Sethaput Suthiwartnarueput: Thailand - a resilient future

Speech by Dr Sethaput Suthiwartnarueput, Governor of the Bank of Thailand, at the Association of International Banks (AIB) dinner talk, Bangkok, 24 July 2024.

* * *

Mr. Giorgio Gamba, Chairman of the AIB
Distinguished guests,

It is a great pleasure to be here again. Before getting to the topic 'Thailand – A Resilient Future' , we have a somewhat challenging present that we need to get through. I would like to share with you about the challenges that we are facing now and likely to face going forward and clarify some misconceptions about what is going on.

Part 1: If the economy is recovering, why does not it feel like it is?

Let me start with the Bank of Thailand (BOT)'s economic outlook. We have been saying in our Monetary Policy Committee statements that the economy is gradually recovering. Recovery is there, but it is slow and very uneven. We expect the GDP growth this year of 2.6%, but a lot of people probably say they do not see nor feel it. Why is that? I think there are a couple of reasons.

First, domestic demand or consumption has been recovering quite well, but manufacturing production has seen much less recovery and remains below pre-COVID level. Last year, consumption grew at 7.1%, which is as high as we have ever seen, and is still going strong in first quarter of this year. However, most of the consumption growth is heavily concentrated in services (about 80%). We also see increased competition from imports, especially from China as reflected in the increasing share of imports from China in the consumption basket. So, the increase in consumption has not necessarily translated into increases in domestic manufacturing activities. In addition, manufacturing production is facing structural headwinds – key exports drivers like petrochemicals saw exports to China drop by 30% in the last three years due to China's greater self-reliance policy.

Second, while the incomes of both non-agricultural employees and self-employed workers have recovered back to pre-COVID level, their recovery paths are very different. Self-employed workers like merchants, taxi drivers and people working in service sectors, had a huge dip in earnings during COVID, which suggested large wealth foregone. So, if you ask people whether they feel like things have recovered or things are as good as they used to be, the answer would clearly be no. On top of that given the slow recovery in income, inflation also has resulted in higher prices and higher cost of living.

Third, household debt has been a big drag. High levels of household debt, at about 91% of GDP in the first quarter of this year, has been a substantial problem that is likely to be with us for a while and not easy to be solved. The reason is that the nature of Thailand's household debt is particularly problematic. The composition of household debt in Thailand is different from other countries where the majority of household debt is

attributed to housing loans, underpinned by an asset. In Thailand, housing loans account for only about one-third of total debt while the other two-third consists of other personal loans and other loans[1]. One important takeaway is that if you really want to solve the household debt problem, we need to see incomes going up.

Taking an example of a household in Thailand's Northeastern region, where household debt is an especially onerous problem for farmers, on average, there has been a steady gap between expenditures and working income[2] over the past 10 years. So even if you fix the existing stock of debt, given the substantial gap between spending and income, they are going to incur new debt again. In order to address and solve the household debt problem on a sustained basis, what is required is not just measures dealing with debt, but you need to try to close that gap. This means that, firstly, we need to keep inflation low and stable because it really affects the expenditures and, secondly, we need to try to raise the level of income. If you ask whether we have done such a good job of that in the past, the short answer would be not really.

I understand that there is big emphasis on trying to boost GDP growth, but GDP is not an end in itself. What we really want to see from higher economic growth is that it translates into higher welfare for households. However, if you look at the track record of the increase in economic growth or national income for the past 10 years, it has not really gone so much into labor income - national income has grown by 37% while labor income has grown 32%. Meanwhile, the government income is laggard, having grown about 5%, so tax revenues do not grow as rapidly as the economy does. The striking figure is that the bulk of national income growth has gone towards corporate profits, which has more than doubled. The main takeaway is that an essential feature to address the debt problem is to make sure that more of GDP growth is translated into higher household income.

Part 2: What to do for greater resiliency?

Let me now transition to my second point of 'what to do for greater resiliency?' which I will break into two parts: what we need to do in the near term and what we try to do in the longer-term to ensure Thailand's resilient future from the standpoint of issues related to the BOT.

Greater resiliency requires what I would call 'a robust policy mix'. I recently had the pleasure of being on a panel organized by the Bank for International Settlements (BIS) on lessons learned from looking back over the past decade of monetary policy. If we look back, one thing that we can see quite clearly is extremely high uncertainty and a lot of unprecedented supply-side shocks – a long period of stubbornly low inflation in which a lot of developed countries' central banks try to push policy rates down to zero or even negative to get inflation up, the Russia-Ukraine conflict which caused inflation in many developed countries to shoot up sharply and remain stubbornly high, and unforeseen supply-side shocks like COVID that central banks are not used to and do not necessarily have the right tools to deal with.

What are the implications for policy and policymakers?

1) High uncertainty puts a premium on 'robust policy' that is appropriate for a wide range of outcomes rather than being optimal. It puts a premium on trying to preserve

optionality and not to constrain room to maneuver. One of the lessons from monetary policy in the last decade is that forward guidance makes good sense when things turn out the way that you forecast, but if they do not you are caught out on a limb and constraining yourself in room to maneuver. We also need to make sure that we keep enough buffers. From the banking standpoint, obviously we are talking about capital and liquidity buffers. From the economic standpoint, it is about having enough foreign exchange reserves and having enough policy space, as well as having strong fiscal stance in order to undertake measures when they become needed.

2) Don't try to do things that undermine stability. Given that there is a lot of uncertainty, you do not want policy to add to that noise. It is important for policymakers to try to avoid overreacting to the latest data, given that data comes out with a lag. That is why we need to be outlook dependent rather than data dependent. Don't just look at the latest data, but what does it imply for outlook going forward. So, we need to understand the source of the change whether that affects outlook as we know that implemented policy will take place and have effects with a lag. We also need to avoid too much fine-tuning. The ability of monetary policy to affect variables that we are interested like inflation is limited. We should have learned this from the period of stubbornly low inflation where central banks in a lot of developed countries had lowered policy rates all the way down to zero but still did not manage to get inflation up. Now with high inflation, the ability to bring inflation back down is also limited given that lots of shocks are coming more from the supply side.

3) Use complementary tools as part of an integrated policy mix. The BOT has been active and working with the International Monetary Fund (IMF) towards an operation called an 'integrated policy framework' (IPF) – looking at monetary policy not just in isolation but in the context of other tools including foreign exchange intervention, macro-prudential tools like loan-to-value (LTV) ratio, and financial measures. When talking about monetary policy, overwhelmingly the emphasis is on interest rates. However, interest rate is just one blunt tool, but is supposed to address a number of different objectives, often going in different directions. For example, people who have excess cash or savings would want to have high interest rates, while those who have debts obviously want to see lower interest rates. Exporters would want to see a weaker exchange rate and lower interest rates, but importers do not want lower exchange rates because then costs go up at the margin. So, this one tool is not going to satisfy everyone but must balance between different trade-offs. What we try to do is to bring in other tools to manage those trade-offs more effectively.

In the context of Thailand, one tool that we use as part of the IPF is foreign exchange intervention. We did not raise policy rates as high as the Fed, so there is a gap interest rates in the US and in Thailand, putting pressure on the exchange rate and causing high volatility. If we only have the interest rate tool, we would have to raise policy rates to be close to the Fed, which would create unintended consequences. I have to emphasize that no central bank likes to do too much foreign exchange intervention, but it is a tool in our toolkit to smooth out the volatility.

On the other hand, given our situation with high levels of household debt, if interest rates are too low, there would be consequences of either potentially causing inflation to pick up or encouraging a lot of extra borrowing. Therefore, we use alternative tools on the financial side on debt restructuring – making sure that households in difficulty are

able to restructure their debts, such as stretching out the length of loan payments. Debt restructuring is a much more effective tool than the interest rate, because it is targeted to those in need and the burden on household after restructuring is reduced by much more than what you would get from lower interest rate. Thus, when undertake these policy decisions, it is important to look not just any one instrument but look at the complete picture of the other toolkits.

Now, I would like to take a bit of a detour and talk about some false or misleading narratives.

Episode 1 – 2022: Back in 2022, the false narrative out there was that the BOT is behind the curve – the BOT is raising the interest rates too slowly causing a big gap between the Fed's and the BOT's policy rate which led to capital outflows and the rapid depreciation of the baht. It sounds reasonable, but the only problem is that it was not true. Back then, we felt that the Thai economy was recovering quite slowly, so our policy response was to raise interest rates in a 'gradual and measured' fashion. Inflation had spiked very high, but we felt that inflation was likely to be a transitory phenomenon. So, we made the conscious decision not follow the footsteps of the Fed in raising interest rates rapidly. There were no significant capital outflows during that period, but we actually had a net capital inflow for the year. The reason behind the depreciation of the baht was the appreciation of the dollar.

Episode 2 – 2024: This year, there is yet another false narrative that the BOT is overly optimistic in its growth forecast causing it to keep interest rate too high. The BOT is also tightening liquidity and lending standards leading to slow credit growth. Let me show you why this is false.

First, are we being overly optimistic in terms of our forecast? I would say, no, because our GDP growth forecast this year at 2.6% is the same as the Bloomberg median consensus forecast. Meanwhile the Ministry of Finance and the NESDC[3] forecasts are 2.4% and 2.5%, respectively, which is not much different. Hopefully I can bring a touch of optimism to tonight's dinner. The latest indicators for Q2 that have been coming out on consumption, exports and manufacturing production are pretty much along with our expectations. So, the outlook path seems to be relatively intact.

Second, are we keeping interest rates too high? In comparison to policy rates in the recent past, yes, our current rate is higher than what it used to be but it is not too high. If we look globally, our current policy rate at 2.5% is among the lowest in the world. There are only three countries that have lower policy rates – Japan, Switzerland and China.

Finally, is the BOT tightening liquidity and lending standards to reduce credit growth and making it more difficult for people to access credit? I would argue that this is false. The BOT does not impose lending standards on banks nor specify a minimum credit score in which banks can lend. Also, the idea about tightening liquidity potentially comes from a misunderstanding about liquidity – that this is like a bucket of water, which is limited, and the BOT can shrink it so there is less liquidity floating around. That is a false image to take away. If you look at private credit and bilateral repo , there is not a relationship between the two. It means that the activities that the BOT doing in terms of buying and selling does not affect liquidity as private credit out there. Although, we do

see that private credit is tapering off, but this is not because of something the BOT does, it is because banks are slowing down their lending due to increase in credit risk.

To conclude, a resilient future will not only require a robust policy mix in the short-term but also need policy measures to address longer-term structural issues. Let me quickly highlight some of the BOT's initiatives in this regard. First, sustainability. One big issue in Thailand is that we have many brown sectors; thus, we need to make sure that there is transition to less brown. What the BOT has done is coming up with key building blocks such as a taxonomy to pinpoint what is brown or green activities. Second, digital. We have done quite well on the digital payments. Now our focus is on promoting greater competition in the financial sector to get the interest rate spreads to come down and to get people better access to credit, in which one way is to push for better data portability or more open data. Lastly, financial access is area of concern, especially in the SME space. This is due to the fact that credit risk for SMEs is very high. There are two ways to solve the problem: either widen the interest rate spread to compensate for credit risks, which we do not want to see, or lessen the credit risk by having guarantee facility partially funded by the government. We are trying to push forward for a proposal to establish a General Credit Guarantee Facility together with the Ministry of Finance, which we hope will see some developments soon.

I will stop there and thank you very much for your attention.

---

[1] As of Q1-2024, credit cards and personal loan accounts for 27% of total household debt, auto-hire purchases accounts for 11% of total household debt.

[2] Working income excludes non-cash income (i.e. welfare, goods or services received without purchase including rental estimated of free-occupied house (including own house)).

[3] The National Economic and Social Development Council