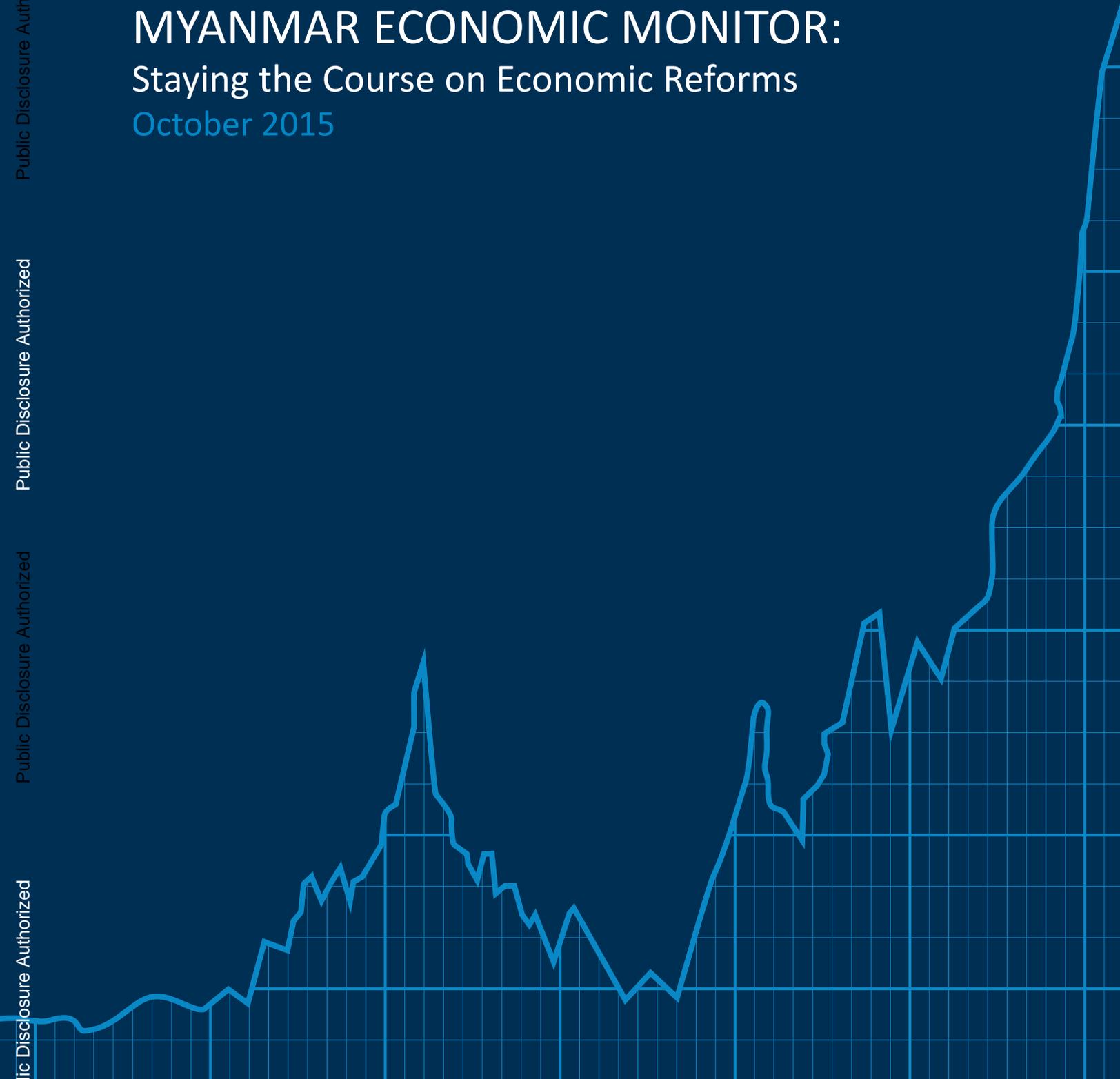


# MYANMAR ECONOMIC MONITOR:

## Staying the Course on Economic Reforms

October 2015



**WORLD BANK GROUP**  
Macroeconomics & Fiscal Management

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The Myanmar Economic Monitor (MEM) aims to periodically take stock of economic developments and highlight economic prospects and policy priorities in Myanmar. The MEM draws on available data reported by the Government of Myanmar<sup>1</sup> and additional information collected as part of the World Bank Group's regular economic monitoring and policy dialogue. The MEM team is very grateful to the Ministry of Finance, the Ministry of National Planning and Economic Development, the Ministry of Commerce, the Central Statistical Organization, the Central Bank of Myanmar, and the Directorate of Investment and Company Administration for excellent collaboration, and to Ulrich Zachau (Country Director, South East Asia Country Management Unit), Sudhir Shetty (Chief Economist, East Asia and Pacific Region), and Ahmad Ahsan (Lead Economist, EAP Chief Economist's Office) for their review and advice.

The MEM was prepared under the overall guidance of Mathew A. Verghis (Manager, Macroeconomics and Fiscal Management Global Practice), Abdoulaye Seck (Country Manager for the World Bank in Myanmar), and Shabih Mohib (Program Leader, South East Asia Country Management Unit) by a team including:

<b>Alexandra Drees-Gross</b>	Senior Financial Specialist	Finance and Markets
<b>Alex Sienaert</b>	Country Economist	Macroeconomics and Fiscal Management
<b>Charles Schneider</b>	Senior Operations Officer	Trade and Competitiveness
<b>Espen Beer Prydz</b>	Economist	DEC Poverty and Inequality
<b>Habib Rab</b>	Senior Economist/Team Lead	Macroeconomics and Fiscal Management
<b>Jason Pellmar</b>	Senior Investment Officer	International Finance Corporation
<b>Julie Earne</b>	Senior Operations Officer	International Finance Corporation
<b>May Thet Zin</b>	Economist/Co- Team Lead	Macroeconomics and Fiscal Management
<b>Nang Htay Htay</b>	Financial Sector Specialist	Finance and Markets
<b>Nagavalli Annamalai</b>	Lead Counsel	Finance and Markets
<b>Puja Dutta</b>	Senior Economist	Social Protection
<b>Reena Badiani-Magnusson</b>	Senior Poverty Economist	Poverty
<b>Sergiy Zorya</b>	Senior Economist	Agriculture
<b>Sjamsu Rahardja</b>	Senior Trade Economist	Trade and Competitiveness
<b>Tenzin Dolma Norbhu</b>	Program Coordinator	Transport and ICT

The team is grateful to Kyaw Soe Lynn and Meriem Gray from EXT for their support and guidance on publication and outreach. Views expressed in the MEM are those of the authors and do not necessarily reflect the views of the World Bank Group, its Executive Directors or the countries they represent.

<sup>1</sup>Please see "Myanmar Staff Report for the 2015 Article IV Consultation-Informational Annex: Statistical Issues" for IMF data adequacy assessment.

## Abbreviations

<b>BIS</b>	Bank for International Settlements	<b>WBG</b>	World Bank Group
<b>CBM</b>	Central Bank of Myanmar	<b>WDI</b>	World Development Indicators
<b>CEIC</b>	CEIC Data	<b>IFS</b>	International Finance Statistics
<b>CSO</b>	Central Statistical Organization	<b>IMF</b>	International Monetary Fund
<b>DICA</b>	Directorate of Investment and Company Administration	<b>kWh</b>	Kilowatt hour
<b>EU</b>	European Union	<b>MMcf</b>	Million cubic feet
<b>FAO</b>	Food and Agriculture Organization	<b>MOAI</b>	Ministry of Agriculture and Irrigation
<b>FDI</b>	Foreign Direct Investment	<b>MOGE</b>	Myanmar Oil and Gas Enterprise
<b>GDP</b>	Gross Domestic Product	<b>REER</b>	Real Effective Exchange Rate
<b>GOM</b>	Government of Myanmar	<b>USDA</b>	United States Department of Agriculture

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# Executive Summary

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## *Recent Developments*

**1** Myanmar grew at an estimated 8.5 percent in real terms in 2014/15. Economic reforms have supported consumer and investor confidence despite ongoing business environment and socio-political challenges. Public consumption and private investment on the demand side, and the services sector on the production side were the main drivers of growth. Agricultural output picked up in 2014/15 after two years of sluggish growth. Output in manufacturing and industry has been strong thanks to gas in particular. There has been growing investment in light manufacturing, which slowed in early 2015/16 together with construction activity linked in part to the upcoming period of political transition.

**2** The economic impact of the floods that hit Myanmar in July 2015 is still being assessed, but will likely adversely affect the main rice crop this year. According to preliminary analysis of Census data, the areas most affected by the floods are those where people were relatively worse off.

**3** Strong demand for investment-related capital imports has widened the current account deficit in 2014/15 to over 6 percent of GDP. Export fortunes remain closely linked to gas (around 40 percent of merchandise exports), which helped offset a drop in forestry exports last year. Agriculture trade was strong thanks to a rebound in the output of beans, pulses and rice. The drop in international commodity prices helped reduce import costs of refined oil, though had not yet fully fed through to gas prices in the first quarter of 2015/16.

**4** Inflationary pressures increased over the course of 2014/15, largely on account of food prices, with CPI rising by 7.5 percent in the year to end March 2015, reaching just over 10 percent in the year to July 2015 due to supply pressures and a weakening Kyat. Although the price of rice, beans and pulses in 2014/15 were stable in line with international developments, the price of processed foods had increased. Rising food prices are anticipated to particularly affect urban poor households and poor rural households who are net-purchasers of food.

**5** Reserve money remained relatively stable till the end of 2014 though overall money supply grew rapidly on account of credit to the private sector. Banking sector exposure to vulnerabilities is limited by its low level of development, but strengthening banking supervision remains a priority to avoid a build-up of risks. The exchange rate depreciated by around 20 percent in nominal terms in the year to August 2015 due to a general strengthening of the US Dollar, a growing current account deficit, and slowing foreign investment inflows in the run up to the elections. Recent efforts by the Central Bank to maintain exchange rate flexibility by allowing further depreciation of the Kyat have helped to curtail the parallel market.

**6** Estimates of Union Budget outturn for 2014/15 signal continued efforts at trying to maintain a prudent fiscal stance in the face of growing public service demands. The general government budget deficit is estimated at 4 percent of GDP for 2014/15. Strong revenue performance was in part due to a windfall from telecom license receipts. Though reforms in tax

administration – including the introduction of self-assessment and the establishment of a Large Taxpayers' Office – are also beginning to pay off in terms of higher revenue collections. Spending on social sectors and economic services continued to trend up as a share of GDP in the 2015/16 Budget. These budget shifts aim in part to reduce household spending on education and health, and to support human development outcomes among poorer households.

### *Economic Outlook*

**7** Economic growth in 2015/16 is expected to moderate to 6.5 percent in real terms, though this is subject to revision as more details come in on the impact of the floods. Agriculture growth will drop on account of the floods, and investment in manufacturing and industry will likely remain slower over the course of the political transition. Inflation in 2015/16 is projected to increase to 11.3 percent (period average) due to a combination of supply pressures caused by the floods and currency depreciation.

**8** Fiscal policy is expected to remain broadly on track, but the current account will come under further pressure due to import demand for post-flood rehabilitation and slowing agricultural exports. Myanmar will also face a number of challenges from the external environment. Slowing growth in China could adversely affect the demand for Myanmar's merchandise exports. Low international commodity prices will affect gas exports, though these could be offset by higher output from Shwe and Zawtika fields that came on stream two years ago, and also higher Kyat earnings from gas as a result of currency depreciation. The

US Federal Reserve's eventual decision to raise interest rates could further strengthen the US Dollar and place added pressure on the exchange rate.

**9** Economic growth is expected to pick up over the medium-term, assuming continued progress on economic reforms and a smooth transition. The agriculture sector should bounce back rapidly, and services should continue to grow at a strong pace thanks to further expansion of telecommunications and banking services in particular. Manufacturing and industry are also expected to pick up post elections, particularly as recent investments in light manufacturing (e.g. garments) begin their operations in newly established economic zones.

**10** Whilst medium-term growth prospects remain strong, addressing the impact of the floods on poor households will be a challenge. The floods have hit two of the poorest States in Myanmar, namely Rakhine and Chin, which have been declared as natural disaster zones. Loss of livelihoods has been compounded by loss of assets and reduced access to social services. This will require a strong public sector response.

### *Policy Watch*

**11** The Policy Watch in this Myanmar Economic Monitor covers a few selected priority issues closely related to Myanmar's overall economic developments and outlook. Other, broader economic and social policy issues that are also central for inclusive and sustainable growth (such as education, health,

<sup>3</sup>See for example the World Bank Systematic Country Diagnostic for Myanmar

rural development, energy, water, environment, or social development) are (or will be) covered in separate publications<sup>2</sup> and/or future issues of the MEM.

**12** Addressing short-term macroeconomic challenges will require continued efforts at maintaining exchange rate flexibility supported by fiscal and monetary discipline. The Central Bank of Myanmar's recent stance to have greater flexibility in the Kyat-Dollar exchange rate is a positive move. In the short-term, exchange rate flexibility will be important given structural shifts in trade, evolving capacity to carry out open market operations, and limited foreign reserves. To control growth in money supply it will be important to implement new prudential regulations in the banking sector (see below) and ensure a gradual elimination of monetary financing of the budget deficit.

**13** Strong growth prospects assume continued progress on structural reforms. The recent adoption of a minimum wage needs to be supported by strong institutional arrangements to ensure efficient labor markets. Other structural reforms include adoption of legislation to strengthen the business environment (e.g. the Investment Law and the Companies Law), modernize the banking sector (Banking and Financial Institutions Law), and strengthen public debt management (Public Debt Law). Efforts to address access to finance is another priority. This remains a big constraint, particularly for poorer households who have more limited sources of collateral and limited access to formal financial institutions.

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<sup>2</sup>See for example the World Bank Systematic Country Diagnostic for Myanmar

# Real Sector

## Continued Recovery In Growth

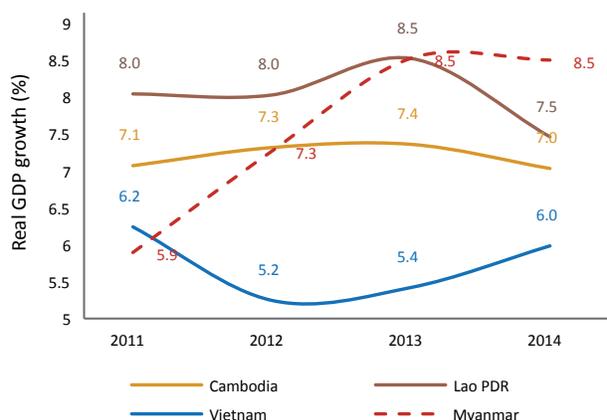
**1 Myanmar’s economy grew at an estimated 8.5 percent in real terms in 2014/15.** This compares favorably to other countries in the region (Figure 1) and reflects pent up demand and continued rebound in economic activity supported by reforms adopted since the country began to open up in 2010/11. This period has seen significant challenges including border conflicts, peace negotiations, preparation for the upcoming political transition, a difficult business environment, and major infrastructure gaps. The overall trajectory of economic reforms, however, has provided positive signals that have supported private consumer and investor confidence.

**2 Myanmar’s growth record since 2010/11 is comparable to other high performing countries in the five-year period following the start of economic liberalization.** Myanmar has grown at an average of 7 percent per annum since 2010/11. Countries such as Korea, Vietnam, China, and others also grew between 6 and 10 percent when they began opening up (Figure 2). Robust growth in these countries was sustained by rapid expansion of manufacturing and exports. The recent spurt in investments, together with rapid growth in supporting services such as transport, telecommunications and banking suggests that Myanmar could also have a similar growth trajectory if reforms and public services can be sustained.

## Public Consumption And Private Investment Driving Growth

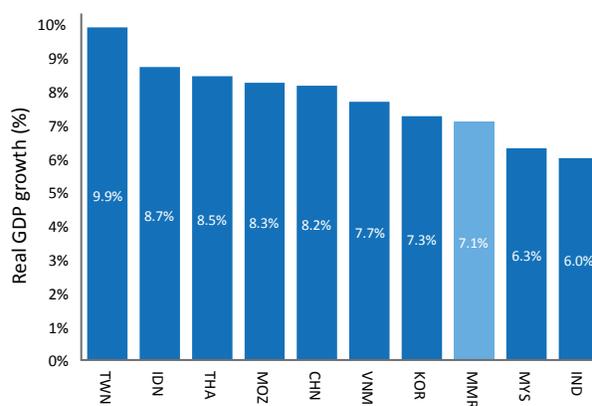
**3 There has been a gradual shift in the drivers of growth on the demand side.** Private consumption has remained high and relatively stable, whilst public consumption has picked up rapidly. This reflects government spending on public services and a rebalancing away from

Figure 1. Real GDP Growth 2011-2014 (%)



Source: GOM, WB Staff Estimates, WDI

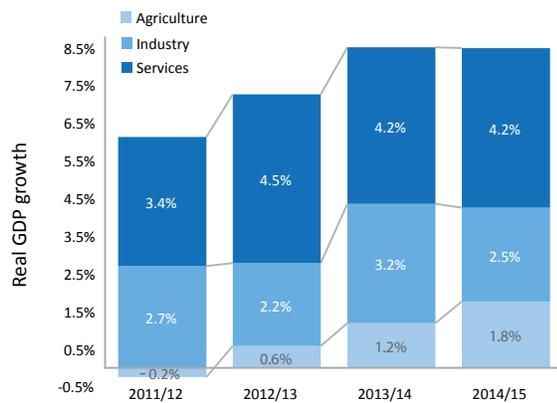
Figure 2. Real GDP Growth (average for 5 years after liberalization)



Source: WDI

capital investment. Whilst public investment needs remain large (e.g. in power and transportation), capital spending in recent years as a share of total spending has also been high. Therefore some rebalancing to make space for recurrent spending in the social sectors is essential for growth. At the same time, reforming public investment management will gradually help to promote more efficient and better targeted public investments.

Figure 3. Sector Contribution to Real GDP Growth



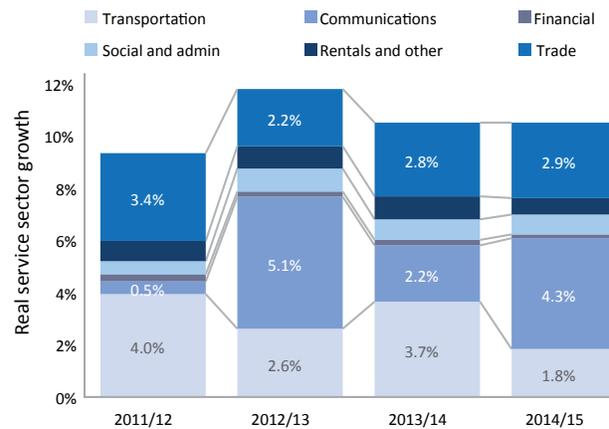
Source: GOM, WB Staff Estimates

**4 The falling share of public investment has been offset by rapid growth in private investment.** Private investments have averaged roughly between 20 and 30 percent of GDP in recent years, which is significant for a country at Myanmar’s stage of development. This reflects important new private construction activity particularly in major urban centers such as Yangon and Mandalay, and a pick-up in foreign and domestic private investment across services, manufacturing and industry. Net exports have had a slight negative contribution to economic growth. This may change over the coming years as Myanmar continues to integrate in the global economy and exports begin to take off, until which domestic demand will continue to be the big driver of growth.

### Services Expanding Rapidly

**5 The positive impact of ongoing reforms is reflected in the robust growth of the services sector.** Services contributed just over 4 percentage points of overall growth in 2014/15 (Figure 3). A big driver of this was telecommunications (Figure 4), which expanded rapidly thanks to new investments and fast growing consumption as a result of market liberalization.<sup>3</sup> The resulting competition and investment in the telecommunications sector have

Figure 4. Contribution to Service Sector Growth (%)



Source: GOM, WB Staff Estimates

contributed to falling costs and rapidly increasing access to telecommunications services.<sup>4</sup>

**6 Telecommunications operators have continued to expand coverage in the early part of 2015/16.** Efforts are being made to extend services to previously unserved areas, and in particular to ensure that flood affected parts of the country are receiving the services they need. In addition, growth in core telecommunications services has attracted other licensees to provide

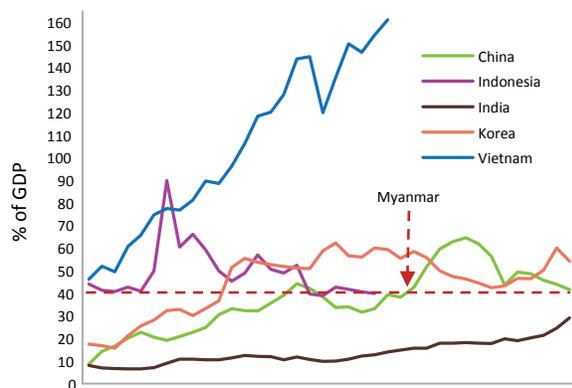
<sup>3</sup> Ooredoo Myanmar and Telenor Myanmar won operating and spectrum licenses in June 2013 following an open competition. A Telecommunications Law was passed in October 2013, licenses were formally awarded in January 2014, and both operators launched their services in August September 2014.

<sup>4</sup> The cost of SIM cards has dropped from \$250 in February 2013 to around \$1 today. Calling costs have fallen from Kyat 50 per minute to around Kyat 20 per minute. A variety of data packages have been introduced, as well as international SMS. International long distance costs have fallen (e.g. the cost of a one minute call to Singapore has fallen from US\$1 to Cents 20 or less). Penetration rate (mobile phones per 100 people) went from less than 10% in February 2014 to 50% as of June 2015.

network infrastructure (e.g. fiber optic installation, tower companies) and network services (e.g. internet services).

**7 Growth in transport services has also increased thanks to expanding internal and external trade.** The transportation sector contributed to around a third of overall service sector expansion in the past four years. External merchandise trade as a share of GDP in Myanmar

**Figure 5. Merchandise Trade After Liberalization (% of GDP)**



Source: WDI, WB Staff Estimates

averaged around 40 percent, similar to other countries in their early phase of liberalization (Figure 5), contributing to domestic freight handling and other trade logistics services (Figure 6). Transportation networks have been affected by flood damage to roads and bridges in early 2015/16, though preliminary indications are that the main corridors (namely Yangon to Mandalay, then North to China) are not as severely impacted.

### Growing Investment In Manufacturing And Industry

**8 Manufacturing and industry output remained strong at over 8 percent in 2014/15 thanks in big part to natural resources.** Gas in particular was a big driver of manufacturing and industry growth in 2014/15. Press reports

on gas earnings in the first quarter of 2015/16 suggest that output remains strong and that the potential impact of falling international commodity prices have not yet filtered through to gas export earnings. Whilst Myanmar is not a major oil producer, available data shows that crude oil output continued its downward trend (Figure 7). This could be linked to substitution for cheaper imports or inadequate investment affecting production capacity.

**Figure 6. Trade Facilitation Services (Tonnage)**



Source: GOM, WB Staff Estimates

**9 The construction sector also grew at around 8 percent in 2014/15 despite some slowdown in larger projects.** Office retail and condominium space in major cities remain hot but projects have come up against a slowdown in pre-sales and concerns over potential overbuild, particularly for condominiums. The construction boom has contributed to growing activity in the area of building materials. Although domestic cement production has been on a downward trend in recent years, it picked up again in 2014/15 (Figure 8). An estimated 40 percent of Myanmar’s demand for cement is met by imports. To improve domestic cement production, the government in 2013 began to privatize its cement plants under the Ministry of Industry. Myanmar Jidong Cement and Myanmar Conch Cement were among the winning bidders. In addition, Thailand’s Siam Cement is also building a large greenfield plant.

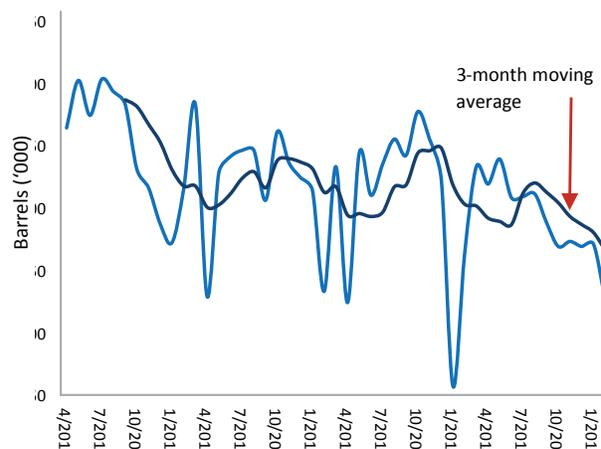
**10 Heavy industry and mining aside, Myanmar has attracted strong investor interest in light manufacturing.** This is reflected in both domestic and foreign investment figures. Prior to 2011, foreign direct investment (FDI) went mainly to natural resources: around 40 percent to hydro, 30 percent to gas, and another 8 percent for mining. Since 2012/13, the balance has started to shift with a rapid increase in the number and value of projects going into light manufacturing. The garments sector in particular is seeing large investments from Korea, Hong Kong and investors based out of Singapore. Myanmar already has a base in garments production. Investors are relocating from other parts of the region given competitive labor costs and new markets afforded by the EU General Systems of Preferences. Domestic investors are looking to expand their current facilities as well as to establish greenfield factories.

**11 Investment activity in more recent months has begun to slow down.** A lot of mega construction projects (e.g. hydropower, road construction) are moving more slowly than expected. It will be important to keep advancing key reforms (see Policy Watch below) to sustain the confidence of investors.

### Rebound in Agriculture

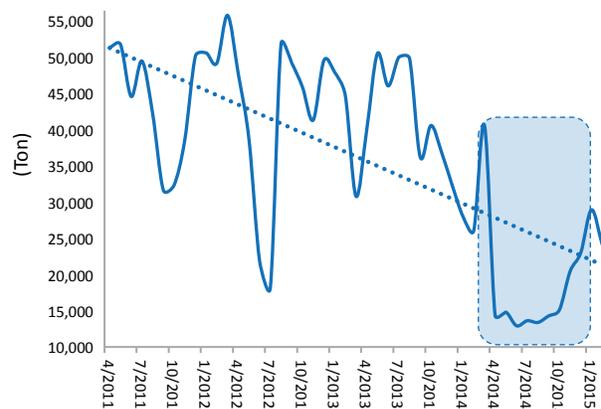
**12 Agriculture output picked up in 2014/15 after two years of sluggish growth** (Figure 9), which contributed to a gradual shift in the sector composition of GDP in favor of services and industry (Figure 10). Real growth in the agriculture sector is estimated to have increased from 3.6 percent in 2013/14 to 5.6 percent in 2014/15. Agriculture contributed around 1.8 percentage points in overall growth in 2014/15. The recovery is attributed in large part to increased crop output from 0.6 percent real growth in 2013/14 to 4.2 percent in 2014/15. Crops account for just under three quarters of agriculture value added. Livestock and fisheries, which account for around a quarter of agriculture output, grew at 7.2 percent.

Figure 7. Crude Oil (Barrels '000)



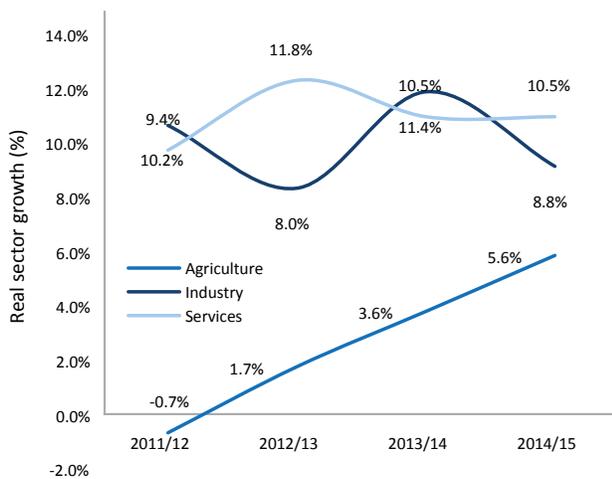
Source: WDI, WB Staff Estimates

Figure 8. Cement Production (Ton)



Source: GOM,

Figure 9. Sector Growth Rate (%)

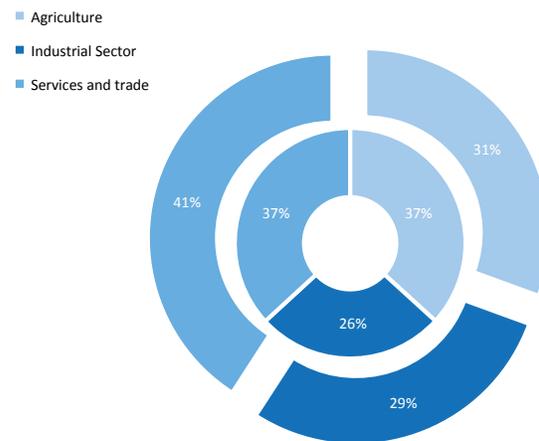


Source: GOM, WB Staff Estimates

**13** Within crop production, rice output increased in 2014/15 though productivity remains low. Rice production is estimated to have increased from 18.7 million tons in 2013/14 to 19.7 million tons in 2014/15.<sup>5</sup> Around 54 percent of the country’s sown areas is planted with paddy, but paddy yields in Myanmar remain among the lowest in the region, adversely affecting overall growth, farmer income and poverty reduction (Figure 12). Well managed irrigation schemes can yield around 4 tons per hectare (ha) but most fields average around 2.5 tons per ha in Myanmar. In contrast, the average per ha yield in Thailand is 2.9 tons; in the Philippines, 3.7 tons; and in Vietnam, 5.6 tons.

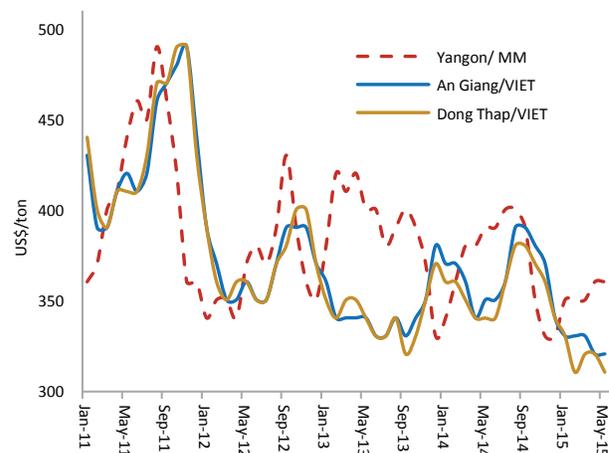
**14** Real rice prices in Yangon followed the path of the past two years, seasonally fluctuating around the mean of Kyat 150,000 per ton. They roughly follow prices in Vietnam, which is Myanmar’s closest competitor on the world rice market, but they continue to be volatile (Figure 11). This is a result of large seasonality (most rice is harvested from October to December) and the low production relative to disappearance (domestic consumption plus export)<sup>6</sup>. Aside from rice, the production of beans and pulses, which account for around 50 percent of value added in crops, grew by 4.4 percent in 2014/15.

Figure 10. Sector Share of GDP 2010 vs 2014



Source: GOM, WB Staff Estimates

Figure 11. Rice Wholesale Prices in Myanmar and name (US\$/ Ton)



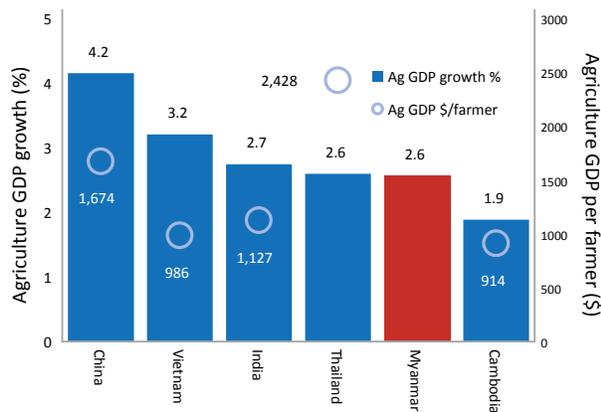
Source: FAO GIEWS

*Floods Impacting Agriculture And Relatively Worse Off Households*

**15** Whilst the full impact of the floods is still being assessed, preliminary indications are that the agriculture sector will be severely affected. It is estimated that around 1.29 million acres of farmland (roughly 4 percent

<sup>5</sup> The alternative estimate of the US Department of Agriculture (USDA) estimates production growth at 5.4 percent. USDA reports rice production to increase from 11.9 million tons in 2013/14 to 12.6 million tons in 2014/15.

**Figure 12. Agriculture growth and income per farmer (2011-2014)**



Source: WDI and WB Staff Estimates

of total sown area) have been damaged, including 687,200 acres of rice paddy and other crops.<sup>7</sup> The loss of income for the 1.1 million people affected by the floods and extensive damage to critical infrastructure linking farms to markets will have negative multiplier effects on supply of agriculture produce. The flooding will negatively affect the main rice crop (harvested in October-December), which according to the FAO is currently at early reproductive stage.<sup>8</sup>

**16** The vast majority of the population affected by the floods is concentrated in 5 States and Regions, some of which are also important areas of agriculture production. The five States and Regions are Ayeyarwady, Bago, Magwe, Rakhine and Sagaing. Preliminary analysis shows that the share of affected population ranges from 3.6 percent in Bago to 8.2 percent in Ayeyarwady.<sup>9</sup> Ayeyarwady is the second most populated State or Region in Myanmar after Yangon, increasing the likelihood of natural disasters affecting a large number of people. Less densely populated Chin State has also been affected quite severely relative to its population size, with 4% of its population impacted by the floods.

**17** Preliminary estimates show that more than half of the affected population is concentrated in 18 townships with more than 30,000 affected persons. Figure 13 maps out the townships that were affected by the floods. Of 330 townships, 131 are registered in the data used as having affected populations. The majority of these affected townships have fewer than 5,000 affected people recorded.

<sup>6</sup> Although the rice stocks to disappearance ratio in Myanmar increased from 4.2 percent in 2014/15 from 3.6 percent in 2013/14, it remained much below the commonly believed safe ratio of 15 percent, which is considered sufficient to keep price volatility low.

<sup>7</sup> UN OCHA, “Myanmar: Floods Emergency – Situation Report No. 3 (as of 11 August 2015)

<sup>8</sup> FAO, “GIEWS Country Briefs,” August 10, 2015

<sup>9</sup> This analysis draws upon the listing of flood affected townships from MIMU/OCHA, dated 20th August. This data was combined with population level information from the Population and Housing Census of Myanmar. As such, the analysis captures a depiction of the socio-economic and demographic characteristics of the flood affected townships prior to any flood impact. It should be noted that the townships listed affected are likely to vary substantially in the degree to which they were impacted by the floods. It is also important to note that the analysis draws upon township level socio-economic characteristics, and therefore is only representative of households enumerated in the census.

**18** The areas that were most affected by the floods were relatively worse off prior to the flooding, as captured by a composite welfare score from the Census data (Figure 14). The floods are therefore affecting a population that was ex-ante vulnerable to poverty. This is especially true for Rakhine and Chin, although these are

not among the most flood affected in terms of absolute population affected. A comparison of the 65 most affected townships<sup>10</sup> with those that were less or not affected by the flooding shows that the severely affected townships were relatively worse off prior to the flooding than the rest.<sup>11</sup>

Figure 13. Townships Affected By The Floods

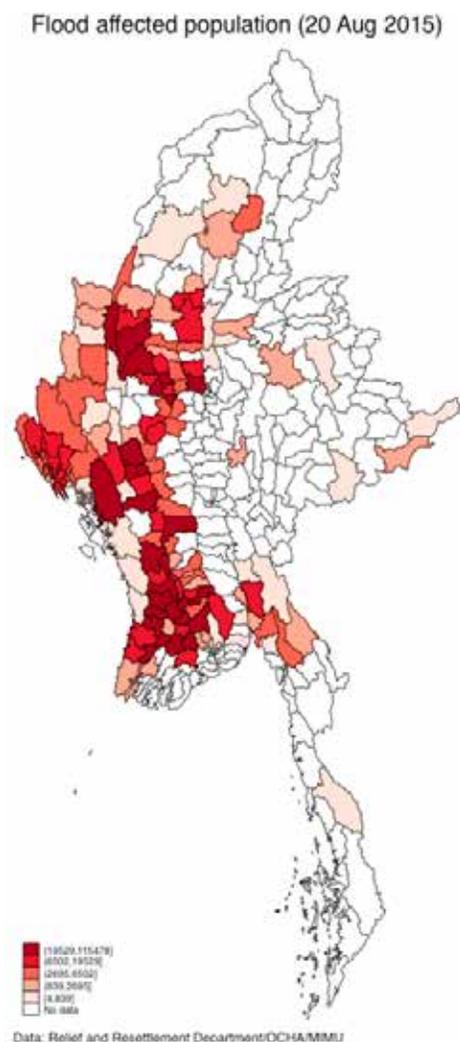
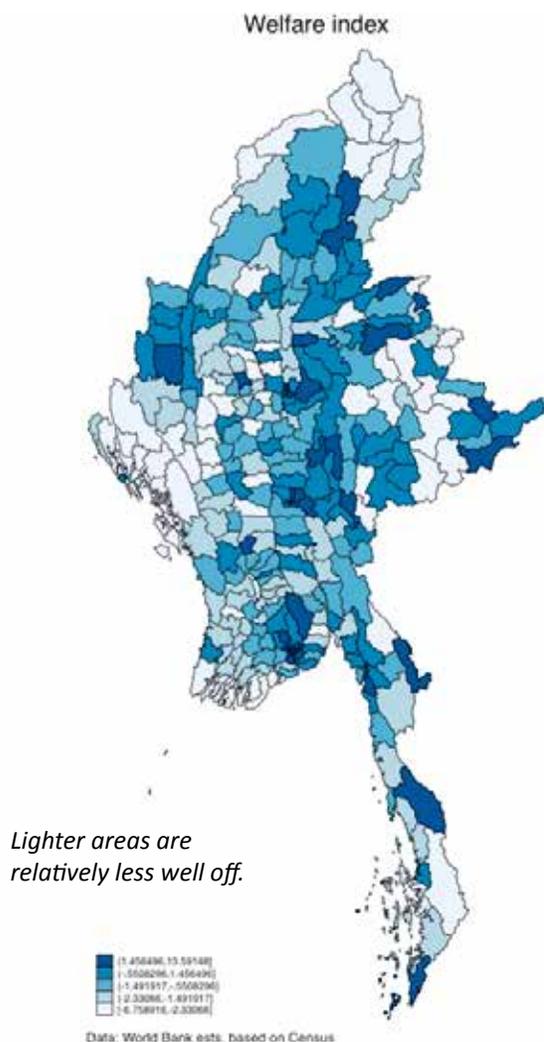


Figure 14. Welfare Index Among Townships Affected By Floods



<sup>10</sup> These are townships with more than 5000 affected households.

<sup>11</sup> The composite welfare score was constructed using a range of household characteristics that vary across better and worse off households (such as housing structures, water and sanitation, household assets such as communications and transportation, and household demographics). The characteristics of welfare were chosen by examining the correlates of poverty from the Integrated Household Living Conditions Assessment Report (Government of Myanmar, UNDP, UNICEF and SIDA, 2011, “Integrated Household Living Conditions Assessment Survey in Myanmar, 2009-10: Technical Report”). The welfare index was then constructed using principal components analysis. A caveat of the approach used is that it is conducted using township level aggregates; since welfare is measured at a household level and aggregated up, this approach would ideally be conducted at a household level.

**Box 1. Myanmar classified as Lower Middle Income based on GNI per capita**

Myanmar's per capita Gross National Income (GNI)<sup>12</sup> in 2014, published by the World Bank in July 2015, stood at US\$ 1,270. Economies with a GNI per capita of \$1,045 or less in 2014 are defined as low-income; those with per capita GNI of between \$1,045 and \$12,736 are classified as middle-income; and countries with a per capita GNI of \$12,736 or more are classified as high-income. Lower-middle-income and upper-middle-income economies are separated at a GNI per capita of \$4,125.

GNI is a measure of overall income in an economy plus net receipts of primary income (e.g. employee compensation, property income) from abroad. It is a measure of the overall economic output of a country. GNI per capita can be large in natural resource dependent countries, which may at the same time have high levels of poverty.

Myanmar was above the low income country threshold in 2014 with a GNI per capita of \$1,270 thanks to rapid growth in recent years, including a boom in the gas sector, combined with an increase in net factor income from abroad.

GNI is not a comprehensive measure of the economy and poverty, it needs to be considered along with other development indicators to decide the best course of policy action to deliver growth that will eliminate extreme poverty and boost shared prosperity.

Countries that are close to the threshold as in the case of Myanmar may also be vulnerable to falling back to low income status. Myanmar has a long road ahead in sustaining economic growth and moving up the middle-income chain whilst ensuring that the poor are benefiting from that growth.

Rising GNI has important implications for mobilization of government revenue to fund much needed public services for the poor. In the near term, Myanmar should not be affected in terms of access to concessional financing given large development needs.

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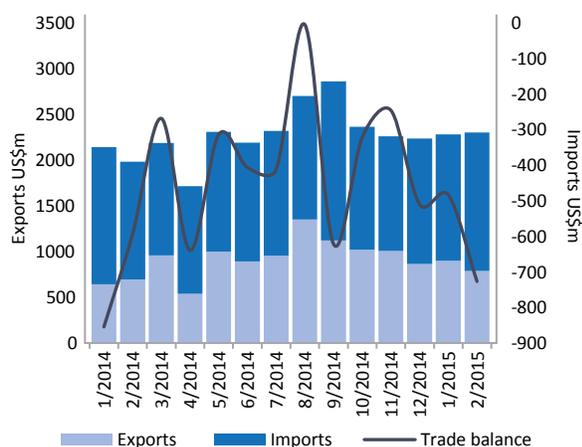
<sup>12</sup> GNI per capita (formerly GNP per capita) is the gross national income, converted to U.S. dollars using the World Bank Atlas method, divided by the midyear population.

# Foreign Trade And Investment

## Growing Current And Trade Account Deficits

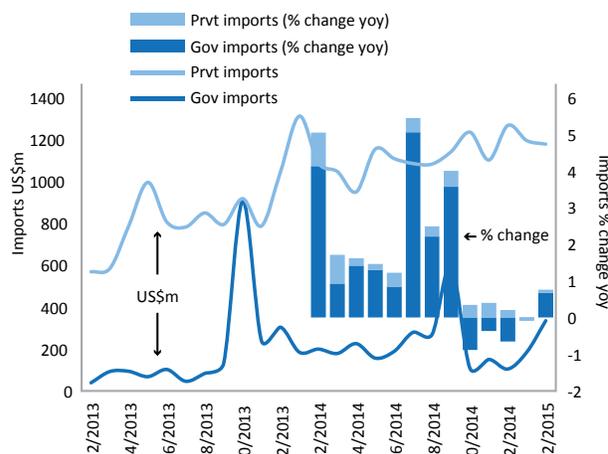
**19 Myanmar’s current account deficit in 2014/15 widened on the back of rapidly growing FDI-related capital imports.** The current account deficit is estimated to have increased from 5.6 percent of GDP in 2013/14 to 6.3 percent of GDP in 2014/15, driven by a growing trade deficit, which is estimated to have increased from 4.5 percent of GDP in 2013/14 to 8.3 percent in 2014/15 (Figure 15). The services account is estimated to have posted a small surplus in 2014/15 thanks to fees and royalties from the telecommunications and gas sectors respectively; a 35 percent increase in foreign visitor arrivals linked to both tourism and business; and an associated jump in domestic air travel by non-residents.

Figure 15. Trade Account (US\$ m)



Source: GOM, WB Staff Estimates

Figure 16. Government vs. Private Imports (US\$ m and % change yoy)



Source: GOM, WB Staff Estimates

**20 The large current account deficit has posed short-term challenges, though investment related imports also bode well for future productivity.** Although foreign investment flows have helped to contain some of the short-term pressures on Myanmar’s overall external position, recent months have seen a slight slowdown in investment partly linked to the upcoming elections. This combined with exchange rate pressures linked to the general strengthening of the US Dollar has weighed on foreign exchange reserves, which at end-March 2015 were reported at around 3 months of import cover.<sup>13</sup> However, a big part of what is driving the current account deficit in the short-term is going towards strengthening Myanmar’s productive base, including its tradable sector. Although public sector imports have increased rapidly with fiscal expansion, most of the import demand comes from the private sector (Figure 16). Policy responses should therefore take into account the nature of the current growth in imports to ensure that these do not stifle investment.

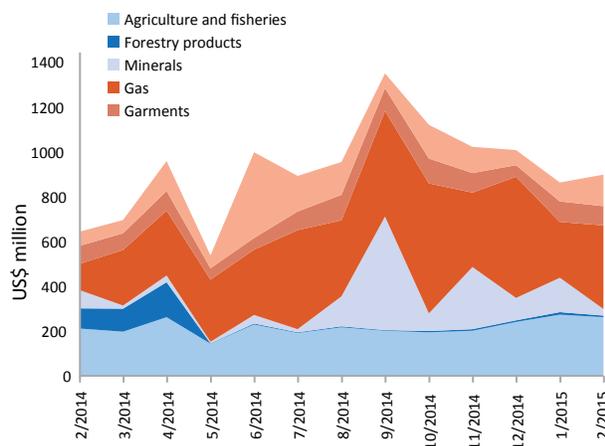
<sup>13</sup> IMF, “IMF Executive Board Completes 2015 Article IV Consultation with Myanmar,” Press Release No 15/428, September 18, 2015

### Slowing Goods Exports

**21** The slowdown in goods exports is partly due to a drop in export of forestry products. Forestry exports in the first 11 months of 2014/15 fell to US\$65 million from US\$ 750 million over the same period in the previous year (Figure 17). This follows a ban imposed by the government on the export of raw timber logs, which accounted for close to 90 percent of forestry exports. The ban has been effective since April 1, 2014 as part of the government’s efforts to promote conservation in light of widespread concerns on over-logging. Until the ban, Myanmar was the only country to export unprocessed teak logs from natural forests.

**22** Gas exports remained strong in 2014/15, helping to offset the loss from forestry. Gas exports increased by 43 percent in nominal terms from US\$3 billion in the first 11 months of 2013/14 to an estimated US\$4.3 billion over the

Figure 17. Goods Exports (US\$ m)



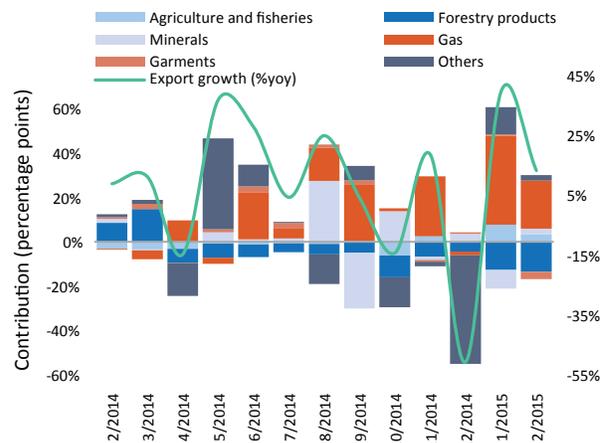
Source: GOM, WB Staff Estimates

same period in 2014/15. Nearly all gas production from Myanmar is exported to China and Thailand. At 42 percent share of total goods’ exports in 2014/15, gas remains one of the big drivers of Myanmar’s overall trade fortunes (Figure 18).

**23** Myanmar’s gas exports do not seem to have yet been affected by the sharp drop in international commodity prices. There are two possible reasons for this. The first is that gas prices are revised every three months by taking the last 12 months’ average of heavy fuel prices and a series of production cost indices. This means that there would be a lag between the drop in heavy fuel prices that started in the summer of 2014 and the feedthrough to Myanmar’s gas prices. The second is that total gas production increased in 2014/15 thanks to expanded output from Shwe and Zawtika fields, which began production 2 years ago. Higher output could therefore have helped to offset any drop in gas prices to date.

**24** Agriculture exports remained strong at around a quarter of total exports including a pick-up in rice exports (Figure 19). The quantity of rice exports increased by around 18 percent, from 1.7 million tons in 2013/14 to

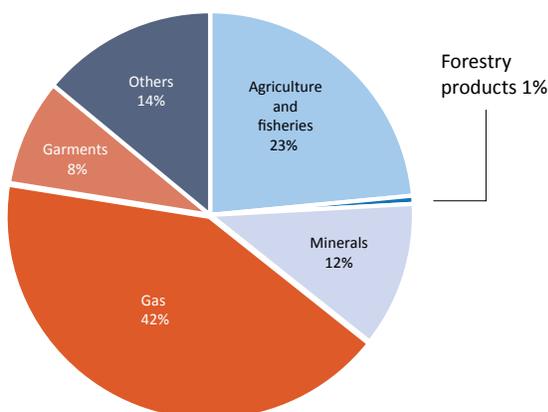
Figure 18. Contribution to Export Growth (% yoy)



Source: GOM, WB Staff Estimates

around 2 million tons in 2014/15 according to the USDA. Rice exports account for 6 percent of total formal exports, but the true share of rice in total exports is much higher as more than half of it is sold unofficially across the border to China. China from time to time bans rice imports from Myanmar, though informal rice trade continues.

Figure 19. Share of goods exports in the first 11 month of 2014/15 (%)

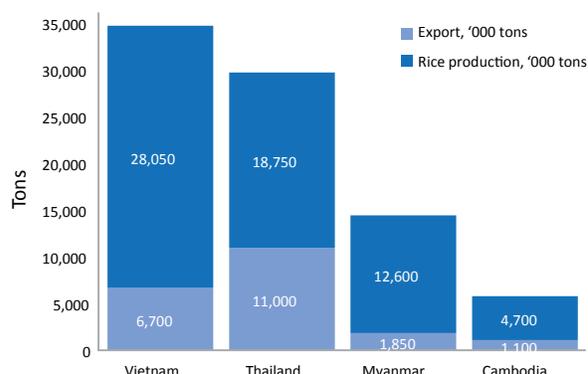


Source: GOM, WB Staff Estimates

**25 Rice exports to the EU, where Myanmar enjoyed preferential tariff rates, also increased, albeit from a low base.** It grew by about 80 percent during September 2014 to April 2015 compared to the same period last year. It should be noted, however, that despite the recent growth in rice exports, Myanmar remains a small exporter compared to its peers. Myanmar’s rice exports were less than 30 percent of Vietnam’s and less than 20 percent of Thailand’s rice exports (Figure 20). Maize exports were up 32 percent due to strong demand from China. Beans and pulses grew thanks to strong demand from India, which absorbs 80 percent of Myanmar’s beans and pulses exports. Meanwhile Myanmar’s fisheries’ exports declined by 14 percent as equipment and infrastructure capacity constraints in the sector kept production below domestic demand.

**26 The official exports of minerals, including gems, slowed down in 2014/15 and early 2015/16.** In the first 11 months of the fiscal year, mineral exports rose to around US\$1.4 billion (12 percent of goods exports) compared to US\$ 1.1 billion over the same period last year. Within minerals, jade contributed around 8% of Myanmar’s total exports between September 2014 and February 2015. Over this period, official statistics show that jade exports declined by 38

Figure 20. Rice production and exports (2014/15)



Source: USDA, WDI, WB Staff Estimates

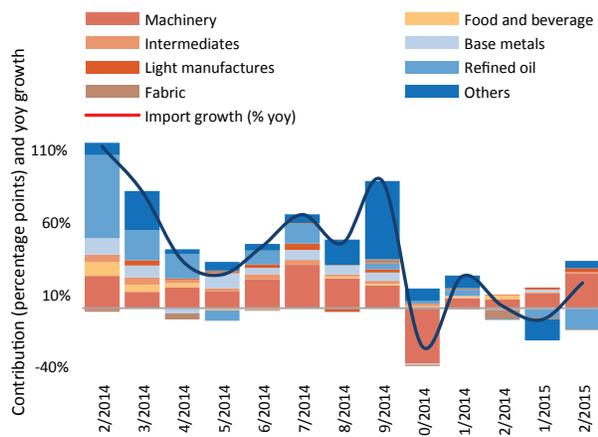
percent compared to the same period last year. Media reports from the annual gems emporium indicate that sales proceeds at this year’s emporium in July declined by 63 percent to US\$1 billion compared to record sales last year. This is linked to disruption in extraction due to ongoing conflict in jade producing areas but could also be due slowing demand in China.

**27 Garment exports continue to grow, albeit slowly.** In the first 11 months of 2014/15, garment exports totaled US\$875 million (8 percent of total goods exports) compared to US\$800 million over the same period last year. Surprisingly, the import of cotton and fabric declined by 19 percent in the same period. The slow pick up may be due to a combination of uncertainties in potential new markets such as the EU and the US, and new investments not yet having begun production.

### Fast Growing Goods Imports

**28 The rapid growth in imports has been driven by the purchase of capital machinery** (Figure 21). In the first 11 months of 2014/15, the share of machinery in total imports was around 37 percent, amounting to US\$4.6 billion, similar to the same period in

Figure 21. Contribution to Import Growth (% yoy)



Source: GOM, WB Staff Estimates

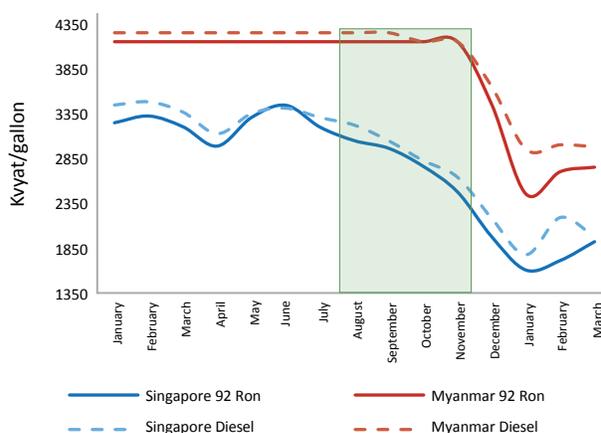
the previous year. The import of base metals also remained at a comparable level of around US\$1.4 billion. Capital goods and intermediate inputs have averaged around three quarters of total imports in the last two years, reflecting rapid growth in private sector investment demand. The import of consumables such as food and beverage, and light manufactures, have remained relatively low and steady at around 5 and 7 percent of total imports respectively.

### 29 The contribution of refined oil in import growth declined in 2014/15, thanks to falling international commodity prices.

In April 2014, refined oil contributed nearly half of year-on-year import growth; in February 2015 it had a negative contribution to year-on-year import growth. Myanmar imports most of its refined oil from Singapore. Fuel pump prices began to fall sooner in Singapore, whilst remaining relatively sticky in Myanmar even after accounting for transportation and other trade costs (Figure 22). Concerns at the time were expressed about the lack of competition in the retail market for petroleum. Since November-December 2014, however, there was a significant downward adjustment, including after the issue was raised in the parliament.<sup>14</sup>

<sup>14</sup> The Voice, “Will Fuel Price Actually be Lowered,” March 30-April 5, 2015

Figure 22. Fuel pump price 2014-15 (Kyat/ gallon equivalent)



Source: The Voice, WB Staff Estimates

## Concentration of Trading Partners

**30 Myanmar’s trade has almost entirely been confined to its neighbors though it is gradually beginning to diversify.** International sanctions have meant that Myanmar’s current trade pattern—focused mainly on South Asia and East Asia region—does not reflect its true potential (Figure 23). China and Thailand account for around three quarters Myanmar’s exports, which are largely driven by gas. With the exception of Thailand, Hong Kong, India and the UK, Myanmar has a deficit with most of its principal trading partners. Outside of China, the largest source of imports for Myanmar is Singapore, which is a major source of Myanmar’s refined oil imports.

## Increased FDI Commitments

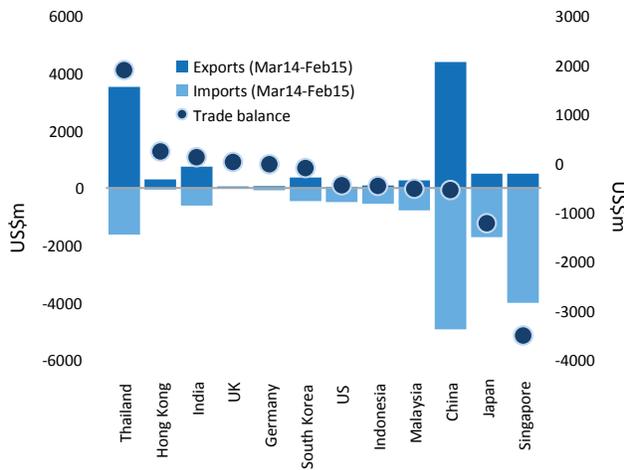
**31 Foreign Direct Investment commitments rose very sharply in 2014/15.** Commitments went from around US\$3.2 billion in 2013/14 to around US\$8 billion in 2014/15. Around 40 percent of this was driven by investment commitments in the gas sector, which picked up rapidly following agreement on 20 Production Sharing Contracts in 2014/15.

Commitments in telecommunication and manufacturing sectors (20 percent each) also grew rapidly, totaling in excess of US\$1.5 billion each in 2014/15.

**32 There will be a lag between this jump in commitments and actual disbursement of foreign investments.** This is partly due to investment slowdown but also due the long lead time before investments in some sectors such as gas can really take off. Therefore some of the disbursements in 2014/15 reflect commitments

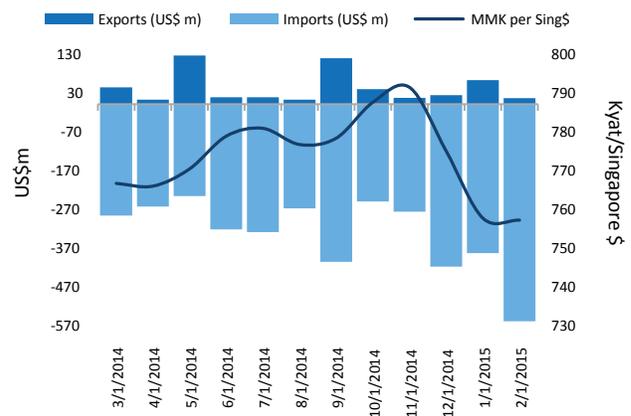
in earlier years. The telecommunications sector for example saw major inflow of FDI in the first five months of 2014/15, totaling an estimated US\$ 3.32 billion (i.e. inclusive of commitments from earlier years). In the manufacturing sector, around 70 percent of FDI commitments is for garments, which is also expected to have started disbursing. In the garments sector, disbursement and construction activities usually start within six months of project approval.

Figure 23. Bilateral Trade (US\$ m)



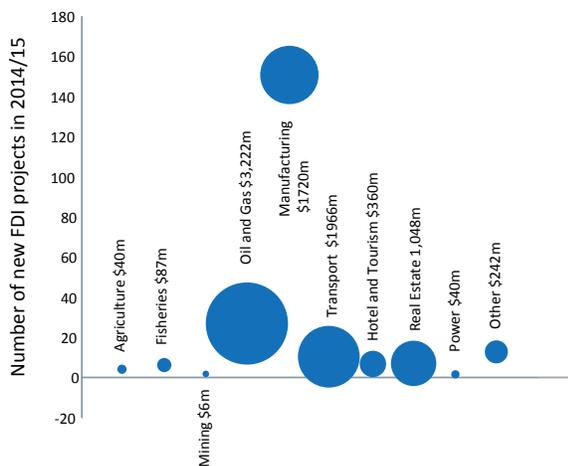
Source: GOM, WB Staff Estimates

Figure 24. Bilateral Trade And Exchange Rate: Singapore



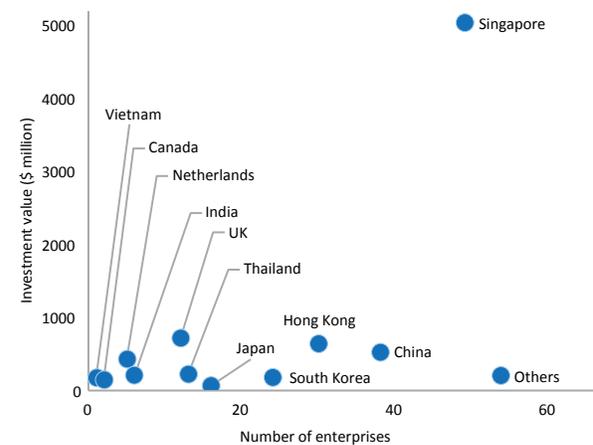
Source: GOM, CEIC, WB Staff Estimates

Figure 25. Number And Value (Us\$ M) Of Fdi Projects (Mar 2014-Feb 2015)



Source: CEIC, DICA, WB Staff Estimates

Figure 26. FDI by Country (2014-15)



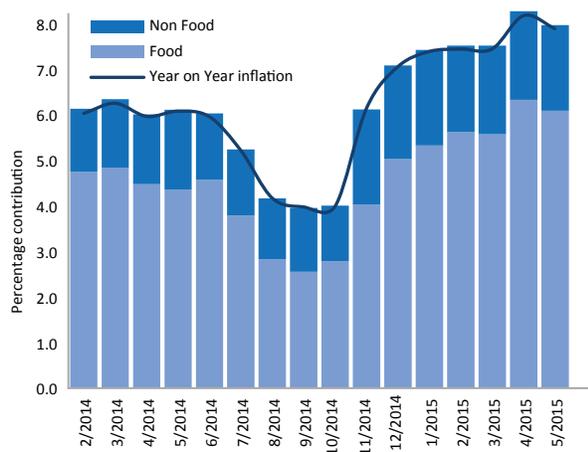
Source: CEIC, DICA, WB Staff Estimates

# Inflation, Monetary And Exchange Rate

## Rising Inflationary Pressures

**33** Inflationary pressures increased in 2014/15 and have remained high in the first half of 2015/16. Consumer price inflation in the year ending March 2014/15 reached 7.5 percent compared to 6.3 percent in the previous year (Figure 27). Inflation had slowed in the first half of 2014/15, but accelerated very rapidly in November 2014 when the Consumer Price Index (CPI) increased by around 2.4 percent. Monthly inflation declined thereafter, before picking up again in April 2015 (Figure 28), reaching around 10 percent in the year to July 2015. This is in contrast to most countries in the region where headline inflation has dropped sharply over the course of

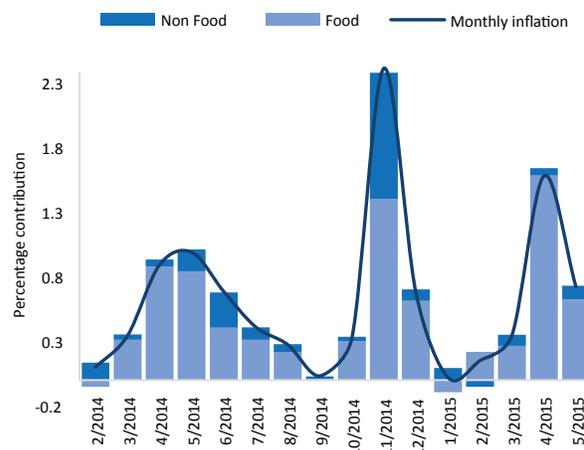
Figure 27. Contribution to yearly inflation (%)



Source: GOM, WB Staff Estimates

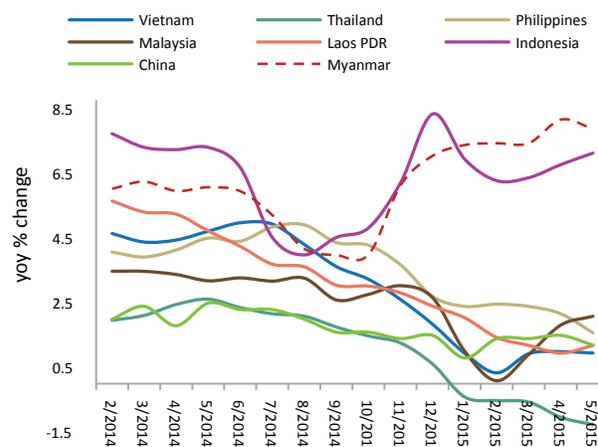
2014/15. With the exception of Indonesia, year-on-year inflation in May 2015 was at 2 percent or below (Figure 29). Lower oil prices have contributed to falling headline inflation in the region, though core inflation (i.e. excluding food and energy) has remained relatively stable.<sup>15</sup>

Figure 28. Contribution to monthly inflation (%)



Source: GOM, WB Staff Estimates

Figure 29. Inflation in selected countries in the region (yoy %)



Source: CEIC, WB Staff Estimates

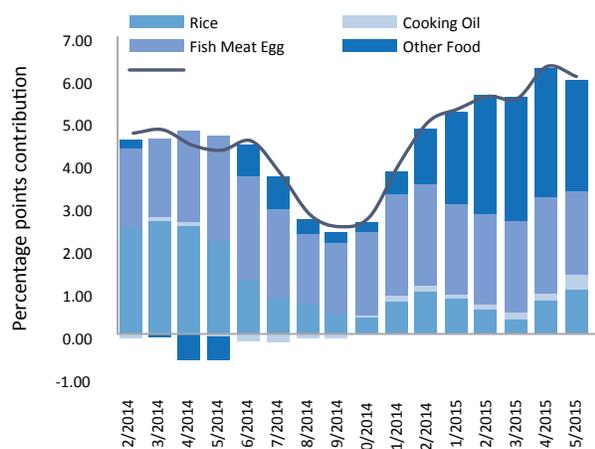
**34** Food items have been the big drivers of inflation in Myanmar in 2014/15 and early 2015/16. Food constitutes around 68 percent of the CPI basket. The contribution of rice, fish and meat has either fallen or remained steady since November 2014 (Figure 30). This is

<sup>15</sup> The World Bank Group, "Global Economic Prospects: The Global Economy in Transition," June 2015

consistent with international food prices (Figure 31) and growth in agriculture in Myanmar. The big drivers of food price inflation since November 2014 were processed foods and to some extent fruits and vegetables (“other food” in Figure 30). The contribution of cooking oil also picked up. Part of this is linked to the nominal depreciation of the Kyat because edible oil and milk products constitute the largest share of food imports. However, domestic supply constraints in the face of rapidly rising consumption of processed foods is also likely to be a big factor.

**35 Non-food inflation was driven mostly by housing costs** (Figure 32). This reflects the ongoing pressures on the rental market particularly through the big increase in demand for both residential and commercial space coming from foreign investors and donors in particular.

Figure 30. Contribution to yearly food inflation (%)



Source: GOM, WB Staff Estimates

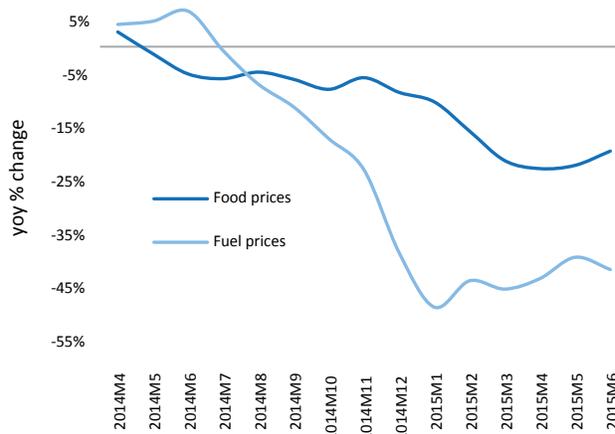
This should moderate in the coming years with completion of ongoing real estate projects. Transportation prices have also declined since the end of 2014 thanks to falling fuel prices.

### Moderate Growth in Reserve Money

**36 Public sector financing needs have historically been a big driver of reserve money growth and a major contributor to inflation**

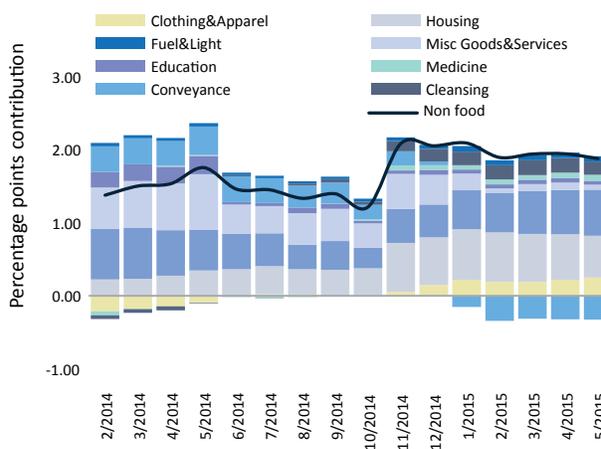
in Myanmar. These needs were, and still largely are, met through the sale of short-term Treasury Bills (3-month) to CBM (monetary financing) and

Figure 31. International food and fuel prices (% change)



Source: WB commodity price data

Figure 32. Non-food inflation drivers (% yoy)



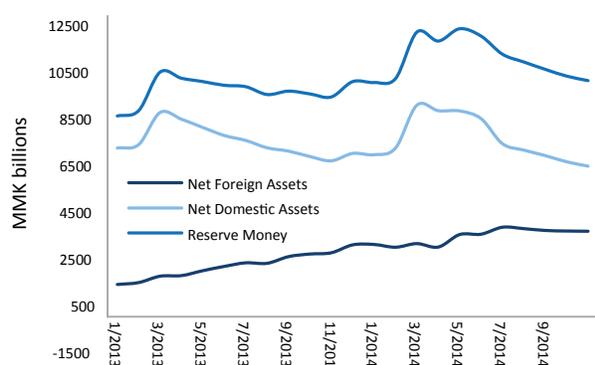
Source: GOM, WB Staff Estimates

subscription of medium-term Treasury Bonds (2, 3 and 5-year) by commercial banks. A policy priority for the government has been to reduce the highly inflationary monetary financing of the budget.

**37 Reserve money declined in end 2014 likely due to back-loaded government spending but also improved fiscal performance** (Figure 33). This is reflected in falling Net Claims on Government (monetary financing) in the latter part

of 2014 (Figure 34), which tends to pick up by the last quarter of the fiscal year due to back-loaded government spending (Figure 35). Nonetheless, monetization of the budget deficit is also expected to have declined in 2014/15 as the government diversifies sources of financing towards medium-term Treasury Bonds, Treasury Bill auctions (starting in January 2015), and increased access to foreign borrowing on concessional terms.

**Figure 33. CBM Assets and Reserve Money (MMK Billions, monthly)**



Source: CBM, CEIC, IMF/IFS

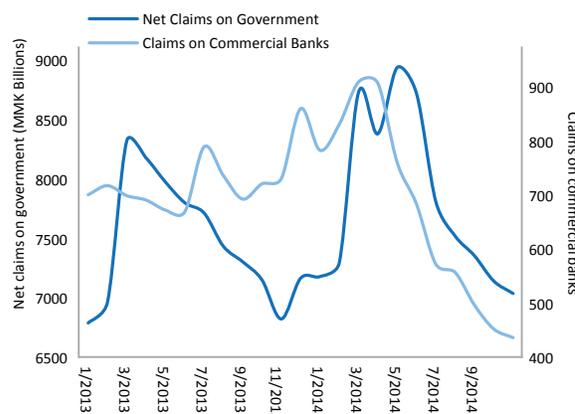
### Strong Growth in Money Stock

**38** Despite moderate growth in reserve money, the overall growth in money stock (M2) has remained strong in line with growing domestic demand. The level of money stock grew by 33 percent in 2013/2014 in nominal terms compared to a five-year peak of 48 percent growth in 2012/13. In the year to November 2014, money supply grew by 21 percent and is expected to have picked up further by the end of the fiscal year due to Net Claims on Government. The ratio of money stock to reserve money (money multiplier) has kept growing since the beginning of the 2014/15 fiscal year (Figure 36).

**39** The contribution to growth in money stock has gradually shifted over the course of the past two years (Figure 37). Prior to

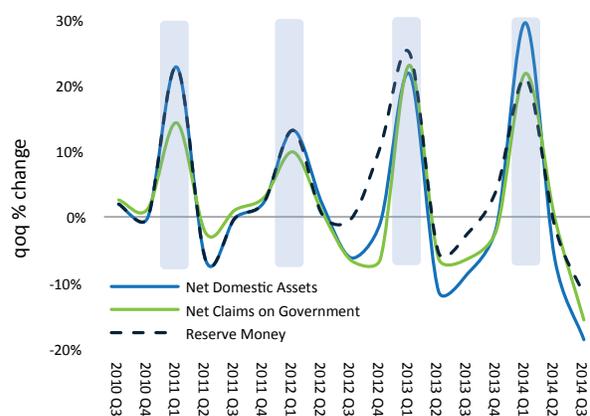
2013/14, money supply was primarily driven by public sector demand. In 2013/2014, trade and investment related foreign exchange inflows led to a big rise in Net Foreign Assets. In addition to this, credit to the private sector has been growing very rapidly at around 50 percent year on year in both 2012/2013 and 2013/2014 (Figure 37), and at around 36 percent in 2014/15.

**Figure 34. CBM Net Domestic Assets (MMK Billion, eom)**



Source: CBM, CEIC, IMF/IFS

**Figure 35. CBM Net Domestic Assets (% change qoq)**

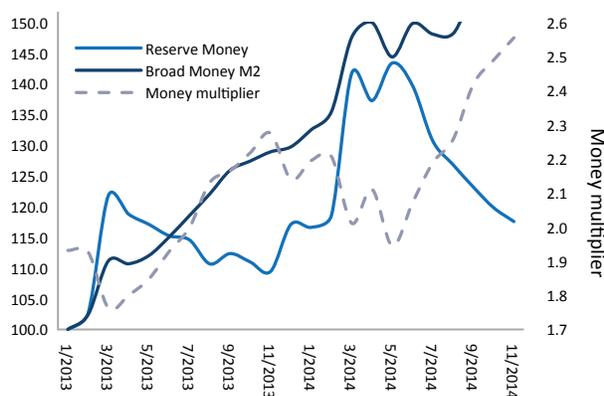


Source: CBM, CEIC, IMF/IFS

### Rapid Rise In Private Sector Credit

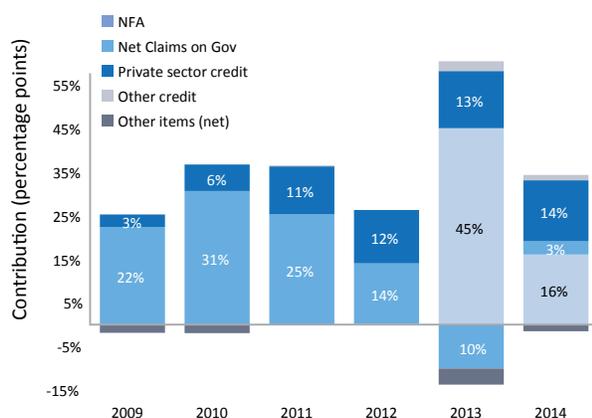
**40** Rapid rise in private sector credit has been on the back of a historically low base of financial intermediation. Interest rates are not yet applied as policy instruments to affect credit growth, despite partial relaxation of controls in 2014. The CBM policy rate has remained fixed at 10 percent since January 2012. Deposit and lending rates for commercial banks are also administratively determined (Figure 39).

Figure 36. Monetary aggregates (Jan 2013 = 100)



Source: CBM, CEIC, IMF/IFS, WB Staff Estimates

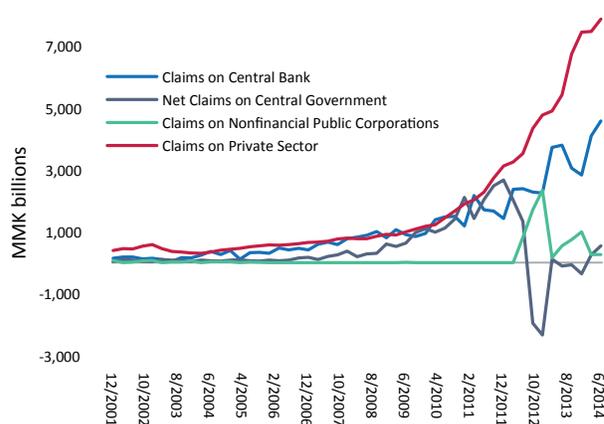
Figure 37. Annual contribution to growth in Broad Money M2 (percentage points)



Source: CBM, CEIC, IMF/IFS, WB Staff Estimates

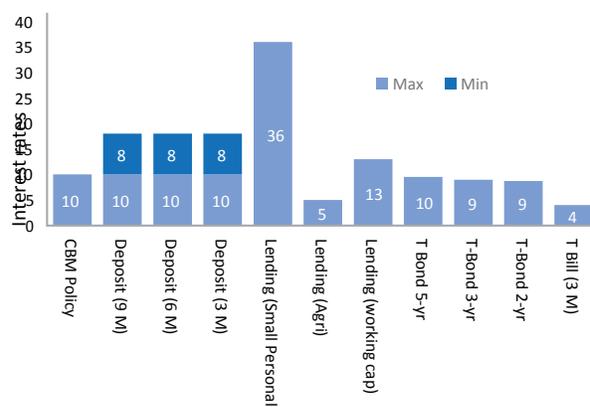
**41** Officially, the CBM reports that the banking sector is well-capitalized. The capital adequacy ratio was just over 20% by the end of the 2014/15 fiscal year, well-above the minimum 10 percent (Figure 40). The non-performing loan (NPL) ratio of private banks is reported at around 2 percent. However, it is essential to note that commercial banks do not yet follow international standards of accounting, which may mean weaker asset quality than currently implied by these ratios, and transparency in data reporting

Figure 38. Commercial Bank Assets (MMK Billion)



Source: CBM, CEIC, IMF/IFS

Figure 39. Interest rates (%)



Source: CBM, CEIC, IMF/IFS

remains a challenge. As such, an important reform priority, which is already underway, is improving asset classification requirements and the quality of data from banks, moving gradually towards international good practices.

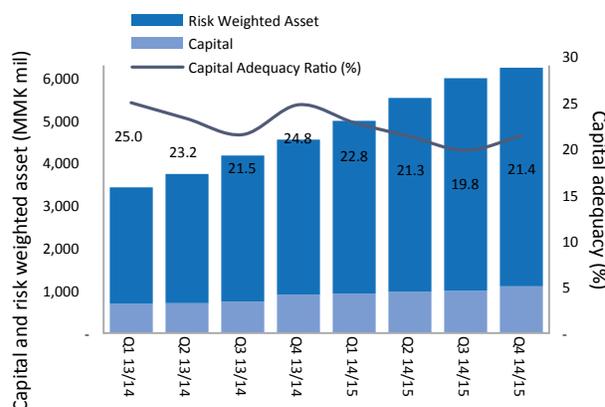
**42 The banking sector is very small with limited lending activities that tend to limit exposure to sector vulnerabilities.** There is limited sectoral concentration in lending (Figure 41). Trade finance with limited credit default risk accounts for around a third of lending. Lending for the rapidly growing construction and real estate sectors, which tend to be higher risk, are relatively low. Lending growth has exceeded growth in deposits, which nonetheless was strong at 20 percent in the year ending 2014/15. The loan to deposit ratio of the banking sector was at 55 percent.

**43 The financial sector is modernizing slowly with new entrants.** A total of nine new international banking licenses were issued during in 2015 to a cohort of largely pan Asian banks. These foreign banks will focus on wholesale lending to foreign firms and are now allowed to intermediate retail deposits. A number of foreign micro-finance institutions (MFI) have entered the market. These MFIs will help modernize the microfinance sector as they operate using a sustainable business model with new products, risk management policies and procedures, and modern core banking systems.

### Exchange Rate Pressures

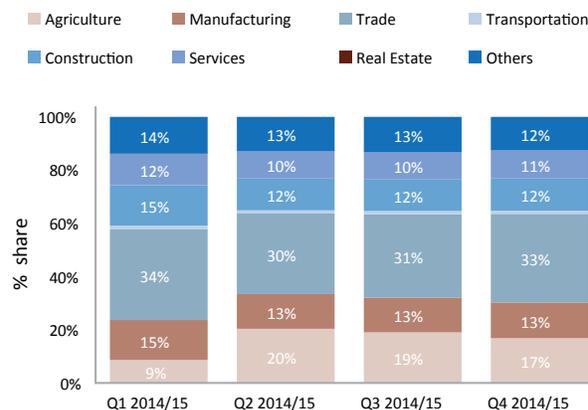
**44 The liberalization of Myanmar’s external accounts have put pressure on its relatively recent exchange rate reforms.** The CBM initiated daily foreign exchange auctions in 2012 to help develop an official foreign exchange market, and eliminate multiple and parallel exchange rates. Under the auction system, the CBM invites bids to purchase and offers to sell foreign exchange from 11 commercial banks. The CBM sets a cut off exchange rate and accepts bids that

Figure 40. Capital Adequacy of Private Banks



Source: CBM

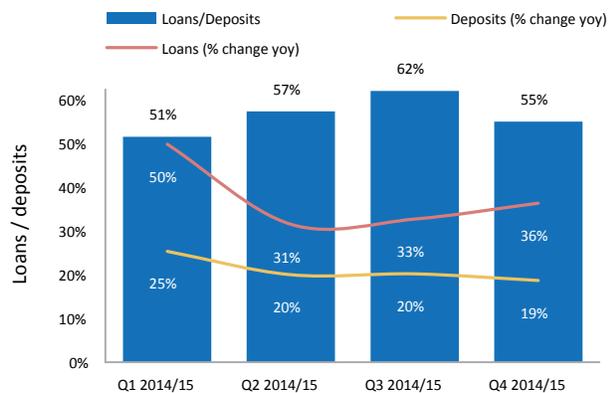
Figure 41. Commercial bank lending by sector (% share)



Source: CBM

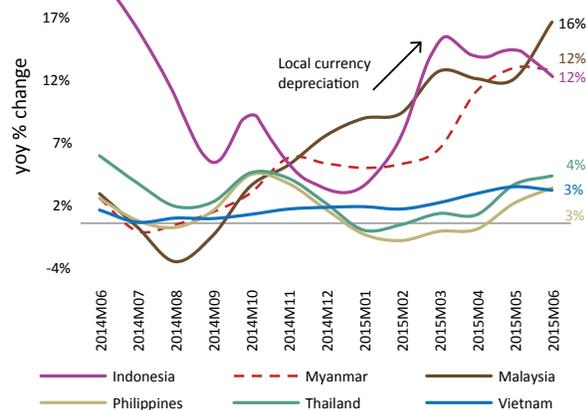
are above this cut off, and offers that are below the cut off. The cut off rate in the daily auctions is in turn the official reference rate set by the CBM. Authorized dealers and licensed money changers are allowed to trade US Dollars within a band of +/- 0.8 percent of the official reference rate. In 2013, the government also introduced a foreign exchange interbank market to complement the auctions by allowing commercial banks to trade foreign exchange among themselves.

Figure 42. Banking sector liquidity (loans/deposits)



Source: CBM

Figure 43. Nominal exchange rate (US\$ vs. Local currency) (% change, yoy)



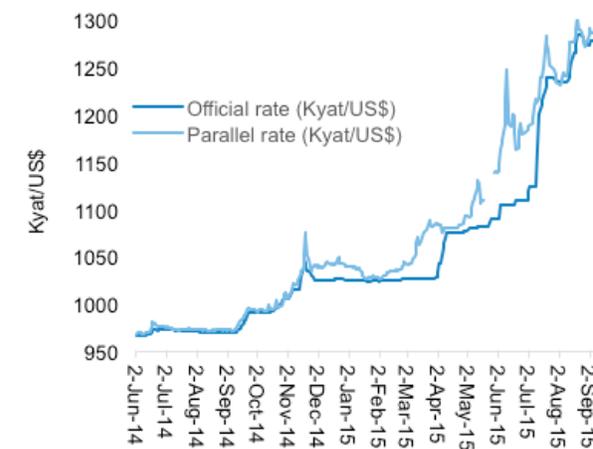
Source: CEIC, WB Staff Estimates

**45** The general strengthening of the US Dollar since mid-2014 has put downward pressure on the Kyat-Dollar exchange rate (Figure 44). The US Dollar has appreciated significantly against most currencies. For example, in the year to June 2015 the Indonesian Rupiah fell 12 percent against the US Dollar in nominal terms, and the Malaysian Ringgit 16 percent (Figure 43). The general rise in the Dollar is attributable to the approaching normalization of US monetary policy, including an eventual increase in interest rates,

which are weighing on capital inflows to emerging markets in Asia. This is in contrast to continued easing in major economies such as the Euro Area and Japan, as well as structural trends, including reduced US oil imports.

**46** In Myanmar, the situation was compounded by a growing current account deficit and slowing foreign investment inflows discussed above. The excess demand for foreign exchange in the auctions in November 2014 led to the reemergence of a parallel exchange rate. Importers were willing to pay 1-1.5 percent above the reference rate, which was adjusting only gradually to growing demands. Although the gap narrowed in January and February, it picked

Figure 44. Official and Parallel Exchange Rates

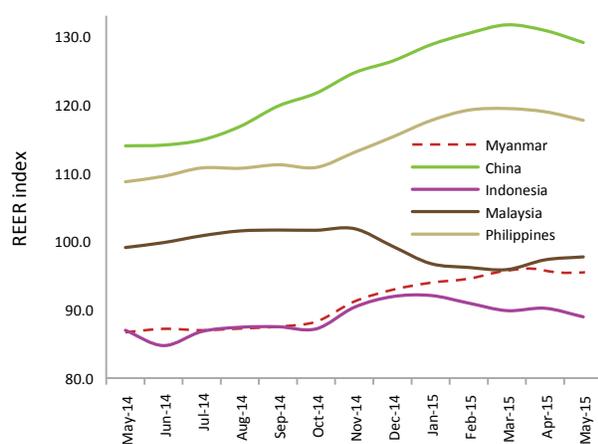


Source: CEIC, www.naungmoon.com, WB Staff Estimates

up again, reaching 4 percent in March. This led the CBM to make an important adjustment to the reference rate from Kyat 1030/US\$ in February to Kyat 1080/US\$ by end April, Kyat 1090/US\$ by end May and closer to Kyat 1120/US\$ by end of June. The Kyat has therefore depreciated by nearly 12 percent in nominal terms against the US Dollar between June 2014 and June 2015.

**47** Despite the depreciation of the Kyat and other Asian currencies against the US Dollar, external competitiveness was hampered by appreciating Real Effective Exchange Rates (REER) (Figure 45). The REER is an index of the domestic currency with currencies of all trading partners, adjusted for trade weights and relative inflation. When considering the REER, Malaysia’s Ringgit depreciated by only 1.4 percent in the year to May (compared to 16 percent nominal depreciation against the US Dollar in the year to June), while Indonesia’s Rupiah actually appreciated in real terms against its trading partners over this period, by 2.3 percent (compared to 12 percent nominal depreciation against the US Dollar in the year to June). In such cases, maintaining a fixed exchange rate against the US Dollar would have impeded international competitiveness even further.

Figure 45. Real Effective Exchange Rates



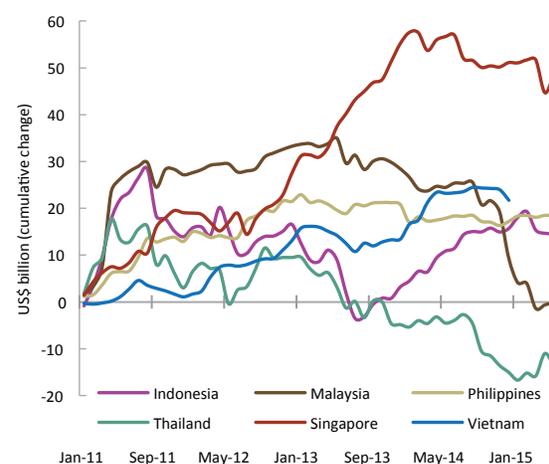
Source: BIS, WB Staff Estimates

**48** Myanmar also experienced some REER appreciation between November 2014 and March 2015 (Figure 45). Over this period, the Kyat appreciated in nominal terms against currencies of major trading partners including Japan, Malaysia, Korea, Indonesia, and Singapore. It is also around this time that relative prices between Myanmar and its trading partners began to diverge (Figure 29). Between March and May 2015, the REER for Myanmar depreciated slightly,

which as noted above is around the time when CBM adjusted the Kyat-US Dollar reference rate. Similar to the examples of Indonesia and Malaysia above, this adjustment was important to maintain Myanmar’s external competitiveness.

**49** Monetary authorities in the region have generally maintained exchange rate flexibility against the US Dollar’s appreciating trend since 2014. Official gross reserves of the ASEAN-5 were 4.9 percent lower in May 2015 than at the start of the US Dollar appreciation trend in June 2014. This decline is comparatively modest, demonstrating that Asian central banks have tended to avoid selling reserves to prop up their currencies against the US Dollar, preferring instead to preserve (and where possible, reinforce) reserve buffers (Figure 46). Only Thailand and Malaysia seem to have significantly drawn down on their reserves. Maintaining this

Figure 46. Gross reserves (US\$ billion cumulative change)



Source: BIS, WB Staff Estimates

flexible stance has allowed the currencies of other commodity exporters in the region (like Malaysia and Indonesia) to absorb some of the shock from lower global commodity prices and demand, notably including hydrocarbons, without which the drag on domestic profits, household incomes, public revenues and, ultimately, economic growth would have been greater.

**50** **CBM's recent stance to have greater flexibility in the Kyat-Dollar exchange rate is a positive move.** This has helped to close the gap between the official reference rate and the parallel market in August and early September 2015 (Figure 44). The CBM's instruction in May to ensure that government transactions are carried out in Kyat was also appropriate. However, administrative measures introduced in May to impose limits on US Dollar withdrawals have sent worrying signals to the market. The parallel market responded by selling US Dollars at a higher price (i.e. beyond the 0.8 percent limit) due to excess demand at the official rate. Speculation started as traders would purchase US Dollars at the official rate and sell at a higher price on the parallel market. Media reports indicated that households held on to US Dollars as a store of wealth. There were also indications that banks and currency traders were not willing to release US Dollars, presumably in the expectation that the Kyat may depreciate more, which became a self-fulfilling prophecy.

**51** **Administrative measures to control foreign exchange transactions can be counterproductive as illustrated by examples from elsewhere.** Experience from other countries that liberalized their exchange rates (Box 2) suggest that administrative controls on

foreign exchange can lead to emergence and/or growth in the parallel market; increased speculative trading; undervaluation in the parallel market as people begin to hoard foreign exchange as a store of wealth; and harmful impact on investment and growth due to lack of foreign exchange for imported capital and intermediate goods. Whilst exchange rate pressures are likely to remain over the short-term (see discussion on economic outlook and policy watch), these need to be addressed through complementary reforms that maintain fiscal and monetary policy discipline to manage pressures on the current account.

### Box 2. Exchange Rate Liberalization in Transition Economies<sup>16</sup>

**Centrally planned economies in Central and Eastern Europe** began their transition to market oriented institutions in the early 1990s. This included price and exchange rate liberalization (Roaf et al, 2014). Choosing a suitable exchange rate regime that could induce a correct set of relative prices and effectively control inflation in an open economy was a major concern for policymakers (Desai, 1998). These countries adopted various exchange rate regimes: fully floating, managed float, independent float, crawling peg, and peg.

Soon after liberalization, most countries experience real appreciation of their currencies. According to Desai (1998), this was linked to initial undervaluation of the nominal exchange rates in the immediate period after the exchange rate was floated. Real appreciation may also be explained by a surge in productivity and income in the tradable sector following liberalization, which leads to increased demand for and relative prices of non-tradables (Halpern and Wyplosz, 2001). Halpern and Wyplosz argue that this process is unavoidable for a developing economy.

Few if any countries had fully floating exchange rates. Exchange rate or managed floats were used as nominal anchors for managing inflation. These were effective in countries that had supporting measures in terms of ensuring fiscal and monetary discipline. Poland and Czechoslovakia were able to stabilize prices whilst others could not manage inflationary expectations due to lack of credibility of the exchange rate anchor.

**Several Sub-Saharan African countries** also undertook fundamental reforms in the 1980s and early 1990s to liberalize their international trade and foreign exchange rate regimes. A study by Maehle et al (2013) looks at the experience of seven of these countries.<sup>17</sup> Prior to liberalization, many of the countries experienced parallel exchange markets with a maximum premium of 4,200 percent in Ghana and 2,100 percent in Uganda during the 1980-84 period. In that same period, real GDP per capita was either in decline or stagnant. There were extensive administrative controls on and rationing of foreign exchange. The reform period posed a number of challenges. There were instances of sharp currency depreciation, high inflation, and large fiscal and current account deficits. Mozambique for about nine years saw increased inflation and currency depreciation from monetary expansion, supply shocks and continued large fiscal deficits (Maehle et al, 2013).

When faced with external shocks during the reform process, some countries tried to fix the exchange rate without supportive fiscal and monetary policies. Malawi employed stop and go exchange rate policies to manage external shocks and used informal administrative procedures to fix the exchange rate when its reserves were low. Malawi's administrative controls included rationing foreign exchange and surrender requirement on export proceeds. Tanzania, on other hand, gradually removed surrender requirement and export proceeds over five years as it switched from a peg to a unified managed float successfully. The gradual removal of controls and complete elimination of them happened despite Tanzania facing high depreciation during the reform process.

Maehle et al (2013) concluded that attempts to fix the nominal exchange rate through administrative means at levels that were inconsistent with the underlying fundamentals and fiscal and monetary policies are used, an increasingly overvalued exchange rate and foreign exchange shortages forced the authorities to either resort to increasingly damaging controls and rationing, or to undertake large ad hoc evaluations, which can have devastating effects on growth and poverty reduction. Economies in the case study benefited the most when reform efforts to liberalize foreign exchange market are sustained despite external shocks, inflation, currency appreciation and depreciation.

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<sup>16</sup> References: (i) Desai, P. (1998). "Macroeconomic Fragility and Exchange Rate Vulnerability: A Cautionary Record of Transition Economies." *Journal of Comparative Economics*, 26, 621-641; (ii) Fomby, T., Ikeda, Y., and Loayza, N (2009). "The Growth Aftermath of Natural Disasters". World Bank Policy Research Working Paper 5002; (iii) Halpern, L. and Wyplosz, A. (2001). "Economic Transformation and Real Exchange Rates in the 2000s: The Balassa-Samuelson Connection." *Economic Survey of Europe*, No. 1. Chapter 6; (iv) Maehle, N., Haimanot, T. and Khachatryan, A. (2013). "Exchange Rate Liberalization in Selected Sub-Saharan African Countries: Successes, Failures, and Lessons." IMF Working Paper, 23, 346-57; (v) Roaf, James., Atoyian, Ruben., Joshi, Bikas., Krogulski, Krzysztof., and an IMF staff team (2014). "25 Years of Transition: Post-Communist Europe and the IMF." Washington, D.C. International Monetary Fund.

<sup>17</sup> Countries in the case study are Ghana, Mozambique, Tanzania, Uganda, Zambia, Kenya, and Malawi. Real GDP per capita data available through 2010.

# Fiscal Policy

## Fundamental Shifts In The Union Budget

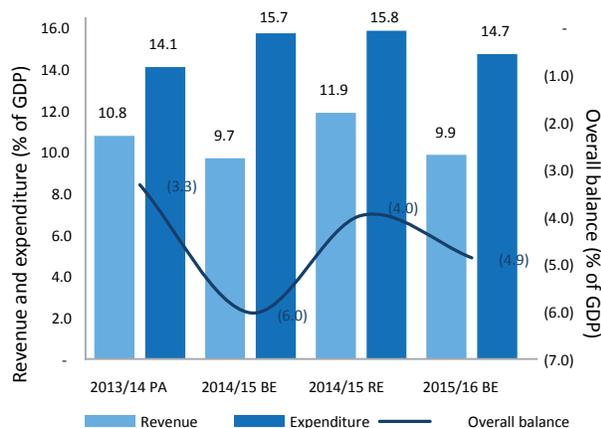
**52** The Union Budget<sup>18</sup> has undergone fundamental shifts in the past three years in line with government objectives to fill important gaps in public service delivery. Decades of government underspending on the back of a very low revenue base previously contributed to poor economic and social outcomes. Since 2011, one off revenue measures including the adjustment to the exchange rate, which led to a level change in government receipts, and revenue windfalls (e.g. from telecom licensing fees in 2014/15) have helped to finance increased spending whilst maintaining a relatively prudent fiscal stance. Efforts to strengthen tax administration and expand the revenue base have also contributed to improved revenue collections, which went from around 6 to 11 percent of GDP between 2009 and 2014. The composition of government spending

has undergone significant rebalancing – the share of social services (e.g. education, health) in total spending has increased from 10 to 33 percent between 2009 and 2014; and the share of capital spending has fallen from 63 to 38 percent.

## Relatively Prudent Fiscal Stance

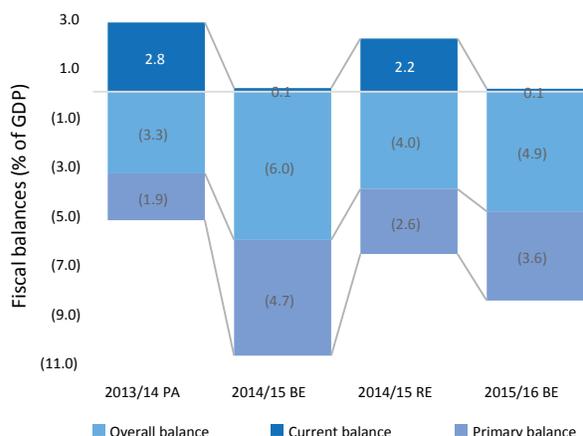
**53** The 2014/15 general government deficit outturn points to continued efforts at maintaining a relatively prudent fiscal stance. The deficit outturn is estimated at 4 of GDP compared to 6 percent in the 2014/15 Budget Estimate (BE) (Figure 47). This is thanks to better than expected revenue collection (11.9 percent of GDP outturn vs. 9.7 percent in the budget). The general government deficit is expected to expand to 4.9 percent of GDP in 2015/16 due to lower revenue and a slight increase in non-interest spending, in particular government wages. This is illustrated by a widening primary deficit (overall balance

Figure 47. Aggregate Revenue, Expenditure And Balance (% Of Gdp)



Source: MOF, WB Staff Estimates<sup>19</sup>

Figure 48. Fiscal balances (% of GDP)



Source: MOF, WB Staff Estimates

<sup>18</sup> This section covers the Union Budget excluding SEE operations. The Union Budget is the equivalent of the general government (i.e. central and sub-national authorities that are engaged in non-market, non-production public service delivery).

<sup>19</sup> Abbreviation: BE = Budget Estimates, RE = Revised Estimates, PA = Preliminary Actuals

excluding interest payments), which is estimated to increase from 2.1 to 3.5 percent of GDP (Figure 48). Despite continued growth in spending, the government maintains a recurrent surplus (recurrent revenue less recurrent expenditure), estimated at 2.2 percent of GDP in 2014/15.

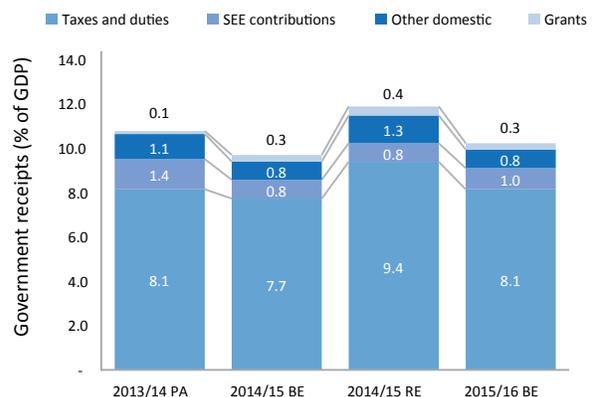
**54** The 2015/16 Union Budget Law (UBL) places a cap on the absolute amount of new borrowing permitted for the year. The cap is at Kyat 3.9 trillion, which covers borrowing by the public sector as a whole. This includes SEEs and external loans approved by the Parliament. Based on available data, net financing from external sources is expected to increase in 2015/16, as is financing from longer-term treasury bonds. As discussed above, monetary financing is expected to decrease slightly. This is an important move towards diversifying financing mix away from short-term, costly, domestic borrowing. The government is working on developing a borrowing plan for future years to maintain a sound mix in its debt portfolio and public debt at sustainable levels.

### Improving Revenue Performance

**55** Revenue performance was strong in 2014/15 with outturn estimated to be 23 percent higher than what was expected in the original budget. This is largely due to higher taxes and duties collections, which account for more than three quarters of total revenue. Within this, taxes on use of state property jumped by 2 percentage points of GDP due to telecom licensing receipts. As the windfall from telecom licensing begins to recede, general government revenue is expected to fall in 2015/16 to around 9.9 percent of GDP from an estimated 11.9 percent of GDP in 2014/15 (Figure 49). The decline is projected to be partially offset by higher collection of income and commercial taxes (Figure 50). This may be due to some reduction in tax exemptions, particularly in the services sector, which was instituted in the 2015/16 Tax Law. There may be also be

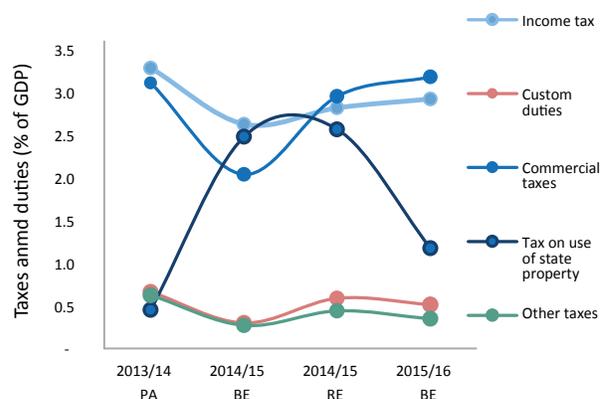
further gains from exchange rate impacts on Kyat denominated gas receipts, which together with higher production could offset any drop in gas prices. Despite these, at around 10 percent, the tax to GDP ratio in Myanmar remains below the ASEAN average, which is closer to 14 percent of GDP.

Figure 49. Government receipts (% of GDP)



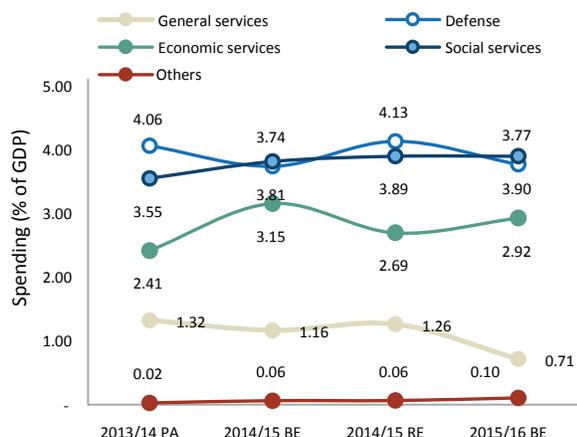
Source: MOF, WB Staff Estimates

Figure 50. Taxes and duties (% of GDP)



Source: MOF, WB Staff Estimates

Figure 51 . Functional Breakdown (% Of GDP)



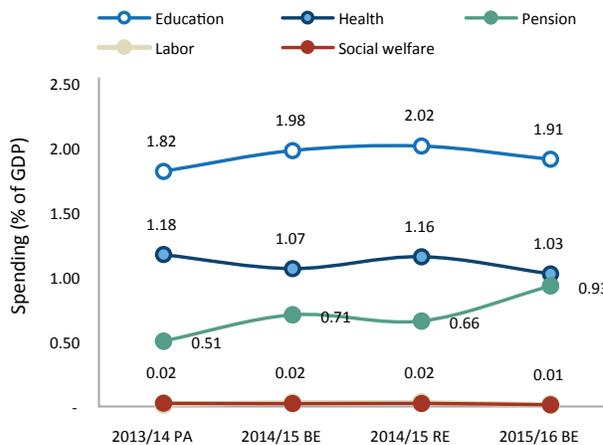
Source: MOF, WB Staff Estimates

**56** Receipts from SEEs (income tax, commercial tax and other contributions) account for around a quarter of general government revenue. Overall receipts are expected to increase slightly from an estimated 2.5 percent of GDP in 2014/15 to 2.8 percent of GDP in 2015/16, which nonetheless remains lower than collections in 2013/14 at 3.3 percent of GDP. Income tax, commercial tax and other contributions by the Myanmar Oil and Gas Enterprise (MOGE) accounts for nearly 11 percent of all general government receipts.

### Aligning Spending With Development Priorities

**57** Despite better than expected revenue, general government spending outturn as a share of GDP in 2014/15 was close to what was estimated in the Budget. This helped narrow the general government deficit. Despite the declining trend as a share of the Budget, defense spending outturn as a share of GDP was higher than what was planned, as was spending on social services. Estimates also show a very slight underspend in the capital budget, which was offset by slightly higher recurrent spending.

Figure 52. Social Services Breakdown (% Of GDP)



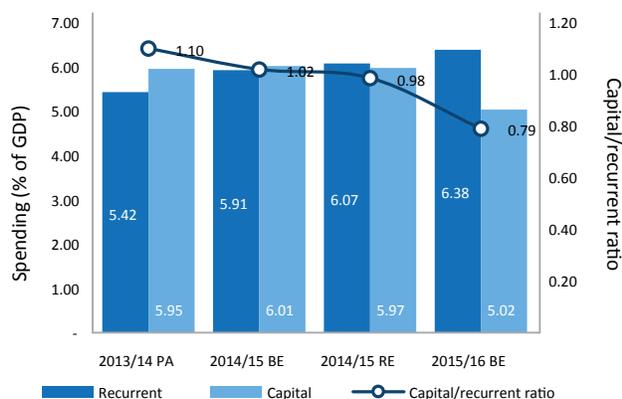
Source: MOF, WB Staff Estimates

**58** Social sector and economic services spending continue to trend up as a share of GDP in the 2015/16 Budget (Figure 51). Social services for the first time constitutes the largest share of the UBL (3.9 percent of GDP compared to 3.77 percent for defense). There is also a sharp decline in spending on general public services (1.26 percent of GDP in 2014/15 to 0.71 percent). Whilst defense spending remains high compared to other countries, it continues to trend down both as a share of GDP and as a share of the budget.

**59** Within social sectors, pensions have seen the biggest increase, albeit from a low base (from an estimated 0.66 percent of GDP in 2014/15 to 0.93 percent in 2015/16). Spending on education and health are both expected to remain at similar levels in terms of share of GDP in the 2015/16 UBL. Pensions will see a major increase linked to the increase in civil service salaries. Health will see a slight decline in real terms, after a nearly nine fold increase between 2009 and 2013.

**60** There is continued adjustment of spending away from capital towards recurrent spending (ratio of capital to recurrent expected to decline from 1 in 2014/15 to 0.8 in 2015/16) (Figure 53). This is partially associated

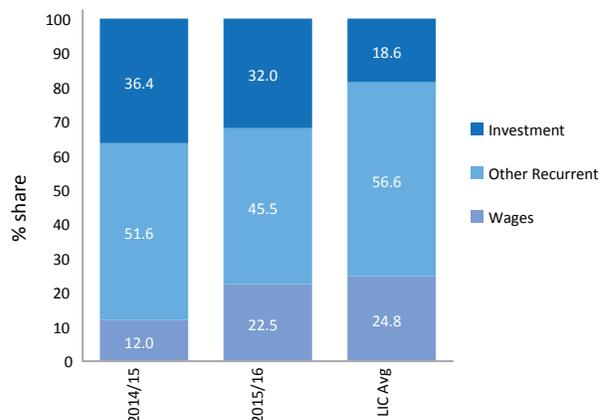
**Figure 53. Recurrent And Capital Spending (% Of GDP And Ratio)**



Source: MOF, WB Staff Estimates

with declining capital spending linked to the establishment of Nay Pyi Taw. Nonetheless, at nearly 40 percent of the overall budget, capital spending remains high compared to other countries as a share of total spending. Recurrent spending is expected to increase from 5.9 percent of GDP in the 2014/15 UBL to around 6.4 percent of GDP in 2015/16. Non-wage recurrent spending is expected to decline between 2014/15 and 2015/16, though the public sector wage bill will nearly double (Figure 54).

**Figure 54. Recurrent Breakdown 14/15 And 15/16 BE (% Share)**



Source: MOF, WB Staff Estimates

**61 The increase in the wage bill in Myanmar does not pose an immediate concern.**

The wage bill can have important implications for the overall fiscal stance and the government’s ability to implement counter-cyclical policies. Upward or downward adjustments to government spending during periods of economic recession or boom respectively become more difficult if non-discretionary spending on wages take up a large share of total expenditure. The general government wage bill (i.e. excluding SEEs) is around 28 percent of recurrent spending, which is slightly lower than other Lower Middle Income Countries (37 percent). Going forward however, any increase should be linked to medium-term fiscal sustainability and to pay and grading reform/performance considerations.

**62 Fiscal transfers to States/Regions will increase by 19 percent in nominal terms between the 2014/15 UBL and the 2015/16 UBL.**

At the moment, central spending accounts for over 90 percent of all spending in States/Regions. States/Regions have as of yet limited assignment of spending responsibilities. A better picture of spending across States/Regions would require data on central spending in States/Regions.

## Economic Outlook

### *Growth And Inflation Outlook Affected By Floods And Slowing Investment*

**63 Economic growth is expected to moderate to 6.5 percent in real terms in 2015/16, though this is subject to review as more details come in on the impact of the floods.** Agriculture growth in particular is expected to slow to 1 percent in real terms. Four of the five most affected States or Regions – namely Ayeyawaddy, Sagaing, Magway, and Bago – are also the top four sources of agriculture output in Myanmar. Whilst the extent of affected areas is still being analyzed, Sagaing and Magway in particular have suffered important damage and have been declared natural disaster zones.

**64 Whilst output in manufacturing and industry are not expected to be affected by the floods, there are indications that new investments are moving more slowly in the run up to the elections.** Much of Myanmar's manufacturing activities are highly concentrated around Yangon and to some extent Mandalay, which have not been as badly affected by the floods.<sup>20</sup> Together, both regions account roughly for over a third of national output. Although the establishment of industrial parks and Special Economic Zones (SEZ) holds the promise of attracting investment in a range of light manufacturing areas, some investors are reportedly biding their time until key legislations are adopted. Some examples include adoption of the Investment Law discussed further below, which will provide greater clarity and transparency over the business regulatory environment.

**65 The services sector in 2015/16 is expected to continue growing at a healthy pace.** Telecommunications services are set to expand further. The recent surge in growth has been on the back of a low base. In reality there are still major gaps to fill in terms of telecommunications services. Ooredoo Myanmar plans to invest

around US\$15 billion in the coming 15 years, and Telenor Myanmar around US\$5 billion in the coming 5 years. In addition, in July 2014, the state owned incumbent, Myanmar Post and Telecommunications (MPT) partnered with Japan's KDDI Corporation and Sumitomo Corporation, who pledged to invest US\$2 billion. Tourist arrivals are not expected to be badly affected by the floods. Whilst some may be deterred, the main tourist destinations have not been affected, and numbers are expected to pick up after the rainy season in the last quarter of 2015.

**66 Economic growth is expected to pick up and remain strong over the medium-term.** Agriculture output is projected to bounce back quickly in 2016/17. Manufacturing and industry investments are also expected to come on stream in the newly established industrial parks and SEZ. The Thilawa SEZ, an hour's drive outside of Yangon, is already partially operational. Around 40 companies have signed up for the 400-hectare initial phase, with operations in bottle manufacturing, auto parts, electronics and garments. Thilawa is the closest of the SEZs to the primary market, Yangon, and will have captive power generation along with all the other requisite ancillary infrastructure and thus is well placed to secure new investments. The Dawei SEZ, owned by the Myanmar and Thai governments, is also underway with new Japanese investment, targeting garments, textiles, food and beverages, and electronics.

**67 Output from the garments sector is expected to start gathering pace in 2015/16 and subsequent years.** There have been some industry concerns more recently due to irregular power supply and recent disagreements

<sup>20</sup> Kudo, T, and Kumagai, S, "Two-Polar Growth Strategy in Myanmar: Seeking High and Balanced Development", UDA Discussion Paper 371, November 2012

over the introduction of a minimum wage. Nonetheless, both foreign and domestic investors have over the past year looked to expand their current facilities as well as to establish greenfield factories. Domestic investors are also seeking to develop garment factory industrial parks, primarily in Yangon and NPT, together with dormitories to house the large labor force required and vocational training schools to ensure their employees have the right skills. A number of international garment sector investors with operations in China have also expressed interest in relocating operations due to labor cost advantages.

**68** Inflation is expected to pick up further reaching an average of 11.3 percent over the course of 2015/16. Part of this will be driven by the impact of the floods on supply of agriculture produce to local markets. There are already reports of sharp increases in the price of rice, beans and pulses. Inflationary pressures are likely to be further compounded further by

increased cost of imports, particularly processed foods and other necessities coming from China and Thailand in particular.

**69** Whilst the medium-term growth outlook remains positive, the floods have hit two of the poorest States in Myanmar. The States of Rakhine and Chin (together with Sagaing and Magway), the two poorest among all States and Regions in terms of the headcount incidence, have also been declared as natural disaster zones by the government.<sup>21</sup> The government estimates that in Rakhine alone, around 210,000 acres of rice paddy was destroyed and 20,000 livestock lost. Loss of livelihoods has been compounded by loss of assets and access to social services including clean water, sanitation, health and education. The government with support from UN agencies, Non-Governmental Organizations, bilateral donors and philanthropists are engaged in a massive humanitarian operation to address the most urgent needs.

**Table 1: Selected Economic Indicators, Projections 2015-2017** <sup>1,2</sup>

	2013/14	2014/15 e	2015/16 f	2016/17 f	2017/18 f
<b>Real gross domestic product</b>	<b>8.5</b>	<b>8.5</b>	<b>6.5</b>	<b>7.8</b>	<b>8.5</b>
<b>GDP, at market prices</b>	<b>14.4</b>	<b>15.6</b>	<b>18.6</b>	<b>17.0</b>	<b>15.3</b>
Agriculture	9.3	12.6	12.4	13.4	12.2
Industry	17.5	15.9	18.0	17.2	15.9
Services	16.6	17.8	23.6	19.3	17.0
<b>CPI Inflation, period average</b>	<b>5.7</b>	<b>5.9</b>	<b>11.3</b>	<b>8.5</b>	<b>6.3</b>
<b>Current account balance, % GDP</b>	<b>-5.3</b>	<b>-6.3</b>	<b>-7.9</b>	<b>-7.0</b>	<b>-5.6</b>
Exports, goods & services	10.4	23.4	26.7	27.2	24.8
Imports, goods & services	15.6	26.0	31.4	21.4	18.5
<b>Fiscal balance, % of GDP</b> <sup>3</sup>	<b>-3.3</b>	<b>-4.0</b>	<b>-4.9</b>	<b>-4.6</b>	<b>-3.7</b>
Revenue (% of GDP)	10.8	11.9	9.9	10.6	11.5
Expenditure (% of GDP)	14.1	15.8	14.8	15.2	15.2

e = estimate, f = forecast

1/ In annual percentage change, unless otherwise noted

2/ Fiscal year, April 1 - March 31

3/ General government

<sup>21</sup> Reliefweb, "Myanmar: Floods and Landslides – Jul 2015"; Government of Myanmar, UNDP, UNICEF and SIDA 2011, "Integrated Household and Living Conditions Survey in Myanmar, 2009-10: Technical report"

### Box 3. Macroeconomic Impact of Floods

The macroeconomic impact of natural disasters has attracted new economic research. Socio-economic preconditions and the specific type of natural disasters will of course influence macroeconomic outcomes in the aftermath of disasters. But the research also points to opposing views on whether natural disasters have any macroeconomic impact at all, with some finding that disasters have little implication for economic growth.<sup>22</sup>

A recent study using data covering 87 countries over the period 1960-2007 finds that floods (unlike droughts, earthquakes and storms) tend to have a positive effect on economic growth over the medium-term.<sup>23</sup> Agriculture tends to pick up more quickly in the year after the flood, and non-agriculture growth tends to follow. The cumulative mean effect of floods on GDP growth is 0.5 percentage points. Whilst the transmission mechanisms are not clear, the paper suggests that these could include factors such as: increased primary output inducing a later expansion of processed goods (e.g. cotton and textile).

Regardless of medium-term recovery, the immediate macroeconomic shock of flooding can be very significant as illustrated by recent disasters. The 2014 floods to have hit **Bosnia and Herzegovina** are estimated to have caused the equivalent of nearly 15 percent of GDP in damages and 5.6 percent of GDP in losses. Agriculture exports suffered due to crop destruction, the current account deficit widened rapidly and the economy went into recession. In **Serbia**, damages amounted to around 2.7 percent of GDP and losses amounted to 2 percent of GDP. The hardest hit economic sectors were energy, mining, and agriculture but significant damages were also inflicted on transport infrastructure (roads, bridges and railways).<sup>24</sup>

The 2011 floods that hit **Pakistan** causes damages estimated at 1.6 percent of GDP. The floods affected major agricultural areas, thereby leading to overall deceleration in growth despite lower impact on services and industry. Inflationary pressures from earlier commodity prices shocks were further exacerbated due to the impact of floods on agriculture supply with inflation remaining in double digits. The fiscal deficit was estimated to have increased from 6 percent of GDP to 6.4 percent of GDP following. The current account deficit was expected to increase from 0.8 percent of GDP to 1.4 percent due to the impact of floods on the cotton crop, which adversely affected exports, and increased imports needed to cover agricultural supply loss and construction material.<sup>25</sup>

The 2011 floods in **Thailand** caused around 11 percent of GDP in total damage and loss. The manufacturing sector bore roughly 70 percent of this. At the time, it was estimated that the floods would reduce real GDP growth in 2011 by 1.1 percent from pre-flood projections, though would recover the following year thanks to reconstruction efforts started in 2012. The current account surplus fell from over US\$ 20 billion to around US\$ 12 billion due to falling manufacturing exports and lower tourism. Lower manufacturing activity also meant a decline in government revenue. However a relatively prudent fiscal stance in the run up to 2011 enabled the government to absorb the fiscal shock.<sup>26</sup>

<sup>22</sup> Hochrainer, S, "Assessing the Macroeconomic Impacts of Natural Disasters: Are there Any?" in WB Policy Research Working Paper 4968, June 2009

<sup>23</sup> Fomby, T, Ikeda, Y, and Loayza, N, "The Growth Aftermath of Natural Disasters," in WB Policy Research Working Paper 5002, July 2009

<sup>24</sup> WB, "Coping with Floods, Strengthening Growth," South East Europe Regular Economic Report (January 2015)

<sup>25</sup> ADB, WB, Gov of Pakistan, "2011 Pakistan Floods: Preliminary Damage and Needs Assessment," 2011

<sup>26</sup> WB et al, "Thai Flood 2011: Rapid Assessment for Resilient Recovery and Reconstruction Planning," 2011

## Maintaining Fiscal Discipline

**70** The government is expected to maintain the general government budget deficit to below 5 percent of GDP in 2015/16. Although revenue is projected to decline, ongoing reforms to tax administration and collections from the service and manufacturing sectors should enable the government to meet its 2015/16 revenue target even with any impact from the floods, which will affect mostly the agriculture sector. One important risk to this outlook is the potential impact of international commodity prices on Myanmar's gas receipts. A drop in gas prices of 16 percent in 2015/16 would still allow for strong spending growth, but any sustained decline would require important spending adjustments even assuming steady growth in output. At the same time, the drop in gas prices could also be offset by the positive impact of currency depreciation on Kyat denominated earnings. On the expenditure side, external grants and concessional lending will help to partially offset the humanitarian and reconstruction costs associated with the floods.

## Heightened Pressure on The External Accounts

**71** There is likely to be continued pressure on the current account. Import demand is projected to increase in light of humanitarian and reconstruction-related needs. This will likely only partially be offset by gas exports and possibly some pick up in garments exports. Despite a drop in prices, gas exports are expected to remain relatively stable thanks to growing output over the medium-term. Agricultural exports will decline due to the flood impact and in light of domestic food security concerns, which only recently led to a lifting of a moratorium on rice exports.

**72** Recent developments in China have far reaching consequences, including potentially for Myanmar. Growth in China is moderating, estimated at 7.4 percent in 2014, and rebalancing gradually from manufacturing to services, investment to consumption, and exports

to domestic spending.<sup>27</sup> China's stock market has suffered major shocks between June and August 2015. Large investments in the run up to June saw a major reversal leading to a 30 percent drop in the Shanghai index in early June. The authorities intervened through cuts in interest rates and other measures to prop up the markets. In August, China devalued the Renminbi on two occasions in a bid to enhance external competitiveness. These developments have fed into: a drop in international commodity prices due to concerns over slowing demand from China; downturns in other major stock markets given the extent to which global companies depend on Chinese demand; and a flight to safety as investors look to US government securities as stable investment thereby leading to further appreciation of the US Dollar.

**73** Myanmar has strong trade and investment links to China. Between a quarter and a third of cumulative foreign investments in Myanmar are from China. In 2014/15, China had 38 new FDI projects accounting for 15 percent of total FDI commitments (\$530 million) for the year. According to official statistics, in 2014 China accounted for around 37 percent of Myanmar's exports, and 31 percent of Myanmar's imports. Myanmar represents a very small share of China's total trade: 0.8 percent of total imports and 0.4 percent of total exports in 2014. Around half of this trade was earlier estimated to be with the bordering Yunan Province.<sup>28</sup>

**74** Myanmar's trade deficit with China has been growing in recent years (Figure 55). Official statistics show that it increased from \$350 billion in 2012, to \$600 billion in 2013, reaching \$1 billion in 2014. This is linked to FDI-related capital imports, which exceeded increased gas sales through a new cross-country pipeline linked to offshore blocks in Rakhine State that came on stream in 2014. The Kyat has depreciated by over

<sup>27</sup> WB, "China Economic Update," July 3 2015

<sup>28</sup> Steinberg, D, Fan, H, "Modern China-Myanmar Relations: Dilemmas of Mutual Dependence," (2012)

40 percent against the Renminbi between January 2013 and July 2015 (Figure 56).

**75 Slowing growth in China could affect Myanmar through trade channels even if the recent stock market turmoil is unlikely to have any direct implications.** The demand for capital goods, which dominate imports from China, are likely to remain high (Figure 57). Myanmar exports to China, which are dominated by natural resources, including gems (Figure 58), however, may decline. This would have a moderate impact on growth, which will continue to be dominated by domestic demand over the medium-term.

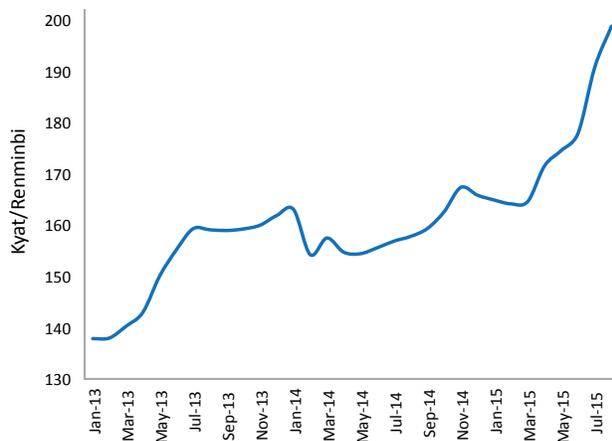
**76 The impact of China on commodity prices will likely put pressure on Myanmar's exports.** There may be some effect on exports at the margins from the general decline in demand in China. The recent sharp drop in sales at the annual gems emporium could be a symptom of this. But despite policy tightening in energy-intensive sectors and overcapacity in key heavy industries, the quantity of Myanmar's mineral fuels and oil exports to China are not likely to be affected since only 0.4 percent of total mineral fuels and oil that China imports were from Myanmar in 2014. The impact on exports could be compounded by the recent clamping on illegal timber and gems trade.

Figure 55. Myanmar-China trade (US\$ m)



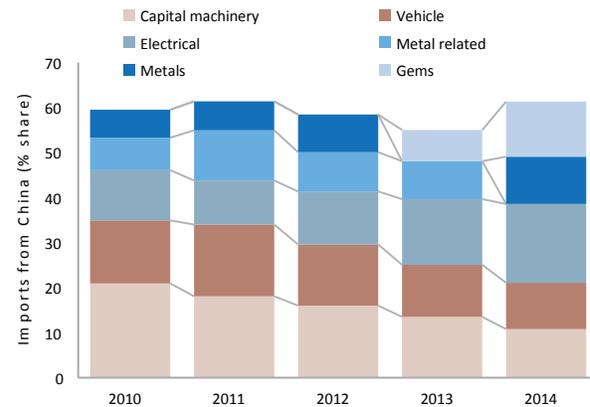
Source: DICA

Figure 56. Exchange rate (Kyats/Renminbi)



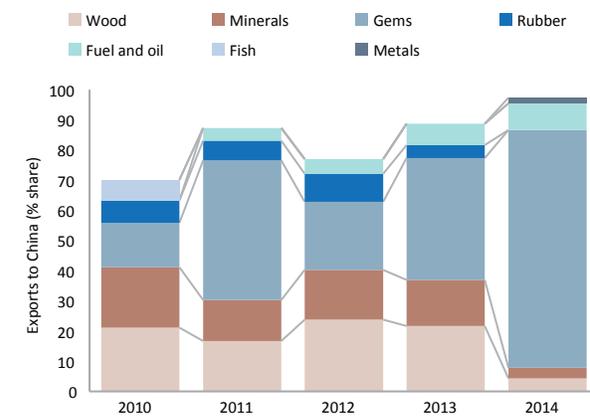
Source: GOM

Figure 57. Top imports from China



Source: Comtrade

Figure 58. Top exports to China



Source: Comtrade

## Policy Watch

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**77** The Policy Watch in this Myanmar Economic Monitor covers a few selected priority issues closely related to Myanmar's overall economic developments and outlook. Other, broader economic and social policy issues that are also central for inclusive and sustainable growth (such as education, health, rural development, energy, water, environment, or social development) are (or will be) covered in separate publications<sup>29</sup> and/or future issues of the MEM.

### *Maintaining Exchange Rate Flexibility And Monetary Discipline*

**78** In light of the above external pressures, **CBM would do well in continuing to maintain flexibility in the Kyat.** This could include widening the band of +/- 0.8 percent around the reference rate. In the short-term, efforts at defending the currency by drawing on foreign exchange reserves will not be sustainable. Reserves at end March were estimated at around three months of import cover, which does not provide much buffer against pressures on the currency. Further depletion of reserves would increase external vulnerability and Myanmar's ability to sustainably finance its current account deficit. Any effort at managing exchange rate volatility needs to be supported by fiscal and monetary discipline to ensure stability and competitiveness.

**79** The costs of maintaining administrative controls on the exchange rate are likely to be greater than the benefits. As discussed above, some nominal depreciation is important for external competitiveness particularly with rising inflation in Myanmar. There is otherwise the real risk of the tradable sector suffering from under-investment. Many import dependent firms faced huge pressures as they were not able to access foreign exchange to carry out their business. Businesses that are trading imports in the domestic market will face higher costs as a

result of depreciation; however many FDI firms faced constraints in their ability to import capital machinery and other goods to establish and expand their production base. In addition, given that a number of these FDI firms also produce for the export market, recent foreign exchange controls could create concerns over access to and repatriation of profits earned in foreign currency.

**80** These developments call for continued strengthening of monetary policy capacity. Liberalization of external accounts have prompted foreign exchange interventions, which impact on money supply. The sale of foreign exchange reserves to prop up the exchange rate in 2013/14 would have contracted money supply, and impacted on domestic demand. Similarly recent downward pressure on the Kyat and concurrent efforts to shore up foreign exchange reserves would have required sterilization to avoid inflationary pressure. These assume of course that foreign exchange intervention is warranted in the first place. In the short-term, exchange rate flexibility will be important given structural shifts in trade, evolving capacity to carry out open market operations, and limited foreign reserves.

### *Strengthening Public Debt Management*

**81** An important milestone in the government's fiscal management reforms is the draft Public Debt Law that was recently submitted to the Parliament. The Public Debt Law offers an important opportunity to strengthen the overall framework for public debt management by clarifying roles and responsibilities, in particular the authority to borrow; setting out clear objectives for debt management, including the need to develop

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<sup>29</sup> See for example the World Bank Systematic Country Diagnostic for Myanmar

a strategy to achieve those objectives; establishing reporting requirements and accountabilities of the principal debt management authority towards parliament.

**82 An important part of the upcoming Public Debt Law is to ensure that the authority to borrow is clearly assigned to one principal debt management entity.** In particular, the Ministry of Finance should be responsible for preparing and implementing the government's borrowing strategy. This would include assessing different financing mix and making recommendations as needed to the Cabinet and the Parliament to ensure that the proposed mix is consistent with the overall borrowing plan and strategy.

**83 The government recently instated closer Ministry of Finance oversight and control over these borrowing decisions.** The draft Public Debt Law should help to formalize this. In 2015/16, the Ministry of Construction accounted for nearly a third of Kyat 970 billion in planned external borrowing. Current policies also allow line ministries to directly service loan obligations through funds that are appropriated through the UBL for this purpose. The Public Debt Law should assign debt servicing responsibility to the Ministry of Finance.

### *More Attention To Non-Rice Agriculture*

**84 Agriculture policy in Myanmar remains heavily focused on rice, which is regarded as a strategic commodity.** In May 2015, the MOAI launched the Myanmar Rice Sector Development Strategy, which aims to strengthen rice exports through higher value and climate-smarter paddy production, enhanced efficiency of value chains, and improved rice quality. This strategy complements the National Export Strategy 2015-2019 launched in March 2015. Although there are no direct farm output and input subsidies for rice, or any other products in Myanmar, public programs such as those in irrigation, seeds, extension, mechanization, and subsidized loans are heavily biased towards rice. In 2013/14, the

Myanma Agricultural Development Bank provided Kyat 1,159 billion of loans, twice as much as in 2012/13 (Kyat 558 billion), according to MOAI. Most of these loans went for paddy production. The Ministry of Cooperatives also borrowed heavily to provide agricultural loans, mainly for rice, resulting in its debt service obligations increasing from Kyat 7 billion in 2014/15 to Kyat 45 billion in 2015/16 (see below section on fiscal developments).

**85 Greater attention to non-rice agriculture development would help boost Myanmar's growth, reduce risk to price fluctuations and help to tackle poverty.** Overall agriculture growth in Myanmar has lagged behind peer countries, despite the country's lower base of agriculture output and income per farmer (Figure 12). Myanmar's agriculture output is below potential not least because non-rice crops, and livestock and fisheries, are suffering from low public goods provision. Although production growth in these sectors has been faster than rice in recent years, neglect in public programs and poor access to finance hamper opportunities for diversification of the rice-based farming systems and for higher exports. This is particularly evident for beans and pulses, in which Myanmar has a particular comparative advantage. Addressing these constraints would help expand agriculture output and help reduce poverty.

### *Options For Managing The Minimum Wage Policy*

**86 The introduction of a minimum wage has generated much debate.** The minimum wage policy of Myanmar was first introduced with the enactment of the Minimum Wages Act, 1949. In 2013, the government passed a new Law on Minimum Wages which established the creation of a National Committee to set minimum wage levels for different sectors. In August 2015, after several rounds of negotiations, a new minimum wage rate of 3600 Kyats (\$USD2.8) per day for all sectors and industries (excluding small businesses employing

less than 15 workers) was approved.

Box 4 summarizes some insights from other countries on institutional arrangements for minimum wage policy that may be relevant for Myanmar.<sup>30</sup>

#### Box 4. Institutional Arrangements For Implementing Minimum Wage Policy

Set a clear (single) objective for the minimum wage policy linked to addressing labor market imperfections: Empirical evidence shows that the impact of minimum wages on poverty is limited. Higher minimum wage can help workers escape poverty, but also push others into poverty when workers lose their jobs due to higher minimum wages. A minimum wage can be appropriate for addressing labor market imperfections for example when employers use market power to keep wages below what would prevail if there were competition.

Keep a simple structure and avoid complex systems with multiple rates: Countries vary widely with respect to the complexity of the system. For example, Indonesia and Mexico set multiple levels across regions, sectors and/or occupational categories, while South Korea, Brazil, and Colombia legislate one single minimum wage that applies to all workers. Although having multiple wages appears desirable, evidence indicates that overly complex systems are difficult to enforce. In the case of Myanmar, the policy rightly limits differentiation.

Agree on the key principles and comprehensive criteria for the fixing the minimum wage level: It is important to agree on a comprehensive list of criteria and indicators. These typically include: cost of living/consumer prices, productivity, enterprise capacity to pay, producer prices, competitiveness, income inequality, immigration, informal economy, unemployment, GDP growth, among others. It is also important for the law to take into account wage structures. For instance, in Myanmar, the notified minimum wage is for standard eight-hour work day; it does not mention overtime compensation which forms the bulk of the take-home wage in many sectors, including garments.

Determine the policy tool and process for future adjustments of the minimum wage: Designing a policy tool that takes into account different economic and social criteria will enable Myanmar's National Minimum Wage Committee to derive a suitable range, which can serve as the basis for negotiation between the negotiating parties. In the UK, for example, the Low Pay Commission conducts a thorough analysis of quantitative indicators and high-quality impact evaluations, complemented by extensive consultations. This allows adjustments whilst minimizing detrimental consequences on employment and wages. It is crucial to make some collection efforts to ensure that the information is timely available for negotiations. The process should be time-bound and involve all negotiating parties, including independent technical experts to represent public interest.

Strengthen enforcement and monitoring capacity: Though only a small fraction of the labor force in Myanmar will be covered by the new minimum wage, it will be important to strengthen enforcement and monitoring capacity to ensure compliance with the regulation.

<sup>30</sup> Del Carpio, X., L. Pabon. (2014). Minimum Wage Policy: Lessons with a Focus on the ASEAN Region. January 2014. World Bank document. 87864-EAP; Pabon, L. (2015). Background note on Minimum Wage Policy in Myanmar, manuscript.

## *Strengthening The Business Environment*

**87** Sustaining growth over the medium-term will require continued strengthening of the business environment and opening up of the space for investment. Although Myanmar scores poorly in the World Bank Group's annual Doing Business Report and the Myanmar Investment Climate Assessment, the government is implementing reforms to reduce administrative burden on the private sector. To oversee and coordinate this process, a Special Task Force for Business and Trade Promotion, chaired by the Minister of Commerce, has been established. One of its functions is to coordinate the government's participation in the recently established Myanmar Business Forum (MBF), a public-private dialogue process designed to improve the ability of the private sector to participate in the policy process. Under the MBF, six Working Groups on agriculture, manufacturing and trade, infrastructure, natural resources, finance and banking and tourism, have been established by the private sector. Discussions in the MBF are helping to inform fundamental laws currently under preparation.

**88** One of these is the new Myanmar Investment Law being prepared by the Directorate for Investment and Company Administration (DICA). The Investment Law aims to streamline investment entry and approval procedures, and strengthen investor protection by guaranteeing access to key resources such as land, labor and capital and by ensuring due process and good governance in regulating investment. By creating a more conducive investment climate and level playing field, the Government hopes to attract greater and more diversified investment in Myanmar while at the same time better targeting investment incentives to meet this objective. A draft of the law was posted on the DICA website and public consultations have been held with the private sector and civil society to obtain feedback and comments.

**89** DICA is also preparing a new Companies Law to modernize and strengthen corporate governance practices. The Companies Act is an important piece of legislation that regulates how companies are formed and managed. It contains provisions on key matters such as the registration of companies, the management and conduct of companies' affairs, financial reporting and audit requirements for companies, share capital and capital raising matters, duties of directors and winding up of companies. A key issue addressed in the law that affects investment in the country is the definition of a foreign company provided in the law. Currently, a single share owned by a foreign investors classifies a company as foreign, thereby restricting land ownership. The law seeks to establish a threshold investment amount by foreigners in a local company before it is classified as a foreign company. This will allow foreign equity investment in local companies without requiring joint-venture arrangements and enable Myanmar companies to raise equity capital from abroad. This provision will also enable foreign participation in future capital markets once established.

**90** Steps are also being taken to address patronage and state capture. Some improvement is seen as public competitive tendering of major projects in telecommunications, electricity generation, and oil/gas have been successfully executed. The recently adopted Competition Law provides for the protection of public interest from monopolistic acts, speculation in goods or services, control of unfair competition, prevention of abuse of dominant position and economic concentration. The law establishes a Competition Commission as a regulatory body with investigative and adjudicative powers and addresses the three standard pillars of competition law (agreements that restrain competition, abuse of dominance and mergers) as well as unfair trade practices. The law also establishes a comprehensive penalty regime with the potential for private damages, conviction of senior managers

and a leniency policy. Effective implementation of the law and the establishment of the Competition Commission will require significant efforts on the part of the Government before the impact of the legislation can be felt in the economy and by investors.

**91 Despite these improvements, more work remains in improving the business environment.** According to the results of the World Bank Group Doing Business Report issued in 2014, Myanmar ranks 177 of 189 in the overall ease of doing business. While Myanmar ranked 189 in starting a business in the 2014 report reforms have been announced regarding the elimination of the minimum capital requirement for local firms and to speed up the issuance of the incorporation certificate. In addition to streamlining procedures for entry of businesses, the government has also made significant improvements in relaxing constraints faced by ongoing business operations. The abolition of the export first policy where firms need to access foreign exchange and the removal of licensing requirements on many import and export products, has significantly improved the operating environment for ongoing business operations.

**92** Constraints remain in other areas. Myanmar ranks 185 in the 2014 Doing Business report in enforcing contracts due to the time and cost of resolving commercial disputes through the court system. The Government is preparing an Arbitration Law to provide an alternative dispute resolution mechanism to speed up contract enforcement. The Doing Business report also shows that the time and cost of obtaining construction permits is very high with Myanmar ranking 130 of 189 and requiring 13 procedures and 128 days. In addition, it is not very easy for businesses to exit, where Myanmar ranks 160 out of 189 on Resolving Insolvency. The Enterprise Survey carried out in 2014 as part of the Investment Climate Assessment identified business inspections as a constraint in the eyes of

the private sector due to the numerous inspections carried out by different government agencies in an uncoordinated fashion.

**93 Registering property in Myanmar is a cumbersome and expensive process.** According to the World Bank's Doing Business Report, it takes 113 days, 6 procedures, and costs 7.2 percent of the property value. As a result of the high cost of transferring title, many land transactions take place based on a notarized contract of sale, which is attached to the land title but does not transfer title within the land registry. The result is that significant blocks of land are 'owned' by individuals whose names are not on the land title. This creates difficulties for using such land as collateral with banks and frequently results in land tenure disputes.

### *Promoting Financial Inclusion*

**94 Access to finance is the most frequently identified obstacle to business in Myanmar.** According to the 2014 Myanmar Investment Climate Assessment, a lack of access to finance is a more significant constraint than access to land, electricity, and access to skilled workforce. In addition, access to finance is one of the most frequently identified main obstacles in all three broad industry sub-sectors, namely manufacturing (23 percent), the retail trade (36 percent) and the services sub-sector (14 percent).

**95 Financial inclusion has therefore been a top priority at the highest levels of government.** This contributed to the enactment of the 2011 Microfinance Law which created a distinct Microfinance Sector. It established specific regulations and a new regulatory body, the Financial Regulatory Department (FRD) located in the Ministry of Finance responsible to license and supervise licensed MFIs. The 2011 Law comes with a set of explicit socio-economic objectives: reducing poverty of grass-root people, creating job opportunities, cultivating saving habits,

supporting cottage industries, fostering SMEs, providing support for diversification of income generating activities of farmers, though there remain elements of the regulations that inhibit rather than support these objectives.

**96 Policy makers have also been actively pursuing the opportunity around mobile financial services.** To advance this effort the CBM passed a Mobile Banking Directive in December 2013 which allowed banks to offer basic mobile financial services. While this measure is helpful in some respects, it only permits banks to lead in the provision of basic accounts and payments. The key unfinished step is to pass regulation that would allow non-banks, particularly mobile network operators, to establish special purpose mobile financial service companies. The CBM is preparing a draft regulation to address this issue.

**97** Despite these efforts, the financial sector has started from a very low base in terms of formal financial sector provision, including:

- i) Myanmar population is thinly-served by financial services: Although 30% of adults use at least one financial service from a regulated financial service

provider, only 6% make use of more than one regulated financial product class (a combination of credit, savings, insurance and payments) and only 5% have a bank account in their name. Among formal a products, credit has the deepest reach (19% formal access), payments at 9.8%, savings at 6% and insurance at 3%. In terms of women, data from the Central Bank of Myanmar indicates only 2% of women having an account at a formal institution.<sup>31</sup>

- ii) High levels of informality throughout economy: There are high levels of informality throughout the economy with a pervasive unregulated financial sector constituting the largest source of lending. An estimated 9.2 million adults have a loan from an unregulated financial services provider with an estimated total outstanding debt as high as K 5.4 trillion (USD 5.7 billion).<sup>32</sup> This is primarily due to lack of credit forcing people to turn to money lenders.
- iii) Farmers’ access to some formal credit and lack access to formal insurance products: In Myanmar farmers make

**Table 2: Basic Set Indicators On Financial Inclusion**

% of adults with an account at a formal financial institution	5%
% of adults with at least one loan outstanding from a regulated financial institution	19%
% of adults with at least one insurance product from a regulated financial institution	3%
% of formal SMEs with an account at a formal financial institution	17%
% of SMEs with an outstanding loan or line of credit	4%

Source: MAP Making Access Possible Myanmar Country Diagnostic 2013

<sup>31</sup> The Role of Finance in Women Economic Empowerment in the ASEAN Region. (2014). Dr. Sandar Oo.

<sup>32</sup> MAP synthesis report P. 14

up two-thirds of the labor force. The Myanmar Agricultural Development Bank (MADB)<sup>33</sup>, is the largest single provider of credit by number of clients currently serving an estimated 2 million farmers but the levels of credit provided is insufficient forcing farmers to use informal sources of credit. Only 2% of farmers use regulated insurance products and most rely on their savings, help from family and friends or informal moneylenders to offset the consequences of risks such as death of family member, illness or crop failure.

- iv) Formal SMEs lack access to formal credit: Though 17 % of formal Small and Medium Enterprises<sup>34</sup> have an account at a formal financial institution only 4% of make use of credit from regulated providers, 22% from unregulated lenders and the rest rely on family savings and retained earnings to fund business expansion.

**98 To address some of the above and other challenge, the government has developed two key strategic plans:** the Myanmar Financial Inclusion Roadmap and the Myanmar Financial Sector Development Strategy, 2015-2020. The Roadmap proposes interventions that primarily relate to capacity and knowledge-building initiatives, corporate reform and modernization programs, consumer protection and financial literacy initiatives, infrastructure enablement projects, and proposed research projects. A time horizon of up to five years has been envisaged for the full impact to be realized. The FSDS aims to provide a comprehensive set of sequenced actions to build a larger, more efficient, and more competitive financial system.

*Improving Banking Supervision*

**99 Continued strengthening of banking supervision rightly remains a government priority.** The CBM, which became

autonomous from government in 2013, is the primary regulator and supervisor of commercial banks. The new Financial Reporting Department in MOF mentioned above is mandated to supervise not only micro-finance institutions, but also insurance companies, lottery, state-owned banks, and other non-bank financial intermediaries. In addition, in 2014 a new Securities Commission was created to oversee the incipient securities market.

**100 The three financial sector supervisory bodies face various challenges due to institutional and human resource capacity constraints.** Supervision focuses primarily on compliance with laws and regulations, not to identify, monitor and manage existing and potential risks in the financial system. Efforts are underway to upgrade financial sector supervision in Myanmar with the assistance of the IMF, neighboring central banks, the WBG and other development agencies. Given the current starting point, it will take several years before Myanmar can be compliant with best international practices.

**101 An important step towards strengthening banking sector supervision is the draft Bank and Financial Institutions Law prepared by CBM and being debated by the Parliament.** The BFI Law should provide the much needed legal framework for an open and market-based financial sector. Myanmar’s current financial institutions law suffers from serious gaps in both the structure and contents required for it to be implemented consistently, transparently, and effectively. The proposed new BFI Law takes into consideration the aforesaid gaps, current problems in the

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<sup>33</sup> MADB is a state-owned bank with 14 regional offices, 169 branches and 44 agency offices with 3357 staff providing short term and long-term credit to over 2 million farmers. MADB is authorized to lend to state owned agricultural organizations, livestock organizations, corporations, private entrepreneurs, village banks, farmers and farm laborers.

<sup>34</sup> Formal enterprises are enterprises that are considered regulated or licensed to operate. This segment represents adults who are self-employed and own and operate their own enterprises.

implementation and enforcement faced by the CBM, and the future direction of the banking system. Importantly, it also defines the scope of power of the CBM adequately, marks the perimeter of exercise of discretion, sets out clear procedures to guide and ensures consistency. It aims to provide a sound legal framework for the implementation of the Basel Core Principles and its passage is expected to fundamentally change the operating environment for banking in Myanmar. Some of the salient features are summarized in below:

#### Box 5. Key Features Of Draft Banking And Financial Institutions Law

**Clear definitions of the types of institutions which are subject to regulation by the CBM and their scope of activities.** Hence, the new FI Law rationalizes the definition of “banking business” (removing the artificial distinction between commercial banks and development banks and using duration of deposit) so as to provide a sound footing for the conduct of banking business. Under the FI law, banking business is rationalized in line with accepted banking norms.

**Non-bank financial institutions regulation.** The law provides for options to provide oversight and if needed regulation of the non-bank financial institution business such as – money remittance, leasing, factoring, e-money and credit card business. A light touch registration system is created for non-bank financial to enable CBM to collect data and information. However, CBM can bring these NBFIs within the regulatory purview of the FI Law if they pose systemic risks as well threat to financial stability. The FI Law also provides a framework for monitoring and dealing with a third category of exempted institutions such as Agriculture Bank, Rural Development Bank, Microfinance Institutions etc., which fall under the authority of another regulator and law. The CBM will have the necessary power with the approval of Ministry of Finance to bring these institutions under FI law if it is in the interest of the public and stability of the financial system.

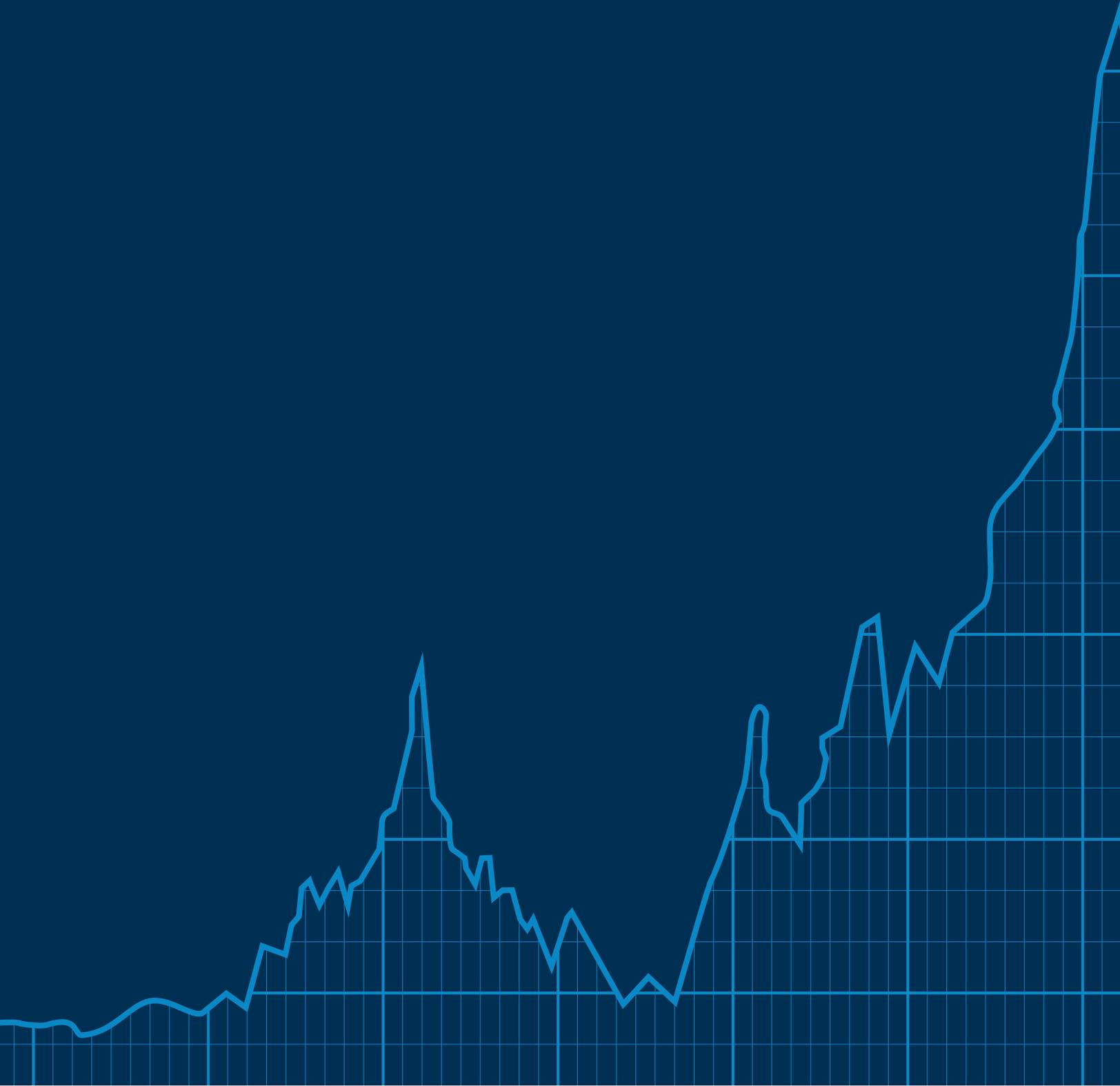
**Licensing.** The new FI law provides for adequate framework for licensing of banks. The new FI law sets out the minimum conditions for licensing, the procedures and the powers of CBM to carry out the licensing function effectively. The new FI law also deals with the licensing of foreign banks either as branches and subsidiary. It also includes a clear list of permitted banking business activities is necessary in the FI Law to ensure banks are able to carry on a broad range of activities including securities and insurance subject to these activities being regulated by the respective laws.

**Sound statutory basis for the prudential supervision of banks.** In line with BCP standards, the authority of CBM to develop and utilize prudential regulations and requirements to control the different types of risks inherent in banking business is clearly provided in the new FI Law. CBM has power to enter into arrangements with foreign supervisory authorities and domestic authorities for cooperation and exchange of information.

**Powers of the state bank to take prompt corrective actions.** The new law provides a graduated approach to the enforcement of prudential requirements, culminating in bank resolution measures such as bank rehabilitation, liquidation and cancellation of the banking license. Accordingly, the FI Law prescribes a gradual sequence of enforcement measures, escalating in intrusiveness.

**Bank resolution measures and insolvency provisions.** The new FI Law introduces a logical sequence of resolution measures, which would begin with an order suspending the business of the bank, or alternatively placing the bank under administration and appointing an administrator to take control of a failing bank, and would culminate in the liquidation of the bank and the cancellation of its license. In line with international good practices and given the current state of insolvency law in Myanmar, the new FI law provides for a comprehensive framework for bank and non-bank financial institutions resolution.

**Payment System.** To supplement the provisions in the CBM law, the new FI law provides more detailed provision to enable CBM to amongst other things, formulate payment system policy, operate and license payment system, ensure finality of payment, co-operate with private sector and designate payment systems



**WORLD BANK GROUP**  
Macroeconomics & Fiscal Management

Yangon Office No.57, Pyay Road  
6 1/2 Mile, Hlaing Township,  
Yangon, Myanmar  
Tel +95 1 654824  
Email [myanmar@worldbank.org](mailto:myanmar@worldbank.org)