Sovereign Actions/Events That Have Had a Material Impact on FX Markets 1981-2004

Over the past 25 years, there have been a number of political and/or policy developments in individual countries that have reverberated significantly in the foreign exchange market. It is important for participants in the fx market to remember these events so that they can manage market practices and expectations going forward. The purpose of this report is to summarize these events; set forth the issue(s) they presented to the OTC fx market; and report whether/how the dislocations or confusion caused by these events was resolved.

History is not necessarily a guide to the future, but knowledge of when and how the market has become dislocated in the past might help market participants communicate internally, and with each other, to address significant sovereign actions or events in the future. Given the spectacular growth of the fx market over the past few years and the participation of new entities and individuals in these markets, it is all too easy to assume that the mechanics of fx trading, confirmation, and settlement will continue without significant disruption or uncertainty. A little bit of history reminds us that (1) the fx market is not, and probably will not remain, immune to future disruptions and (2) fx market participants should not become complacent about the functioning of the market.

1981

Mexico
August to September
Economic Conditions: An economic boom resulting from various oil discoveries and rising oil prices led to increased government spending and dependency on oil exports. When oil prices fell due to the 1980s global oil glut and Mexico's current account deficit and budget deficit jumped, capital flight ensued. Amidst peso devaluation and contradictory economic policies, capital flight continued to accelerate.
Event: In response, in August, the Mexican government froze dollar-denominated bank accounts, later forcing the conversion of these accounts at below-market rates. During the same month the government was forced to implement a 90-day suspension on foreign debt payments. On September 1, 1982, full exchange controls on capital flows were adopted and the Mexican private banking system was nationalized.
Impact on FX Market:
Resolution: Sept 1, 1982 -- full exchange controls on capital flows adopted; Mexican private banking system nationalized.

1984

New Zealand

July

Economic Conditions: Earlier in the year, markets perceived the New Zealand dollar to be overvalued as compared to the basket of currencies against which it was then fixed. Market anticipation of a political victory for the Labour Party, which favored the New Zealand dollar's devaluation, triggered capital outflows.

Event: The Labour Party was elected and subsequently closed the foreign exchange market closed for four days, during which time no official fixing rate was quoted.

Impact on FX Market: A 20 percent devaluation of NZ dollar versus a basket of currencies ensued.

Resolution:

1991

Kuwait

Economic Conditions: Military invasion impacted settlement of Kuwaiti Dinar transactions. The Iraqi occupation authority placed the Kuwaiti Dinar on a par with the Iraqi Dinar in August 1990. Kuwait's new Dinar was issued on March 24, 1991 at the same rate as the old Dinar on August 1, 1990, the date before Iraq's invasion. Rates for the new Dinar became available from June 1991.

Event:

Impact on FX Market:

Resolution: March 24, 1991-- Kuwait's new Dinar issued.

Chile

Economic Conditions:

Event: Short-term capital controls were implemented by which foreigners wishing to move short-term funds into Chile were required to first deposit their money with Chile's central bank for a specified amount of time without interest. This was called the Unremunerated Reserve Requirement (URR), and was essentially a tax on any capital inflows. From June 1991 through September 1998, the URR averaged 4.24 percent per year, and reached its peak in November 1997 at 7.7 percent.

Impact on FX Market:

Resolution:

1994

Venezuela
June

Economic Conditions: President Perez shielded the banking industry from foreign competition, and allowed banks to conduct business almost completely without regulation. Corruption and high-risk lending ensued. When oil prices fell in the early 1980s due to the global oil glut, the boom economy began to decline and social and political unrest were exacerbated. Perez was impeached on corruption charges in 1993 and violent riots began to undermine previous attempts at economic reform. A banking crisis ensued in the wake of Banco Latino's failure during which the Venezuelan government was forced to bail out over half of the country's banks. Fifty-six financial institutions were closed and 25 were taken over the by government. Capital flight depleted the country's total reserves, which fell from $12.7 billion prior to January 1994 to $8.9 billion by June 1994.

Event: The Central Bank of Venezuela ordered commercial banks not to engage in foreign exchange transactions. The foreign exchange market reopened two weeks later with a fixed exchange rate and exchange controls including controls on external debt payments and the repatriation of US dollars.

Impact on FX Market: Because the government approves the trading of the US dollar denominated Brady bonds, an alternative to the fixed FX rate was developed at a rate implied from the value of the Brady bonds.

Resolution: The Bolivar was eventually devalued on December 11, 1995 by 41 percent.

1995

South Africa
March

Economic Conditions:

Event: The South African government unified the previously two-tier currency system that had consisted of both a commercial and a financial rand by abolishing the financial rand. Both the commercial and the financial rand rates had previously been quoted by the South African Reserve Bank.

Impact on FX Market:

Resolution:

Brazil
[date]

Economic Conditions: While in 1992, the Brazilian government took steps to liberalize its capital inflows policies, by 1993 it began to reverse some of these policies in order to prevent further increases in government debt.

Event: Brazil prohibited inflows to futures and options markets, and raised the financial transaction tax in order to generally discourage inflows. The "entrance" tax levied on the Foreign Capital Fixed Yield Funds was extended to all portfolio investments. Renewed and new loans were subject to minimum terms of 36 or 96 months, respectively.

Impact on FX Market:

Resolution:

1997

Thailand
May

Economic Conditions: Asian economic crisis.
Event: Bank of Thailand restricted Thai banks from supplying baht to non-Thai investors who did not demonstrate a legitimate commercial purpose. In January of 1998, the Bank of Thailand placed limits on the amount of baht-denominated credit that a resident could grant to a non-resident.
Impact on FX Market: An on- and off-shore market developed.
Resolution:

1998

Indonesia
May

Economic Conditions: Civil unrest.
Event: The Bank of Negara closed on May 14 (afternoon) and 20. Commercial banks also closed on these and intermittent dates. Bank of Indonesia closures were announced on the day they occurred.
Impact on FX Market: Major issues included whether the closed days were business days and whether interest was due if a transaction settled after its scheduled date.
Resolution: The market treated May 14 as a business day and May 20 as a non-business day. Various solutions were adopted for interest payments on a bilateral basis.

Russia
August

Economic Conditions: Sovereign default, devaluation, and imposition of a 90-day payment moratorium prohibited the payment of hard currency by Russian residents to nonresidents.
Event:
Impact on FX Market: Trading on Moscow Interbank Currency Exchange (MICEX) and fixing of RUB/USD rate by MICEX was disrupted. MICEX failed to update Reuters page.
Resolution: The Chicago Mercantile Exchange and EMTA published a reference rate and revised its definition to accommodate market concerns.

Malaysia
September

Economic Conditions:
Event: Malaysia's central bank imposed foreign exchange controls on the ringgit, including fixing the foreign exchange rate at US$1 to 3.8 ringgits, prohibiting or requiring Bank of Negara approval of any fund transfers between non-residents' savings accounts, limiting the amount that non-residents could deposit or withdraw from savings accounts, and placing restrictions on currency used for trading by prohibiting trades to be settled in ringgit terms. At the same time, the central bank cut interest rates and embarked on a policy of "reflation." A 12-month minimum holding period was placed on foreign portfolio equity investments, though in 1999, this was replaced by a graduated exit tax designed to pace capital outflows.
Impact on FX Market:
Resolution:

2001

Indonesia

January

Economic Conditions: A sharp, around 7 percent in Indonesia's currency due to dollar buying and capital flight related to increased social and political uncertainty.
Event: On January 12, 2001, Indonesia's central bank imposed foreign exchange controls, prohibiting residents from making loans to non-residents, prohibiting non-residents from transferring ringgit-denominated funds out of Indonesia, and reducing the amount of foreign currency that residents are allowed to sell forward to non-residents to US$3 million, down from US$5 million.
Impact on FX Market: The controls were effective in minimizing speculative activity in the offshore ringgit market.
Resolution:

Argentina

December to February 2002

Economic Conditions: Argentina formally defaulted on its debt in late December of 2001, and devalued the Argentine peso in early January.
Event: The country's foreign exchange market was closed from December 21, 2001 through January 10, 2002, and from February 4 through February 8, 2002. On January 11, the government made public a schedule to gradually lift deposit controls over a period of 3 years. The peso depreciated about 40 percent following the announcement.
Impact on FX Market:
Resolution: In December, market participants requested that the Chicago Mercantile Exchange conduct a poll of reference dealers. However, the closing of Argentina's FX market interrupted the poll. EMTA recommended that ARS NDF contracts be settled using the ARS Survey Rate published on the EMTA website no later than January 15, 2002. When the FX market was closed in February, EMTA recommended that ARS NDF Contracts with Scheduled Valuation Dates between February 4 through February 11, 2002 be settled as soon as practicable, and no later than February 13.

2003

Venezuela

January

Economic Conditions: Capital flight due to a rapidly depreciating Bolivar.
Event: Venezuela's central bank instituted capital controls by raising commercial bank reserve requirements, prohibiting the sale of U.S. dollars by banks to firms not domiciled in Venezuela, and lowering the maximum amount of U.S. dollars that banks were allowed to hold from 15 percent of equity to 12 percent. In addition, foreign exchange controls restricting transfers of hard currency by residents to nonresidents were implemented.
Impact on FX Market:
Resolution:

Thailand
September and October
Economic Conditions: Speculative short-term capital flows.
Event: The Bank of Thailand announced capital controls to stem what they described as short-term capital inflows that were speculative in nature. Financial institutions in Thailand were restricted from borrowing baht absent an underlying transaction meeting certain requirements. In addition, the Bank of Thailand announced restrictions on interest payments on non-resident accounts at local financial institutions.
Impact on FX Market: The Thai capital controls appeared to have had a limited impact stemming Thai baht appreciation.
Resolution: However, market participants discussed the effects of the regulations and the prospect of additional regulations as possibly leading to the creation of an NDF market for the Thai baht, which was then deliverable.

2004

Korea
January through April
Economic Conditions: Appreciation pressures on the Korean won.
Event: The Bank of Korea announced a series of NDF restrictions in January, 2004. Onshore banks that were short the dollar against the Korean won in NDFs were required to maintain at least 90 percent of their January 16 short position. Onshore banks that were long the dollar against the Korean won in NDFs could not exceed 110 percent of their long position. Daily reporting of NDF positions to the Bank of Korea was mandatory. Subsequently, the Bank of Korea modified these restrictions through April 20th, at which time banks would not be required to maintain any short.
Impact on FX Market:
Resolution: