Prasarn Trairatvorakul: Managing Thailand's turnaround

Speech by Dr Prasarn Trairatvorakul, Governor of the Bank of Thailand, at the Association of International Banks (AIB) Dinner Speaker Series, Bangkok, 15 May 2014.

* * *

Introduction

It is my great honor and pleasure to be back here in this auspicious occasion, and, first of all I would like to thank the Association of International Banks for inviting me to give a talk this evening.

Much has changed, since I gave an address at this event last year. Though it is still warm and sunny in Thailand, the economic condition is not quite the same. The economy continues to slow down after accelerated domestic spending in the past few years, worsened by political uncertainty that continues to this day. On the external front, the recent global economic recovery and monetary policy abroad has evolved with less uncertainty than before.

For this exclusive evening, it is timely for me to share with you the recent economic developments and outlook of the Thai economy as well as our roles to support sustainable growth of the Thai economy and safeguard financial stability amid prolonged political uncertainty.

Recent and current economic situations

Let me first start by describing the economic developments. ***Thailand's recent economic circumstances have been unfavorable, but may have reached the trough.*** Internally, growth has decelerated since the second half last year, owing mainly to diminishing domestic spending. The champagne party, fueled by the first-car tax rebate and rice pledging schemes, has ended, and we wake up with a hangover: worsened traffic jams, an overflow of durable goods and high household debt. Adding to this backdrop, political tension rose and parliament dissolved late last year. This has dented private confidence and government spending, and puts further pressure on already-weak domestic demand. Loss of confidence means postponed public and private investment as stakeholders tend to wait for more stable economic environment before taking the next steps.

Last year, Thailand has not benefited from exports as we expected, due to weak global economic recovery and domestic supply constraints. Furthermore, tourism was negatively affected by the political situation.

With respect to the first quarter of this year, economic performance has been unsatisfactory so far and negative growth is predicted. Naturally, negative growth numbers may have raised concern regarding a recession. However, I would like to offer a ray of hope by pointing out that the ***second quarter of negative growth is unlikely to occur***, as the latest economic data for March suggests growth may have reached the lowest point. Furthermore the so-called "technical recession" would occur once economic fundamentals have simultaneously deteriorated, which is a lengthy process. To date, this situation does not apply to Thailand.

Looking ahead

Ladies and gentlemen,

Despite the heavy costs of political uncertainty, ***Thailand's underlying fundamentals remain supportive***. Looking at variables whose imbalances tended to be associated with crises in the past, we do not see these variables approaching crisis levels but rather staying at low risk levels. What we are observing is a mainly sentiment-led slump in demand and subsequently an opportunity for strong domestic rebound when sentiment improves. I would like to explore some key variables in more detail.

Financial volatility is well contained amidst economic slowdown. Exchange rate has been relatively stable and international reserves have remained high, reflecting some degree of confidence among foreign investors and appropriate exchange rate management. Inflation expectations are firmly anchored, allowing monetary policy some room to address the downside. We benefit from this stability because ***consistent macroeconomic policy commands credibility from the public***. It is worth mentioning a risk when it comes to volatility: that even with the Fed's QE tapering already factored into the markets, the monetary policies of advanced economies continue to exhibit likelihood of change. These policy changes could cause Thailand to experience capital outflows or a volatile exchange rate. The Bank of Thailand closely monitors these risks and currently assesses them to be manageable given Thailand's financial structure.

Credit risk is also moderated by the wisdom of the private sector. Private companies have recently kept leverage in check at a cautionary debt-earnings ratio. Financial institutions are carefully managing loan quality, as household debt levels that have been decelerating since last year indicate. Moderate leveraging of firms and households together with strong balance sheets of banks allow private sector to withstand economic shocks.

Unemployment rate is low and stable, leaving households with enough purchasing power to start spending again when the economy rebounds.

Greatly adding to the strength of domestic purchasing power is the export sector. Global recovery has become firmer as recent economic indicators such as Global Purchasing Managers' Index, or PMI, reflect the more resilient recovery in advanced economies. Nearer to this region, the decelerating Chinese economy is not a major cause for concern since it is more about economic restructuring than unexpected slump in domestic demand. The overall impact for Thailand is that ***exports are still expected to be our main engine of growth this year***. The risk to watch out for concerning exports, again stems from the monetary policy changes of advanced economies. These policy changes could cause economic slowdown in ASEAN and China and further affect Thai exports to these countries; however, this type of risk is still remote.

Other fundamentals include our location and workforce advantages. Thailand is located in the center of ASEAN and has well-developed logistics, and acts as a hub for trade with CLMV, presenting an opportunity to access fast growing markets. As for the workforce, our semi-skilled labor fills an important niche in the world market.

Looking at strong fundamentals just mentioned, we can see that ***Thailand's turnaround is no false hope***. Indeed, the return to net inflow of foreign investment since the beginning of April, indicates the return of foreign interest in Thailand.

However Thailand's structural improvement needs a long way to go. ***Furthermore, economic fundamentals can be eroded if political uncertainty and global risks intensify***. The prolonged political impasse will further reduce confidence, financial positions, and government spending. The labor force is already beginning to feel the stress, as recent surveys show the number of overtime hours worked has begun to shrink.

Now I have presented to you the future conditions, from sound fundamentals to possible risks. With these conditions in mind, I believe that maintaining status quo while waiting for the political situation to resolve is not the appropriate way out because sound fundamentals alone cannot lead to growth. ***Thailand should use the current lull in activity as an opportunity to reposition for future growth.*** Indeed the private sector is already in transition, but still has a way to go. Further investment will both jolt some energy back into the economy and build an even stronger foundation for long term growth.

Supportive roles of the Bank of Thailand and financial institutions

An economy in transition needs support from all sectors of the economy. The real sector, financial institutions, and the Bank of Thailand have their own important roles which I would like to elaborate.

Thailand's economy should ***transition from efficiency to innovation*** to build competitive advantages. Up to now, we have increased productivity by reallocating labor and capital. But this advantage diminished since the global financial crisis.

Firms may consider ***moving up the value chain to differentiate products and enhance value.*** There are two possibilities that exist in Thailand depending on the industry. The industries that are behind need to catch up with the ongoing trend, and industries that have the opportunity, can leap ahead of the trend. In either case, ***Research and development investment is needed***.

To address the issues just mentioned, Thailand's financial sector, which includes my esteemed guests for today and the Bank of Thailand, must set clear directions for our roles. To deal with the structural challenges, ***the private sectors need support from the financial sectors***. They will require long term and low cost funding, from both domestic and international sources.

Ladies and gentlemen, your operation of financial institutions with both caution and long term vision has so far contributed to financial stability in Thailand. We would like you to ***continue placing value in the long term, and providing liquidity for established customers*** who will definitely return to growth after Thailand's rebound. Such support creates long term value for your international investors and helps both your future returns, and to usher the economy through the slump.

For the Bank of Thailand's part, we continue improving financial system strength and efficiency. ***Further liberalization of financial services***, progressing as planned in Financial Sector Master Plan II, ***will provide Thailand opportunity for firms to have better access to funds at a more competitive price***, especially small businesses which comprise a large part of the workforce. This adds another dimension to Thailand's competitiveness and will help strengthen economic growth.

Now, let me turn towards the Bank of Thailand's other major responsibility – to balance between financial stability and economic growth. The role of monetary policy is to manage the financial environment to ensure macroeconomic and financial stability. ***The Monetary Policy Committee, or MPC, has maintained an accommodative monetary policy stance*** throughout the adverse shocks in the last couple of years.

In the current episode, we are conducting monetary policy to maintain a right balance between economic growth and financial stability, including inflation. The current policy rate which is negative in real term has already helped alleviate small businesses and households' interest burden and can help the private sector survive the short term slump.

Turnaround is coming!

Weak sentiment due to the uncertainty about the political situation is the root cause of the faltering domestic demand. Political resolution is beyond our scope, so it may be appropriate to ***focus more on the medium and long term strategy necessary to support the economic rebound*** once the political status improves. The collaboration between private businesses and financial sectors to deal with the mentioned structural challenges is required to lay a solid foundation of the future economy.

To conclude my talk today, I would like to reaffirm that ***our fundamentals are strong and that we in Thailand will do our best to regain full potential to achieve sustainable economic development***.

Let's think about challenges of the bear during winter. Even while hibernating, the bear cannot stay perfectly still. It needs to move and keep its muscles warm to prepare for spring. Thailand's current economic condition is like a winter, we stakeholders are the bear that is hibernating, and like the bear, we must prepare for the coming spring. ***If we keep playing our roles in managing the economic transition, we will all reap the benefits of the turnaround.***

Thank you.