Statement at the Conclusion of the 2011 Article IV Mission to Myanmar

NAY PYI TAW, 24 Jan—The International Monetary Fund issued a press release dated 25 January 2012, and the full text of the press release is as follow:-

An International Monetary Fund (IMF) mission led by Ms. Meral Karasulu visited Nay Pyi Taw and Yangon during January 9-25, 2012 for the 2011 Article IV Consultation. The team met with the authorities and other key counterparts to discuss recent economic developments and the outlook for Myanmar. At the conclusion of the mission, Ms. Karasulu issued the following statement today in Nay Pyi Taw:

"We would like to thank the authorities and other counterparts for their close cooperation, open engagement and warm hospitality.

"The new government is facing a historic opportunity to jump-start the development process and lift living standards. Myanmar has a high growth potential and could become the next economic frontier in Asia, if it can turn its rich natural resources, young labour force, and proximity to some of the most dynamic economies in the world, into its advantage.

"Delivering on these expectations with inclusive and sustainable growth should start with establishing macroeconomic stability. This process has already begun with plans underway to unify the exchange rate and lift exchange restrictions on current international payments and transfers. As this essential process continues, channeling the reform momentum to improving monetary and fiscal management and to structural reforms would allow taking full advantage of the positive effects of exchange rate unification.

"Modernizing Myanmar's economy will be a process of removing impediments to growth by enhancing business and investment climate, modernizing the financial sector, and further liberalizing trade and foreign direct investment. The government's recent efforts go in the right direction and would benefit from broader consultation with stakeholders and using the best international practices distilled from other countries' experiences.

"Myanmar's real GDP growth is expected to increase to 5 ½ percent in FY 2011/12 and to 6 percent in FY 2012/13, driven by commodity exports and higher investment supported by robust credit growth and improved business confidence. Inflation, projected at 4.2 percent for FY 2011/12, is expected to pick up to 5.8 percent in FY 2012/13 as the recent decline in food prices phases out. The parallel market exchange rate of the kyat has appreciated by about 32 percent in nominal effective terms since end-FY 2009/10. The appreciation pressures are primarily due to large foreign inflows into the economy, which cannot find an outlet due to exchange restrictions on current international payments and transfers.

"Risks to this outlook are broadly balanced. On the downside, a drop in regional demand could negatively affect exports, although Myanmar, as in 2008, remains largely insulated from the developments in advance markets. If sustained, exchange rate appreciation could undermine Myanmar's already limited external competitiveness. On the upside, the recent easing of foreign direct investment restrictions, increase in private sector credit, and continued progress toward lifting exchange restrictions and unifying the exchange rate could bolster growth.

"Reforming the complex exchange rate system is a priority to eliminate constraints on economic growth. The technical work by the Central Bank of Myanmar (CBM) is already under way to establish the necessary market structure for this important process. Ultimately, the unification of the exchange rate would require moving away from the 'export first' policy. In light of the appreciation pressures, certain exchange restrictions can be removed immediately, for example, by allowing the use of all foreign currency bank account balances for imports, easing import licensing requirements and access to the newly-established foreign exchange retail counters.

"A successful exchange rate unification would require improvements in all areas of macroeconomic management. This will have to start with establishing a monetary policy framework to focus on price stability. The authorities' plan to grant operational autonomy and accountability to CBM is a welcome first institutional step towards this goal. While the recent reduction in interest rates is welcome, we do not see room for further interest rate cuts in the near term in light of the buoyant growth expectations and the inflation outlook. Within the current regulatory constraints on financial intermediation and impediments to productive investment, lower real interest rates would risk channeling savings to potentially speculative outlets, such as real estate. The onus of stimulating productive investment is now on structural policies to reduce barriers to private sector development and improve financial intermediation.

"Further reducing inflation would require stopping the financing of the fiscal budget deficits through money creation. The authorities made some progress by revising the fixed interest rate structure to provide financial incentives for bond purchases. Efforts should now be geared towards establishing treasury bond auctions to fully bond finance the deficit at market-determined interest rates. Expanding the retail sales of treasury bonds would be also useful, by allowing private banks to sell treasury bonds to their retail customers and by lifting restrictions on state banks' holdings of treasury securities.

"The discussion of the 2012/13 budget in the new parliament provides a historic opportunity to redefine national spending priorities and bring fiscal transparency. We welcome the authorities' plans to reorient spending to health and education, while targeting a moderate fiscal deficit, which we project to be about 4.6 percent of GDP, about 1 percent lower than the last year's deficit. A prudent fiscal policy is essential to maintain macroeconomic stability, especially during the exchange rate unification process.

"The exchange rate unification is expected to improve fiscal revenues. However, a market-determined exchange rate will also transparently reveal the losses of state economic enterprises (SEEs), especially those that rely on imported goods. Overall, the fiscal balance is expected to improve in the medium term, but mainly due to new gas exports from Shwe and Zawtika projects once they come on line. These additional revenues should be used to build human capital and infrastructure. These are key priorities to alleviate poverty and reduce bottlenecks to industrialization.

"The sizable development needs of Myanmar would require additional fiscal revenues, primarily from non-resource based sources, to safeguard fiscal sustainability and prevent boom-and-bust cycles associated with fluctuations in commodity prices. There is room to increase revenues by improved tax policies that should emphasize direct taxation over indirect taxes to protect the poor. In this regard, recent efforts to simplify the structure of several taxes are welcome and should go further, while reforms to tax administration remain essential to broaden tax bases and reduce tax avoidance.

"The adoption of a market-determined exchange rate in SEEs' operations would allow better assessment of their performance, and provide an opportunity to accelerate SEE reforms. These efforts should focus on containing their losses by gradually reducing regressive subsidies, which benefit higher income groups, to protect the most vulnerable poor. Further privatization and allowing SEEs to operate on a commercial basis are also needed to foster private sector-led growth.

"Modernization of the financial system should be expedited to facilitate broad-based growth. Improvements to financial intermediation should begin by phasing out the deposit-to-capital ratio and expanding the list of collateral, including to all crops. Expansion of bank networks, especially in rural areas, is essential to increase access to finance. Nurturing a stronger commercial banking culture requires price competition. Interest rate liberalization started with some freedom in setting deposit rates, and should be extended to loan products. A level playing field between state and private banks, including in the areas of regulation and supervision, is critical to promote competition. The move towards a market-determined exchange rate calls for enhanced regulation and supervision of banks. Allowing joint ventures with foreign banks would expedite the transfer technology and prepare the sector for ASEAN financial integration in 2015.

"The agriculture sector needs more credit to increase productivity and improve rural livelihoods. Besides increasing lending facilities of Myanma Agriculture Development Bank and micro finance, private banks should also be encouraged to lend to agriculture. The planned land reform provides a unique opportunity, and should ensure that land titles of farmers can be used as collateral. However, credit alone will not suffice to increase rural growth, which is essential to alleviate poverty. Investment in rural infrastructure, including through community-driven development initiatives, and spending on health and education, are also essential.

"Recent steps to improve competition in key sectors, such as gasoline and palm oil imports, have been successful to reduce informal market activity and reduce prices. These positive examples can easily be multiplied by eliminating nontransparent licensing practices. Replicating the success of FDI in the energy sector in other sectors would contribute significantly to private sector development, help diversify the economy, and open up new export opportunities. Elimination of exchange restrictions on current international payments and transfers is essential to facilitate FDI. The planned development of special economic zones would address infrastructure bottlenecks and attract FDI. However, promoting private sector development would require stronger efforts to improve the business climate. Reducing the cost of doing business would aid the emergence of viable small and medium size enterprises.