

EIC sees baht continuing to face appreciation pressures, revising its 2020 year-end forecast downward to 29.5-30.5 baht per USD

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The EIC sees the baht continuing to face appreciation pressures in 2020, but to a smaller degree than in 2019. The EIC feels that the baht at the end of 2020 will prevail within a range of 29.5-30.5 baht per USD as Thailand is still facing structural challenges causing the current account surplus to remain high. Meanwhile, demand for outward investment is still low due to a high degree of home-bias and thus considerable demand for the baht relative to USD. The US dollar index is also expected to weaken slightly, prompting the baht to strengthen.

However, other factors leading to a slower pace of baht appreciation compared to 2019 include an improvement in outward investment by Thai corporates, a likely decline in the selling of gold to realize profits, and a Thai – US interest rate gap that could possibly widen.

The baht's rapid surge toward the end of the year came under the spotlight of many parties.

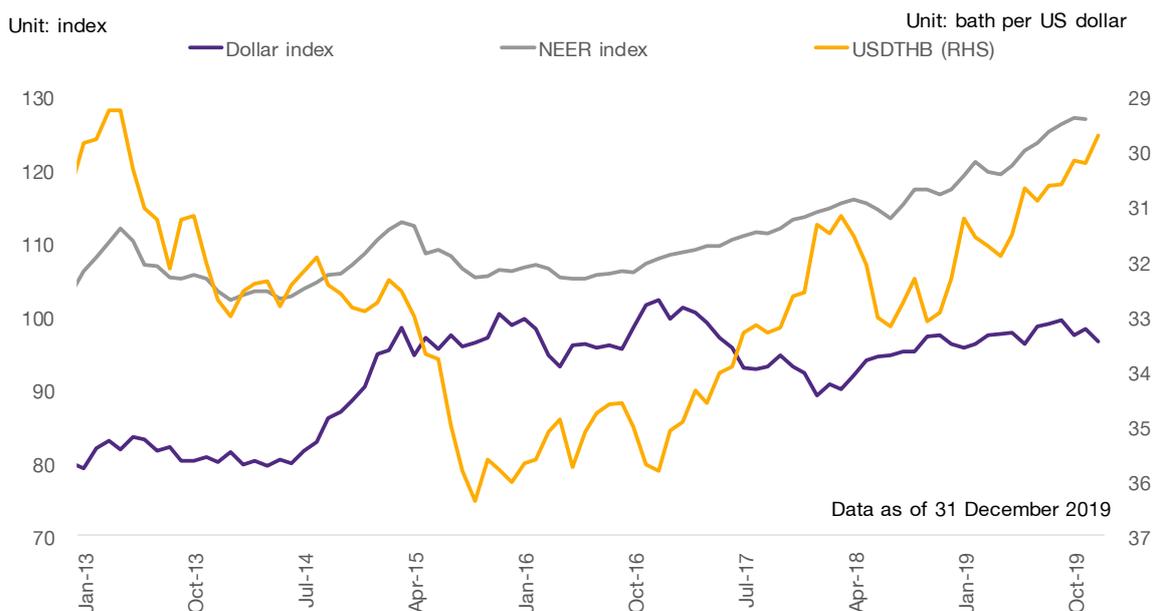
The BOT said that this rapid appreciation stemmed from low liquidity in the financial market during the holidays, resulting in an imbalance in foreign exchange trading transactions, and also from a weakening USD. The EIC therefore presents its analyses of the Thai baht outlook for 2020 so that businesses can be prepared to cope with baht volatilities in the period ahead.

The EIC has adjusted its views on the baht in the belief that it will stay within a range of 29.5-30.5 baht per USD by the end of 2020.

The baht was previously seen staying within a range of 30-31 baht per USD in the previous quarter's Outlook report. The baht averaged 31.05 baht per USD in 2019, up 4.1% from 2018. The Nominal Effective Exchange Rate (NEER) averaged 123.2 in 2019, up 6.6% from 2018 (Figure 1). The baht will likely continue to face appreciation pressures in 2020, but to a smaller degree than in 2019.

Figure 1: 2019 averages of the baht against the USD and the NEER index strengthened 4.1% and 6.6%, respectively, from last year

USDTHB NEER index and Dollar index



Source: EIC analyses based on data from Bloomberg

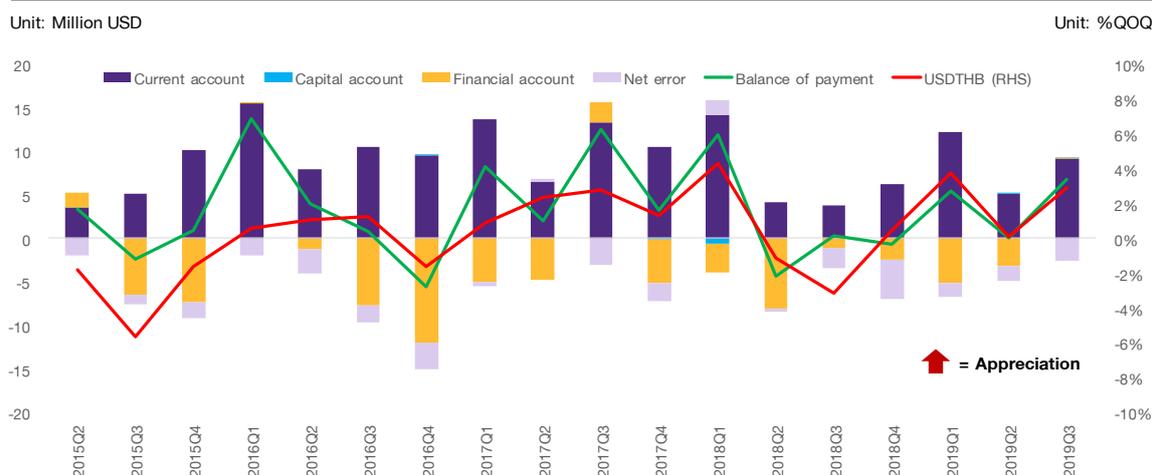
The EIC expects the baht to strengthen against the USD due to the following factors

1. **Thailand's current account surplus will remain high in 2020**, and the EIC sees Thailand's current account surplus in 2020 remaining at a similarly high level as in 2019 due to 1) export and import values in 2020 that will likely stabilize from last year, 2) tourism, which will continue to expand but at a moderate pace, and 3) domestic investment, which will remain subdued. All in all, Thailand's current account surplus, despite a slowdown, will remain high at roughly 6.3% of GDP compared to 6.5% of GDP in 2019 (Figure 2). Meanwhile, demand for outward investment remains low, with a high degree of home-bias. This leads to considerable demand for baht relative to the USD.

Moreover, a high current account surplus and large foreign exchange reserves to foreign debt will continue to make the baht a regional safe haven. Therefore, the baht will likely weaken to a smaller extent than other regional currencies during risk-off sentiment.

Figure 2: The baht is likely to strengthen while the current account surplus remains high

Balance of payment and USDTHB



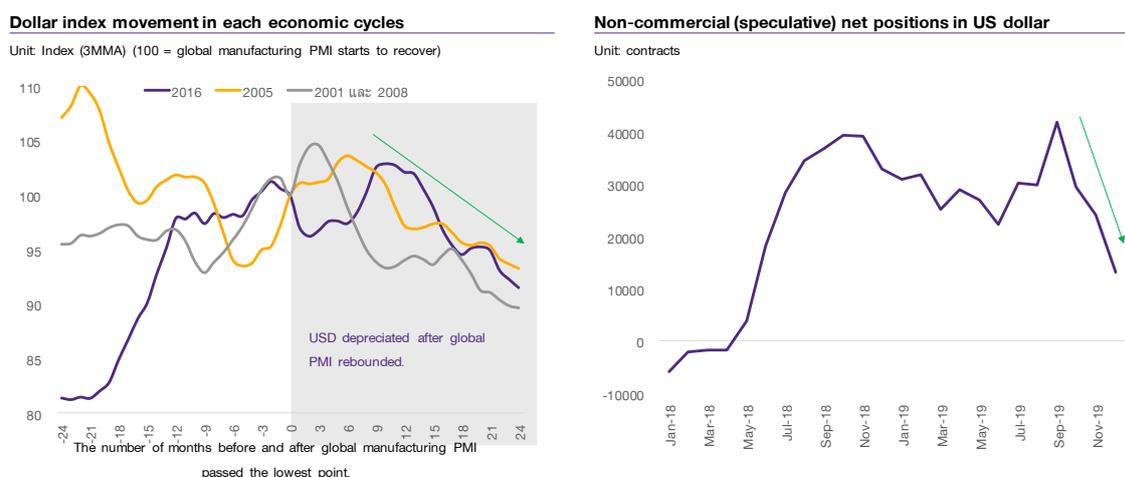
Note: Quarterly baht figures are calculated by averaging daily baht values.

Source: EIC analyses based on data from Bloomberg and the Bank of Thailand

2. **Declining risks to global economic growth will likely induce capital flows back to emerging markets in Asia (EM-Asia), including Thailand.** The EIC thinks that successful progress on the Phase 1 Trade Deal between the US and China will be a factor significantly reducing downside risks to exports and economic growth in EM-Asia. Risks concerning Brexit also improved after the Conservative party won a majority. Given these factors, risks to global economic growth will likely decline in 2020. The EIC expects this to boost investor confidence, thereby inducing capital flows back to emerging markets.
3. **The US dollar index is anticipated weakening slightly, prompting the baht to strengthen.** The EIC found that demand for USD holding during the economic downturn rose as it is a major global currency and low risk. Looking ahead, the global economic outlook will likely improve, the risks of a global recession have decreased, and demand for holding USD will thus fall. (Figure 3) This trend began to be seen somewhat in the last quarter of 2019 from a lower number of speculative contracts in USD. **However, the EIC believes that the USD will not weaken much,** as although the Federal Reserve (Fed) is expected to hold its rate steady throughout 2020 (from a previously expected hike), the monetary policy stances of other major central banks will likely be more accommodative. The European Central Bank (ECB) and the Bank of Japan (BOJ) will likely keep their policy rates

on hold in 2020, but will continue monetary policy easing through quantitative easing (QE). Moreover, the possibility that the ECB and BOJ will cut their policy rates in 2020 is higher than in the case of the Fed. Thus, the euro and the yen could possibly weaken against the USD. In addition, uncertainties over the Free Trade Agreement between the UK and EU might cause the pound and euro to weaken against the USD.

Figure 3: The US dollar index could possibly weaken slightly as the global economic outlook improves. The latest data suggested that speculative contracts in USD have begun to decline.



Source: EIC analysis based on data from Bloomberg and JP morgan.

4. **Limitations on the BOT easing its monetary policy and managing exchange rate.** Monetary policy easing, including cutting the policy rate, can partly help weaken exchange rates. However, with an increasingly limited ability of the BOT to cut the policy rate given its historical low policy rate, the ability to manage the baht through this channel has thus decreased. Moreover, Thailand still faces the risk of being labelled a currency manipulator by the US Treasury, making it difficult for the BOT to manage the currency as much as in the past. The baht will Therefore continue to face appreciation pressures.
5. **The yuan will likely appreciate, so regional currencies, including the baht, may strengthen in tandem.** When the trade war intensified, the yuan weakened significantly. Chinese goods thus gained price competitiveness over other countries. This affected the outlook for the exports and economic growth of China's trading partners. Regional currencies, especially for those countries exporting similar goods with China, weakened in tandem. In recent periods, the baht weakened in line with the yuan as the trade war intensified. However, the intensity of the trade war is likely to abate and the confidence of global investors will likely improve. The yuan is thus expected to strengthen, and given Thailand's strong external positions the baht could also become stronger.

However, the EIC expects that baht appreciation in 2020 will be slower than in 2019 due to the following factors.

1. **Thailand’s financial account deficit could widen slightly** due to increasing outward investment over the past five years (since 2015). The EIC expects larger outward investment by Thai corporates in 2020, partly supported by the low level of Thailand’s economic growth relatively to other regional countries, as well as relatively high domestic uncertainties. Moreover, relaxation of capital outflow measures by the BOT should be a supporting factor for Thai corporates for M&A with foreign businesses. Also, portfolio investment abroad should gradually increase. The EIC thus sees the financial account deficit widening, which will help reduce pressures on the baht through a decline in the balance of payment surplus.
2. **Pressures from the selling of gold to make profits declined.** When the global economy faces higher risks, risk-off sentiment occurs and investors choose to increase their holdings in safe assets, including gold. Gold prices thus rise during that period. Some gold investors in Thailand sell gold into the global gold market to make profits from price increases, increasing demand to convert USD earned from selling gold into baht. The baht therefore becomes stronger during that period. However, as risks to the global economy are expected to fall next year, any increase in gold prices will likely slow down or even decrease. (Figure 4) Therefore, pressures on the baht from this factor will be lower. In addition, the relaxation of foreign exchange regulations by the BOT allowing gold traders to keep their foreign exchange proceeds from selling gold in foreign currency deposit (FCD) accounts for future investment, without having to convert into baht immediately, will also help alleviate appreciation pressures in the following year.

Figure 4: Gold speculation slowed down in the fourth quarter as risks to the global economy declined.



Source: EIC analysis based on data from Bloomberg

3. **Outlook for interest rate gaps between Thailand and other major economies.** If the Thai economy worsens more than the MPC expected, stressing the need to cut the policy rate further to support the economy, Thailand's short-term government bond yields will fall below those of the US. Investors may choose to invest in other higher-yielding assets (carry return). Capital flows that were expected to flow into Thailand may be reduced, and even outflows can be expected, possibly weakening the baht. However, According to EIC studies, the interest rate gap has very little impact on the baht and is a lesser influence than structural factors such as the size of the current account.

Overall, the EIC forecasts the baht continuing to face appreciation pressures in 2020, but to a lesser degree than in 2019. The EIC sees the baht at the end of 2020 prevailing in the range of 29.5-30.5 baht per USD. This is because Thailand still has to face structural challenges which can cause the current account surplus to remain high, while demand for outward investment is still low with a high degree of home-bias. This will lead to considerable demand for the baht relative to USD. In addition, the US dollar index could possibly weaken slightly, resulting in a relatively stronger baht. However, supporting factors helping the baht not strengthen as fast as in 2019 include outward investment by Thai corporates that will likely increase, a decline in the selling of gold to realize profits, and a possibly widening interest gap between Thailand and the US.

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