

The Resilience of The Thai Economy: *1991-2005*

Bhanupong

Lecture 4

Reading: Macroeconomic Policy (Chapter 2)

Course Syllabus

Lecture 4: Resilience of the Thai economy: 1991-2005

There appears to be some structural mechanisms that would lessen the impact of economic crisis, whether shocks are internal or external.

It is impossible to rule out various future shocks such as oil price hikes, realignments of major currency values, or crisis contagion.

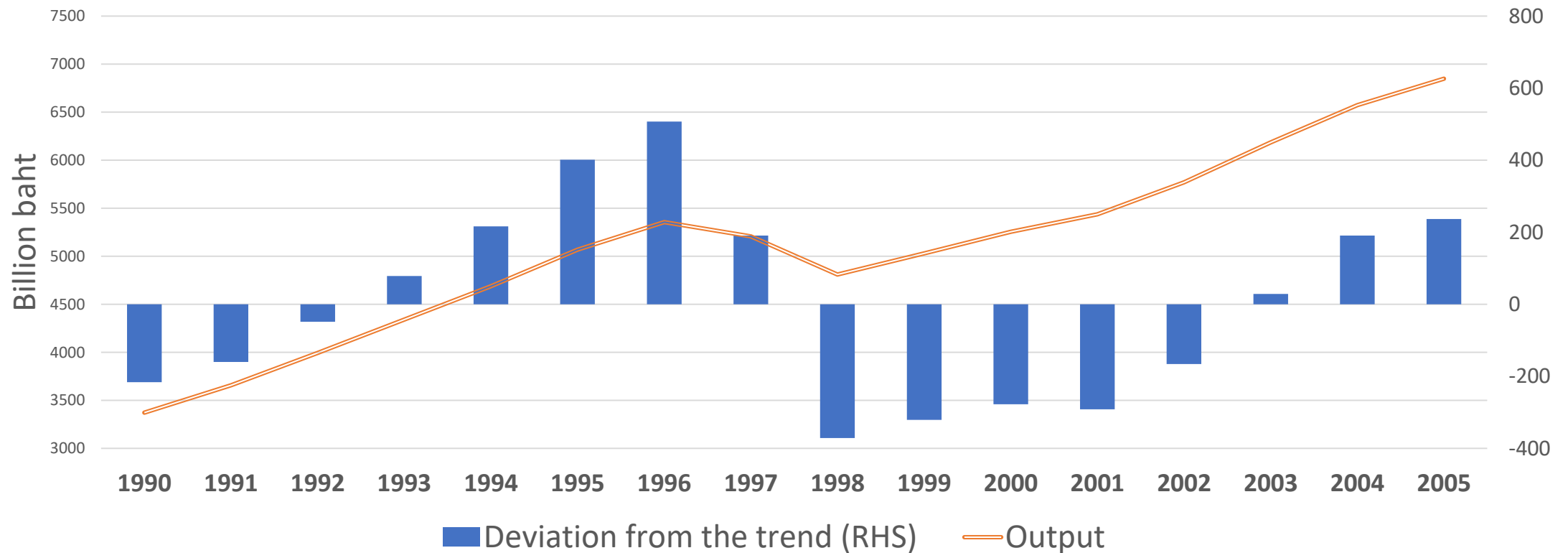
Is the Thai economy resilient enough to regain its pre-shock growth path in a V-shaped recovery in 2019/2020?

Main Themes

1. Booms and busts
2. Human capital investment
3. Resilience
4. Irrational exuberance
5. Exports and world business cycle
6. How recessions start

1. Booms and busts: Asian Financial Crisis (1998)

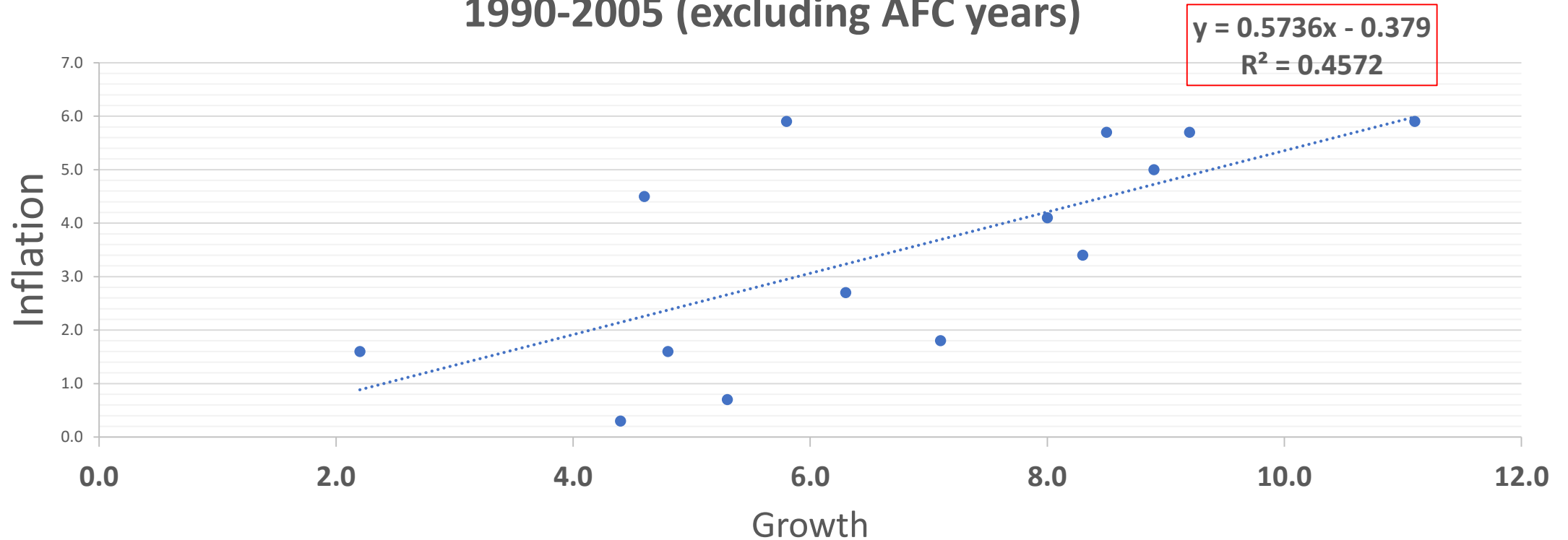
Fig 1: Deviation from the stable growth path



Overheated economy gave rise to demand pull inflation

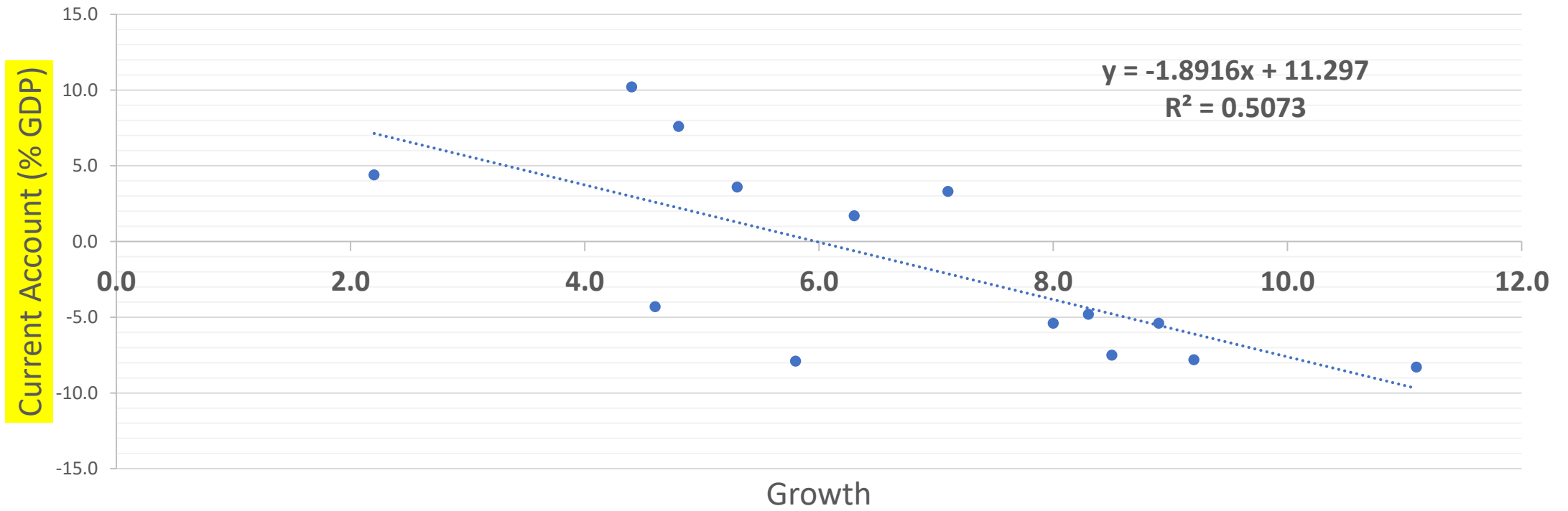
why are AFC years excluded in Figure 2

Figure 2. Growth-Inflation tradeoff
1990-2005 (excluding AFC years)



High growth and widening current account deficit

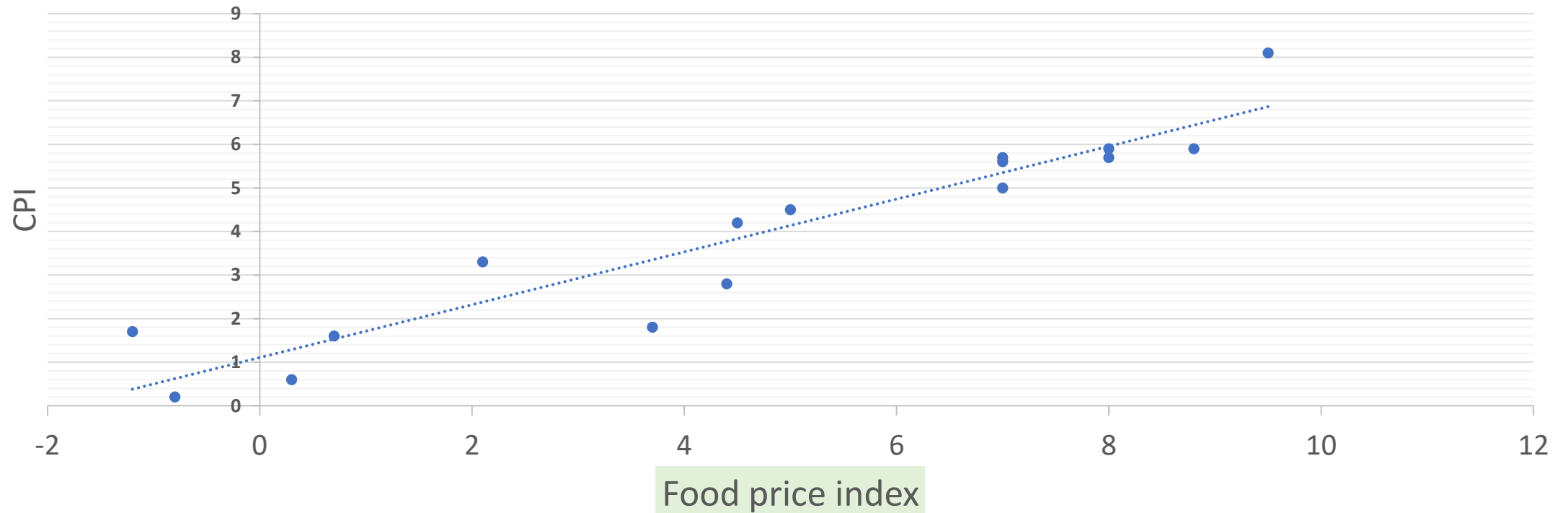
Figure 3. Growth and External Imbalance: 1990-2005
excluding 1997 and 1998



The importance of food prices in the CPI

Figure 4. CPI and food price inflation
1990-2005

$$y = 0.6063x + 1.1084$$
$$R^2 = 0.8829$$



How to dealing with rising oil prices

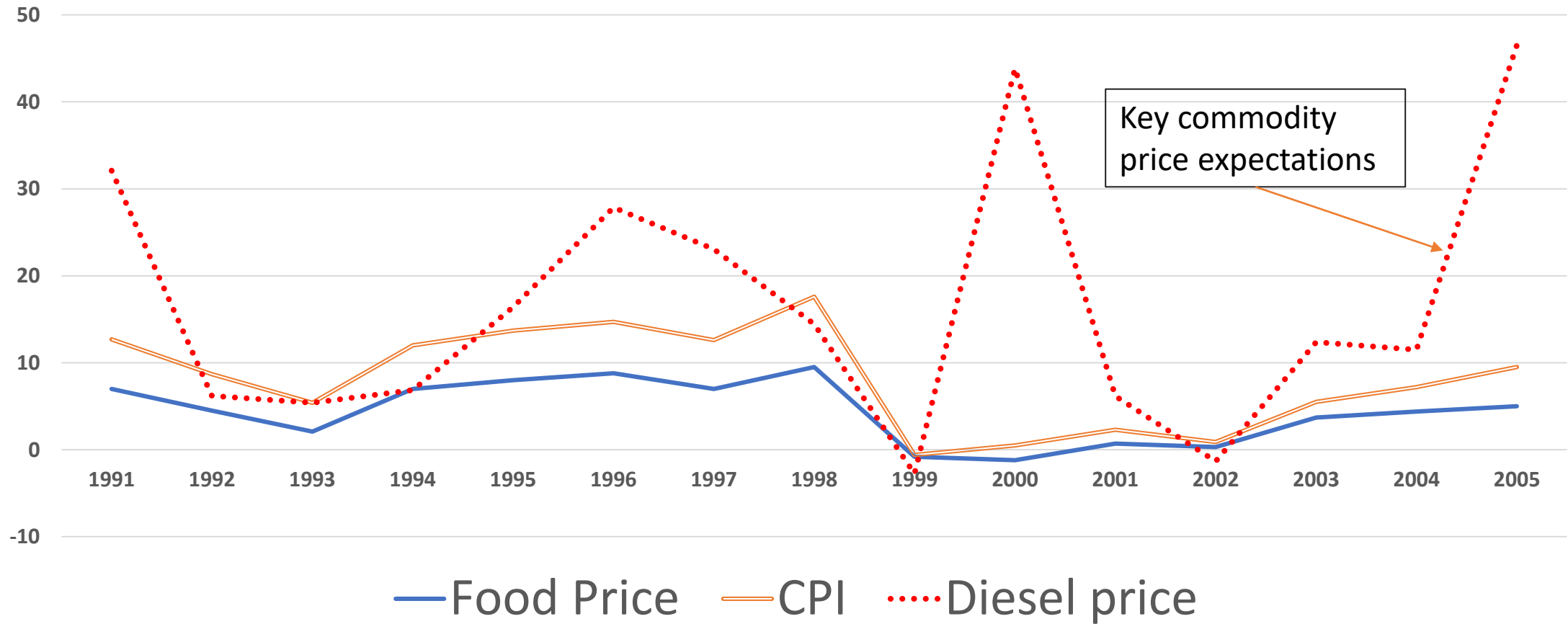
Midnight Economist

Figure 5 Crude Oil Monthly Price
1992-2005



Inflation inertia

Figure 6. Inflationary Expectations (Sticky prices)

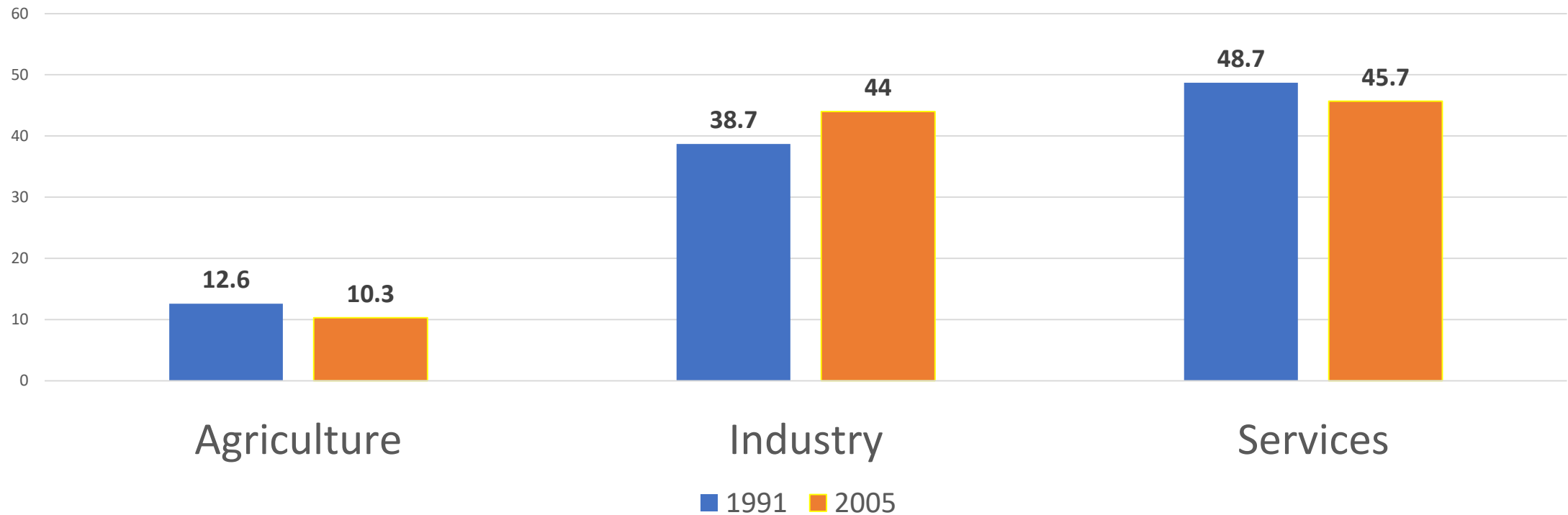


2. The role of human capital in economic development: Theodore Schultz

- 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.
- 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.

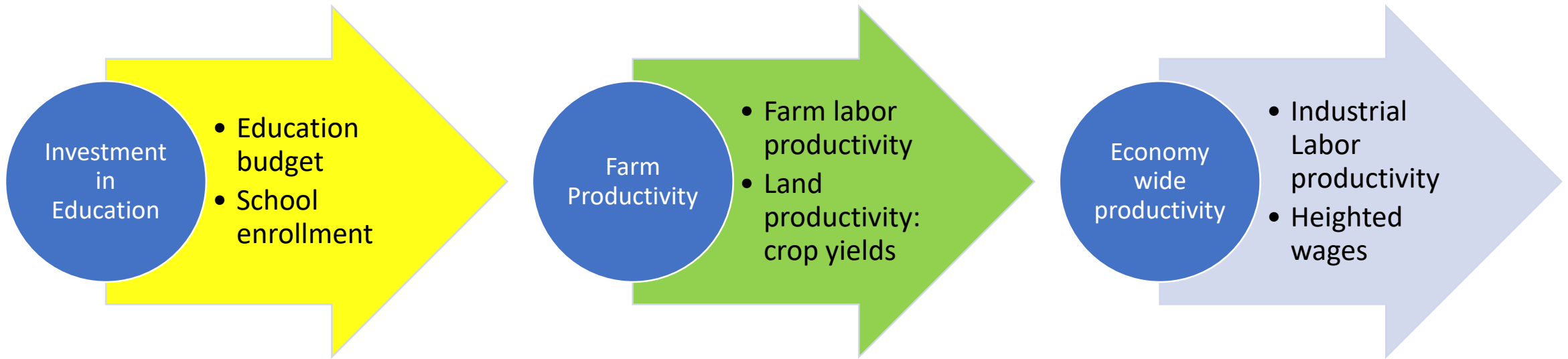
Gradual transformation of output structure

Figure 7: structural transformation
(Share of sectoral output in GDP)



Human capital (public) 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

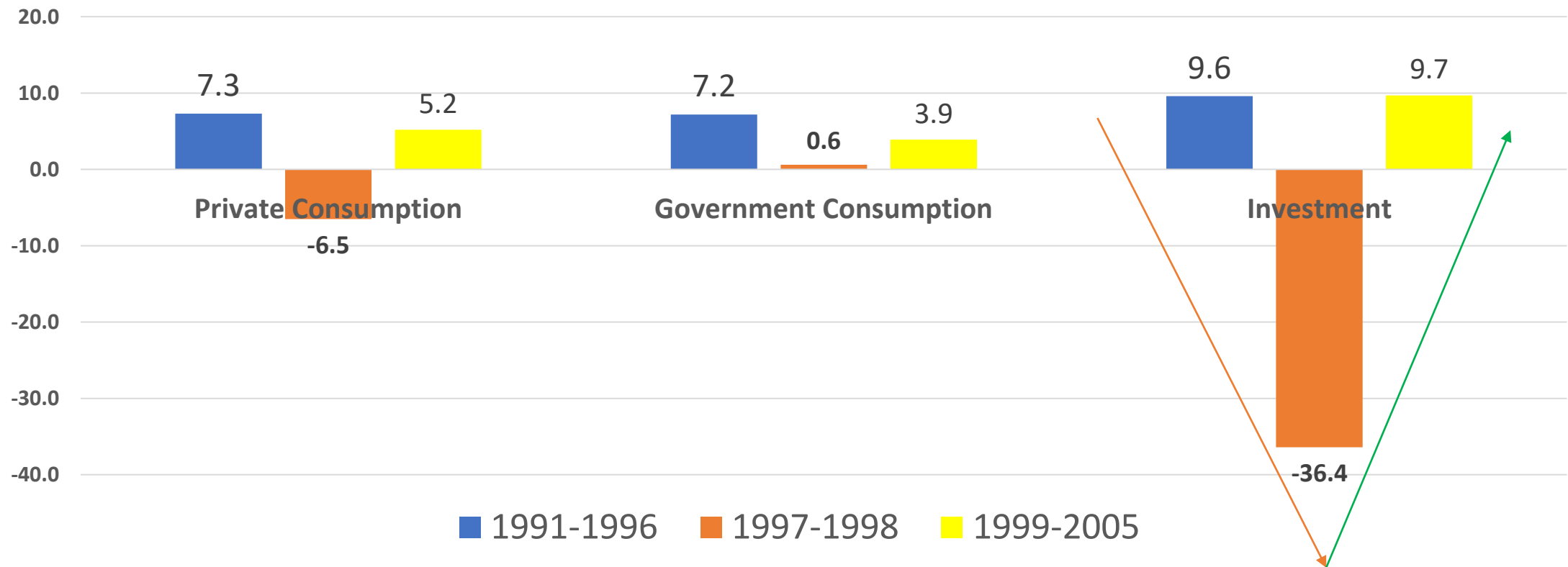


Theodore Schultz's sage advice: Don't neglect agriculture

- Schultz 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.

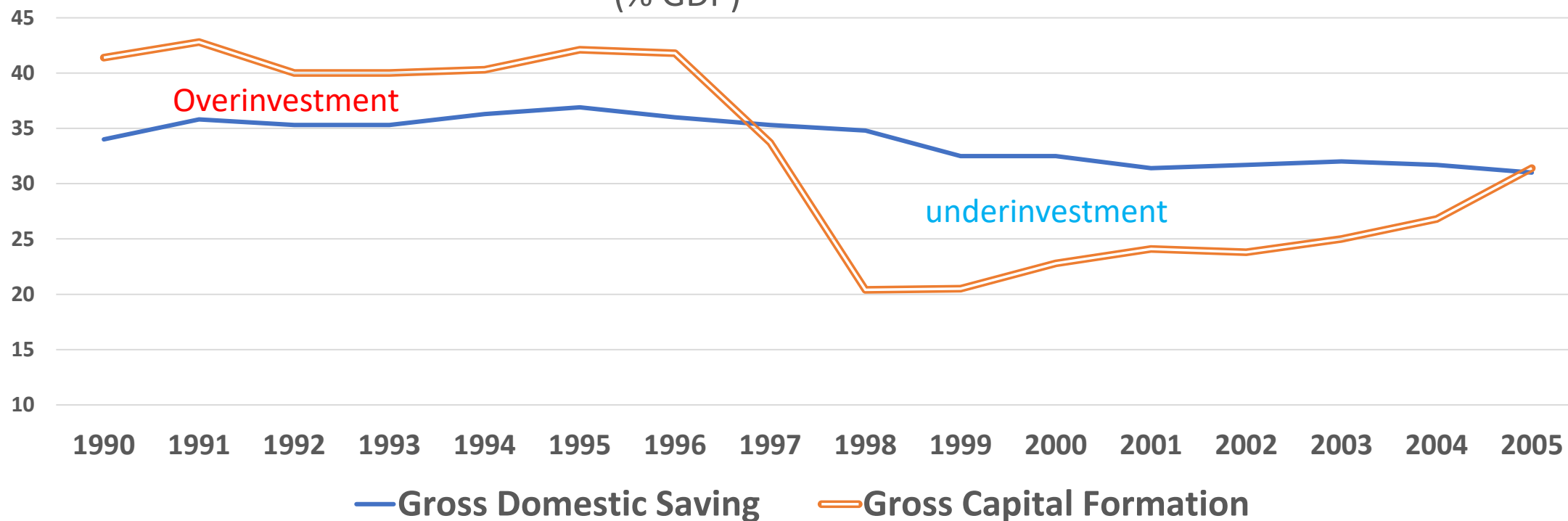
3. Resilience: V-shaped recovery

Figure 8. Growth of Domestic Demand (%)



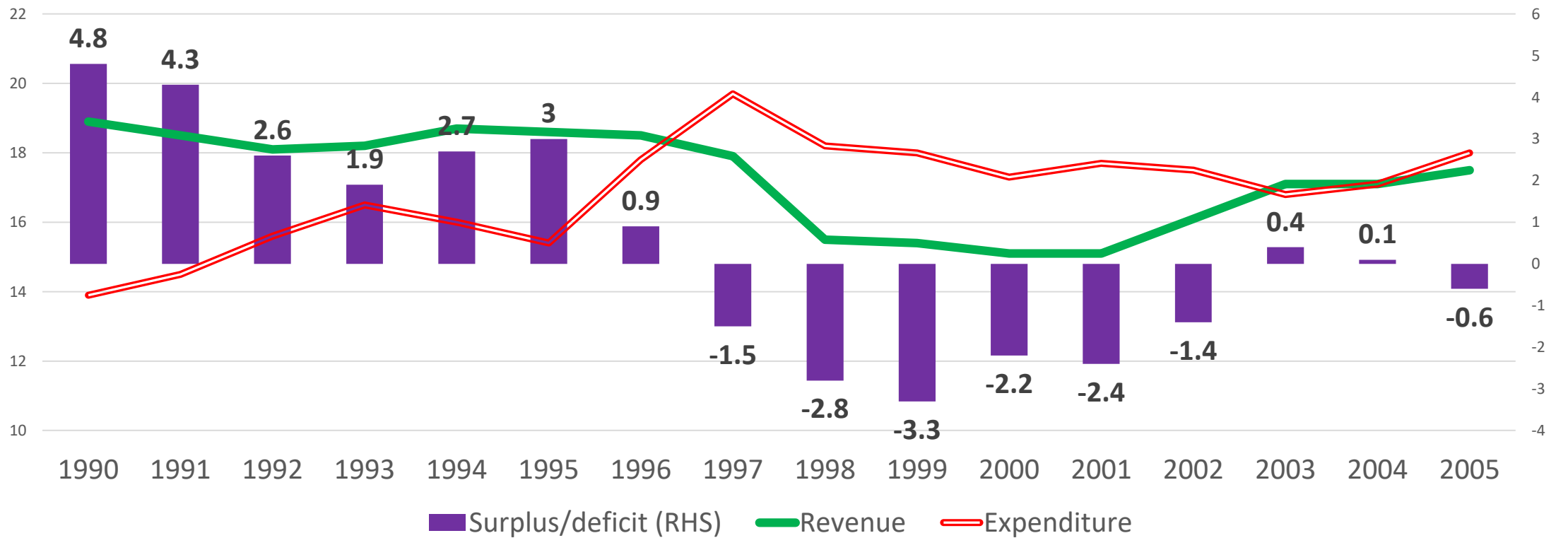
$$M - X = (I - S) + (G - T)$$

Figure 8. Investment-Saving Gap
(% GDP)



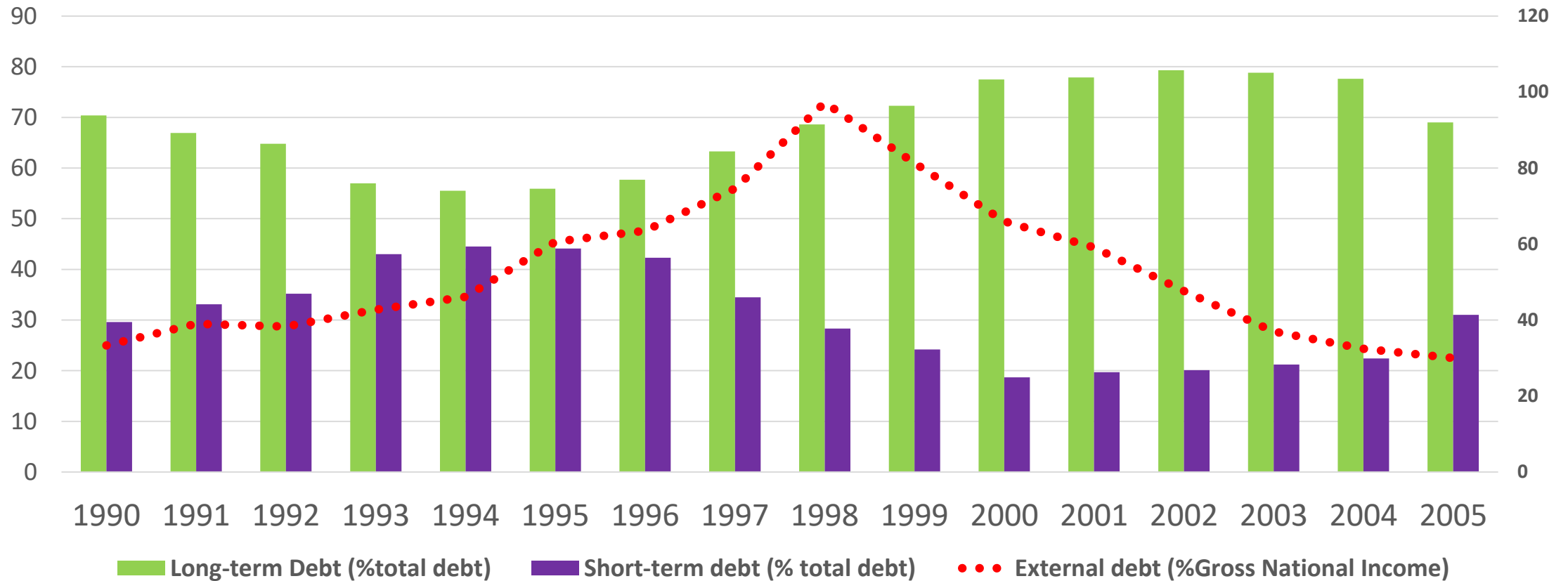
From surplus to deficit budget

Figure 9. Fiscal Position



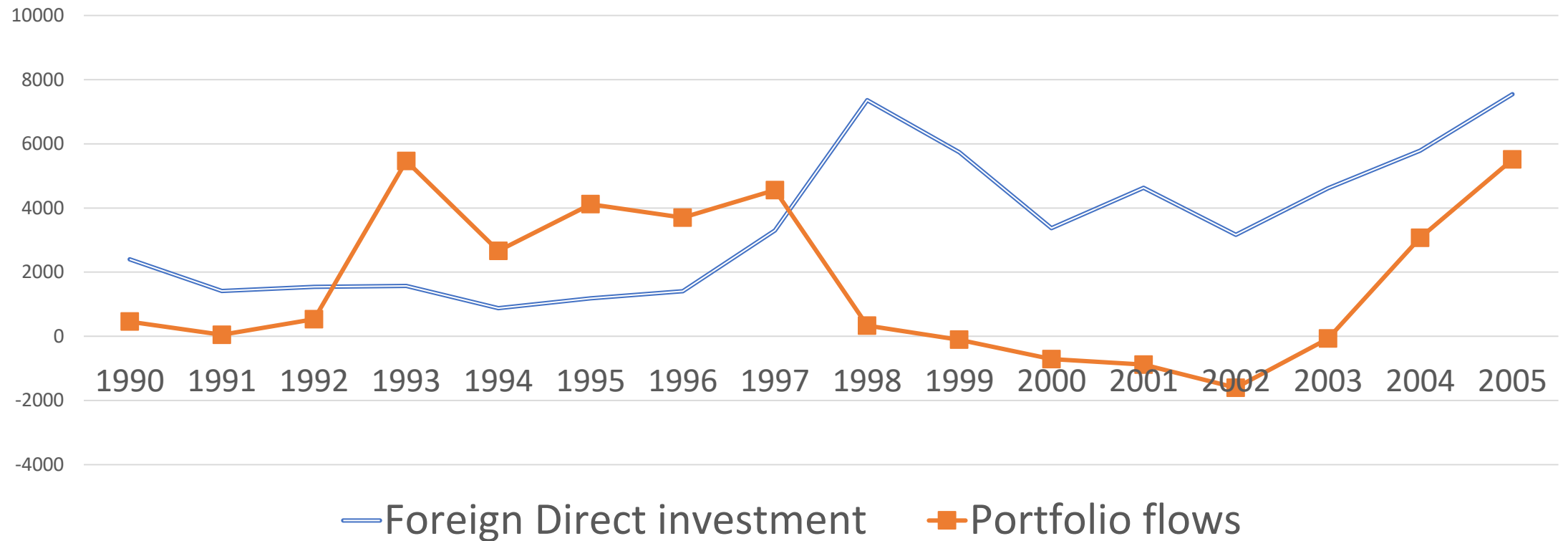
Sustainable external debts

Figure 10. External Debts



Complementarity between FDI and PFI

Figure 11. FDI and Foreign Portfolio Investment



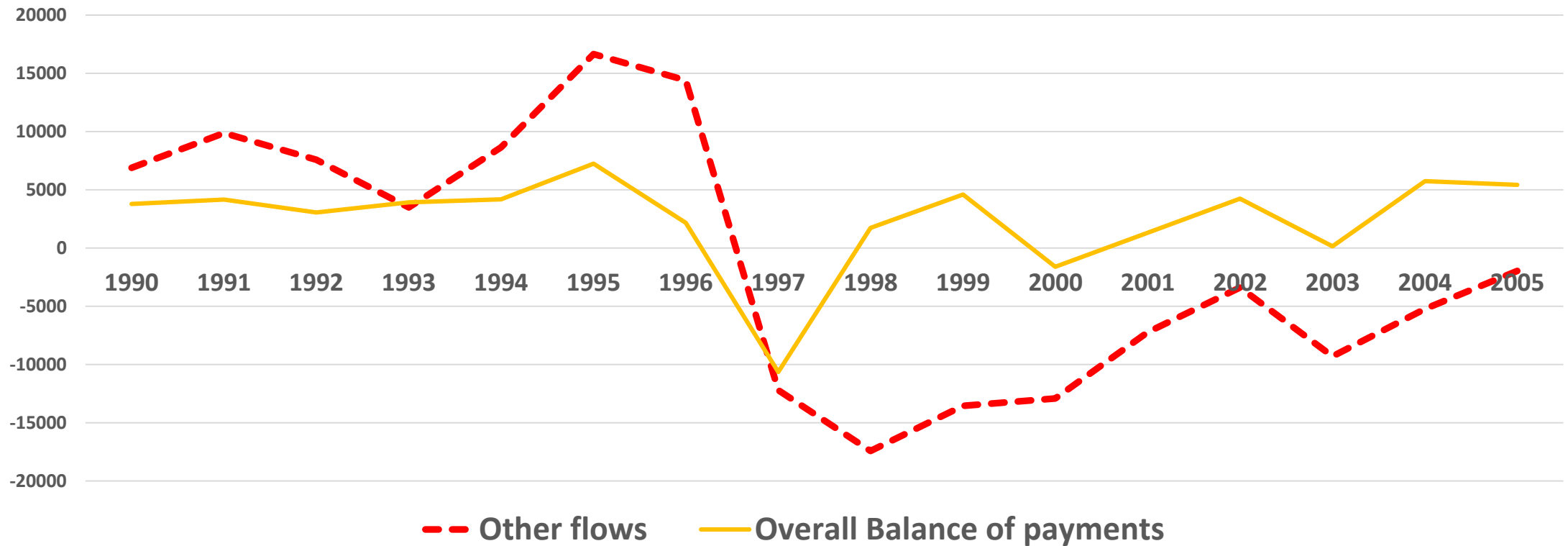
When exports decline, so do imports

Figure 19. Export and import growth: Long run relationship



Beware of speculators (Non-resident baht account)

Figure 12. Other flows



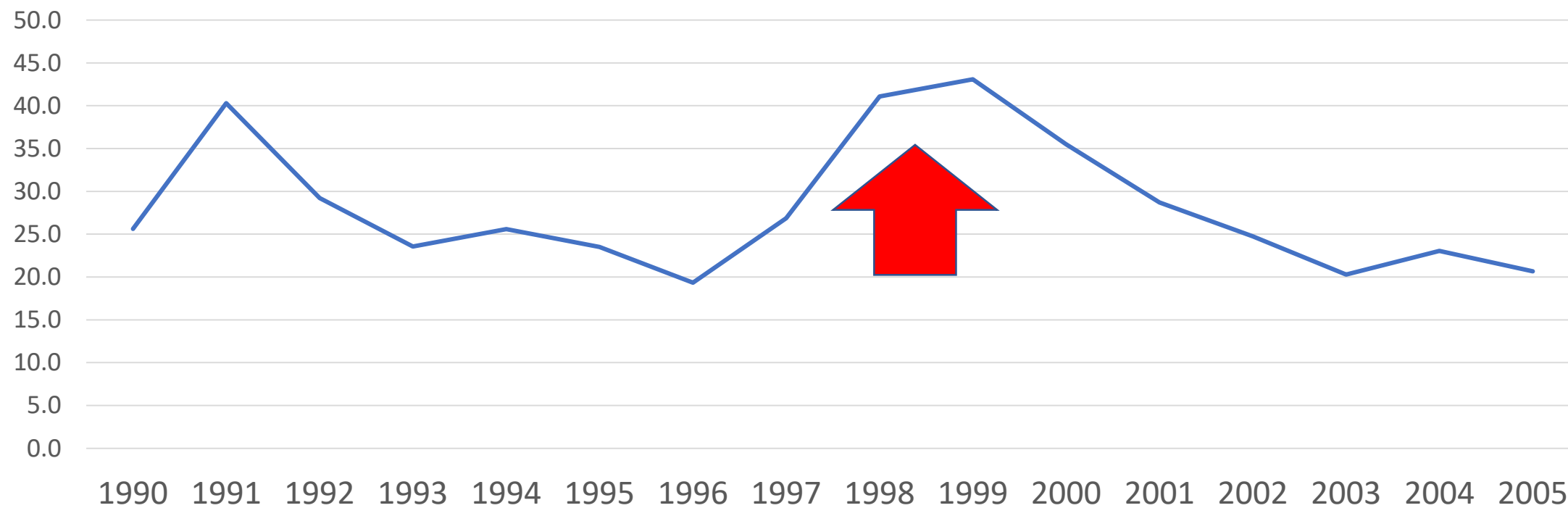
4. Irrational exuberance: A state of mania

- Tulip mania 1637, bitcoin 2017
- In the stock market, it's when investors are so confident that the price of an asset will keep going up, they lose sight of its underlying value.
- The phrase “*irrational exuberance*” was coined by former Federal Reserve Chairman Alan Greenspan in 1996.

The fear index (VIX)

Figure 13. Thailand's stock market volatility Index (VIX)

Source: FRED



At the later expansion phase of the business cycle

- Investors egg each other into a state of irrational exuberance. *They become so greedy for profits that they overlook deteriorating economic fundamentals.*
- They get into a bidding war and send prices up even higher.
- Irrational exuberance can only occur during the later expansion phase of the business cycle.
- That's when the economy has been running at full capacity for a while.
- There is not a lot of undiscovered opportunities.
- If investors strictly followed the fundamentals, they would reject these poor investments and remain in cash.

Irrational exuberance causes recession

- But investors still try to outperform the market. They desperately search for any overlooked profit. As a result, they sink more money into investments with ever-deteriorating returns.
- As a result, a **herd mentality** develops. Investors follow each other into whatever asset is rising.
- They create an asset bubble. It usually occurs in stocks but has also happened in housing, gold, or even Bitcoin.

Irrational exuberance causes recession

- It may even look like prices are rising for valid reasons. But anything can burst the bubble. As a result, ***the frenzy of greed turns to panic when asset prices return to their real-world values.***
- Investors sell at any cost, sending prices below their real value.
- The collapse then spreads to other asset classes. An economic contraction follows, usually leading to a recession. Irrational exuberance is usually how a stock market crash causes a recession.

Define a recession

- A recession is commonly taken to mean *two or more consecutive quarters* of falling output.
- Recessions happen when many economic variables—GDP, industrial production, employment and so on—*flip* from expansion to contraction.
- Most people working today cannot remember a recession not linked to financial chaos. But downturns can occur without stockmarket meltdowns.

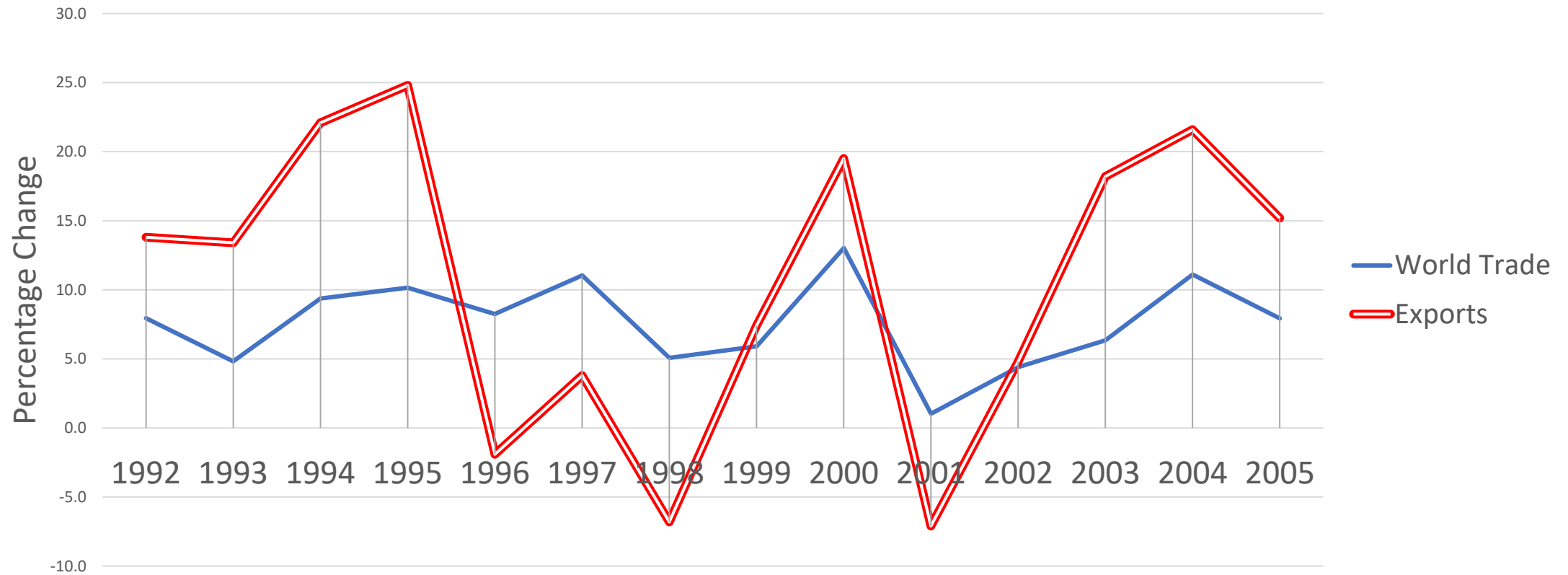
The onset of a downturn is as much a matter of mood as of money

(The Economist, August 19, 2019)

- A matter of mass psychology, or “**animal spirits**”, as John Maynard Keynes put it.
- People spend their incomes freely, on everything from homes to haircuts, in the belief that their jobs will not disappear and their incomes wither.
- Consequently, builders and stylists have jobs and incomes from which they too can spend.

5. Exports and world business cycle

Figure 21. Impact of world business cycle on Thailand's exports



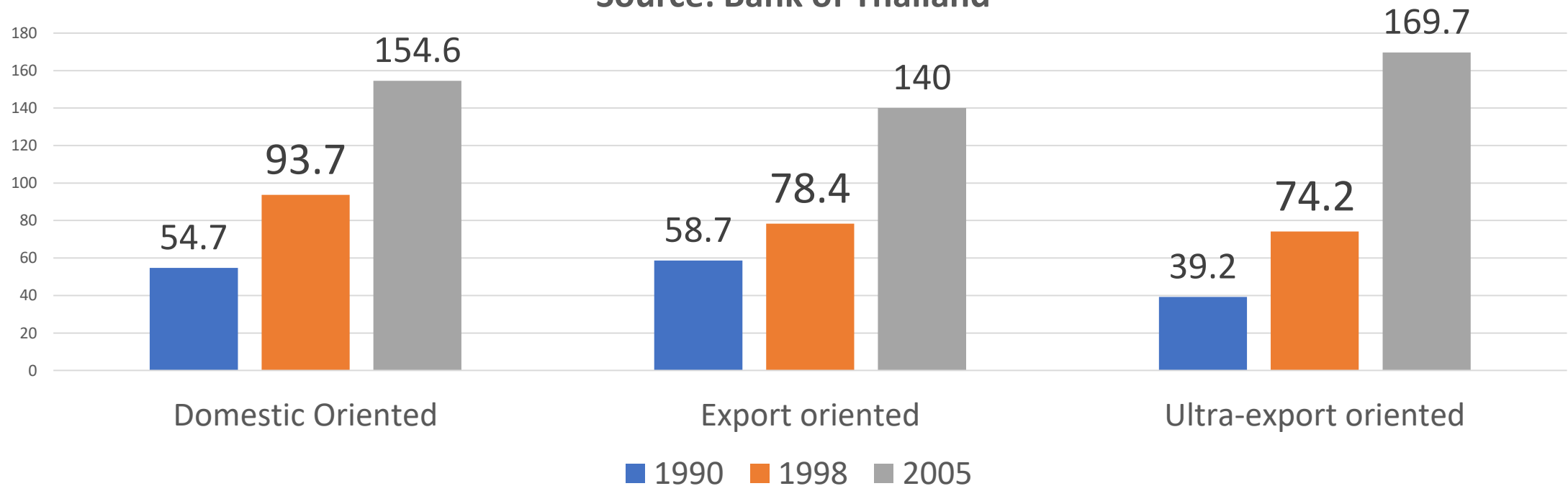
Three types of export industries: market-oriented classification

- Domestic oriented, exporting less than 30 % of total output
- Export oriented industries, exporting between 30 and 60% of total output
- Ultra export oriented industries, exporting more than 60% of total output

Three types of industries, classified according to market orientation (exports-to-output ratio)

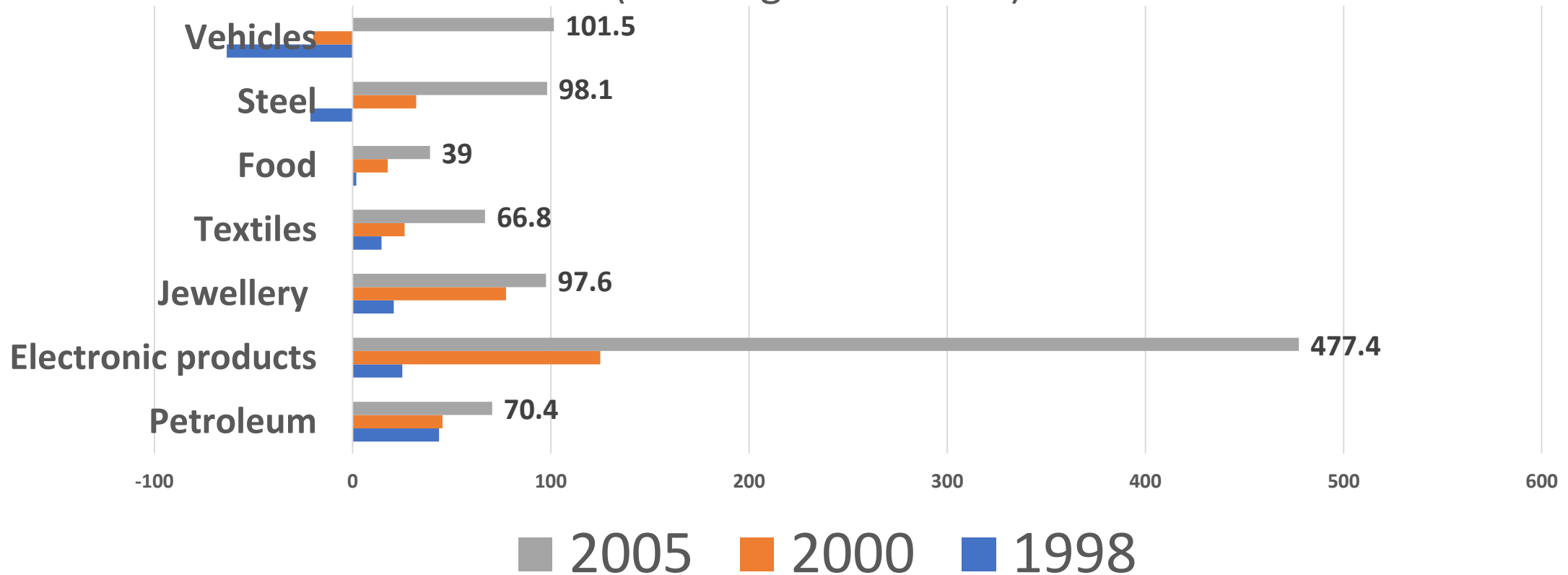
Figure 17. Manufacturing Production Index
(2000=100)

Source: Bank of Thailand

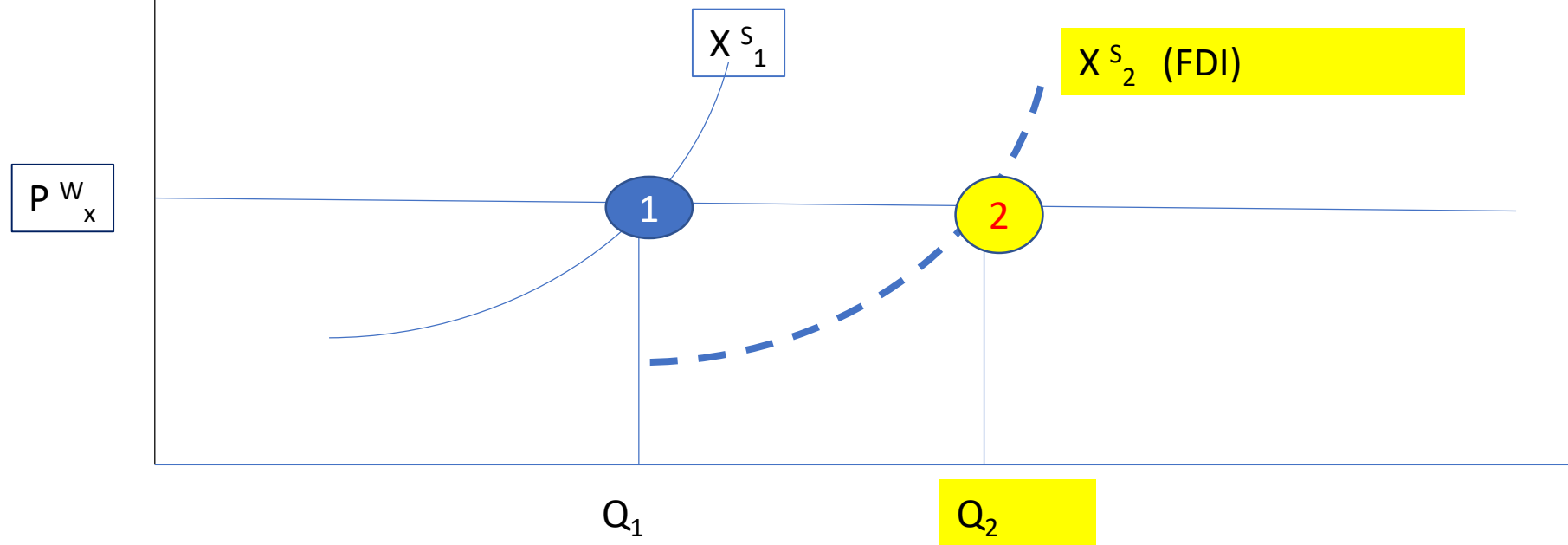


FDI inflows and the growth of industrial exports

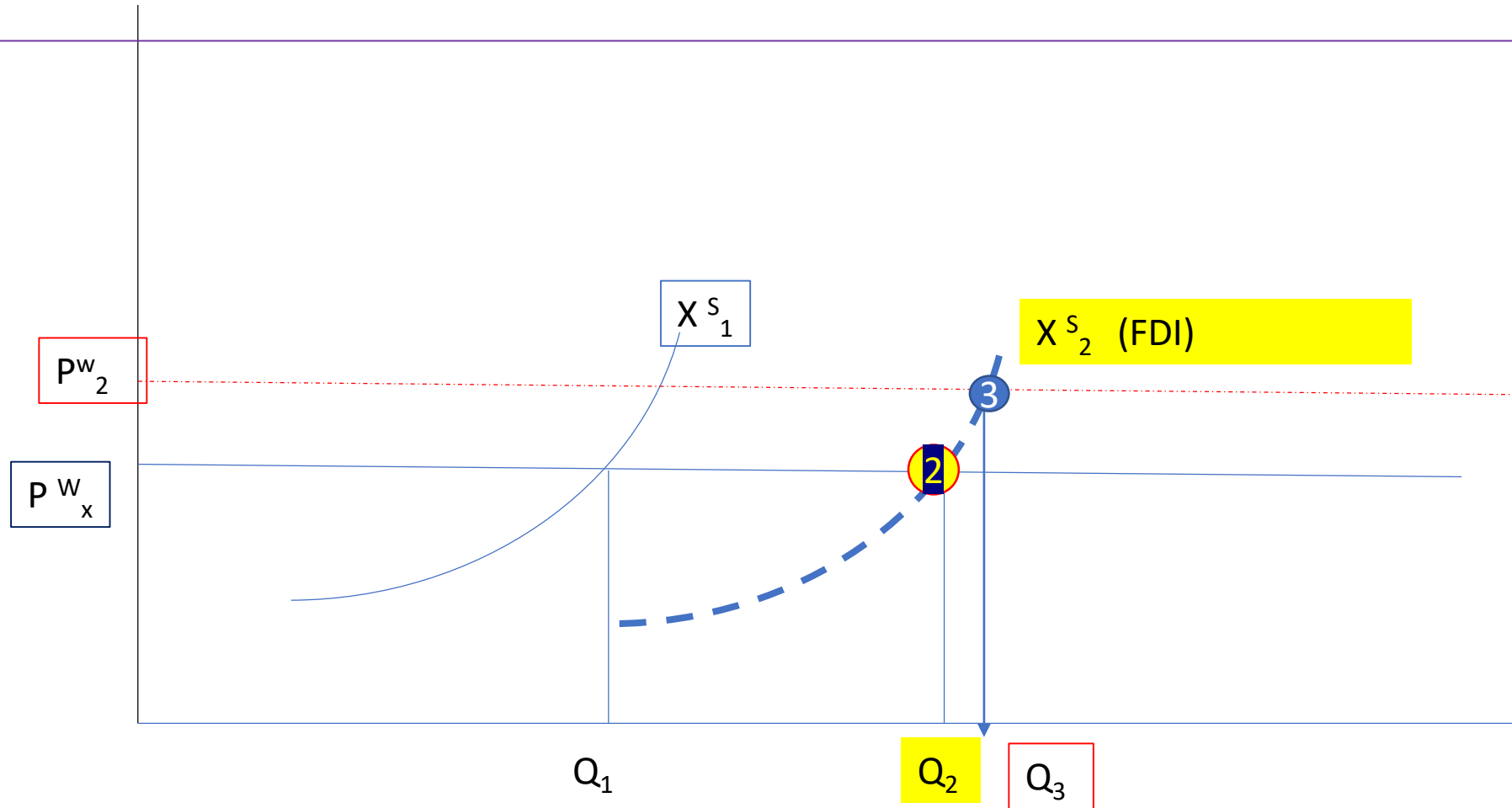
Figure 18. V-shaped recovery of industrial exports
(% change from 1995)



Export capacity is enhanced by stock of foreign capital



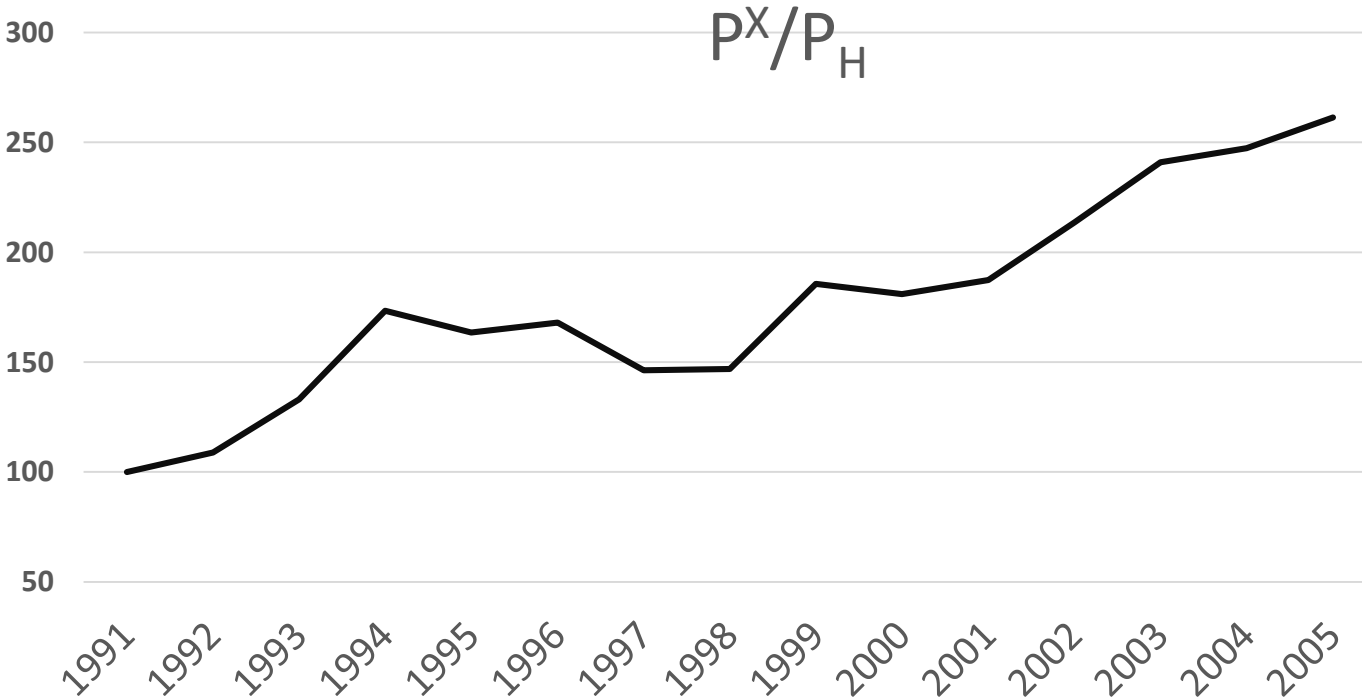
Increased world export prices raise exports



Trade vs non-traded prices

Ratio of export to housing prices

Figure 16. An indicator of Dutch
Disease

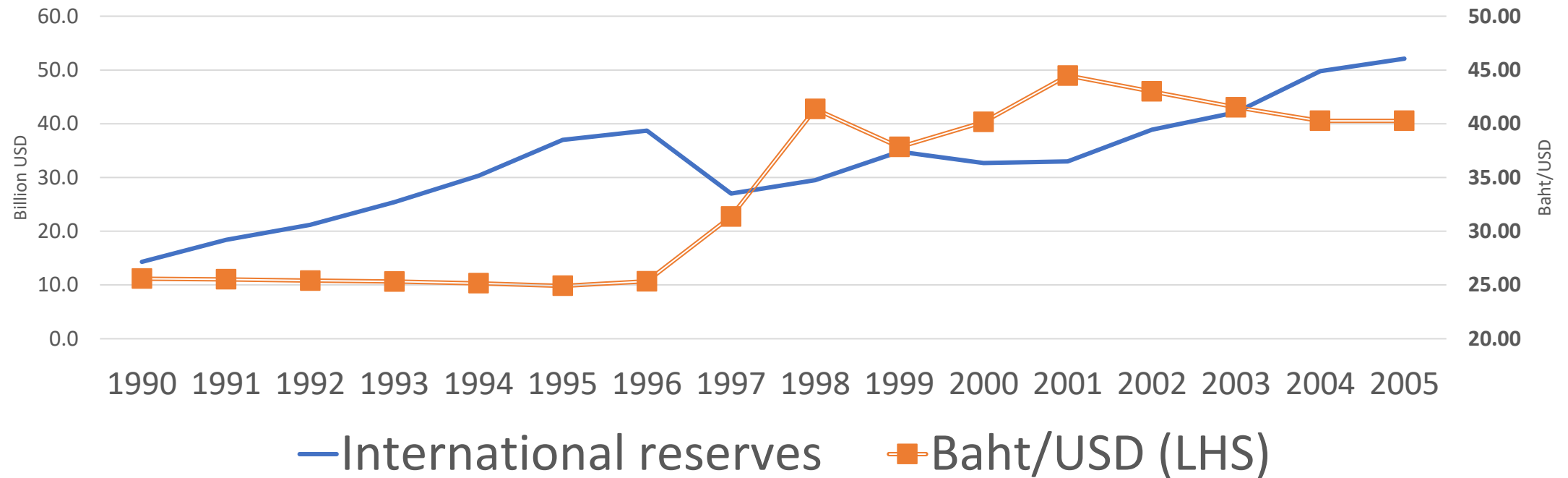


If export prices (P_X) rise faster than housing prices (P_H), resources will be allocated to producing export products.

Some industries will respond to price rises more than others to external prices, given domestic supply conditions (supply price elasticity)

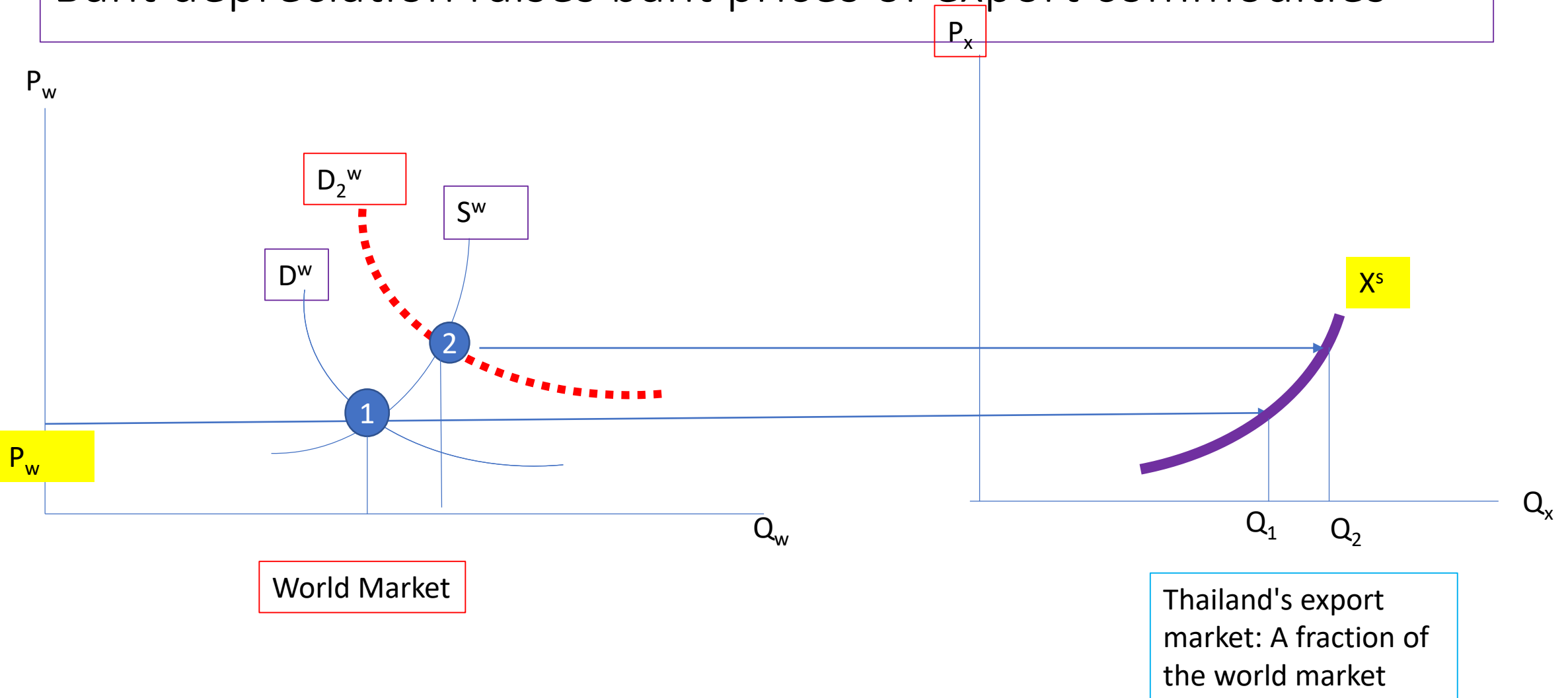
Who is craving for the weak baht?

Figure 20: International reserves increased after a massive depreciation in 1998



Expansion of world trade raises dollar prices of export commodities

Baht depreciation raises baht prices of export commodities



6. How recessions start

(The Economist, August 19, 2019)

- Faith in economic expansion is *self-fulfilling*. But it is not invulnerable.
- **Contagious pessimism** can flip an economy from one equilibrium to another, in which cautious consumers spend less and hiring and investment fall accordingly, *validating the initial outbreak of pessimism*.
- Shocks can precipitate a switch in sentiment by weakening links in the great chain.
- But if the public is confident enough of the durability of an expansion then even a big shock may not halt it.
- Conversely, if the mood in markets and on Main Street is sour enough, even a modest nudge may push an economy into a slump.

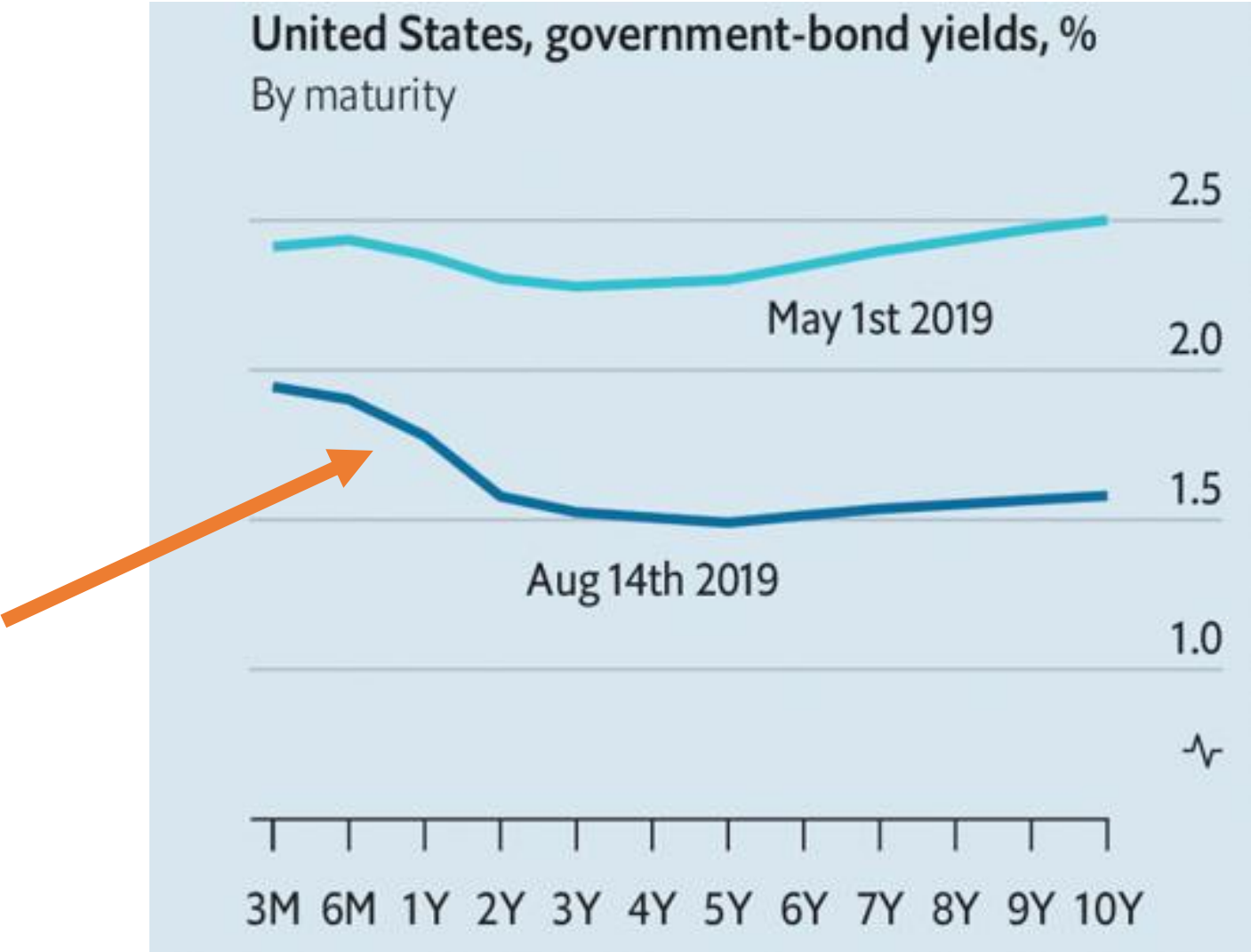
Investors' mood

The Economist 19th August 2019



Nervous investors are reaching for the safety of the dollar. The yen and Swiss franc, habitual sanctuaries, are among the few currencies that have risen against it. The price of gold, another haven, is at a six-year high.

Inverted yield curve



The price of gold, another haven, is at a six-year high.

The price of copper, *a barometer of global industry*, is down from its recent peak



Faced with uncertainty, investors put money in the US stock market.

MSCI's emerging-market share index leans heavily towards "Factory Asia"

Europe's markets lean towards banks and carmakers, which suffer in downturns.



Recession? What recession?

- In July 2019, the American economy added 164,000 jobs and retail sales kept climbing.
- ***The last global slump*** occurred amid an epic financial crisis. The one before that began nearly two decades ago, accompanied, again, by a stock market crash.
- Between August 2000 and September 2001 the S&P 500 index fell by more than **30%** and the NASDAQ by more than **60%**.

The world mood is troubled

- The credible promise to resist downturns by fiscal and monetary policy gives markets confidence that the economy will keep up its strength.
- ***But confidence is slippery.*** It may ***wane*** as interest rates fall, leaving central banks less room to jolt economies out of their pessimism, and as government policymakers fumble their fiscal tools (It sounds familiar, doesn't it?)
- It may wilt in the face of leaders' erratic and self-defeating behavior.
- Recessions, to no small degree, are ***a state of mind*** (explain why).



Some people have chosen not to visit relatives

- Tonight Chinese families gather to celebrate the lunar new year. There will be empty chairs. Some people have chosen not to visit relatives, for fear of exposing themselves to the new coronavirus, which since December has caused sometimes-lethal bouts of pneumonia.
- China's government has acted more quickly and openly than when battling **SARS**, an infection the authorities tried to hush up when it broke out in **2002**. But that is a low bar, and distrust is high.
- Some people in China are surprised by the way the government has responded, with the unprecedented **quarantining of five cities**.
- The lockdown came only a few days after officials said there was little chance of sustained human-to-human transmission, and after many people had set off on their holidays—some carrying the virus.
- But international experts say there is no clear evidence that the government dawdled. Much is still unknown about how the new virus behaves, and how lethal it will be.

WHO calls coronavirus 'an emergency in China'

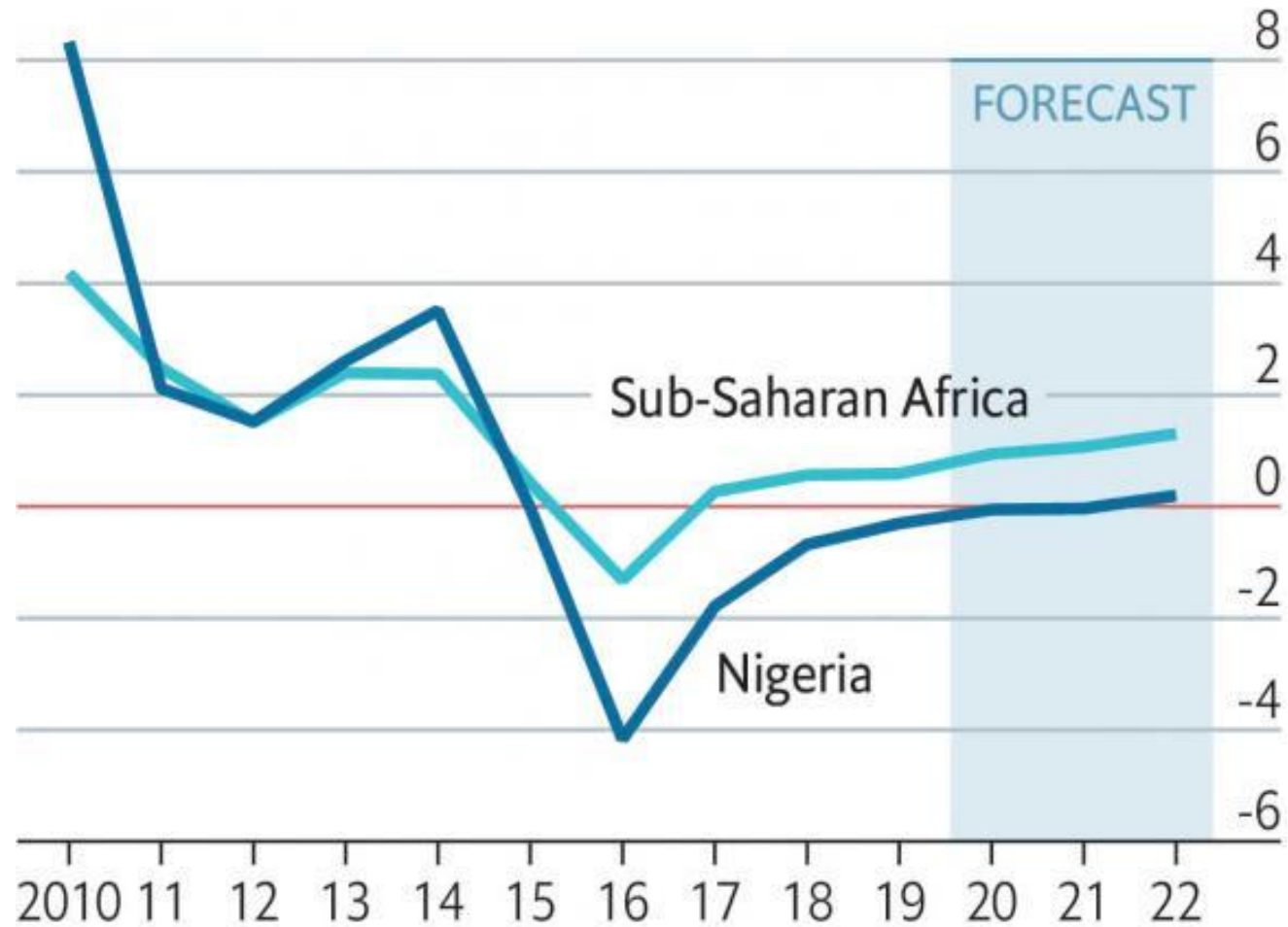
China confirms 18 deaths, 634 virus cases by Thursday



Staff members check **body temperatures** of the passengers arriving from the train from Wuhan to Hangzhou in Zhejiang province at Hangzhou Railway Station ahead of the Chinese Lunar New Year on Thursday. (Reuters photo)

That shrinking feeling

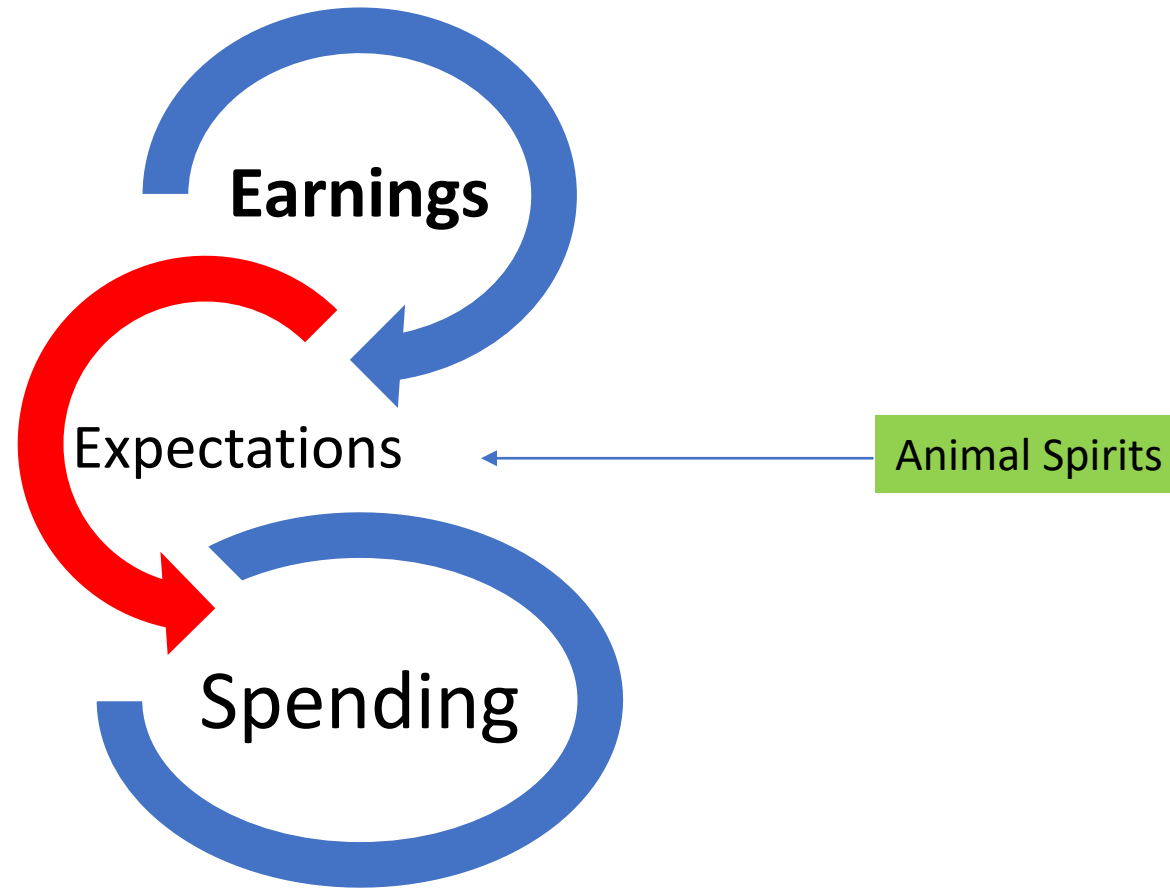
GDP per person*, % change on a year earlier



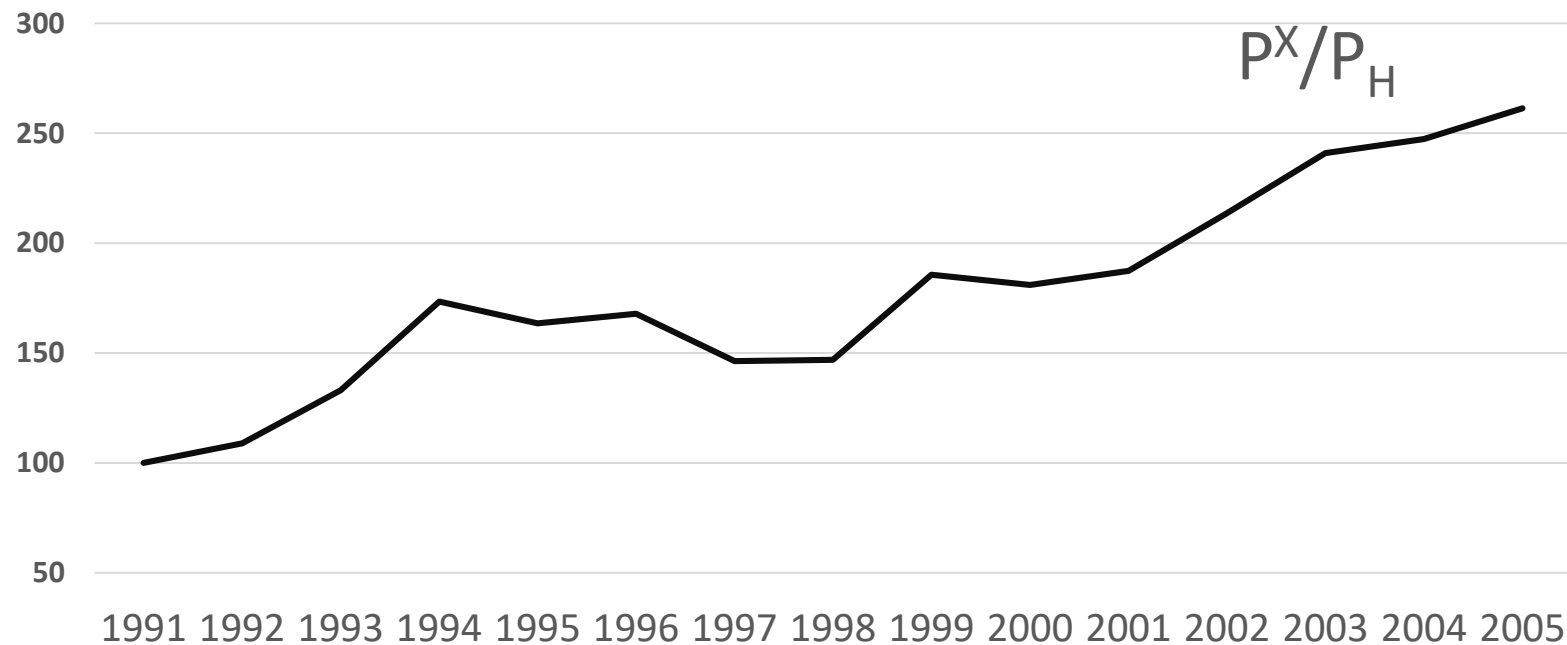
Source: IMF

*At purchasing-power parity

Economies are great chains of earning and spending, *held together* by shared expectations that all will continue as normal (no shocks)



Does this figure indicate a looming Dutch disease?



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 and political will.

Conclusions

- Capital flows are related to exchange rate movements.
- Asset bubbles are associated with expectations and monetary expansion.
- *Expectations can move real variables.*
- External influences on the Thai economy increase with higher degree of globalization.

Key words

1. Booms and busts
2. Human capital investment
3. Resilience
4. Irrational exuberance
5. Exports and world business cycle
6. How recessions start

Review Questions

- Why do you think that the 1991-2005 is a period of resilience despite the AFC?
- Has the Thai economy in 2019 become less resilient than the period 1991-2005? Compare and contrast the challenges in 2006 with 2019/2020.
- Is Thailand experiencing a property bubble? If so, explain why. Should the Central Bank prick asset bubbles?
- How far can a country rely on domestic demand stimulus?

“Habit is necessary; it is the habit of having habits, of turning a trail into a rut, that must be incessantly fought against if one is to remain alive.”

Edith Wharton