Prasarn Trairatvorakul: Managing the economy at a crossroads

Speech by Dr Prasarn Trairatvorakul, Governor of the Bank of Thailand, at the Foreign Correspondents' Club of Thailand (FCCT), Bangkok, 3 July 2014.

* * *

Distinguished Guests,

Ladies and Gentlemen,

It is my pleasure to be here once again, to address the oldest press club in Southeast Asia. I congratulate you for the outstanding works in Thailand over these years. Journalism is indeed a special profession, one whose status is sometimes hailed as "the fourth pillar of the state" alongside the legislature, the executive and the judiciary. Such privilege comes with a somber weight of commitment to accurate reporting and balanced viewpoints. These qualities are needed more than ever today, as there is much public demand to understand the implications of the recent political development. I will share with you today my early assessment from a policymaker's standpoint, regarding the latest economic outlook and key challenges to public policy lying ahead.

Current economic assessments

First, let me give you a brief summary of where we are. The buildup of political tension late last year came at an unfortunate time for the economy. The economic activity was already hampered by weak domestic demand amid high household debt and a lackluster global economy. As the political uncertainties persisted, the repercussion on consumer and business confidence grew, denting private consumption and investment. The lack of a functioning government early this year also curtailed public finance capability, subjecting infrastructure investment to further delay and putting 2015 fiscal budget at risk. Tourism, a shining sector in 2013, was increasingly weighed by security concerns. A tepid recovery in exports offers only a partial offset to softening growth, and could not prevent the overall economy from contracting in the first quarter.

It is under this backdrop that the end to political stalemate in May provided some cause for short-term optimism. ***The first relief comes from a resumption of government spending.*** The presence of a fully functioning government ensures that the budget for 2015 fiscal year could be prepared on time, eliminating the risk of a Thai-style "fiscal cliff". An acceleration of public disbursement in the short-term is also providing a welcomed boost to the economy. Plan for public investment in infrastructure is now back on track, and there have been renewed efforts to maximize the efficiency of these projects.

A resumption of effective fiscal policy, in turn, lends support to domestic demand recovery. Repayment of overdue debt to farmers, approvals of backlog projects by the BOI, and fresh loans to the SMEs provided quick relief in and of themselves, but the combined multiplier effects could also be meaningful. By shoring up income and improving overall sentiments, these measures constitute an important effort to revive private spending. Fast indicators already suggest that private consumption and investment are stabilizing, and private confidence improving. We expect the recovery of domestic demand to gain more traction going forward, especially in the second half of this year.

In light of these recent events, our latest growth projection for this year has been revised upward to 1.5 percent. While this figure may be much lower than long-term potential growth of around 4 to 5 percent, it is chiefly dragged down by the first-quarter contraction – bygones if you like. From this quarter onwards, we anticipate a clear pickup in growth and a V-shaped recovery. Many independent forecasters are currently holding a similar view, and most have revised up their growth projections after the political turning point in May.

This brighter economic outlook is not without risks, however. Exports of goods in particular have underperformed thus far this year, despite their insulation from domestic political turmoil. A number of factors are at play, some temporary, others more secular. Weaker economic growth in regional trading partners, including China and ASEAN, has been one cyclical hindrance. Global trade also appears to be lagging global growth, limiting scope for emerging economies like Thailand to leverage on advanced economies' recovery. More deep-rooted structural issues at home may also be responsible, as segments of the manufacturing sector are not integrated into the modern global supply chain. For these reasons, exports may play a less active role in its contribution to growth this year.

On the financial stability front, we remain cautious but optimistic. Domestically, the prolonged period of economic slowdown has subjected indebted households and smaller businesses to financial strains. Loan quality for weaker borrowers has deteriorated somewhat as a result. The good news is that these risks have been confined to specific sectors, and the banking system remains strong and has weathered the slowdown very well, owing to their prudent risk management policies. Externally, we also cannot rule out further episodes of volatile capital flows owing to shifts in monetary policy abroad. Our economy has proven resilient to such shocks in the recent past, thanks to strong macroeconomic fundamentals and robust policy framework. We will closely monitor the adjustment process to ensure that risks to financial stability continue to be contained.

To summarize, the economy seems to be at an inflection point. The outlook for growth has improved following the political event in May. But a new set of challenges has also emerged. Now that political uncertainties have waned, what should be the priorities for public policy? What are key areas of needed "economic reform", and what should such agenda entail? This brings me to the second topic of my talk, that of challenges to public policy management during the current period of transition.

Challenges to public policy management

The agenda for economic reform under discussion today is wide-ranging and may at times seem confusing to the public. ***To organize one's thoughts, it might be helpful to revisit the basic role of government in a modern economy.*** At its most basic level, the government exists to provide services that otherwise cannot be carried out by private market – things like infrastructure, law enforcement, or national defense. Public policy may also pursue social welfare objectives in accordance with its citizen's wills, for example to promote income equality or access to health care and education. Finally, but no less important, public policy must provide a stable environment for the nation to prosper, and avoid being the cause of malaise itself.

Based on these basic tenets, the present challenges for Thai policymakers are twofold. Public policy must first aid the private sector in overcoming structural bottlenecks and lift the economy's potential growth by addressing areas where market has failed. Secondly, the policymakers must restore and maintain macroeconomic policy credence, and lay a stronger foundation for the economy to grow on a sustained basis. Let me take each of these in turn.

1. Structural policy to boost potential growth

The Thai economy is growing at a pace well below what a typical country with the same level of income should be able to attain. Failure to sustain a higher pace of growth over an extended period, even when demand pressure has eased, suggests that part of the problem could be from the supply side.

It is no secret that infrastructure in Thailand needs an overhaul. Indeed, very few would dispute the merits of large-scale public investment. The challenge is to strike a balance between timely implementation and rigorous cost-benefit analyses, as well as efforts to make the most efficient use of public resources. Focusing on those projects with the greatest potential for "crowding-in" private investment should also be encouraged. Multiplier effects would provide additional lift to potential growth at no public cost, and would be the very evidence that public policy has served its function of aiding the private sector.

Current supply constraints are not limited to physical capital, but extend to human capital as well. In 20 years, Thailand will be among the first ASEAN countries to enter an aging-population phase, with share of senior citizens rising from 15 to 27 percent of total population. Early symptoms have already been felt in some industries, whose capacity to produce and invest is stifled by the lack of qualified labour. Tight labour market is also indicative of labour shortage at the lower end of the skill spectrum. Market forces have failed to resolve these issues. Education policy, tax incentives, minimum wage, and migration policy all have bearings on the labour market dynamics. The long-term growth implications of these policies should be incorporated into the policymakers' considerations.

Implementing a comprehensive set of economic policies to lift potential growth, while pursuing other public policy objectives, is not an easy task. It requires a close coordination among various policy authorities. It also takes immense skills to introduce the right sequencing of policies at the right time. These prerequisites must also be backstopped by strong policy credibility, the second area of priority.

2. Maintaining macroeconomic policy credibility

In its quest to provide public services, the policymakers must avoid being the source of harm. International experience is filled with cautionary tales of how a lack of policy discipline could lead the economy awry. Over-bloated and inefficient government increases risks of unsustainable public finance, and can sow the seeds for political conflicts. Lax monetary discipline is associated with hyperinflation and financial instability. Maintaining macroeconomic policy credibility and discipline must be an integral part of economic reform in Thailand.

Policy credence is not an independent choice, but is shaped by the overall institutional setup. Institutions are the set of rules and norms that governs the incentives of economic agents and constrains their behaviours. Political developments, strength of the legal system, property rights enforcement, quality of workforce, degree of corruption are but some aspects of the institutional environment. They all interact with the policymakers' ability to pursue their objectives credibly.

Institutions evolve via a mixture of history, will power and luck. A combination of factors at critical junctures can determine the path of institutional change. Thailand must seek to make the most of the current windows of opportunities, to build on reform momentum, and promote a virtuous circle of institutional development. The ultimate goal is to have a political setup that is in accordance with international standards, with a stronger institutional framework to promote a credible and effective public policy.

Monetary policy

Let me now devote the last few minutes of my talk to discuss how the current monetary policy fits into the overall public policy directions.

Monetary policy's legal mandate is to preserve price and financial stability. Throughout the last couple of years, the Monetary Policy Committee has maintained an accommodative policy stance to support the economy. Weighing risks to financial stability against downside risks to growth, the Committee carefully adjusted the degree of policy accommodation to ensure sufficient support to domestic demand. The last policy rate cut took place in March this year, as lower risks to domestic financial stability and subdued price pressure opened room for monetary easing in light of higher risks to growth.

In our latest meeting in June, the Committee voted unanimously to maintain policy rate at 2 percent. The Committee was encouraged by reduced political uncertainties and a resumption of functioning government. We also deemed recent fiscal actions and prevailing monetary policy accommodation as lending adequate support to recovery. The Committee will continue to monitor the situation, and ensure that the ongoing recovery gains traction, in the context of price and financial stability consistent with our mandate.

The Committee has been able to maintain policy credibility and adhere to our mandate thanks to our operational independence. The institutional setup must continue to protect this independence, so that monetary policy can remain a cornerstone of Thailand's macroeconomic stability. The MPC is aware that our operational independence would mean little in the absence of public trust. We are determined to continue exercising prudence, impartiality, and balanced judgements in deliberating monetary policy. That is ultimately the very source of our credibility.

To close my remarks this evening, I hope the FCCT will continue to promote the professional interests of foreign correspondents working in Thailand, and initiate lively and insightful discussion as it has done for the past sixty years.

Thank you.