
# Blended finance in Myanmar

TCX's role in realizing financial inclusion through innovative partnerships in Myanmar

TCX

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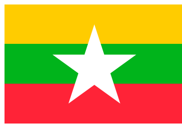
A greater variety of financial instruments helps to make the financial sector of Myanmar more attractive for a broader group of investors and allows for a better diversification of risk.

## ACRONYMS

| | |
|---|---|
| DFI | Development Finance Institution |
| LCY | Local Currency |
| LIFT | Livelihoods and Food Security Trust Fund |
| MFI | Microfinance Institution |
| TCX | The Currency Exchange Fund |
| UNCDF | United Nations Capital Development Fund |
| USD | United States dollar |

TCX



# FOREWORD

**WITH GREAT PLEASURE I PRESENT TO YOU A CASE STUDY ON THE ROLE OF TCX IN MYANMAR.** This report is part of a unique series of short illustrative stories that TCX produces. Our first case study covered the Kyrgyz Republic during the 2014 Russian ruble crisis.[1] Case studies on Azerbaijan, Ghana and Kenya were highlighted in TCX's 10-year evaluation report.[2]

The general development finance industry's consensus is that a client that earns local currency, should be financed in local currency. The debate increasingly concentrates on the question how to realize this, and the solution differs per country. Especially in the least developed countries, local financial markets are too shallow to cater for local demand for funding, and too underdeveloped to provide tools to mitigate currency risk. Myanmar is no exception. Since the country opened up and removed its barriers to foreign investment, the demand for local currency financing has heavily outweighed the supply.

This is exactly the type of situation for which TCX was established 10 years ago. Especially in the most challenging financial markets like Myanmar, where hedging solutions are almost inexistent, TCX has become the only source at scale for international funders to provide loans in local currency to microfinance organizations, local banks, and entrepreneurs. Parallel to generating kyat finance, TCX – in partnership with the Livelihoods and Food Security Trust Fund (LIFT) and other development finance institutions (DFIs) – has become an important partner of the development finance community in Myanmar, supporting policy reforms and stimulating the use of local currency.

This case study is an illustration of the interventions of TCX in Myanmar, with a specific focus on Myanmar's microfinance sector. It is a story of culture and tradition, of partnership and of creating access to sustainable finance in the formal market. This is more reliable and can better protect small entrepreneurs against financial risk than the moneylenders that operate in the informal market. Simultaneously this case study is an illustration of a donor using TCX to unleash the investment potential of the global Development Finance community for the benefit of a specific country.

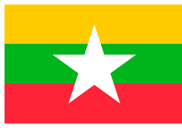
The report is organized as follows: the first section gives a broad overview of the challenges the (micro)finance sector in Myanmar is faced with, how these challenges are addressed, and what the direct results are of the intervention. The second section gives an insight in TCX's strategy to stimulate commitments to local currency financing, especially in imperfect markets.

Local currency finance protects individuals, companies, banks and ultimately the financial system in emerging markets from the volatility of international financial markets. Offloading currency risk to the end user goes against the fundamentals of development finance, to promote stability, economic growth and job creation, lifting people from poverty. This case study shows that a relatively small investment from the LIFT facility, can go a long way in realizing positive change.

**Ruurd Brouwer**
**CEO, TCX**

1 | TCX (2015) TCX's role in the Kyrgyz Republic during the 2014 Russian ruble crisis and beyond. This report is available at www.tcxfund.com.

2 | TCX (2017) The development impact of local currency solutions. An evaluation of 10 years TCX. This report is available at www.tcxfund.com.



# How local currency finance benefits Myanmar farmers


**The Situation.** Historically, Myanmar has been a country with a thriving private sector and an entrepreneurial culture. Currently, Myanmar is going through a structural political and economic transformation. The agriculture sector still dominates the economy and an estimated 70% of the population lives in rural areas. Although poverty has declined in recent years, poverty levels are still relatively high, especially in these rural areas. For a variety of reasons, including a lack of infrastructure in terms of access to roads and electricity, land and labor productivity are relatively low. For example, during monsoon season, one day of work generates only 23 kg of paddy in Myanmar, compared to 62 kg in Cambodia, 429 kg in Vietnam, and 547 kg in Thailand (World Bank, 2017). Farmers will benefit from improved public services, but also from additional knowledge on how to manage a farm, an increased supply of a diverse range of seeds, an efficient use of fertilizers. This requires access to working capital.

In Myanmar, the financial sector is severely underdeveloped. Banks are mostly situated in urban areas and are unable to offer small loans at low interest rates to small farmers and entrepreneurs. Informal moneylending is a very common phenomenon. Informal moneylenders and pawnshops are largely tolerated and easily accessible, because they only require relatively little collateral. Parallel to attempts of Myanmar's government to regulate the financial market, strengthen banks and broaden their lending mandates, the microfinance sector is widely seen as a key development tool to promote financial inclusion and alleviate poverty (GIZ, 2016). At the same time, international investors are keen to explore investment opportunities in Myanmar. Unfortunately, devaluation risks are severe and regulation prevents lending at market rates. International investors thus are hesitant to provide finance to microfinance institutions (MFIs), the MFIs are reluctant to take US dollars, and kyat funding is not possible due to the lending rate caps. A stalemate existed.

**The Strategy.** To improve the lives and prospects of smallholder farmers and landless people in rural Myanmar, LIFT, a multi-donor fund, was established in 2009. To break open the stalemate and allow international funds to flow, LIFT and TCX partnered to create a local currency funding option at below-cap rates for international investors. A USD 10 million dollar subsidy was used to catalyze USD 80 million of funds in local currency (MMK 109 billion) from 12 international lenders to 11 local MFIs.

**The Value.** The USD 80 million were used by the MFIs to serve over 300,000 clients (84% of these clients are women, 64% of the clients live in rural areas). In addition to providing access to finance for end-clients, the additional funds (equity) allowed MFIs to leverage their capital and secure deposits to increase their lending capacity even further to meet the estimated unmet demand by microfinance clients.

# 1. DEVELOPMENT IMPACT

## Blended rates as part of the local currency financing solution in frontier markets.

- **Since Myanmar opened up for trade and investment, all stakeholders involved, i.e. the government, central bank, foreign investors, banks, microfinance institutions, and entrepreneurs, have carefully navigated through a difficult economic and security environment to develop the financial infrastructure.**

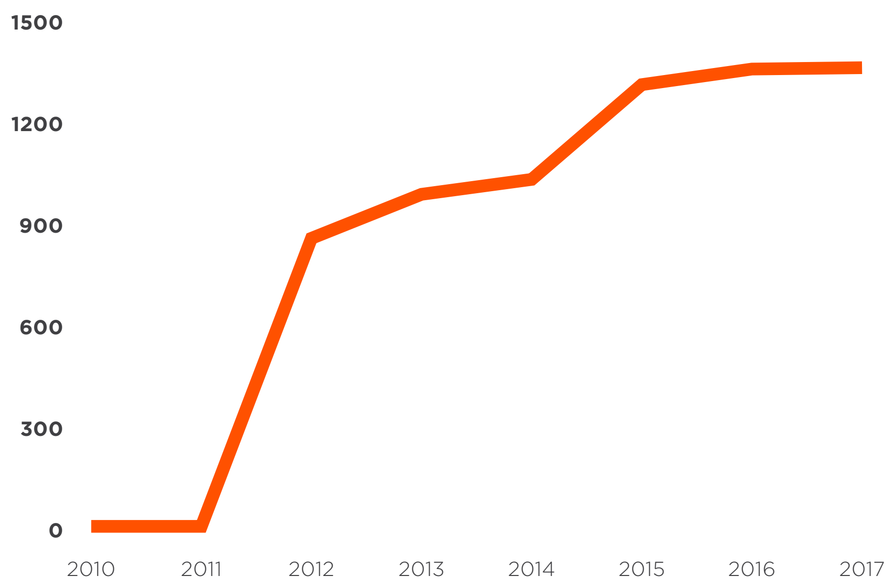
- **Although the financial sector of Myanmar is at the earliest stages of development, a growing part of the population has access to formal financial services, especially via the microfinance sector.**

- **Despite financial and regulatory reforms, the microfinance market is still small and has enormous growth potential, especially via international investors, because of the lack of funding options in the local market. This requires a blended finance strategy – such as the one provided by TCX in partnership with LIFT – that mitigates the variety of financial risks, including interest rate risk and currency risk, to which both microfinance institutions and investors are exposed.**

**MYANMAR HAS ALWAYS BEEN A REGIONAL TRADING HUB** thanks to its location at the intersection of China and India, two of the world's most vibrant economies. A long period of military rule broke with this tradition. In 2011, Myanmar opened up for trade and investment again. Since then, Myanmar has taken its first steps on the global market place, experiencing economic growth, a decline in poverty, an initial increase of foreign direct investments, more dynamic trade, and a more flexible exchange rate.

**Figure 1 | Nominal exchange rate 2009 - 2017** (MMK per USD)

**Source: Bloomberg 2018**

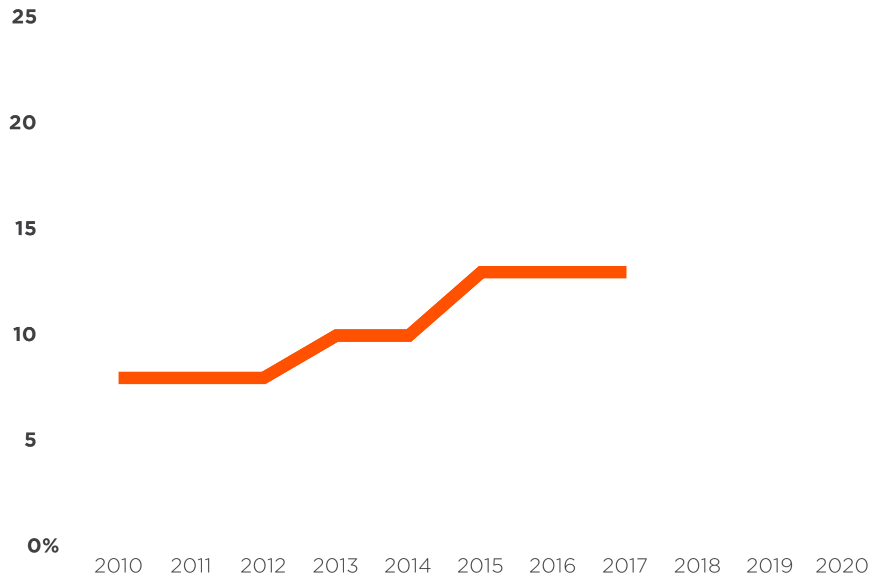


# TCX blended donor funding with the financial inclusion mission of development finance institutions operating in Myanmar. Combined, they realized over USD 80 million in local currency investments.

**TO SUPPORT FINANCIAL INCLUSION IN MYANMAR,** especially microfinance institutions have a high demand for financing. Unfortunately, lending to microfinance providers in Myanmar is heavily constrained. As in many fragile countries, there is a range of risks in Myanmar – including political instability, natural disasters, financial risks, including currency risk and regulatory risks. Regulation protects the end-clients of MFIs from currency risk; MFIs are not allowed to lend in hard currency to their borrowers. In Myanmar, the foreign exchange risk is borne at MFI level, when international investors provide loans in US dollars to the MFI. Foreign investors do not want to take the currency risk on the Myanmar kyat and offer dollars. Moreover, the Central Bank of Myanmar imposed an interest rate ceiling (cap) of 13% on lending, which is not enough to compensate for the risks involved in lending in kyat to microfinance institutions.

**Figure 2 | History of the cap, 2010-2020** (in %)

**Source: TCX, 2018**




**The challenges faced by international investors and the MFIs were recognized by LIFT, a consortium of international donors, whose goal is to stimulate financial inclusion of rural people in Myanmar and to improve their lives in general. TCX and LIFT established a unique cooperation that opened the microfinance sector for larger scale foreign investments by DFIs and Microfinance Investment Vehicles. TCX provided a hedging service which enabled investors to lend in local currency to Myanmar's microfinance sector. LIFT made funds available to subsidize the interest rate levels of these local currency loans, bringing them down to 13%, i.e. the level of the Central Bank interest rate cap. The result is that lending in kyat became attractive to both foreign investors and MFIs. The USD 10 million catalyzed over USD 80 million of new investments, denominated in kyat, into the Myanmar microfinance sector.**

## 2. DIRECT DEVELOPMENT RESULTS

### The role of TCX in reducing currency risks for the microfinance sector in Myanmar

- **To expand and satisfy the microfinance needs of the population, microfinance providers were looking for significantly more funds. However, the volatility of the Myanmar kyat (MMK), combined with the regulatory interest rate ceiling (13% p.a.), made lending in local currency unattractive to investors.**

- **A USD 10 million subsidy was used to catalyze USD 80 million of funds in local currency (MMK 109 billion) from 12 international lenders to 11 local MFIs to serve over 300,000 clients (84% of these clients are women, 64% of the clients live in rural areas).**

**THE UNIQUE PARTNERSHIP BETWEEN TCX AND LIFT** enabled local currency financing into the Myanmar microfinance market. The program has been very successful, which is underpinned by the total requests for allocations that were submitted to TCX. 11 of the 17 MFIs that were shortlisted by 12 different lenders who benefitted from the program subsidy and received funding at 13% in kyat. The total demand for local currency finance (USD 201 million or 92 loans to hedge) highly exceeded the available amount of the USD 10 million subsidy, which could only support USD 80 million, or 40 loans requiring a hedge.

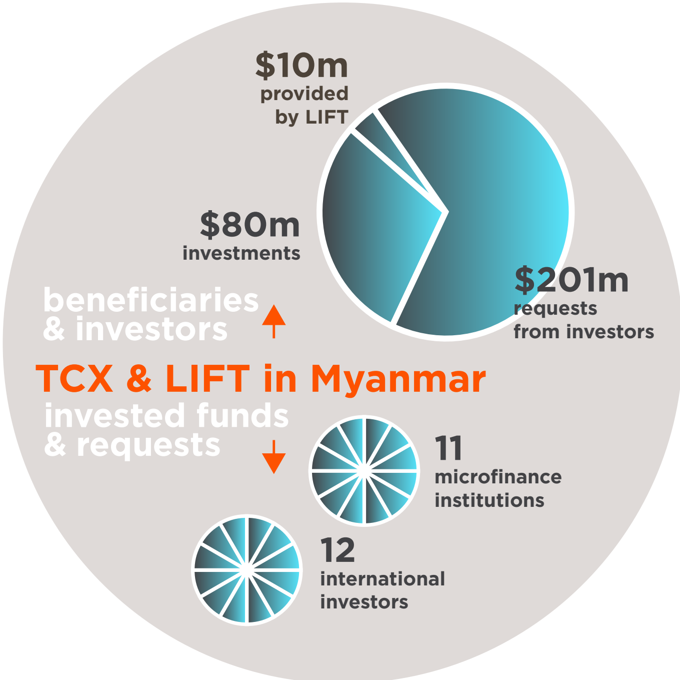
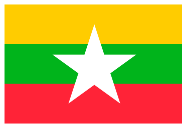



**Table 1 | Requested allocations vs. loans hedged via the LIFT program**

| | Requested Allocations | Loans Hedged |
|---|---|---|
| Volume (USD) | 201 | 80 |
| Lenders (#) | 20 | 12 |
| Loans (#) | 92 | 40 |
| MFIs (#) | 17 | 11 |

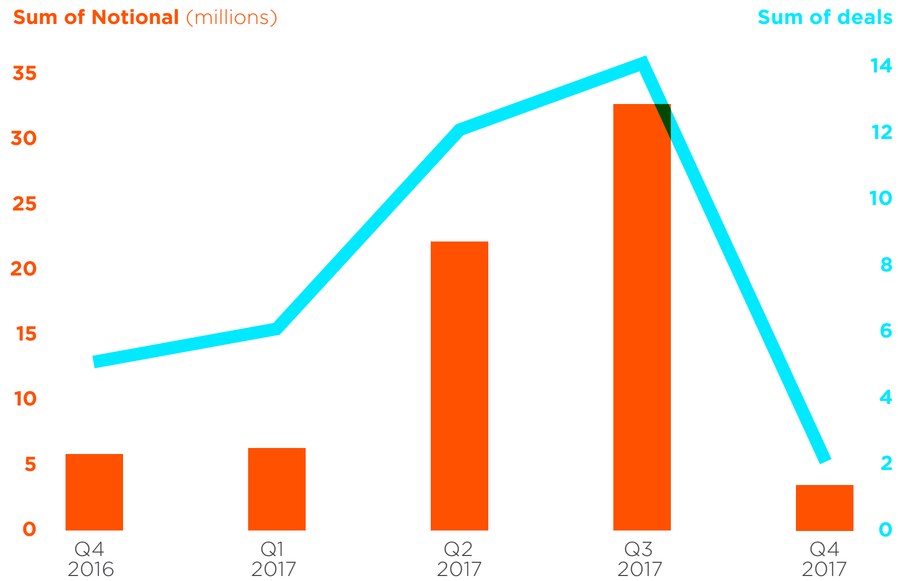
**Financial inclusion is an important enabler of the Sustainable Development Goals, spurs economic growth and improves people's everyday lives.**



The combined strength of TCX and LIFT led to a practical solution which enhanced the sustainability of the MFI sector and financial inclusion in Myanmar. This solution was designed to enable MFIs to scale up their lending volumes, directly by mitigating currency and credit risks, and indirectly by providing the capacity to leverage their capital and secure deposits.

**Figure 3 | TCX production figures for the Myanmar kyat, 2016-2017** (in USD million)

**Source: TCX, 2018**




In addition to the actual transactions, TCX has played an important role to support policy reforms to strengthen the development of the financial sector in Myanmar. TCX's intervention in Myanmar shows how donors can support financial inclusion through new partnerships and blending finance in imperfect markets.

## TCX'S interventions in the development of the financial sector in Myanmar

**2013**

**TCX scouting mission.**

- Development of a macroeconomic forecasting model (FPAS) to construct a LCY yield curve.
- LIFT-UNCDF-TCX investor conference organized.
- LIFT-TCX partnership to establish a hedging facility.

**2014**

**Letter of appreciation to commit to the growth of the microfinance industry.**

**2015**

**IFC, LIFT and CGAP roundtable on microfinance.**

- Queen Maxima of the Netherlands visited Myanmar in her capacity of UN Secretary General Advocate (UNSGA) for Inclusive Finance.

**2016**

**LIFT - TCX USD 10 million agreement to subsidize rates in local currency.**

# 3. TCX | A SHARED COMMITMENT TO LOCAL CURRENCY

## The role of TCX in reducing currency risks for the microfinance sector in Myanmar

**THE OBJECTIVE OF TCX IS TO PROMOTE LOCAL CURRENCY FINANCING** to reduce the risk that arises when international investors provide debt to borrowers in developing countries. TCX supports development finance (i.e. long-term international funding as a necessary supplement to domestic funding) by providing currency hedging instruments that absorb this currency mismatch. These instruments enable development finance institutions to provide their borrowers with finance in their own currency. As it is generally the entrepreneurs in the developing markets that would otherwise bear the currency risk, TCX, by eliminating this risk, contributes to more sustainable development in those countries.

As of the beginning of 2018, TCX managed a portfolio of USD 1.7 billion across 836 transactions in 53 emerging market currencies in 5 regions globally. TCX is an investment fund with both public and private shareholders. At the end of 2017, TCX had 24 investors, including the Dutch and German governments:

**THE FOLLOWING KEY PRINCIPLES are guiding TCX's operations:**

- **FOCUSED PRODUCTS: TCX only invests in market risk management products such as currency swaps. It does not provide funding.**
- **UNIQUE RISK MANAGEMENT: TCX assumes outright currency risk in highly illiquid markets, managing risk through portfolio diversification across all regions and countries in the emerging and frontier markets.**
- **ALIGNMENT WITH SHAREHOLDERS: By working with the commercial officers of its shareholders, TCX has origination access to their combined client networks and deal-flow. TCX tailors its investments for these institutions.**
- **MARKET-BASED PRICING: TCX invests in products that are priced in accordance with prevailing market rates and methodologies.**
- **ADDITIONALITY: TCX only invests where its counterparties have no adequately priced commercial alternatives.**
- **TCX only hedges actual exposures.**

**WWW.TCXFUND.COM**

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Disclaimer: The third-party data used in this report is based on information that TCX believes is accurate, reliable, and consistent over time, but that TCX has not independently verified.