CLIENT ALERT

Exchange Rate Unification Delayed

Cuban government officials have repeatedly indicated that currency unification is a top reform priority, but we expect that ideological hesitancy and practical implementation considerations will result in significant delays. We now anticipate that the dual exchange rate regime will persist until 2018.

It is difficult to anticipate the precise timeline of unification, but given its centrality to the country's broader effort to more deeply integrate into the global economy; we expect its implementation in the near future.

The government first announced its intentions to unify the country's two official exchange rates - the 'convertible peso' (CUC), pegged one-to-one with the US dollar, and the 'national peso' (CUP), which trades at around CUP24.00/USD - in 2013, but in subsequent quarters, details regarding the initiative have been scarce. The government issued higher-denominated CUP notes, ranging from CUP200 to CUP1, 000, in during the last quarter of 2015 in order to prepare for convergence between the two pesos, while state-owned enterprises were directed to prepare for peso unification.

At the Seventh Congress of the country's ruling Communist Party held in April, a major party gathering held every five years to set priorities for government policy. Officials disappointed many international observers by failing to make much mention of currency reform at all, much less establish a timetable or detailed plan of action.

There is a consensus about the need for unification. Given the drastic difference in value between the two currencies, a two-tiered socioeconomic structure has gradually emerged, whereby the earners of convertible pesos have much more purchasing power, particularly for sought –after imported goods. Meanwhile, the national peso`s usefulness is confined to basic goods, such as those provided at government- run ration stores.

Most likely the government will ultimately opt for an incremental adjustment, converging both the national and convertible peso to an intermediary rate. This will help mitigate the likely inflationary impact of what will amount to significant currency devaluation.