

Unification of the Segmented Foreign Exchange Market in Myanmar

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Research Questions

- Does the move to a managed float exchange rate system in April 2012 signify the unification of the foreign exchange market?
- What are remaining challenges to establish the ground for exchange rate policies?
 - 1. Transmission channel**
 2. Market instruments

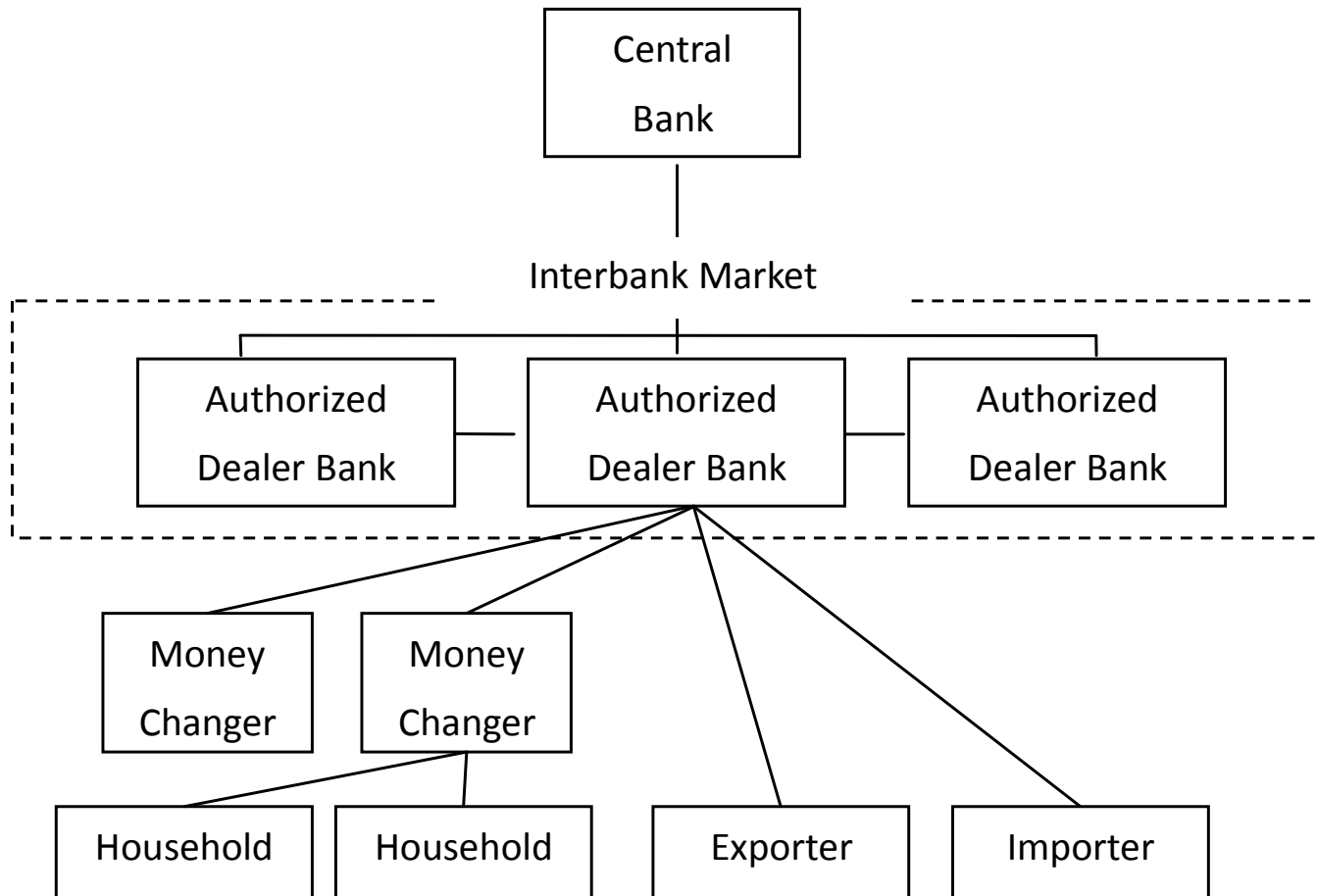
Outline of Presentation

1. Unified foreign exchange market and segmentation: Benchmark case
2. Market structure before the reform
3. Reform and remaining challenges
4. Policy recommendations

Section 1

UNIFIED FOREIGN EXCHANGE MARKET AND SEGMENTATION

1. Hypothetical benchmark: banks are in the middle. (1/2)



1. 1. Hypothetical benchmark: banks are in the middle. (2/2)

- Foreign exchange dealer banks as main counterparties
- **Transmission channel** of exchange rate policies

2. Causes of segmentation

1. Price (exchange rate) controls

- Pegged rate and parallel rate

2. Regulations

- Regulations on the **uses** and **sources** of foreign exchange
 - Ban on portfolio investment
 - ‘export-first, import-second’ policy (export earnings and US dollar cash)

3. Why is segmentation a problem?

- Implicit tax on exporters and implicit subsidies on importers
- Price distortion and inefficient resource allocation
- Block **transmission channel**: Financial authorities cannot control all segments.

Section 2

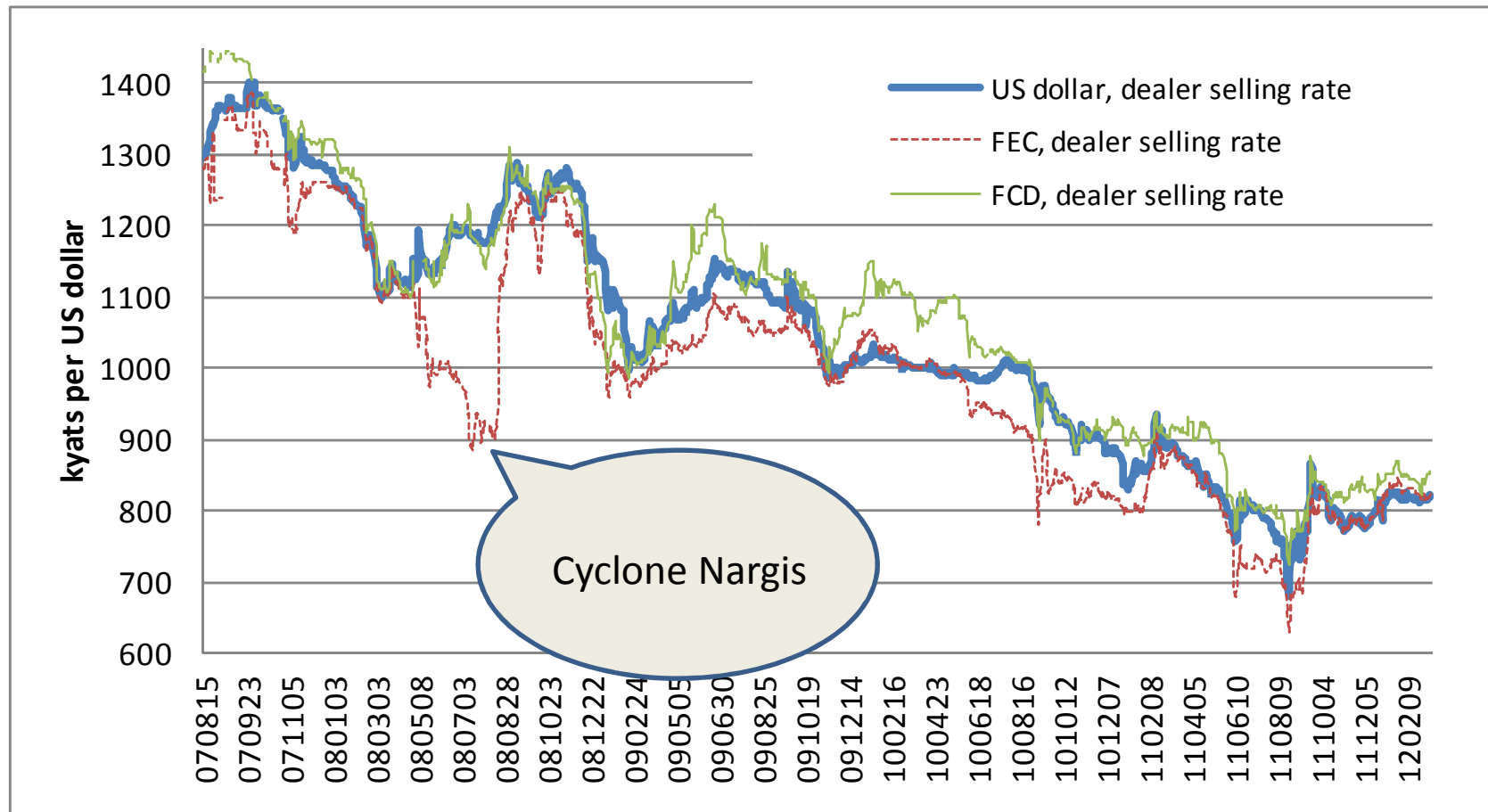
MARKET STRUCTURE BEFORE THE REFORM

Two segmentations in Myanmar

1. Between public and private sectors
 - Official exchange rate in the public sector
 - Parallel exchange rates in the private sector

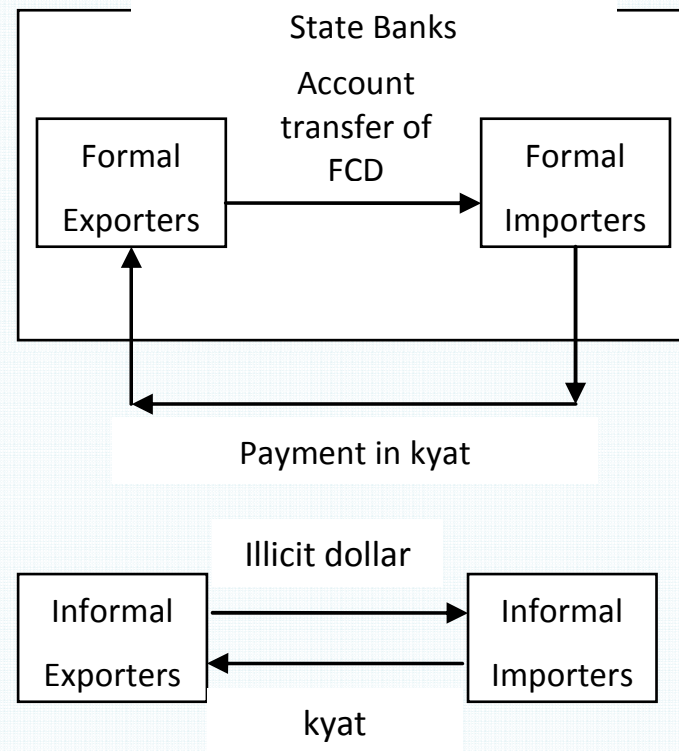
2. Within private sector
 - Conditionality of **import licensing**
 - Export earnings (Foreign Currency Deposits)
 - Dollar cash
 - Foreign exchange certificate (FEC)

The gaps among export earnings, US dollar cash, and FEC



Source: Japan External Trade Organization, Yangon Office

Transactions took place outside the banking system.



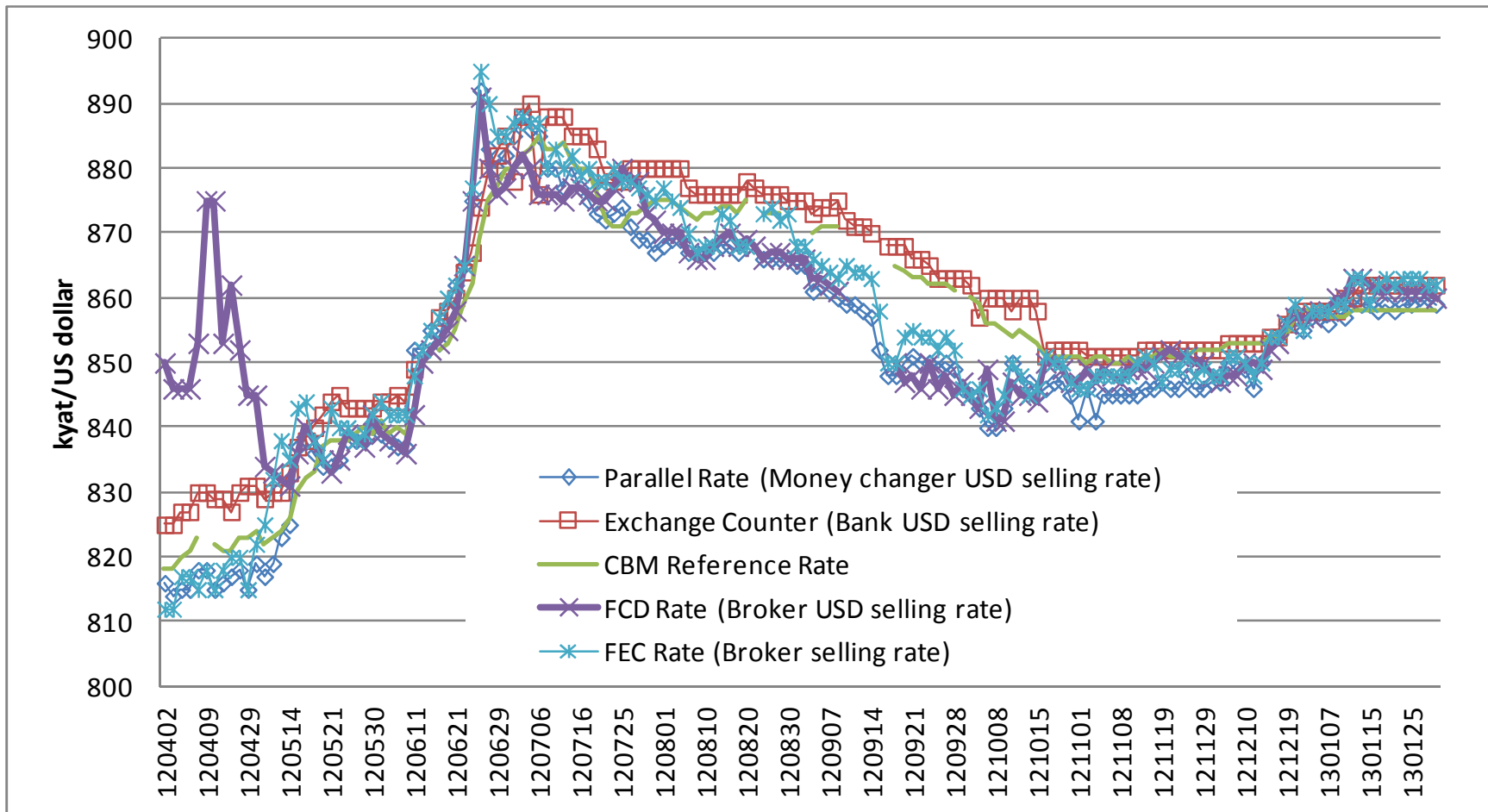
Section 3

REFORM AND REMAINING CHALLENGES

1. Reforms under the new government

- **October 2011:** opening of money change counter
- **November 2011:** foreign exchange dealer license to 11 banks (later 14 banks)
- **April 2012:** move to a managed float system
 - Daily announcement of Central Bank reference rate
 - Auction of foreign currency with AD banks
- **April 2012:** **abolition of 'export first' policy**
- **August 2012:** permission of int'l banking services at private AD banks
- **December 2012:** money changer license to non-banks

Mark-up of export earnings disappeared in May 2012, but there were some gaps among rates.



Source: Japan External Trade Organization, Yangon Office

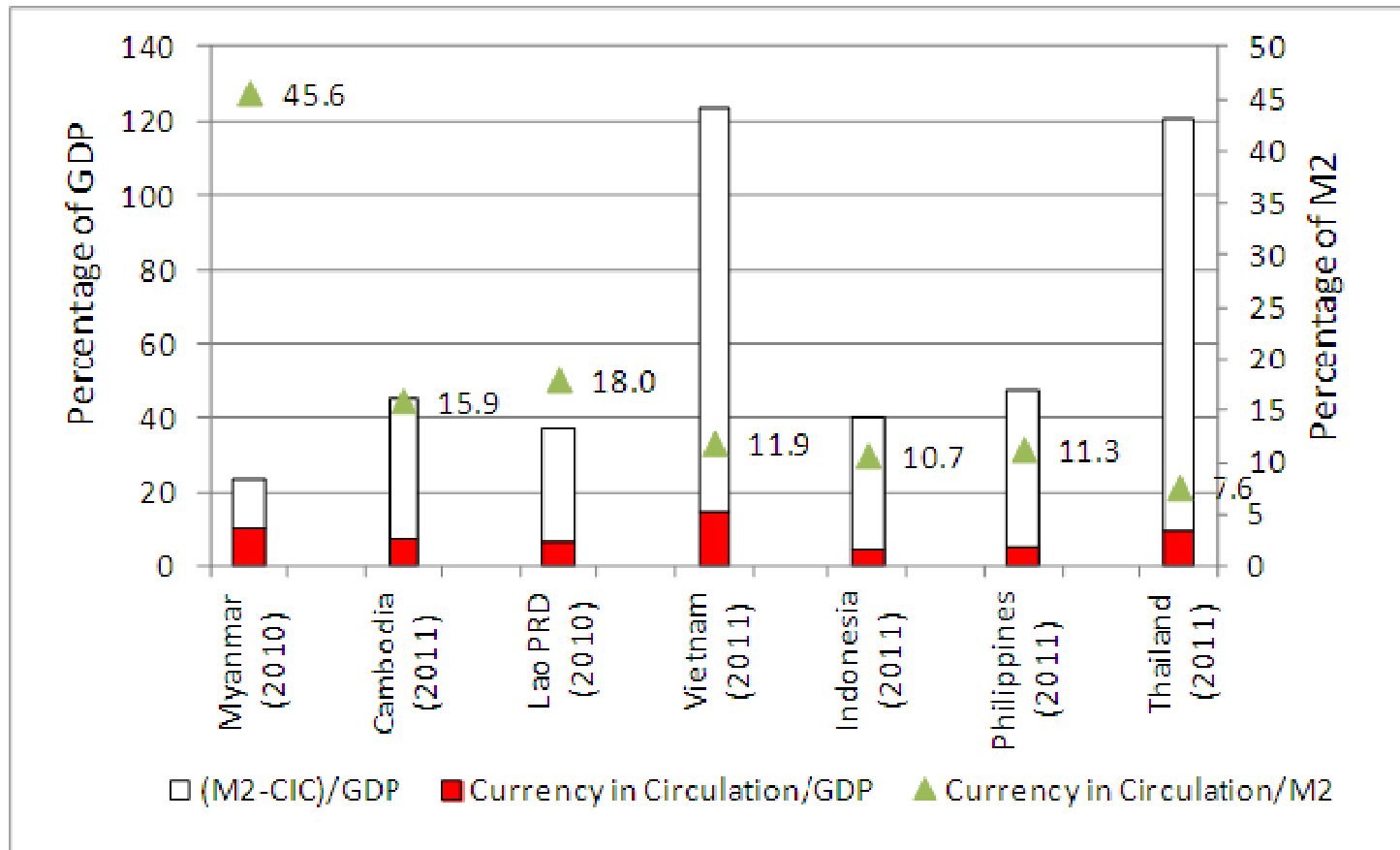
2. Remaining challenges (1)

- Segmentation between public and private sectors
- Segmentation within private sector
 - Price gaps
 - Large parallel market: Banking sector is not intermediating the foreign exchange transactions.
 - **Domestic account transfer** and parallel market
 - Limited **transmission channel** of exchange rate policies

2. Remaining Challenges (2)

- Underdeveloped financial market
 - Limited instruments for **sterilization**

Sterilization instruments are limited.
 Kyat cash is predominant in small financial market.



Source: IMF, *International Financial Statistics*

Note: CIC stands for Currency in circulation.

Section 4

POLICY RECOMMENDATIONS

Policy Recommendations (1)

Transmission mechanism

- Encourage exporters to sell their foreign exchange to banks
 1. Stick: **Tax on domestic account transfer of export earnings**
 2. Carrots: Discount market of L/C
 3. CBM's commitment to convertibility
 - Larger intervention when necessary
 4. People's expectation on stable exchange rate (when kyat is weakening, people do not release dollar)

Policy Recommendations (2)

Instruments for sterilization

- Banking sector development
 1. **Foreign currency deposits** as a source of kyat deposits
 2. Prohibition of **foreign currency loans** to prevent dollarization

Thank you for listening!

For inquiries and comments, e-mail to
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Appendix

TREND OF REAL EFFECTIVE EXCHANGE RATE

Real effective exchange rate: appreciation exceeds 100%

