Macroeconomic Risks in the Greater Mekong Sub-Region: Perspectives of External Balance and Monetary Policy

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ABSTRACT

This paper investigated the macroeconomic risks in the Greater Mekong Sub-region (GMS) from the perspectives of their external balances and monetary policies. The main findings are: 1) especially in Vietnam, the continuous deficit in current account accompanied with the decline in financial-account surplus and foreign reserves has increased economic risks in external balance, which seems to be a quite similar picture to the pre-crisis (1996-97) Thailand; 2) the rising real exchange rate, i.e. the loss of price competitiveness caused by domestic high inflation has been deteriorating the current account, except for Thailand; 3) the domestic high inflation can be attributed to the inability for central bank to manage monetary base against external capital flows through the sterilization, except for Thailand; 4) the clear contrast between the resilience of monetary policy to capital-flow shock in Thailand in 2000-2011 and its fragility in Vietnam in 2000-2011 and Thailand in 1986-1996, was also identified by the impulse response estimation in the analytical framework of VAR model.

Keywords: *Cambodia, External Balance, Impulse Response Estimation, Lao PDR, Myanmar, Monetary Policy, Thailand, Vietnam*

1. INTRODUCTION

This paper aims to investigate the macroeconomic conditions in the Greater Mekong Sub-region (hereafter referred to simply as GMS), and assess their macroeconomic risks from the perspectives of their external balances and monetary policies.

The GMS generally refers to a geographical region covering five countries – Cambodia, the Lao People's Democratic Republic (Lao PDR), Myanmar, Thailand and Vietnam – as well as southern parts of China (Yunnan Province and Guangxi Zhuang Autonomous Region). Although the economies above share not only the Mekong River but also deep cultural, ethnic and historical similarities, substantial economic cooperation among these economies had not developed until the 1990s, due to international political difficulties during the cold war and the delayed transition of these economies except Thailand to market economies. In 1992, with the main support of the Asian Development Bank (ADB), the GMS countries met together for the first time and agreed to launch a program of sub-regional economic cooperation designed to facilitate economic linkages across their borders. For about two decades since then, the GMS

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economic cooperation in terms of preparing for both hard and soft (e.g. logistics) infrastructures and of creating economic-corridor strategy, has been steadily promoted, although the 1997-98 financial crises directly hit Thailand and gave downward impacts to other GMS economies. In fact, economic integration within the GMS has been facilitated in the forms of trade and investment integration for these two decades. The intra-trade ratio of the GMS, though its level to the world is still lower than 10 percent, has represented a steady increase for the last two decades, and its ratio within ASEAN has shown a remarkable growth from 8.7 percent in 1990, through 18.0 in 2000, toward 32.3 in 2010 (see Figure 1 in the Appendix). As for the intra-investment in the GMS, Lao PDR accepted the direct investment from Vietnam and Thailand by around 20 percent respectively of its total direct investment in the 2000s, and Myanmar received the direct investment from Thailand by 30 percent for the last two decades (the data sources of direct investments are "Ministry of Investment Planning" in Lao PDR, and "Directorate of Investment and Company Administration and Central Statistical Organization" in Myanmar).

As for academic circles, there has been fewer accumulation of literature in the area of the GMS studies, probably because the GMS framework itself has shown just a short history for the past two decades and it seems to have been premature to conduct quantitative studies on GMS due to the lack of data availability. Table 1 in the Appendix describes the limited literature, which includes such specific fields as economic corridors (e.g. Masviriyakul, 2004; Ishida, 2005; Tan, 2014, Panennungi, 2014), infrastructure (e.g. Edmonds & Fujimura, 2008; Bafoil & Ruiwen, 2010), logistics (e.g. Khanal, 2008; Kengpol, 2008; Banomyong, 2008; Kawasaki *et al*., 2014), trade and direct investment (e.g. Poncet, 2006; Pham, 2008; Strut & Srone, 2009; Strutt *et al*., 2008; Taguchi & Oizumi, 2014), labor migration (e.g. Sciortino, 2008; Latt, 2013), energy (e.g. Yu, 2003; Yang *et al*., 2009), and tourism (e.g. Alampay, 2008), as well as general overviews and assessments on GMS framework (e.g. Than, 1997; Park *et al*., 2003; Krongkaew, 2004; Hensengerth, 2011; Walsh, 2013; Salvarajah, 2014). As far as we see the article list in Table 1, we can not find a quantitative study to investigate macroeconomic conditions in GMS deeply and comprehensively.

This article tries to target macro economies in GMS as a first challenge against the existing literature, and to examine their macroeconomic risks from the perspective of their external balances and monetary policies. We can pick up the following two points as backgrounds in which we deal with macro economies in GMS this time. First, economic integration has been strengthened as we saw the trends in intra-trade and intra-investment within GMS. It means that one economy in GMS can not be indifferent to the macroeconomic conditions of the other economies in GMS, since one economy may receive a contagion effect from macroeconomic shocks of the other economies. Second, the scheme of monetary cooperation and surveillance of macro-economy has just been covering the GMS economies in the framework of the ASEAN+3. The Chiang Mai Initiative Multilateralization (CMIM), i.e. the facility of multilateral currency swaps has just come into effect since March 2010, by including Cambodia, Lao PDR, Myanmar and Vietnam. In addition, the ASEAN+3 Macroeconomic Research Office (AMRO) has been established as the surveillance unit of CMIM since early 2011. The AMRO, also including Cambodia, Lao PDR, Myanmar and Vietnam, is expected to play a role to monitor and analyze regional economies, and to contribute to early detection of risks, swift implementation of remedial actions, and effective decision-making of CMIM. Considering these backgrounds, it is an appropriate time for the GMS macro-economies to be examined on a quantitative base.

In this article, we examine five economies, i.e. Cambodia, Lao PDR, Myanmar, Thailand and Vietnam, and do not include the province and region of China, since we focus on macro-economies, especially on countries' external balances and monetary policies.