

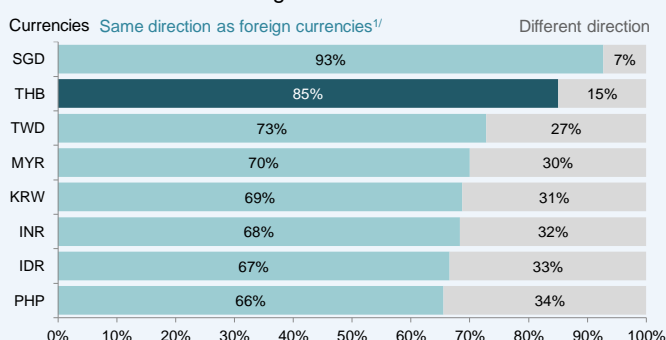
The BOT and the development of the new foreign exchange (FX) ecosystem

The Bank of Thailand (BOT) is committed to developing the Thai financial market and the FX market to be continuously effective by accelerating the development of the new FX ecosystem, in which capital movement is more balanced, the baht is stable and flexible in both directions driven by market forces, and businesses have greater access to FX-hedging instruments with lower costs from greater competition among providers. These factors would help address the structural problems of the FX market, which would prepare the Thai economy to cope with financial markets' volatility in the future.

In the past, the baht and regional currencies' movement was mainly determined by external factors. Data from the past 5 years indicates that the baht moved in line with foreign currencies as high as 85 percent of daily changes, a rate close to other regional currencies (Chart 1). Meanwhile, domestic factors played a secondary role in influencing the currency movement. Nevertheless, there remained a number of important structural issues in the Thai FX market, which led to the baht's recent appreciation and made Thai businesses more vulnerable to currency movement than their peers in other countries. These structural problems include:

Chart 1 The baht movements were primarily driven by external factors

Movements of THB and regional currencies



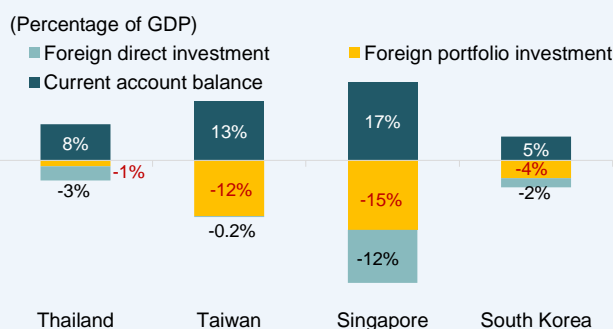
Note: ^{1/} refers to fluctuations that move in the same direction as the U.S. Dollar Index (DXY) or the Asian Dollar Index (ADXY). "Different direction" refers to fluctuations that do not move in the same direction as the U.S. Dollar Index (DXY) and the Asian Dollar Index (ADXY). The data is the daily average from 2015-2020.

Source: Bloomberg

1. Foreign capital movement is unbalanced. During the past 5 years, Thailand attracted high capital inflows from continuously high current account surplus at 8 percent of GDP per year on average, while capital outflows for direct investment and foreign portfolio investment stood at merely 4 percent per year on average. This is in part because Thai investors acquired fewer foreign assets compared with other countries, and are more likely to invest in domestic assets (high home bias) (Chart 2).

Chart 2 Thailand experienced larger capital inflows than outflows

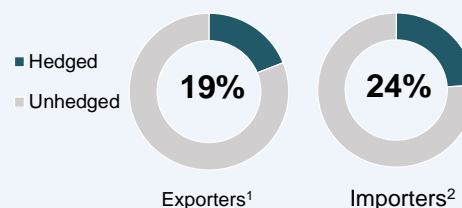
Foreign investment compared to current account balance (avg. from 2015-2019)



Sources: IMF and Bloomberg

Chart 3 Businesses barely coped with exchange rate fluctuations as both exporters' and importers' hedging were in the lesser proportion

Proportions of businesses that hedged against FX (average from 2016-2020)



Note: Five-year average from 2016-2020, calculated as follows:

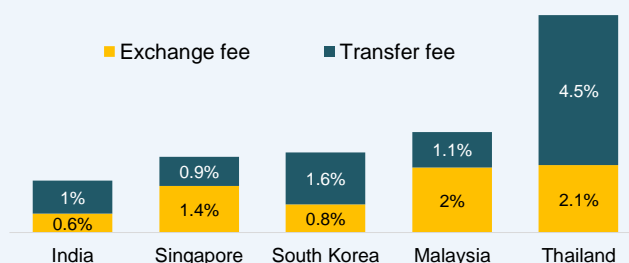
- (1) Calculated from the outstanding sale for FX Forward relative to the total export value of the previous three months
- (2) Calculated from the proportions of FX hedging transactions of importers, calculated from the outstanding purchase for FX Forward, relative to the total import value for the next three months

Source: Bank of Thailand

2. The Thai corporate sector insufficiently manages FX risks. Businesses can manage FX risk through various methods such as the purchase and sale of forward and option contracts. However, Thai businesses engaged in FX hedging at merely 19 percent of export values and 24 percent of import values (Chart 3), the rates of which should be higher.

3. FX transactions remain costly. This is one of the obstacles preventing Thai investors from diversifying their portfolio to include foreign assets, which leads to limited FX hedging among Thai businesses. 99percent of FX transactions remain concentrated among commercial banks and FX transaction fees in Thailand are higher than regional peers, as reflected by the fees in currency exchange and international transfer at 6.6 percent per transaction (Chart 4).

Chart 4 Thailand's costly FX transactions were reflected in the higher FX transfer fee relative to other countries in the region
FX transfer fee (percentage of total transaction fees)



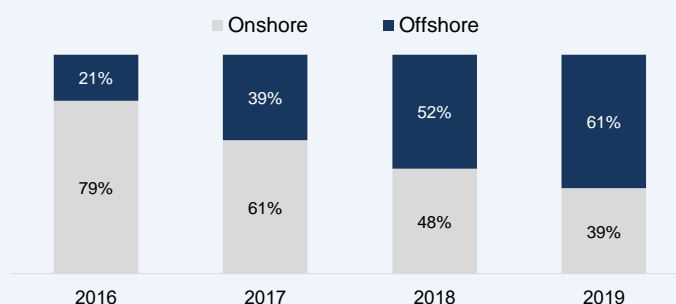
Note: The calculation is based on the average cost of transferring 500 U.S. Dollars, separated into the exchange fee and transfer fee, charged by both banks and non-banks from Q1-Q3 of 2020

Source: World Bank

4. Baht transactions in offshore markets highly influence exchange rate. The volume of baht transactions in offshore markets has continued to grow, currently accounting for 61 percent of all baht transactions. The sizable offshore markets increasingly allow the global financial markets' volatility to affect the baht and undermine the central bank's currency management ability (Chart 5).

Chart 5 The growing baht transactions in the offshore market which were larger than the onshore market exposed the baht to the global financial market's volatility

Proportions of baht transactions in each market

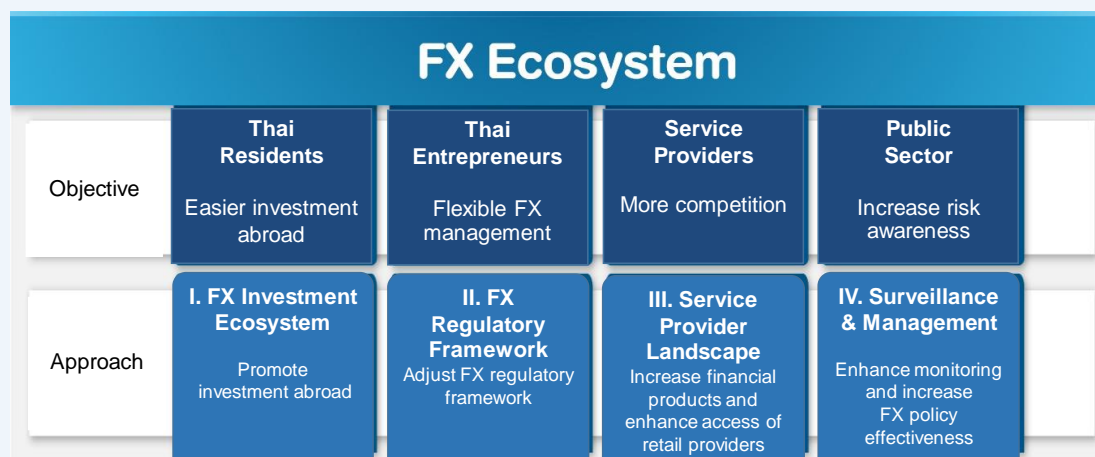


Note: Offshore transactions were calculated from the FX-THB transactions between non-residents, while onshore transactions were calculated from the FX-THB transactions of non-residents and residents against the domestic commercial banks

Source: Bank for International Settlements

Given the factors mentioned above, the BOT has therefore accelerated measures to advance the development of the new FX ecosystem for Thailand to address structural issues of the FX market in a sustainable manner. This would require collaboration from various stakeholders including both the government and the private sector to jointly advance well-integrated measures striving for tangible results. The BOT devises the plan into four aspects (Chart 6) as follows.

Chart 6 The BOT expedited the new FX ecosystem to promote the balanced capital flows



The first aspect: shaping the FX investment ecosystem to bring about balanced capital movement through direct investment and investment in foreign assets. The BOT has implemented changes to the procedures and regulations seen as obstacles to make foreign-asset investment easier, more flexible, and close to investing in domestic assets by

1. **Liberalizing foreign currency deposit (FCD) accounts** to make it easier for Thai people to use FCD accounts domestically, including deposit, withdrawal, and transfer between Thai citizens within Thailand;
2. **Simplifying rules and procedures**, such as (1) increasing the investment limit for retail investors to 5 million U.S. dollars per year, (2) abolishing the total investment limit that the BOT allocated to investors regulated under the Securities and Exchange Commission (SEC), and (3) expanding the class of foreign-currency-denominated products that can be offered in Thailand to be more diverse, for example, trade in gold, exchange traded fund, and U.S. dollar deposit receipt;
3. **Promoting the private sector's investment abroad**, including both entrepreneurs' direct investment and institutional investors' security investment, such as insurance companies and provident funds.

The second aspect: adjusting FX regulatory framework to be in line with the changing economic and financial-market contexts. The framework would also be conducive for Thai businesses to manage FX risks more freely and for the economy to better withstand currency volatility. Three measures would be executed simultaneously, including (1) adjusting regulation for capital inflows and outflows to be more balanced, (2) reducing barriers to the private sector's FX risk management, and (3) reducing administrative burden when businesses declare FX transactions.

The third aspect: changing FX service provider landscape to reduce transaction costs, increase financial products to meet the demand, and enhance access of retail providers through promoting competition among providers. Examples include, (1) expanding the scope of FX transactions offered by existing providers and supporting new providers, particularly non-banks whose services remain limited in scope, and (2) changing regulation to suit new types of financial services such as online transactions and digital platforms in line with the changing behavior of users.

The fourth aspect: improving monitoring and effectiveness of FX surveillance and management policy to timely alert the government of risks and to prepare policies to cope if crises arise. These improvements include, for example, (1) increasing both transactions in onshore markets by supporting non-residents who perform trade and investment activities in Thailand to transact with banks operating in Thailand with greater convenience. (2) Improving the monitoring system on investors' behavior which might affect the stability of the baht, for example, by requiring bond pre-trade registration. (3) Preparing plans and measures in FX management that can be implemented readily and are well-targeted.

The aim to accelerate the development of the new FX ecosystem is an important policy agenda that the BOT and other related agencies would continue to implement starting from the measures announced on 20 November 2020^{12/} which entail (1) allowing Thai citizens to freely deposit foreign currencies, (2) adjusting regulation and procedures for foreign-asset investment, and (3) requiring registration for identifying individuals for bond transactions. Following this, the BOT and other agencies would continue to announce additional measures covering the four aspects to advance the Thai FX market towards the new ecosystem, which would allow more balanced capital movement, greater convenience and higher volume of Thais' investment in foreign assets, more flexibility for businesses' FX risk management, and greater vigilance and timely implementation for the government. If all players in the FX market successfully adjust themselves towards the new ecosystem, this would bring sustainable solutions to the existing structural impediments in the market.

^{12/}BOT Press Release No. 81/2020: BOT accelerates measures to advance the development of the new Thai FX Ecosystem (20 November 2020)