WHAT CURRENCY SHOULD YOU HOLD?

When I moved to Thailand in 1996, the Thai Baht was more or less fixed to the US Dollar and THB25.00 : USD1.00 and very stable to the British Pound at THB40.00 : GBP1.00 . Then came the financial crisis in 1997 and by the end of January 1998 the Baht had spiraled down to THB53.50 : USD1.00 and GBP88.50 : THB1.00. I remember buying my first car in Thailand by transferring GBP savings with the deposit paid in December 1997 and the balance paid in January 1998, which resulted in over 50% savings in my GBP outlay in just over six months! If I had used my THB savings there would have been no currency effect, but clearly in this case it made sense to cash in some Pounds.

This was an extreme circumstance but it does illustrate the point that expatriates in particular have to be mindful of the currency of their invested assets and where they will be realized.

The Thai Baht has recovered significantly since then as the Thai economy has made significant strides forward that reflect the currency value today. However, it is still at a 25% lower exchange rate to both the US Dollar and British Pound than before the 1997 financial crisis. This means that had I put my Thai Baht in a drawer in May 1997 and then converted it to US Dollars today, not only would the value have been eroded significantly by inflation, I would still only get 75% of the convertible value when I had put in the drawer. Such are the consequences of time and the effect of inflation on different currencies.

Currencies are always on the move

People can be too easily be influenced by interest rates and do not pay enough attention to the possibility of currency movements. Only a few years back, when USD borrowing rates were around 5%, many expatriates were tempted to take out a mortgage in Japanese Yen at barely 2% even though the property was valued in GBP or USD and most were being paid in USD. A very attractive money-saving loan on first appearances. Unfortunately the Yen appreciated by more than 30% over a short period of time so that borrowers found their mortgage payments rising by that amount in the currency they earned. If they were paying $1,000 a month to repay the loan at the start, this now became $1,300 a month. So in USD terms they were now paying 32% interest instead of 2%. Such are the dangers of currency speculation.

Institutions will often do the same in what is known as the ‘carry trade.’ This is a way of making money by borrowing in a low interest currency and investing in a high interest currency. The key to making a profit lies in converting back to the original currency before the second currency falls. It is a dangerous game for small investors who do not have their eye on the ball 24 hours a day and who cannot act swiftly.

When the Euro was created on January 1st, 1999 it was the equivalent of USD1.17. Since then it has fluctuated between USD0.85 and USD1.58, providing opportunities to speculators for significant gains – or losses – over the course of just under 15 years. At the time of writing the Euro stands at USD1.35. Who knows where it will be this time next year or for that matter where will any of the world’s currencies be in relation to each other.

So in what currency should we keep our money?

The answer to this question depends on many factors, including one's own personal situation. As a general rule we should hold the bulk of our money in the currency in which we expect to spend it. There are exceptions of course. If you have a large amount of cash in the currency of a developing country you are likely to see it devalue faster than major currencies. But even then it may be unwise to speculate in the short term. Let's say you are running a business in Bangkok and employ a large number of local staff. Your commitments are in Baht and are known. Should you keep all your cash in USD, you could be caught by a rise in the Baht as we saw for quite a long period before it started to pare back earlier this year. But even with the fall, your wage bill in Baht would be the same. For the longer term however, you would be wise to keep your reserves in a stronger currency because inflation and Government policies are likely to push Baht prices and wages higher.

Should you hold cash in more than one currency?

Nothing wrong in having a healthy local bank account in Baht to meet all your short term needs, but long term savings would be best offshore in a strong currency. I say offshore because there is always a risk when a country is in financial distress that your US Dollars could be seized and converted into local devalued currency. I would emphasize it is unlikely, but it has happened elsewhere in countries such as Argentina. Countries can also impose strict exchange controls at any time. The Bank of Thailand still administers exchange controls based on legislation that dates back to 1942, but policy has been loosened quite significantly with improvements in the economy since the 1997. Even the UK had exchange controls up to the early 1970's.

But what other currencies should you hold?

For an expatriate living in Thailand the question would be what is your 'base' currency? If you plan to return to the UK it would be British Pounds. If you plan to return to continental Europe it would be Euro. If you do not plan to return to your home country it could be a mix of hard currencies but the US Dollar would be the favorite as globally it is still the predominant currency.

If you are paid in USD but want to save in say, Euro, what should be the currency of your savings plan? If you have a regular savings plan it should be USD since if there is a major fluctuation in the two currencies you could find the savings burden becomes too great. But you can still save indirectly in Euro by buying Euro-denominated assets, such as stock and bond funds, with your Dollars.

Which brings me to another point; you can protect your currency by investing in real assets in that currency. An example is buying land or property in Thailand. The Baht may fall, but real assets will hold their value. Even investing in the stock market with all its volatility is more likely to protect you than holding cash. After all, companies can raise their prices and continue to make profits even if a currency is falling.

There may be situations where you are buying a property in one country and perhaps plan to send children to college/university in another. This would be justification to build up assets in the currency of those countries.

What about gold?

Gold was actually one of the world's first currencies. Even today gold coins are legal tender but their market value is invariably higher than their face value. Gold is questionable as an investment; it pays neither interest nor dividends. It does have some limited industrial applications but its main function is to act as a store of value. It is unique in that it is virtually indestructible and its supply is limited, unlike paper money, which governments can print to their hearts' content. For this reason alone investors should consider holding up to 5% of their portfolios in some form of gold, whether physical or within a bullion fund or even via gold mining shares or funds. It is a useful hedge or insurance against economic or political turmoil or depreciating currencies.

So what is the best strategy to follow?

As always, it depends on individual circumstances but some of the basic principles are:

- Maintain ample cash resources in the currency you use from day to day.
- If the currency is a 'weak' one but you need to remain in the currency move surplus cash into 'real' assets such as land or property and even company stocks which are more likely to hold their real value.
- Build up longer term cash and assets in the currency you are likely to spend, for example in retirement.
- Build up savings in currencies you may need for special purposes such as children's education.
- Be aware of the risks of speculating in currencies, such as taking a low interest loan in a currency that could rapidly appreciate. Conversely be wary of investing in currencies that offer high rates of interest.

While essential for the short term, at the end of the day, neither cash nor currencies are good long term investment vehicles. For your long term needs they should be invested in a diverse basket of assets.

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