

M R Pridiyathorn Devakula: Outlook for 2002 and the road ahead

Speech by Mr M R Pridiyathorn Devakula, Governor of the Bank of Thailand, to the Foreign Banks Association, Bangkok, 6 March 2002.

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Mr Weerasinghe, distinguished guests, Ladies and Gentlemen,

Let me begin by thanking the Foreign Banks Association for hosting this enjoyable event and for inviting me to speak. I am honored to be here and would like to extend once again my congratulations to Mr. Weerasinghe on his presidency of the FBA. The formal meeting we had in late January offered an opportunity for me to exchange many useful views and ideas with you. I consider that fruitful and I also appreciate the opportunity given to me this evening. I hope my talk tonight will enhance communication and our mutual understanding even further.

I wish to use my time tonight to share with you our view on the current state of the Thai economy as well as what we see now as the outlook for 2002. It is my intention to discuss with you our assessment of the nature of the incipient recovery process that is now taking place, and to identify the risks and challenges we may face in the near future.

Ladies and gentlemen, permit me to go straight to the crux of the matter.

We enter the year 2002 with more confidence. The Thai economy had most assuredly bottomed out last year. The latest released January economic figures point to more strength in the fourth quarter of 2001 than we had anticipated, given the event on September 11.

And, with the current more supportive fiscal and monetary policy stance as well as the expectation of a rebound in the US, the overall environment this year is more conducive to growth than last year. From this vantage point, we are of the view that the economy could grow by 2-3 per cent this year while inflationary pressure would be virtually absent. A continuing expansion in domestic demand and a rebound in exports in the latter half of the year would be the key drivers of this year's growth. The outlook for inflation remains tame, with core inflation expected to hover around 1-1.5 per cent, well within the target corridor of 0-3.5 per cent.

Last year, notwithstanding the slowdown in the global markets, the Thai economy exhibited a noted degree of resiliency. While the world economy was in a slump, Thailand's exports did not fall to the extent observed in many countries in the region. And, even as export fell by about 7 per cent, output growth remained positive in every quarter. In terms of macroeconomic stability, we saw an improvement both on the domestic and external fronts. In fact, Thailand external position strengthened significantly over 2001. The current account registered a large surplus and external debt continued to fall sharply in 2001. Our reserve position remains strong.

I am convinced that a flexible mix between monetary and fiscal policies, plus the diversified structure of production and exports, did allow the economy to avoid contraction and build on greater external stability. With the improved environment for growth that I have just noted, I am more comfortable today than last year to talk about an economic recovery. My optimism, however, remains guarded. Because on this road to recovery, there are still many risks. Such risks, if not managed well, could undermine the sustainability of the recovery process.

Let me first talk about the macroeconomy and our view for 2002. Then I will describe the challenges ahead as well as our thoughts on how to manage them.

First, the economic recovery.

What do the recent economic numbers tell us?

In January, the economy showed signs of continued expansion despite the sluggish global conditions, thanks largely to the momentum in domestic demand. A number of indicators suggested that the economic conditions had improved somewhat from the recent months. For instance,

- Consumption and investment continued to improve in January. In particular, the Private Investment Index (PII) continued to increase. A significant expansion was seen in construction, following the spur in housing demand and construction activities.

- It looks like this good news on the domestic demand front warrants a significant increase in the January Business Sentiment Index (BSI) and the index looking 3 months ahead.
- Export quantities continued to improve with the year-on-year growth rate in a high positive. This represents both the pick-up in our trading partners' purchasing power and our staying ability to compete.

Another factor that continued to firm up the recovery process came from the fiscal front.

- During the first four months of fiscal year 2002, the budget disbursement rate accelerated compared to same period last year. This front-loaded fiscal stance will surely contribute to a sooner recovery. I must note here, however, that the jury is still out on what these early signs may portend. I believe the impassioned judgment on the speed of the recovery must await more data.

Ladies and gentlemen,

It is rather unfortunate that while economists are busy debating whether these early signs point to a tangible recovery, the recent strong boom in the stock market seemed to have overwhelmed that debate.

On this point, let me say that we need to distinguish between the recent asset price performance and the economic fundamentals.

It is true that the performance of the listed SET firms has improved. The improvement was led in part by better-than-expected profitability of listed companies. Corporate profits in general were also on the rise in 2001, compared to 2000. With this improvement, we are now more able to segregate the winners - that is, the strong performers -- from those lagging behind. This presents a stark contrast to the previous pictures in which almost all sectors were judged to have performed poorly. Another factor that contributed to the strong performance in the stock market is that the Thai market had a relatively low P/E ratio compared to other markets, regional and extra-regional, and the positive price correction might have been at large.

But, whether the inflows that have been driving the market up will stay for long will depend on the underlying fundamentals. This is to say that in order to attract long-term investors that they need, Thai companies must persevere with business restructuring and continue to reform their operations. But more importantly at the macro level, the economic recovery process must continue firmly, and be supported by the right policy mix and by further progress on the unfinished reforms.

I would like to turn your attention now to what we see as the risks in the process of recovery.

The speed and robustness of the recovery will depend in large part on the turnaround of the global economy. On this front, the Bank of Thailand remains cautious in our optimism.

Our guarded optimism is based on two reasons. First, the US economy, which absorbs roughly 20 per cent of our exports, is likely to rebound later in the year while Japan, where 15 per cent of our exports go, seems more likely to remain in the mire for the rest of the year. Therefore, the global economy as a whole may not be expanding much.

Second, a US recovery, particularly if led by electronics, may not benefit Thailand as much as it will benefit other regional economies. This is owing to the diversified nature of Thailand's exports. For example, electronics count for only 26 per cent of our total exports while they count for 36 and 60 per cent of Taiwan's and Singapore's exports, respectively. Furthermore, the US takes in more than 40 per cent of Taiwan's electronics exports. So, a US rebound would likely benefit them more than us.

Therefore, while we are hopeful that the US economic trend is more upbeat, we harbor a healthy dose of reservation insofar as the immediate gains brought on by the US recovery are concerned.

Another risk to growth is in the effectiveness of policy stimulus to meet the growth challenge.

In the past few years, various fiscal stimulus packages have been the principal motor driving the economy. Later this year, however, the necessary consolidation will take place to ensure fiscal sustainability, and sound economic management will demand a right mix of policies. Having achieved external stability and price stability, there is room for monetary policy to be more accommodative to growth.

On this point, I wish to emphasize that even though our focus today is on economic recovery, the Bank of Thailand's monetary policy objective remains that of maintaining price stability.

It is my belief that an important pre-condition for growth on a sustained basis is a stable macroeconomic environment. However, I doubt that macroeconomic policy alone will be sufficient for long-term economic growth. We, therefore, need to look beyond macroeconomic policy.

To meet the growth challenge, Thailand needs a steady and sincere effort at the micro-level to put our economy back on a more robust growth path. The reforms must aim for good corporate governance, faster debt restructuring, and the efficient and effective banking sector.

Without these actions, the potency of the fiscal and monetary policies will be limited, and whatever gains in output we make will be ephemeral.

The bottom line, Ladies and Gentlemen, is that Thailand will stand ready to reap the full advantage of an upcoming global recovery only if the real sector becomes competitive and the financial sector functions smoothly.

The Bank of Thailand can contribute to the growth process by conducting a responsible monetary policy to ensure price stability, and by prodding the economy along the path of institutional reforms that have been initiated. With a sound policy framework and institutional reforms in place, a more efficient economic structure will have been built and the entrepreneurial energy of the private sector can be unleashed to ensure greater economic well being.

This brings me to the last point I wish to make tonight, that is the need to speed up the structural reforms.

I am convinced that the necessary transition toward more robust and durable growth lies in breaking out of the current constraints imposed on the economy post-1997, the most pressing of which is the debt-overhang problem. To go forward we first need to unshackle ourselves. The crawling pace of debt resolution is tying down the economy. If we could not resolve the debt problem in a timely manner and adopt new work practices, it will be next to impossible to compete successfully in the world market.

The Bank of Thailand and the Government are alert to this challenge. And the Government has already initiated the process of overhaul.

One notable attempt at debt restructuring is the establishment of the Thai Asset Management Corporation (TAMC). The entity was set up to reduce distressed assets in the banking system through centralization of NPLs' management. This should allow banks to resume their normal function and new lending. New lending is needed to provide the working capital to support corporate restructuring as well as business expansion. This way, our energy will be channeled toward more productive enterprises. And, with the authority to liquidate and rehabilitate businesses through swift legal procedures, the TAMC is unique in its unprecedented power.

Next, given that a substantial share of distressed assets remains outside the purview of the TAMC, I see the need to expedite the process of corporate debt restructuring which requires a speedy passage of the reformed bankruptcy law. This action will be testimony to the sincere effort that we in the authorities can make for the benefit of our future generations.

Insofar as the banking sector is concerned, the Bank of Thailand regards better enforcement of the banking and financial institution regulations as a priority.

This is an area that the Bank of Thailand takes leadership role to strengthen the soundness and efficiency of the financial institutions. Our leadership must lead to an outcome which makes practical sense, measures up to international best practices, and must be market-oriented.

On this front, we have been actively involved in the consultation process for the New Basel Capital Accord, which will provide a more comprehensive and sensitive approach to addressing risks through the use of minimum capital requirements, supervisory reviews and market discipline.

The second agenda of the banking sector reform is enhancing our risk management capacity. Toward this end, our Supervision Group has moved from regulation and transaction-testing toward risk-based supervision.

We realize that good rules alone do not automatically translate into honorable practices. Therefore, we consider an upright supervisory role as a sine qua non to ensure honest banking practices.

The new supervisory practices can be considered a milestone in this area. Our aim is to nudge Thai banks to change their business practices. Currently, they are working harder than ever to satisfy some of the new rules, notably those that link risk-based classification of debts to provisioning for loan losses.

We are in effect encouraging banks to eschew the old norm of collateral lending and adopt new practices of examining cash-flow projections and other indicators. This reform was implemented hand in hand with the corporate sector reform under the purview of the SEC. This practice will only lead to a more efficient allocation of financial resources. Under the new rules and our strict supervisory practices, we are optimistic that the banking system will play a more meaningful role in the economy in the near future.

Ladies and gentlemen,

Much has transpired since 1997. Our economy has been under intense pressure to perform, and I am confident enough to say that we are in a better position today to manage future challenges. Although, the outlook for 2002 is brighter than that of last year, we do remain somewhat cautious. The reform process must continue so that the global pick-up does not pass us by and that our economy can secure the potential gains imbedded in our talented entrepreneurs and workforce.

It has been an honor and thank you for your attention tonight.