Veerathai Santiprabhob: Recent developments and the way forward for the Thai economy

Speech by Dr Veerathai Santiprabhob, Governor of the Bank of Thailand, at the Japanese Chamber of Commerce (JCC) Dinner Talk, Bangkok, 8 March 2016.

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Mr. Akira Murakoshi, President of the Japanese Chamber of Commerce,

Mr. Akihiro Uchikawa, Minister of the Embassy of Japan,

Members of the JCC Board,

Distinguished guests, ladies and gentlemen,

A very good evening to you,

I would like to thank the Japanese Chamber of Commerce for inviting me to address the prestigious group of audience at this special event. I assume that many of you had become quite acquainted with my predecessor, Governor Prasarn, as he had joined this annual dinner talk every year over the past five years. Although this is my first time speaking at this event, I would say I feel more like coming to meet my longtime friends, thanks to your warm welcoming and also to the longstanding ties between Thailand and Japan.

With over 5,000 firms actively operating in Thailand, the coverage of Japanese businesses extends over more industries than that of any other countries investing in Thailand, both in the real and the financial sectors. As many of you know, just two weeks ago, I was speaking at the opening ceremony of the Sumitomo Mitsui Trust Bank in Thailand, which marks another milestone for a closer bond between the Japanese and Thai financial systems.

This evening, it is my honor to share with you my thoughts on *the recent economic developments and the way forward for the Thai economy*, which I believe is at the heart of Japanese businesses in Thailand, as much as it is at the heart of us at the Bank of Thailand.

In the first part of my talk, I would like to recap the *current global market developments and highlight Thailand's financial strength* as we venture through the world of volatility. Second, I will share the Bank of Thailand's view on the country's *current economic conditions and outlook*. I will then turn to discuss *key initiatives and factors to drive the Thai economy forward*, in particular how Thailand is working towards becoming a regional connector for trade and financial services.

Let me start by talking about global volatility

Ladies and gentlemen,

The year 2016 started off with growing concerns about the global financial markets, with significant spillovers to stock markets, exchange rates and commodity prices across emerging economies. What brought about heightened volatility in the global markets? I would like to highlight three key sources at play.

The first factor is inevitably China. Large fluctuations in its financial markets reflected investors' concerns on slowing Chinese economic growth and policy responses. More importantly, China's economic restructuring, with transitions from investment to consumption, and from manufacturing to services, has altered growth pattern and created enormous uncertainty to the world economic recovery as well as the global financial markets.

The second factor driving market volatility stems from the plunge in prices of oil and commodities. Depressed prices put pressures on commodity-exporting countries and related industries. For oil producers, the prolonged low prices would also result in losses in revenue and profitability, and increase risks of default on their debt payments. These could trigger another rout of credit events and liquidity tightening in financial markets.

The third factor is the monetary policy divergence between the US and other major advanced economies. While the US Federal Reserve is poised to gradually tighten its policy stance, the Bank of Japan recently joined the club of many European central banks to adopt a negative interest rate policy, and is likely to ease the policy even further. Amid the fragile global recovery, the divergence in the monetary policy stance as well as in the recovery paths among the major economies cause a great deal of global uncertainty, and prompt capital flows to be overly sensitive to news and even slight changes in market expectations.

In this highly interconnected world, these global risks surely have widespread spillovers to all countries not least emerging markets, Thailand included. ***But, the impact on the Thai financial markets, as you might have seen, has so far been relatively limited***, compared to other emerging markets, thanks to Thailand's strong external position which serves as a great buffer against global volatility.

Allow me to highlight some of our resilient features:

- We continue to have a strong current account position with the current account last year registering a surplus of 9 percent of GDP, or around 35 billion US dollars, thanks largely to a substantial saving on energy imports.
- Our international reserves have been at a healthy level, standing at three times of the short-term external debt we hold.
- Our capital markets are relatively less exposed to the risk of capital flight, with foreign holdings at less than 9 percent of the Thai government and Bank of Thailand bond outstanding, compared with more than 30 percent in some other emerging markets in the region.
- External debt of the Thai corporate sector has been relatively low, hovering around 13 percent of total corporate debt. And, most of the external debt belongs to large corporations which have used the proceeds to finance their investment aboard and are able to manage their exchange rate risks sufficiently well. As a result, the currency mismatch does not pose a threat to the Thai corporate sector, unlike what they experienced during the 1997 economic crisis.

Taken together, the strength of Thailand's external position on many fronts has helped the Thai economy withstand the recent global financial turmoil, and would continue to provide cushions against possible external shocks in the future.

Nevertheless, it would be a mistake to be complacent with where we stand and fail to anticipate greater challenges ahead. The world has entered an era of far greater volatility in the so-called new normal environment. I want to stress that we must not fear volatility, but always be mindful and well-prepared for any unforeseen events.

In the short run, the Bank of Thailand stays firmly committed to maintaining our robust buffers. To build market resilience in the longer run, we embrace on financial market developments, as deep and liquid markets would better absorb large swings in capital flows. We continue to encourage the use of risk management instruments, particularly foreign currency hedging, which would mitigate the negative repercussions of financial market volatility on businesses. We also plan to further relax capital flow regulations to allow more balanced flows in and out of the country which would enhance stability against speculative flows.

Ladies and gentlemen,

Let me now turn to the Bank of Thailand's assessment of the Thai economy in 2016. The Thai economy shows signs of gradual, though uneven, recovery. Based on our assessment in December of last year, GDP in 2016 was projected to grow at 3.5 percent which is higher than the 2.8 percent growth last year.

I must admit, however, that ***since last December, the global economy has continued to face stronger headwinds*** ranging from increased financial market volatility, slowing emerging market growth, continued oil price slumps, and diverging monetary policy paths. These could weigh on the pace of the already fragile global recovery and create more bumps in the road for the Thai economy than we have anticipated. Moreover, the impact could be more pronounced in the rural areas, where drought and low commodity prices worsened the already weak farm income.

Nevertheless, I believe there are grounds for optimism for the Thai economic growth. The Thai economy this year will continue to be driven largely by domestic demand and tourism. Exports will likely remain flat or decline further, not only due to subdued global demand but also price effects as export prices have tumbled following the low commodity prices. But, ***so far the impact on the labor market, even those in export-oriented sectors, has appeared well-contained.***

Notwithstanding the threatening uncertainty around us, tourism continued to be a main growth driver for the Thai economy, with expected tourist arrivals of around 31 millions in 2016. The CLMV market is another bright spot. The Thai exports to CLMV market are expanding in accordance with their growing middle class and vibrant economic activities. The CLMV market is now accounting for 10.4 percent of Thai total exports, which is already larger than our exports to Japan, the third largest export destination.

In terms of the domestic economy, we have learned from the latest GDP release that the construction sector has picked up with a strong growth of more than 20 percent in the fourth quarter of last year, thanks to government infrastructure projects. The spillovers from these projects are also benefiting the real estate market. Demand for properties continues to expand as we see mortgage loans growing at around 10 percent year on year in recent months.

Financing conditions have also been favorable. Monetary policy stance remains accommodative and in full support of economic recovery. And, despite the slow economic growth, the overall credit and corporate bond issuance to the private sector continues to grow at around 7 percent. The Bank of Thailand would ensure that the cost of funds is conducive to the ongoing recovery, while also keeping a cautious eye on risks to financial stability.

On the fiscal front, the government has become more effective in disbursing and implementing investment projects. Government relief and stimulus measures are also essential at difficult times, especially for those severely affected by adverse economic situations, such as from the current drought.

But while taking care of the short-term issues, we must not forget to reckon longer term challenges facing the Thai economy. Thailand is in need of serious initiatives to upgrade and unlock our economic potential in the long term. In this context, we welcome many new initiatives by the government to push ahead with structural reforms.

This brings me to the last part of my talk tonight on the way forward for the Thai economy, and how we and our partners like Japanese businesses may ride together toward sustainable prosperity.

Let me first touch upon some of the ongoing reforms and give you a better picture of what we could expect to benefit from them. ***Among various initiatives to upgrade legal infrastructure in Thailand, steps have been taken to put in place more efficient and more business-friendly laws and regulations***. The new *Licensing Facilitation Act* will help streamline bureaucratic processes in obtaining a business license, registration and approval. The *Business Security Act* will help improve SMEs' access to bank loans by allowing more types of assets to be used as collaterals. The new *Payment System Act* will unify all related laws governing the payment system and lift its standards to international best practices.

In addition, the law to reform the governance structure of *state-owned enterprises* is underway. The success of this reform will not only improve the performance and transparency of state-owned enterprises (SOEs), but also unlock the potential of our country's strategic assets, create a more level playing field between SOEs and private businesses, and strengthen the country's overall competitiveness.

I believe that these developments have a great potential to improve administrative efficiency and make doing business in Thailand easier. ***The legal reform will be here to stay regardless of which political party comes into power after the next election.***

Moreover, with the introduction of changes in the Board of Investment's criteria for investment privileges, the government has geared up its effort in promoting high value added industries. I am glad to see many Japanese firms taking advantage of the new BOI scheme, especially the ones with R&D incentives. I look forward to witnessing the growth of Japanese cutting-edge electronics, automotive design and testing centers, and other advanced-technology products being made in Thailand.

Besides upgrading our own economic and legal infrastructure, reaching out to other economies in the region is another structural transition that will drive Thailand forward. Thailand's close economic ties with our neighbors are paving the way for us to become a regional connector of trade and financial services. Thanks to Thailand's geographic location, superior financial infrastructure, and strong supply chain networks, Thailand holds many advantages to be a *regional springboard* for companies wishing to expand their operations in the Greater Mekong Sub region (GMS).

We can benefit from the complementarities each country has to offer – abundant natural resources, raw materials and younger population in CLMV while Thailand's position can greatly facilitate connectivity and enhance growth potential of the whole region.

How may we leverage on this strategic position?

- ***Thanks to our cross-border infrastructure and logistics systems, Thailand has been the center for logistic distribution of goods and services in the region.*** The CLMV markets and the AEC offer a great prospect for businesses that are based in Thailand to capitalize on the close proximity of related industries. Products made in Thailand have been well-received among our neighbors due to their good reputation and high quality.
- ***Beside the geographical advantage, the Thai baht has gained wider acceptance in trading transactions with our neighbors.*** The use of local currency in regional trade has lowered financial transactions costs for businesses, especially in the current period of foreign exchange volatility. In this connection, the Bank of Thailand has relaxed capital account regulations to further support the use of local currency in the GMS region.
- ***To support regional connectivity, Thailand also offers <u>Treasury Centers and International Headquarters</u> as platforms for businesses to improve efficiency in financial and resource management.*** Some Japanese multinational firms have already been granted licenses and I am glad to learn that many more have expressed interests for setting up a Treasury Center as well as an International Headquarter in Thailand.

On the financial side, Japan and Thailand have continued to strengthen our financial linkages. In Thailand, there are currently a total of 26 Japanese banks' representative offices, 2 full branches, one locally incorporated bank and one subsidiary, which was just recently inaugurated. Japanese non-bank financial institutions providing personal loans, nano-financing and insurance services also maintain a strong presence in our Thai market.

Looking around in the region, we are proud to be the country with the most active and most comprehensive Japanese financial service providers.

Indeed, Japanese financial institutions have taken the lead to use Thailand as a strategic foothold for spreading their wings in the region. As a case in point, the Bank of Tokyo-Mitsubishi recently acquired a microfinance bank in Cambodia, using the Bank of Ayudhya in Thailand as a base for the acquisition. Such financial linkages will serve Japanese enterprises and tap opportunities in one of the region's exciting emerging markets. The strong presence of Japanese financial institutions in the region will surely be an important conduit for non-financial companies in Japan to leverage on the promising prospect of the GMS region.

Ladies and gentlemen,

We have indeed come a long way and have gone through several tests of external disturbances. ***Let me assure you that the Bank of Thailand will continue to strengthen our macroeconomic resilience and stay firmly committed to financial stability*** as one of our principle mandates.

We also embrace continuing reforms and upgrades in the financial sector to remove obstacles to the development of regional trade and investments. We are confident that Japan, Thailand and the region can mutually benefit from broader and deeper linkages, both economically and financially. With stronger economic and financial ties, I am excited to see how we, together, will move the region forward and continue to work closely in the global arena.

Again, it is my great honor to be here tonight with our close and longtime friends who have supported Thailand's economic and financial development. Thank you very much for your friendship, your commitment, and your contribution to the Thai economy. I look forward to further cooperation between our countries for many years to come.

Thank you very much.