Thailand's Growth Rebalancing

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Presentation Outline

- Introduction to Thailand's Growth Path
- Lesson from the 1997 – 1998 Economic Crisis
- Impacts of Global Recession on Thai Economy
- Policy Responses by Thai Government
  - Fiscal Stimulus Programs
  - Monetary Stimulus Programs
- Strategies to Rebalance Growth

Background

- Thailand has undergone several growth restructuring
  - export-led (1980s) → investment-led (1990s) → export-led (post-1997 crisis)
- Lately, manufactured export played the most important role on growth (esp. High-Tech exports)
  - Post-crisis Investment have been sluggish, and dominated by FDI
- Vibrant export and sluggish domestic demand

  → rapid accumulation of foreign reserves

From Development Success to Crisis

- Development success for many decades. Not super-star (like South Korea or Taiwan) but very satisfactory.
- Structural changes in economy from agriculture to light manufacturing. Plaza accord in 1985 led to rapid increased in FDI (particularly from Japan) and a period of double digit growth from 1986 to 1995.
- Also led to bubble and excessive investment.
- Greater competition in world markets, weaken fundamentals and macroeconomic policy mis-management (Mundell impossible trinity) led to 1997 crisis.

Crisis Resolution

- Insolvency led to new exchange rate regime (managed float) and large depreciation of currency. Led to widespread bankruptcy, particularly of companies who had large foreign borrowing and domestic oriented companies.
- Export sector (including agriculture) became more competitive and drove the economic recovery. Domestic investment and consumption slumped, and export became the main engine of growth.
- The share of export in GDP increased significantly. This was also the case for many other East Asian economies, though relative increase varies.

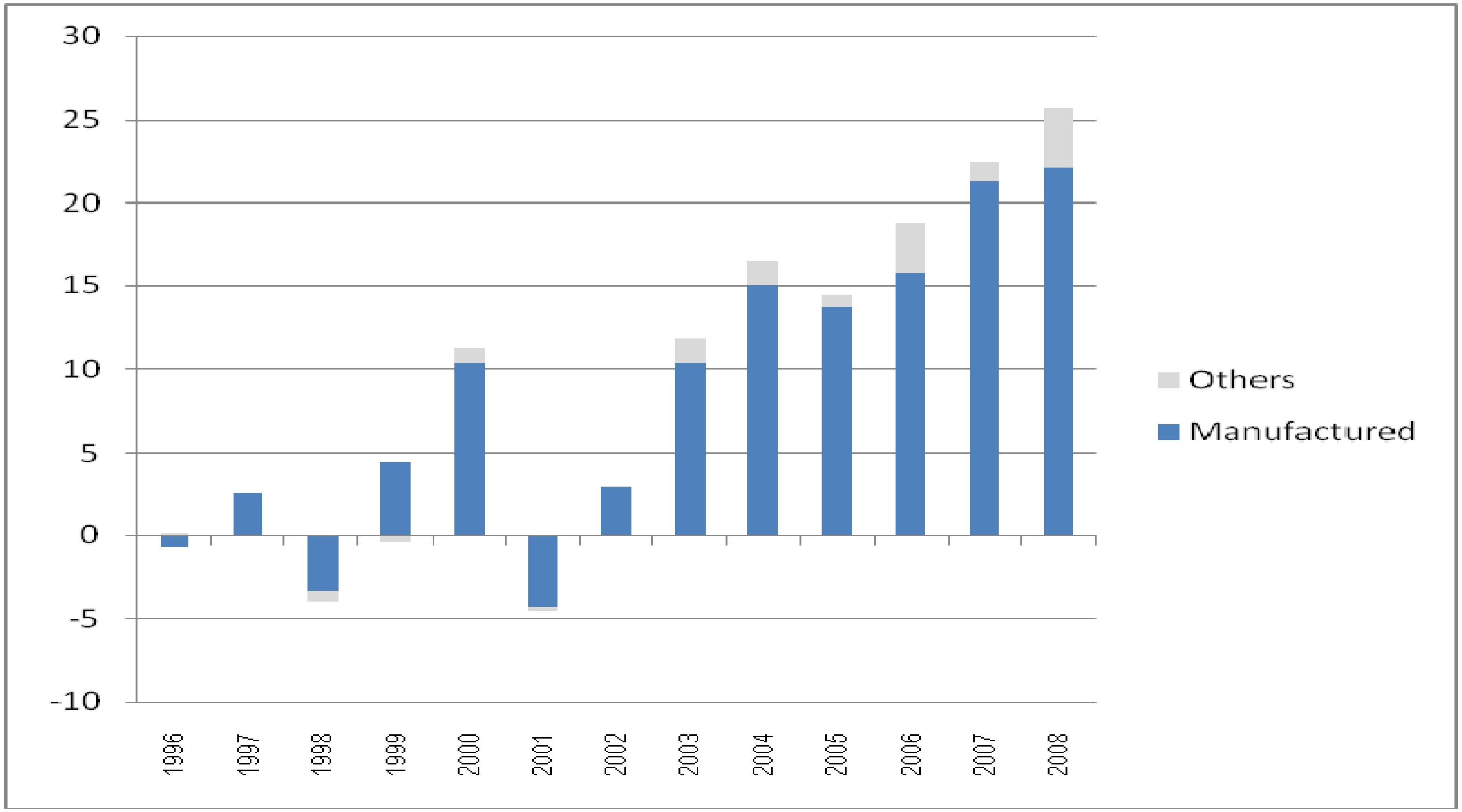
Share of Export of goods and services to GDP, various countries

	1990-1996	1997-2006	differences	Latest (2006)
Indonesia	26.3	35.6	9.3	30.9
Republic of Korea	27.2	39.9	12.6	43.2
Malaysia	83.2	114.9	31.8	117.0
Philippines	32.6	50.2	17.6	46.4
Thailand	37.9	64.6	26.7	73.7

Source: World Development Indicators 2008.

The increased dependence on export of Thailand is more pronounced than most countries, (except Malaysia which has already been very wide open economy).

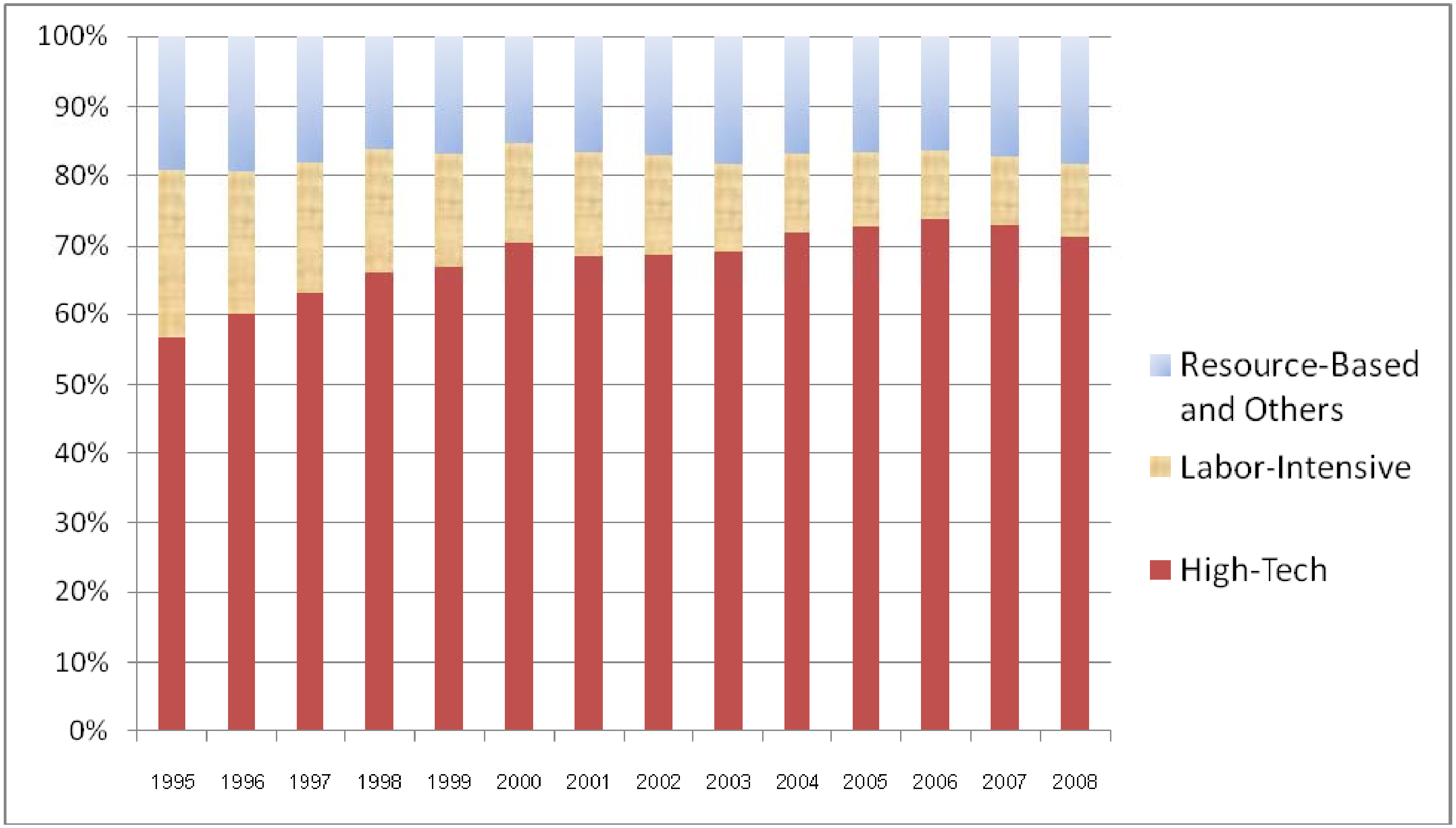
Changes in Export Value from previous year, 1996-2008 (billion US$)



Note: calculated at current US dollar value.
Source: Bank of Thailand.

Manufactured exports explained almost entirely the annual increases in total exports since 1996.

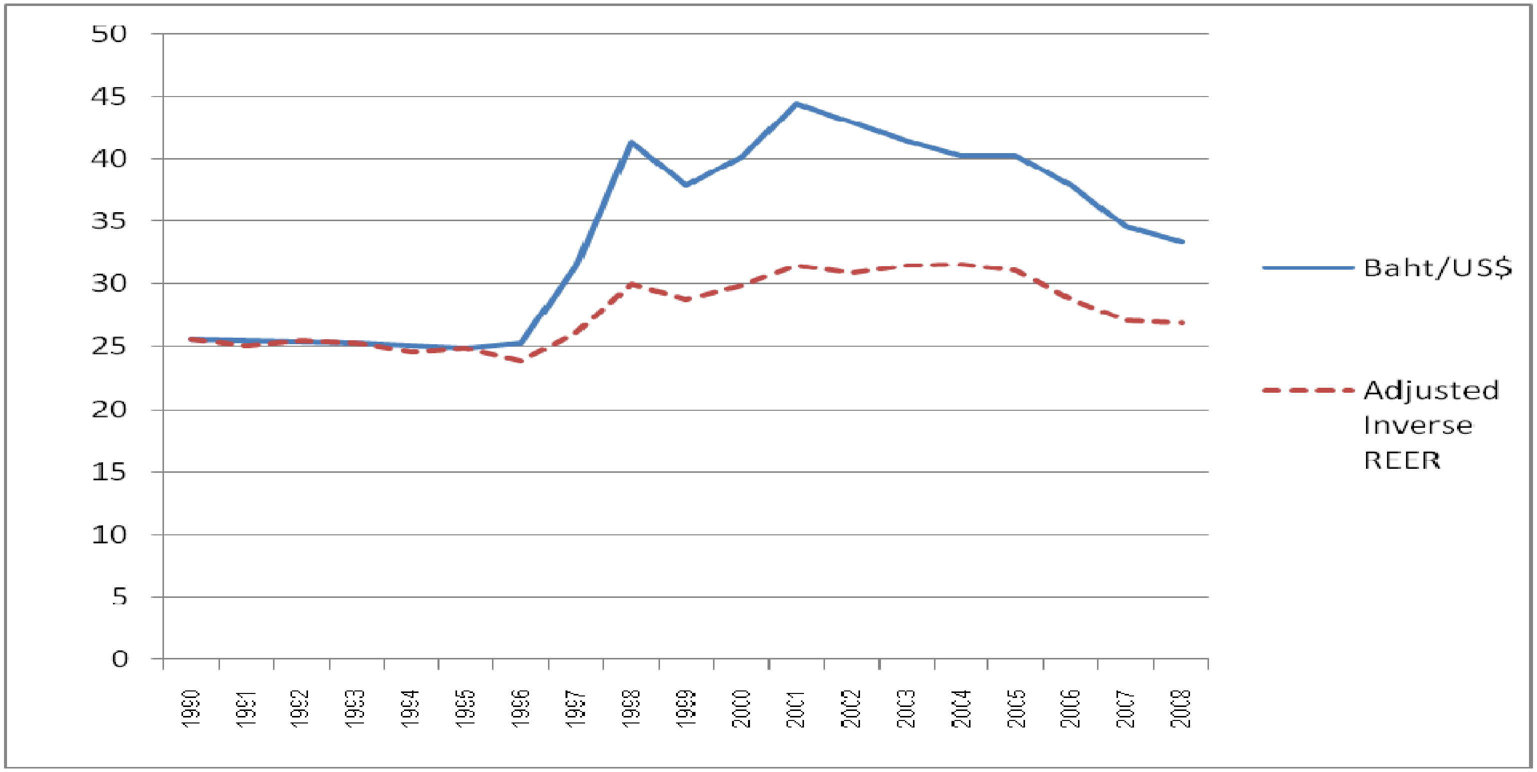
Structure of Manufactured Exports, 1995-2008



Note: calculated at current US dollar value.
Source: Bank of Thailand.

'High-Tech' exports play the most important role

Movement of Exchange Rate, 1990-2008



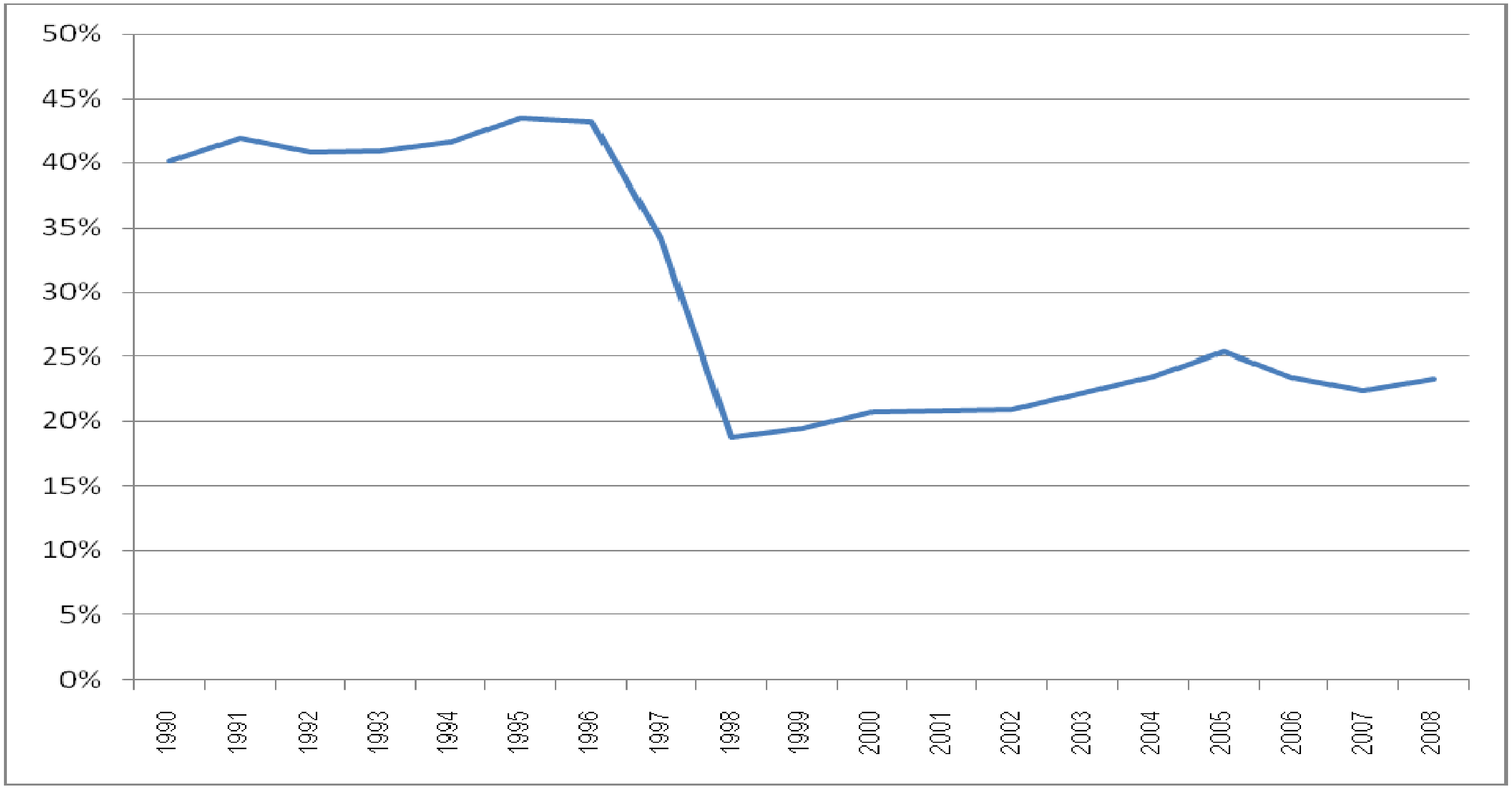
Note: REER indicator is adjusted to have the same value (at 1990) as the US dollar.
Source: Bank of Thailand.

Price (exchange rate, REER) effect does not explain much of the export increase. High dependence on export is more from structural change.

Investment Share in GDP Still Low

- Share of Investment in GDP still much lower than pre-crisis, although pre-crisis investment clearly excessive.
- Excess capacity remained for 6-7 years after the crisis, so no need for much new investment. For new investment, FDI's role became more important.

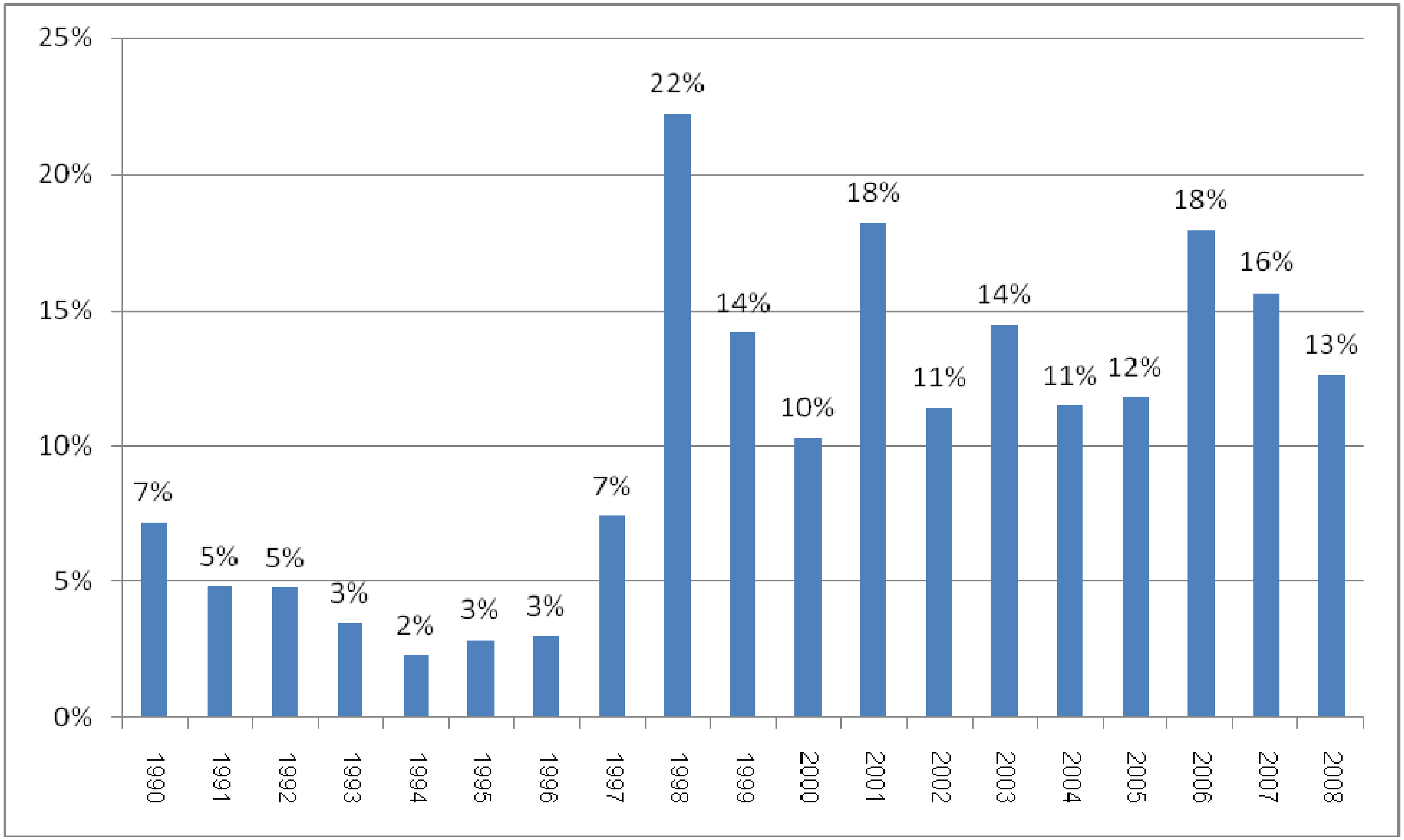
Share of investment in real GDP, 1990-2008



Note: calculated at current baht value.
Source: Bank of Thailand.

Aggregate investment dropped steeply after crisis and remain sluggish ever since.

Share of FDI in total investment, 1990-2008



Note: calculated at current baht value.
Source: Bank of Thailand.

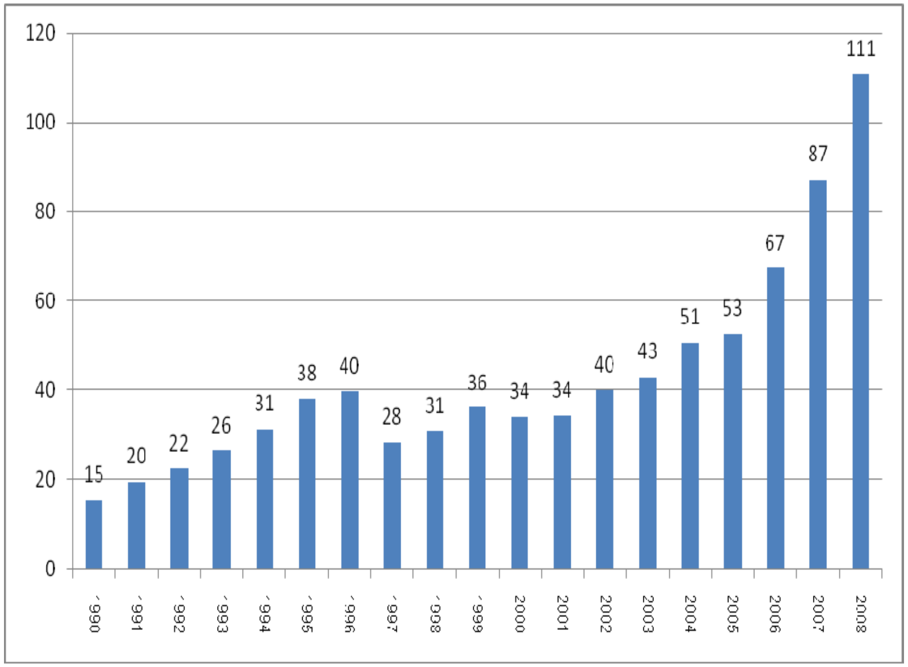
And FDI plays much larger role then pre-crisis

Foreign Reserves Accumulation

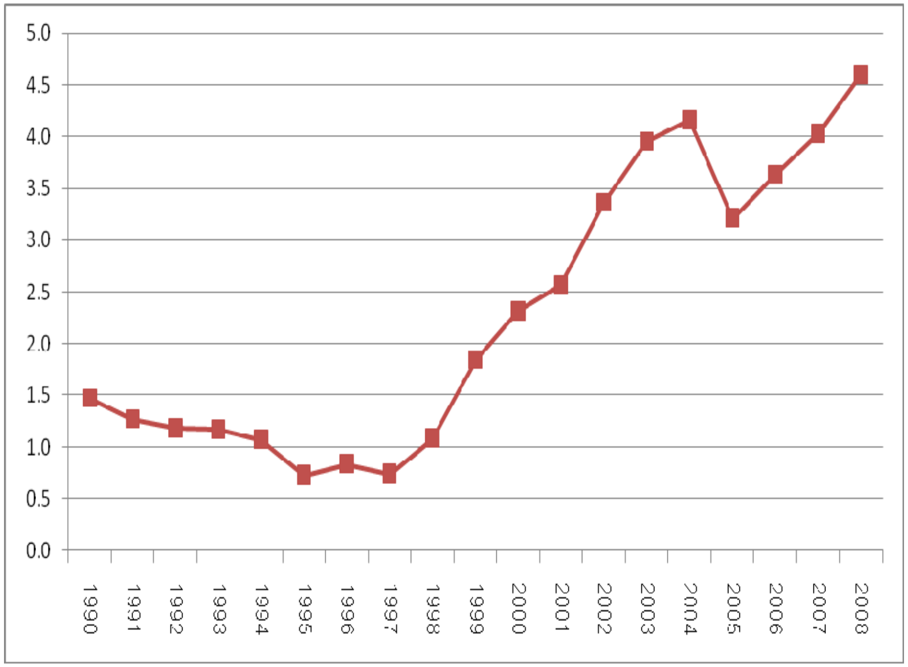
- Export-led growth plus low investment led to current account surplus.
- Large capital inflows around 2006-2007 also boosted the accumulation of foreign reserves.
- Pressure on the Baht also led to introduction of controversial capital controls in December 2006 (eventually removed in March 2008).
- Although short-term debt now only about 25% of foreign reserves, reserves also need to back up other contingent liabilities, particularly foreign holdings of stocks and bonds.

Foreign Reserves,1990-2008

Billion US$



Ratio to external short-term debts (%)



Source: Bank of Thailand.

The external stability is therefore in a much better shape compared to the situation prior to the 1997 crisis.

Lesson from the 1997-1998 Economic Crisis

- A coherent macroeconomic management is necessary (avoid Mundell's impossible trinity).
- The country's competitiveness must be closely monitored and evaluated. Measures must be taken in time.
- Good governances are essential in both public and private sector.
- Financial globalization is accompanied by increased volatilities and risks. Good risk awareness and good risk management are extremely important.
- Fully-fledge formal safety net must be developed.
- In general, need right **P**aradigm, need **P**rudent Policies, and need to be **P**ragmatic.

Impacts of Global Recession

- Main problem is poor risk management oversight and poor governance (crony capitalism) in US. Partly related to the 'global imbalance', though with better risk supervision in US global imbalance will not lead to this crisis.

Impacts on Thai Economy:

  - Relatively small direct exposure to toxic assets. Lessons learned from 1997 crisis very helpful.
  - Up to October 2008, export growth was still almost 20%, decline started in November 2008 and became about 20% y-o-y since then. (Same picture for most of the other ASEAN economies)
  - GDP declined 4.3% y-o-y in 2008 Q4. Overall growth for 2008 was 2.6 %.

Impacts of Global Recession (2)

- Production fell across-the-board, more so among export-dependent sectors.
- Largest risk on employment. If export declines continue for some time, layoffs will become the biggest problem for the government.
- Unfortunately, domestic political conflicts continue, and have affected tourism and the investment climate, though luckily, the impacts appear to be mainly short-term in nature.

Export Growth Trends

Export Growth (Nominal US$)						
	2006	2007	2008H1	2008Q3	2008Q4	Jan 09
Indonesia	14.4%	20.5%	28.0%	26.9%	-16.3%	-36.1%
Malaysia	14.0%	9.6%	9.0%	21.4%	-13.0%	n.a.
Philippines	18.9%	7.1%	4.1%	4.2%	-21.8%	n.a.
Singapore	18.4%	10.1%	2.8%	14.5%	-15.5%	-38.3%
Thailand	18.7%	17.0%	23.3%	28.4%	-9.4%	-25.3%
Viet Nam	22.1%	22.2%	31.8%	44.8%	6.7%	-22.6%
China	27.2%	25.7%	21.8%	23.1%	4.4%	-17.5%
Source: Official Sources						

GDP Growth Trends

GDP Growth (%)					
	2006	2007	2008H1	2008Q3	2008Q4
Indonesia	5.5	6.3	6.4	6.1	5.2
Malaysia	5.9	5.7	6.7	4.7	0.1
Philippines	5.4	7.3	4.6	4.6	4.2
Singapore	9.4	7.7	4.5	-0.6	-12.5
Thailand	5.1	4.8	5.6	3.9	-4.3
Vietnam	8.2	8.5	6.5	6.6	5.7
China	11.1	11.9	10.4	9.9	7.0

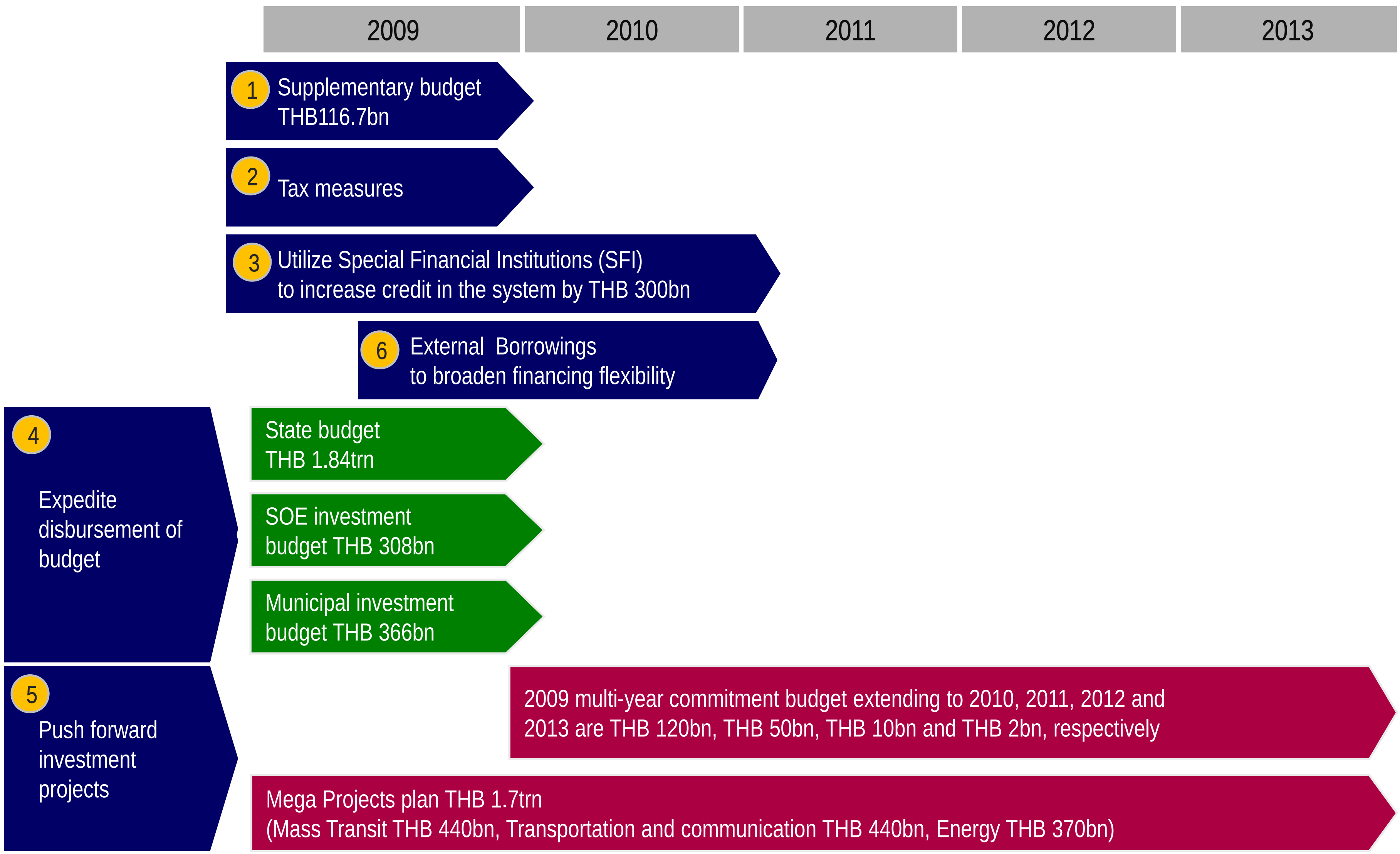
Source: Official Sources.

Policy Responses by Thai Government

Current crisis much more tricky to deal with than 1997 crisis. Hits at the very model of East Asian export-led growth.

- Fiscal Stimulus Programs
  - Six fiscal programs to stimulate the economy
  - Increased government spending and tax cuts are the most pursued measured
- Monetary Stimulus Programs
  - Aggressively cutting policy interest rates, 4 times since December 2008
  - The next step is to inject money supply into the economy to prevent liquidity problem

Fiscal Stimulus Programs



Source: Fiscal Policy Office.

Additional Mid-year Supplementary Budget

Projects / Expenditure items	Amount (million Baht)
Total mid-year supplementary budget	**116,700.0**
Economic recovery and confidence restoration	**37,464.7**
1.1 Living cost subsidy for low-income earners and gov't officials	18,970.4
1.2 Extension of 5 measures to reduce living cost*	11,409.2
1.3 Water resources for farmers and agriculture	2,000.0
1.4 Road construction in villages and rural area	1,500.0
1.5 Commercial funds for low income earners	1,000.0
1.6 Tourism promotion	1,000.0
1.7 Small water resource and water management	760.0
1.8 Small and medium enterprise promotion	500.0
1.9 Economic confidence restoration and national image promotion	325.0
Revenue creation, Quality of lives enhancement and social security	**56,005.6**
2.1 Free education program for the first 15 years	19,001.0
2.2 Sufficiency economy promotion of society development fund	15,200.0
2.3 Monthly allowance for senior citizens	9,000.0
2.4 unemployment reduction and labor potential promotion	6,900.0
2.5 Health care promotion	3,000.0
2.6 Civil servant and police officers housing scheme	1,808.0
2.7 Clinic and health station development	1,095.8
Expenditure under emergency circumstances	**4,090.4**
Treasury cash repayment	**19,139.5**

* Modification from six months government economic stimulus package include: (1) Free 30 m^2 water supply (reduce from 50 m^2); (2) Free electricity up to 90 units/mths (up from 80), but abolish the half-price scheme from 80-150 units/mth; (3) excluding the oil excise tax reduction

Source: Fiscal Policy Office.

Tax Measures

Sector	Policy Details
Individual Taxpayers	Expand minimum taxable income from 60,000 Baht to 1 million Baht which would be subjected to 0.5 percent tax rate
Community Enterprises	Income tax exemption for community enterprises with an annual income of less than 1.8 million Baht (previously from 1.2 million Baht) for 58,000 community enterprises nationwide (only for income received between 2009 to 2010)
Venture Capital	Income tax exemption for any gains from transferring of SMEs' stock to venture capitalists (only applied for SMEs with asset worth less than 200 million baht or number of workers less than 200)
Real-Estate	Personal income tax allowance of up to 300,000 baht for houses or condominiums purchased or transfer in 2009 and tax allowance of up to 100,000 baht for mortgage interest payment.
Tourism	Double tax deduction for conference and meeting expenses hosting in Thailand
Investment Fund	Exemption income tax for dividend income and capital gain from sales of SMEs' stocks until 2012
Debt Restructuring	Exemption of income tax and stamp duty arising from debt restructuring taking place in 2009
Merger and Acquisition	Exemption of income tax from merger and acquisition of businesses which takes place in 2009

Source: Fiscal Policy Office.

The total tax loss from these measures is estimated at around 40 billion Baht.

Monetary Policy Decision

Decision Dates	Announced Policy Interest Rate	Decision
16-Jan-08	3.25	Hold
27-Feb-08	3.25	Hold
9-Apr-08	3.25	Hold
21-May-08	3.25	Hold
16-Jul-08	3.50	up 25 bps.
27-Aug-08	3.75	up 25 bps.
8 Oct 08	3.75	Hold
3-Dec-08	2.75	Cut 100 bps
14-Jan-09	2.00	Cut 75 bps
25-Feb-09	1.50	Cut 50 bps
8 Apr 09	1.25	Cut 25 bps

Source: Bank of Thailand.

Limitations of Fiscal Stimulus

- Luckily Thailand is starting from a strong fiscal position, so has room for major fiscal stimulus.
- However, most fiscal stimulus only have short-term impacts. For sustained impacts, needs more and more fiscal stimulus over time.
- Need to focus on fiscal expenditures that will promote sustainable growth, e.g. economic productivity and restructuring.
- Most countries seem to be pursuing fiscal stimulus on assumption that crisis will only be short-term. This is likely to be wrong. Crisis impacts likely to be at least 4-5 years.

Limitations of Fiscal Stimulus (2)

- After 1997, Thailand hit bottom in about 18 months after start of crisis. However, it took about 5 years before output got back to the level of the pre-crisis peak. During this time, plenty of excess capacity so low private investment.
- Even after cleaning up the banks, they had limited good borrowers to lend to, so bank lending remained sluggish for many years.
- It was 8 years after the crisis before NPL ratio fell below 10%.

Strategies to Rebalance Growth

Based on CGE simulations a few years back.

1. Improving Productivity

- The best way is to improve “human capital”

2. Lowering Import Dependence

- Lowering import-content of major exporting sectors (to reduce imports of intermediate goods) Comprehensive industry clustering might help.
- Advancing “R&D” will help reduce import of capital goods.

3. Lowering Energy Dependence

- The serious problem is inefficient energy use.

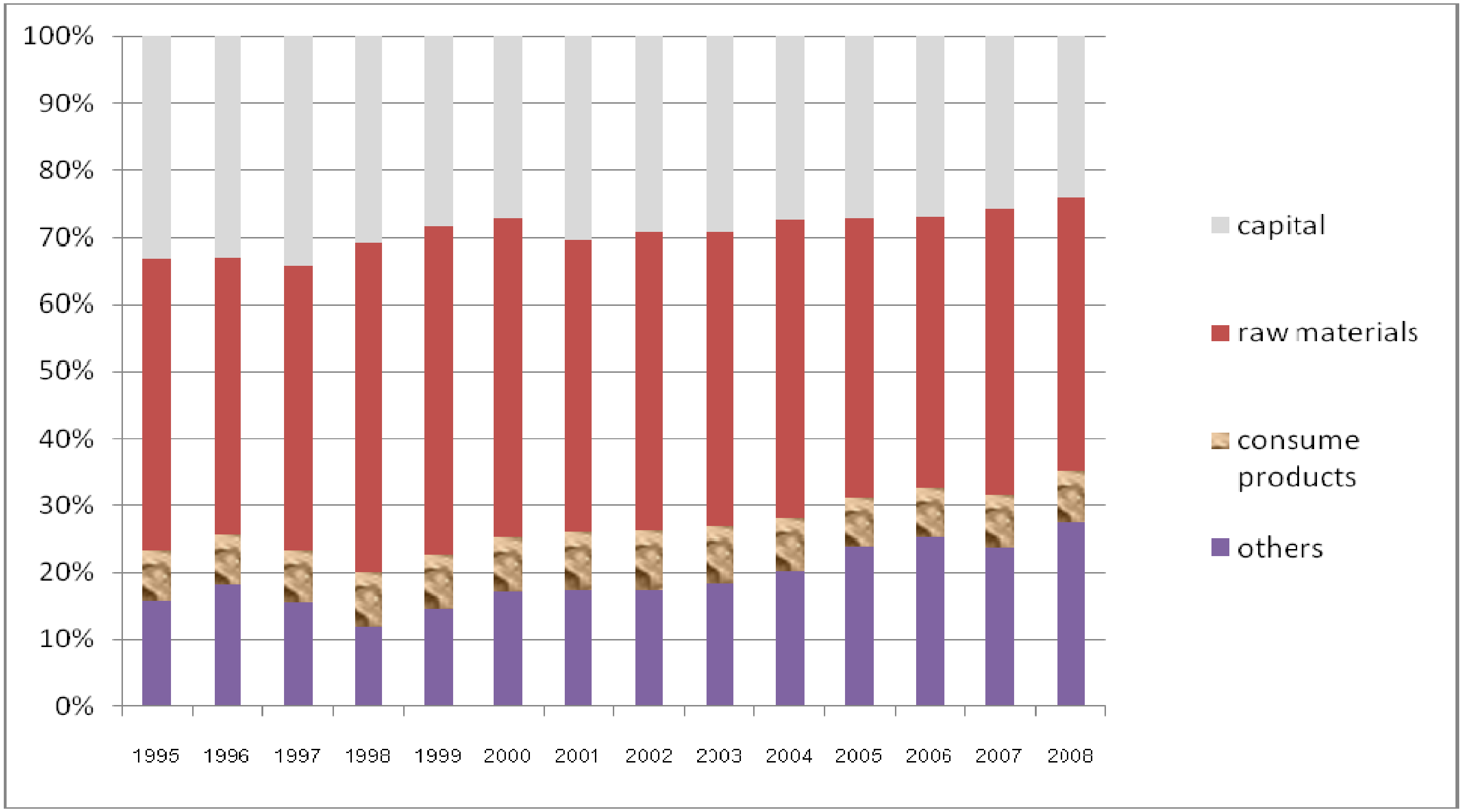
International Ranking of Thai Education and Training (selected indicators)

Quality of primary education	64
Primary enrollment*	61
Education expenditure*	46
Secondary enrollment*	85
Tertiary enrollment*	44
Quality of the educational system	53
Quality of math and science education	55
Quality of management schools	49
Internet access in schools	42
Local availability of research and training services	58
Extent of staff training	51

Note: total number of countries is 134.

Source: The Global Competitiveness Report 2008-2009, World Economic Forum (WEF)

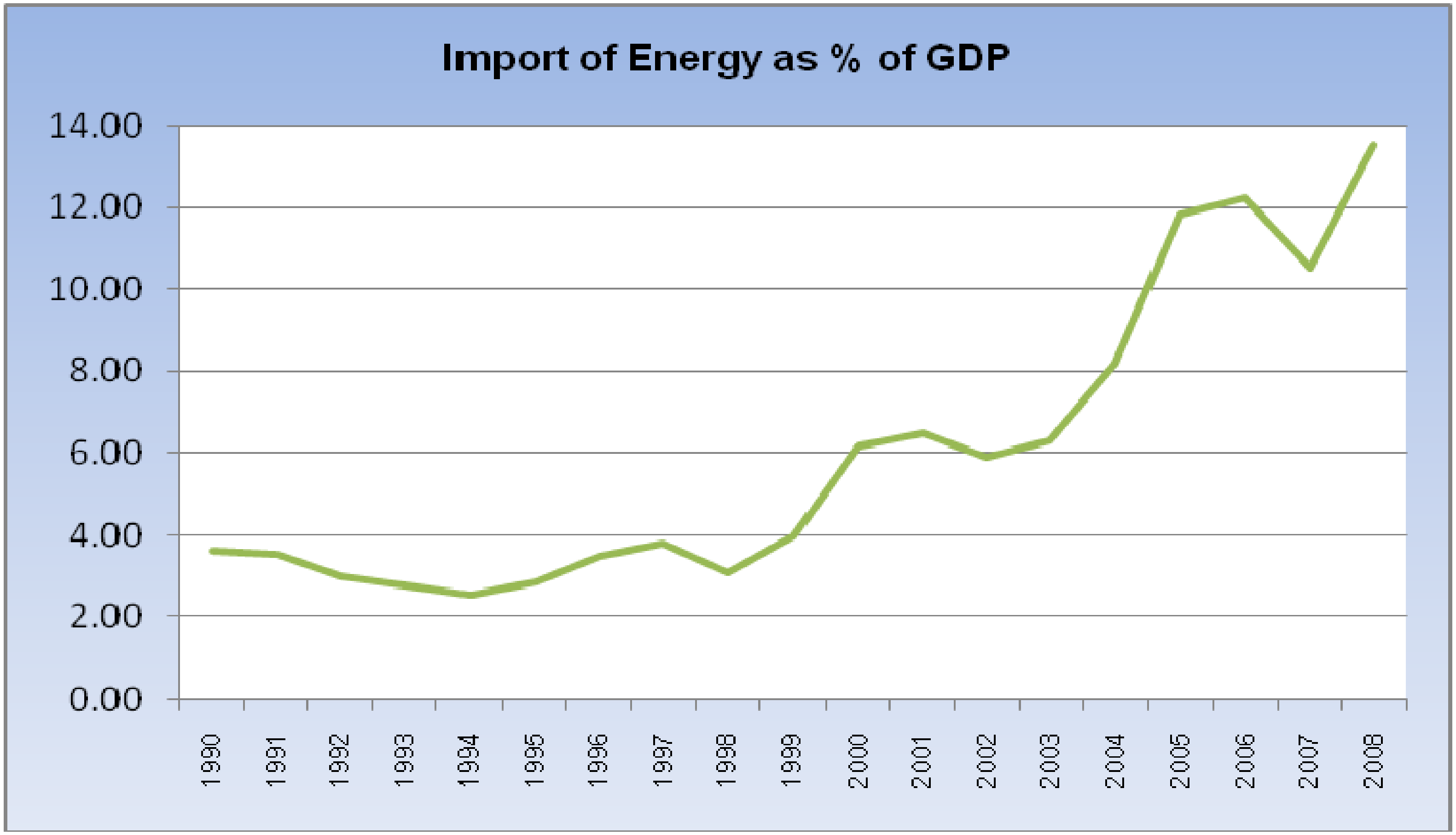
Import Structure



Source: Bank of Thailand.

Almost half of Thailand's imports are raw materials and intermediate goods.

Dependence on Imported Energy



Source: Bank of Thailand and the National Economic and Social Development Board.

The proportion of imported energy in GDP increased by three times in less than a decade.

Strategies to Rebalance Growth (2)

4. Improving Income Inequality

- Help expanding domestic market by increased general purchasing power of those in the middle to lower part of income distribution. Less aggregate saving.

1. Regional Cooperation

- Enhance regional trade lessen dependence on traditional economic poles.
- Regional financial cooperation will help reduce the region's financial risks and increase the region;s influence in shaping the direction of the international financial system.