems to be limited. This positive quality can be attributed to the economy's strong fundamentals and the high sense of tolerance by the Thai public. If, however, such shocks are more frequent or of a longer duration, they can erode the capacity of the economy to adjust to future shocks.

And the ***third*** observation is that political instability, if it persists or worsens further, will have adverse implications for Thailand's long-term economic performance. This is because political instability affects policy continuity as well as divert the attention of policymakers away from the longer-term issues. If that happens, the lack of a clear long-term policy can discourage the flows of future investment, both domestic and foreign, thereby limiting the economy's capital formation and potential growth.

Fortunately, Thailand is not yet at this stage. Investment both private and public, are still growing. And at the Bank of Thailand, we always approach the policy decision with a longer-term perspective. Today's decision to begin the process of policy normalization is a clear example of decision taking with a view of preserving longer-term economic and financial stability. This is what we do and this is what we will continue to do.

Let me stop here. I hope this brief remark has been useful. Again I want to thank the Australian-Thai Chamber of Commerce for the invitation. Thank you.