The Impact of Falling Tourism Industry Caused by Covid-19 on Thai Currency and the Thai Baht's Prospects

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Abstract. The purpose of this paper is to analyze the influence of the severe drop in the tourism industry caused by the pandemic in Thailand on the US dollar/Thai baht exchange rate over the last two years. In order to provide an explanation for the recent devaluation of the Thai baht, this article discusses the significance of tourism to the economy of Thailand, as well as the potential effects a drop in tourism could have on interest rates, inflation, and other aspects of the Thai economy. The article predicts that the Thai tourism industry will soon revive, given the Thai government's current tourism promotion measures and the successes already achieved by these programs. By investigating the impact of tourism fluctuations on the Thai baht's exchange rate, the report forecasts a gradual appreciation of the baht over the next few years.

Keywords: Thai Baht; Thailand; Tourism Industry; Thai Economy; Exchange Rate.

1. Introduction

Covid-19, which is still not eliminated, has spread over the globe in 2020, with global health hazards. Nearly all nations have imposed restrictions on population mobility, with stringent regulations on entry and exit, and global economic activity is disrupted heavily. In 2020, Thailand was one of Asia's economies most severely impacted by Covid-19. Before the pandemic, tourism was a significant contributor to Thailand's economy, accounting for close to 20% of the country's GDP. The policies of lockdown and quarantine implemented in a number of nations have contributed to a significant drop in tourism; as a result, the revenue generated by tourism in Thailand decreased by 74 percent in the year 2020 (Pattaya Mail, 2020). Figure 1 displays, for the years 2017 through 2020, the percentage contribution of tourism to Thailand's GDP. This figure reveals that the percentage contribution of tourism has significantly decreased in 2020, falling from around 18% to 5.65%. On the other hand, the exchange rate of the US dollar to the Thai baht is another aspect of the Thai economy that has undergone massive change since the outbreak. As can be seen in Figure 2, beginning in the middle of 2020, there is a discernible increase in the USD/THB exchange rate, and in 2022, it reaches the highest level in the last 5 years. This indicates that the Thai baht has drastically devalued during the past two years. Given the significant changes in these two components of Thailand's economy, there may be a connection between the two, with a substantial drop in tourism leading to a devaluation of the baht.

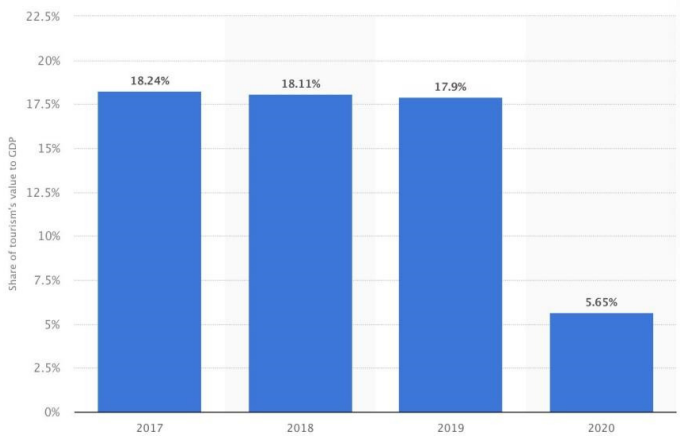


Figure 1. Share of tourism contribution to the Gross Domestic Product (GDP) value in Thailand from 2017 to 2020 (Source: Statista, 2022)



Figure 2. US Dollar Thai Baht (Source: Trading Economics, 2022)

Tourism has continued to grow and diversify over the past few decades to become one of the greatest economic sectors in the world. Given the fast expansion of international tourism, tourist arrivals are an essential concern for national policymakers, since they represent a substantial influx of financial resources, particularly to developing nations. What everyone acknowledges is that the expansion of tourism has the potential to significantly reduce the current account deficit, which would therefore improve the balance of payments and boost GDP growth while also increasing the possibility of currency appreciation (Obstfeld and Rogoff, 1996). Kuncoro (2016) modeled the relationship between tourism and the exchange rate utilizing Indonesian data, and the results demonstrated that tourism had a substantial capacity to absorb foreign sources of capital. In order to maintain enough foreign reserves and a stable exchange rate, enhancing the competitiveness of the tourism sector should be a key component of the program to stabilize the exchange rate. However, since covid-19 has spread over the world in recent years, the Thai tourism economy has taken significant damage. Therefore, my data will be more obvious than Kuncoro's.

2. Analysis

2.1 Foreign Direct Investment

Foreign direct investment is an important element of Thailand’s economic development, and the country is one of the major FDI destinations in Southeast Asia. However, the recession caused by Covid-19 in Thailand has weakened the country's attractiveness to investors. As Figure 3 shows, the FDI flow of Thailand has fallen to USD -5 billion in 2020, down from USD 5 billion in 2019. Thailand's tourism industry is one of the country's most important economic drivers, and tourism investment also makes up a significant share of the country's inflow of foreign direct investment. This encompasses various sub-industries within the tourism sector, such as the hospitality industry, the entertainment sector, and the catering industry. However, due to the various restrictions on entry and exit from countries under the epidemic, people no longer have confidence in Thailand's tourism industry, which has led investors to stay away from investing in these tourism industries in Thailand. Moreover, as a result of the COVID-19 epidemic and the ensuing supply interruptions, demand shrinkage and unpredictability have emerged, the entire economy is in recession, making Thailand less attractive. As a result of this significant drop in foreign direct investment, there will be less of a demand for the Thai baht, and less supply of foreign currency which will result in the currency's depreciation. A reduction in foreign direct investment also results in a reduction of capital accumulation in Thailand, which has an effect on the level of output in the country, alters the prices

of traded and non-traded goods, has an effect on the terms of trade for the country, and therefore has an effect on the level of the exchange rate.

However, the Thai government has recognized the economic recession brought on by the fall in foreign direct investment. The Board of Investment of Thailand (BOI) provides tax and non-tax incentives for eligible Thai investment projects to both Thai and foreign investors, such as the income tax exemption, the land ownership for foreign companies, and Visa and work permit privileges for expatriates (LLOYDS BANK, 2022). These policies have worked, as inward investment in Thailand has picked up in 2022 and is still generally on an upward trend going forward. And with the advancement of medicine, Thailand will continue to be an attractive investment destination after the pandemic is eradicated over the next several years, which could allow the Thai baht to continue appreciating.

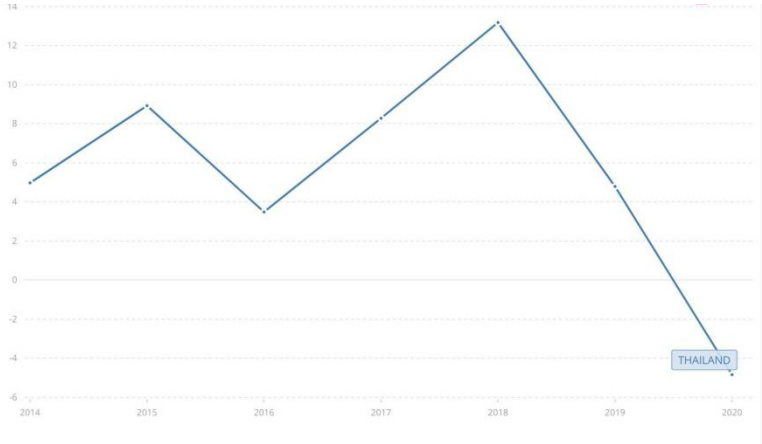


Figure 3. Thailand FDI Flow from 2014 to 2020 (Source: The World Bank, 2020)

2.2 Interest Rate

The Central Bank of Thailand responded to the effects that the pandemic had on the economy by reducing interest rates three times during the first half of 2020. Since then, the Bank of Thailand has maintained the interest rates at a historic low of 0.5 percent until August 2022. By reducing interest rates, consumers are no longer eager to save money in the bank, but are instead increasing their consumption of funds previously invested, while the cost of loans has decreased and more people are willing to borrow money to invest. This increases the liquidity of assets on the stock market, and the increase in consumption boosts domestic demand, which can withstand the epidemic-caused slump and hasten the economic recovery of Thailand. Nevertheless, low interest rates can cause currency depreciation while fostering economic recovery. When the interest rate on a currency declines, the interest returns on that money declines, the currency becomes less appealing, demand decreases, and the currency loses value. If interest rates are lower than in other nations, there will be a significant outflow of capital, a decline in foreign capital inflows, and a worsening of the capital account balance, while the foreign exchange market will sell off this currency, resulting in its devaluation. The US Fed's interest rate hike beginning in 2022, which is currently 2.5%, made the interest rate spread between two countries large. According to the interest rate parity, such differences may lead to changes in exchange rates to avoid arbitrage.

Low interest rates have caused significant inflation in Thailand, and it is crucial to combat inflation because it could force more Thais into poverty, especially as the Russia-Ukraine crisis puts pressure on food and energy prices. And with the epidemic gradually under control and the relaxation of tourism policies in many countries, Thailand's tourism industry has improved and the economy is gradually recovering. According to a report by the World Bank, Thailand's economy is recovering faster than anticipated, spurred by a return to tourism growth, allowing the nation's central bank more ability to hike interest rates to fight inflation. Kiatipong Ariyapruchya, a senior economist at the World Bank, stated at a briefing in Bangkok that normalization of interest rates in Thailand might begin soon, and policy rates could be raised gradually as the economy recovers (Yuvejwattana, 2022).

As Figure 4 displays, Thailand's central bank raised its key interest rate by 25 basis points for the first time in nearly four years on August 10, 2022.

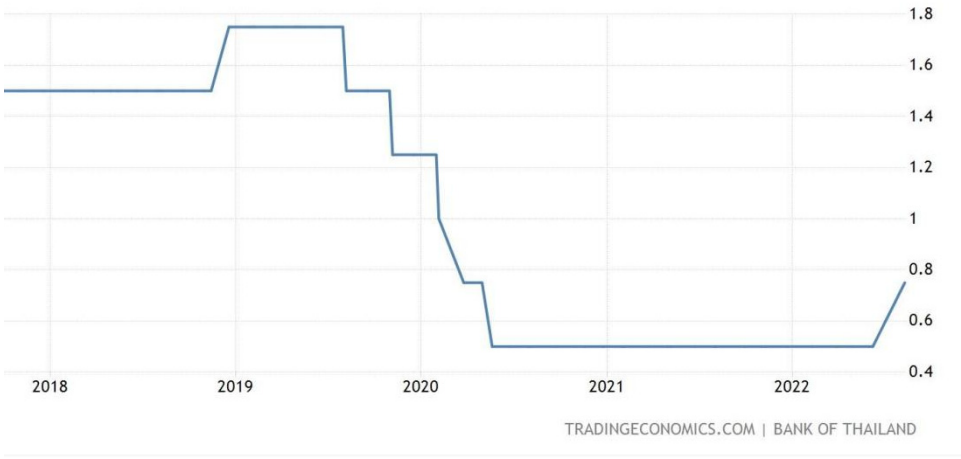


Figure 4. Thailand Interest Rate (Source: Trading Economics, 2022)

2.3 Inflation

Inflation in Thailand has been accelerating for the past two years, reaching a 14-year high in June 2022 (Yuvejwattana and Nguyen, 2022). The high inflation rate is partially attributed to the previously mentioned low interest rates, as low interest rates encourage people to spend more, which increases demand for goods. However, the lack of human and material resources during the epidemic restricts production from increasing, resulting in higher prices of goods and inflation. On the other hand, since agriculture and tourism are Thailand's predominant industries, a substantial number of essential goods should always be imported. Due to the inconvenience of trade during the epidemic and the disruption of international exchanges, the import of many essential goods has been restricted, and Thailand's domestic production is unable to keep up with demand, resulting in a shortage of supplies and price increases, which cause inflation. High inflation has reduced the purchasing power of the Thai baht relative to other currencies, thus the USD/THB exchange rate increased.

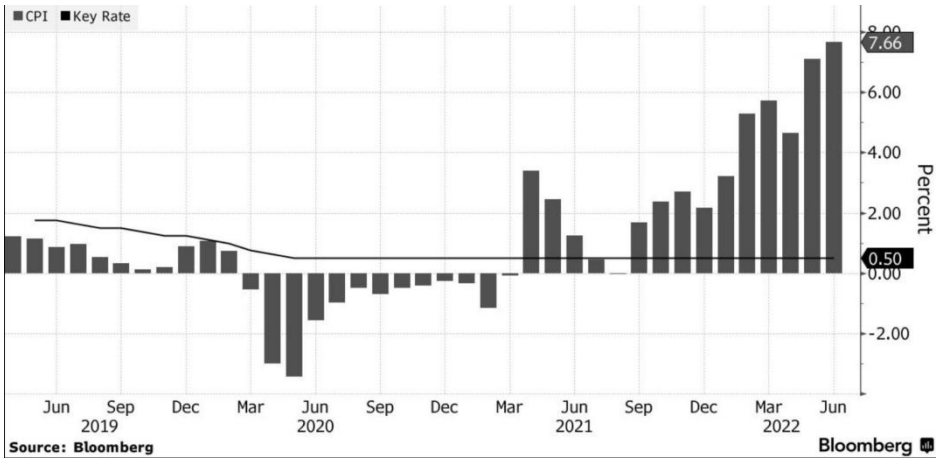


Figure 5. High Inflation Boosts Case for Thailand to Raise Interest Rates (Source: Bloomberg, 2022)

The Bank of Thailand is shifting its focus by tightening monetary policy to prevent hyperinflation that could drag down economic growth. In spite of surging fuel prices and a shaky economic recovery, Thailand will attempt to maintain inflation below 5 percent this year, according to Prayuth Chan-ocha, the prime minister of Thailand (Sriring and Stapporncharnchai, 2022).

2.4 Current Account

Thailand is facing a rare back-to-back current account deficit as the prognosis for tourist arrivals fades and a rise in energy import bills resulting from surging oil prices (Yuvejwattana, 2022). A significant portion of Thailand's exports consist of agricultural items, such as fruits, rice, and raw material rubbers. Due to the closure of countries caused by the pandemic, exports have declined and the price of imported goods such as oil has risen, leading Thailand's current account deficit to worsen. The current account deficit leads to the less demand of Thai currency and depreciation of Thai Baht. The bank of Thailand observes that Thailand's economy is on the revival following the COVID outbreak. However, private spending, especially tourism, which contributes significantly to the country's gross domestic product, remains sluggish, requiring the government to rely heavily on exports.

The Thai Ministry of Commerce reports that the country's exports climbed by 12.7% year-on-year in the first six months of 2022, already surpassing the ministry's objective of 4% export growth for this year. And as the epidemic continued to improve, Thailand's workforce regained. Due to the country's cheap labor and unique natural conditions, coupled with the relaxation of various countries' epidemic prevention policies and the continued opening of the country's borders, Thailand's current account will gradually improve, which means that the USD/THB exchange rate may decrease in the future.

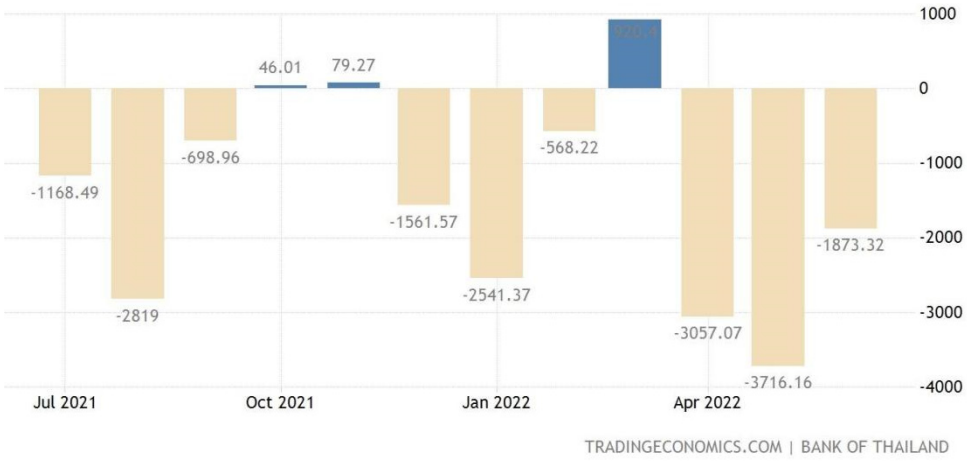


Figure 6. Current Account of Thailand (Source: Trading Economics, 2022)

2.5 Government's Measures on Increasing Thailand's Tourism Industry

In 2019, Thailand ranked seventh in the world for international arrivals, with a record-breaking 40 million visitors, and the top three expenditure categories for inbound visitors were accommodation (28%), shopping (24%), and food and beverages (21%). In addition, between 2014 and 2019, Thailand's tourism industry created 36 million employments. Tourism is undoubtedly Thailand's leading sector. Unfortunately, the epidemic and related limitations have had an especially negative impact on tourism, as foreign travel has dramatically declined. In September 2021, the number of passengers on foreign flights to Thailand decreased by 95% compared to the previous year. In turn, only 9% of hotel rooms were occupied (Saxon, Sodprasert and Sucharitakul, 2021). The reduction in tourism spending has had a significant impact on the hotel industry, the restaurant industry, and other tourism-related industries, which comprises 1.2 million small and medium-sized businesses, and has also increased unemployment. Likewise, the aforementioned elements are likely to be impacted by the reduction in tourism, as the Thai economy is highly reliant on foreign tourist revenue. A decline in tourism will reduce the country's attractiveness to investors, as tourism investment accounts for a large portion of the investment industry, while the government has chosen to cut interest rates to promote economic recovery in response to the decline in tourism, resulting in an increase in interest rate spreads and an increase in the inflation rate, all of which will result in a depreciation of the currency.

In fact, the Thai government has recognized the enormous economic damage caused by the lack of tourists and begun promoting tourism. The Thai government has introduced a number of policies to promote tourism in the wake of the outbreak, such as "Rao Tiew Duay Kan" (We Travel Together) program. Currently, the Thai government has invested 9.3 billion baht in this project to provide tourists with a 40% discount on hotel price per room per night, as well as 600 baht per day in food discounts and entrance fees to tourist attractions (Techakitteranun, 2022). The Prime Minister has announced that the end of the epidemic would occur on October 1, 2022, and that the Thai Epidemic Control Center will be dissolved. This year, Thanakorn Wangboonkongchana, a government spokesman, quoted a Ministry of Tourism prediction that overseas arrivals will surpass 9.3 million. This is 55 percent higher than the Bank of Thailand's earlier this month estimate of 6 million and the National Economic and Social Development Board's expectation of 7 million. The second half of the year is anticipated to see a tripling of arrivals to 7.2 million from an estimated 2.1 million in the first half, pushing the baht up as much as 0.6% (Figure 8) against the dollar (Nguyen, 2022). Large numbers of tourists are returning to Thailand as global travel demand recovers; therefore, the Thai baht will appreciate further in the future.

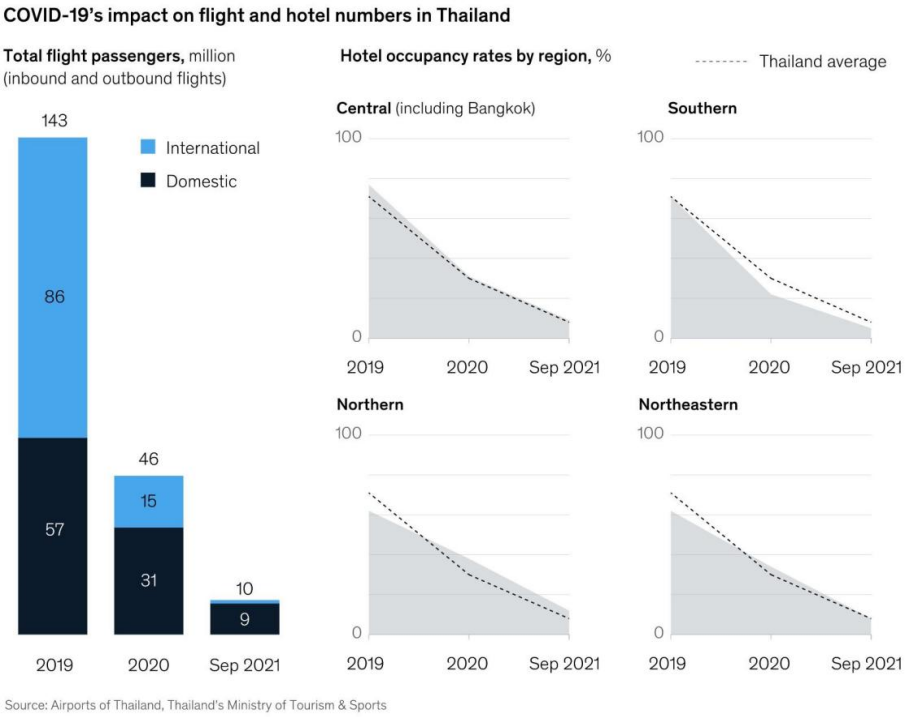


Figure 7. Covid-19's Impact on Flight and Hotel Numbers in Thailand (Source: McKinsey)



Figure 8. Thai Baht is Poised for Fourth Day of Gains as Tourism Outlook Improves (Source: Bloomberg)

3. Conclusion

According to the analysis of the data, the reduction in tourism, which is Thailand's primary industry, as a result of the epidemic may have an effect on foreign direct investment, interest rates, inflation rates, and even the current account, all of which may have an effect on the exchange rate. Therefore, the recent depreciation of the baht is largely related to the decrease in tourism that has occurred in Thailand. However, in order to combat the impacts of the recession, the government of Thailand has implemented a number of policies, which have already had a considerable impact and will continue to do so in the future. Accordingly, in the immediate future, the value of Thai baht will gradually increase, and it will gradually revert to the level it was at before the outbreak.

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