

DOLLARIZATION OR DE- DOLLARIZATION

LAO EXPERIENCE ON DE-DOLLARIZATION

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*IMF AND JICA JOINT CONFERENCE ON FRONTIER AND
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Background

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- Cambodia and Lao PDR have long experienced high dollarization over the past two decades, posing a challenging task for macroeconomic management, especially the conduct of an effective monetary and exchange rate policy
- Cambodia and Lao PDR were classified as highly dollarized economies in early 1990s by IMF (Balino, Bennett and Borensztein, IMF 1999) as measured by FCD/M2 exceeded more than 30 percent

Background

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In Cambodia

- Macroeconomic and political stability has been well maintained.
- However, dollarization has long persistent and even risen. (Hysteresis Effect)

→ *Contrary to the general belief that macroeconomic and political stability help reduce dollarization (Duma, 2011)*

Background

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- NBC&JICA joint survey
 - ▣ Provides very useful and rare survey from literature to understand the behavior of economic agents and can be helpful for policymakers to formulate an appropriate de-dollarization policy.
 - ▣ The survey is informative and covers a lot of interesting multidimensional views on drivers and behavior of dollarization in Cambodia

Dollarization in Lao PDR-

Causes

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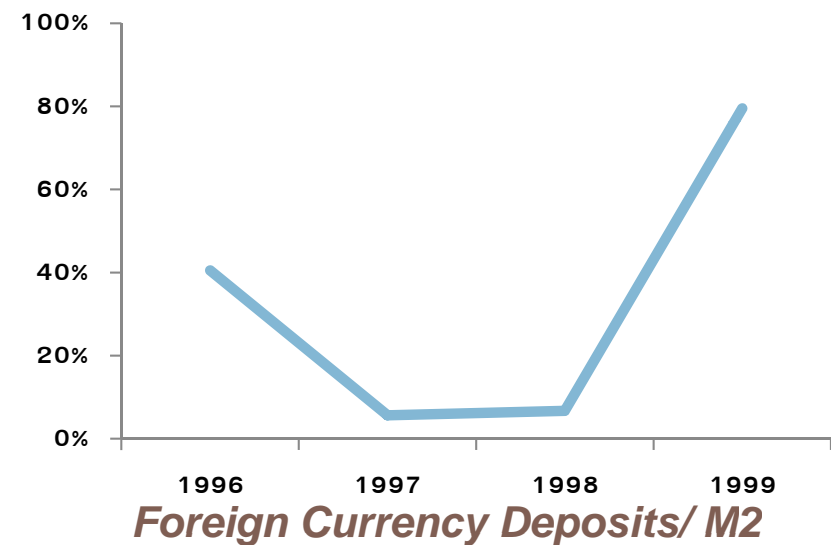
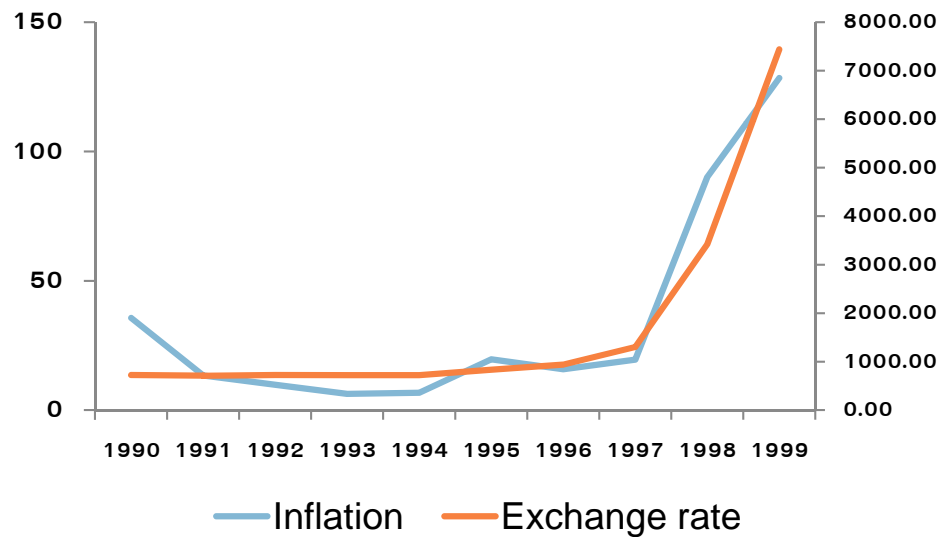
- Early 1990s
 - ▣ Era of economic liberalization and deregulation, coupled with lack of experience of market-oriented economy management led to high inflation and large depreciation of Kip
 - ▣ Channels for foreign currency inflows: FDI, tourism, aids, loans, remittances, etc.

- Dollarization aggravated during the Asian Financial Crisis
 - ▣ Macroeconomic instability arose
 - High inflation
 - Rapid Depreciation of exchange rate

→ Loss of confidence in domestic currency

Dollarization in Lao PDR- Causes

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Dollarization in Lao PDR- Persistent Factors

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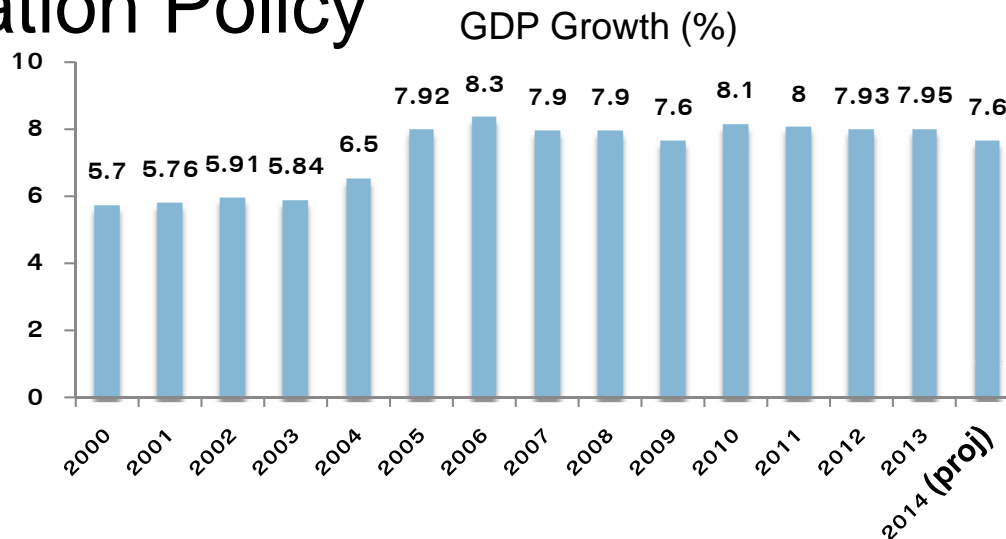
- Country's geographic and cultural proximity to major countries that leads to a huge cross-border trade:
 - ▣ Thailand: the largest trading partner
 - ▣ China, Vietnam, etc
- The convenience in large transaction settlement and price denominated for valuable goods.

De-dollarization Policies in Lao PDR

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Realizing the dollarization and its effects on the economy, Lao government has implemented the mix of policy instruments as follows:

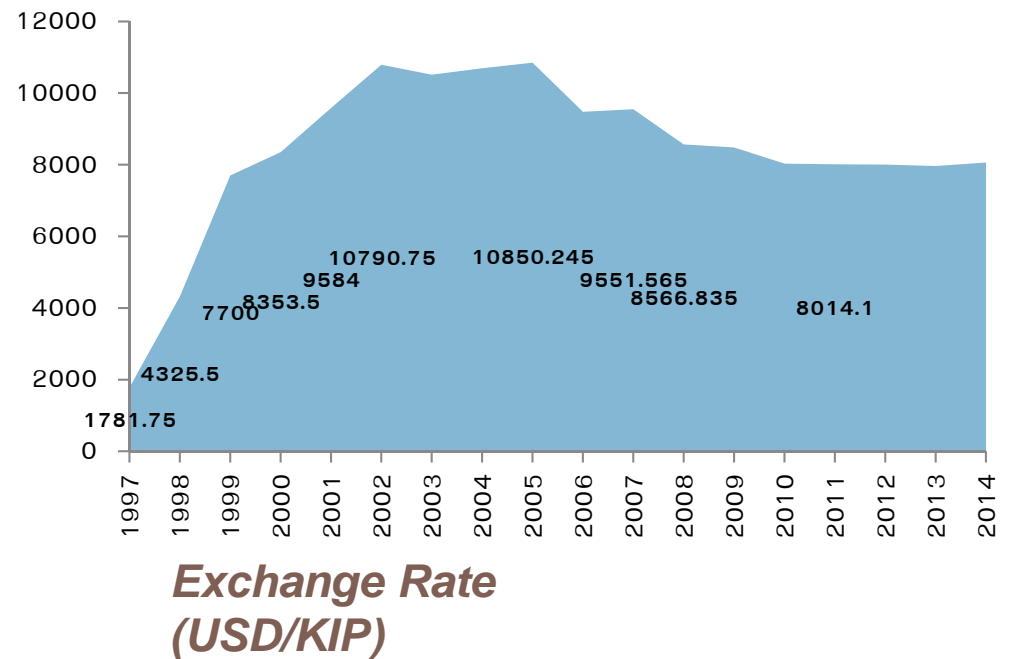
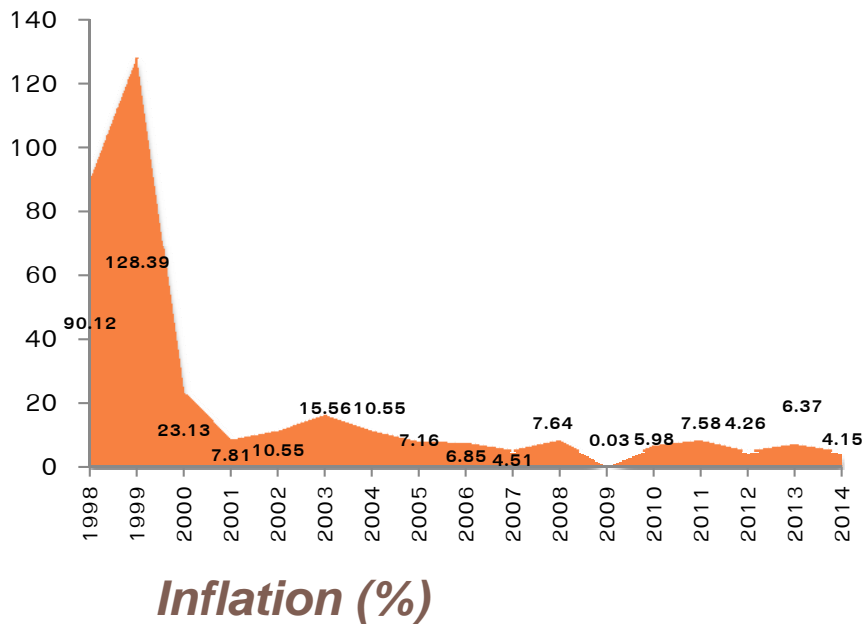
- Maintained macroeconomic stability through Exchange rate –based Stabilization and disinflation Policy



De-dollarization Policies in Lao PDR (con't)

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- Brought inflation and exchange rate to stable level



De-dollarization Policies in Lao PDR (con't)

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□ Regulatory changes

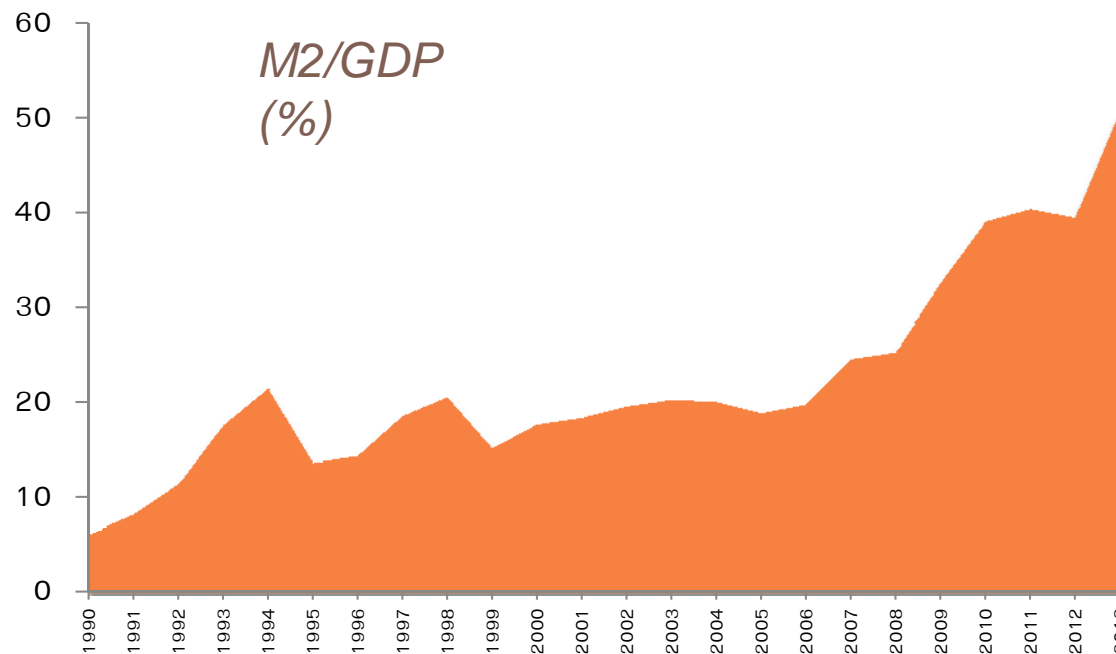
Upgraded PM Decree to Presidential Decree in 2008 on FC management and precious metals and further upgraded into FC management Law in 2014

- Issued PM decree on FC management and promotion of local currency for domestic payment
 - ▣ Requires all unit of account to be denominated in Lao kip.
 - ▣ Conduct regular inspection and monitoring for stores, shops, local markets
 - ▣ Imposed sanction measures.
- Lao kip promotion campaign nationwide
 - ▣ Carried out periodic dissemination seminar on FC management Decree and the use of Lao kip

De-dollarization Policies in Lao PDR (con't)

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- Developed financial intermediaries
 - ▣ Number of banks grew threefold during past decade
 - *Broad money grew significantly*



De-dollarization Policies in Lao PDR (con't)

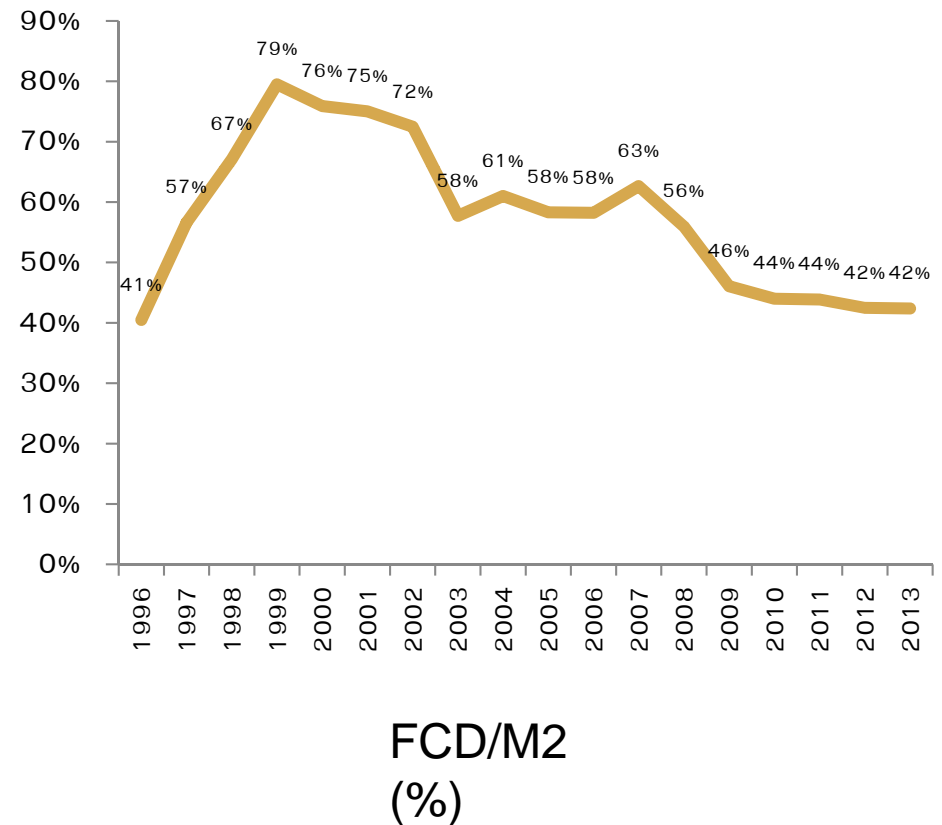
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- Higher reserve requirement on foreign currency
 - ▣ 5% for LAK; 10% for USD
- Improvement of domestic payment system
 - ▣ Increased number of ATMs
 - ▣ Modernize banking service: online banking, smart phone banking
 - ▣ Salary and utilities payment via bank transfers
 - ▣ Usability of the local currency-higher Kip denomination

Policy Outcomes

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- The steady economic growth, stable exchange rate and inflation rate have led to a favorable progress in de-dollarization in Lao PDR.
 - ▣ Declined from 80% to almost 40%



Policy Outcomes (con't)

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- The behavior of economic agents has gradually changed as many shops, markets are increasingly quoted price of goods and services and settled payment in local currency

Looking ahead for policy options

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To build on the previous success in reducing dollarization in Lao PDR , Lao PDR will keep on the momentum of pursuing ongoing policy measures as follows

- Maintain a long-term macroeconomic stability
- Widen the scope of modernization of domestic payment
- Promote the use of kip for payments through improved domestic payment system
- ATM pool among commercial banks
- Enforcement of newly enacted Law on foreign currency management
- Continue promotional campaign nationwide through the use of domestic currency for domestic transaction

Looking ahead for policy options (con't)

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- Prudential regulation-Move toward risk-based supervision
 - Help better monitor risks taken by banks in extending in FC loans and restricting commercial banks to lend in foreign currency;
 - Strengthening domestic financial market
 - Developing alternative financial instruments denominated in local currency such as stock, corporate bonds
 - Issuance local currency denominated vehicle for domestic investment
 - Promote local currency interbank market

Conclusion

- After strong effort made by Lao PDR more than a decade , dollarization has declined significantly in Lao PDR .
- In light of the remarkable progress , Lao PDR implemented a series of policy measures ranging from exchange rate-centered stabilization policy, regulatory changes, improvement of domestic payment and the usability of local currency, the nationwide promotion of the use of domestic currency for domestic transaction