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CHALLENGES AMID CONFLICT

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MYANMAR ECONOMIC MONITOR:

CHALLENGES AMID CONFLICT

December 2023

Preface and Acknowledgements

The Myanmar Economic Monitor (MEM) is published semiannually and produced by the World Bank's Myanmar office. This edition was prepared by a team comprising Kim Alan Edwards (Program Leader and Senior Economist, Task Team Leader), Kemoh Mansaray (Senior Economist, Task Team Leader), Thi Da Myint (Country Economist), Faya Hayati (Senior Economist), and Aka Kyaw Min Maw (Consultant). The MEM was developed under the guidance of Sebastian Eckardt (Practice Manager, Macroeconomics, Trade, and Investment) and Mariam J. Sherman (Country Director).

The team is grateful for the close collaboration and inputs provided by Ildrim Valley (Public Sector Specialist), Pike Pike Aye (Public Sector Management Specialist), Sutirtha Sinha Roy (Economist), Smita Wagh (Senior Financial Sector Specialist), Nang Htay Htay (Financial Sector Specialist), Valens Mwumvaneza (Senior Agriculture Economist), Yashodhan Ghorpade (Senior Economist), Soonhwa Yi (Senior Economist), Tara Beteille (Senior Economist and Program Leader), Mateo Ambrosio Albala (Consultant), Nay Nwe Linn Maung (Consultant), Myoe Myint (Senior Energy Specialist), Joonkyung Seong (Senior Energy Specialist), Myint Kyaw (Operations Officer), Sadig Aliyev (Program Leader), Win Htein Lin (Consultant), Patrick Barron (Adviser), Khin Thida Maw (Country Officer, IFC) and Daisuke Fukuzawa (Economist).

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Abbreviations

ACLED	Armed Conflict Location and Event Data Project
AML/CFT	Anti-money laundering and countering the financing of terrorism
ASEAN	Association of Southeast Nations
ATM	Automated Teller Machine
bbl	Barrel of Crude Oil
CBM	Central Bank of Myanmar
CBRs	Correspondent banking relationships
CMP	Cut-Make-Pack
COICOP	Classification of Individual Consumption According to Purpose
CPI	Consumer Price Index
CSO	Central Statistical Organization
DBS	Development Bank of Singapore Limited
EAO	Ethnic Armed Organization
EAP	East Asia and Pacific
EU	European Union
FAO	Food and Agriculture Organization
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FRD	Financial Regulatory Department
FY	Fiscal Year
GDP	Gross Domestic Product
GSP	Generalized System of Preferences
IFPRI	International Food Policy Research Institute
IOM	International Organization for Migration
LPG	Liquefied Petroleum Gas
MEM	Myanmar Economic Monitor
MFTB	Myanmar Foreign Trade Bank
MGMA	Myanmar Garment Manufacturer Association
MICB	Myanmar Investment and Commercial Bank
MFI	Micro Finance Institution
MMK	Myanmar Kyat
MoM	Month-on-Month
MOGE	Myanma Oil and Gas Enterprise
MOPF	Ministry of Planning and Finance
MHWS	Myanmar Household Welfare Survey

MLCS	Myanmar Living Conditions Survey
MSME	Micro, Small and Medium Enterprises
MUFG	Mitsubishi UFJ Financial Group
NPL	Nonperforming loans
OBS	Outward Bound Singapore
OCBC	Overseas-Chinese Banking Corporation
PGMF	Pact Global Microfinance Fund Myanmar
PMI	Purchasing Managers' Index
POS	Point of Sale
ROA	Return on assets
ROE	Return on equity
SOE	State-Owned Enterprise
SEE	State-Owned Economic Enterprise
UK	United Kingdoms
UOB	United Overseas Bank
USD	US dollar
US	United States
USDA	United States Department of Agriculture
WFP	World Food Programme
YBS	Yangon Bus Services
yoy	year-on-year

Executive Summary

Economic conditions have deteriorated in the past six months, with the signs of recovery observed in the first half of 2023 proving to be fragile and short-lived. Macroeconomic volatility resumed, with the kyat depreciating by around 18 percent against the US dollar over the three months to the end of September. More recently, armed conflict has escalated across the country, severely disrupting lives and livelihoods, blocking major transport routes and trade channels, and heightening uncertainty around the economic outlook. The latest available CPI data reveals inflation of 28.6 percent over the year to June 2023, but the subsequent kyat depreciation and rise in conflict has led to a further increase in prices in the period since. Power shortages have persisted, creating further challenges for businesses and households. And while the authorities have made a range of frequent and in some cases punitive market interventions, they have generally been unsuccessful in restoring stability in key prices.

Conflict has escalated across much of Myanmar since October causing displacement, labor shortages, and increased logistics costs (Figure ES 1). The UN estimates that more than half a million people have been newly displaced due to the rise in conflict since late October, adding to the 2 million people who were already displaced. Armed clashes have disrupted vital trade routes, particularly in the northern Shan state, which is a major hub for border trade with China. Operations at several border crossings with Thailand and India have also been disrupted. This has implications for Myanmar's international trade across land borders, which accounted for 40 percent of its exports and 21 percent of its imports in the six months to September 2023. Key transport routes within Myanmar have been blocked, restricting the movement of people and trade of goods, and leading to shortages of food and other basic items in local markets.

Renewed pressure on the exchange rate and inflation has been triggered by a combination of internal and external developments (Figure ES 2 and Figure ES 3). The depreciation coincided with the announcement of U.S. sanctions on two large state-owned banks, the imposition of restrictions on cross-border payments by international banks, and the launch of a higher denomination 20,000-kyat banknote which fueled renewed inflation and devaluation expectations. Fears of a reduction in foreign exchange inflows stemming from these developments reinforced ongoing pressure on the balance of payments associated with a reduction in merchandise exports, a moribund international tourism sector, and a lack of foreign investment. The resulting exchange rate depreciation is being reflected in price pressures which have been exacerbated by elevated conflict and logistics constraints. According to WFP data, the prices of six major food items (rice, pulses, edible oil, onions, eggs and tomatoes) have increased by an average of 16.6 percent annually between 2017 and June 2023. Various efforts to fix prices of fuel and food items at non-market levels have resulted in supply disruptions and in several cases have proven unsustainable.

Interventions to encourage foreign currency inflows and regulate exchange rates have generally been ineffective in restoring stability, while exacerbating uncertainty and market distortions. Foreign currency surrender requirements have been maintained (though partially eased), limiting Myanmar exporters' ability to benefit from the depreciating kyat. However, these measures have done little to address foreign currency shortages. Multiple exchange rates are in operation in Myanmar and the spread between the official and the parallel market rate has widened, with persistent shortages of foreign currency at the below market rates. This in turn has constrained the issuance of import licenses, contributing to shortages of imported inputs and consumption goods. At the same time, a lack of clarity around the implementation and enforcement of frequently changing and often non-transparent instructions has raised uncertainty and increased compliance costs.

Power outages have persisted throughout the year, indicating underlying structural challenges in the energy sector. Outages have remained severe despite the onset of the rainy season, which in normal circumstances tends to stabilize hydropower output. This has been largely due to a drop in gas-generated supply and conflict-related disruptions to power transmission and generation infrastructure. Power blackouts in residential areas and industrial zones have lasted for extended periods, impacting businesses and households. On average, recently surveyed garment firms estimated their total losses attributable to power outages to be equivalent to 31 percent of their total annual sales in 2022, due in large part to the cost of running generators to substitute for power from the grid.

Against this challenging backdrop, indicators of economic activity have generally deteriorated since mid-2023. In the September 2023 round of the World Bank Firm Survey, firms reported operating at 56 percent of their capacity on average, 16 percentage points lower than in March 2023 (Figure ES 4). While all firms suffered setbacks, the reduction in operating capacity was steepest in the services sectors, including wholesale and retail trade, following a large reported decrease in sales from a year earlier. The manufacturing purchasing managers index contracted in October and November as firms reported a drop in output and new orders (Figure ES 5). Floods, conflict, high input costs, and trade restrictions have limited the ability of farmers to benefit from favorable export prices, and curtailed the investments needed to support future production. Compared with the same period a year earlier, merchandise exports contracted by 11 percent in the six months to September 2023, in part reflecting slowing global demand (Figure ES 6). FDI commitments have remained very weak.

Meanwhile, fiscal space remains constrained, with a widening deficit in large part financed directly by the central bank. The fiscal deficit widened to 6.4 percent of GDP in the year-ended March 2023, reflecting a contraction in revenue that more than offset a modest decline in spending. Spending on goods and services declined by almost 2 percentage points of GDP, partly offset by an increase in capital spending. Alarmingly, the combined spending on education and health has fallen to around 2 percent of GDP, down from almost 4 percent in 2019/20. Central bank financing is estimated to have covered around 70 percent of gross public financing needs (about 4.8 percent of GDP) in the year to March 2023.

Household incomes continue to be stretched by the cumulative impact of recent shocks. In the first half of 2023, 40 percent of households surveyed in IFPRI's Myanmar Household Welfare Survey reported lower income compared with the previous year, while only 25 percent reported an increase. The analysis further shows that median real incomes fell by 10.2 percent between the June quarter 2023 and a year earlier. Food prices have risen further from already high levels, outpacing the wage increases of most workers. Results from IFPRI's Agri-food System Monitoring in Myanmar revealed that the cost of a healthy diet increased by 111 percent between June 2020 to August 2023. Analysis based on Myanmar Living Conditions Survey (MLCS) and WFP survey data shows that poorer households are particularly exposed to high food price inflation. The increase of the de facto minimum wage by 21 percent in October – the first increase since May 2018 – will do little to mitigate the impacts of this high food price inflation (28.6 percent in June) on food security.

Migration – both within Myanmar and internationally – has become an important coping mechanism. Outward flows have been spurred by conflict, declining real incomes, and reduced economic opportunities.

Migrant workers are primarily low-skilled, with little formal education, and mainly employed in agriculture, construction, and manufacturing[1]. The World Bank estimates that Myanmar workers in Thailand earn around double the amount they earned at home, with the remittances that these workers send augmenting the incomes of Myanmar households and financing expenditures on daily necessities, housing and education. On the other hand, increasing movements of labor out of Myanmar have led to reports of labor shortages in some areas and sectors, while the associated decline in human capital poses longer-term development risks.

In light of these severe challenges, near-term growth prospects have weakened further. GDP is projected to grow by just 1 percent in the year ending March 2024 (Table ES 1). Even assuming no further escalation in conflict, growth is expected to remain subdued the following year. This baseline forecast is predicated on a broad-based slowdown across productive sectors. The agriculture sector is particularly exposed to conflict-related border trade disruptions with over a third of agricultural exports going to China, India and Thailand via land. Growth in the manufacturing sector is projected to slow given ongoing electricity shortages and worsening logistics disruptions, combined with slowing external demand. Wholesale and retail trade will remain subdued given persistent downward pressure on household incomes and upward pressure on consumer prices. The forecast implies that GDP in 2024 would still be around 10 percent lower than in 2019, indicative of the persistent impacts of recent shocks to both the supply and the demand side of the economy (Figure ES 7). Note that the macroeconomic indicators in Table ES1 – both history and projections – have been aligned to the March-ended fiscal year (Box 4 provides more details). The underlying quarterly data and assessment of the macroeconomic trajectory in the recent period remains unchanged.

Table ES 1 Economic data and projections

(annual percent change unless indicated otherwise)

	2019-20	2020-21[e]	2021-22[e]	2022-23[e]	2023-24[f]	2024-25[f]
Real GDP growth, at constant factor prices	6.6	(9.0)	(12.0)	4.0	1.0	2.0
Agriculture	2.2	(5.7)	(12.8)	(2.2)	(2.8)	4.0
Industry	8.0	(11.8)	(8.2)	8.0	1.5	2.8
Services	7.8	(8.4)	(14.7)	3.9	2.5	0.2
CPI inflation, year average	9.1	2.3	9.6	27.2	20.1	12
Trade balance (% of GDP)	(5.6)	(2.9)	(2.4)	(6.0)	(6.8)	(6.7)
Current account balance (% of GDP)	(1.8)	(0.4)	(2.4)	(6.3)	(6.7)	(6.1)
Fiscal balance (% of GDP)	(6.2)	(7.5)	(4.7)	(6.4)	(5.7)	(5.1)
Public debt (% of GDP)	42.3	54.6	61.5	62.6	61.5	61.1

Note: April-March fiscal year

Inflation is expected to remain high in the year ended March 2024, at around 20 percent. While several prices eased in the first half of 2023, the recent re-emergence of exchange rate pressures is likely to see prices continue to rise at a rapid pace this year, with modelling for Myanmar indicating that a 1 percent depreciation in the exchange rate typically associated with an additional 0.5 percent rise in consumer prices over the next one to two quarters. Relatively high inflation is expected to persist over the next couple of years, driven by ongoing pressure on the balance of payments and kyat exchange rate, local supply constraints caused by conflict, trade and transport disruptions, and the renewed reliance on central bank financing of budget deficits.

1 International Organization for Migration (IOM), (2023). Flow Monitoring Findings: Profiles Of Myanmar Nationals Crossing into Thailand. https://dtm.iom.int/report-product-series/flow-monitoring-myanmar-nationals

Balance of payments pressures are also expected to persist over the medium-term with a projected widening of the trade and current account deficits, to 6.8 and 6.7 percent of GDP, respectively, due mainly to an anticipated slowdown of exports. Recent disruptions of the logistics and supply chains due to conflict could reduce net services receipts but remittance inflows are expected to continue recovering due mainly to the country's large migrant workforce and the existence of favorable close-to-market exchange rates for remittances. Financing the current account deficit will remain challenging due to low foreign investment, while there is a lack of clarity around the authorities' ability and willingness to draw down international reserves.

The overall budget deficit is projected to remain elevated at 5.7 percent of GDP in the fiscal year ending March 2024. Revenues from SEEs are projected to moderate sharply reflecting increased operational challenges and losses. Spending is also projected to decline by 2.2 percentage points to 24.0 percent of GDP, reflecting declines in both recurrent and capital expenditure. Spending on education and health combined is expected to be just 2.2 percent of GDP, equivalent to just over half of the allocation to defense. Total public debt is expected to remain broadly stable at just above 60 percent of GDP, with the impact of budget deficits on the debt-to-GDP ratio continuing to be broadly offset by faster inflation.

There are significant downside risks associated with these projections, with the recent rise in conflict broadening the range of possible outcomes in the short- and medium-term. In addition to its impacts on internal displacement and livelihoods, the escalation in fighting has the potential to block vital land trade and supply chains, sharply curtail mobility and consumption, and disrupt businesses' ability to operate. Other risks include the risk of power outages worsening further, the risk of trade disruptions following recent restrictions on cross-border payments, and the risk of more protracted shortages of foreign currency and imported inputs resulting from the implementation of price controls and other market interventions. Medium to long-term prospects for living standards are at considerable risk due to broad-based declines in real wages and labor productivity, as well as a widespread erosion of human capital. In addition, policy responses that rely heavily on market interventions - such as price controls and trade restrictions - are likely to amplify risks of growing inefficiencies and reduced productivity gains from specialization and exposure to international competition.

Looking beyond these overall economic trends, this edition also provides an in-depth analysis of Myanmar's garment sector, a key driver of growth and job creation in the economy. As the special topic section of this report shows, Myanmar's garment industry has significant potential to act as a driver of growth in employment, labor productivity, and incomes, following the path of several other East Asian countries. Rapid growth over the past decade – from a very low base – suggests that Myanmar's garment industry was previously on course to follow the trajectory seen in several other East Asian countries, driving increases in employment, labor productivity, and incomes (Figure ES 8). But conflict, logistics costs, macroeconomic instability, trade and foreign exchange constraints, and electricity shortages have disrupted firms' operations and raised the costs of doing business. This in turn has reduced the international competitiveness of the garment industry and the incentives for both domestic and foreign investment, shifting its focus to survival rather than longer-term expansion. Results from World Bank Garment Industry Survey 2023 indicate that only 18 percent of firms plan to upgrade their operating models in the next three years, with most opting to continue operating under the relatively low value-add cut-make-pack (CMP) model. The overvalued official exchange rate, in conjunction with foreign currency surrender requirements and trade restrictions, has also impaired the competitiveness of Myanmar's garment sector and other export-oriented manufacturing and agricultural firms. Ensuing foreign currency shortages have been reflected in limited access to import licenses, reducing businesses' ability to access key imported inputs. The scarring effect of these trends has the potential to severely limit Myanmar's growth potential over the longer term, both in the garment industry and across the broader economy.

Figure ES 1: Conflict intensity across Myanmar

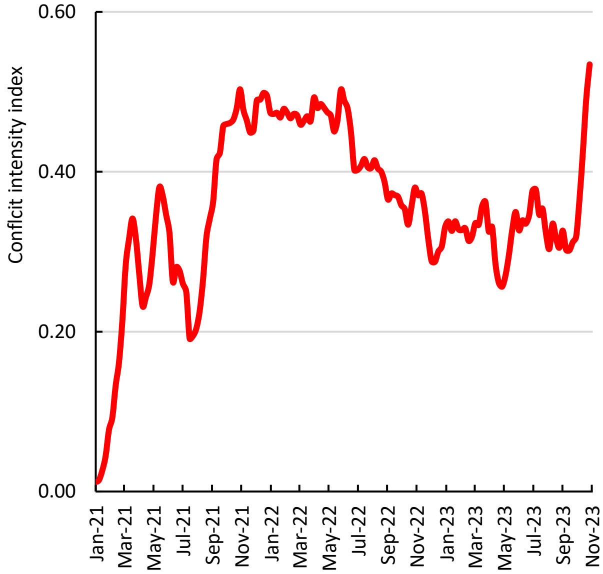


Figure ES 2: Exchange rates (kyat per USD)

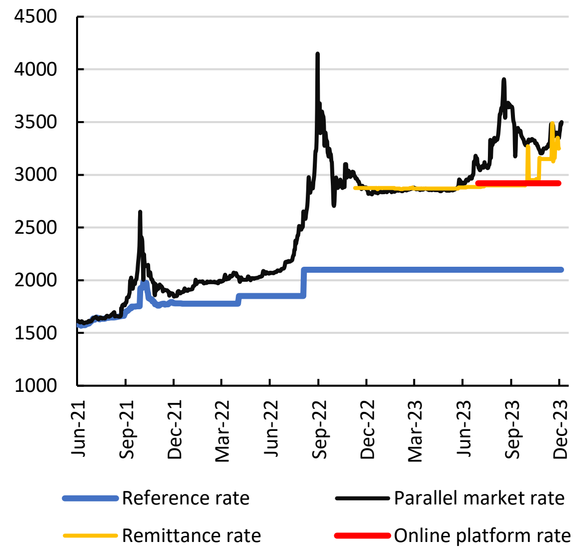


Figure ES 3: CPI inflation

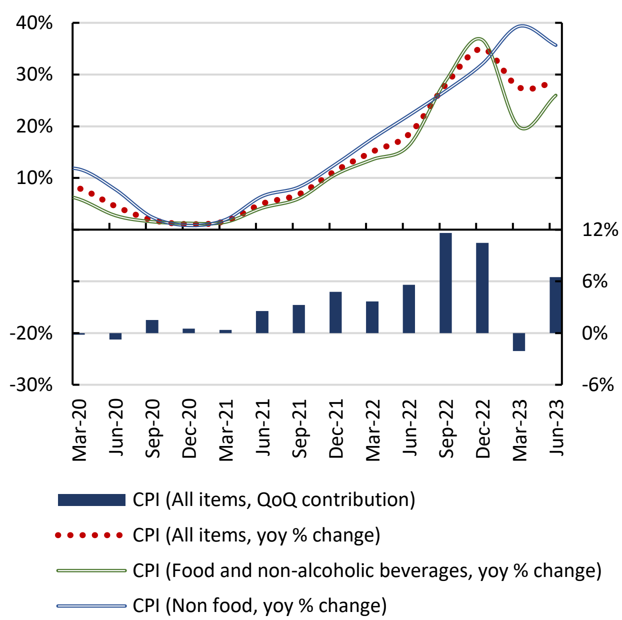


Figure ES 4: Firms' average operating capacity

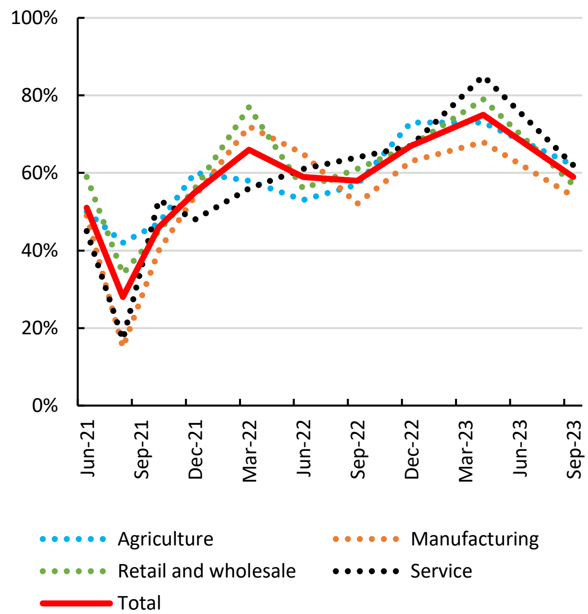


Figure ES 5: Manufacturing Purchasing Managers' Index
(< 50 indicates contraction, > 50 indicates expansion)

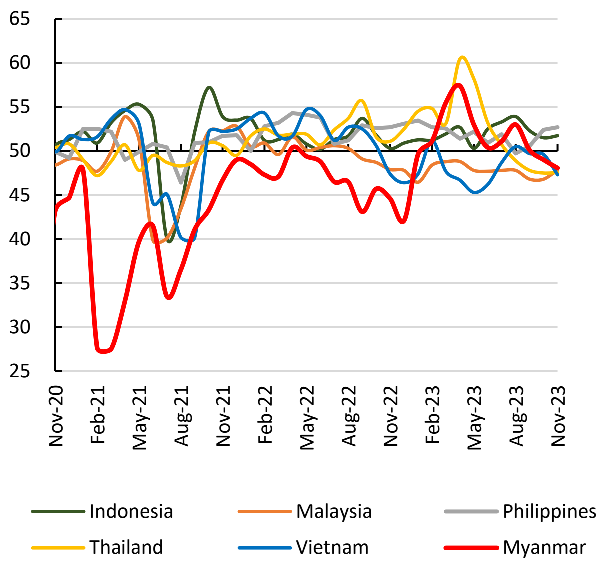


Figure ES 6: Merchandise exports
(USD values, 2019 = 100)

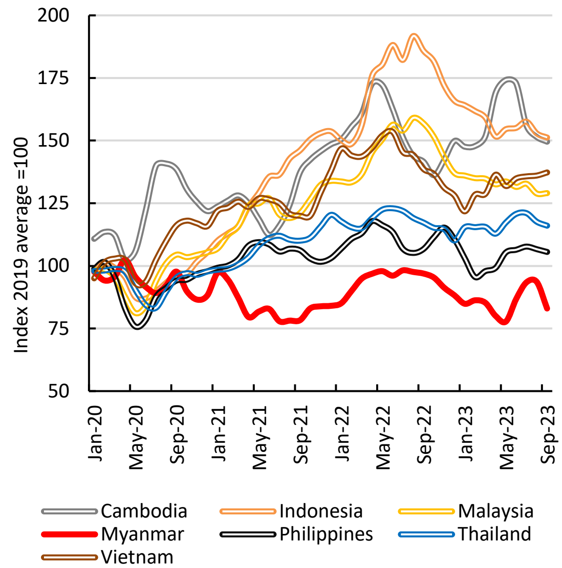


Figure ES 7: Real GDP estimates and projections

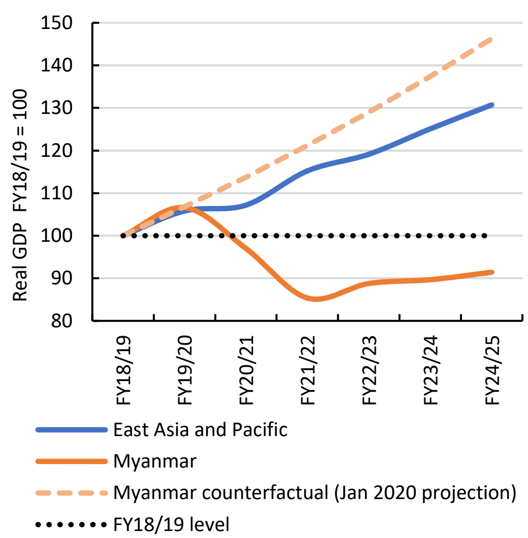
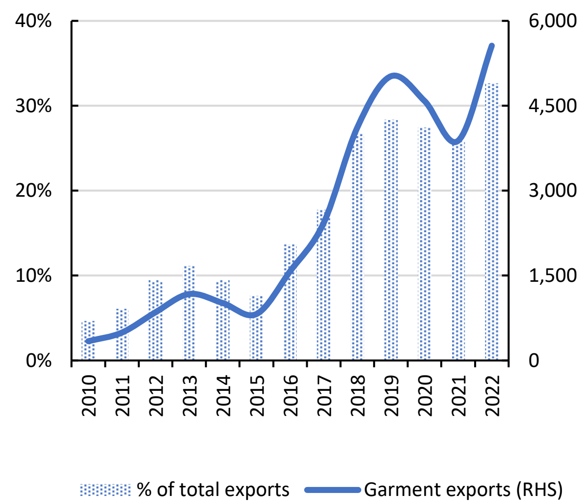


Figure ES 8: Myanmar garment export trends

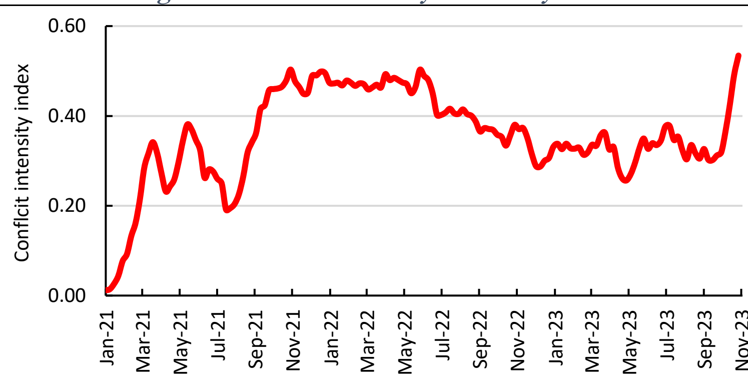


I. Recent Economic Developments

A. Economic conditions have become more volatile over the past six months

Conflict has escalated across Myanmar since October, spurring displacement and disrupting livelihoods, while at the same time increasing the costs of moving goods around the country and across borders (Figure 1**).** The UN estimates that more than half a million people have been newly displaced due to the rise in conflict since late October, adding to the 2 million people who were already displaced. Fighting in Northern Shan state has disrupted vital highways to China like Lashio-Muse and Lashio-Chin Shwe Haw. Northern Shan is the main hub for border trade with China, accounting for about 40 percent of the total trade through land borders. Other areas including Sagaing, Kayah and Rakhine[2] have also witnessed a surge in armed conflict. The potential for disruption of trade flows with China and other bordering countries poses substantial risks for supply chains, business operations, and exports. Moreover, the increase in uncertainty caused by the spike in conflict is likely to have driven an increase in precautionary behavior, limiting household consumption and further reducing business incentives to invest.

Figure 1: Conflict intensity across Myanmar



Source: WB staff calculations using data from the Armed Conflict Location and Event Data Project (ACLED)
Note: Conflict intensity is calculated as a geometric mean of events and fatalities. Events include battles, explosions and remote violence, protests, riots, and violence against civilians. Fatalities represent the total fatalities resulting from each event. The chart shows the normalized value of the conflict intensity index between 0 and 1. Data is weekly and up to the week ending on November 25, 2023. Data reflects 4-week moving average.

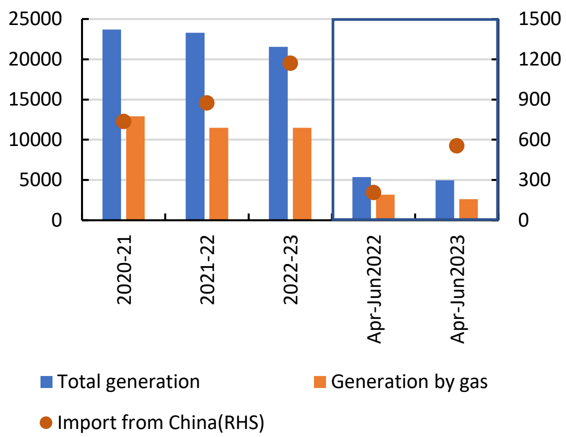
Exchange rate volatility increased between June and December 2023, reflecting balance of payments pressures, domestic policy changes, and the imposition of international restrictions. This has raised the prices of imported inputs and fuelled inflationary pressures. Following a period of stability in the first half of 2023, the kyat depreciated sharply against the US dollar in July and August. In response, interventions to encourage foreign currency inflows and enforce non-market exchange rates have become more frequent and, in some cases, punitive. But these measures have done little to address fundamental balance of payments pressures associated with a reduction in merchandise exports, a moribund international tourism sector, and a lack of foreign investment. Foreign currency shortages persisted through this period, reflecting the difficulty of ensuring the availability of foreign currency at below-market exchange rates given these balance of payments

[2] Sagaing, Northern Shan, Rakhine, and Kayah accounted for about 17 percent of Myanmar's GDP in the fiscal year 2021-22.

pressures, and resulting in restricted access to import licenses and shortages of imported inputs. In early December, the Central Bank of Myanmar announced that it will no longer set the exchange rate on the online foreign exchange platform (introduced in June 2023) and instead allow market forces to determine the rate. The full implications remain unclear at the time of writing, with a lack of clarity around how these measures will be implemented in practice.

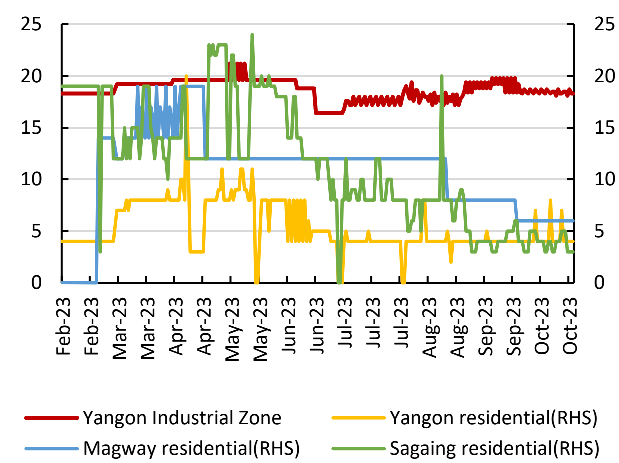
Power outages have persisted across the country despite heavy rains during the monsoon season, reflecting structural constraints in energy provision. Myanmar's power generation declined by 8 percent from 5,376 million kWh in the first half of 2022 to 4,960 million kWh over the same period in 2023 (Figure 2), largely attributable to an 18 percent year-on-year drop in gas-generated supply as well as limited investment and disruptions to power transmission and generation infrastructure. Electricity outages have persisted for substantial periods each day – around 4 hours in Yangon residential areas on average and 18 hours in industrial zones – though in some other residential areas the situation seems to have improved somewhat in recent months (Figure 3). Over 200 attacks on the power grid have been reported by the authorities between February 2021 and April 2023. The power sector continues to be constrained by financial vulnerabilities including increased grid maintenance costs, decline in revenues and currency depreciation. While energy imports accounted for 11 percent of total electricity generation between April to June 2023 (Figure 2), these imports from China are not yet fully integrated into the national power grid and are insufficient to close the substantial demand-supply gap.

Figure 2: Power generation and imports (million kWh)



Source: CSO and China customs department

Figure 3: Electricity outages per day (hours)



Source: FMR

B. Economic indicators have weakened, reflecting heightened volatility and uncertainty

The September 2023 round of the World Bank Firm Survey indicates that economic activity has slowed since March. Firms reported operating at 59 percent of their capacity on average in September (Figure 4), 16 percentage points lower than in April 2023 and around the same level as in September last year, a period which was also characterized by significant macroeconomic volatility and uncertainty. The reduction in operating capacity was particularly marked in the services sectors, including wholesale and retail trade, following steep reported reductions in sales. Almost half of all firms reported lack of sales to be their most significant operational challenge in September 2023, up from 18 percent in April (Figure 5).

Figure 4: Firms' operating capacity, sales, and profits

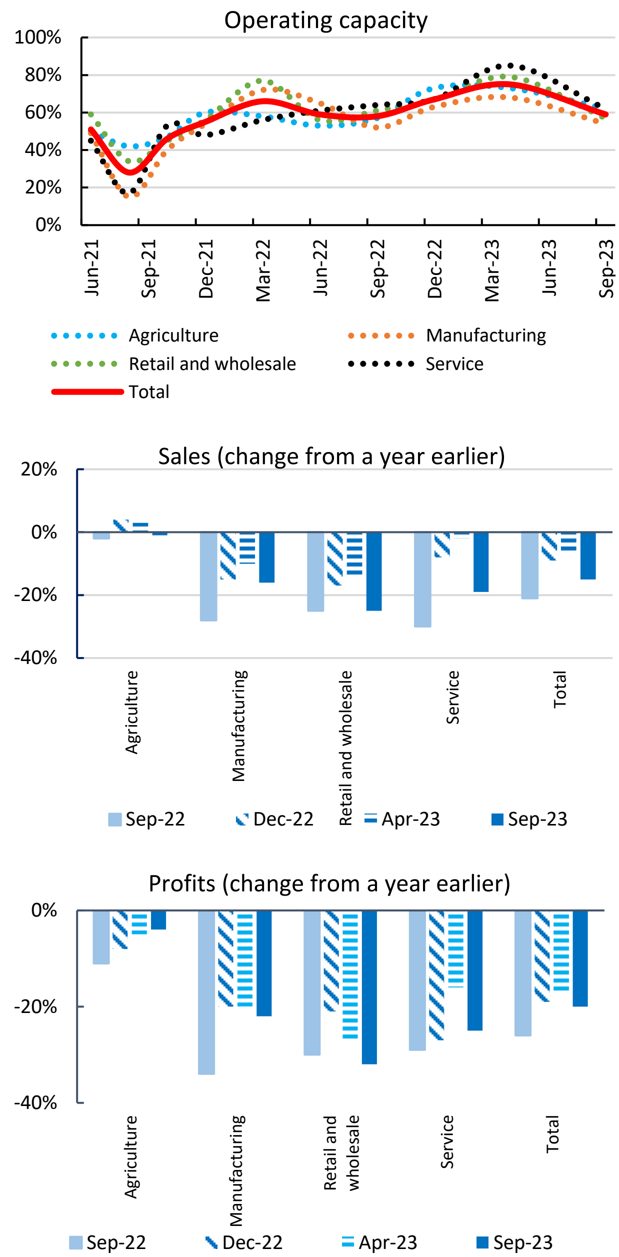
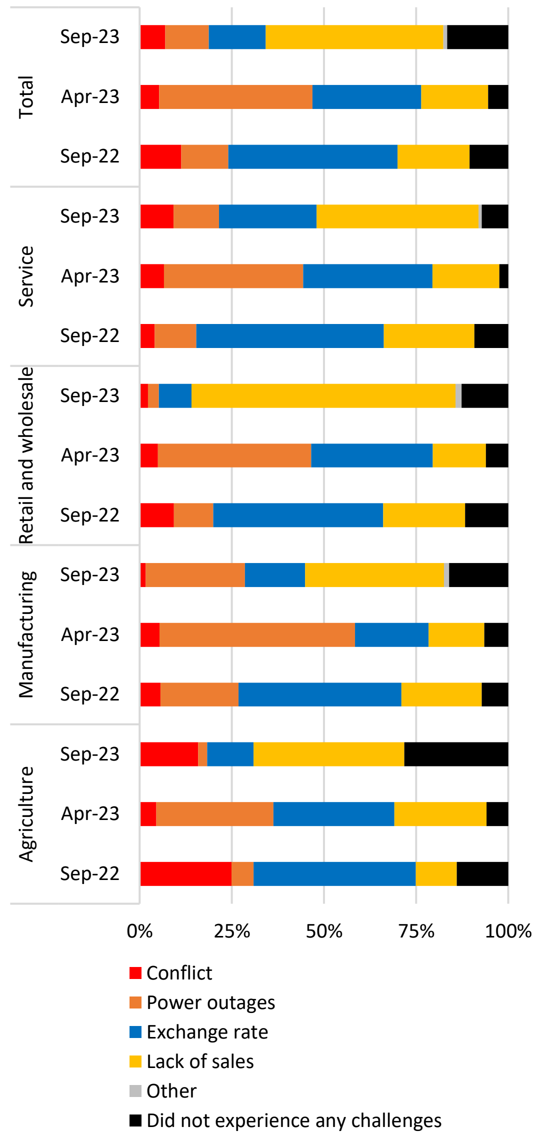


Figure 5: Challenges to firms' operations (share of firms reporting) in September 2023

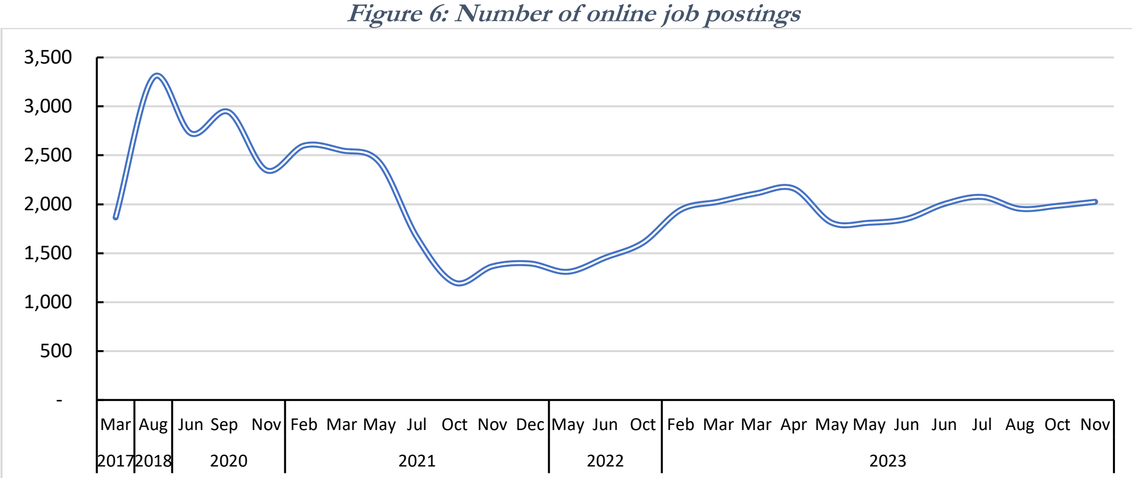


Source: World Bank firm monitoring surveys

Note: Firms were asked to report on the last completed month. Changes in sales and profits are from a year earlier. "Service" refers to non-retail and wholesale services. In figure 5, other includes trade and foreign exchange regulation and difficulty in paying foreign suppliers or receiving payments abroad, and these are included only in the September round.

Indicators of labor demand provide an alternative perspective on the evolution of economic activity across different sectors in recent years. World Bank firm survey results show that until mid-2022, a greater proportion of firms reported laying off workers than hiring them. The reverse was true from September 2022 onwards, suggesting an improvement in labor demand. The same trend can be observed in online job postings which began to slowly recover from mid-2022 onwards after declining steeply in 2020 and 2021 (Figure 6). Nevertheless, the total number of job postings remains well below pre-pandemic levels, consistent with an economy that is yet to fully recover from the earlier contraction in activity. Vacancies remain particularly weak in manufacturing; logistics; legal, accounting and finance; and several other professional services. On the other hand, current postings for education, teaching, childcare and medicine and nursing-related positions exceed November 2020 levels.

Figure 6: Number of online job postings

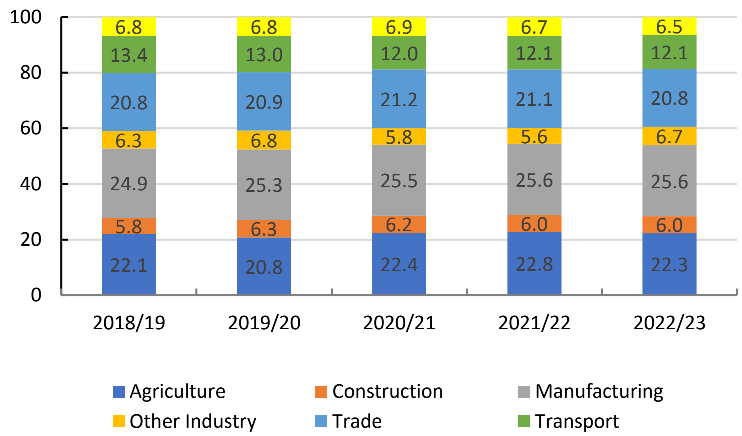


Source: World Bank staff online data collection and calculations. Timeline not to scale.

Taking a longer term perspective, the structure of Myanmar's economy has remained largely unchanged in recent years (Figure 7). This reflects the impacts of recent shocks which have raised operating constraints and costs, increased business uncertainty, reduced labor demand, and curtailed mobility. These impacts in turn have tended to stall the structural transformation process, preventing a shift into higher value-added activities.[3] Manufacturing, agriculture, and trade remain the most important sectors of the economy, contributing on average 26, 22 and 21 percent, respectively, of total gross value added between 2019/22 and 2022/23. Transportation is the fourth most important economic sector, contributing about 12 percent of gross value added over the same period followed by construction with 6 percent.

[3] See World Bank (2023), A Growing Crisis: Work, Workers and Well-being in Myanmar.

Figure 7: Gross Value Added at purchaser prices by sector (% of total), 2019 - 2022



Source: Planning department, World Bank staffs' estimate

Despite challenges related to conflict, weather shocks and high input prices, agricultural production is expected to have increased modestly in 2023. According to the USDA, Myanmar's rice production is projected to increase by 1.7 percent in 2023. On the other hand, exports are expected to decline due to lower production in 2022 and a reduction in carry-over stocks available for export, as well as the imposition of temporary measures in August 2023 to reduce exports and curtail storage of paddy in an effort to stabilize local rice prices[4]. At the same time, there has been an upturn in the production and export of beans and pulses production, with export volumes increasing by 6 percent between April and September driven mainly by growing demand from India.

Results from the September round of the World Bank Firm Survey show that agricultural firms were on average operating at 62 percent of their capacity, 11 percentage points lower compared to April 2023. Firms cite conflict, difficulty in accessing foreign exchange, frequent power outages and the reduction in sales as the major reasons for the slump in operating capacity. Frequent power outages continue to adversely affect rice millers, forcing them to rely on diesel generators, increasing their operating costs and lowering profits. Agricultural inputs have become more costly and harder to access in recent months due to the depreciation of the kyat against the US dollar, limited access to credit, and import license delays. IFPRI's 2023 rice productivity assessment indicates that the cost of fertilizer, labor and mechanization services have increased by 13 – 21 percent in 2023[5]. High input costs, in conjunction with foreign currency surrender requirements, have reduced the profitability of agricultural export earnings.[6] Recent flooding has damaged rice fields in some parts of the country. Both sales and profits of agricultural firms declined in September compared to April due to these

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[4] According to the United States Department of Agriculture – Foreign Agricultural Service (USDA-FAS) (2023) Grain: World Markets and Trade, October, URL: https://downloads.usda.library.cornell.edu/usda-esmis/files/zs25x844t/5d86qh60t/v405tv21w/grain.pdf .

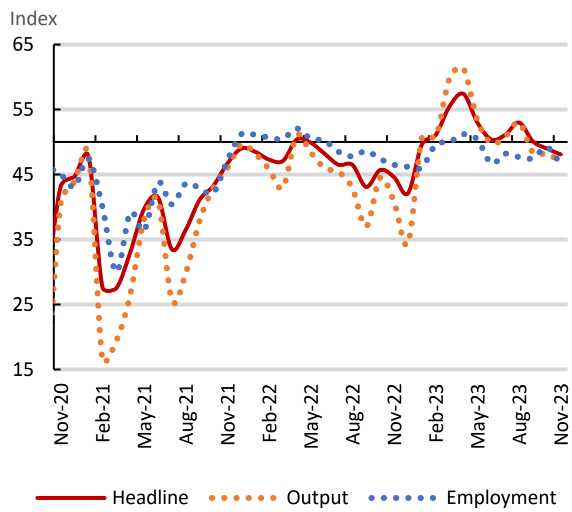
[5] IFPRI (2023) Rice productivity in Myanmar: assessment of the 2023 dry season, Strategy Support Program - Research Note 99, September

[6] Effective March 1, 2023, rice exporters exporting through the land border, previously exempted from the foreign currency surrender requirements, must also convert 50 percent of their export earnings into kyat at a lower official reference rate compared to the market.

prevailing challenges (Figure 4). The more recent escalation in conflict has the potential to have a pronounced impact on agricultural trade over land borders (see Box 3).

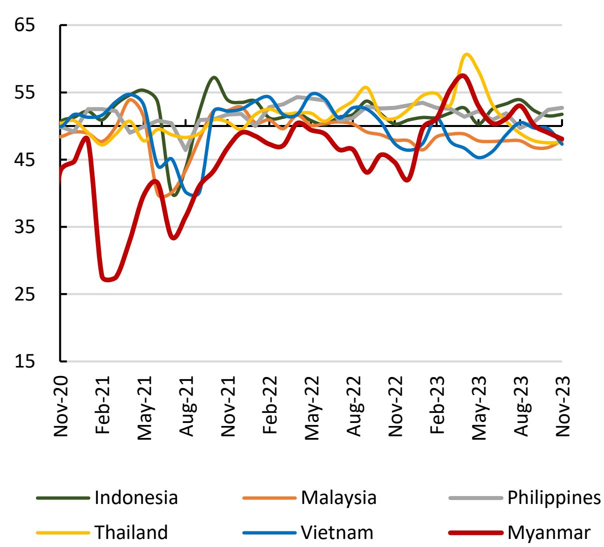
After expanding in the eight months to September, the manufacturing purchasing managers index (PMI) contracted in October and November. Increased demand for processed food items and textiles and clothing during the first half of 2023 underpinned the expansion of the PMI between February and September, off a very low base considering the long period of contraction observed over the three years to 2022. There are some indications that import substitution policies[7] targeted at domestic industries including food processing, wood and paper helped to support output, new orders and hiring in some cases. However, the PMI has again fallen below neutral levels since October, signaling a return to contraction (Figure 88). The reduction in output and new orders was largely explained by a slowdown in domestic demand, due in part to increased precautionary behavior in response to the escalation of conflict, as well as high inflation which has squeezed real household incomes. Raw materials shortages and power outages continue to restrain manufacturing activities. In addition, suppliers' delivery times lengthened in October and November reflecting supply chain disruptions due to delays in obtaining import licenses and logistics bottlenecks associated with increased level of conflict. Except for Indonesia and Philippines, the PMI declined across the EAP region, partly reflecting the slowdown in external demand (Figure 9).

Figure 8: Manufacturing Purchasing Managers' Index (>50 indicates expansion, < 50 indicates contraction)



Source: S&P Global Market Intelligence. CSO quarterly bulletin

Figure 9: Regional Manufacturing Purchasing Managers' Indices (>50 indicates expansion, < 50 indicates contraction)

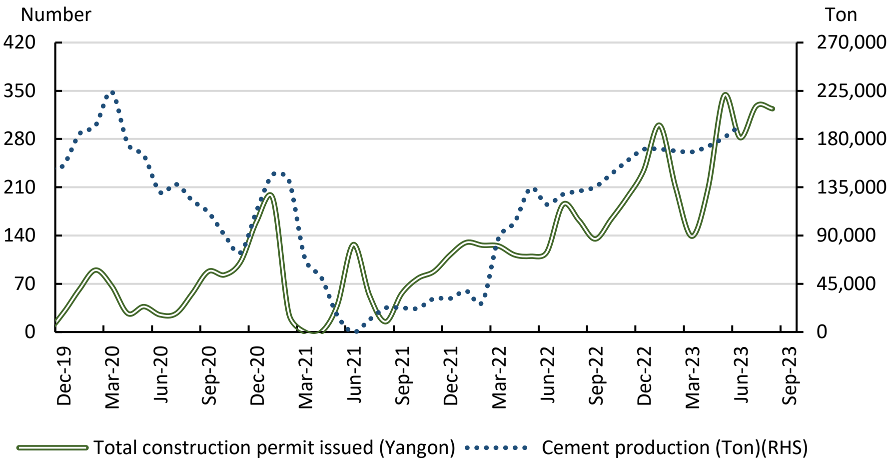


Source: S&P Global Market Intelligence

[7] These include restrictions on the importation of specific commodities (including through restrictions on access to foreign exchange), and the reopening of state-owned manufacturing industries previously suspended due to economic unviability.

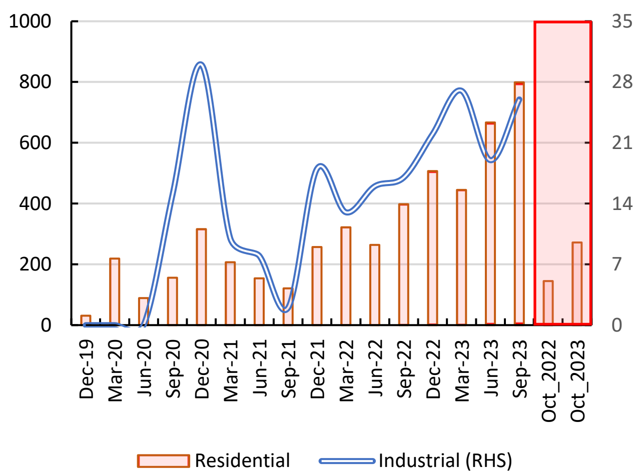
Indicators of residential construction remained relatively strong in the second half of 2023, but large infrastructure projects continue to suffer setbacks. Residential construction permits and cement production continued to trend upwards (Figure 10), supported by safe-haven demand for residential property which drove a pronounced increase in Yangon real estate prices in recent months (Figure 11 and Figure 12). However, larger-scale commercial real estate projects continue to stagnate, with no approved foreign investments in the real estate sector since April 2023. Despite efforts to revive them, public infrastructure projects including roads, bridges, and public buildings are moving at a very slow pace due to budget constraints. Increased regulatory uncertainty, limited access to foreign currency, and delays in obtaining import licensing for construction materials (which are treated as low priority compared to other imports), have also complicated investments in major infrastructure projects.

Figure 10: Construction permits (number) and production of construction materials (ton)



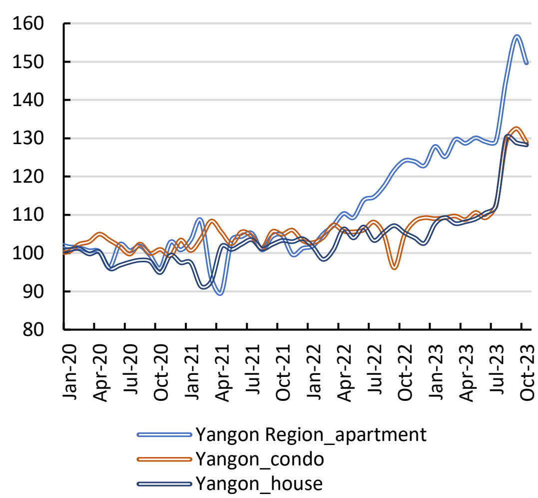
Source: Yangon City Development Committee, CSO

Figure 11: Total number of construction permits issued in Yangon



Source: Yangon City Development Committee

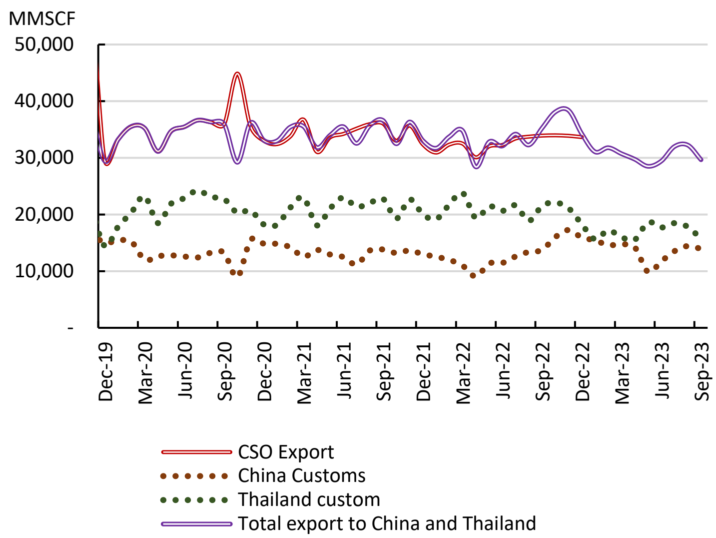
Figure 12: Residential sales price index in Yangon



Source: iMyanmar house

Myanmar's natural gas production continued its downward trajectory due mainly to dwindling reserves and a lack of investment in new energy sector projects. Both production and export of natural gas declined since April 2023 (Figure 13), due mainly to the slump in output from major gas fields such Yetagun, Yadana and Zawtika. Depletion of reserves, lack of new investments in the upstream oil and gas sector and regular maintenance of pipelines (especially Yadana) has constrained production. New international sanctions on Myanma Oil and Gas Enterprise (MOGE) could pose additional challenges for the oil and gas sector by restricting the provision of financial services and deterring badly needed foreign investments.

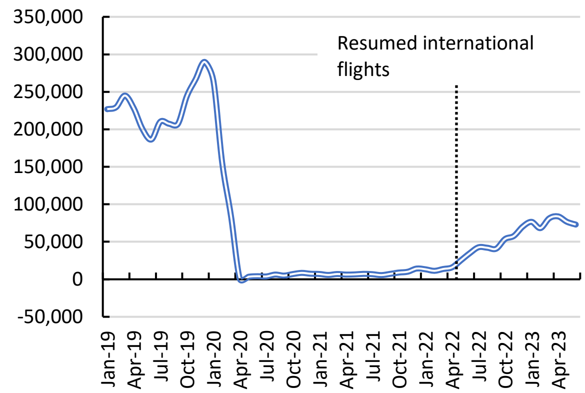
Figure 13: Natural gas export volume



Source: China Customs, Thailand Ministry of Energy

Weaknesses in tourism, trade and transportation underscore continued weakness in the services sector. The recovery in tourism since 2021 has been only modest: international arrivals increased to 460,000 passengers in the first half of 2023, 50 percent higher than the same period last year, but still very low compared to the 1.32 million arrivals recorded between January-June 2019 (Figure 14). Most of the new arrivals were from China, Thailand, Japan, South Korea, and India, and opted for relatively short stays. Initiatives to boost the tourism sector including implementation of visa on arrival schemes for selected Asian countries have as yet failed to yield dividends. Several international hotel chains have remained closed since the pandemic, and the tourism sector accounts for a large proportion of banks' non-performing loans (see section E below). Domestic tourism has been stronger, although hotels remain closed in conflict-affected areas and high air ticket prices present challenges. On average, domestic airports experienced a moderate 10 to 15 percent rebound in passenger traffic during the first half of 2023.

Figure 14: International arrivals in Myanmar



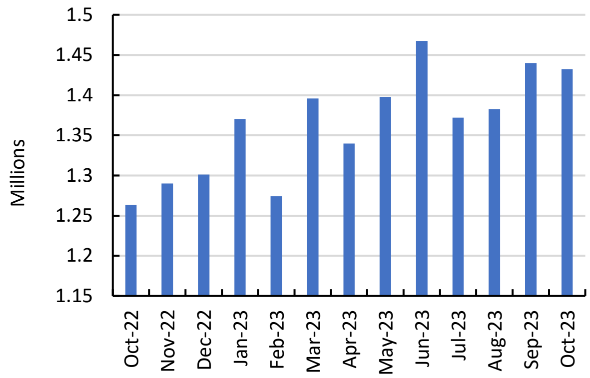
Source: Department of Civil Aviation Myanmar.

Recovery in the transport sector has continued at a slow pace. Public transport options in Yangon Region, including the Yangon Circular Railways (YCR)[8] and the Yangon Bus Service (YBS) remain important in facilitating the daily commute of low-income households. Daily passenger volumes for the YBS increased from 1.32 million to 1.43 million between May and October 2023 (Figure 15) but remain below pre-pandemic level of about 1.8 - 2.5 million[9]. Railway passenger numbers increased also by 65 percent from January to June 2023 compared to the same period in 2022 while railways freight passenger services volume increased by 75 percent (Figure 16). However, as of June 2023, railway passengers and freight ton-miles remain 73 percent and 27 percent below 2019 levels respectively. Disruptions to rail services can have a substantial economic impact given reliance on rail to move agriculture harvests and other bulk domestic commodities cost-effectively.

[8] The YCR carries an average of approximately 90,000 passengers each day, covering a distance of 46 kilometers with a network of 39 stations around Yangon Region

[9] Myanmar Times, February, 2021.

Figure 15: Average daily YBS passengers by month



Source: YRTC official social media.

Figure 16: Myanmar passenger-miles/freight ton-miles via railway

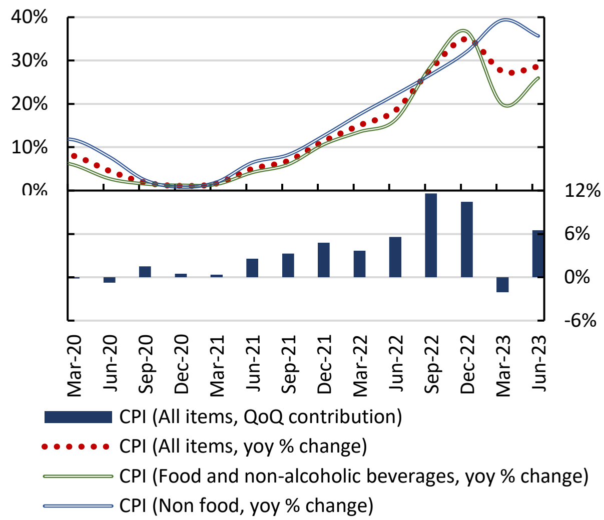
Source: Myanmar Central Statistical Organization

Retail and wholesale firms surveyed reported that their sales have declined, reflecting reduced consumer spending amid high inflation, weak nominal incomes, and conflict-related uncertainty. Results from the September 2023 round of the World Bank Firm Survey indicate that sales of retailers and wholesalers declined by 25 percent on average compared to the same period last year. This weakness in sales can be attributed to persistently high inflation, which has strained weak nominal incomes and crowded out spending on non-essential items, the additional volatility in prices prompted by the steep exchange rate depreciation in July and August, and uncertainty related to exchange rate policy changes and the imposition of international sanctions. On the other hand, efforts to impose controls on the prices of basic food items such as edible oil and rice have squeezed the profits of retailers and wholesalers and exacerbated shortages in some cases. Wholesale and retail firms reported operating at just 57 percent of their capacity in September, a 22-percentage point decline compared to March, while 72 percent of retailers and wholesalers reporting a lack of sales as the most significant challenge to their operations, up from just 14 percent in March (Figure 4 and 5). The more recent spike in conflict has likely exacerbated the precautionary behavior of consumers, putting further downward pressure on retail sales. The traditional trade sector – which accounts for almost all sales in rural markets and an estimated 90 percent of total sales – faces additional constraints from conflict and logistics disruptions.

C. Consumer price inflation remains high

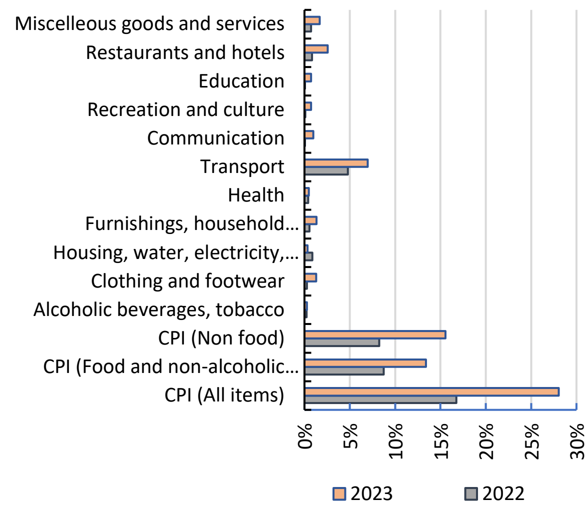
Consumer prices increased by 28.6 percent over the year to June 2023, with CPI inflation moderating only slightly from the peak of 35 percent recorded in December 2022 (Figure 17). Inflation has been driven by a surge in food and transport prices (Figure 18) on account of exchange rate depreciation (see section D), and disruptions in the local supply of agricultural products due to increased conflict, transport constraints, and trade restrictions. The sharp exchange rate depreciation in July and August is likely to have triggered additional inflation in the September and December quarters, while the introduction of a new 20,000-kyat banknote in July further fueled inflationary expectations. There is strong passthrough from exchange rate changes to inflation in Myanmar (Figure 19) with a one percentage point shock to the exchange rate estimated to increase inflation on average by 0.50 percentage points over the next one to two quarters[10].

Figure 17: CPI inflation



Source: CSO, World Bank staff estimates

Figure 18: Contribution to CPI inflation (annual average)



Source: CSO, World Bank staff estimate

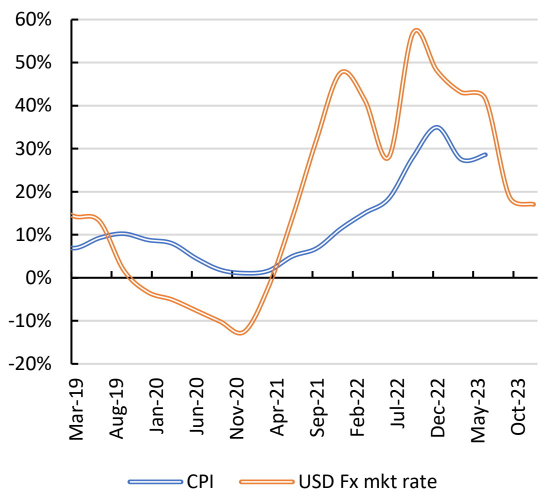
Food price inflation picked up to 26.0 percent in June, up from 19.8 percent in March (Figure 17**).** Areas affected by conflict witnessed significant increases in food prices, largely by supply shortages as armed clashes disrupted vital trade routes. Between April and October, rice prices more than doubled in Kachin, Chin, Sagaing and Kayin (Figure 22). Taking a longer term perspective, recent analysis by the International Food Policy Research Institute (IFPRI) found that the cost of a healthy diet increased by 111 percent between June 2020 and August 2023 while the cost of a common diet increased by 130 percent[11]. Prices of pulses, pork, and leafy greens have approximately doubled, rice prices nearly tripled, and edible oil price more than quadrupled over that same period.

The authorities have introduced price control measures and export restrictions to respond to the sharp increase in food prices. However, these measures have been only partially effective: both the Yangon and WFP food price indexes declined in September and October, but prices remain at high levels and reports of domestic supply shortages persist (Figure 21). The reference price for edible oil was set between 4,160 kyat and 4,340 kyat per viss (or 1.68 kilograms), well below the market price of about 10,000 kyats. Profits from the sales of edible oil were capped at 10 percent of the wholesale reference price. Strict enforcement of price controls led to the arrests of some sellers who allegedly exceeded the fixed reference prices for rice and edible palm oil.[12]

[10] World Bank June 2023 Myanmar Economic Monitor
[11] IFPRI (2023) Monitoring the Agri-food System in Myanmar: the rising costs of diets and declining purchasing power of casual wage laborers, June 2020 – August 2023. Strategy Support Program - Research Note 102
[12] There are various reference prices for different brands of rice and reference price could be higher or lower than the market price depending on the brand.

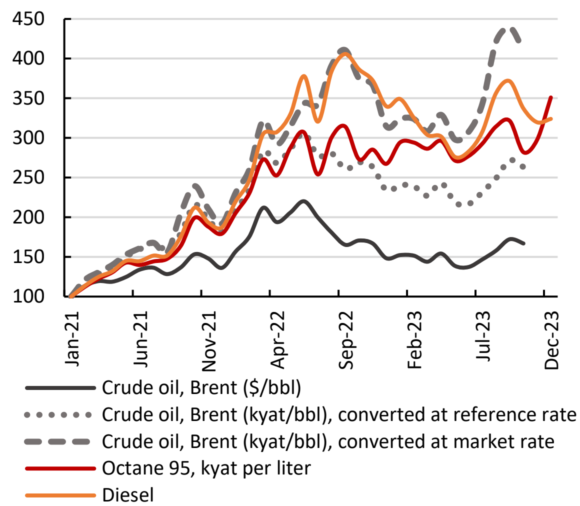
Nevertheless, edible oil and rice prices available in local markets remain well above levels seen in the first half of 2023 (Figure 22 and Figure 23). At the end of August, the authorities imposed a 45-day moratorium on the issuance of rice export licenses (those who already had licenses were allowed to continue exporting rice). The moratorium on rice exports in conjunction with limits on rice storage[13] helped to release a substantial volume of food products to the local market and appeared to be temporarily effective in reducing prices. But such measures may undermine future investment in agriculture to the extent that the risk of price controls and export restrictions impact profitability.

Figure 19: CPI inflation (YoY) vs changes in USD/kyat exchange rate (YoY)



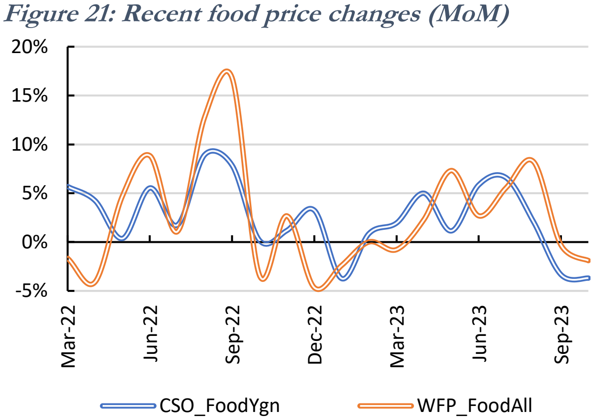
Source: CSO and money changers

Figure 20: Fuel price and key drivers, January 2021=100



Source: World Bank commodity price, Denko

Figure 21: Recent food price changes (MoM)

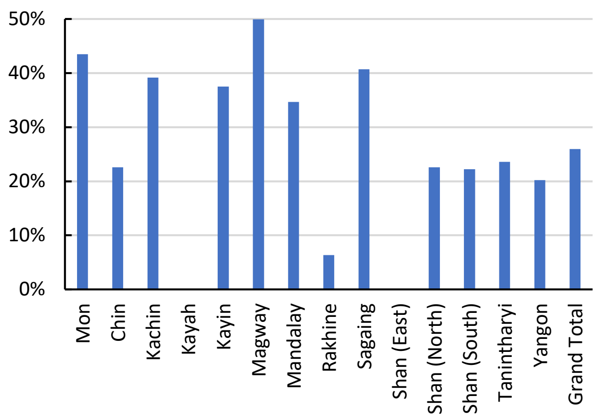


Source: CSO

13 A directive from the authorities limited the amount of paddy permitted for storage to above 20,000 baskets (approx. 46 lbs per basket) or worth about 200 million Kyat.

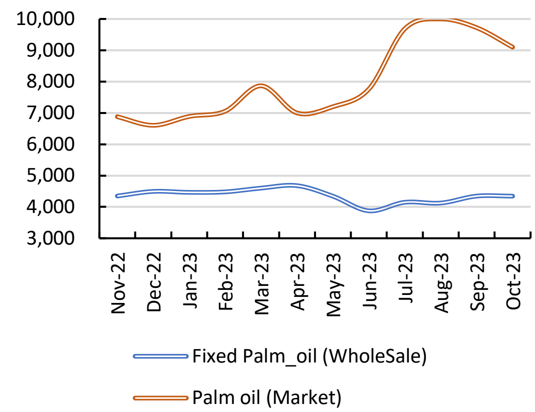
After peaking in March, nonfood inflation moderated to 35.9 percent in June, with high transport inflation the major contributor (Figure 17 and Figure 18). In early December, there were long queues at gas stations, as both diesel and petrol became relatively scarce due mainly to significant import delays with fuel importers reporting difficulties in obtaining foreign currency. Up until recently, fuel importers have been able to access a substantial proportion of their foreign currency needs at the reference rate of 2,100 kyat per USD, enabling them to profitably sell at regulated prices. But in December, gasoline importers have been unable to obtain their forex requirements at the reference rate and have had to source US dollars at market rates, triggering a substantial increase in price (Figure 20) and fueling expectations of further fuel price increases.

Figure 22: Regional changes in rice prices (low quality) between April and October 2023



Source: WFP

Figure 23: Reference price vs the market price of edible oil (kyat per viss)

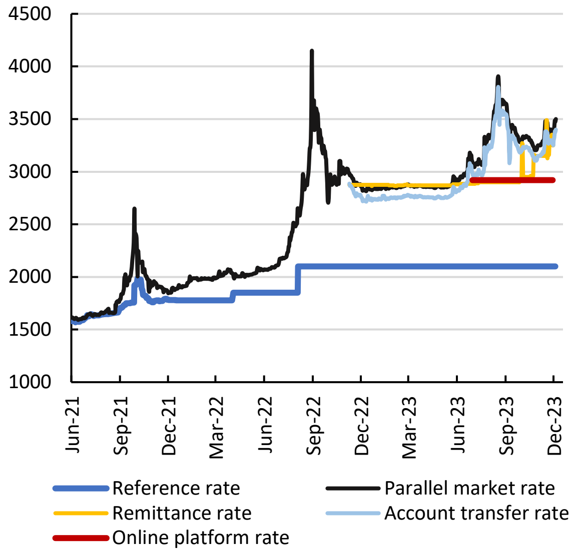


Source: CSO, media monitoring

D. There has been substantial volatility in the kyat exchange rate

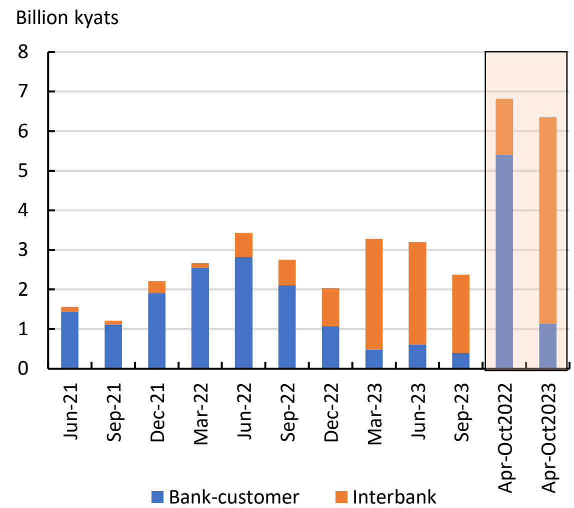
The kyat exchange rate came under renewed pressure in the second half of 2023. As of early December, the kyat had depreciated by about 14 percent against the US dollar from its level in May, following substantial volatility in the September quarter (Figure 24). The sharp depreciation in July and August followed the introduction of U.S. sanctions on two large state-owned banks, the announcement of restrictions on cross-border payments by international banks, and the launch of a higher denomination 20,000-kyat banknote which fueled renewed devaluation expectations. Fears of a reduction in foreign exchange inflows stemming from these developments reinforced ongoing pressure on the balance of payments associated with a reduction in merchandise exports, a moribund international tourism sector, and a lack of foreign direct investment (see Section F). The gap between the parallel market rate and the official reference rate grew larger (to around 60-70 percent), with persistent shortages of US dollars at below market rates.

Figure 24: Recent exchange rate developments (kyat per USD)



Source: CBM, money changers, and applications

Figure 25: Foreign exchange transactions (billion kyats)



Source: CBM

In response, interventions to encourage foreign currency inflows, limit outflows, and enforce non-market exchange rates have become more frequent and, in some cases, punitive. These included the introduction of an online foreign exchange trading platform, which effectively forced foreign exchange transactions involving banks – including sales of the 50 percent of export earnings which were at that point exempt from foreign currency surrender requirements – to be conducted at a rate below that available on the parallel market. This prompted a significant increase in interbank trades (Figure 25). Multiple exchange rates have emerged in Myanmar serving different purposes and market segments (Box 1). Enforcement of exchange rate controls and limits on parallel market activity has tightened, with arrests of money changers and the revocation of a large number of foreign exchange licenses. Rules have also been introduced to tax the foreign currency incomes of migrant workers and to compel them to remit 25 percent of these incomes every month through official banking channels or be denied access to public services such as passports. Several measures have also been introduced to diversify the currencies used for cross-border payments and promote the use of the Chinese yuan, Thai baht, and Indian rupee. At the same time, foreign exchange surrender requirements remain in place, though they have been progressively eased (see below).

As demonstrated by the elevated currency volatility in the past 18 months, these measures have generally been ineffective or only temporarily effective in restoring stability to foreign exchange markets, while exacerbating uncertainty and market distortions. In particular, these measures have done little to mitigate shortages of foreign exchange. Flow on effects from the shortage of foreign exchange have included restrictions on the issuance of import licenses, contributing to shortages of imported inputs and consumption goods. The allocation of US dollars at the official rate is being increasingly tightly rationed to benefit priority sectors. While use of the yuan and baht is being encouraged as alternatives to US dollar payments, many traders and banks are also facing challenges in accessing these currencies. At the same time, a lack of clarity around the implementation and enforcement of frequently changing and often non-transparent instructions has raised uncertainty for banks and trade-dependent businesses.

In early December, the Central Bank of Myanmar announced that it would allow exchange rate transactions by banks and licensed dealers to be conducted at the market rate. Foreign currency surrender requirements were also eased, with exporters now having to convert 35 percent of foreign currency export earnings to kyat within one day of receipt, down from 50 percent in the period from July to November 2023 and 65 percent in the year prior to July 2023. These announcements followed the reported cessation of dollar sales to fuel importers at the official rate of 2100 kyat to the dollar. The full implications remain unclear at the time of writing, with a lack of clarity around how these measures will be implemented in practice. But the moves likely reflect the difficulty of ensuring the availability of foreign currency at below-market exchange rates given ongoing pressures on the balance of payments.

Box 1: Emergence of multiple exchange rates

In August 2021, Myanmar abandoned its managed float exchange rate regime in favor of a fixed reference exchange rate, set at 2100 Kyat per USD. The CBM discontinued regular auctions of foreign currency to support the kyat, and instead implemented a range of administrative measures including foreign exchange surrender rules and trade license requirements. Despite these measures, the parallel market exchange rate has continued to depreciate, with the kyat about 60 percent lower against the US dollar than it was in 2021, while shortages of foreign currency persist.

As part of the system of heightened foreign exchange controls, multiple exchange rates have emerged (Figure 24), each with different objectives and serving different market segments. The main exchange rates currently applicable are discussed below.

1. **Reference rate**: is fixed at 2,100 kyat per USD and exclusively for exporters and importers. On December 5th, the CBM revised the foreign currency surrender requirements so that exporters are required to surrender 35 percent of their export earnings at the official reference rate (down from 50 percent previously). The surrendered foreign currency is sold to importers of priority commodities such as fuel and edible oil at the same rate. However, the list of priority products changes frequently and lately importers have not had all their forex needs met at the reference rate.
2. **The online Interbank Foreign Exchange Platform Rate**: This rate is applicable to that proportion of export earnings that are not subject to surrender requirements. Previously the CBM set the rate on the online foreign exchange platform, and it fluctuated between 2,900 – 2,950 kyat per USD. As of December 5th, the rate on the interbank platform is determined by market forces (demand from importers and supply by exporters).
3. **The remittance rate**: applies to migrant workers' remittances through official channels such as AD license holders and money changers. It was initially set at 2,900 kyat per USD but currently fluctuates around 3,300 kyat per USD, about 5 percentage lower than the market rate.
4. **Account transfer rate**: applicable mainly to importers and individuals overseas making payments such as education, medical treatment, relocation, and condominium purchases outside. Such transaction rates are flexible and negotiated between banks and customers. It usually hovers around the market rate (about 3 percent lower than the market rate).
5. **Parallel market rate**: a market determined rate that is available outside the formal financial system. There has been a significant crackdown on parallel market activities in recent months, making it more difficult to access foreign currency in the parallel market.

E. The financial sector is exposed to several risks

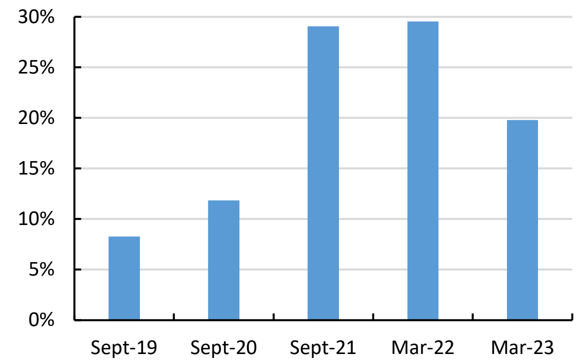
Myanmar's financial sector is facing a range of external pressures which have the potential to disrupt cross-border transactions. In October 2022, Myanmar was designated as a high-risk jurisdiction by the Financial Action Task Force (FATF) due to significant deficiencies in its anti-money laundering and countering the financing of terrorism (AML/CFT) efforts[14]. Subsequently, JP Morgan terminated USD clearing services for transactions originating from Myanmar in the first quarter of 2023. In June 2023, the United States government announced sanctions against Myanmar Foreign Trade Bank (MFTB) and the Myanmar Investment and Commercial Bank (MICB), two large state-owned banks that are legally mandated to manage foreign exchange transactions on behalf of Myanmar's state-owned enterprises. Singapore's United Overseas Bank (UOB) announced restrictions on cross-border payments to and from Myanmar effective October 1, 2023, including closure of nostro accounts of military-affiliated entities (Box 2). Since these measures have become effective there is anecdotal evidence to suggest that firms have adopted various measures to adapt, including by shifting their business to other banks, restructuring their international transactions, and/or attempting to use alternative currencies such as the yuan and baht to facilitate international trade. Nevertheless, there is ongoing potential for disruption to trade flows (payments for exports and imports), workers' remittances, and financial flows (including debt repayments and investment income), worsening the country's balance of payment problems.

Nonperforming loans (NPLs) pose substantial risks to bank balance sheets. Publicly available information from a sample of commercial banks indicates that the NPL ratio stood at approximately 20 percent (Figure 26). The high NPL ratio was in part explained by loans to the hotel and tourism sector, which has remained very weak after the impact of the COVID-19 pandemic and military coup. But even after excluding loans from the tourism sector, the NPL ratio remains high at 15-16 percent, still well above the prudential limit. High NPLs have squeezed bank profitability: both return on assets (ROA) and return on equity (ROE) declined in 2022, reflecting increased loan-loss provisioning.

On the other hand, bank deposits appear to have stabilized in the year to June 2023, supporting growth in credit. This indicates that depositors have regained some degree of confidence in the banking system after the liquidity crises in 2021 (Figure 27). The average liquidity ratio of a sample of banks was approximately 50.0 percent as of March 2023, well above the CBM's 20.0 percent minimum requirement, supported by the surge in deposit mobilization. As of June 2023, bank credit had increased by 18.0 percent[15] compared to the same period last year driven mainly by loans to micro small medium-sized enterprises (MSMEs) and the real estate and construction sectors.

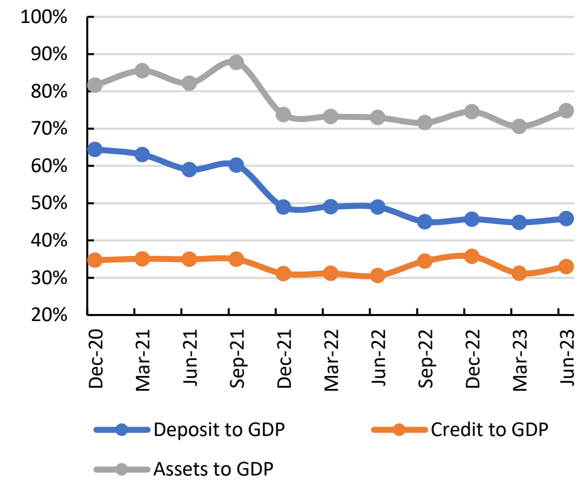
[14] FATF called on its members as well as nonmembers to apply "enhanced customer due diligence (CDD) measures" to mitigate AML/CFT risks from Myanmar.
[15] Total bank credits reached 39.92 trillion kyat, about 33.0 percent of GDP.

Figure 26: Non-performing loans (percent)



Source: Public reporting from sample of commercial banks, World Bank Staff estimates

Figure 27: Deposits, credit and assets to GDP



Source: CBM

Box 2: Recent restrictions on cross-border payments[16]

Correspondent banks play a critical role in facilitating cross-border payments in Myanmar. According to the CBM, cross-border payments to and from Myanmar stood at US$26 billion in 2021, equivalent to about a third of GDP. Most of Myanmar's correspondent banks are Singapore-based (such as OCBC, UOB, OBS, DBS); some are also based in Thailand, Korea (KEB bank) and Japan (MUFG bank). Of the Singaporean banks, UOB has among the most significant correspondent banking relationships (CBRs) with Myanmar counterparts, including state-owned banks.

There are several possible implications of UOB's recent decision to restrict international payments to and from Myanmar, though actual impacts since the decision came into effect on 1 October have been difficult to discern. The restrictions have the potential to disrupt trade flows (payments for exports and imports), workers' remittances, and financial flows (including debt repayments and flows of investment income). They could directly affect access to Myanmar's foreign exchange reserves, some of which are held in Singapore. The decision also creates uncertainty among Myanmar banks and businesses, given the potential for other Singaporean banks to follow suit and impose similar restrictions. In addition to the direct reputational impacts that individual Myanmar firms would face if their ability to make international payments is impeded, Myanmar's attractiveness as a destination for foreign investment will deteriorate further.

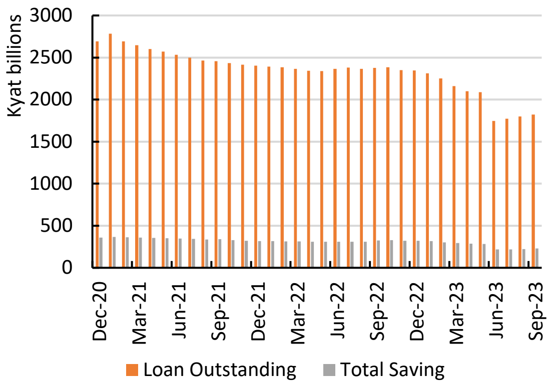
[16] Cross-border payments are made through a network of correspondent banks – an arrangement where one bank (the respondent bank) opens a foreign currency deposit or liability account (also known as a 'nostro account') in another bank (the correspondent bank) to facilitate a range of international transactions and services.

The authorities have reacted to the latest restrictions on cross-border payments by introducing measures aimed at reducing Myanmar's reliance on the US dollar – and, by extension, correspondent banks that facilitate US dollar payments. On June 1, the Foreign Exchange Supervisory Committee issued a directive mandating the use of yuan for cross-border trade with China. Under the directive, traders must provide a bank statement proving they have yuan in their bank account when applying for an import license for border trade with China. On August 14, CBM issued a directive that allowed licensed banks to utilize Thai Baht for international payments and settlements (beyond those payments associated with Thai border trade). The CBM has also negotiated with the Reserve Bank of India to create rupee-kyat payment and settlement mechanisms.

At the margin, these measures could reduce reliance on US dollars and the CBRs that facilitate US dollar payments, but only to the extent that overseas counterparts are willing to make and receive payments in their local currencies rather than dollars. Moreover, banks in Thailand and China are not as globally integrated as Singaporean banks and hence an attempted diversion of CBRs to these countries could have longer-term implications for the cost and ease of transacting with Myanmar firms. Importantly, measures to promote the use of non-USD currencies will not help to mitigate the issues associated with an overvalued official exchange rate and multiple non-market exchange rates, which continue to act as a more fundamental constraint to trade.

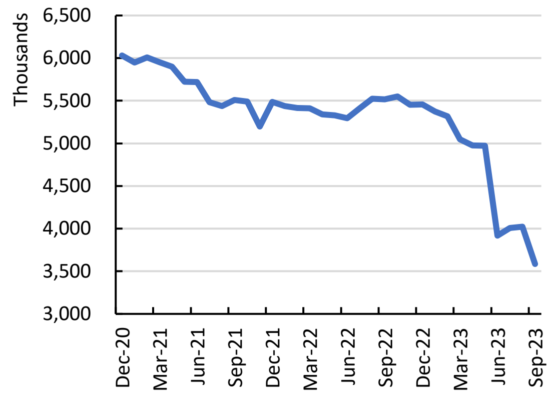
The performance of microfinance institutions weakened further during 2023 reflecting the effects of conflict and the challenging macroeconomic environment. As of September 2023, the loan portfolio had declined by 23 percent to 1,823.08 billion kyat (Figure 28) compared to the same period last year while the number of clients fell by 35 percent to 3.6 million (Figure 29). These developments largely reflected the closure of Pact Global Microfinance Fund Myanmar (PGMF) in June 2023 as well as conflicts affecting certain remote parts of the country, which made it more difficult for MFIs to locate or access clients. NPLs are estimated at around 30 percent of total loans in 2023, due mainly to a combination of poorly-performing legacy loans and conflict-related defaults as clients are displaced. At the same time, MFIs are struggling to access the funding necessary to provide new loans to their clients. Borrowing from international lenders has been hindered by foreign exchange restrictions imposed by the CBM, and the risks of currency fluctuations which impact repayment obligations. The MFIs are therefore increasingly dependent on borrowing from local banks, but the collateral requirements associated with these loans are often very costly.

Figure 28: Loans outstanding and savings - MFIs



Source: FRD

Figure 29: Number of clients - MFIs

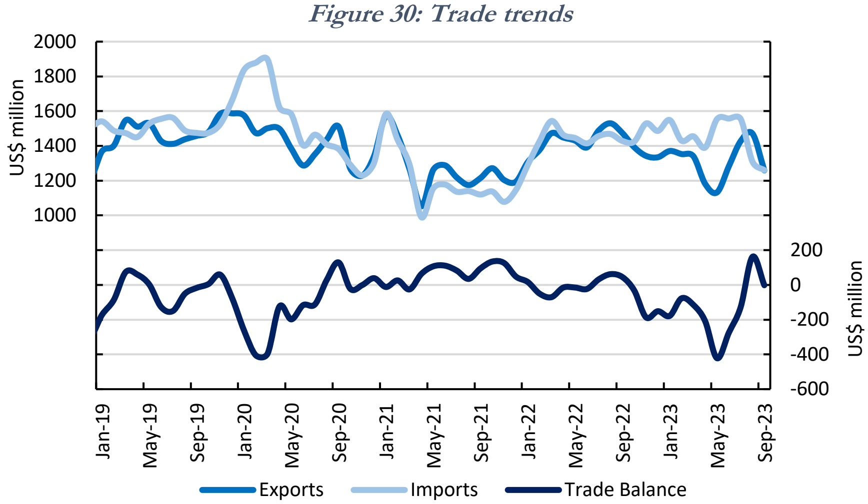


Source: FRD

F. Myanmar's trade deficit widened, increasing balance of payments pressures

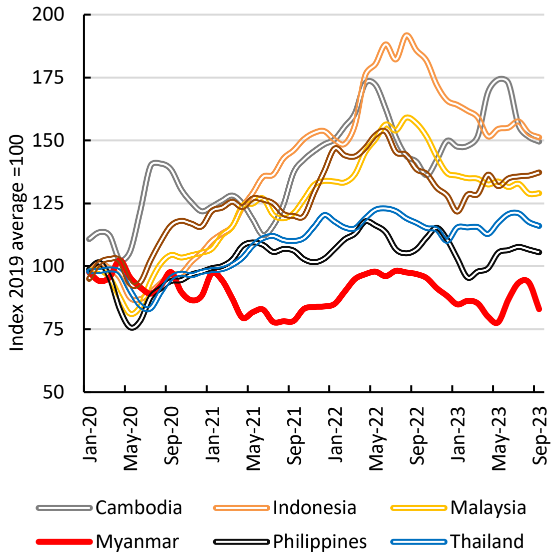
Myanmar's external trade balance has weakened over the past year due to a combination of softening external demand and increased logistics constraints. The trade deficit increased to US$831 million during the six months, April to September 2023, from a surplus of US$65 million in the same period last year (Figure 30) as the reduction in imports was offset by a drop in exports. Exports contracted by 11 percent, due partly to a global downturn in demand and partly to the increase in logistics constraints owing to conflict in some parts of the country. Several regional peers in East Asia and Pacific also recorded declines in exports due largely to weak global demand (Figure 31).

Figure 30: Trade trends



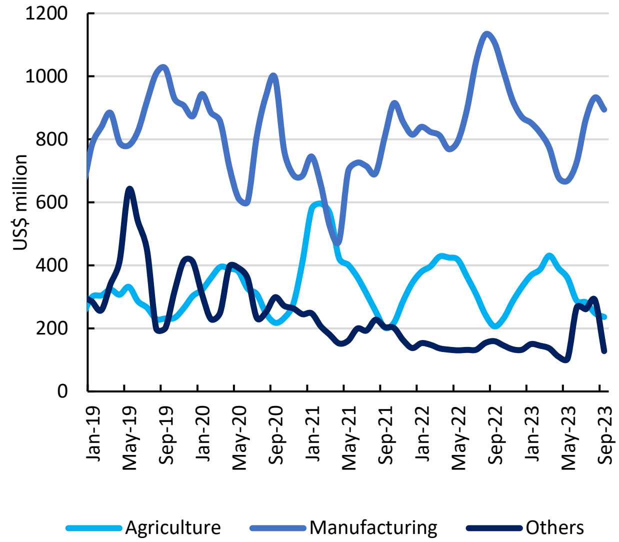
Source: Ministry of Commerce
Note: Data reflects 3-month moving average

Figure 31: Goods exports of EAP countries



Source: General Department of Customs and Excise of Cambodia, Indonesia' Central Bureau of Statistics, Department of Statistics Malaysia Myanmar's Ministry of Commerce, Thailand's Ministry of Commerce, Philippines Statistics Authority, General Statistics Office of Vietnam
Note: Data reflects a 3-month moving average and is seasonally adjusted.

Figure 32: Exports by sector

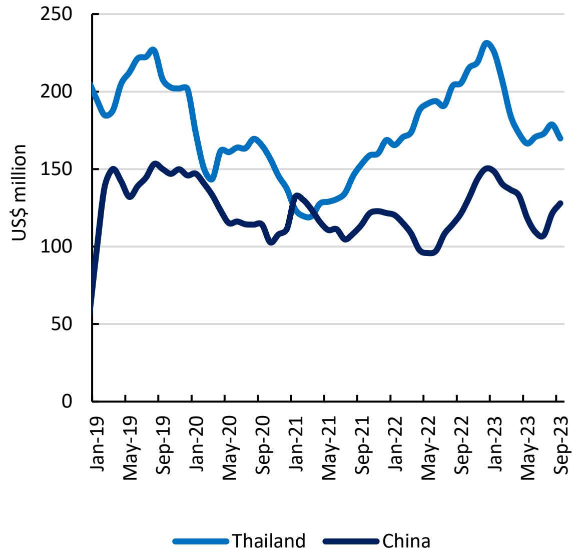


Source: CEIC and Ministry of Commerce
Note: Data reflects a 3-month moving average.

The drop in manufacturing exports primarily explained the overall reduction in exports over the half year, April – September 2023. Manufacturing exports declined by 19 percent, approximately US$1.1 billion, compared to the same period last year, due largely to weak global demand (Figure 32). Both natural gas and garment exports, the major components of Myanmar's manufacturing exports, experienced sharp declines in the six months to September 2023. Mirror analysis indicate that Myanmar's natural gas exports declined by 6 percent in value terms due mainly to a 15 percent contraction in gas exports to Thailand, which constitutes about two-thirds of Myanmar's gas exports (Figure 33). Meanwhile, gas exports to China, accounting for the remaining one-third, increased by 9 percent. Similarly, garment exports to Myanmar's major markets declined by 19 percent (Figure 34). The most significant decline in garment exports occurred in the EU, the UK, and the US, which together constitute two-thirds of Myanmar's total garment exports, and experienced a 26 percent decline. The decrease is attributed mainly to waning demand in the European and US markets, as well as the withdrawal of some global brands from Myanmar's market.[17,18]

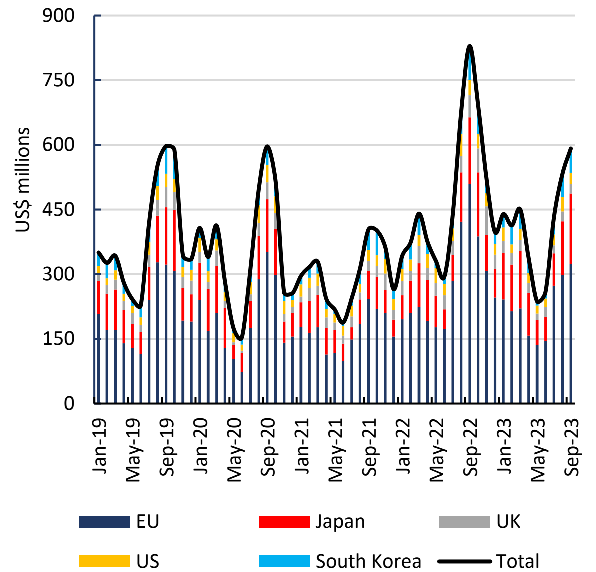
[17] Bright Green, 2022. Marks & Spencer joins other brands in exiting Myanmar following pressure from unions.
[18] Irrawaddy, 2023. H&M's Forced Exit Leaves 42,000 Myanmar Workers Asking How They Will Eat.

Figure 33: Myanmar gas exports to China and Thailand



Sources: China's General Administration of Customs and Thailand's Ministry of Commerce
Note: Data reflects a 3-month moving average. Data is mirrored using natural gas imports reported by China and Thailand to proxy Myanmar's gas exports to partners.

Figure 34: Garment exports to the major markets

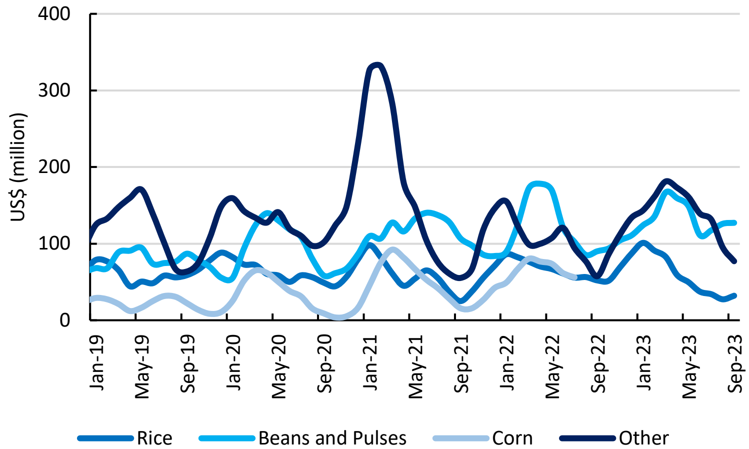


Source: WB staff calculation using data from Eurostat, Statistics of Japan, UK Office for National Statistics, US Census Bureau, and Korea Customs Service
Note: Import data from Myanmar's major markets are mirrored to examine the latest trends of garment exports to major markets.

Agricultural exports declined by 8 percent in the six months to September compared to the corresponding period last year (Figure 32). Notably, the value of rice exports, a major component of agricultural exports, saw a significant decline of 39 percent (Figure 35). This decrease is likely associated with a decline in rice production as the global rice price remained high over the same period.[19] The Food and Agriculture Organization (FAO) had previously projected a 10.2 percent decrease in rice production in 2022 compared to 2021.[20] Reduced production in 2022 could result in a decline in rice exports in 2023, given the lower availability of rice stocks. In contrast, beans and pulse exports demonstrated positive trends, increasing by 12 percent and 6 percent in terms of value and volume, respectively, during the half year April - September. This growth can be partly attributed to a memorandum of understanding and the growing demand from India.[21]

[19] FAO Rice Price Update November 2023
[20] FAO, 2023. GIEWS Country Brief, The Republic of the Union of Myanmar. June 13, 2023.
[21] Global New Light of Myanmar, 2023. Myanmar's various pulses exports bag US$715 million during April-September.

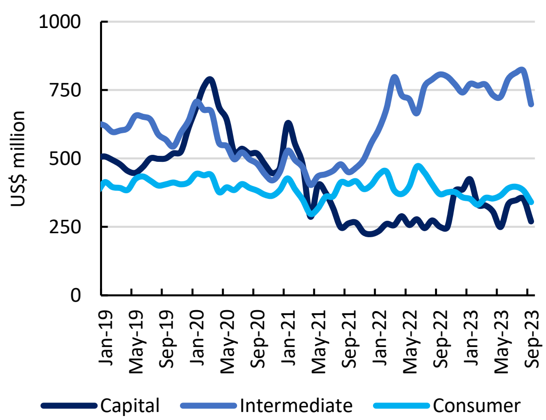
Figure 35: Agricultural export trends



Source: Central Statistical Organization, Ministry of Commerce, and Myanmar Rice Federation.
Note: Monthly corn exports data is available only up to July 2022: corn exports are included as part of the "other" series from August 2022 onwards.

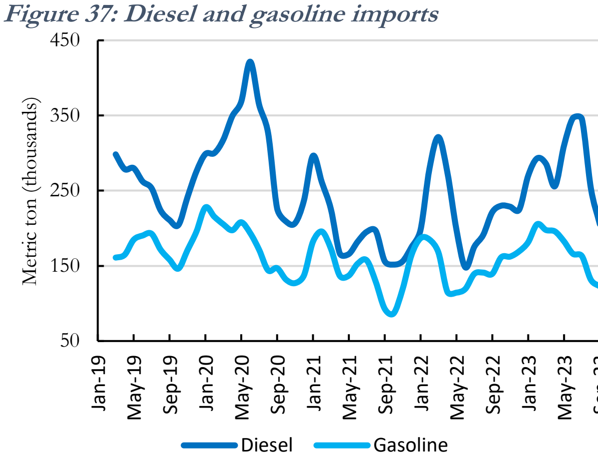
Imports remained relatively stable during the half year April to September 2023, experiencing only a 1 percent decline compared to the same period last year. Intermediate imports, a significant driver of Myanmar's imports since late 2021, remained steady, while consumer imports continued their decline (Figure 36).

Figure 36: Import trends



Source: Central Statistical Organization, and Ministry of Commerce
Note: Data reflects a 3-month moving average.

Figure 37: Diesel and gasoline imports

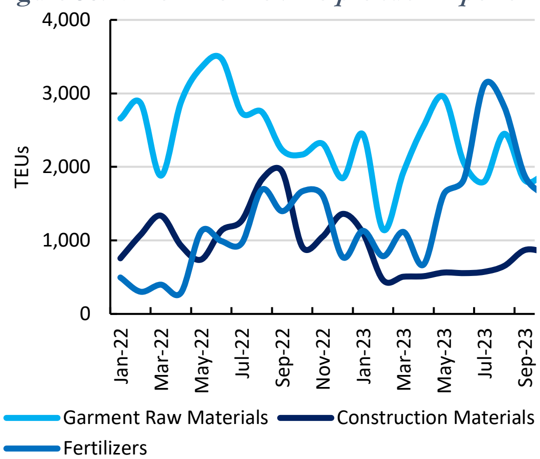


Source: Shipping operators
Note: Data reflects a 3-month moving average.

Within intermediate products, fuel and fertilizer imports increased while imports of garment raw materials declined. The volume of fuel imports (diesel and gasoline) saw a substantial 36 percent increase in the six months to September compared to the same period last year (Figure 37). This rise is primarily attributed to increased global crude oil prices as well as domestic power outages, which contributed to a 49 percent increase in diesel imports as businesses had to rely on diesel-based generators for their operations. However, both diesel and gasoline imports have trended downward in recent months due to restrictions on fuel imports. Alongside fuel imports, fertilizer imports also increased by 46 percent in volume terms compared to the same period last year, notwithstanding a downward trend since July 2023 (Figure 38). In contrast, available data suggests a decline in imported raw materials for garments, aligning with the decreasing trend in garment exports, as well as a decline in construction materials.

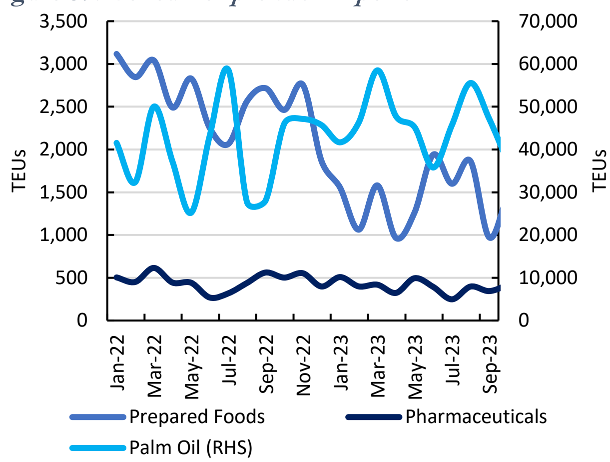
The reduction in capital imports as well as construction materials is indicative of the weak recovery of foreign direct investment, especially for public infrastructure projects. Among consumer imports, the volume of palm oil imports increased by 21 percent, while the volume of prepared food and pharmaceutical imports declined by 73 and 12 percent, respectively (Figure 39). This in part reflects the impact of import license restrictions, leading to the substitution of local production for certain imported products, as well as weaker domestic demand.

Figure 38: Other intermediate product imports



Source: Shipping operators

Figure 39: Consumer product imports



Source: Shipping operators

Box 3: Border disruptions and their potential impacts on trade

The increase in armed clashes since October has disrupted several land trade routes to neighboring countries which account for a substantial proportion of Myanmar's overall trade. In the north, clashes between the military and ethnic armed groups periodically blocked the key crossings at Muse, Chin Shwe Haw and Lweje into China. In the southeast, fighting has obstructed the Myawaddy and Mae Sot crossings with Thailand. Trade via land is an important component of Myanmar's merchandise trade as it accounted for about 40 percent of all exports between 2021 – 2023 and 20 percent of total goods imports over the same period. Thailand and China are the major land trade partners (Figure 40 and Figure 41). Major land exports are agricultural products (rice, corn, bean and pulses, etc) and manufactured goods (Figure 42), mainly natural gas. Major imports through land borders include consumer goods, capital (mechanical/electrical equipment) and intermediate goods (mainly raw materials for garments manufacturing) (Figure 43).

Figure 40: Land imports from Thailand and China by major land border post

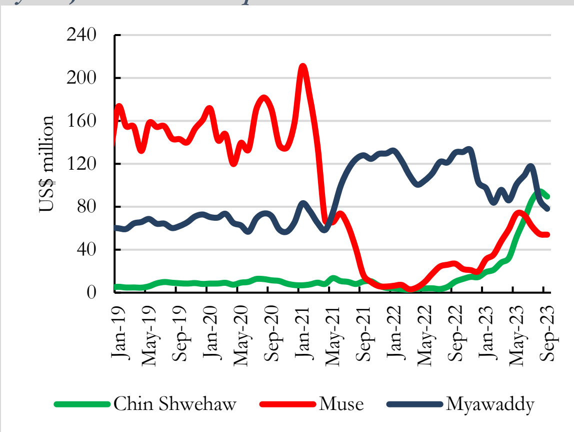
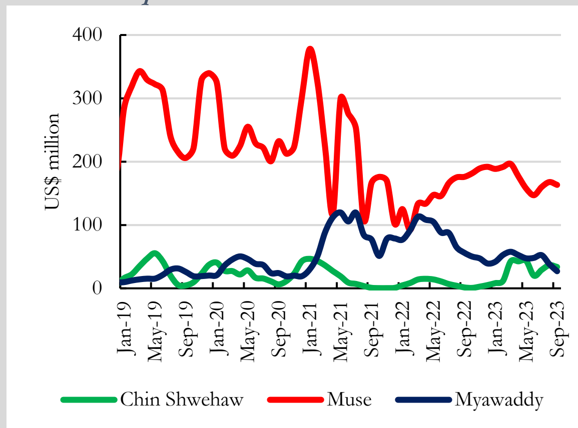


Figure 41: Exports to Thailand and China by major land border post



Source: WB staff calculation using data from Ministry of Commerce

Figure 42: Myanmar land exports by product

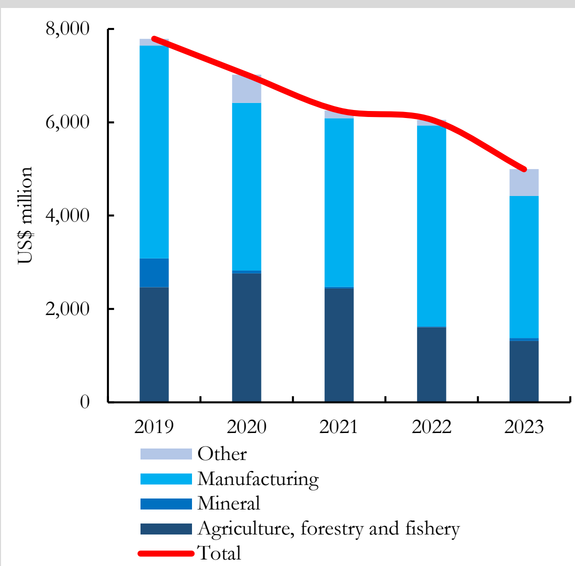
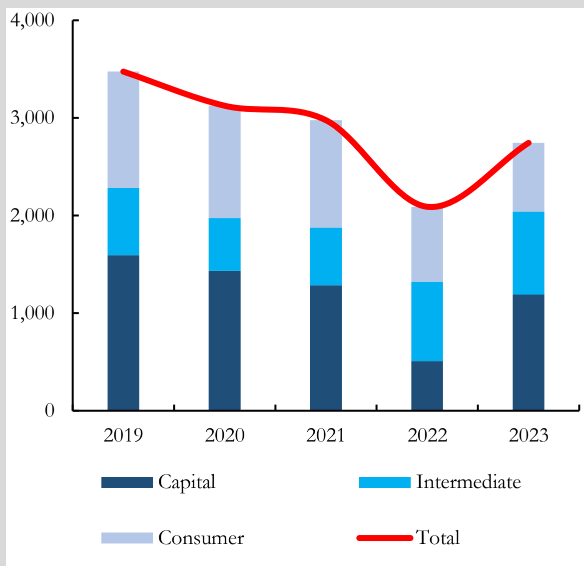


Figure 43: Myanmar's land imports by product



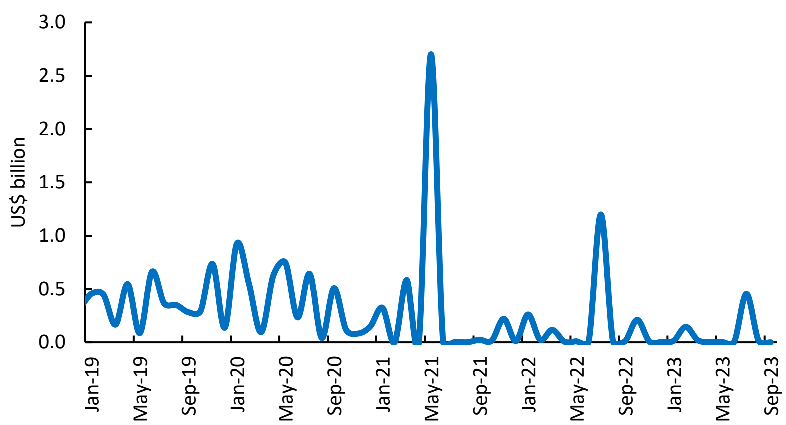
Source: Central Statistical Organization and Ministry of Commerce, World Bank staff estimates
Note: Agriculture, forestry and fishery also include animal exports. The data for 2023 includes data up to October.

Myanmar's export trade is vulnerable to land border disruptions given the large share of goods exports that go through land borders (40 percent). Among land exports, agriculture commodities, which comprise about a third of land exports, are the most vulnerable to border trade disruptions. More than one-third of agricultural exports go through land borders, with roads tending to provide the most cost-effective route to the large neighboring markets. Given the perishable nature of agricultural commodities, the disruption of these trade routes has the potential to impose significant losses for agricultural exporters, especially for goods in transit, as well as increasing logistics costs as farmers look for alternative routes to reach export destinations. The remaining two-thirds of land exports are manufactured products, which are primarily natural gas exports and likely to be largely unaffected by border disruptions.

Myanmar's overall imports are also vulnerable to land border disruptions with about 20 percent of total imported goods coming via land. About half of all land imports in 2023 were consumer products imported from China, while 40 percent of total land imports were capital goods. Disruptions to border trade therefore have the potential to affect the availability and prices of some consumer imports, as well as firms' access to key inputs such as machinery and equipment.

Foreign direct investment (FDI) commitments remained low at US$484 million half year, April – September 2023, 61 percent lower than the same period last year (Figure 44**)[22].** The modest spike in July 2023 was largely attributable to approvals of Singaporean investments in power projects. By industry, the power sector dominated total FDI commitments, accounting for 66 percent of the total (US$318 million across two projects). Transport and communication accounted for 16 percent (US$78 million, additional investments in existing projects), and manufacturing accounted for 13 percent across 26 projects. Singapore regained its position as the largest source of foreign investment in the six months to September, contributing 70 percent (approximately US$337 million) of the total FDI commitments across five projects. Chinese investors accounted for the remainder.

Figure 44: FDI commitments



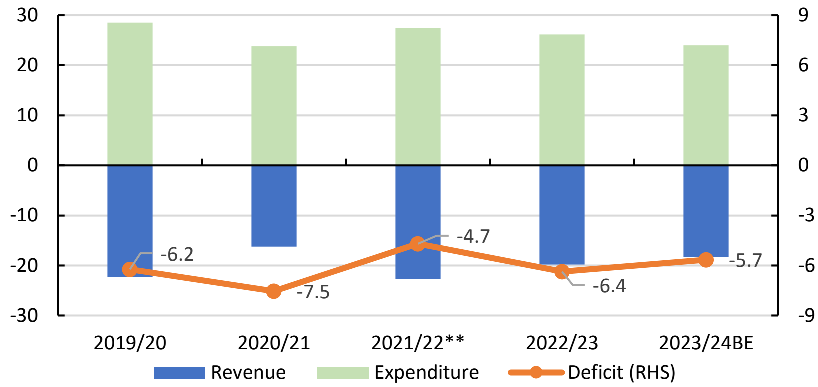
Source: Directorate of Investment and Company Administration (DICA)

[22] Cumulative FDI commitment data from DICA for September 2023 remained unchanged from August 2023. While the data sheet URL was titled September 2023, the date in the data column referred to was August 31, 2023, leading to the assumption that no FDI commitments were recorded in September.

G. Fiscal space remains constrained, with revenues well below pre-pandemic levels[23]

Myanmar's headline fiscal deficit widened to 6.4 percent of GDP in the fiscal year ending March 2023 (2022/23) driven mainly by weak domestic revenue mobilization (Figure 45)[24]. Despite the authorities' published intention to increase spending to stimulate economic growth, total expenditure declined by 1.2 percentage points of GDP, constrained by weak domestic revenue mobilization and limited sources of financing.

Figure 45: Fiscal aggregates (% of GDP)



Source: MOP, CBM, IRD and World Bank staff calculations. BE refers to Budget Estimate.

Total revenues have declined steadily since end-March 2022 (Figure 46) due mainly to sluggish economic activity as recovery from the coup and COVID-19 remained severely constrained. Total revenue fell by about 3 percentage points to 19.8 percent of GDP in 2022/23 as both tax and nontax revenue declined reflecting subdued economic activity. Tax revenue declined by 0.6 percentage points to 6.0 percent of GDP driven mainly by lower collection of income and commercial taxes despite the introduction of more stringent tax enforcement measures. Nontax revenue remained the main source of government revenues accounting for about 68 percent of total revenues in 2022/23. After increasing in the previous six months, total nontax revenues fell by about 2.3 percentage points to 13.8 percent of GDP driven mainly by a sharp drop in "other current receipts" which includes all revenues collected by government ministries, departments and agencies (Figure 47). The drop in the "other current receipts" partly reflects the slow recovery of key sectors such as tourism, health, and education, reducing service fees collected by agencies in these sectors. Revenues from State-owned Economic Enterprises (SEE) remained flat over the past 12 months at 1.9 percent of GDP after a moderate recovery last year, an indication that commercial activities of these public enterprises were yet to fully recover. However, other nontax revenue increased to 2.2 percent of GDP from 1.4 percent of GDP last year due mainly to the introduction of new levies and fines. For instance, the authorities have introduced

[23] In this section "2021/22" refers to the six month period October 2021 to March 2022, during which Myanmar transitioned between a September-ended and a March-ended fiscal year. Budget aggregates for the fiscal year 2021/22 have been annualized for ease of comparison.

[24] World Bank (forthcoming): Myanmar Budget Brief.

several new registration fees for businesses and online public services. Furthermore, stiff fines have been introduced for failure to comply with regulations and directives.

Figure 46: Tax revenue composition

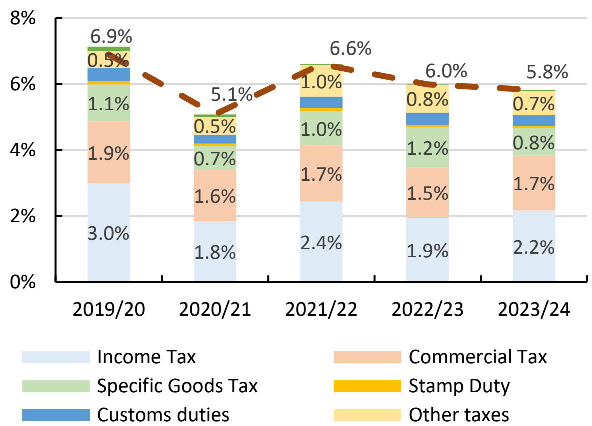
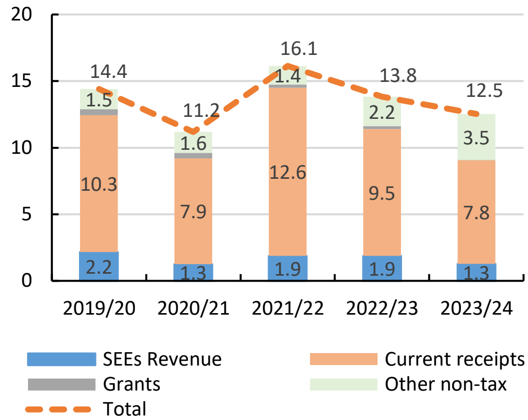


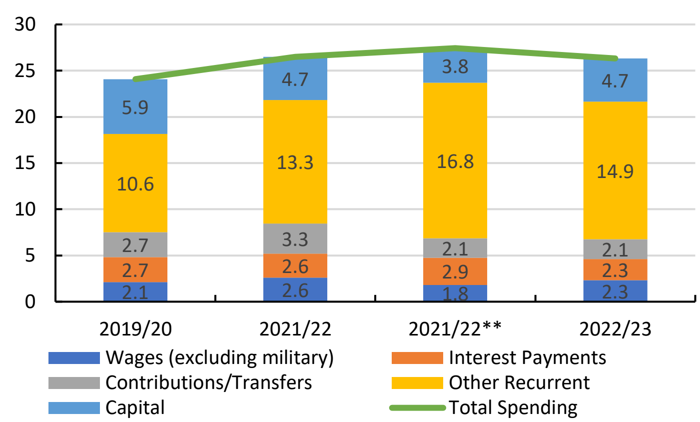
Figure 47: Nontax revenue composition



Source: MOP, CBM, IRD and World Bank Staff Calculations. BE means Budget Estimates

Total expenditure fell by about 1.2 percentage points to 26.3 percent of GDP in the year ending March 2023 (Figure 48) driven by a reduction in recurrent spending. Compared to the annualized rate for last year, recurrent spending fell sharply by 2.1 percentage points to 21.6 percent of GDP in 2022/23 due to a drop in interest payments on debt and cutbacks in 'other current expenditure' (which mainly include goods and services purchases by ministries and departments). Interest payments declined to 2.3 percent of GDP from 2.9 percent last year reflecting a slight moderation of domestic interest payments due mainly to cyclical factors, while external interest payments remained unchanged at 0.2 percent of GDP. However, wages and salaries (excluding emoluments of the military) rose by 0.5 percentage points to 2.3 percent of GDP. In light of the rising cost of living, new allowances were announced in July 2023 which could contribute to further increases in wages next fiscal year.

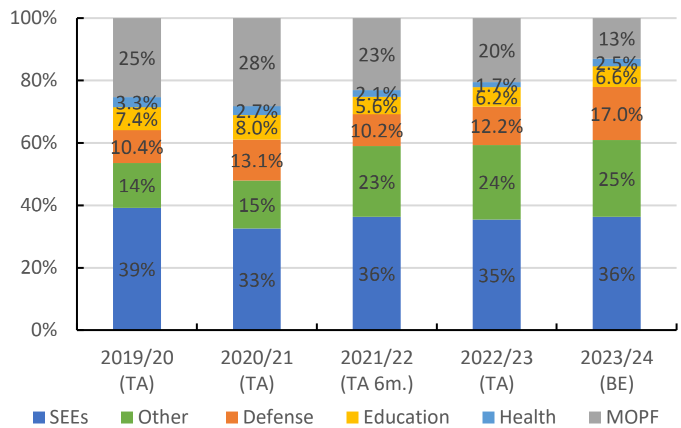
Figure 48: Composition of expenditure by economic uses (% of GDP)



Source: Central Bank of Myanmar Quarterly Financial Statistics; WB staff estimates.

After declining by over 2 percent of GDP since the pandemic, capital expenditure rose by about 1 percentage point to 4.7 percent of GDP in 2022/23, but spending on public services remains very low (Figure 49). Combined spending on health and education has declined from 3.8 percent of GDP in 2019/20 to around 2 percent in 2022/23. The share of the health and education budget in overall spending has also declined by about 3 percent over the same period. But spending on the education sector grew moderately to about 6.2 of total spending during the fiscal year ending March 2023 compared to 5.6 percent last year reflecting the gradual reopening of schools, colleges, and universities in areas unaffected by conflict. As a share of total spending, health expenditure declined to 1.7 percent, down from 2.1 percent a year earlier reflecting challenges in public health financing and broader fiscal constraints. At about 12 percent of total spending on average, defense expenditure has exceeded the combined spending on health and education since 2021.

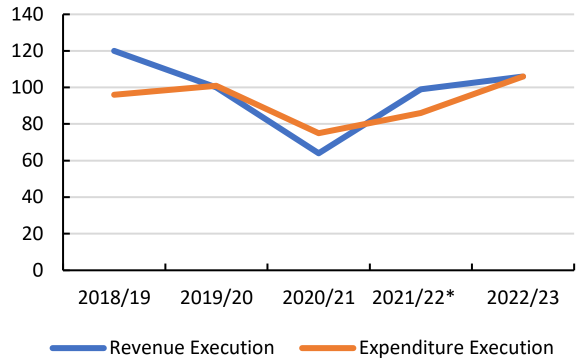
Figure 49: Composition of expenditure by government function (% of total spending)



Source: MOPF - https://www.mopfi.gov.mm/; WB staff estimates.

Budget execution picked up during the 2023 fiscal year. Spending exceeded the budget by 6.5 percent in 2022/23 (Figure 50), compared to a 20 percent under-execution of the budget the previous fiscal year. The higher execution rate was likely in large part due to high inflation which has resulted in increased delivery costs, rather than improved budget management. Similarly, revenue collection exceeded target by about 6 percent due mainly to the increase in inflation. Both tax and nontax revenues have declined as a share of GDP suggesting relatively weak performance in revenue collection in real terms.

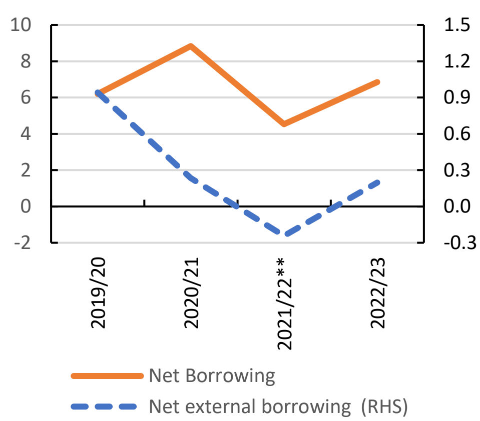
Figure 50: Budget outturn, spending and revenue as % of the budget estimate



Source: https://www.mopf.gov.mm/; WB staff estimates. *means 6 months.

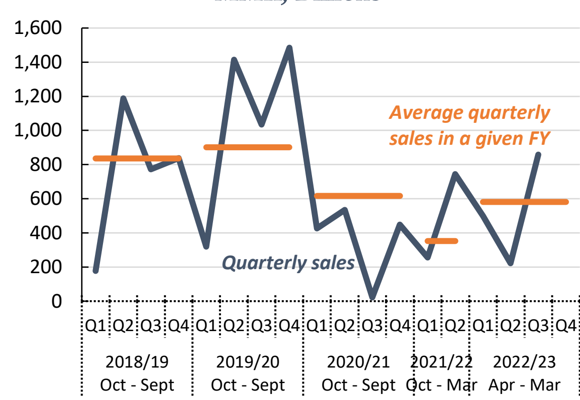
Budget financing needs remain large with net borrowing from the economy estimated at about 7.0 percent of GDP during the fiscal year ending March 2023. Net external borrowing stood at 0.2 percent of GDP (Figure 51), accounting for about 3 percent of total borrowing, reflecting increased difficulties in obtaining external financing. Net borrowing from domestic sources was estimated at 6.8 percent of GDP, up from about 5 percent last year, reflecting the increased fiscal deficit which was financed mainly by the Central Bank, with activity on domestic security markets remaining subdued. Available information indicates that about 70 percent of domestic borrowing is from the Central Bank of Myanmar (CBM), equivalent to about 4.8 percent of GDP. While the sale of Treasury Bonds picked up in 2023, the average quarterly sales volume remains below 2021 levels. The volume of T-bonds sold rose to MMK 858 billion during the last quarter of 2022/23 (January – March), the largest quarterly increase since December 2020 (Figure 52). Total bond sales were equivalent to about 2.0 percent of GDP during 2023 compared to 3.2 percent before the pandemic.

Figure 51: Budget financing needs (% GDP)



Source: Central Bank of Myanmar Quarterly Financial Statistics; WB staff estimates. ** means annualized estimates

Figure 52: Quarterly securities auction of T-Bonds in MMK, Billions



Source: Central Statistical Organization; WB staff estimates

Public debt is estimated to have remained relatively stable at above 60 percent of GDP in FY2023, with the impact of recent deficits being broadly offset by high inflation. Domestic debt to GDP has increased significantly from 27 percent in 2019/20 to about 41 percent in 2022/23 as external borrowing was limited. The total external debt stock stood at 23.1 percent of GDP in FY2023, 71 percent of which was held by bilateral creditors and the remainder by multilateral creditors. The increase in public debt between 2020 and 2022 – almost 20 percent of GDP – can be attributed to relatively high fiscal deficits, sluggish economic recovery from the coup and the pandemic and exchange rate valuation effects.

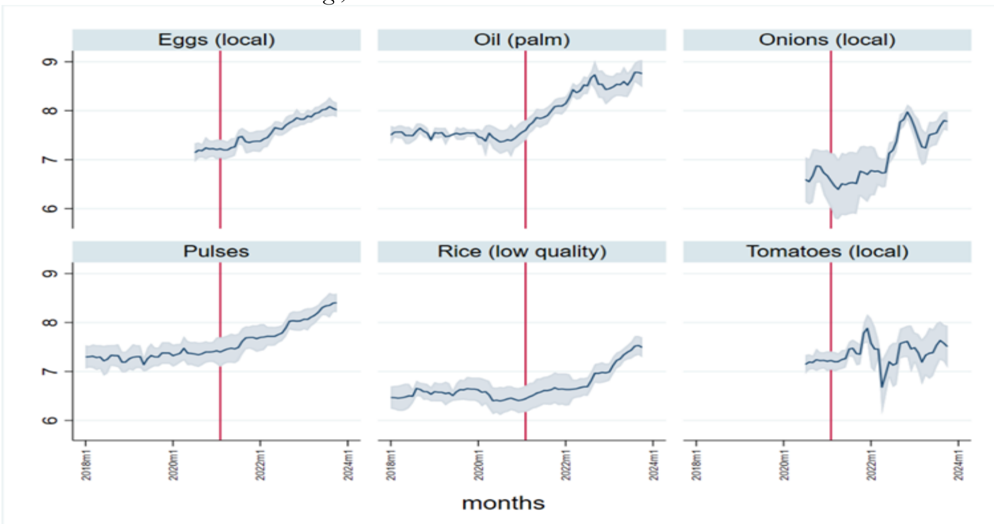
H. Economic shocks and conflict continue to negatively impact livelihoods.

Households continue to suffer from conflict and macroeconomic shocks including high food price inflation. Findings from the fifth round of the Myanmar Households Welfare Survey (MHWS), conducted by International Food Policy Research Institute (IFPRI) between March – June 2023, indicates that food insecurity has worsened since 2021/22.[25] The proportion of households with a borderline or poor food consumption score – a measure of nutritional value and food frequency – increased to 17.7 percent, up from 9.4 percent in the first round (Dec 2021 to Feb 2022). The shares were highest in Chin, Kayah, and Kachin. Inadequate diet diversity among adults rose from 20.6 to 27.2 percent. Rising food prices, conflict and physical insecurity were found to increase the likelihood of poor diet quality, while remittance-receiving households were less likely to experience hunger or poor dietary diversity. More recently, in August 2023, FAO-WFP reported that about 5 percent more households had adopted additional crisis and emergency coping strategies since May 2023[26].

Worsening food security is large part explained by high and rising food prices. The recent high food price inflation has been particularly damaging in the context of weak nominal household incomes. World Bank analysis using MLCS and WFP surveys indicates that for households in the bottom two quintiles of the consumption distribution, prices of the six major commodities (rice, pulses, edible oil, onions, eggs and tomatoes) have increased by an average of 16.6 percent annually between 2017 and June 2023 (Figure 53). This is about 2.3 percentage points per year higher than for the households at the top of the consumption distribution. This is because poorer households tend to live in areas in which food prices at local markets have risen more quickly. This means that, every year, the poorest households have paid more than the richest households to achieve the same level of consumption of these six major food items. Moreover, food accounts for 64 percent of total consumption of the poorest quintile, versus 43 percent of the consumption of the richest quintile, exacerbating the impact of the relatively rapid food price inflation that the poor experience and making it more likely that important non-food expenditures on education, health, and other productive human capital investments will be crowded out.

[25] IFPRI Myanmar (2023), The State of Food Security and Nutrition in Myanmar: Findings from five rounds of the Myanmar Household Welfare Survey, Strategy Support Program - Working Paper 45, October.
[26] FAO-WFP (2023) Data in Emergency – Monitoring (Round 7), August.

Figure 53: Changes in retail food prices (2017 – 2023)
Prices in logs, shaded blue areas show variation across markets



Source: Myanmar Living Conditions Survey (2017), Myanmar Subnational Phone Survey (MSPS) and World Bank Staff estimates

Most households have reported reduced income levels. Results from the fifth round of MHWS[27] show that during the first six months of 2023, 40.2 percent of households reported lower income compared with the previous year (55 percent in earlier rounds), with 24.5 percent reporting income losses equal or greater than 20 percent. Only about a quarter of households saw their income increase. Between mid-2022 to mid-2023, the median real total income of households excluding on-farm households, declined by 10.6 percent in rural areas and 10.0 percent in urban areas.

Outward migration has been spurred by lower real incomes and reduced economic opportunities, as well as elevated levels of conflict. The primary destination has been Thailand, which has 1.9 million documented migrants from Myanmar as of December 2022 (according to some estimates28, including irregular migrants would double this figure). Migrant workers are primarily low-skilled, with little formal education, and mainly employed in agriculture, construction, and manufacturing.[29] The World Bank estimates that Myanmar workers in Thailand earn around double the amount they earned at home, with the remittances that these workers send augmenting the incomes of Myanmar households and financing expenditures on daily necessities, housing and education.[30] On the other hand, increasing movements of labor out of Myanmar have led to reports of labor shortages in some areas and sectors, while the associated decline in human capital poses longer-term development risks.

[27] IFPRI (2023) Vulnerability and welfare. Findings from the fifth round of the Myanmar Households Welfare Survey (March – June 2023), Strategy Support Program - Working Paper 44, September.
[28] IOM Thailand: Migration Contexts. https://thailand.iom.int/migration-context
[29] International Organization for Migration (IOM), (2023). Flow Monitoring Findings: Profiles Of Myanmar Nationals Crossing into Thailand. https://dtm.iom.int/report-product-series/flow-monitoring-myanmar-nationals
[30] Myanmar Subnational Phone Survey (2022/23).

II. Outlook and Risks

The economic outlook has darkened due to the recent escalation of conflict and the resumption of macroeconomic volatility. After showing some signs of recovery last year, real GDP is expected to grow by just 1 percent in the fiscal year ending March 2024[31] as supply chains and major transport and trade routes are disrupted, and as conflict-related uncertainty dampens consumption and investment (Figure 54). Macroeconomic volatility has exacerbated exchange rate depreciation pressures and shortages of foreign exchange, reducing businesses' access to imported inputs and raising their costs. The projections imply that GDP is currently around 10 percent lower than in 2019, indicative of the persistent impacts of recent shocks to both the supply and the demand side of the economy (Figure 55). Growth is expected to remain subdued at about 2 percent next fiscal year (2024/25) due to the deterioration of the security situation, ongoing power supply challenges, waning external demand and elevated price inflation. Note that the macroeconomic indicators in **Table 1** – both history and projections – have been aligned to the March-ended fiscal year (Box 5 provides more details). The underlying quarterly data and assessment of the macroeconomic trajectory in the recent period remains unchanged.

This baseline projection is predicated on a broad-based slowdown across productive sectors. Wholesale and retail trade will remain subdued given persistent downward pressure on household incomes and upward pressure on consumer prices. Growth in the manufacturing sector is projected to slow given ongoing electricity shortages and worsening logistics disruptions, combined with slowing external demand. Conflict, high input costs, and trade restrictions are limiting the ability of farmers to benefit from favorable export prices, and have curtailed the investments needed to support future production. The agriculture sector is particularly vulnerable to border trade disruptions with over a third of agricultural exports going to China, India and Thailand via land.

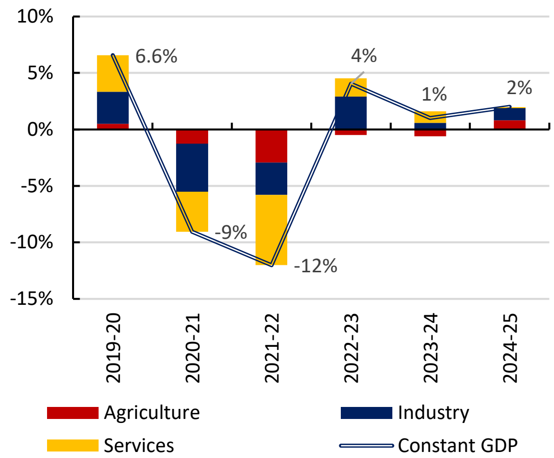
Table 1 Selected Macroeconomic Indicators (annual percent change unless indicated otherwise)

	2019-20	2020-21^{e}	2021-22^{e}	2022-23^{e}	2023-24^{f}	2024-25^{f}
Real GDP growth, at constant factor prices	6.6	(9.0)	(12.0)	4.0	1.0	2.0
Agriculture	2.2	(5.7)	(12.8)	(2.2)	(2.8)	4.0
Industry	8.0	(11.8)	(8.2)	8.0	1.5	2.8
Services	7.8	(8.4)	(14.7)	3.9	2.5	0.2
CPI inflation, year average	9.1	2.3	9.6	27.2	20.1	12
Trade balance (% of GDP)	(5.6)	(2.9)	(2.4)	(6.0)	(6.8)	(6.7)
Current account balance (% of GDP)	(1.8)	(0.4)	(2.4)	(6.3)	(6.7)	(6.1)
Fiscal balance (% of GDP)	(6.2)	(7.5)	(4.7)	(6.4)	(5.7)	(5.1)
Public debt (% of GDP)	42.3	54.6	61.5	62.6	61.5	61.1

** Budget Estimate
Note: April-March fiscal years

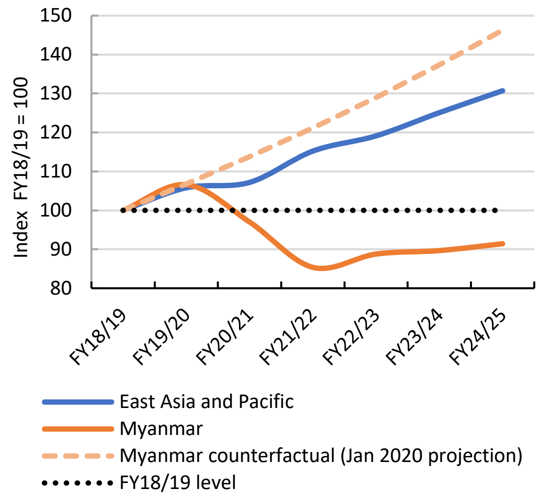
[31] Macro indicators have been aligned with Myanmar's current April – March fiscal year.

Figure 54: Real GDP growth and contributions to real growth by sector (percent, percentage points)



Source: Planning department and World Bank Staff

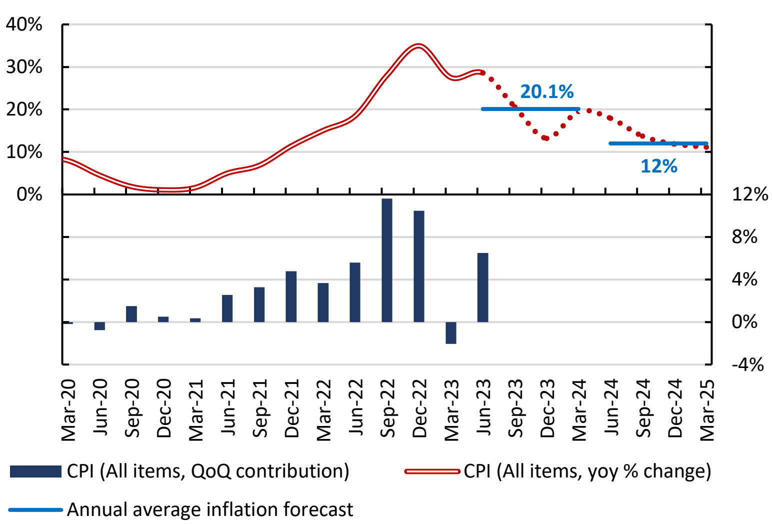
Figure 55: Real GDP estimates and projections



Source: CSO and World Bank Staff

Inflation is expected to remain high in the year ended March 2024, at around 20 percent (Figure 56). While some prices eased in the first half of 2023, the recent re-emergence of exchange rate volatility is likely to see prices continue to rise at a rapid pace this year, with modelling for Myanmar indicating that a 1 percent depreciation in the exchange rate is typically associated with a 0.5 percent rise in consumer prices over the following quarter. Relatively high inflation is expected to persist next year, driven by ongoing pressure on the balance of payments and kyat exchange rate, local supply constraints caused by conflict, trade and transport disruptions, and the renewed reliance on central bank financing of budget deficits.

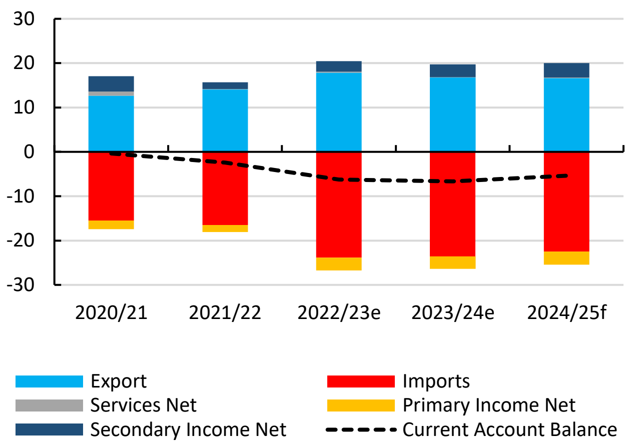
Figure 56: Inflation forecast



Source: CSO and World Bank Staff

The deficit in the current account is expected to widen by 0.4 percentage points to 6.7 percent of GDP in the fiscal year ending March 2024 due mainly to an increase in the trade deficit (Table 1). The trade deficit is projected to increase by 0.8 percentage points to 6.8 percent of GDP (Figure 57) driven by lower-than-expected exports, reflecting weak external demand, conflict related disruptions of land trade routes and declining natural gas production. Ongoing weakness in international tourism will translate to weakness in services receipts. On the other hand, despite the recent introduction of a 10 percent income tax on migrant workers, remittance inflows are expected to continue to strengthen given the country's large and growing migrant workforce as well as the existence of favorable close-to-market exchange rates for remittances. Amid external financing constraints, the widening of the current account deficit has the potential to increase exchange rate depreciation pressures.

Figure 57: Current account (percent of GDP)



Source: Central Bank, World Bank staffs' estimate

The overall budget deficit is projected to remain elevated at 5.7 percent of GDP in the fiscal year ending March 2024, explained largely by budgeted cutbacks in both spending and revenues. Revenue is projected to decline by 4.1 percentage points to 18.4 percent of GDP, driven mainly by lower tax and nontax revenues. Revenues from SEEs are projected to moderate sharply, reflecting increased operational challenges and losses. Spending is also projected to decline by 2.2 percentage points to 24.0 percent of GDP, reflecting declines in both recurrent and capital expenditure. Spending on education and health combined is expected to be just 2.2 percent of GDP, equivalent to just over half of the allocation to defense. Total public debt is expected to remain above 60 percent of GDP after increasing rapidly from just over 40 percent in 2019/20 due to weaker economic activity and large fiscal deficits.

There are significant downside risks associated with these projections, with the recent rise in conflict broadening the range of possible outcomes in the short- and medium-term. In addition to its impacts on internal displacement and livelihoods, the escalation in fighting has the potential to substantially block vital land trade and supply chains, sharply curtail mobility and consumption, and disrupt businesses' ability to operate. Other risks include a worsening of power supply constraints or an increase in financial sector disruptions following recent restrictions on cross-border payments. Medium to long-term prospects for living standards remain at considerable risk given evidence of a broad-based fall in real wages and productivity as well as erosion of human capital. In addition, policy responses that rely heavily on market interventions – such as price controls and trade restrictions – are likely to amplify risks of growing inefficiencies and reduced productivity gains from specialization and exposure to international competition.

Box 4: Aligning macroeconomic indicators with Myanmar's April – March fiscal year

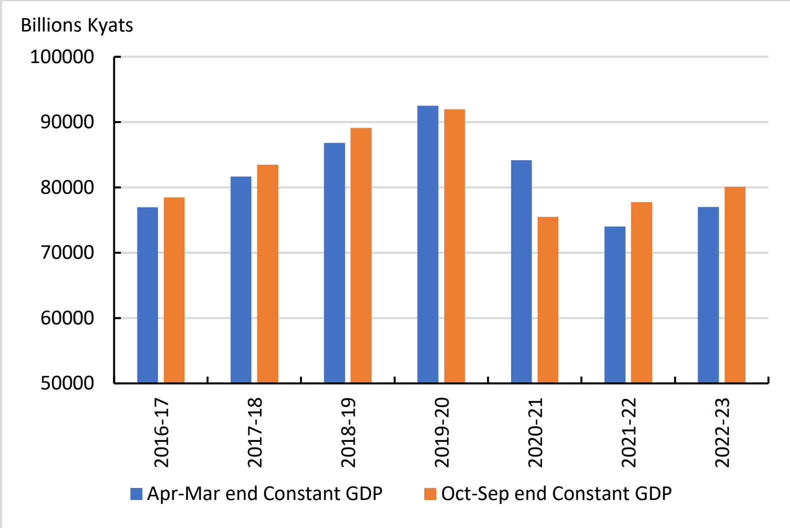
In 2022, the authorities changed Myanmar's fiscal year from the period October 1st – September 30th to April 1st – March 31st. The consumer price index (CPI) was rebased in 2023 with 2017 selected as the new base year using weightings based on the 2017 Myanmar Living Condition Survey (MLCS), expanding the basket of goods covered to 271. There was also a shift from monthly to quarterly CPI releases. Prior to these changes, Myanmar's GDP data series used two base years, 2010/11 and 2015/16. The 2010/11 base year covered historical GDP data through to 2014 while 2015/16 base year series included data stating from 2015 onwards.

To obtain continuous time series for GDP we convert historical 2010/11 base year estimates to the 2015/16 base year through a data splicing method otherwise known as 'base shifting' wherein the values of the 2010/11 base year are adjusted by multiplying them with a conversion factor. The conversion factor is the ratio of the 2015/16 base year value to the 2010/11 base year value in the overlapping year. The base shifting method was applied to annual production GDP estimates for ease of analysis. To obtain the disaggregated quarterly and sectoral data for the 14 subsectors, the new 2015/16 annual series were multiplied by their respective quarterly and subsector shares for the old series.

Similarly, CPI values in the 2012 base year were also converted to 2017 CPI values using the 'base shifting' method to obtain a continuous CPI series. The available CPI data included quarterly data for the headline, food, and nonfood as well as 11 other COICOP categories. But the overlapping data for the old and new series was provided for headline inflation only. Hence, we first applied our splicing method to the headline series and then multiply the new 2017 headline series by the respective shares of the COICOP categories.

Finally, annual estimates for key macroeconomic aggregates including GDP and inflation were previously computed using the October – September fiscal year. To obtain new fiscal year estimates for GDP, we instead aggregate the quarterly data beginning from June quarter (Q1) to the following March quarter (Q4) for each year (Figure 58). For inflation, we compute the average quarterly inflation over the same period. The underlying quarterly data remain unchanged, as does our assessment of the macroeconomic trends over this period.

Figure 58: Real GDP, old versus new fiscal year



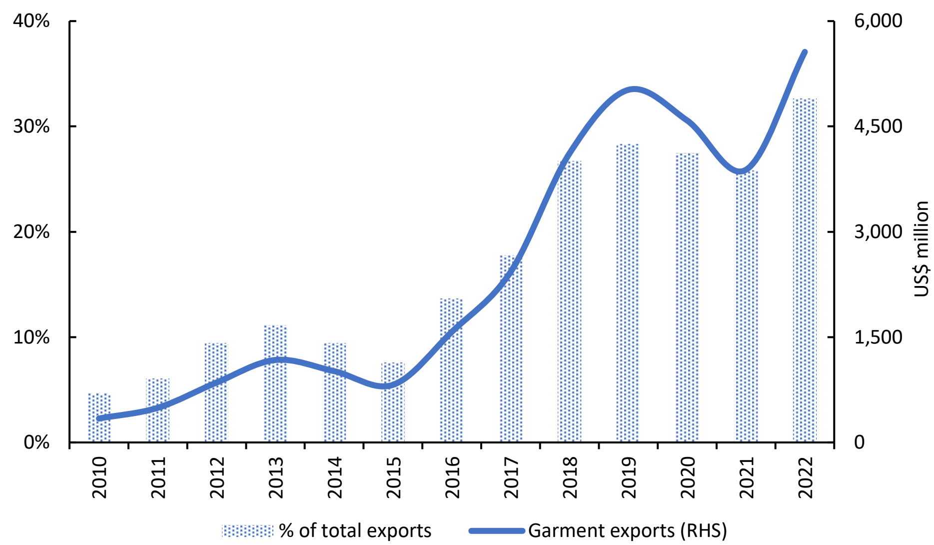
Source: Planning department, World Bank staffs' estimate

III. Myanmar's garment industry: Potential curtailed

A. Introduction

Myanmar began exporting garments in the mid-1990s following the example of its East Asian neighbors, who accelerated their economic development through export-oriented policies that increased and sustained garment exports. After a promising start, the development of Myanmar's garments industry faced significant setbacks during the 2000s due mainly to socio-political factors, including international sanctions by the United States (US),[32] which were backed by the European Union (EU). Although Myanmar tried to adapt by increasing exports to Japan and South Korea, garment exports stagnated during the 2000s mainly due to the denial of access to US and EU markets. However, garment exports have grown rapidly over the past decade, following the lifting of US and EU sanctions in 2013, aided by preferential market access in key markets and relatively cheap labor. The lifting of sanctions paved the way for duty-free access to the EU market under the Generalized System of Preferences (GSP) he Everything but Arms (EBA) scheme, part of the EU's Generalized System of Preferences (GSP). Myanmar also became a beneficiary of the US'GSP program in 2016, allowing garment exports from the country to benefit from low tariff access to another large market and encouraging additional foreign investment in the sector. Garment exports have expanded to be around six times as large as in 2010 (Figure 59), benefitting from trade preferences from the EU, which accounts for over half of Myanmar's total garment exports, as well as from the US.

Figure 59: Myanmar garment export trends



Source: WB staff calculations using data from World Integrated Trade Solution (WITS)

The coup and COVID-19 shocks had substantial impacts on the garment industry. Exports declined sharply in 2020 and 2021 (Figure 59). As a result of the COVID-19 first wave alone, the industry is estimated

[32] The United States Government imposed an import ban on all Myanmar's products in 2003.

to have suffered at least 150,000 job losses in early 2020.[33] By the end of 2020, it was reported that more than 100 out of approximately 700 garment factories were forced to shut down either temporarily or permanently, leading to job losses and significant disruptions in operations.[34] However, garment exports recovered in 2022 to above 2019 levels, while firms operated for around 95 percent of the available operating hours in 2022, according to the 2023 Garments Survey. By early 2022, most estimates indicate that there had been some improvement in garment industry employment, but estimates of around 500,000 workers as of January 2022 remained well below pre-pandemic levels of about 700,000 workers. This is important not just for garment workers themselves, but the families they support: a recent study commissioned by the Myanmar Garment Manufacturer Association (MGMA) estimated that garment worker incomes support approximately two million people, primarily based in rural areas.[35]

In this special topic we take a longer-term perspective on Myanmar's garment industry. We show that garment sector employment, productivity, and wages remain relatively low compared with international peers, despite fast growth over the past decade. While the industry has substantial potential as a driver of economic development in Myanmar, higher operating costs and constraints to doing business have reduced the industry's international competitiveness, forcing firms to focus on survival rather than investment and growth. This implies that a continuation of the industry's fast growth trajectory – following the path of countries such as Vietnam, Bangladesh, and Cambodia – is likely to be harder to achieve in the period ahead.

B. Myanmar's garment industry has significant scope for further development

i) Employment

The garment industry is an important source of employment in Myanmar, particularly for young migrant women from rural areas of the country. The industry employed about 500,000 workers as of January 2022, accounting for around 2.3 percent of total employment and 23 percent of manufacturing sector jobs.[36] Women play a comparatively large role in garment firms as workers, managers, and owners. The survey of 100 garment firms conducted by the World Bank from March to May 2023 indicates that about 85 percent of garment workers (and 56 percent of garment firm managers) in Myanmar are women.

Nevertheless, garment sector employment in Myanmar is relatively low compared with other garment exporters in the region. Even prior to the dual shocks of the pandemic and coup, garment sector workers comprised less than 3 percent of Myanmar's labor force (Figure 60). This is well below Cambodia, Bangladesh, and Vietnam, and translates into relatively low worker numbers in absolute terms, given Bangladesh and Vietnam have much larger labor markets than Myanmar.

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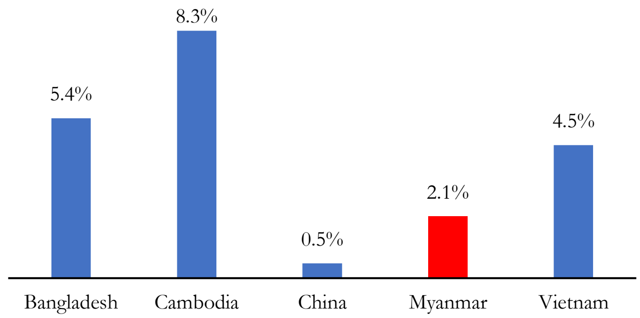
[33] Ibid
[34] Frontier Myanmar. 2021. Garment Workers Face a Fresh Threat: A Boycott.
[35] MGMA. 2022. Report of Assessment Survey on Myanmar Garment Industry 2021 – Workers' Perspectives.
[36] Ibid

Figure 60: Garment workers (% of the labor force)

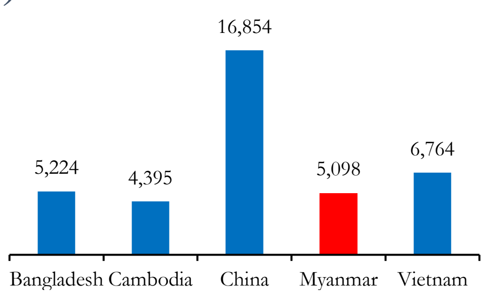


Source: WB staff estimates using data from Radio Free Asia, the Diplomat, ILO (2020), Business & Human Rights Resource Center, MGMA (2022), and the World Development Indicators (WDI)

ii) Labor productivity

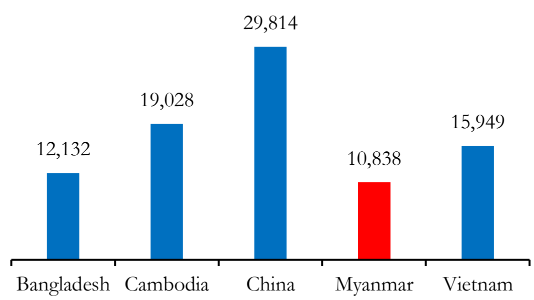
Comparative data indicates that Myanmar exports and value-added per worker[37] fall below regional peers (Figure 61 and Figure 62). Most garment firms in Myanmar operate under a cut-make-pack (CMP) model, the least complex manufacturing model, in which manufacturers receive raw materials from international buyers and are paid to produce finished garment products for export. The CMP model is a labor-intensive production process that heavily relies on foreign inputs and exhibits relatively low value-added. Experience from comparators suggests that the higher labor productivity in garment firms achieved elsewhere has resulted from more efficient use of inputs (factor utilization), greater capital intensity, and technology adoption and innovation. For instance, Chinese garment firms have adopted sophisticated capital-intensive production processes and have a more highly-skilled labor force than most comparators.

Figure 61: Estimated value added per worker in 2022 (US$)



Source: Grand View Research and WB staff estimates

Figure 62: Garment exports per worker in 2022 (US$)



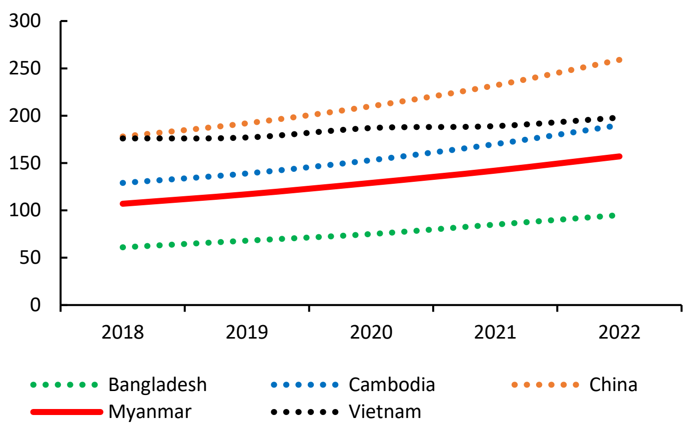
Source: WB staff calculation using data from Radio Free Asia, the Diplomat, Business & Human Rights Resource Center, MGMA (2022), and the World Integrated Trade Solution

[37] Value-added per worker was computed as total garments production less cost of raw materials and overheads divided by workforce.

iii) Labor costs

Garment worker wages in Myanmar have historically been lower than in most of its peers. Wages in the garment industry typically comprise several components, with the basic wage augmented by a range of allowances and bonuses. Internationally comparative data indicates that the average monthly wage (including allowances and bonuses) of Myanmar garment workers has remained below peers over the five years to 2022, with the exception of Bangladesh (Figure 63). Even after accounting for the announcement that workers in Myanmar will receive an additional daily allowance of 1,000 kyat from October 2023, the average Myanmar garment worker wage would still remain well below average garment worker wages in Cambodia, Vietnam, and China.

Figure 63: Average monthly wages of garment workers (US$)

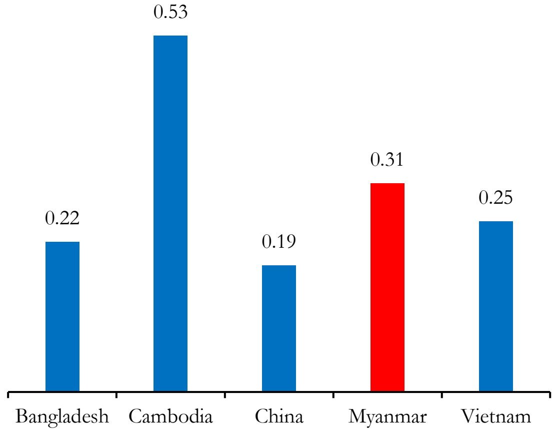


Source: Grand View Research

Note: Wage data was primarily collected through interviews with major garment manufacturers in Myanmar, Cambodia, Vietnam, China, and Bangladesh. The average wage per worker was calculated as the total labor expenditure of the manufacturers divided by the overall employee count, including managers, senior workers, and other staff. Note that the 2021 and 2022 data points for Myanmar convert the calculated kyat average wage into US dollars at the official exchange rate: conversion at the market exchange rate would yield a lower US$ average monthly wage.

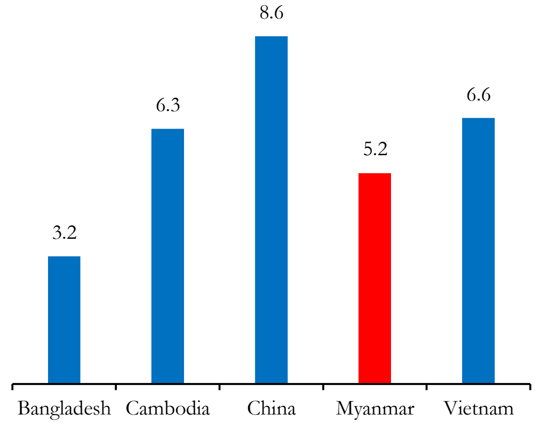
Relatively low garment sector wages have allowed Myanmar's garment sector to remain internationally competitive, given its relatively low labor productivity. A key measure of competitiveness is unit labor costs: the labor cost associated with the production of one dollar of output (value added). Combining the above data on value added per worker and wages indicates that unit labor costs in Myanmar are lower than in Cambodia but higher than in other regional peers (Figure 64). This reflects the higher productivity of workers in China and Vietnam, and the lower wages received by those in Bangladesh (Figure 65). The World Bank Garment Industry Survey 2023 finds that wages account for about one-fifth of the total cost of garment production, which implies that labor costs – in conjunction with access to trade preferences and assessments of the broader operating environment – play an important role in attracting foreign investment. Relative labor costs are particularly important for Bangladesh, Cambodia and Myanmar, given the labor intensity of the CMP operating model.

Figure 64: Daily unit labor cost of value added (US$) in 2022



Source: WB staff calculation using data from Grand View Research
Note: Unit labor cost is measured as the ratio of daily wage to the amount of output produced by each worker per day.

Figure 65: Daily wage (US$) in 2022



Source: WB staff calculation using data from Grand View Research and Wage Indicator

C. Recent developments have curtailed the industry's potential

Taken together, these indicators suggest significant scope for Myanmar's garment industry to grow and develop further over the medium to long term. Myanmar's garment exports have grown by 32 percent per year on average over the past 12 years (between 2011 and 2022), off a very low base. Scaled by population, Myanmar garment export values are currently approaching those in Bangladesh and Vietnam a decade ago (Figure 66), while the global market share of Myanmar's garment sector is similar to that of Cambodia in 2012 (Figure 67). And as illustrated in the previous section, garment industry employment remains relatively low as a proportion of Myanmar's labor force, while there is significant room for growth in labor productivity which would support higher wages. Under normal circumstances, Myanmar's garment industry would be well placed to build on its existing strengths of cheap and abundant labor (as revealed in the World Bank Garment Industry Survey 2023) in the years ahead. An expansion in garment sector employment would directly support the livelihoods of workers and their families, while contributing to the overall structural transformation of Myanmar and thereby boosting labor productivity across the economy. At the same time, a shift to a higher value-added operating model and a more diversified set of manufactured outputs would increase labor productivity within the industry, allowing garment worker wages to increase while maintaining Myanmar's international competitiveness.

Figure 66: Garment export per capita trend

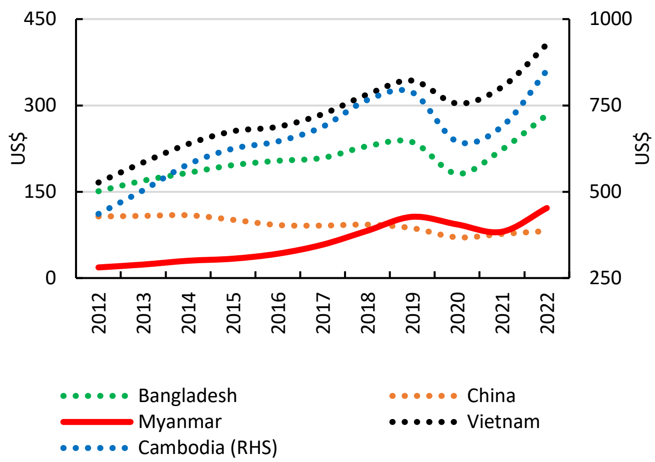
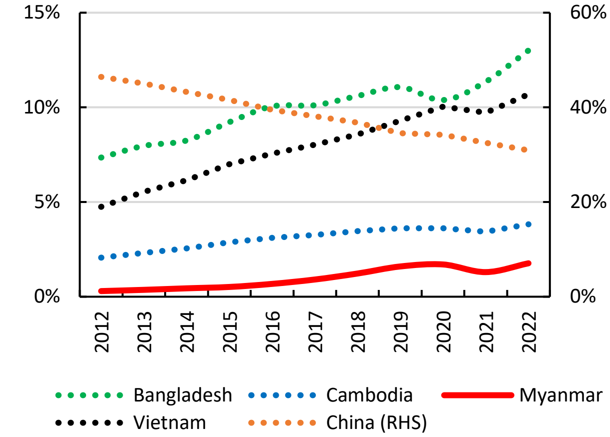


Figure 67: Global market share, 2012 - 2022



Source: WB staff calculation using mirror data from the World Integrated Trade Solution (WITS)
Note: To avoid potential classification problems related to garment products and statistical discrepancy when comparing exports of Myanmar and its peers in the global market, mirror data is used for exports.

But recent developments have worsened the operating conditions of Myanmar's garment firms and turned their focus to survival rather than growth. Major constraints affecting the garment industry include limited access to power supply, logistics bottlenecks, trade and foreign exchange restrictions, and labor churn. These constraints increase the cost of doing business and will tend to reduce the international competitiveness of Myanmar's garment industry – as well as its attractiveness as a destination for foreign investment – to the extent that they persist over time.

i) Access to electricity

Among comparators, Myanmar is the only country where firms report challenges with meeting energy consumption needs. On average, in 2022, garment firms experienced two power outages per day, each lasting approximately 3.5 hours, causing firms to rely on mainly privately owned off-grid generators (Figure 68), with surveyed firms reporting that 62 percent of their total electricity consumption is from generators (Figure 69). Total losses attributable to power outages were estimated to be equivalent to about 31 percent of total annual sales of garment firms in 2022. The reliance on generators raised fixed investment and variable costs, including expenses for diesel and maintenance. Although firms have acquired generators, there are frequent episodes of fuel scarcity, further worsening overall operational challenges and raising costs.

Figure 68: Power outages and estimated sales lost

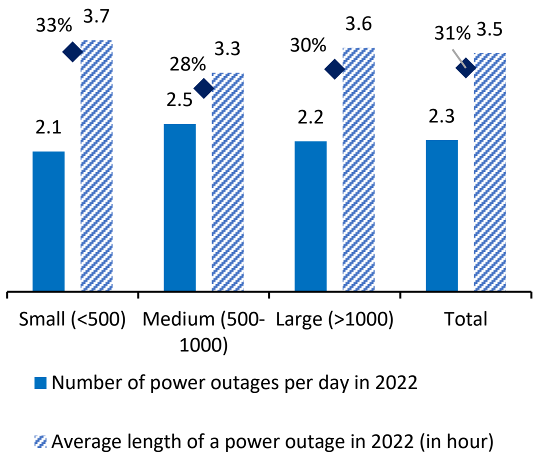
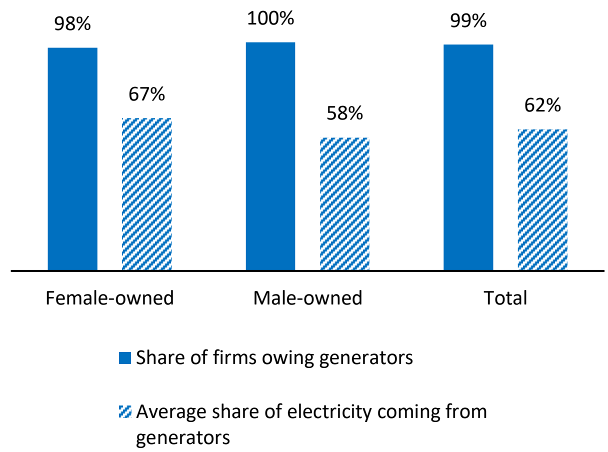


Figure 69: Reliance on off-grid generators

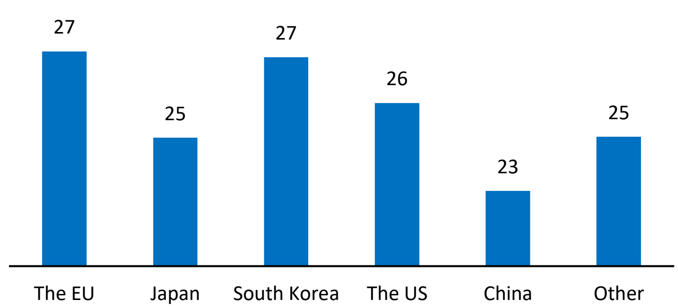


Source: World Bank Garment Industry Survey 2023

ii) Logistics constraints

Conflict and political instability have significantly increased the costs of moving cargo over land. While export is primarily through sea, fabrics are imported mainly from China via land borders by 32 wheelers. Both container and trucking service charges have increased, with the latter driven by increased fuel costs. Export lead times vary significantly depending on the destination country, the contract with buyers and the specific logistics involved. Production processes, including cutting, sewing, and finishing can range from just under a month to a couple of months, depending on the complexity of the garment, the efficiency of the factory, and the volume of the order. According to World Bank Garment Industry Survey 2023, it takes Myanmar firms about 4 weeks to export finished goods to major markets after completing production (Figure 70) compared to 2 to 4 weeks for Chinese firms for instance.

Figure 70: Export lead times of finished goods in 2022 (measured as average days taken to export to major markets)



Source: World Bank Garment Industry Survey 2023

iii) Trade and foreign exchange restrictions

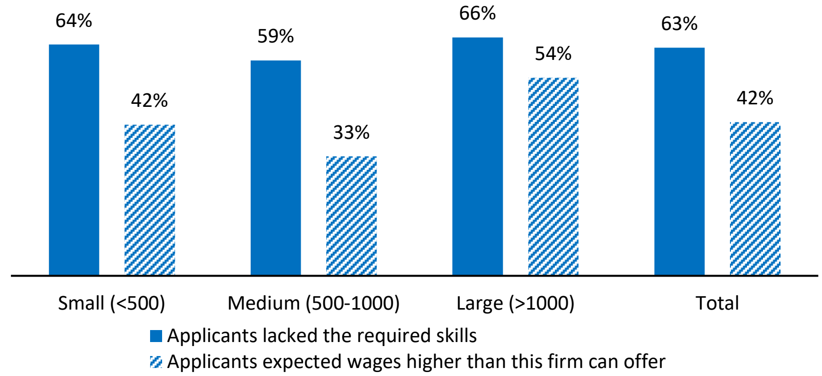
Import and foreign exchange restrictions are among the most significant constraints facing garment firms. While CMP raw materials – which comprise the bulk of garment firm inputs – are generally exempt from import taxes and have relatively easier access to import licenses, other inputs, including machinery, are captured by recently imposed restrictions. For these inputs, firms have experienced delays in receiving import licenses since 2021. According to the World Bank Garment Industry Survey 2023, the import license application process takes at least 2 months compared to less than a week before 2021. Additional follow-up to the online application is generally required, causing further delays. Import licenses for machinery can take up to 4–5 months. Moreover, the depreciation in the market exchange rate has substantially raised the kyat-denominated price of many of these inputs. On the other hand, garment firms have not benefited from the full extent of the depreciation in terms of their export competitiveness, as they have been forced to convert a proportion of their CMP service payment into kyat at the unfavorable official exchange rate. This has further squeezed the profit margins of garment firms.

iv) Labor shortages

Garment factories have also faced labor shortages and increased labor churn. Some firms have experienced employee resignations driven by outward migration to countries like Thailand and Malaysia. This has been primarily due to declines in real wages in Myanmar and the pursuit of higher wages abroad, with some reports also indicating that working conditions in some garment industries have deteriorated. In a report released in March 2021, the U.K.'s Business and Human Rights Resource Centre identified 200 cases of labor and human rights violations affecting at least 104,000 workers in Myanmar's garment industry[38]. About 63 percent of garment firms surveyed by the World Bank experienced challenges in hiring production employees (Figure 71). In response to recent labor shortages, certain firms are adopting measures like offering loyalty fees to retain employees, particularly skilled workers such as supervisors. Firms also offer bonuses or financial incentives tied to performance and attendance, as well as incentives targeted at female workers including free transportation and generous maternity and annual leave policies.

[38] Business and Human Rights Resource Centre (2021) - In the line of fire: Increased Legal Protection Needed as Attacks Against Business & Human Rights Defenders Mount In 2020. https://media.bhrrc.org/media/documents/HRD_2020_Snapshot_EN_v9.pdf Also see https://www.business-humanrights.org/en/from-us/covid-19-action-tracker/myanmar/

Figure 71: The share of firms experiencing challenges with hiring production workers



Source: World Bank Garment Industry Survey 2023

D. Summary and conclusion

Higher operating costs and various constraints on doing business have reduced the garment industry's competitiveness, putting downward pressure on output and productivity. Garment firms have faced a range of operational challenges, including unreliable power supply, a deteriorating security environment, logistics disruptions, macroeconomic instability, difficulties in obtaining import licenses, foreign currency surrender requirements, and increased labor churn. These challenges have increased the cost of doing business and reduced the international competitiveness of Myanmar's garment industry.

Combined with the ongoing threat of adverse external developments, these operating constraints have meant that the garment industry has had to focus on survival rather than investment and growth. Higher costs and operating constraints have curtailed production and reduced margins, putting downward pressure on workers' wages. At the same time, several external risks persist for the industry, including the exit of foreign buyers. In this context, results from World Bank Garment Industry Survey 2023 indicate that only 18 percent of firms plan to upgrade their operating models in the next three years, with most opting to continue operating under the CMP model. Focus group discussions with garment manufacturers indicated that the uncertain business environment largely explains why most firms prefer to stay with the CMP model.

Despite the rapid growth of Myanmar's garment industry over the last decade, the country is unlikely to continue on the trajectory observed in several other countries in the region if prevailing constraints persist. There are signs that Myanmar's relatively cheap labor costs are no longer fully compensating for its lower productivity due to the recent emergence of operating constraints and risks that are eroding its competitive advantage. To the extent that challenges on both the domestic and external front persist, the growth of the garment industry is likely to remain constrained and well short of its potential.

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