

Prasarn Trairatvorakul: The strength of the Thai economy and future development in Thailand's financial system

Speech by Dr Prasarn Trairatvorakul, Governor of the Bank of Thailand, at the British Chamber of Commerce, Bangkok, 4 September 2012.

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Ladies and gentlemen,

First of all, I would like to thank the British Chamber of Commerce for inviting me to give a keynote speech at this prestigious gathering. The Great Britain and Thailand have built strong economic relationship and business ties over the decades. Within Europe, the Great Britain is by far the second biggest trading partner of Thailand, accounting for 13.9 percent of total trade volume between Europe and Thailand. In terms of foreign direct investment, Britain is also the second most important investors among European nations, particularly in banking, real estate, and retail sales sectors. I, therefore, hope that Thailand and Britain will continue this strong tie both in terms of trade and investment, and to prosper together in the future.

The past few years have brought us many economic surprises and challenges. After severe floods took a toll last year, Thailand is currently facing much challenge from the global economic downturn, particularly from the continued Euro debt crisis and more intensified global competition. Despite this backdrop of strong headwinds from abroad, I believe that ***the Thai economy will be able to sail through.*** I am pleased to say that during the first half of this year, post-flood recovery has been robust. Production constraints continue to ease, while private sector demand is back on track. The growth momentum in the period ahead is likely to sustain, driven mainly by domestic demand. We expect that economy will grow at 5.7 percent this year and 5.0 percent next year.

This episode of rapid growth recovery is that it also witnessed macroeconomic stability. Thailand has a long history of low and stable inflation, averaging around 3 percent over the decades. The unemployment rate in recent years has also been low at around 1 percent. Meanwhile, external position remains solid with moderate short-term external indebtedness. The banking sector has been safe and sound with sustained profitability amidst the ongoing global financial crisis. Despite capital inflows into Thailand, there appears to be no sign of asset price bubble while the degree of leverage in the corporate and household sector is still low. Such promising outlook is reflected in Thailand's sovereign credit rating which has been stable at investment grade despite intermittent political tension.

At this juncture, please allow me to highlight ***a number of Thailand's fundamental strengths that underpin this positive outlook.*** First, our ***corporate sector remains competitive with accumulated robust savings and profitability.*** This fact is well evidenced by their healthy balance sheets and their ability to explore investment opportunities overseas. Net profit of most listed companies in the second quarter 2012 turned out be positive despite damages inflicted by the floods. With strong financial positions and more trade liberalization, an increasing number of firms have gone overseas, as indicated by a marked increase in Thai Direct Investment from \$3 Billion in 2007 to \$.10.6 Billion in 2011.

Second, ***supportive fiscal and monetary policy*** has helped enhance growth while continuously strengthened stability in the Thai economy. This achievement has been attributable to responsive fiscal and monetary policy, together with market-friendly regulations aimed at keeping the economy operating close to its potential. The rapid recovery from the great floods last year amid global economic uncertainty has revealed the importance of fiscal stimulus and government efforts in restoring public confidence. At the

same time, the expansionary monetary policy stance has helped accommodate business restoration process.

Third, ***Thailand has a strategically well placed- location*** for international investors to benefit from rising Asian integration. The rise of China and the ASEAN Economic Community (AEC) evidently provide enormous opportunities for businesses operating in Thailand to expand and prosper from enlarging market size and integrated regional supply chain. Automotive and electronics industries are prominent examples that have long gained competitiveness after establishing complex supply chain-hub in Thailand and obtaining a critical foothold in the region.

Finally, ***the Thai financial system has been resilient to the global financial crisis***. And the key reason for the banking sector's resiliency is that our financial system remains relatively non-complex. The financial transactions are derived from real economic activities, and hence risks are understandable and manageable, with lending to domestic companies accounting for 70 percent of loan portfolio and the rest is mainly mortgage loan.

The direct exposure of Thai banks to European countries is also very small. Investments and loans made by Thai banks to Europe are only 0.3 percent of total assets, while claims on Thai banks by European countries are even smaller at 0.03 percent of total liabilities. Nevertheless, we will be watchful of the second round impact of the EU crisis, particularly via impact on exports that could impact asset quality.

Apart from the existing solid fundamentals outlined above, Thailand is currently striving to develop a more efficient financial system to anticipate increased regional integration. The key driver and rationale behind this momentum is clear. ASEAN economies aim to increase competitiveness from increased economy of scale and scope, and technology transfer, with link up of supply chain of ASEAN and ASEAN plus 3, in particular. This, in turn, will help strengthen our competitive position in the global market.

Thus, the vision of financial sector is that it should seamlessly facilitate this process, whilst safeguarding financial stability. It should be emphasized that economic integration in ASEAN is not aimed to reach the same level of integration as EU, as the single currency and monetary union is not on the agenda.

The banking sector liberalization agenda includes discussion on harmonized standards of regulations, which is key criteria for licensing, as well as financial stability arrangement. This will be finalized this year, with timeline of liberalisation in 2014 to 2020, depending on country's readiness. Capital market integration will also be important to ensure that regional market becomes deeper and wider, to serve growing needs of growing and large investment projects to link up the region's production and infrastructure. Moreover, it will also help to intermediate capital inflows into the region in a more efficient and stable manner. Regional capital market will also be important for managing the growing pension funds of the region, where some countries are facing growing savings but aging population. It will offer a regional alternative to the currently fragile market in the west.

How well prepared is Thailand for this?

The banking system already has high degree of foreign participation. Market share of foreign banks and hybrid banks is 20 percent. The foreign banks also accounts for about 50 percent of transactions in OTC derivatives market here. These main players in foreign and hybrid banks include banks from the UK, EU, US, Japan, and China, as well as banks from Singapore and Malaysia. Thus, the banking system and Thai banks are familiar with international competition. Thai banks already have presence in all ASEAN countries, except Brunei. And for this, the AEC will help reduce barriers and enhance business operations of Thai banks abroad.

The Financial Sector Master Plan phase II, for 2010–2014, has outlined to the banks the timeline of increased competition, and thus banks have prepared themselves. In line

with this, we have already announced that existing foreign bank branches can open up to 20 branches in Thailand if they choose to become local subsidiaries with capital base in the country. We are also assessing the possibility of allowing new restricted banking license 2012–2013, and possibly new commercial bank license in 2014 if such banks facilitate our regional economic and investment policy.

Finally, let me turn to the progress in capital market to complete a picture of the financial sector. **Collective action of both public authorities and private sector since the ASEAN crisis has rebalanced our financial market from a predominantly bank-based to a more balanced one with a growing role of capital market.** Sizes of the bond and stock markets have noticeably increased. Number of market participants has also been rising with a more variety of financial products. Moreover, since March 2012 the Thai capital market has been upgraded to the Advanced Emerging Market status in the FTSE Global Equity Index Series from Secondary Emerging Market status. **More exciting development is expected to continue under the 5-year Capital Market Development Master Plan which was established in 2009. Apart from the internal push, ASEAN exchange linkage under the vision of AEC is taking place this year** to allow global investors to trade ASEAN blue chip stocks at lower costs through a single platform. This initiative will ultimately raise the visibility of ASEAN capital market and continue to attract more capital flow.

To sum up, as economic integration and upgrade of efficiency and competitiveness is key to our development, Thailand's financial system is geared to facilitate this process. To do so, financial liberalisation will play a key role, with contribution by ASEAN banks as well as foreign banks operating in this region.

Ladies and gentlemen,

I would like to reiterate that with solid economic strengths and a wide-ranging development in Thailand's financial system, the Thai economy will continue to be resilient in the face of the dismal global outlook. The BOT is fully committed to sound monetary policy conduct and financial-sector development via the Financial Sector Master Plan as well as play a supporting role in Capital Market Development Master Plan.

Let me end my remark by thanking the British business community for substantial contribution to our economy. Your contribution will not only strengthen our long history of economic partnership but also bring economic prosperity to both Britain and Thailand. I very much hope that the mutually beneficial ties between British and Thailand will blossom into the future.

Thank you