International Monetary Fund

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Bangkok, Thailand
March 23, 1999

Dear Mr. Camdessus:

1. We are pleased to inform you that considerable progress continues to be made in our economic reform program, both by way of policy implementation and economic outcomes. Reflecting the supportive stance of monetary and fiscal policies, output has stabilized in large parts of the economy, inflation has fallen sharply, and the external position has strengthened further. Growing confidence has allowed interest rates to fall below pre-crisis levels without compromising exchange rate stability. These are significant achievements, especially when viewed against the background of unsettled emerging markets and economic weakness in many of our trading partners.

2. At this sixth review of the program, we have adapted the economic policy framework, in the light of our experience, to strengthen the momentum for recovery:

- First, we will adopt shortly the expenditure package, foreshadowed in the last letter of intent, amounting to about 1 percent of GDP (B 53 billion). This package is aimed at strengthening the social safety net for those most affected, especially the rural poor, and boosting domestic demand, through labor-intensive investment projects. The full details of this expenditure package, which is entirely financed by the Miyazawa Initiative and the World Bank, will be announced on March 30, 1999.

- Second, with the fiscal cost of financial restructuring now estimated to be about 1 percent of GDP lower than previously projected, we are elaborating additional tax reduction and spending measures to maintain the fiscal stimulus. Thus, we have raised the 1998/99 public sector fiscal deficit target by about 1 percent of GDP to about 6 percent of GDP (excluding the interest costs of financial restructuring). The tax reductions, to be announced on March 30, are being carefully designed to address the principal weaknesses in consumer and business sector demand. The expanded public sector deficit target also makes room for new foreign-financed spending for social safety net and public investment.

- Third, in light of the growth of nonperforming loans, we have taken a number of steps to ensure full implementation of financial sector reform. Driven by enhanced prudential rules and supervision, progress has been made in gradually recapitalizing the banking system toward levels consistent with best international practice, and this process will continue in the period ahead. At the same time, all preparatory steps for the privatization of intervened banks have been resolved, and it is now expected that concrete results will be achieved by October 1999.

- Fourth, to speed up corporate debt restructuring and revive credit to the real economy, the institutional framework for corporate debt restructuring has been again reviewed and further strengthened, notably through the introduction of procedures for invoking inter-creditor and creditor-debtor mediation and arbitration. Most importantly, Parliament has now approved the key amendments to the Bankruptcy Law, the new Bankruptcy Courts Law, two laws on foreclosure, the Corporatization Law, and the Condominium Act. We will make every effort to cooperate with Parliament and urge speedy passage of the remaining legislation aimed at economic recovery. The decision to extend the current parliamentary session for the consideration of constitution-related laws should help facilitate this process.

3. As the economic situation evolves, additional policy initiatives and refinements may be needed in the course of 1999, and these can be taken up at the next program review in June of this year, as well as in the subsequent reviews. In any event, the government stands ready, in consultation with the Fund, to take whatever additional measures that may be needed to ensure the continued success of the program.

Sincerely,

/s/	/s/
Tarrin Nimmanahaeminda Minister of Finance	M.R. Chatu Mongol Sonakul Governor, Bank of Thailand

Attachment (Memorandum on Economic Policies)

Mr. Michel Camdessus
Managing Director
International Monetary Fund

Memorandum on Economic Policies of the Royal Thai Government

March 23, 1999

1. Steady implementation of the reform program is laying a strong basis for economic recovery in 1999. Efforts to intensify financial sector reform, corporate debt restructuring and legislative reforms should facilitate the resumption of credit to the real economy. These efforts remain at the heart of the program. At the same time, action is being taken to ensure that fiscal policy continues to provide sufficient stimulus to be fully supportive of recovery.

2. Targets and performance criteria through September 1999 are set out in Annexes A-C. Due to scheduling difficulties, IMF Board consideration of the sixth review of the stand-by arrangement is now expected to take place only in April. Accordingly, it is requested that the applicability of end-March performance criteria be waived for purchases up to SDR 2,400 million under the arrangement.

I. Macroeconomic Framework and Policies for 1999

3. The program's macroeconomic framework remains broadly appropriate (Table). There are grounds for guarded optimism in manufacturing and agricultural production, both of which are projected to rise; however, weakness in international prices is likely to depress farm incomes. Overall, despite downside risks, real GDP growth should be close to the 1 percent projected at the last review, while inflation is likely to decline to around 2½ percent in 1999. The external position is projected to strengthen, with further rebuilding of foreign exchange reserves to $32-34 billion by the end of the year, and improved external indicators.

Table. Macroeconomic Framework for 1999

	1998 Est.	1999 Outlook
	(In percent)	
Real GDP growth	-8	1
CPI inflation (period average)	8	2½
	(In billions of U.S. dollars)	
External current account balance	14	12
(In percent of GDP)	12	9
Gross official reserves (end-period)	29½	32 to 34
(In months of imports)	8½	9
(In percent of short-term debt)	123	191-203
Unwinding of swaps and forwards	11½	4

Fiscal Policy and the Social Safety Net

4. On current trends, and without any additional measures, both revenue and expenditure are likely to be below the level envisaged during the last review. Expenditures are expected to be about ½ percent of GDP lower than planned, reflecting delayed foreign financing, and difficulties in accelerating project implementation. On the revenue side, it is now anticipated that lower baht import values will reduce tax collections by about ½ percent of GDP.

5. The developments noted above would keep the public sector deficit at about 5 percent of GDP, but the lower spending would, on balance, provide less stimulus to aggregate demand in 1998/99. Moreover, reflecting lower interest rates, the cost of financial sector restructuring is now also expected to be about 2 percent of GDP, almost 1 percentage point lower than previously estimated. Accordingly, it is now proposed to aim for a somewhat higher deficit of about 6 percent of GDP for the public sector; the corresponding quarterly fiscal targets are set out in Annex A.

6. The expanded deficit target accommodates a major tax stimulus package--to be announced on March 30--and new expenditure measures in the remainder of the fiscal year. These new tax and spending measures will bear testimony to the government's commitment to a fiscal stance fully supportive of recovery, while safeguarding the medium-term structural fiscal position.

7. Furthermore, the additional expenditure of about 1 percent of GDP announced at the time of the last review has also been oriented toward strengthening the social safety net and boosting aggregate demand. Administrative arrangements have been put in place for quick disbursement once the foreign financing is received from the World Bank and Japan. The package includes significant increases in the coverage of in-kind and cash social benefits,

temporary employment for blue and white collar workers and additional funding for water and irrigation programs.

Monetary and Exchange Rate Policy

8. The stabilization of the exchange rate, within a market-determined framework, has been brought about by the commitment to use interest rate policy flexibly. This has permitted money market rates to fall to well below pre-crisis levels--a development increasingly reflected in lower bank lending rates--which is easing pressures on the corporate sector. With an accommodative monetary policy in place, the larger task of reviving credit flows hinges on financial sector reform and corporate debt restructuring.

9. The BOT's quantitative monetary program has been modified to take into account trends in the demand for broad money (M2A) and reserve money, both of which have been growing more slowly than envisaged at the last review. The ceiling on net domestic assets (NDA) and the indicative limit for reserve money for end-March, 1999 have been lowered in line with recent trends. Nevertheless, the newly established ceilings and indicative limit for end-June and end-September fully accommodate the expected rise in the demand for broad money associated with economic recovery, and the monetary stance remains fully supportive of recovery (Annex B).

External Sector

10. The balance of payments outlook for 1999 remains strong. No major change is expected in the overall balance, although the components have been revised in light of updated information. Thus, the current account surplus is now projected to be slightly larger than expected at the last review, with continued weakness in import demand outweighing weaker external demand for exports. Offsetting this, the capital account deficit is projected to be somewhat larger, mainly on account of a lower debt rollover ratio. However, after taking into account resources mobilized from bilateral partners (in particular, additional funding under Japan's Miyazawa Initiative), it is still expected that gross official reserves will rise to the \$32-34 billion range by end-1999. The associated floors for net international reserves are set out in Annex C.

II. Financial Sector Restructuring

11. The private sector-led recapitalization process, supported by the state, remains the key element in the strategy for strengthening the core banking system in Thailand. To drive the process forward, the BOT held discussions with all 13 commercial banks during January 1999 and completed, as envisaged, memoranda of understanding (MOUs) with those banks needing to raise capital during the first half of 1999.

- After submitting detailed business plans, six private banks--including the largest ones--were judged to have adequate capital during the first half of 1999 and did not require MOUs. Among these banks, at least two have raised sufficient capital for the next two years. Another two are in the process of raising additional capital from the market, and the other two are majority foreign owned, and have adequate access to capital. These six banks account for 56 percent of financial system deposits.
- Two private banks, which have signed MOUs with the BOT, are in the process of raising private capital in conjunction with government assistance through the Tier 1 capital support scheme. They account for 15 percent of bank deposits.

- The government remains committed to fully recapitalizing two state banks, KTB and Bank Thai, which together account for 20 percent of bank deposits, and preparing them for privatization over the medium term. The recapitalization process of these banks was specified last August, and is contingent upon BOT approval of restructuring plans, a process we firmly intend will be completed by April 30.

- The three intervened banks will be recapitalized through early privatization.

Given the success of the MOU process in putting in place a forward-looking monitoring system, the BOT intends to repeat this exercise, and require all financial institutions needing to raise additional capital through December 1999 to sign MOUs by the end of July (the signing of MOUs with banks will be a performance criterion for end-July 1999). At that time, all banks and finance companies will also be asked to submit detailed recapitalization plans through end-2000 (Box A).

12. Despite some delays in the process, the government remains committed to privatizing Bangkok Metropolitan Bank, Siam City Bank, and Radanasin Bank (which has acquired the intervened Laem Thong Bank). The process for Radanasin Bank is at a somewhat more advanced stage, and it is expected to be the first bank offered for sale in the next few weeks. Financial advisors for the other two banks have now also been appointed, and the framework for their privatization have been approved by the Cabinet. With a view to finalizing the sale of all three banks by the third quarter of the year, the first round of bidding and the selection of short-listed bidders is expected to be completed by end-June 1999 (performance criteria under the program).

13. The financial restructuring process is approaching a particularly complex phase that will require closer coordination among the agencies involved in policy implementation (especially the Ministry of Finance, the BOT, the FIDF, and the Financial Restructuring Advisory Committee). We have clarified lines of responsibility among these agencies. All agencies will be required to submit regular progress reports to the Ministry of Finance, which will assume a coordinating role. Further, to forestall further delays in decision making, we have clarified legal indemnity protection for the FIDF staff and Directors, and FIDF management has been strengthened through the recruitment of external banking experts.

14. Meanwhile, progress continues to be made in regulatory reform broadly as envisaged. A draft Financial Institutions Law is nearing completion and will be sent to the banking industry for comments by April 1999. The law will strengthen supervision procedures and provide the BOT with clear and full supervisory responsibility. It is expected to be submitted to Cabinet in mid-1999, with parliamentary consideration expected in the second half of the year. Also, a deposit insurance law is currently being drafted to eventually replace the blanket guarantee of the financial system that was introduced at the start of the program.

15. The Financial Sector Restructuring Authority (FRA) will soon begin the process of disbursing the proceeds from previous sales and the FRA is expected to complete all auctions by mid-1999. The unsold business loans from the FRA December auction were re-auctioned on March 19, 1999. The FRA modified the auction procedures to allow wider participation and profit-sharing bids. The Asset Management Corporation participated as a bidder of last resort, and care was taken to ensure that its bids reflected fair market value.

III. Corporate Debt Restructuring, Legal Reform, and Market Opening

16. The institutional framework for voluntary corporate debt restructuring has been

progressively strengthened over the past few reviews, with the most recent initiatives including the development of guidelines for invoking inter-creditor and creditor-debtor mediation and arbitration. Important results have already been achieved under the Corporate Debt Restructuring Advisory Committee (CDRAC), with some 67 cases having been successfully restructured, including a number of large headline cases in recent weeks; thus CDRAC will increase the number of cases it targets for rapid debt restructuring from the current 200. Further, the CDRAC will begin arranging for debt restructuring experts to act as facilitators in the negotiating process. Nevertheless, there remains a need to accelerate out of court debt workouts.

17. In this regard, reform of the legal framework for bankruptcy protection of debtors and foreclosure rights of creditors is a key element of our strategy. Accordingly, Parliament recently passed amendments to the bankruptcy law and also approved the law establishing specialized bankruptcy courts. Further, on foreclosure proceedings, two of the three bills in this area have been approved by Parliament. The government will continue to cooperate with Parliament to complete the consideration of the remaining foreclosure bill as soon as possible.

18. Equally important on the legal agenda are our efforts to liberalize private domestic and foreign investment in key sectors, including real estate, which have been particularly hit by the economic crisis, and so increase liquidity in these sectors. As described in previous MEPs, the key initiatives include: (i) the new Foreign Investment Law; (ii) amendment of the Land Code; (iii) the new Condominiums Act; (iv) the new Lease Act; and (v) the new Corporatization Law (to facilitate privatization of state enterprises). The Corporatization Law and the Condominium Act have now been approved by Parliament. The government will continue to cooperate with Parliament to complete consideration of the remaining laws as quickly as possible.

19. The privatization program is an important element of our medium-term economic restructuring program. Since Cabinet approval of the Master Plan in September 1998, progress has been made in a number of areas. In the energy sector, plans have recently been approved (i) to allow private sector participation in the Ratchaburi Power Plant by end-1999, (ii) to begin the divestiture of government equity in Bangchak Petroleum in mid-1999, and (iii) to restructure the Natural Gas Supply Industry. Furthermore, a newly appointed financial advisor is preparing the bidding methodology for the divestiture of MOF's stake in ESSO Thailand as soon as market conditions permit, and should be completed by end-1999. In the transport sector, a bidding prospectus for the privatization of Thai Airways in mid-1999 is being prepared and financial advisors are being selected to help with the corporatization and eventual privatization of the Airport Authority. Finally, with a view to increasing private sector participation in the Metropolitan and Provincial Water Authorities and Wastewater Management Authority, the government has begun a study of the water sector including with regard to the need for a regulatory framework and tariff structures.

Box A. Financial Sector Reforms[1]

Measure		Date
I.	**Remaining Steps in the Implementation of the August 14 Announcement for Financial Restructuring**	
	Bangkok Metropolitan and Siam City Banks--to be privatized	

	• Selection of financial advisors for privatization by December 1, 1998.	Done
	• *Cabinet approval of privatization approach*.	March 30, 1999
	• *Completion of the first round of bidding*	June 15, 1999
	• *Selection of short listed investors (Performance criterion).*	June 30, 1999
	• *Due diligence by short listed investors and selection of winning bid.*	July-August, 1999
	• *Closing negotiations and approval of winning bid.*	October 15, 1999
	Bangkok Bank of Commerce--to be transformed into AMC and wound down	
	• Adoption of plan for closure by end-1999 and establishment of AMC by end-1998.	Done
	• Banking license revoked.	April 30, 1999
	First Bangkok City Bank--to be integrated with Krung Thai Bank (KTB)	
	• Recapitalization of KTB for integrating First Bangkok City's assets by December 15, 1998.	Done
	• Cabinet approval of loss sharing arrangements for KTB.	March 30, 1999
	• *MOF to issue instructions to effectively close First Bangkok City Bank.*	April 30, 1999
	Union Bank--to be integrated with Krungthai Thanakit and twelve intervened finance companies, including recapitalization of the combined entity after full provisioning	April 15, 1999
	Laem Thong Bank--to be integrated with Radanasin Bank and privatized	
	• *Cabinet approval of privatization modality.*	Done
	• *Completion of the first round of bidding and selection of short listed investors (Performance criterion).*	June 15, 1999
	• *Closing negotiations and approval of winning bid.*	July 31, 1999
	Krung Thai Bank--operational restructuring and recapitalization after full up-front provisioning	April 30, 1999
II.	**Recapitalization of Financial Institutions**	
	• Based on established prudential norms, MOUs will be signed with all banks needing to raise additional capital through June 1999 (by January 31, 1999).	Done
	• Similar MOUs to be signed with finance companies (by January 31, 1999).	Done
	• *Based on established prudential norms, recapitalization plans will be submitted by all banks needing to raise additional capital through end-2000. MOUs will be signed with those banks needing to raise additional capital through December 1999 (Performance criterion).*	July 31, 1999
	• *Similar requirement to apply to finance companies.*	July 31, 1999
III.	**Regulatory and Supervisory Framework**	
	• Issue regulation regarding finance companies' entitlement to a banking license by end-1998, with a view to facilitate the consolidation of the finance company sector.	Done
	• Issue operational guidelines for private AMCs by end-1998.	Done
	• Review of central bank, commercial bank, and finance company laws by end-January 1999.	Done
	• *Submission to Parliament of Currency Act.*	Mid-1999
	• Enact a new Financial Institutions Law (covering banks and finance companies).	
	– Review of the draft by legal experts, and by industry representatives.	May 31, 1999
	– Cabinet approval.	July 31, 1999
	– Submission to Parliament.	August 31, 1999

	• Based on new Financial Institutions Law: (i) issue new prudential regulations, including foreign exposure and lending to related parties; (ii) establish requirements for auditing, accounting, and disclosure for all financial institutions, consistent with international best practices.	Soon after enactment of Law.
	• Draft plan for deposit insurance scheme to replace comprehensive guarantee over medium term by end-1998.	Done
	• *BOT to complete preliminary draft law establishing new deposit insurance scheme.*	August 31, 1999

[1]Revised or new measures are italicized.

ANNEX A

Fiscal Targets

The definitions of all variables and sectors are unchanged from the previous Review and the same adjustments apply for FIDF operations. Principal and interest payments arising from financial sector restructuring, including from fiscalization of FIDF obligations, continue to be excluded.

1. Indicative limits on the cumulative balance of the central government

	Ceiling (In billions of baht)	
	Fifth Review	Sixth Review
Cumulative balance from September 30, 1998 to:		
December 31, 1998	- 63	-31 (actual)
March 31, 1999	- 85	-85
June 30, 1999	...	-90
September 30, 1999	...	-100

The cash balance of the central government is defined as in the treasury accounts (which exclude amortization and foreign-financed expenditures). The coverage of these accounts was described in the MEP of May 26, 1998. Privatization receipts are excluded.

2. Performance criterion on banking system net credit to the public sector

	Ceiling (In billions of baht)	
	Fifth Review	Sixth Review
December 31, 1998	-211	-263 (actual)
March 31, 1999	-151	-151
June 30, 1999	...	-139
September 30, 1999	...	-123

ANNEX B

Monetary Targets

The definitions of all performance criteria and indicative limits are unchanged from the previous Review. The adjustor on NDA has been modified to permit more flexibility in managing reserve money and the accumulation of foreign exchange reserves.1 For the purposes of program monitoring, the baht value of NFA of the BOT will be calculated using the exchange rates given in the previous MEPs.

1. Performance criterion on net domestic assets of the BOT

	Ceiling (In billions of baht)	
Outstanding Stock as of:[1]	Fifth Review	Sixth Review
End-December 1998	-103 (adjusted)[2]	-118 (actual)
End-March 1999	-28 (performance criterion)	-46 (performance criterion)
End-June 1999	...	-32 (performance criterion)
End-September 1999	...	-28 (performance criterion)

[1]Calculated as the average of the closing positions on the last five working days of the month and the first five working days of the following month.
[2]Adjusted for the excess of NFA over its projected baseline.

2. Indicative limits for reserve money

	Ceiling (In billions of baht)	
Outstanding Stock as of:[1]	Fifth Review	Sixth Review
End-December 1998	485	470 (actual)
End-March 1999	490	480
End-June 1999	...	477
End-September 1999	...	477

[1]Calculated as the average of the closing positions on the last five working days of the month, and the first five working days of the following month.

ANNEX C

External Sector Targets

The definitions of all performance criteria, as well as the exchange rates used, are unchanged from the previous Review.

1. Performance criterion on net international reserves of the BOT

	Floor (In millions of U.S. dollars)	
	Fifth Review	Sixth Review
Stock as of July 31, 1997	1,144 (actual)	

Cumulative change from level on July 31, 1997		
End-December 1998	14,000 (performance criterion)	18,489 (actual)
End-March 1999	15,500 (performance criterion)	15,500 (performance criterion)
End-June 1999	...	19,500 (performance criterion)
End-September 1999	...	20,000 (performance criterion)

The program definition of NIR of the BOT is as described in the May 26 MEP.

2. Performance criterion on contracting or guaranteeing of new external debt

The limit applies to the contracting or guaranteeing by the public sector of new nonconcessional external debt with an original maturity of more than one year, as defined in the MEP of May 26, 1998.

	Ceiling (In millions of U.S. dollars)	
	Fifth Review	Sixth Review
Cumulative from August 10, 1997		
End-December 1998	9,000 (performance criterion)	3,677 (actual)
End-March 1999	9,000 (performance criterion)	9,000 (performance criterion)
End-June 1999	...	9,000 (performance criterion)
End-September 1999	...	10,000 (performance criterion)

3. Performance criterion on the stock of short-term debt outstanding

The public sector will not contract or guarantee any new debt of maturity up to one year. Excluded from these limits are guarantees associated with the financial system restructuring, the balance ofpayments financing package envisaged under the program, normal import-related credits, forward contracts, swaps, and other futures market contracts.

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[1]The modification gives the BOT greater latitude to increase reserve money if the balance of payment position strengthens. Henceforth, the adjustor will now apply only to *specific* foreign exchange transactions of the BOT. Thus, the NDA ceiling will be adjusted downward by the amount of BOT foreign exchange receipts from international sovereign bond issues, the Miyazawa Initiative, and structural adjustment loans from the World Bank and AsDB. Changes in reserve regulations will modify the NDA ceiling and the indicative limit on reserve money, as described in the MEP of May 26, 1998.