



## Thai Baht: The Case For Fixed Rate Management : April 29 2010

The 2008 Crisis has fundamentally changed global economic dynamics and the world has entered a new era. The post millennium credit boom that propelled Asia out of the 1997 crisis and the west out of its technology bubble burst is over. This current depression or recession, however you wish to designate it, is a new situation unlike anything we have experienced before which makes it difficult to make comparisons. Economies in south-east Asia that have so far been largely sheltered from the global crisis need to recognize that the world has seismically changed and that the formula that worked so well in the past decade will no longer work as well from 2009. Holding out for a western recovery will be a long wait and active short and medium term economic re-invention is essential to future national wealth.

The financial crisis has metamorphosed into a sovereign debt crisis and the world is now divided by balance sheet risk. On the one side we have economies like most of South East Asia with strong fundamentals, budget surpluses, high reserves and well structured finance sectors where confidence is higher. On the other side are the G20 countries with high balance sheet risk that will likely be in recession for a number of years. They now seem to be inexorably drifting towards the Japanese experience- many years of deleveraging private debt subsidized by quantitative easing. By the time private debt is normalized public debt has mushroomed to the extent that a resumption of real economic growth continues to be stifled until this is also deleveraged. The G20 balance sheets are now the sovereign equivalent of sub-prime. Leading the charge is Japan where public debt now exceeds a mind-boggling 200% of GDP with Europe and the USA hot on their heels. They all need to cut back spending, but this will result in lower tax receipts and an even bigger deficit. At a certain point the multiplier they seek becomes a divider and they may have little choice but to choose default on their debt rather than risk hyperinflation of their currencies.

South-east Asian economies need to wake up to this urgently and look at:

- Major government investment in new technologies and products.
- Aggressive and active development of new export markets.
- Change their approach to FX risk. Western currencies are at the beginning of a long term slide and for smaller export-based economies to continue following previous FX approaches is illogical and will become increasingly risky.

Strategic change is a hard thing, but maybe it is now time for South-east Asia to follow a new trade and economic role model- the Chinese rather than the USA model?

South-east Asian currencies are now strengthening artificially not in response to domestic growth but in response to western weakness. This development must almost certainly intensify, and if impetus is left to the market we will almost certainly see the Thai Baht drop below 30 to USD and even below 1990s levels. This would be catastrophic for exports and tourism. The most logical and simplest way of counteracting this is implementation of a managed peg similar to the Chinese model. This would immediately stimulate growth by increasing GDP, and would automatically build up reserves. The downside is inflation risk but this is the lesser of two evils particularly in a global recession.

A number of reasons have been mooted for not implementing a peg such as the need for reserves to defend the currency. 2010 is the opposite of 1997 though, and reserves are only needed to defend an overvalued currency. Given the perilous state of western markets the Thai Baht is now effectively undervalued by the markets. Hot money flows have also been flagged, but given the likelihood of western deflation, hot money flows into Thailand will be an issue whether the currency is pegged or not.

The Thai Baht could be fixed against a basket of currencies related to say: export destination markets; or foreign direct investment; or even commodity & energy prices. The great thing about a peg is an economy has freedom of choice as to how it engineers such a process, and given the perils currently prevalent in the global market, it is surely better to be an aggressor rather than a victim. The sooner a peg is placed, the sooner the benefits will flow and the lower the risk of future rebound volatility when and if the major western currencies reverse their current long-term decline.



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