Pongpen Ruengvirayudh: Challenges in the rotating world

Keynote address by Ms Pongpen Ruengvirayudh, Deputy Governor of the Bank of Thailand, at the Thomson Reuters FX Awards Ceremony 2013, Bangkok, 27 March 2013.

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Distinguished guests, Ladies and Gentlemen,

1. It is an honour for me to join the Thomson Reuters 2013 FX Awards Ceremony today. I would like to take this opportunity to congratulate the winners of the FX awards this year and to thank all market participants, as well as Thomson Reuters, for your contribution to the development of the Thai foreign exchange market. For the winners of the awards this year, one is reminded that the awards are given not only for the outstanding achievement on business grounds, but also as recognition of the notable efforts in enhancing market efficiency. So a hearty congratulation for a job well done!

2. As you know, much has happened over the past few years, both at the global level and within the Thai economy. The global economy has shown signs of improvements, although in a measured pace, but reactions from the financial markets seem to run ahead of developments on the grounds. For many of us who have seen the global economy and financial markets over many business cycles, such euphoria and exuberance can be expected whenever global risk sentiments improve and investment strategy shifts toward more risk- taking. Today, a new theme or the so-called “The Great Rotation”, has taken the center stage. However, such turnaround may lead to new concerns and challenges going forward. Today’s event thus provides an opportune occasion for us to deliberate and exchange views on this topical issue.

3. Although latest economic data point to stronger growth momentum and smaller tail risks, uncertainty and short-term threats still remain. For example, the situation in Europe can easily come back to take centre stage thus providing a reality check and a pointed reminder that structural problems take time to resolve. Besides, anti-austerity pressure could delay ongoing reform efforts. This may, from time to time, raise uncertainty and spark volatility in the market. Meanwhile, improving economic outlook in the US needs to be tempered with reality of the fiscal drag and the near-term risk from spending cuts which can come back to hit market sentiment. Thus, we should proceed with care since the market has somewhat overly priced in the global recovery story.

4. The challenges from the great rotation can be viewed in two dimensions. ***First,*** risk preference has shifted from safety to riskier assets with the improved global sentiment. Particularly, global stock markets have rallied far beyond the modest global recovery. This can be seen in the MSCI World Index which surged by almost 25% during the last 9 months while global growth remains at low level.

5. Rallies in stock prices on the back of over optimistic sentiment may sow the seeds of potential bubble. Although the market realizes that a further rise in the asset price would virtually compress yield, the market appears to be less concern about a bubble in asset prices. Therefore, there is a risk of a sharp correction which we all witnessed in the recent episode in the Thai stock market last week.

6. The ***second*** dimension of the great rotation is the global fund flow, which is one of the greatest challenges emerging markets are experiencing. The continued monetary easing in advanced economies, economic growth differential and protracted low interest rate environment are key factors pushing investors to search for yield; fund flows have therefore switched from advanced to emerging economies.

7. This second dimension of the great rotation is a concern to policymakers in the region and has called for wider public discussions among academics, businesses and policymakers. Discussion typically centred on the potential recourse to macroprudential or unconventional measures on the part of recipient countries, given that such practice has been adopted by the source countries of the fund flows. As market participants, we all recognize the benefits of capital inflows that provide a two way view for the market, thus adding depth and breadth to emerging financial markets. Therefore any considerations on the use of capital flows policies need to be carefully thought out with consideration of potential unintended consequences and impacts. Needless to say, there is greater acceptance for these measures to be part of the toolkit of the authorities and *central banks are continually monitoring the markets and ready to take actions in cooperation with regulators and market participants.*

8. To respond to the surge in inflows, the BOT has chosen the route of capital account liberalization as the most natural counter to encourage the outward flows of capital. We believe that this measure will help lessen the pressure from the rotating fund flows as well as provide the opportunity for Thai enterprises to secure new markets in preparation for the ASEAN Economic Community (AEC). The roadmap includes relaxation in outward direct investment and portfolio investment. In addition, the BOT has allowed Thai corporates to issue foreign exchange denominated bonds domestically. There is no reason why a reputable Thai corporate should have to go oversea to secure funding if they are well known domestic household names that can mobilize funds at a more attractive rate domestically. Hence, the rotation in fund flow will be taken place at both ends; thereby balancing Out-In with In–Out flows.

9. Against the backdrop of a rotating world, the financial industry is confronted with tighter regulation. Since the collapse of Lehman Brothers in 2008 the world has been thrown in a global recession for half a decade. During this time the debate on financial reregulation has raged from public outcry over bonus compensation of bank CEOs to reregulation of financial services in the form of Basle III, Dodd Frank and similar regulations across the Atlantic. Under the current course, the trend towards tightened financial regulation is not likely to be reversed and we would all have to live to more regulation, though much of the new regulations were cure for diseases that were contracted elsewhere.

10. When speaking about financial regulation, I am reminded of the issue of transparency and governance. The investigation into the LIBOR scandal in major global financial centres and the consequent pursuit of similar investigation in regional financial centres point to the need for greater attention to market conducts. As market confidence is critical to the development of financial markets, any scandals may derail and set us back in the development process. We therefore have a duty to oversee that our markets function in a fair and transparent manner, to safeguard the reputation and trust of the users of financial services. In the past few years, the Bank of Thailand, with the help of key market participants, have put a great effort to promote our own reference rate – the BIBOR, so we have an interest to see that the market is transparent and inspire confidence among the users.

11. To enhance market conduct, the BoT in collaboration with the ACI are considering a code of conduct for FX dealers and brokers. This would institute a process by which these businesses, which are important infrastructure in the Thai foreign exchange market, are given attention and importance to ensure that they contribute to building confidence and trust.

12. In conclusion, let me congratulate once again the winners of this year’s FX Award. Let me also thank Thomson Reuters again for inviting me today. With the support and continued cooperation from all side, the Thai financial markets would continue to press on with the reform efforts that have been made over the years. These improvement will help raise the standard of practice and ensure that our financial market continue to make a positive contribution to the growth and development of the Thai economy which is the ultimate goal for sustainable development.

Thank you.