Country Report

Myanmar (Burma)

Myanmar (Burma) at a glance: 2006-07

OVERVIEW

The State Peace and Development Council (SPDC, the ruling military junta) will push on with its "road map to democracy", but there is little likelihood that this will lead to meaningful political reform. The US continues to push for UN action against Myanmar, but the junta's ties with China are fairly strong, and the Association of South-East Asian Nations (ASEAN) is still committed to engaging with the SPDC. The leader of the opposition National League for Democracy (NLD), Aung San Suu Kyi, remains under house arrest, and her party continues to face restrictions on its activities. Army hardliners have consolidated control, and conflict with armed ethnic groups is likely to escalate. Economic policymaking will continue to be erratic. Although the energy sector will remain fairly buoyant, overall economic growth will be weak. High inflation and poor confidence will exert downward pressure on the kyat's free-market exchange rate. Rising exports of gas will help to keep the current account in surplus.

Key changes from last month

Political outlook

- In early June the junta announced that Aung San Suu Kyi's period of detention had been extended by 12 months. International pressure on the junta for political reform and for the NLD leader's release from house arrest will remain intense.

Economic policy outlook

- The government remains heavily dependent on funding by the Central Bank of Myanmar to finance its expenditure. By February 2006 the central bank's claims on the government had risen by 35% since end-2004.

Economic forecast

- The free-market kyat continues to regain some ground after reaching a historic low in late April. However, there is little prospect of the currency strengthening markedly in 2006-07.

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Outlook for 2006-07

Political outlook

Domestic politics

The State Peace and Development Council (SPDC, the ruling military junta) is not expected to make any meaningful progress with political reform in 2006-07. The junta agreed to the visit of the UN under-secretary general for political affairs, Ibrahim Gambari, in May and permitted him to visit Aung San Suu Kyi, the leader of the main opposition party, the National League for Democracy (NLD), who remains under house arrest. However, it is unlikely that Mr Gambari's visit signals that the junta is planning to change tack. Indeed, there had been some speculation that Aung San Suu Kyi would be freed from detention soon after Mr Gambari's visit, with Mr Gambari appealing for her release when meeting the SPDC's chairman, Senior General Than Shwe, but the junta has since extended her detention period by a further 12 months (from May).

The junta's decision to provide the UN official with access to the detained opposition leader was undoubtedly aimed at diffusing international pressure for political reform, particularly from the US and some UN Security Council members. However, by refusing to release Aung San Suu Kyi, the junta has failed to achieve this goal. During his briefing to the UN Security Council soon after his visit to Myanmar, Mr Gambari called for continued resolve to persuade the junta to release Aung San Suu Kyi, particularly as "lines of communication" had opened up. Although the council did not take any immediate action, the US proposed a draft resolution on Myanmar, which is thought to include calls for Aung San Suu Kyi's release and the establishment of an inclusive and democratic political process.

The junta will continue to proceed with its "road map to democracy", a process that lacks credibility primarily because it is not inclusive. However, progress will remain protracted. The National Convention (NC) has made some progress towards meeting its objective of drafting principles for a new constitution, one of the first steps on the road map. However, lengthy gaps between NC sessions, which contribute to the drawn-out nature of the reform process, have raised doubts about whether the junta is really intent on completing the process. Indeed, it appears that the junta would be content to plod on with the reform process for a number of years, using such time to consolidate its power, cracking down on opposition groups and bolstering its own political support block, the Union Solidarity Development Association (USDA). (The USDA now boasts some 22m members, although it is likely that many of these members were coerced into joining.) The junta has already declared most of the country's political parties to be illegal, and it may well seek to sideline the NLD still further before moving on to later stages of the road map, such as the holding of a general election. The junta has already said that the NLD was close to being outlawed, claiming that it had ties with terrorist groups.

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International relations

Assuming that little progress is made in terms of initiating genuine political reform, and that Aung San Suu Kyi remains in detention, the junta's ties with some of its fellow members of the Association of South-East Asian Nations (ASEAN) will be tense in 2006-07. Although the junta finally allowed the Malaysian foreign minister, Syed Hamid Albar, to visit in March as an ASEAN representative, the visit was not a great success. Mr Syed has since stated that the junta did not provide any credible evidence that its reform programme was on track. However, ASEAN remains committed to engaging with the SPDC, and Mr Syed has proposed a follow-up visit.

The US and the EU will continue to be vocal critics of the junta in 2006-07, with a range of sanctions and restrictions remaining in place. Indeed, in May the US president, George W Bush, called on the US Congress to renew economic sanctions against Myanmar, which include a ban on all imports from the country. However, as long as ties with China, India and Russia continue to improve, the junta will not be overly perturbed by the efforts of Western governments to effect political change in Myanmar. Indeed, although there appears to be growing concern about the situation in Myanmar among some members of the UN Security Council, China and Russia have yet to agree with the US that Myanmar poses a threat to international security.

Economic policy outlook

Policy trends

The quality of economic policymaking is poor and will remain so in 2006-07. The junta has displayed an inability to implement policies aimed at supporting sustainable growth and reducing poverty. Most recently, in March it decided to raise salaries for public-sector workers and military personnel by between 500% and 1,200%, seemingly to offset any discontent over the shifting of the government's administrative base from Yangon to Pyinmana. Although the pay increase has been welcomed by the previously vastly underpaid public-sector workers, the sheer size of it is just one example of the extreme policy measures the junta implements with apparently little consideration for potentially damaging side-effects. Other examples include the implementation of a ban on rice exports in 2004 in an effort to bring down food price inflation, and a surprise eightfold increase in retail fuel prices in late 2005 in an effort to ease the burden of its fuel subsidy programme. In 2006-07 there is little prospect of the junta changing its approach to policymaking, and most of its policy initiatives will continue to contribute to the overall sense of economic uncertainty that has damaged both consumer and business confidence.

Fiscal policy

The outlook for fiscal policy is dire, with the junta set to continue to borrow from the Central Bank of Myanmar to finance its rising budget deficits, particularly now that its salaries outlay has expanded sharply. Although there is a lack of up-to-date statistics on the government's fiscal position, it is unlikely to be healthy. Despite strong growth in tax revenue, which rose by 60% year on year in fiscal year 2004/05 (April-March), the government remains heavily dependent on central bank funding to finance its expenditure. By February 2006 the central bank's claims on the government had risen by 35% since

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end-2004, reflecting the fact that tax revenue is inadequate to cover public-sector expenditure. Some cuts have been made to health and education services, but in most areas—and particularly defence—state spending is thought to be high. Over the next few years the junta is unlikely to make the necessary cuts to either defence or non-essential spending, and the general government budget deficit is expected to rise steadily. The overall public-sector deficit will also remain high because of the loss-making operations of state-owned enterprises.

Monetary policy

In a surprise move in April the central bank and private commercial banks raised interest rates. The decision by the central bank to tighten monetary policy by raising its leading indicator rate by 2 percentage points to 12%, the first such move in around five years, coincided with the government's decision to raise public-sector salaries. In this sense, the move was probably aimed at containing inflationary pressures. However, it is a case of too little, too late, with inflation already surging ahead. The central bank generally appears to be reluctant to tighten monetary policy aggressively primarily because it remains under the full authority of the state and is therefore keen to avoid increasing the government's debt-servicing burden. The central bank has been printing money and providing the government with full access to credit to finance the state budget deficit.

Economic forecast

International assumptions

International assumptions summary
(% unless otherwise indicated)

	2004	2005	2006	2007
Real GDP growth				
World	5.6	4.9	4.9	4.3
OECD	3.2	2.6	2.7	2.3
China	10.1	9.9	9.5	8.1
EU25	2.4	1.7	2.3	2.1
Exchange rates				
¥:US$	108.1	110.1	109.2	98.5
US$:€	1.244	1.245	1.296	1.390
SDR:US$	0.675	0.677	0.665	0.635
Financial indicators				
€ 3-month interbank rate	2.13	2.15	2.90	3.69
US$ 3-month Libor	1.62	3.56	5.31	4.95
Commodity prices				
Oil (Brent; US$/b)	38.5	54.7	70.0	66.0
Gold (US$/troy oz)	409.5	445.0	530.8	500.0
Food, feedstuffs & beverages (% change in US$ terms)	8.5	-0.5	4.0	-4.2
Industrial raw materials (% change in US$ terms)	21.0	10.5	20.0	-17.9

Note. Regional GDP growth rates weighted using purchasing power parity exchange rates.

The pace of global economic expansion is likely to decelerate in 2006-07, but the impact on Myanmar's economy will be minimal. Solid growth in Myanmar's main export markets in Asia—particularly China, Thailand and India—will ensure that the country's exports remain buoyant. The price of crude

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oil (dated Brent Blend) is forecast to average US$70/barrel in 2006 and US$66/b in 2007. As Myanmar is heavily dependent on imports of refined petroleum products for transport and electricity generation, the rise in oil prices in 2006 will continue to add to inflationary pressures. Myanmar's rice exporters will benefit from rising global rice prices in 2007, offsetting a dip in prices in 2006. However, global copper prices will fall in 2007, hitting the value of Myanmar's exports of metals, which surged in 2004 in line with strong world prices and higher output.

Economic growth

There are increasing signs of a pick-up in economic activity, but there is still little evidence to support the junta's claims that the economy is growing at double-digit rates. Exports surged in early 2005 and output by state-owned enterprises appeared fairly buoyant, with the main area of growth being the oil and gas sector. This is also the only economic sector that has been attracting major foreign investor interest. The other parts of the economy will remain weak in 2006-07. Agriculture continues to suffer from poor productivity, with output remaining below potential. Manufacturing remains constrained by the inadequate quantity and quality of inputs, primarily owing to problems in terms of access to imports. Other problems include power shortages, a lack of capacity to keep up with cheap imports from Thailand and China, and limited demand for manufacturing exports, such as garments, partly because of the US ban on imports from Myanmar. Weak GDP growth is also reflected in the poor prospects for consumption and investment. Consumer spending is constrained by low average incomes and a lack of confidence owing to accelerating inflation, the weak free-market exchange rate and uncertain employment prospects.

Inflation

Consumer price inflation continues to rise sharply, with prices for important commodities soaring in the wake of the government's decision in March to raise public-sector salaries. Rice prices have soared and fuel prices also remain at historical highs following the junta's decision in October last year to increase retail fuel prices eightfold. The junta also raised electricity prices tenfold in May. The Economist Intelligence Unit forecasts that inflation will reach an annual average of nearly 50% this year, and 30% in 2007, up from an estimate of around 20% in 2005. (Our inflation forecasts are based on official historical data, which probably do not reflect the full extent of rises in consumer prices.) It is, however, probable that the junta will attempt to contain inflation by implementing ad hoc, ill-devised remedies. In 2004 the junta imposed a ban on rice exports, a move that drove inflation down into single-digits, but created severe hardship for rice farmers and further undermined confidence in the economy.

Exchange rates

After remaining fairly stable during the first few months of 2006, the free-market kyat plummeted from around Kt1,150:US$1 in March to a record low of around Kt1,450:US$1 in late April in the aftermath of the government's decision to increase salaries for public-sector workers, a move that has fuelled fears of accelerating inflation. Although the kyat has regained some ground, rising to around Kt1,270:US$1 in early June, there is little prospect of the kyat strengthening markedly in 2006-07, owing to the general political and economic

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uncertainty and the potential for further ill-planned ad hoc policy changes. There is also no prospect of the junta realigning its official exchange rate with the free-market rate. The overvalued official rate, which is linked to the IMF's special drawing rights, will remain stable at around Kt6:US$1 in 2006-07.

External sector

The current account is forecast to remain in surplus in 2006-07, underpinned by a wide merchandise trade surplus. Although there are a number of factors limiting export growth, notably the US ban on imports from Myanmar and international consumer boycotts of Burmese goods, Myanmar has succeeded in boosting exports of natural gas to Thailand, in addition to expanding its markets in China and India for its mining, energy, and agricultural and forestry products. Exports to these markets will rise further in 2006-07. The import bill will also expand in 2006-07, after falling in 2005. If planned oil and gas projects develop rapidly, there could be a surge in imported machinery and materials, but growth in imports of other goods, particularly consumer goods, will still be restrained by the shortage of foreign exchange and high import taxes.

The merchandise trade surplus in 2006-07 will be partly offset by the large deficit on the combined services and income accounts. The income deficit will expand in line with the expected repatriation of profits by foreign investors in the mining and energy sectors, but official transfers (remittances by overseas migrant workers and limited aid inflows) will offset the deficit on the services account. Although tourist arrivals are picking up, there is unlikely to be a major expansion in the tourism industry, owing to the poor political climate.

Forecast summary

(% unless otherwise indicated)

	2004[a]	2005[a]	2006[b]	2007[b]
Real GDP growth[c]	-2.7	3.7	1.8	2.4
Gross fixed investment growth[c]	0.5	2.5	4.0	6.0
Gross agricultural production growth[c]	-3.5	2.0	1.2	1.5
Consumer price inflation (av)	4.5[d]	20.3	50.5	30.1
Consumer price inflation (year-end)	3.8[d]	49.7	30.4	29.3
Short-term interbank rate	15.0[d]	15.0[d]	17.0	17.0
Government budget balance (% of GDP)[c]	-2.2	-3.0	-4.3	-4.3
Exports of goods fob (US$ bn)	2.9[d]	3.3	3.8	3.7
Imports of goods fob (US$ bn)	2.0[d]	1.8	1.9	2.2
Current-account balance (US$ bn)	0.1[d]	0.7	0.8	0.4
Current-account balance (% of GDP)[e]	1.3	8.0	7.0	3.1
External debt (year-end; US$ bn)	7.5	7.0	7.6	7.8
Exchange rate Kt:US$ (av)[f]	910.0	1,095.0	1,315.0	1,450.0
Exchange rate Kt:¥100 (av)[f]	841.6	994.8	1,203.9	1,472.1
Exchange rate Kt:€ (av)[f]	1,131.8	1,363.0	1,703.9	2,015.5
Exchange rate Kt:Bt (av)[f]	22.6	27.2	34.0	38.4

[a] Economist Intelligence Unit estimates. [b] Economist Intelligence Unit forecasts. [c] Fiscal year (beginning April 1st of year shown). [d] Actual. [e] Fiscal year (beginning April 1st of year shown); at free-market exchange rate (which understates size of GDP). [f] At free-market exchange rates.

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