

Myanmar Coup: What Next?

[In a Nutshell](#): In a **shocking**, but not entirely unflagged, **political gambit**, **Myanmar's military staged a coup and declared a year-long State of Emergency on the pretext of widespread election fraud**. This thinly veiled power grab inevitably **drives up political risks** and **subjects investors to significantly elevated uncertainty**. International condemnation has been swift and expected. But the **cover of Constitutional legitimacy to prepare for re-elections** and **implicit support from China and Russia** within the UN Security Council may buy some time in terms of **economic sanctions**; which will **determine the severity of economic and FX shocks**. Nevertheless, the spectre of extended military regime and uncertainty could provoke Dollarization, and subject MMK to some degree/duration of depreciation pressures; even if the central bank has tools to mitigate these. The **biggest risk in terms of FX markets may be the ability to access USD funding onshore**; regardless of USD/MMK rates.

[Military Coup](#)

On Monday (1st Feb), **just before Parliament was set to commence, the military government staged a coup and declared a state of emergency that is to last for a year**. Power is transferred to the **military Commander-in-Chief, Min Aung Hlaing** and **Myint Swe**, a former general and military-backed VP, will temporarily assume the role of the President. **Aung Aan Suu Kyi** and key/senior members of NLD are reportedly **detained**. With media, internet and communications impeded, new flow from Myanmar is patchy and in need of verification.

[Constitutional Paradox](#)

On a technicality this coup is constitutional. The **military, which has alleged election fraud as the motivation for the coup, has specifically invoked the Constitution* in declaring a State of Emergency**; as the Constitution expressly leaves allowance for.

* Article 417 in framing election fraud as a "forcible" misappropriation of sovereignty, which warrants a State of Emergency and Article 418, which allows for transfer of power to the military chief

[Timing & Motivations](#)

To be sure, **writing of the coup has been on the wall** since the results of Myanmar's second democratic **elections** (in November) **revealed a landslide for saw Aung San Suu Kyi's National League for Democracy (NLD)**; which won 396 out of the 476 seats (>83%).

The **coup timed just ahead of the session in Parliament to certify the election result** is self-explanatory. But **motivations may be varied and less straight forward**. For one, the **NLD's sweeping mandate is clearly a thorn, although not an existential threat**. Fact is, the automatic 25% of all seats conferred to the military means that NLD

cannot pass laws without the military's buy-in. Moreover, constitutional privileges of the military include a stronghold on three key ministries – Home Affairs, Defense and Border Affairs. So this **may be an opportunistic move**.

Where timing and motivation collide is **the expected mandatory retirement of the military Commander-in-Chief, Commander-in-Chief, Min Aung Hlaing**, later this year. If indeed, this has elements of a power grab, then concerns about prolonged military rule under his leadership may grow; and fears of a dictatorship may creep in.

[Cover of Election Fraud Buys Time](#)

That said, the reticence of the military thus far has revealed very little in terms of plans; so the **situation is defined by lack of clarity**. But initial comments are **ostensibly not inconsistent with the military taking the view of re-elections down the road to rectify alleged fraud**.

This is likely to be the justification for the coup as well as a **one-year Emergency to stabilize the economy through the COVID pandemic**. To be sure, deferring re-elections under unique circumstances of political instability (although admittedly self-inflicted), and the COVID pandemic while tenuous, is not deemed outlandish. At least not the declaration of the State of Emergency in itself, which, may at least temporarily be imposed under the cover of the Constitution; even if it **does push the envelope of the democratic process**.

[Diplomatic Risks: From Rhetoric to Repercussions](#)

International rebuke has been swift, and unequivocal in condemnation of the coup. This has inevitably led to elevated diplomatic tensions. **But that is not the litmus test for a more significant and persistent diplomatic/political upheaval**. Fact is, military coups in Thailand in the last two decades, have averted diplomatic catastrophes or economic ruin.

Instead, repercussions such as economic sanctions – especially imposed on a multilateral basis – are **usually the defining catalyst for a negative economic spiral from the political turmoil**. Admittedly, one is not entirely divorced from the other. But, follow-up diplomatic/economic sanctions, such as those threatened by the US, need to be assessed. And as always, the dilemma for international actors is the **disproportionate pain sanctions inflict on the ordinary citizens**; but often with limited impact on the leaders of military rule.

[\(Re-\)Election & Detention](#)

Announcements by the military of **plans to hold re-election** (after the Emergency) and a **show of releasing detainees** (even if only conditionally so) may be the **low(est) bar to avoid an escalation in international antagonism and higher risks of sanctions**. Due process via courts may be another gauge for the international community to assess the need for, and/or course of, follow-up action.

[Mitigating Economic Pain?](#)

Admittedly, **political turmoil and coups**, insofar that it **heightens investor uncertainty, disrupts economic activity** and **raises the specter of political persecution**, will **dampen underlying confidence and economic activity**. And in the midst of a pandemic, the **economy could be needlessly impeded in its nascent, fragile economy**.

But perversely enough, there is a **half-full take**. That is, the **investment/consumption forgone from the coup may be lower given that the pandemic had already suppressed the “run rate”** for these economic outcomes. Hence, **if the military can re-instill confidence**, and possibly **demonstrate very efficient vaccine rollout/pandemic management** alongside **sound economic policies** and reinstate **smoothly functioning FX and inter-bank markets**, Myanmar can **deflect** a good deal of **potential economic damage**.

Above all, with **Myanmar likely to have the buy in of China and Russia**, the **bar for sweeping action and sanctions** by the UN Security Council may thus be higher if China and Russia oppose. And so, **apart from peculiar macroeconomic-healthcare circumstances** and **avenues for military administrators to restore some economic stability**, the **backing of China and Russia could also buy Myanmar some breathing space** during the one year of Emergency; **hence avert the most debilitating impact from geo-political threats and economic sanctions**.

Economic Outcomes

Myanmar Growth & Inflation Forecasts

		2016-18	2019	2020	2021	2022	2023	2024	2025
GDP	%YoY								
	IMF (Pre-Coup)	6.2	6.5	2.0	5.7	6.2	6.4	6.5	6.5
	More Severe				2.2	3.8	4.6	4.8	4.8
	Less Severe				3.8	4.6	5.8	6.5	6.5
Average CPI	%YoY								
	IMF (Pre-Coup)	6.6	8.6	6.1	6.2	6.0	6.0	6.0	6.0
	More Severe				13.6	11.2	8.8	7.6	7.2
	Less Severe				10.5	8.8	6.5	6.0	6.0

Source: IMF, World Economic Outlook Database (Oct 2020), Mizuho Estimates

All considered, we expect that **2021 growth recovery will be knocked back** from an estimated 5.7% recovery as per IMF forecasts to as low as 2.2% as the **economy is deal a simultaneous supply- and demand-shock** that reverberates in a **worse case^ scenario of prolonged uncertainty and military rule**. What's **worse** is that **stagflation-type economic pain** rather than isolated headwinds to growth present themselves amid adverse shocks and disruptions colliding with fear/panic.

This as simultaneously **disrupted supply-chains, logistics and fear-driven hoarding drive costs sharply higher** (with a cruel self-fulfilling spiral). **Expectations of a weaker MMK could also compound this cost-push** via the imports channel. All of which **result in materially higher inflation**, which is **stickier in the case of worse^ case scenarios** with prolonged military rule; but fades more discernibly in less dire iterations.

[^]Worse case, in our assumptions, do not factor in sweeping and debilitating sanctions and indefinite military rule. We consider this to be “tail risk”, resulting in much more severe economic growth impact alongside more persistently higher inflation. Instead worse case scenario entails a more meandering restoration of democratic election framework and selective sanctions.

Dollarization Reflex

Heightened **fears of economic disruption, soaring inflation** and a **collapse in investor demand/ FX inflows** (exacerbated if sanctions come into play), both of which are **associated with material devaluation of the MMK**, will **conspire to amplify the reflex to preserve wealth**. The **ultimate manifestation** of which will be **“Dollarization”**. That is, consumers and investors alike showing a **strong preference for transacting in USD as well as storing wealth in USD cash and/or USD-denominated assets**.

The danger is that **Dollarization is self-reinforcing given the feedback loop between demand for USD and expectations of a weaker MMK**. And so, in the most extreme iterations, could result in a succession of currency devaluation leading to a failed monetary system. But we do not assume this as the base case; not at this juncture.

Instead, in response to signs of “Dollarization”, the **central bank is expected to wield cross-border capital controls**, restrictions in **foreign currency account holdings**, and possibly **stipulate local currency denominated transactions onshore**. *Exports surrender may also be an option considered* depending on the severity of USD shortage onshore. Point being, the **central bank is equipped, and stands ready, to stabilize MMK so long as “tail risks” involving catastrophic political outcomes are avoided**.

FX Market Consequences

Accordingly, **MMK (adjusted for broad USD moves) has been remarkably steady in the aftermath** of the coup; suggesting **some degree of measures to curb capital outflows in response to the political upheaval**. To some extent, this also reflects thin and tightly-controlled onshore MMK market. As such, the **central bank may be able to exert effective control**; in the context of capital control measures at its disposal and its improved FX reserve position. Especially **if LNG and other key exports are unfettered by the political turmoil**, providing necessary FX reserves for cushion.

Admittedly, onshore **USD premium will surge from Dollarization**. Question though is **to what degree the central bank is able to assuage nerves** by **providing foreign MNCs with assurances and incentives to keep USD onshore** and/or provide requisite USD for repatriation on a need basis.

The easy declaration is that **MMK will be inclined to depreciate**. What’s tricky is determining severity. Notably, persistent weak USD trend alongside heightened fears of prolonged military rule descending into dictatorship being adequately assuaged may restore MMK stability fairly quickly; particularly, **signs of re-election could alleviate substantial pressures on MMK**. And rising commodity (LNG) prices and imports compression may buy some buffer via C/A improvement into 2021.

All said, the **upshot is that without being able to ascertain the political outcomes** within Myanmar (the iteration of military rule) and the **response of the international community** led by the US (in particular sanctions), the **extent of MMK shock will be hard to determine**. As such, **we have not officially changed our pre-coup forecasts below**:

USD/MMK	Current spot	Mar 21	Jun 21	Sep 21	Dec 21	Mar 22	Jun 22
Pre-coup case	1330-45	1290 - 1360 (1320)	1320 - 1390 (1350)	1310 - 1370 (1340)	1290 - 1350 (1330)	1280 - 1350 (1320)	1280 - 1350 (1315)
Prolonged Uncertainty	1330-45	1310 - 1560 (1480)	1360 - 100 (1435)	1360 - 1450 (1400)	1340 - 1410 (1380)	1310 - 1380 (1350)	1300 - 1370 (1340)
Less Severe Case	1330-45	1310 - 1460 (1400)	1370 - 1480 (1402)	1340 - 1440 (1370)	1310 - 1400 (1348)	1300 - 1370 (1335)	1290 - 1360 (1335)

More Severe (Prolonged Uncertainty):

But that said, we think that **somewhat more severe versions** of military rule and harsher response from the international community** (30% odds) will likely result in **greater degree of MMK depreciation in H1**, but perhaps giving way to some traction as hopes for re-election come through for 2022.

** This “prolonged uncertainty” does not entail sweeping and debilitating sanctions and indefinite military rule with Myanmar regressing to a reclusive economy under military dictatorship. So it is a milder version of “tail risks” that may entail 10-20% more MMK depreciation that may be far stickier.

Less Severe:

The **less jarring outcome for the MMK** may be a **well-detailed plan for re-election and efficient healthcare, economic and policy management** by the military – which remains committed to democratic election after the Emergency. This could see **downside volatility in MMK starting to fade sooner in H2**, and for the MMK to be shored up alongside regional peers (albeit relatively under-performing) against a softening USD trend.

FX Risk is About “Show Me the Money”

The **flip side of the central bank being better able to stabilize the MMK** is that regardless of MMK rate/stability, the **ability to acquire USD onshore in Myanmar could get increasingly challenging**; especially if uncertainty during the military coup is drawn out, or worsens. And the **Dollarization reflex** that tends to **feed off itself will tend to exacerbate USD shortages onshore**. At this point, the risk of a **bifurcated MMK market** (with significantly lower and collapsing MMK) becomes a real (albeit tail) risk.

For investors, both prospective and existing, the **challenge than is to ascertain the rates of MMK at which investments (brought into the country) with respect to the MMK rate for outward repatriation**. More worryingly, this **disparity in onshore and offshore MMK rates may remain a moving target**. The (in)ability to hedge these risks effectively will also push up hurdle rates and overall costs. And **access to central bank guarantees to access USD becomes imperative**.

Of Best Guesses & Worst Fears

At this juncture, **political motives and strategic plans of the military remain highly opaque**. Our **best guess is** that the **central bank**, while conspicuous in its silence (probably waiting for an official state from the military rulers first), is **probably well-placed to assuage and stabilize markets/economy by providing liquidity and credit support and shoring up the MMK**. And our most fervent hopes are that the military rulers now are acutely aware that **it is in everyone’s (including their) best interest** to restore confidence and economic normalcy; by promising a return to democratic political processes sooner rather than later.

But stabbing in the dark and hoping for the best provides no consolation and will not restore confidence. And in the meantime, the **binary nature of**, and **narrow margins of errors associated with, the coup cannot be ignored**. And the **worst fear** is a **precipitous descend into military dictatorship** that leads to far more devastating economic outcomes and extreme devaluation pressures that we have not explicitly covered.

Timeline of key political events	
1948	Burma, which Britain annexed in 1852, initially as part of India, becomes independent, with nationalist leader U Nu as prime minister
1962	A government led by U Nu, elected two years before, is overthrown in a military coup
1988	The ruling junta seizes power in the aftermath of street protests and the National League for Democracy is formed
1989	The junta declares martial law and changes the country's name to Myanmar. Aung San Suu Kyi, the daughter of independence hero Aung San, who was assassinated in 1947, is held for "endangering the state"
1990	The NLD wins a landslide victory in an election allowed by the junta, but the results are then ignored by the military government
1991	Aung Suu Kyi wins the Nobel Peace prize
1995	Aung San Suu Kyi is freed from house arrest
2000	Aung San Suu Kyi put under house arrest again for flouting a travel ban and freed again in 2002
2006	The government moves the capital from Yangon to Naypyidaw, a newly built city in the jungle
2007	The protests escalate into a broader pro-democracy demonstration - protesters greet Aung San Suu Kyi outside her home, the first sighting of her in public since 2003
2008	Cyclone Nargis devastates large parts of Myanmar, particularly the Irrawaddy delta region, killing an estimated 130,000 people
2009	Aung San Suu Kyi begins talks with Myanmar's military leaders and is allowed to meet Western diplomats
2010	March: Government announces that long-awaited election laws have been passed, with provisions for an electoral commission hand-picked by the junta; NLD votes to boycott polls. A splinter party - National Democratic Front (NDF) - later gains legal status and plans to compete in polls
	November: Main military-backed party, the Union Solidarity and Development Party (USDP), claims resounding victory in first election for 20 years. Opposition groups allege widespread fraud and the election is widely condemned as a sham; A week after the election, Aung San Suu Kyi - who had been prevented from taking part - is released from house arrest
2011	March: Thein Sein is sworn in as president of a new, nominally civilian government
	November: Pro-democracy leader Aung San Suu Kyi says she will stand for election to parliament, as her party rejoins the political process
2014	May: US extends some sanctions for another year, saying that rights abuses and army influence on politics and the economy persist
	October: Parliamentary elections set for October/November 2015
2015	February: Government withdraws temporary voting rights from Muslim Rohingyas ahead of proposed constitutional referendum, following street protests by Buddhists
	May: Hundreds of Muslim Rohingyas migrants leave by sea in flimsy boats, along with migrants from Bangladesh UN criticizes failure of south-east Asian states to rescue them
	November: Opposition National League for Democracy - led by Aung San Suu Kyi - wins enough seats in parliamentary elections to form a government
2016	March: Htin Kyaw sworn in as president, ushering in a new era as Aung San Suu Kyi's democracy movement takes power after 50 years of military domination
2018	March: President Htin Kyaw resigns on health grounds and is replaced by Win Myint, a fellow Suu Kyi loyalist
2020	November: Aung San Suu Kyi's National League won 396 out of the 476 seats and Parliament under Parliament under the new government set to commence on 1 February 2021.
2021	February: Army chief Min Aung Hlaing takes over for one-year period

Sources: BBC, Guardian, Economist, Mizuho Bank

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