Prasarn Trairatvorakul: The rise of Asia – finding the right balance for policy

Address by Dr Prasarn Trairatvorakul, Governor of the Bank of Thailand, at the Japan Bank for International Cooperation (JBIC) seminar on "Outlook for the Global Economy and Financial Markets 2011", Bangkok, 8 February 2011.

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Distinguished Speakers and Guests,

Ladies and Gentlemen,

It is my honor and pleasure to address today's distinguished audience on the outlook of and the main challenges facing the global and Thai economies. Rather than giving you data and projections, which are readily available, I would like to take this opportunity to share with you my observations on the economic future of Asia and Thailand. While economic recovery in the West will likely be constrained by crisis legacies, the rapid bounce-back in Asia and its fast rising role in the world economy have made many believe that Asia is on the continued rise, to the extent that Asia is entering a golden age. Nevertheless, there are questions whether Asia can manage the risks associated with continued growth, particularly inflationary pressure and the impact of volatile capital flows.

In line with this introduction, my presentation today will focus on four related topics. First I would like to pose a question whether Asia is truly approaching a golden age. Secondly, to sustain the rise of Asia, I would like to highlight the need for Asian economies to build capacities, as well as strengthen innovation and productivity. To follow, I will discuss the role of policy in and ensuring that growth is sustainable and not prone to relapses, especially ways to mitigate potential economic and financial imbalances. And finally, I will explain how the Bank of Thailand intends to find the right balance for policy to foster businesses and investment during the rise of Asia.

Ladies and Gentlemen,

Since the ancient Greek and Indian times, a golden age refers to a period of peace and unity, stability, and rising wealth, with an abundance of hope and opportunities. Evidence has pointed out that Asia has increasingly embraced these characteristics.

In terms of peace and unity, we have witnessed increasing international cooperation to boost economic welfare and safeguard against risks in the region. For ASEAN, this has been reflected by the increase in free trade and investment agreements both bilaterally and under the ASEAN Economic Community. In a broader group, the ASEAN+3 countries have been working closely to set up and improve a committed mechanism for regional crisis prevention and management.

As for economic stability, I think that the robust recovery, low level of public debt, together with sufficient foreign reserves have demonstrated that Asian regional economies have the satisfactory capacity to cope with future shocks.

In terms of increasing wealth, it is clear that the share of emerging Asia in world GDP has been increasing markedly with a status as a global production hub of manufactured goods. This is projected to rise even further. While this share was around 8 percent in the early 1980s, it is expected to increase to 30 percent in the middle of this decade.

Although the above evidence has indicated that Asia is on the rise, whether or not this rise will be sustained will depend on a number of factors. To do so, Asia needs to become a global innovation hub, and rely significantly more on our own domestic and regional demand. Moreover, we also need to assess whether prosperity will spread to all of the regional economies.

Ladies and Gentlemen,

Against this hopeful background, we need to reflect on the positioning of Thailand. As long-term business partners in Thailand, I am certain that Japanese businesses have carefully assessed the prospects of Thai economy in comparison with our peers in the region. And, I think we share a common view that Thailand needs to climb up the value chain in order to benefit from the expansion of the regional production network. This is a very important challenge as competitiveness from low labor costs will evaporate, and there is a risk of being marginalized in the increasingly competitive environment.

Recognizing that Thailand needs to come up with concrete plans and strategies to foster capacities and productivity, the Bank of Thailand has emphasized on various occasions that our economy needs to have a clear development strategy. In fact, several Asian countries have already announced goals ranging from becoming world leaders in science, technology or human resource development.

However, the common key success to all these strategies is investment. Increasing and improving physical and human capital is vital for ensuring and fostering opportunities in the future period of growth. And foreign direct investment will continue to be a significant source of knowledge and technology transfers as well as productivity improvement.

Yet for businesses to make long-term investment commitments, it is necessary that economic fundamentals be conducive. This is where policymakers can help encourage investment expansion and, in the purview of the central bank, this means finding appropriate ways to mitigate risks to economic and financial stability.

As all of us are aware, the main risk at present can arise from massive capital inflows from outside Asia and potential abrupt reversals as a result of the divergence in economic growth between the advanced economies and emerging Asia.

While the growth outlook for Asia is positive, there are still significant risks to the recovery in the US, the Euro area, and Japan, including unemployment, high public debt, and the housing slump. In these countries, policies continue to focus on shoring up their recovery and strengthening their own momentum of growth, with monetary policy remaining loose.

This is in stark contrast to Asia's emerging markets, where the threat of inflation is real and present in the near term. Inflation is expected to rise, given rising costs and rising demand, allowing producers to pass on cost increases to consumers. In addition, rising demand from emerging markets can potentially further push up commodity prices and inflation expectations. Therefore, anchoring inflation expectations and ensuring long-term price stability is the policy priority in emerging Asia, and in Thailand.

The policy divergence between advanced and emerging economies will make it difficult for both sides to arrive at any policy coordination which could lead to a win-win situation at a global level. Countries will likely pursue their self-interests in conducting policy, despite the externalities such policies may bring about. While it is unlikely that we will achieve a solution that would satisfy everyone, I would like to stress that we should aim to prevent ourselves from ending up in a lose-lose situation for all, such as a return to protectionism.

Ladies and Gentlemen,

As Asia is on the rise, another source of risk is that complacency can easily set in, both in the private sector's risk taking behavior and in the way policy is conducted. You may recall that almost 15 years ago, Thailand was also part of the "Asian Miracle" and was on track to becoming the 5th "Asian tiger", before unsustainable behavior led to the Asian economic and financial crisis.

In order to prevent the mistakes of the past and guarantee that future growth in Asia is sustainable, both the private and public sectors must not be complacent. To ensure these costly mistakes are not repeated, policies must be firmly grounded on safeguarding macroeconomic stability.

This leads me to my final point, which is, how the Bank of Thailand plans to deal with these potential risks on both the external and internal fronts. For external risks, recognizing that sizeable capital inflows could be out of line with real developments, and that spillovers can persist in the near future, we need to closely monitor the external environment to capture these risks. It is also important to improve Thailand's capacity to cope with international capital flows by developing a systematic capital flows master plan, and promoting the use of financial hedging instruments and the foreign exchange risk management capability of the private sector. The Bank of Thailand also stands ready to implement emergency measures of varying degrees to deal with volatile capital movements as appropriate.

In addition, to prevent these inflows from causing economic and financial instability, the Bank of Thailand has prepared a toolkit of macro prudential measures to ensure the soundness of the macro economy and the financial sector. Measures to prevent overheating in particular segments of the property market are one example.

Ladies and Gentlemen,

It would be uncommon for a central banker not to mention inflation and monetary policy in any speech. I would therefore like to emphasize that the Bank of Thailand's monetary policy aims to achieve domestic price stability and tighten to more normal levels consistent with Thailand's macroeconomic fundamentals. Price stability helps foster a stable and predictable macroeconomic environment conducive to investment and growth. This is because it helps investors, businesses, and household to effectively make plans and manage their risks, as well as lower businesses' cost of funds.

To end my remarks today, I would like to stress that while there remain risks and uncertainties surrounding the overall outlook for global growth, prospects for Asia remain relatively bright. However, countries in Asia, and Thailand especially, need to put real efforts to foster capacity, innovation, and productivity. We must also prevent excessive risk taking and lax policy-making from becoming the norm. This requires preempting excessive risk-taking and conducting policy with prudence.

I can assure you that the Bank of Thailand is committed to ensuring a stable macroeconomic environment which would help investors, businesses, and households in planning their economic activities and to operate effectively. However, policies can mitigate only parts of the spectrum of risks. The business sector must also be mindful and well-prepared to deal with new risks and challenges, going forward.

Thank you.