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Exchange-rate ROULETTE

Gap between official and black-market rates for the kyat is widening as dollar shortage in Myanmar becomes acute. By **Larry Jagan** in Yangon

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● Myanmar's currency exchange problems are the talk of the town as the black-market rate for US dollars is set to soar further.

The current crisis, which has engulfed banks, money changers and importers over the past four months, is largely the result of misguided central bank policies and mixed messages, according to international financial experts.

But some politicians are exploiting the crisis to blame it on international companies remitting profits abroad. They are threatening parliamentary action, which would send shock waves through the investment community.

"Exporters are happy when the kyat depreciates — as it boosts their sales — but the importers on the other hand are left crying," said William Aung, a financial analyst based in Yangon. "For an import-dependent Myanmar, the depreciation of the kyat is very bad news for the country's consumers."

Last week the dollar was being quoted at 1,110 kyat by the central bank, with the commercial bank selling rate at 1,119, but the black-market selling rate was 1,184 kyat. Selling rates earlier in the month went as high as 1,240 kyat and briefly hit 1,300.

Local entrepreneurs believe the crisis is also restricting liquidity and impeding local industry. This has dampened business sentiment, and analysts do not expect this to change before the new government is in place around the end of the first quarter next year.

The International Monetary Fund has now waded into the debate, warning that the currency could face a "perfect storm", especially if and when the United States raises interest rates.

"Myanmar simply does not have enough foreign reserves to resist kyat depreciation," the IMF warned, urging the Central Bank of Myanmar to allow a "steady" fall in its value to help make exports more competitive and reduce imports.

The central bank is estimated to have only about US$8 billion in foreign reserves and gold.

Earlier this year, many banks and money changers stopped selling dollars to customers — although they still bought them over the counter — causing panic among businessmen, especially importers. Local banks' clients with dollar accounts can only withdraw up to $5,000 twice a week.

But many banks cannot even honour that — and thus pay out a mix of dollars and kyats, which are at the official exchange rate. "For the past month or so, when I withdraw from my dollar account, I get fewer and fewer dollars, and more and more kyat," complained Joey Chan, a local IT businessman. "It's currently 60% kyat and 40% dollars."

"There is only one answer. Float the kyat and allow the market to determine its real market value"

SEAN TURNELL
Macquarie University

The central bank just does not seem to have enough dollars to meet the demand. One company estimates that it has less than 10% of the current demand. Some experts also believe that foreign export earnings are being parked offshore, and not being brought into the country and circulated in the market, exacerbating the shortage.

Ominously though, the speaker of the lower house, Shwe Mann and some of his cohorts in parliament have a different take, arguing that the dollar shortage was the result of the international companies operating in Myanmar sending their earnings abroad.

Earlier last month, the finance minister, planning minister and the deputy governor of the central bank were summoned to parliament to answer questions about the currency crisis.

After open questioning, they were grilled again in a private meeting with several senior MPs — mainly heads of various oversight committees. At this meeting the speaker blamed the international telecoms companies, Telenor and Ooredoo, for the leakage of dollars, said one MP at the meeting.

The two mobile operators stand accused of earning hundreds of millions of kyat per month, converting the revenue to dollars and taking them out of the country. Shwe Mann reportedly told the meeting that "the telecom companies' licences may have to be reconsidered".

But the scarcity of dollars in the official banking system is largely due to the growth in the currency black market, say financial analysts. One of the main causes for this is the disparity between the two exchange rates.

Every day the government conducts a foreign-exchange market, which is meant to establish the daily reference rate. Until recently this has been slightly lower than the actual market rate. But over the last three months things have began to gone badly awry.

This may be understandable as there is a fierce battle going on within the central bank over monetary policy, and especially on how to handle the current depreciation of the kyat and the insufficient supply of dollar bills.

Two weeks ago the central bank intervened, offering to sell dollars to importers at the official rate to help them and reduce exchange rate problem.

So far, only fuel and palm oil importers have been granted this concession, and only via letters of credit and not cash, although other importers may be allowed the same privilege in the near future.

However, this is a significant step as Myanmar imports $40 million in palm oil a month. It is though, effectively subsidising the price of palm oil to the consumers — provided the importers do not try to squeeze extra profits from the situation.

This is the first time the central bank has intervened, in what the Australian

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economist and Myanmar specialist Sean Turnell calls an "innovative way to minimise the damage caused by the government's 'managed' flotation of the currency".

But the real problem is that the central bank governor remains wedded to the traditional approach of the former military and socialist governments of the past, which insisted that the exchange rate had to be controlled and currency instability prevented.

"They can't let the kyat float as they are still control freaks," said a local currency trader, who declined to be identified.

"There's a money pathology in the senior echelons of government that's a hangover from the past," said Mr Turnell.

Some ministers — especially in the president's office — believe kyat depreciation would be a loss of face. They see a stable exchange rate as a matter of national pride, even if it impedes economic development, making it inefficient, uncompetitive and fuelling inflation.

There are some on the central bank's board who favour full liberalisation of the kyat, and while the bank has paid lip service to floating the kyat, a hybrid has emerged between the rate backed by the central bank and the one in the street.

This has made official currency exchange operators increasingly reluctant to sell dollars to customers at the official rate. Though they buy dollars at the official rate, they prefer to sell them at the higher black-market rate to unofficial currency traders.

"The informal dollar rate has fluctuated at just under 1,200 to the kyat for the past two weeks," said Vijay Dhayal, senior consultant with New Cross Roads Asia, a financial advisory and research firm in Yangon.

"It has stabilised since the central bank's partial intervention, but it is unlikely to be enough to prevent further significant depreciation of the kyat in the future."

Currency speculators predict the kyat will depreciate to between 1,500 and 1,600 by October. This will certainly send more shock waves through the economy, leaving importers in desperate straits, as demand is likely to soar as the elections near.

"For now banks here are just a little confused with the central bank as to what they are looking for in the markets," said a Yangon banker, who declined to be identified.

"While the central bank is split the banks are likely to continue to toe the line," Mr Dhayal added.

But sticking to the current policy may also have political consequences — raising the spectre of the failed currency measures during the previous military regimes — and a dual currency system as in the past.

Many bankers and businessmen believe it's time for the central bank to bite the bullet. "There is only one answer," added Mr Turnell. "Float the kyat and allow the market to determine its real market value."

This would mean volatility in the short run while the market found its equilibrium, before conditions stabilise. But nothing that dramatic will be allowed to happen in the lead-up to the elections.

"The depreciation of the kyat would be unambiguously good for the Myanmar economy, helping make it more competitive," said Sean Turnell.

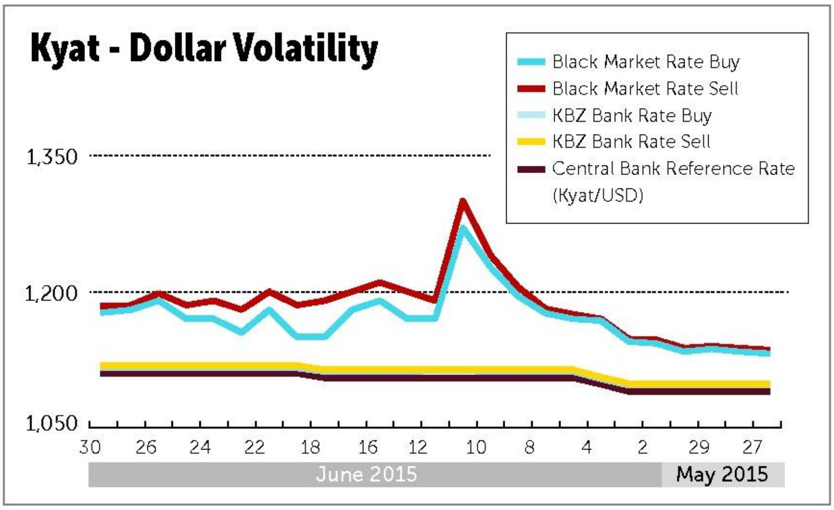
But not everyone agrees that a full flotation is the answer. Some argue that a more managed approach would be more appropriate. "No Southeast Asian currency works on a floated exchange. Instead they operate a 'managed float' that values them against a basket of currencies," said George McLeod of PricewaterhouseCoopers Thailand.

He added that Myanmar was an underdeveloped economy that lacks indigenous industry and growing consumer demand has made the country vulnerable to trade deficits.

A free-float model could lead to excessive short-term currency volatility that would benefit big "crony" players, but could be detrimental to foreign investment and emerging local small businesses.

As long as the dual rate is tolerated, the black market will certainly prosper. And there is little likelihood that central bank policy is going to change in the near future "The bank is likely to continue to use strong-arm tactics to support the kyat," said a senior executive of a leading Myanmar bank.

"However, after the elections and in the early stages of the new government the current budget deficit will increase the pressure for a free-floating kyat, and in the longer run this may make more sense rather than letting it go free now as the markets would play on the weakness of the government ahead of an election."



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