

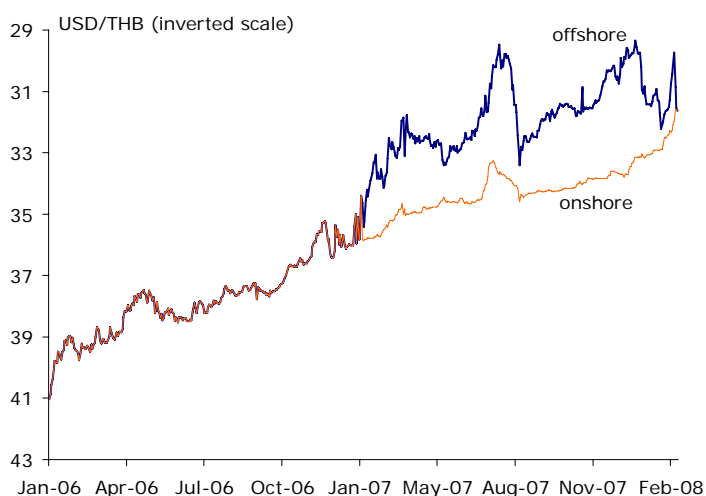
Onshore and offshore markets to converge

4 March 2008

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The Bank of Thailand (BOT) announced on Friday that it would lift the unremunerated reserve requirement (URR) on short-term capital inflows with effect from 3 March 2008. This represents the near-elimination of the capital controls that were imposed in December 2006, and paves the way for a convergence of the onshore and the offshore baht market.¹

The onshore and offshore Thai baht converge

Source: Bloomberg

Prior to the imposition of capital controls in December 2006, the onshore and offshore markets were in sync, reflecting the full convertibility of the THB and the active participation of market participants in the onshore market. In late January 2007, in a further attempt to stem capital flows into the equity and FX markets, the central bank banned Thai banks from executing offshore forward currency contracts with foreign entities. This effectively created a two-tiered market for the baht and “shut down” the offshore market. Opportunities to arbitrage between these markets are further limited due to the withholding tax that was introduced in the December capital controls.

Since then, the progressive relaxation of capital controls over the course of 2007 has seen this wedge narrow. The most recent announcement will see the onshore and the offshore rates converge, with liquidity returning to the offshore market now that foreign and resident market participants are able to trade in the onshore market. In the two trading days since the announcement, the onshore rate has strengthened toward the offshore rate, as seen in the chart above.

The lifting of restrictions opens scope for a somewhat faster appreciation of the currency, as already suggested by the movement in the onshore rate. Since the start of the year, the onshore Thai baht had strengthened by some 6.6% against the US dollar, and the offshore baht had appreciated by 1.2% (from a relatively stronger starting position). This is relative to a weak US dollar

¹ Customers who have previously held Special Non-resident Baht Accounts for Securities (SNS); Special Non-resident Baht Account for Debt Securities and Unit Trusts (SND); or Special Non-resident Baht Account for Trade and Services (SNT) need to provide instructions on these accounts prior to 14 March. For further details related to BOT’s announcement and on BOT-classified account changes, please see the Appendix.

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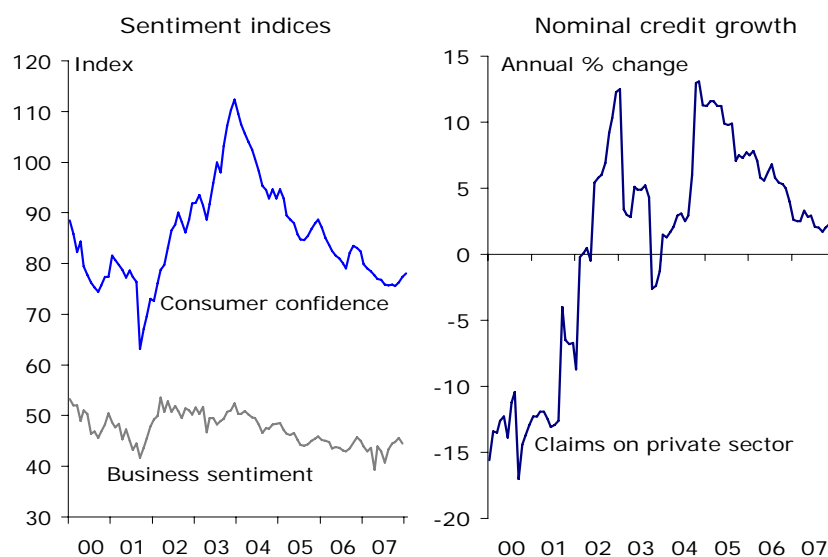
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environment, however; against the euro and the Australian dollar, the onshore baht rate has appreciated by 1.2% against the euro and 4.7% against the AUD, while the offshore rate has held steady or lost ground against these currencies. The BOT, in its announcement, stressed its desire for continued stability of the exchange rate, and is likely to remain active in the market to ensure against a rapid currency appreciation.

Going forward, we expect the baht to continue a mild appreciation against the US dollar for the next few months. However, we expect the Australian dollar in particular to outperform the Thai baht in a weak US dollar environment. Over the medium term, the Thai baht is expected to hold steady or lose ground against the US dollar as it begins its anticipated recovery later this year.

Within Thailand, the further liberalisation of capital controls comes amidst improving business and consumer sentiment. The new People's Power Party-led government has unveiled a big spending package, announcing a THB100 bn rural development programme in February and pledges to embark on large-scale infrastructure projects, including nine rail lines for Bangkok's mass transit system and upgrades to air and sea ports. In addition, according to the BOT release, foreign exchange flows have become more balanced with the trade surplus narrowing in January and offshore investment gaining momentum.

Domestic activity expected to gain momentum



Sources: Bloomberg, Datastream

However, the boost to domestic activity comes as exports face declining demand. The US absorbs 13% of Thai exports and is the single largest market. Imports are expected to accelerate not only as a result of a high oil import bill but also from the ramp-up in investment activity. Nevertheless, the Thai economy is expected to gain momentum in 2008, with growth forecast to reach 5½%. The economy expanded by a stronger-than-expected 5.7% over the year to Q4 2007, bringing full-year growth to 4.8% in 2007.

Thailand: macroeconomic and currency forecasts

	2006	2007e	2008f	2009f
Real GDP growth (% ch)	5.0	4.8	5.6	6.0
Inflation (% , yr avg)	4.7	2.3	3.5	2.5
Current account (% GDP)	1.1	5.9	3.3	3.3
FX reserves (US\$ bn)	65.1	84	95	103
Policy rate* (% pa, end-period)	5.0	3.25	3.50	3.75
Currency Forecasts (end-period)	Jun 08	Sep 08	Dec 08	Mar 09
USD/THB ⁺	30.6	30.9	31.3	31.5
EUR/THB	47.1	46.7	46.0	44.7
AUD/THB	28.8	28.4	28.2	27.4

*: Prior to Jan 2007; 14-day repurchase rate. Currently, 1-day repurchase rate

Source: Economics@ANZ

Appendix A

Mrs. Tarisa Watanagase, Governor of the Bank of Thailand, announced the lifting of the unremunerated reserve requirement on short-term capital inflows, effective 3 March 2008. The details are summarized as follows:

The Bank of Thailand (BOT) has introduced the unremunerated reserve requirement (URR) on short-term capital inflows since 18 December 2006 to deter short-term capital inflows and one-way speculation on the Thai baht that led to excessive volatility of the Thai baht that might have caused wider economic instability particularly at the time when domestic demand was moderating and robust export growth was the main driver of the economy.

The URR measure has lessened the pressure of baht speculation and been pivotal in ensuring the baht stability and its movement more in line with regional currencies. Aware of the adverse effects of the URR measure on financial costs of businesses that need to raise funds from abroad, the BOT has therefore relaxed the measure over time. The BOT has also been communicating consistently the intention to use this measure only temporarily and to lift it when the situation is appropriate.

After careful consideration of changes in the environment and factors, the BOT deems that it is now the appropriate time to lift the URR measure for the following reasons:

- Economic data in the fourth quarter of 2007 and January 2008 indicates a healthier recovery in domestic demand along with continued robust export growth. Moreover, additional fiscal stimulus by the government that helps boost confidence will further lend support to the continuation of this recovery.
- Foreign exchange inflows/outflows have become more balanced from moderating trade account surplus in January 2008, increasing amount of Thai investment abroad, and regulations that permit residents to deposit foreign currencies effective early February 2008.
- Real sector and exporters have been adjusting well to the appreciation of the baht through a much greater amount of foreign exchange hedging and improvements in production efficiency, management, and market diversification.
- The BOT has more instruments to manage liquidity and the currency under the new Bank of Thailand Act. In addition, plans by the Ministry of Finance to adjust the structure and management of public debt along with consideration to make use of the soon-effective Public Debt Management Act will further improve the balance of capital flows.
- Recently, there have been widespread expectations of the lifting of the URR measure and market participants have adjusted their behaviors in line with these expectations. This has eroded the effectiveness of the URR measure.

To help manage the inflows/outflows of capital after the lifting of the URR measure, the BOT deems appropriate the following supporting measures:

- 1) Encourage portfolio investment abroad by increasing the foreign investment limit for the Securities and Exchange Commission (SEC) to USD 30 billion to allocate to securities companies, mutual fund companies, and individual investors (through investments with private funds or securities companies).
- 2) Improve the measures to prevent Thai baht speculation
 - a) Revise the rule for domestic financial institutions to borrow baht from non-residents by reducing the limit for transactions with no underlying trade or investment for all maturities to no more than 10 million baht outstanding balance per group of non-residents so as to limit channels of speculation.

- b) Revise the rules regarding the provision of Thai baht liquidity by domestic financial institutions to non-residents by expanding each institution' limits for transactions with no underlying trade or investment to no more than 300 million baht outstanding balance per groups of non-residents so as to increase demand for purchases of foreign currencies and two-way flows.
- 3) Revise the structure of Non-resident Baht Account (NRBA) by segregating into Non-resident Baht Account for Securities (NRBS) and Non-resident Baht Account (NRBA) so as to help monitor fund flows of non-residents. Under the new structure, the transfer of baht between the same types of accounts is allowed while the transfer between different types of account is prohibited.

To support the adjustment and improve the production efficiency of SMEs, the BOT has launched the following temporary supportive programs:

- 1) Program to support production efficiency improvement of SMEs by providing soft loans through financial institutions totaling 40,000 million baht for a period of three years.
- 2) Facility to purchase (back-to-back) foreign currency that SMEs sold forward to financial institutions for a period of 6 months.

The BOT is confident that the implementation of the aforementioned measures under the managed float regime will ensure that the Thai baht moves in line with economic fundamentals without excessive volatility.

Bank of Thailand

29 February 2008

For a further detailed summary of the revision of rules, including matters relating to refunds of URR holdings and the types of accounts that will replace SNS, SND, SNT and NRBA accounts, please see Appendix B or visit the BOT web site:

<http://www.bot.or.th/BoThomepage/index/index_e.asp>

Appendix B

Removal of the Unremunerated Reserve Requirement (URR) and Request for Refund of the Reserves

Previous Rules

Financial institutions shall withhold 30% of foreign currencies purchased or exchanged against Baht from their customers as reserves except in certain cases such as:

- Goods, services, direct investment, investment in stocks, investment in immovable properties
- Loans, investment in debt instruments, and investment in unit trusts which have been fully hedged
- Loans in an amount not exceeding USD 1 million and with a maturity of at least 1 year.
- Investment in newly issued units of existing property funds

Request for refund of the reserves

Should the fund remains in Thailand for at least 1 year, the full amount of the reserve withheld shall be refunded.

Should the fund remains in Thailand less than 1 year, two thirds of the reserve withheld shall be refunded.

New Rules

Financial institutions shall purchase or exchange foreign currencies against Baht from their customers in full amount without withholding 30 percent of foreign currencies as reserves in all cases.

Request for refund of the reserves

1. Customers whose foreign currencies were withheld as reserves shall make a request for full refund to the Bank of Thailand through financial institutions without having to prove whether the funds have remained in Thailand for at least 1 year. The reserves will be unremunerated.
2. The Bank of Thailand shall remit the funds to such financial institutions on the seventh working day from the date the requests from the financial institutions have been received.
3. If the customers do not request for refund within 2 years from the date the reserves were withheld, the amount shall be considered forfeited. The forfeited funds would be earmarked for public benefits.

Request for unwinding of hedging transactions

- Customers who hedge their foreign exchange risks for exemption from URR and wish to unwind their hedging contracts shall submit a request to the Bank of Thailand through financial institutions on a case-by-case basis. Once received, the Bank of Thailand shall consider the request for approval within 15 working days.

Summary of Rules regarding Non-resident Baht Accounts

Previous rules

Divided into 4 types:

1. Special Non-resident Baht Account for Securities (SNS): For investment in equity instruments and derivatives transactions exempted from the reserve requirement which are stocks listed on the stock exchange, other equities, derivatives instruments traded on TFEX and AFET, and Exchange Traded Funds.
2. Special Non-resident Baht Account for Debt Securities and Unit Trusts (SND): For fully hedged investment in debt securities and unit trusts which are exempted from the URR
3. Special Non-resident Baht Account for Trade and Services (SNT): For trade and services.
4. Non-resident Baht Account (NRBA); For all purposes such as trade, services, direct investment, investment in immovable properties, and loans

Rules and Conditions

- Deposit into and withdrawal from SNS, SND, and SNT requires submission of related documents
- Deposit into NRBA requires submission of related documents.
- Withdrawal from NRBA does not require submission of related documents.
- Baht in SNS, SND, and SNT can be transferred only within the same type of accounts.
- Baht in NRBA can be transferred to another NRBA, SNS, and SND
- The outstanding balance of SNS, SND, and NRBA belonging to each non-resident shall not exceed Baht 300 million for each type of account and the outstanding balance of SNT shall not exceed Baht 100 million.

New rules

Accounts divided into 2 types:

1. Non-resident Baht Account for Securities (NRBS): For investment in securities and other financial instruments such as equity instruments, debt instruments, unit trusts, financial derivatives transactions traded on TFEX, AFET including sale proceeds, returns, and related payments from such investments.
2. Non-resident Baht Account (NRBA) - for general purposes: For general purposes except investment in securities and financial instruments such as trade, services, direct investments, investment in immovable properties, loans, and other transactions.

Rules and Conditions

Deposit into and withdrawal from NRBS and NRBA requires submission of related documents

Baht in NRBS, NRBA can be transferred only within the same type of accounts. Transfers between NRBS and NRBA are not allowed.

The outstanding balance of NRBS and NRBA shall not exceed Baht 300 million per person for each type of account.

Relaxation during 3-14 March 2551

Existing SNS and SND can be used as NRBS. The total outstanding balance of such accounts combined shall not exceed Baht 600 million.

Existing SNT can be used as NRBA. The total outstanding balance of such accounts combined shall not exceed Baht 400 million.

Financial institutions shall contact their customers to transform SNS, SND, or SNT or close such accounts. Should the holders of such accounts not request the financial institutions for such transformation after 14 March 2008, financial institutions shall transform SNS and SND into NRBS and transform SNT into NRBA.

Summary of Revisions to the Measures to Prevent Thai Baht speculation

1. Measures to Limit Thai Baht Liquidity

(1) Providing Thai Baht to non-residents (NRs) without underlying trade or investment in Thailand

- Previous Rules: The aggregate outstanding balance of all transactions undertaken by all financial institutions must not exceed THB50 mn per group of NRs
- New Rules: Total outstanding balance of all transactions undertaken by each financial institution must not exceed THB300 mn per group of NRs

(2) Purchasing foreign currencies against Thai Baht from non-residents for value same day or value tomorrow

- Previous Rules: Required prior permission from the BOT and only transactions with underlying trade or investment in Thailand were allowed.
- New Rules: Allows financial institutions to purchase foreign currencies against Thai Baht for value same day or value tomorrow without prior permission from the BOT. For transactions without underlying trade or investment in Thailand, the outstanding balance (inclusive of all transactions which result in providing Thai Baht liquidity to NRs without underlying) of each financial institution shall not exceed 300 million Baht per group of NRs.

2. Measures to Curb Capital inflows

Borrowing Thai Baht or undertaking transactions comparable to Thai Baht borrowing from NRs without underlying trade or investment in Thailand

- Previous Rules: For transactions with maturities not exceeding six months, the aggregate outstanding balance of all transactions undertaken by all financial institutions must not exceed THB 50 million per group of NRs.
- New Rules: Regardless of maturities, total outstanding balance undertaken by each financial institution must not exceed THB 10 million per group of NRs.

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