Roles of public policies in restoring the Thai economy amid the highly uncertain COVID-19 outbreak

The COVID-19 outbreak led to unprecedentedly severe impact on the economy and the way of life. Consequently, governments worldwide had to impose strict containment measures to control the spread of the virus, causing temporary disruptions to economic activities across several sectors. It was the first time in the history that almost all economic engines shut down simultaneously. It could thus take several years before economic activities return to the pre-pandemic level.

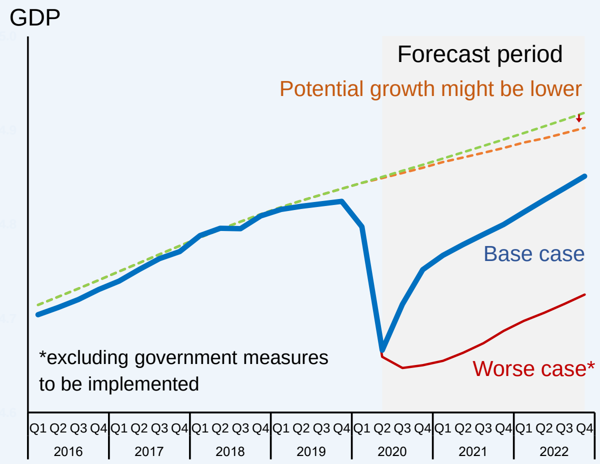
However, the Thai economy, compared to others, still have strong buffers in various aspects. **(1) External stability remained solid**, with high levels of current account surplus and international reserves, as well as a low level of external debt to GDP. **(2) Fiscal space remained adequate** for the government to provide relief measures and support economic recovery, with public debt outstanding at 43 percent of GDP in April 2020, well below the international benchmark of 60 percent. **(3) Financial institutions stability remained robust**, as reflected in high levels of commercial banks' capital funds and reserves.

Despite the presence of these strong buffers, vulnerabilities existed in certain sectors. In particular, household debt remained high. SMEs also faced intensifying competition from large businesses, e-commerce and rapid technological changes. These existing vulnerabilities were aggravated by the COVID-19 situation. Hence, the use of abovementioned buffers would be crucial to shore up the economy in the period ahead. **Policymakers would need to take into account current key challenges, as well as should be forward-looking to changing environment after the COVID-19 outbreak subsides.** Roles of public policies should address the following aspects:

1. Role in providing short-term economic support

The public sector has employed buffers of the fiscal and financial institutions to urgently provide liquidity support and ease financial burdens of households and businesses, especially in the initial phase when a large number of people were affected by the COVID-19 containment measures. The government introduced large-scale relief measures to alleviate and remedy those affected by the outbreak in the short run. Meanwhile, the Bank of Thailand cut the policy rate to the historically low level and introduced credit measures to assist borrowers through financial institutions, such as debt repayment moratorium and reduction, debt restructuring, and soft loans. Such policy synchronization would help support the Thai economic recovery in the medium term, in line with the baseline projection (the blue line in Chart 1).

Chart 1 Projections of the Thai economic recovery path



As the baseline projection suggested, **despite the massive government stimulus, it would take some time before the Thai economy could return to the pre-COVID-19 level.** This was because the income shock has a long-term impact on the private sector's financial positions. In addition, businesses, especially those in the tourism sector, have to alter business models in response to the new normal where people became more concerned on health safety, at least until vaccines and medicines become readily available. **Hence, in the next period in which the outbreak would be contained and the government starts to relax containment measures, public policies would have a vital role in supporting the economic recovery toward the pre-pandemic level.** Fiscal and supply-side policies, together with financial and credit measures, would be of particular importance.

2. Role in mitigating risk of the worst case scenario and maintaining the long-term potential of the Thai economy.

The worst case scenario should be developed in order to prepare for risks that could arise amid the highly uncertain global environment, as well as assess the adequacy of buffers, especially **if the economy contracts significantly this year and is unable to recover to its previous growth path in the medium term** (the red line in Chart 1). This could happen as a result of (1) external factors, such as the global spread of COVID-19 which could cause a more severe and prolonged global economic contraction, and trade tensions between the U.S. and China that could intensify and further weigh on Thai exports and tourism, and (2) domestic factors, such as the second wave of the COVID-19 outbreak that could prompt the government to re-introduce strict containment measures and prevent the introduction of travel bubbles. This worst case scenario did not include additional government measures to be implemented. Thus, economic developments and the COVID-19 situation should be closely monitored through real-time economic indicators.

Should the worst case scenario materialize, the damage would not be limited only to the short-term impact, but would also leave the long-term economic scars even after the outbreak subsides. This would, in turn, cause Thailand's potential economic growth to decline (the orange dotted line in Chart 1). The long-term impact could stem from risks in both the economy and the financial system. Examples include, first, some businesses may become bankrupt and permanently closed, while businesses that survive may decide to reduce or delay their investments. Second, many businesses may reduce employment, causing workers to face greater difficulties in finding new jobs, especially those who lack the skills required by other industries. Third, there could be massive defaults of corporates and households, resulting in much higher levels of non-performing loans (NPL) and rendering inadequate commercial banks' capital and loan loss provision to cover risks from new loans in the period ahead. This could cause a macro-financial negative feedback loop on the economy in the long term.

Although the existing buffers remained strong, the public sector should optimize the use of these buffers to ensure the fullest efficiency and should be prepared for any case of emergency. An emphasis should be given to factors that could have an extensive impact on financial institutions, businesses and households, and to variables with large multiplier effects or high linkage with various sectors of the economy. **To mitigate the risk of the worst case scenario and enhance Thailand's potential economic growth, it is imperative to focus on the following issues:**

1. Preventing the spillover of economic problems to the financial system, both financial markets and financial institutions system. The Bank of Thailand accelerated certain actions which include the followings. First, a timely implementation of measures was done to stabilize the financial markets in order to shore up investor confidence and reduce financial market volatility, such as purchases of government bonds to maintain liquidity in the bond market, the establishment of the Mutual Fund Liquidity Facility (MFLF) and the Corporate Bond Stabilization Fund (BSF). Second, financial institutions were encouraged to expedite debt restructuring to ensure that borrowers would be able to repay their debt under the revised conditions, which would reduce risk of NPL and help support the stability of financial institutions system. Third, the Bank of Thailand requested cooperation from commercial banks to suspend interim dividend payments in 2020, stock buybacks, and any early redemption or purchases of debt instruments qualified as tier-1 or tier-2 capital prior to their maturities to ensure that commercial banks sustain strong capital. Such implementation would help shore up confidence in the financial markets and financial institutions system, as well as ensure sound preparation for coping with the risks in the future.

2. Designing supply-side policies to support the economic restructuring both policies related to business operation, capital reallocation, and labor to be consistent with the post-COVID environment. Once the COVID-19 outbreak subsides, businesses in different sectors would face varying manners of recovery and difficulties regarding adjustment. This might lead some industries to be unable to fully recover and have excess capacity. The government should, first, establish mechanism to manage excess capacity in the Thai manufacturing sector, such as policies to facilitate mergers and acquisitions among businesses with substantial excess capacity, particularly those in tourism-related businesses, or policies to promote adjustments of business models to suit the post-COVID environment. Second, the design of policies to support and enhance the competitiveness of high-potential targeted industries with fast recovery potential after the pandemic subsides could be done through, for example, providing incentives through the use of fiscal, financial, and credit measures for the private sector to invest, as well as relaxing government regulations that remain obstructive to business operations. Third, the government should also expedite infrastructure investment especially public-private partnership projects both within and outside the Eastern Economic Corridor (EEC), together with infrastructure for the digital economy. Fourth, reskilling and upskilling of workers should be promoted to support employment in targeted industries and adjustments of businesses to suit the post-COVID environment. Fifth, reforms of government regulations that are outdated or obstructive to the adjustments of businesses to the new economic landscape should be accelerated.

In conclusion, although Thailand is currently able to contain the spread of COVID-19 and has adequate buffers to implement financial and fiscal measures to address the impacts of the COVID-19, it is however necessary to stand ready to introduce measures to cope with risks in the period ahead in a more targeted, timely and effective manner. This would ensure adequate buffers and reduce risk of economic scars should the worst case scenario materialize. In addition, this would help sustain the long-term potential economic growth. The implementation of these measures would require policy synchronization between public health policies, the fiscal, financial and credit measures, as well as supply-side policies, in order to support economic restructuring to be consistent with the COVID-19 situation in a given period.