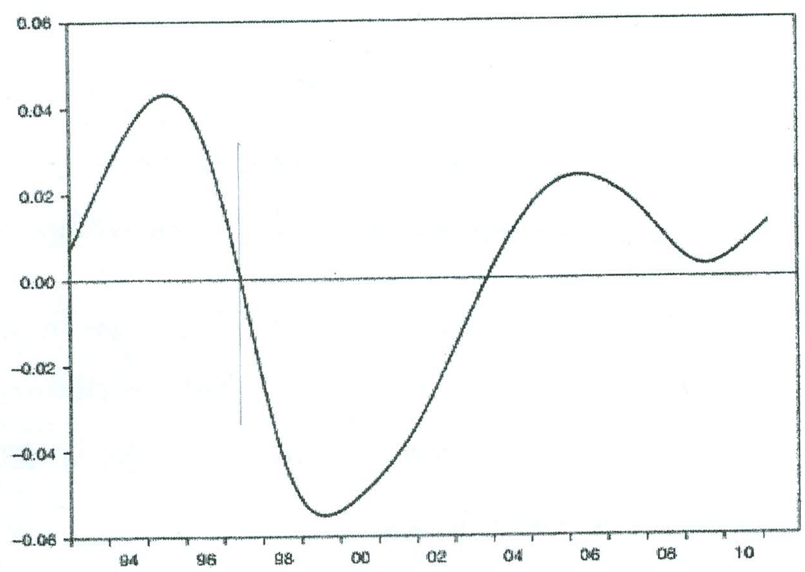
1. Explain how the Thai economy experienced a roller-coaster between 1993 and 2010. How was consumption related to the recession in 1998?



Note: Standardized deviation of actual level of output from its trend level.

Source: Calculation based on data in Figure 12.9.

Figure 12.10 *Climbing hills and falling off cliffs*

- Before 1997 crisis, Thailand experienced stable growth with desirably low level of inflation. The main growth was driven by investment. This signaled that Thailand was in the ~~period~~ of initial stage of growth since the growth was led by investment; not mass-consumption. Also; this investment provided the fundamental factor for growth in term of physical capital deepening.
  - Also; inflation was kept low due to no source of spiral inflation. At that period, there was financial deepening, which increased the rate of saving and in turn reduce velocity of money. Since $\dot{P} = \dot{m} + \dot{v} - \dot{Q}$, as $\dot{Q}\downarrow$, $\dot{P}\downarrow$ holding other things constant.
- Yet, the long period of stable lured people to be over-confident. They got a misconception that the unsuccesful business would be helped by long-term growth of the economy.

  - A fixed exchange rate regime created an illusion ~~of~~ zero foreign exchange risk. Also, exchange rate was fixed at unrealistic level; making the currency vulnerable to speculative attack.

- More capital inflow led to "Dutch disease"; in which traded sector was hurted by an increase in price of non-trade sector
- Current account deficit became wider; raising doubt. about. the sustainability of curreny peg.
- Finally, BoT lost currency battle. Baht depreciated a lot agaist U.S $. Debt dominated in dollars rose while asset (like stock market) lost in value as capital flight out of. Thailand.
- This debt-deflation episode led to a plunge in economic output; resulting in negative deviation from the tred as in the graph. during 1997-98.

- Since exchange rate depreciated, export sector played an important role for Thai economic resilience. Also, agricultural sector helped absorb unemployment and at the same time generated high income through the early 2000s. Hence, though consumption and investment fell, it was still possible for Thai Economy to rebound.
  - Mostly; consumption is determined by wealth, income and consumer confidence. During 1998 crisis, income was low due to dull econmic condition. Wealth in term of aset held fell in value (like stock market). Also, people felt uncertain about the future prospect of ~~econmy~~ economy. Hence, consumption fell during 1998 crisis.
  - Yet, due to economic resilience, deviation from output trend got improved. until the next crisis.

- In 2007-2008, hamburger crisis in U.S. spread world wide to other countries including Thailand. Thai ecomomy was actually affected. As U.S. was the major. importer of Thai product.; GFC hurted Thai export. Yet, in this time, learning. from previous mistake, the economy was less affected; as in the graph, the deviation was still positive but lower during 2007-2008.
  - BoT acted rapidly to ease monetary policy by cutting policy rate Also, sufficient liquidity in the banking system was provided.
  - Moreover, in stead of going into weird financial product in the same way as major countries, Thai financial institutions were not interested. Hence, the crisis was not exacerbated by the problem in financial sectors as in other countries.

2. What can we learn from reading the article "Thailand's macroeconomic policy after 1997," (Asian Economic Papers, 2003), in terms of providing a macroeconomic policy guideline to current economic ministers?

The term macroeconomic policy consists of both fiscal policy and monetary policy. So, the first part is monetary policy and fiscal policy is discussed in later part.

Monetary Policy after 1997: with the new exchange rate regime, inflation-targeting was adopted by BoT.

- The first lesson is that, even though the inflation is targeted, other variables should also be focused. For example, at that time, the urgent issue seemed to be unemployment and a fall in output. Also, BoT should be held responsible to some extent, if the target is not met. For instance, currently, inflation is lower than the target of 1%-4%. ~~The~~ There should be the symmetry in adopting policy during high and low inflation. This failure may lead to deflation, generating concern about Thai economy right now.
- Furthermore, monetary policy should be used as stabilizing tool though there is a lag of effectiveness. The implication is that BoT need to be more vigilant and able to detect the sign of bussiness cycle early such that monetary policy could be adopted before hand to lessen the severity that would happen in the future.
- Bank-lending channel is the major transmission of monetary policy. Since, in Thailand, there seem to be weak relationship between policy rate and market rate, as well as asset market, BoT should encourage the expansion of bank credit by injecting liquidity to commercial banks such that amount of loan supply can increase.
- Expectation of the market is also important. Banks will not be willing to lend if they perceived no sign of economic recovery. Also consumers will not borrow if they suspect uncertainty. Hence monetary policy needs to anchor market expectation by forward guidance, for example, in order to render bank-lending channel the most effective.

Fiscal Policy after 1997; before crisis the policy was conservative, Yet, after the crisis, the policy seemed to be more expansionary.

- The first lesson to learn is that conservative policy does not always unproductive. As seen in the period ~~of~~ prior to crisis, the balanced budget helped support growth and stable price level. As budget was balanced there was no reason to depend on BoT to print the money for financing deficit.

- Moreover, the term conservative needs not to mean 'balanced budget' all the time. Instead, fiscal policy should perform the stabilizing role as well. Specifically, during the boom, government should run budget surplus to deter overheat and during the bust, should run budget deficit to facilitate recovery. In this sense, fiscal policy would promote long-term growth by reducing business cycle.

- Also, budget deficit does not always benefit the country. Mostly, budget deficit in the recent past was due to populist policy. Instead of promoting long-term growth, this may ruin the nation. The reason is that business would act like a problem child; always ask for help and does not get mature. Hence, the competitiveness in the long-run would be reduced. Moreover, just giving money to rural area may not result in efficient use of resource since it will be like giving them a fish without teaching how to catch; making them less self-reliant.

- Finally, apart from stabilizing role, the goverment spending should be paid to major development for the country. As Japan in the past, we should focus more on education, nation-wide infrastructure and rural area investment. These factors would be the foundation for our economy to grow sustainably in the future.