

The Resilience of The Thai Economy: 1991-2005

Bhanupong

Lecture 4

Course Syllabus

Lecture 4: Resilience of the Thai economy: 1991-2005

- There appears to be some structural mechanisms that would lessen the impact of economic crisis, whether shocks are internal or external. It is impossible to rule out various future shocks such as oil price hikes, realignments of major currency values, or crisis contagion. Is the Thai economy resilient enough to regain its pre-shock growth path in a V-shaped recovery in 2018?
- Reading: “Resilience of the Thai economy” in ***Thailand’s Economic Recovery***, Cavan Hogue (ed.), Institute of South East Asian Studies, Singapore, 2006.

Key words

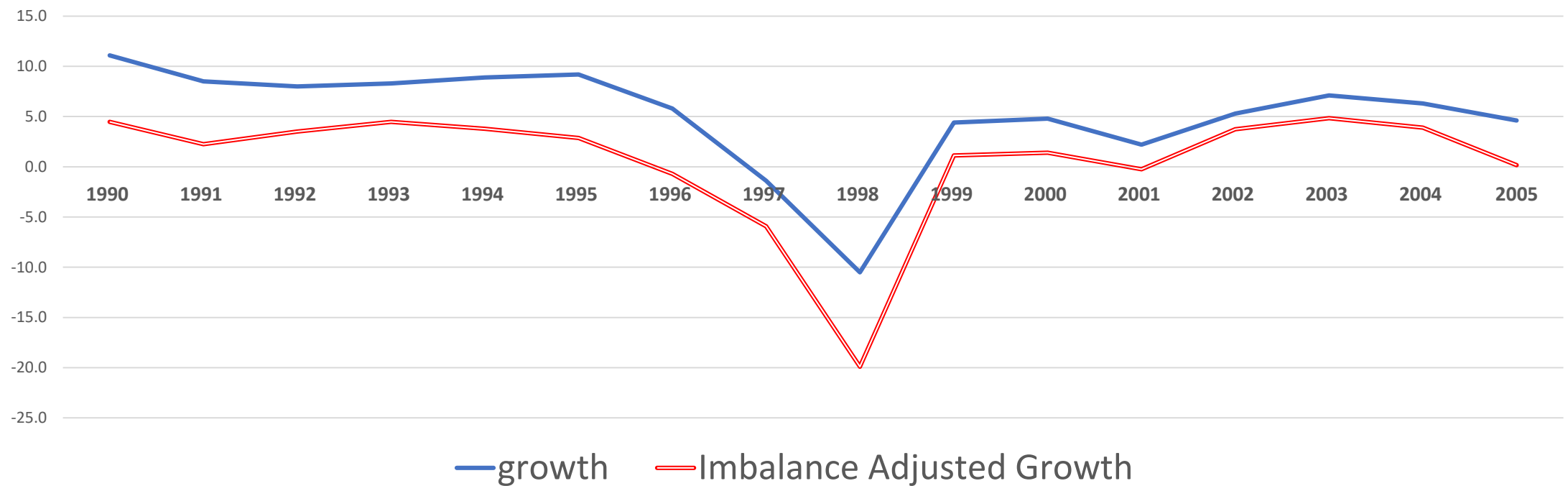
- Growth with Price Stability
- Imbalance-adjusted growth rate
- Human capital
- Strengthening Fiscal Position
- Recession and recovery
- Irrational Exuberance
- Fear of appreciation
- Export-oriented industries and FDI
- World business cycle

Imbalanced adjusted growth rate

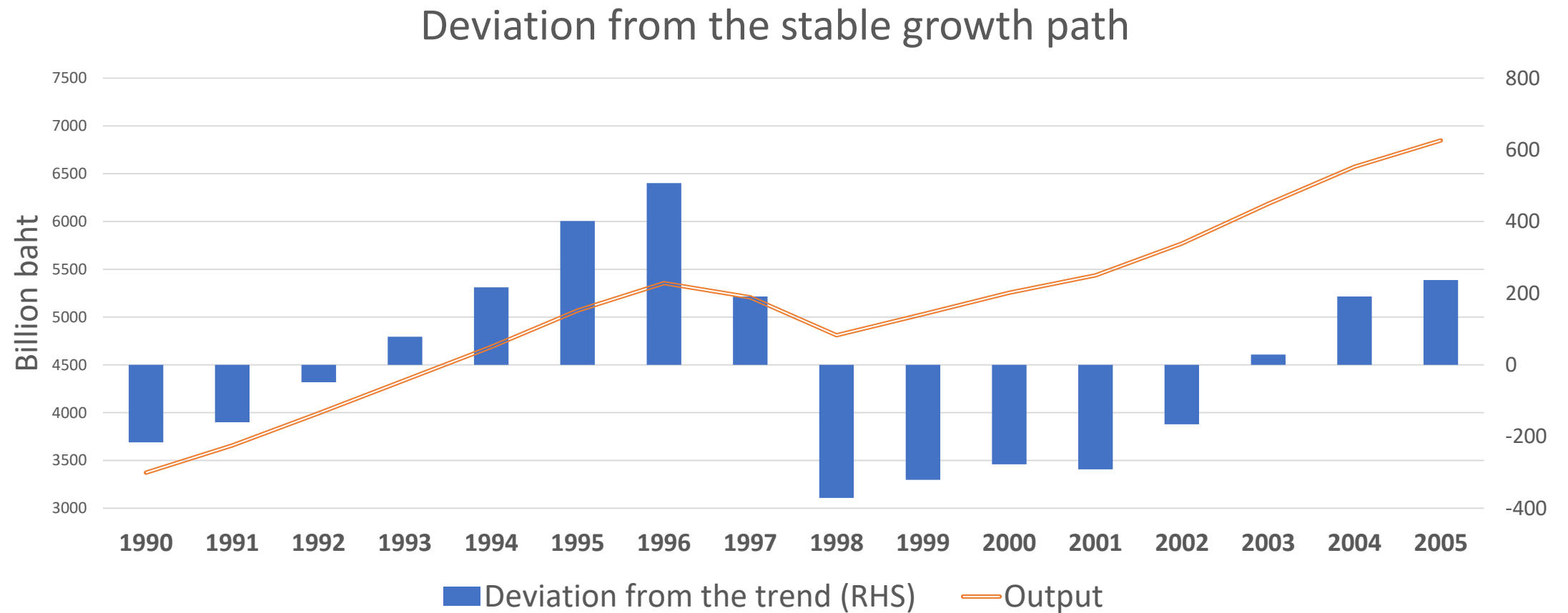
- Real GDP Growth can occur simultaneous with internal imbalances between aggregate demand and supply, which create price adjustments
- External imbalances also be indicated by surplus or deficit in the current account
- To measure sustainable economic growth, GDP growth can be measure by adjusting GDP growth rate by adjusted the weighted average of the absolute value of price changes (inflation or deflation) and current account (surplus or deficit current account balance as % of GDP)

Internal disequilibrium is reflected by price adjustments (inflation and deflation), while external equilibrium by imbalance current account (surplus or deficit)

Figure 1. Actual and Imbalance-Adjusted GDP Growth Weighted average of absolute values of price changes and current account (% GDP) disequilibrium: weights are 0.7 and 0.3 respectively

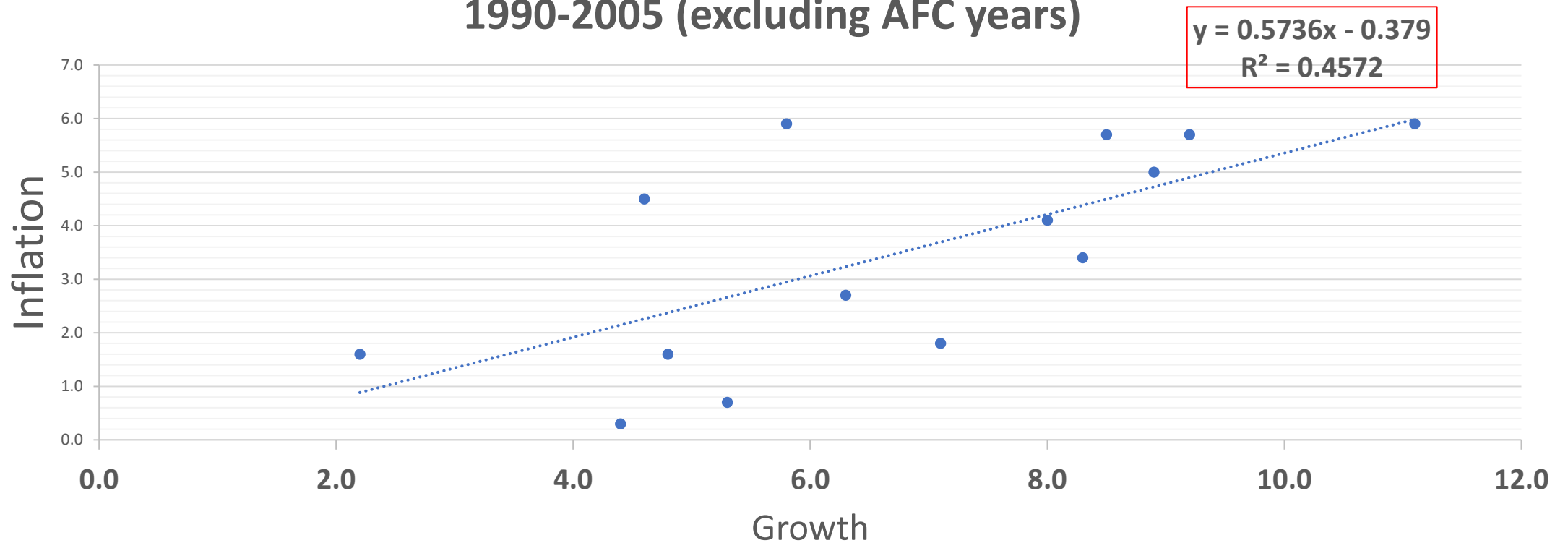


Booms and Busts: AFC



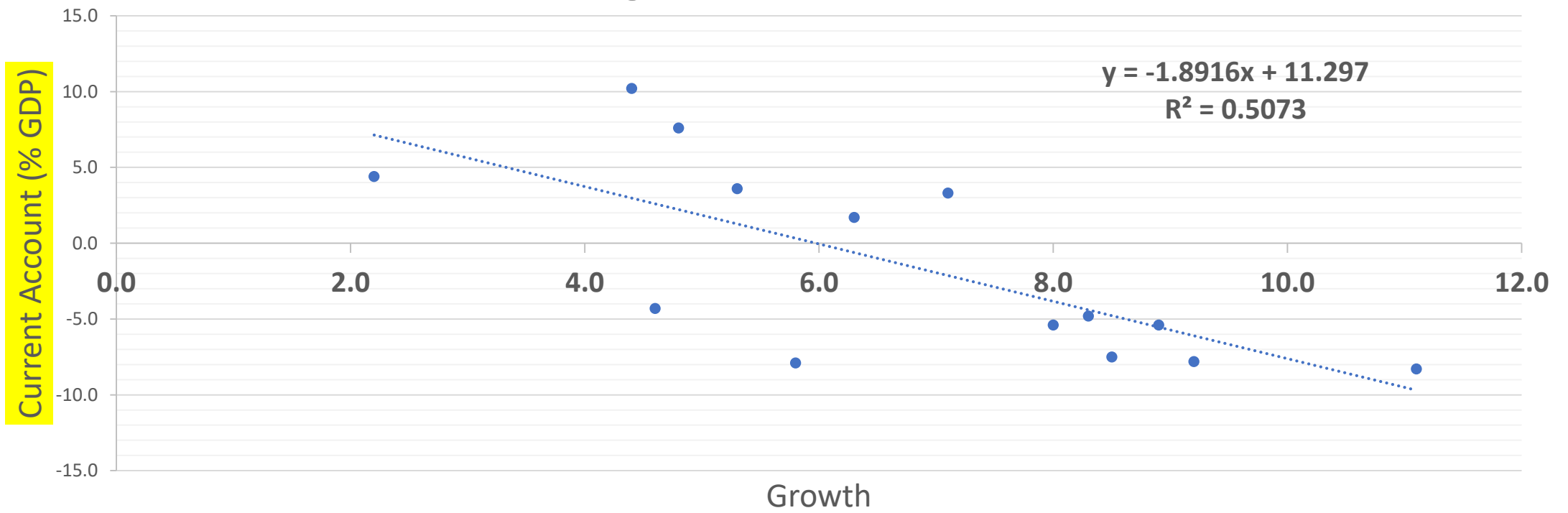
Overheated economy gave rise to inflation: Demand pressure

Figure 3. Growth-Inflation tradeoff
1990-2005 (excluding AFC years)



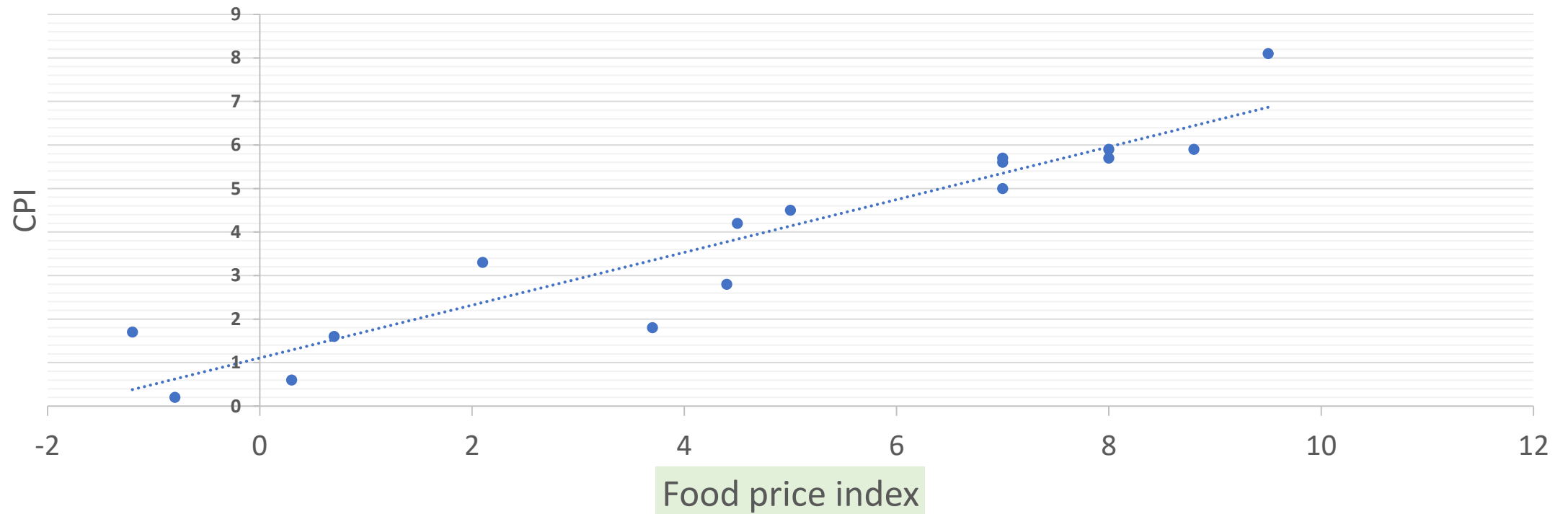
High growth, high current account deficit

Figure 4. Growth and External Imbalance: 1990-2005
excluding 1997 and 1998

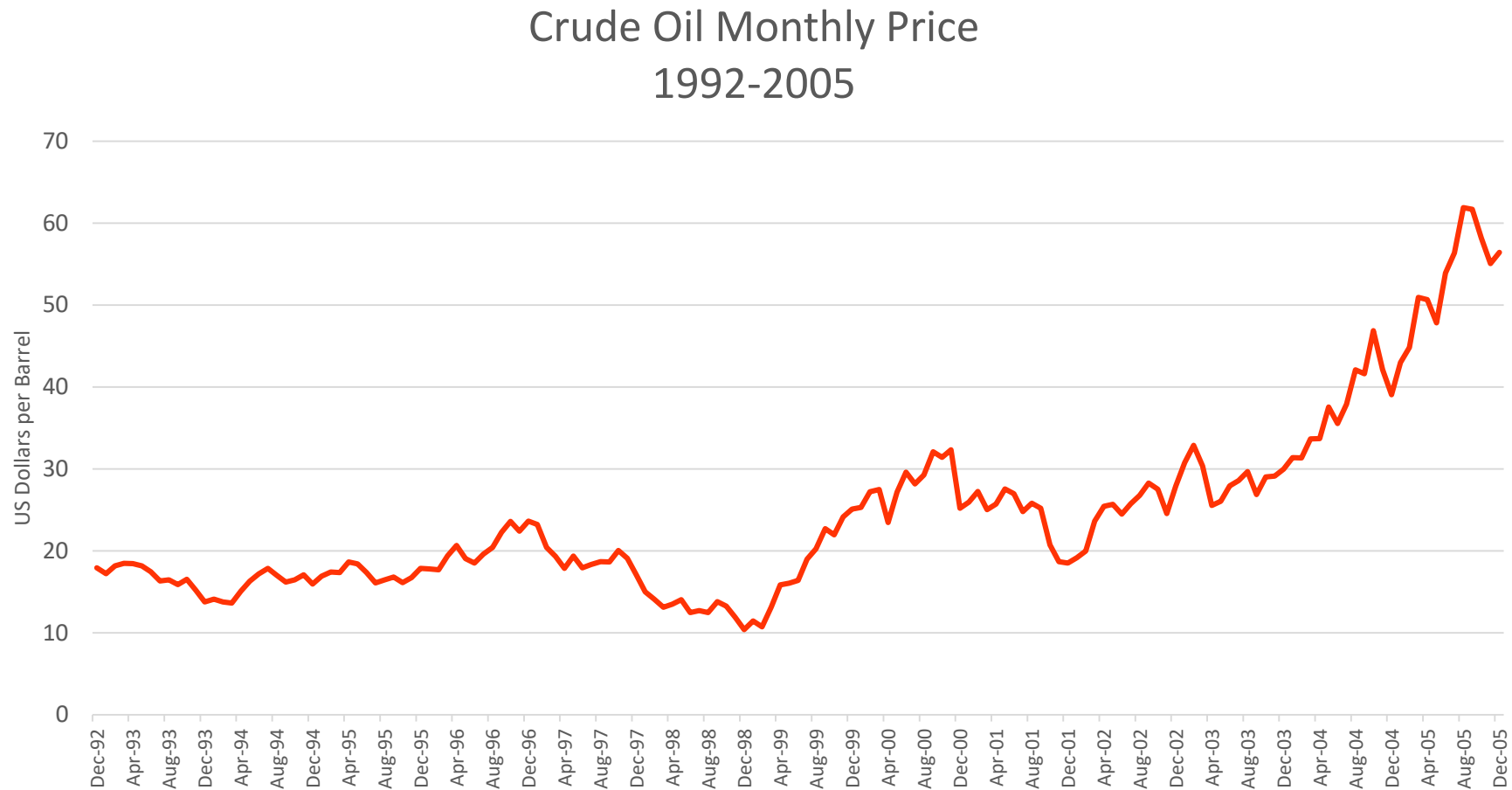


The importance of food prices

Figure 5. CPI and food price inflation
1990-2005

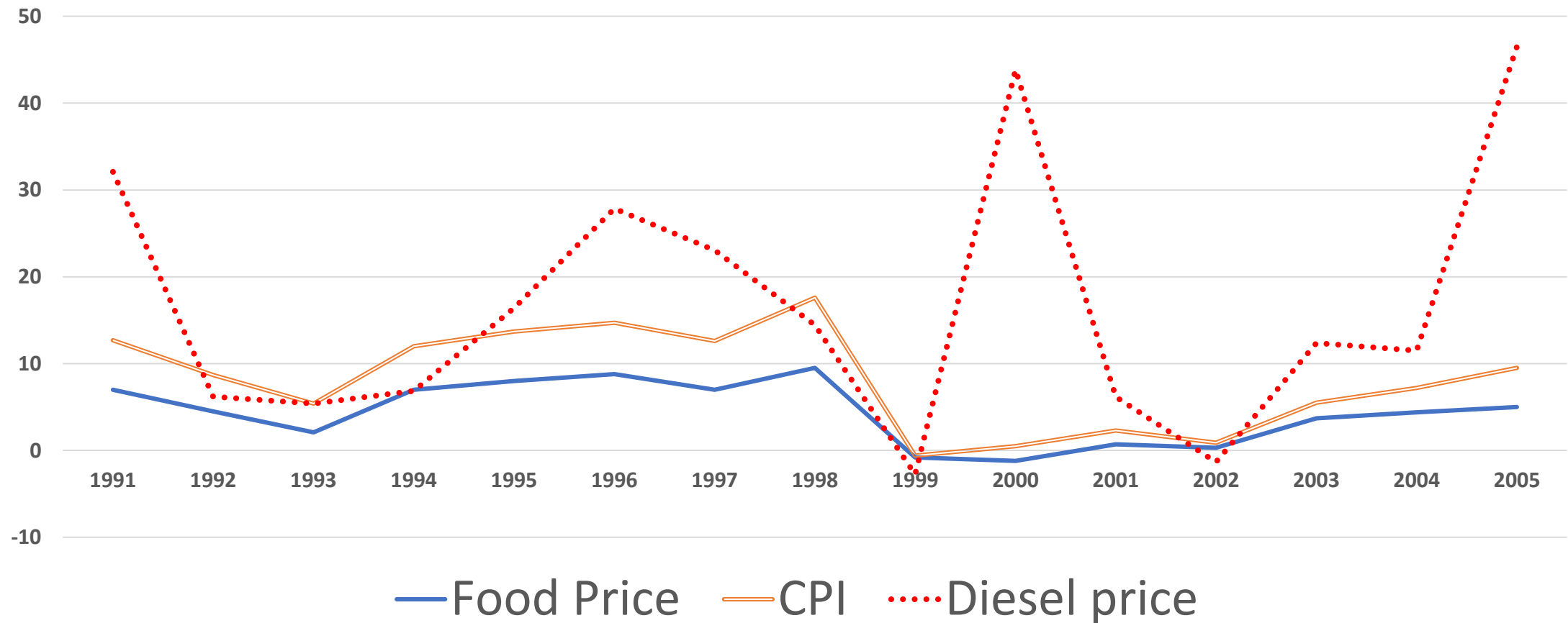


Dealing with rising oil prices



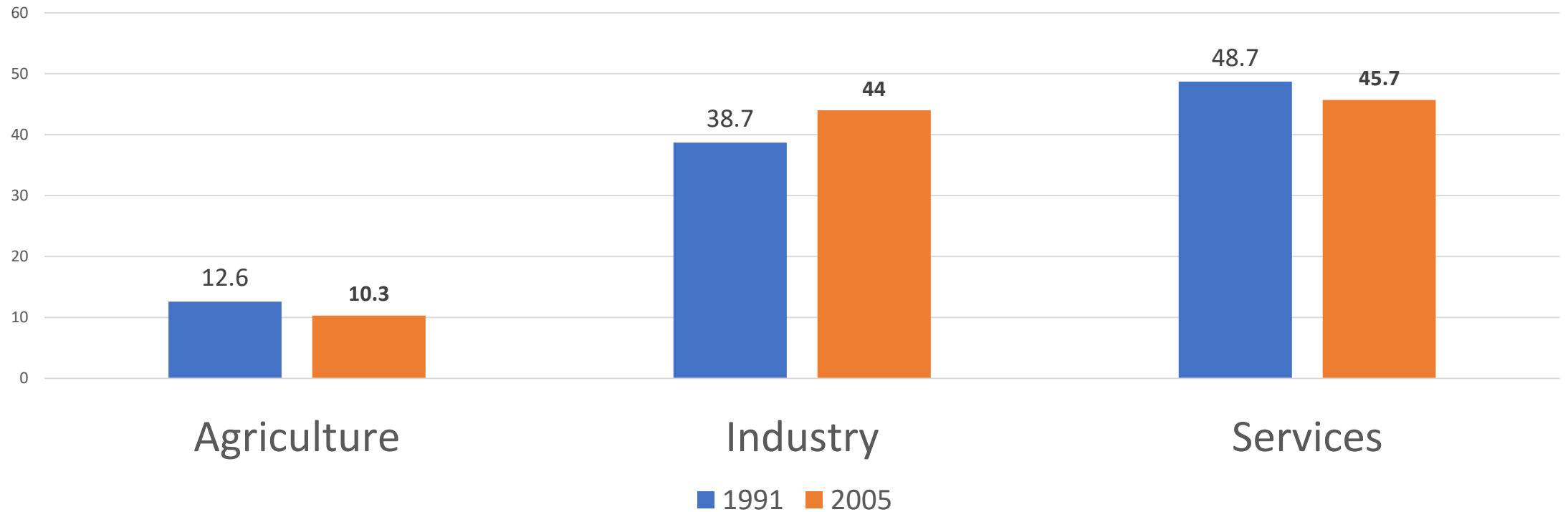
Inflation inertia

Figure 6. Inflationary Expectations (Sticky prices)



Gradual transformation

structural transformation
(Share of sectoral output in GDP)



Human capital investment

	Public Expenditure on education (%GNP) 1989	Secondary school enrolment (1988-89)
China	2.4	44
India	3.2	43
Indonesia	0.9	47
Korea	3.6	87
Malaysia	5.6	87
Thailand	3.2	28

Theodore Schultz: Human capital and economic development

- Schultz first wrote about the connections between education and productivity.
- At the time, other economists were having trouble explaining how the economies of such nations as Germany and Japan grew so quickly after World War II.

The role of human capital in economic development

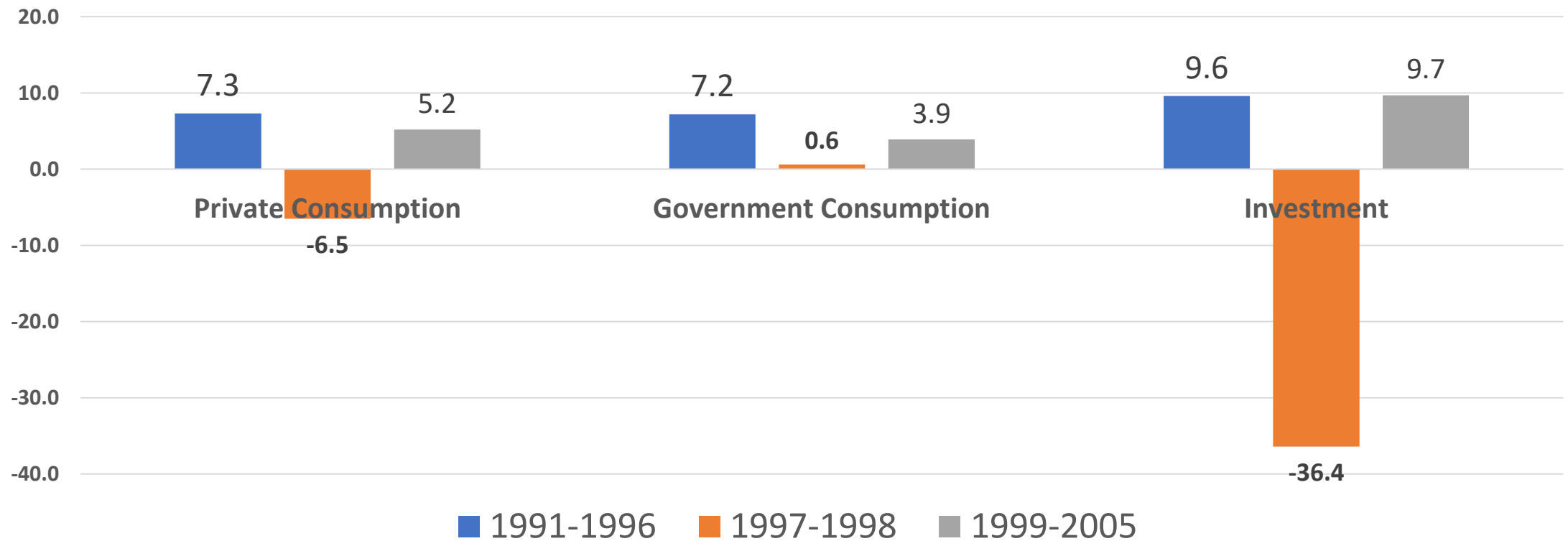
- Some economists attributed the improvements in those nations and others to "technical change," but Schultz identified **people** as the source of the economic growth.
- Schultz was the first economist to systematize "how investments in education can affect productivity in agriculture as well as the economy as a whole," according to his 1979 Nobel citation.

Theodore Schultz: Don't neglect agriculture

- He was often a critic of developing nations' efforts to expand industrialization at the neglect of agriculture development.
- By being able to show that economic growth depended on "human capital," Schultz opened a whole new area of research and paved the way for work by other economists.

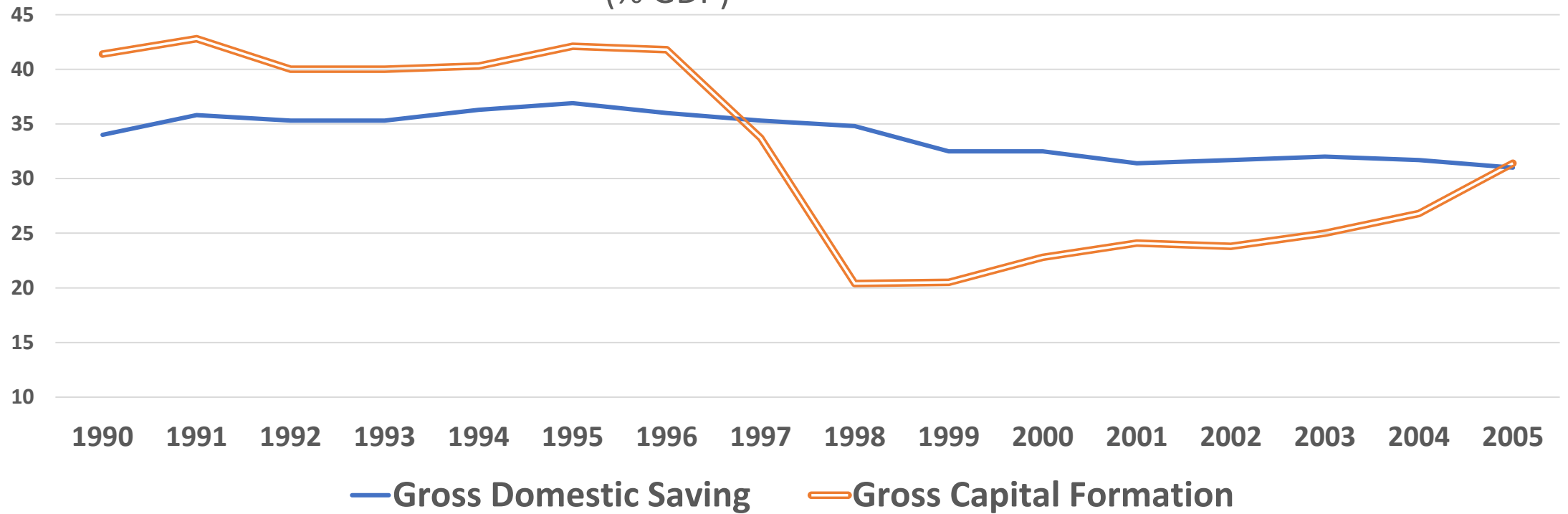
V-shaped recovery

Figure 7. Growth of Domestic Demand (%)



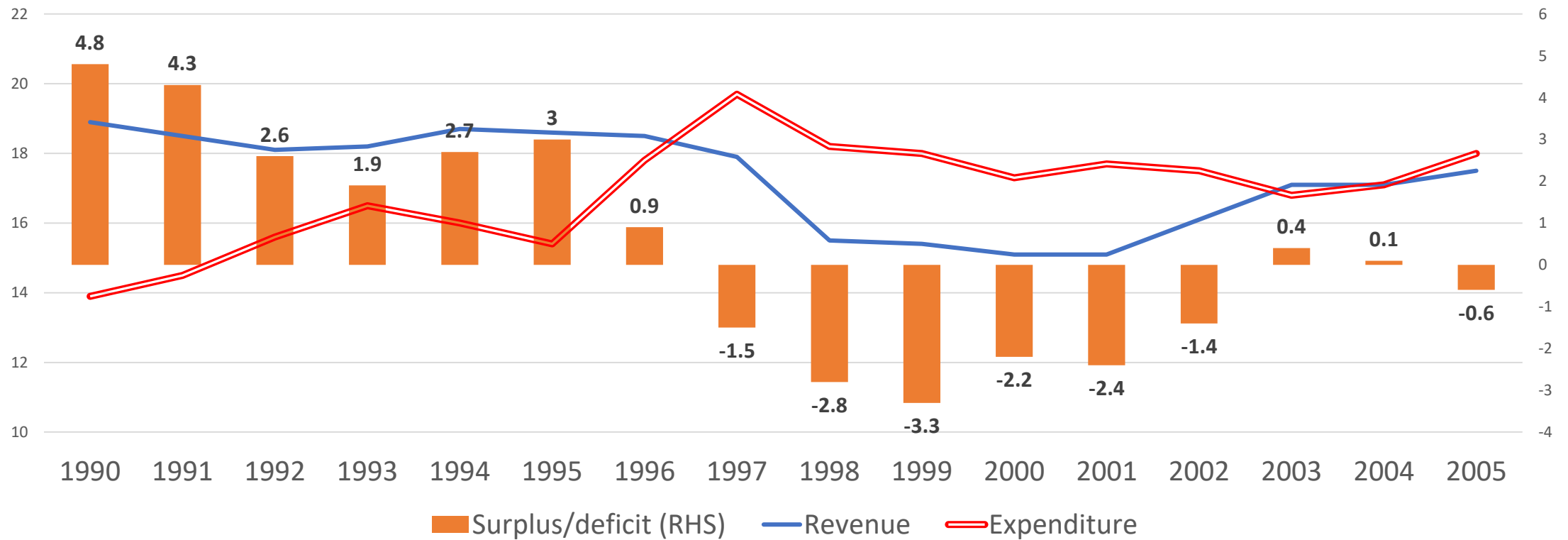
$$M - X = (I - S) + (G - T)$$

Figure 8. Investment Saving Gap
(% GDP)



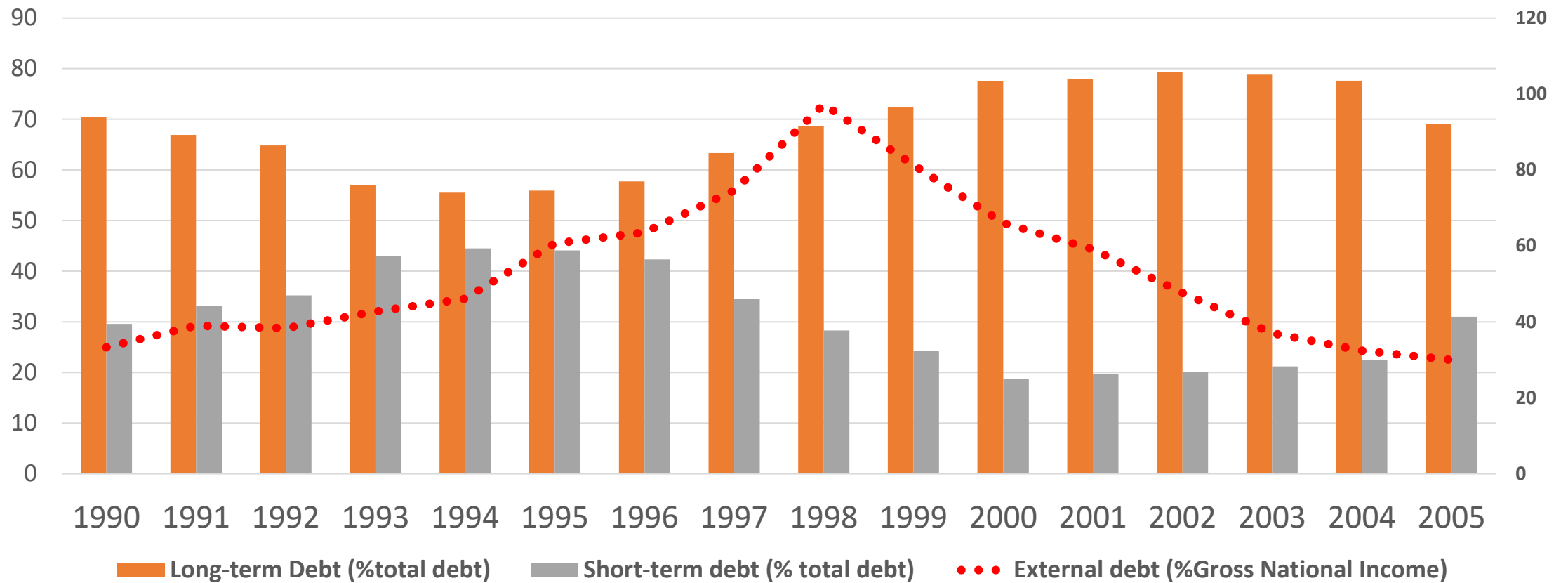
In good shape

Figure 9. Fiscal Position



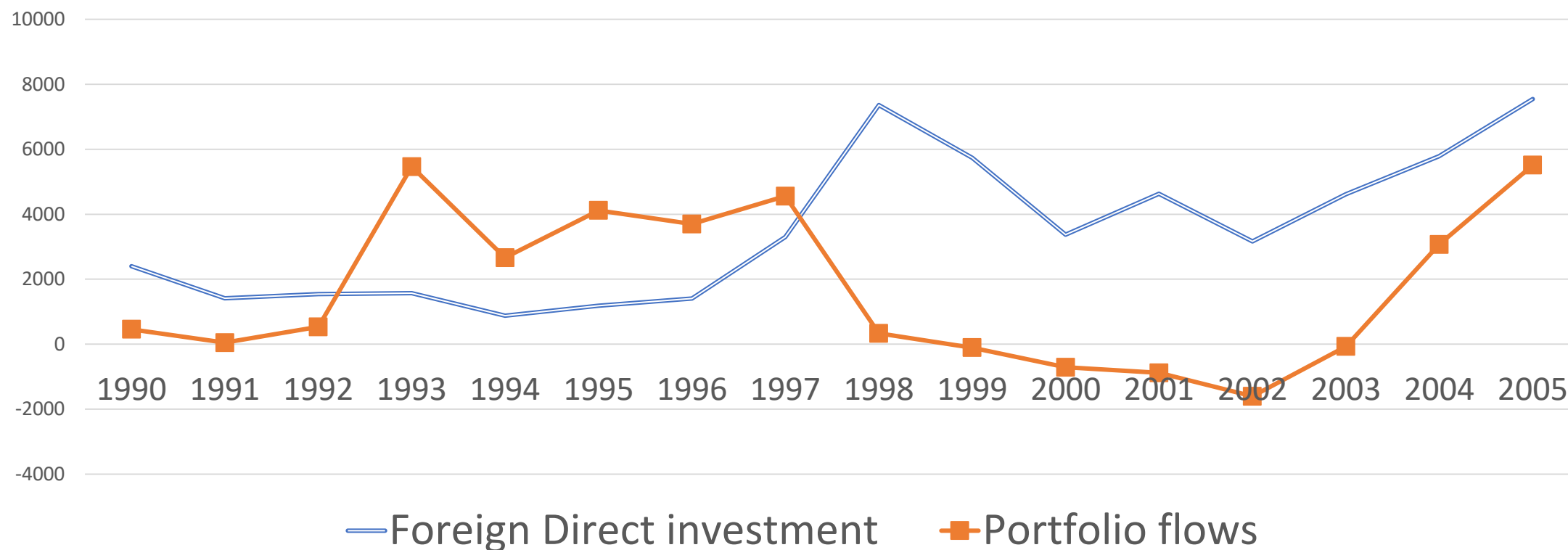
Sustainable external debts

Figure 10. External Debts



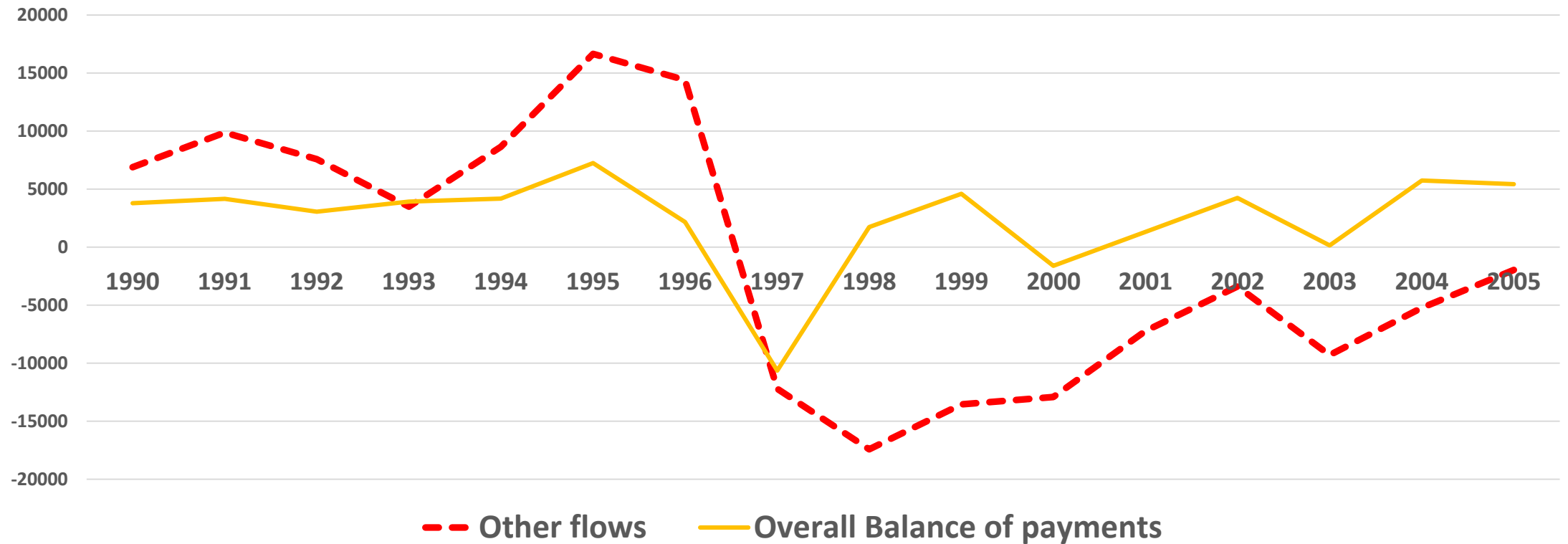
The good old days

Figure 11. FDI and FPI



Beware of speculators (Non-resident baht account)

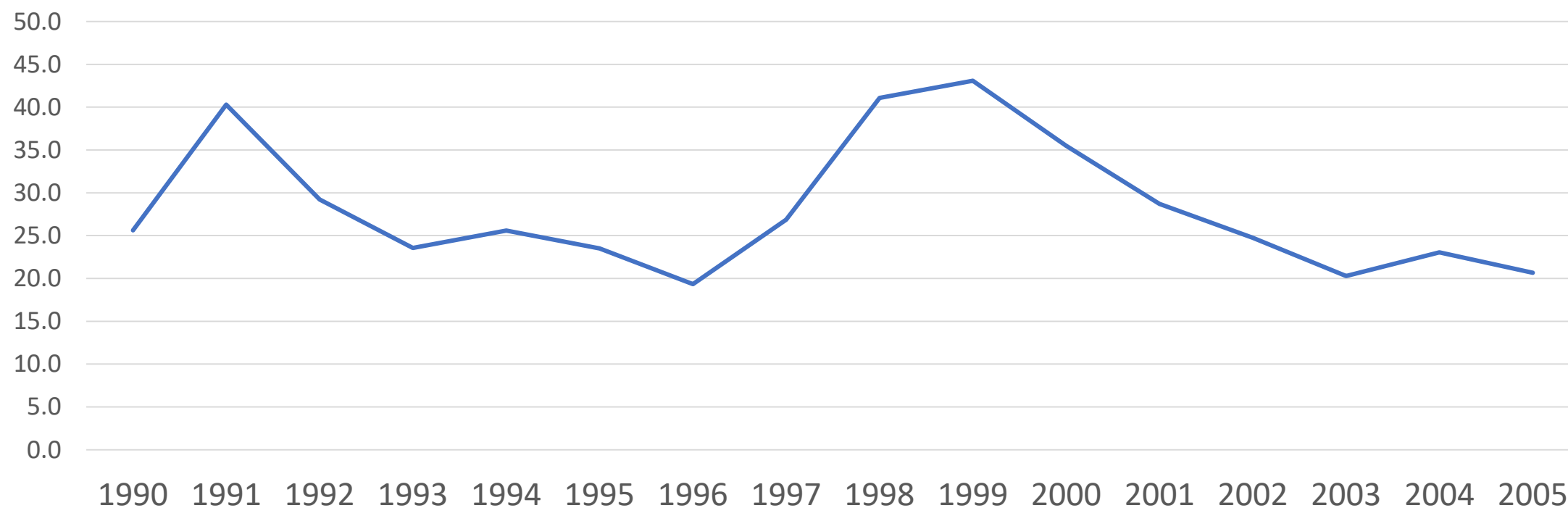
Figure 12. Other flows



The fear index

Figure 13. Thailand's stock market volatility Index (VIX)

Source: FRED



Irrational Exuberance

by Robert J. Shiller

- The Stock Market Level in Historical Perspective
- Precipitating factors: The Internet, the baby boom, digital economy, robotics, and other events
- Amplification Mechanisms: Naturally Occurring Ponzi Processes

The SET index: bull market (since September 2017)



SET Index: Five years ago

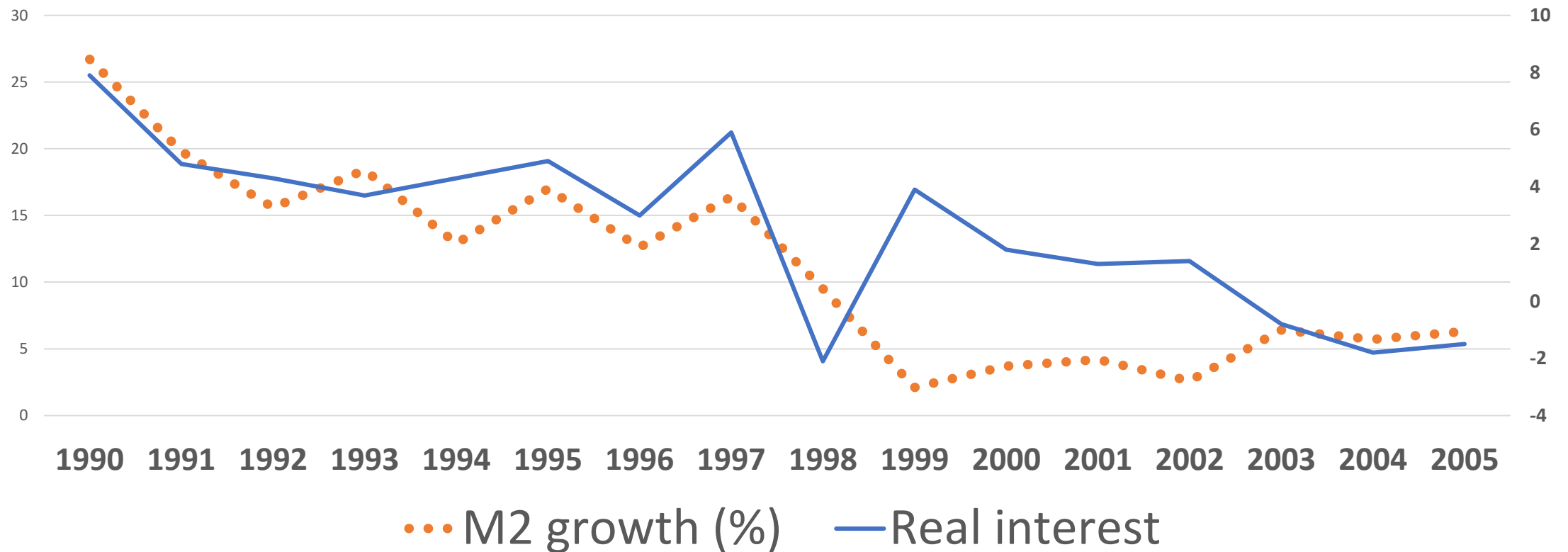


Irrational Exuberance

- Psychological Factors
(Tulip mania: 1637, bitcoin 2017)
- Herd Behavior and Epidemics
- Attempts to rationalize exuberance
- Efficient markets, Random walks, and Bubbles

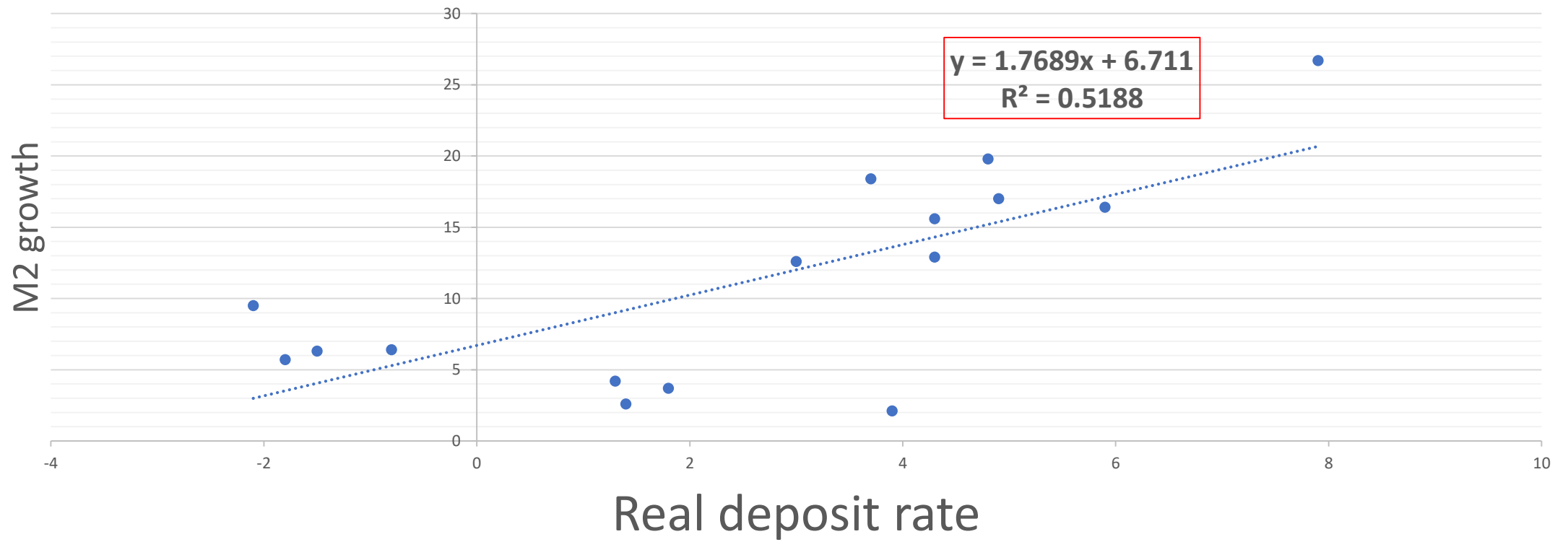
Dwindling incentives to save

Figure 14. Financial savings and real interest rates



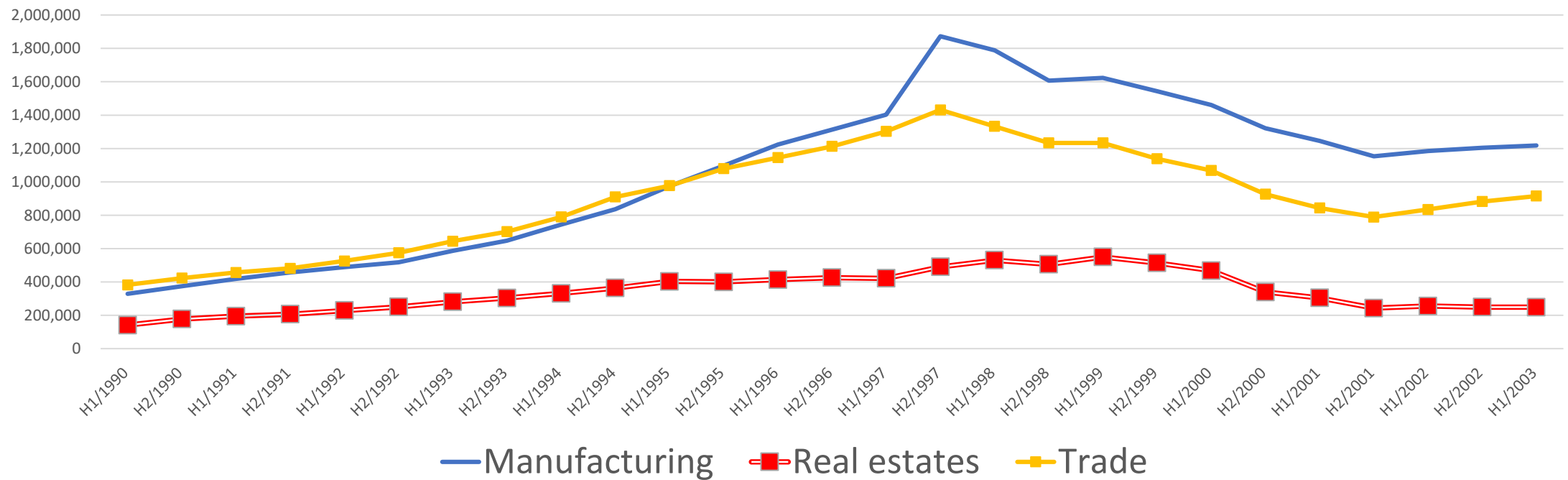
Substitution vs Income effect from rising interest rates

Money Deposits in responses to real Interest rates



Loanable funds

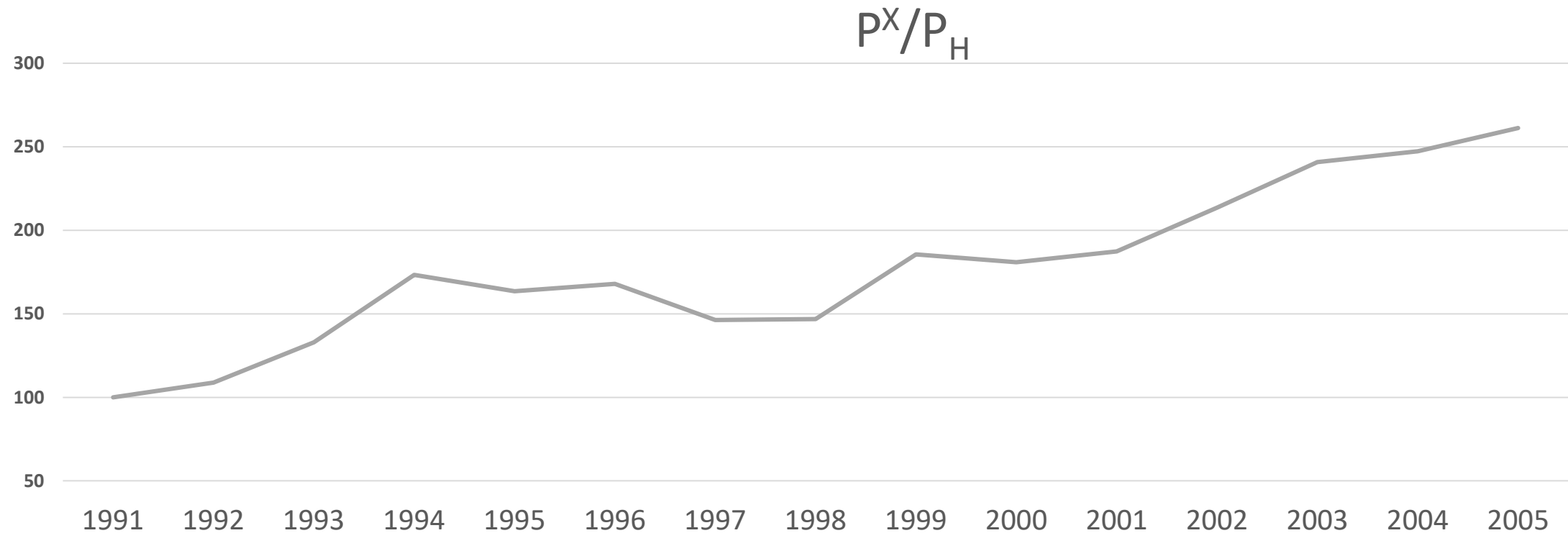
Figure 15. Commercial bank loans
million baht



Trade vs Non-traded prices

What is the Dutch disease? Name countries that are suffering from the disease.

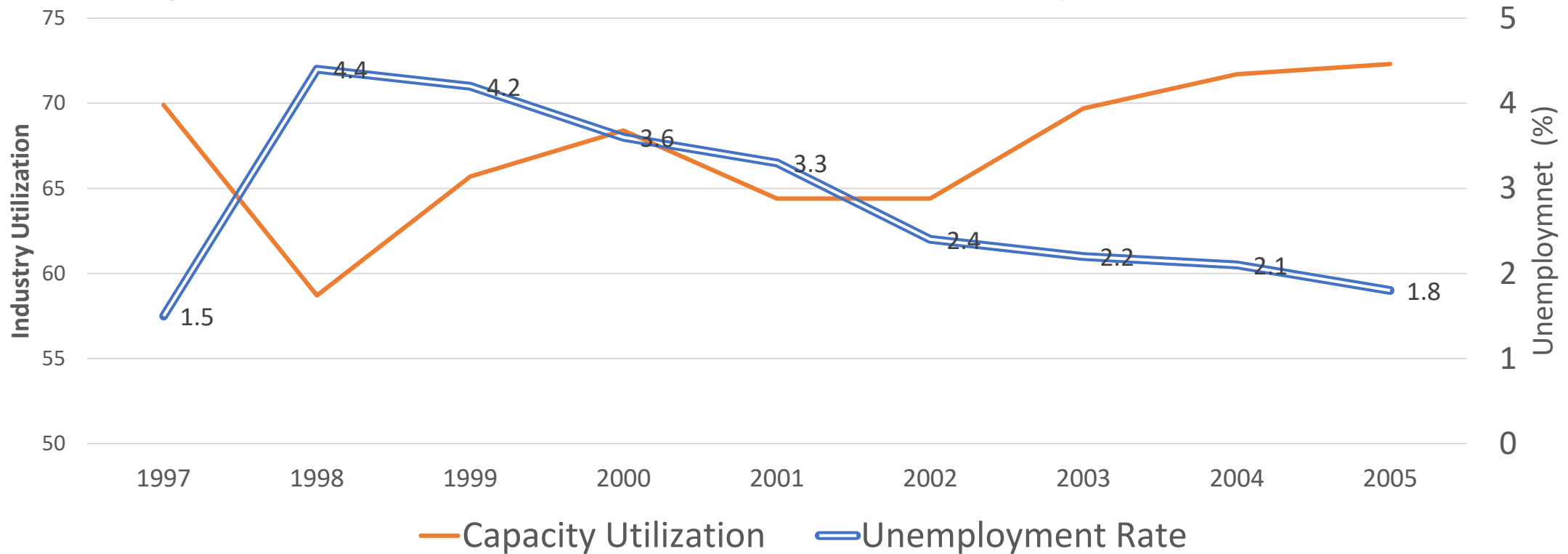
Figure 16. An indicator of Dutch Disease



Unbelievably low unemployment rate

Explain why

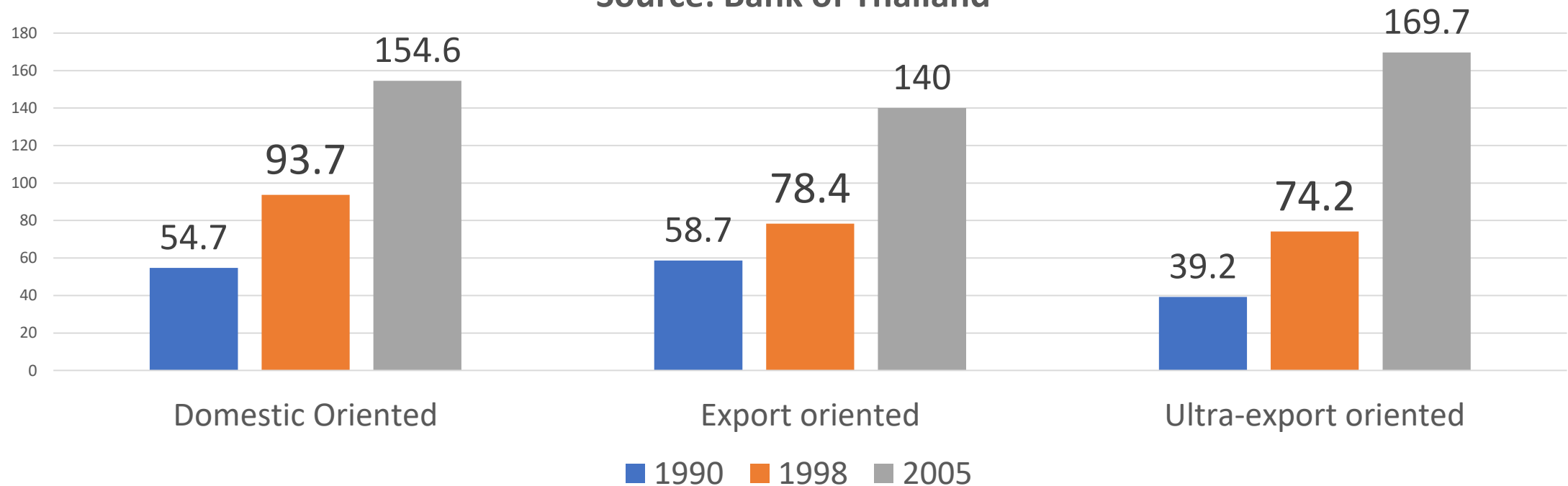
Figure 17. Asian Financial Crisis and the Recovery



Three types of industries: By market orientation (exports-to-output ratio)

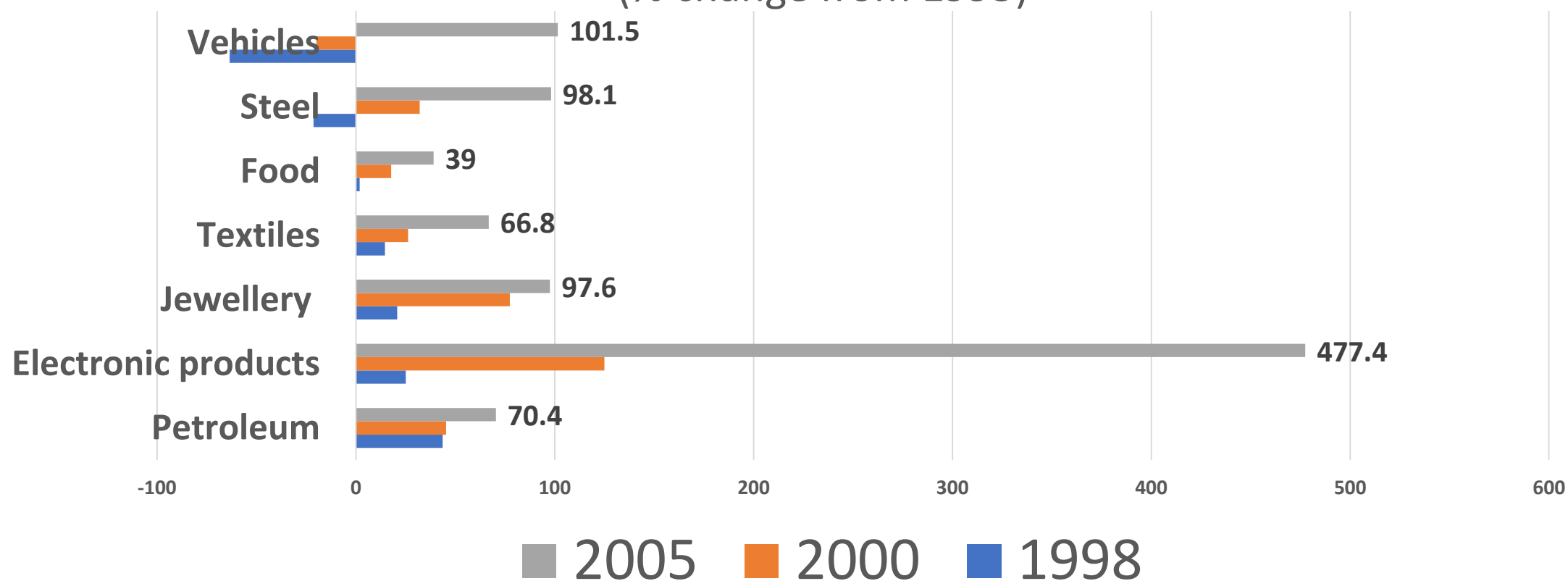
Figure 18. Manufacturing Production Index
(2000=100)

Source: Bank of Thailand



Thanks to FDI inflows

Figure 19. V-shaped recovery of industrial exports
(% change from 1995)



Non-spurious relationship

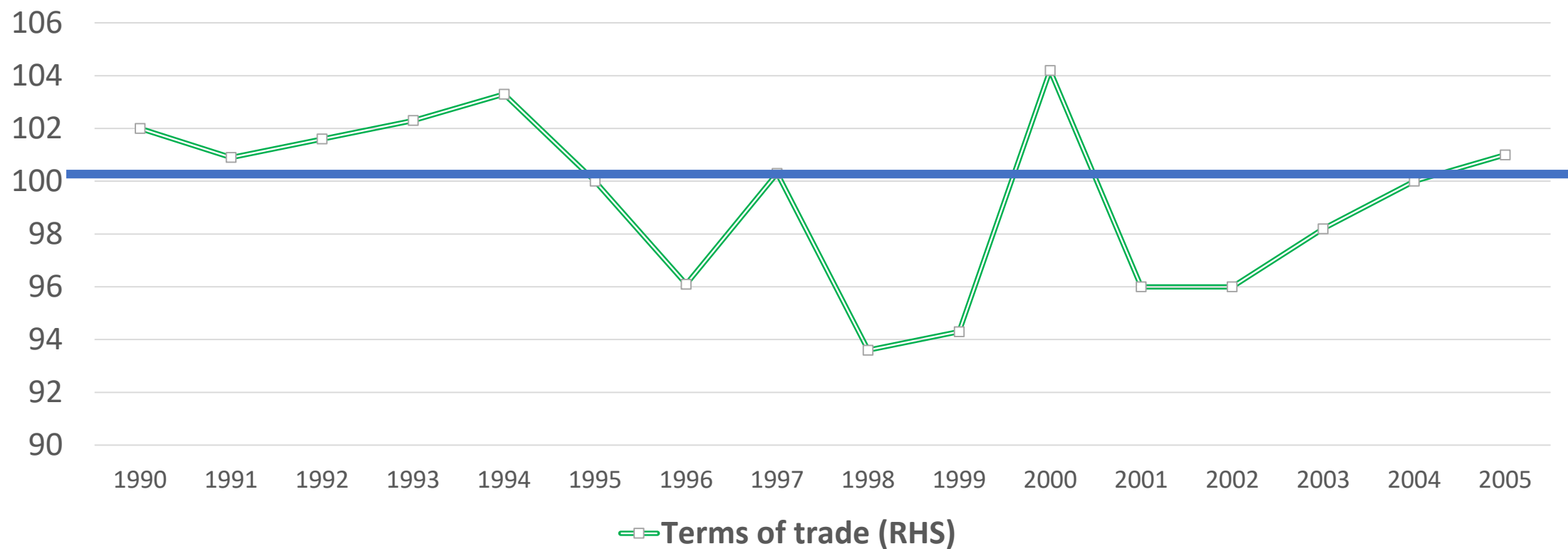
What is a spurious relationship?

Figure 20. Export and import growth: Long run relationship



Terms of trade: Cyclical Pattern

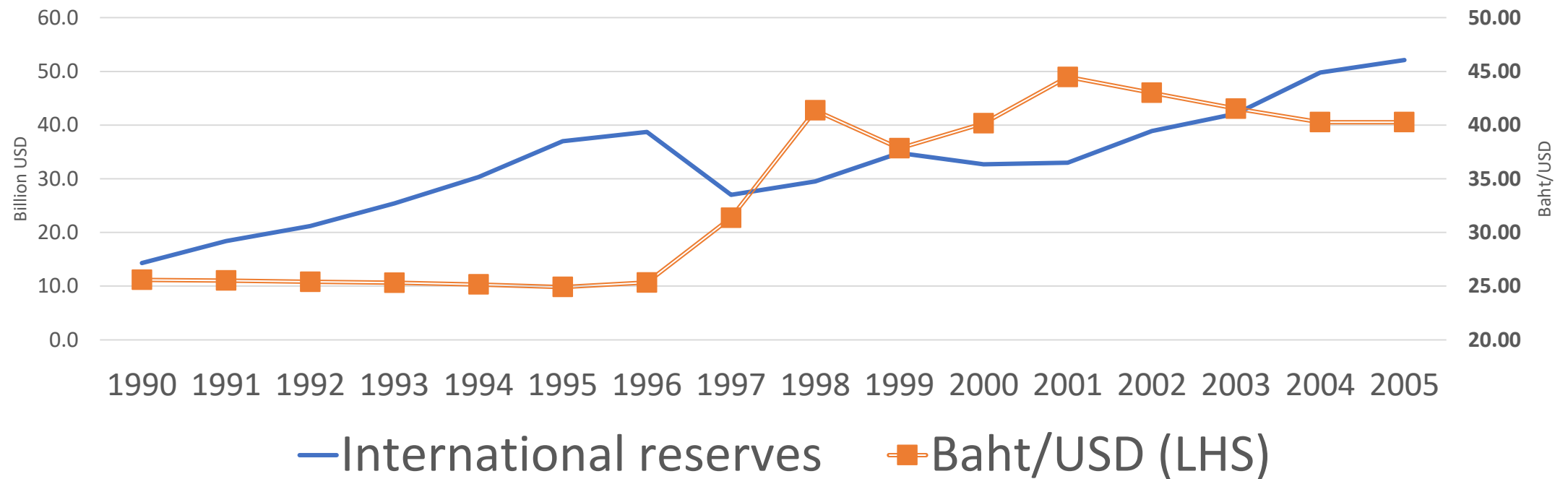
Figure 21. Terms of trade



Preferred Stability: Fear of appreciation

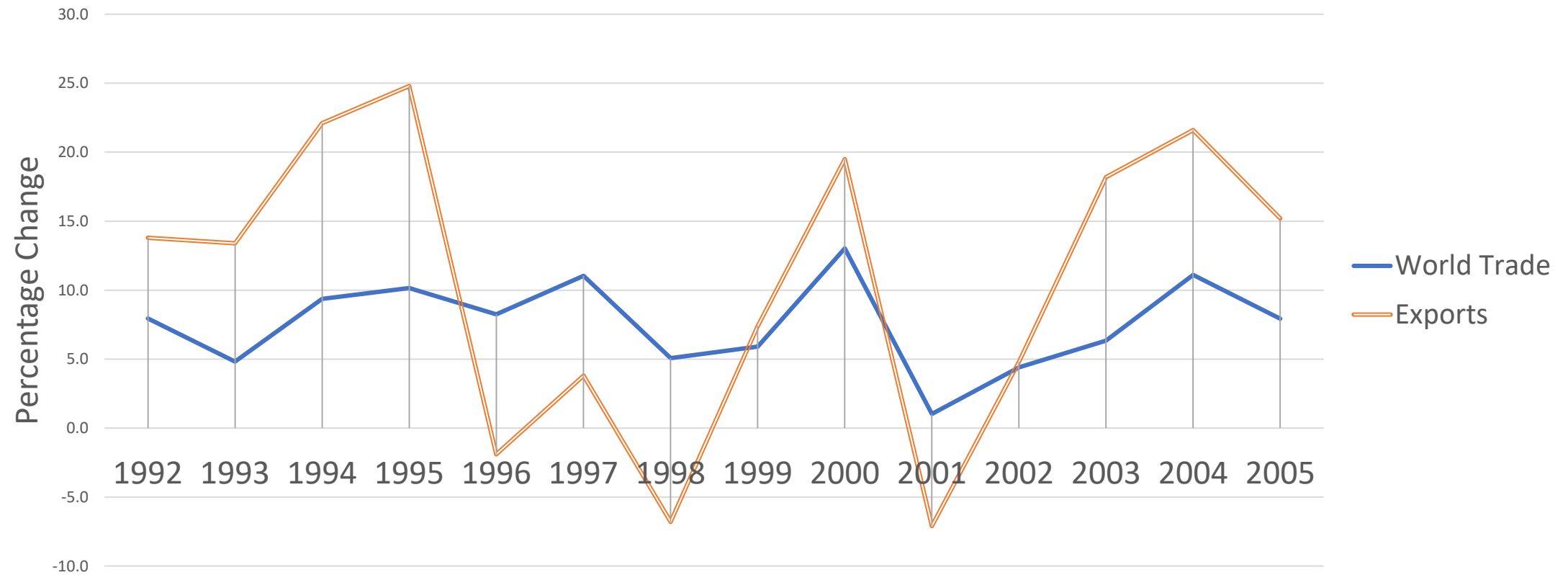
Has the BoT fear of floating?

Figure 22. International Reserves after a massive depreciation



High income elasticity of export demand for Thailand's exports

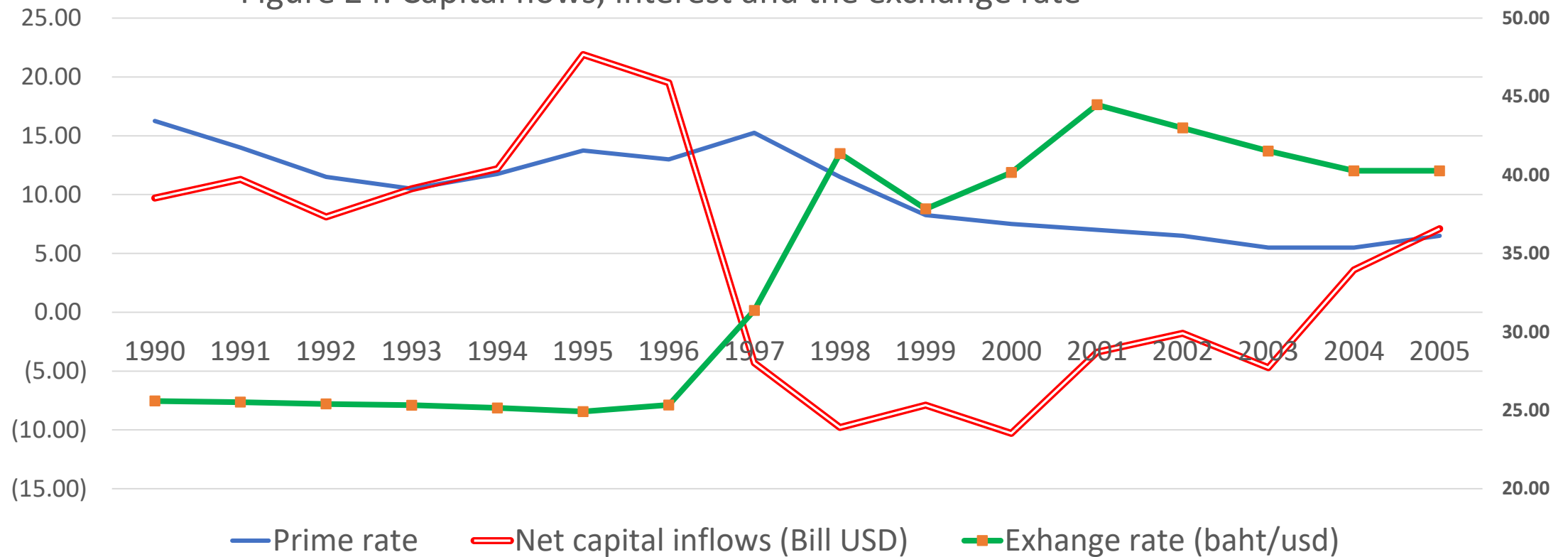
Figure 23. Impact of world business cycle on Thailand's exports



How were they related?

Any causal relationship between exchange rate and capital inflows? Any lurking variables or confounding factors?

Figure 24. Capital flows, interest and the exchange rate



Conclusions

- Resilience of the Thai economy had been demonstrated after the financial and exchange rate crises in the period 1997-98.
- Realistic exchange rates are the key for successful external imbalance adjustments.
- Fiscal balances and external debts depend on fiscal discipline.

Conclusions

- Capital flows are related to exchange rate movements.
- Asset bubbles are associated with expectations and monetary expansion.
- External influences on the Thai economy increase with higher degree of globalization.

Review Questions

- Has the Thai economy become more or less resilient than the period before 2006?
- Is Thailand experiencing a property bubble? If so, explain why. Should the Central Bank prick asset bubbles?
- How far can a country rely on domestic demand stimulus?