Unification of the Segmented Foreign Exchange Market in Myanmar

February 2013

Koji KUBO

Institute of Developing Economies (IDE-JETRO)

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 for the unification of foreign exchange market?

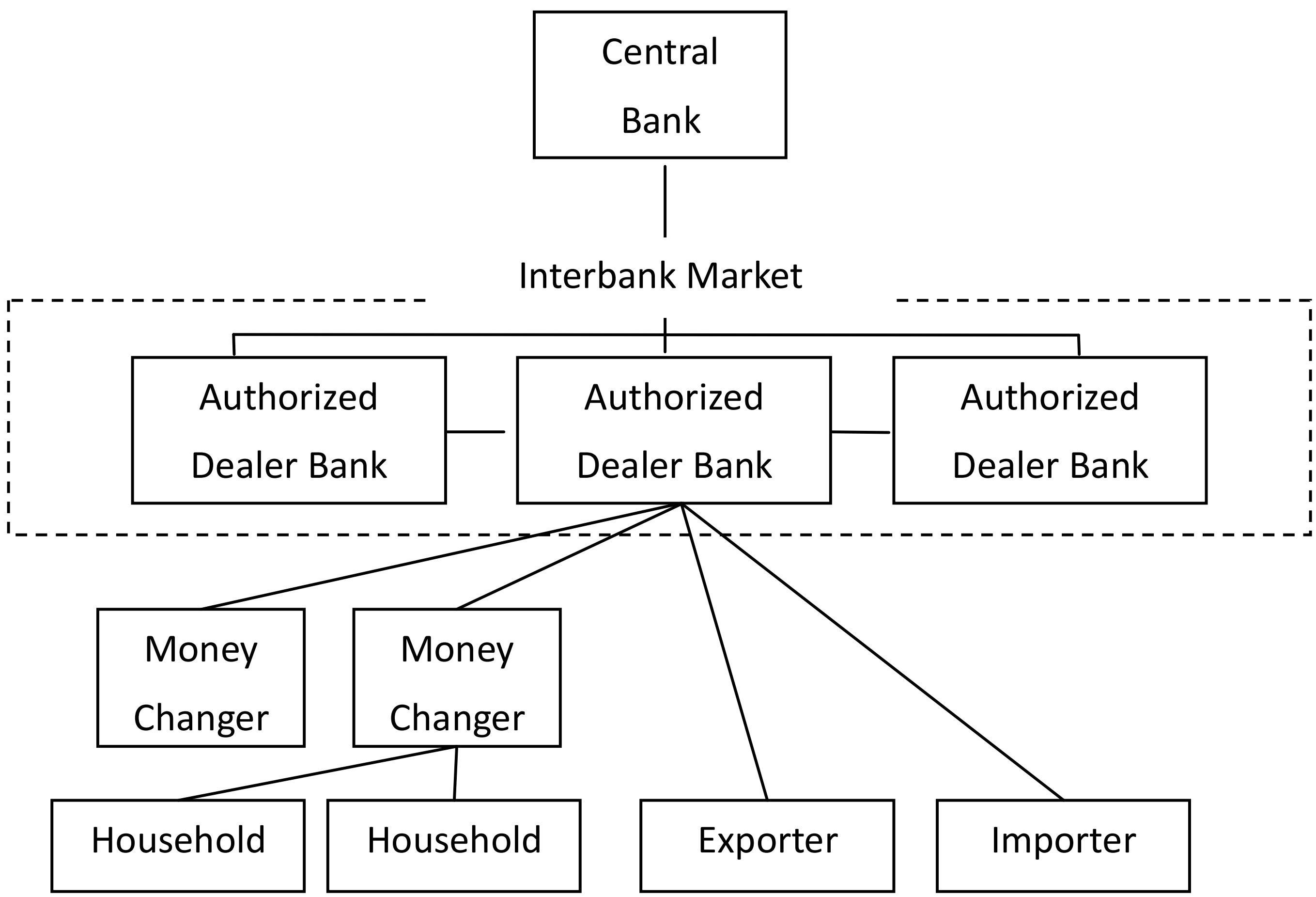
Outline of Presentation

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. Unified foreign exchange market: benchmark case



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 capital account transaction
     - ‘export-first, import-second’ policy (export earnings and greenbacks)

3. Why is segmentation a problem?

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

Section 2

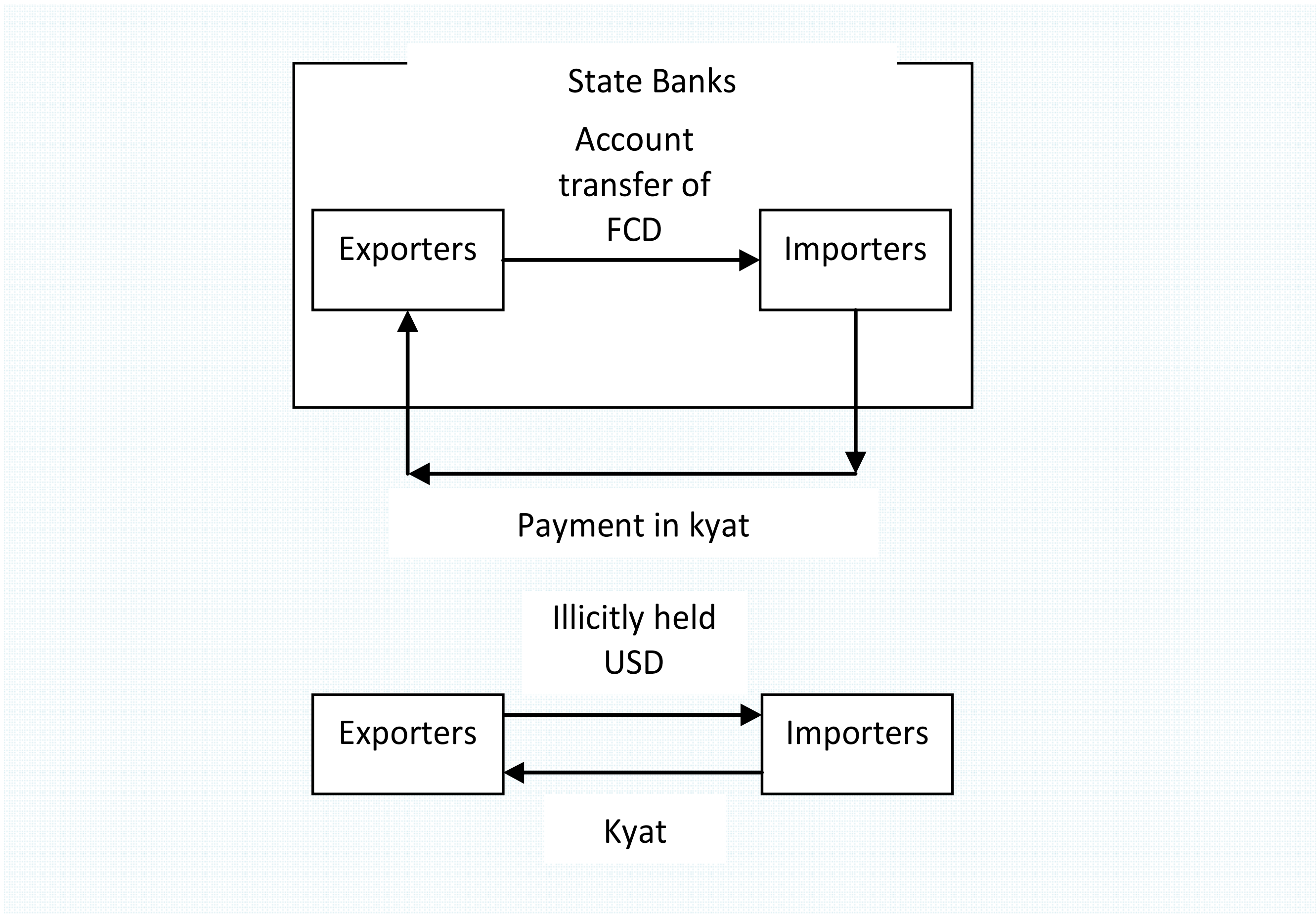
MARKET STRUCTURE BEFORE THE REFORM

Two segmentations in Myanmar

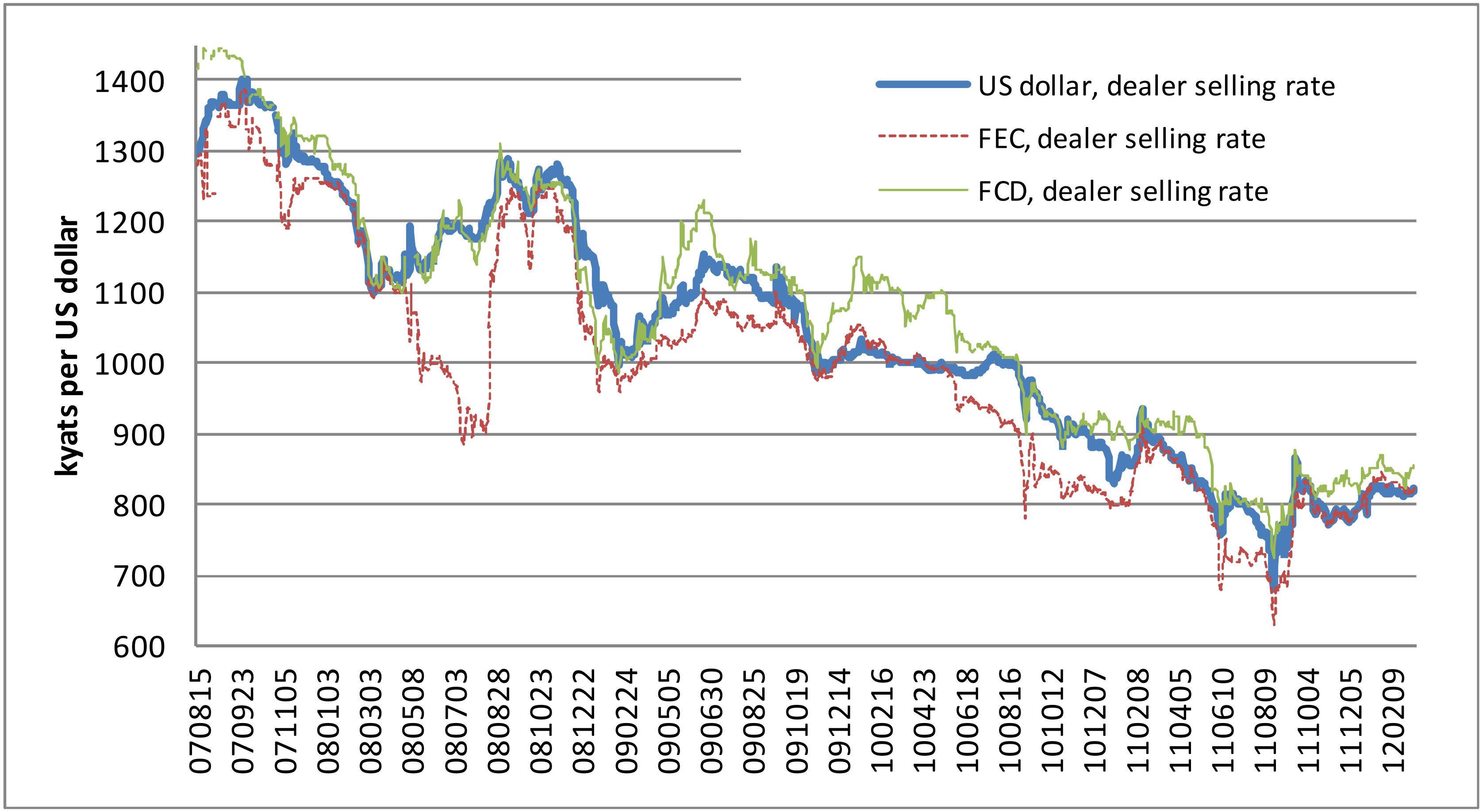
1. Between public and private sectors
   - Official exchange rate in the public sector
   - Parallel exchange rates in the private sector

2. Within private sector
   - Export earnings for import license (Foreign Currency Deposits)
   - Dollar (greenback)
   - FEC

Fragmented foreign exchange market in private sector



The gaps among greenback, export earnings and FEC used to fluctuate.



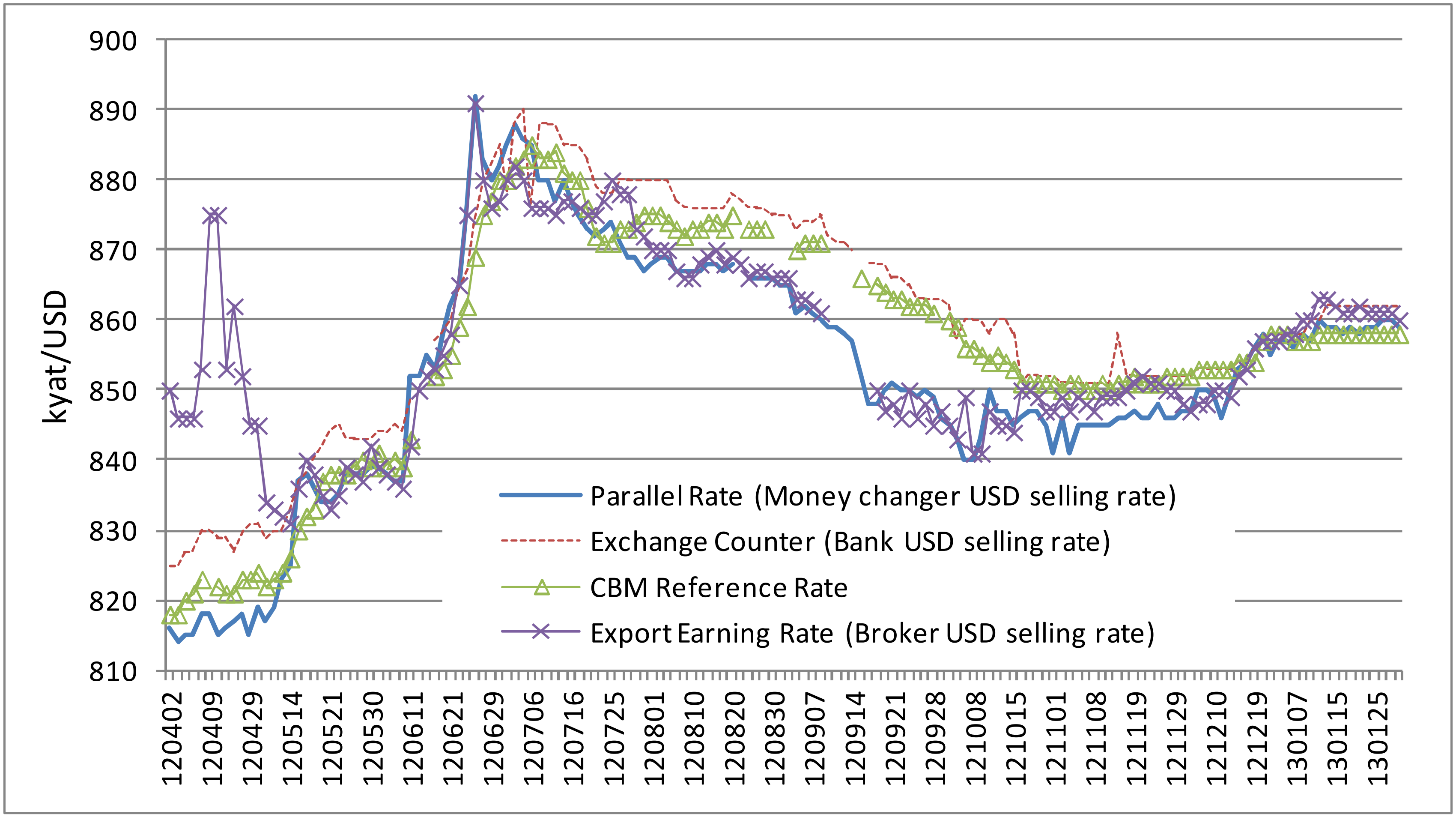
Section 3

REFORM AND REMAINING CHALLENGES

1. Reform under the new government

- October 2011: opening of foreign exchange counter
- November 2011: authorized dealer bank license to 11 banks (later 14 banks)
- April 2012: move to 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.



2. Remaining challenges (1)

- Segmentation between public and private sectors

- Segmentation within private sector
  - Price gap
  - Large parallel market: Banking sector is not intermediating the foreign exchange transactions.
    - AD banks do not buy export earnings from exporters.
      - CBM purchased USD 435 million in last 10 months. (small market intervention.)
      - Size of foreign currency deposits is USD 7,384 million.
      - Total private exports are around USD 3 to 5 billion a year.

2. Remaining Challenges (2)

- Can CBM influence the parallel market rate?
  - As CBM trades only with AD banks, unless AD banks trade with retail customers, CBM can't influence the exchange rate of retail market.
  - **Domestic account transfer** and parallel market for export earnings

Section 4

POLICY RECOMMENDATIONS

Policy Recommendations for unification of foreign exchange market

- Encourage exporters to sell their foreign exchange to banks, and encourage importers to buy foreign exchange from banks
  1. **Tax on domestic account transfer of export earnings**
  2. 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)

Thank you for listening!

For inquiries and comments, e-mail to

koji_kubo@ide-jetro.org