Resilience of the Thai Economy

1991-2005

Bhanupong

Lecture 4

Outline

- Social and macroeconomic indicators
- Fiscal balance and external debt
- Monetary sector and capital inflows
- Asset bubbles and irrationality
- External influences
- Inflation is on the way back (2017)

Recap: Economic and social development plans

6th plan (1987-1991)

Maintain economic growth

Upgrade quality of life

7th plan (1992-1996)

income distribution

improve quality of life and **environment**

Recap: Economic and social development plans

8th plan **(1997-2001)**

Human-centered development

Public participation

Sustainable development

9th plan (2002-2006)

Competitiveness

Financial immune system

Self-reliant and resilient society

Social indicators: 1990

	Per capita GNP 1990 (USD)	Life expectancy at birth (years)
China	370	70
India	350	59
Indonesia	570	62
Malaysia	2,320	70
Thailand	1,420	69

Income distribution in the 1980s

	The poorest 20 ***percent (share of their income)***	***Gini Coefficient***
India (1983)	8.1	0.42
Indonesia (1985)	8.8	0.31
Malaysia (1985)	4.6	0.48
Philippines (1985)	5.5	0.45
Thailand (1988)	4.0	0.47

Percentage of population living below the poverty line

	Total	Rural
India (1983)	48	51
Indonesia (1985)	39	44
Malaysia (1985)	27	38
Philippines (1985)	58	64
Thailand (1988)	30	34

Inclusive vs. Exclusive growth

Vinod Thomas (ADB)

- Overall growth has failed to translate into similar improvements in living standards.
- One indication that growth is not reaching a broad enough segment of the population is relatively weak household consumption.

Inclusive vs. Exclusive growth

- Estimates suggest this grew only 5.7 per cent annually in the 1990s and 5.5 per cent in the 2000s in the region, even as gross domestic product surged 9 per cent and 8.2 per cent respectively in the two decades.
- This is particularly troublesome for countries attempting to expand domestic consumption and bring the benefits of growth to more people, such as in China.

The poor must have a stake to sustain economic success

- As a measure of rising inequality, China's Gini coefficient has gone up from below 0.3 in the 1970s to above 0.47 in recent years.
- China faces a yawning income divide, separating richer urban areas in the eastern coastal regions from western inland areas.

Exclusive growth prevents the poor from accessing basic needs

- Another part of the problem is that many lower-income groups have inadequate access to basic services in health care, education, or safe drinking water and sanitation, leaving them ill-equipped to participate in economic advancements.
- This is evident in case studies from Pakistan, the Philippines and Vietnam.

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.

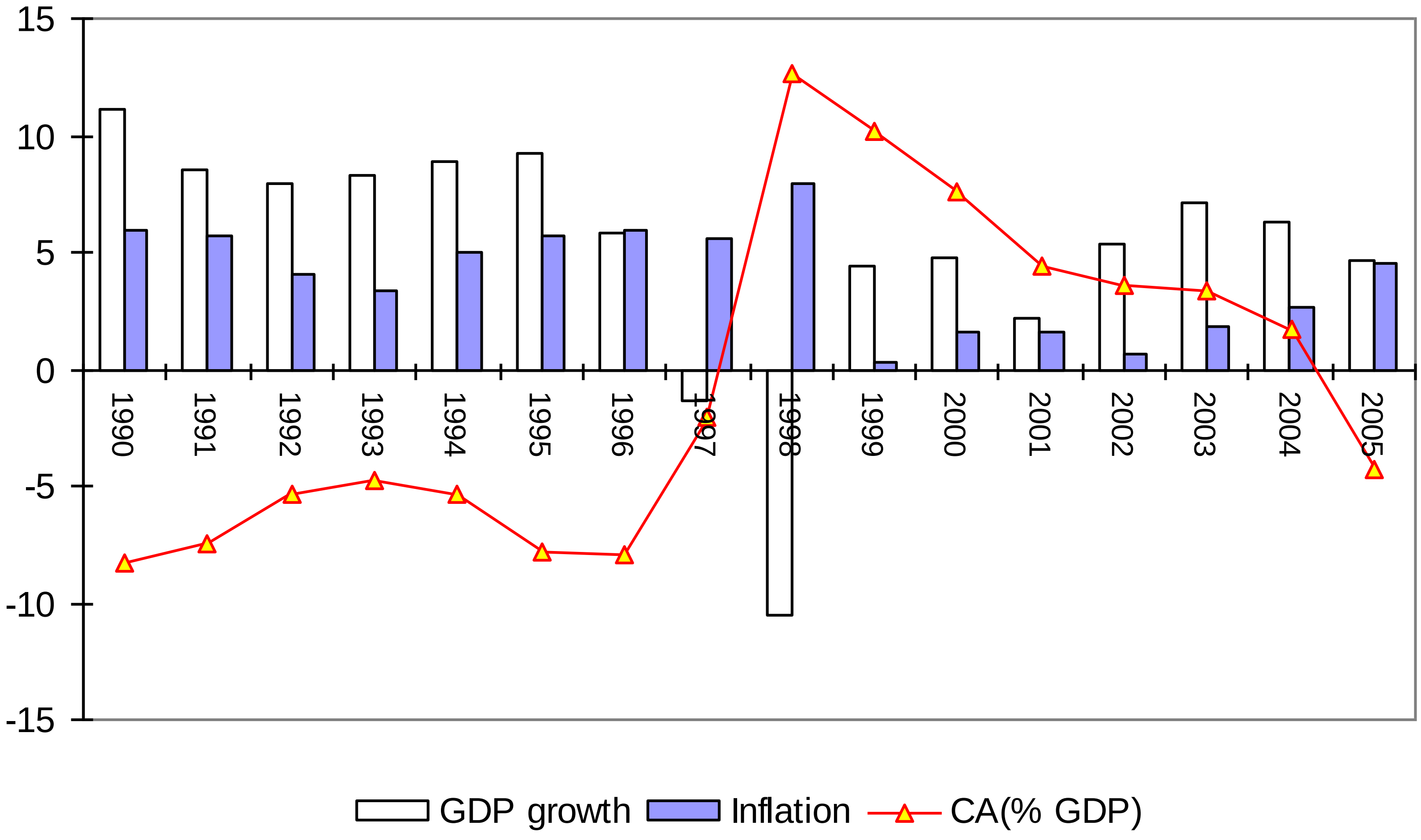
The role of human capital in economic development

- 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.

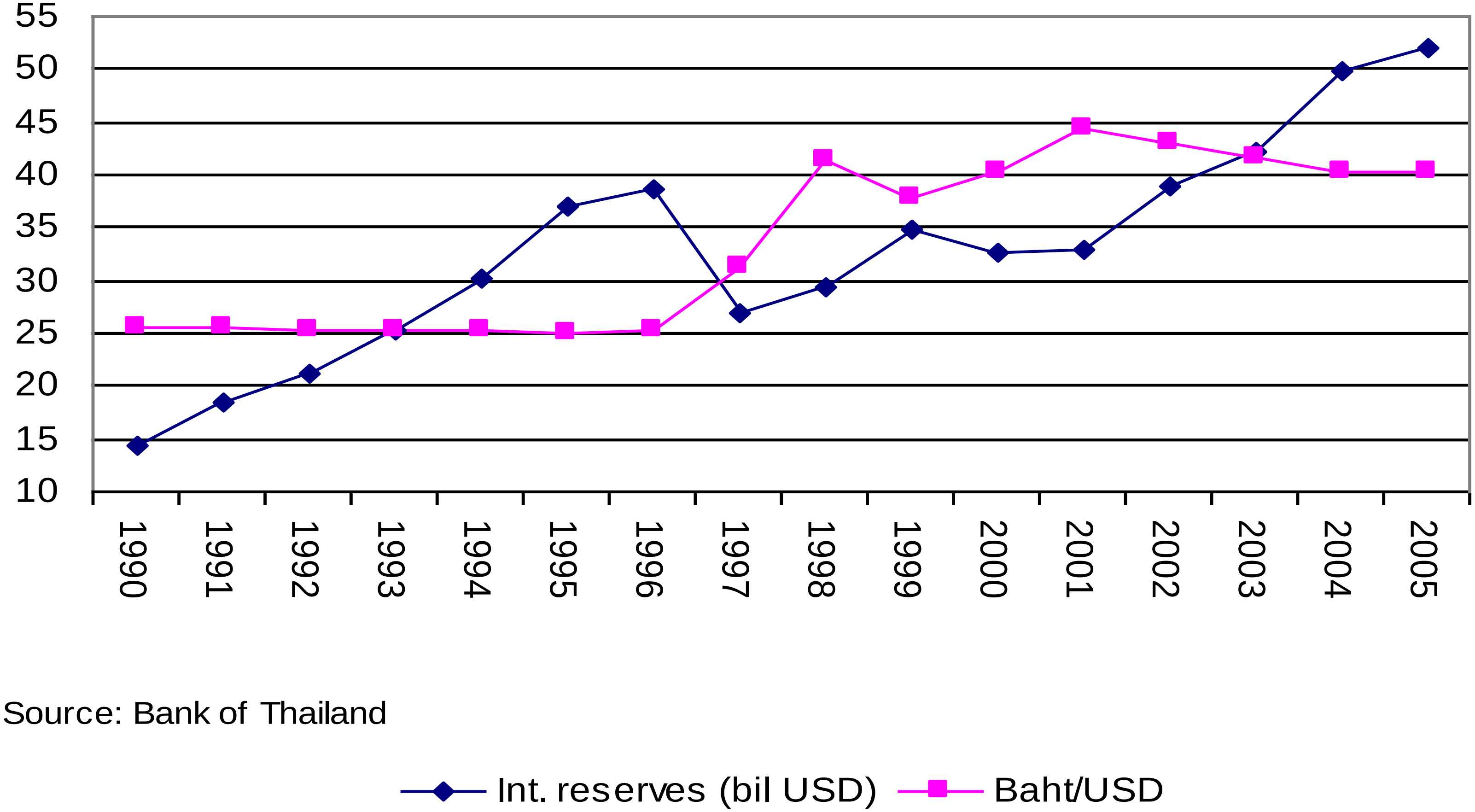
Theodore Schultz: Don’t neglect agriculture

- 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.

The three economic vital signs 1980-2005

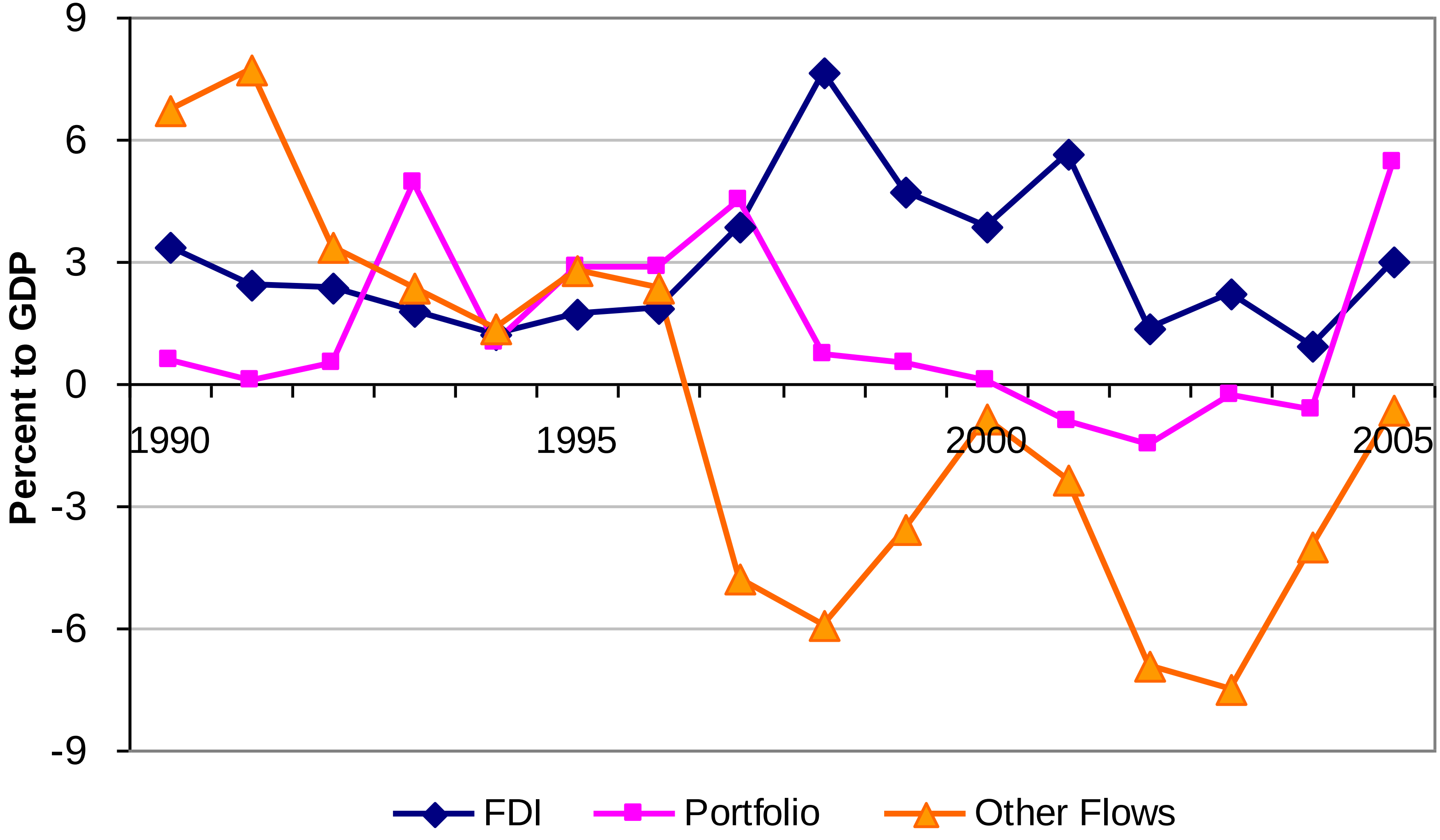


Rising international reserves
What was the main reason?



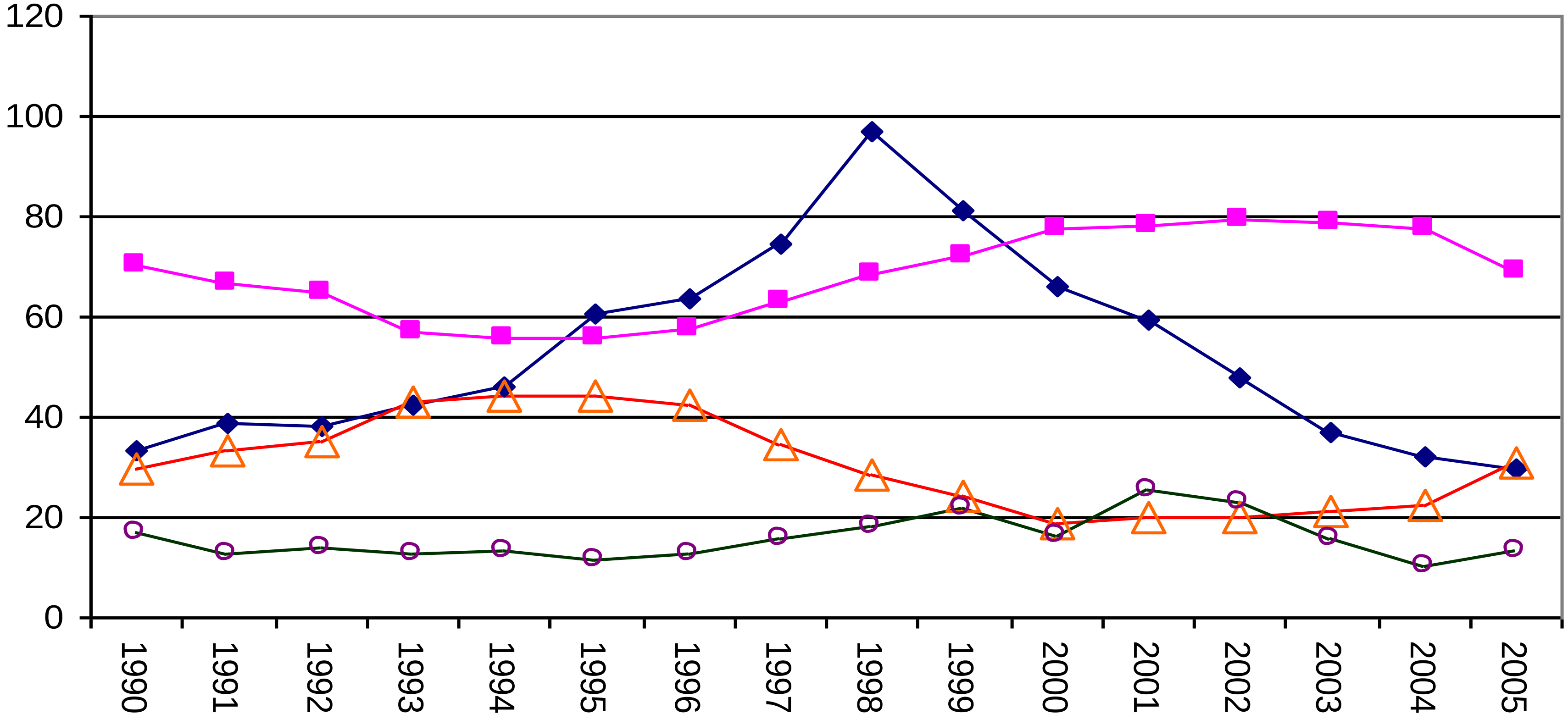
Source: Bank of Thailand

Hot and cold capital flows



Source: Bank of Thailand

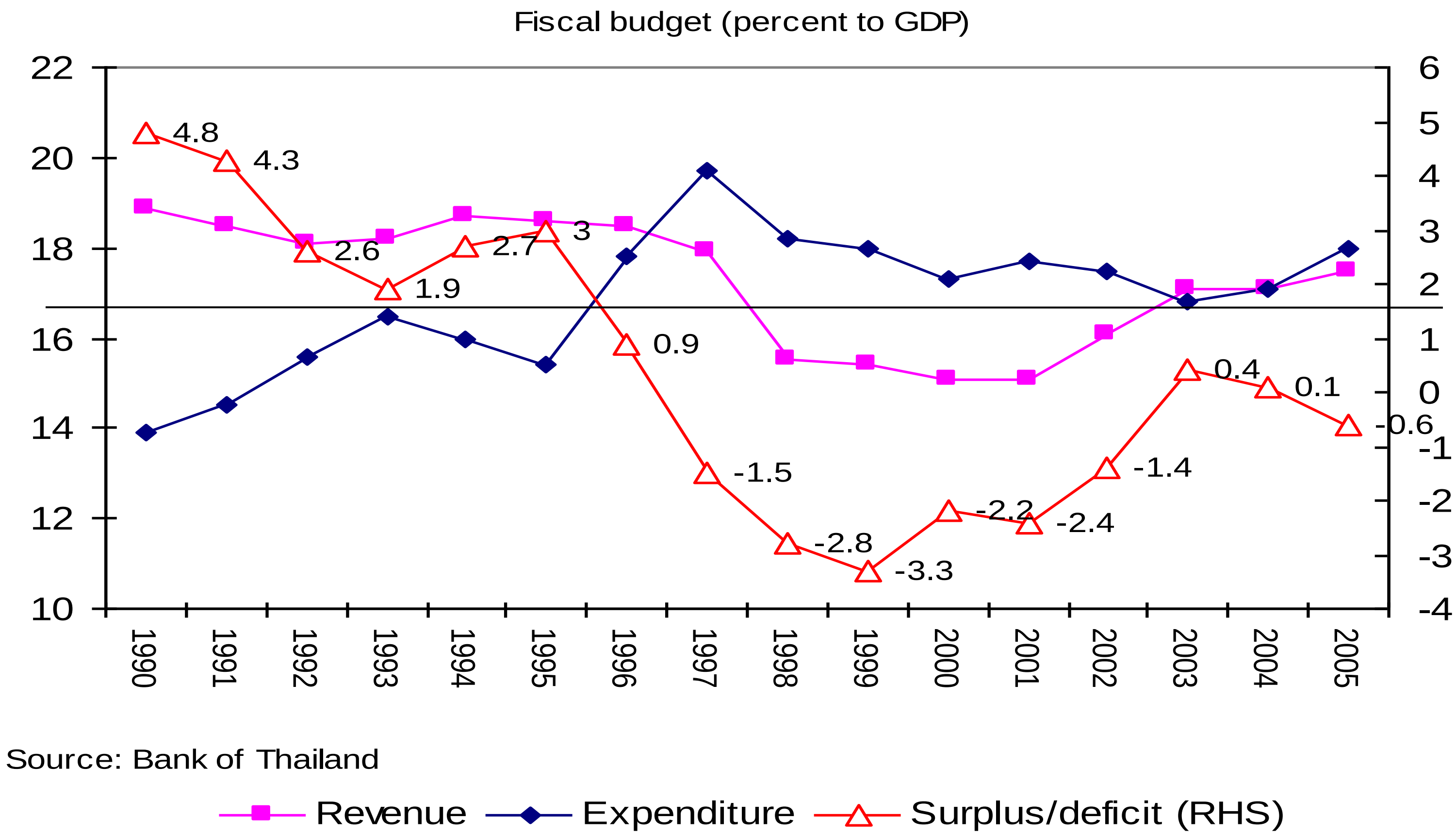
Improving debt maturity structure: declining short term debt



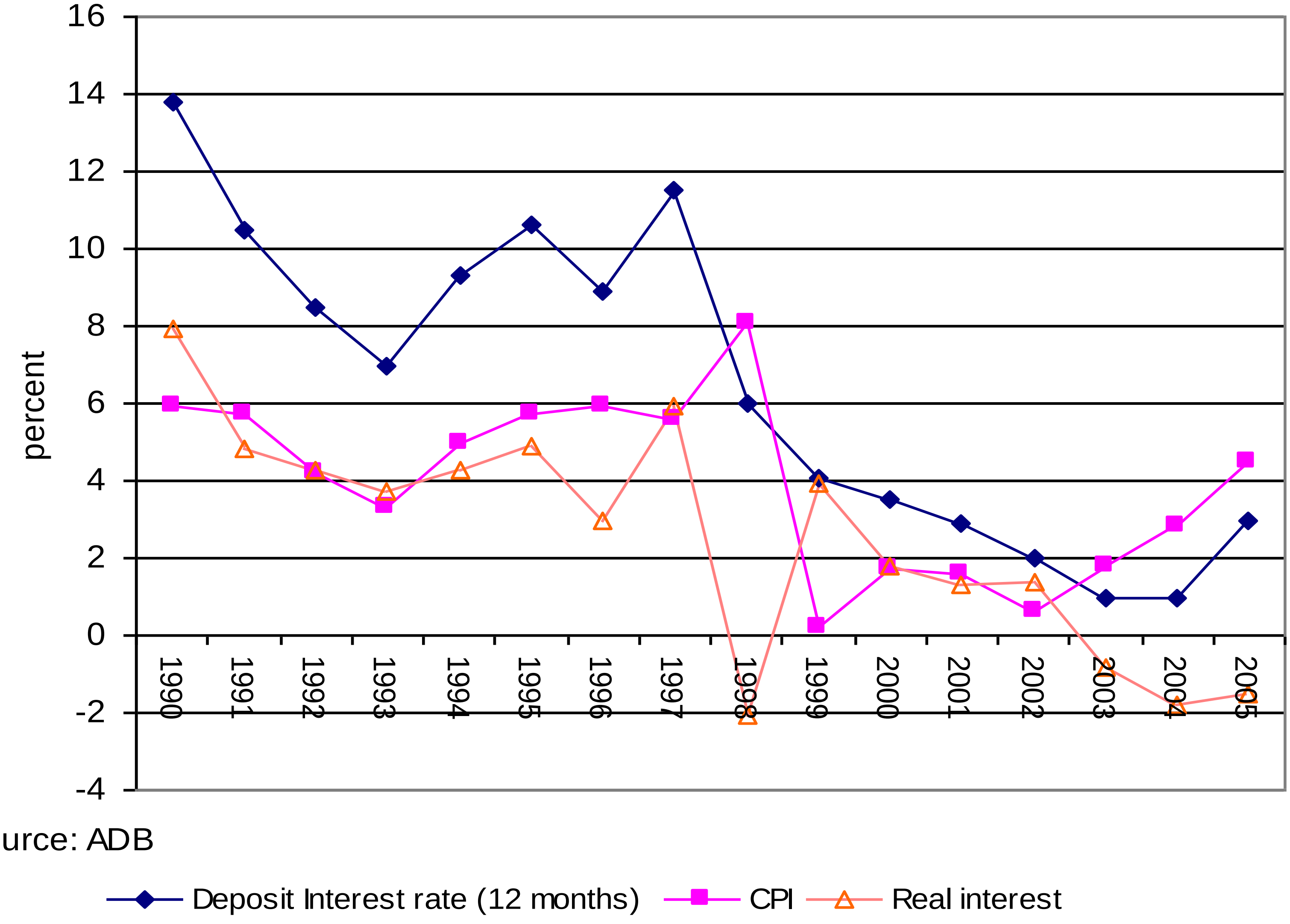
Source: Bank of Thailand

Fiscal discipline and self discipline

Self discipline is when one uses *reason* to determine the best course of action that *opposes* one's desires. It is the ability to motivate oneself in spite of *a negative emotional state.*
Using *willpower* routinely and even automatically.

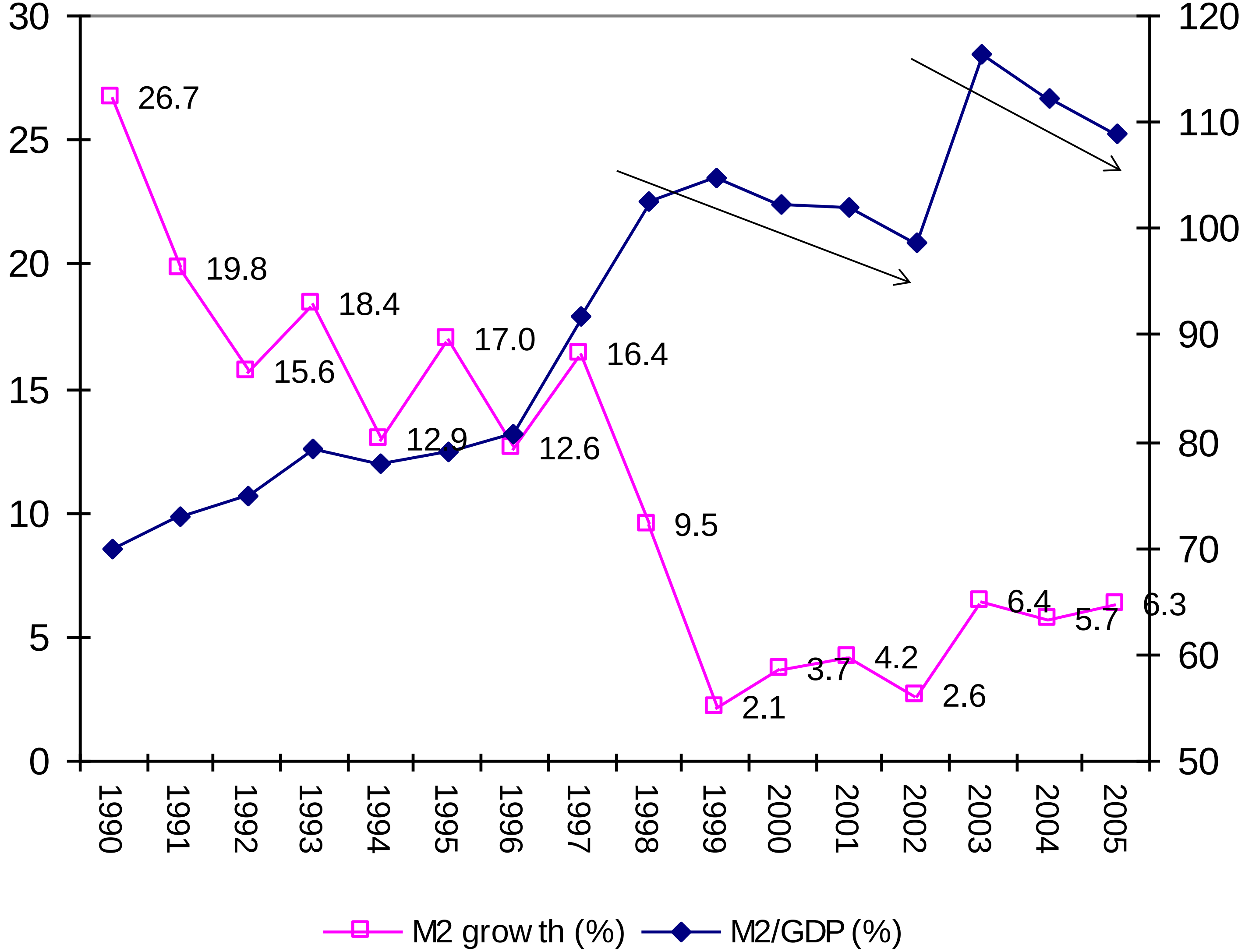


Less incentive for financial savings

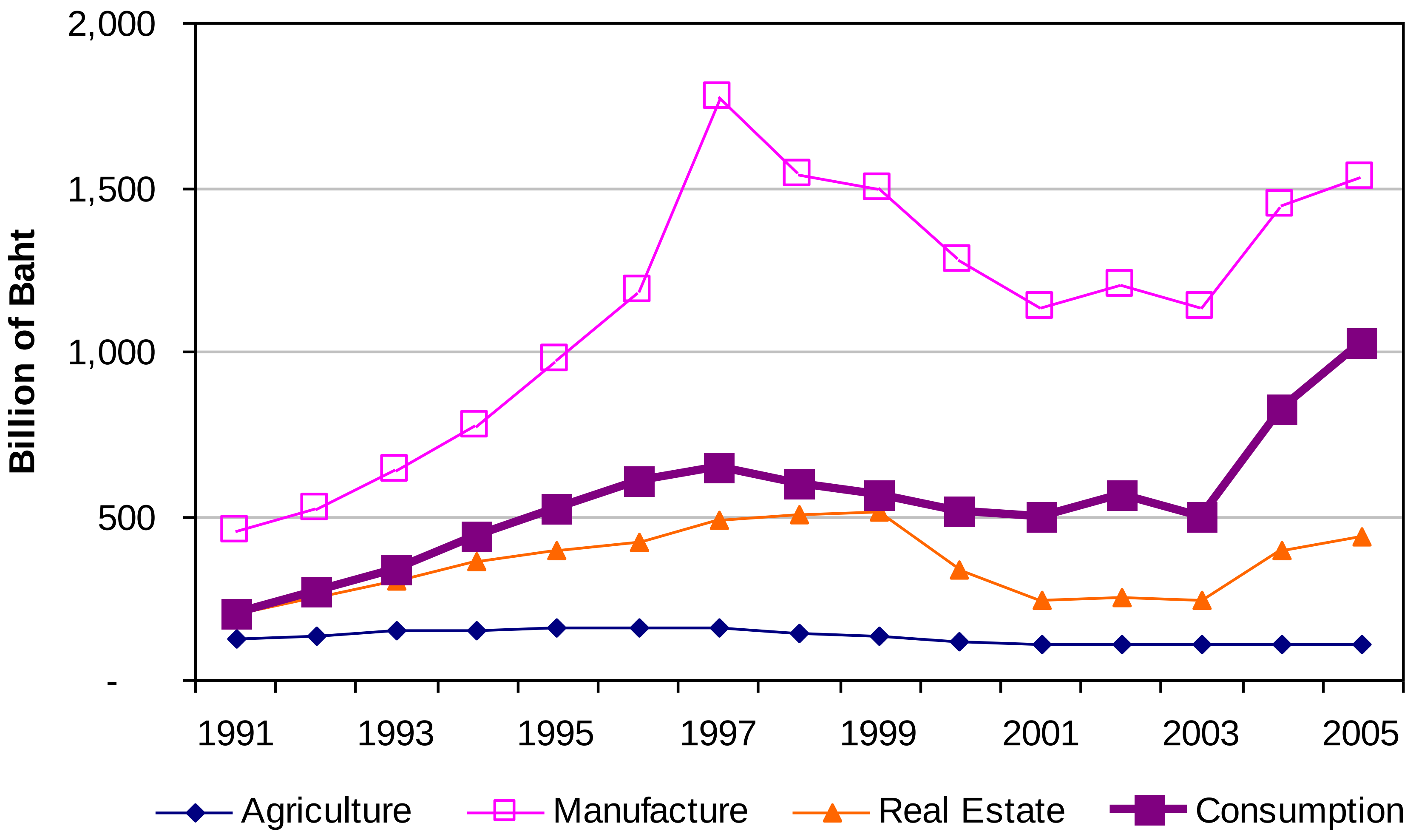


Surce: ADB

Monetary growth slowdown

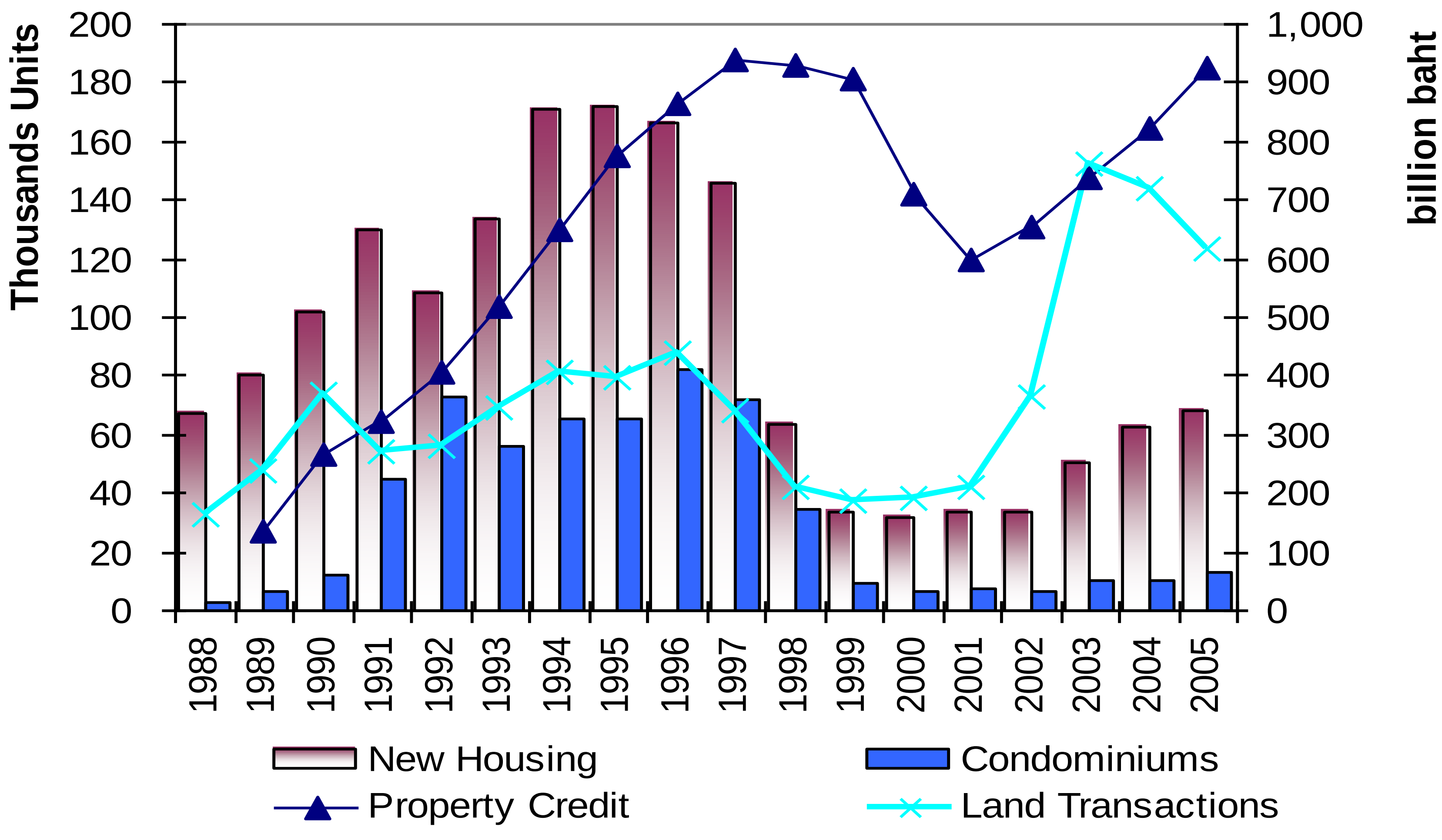


Bank loan expansions: sectoral trend



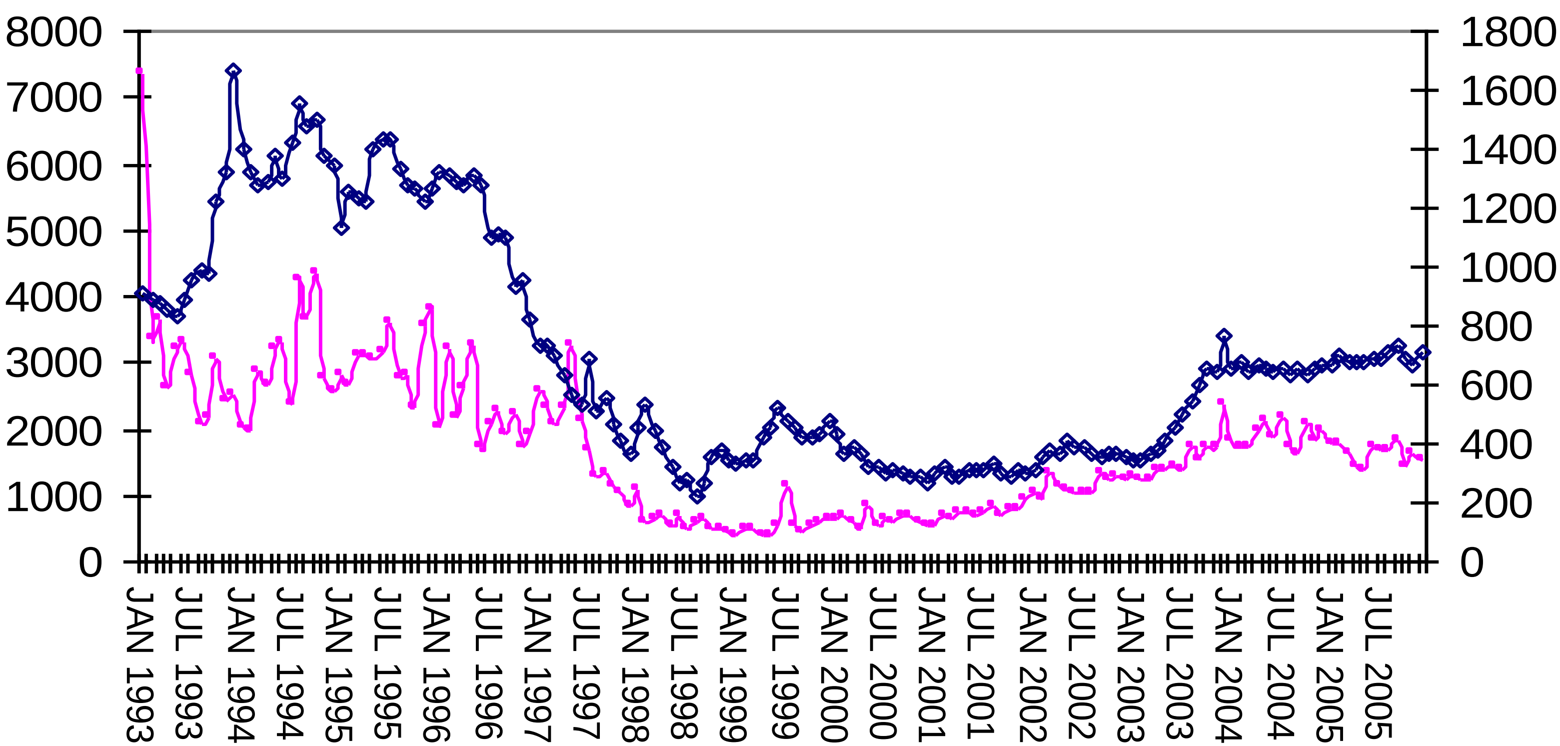
Source: Bank of Thailand

Property bubble



Source: Bank of Thailand

Property and stock bubbles: together we shall



Source: Bank of Thailand

Construction Areas Permitted in Municipal Zone (1,000 sq.m) — SET Index (RHS)

Blackie Sherrod: how the rich and the poor view investment

- “If you bet on a horse, that’s gambling.
- If you can make three spades, that’s entertainment.
- If you bet cotton stock will go up three points, that’s business. See the difference?”

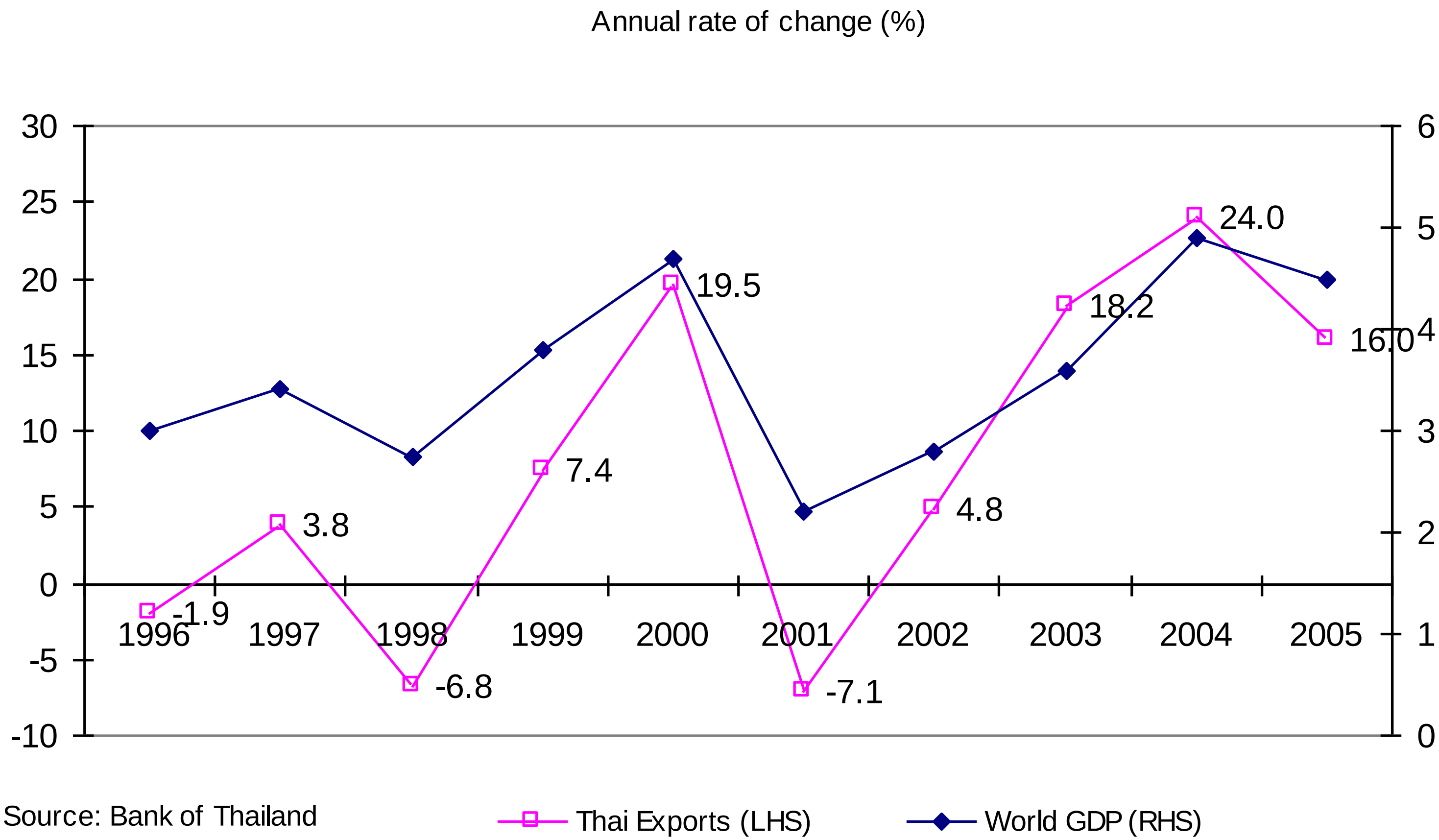
Irrational Exuberance
Robert J. Shiller

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

Irrational Exuberance

- **Psychological Factors**
- **Herd Behavior and Epidemics**
- **Attempts to Rationalize Exuberance**
- **Efficient markets, Random walks, and bubbles**

Impact of world business cycle: exports fluctuations: 1990-1995



Source: Bank of Thailand

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 less resilient since 2006?
- Are we experiencing a property bubble? If so, explain why. If not, why not? Should the Central Bank prick asset bubbles?
- How far can a country rely on domestic demand stimulus?

Inflation is on the way back in the rich world, and that is good news

- It was telling that Germany, a country with a phobia of rising prices, in the first week of 2017 reported a jump in inflation. Its headline rate rose from 0.8% to 1.7% in December.
- After two years of unusually low price pressures, inflation across the rich world is set to revive this year.

Inflation is on the way back in the rich world, thanks to the oil price

- Much of this is because of the oil price, which fell below $30 a barrel in the early months of 2016 but has recently risen above $50 (see chart).
- The **three big drivers of inflation** in the rich world: the price of imports, capacity pressures in the domestic economy and the public's expectations.

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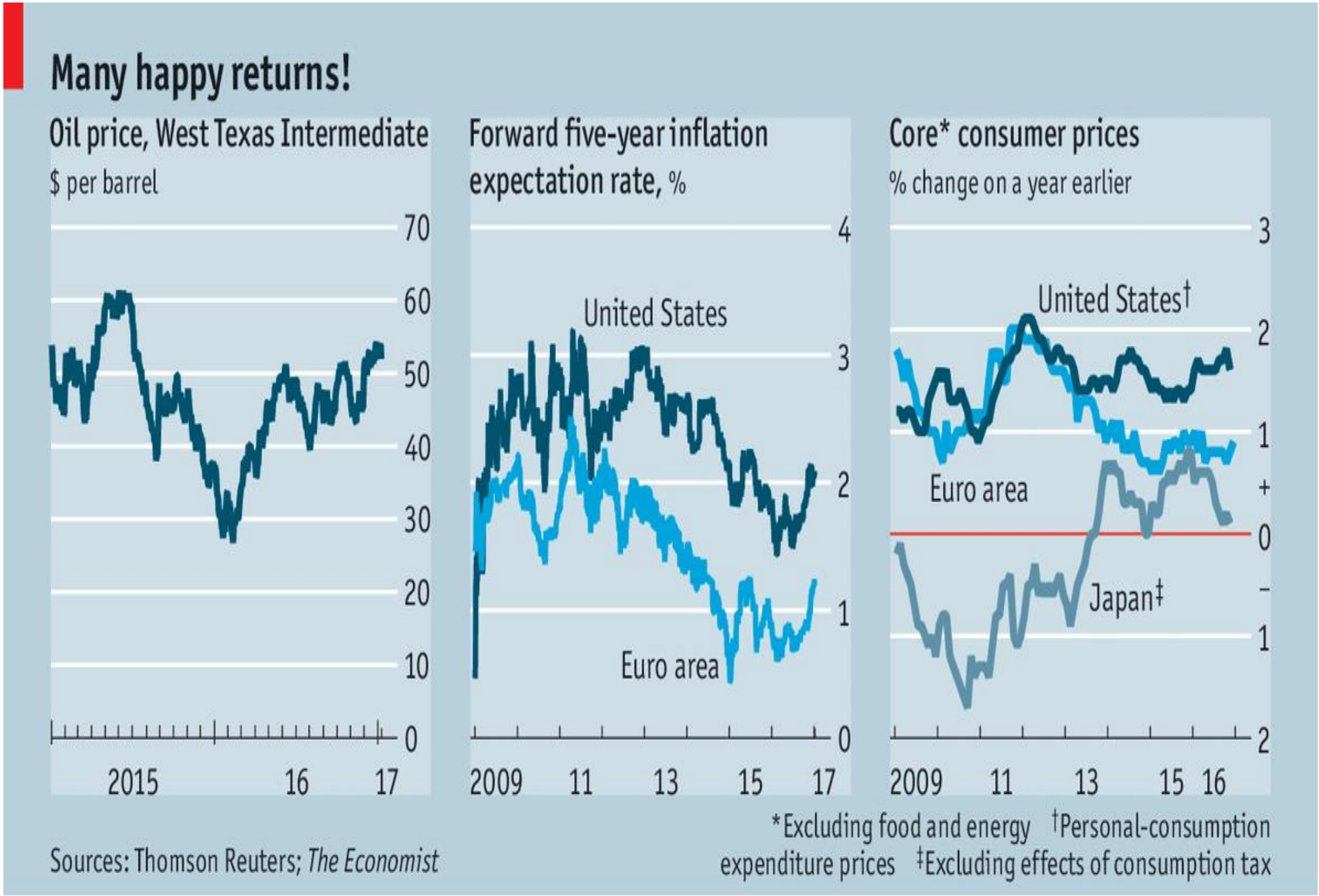
China and world inflation

- After falling for 54 months, producer prices in China are climbing at last.
- Prices at the factory gate rose by 5.5% in the year to December.
- China’s supply glut, though still vast, is shrinking.
- An improving demand climate is reflected in upbeat surveys of manufacturing purchasing managers across Asia and in the rich world.
- It is also visible in a revival in commodity prices.

Deflationary fears are at last on the point of being banished

Jan 14, 2017



Economist.com

China is back on track

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2. Capacity Pressure

- The second big influence on inflation is the amount of slack (or spare capacity) in the domestic economy.
- The unemployment rate, measuring labour-market slack, is often a convenient gauge.
- On that basis, America's economy, with unemployment at 4.7%, is close to full capacity.
- Average wages rose by 2.9% in the year to December, the highest rate since 2009.
- Assuming that trend productivity growth is around 1%, then wage growth of around 3% is consistent with a 2% **rise in unit-wage costs**, in line with the Fed's inflation target.

3. Expected inflations

- Firms will feel freer to push up prices, and employees to bargain for bigger wage rises, if they expect higher inflation.
- In theory expectations are in the gift of central banks. If they can convince the public that they have the tools to regulate aggregate demand, and thus the level of slack, expectations should converge on the central bank’s inflation target, usually 2% in rich countries.
- But expectations are also influenced by what inflation has been recently.