The Resilience of The Thai Economy: 1991-2005

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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

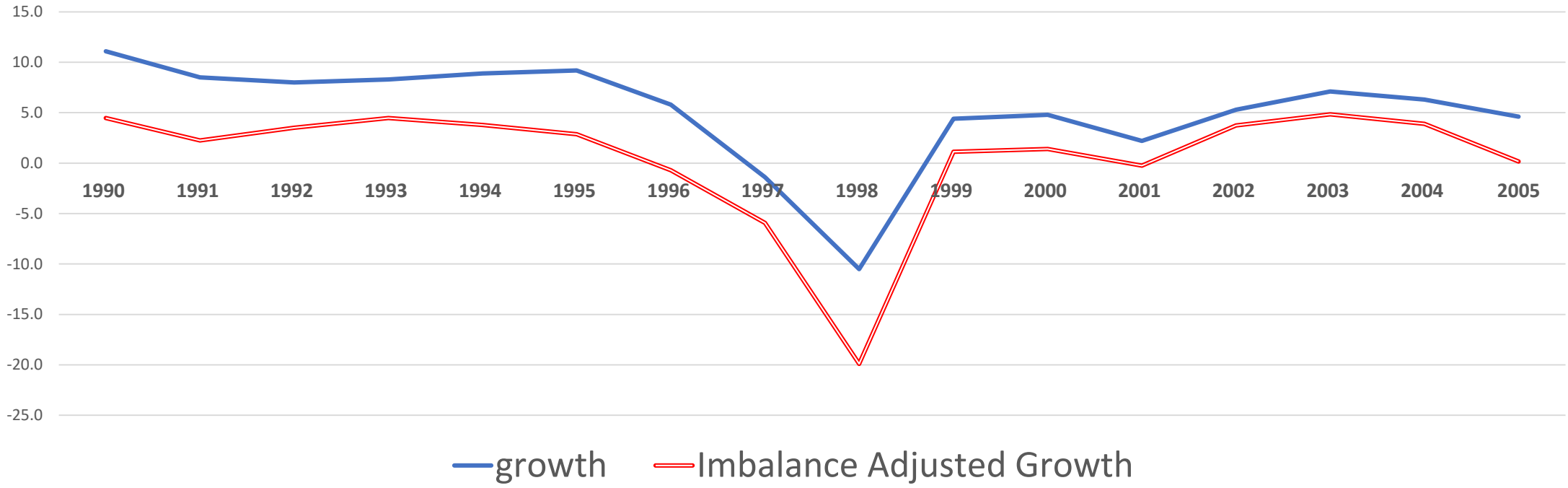
- Growth with Price Stability
- Imbalance-adjusted growth rate
- Human capital
- Strengthening Fiscal Position
- Recession and recovery
- Irrational Exuberance
- Fear of appreciation
- Export-oriented industries and FDI
- World business cycle

Imbalanced adjusted growth rate

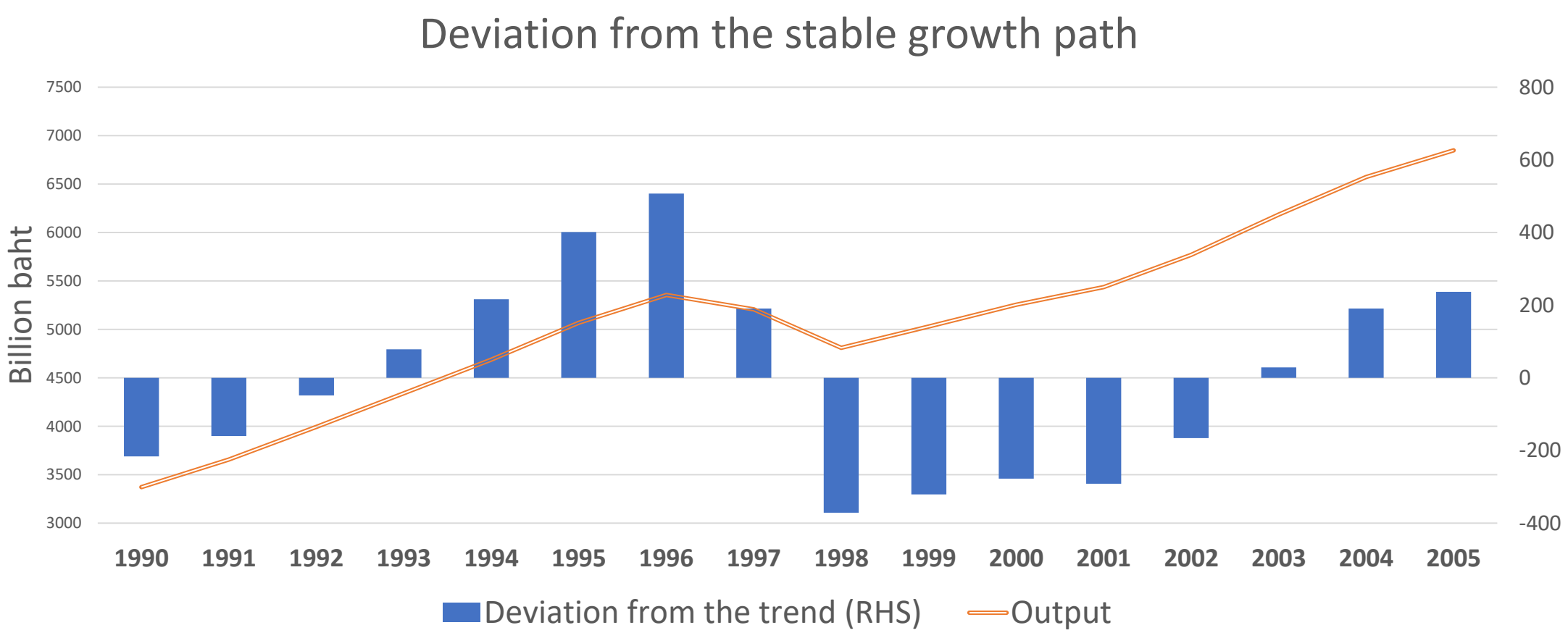
- Real GDP Growth can occur simultaneous with internal imbalances between aggregate demand and supply, which create price adjustments
- External imbalances also be indicated by surplus or deficit in the current account
- To measure sustainable economic growth, GDP growth can be measure by adjusting GDP 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)

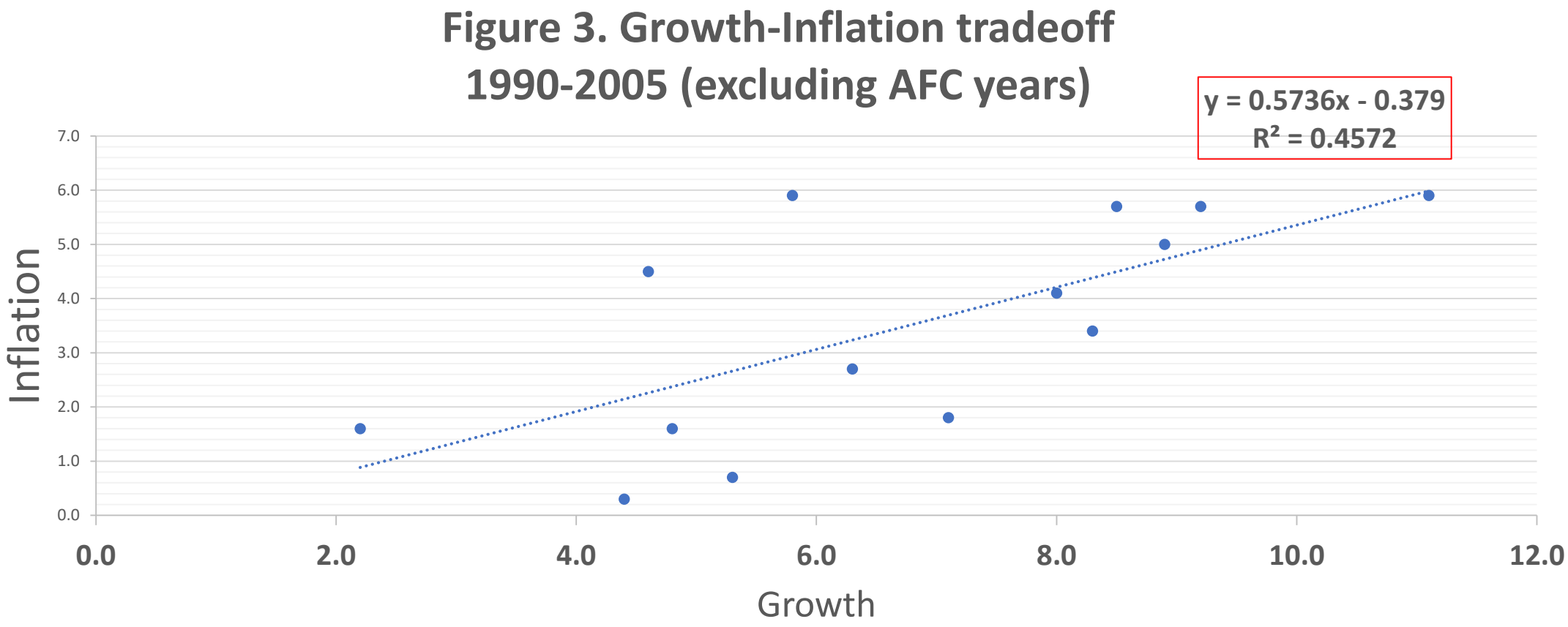
Figure 1. Actual and Imbalance-Adjusted GDP Growth Weighted average of absolute values of price changes and current account (% GDP) disequilibrium: weights are 0.7 and 0.3 respectively



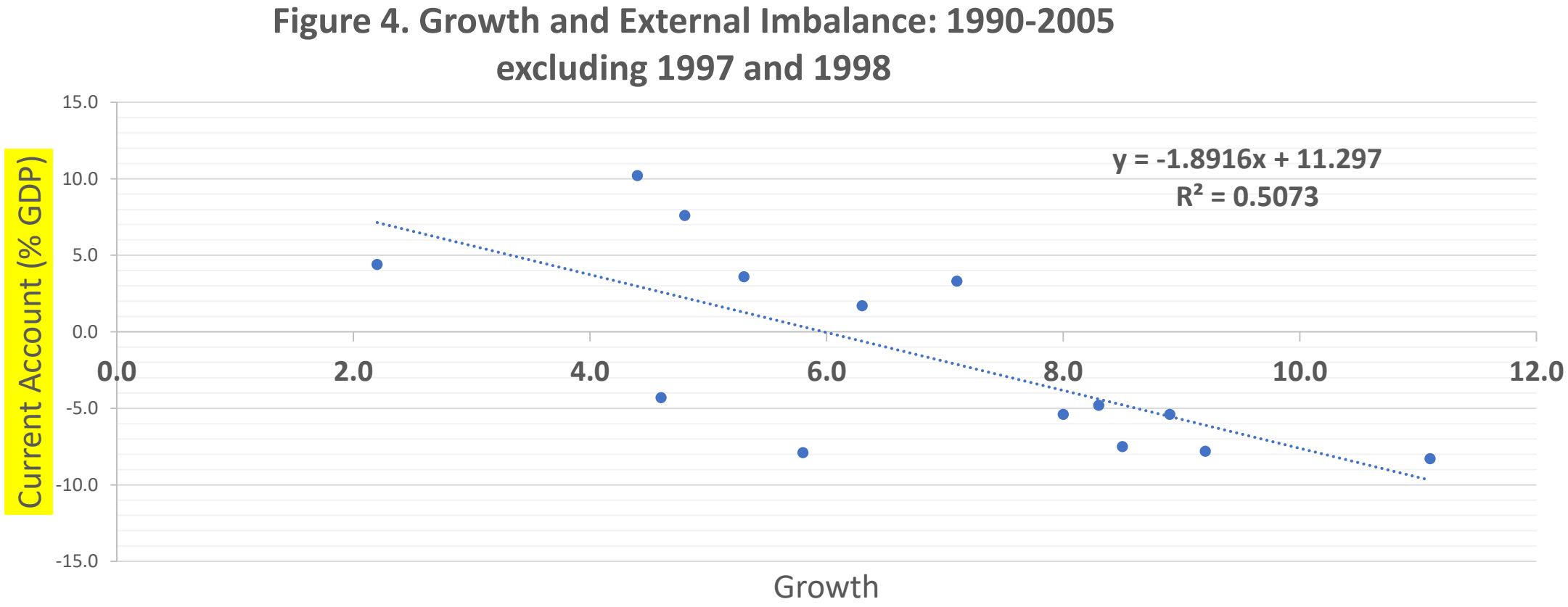
Booms and Busts: AFC



Overheated economy gave rise to inflation: Demand pressure

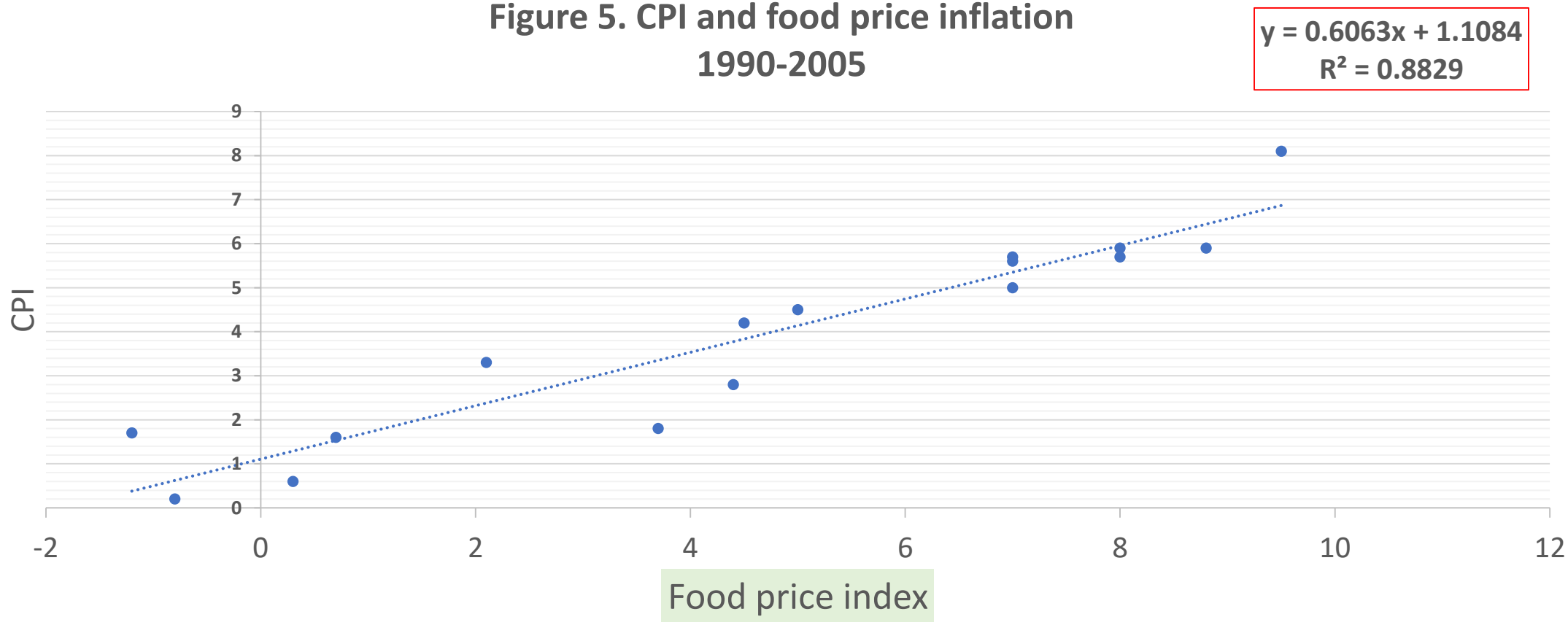


High growth, high current account deficit

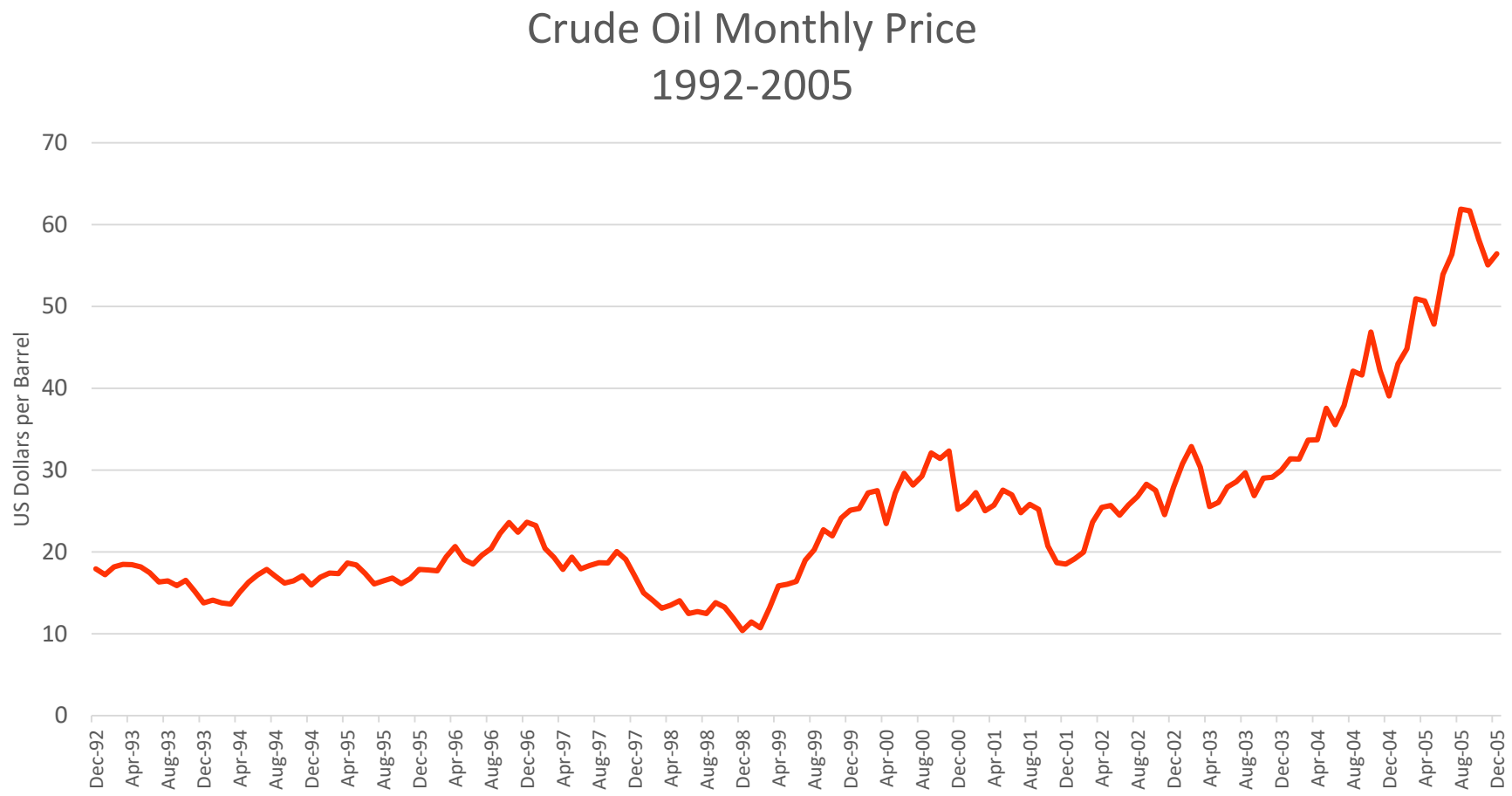


The importance of food prices

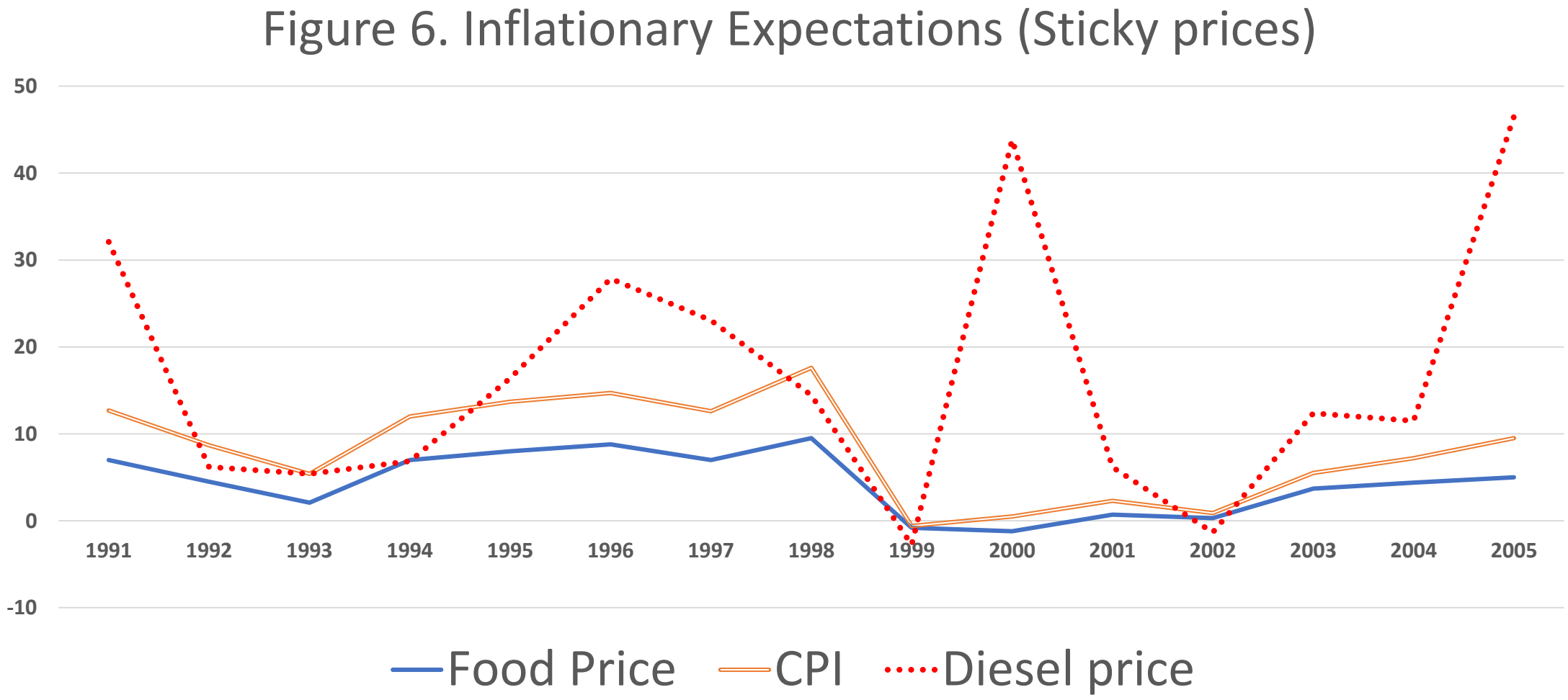
Figure 5. CPI and food price inflation 1990-2005



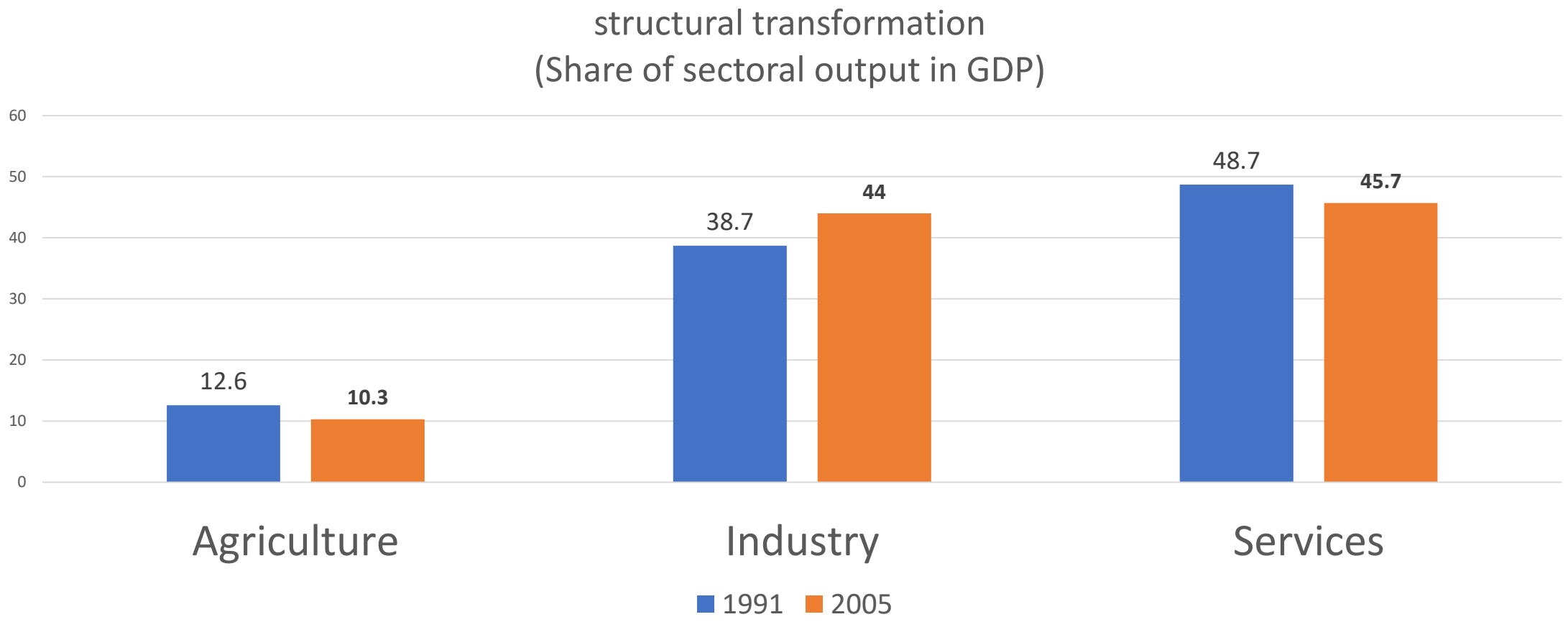
Dealing with rising oil prices



Inflation inertia



Gradual transformation



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.

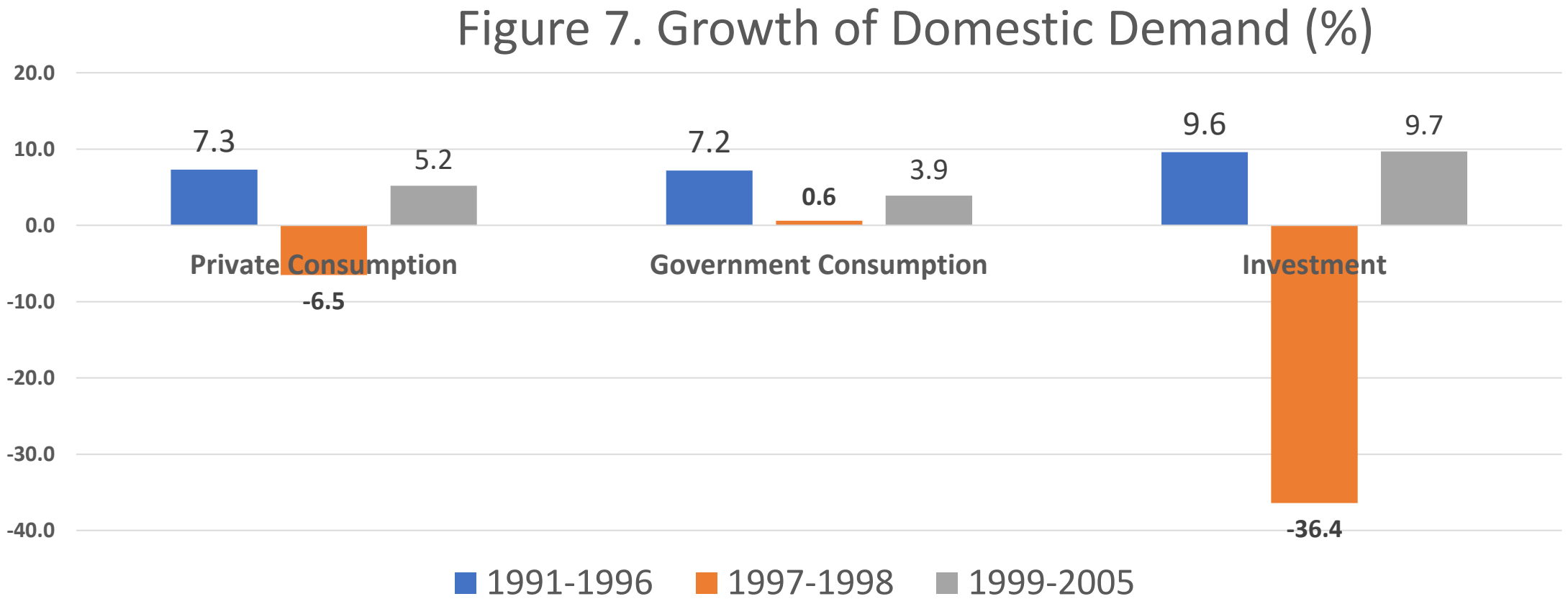
The role of human capital in economic development

- 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



M – X = (I-S) + (G-T)

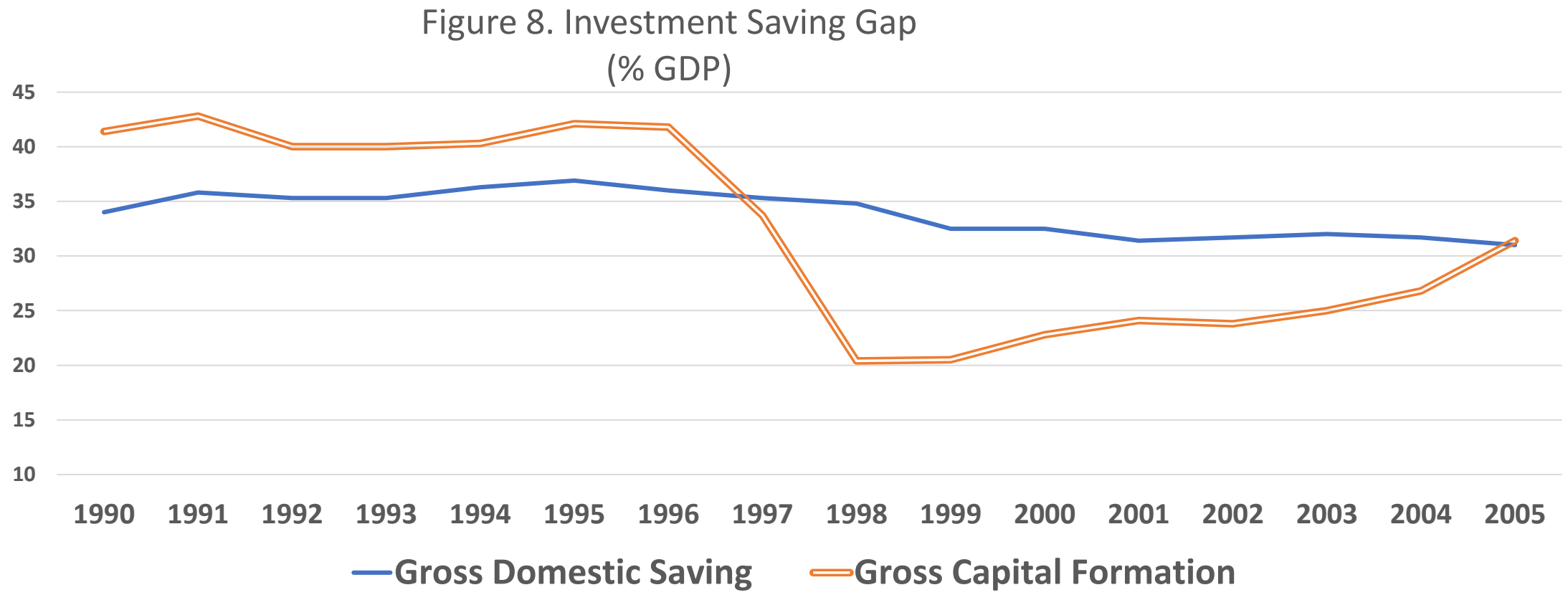
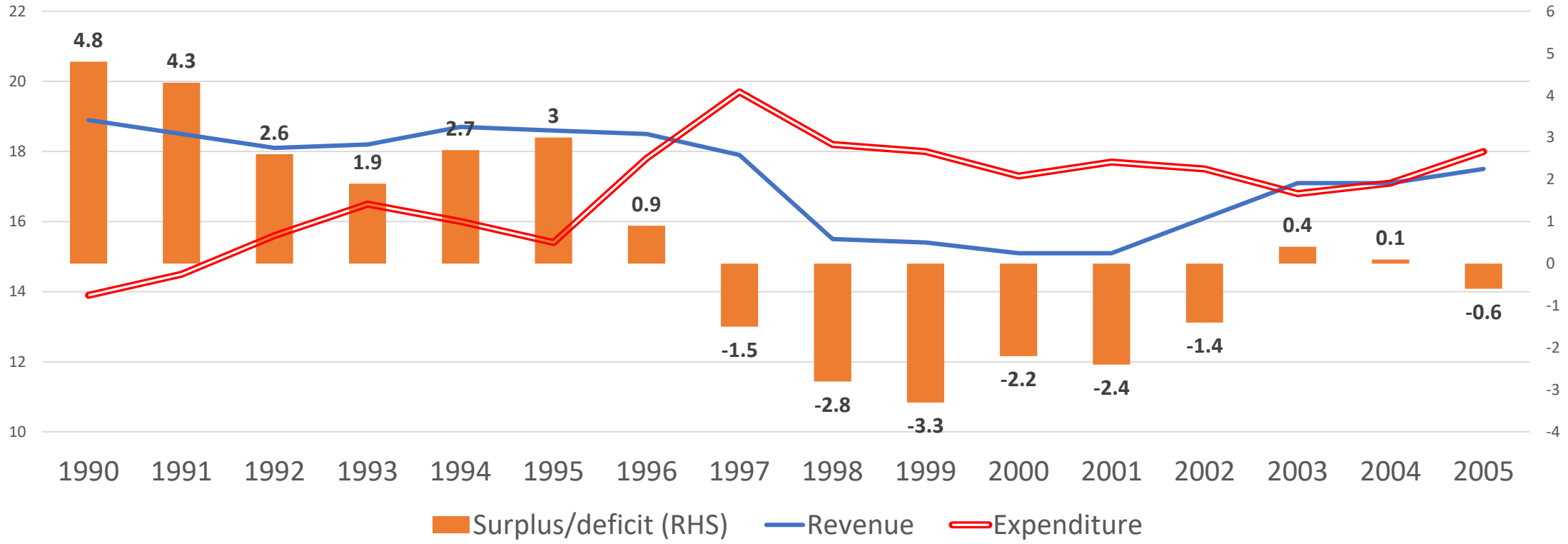


Figure 8. Investment Saving Gap
(% GDP)
45
40
35
30
25
20
15
10
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
Gross Domestic Saving
Gross Capital Formation

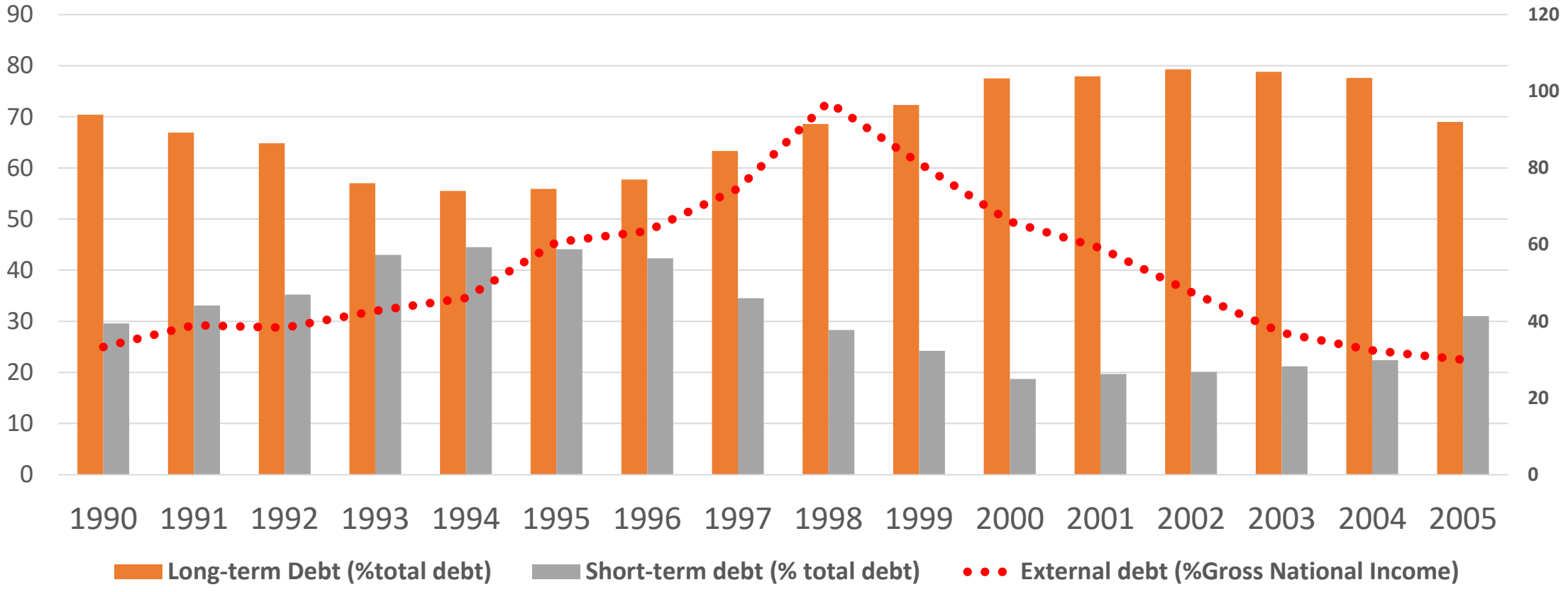
In good shape

Figure 9. Fiscal Position

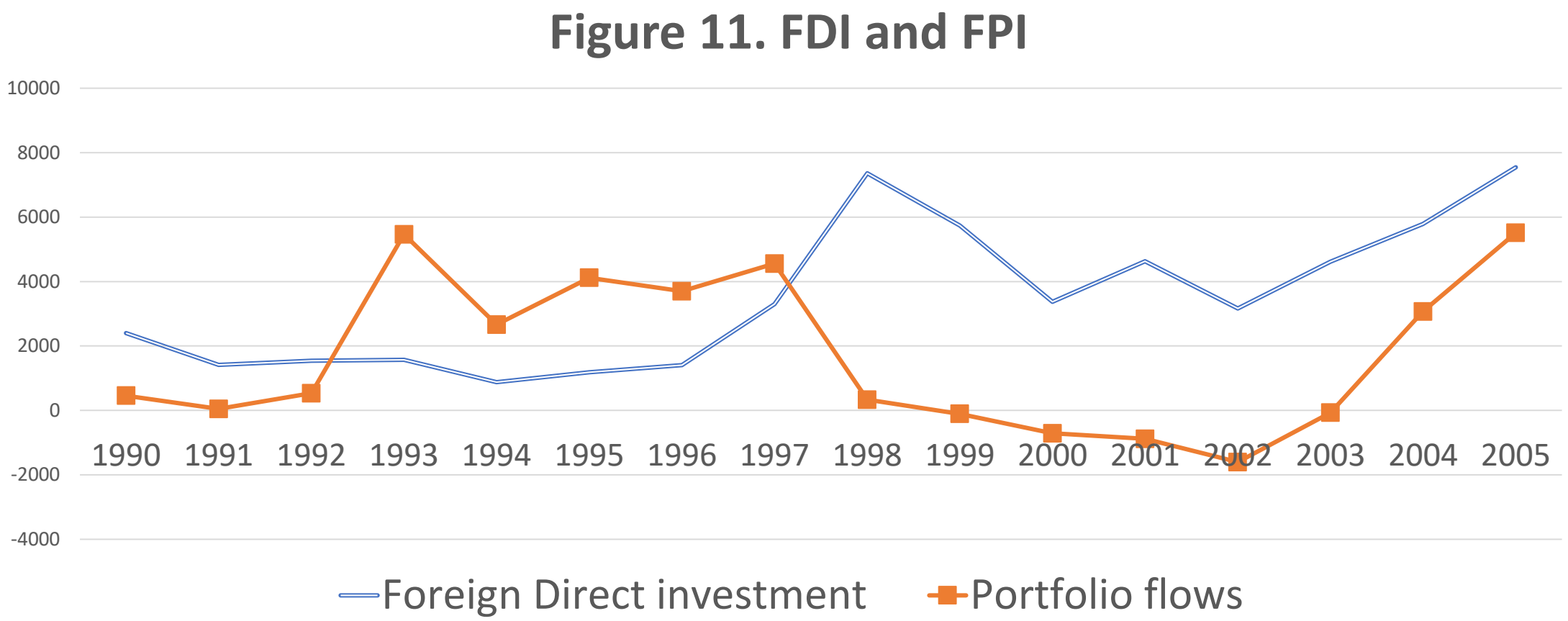


Sustainable external debts

Figure 10. External Debts

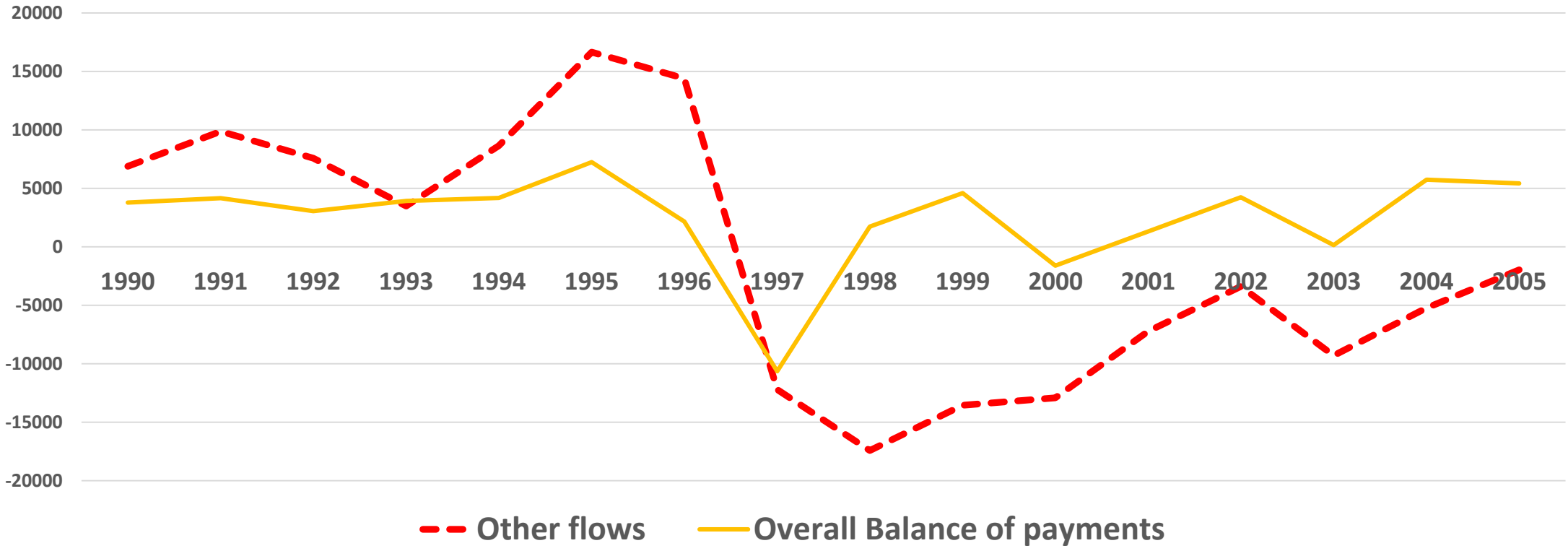


The good old days



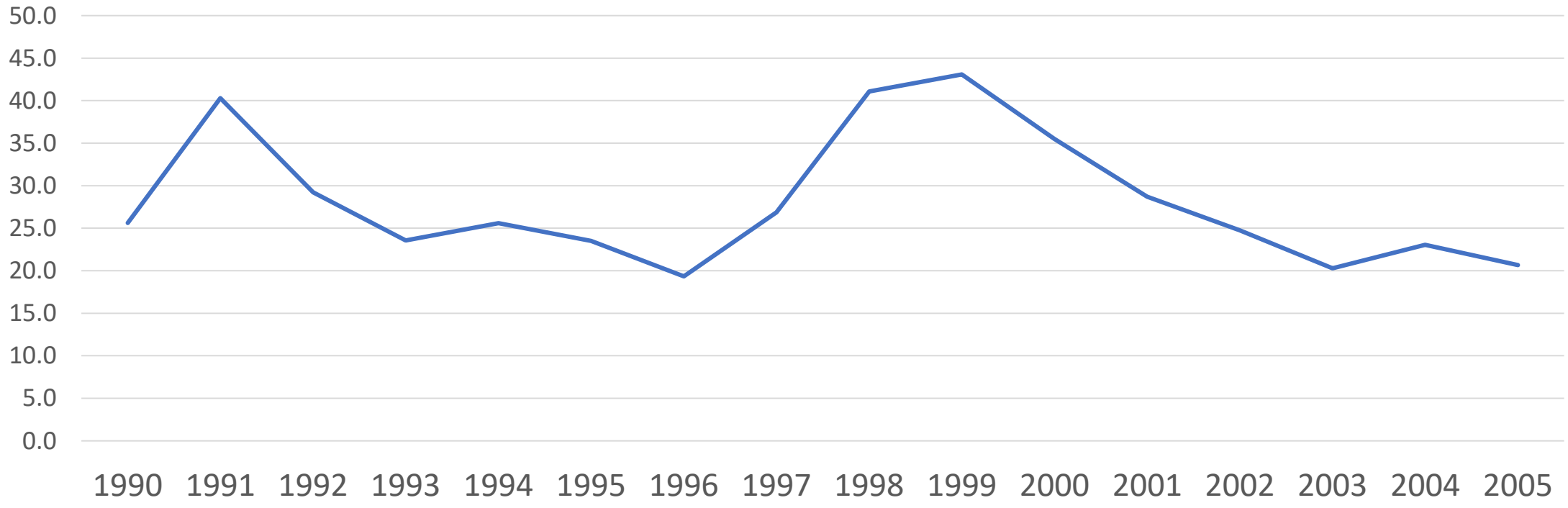
Beware of speculators (Non-resident baht account)

Figure 12. Other flows



The fear index

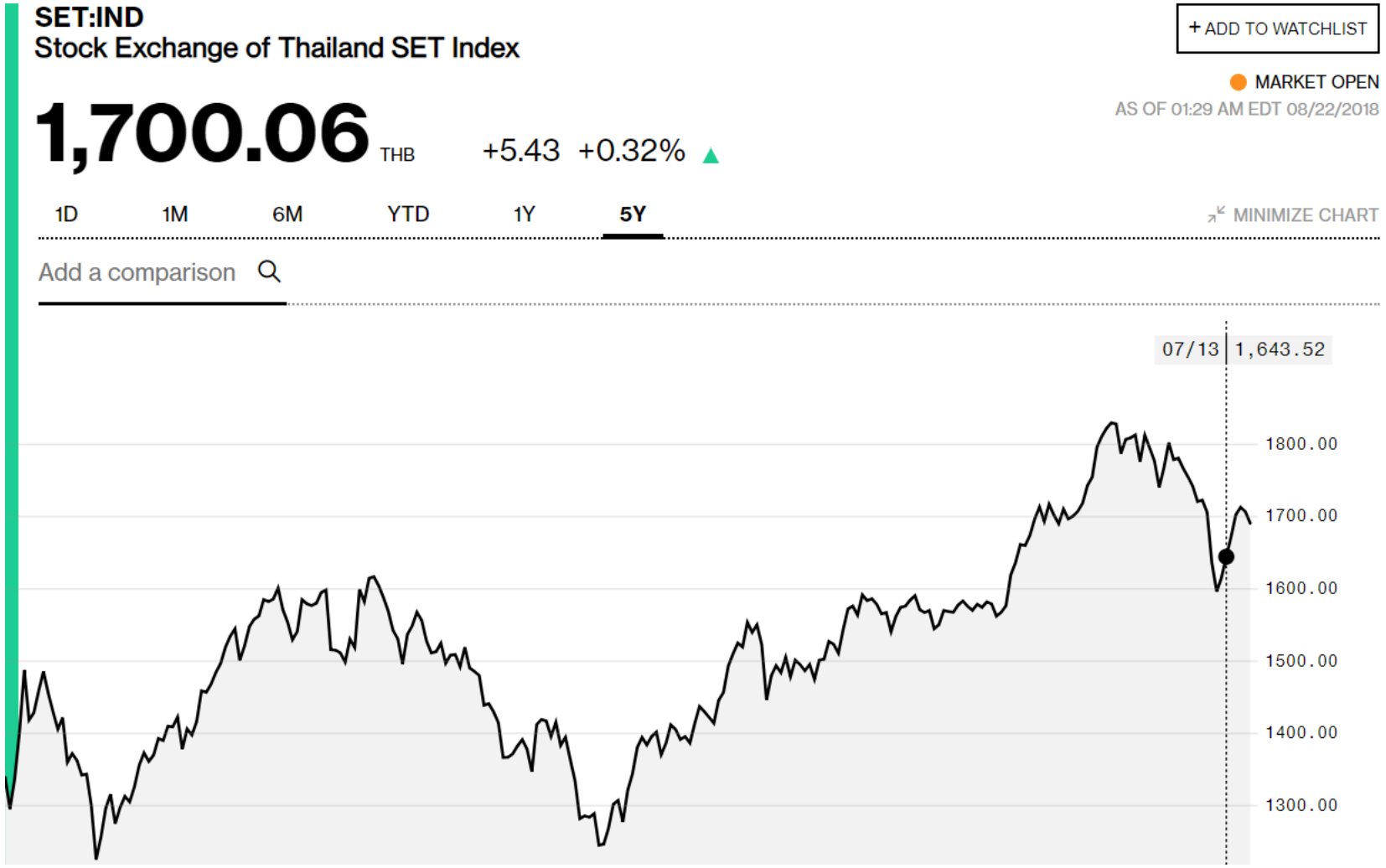
Figure 13. Thailand's stock market volatility Index (VIX)
Source: FRED



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: A bull market?



Irrational Exuberance

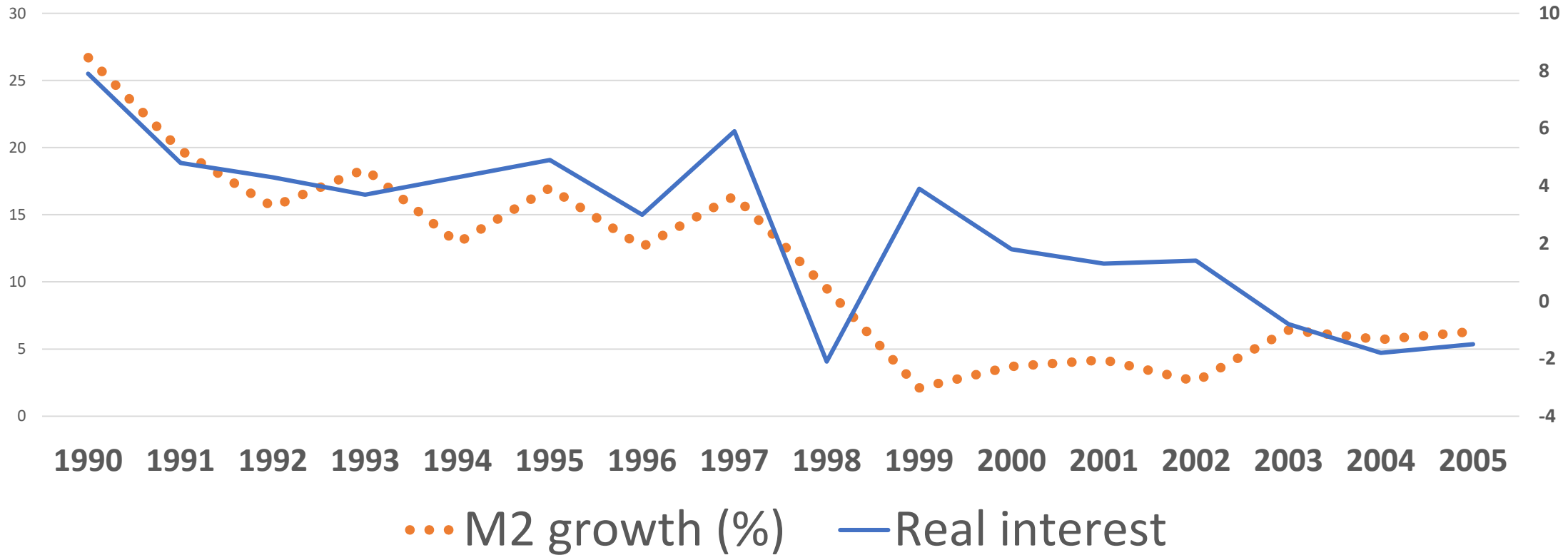
- Psychological Factors

(Tulip mania: 1637, bitcoin 2017)

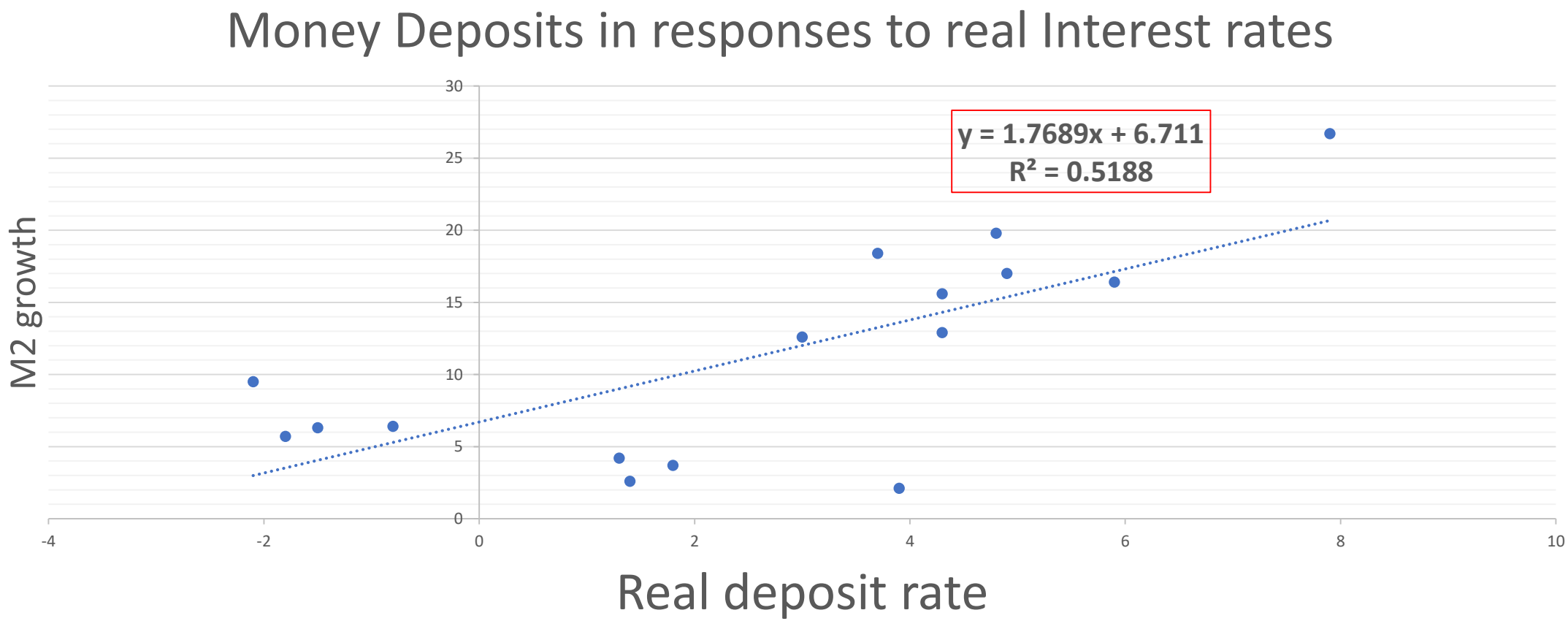
- Herd Behavior and Epidemics
- Attempts to rationalize exuberance
- Efficient markets, Random walks, and Bubbles

Dwindling incentives to save

Figure 14. Financial savings and real interest rates

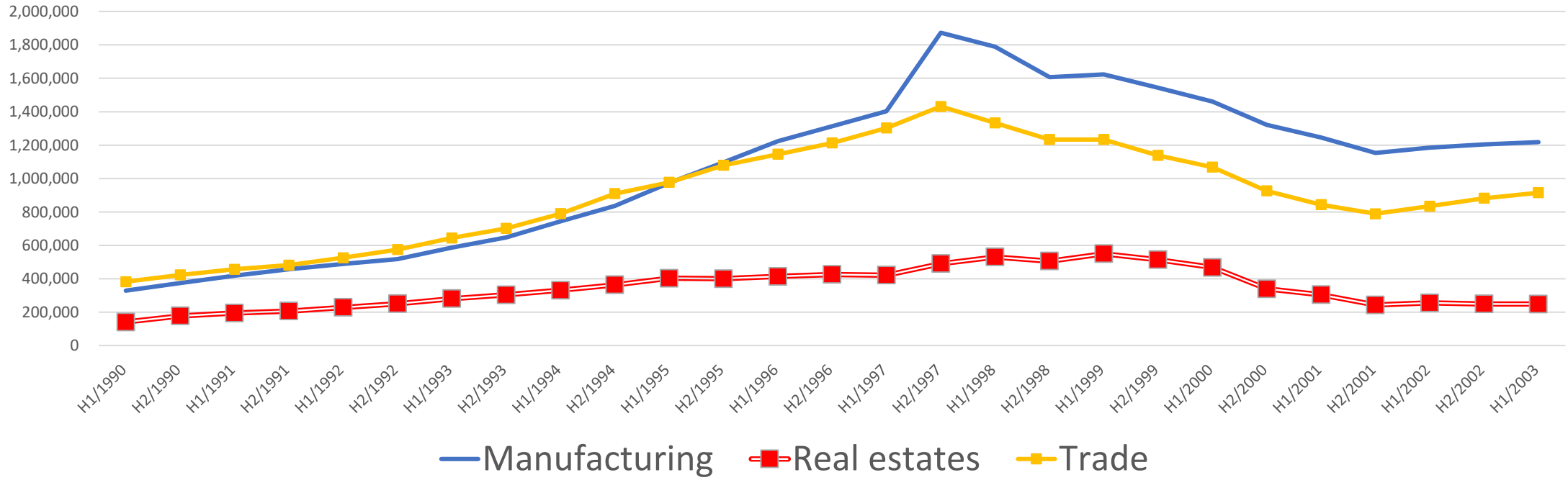


Substitution vs Income effects on financial savings: Changing interest rates



Loanable funds

Figure 15. Commercial bank loans
million baht

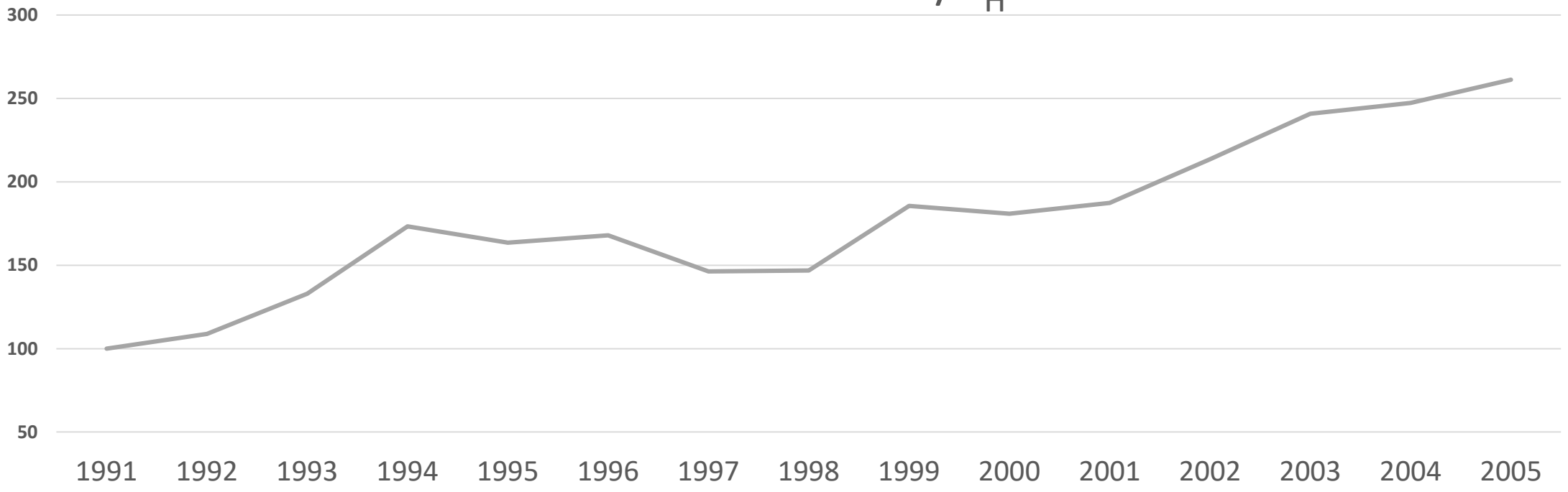


Trade vs. Non-traded prices

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

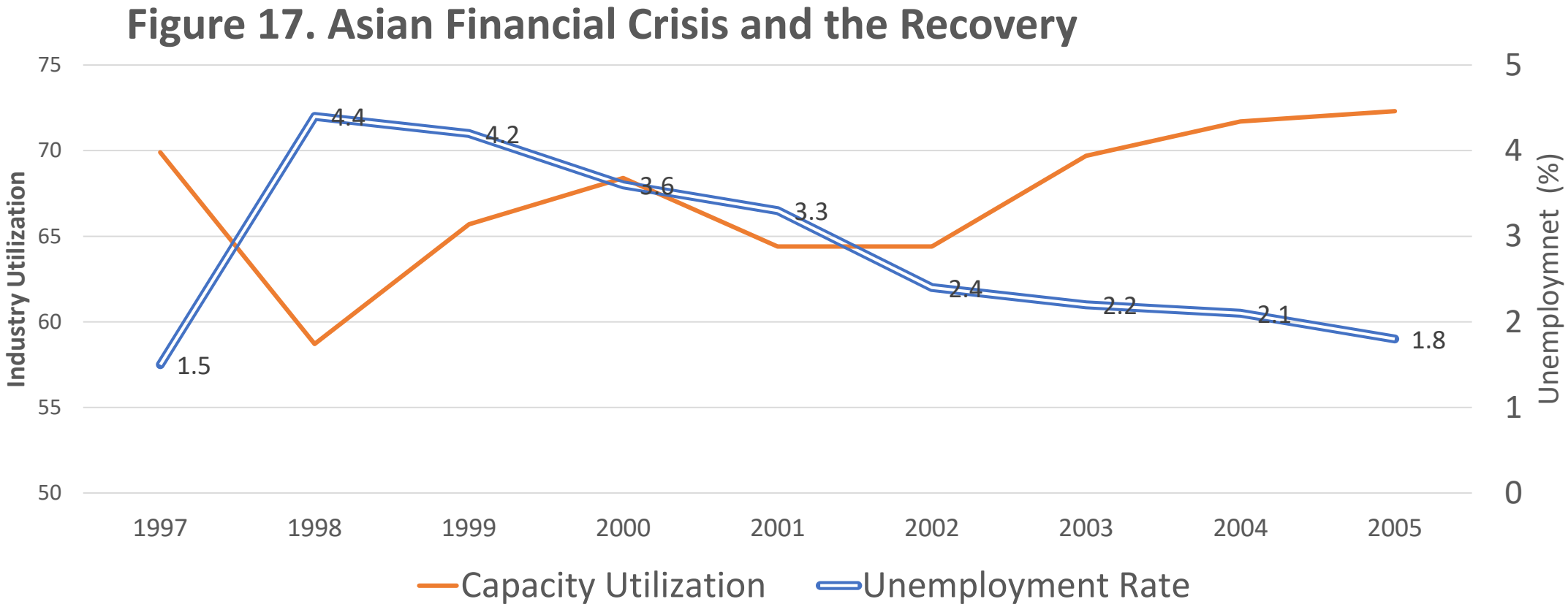
Figure 16. An indicator of the Dutch Disease

P^X/P_H



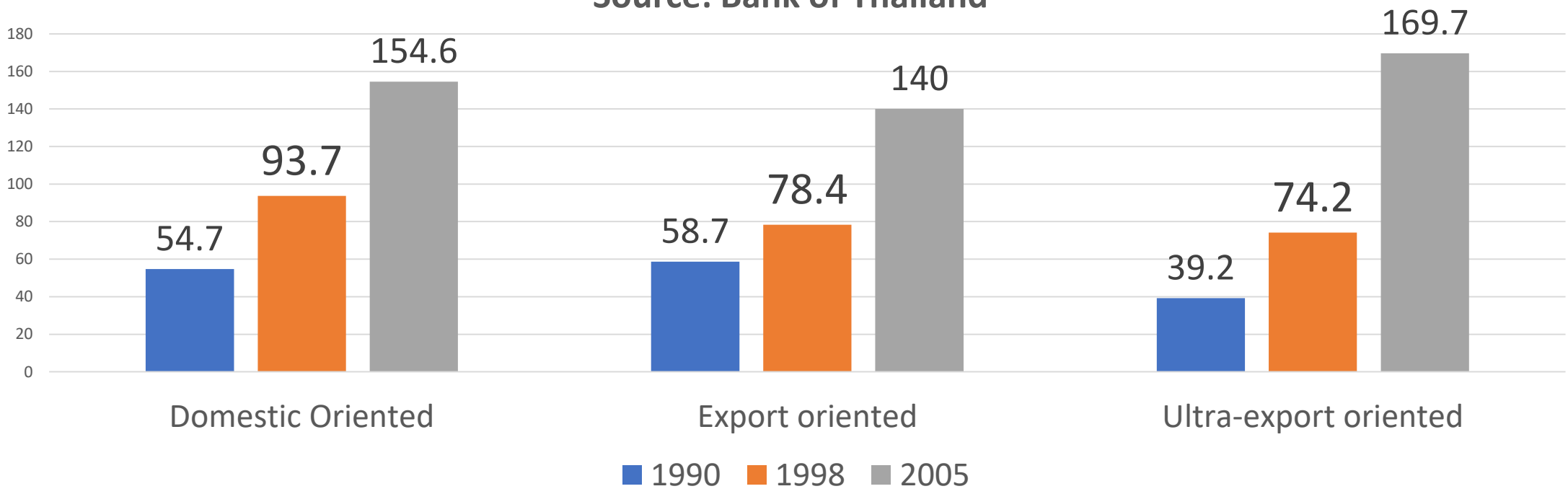
Unbelievably low unemployment rate

Explain why



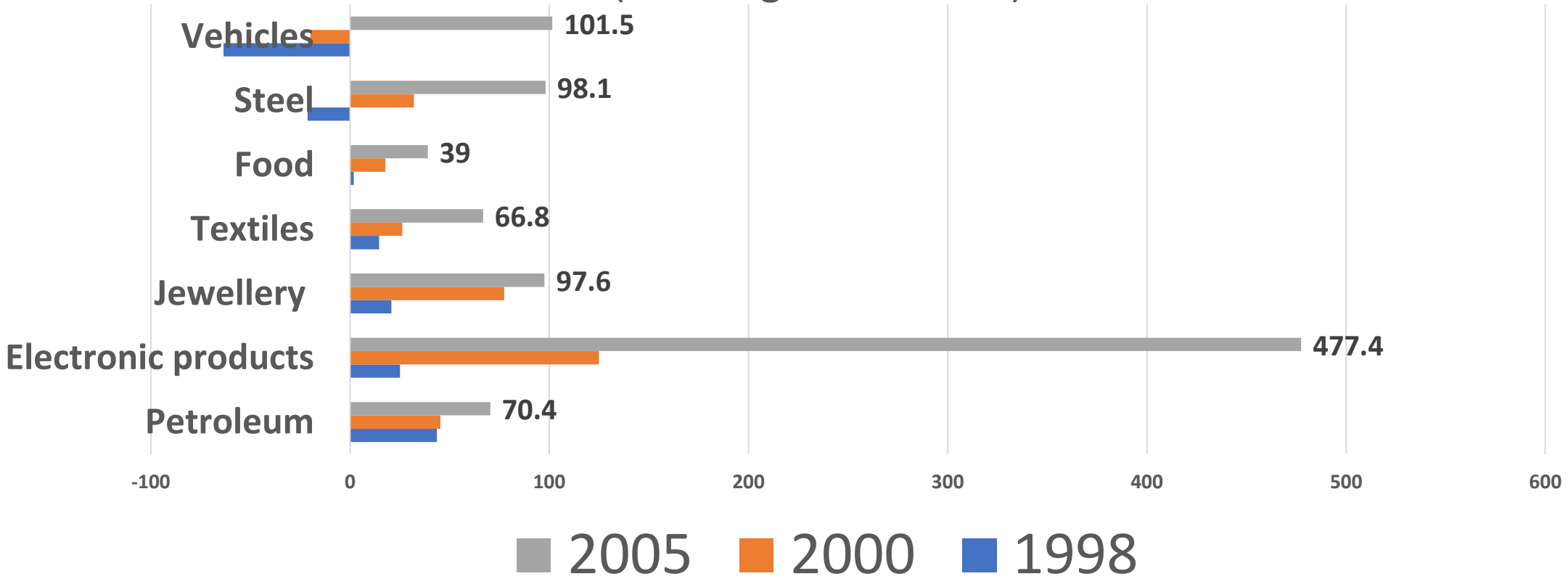
Three types of industries: By market orientation (exports-to-output ratio)

Figure 18. Manufacturing Production Index (2000=100)
Source: Bank of Thailand



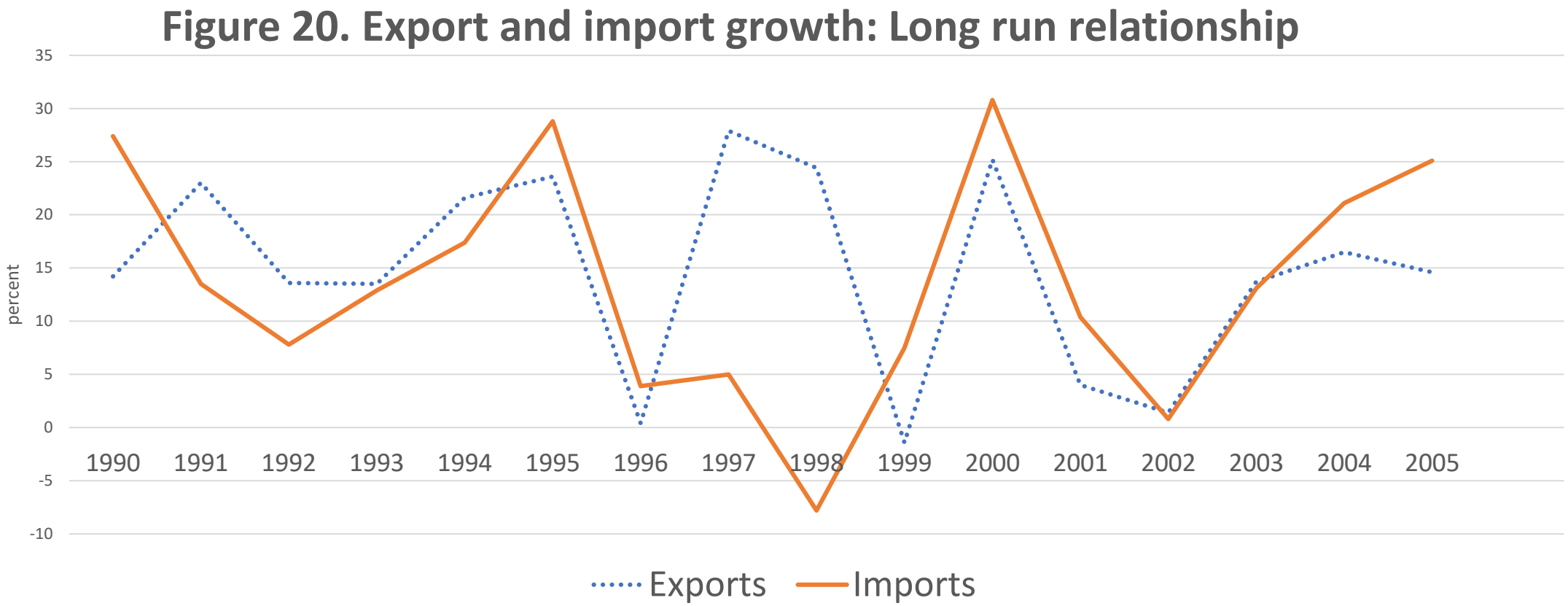
Thanks to FDI inflows

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



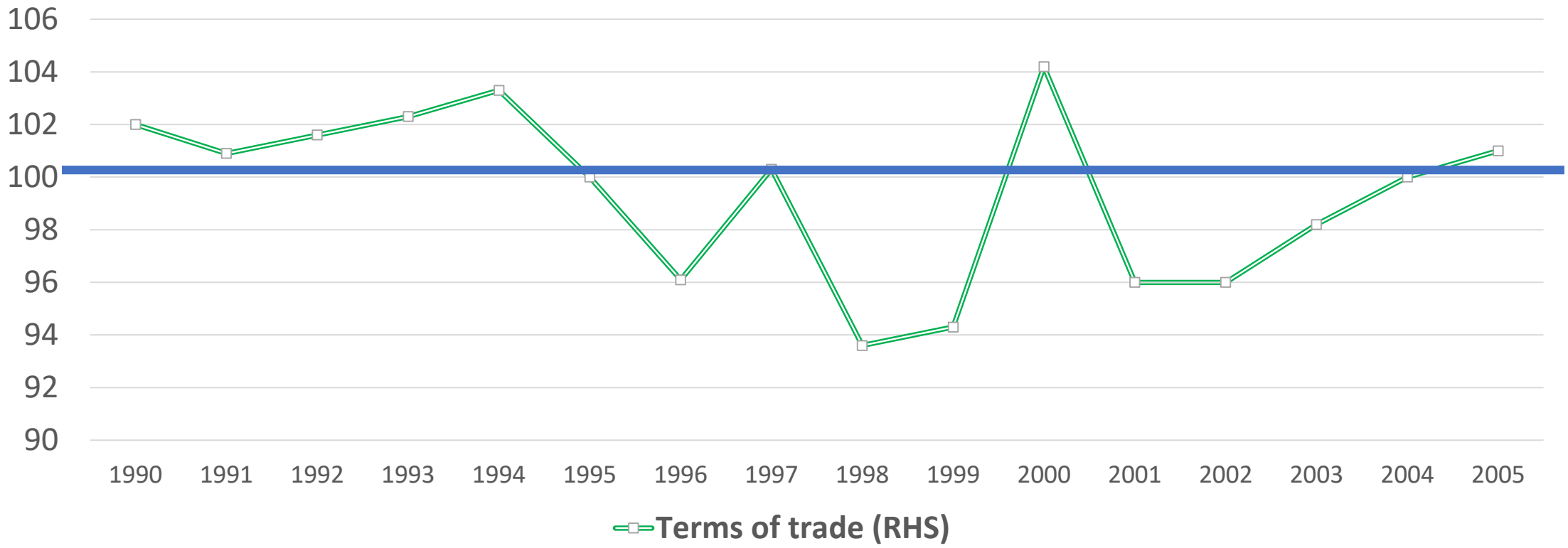
Non-spurious relationship

What is a spurious relationship?



Terms of trade: Cyclical Pattern

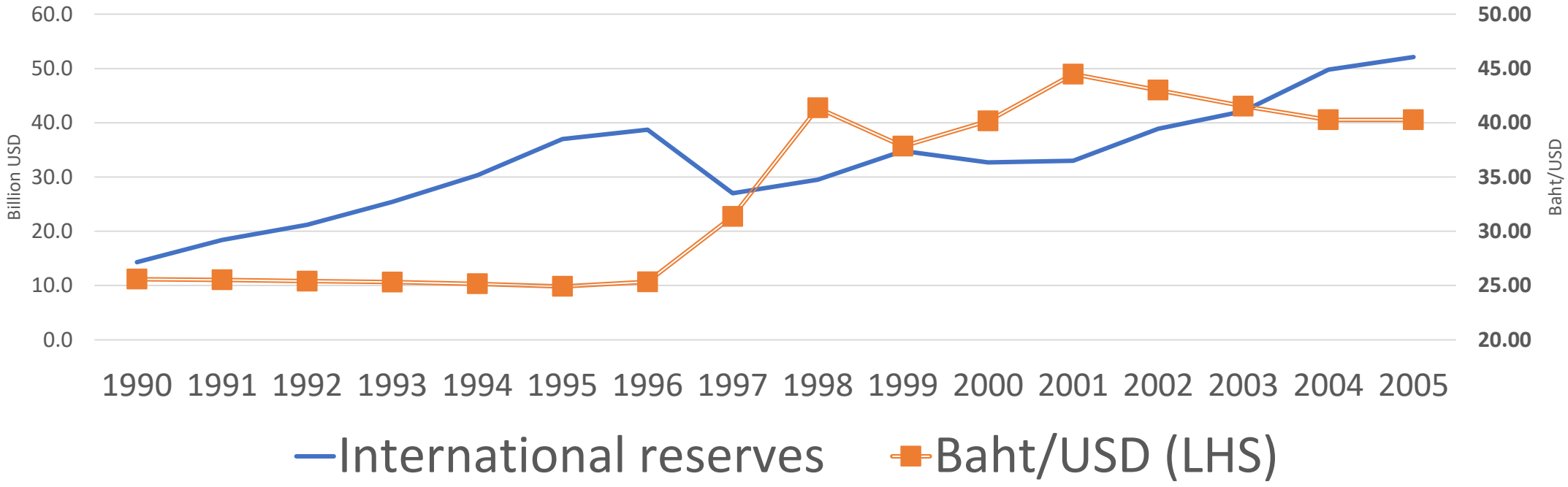
Figure 21. Terms of trade



Preferred Stability: Fear of appreciation

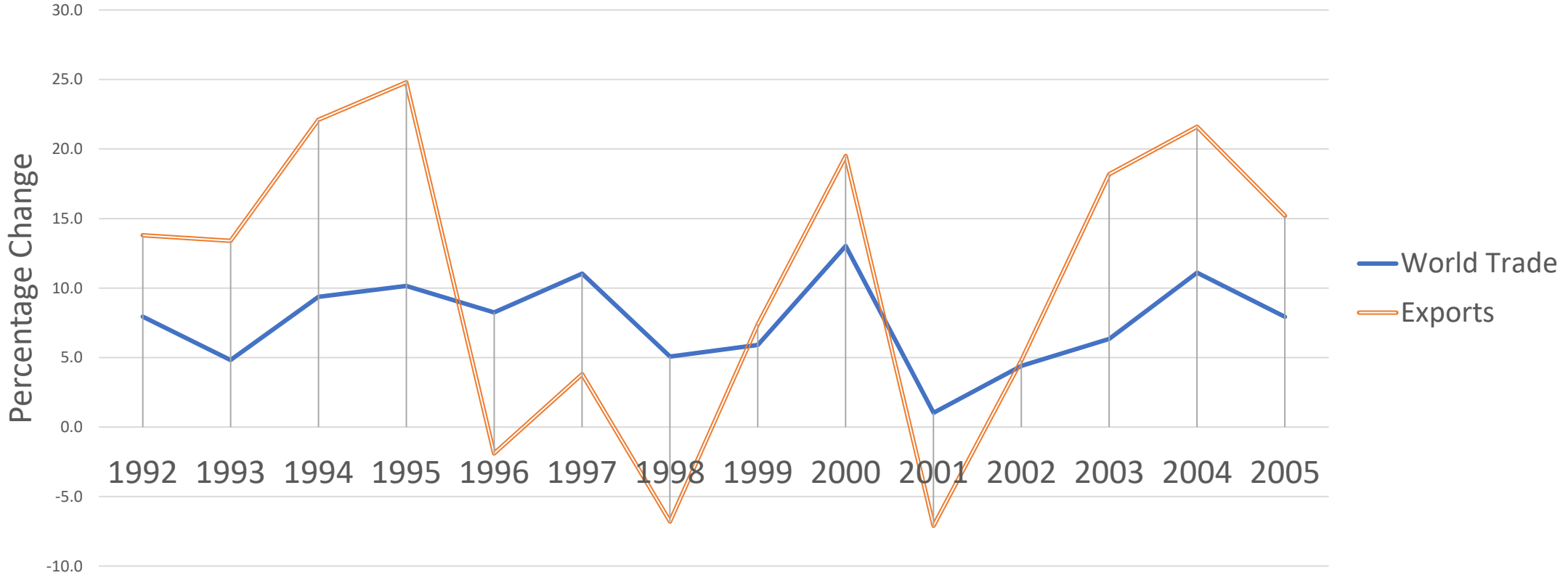
Has the BoT fear of floating?

Figure 22. International Reserves after a massive depreciation



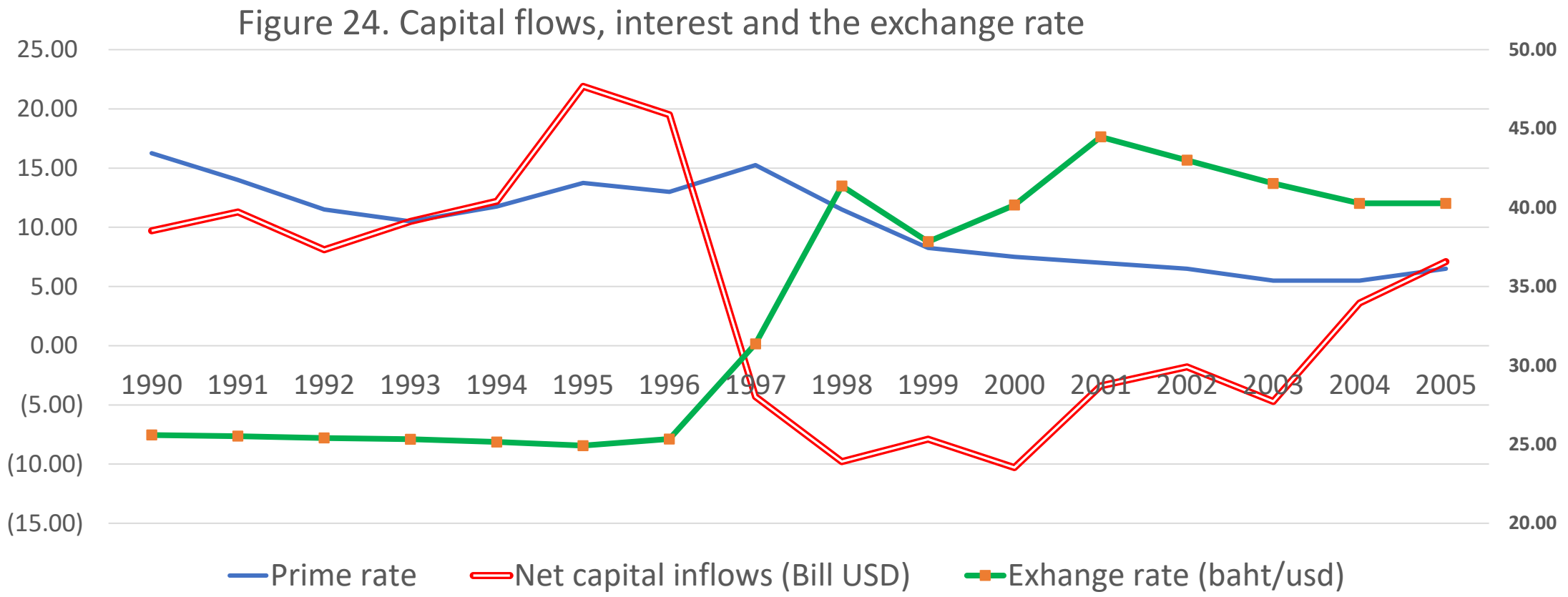
High income elasticity of export demand for Thailand's exports

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?



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?