

The hard road ahead for Thailand's economic recovery

Bhanupong

Lecture 9

The Hard Road Ahead for Thailand's Economic Recovery

Bhanupong Nidhiprabha

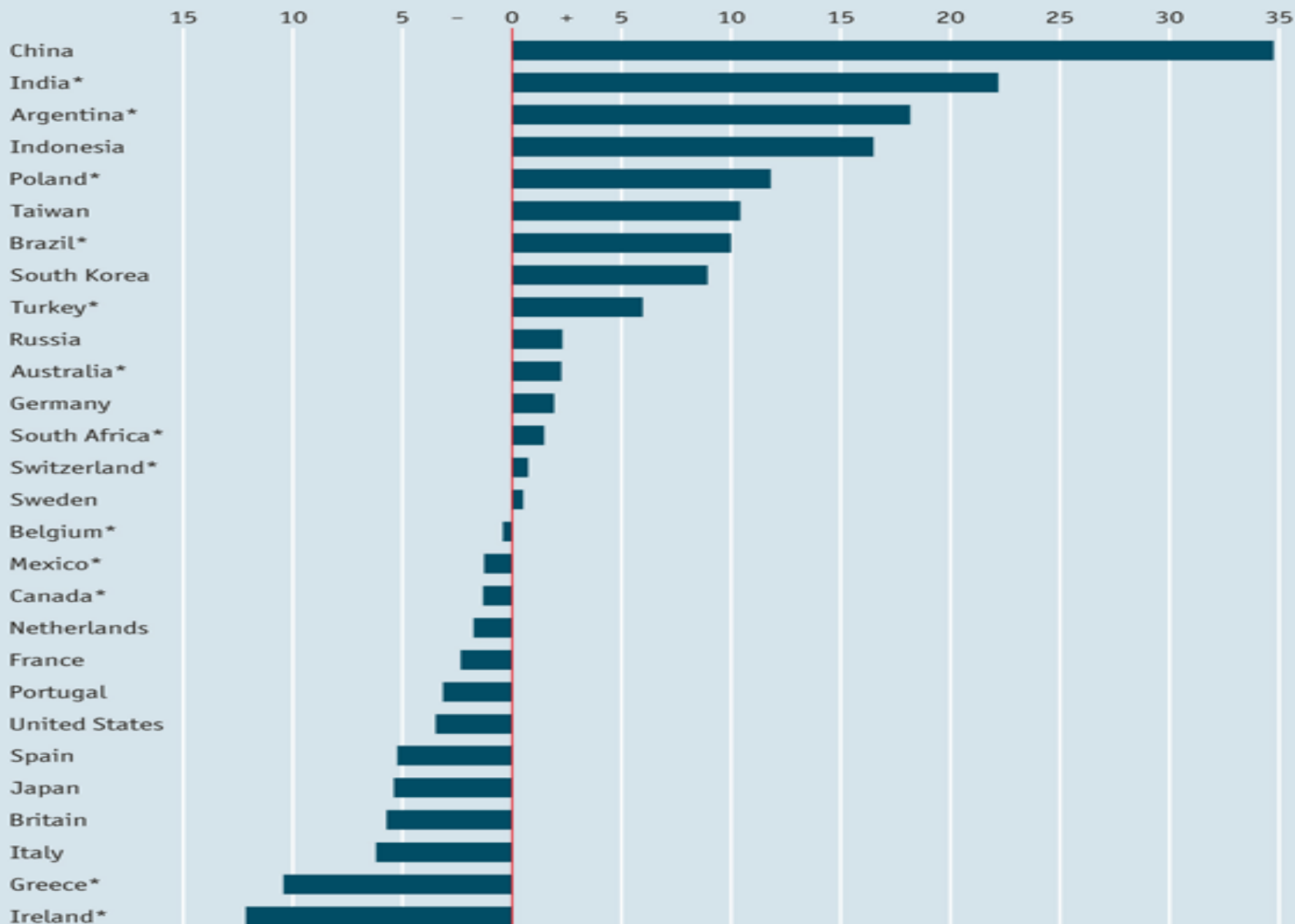
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Abstract

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

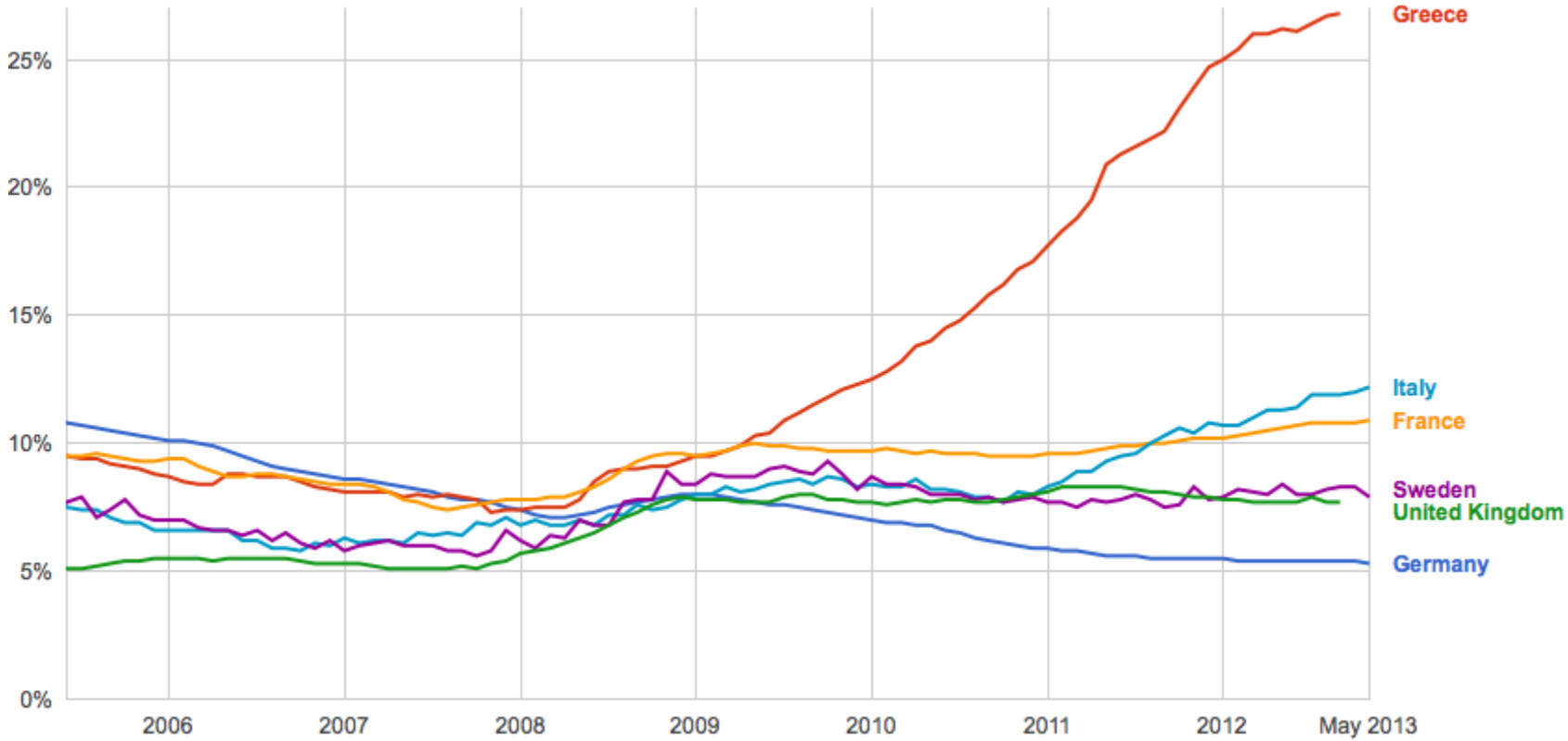
Q4 2007 to Q2 2011, % change



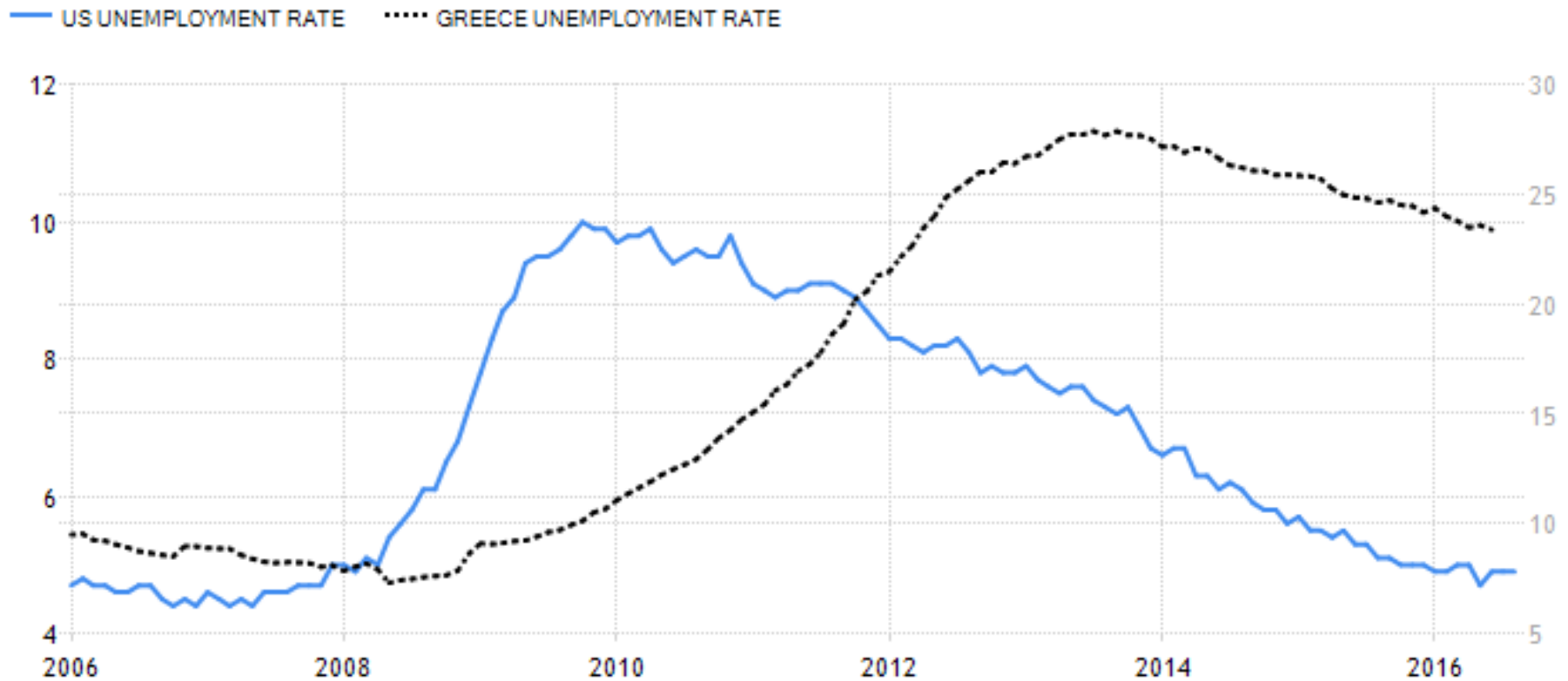
Sources: Economist Intelligence Unit; Haver Analytics; IMF; JPMorgan; *The Economist*

*Q2 2011 estimate

Unemployment rate in Europe



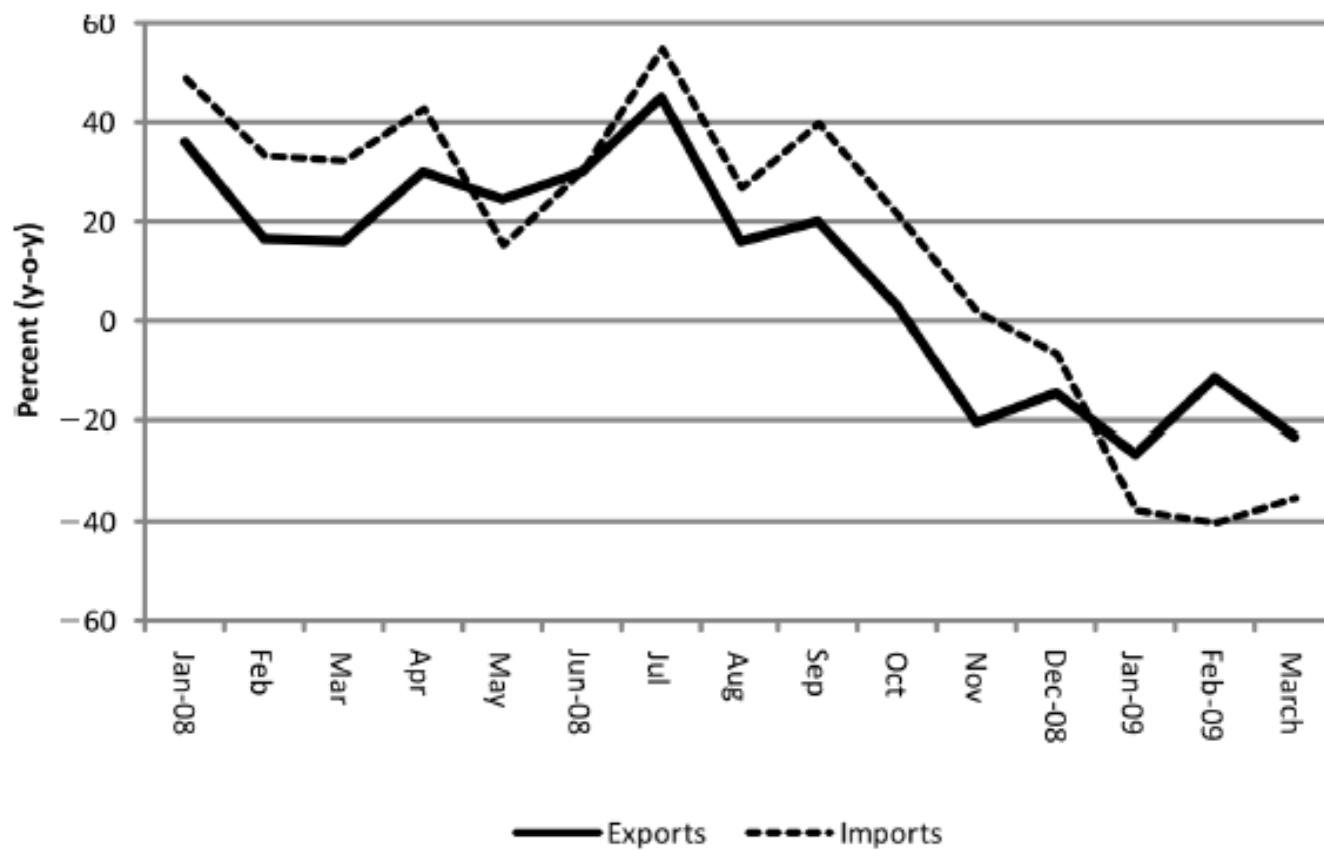
Unemployment in Greece and the US



SOURCE: TRADINGECONOMICS.COM

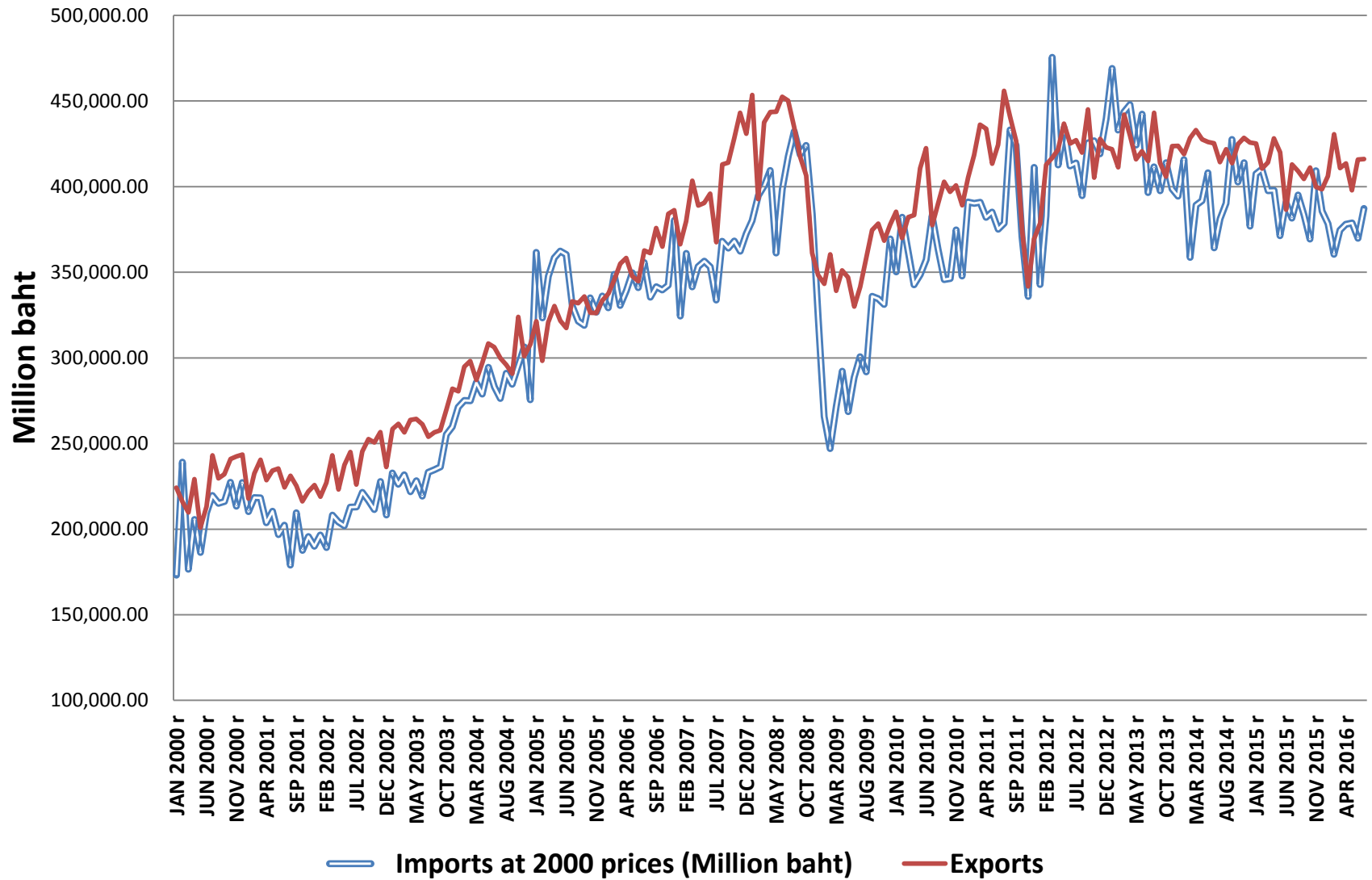
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Figure 1. The collapse of the last engine of growth

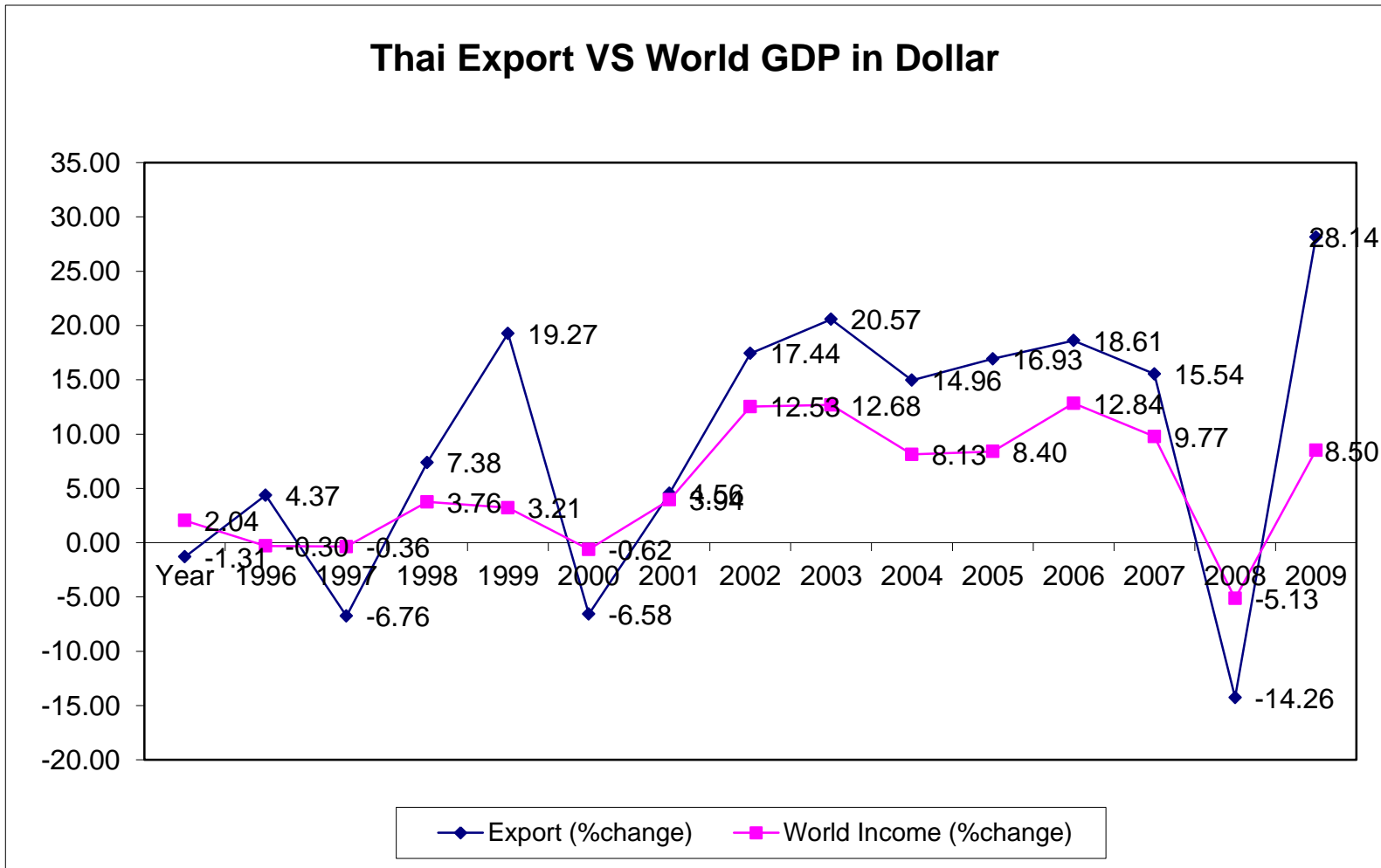


Source: Ministry of Commerce

Collapses of growth engine

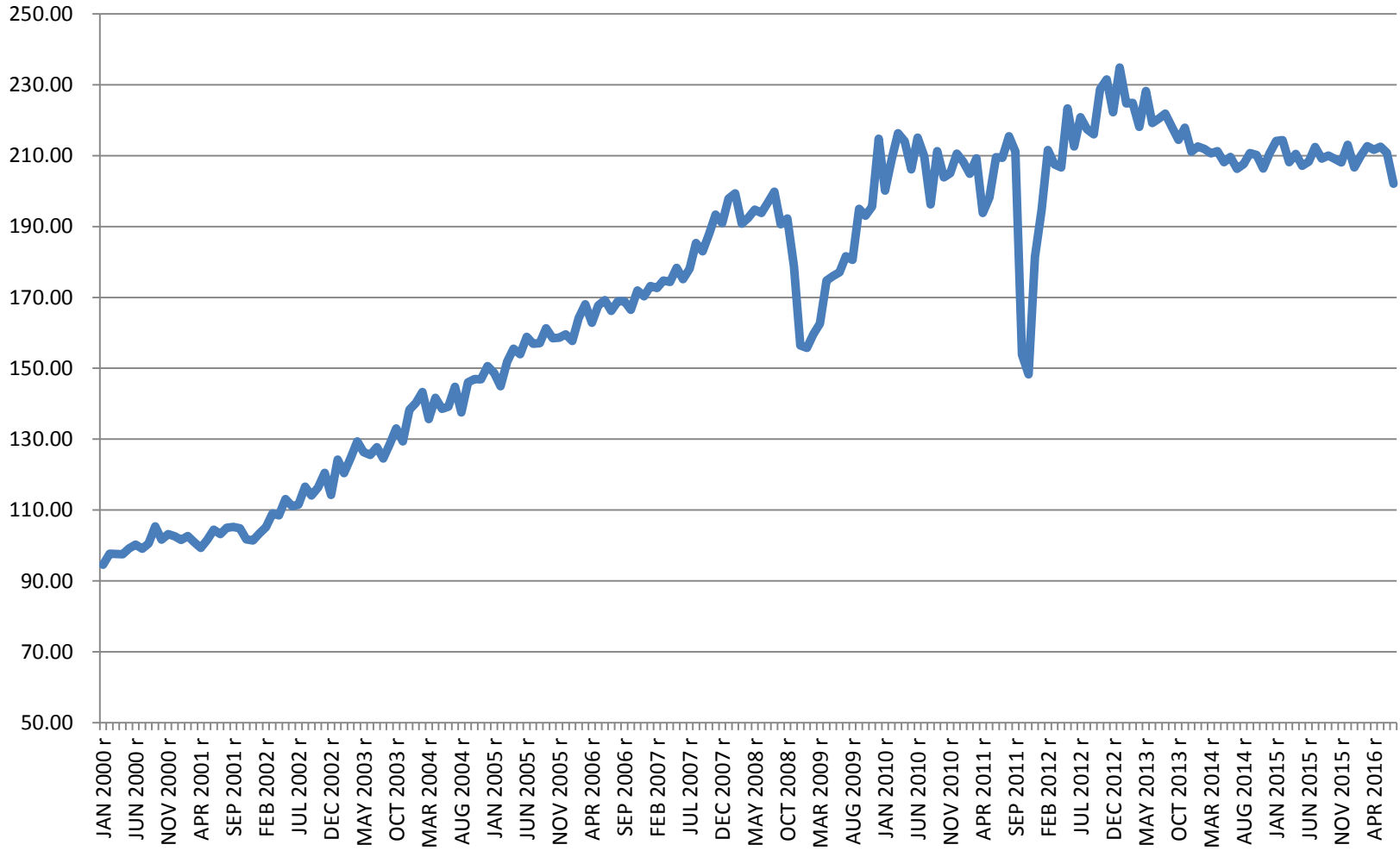


Impact of Global Recession

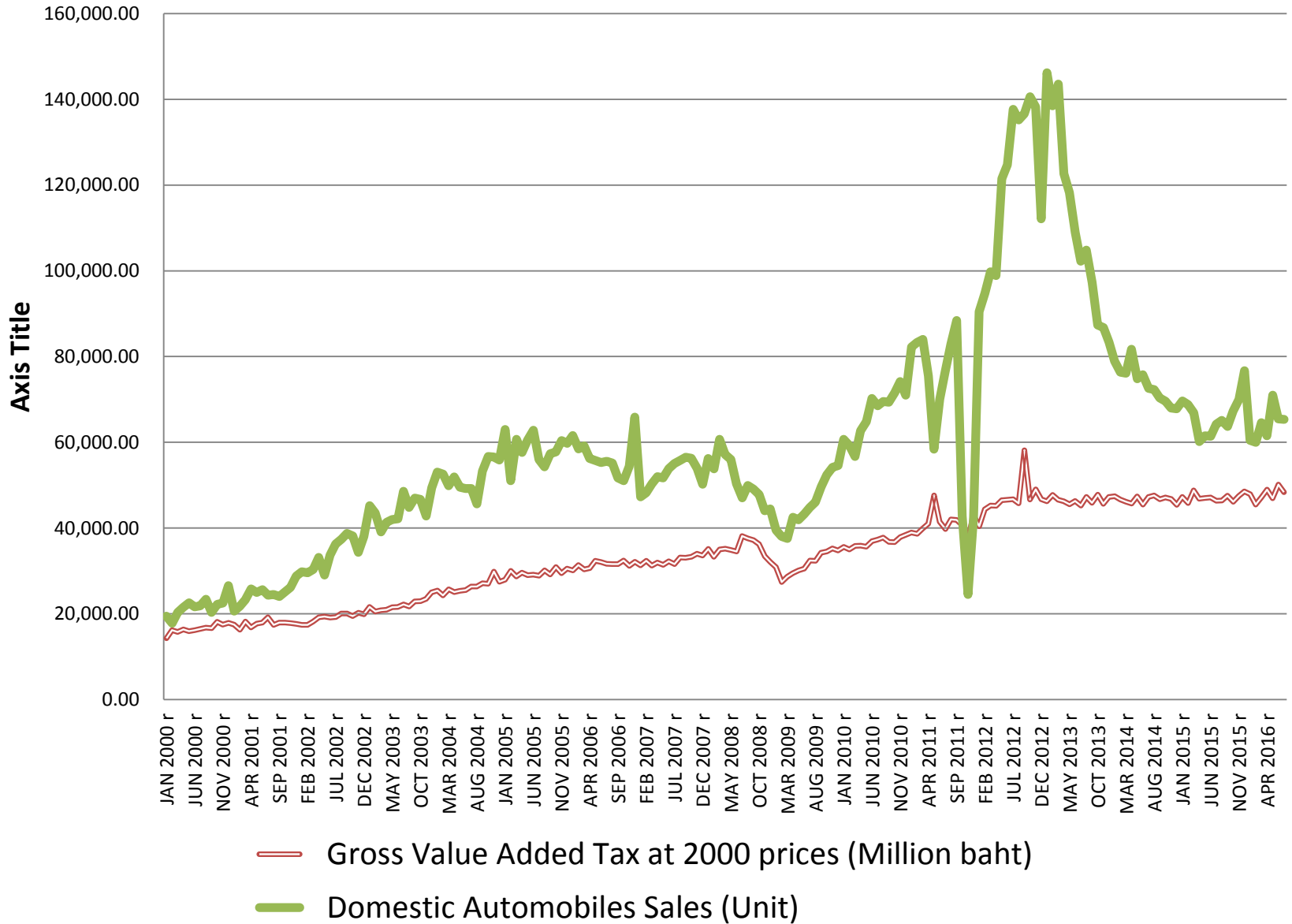


Manufacturing Production Index

Jan 2000- July 2016



Coincident Economic Indicators



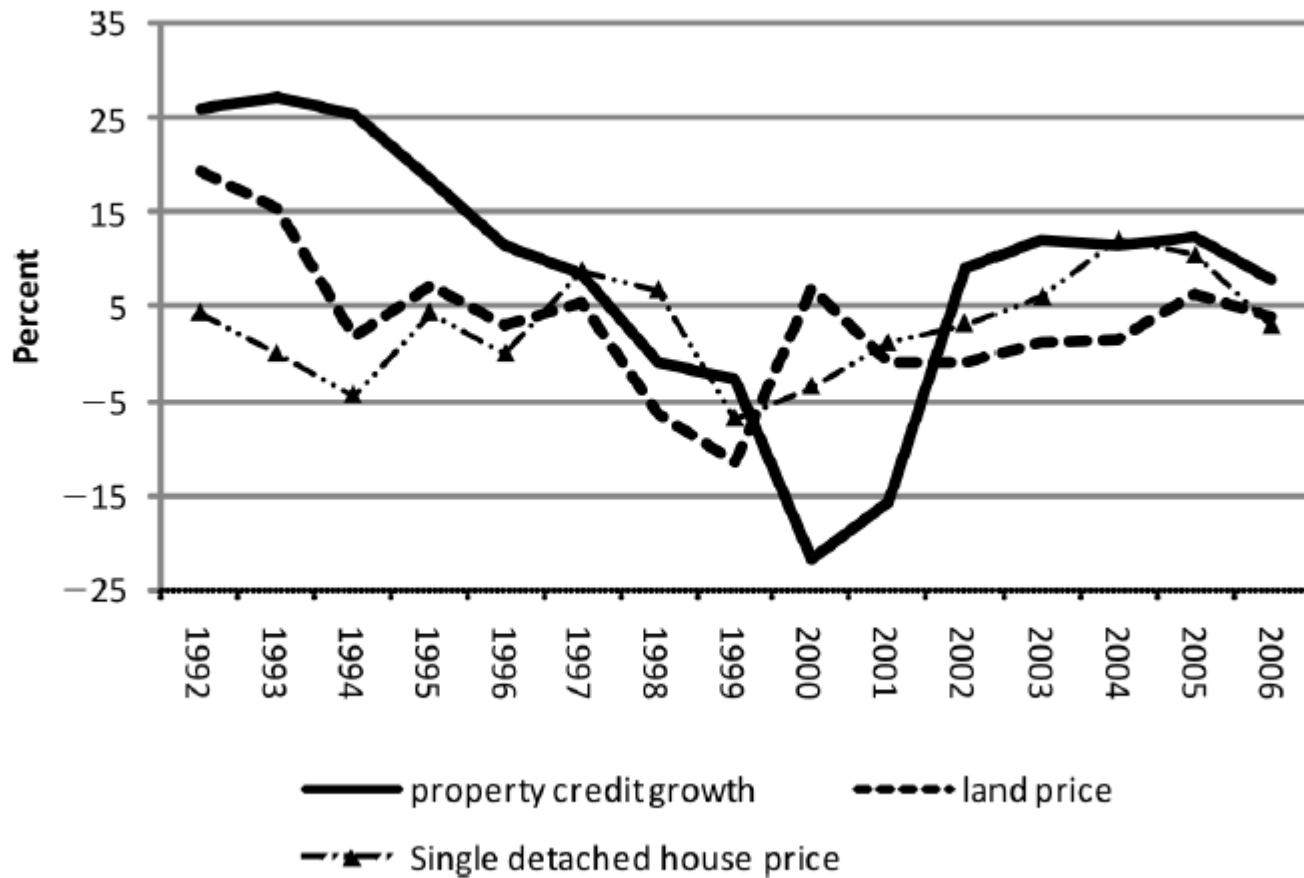
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Table 2. Contribution to GDP growth of demand components (percent)

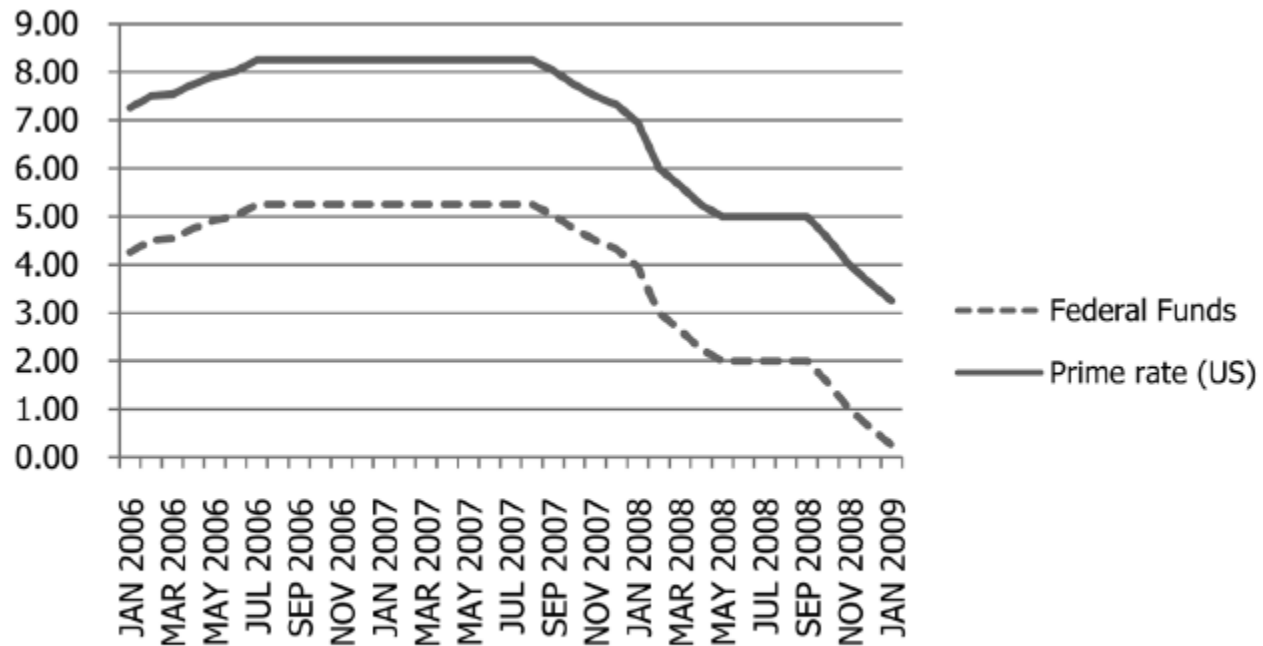
	1990-96	1997-98	1999-2005	2006-07
Private consumption	51.2	-57	63.8	25.3
Government consumption	8.8	-8	10.0	16.8
Investment	57.0	-313	48.8	-8.1
Net exports	-17.0	278	-22.6	65.9

Source: Author's calculation.

Figure 4. Real estate bubbles and property credit

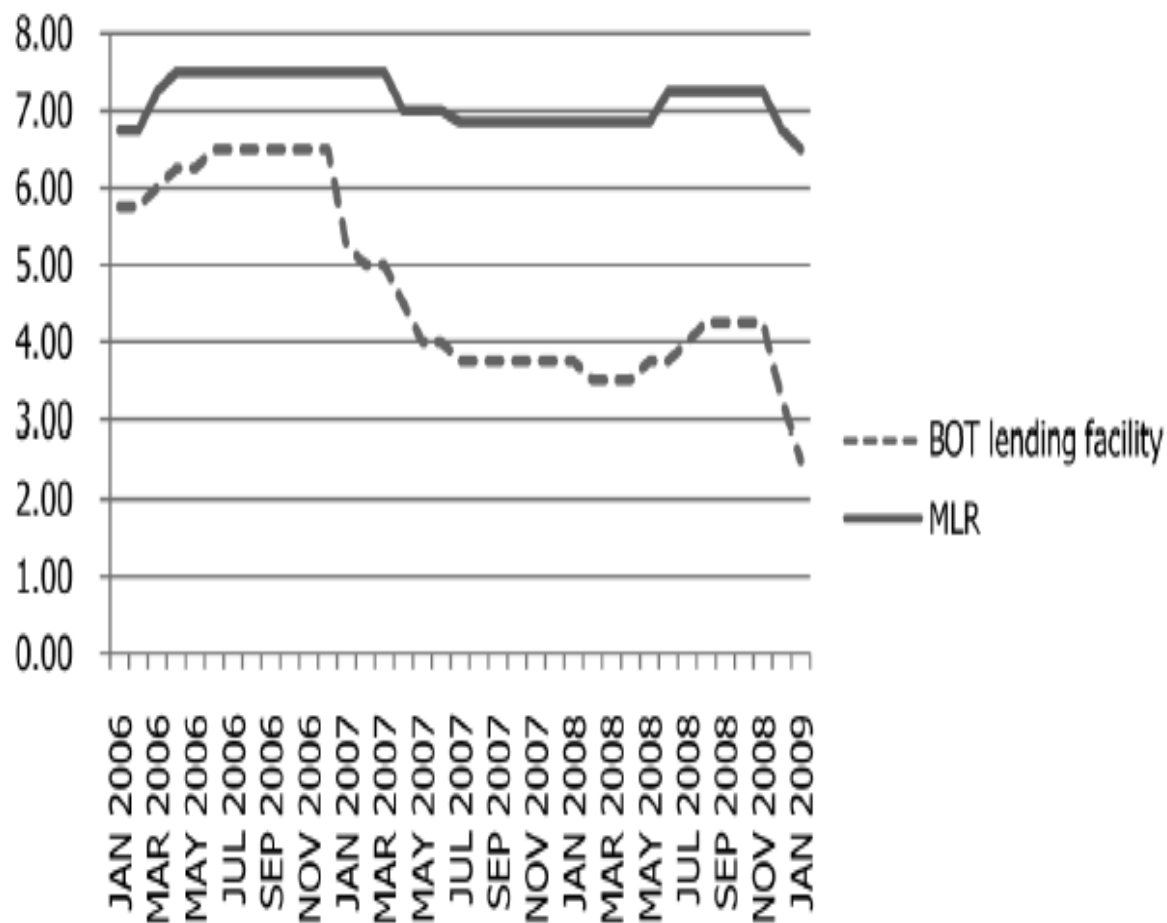


The Fed and its impact on commercial banks' prime lending rate



Source: Bank of Thailand.

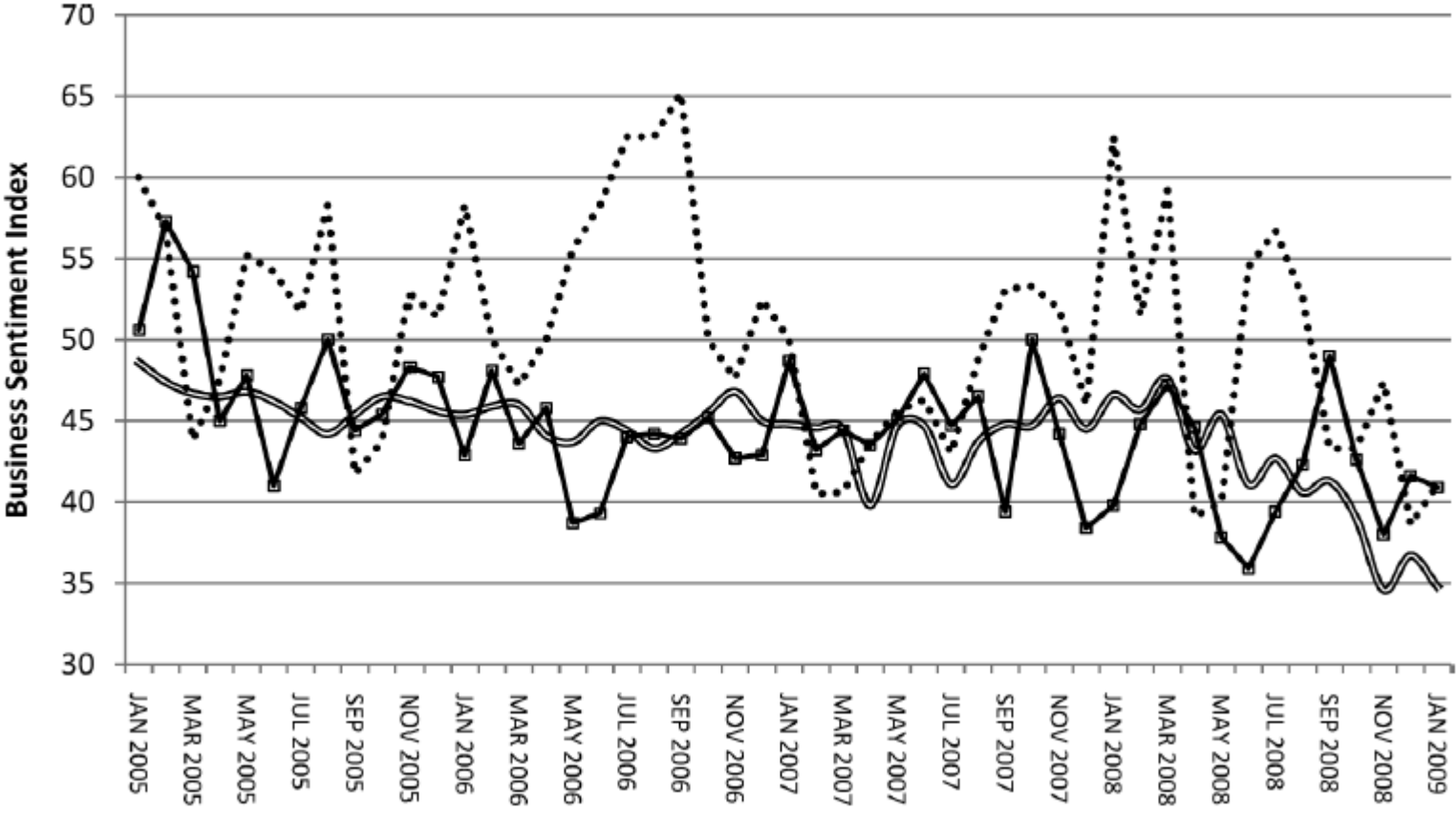
The BOT and its impact on commercial bank Minimum lending rate (MLR)



Pessimism and effectiveness of monetary policy

- 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



Business Sentiment Index (BSI)

Source: Bank of Thailand

A survey of 1,500 business enterprises

Index = 50 indicates that business sentiment remains stable.

Index > 50 indicates that business sentiment has improved.

Index < 50 indicates that business sentiment has worsened.

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

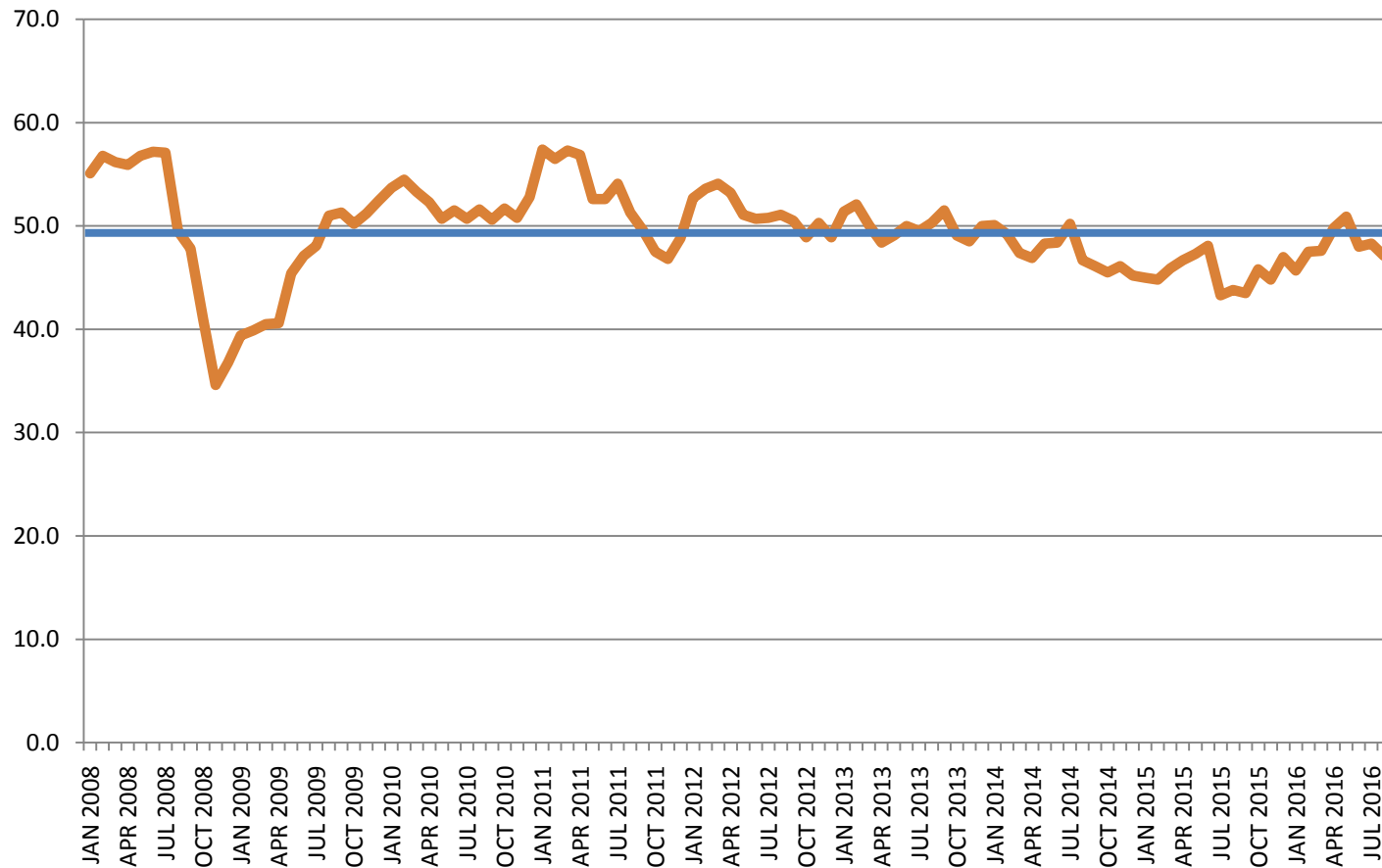
⁸ Ravallion and Chen (2005) provide evidence rejecting the commonly held view that poor people tend to rapidly consume the income from a development project. Aid recipients felt that a large share of the income gains was likely to be transient.

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.

Business Sentiment Index:

Output price



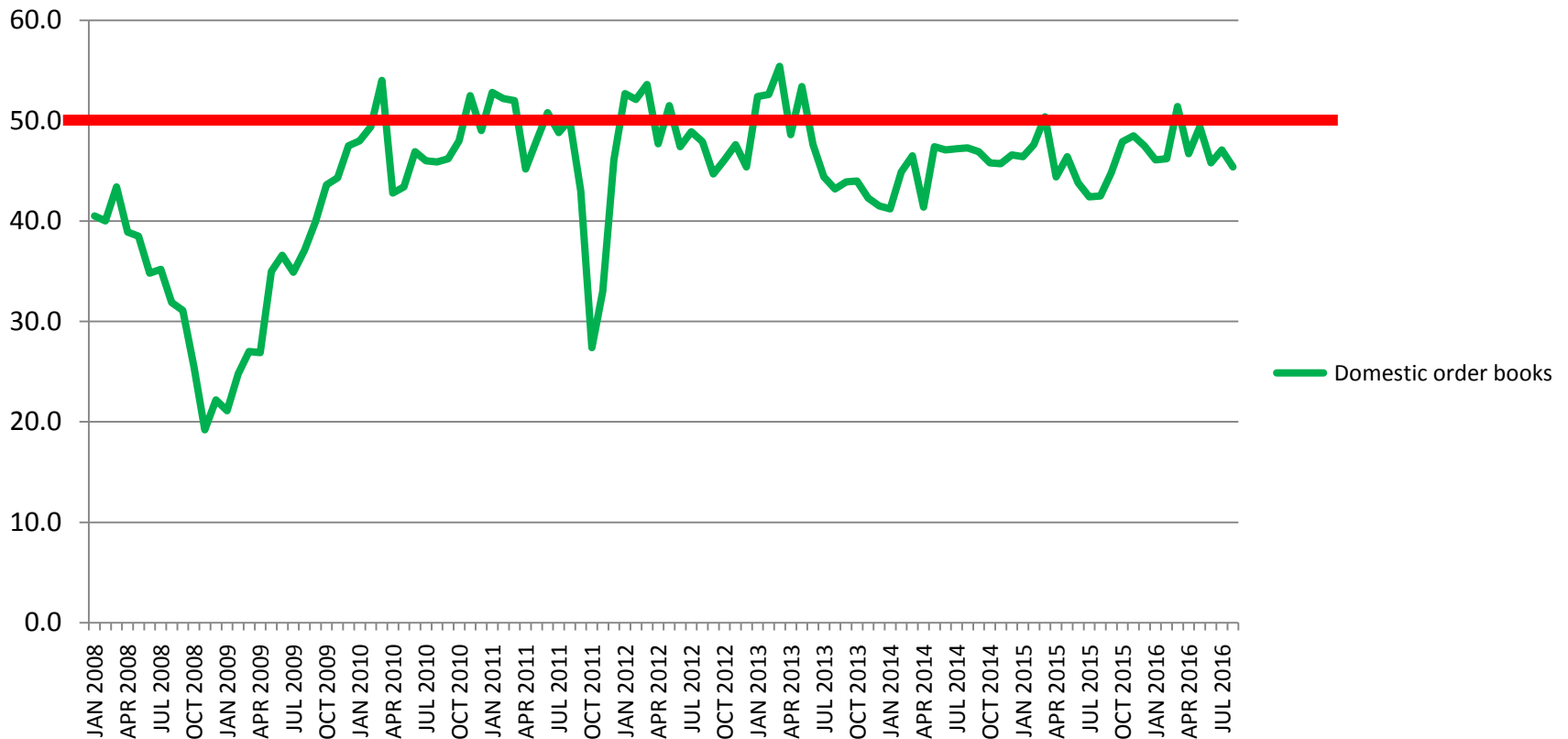
Business Sentiment Index

Foreign order books



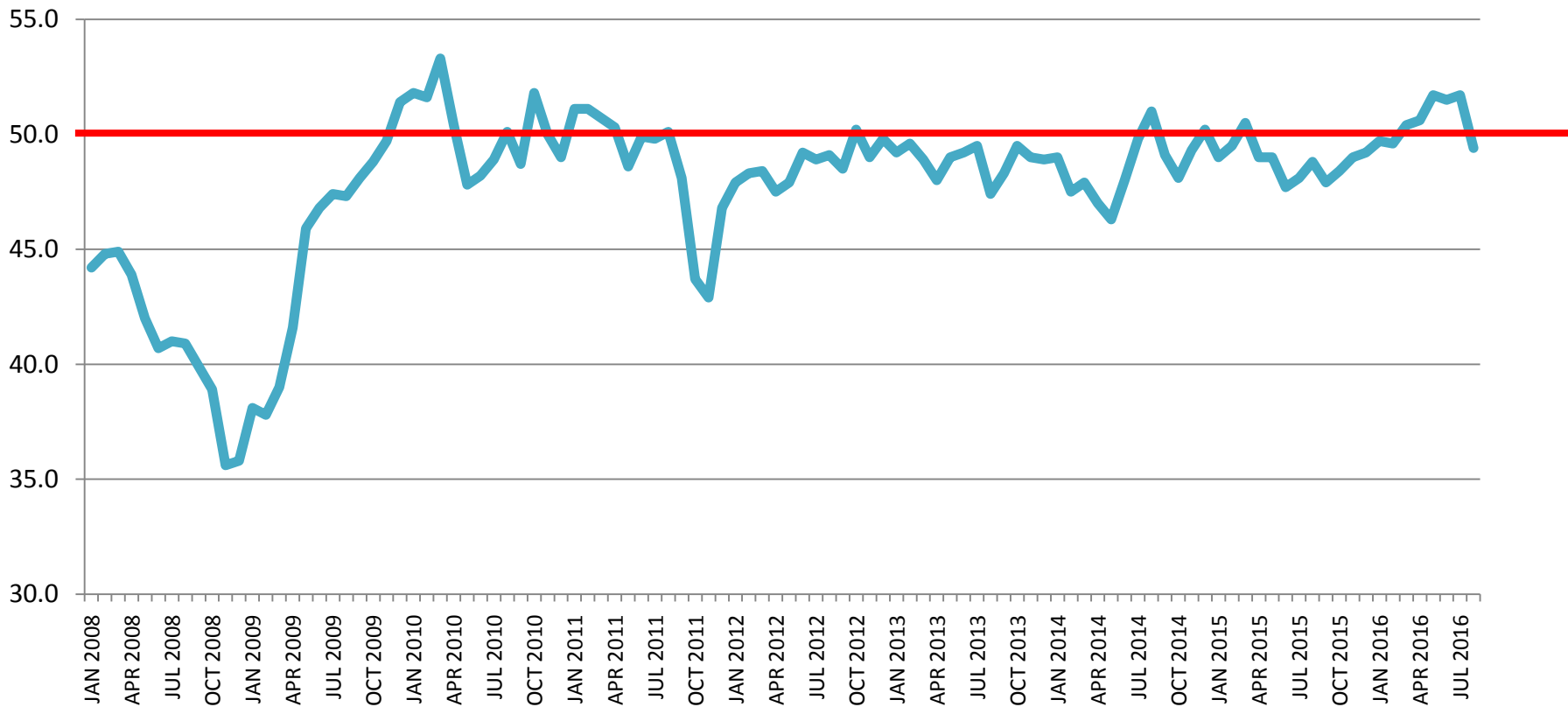
Business Sentiment Index

Domestic order books



Business Sentiment Index

Liquidity



Short-term gain, long-term loss?

- 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

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

Bhanupong Nidhiprabha

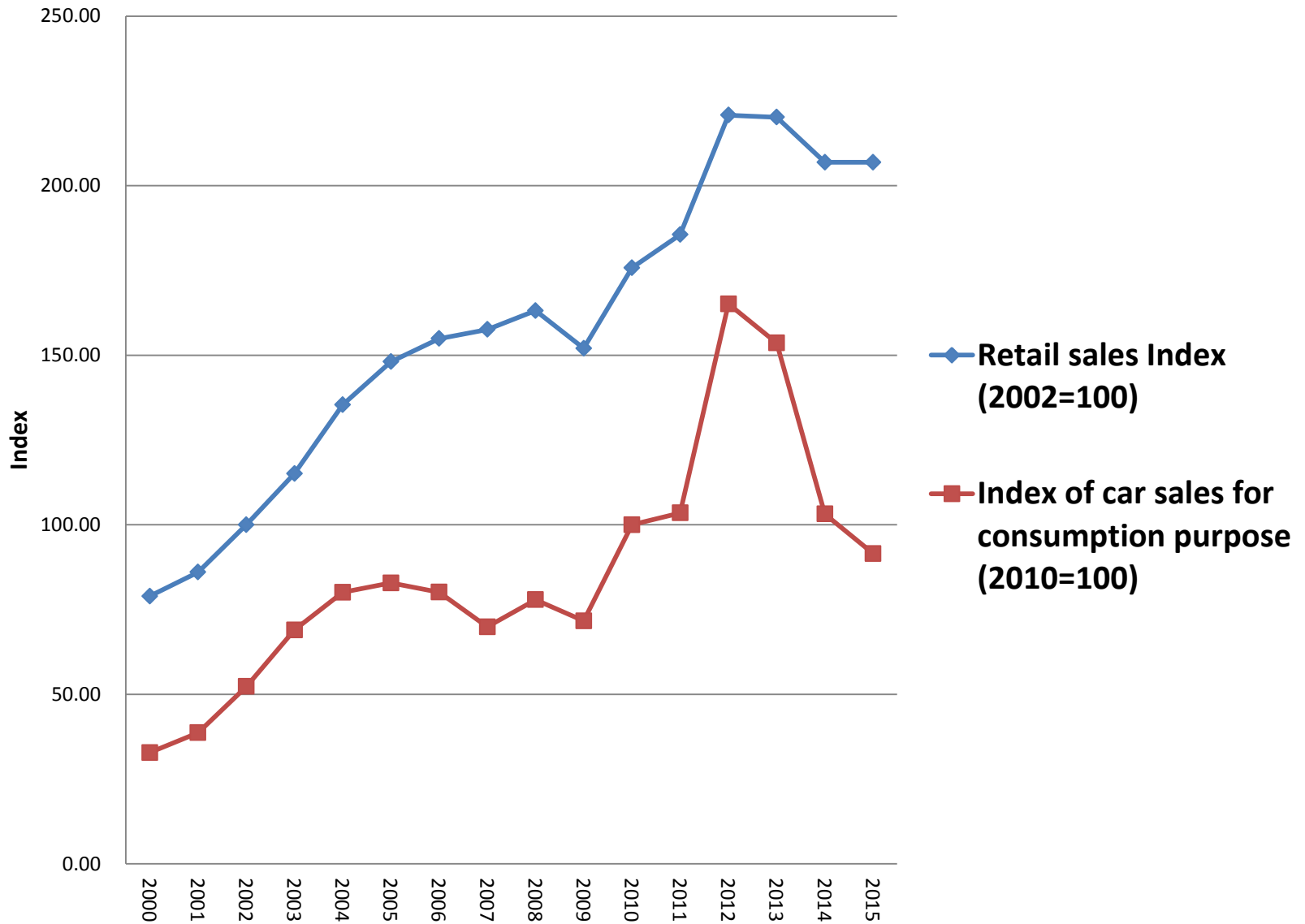
This paper investigates Thailand's macroeconomic policy responses to the global financial crisis in 2009. Empirical evidence found in this paper indicates that fiscal policy is relatively less effective than monetary policy. Tax reduction is more powerful in stimulating output than government spending. 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.

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.

Private Consumption Indicators



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)

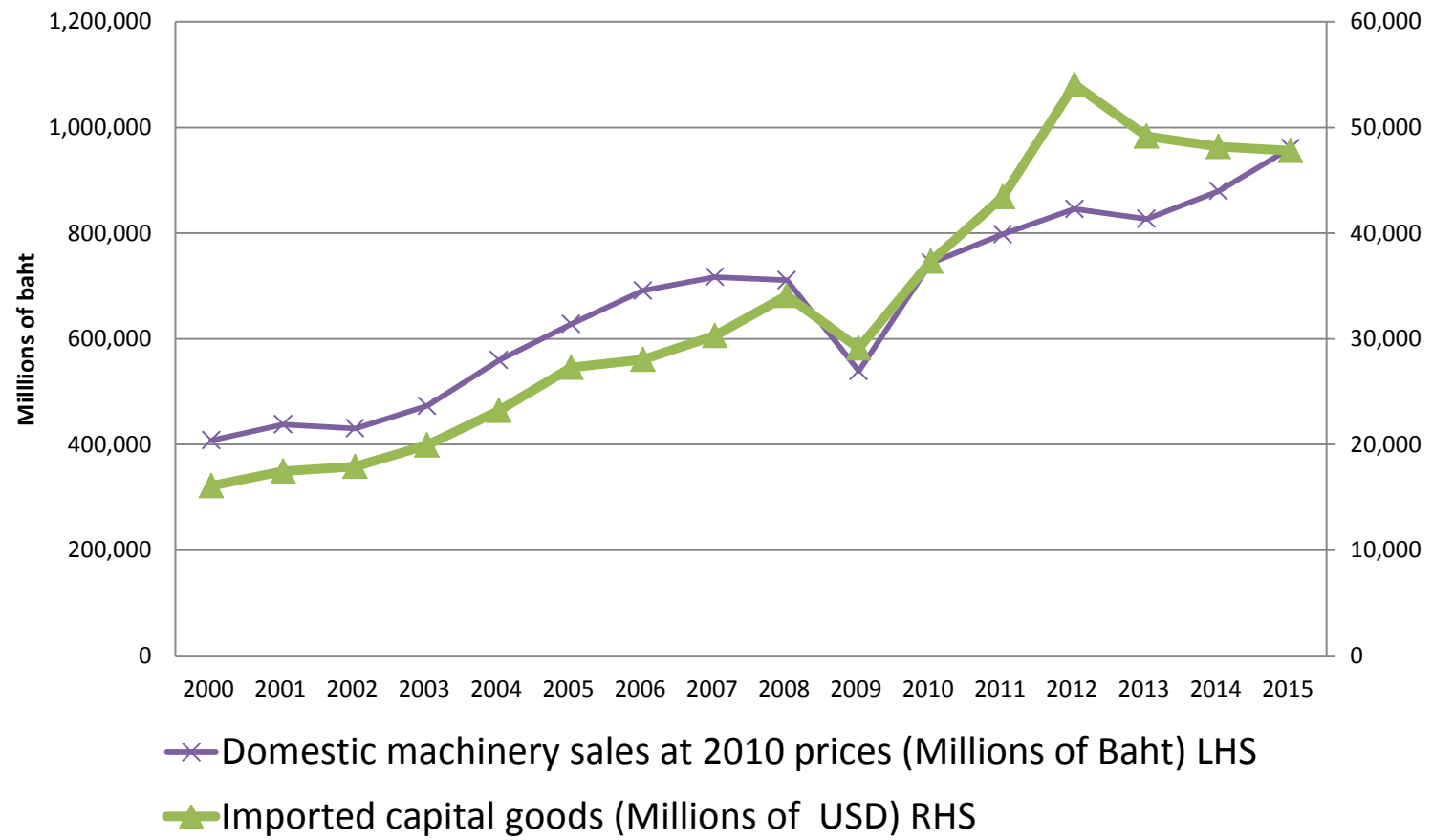
	<i>Output</i>	<i>Business sentiment index</i>	<i>Inflation</i>
2000–05	2.96	2.42	1.43
2006–09	11.3	3.44	3.06

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.

Private investment Indicators



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.

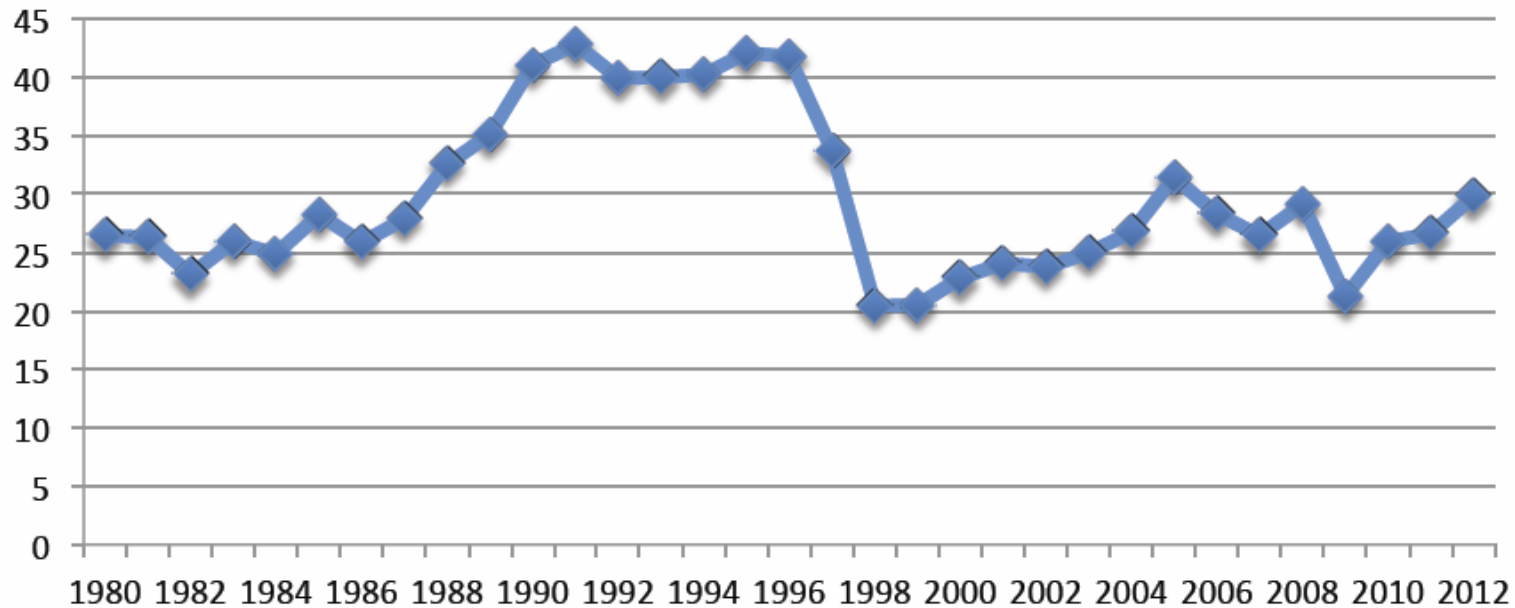
Monetary policy remains effective despite the high degree of capital convertibility because its impact on the exchange rate intensifies the initial impact of monetary policy on the aggregate demand.

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.

Investment Slump in Thailand

Share of investment in GDP (%)



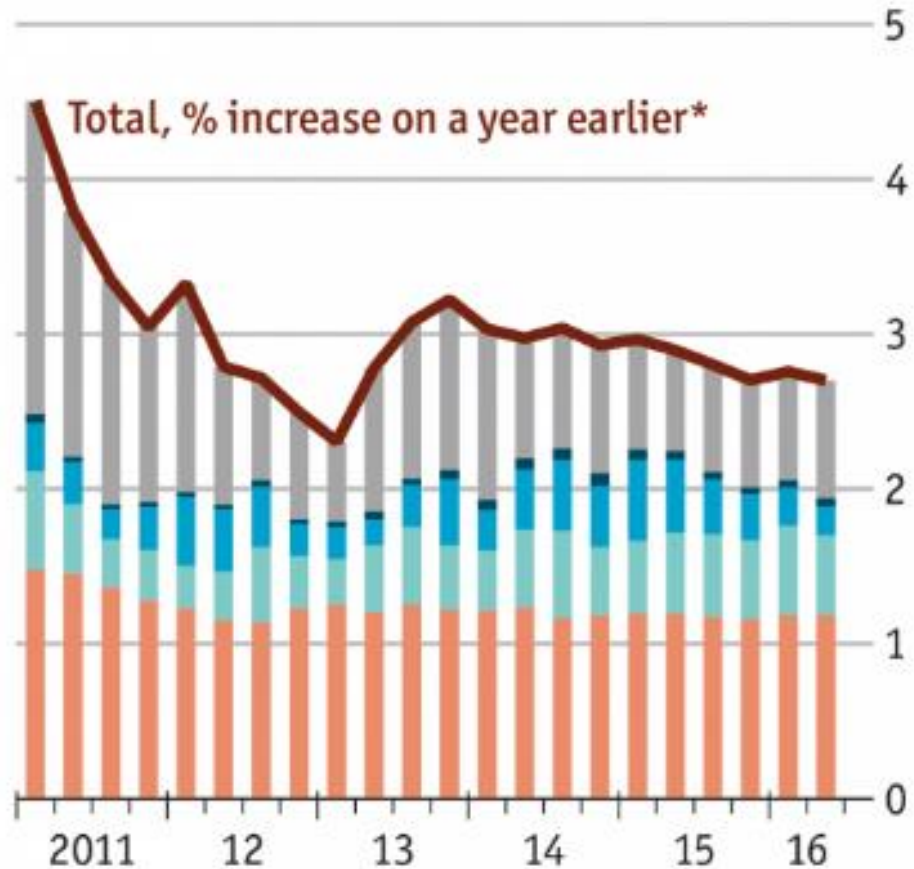
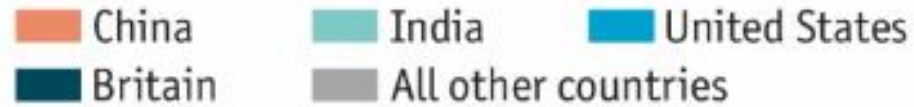
Slow going: world GDP

- The second quarter, according to *The Economist's* estimates, was none too exhilarating.
- Global year-on-year economic growth reached 2.7%, a whisker below the previous quarter's. Blame the slowdown on Asia.
- China clocked in at 6.7%—well below its long-term average, but better than expected, and propped up by a hefty, demand-boosting increase in government spending.
- India's performance worsened, too, though with growth above 7% it remains the world's fastest-expanding big economy. Such figures provoke envy in rich countries.

Uneven effort

World GDP, contribution to growth

Percentage points



Sources: Haver Analytics; IMF; *The Economist*

*Estimates based on 55 economies representing 84% of world GDP. Weighted GDP at purchasing-power parity

Slow going: world GDP

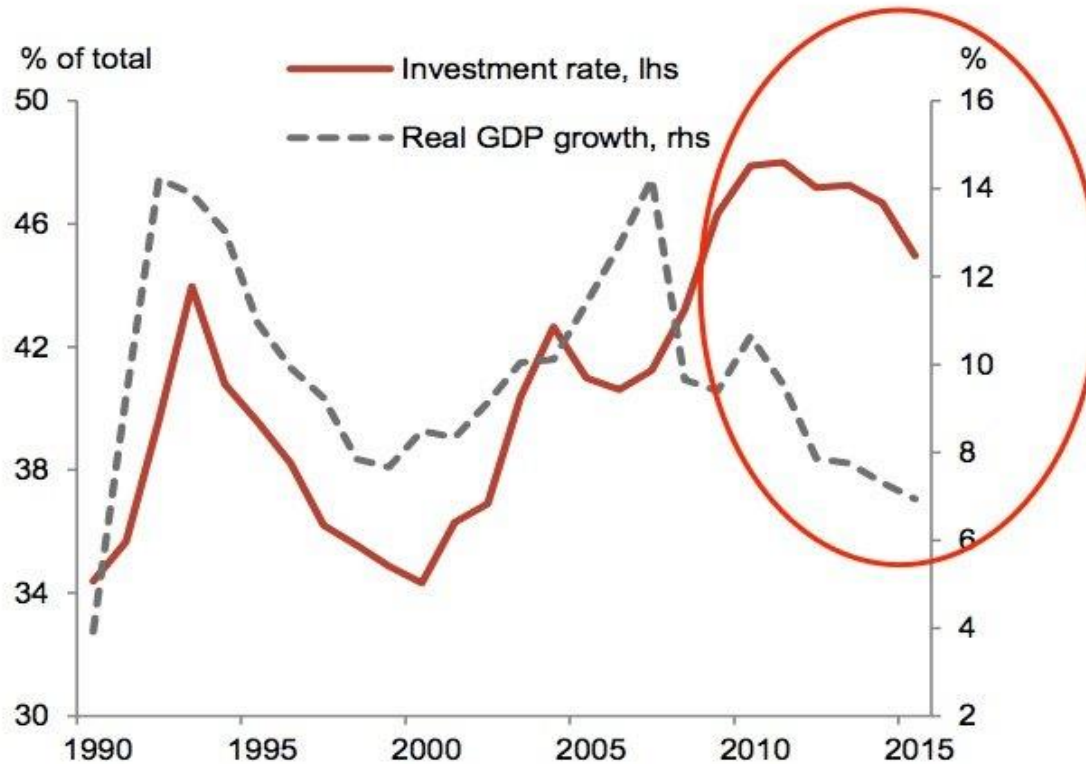
- In America, growth slipped to little more than one-sixth of India's rate (though strong income numbers this week brought cheer).
- Among advanced economies, the surprising bright spot was Britain: output ticked up at an annual rate of 2.2%, up from 2% in the previous quarter.
- All that uncertainty in the run-up to the Brexit referendum seems not to have greatly affected the economy. Yet.

How China's government strategy to fuel growth is seriously failing:

- China has a massive debt problem, its economic growth is slowing, and it is now becoming a major concern for investors around the world. China takes on huge amounts of debt in order to fuel its ferocious economic growth.
- In June, Li Yang, a senior researcher with the China Academy of Social Sciences said China's total borrowings were more than double its GDP in 2015 at 168.48 trillion yuan (\$25.6 trillion).

More debts, followed by higher investment (the way it used to be)

Fig. 21: Investment rate vs real GDP growth



Source: CEIC, WIND and Nomura Global Economics.

Ghost cities in China

- Some Chinese cities are now notoriously known as “ghost cities” for their empty skyscrapers, luxury apartments and magnificent squares.
- These “ghost cities” are a result of excessive housing and infrastructure construction, and speculation on property demand. The emergence of ghost cities is a consequence of China's land-centred urbanisation.
- Land-centred urbanisation is rooted in local GDPism, which in turn results in aggressive developmentalism and excessive investment among China's local governments.

A Ghost City in China



As many as **24 new cities** are being built every year! How is this possible ?
The Chinese Government has allowed for this this expansion to continue i order to keep their economy growing but the level of infrastructure development is far ahead of the demand for property.



Ghost cities of China exceed 64.5 million vacant homes

Not as effective as before

- This chart proves that China's strategy of fueling growth by taking on debt and investing in state-owned enterprises is not working anymore.
- But growth is slowing. China no longer puts up double-digit GDP growth, and instead is recording numbers like 6.7 % for the second quarter.
- A number of asset managers and analysts believe the number is lower.
- Extra debt is no longer producing the growth it did back in 2005.

Zombie firms in China

- The term "Zombie Company" was applied to Japanese firms supported by Japanese banks during the period known as the loss decade after the collapse of the Japanese asset price bubble in c.1990.
- By 2016 following economic downturn in Chinese industrial companies (steel, aluminum, paper) had developed gross overproduction capacity problems, with overcapacity rising from 0% in 2007 to an average of 13% by 2015, with figures higher than 30% in some industries (cement, steel in 2014).
- At the 2016 National People's Congress the country's government recognized the issue of the 'Zombie Enterprises' and announced that it was to close or reorganize many state owned (public) industrial companies by 2020.¹ In coal and steel industries resultant loss of work was expected to result in 1.8 million redundancies (15% of workforce), with total redundancies estimated to be up to 6 million workers.