

Currency Note

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After Thai, Will It Be Malaysia?

- ◆ Bank of Thailand had instructed all banks to hold in reserve for one year 30% of the capital inflows. Those who withdraw the reserved amount in less than a year will be fined 33% of the 30% portion. We construe the move as a tax that is somewhat similar to Malaysia when the capital control was imposed in September 1998.

- ◆ Details of the measures and related operational procedures are as follows:
 1. After one year, customers whose foreign currencies have been withheld can request for refunds by submitting related evidence to prove that the funds have been in Thailand for at least one year.
 2. Once financial institutions have examined and certified the one-year minimum stay period, they shall inform the BoT to return the funds, through them, to their customers.
 3. Should any customers wish to repatriate their funds earlier than one year, they would be refunded only two-thirds of the amount.
 4. Foreign exchange transactions that have been traded prior to Dec 19, 2006 are exempted from this reserve requirement.
 5. Foreign direct investments or unrequited transfers would initially be subject to the reserve requirement but shall be refunded upon submission of supporting evidence through financial institutions. Once financial institutions have examined and certified the legitimacy of such claims and the BoT deems it appropriate, the BoT shall promptly return the full amount.
 6. Financial institutions shall remit the required reserves, in the form of foreign currencies, to the BoT on the 7th of the subsequent month.
 7. The earnings received from this measure would be earmarked for public benefits.

- ◆ We believe the draconian measure is to contain Thai Baht from appreciating strongly against the US Dollar, as it will choke their export competitiveness and trade balance. Also, the move is to curtail the strong inflow of short-term funds into both the equity and debt market. In short, we feel this measure is to ease potential pressure on Thai's economy, which if left unchecked could bring about a similar fate that happened in July 1997 which forced the Thai Government to devalue the Baht and eventually triggered financial crisis in the region.

Table 1: Currency & Equity Market Performance

Bourses	Currency		Equity	
	YTD	19/12 - 18/12	YTD	19/12 - 18/12
Singapore	-7.1	-0.38	23.4	-2.2
S. Korea	-7.5	0.52	3.5	-0.4
Thailand	-12.7	-0.50	-12.8	-14.8
Malaysia	-5.4	0.59	17.9	-1.9
Indonesia	-6.5	1.04	49.4	-2.8
Philippines	-6.5	0.08	35.9	-1.0

Source: Bloomberg

*For Currency: - implies appreciation and + implies depreciation

- ◆ Following the imposition of these measures, we opine that Thailand's risk premium would accelerate. On that note, we foresee an immediate correction to both their equity and currency market. Going forward, we expect liquidity to tighten and the market is expected to turn pale. Investors' would become more apprehensive in fear that the Thai market would experience a similar nemesis as that of the Malaysian when capital control was in place. Hence, we can expect funds switching to other markets in this region.
- ◆ What is interesting is that within 27 hours, there has been a policy change in Thailand. While Bank of Thailand imposed capital control on 18th December 2006, the Finance Minister on the other hand announced that stocks would be exempted from the rules after an investor revolt that saw the biggest one-day market plunge in 16 years. From here, we can deduce that the military-backed government as well as Bank of Thailand are clearly out of touch with market sentiments.
- ◆ **Question: Is Malaysia next in line?**
 - **Is history repeating?** In today's scenario, it is not about devaluing the currency, but more of a change in currency policy management. We found the equity market taking a beating, down by 1.9%, while Ringgit vis-à-vis US Dollar fell by 0.59% between 18th December 2006 & 19th December 2006. It should not surprise or upset investors', despite the local authorities vehemently assuring that the present exchange rate policy management will remain intact. The reason being, in the past we are known for policy inconsistency or 'flip-flop' policy. Investors' fear if the situation in Thailand turns ugly, Malaysia might impose a similar draconian measure to protect its currency and equity market.

❑ **The Likely Scenarios!**

- ❑ Scenario 1: If the authorities adopt the 'flip-flop' policy or revert to the orthodox currency management policy, we will have to downgrade our present optimistic assessment on the Malaysian economy and capital market for 2007. On the assumption that Malaysia adopts the orthodox capital control measures, we are forced to scale down the real GDP growth projection for 2007 from 5.8% y-o-y to 5.0% y-o-y. As for the equity market, our target of 1,250 points in 1H07 for KLCI may not materialize. The reason being, we expect the local market to be supported primarily by local institutions.
- ❑ Scenario 2: If the authorities adhere to their commitment of a more flexible exchange rate policy that is now in place, we can expect investors' optimism to rekindle. This would benefit both the economy and capital market, taking advantage from potential switching of portfolio from Thailand to other bourses in the region. Under such circumstances, we will maintain our optimistic assessment towards the economy and capital market for 2007.

- ❑ **Conclusion.** We can expect the downside risk to prevail for both the currency and equity market in a very near term. Stabilization would come into play when investors' are convinced that our authorities are committed on their policy management, in particular the exchange rate policy management. To sum up, as long as policies remain consistent, we believe the local bourse and currency market will be able to withstand the external vagaries.

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