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"Ten Years After the Asian Currency Crisis: Future Challenges for Asian Economies and Financial Markets"

At the outset, I would like to thank Governor Fukui and the Center for Monetary Cooperation in Asia, Bank of Japan, for inviting me to speak at this special international symposium and for the excellent arrangements made. It gives me both a great honor and pleasure to meet with many people who are genuinely interested in our ASEAN economies.

In this first session, I have been asked to speak on changes in Thailand's economic dynamism after the 1997 crisis as well as the Bank of Thailand's view on where the Thai economy is heading.

Due to the time constraint, I will limit my talk to only three key points.

The first is that the Thai economy is now back on a firm growth path and has become more resilient. **[Slide 1]**

For nearly five years after the 1997 crisis, the Thai economy went through a period of substantial adjustment. The tough adjustment was unavoidable because the crisis had inflicted a deep wound on the economy. During 1997-1998, we underwent a severe economic contraction, thousands of companies went bust, hundred thousands of people became unemployed, and the amount of non-performing loans in the financial system skyrocketed. The economy staged a rebound in 1999 and 2000. But the recovery was cut short by the global economic downturn in 2001, when growth that year registered merely 2.2%.

Things then started to turn in 2002. Despite the continued global slump, the Thai economy expanded 5.3% that year and has since been on a firm growth path. The resiliency of the economy is evidenced by the fact that during the past two years Thailand has weathered several economic storms -- the Tsunami, avian flu, political uncertainty, and the recent oil shock -- with only a moderate slowdown in GDP growth.

[Slide 2] The key driver behind the current economic expansion has been a combination of domestic demand and exports. The latter, in particular, has always been our main engine of growth. One reason for this is that our export structure has become **more diversified**, both in terms of product and destination. For example, over the past twelve years, Thailand's exports to ASEAN + China as percent of total exports has increased from 25 to 30% whereas those to G3 have declined from 51 to 42%. This allows us to reap benefit from the growing intra-regional trade, particularly China-related.

[Slide 3] But perhaps more important from the point of view of the Bank of Thailand is that the current growth has been accompanied by a good degree of both internal and external stability. On internal stability, despite the recent surge in oil prices, inflation remains well in control. Core inflation, which is the Bank of Thailand's policy target, is comfortably in the target range of 0-3.5%.

And the unemployment rate, which shot up after 1997, has now returned to the level comparable to the pre-crisis period.

[Slide 4] On external stability, international reserve is now at a historic high of 67 billion USD and covers 3.4 times of short-term debt. In dollar terms, total external debt now stands roughly at half of its peak in 1997. Part of this rundown has been supported by the current account which has been in surplus in eight of the nine years after the crisis. It is worth noting however that external debt has picked up recently, and is being monitored closely

[Slide 5] At the micro level, eight years after the crisis we see a strengthening in several aspects of corporate financial performance. Returns on assets of listed companies are now about twice its pre-crisis average while the average debt-to-equity ratio has fallen to about one-to-one. Higher returns and falling leverage have contributed to the interest coverage ratio of about 7 times. Nevertheless, the past two years have witnessed a squeeze in firms' gross profit margin as a result of increased competition and the appreciation of the baht relative to other regional currencies.

[Slide 6] And as for the banking sector, which was at the center of the crisis, painful financial restructuring has now bore fruits. The banking sector has gained strength, with stronger profitability. The level of non-performing loans has been cut down by four-fifth from its peak in 1998 to about eight percent in Q3 2006. And with the BIS ratio of nearly 15%, the banking system appears well cushioned to unexpected shocks.

[Slide 7] Finally, the fiscal sector benefits greatly from the economic upturn. Increasing corporate profits and consumption spending have resulted in higher tax revenues, allowing the government to strengthen its fiscal position significantly. Public debt to GDP has declined and is currently at only 41% of GDP.

Ladies and gentlemen, I hope my account of these selected developments has shown you how far the Thai economy has come since 1997. The improvement was not due to luck or natural recovery process. It took a concerted effort by both the public and the private sectors to enable this turnaround.

A natural question that follows then is whether this renewed dynamism will be sustained and this leads to my second point.

That is, despite important challenges both domestically and externally, the medium-term outlook of the Thai economy remains positive.

In the medium term, the most important challenge for the Thai economy is how to cope with a slowdown in the world economy and a volatile global financial market. Thailand, like many emerging market economies with a small and shallow financial market, is particularly vulnerable to fast-moving international capital. Such rapid movements of capital flows can cause exchange rate to be vastly out of line with the underlying economic fundamentals and have negative impacts on the export or the import sectors depending on the direction of exchange rate movement. In our case, the recent surge in capital inflows has caused a one-way appreciation of the baht relative to regional currencies to the point that it may have become detrimental to both competitiveness and the ability to adjust of the real sector.

Sustaining the growth momentum in such an adverse external environment is not an easy task. The key is to ensure that the baht does not move further ahead of other regional currencies. But this alone will not be enough. We also need help from domestic demand which has been somewhat soft due to a number of domestic and external factors during the past year.

[Slide 8] Whether we shall see a turnaround in domestic demand will depend on a number of factors. Some of these are fortunately on our side. First of all, oil prices, which hit the economy very hard this past couple years, appear to have settled down around 55 USD. While we cannot rule out another surge in oil prices, the possibility of that happening is at the moment not very large. Furthermore, given a high base, the relative impact of a price increase will be smaller this time around.

A potential factor to support Thailand's medium-term expansion will be a pickup in private investment, expected in the second half of this year. Although Thailand's investment share of GDP has expanded gradually since the economic recovery, it remains well below pre-1997 level and thus room for more investment. At the same time, the capacity utilization rate has steadily climbed up to the point that, if left to their own accords, firms will soon need to make new investments in order to meet demand.

Facilitating the pickup of private investment growth will be bank's improved ability and willingness to lend as the banking sector's NPLs are expected to decline to a low single digit this year. This further strengthening of banks' balance sheets will allow banks to lend at lower carrying costs. Furthermore, the ongoing preparation for the sector-wide adoption of Basel II at the end of 2008 will help ensure the quality of the new private credits.

An additional economic stimulus will come from the fiscal side. With a strong fiscal position, the Thai government this fiscal year has opted for the use of a budget deficit to support economic growth. Key infrastructure investment projects include the expansion of mass transit network in Bangkok, water resource management, and an integrated logistic system. These public investments will partially take up the slack in the first half of the year as well as speed up private investment through a crowding-in effect.

Of course, there remains the issue of political incidents which can still make things less rosy. This would not be under policymakers' control; the government, however, is doing its best to take necessary safeguard measures in order to assure people of the state of security.

Ladies and gentlemen, being confident of the medium-term outlook does not mean that we will be complacent. After all, we are in an environment of an ever-increasingly competitive global arena, more integrated financial markets, volatile capital flows, more inter-linkages between economies, and increasing trends toward liberalization. For policymakers, this means that the conduct of policy will become more demanding in the periods ahead.

[Slide 9]This leads to my third and final point. That is, to ensure that growth and stability are sustained in the long run, we need policy tools and persistent reforms going forward.

From a long-term perspective, the critical challenge for the Thai economy is how to continuously improve its flexibility, efficiency, and competitiveness. In this respect, a crucial policy effort is a combination of financial and real sector reforms and policies that promote a sound and stable macroeconomic environment.

To mention a few, infrastructure building will continue to be strengthened particularly through amendments and introduction of a number of legislation. The Financial Sector Master Plan

(FSMP) will move onto its second phase, with the review of the plan and emphasis on increased competition and consideration on potential entry of new players to further enhance efficiency and resiliency. As a tool, the macro-prudential and risk assessment framework which includes development of an early warning system model to bolster our financial stability analysis in order to make pre-emptive policy responses when appropriate has also been put in place.

With regards to real sector reform, significant attempts have been made to raise real sector productivity, promote transparency, and strengthen governance. Nevertheless, there remains more to be done on this front. The most important issue here is to keep pressing on with the reform effort and not to let reform fatigue get into our way.

The adoption of a full-fledged inflation targeting regime in 2000 eliminated the inconsistencies among monetary policy, exchange rate policies, and capital flow policies that had contributed to the 1997 currency crisis. This framework has served us well, with enough flexibility to accommodate other important policy objectives such as output stabilization, provided that inflation remains in check. In fact, the consistent improvement in our monetary policy mechanism and thus its efficacy have given me reasons to be optimistic about the prospect of our present regime. Seeing less inflationary pressure, the Monetary Policy Committee this month turned to an accommodative stance to ensure that the economy continues on a satisfactory course.

Recognizing that inflation targeting is not a panacea, the Monetary Policy Committee has supplemented the framework with a regular monitoring and assessment of seven key areas of financial imbalances, where buildup may threaten the macroeconomy and price stability. These seven areas are the country's external position, the real estate sector, bank credit, household and corporate financial positions, the financial market, and the fiscal position of the Government.

Ladies and Gentlemen, despite all these reform efforts and the stronger foundation the Thai economy now has, we have to remain vigilant. Today, the change of pace in the global economic environment is simply unprecedented. Some of these changes, if left unchecked, may have significant implications on a country. While the new global dynamics represents an opportunity for a country like Thailand to leap forward, it also entails increasing risk of economic instability. The evolving complexity of the global economy means that conventional thinking and approaches to deal with economic problems may, at times, need to be adapted. The 1997 crisis highlighted this point. Back then, the conventional wisdom for a crisis-ridden country is to adopt restrictive monetary and fiscal policies. As we all now know, over-tightened stance aggravated the already fragile situation and created many unnecessary pains. Only when the crisis contagion spread to several countries was it evident that such measure was a wrong medicine for Asia, which ultimately led to the abandonment of some of these measures.

Today we are faced with the major problems of global imbalances and large and volatile capital flows. Yet, the conventional wisdom remains an adherence to market mechanisms. This has proved to be inadequate, with Thailand's very recent experience in dealing with the one-way momentum of the baht appreciation. After a number of unsuccessful conventional measures, we had to resort to the unconventional measure of imposing a reserve requirement on capital inflows, as you all know, to put a brake on the one-way momentum. A measure like this, by nature, is short-lived. I believe that in order to come up with more sustainable solutions, international policy dialogues such as the Fund-initiated Multilateral Consultation would need to be strengthened. Short of a regional or global-coordinated efforts, some unnecessary and painful adjustments may have to be introduced no matter how strongly committed we are to the conventional market mechanism.

Ladies and gentlemen, to quickly summarize, the Thai economy is now doing much stronger in terms of growth and stability with a moderately positive medium-term outlook. Yet we recognize that risks to the economy evolve continually and come in many forms. We therefore put a strong emphasis on managing potential risks that could take away our current economic dynamism. This includes proactive oversight, strengthened stability framework, persistent reforms, and vigilance in dealing with complex challenges. In doing so, we hope to translate the current momentum into long-term sustainability.

Thank you for your attention.