

# Hindrances and Limitations of Digital Currencies Adoption in Frontier Markets

[info@huracapital.com](mailto:info@huracapital.com)

**Ekin Sezgen**

### Undeveloped & constrained banking system

- Underdeveloped consumer banking ecosystem (totalitarian state)
- State worried about private sector activities and thus banks were kept weak
- Central bank has taken a conservative view on all banking activity and is nervous about protecting the existing system (control-oriented mindset)
- Underbanked population stemming from the distrust of people towards banks (stemming from several bank runs in Myanmar history), that have led to credit being in short supply (e.g. no mortgage lending, no personal finance)

### Relatively new adoption of digital services

- Restrained digital environment – prohibitive cost of personal connectivity
- Military has had a “control” mindset and uptake of mobile phones were limited
- Only past couple of years, GSM revolution (access to smart phones, 5G has slowly started to take off)



## Myanmar stops short of digital currencies because Central Bank has discouraged people to adopt these tech

### Limitations

- Financial illiteracy
- Internet penetration (41% as of January 2020)
- Smart phone penetration (80%)
- Central bank outlawed the use of digital currencies in the country amid rising demand (May 2020)
- CAT doesn't trade outside of Myanmar → shallow forex market
- Need for smoother trade and transactions
- People that have banking license can get a P2P license
- Smoother need of trade and transactions
- P2P and digital wallets – people are much more comfortable with these offerings
- Online side of things is gobbling up
- Digital currencies can be more widely adopted if Central Bank's view towards digital currencies changes



### Limitations

1. Technological illiteracy partially offset by wide usage of Facebook and smartphones
2. Lebanese people are skeptical towards a new technologies. Country is filled with traditionalists and they are hesitant that they might lose their savings through digital currencies (numerous bank runs have dampened people's appetite to take risks with their money)
3. Difficulty in trading and buying cryptocurrencies partially offset by investing through P2P exchanges (Lebanese central bank, Banque du Liban) made it nearly impossible to buy/sell bitcoin via conventional ways through international exchnages
4. Bitcoin is not a medium of exchange yet. It needs to become more easily redeemable in conventional currencies which can be used for grocery purchasing and other essentials

### Catalysts

1. Financial crisis
2. Devaluation of Lebanese pound
3. Political instability



### Expert Interview Notes

1. Central bank of Lebanon declared its illegal to trade bitcoin with trading account or credit card – demolish trust – its not permitted to buy and trade bitcoin – direct hit
2. Lack of awareness (SMEs)
3. Inertia → people are used to fiat money (USD)
4. People don't take the initiative to venture into something new – pressing economic situation (inflation currency) forced to see outside of the box
5. Lack of trust & awareness as well as policy & Inertia are the main reasons why digital currencies (especially bitcoin) are not adopted as a store of value or mean of exchange.

Bank account outside of Lebanon – they can then sell it locally mainly via OTC physical trx

Possible bitcoin arbitrage

Purchase bitcoin overseas bank account

Sell bitcoin via wallet to wallet transfer

And get cash (5%) commission

Spreading awareness is key

You can withdraw only USD 15 on a monthly basis from your bank account. These fundamental issues have to first be sorted out in order to pave the way for more wide digital currencies adoption



### Limitations

1. Regulation needs to provide legality on crypto usage (A law permitting transactions in international currency was implemented in 2019 which opened up payments in dollars and crypto) Next step would be implement a crypto accounting degree so larger firms can include crypto in their books
2. Easy-to-use crypto products and liquidity is required
3. Education (how to acquire, store and transact in crypto)

### Catalysts

1. Political unrest
2. Frequent and lengthy blackouts
3. Skyrocketing inflation

Note: There are now over thousand locations accepting crypto payments, and people are enthusiastic to download wallets (Burger King started accepting crypto payments). While a thousand merchants represent less than 1% of total stores in the country, this is a level of adoption and usage not seen anywhere else



## Limitations

1. While Argentina's central bank was an early mover in looking at efficiencies created by blockchain, it issued statements as far as back in 2014, telling citizens they could not use digital assets as a form of legal tender and warning of potential fraud
2. Section 765 of the Civil Code determines that only the Argentine fiat currency can be considered as money, thus excluding any possibility of including cryptocurrencies in such category
3. In November 2019, Argentina's central bank had formally banned consumers from purchasing Bitcoin and other cryptocurrency using credit cards but citizens trade bitcoins on P2P platforms such as Local Bitcoins
4. Cryptos do not offer predictability and stability for the underlying need for a universally-accepted stablecoin and financial standard that could be adopted by anyone in the world
5. Ban on crypto purchase with credit card by Central Bank in October

## Catalysts

1. High volatility and devaluation of Argentine peso
2. Fragile economy
3. Low economic visibility
4. Despite the volatility of crypto, Argentinians trust it more as a store of value than the peso because Bitcoin cannot be manipulated by the government



### **Contacts Interviewed:**

- Kevin Murphy – Andaman Capital Partners (Yangon) and collected information on Myanmar
- Diez Martin Ignacio (Banco Hipotecario) and collected information on Argentina
- Daniel Baeza (Frontclear Management) and collected information on Latin America in general
- Ahmad Diab SMAP Energy on Lebanon
- Turkish contacts



### Three main reasons why digital currencies haven't been widely adopted as store of value and medium of exchange in Frontier Markets

- 1. Price volatility:** Belief that one is entering late to the party around the price he/she pays for something that might be overvalued – difficult to measure based on traditional valuation methods. FX rates are obviously largely determined by several inputs such as balance of payments, current account deficit, reserves, political stability, economic visibility, inflation, interest rates, etc. There is no certainty around the real value of digital currencies and more specifically it is difficult to rationalize which of them will succeed and which will not. Accordingly, these instruments are more often used for trading purposes rather than being adopted as a store of value by having a long-term exposure
- 2. Trust:** Plays a crucial role when it comes to a currency and based on interviews, people are afraid that several cryptocurrencies might not be secure and that they might be hacked. In studied frontier markets, people use local currency for “medium of exchange” and perform foreign transactions by converting their capital / savings to USD. In other words, local currency is used for transactional purposes done locally and US Dollar for savings and foreign transactions
- 3. Friction:** Issues in governance and regulation plays a fundamental role. Regulatory hurdles and lack of cooperation and support from Central Banks located in Frontier Markets impose a friction in the adoption of digital currencies. Authorities make it difficult to buy cryptos using credit cards and this is typically done through P2P. For foreign transactions, there are restrictions in order to exchange local currency against any currency (that include cryptos) and the infrastructure of the payment systems abroad is in USD (i.e. in order to take money abroad, you have to do it in USD and then you have to convert them into cryptos, so there are two conversions to be done and fees to be paid and once you convert into USD, it doesn't add much value to convert into cryptos just for payment purposes

## Stablecoins – Promising Altcoin but not as widely supported by Bitcoin

**Stablecoins** are a type of cryptocurrency that often has its value pegged to another asset such as fiat currency, or precious metals. Stablecoins act as a potential antidote to Bitcoin's and other altcoins' volatility by tying the value of the coins to existing currencies. By tackling the core issue – price volatility – by being collateralized. Facebook's Libra is a great example and the most famous stablecoin

- Challenges with stablecoins is that they are an even newer form of digital currency with much less history and track record compared to bitcoin
- Another challenge involves lack of liquidity
- Difficulties in adoption of stablecoins arise from the lack of transparency in these form of cryptocurrencies (e.g. USD 850mn of Tether's funds were used to cover losses at Bitfinex, an affiliated exchange – affecting confidence in stablecoins)
- Development challenges such as weaker capacity to address AML risk and lack of robust cash-in / cash-out solutions as well as cross-border challenges such as capacity constraints in cross-border coordination and oversight challenges make stablecoins a less preferred choice of cryptocurrency compared to bitcoin
- Regulatory and oversight challenges and risks (e.g. cyber security, data privacy, tax compliance)

Source: G7 Working Group on Stablecoins, October 2019

## Attractiveness of Bitcoin in Latin America and some of the challenges of adoption from a high-level view

**Current turbulence in frontier market currencies, especially Argentinian peso and Venezuelan bolivar increased appetite for bitcoin in those countries. Money printing will eventually play a contributive approach to inflation and current debasement of fiat currencies along with political instability and uncertainty make bitcoin, among other altcoins the most attractive alternative asset class in Latin America. Having an alternative option other than gold makes bitcoin appealing.**

### **So why haven't bitcoin buying really picked up in Argentina and Venezuela?**

- Not a lot of sophistication among Latin American buyers
- People who are most subject to the negative impacts of political and economic instability tend to be on the lower or middle end of the social spectrum – they don't have significant amount of wealth and largely depend on remittances
- Users are difficult users – lack of knowledge and financial illiteracy
- Economics and social demographics play a significant role in determining the level of adoption of bitcoin in Latin America in general
- Government efforts to push back on digital currencies, especially bitcoin – the most liquid and most widely adopted relative to other digital currencies – is a big deterrent
- It will take time to instill trust into bitcoin
- As bitcoin becomes less volatile and governments relax regulations, it will provide a suitable ground for exponential growth in adoption

## Multi-variable Model

### **Odds of a country adopting digital currencies faster increases when we encounter the following**

- Distrust in banks and financial system are greater than others
- Countries that are experiencing inflation crises – occurrence of inflation crises is associated with increased adoption of Bitcoin infrastructure
- Bitcoin infrastructure seems to be complimentary to existing financial systems – it is important to point out that less adoption is observed where share of unbanked are highest!
- More Bitcoin infrastructure is found where the willingness to take risks are higher
- Focus should be on bitcoin instead of other digital currencies and altcoins because most cryptocurrencies are recorded as clones or variations of the Bitcoin technology and build their blockchain as a fork of the Bitcoin technology or on nearly identical transaction ledgers. Bitcoin also has the highest cryptocurrency trading volume, constitutes more than half of cryptocurrencies' market capitalization, provides liquidity to other cryptocurrencies and enables a secondary market for the cryptocurrency ecosystem to thrive on. Accordingly it is the benchmark and best indicator to assess the limitations of digital currency adoption in frontier markets
- The growth of Bitcoin infrastructure has the likelihood to be supported by the actual use of bitcoin (means of exchange) – whether people can use it for transactional purposes
- Speculation is a factor impacting the extent of adoption