Macroeconomic policy after July 1997

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Lecture 6

Asian Economic Papers (2003)

Main themes

- Macroeconomic development after 1997
- Monetary policy under the “new” exchange rate regime
- Fiscal policy stance
- A balancing act
- Signals of a recession

Thailand's Macroeconomic Policy after July 1997

Table 1. Average growth of macroeconomic variables in Thailand (1997–2001)

Macroeconomic variable	July 1997 to December 1998	January 1999 to December 2000	January 2001 to December 2001
Manufacturing output index (percentage change)	−8.27	7.99	1.25
Government expenditure (percentage change)	−11.22	1.12	2.13
CPI (percentage change)	7.67	0.94	1.86
Nominal exchange rate (baht/US$)	40.33	−0.51	14.09
Repurchase rate of interest (14 days)	15.38	1.80	1.75
Monetary base (percentage change)	2.15	3.60	7.00

Source: Bank of Thailand (http://www.bot.or.th).

Note: Figures are averages of monthly data.

Table 3. Thailand's wage and price adjustments and capacity utilization during 1997–2000

Year	Price (CPI)	Real average wage rate of all sectors	Capacity utilization (%)
1997:1	4.53	6.82	68.72
1997:2	4.86	7.35	57.44
1998:1	7.83	−0.09	51.90
1998:2	9.65	−3.86	48.78
1999:1	4.68	−4.09	55.06
1999:2	−0.32	−1.53	57.39
2000:1	0.16	−0.56	59.87
2000:2	1.68	−1.49	59.14

Source: Bank of Thailand, labor force survey (http://www.bot.or.th).

Figure 1. Trade-off between unemployment and inflation in Thailand

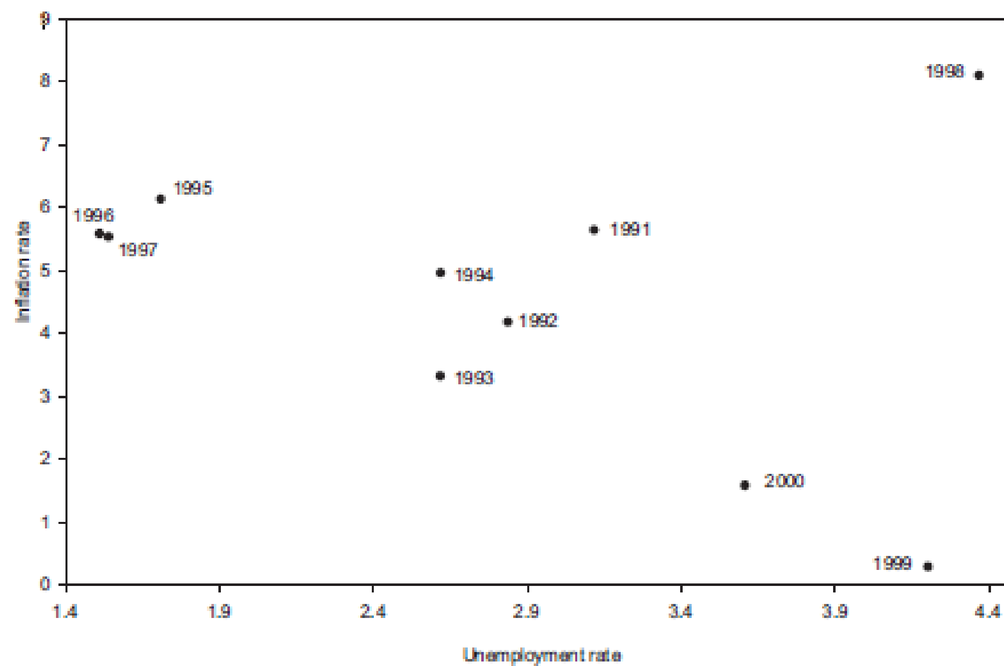

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Figure 2. Nonperforming loan ratio and bank credit growth in Thailand

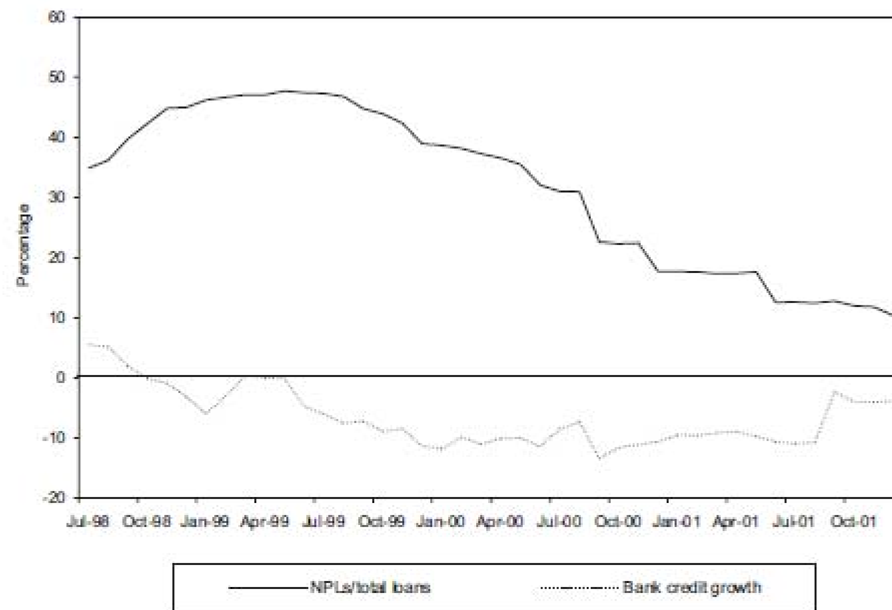
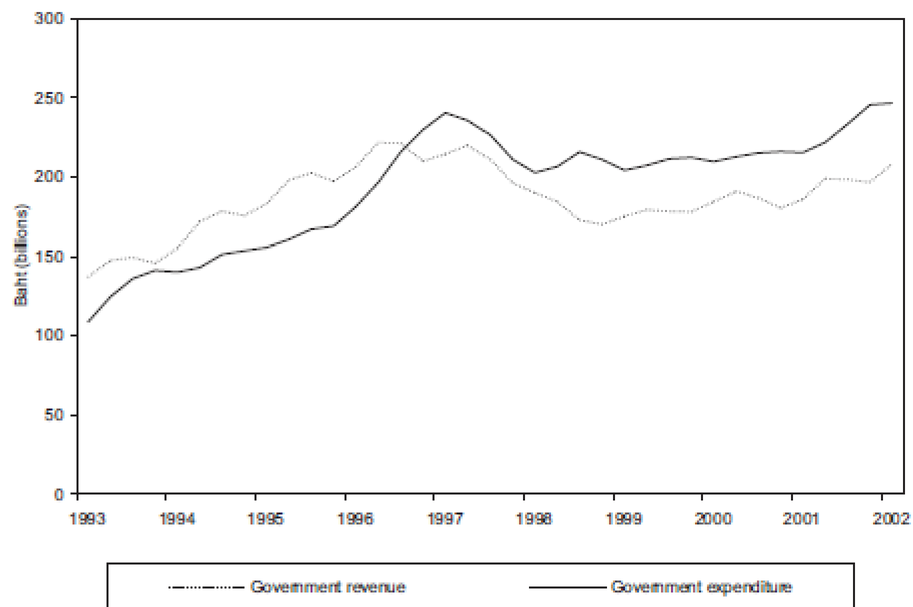


Figure 3. Fiscal policy stance in Thailand



Inflation vs. unemployment

- Thailand's labor market is flexible enough that wage cuts occur during recession, a feature that reduces unemployment.
- The price level does not adjust as quickly as wage rates.
- Because of inflation inertia, there is a trade-off in the short run between inflation and unemployment.
- Expansion monetary policy can reduce unemployment with minimal inflation.

Monetary policy in an open economy

- The interest rate hike of 100 basis points in June 2001 was a policy mistake.
- The BOT should have eased its monetary policy to prevent a slowdown in 2001.
- Many central banks in Southeast Asian countries cut their bank rates in line with the aggressive monetary easing by the Fed in response to shocks and the global slowdown.
- Thailand’s relatively high interest rate was intended to stem capital outflows.

Interest rates and exchange rates

- The BOT once again tried to use the high interest rate policy to protect the baht, which has gained strength while the yen has depreciated against the dollar.
- The high cost of defending the currency by using high interest rates should be obvious from the painful experience of Thailand during the currency crisis.
- The year 2001 could have been better for Thailand had the BOT adjusted its interest rate in line with the rate in the US. The BOT belatedly began reducing the repurchase rate in early 2002.

Concluding remarks

- With a realistic exchange rate and steady growth in the monetary base, even in the face of virulent external circumstances, the Thai economy can still make the best use of globalization by maintaining a moderate expansion along a sustainable growth path through employing a sensible economic policy.