Islamic Currencies: What's For Dinar?

The etymology of money is replete with "fun facts." The word "dollar" derives from the *Joachimsthaler*, named after the Bohemian city of Joachimsthal. During the period when Spain had a Habsburg king, namely Charles V (Carlos I in Spain) of the Holy Roman Empire, the coin acquired circulation in Spain's American colonies where the "thaler" or "tolar" ending was corrupted into "dollar."

Or, consider the slang term for loose cash, "dinero." This is a straight adaptation of the Spanish word; it has moved into American English through the U.S.' large Hispanic minority. As Spain itself was under Moorish rule in all or part of eight centuries and traded with Islamic North Africa afterwards, no one should be surprised the word worked its way into Spanish from Arabic…with stops from the Greek *denarion* (meaning "ten asses," at which point we shall go no further) and the Latin *denarius*, related to "ten," and ultimately to the proto-Indo-European root, *dekm*, also referring to "ten." Apparently the concept of counting to ten led to the widespread distribution of a word for money not only in Indo-European languages directly, but also back into Indo-European languages via Arabic.

The Dinar Today

"Gold" supposedly is the oldest word in continuous use in English, and it certainly enjoys something of an exalted place in commerce and finance. Why, then, do all of the dinars in circulation today struggle so much? Let's take a look at six dinars in the Islamic world for which something of a market exists:

1. Algerian (DZD)
2. Iraqi (IQD)
3. Kuwaiti (KWD)
4. Libyan (LYD)
5. Sudanese (SGD)
6. Tunisian (TND)

The Serbian dinar (SGD) has something of a market, but even though Serbia was under Ottoman rule for centuries and has a Muslim minority, we really cannot call it an Islamic country. The Bahraini (BHD) and Jordanian (JOD) dinars are not traded enough to consider.

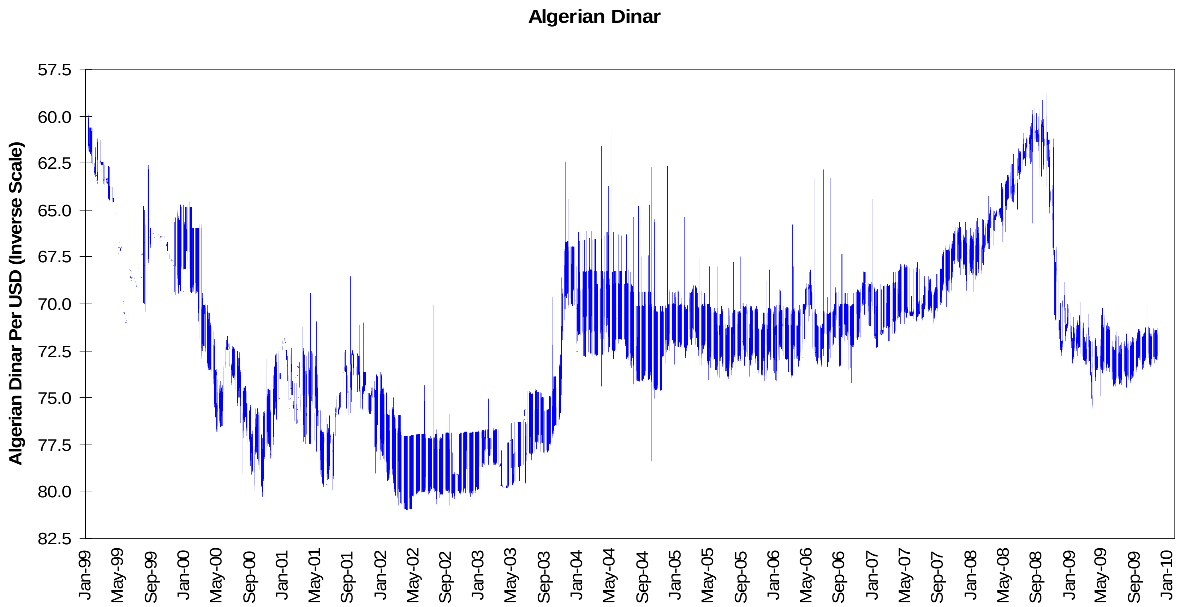
Two considerations arise immediately in discussion of trading various dinars. The first and perhaps the most important is the Islamic prohibition on interest. As currency trading is borrowing in one currency and lending in another, the direct prohibition on a stated interest rate can and does present some impediments. It would be as if we had to run a hotel kitchen without using an oven or a stove.

The second involves an unavoidable piece of political incorrectness, and that is the nature of the states involved. Sudan has been involved in decades of civil war, the human rights debacle of Darfur included, Libya has been under the rule of Muammar Qaddafi for four decades, the Iraqi dinar in question is actually the "new" Iraqi dinar, and if you have to ask what happened to the old Iraqi dinar… Kuwait has been living off the astonishing wealth produced by the supergiant Burgan oil field since the late 1930s, and the ruling al-Sabah dynasty only recently has moved to grant its own citizens a modicum of political power. Neither Algeria nor Tunisia has been able to move into the next level of economic development despite their educated populations, many of whom are Francophone, and proximity to the European Union.

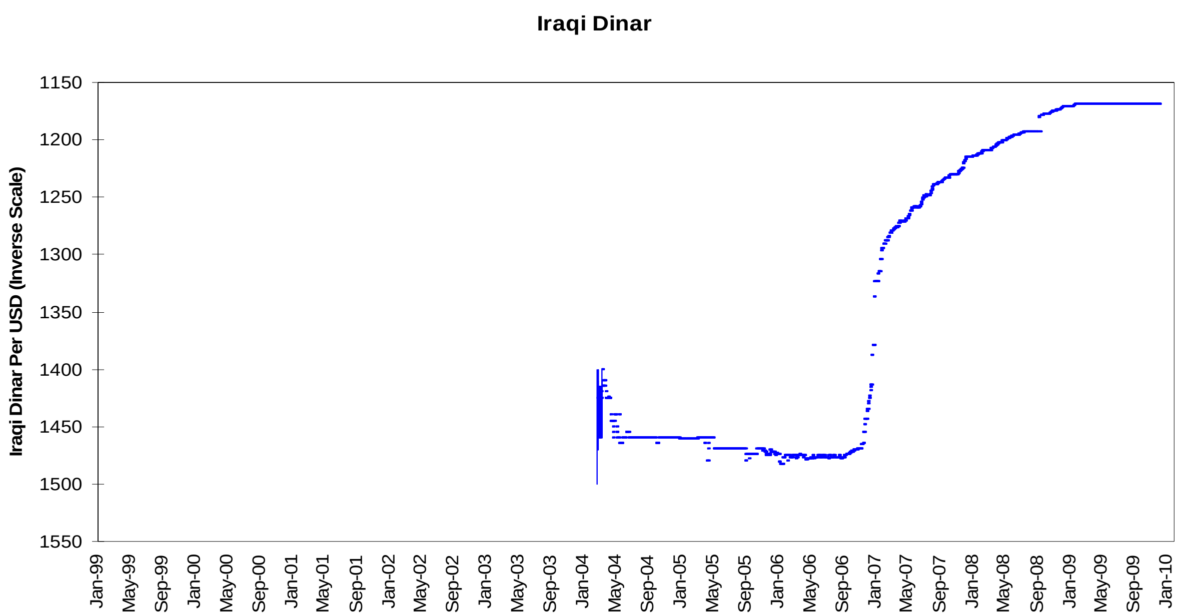
The normal tools we might use to analyze a currency, such as expected interest rate differentials or implied volatility trends, are lost to us. So, too, are the technical tools of selecting an optimal N-day moving average for the simple reason there are too many days where the high and low of the currency are the same.

Review Of The Markets

The Algerian dinar has put in three periods of significant trendiness since the January 1999 advent of the euro. The first was a general weakening as the dollar strengthened against the euro going into mid-2002. The second was a rally between mid-2007 and the peak of the 2008 financial crisis; the third was an abrupt collapse in late 2008 as investors everywhere fled to the safest assets they could find. There are no stock indices for Algeria or any other capital markets to which we can point for purposes of ascertaining prospective returns on assets.

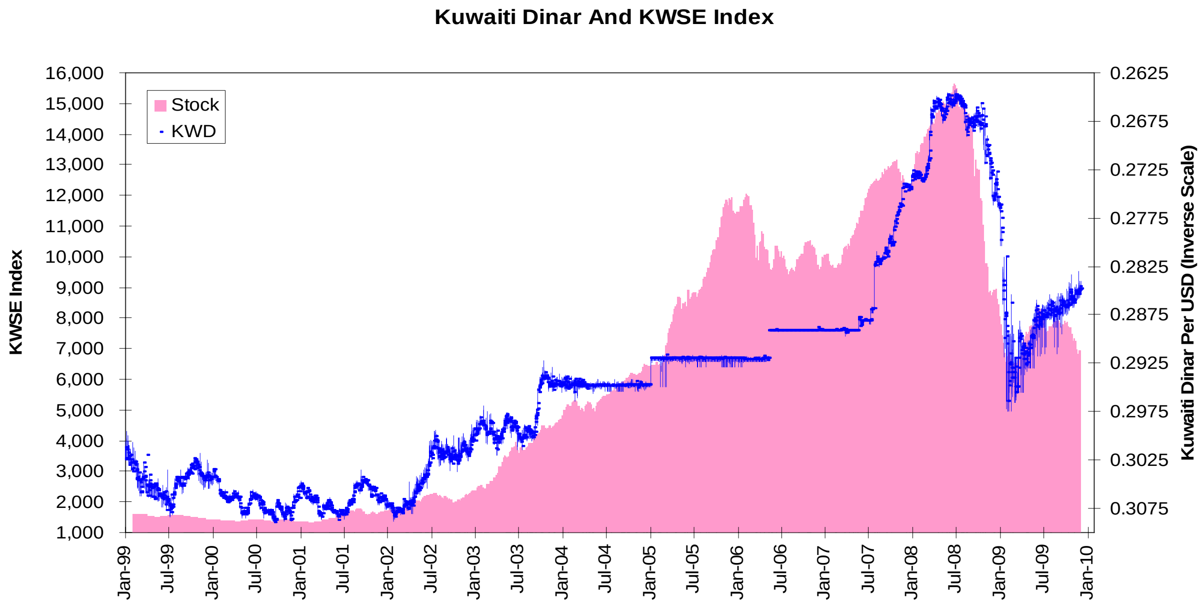


The Iraqi dinar can be excused for much as it must be difficult to establish a currency whilst under a combination of civil war and military occupation. This makes the IQD's rally since the start of 2007 both interesting and suspect. As the war stabilized and the Maliki government increased some measure of stability, speculative capital flowed into Iraq and the IQD put in a strong rally, which stopped by fiat in 2009. As in the case of Algeria, however, we have no other ancillary indices or interbank markets from which we can obtain further data.

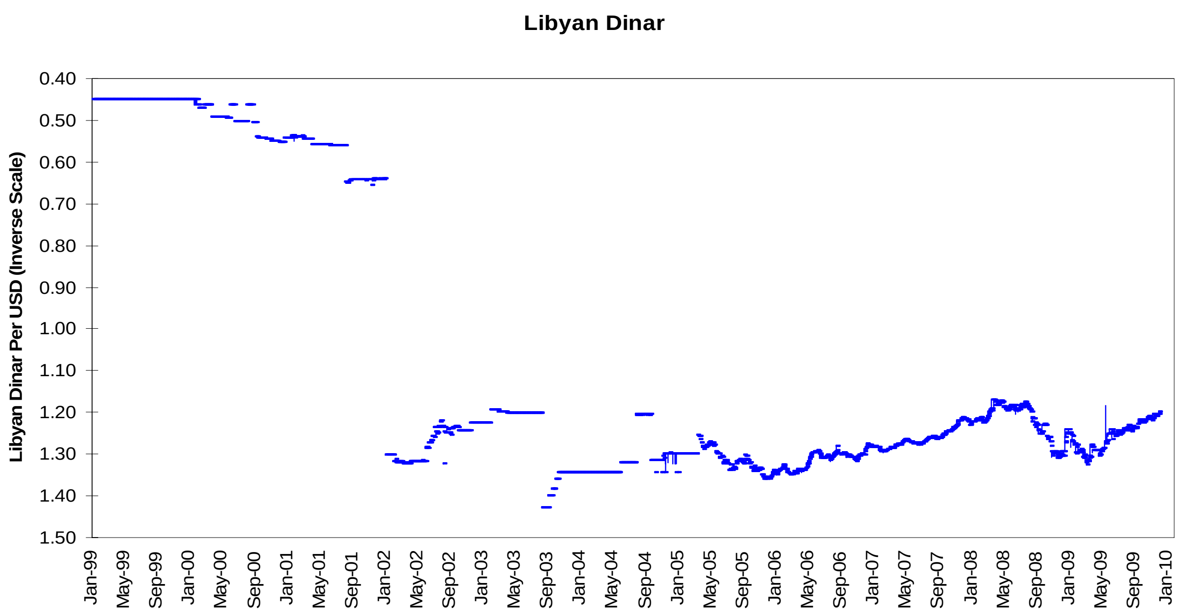


Kuwait presented the very picture of a managed float over much of the post-1999 period; the KWD strengthened during the long economic boom of 2004-2008 as oil money flowed more rapidly than ever into the country. It then fell sharply as investors fled in late 2008; this is most unsurprising.

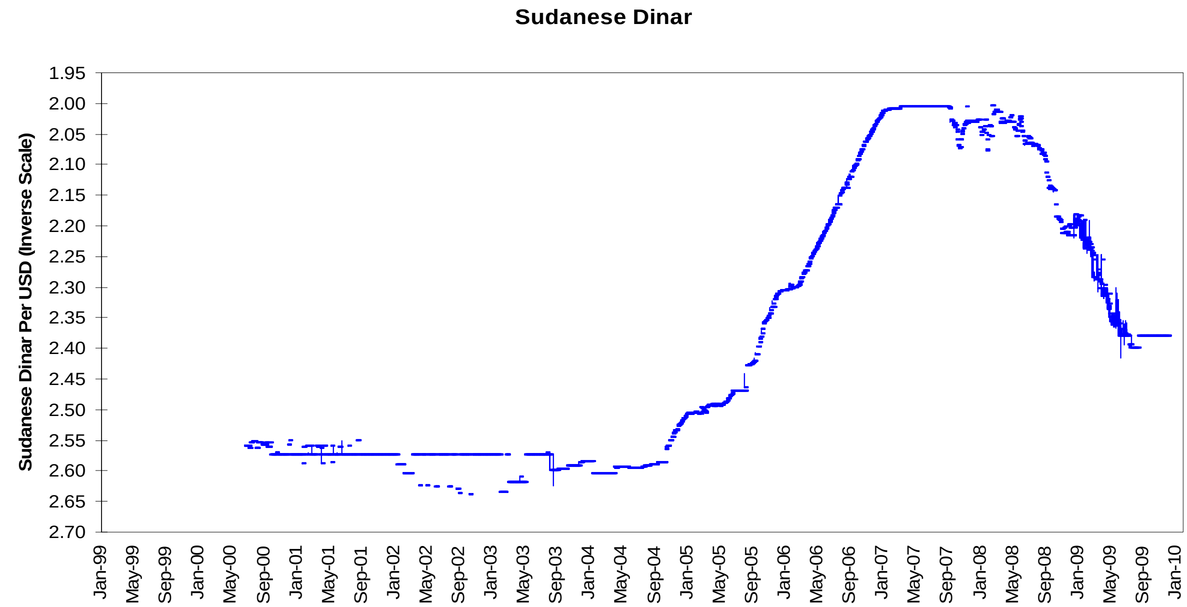
Kuwait does have an active stock market, and in a striking contrast to the pattern we often see with the major currencies, the stock market and currency had tended to rise and fall together. This stopped in October 2009 as a rising level of financial stress started to hit a number of states in the region; the problems announced by Dubai in late November 2009 were still almost two months away. Kuwait also has an interbank market for interest rate contracts, but it is not sufficiently deep and liquid to do a normal interest rate differential analysis.



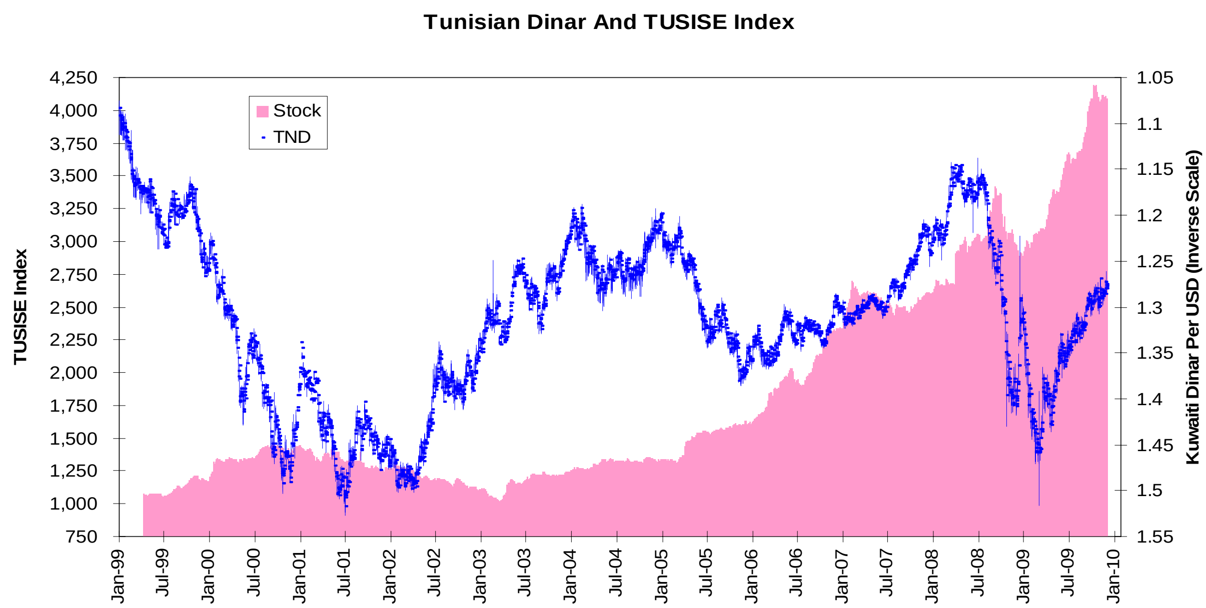
The Libyan dinar broke in a devaluation-style manner in early 2002 and has remained in a closely managed range since that time. There are no interbank or equity markets in Libya. Were it not for an accident of geology, this might be one of the poorest, most desolate countries on Earth.



We could say almost the same thing about Sudan, but twice over. It is not a complete desert; no, it has one of the largest and most impenetrable swamplands in the world, the Sud, in its south to go along with its desert in the north. Combine that with a nonstop civil war between its Muslim north and animist/Christian south plus a drift toward the various Islamic extremist factions wandering about in the region and you have…a currency that rallied in a managed line between 2005 and 2007 and fell in an equally straight line after 2008 until it stopped by decree in October 2009.



Finally, we come to Tunisia. Like Kuwait, Tunisia has an active stock market we can point to, and it has a listed interbank market that does not trade. Unlike Kuwait, Tunisia is not blessed with massive oil wealth or a huge population of expatriates who do all the work, and therefore the link between the currency and the stock market is not particularly strong. The TND chart is the most "advanced" chart we can point to in this survey of dinars; it rises and falls in a market-like manner.



Conclusion

We should ask the simple and direct question whether having a tradable or convertible currency makes an economy develop more quickly or whether development is a precondition for a tradable currency. A body of evidence favors the former. When a country decides to make its currency tradable, either freely or freely enough, it is sending a signal to the global community it is ready, willing and able to adhere to certain standards. Moreover, to the extent the presence of a central bank regulating monetary policy within a country is a sign of advancement – and we will withhold from some obvious digs here – the absence of a central bank willing to provide for the free flow of a currency across borders is a sign of arrested development. Consider the signals sent at various times by Ecuador and Argentina to "dollarize" their currencies. They effectively ceded control of their monetary policy and therefore a good chunk of their sovereignty to the Federal Reserve. If you ever wonder about the wisdom of currency trading, ask someone who has lived under a currency board what it is like to have their money supply and therefore their internal interest rates and credit flows regulated elsewhere.

The lesson we can take away from this survey of dinars is the countries that use them have some work to do before they can sit as full members of the adult table. For now, the question, “What’s for dinar?” must be answered, “Regardless of what, you have to sit with the children.” How embarrassing is that?