The hard road ahead for Thailand's economic recovery

Effectiveness of macro policy in response to shocks

Bhanupong

Lecture 9

Course Syllabus
Lecture 9

(1) The long road ahead for Thailand's economic recovery

(2) Effectiveness of policy responses to shocks

Key words

- Austrian Business Cycle Theory
- Coincident, leading, and lagging indicators
- Business sentiment and consumer confidence
- Volatilities of macro variables
- Effectiveness of fiscal and monetary policy
- Hysteresis
- The K-shaped recovery

1. The long road to recovery

The Hard Road Ahead for Thailand's Economic Recovery

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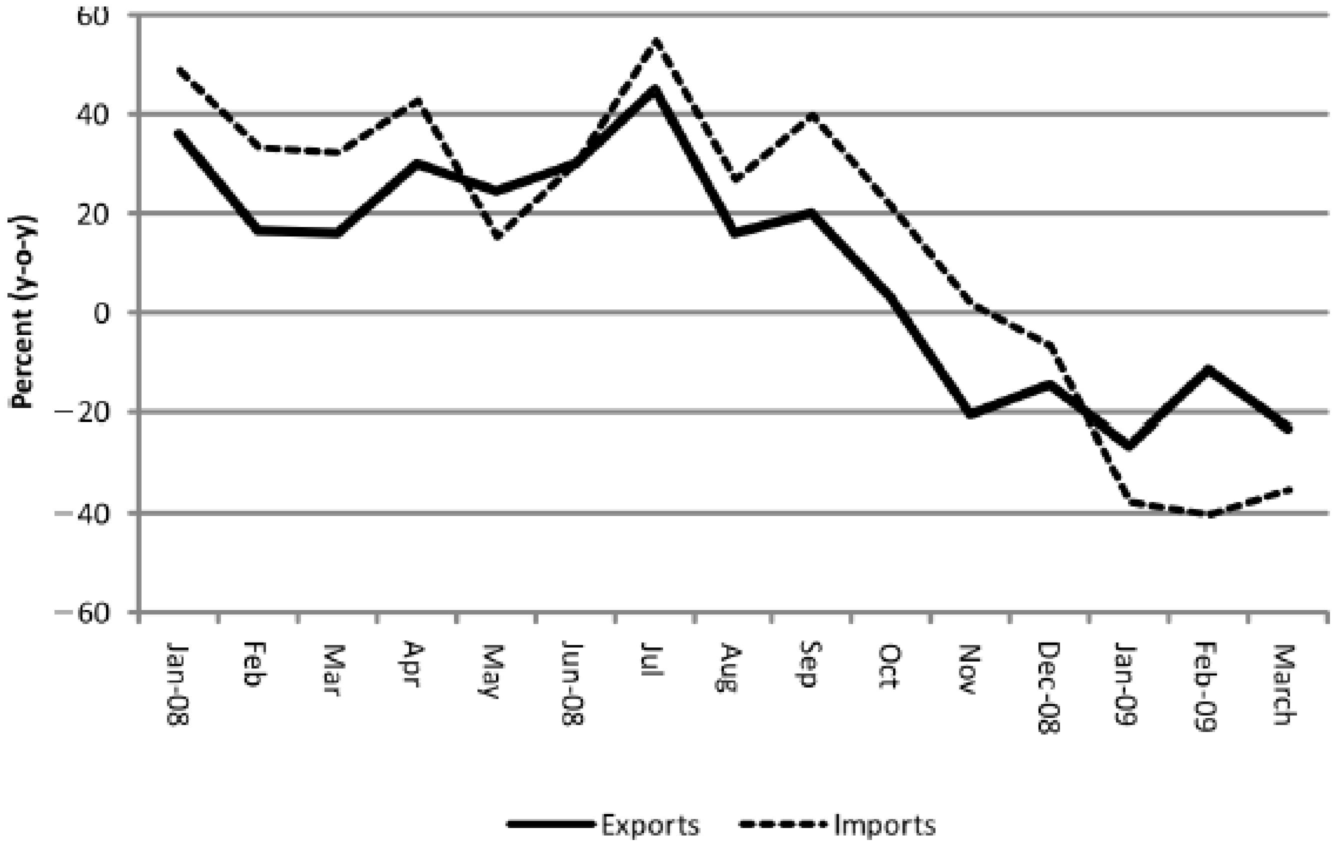
Abstract
Globalization leads to the increasing complexity of production networks through foreign direct investment, which transmits demand shocks from the rest of the world to the Thai economy. Short-term fiscal stimulus would not be able to shorten the length of recession unless consumer confidence 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.

Figure 1. The collapse of the last engine of growth



Source: Ministry of Commerce

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

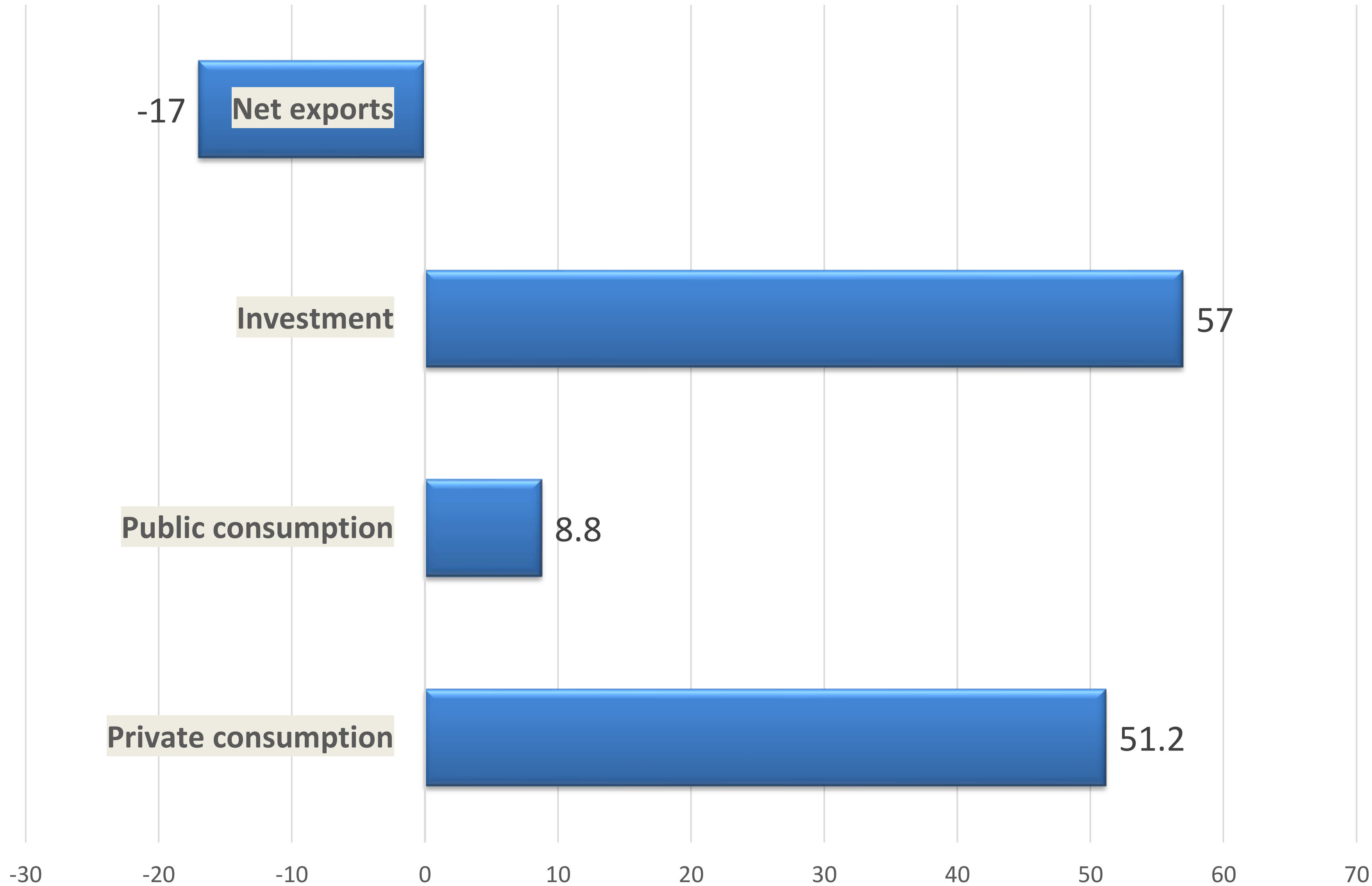
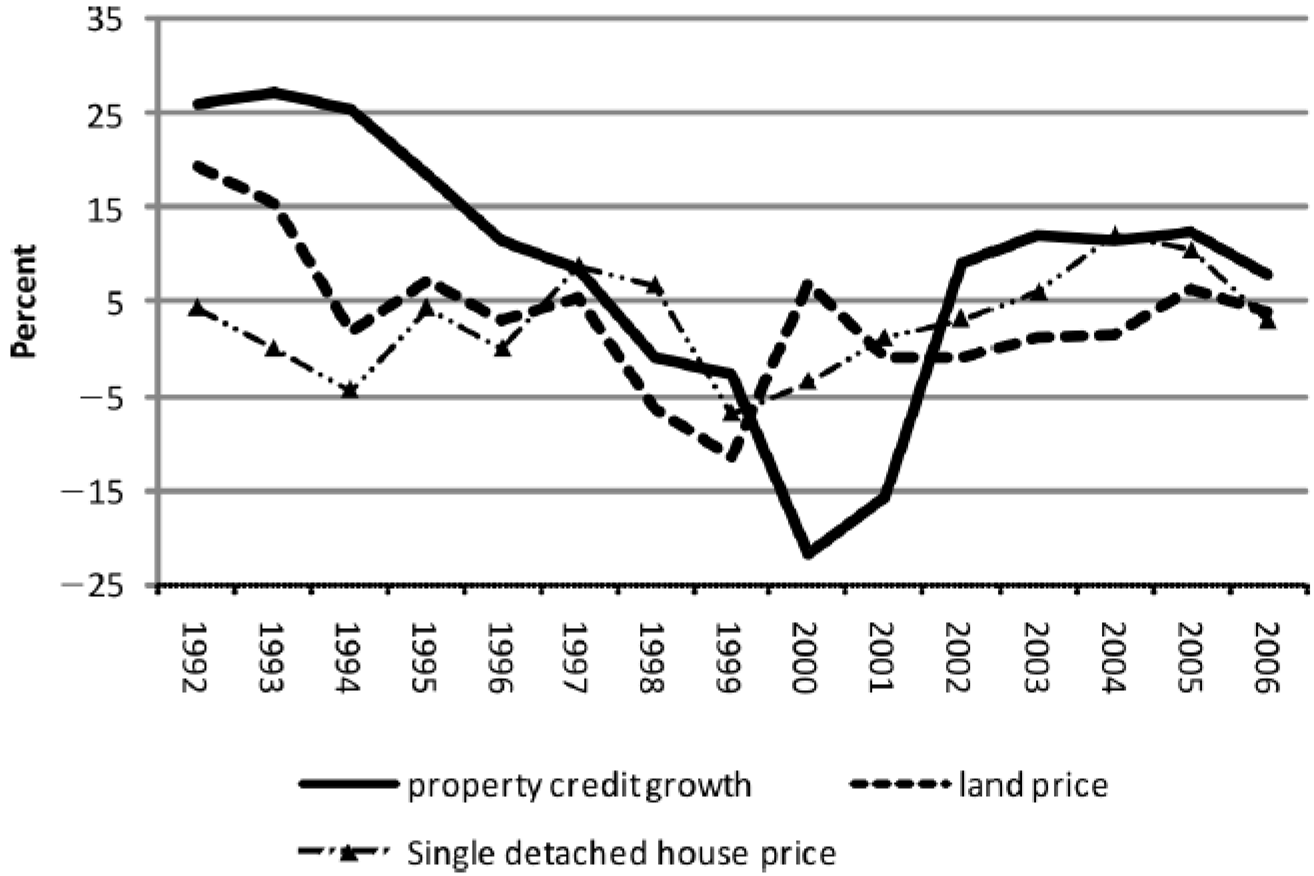


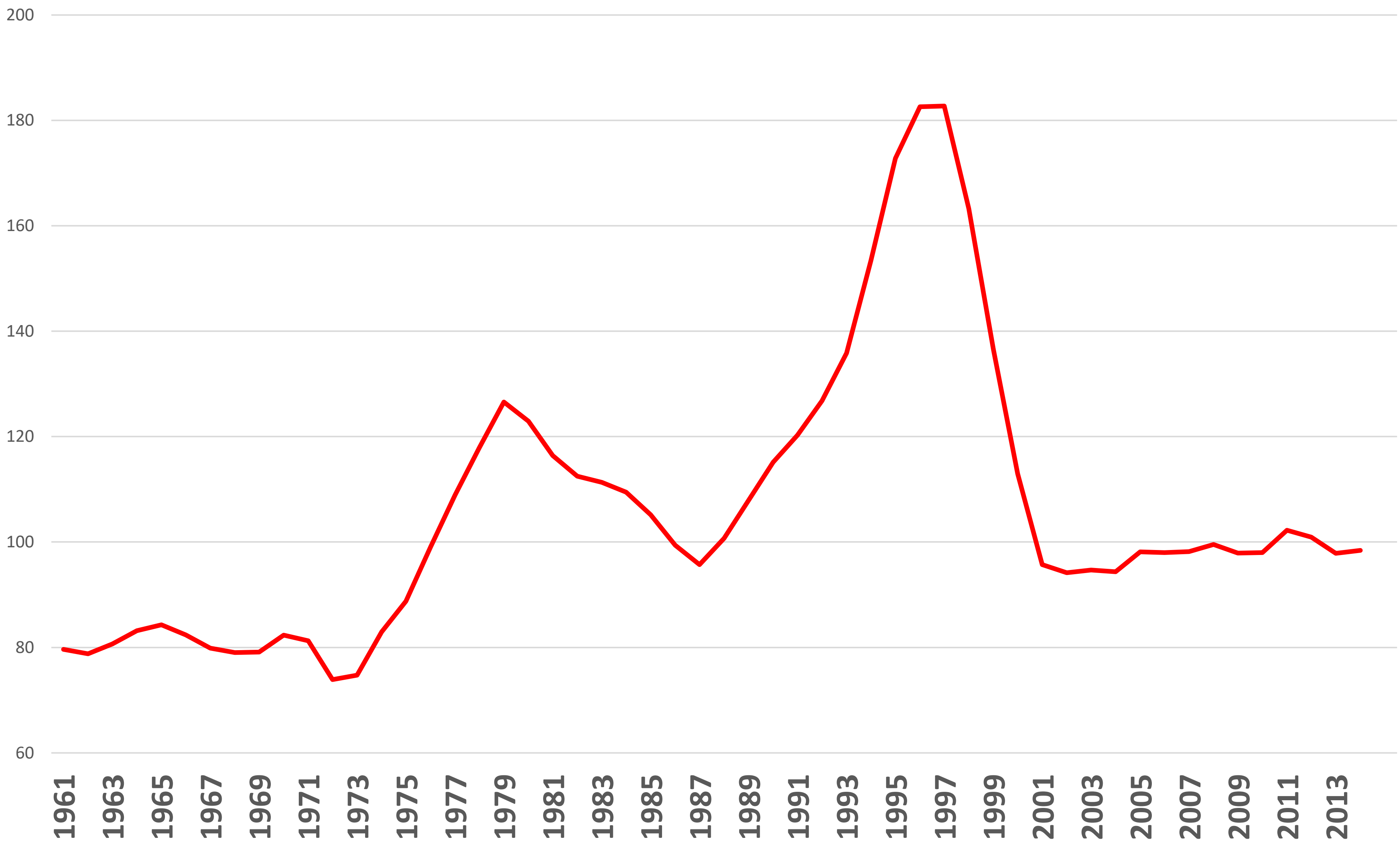
Figure 4. Real estate bubbles and property credit



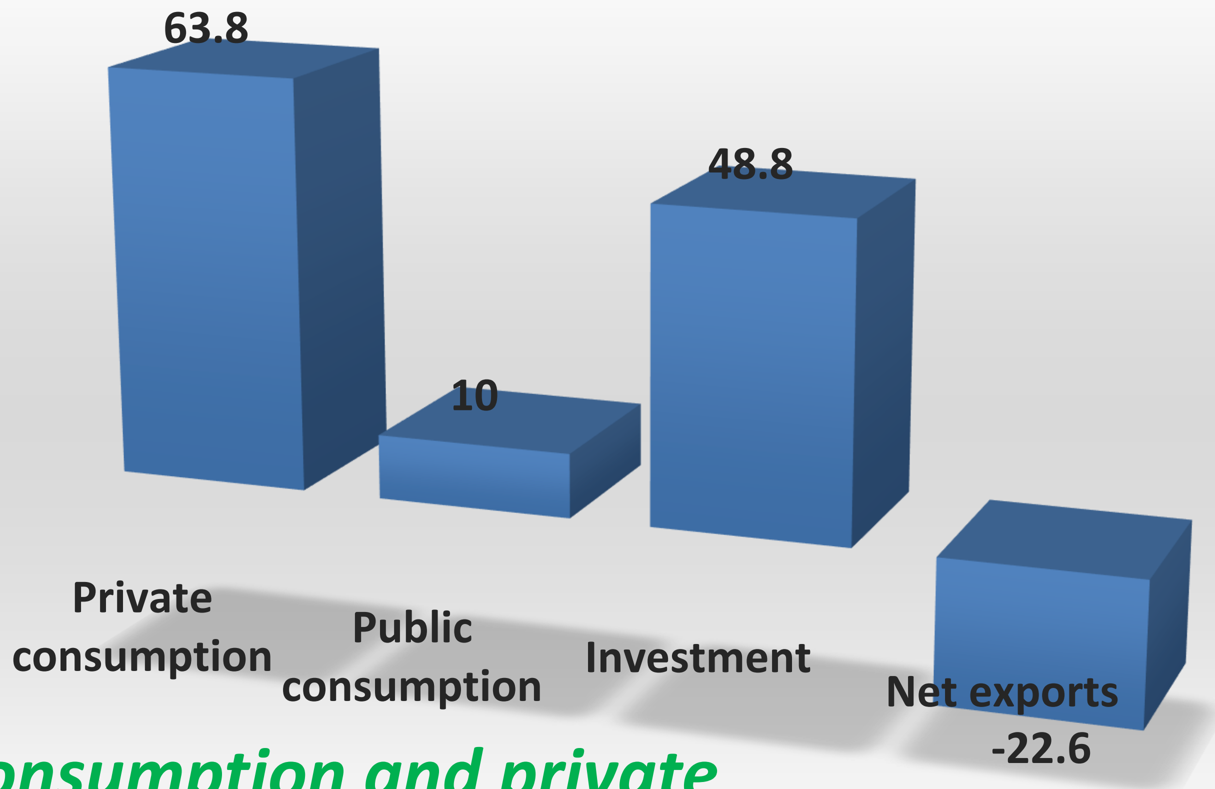
Austrian Business Cycle Theory

- 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.

Commercial Banks' loan-to-deposit ratio

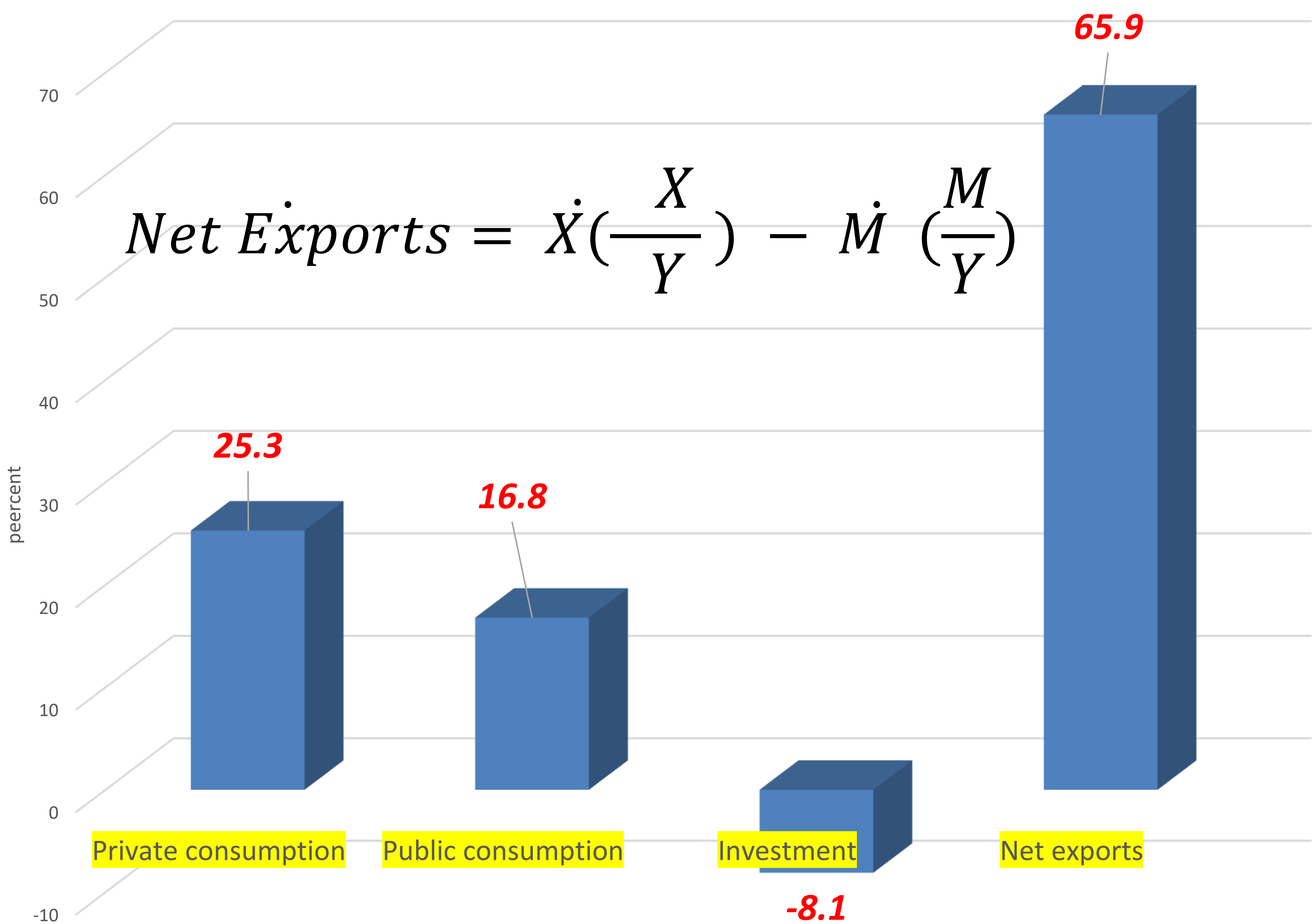


Contribution to GDP growth: 1999-2005



Consumption and private investment were major growth drivers

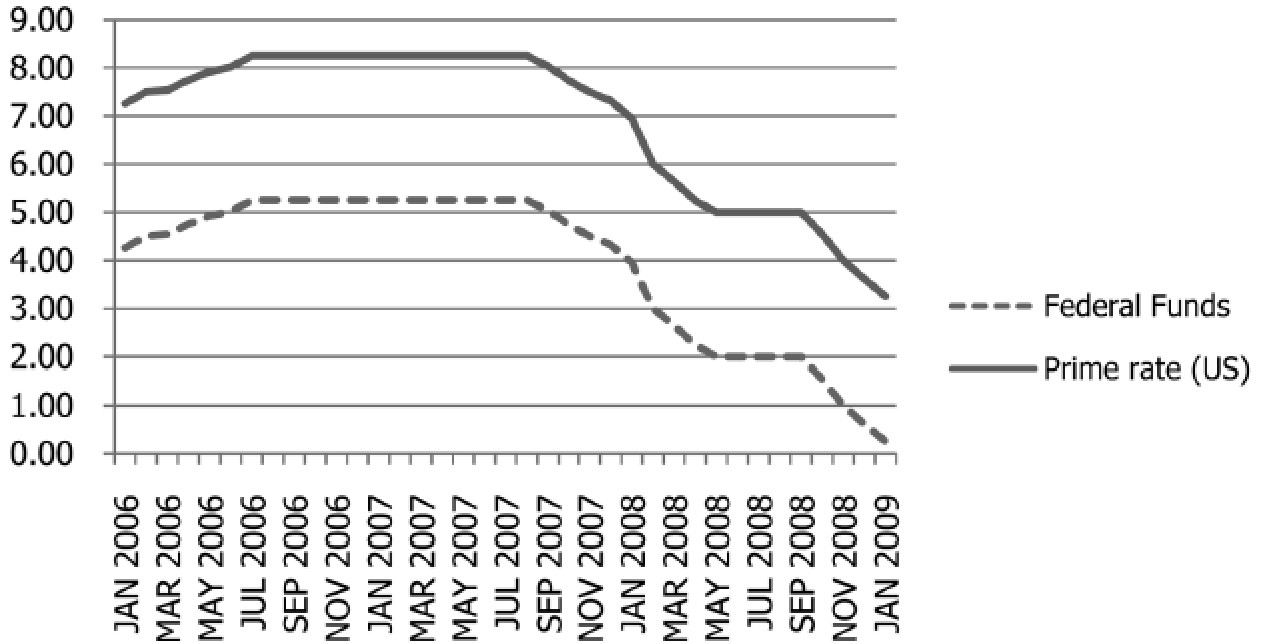
Contributors to GDP growth: 2006-2007



$$Net\ \dot{Exports} = \dot{X}\left(\frac{X}{Y}\right) - \dot{M}\ \left(\frac{M}{Y}\right)$$

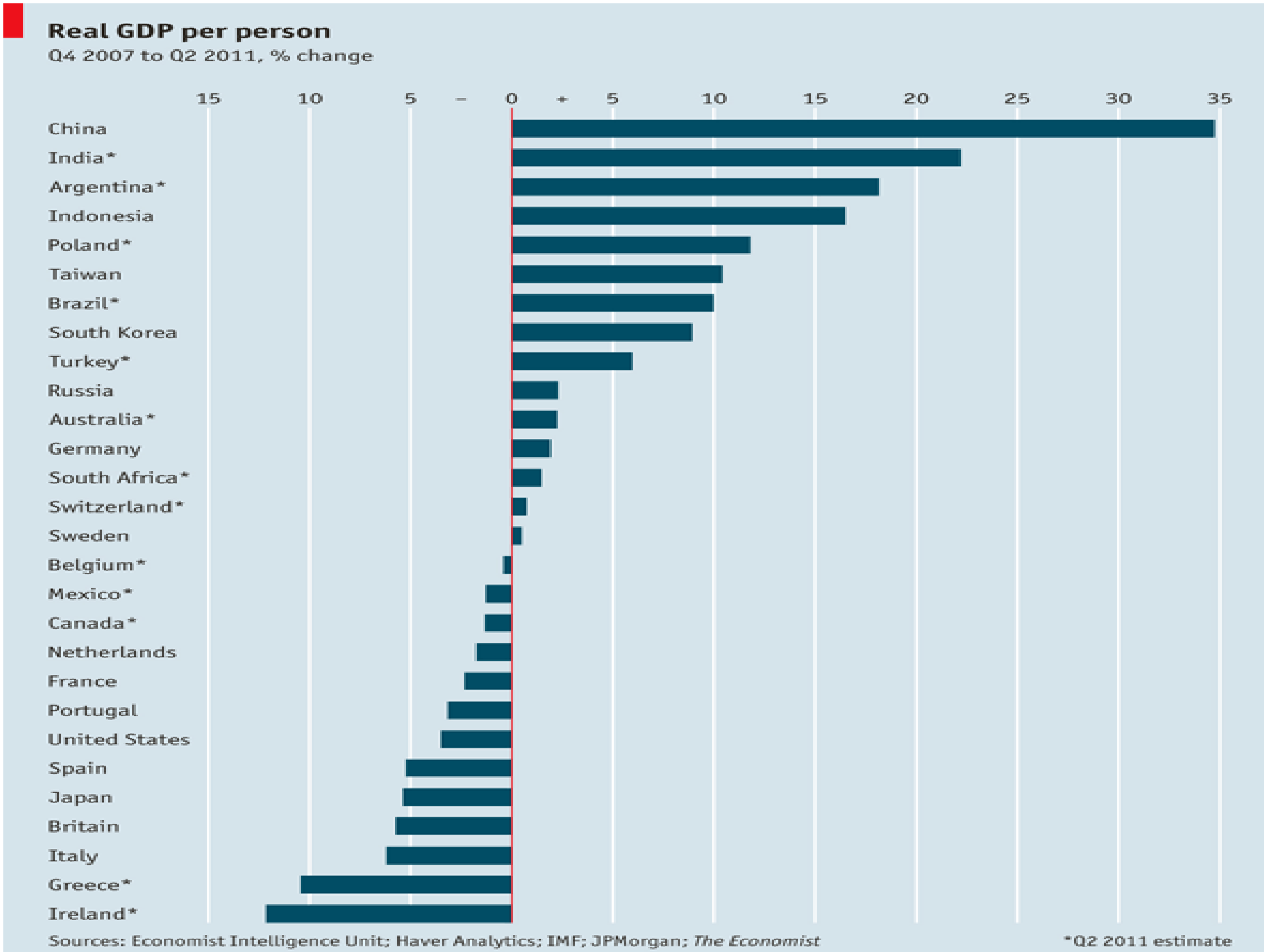
A collapse of private investment

The federal funds rate impacted on the U.S. prime rate

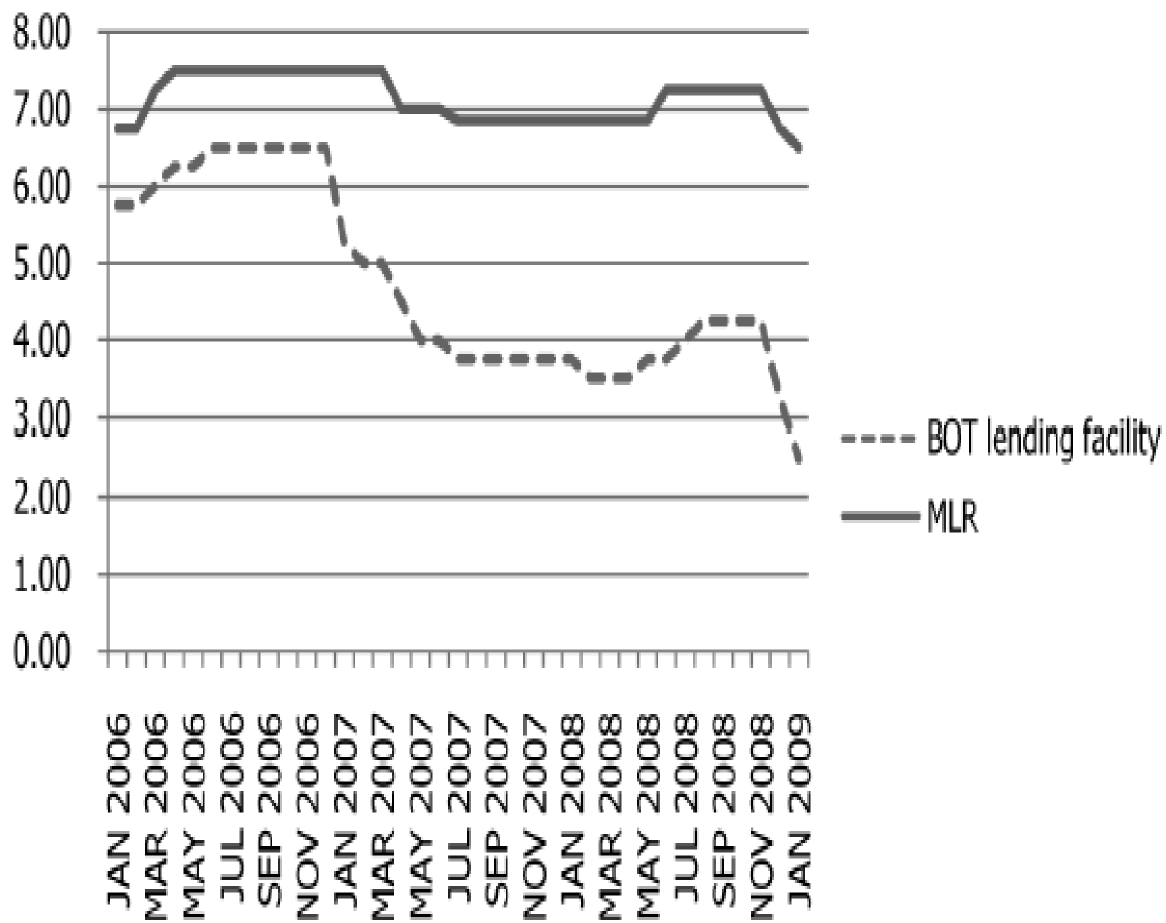


Source: *Bank of Thailand.*

Global Recession and Recovery: 2011/2007



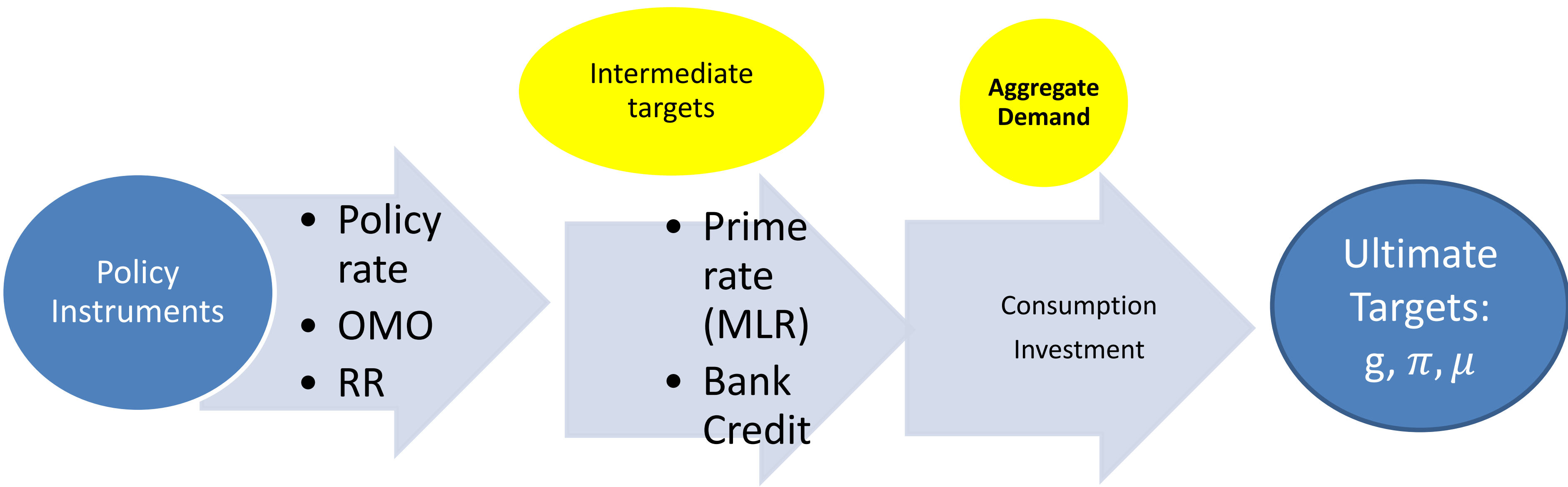
The BoT key policy rate had little impact on Minimum lending rate (MLR)



Source: Bank of Thailand.

“If anything can go wrong, it will.”

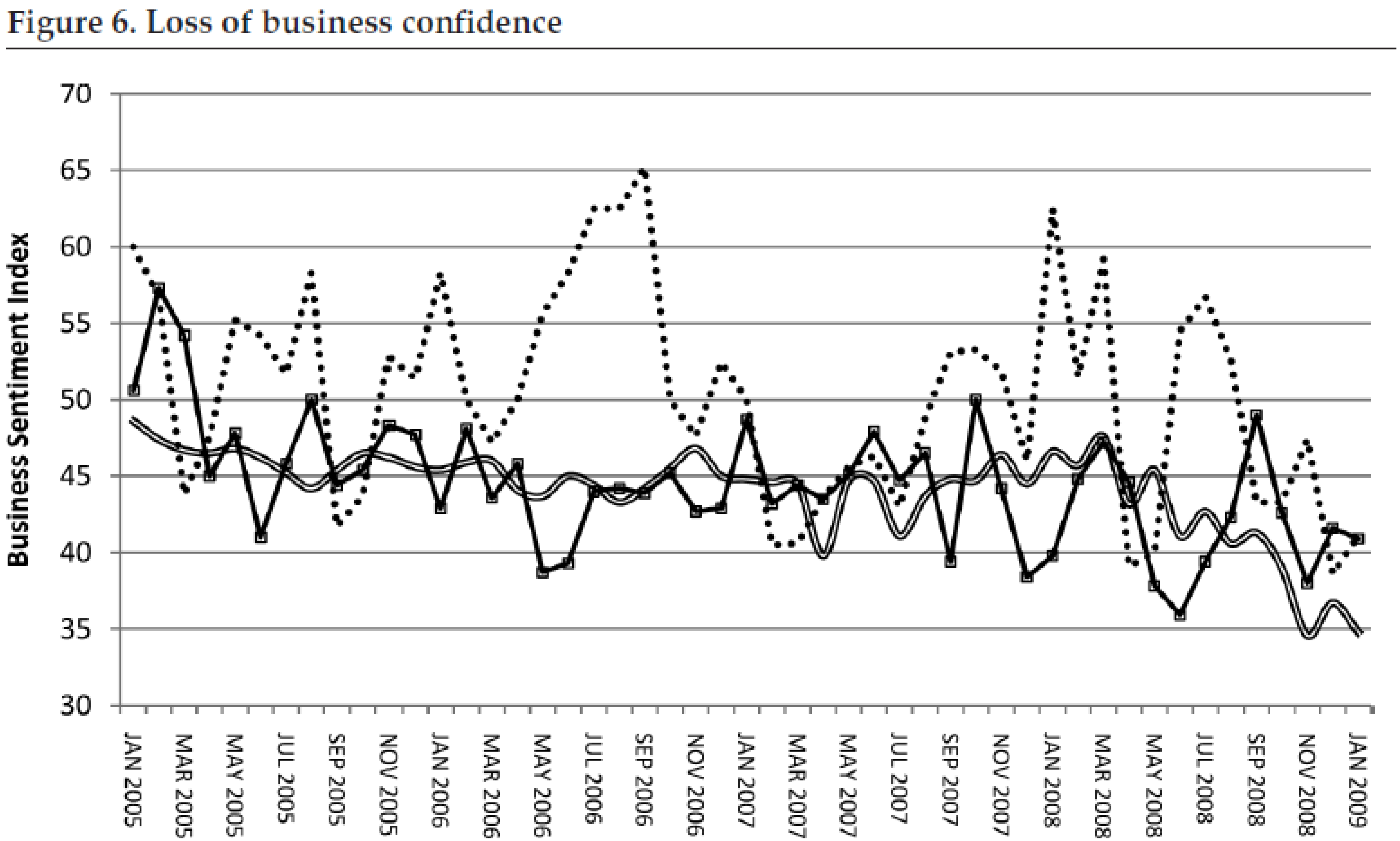
Murphy’s Law



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 (*Acceleration theory of investment*).

When pessimism reigned



Theory of trade cycles: Phycological factor

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.

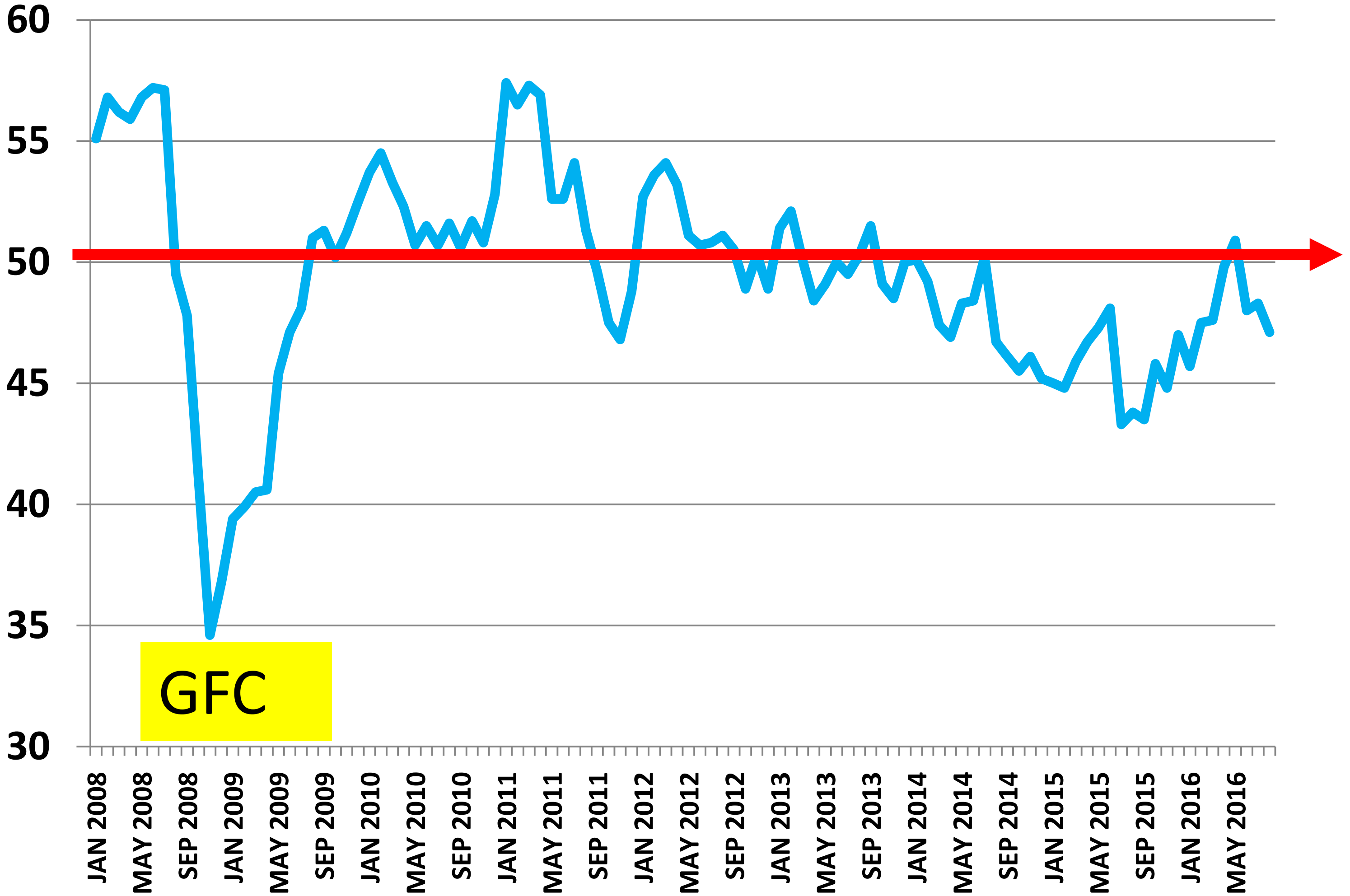
Strong rule of law is required to regain investor positive sentiment and consumer confidence

- 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.

Weak rule of law and rampaging corruption destroy investor and consumer confidence

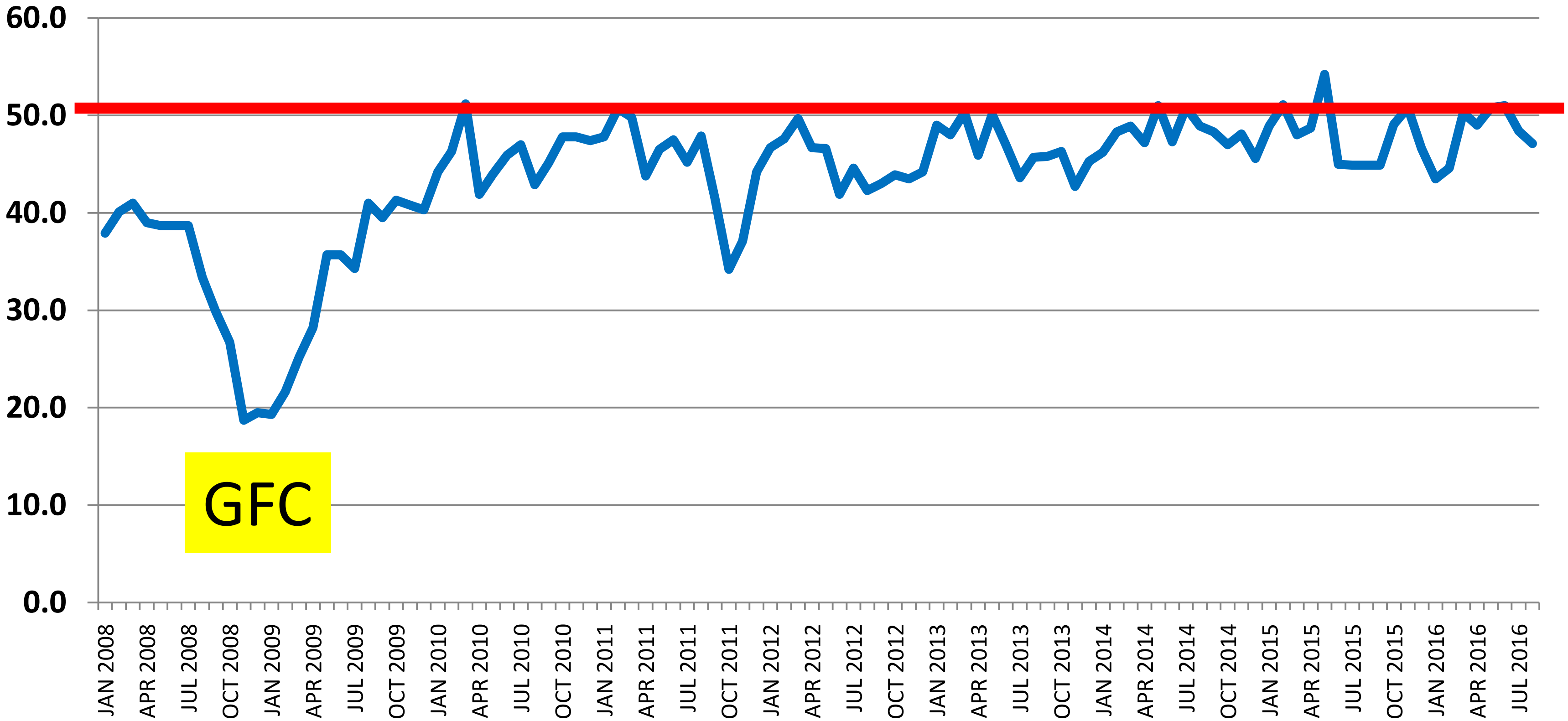
- Once we allow elements of unknowns to violate established social obligations and contracts, business confidence erodes quickly; eventually it could lead to a ***negative long-term impact on economic growth***.
- Business Sentiment Indexes are constructed into four different areas: Output prices, domestic and foreign orders, and liquidity.

Business Sentiment Index
(1) ***output prices***

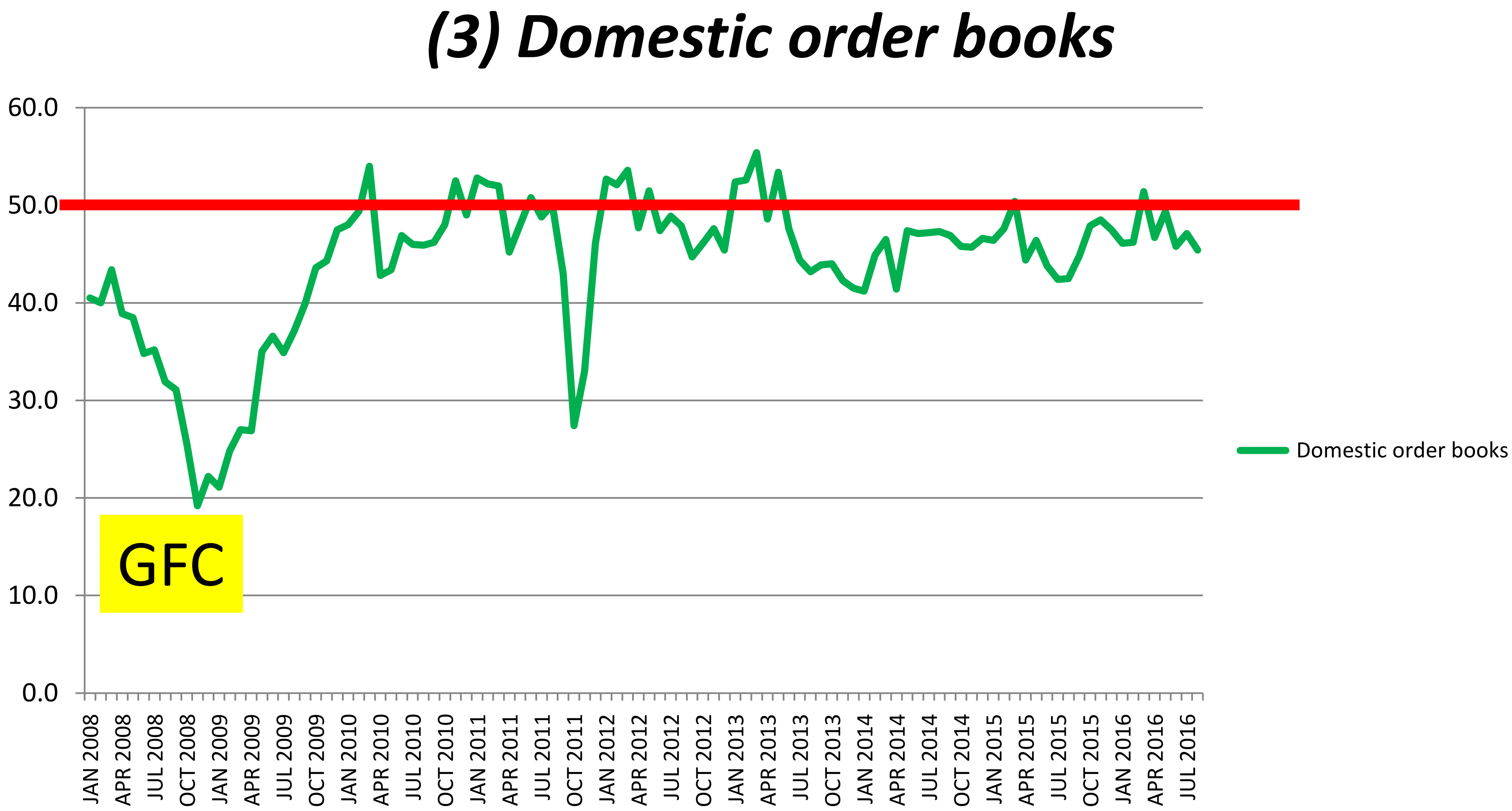


Business Sentiment Index

(2) Foreign order books



Business Sentiment Index



Short-term gain vs. long-term loss

- Fiscal policy is the only remaining policy option left.
- 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

2. Macro policy response

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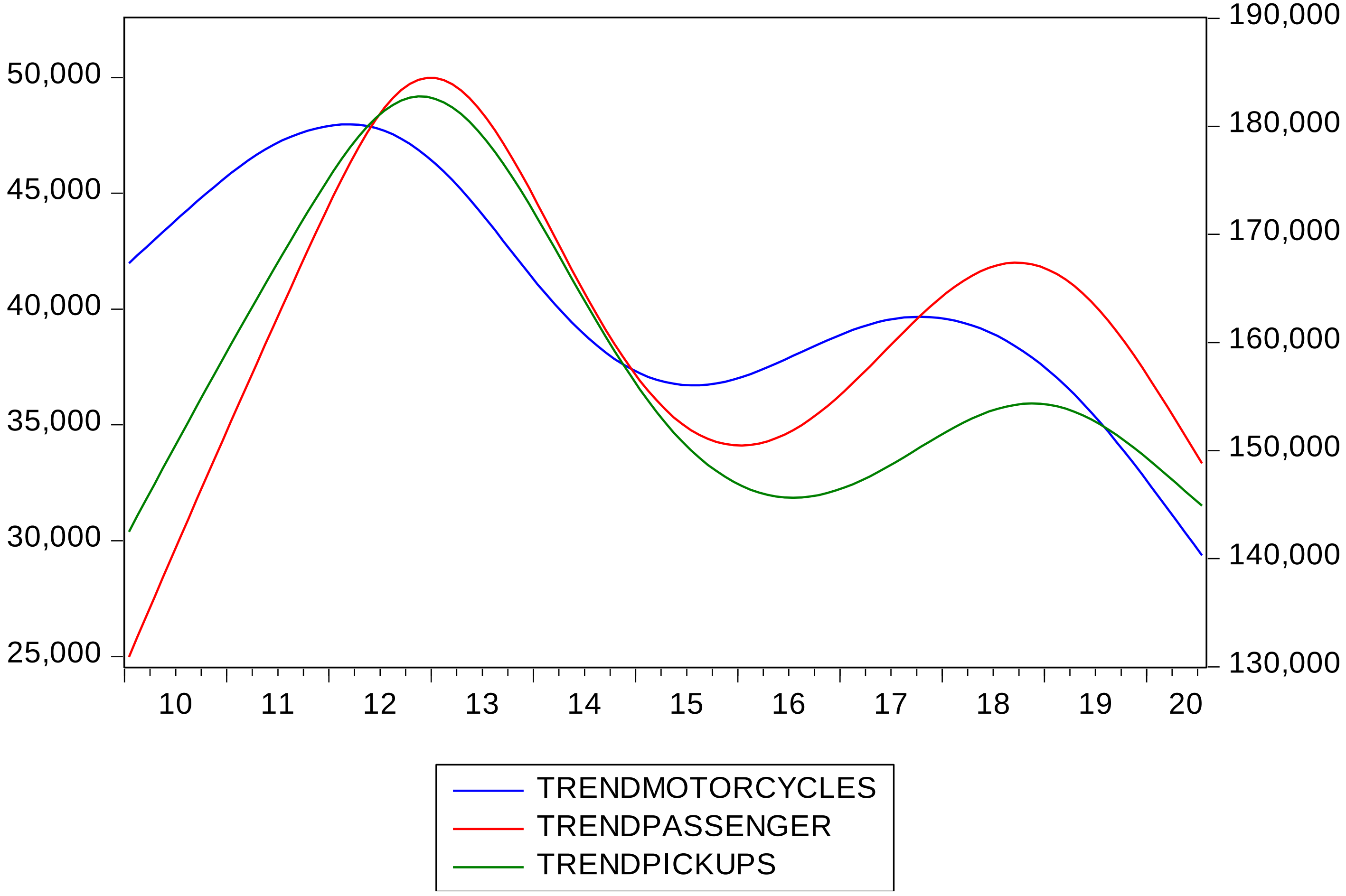
Effectiveness of Thailand's Macroeconomic Policy Response to the Global Financial Crisis

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.

Private consumption indicators



What determines consumption expenditures

- Traditional theories of consumption behavior: *Life Cycle Hypothesis*, Permanent Income Hypothesis, Relative Income Hypothesis, and Random Walk Hypothesis.
- **Instant vs delayed gratification**: The role of psychology.
- ***Expectations about the future*** also play an important role.
- The role of credit availability should not be underestimated.

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 heightened risk exposure to **output and consumption volatility** that would lead to serious economic crises.

Increasing volatilities after the 2006 coup: Growth, sentiment, and inflation

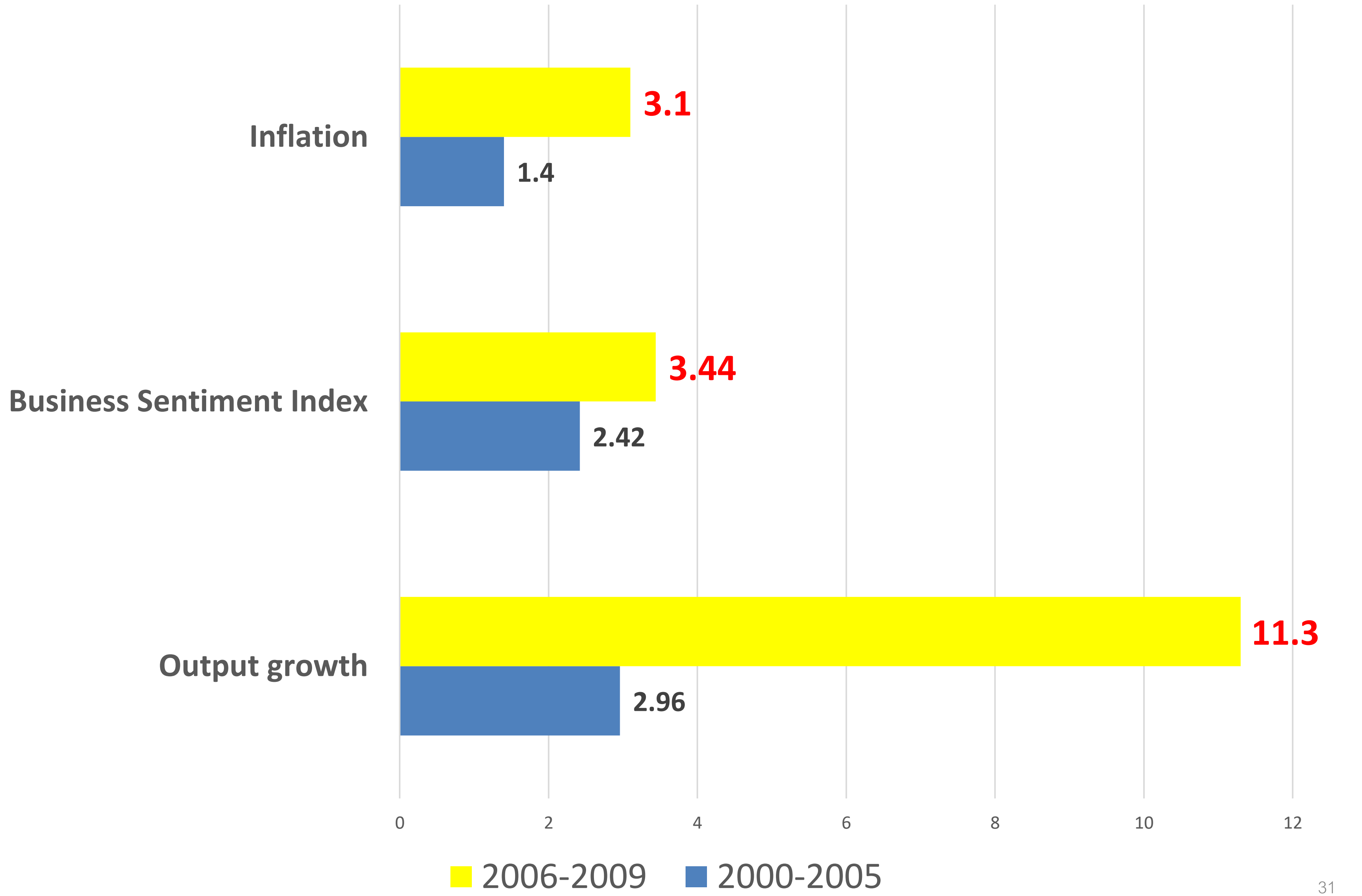
TABLE 2
Volatility in Output, Price, and Business Confidence
(Measured by standard deviation)

	Output	*Business sentiment index*	*Inflation*
2000–05	2.96	2.42	1.43
2006–09	11.3	3.44	3.06

SOURCE: Bank of Thailand.

Heighted Volatilities

(standard deviation)

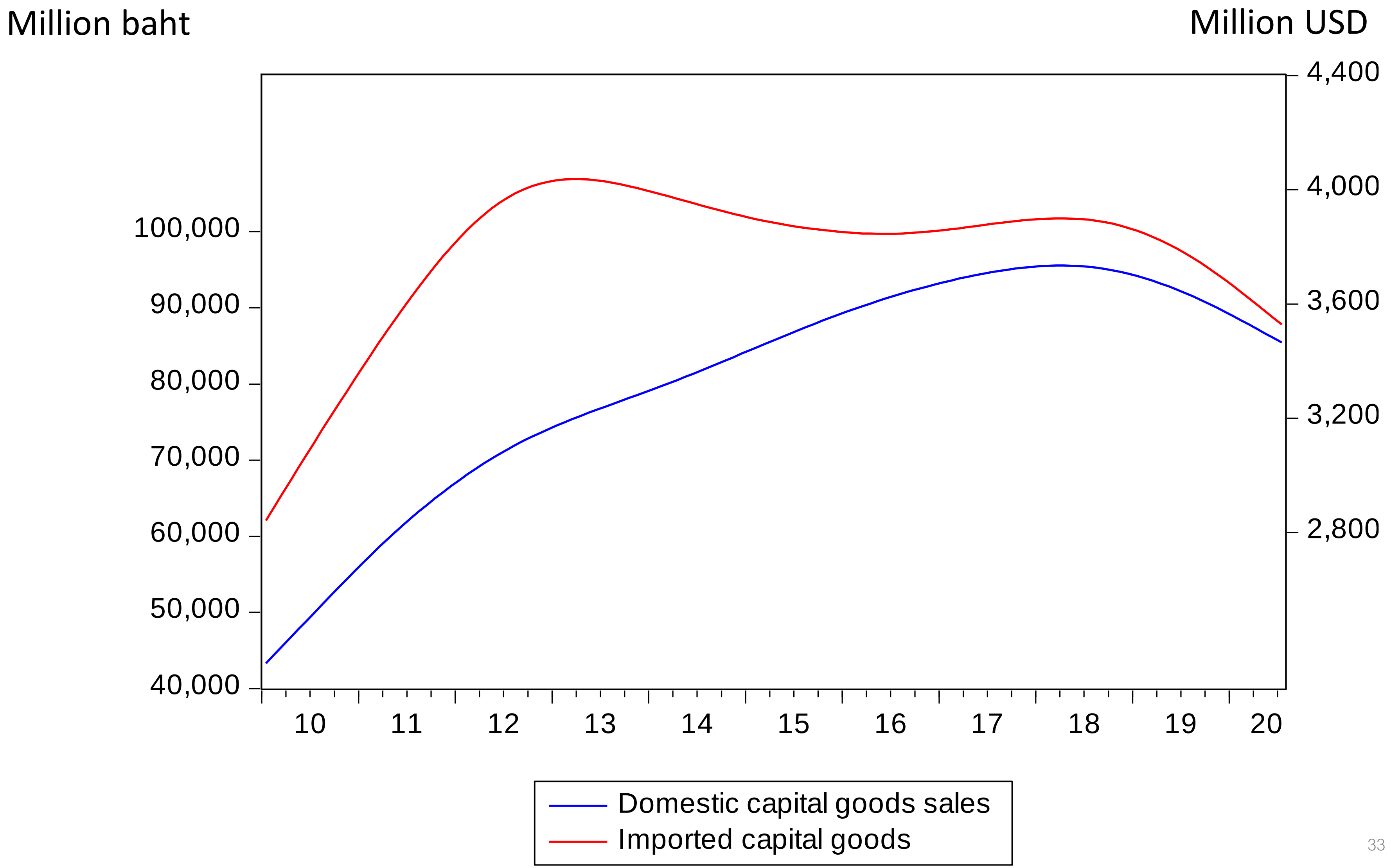


The effectiveness of policy responses depends on the government's ability to maintain the rule of law, accountability, human rights, and effective legal infrastructure.

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

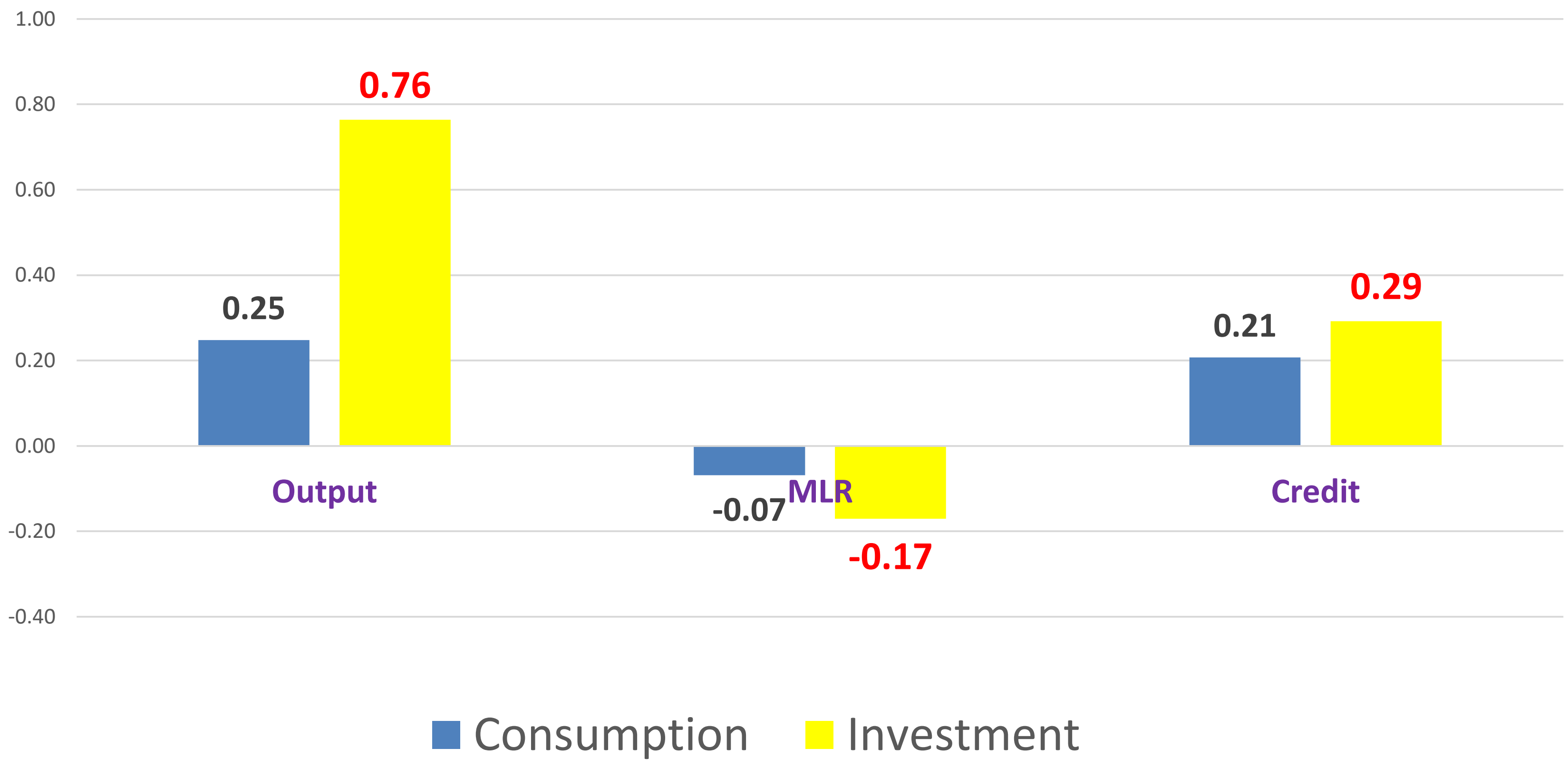
Investors can proceed with less concern about risk and uncertainty that may arise from policy inconsistency

Trends of private investment
Jan 2010-July 2020



Elasticities of Consumption and Investment Expenditures (trend)

Source: FMOLS estimates (Jan 2000-June 2017)



If those policy stimuli can be employed 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 (e.g. China-U.S. trade War).

"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" Elucidate.

Fiscal policy is less effective than monetary policy

- Recall the Mundell Fleming model
- When exchange rate is fixed, fiscal policy work like a charm.
- But when the exchange rate is allowed to change, fiscal policy become less effective as the exchange rate hinders rather than help the fiscal stimulus.

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

Accommodative monetary policy propels exports since it causes capital outflows, thereby depreciating the baht.

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

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.

Hysteresis

(Lag behind)

- ***Effects that persist after the initial causes giving rise to the effects are removed***.
- Think about a person who started smoking at the age of 20, and quitted at 40s. She had a high chance of having lunch cancer at the age of 55. Alas, she did.
- Hysteresis refers to the possibility that periods of high unemployment tend to increase the natural rate of unemployment (or Non-Accelerating Inflation rate of Unemployment: NAIRU)
- Unemployed people lose their skills during unemployment, which makes them less likely to again get jobs.

A coup 'won't happen again’

Bangkok Post 8 September 2020

- Army chief Apirat Kongsompong dismissed rumors of a coup d'etat, as the spokesman of the opposition Move Forward Party warned against a power take-over, saying public sentiment has changed.
- "Don't worry. [A coup d'état] will never happen again," Gen Apirat told the Bangkok Post on September 9.
- When asked about the protest planned for Sept 19 by students and activists, he added that the prime minister is capable of handling the political situation.

Army chief Apirat Kongsompong

Can Thailand recovery from the deep slump?

- ***The effectiveness of policy responses*** to external shocks 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***.

MACROECONOMIC INDICATORS THEN AND NOW

1997	Indicator	2019
-2.8%	**GDP growth**	2.3% (as of Q2)
US$27 billion	**Foreign reserves**	$220.2 billion (as of Aug 30)
-$3.1 billion	**Current account**	$1.8 billion (as of July)
41.37 on average in 1998	**Baht value vs dollar**	30.65 (as of Sept 6)
Corporate debt at 77.5% of Thailand's total external debt	**Debt**	Household debt at 78.7% of GDP (as of Q1)
Over 40%	**NPLs**	2.95% (as of Q2)
4.4% in 1998	**Unemployment rate**	1.1% (as of July)
• Aggressive lending by financial institutions • Oversupply and speculation in real estate • High debt-to-equity ratio • Hot-money inflows and burgeoning foreign debt	**Vulnerabilities**	• Domestic political uncertainty • Search-for-yield behaviour in properties and deposit interest of savings cooperatives • Slow advancement of technology adoption • High household debt • Ageing population and shortage of skilled labour

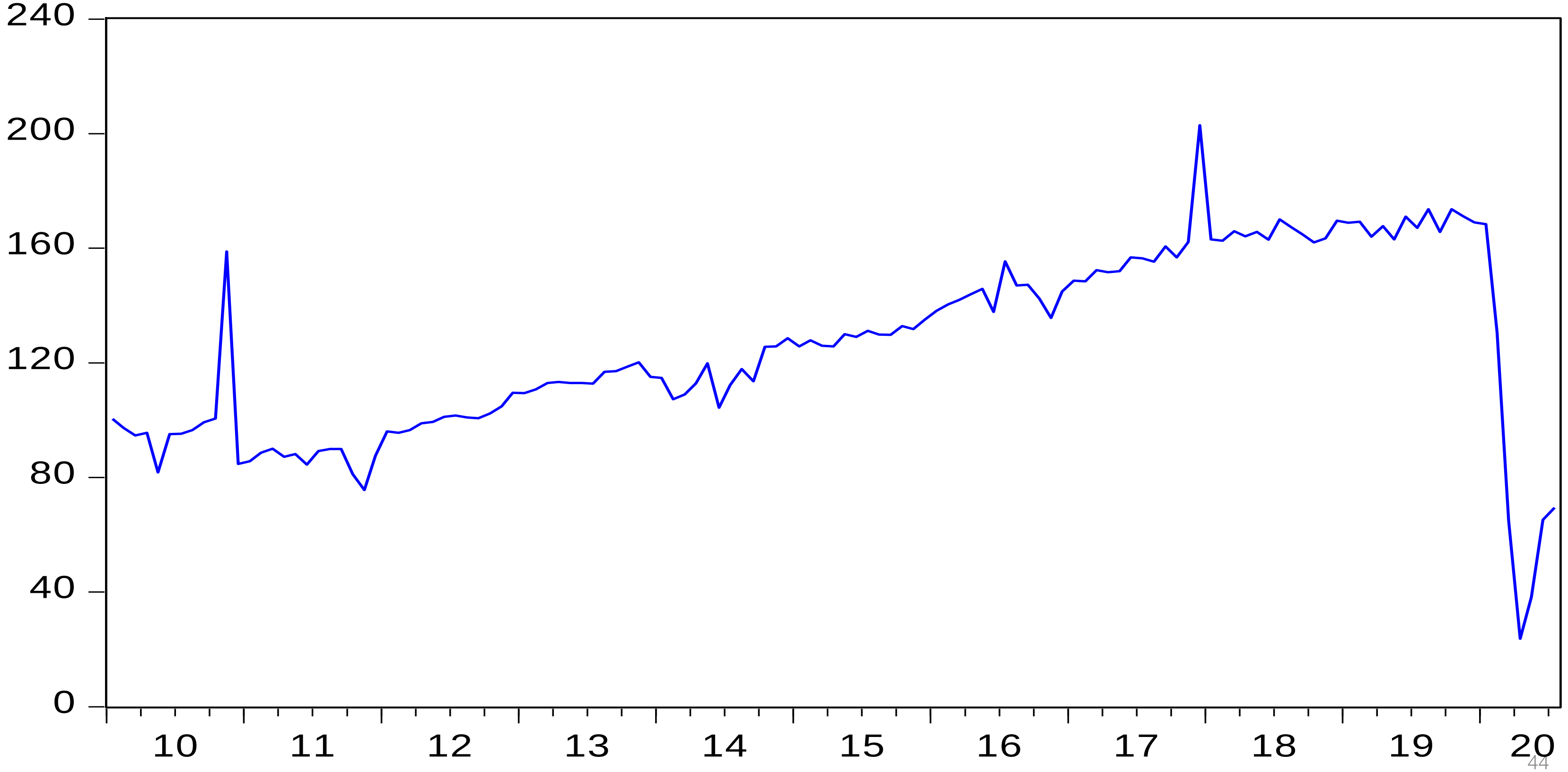
Sources: Bank of Thailand, National Economic and Social Development Council, Sukhothai Thammathirat Open University, Bloomberg, Coface

BANGKOK POST GRAPHICS

Impacts of Covid-19

The recovery will be low and slow, taking years for consumer confidence and business sentiment to return to pre-coronavirus levels.

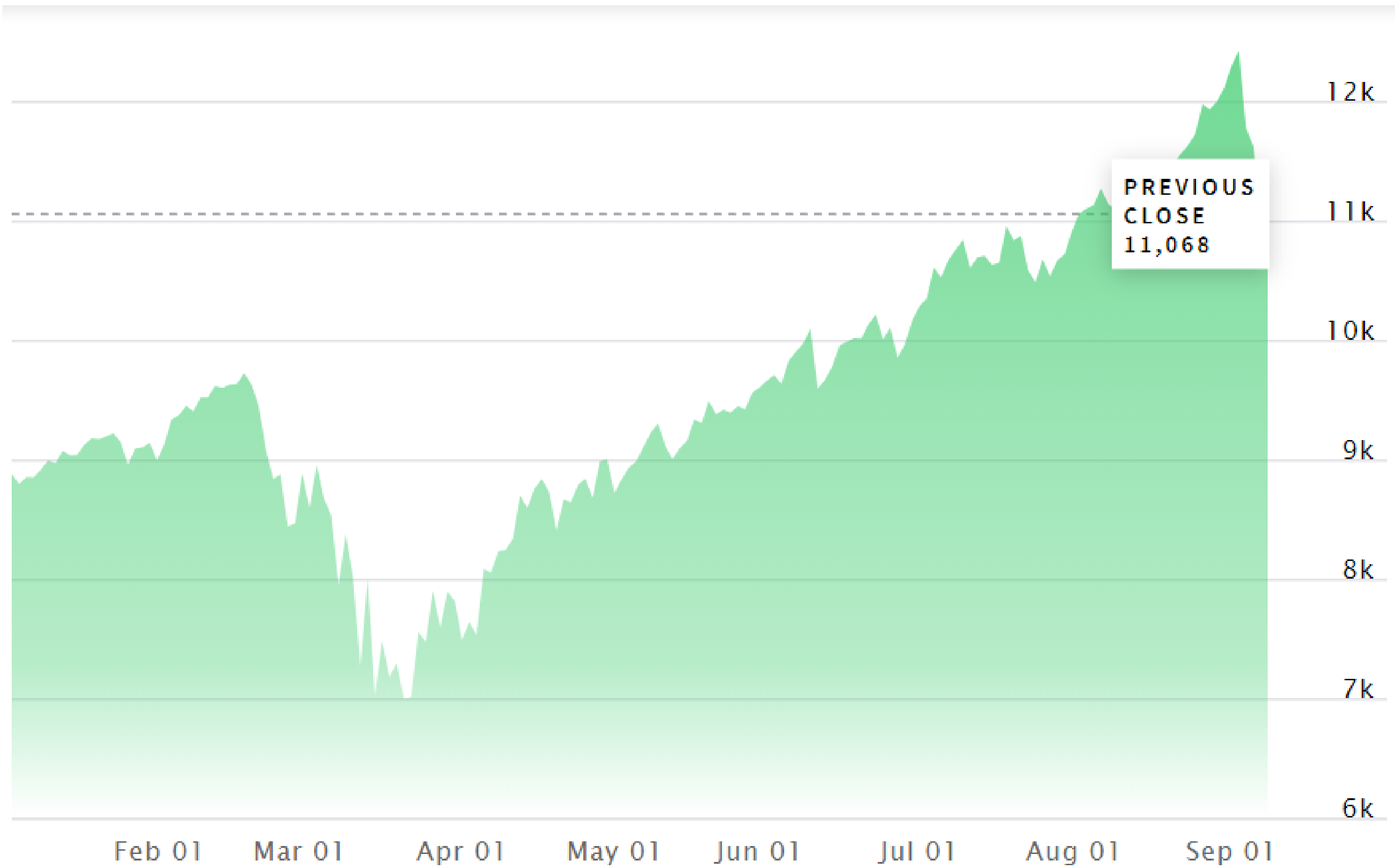
VAT from hotels and restaurants



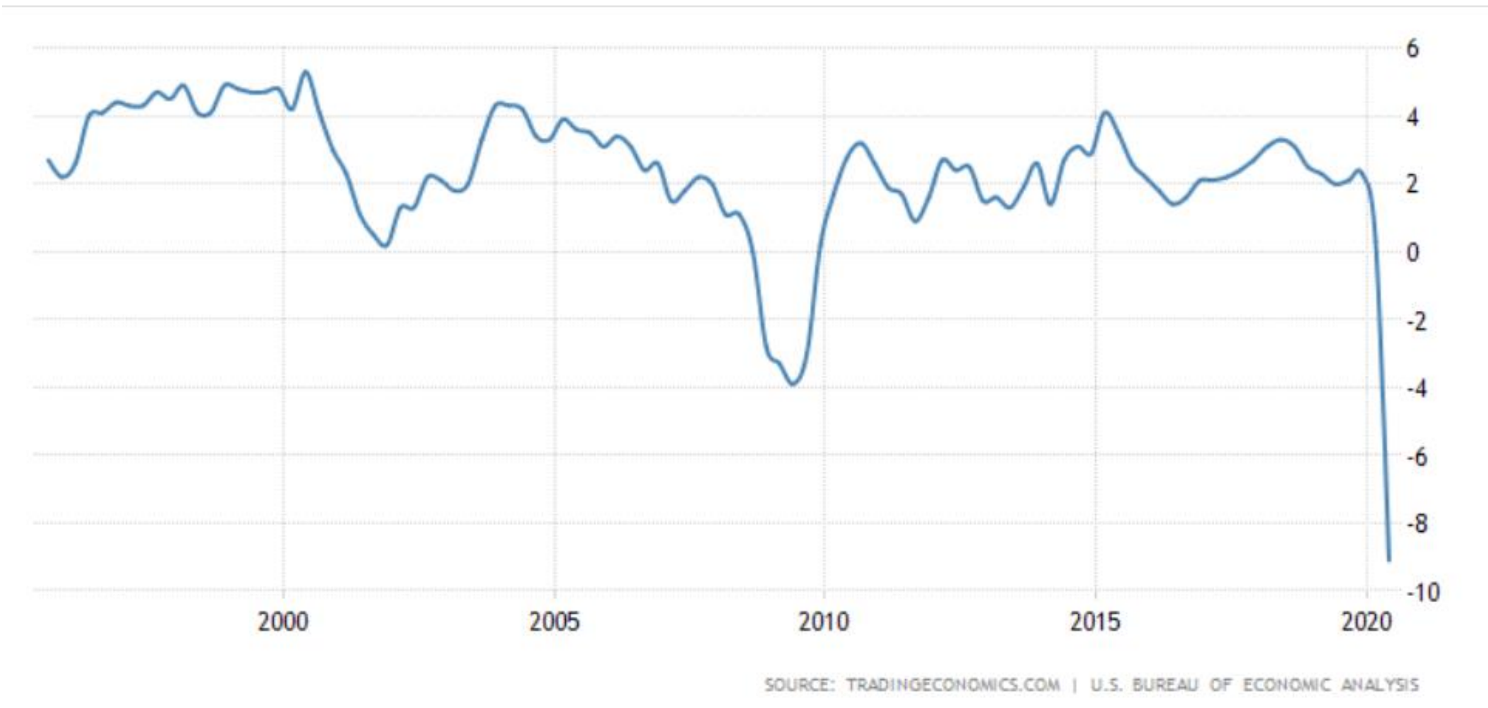
K-shaped recovery in the U.S.

- There are multiple speed bumps ahead for the recovery.
- There is a clear sign of a K-shaped recovery: A separation between the financial and the real sector.
- The K-shaped recovery has a profound impact on Thailand’s recovery.

Nasdaq-100 Index (NDX)



GDP the United States contracted 9.10 percent in the second quarter of 2020 over the same quarter of the previous year.



A Nike Swoosh Recovery?