

Cambodia, Laos and Myanmar Business Forecast Report Q3 2014

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Abstracts

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Cambodia Myanmar faces a key test of its nascent reform drive as suggestions for the amendment of its highly flawed constitution are set to be announced. Of particular interest will be the military (Tatmadaw)'s suggestions, which will be the culmination of a review process undertaken earlier in 2013. One of the key questions that may be answered is whether or not the military will agree to a smaller presence in the country's parliament, where it currently holds a mandated 25% of seats. Additionally, the constitutional review may provide the answer as to whether or not venerable opposition leader Aung San Suu Kyi will be allowed to run for president in the upcoming 2015 general election, which would be a major step towards the legitimisation of the elections as a free and fair process. While Myanmar's economic growth potential remains enormous, the country's entire development story will likely hinge upon the government's ability to maintain reform momentum through 2015's elections and beyond.

Laos

A potential agreement between the ruling Cambodian People's Party (CPP) and the opposition Cambodia National Rescue Party (CNRP) regarding electoral reform could end Cambodia's political stalemate. Such an agreement would see the CNRP return to parliament, and bring an end to street protests which have threatened to escalate into violence over recent months. We hold a positive view on Cambodia's agriculture potential, and in particular rice exports, which, having grown by 6% annually on average between 2001/02 and 2012/13, are set to almost double from the 800,000-900,000 tonnes in recent seasons to 1.5mn tonnes by 2020/21. That said, Thailand's return to

the international export market, and Myanmar's ongoing increases in market access, pose salient threats to Cambodia's export outlook.

Myanmar

Despite acknowledging that urgent fiscal reforms are needed, Vientiane has done little to alter its excessive spending patterns with the fiscal deficit widening substantially to 5.8% of GDP in FY2012/13 from 1.3% in the previous year. Public expenditures swelled as a result of a surge in the public sector wage bill owing to a rapid expansion in the civil servant headcount and substantial raises in civil service wages. Revenues, meanwhile, were hurt by a fall in mining income as commodity prices were subdued and gold production fell. We believe that fiscal reforms are likely to dominate Laos' political scene as the government continues to struggle to arrest a deteriorating fiscal position.

While we have highlighted that Vientiane has not been able to alter its profligate spending patterns, some quarters of the government appear resolute to curb public spending. We also highlight that concerns towards the human rights situation in Laos are on the rise and further repressive acts by the government runs the risk of reversing the solid economic progress that has been made over the years. Unless Vientiane starts to make significant headway, it is unlikely to reverse a continued deterioration in its fiscal position.

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Election Reform Agreement Would Be A Significant Breakthrough

A potential agreement between the ruling Cambodian People's Party and the opposition Cambodia National Rescue Party (CNRP) regarding electoral reform could end Cambodia's political stalemate. Such an agreement would see the CNRP return to parliament, and bring an end to street protests which have threatened to escalate into violence over recent months.

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Long-Term Political Outlook

Addressing Corruption And Inequality Will Be Key To Stability

Cambodia's long-term political outlook depends on the ruling Cambodian People's Party (CPP)'s ability to address widespread corruption and income inequality, which have been fuelling public dissent against the government in recent years. The recent rise in support for the main opposition party shows that the CPP's grip on power is waning, which could lead to heightened political uncertainty over the coming years.

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Bullish Rice Outlook Despite Regional Threats

We hold a positive view on Cambodia's agriculture potential, and in particular rice exports, which, having grown by 6% annually on average between 2001/02 and 2012/13, are set to almost double from the 800,000-900,000 tonnes in recent seasons to 1.5mn tonnes by 2020/21. That said, Thailand's return to the international export market, and Myanmar's ongoing increases in market access, pose salient threats to Cambodia's export outlook.

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Risks To Infrastructure Outlook Unresolved

We expect Cambodia to experience a moderation in construction and infrastructure growth over the near-term. This is because several factors continue to dampen the near-term growth potential of both sectors - namely greater policy uncertainty following the outcome of the 2013 elections, growing competition from Myanmar, limited upside to investment, and ongoing land disputes.

CHAPTER 2.1 POLITICAL OUTLOOK - LAOS

Domestic Politics

Political Repression The Key Risk

Laos may score highly on its short-term political risk ratings due to the tight state control over all branches of the government. That said, it is this tight control, and surfacing signs of political repression, that lead us to score the country's long-term political risk fairly poorly.

This could possibly also adversely impact the country's longer term economic growth trajectory.

Long-Term Political Outlook

Growing Dissent Against LPRP Poses Risk Of Upheaval

Laos's long-term political outlook will depend heavily on how well the country balances the need to spur economic growth to achieve its millennium development goals and the need to address widespread corruption and dissent against the government. Heavy reliance on foreign aid and development assistance also means that the country's policies will remain susceptible to the political and economic interests of its much more powerful neighbours .

CHAPTER 2.2 ECONOMIC OUTLOOK - LAOS

Economic Activity

Diversification Sorely Needed

Laos' hydropower sector has been, and is likely to continue to be, a strong driver of economic growth. That said, a failure to diversify into alternative sources of economic growth risks the country falling prey to the 'Dutch Disease'.

CHAPTER 2.3: KEY SECTOR OUTLOOK - LAOS

Infrastructure Outlook

High-Speed Rail: Risks Weighted To The Downside

Laos and China look set to resume negotiations on the USD7.2bn railway project that will link the two countries together. While we believe that an economic case could be made for the railway project, we are of the view that the downside risks far outweigh the benefits that could be derived from the project. We highlight in particular that Laos remains exposed to the possibility of a drying up in credit as Chinese policymakers look to rein in a credit binge at home, while relying on a resource-based loan agreement would mean that Laos' loan tenure would be subjected to the vagaries of commodity prices.

CHAPTER 3.1 POLITICAL OUTLOOK - MYANMAR

Domestic Politics

Census Struggles Highlight Ongoing Political Quagmires

Myanmar's beleaguered and controversial national census underscores the country's extremely difficult political position despite the ongoing implementation of revolutionary reforms that began in 2011. That said, the chief risk to the reform process remains the general elections planned for 2015. While it is our core view that the government will manage these elections in a way that will not threaten the country's long-term economic outlook, political risks will nevertheless continue to play a prevalent role in our assessment of Myanmar's nascent economic transformation.

Table: Political Overview

Long-Term Political Outlook

Regime Change From Within

Myanmar remains one of very few Asian states to have withstood the tide of democratisation since the 1980s. Although Myanmar held its first elections in 20 years in November 2010, these were widely considered a sham, with the military-backed Union Solidarity and Development Party winning most of the seats. However, the government has since mid-2011 embarked on a surprisingly strong reform path that is leading to its re-emergence on the international scene.

CHAPTER 3.2 ECONOMIC OUTLOOK - MYANMAR

Economic Activity

Tourism Sector Flourishing As Reform Process Matures

Myanmar's economy achieved real GDP growth of 7.5% in FY2013/14 according to ADB estimates, beating our above consensus forecast of 7.1% on the back of a tourism and natural resources boom. Still, the maturation of the government's economic reform drive remains the key to unlocking Myanmar's longer-term economic potential, and we note that developments in foreign investment and banking sector regulation reflect a positive trajectory.

CHAPTER 3.3: KEY SECTOR OUTLOOK - MYANMAR

Infrastructure Outlook

Construction Infrastructure Potential Yet To Be Maximised

We believe that near-term growth in Myanmar's construction sector will remain at levels that are modest relative to its massive growth potential. The sector remains unable to achieve its full potential due to limited upside to foreign investment - the main driver of construction activity - and the numerous threats to the country's political environment before and during the 2015 general elections. In addition, recent issues with two of Myanmar's largest infrastructure projects have highlighted the lack of maturity in the country's business environment.

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