CascadeAsia Advisors

2013 Country Outlook: Myanmar

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- **GDP growth to reach 6.5%; tourism, trade, FDI to increase sharply**
- **Myanmar's financial system ready to enter 21st century**
- **Independent monetary policy to be implemented in 2013**
- **Inflation to remain flat at 5.3%**
- **Political stability likely, though policy activities to continue**
- **Private equity interest growing; stock exchange to open in 2015**
- **Violence, minority reconciliation, corruption threaten reform**
- **Quest for economic growth, individual actors, independent media, international community encourage continued reform**

Economic Outlook

GDP growth to reach 6.5%; tourism, trade, FDI to increase sharply

We expect GDP growth to reach 6.5% in 2013, with significant investment in tourism, construction, oil, and natural gas fueling expansion. The potential for 8-10% growth exists but is likely several years away even if best-case reform and development scenarios play out.

2013 will be a good year for trade, with imports expected to rise 16% y/y and exports increasing 13%. The easing of import licensing and a more independent monetary policy could widen the current account deficit to 4% of GDP this year. The *kyat* depreciated nearly 10% following initiation of a managed float in April, spurring export demand. It ended the year off 5%.

FDI will increase significantly, driven largely by tourism and the extractive sector. The China-Myanmar oil pipeline, set to begin operations in the second half of 2013, will generate transit fees of up to $40 million per year. Despite the government's invitation of foreign energy companies to bid for exploration rights of 18 onshore oil and gas blocks in January, Western oil majors will likely wait until more lucrative offshore blocks are on offer. Myanmar is set to apply for the Extractive Industries Transparency Initiative (EITI) candidate status by December 31st. Major entrances by Western interests, if any, are not expected until late 2013 or 2014.

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The number of tourists visiting Myanmar could reach 1.4 million in 2013, a 30-35% increase over 2012. Investment in tourism and hospitality, which now accounts for a mere 2.6% of total FDI, will see a short-term surge. The need for adequate infrastructure in tourism will trigger an increase of FDI into construction.

We anticipate strong growth in manufacturing investment, particularly in the garment sector, after the U.S. government relaxed the ban on imports from Myanmar last fall. Investment in telecommunications, which now constitutes less than 1% of total FDI, is also set to rise.

Myanmar's financial system ready to enter 21st century

The domestic banking system is gradually opening up to international integration and competition. Visa, MasterCard, and JCB anticipate having networks in place to accept credit card transactions in 2013, though they will not begin issuing cards to Myanmar consumers until 2014. While several major international banks will open branches in Myanmar this year, it remains unlikely that they will obtain full licenses before 2015.

Monetary Policy Outlook

Independent monetary policy to be implemented in 2013

After initiating a managed float of the *kyat* last year, the Central Bank of Myanmar (CBM) plans to implement an independent monetary policy by mid-2013. Draft legislation, issued in November, left too much control in the hands of the government. Much wrangling is likely before the legislation is finalized. Still, by the end of 2013, the CBM will likely be setting interest rates, managing reserves, and conducting open market operations independent of the Ministry of Finance and Revenue. Ultimately, this should lead to improved price and financial stability.

Inflation to remain flat at 5.3%

While Myanmar has recently endured periods of high inflation, with CPI increases topping 20% in five of the past ten years, inflation has settled into single digits since 2009. We anticipate inflation to remain flat at 5.3% in 2013, a slight downtick from last year. Stability is dependent upon successful implementation of an independent monetary policy, however, as the CBM currently employs few tools to ensure that inflation remains in check.

Political Outlook

Political stability likely, though policy activities to continue

Myanmar has seen significant political change in each of the past two years, with the transfer of power from military to civilian leadership in 2011 and parliamentary elections in 2012. 2013 should be less eventful. With no elections scheduled, ASEAN leadership looming, and

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Myanmar's hosting of the World Economic Forum on East Asia in June and the Southeast Asian Games in December, political volatility will be avoided.

We do anticipate continued activity on the policy front. Major initiatives on Parliament's agenda this year include the telecommunications and mining laws. Despite passage of a major foreign investment law in November, significant legal and regulation obstacles remain, discouraging investment. Property and intellectual property rights are two key areas that must be addressed.

Peace talks and reconciliation of the country's ethnic minority groups are ongoing and remain critical to the country's political stability.

Market & Investment Outlook

Private equity interest growing; stock exchange to open in 2015

Myanmar is preparing to open its first stock exchange in 2015. Private equity interest is growing, though much of the initial capital is flowing to foreign firms with significant stakes in the country—and not to Myanmar companies directly. The Italian-Thai Development Company, the lead developer of the Dawei special economic zone, is a good example. Silk Road Management, among the first investment firms to launch a Myanmar equity index, took on a significant stake in the company in early 2012. Other private equity firms, such as Leopard Capital and Bagan Capital, will launch Myanmar funds in 2013.

Prospects for Continued Political & Economic Reform

Violence, minority reconciliation, corruption threaten reform

Among the biggest threats to continued reform are challenges involving reconciliation of the country's ethnic minorities. Two current flashpoints are Kachin State in the north and Rakhine State in the west. Fighting between the Myanmar armed forces and the Kachin Independence Army intensified in the latter months of 2012. Recently, evidence has emerged that the army is acting independently of the central government. Meanwhile, long-simmering tension between the majority Buddhist Rakhine and minority Muslim Rohingya erupted in several waves of deadly violence and property destruction in 2012.

While relations between the government and minority groups such as the Shan and Karen have improved, the calm is fragile. The United Wa State Army may be stirring up trouble in the northeast, as intelligence reports indicate that Wa rebels have been steadily acquiring advanced weapons from China.

Another obstacle to reform success is a bureaucracy rife with corruption. Transparency International in 2012 once again rated Myanmar among the most corrupt countries in the

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world; only Sudan, Afghanistan, North Korea, and Somalia were deemed worse. Many tycoons with links to the former junta continue to wield enormous influence in a still-opaque business environment, although some seek to rebrand themselves as legitimate businessmen or even philanthropists in search of foreign partners.

Quest for growth, individual actors, international community encourage further reform

Despite numerous threats, Myanmar's reforms are likely to continue for several reasons. After decades of stagnation, the country's leaders grew weary of watching their neighbors' economies grow while theirs did not. Reversion to economic policies of the past is unlikely because they were undeniably unsuccessful. Even conservatives within Thein Sein's party deemed a return to past policies impossible.

Myanmar's embrace of democracy and economic liberalization is in part an attempt to avoid Chinese domination. Fear of Chinese influence overwhelming Burmese culture and identity remains a geostrategic factor favoring further reforms.

As in neighboring democracies, individuals matter in Myanmar. The reform process has been driven primarily by Aung San Suu Kyi, Thein Sein, and reformists in his super-cabinet such as U Aung Min (Railways Minister) and U Soe Thein (Industry Minister and head of the Myanmar Investment Commission), among others. As long as these individuals remain in power, the push for reform is likely to continue. In the long term, the ability of future governments to maintain political stability and reform momentum cannot be taken for granted.

Private daily newspapers will be launched in April, marking the first time in 45 years that Myanmar citizens will have access to daily papers that are not controlled by the state. Along with the easing of press censorship and other expansion of press freedoms, the presence of private dailies will facilitate more accountability and transparency in the political process.

Finally, Myanmar will continue receiving assistance from members of the international community, who now have much at stake in seeing reforms succeed. Both the World Bank and Asian Development Bank have reentered the country, while the United States and Japan have begun helping Myanmar integrate into global financial markets.

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