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Research Briefing
Emerging markets

New Asian frontier markets
Bangladesh, Cambodia, Lao PDR, Myanmar

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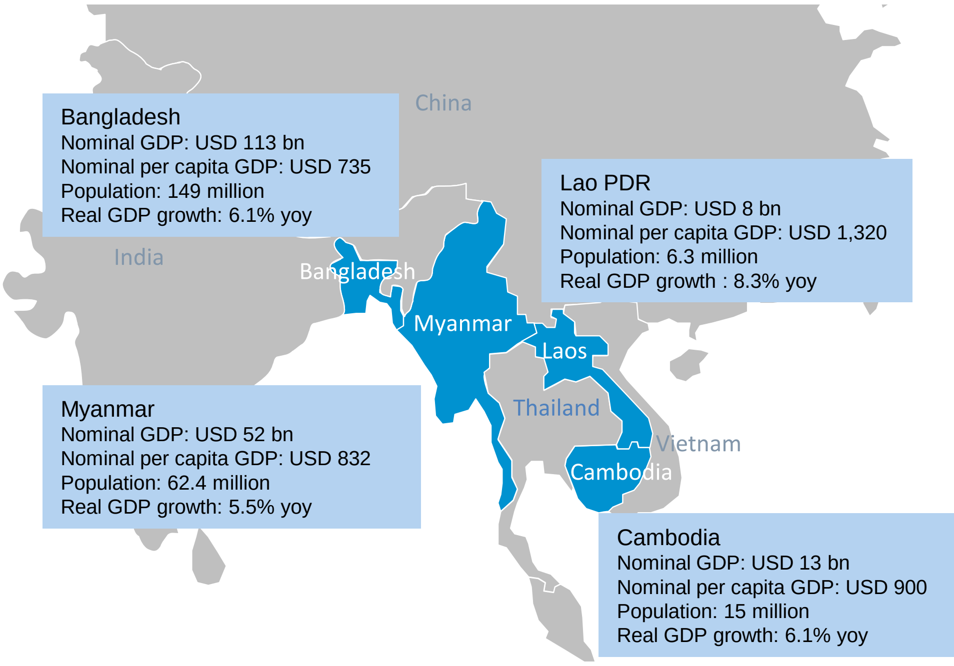
This note seeks to put in perspective the economic development of Bangladesh, Cambodia, Laos and Myanmar. All of these countries have very low per capita income but have been experiencing high growth rates, with annual average GDP growth of 6.3% in the 1990s and almost 8% in the 2000s. In the medium term, we expect real GDP growth to remain strong at 6-8% p.a. At a time when developed market economies are still recovering from the financial crisis, Europe is slipping into a second recession and even large emerging markets such as China and India are slowing down, it is worthwhile to take a closer look at countries in an early stage of "emergence".

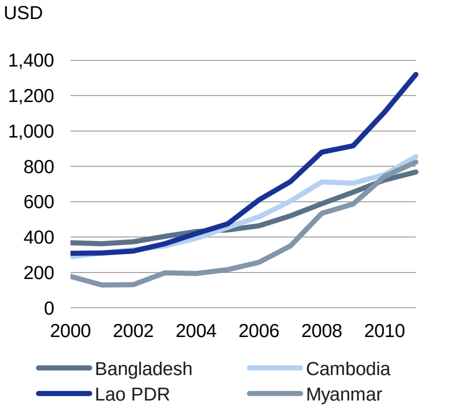
The new Asian frontier markets form a region of promising potential. Nominal GDP of the four countries together is comparatively low at USD 187 bn, around one-fifth of the ASEAN-5[1] total and less than one-tenth of the Asian Tigers[2]. But fast growth has enabled the group's economic size to more than double since 2005, and it is projected to reach USD 294 bn by 2017, roughly the current size of Malaysia.



Source: DB Research; 2011 data

[1] Indonesia, Malaysia, Philippines, Thailand and Vietnam
[2] Hong Kong, Singapore, South Korea, Taiwan

Rapid growth in GDP per capita 1



Sources: IMF, DB Research

Energy wealth, low labour costs and trade concessions are main competitive advantages. The main industry of Bangladesh and Cambodia is textiles, while the energy sector features prominently in Myanmar and Laos. The region's labour costs are attractive, and there are also special concessions for the import of goods from these markets. For example, their goods enjoy duty-free access to the EU. These advantages make them attractive as a manufacturing base.

Macroeconomic stability has improved over the years. These economies have seen declining or stable public debt as a percentage of GDP. Fiscal deficits have stayed below 6% of GDP. The external debt profile reveals a high proportion of long-term debt, which mitigates refinancing risks. Current account deficits are high, except in Bangladesh.

Trade with the world looks set to grow. Laos and Myanmar mainly trade with other Asian countries. Bangladesh and Cambodia exports are more global than regional; their main destination is the US. Laos is seeking WTO membership by the end of 2012 and Myanmar just returned to international markets last April as the US lifted its sanctions. In addition, as Cambodia, Laos and Myanmar are part of ASEAN, they stand to benefit from the ASEAN Economic Community (AEC) which is set to start in 2015, leading to a lifting of intra-ASEAN barriers on labour and capital movements.

Underdeveloped infrastructure, financial markets and institutions. Physical infrastructure in these countries is very limited, capping the growth potential. Social indicators remain poor, and in Myanmar and Bangladesh political conflicts need to be managed. State ownership limits competition in the banking sector. Rapid credit growth should be monitored, since it could potentially cause overheating and lead to a hard landing if not properly managed. These shortcomings notwithstanding, the countries' early stage of development should allow for "easy" productivity gains during an initial investment-led growth phase.

Key economic indicators 2

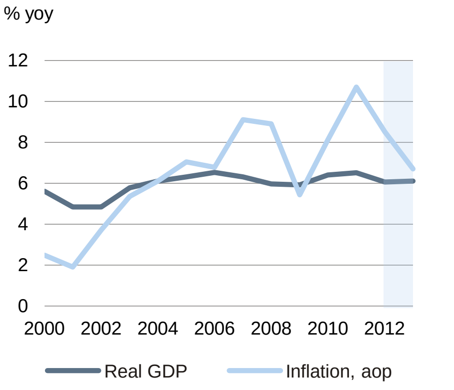
2011 data

	Bangladesh	Cambodia	Lao PDR	Myanmar
Nominal GDP, USD bn	113.0	12.9	7.9	51.9
Real GDP growth, % yoy	6.1	6.1	8.3	5.5
Nominal GDP per capita, USD bn	735	900	1,320	832
Population	148.5	15.1	6.3	62.4
CPI, % yoy	10.7	5.5	8.7	4.2
Fiscal balance, % of GDP	-4.1	-4.1	-2.9	-5.9
Current account, % of GDP	0.0	-8.1	-21.4	-2.6

Sources: IMF, DB Research

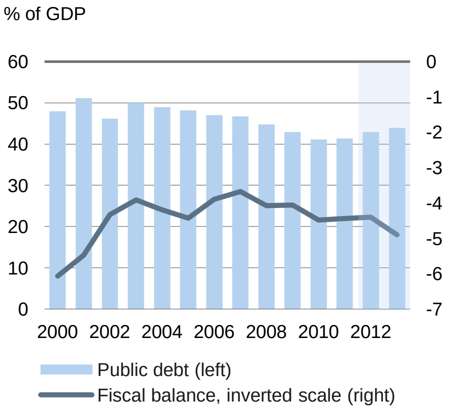
Bangladesh: Large population, strong growth supported by workers' remittances

Bangladesh: Growth & inflation 3



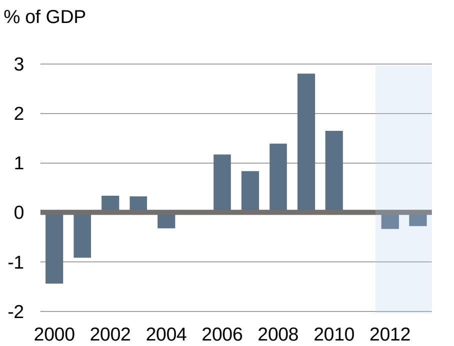
Source: IMF

Bangladesh:
Public debt and fiscal balance 4



Sources: WEFA, DB Research

Bangladesh: Current account 5



Source: IMF

Key facts

Bangladesh, a parliamentary democracy since 1991, has a population of nearly 150 million people, comparable to Pakistan's 175 million. Nominal GDP is USD 114 bn, the largest of the countries in this study. However, its nominal GDP per capita is the lowest, at USD 735 in 2011. The country's large population size provides opportunities not only as a huge pool of labour, but also as a big domestic market. Bangladesh's main industry is textiles, which accounts for 67% of total exports. This heavy reliance on a single industry increases the vulnerability of the export sector. The main export markets are the US and the EU, which take 80% of total exports, another concentration risk source. In the past five years Bangladesh experienced stable and robust growth rates of about 6%.

Political outlook

The overall political situation is stable but there are risks that high inflation could aggravate social tensions. The ruling party, Awami League, won the elections in 2008 with a large majority (more than 75% of votes) and is expected to stay in power throughout the current legislative period until 2014. A key problem that needs to be addressed is poverty, as about one-third of the population lives below the poverty line. Food prices and income distribution, especially for farmers, need to be addressed. Occasional violence between religious and ethnic groups is also a threat.

Economic outlook

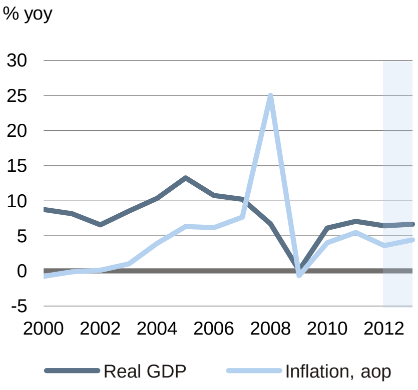
Bangladesh faces two major economic challenges – limited energy supply and high inflation. As energy demand exceeds supply, power rationing is unavoidable. The shortage in energy is caused by outdated power plants and miscalculation of power demand. Inflation may decline from its peak, but it will persist at one of the highest rates in Asia (about 10% in 2012), driven mainly by high energy prices and structural inefficiencies, similar to India.

Macroeconomic stability compares favourably to peers in the area of external liquidity, since the current account has been in surplus in recent years due to large remittances, although a small deficit is projected during the next few years. Bangladesh's fiscal deficit is high compared to that of other countries covered in this note, at around 4% of GDP. Public debt is above 40% of GDP and projected to rise moderately. While the fiscal outlook is not deteriorating significantly, consolidation is not assured either.

All in all, Bangladesh's economic outlook is positive. Real GDP growth is likely to stay around 6% yoy and may accelerate further in the medium term if investment in infrastructure takes off. Remittances, mainly from workers in the Middle East, bolster external revenues, but they are dependent on the situation in the Gulf region. At 10.5% of GDP, Bangladesh's remittances/GDP ratio is the highest in the world.

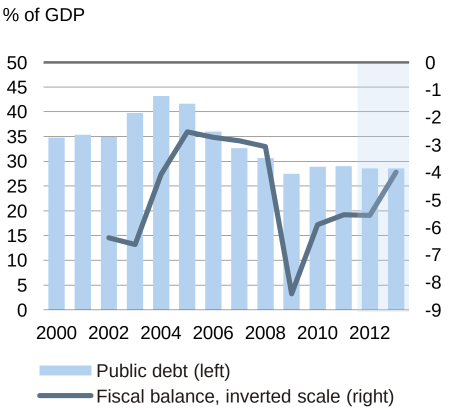
Cambodia: Positive growth outlook with diversification challenges

Cambodia: Growth & inflation 6



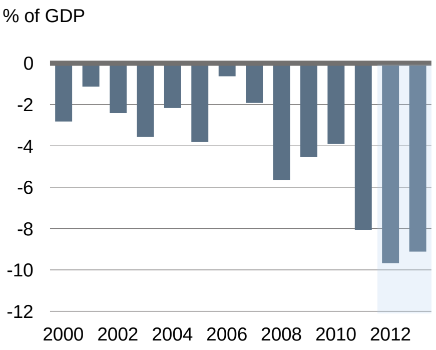
Source: IMF

Cambodia:
Public debt and fiscal balance 7



Sources: WEFA, IMF

Cambodia: Current account 8



Source: IMF

Key facts

Cambodia has a small economy, with nominal GDP of USD 13 bn in 2011, around 10% of Bangladesh's. Per capita income is also low, at USD 900. The economy is heavily dependent on the garment industry, which accounts for around 70% of total exports. Over-dependence on textiles caused Cambodia's growth to dip from 6.7% in 2008 to 0.1% yoy in 2009, during the global recession. The government now tries to promote rice exports to diversify the export sector.

Agriculture's share in GDP has been declining but remains substantial at 36%. Around 80% of the total population work in agriculture. Within services, tourism is a key sector, accounting for 12.5% of GDP. Around 2.5 million tourists visited Cambodia in 2010 and brought USD 1.4 bn in revenue. The local economy is heavily dollarised; more than 95% of the broad money supply is in US dollars.

Political outlook

Democracy was established in Cambodia in the early 1990s, but in practice it resembles a one-party-state, with the ruling party having a strong grip on parliament. Political challenges could, however, come from demands for economic reform and governance. Economic diversification will likely have repercussions on land and property rights. A sound legal framework will be needed in order to prevent lands grabs and social discontent.

Border relations between Cambodia and Thailand have been tense. A clash over the territory surrounding the Preah Vihear temple was solved in June 2011, but the sovereignty dispute over the Gulf of Thailand has yet to be fully resolved.

Economic outlook

Cambodia's economic outlook is positive with real GDP back on track for 6% annual growth in the near term and the potential to accelerate to 7%+ in the medium term, assuming successful economic diversification and continued inflows of foreign investment.

Macroeconomic stability in general is not at risk. In the near to medium term, CPI inflation is expected to stay below 5% yoy (annual average) while the fiscal deficit is expected to remain at 2-3% of GDP. Cambodia's public-sector debt compares favourably to peer levels at below 30% of GDP.

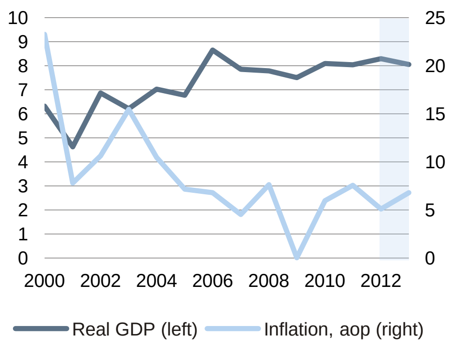
The banking sector has been resilient in the wake of the 2009 global recession and the recent sharp correction in property prices. According to the IMF, the NPL ratio declined to 3% in 2011 from 4% in 2009-10. However, rapid growth in credit to the private sector (around 30% of GDP in 2010-11) could pose challenges.

External liquidity is weak. The current account deficit shot up to 10% of GDP in 2011 from 4% in 2010, and is expected to remain high over the next few years. Financing requirements will remain large, and Cambodia will remain heavily dependent on foreign investment. More than 50% of FDI comes from China and overseas Chinese investors. The external debt profile is supported by the overwhelmingly long-term tenor.

Laos: Smallest economy but highest per capita income

Lao PDR: Growth & inflation 9

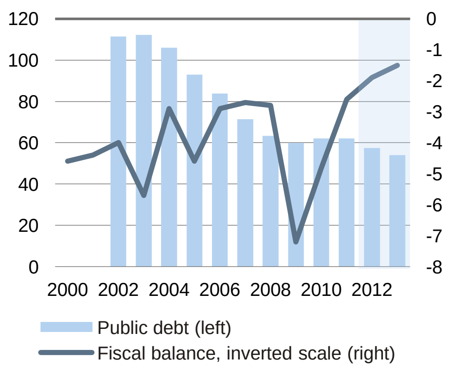
% yoy



Source: IMF

Lao PDR:
Public debt and fiscal balance 10

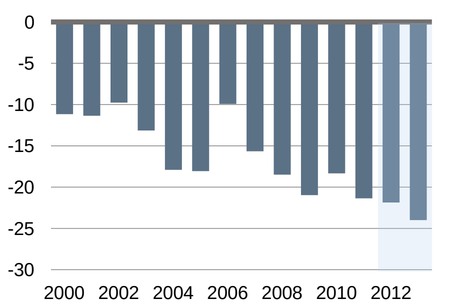
% of GDP



Sources: WEFA, IMF

Lao PDR: Current account 11

% of GDP



Source: IMF

Key facts

Lao People's Democratic Republic (PDR) is the smallest economy in this peer group with nominal GDP of only USD 8 bn but with the highest nominal per capita income at USD 1,320.

In the past 10 years Laos experienced consistently strong GDP growth of 6.2-8.7% p.a. Even the global financial crisis in 2009 had little impact on the country, as it is economically quite isolated. Real GDP increased by 7.6% yoy in 2009 and around 8% yoy in 2010-11. The economy rests almost equally on 3 pillars: the industry and the service sectors each have a share of around 35% of GDP and the agriculture sector another 30%. Within the industry sector, hydropower and mining are significant. Laos exports hydropower to neighbouring countries. The garment and tourism industries are also relevant.

Lao PDR's main trading partner is Thailand, with a share in total imports of 65% and exports of 40%. Therefore, the Laos authorities pay special attention to managing the exchange rate between the Laos currency, the kip, and the Thai baht.

Political outlook

Lao PDR is one of the few remaining single-party Marxist socialist republics. The only legal party since the establishment of the Republic in 1975 is the Lao People's Revolutionary Party. Laos is seeking WTO membership by the end of 2012 and ASEAN free trade area membership by 2015, also aiming to leave the group of the least developed countries by then. With a GDP per capita of USD 1,320 in 2011, the country has the potential to achieve this goal.

In the past 10 years, urbanisation increased by 10%, which means that today one-third of the population lives in cities. As urbanisation accelerates, inequality in income distribution has increased, with the rural population being left behind. This is a potential source of social tensions.

Economic outlook

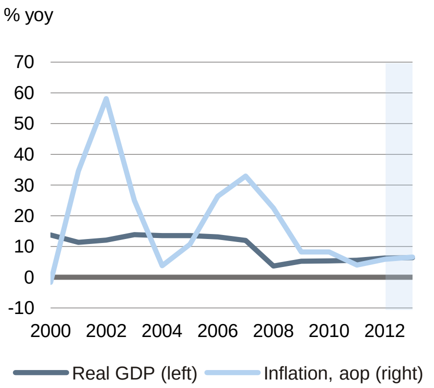
Severe floods in late 2011 damaged the irrigation system, which resulted in poor rice harvests. The floods highlighted Laos' vulnerability in food security and aggravated inflationary pressure. Its medium-term growth outlook is supported by increasing demand for hydropower on the part of neighbouring countries such as China and Thailand. Real GDP is expected to grow at a rate of around 8% in 2013. Greater openness will help to enhance growth prospects further.

Macroeconomic stability is not a concern from a domestic angle. Inflation has been on a downtrend after the flood impact. The fiscal deficit has been narrowing in recent years to around 3% of GDP in 2011 and is expected to narrow further in 2012-13. However, a major drawback is the large current account deficit, which was a whopping 21% of GDP in 2011, making Laos heavily dependent on external financing.

Ascension to WTO membership, which Laos hopes to attain by end-2012, should help the country strengthen reforms and thus make it more attractive to foreign investment.

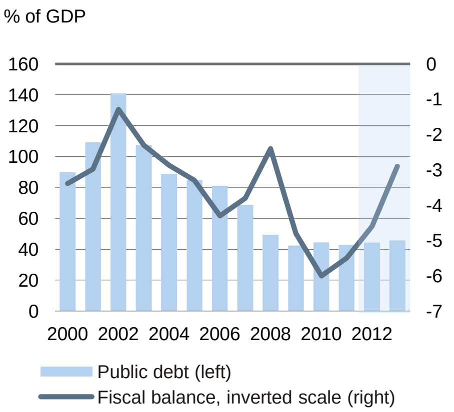
Myanmar: Resource-rich country opening up

Myanmar: Growth & inflation 12



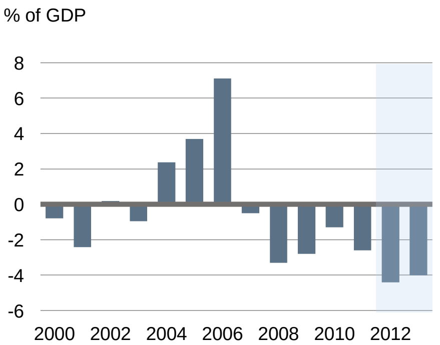
Source: IMF

Myanmar:
Public debt and fiscal balance 13



Sources: WEFA, IMF

Myanmar: Current account 14



Source: IMF

Key facts

Myanmar has the 2nd largest economy in this peer group, at USD 51 bn in 2011. It is also the 2nd poorest after Bangladesh, with nominal per capita income of just USD 832. Myanmar is a country of more than 60 million people with vast natural resources and an attractive geographical position between China and India. Its gas reserves are large, estimated at 22.5 trillion cubic feet. The economic structure is changing, with the share of agriculture in GDP declining, and that of services and industry expanding. Nevertheless, agriculture continues to generate the largest share of GDP at 40%, with two-thirds of the workforce employed in this sector.

Political outlook

In the by-elections held on April 1, 2012, the opposition party, National League for Democracy, won a stunning majority. In the past, an array of international sanctions had been imposed on Myanmar, but with the reform of the political system this year part of the sanctions were lifted. Along with further reforms, more sanctions are expected to be suspended in 2013. To ensure sanctions will be lifted and to avoid social turmoil, the government needs to address internal problems that range from minority conflicts to the plight of landless farmers. Although political and financial reforms are steps in the right direction, the country's fundamental power structure is likely to remain unchanged, with the military and its allies retaining a legislative majority.

Aung San Suu Kyi is the leader of the opposition National League of Democracy, and hence the head of the democratic movement. How she strikes a balance in achieving democratic progress while maintaining a workable relationship with the military-backed government will be influential in charting Myanmar's political course.

Myanmar, being a multi-ethnic country, often witnesses conflicts that could delay economic progress. Minority rights and inter-ethnic relations thus need to be managed carefully.

Economic outlook

An exchange-rate reform of the kyat was launched earlier in 2012. A multiple exchange rate system was replaced by a unified managed float, which led to an initial depreciation of the kyat. Changes in economic policy have been aimed at increasing the role of market forces and improving transparency, which is favourable for economic development at a time when the West starts to re-engage with Myanmar. Further economic engagement is, however, conditional on steady political reform progress.

Myanmar is not only attractive for its rich natural resources but also the abundance of low-skilled workers. There is great potential for intensive export-oriented manufacturing. Given its early stage of reform and opening, productivity gains can be achieved easily because of a current lack of modern technology.

Macroeconomic stability has improved in general although pockets of risks exist. In recent years, inflation has come down from double-digit levels, but overheating remains a risk. Credit growth has been very high in recent years (35% yoy in FY2009/10). The fiscal deficit rose in recent years to around 6% of GDP in 2011 and could rise further. Public debt is estimated at around 53% of GDP in 2011 but is expected to decline in the medium term.

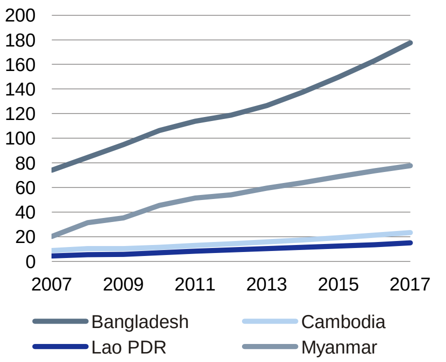
Exports have been rising but the current account remains in deficit. The latter is mainly financed by foreign direct investment. Therefore, the kyat is not expected to fall under strong depreciation pressure. Due to the new political situation prospects for the tourism sector are bright. In 2011 the number of visits to the country rose by 30%. This is positive for external accounts. Myanmar is in arrears on its external debt, which needs to be resolved with creditor countries. The outlook for an amicable solution has improved.

Overall, the economic outlook is positive. GDP is expected to grow by 6% in 2012-13, rising further in the medium term. Much depends on whether the regime can maintain the momentum of economic and political reform and keep societal harmony intact.

Conclusion

Asian frontier markets: Nominal GDP 15

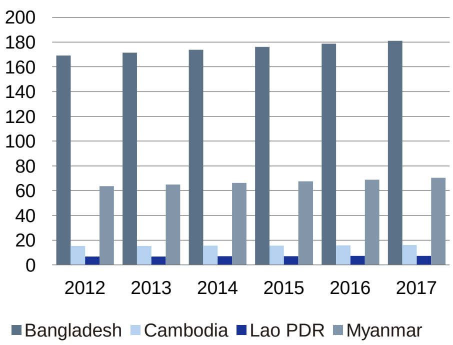
USD bn



Source: IMF

Asian frontier markets: Population 16

m, eop



Source: IMF

We expect the Asian frontier markets (AFMs) to be on a solid and accelerating growth path over the next five years, with real GDP growth potentially accelerating to 7-8% annually. All of the countries are expected to be members of the WTO by 2017. Trade at the regional and international levels is expected to deepen and drive growth in these countries.

By 2017 their combined population will reach an estimated 251 million people, compared with 232 million today. Together with a rising GDP per capita, this means a much larger consumer market. The consumer market is still young and there is large unmet demand for basic consumer products, durable goods such as electrical appliances and automobiles, and services such as telecoms and IT services. The countries' currently underdeveloped infrastructure spells large opportunities for investment in basic facilities such as roads, rail and ports. The incipient boom in tourism, especially in Myanmar, is another supportive factor.

There are some risks to this constructive outlook. First, being primarily agricultural economies, these countries are vulnerable to natural catastrophes, which can depress growth and lead to higher food prices and inflation. Second, there is the issue of political instability, which is detrimental to investment and growth. Third, there are risks that economic reform may be stalled. Fourth, risks could also arise from greater interdependence with the global economy. While in general greater openness to foreign trade and investment should have a net positive impact, the AFMs must be mindful of contagion risks and manage them appropriately.

Beyond these immediate risks, there are important challenges to tackle such as poverty reduction and protection of the environment and the national heritage. Improvements on these fronts will help the AFMs maintain their attraction for FDI flows.

Finally, economic reform will need a more commercially-driven banking sector and financial markets, as well as a robust regulatory regime. There is tremendous potential in the banking sector of these countries given the currently under-served demand for both savers and depositors.

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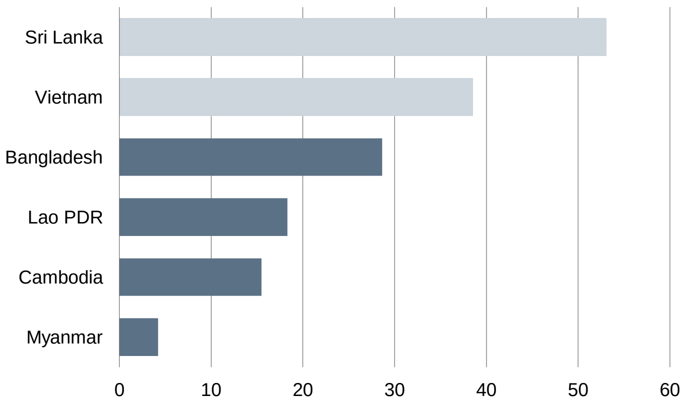
Appendix I: Governance indicators

Rule of law 17

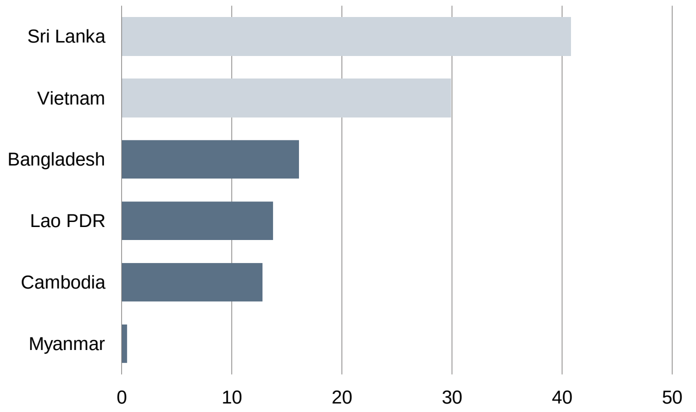
2011 (100 = best, 0 = worst)



Source: World Bank

Control of corruption 18

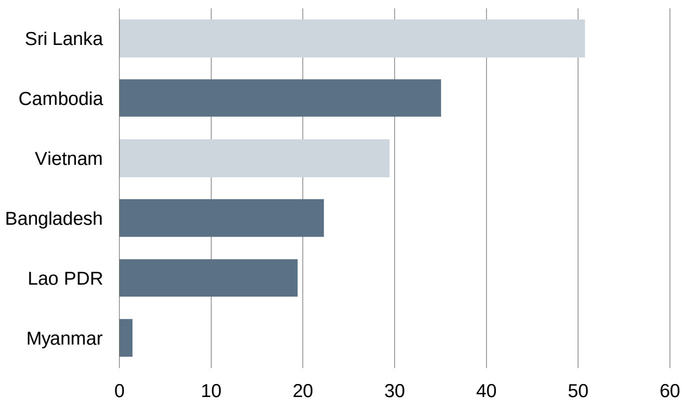
2011 (100 = best, 0 = worst)



Source: World Bank

Regulatory quality 19

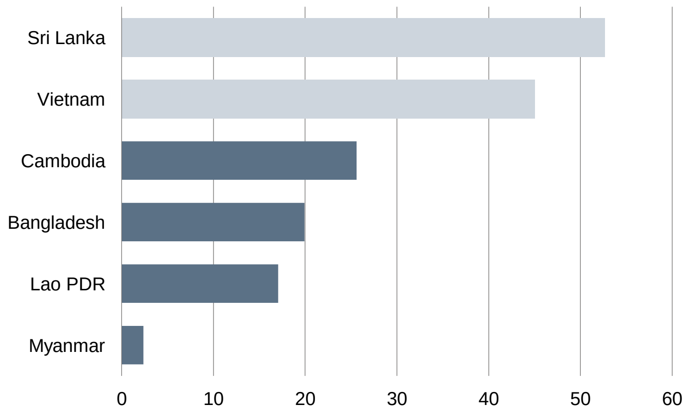
2011 (100 = best, 0 = worst)



Source: World Bank

Government effectiveness 20

2011 (100 = best, 0 = worst)

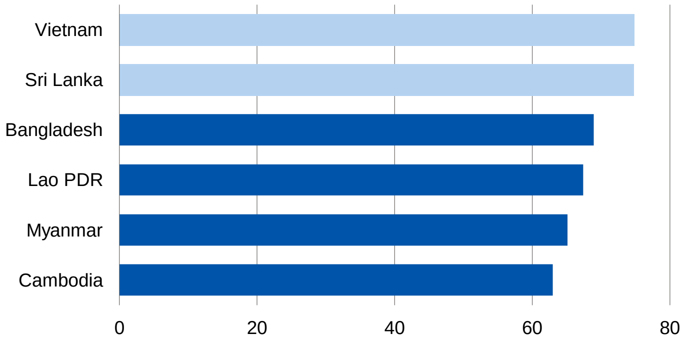


Source: World Bank

Appendix II: Social indicators

Total life expectancy 21

No. of years, 2011* (100 = best, 0 = worst)

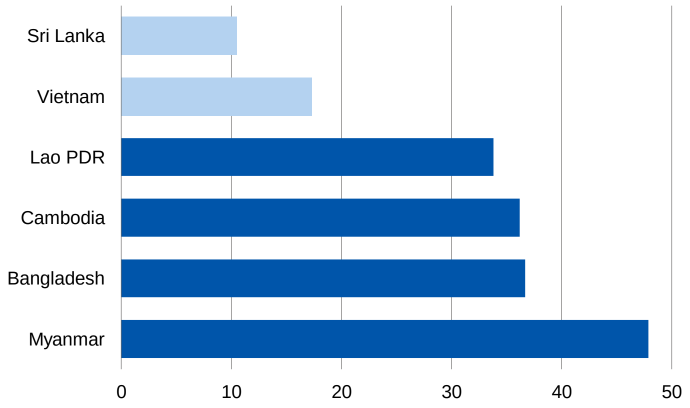


*Latest data for Sri Lanka: 2010; Vietnam: 2010

Sources: WDI, ADB

Infant mortality rate 22

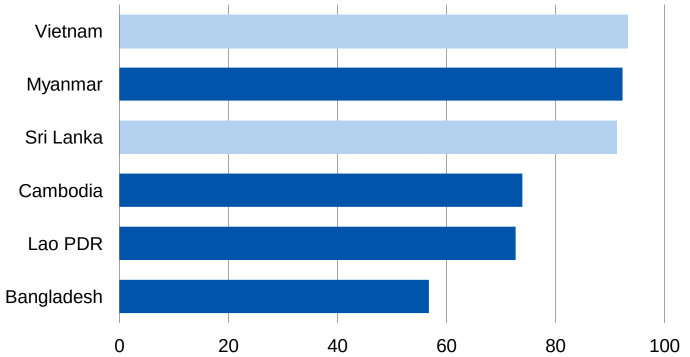
Per 1,000 live births, 2011 (100 = worst, 0 = best)



Sources: WDI, ADB

Adult literacy 23

Age >15, %, 2010* (100 = best, 0 = worst)

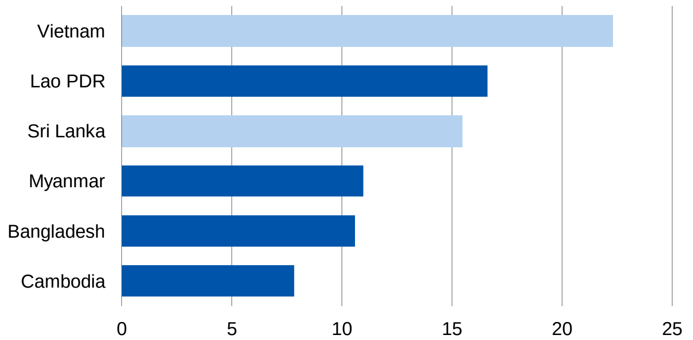


*Latest data for Cambodia: 2009; Laos :2005

Sources: WDI, ADB

Gross tertiary enrolment rate 24

%, 2010* (100 = best, 0 = worst)



*Latest data for Bangladesh: 2009; Cambodia 2008; Myanmar:2007

Sources: WDI, ADB

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