SUR/01/89
Revision 1

August 16, 2001

To: Members of the Executive Board

From: The Secretary

Subject: **The Acting Chairman's Summing Up at the Conclusion of the 2001 Article IV Consultation and Post-Program Monitoring Discussion with Thailand—Executive Board Meeting 01/82 (8/2/01)**

The attached summing up (SUR/01/89) is being reissued to revise the first sentence of the second paragraph on page 1, from:

"Despite this progress, Directors observed that the difficult external environment, the need for further structural reforms, and uncertainties about the future orientation of economic policies have dampened the recovery, with GDP growth likely to be at most 2 percent this year and subject to downside risk."

to:

"Despite this progress, Directors observed that the difficult external environment, the need for further structural reforms, and uncertainties about the future orientation of economic policies have dampened the recovery, with GDP growth likely to be around 2 percent this year and subject to downside risk."

and to revise the second, third, and fourth sentences of the first paragraph on page 2, from:

"Directors welcomed the BOT's recent affirmation of the inflation-targeting framework, which has gained credibility with financial markets and should serve as a useful guide to interest rate policy. They regretted last June's increase in interest rates, which was not consistent with the inflation-targeting framework, and, in the absence of inflationary pressures, cautioned against further increases, which could undermine policy credibility, threaten the recovery, and jeopardize the financial position of banks and corporations. In this regard, the authorities' intention not to increase interest rates further in the near term was welcomed, and in view of the weakening recovery some Directors thought that lowering interest rates should not be ruled out."

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to:

"Directors welcomed the BOT's recent affirmation of the inflation-targeting framework, which has gained credibility with financial markets and should serve as a useful guide to interest rate policy. Most Directors expressed concern over last June's increase in interest rates, which was undertaken for objectives outside the scope of the inflation-targeting framework, and, in the absence of inflationary pressures, cautioned against further increases, which could undermine policy credibility, threaten the recovery, and jeopardize the financial position of banks and corporations. However, a view was also expressed that the apparent deviation from the policy framework should be viewed against the recent decline in the current account surplus, and should be put in context. Directors welcomed the authorities' intention not to increase interest rates further in the near term, and in view of the weakening recovery some Directors thought that lowering interest rates should not be ruled out."

These changes reflect better the record of the discussion.

Att: (1)

SUR/01/89
Revised: 8/16/01

August 6, 2001

The Acting Chairman's Summing Up at the Conclusion of the 2001 Article IV Consultation and Post-Program Monitoring Discussion with Thailand Executive Board Meeting 01/82—August 2, 2001

Executive Directors agreed with the thrust of the staff appraisal. They noted that the authorities have made much progress over the past few years in stabilizing the economy and fostering an economic recovery. Directors particularly welcomed the sharp reduction in short-term external debt and the rebuilding of official reserves, which have resulted in a significant reduction in Thailand's external vulnerability. Financial sector restructuring has facilitated a gradual recovery of the banking sector, while regulatory reforms have strengthened the oversight of the financial system.

Despite this progress, Directors observed that the difficult external environment, the need for further structural reforms, and uncertainties about the future orientation of economic * policies have dampened the recovery, with GDP growth likely to be ~~at most~~around 2 percent this year and subject to downside risk. They agreed that minimizing this risk and containing vulnerability to external developments will require supportive macroeconomic policies, accelerated restructuring of bank and corporate balance sheets, and consistency in the formulation and presentation of economic policies. Looking ahead, Directors considered that maintaining an open trade and investment regime, along with appropriate macroeconomic and structural policies, including in the areas of education and skills development, are the foundations for achieving sustained high GDP growth over the medium term.

Directors welcomed the new Bank of Thailand (BOT) Governor's commitment to maintain a flexible exchange rate regime, noting the positive role that exchange rate flexibility has played in reducing external vulnerability and maintaining competitiveness. To enhance the credibility of monetary policy and avoid conflicting objectives, they emphasized the importance of clearly defining, and when necessary, prioritizing monetary and exchange rate policy goals. In this regard, Directors were encouraged by the authorities' recent clarification that their aim is to limit short-term exchange rate volatility rather than to target a particular level or range for the baht, or to resist exchange rate movements owing to fundamentals or regional market developments. While welcoming these assurances, they, nevertheless, cautioned that pursuit of the objective of reducing exchange rate volatility should not be allowed to compromise the strength of reserves. Directors also welcomed the authorities' recent statements ruling out any tightening of capital controls. They cautioned that tightening foreign exchange reporting requirements, if pursued too aggressively, could undermine confidence and discourage foreign investment.

Directors welcomed the BOT's recent affirmation of the inflation-targeting framework, which has gained credibility with financial markets and should serve as a useful
* guide to interest rate policy. ~~They regretted~~ Most Directors expressed concern over last June's increase in interest rates, which was ~~not consistent with~~ undertaken for objectives outside the scope of the inflation-targeting framework, and, in the absence of inflationary pressures, cautioned against further increases, which could undermine policy credibility, threaten the recovery, and jeopardize the financial position of banks and corporations.
* However, a view was also expressed that the apparent deviation from the policy framework should be viewed against the recent decline in the current account surplus, and should be put in context. ~~In this regard,~~ Directors welcomed the authorities' intention not to increase interest rates further in the near term ~~was welcomed~~, and in view of the weakening recovery some Directors thought that lowering interest rates should not be ruled out. Directors also emphasized the importance of pressing ahead with legislation to enhance central bank independence.

Directors noted that the authorities face the difficult challenge of balancing support for economic activity with a commitment to fiscal consolidation to reduce public debt. While the public sector deficit for the current fiscal year is appropriate, they stressed that, in view of the rising public debt, fiscal consolidation should prevail from next year on, though some flexibility could be maintained in view of the risks to the economic outlook. Directors generally welcomed the intention to set aside a reserve fund that would provide such flexibility, but stressed that its size should remain limited and that the conditions triggering its use should be clearly specified in the budget. Referring to the debt suspension program for farmers, a number of Directors cautioned that the new fiscal initiatives should be assessed both in light of their lasting economic effectiveness and their impact on an already weak credit culture. Directors commended the authorities' recent announcement of a medium-term fiscal framework, which includes a commitment to balance the budget within five years and contain public debt to no more than 60 percent of GDP. They noted that, to bolster the credibility of this plan, it would be helpful to announce a schedule at an early opportunity for the reversion of the value-added tax rate to 10 percent.

Directors commended the authorities on the expeditious establishment of the Thai Asset Management Corporation (TAMC). They looked forward to the TAMC's determined action in meeting the important challenge to accelerate the pace and improve the quality of corporate debt restructuring, and thereby tackle the problem of distressed assets in the banking system. Directors urged the TAMC to demonstrate early in its operations that it is prepared to use its strong legal powers to secure the cooperation of debtors. They also stressed that the TAMC's forthcoming operating guidelines will need to ensure maximization of asset recovery as well as transparency and even-handedness of its operations. As a large volume of distressed assets will remain on the books of the private banks, even after the establishment of the TAMC, Directors urged the authorities to enhance the legal framework for debt restructuring outside the TAMC, noting that this will facilitate the resumption of bank lending. They looked forward to the early consideration of amendments to strengthen the bankruptcy law, but also saw scope for more effective implementation of the current laws.

Directors were encouraged by the authorities' intention not to relax banking supervision standards, as any backtracking could damage the credibility of the government's reform agenda. They were, however, concerned about the continued poor operating performance of the state banks and, in this regard, cautioned that any attempt to increase lending through state banks and specialized financial institutions without due regard to the viability of borrowers could set the stage for future losses at those institutions.

Directors commended the Thai authorities for their excellent record in improving data dissemination, both to the Fund and to the public. An impressive array of economic statistics is now available, and Thailand has made much progress in enhancing transparency in this key area.

Directors looked forward to a continued close policy dialogue with Thailand under Post-Program Monitoring.

It is expected that the next Article IV consultation with Thailand will be held on the standard 12–month cycle.