Office Memorandum

To: Members of the Executive Board January 3, 2013

From: The Secretary

Subject: **Myanmar—Assessment Letter for the Asian Development Bank and the World Bank**

Attached for the **information** of Executive Directors is the Fund's assessment letter on the macroeconomic conditions in Myanmar, which was requested by the Asian Development Bank (AsDB) and the World Bank.

If the authorities of Myanmar consent to the publication of this assessment, it may be published by the AsDB and the World Bank.

Questions may be referred to Ms. Karasulu (ext. 37113) and Mr. Pitt (ext. 38841) in APD.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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MYANMAR—ASSESSMENT LETTER FOR THE ASIAN DEVELOPMENT BANK AND THE WORLD BANK

January 3, 2013

Myanmar is in the midst of a historic political and economic transition. After decades of isolation and conflict, the new government of Myanmar has started an ambitious program of political and economic reforms with the aims of becoming a modern developed nation and better integrating Myanmar with the international community. The authorities have already taken steps to improve their macroeconomic management capacity and begun implementing reforms in key policy areas, including the exchange rate regime, financial sector and central bank reform, and the fiscal sector.

Partly as a result, economic performance has improved. In FY 2011/12, growth accelerated slightly to 5½ percent, bolstered by foreign investment in energy. Inflation fell to 5 percent y/y, almost half of that the previous year, mainly due to declining food prices, and supported by reduced central bank financing of the budget deficit. Despite a widening of the current account deficit to 2½ percent of GDP, FDI inflows saw international reserves rise to US$4.2 billion at end-September, covering 3¼ months of recorded prospective imports of goods and nonfactor services. The fiscal deficit rose moderately to 6 percent of GDP. Credit to the private sector continues to grow rapidly, at 63 percent y/y at end-July, but from a very small base (8¼ percent of GDP), mainly due to structural factors.

The short-term outlook is favorable. Notwithstanding the difficult external environment, Myanmar's economic prospects have improved, reflecting reform momentum and improved business sentiment following the suspension of sanctions. In FY2012/13, growth is projected to accelerate to 6¼ percent on the back of rising investment. Inflation is expected to pick up to around 6 percent, as food prices bottom out. The budget deficit is projected to decline to about 5¼ percent of GDP, with increased spending on health, education and infrastructure. Due to recent import liberalization and the lifting of some exchange restrictions, the current account deficit is expected to widen to 4 percent of GDP. Nevertheless, gross international reserves are projected to rise to around 4 months of imports mainly due to continued robust FDI inflows.

There are several risks to the outlook. On the downside, the main domestic risks arise from limited implementation capacity. Separately, a potential escalation of the ethnic conflict in Rakhine state and other border regions could undermine confidence and slow reforms. Global economic uncertainty also weighs on the outlook, although Myanmar remains mostly insulated from developments in advanced markets. Myanmar's largely agriculture-based economy also remains vulnerable to severe weather events as well as global commodity price shocks. On the upside, faster response from foreign investors to ongoing reforms could further boost FDI and growth.

Medium-term prospects appear promising. Over the next five years, growth is projected to rise to around 7 percent, provided the reform momentum is maintained. The current account deficit is expected to rise to 5½ percent of GDP, reflecting increased import demand for investment and consumption goods, and financed mainly by higher FDI. Gas exports, forecast to peak in FY2014/15, should help boost international reserves and government revenue. Spending on health and education is projected to increase, consistent with the authorities' goals. Improved revenue performance, however, should see the medium-term fiscal deficit narrow to around 4½ percent of GDP, which remains sustainable even under conservative revenue and foreign aid assumptions.

A debt sustainability analysis (DSA) suggests that Myanmar is classified as in debt distress due the presence of arrears. However, the planned resolution of arrears to the World Bank, Asian Development Bank and Japan would reduce arrears by more than half. Rescheduling of all arrears on concessional terms and a gradual reduction in reliance on nonconcessional borrowing as assumed under the DSA baseline, would change the rating to low risk of debt distress. The standard stress tests do not reveal significant vulnerabilities for external debt under the baseline although risks to public debt sustainability could emerge in the event of a permanently higher primary fiscal deficit, permanently lower growth over the medium to long term, or a large depreciation of the exchange rate. The authorities recognize that a successful resolution of arrears is essential for Myanmar to re-engage with the international community and ensure debt sustainability.

Fund relations. The authorities have agreed with Fund staff on a 12-month staff monitored program (SMP) through December 2013 to support their macroeconomic goals, which include raising growth in a sustainable way, opening the economy, reducing poverty, and achieving greater equity. To realize these goals, the government recognizes the need to preserve macroeconomic stability, build a framework and institutions for macroeconomic management, and continue reforms in key economic sectors. The SMP incorporates critical steps in these areas. Its central objectives are three-fold: maintaining low and stable inflation within a consistent macroeconomic framework; building international reserve buffers in light of the on-going liberalization of imports and the foreign exchange regime; and continuing to build the institutions and instruments needed to ensure macroeconomic stability. The program takes into account capacity constraints and focuses on realistic but ambitious measures that equip Myanmar to manage the risks arising from opening up and liberalizing the economy. It emphasizes moving toward a unified exchange rate and a more independent monetary policy at an early stage, and prioritizes strengthening the supervisory and regulatory framework before further financial liberalization to guard against vulnerabilities that may arise from dismantling financial sector controls in a rapidly changing environment. On the fiscal front, limiting deficits and ensuring their noninflationary financing will be key to maintaining macroeconomic stability. The program therefore envisages initial steps to increase tax revenues to allow higher spending on priority areas while limiting central bank financing and reducing dependence on natural resource revenues over time. In all these areas, the authorities' policies will continue to be supported by IMF technical assistance in coordination with other development partners.

Table 1. Myanmar: Selected Economic Indicators, 2007/08–2012/13 1/

GDP (2010/11): US$45.4 billion 2/
Population (2007/08): 57.5 million
Quota: SDR 258.4 million

	2007/08	2008/09	2009/10	2010/11 Est.	2011/12 Est.	2012/13 Proj. 3/
	(Percent change; unless otherwise indicated)					
Real GDP and prices						
Real GDP	12.0	10.3	10.6	10.4	…	…
Staff working estimates of real GDP	5.5	3.6	5.1	5.3	5.5	6.3
Agriculture 4/	8.0	3.4	4.7	4.4	4.4	4.2
Industrial production 5/	21.8	3.0	5.0	6.3	6.5	7.2
Services and trade	12.9	4.2	5.8	6.1	6.3	8.5
Consumer prices (period average)	32.9	22.5	8.2	8.2	4.0	6.1
Consumer prices (end of period)	28.8	9.2	7.1	8.9	5.0	6.1
	(In percent of GDP)					
Public sector operations 6/						
Total revenue (including grants)	14.1	13.0	11.7	13.0	13.0	19.3
Total expenditure 7/	17.9	15.5	16.9	18.4	19.0	24.6
Overall balance	-3.8	-2.4	-5.2	-5.5	-6.0	-5.3
Central bank financing	2.7	3.0	3.1	4.2	2.8	1.6
Domestic public debt	16.4	16.7	19.9	22.9	25.1	25.3
	(Annual percentage change)					
Money and credit						
Broad money	21.0	23.4	34.8	36.3	26.3	28.6
Domestic credit	22.1	24.0	34.8	34.4	25.1	28.0
Government (net)	23.3	25.6	34.4	28.5	16.6	14.0
Credit to private sector	16.7	16.2	36.9	65.4	60.1	48.0
	(In millions of U.S. dollars, unless otherwise indicated)					
Balance of payments						
Trade balance	924	302	72	796	-10	-1,313
Exports	6,446	7,241	7,139	8,980	10,170	11,308
Imports	-5,522	-6,938	-7,067	-8,184	-10,180	-12,621
Current account balance (excluding grants)	-99	-1,038	-991	-590	-1,331	-2,120
(In percent of GDP) 2/	-0.5	-3.3	-2.8	-1.3	-2.6	-4.0
Overall balance	239	-405	-28	-333	-522	1,124
Gross official reserves						
In millions of U.S. dollars	2,039	2,254	2,909	3,309	3,818	5,071
In months of total imports	3.2	3.5	3.8	3.5	3.3	4.0
External debt						
Total external debt (including arrears)	12,305	12,744	13,207	13,643	14,632	12,251
(In percent of GDP) 2/	61.0	40.6	37.5	30.1	28.4	23.1
External debt arrears 7/	8,365	8,825	9,323	9,850	10,592	2,372
Terms of trade (in percent change)	-1.1	2.8	4.5	-7.5	7.1	3.4
Exchange rates (end of period)						
Official exchange rate (kyat per U.S. dollar)	5.2	5.8	5.7	5.4	5.2	…
Parallel rate (kyat per U.S. dollar) 8/	1,110	992	1,004	861	824	864
Central bank reference rate (kyat per U.S. dollar) 8/						851
GDP in billions of kyats	23,336	28,778	32,351	36,436	39,719	44,797
GDP in millions of U.S. dollars 2/	20,182	31,367	35,225	45,380	51,444	53,140

Sources: Until FY2009/10 the authorities, with some adjustments by IMF staff; from FY2010/11 IMF staff estimations and projections.

1/ Fiscal year (April–March).
2/ Before FY2012/13, GDP converted at a weighted exchange rate, where the official and FEC market rates are weighted with about 8 and 92 percent, based on the respective shares of public and private sectors in GDP.
3/ The authorities adopted a managed float on April 1, 2012.
4/ Including livestock, fishery, and forestry.
5/ Including manufacturing, power, energy, construction, and mining.
6/ Consolidated public sector; includes the Union government and state economic enterprises.
7/ For 2012/13 incorporates the terms of bilateral arrears clearance agreement with Japan, World Bank and AsDB.
8/ The exchange rate for FY2012/13 is as of November, 16, 2011.