# Myanmar—Assessment Letter for the Asian Development Bank

June 10, 2020

*This note provides the IMF staff's current assessment of Myanmar's macroeconomic conditions, prospects, and policies. The assessment has been requested in relation to a proposed budget support loan to Myanmar to be considered by the Asian Development Bank in July 2020.*

## I. Recent Developments, Outlook, and Risks

1. **The COVID-19 outbreak has deeply affected the Myanmar economy**. From the onset of the outbreak, tourist arrivals have sharply declined, and supply chains have been disrupted in the labor-intensive garment sector (about one-fourth of exports), cross-border trade and agriculture (half of employment). This has resulted in widespread layoffs and factory closures. Containment measures have further curtailed domestic demand, while magnifying preexisting weaknesses in the real estate and construction sectors. Inflation fell to 6.6 percent in March, while the kyat has appreciated, likely reflecting strong export performance and import compression through March. Reserves edged up to US$6.0 billion as of April 2020 as a result of the temporary improvement in the trade balance.

2. **The economy is expected to weaken substantially, and the external position is projected to deteriorate without additional external financing**. Assuming a localized outbreak that is largely contained by Q3 FY2019/20, output growth is still expected to slow down to 1.4 percent due, in large part, to the reduction in domestic production and a sharp contraction in global demand. Growth is projected to gradually recover, reaching 6.0 percent by end-FY2020/21. The current account deficit is expected to widen to 4.3 percent of GDP in FY2019/20 reflecting lower garment exports and gas prices, higher imports, and weaker tourism and remittances. On the financing side, FDI will slow as projects are delayed, though also limiting intermediate imports, potentially lowering reserve coverage below current levels. Additional external financing could bring reserves coverage to a more adequate level, assessed to be about 5 months of prospective imports which will be critical to maintaining stability, given the uncertainty around the pandemic and external and financial sector vulnerabilities.

3. **The required fiscal stimulus to contain the impact of the pandemic will widen the fiscal deficit, necessitating additional financing**. Announced measures in response to the shock are expected to raise expenditures by around ¾ percent of GDP for the remainder of FY2019/20, and 1−2 percent of GDP in FY2020/21, although spending needs could increase significantly if the outbreak worsens. On the revenue side, weaker economic activity, targeted tax relief measures and falling gas prices will lower tax buoyancy and reduce revenues by nearly 1½ percent of GDP relative to FY2018/19. This will widen the fiscal deficit close to 6 percent of GDP in FY2019/20 and FY2020/21. The authorities may need to identify additional sources to finance the deficit and face increasing short- and medium-term debt levels.

4. **The economic effect of the outbreak is expected to weigh on banks' asset quality and stall progress on recapitalization**. Prior to the outbreak, banks had been making progress, though uneven, in addressing legacy loans and moving toward prudent loan classification, provisioning and

capitalization. The Central Bank of Myanmar (CBM) has extended the phase-in period for compliance with prudential regulations by three years to support bank credit to curtail the impact of COVID-19 The deterioration in the debt repayment capacity of households and corporates as the pandemic works its way through the economy coupled with extended regulatory forbearance, could further raise nonperforming loans (NPLs) and recapitalization costs. Credit growth, though slowing, remained robust at 14.2 percent y/y as of December 2019, and deposits have held up thus far, but increased cash demand could increase pressure on bank liquidity and market interest rates.

5. **Risks are tilted heavily to the downside**. Risk of external and overall debt distress is assessed as low; however, rapidly evolving circumstances, reflecting lower growth prospects and large financing needs due to COVID-19, have made prominent several vulnerabilities. The debt outlook is most vulnerable to slowdown in exports and natural disasters. Additionally, a more prolonged global outbreak could interact with banking sector fragilities, leading to higher debt levels through contingent liability materialization in the form of recapitalizations. On the external front, external demand could remain subdued for longer than anticipated with extended supply chain disruptions with weak FDI and tighter and more volatile financial conditions.

## II. POLICY RESPONSES

6. The authorities have responded with a COVID-19 Economic Relief Plan (CERP) which comprises several emergency fiscal, financial and monetary measures, including higher health spending.[1] The plan is being costed and sequenced and is expected to evolve.

7. **Fiscal Policy**. As part of the CERP and Budget directives, several announced policies are being implemented, while others are still being designed. They include tax relief and deferments, and duty suspensions on medical goods, partial exemption of household electricity tariffs, and the creation of a fund (MMK 100−500 billion) to provide soft loans to the private sector for working capital. The authorities are reallocating up to 10 percent of budget expenditures to COVID-19 related spending with line ministries and toward the COVID-19 Contingency Fund in FY2019/20, as well as expanding quarantine facilities, importing COVID-related medical products and upgrading existing health facilities. The authorities are also prioritizing ready, high impact public investments, and streamlining approvals for private investments and PPPs. They are also increasing transfers to benefit lower income groups, to all regions of the country and establishing a credit guarantee scheme for SMEs and high growth sectors conditional on maintaining employment.

8. In the near-term, fiscal spending should focus on containing the spread of the virus, boosting healthcare, and providing transfers. Cash and in-kind transfer programs for the most vulnerable households and at-risk populations covering all regions of the country through mobile payments accounts, based on clear eligibility criteria (first phase based on the food rationing scheme database) should be established. More generally, key budgetary actions should be taken, and fiscal-structural reforms accelerated to improve budget execution and reporting. These include enacting a FY2020/21 budget with greater appropriations to social sectors and COVID-19 relief, improving cash

[1] Please refer to the IMF's Policy Tracker which has detailed description of the authorities' policy measures and responses to COVID-19.

management and coordination between Treasury and CBM, strengthening fiscal and debt reporting (especially COVID-19-related spending) and procurement transparency, conducting a targeted audit of COVID-19 related spending by OAGM and publishing it relatively quickly, and closely monitoring loans and guarantees to manage fiscal risks. Implementing the recently enacted Tax Administration law and submitting the draft Income Tax Law to Parliament in FY2020/21 to be effective in FY2021/22 should enhance revenue mobilization. Broad based reforms to strengthen governance and combat corruption will be important to leverage development partner support.

9. **Monetary and Exchange Rate Policy**. CBM responded quickly to the COVID-19 shock, appropriately easing the monetary stance, by cutting the bank rate by a cumulative 300 bps, moving downward the deposit rate floor and lending rate caps proportionally. The reserve requirement ratio has been temporarily lowered for two years from 5 to 3.5 percent, deposit auctions are paused, and the weight of long-term government securities in banks' liquidity ratio calculations to facilitate domestic debt issuance and liquidity has been raised. The current policy rate is sufficiently accommodative and further interest rate reductions should be assessed against macroeconomic developments and financial stability considerations. To manage liquidity conditions, CBM should now clarify the operational framework for the emergency liquidity assistance and credit auction facilities and strengthen liquidity management. The recently introduced FX intervention rules should continue to help limit excessive exchange rate volatility, while building gross international reserves over the medium term.

10. **Financial Sector Policies**. Various policies to support bank lending have been announced. Banks will be allowed to restructure or reschedule loans and assets impaired by the consequences of COVID-19. The CBM will ask the banks to separate these COVID-19 impaired loans from other loans in order to receive different treatment and close monitoring. While banks have been given an additional three years to become fully compliant with prudential regulations, the CBM will closely monitor and ensure progressive steps towards full compliance. The CERP intends to partially guarantee new loans to SMEs and severely impacted sectors, and these will be transparently provided through a new government guarantee agency with the support of the Asian Development Bank (ADB). Any decision and mechanisms to absorb NPLs and/or recapitalize banks will be undertaken in a manner consistent with reducing fiscal costs and in consultation with the World Bank and the Fund. The authorities should closely monitor banks' liquidity situation and advance contingency arrangements to address potential banking sector stress. This will help support liquidity and keep the payment system stable, which is critical to ensure financial stability and support bank intermediation.

## III. FUND RELATIONS

11. Myanmar is on a standard 12-month Article IV consultation cycle. The 2019 Article IV consultation was concluded by the IMF's Executive Board on February 28, 2020. The authorities have requested IMF assistance on account of present and urgent balance of payments needs due to the impact of COVID-19 under the Rapid Credit Facility and Rapid Financing Instrument. The authorities also intend to avail of the Debt Service Suspension Initiative supported by the G-20 and Paris Club.

## Table 1. Myanmar: Selected Economic Indicators 1/

| | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 |
|---|---|---|---|---|---|
| | Est. | Est. | Proj. | Proj. | Proj. |
| **Output and prices** | | | | | |
| Real GDP [2] | 5.8 | 6.4 | 6.5 | 1.4 | 7.3 |
| CPI (end-period; base year from 2014/15=2012 ) | 3.4 | 8.6 | 9.5 | 4.4 | 7.2 |
| CPI (period average; base year from 2014/15=2012) | 4.6 | 5.9 | 8.6 | 5.9 | 6.3 |
| **Consolidated public sector [3]** | | | (In percent of GDP) | | |
| Total revenue | 17.9 | 17.6 | 16.0 | 14.8 | 14.6 |
| Tax revenue | 7.2 | 7.1 | 6.6 | 6.0 | 6.2 |
| Social contributions | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Grants | 0.4 | 0.3 | 0.4 | 0.4 | 0.4 |
| Other revenue | 10.3 | 10.1 | 8.9 | 8.3 | 7.9 |
| Total expenditure | 20.8 | 21.0 | 20.0 | 20.6 | 20.4 |
| Expense | 14.3 | 13.9 | 13.4 | 14.3 | 14.0 |
| Net acquisition of nonfinancial assets | 6.4 | 7.1 | 6.6 | 6.3 | 6.3 |
| Gross operating balance | 3.6 | 3.7 | 2.6 | 0.6 | 0.6 |
| Net lending (+)/borrowing (-) | -2.9 | -3.4 | -4.0 | -5.8 | -5.8 |
| Total public and publicly guaranteed (PPG) debt | 38.4 | 40.3 | 39.5 | 43.6 | 45.2 |
| **Money and credit** | | | (Percent change) | | |
| Reserve money | 8.0 | 4.6 | 11.3 | 13.5 | 13.6 |
| Broad money | 21.4 | 18.6 | 15.4 | 13.4 | 15.2 |
| Domestic credit | 22.3 | 21.4 | 17.4 | 14.8 | 16.2 |
| Private sector | 27.4 | 21.2 | 16.4 | 14.1 | 13.8 |
| **Balance of payments [4]** | | | (In percent of GDP) | | |
| Current account balance | -6.8 | -4.7 | -2.6 | -4.3 | -4.2 |
| Trade balance | -7.5 | -5.2 | -3.2 | -3.5 | -4.0 |
| Financial account | -8.4 | -5.9 | -4.1 | -5.0 | -4.9 |
| Foreign direct investment, net [5] | -5.8 | -4.8 | -3.1 | -2.7 | -2.7 |
| Overall balance | 0.5 | 0.5 | 0.3 | 0.7 | 0.8 |
| CBM reserves (gross) | | | | | |
| In millions of U.S. dollars | 5,142 | 5,462 | 5,667 | 6,923 | 7,718 |
| In months of prospective GNFS imports | 3.2 | 3.8 | 4.6 | 5.0 | 5.0 |
| As a share of broad money | 15.2 | 15.6 | 13.8 | 15.4 | 15.7 |
| Total PPG external debt (billions of U.S. dollars) | 9.2 | 10.9 | 10.1 | 11.9 | 13.4 |
| Total PPG external debt (percent of GDP) | 15.0 | 16.3 | 14.8 | 16.9 | 17.4 |
| Exchange rates (kyat/$, end of period) | | | | | |
| Official exchange rate | 1,357.7 | 1,551.5 | 1,533.0 | … | … |
| Parallel rate | 1,350.9 | 1,563.6 | 1,533.1 | … | … |
| **Memorandum items:** | | | | | |
| GDP (billions of kyats) | 82,700 | 92,789 | 105,012 | 113,055 | 129,865 |
| GDP (billions of US$) | 61.5 | 67.1 | 68.5 | 70.2 | 77.5 |
| GDP per capita (US$) | 1,267 | 1,279 | 1,242 | 1,321 | 1,440 |

Sources: Data provided by the Myanmar authorities; and IMF staff estimates and projections.

1/ From 2018/19 onwards the fiscal year was changed to an October 1 to September 30 format. This table uses the new fiscal year definition for both historical data and projections.

2/ Real GDP series is rebased to 2015/16 prices by the authorities.

3/ Union and state/region governments and state economic enterprises. Revised to reflect Government Finance Statistics Manual 2014

4/ The balance of payments data has been revised according to the BPM6 methodology.

5/ FDI from 2017/18 onwards reflects improved forex transaction data collection, which has caused a break in the data series.