

Prasarn Trairatvorakul: “The Role of the Central Bank in Driving Thailand’s Sustainable Growth”

Speech by Dr Prasarn Trairatvorakul, Governor of the Bank of Thailand, before the Thai Forum, New York, 8 October 2014.

* * *

Ladies and gentlemen,

Thailand has undergone much change this year, and the usual visitors from abroad may have chosen, understandably, to watch developments from afar. It is thus my sincere pleasure to bring some of Thailand to your very doorstep. The country is now at an important juncture. Political uncertainty has subsided and some promising government plans have taken place. Therefore there is no better time for domestic and international investors alike to capitalize on the new wave of growth.

Thailand’s immediate challenge is to restore growth to its potential. For much of the past seven years, we have been experiencing sub-par growth rates. As the economy now wakes up from its third contraction since 2008, it is time to focus on Thailand’s avenues for restoring normal growth again. How can an economy rebound from a contraction back to growth? Part of the answer lies in the economy’s strong fundamentals, and the Bank of Thailand, as the central bank, plays a part in safeguarding them as attested by quick rebounds of the Thai economy after the Great Recession in 2008 and the Thai floods in 2011. In addition, as caretaker of the country’s banking system, the Bank of Thailand also fosters development of the financial system to bring about growth. I would now like to lead you through the details of our role in growth and hope that by the end of our talk you will have gained firmer belief that Thailand’s policy makers are committed to the country’s long-term growth.

My talk today will cover the two roles that the Bank of Thailand plays in building sustainable growth. Firstly, I would like to describe the ongoing role of **economic stabilization**, as stability is a prerequisite for sustainable economic growth in the long term. Secondly, I will address **growth opportunities available to Thailand and the Bank of Thailand’s role in developing the financial structure that enables the capture of these opportunities**. Due to necessity as well as design, several structural changes are now underway in Thailand, and the Bank of Thailand aims to facilitate the transformation of these changes into sustainable long-term growth.

Ladies and gentlemen,

When businesses go about their daily activity, they not only produce goods for consumption today, but they also innovate and improve their tools of trade in order to produce more and newer goods in the future. When the economy enters a long slump, these improvements are foregone and future growth potential is diminished, a situation known as hysteresis. Therefore a smooth growth path is desirable for sustainable growth. This brings us to the first role of the central bank in this talk, safeguarding stability and balance in the economy. In particular, the Bank of Thailand monitors three facets of stability: growth stability, price stability, and financial stability.

In terms of growth stability, we have been on the low end of the balance. We observe Thailand’s average growth to be near zero in the past three quarters, and currently we are still well below the long-term trend. The underperformance was contributed to by political uncertainty and drawdown from earlier accelerated spending encouraged by previous government policies. The long stretch of low growth calls for the central bank to step in with policy that shores up demand. The Bank of Thailand has implemented accommodative monetary policy since the beginning of the year, while price and financial stability were also carefully monitored to ensure they were not compromised.

The accommodative stance has shored up demand up until now, with businesses gradually upgrading and adding capacity during the downturn, and as we enter recovery, they have retained the ability to resume production at normal levels. Continuation of monetary policy accommodation will benefit further investment through the availability of funds, especially now that the recent political clarity helps restore confidence both domestically and internationally. Revival of confidence is vital to recovery and restoration of growth towards potential. Recent economic data is supportive, showing that consumption and tourism have started to pick up and stimulus measures from the government have risen. On the external front, the steady recovery of the world economy, especially the U.S, will bolster the export sector. **All these positive prospects point to on-track economic recovery** and movement towards fulfilling the growth stability objective.

Ladies and gentlemen,

We forecast Thailand to grow at around 4.8% next year, a rate that means steady recovery to normal levels of economic activity. As the economy returns to full capacity, inflation and financial risks may surface. To ensure sustainability, the process of growth must not create imbalances in the economy that will draw down future growth. This brings us to the two other aspects of stability: price and financial stability. The Bank of Thailand has had much success in anchoring inflation expectation through our Inflation Targeting framework, adopted since 2000. Many times during this period, well-anchored inflation expectation has allowed flexibility for the Bank of Thailand, when needed, to actively support growth and ensure financial stability.

As you well know from the Subprime Crisis, an economy with growth stability and price stability can still fall into contraction due to financial causes. The Bank of Thailand has learned from our own experience with a financial crisis as well as others' and has been vigilantly monitoring indicators of risk to financial stability in the economy, and has policies developed especially to ensure financial stability. Conducting policy through the use of interest rate alone may not be sufficient to take care of financial imbalance. In addition to monetary policy, which sometimes is too blunt to optimally take care of financial stability, we have adopted macroprudential tools since 2002 and employed them to help us cover and specifically target areas of the financial system. For example, we monitor excessive credit card loans to sub-par debtors, excessive foreign exchange speculation, and formation of a real estate bubble.

Apart from abovementioned policies, the managed float exchange rate regime helps maintain stability in capital flows. Under this regime, Thai Baht is allowed to move in line with the market forces but gives the central bank ability to influence the exchange rate in the time of excessive volatility.

All the mentioned policies have helped to keep the current economy in good balance. Today, capital flows, private sector balance sheets, as well as real estate values remain healthy, **which should enable fast recovery.**

Although the economy is anticipated to recover after private confidence regains, **some notable risks must be addressed and closely monitored over next year.** One that is worth mentioning is the expected U.S. interest rate normalization after recovery of the U.S. economy, which could lead to capital flow volatility in Thailand.

Even with **headwind from the Fed's action of hiking policy interest rate, we anticipate only limited impact** on overall Thai economy as the market has already gradually priced in the Fed's stance since last year. Additionally, our reserves remain high, allowing the economy to be cushioned from the possible outflows of capital. Moreover our managed float exchange rate regime automatically stabilizes against possible volatility. At the same time, **household debt, currently at 83% of GDP, requires a long-term solution. While its effect so far remains contained, its risk cannot be ignored.** Over the recent years, the Bank of Thailand has built awareness of this risk in the public which has contributed to the natural adjustment of the market and therefore the slowdown of household debt

accumulation. Going forward, the Bank is proposing a national agenda to the government to promote financial literacy and discipline to ensure long-term stability in line with our own ongoing financial awareness projects.

I have now talked about the central bank's commitment to growth, price, and financial stability in order to support sustainable growth. Now that we are in recovery, minding the future risks to financial and price stability, and being in possession of stabilization tools tested and refined over time, ***the Monetary Policy Committee will carefully weigh the tradeoff between short-term growth and long-term risks and ensure that the economy will have enough financial ease to recover to sustainable growth.***

Ladies and Gentlemen,

I would now like to move on to the second role of the Bank of Thailand: facilitating an expansion of the growth frontier. Keeping balance as described in the first part is achieved through the use of the Bank of Thailand's tools in guarding economic stability. To allow stakeholders to move forward and capture new opportunities, the Bank of Thailand employs its other instruments to enhance financial sector efficiency and create a favorable financial environment for investment that would lead to higher productivity growth.

Going forward, the strategic location of Thailand and regional trend towards more economic integration provides ***an opportunity for Thailand in terms of market reach.*** We are located in the centre of ASEAN, with a combined population of more than 600 million, a large proportion who are of middle income and have potential to spend on goods and services. We are also to enter the ASEAN economic community, a regional agreement to liberalize and integrate trade in 2015 which would further develop trade prospects. Economic integration with CLMV countries will open up the opportunity to tap into a rapidly-growing consumer market as well as the regional workforce. Thailand is well known as a high performance production base in the region, especially for automobiles, food and petrochemicals. Meanwhile, the CLMV countries have a young and abundant labor force. Thus Thailand can benefit from a production supply chain that makes use of the CLMV resources for more efficient production to support businesses at home.

Seeing these chances, the government has given priority to infrastructure by endorsing investment plans, especially in railways and roads, to reduce transportation costs, and setting up Special Economic Zones at five locations along our border to reap the benefit from our strategic location as a gateway to other ASEAN countries.

On the side of the Bank of Thailand, we facilitate the ease of doing business through the ***Capital Account Liberalization Master Plan*** so that businesses can benefit from this opportunity. The progress can be observed by both trade with CLMV, which has been growing annually with double digits over the past 4 years, and more efficient allocations of capital and resources as seen in an ***increasing number of Thai companies doing outward Foreign Direct Investment.***

In addition ***the SMEs***, which account for approximately 95% of total businesses in Thailand, have been ***playing an essential role in driving the economy and will continue to do so going forward.*** They are an integral part of the supply chain and one of the key success factors of Thailand's previously-mentioned high-potential industries. There are also SMEs who have the capability to produce high value added products by creating their own innovation such as the seasoning packages you see in Asian grocery stores here. Another example is ready-to-drink coconuts, a product that combines a coconut in its natural shell with an opener such as one you'd find on a soft drink can. It is a recent entrepreneurial product that has outstanding growth in exports since launch.

In 2004, the Bank of Thailand launched the ***Financial Master Plan*** which aims to increase efficiency and financial access by promoting competition in the market. Since implementation, we have observed the improvement in Thailand's financial infrastructure from ***reduced cost-to-income of commercial banks and particularly from SMEs' greater***

financial access. The cost of raising funds in Thailand has been reduced through the well-developed financial market since more players are allowed to offer variety of financial products. Moreover, the increasing in competition among commercial banks provides higher incentive for them to serve a wider range of customers, especially SMEs, who once have limited access to raise funds and relied on self-funding in a less-developed market. In another project to ease SMEs access to funds, the Bank of Thailand has set up the SMEs Database to reduce asymmetric information in the market and provide a more favorable business environment.

Ladies and Gentlemen,

The Bank of Thailand pursues the goal of sustainable well-being, and strong economic fundamentals are requisite to achieving this goal. We closely assess the growth, price, and financial stability in order to ensure our mandate. Meanwhile, to expand the growth frontier we consider thoroughly in all aspects to develop the financial system as a policy instrument, encouraging business to capture the rich opportunity from Thailand strategic location.

In the soccer game of the economy, the Central Bank acts as **Center Back**. In order to **safeguard** stability during the recent circumstances, we have played a **proactive** role due to high economic uncertainty. Now that political and economic clarity is higher, the central bank will play a supportive role. At the back we can clearly see the whole field and choose a path **to support the team's offense**, especially now that the government has gotten back to its position as the **play maker** to **assist the private sector** to reach the goal of achieving growth potential.

Thank you.

The resilience of the Thai economy

1. Credible macroeconomic policies

A key strength of the Thai economy is sound macroeconomic policy management, which has allowed the country to weather through various shocks relatively well. In fact, it often tops the list of positive factors cited by credit rating agencies in their sovereign credit assessment reports. More specifically, the country is often credited for having a robust macroeconomic policy framework and close coordination among public agencies.

– Monetary Policy:

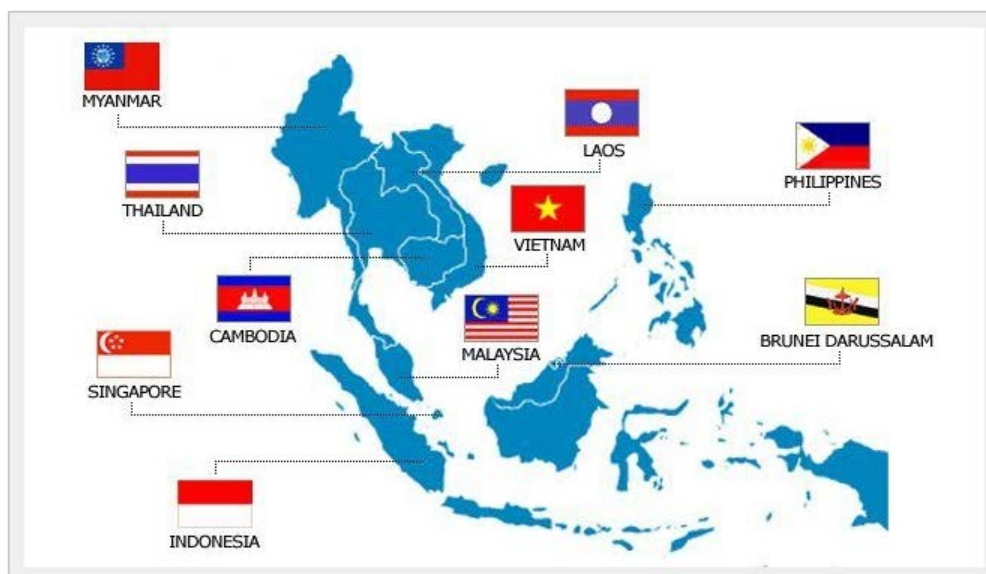
Under a flexible inflation targeting framework, the Monetary Policy Committee (MPC) cautiously weighs overall stability against downside risks to growth. In the absence of a fully-functioning fiscal authority prior to changes in the political situation, the MPC stepped up and reduced the policy rate to support the economy.

– Fiscal Policy:

Fiscal policy formulation and public debt management are guided by explicit fiscal rules, which provide checks and balance against potential challenges to fiscal discipline from offbudget expenditure and financing. In this connection, public debt-to-GDP stood at 46.85% in July 2014, indicating favorable fiscal discipline. Recently, the government has announced concrete roadmaps which help bolster public confidence. Going forward, the government will continue to play proactive roles in supporting an economic rebound.

2. Strategic location

Thailand is located in the center of the Greater Mekong Sub-region (GMS). Rich human and natural resources in the GMS will make it a new frontier for economic growth in ASEAN, providing clear opportunities for the region. As ASEAN comprises 600 million people, the majority of which are growing middle class, economic integration via the ASEAN Economic Community will further enhance trade prospects through increase demands and an expanding market. Building upon this strategic location, the government investment plans on infrastructure, particularly railways and roads, and the establishment of five Special Economic Zones (SEZ) along provincial borders will help to facilitate an increase in border trade.



3. Sound banking sector

The Thai Banking sector is in a strong position to help accommodate economic growth and support the country's development. The Bank of Thailand continues to improve financial system strength and efficiency. Meanwhile, the Bank of Thailand has also conducted risk-based supervision and enhanced its supervision and examination frameworks in line with international standards set by the Basel Committee on Banking Supervision. These transparent supervisory practices and the promotion of sound corporate governance, as well as risk management in financial institutions, help safeguard financial system stability.

In the second quarter of 2014, Thailand's capital adequacy ratio stood at 15.67%, well above the international requirement of 8.5%. Additionally, the ratio of actual to regulatory loan loss provision increased to 169.8%. These conditions ensure that the banking sector is capable of dealing with unexpected risks, particularly credit risks.

4. External stability

In light of global financial market volatilities, which resulted from divergent monetary policy paths amongst major industrialized economies, Thailand's external stability is strongly safeguarded against volatile capital fluctuations. Flexible exchange rate serves as a cushion against external shocks, while careful implementation of macroprudential policies and capital flow management options stand ready to preserve financial balance. Currently, Thailand has strong external position with international reserves exceeding the international benchmark for reserve adequacy. The latest data indicate that reserve to short-term debt ratio is at 2.7, reassuring that the policies being implemented are capable of safeguarding the economy against capital flow risks.

5. Growth prospects

Although Thailand has averaged near zero growth in the past three quarters, strong fundamentals combined with overall stability have contributed to the ongoing recovery of Thai economy and, hence, to future growth. Looking ahead, the Bank of Thailand anticipates GDP to expand by 4.8% next year. The revival of private sector confidence, after political clarity, will encourage private consumption and investment. At the same time, the resumption of a fullyfunctioning government allows government spending to further boost the economy.

BOT Forecast Summary

(%)	2013*	2014	2015
GDP Growth	2.9	1.5	4.8
Core Inflation	1.0	2.2	2.1
Headline Inflation	2.2	1.6	1.3

*Actual Data

Monetary Policy Group
Bank of Thailand