AMRO Annual Consultation Report

Myanmar - 2018

The ASEAN+3 Macroeconomic Research Office (AMRO)

July 2018

Acknowledgements

1. This Annual Consultation Report on Myanmar has been prepared in accordance with the functions of AMRO to monitor, assess and report its members' macroeconomic status and financial soundness and to identify the relevant risks and vulnerabilities, and assist them in the timely formulation of policy recommendation to mitigate such risks (Article 3(a) and (b) of AMRO Agreement).

2. This Report is drafted on the basis of the Annual Consultation Visit of AMRO to Myanmar from May 15 to 25, 2018 (Article 5 (b) of AMRO Agreement). The AMRO Mission team was headed by Dr Jae Young Lee, Group Head and Lead Economist. Members include Dr Xianguo Huang (Country Economist for Myanmar), Mr Paolo Hernando (Senior Economist and Back-up Economist for Myanmar), Mr Xinke Tang (Researcher and Back-up Economist for Myanmar) and Ms Mya Hnin Wai Pwint (Associate). AMRO Director Dr Junhong Chang and Chief Economist Dr Hoe Ee Khor also participated in key policy meetings with the authorities. This AMRO Annual Consultation Report on Myanmar for 2018 was prepared by Dr Jae Young Lee, Dr Xianguo Huang, Mr Paolo Hernando, Mr Xinke Tang, Ms Mya Hnin Wai Pwint and Mr Justin Lim; peer reviewed by Dr Seung Hyun Hong (Group Head and Lead Specialist) and Mr Anthony Tan (Senior Economist); and approved by Dr Hoe Ee Khor, AMRO Chief Economist.

3. The analysis in this Report is based on information available up to 29 June 2018.

4. By making any designation of or reference to a particular territory or geographical area, or by using the term "member" or "country" in this Report, AMRO does not intend to make any judgements as to the legal or other status of any territory or area.

5. No part of this material may be disclosed unless so approved under the AMRO Agreement.

6. On behalf of AMRO, the Mission team wishes to thank the Myanmar authorities for their comments on this Report, as well as their excellent meeting arrangements and hospitality during our visit.

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Executive Summary

1. **Myanmar's economy was on a gradual recovery path in Fiscal Year (FY) 2017/18, after slowing down in the previous year.** The economy grew by 6.8 percent in FY2017/18, compared to 5.9 percent in FY2016/17, driven by expanding public spending and exports. Favorable weather conditions helped to spur a recovery in agricultural production. The Myanmar economy is projected to grow at 7.1 percent and 7.4 percent in 2018 Half-Year Interim and new FY2018/19, respectively.[1]

2. **Inflation moderated further mainly due to lower food inflation, while core inflation started to pick up in the later part of the fiscal year.** The forecast inflation rates are 4.9 percent in 2018 Half-Year Interim and 5.0 percent new FY2018/19.

3. **The trade deficit improved in FY2017/18 on the back of stronger export growth.** The rebound in exports relative to imports in FY2017/18 helped to narrow the trade deficit, although the current account deficit widened slightly to 4.3 percent of GDP. However, this was covered by stronger FDI inflows and the overall balance of payment was in surplus. The foreign reserves increased modestly from the previous year and reached USD 5.4 billion in March 2018.

4. **Credit growth, albeit high, has been on a decelerating trend with a slowdown in lending from domestic banks.** The credit growth has been declining steadily in the previous years. The issuance of new bank regulations since July 2017, reflecting the coming into force of the Financial Institutions Law of 2016, is a significant step towards bringing the regulatory standards closer to international standards.

5. **While revenue growth remains weak, the disbursement of externally-financed capital expenditure has been improving.** The tax revenue collected by the Internal Revenue Department grew less than its revised estimate, due to lower-than-expected income tax from SEEs. The disbursement of ODA projects has improved significantly, and total capital expenditure is expected to increase as a percentage of GDP in FY2017/18. The sizable fiscal deficit has been financed increasingly through government securities, including both bonds and bills.

6. **Risks to growth and inflation are substantial both internally and externally.** The risks to growth emanate mainly from ongoing ethnic tensions in Rakhine State and uncertainties in the global environment related to trade and energy prices. Exchange rate pressure and weather conditions that lead to supply-side disruptions will continue to be key sources of inflation uncertainty.

7. **External stability risks remain significant in light of trade and energy price uncertainty, in addition to ethnic tensions in Rakhine State that continue to weigh on investor sentiments.** Energy exports are estimated to decline in volume as certain gas wells are currently in the declining phase of their project cycles, while new

[1] Myanmar's fiscal year will change, starting from this year, from April-March to October-September. The 2018 Half-Year Interim is from April to September 2018 and will serve as the transition period to the new fiscal year 2018/19 which will commence from October 2018 and ends September 2019.

exploration projects will take time to reverse the downward production trajectory. The ethnic tensions could dampen investor confidence and discourage tourist arrivals, particularly from outside the region.

8. **The financial sector is vulnerable and requires active risk management amidst the efforts on raising banking regulation standards.** In particular, the vulnerabilities associated with poor asset quality and thin capital buffer could increase further, in light of the implementation of stricter loan classification standards under the new prudential regulations, and difficulties that some banks face in reducing their overdraft facilities and restructuring them into longer-term loans.

9. **Subdued revenue from state economic enterprises (SEEs) in the energy sector and subsidies to loss-making SEEs will continue to put pressure on the fiscal position.** Raising additional revenue from the gas sector will be challenging in view of the depleting gas fields going forward and the significant lag between gas exploration and production.

10. **Enhancing tax revenue and containing current expenditure are critical to strengthening the fiscal position.** There is a need to continue optimizing fiscal resources by directing more resources towards priority areas with continued improvement in spending efficiency. Adhering to medium-term fiscal discipline should help ensure fiscal sustainability, supported by the establishment of fiscal rules and a resource fund.

11. **The introduction of a more disciplined monetary policy framework has contributed to a reduction in macroeconomic imbalances and inflation.** A more active use of reserve requirement could be helpful under the current money-targeting framework. In the medium term, with further development of market infrastructure, gradual liberalization of domestic interest rates should help to enhance policy effectiveness. We welcome the flexible management of the exchange rate.

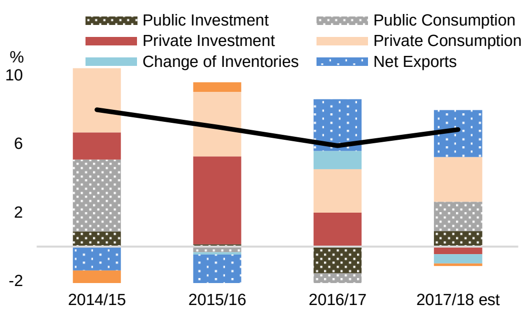
12. **The implementation of new banking regulations will enhance the soundness and resilience of the financial system and contribute to developing a healthier banking sector over the medium term.** In the short turn, the process of compliance with new banking regulations could put pressure on banks and dampen the economy and should be managed judiciously.

13. **Structural and institutional reforms to develop a market-based economy and inclusive growth should be accelerated under a comprehensive and coherent policy framework.** Timely implementation of new laws and strengthening the rule of law in Myanmar should boost private investor confidence in the economy.

A. Recent Developments and Outlook
A.1 Real Sector Developments and Outlook

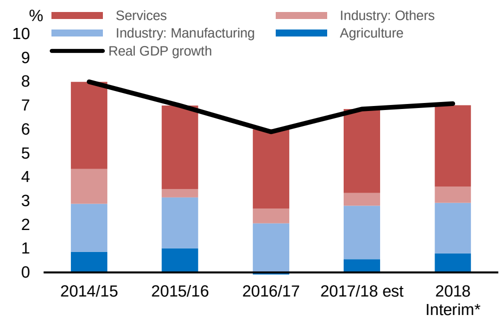
1. **Myanmar's economy was on a gradual recovery path, led by expanding public spending and exports, as well as a pick-up in agriculture and manufacturing activities.** After slowing down in FY2016/17 during the transition to a new government, government spending in terms of both consumption and investment rebounded in FY2017/18. With strong growth in garment exports and a mild recovery in global energy prices, net exports continue to contribute positively to growth. Private investment remained soft, partly constrained by tighter financial conditions and also likely due to the wait-and-see attitude adopted by some investors pending clearer policy directions and resolution of the ongoing ethnic tension in the Rakhine State. GDP growth increased to 6.8 percent in FY2017/18 from 5.9 percent in FY2016/17. From a GDP production perspective, a rebound in agriculture production reflecting favorable weather condition, and growing service activities underpinned the economic expansion. Manufacturing—led by the garment sector—continued to provide stable support for industrial growth. Meanwhile, transportation, communication and trade helped contribute to faster growth in the service sector.

Figure 1. Real GDP Growth, Expenditure Side



Source: Ministry of Planning and Finance (MoPF)

Figure 2. Real GDP Growth, Production Side



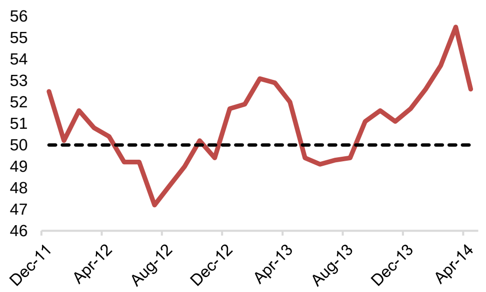
Note: 2018 refers to half-year interim fiscal budget from April to September 2018.
Source: MoPF, AMRO staff projection

2. **The higher-frequency PMI indicator suggests there has been a solid expansion in manufacturing activities, led by exports and supported by credit expansion.** Monthly PMI readings indicated that the momentum of manufacturing activities in the second half of FY2017/18 was strong, led by new orders. This expansion in domestic manufacturing has been accompanied by sustained growth in manufacturing export, at 22.0 percent for the whole of FY2017/18. Although overall credit growth softened, the outstanding loans to manufacturing—accounting for around 11 percent of bank lending—grew by 27 percent as of September 2017.

3. **Inflation moderated further in FY2017/18 mainly due to lower food inflation, while core inflation—excluding food and energy—started to pick up in the later part of the**

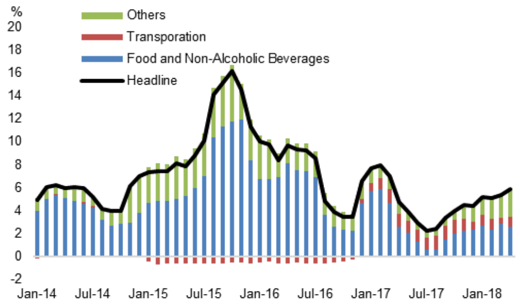
fiscal year. Inflation fell to 4.0 percent on average during the FY2017/18, compared to 6.8 percent in FY2016/17. While CPI components related to energy prices started to contribute positively to inflation, a sharper drop in food inflation—accounting for 58.5 percent of the CPI basket—caused headline inflation to fall in FY2017/18. A stable kyat and contained Central Bank of Myanmar (CBM) financing have also contributed to a reduction in inflationary pressure. While food inflation has been contained, other items, excluding food and energy-related items, have started to show an upward trend starting in the later part of the fiscal year, registering a 5.8 percent increase in prices in the first quarter of 2018.

Figure 3. PMI



Note: Values above 50 indicate expanding activity, and vice-versa.
Source: Nikkei/ IHS Market

Figure 4. CPI Inflation and Contributions



Source: Central Statistics Office (CSO)

4. **Going forward, the Myanmar economy is projected to grow at 7.1 percent and 7.4 percent in FY2018 interim period and new FY2018/19, respectively**.[2] The economic recovery will be supported by sustained FDI inflows, improving investment sentiment, and continuing strong growth in garment exports and domestic consumption. In addition, infrastructure construction activities related to upgrading connectivity, and electricity infrastructure such as gas-to-power plants and upgrading the Yangon-Mandalay expressway, will help maintain the growth momentum. Total FDI approvals in FY2017/18 declined to USD5.7 billion, compared to USD6.7 billion the previous year, as a result of no applications in the oil and gas sector, and a sharp drop in transport and communication sector. However, on a positive note, there has been a diversification of approved FDI projects in FY2017/18 with manufacturing and real estate projects growing by 41.7 percent and 51.7 percent respectively. (See **Box A** for more details of the Myanmar Companies Act 2017 which is expected to help attract more foreign investment)

5. **Inflation is forecast to stabilize at 4.9 percent in for FY2018 Interim and 5.0 percent in FY2018/19.** Inflation rates for 2018 interim and FY2018/19 are expected to be moderate if good weather conditions continue. The increasing contribution from energy-related transport is expected to be gradual, in line with global energy prices. From a monetary

[2] The 2018 half-year Interim is from April to September 2018 and serves as the transition period to the new fiscal year 2018/19 commencing from October 2018 and ends September 2019.

policy perspective, the progress in phasing out CBM direct financing of the fiscal deficit and a stable nominal effective rate of the kyat should help anchor inflation expectations at a moderate level going forward.

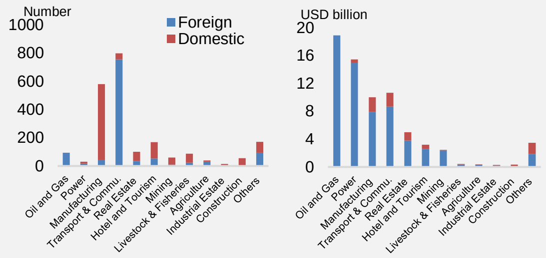
Box A. Myanmar Companies Act (2017)

The new Myanmar Companies Act 2017 (MCA 2017)—was signed into law on 6 December 2017 and came into effect on 1 August 2018. This box highlights some of the key aspects of this new corporate law and discusses its potential impact on the domestic economy.

The re-definition of "foreign company" creates the flexibility to optimize corporate ownership and allows for more foreign participation in local firms in more sectors that are currently subject to investment restrictions. In the previous companies Act 1914, "local company" was defined as a company fully owned by domestic citizens with 100 percent ownership. This excludes the possibility of partial participation of foreign investors in local companies without the latter losing the status of being a local company which has fewer investment restrictions than foreign companies. MCA 2017 relaxes this and allows local companies to maintain the "local" status while attracting up to 35 percent of equity investment by a foreign investor, thus effectively opening the door for foreign participation in broader sectors. In addition to the rule with regards to foreign ownership, MCA 2017 also adjusts the rule to allow sole proprietorship in private companies, thus dropping the past requirement that foreign companies need to have a local partner first before they can do business in Myanmar. The new Act removes the minimum requirement on the number of shareholders and directors for incorporation, which enables both domestic and foreign investors to have full ownership at their discretion.

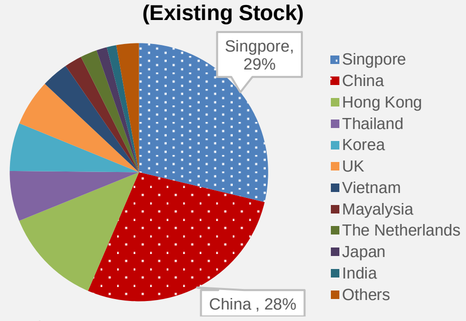
The new Act addresses some of the issues related to corporate governance through strengthened compliance, which can help improve transparency and accountability in the corporate sector in the medium term. While easing the requirements of the director of a company from being a Myanmar citizen to "ordinary resident" status, the MCA 2017 lists specific duties of corporate directors, obligations of a company, and other key aspects related to corporate governance. While the detailed implementation has yet to unfold, the law provides a good legal foundation and guidance to the Myanmar business sector in developing transparency and trust. MCA 2017 simplifies administration procedures and reduces compliance costs. It is now easier to shift between "local" and "foreign" as the authorities now only need to be notified about the change, compared to in the past when such a change would need explicit government approval. On the other hand, corporate compliance with the new law will be likely stronger, compared to the previous law.

Figure A1: Investment in Real Sector by Sector and by Entity (Existing Stock)



Note: as of December 2017.
Source: Directorate of Investment Commission and Administration (DICA)

Figure A2: Investment in Real Sector by Country (Existing Stock)



Source: DICA

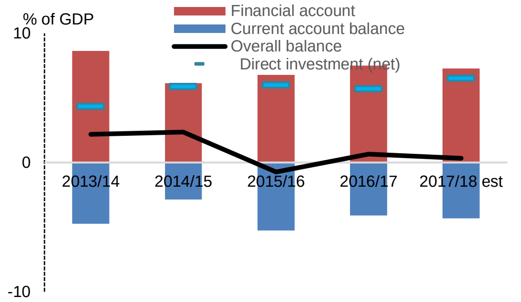
The new law aims to relax restrictions on foreign ownership and provide a conducive environment for foreign investment. Relaxing restrictions on foreign investors' participation in local companies and allowing sole proprietary ownership will nourish a more conducive legal environment. Foreign capital has been a key contributor to overall private investment in Myanmar, accounting for 53 percent of companies registered at DICA and 87.7 percent of total investment stock as of Q1 2018. While foreign investment will continue to concentrate on energy- and infrastructure-related projects, more diversified investment into other sectors could be stimulated going forward with the more liberal legal environment. Equity investment through the Yangon Stock Exchange is possible but the details for implementation are yet to be known.

In the medium term, the Act will also contribute to improving the efficiency of various sectors through knowledge spillovers and technology transfer. For instance, empirical evidence suggests that foreign minority participation in domestic banks will help improve the banking sector's efficiency. The construction sector can also learn from and benefit from collaborating with foreign counterparts in adopting best practices and technologies.

A.2 External Sector and the Balance of Payments

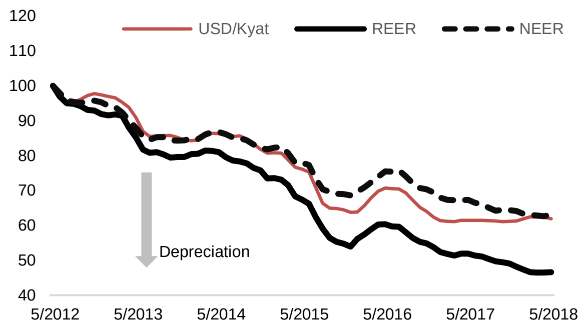
6. **The rebound in exports relative to imports in FY2017/18, helped to narrow the trade deficit, although the current account deficit remained sizeable.** Both exports and imports rebounded in FY2017/18—registering growth of 22.3 percent and 8.4 percent respectively—leading to a lower trade deficit. During the same period, the service account surplus remained flat in percent of GDP as tourism-related receipts were subdued. The current account deficit is estimated to have widened from -4.1 percent to -4.3 percent of GDP in FY2017/18, mainly due to a drop in secondary income[3].

Figure 5. Balance of Payments



Note: A statistical adjustment in the data source of secondary income mainly contributed to a widening current account deficit.
Source: CBM, AMRO staff estimates

Figure 6. Exchange Rate



Source: CBM, AMRO staff calculations

7. **Overall BOP remained in surplus in FY2017/18, as the recovery in FDI inflows provided a boost to the financial account surplus which more than covered the current account deficit.** FDI exhibited a strong recovery in the first three quarters of the fiscal year and stood at USD3.9 billion, partly driven by a large project in the energy sector, compared to USD2.5 billion at the same period of FY2016/17. The financial account surplus is estimated to be 7.3 percent of GDP in FY2017/18. As a result, the BOP remained in surplus leading to an increase in foreign reserves. Following a slowdown in the disbursement of Official Development Aid (ODA) projects in the previous year upon review by the new government, the inflows related to ODA disbursement started to recover in FY2017/18, standing at USD588 million compared to USD366 million in the previous year. With overall balance continuing to be in surplus, foreign reserves recorded a modest increase from USD5.1billion in March 2017 to USD5.4 billion in March 2018.

[3] CBM has been using a new source to estimate the secondary income account for BOP data in FY2017/18, which has a big impact on the number of current transfer.

8. **While kyat has been stable against the USD through most of the year, it has started depreciating since April 2018 due to a stronger US dollar.** The kyat was able to remain stable against the USD through FY2017/18, reflecting mainly external factors. Stronger growth in exports than imports helped alleviate the market pressure on kyat's depreciation amidst a weaker USD against other major global currencies. The effective exchange rates of the kyat continued to be weak against Myanmar's key trading partners' currencies such as THB, SGD, and CNY which strengthened against the USD. However, with the USD strengthening again since April this year, the kyat has started depreciating against the USD.

9. **External public debt is low and remains contained reflecting slow ODA disbursement and increasing repayments.** The gross external public debt remains low and it has not been growing as a percentage of GDP, with increasing repayments and slow ODA disbursements. It was estimated at around 14.0 percent of GDP as of the end of FY2017/18, and comprised largely medium- and long-term debt.[4]

A.3 Monetary Condition and Financial Sector

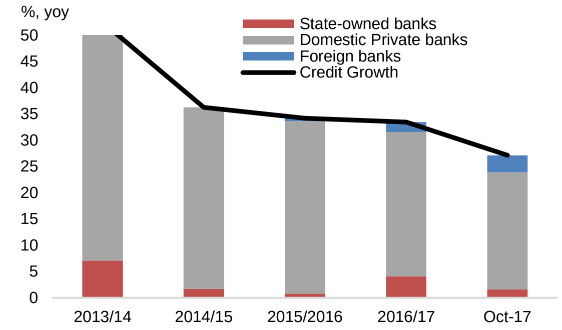
10. **The implementation of new bank regulations in July 2017 is a significant step in bringing the regulatory framework closer to international standards, and it will help enhance the soundness of the banking system.** The new regulatory Basel-II-standard framework will bring the regulatory regime in line with the Financial Institutions Law of 2016 and closer to international standards. The banking sector has been in a gradual process to comply with the new framework by adjusting their business model. Except for several banks which have yet to fulfill the regulatory CAR and have committed to extended timelines, most of the banks have been able to fulfill the capital requirements. The progress in converting overdraft facilities[5] to term loans has been mixed as some borrowers are reluctant to face the higher cost and lower flexibility of term loans (See **Box B** for the new banking regulations and the prospect of the banking sector going forward).

11. **While credit growth has remained high, it has been decelerating led by a slowdown in lending by domestic banks**. In response to the tighter regulation, domestic credit growth to the private sector has been slowing as a whole, growing at 23.4 percent (yoy) as of end-March 2018, down from 33.5 percent at the end of March 2017. As foreign banks have been expanding rapidly from a low base being new entrants, the domestic banks—including both private and state bank—have been slowing their lending. On the funding side, deposit growth has been stable, growing at 22.0 percent (yoy) as of end-March 2018 compared to 24.1 percent (yoy) in the previous year, with foreign banks' deposits growing

[4] A debt relief during FY2012/13 and FY2013/14 registered a total of USD10.8 billion.
[5] CBM required banks to reduce the overdraft facilities to 50 percent of loan portfolio by 6 July 2018.

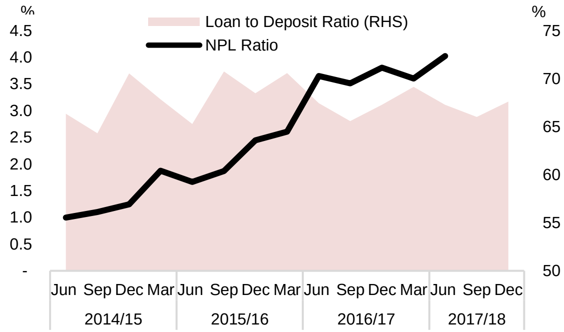
more rapidly from a low base. The overall liquidity situation, measured by broad money, is relatively stable with money growing at 18.0 percent as of end-March 2018 from 19.4 percent a year ago.

Figure 7. Credit Growth to Private Sector



Source: CBM

Figure 8. Loan-to-Deposit and Non-performing Loan Ratios (Private Banks)



Source: CBM

12. **While progress has been made, the banking system needs continued modernizing and liberalization** (See **Box B** for the details)**. Higher prudential standards reflecting the adoption of a new regulatory framework that is in line with international standards would help to improve the soundness of the banking system.** The asset quality of domestic banks deteriorated in the past four years amidst rapid credit expansion, while several domestic banks remained undercapitalized as of March 2018. The non-performing loan (NPL) ratio of domestic private banks has been increasing, and reached 4.0 percent as of June 2017, compared to 1.0 percent three years ago. Banks' capital adequacy ratios have been improving since the enforcement of capital requirement, with most of the banks approaching 8.0 percent of the minimum required ratio as of March 2018 aggregated at the sector level. Banking sector profitability, on the other hand, has been moderating, in the face of increasing competition with returns on asset and equity at less than 1 percent and 10 percent as of March-2017 for some banks. The increasing regulation-compliance costs will affect profitability further going forward.

13. **While the real estate sector as a whole continued to remain subdued, some segments of the sector have started to show signs of recovery.** While real estate prices continued to witness a correction, some indicators in the sub-segment markets suggest signs of recovery in the real estate market. For instance, the office occupancy in the office segment has been improving, and retail occupancy has stayed high despite increasing supply. The strong demand in smaller-size service apartment and industrial real estate has helped prices

remain stable. Meanwhile, the condominium market faces the biggest challenges with likely continuing downward pressure on prices and heightened supply going forward.[6]

Box B. Banking Sector in the New Regulatory Environment

To implement the clauses under the Financial Institutions Law 2016, CBM announced a series of regulations on 7 July, 2018 describing the requirements related to capital, loan exposure and reclassification, as well as recovering overdraft loans (Table B1 lists these new regulations and effective dates). This box provides a background for these regulations and the prospect of the banking sector going forward.

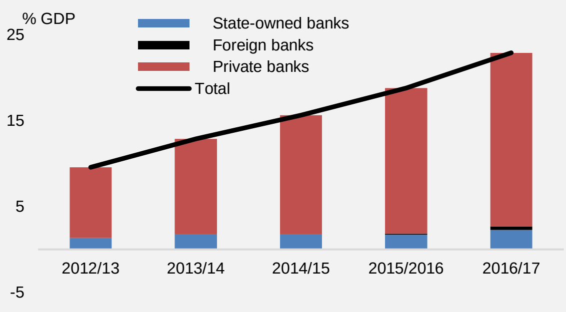
Table B1: New Prudential Measures Announced in 2017

Prudential Measures	Content	Effective Date
Capital Adequacy Ratio (CAR)	Minimum Tier-1 and regulatory CAR are 4 and 8 percent respectively	January 6, 2018
Liquidity Ratio	20 percent of assets in cash (or cash-equivalents)	July 7, 2017
Large Exposure	Single borrower is capped at 20 percent of capital	July 7, 2017
NPLs and Provisioning	Reclassification with shorter-due date and more provision needed	January 6, 2018
Overdraft Exposure	Reducing to 50/30/20 percent of loan portfolio.	July 6, 2018/2019/2020 respectively

Source: CBM

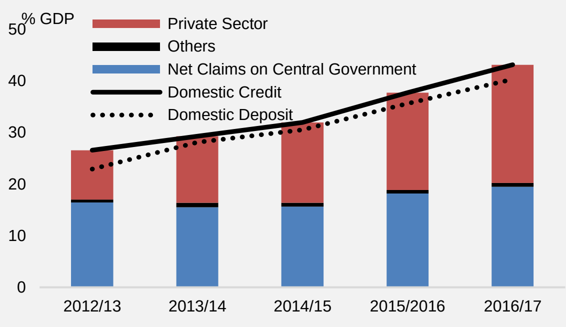
Loans to the private sector have been growing fast, in line with the national strategy to transition to a private sector-driven economy. Starting from a low base, in the past few years, credit to the private sector has grown at an average of 40.0 percent (year on year), or from 9.6 percent of GDP at the end of 2012/13 (March 2013) to 25.4 percent as of September 2017. Loans to the private sector—led by domestic private banks—accounted for the bulk of the expansion and the outstanding credit to private sector has surpassed the value of the credit to the central government since 2017.

Figure B1: Loan Expansion to Private Sector



Source: CBM

Figure B2: Overall Credit to the Economy



Source: CBM

The domestic legislative and regulatory environment has been undergoing upgrading to catch up with the changing economic landscape and the evolution of the banking sector. The Foreign Exchange Management Law in 2012, Central Bank of Myanmar Law in 2013, and Financial Institutions

[6] On the other hand, clarification on non-resident ownership and a reduction in the transfer fees of property titles according to the newly issued rules of the Condominium Law—which also facilitates mortgage financing—will provide support to this segment once the law is implemented effectively.

Law 2016 have laid the foundation for Myanmar to establish an independent monetary authority to formulate market-based monetary and exchange rate policies, and to upgrade the framework for proper banking supervision. The detailed regulations implemented since July 2017 and follow-up directives have touched upon the key aspects of regulation such as capital requirement, asset classification and loan exposure.

Additional measures to strengthen the governance of the banking sector and improvement in the data availability continue to pave the way for the modernization of the banking sector. New regulatory initiatives related to auditing, related parties and acquisition are currently being drafted by the CBM, which will further help improve the regulatory framework going forward. On the other hand, the establishment of a system-wide credit data portal will strengthen both supervisory insights by CBM and asset risk management by banks. The Myanmar Credit Bureau has been officially established in May 2018, aiming to centralize loan data from the micro level that are fragmented at the level of each lender. While it will take some time for the new organization to collect sufficient data for analysis, it is an important step in strengthening data adequacy in the banking sector and in helping manage risks in the medium term.

The rapid credit growth in the short term has led to a deterioration in the banking sector's asset quality and profitability. In tandem with the rapid credit growth at private banks, the NPL ratio has been on a rising trend suggesting weak lending standards owing to increased competition among banks to expand their balance sheet size. Meanwhile, the ability of some banks to withstand shocks remains thin as the capital buffer is relatively low. The ongoing practice of overdraft facilities has made the accurate assessment of loan quality difficult, although all overdraft facilities are collateralized by assets which reduce banks' risk exposure. Overdraft reduction was estimated to account for 70.0 percent of the outstanding loans in early 2018. However, large exposure risks prevailed in a few banks. As the big conglomerates control some of the banks, such an ownership structure has led to a high share of related-party loans and a high risk of loan concentration. Banking sector profitability, measured by return on assets, has been in decline since it hit a peak in 2013/14, as a result of increasing competition.

In the medium term, the demand for credit will remain strong, and banks could deliver more diversified products to serve their customers. Due to a restriction on loan terms, credit to the private sector has mainly gone to agriculture, trade and service activities, which accounted for 59.0 percent of total outstanding loans, while loans to manufacturing stood at just 10.0 percent of the total loans as of October 2017. The introduction of term loans helps the banking sector to play a more important role in channeling savings to longer-term loan demand from the manufacturing sector. On the retail banking side, diversification is still at a very early stage, and a few banks have just started to provide mortgage loans to finance affordable housing projects, which could potentially be a fast-growing market.

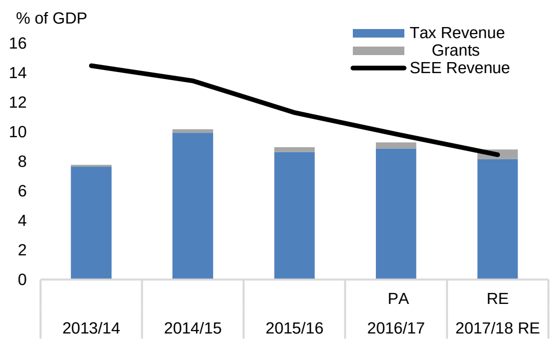
A.4 Fiscal Sector

14. **Weak fiscal revenue continues to be a challenge owing to slow-growing tax revenue.** The estimated tax revenue remained subdued at about 8.2 percent of GDP in FY2017/18, lower than in the previous year. The decline has been due to normalized growth in the collection of commercial and specific goods, which grew at 36.0 percent in the initial year of reform in FY2016/17 and is estimated to grow at around 15.0 percent in FY2017/18.

15. **Declining revenue from state economic enterprises (SEEs) in the energy sector and increasing subsidies to loss-making SEEs will continue to put pressure on the fiscal position.** Energy-related SEE revenue and tax contributions have been falling steadily

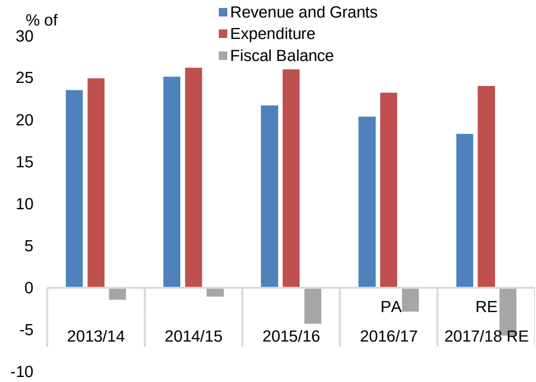
over the last several years.[7] Going forward, revenue from the gas sector will continue to decline, as some existing gas fields are depleting and there is a significant lag between new gas exploration and actual production from those explored gas fields. Meanwhile, competition from the private sector and imports will exert more pressure on SEEs' profitability—some SEEs are operating in textiles and light industries—and lead to a larger fiscal deficit. Ongoing SEE reforms to scale down inefficient and loss-making SEEs, including corporatization and joint ventures, are necessary to improve fiscal efficiency. However, the reforms are understandably difficult and hampered by a lack of alternative employment opportunities or compensation schemes for the retrenched workers (See **Selected Issue 2** for the fiscal flows of SEEs and future reform directions).

Figure 9. Tax Revenue and SEE Receipts



Note: SEE Revenue refers to the receipt before the new profit transfer to the central government.
Source: MoPF

Figure 10. Budget Balance



Source: MoPF

16. **Fiscal expansion through strong public spending has supported economic growth.** After the slowdown in project implementation to USD366 million in the previous year, the disbursement of ODA projects has improved significantly this year, to USD588 million, and total capital expenditure is budgeted and expected to increase as a percentage of GDP in FY2017/18 according to the revised estimates. Some of the current expenditure such as health has also increased significantly from a low base of 2.6 percent to 3.5 percent of total expenditure.

17. **The sizable fiscal deficit has been financed increasingly through market-based approaches.** The primary deficit is expected to widen from 1.3 percent of GDP in FY2016/17 to around 4.2 percent of GDP. The pressure on CBM financing has been reduced thanks to more issuances of government securities including both bonds and bills. The outstanding amount increased by 90 percent as of March 2018 compared to the previous year, reaching

[7] Based on the plunge in oil prices in the past years, Myanmar's revenue from the gas sector also declined significantly, putting pressure on the fiscal account. Rising commodity prices will benefit Myanmar, but with some lag due to selling prices take the average of historical prices.

Kyat4.2 trillion. The public debt was estimated to be around 40 percent of GDP in FY2017/18, including the CBM claims which accounted for 45 percent of the total debt.

B. Risks, Vulnerabilities and Challenges

18. **Our baseline for FY2018 interim and new FY2018/19 economic growth projects continuing expansion in manufacturing, subject to short-term risks, and progress on addressing vulnerabilities and long-term challenges.** The agriculture and service sectors remain stable in the baseline scenario. Meanwhile, manufacturing is projected to grow faster in FY2018 interim and FY2018/19. On the expenditure side, the baseline foresees a mild increase in private investment and improving net exports. Risks related to the macro landscape could arise on various fronts amidst the vulnerabilities and challenges the economy faces.

B.1 Near-term Risks to the Macro Outlook

19. **Risks to growth could emanate from an extended period of ethnic tensions in Rakhine State and uncertainties in the global economy related to trade protectionism and energy prices.** The direct impact of the ongoing ethnic tension in Rakhine State remains largely localized, while the indirect impact on the economy could be significant in terms of dampening investor confidence and discouraging tourist arrivals, particularly from outside the region. It may also cause uncertainties or difficulties in maintaining the preferential trade arrangements and access to ODAs that Myanmar currently enjoys, or those that it tries to secure in the future. All these factors could impact capital inflows and external position.

20. **The potential risks arising from escalating US trade conflicts—particularly with China and the EU—could have limited impact on Myanmar's economy given its narrow export base and limited participation into the global value chain.** The key Myanmar exports include gas, garment and agricultural products, for which China is the key markets for all three and the EU are the most important market for garment. The implemented and proposed trade measures in the near-term, on products such as steel & aluminum, high-tech industries and automotive, are unrelated to Myanmar's key exports and therefore will not affect Myanmar's economy directly. However, there could be indirect impacts through weaker growth in China and EU, leading to lower import demand and tourist arrivals.

21. **Risks to inflation stem mainly from the external front.**[8] The risks on inflation associated with the economic recovery are low given that the recovery is still in an early stage.[9] Moreover, subdued credit growth–especially in response to the new regulatory environment–would help ease demand pressure. Inflation, however, may be boosted on account of depreciation through imported inflation. A stronger US dollar will exert downward pressure on the kyat.

22. **External risks remain significant in light of trade and energy price uncertainties.** Agricultural exports remain vulnerable to volatile weather conditions and shifts in bilateral relations with major trading partners such as China and India. Energy exports are estimated to decline in volume as certain gas wells are currently in the declining phase of their project cycles. The fast-growing garment exports sector, which has benefited from the EU market under Everything-But-Arms duty-free treatment, may face challenges when the EU-Vietnam FTA comes into force in the near future that could provide a competitive edge to Vietnam (See **Selected Issue 1** for a detailed analysis of the garment sector and export manufacturing in Myanmar).

23. **While the financial sector's resilience may gradually improve in the medium term through the new prudential regulations, vulnerabilities in the banking system remain significant.** The banking sector's vulnerabilities, mainly associated with poor asset quality and a slim capital buffers, have been identified in detailed banking directives since July 2017. Banks need to restructure their balance sheets in accordance with the new regulations, which could put pressure on asset quality and lending activities during the restructuring. While reducing overdraft facilities to build a more term-loan based asset book is essential for improving liquidity risk management, the process has to be managed judiciously. Should the effort to scale back overdraft facilities be too rapid, it could trigger a sharp slowdown in credit growth with adverse effects on the economy. With the adoption of a stricter definition of NPLs, domestic banks are faced with higher NPL ratios and the need to make higher provisions. Several banks will also need capital injections from their shareholders or external investors in order to meet regulatory requirements.

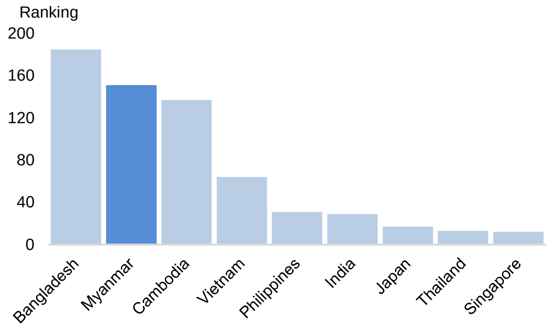
B.2 Longer-term Challenges and Vulnerabilities

24. **The lack of basic hard and soft infrastructure remains the key bottleneck to mid- to long-term economic growth.** Sustained economic growth requires the development of a

[8] With the food components accounting for a major share of CPI basket, idiosyncratic factors such as weather conditions will continue to be a key driver for the volatility in food inflation and headline inflation.
[9] The improving legal framework to incentivize investment—especially the new companies law effective starting August 2018—together with concreate actions to push forward the policy agenda and enhance government efficiency. In response, private investment may pick up faster than in our baseline scenario, and lead to a higher growth and inflation trajectory.

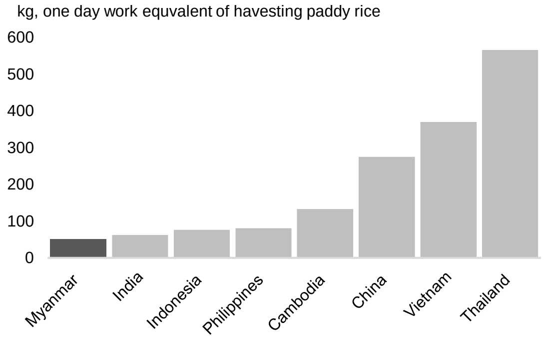
private-sector-based economy with enhanced industrial development and export competitiveness.[10] Although it is one of the priority sectors for exports, productivity in the agriculture sector in Myanmar remains among the lowest in the region due to weak infrastructure and horticultural practices. The infrastructure and logistics gap also constrain export competitiveness in the manufacturing sector. On these issues, upgrading the infrastructure for electricity, transportation and telecommunication is critical to boosting output. In particular, insufficient and unreliable electricity supply has hindered the development of industries across sectors in the economy.[11] In terms of human capital, while Myanmar enjoys the advantage of young demographics, most of the labor force is unskilled. The rule of law and the legal framework could be further strengthened in order to foster confidence and support the development of the private sector in Myanmar.

Figure 11. Getting Electricity



Source: World Bank (WB)

Figure 12. Agriculture Productivity



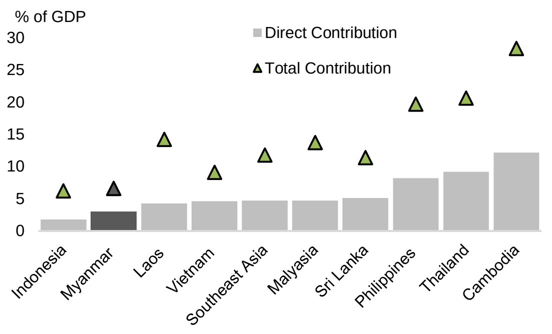
Note: based on the average of dry and monsoon seasons.
Source: WB

25. **Developing the service sector by tapping into its tourism potential requires challenges to be addressed on various fronts.** Myanmar's tourism industry boasts a plethora of historic sites and diverse natural attractions. According to the World Travel & Tourism Council, the contribution from tourism in Myanmar to the economy stands among the lowest internationally as this sector remains underdeveloped in a cross-country comparison.[12] Total tourist arrivals numbered 3.4 million in 2017, accounting for 2.7 yoy growth – modest performance compared to neighboring countries. Ranked 134 out of 141 countries in the WEF Global Travel & Tourism Competitiveness Index (2015), Myanmar lagged in all areas including enabling environment and infrastructure.[13] A significant drop in tourist arrivals in 2016 was linked to the escalating ethnic

[10] The Ministry of Commerce published Myanmar's national export strategy in March 2015, helping identify the priority export sectors. The plan for industrial development, issued by the Ministry of Industry, outlined prioritized sectors for industrial development in February 2016. The Myanmar Investment Commission issued a policy initiative—the Indicative Private Sector Development Framework and Action Plan—to develop a roadmap for Myanmar's transition to an economy led by the private sector, in March 2016.
[11] The government has planned to double electricity capacity from the current 3000 Megawatts by 2021 with the approval of four gas-to-power plants. While there is uncertainty around these projects going forward, other aspects related to electricity, such as enhancing grid connectivity and transmission efficiency, and reducing electricity subsidies to encourage investment, need to be tackled to ensure sustainable and systematic improvements in the medium term.
[12] https://www.wttc.org/-/media/files/reports/economic-impact-research/countries-2018/myanmar2018.pdf
[13] http://www3.weforum.org/docs/TT15/WEF_Global_Travel&Tourism_Report_2015.pdf

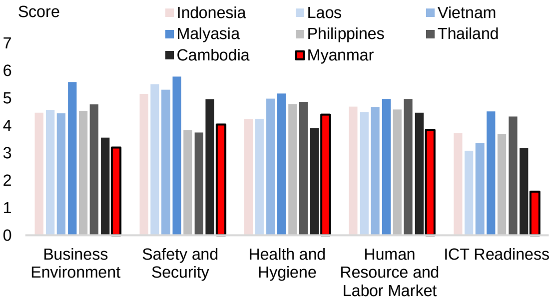
tensions in the Rakhine states at that time. This fact highlights the importance of security in attracting tourists.

Figure 13. Travel & Tourism Contribution to GDP[14]



Source: World Travel & Tourism Council 2018

Figure 14. Travel & Tourism Competitiveness Index (Enabling Environment)



Source: World Economic Forum, The Travel & Tourism Competitiveness Report 2017.

Authorities' Views

26. **The authorities recognize the risks in the short term and structural challenges to tackle on the longer-term.** They acknowledged that the GDP growth was weaker than expected in FY2017/18 due to uncertainties related to the Rakhine state crisis, which affected the tourism sector. The authorities expect that growth will pick up gradually towards 7-7.5% over the medium term. They will push forward implementation of the new regulations under Basel II and enhance the supervisory capacity of CBM. For several banks that have not yet been in compliance with capital adequacy, a reasonable extension of the deadline for implementation of the Base II accord based on bilateral discussion will apply. The authorities emphasized that the vulnerabilities in the banking system were not the result of new regulations but the process of enhancing transparency. Various government agencies were committed to strengthening their efforts in addressing longer-term issues such as the infrastructure and logistics gap, and the progress has been made.

C. Policy Discussions and Recommendations

27. We welcome the government's initiative in launching the Myanmar Sustainable Development Plan (MSDP), which will help align various policies and institutions in order for Myanmar to achieve stronger and more inclusive growth.[15] We also commend the authorities'

[14] Direct contribution reflects the total spending on this sector by residents and non-residents for business and leisure purposes and government spending on such services directly linked to visitors. The total contribution additionally includes indirect contribution (the GDP supported by this sector's investment, government spending helping travel and tourism activities, and domestic purchases by the sectors dealing with tourists) and induced contributions which measure GDP supported by the spending of those who are directly or indirectly employed in this sector.

[15] The MSDP strives for a peaceful, prosperous and democratic Myanmar, sharing five goals under three pillars. The goals include a). peace and national reconciliation, security and good governance, b). economic stability and strengthened macroeconomic management, c). job creation and private sector led growth, d). human resources and social development for a 21st century society, e). natural resources and the environment for national prosperity. The three pillars consists of peace and stability,

reform efforts in several areas, including fiscal, monetary, financial and foreign exchange, with steady progress being made over time.

C.1 Strengthening Fiscal Position and Improving Spending Efficiency

28. **Enhancing tax revenue and containing current expenditure is critical to strengthening fiscal position.** We welcome the authorities' continued efforts towards strengthening tax administration and broadening the tax base. However, more efforts including the establishment of an integrated tax administration system, recalibration of tax expenditures and capacity building are needed to shore up tax revenue. As a share of GDP, tax revenue in Myanmar is among the lowest in the region (See **Box C** for a review of fiscal reforms in Myanmar). There is also a need to strengthen tax auditing and to review fiscal incentives such as tax holidays. Current expenditure, which accounts for more than 60 percent of Union Expenditure and 80 percent of SEE expenditure, should only grow in tandem with improved public services and to accommodate enhanced expenditure allocation.

29. **There is a need to continue optimizing the use of fiscal resources by directing more resources towards priority areas and enhanced by a continued improvement in spending efficiency.** An improvement in physical infrastructures such as transport and electricity can increase the productivity of existing human and physical capital to support longer-term growth. While capital expenditure started to pick up in FY2017/18, it remains low as a share of GDP given that economic development is still at an early stage. Upgrading the budgeting process to allow for multi-year funding could help in boosting the implementation and efficiency of public investment. Meanwhile, spending efficiency and disbursement capacity need to be enhanced in tandem with increased spending.

30. **Adhering to medium-term fiscal discipline should help ensure fiscal sustainability, supported by the establishment of fiscal rules and a resource fund.** Given that government revenues such as from energy-related items will continue to be volatile, a multi-year fiscal framework to manage such revenue with inter-generation concerns should be considered. In addition, the authorities may consider establishing fiscal rules to act as a buffer against volatile resource revenue and support fiscal sustainability in the medium- and long-term. A resource fund is also a viable option as it could serve to redirect off-budget revenues to buffer against volatile commodity prices while improving cash management.

31. **There is room for public debt management framework to be strengthened further.** Gradually phasing out CBM direct financing of fiscal deficits should be a key

prosperity and partnership, and people and planet. The MoPF is in the process of incorporating feedback from consultation with various stakeholders and updating the draft.

consideration for the domestic public debt management, as it avoids monetization of the deficit thereby contributing to macro stability in the economy. Meanwhile, strengthening a medium-term debt strategy will help ensure debt sustainability. Developing the domestic government securities market will require more efforts in liberalizing interest rates and improving communication with the markets.

32. **Pushing forward SEE reforms will help strengthen the fiscal position and also encourage the development of the private sector**. With SEE performance deteriorating in the past couple of years, SEE reforms, including restructuring ownership and enhancing transparency, should be a priority to improve their economic viability and efficiency. This also requires strengthening the legal framework for corporatizing and privatizing SEEs which facilitates the development of the private sector.

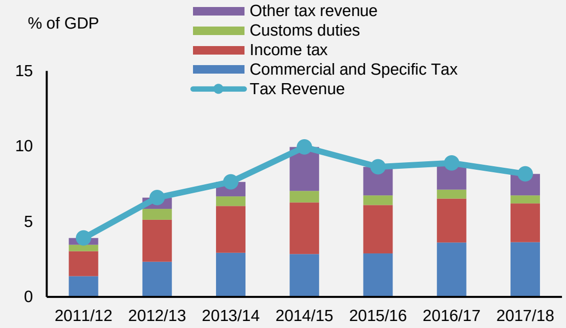
Authorities' Views

33. **The authorities agree that the fiscal position should improve further by enhancing tax revenue while pursuing SEE reforms.** They are fully aware of challenges related to low tax revenue and will put more efforts on strengthening tax administration while considering changes in tax policy in the medium term. Continuing efforts to enhance implementation capacity is needed to improve the disbursement of capital expenditure, which is still very low. While pushing for more autonomy and self-independence, SEE reforms will be done step by step based on Corporatization Law, which is in the process of being updated.

Box C. Fiscal Reforms in Myanmar

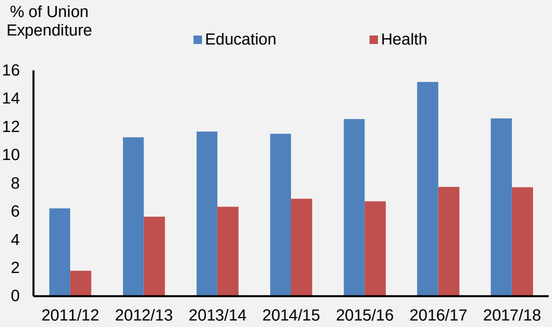
Targeted reforms to increase tax revenue have been initiated since 2012. Prior to the opening up of the economy in 2012, the revenue system in Myanmar was heavily dependent on non-tax revenues. This resulted in very low tax collection, with tax to GDP ratio at only 3.9 percent in FY2011/12, the lowest in the region. Since 2012, significant reforms have been initiated in the major revenue generating agencies of the government, particularly at the Internal Revenue Department (IRD), under the Ministry of Planning and Finance. This includes re-organizing the IRD into functional departments, instead of by type of tax. A Large Taxpayers Office (LTO) was also set-up within IRD to improve tax collection efficiency for the largest companies in Myanmar, which has since been expanded to include three Medium Taxpayers Offices (MTO). The way taxes were paid was also improved, moving to a self-assessment methodology, coupled with tax audits, which lessened the discretion of tax collectors with regards to the filing of individual tax liabilities. In addition to tax administration reform, reform of tax policy was also pushed forward, with the unifying of the rate for commercial tax at 5 percent in 2014, and introducing a specifics goods tax in 2016. Although tax as a percent of GDP fell in FY2015/16 in large part due to the fall in commodity prices and declining income tax from state economic enterprises, it is targeted to rise to 9 percent of GDP in 2018 and reach up to 14 percent of GDP in the medium-term.

Figure C1. Evolution of Tax Revenue



Source: MOPF, AMRO staff estimates

Figure C2. Spending on Education and Health



Source: MoPF

To improve development outcomes amid the limited resources available, expenditures were directed towards priority spending areas such as education and health. Budget reforms were initiated since the economy started to open up in 2012, beginning with re-allocating more of the budget towards critical social spending in education and health. Spending on education and health was low at 6.2 percent and less than 2 percent of Union Expenditure. This has since grown rapidly from a low base, to reach 12.6 percent and 7.7 percent of total Union spending, respectively, in FY2017/18. Budget reforms are currently being carried on with the support of the World Bank under the Public Financial Management (PFM) Reform, with the aim of improving the design, implementation and reporting of budget performance. A 3-year medium-term budget framework was also introduced in 2015 to improve the planning process. Under the new framework, strict ceilings are provided for each ministry to cap spending, while providing the flexibility for ministries to allocate the amounts among its related departments and offices. The 3-year budget framework has thus enabled better planning for ministries to strive to allocate budget resources towards priority areas effectively. This has also allowed better control of major fiscal aggregates by the Budget Department, particularly the fiscal deficit.

Debt management and financing were also reformed with the setting up of the Treasury Department in 2014. A significant reform has been the consolidation of debt management function within the MOPF, with the establishment of the Treasury Department in September 2014. The legal and regulatory framework for debt management was further strengthened with the passage of the Public Debt Management Law in January 2016, enabling the central management by the Treasury Department not only of debt but also of guarantees. Significant strides have also been taken in developing the domestic debt market, with the launch of Treasury Bills in January 2015 and Treasury Bonds in September 2016. To improve the financing plan and better manage cash balances, the Treasury Department is working on enhancing cash flow forecasting. The combination of greater issuance of Treasury Bills and Bonds, coupled with better cash management will help reduce and eventually phase-out in 2-3 years the direct deficit financing from the Central Bank of Myanmar.

Fiscal reform needs to continue on several fronts. Continued enhancements in revenue administration, particularly streamlining of procedures and automation are needed. However, revenue administration reform would not be enough to pull up the relatively low tax collection in Myanmar. Expanding the tax base through several tax measures is required. In this regard, authorities may consider the introduction of Value Added Tax (VAT) and other similar tax measures. In terms of expenditure management, the medium-term planning framework needs to be further strengthened, to improve forecasts of fiscal spending and effectively direct budget resources to development priorities. Enhancing the efficiency of budget procedures will help maximize the benefits of government spending, despite the limited fiscal space. In terms of debt and cash management, given the relatively new Treasury Department, continued institutional and capacity development are needed. Developing a medium-term debt strategy which takes into careful consideration the costs and risks to the budget under a debt sustainability assessment is needed. Further developing the domestic debt market through transparent and regular issuance of bills and bonds, thereby building a yield curve, will help ensure a reliable source of financing for government and reduce reliance on central bank financing.

C.2 Enhancing Monetary Policy Framework

34. **The progress made in implementing the money-targeting framework has been commendable and should be continued.** The introduction of a more disciplined monetary policy framework has contributed towards reducing macroeconomic imbalances and inflation. The reserves money-targeting framework has helped the CBM in making annual forecasts for reserve money growth and provides a guide towards reducing CBM's direct financing of the fiscal deficit. We commend the ongoing efforts by MoPF and CBM to reduce fiscal deficit monetarization with the commitment to phasing out CBM financing by 2020. This, in turn, should contribute towards greater fiscal and monetary discipline and help to anchor inflation expectation.

35. **The active use of reserve requirement could be helpful under the current money-targeting framework.** The conduct of monetary policy is centered on market operations with reserve money as an operational target and broad money as an intermediate target. The autonomy in targeting reserve money should increase with the phasing out of CBM direct financing of the fiscal deficit. Meanwhile, targeting broad money growth continues to be a challenge given the ongoing changes in the banking system and its effects on key behavioral parameters. In this context, adjusting the required reserve ratio could also contribute towards policy calibration.

36. **With further development of the financial markets, gradual liberalization of interest rates should enhance policy effectiveness in the medium term.** Over the short term, further development of the interbank market and repo market will help banks in managing liquidity and improve the discovery of market-based interest rates for short-term instruments. With regard to longer-term interest rates, the deepening government securities market in terms of both liquidity and extended maturity could help in establishing a benchmark yield curve for pricing longer-term loans and securities. Such a development of interest rate term-structure should pave the way for eventually moving to a more interest-rate based monetary policy framework. In tandem, increasing the flexibility for floor and ceiling rates should be considered for the current interest-rate setting mechanism, before a fully market-determined rate setting mechanism takes shape.

Authorities' Views

37. **The authorities agree that the monetary framework has been progressing while further liberalization will depend on the development of market infrastructure.** Both actual reserve money and broad money growth have been within the targets in FY2017/18,

and CBM has been actively using auctions to manage liquidity while the tool of reserve requirement ratio has remained unchanged. The liberalization of interest rates will be undertaken gradually following the development of the financial markets.

C.3 Improving Financial Sector Resilience

38. **The implementation of new banking regulations will enhance the soundness and resilience of the financial system and will contribute to developing a healthier banking sector over the medium term.** The new regulations, which are based on Basel II standards, aim towards enhancing capital and liquidity buffers, reducing exposure to single customers, and the share of overdraft facilities in total loans, as well as implementing stricter asset classification and provisioning. These comprehensive measures will help domestic banks in adopting modern banking practices over time and improving their soundness.

39. **Compliance with new banking regulations could put pressure on banks and the corporate sector, and the implementation of such regulations should be managed judiciously.** The substantial credit and liquidity risks related to large exposure limits and overdrafts must be addressed for individual banks and their corporate clients. We welcome CBM's close coordination with individual banks to formulate concrete plans based on an assessment of each bank's balance sheet to enhance their capital buffer and implement the new regulations. We also commend CBM's plan of gradually reducing overdraft facilities to 20 percent of total loans by July 2020. In addition, developing a framework for NPL resolution will help address credit risks related to both cyclical and structural factors.

Authorities' Views

40. **The authorities focus is on implementing prudential policies to strengthen financial soundness and their intention is not to slow down the credit growth in the process.** Meanwhile, a sound loan practice based on new regulations will help to improve loan quality and ensure the soundness of the banking sector.

C.4 Maintaining External Stability

41. **We welcome the flexible management of the exchange rate to align with market conditions.** CBM has adopted a new mechanism for the reference rate based on the weighted average of market-based rates without band restrictions. Therefore, the exchange rate could be adjusted to reflect the market condition better. In this regard, we support the continuing efforts towards developing an interbank FX market so that it can play a bigger role in determining the exchange rate over time. We also encourage the CBM to continue building foreign reserves by opportunistically intervening in the FX market.

42. **A further build-up of international reserves is recommended to strengthen buffer against external shocks.** Myanmar's reserves level remains relatively low compared to regional peers. Foreign exchange inflows from export earnings and FDI inflows will likely remain volatile, due to external uncertainties and vulnerability to natural disasters. Continued growth in export-oriented industries, tourism, and an improved investment environment, would help in sustaining foreign exchange inflows, and help the central bank in building up reserves.

Authorities' Views

43. **The authorities agree that there is a need to build up international reserves as a buffer against external shocks.** The build-up of CBM international reserves will be done through the forex market, which will depend on macroeconomic conditions, trade dynamics and investment flows going forward.

C.5 Advancing Structural and Institutional Reforms

44. **Reforms to develop a market-based economy targeting inclusive growth should be accelerated under a comprehensive and coherent policy framework.** Pressing ahead with structural reforms in Myanmar—including hard and soft infrastructure, and the regulatory and legal environment—is critical for sustainable and inclusive economic growth. This, in turn, will accelerate private sector development and create further business opportunities. Upgrading the key infrastructure including electricity and logistics is essential in providing an attractive environment for investment and trade. In addition, the education system must be upgraded with an emphasis on vocational training to provide the necessary skill sets and talents to meet the needs of the economy. Business interests and investor confidence could strengthen with the welcome enactment of the New Investment Law and Myanmar Companies Law.

45. **More coordinated efforts to facilitate FDI approvals and implementation should be made between central and local governments, as well as inter-ministries.** While the central government has delegated more power to local authorities to facilitate the investment approvals, challenges related to decentralization, including capacity constraints and information sharing, should be addressed in a timely manner. In addition, coordination between the Myanmar Investment Commission and other ministries should be further enhanced. Effective and efficient one-stop services to potential investors are key to attracting more investment.

46. **Strengthening the rule of law should help boost private sector confidence in investing in the economy and help integrate the informal sector into the formal economy**.

This will also enable stronger governance and the increased provision of better public goods with accountability.

C.6 Enhancing Data Adequacy

47. **The authorities have made tremendous progress in improving official statistics**. Monthly inflation data have been available with reduced lags. BOP data has been improving by leveraging more data sources. Meanwhile, public debt statistics reveal the current structure of public debt, while national account data collection based on the new integrated household survey, are also in progress. The Central Statistical Organization has collected household and expenditure data through the survey in 2017.

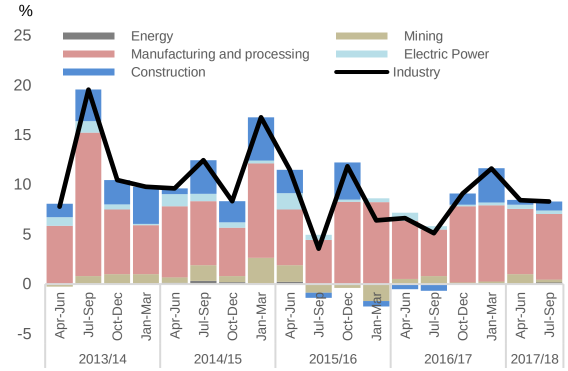
48. **Further improvement in data adequacy is required to enhance economic assessment.** Detailed GDP statistics are still not frequent enough, while other price data such as PPI, are still unreported. In the fiscal sector, while debt statistics could consider estimating contingent liabilities, the overall government financial statistics need further improvement, especially in relation to SEEs. Separately, the estimate of actual FDI inflows could be made publicly available. Additionally, information on detailed bank loans by sector could strengthen bank supervision and avoid misclassification.

Appendices

Selected Figures for Major Economic Indicators

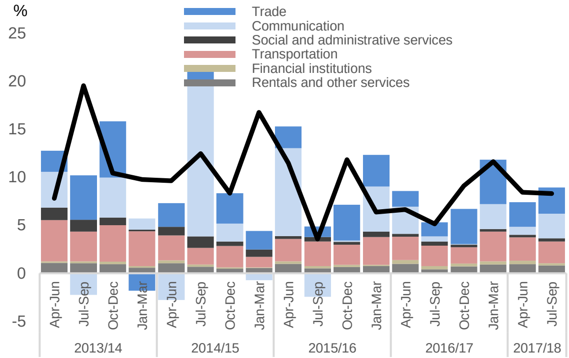
Figure 1.1. Real Sector

Manufacturing and processing led industrial expansion.



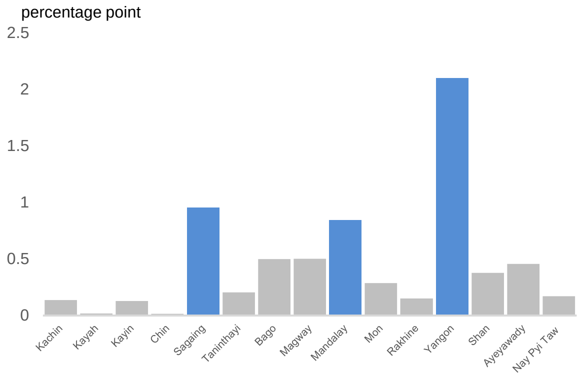
Note: 2018 refers to a special half-year interim fiscal budget from April to September 2018.
Source: MoPF, AMRO staff calculations

Transportation, trade and communication were key for service sector growth.



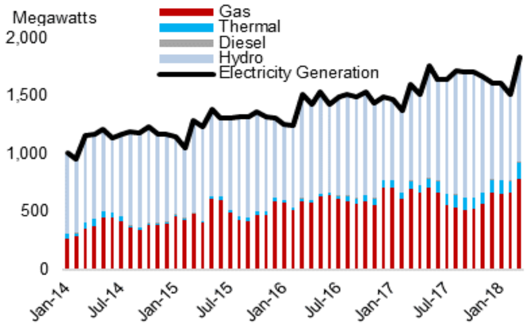
Source: MoPF, AMRO staff calculations

Economic growth was mainly contributed by the top three states/ regions, which accounted for half the GDP.



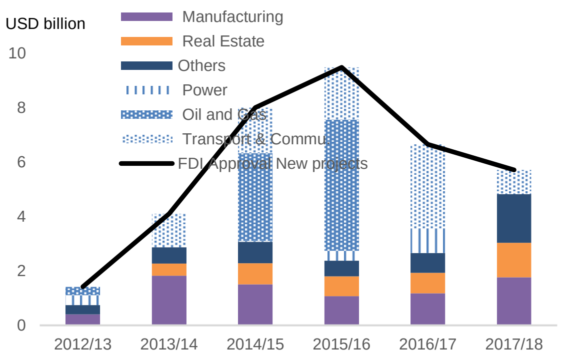
Note: as of FY2016/17.
Source: MoPF

Given the potential electricity supply gap of around 3000 megawatts by 2021, new projects have been approved to scale up gas-to-power production.



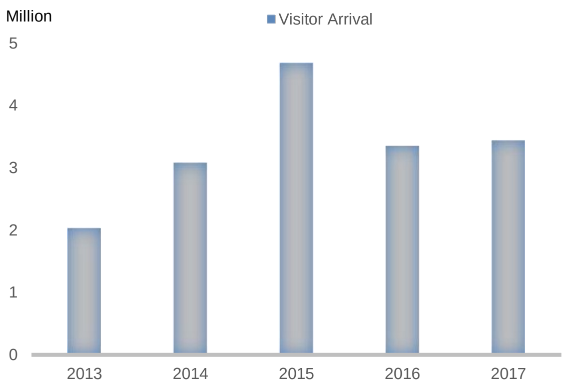
Source: CSO

FDI approvals remained subdued in total value. However, there is an early positive sign of investment diversification.



Source: DICA

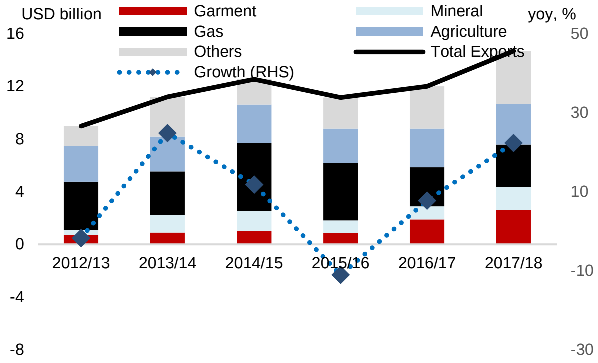
Tourist visitor arrivals continued to be subdued, and more efforts are needed to tap the market potential.



Source: CSO

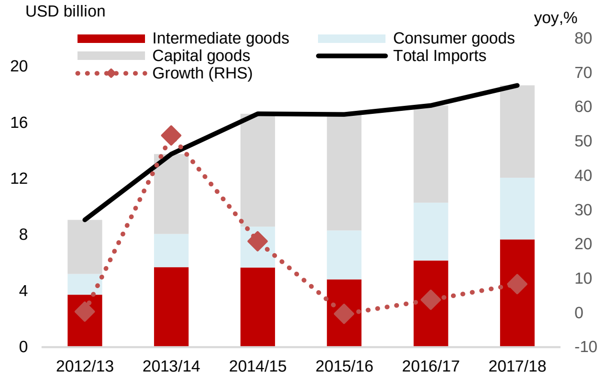
Figure 1.2 External Sector

Total exports have been growing strongly due to expanding garment exports and a rebound in mineral exports.



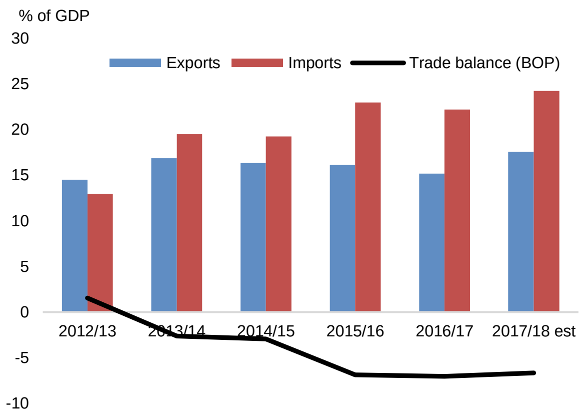
Source: CSO, AMRO staff estimates

The fast growth of intermediate goods imports has accompanied strong export growth.



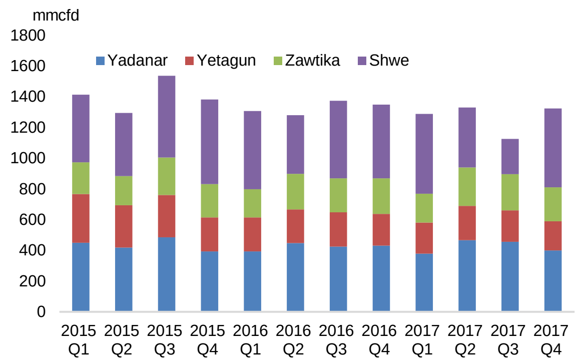
Source: CSO, AMRO staff estimates

Although stable as a percentage of GDP, the trade deficit remains large.



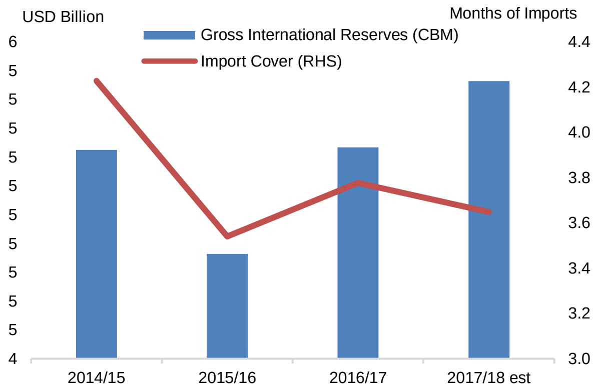
Source: CBM, AMRO staff estimates

There is increasing pressure on gas export as certain gas wells are currently in the declining phase of their project cycles.



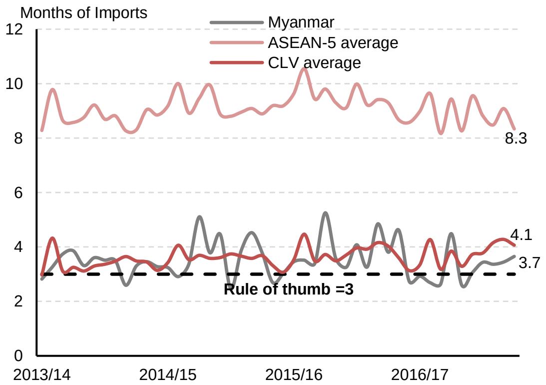
Source: CBM, AMRO staff estimates

CBM needs to strengthen its international reserves buffer to protect against external shocks.



Note: Import cover is in months of imports of goods & services
Source: CBM, AMRO staff calculations

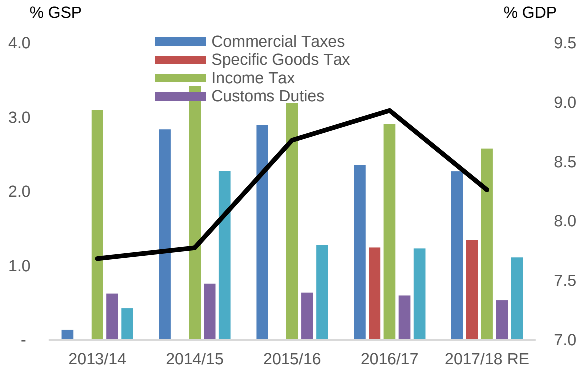
The import cover in Myanmar is slightly lower than the average of CLMV.



Source: CBM, AMRO staff calculations

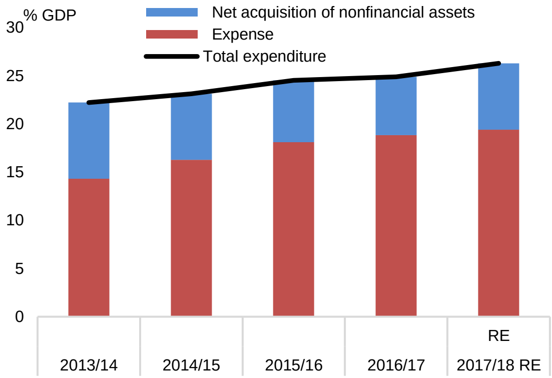
Figure 1. 3 Fiscal Sector

More effort has to be put into strengthening the tax revenue.



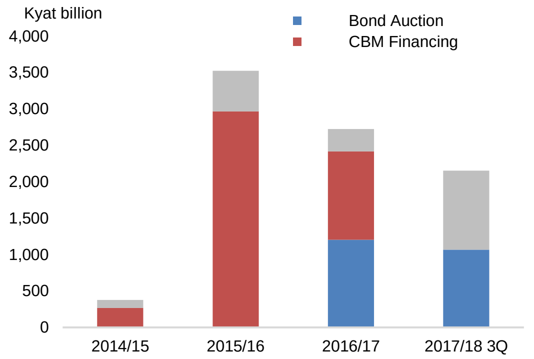
Note: BE stands for original budget estimates, and RE stands for revised budget estimates
Source: MoPF

The rising fiscal expenditure has been mainly driven by current expenditure over the years.



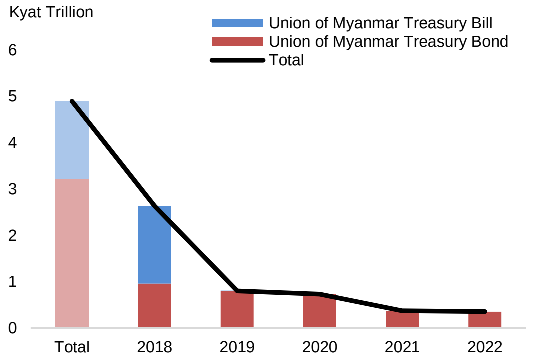
Source: MoPF

Progress has been made on more market-based government financing methods.



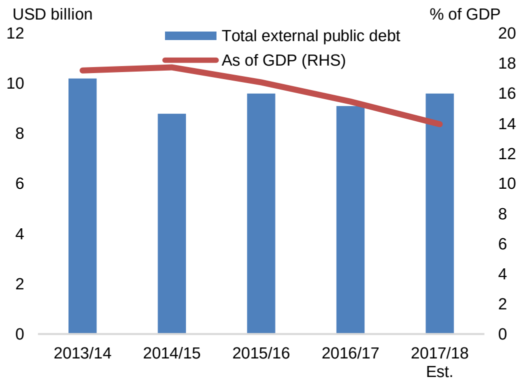
Source: MoPF

The maturity of government financing remains short.



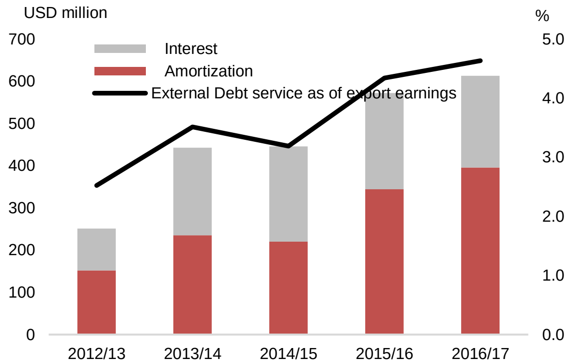
Source: MoPF

As external public debt remains moderate, utilizing more ODA financing could be considered, but FX risks need to be managed well.



Note: as of 19 March 2018
Source: MoPF

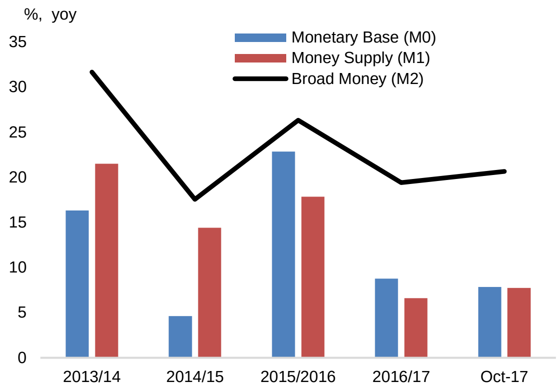
External debt service has been on a rising trend, driven by the increasing repayment burden.



Source: MoPF

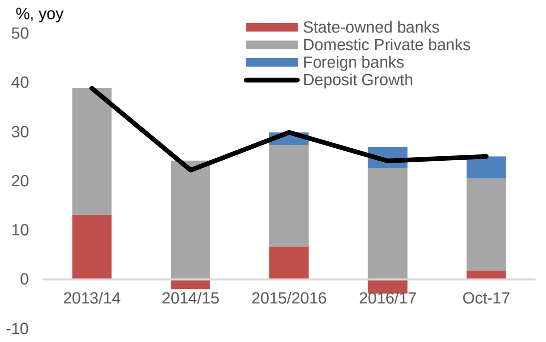
Figure 1. 4. Monetary and Financial Sectors

Broad money growth has been relatively stable.



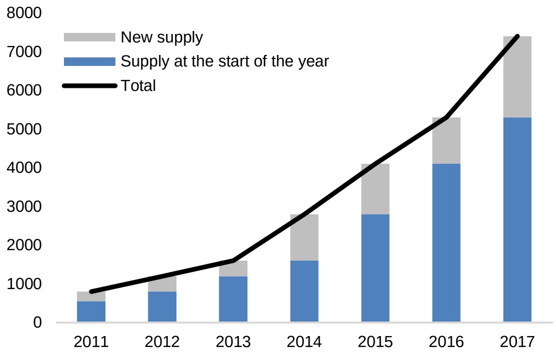
Source: CBM

While overall deposit growth has been stable, foreign banks have started to take more deposits in the banking system.



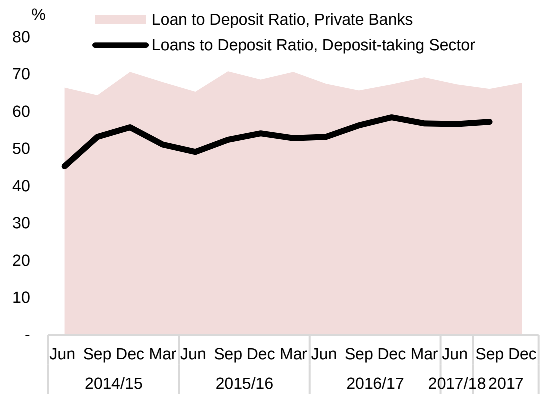
Source: CBM

Condominium supply continued to increase in Yangon but is expected to slow down owing to subdued prices.



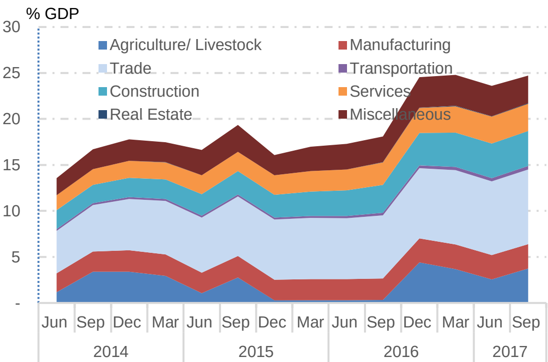
Source: CBM

Loans to deposit ratios of deposit-taking institutions remained stable



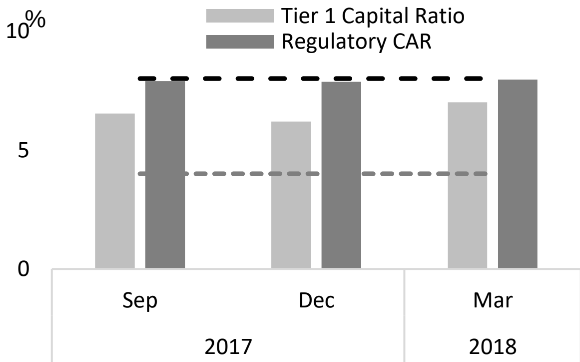
Source: CBM

The bank loans to the private sector remained low as a percentage of GDP.



Source: CBM

The implementation of new capital ratios has been helping increase capital buffer of the banking system.



Source: CBM

Selected Economic Indicators for Myanmar

	2014/15	2015/16	2016/17	2017/18	2018 Int*	2018/19*
					Projection	
Real sector and prices	(in annual percentage change)					
Real GDP 1/	8.0	7.0	5.9	6.8	7.1	7.4
CPI (2012=100, period average)	5.1	10.0	6.8	4.0	4.9	5.0
CPI (2012=100, end-period)	6.1	8.4	7.0	5.4	2.1	4.9
Balance of payments	(in millions of USD, unless specified)					
Trade balance	-1858.7	-4048.0	-4394.2	-3715.3	-1935.1	-5122.6
Current account balance	-1419.3	-3009.5	-2409.1	-2964.6	-1615.1	-4210.8
in percent of GDP	-2.2	-5.1	-3.8	-4.4	-7.0	-6.2
Financial account	3044.0	3885.8	4406.3	4998.9	2534.9	5338.6
Direct investment (net)	2915.8	3443.0	3360.0	4500.0	2500.0	5100.0
ODA (net)	314.9	444.5	-35.0	98.9	34.9	238.6
Total external debt in percent of GDP	13.4	16.1	14.4	14.3	14.1	14.5
Gross international reserves	5124.6	4764.0	5133.9	5364.0	5583.8	6111.6
In months of imports	4.2	3.5	3.8	3.6	3.4	3.1
Fiscal sector 2/	(in percent of GDP)					
Revenue and grants	25.2	21.7	20.4	18.4	22.7	18.7
Tax revenue	9.9	8.6	8.9	8.2	8.4	9.1
SEE receipts	12.6	10.2	9.1	7.7	11.2	7.0
Expenditure	26.2	26.0	23.0	24.1	30.6	23.0
Fiscal balance	-1.1	-4.3	-2.6	-5.7	-8.0	-4.3
Primary balance	0.3	-3.1	-1.3	-4.2	-5.7	-2.7
Public debt	34.8	39.1	39.3	40.8	-	44.6
Monetary and financial sector	(in annual percentage change, end-period, unless specified)					
Domestic credit	10.4	32.4	24.5	20.2	20.4	25.2
Private sector	36.3	34.2	33.5	23.4	20.0	24.4
Broad money	17.6	26.3	19.4	18.0	17.4	22.3
Reserve money	4.6	22.8	8.8	6.0	10.0	10.0
Loan-to-deposit ratio	67.9	70.6	69.2	70.0	-	-
Non-performing loans ratio	1.9	2.6	3.6	-	-	-
Memorandum items:						
Exchange rate (kyat per US$, average)	995.3	1222.4	1260.6	1355.8	1417.5	1458.8
Exchange rate (kyat per US$, end of period)	1027.0	1216.0	1362.0	1335.0	1500.0	1417.5
Nominal GDP (in billions of USD)	65.6	59.5	63.2	67.3	23.2	73.9
Nominal GDP (in billions of Kyat)	65261.9	72714.0	79722.9	91282.6	32873.2	99148.7

Notes: *2018 half-year Interim refers to April to September 2018; new full-year fiscal year starts from October to September next year
1/ Real GDP series base year is 2010/11 prices
2/ Consolidated budget for Union and state/regional governments and state economic enterprises; FY2017/18 refers to revised budget estimates and 2018 Interim original budget estimates; includes disposal of non-financial assets.
Sources: National authorities, AMRO staff estimates

Balance of Payments

	2014/15	2015/16	2016/17	2017/18 Est.	2018 Interim* Proj.	2018/19* Proj.
			(In millions of US dollars)			
Current account balance	**-1,419**	**-3,009**	**-2,409**	**-2,965**	**-1,615**	**-4,211**
Trade balance	-1,859	-4,048	-4,394	-3,715	-1,935	-5,123
Exports, f.o.b.	10,385	9,498	9,471	11,308	6,540	15,239
Of which: Gas	5,179	4,343	2,970	3,207	1,718	3,922
Imports, c.i.f	12,244	13,546	13,865	15,023	8,475	20,361
Services (net)	1,300	1,078	1,315	1,451	720	1,537
Receipts	3,602	3,678	3,759	4,070	2,179	4,593
Travel	1,864	2,137	2,258	2,370	1,304	2,793
Other	1,738	1,541	1,502	1,700	875	1,800
Payments	2,302	2,601	2,444	2,620	1,459	3,056
Interest	391	363	374	374	194	400
Travel	117	129	141	156	86	180
Other	1,795	2,109	1,929	2,090	1,179	2,476
Primary Income	-3,154	-2,527	-2,125	-1,900	-1,000	-1,975
Credits	184	443	394	400	200	475
Debits	3,338	2,971	2,519	2,300	1,200	2,450
Secondary Income (net)	2,293	2,488	2,795	1,200	600	1,350
Receipts	3,826	3,881	4,050	1,500	800	1,800
Payments	1,533	1,392	1,255	300	200	450
Capital and Financial account	**3,044**	**3,886**	**4,406**	**4,999**	**2,535**	**5,339**
Direct investment (net)	2,916	3,443	3,360	4,500	2,500	5,100
ODA (net)	315	445	-35	99	35	239
Medium- and long-term disbursement	539	786	366	588	260	639
Repayments	224	342	401	489	225	400
Currency and deposit	-4	-146	1,036	700	0	0
Other	-182	145	45	-300	0	0
Net errors and omissions	**-451**	**-1,295**	**-1,619**	**-1,804**	**-700**	**-600**
Overall balance	**1,169**	**-419**	**378**	**230**	**220**	**528**
Memorandum items:						
Gross reserves (in millions of U.S. dollars)	5,125	4,764	5,134	5,364	5,584	6,112
In months of imports of goods and services)	4.2	3.5	3.8	3.6	3.4	3.1
GDP in billions of U.S. dollars	65.6	59.5	63.2	67.3	23.2	68.0
Exchange rate (Kyat per US$, period average)	995.3	1222.4	1260.6	1355.8	1417.5	1458.8

Notes: *2018 half-year Interim refers to April to September 2018; new full-year fiscal year starts from October to September next year
Sources: National authorities, AMRO staff estimates

Statement of Central General Government Operations

	2014/15	2015/16	2016/17	2017/18 Est.	2018 Interim* Proj.	2018/19* Proj.
	(In billions of kyat)					
Union Gov and SEEs						
Revenue and Grants	**16,425**	**15,815**	**16,271**	**16,766**	**7,447**	**18,567**
Tax	6,488	6,281	7,083	7,453	2,752	8,995
Non-tax 1/	986	1,061	990	982	425	1,200
Profit transfers from SEE	538	819	591	676	280	773
SEE receipts net of transfers	8,248	7,406	7,276	7,049	3,698	6,940
Grants	166	247	332	606	292	658
Expenditure	**17,116**	**18,924**	**18,368**	**21,969**	**10,071**	**22,804**
Expense (current expenditure)	12,515	14,216	14,404	16,914	7,981	16,855
Of which: Wage	1,370	1,911	2,722	2,932	1105.764	3,100
Of which: Interest payments	879	867	1,078	1,325	749	1,600
Net acquisition of non-financial assets	4,601	4,707	3,964	5,055	2,090	5,949
Balance	**-691**	**-3,109**	**-2,097**	**-5,203**	**-2,624**	**-4,237**
Net lending/borrowing	**-691**	**-3,109**	**-2,097**	**-5,203**	**-2,624**	**-4,237**
(Primary balance)	189	-2,242	-1,019	-3,878	-1,875	-2,637
Financing Needs	**691**	**3,109**	**2,097**	**5,203**	**2,624**	**4,237**
Actural Financing	382	3,341	2,500	-	-	-
Memorandum items:						
Exchange rate (Kyat per US$, period average)	995	1,222	1,261	1,356	1,418	1,459
GDP at current price	65,262	72,714	79,723	91,283	32,873	99,149

Notes: *2018 half-year Interim refers to April to September 2018; new full-year fiscal year starts from October to September next year
The budget includes both Union and SEEs which are budgeted in the Union Budget according to the Union Budget Law but not consolidated due to data unavailability in the granular level.
1/ It includes disposal of non-financial assets.
Sources: National authorities, AMRO staff estimates

Monetary Survey

	2014/15	2015/16	2016/17	2017/18	2018 Interim* Proj.	2018/19* Proj.
	(In billions of kyat at end of period)					
Net Foreign Assets (NFA)	**8,011**	**9,263**	**9,281**	**9,306**	**9,311**	**10,034**
Central bank	4,861	5,374	6,550	6,693	7,024	7,223
Assets	5,276	5,847	7,016	7,178	7,504	7,723
Liabilities	415	473	466	485	480	500
Other depository corporations	3,150	3,888	2,731	2,613	2,544	2,811
Assets	6,235	7,165	5,856	5,997	6,270	6,453
Liabilities	3,085	3,276	3,125	3,385	3,539	3,641
Net Domestic Assets (NDA)	**20,513**	**26,777**	**33,753**	**41,466**	**43,720**	**54,738**
Domestic Credit	20,846	27,608	34,362	41,317	43,720	54,738
Net claims on central government	10,191	13,419	15,538	18,252	17,358	21,842
Private Sector	10,183	13,667	18,244	22,517	25,962	32,296
Other items (net)	-333	-831	-609	149	0	0
Broad Money (M2)	**28,524**	**36,040**	**43,034**	**50,772**	**53,928**	**65,934**
Currency Outside Depository Corporations	8,605	10,157	10,920	11,604	11,850	12,916
Deposits	19,920	25,883	32,114	39,168	42,078	53,018
	(in annual percentage change, end-period, unless specified)					
Net domestic assets	**11.8**	**30.5**	**26.0**	**22.9**	**18.1**	**25.2**
Domestic credit	10.4	32.4	24.5	20.2	20.4	25.2
Net claims on central government	13.5	31.7	15.8	17.5	21.0	25.8
Private Sector	36.3	34.2	33.5	23.4	20.0	24.4
Broad money	**17.6**	**26.3**	**19.4**	**18.0**	**17.4**	**22.3**
Memorandum items:						
Velocity (GDP-to-average broad money)	2.47	2.25	2.02	1.95	0.63	1.65
Broad money/GDP	0.44	0.50	0.54	0.56	0.82	0.67
Exchange rate (kyat per US$, end of period)	995.25	1,222.38	1,260.60	1,355.82	1,417.50	1,342.50
GDP at current price	65,262	72,714	79,723	91,283	32,873	99,149

Notes: *2018 half-year Interim Fiscal Year (FY) refers to April to September 2018; new full-year FY starts from October to September next year.
Sources: National authorities, AMRO staff estimates

Data Adequacy for Surveillance Purposes: a Preliminary Assessment

Surveillance Areas	Data availability(i)	Reporting frequency/ Timeliness(ii)	Data quality(iii)	Consistency(iv)	Others, if any(v)
National Account	GDP on the production side is the main approach, while the expenditure approach is still a work-in-progress. Hard-copy of data is available.	Disseminated on an annual (fiscal year—April to March) basis. Timeliness is one-year. However, estimates and forecasts are provided by the authorities upon request.	Coverage of the growing private sector is incomplete due to a lack of annual enterprise/ economic surveys.	Myanmar's National Account broadly follows the concepts and definitions of the *System of National Accounts 1968*.	In the medium term, they plan to adopt the *2008 SNA* with the help of the SNA team established in the Planning Department.
Balance of Payments (BOP) and External Position	Hard-copy of data is available.	Periodicity is annual—on a fiscal year basis (April to March). Timeliness is5 months.	Gaps in some services, direct investment assets and other investment assets impact the reliability of the data.	The statement of the BOP is compiled broadly according to the classification of the *BPM6.*	-
Nation (Union+ Region/ State) Budget and Government/ External Debt	The Budget Department of MoPF has disseminated Government Fiscal Data for 2012-2013 PA to 2017-2018 Revised Estimate on MOPF Website since 2018 March.	The periodicity of data is annual, on a fiscal year basis (April to March). Timeliness is about 10 months after the end of the reference year.	There is data discrepancy between above the line data (the difference between revenue and expenditure) and below the line data (financing).	The Budget Department of MoPF compiles Government Finance Statistics according to GFS 2014 Methodology cash basic.	The plan for future improvement is to compile the quarterly Gover nment Finance Statistics.
Money Supply and Credit Growth	Selected Monthly Economic Indicators are available online.	Data on monetary aggregates are available on a monthly basis with 4-5 months lag.	Source data comprises five sets of accounts, each one in a different format: a separate set of accounts for each of the four state-owned banks and one set for the private banks.	Money Supply and Credit statistics are broadly compiled in accordance with the Monetary and Financial Statistics Manual (*MFSM)* methodol ogy.	Revisions on past time-series are made without adequate explanation on the underlying reasons for the revisions.
Financial Sector Soundness Indicators	Data are not publicly disseminated but are available upon request.	Data with a one-year lag are available upon request.	Banking sector indicators have yet to be brought in line with international standards.	Revisions on past time-series are made without adequate explanation about the underlying reasons for the revisions.	-
State-Owned-Enterprises Statistics	Data are not publicly disseminated but are available upon request.	State-owned enterprises' production (volume, value, and unit price) is reported monthly and yearly by line ministries.	Limited data on the financial health of SEEs are collected.	Accounts of SEEs are compiled according to internal methods.	-

Source: AMRO staff compilations. This preliminary assessment will form the "Supplementary Data Adequacy Assessment" in the EPRD Matrix.

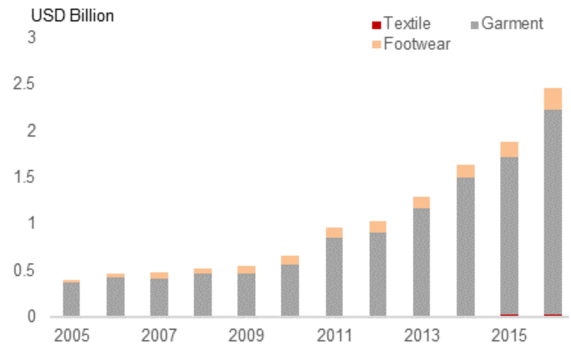
Notes:
(i) Data availability refers to whether the official data are available for public access by any means.
(ii) Reporting frequency refers to the periodicity that the available data are published. Timeliness refers to how up-to-date the published data are relative to the publication date.
(iii) Data quality refers to the accuracy and reliability of the available data given the data methodologies.
(iv) Consistency refers to both internal consistency within the data series itself and its horizontal consistency with other data series of either same or different categories.
(v) Other criteria might also apply, if relevant. Examples include, but are not limited to, potential areas of improvement for data adequacy.

Annexes: Selected Issues

Issue 1. Export Manufacturing Development in Myanmar: Embracing the Garment Sector

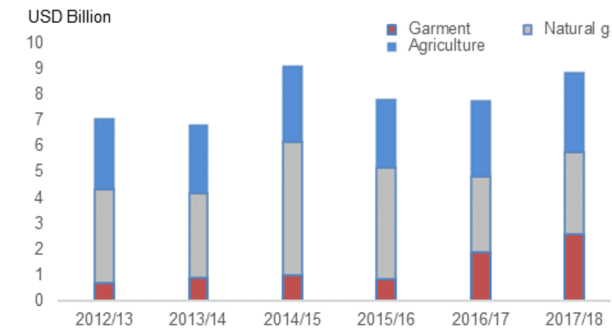
1. **Myanmar has embarked on developing domestic industries and promoting exports through more concerted efforts since 2015, identifying the key priority sectors for development and key challenges to address.** To guide trade development and enhance export competitiveness, the launch of Myanmar's national export strategy (NES) in March 2015 identified the priority export sectors and key issues to address across these sectors. Seven potential sectors are highlighted for export promotion, including textiles and garments and tourism.[16] In reference to NES, the Ministry of Industry issued an overarching plan for industrial development in February 2016, which provided information on domestic geographic choices for developing industries and listed key challenges, besides outlining priority sectors for industrial development.[17]

Figure S1. Garment exports accounted for a majority of exports from Myanmar's textile and garment industry



Note: Export data is the sum of imports by trading partners.
Source: UN Comtrade

Figure S2. The share of garment exports in total exports has increased substantially in the past two years



Source: CSO

2. **Both Myanmar's national industrial and export strategies have prioritized the textile and garment sectors.** From a global perspective, the textile and garment industry epitomizes globalization with its continuing production shifts.[18] While labor cost differentials are among the main drivers behind the relocation behavior of the garment industry, other factors such as preferential trade treatment and individual corporate strategies are also important. The textile and garment industry in Myanmar, through its participation in the global value chain and benefiting from production shifts from other countries with higher labor cost, could play a critical role in developing domestic manufacturing capacity and promoting

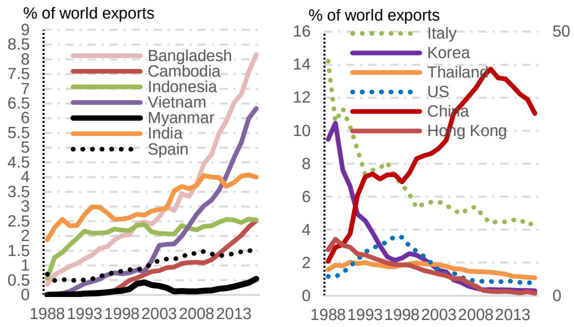
[16] The sectors highlighted in the strategy include textile and garment; forestry products; agriculture products such as rice, beans, pulses and oilseeds; rubber; and fisheries; and tourism for service exports.

[17] Prioritized sectors under this plan include labor-intensive industries such as garments, shoes, packing and wood-based products in the short term; more advanced sectors such as shipping building and auto-parts in the medium term; and high-tech manufacturing such as semiconductors and pharmaceuticals in the longer term. In March 2016, the Myanmar Investment Commission also issued the policy initiative—Indicative Private Sector Development Framework and Action Plan—to develop a roadmap for Myanmar's transition to an economy led by the private sector.

[18] Triggered initially by the search for lower labor costs, the garment industry's production has shifted out from industrialized countries to least development countries since the 1950s. In Asia, Japan was a key production base following the shift from the U.S. and Europe in 1950s and 1960s. In the following decades, production from Japan first shifted to Hong Kong, Taiwan, Korea and Singapore in 1970s and 1980s, and then moved further to China, some countries in Southeast Asia and South Asia. Most recently, we have witnessed an increasing number of garment industry investors move from China into Vietnam, Cambodia, and most recently Myanmar. Meanwhile, with this movement, some economies could climb over the value chain and develop their capacity in designing, branding and marketing, and retain these activities while production shifts away.

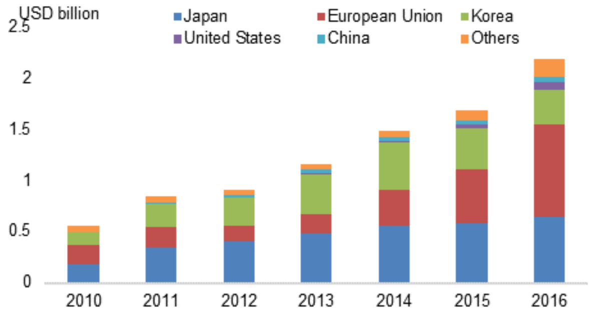
exports. Exports from the sector have increased substantially in the past three years (Figure S1). Among all the products in this sector, garments are the major contributor to exports, with exports estimated at USD2.7 billion in 2017 and expected to become the biggest export item in the next one to two years, outpacing gas exports and all agriculture exports (Figure S2). Given the size and growth of the garment sector, it is viewed as a driver for future manufacturing growth in NES.[19]

Figure S3. Changing Garment Export Shares



Source: UN Comtrade, AMRO staff estimates

Figure S4. Destinations for Myanmar's Garment Exports



Source: UN Comtrade

Table S1: Myanmar's Tariff-free Access under the U.S. GSP Scheme

Eligible Items	Ineligible Items
Some manufactured items;	Most textiles & apparel;
Jewelry;	Watches;
Some agricultural products;	Footwear;
Travel goods;	Gloves & leather goods
Carpets	

Source: Office of the United States Trade Representative

3. **The prospects for Myanmar's garment sector look very promising, given the size of the global market.** According to UN Comtrade statistics, world garment exports totaled USD403 billion in 2016 – Myanmar accounted for just 0.5 percent of this total compared with 8.2 percent for Bangladesh, 6.3 percent for Vietnam, and 2.5 percent for Cambodia (Figure S3), with the E.U., the U.S., and Japan collectively accounting for 62.9 percent of the total imports.

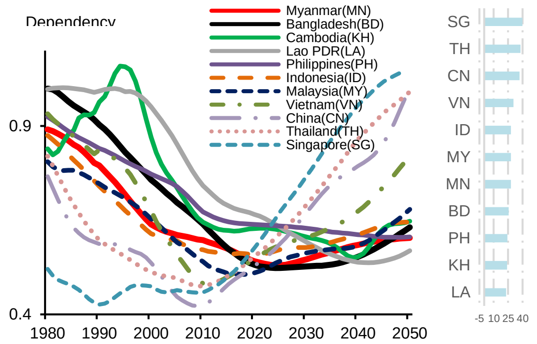
4. **Myanmar's comparative advantages are substantially owing to preferential trade treatment.** Myanmar witnessed a fast expansion in exports, especially in the E.U. market since the reinstatement of "Everything but Arms" (EBA) in 2013. This Generalized Scheme of Preferences (GSP) preferential trade regime grants Myanmar duty-free and quota-free access to the E.U. market.[20] For the U.S. market, the GSP scheme does not include most textile and garment items (Table S1).

5. **While enjoying preferential trade treatment, exporters can also benefit from the young demographics and low labor costs in Myanmar.** The young population structure will

[19] Myanmar has also increased production in cotton and textile manufacturing over time. However, textile production can still only satisfy a small portion of domestic demand.
[20] GSP preferences were withdrawn from Myanmar in 1997. Currently, the countries are entitled for EU EBA-GSP in Asia include Afghanistan, Bangladesh, Bhutan, Cambodia, Lao PDR, Myanmar, Nepal, and Timor-Leste.

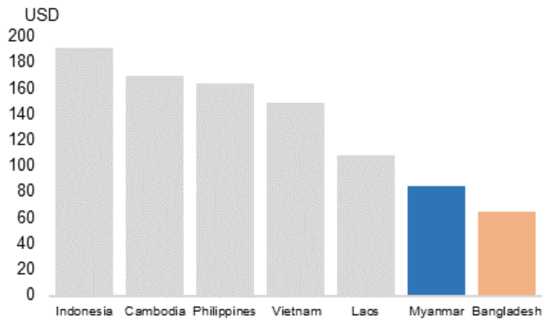
allow Myanmar to enjoy a demographic dividend in the next two decades, similar to Cambodia, Laos, and Bangladesh (Figure S5).[21] Myanmar still has one of the lowest minimum wages for garment workers in the region, even after the new wage increase that came into effect in April 2018. Before this hike, the minimum wage rate in Myanmar was at par with Bangladesh, which is the biggest garment exporter in South and Southeast Asia (S6).

Figure S5. Age Dependency Ratio and Median Age of Population



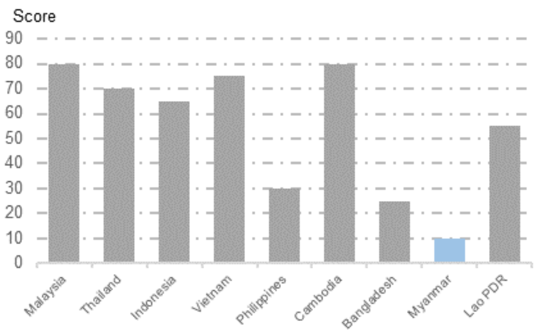
Source: CSO

Figure S6. Minimum Wage



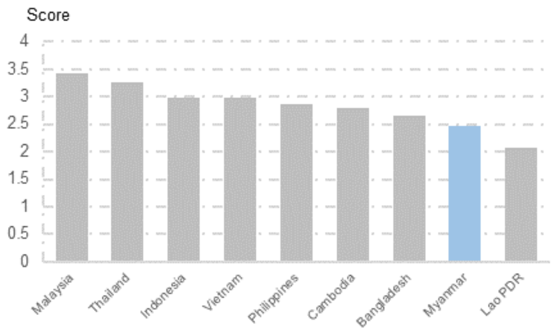
Note: An unweighted simple average is computed to get the country Mean for the cases within-country regional variations of minimum wage exist.
Source: AMRO staff calculations based on public data

Figure S7. Access to Credit



Note: Distance to frontier score (0=lowest performance to 100=frontier)
Source: WB

Figure S8. Logistic Performance Index (2016)



Note: Overall (1=low to 5=high)
Source: WB

6. **With the advantages accruing from the preferential trade agreement and low labor costs, Myanmar can utilize the time window before the trade agreements expire to address the key constraints it faces in improving both the environment for domestic manufacturing as well as the efficiency of trade logistics.** The lack of stable electricity supply and skilled labor hinder the expansion of the domestic manufacturing sector severely. Separately, the difficulty in access to bank credit is viewed by SMEs as the key constraint to expanding production activities, especially for those firms in the garment sector and those that look for export financing (Figure S7). In this regard, neighboring firms in Laos and Cambodia find it much easier to secure financing. Transportation infrastructure and logistics costs are also critical factors to exporters' costs and their potential capacity to climb up the value chain.

[21] Myanmar has a labor force of 25.4 million in 2017, compared to 9.4 million in Cambodia, 3.6 million in Laos and 66.6 million in Bangladesh.

Myanmar still ranks as one of the lowest in the region in terms of its logistics performance, dragged down by all key aspects including infrastructure, customs, and shipments (Figure S8).

7. **Further utilization of the U.S. GSP can lead to more opportunities while the coming into effect of the E.U.-Vietnam FTA will put pressure on Myanmar's export competitiveness.** While the U.S. GSP scheme for Myanmar does not include garments, it does allow for a wide range of tariff-free exports that can potentially be developed in Myanmar. For instance, with the tariff exemption for travel goods, Cambodia has been able to increase travel goods exports from USD64 million in 2016 when the exemption was granted to around USD500 million in 2018. On the other hand, the coming into effect of the EU-Vietnam FTA, the negotiations for which were completed in 2017, will impose a threat to Myanmar's exports to the E.U., which accounted for more than 40 percent of its garment exports and is Myanmar's fastest growing export market. The current tariff rate for Vietnam garment exports to the E.U. market is 12 percent, and once the FTA comes into effect, this will fall to zero percent, making Vietnamese garment exports more attractive.

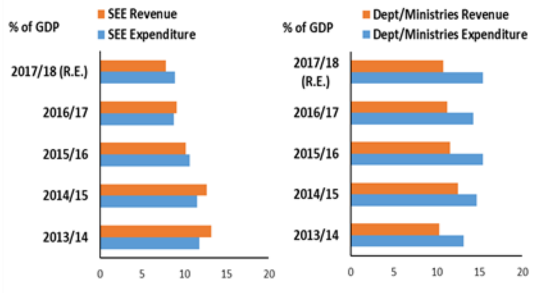
8. **Headwinds could come about if domestic wages rise faster than productivity gains, and also from automation in other markets.** The recent 33.0 percent increase in wages in Myanmar was substantial. Although the level of wages is still low in comparison to regional peers, increases in wages going forward need to reflect productivity gains and should be in tandem with improvements in other factors such as logistics cost and efficiency, stable electricity supply, and enhanced labor skills. From a longer-term perspective, the garment industry—one of the most globalized—will likely evolve to become more automated instead of labor-driven, in response to advances in artificial intelligence and digital technology amidst rising labor cost, as well as enabling mass customization. A sufficient reduction in costs due to increased automation in other manufacturing markets will also cause the garment industry shifting offshore production back onshore to be closer to customers, leading to Myanmar becoming less attractive as a production base. Therefore, the time window for Myanmar to make gains in the garment industry and move up the value chain is likely to be shorter than was the case in the previous cycles.

9. **Myanmar should make greater efforts for broader structural reforms in order to develop the manufacturing sector further by utilizing the opportunities available for the garment sector.** To develop its garment industry to compete against the incumbent exporters within the limited time window, and develop other manufacturing activities, Myanmar needs to address the bottlenecks in a timely and systematic manner. Meanwhile, prioritizing labor skills and overhauling the education system to be more market-oriented are essential, along with continuing policy adjustments to facilitate growth in the sector. Progress on these fronts will help grow the garment manufacturing sector while allowing Myanmar to climb up the global value chain, enabling the country to benefit from the dynamics of automation which replace not only old jobs but also create new job opportunities.

Issue 2. Understanding the Fiscal Flows of State Economic Enterprises in Myanmar

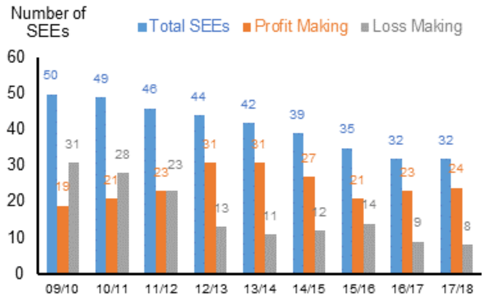
10. **State Economic Enterprises (SEEs) form an integral component of the overall fiscal accounts in Myanmar.** SEEs in Myanmar are attached to a line ministry related to the particular sector in which the SEE operates, according to the SEE Law enacted in 1989.[22] SEEs in Myanmar constitute a significant portion of the revenue and expenditure accounts in the Union Budget. In FY2013/14 alone, revenues from SEEs accounted for more than half of the consolidated public sector revenue (comprising Departments/Ministries together with SEEs). Although the proportion has steadily declined, it has remained high, accounting for over 40 percent of total revenues in FY2017/18. A similar trend can be seen with regard to SEE expenditures, which accounted for almost half of the consolidated public sector expenditure in FY2013/14, and has since dropped to less than 40 percent in FY2017/18 (Figure S9).

Figure S9. SEEs and Departments/Ministries Revenue and Expenditure



Source: MoPF

Figure S10. Total Number of SEEs



Source: MoPF

11. **SEE reform has been an ongoing priority of the government, especially since the opening up of Myanmar's economy in 2012.** The government has consistently sought to implement much-needed reforms to make SEEs more profitable and resilient, specifically to be less dependent on the Union Budget. This reform process has accelerated since the economy was opened up in 2012, with the number of profit-making SEEs rising from a little over a third of total SEEs in 2009/10, to over three-quarters in FY2017/18 (Figure S10).[23]

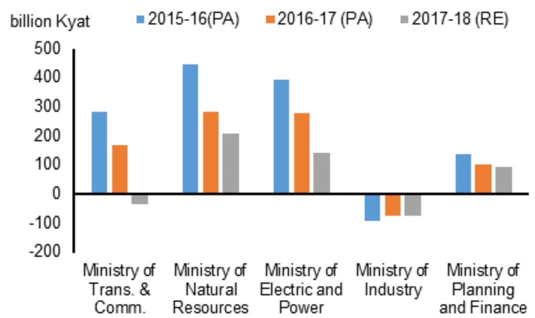
12. **The reform includes more autonomy for SEEs.** Prior to the opening up of the economy, SEEs were required to give up all their profits to the central government, which is then re-allocated back to the SEEs via the Union Budget. As part of the reform process, SEEs were allowed to retain a portion of their profits after paying 25 percent income tax and 20 percent contribution/dividend to the Union Budget. Providing SEEs with their own funds, particularly to boost their working capital, was envisioned to make SEEs more self-sustaining, enabling the SEEs to stand on their own and be less reliant on the Union Budget.

13. **The governance of SEEs in Myanmar follows a decentralized structure, wherein each SEE is under the supervision of line ministries in a related sector.** Although the Ministry of Planning and Finance (MOPF) has general oversight over SEEs, this basically

[22] The SEE Law provides the right to government to engage in activities in 12 strategic sectors, including teak, forest products, petroleum & natural gas, pearl, jade & precious stones, fish & prawn, postal & telecommunications, air and railway transport, banking and insurance, broadcasting and television, metals, electricity generation, and security & defence.
[23] However, the fall in loss making SEEs need to be carefully interpreted, as most of these have been transformed as departments or units within government, with 12 former SEEs being re-absorbed back into the Union Budget from FY2012/13 to FY2017/18.

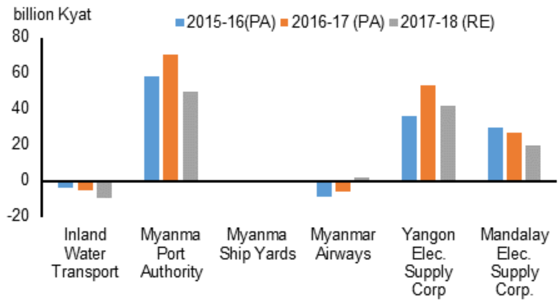
comprises the budget process only. SEEs are attached to a particular Ministry that is in charge of policy for the sector, with the Ministry at times also acting as a regulator of the SEE. Line ministries with the largest SEEs are shown in Figure S10. SEEs under the Ministry of Natural Resource and the Ministry of Electric and Power show consistent but declining profits, while SEEs under the Ministry of Industry show consistent losses. The SEEs under the Ministry of Transportation and Communication also revealed some losses in the most recent period. The MOPF directly oversees the state-owned banks and insurance company. SEEs under these line ministries operate within the Union Budget, and to varying degrees, are allocated funds from the budget for current expenditure, capital expenditure and debt repayment, depending on their profitability and the availability of funds for working capital by each SEE. Seven SEEs have been taken out of the Union budget and corporatized. Corporatization allows joint private and public ownership by establishing a separate legal entity with assets and liabilities held in the corporatized SEEs own name. Corporatized SEEs are treated as being outside of the Union Budget, effectively freeing funds that were formerly allocated for the expenses of these corporatized SEEs. (Figure S12).

Figure S11. Operating Profit/Loss of SEEs under particular line Ministries



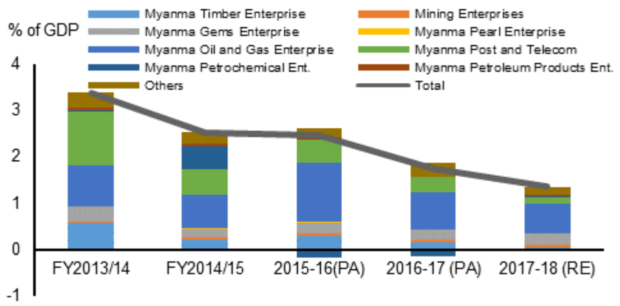
Note: Operating profit/loss refers to the difference of sales and operational expenditure, and does not include debt payment and capital expenditure.
Source: MoPF

Figure S12. Operating Profit/Loss of Corporatized SEEs



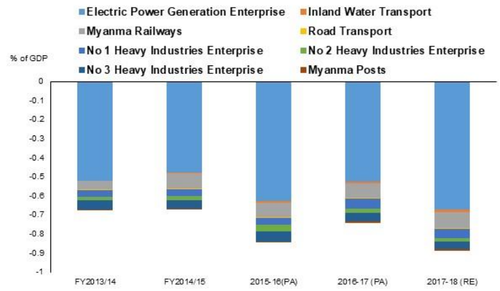
Note: The Central Bank of Myanmar is also considered corporatized, bringing to seven the total number of SEEs outside the Union Budget.
Source: MoPF

Figure S13. Profit Making SEEs



Source: MoPF

Figure S14. Loss Making SEEs



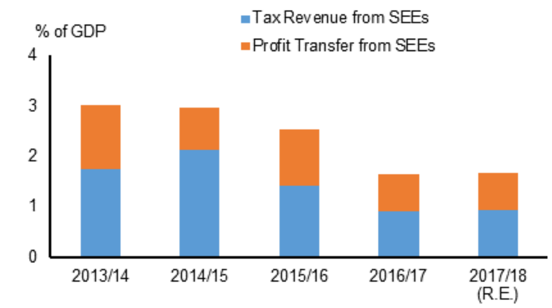
Source: MoPF

14. **Profit-making SEEs are dominated by those operating in the resource and telecommunications sectors.** Profit-making SEEs are led by the Myanma Oil and Gas Enterprise (MOGE) and the Myanmar Post and Telecom (MPT) (Figure S13). Profits by MOGE were boosted by the start of production in the Shwe and Zawtika off-shore gas fields in 2013 and 2014, respectively. However, profits have since declined from the peak in FY2015/16 due

to the fall in global energy prices. The recent recovery in global energy prices is expected to pull up MOGE profits. However, this will be tempered by falling gas volume in older projects, particularly the Yadana and Yetagun offshore gas fields. Profits from MPT have likewise steadily declined, driven down by greater competition since the sector opened up in 2012. Profits from timber also used to be large but have likewise dropped with increased restrictions, along with the imposition of a logging ban in 2016.

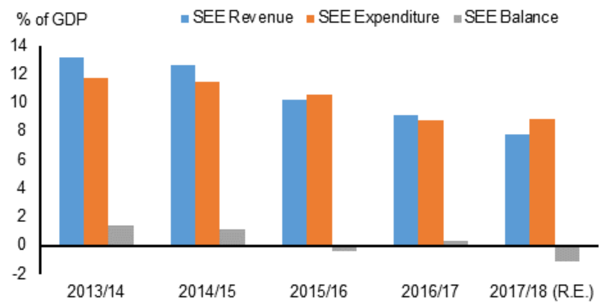
15. **Loss-making SEEs are mainly from the electricity and industry sectors.** Losses from SEEs are dominated by the Electric Power Generation Enterprise, which accounts for almost three-quarters of total losses in the past five years (Figure S14). Losses have mounted as the government sought to expand access to electricity by investing more in the sector. Meanwhile, electricity tariffs have remained low and considered to be below the recovery cost of operation. Another contributing factor may be the depreciation of the exchange rate, as a portion of Myanmar's energy imports is for the electricity sector. Myanmar Railways has also been a large drain, as chronic losses are funded through the budget. SEEs involved in the industrial sector have not been doing well either, with the combined No.1, No.2 and No. 3 Heavy Industries Enterprise[24] accounting for around 14 percent of total SEE losses.

Figure S15. SEE Contribution to Public Sector Revenue



Source: MoPF

Figure S16. Overall SEE Fiscal Position



Source: MoPF

16. **Shifting global and domestic trends have changed SEEs' contribution to the overall fiscal accounts from being a net positive contributor to being a drain on the budget.** The combination of a fall in global energy prices, increased competition with the private sector (and imports), and higher investments in the electricity sector even as tariffs remain below recovery levels, has led to a steady decline in the contribution of SEEs to public sector revenue (Figure S15). The fall in SEE revenues, while SEE expenditures remain high, is estimated to have resulted in an overall negative balance for SEEs in FY2017/18 (Figure S16), implying that the Union Budget is supporting SEEs as a whole.

17. **Increasing SEE expenditures amid the steady fall in SEE revenues call for stepped-up reforms to prevent a further drain on fiscal resources.** Amid the ongoing efforts to reform

[24] Before 2012 there were clear delineations between the various Heavy Industries Enterprises, with No.1 in-charge of factories related to consumer products such as textile, ceramic and food, with No. 2 involved in manufacture of heavy machineries for transportation, agriculture and electrical industry and No. 3 for all other factories not falling into No.1 or No.2. This has changed since 2012 with no particular industry assigned for each enterprise as in the past, but rather ensuring that a reasonable number of factories are under each Enterprise, with the automobile related factories transferred to the Ministry of Defence.

SEEs to make them less reliant on the Union Budget, there have been some setbacks, particularly pertaining to the increase in transfers from the Union Budget to some SEEs to help address falling revenues and/or losses. A combination of SEE restructuring and expenditure rationalization, together with a clear articulation of government policy to improve the efficiency of SEEs, would significantly benefit the reform effort. Policy directions from the government would improve SEE management, as currently there is no overarching government plan with regards to which SEEs should pursue corporatization and privatization, and which SEEs should remain under the Union Budget. Although short-term actions to cut expenditures to help increase profit could be useful, the majority of reforms require a medium- to long-term perspective that is focused on the role of SEEs in the economy, the relationship of SEEs to the overall public sector, and the equally important issues of improving governance, enhancing oversight and evaluation, as well as promoting transparency. In addition to improving the efficiency of SEEs, corporatization and privatization will also need to take into careful consideration the welfare of existing workers in SEEs, which currently employ around 145,000 people. Expenses for staff retraining need to be considered, together with severance pay and early retirement procedures in cases of redundant workers once SEEs are restructured to become more efficient. Underlying these initiatives is the need to upgrade the accounting and financial reporting of SEEs to allow for a comprehensive and timely assessment of their financial positions.

18. **Establishing a clear and unified government policy towards SEEs will spur reform.** The reform effort has been ongoing, generally aimed at improving SEEs' performance and enabling them to be less reliant on the budget. Currently, line ministries in charge of SEEs, and even SEEs themselves are trying to find investors to upgrade their operations. Progress remains hampered, however, by a host of factors relating to the uncertainty on what model they should take, capacity constraints within the line ministries and SEEs to deal with investors, and the inertia of continuing to operate as in the past. A clear national plan led by the government with definitive strategies toward SEE corporatization and privatization should spur the reform further. In particular, it is necessary for the government to foresee the role of SEEs in Myanmar's economic development, clearly defining the industries that will benefit from government support, and, on the other end, the industries that require less government involvement, paving the way for private sector-led initiatives to flourish.

19. **In addition to an overall SEE reform plan, the government needs to state the objectives for each SEE clearly.** Setting clear financial and non-financial objectives for each SEE that is in line with the overall SEE reform plan will provide clear guidance for the management of each particular SEE on what direction it should take. Setting non-financial objectives is particularly important if the SEE operates in a sector that is considered a public good such as electricity generation or strategically important such as petroleum and natural gas. Further clarifying the objectives for SEEs will also identify those with largely commercial functions, which can then be fully corporatized in the future.

20. **Clarifying the role of government in the governance of SEEs also needs to be changed to push the reform effort forward.** In Myanmar, the governance of SEEs is dominated

by the government. Thus the government takes on the role of the board of directors. At the same time, the government takes the role of regulator. This dual role raises the possibility of conflicting of interests for the government. In this regard, a clear separation between the government's role as owner and regulator is needed. Establishing an independent board of directors to take into account the interests of various stakeholders vis-à-vis the national interest, while also providing strategic direction, would be a positive step in improving the governance of SEEs.

21. **Putting in place a performance evaluation system would support SEEs reforms.** With clarified roles and objectives for SEEs as a whole, and for individual SEEs in particular, a performance evaluation system that monitors achievements against the set objectives is expected to enhance the efficiency and transparency of SEEs. This could be done through performance contracts with each SEE, with accompanying quantitative and qualitative performance indicators to gauge whether objectives were achieved. Reporting to the public on the results of the performance indicators would likewise improve transparency regarding the operations of SEEs, encouraging quality of SEE accounts and enhancing SEE credibility.

22. **Designating a new or existing government body to be responsible for the process of SEE reform would provide more focus compared to the current decentralized structure of SEE governance.** Currently SEE governance is decentralized, with each SEE attached to a line ministry in-charge of the particular sector in which SEE operates. Designating a dedicated body, possibly a new or existing department at the MOPF would enable a more holistic view, ensuring the national interest in the implementation of SEE reform compared to sector or industry-specific concerns of line ministries. A dedicated body would likewise be able to build capacity more effectively, developing specialized skills needed for the oversight and performance evaluation of SEEs.