

Challenges to the Thai Economy

Pornvipa Tangcharoenmonkong

Team Executive

Macro Economics Team

Monetary Policy Group Bank of Thailand

What started off as a crisis in the US financial system has escalated to a world economic crisis due to global financial integration and close linkages in today's financial system and the real economy.

In Thailand, the financial sector has been in good health, partly due to significant developments in risk management and regulatory framework after the 1997 crisis. However, the export sector was hit hard. This adversely affected production, employment and income. As a result, domestic demand deteriorated, and fiscal policy was called for as a last resort to provide an engine of growth.

The government introduced a supplementary budget of Bt116.7 billion for fiscal 2009, while the Bank of Thailand cut policy rate by 2.5 per cent in December 2008, from 3.75 to 1.25 per cent. Money-market interest rates as well as commercial banks' deposit and lending rates followed suit.

Private investment also deteriorated sharply after the crisis. This situation, if left for too long, could have hampered Thailand's potential growth. Therefore a second stimulus package was approved shortly after the implementation of the supplementary budget. This package of Bt1.4 trillion will be spent mostly on public investment over three years in order to enhance productivity in the long run. The first of these projects are expected to start in the fourth quarter of this year.

As stimulus impact from fiscal and monetary policy materialized, recent indicators reflect a positive adjustment in the economy. Despite a downward revision of this year's growth forecast by various agencies, this was mainly the result of the sharp contraction of 7.1 per cent in the first quarter. The momentum of the economy, however, has improved since the second quarter.

Going forward, numerous challenges face policy-makers. Political unrest since 2006 has shifted sources of growth towards net export as domestic demand continue to weaken in line with deteriorating sentiment. Moreover, since the outbreak of the global financial crisis in October 2007, export performance has deteriorated in line with trading partners' economies.

Fiscal and monetary policy implementation in the new financial environment could be more complicated than ever before. Fiscal spending in many countries has resulted in a hike in fiscal deficit and public debt. Therefore fiscal roles could be somewhat limited in the medium term if the world economy does not recover as expected. Likewise monetary policy has been aggressive in cutting interest rates, and some central banks face limited room for further cuts while the effectiveness of a quantitative-easing approach has yet to be proved.

This crisis has created a new environment for the world financial system, and further development and change in the financial platform have yet to be seen. Thailand, being a small and open economy, is facing an imminent challenge in conducting a fiscal-and monetary-policy mix in order to support sustainable growth.

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(The views expressed are the author's own.)

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