

CHAPTER 3

FOREIGN EXCHANGE MARKET IN THAILAND

This chapter provides the details for the foreign exchange market. Begin with an introduction to Thailand exchange rate system. Then focus on the foreign exchange market in Thailand. Participants in Thailand foreign exchange market are discussed next. Finally, the derivative market in Thailand are provided.

3.1 Thailand Exchange Rate System³⁶

On joining the International Monetary Fund (IMF) in 1949, Thailand pledged to abide by the Bretton Woods System. To establish a parity, the baht was fixed against the US\$ whose value was set against gold. Fluctuation of the baht must be within +/- 1% of the parity. In 1955, the Exchange Equalization Fund (EEF) was established to control the stability of the baht through intervention in the foreign exchange market if rates fluctuate beyond limits. Daily mid-rates for baht against major currencies were published by the EEF.

The Basket of Currencies system in valuing the baht was introduced on November 2, 1984. The baht was converted from a currency pegged solely to the US\$ to one pegged against a basket of currencies. "Daily fixing" of the baht announced by the Bank of Thailand (BOT) is based on the value of the currencies in the basket at 8.00 am. Approximated proportion of the three major currencies in the basket studied by the Thai Farmers Bank treasury research is 80% US\$, 13% JPY, and 7% DM. Exact composition of the basket, however, is known only to a few at the EEF. Since the inception of the basket of currencies system. The exchange rate of Thai baht among major currencies, especially US\$ are in fact remained stable. (Table 3.1)

³⁶ Summarize from "Thailand : its currency and capital markets". Reprinted from Asiamoney May 1997 by Thai Farmers Bank.

TABLE 3.1 EXCHANGE RATE OF THAI BAHT : MAJOR CURRENCIES
1989 -1996

Year	Buying Rate					
	U.S. dollars	% Δ	Pound sterling	% Δ	Japanese yen	% Δ
1989	25.6020	0.0000	41.9189	0.0000	0.1857	0.0000
1990	25.4960	-0.4140	45.3618	8.2132	0.1764	-5.0081
1991	25.4157	-0.3150	44.8965	-1.0258	0.1886	6.9161
1992	25.3203	-0.3754	42.7602	-4.7583	0.2025	7.3701
1993	25.2197	-0.3973	37.8211	-11.5507	0.2270	12.0988
1994	25.0498	-0.6737	38.2998	1.2657	0.2447	7.7974
1995	24.8154	-0.9357	38.1159	-0.4802	0.2649	8.2550
1996	25.2439	1.7268	39.3596	3.2629	0.2317	-12.5330

SOURCE : Bank of Thailand.

Presently, Thailand foreign exchange market has become more liberalized since the deregulation of foreign exchange transactions beginning from the accepted IMF 8 on May 24, 1990³⁷ (see the detail in Appendix. E) to the adaptation of the managed float exchange rate system on July 2, 1997. Under the managed float exchange rate system, the exchange rate is mostly determined by the demand and supply of currencies by private parties. The exchange rate moves in response to market forces. Each commercial bank will quote the exchange rate themselves (Counter Rate) and this rate may differ among them. The bank's expectation, the profit margin and their negotiate power with customers are the factors that influence their exchange rate.

The government may sometimes intervene in foreign exchange markets (in order to influence the exchange rate) to prevent the over fluctuate in short run and lead to the stability in long run. In general, the exchange rate

³⁷ Tashmai Rikshasuta. Ibid., p. 1.

movement under the managed float system will fluctuate more than the basket of currencies system due to the world's foreign exchange market. Exchange rate will be reflect the market's demand and supply in every second.

3.2 Foreign Exchange Market in Thailand

Thailand foreign exchange market grow more significantly during a recent year. Table 3.2 shows the foreign exchange trading growth from 1992-1997. The US. dollar is a currency trading most (Table 3.3). The value of foreign exchange market trading in Thailand is around 200-250 million US\$ daily. Foreign exchange markets in Thailand can be differentiated into two types: spot and forward. In spot markets, currencies are bought and sold for immediate delivery and payment (delivery in 1 or 2 business days) ; in forward (futures) markets, contracts are provided for the delivery of currencies at some future date (1,2,3,6,12 months are the most common).

The forward foreign exchange market is the most common and active derivative market in Thailand. Forward exchange transactions are carried out between commercial banks and customers as well as among the commercial banks. Most banks offer forward contracts to corporate customers in both the major and the regional currencies. However, only the US\$/baht forward is traded in the interbank market. Prices can be found for all periods up to one year with good liquidity on the shorter ends, up to six-month maturity. Longer maturities are more liquid offshore in Singapore and Hong Kong.³⁸

³⁸ Asiamoney. Ibid., p. 31.

TABLE 3.2 COMMERCIAL BANKS' PURCHASE AND SALES OF FOREIGN EXCHANGE 1992-1997

Year	Purchases	Sales
1992	2,141,686	2,102,824
1993	4,013,378	3,847,081
1994	8,218,674	8,227,287
1995	13,414,177	13,303,335
1996	23,862,844	23,856,678
1997	25,104,484	25,474,023

SOURCE: Bank Of Thailand

3.3 Participants in Thailand foreign Exchange Market

The main participants in Thailand foreign exchange market can be categorized as follows :

1. Retail Customers.
 - 1.1 Exporters who sell foreign currency to receive Baht .
 - 1.2. Importers who sell Baht to receive foreign currency.
 - 1.3 Those who borrow abroad are both a seller and a buyer of foreign currency / Baht.
 - 1.4 Foreign investors that are both seller and buyer foreign of currency /Baht.

The retail customer usually do not either transact directly with each other or send orders to buy or sell to a centralized market. In the process of exchanging currencies, retail customers transact with commercial banks.

2. Commercial Banks is a dealer/ market maker for their customer and buy / sell for their own investment (cover their portfolio position).

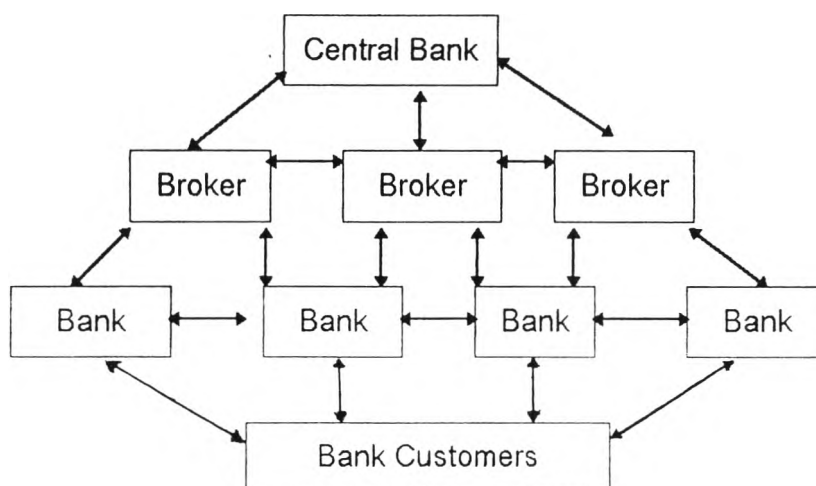
3. Foreign exchange brokers.

In the international foreign exchange markets, banks utilizing the foreign exchange market usually do not transact directly with each other. They interchange currencies through foreign exchange brokers, which function as interbank intermediaries.

4. Bank of Thailand, in order to influence the exchange rate prevent the over fluctuation in short run, is an institution in charge of regulation and controlling the economy system. It is both seller and buyer foreign currency / Baht.

5. Speculators / Arbitragers are both sellers and buyers of foreign currency /Baht so that they may earn a profit from subsequent price movements.

FIGURE 3.1 THE FOREIGN EXCHANGE MARKET TRADING.



The boxes represent foreign exchange market participants and the lines are the business connection between them.

1. Bank customers (Retail customer and speculators) place buy or sell orders with their respective banks.
2. Commercial Banks balance the buy or sell orders that they receive and if they have insufficient or surplus position they then place buy or sell orders with other banks or more usually with their brokers.
3. Foreign exchange brokers bring together banks that are trying to buy foreign exchange with those that are willing to sell. They collect buy and sell quotations for most currencies from many banks, so that by going through a broker the most favorable quotation is obtained quickly and at very low cost.
4. Bank of Thailand keeps a daily watch on exchange rate developments and intervenes to buy or sell its currency from time to time by placing buy or sell orders with its brokers.

3.4 Derivative Market in Thailand³⁹

The Thailand Securities and Exchange Commission (SEC) is planning to create a regulatory framework for a derivatives market and its intermediaries. A draft legislation has already been circulated for public comment and is expected to be implemented by June 1999. The underlying products will include financial products and contract categories will be divided into forward type, option type, other types of agreements specified by the SEC and a combination of all. As part of to gain more experience before the formal establishment of an official derivatives exchange, the SEC recently announced the launch of an over-the-counter (OTC) derivative market by local securities firms on 30 January 1998.

Under the draft of the SEC notification, the commission's criteria for approving derivative transactions by securities companies will be divided into three levels :

³⁹ Summarize from "The Recent Development of the Derivative Market in Thailand" by Supachai Arunthamsakul and Aspisith John Sutham. *SET Journal* v 2 no 16 January 1998, p.43-46.

1. General approval for derivative transactions conducted for the purpose of **hedging risk**.
2. Approval for derivative transactions conducted for the purpose of **speculation**. In this case, the securities company must notify the SEC before it starts doing business.

Securities companies which have received approval to conduct derivative transactions, either for hedging or speculative purposes, must deal only with local or foreign financial institutions or in an exchange recognized by the SEC.

3. Approval for derivative transactions for the purpose of **client services** (includes derivative advisors). In this case, approval from the SEC is required. Securities companies which have received approval to conduct a derivatives client service business can serve **only institutional investors**, not retail investors. It should also be noted that the securities company must seriously endeavor to evaluate the readiness, knowledge and understanding of all its clients in terms of all its clients in terms of derivative transactions.

Derivative commodity products will be governed by a separate law, traded in a separate exchange and supervised by a separate governmental agency, the Ministry of Commerce(MOC). The law on derivative commodities is still under consideration by the MOC and it is difficult to predict how soon it will be in force. The success of the OTC derivatives market will play a key role in setting up a formal derivatives exchange under a new law in the near future.

TABLE 3.3 THE FOREIGN EXCHANGE TRADING 1992-1997.

CURRENCIES	1993	1994	1995	1996	1997	TOTAL	%
US\$	7,332,173	15,843,387	26,037,661	47,005,251	49,772,488	145,990,960	0.9777
YEN	240,604	272,055	327,122	364,337	400,337	1,604,455	0.0107
DM	86,171	91,545	113,676	108,660	114,081	514,133	0.0034
STERLING	32,564	33,345	34,484	40,567	50,508	191,468	0.0013
OTHERS	168,947	205,629	204,569	200,707	241,093	1,020,945	0.0068
TOTAL	7,860,459	16,445,961	26,717,512	47,719,522	50,578,507	149,321,961	1.0000

SOURCE : Bank Of Thailand