

**“Trends and Prospects of Thailand’s Banking and
Financial Sector and its Impacts on the Thai Economy”**

by

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**Your Excellencies
Distinguished Guests
Ladies and Gentlemen,**

I am honoured and pleased to be here today to share my thoughts on Thailand’s strategies going forward, particularly the trends and prospects of our banking and financial sector, and its implication on the Thai economy.

By now, the 1997 crisis in Thailand must be quite familiar, if not an over analysed subject, so, I will not dwell on it. Just touching on the salient aspects, enough for you to see the changes that have taken place throughout the process of resolving the crisis. After all, we should be

focusing on the future, which is something manageable, rather than the past, which is a done deal though it has value of lessons.

And the one lesson that is critical is that we must resolve the root cause of the problem.

Ladies and gentlemen,

Managing the economy and the financial system, to make it grow healthily and equipped with the ability to adapt and re-generate and renovate itself, albeit after a storm, is probably much like a gardener who tend his garden. It requires care, ploughing, sewing of seeds, watering, weeding, and a more entrepreneurial kind might resort to the use of controversial genetic technology and so on.

In all, there is much foundation, technology, resources, care and patience that goes into it. Indeed, a good perennial garden may look barren after a cold winter or a forest fire, but if the plants and the bulbs themselves are resilient and can re-generate and adapt, or even mutate to more resilient specie, then we have a hope of a healthy and self-supporting ecological system.

In that case, the evolutionary process would be one with a stable dynamic, driven by natural selection, much akin to a well functioning market mechanism in the economic and financial system.

So how does one achieve this state in the context of a financial system after a crisis?

First of all, let's take stock, to see the initial starting point. On the macro front, the economy has already bottomed out in 1998 when we experienced a contraction of 10.8%. Since then, GDP grew by 4.2% and 4.3%, in 1999 and 2000, respectively. But for this year, it is expected to moderate along with the global economy to 2.5% to 4%.

On the macro stability front, our external debt declined from a peak of 112.3 billion US dollars in June 1997 to 80 billion US dollars as of January this year. Inflation averaged at 1.6 % last year, and stood at 1.4% in March, and our inflation targeting monetary framework appears to work well.

We had a balance of payments deficit of 2 billion US dollars last year, despite the surplus on the current account of 9 billion US dollars, due to capital outflow, mostly the repayment of debt, which is reflected in the decline in external debt.

Our international reserve now amounts to 31.89 billion US dollars, giving coverage of 1.7 times the short-term debt, quite comfortable. Given the turn-around, the progress can be considered significant, and

contributed to the restoration of the sovereign rating back to investment grade status last year.

But ladies and gentlemen, we have much work to do yet. The recovery remains vulnerable in some areas. Particularly, the corporate sector continues to face, not only debt overhang, but also perceived risk overhang, while the cost of financial and economic crisis has been hefty, and left a burden for the future which must be carefully managed, particularly with regard to two issues, namely moral hazard of financial bail out and the fiscal sustainability over medium term.

And, at the core of all of these, sustainability in financial system means we need to see the clients of the financial system healthy. This means we need to make sure our corporate sector gets back on its feet, able to compete and improve productivity. In short, we need corporate reform which, in turns, needs support of the authorities, whether in terms of regulatory reform to remove red tapes and obstacles as well as undue tax burden, but also in terms of improving education and technology, particularly IT related, as well as modernizing the laws.

Ironically, the devastation of the crisis itself did bring an opening for change. Not only has the urgency and critical need to survive brought about increased alertness to competition and risk, but such new institutions as Thai Asset Management Corporation, or TAMC, would seek to improve

asset value it manages by empowering itself with the authority to carry out corporate reform including merger.

Our strategy is to tackle the problem with an integrated approach of reform, going beyond mere finance, and striving to lay down a foundation for a better managed and better run financial system and economy.

What are our chances of success? This of course depends on the extent of our problem. So, before we do anything, we must gauge the cost of the crisis, and then evaluate our strategy so far and progress over the last three years, and then later on discuss the strategy and prospect of our financial system in the future.

In 1997, the financial crisis caused a bank run on a large scale. To restore confidence, a blanket guarantee was made, and eventually the Government closed down 56 out of 91 finance companies, bearing the cost of repaying the depositors due to the guaranty.

Unemployment peaked at 5.3 % in the second quarter of 1999, though it has now declined to 3.7% in last quarter of last year.

Corporate failure was quite substantial, although some of the more flexible large corporations did manage to restructure themselves in time to ensure survival along with the rather robust manufactured exports, and are seeing profits. In general though, the crisis led to significant impairment

of asset value. To gauge this, a preliminary estimate could be seen from the asset sale of the Financial Restructuring Agency, or FRA. FRA auctioned asset with a book value of 743 billion baht, and sold it for 263, therefore achieving a recovery rate of 35%. This figure may be somewhat low given that, with hindsight, some of the bidders have resold some of these assets and made substantial profit.

This may be explained by a number of factors, namely the FRA perhaps did not do a great job at auctioning, or that the bidder subsequently manages the asset well and has increased the value, or that the economic prospects has improved, giving businesses improved prospects. Whatever the case, the decline in asset value further depresses wealth and negatively affected consumption, in addition to the decline in farm income from low commodity prices.

As for the cost to the taxpayers of financial restructuring, the government has agreed to undertake the burden of the Financial Institutions Development Fund, or FIDF, by issuing bonds and guarantying bonds issued by the FIDF to a combined amount of 612 billion baht.

The direct injection as tier-1 and tier-2 capital support scheme, in the August 14th 1998 Package, amounted to around 73.7 billion baht.

Let's recap for a moment. What was our strategy in resolving the crisis, and how well did it work?

Ladies and gentlemen,

We intervened, nationalized, and privatised "insolvent Banks." On going banks were required to recapitalise, and allow entry of strategic or "pure investment" partners – hence a breath of competition to propel the other Thai commercial banks to upgrade. Consequently, 4 banks were bought by foreign banks, 4 are State-owned, and the remaining 5 are still privately owned.

Addressing the NPL problem, we took the market-based approach. We set up the Office of Corporate Debt Restructuring Advisory Committee (CDRAC) to play the role of coordinator and mediator. By February of 2001, around three hundred and seventy thousand cases, involving about two trillion baht of debt restructuring have been completed. The establishment of privately owned AMC's was encouraged to further resolve the NPL problem. In all, 15 privately owned AMC's have been approved, and approximately 57 billion baht worth of assets have been transferred as of December 2000.

At the same time, we have enacted the Bankruptcy and Foreclosure Laws, improved banking standard – particularly with respect to asset

classification and provisioning requirement, imposed good governance, and implemented risk-based supervision.

Ladies and Gentlemen,

As a result of our effort, confidence has increased. Overall, financial position of the Thai banking industry has improved remarkably. Non-performing loans to total credit has now been reduced to 17.65 % as of February 2001, from its peak at 48 % in 1998. A number of banks are now showing profits with effective interest spread improving to 2.03 percent by the fourth quarter last year.

So, is it all well, and where do we stand at this point? Looking ahead, we must brace ourselves for future risk. Let's look at some major drivers in the next year, at home and abroad.

First, weak global economy poses yet another downside risk to the recovery as exports, which have been the main driving force, began to moderate in the last two months as a result of economic slowdown in the U.S. and Japan. Fiscal stimulus and the recovery of domestic demand then become essential to boost growth and offset the weakening of external demand. In this regard, the government is briskly employing a process of people participation and brain-storming to get an early operating plan for

many programs, which will provide social safety net, such as healthcare programs.

Second, excess production capacity, capital outflows and increased volatility of exchange rates demand close monitoring.

Third, intermediary function of the banking sector is still hampered by risk and uncertainty. Lending has yet to resume on a broad basis. Last year, deposit of commercial banks rose by 5.3%, but credit outstanding, adding back debt write-off and loans transferred to AMCs, rose by only 0.6 %.

Here, the problem does not lie with the fact that commercial banks do not have enough capital to support lending because in fact, they do. Moderate economic growths as well as continued lack of adequate information to gauge the borrower's situations and prospects are important hindrance to the credit mechanism. On this point, we have made some improvements regarding disclosure and accounting standards of the corporation, as well as initiating a Credit Bureau which will centralise and improve information on prospective borrowers. The Credit Bureau is not fully empowered yet, but the government has agreed to continue with the draft law already with the Senate, which will unblock the operation of the credit bureau.

Fourth, despite progress achieved thus far, we still need to pay close attention to the problem of NPL. Though the overall level of NPL remains somewhat stubborn implying that we need to rethink the situation closely.

The Government plans to set up the Thai Asset Management Corporation (TAMC) under a special legislation, which will enhance effectiveness of the management of asset, as it will allow a more effective corporate restructuring. Although it may increase our total fiscal cost, the level of public debt on a projected peak cash flow basis will still be less than 50% of GDP, not the highest in our history, not abnormal in terms of international comparison, is manageable, and stress testing shows that it is not highly variable.

I can now clearly predict that the TAMC will be up and running by the middle of June, having chosen the information system and seconding 10 Bank of Thailand staff to help prepare the groundwork as of this week.

Incidentally, I have to relate at this point that in our eagerness to keep this vast asset disposition honest, we ended up with probably our first institution that is Continental Europe in the management structure; that is to say having a Supervisory and a separate Board of Directors.

Fifth, but importantly, education and labour skill remain top priority along with research and development, which will be instrumental

for increased national productivity and competitiveness, and is the challenge and barrier to entering into "knowledge-base economy". In the final analysis, it is these supply-side factors which determine a country's potential output.

Ladies and Gentlemen,

What about the trends and prospects of the Thai banking and financial sector? The role of the policy maker is to create a mechanism which fosters a natural selection process to ensure a strong and efficient financial system, not for its own sake, but to serve the rest of the economy. But does this philosophy mean we will adopt a hands-off or hands-on attitude?

The answer is that while we believe in the merits of the market forces, we see that the market has many failures and imperfections which require correction. However, we will not monopolise the duty and job of correcting these problems. We want input from all stakeholders – the financial players, their clients, other authorities, and so on.

Moreover, since the crisis, the structure of private sector financing within Thailand has changed noticeably. Direct borrowing became more popular. The Bank of Thailand foresees a growing relative role and share of the market-based structure, and we project a possible decline in the share

of bank credits, from 77 % of the total sources of funds presently, to 55 % over the course of next 10 years.

At the same time, rapid financial innovations and intensified competition in the global market will inevitably have an effect on the local financial scene. In fact, new business models in the financial industry that embraces new technology together with greater competition as created by the new hybrid banks are already here and likely to become even more apparent in the years ahead.

As policy makers, the Bank of Thailand needs not only stay alert to a surge of new market developments, but also needs to create a mechanism that fosters a natural selection process to ensure a strong and efficient system. Proper incentive and infrastructure to further enhance the competitiveness of each and individual bank and as an industry have to be instated.

To illustrate, we have now announced the rules for Internet banking, defined as the traditional counter service banking using e-commerce technology. Our idea is simple in that what could be done over-the-counter will be allowed over the Internet.

We have also sought to reinforce the practice of good corporate governance. Where cross directorship exists, we have put a new limit on

bank's lending to the company, limit the shareholding of bank's directors in the company, and limit number of companies that top management and directors of a financial institution can hold directorship in. Where information disclosure is involved, financial institutions have to disclose information on NPLs, lending to related parties and violation against the Bank of Thailand's rules and regulations.

And we will continue to put effort in this area. We are expecting to launch Directors' Handbook for the financial community by year-end, and further encourage the necessity increased transparency of appointments and compensation.

Ladies and Gentlemen,

The reform at the Bank of Thailand itself is even more broad based. On an institutional basis, a number of transformation projects to change the existing policy-making process from a governor-based to a committee-based and from transaction testing to risk-based supervision, and so on, are being carried out.

On the first of January 2001, a new structure of Supervision Group became effective. A new Department of Risk Management and Information Technology Examination has been set up, which will help to ensure that the supervision process will be more selective, proactive and

forward looking. Central Point of Contacts were introduced to keep in closer touch with the financial institutions. In addition, a system of risk rating covering 5 major areas of risk was initiated as part of the new supervisory procedures to measure the inherent risk and its trend.

Equally important, enhancing the capacity of the supervisors through training following the FDIC's methodology has been initiated. Every examiner must pass the Commissioner's Exam in order to get certified.

Legal reform to modernize our supervisory tool to cope with the change of the banking business is also on the way, particularly, the new Financial Institutions Bill has been drafted and is already in the Senate to update our existing legislations governing banks and finance companies, consistent with international best practices in banking supervision. Here, the vital principles are manifold, but important is the empowerment of the Bank of Thailand to conduct examination and supervision of the financial conglomerates on the consolidated basis, as well as allowing universal banking

To further facilitate the development of the Thai financial infrastructure, we recently started the process to draft a "Master Plan of Financial Institution System" which will lay out the foundation of the Thai financial system over the next 10 years. It will provide a mechanism to

ensure an evolution of the financial system towards a suitable and optimal structure, which hopefully will not be static, but will continue to evolve and re-generate itself, and indeed achieving a learning organism, whose survival is judged by the value added it delivers to its clients in terms of the ranges and availability of new financial products.

The plan will involve two basic assumptions: the pace of transformation will move on a graduated basis – not the “Big Bang” – and it will cover the whole financial sector. There will not be a select committee, but rather a series of public hearing to solicit comments from the practitioners. We should be able to provide the industry with some tentative direction statement within the next six months and details of the master plan will be ready a year later.

At this point, several interesting and perhaps controversial issues have already been discussed. They include topics such as the trend towards consolidation, the necessary infrastructure such as skill training mechanism for financial workers, role of the central bank in the development process, the relative pros and cons of bank-based versus market-based financial structure, and of interest here, I am certain, the role of foreign banks.

Ladies and Gentlemen

To sum up, what should we expect of the Thai economy?

We are working towards being ready for the intensified global competition and for rapid technological progress. On a micro level, a market-oriented policy framework will be emphasized. On the macro level, we will work to make sure that it would be conducive to investment with sustainable growth, and fiscal deficit promptly converging to ensue a sustainable investment-saving gap.

We can not promise a return to 8% GDP growth, rather a better managed and better run economy, driven by productivity growth as a result of restructuring taking place.

But remember this, we are coming from an economy that has a per capita income of only 2000 dollars. An economy that is far from its potential performance. An economy with an idle capacity of 46% not being used and not being impaired by being NPL.

Who knows if when things are ready how fast our growth will be.

Thank you for your attention.