Chapter 5

Conclusion

5.1 Summary of Findings

The main purpose of this study has been to measures the degree of openness of Thailand financial system and speed of adjustment of domestic interest rate to foreign interest rates after financial liberalization. Based on the results of the analysis, the main conclusion is that the Thai financial system is quite open. Moreover, as financial liberalization proceeds, domestic and foreign financial markets will become increasingly closely linked which an important objective of the liberalization program. The liberalization on foreign exchange policy which has removed various restrictions on the flows of funds, has made it more convenient to mobilized funds and had a greater effected has domestic interest rates movements, however, foreign interest rates also have a greater effect on domestic interest rates. However, the economy has fully open, but it full open only on capital inflows, there are some restrictions on outflows. Nevertheless, the financial market is effected by external shocks such as the high volume of capital inflows and outflows for investing in equity markets.

Although Thailand's capital account is quite open, because of the existing restrictions on the capital account as well as transaction costs and information lags, there is considerable scope for monetary policy in the short term. This view is supported by the result of this study which estimated Thailand's long-run openness coefficient to be about one and a short-run coefficient estimated to be about two-third. This finding implies that about two-third of the difference between domestic and foreign interest rates is eliminated in each month, suggesting that information lag and other source of friction in the system are important in the short term. However, after financial reform, the financial market was more effected by external and internal shocks which affected to the of domestic interest rates movement. An important implication of this study is that we can conclude that the domestic interest rate was not only influenced by internal factors but also the external factors. While the model results suggest that the Thai economy is fully open, in practice, this is the case for capital inflows, however some restrictions remain on capital outflows.

Chapter 1, reviewed Thailand's experience in managing foreign capital movements. As noted, Thailand's reliance on foreign capital has always been large and foreign capital has played a crucial role in allowing the economy to achieve a relatively fast pace of economic expansion. While foreign capital does bring substantial benefits to the country, it can also complicate the task of macroeconomic management especially if the macroeconomic impacts of the inflows are not properly handled or the utilization of foreign capital is not consistent with the overall macroeconomic objectives. To lessen this impact, the extent and timing, as well as the utilization of the inflows, need to be carefully managed and coordinated so that the inflows can make the most effect contribution to the economy's development objectives. Important in this context is the need to remove distorted incentives so that use of foreign capital can lead to an efficient allocation of resources.

5.2 Policy Implications

Following the reasons outlined for financial liberalization combined with the literature review and the theory of McKinnon and Shaw, suggests that the key reforms were aimed at liberalizing interest rates, reducing controls on credit, enhancing competition and efficiency in the financial system, strengthening the supervisory framework, and promoting the growth and deepening of financial markets as well as raising the real interest rates and contributing to financial deepening as more resources were mobilized through the financial system. Moreover, the liberalization of interest rates has contributed to improving resource allocation, the mobilization of savings, and the efficiency of investment. The liberalization of the domestic financial systems has been accompanied by the relaxation of restrictions on international capital flows and shift toward more flexible exchange rate arrangements.

However, as the financial system becomes more internationalized and sophisticated, there will be a greater degree of capital mobility. The monetary authorities may face difficulties in controlling domestic liquidity and money growth. Moreover, the wide interest rate margin or profits which commercial banks now enjoy is primary due to interest rate liberalization. Exchange control deregulation, on the other hand, does not equip all borrowers with equal access to credits abroad. Therefore, in the initial period after such interest rate liberalization, commercial banks are the parties have to improve their efficiency in order to maintain their position in the market.

The performance of financial liberalization policies in the past, judged by their present outcomes, has been exceptionally good. For these reasons, the government has drawn up three-year plan to develop and modernize the financial system and reduce a government intervention. Efforts have been directed at encouraging savings mobilization to support further economic development, boosting the competitiveness of financial institutions, promoting the development of new financial instruments and services, and turning Thailand into a regional financial center.

To facilitate these goals, the Bank of Thailand implemented between 1990-1992, a three-year plan as follows:

- Deregulating interest rates and financial institutions' portfolio management and relaxing exchange control;

- Developing the supervision and examination system, improving monitoring and analytical procedures, adjusting the capital to risk asset ratio in line with the guideline set by the Bank for International Settlements, training bank examiners, and developing an information system;

- Promoting financial innovations in both primary and secondary market; and

- Improving the payment system that its targets were to reform the interbank clearing system and to establish the second note-printing works.

However, obstacles to financial liberalization may appear discouraging, they are not insurmountable. In 1993 and 1994, the Thai financial system was more competitive, Thai financial institutions became more alert in adjusting their deposit rates as a means to capture or retain deposits. This was done because domestic savers had more options as to where to place their savings.

Once the government devotes more time and efforts to further trim down market barriers and rigidities, thus giving customers added mobility, more competition and efficiency will be achieved. Possible future measures could include:[21]

- broadening the role of finance companies so that they can better compete with commercial banks. More foreign banks and more Thai banks may then be allowed to open.

- giving thorough consideration to exit policies[22] and the disclosures of examination results.

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[21] Pakorn Vichyanond, "Thailand's Financial System: Structure and Liberalization", Thailand Development Research Institute, 1994, p.84

[22] leave from the industries

These two policies directions are consistent with market mechanisms which facilitate financial liberalization. If such disclosures and exits are permissible, financial institutions will automatically feel pressurized to achieve high performance. In other word, these two policy channels function as a safety valve.

The recent changes in Thailand's financial system towards becoming international may have positive effects on the growth and efficiency of the economy. In order to realize the potential benefits the monetary authorities should continue to maintain economic stability and address the followings points in order to minimize the risk of being adversely affected by financial liberalization.

1. If the domestic financial system is to be competitive, it must have an adequate number of participants.

2. The authorities' method of operation must be able to adapt to changes in the economic and financial structure of the capital mobility acting from financial reforms, such as monitoring of potential risks, creating of benchmarks for financial instruments, creating of tools for sterilizing unforeseen capital flows, and relax action of controls on capital outflows.

3. A financial reforms policy should include an optimal mix of various types of financing, taking into account both the international and domestic policies. The optimal mix would be such that changes in any one component could be absorbed by changes in the other without having excessive impact on the objectives of the financial reforms.

4. The monetary authorities should take a more effective supervisory and regulation role with respect to financial institutions and also maintain a proper balance between the speed of financial liberalization and economic development.

5.3 Limitation and Suggestion for further Studies

This study has attempted to investigate the impact of financial liberalization policy on domestic interest rate. The Bank of Thailand was entrusted with a broad range of financial liberalization measures throughout the period of 1985-1994. Each of the measures of liberalization policy on the deregulation, the relaxation of foreign exchange control and BIBFS have been undertaken (see Appendix IV). There are clearly however, many external factors affecting domestic interest rate movements while require further investigation.

While addressing many of the relevant issues, the results of this study do not fully explain the impact of financial liberalization on domestic interest rate, because some data which are used in the approaches are not well representative, i.e., overnight interbank rate was proxy for domestic interest rate which do not have the same maturity of the one-month LIBOR rate which was a proxy for foreign interest rates. In practice, a one-month interbank rate could not be found. In addition there are auto correlation problems which produce inconsistent estimates of the standard deviation. Moreover, it is difficult to classify the external factors to combined with the model such as shock from conflict of trade agreement between USA. and Japan or financial crisis of Baring Securities in Singapore which affected the world financial market, and how can apply seasonal for domestic interest rates which is a standard acceptance. Furthermore, the other variables, such as fiscal budget balance which affect domestic interest rates should also be further analyzed and the impact of financial liberalization on domestic interest rates should also further improve analyzed as mention above.