

The hard road ahead for Thailand's economic recovery
Effectiveness of macro policy in response to GFC

Bhanupong

Lecture 9

The Hard Road Ahead for Thailand's Economic Recovery

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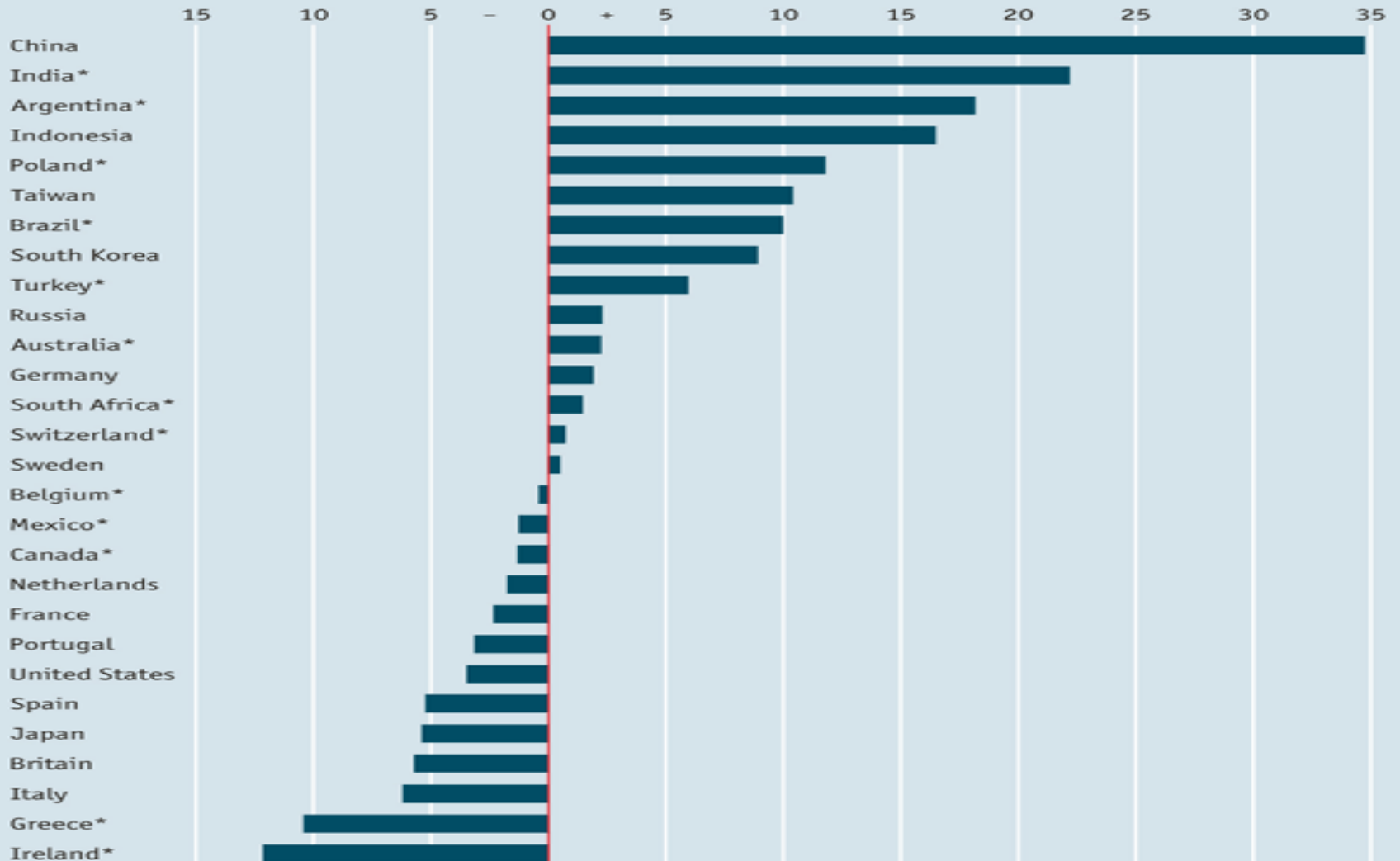
Abstract

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.

Global Recession and Recovery

Real GDP per person

Q4 2007 to Q2 2011, % change

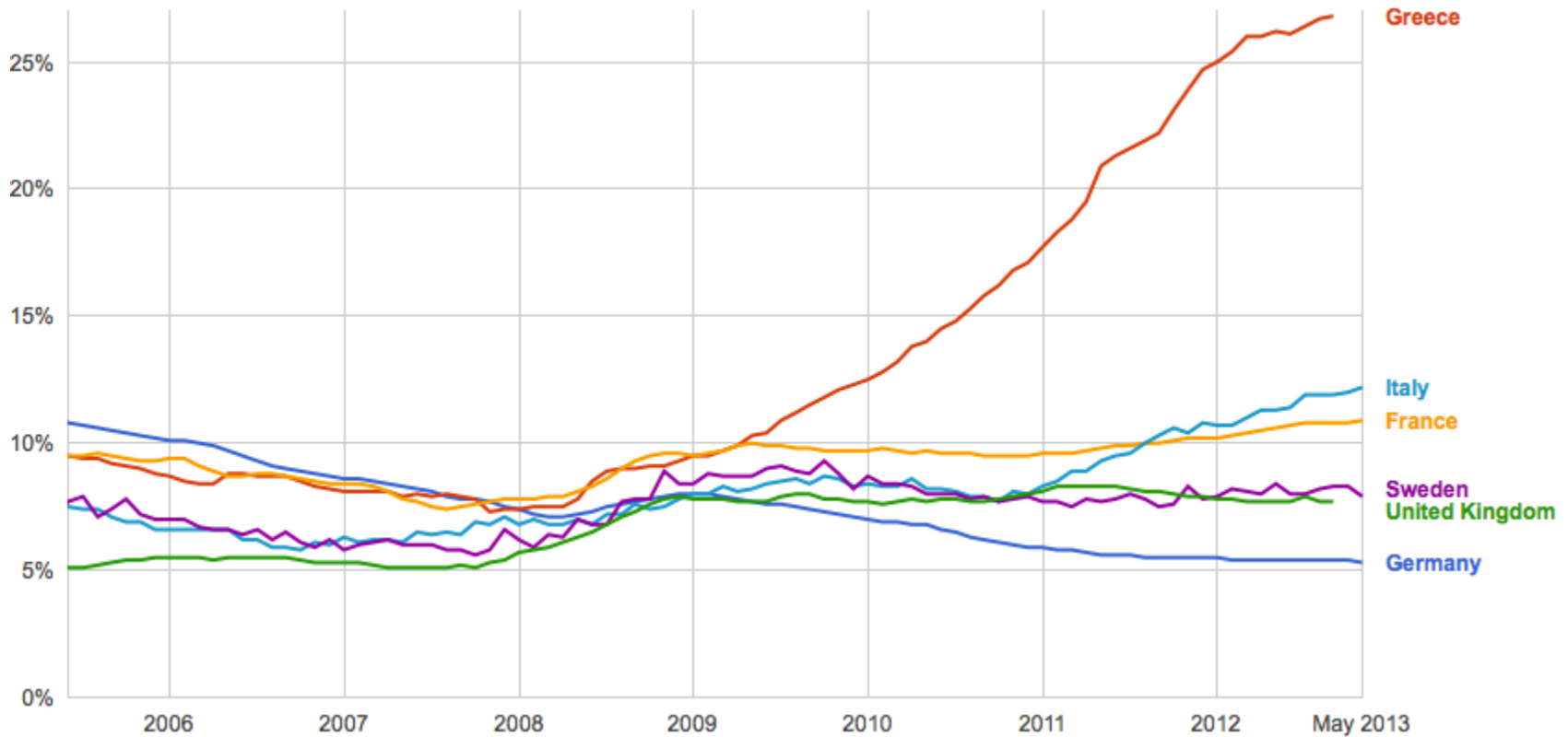


Sources: Economist Intelligence Unit; Haver Analytics; IMF; JPMorgan; *The Economist*

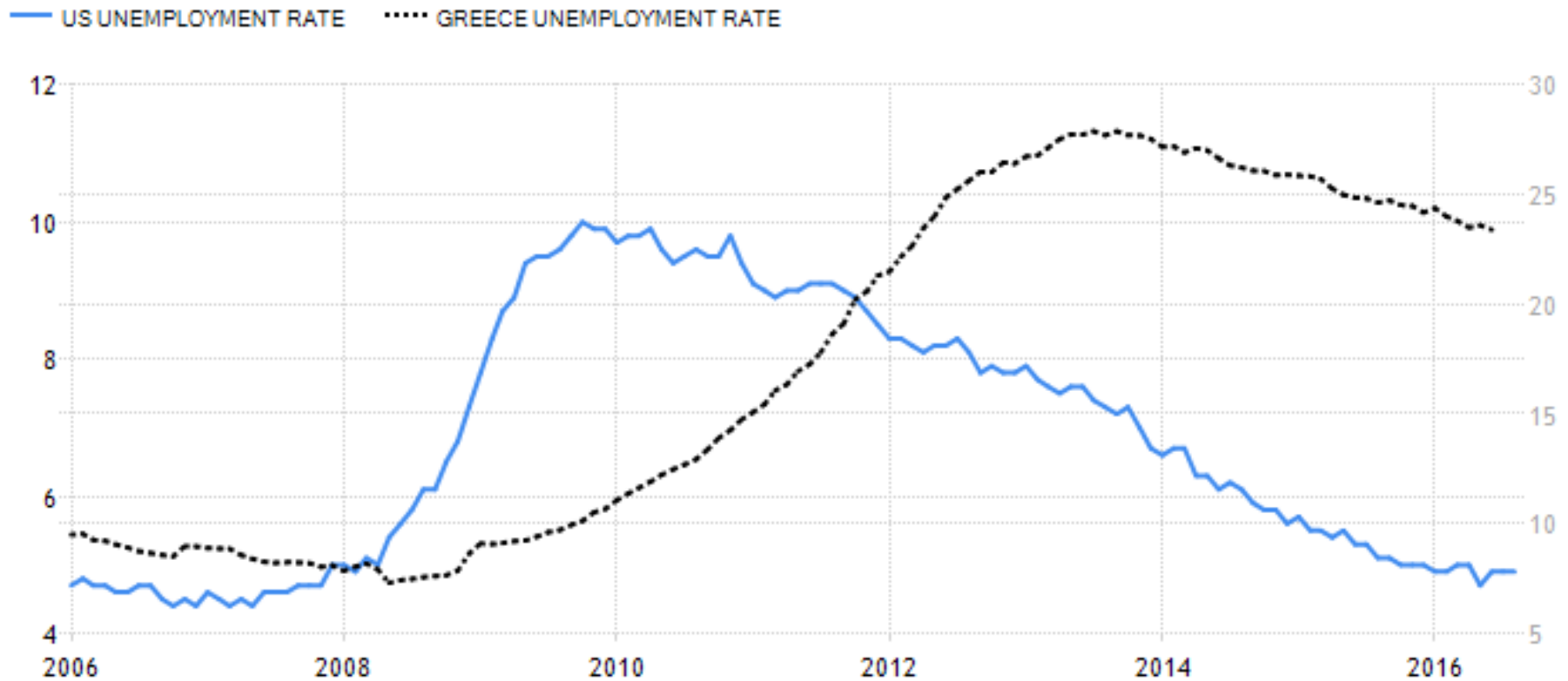
*Q2 2011 estimate

Unemployment in Europe

Why it differed among the EU member



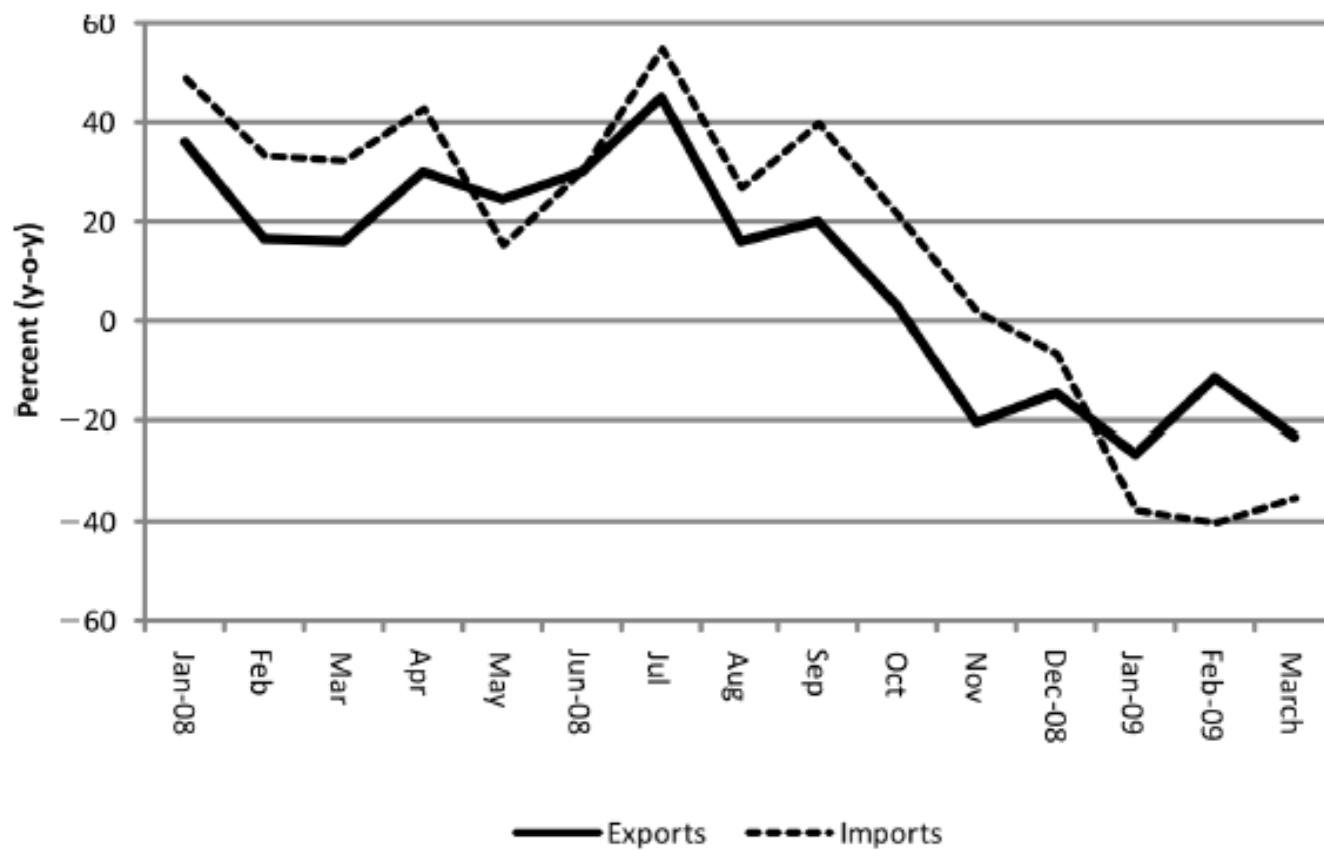
Unemployment in Greece and the US



SOURCE: TRADINGECONOMICS.COM

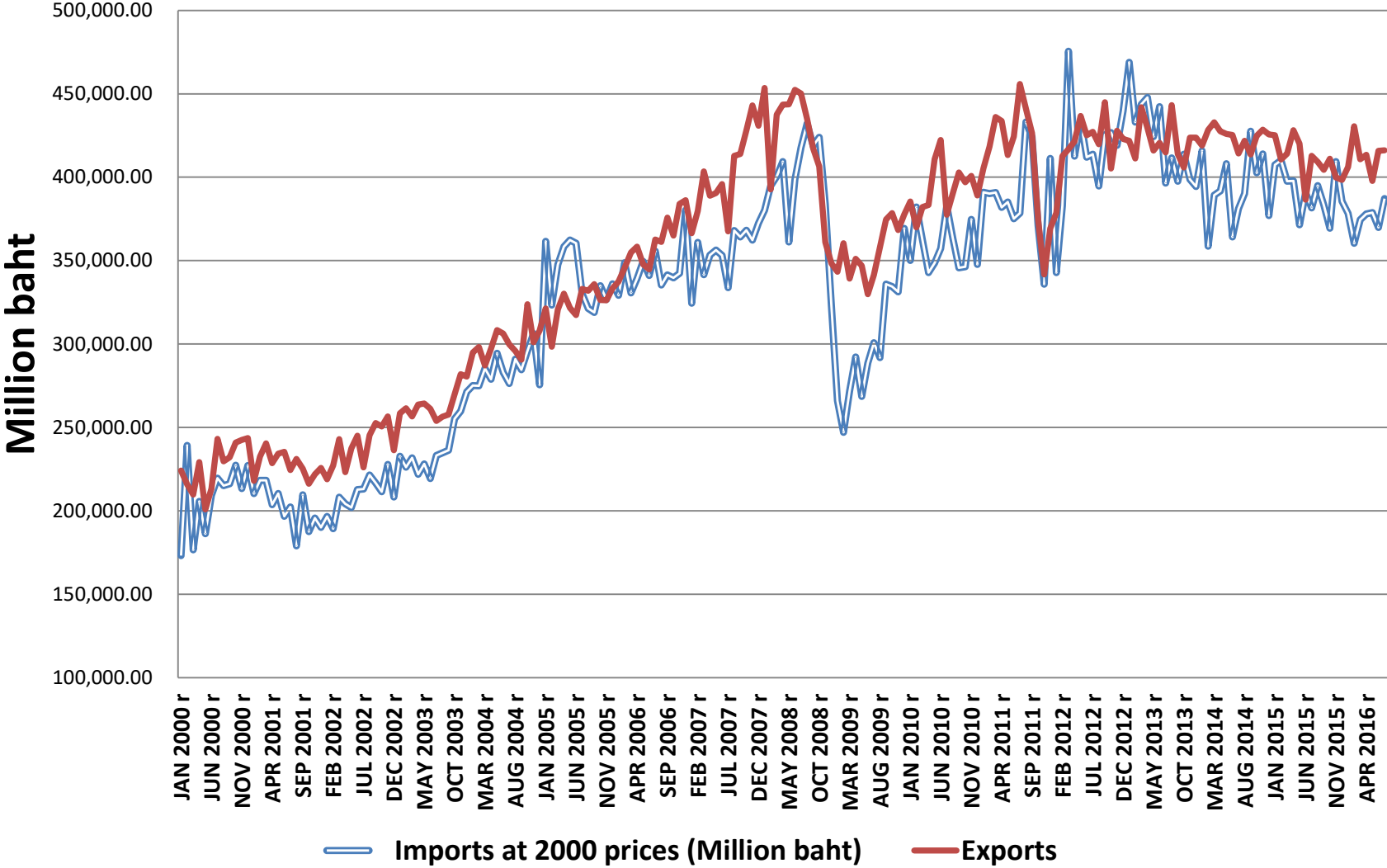
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Figure 1. The collapse of the last engine of growth



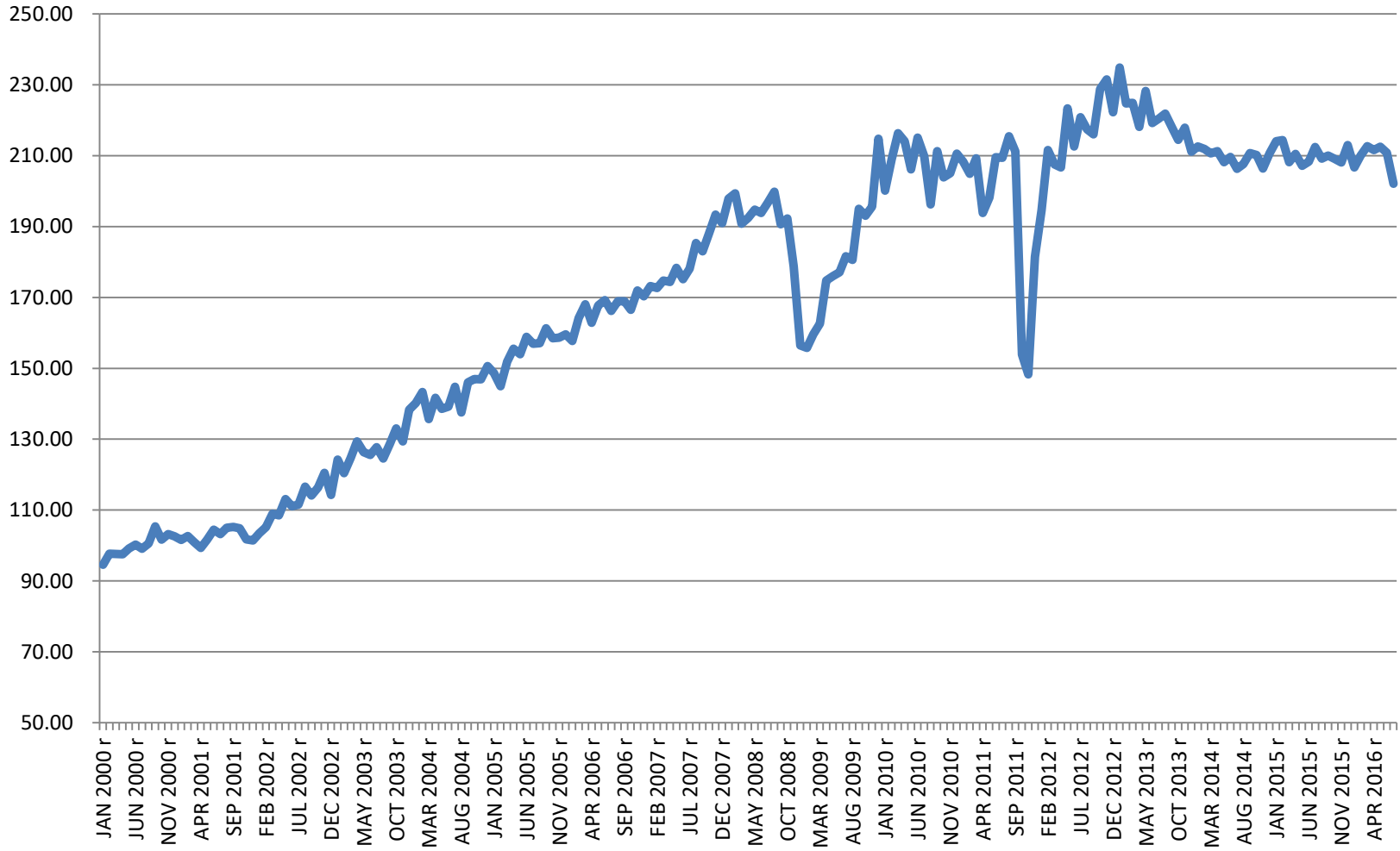
Source: Ministry of Commerce

Collapses of growth engines

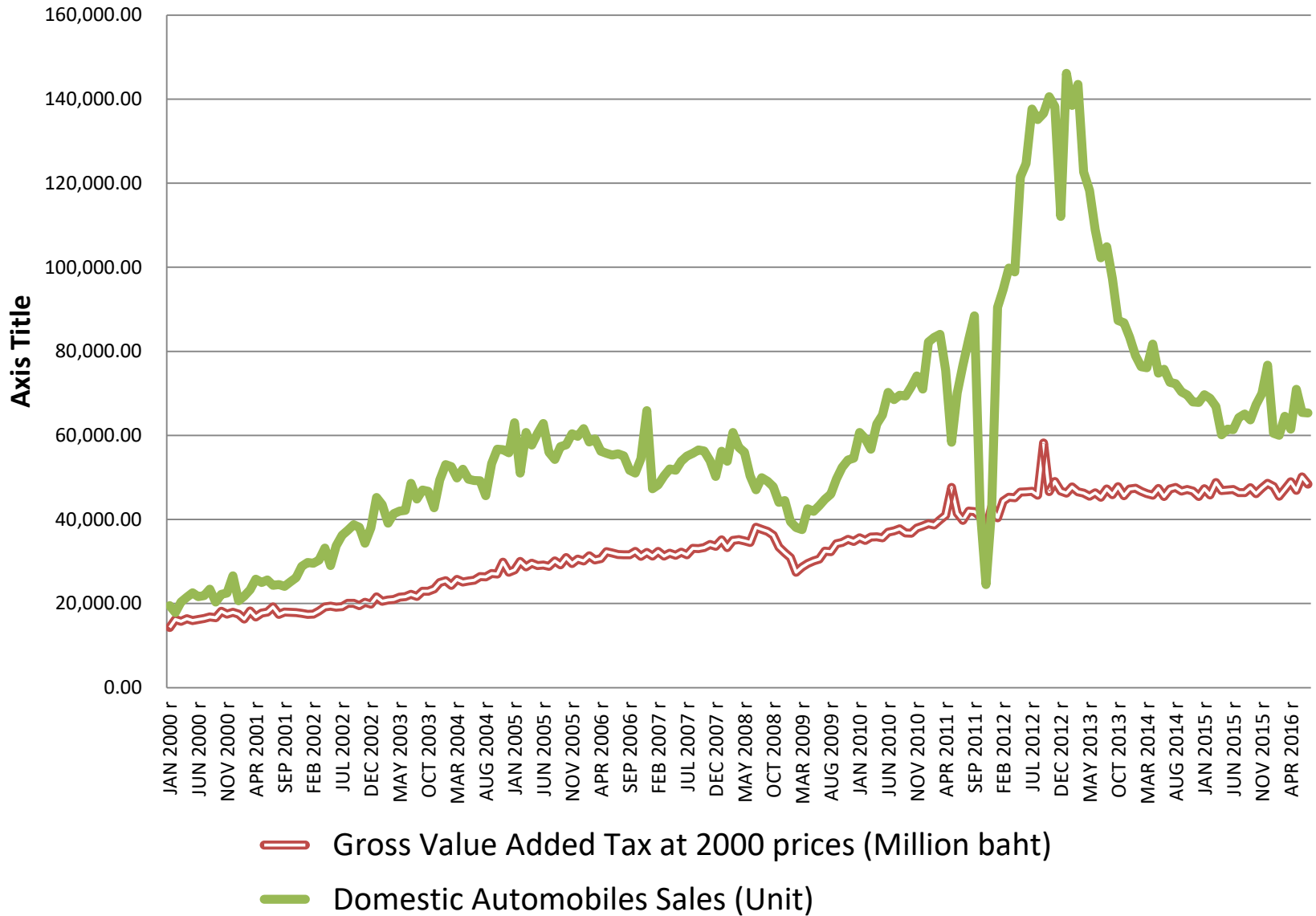


Manufacturing Production Index

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.

Contribution to GDP growth: 1990-96

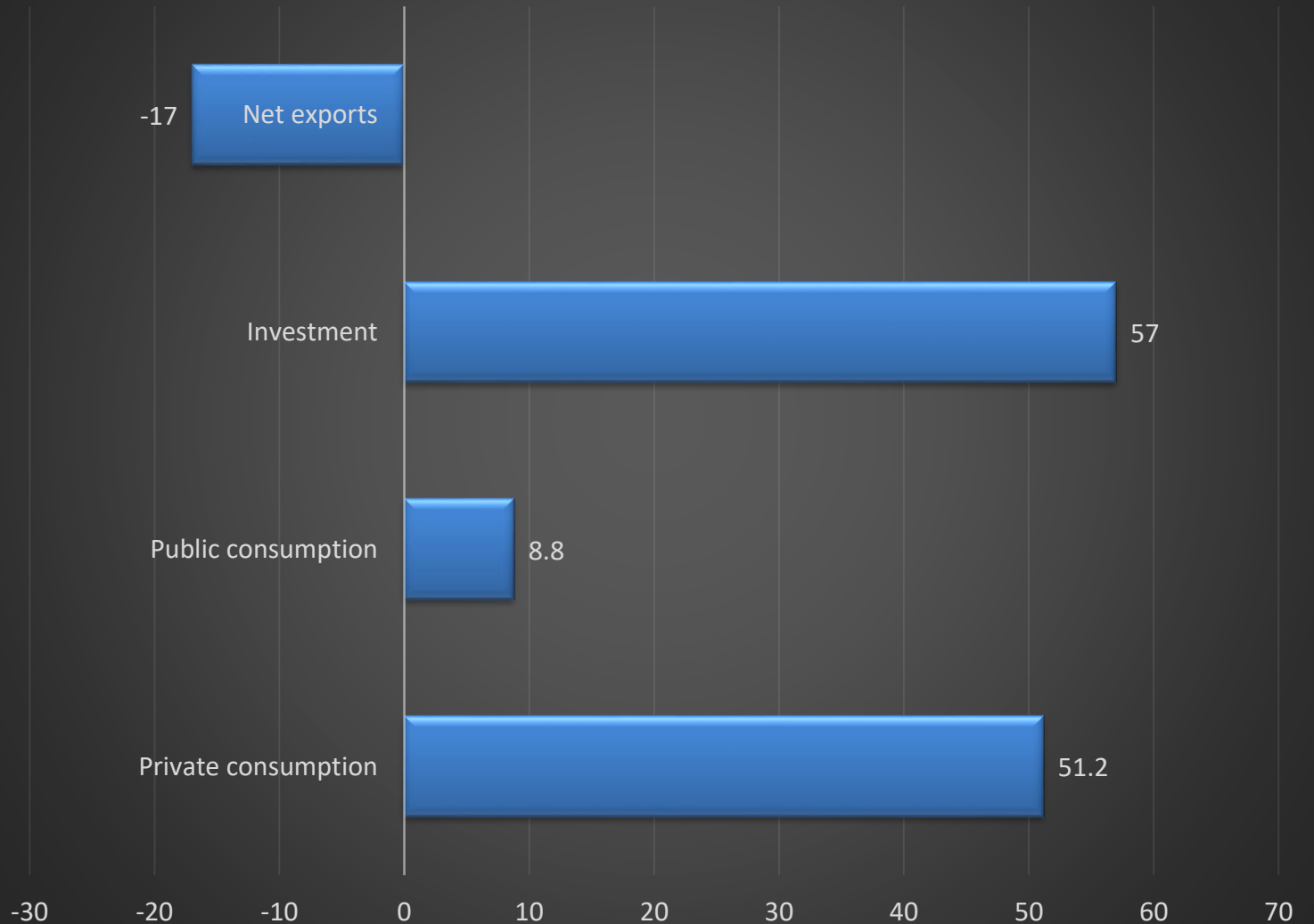
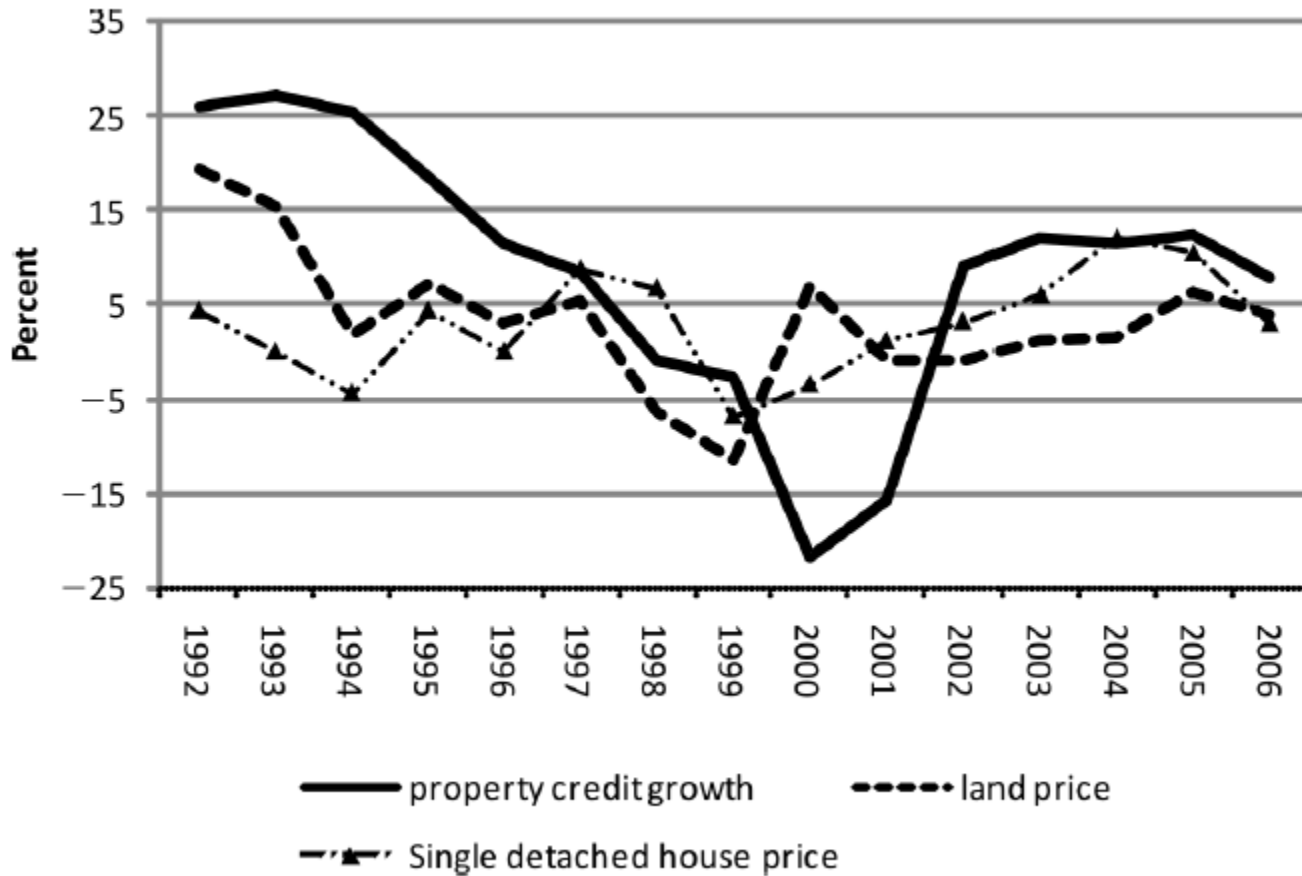


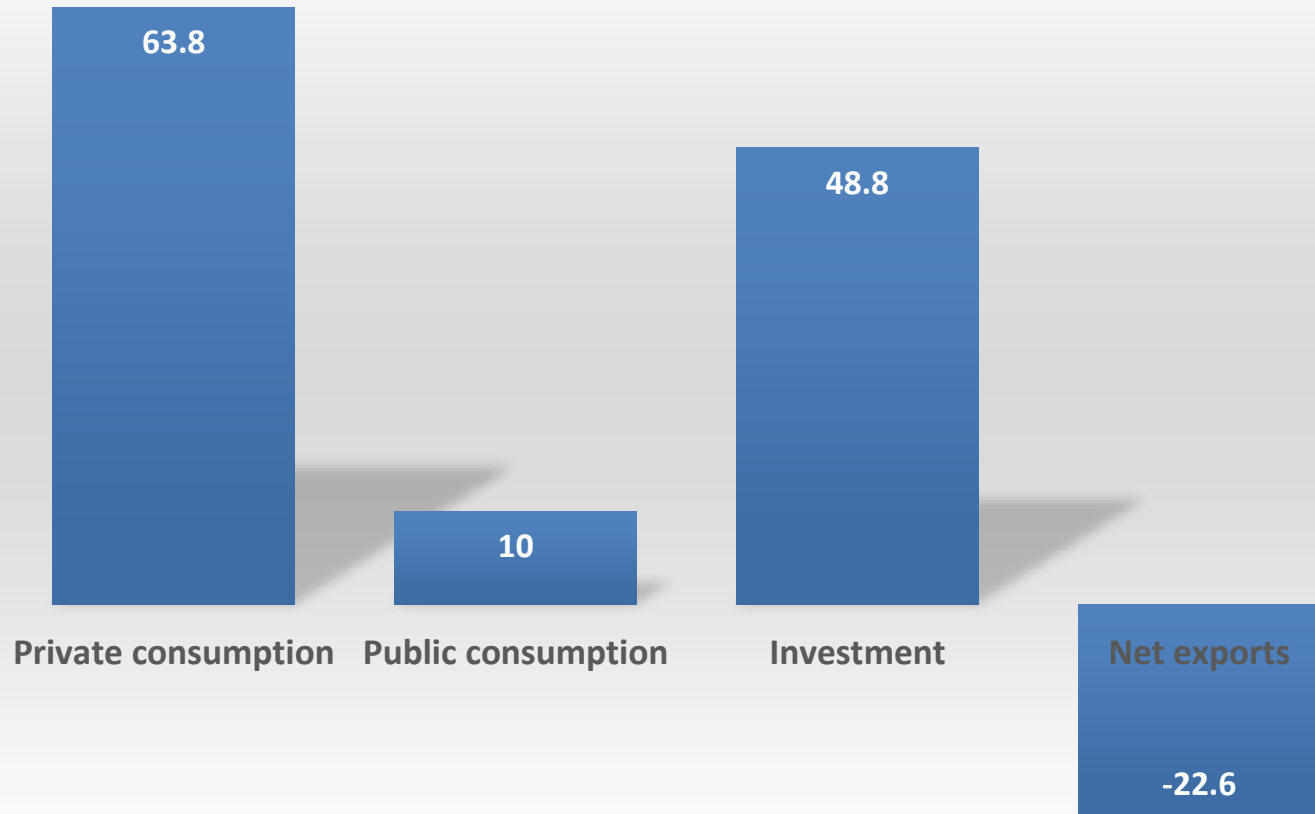
Figure 4. Real estate bubbles and property credit



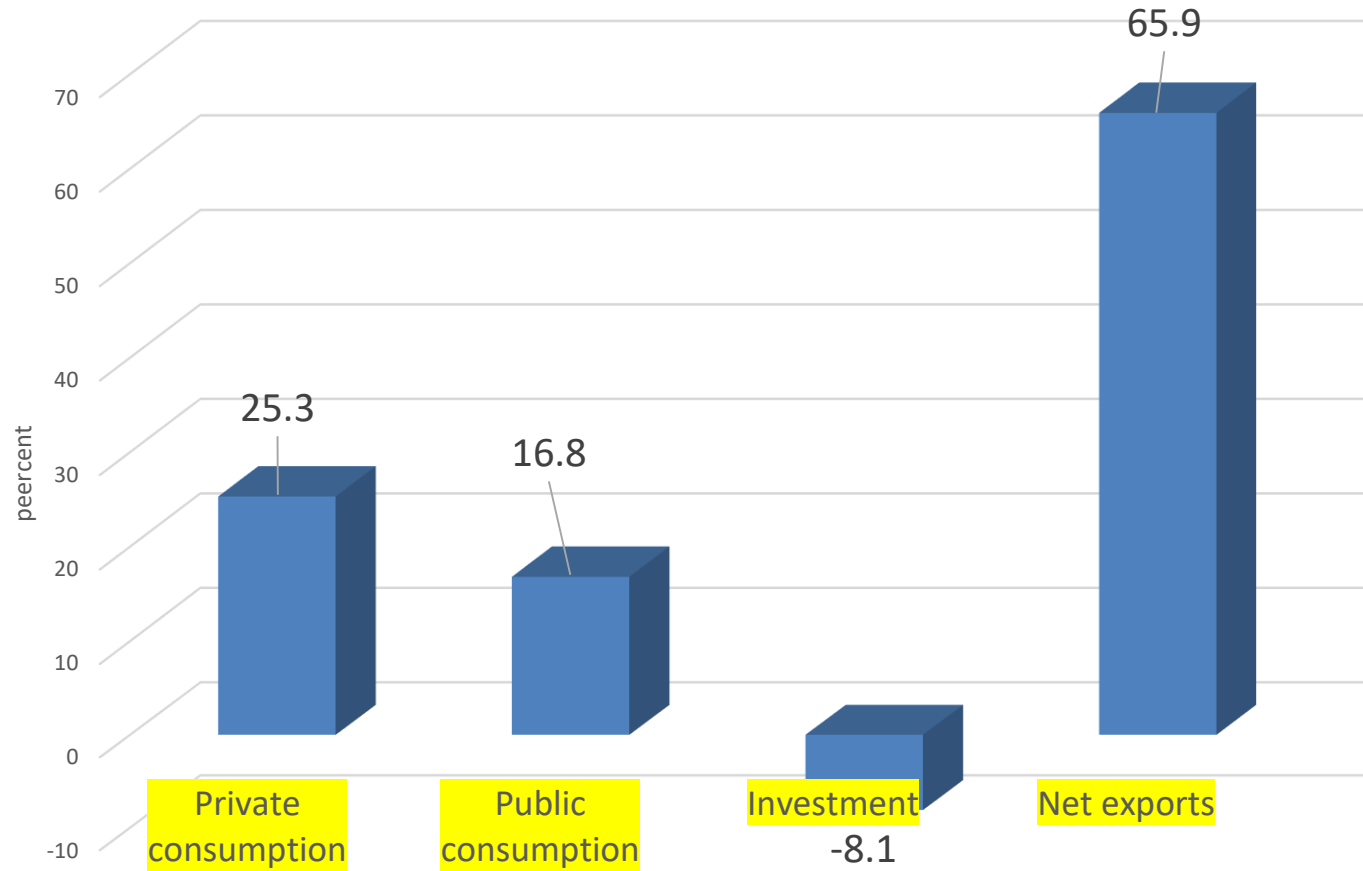
Austrian Business Cycle Theory

- The theory views business cycles as the consequence of excessive growth in bank credit, due to artificially low interest rates set by a central bank
- The Austrian business cycle theory originated in the work of Austrian School economists Ludwig von Mises and Friedrich Hayek, who won the Noble Prize in economics in 1974.

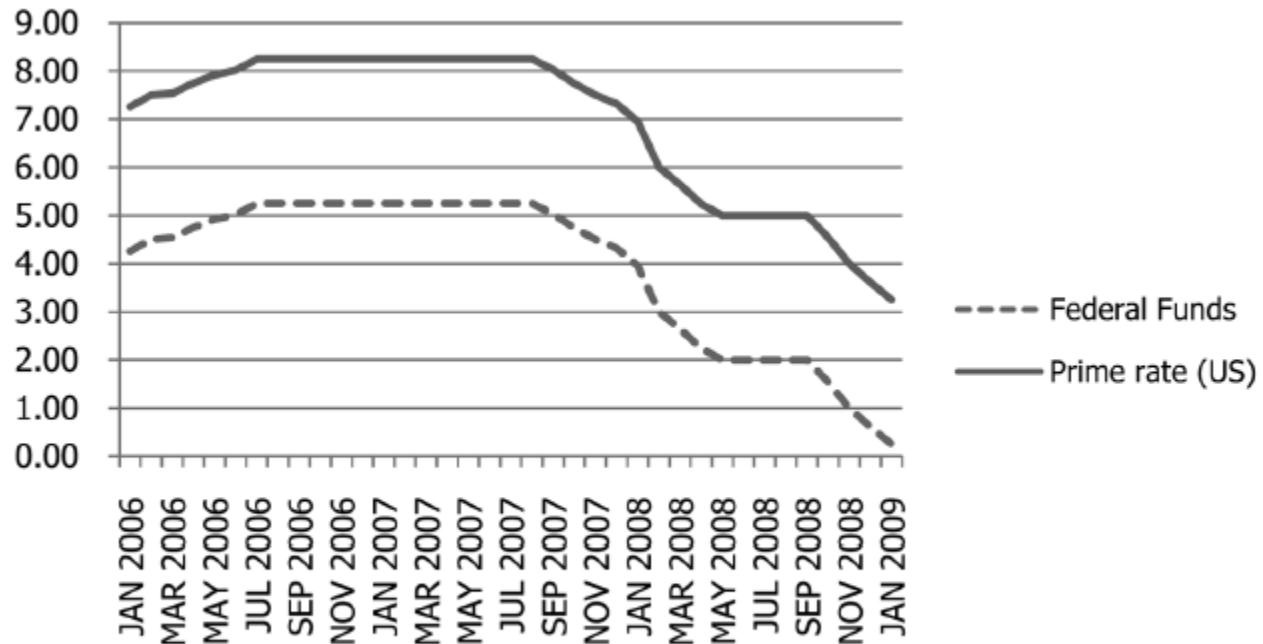
Contribution to GDP growth: 1999-2005



Contribution of GDP growth: 2006-07

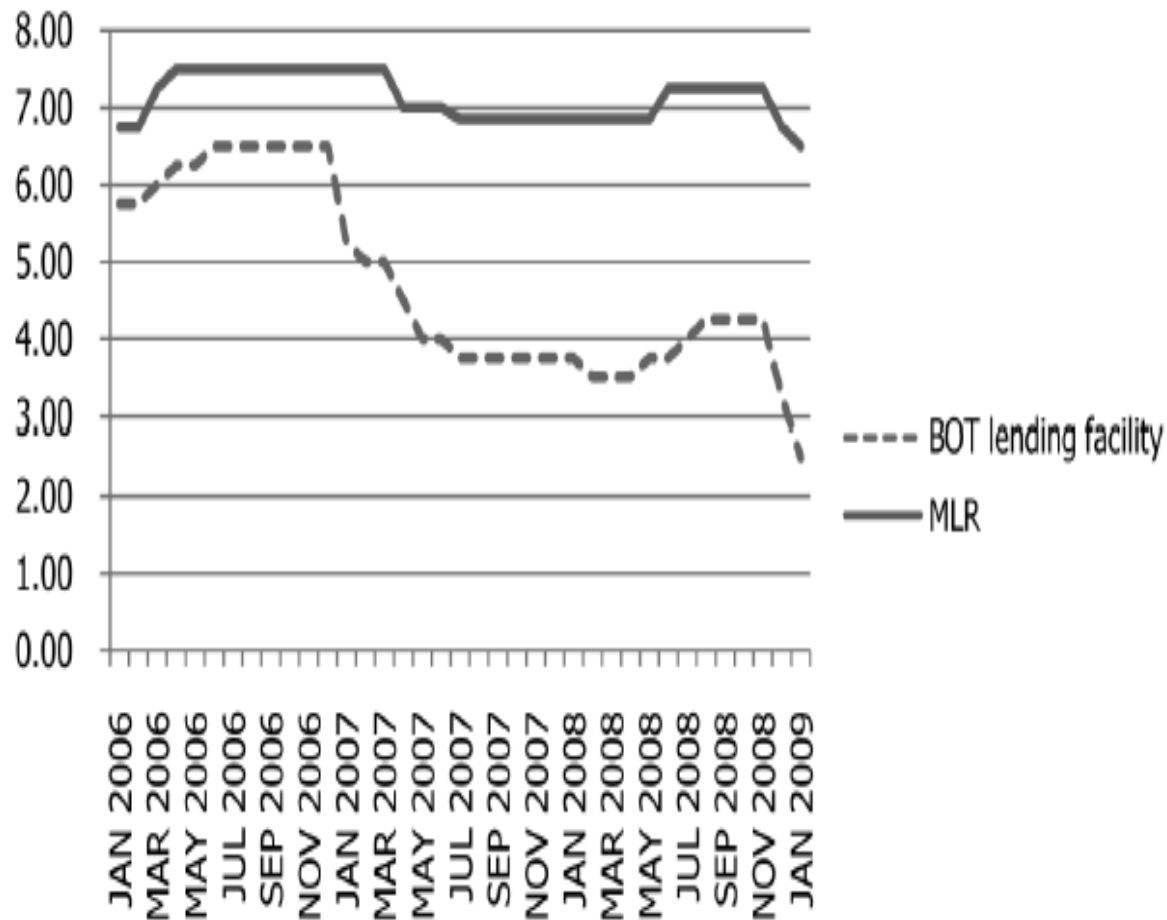


The Federal funds rate and impact on US prime lending rate



Source: Bank of Thailand.

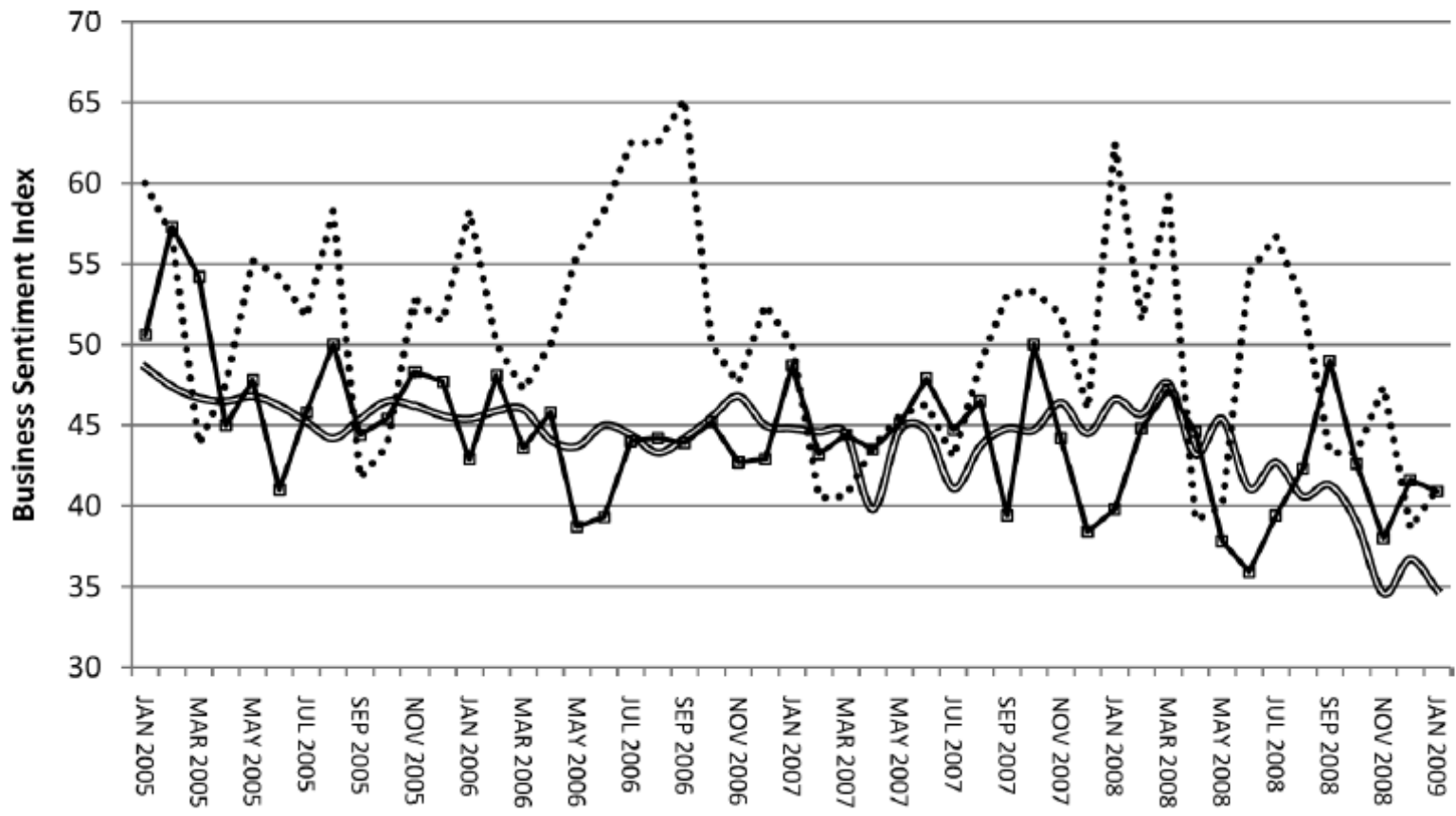
The BoT key policy rate and impact on commercial bank Minimum lending rate (MLR)



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.

Weak rule of law and rampaging corruption: 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 depends on: output prices, domestic and foreign orders, and liquidity.

Military finally dumps B350m airship

Source: Bangkok Post: September 15, 2017

- The army has finally decommissioned its controversial 350-million-baht airship after eight years' service during which time the blimp crashed once while it was mostly grounded the rest of the time as it was plagued by various defects.
- The last time the airship was flown was on Dec 13, 2012, when it was used in a patrol operation during a visit to the deep South by former prime minister Yingluck Shinawatra.

Check Thailand's CPI world ranking between 2012 and 2016

UPS, BUT MOSTLY DOWNS

Timeline of events over the past eight years for the army airship bought for 350 million baht while Interior Minister Anupong Paojinda served as army commander amid fierce criticism it was too expensive.



■ March 10, 2009
The Democrat Party-led government approves a budget of 350 million baht for the army under Gen Anupong's leadership to buy the airship, systems and accessories through a special procurement process. The airship is destined to carry out surveillance operations in the far South.

■ April 23, 2009
The army signs a contract to buy the blimp from Aerial International Corporation.

■ Dec 18, 2009
The airship is commissioned into service with a special task force of the 15th Infantry Division in Nong Chik district of Pattani.

■ Jan 15, 2010
The army aims to use the airship for the first time but is forced to postpone its plans after technical problems.

■ March 5, 2010
A committee tasked with monitoring the performance of the airship upon taking delivery of it finds several

problems with its camera and balloon while the blimp can reportedly fly at only one-third the height claimed in its specifications, which is too low if shot at from the ground.

■ May 27, 2010
The committee, however, approves the delivery of the airship in spite of public criticism over the performance and capability issues.

■ July 23, 2010
The army asks the supplier to replace it with a new one after ruptures and leaks are detected. But in the end the army agrees it should only be repaired.

■ Aug 3, 2010
Gen Anupong dismisses corruption allegations in the airship's procurement, saying all officials involved strictly followed the law and the repair of the airship is covered under its warranty.

■ Oct 1, 2011
Gen Prayut Chan-o-cha succeeds Gen Anupong as the new army commander.

■ Feb 18, 2011
Military personnel fly the airship for the first time to test its performance after the repairs.

■ March 17, 2011
The Pheu Thai Party grills Mr Abhisit in the House for approving the budget to buy the blimp.

■ February, 2012
The airship is flown again in a new test but can fly at an altitude of 500 metres for only a couple of hours.

■ September, 2012
The army signs a contract to hire Worldwide Aeros Corp and M-Landarch Co to repair the airship at a cost of 50 million baht.

■ Dec 13, 2012
The airship suffers an accident when its pilot loses control of the vessel while descending near its hangar after a flight.

■ Jul 18, 2013
The 4th Army denies decommissioning the airship, saying it is under repair again.

■ Sept 5, 2014
The airship makes an emergency landing in a paddy field in Pattani's Yarang district after encountering strong winds and poor visibility.

■ Dec 24, 2015
The National Anti-Corruption Commission dismisses a petition lodged with it against former deputy prime minister Suthep Thaugsuban for alleged dereliction of duty in connection with the airship's procurement.

■ Sept 14, 2017
Incumbent army chief Chalermchai Sitthisad confirms the decommissioning of the blimp eight years after it was procured.

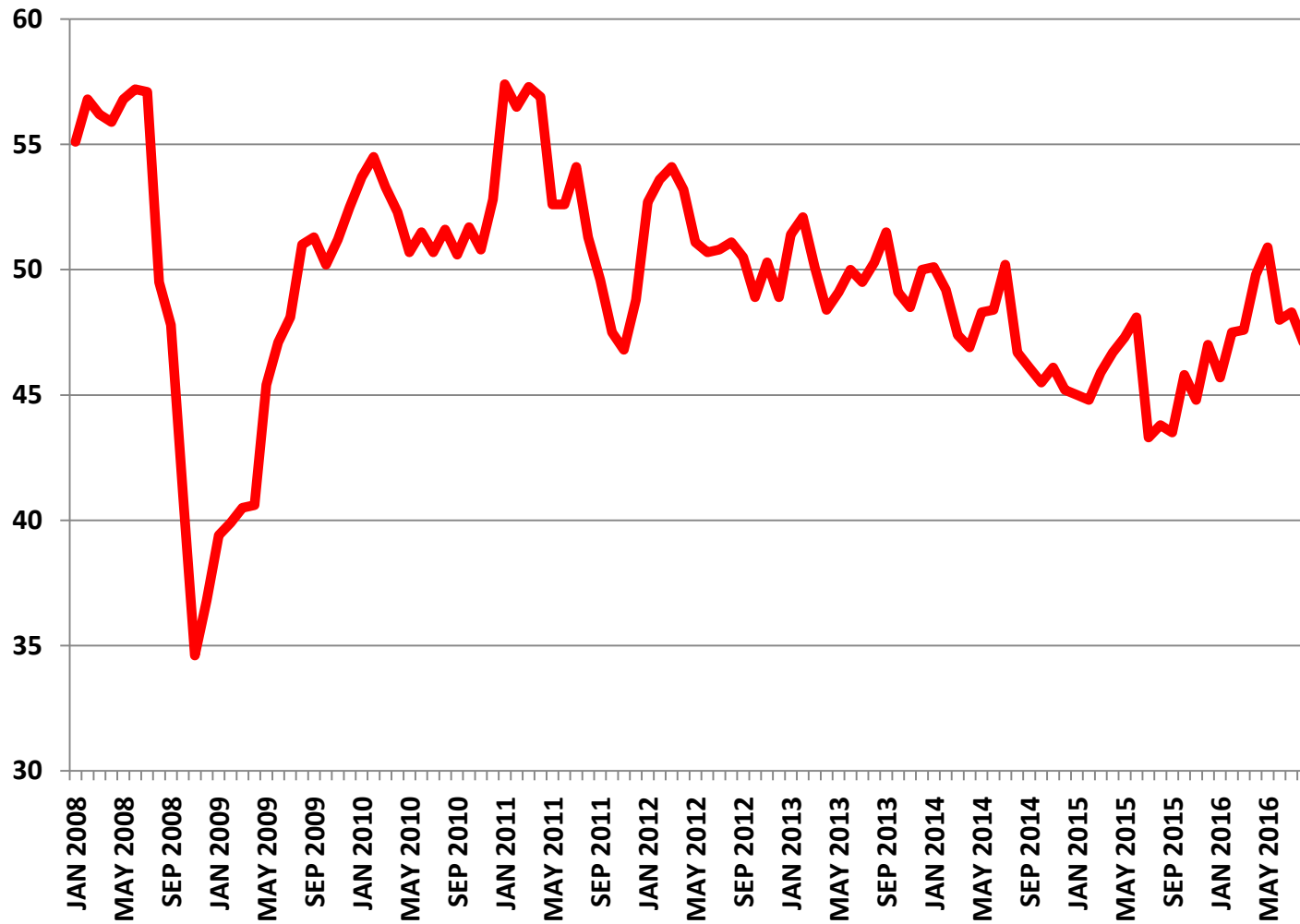
In the name of security surveillance

- The army reportedly had to spend up to 25 million baht in some years on refilling the airship with helium, even though it was almost never used.
- Gen Prayut, as army chief, approved the hiring of a private company to maintain the airship at a cost of 50 million baht a year, which allowed the blimp to be flown again occasionally on security surveillance operations.

Dereliction of duty

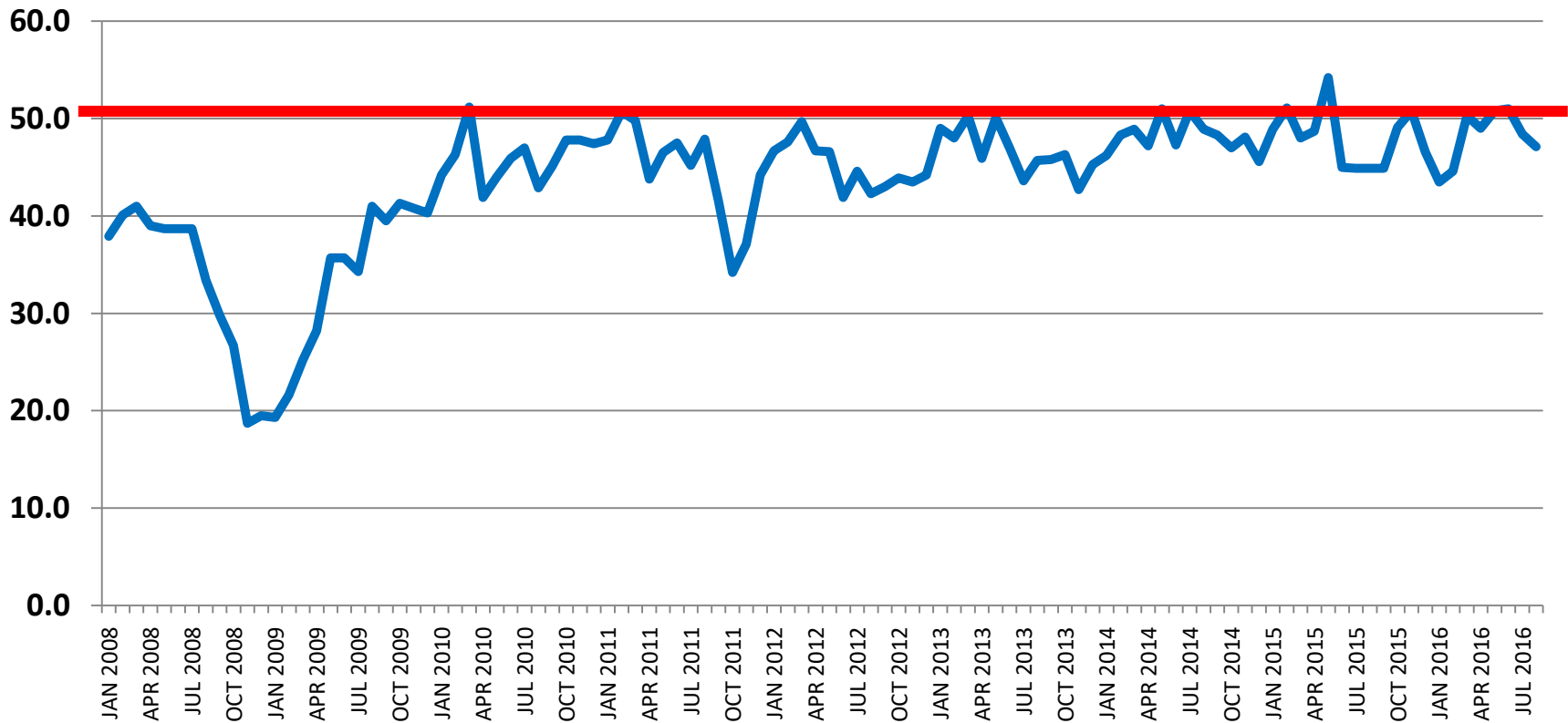
- The purchase of the controversial airship previously triggered a dereliction of duty allegation against former deputy prime minister Suthep Thaugsuban.
- He was at the time accused by the Pheu Thai Party of failing to stop the army from buying the airship at an inflated price.
- Citing the dereliction of duty allegation, Pheu Thai petitioned the National Anti-Corruption Commission (NACC) to impeach Mr Suthep, but the NACC later on Dec 24, 2015 dismissed the request.
- The NACC said it found no evidence to prove that Mr Suthep was guilty of dereliction of duty.

Business Sentiment Index: *output prices*



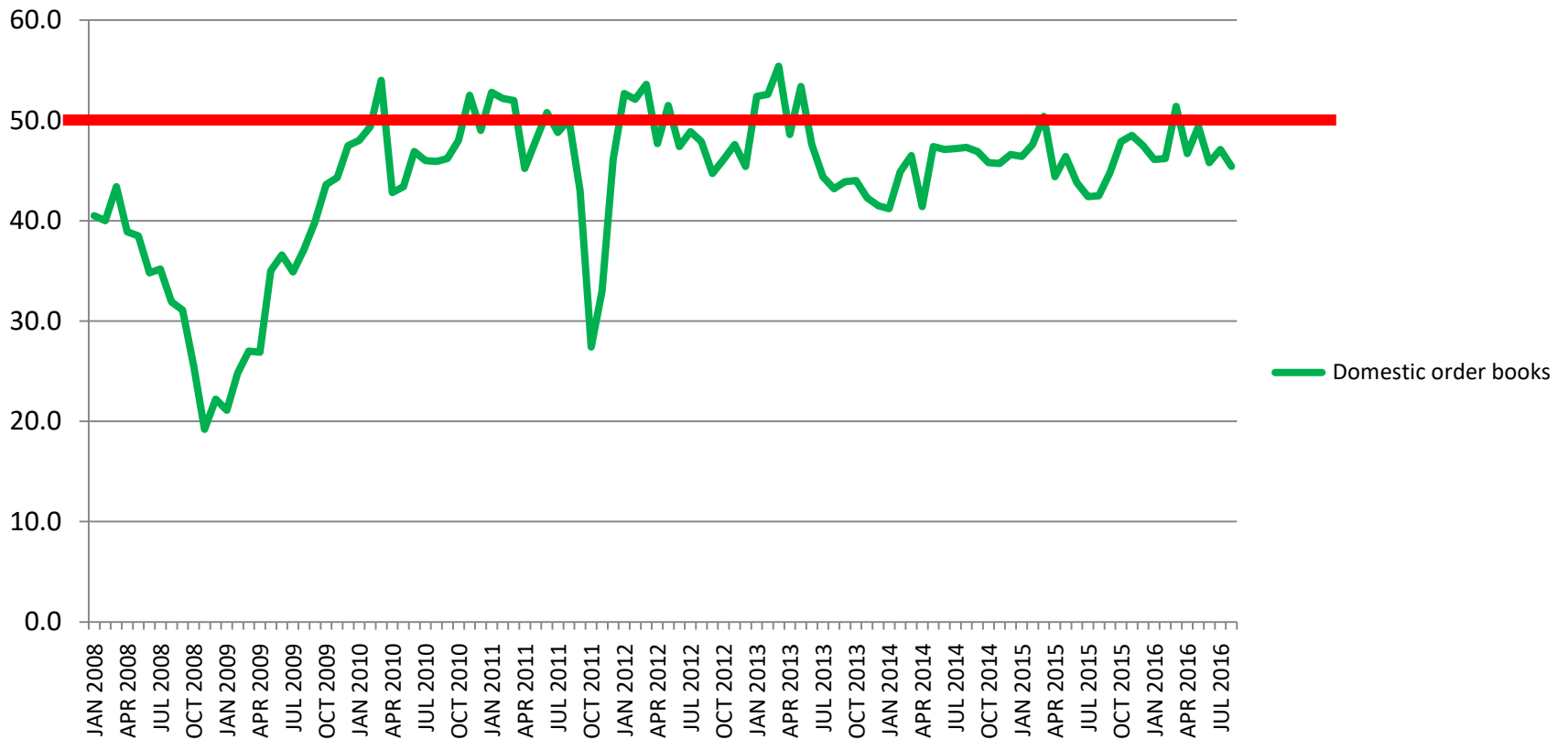
Business Sentiment Index:

Foreign order books



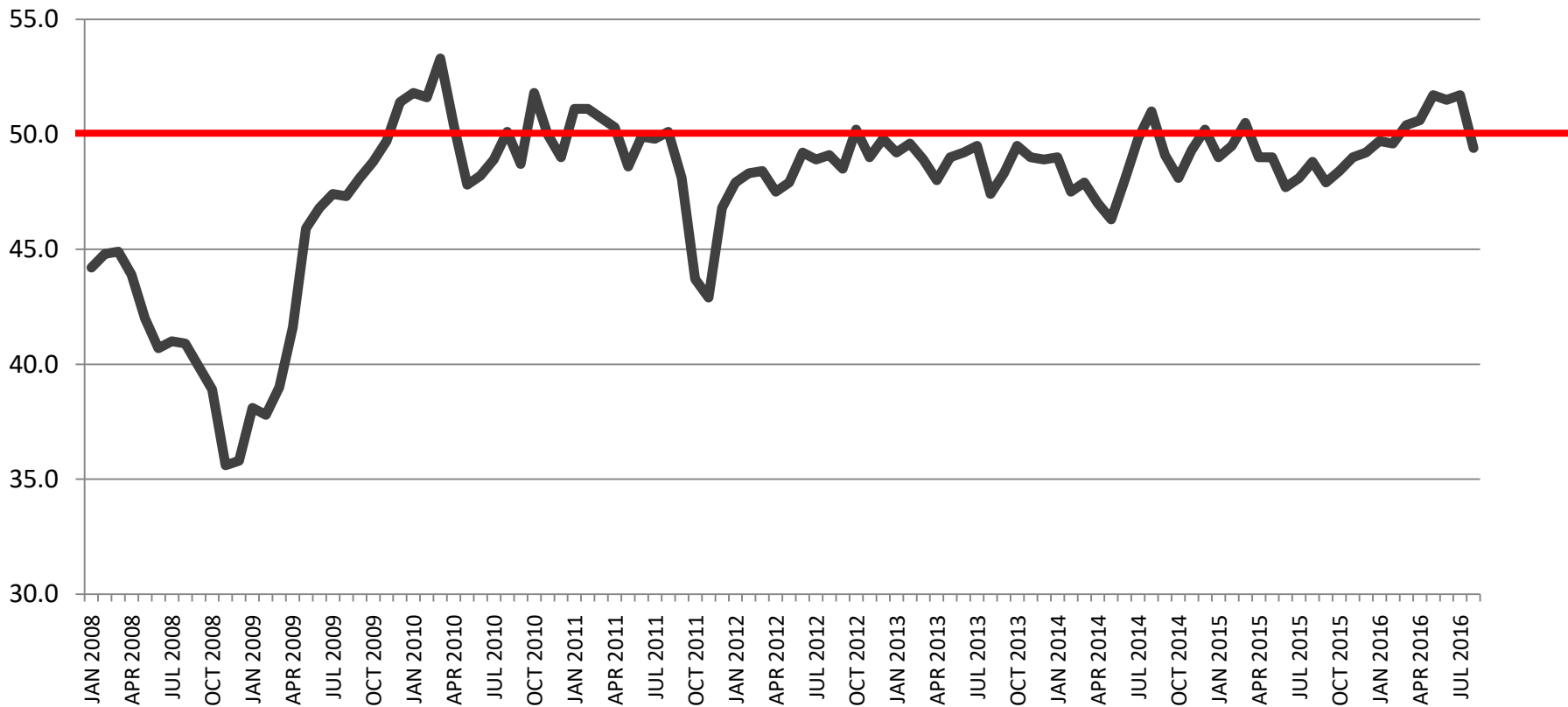
Business Sentiment Index:

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

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

Bhanupong Nidhiprabha

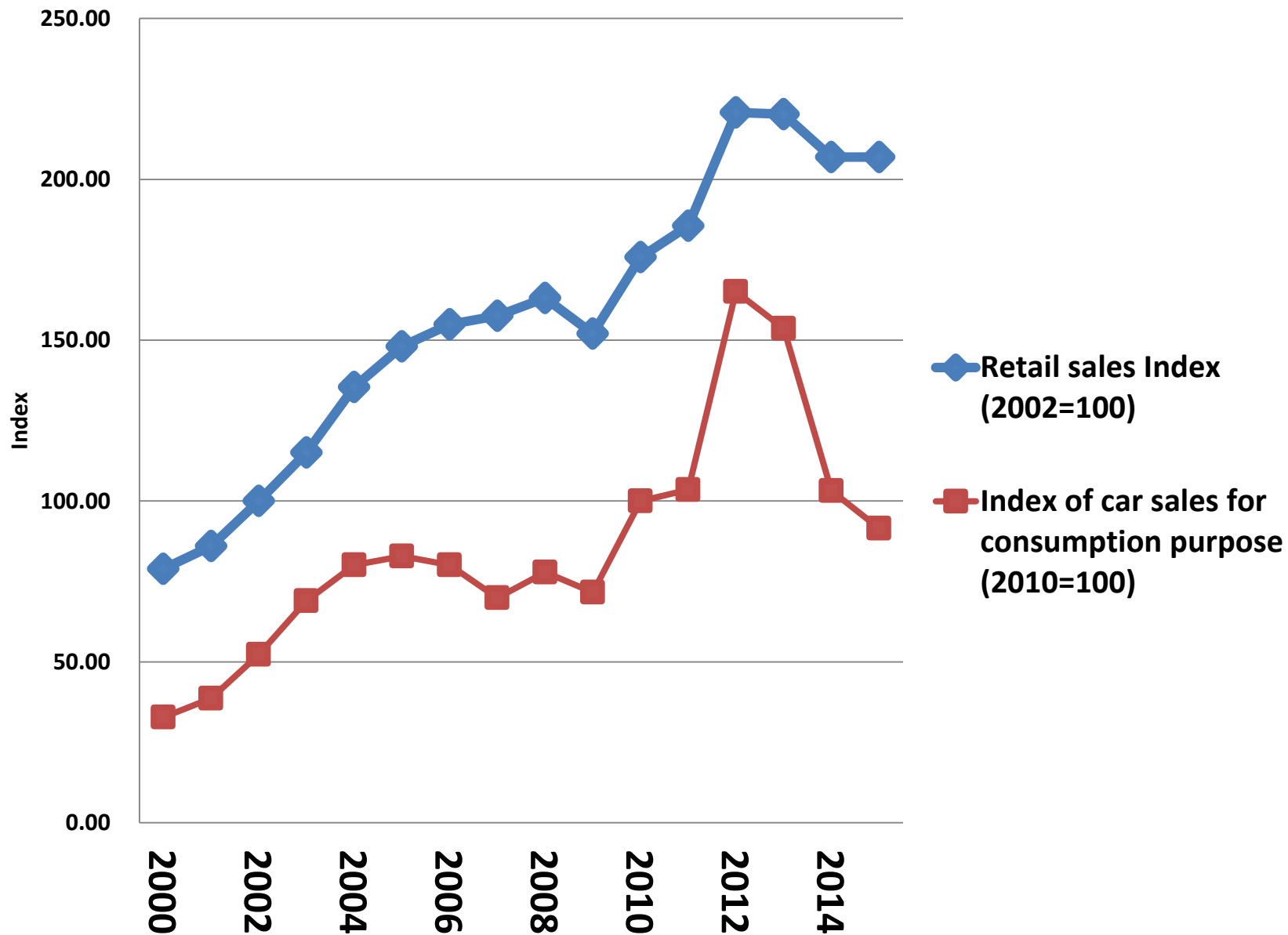
This paper investigates Thailand's macroeconomic policy responses to the global financial crisis in 2009. Empirical evidence found in this paper indicates that fiscal policy is relatively less effective than monetary policy. Tax reduction is more powerful in stimulating output than government spending.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

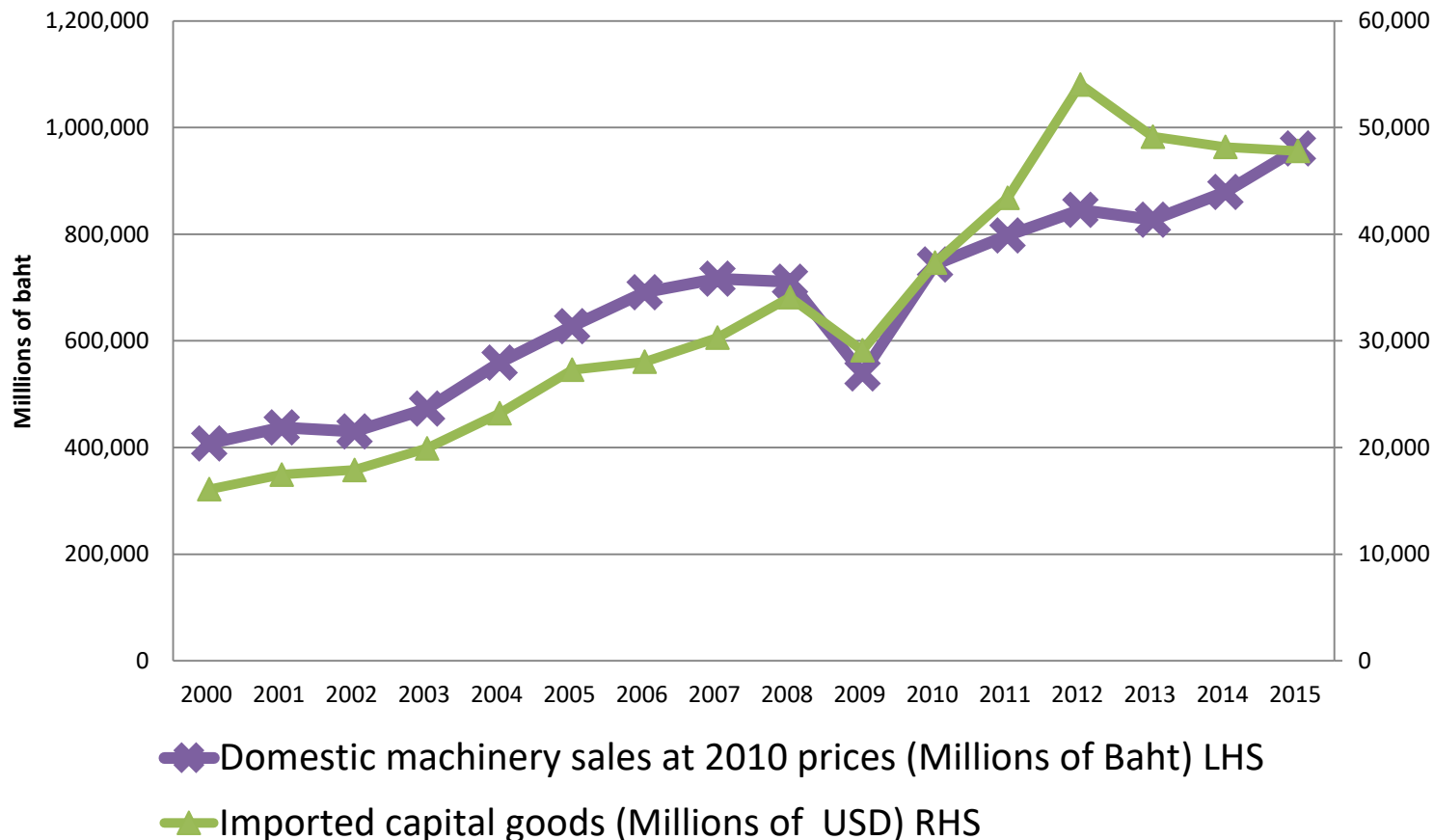
	<i>Output</i>	<i>Business sentiment index</i>	<i>Inflation</i>
2000–05	2.96	2.42	1.43
2006–09	11.3	3.44	3.06

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.

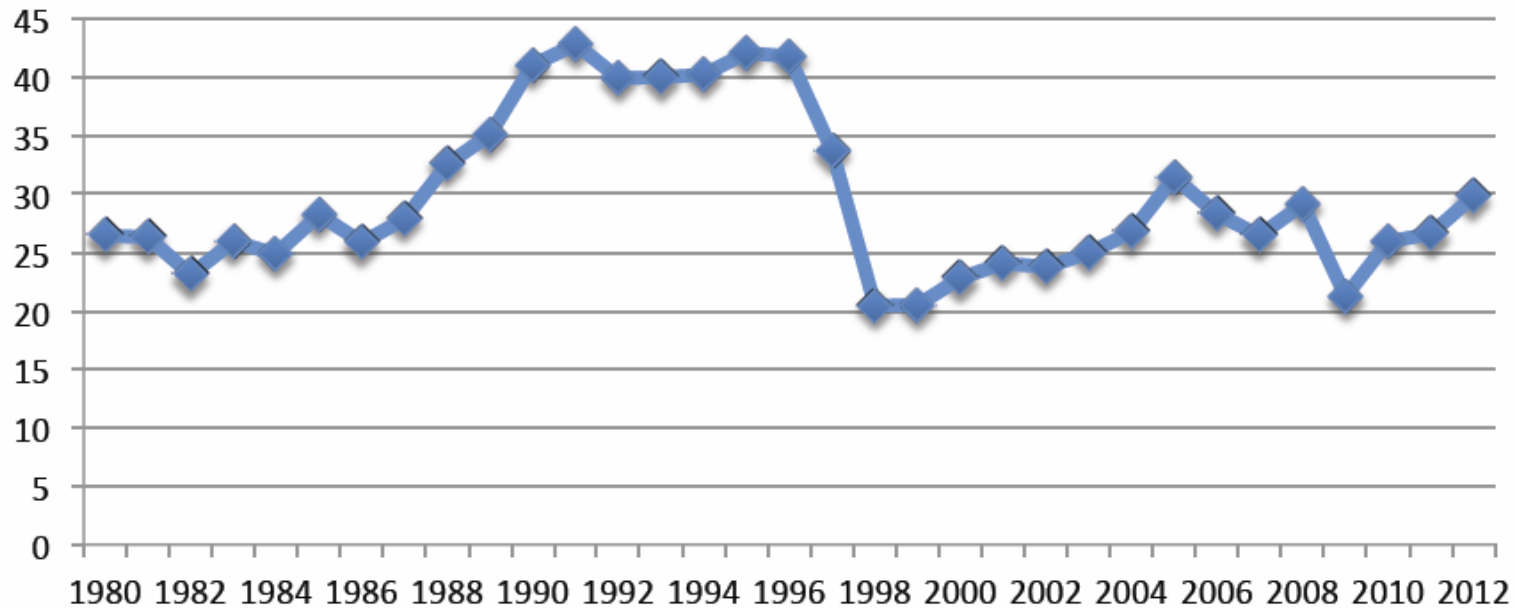
Monetary policy remains effective despite the high degree of capital convertibility because its impact on the exchange rate intensifies the initial impact of monetary policy on the aggregate demand.

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 (%)

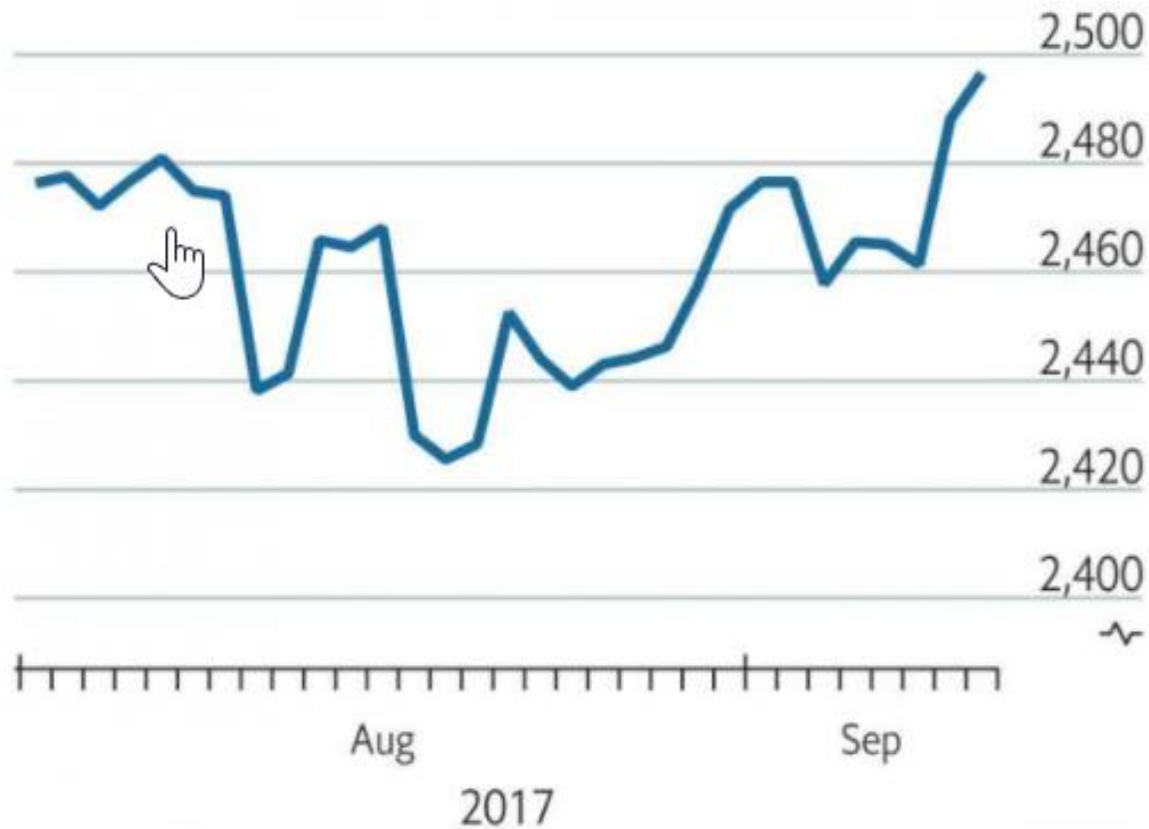


Bulls are back

- The S&P 500 index managed another record closing high on Tuesday, signalling not just relief that hurricane Irma caused less damage than feared but diminishing concern, at least for the moment, about the prospect of military confrontation with North Korea.
- There will be wobbles, but investors hope they can now return to focusing on some positive economic fundamentals.

New heights

S&P 500, 1941-43=10



Source: Thomson Reuters

Bulls are back: Wall Street

- Most fund managers think that global growth will strengthen and corporate profits increase over the next year, according to a poll by Bank of America Merrill Lynch.
- The main threat to the markets may not be a Jong Un, but a Janet.
- The stronger the global economy looks, the more central bankers such as Janet Yellen of the Fed will seek to withdraw the stimulus they have provided since the financial crisis.
- Today the Bank of England will be the latest central bank to signal its intentions.

On September 14, 2017

Philippine stocks rise to record close, SET to 24-year top

- The Stock Exchange of Thailand (SET) rose 1%, closing at their highest since January 1994.



Zombies and Ghost Cities 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 in 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

- 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.

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 1990s.

Zombie firms in China

- 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.
- 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.