# 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 engagement 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 in 2006-07. 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

- It is possible that ASEAN will now defer to the UN in its efforts to promote genuine political reform in Myanmar. This approach will suit some ASEAN members, most notably Thailand, whose current caretaker government has been keen to maintain fairly close commercial ties with the junta.

#### Economic policy outlook

- The SPDC has moved ahead with plans to sell stakes in 11 state-owned enterprises. However, over the next few years the junta is unlikely to make the cuts in either defence or non-essential spending that would be needed to rein in its budget deficits.

#### Economic forecast

- Export revenue expanded by nearly 60% in 2005, whereas imports contracted by around 12%. Based on this merchandise trade data, the Economist Intelligence Unit estimates the current-account surplus in 2005 to have been equivalent to 12.1% of GDP.

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# Outlook for 2006-07

## Political outlook

**Domestic politics**

The State Peace and Development Council (SPDC, the ruling military junta) will continue to maintain a firm grip on power in 2006-07. Although it has pledged to push ahead with a "road map to democracy", this process lacks credibility as it is not inclusive and will ultimately leave power in the hands of the military. In recent months the junta has displayed an apparent willingness to re-engage with the UN. It surprisingly 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). The junta has also indicated recently that Mr Gambari would be permitted a second visit (although no time-frame was announced). However, despite these moves, the junta is not planning to change tack. Indeed, soon after Mr Gambari's initial visit, the junta extended Aung San Su Kyi's detention period by a further 12 months (from May 2006). The NLD vice chairman, Tin Oo, also remains under house-arrest.

The junta is therefore probably hoping that its words, even if they are not backed up by immediate action, will have an impact in terms of diffusing international pressure for political reform, particularly from the US and some other UN Security Council members. However, its refusal to release Aung San Suu Kyi means that the junta will not have much success in making a convincing case that it is intent on initiating genuine reform. 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. 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.

Despite this external pressure for an inclusive reform process, the junta will push ahead with its own reform road map. In late July the SPDC's secretary-1 and chairman of the National Convention (NC) Convening Commission, Lieutenant General Thein Sein, claimed that the convention had completed 75% of its work on 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 slow nature of the reform programme, 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 this time to consolidate its power, cracking down on opposition groups and bolstering its own political support block, the Union Solidarity Development Association. The junta may 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 NLD, which is boycotting the NC, is hoping to set up a dialogue process with the SPDC, but it is unlikely to have any success in this respect.

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**International relations**

Despite rising tension between the junta and the governments of some Association of South-East Asian Nations (ASEAN) countries, the regional group will continue to eschew any moves to intervene directly in Myanmar's domestic affairs. In the final joint communiqué following the ASEAN ministerial meeting in late July in Malaysia, ASEAN's foreign ministers did little more than note their concerns over the slow pace of reform and the continued detention of Aung San Suu Kyi. It is possible that ASEAN will now defer to the UN in its efforts to promote genuine political reform in the country. This approach will suit some ASEAN members, most notably Thailand, whose current caretaker government under Thaksin Shinawatra has been keen to maintain fairly close commercial ties with the junta. Thaksin made a surprise trip to Myanmar in early August, during which he is thought to have pushed for closer economic co-operation between the two countries, particularly on energy.

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. In early August the US renewed economic sanctions against Myanmar, which include a ban on all imports from the country. The US administration is set to continue its push for a UN Security Council resolution on Myanmar. However, it is unlikely to succeed in the near future, given that China, Russia and Japan hold the view that Myanmar does not pose a threat to international security.

## Economic policy outlook

**Policy trends**

There will not be any improvement in the junta's capacity to manage the economy in the foreseeable future. A coherent policy to stabilise the economy is unlikely to be implemented, and the junta's penchant for extreme policy initiatives will remain a major factor undermining consumer and business confidence. Although a recent pay increase of between 500% and 1,200% for public-sector workers and military personnel has been welcomed by this previously vastly underpaid body of employees, the junta cannot afford to meet this expansion in its salary bill without borrowing more from the Central Bank of Myanmar. Moreover, the junta has shown little concern for the likely upward pressure that the wage increases will have on the general price level. Although the local authorities in the capital, Yangon, have put in place controls on the sale of rice in order to prevent prices from rising further, this move has created anxiety among local rice traders, some of whom have reportedly been arrested in recent weeks. A ban on rice exports in 2004 helped to reduce local rice prices, but caused considerable hardship for rice farmers and traders.

**Fiscal policy**

The outlook for fiscal policy is dire, with the junta set to continue to borrow from the central bank to finance its high public-sector fiscal deficits, particularly now that the salary outlay for the public sector 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, as the government remains heavily dependent on central bank funding to finance its expenditure—in March 2006 the central bank's claims on the government had risen by 28% year on year. The SPDC has moved

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ahead with plans to sell stakes in 11 state-owned enterprises (SOEs), and tax revenue continues to rise at a fairly rapid pace in nominal terms. However, over the next few years the junta is unlikely to make the cuts to either defence or non-essential spending that would be needed to rein in its budget deficits.

**Monetary policy**

The central bank has yet follow up on its surprise move in April (along with private commercial banks) to raise interest rates, despite the acceleration in inflation. The central bank's decision to raise its leading indicator rate by 2 percentage points to 12% in April, 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. Although current trends in inflation would suggest the need for further monetary policy tightening, the central bank remains reluctant to tighten monetary policy aggressively because it operates under the full authority of the state and is therefore keen to avoid increasing the government's debt-servicing burden.

## Economic forecast

**International assumptions**

**International assumptions summary**
(% unless otherwise indicated)

| | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|
| **Real GDP growth** | | | | |
| World | 5.5 | 4.9 | 5.3 | 4.7 |
| OECD | 3.1 | 2.6 | 3.0 | 2.2 |
| China | 10.1 | 9.9 | 10.7 | 9.9 |
| EU25 | 2.4 | 1.7 | 2.6 | 2.1 |
| **Exchange rates** | | | | |
| ¥:US$ | 108.1 | 110.1 | 114.1 | 100.3 |
| US$:€ | 1.244 | 1.245 | 1.255 | 1.365 |
| SDR:US$ | 0.675 | 0.677 | 0.678 | 0.641 |
| **Financial indicators** | | | | |
| € 3-month interbank rate | 2.13 | 2.15 | 3.06 | 3.86 |
| US$ 3-month Libor | 1.62 | 3.56 | 5.28 | 5.33 |
| **Commodity prices** | | | | |
| Oil (Brent; US$/b) | 38.5 | 54.7 | 71.1 | 70.0 |
| Gold (US$/troy oz) | 409.5 | 445.0 | 639.5 | 700.0 |
| Food, feedstuffs & beverages (% change in US$ terms) | 8.5 | -0.5 | 8.9 | -4.5 |
| Industrial raw materials (% change in US$ terms) | 21.0 | 10.3 | 43.6 | -3.2 |

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

The Economist Intelligence Unit has revised up its forecast for real GDP growth in China this year to 10.7% (previously 9.5%), owing to the fast pace of growth posted in the second quarter despite official efforts to tackle overinvestment in certain sectors. In line with the revisions to growth in China, coupled with a strong performance generally across the globe, we forecast that world GDP growth will pick up pace in 2006. A significant slowdown in the OECD economies will occur in 2007, largely a result of weakening performance in the US, but solid growth in Myanmar's main export markets in Asia—particularly China, Thailand and India—will ensure that the country's exports remain

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buoyant. We have revised upwards our forecast for the price of crude oil (dated Brent Blend), to US$71.1/barrel in 2006 (previously US$69.7/b) and US$70/b in 2007 (previously US$66/b). As Myanmar is heavily dependent on imports of refined petroleum products for transport and electricity generation, this means that inflationary pressures will remain high in 2006-07.

**Economic growth**

Economic activity appears to have picked up in 2005, with strong growth in exports and output by SOEs. However, there is still little evidence to support the junta's claims that the economy is growing at double-digit annual rates. The oil and gas industry is the main area of growth, and it is the only economic sector that has been attracting significant foreign investor interest. However, agriculture was boosted by a slight expansion in rice production in 2005, as Myanmar escaped the drought-related problems suffered by neighbouring Thailand. There is little prospect of major improvement in the overall economy in the next few years. There will be continued growth in the oil and gas sector, in terms of both production and exploration activity, but the rest of the economy will remain weak. 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 and the weak free-market exchange rate.

**Inflation**

Anecdotal evidence suggests that consumer price inflation continues to rise sharply. Prices for important commodities soared in the wake of the government's decision in March to raise public-sector salaries, and rice and fuel prices remain high. However, official data are unlikely to reveal the full extent of inflation. In January-November 2005 year-on-year inflation averaged 8.9%, according to official statistics, despite the fact that retail fuel prices rose eightfold in October. Based on the official data series, we forecast that annual inflation will average around 30% in 2006-07, but the real level of inflation could be closer to 50% this year. It is probable that the junta will attempt to contain inflation by implementing ad hoc, and potentially ill-devised, remedies, but these will be of a short-term nature and will fail to resolve the structural weaknesses 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 fuelled fears of accelerating inflation. Although the kyat has regained some ground and remained fairly stable at around Kt1,350:US$1 in July and August, there is little prospect that it will strengthen markedly in 2006-07. Despite the surplus on the current account, confidence in the kyat is weighed down by the general political and economic uncertainty in the country and the potential for further

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

**External sector**

Export revenue expanded by nearly 60% year on year in 2005, driven by a surge in gas exports, whereas imports contracted by around 12% during the same period. Based on this merchandise trade data, we estimate that the current-account surplus in 2005 stood at the equivalent of 12.1% of GDP. Despite doubts over the reliability of data released by the Central Statistical Organisation, export revenue is set to remain strong in 2006-07. 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's exports of natural gas to Thailand continue to increase, and demand from China and India for Myanmar's mining, energy, and agricultural and forestry products will remain buoyant. 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 current account is forecast to remain in surplus in 2006-07, with the wide merchandise trade surplus being only partly offset by the large deficit on the combined services and income accounts. The income deficit is expanding in line with the 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.

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**Forecast summary**

(% unless otherwise indicated)

| | 2004[a] | 2005[a] | 2006[b] | 2007[b] |
|---|---|---|---|---|
| Real GDP growth[c] | 0.2 | 5.2 | 2.0 | 2.5 |
| Gross fixed investment growth[c] | 0.5 | 0.2 | 0.2 | 6.0 |
| Gross agricultural production growth[c] | -3.5 | 3.5 | 1.2 | 1.4 |
| Consumer price inflation (av) | 4.5[d] | 9.3 | 30.8 | 29.7 |
| Consumer price inflation (year-end) | 3.8[d] | 13.9 | 38.3 | 29.3 |
| Short-term interbank rate | 15.0[d] | 15.0[d] | 17.0 | 17.0 |
| Government budget balance (% of GDP)[c] | -1.9 | -3.0 | -4.8 | -4.7 |
| Exports of goods fob (US$ bn) | 2.9[d] | 4.6 | 5.2 | 5.4 |
| Imports of goods fob (US$ bn) | 2.0[d] | 1.7 | 2.1 | 2.4 |
| Current-account balance (US$ bn) | 0.1[d] | 1.1 | 1.1 | 1.0 |
| Current-account balance (% of GDP)[e] | 1.1[d] | 12.1 | 11.4 | 8.3 |
| External debt (year-end; US$ bn) | 7.2[d] | 6.8 | 7.2 | 7.7 |
| 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 | 1,152.8 | 1,446.4 |
| Exchange rate Kt:€ (av)[f] | 1,131.8 | 1,363.0 | 1,650.6 | 1,979.3 |
| Exchange rate Kt:Bt (av)[f] | 22.6 | 27.2 | 34.2 | 38.6 |

[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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