大 華 銀 行
UNITED OVERSEAS BANK

Company Reg No. 193500026Z
UOB Economics-Treasury Research

Suan Teck Kin Suan.TeckKin@uobgroup.com

Friday, 29 February 2008

Flash Notes

Bank of Thailand Lifts Capital Controls, Effective 3 March 2008

Bank of Thailand Governor Tarisa Watanagase announced at a press conference less than an hour earlier that the Thai capital control measures will be lifted, effective next Monday, 3 March 2008. The governor at the press conference noted that the situation now is "suitable" for the removal of capital controls and that measures "will be implemented" to support the removal. She also said BoT would not use interest rate policy to influence the Thai baht exchange rate.

The move by Bank of Thailand was largely anticipated after the new government was elected on the 23 Dec 2007 general election, which promised to scrap the capital controls.

The Thai capital controls were imposed in December 2006 after the military coup in September, to manage capital flows and contain the THB appreciation. But the imposition created panic among investors initially given the surprise nature of the move and led to the biggest one-day selloff on the Thai stock market that triggered a limit down circuit breaker.

Impact/Implications:

- Removal of capital controls will certainly be perceived as a positive by foreign investors. Thailand has lost much of its allure as an investor-friendly destination due to the draconian and surprise nature of the measures as well as the imposition of military rule after coup in September 2006. The Thai stock exchange is likely to be a key performer on Monday as foreign investors take renewed interest in Thailand. YTD, the SET index is one of the best performers in Asia, down only 1.4% compared to Vietnam stock index (-28.5%), STI (-12.7%), and KLCI (-6.1%), and just behind JCI (-0.9). However, do note that the Thai stock index lagged the region severely in 2007 having lost 4.8%, while the second worst performer Kospi still managed to gain 4% last year.

- Despite subsequent relaxation of some rules, the Thai capital controls created a costly barrier to foreign investors due to the now-infamous Unremunerated Reserves Requirements (URR) of 30% of fund inflows. As such removal of the URR will be a positive development for Thailand due to the clearing of this uncertainty and would benefit both the portfolio and FDI flows. This would have a positive impact on the Thai official growth forecast of 4.5-5.5% for 2008, compared to just 4.8% in 2007 as the economy was dragged down by a year of military rule.

- With the capital controls to be lifted on 3 March, the USD/THB rate is expected to converge towards the current onshore rate, which is at 10 1/2-year low of 31.50, compared to offshore rate of around 30.80. The two rates had been converging since late December 2007 when the new Thai govt signaled its intentions to remove capital controls. However, given the broad USD weakness in recent weeks, the USD/THB is expected to face downward pressures just like the rest of other Asian currencies. We expect the BoT to step in aggressively at least in the initial stage to maintain order in the FX market, although it may be a difficult task since the currency will be free floating. With the onshore THB having gained only 5.2% in 2007 against the USD, lagging behind the likes of PHP (+19%) and RMB (+6.9%), there is much room for the THB to catch up this year. Indeed, onshore THB is so far the top Asian performer YTD in 2008, up by 5.3%, followed by TWD at +4.9% against the USD.