

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

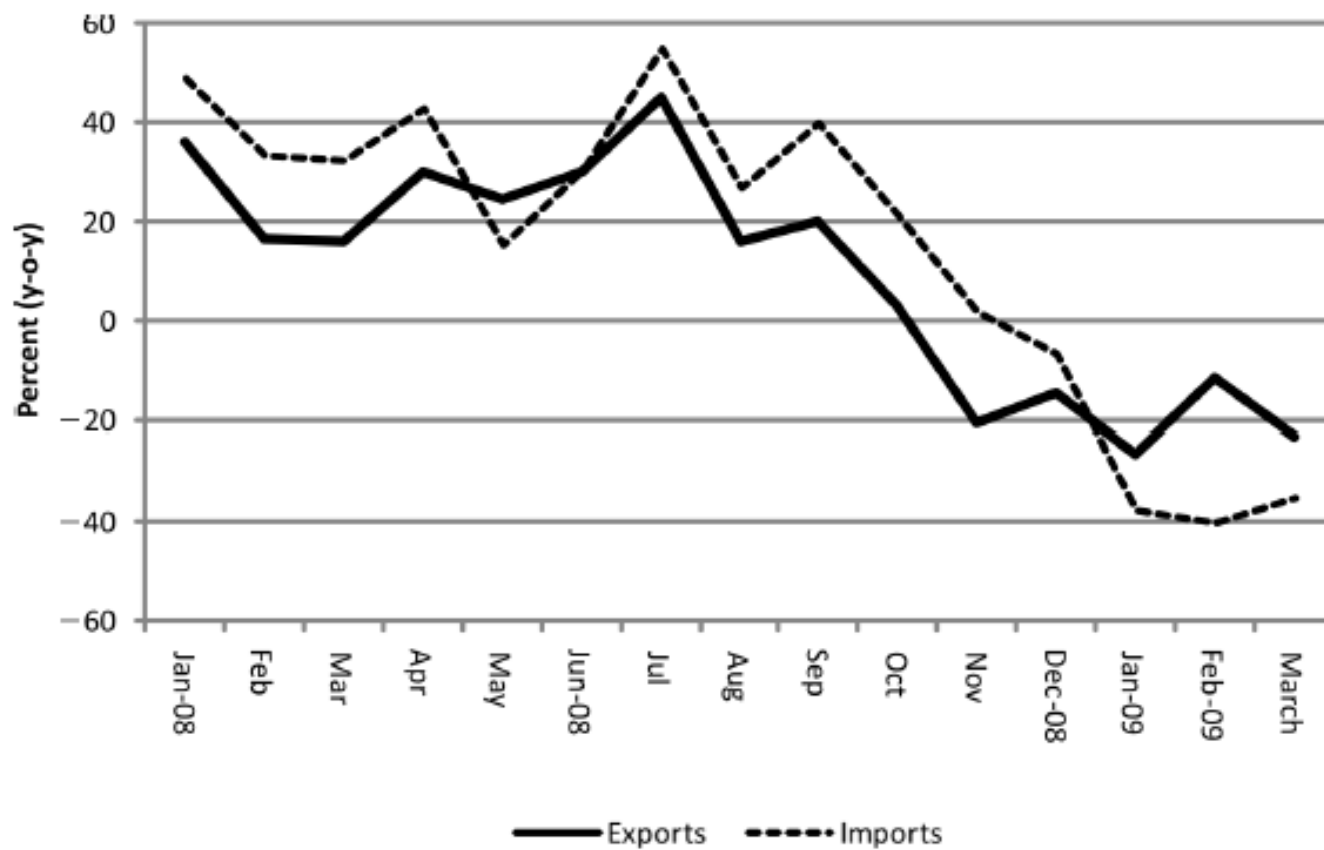
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Abstract

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.

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

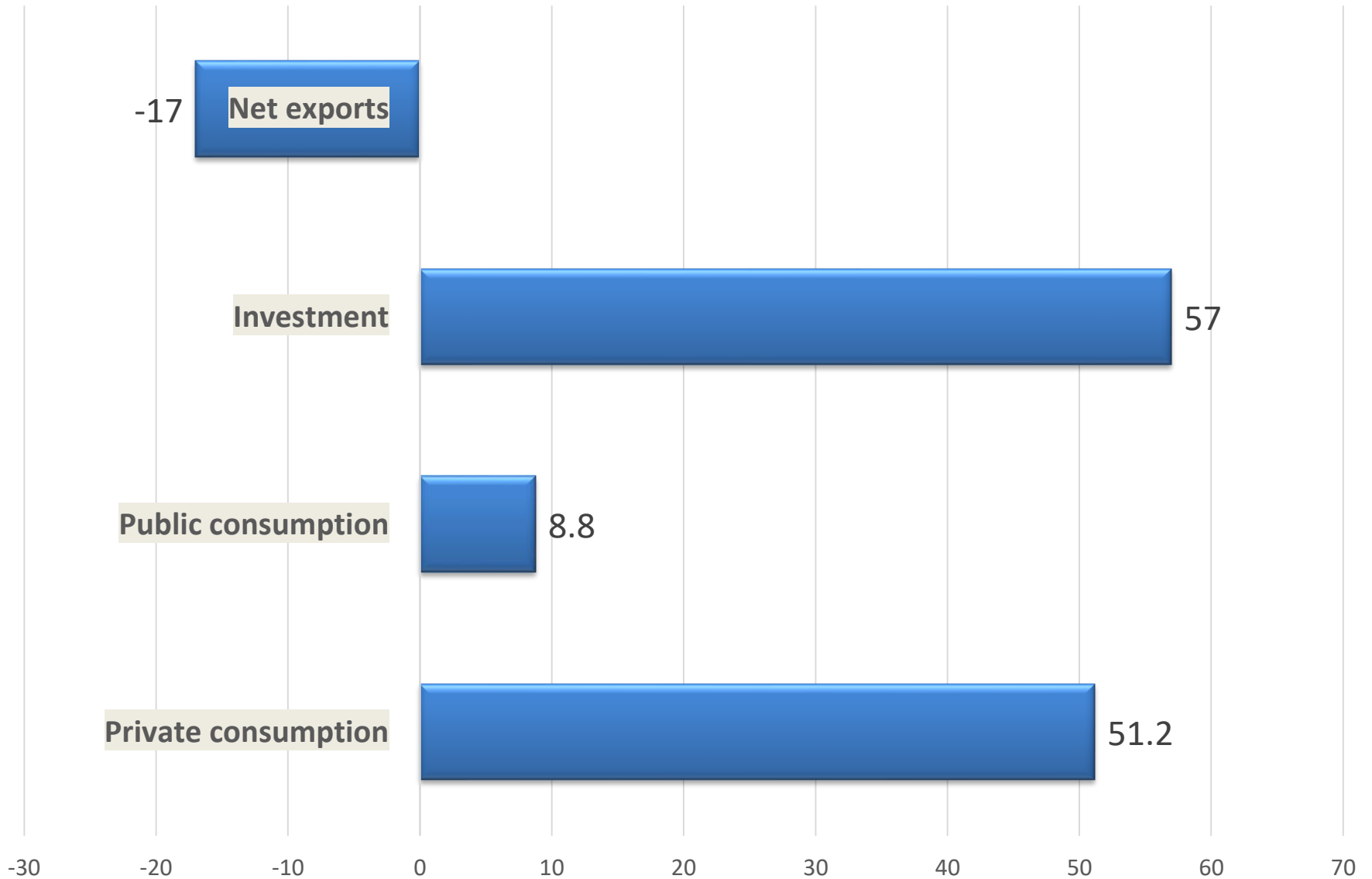
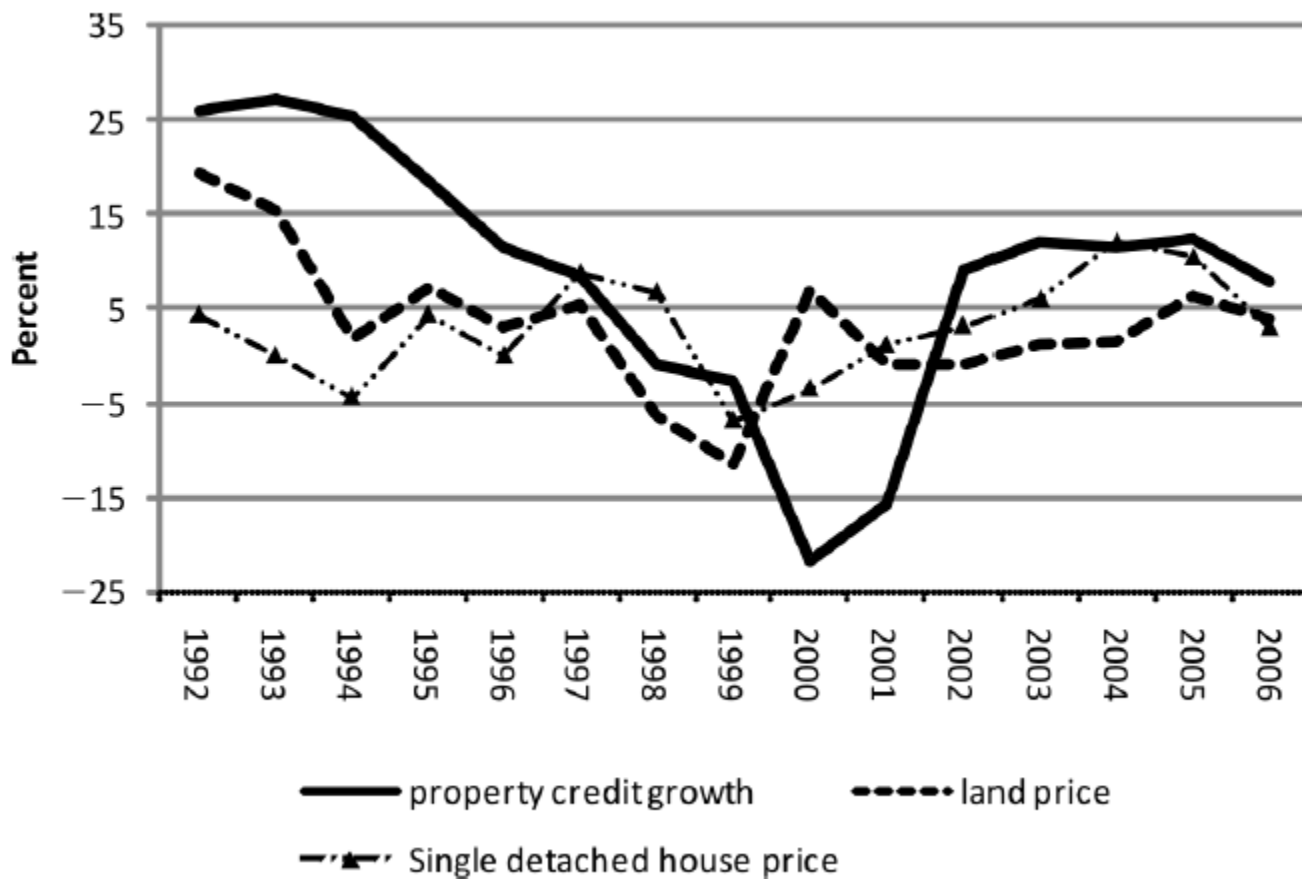


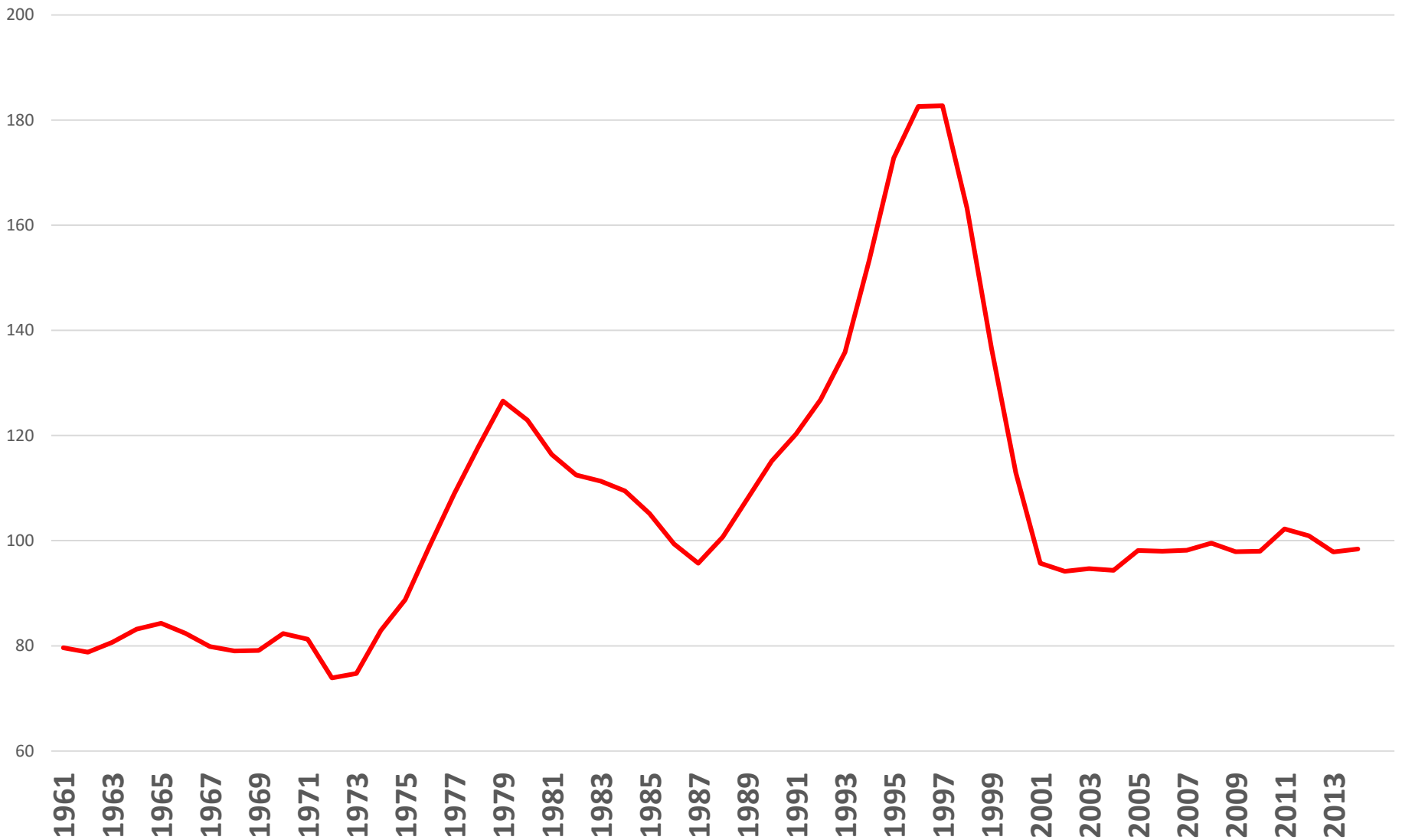
Figure 4. Real estate bubbles and property credit



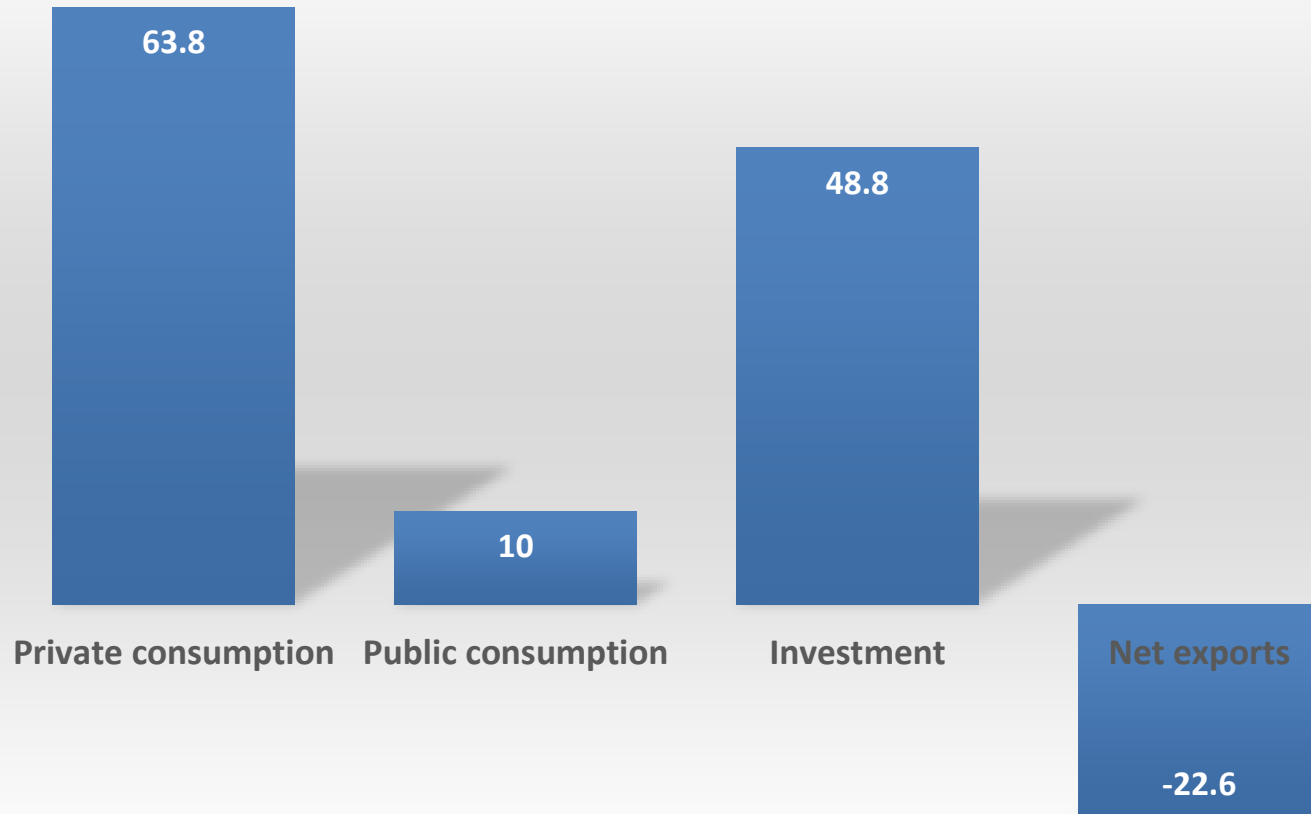
Austrian Business Cycle Theory

- 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.

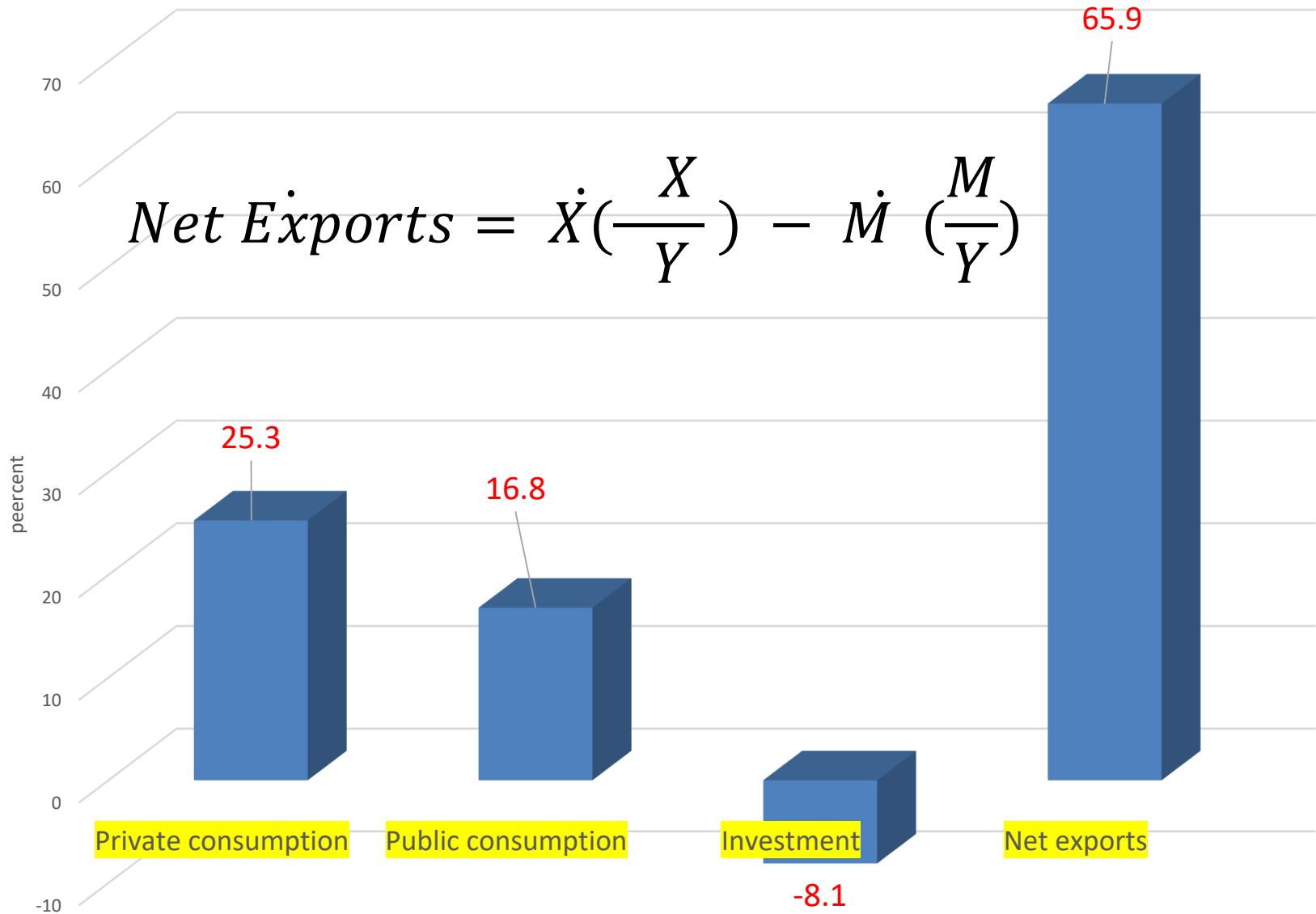
Commercial Banks: loan/deposit ratio



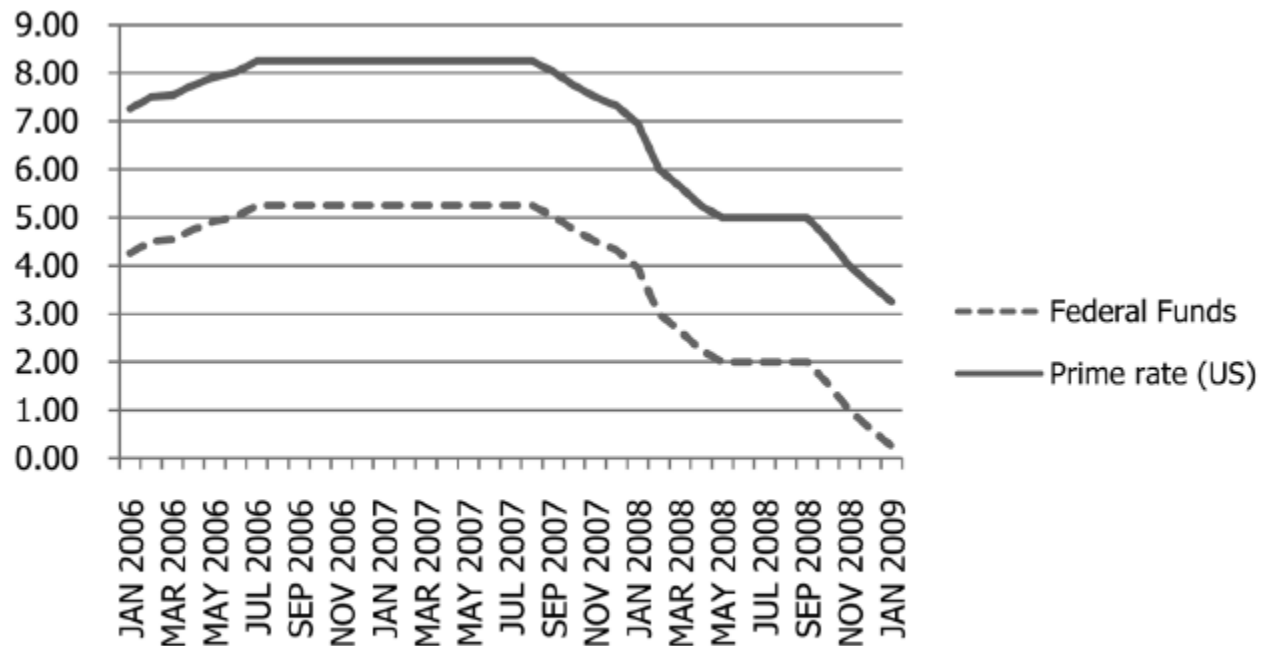
Contribution to GDP growth: 1999-2005



Contributors to GDP growth: 2006-2007

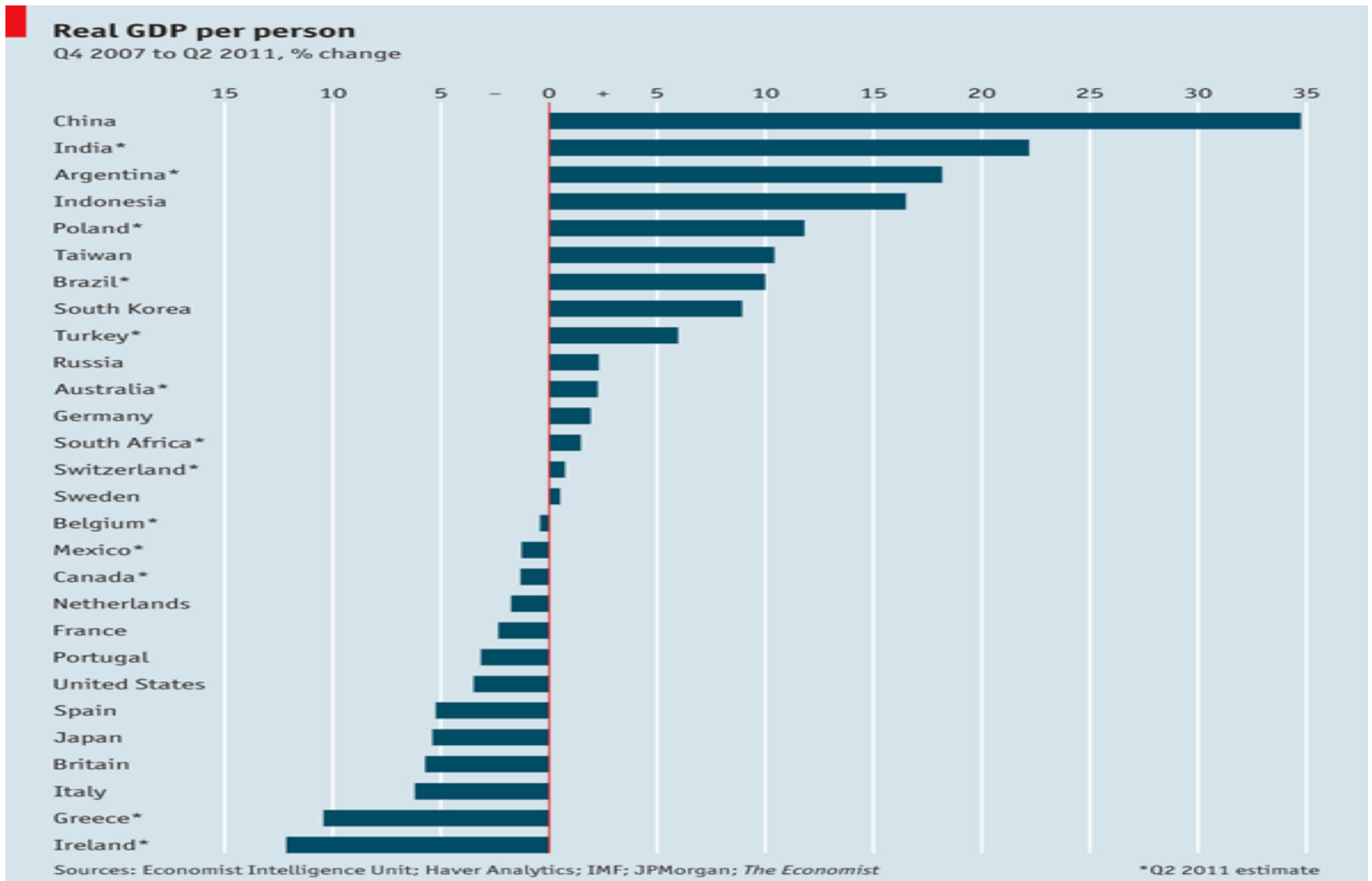


The federal funds rate and impact on the U.S. prime rate

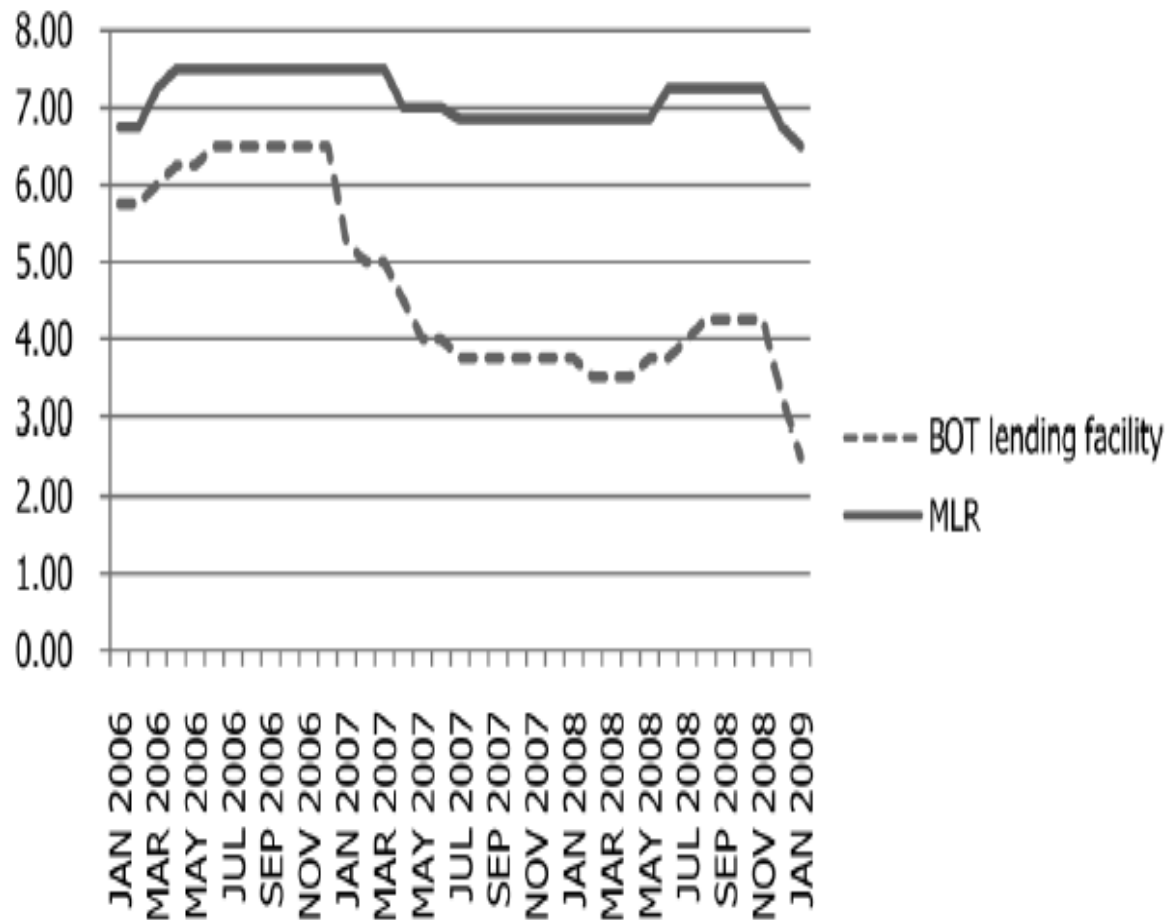


Source: Bank of Thailand.

Global Recession and Recovery

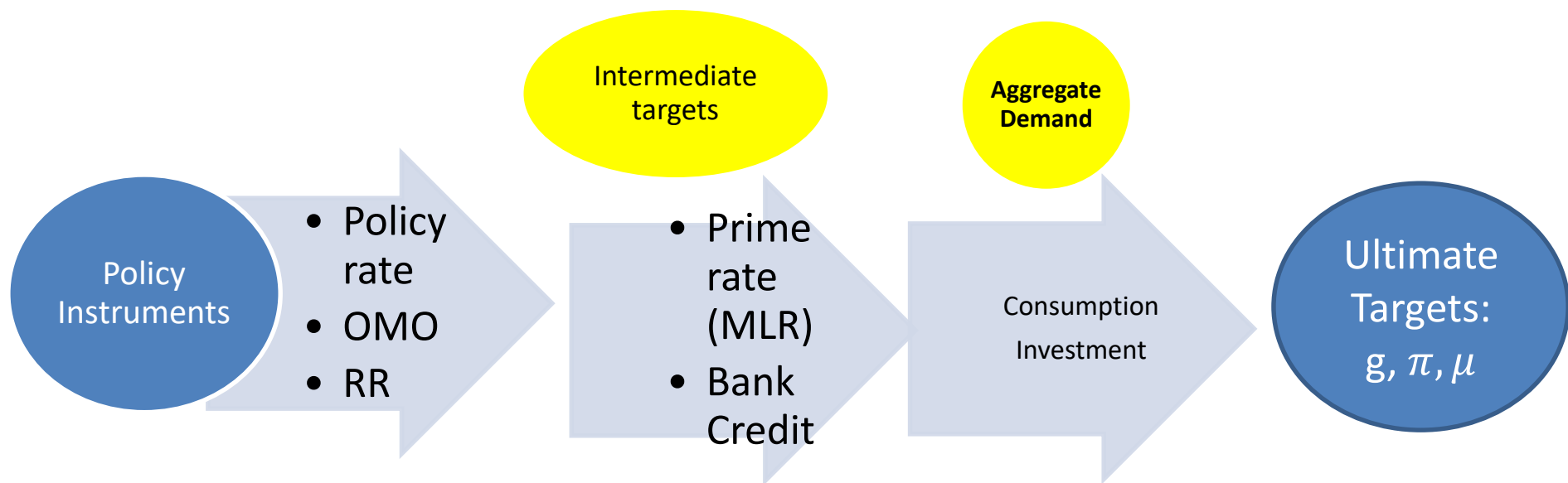


The BoT key policy rate and impact on commercial bank Minimum lending rate (MLR)



“If anything can go wrong, it will.”

Murphy’s Law

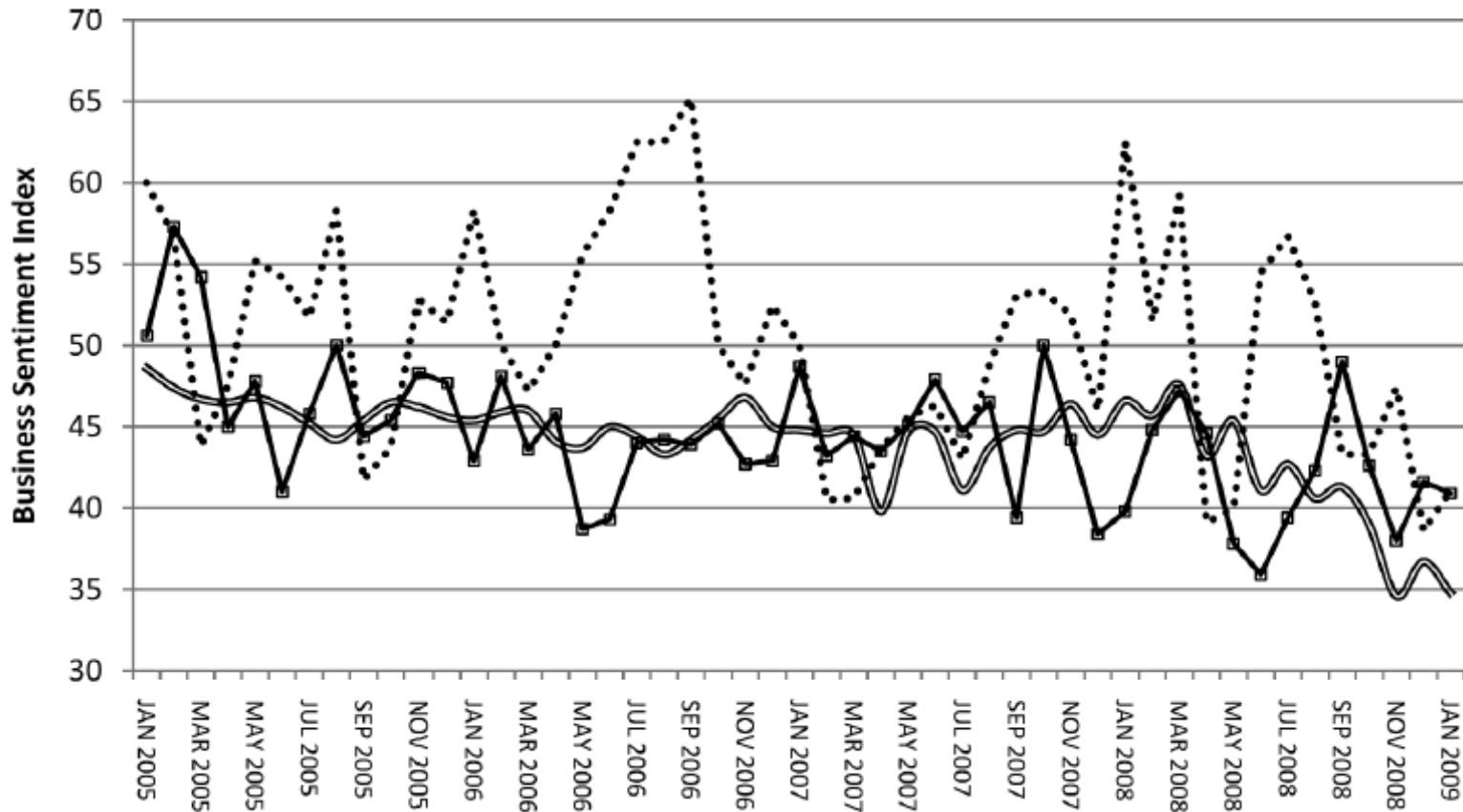


Pessimism and effectiveness of monetary policy

- 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

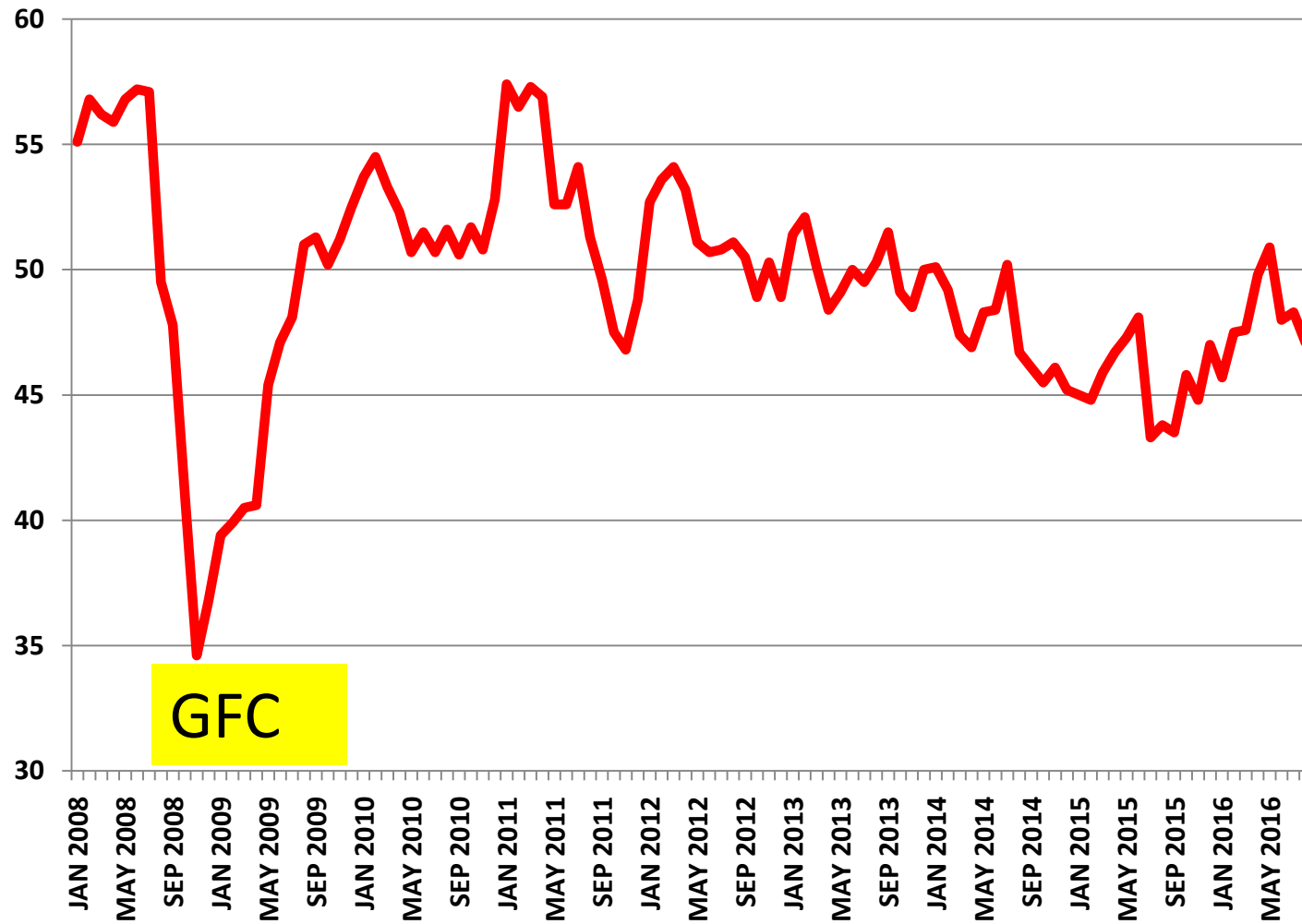
- Business sentiment can be restored and maintained by policy consistency.
- If the government and the public adhere to the rule of law, political shocks can be minimized as a concern for fairness would be eased.

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.

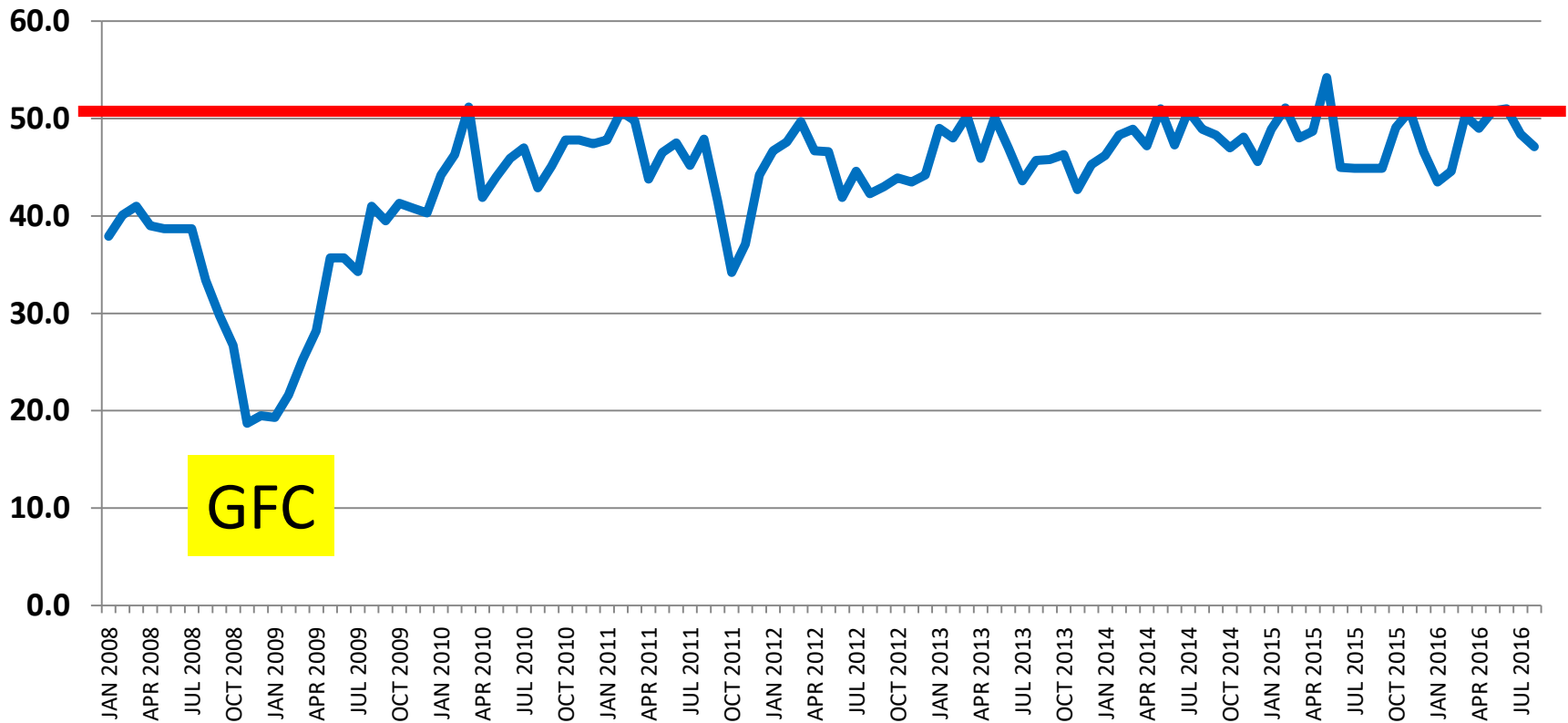
Business Sentiment Index

(1) *output prices*



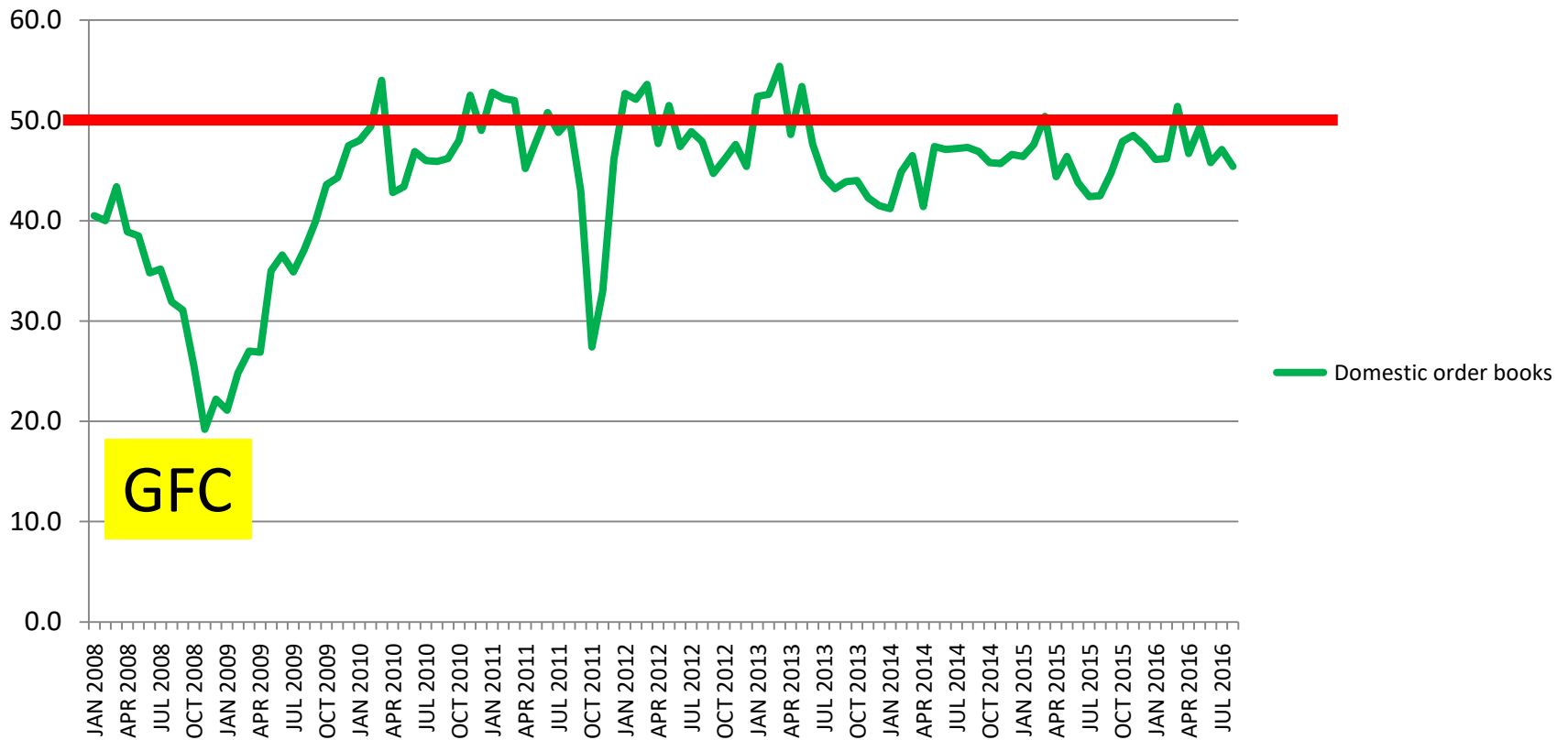
Business Sentiment Index

(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

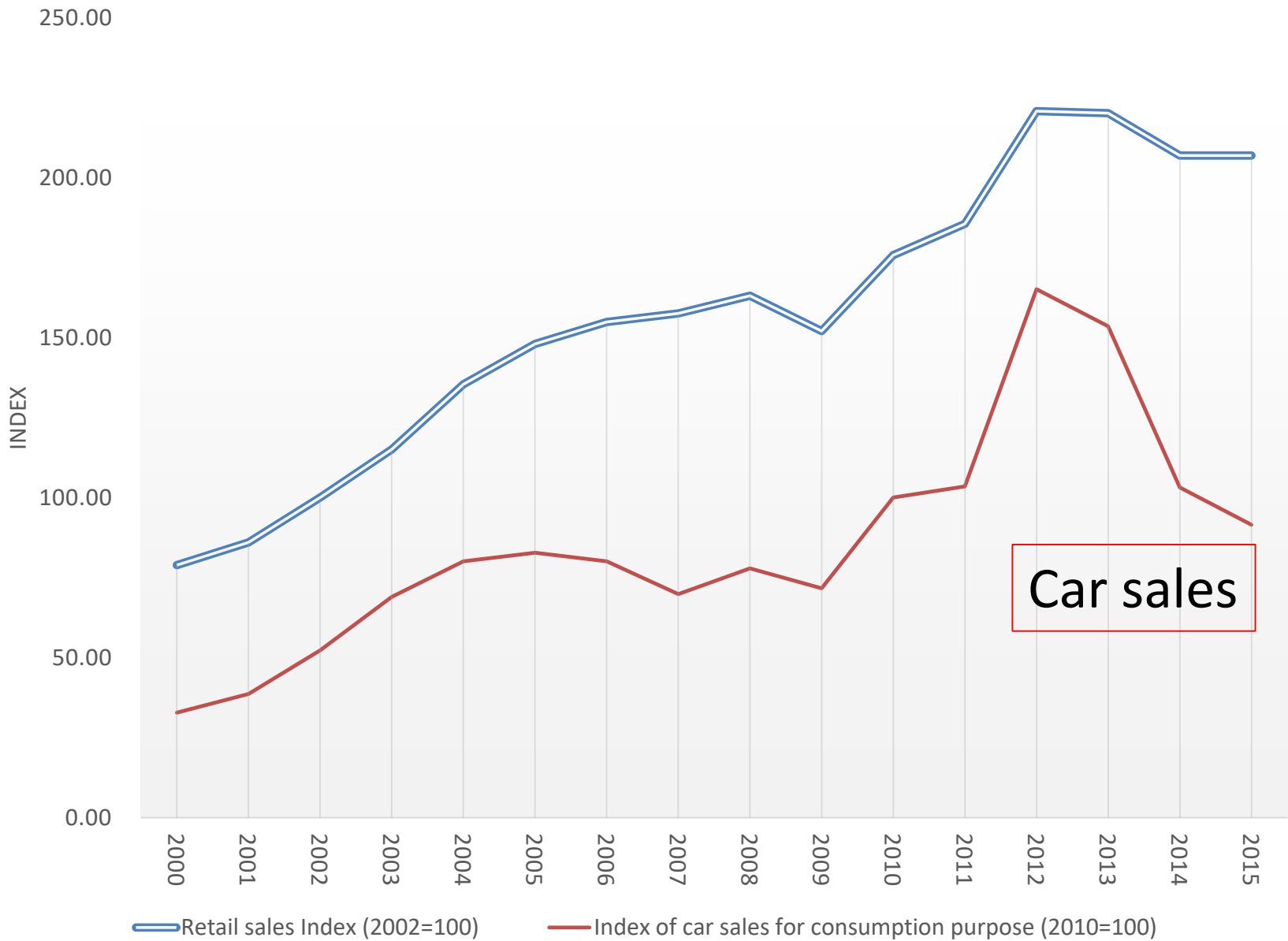
Effectiveness of Thailand's Macroeconomic Policy Response to the Global Financial Crisis

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

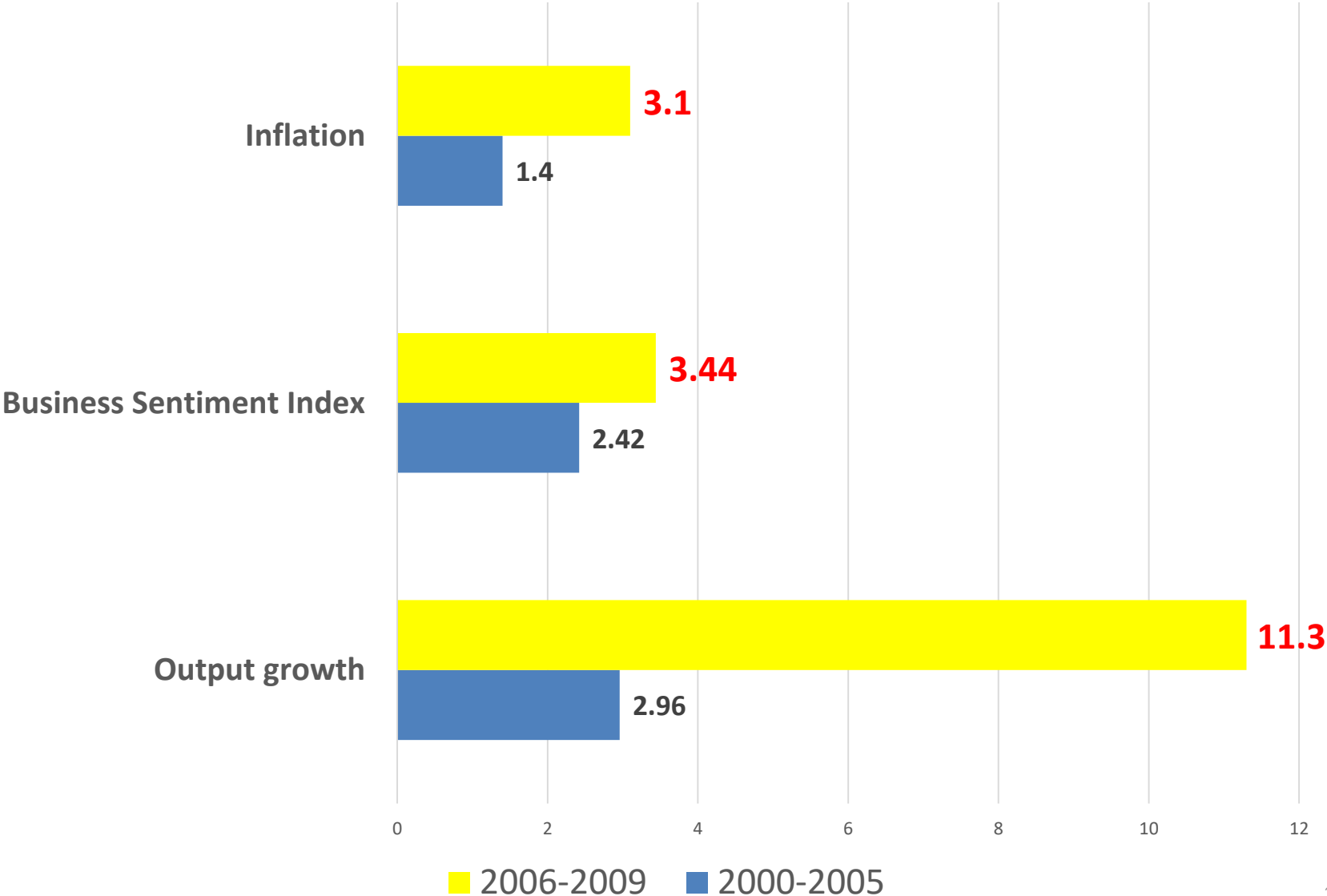
TABLE 2
Volatility in Output, Price, and
Business Confidence
(Measured by standard deviation)

| | <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)

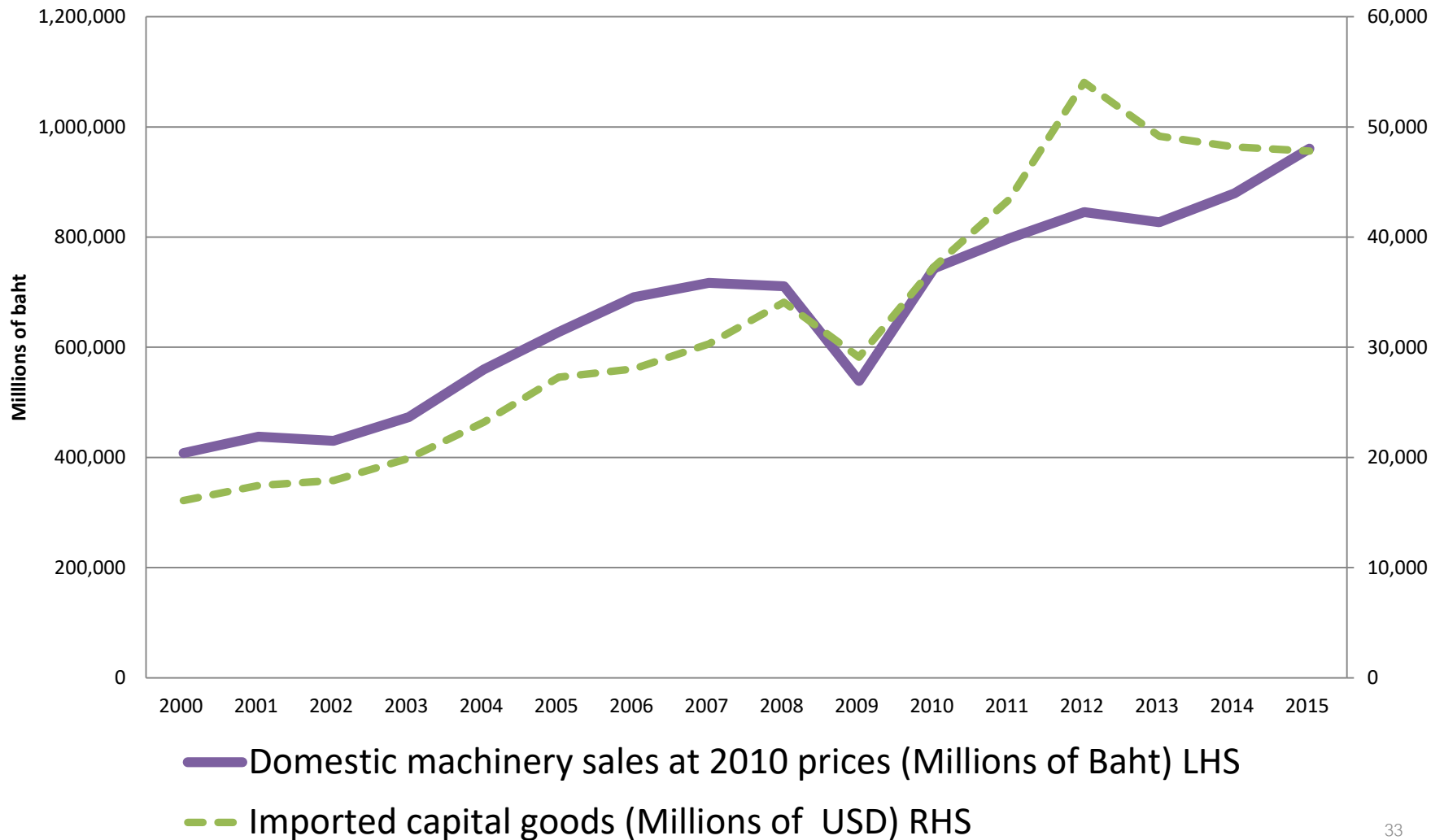


The effectiveness of policy responses depends on the government's ability to maintain the rule of law, accountability, human rights, and effective legal infrastructure.

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

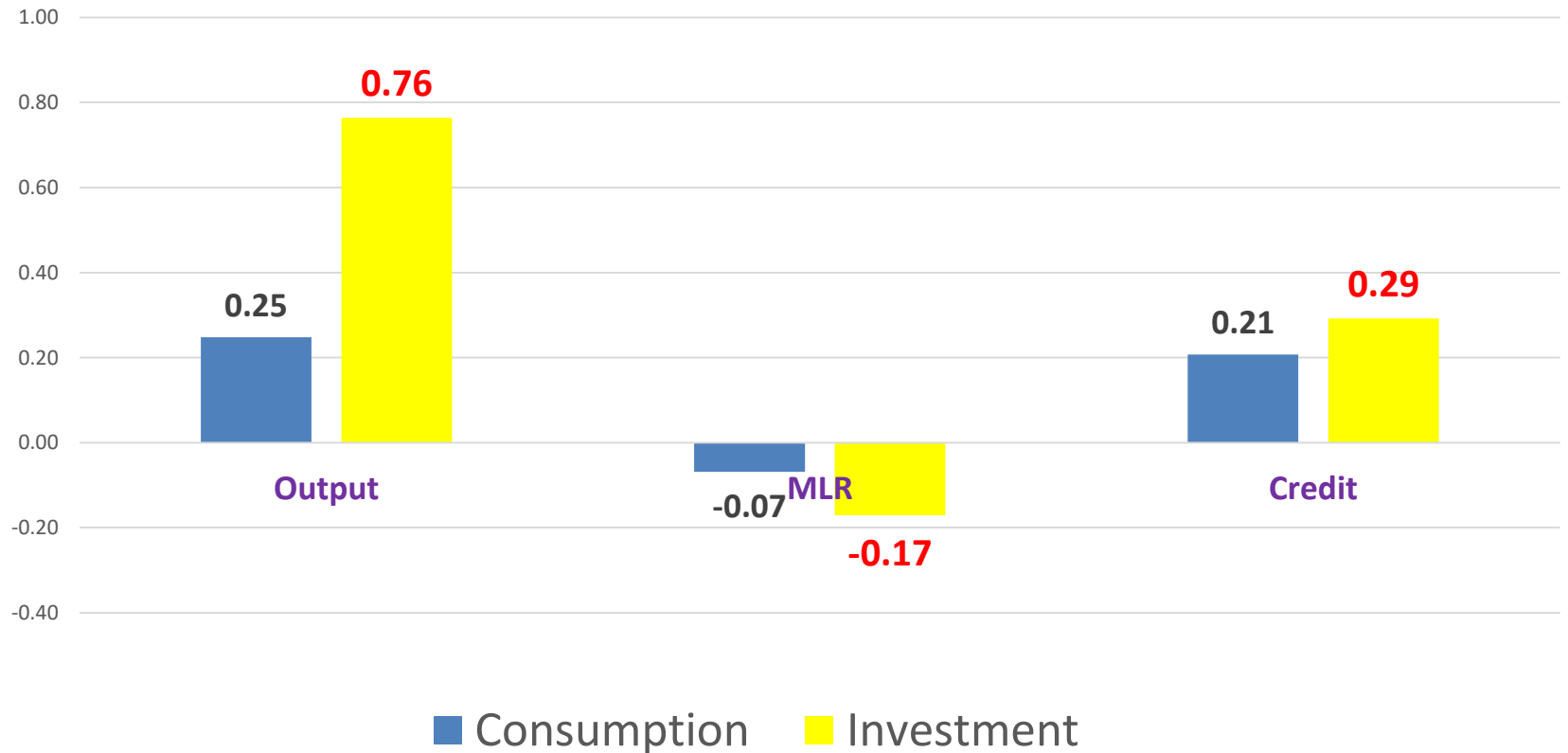
Investors can proceed with less concern about risk and uncertainty that may arise from policy inconsistency

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-US 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 the 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.

Currency appreciation does not necessarily lead to output contraction.

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.

What determines Thailand's exports?

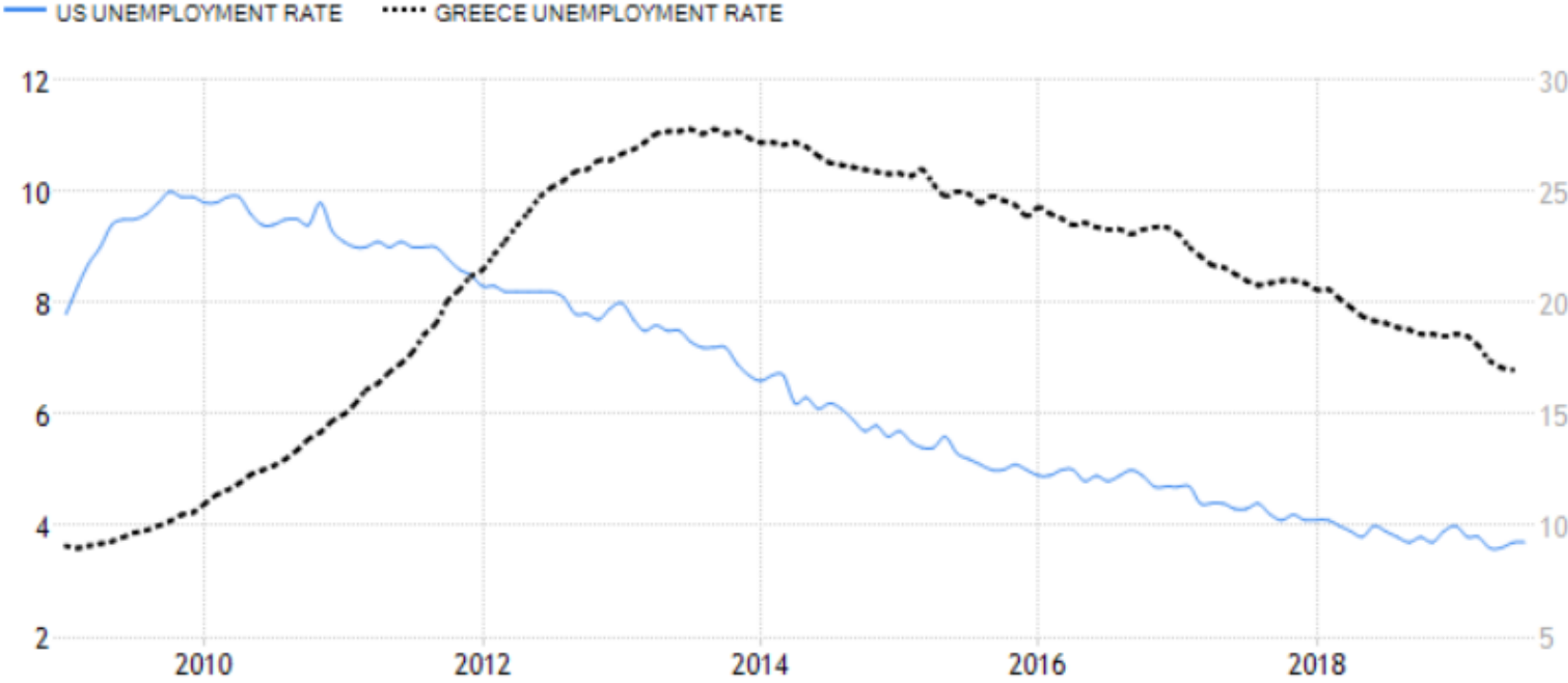
A sustainable recovery depends on the resumption of world trade expansion and regained consumer confidence.

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?

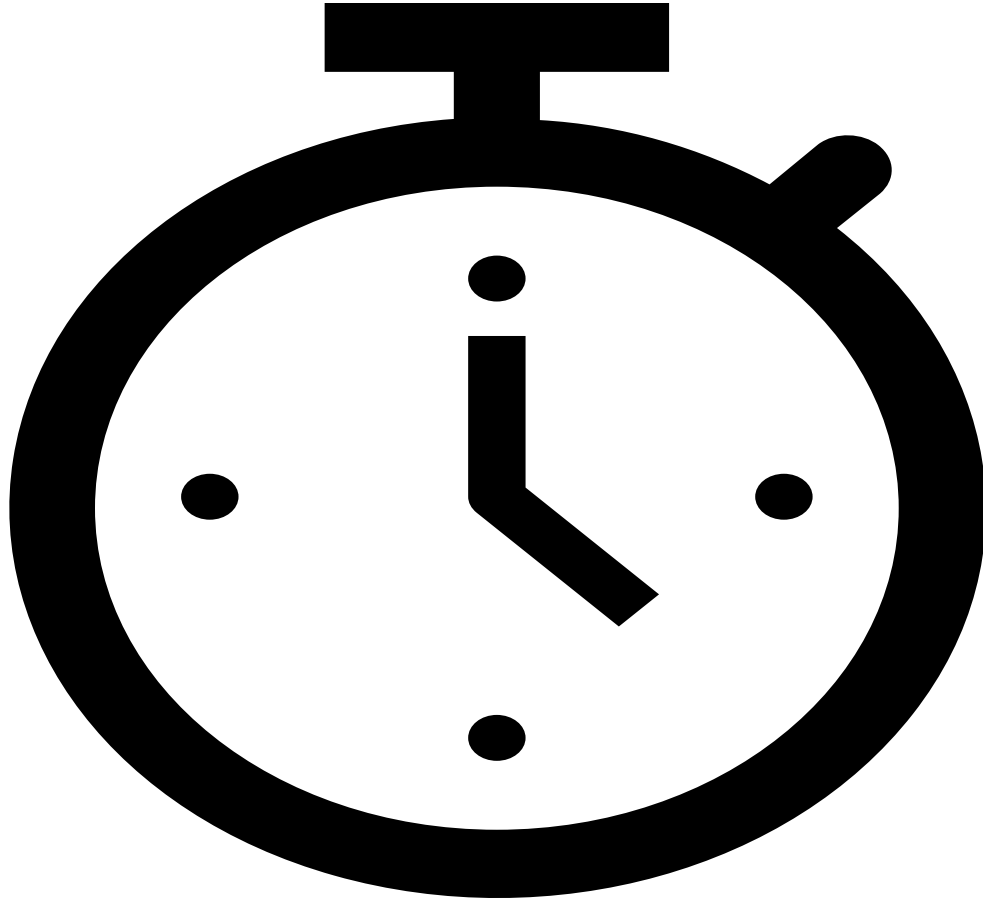
- ***The effectiveness of policy responses*** to external shocks depends on the government's ability to maintain the rule of law, accountability, human rights, and effective legal infrastructure.
- Maintaining the rule of law implies ***predictable outcomes*** from court ruling of legal disputes.
- Investors 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% |  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) |
| <ul style="list-style-type: none"> ● Aggressive lending by financial institutions ● Oversupply and speculation in real estate ● High debt-to-equity ratio ● Hot-money inflows and burgeoning foreign debt |  <p>Vulnerabilities</p> | <ul style="list-style-type: none"> ● 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



GDP growth seeks port in a storm

Bangkok Post: 9 SEP 2019

IMPROBABLE RECESSION?

- An economic recession or a situation akin to the 1997 crisis is a speck on the horizon, given that the country's economic fundamentals remain solid and the economy is still expanding, albeit at a slower pace, said Fiscal Policy Office (FPO).
- The notorious economic collapse was marred by a 7.7% contraction in GDP in 1998; high inflation of 8%; unemployment swelling to 4.4%; a current account deficit of 8% of GDP; a the non-performing loan (NPL) ratio exploding to 45%.
- Foreign reserves amounted to US\$27 billion in 1997, compared with \$220.2 billion at the end of August 2019. International reserves were 0.7 times short-term debt in the year the country's economy collapsed

VAT gradually falling short of 2019 target

Bangkok Post: September 9, 2010

- VAT is the Revenue department's largest revenue contributor at 70-80%.
- VAT from domestic sales and services and imported goods provides equal contributions to the Revenue Department. The firmer baht is also dealing a blow to VAT collection as imported goods shrink in value.
- VAT collection, an indicator of domestic consumption, was 0.5% lower than targeted for the nine months through June.

Thailand's healthcare ranked sixth best in the world

Bangkok Post September 9, 2019

- According to CEOWORLD, which published the list early last month, Thailand was among the few Asian countries which managed to enter the top 10 in 2019, along with South Korea in second place and Japan in third place.
- Thailand beats Spain, France, Belgium in CEOWORLD's 2019 list

The Health Care Index

- The Health Care Index is a statistical analysis of the overall quality of a country's healthcare system, including infrastructure; health care professionals' (doctors, nursing staff, and other health workers) **competence, cost, availability of quality medicine**, and government readiness, according to the CEOWORLD website.
- It also takes into consideration other factors including, environmental sustainability, access to clean water, sanitation, **government readiness on imposing penalties on high-risk behavior**, such as tobacco use, and excess sugar intake.

At what price? Apple's new iPhones

- The price will be the main news analysts look for when Apple announces its latest iPhones today. Will the firm try to milk its base by going way above the \$1,000 it reached two years ago with the iPhone X, or expand it by going lower?
- The new devices would allow it to move either way, if you believe the leaks. The three iPhone 11 models are expected to look little different from their predecessors, but with a new camera, a faster processor and something called “reverse wireless charging” (that lets you charge Apple's wireless headphones).

At what price? Apple's new iPhones

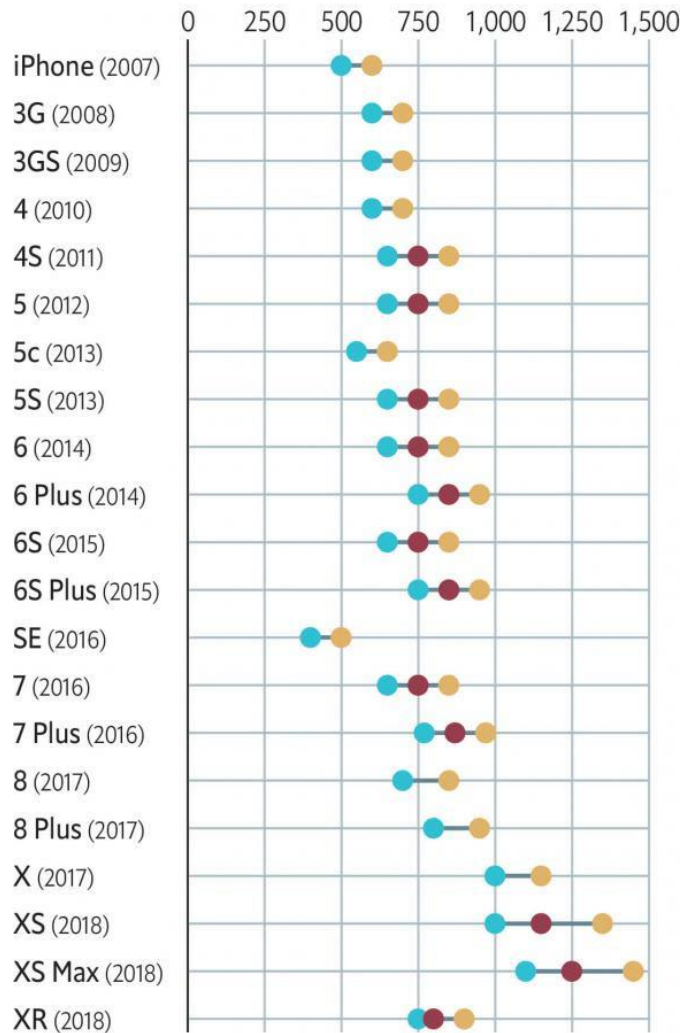
- Aficionados recommend that buyers wait until next year, when Apple is expected to give its line-up a major upgrade, adding such things as 5G and advanced augmented-reality features.
- Rumour has it that it may even deliver a foldable phone then for more than \$2,000 and an affordable one for under \$400.

Apple's new iPhones

Shut up and take my money

United States, Apple iPhone price at launch, \$

Memory capacity: ● Smallest ● Mid ● Biggest



Sources: Company reports; news reports