EE460: Resilience of the Thai Economy

1991-2005

Bhanupong

Lecture 4

Outline

- Social and macroeconomic indicators
- Fiscal balance and external debt
- Monetary sector and capital inflows
- Asset bubbles and irrationality
- The role of expectations
- External influences: When China sneezes..

Recap: Economic and social development plans

6th plan (1987-1991)
Maintain economic growth
Upgrade quality of life

7th plan (1992-1996)
income distribution
improve quality of life and **environment**

Recap: Economic and social development plans

8th plan **(1997-2001)**

Human-centered development

Public participation

Sustainable development

9th plan (2002-2006)

Competitiveness

Financial immune system

Self-reliant and resilient society

Social indicators: 1990

	Per capita GNP 1990 (USD)	Life expectancy at birth (years)
China	370	70
India	350	59
Indonesia	570	62
Malaysia	2,320	70
Thailand	1,420	69

Income distribution in the 1980s

The lower the coefficient, the more equitable income distribution

	The poorest 20 ***percent (share of their income)***	***Gini Coefficient***
India (1983)	8.1	0.42
Indonesia (1985)	8.8	0.31
Malaysia (1985)	4.6	0.48
Philippines (1985)	5.5	0.45
Thailand (1988)	4.0	0.47

Gini coefficient in high income countries

- UK, Italy 0.34
- Portugal 0.36
- Netherlands 0.31
- Germany 0.32
- France 0. 33
- Sweden, Austria 0.26
- USA 0.45
- Singapore 0.48

Annual Salary (USD) of the Prime minister/President

- Singapore 1.6 million USD
- USA 400,000
- UK 200,000
- China 22,000

Percentage of population living below the poverty line (2 dollars a day)

	Total	Rural
India (1983)	48	51
Indonesia (1985)	39	44
Malaysia (1985)	27	38
Philippines (1985)	58	64
Thailand (1988)	30	34

Inclusive vs. Exclusive growth

Vinod Thomas (Asian Development Bank)

- Overall growth has ***failed*** to translate into similar improvements in ***living standards***.
- One indication that growth is not reaching a broad enough segment of the population is relatively *low* ***household consumption.***
- Estimates suggest household consumption grew only **5.7** per cent annually in the 1990s and 5.5 per cent in the 2000s in the region, even as gross domestic product surged ***9 per cent*** and 8.2 per cent respectively in the two decades.
- ***Isn't it because people consume less for addition income earned? Or people are still too poor to save?***

Exclusive growth

- This is particularly troublesome for countries attempting to expand domestic consumption and bring the benefits of growth to more people, such as in China.
- As a measure of rising inequality, China's Gini coefficient has gone up from below 0.3 in the 1970s to above 0.47 in recent years.
- China faces a yawning income divide, separating richer urban areas in the eastern coastal regions from western inland areas.

Exclusive growth: Denied access to public services

- Another part of the problem is that many lower-income groups have ***inadequate access*** to basic services in health care, education, or safe drinking water and sanitation, leaving them ill-equipped to participate in economic advancements.
- This is evident in case studies from Pakistan, the Philippines, and Vietnam.

Human capital 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

Define education

- “An investment in knowledge pays the best interest.” Benjamin Franklin
- “The roots of education are bitter, but the fruit is sweet.” Aristotle
- “Education is the ability to listen to almost anything without losing your temper or your self-confidence.” Robert Frost

Theodore Schultz: The role of human capital in economic development

- 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.

Theodore Schultz: The role of human capital in economic development

- 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.

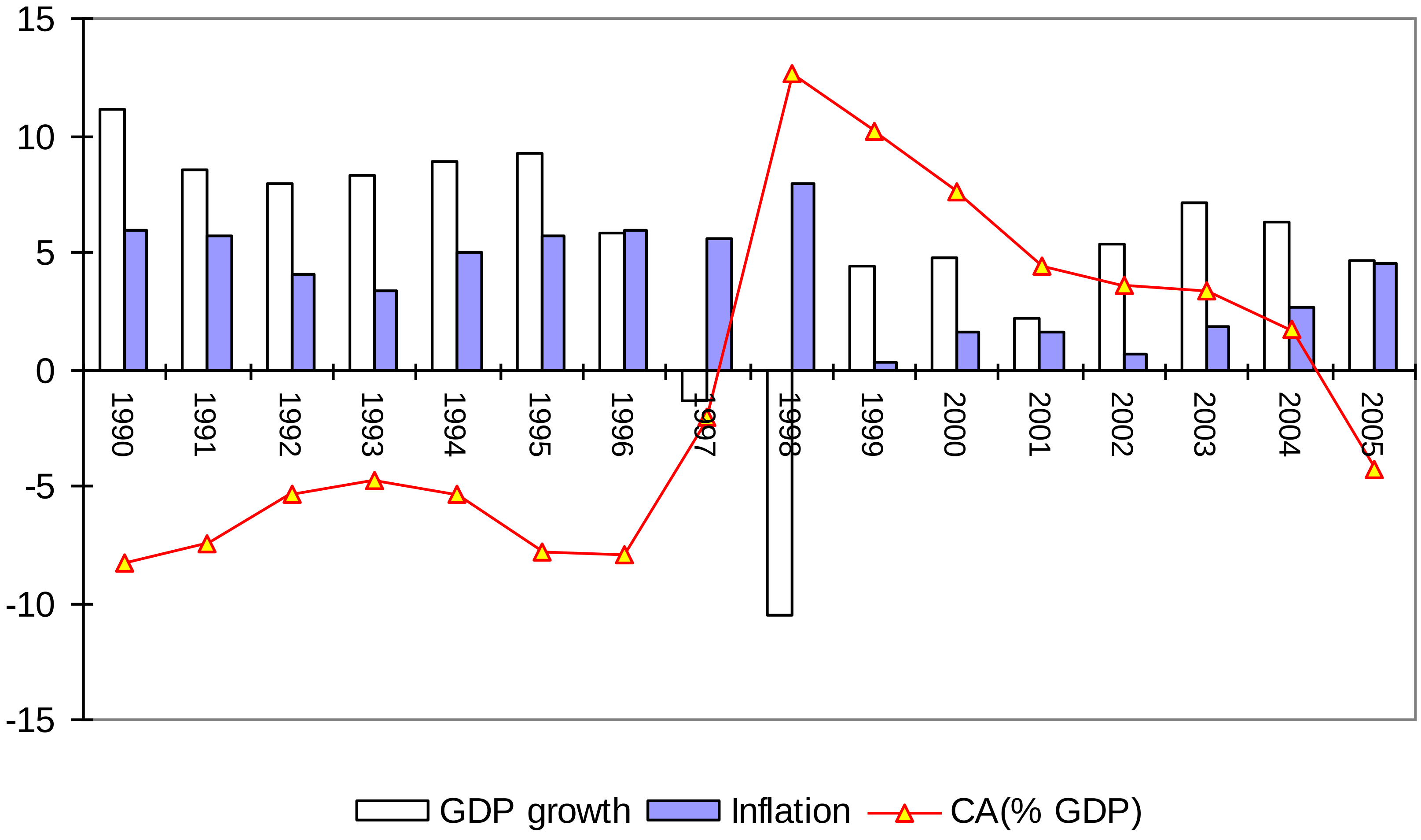
Don’t neglect agriculture

- 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.

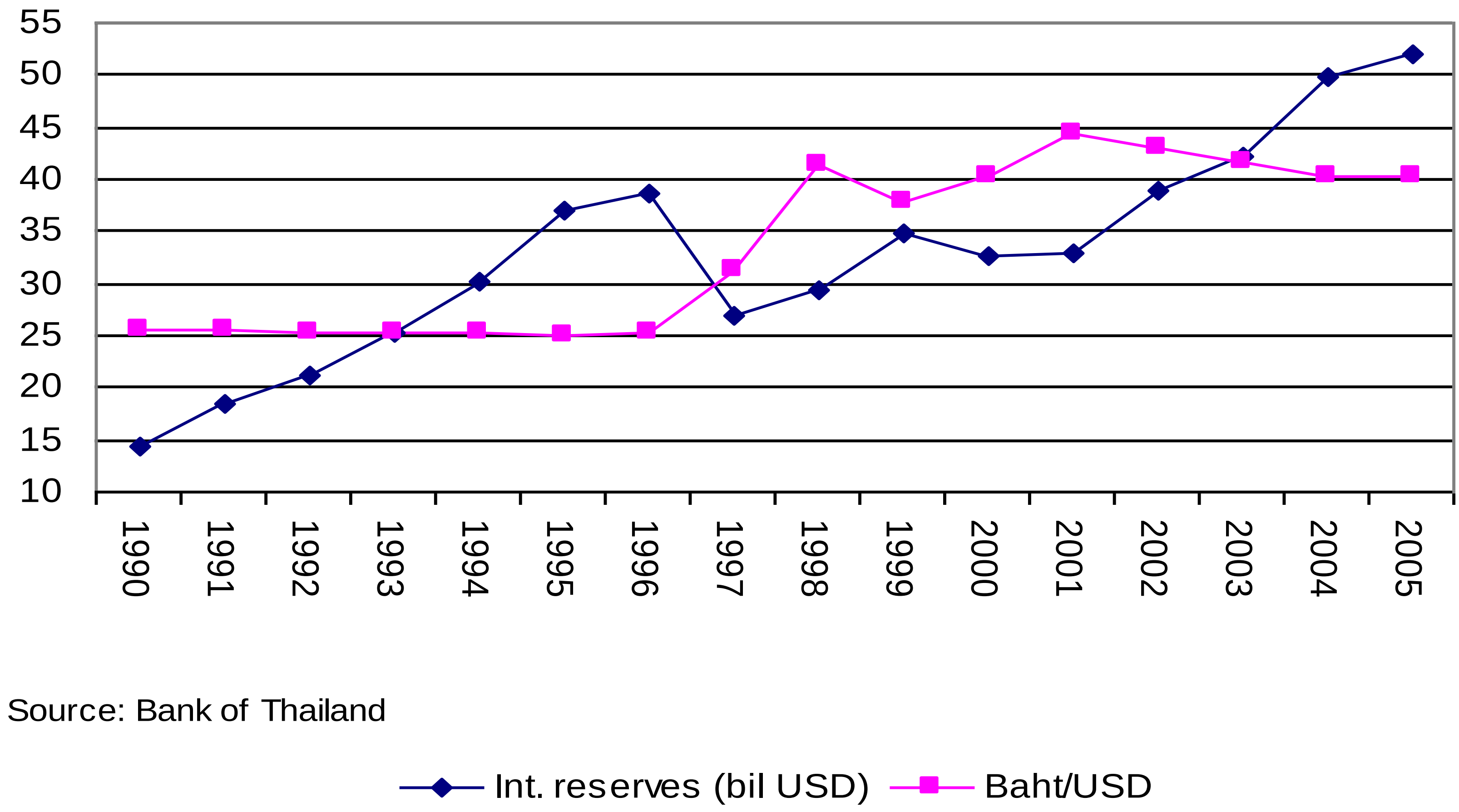
On Macroeconomic Environment

- GDP growth (soft vs. hard landing)
- Current account deficit (surplus) (% GDP)
- Inflation vs. deflation

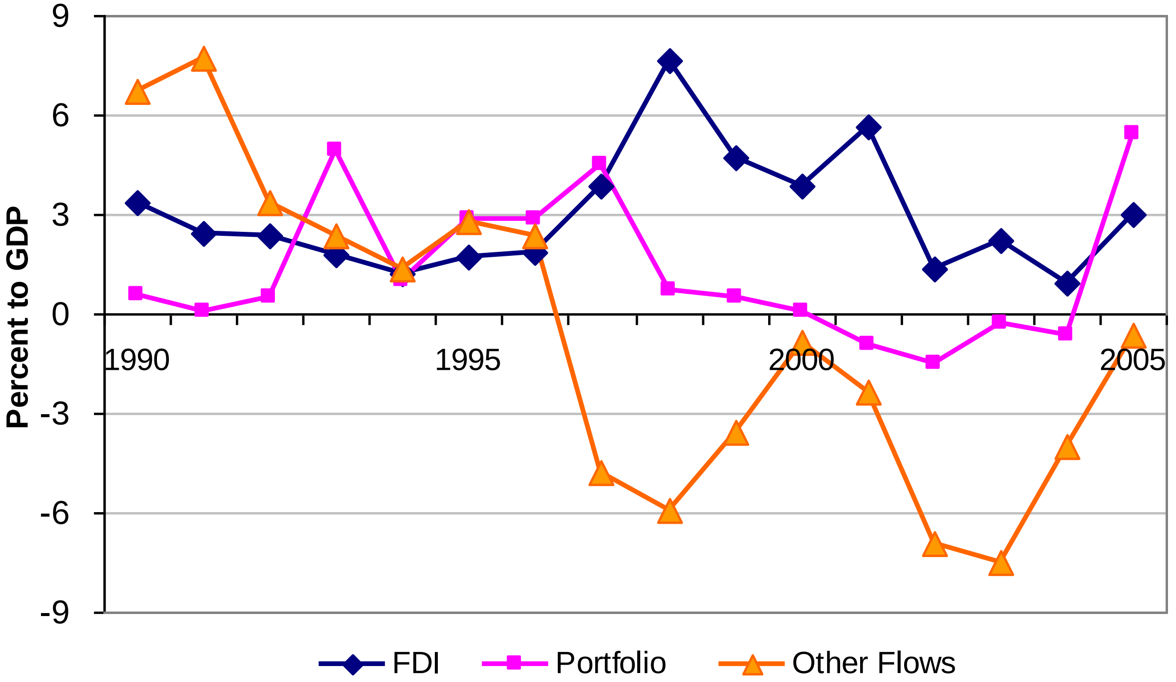
The three economic vital sighs



Rising international reserves
What was the main reason?

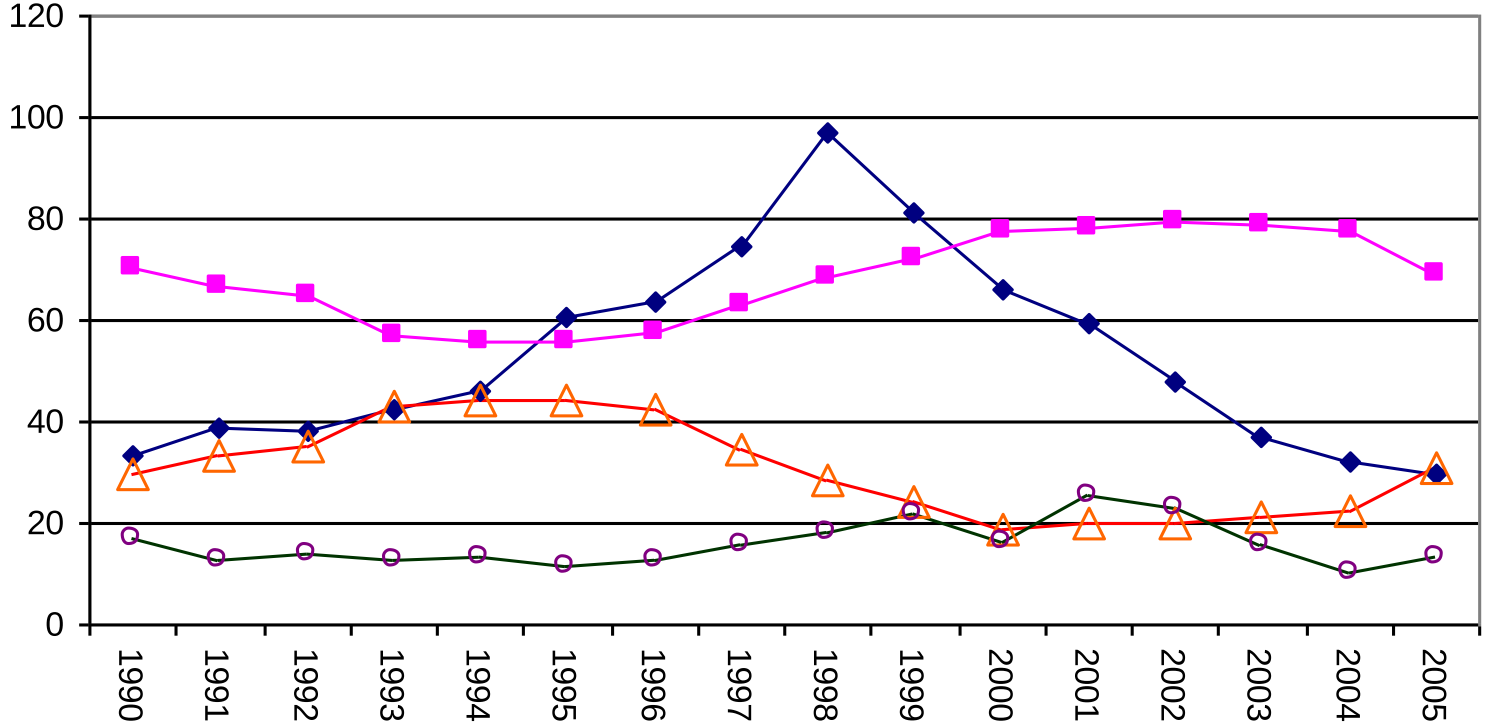


Hot and cold capital flows



Source: Bank of Thailand

External debt structure

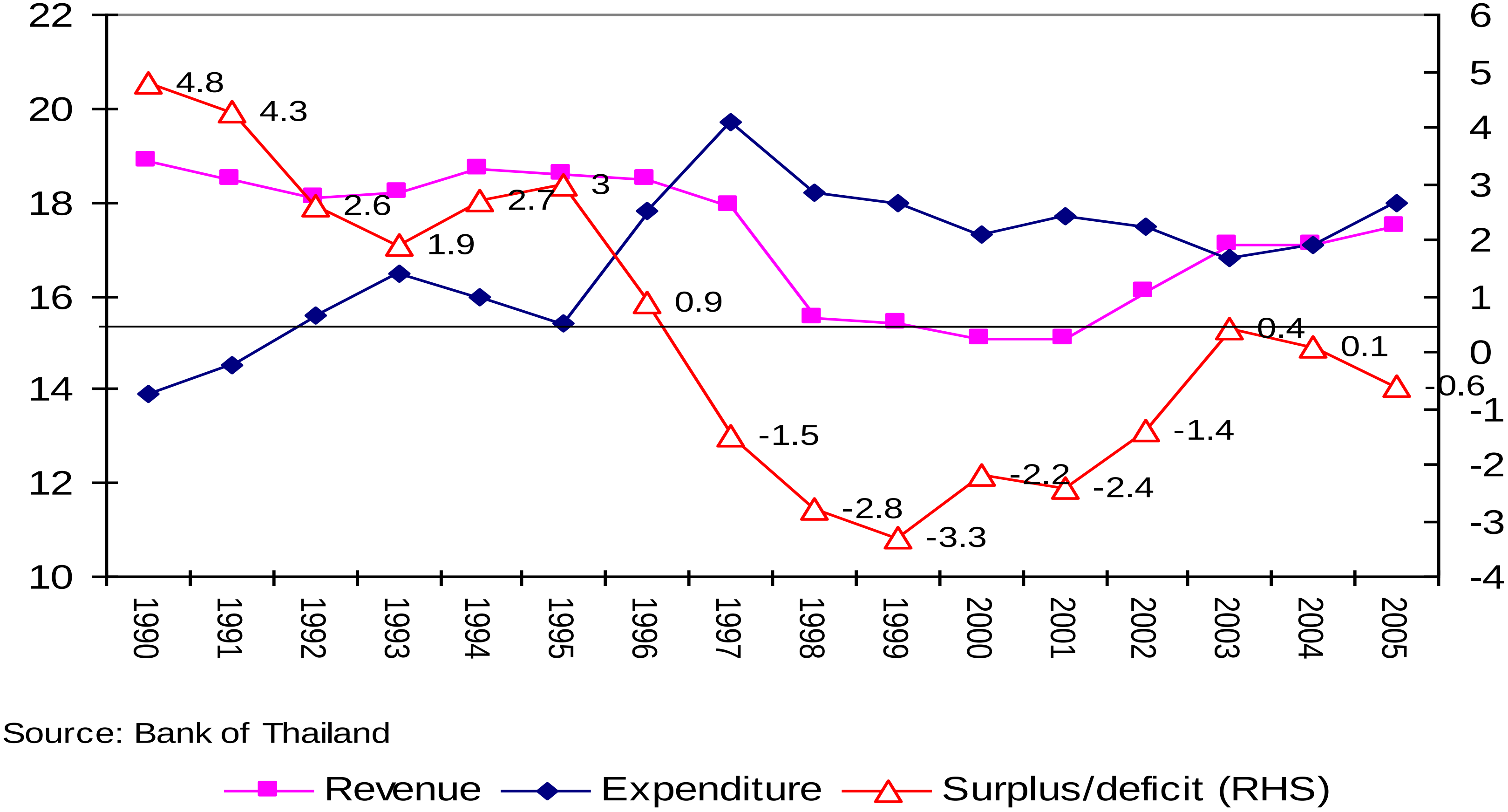


Source: Bank of Thailand

Fiscal discipline and self discipline

Self discipline is when one uses *reason* to determine the best course of action that *opposes* one's desires.   It is the ability to motivate oneself in spite of *a negative emotional state.*
 Using *willpower* routinely and even automatically.

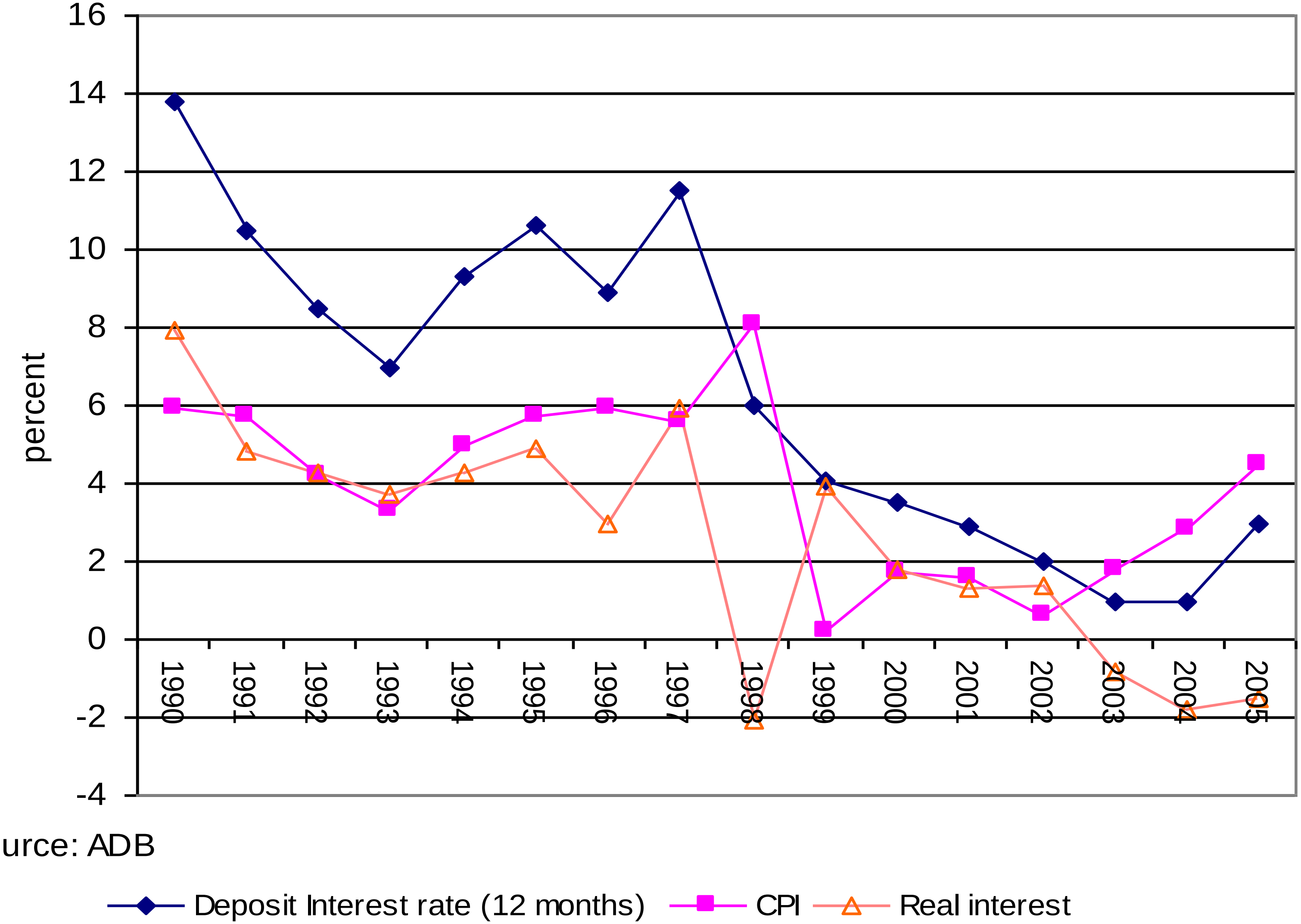
Fiscal budget (percent to GDP)



Source: Bank of Thailand

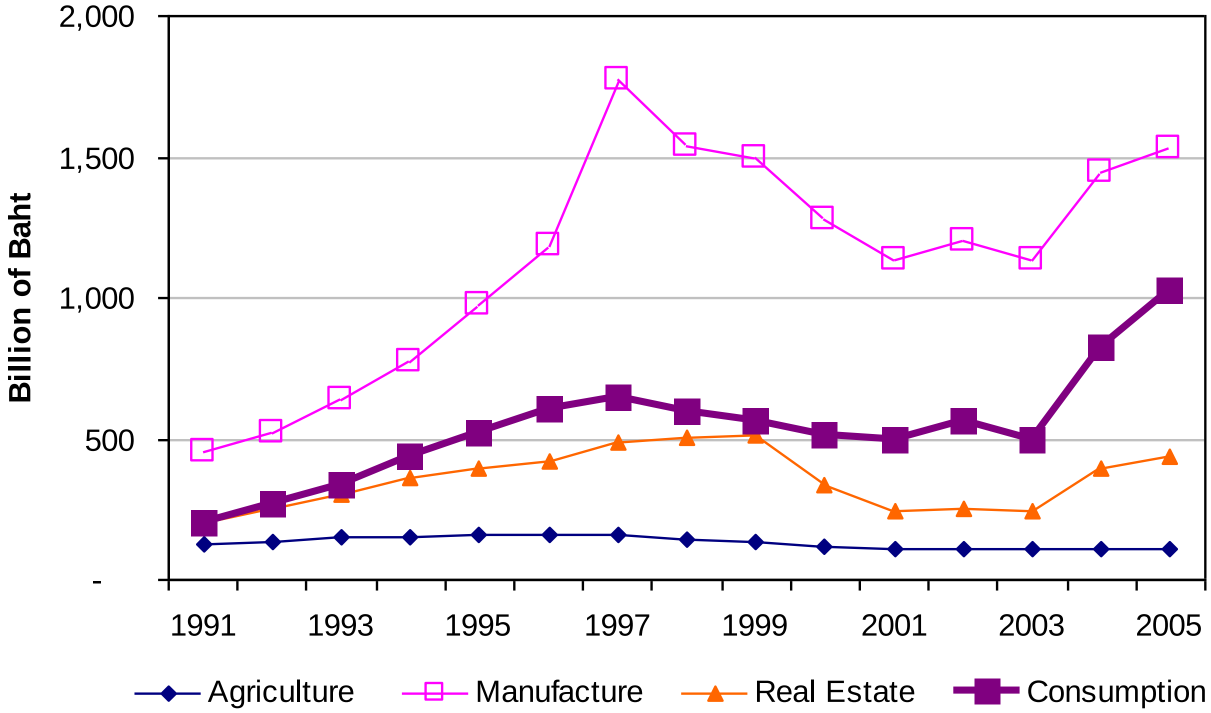
Incentive for financial savings

Fisher Effect?



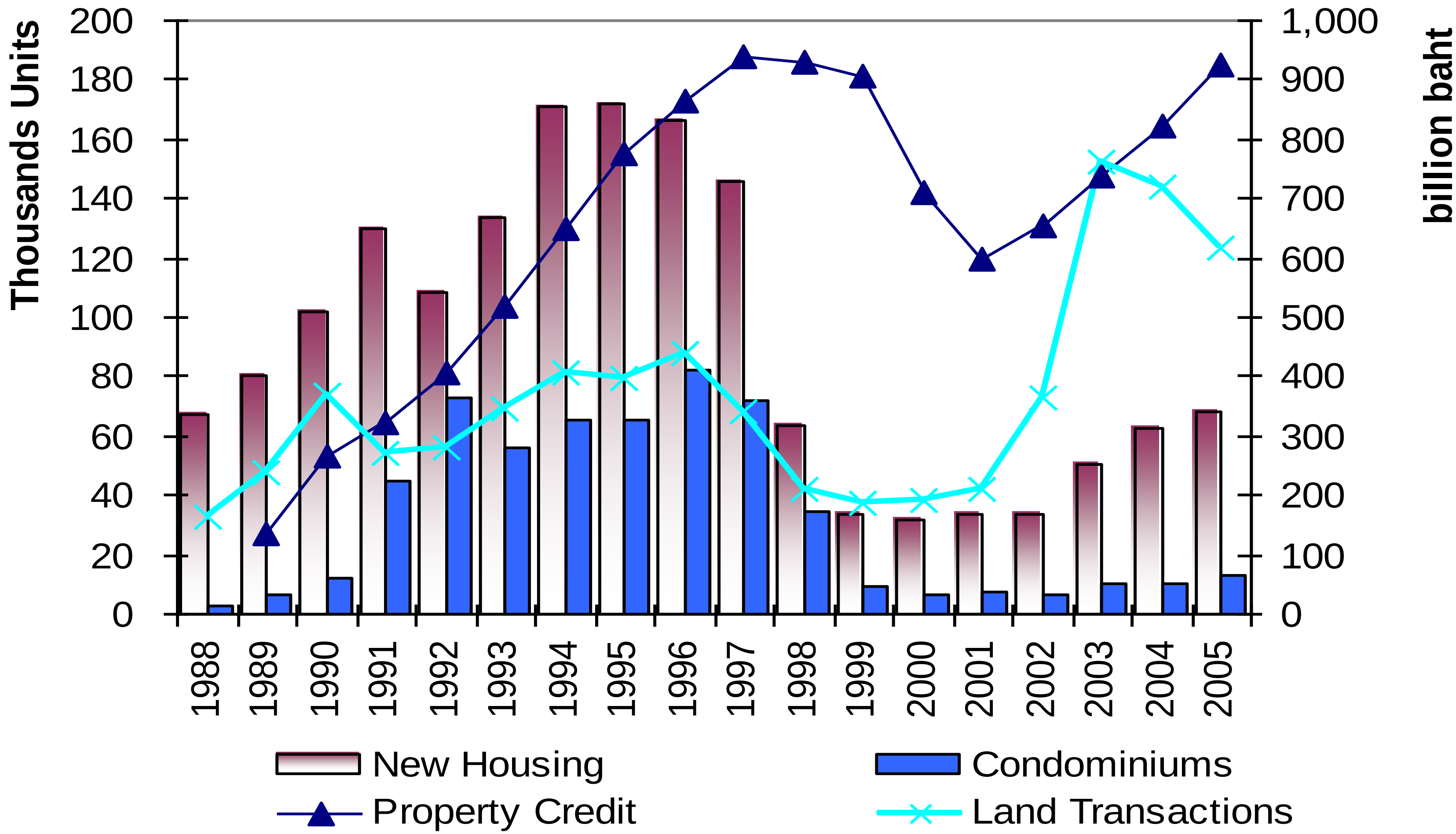
Surce: ADB

Bank loan extension



Source: Bank of Thailand

Property bubble



Source: Bank of Thailand

Blackie Sherrod

- “If you bet on a horse, that’s gambling.
- If you can make three spades, that’s entertainment.
- If you bet cotton will go up three points, that’s business, see the difference?”

Irrational Exuberance
Robert J. Shiller

- **The Stock Market Level in Historical Perspective**
- **Precipitating factors: The Internet, the baby boom, and other events.**
- **Amplification Mechanisms: Naturally Occurring Ponzi Processes**

Rational Expectations

- In many economic situations , the outcome depends partly on what people expect to happen.
- The price of an agricultural commodity, for example, depends on how many acres farmers plant, which in turn depends on the price farmers expect to realize when they harvest and sell their crops.
- The value of a currency and its rate of depreciation depend partly on what people expect that rate of depreciation to be.
- That is because people rush to desert a currency that they expect to lose value, thereby contributing to its loss in value.
- Similarly, the price of a stock or bond depends partly on what prospective buyers and sellers believe it will be in the future.

Paul Samuelson and William Nordhaus

- Economics (16th edition, 1998)
- "Expectations are said to be rational if they do not present systematic (or biased) errors and use all available information ."

$$P = P^{*} + \varepsilon$$

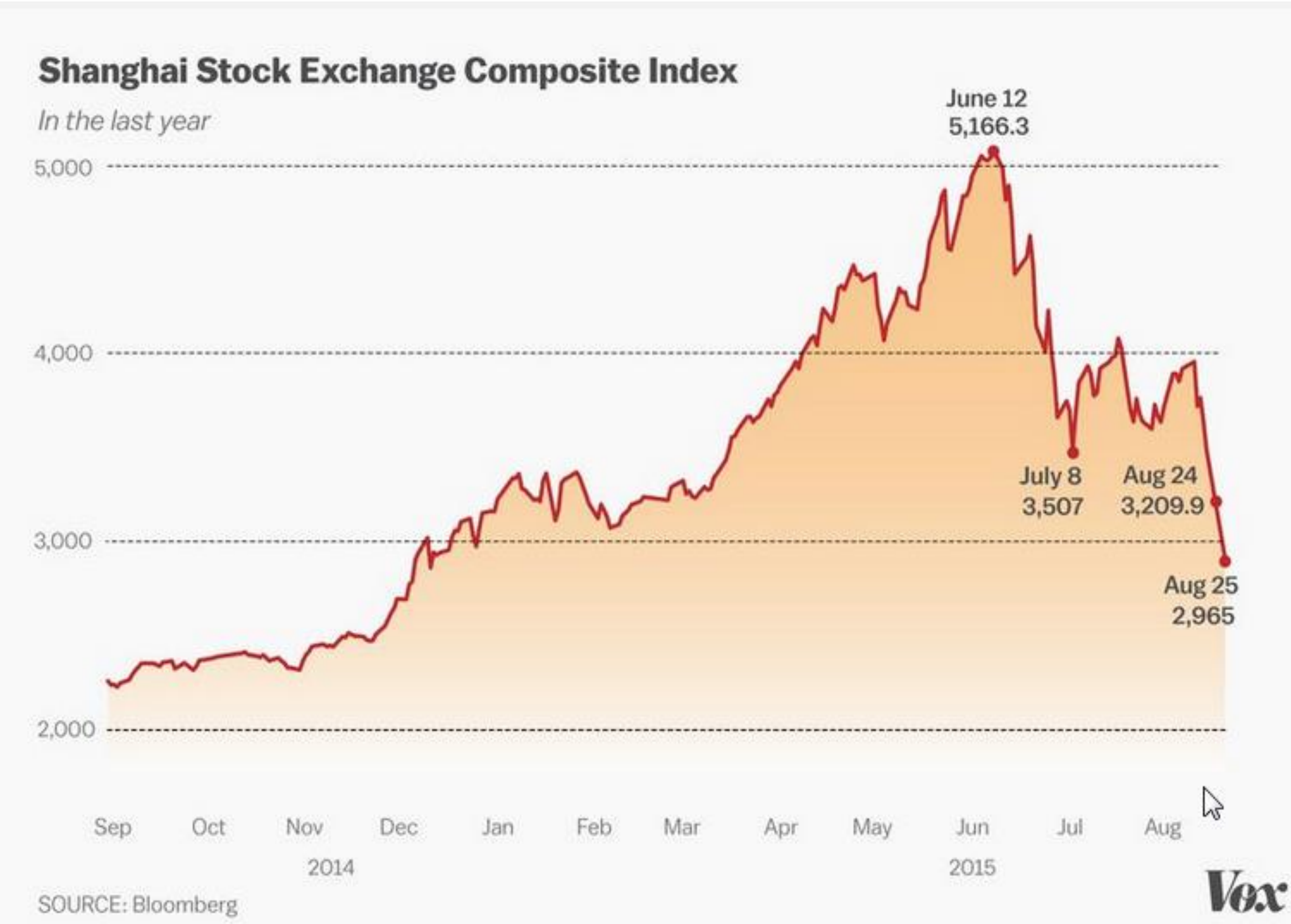
$$\mathrm{E}(P) = P^{*},\ \mathrm{E}(\varepsilon)=0$$

Thomas Sargent

- The concept of rational expectations asserts that outcomes do not differ systematically (i.e., regularly or predictably) from what people expected them to be.
- The concept is motivated by the same thinking that led Abraham Lincoln to assert, "You can fool some of the people all of the time, and all of the people some of the time, but you cannot fool all of the people all of the time."
- From the viewpoint of the rational expectations doctrine, Lincoln's statement gets things right. It does not deny that people often make forecasting errors, but it does suggest that errors will not persistently occur on one side or the other.

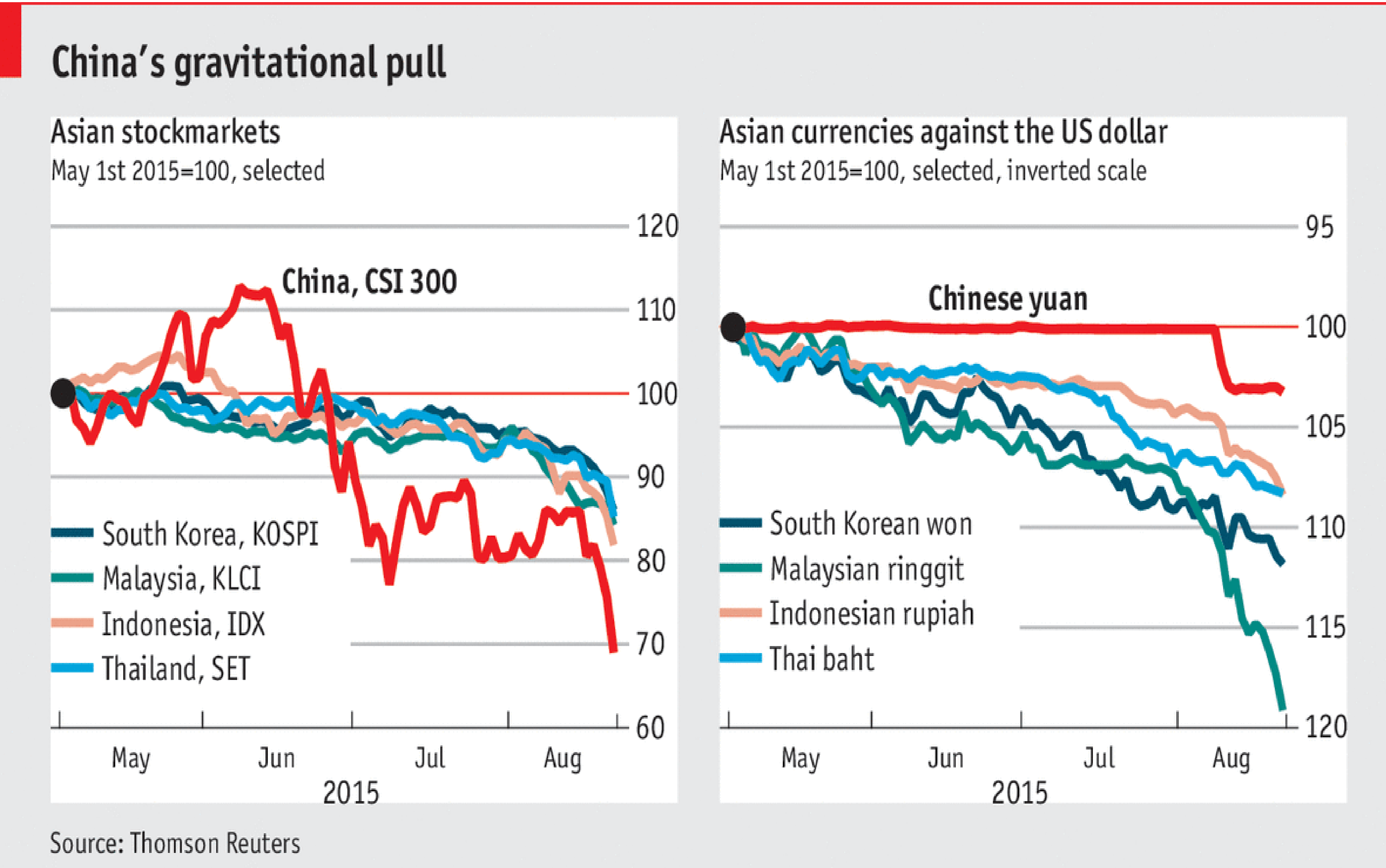
China's stock market had a debt-fueled boom, followed by a crash

- Between June 2014 and June 2015, China's Shanghai Composite index rose by 150 percent.
- A big reason for the stock market rally was that a lot of ordinary Chinese people began investing in the stock market for the first time.
- More than 40 million new stock accounts were opened between June 2014 and May 2015.


Shanghai Stock Exchange Composite Index
In the last year
June 12
5,166.3
5,000
4,000
3,000
2,000
July 8
3,507
Aug 24
3,209.9
Aug 25
2,965
Sep
Oct
Nov
Dec
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
2014
2015
SOURCE: Bloomberg
Vox

Irrational Exuberance
Robert J. Shiller

- **Psychological Factors**
- **Herd Behavior and Epidemics**
- **Attempts to Rationalize Exuberance**
- **Efficient markets, Random walks, and bubbles (based on rational expectations)**



Economist.com

Capital flight from China

- In 2014, $134.3 billion in capital left China.
- One trillion dollars left China in 2015
- The monthly average of outflows from China used to be $11 billion.
- That’s worse than even the most bearish China analysts could have even imagined.

Expectations of the yuan devaluation

- The yuan has depreciated around 5% against the US dollar over the last year, outflows should’ve been about $200 billion.
- In December, the government spent $108 billion to stop the yuan from falling too fast.
- In September, star China analyst Charlene Chu — known for her bearish outlook on China’s credit and liquidity situation — wrote out a dark scenario on foreign-exchange reserve depletion.

Not even the darkest minds imagined it would be this bad for China

- The worst-case scenario saw outflows from September to December 2016 hitting $180 billion.
- For the full year of 2016, they would hit $540 billion.
- The risk is that depreciation triggers capital flight, dealing a blow to the stability of China’s financial system.
- Bloomberg economist ‘s calculation is that a 1% yuan depreciation against the dollar triggers about $40 billion in capital flight.

People's Daily, Jan 27, 2016 (The Communist Party's mouthpiece)

- "Soros's war on the renminbi and the Hong Kong dollar cannot possibly succeed — about this there can be no doubt."
- This warning comes at time when China's officials are trying hard to get everyone confident in the renminbi again.
- The currency has fallen by about 5.7% since August, when China's central bank, the People's Bank of China, first depreciated it.
- As for Soros, last week the billionaire investor told Bloomberg TV that he had best against the S&P 500, Asian currencies, and commodity-linked economies.

U.S. Dollar/Chinese Yuan, W, FXCM
O 6.60903 H 6.62028 L 6.59998 C 6.61218
realtime
Vol (20, false)
56.881K 144.457K
USDCNH, W
U.S. Dollar/Chinese Yuan
6.700
6.612
6.500
6.400
6.300
6.200
6.100
6.000
USDCNH chart by TradingView
Mar
2013
Jul
2014
Jul
2015
Jul
2016
All
5y
1y
YTD
6m
3m
1m
5d
1d
08:23:17 (UTC)
%
log
auto

George Soros: The man who broke the Bank of England

- While Soros didn't specifically mention the renminbi or the Hong Kong dollar, he did say China was one of the "root causes" of the global bear market and the country was probably looking at a hard landing.
- "The Chinese left it too long to address the changeover in the growth model that they have to adopt from — investment and export-led to domestic-led. So a hard landing is practically unavoidable,"
- Notably, this isn't Soros' first rodeo when it comes to currencies.Back in 1992, he "cemented his reputation as the premier currency speculator in the world" after he "broke the Bank of England."
- At the time, the British government was trying to buoy its currency artificially in the European Exchange Rate Mechanism while Soros and some other speculators shorted the pound.
- The British ultimately withdrew from the ERM, as they couldn't keep the pound above its agreed lower limit. Soros made $1 billion on the deal.

Conclusions

- Resilience of the Thai economy had been demonstrated after the financial and exchange rate crises in the period 1997-98.
- Confidence on the bah exchange rate was restored.
- Realistic exchange rates are the key for successful external imbalance adjustments.
- Sustainability of fiscal balance and external debts depends on fiscal discipline.

Conclusions

- Capital flows are related to exchange rate movements.
- Asset bubbles are propelled by expectations and monetary expansion.
- External influences on the Thai economy increase with higher degree of globalization.

Review Questions

- Has the Thai economy become less resilient since 2006?
- Are we experiencing a property bubble? If so, explain why. If not, why not? Should the Central Bank prick asset bubbles?
- How far can a country rely on domestic demand stimulus? (China saved the world in 2009 after the GDC, by increased public spending).
- Compare and contrast the exchange rate policy of the BoT in 1997 and the PBC in 2015.