

ABSTRACT

This study investigates the effects of exchange rate changes on investment of manufacturing firms in Thailand during the period between 2001 and 2005. We distinguish exchange rate impacts on investment into three channels: the effect of exchange rates pass through domestic prices, the effect passed through exports channel, and the impacts through input imports. The empirical estimation is performed using firm-level data from the industrial survey conducted by Office of Industrial Economics. The result shows that, on one hand, exchange rate depreciation tends to reduce investment due to the exchange rates pass through high inflation and then lower domestic demand. On the other hand, exchange rate depreciation tends to increase expected profits and then investment of firms heavily reliance on export sales. Interestingly, we found that investment tends to increase through import cost when baht depreciation. The result from import channel seems to show the typical characteristics of Thailand's manufacturing sector that production for exports relies heavily on imported inputs. However, we found that, at the aggregate level, the effect of exchange rates on domestic demand dominates the international trade effects. Then, overall exchange rate depreciation generally discourages investment of our sample firms. In addition, the size of the effect of exchange rates on firms' investment is decreasing with the degree of price-cost markups. Investment in firms with high markup experiences lower sensitiveness to exchange rate changes than in low markup firms since high markup firms have more ability to absorb the effect of exchange rates in their markups, hence pass little effect on investment.

Changes in exchange rate have an impact on investment in any channels of exposure in 6 industries that have low markup, namely, food and beverage industry; textile and apparel industry; wood and furniture industry; paper and publishing industry; chemical, rubber and plastic industry; and machinery and equipment industry. In contrast, exchange rates have an insignificant impact on investment at the three industries that have high markup, i.e. non-metallic and mineral industry; metal and fabricated metal industry; and vehicle and transportation equipment industry. The feature of high price-cost markup in these industries may

absolutely dilute the effect of exchange rates on investment so that the investment is not sensitive to exchange rates.

On average, the exchange rate impacts on investment of manufacturing firms in Thailand are small in magnitude. Comparing across firm size and nationality shows that investment of small firms, are more affected by exchange rates than large firms, and investment of Thai firms are more vulnerable to the external exposure than foreign-owned firms.

The results of this study imply that exchange rate policy towards investment should be neutral, because both favorable and unfavorable conditions to investment are it concurrently created by an exchange rate policy. Assistance to small and Thai firms might be necessary due to their vulnerability to exchange rate changes.