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BRIEF

JUNE 2014

# BANKING ON MYANMAR: A STRATEGY FOR FINANCIAL SECTOR REFORM

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Once the envy of Asia, Myanmar's financial sector is now a shadow of its former self. After decades of misguided junta-led strategies, state ownership, and policy shocks, confidence in cash as a safe asset and banks as trustworthy institutions has evaporated. Finance is a binding constraint on Myanmar's future development. The government needs a reform strategy that supports the financial sector's rapid development while ensuring its stability, efficiency, and accessibility.

## Performance Challenges

- By most international standards, Myanmar's financial sector is small.
- Growth of the banking system is constrained by weaknesses in basic institutions and infrastructure.
- The central bank has no real-time link to receive financial data from banks, and it has limited capacity to analyze that information and provide effective supervision.
- Inhabitants of rural areas, especially farmers, have limited access to financial services in rural areas.
- Land is the preferred collateral, so lending is effectively restricted to landholders.
- State banks are inefficient and encumbered by government-imposed social responsibilities, making them uncompetitive against private banks.
- Most private banks are owned by commercial groups, and significant lending to related parties can mask large default risks.

## Recommendations for Financial Sector Reform

*Short Term (one to two years)*

**Build strong institutional foundations for the banking system.** The sector needs modern clearance and settlement systems, a stronger central bank (especially in its ability to supervise), a money market, and fewer restrictions on opening bank branches.

**Ensure that foreign investment in the banking system occurs slowly and in stages.** A few foreign banks could be allowed to enter Myanmar's banking system, but only under restrictive conditions, until the regulatory framework is stronger and domestic banks are more efficient and financially stable.

**Adjust interest rates to ensure they are positive in real terms.** The central bank should continue to set interest rates but adjust them as macroeconomic conditions demand.

*Medium Term (three to five years)*

**Focus on broader structural changes.** Policy priorities should include restructuring state banks by closing, merging, or transforming them into one—or at most two—state-owned development banks; revamping microfinance; developing a framework to manage systemic risks; establishing a government bond market; preparing for branchless banking; and installing a deposit insurance system.

*Long Term (five to ten years)*

**Consider gradual and phased interest rate liberalization.** Such liberalization should only occur when the banking system has stable financial foundations and the central bank provides effective supervision.

**Develop the stock market.** After the money and bond markets start to function smoothly, the government can turn to developing the stock exchange.

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