Prasarn Trairatvorakul: Thailand in the new regional and global financial landscape

Speech by Dr Prasarn Trairatvorakul, Governor of the Bank of Thailand, at the International Chamber of Commerce (ICC) Thailand General Council and Networking Dinner, Bangkok, 30 September 2014.

* * *

Good evening distinguished guests, ladies and gentlemen.

I am delighted to be here today, to address honorable members of Thailand International Chamber of Commerce. Thailand International Chamber of Commerce has made an important contribution to our nation in two main ways. At home, the organization helps develop awareness among members on future trends of business. In the international arena, the International Chamber of Commerce ensures member's participation in the formulation of trade and investment policies. On this occasion, I would like to express my appreciation for the hard work that you have done throughout the past fifteen years and the strategic function that your organization will continue to serve in a more dynamic environment going forward.

Today, I would like to share with you my perspective on how Thailand could prosper in the new regional and global financial landscape.

Let me offer an analogy. Imagine yourself embarking on an important challenge, perhaps a new job with demanding responsibilities. Naturally you may feel a little nervous, since there is no guarantee that the new venture will be a successful one. A transition to a successful career consists of three stages. The first is to familiarize yourself with this new environment – to get to know new colleagues, to learn about the culture of the workplace, and basically to settle in. Some may find this phase more challenging than others, especially if they were easily shaken by cultural shocks. Once you have settled in the new place, you may discover certain shortcomings of yours are constraining your career advances. These shortcomings may already be existing, but are only exposed by the new job. Fixing these shortfalls is the second step in the transition. Finally, to make a significant progress in the career, you will have to set the bar for yourself, and strive to reach it through learning and development. This will require insights to identify one's strengths, and skills to take advantage of them given the dynamics of the working environment.

The stages of economic development may be thought of in a similar vein, consisting of three pillars. The first pillar is to ensure that the economy 'settles in' the new global environment smoothly, and remains resilient against new types of shocks. The second pillar is to identify and fix structural shortfalls that may have hindered economic development in the past, and could become even more binding in the future. The last pillar is to lay out a clearer long-term plan for strengthening and developing the economy, leveraging on its strength and the opportunities presented by the evolving landscape.

The first pillar: maintaining stability

Distinguished guests,

With an increasingly globalized economy and financial markets, the world is irreversibly and ever more interconnected. As a small member in the global community, we have no choice but to take this trend as given, and focus on fortifying the economy's resilience against currents of uncertainties. The financial environment today continues to be shaped by the legacy of the global financial crisis. As the Federal Reserve continues to scale down its unconventional monetary policy and normalization of their policy rate looms, many emerging economies may experience sporadic fluctuations of capital flows and asset prices – be they in the bond, equity, or foreign exchange markets. So-called QE taper tantrum last year did prove disruptive for some members of the emerging markets club. That experience highlights the importance of maintaining sound macroeconomic fundamentals in order to foster the economy's resilience against shocks of external kind. Despite higher global interconnectedness, investors do differentiate at the margin. Those countries with stronger macroeconomic stability both experienced less volatile capital outflows, and are less disrupted by them.

This is not to say that financial market rationality can always be counted upon. Global fund flows may also be subject to fads, speculation, and short-termism. Left on its own, the resulting financial market volatility could prove damaging for overall macroeconomic stability. The policymakers have an important task of pre-empting such excessive and unjustified volatility.

Thailand has had its fair share of volatile capital flow episodes in recent years. The economy has however managed to withstand these tests quite well, a testimony to the economy's resilience to external shocks. Exchange rate flexibility, a lack of external imbalances, very low external debt, strong and flexible private sector all contributed to the success. As a backstop, the Bank of Thailand also has a comprehensive policy to deal with potentially disruptive capital flows, with sequencing that makes up multiple lines of defense. Having a credible policy response strategy confers an additional benefit of discouraging speculative flows in the first place. Equipped with a wide range of policy tools, including large foreign reserves, the current policy capability is adequate in meeting challenges of the day.

Second pillar: fixing the shortfalls

Ladies and gentlemen,

At the same time, a number of pressure points in the Thai economy have started to emerge in the aftermath of the global financial crisis. The decline of economic growth in recent years relative to pre-crisis period hints at structural bottlenecks holding back the economy. Exports which were the leading driver of pre-crisis growth are expected to be flat this year, lagging those of our competitors. Anecdotal evidence suggests that some manufacturing sectors are struggling to be integrated into the global modern supply chain. Slow gain in labor productivity, and inadequate investment may be hindering the overall technological advances, a critical pre-requisite for sustaining long-term development. These problems are potentially our existing shortfalls that need to be overcome in the second pillar of development.

However, it may be too premature to put the entire blame on structural flaws. There are a number of cyclical headwinds suggesting that the recent subdued growth could be just a temporary phenomenon. The more diversified export product range in Thailand implies that our global growth 'beta' may be lower than that of our specialized hi-tech exporter peers. This is not necessary a shortcoming, since some high-end manufacturing sector such as semiconductor is prone to strong cyclical swings, with a short and sharp upturn followed by a protracted downturn. But by implications, export diversification that helped lessen the impact of global recession then, is limiting our sensitivity to the global recovery now. It may therefore take some time for exports to show a firmer recovery.

Another factor weighing on private sentiments and domestic demand until recently is the political development. Economic uncertainties brought about by street protests and threats of violence late last year have had a discernible impact on private spending and tourism. But a political resolution in the second quarter has lifted the fog, and the incoming data since suggest that there has been a steady improvement in private sector confidence. The resumption of public spending is also adding to growth impetus, including through accelerated disbursement of fiscal budget, and infrastructural public investment. The government's efforts to balance the short-term stimulus needs with the long-term improvement of fiscal spending efficiency should also be welcomed. As the fiscal support starts to kick in, the domestic demand should continue to lead this recovery.

This cyclical narrative does not obviate the fact that important structural impediments do exist and need to be addressed. According to the latest Global Competitiveness Report, Thailand compares less favourably in terms of capacity to innovate, quality of workforce, and infrastructure. Labor market efficiency has fallen 42 places in less than four years, against the backdrop of labor shortage that could worsen as the society ages. Improving education and labor market reform are therefore critical as a foundation for innovation-driven development. The integration of manufacturing sector into the global supply chain needs to be a more dynamic and forward-looking process. The old days of easy wins are bygones. Knowledge and vision are necessary preconditions for innovation-led growth. The current government's reform agenda indeed places a great focus on providing the right incentives and environment for the private sector to undertake the next big leap of improving their productivity and innovative capacity. But the ultimate success will hinge on the private sector rising to these challenges and following through with their actions and ingenuity.

Third pillar: strengthening the economy & development

Ladies and gentlemen,

Let me now turn to the final pillar, that of strengthening the structure of the economy towards a sustainable long-term economic development. I have touched upon several real sector issues that could pose challenge to Thailand's prosperity. But there are also important financial sector areas that are no less important, despite the immediate consequences being less evident. Financial development, indeed, is an integral part of economic development. The relatively small financial market in Thailand means that large-scale cross-border activities, especially mergers and acquisition, cannot take place without adversely affecting financial market volatility. Promoting deeper financial market would help facilitate more long-term direct investment that is needed for the economy to upgrade its technological capability. Financial development also entails broader banking and payment issues. For example, diversifying the sources of financing and reducing the degree of dependence on banks, would help the financial system better absorb shocks and improve efficiency of funding. Upgrading the financial infrastructure and payment system is necessary for the economy to reap full benefits from regional trade integration in the new digital age.

Implementing financial development is not a straightforward task, and among other things, it is complicated by the need to ensure financial stability. Bigger financial system can increase the system's fragility, which if left unchecked, could undermine economic development efforts. Financial innovation, in some instances, could encourage risk-taking activity that raises rather than reduces market inefficiencies. These considerations mean that financial development must be accompanied by a robust policy framework that places financial stability as a high priority. This is indeed the practice followed by the Bank of Thailand.

Monetary policy

On that note, let me briefly discuss the role of the Bank of Thailand in this new environment. Our key contribution to the long-term economic development efforts is to provide a stable macroeconomic and financial backdrop, so that the prosperity can be attained without interruptions. The current priority for monetary policy is to ensure a robust economic expansion, as the recovery remains in its infancy stage. The Monetary Policy Committee (or MPC) has therefore been maintaining the policy interest rate at a relatively low level, in view of supporting the economy during this transition. Currently low inflation, subdued global commodity prices, and stable external environment, afford us policy space to focus on the growth objective for the time being. Nonetheless, the committee will also continue to monitor any risks to financial stability, given that the policy rate has been low for some time. Businesses and households should see the current monetary policy stance as conditional on the economic outlook and financial conditions, and prepare themselves for possible turns of events.

Distinguished Guests,

While the ongoing economic recovery is a welcomed development, we must not lose sight of the much-needed reforms. Failing to do so would have repercussion for the economy's potential growth, a critical cornerstone for long-term well-being of the nation. Thailand stands at a crossroads, and the road ahead may not be paved with gold. But given a skillful maneuvering of the private sector and our cooperation, I am confident we will reach our common goals.

Thank you.