

The hard road ahead for recovery and macroeconomic policy response to the GFC

Bhanupong

Lecture 9

The Hard Road Ahead for Thailand's Economic Recovery

Bhanupong Nidhiprabha

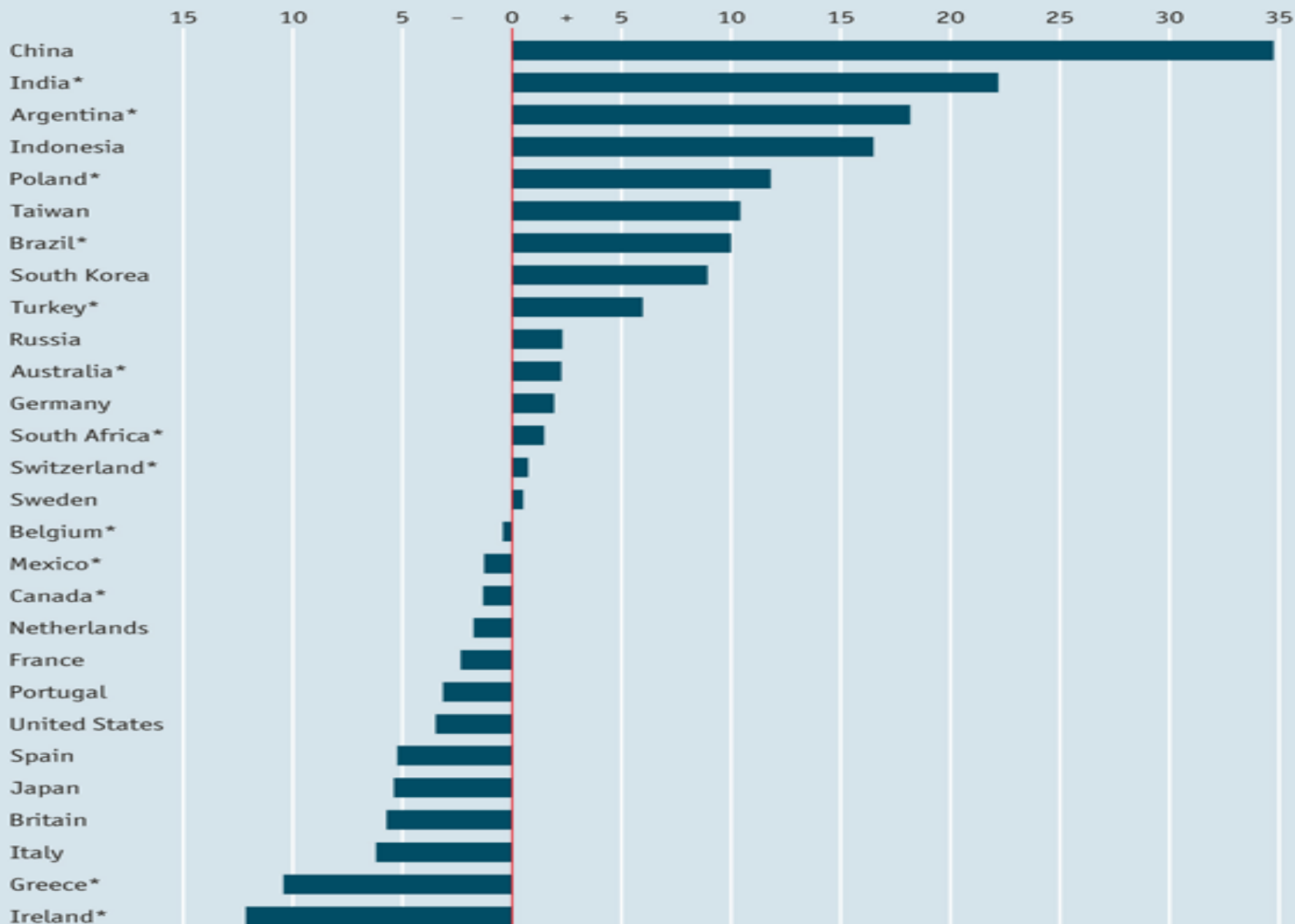
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Abstract

Globalization leads to the increasing complexity of production networks through foreign direct investment, which transmits demand shocks from the rest of the world to the Thai economy. Short-term fiscal stimulus would not be able to shorten the length of recession unless consumer confidence is restored. Violation of established social obligations and contracts erodes business sentiment and eventually would lead to a negative long-term impact on economic growth. The duration of the recession and the speed of a recovery hinge on the government's ability to restore confidence during uncertain times.

Real GDP per person

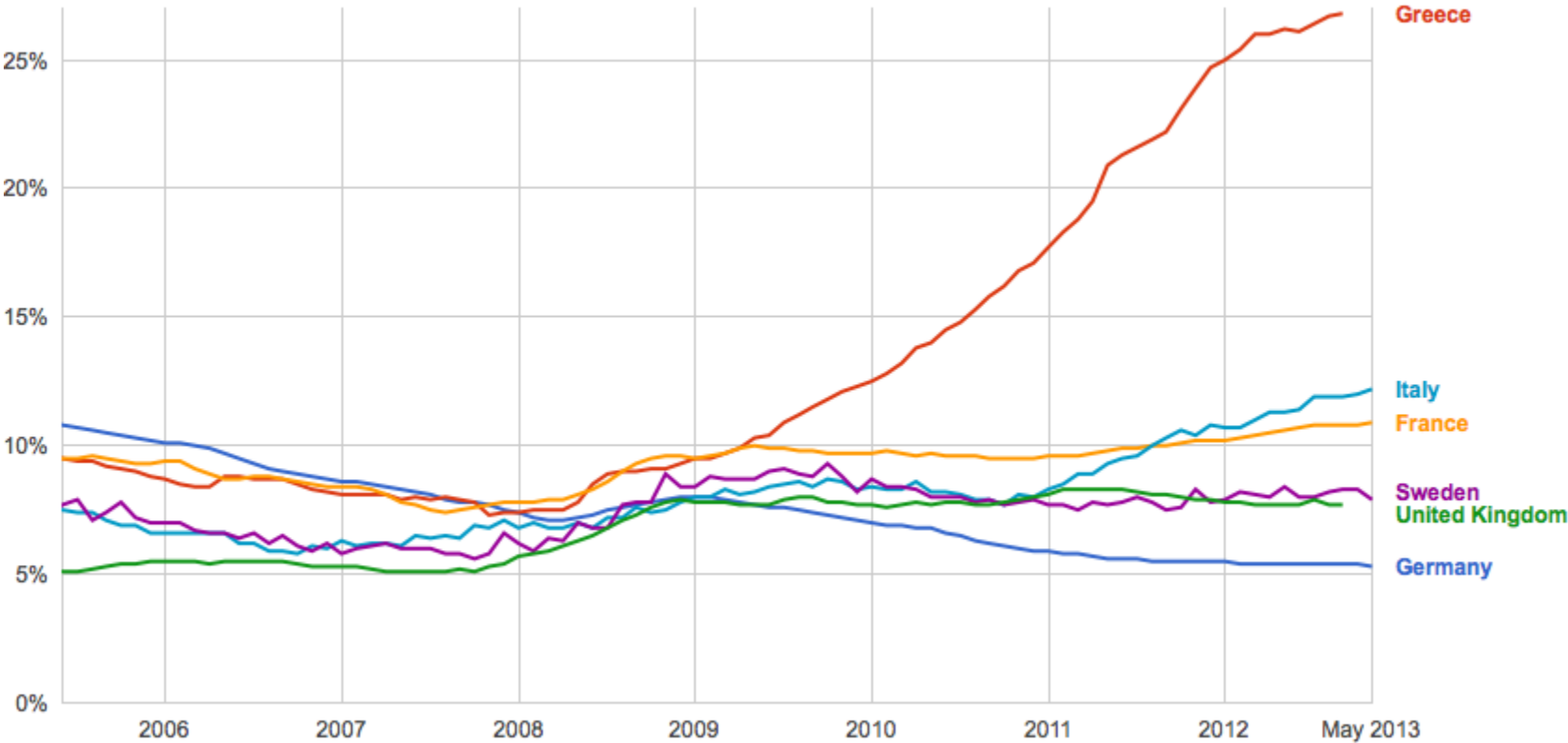
Q4 2007 to Q2 2011, % change



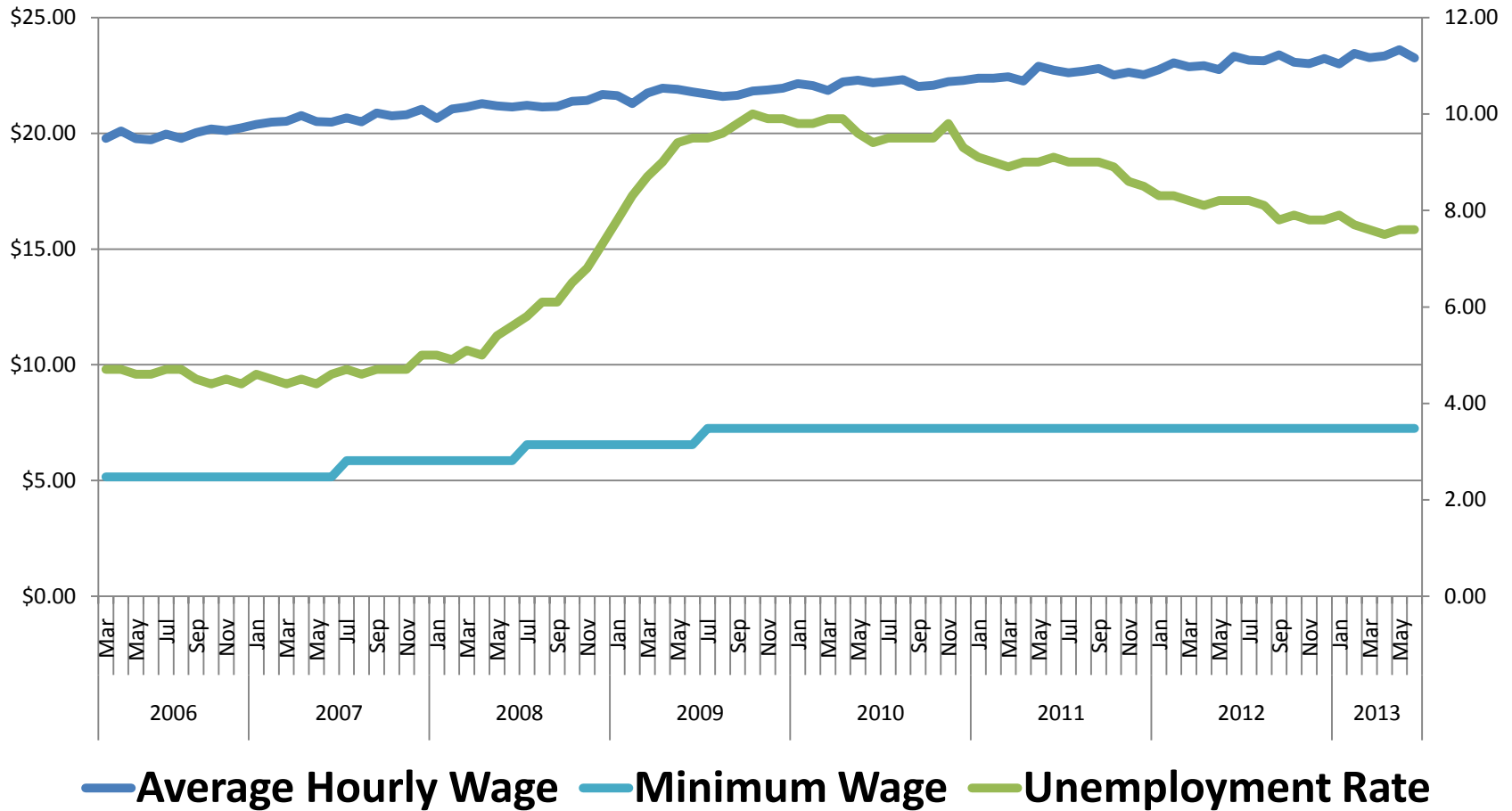
Sources: Economist Intelligence Unit; Haver Analytics; IMF; JPMorgan; *The Economist*

*Q2 2011 estimate

Unemployment Rate in Europe

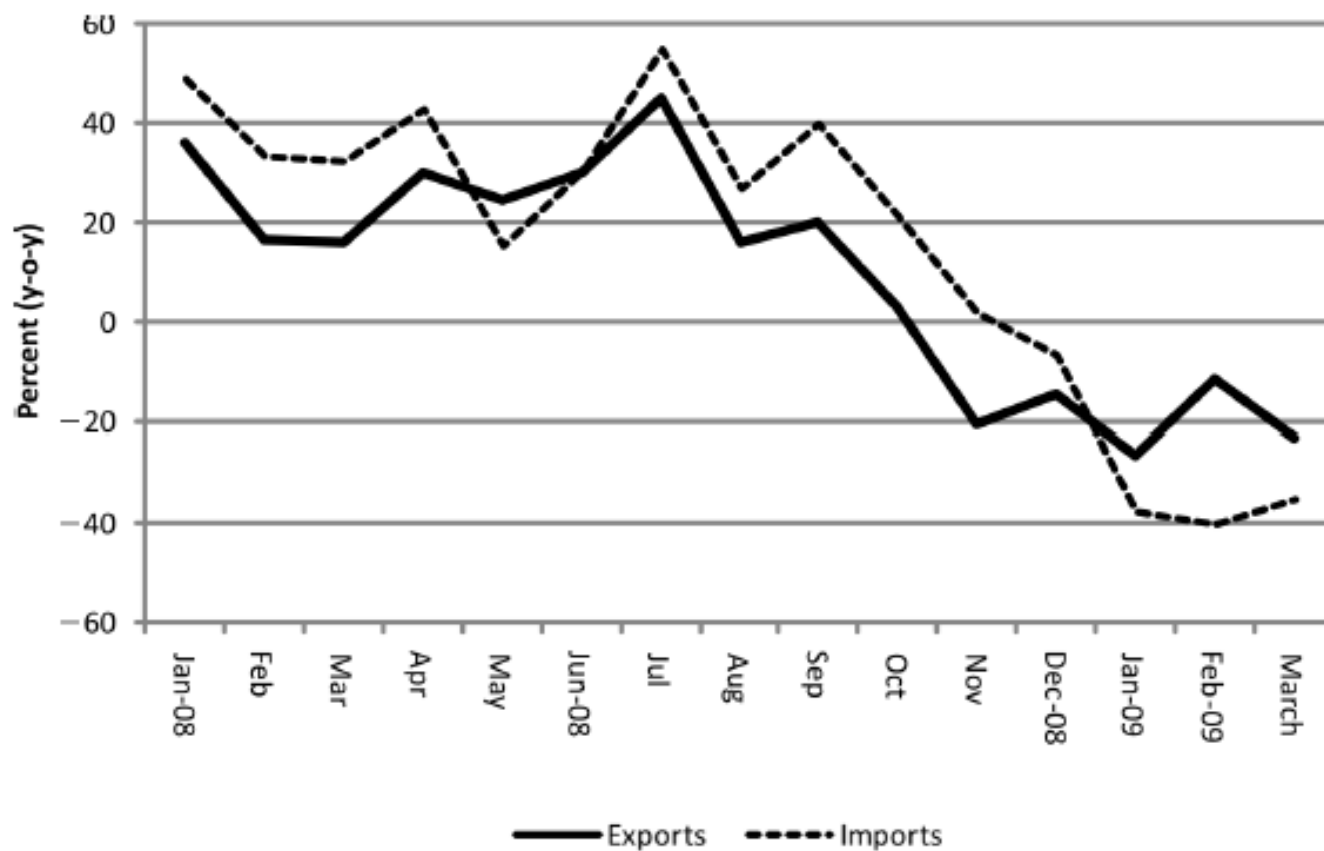


Wage and unemployment in the US



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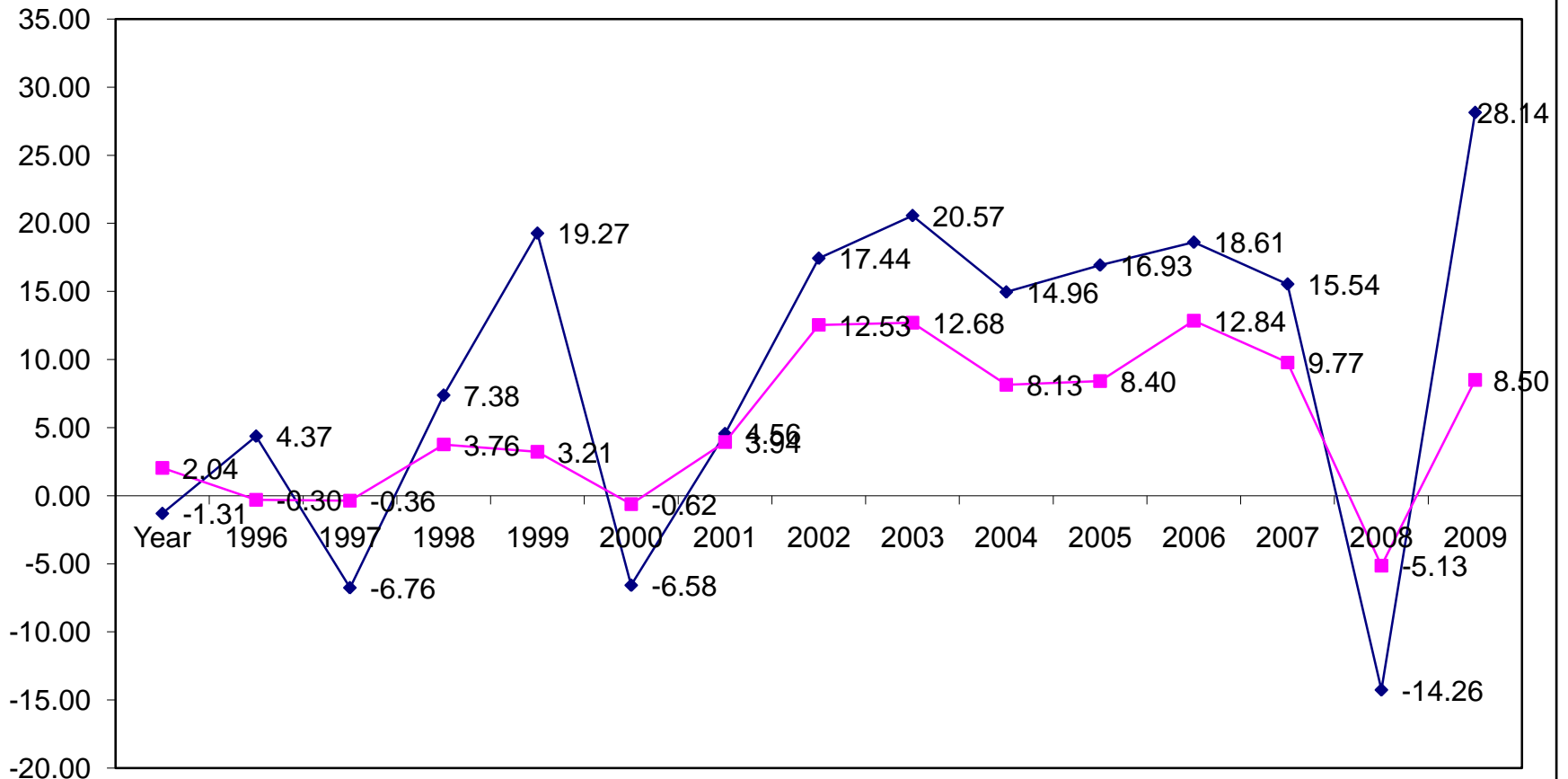
Figure 1. The collapse of the last engine of growth



Source: Ministry of Commerce

Impact of Global Recession

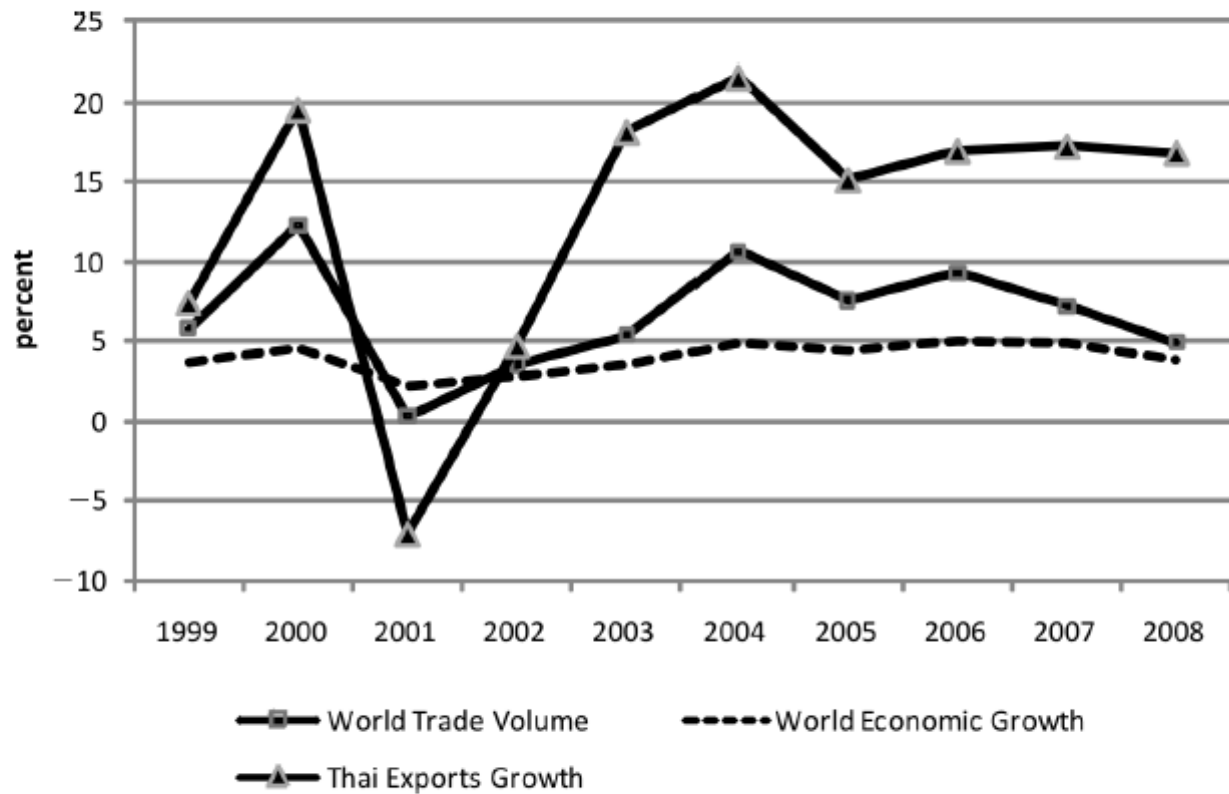
Thai Export VS World GDP in Dollar



◆ Export (%change)

■ World Income (%change)

Figure 2. Impact of shrinking world trade



Source: Bank of Thailand.

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Table 1. Rate of industrial capacity utilization by market orientation

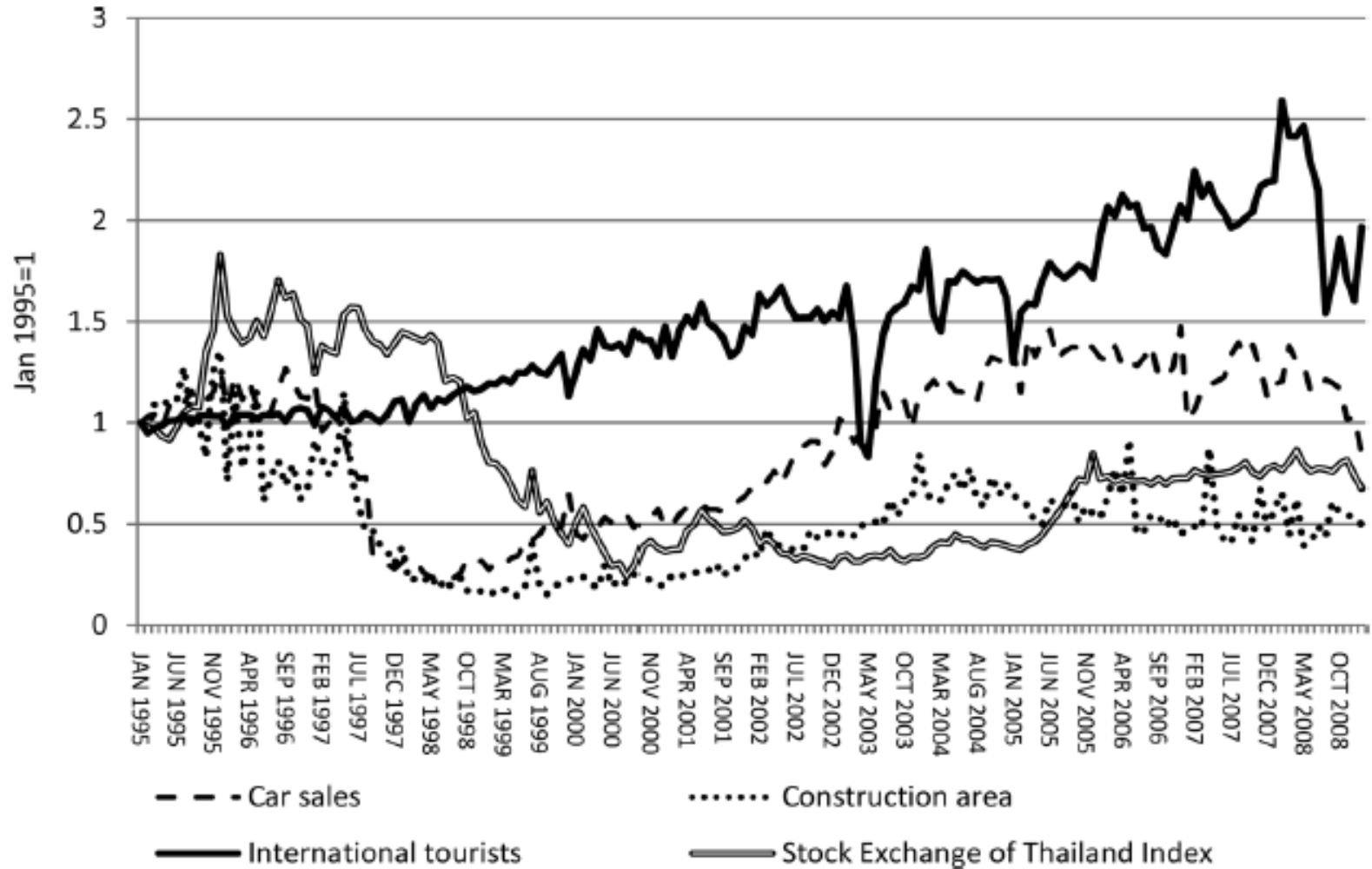
	1995–98	1999–2005	2006–08	1995–2008
Domestic oriented	74.3	69.6	79.3	74.4
Export oriented	60.6	63.7	68.5	64.3
Ultra-export oriented	71.5	68.8	66.4	68.9

Source: Bank of Thailand.

Note: Domestic market-oriented industry is defined as the industry that exports less than 30 percent of total production, as export-oriented if exports are between 30 and 60 percent, and as ultra-export-oriented if exports are more than 60 percent, respectively.

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Figure 3. Signs of imminent recession



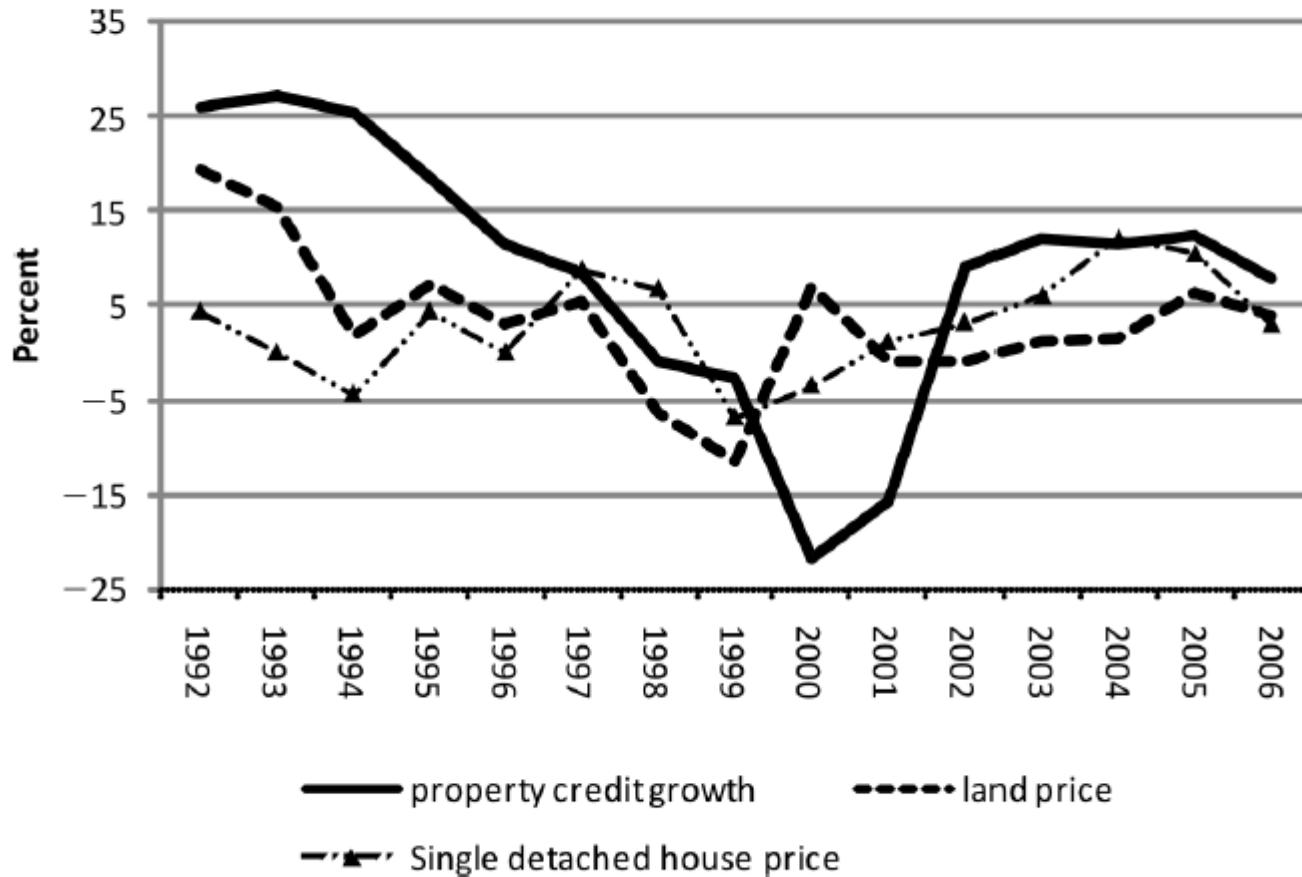
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Table 2. Contribution to GDP growth of demand components (percent)

	1990-96	1997-98	1999-2005	2006-07
Private consumption	51.2	-57	63.8	25.3
Government consumption	8.8	-8	10.0	16.8
Investment	57.0	-313	48.8	-8.1
Net exports	-17.0	278	-22.6	65.9

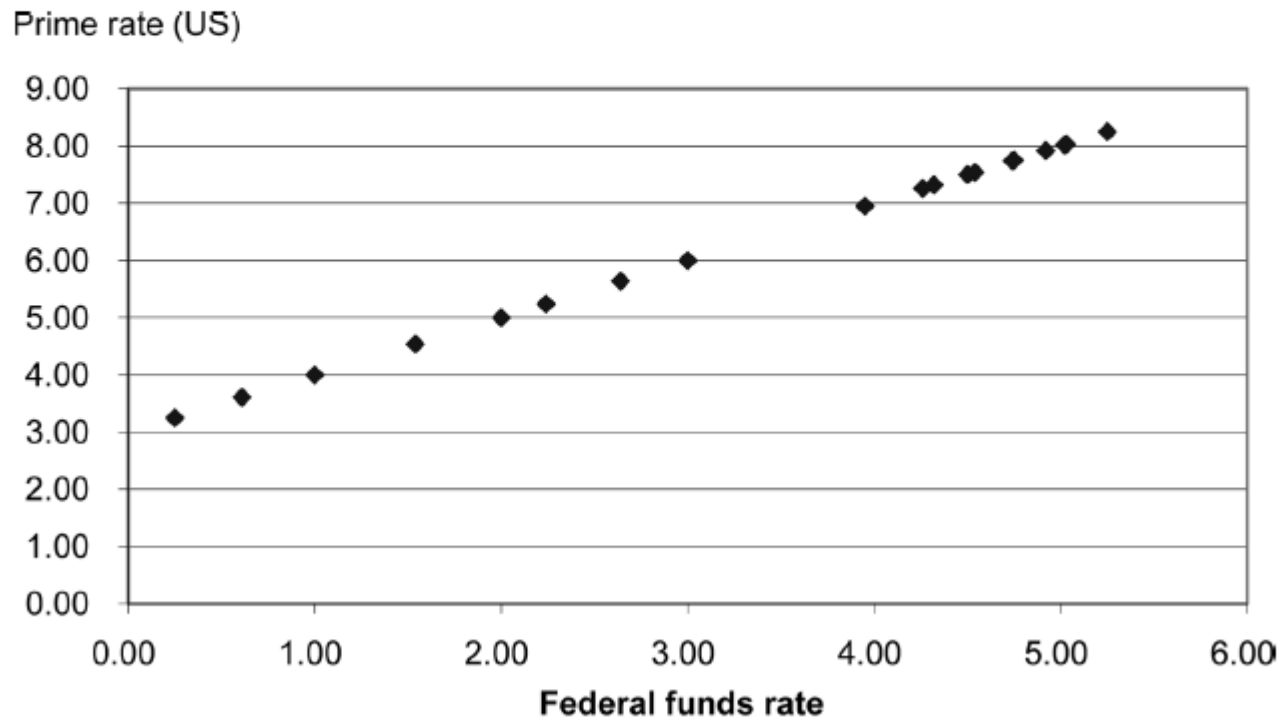
Source: Author's calculation.

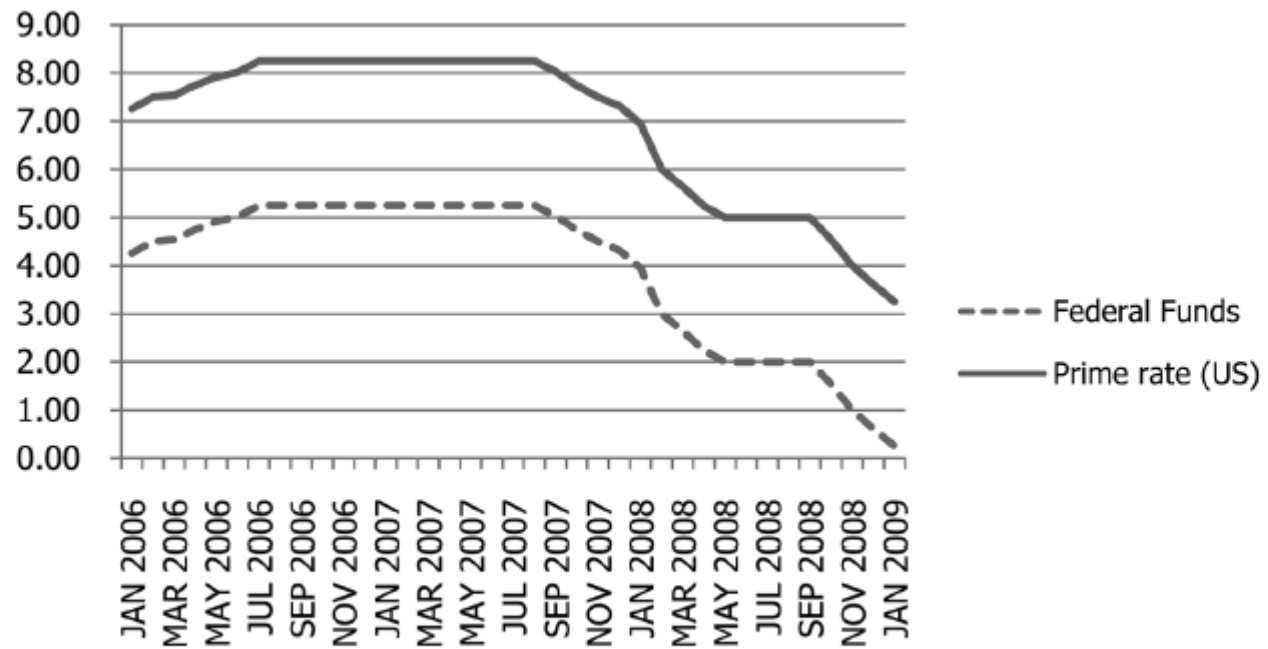
Figure 4. Real estate bubbles and property credit



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Figure 5a. Impact of the key policy rate in the United States

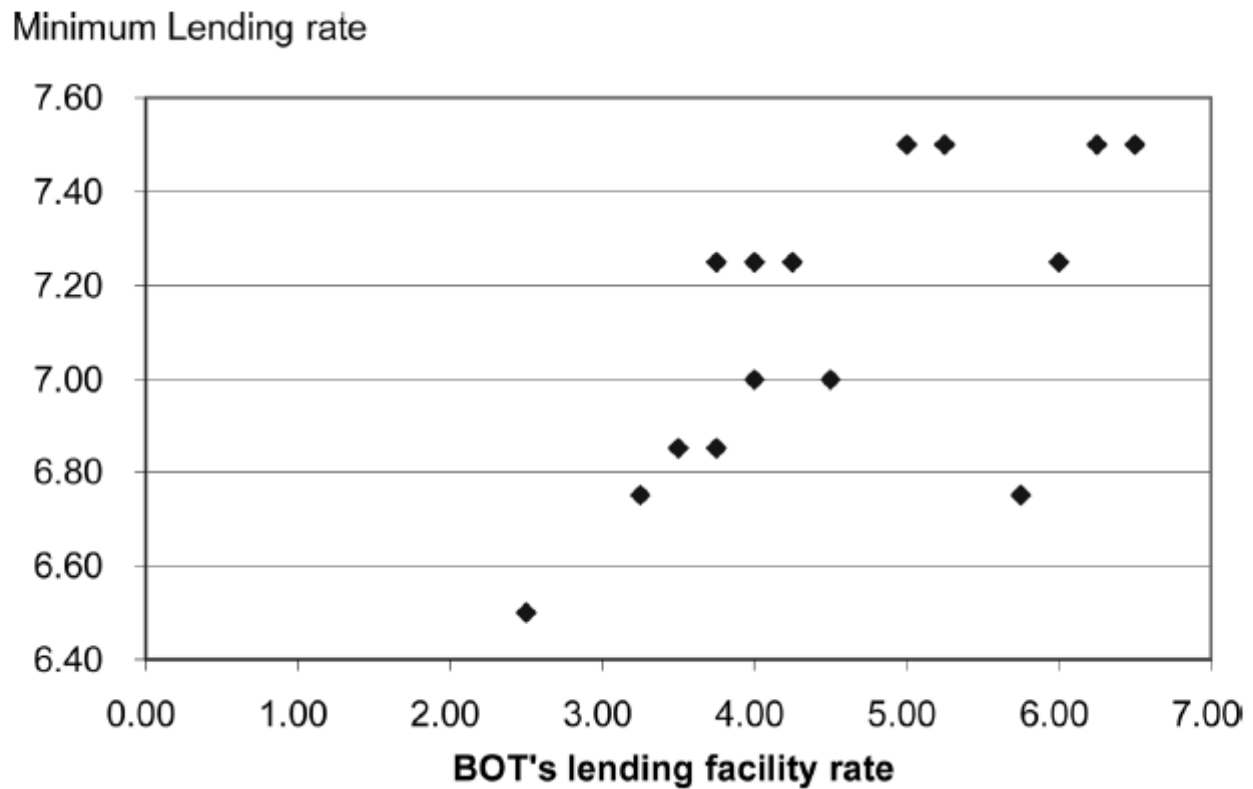


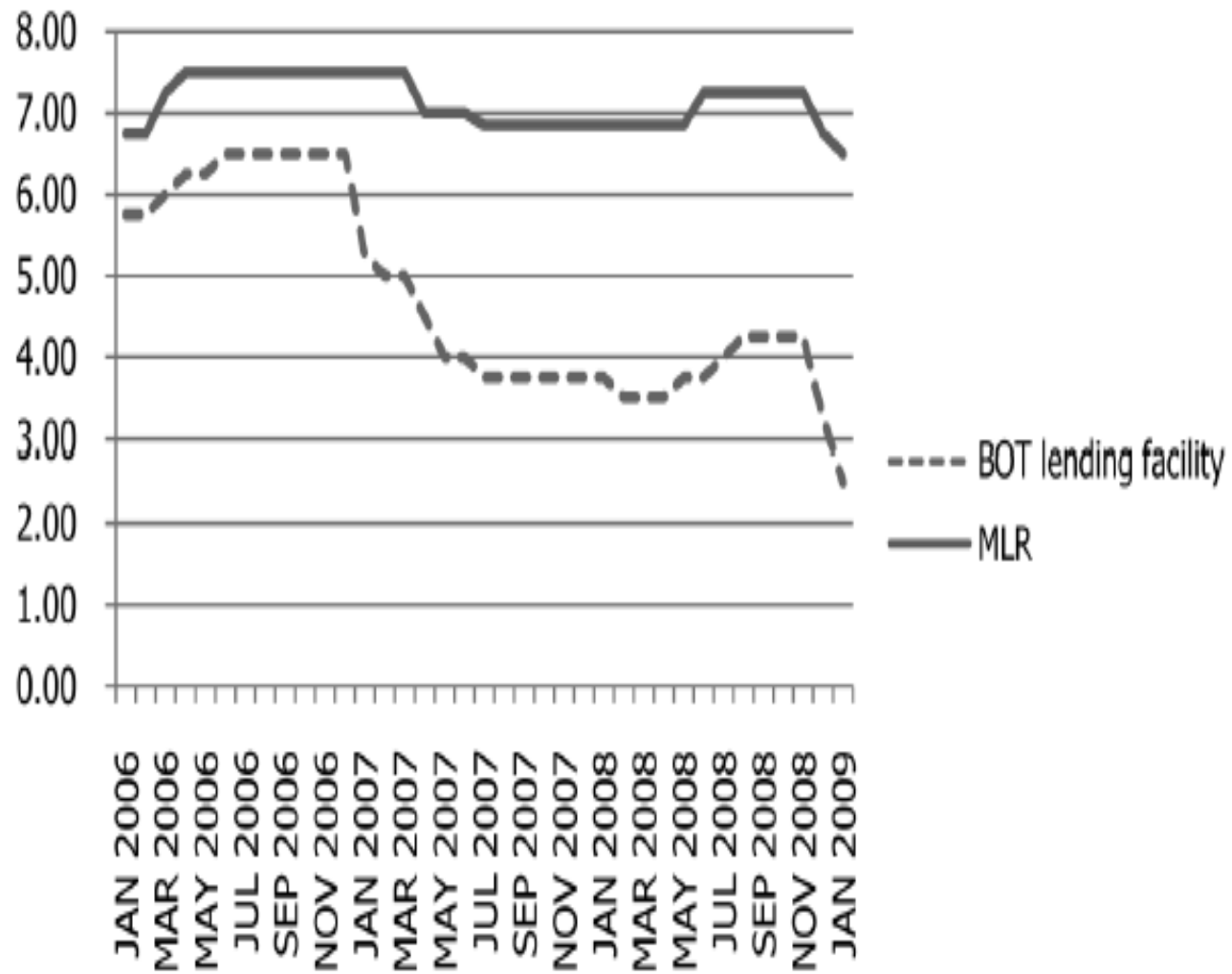


Source: Bank of Thailand.

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Figure 5b. Impact of the key policy rate in Thailand

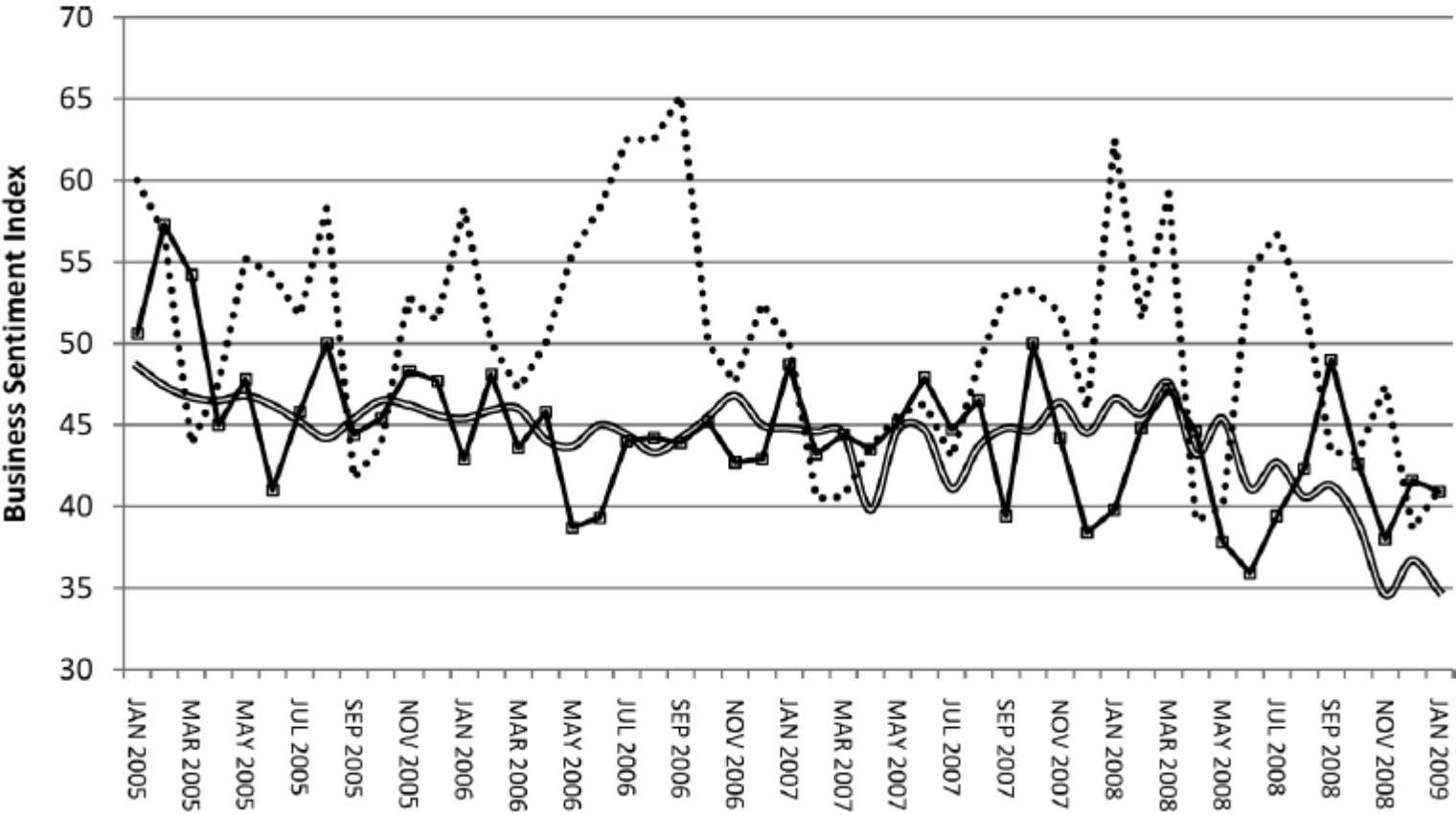




Source: Bank of Thailand.

- In a mild business cycle, fear of recession and pessimistic expectations can increase the perception of the fall in future income and it can turn a mild recession into a depression (J.M.K)
- During the boom investment would expand in response to strong sales growth.
- In turn, capital spending on new plants would generate employment and income that further induce more capital formation.

Figure 6. Loss of business confidence



If consumers view the increase in public spending as a positive transitory income, the impact of fiscal stimulus would be weak. Only when consumers view that their permanent income increases do they respond by increasing their permanent consumption. The expansionary impact of fiscal deficit is questionable since the benefits from the stimulus package are temporary.⁸

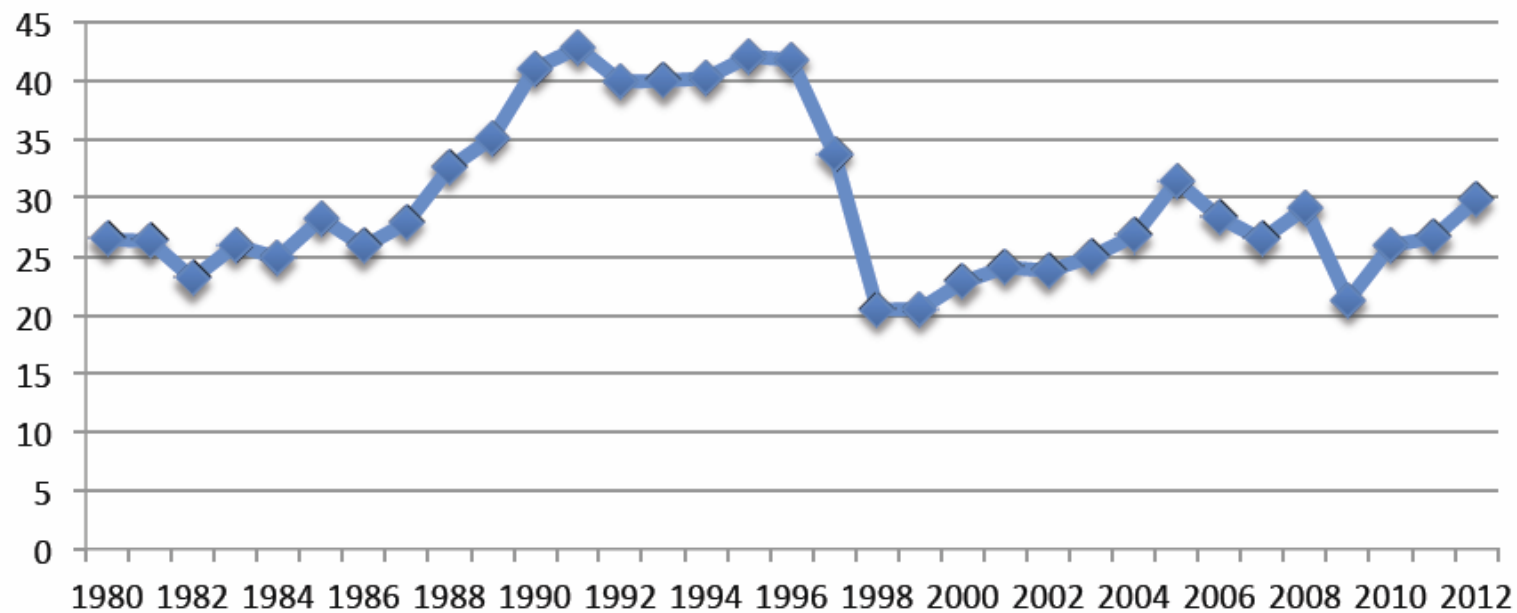
The marginal benefit and cost of each stimulus program must be examined. The urgency of spending is not as important as the long-run impact on growth. If the increase in the budget concentrates in current rather than capital spending, the impact on long-term growth is questionable. Spending on infrastructure and communication lead to a higher growth of output than other types of government spending. Furthermore, the rising proportion of current expenditures in the total budget

⁸ Ravallion and Chen (2005) provide evidence rejecting the commonly held view that poor people tend to rapidly consume the income from a development project. Aid recipients felt that a large share of the income gains was likely to be transient.

Business sentiment and consumer confidence

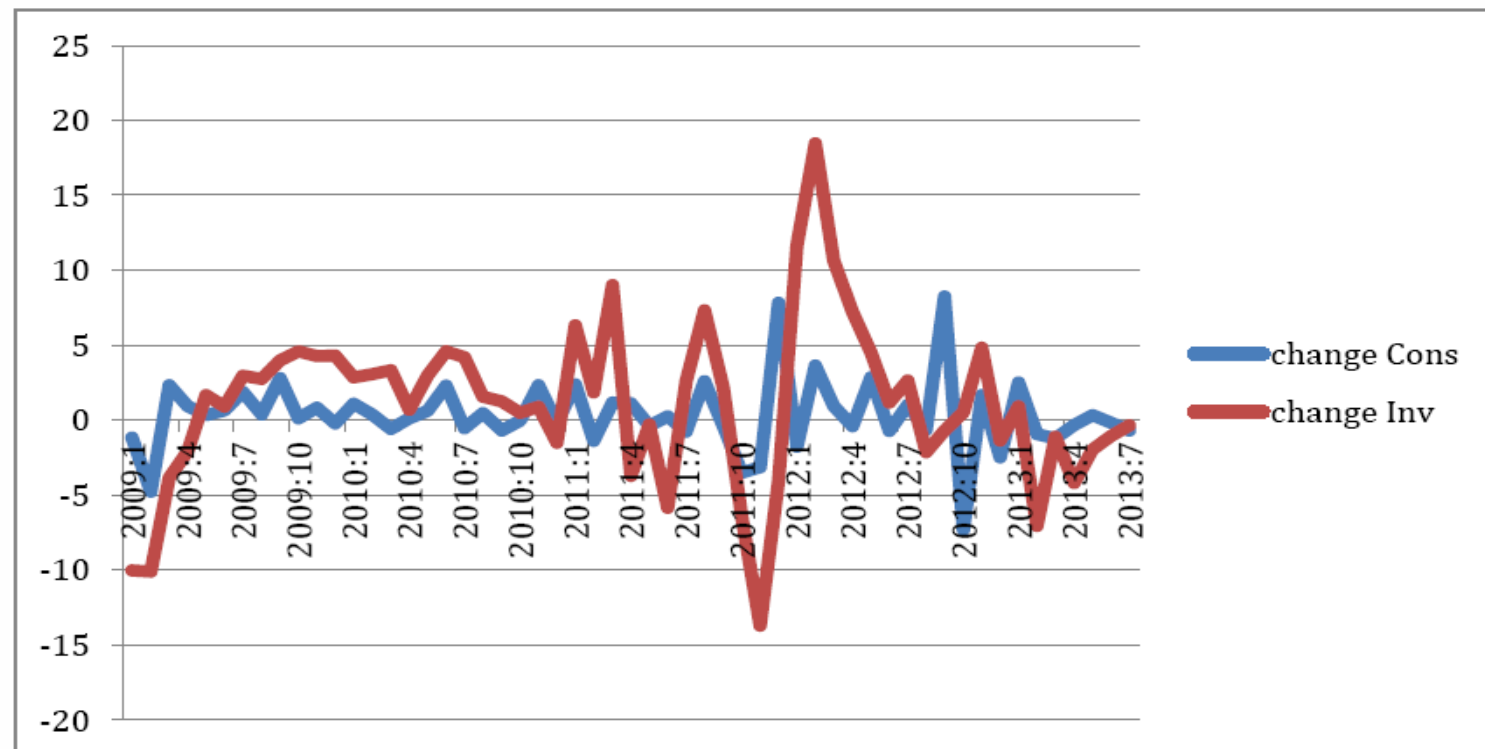
- Business sentiment can be restored and maintained by policy consistency.
- If the government and the public adhere to the rule of law, political shocks can be minimized as a concern for fairness would be eased.
- Once we allow elements of unknowns to violate established social obligations and contracts, business confidence erodes quickly; eventually it could lead to a negative long-term impact on economic growth.

Share of investment in GDP (%)



Does increased investment lead to current and future consumption?

Data focusing on year 2009-2013:



Short-term gain

- Fiscal policy is the only option left. (Why?)
- Unless the government maintains law and order to restore business sentiment and enhance consumer confidence, both the monetary and fiscal policy package would fail miserably.
- Ultra-populist policy would lead to an unsustainable fiscal position.
- Fiscal discipline has been neglected in the pursuit of short-run political gain at the expense of the long-term economic growth and stability

Effectiveness of Thailand's Macroeconomic Policy Response to the Global Financial Crisis

Bhanupong Nidhiprabha

This paper investigates Thailand's macroeconomic policy responses to the global financial crisis in 2009. Empirical evidence found in this paper indicates that fiscal policy is relatively less effective than monetary policy. Tax reduction is more powerful in stimulating output than government spending. Maintaining undervalued exchange rates does not create the output expansion effect. Sustained economic recovery requires growth in the world trade volume and enhanced business confidence.

Keywords: Thailand, output volatility, effectiveness of monetary and fiscal policy.

During the period 2000–09, exports were the most volatile component of aggregate demand. Table 1 shows that the standard deviation of the cyclical movement in exports in the period 2006–09 increased sharply — almost tripled the level in the period 2000–05. Export instability stemmed from structural changes of production patterns that have become more heavily reliant on external demand.

Investment instability can be attributed to domestic political uncertainty that does not provide favourable investment climates. Because of its irreversibility, large investment projects can

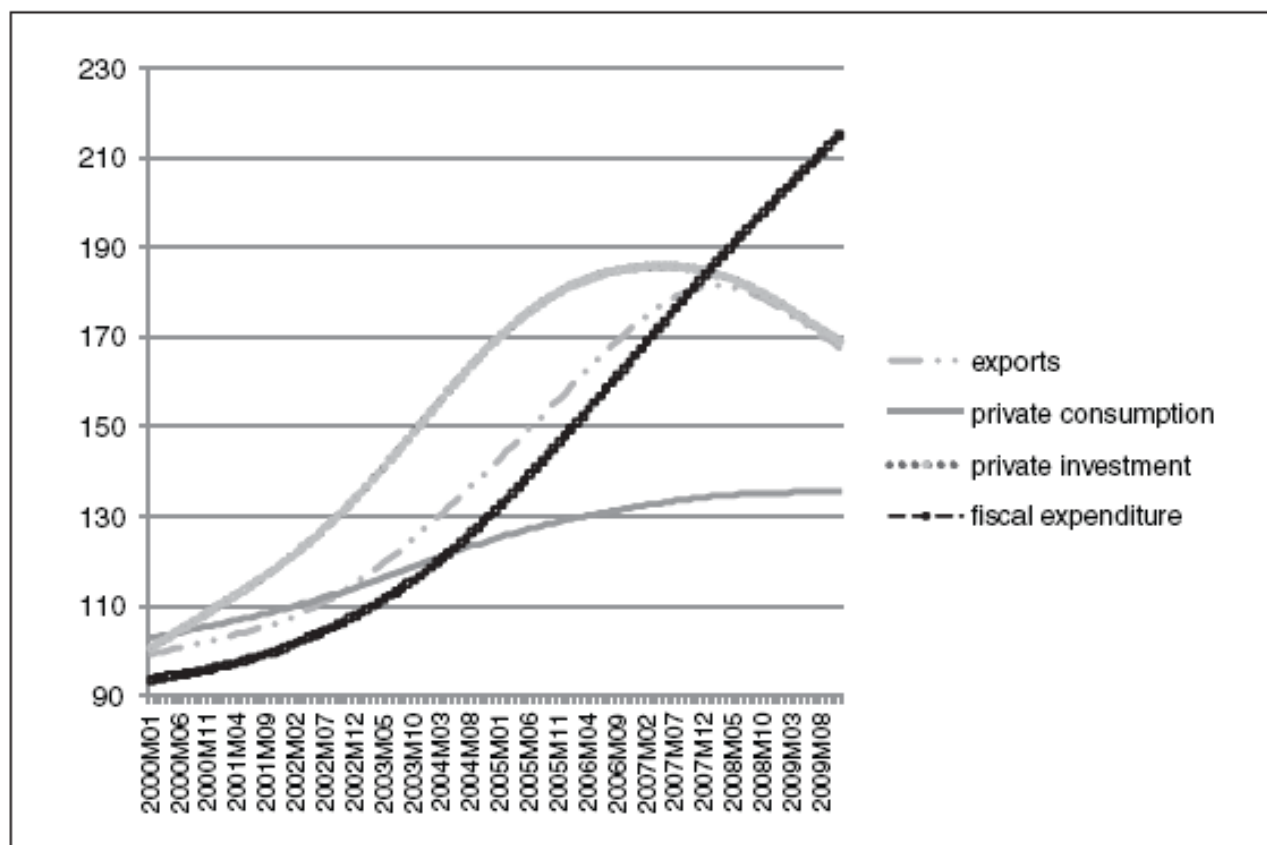
As a result of the increased volatility in private spending and exports in the period 2006–09, output fluctuated more virulently. The standard deviation of the cyclical component of output increased from 2.9 to 11.3 (Table 2). Ramey and Ramey (1995) report the evidence indicating a negative correlation between output volatility and economic growth in their cross-country study. In the case of Thailand, average GDP growth declined from 5.1 per cent to 2.4 per cent during the same corresponding period. Similarly, the business sentiment index shows increasing variations. The standard deviation of inflation rate

TABLE 1
Increasing Volatility of Aggregate Demand
(Standard deviation of cyclical components)

	<i>Fiscal spending</i>	<i>Private investment</i>	<i>Exports</i>	<i>Private Consumption</i>
2000–05	2.18	3.92	4.58	1.42
2006–09	3.42	7.4	13.45	2.86

SOURCE: Bank of Thailand.

FIGURE 3
Long-term Paths of Aggregate Demand Components

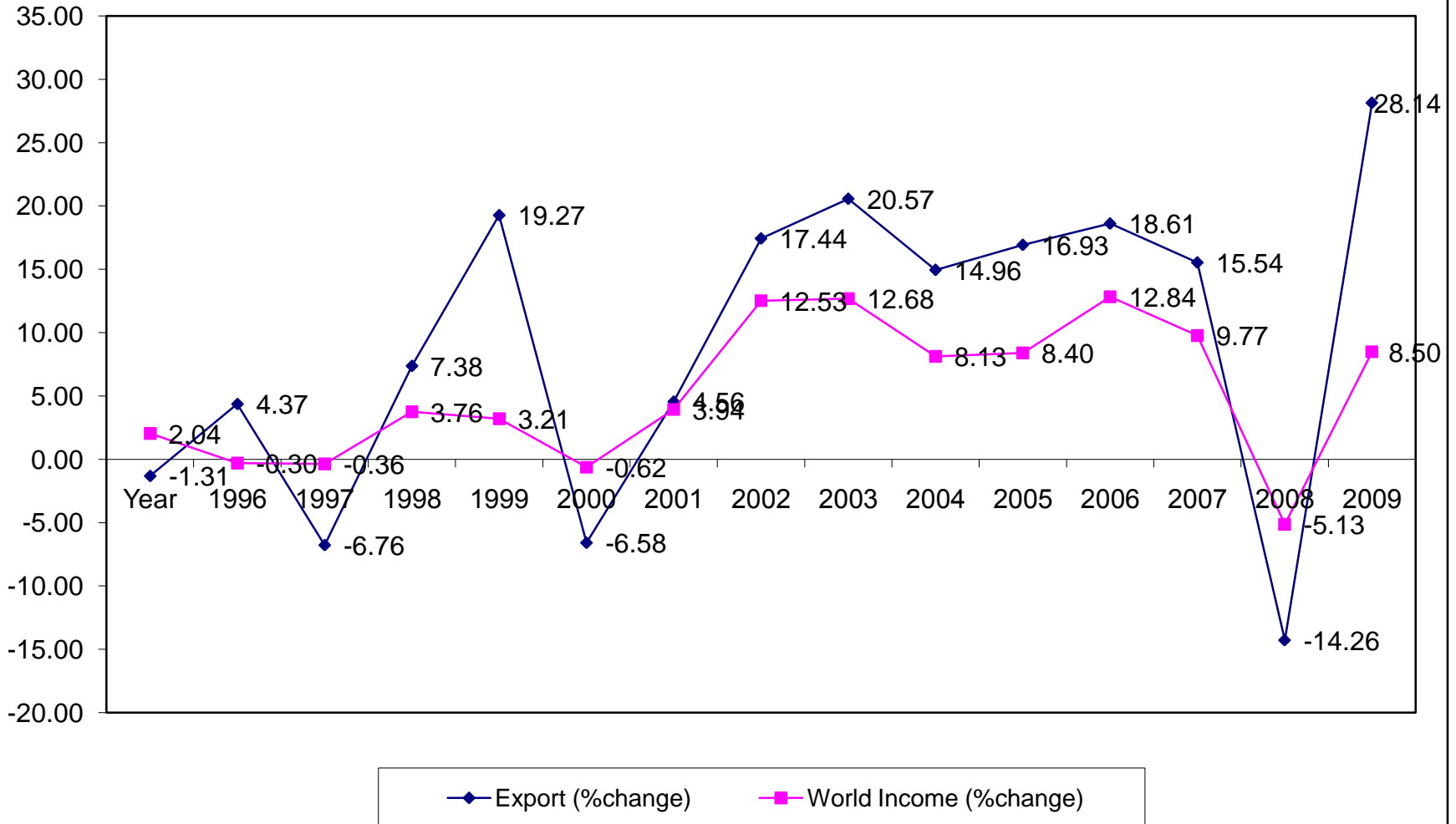


SOURCE: Hodrick-Prescott Trend values obtained from data provided by the Bank of Thailand.

When consumption and investment spending are constrained by poor business sentiment and weak consumer confidence, the recovery must come from the rebound of export demand.

A sustainable recovery depends on the resumption of world trade expansion and regained consumer confidence.

Thai Export VS World GDP in Dollar



The year 2006 witnessed a fundamental change in Thailand's politics, which has a profound impact on the previously stable economy.

The economic outcome of policy responses to external shocks is influenced by the quality of institutions.

Political transformation through military coups, revolution, and civil war cycles involve high risk exposure to **output and consumption volatility** that would lead to serious economic crises.

TABLE 2
 Volatility in Output, Price, and
 Business Confidence
 (Measured by standard deviation)

	<i>Output</i>	<i>Business sentiment index</i>	<i>Inflation</i>
2000–05	2.96	2.42	1.43
2006–09	11.3	3.44	3.06

SOURCE: Bank of Thailand.

The effectiveness of policy responses depends on the government's ability to maintain the rule of law, accountability, human rights, and effective legal infrastructure.

Maintaining the rule of law implies predictable outcomes from court ruling of legal disputes.

Investors can proceed with less concern about risk and uncertainty that may arise from policy inconsistency.

If those policy stimuli can be used under a favorable investment environment, Thailand can recover quickly from the global financial crisis and would have been subject to lesser adverse consequences of the global recession.

Thailand has sufficient policy instruments to respond to fluctuations in the global export demand, but those policy instruments must be selectively chosen to ensure maximum impacts on stabilization.

How can we rekindle favorable investment climate?



Monetary policy remains effective despite the high degree of capital convertibility because its impact on the exchange rate intensifies the initial impact of monetary policy on the aggregate demand.

Currency appreciation does not necessarily lead to output contraction.

These macroeconomic policies would be more powerful with accompanying measures to boost consumer confidence and business sentiment to nourish the animal spirits of investors.