

‘An Assessment of International Reserves in Thailand and Their Implications, 1990s – 2016’

Some might have heard the words ‘International Reserves’ or ‘Foreign Exchange Reserves’ before. In general, these terms are used interchangeably, as both have the same meaning. International reserves are reserve assets, held by central banks, in foreign currencies. The traditional role of international reserves is to back up the domestic currency of the country. Nonetheless, due to the financial integration as a result of globalization, international reserves are now used as a tool to implement monetary policy, such as sterilized intervention, in order to maintain the financial stability of the nation.

This paper assesses Thailand’s International Reserves in three areas. Firstly, it briefly provides descriptive information regarding the trend of Thailand’s international reserves from 1990s until the present (Figure1). It then underlines effect of the Asian Financial Crisis (AFC) on Thailand and the manner in which the Bank of Thailand (BOT) coped with the issue. Thirdly, the Global Economic Crisis (GEC) is introduced in terms of its consequential effect on Thailand, together with a discussion on implications behind the decision made by the BOT to use the exchange rate regimes at the time of those crises. Lastly, the term fear floating will be introduced with examples of Philippines and Indonesia that shared the same pattern and the analysis on China who has the same characteristic but reveal different outcome.

The level international reserves in Thailand from early 1960s until 2016 can be viewed in the graph in Figure 1. It can be observed that the level of Thailand’s international reserves has increased significantly throughout the period from approximately hundreds of millions of dollars in the early 1960s to approximately 171 billion dollars in 2016. Any increase or decrease in the level of international reserves – implying that there had been an intervention by the BOT at the time – indicates that monetary policy scheme has a significant influence on the level of reserves of Thailand. However, there were two noticeably dropping trends in 1996 – before the rebound in 1998 – and also in 2008 onwards until 2015.

An economic implication is explained in Figure 1: Supply and Demand for foreign currency (\$) in Thailand. According to the graph below, it illustrates the demand and supply of dollars, where the X-axis denotes a total amount of dollars in the Thai economy and the Y-axis denotes the THB/USD exchange rate. Assume that the current equilibrium is at 35 baht/dollar, and that the

dollar amount is at Q1. As Thailand is an export-dominated country, it prefers the Baht to be depreciated. During 2002 until 2012, there was an excessive amount of capital inflows into Thailand as the country was very attractive to investment relative to other countries in the same region. Capital inflows of the Baht should have appreciated against the US dollar, yet this was not the case at the time due to the intervention by the BOT. Graphically, as a result of capital inflows into the Thai economy, there is rightward shift of the supply of foreign currency from S_1 to S_2 . At the current exchange rate, there is excess supply of dollars in the economy; hence, in order to eliminate the excess amount of dollars, the baht must appreciate from 35 baht/dollar to 25 baht/dollar and the quantity of dollars increase from Q1 to Q2. Nevertheless, this exchange rate adjustment did not occur in Thailand, as it is an export-oriented country which fears appreciation that might distort the level of competitiveness of the country. Therefore, the BOT intervened by purchasing the excess supply of dollars and selling domestic currency into the market such that the exchange rate would remain at 35 baht/dollar. This mechanism is called 'sterilized intervention' by the central bank. This is the implication behind an accumulation of the international reserves over time.

Before the AFC – known as the 'Tom Yum Goong Crisis' – which originated in Thailand, the baht was pegged with US currency. This is because BOT has employed a basket of currencies to calculate the mid-exchange rate and imposed the heaviest weight on USD and Thailand as a consequence, was perceived as a strong growth economy with exchange rate stability. Therefore, many foreign investors tended to borrow from abroad and invested in Thailand, which led to excessive amount of borrowing in the country as a result of the gigantic amount of capital inflows. Eventually the baht was succumbing to the speculative attack. From Figure 3 it can be observed that an exchange rate depreciated sharply from 25฿/\$ to 53฿/\$, and baht has never gone below 30 baht's territory until today. Afterwards, BOT intervened to defend the exchange rate in other words preventing further depreciation by reducing the weight of dollar in the currency basket. Consequently, in order to maintain the financial and economic stabilities of the nation, the BOT stepped in with the help of the International Monetary Fund (IMF) July 1997, with the result of ending decades of fixed exchange rate regime since the end of the Second World War. Thailand was adopted the 'Floating Exchange Rate Regime' namely 'Monetary targeting system' for the first time. The aim of this policy was to regain the confidence of the

investors after the failure of the fixed exchange rate regime. Simultaneously, in order to prevent the speculative attack in the offshore markets, the Thai central bank sold the foreign reserves or sterilized with the aim of stabilizing the exchange rate, as shown in Figure 1 by the decline in the international reserves from 320 million dollars in 1996 down to 260 million dollars in 1998. Eventually, ‘the confidence in Baht was restored due to the swift and massive intervention in off shore market’.

Another important crisis that hits the global economy was the 2008 ‘Global Economic Crisis’. The central origin of this crisis lies in the housing bubble of the United States, which itself originated from the activities and tendencies within the real estate and financial sectors in that country. This ultimately led to a severe economic downturn in the US, resulting in capital outflows from the US to other developing economies including Thailand. As investors moved funds to the emerging economies, local currency in each country would appreciate as a result of capital inflows. For Thailand, which has particularly used the ‘inflation targeting regime’, the BOT had to react by selling-off foreign reserves in order to retain the level of competitiveness of the export sector as well as defend the value of baht, resulting in the deterioration of the international reserves with some range of fluctuation from 2008 onwards. However, it was not only Thailand that dealt with the threat of currency appreciation, but the same pattern of declining in the level of international reserves can also be examined in other Asian countries – labelled as ‘Fear of Floating’ countries – such as Malaysia and the Philippines, as shown in Figures 2.

Fear of Floating refers to countries that prefer smoother exchange rate rather than flexible exchange rate. One interesting case, which can be comparable to Thailand, is China who is considered to be one of ‘Fear of Floating’ countries; in fact China is a well-known example of ‘Fear of Appreciation’. As we know that China is an export-driven economy implying that an exchange rate plays a significant role in determining the level of competitiveness of China. Hence, People’s Bank of China or the Chinese central bank must ensure that Yuan does not appreciate against US dollar who is the biggest importer. The currency intervention has taken place throughout the history to retain the advantage in an exporting sector; it also aims to avoid the quick appreciation of the Yuan against USD. Figure 4 shows the comparison between

Thailand and China level of International Reserves. There was an accumulation in the level of international reserves throughout decades in both countries, where Thailand always had a higher amount of reserves until after 2013 when China's international reserves surpassed Thailand for the first time, yet for a short while it dropped. This is because the effect of the GEC when Thailand was facing the tremendous amount of capital inflows and it had to defend the currency. Likewise Philippines and Malaysia, Thailand was in the same period of W-shape recovery. An explanation for China could be the currency intervention to defend its currency by selling of foreign reserves they have. However, Chinese Yuan has been perceived as an undervalued currency for too long thus it is expected to appreciate in the future.

In conclusion, both the AFC and GEC have played a crucial part in the distortion of the level of international reserves in Thailand. Moreover, the Bank of Thailand has always constantly intervened in the financial as well as foreign exchange markets because of a 'Fear of Floating'. Thailand has never adopted the 'Free Floating regime' due to the fact that the nation relies heavily on an exporting sector, and thus it would suffer greatly from an appreciation of the Baht. Today, Thailand is back to a managed float exchange rate system – termed an 'inflation targeting regime' – though with the difference of the Baht being pegged with a basket of foreign currencies, rather than USD alone.

Appendix

Figure 1: Supply and Demand for Dollars in Thailand

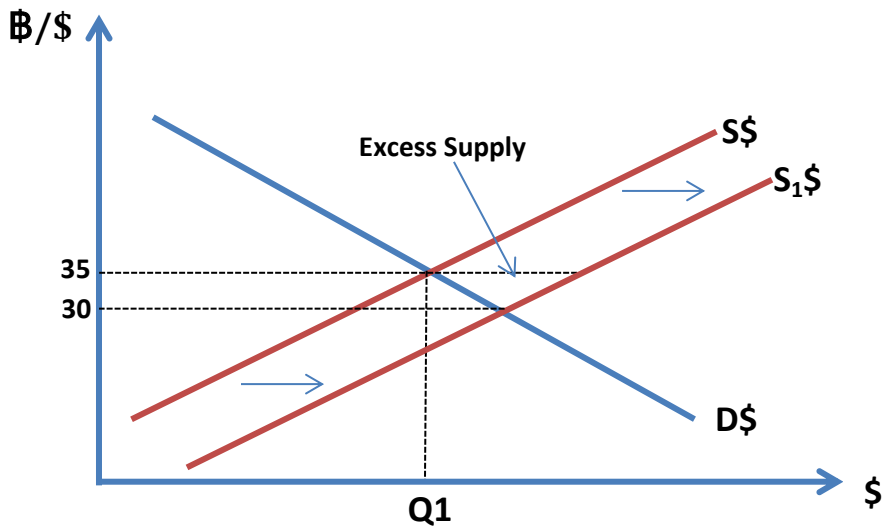
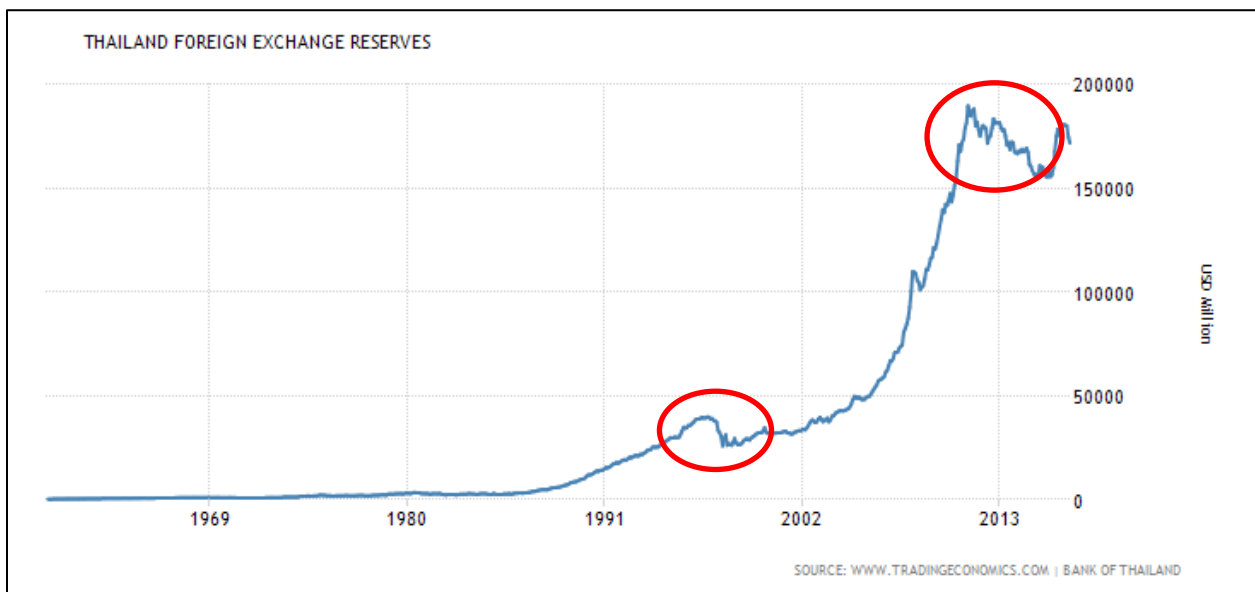
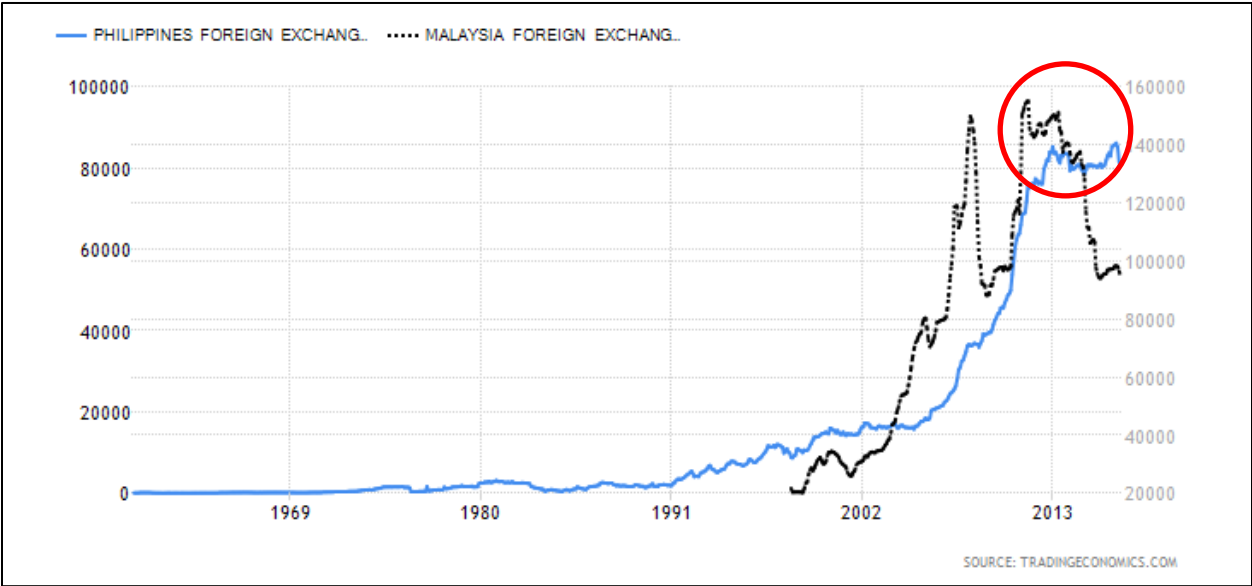


Figure 2: The level of Thailand International Reserves from 1960s-2016



Source: <http://www.tradingeconomics.com/thailand/foreign-exchange-reserves>

Figure 3: The level of Philippines and Malaysia International Reserves



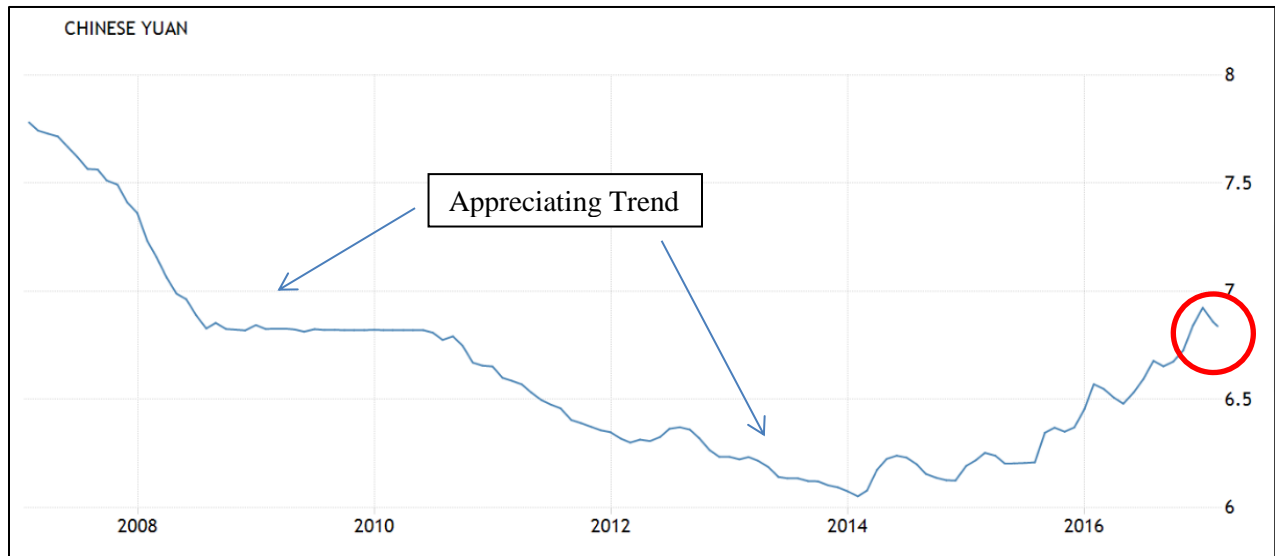
Source: <http://www.tradingeconomics.com/philippines/foreign-exchange-reserves>

Figure 4: Historical data of THB/USD



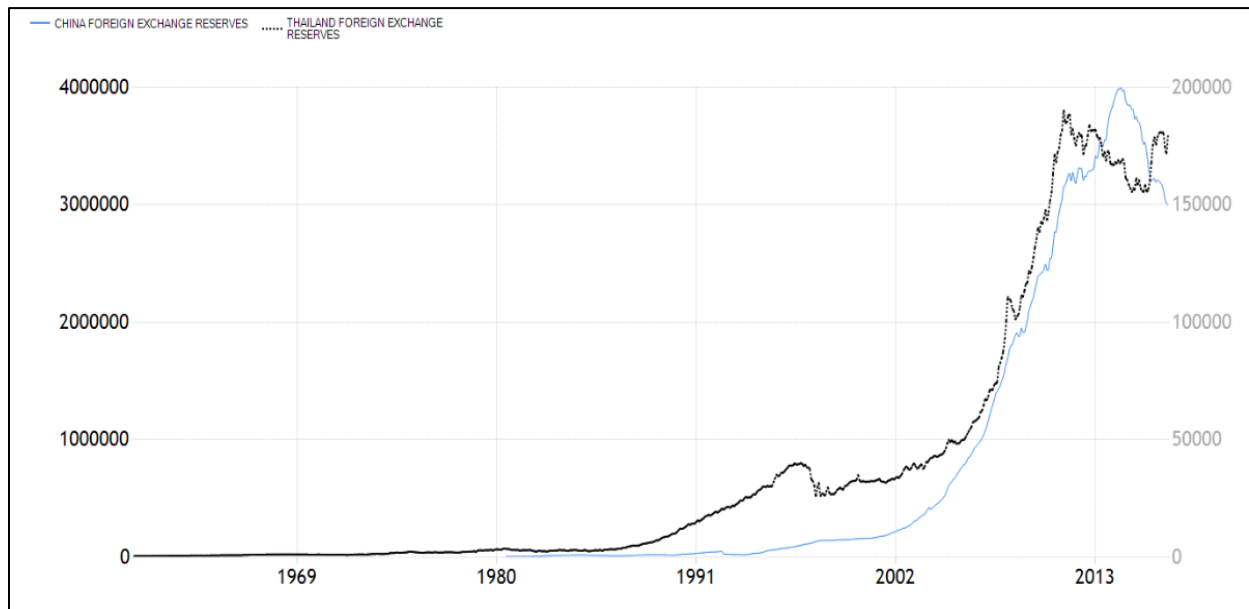
Source: <http://www.tradingeconomics.com/thailand/currency>

Figure 5: Historical data of RMB/USD



Source: <http://www.tradingeconomics.com/china/currency>

Figure 6: The level of International Reserves of China compare to Thailand



Source: <http://www.tradingeconomics.com/china/foreign-exchange-reserves>

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