Current Status of Myanmar Economy

Summary

The Myanmar economy has continued to achieve favorable growth ever since 2011, when the transition to civilian rule by the military regime took place. The years 2013 and 2014 stand out especially, when a string of major projects were implemented one on top of the other, including oil and gas field development, the building of telecommunications infrastructure, and construction of a new airport. These projects were supported by large-scale capital expenditure, which contributed to the economy's achieving high growth exceeding 8%. After that point the number of major projects being carried out in Myanmar decreased somewhat, but growth has remained favorable due to strong demand for the construction of office buildings, residences, and shopping centers, as well as growth in the number of foreign companies entering Myanmar's marketplace, including manufacturers of clothing and handbags & brief cases hoping to benefit from the low cost of labor.

The flip side of the generally favorable growth is Myanmar's currency, the Kyat, which is basically moving towards depreciation. (1) Raw materials and capital stock required for growth are difficult to procure domestically. The country depends for the most part on imports for these, and hence is now experiencing the expansion of its trade deficit. (2) The country is experiencing cost-push inflation as a result of raising wages to a level incompatible with the productivity of mostly overseas corporations. (3) There is also demand-pull inflation due to domestic supply capability which is insufficient for the handling of rapid growth.

Obtaining a stable exchange rate requires correction of the macro imbalance which is behind improvement in competitiveness, but this is something that will take time. Hence, the country's currency will likely continue to experience depreciation pressure.

1. Myanmar's Economic Trends

The Myanmar economy has continued to achieve favorable growth ever since 2011, when the transition to civilian rule by the military regime took place. The years 2013 and 2014 stand out especially, when high growth exceeding 8% was achieved. The Myanmar government has a strategy of making use of overseas technology in rebuilding the economy. During this period, the government has (1) strengthened exploration and development of oil and gas fields, and (2) implemented public bidding on licensing for telecommunications operations.

Foreign companies whose bids were accepted have implemented large-scale capital expenditure, thus contributing greatly to Myanmar's economic growth. Bidding also occurred during the same years for construction of Yangon International Airport, Terminal 1. The company which won the bidding was a domestic Myanmar conglomerate, Asia World, which since that time has implemented large-scale investment contributing to the country's growth. Since 2015, the number of major projects being carried out in Myanmar decreased somewhat, but growth has remained favorable due to strong demand for the construction of office buildings, residences, and shopping centers, since the country's transition to civilian rule. Meanwhile, other major construction projects have also gotten started, such as the Yangon Railway Station building site development, and the Military Museum site development, and these are expected to continue contributing to growth in the future.

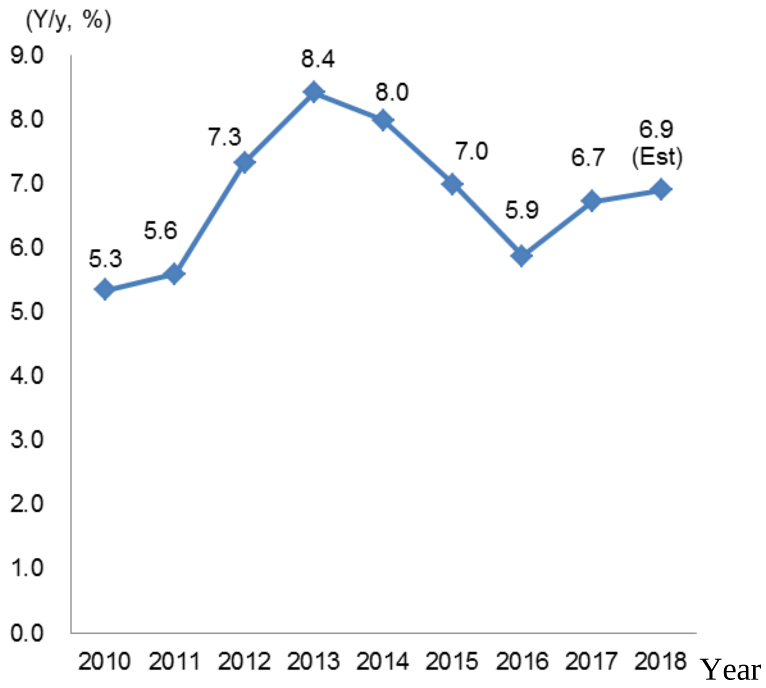
The area other than oil and gas field development and telecommunications infrastructure which is most conspicuous is growth in entry into Myanmar's market of light industry involved in the manufacture of clothing and handbags & brief cases. Corporations entering this field are many, coming from Japan, China, and Korea. Behind this development lies the low personnel expense in Myanmar, as well as most-favored-nation treatment which includes exemption from tariffs.

These corporations are involved in labor-intensive businesses and contribute greatly to local employment. Meanwhile, finished products exported, meaning growth in exports, especially to Japan. The proportion of total exports from Myanmar accounted for by clothing and handbags & brief cases is continuing to grow. Meanwhile, as exports in this field of business grow, the number of corporations involved in container transport also grows, as well as related areas such as the development of port facilities.

In the area of development of industrial parks, Japan has had a central role in the Thilawa Special Economic Zone, whose development is progressing smoothly. Work on this project encompasses the development of infrastructure in adjacent areas as well. Hence there are no problems such as insufficient electrical power and so on. Corporations setting up in the new economic zone represent a wide range of industries, including construction materials, packaging & containers, the garment industry, foods & beverages, agriculture related, automobile related, electrical power, medical related, handbags & brief cases, logistics (distribution), refrigerated warehousing, industrial gas, machine tools, camera parts, wood products, animal feed, rubber products, industrial waste treatment, vocational training, and rentals.

As for purpose of entering the local market in Myanmar, approximately 60% of the total number of corporations plan on supplying a product or service whose domestic supply has been insufficient up to this point. Approximately half of the companies setting up in the industrial zone are Japanese. This is related to the fact that the development project has been led by Japan. The Thilawa Special Economic Zone is still in the early stages of development. Once development of roads in the adjacent areas has progressed, access to downtown will be improved, and convenience of the industrial zone will also improve greatly, increasing the efficiency of economic activity there.

Figure (1) Change in Real GDP Growth Rate



Source: IMF; compiled by DIR.
Note: Figures for 2018 are IMF estimates.

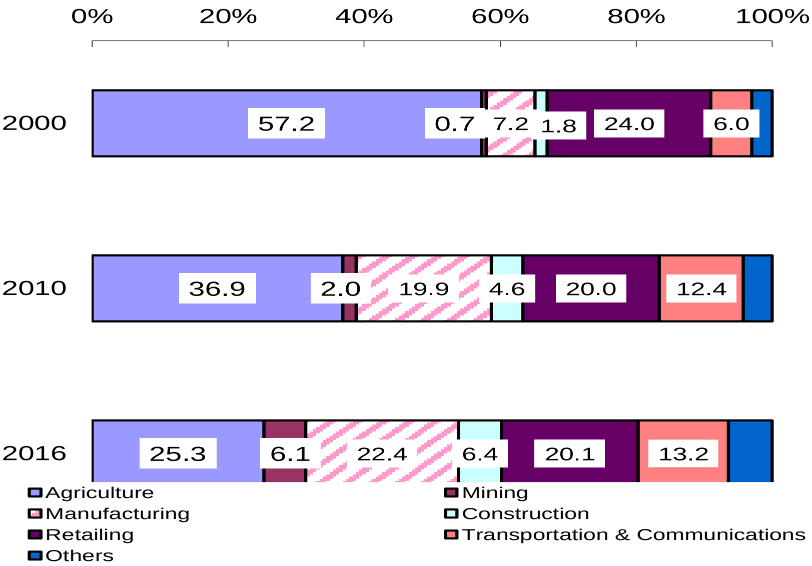
In general, economic development is progressing smoothly, but in order to change the structure of the economy to that of a high-value-added one, Myanmar must be transformed from an agricultural economy to an industrial one. Myanmar has much fertile land, and is hence an excellent location for agriculture. The government of Myanmar is implementing policies to improve agricultural productivity and to increase employment in that area. Because of this focus on agriculture Myanmar has fallen behind in industrial development. Moreover, the country's transportation infrastructure is poor, and access to metropolitan areas is not good. This makes transport of workers from rural areas to urban areas difficult is one of the factors that have been a hindrance to industrialization centering on urban areas.

The above describes the general situation, but at the same time Myanmar is in fact taking the path toward gradual industrialization, making use of foreign direct investment and bringing in technology and know-how from overseas. However, with the exception of a major project such as the Thilawa Special Economic Zone, the country still suffers from a shortage of energy and insufficient infrastructure. Hence, as of this point, the foreign corporations which have entered the local market tend to be those which are less severely affected by these problems. In other words, there are manufacturing and export of clothing and handbags & brief cases as well as similar light industries.

Although these industries do contribute to Myanmar's exports, they do little to influence the development of domestic industry. Moreover, their main interest is in the low level of personnel expenses in Myanmar, so if wages were to grow to a much higher level, these companies are likely to move on to a different country which still has low wages. From the viewpoint of growing Myanmar's domestic industry, this kind of corporation is not that desirable.

In order to obtain technology and know-how from overseas and build an industrial structure, as well as improve domestic supply capability and export competitiveness, industries with a broad influence, and which can cause an industrial ripple effect, such as electronic parts and transport equipment, are the most desirable. And in order to encourage these industries to come to Myanmar, the required condition is to have a firmly established fundamental infrastructure, including a stable supply of energy, roads, and port facilities. The government should prioritize the development of infrastructure, and make unwavering, ongoing efforts to accomplish this goal.

Figure (2) Value-Added Ratio by Industry (%)



Source: United Nations Statistics; compiled by DIR.

Myanmar's industrial structure has been steadily changing ever since the transition to civilian rule in 2011. When we compare the value-added ratio by industry in 2010 and 2016, we can see that agriculture's share fell from 36.9% to 25.3%. Meanwhile, the value-added ratio has grown in the following industries: mining (2.0% → 6.1%), manufacturing (19.9% → 22.4%), construction (4.6% → 6.4%), and transportation & communications (12.4% → 13.2%). As for mining, its value-added ratio grew as a result of the government's approval of the development of oil and gas fields.

Manufacturing's share grew as a result of the entry of more foreign manufacturers into the Myanmar market, most of these in the area of manufacturing of clothing and handbags & brief cases. The value-added ratio of construction grew as a result of basic infrastructure development, including roads and port facilities, as well as the construction of offices and residences, which had been suffering a chronic shortage. The value-added ratio of transportation & communications grew as a result of the government having granted telecommunications licenses to two foreign companies.

This has led to the rapid spread of telecommunications infrastructure and mobile phone usage. The spread of mobile phones has contributed greatly to growth in consumption, especially in the area of durable goods. From the viewpoint of the goal of industrialization, the decline in the value-added ratio of agriculture and the increase in the value-added ratio of manufacturing is desirable. However, the fact that most of this is in the area of light industry remains a problem. The country needs to continue increasing the ratio of manufacturing in the future, as well as shifting from light industry to heavy industry, while at the same time promoting the accumulation of capital, and the building of a competitive system of production.

2. Depreciation of the Myanmar Kyat

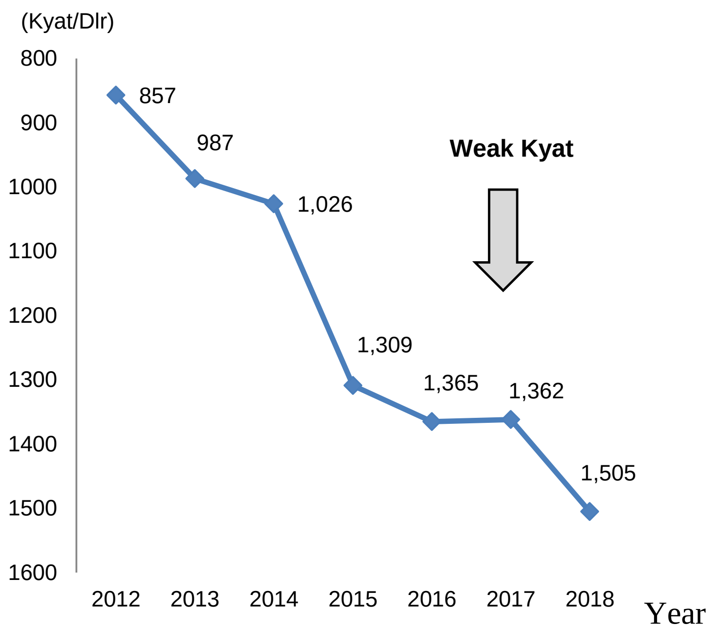
The flip side of the generally favorable growth is Myanmar's currency, the Kyat, which is basically moving towards depreciation. There are a number of factors behind this, but primarily, the country opened its doors and began relations with overseas economies while its own economy was still vulnerable, and activation of corporate activity produced various imbalances as follows;

(1) Raw materials and capital stock required for growth are difficult to procure domestically. The country depends for the most part on imports for these, and hence is now experiencing the expansion of its trade deficit,

(2) The country is experiencing cost-push inflation as a result of raising wages to a level incompatible with the productivity of mostly overseas corporations and

(3) There is also demand-pull inflation due to domestic supply capability which is insufficient for the handling of rapid growth. Together these factors have led to depreciation of the country's currency.

Figure (3) Kyat to Dollar Rate
(Central Bank of Myanmar Reference Rate)

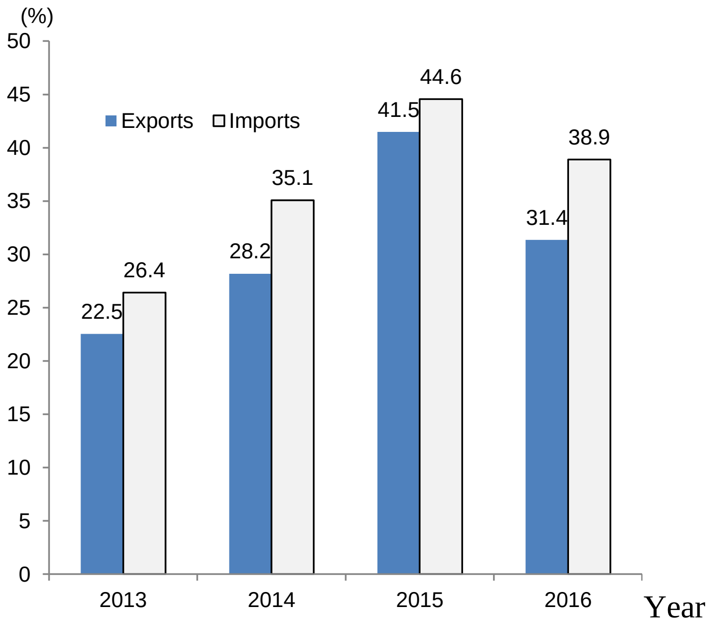


Source: Central Bank of Myanmar; compiled by DIR.
Note: Year-end figures used. Figures for 2018 are from August 28.

The Kyat/Dollar rate (Bank of Myanmar reference rate) as of 2012 was 850/dollar, but over the years the currency steadily weakened, hitting 1,362/dollar as of end 2017. Depreciation was especially rapid from end 2014 to end 2015 when the rate hit 1,062/dollar. Speaking in macroeconomic terms, that period saw a rapid rise of the inflation rate, as well as expansion of the trade deficit.

The major kyat depreciation reflected this state of affairs. The kyat/dollar rate remained relatively stable into 2018, but then around May, it began falling again through June, influenced by the weak Chinese yuan and other factors. Myanmar has close business ties with China, with the import/export balance of key commodities as of 2016 at 31.4% in exports to China as compared to 38.9% in imports. For all intents and purposes, these close business ties make Myanmar a part of the Chinese economic zone, and hence the kyat is closely linked with movements in the Chinese yuan.

Figure (4) Myanmar-China Key Commodities Import-Export Ratio



Source: Myanmar Central Statistical Organization; compiled by DIR.

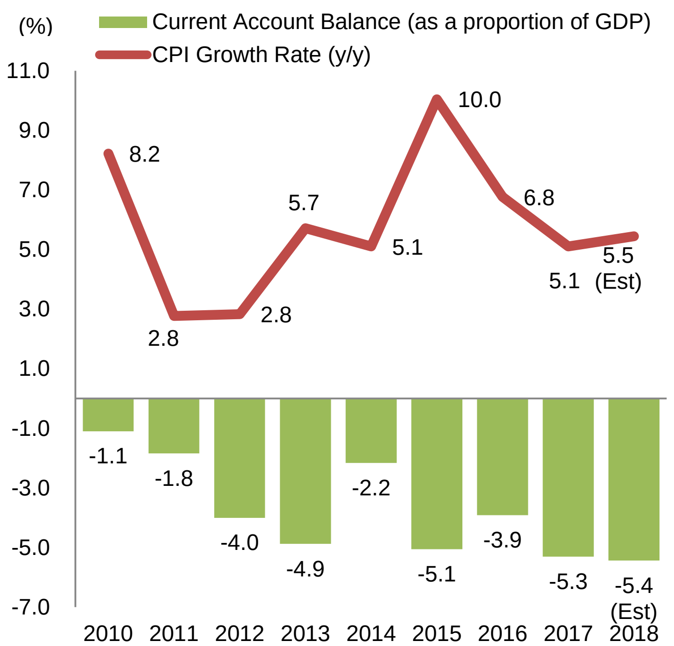
It will be difficult for the kyat to stabilize without first correcting the negative balance of an expanding trade deficit with rising inflation rate. There are a number of possible policy measures that might correct this macro imbalance. First, focusing on the major factor in transforming the current of the country's economic activity, that is direct foreign investment, one approach would be to slow down the procedure for approval of direct foreign investment, and reduce the amount of imports associated with said investments so as to avoid further expansion of the trade deficit.

Secondly, put import replacement and export promotion measures in place so as to reduce the import value and increase export value as a means of improving the trade balance. The third approach is to use monetary tightening and fiscal restraint measures to keep domestic demand under control, thereby reducing imports and improving the trade balance, while at the same time keeping the inflation rate down.

The only problem is that there are difficulties associated with these measures. If the country were to implement the first and third measures described here, there is a good policy that it would cause an economic slowdown, while in addition, technical transfer from overseas would also fall behind. This holds the risk of causing the country's economic growth to shift into the negative numbers.

The second measure suggested would take time since it is associated with industrial policy, and it would be difficult to achieve results in the short-term. Considering the complications, the only thing to do may be continue with the status quo since it would be too difficult to carry out any really drastic measures. This means that it is highly likely that currency depreciation pressure will continue.

Figure (5) Changes in CPI Growth Rate and Current Account Balance



Source: IMF; compiled by DIR.
Note: Figures for 2018 are IMF estimates.

For a developing country, the problem of currency value is closely associated with the basic nature of its economy, hence the long-term view is preferable. For instance, the problem of the trade deficit should be thought of in terms of the country's export competitiveness. In other words, as long as the trade deficit continues, it is highly possible that the exchange rate is not commensurate with the country's export competitiveness. In a sense, it can be considered normal for adjustment of the exchange rate to occur up to the point where competitiveness can be recovered. So, continued depreciation of the exchange rate does not really warrant pessimism. Competitiveness can be increased by improving the country's economic tone over time. This task requires effort and patience, but eventually the time will come when a turnaround occurs and the exchange rate moves toward a stronger kyat. This will occur when domestic supply capability and export competitiveness are improved.

There is one major problem with a macro imbalance. That is, if deterioration becomes extreme, it can cause a momentary shock to the system, which could produce major damage to the domestic economy. For instance, in the case of Vietnam, the inflation rate grew over 20% in comparison to the previous year around 2011, and the economy could not endure the country's tight money policy. This resulted in a stalled economy. In the case of Indonesia, despite the increase in inward direct investment and a continuing current account deficit during the 1990s, the exchange rate was kept high. This caused a problem in financing of the current account deficit and in 1997 and beyond, a major correction in the exchange rate became unavoidable. In order to avoid this state of affairs, care must be taken regarding the degree to which the imbalance is allowed to grow, and when signs of breakdown are detected, appropriate countermeasures, such as austerity measures, should be put in place.