PRESS RELEASE NO. 97/37

Press Release: IMF Approves Stand-by Credit for Thailand

August 20, 1997

The International Monetary Fund (IMF) today approved a stand-by credit for Thailand, authorizing drawings of up to SDR 2.9 billion (about US$3.9 billion) over the next 34 months to support the government's economic program. Of the total, SDR 1.2 billion (about US$1.6 billion) is available immediately, and a further SDR 600 million (about US$810 million) will be available after November 30, 1997, provided that end-September performance targets have been met and the first review of the program has been completed. Subsequent disbursements, on a quarterly basis, will be made available subject to the attainment of performance targets and program reviews. The stand-by credit is equivalent to 505 percent of Thailand's quota[1] (#I2) of SDR 573.9 million (about US$780 million) in the IMF. (#I2)

In approving Thailand's request for the stand-by credit, the IMF made use of the accelerated procedures established under the Emergency Financing Mechanism (EFM), which was adopted in September 1995. The EFM strengthens the IMF's ability to respond swiftly in support of a member country facing an external financial crisis and seeking financial assistance from the IMF in support of a strong economic adjustment program.

Background

After a decade of great economic success, aided by a strong track record of prudent macroeconomic policies, Thailand's economic situation deteriorated progressively in recent years, and became increasingly vulnerable since 1993, as reflected in a persistent and widening current account deficit, which peaked at 8 percent of GDP in 1996; an associated high external debt burden (50 percent of GDP), of which some 40 percent is short-term; and serious weakness in the financial system, particularly-but not exclusively-in finance companies. The situation was exacerbated by external shocks. From mid-1996, Thailand was confronted with a series of adverse developments, including a sharp slowdown in exports and GDP growth; growing difficulties in the property sector; a sharp fall in the stock market; and some weakening of the fiscal position.

During the first half of 1997, the authorities took some measures to address the growing signs of fiscal deterioration, as well as to strengthen the financial and property sectors, but these proved insufficient to restore market confidence. Growth and investment continued to slow, support for financial companies accelerated progressively, and there was evidence of growing financial disintermediation. In this environment, there followed a series of increasingly serious attacks on the baht.

On July 2 the authorities introduced a managed float of the baht, which subsequently depreciated about 20 percent against the U.S. dollar during July. However, reports that borrowers were facing increasing difficulties rolling over short-term debt, intensified outflows from finance companies, and accelerated injections of financial support from the Financial Institutions Development Fund (FIDF) precipitated a widespread loss of confidence. Recognizing that the economic and financial situation had now become precarious, the authorities moved swiftly to put together a comprehensive economic package.

The Medium-Term Policy Strategy

The Thai government's 1997-2000 policy framework, which the stand-by credit supports, is designed to restore confidence and economic stability at an early stage and lay the foundation for sound growth over the medium-term. The measures under the program are designed to bring about orderly shifts in domestic saving-investment balances that will underpin the reduction in the external current account deficit to a more sustainable 3 percent of GDP in 1998. Additional structural measures to reinforce the outward orientation of the economy are an important part of the package to bring about a recovery of the economy to Thailand's annual growth potential of 6-7 percent over the medium-term.

Central to the medium-term strategy is the new exchange rate regime. The managed float adopted on July 2, 1997 should alter the incentive framework for short-term capital flows and protect the future level of foreign exchange reserves. Fiscal policy aims at maintaining the public sector in surplus in order, inter alia, to provide a necessary margin to absorb financial restructuring costs. In the monetary field, strict control over the monetary aggregates includes ending the recent practice of open-ended, unconditional financial support to insolvent institutions, and the development of further monetary policy instruments. Improved public disclosure of key economic information is also envisaged under the program.

Structural reforms to address the causes of the present economic difficulties are essential to the strategy, in particular the strengthening of the financial system, while minimizing moral hazard risks. The success of the program hinges crucially on isolating insolvent institutions and ensuring the viability of those remaining through early recapitalization, and strengthened regulatory requirements and supervision. An important determinant in the timing and strength of the recovery will be the turnaround in the export sector. The relative price effects of the devaluation will boost competitiveness in low-end export markets in the short to medium-term. However, to assist in the structural adjustment to higher-technology production and exports that has been on the authorities' agenda, the medium-term strategy also contains accelerated privatization of strategic sectors, increased emphasis on secondary education and training (in part, also motivated by the need for social safety net protection), and other efforts to strengthen competitiveness.

The 1997-98 Program

The principal objective of the program for 1997-98 is to achieve an orderly adjustment of the domestic economy to the sharp, forced reduction in the current account deficit to about 5 percent of GDP in 1997 and 3 percent of GDP in 1998. This will involve ensuring positive growth of 2.5 percent in 1997 and 3.5 percent in 1998; maintaining gross official reserves at the equivalent of 4.2 months of imports in 1997 and 4.4 months in 1998; limiting the end-period rate of inflation to 9.5 percent in 1997 and 5 percent in 1998; and initiating a credible and up-front restructuring of the financial sector.

Fiscal policy is the key to the credibility of the overall program. The focus of fiscal policy will be to restore a small overall surplus in the public sector by 1998 through an increase in the rate of the value-added-tax (VAT) to 10 percent from 7 percent, and initiating expenditure cuts in a number of areas, while protecting spending on health and education. An improvement in the financial position of the state enterprises will be effected through increased oversight on expenditures and a greater emphasis on privatization. In the near term, this will entail significant increases in the prices of some utilities and petroleum products, although bus and rail fares will remain subsidized for social reasons. Monetary policy is designed to support the inflation and balance of payments objectives of the program.

Structural Policies

Under the program, reestablishing domestic and external confidence in Thailand's financial system is crucial to maintaining an open capital account, within existing financing constraints. A solvent and profitable financial sector is also a clear precondition for the restoration of rapid growth and for removing the threat of recurring financial crises. At the heart of the strategy has been the up-front separation, suspension, and restructuring of unviable institutions, immediate steps to instill confidence in the rest of the financial system, strict conditionality on the extension of FIDF resources, and the phased implementation of broader structural reforms to restore a healthy financial sector. Recognizing that the financial system will face deteriorating conditions for some time, the authorities will require all remaining financial institutions to strengthen their capital base expeditiously. This will include a policy of encouraging mergers, as well as foreign capital injection.

Financing Need

On August 11, 1997 in Tokyo, the IMF convened a meeting of interested countries to discuss Thailand's efforts to address its economic problems and to fill the financing gap. At that meeting, pledges were received from Japan (US$4 billion) Australia, Hong Kong, Malaysia, and Singapore (US$1 billion each), and Indonesia and Korea (US$0.5 billion each). Subsequently, China pledged US$1 billion, and the World Bank and Asian Development Bank announced contributions of US$1.5 billion and US$1.2 billion respectively. The total financing from these sources amounts to US$12.7 billion. Although details have still to be finalized, it is expected that the loans from the bilateral lenders to Thailand will be disbursed in the same proportions as the IMF stand-by credit. The contributions of the World Bank and the Asian Development Bank are subject to consideration by their respective Boards. The proceeds from the credits extended by theIMF and the bilateral lenders will be used solely to help finance the balance of payments gap and to rebuild the official reserves of the Bank of Thailand.

The Challenge Ahead

The decisive actions undertaken by the Thai authorities should allow growth to remain positive during the adjustment period, which will contribute to the program's wider acceptability and sustainability. But there are risks to the realization of the program's objectives. In particular, strong resolve will be required to sustain the fiscal adjustment and implement the necessary financial sector restructuring in the face of a slowing economy.

What the reaction to the Thai crisis underscores is that impressive regional support has been mobilized; and that the EFM has allowed a speedy international response, demonstrating the ability of the international community, acting through the IMF, to face in an appropriate way the challenges of globalized markets.

Thailand: Selected Economic Indicators

	1994	1995	1996	1997*	1998*
			(Percent change)		
Real GDP growth	. 8.9	8.7	6.4	2.5	3.5
Consumer prices (end of period)	5.3	7.1	4.8	9.5	5.0
			(Percent of GDP)		
Overall public sector balance (deficit -)	1.8	2.5	2.2	-1.6	1.0
External current account balance (deficit -)	-5.6	-8.0	-7.9	-5.0	-3.0
			(Months of imports)		
Gross official reserves	6.8	6.3	6.6	4.2	4.4

Sources: Thai authorities; and IMF staff estimates.
* Program.

[1] A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing, and its share in the allocation of SDRs.

IMF EXTERNAL RELATIONS DEPARTMENT

Public Affairs
E-mail: publicaffairs@imf.org (mailto:publicaffairs@imf.org)
Fax: 202-623-6278

Media Relations
E-mail: media@imf.org (mailto:media@imf.org)
Phone: 202-623-7100