Veerathai Santiprabhob: The Bank of Thailand's financial and monetary policies – the way forward

Speech by Dr Veerathai Santiprabhob, Governor of the Bank of Thailand, at the Thailand Focus 2016 "A new growth strategy", Bangkok, 31 August 2016.

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Chairman of the Stock Exchange of Thailand,

Secretary General of the Securities and Exchange Commission,

President of the Stock Exchange of Thailand, Chairman of Phatra Securities, and President of Asia Pacific Bank of America Merrill Lynch

Distinguished Guests

Ladies and Gentlemen,

A very very good morning to you all.

It gives me great pleasure to be back at this prestigious forum. Let me begin by thanking the Stock Exchange of Thailand, Phatra Securities, and Bank of America Merrill Lynch for inviting me to be part of the 10th anniversary of Thailand Focus. I believe many of you, if not all, have learnt about Thailand's reform initiatives and kept eyes on the outcomes of these developments. Today, this forum will bring you insights from the nation's key policymakers and give you a chance to learn about exciting opportunities which Thailand has to offer.

As for my part, I would like to share with you my perspectives on ***'The Bank of Thailand's Financial and Monetary Policies'***. Indeed, as the Thai economy is undergoing transformation in order to lift our growth potential, I would like to highlight the roles of monetary and financial policies in facilitating this critical transition.

If you may recall, the key takeaway from my talk last year is that the Thai economy is like a car which has good suspension, but whose engine is in need of an overhaul in order to move faster. Our sound external position and strong financial institutions are analogous to that good suspension, which has so far afforded us a smooth ride on the bumpy road of global financial volatility. It has been almost a year since our last check-up, and as it has indeed been an eventful year, I would like to start my talk today by revisiting how the conditions of our car have developed since then. In the second part of my talk, I will discuss how the Bank of Thailand will contribute to the engine overhauling process – along with the private sector and the government which have already launched several initiatives.

In the span of just 8 months since my last Thailand Focus address, the global economy has gone through several turbulent periods. If you all may recall, on the first working day of the year, the Shanghai Stock Index fell by 7%, with two circuit breakers triggered in one day. Crude oil prices saw a steady rise from below 30 USD per barrel to over 50 USD, before being struck in a back-and-forth market within the 40 to 50 USD range. Besides, we have again witnessed multiple rounds of volatility in the global financial markets as a result of shifting expectations of the Fed's rate hikes. More recently, Brexit brought to the forefront the concerns over the health of the European economy, leaving the rest of the world with less hope of a broad-based economic recovery. Furthermore, 6 central banks have implemented the negative interest rate policy resulting in irregular financial market structure[1]. An extraordinary amount of the world's sovereign debts carry negative yields. Meanwhile, major currencies have been volatile. Relative to the USD, the Japanese Yen appreciated by 18%, whereas the British Pound dropped by 12% year to date.

As for a small open economy like Thailand, domestic financial markets inevitably felt the ripple effects of the developments and growing anxiety at the global level. Once again, risk appetite has turned towards emerging markets – and Thailand is no exception. While last year, we saw a net portfolio outflow of around 7.6 billion USD, the first 7 months of this year already recorded a net inflow of over 5 billion USD into bond and equity markets combined. 10-year bond yield hit a record low at 1.54%, while the Stock Exchange of Thailand index has marked about 20% gain to date, compared with a 14% fall just one year earlier.

Despite volatile asset price movements, the Thai financial system remains resilient thanks to our sound external position and sound financial system. As in the past, foreign participation in the Thai bond market remains at less than 10 percent, while that in the stock market is around 30 percent of the market capitalization. Both figures are well below those of our regional peers, suggesting that we are relatively more immune to abrupt capital flights. **On the external stability front, Thailand continues to perform well across most indicators.** Last year, our current account recorded a large surplus of over 8% of GDP, and it is expected to grow further this year. Moreover, we continue to have more than enough international reserves to cover our foreign debt obligations.

Our banking system continues to be strong, with ample capital buffer and cushion against bad loans. Their capital adequacy ratio continues to be well above the required level of 8.5%, and has increased slightly since my last address. Moreover, amid the gradual economic recovery, banks continue to accumulate high level of loan loss provision to cushion for deteriorating loan quality. The aggregate NPL figure remains manageable at around 2.7% and the combined profits of the banking sector remain sizeable despite being slightly trimmed by the additional loan-loss provisioning.

Ladies and Gentlemen,

Maintaining sufficient buffers have proved essential in coping with the financial turbulence of the past year, as they helped to shield the economy from facing the full impacts of external shocks. Besides the financial system, the real economy has also been a beneficiary of stable financial environment. In the first half of this year, the Thai economy expanded by 3.4%. Despite being weighed down by one of the most severe droughts during the past year, farm income and rural consumption have recently regained their momentum, as rainfalls are back to its normal level. In the meantime, public investment and stimulus measures have also helped restore private confidence, while strong growth in the tourism sector continues to reinforce the momentum of our economic recovery.

Ladies and Gentlemen,

Such positive economic development should indeed be welcomed. However, it should not distract us from making continued investment on a more important task which is to undertake the much-needed structural adjustments. This is what I referred to as "an engine overhaul" in my talk last year. Fortunately, technology and innovation offer very powerful tools which can be used to accelerate our growth engine. We need to first position ourselves to receive the full benefits of their arrival – both in terms of human capital and infrastructure**.** The good news is that the government has already launched several initiatives geared in this direction. Throughout this forum, you will get to learn about the rationale and aspiration of key reform initiatives, such as the new S-curve, public private sector collaboration, and upgrading of the tourism and the healthcare sectors.

The Bank of Thailand also plays a critical role in this engine overhauling process, both through our conduct of monetary policy and financial sector development policy. In the former, we aim to provide an accommodative and stable macroeconomic and financial environment, so that the ongoing recovery is supported by ample liquidity and not interrupted by excessive volatility. In the latter role of development, we aim to put in place more efficient financial infrastructure in order to facilitate business activities and thereby enhancing their competitiveness. Let me elaborate on each role one by one.

Recent experiences have demonstrated to us just how volatile the financial environment could be – both in terms of risks to economic growth and the policy responses that follow. Unfortunately, the journey ahead is paved with similar challenges, if not greater – financial stability risks and economic rebalance in China, the growing monetary policy divergence, the lower-for-longer interest rate policy and perhaps a more widespread use of unconventional measures by central banks of Advanced Economies. As a small open economy, we must therefore ensure that there is sufficient policy room to mitigate the potential adverse impacts or events that could unfold in the future. **In this context, the Monetary Policy Committee's decision to maintain the policy interest rate should be viewed as a preference to preserve the limited policy space for rainy days ahead.** The Monetary Policy Committee expected headline inflation to return to the target band later this year, while core inflation has stayed positive at around 0.8% since the beginning of this year. However, in the event of abrupt or excessive movements of financial market variables or capital flows, the Bank of Thailand stands ready to utilize the necessary policy tools in order to support economic recovery and ensure the well functioning of the domestic financial markets. Looking forward, amid the prolonged low rate environment both at home and abroad, we will continue to closely monitor the buildup of imbalances and underpricing of risks in the financial system, while preparing to take necessary actions in order to prevent them from becoming systemic risks.

All in all, monetary policy in the periods ahead will continue to be a delicate balancing act between risks of inflation, growth and financial stability, and the Monetary Policy Committee will make sure that its actions do not add vulnerability to the financial environment.

Regarding our financial sector development policy, the Bank of Thailand believes that efficient and inclusive financial and payment systems can help empower our growth engine. By efficiently allocating resources to match the diverse needs of different sectors in our economy, we should be able to release their untapped potential and therefore enhance Thailand's competitiveness. Indeed, our three master plans – namely the Financial Sector Master Plan, the Payment System Roadmap and the Capital Account Liberalization Master Plan – have been designed with such goals in mind.

Although each plan is different in their rationales and implementation, their intended outcomes can be summarized along three key dimensions – (1) to reduce cost of financial services for households and businesses (2) to deepen financial inclusion and (3) to facilitate financial connectivity in the region.

Allow me to delve into some details.

Starting with reducing costs of financial services. As the Thai economy can no longer compete on supply of cheap labors, cost competitiveness in other areas are critical. In light of this objective, **the Financial Sector Master Plan and the Payment System Roadmap envisage that cost savings in the financial sector due to more efficient operation of financial institutions and the payment system would be passed on to the real sector and the households.** Here, I would like to note that the term financial institutions go beyond banks and finance companies to include non-bank players like e-Payment service providers and **FinTech** (Financial Technology) firms as well.

The Bank of Thailand believes that the very foundation for improved financial services' efficiency is through the adoption of digital technology and shared infrastructure. The former comprises digitization of operations, product offerings and service channels. An example of the shared services initiatives is the **PromptPay** system, the Minister of Finance mentioned in the speech. **PromptPay is an integrated retail fund transfer system that will allow individuals, businesses, and government to transfer funds across service providers at low costs with ease, flexibility and resilience.**

On top of the promotion of e-commerce, PromptPay together with other e-Payment initiatives, for example shared point of sales (POS) terminals, digital tax messaging, standardized QR codes, will lead to **significant reduction in costs of cash management and paper processing**, currently borne by banks, businesses, consumers, as well as the Bank of Thailand. In addition, the move from cash-based transactions to more electronic-based transactions can potentially reduce incidences of corruption and improve governance through greater transparency.

On the regulatory front, an important development is the crafting of **the Payment System Act** which aims to consolidate fragmented laws and regulations governing electronic payments. The Act will set out business rules and regulatory framework for our payment systems that meet international standards. To date, the Act has been endorsed by the cabinet and expected to soon be presented to the National Legislative Assembly.

Let me say a few words about FinTech. **We view FinTech as an important addition to our financial service ecosystem. FinTech would give consumers more options and save operating costs for financial institution and service providers.** On a bright side, FinTech firms are agile and efficient by nature. Yet allowing certain types of them to run freely may destabilize the ecosystem. We need to promote financial innovation while ensuring that potential risks from its misuse would not contribute to systemic risks' build-up. Equally important, there needs to be adequate consumer protection.

The Bank of Thailand aims to foster **a symbiosis between FinTech and our current financial ecosystem**. Among others, we would adopt the **Regulatory Sandbox Framework**, allowing banks and FinTech firms to test their innovation with limited group of customers before launching their services to broader public. Financial institutions are also allowed **to invest more flexibly in FinTech related venture capital**. It is worth noting here that the benefits of FinTech are not only limited to lower cost of financial services but also greater financial inclusion, to which I now turn.

Greater financial inclusion not only improves welfare of the people but also unleashes economic potential of the previously excluded. The Bank of Thailand has focused on promoting financial system's access and inclusion. For instance, e-Payment channels play an important role in providing payment access at low costs. Money transfer via the PromptPay platform will be free for the amount not higher than 5,000 baht. Besides, the government will also be able to use e-Payment as a means to directly transfer welfare benefits to the targeted group of end beneficiaries as mentioned by the Minister of Finance.

In addition to embracing FinTech and implementing the e-Payment as part of the key measures to improve financial access, other notable measures are the implementation of the **Business Security Act** and the expansion of data bases for individual and SME borrowers. **The Business Security Act, which came into effect in July of this year, expands the list of eligible collaterals for secured lending by financial institutions** to include things like inventories, and receivables. The passage of this Act is a win-win for small businesses as well as banks. The Bank of Thailand regulations on loan classification, provisioning requirement, and valuation guidelines have been issued to help banks adopt this new collateral regime.

Ultimately however, we would like to see Thailand moving from collateral-based lending towards cash-flow-based lending especially for small businesses with few or no eligible collaterals but otherwise viable prospects. In order to do so, we need to have sufficient **data for credit risk enhancement and monitoring**. In light of this objective, we are developing an industry-wide SME database from pooled bank data for banks to use for their planning and risk management. In addition, we are working with relevant parties to amend the **Credit Bureau Act** to expand its membership to players like Peer-to-Peer (P2P) lenders. These efforts would get along well with the government policy to expand the roles and coverage of **Thai Credit Guarantee Corporation (TCG)** to provide credit access for SMEs lacking collateral security.

Ladies and Gentlemen. If we look beyond our domestic market, increasing regional integration brings numerous exciting business opportunities. Thailand's strategic location at the heart of Mainland ASEAN along with close economic relations with our neighbors make us a natural candidate to become a regional connector of trade and financial services. We have offered many fronts to enhance such connectivity.

To begin with, the **Capital Account Liberalization Master Plan** aims to make our financial markets serve residents and non-residents more flexibly with diverse products and services. This would facilitate regional financial transactions. Companies with regional operations are encouraged to set up a **Treasury Center (TC)** with the flexibility of foreign exchange regulations as well as tax incentives. To date, 16 companies, most of which are Multinational Corporations (MNCs) with intention to use Thailand as a springboard to gain access to CLMV, have already received a TC License, with several more to participate.

The Bank of Thailand is also continuously promoting **the use of local currency in regional trade settlement**. In March this year, cross-currency dealers were appointed to act as clearing agents for the Baht and the Malaysian Ringgit. In the near future, we will allow **securities companies** to buy and sell foreign currencies within the scope of their brokerage business. Foreign corporations will also be permitted to **borrow directly in Thai baht from domestic financial institutions to invest in the Greater Mekong Subregion (GMS)**. Also in March of this year, we have signed Letter of Intent with Malaysia and Indonesia, and negotiations are currently under way, to establish **the Qualified ASEAN Banks**. Looking forward, this initiative should help enhance financial connectivity, and improve operational flexibility of businesses in the region.

Ladies and gentlemen, as I outlined above, the Bank of Thailand is committed to establishing financial infrastructure which will facilitate efficient and inclusive growth. If Thailand were to drive through the volatile and fragile global economy, the growth engine must be modified to suit this demanding environment. The financial technology, financial inclusion and regional connectivity are very potent tools which can be used to upgrade our financial engine – so that our vehicle will be agile and powerful enough to move forward effectively in the changing terrain. In the meantime, the Bank of Thailand will continue to ensure that our suspension system be well maintained in order to have a smooth ride on the bumpy road toward sustainable economic prosperity.

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[1] Include the central banks of Euro area, Sweden, Switzerland, Denmark, Japan and Hungary.