Pongpen Ruengvirayudh: Thailand in 2014 – recent developments and challenges ahead

Keynote address by Ms Pongpen Ruengvirayudh, Deputy Governor for Monetary Stability of the Bank of Thailand, at the Thomson Reuters FX Community Forum 2014, Bangkok, 18 February 2014.

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Distinguished Guests,

Ladies and Gentlemen,

1. It is a distinct pleasure to be back here again and I would like to thank Thomson Reuters for the invitation. To the winners of this year's FX awards, I would like to congratulate you on your notable achievements. And to the rest of the market participants, I would like to express my thanks for your continuing contribution to the development of the Thai foreign exchange market.

2. Much has changed both at home and aboard since I gave an opening address at this event last year. On the external front, the US Federal Reserve's planned scaling-down of its QE program has sparked turbulence in the emerging markets as investors continue to speculate on the Fed's exact tapering timeline. On the domestic front, the absence of political solutions continues to subdue public and private spending, with unavoidable repercussions on overall growth outlook. Certainly, the interplay between these recent developments will have profound implications for the Thai economy to some extent going forward. For this reason, I would like to take this opportunity to share with you my views on these important developments and the potential challenges they pose to the Thai economy.

3. Let me start with the developments on the external front. As you remember, around this period of last year, one of the issues that had attracted a lot of public attention was the continued influx of fund flows into the emerging markets including Thailand. But this theme has suddenly changed when the US Federal Reserve signaled in May its intention to scale down, and eventually terminate, its asset purchasing program. The signaling immediately sparked turbulence in capital and currency markets in emerging economies and certainly serves as a recurring reminder that the linkages in the international economy are as psychological as they are mechanical. From June to August, Thailand, like other economies in the region, continued to witness further episodes of outflows as investors continued to reform their expectations towards the exact tapering timeline.

4. In the recent months, turbulence in the markets seems to have somewhat been moderated. This possibly reflects the fact that much has been priced in during the earlier outflow episodes, as well as the fact that it has been clearer to the markets now that any further tapering by the Fed will likely be done in an incremental manner. This is, however, not to say that short-term volatilities are no longer with us. The challenges going forward for policymakers are, therefore, not only to have the right set of policy responses in place to deal with these short-term volatilities, but also to make sure that all the market participants are well prepared for the scenarios that could be expected.

5. Besides dealing with short-term volatilities, another related challenge that has come with the reality of QE tapering is maintaining strong economic outlook. Specifically, recent data seem to suggest that signs of economic softness that are reflected in, for instance, deteriorations in the current account performance and weak public finances, are likely to amplify the probability of abrupt flow reversals. That is, the remaining pool of funds seems to differentiate between their investment destinations based more on fundamentals, as is exemplified in the recent episodes of substantial outflows in some of the "Fragile Five" countries.

6. When looked at from this fundamentals perspective, Thailand's recent economic slowdown and political setback definitely come to mind as another growing concern. Particularly, manufacturing production and private spending have already shown signs of moderation in the midst of political uncertainty and poor economic outlook. This, combined with the likely additional delay in public spending, could have further dampening effects on growth. Moreover, should the current political situation persist, prolonged political instability will certainly have dire consequences firstly on the tourism industry but also eventually on our ability to maintain and attract the FDI flows. The country's higher credit default swap, if left unchecked, could lead to higher funding costs in the financial markets and certainly constitutes another challenge going forward. I do hope, however, that political uncertainty will be a short-term factor and that political stability will be achieved again once agreements are reached among the different groups in the society.

7. In the meantime, the Bank of Thailand has been keeping a close eye on the economy as well as any sign of excessive turbulence in the financial markets, and stands ready to take appropriate actions as warranted. In response to the weakening economic conditions, the MPC has cut the policy rate by 25 basis points at its November meeting to shore up sentiments and mitigate downside risks. The rate was further maintained in the last MPC meeting to retain the accommodative stance without compromising financial stability.

8. With that said, preparation on the side of the private sector is equally important. In this regard, I would like to encourage commercial banks to help raise the private sector's awareness and encourage the use of the available financial instruments to manage their FX risks. I wish to point out that in these uncertain times where outcomes are driven as much by expectations as by the underlying fundamentals, protection against the FX risks should be viewed as the dominant strategy. That is, protection should be recommended irrespective of whether there is any observable trend of the currency and irrespective of whether one is on the importing or exporting side of the trade. Also, if your clients are engaged in intra-regional trade, recommending using a regional currency to reduce overreliance on the major currencies may be worth considerations.

9. Ladies and gentlemen, I would like to touch upon two more important developments in the Thai financial markets before concluding. The first of these is the launch of the ***code of conduct for FX dealers*** by the end of this quarter. On behalf of the Bank, I would like to thank everyone involved, especially the ACI, for your considerations and suggestions that have made this long-term project a feasible one. I hope that the code of conduct will help guide fair and ethical market practices and increase confidence among the market participants for many years to come.

10. Another development is in the area of ***market reference rate reform***. The transaction-based valuations to the benchmark calculations for the Thai Baht implied interest rates (THBFIX) will be introduced in the second half of this year, in place of the current survey-based model. The change is in line with the approach adopted by many other countries to reduce the risk of rate manipulation that has become the subject of vast discussions over the past few years. With these reform efforts underway, I hope the Thai financial markets will continue to inspire confidence among the market participants and allow us to move through these uncertain times with minimum disruptions.

11. Ladies and gentlemen, without further delay, let me conclude by congratulating the winners of the FX awards once again. I would also like to reiterate my thanks to Thomson Reuters for the invitation as well as for your continuing support as an important facilitator and information provider in the Thai financial markets. With several factors both internal and external having materialized over the last several weeks, one can already see that 2014 will be yet another challenging year for the Thai economy. However, with cooperation from all sides, I hope we shall be able to weather the upcoming storms with a common vision and readiness, and that a clear blue sky is beckoning in the distance.

Thank you.