CHAPTER 1

INTRODUCTION

1.1) Statement of Problem and Its Significance

Over the past decade, the Stock Exchange of Thailand (SET) has developed from a mini-market into one of the world's major emerging markets. Figure 1 shows the market capitalization growing from $1 billion to $36 billion, annual trading volume from $100 million to $30 billion, and the number of listed companies more than tripling from 80 to 276 between December 1981 to December 1991.[1] Figure 3 shows the stock market index which soared upwards from 600 after the 1991 coup to a peak of 1,750 in January 1994. Stock prices lost any contact with the reality of the company profits. Figure 4 shows the average price-earning ratio that rose from sixteen in 1992 to twenty-six in 1993. For the blue chips, the ratio was above thirty.

Fueling the rapid market growth were strong economic and industrial growth, sound and stable economic policies, high savings and investment rates, growing local wealth, attractive stock market returns, a generally stable political climate, and a heavy influx of foreign portfolio investment including a number of country funds.

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[1] Antoine W. van Agtmael, Emerging Markets Management : Thailand from Mini-Market to Leading Emerging Market (Washington, D.C.), pp. 121-141.

From here, the index fell down unevenly. The foreign funds withdrew from firms that made or sold things, firms in the "real economy". Future earning were predictable and would never justify the puffed P/E ratios. Instead, the investors put some anchor money into a few "safe" stocks, including the big banks and famous companies. Moreover, the ambitious money were put into the speculative side of the market - into property, finance, telecoms – where booms might deliver a windfall capital gain. By 1996, only eight stocks accounted for a third of market capitalization. Some 57 percent of all transactions were in banks and finance and another 22 percent in property and telecoms.[2]

Some twenty to thirty stocks attracted all the market activity. From the early 1994, most of the other 380 went into slow decline, first miring the retail investors in 140 billion baht of margin loans, and then driving many of them out of the market. In November 1995, a hysterical retail investor shot and wounded himself in the stock exchange building. Government threw thirty billion baht into a support package, which did little to deflect the trend.

Finance firms outside Thailand began to warn clients that the market was overloaded. However, the investors were committed and wanted growth and good news about long-term prospects and the market downtrend was expected to be reversible. Eventhough investors realized that prices exceed fundamental values, but they still

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[2] Pasuk Phongpaichit and Chris Baker, Thailand's Boom and Bust : Bubbling Over (Chiang Mai Silkworm Books, 1998), pp. 98-103.

believed there was a good probability that the bubble will continue to grow and yield a high return, therefore they stayed in the market despite the overvaluation. Additionally, in early 1996, foreign firms were still the most active on the Thai stock market.

The break came in mid-1996. The revelation of the Bangkok Bank of Commerce scandal was the psychological turning point. Foreign investors began to sell their holdings of Thai stocks, unloading fifty billion bahts between June and year-end. The stocks, which the foreign investors had favored now, plummeted. Over the second half of the year, the market lost a third of its total value. Foreign sources began to pull back their loans to local banks and finance companies. From June 1996 onwards, short-term funds slipped away. After 2 July 1997, the index fell sharply down to 372.69 points at the end of 1997. Moreover, the SET index hit the lowest point at 257.44 on 16 June 1998. Investors who invest in the SET faced a substantial loss.

The overseas analysts used to write about Thailand with phrases "the decade of easy money", the "asset bubble" and the "manic honeymoon". The sequence of increases in stock prices followed by a dramatic price drop has sparked interest in bubble, particularly, whether bubbles were present in Stock Exchange of Thailand. This situation of a stock market crash leads to the study of this thesis.

1.2) Objectives

The purpose of this study is to test whether bubbles were present in the Stock Exchange of Thailand by investigating an evidence of the bubble in the stock market.

1.3) Scope of Study

The main study focuses on **abnormal continuously compounded real monthly returns** for value-weighted portfolios of all stocks in the Stock Exchange of Thailand (SET) from April 1985 to February 2000 excluding the stock market crash period during July 1997 to December 1998.

1.4) Organization of the Study

The organization of this thesis is as follows: Chapter one proposes statement of the problem and its significance, the objectives, the scope of the study and the organization of the study. Chapter two presents the theoretical background. Chapter three reviews the literature related to this study. Chapter four explains the research methodology being used in this thesis. The empirical results are presented in chapter five. And chapter six concludes the study.

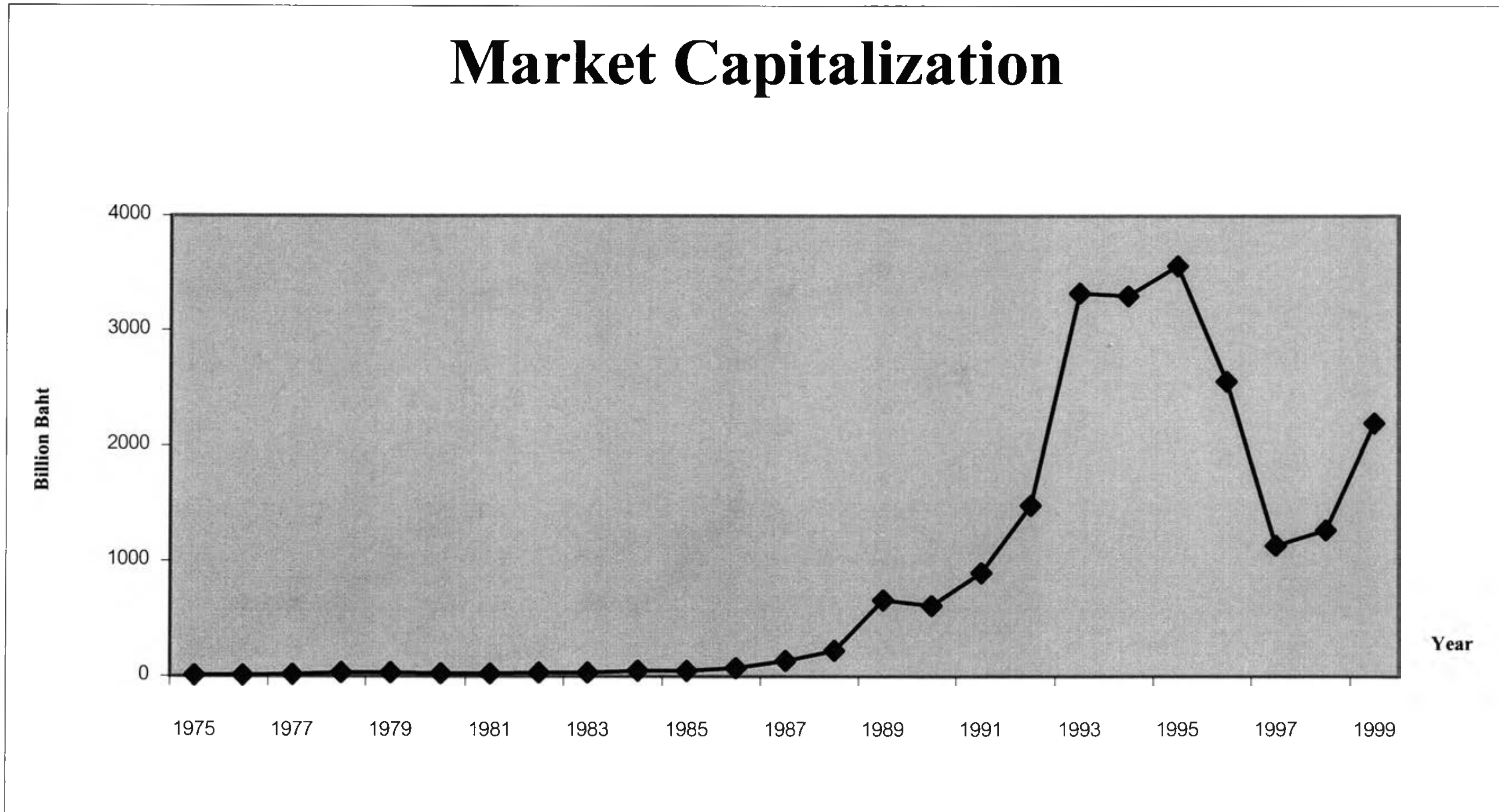

Figure 1 : Market Capitalization in the year 1975-1999

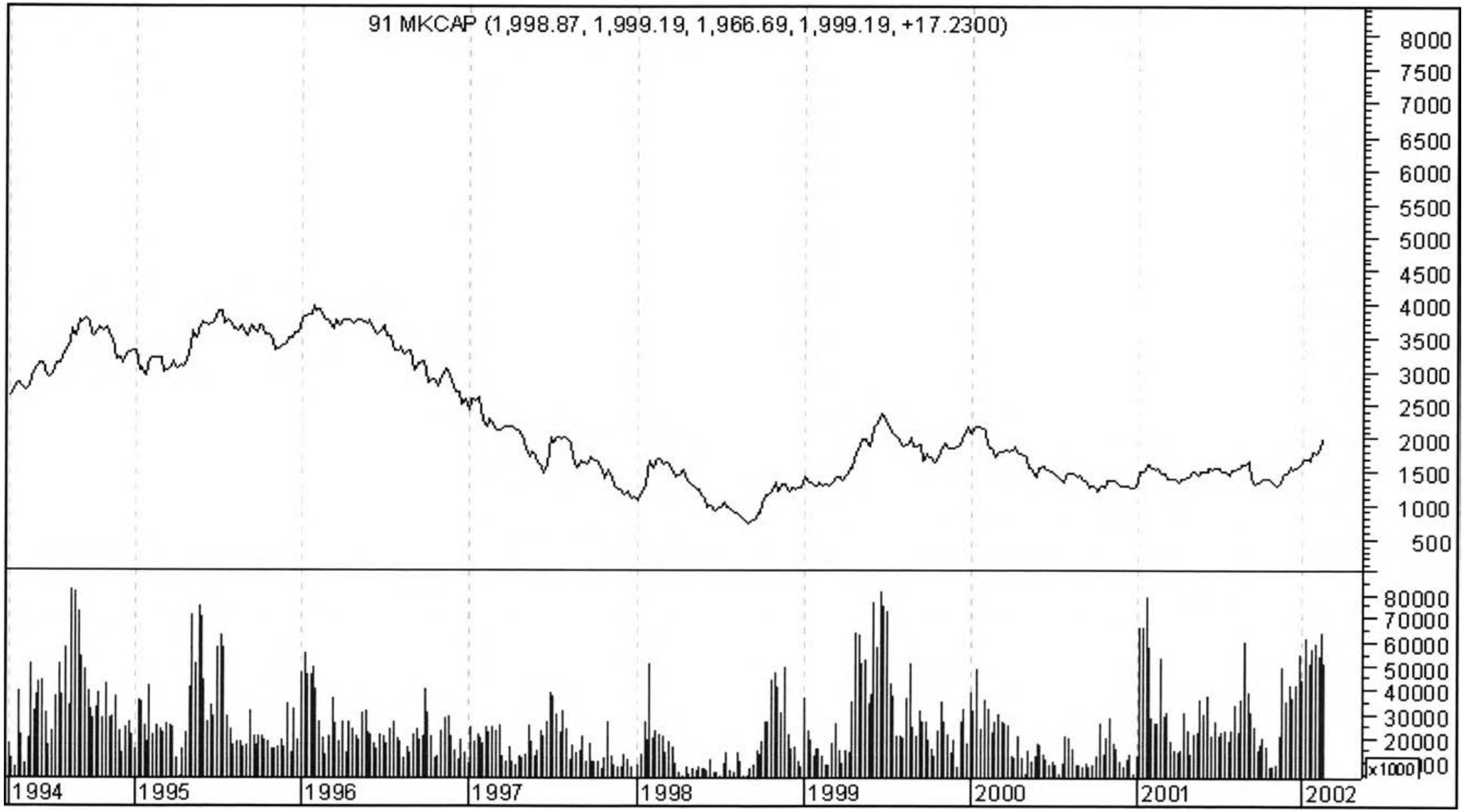

Figure 2 : Market Capitalization in the year 1994-2002

Figure 3 : SET Index in the year 1975-2002

Figure 4 : Price per Earning Ratio in the year 1989-2002

Figure 5 : Dividend Yield in the year 1989-2002