

# **Design and Development of Foreign Exchange Market**

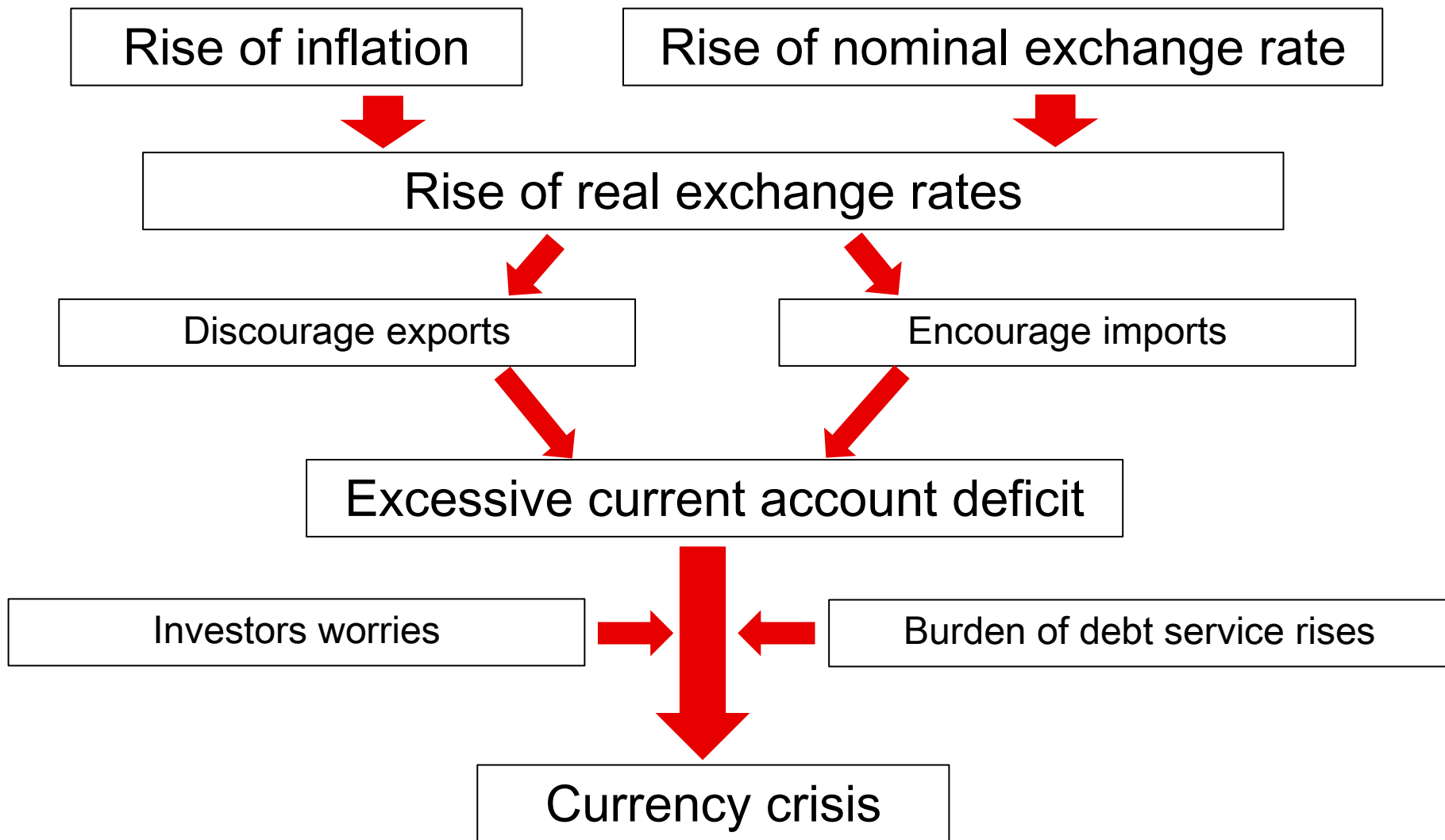
May 2017

Mitsuru Yaguchi

Institute for International Monetary Affairs

# Facts and theories of foreign exchange regimes and markets in the developing countries

# (1) Typical mismanagement that could lead you to a currency crisis





## (2) Theoretical Categorization of Currency Regimes - ②

### How to manage flexibility

#### How to make flexibility of exchange rate system

- (a) What should the value of currency be pegged to  
(a currency or a basket)
- (b) Width of target zone  
(narrow or wide)
- (c) Frequency of target change  
(daily, monthly, quarterly, ...)
- (d) Reference of target change  
(monthly inflation data, market rates of previous day, ...)

## (2) Theoretical Categorization of Currency Regimes - ③

How to control daily movement of foreign exchange rate



By intervention to the market.



To make the intervention effective with limited foreign reserve,



You need capital control.

## (2) Theoretical Categorization of Currency Regimes - ④

### Capital control

Before Asian currency crisis

- Liberalization is almost unconditionally believed to make growth and prosperity. (“Washington consensus”)



After Asian currency crisis

- Liberalization should be proceeded under an appropriate order. (Sequence matters.)  
Liberalization without consideration of sequence is more harm than good!

## (2) Theoretical Categorization of Currency Regimes - ⑤

### History of foreign exchange rate regime in each country

Chronological Change of Foreign Exchange Arrangement of Each Country in Asia and Pacific

	1993	2000	2012
Dollarization / Use of other ccy		Cambodia	Cambodia
Currency Board	HKD	HKD	HKD
Fixed to US dollar	CNY, INR	CNY, MYR	
Crawling Peg	IDR, KRW	VND	CNY, VND
Basket Peg	THB, PGK, MYR, PKR, SGD	SGD	SGD
Managed Float	JPY, LKR, PHP, TWD, VND	IDR, INR, JPY, KRW, LKR, PGK, PHP, PKR, THB, TWD	IDR, INR, JPY, KRW, LKR, MYR, PGK, PHP, PKR, THB, TWD
Pure Float			

CNY-China, HKD-Hong Kong, INR-India, IDR-Indonesia, JPY-Japan, KRW-Korea, MYR-Malaysia, PGK-Papua New Guinea, PKR-Pakistan, PHP-Philippines, SGD-Singapore, LKR-Sri Lanka, THB-Thailand, TWD-Taiwan, VND-Vietnam

(Source) Compiled by IIMA based on the IMF data



### (3) Categorization by Regulation and Market Practice - ①

- Four dimensions in categorizing types

- ① if you require an evidence of underlying demand when a resident conduct a foreign exchange, (and if you require the evidence on invoice basis (firm-committed) or forecast basis)
- ② how far you admit non-residents' transaction of your local currency with overseas located banks
- ③ if you admit Off-shore market
- ④ how you should handle with NDF (Non-Deliverable Forward)

### (3) Categorization by Regulation and Market Practice - ②

Categorization by practical issues

		Restriction on residents' transaction: Principle of underlying demand *  ①  × : firm-committed transaction only △ : forecast transaction occasionally acceptable ○ : forecast transaction acceptable ◎ : no restriction	Off-shore transactions							Off-shore market  × : no exist ○ : exist  ③	Model	④ NDF	
			Restriction on non-residents' transaction with overseas located banks ② × : no admit, △ : admit with conditions, ○ : admit									NDF market  ○ : exist	Domestic banks access to NDF markets  × : no admit △ : admit with conditions ○ : admit
			Current account			Capital account							
			Spot value		Forward value	Spot value		Forward value					
			Buy local currency	Sell local currency	Buy and sell	Buy local currency	Sell local currency	Buy and sell					
Taiwan	TWD	×	×	×	×	×	×	×	×	a	○	△	
Vietnam	VND	×	×	×	×	×	×	×	×		×	× (vanished)	no NDF market
Korea	KRW	○	△	×	×	△	×	×	×	b	○	○	
Philippines	PHP	×	○	×	×	×	×	×	×		○	×	
Pakistan	PKR	△	○	×	×	○	×	×	×		no NDF market	no NDF market	
SriLanka	LKR	×	○	×	×	○	×	×	×		no NDF market	no NDF market	
Papua New Guinea	PGK	×	○	×	×	○	×	×	×		no NDF market	no NDF market	
India	INR	△	○	×	×	○	×	×	×		○	×	
China(CNY)	CNY	○	△	△	△	△	△	△	×	c	○	×	
Indonesia	IDR	○	△	△	△	△	△	△	×		○	×	
Malaysia	MYR	○	△	△	△	△	△	△	×		○	×	
Thailand	THB	○	○	○	○	○	○	○	○	d	(no need)	(no need)	
China(CNH)	CNH	◎	○	○	○	○	○	○	○	e	(no need)	(no need)	
Hong Kong	HKD	◎	○	○	○	○	○	○	○		f	(no need)	(no need)
Singapore	SGD	◎	○	○	○	○	○	○	○			(no need)	(no need)

\* Actual categorization of restrictions on residents' transactions is more complex according to duration of contract, difference of buy-sell side, etc.

(Source) Compiled by Bank of Tokyo-Mitsubishi UFJ and Institute for International Monetary Affairs, November 2015

## (4) Three factors which enhance the development of foreign exchange market - ①

### ① Payment and Settlement System

Reliable and quick settlement system is indispensable for banks to deal with each other and to establish confidence in banking system.

### ② Brokers

Brokers should aggregate market information for efficient and transparent price-making (market-making).

### ③ Market committees

Market committee make market rules and become a communication partner for regulators in making regulations.

“Those who use market know the market best, and should make market rules.”

## (4) Three factors which enhance the development of foreign exchange market - ②

### Market committee in Hong Kong

#### Treasury Markets Association (TMA)

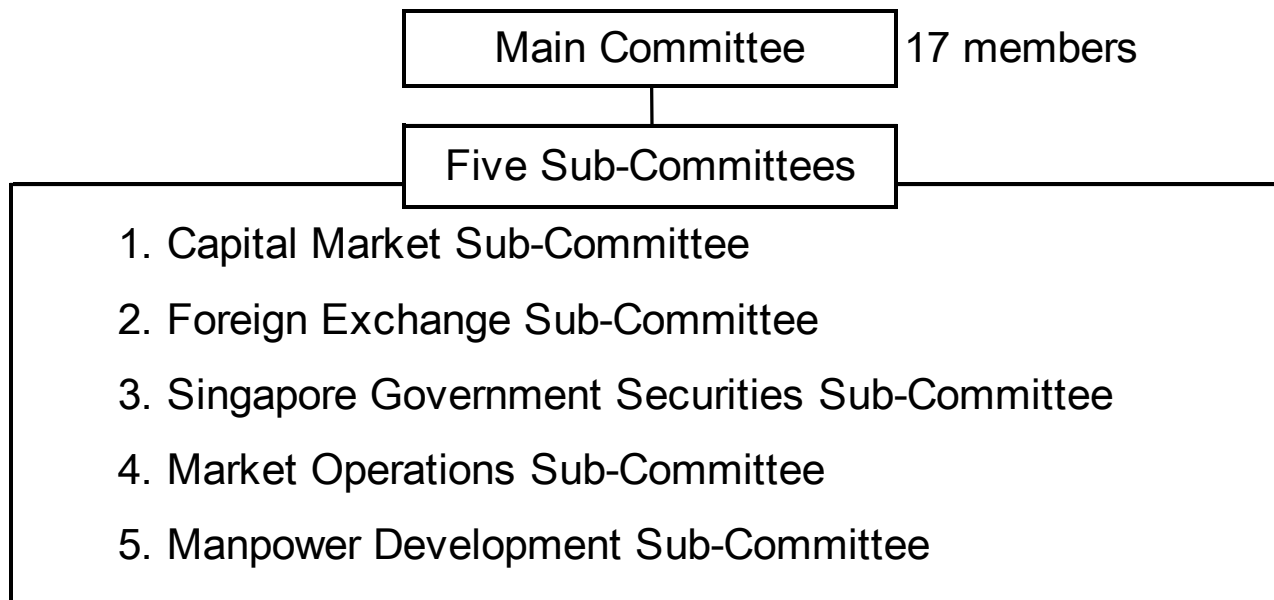


(Source) <http://www.tma.org.hk>

## (4) Three factors which enhance the development of foreign exchange market - ③

### Market committee in Singapore

#### Singapore Foreign Exchange Market Committee (SFEMC)



(Source) <http://www.sfemc.org>

# Recommendation for the development of foreign exchange markets

# Our recommendation

- (1) Establish a market committee
- (2) Foster brokers
- (3) Enhance a market making function
- (4) Build up trustworthy commercial banks

This report is intended only for information purposes and shall not be construed as solicitation to take any action such as purchasing/selling/investing financial market products. In taking any action, each reader is requested to act on the basis of his or her own judgment. This report is based on information believed to be reliable, but we do not guarantee its accuracy. The contents of the report may be revised without advance notice. Also, this report is a literary work protected by the copyright act. No part of this report may be reproduced in any form without express statement of its source.

Copyright 2017 Institute for International Monetary Affairs (IIMA) (公益財団法人 国際通貨研究所)  
All rights reserved. Except for brief quotations embodied in articles and reviews, no part of this publication may be reproduced in any form or by any means, including photocopy, without permission from the Institute for International Monetary Affairs.

Address: 3-2, Nihombashi Hongokuchō 1-Chōme, Chūō-ku, Tokyo 103-0021, Japan

Telephone: 81-3-3245-6934, Facsimile: 81-3-3231-5422

〒103-0021 東京都中央区日本橋本石町1-3-2

電話: 03-3245-6934 (代) ファックス: 03-3231-5422

e-mail: [admin@iima.or.jp](mailto:admin@iima.or.jp) URL: <http://www.iima.or.jp>