



International Monetary Fund

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The following item is a Letter of Intent of the government of Thailand, which describes the policies that Thailand intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Thailand, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

Use the free [Adobe Acrobat Reader](#) to view [Table 1](#), [Table 2](#), [Boxes](#) and [Annexes](#).

Bangkok
November 25, 1997

Dear Mr. Camdessus:

1. The new government headed by Prime Minister Chuan has reconfirmed its full commitment to the economic program specified in the Memorandum on Economic Policy (MEP) of August 14, 1997. Indeed, the new economic team is determined to take a number of additional measures to strengthen the policy package and reinforce public confidence in the program. Implementation of the policies specified in the MEP has been overshadowed by very difficult economic conditions in Thailand as well as in the region. Nonetheless, all of the performance criteria for end-September 1997 were met. The new government is determined to proceed rapidly with implementation.

I. Revised Macroeconomic Framework for 1997-98

2. Our program has now to contend with a less favorable short-term macroeconomic outlook than originally anticipated. In particular, the slower return of confidence has further depreciated the exchange rate, put pressure on interest rates, and is resulting in a much sharper decline in private investment and consumption than originally anticipated. While this turn of events will imply a weaker economy in the period immediately ahead, we are confident that the determined implementation of the economic program will establish the conditions for Thailand's economy to return to stable growth.

3. Thus, we have reassessed the key macroeconomic objectives for 1997-98 and these are presented in [Table 1](#). While overall growth is still expected to be positive during this period as a whole, there will be economic contraction in many sectors in the period immediately ahead. The sharper economic downturn will help dampen the effect of currency depreciation on prices, and inflation is now projected to be only slightly higher than originally programmed in spite of the much weaker baht. The external current account deficit will, also, adjust faster than originally expected, falling to 3.9 percent of GDP in 1997 and to 1.8 percent of GDP in 1998--i.e., more than one percentage point lower than the initial program targets. This will help offset a weaker than expected capital account.

II. Macroeconomic Policies

Fiscal policy

4. The altered macroeconomic environment--especially, the weaker economy and the larger exchange rate depreciation--has eroded the setting for fiscal policy. The revenue shortfall relative to the Budget for 1997/98 is now expected to be in the order of B 133 billion (or 2½ percent of GDP), much of which can be attributed to the slower pace of economic activity. Nevertheless, we are determined to maintain the fiscal goal of keeping the consolidated public sector in a surplus of 1 percent of GDP in 1997/98. This will ensure an orderly offset to the anticipated costs of the financial sector restructuring, while also providing a clear signal of the government's intent to implement the economic program.

5. For this purpose, we have reinforced the fiscal program (Annex A) through additional measures to ensure compliance with the fiscal goal. These measures are presented in Table 2, and full government approval of all the measures is now in place. While we have been forced to increase our reliance on import duties, the increased duties on luxury items and the small surcharges are temporary and consistent with our obligations to the WTO; we have committed to reverse them by end-1999, and will strive to do so earlier. Toward this end and, most importantly, to ensure an elastic and efficient tax structure in Thailand, we intend to carry out a comprehensive review of the present tax system. For this reason, we are requesting early technical assistance from the Fund.

6. The economic downturn is also likely to reduce the retained earnings of nonfinancial public enterprises. However, we continue to aim for a balanced financial position for this sector. Since the adoption of the program in August, we have reviewed the investment programs of these enterprises and curtailed lower priority investment spending. The new expenditure limits for the public enterprises have now been announced by the National Economic and Social Development Board and adopted by the government. The principal cuts have taken place in the investment programs of the utilities (the electricity and water authorities, the telephone company), and Thai Airways. At the same time, adjustments are being made in all utility and state enterprise charges to reflect the larger depreciation of the baht, except for bus and rail fares which continue--as provided for in the program--to be set below costs for the time being for social reasons. Given the uncertain macroeconomic environment and its impact on budget revenues, fiscal developments have to be kept under constant review and reassessed at the time of the second program review.

7. Wage policy continues to be supportive of the objective of minimizing the impact of the depreciation of the baht on prices. The increase in the minimum wage for the year 1998 has been limited to 2-3 percent.

Monetary Policy

8. Within the framework of our flexible exchange rate policy, monetary policy will need to play a greater role in stabilizing conditions in the foreign exchange market and containing the inflationary impact of the exchange rate depreciation. This has implications for interest rate policy as well as for the monetary program. As part of the BOT's resolve to maintain such a tight monetary stance, interest rates will principally be set with the objective of helping stabilize the exchange rate and restore confidence in domestic financial assets. As a guide to this policy, and once the exchange market has stabilized, we intend to keep interest rates within the interest rate range specified in Annex B. However, until the foreign exchange stabilizes, we will be keeping short-term interest rates above this range, as necessary, in order to help stabilize the exchange market, and we will continue to use interest rates flexibly in this way whenever warranted by uncertainties in the foreign exchange market. Consistent with the return of market confidence, we hope to bring this range down progressively, and interest rate policy will be closely reviewed with the Fund as part of future program reviews. We recognize that a sustainable lowering of interest rates will depend upon the return of confidence, based on the determined implementation of

financial sector restructuring and fiscal consolidation.

9. The monetary program has been reassessed in light of the larger-than-expected capital outflows and further depreciation of the exchange rate, which provide clear evidence that the demand for baht denominated assets has been weaker than originally anticipated. Thus, on the basis of a further rise in the velocity of broad money, M2A is now projected to grow by 1.5 percent by end-1997 and 6.8 percent in 1998. At the same time, the slow return of confidence has increased the demand for currency relative to broad money, and reduced the money multiplier. Therefore, we now aim to contain the expansion of reserve money growth and NDA of the BOT to levels within the original program limits and indicative targets for these aggregates during 1997-98. (Annex B contains the performance criteria that have been set for the period through March 31, 1998.)

External Sector Policies

10. Although current account adjustment is proceeding rapidly, the capital account is weaker than expected. Overall, we still expect to maintain the gross international reserves of the Bank of Thailand at the originally set levels (at least US\$23 billion at end-1997, equivalent to about four months of imports). However, to give greater flexibility to reserve and debt management to respond to any risks in projected private capital inflows, we have established new performance criteria for the net international reserves (NIR) of the BOT as well as for external public sector borrowing, for December 31, 1997 and March 31, 1998 (Annex C). We will continue to review carefully these limits, in the context of the overall financing of the program, in future program reviews. We will also consult with the Fund on the utilization of the new borrowing limits.

11. Looking ahead, we believe that strict implementation of financial sector restructuring (explained below) will help restore market confidence and contain outflows. Also, despite the rollover of forward and swap obligations, we expect that the total of such liabilities would be reduced to about US\$9 billion by end-1998, which would comprise of liquidity-related swaps with onshore banks.

12. It remains our intention to remove as quickly as possible the restrictions on purchases and sales of baht by nonresidents as well as the restrictions on baht-denominated borrowing by nonresidents and on the sale of debt instruments and equities for baht. We expect this will contribute to an early restoration of confidence.

III. Financial Sector Restructuring

13. As envisaged in the original program, we have made very considerable progress in elaborating the government's strategy for the overall restructuring of the financial sector (this was done through a comprehensive announcement on October 14, 1997), and in moving decisively toward its implementation (six emergency decrees setting out the legal basis for our strategy have now been ratified by Parliament). Our detailed plans in this area for the period immediately ahead are contained in Boxes A and B, including the specification of performance criteria for the most important measures.

14. As envisaged, we are moving ahead as expeditiously as possible with the restructuring of the 58 suspended finance companies. Box A summarizes the key steps in the process: (i) the establishment of the full institutional structure in the coming weeks; (ii) the determination by the Financial Restructuring Agency (FRA) of the status of the 58 suspended finance companies by the end of November according to the strongest possible criteria; (iii) the disposal by the FRA of all good assets of closed finance companies as soon as possible thereafter; and (iv) the completion of disposal of all assets by the FRA by the end of 1998. This restructuring will proceed with transparency and without any

interference.

15. We have also elaborated the strategy for preemptively recapitalizing and strengthening the remainder of the financial system, so that its regulatory framework can be brought fully in line with international best practices by the year 2000, and that governance concerns regarding the management of this key sector can be transparently addressed. The BOT will have a clear mandate to carry out the necessary restructuring of the sector. Key steps toward this end, detailed in Box B, include: (i) the early tightening of loan classification rules and their progressive strengthening over the program period to reach international best practices by the year 2000; (ii) timetables for the recapitalization of all undercapitalized financial institutions during 1998; and (iii) streamlining of bankruptcy procedures; and (iv) reaffirmation of disclosure and auditing requirements for all financial institutions.

16. Crucial for both parts of the strategy is the liberalization of foreign equity investment in the financial sector. Thus, the government has already announced the full liberalization of such investment for a period of ten years, with all those who enter in this period being grandfathered permanently with respect to the absolute amount of their equity holding.

IV. Privatization, Social Services, And Legal Framework

17. Privatization is one of the key medium-term goals of our program. We have completed the preliminary work needed to increase the role of the private sector in energy, public utilities, communications, and transport sectors. We expect to announce firm plans in these areas by June 1998. The majority owned state enterprises which are already corporatized will be the first ones to be privatized. Indeed, we intend to reduce the government's stake in the national airline (currently 93 percent) and Bangchak petroleum company (currently 80 percent) to well below 50 percent by mid-1998, if market conditions permit. We also intend to submit to Parliament by June 1998, the necessary legislation to facilitate the privatization of the state enterprises which are not currently corporatized.

18. Given the sharper-than-expected impact on the domestic economy of the adjustment process, the government is determined to accelerate the implementation of plans to protect the weaker sections of society. Thus, we expect the Asian Development Bank to move speedily and announce a social sector support program by early 1998. With the help of the World Bank, we hope to widen even further the reach of our social services, and we expect to expand on the above initiatives by the start of the second year of the program period.

19. The government has also made considerable progress in bringing the legal and regulatory framework in line with international standards and consistent with the smooth implementation of the overall economic program. Financial sector legislation has already been reviewed and amended as part of the restructuring exercise; we will be amending the Currency Act in order to modernize the regulatory framework for central banking operations; and amendment of the Bankruptcy Law and Civil and Commercial Code are also envisaged to facilitate implementation of the financial restructuring framework.

20. It is our firm belief that the bold and detailed policy measures enunciated here, together with the greater transparency that we have adopted on economic data and policies, will lay the foundation for a decisive turnaround in confidence and economic performance, and lead to a resumption of capital inflows. The government is prepared to take any further measures that may become appropriate for this purpose, will consult with the Fund on the adoption of any such measures, and will provide the Fund with any necessary information in accordance with the policies of the Fund on such consultations.

Sincerely,

/s/

/s/

Tarrin Nimmanahaeminda
Minister of Finance

Chaiyawat Wibulswasdi
Governor, Bank of Thailand

Attachments

Mr. Michel Camdessus
International Monetary Fund
Washington, D.C. 20431
U.S.A.
