INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 01/90
FOR IMMEDIATE RELEASE
August 16, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2001 Article IV Consultation and Post–Program Monitoring Discussion with Thailand

On August 2, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation and Post–Program Monitoring discussions with Thailand.[1]

Background

Thailand successfully completed a 34–month Stand–By Arrangement on June 19, 2000. The arrangement was part of a US$17.2 billion official financing package from multilateral and bilateral contributors. Over the course of the arrangement, a total of US$14.3 billion was drawn (including US$3.4 billion from the Fund). Scheduled repayments began late last year, and have so far amounted to US$1.6 billion (of which about half is to the Fund).

Thailand has been recovering over the past few years from the severe economic crisis of 1997–98. In the years preceding the crisis, strong capital inflows fueled rapid economic growth, leading to large current account deficits and concealing financial fragilities. The external imbalances culminated in a loss of reserves, forcing the authorities to abandon their exchange rate peg in mid–1997. Compounded by regional contagion, a large depreciation and steep economic contraction ensued. This resulted in a large increase in non–performing loans, further undermining the health of the financial system.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the August 2, 2001 Executive Board discussion based on the staff report. Meanwhile, Post–Program Monitoring is conducted concurrently and provides closer monitoring of the circumstances and policies of members whose arrangement has expired but that continue to have Fund credit outstanding.

As the exchange rate began to stabilize in mid–1998, macroeconomic policies were gradually eased to support the weak economy. A social safety net was introduced with World Bank support to cushion the impact of the crisis on vulnerable segments of the population. The authorities also moved decisively to address the substantial problems in the financial sector. Unviable institutions were taken over by the state, while a comprehensive deposit guarantee was put in place to preserve confidence. To prevent financial sector problems from recurring, an enhanced prudential framework was phased in, bringing capital adequacy standards and loan classification and provisioning rules in line with international best practice. In addition, the government adopted measures to facilitate voluntary debt restructuring, including through the establishment of the Corporate Debt Restructuring Advisory Committee (CDRAC). Bankruptcy procedures were also reformed and various tax impediments were eliminated.

As a result of these efforts, significant progress has been made over the past few years in stabilizing the economy and fostering an economic recovery. External vulnerability has been substantially reduced as a result of the large payoff of short–term external debt, and official reserves have been rebuilt. The supportive policy framework, combined, until recently, with strong external demand, has helped restore growth, with the economy expanding by over 4 percent in each of 1999 and 2000. Moreover, private banks have raised almost US$10 billion in new capital, and Thailand is emerging from the crisis with two–thirds of its banking system in private hands. Headline NPLs have fallen sharply, and bank profitability has recovered.

However, the economic recovery remains fragile and is now being undermined by the weakening global environment. Exports, which grew by almost 20 percent last year, have fallen sharply this year, as elsewhere in the region. With the pickup in domestic demand still too weak to offset faltering global demand, the economic outlook has deteriorated.

Recent developments highlight that a number of economic weaknesses must still be addressed for the recovery to remain on track. In particular, the slow pace and questionable quality of corporate debt restructuring continue to undermine bank profitability and capitalization. Although headline NPLs have declined, there has not yet been a significant deleveraging of the corporate sector. As such, system–wide distressed assets remain high, especially among state–owned and intervened financial institutions.

To address these weaknesses, the new government that came to office in March has proceeded with plans to establish the Thai Asset Management Corporation (TAMC). The TAMC was formally established in June, and is expected to begin acquiring assets by the third quarter of the year. All told, it is expected to acquire about half (US$30 billion) of the financial system's distressed assets. It will acquire almost all (US$25 billion) of the state–owned financial institutions' distressed assets and about one–quarter of private banks' distressed assets (US$5 billion). Therefore, private banks will still need to engage in debt restructuring to resolve their remaining distressed assets.

Executive Board Assessment

Executive Directors 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 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. 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. 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.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Thailand: Selected Economic Indicators, 1997–2001

	1997	1998	1999	2000	2001 Projection
Real GDP growth (percent)	-1.4	-10.8	4.2	4.4	2.0
Consumption	-1.3	-9.5	3.5	4.9	3.4
Gross fixed investment	-21.1	-45.1	-4.0	5.4	9.0
CPI inflation (end period, percent)	7.7	4.3	0.7	1.3	3.0
CPI inflation (period average, percent)	5.6	8.1	0.3	1.5	2.5
Saving and investment (percent of GDP)					
Gross domestic investment	33.3	20.3	19.9	22.7	24.9
Gross national saving	31.2	33.1	30.2	30.2	29.3
Foreign saving	2.1	-12.8	-10.2	-7.6	-4.4
Fiscal accounts (percent of GDP) 1/					
Central government balance	-0.9	-2.4	-3.6	-3.0	-3.6
Revenue and grants	18.6	16.2	15.5	15.5	15.1
Expenditure and net lending	19.5	18.7	19.0	18.5	18.7
Government balance 2/	-1.3	-4.4	-4.1	-3.7	-4.4
Nonfinancial public enterprise balance	-1.3	-1.4	-2.0	-0.9	-1.1
Comprehensive public sector balance	-2.7	-5.8	-6.1	-4.6	-5.4
Monetary accounts (end period, percent)					
M2A growth	2.0	6.1	1.3	2.2	6.0
Balance of payments (billions of US$)					
Current account balance	-3.2	14.3	12.5	9.2	5.2
(Percent of GDP)	-2.1	12.8	10.2	7.6	4.4
Exports, f.o.b.	56.7	52.9	56.8	67.9	67.2
Growth rate (in dollar terms)	3.8	-6.8	7.4	19.6	-1.1
Growth rate (volume terms)	7.3	8.5	11.1	22.5	-1.4
Imports, c.i.f.	61.3	40.6	47.5	62.4	65.9
Growth rate (in dollar terms)	-13.4	-33.8	16.9	31.3	5.5
Growth rate (volume terms)	-9.9	-27.5	22.5	22.3	4.1
Capital account balance 3/	-15.3	-16.8	-10.5	-11.4	-3.8
Medium- and long-term	10.0	5.1	1.9	-3.2	-0.7
Short-term 3/	-25.4	-21.9	-12.4	-8.2	-3.1
Overall balance	-10.6	2.6	5.2	-2.1	-1.8
Gross official reserves (end year)	27.0	29.5	34.8	32.7	30.9
(Months of following year's imports)	8.0	7.5	6.7	6.0	5.2
(Percent of maturing external debt)	57.1	77.6	109.9	131.0	137.2
Forward position of BOT (end year)	18.0	6.6	4.8	2.1	2.1
External debt (revised series)					
In percent of GDP	72.3	93.9	78.4	65.8	60.2
In billions of US$	109.3	105.1	95.6	80.2	70.1
Public sector	24.1	31.1	36.0	33.8	30.3
Private sector	85.2	74.0	59.6	46.4	39.7
Medium- and long-term	46.9	45.7	39.8	32.2	28.5

India: Selected Economic Indicators 1/

	1997/98	1998/99	1999/00	2000/01
		Percentage change		
Domestic economy				
Real GDP at factor cost	4.8	6.6	6.4	5.8 2/
Industrial production	6.6	4.1	6.6	5.0
Wholesale prices	4.3	6.0	3.4	7.1
Consumer prices	6.8	13.1	3.4	3.8
		In billions of U.S. dollars		
External economy				
Merchandise exports	35.7	34.3	38.3	45.1 2/
Merchandise imports	51.2	47.5	55.4	63.1 2/
Current account balance	-5.5	-4.0	-4.2	-5.2 2/
(In percent of GDP)	-1.3	-1.0	-0.9	-1.1 2/
Direct investment, net 3/	3.5	2.4	2.1	2.1 2/
Portfolio investment, net	1.8	-0.1	3.0	2.4 2/
Capital account balance	9.8	8.6	10.2	11.4 2/
Gross official reserves 4/	29.4	32.5	38.0	42.3
(In months of imports) 5/	6.0	5.8	5.9	5.9
External debt (in percent of GDP) 4/	22.8	23.4	21.8	22.2 2/
Short-term debt (in percent of GDP) 4/ 6/	2.9	2.7	2.2	2.3 2/
Debt service ratio (in percent of current receipts)	19.3	19.3	17.8	14.5 2/
Change in real effective exchange rate (in percent) 4/	5.6	-6.2	1.1	6.2 2/
		In percent		
Financial variables				
Central government balance (in percent of GDP) 7/	-4.9	-5.4	-5.4	-5.4 2/
Consolidated public sector balance (in percent of GDP) 7/	-8.5	-9.6	-11.2	-10.4 2/
Change in broad money 4/	18.0	19.2	13.6	17.4
Interest rate 4/ 8/	7.3	8.7	9.2	8.8

Sources: International Financial Statistics; Reserve Bank of India; Ministry of Finance; CEIC; and IMF staff estimates.

1/ Data are for April-March fiscal years, and are those that were available at the time of the Board meeting.

2/ Staff estimates as of June 2001.

3/ Net foreign direct investment in India less net foreign investment abroad.

4/ End of period.

5/ Imports of goods and services projected over the following twelve months.

6/ Residual maturity basis, except contracted maturity basis for medium- and long-term nonresident Indian accounts.

7/ Excluding divestment receipts from revenues and onlending of small saving collections from expenditures and net lending.

8/ 91-day Treasury Bill rate.