With limited room for additional monetary easing, baht appreciation weighs down foreign demand in Thailand

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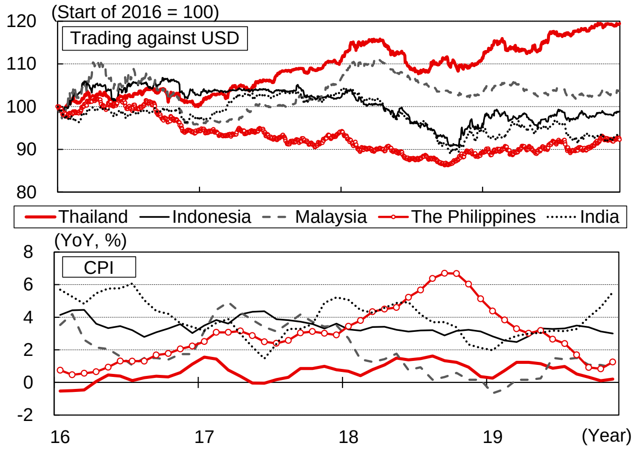
The Thai baht (THB) remains strong. During the latter half of the year, there was a period of temporary weakness against the US dollar (USD), but it is now trading at around USD/THB 30.0~30.5 for the first time in approximately six years and continues to stand out alone in Asia in terms of strength (Chart 1).

As a stable currency and in terms of purchasing power parity, the THB has easily become the subject of upward pressure since the Asian currency crisis. This is due to the fact that, compared with other Asian countries, Thailand has a large surplus in its current account – over 10% of nominal GDP – and a low CPI in recent years. This means that it is not necessary to maintain the value of its currency due to high interest rates (Thailand has a high degree of freedom when it comes to interest rates). In fact, during the period up until 2018 when the US was tightening its monetary policy, Thailand's interest rate rose by a relatively small amount (Chart 2).

That being said, the current appreciation of the THB exceeds the limits of "stable currency trading" and has become a headwind for the export and tourism industries. Also, it is important to be aware of the various restrictions which policy makers face in dealing with this situation. First, while it is possible to lower interest rates, the Bank of Thailand had to maintain interest rates in December after it cut them by 0.25% in November. This was to maintain the option of future easing measures should the need arise, but it suggests it is possible that interest rates will fall below their absolute levels and the level of freedom in terms of monetary policy may be restricted. In addition, it cannot be overlooked that Thailand was almost added to the US Treasury's watch list of currency manipulators in May. As a result, The Bank of Thailand announced in November that it will relax rules to facilitate capital outflows (repatriation of export proceeds, investment in foreign securities, outward transfers and settlement of gold trading in foreign currency). However, it is uncertain as to how effective these policies to promote capital outflow will be for domestic corporations and investors as most of the pressure from THB buying appears to come from overseas investors.

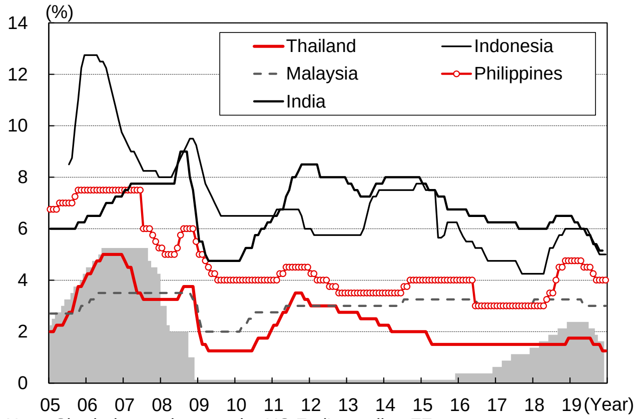
Although the scope for domestic policies is limited, it is likely the US will maintain its policy rate for the time being. Therefore, it is important to keep an eye on the possibility of downward pressure on Thailand's economy from a slump in foreign demand due to the strong THB.

Chart 1: Exchange Rate and CPI of Asian Countries



Source: Each country's national statistics, MUFG Bank Economic Research Office

Chart 2: Interest Rates of Asian Countries



Note: Shaded area denotes the US Fed's median FF rate

Source: Each country's national statistics, MUFG Bank Economic Research Office

(Translated by Elizabeth Foster)

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