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WORLD BANK GROUP
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
MULTILATERAL INVESTMENT GUARANTEE AGENCY

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Statement by the Hon. TARRIN NIMMANAHAEMINDA ,
Governor of the Bank for THAILAND ,
at the Joint Annual Discussion

Statement by the H.E. Tarrin Nimmanahaeminda
Minister of Finance of Thailand
At the 1998 IBRD/IMA Joint Annual Meetings
(Delivered by the H.E Pisit Leeahtam, Deputy Minister of Finance)

It is a great pleasure and privilege for me to address the Annual Meetings of the Governors of the Fund and the Bank in Washington DC this year.

Since the last Meetings in Hong Kong, the world economy has deteriorated significantly. The effects of the currency and financial crisis in East Asia have spread not only within the region, but also to markets as distant as Russia and Latin America. Continuing turmoil in international financial markets raises the specter of a meltdown on a global scale. It is time for a decisive international policy coordination among both developing and developed countries, as well as by the multilateral financial institutions. Previous speakers have already pointed out the precarious world condition and I will limit my presentation to a few issues involving my country.

Being the first to slip into crisis, Thailand is destined to be one of the first to get out. We realized fully that this is only possible through a comprehensive reform program supported by the international community. I will briefly review the progress we have made. After which, I will discuss the causes, the responses, the immediate problems and the risks. I will then finish with a few observations about the Fund and the Bank.

## The Causes

I consider 3 factors as the causes of the crisis that erupted in Thailand last year.

First, on the fundamental side, the current account has been in a large deficit for a number of years. This has been fueled by huge capital inflows as local corporates made use of foreign resources without adequately taking into account exchange and market risks. At the same time, the banking system has not been prudent in assessing credit risks. When exports did not perform as expected in 1996, the stock market reacted negatively and thus causing runs in both the currency market and financial system.

Second, in response to the runs, the authorities did not pursue appropriate policies both in coping with the speculation on currency and the liquidity problem of financial institutions. They defended the Baht up to the point of depleting the reserves and aggressively made use of public funds to support the insolvent financial institutions.

Third, when the actual magnitude of the net official reserves was disclosed for the first time in August 1997, the market panicked. Even though the Government came up with a strong. stabilization program supported by the IMF, it did not regain confidence, particularly, when credibility of the policy makers was in question. This probably sent the strongest shock wave on transparency and accountability problems and thus became a contagion effect.

## The Response

With the new Government was installed in mid-November last year, Thailand has responded to the crisis by strictly adhering to the comprehensive reform program. Apart from aiming at stabilizing the macroeconomics setting, it includes restructuring the financial system with the strengthening of supervision, restructuring corporate debt, amending the legal framework, promoting good corporate governance, privatizing state enterprises and further opening the economy. Moreover, social programs to address the plight of the underprivileged have been initiated and put in place.

To regain confidence and reverse the steady downward trends of both the stock market index and currency value, the Government has undertaken policies based on principles as follows: stabilization, transparency, private sector's own initiative in external debt management, and maintaining open economic policy.

First on stabilization, we place a high priority on stabilizing the economy by pursuing cautious monetary and fiscal policies, which include: inducing short-term interest rates at levels consistent with exchange rate stability; sourcing foreign funds from multilateral and bilateral agencies; restructuring the financial sector to re-establish depositor confidence; and arranging dedicated lines of credits for exports and other key sectors.

Second, we attach great importance to transparency as a critical means to shore up market confidence and impose policy discipline on the officials, in particular, the dissemination of information such as the Letters of Intent and the statistics in line with the IMF-SDDS system. For example, net official reserves are announced on a weekly basis.

Third, on private initiative, it is important to note that in managing the external payments accounts during the crisis period of the past 15 months, the private sector itself has been. primary players both in mobilizing or allocating investment and in arranging the settlements or rollover of their obligations. The Government has resisted a call for both direct and indirect interference there by preserving the voluntary nature of external debt settlements among the private sector. This is therefore consistent with the market-oriented character of private financial activities in Thailand.

Fourth, in resolving the crisis and laying the basis for reform, Thailand has strictly adhered to the principles of openness and rejected any pressure for protectionism. We have not resorted to administrative means to replace the market mechanism. In contrast, open market policy constitutes a prominent part of our latest reform program.

Despite a difficult external environment, these measures have successfully restored stability. The current account has reversed from a deficit of about US$ 1.2 billion per month to a surplus of about US$ 1 billion per month in 1998. Net international reserves position increased to US$ 15 billion in September 1998. Nearly all of the external swap obligations with foreign banks abroad have been unwound with only a few hundred million US dollars remaining. Gross reserves now account for 7.2 months of imports and are able to cover all of the total short-term-external debt. The currency which had depreciated throughout 1997 started to appreciate from over 55 Baht/US$ in January 1998 to around 40 Baht/US$ in the first quarter of 1998 and has been stabilized ever since. We have also been successful at restraining inflation which, having peaked in June, is estimated at around 9 percent for this year. Consequently, short-term interest rates declined markedly from over 20 percent in January to less than 7 percent in September.

## The Immediate Problems

Despite stability in the macroeconomy, the internal working of the real and financial sectors has become a major problem. The real sector is faced with a shortage of credit as the banking sector becomes excessively risk-averse while non-performing loans rapidly expand. This in turn induces private borrowers to refrain from honoring their obligations and exacerbates the NPL problems. We have to break this vicious circle.

We are addressing the non-performing loan problem in several ways. The center point is private debt restructuring. We have introduced new rules governing NPL exit procedure based on international standards. We have provided tax incentives for debt restructuring. Our recently announced capital support facility also provides direct incentives for debt restructuring. We have established a high-level committee to facilitate the debt restructuring process using a market-based approach. We are fully cognizant that the debt restructuring process needs to be complemented by effective supporting legislation. For this reason, we are in the process of amending foreclosure and bankruptcy legislation which we expect will be enacted later this year.

To strengthen the financial sector, first we have placed a requirement for all financial institutions to submit plans for their capital increases under Memoranda of Understanding (MOU) with the Bank of Thailand. Second, we have gradually tightened loan classification and provisioning standards in line with international practice. Third, we liberalized the limit on foreign equity ownership in financial institutions. Furthermore, as part of our process to improve the operations of the Bank of Thailand, we have brought in experts from central banks of industrialized countries to support a high-level commission in developing recommendations for strengthening the central banking and bank supervision in Thailand.

Higher provisioning requirements due to tighter standards and declining asset quality have, however, caused financial institutions to become increasingly capital-constrained and restricted their ability to lend. At the same time, the deteriorating economic environment has made it very difficult for financial institutions to raise private capital on their own from both domestic and foreign sources. For this reason, the Government announced a financial sector restructuring plan on August 14 which included two capital support facilities totaling 300 billion Baht. In partnership with the private investors, we will recapitalize financial institutions by exchanging Government bonds for preferred shares and subordinated debt. These facilities are structured to catalyze the entry of private capital as well as to facilitate new lending and corporate debt restructuring. Both facilities have appropriate safeguards built-in for the use of public funds. The new capital injection will be on a preferred basis, and the Government or new investors will have the right to replace the current management. The burden on public finances will be minimized with the requirement for preferred shares and subordinated debt to yield returns higher than interest payments on Government bonds.

## Policy Shift

With stabilization achieved, a more solid basis for the resumption of economic activities is now established. We have phased in measures to stimulate aggregate demand in order to contend with the sharper than anticipated economic contraction. The depressed state of Asian economies, coupled with widespread currency devaluation among our competitors, suggests that a large increase in exports demand is not likely in the near future.

As a consequence of the financial crisis, domestic private demand for consumption and investment has dropped substantially. The burden of raising aggregate demand therefore falls heavily on the budget. Concurrently, we are creating training and employment programs to mitigate labor problems. Government spending is the most direct means to strengthen the social safety net and mitigate the impact of the crisis upon the poor. We have obtained assistance from development agencies to provide both financial and technical supports to manage the social dimension of the crisis. Consequently, Thailand gradually relaxed, its fiscal stance for fiscal year 1998 from a public sector surplus of 1 percent of GDP at the outset of the program in August 1997 to a deficit (excluding the cost of financial sector restructuring) of 2 percent and 3 percent in February and May of this year, respectively. To further stimulate the economy, the Government will continue to maintain an overall public sector deficit of around 3 percent for fiscal year 1999. Nevertheless, this will be self-correcting as the economy rebounds and should not create a structural deficit.

To stimulate private demand, we have also gradually lowered interest rates while maintaining exchange rate stability. However, the critical factor in restoring the health of the real sector is to induce the banking system to resume its intermediary role with the measures as outlined above. We have also tried to ensure that critical sectors such as exports, housing, agriculture and small-scale industries receive adequate credits through state-owned specialized financial institutions. We have mobilized funding particularly from both official and private organizations abroad for this purpose.

## The Risks

Thailand has done its best to establish a solid foundation for a rapid and sustained economic recovery. Our comprehensive reform measures should allow the economy to return to positive growth in the coming months. We are endeavoring to implement the measures within the timeframe stipulated in the program. However, in the current global environment, there is little doubt that external conditions will continue to be critical for the recovery of Thailand and other countries in crisis. In this context, I would like to invite all the stronger economies to undertake a global solution in supporting the world economy in at least four ways.

First, the demand management policies of the major countries should be well orchestrated to avert a world recession. More importantly, maintaining an open market for trade is fundamental in assisting the debt-trapped emerging countries.

Second, it is now extremely difficult for emerging economies to source funds from private intentional capital market. The G-7 governments should therefore consider extending assistance to induce capital flows to those countries in crisis. In this regard, I would like to praise Japan for the Miyasawa scheme in providing bilateral support to Asian countries for promoting reform and facilitating recovery.

Third, a system needs to be put in place for monitoring, if not regulating, cross-border short-term capital flows. This could enable us to mitigate the adverse effects of volatile capital movements. Recent events have highlighted not only the excessive leverage and exposure of highly speculative "hedge" funds and their threat in disrupting markets, but also the lack of adequate disclosure and regulatory standards.

Fourth, G-7 countries should support China in its role as an anchor of economic stability for Asia. The stability of the Chinese currency is a necessary condition for a stable economic environment in the region.

Mr. Chairman,

Let me now turn to the important role of multilateral financial institutions at this difficult juncture. I have participated in the G-22 working groups and would like the Bretton Woods institutions to carefully consider the recommendations made by the three working groups in shaping a new architecture for the world economy. Let me now turn to the immediate matters regarding the roles of the World Bank and the Fund.

IBRD Matter

On the Bank matters, the crisis has underscored the extreme volatility of private capital flows and the importance of official resource transfers. Supplementing resources to strengthen the World Bank is crucial. I urge the donor community to do their utmost in replenishing IDA-12. This is vital in ensuring that the poorest nations would have sufficient resources available to cope with the upcoming difficulty. While pursuing this difficult task the World Bank must maintain its triple-A status in the capital market.

IMF Matter

Turning now to the Fund matters, I welcome the establishment of the Supplemental Reserve Facility to address large short-term financing needs. In addition, in view of the low liquidity levels, I urge all members to consent quickly to the Eleventh General Review of Quotas. We should also quickly accept the Fourth Amendment on the Special One-Time Allocation of SDRs. These all should help enhance the effectiveness of the Fund in coping with the new challenges ahead.

Final Remarks

I would like to conclude by commanding the two Bretton Woods institutions for their speedy, flexible, and decisive responses to the crisis. I wish to thank them for their roles in working with us in Thailand throughout the crisis during the past year. Their ability to marshal international support, including their policy advice and financial resources, has been extremely crucial in helping us cope with the crisis. It also highlights the continuing importance and relevance of these institutions. They have fulfilled, and possibly exceeded, the role that was envisaged for them by their founders some fifty years ago. The current crisis provides them with an important opportunity to further define their role in the global arena. With decisive actions on the part of the multilateral financial institutions, G-7, and the countries in crisis, I am confident that we can jointly overcome the difficult challenges facing us today.

Thank you.