ASIA MONTHLY

February 2020

株式会社日本総合研究所

https://www.jri.co.jp/english/periodical/asia/

This report is the revised English version of the February 2020 issue of the original Japanese version (published 28th Jan.).

Topics *Issuance of digital yuan has been approaching*

The People's Bank of China is expected to issue the digital yuan soon. This is to maintain and strengthen controls over domestic capital flows and economic activities. In addition, it has an aspect related to China's battle for supremacy with the United States.

■ China is ahead of other countries in research on digital currencies

The digital yuan is expected to be issued soon. On August 10, 2018, Mu Changchun, Deputy Director of the People's Bank of China's Payment and Settlement Department, said at a symposium held in Yichun, Heilongjiang Province, "Digital yuan is now ready to come out if called out." In fact, the People's Bank of China started research on digital currencies in 2014, and launched the Digital Currency Research Institute in 2017 to make practical use of their findings. The systematic development of the digital yuan started in 2018, and as of August 2019, 74 digital currency patents had been filed. The digital yuan is expected to be introduced on a trial basis in Shenzhen and Suzhou.

Research on the issuance of digital currencies by central banks is also progressing in other countries. For example, the Bank of Canada launched "Project Jasper" with the private sector in March 2016 to study interbank settlements using distributed ledger technology (DLT). In December 2016, the Bank of Japan launched a joint study "Project Stella" with the European Central Bank (ECB) on the applicability of the DLT to financial market infrastructure. In January 2020, the Bank of Japan also announced the establishment of a digital currency research group with the Bank for International Settlements, the Bank of England, the ECB, and other institutions. In July 2019, the National Bank of Cambodia started trial operation of "Bakong," which was developed with a Japanese company that provides blockchain technology. However, other central banks generally began studying digital currencies after 2016, and China has been leading other central banks in studying digital currencies.

Central banks around the world are studying digital currencies because of changes in the monetary environment, including technological innovations in the financial sector, changes in payment services, and a decline in the use of cash. This is also due to the growing debate on financial inclusion in emerging economies to make financial services available to all.

The expected mechanisms for the issuance and distribution of the digital yuan are as follows. First, the People's Bank of China will issue digital yuan in exchange for the same amount of the reserves held by financial institutions. Financial institutions then exchange the digital yuan for the same amount of cash

Trends in Research on Digital Currencies by Central Banks

Country	Year of commencement of research	Contents of Research
China	2014	Established the Digital Currency Research Institute. The digital yuan was expected to be introduced on a trial basis in Shenzhen and Suzhou.
Canada	2016	Implemented "Project Jasper" to study interbank settlements using distributed ledger technology (DLT).
Singapore	2016	Implemented "Project Ubin" to study interbank settlements using DLT.
Japan	2016	Conducted a joint survey on DLT called "Project Stella" with the European Central Bank (ECB) and established a research group on digital currencies with the Bank for International Settlements, the Bank of England, the ECB, and other institutions.
EU	2016	In addition to "Project Stella" with the Bank of Japan, a proof of concept study was conducted on the anonymity of central bank digital currencies.
Sweden	2017	Researched the issuance of "e-krona" and published two reports on the topic. Conducted trials using a platform developed jointly with IT companies.
Uruguay	2017	20 million "e-Pesos" were issued. Tested the digital currency with 10,000 mobile phone users for in-store payments and person-to-person money transfers.
Cambodia	2019	Started trial operation of digital currency "Bakong." The official introduction of the digital currency is scheduled for 2020.
France	2019	Trial of digital currencies for interbank settlements among financial institutions is scheduled by March 2020.
Ghana	2019	Researching the issuance of "e-cedi." Discussed a pilot project in a sandbox environment.

Source: Prepared by The Japan Research Institute, Limited, based on Feature: Digital Currencies in Motion (The Japan Financial News, page 13, January 10, 2020 edition) (The original sources are statements and materials from central banks) and deposits held by companies and individuals. Companies and individuals then use the digital yuan to make payments and remit money.

Meanwhile, Alibaba and Tencent are expected to be included in the category of the aforementioned financial institutions. The Chinese government has been instructing the two firms to work with state-owned banks for several years and has required them to follow the same rules that are required of existing financial institutions, such as setting aside reserves. Although Alibaba and Tencent are not yet financial institutions as defined by the China Banking and Insurance Regulatory Commission, they have been positioned as financial institutions in a practical sense.

■ The Chinese government's aims are to maintain and strengthen control and win its battle for supremacy with the United States

The Chinese government aims to issue a digital yuan for the following three reasons. First is to maintain domestic control against threats from abroad. The existence of the Libra that Facebook plans to issue represents a major threat to the Chinese government. This is because the Chinese financial system is characterized by the yuan as the legal currency, the regulation of international capital flows, and the central role of financial intermediation entrusted to state-owned banks. In this way, the government controls the flow of funds and economic activities to stabilize the economy and finance. If digital currencies such as Libra were widely used in China instead of the yuan, restrictions on capital flows would become ineffective and the role of state-owned banks in financial intermediation would decline significantly. The Chinese government could lose control over the flow of funds and economic activities, which could destabilize its financial and economic management. By issuing its own digital currency, the Chinese government apparently aims to prevent the inflow of other digital currencies.

The second reason is the strengthening of control. The Chinese government has focused on controlling the flow of funds and economic activities, but it has not necessarily succeeded. In China, tax evasion and capital flight have become social problems as companies and individuals, especially in rural areas, have become fed up with being forced to pay unreasonable taxes and expenses. Moreover, huge amounts of money are flowing into shadow banking, which can avoid the Chinese government's surveillance and control. The introduction of the digital yuan will help prevent tax evasion and reduce financial risks if the government can better understand the flow of funds and economic activities. Supply chain productivity and smart city maturity are also expected to increase.

The third reason is China's battle for supremacy with the United States. At a symposium held in Shanghai on October 27 last year, Huang Qifan, Vice Chairman of the China Center for International Economic Exchanges (CCIEE), said, "It is risky for Chinese companies to use the international settlement network SWIFT, which is essential for dollar-denominated trade, and the U.S. settlement system CHIPS." By monitoring U.S. dollar transactions, the U.S. government can grasp the flow of cash and movements of Chinese companies, including state-owned enterprises. It is also possible for the U.S. government to exclude Chinese companies from SWIFT and CHIPS. In China, it is a common view that the United States holds world supremacy because the U.S. dollar is the key international currency. It is fair to say that the Chinese government intends to challenge "U.S. dollar supremacy" not only economically, but also in terms of security, by pushing forward with the internationalization of the digital yuan.

Despite the above, it will not be easy to spread the digital yuan in other countries. In China, the digital yuan may spread rapidly among businesses and individuals. Already, the share of cashless payments using Alipay and WeChat Pay is about 60%, which is higher than those in the United States and Europe. It is not difficult for the Chinese government to establish a subsidy system aimed at promoting the digital yuan. It would also be possible to limit government and state-owned enterprises' payments to the digital yuan. However, when it comes to the spread of the digital yuan in other countries, cashless payment rates are not as high in many countries as in China. Moreover, governments in other countries are likely to be wary of the digital yuan just as Beijing is wary of Libra. Even Southeast Asian and African countries, which are interested in the "Belt and Road Initiative (BRI)" proposed by the Xi Jinping administration, would like to avoid China's growing influence as a result of the widespread use of the digital yuan in place of their own currencies. Instead, those countries will likely focus on issuing their own digital currencies.

As stated above, the issue of the digital yuan is expected to occur soon, but some unpredictable changes are anticipated after that. Meanwhile, we should monitor the actual mechanism of issuance and distribution as well as the pace of dissemination.

(Shinichi Seki)

Topics Myanmar's challenges of the foreign relations and the investment environment

The Myanmar economy remained stagnant in the 2010s despite high expectations. This was mainly due to the undemocratic military government and the undeveloped environment for attracting foreign capital. It remains to be seen whether Myanmar will be able to improve its external relations and reform its economic structure.

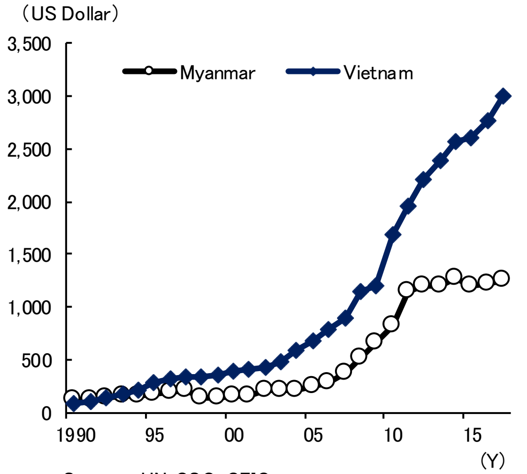
■ Myanmar's economy remains stagnant despite expectations

Since the "transition to civilian rule" in 2011, the Myanmar economy has enjoyed a high level of attention. But this is not the first time Myanmar has been in the spotlight. Following its first boom in the early 1990s, Myanmar's economy has been expected to become the "Last Frontier in Asia" for nearly 30 years.

The high potential of both domestic and external demand is behind the expectations for the Myanmar economy. The population reached 54 million in 2019, and is expected to exceed 62 million in the 2050s. With economic development, Myanmar could become an attractive market for many companies, if a middle class of active consumers emerges. On the external demand side, Myanmar is located in a strategic position for Asian trade with China and India in the north and west.

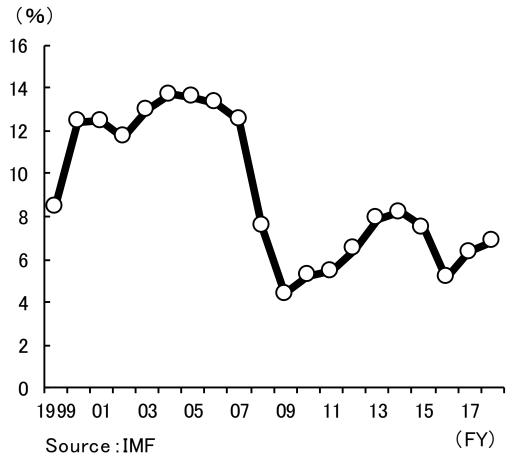
However, looking at recent developments in Myanmar's economy, these expectations have continued to be disappointed. Per capita GDP has been stagnant for a long time, standing at around USD 1,200. This is in contrast to Vietnam, which had a similar income level around 1990, and has since grown steadily, with per capita GDP exceeding USD 3,000, a level at which automobiles and consumer durables are expected to spread rapidly, in 2017.

＜Per Capital GDP in Myanmar and Vietnam＞



Source : UN, GSO, CEIC

＜Real GDP Growth in Myanmar＞



Source : IMF

■ The transition to "civilian rule" has not helped to increase economic growth

"Undemocratic military rule" is generally pointed out as a cause of the long-term stagnation of the Myanmar economy. Indeed, since 1988, the military government has oppressed popular protests by force and placed pro-democracy activist Aung San Suu Kyi under house arrest for nearly 15 years, in stark contrast to western democracy. This "undemocratic military rule" drew strong criticism and economic sanctions from the West, and Myanmar's exports to the West plummeted from the mid-2000s. In light of these facts, there is no doubt that "undemocratic military rule" has been a major obstacle to Myanmar's economic development.

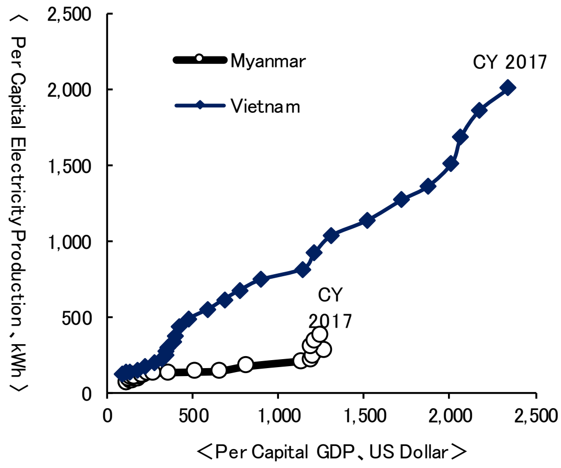
However, considering the following three points, "undemocratic military rule" is not the only cause of the long-term stagnation. First, the development of many emerging Asian countries was brought about by systems that were not necessarily democratic, such as development dictatorships and one-party dictatorships. Second, although Myanmar's military regime failed to build relations with Europe and the United States, it was able to steadily implement approaches to China, India, and ASEAN markets by leveraging Myanmar's geographical advantage. Third, and most importantly, growth rates did not accelerate even after the "transition to civilian rule" in 2011.

■ Another factor is the lack of an environment that attracts foreign investment

What other factors have hampered Myanmar's economic growth other than the "undemocratic military rule?"

In contrast to Myanmar, Vietnam has grown steadily. Since the start of its reform and opening policy "Doi Moi" in the late 1980s, the Vietnamese government has been making great efforts to improve the environment to attract foreign capital, which in turn has led to the development of an export-oriented manufacturing industry and high growth. Looking back at Myanmar, the government has not sufficiently improved the environment to accept foreign companies for a long time. The following three points are particularly notable.

＜Per Capital GDP and Electricity Production in Myanmar and Vietnam＞



Source : ADB, UN
Note : The period is 1990-2017.

The first is the lack of infrastructure. In particular, Myanmar faces a serious shortage of power supply capacity, which is essential for the manufacturing industry. As of 2017, Myanmar's electricity production capacity was only about 40% of that of Vietnam when its income levels were similar. The second is an opaque foreign exchange market. Prior to foreign exchange market reforms in 2013, official and informal rates coexisted in Myanmar, and the private sector was virtually forced to use these volatile informal rates. The third is inefficient and opaque administrative functions. The biggest problem is corruption. According to the international NGO Transparency International's "Corruption Index 2018," Myanmar ranks 132 out of 180 countries.

■ The risk of a continued slump is increasing

In Myanmar, after a general election in November 2015, the de facto Aung San Suu Kyi government was inaugurated in March 2016. International opinion has welcomed Myanmar's full-fledged democratization, and the Obama administration abolished all economic sanctions against the country. Many foreign companies, including Japanese enterprises, had hoped that Myanmar's economy would take off in earnest as business conditions improved to attract foreign capital under the democratic Suu Kyi regime.

However, the newly inaugurated Suu Kyi administration, while focused revising the Constitution, failed to deliver effective economic policies, and the investment environment did not improve as much as expected. For example, power shortages became more serious year after year, and in the summer of 2019, rolling blackouts were carried out in Yangon, the largest city in the country. In terms of exchange rates, the government nominally adopts a managed floating exchange rate system, but in reality, the exchange market is not functioning sufficiently, and some point out that the official rate announced by the central bank only confirms the informal market rate. In addition, the low evaluation in the Corruption Index ranking mentioned above is a result of the Suu Kyi administration's efforts to eradicate corruption.

To make matters worse, Myanmar's image as a democratic country, which was built by the Suu Kyi regime, is collapsing again in relation to the Rohingya refugee issue. If this situation continues, the world's expectations of Myanmar's economy could be betrayed again.

In November 2020, Myanmar will hold its first general election in five years. According to local media reports, there is a high possibility that the Suu Kyi regime will continue after the election. Regardless of the outcome of the election, however, the next regime must face reality and steadily advance economic structural reforms to build favorable external relations and attract foreign capital in order to achieve Myanmar's economic leap forward.

(Yuta Tsukada)