



Myanmar Financial Sector Reforms

Policy Note



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Summary of Key Messages

During Myanmar's decade of reforms, financial sector reforms were widely recognized to be a critical underpinning of Myanmar's democratization process, enabling the transition to a more egalitarian, accessible economy.

When Myanmar started opening up to the rest of the world in 2010-11, previous financial crises and opaque interventions, as well as repeated structural overhauls, had significantly undermined the public's trust in the formal financial system. Private banks were perceived as serving a small elite class, whereas most of the public relied on informal financial service providers. An economic history peppered with instances of high inflation, demonetization, banks runs, and episodes of market volatility had fed into the public's perception that they were better off storing their wealth in real assets. Hence, establishing an open, stable, and accessible financial system, that would facilitate financial intermediation for productive purposes was an important requisite for achieving economic democratization.

Accordingly, the Government developed a program of wide-ranging financial sector reform and development as described in the *Financial Sector Development Strategy 2015-2020*, and then supplemented and updated their approach via other strategy documents. However, bringing stability, transparency, good governance, and accessibility to the financial system in



Myanmar was in effect taking on a plethora of legacy issues. Myanmar's financial sector had borne the brunt of several years of unintended policy consequences, from both its colonial and post-independence eras. For instance, to ensure that asset and liability maturity profiles matched on a bank's balance sheet the central bank had largely restricted term loans to one year duration. This was intended to ensure that bank loans did not have a tenor that exceeded the maturity of their source of funds, mainly short-term deposits. But it ended up creating an incentive for banks to rely excessively on overdrafts, to circumvent the transaction costs of one-year term loans. At their peak overdrafts comprised 75 percent of bank lending in Myanmar. Similarly, interest rates caps intended to protect borrowers had resulted in most businesses and individuals being pushed towards informal providers, who could charge usury rates with little oversight.

Despite significant political economy challenges and capacity constraints, since 2011 policymakers were able to carry out a substantial program of reforms to strengthen the financial sector and promote market development. In the decade that Myanmar's government made a concerted effort to modernize Myanmar's financial system it was able to make significant, if uneven, progress. The building blocks for encouraging the confidence of the public in the banking sector were put in place with an overhaul of the legal and regulatory framework to bring it closer to the best practices that had developed in the years that Myanmar's financial sector was isolated. With the entry of Micro Finance Institutions (MFIs) and digital payment service providers financial inclusion was rising. The long-term finance market was slowly picking up with the introduction of new products on both the supply and the demand side. After decades of isolation, one of the last untapped markets in Southeast Asia was opening up to the financial and technical expertise benefits of integration with regional and international markets.



However, due to the impact of COVID and the coup of February 2021, this reform agenda is at severe risk of stagnation or reversal. Events in the last two years have served to seriously undermine the hard-won progress made in bringing Myanmar's financial sector into the 21st century. While Myanmar's financial sector was not alone in experiencing the debilitating impact of the COVID-19 pandemic, the coup of February 1, 2021, and the political and economic uncertainty that followed have uniquely de-stabilized the system. The sanctions imposed by the international community after the coup and Myanmar's pre-existing FATF grey listing are once again pushing the financial system into isolation.

Progress in the modernization and accessibility of the financial sector is contingent on stability and the confidence of the public in financial institutions. Neither of these pre-conditions are currently being met in Myanmar. While many of the challenges that Myanmar is facing right now are playing out through the financial sector, their solution does not necessarily lie in the financial sector. Despite the lack of reliable data, it is possible to infer that a range of financial institutions in Myanmar have been severely impacted on the liquidity, asset quality, and solvency fronts. Any gains made on pushing the access agenda have also been jeopardized. Moreover, the erosion of the autonomy of the regulators has its own implications for the political will to exercise any oversight. Rectifying the damage to the sector under current circumstances seems especially challenging, unless there is stability and the public's confidence in the financial system is restored incrementally. ●



1 A Decade of Reforms



A Financial Sector Landscape

Myanmar has one of the most underdeveloped financial sectors in East Asia even though it had embarked on a path of political and economic reforms in 2010-11. Indeed, compared to regional peers, the country lagged behind on key metrics such as domestic credit to private sector as a share of GDP, depositors with and borrowers from commercial banks (per 1,000 adults), or private credit bureau coverage (percent of adults) (Table 1). Banking assets make up more than 90 percent of Myanmar's total assets of the financial sector. The system comprised four state-owned banks and twenty-seven private sector banks, and the branches of 13 foreign banks (Table 2). Despite the number of institutions, banks in Myanmar played a very limited role in deposit mobilization and lending, even when compared to peers such as Vietnam, Cambodia and the Philippines (Figures 1 and 2). However, the informal market flourished, with an estimated 75 percent of credit provided by money lenders, complemented by other forms of informal credit sources such as shop credit and input suppliers. Loan pricing and recovery practices in the informal markets were often problematic and any attempts by the government to forbid such practices and to protect borrowers, only further increased the risk premiums for those in need of credit.



TABLE 1 Myanmar's Banking Sector Compared to Regional Peers

	Myanmar	Cambodia	Laos	Malaysia	Thailand
Domestic credit to private sector (% of GDP)	25.3	99.6		120.4	144.6
Bank nonperforming loans to total gross loans (%)	n/a	2.0		1.5	3.1
Depositors with commercial banks (per 1,000 adults)	239.5		598.8	744.1	1279.8
Borrowers from commercial banks (per 1,000 adults)	4.4		27.8	324.3	363.1
Firms using banks to finance investment (% of firms)	7.1	2.5	8.6	35.3	15.3
Firms using banks to finance working capital (% of firms)	11.2	18.2	23.1	42.6	28.9
Private credit bureau coverage (% of adults)	0.0	50.4	0.0	89.1	56.5
Public credit registry coverage (% of adults)	0.0	0.0	14.5	64.9	0.0

Source: World Bank World Development Indicators, World Bank Enterprise Survey Myanmar 2016, Milken Institute (2017).

Note: Most of the data is from 2018, some from 2019, and in a few cases from 2015 or 2016, when the latest Enterprise Survey was conducted in the respective country.

TABLE 2 The Structure of Myanmar's Banking System

	NUMBER		BRANCHES		TOTAL DEPOSITS (% OF SYSTEM)		TOTAL ASSETS (% OF SYSTEM)		TOTAL LOANS (% OF SYSTEM)	
	2018	2019	2018	2019	2018	2019	2018	2019	2018	2019
State-owned Banks	4	4	545	544	26.4	22.0	33.3	27.6	11.2	12.8
Private Banks	24	27	1719	1835	65.9	69.4	57.3	62.0	84.6	79.5
of which: Systemic Banks	6	6			61.2	0.6	52.5	51.1	68.9	64.7
Foreign Bank Branches	13	13	13	13	7.7	8.6	9.5	10.4	4.3	7.7
Total Banking system										
In percent of GDP					47.9	47.0	63.5	66.0	25.3	28.3

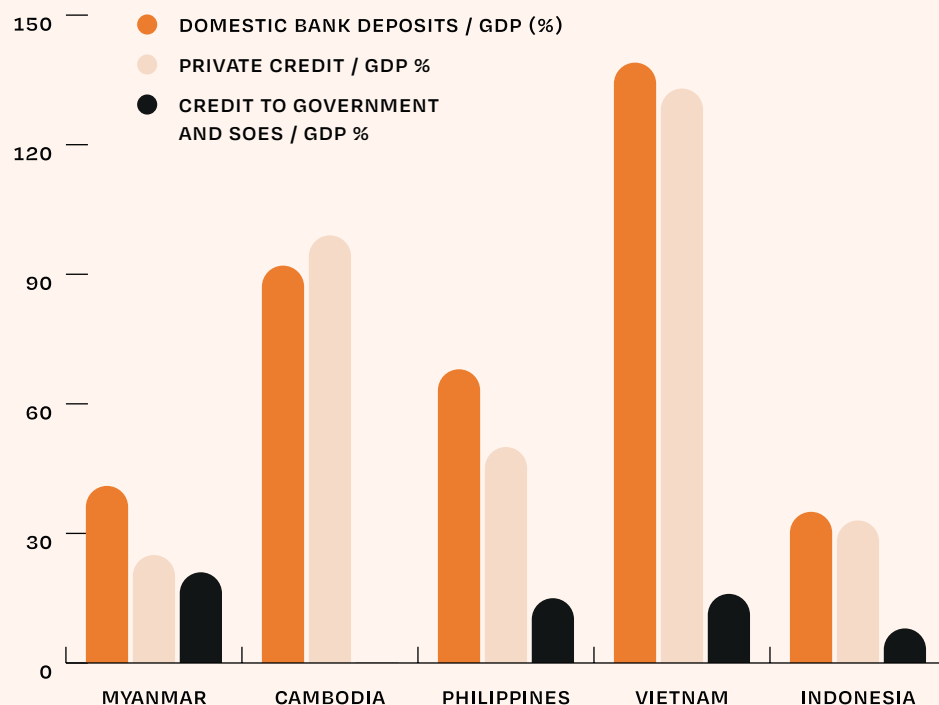
Source: Myanmar authorities, IMF Myanmar 2019 Article IV Consultations.

It was also apparent that Myanmar's banking sector could not continue to grow without addressing some of the structural issues originating in unintended policy outcomes. Myanmar's state-owned banks from its socialist past rapidly lost market share with the entry of private banks since the early 1990s, being left with just under one-third of the banking sector assets.



FIGURE 1

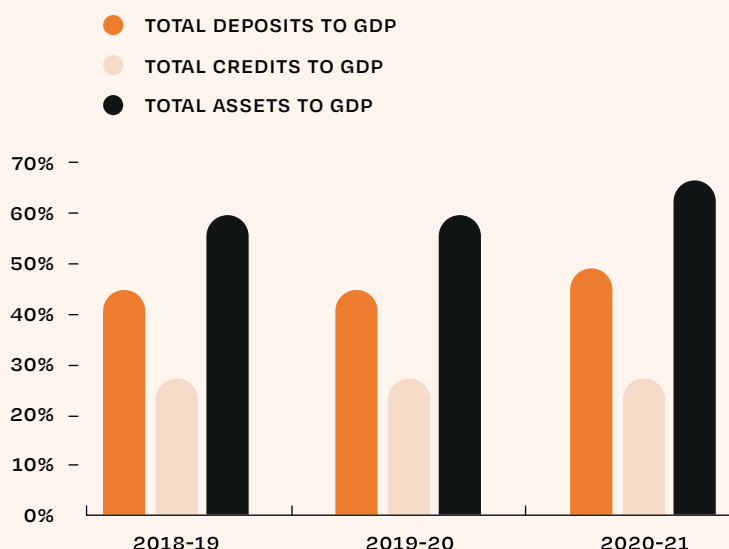
Financial Depth:
Myanmar and Comparators
(ratio to GDP)
— 2018 Finstats



Source: World Bank FinStats Database 2020.

FIGURE 2

Myanmar's Banking Sector
Size by Deposits, Credits
and Assets to GDP



Source: CBM.

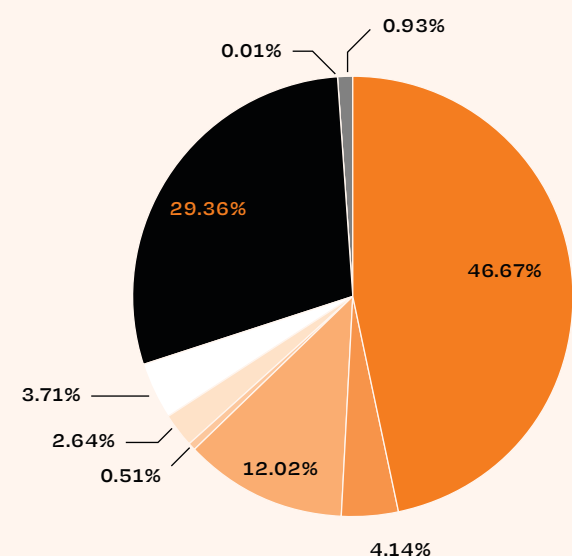
They increasingly struggled to maintain financial sustainability and the strategic rationale for their continued role in the market. Myanmar's private banking sector is dominated by a few large players with ties to domestic conglomerates, and comprises a long tail of smaller banks. Data on the sectoral and geographical distributions of the loan portfolios of public versus private banks further underlines the divide in the banking sector (Figures 3a and 3b). While state-owned banks primarily financed agriculture (47 percent of their loan



portfolio), followed by trading (12 percent), domestic private banks primarily financed trading (26 percent of their loan portfolio, followed by the services (18 percent), construction (17 percent). Agriculture plays a very small share of private banks financing – only 2 percent of their loan portfolio.

FIGURE 3A

Sector Lending of State Banks 2020-2021

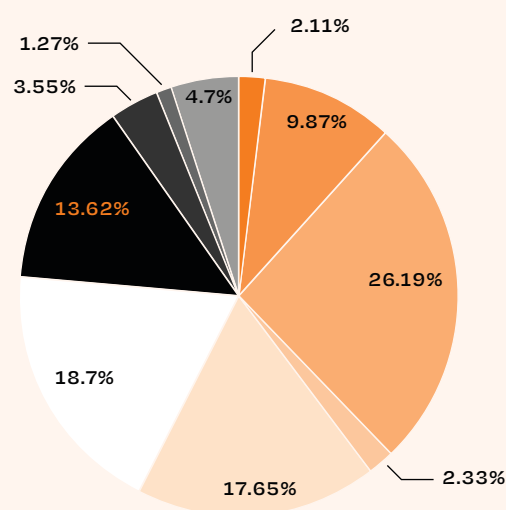


AGRICULTURE
PRODUCTION
TRADING
TRANSPORTATION

CONSTRUCTION
SERVICES
GENERAL
HIRE PURCHASE

FIGURE 3B

Sector Lending of Private Banks 2020-2021



HOUSING LOANS
SME LOANS

Source: CBM.

The sector has long been subject to restrictions on loan maturity to 12 months, interest rate caps, and rigid collateral requirements. Banks adapted to these circumstances by relying excessively on over-collateralized, relationship-based lending through overdrafts that they rolled over routinely. In addition, the interest rate caps also disincentivized banks from seeking out riskier, unknown clients. Hence, financial access was largely restricted to known, larger companies and SMEs had to rely on self-financing and the informal market. Thus, over time the credit and risk appraisal functions in



most banks had significantly atrophied. With the result that loan-to-deposit ratios for banks (including state-owned banks) have always tended to be low and banks in Myanmar have struggled to make money from their core business of financial intermediation, squeezed by low net-interest margins (NIMs).

The tenor of financing in Myanmar was disproportionately tilted towards the short-end, with most instruments maturing in the one to three-year range. For decades the lack of trust in macro stability and in the banking sector had ensured that most people kept their long-term savings in the form of gold, real estate, or even under their mattress. In addition to the public mistrust, there was also a vast gap in the availability of formal long-term instruments. The very limited development of the insurance and pension sectors meant that there was a general scarcity of instruments where people could place their long-term savings. Additionally, interest rate caps, restrictions on term loans, a limited market in government bonds, and the scarcity of long-term corporate financing instruments (debt and equity) contributed to the significant gaps in the information generation processes that would have allowed the market to price money at different maturities, otherwise known as the yield curve.

B Reform highlights

With the passage of the Central Bank of Myanmar Law (CBM) in 2013, the government launched an ambitious legal and regulatory overhaul of its financial sector framework with a view to strengthen oversight and promote market development. The CBM law marked a clear break with the past and indicated that policymakers understood the importance of having an independent regulator subject to minimal political interference. This was followed by the Financial Institutions Law of 2016, and a series of subsequent regulations which furthered the



role of the CBM as an independent regulator with substantial supervisory powers. Similar modernization of the legal and regulatory framework also promoted the development and oversight of microfinance and insurance sectors. The operationalization of the Yangon Stock Exchange in 2016, though slow to take off, opened up the possibility of bringing transparency and good governance to corporate financing.

While the pace and impact of these reforms was often uneven, there was nevertheless important progress achieved in the interim years. A complex baseline scenario, decades of isolation from the rest of the world, and serious capacity constraints made the roll out of Myanmar's financial sector reform agenda a long-drawn process at times. Private sector players from region and beyond, who were quick to perceive the opportunities in one of East Asia's last untapped markets, were often frustrated by the overly cautious approach taken by policy makers. But the decade did see important gains on the financial inclusion front as both microfinance and mobile money products targeted hitherto underserved market segments. And the opening up of the insurance sector offered a wider array of products and services with the possibility of lengthening the yield curve.

Banking Sector

Private banks were issued licenses, beginning in 1992, as part of an effort by the State Law and Order Restoration Council (SLORC) to introduce market-based reforms in Myanmar. Although there were 21 banks by 2002, interest rate ceilings and collateral requirements meant that credit was only accessible to the connected, often engaged in resource rich and fast return industries. Most of the country continued to rely on their own or informal funds. Perceiving a high liquidity risk environment for banks, reserve requirements were high and held with the CBM. The CBM had claims on the government through direct lending which increased money supply and caused high and chronic inflation. Distrust



in the currency eventually led to a ‘dollarization’ of the financial system. Eventually, in 2002, panic fueled by rumors about the liquidity situation in some major banks in the market, caused a run on the banks and eventually the 2003 banking crisis. In addition to causing major economic hardship for many in Myanmar, trust in the formal banking system decreased even further. Following the crisis, there was a reshuffle among the private banks following CBM’s judgement to remove or limit banking licenses. The CBM continued to act as a financing arm of the state and engage in money printing practices. Hence, the state continued to crowd out private potential borrowers.

With the emergence of a salaried middle-class in urban areas in the early 2000s the deposit base of private banks grew quite rapidly making it imperative that these banks maintain sound balance sheets and good business practices.¹ Towards this end, after the Financial Institutions Law of 2016 came into effect, the CBM issued several regulations relating to prudential banking norms and sound governance of banks. The first set of regulations issued in July 2017 introduced to the banking system in Myanmar the minimal prudential requirements that most banks and regulators all over the world have adopted as markers of sound banking practices.² The regulation related to asset classification and provisioning, capital adequacy, large exposures, liquidity ratios. As part of their compliance with these regulations banks were required to convert their overdraft lending to term loans and require both interest and principal repayments from their borrowers.

The issuance of these regulations revealed significant fault lines in the banking system. Particularly problematic was the system’s reliance on overdrafts, which at their peak comprised more than seventy-five percent of lending by banks at the aggregate level. Although these overdrafts were heavily collateralized, banks had typically only been collecting interest payments

¹ Myanmar experienced a two-fold increase in the number of depositors in the banking system between 2011 and 2016, but yet at only 252 depositors per 1000 adults this number significantly lagged the developing EAP average of 963 depositors per 1000 adults.

² These four directives regarded the Capital Adequacy Regulation (16/2017), Asset Classification and Provisioning Regulations (17/2017), Large Exposures Regulation (18/2017), and Liquidity Ratio Requirement Regulation (19/2017).



on these products which they were rolling over quite commonly. Hence, converting these overdrafts to term loans and adopting minimal global standards on asset classification and provisioning would be reflected in an overnight deterioration of asset quality and rise in NPLs as the repayments on overdrafts did not include amortization. This would have corrosive feedback effects on capital adequacy and severely undermine the stability of the entire banking system. In response to the difficulties experienced by banks in immediately implementing these regulations the CBM allowed for a three-year transition period so that banks could make the necessary adjustments, converting overdrafts to term loans and preparing recovery plans as needed. The deadline was further extended to August 2020, and then as part of the CBM's Covid-19 policy response the deadline was once again extended to August 2023.

At the same time, the Government undertook a major reform program to restore the strategic relevance and financial sustainability of state-owned banks. The four largest state-owned banks (SOBs) in Myanmar emerged from the splitting up of its socialist era mono-bank and rapidly lost market share with the advent of private sector banks in Myanmar, since the latter offered enhanced customer services to their customers.³ From 2015 the 2019 their joint market share of bank assets decreased from 37 percent to 27 percent. Accordingly, the Ministry of Planning and Finance (MOPF) undertook a special diagnostic of the SOBs to formulate a vision for their future. The diagnostic affirmed the urgent need to modernize the SOB banks and enhance their governance arrangements, but also revealed that these banks had significant brand equity based on name recognition and a history of working with underserved markets and products such as rural and agricultural credit, which private banks had left alone. In fact, in 2020-21 agricultural lending made up only 2 percent of the loan portfolio of private banks, whereas it accounted for almost 50 percent of the loans made by SOBs. Private sector loans were also heav-

³ The four largest SOBs in Myanmar are Myanmar Economic Bank (MEB), Myanmar Agriculture Development Bank (MADB), Myanmar Foreign Trade Bank (MFTB), and Myanmar Investment and Commercial Bank (MICB).



ily concentrated in the more advanced state of Yangon and Mandalay which received 91 percent of all loans from the private sector. Hence, the role of the SOBs in providing credit to critical economic activities and working with underserved borrowers was very important.

The Government's renewed vision for SOBs entailed a merger that would consolidate to the same balance sheet the substantial deposits of the Myanmar Economic Bank (MEB) and the rural and agriculture focused loan portfolio of the Myanmar Agricultural Development Bank (MADB). The special diagnostic indicated that MEBs loan portfolio did not fully utilize its advantages in deposit-taking due to its name recognition and sound reputation, especially with non-urban customers. At the same time MADB that had over many years built a solid reputation with rural borrowers, but it relied almost entirely on subsidized credit line from MEB to lend to this segment. Hence, the most pragmatic next step was to merge and modernize the two institutions and their product offerings such that it created a viable, retail bank that would focus on value-chain financing for the critical but underserved rural economy. Accordingly, the MOPF developed a detailed business and transformation plan towards this end.

Microfinance Sector

After the passage of the Microfinance Law in 2011 Myanmar's microfinance institutions (MFIs) experienced robust growth and a rapidly expanding client base. In less than a decade there were more than 190 MFIs in Myanmar with almost 6 million clients throughout the country by February 2020 – a 142 percent increase since December 2016. The rapid expansion of MFIs can be explained by their focus on a client base that typically relied on the informal money lender. Under the Law the loan size was capped at approximately US\$ 7000 and the average loan was at most a few hundred dollars. Lending interest rates were capped at 28 percent and this was far below the rate that was being



changed in the informal market. Moreover, MFIs were not allowed to request any form of collateral from their clients. therefore, the MFI loan portfolio saw significant growth, from 451.8 billion Kyat in December 2016 to 2.188 billion Kyat in February 2020 – a 385 percent growth in about three years. The 10 largest MFIs were almost all partially or wholly internationally owned and held about 80 percent of all MFI assets. Most MFI clients in Myanmar are women (around 85 percent) with the majority of loans being group loans. And by and large before the pandemic the sector was stable with very low indicators for portfolio at risk.

A new Microfinance Business Law was passed by Lower House in Parliament in February 2020 and was submitted to the Upper House in the last session of the 2016-elected Parliament. The new Law would have lifted restrictions on; deposit mobilization; product offerings such as microinsurance products; acceptance of collateral on larger loans; enterprise loan limits (Ks10m to Ks20m); and MFIs ability to further share information with a credit bureau. The new legal framework was intended to address several issues that were impeding the sector including chronic liquidity shortages and the growing risk of personal indebtedness as anecdotal evidence indicated growing cross-borrowing among clients.⁴

Insurance Sector

Myanmar's insurance sector had been a monopoly for over half a century and it is only after 2013 that the market began gradually opening up. That year 12 licenses were granted to privately-owned, domestic operators. The state-owned insurance company, Myanma Insurance, continued to maintain a leading role, and managing an insurance pool that absorbed all premiums above a certain threshold, and all insurers were obliged to offer the same products and follow the official pricing. The dominant product in the insurance market was motor third-party liability (MTPL), which remained largely concentrated in the urban center of Yangon.

⁴ Cross-borrowing refers to a phenomenon whereby an individual borrower has exposures to multiple MFIs, and could conceivably be using loans from one MFI to meet his/her obligations to another institution. The lack of data on cross-borrowing makes it difficult to assess the risks of both personal indebtedness and systemic loan impairment.



“Despite operational restrictions the insurance sector was slowly growing, supported by increased domestic private-sector participation”



Despite operational restrictions the insurance sector was slowly growing, supported by increased domestic private-sector participation. As the private sector entered the insurance market, the total number of insured rose from 4.2 million in June 2018 to 4.9 million in June 2019. The value of insurance premiums from private sector insurers stood at 0.1 percent of GDP, or kyat 32 billion, which grew by 40 percent (yoy) in Q3 2018/19, albeit from a low base. Life insurance accounted for 31 percent of the market, and property insurance represented 55 percent of the market.

The most significant impetus to market expansion was the decision to open up the insurance sector to foreign companies as per Announcement No. 1 / 2019 on Insurance Market Liberalization for Foreign Entities by the MOPF. The development was part of the Myanmar Insurance Sector Liberalization Roadmap and granted permission to a company that wanted to operate the business of insurance, underwriting agency and insurance broking with foreign investment. Subsequently, the MOPF announced on April 5, 2019 that it was granting licenses to five foreign insurance companies to operate 100 percent owned life insurance. These five were AIA of Hong Kong, Chubb Tempest Reinsurance of the United States, Dai Ichi Life Insurance of Japan, Manufacturers Life Insurance of Canada and Prudential of England. The successful foreign insurance companies were required to comply with pre-licensing conditions established by the MOPF. ●



2

Impact of
COVID-19

5 MYANMAR COVID-19 MONITORING draws from a monthly survey of households and enterprises undertaken by the World Bank Poverty and Equity and Macro, Trade and Investment Global Practices with support from Myanmar Central Statistical Organization (CSO) to provide regular updates on households' living conditions and enterprises' activities. It also includes a community assessment led by the Social Development Global Practice.



Despite the relatively limited spread of COVID-19 infections in the early months of the pandemic, data from monthly monitoring surveys of firms indicated that businesses were already feeling the impact of repeated lockdowns.⁵ And this impact got increasingly serious with each successive wave of the pandemic. As might be expected, firms in the service sector were the most significantly affected by COVID-19. As were small and micro firms that did not have the buffers to tide over the repeated interruptions of their daily cash flows. While in March 2020 fewer small and micro firms reported being negatively impacted by COVID-19, by May 2020 the situation had deteriorated such smaller sized firms were significantly worse off than large firms. Only 3 percent of large firms in May 2020 reported a risk in falling in arrears over the following three months, compared to 40 and 35 percent of medium and micro firms, respectively. Furthermore, the pandemic underlined the differential impact to credit as per firms size and over one-third of small firms have experienced a reduction in access to credit, compared to only 1 percent of large firms experiencing this setback in May. Female-owned firms were more likely to report negative effects from COVID-19 in Myanmar. The negative impact of COVID-19 in terms of reduced access to credit, cash flow shortages, reduction in sales and temporary closure has, on average, affected women entrepreneurs more harshly than male owners. In this case as well, reduction in access to credit was the key differentiator between women and male business owners, where women fare significantly worse than their male counterparts.

The feedback effects of this downturn in real economic activity were felt by the financial sector as firms struggled to meet existing debt service obligations and yet needed additional working capital loans to continue operating. For the banking sector the pandemic hit at a critical juncture in their transition to a new prudential framework and added to the strain of setting their books right. While the impact on the banking sector was somewhat obscured by the lagged nature of indicators of asset quality deterioration, for microfinance institutions (MFIs) the lockdowns had the immediate impact of disrupting the face-to-face interactions with clients which were the principal form of both loan disbursement and collections. Furthermore, as the data indicate their clients were among the hardest hit by the lockdowns and also the least equipped to ride them out. One international MFI reported its repayment rate decreased from 99 percent to 19 percent of expected payments almost overnight.⁶ Moreover, because of COVID-19 there were reductions of more than 60 percent in planned disbursements in 2020. The data for May 2020 indicated that the MFI portfolio-at-risk (PAR) had climbed rapidly climbed to 13 percent, as the cash and capital buffers of MFI clients were being rapidly depleted in the current environment. And this pattern repeated with each lockdown. As in other countries, the regulators encouraged credit providers to work with their clients to reschedule/restructure loans, although they were more conservative on forbearance measures than other jurisdictions.

The Government introduced several measures to mitigate the impact of the crisis on the banking sector. For the first time in several decades the CBM reduced its policy reference rate from 10 percent to 7 percent effective May 1, 2020. Since interest rates in Myanmar were capped around the reference rate this effectively lowered the floor on the deposit rate from 8 percent to 5 percent and lowered the ceiling on the lending rate from 13 percent to 10 percent. Given the lower deposit rates, uncertainty with regard to Covid-19, and the pub-

⁶ <https://www.mmmtimes.com/news/microfinance-institutions-myanmar-face-covid-19-cash-flow-crisis.html>



lic's general lack of trust in the banking system, there were concerns that the banking system might experience an outflow of deposits as people turned to cash, gold or forex as safe haven assets. But that risk did not materialize at that time, and liquidity in the system was stable. In keeping with other central banks at that time the CBM also lowered statutory liquidity requirements to ease the pressure on banks. But perhaps the most consequential policy measure introduced at this time was the extension of the deadline for the compliance with the four prudential regulations issued in July 2017 from August 2020 to August 2023. While there was sufficient justification for this extension given the unprecedented crisis, it did serve to stall the momentum on the reform process and serve as demotivation for those banks that had actually made an effort to put their books in order, while letting others off the hook.

In addition to their clients being especially hard-hit MFIs were also facing issues with raising liquidity. Under the legal framework governing the operations of MFIs in Myanmar, they have limited deposit taking powers and typically rely on both foreign and local investors and banks to raise financing. As the crisis persisted the risk appetite among the conventional sources of finance started showing signs of diminishing and MFIs were foreseeing significant difficulties on this front. Thus, the sector was experiencing a significant squeeze and needed to access to reasonably-priced finance to be able to continue to serve some of the most vulnerable businesses. In response the MOPF set a low-cost liquidity facility for MFIs that disbursed through the MEB. Uptake was swift and the facility had to be topped up subsequently. But the new Microfinance Law that would have provided a more permanent solution to the funding issue for MFIs was lined up for passage in the first session of Parliament in 2021. ●



3 Since February 1, 2021



Myanmar's banks were among the most immediately and severely impacted businesses in the aftermath of coup of Feb. 1. In fact, the ongoing uncertainty continues to severely strain liquidity in the system, as well as disrupt the provision of basic financial services. Long queues at ATMs and bank branches characterized the first several months after the coup, made worse initially by staff absences and internet interruptions. Liquidity pressures have persisted as the public continues to be cautious about new deposits, both kyat and hard currency deposits. And it is not clear to what extent financial institutions have been able to meet credit needs, including for critical sectors such as agriculture. There seems to have occurred a significant "de-formalization" in the provision of financial services in a short period of time and it seems unlikely that Myanmar will be able to preserve the gains made in the preceding decade in the absence of political stability.



Pre-existing risks and vulnerabilities in Myanmar's financial sector have been exacerbated by the February 2021 coup, with important implications for the country's financial stability, even as official data indicate that the system has remained stable or even improved. As Table 3 illustrates, the performance of Myanmar's banking sector in terms of the financial stability indicators was problematic even before the coup, with low profitability (i.e. ROE and ROA) metrics, high non-interest expenses as a share of gross income and low CAR ratio. And these numbers did not fully account for the transition that Myanmar banks were making to a modern prudential framework. The coup exacerbated many of the banking sector's key vulnerabilities. Indeed, by some accounts⁷, in the aftermath of the coup, Myanmar's banking sector saw around 70 percent of its deposits leaving the banking system, moving the country even further towards a cash-based economy. The impact of such massive withdrawal on the financial sector cannot be overstated, and if persistent, it could lead to a considerable shrinking of the banking sector, much lower financial intermediation for productive purposes, and an overall negative impact on the country's economic growth. The CBM responded with limits on cash withdrawals that still remain in place, but their effectiveness has waned as by now most households and business hold minimal deposits in banks.

⁷ Based on discussions with industry representatives.



TABLE 3 Financial Soundness Indicators for Banks

FSI	Financial Year		
	2018-19	2019-20	2020-21
Return of Assets	-0.02%	0.22%	0.37%
Return of Equity	-0.35%	2.85%	3.92%
Interest Margin to Gross Income	48.68%	65.13%	62.18%
Noninterest Expenses to Gross Income	98.15%	83.10%	67.60%
Liquid Assets to Total Assets	47.30%	48.22%	49.12%
Liquid Assets to Short-term Liabilities	60.28%	59.41%	63.50%
Capital to Assets	7.09%	7.65%	9.50%

Source: CBM

Another consequence of the massive withdrawal in bank deposits has been the channeling of savings into gold, real estate and US dollars, as safe haven assets. This has put an upward pressure on the price as these assets, as evidenced by their considerable appreciation this year. Indeed, the domestic price of gold in Myanmar reached an all-time record high at the end of September 2021, when it reached 2.22 million kyats (~ \$932.7) per tical⁸, after which it declined somewhat towards the end of the year (Figure 3a). The MMK-USD exchange rate depreciated by approximately 47.5 percent between the beginning of the year and October 12, 2021. This prompted several interventions from CBM, which has sold \$428.8 million between February 1, 2021 and end of December 2021, in an attempt to reduce further pressure on the MMKs and to support critical sectors in dire need of US dollars. On the real estate front, while reliable data are not available, anecdotal evidence suggests an increase in property sales post-coup, as confidence in the kyat and local banks plunged and people opted for trusted assets such as real estate.

The banking sector continues to function in a challenging environment since the coup, with the general public struggling to withdraw cash and having to pay service fees as high as 6-8 percent. The problem was most severe with respect to currency notes as the German company that partnered with the CBM on

⁸ http://www.news.cn/english/2021-09/28/c_1310215178.htm

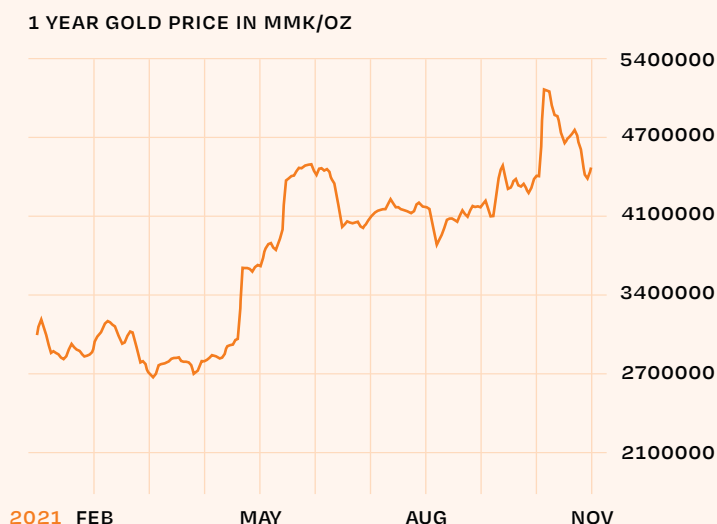


printing currency suspended their contract after the coup and the issuance of new notes was thus impacted. This has led to the development of many informal cash withdrawal services, which charge high additional fees to customers for withdrawing cash. For instance, Wave Money announced in mid-November 2021, it terminated 812 agents who were found to be charging extra fees for cash withdrawals. The one somewhat positive development is that three major lenders removed advanced booking requirements to withdraw cash in early November. Indeed, customers of *Yoma Bank*, *Glory Farmer Development Bank*, and *Ayeyarwaddy Farmers Development Bank* can currently take out between MMK300,000 to MMK1m per week without the need to make an appointment in advance.

On November 3, 2021, the CBM announced new rules for transactions, ordering that all payments over MMK20 million (the equivalent of around \$11,000) must be made through digital transfer. The main goal of these rules appears to be a better monitoring of transactions and limiting the need for cash, which continues

FIGURE 4A

The Evolution of Gold Price in Myanmar



Source: www.goldprice.org



FIGURE 4B

The Evolution of the USD to MMK Exchange Rate



Source: <https://www.xe.com/currencycharts/?from=USD&to=MMK&view=1Y>

to remain in short supply. However, it is unclear how the rule has been enforced. CBM later mentioned that 50 percent of a transfer above MMK20 million made to a new account (which has been set up since the coup) could be withdrawn as cash, but only 25 percent if the transfer is made to an old account (i.e. set up prior to the coup). Given the CBM has been unable to force banks to offer weekly withdrawal limits of MMK2 million for an individual and MMK20 million for a business, it seems unlikely banks have been complying with this rule.

In a further indicator of the cash shortages faced by banks, on November 25, 2021, the CBM temporarily amended the minimum reserve requirement for commercial banks. Directive No.19/2021 instructs lenders to keep 25% of the 3% minimum reserve requirement (0.75%) as cash in hand, and the remaining 75% (2.25% of the requirement) must be deposited at the central bank. Failure to comply will result in fines. This amendment became effective on December 8, 2021 and is supposed to last for six months⁹.

The one thin silver lining in the midst of these developments has been an uptick in both card and digital payments, largely driven by activity in urban areas, in response to the restrictions imposed both as a result of the pandemic and the military coup. Indeed, while the number of ATM transactions plummeted in the months following the coup, the number of POS / digital payment transactions increased exponentially over the same period (Figure 5a). Similarly, after an initial shock and decline, the total number of e-commerce transactions increased steadily since March 2021 (Figure 5b). Moreover, the volume of digital payments increased by 47 percent between February and September 2021, although they are still under the high volume recorded in January 2021, just before the coup; similarly, the value of these digital payments has recovered somewhat since the coup, but not to the pre-coup levels (Figure 6a). Last, but not least, the number of digital payment provider

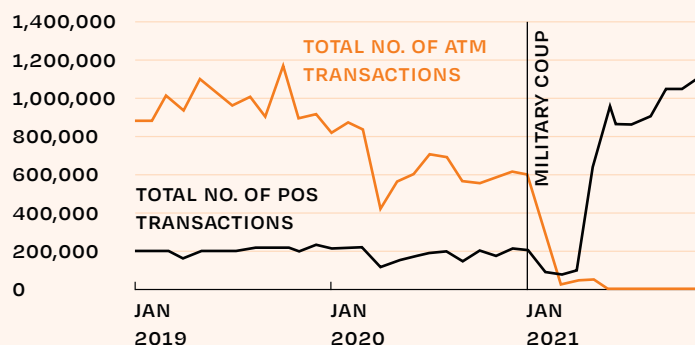
⁹ Previously, the minimum reserve requirement was 3.5 percent (<https://www.ceicdata.com/en/myanmar/reserve-requirement-rate>).



clients increased throughout 2021, although the rate of increase appears to have slowed down since the coup (Figure 6b).

FIGURE 5A

Card payments took off after the Coup



Source: Financial sector digital channels

FIGURE 5B

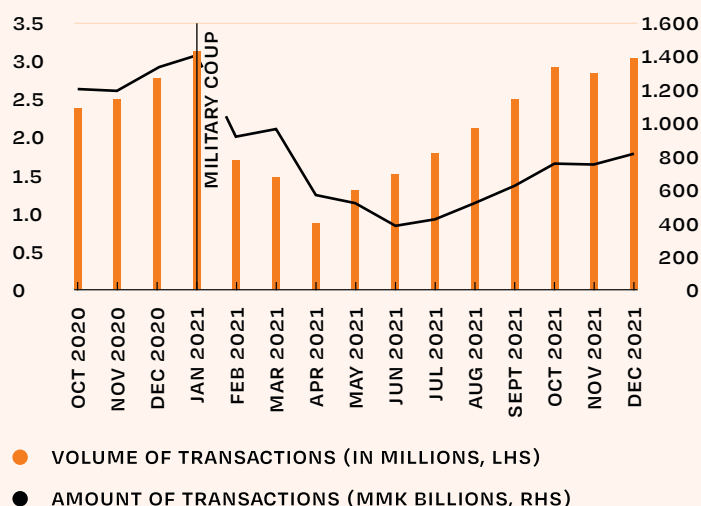
The total number of E-commerce transactions has increased steadily since the coup



Source: Financial sector digital channels

FIGURE 6A

After the initial decline, the volume of digital payments increased significantly since the coup

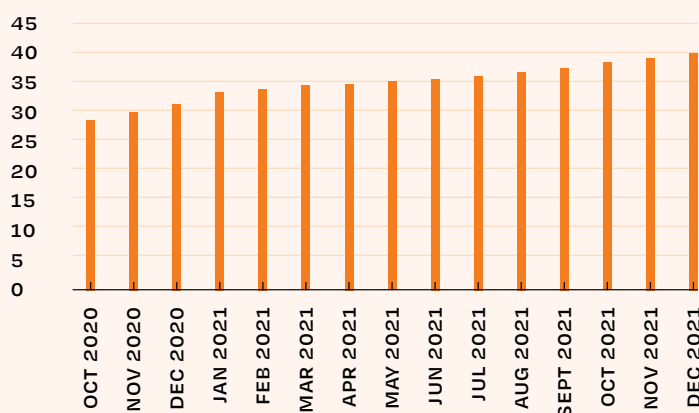


● VOLUME OF TRANSACTIONS (IN MILLIONS, LHS)
● AMOUNT OF TRANSACTIONS (MMK BILLIONS, RHS)

Source: Financial sector digital channels

FIGURE 6B

The number of digital payment provider clients continue to increase in 2021



Source: Financial sector digital channels

Faced with a rapidly depreciating kyat and a general shortage of hard currency the CBM has resorted to increasingly draconian measures to ration the public's access to hard currency. The key measures adopted by



CBM can be summarized into five broad categories: i) it responded to the depreciation of the kyat by temporarily suspending the reference rate and by adopting several measures aimed at slowing down the MMK depreciation; ii) it suspended the free spread range and revisited the managed floating exchange rate; iii) it allowed the use of additional currencies as official settlement currencies, including the Chinese yuan and the Japanese yen; iv) it sold a significant amount of USD in the market, but in recent months due to the shortage of USD, it reduced these sales significantly to around US\$30 million during February and March 2022; v) it proactively used bilateral currency to support trade, reduce USD-MMK exchange rate volatility and promote local currency in line with the ASEAN Financial Integration.

Most recently, on April 3, 2022, the CBM issued a notification on repatriation of foreign currency and conversion into Myanmar Kyat (MMK) and then subsequently they issued three related instructions (for inward remittance, outward remittance, and exemption) to the Authorized Dealers (AD) licensed banks. CBM also issued on April 7, 2022 an instruction to banks on limiting card payments, as a way to control the outflow of USD abroad.¹⁰ Subsequent exceptions for foreign entities, and their employees and the widening gap between the official and parallel market exchange rates have raised questions about the effectiveness and the sustainability of these measures.

10 The new instruction stipulates the following: i) the maximum amount of international prepaid cards (MasterCard, VISA, UPI) is USD 2,500. (Previously it was USD 5,000); ii) the maximum amount of international credit card (MasterCard, VISA, JCB, UPI credit card) and international co-brand card (MPU-UPI, MPU-JCB) is 25 million MMK. (Previously it was MMK 50 million); iii) the position of issuing, acquiring on the said international prepaid cards, international credit cards, and international co-brand cards shall be reported to the CBM on weekly basis.

The dual crisis of COVID-19 pandemic and the military coup has led to MFIs facing severe disruptions to their businesses. Indeed, with field staff prevented from coming to work, customers missing repayments, and troubled local banks trapping MFIs' funds that otherwise would be repaid to lenders or distributed as local loans or staff salaries, the MFI sector is in a dire situation. Moreover, the MFI sector has been greatly impacted by the domestic banking sector crisis and the pause in foreign lenders to Myanmar's financials sec-



tor. Anecdotal evidence indicates that asset quality in the MFI sector has deteriorated significantly since the coup, with the larger MFIs experiencing NPL rates of around 15 percent and smaller ones, often in excess of 20-25 percent. This could result to a more pronounced crisis should many MFIs go out of business or run out of funds to support an estimated 5 million borrowers. ●

4 What happens now?



The medium-term scenario for the financial system is not entirely clear, but it seems highly likely that the gains made over a decade will be eroded quite rapidly. While there has been no obvious dismantling of the updated legal and regulatory framework that was put in place in the decade of reforms, the current political economy situation does not bode well for the implementation or furtherance of these reforms. And there is no indication that the current regime has an alternative program to restore finan-



cial stability and make the financial system more inclusive. In fact, they have resorted to a series of ad hoc measures that can at best put out small fires, and that too with limited effectiveness, while significantly damaging trust in the financial system. There are questions about the independence of the regulatory agencies and their will to exercise prudential oversight. At the same time, the market has been severely disrupted, and it is not clear which financial institutions can meet even the minimal standards on liquidity, asset quality, and/or solvency. Under normal circumstances the supervisor would have initiated some sort of corrective action against specific bank (s), or eventually arranged for an orderly exit, but in the current scenario it is more likely that the crisis will play out as a slow decline of most of the banking sector. Foreign investors who had previously lined up to enter credit and insurance markets have had reason to rethink their stance.

Going forward the structure of the financial sector will reflect the structure of the real sector. The impact of prolonged period of uncertainty has already been felt by the real economy. While GDP contracted by 18 percent last year, this year economic activity is expected to remain stagnant. Moreover, there has been a distinct move towards de-formalization as weakened institutions have compelled businesses to seek informal operational solutions. This has also been true for credit provision. Under these circumstances banks will likely show a marked preference for large corporates, especially those that deal with foreign exchange, as they offer opportunities to charge fees as well. As MFIs and other financial service providers that serve the retail segment of the market come under increasing operational strain, their borrowers will have to rely on informal service providers. In many ways, this takes Myanmar's financial sector full-circle back to era before 2010-11, when the banks served an elite few and most of the general public relied on informal credit providers and all the malpractices that reliance entails. ●

