THAILAND: STIMULATING ECONOMIC RECOVERY

Chalongphob Sussangkarn

1. Between July 1997, when Thailand had to float the baht, and the end of 1998, the country's solvency in terms of foreign exchange improved significantly due to the stringent IMF program and subsequent severe recession (Table 1) and substantial current account surpluses (Table 2). Net official reserves (net of forward commitments and borrowing from the IMF package) increased from a low of US$1.8 billion to US$11.7 billion by end-December 1998. Net official reserves plus bank foreign assets amounted to about 100% of the country's outstanding short-term foreign debt by end-December 1998. The average exchange rate has strengthened from about 54 baht per U.S. dollar in January 1998 to around 36-38 baht per dollar in the first part of 1999.

Table 1: Thailand's Quarterly Real GDP Growth Compared to Same Quarter of Previous Year, 1997 and 1998

	Percent
1997 Q1	1.3
Q2	-0.6
Q3	-2.0
Q4	-3.6
1998 Q1	-5.8
Q2	-12.0
Q3	-11.0

Source: National Economic and Social Development Board.

Table 2: Quarterly Current Account Balance, 1997 and 1998

	Million US$
1997 Q1	-2,013
Q2	-3,128
Q3	-694
Q4	2,890
1998 Q1	4,201
Q2	2,810
Q3	3,411
Q4	3,861

Source: Bank of Thailand.

2. The severe recession can be looked upon as the price that was paid to recover from the state of bankruptcy that the country got into as a result of using vast amounts of foreign reserves in the futile attempt to defend the baht against speculative attacks.

Table 3: End-Quarter Net Official Foreign Reserves

		Net Official Reserves
		billions US$
1997	Q2	2.9
	Q3*	1.8
	Q4	1.9
1998	Q1	2.8
	Q2	5.4
	Q3	6.8
	Q4	11.7

Notes: *Drawing from the IMF package started in September 1997. Net Reserves are Gross Reserves net of outstanding forward commitments and borrowing from the IMF package (including drawings from the IMF package contributed from other sources).
Source: Bank of Thailand.

3. While the country's solvency has been restored, Thailand is now facing an equally serious problem of insolvency of the business sector. By the end of 1998, about half of all loans by Thai banks were non-performing, and finance companies were facing an NPL ration of about 70%. Thus, a vast proportion of Thai business faces insolvency. This makes economic recovery difficult to achieve.

Table 5: Quarterly NPL Ratios in the Financial Sector

		Thai Banks	Finance Companies
		percent	
1998	Q1	29.4	43.8
	Q2	35.9	52.6
	Q3	42.9	60.6
	Q4	49.3	69.8

Source: Bank of Thailand.

4. The very high ratio of NPLs in total credit extensions can be attributed to the economic recession and also to the effect of the depreciation of the baht on company balance sheets. However, many also blame the stringent requirements in the IMF program requiring financial institutions to quickly upgrade their prudential standards. The rationale is that the banking crisis is part of the overall financial crisis, and reform to strengthen the financial sector is crucial for the country to eventually recover. However, the required rapid pace of reform in a situation of economic downturn has led to a severe mal-functioning of the financial sector. The main business of financial institutions at present is to increase capital sufficiently to provide adequate provisioning for NPLs.

5. Regulations on loan classification and provisioning were tightened in March 1998 aiming to upgrade financial institutions to international standards by the year 2000 (Table 6).

Financial institutions can make provisions in five equal installments every six months (20% of required provisioning in each installment) starting at the end of December 1998 and going up to December 2000. At present all local financial institutions are struggling to find enough additional capital to meet the required provisioning. The government announced capital support facilities in August 1998 using public funds to help with re-capitalization of Tier-1 financial institutions. But, those using the facility will have to make full provisioning up to the year 2000 requiring existing shareholders to write down their capital and with a high possibility that existing management will be replaced.[1] Because of this, many financial institutions are reluctant to make use of the facility.

Table 6: Loan Loss Provisioning Requirements for Commercial Banks

Months Overdue	Previous Provision	New Provision
None	0%	1%
0-3 months	0%	2%
Up to 6 months	15%	20%
Up to 1 year	100%	50%
More than 1 year	100%	100%

6. As financial institutions struggle to make provisions for NPLs, the real sector has been severely affected. Financial institutions are unwilling to risk further NPLs and real sector businesses find it very difficult to get new credit or even maintain previous levels of credit. This leads to further contraction in production. The vicious cycle of recession—increasing NPLs—reluctance to lend to the real sector—and deeper recession has been ongoing. Substantial debt restructuring needs to be carried out to bring back economic health, and this is likely to take many years to complete.

7. Part of the IMF package calls for passage of new laws. Some of the crucial laws entail easier business foreclosure and speedier bankruptcy procedures intended to give creditors more leverage vis-a-vis debtors and encourage the debt restructuring process. However, for the new laws to be really effective, it is crucial that they are not resorted to on a large scale. If extensive foreclosures and bankruptcies arise as a result of the passage of these laws, one can expect a second round of disruptions in production and continued severe recession.

8. Real GDP in Thailand is estimated to have declined by more than 8% in 1998. It is important for a return of confidence that the economy begin to recover in 1999. Many factors make recovery difficult, such as the NPL problem, large excess capacities in the economy, and sluggish export performance. The government announced a major fiscal stimulus package on 30 March 1999. The package included a reduction in the value added tax (from 10% to the pre-crisis level of 7%), a reduction in the personal income tax for the lowest bracket, a reduction in the excise tax on bunker fuel, a price reduction for electricity and LPG, and a 53 billion baht increase in government expenditure financed by external borrowing (partly through the Miyazawa Fund).

9. The fiscal stimulus package is expected to lead to a real GDP growth rate in 1999 of about 0.9%, which is close to the government estimate of 1% (Tables 7 and 8). The growth rate is however contingent on being able to increase the U.S. dollar value of exports by about 3.5%. Export growth in January and February was still negative, but preliminary figures for March show improvement. If export growth for the whole year is zero or negative, then 1999 real GDP growth may be zero or negative as well.

[1] The August 1998 scheme also provides for government assistance for tier-2 capital linked to financial institutions' ability to restructure debts with debtors.

Table 7: Base Case Projection Before 30 March 1999 Package

	1998	1999	2000
Real GDP growth (%)			
Agriculture	1.9	1.7	1.9
Industry	-13.5	-1.1	3.0
Services	-6.1	-0.4	2.0
Total real GDP	**-8.4**	**-0.4**	**2.4**
Inflation rate (%)	8.1	3.4	2.8
Merchandise exports			
Billion baht	2,184.4	1,975.9	2,073.7
% growth	22.0	-9.5	4.9
Billion US$	52.82	54.89	57.60
% growth	-6.9	3.9	4.9
Merchandise Imports			
Billion baht	1,688.4	1,550.2	1,635.5
% Growth	-9.9	-8.2	5.5
Billion US$	40.81	43.06	45.43
% Growth	-33.5	5.5	5.5
Balance of Trade			
Billion baht	496.0	425.7	438.1
Billion US$	12.01	11.82	12.17
Current Account			
Billion baht	580.2	502.3	516.4
% of GDP	12.0	10.2	10.0
Billion US$	14.06	13.95	14.35

10. The fiscal stimulus package is expected to lead to an increase in fiscal deficit of about 134 billion baht over the next two years, and real GDP (in 1998 prices) is expected to increase over the next two years about 139 billion baht.

11. While the 30 March 1999 fiscal stimulus package is necessary to generate a return of confidence, the obvious longer-term cost is the larger public sector deficit. Since the start of the crisis, the public sector deficit has more than doubled. The ratio of the public sector deficit (including state enterprises) to GDP is expected to increase to about 45% by the end of 1999 from about 18% at the beginning of the crisis.[2]

[2] This excludes borrowing from the IMF package.

Table 8: Base Case Projection Including 30 March 1999 Package

	1998	1999	2000
Real GDP growth (%)			
Agriculture	1.9	1.7	2.0
Industry	-13.5	1.0	3.2
Services	-6.1	0.7	2.0
Total real GDP	**-8.4**	**0.9**	**2.5**
Inflation rate (%)	8.1	3.1	2.4
Merchandise exports			
Billion baht	2,184.4	1,968.0	2,067.8
% growth	22.0	-9.9	5.1
Billion US$	52.82	54.67	57.44
% growth	-6.9	3.5	5.1
Merchandise Imports			
Billion baht	1,688.4	1,579.7	1,669.5
% Growth	-9.9	-6.4	5.7
Billion US$	40.81	43.88	46.38
% Growth	-33.5	7.5	5.7
Balance of Trade			
Billion baht	496.0	388.4	398.3
Billion US$	12.01	10.79	11.06
Current Account			
Billion baht	580.2	455.0	465.9
% of GDP	12.0	9.1	8.9
Billion US$	14.06	12.64	12.94

12. Patience is needed with regards to economic recovery. There are of course political pressures for more rapid recovery. However, this could only come about through further massive public spending which would impose high future costs. A sustained recovery will take time. Debt restructuring without extensive recourse to foreclosures and bankruptcies is crucial, and this takes time. Similarly, re-capitalization and restructuring of the financial sector will also take time. Thailand's real per capita GDP is not expected to return its 1996 level before the year 2005 (Figure 1). Even if this were the case, the average real per capital GDP growth between 1985 and 2005 would still be about 4-5% per annum. This should be regarded as satisfactory. Very high rates of pre-crisis growth have proven to be part of the bubble that finally burst. Post-crisis growth in real per capita GDP of around 5% per annum should prove more sustainable.

Figure 1
Projected Real Per Capita GDP