MYANMAR — ASIA’S UNCUT GEM
THE REMARKABLE TRANSFORMATION UNDERWAY IN ASIA’S LAST FRONTIER
FOREWORD

ANZ is uniquely positioned, via its super-regional presence, to make a major contribution to the conversations on key issues relating to the Asia region’s future. An increasingly important conversation ANZ is now leading is on the Greater Mekong, and Myanmar in particular. We believe that the Greater Mekong and Myanmar will come to play a more pivotal role in the new ‘factory Asia’ that will coalesce in Southeast Asia as production platforms migrate from the elderly and expensive economies of the north (China, Japan, South Korea) to the youthfully abundant and cheaper economies of the south. The key challenge for Southeast Asia is to manage that process smoothly via increased interconnectivity and freer capital flows.

Myanmar, strategically located between Asia’s two emerging giants of China and India perhaps stands to gain the most over the Asian Century. Myanmar is both a fascinating and remarkable story, and one filled with promise, opportunity, and undoubtedly a few challenges. After decades of self-imposed isolation, this important Mekong economy has only in the last three years started to re-engage with the region and the rest of the world.

The complete absence of foreign direct investment (except by China) during the country’s 50 years of economic isolation (a period where FDI ushered in successive waves of industrialisation and transformation across the rest of Asia) has been one of the key causal factors behind Myanmar’s remarkable underdevelopment. It has only been since 2011, under a civilian government led by President Thein Sein, that significant developments have been undertaken to permit the gradual repeal of sanctions, thus allowing Myanmar to begin re-engaging with the rest of the world.

In this special ANZ Research In-Depth report we outline the key and abundant promises of Myanmar and consider what some of the key risks to achieving that promise and potential will be. Our conclusion is that the rapid economic transformation of Myanmar is a wonderful ‘promise’, but not a foregone conclusion. The moniker ‘frontier’ seems truly well-deserved on many levels at this time, and important steps will need to be taken in institutional, policy, corporate, and regulatory design.

Our thesis is simple: if Myanmar is able to set up transparent institutions and an FDI-friendly environment, then inward FDI should enable the skills and technology transfer needed to rapidly transform Myanmar’s economy from agrarian and resource to manufacturing. The pace at which that transformation occurs should be the fastest industrialisation episode Asia has ever witnessed. If Myanmar can achieve this, it will be a remarkable transformation and one that is well-deserved after decades of economic isolation.

Andrew Géczy
CEO International and Institutional Banking
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MYANMAR: ASIA’S UNCUT GEM

This report, the second in the ANZ Research In-Depth series, presents the simple thesis that after five decades of economic isolation, Myanmar will experience a rapid economic catch-up in the coming ten years. This economic catch-up will make itself apparent in one of the fastest industrialisation and manufacturing sector build-outs the Asian region has ever seen.

Key Points

• Myanmar is endowed with Asia’s most outstanding location. Geographically, Myanmar is the Asian economy most strategically positioned to benefit from the dual economic ascension of China and India.

• Myanmar is on the cusp of an industrialisation process that should see it rapidly build out its domestic manufacturing capacity and (given its abundant and youthful population) become a magnet for foreign direct investment.

• Economic reforms and the lifting of sanctions are seeing Myanmar rapidly re-engage with the rest of the world, and the speed of that re-engagement is not without risk.

• Economic and political isolation has resulted in poorly capitalised financial institutions, untested regulatory structures that may have too heavy or too light a hand, and a workforce with a skillset unsuitable to the production platforms the rest of the region is now attracting.

• Our conclusion is that the rapid economic transformation of Myanmar is a ‘promise’, not a foregone conclusion. Institution building is in its infancy, rule of law and corporate governance are largely untested, and the moniker ‘frontier’ truly seems well-deserved on many levels.

Myanmar is strategically located at the very heart of Asia with China to the east, India to the west and the ASEAN to the south.

Will production platforms shift from older northern economies to younger Mekong economies?

Source: ANZ Research
After several decades of economic isolation, Myanmar has commenced a profound re-engagement with the global economy that we expect to usher in a rapid phase of industrialisation and deep economic transformations across sectors, institutions, and markets. The sum of those transformations, if aligned with good macroeconomic policy, should be a purpose-built economy, designed to take advantage of its unique geographic and strategic location at the very heart of Asia. If this is truly the Asian Century, where we witness the rise of China and India, then Myanmar is the very geographical heart of the Asian Century.

The opportunities and promise of Myanmar are undoubtedly huge, but so are the challenges. With this in mind, we commence this report by adopting a balance sheet approach to map out the opportunities and challenges facing Myanmar in the coming years and decades. The balance sheet approach highlights the instrumental role that good policy design must take in creating the institutions and structures best suited to tap these opportunities and manage these challenges. More importantly, it highlights the key role that global players, such as multilateral agencies, multinational companies, and foreign governments can play via foreign aid and foreign direct investment in assisting the rapid transformation and development of Myanmar. Indeed, one of the clearest conclusions of this paper is the important role of FDI as a key enabler of change in Myanmar.

The complete absence of foreign direct investment (except by China) during the country’s fifty years of economic isolation (a period in which FDI ushered in successive waves of industrialisation and transformation across the rest of Asia) has been one of the key causal factors behind Myanmar’s remarkable underdevelopment. It has only been since 2011, under a civilian government led by President Thein Sein that significant developments have been undertaken to permit the gradual repeal of sanctions, thus allowing Myanmar to begin re-engaging with the rest of the world.

Figure 1: The cost of economic isolation — Myanmar’s economic underperformance from 1950 onwards

Source: CEIC, ANZ Research
That re-engagement is likely to be rapid. Indeed, in the coming years Myanmar is going to give every indication that its economy is fundamentally overheating. Growth is currently accelerating in Myanmar and we expect the economy to experience sustainable growth of between 8–9% over the next five years; some periods could be as high as 10%. The current account deficit will widen as capital goods and technology are imported, and monetary growth will be extremely fast as transactions are increasingly monetised for the first time. By its very nature, the ambitious reform program that is aimed at opening up the economy is going to lead to large capital inflows and elevated metrics on many of the measures that economists typically use to assess overheating. Still, the medium-term potential growth rate of Myanmar is probably in excess of 7.5% for the foreseeable future.

The key underpinning to that potential is generous physical and demographic endowments. Strategically located between China and India, Myanmar has large reserves of hydrocarbons and other precious minerals, as well as millions of hectares of arable land and an abundant water supply to cultivate them.

Myanmar's key endowment is a large and youthful population that should see Myanmar emerge as a production hub for low-cost labour-intensive sectors. With the right education and training reforms, the population could be upskilled to engage in higher value-added production.

The industrialisation path is a well-trodden one across Asia, and we expect Myanmar to follow that path. Economic transformation requires significant and sustained growth in both industry and services, facilitated by both high public and private investment. A concerted effort by public and private agents boosting strong growth in the industry sector is the key to economic transformation.

To sustain economic transformation, it becomes important that workers upskill and production moves up the value-added chain. Again, the public sector has a key role to play here in providing the vocational training and education infrastructure to upskill the workforce. The private sector also plays a complementary role, via technology and skills transfer, aligned with higher value-added foreign direct investment.

Source: Bloomberg CEIC, ANZ Research

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Source: Bloomberg CEIC, ANZ Research
One of Myanmar’s largest development projects to date has been the creation of the Thilawa Special Economic Zone (SEZ) that highlights a number of key aspects of Myanmar’s rapid industrialisation to date and should become a broader template for the industrialisation and more efficient utilisation of Myanmar’s abundant and youthful labour force.

A key enabler of Myanmar’s industrialisation is likely to be the multilateral architecture of the Greater Mekong and the ASEAN Economic Community (AEC). Industrialisation could be accelerated in Myanmar and its neighbouring Mekong economies through the adoption of the AEC in December 2015. The AEC presents both opportunities and risks, with structural transformations absolutely required upon entering the ASEAN common market. A common market for capital and labour will thus present a significant opportunity in terms of attracting inward FDI to fully utilise Myanmar’s youthful and inexpensive labour force. However, if production platforms prove sticky and slow to migrate, an outward labour exodus from Myanmar would be a key risk.

But returning to our balance sheet approach, the advantages of Myanmar and the Mekong more broadly do strongly suggest that production platforms will shift to Myanmar very quickly. Its strategic advantage as the bridge between India and China and the fact that it is likely to be located at the very heart of the rapidly growing Asian ‘consuming’ class are enormous advantages. By 2030, we estimate that half of the world’s consuming class will be located within a four hour flight from Myanmar. It therefore makes logical sense for Myanmar to develop into the key production and distribution hub at the very heart of Asia.
INTRODUCING THE OPPORTUNITIES AND CHALLENGES — A BALANCE SHEET APPROACH

A large part of Myanmar’s economic promise is due to the fact that the economy has emerged from almost complete economic isolation with the rest of the world. These episodes of isolation and subsequent re-engagement are extremely rare and thus present a myriad number of opportunities for trade and foreign investment and the ability to access untapped markets for the first time.

The immediate period ahead, following five decades of economic isolation, is not without significant risks. The isolation has resulted in poorly capitalised financial institutions, untested regulatory structures that may have too heavy or too light a hand, and a workforce with a skillset entirely unsuitable to the production platforms the rest of the region is now attracting. The entry of foreign banks, including ANZ, could well prove to be an additional burden on newly established supervisory and regulatory agencies with limited previous exposure to international finance. To accurately gauge the extent of these untapped opportunities, and the considerable challenges in realising them, a simple balance sheet approach is appropriate.

Myanmar’s opportunities and challenges — a balance sheet approach

<table>
<thead>
<tr>
<th>OPPORTUNITY</th>
<th>CHALLENGE</th>
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<tbody>
<tr>
<td><strong>Strategic location between India and China and the ASEAN</strong></td>
<td><strong>Enormous cost of ‘connectivity’</strong></td>
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<td>Myanmar is unique in sharing a land border with both India and China and thus has to its immediate east and west a potential market with a combined size approaching three billion people in the coming decades. Myanmar will also integrate more fully into the ASEAN Economic Community (AEC) from December 2015 onwards, a potential common market of over 600 million people.</td>
<td>Myanmar’s geographic location is the core of its promise, however, economic isolation means land, sea, and air-based linkages are underdeveloped. Some estimates place the cost of building Myanmar’s transport and logistics connectivity as high as USD650–750bn in the coming years to fully utilise this strategic geographic advantage and leverage greater connectivity with other Mekong economies and the ASEAN1.</td>
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<tr>
<td>Myanmar will emerge as a key supplier of minerals, natural gas, and agricultural produce to Asia in the coming decades.</td>
<td>China, India and the ASEAN neighbours will need to be ‘partners’ in building logistical links to these economies. A targeted strategy of managing large capital inflows and possible lumpy flows and volatility as this infrastructure is built out will be required.</td>
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<tr>
<td>Myanmar could develop into a regional manufacturing and logistics hub located between Asia’s two giants.</td>
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<tr>
<td><strong>Untapped human capital</strong></td>
<td><strong>Labour exodus</strong></td>
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<td>Decades of economic isolation has left Myanmar with a youthful but unskilled labour force. As such, it is the lowest unit labour cost market in Asia, with average wages even lower than Africa. It should retain this relative wage advantage for a considerable period ahead, which will be the key to attracting foreign direct investment (FDI) platforms to utilise the last untapped labour market in Asia.</td>
<td>Underdeveloped human resources and a lack of vocational education all present a significant risk of a mass labour market exodus once labour market migration becomes more fluid under the AEC in December 2015. Though labour and employment statistics are patchy, some estimates suggest that this labour exodus is already underway with over 2.5 million migrant workers from the Mekong — mainly from Myanmar — already residing in Thailand2. Most of these workers are undocumented and work informally in the low wage service and manufacturing industries. Vocational training will be necessary to make more mobile labour ‘sticky’ in Myanmar.</td>
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<td>Currently, more than a quarter of the population lives below the poverty line, while more than one-third of the labour force is unemployed. A key policy goal should be rapidly moving towards full employment and poverty reduction.</td>
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2 ‘Six Markets to Watch’ Foreign Affairs, January 2014.
OPPORTUNITY

Large hydrocarbon resources
Following a strategic geographic location, Myanmar’s second ‘gift’ is its endowment of natural, agricultural, energy, and precious resources. Myanmar’s hydrocarbon reserves are estimated at 2.5tcm of natural gas and 3.2 billion barrels of crude oil — numbers which are significant in the regional ASEAN context. These tentative figures are most likely set to rise in the coming years as surveying has been preliminary and as offshore exploration begins.

Given its strategic position between India and China and the ASEAN, there should be a natural captive market for Myanmar’s resources exports in neighbouring economies where Myanmar’s geographical proximity will reduce transport and distribution costs and make Myanmar’s hydrocarbon energy resources extremely price competitive.

Endowment of precious and semi-precious stones
With concerns over the equity of gem extraction in Africa (eg blood diamonds), Myanmar could position itself well in this ultra-luxury segment. The number of high-wealth and ultra-high wealth individuals in both China and India will be growing strongly in the coming years, a potentially large market for Myanmar’s precious gems.

Significant arable land and generous water supply could see Myanmar return as the ‘rice bowl’ of Asia
Myanmar is the largest country in land-based Southeast Asia, with fertile lands and enormous untapped agricultural opportunity. Development of agricultural land and employment, plus programs to boost agricultural productivity should see Myanmar emerge as one of the most competitive and efficient agricultural producers and exporters in the region.

With concerns over land degradation and environmental pollution in both China and India, Myanmar could uniquely position itself as the region’s ‘clean’ agricultural producer.

CHALLENGE

Overreliance on and foreign exploitation of Myanmar’s resources wealth
Myanmar can make strong and early gains by relying on revenues from resource extraction. Even as international energy prices have fallen through 2014–15, as a new entrant to the market, Myanmar will be likely to capture market share within the region. However tempting, an overreliance on resource exports after the initial stages of growth transformation will be detrimental to medium-term growth prospects. Striking the right balance between resource extraction, which will perhaps return immediate economic rents but will largely utilise unskilled labour, and upskilling workers for manufacturing work that will return a medium-term economic rent will be crucial to ensuring Myanmar’s growth into a well-balanced economy.

There is a risk that funding the development of extraction infrastructure and technology may see resources transferred out of Myanmar at below-market prices.

Striking the right balance between resource extraction and development

As previous.

Synergies should be sought to align precious and semi-precious stone extraction, polishing, and sales with the burgeoning tourism sector where appropriate.

Rent extraction from land and slowing pace of urbanisation

Development of the agricultural sector could potentially slow the pace of urbanisation in an economy with very low urbanisation rates. Ultimately the transition from low-income to higher low-income and eventually middle-income will require an urbanised and upskilled manufacturing workforce. The productivity of the agricultural sector will have to be boosted as a priority and urbanisation policies will need to be encouraged to balance this. With growing Western and Eastern tastes for organic food and farm-to-table produce, agricultural policy should also be mindful of small, bespoke, and boutique producers and unique brands should be incubated and fostered.

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3 Estimates reported by Insight Alpha.
### OPPORTUNITY

**Harnessing resource revenue for growth**

Though ultimately balanced growth is more desirable, running resource extraction at a firm clip and using revenues to fund social and physical infrastructure would be an appropriate policy in the initial stages of growth.

With commodity prices (particularly energy) in sharp decline through 2014–15, an overreliance on volumes should be avoided.

**A ‘greenfield’ opportunity to design and build an economy set to harness its unique geographic and resource opportunities**

The lack of legacy issues and inefficient infrastructure poorly designed for transitioning to a modern manufacturing economy is one of Myanmar’s key advantages. It has the unique opportunity to purpose-build infrastructure and logistics optimally designed for its place in 21st century Asia.

**Accelerating urbanisation**

The vast majority of Myanmar’s citizens live in rural areas and are agrarian. Urbanisation, when managed well, is a powerful tool in lifting labour market access, providing access to services, and improving the quality of life.

**No legacy infrastructure could accelerate the move to a digital economy**

Myanmar is massively underdeveloped and has very little in the way of ‘legacy’ infrastructure. This presents a remarkable opportunity to Myanmar to use digital technology and thereby avoid the massive costs in building a bricks-and-mortar delivered nationwide network of banks, government offices, retail, education, etc.

Digital technology can be embraced to connect rural and remote populations.

**Becoming a destination for FDI platforms**

The key challenge is attracting FDI platforms in the inputs into production to be able to meet industrialist demand. Labour is one, a secure and stable source of electricity is the other.

Myanmar, through negotiations with neighbours, should be able to harness the mighty Mekong for hydro power generation and become a ‘battery’ for industrialists.

### CHALLENGE

**The resources curse**

FDI has been heavily concentrated in the resources and energy sector in the early stages of development so far, with little pick-up in infrastructure and other sectors that are necessary to facilitate stronger manufacturing FDI growth. The visible hand of the government, using resource revenues, may be required.

**Leveraging China if it succumbs to the middle income trap**

Myanmar must design an economy that clearly exploits its geographical advantage to China and India without being entirely reliant on it. As these neighbouring economies will become principal sources of external demand and probably heavy investors in Myanmar, they both have lengthy low-middle-high income transitions ahead of them.

**Funding urbanisation and avoiding slums**

Myanmar has one of the lowest urbanisation rates in Asia, with just 13% of the population urbanised. This will at least double in the next 15 years and that additional urban build — two cities the size of Yangon — will be expensive.

**Imported technology and intellectual safety**

Myanmar clearly does not have a comparative advantage in technology production, so most of this technology and know-how will have to be imported and this could inflate the trade deficit.

Technology and skills transfer will need to be harnessed to rapidly deepen the human capital of locals through this process.

A further consideration is that digital technology can be hacked and commercial and politically sensitive information could be revealed.

**Very poor telecommunications and electricity infrastructure**

Myanmar presently has one of the lowest rates of electricity consumption per capita in the world. About 73% of the population lacks access to electricity. Existing power infrastructure meets only about half of the current demand, resulting in frequent blackouts and the rationing of the electricity supply. This may dissuade manufacturers from shifting production platforms to Myanmar.

World Bank initiatives to boost the national power supply and rapidly expand the telecom sector appear to be occurring.
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