

# **The hard road ahead for Thailand's economic recovery**

**Effectiveness of macro policy in response to GFC**

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

# 1. The long road to recovery

## The Hard Road Ahead for Thailand's Economic Recovery

---

### **Bhanupong Nidhiprabha**

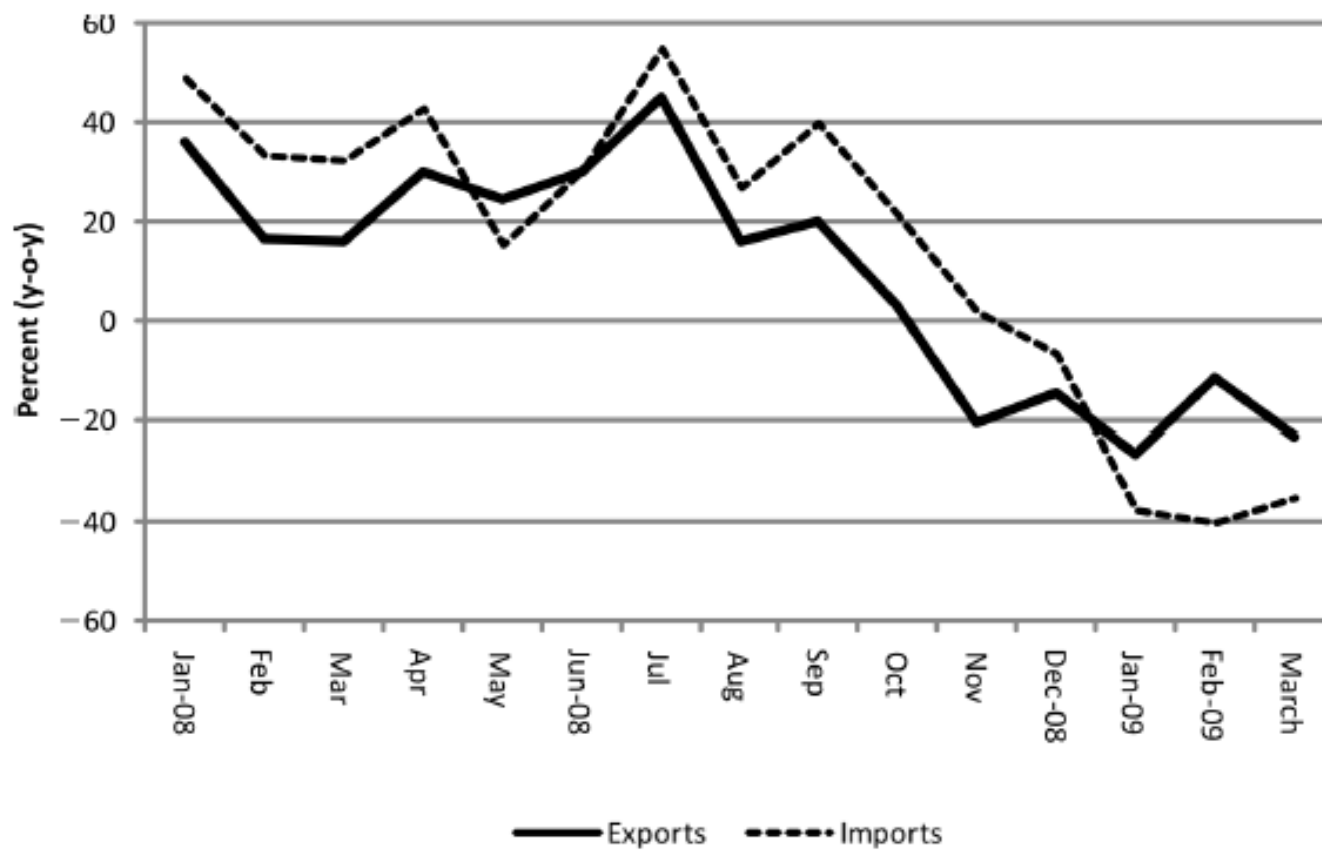
Thammasat University  
Faculty of Economics  
2 Prachan Road  
Bangkok 10200  
Thailand  
bhanupong@econ.tu.ac.th

### **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.

## The Hard Road Ahead for Thailand's Economic Recovery

Figure 1. The collapse of the last engine of growth



Source: Ministry of Commerce

## The Hard Road Ahead for Thailand's Economic Recovery

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

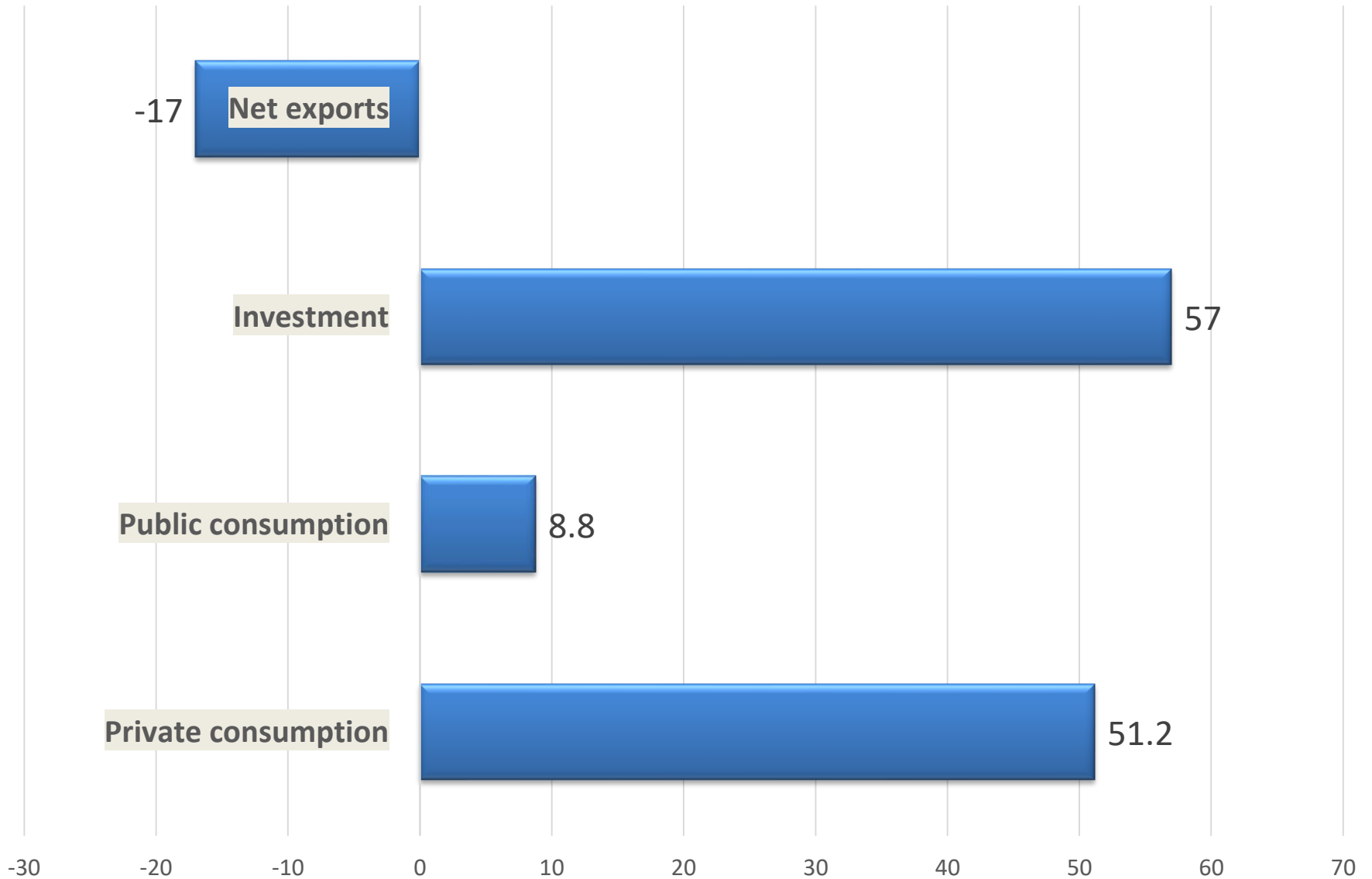
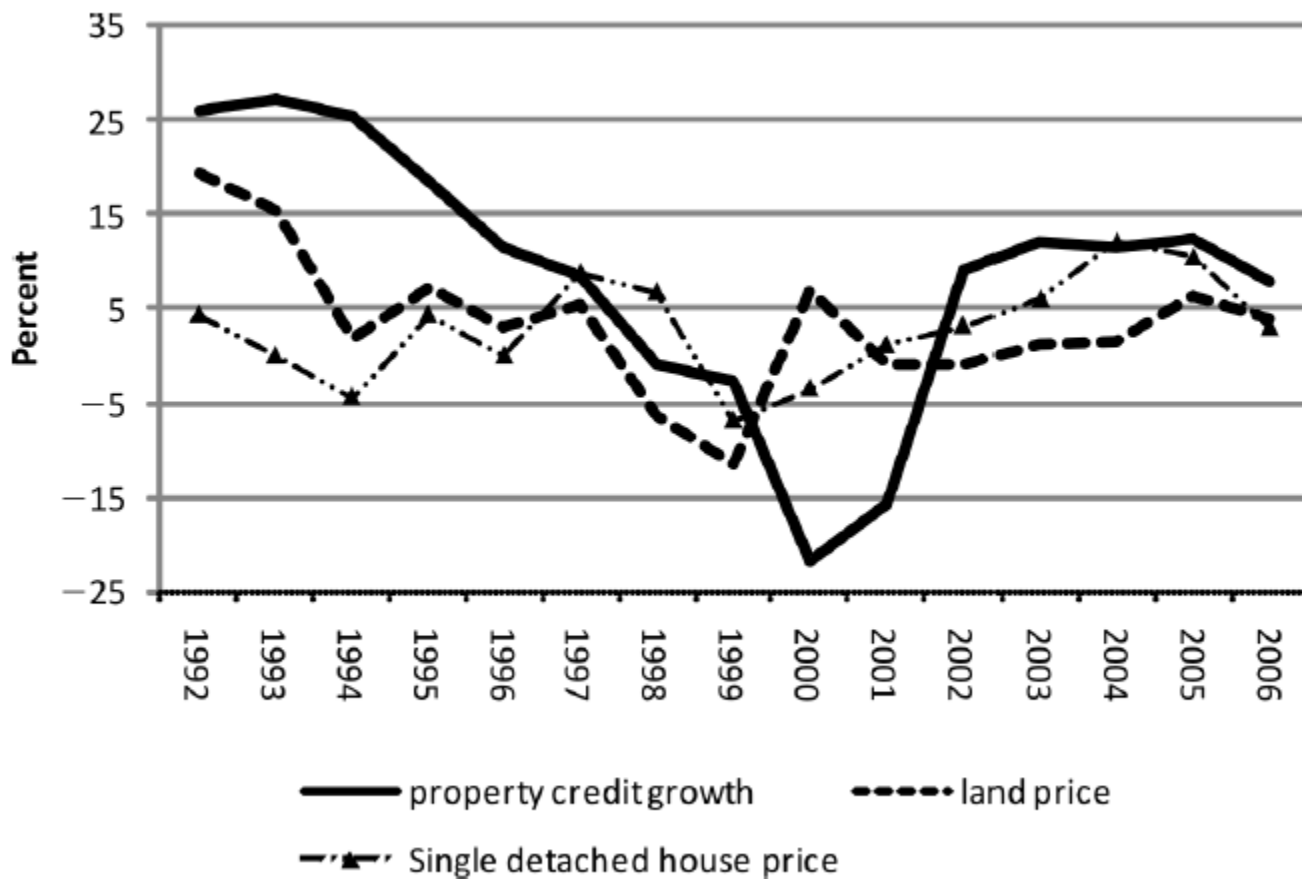


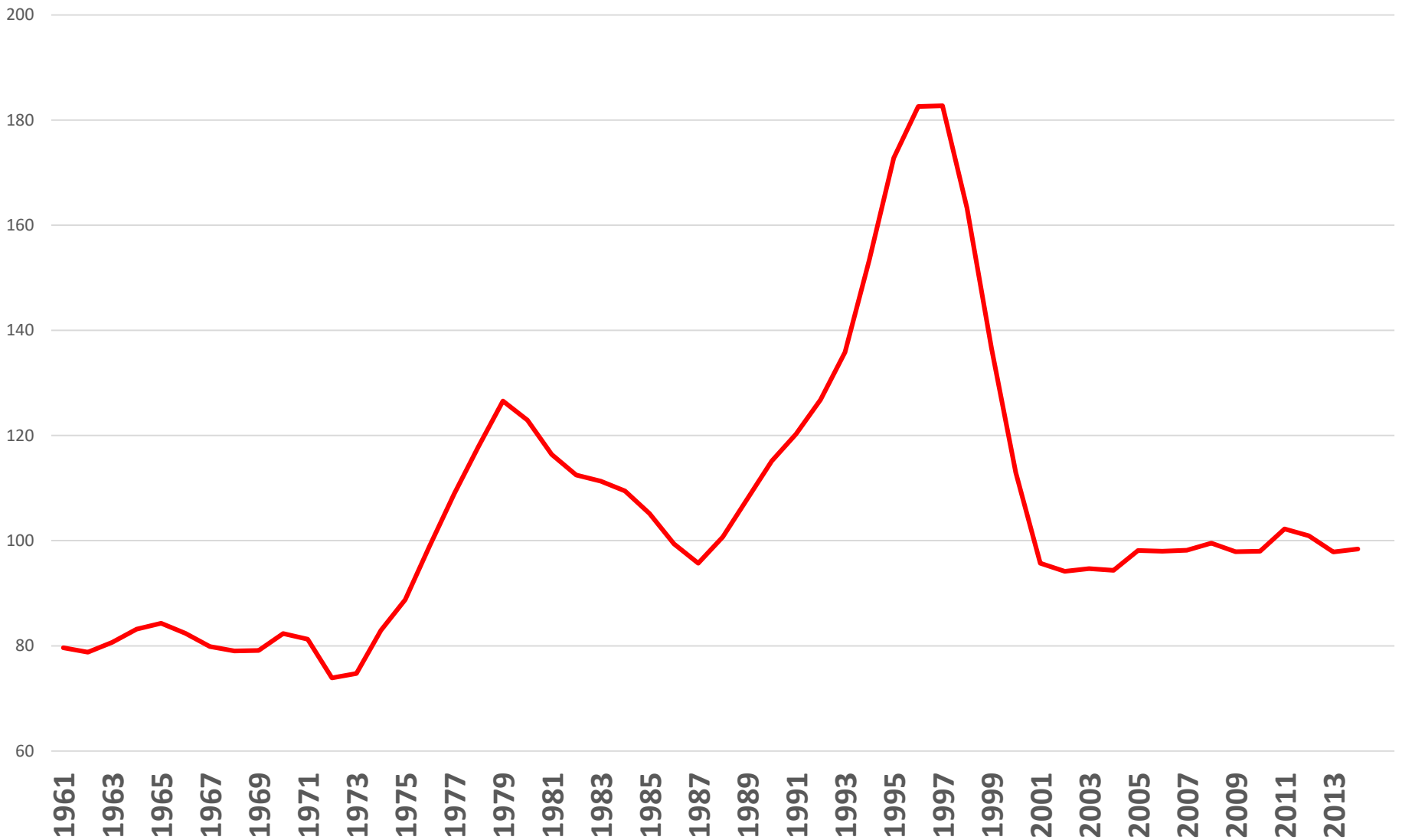
Figure 4. Real estate bubbles and property credit



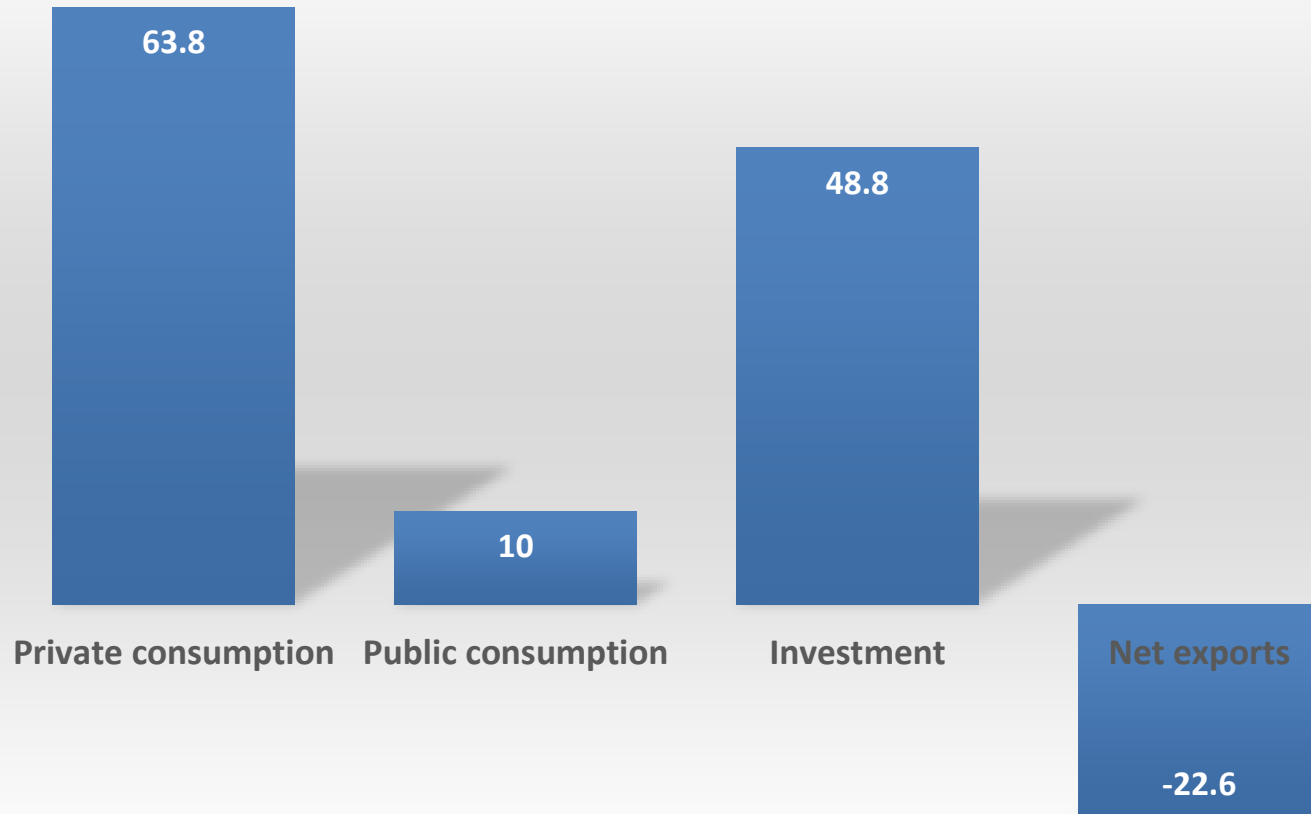
# Austrian Business Cycle Theory

- 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.

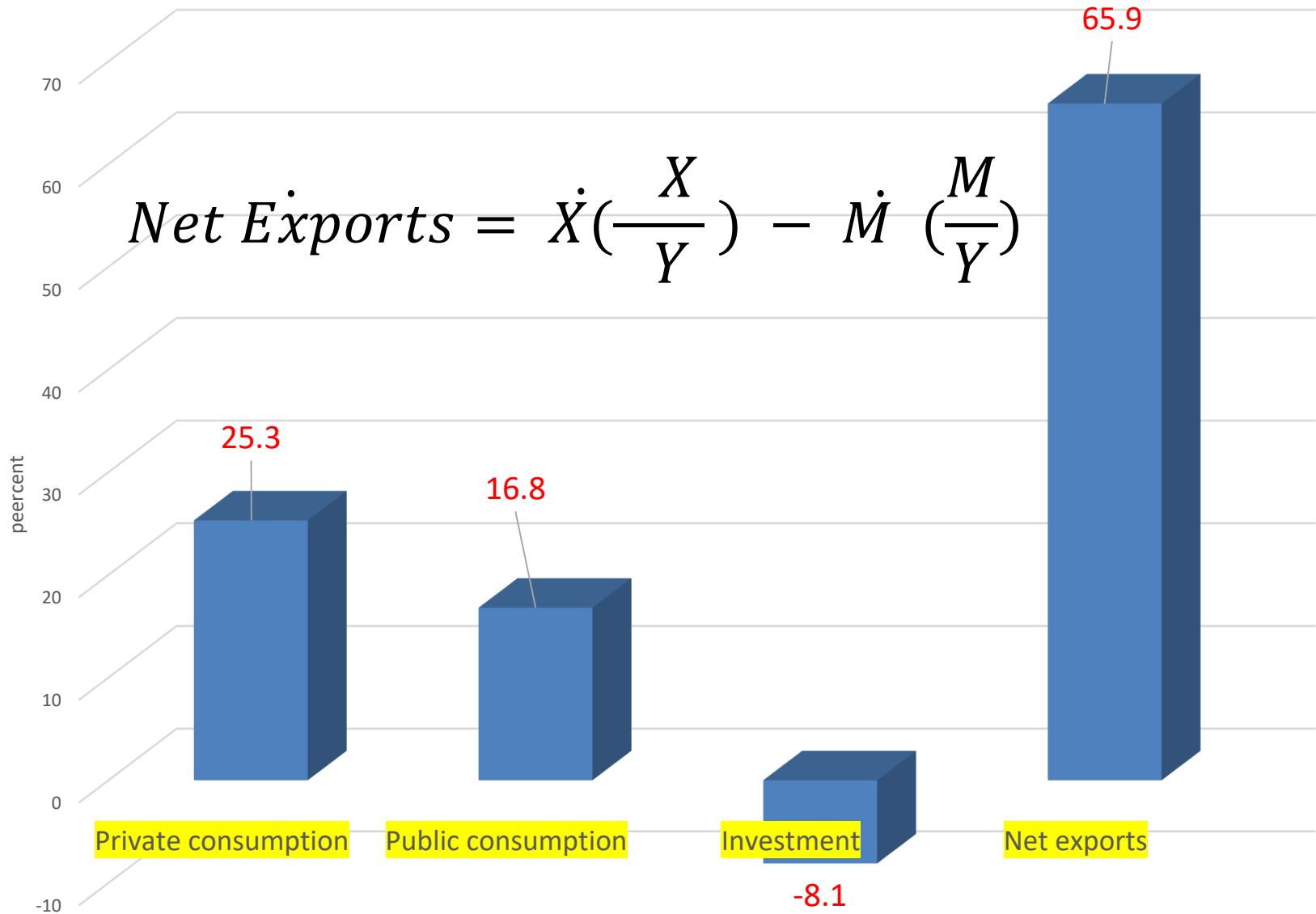
# Commercial Banks: loan/deposit ratio



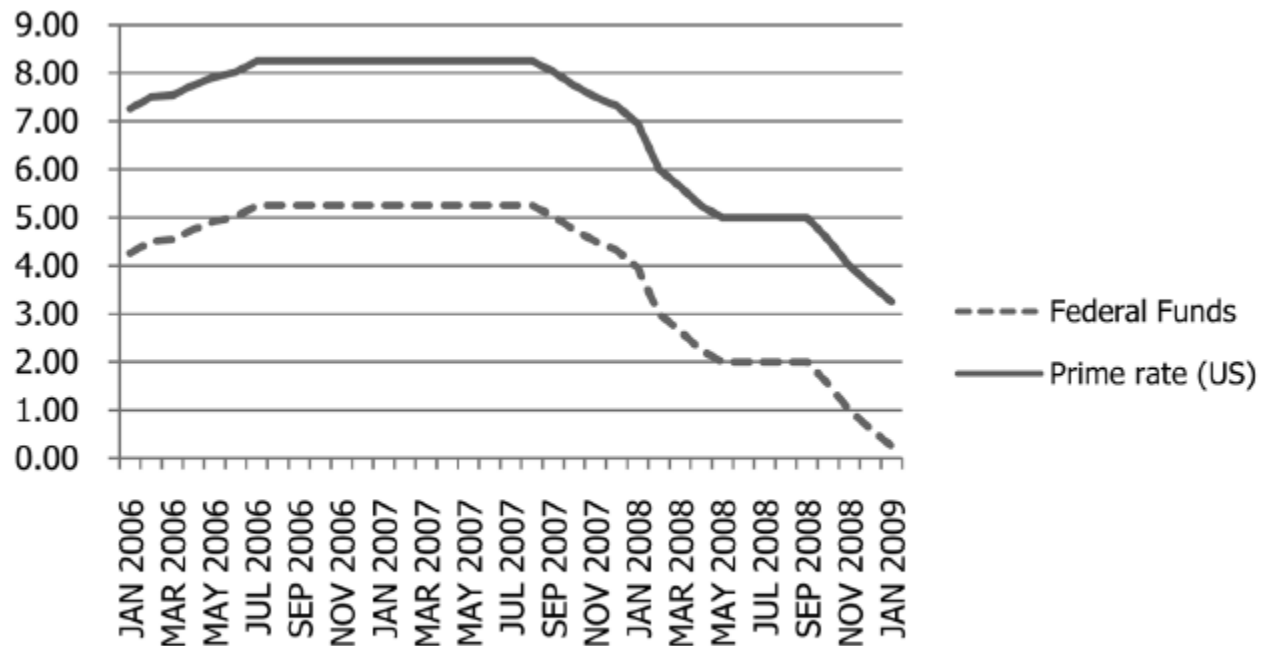
# Contribution to GDP growth: 1999-2005



## Contributors to GDP growth: 2006-2007

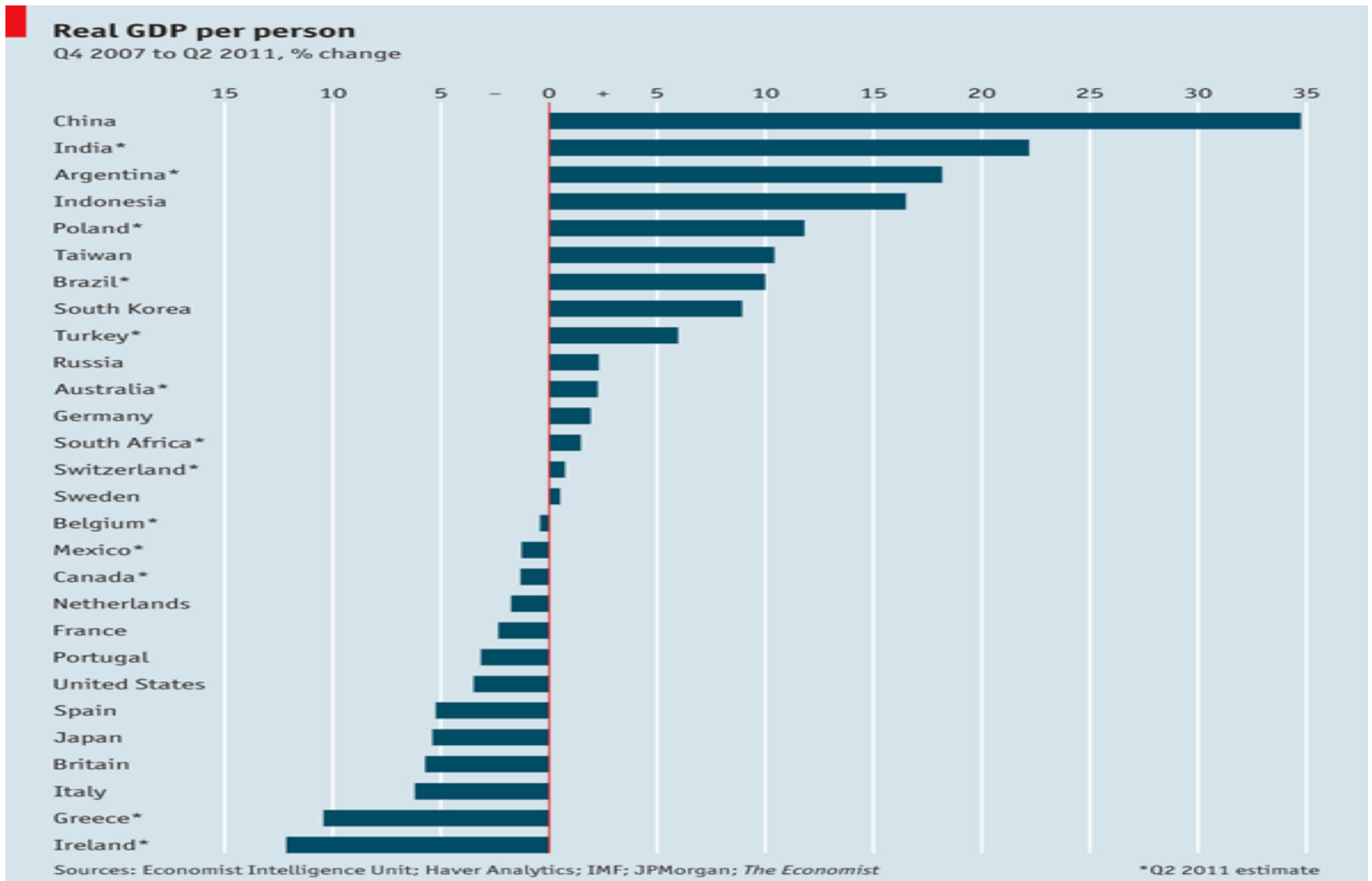


# The federal funds rate and impact on the U.S. prime rate

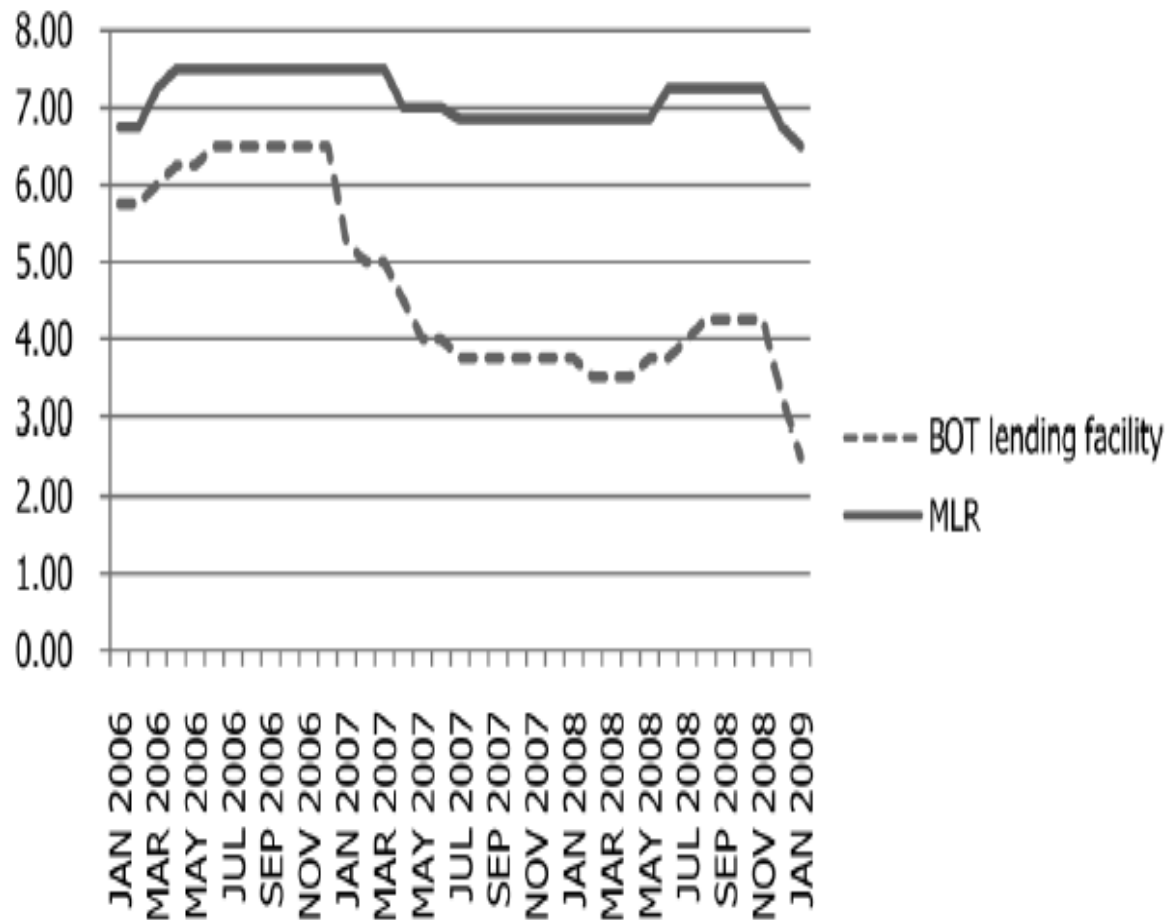


Source: Bank of Thailand.

# Global Recession and Recovery

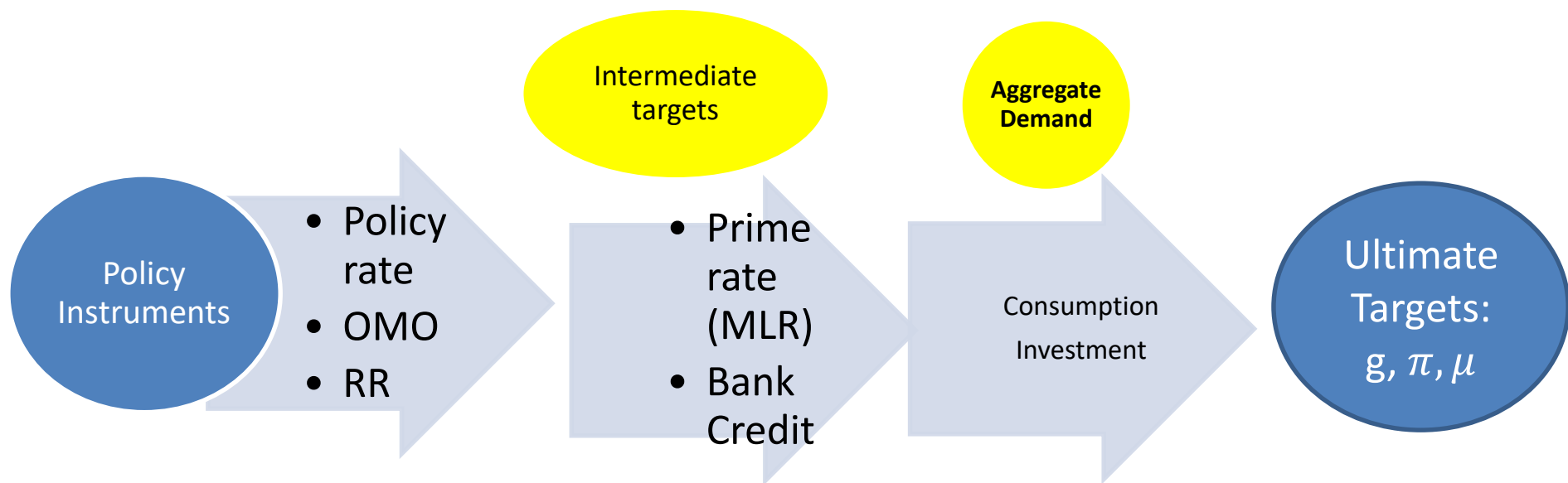


# The BoT key policy rate and impact on commercial bank Minimum lending rate (MLR)



# “If anything can go wrong, it will.”

## *Murphy’s Law*

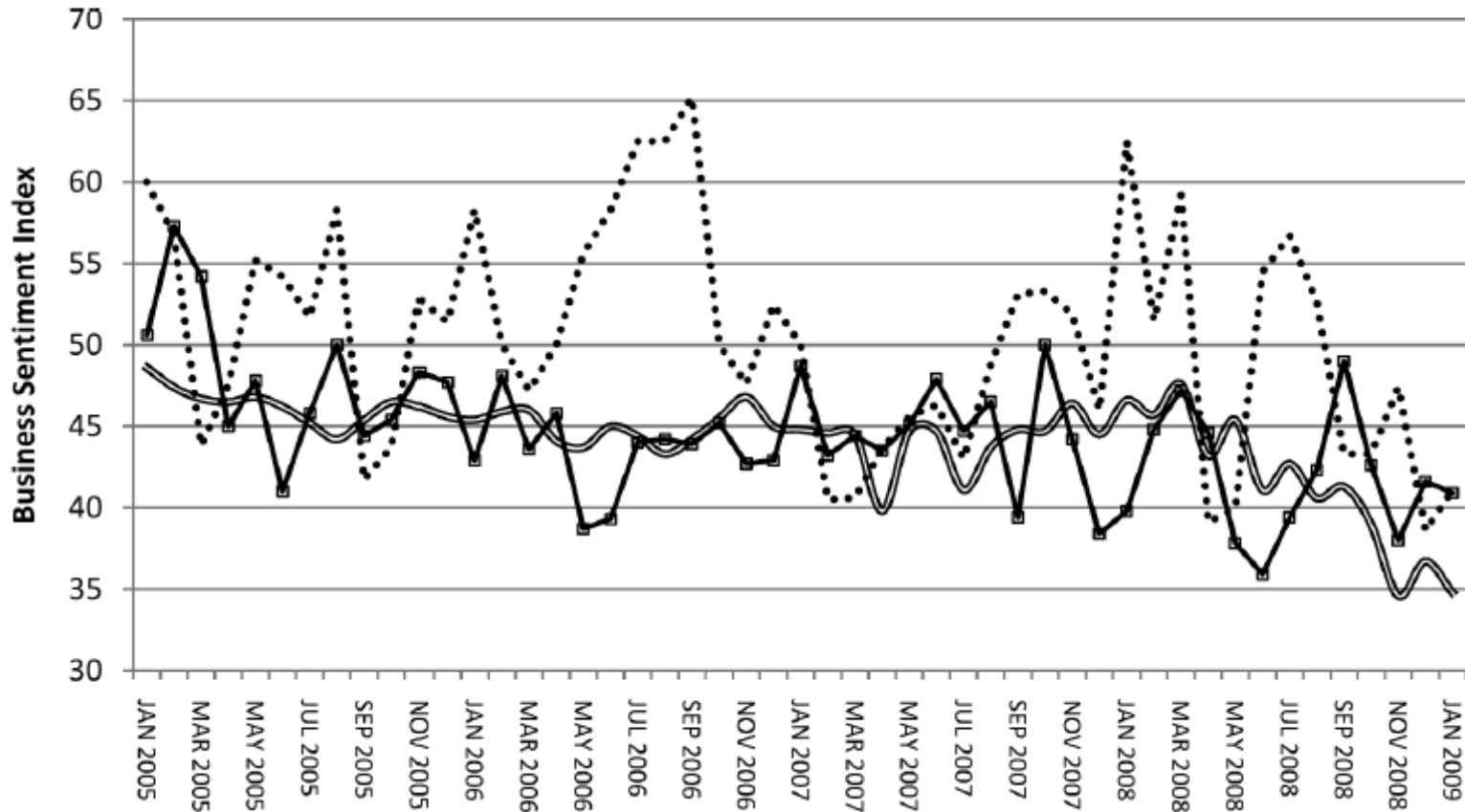


# Pessimism and effectiveness of monetary policy

- 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

Figure 6. Loss of business confidence



Theory of trade cycles: Psychological 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

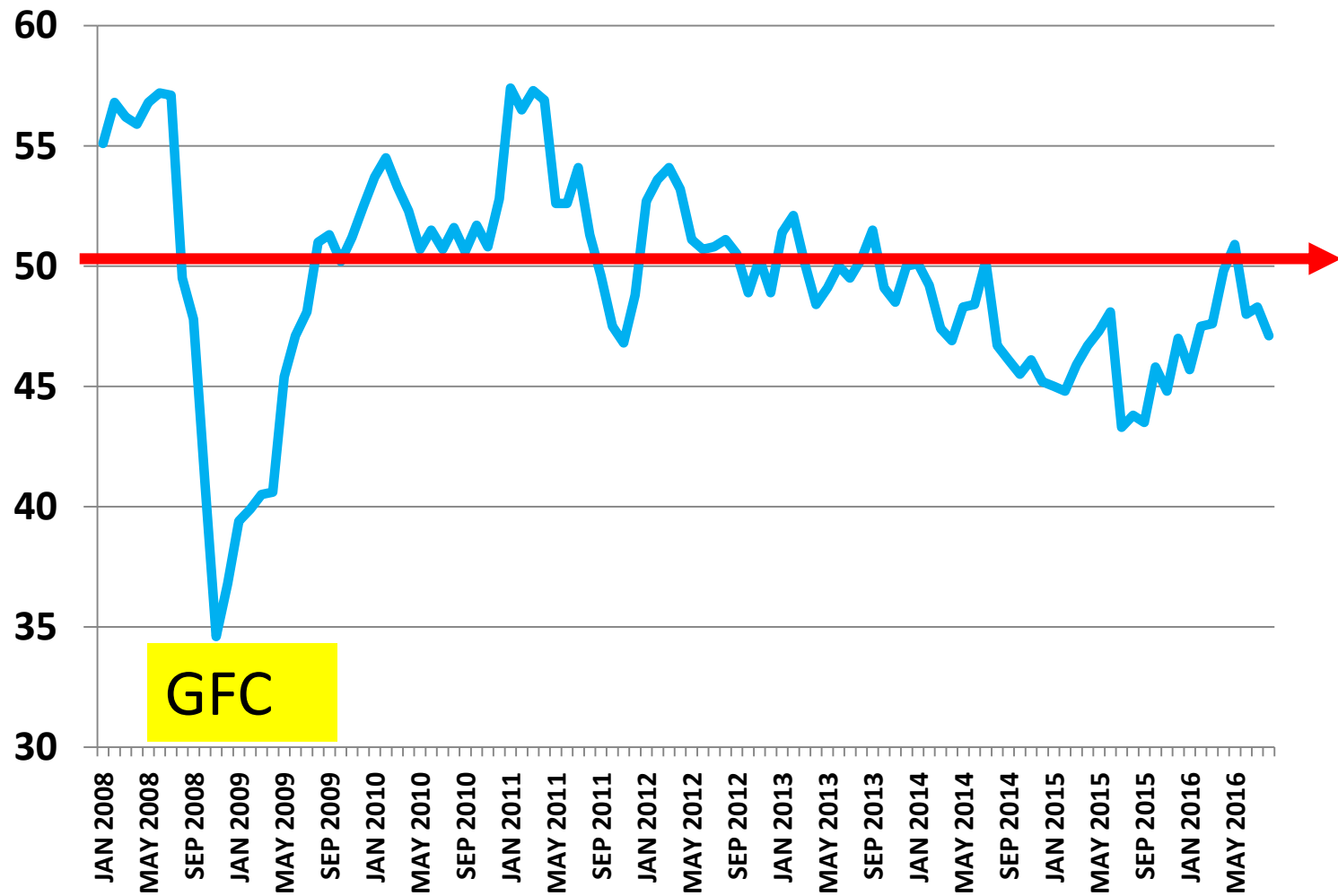
- Business sentiment can be restored and maintained by policy consistency.
- If the government and the public adhere to the rule of law, political shocks can be minimized as a concern for fairness would be eased.

# 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.

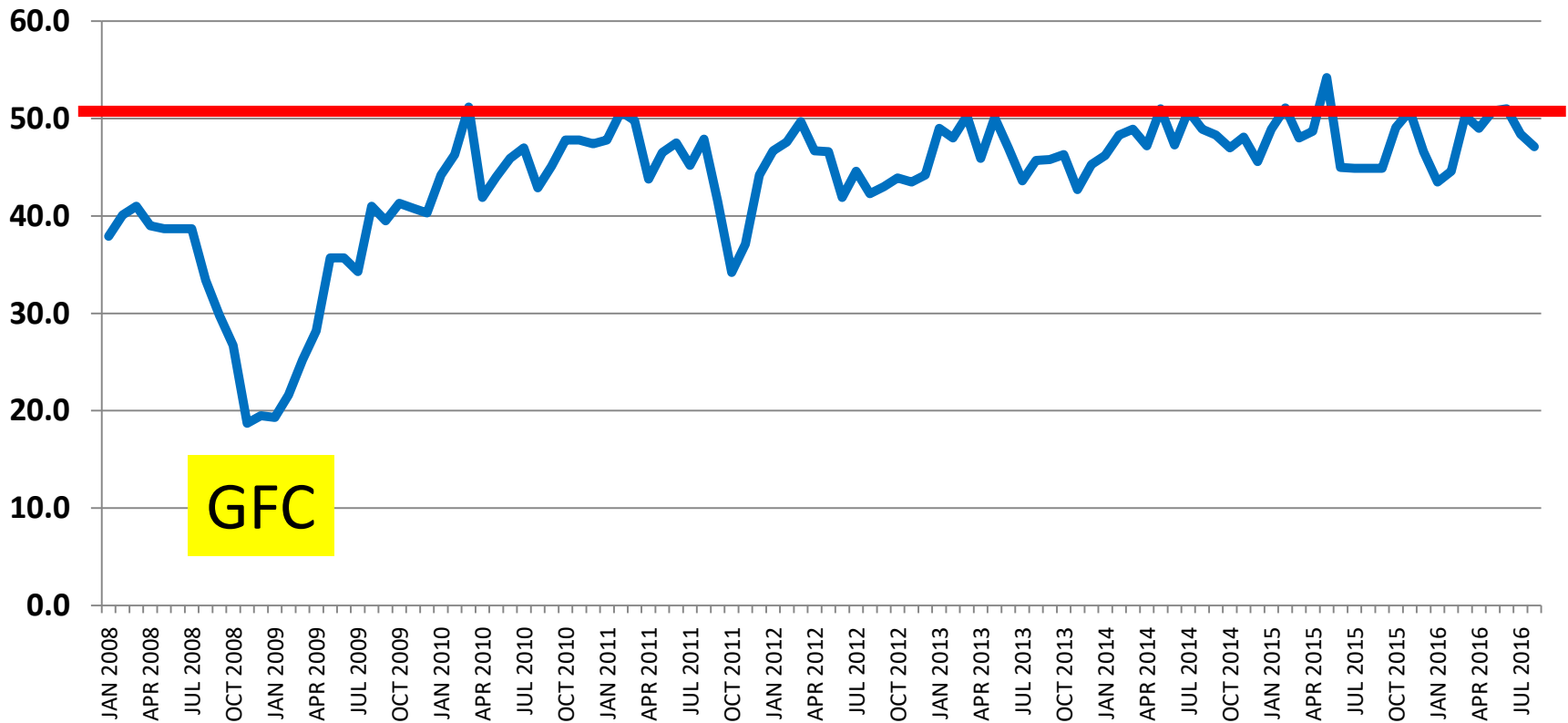
# Business Sentiment Index

## (1) *output prices*



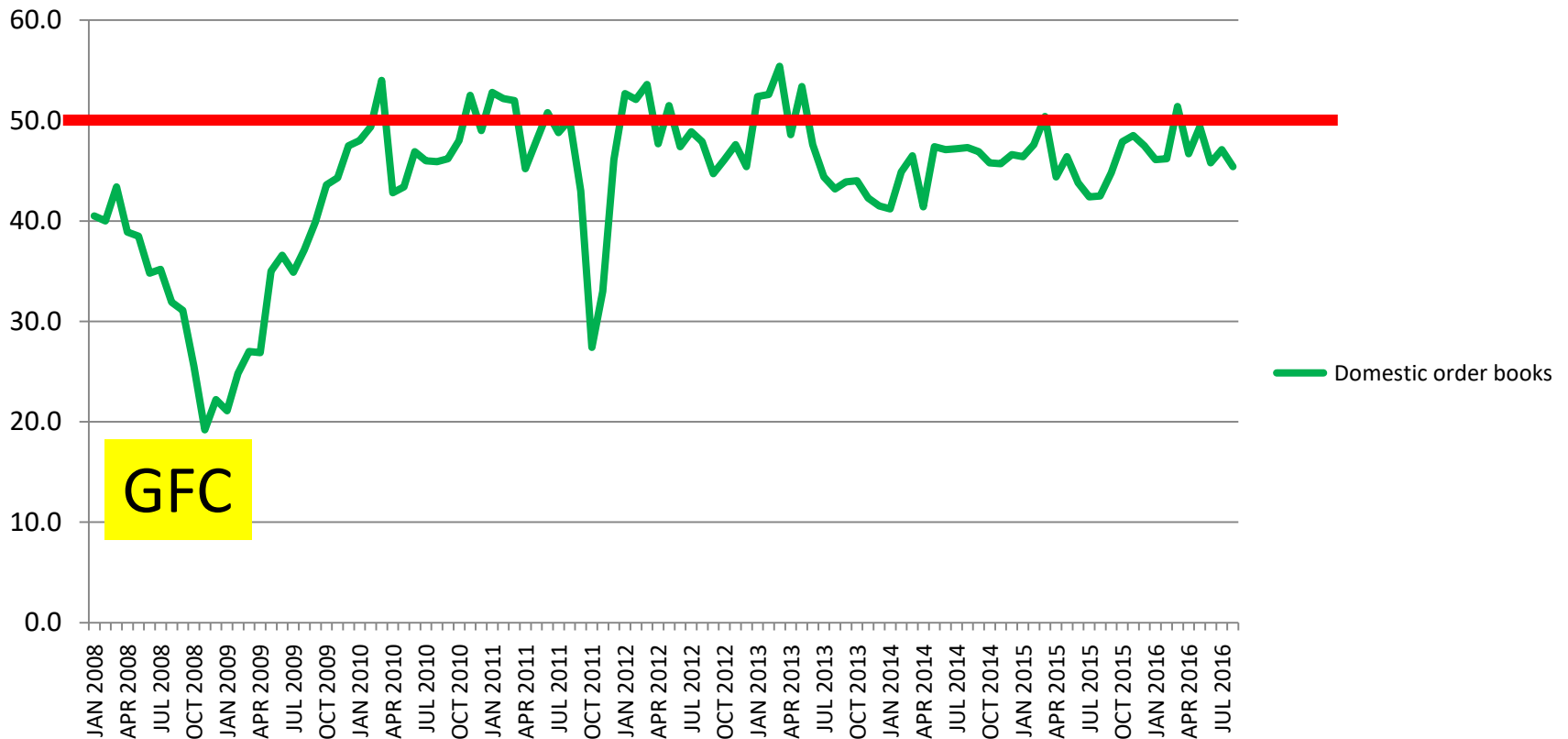
# Business Sentiment Index

## *(2) Foreign order books*



# Business Sentiment Index

## *(3) Domestic order books*



# 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

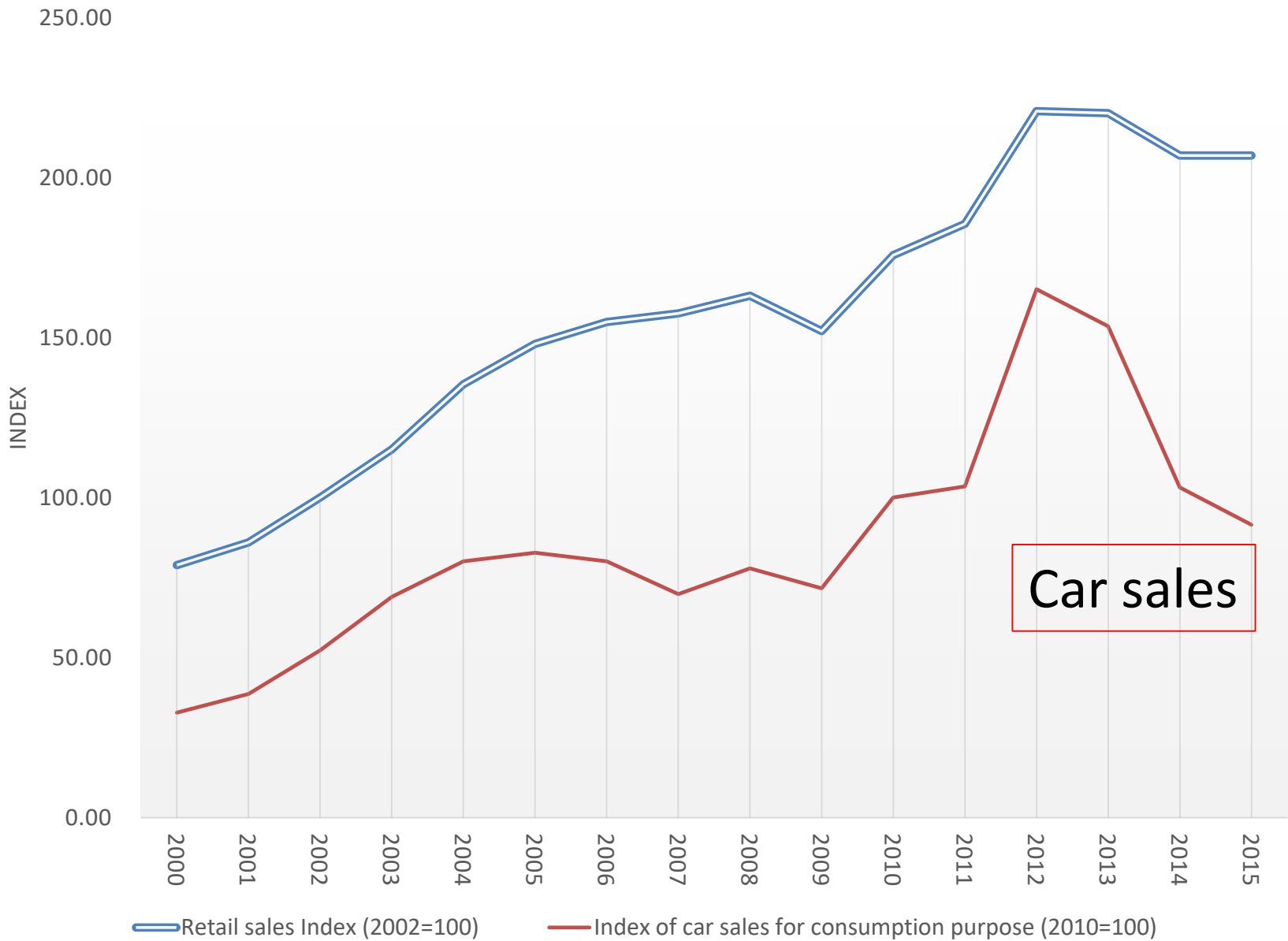
# Effectiveness of Thailand's Macroeconomic Policy Response to the Global Financial Crisis

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: LCH, PIH, RIH, 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

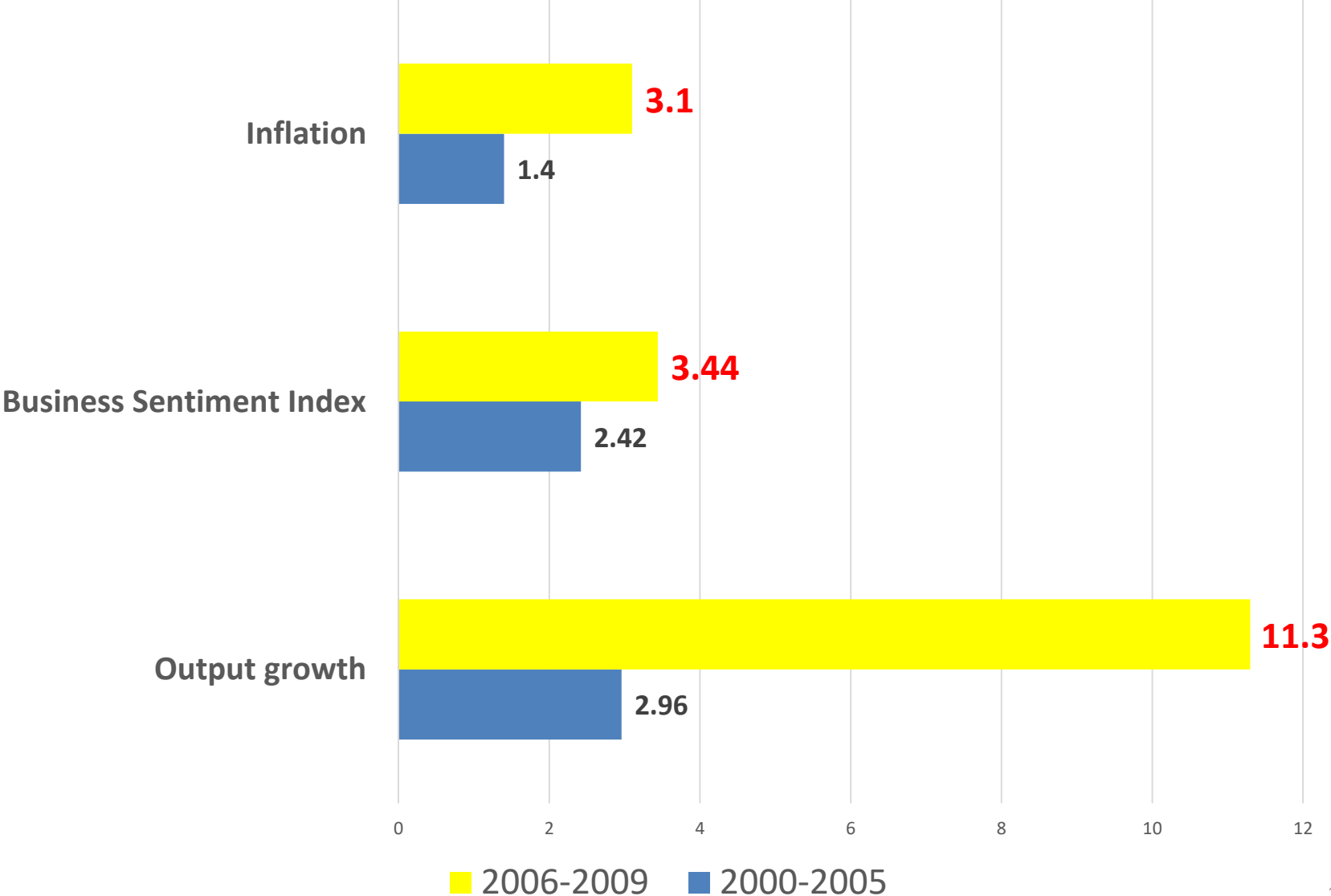
TABLE 2  
Volatility in Output, Price, and  
Business Confidence  
(Measured by standard deviation)

	<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.

# Heightened Volatilities

(standard deviation)

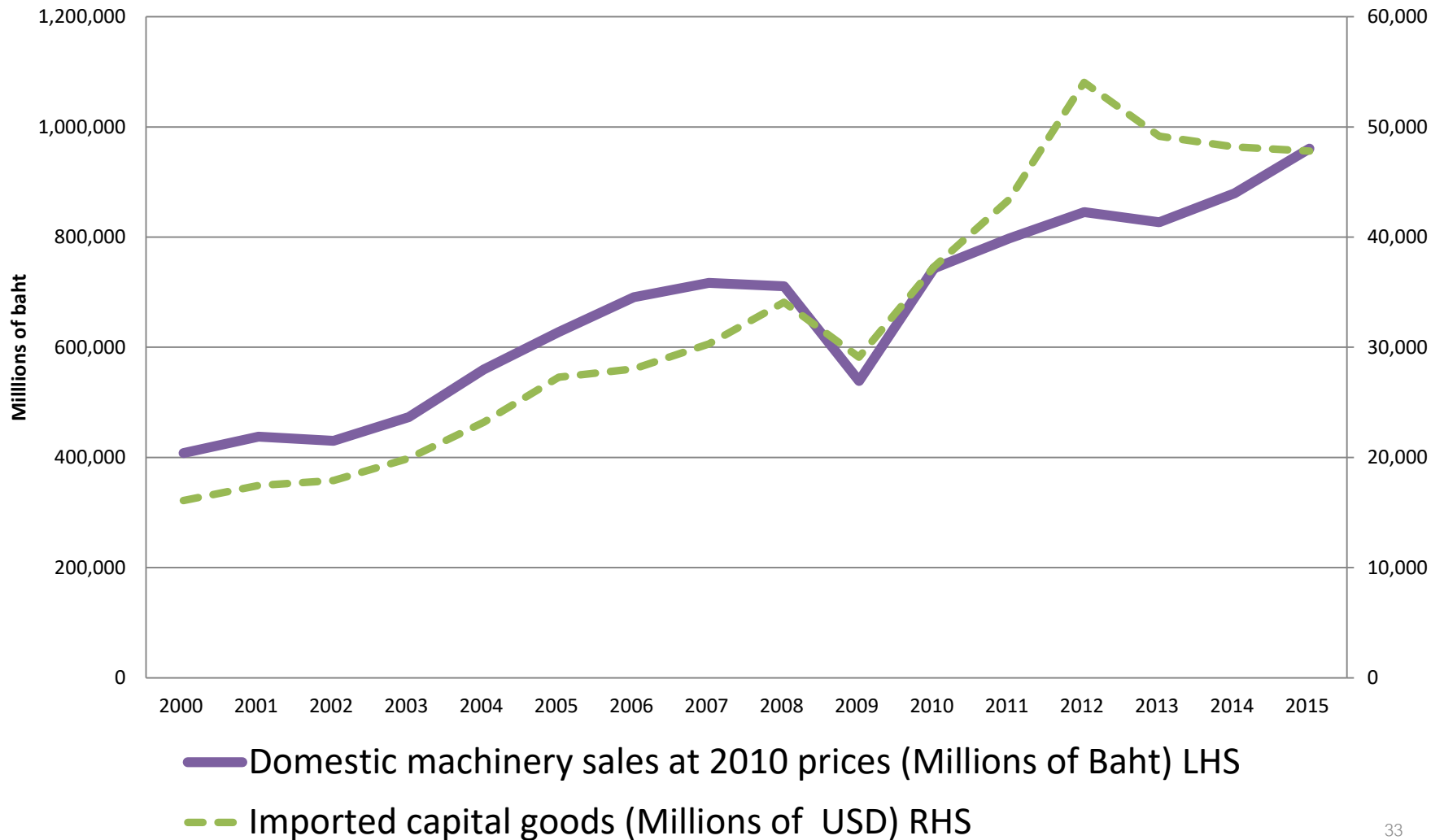


The effectiveness of policy responses depends on the government's ability to maintain the rule of law, accountability, human rights, and effective legal infrastructure.

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

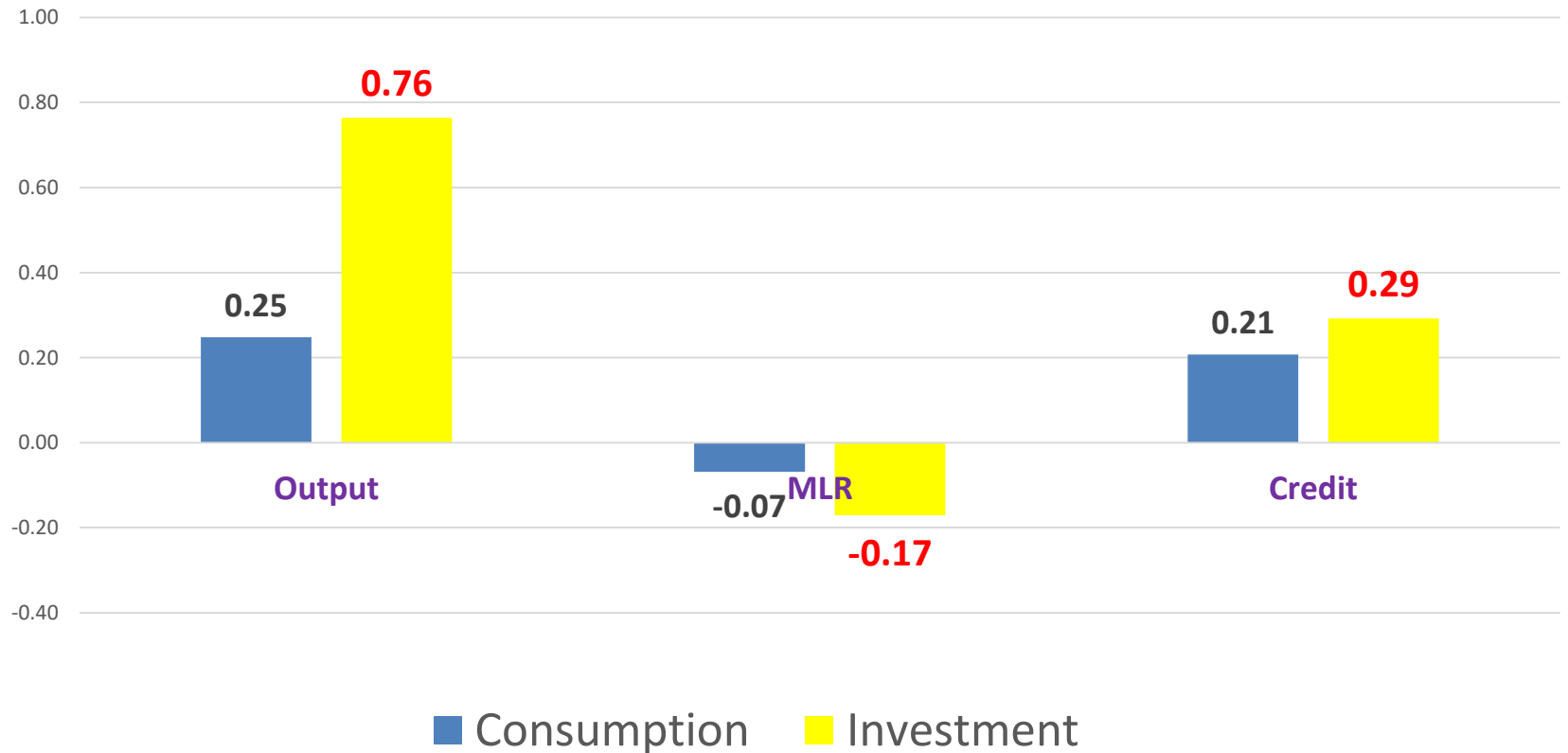
Investors can proceed with less concern about risk and uncertainty that may arise from policy inconsistency

# Factors determining private investment



# 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.

# 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 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.

These macroeconomic policies would 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.

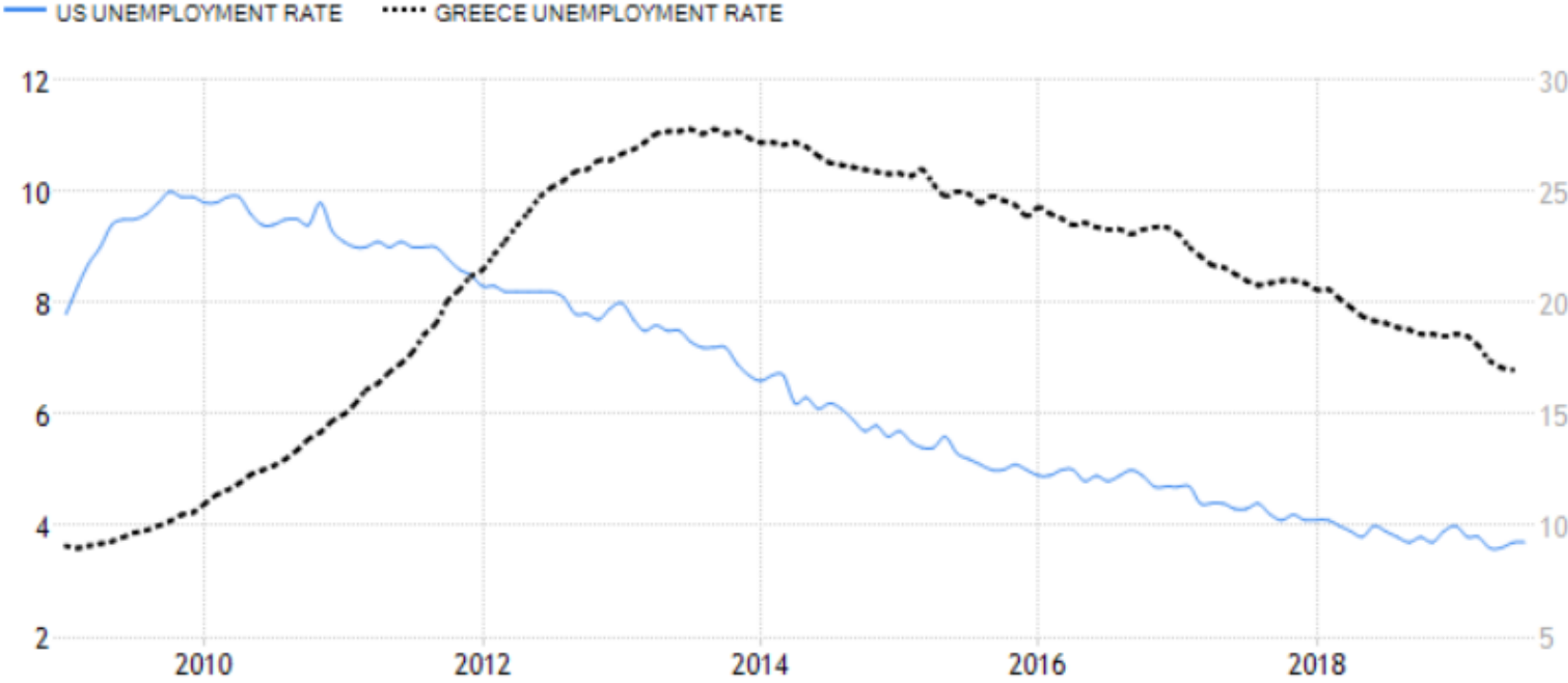
A sustainable recovery depends on the resumption of world trade expansion and regained consumer confidence.

# 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 quit at 40s. She had a high chance of having lung 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.

# Unemployment in Greece and the U.S.











SOURCE: TRADINGECONOMICS.COM

# Can Thailand avoid the downturn?

- ***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***.
- Fiscal and monetary policies would be more powerful with accompanying measures to boost ***consumer confidence and business sentiment*** to nourish the animal spirits of investors.

# MACROECONOMIC INDICATORS THEN AND NOW



1997	Indicator	2019
-2.8%	 <b>GDP growth</b>	2.3% (as of Q2)
US\$27 billion	 <b>Foreign reserves</b>	\$220.2 billion (as of Aug 30)
-\$3.1 billion	 <b>Current account</b>	\$1.8 billion (as of July)
41.37 on average in 1998	 <b>Baht value vs dollar</b>	30.65 (as of Sept 6)
Corporate debt at 77.5% of Thailand's total external debt	 <b>Debt</b>	Household debt at 78.7% of GDP (as of Q1)
Over 40%	 <b>NPLs</b>	2.95% (as of Q2)
4.4% in 1998	 <b>Unemployment rate</b>	1.1% (as of July)
<ul style="list-style-type: none"> <li>● Aggressive lending by financial institutions</li> <li>● Oversupply and speculation in real estate</li> <li>● High debt-to-equity ratio</li> <li>● Hot-money inflows and burgeoning foreign debt</li> </ul>	 <p><b>Vulnerabilities</b></p>	<ul style="list-style-type: none"> <li>● Domestic political uncertainty</li> <li>● Search-for-yield behaviour in properties and deposit interest of savings cooperatives</li> <li>● Slow advancement of technology adoption</li> <li>● High household debt</li> <li>● Ageing population and shortage of skilled labour</li> </ul>

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