Thailand: Path of Financial Restructuring

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With the world's interest clearly focused on the events in East and Southeast Asia, I would like to update you on the recent policy initiatives and ongoing activities on financial reform and restructuring in my country. Given that the currency turmoil started in Thailand, we certainly hope that the principle of "first-in first-out" will apply and bring us out of this situation soon. I would like to start with a short background of events leading to the crisis, followed by Thailand's subsequent adoption of the IMF programme. 1 will then conclude with a note on the future prospects for financial sector restructuring and development in Thailand.

I Events Leading to the Crisis

During the late 1980s and early 1990s, Thailand's rapid economic growth was hailed as one of the great success stories of Southeast Asia. This extended period of growth was propelled by buoyant export performance following the decoupling of the exchange rate from a single peg to a basket peg system in 1984; and a dynamic investment outlook, especially from Japan's booming domestic economy. In 1993, the establishment of the Bangkok International Banking Facility (BIBF) – a special vehicle to provide offshore banking services – became an important channel for foreign funds to accommodate the growing domestic needs for investment, asset acquisition and industrial expansion. Following double digit growth during 1988 to 1990, the country's growth rate stabilised at around 8-9% in the early 1990s.

By the mid 1990s, a number of factors, both external and internal, combined to bring about a sharp economic downturn, which culminated in one of the most painful chapters of Thailand's recent economic history. The widening current account deficit to around 8% of GDP in 1995 sent out red alert worldwide, which was apparent to everyone but ourselves. Yet it was the sharp drop in exports, from some 24% annual growth in 1995 to a 0.2% contraction in 1996 that finally sent out distressed signals. This phenomenon may have an origin rooted since the 1994 devaluation of the Chinese currency, which along with the delayed adjustment of Thai export

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competitiveness, the strengthening of the US dollar, and an inflexible exchange rate mechanism, resulted in a crisis of confidence. On the internal front, the intensification of the financial sector problem stemming from inadequate measures to cope with the influx of foreign funds through the BIBF, and the 12-month income recognition rule of financial institutions non-performing loans, heightened the atmosphere of cynicism and subsequently brought on a series of speculative attacks on the currency. Business cycles are recurring events worldwide, and as such were no strange phenomena in Thailand. Yet the financial sector's inherent weakness of maturity mismatching, reckless lending and mis-allocation of foreign funds, proved to be non-resistant to this particular downturn. On 2nd July 1997, the authorities announced a change in the exchange rate regime, and one month later Thailand entered the IMF programme.

II IMF Programme

The discipline and austerity programme imposed on the country during this IMF programme period has seen a lower output growth, indeed the first negative GDP growth in Thailand's modern economic history. Higher inflation, and a narrowing current account deficit ensued, as the process of consolidation takes place. Nevertheless, the economy's strong underlying fundamentals – high savings rate, an abundance of agricultural, natural and human resources, diversified economy and export base – remain important assets during the restructuring process.

Financial Sector Restructuring

The cornerstone of the present government programme, with the IMF concurrence, is the determined efforts to restore confidence through strict fiscal and monetary disciplines, and a comprehensive financial restructuring programme. In this connection, a wide-ranging programme has been mapped out encompassing sweeping changes in the supervisory and regulatory practices, as well as the legal infrastructure and operational procedures. In August 1997, the authorities took decisive steps to segregate unviable and insolvent finance companies from the rest of the system through the temporary suspension of their operation. Companies wishing to resume business are required to submit rehabilitation plans to the newly established Financial Sector Restructuring Authority (FRA) of which I am now Chairman. Those whose plans are considered unviable would undergo an orderly liquidation process. Following the decision to close all but 2 of the 58 suspended finance companies in early December 1997, the disposal of asset began in February 1998, in a most transparent and strictly market determined process. This is set to be completed by December 1998 as stipulated in the third Letter of Intent with the IMF.

To assure reasonable bids for the assets of the closed finance companies, two new government-owned institutions, the Radhanasin Bank (RAB) and the Asset Management Corporation (AMC), were set up with a mandate to participate in the auction process along with other private bidders. The RAB is expected to bid for the highest quality assets and be guided by the strictest commercial principles. The AMC is charged with the responsibility of managing the assets and maximising asset recovery and to aim for the lowest quality assets.

With regard to the legal and regulatory infrastructure, on March 4, Parliament approved the new Bankruptcy Law, while work is ongoing to expedite the procedures of foreclosure with a view to facilitating the orderly winding down or rehabilitation of insolvent companies.

Strengthening the Core Financial System

As Chairman of the Financial Sector Restructuring Authority, I have been entrusted to oversee the process of asset disposal for the closed finance companies. I should like to point out, however, that the size of the assets of the 56 closed finance companies – some 860 billion baht or $20 billion – represents a mere 11% of the total size of the country's financial system of some 8 trillion baht or $190 billion. The remaining part which is the core of the financial system comprising 15 operating Thai banks, 35 finance companies and a number of BIBF of both domestic and foreign banks, is indeed the most crucial and whose strength and viability will provide the foundation for the growth and development of the country's economic system. This is where most of the work and attention is focused on, in particular on the determination process and reclassification of asset quality.

On asset classification, the Bank of Thailand, as the responsible supervisory agency, has progressively tightened rules and regulation concerning asset classification and provisioning requirements, as well as income recognition of banks and finance companies. Effective 31st December 1997, loans which are 6 months in arrears will be classified as substandard, an adjustment from the old rule of 12 months with collateral, and banks must provide 15% reserve against it, while the rate applicable to finance companies is 20%. This loan loss provision is fully tax deductible. In addition, accrued interest will be recognised as income up to 6 months compared to the old 12 months rule. Commercial banks have to use this definition when disclosing non-performing loans. Furthermore, the Bank of Thailand will adopt a package of new regulations covering loan classification and provi-

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sioning that is consistent with the best international practices. The package will be gradually phased in and fully implemented by the year 2000.

With regard to the recapitalisation process, local financial institutions are actively seeking foreign strategic partners. Early this year, the Government intervened in 4 medium-sized banks which were unable to raise capital, and replaced its management and ordered a capital write down. Recapitalisation was subsequently undertaken through a debt-equity conversion by the Financial Institutions Development Fund – a separate juristic entity from the Bank of Thailand – entrusted to provide liquidity support during the deposit run on the financial institutions. Further interventions are not anticipated as the remaining institutions are undertaking recapitalisation plans, while the reprivatisation of the intervened banks will be made as soon as possible.

Encouraging Foreign Private Investment

To ensure that new investment in local financial institutions lead to the development of a sounder banking system, an additional guideline on the "fit and proper" qualifications of executives and management, as well as licensing requirements have been announced. Given the limited availability of domestic capital, the restriction on foreign participation in Thai financial institutions was amended accordingly to encourage new capital from abroad and ensure the successful implementation of the recapitalisation. Foreign investors are allowed to take majority shareholding in local financial institutions for up to ten years, following which the amount of shares so acquired would be grand fathered. For other types of financial institutions such as securities companies, the relevant laws governing the limit on foreign equity participation, namely the Alien Business Law, will soon be amended to permit 100% foreign ownership.

Strengthening the Supervisory Role of Related Government Agencies

An important corollary from the current financial institutions crisis has been the issue of supervisory oversight. In this connection, the government will form a task force including eminent international financial experts to develop specific proposals regarding the independence and institutional strengthening of the central bank. This is expected to result in revisions to the Bank of Thailand Act by 1998. In addition, the government will undertake a comprehensive review of the roles of various financial institutions as well as the supervisory and regulatory framework. It is expected that these efforts will result in a modern and efficient supervisory regime that can support the development of a sound and competitive financial system.

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III Future Prospect

In looking ahead, this episode of crisis will bring about significant changes to the existing supervisory and operational landscape of the country's financial system. Thailand's financial system has largely been dominated by commercial banks accounting for almost 70% of the share of the financial sector, of which more than half is accounted for by the four largest banks. The recent financial distress have drained funds from the smaller banks and other financial institutions to the larger banks, thereby re-enforcing this highly skewed structure. Recognising this, the authorities are aiming to improve the structure of the market towards a more balanced development of the equity, bond and credit markets. As Chairman of the Stock Exchange of Thailand, I am also actively involved in the modernisation of the country's capital market to provide an alternative for fund mobilisation, thereby lessening reliance on commercial banks credit allocation decisions. International standards will progressively be adopted as regard transparency and accounting practices as well as financial auditing and disclosure. A new departure in the present credit appraisal system based on cash flows rather than asset-based is also evolving. General resource allocation will be improved through market-oriented signals, while capital adequacy standard will continue to be strengthened further.

Amidst this painful process of adjustment, signs of improvement have emerged on the macroeconomic front. The current account deficit, the initial trigger of uncertainty over its sustainability, has narrowed by almost 80% in 1997 compared to 1996, representing an improvement following the flotation of the baht. Inflation, on the other hand, has been kept at a manageable level of below 12%. Since September 1997, when the economy turned in a current account surplus – the first in 34 months – the country has been able to generate more foreign exchanges to service its external obligations. This is a positive sign leading to the restoration of confidence in the gradual recovery of the economy.

The present economic and financial difficulties are by no means unique to Asia or Thailand. Although the transition phase will be painful to all those affected, it should be viewed as a sign of correction and adjustment towards a more mature and developed system. On the political front, the country has made significant strides with the enactment of the new constitution which will pave the way for the evolution of cleaner politics and good governance, which should benefit the country at large, as well as our trading partners.

Let me assure you that after these painful events, we shall not be complacent. We recognise that in the upcoming years, there are hard work and tough decisions that require strong political will. This is especially crucial

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during the next six months. As the current trend in Thailand is showing progressive improvement, this has given hope and encouragement to all of us in Thailand to face up to the challenges ahead. With the support and understanding of the international community, as well as the culture flexibility and work ethics of the Thai people, the economy should be able to recover and regain its sustainable growth path, within the next two years.

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