

## CHAPTER V

### CONCLUSION AND SUGGESTIONS

#### 5.1 Conclusion

The purpose of this paper aims to study interactions of hot money or short-term capital flow in capital and financial accounts of the Bank of Thailand's balance of payments with key economic factors that consist of covered interest parity differentials, foreign exchange rate, relative returns on stock markets between Thailand (Set Index) and the United States (S&P 500) and forward exchange rate under tightened restrictions of capital control.

It was evidence that the massive tide wave of foreign capitals penetrated to Thai economy and many East Asian countries in 2001 and accelerated in 2006. Thailand was collapsed once from reversal of huge flow in July 1997 and it spent many years to rebuild stability for Thai economy. The recent instability might not be displayed like the past since the Bank of Thailand implemented many regulations to prevent Thai economy. The main concentration of this paper is to distinguish high volatility flows, hot money or short-term capital flow and interactions of the flow and key determinant factors.

We employ several empirical techniques to distinguish between cool and hot money. The implicit label of hot money or short-term capital flow by nature that has visited Thailand are the private capital flows in capital and financial account that consists of equity securities, debt securities and foreign currency and deposits in banking sector (included Nonresident Baht Accounts).

The empirical results from the Vector Autoregression estimations show that short-term capital flow or hot money does not have much effect to the key economic factors. The key economic factors (covered interest parity differentials, foreign exchange rate and relative returns) that we are interested in also do not attract short-term capital flow to Thailand. It may imply that the perfect market assumption does not hold in Thailand. It is also possible that there are many transactional costs or uncertainties make difficulties to arbitragers to gain profits from the parity deviation. Tightened measures and policies related with foreign exchange which have been implemented by the Bank of Thailand are not effective to protect Thai economy from massive short-term capital flows. However, we can not obtain the pleasure result as we expected from forward rate. The forward rate might not be the best indicator that can reflect movements of huge tide wave of foreign capital flows as most studies mention.

Insignificant results from empirical estimation leads to the question whether the purpose of regulating capital controls aim to shaping behaviors of hot money or short-term capital flows in order to prevent financial crisis like a decade before. The argument places that remunerated reserve requirement measure and other capital restriction measures were implemented by purpose of protecting Thai Baht appreciation. The evidence appears in figure 25 that restriction on capital flows become more tightened when THB/USD exchange rate is appreciated but the effect is not quite strong as we expect. The reason for explaining the weak effectiveness might be seen clearly from rapid relaxation on unremunerated reserve requirement within a day on December 19, 2006.

The significant effects that are not occurred with hot money become effect to cool money showed in this study that long-term capital mobility flow into Thai economy led appreciation of Thai Baht as well as capital control measures imposed by monetary authority becomes more tighten while massive long-term capital flow comes to Thailand.

## 5.2 Policy implication

Since massive foreign capital flows visited Thai economy and accelerated in 2006, the monetary authority overreacted to the situation by implementing the severe capital control measure, remunerated reserve requirement, to cope with appreciation in Baht. The outcome of the control became worsened until the authority had to relax the controls in some sector within a day with losing credibility to both foreign and domestic stakeholders. There are various compromised alternatives for fighting against economic instability instead of ruling the strong policy and receiving adverse outcome from rapid response of financial market.

Derivatives and financial instruments are the one of effective tools in the sophisticated world that can hedge against risks and uncertainties in financial market. The monetary authority should establish organization to monitor and foster private sectors to use financial instruments in order to prevent themselves from risks and uncertainties instead of taking action as a strict regulator (for instance, ruling unremunerated reserve requirement to slow down currency appreciation).

Since huge upsurge of capital inflow accelerated to Thailand, the Bank of Thailand reacted by implementing policies rely on blocking on capital inflows. It would be plausible that monetary authority is able to foster potential Thai investors to invest in other countries or monetary authority, including government, has to establish Sovereign Wealth Fund for investment abroad in order to reduce pressure on exchange rate and balance flows of capital.

On the other hand, the behavior of short-term capital flows tend to change over time combining with sophisticated financial engineering instruments so the explicit label can not represent the nature behavior of each flow, whenever the monetary authority attempt to regulate on a specific channel, the hot flows are willing to change to another accounts with ease. The important way is to reform the whole regulation instead of blocking each channel separately on the ad hoc basis.

### 5.3 Limitations and suggestions

The data we used in the model are not delicate enough as it would be, especially data published by the Bank of Thailand. The data was recorded in many patterns and difficult to combine or even cross-check between tables. The monthly data of capital flows are not available; the short-term capital flow data that used in the model was converted by Eviews software to be monthly data.

Most of index produced is yearly-based index. The monthly capital control index is a pilot study. This index needs to further development delicately in order to provide the desirable results to the next study.

The model that we use in this study considers only 6 variables with monthly data. However, in the integrated financial world, there are many complexities and rapid change. In order to capture volatility and mobility of short-term capital flows, we require more complex model for further study.