ASIAN DEVELOPMENT Outlook 2003 Update

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Foreword

The analyses of macroeconomic trends, policy developments, and short-term forecasts for the developing member countries of the Asian Development Bank (ADB) that were presented in the *Asian Development Outlook 2003* (*ADO 2003*) published in April 2003 are reviewed in this *Update*. Despite significant economic shocks linked to the conflict in Iraq, higher oil prices, and the outbreak of the severe acute respiratory syndrome (SARS) epidemic, growth in the Asia and Pacific region continued to be robust during the first three quarters of 2003. This achievement is remarkable as it occurred despite a weaker than expected recovery in the major industrial countries in the first half of 2003. Hence, the projection for aggregate gross domestic product (GDP) growth for 2003 is unchanged compared to that made in *ADO 2003*, and the GDP forecast for 2004 has now been revised upward.

This *ADO 2003 Update* was prepared by the staff of the Asian Development Bank from East and Central Asia Department, Mekong Department, Pacific Department, South Asia Department, Southeast Asia Department, the various resident missions of ADB and the Economics and Research Department (ERD). The analysis in the *Update* has been coordinated by ERD with the ADO team led by Jean-Pierre Verbiest, Assistant Chief Economist, Macroeconomics and Finance Research Division, comprising Douglas Brooks, Emma Xiaoqin Fan, and Akiko Terada-Hagiwara. The economists who contributed individual country analysis include Amanah Abdulkadir (Indonesia), Ramesh Adhikari and Dao Viet Dung (Viet Nam), Giovanni Capannelli and Diwesh Sharan (the Pacific), Yolanda Fernandez-Lommen (Mongolia), Naved Hamid and Safiya Aftab (Pakistan), Rajiv Kumar (Central Asia), Sukanda Lewis (Cambodia), Xuelin Liu (Philippines), Jayant Menon and Rattanatay Luanglatbandith (Lao PDR and Thailand), Sudipto Mundle and Hiranya Mukhopadhyay (India), Sungsup Ra (Nepal), Purnima Rajapakse and Zhahid Hossain (Bangladesh), Min Tang and Jian Zhuang (People's Republic of China), and J. Ernest Zveglich and Shenuka Chanmugam (Sri Lanka). The special chapter on the impact of the SARS epidemic was prepared in cooperation with Oxford Economic Forecasting. Charissa N. Castillo coordinated the overall publication of the *Update*.

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Acronyms and Abbreviations

AFTA	ASEAN Free Trade Area
ASEAN	Association of Southeast Asian Nations
CPI	consumer price index
DMC	developing member country
EU	European Union
FDI	foreign direct investment
GDP	gross domestic product
GNP	gross national product
IMF	International Monetary Fund
Lao PDR	Lao People's Democratic Republic
NPL	nonperforming loan
OECD	Organisation for Economic Co-operation and Development
PDMC	Pacific developing member country
PICTA	Pacific Island Countries Trade Agreement
PRC	People's Republic of China
SARS	severe acute respiratory syndrome
SME	small and medium enterprise
US	United States
VAT	value-added tax
WTO	World Trade Organization

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Definitions

The economies discussed in the *Asian Development Outlook 2003 (ADO 2003) Update* are classified by major analytic or geographic groupings, such as industrial countries, developing Asia, and transition economies.

For the purposes of *ADO 2003 Update*, the following apply:

- **Association of Southeast Asian Nations (ASEAN)** comprises Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam.
- **Developing Asia** refers to 41 developing member countries (DMCs) of the Asian Development Bank discussed in *ADO 2003*.
- **East Asia** comprises People's Republic of China; Hong Kong, China; Republic of Korea; Mongolia; and Taipei,China.
- **Industrial countries** refer to the high-income OECD countries defined in World Bank, available: www.worldbank.org/data/countryclass/classgroups.htm#High-income.
- **Newly industrialized economies (NIEs)** comprise Hong Kong, China; Republic of Korea; Singapore; and Taipei,China.
- **Southeast Asia** comprises Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam.
- **South Asia** comprises Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.
- **Central Asia** comprises Azerbaijan, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.
- **The Pacific** comprises Cook Islands, Fiji Islands, Kiribati, Republic of the Marshall Islands, Federated States of Micronesia, Nauru, Papua New Guinea, Samoa, Solomon Islands, Democratic Republic of Timor-Leste, Tonga, Tuvalu, and Vanuatu.
- **Transition economies** refer to the countries of Central Asia, Mongolia, Cambodia, Lao PDR, and Viet Nam.
- The **euro zone** comprises Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, and Spain.
- Unless otherwise specified, the symbol "$" and the word "dollar" refer to US dollars.

The *Statistical Notes* give a detailed explanation of how data are derived.

- Billion is 1,000 million.
- Trillion is 1,000 billion.
- Unless otherwise specified, the symbol $ means United States dollars; dollars are current US dollars.
- Basis points (bps) refer to hundredths of 1 percentage point.
- Growth rates refer to year-on-year percentage change unless otherwise specified.
- This *ADO 2003 Update* is based on data available up to 26 September 2003.

Developing Asia and the World

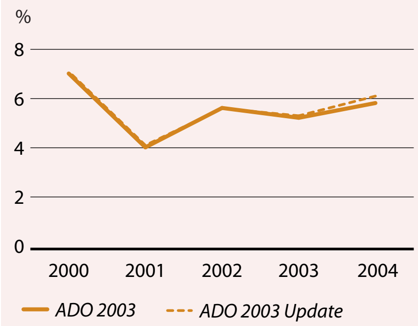
Economic growth in the Asia and Pacific region will continue to be the fastest in the world in 2003 and 2004. Despite significant shocks in the first half of 2003, including uncertainties linked to the conflict in Iraq, regional terrorist threats, higher global oil prices, and the severe acute respiratory syndrome (SARS) epidemic, most economies of the region—significantly the People's Republic of China (PRC) and India—expanded at close to the rate projected in the Asian Development Outlook 2003 (ADO 2003)*, published in April this year.*

The forecast for aggregate gross domestic product (GDP) growth in the Asia and Pacific region in 2003 is maintained at 5.3%, with the subregions of South Asia and Central Asia growing somewhat faster than projected in ADO 2003*. This outturn is all the more remarkable as it will have occurred after recovery in the major industrial countries, notably the United States and the euro zone, was weak in the first half of 2003. However, the recovery in the industrial countries is now projected to firm up substantially during the second half of 2003, and particularly in 2004, benefiting the region's economies. Hence, aggregate GDP growth for the region in 2004 has been revised upward to 6.1%.*

Two distinct features are associated with the economic developments in the Asia and Pacific region in the first half of 2003. One is the continued rapidly increasing importance of the PRC as a driver of intraregional trade and economic growth—exports from East, Southeast, and South Asia to the PRC grew at startling rates during the first half of 2003. The other is the continued substantial accumulation of foreign exchange reserves by several countries over the past year.

Looking ahead, fiscal consolidation, improvements in the investment climate to substantially increase business investment, and reforms of the financial sector pose significant policy challenges for sustaining rapid long-term growth in the region.

GDP Growth in Developing Asia



Source: *ADO* database.

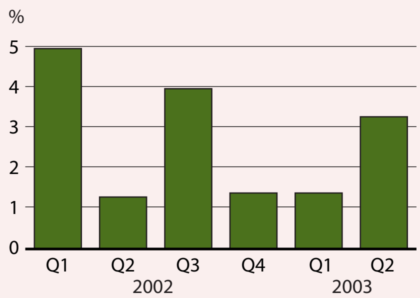
Table 1.1 Baseline Assumptions on External Conditions, 2002–2004

	2002 Actual	2003	2004
GDP Growth			
Industrial countries	1.4	1.6–1.9	2.6–2.9
United States	2.4	2.3–2.6	3.6–3.9
Euro zone	0.8	0.4–0.6	1.6–1.9
Japan	0.3	1.8–2.2	1.4–1.8
Memorandum Items			
United States Federal Funds rate (%)	1.7	1.1	1.1–1.3
Brent crude oil spot prices ($/bbl)	25.0	27.0–29.0	24.0–26.0
Global trade volume (% change)	3.2	4.0–5.0	6.5–7.5

Note: Staff projections are based on the Oxford Economic Forecasting World Macroeconomic model.

Sources: US Department of Commerce, Bureau of Economic Analysis, BEA News Releases, available: www.bea.doc.gov/bea/dn/nipaweb/; Statistics Bureau & Statistics Center of Japan, available: www.esri.cao.go.jp/en/sna/menu.html; Eurostat Euro Indicators, available: www.europa.eu.int/comm/eurostat/; World Bank Development Economics Prospects Group; US Federal Reserve, available: www.federalreserve.gov/releases/n15/data/fedfund.txt.

GDP Growth, United States



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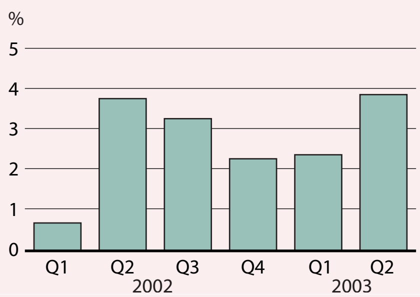
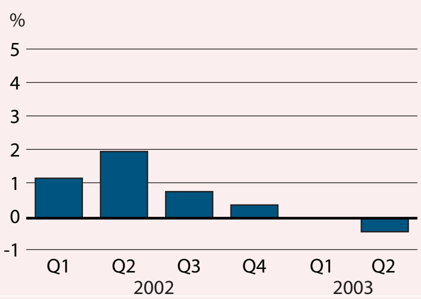
GDP Growth, Japan



Source: www.esri.cao.go.jp/en/sna/qe031-2/gdemenuea.html.

GDP Growth, Euro Zone



Source: http://europa.eu.int/comm/eusostat/Public/datashop/print-product/EN?catalogue=Eurostat&product.

Outlook for Industrial Countries, 2003–2004

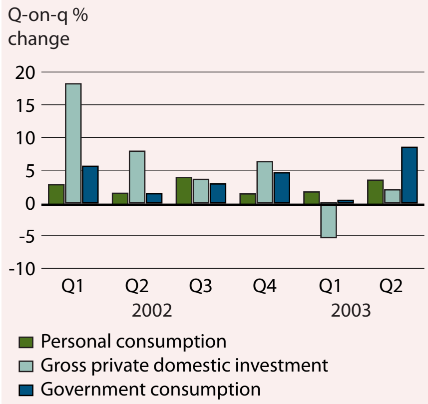
The weak recovery in the major industrial countries that took place in the first half of 2002 petered out in the second half of that year, and, as projected in *ADO 2003*, remained subdued in the first three quarters of the current year. A return to a growth rate closer to trend is not projected for the United States (US) economy until the first half of 2004, while growth in the euro zone and in Japan, which, although showing some signs of improvement in the third quarter, will lag and remain below potential. Hence, at the end of the third quarter of 2003, nearly 2 years after the official end of the 2001 US recession, the long-awaited firm recovery in the major industrial countries is still some time away. This is perhaps not surprising given the significance of the shocks experienced by the world economy since the end of 2000. While the world economy was adjusting to the burst of the "high tech" bubble and the corporate excesses of the late 1990s, the events of September 11, 2001, the conflict in Afghanistan followed by that in Iraq, deflationary conditions in some economies, and volatile oil markets, all substantially raised uncertainty in the world economy, thus hindering the recovery process. A notable feature of the current recovery is the lack of synchronization of growth among the major industrial countries, with the US economy significantly outperforming most other Organisation for Economic Co-operation and Development (OECD) economies. Overall, accommodative monetary and expansionary fiscal policies in the major industrial countries will contribute to higher growth. Hence, there is a stronger sense of optimism than just a year ago, although risks to the outlook remain significant.

In the US, quarterly GDP growth for 2003 has been weak but improving, indicating that the economy could expand at about the same rate as in 2002. After a relatively upbeat second quarter, third quarter 2003 GDP growth will probably be around 4.0%. A somewhat firmer rebound than the *ADO 2003* baseline forecast is projected in 2004, bringing GDP growth closer to potential (estimated at 3.5–4.0%). Many indicators point to an acceleration in economic activity at the end of the second quarter and in the third. Consumer spending remains robust and consumer confidence appears generally to be improving, partly as a result of substantial tax cuts and a rallying stock market. The Conference Board's Consumer Confidence Index bounced back to 81.3 in August from 77.0 in July. The residential real estate market has stayed surprisingly strong as indicated by housing starts in August (about 1.8 million). However, leading indicators, such as building permits issued, indicated potential future slowing in construction as mortgage rates started rising. While increases in government spending, particularly defense spending, are underpinning faster growth, what is important is that business investment has shown signs of revival, though it remains relatively weak. Business confidence indexes have all been pointing to improved sentiment. However, while the real economy has improved, a worrisome development has been the substantial widening of the fiscal deficit, which could reach about $400 billion in fiscal year 2003, up from $158 billion in 2002. At the same time, the estimated $553 billion current account deficit for 2003 does not show signs of improvement, in spite of a continued weakening of the dollar against major currencies in the first half of the year. Further, the sluggish US economic recovery of the past year and a half has been characterized as a jobless recovery. As quarterly economic growth accelerated in 2003, the unemployment rate hardly declined, while data for August show that the economy actually shed jobs. The unemployment rate remained high, at 6.1%. The job losses appear to be structural rather than cyclical. Productivity growth remained very strong however, increasing by an estimated 6.8% in the second quarter, but ironically this good news means that the US economy will have to grow faster and for longer to generate employment—which should be seen as GDP expands more rapidly in 2004. In the meantime, productivity growth has been boosting corporate profitability.

As projected in *ADO 2003*, the euro zone is likely to post a very weak economic performance in 2003 as several of its economies (Belgium, France, Germany, Italy, and Netherlands) experienced a contraction in the second quarter of 2003. Quarter on quarter, the euro zone economy shrank by 0.1% in April–June 2003, but year on year grew by 0.2% (a figure marginally improved on by all the 15 European Union [EU] countries, at 0.5%, largely because of the United Kingdom's solid growth). Private consumption, investments, and exports all decreased in the second quarter in the euro zone. Many business confidence indicators in the zone point to relatively sluggish growth in the second half of 2003 in spite of modest signs of improvement in some of the larger economies. Germany's IFO business confidence index improved for a fourth consecutive month in August to 90.9 from 89.3 in July, buttressing hopes of a better performance in the second half of 2003. In France, leading indicators have also improved in recent months.

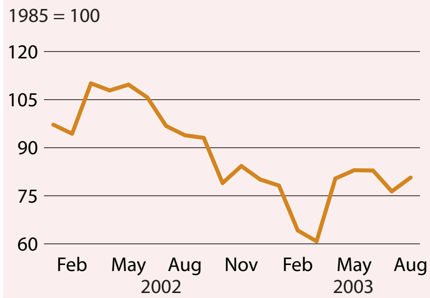
The euro's appreciation has been hurting exports, and governments have been slow to implement fiscal stimulus. However, a more proactive fiscal policy can be expected over the next few months as Germany,

GDP Growth by Expenditure Account, United States



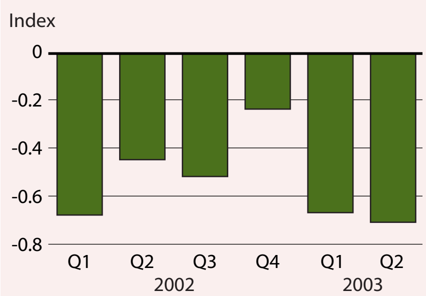
Source: www.esri.cao.go.jp/en/sna/qe031-2/gdemenuea.html; www.bea.doc.gov/bea/dn/nipaweb/TableViewFixed.asp>SelectedTable=164&FirstYear=2002&LastYear=2003&Freq=Qtr.

US Conference Board's Survey of Consumer Confidence



Source: Bloomberg L.P. downloaded 8 Sep 2003.

Euro Zone Business Confidence Indicator

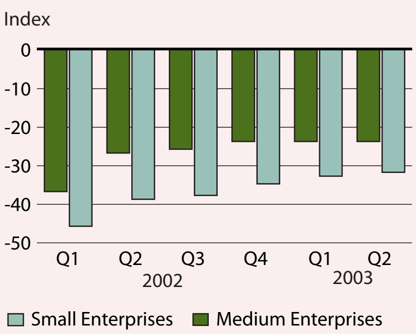


Source: Bloomberg L.P. downloaded 27 Aug 2003.

$/€ Exchange Rate, 2003

Source: Bloomberg L.P. downloaded 8 Sep 2003.

Tankan Business Confidence Index



Source: Bloomberg L.P. downloaded 27 Aug 2003.

Total Exports, PRC

Source: CEIC Data Company, Ltd. downloaded 9 Sep 2003.

France, and probably Italy announce some tax cuts. The Stability and Growth Pact, limiting euro zone budget deficits to 3.0% of GDP remains, however, a major hurdle to a more expansionary fiscal policy. On the monetary side, there is more room for maneuver as inflation has fallen to about 2.0%. Overall, the euro zone economy will probably expand by 0.4–0.6% in 2003, well below the projected range in *ADO 2003*. The euro zone should experience recovery in 2004, but with growth in the range only of 1.6–1.9%, despite a stronger forecast expansion seen in the US, the euro zone's largest export market. Growth in the United Kingdom is expected to hold up somewhat better than in the euro zone, but still below par, at a rate of around 1.7% in 2003, improving to 2.6–2.9% in 2004. Growth in the 15 EU economies is projected to be about 1.7–2.0% in 2004.

A number of encouraging factors have significantly raised Japan's growth prospects compared to the *ADO 2003* forecast. GDP is now projected to expand by around 2.0% in 2003. Both net exports and domestic demand contributed to the acceleration in growth in the first half of 2003 when GDP expanded at an annual 3.9%. In nominal terms, GDP growth was more modest at 1.2%, due to a continued negative GDP deflator. While consumer demand showed some improvement, business investment gained substantially, growing at an annual 7.0%. Moreover, exports to the PRC and the US appear to be growing strongly. The Tankan index of business confidence also continued to improve, although it remains negative. On the stock market, the Nikkei 225 index passed the 10,000 mark, indicating some return of investor confidence. However, the consumer price index showed a continued decline, and, for 2003 as a whole, it could fall by about 0.5%.

In spite of positive developments, projections for 2004 indicate better but relatively modest GDP growth in Japan. Faster growth in the country's export markets will have a positive impact. However, many fundamental issues still need to be addressed in the economy, including the problem of continuing deflation, record high unemployment, the resolution of nonperforming loans, large public debt (estimated at about 160% of GDP), and slow financial and corporate restructuring. Until these are tackled firmly, projections over the medium term indicate no major acceleration of economic growth beyond 2.0% in 2004 and the following years.

Developments in World Trade and Commodity Prices

Slower than expected GDP growth in the major industrial countries has led to a downward revision in aggregate world trade as measured by world export volume. The *ADO 2003* projection of 5–6% expansion in 2003, already on the pessimistic side in April 2003, has been brought down a full percentage point, while projections for 2004 have been adjusted slightly downward as growth in the world economy remains uneven, with persistent underperformance in the euro zone and in Japan. Nevertheless, trade growth in 2003 is an improvement over the outturns for 2001 and 2002, but remains well below the 1993–2002 average. Export volumes from developing countries are expected to expand at a rate close to double digits, with much of this concentrated in the Asia and Pacific region. In nominal terms, aggregate exports from developing Asia, accounting for around 18% of world exports, grew at a rate of almost 20% in the first half of 2003. The PRC's exports (accounting for over 5% of world exports) expanded by 34% in the same period.

In *ADO 2003*, oil prices were projected to remain volatile while declining somewhat from their first quarter peak. The unsettled situation in Iraq, low inventory levels in the US, and some cutback in production by Organization of Petroleum Exporting Countries (OPEC) members have kept pressure on oil prices, implying a sizable risk premium. The average Brent price up to mid-September stood at $28.8 per barrel. Average prices for 2003 and 2004 are now likely to be on the upper bound of the *ADO 2003* forecast range (Table 1.1). For many of developing Asia's economies, this will push up earlier projections for imports, particularly PRC, India, Korea, and Thailand. These countries have, however, comfortable current account surpluses, while the macroeconomic model simulations discussed in *ADO 2003* (p. 26) indicate that current projections for oil prices will have only a very limited impact on growth.

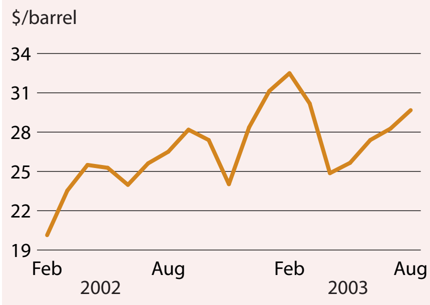
The strengthening of metals and mineral prices (in dollar terms) as discussed in *ADO 2003* has continued, due to recovering demand and a weaker dollar. Prices of aluminum, copper, steel, and tin increased significantly in the first half of 2003. As world economic growth improves in 2004 and as markets become tighter, metals and mineral prices are expected to continue to rise. In contrast, most agricultural commodity prices—many of which had risen significantly in 2001–2002 due to adverse weather conditions or reduced supply after a period of low prices—generally softened in the first half of 2003 as supply conditions improved sharply (for, e.g., cocoa, coffee, fats and oils, and grains). Overall, non-oil commodity prices are likely to increase moderately for the rest of 2003 and in 2004. For one commodity of particular importance to the region, rice, projections are, however, for a modest price increase in 2003 and 2004.

Prices of electronics components, which collapsed in 2001 and 2002, appeared to show some very modest revival in 2003. Prices for DRAM chips, integrated circuits, and microprocessors recovered somewhat in 2003, with a further improvement projected for 2004 as the recovery strengthens and business investment improves. For those Asian economies which are large electronics exporters, this is a welcome development.

Developments in Financial Markets

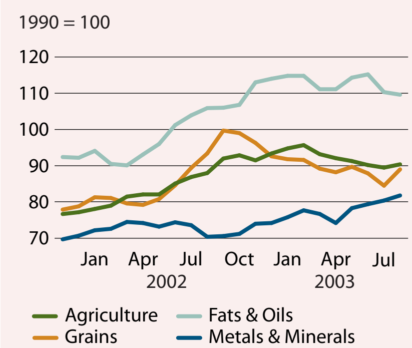
As projected in *ADO 2003*, inflation, particularly core inflation, remained very low in the major industrial countries in the first half of 2003, mainly as a result of the very weak recovery and continued overcapacity in some industries. On a quarterly basis in 2003, inflation has edged up somewhat in the US compared to 2002 but remains at around 2.0%. In the euro zone, inflation is also about 2.0% while in Japan, deflationary conditions persist. Core inflation in the major industrial countries could fall further in 2003 and early 2004 and the danger of a short bout of global deflation, though not yet fully written off, is receding as signs of a stronger worldwide recovery are becoming more evident. Monetary authorities have acted proactively, particularly in the US, where the Federal Funds rate is currently 1% and will most likely average 1.1–1.3% for 2003. The exception is Japan, where the policy rate is already close to zero. A further cut in the US Federal Funds rate is possible if recovery is yet again retarded. In the

Crude Oil Price (Brent spot)



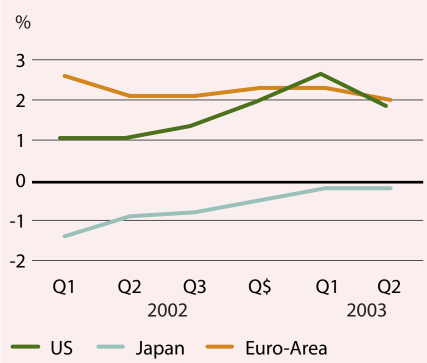
Source: www.worldbank.org/prospects/pinksheets/.

Selected Commodity Prices



Source: www.worldbank.org/prospects/pinksheets/.

Inflation Rate, G3

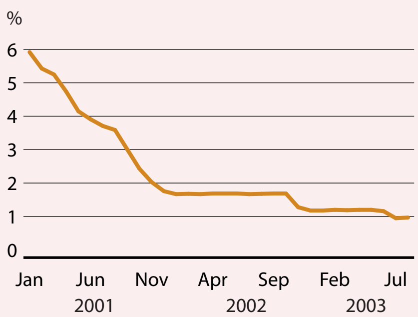


Sources: US Department of Commerce, Bureau of Economic Analysis; Statistics Bureau and Statistics Center of Japan; Eurostat Euro Indicators.

Price-Adjusted Broad US Dollar Index

Source: Federal Reserve Statistical Release, available: www.federalreserve.gov/releases/H15/data/m/fedfund.txt.

US Federal Funds Rate



Source: Federal Reserve Statistical Release, available: www.federalreserve.gov/releases/H15/data/m/fedfund.txt.

US 10-Year Bond Yield

Source: Bloomberg L.P. downloaded 8 Sep 2003.

euro zone, the European Central Bank has more room for maneuver as the average inflation rate remains low and several major economies of the euro zone are stagnating.

In line with the continued loosening of monetary policy in major markets, benchmark international interest rates are expected to be somewhat lower in 2003 than in 2002. The London interbank offered rate (LIBOR) ($, 6 months) is projected to average 1.3% in 2003, down from 1.9% in 2002. A progressive increase is projected from 2004 onward with the average rate estimated at 2.0% in 2004. On the foreign exchange markets, the US dollar depreciated significantly against the euro, reaching a trough of $1.19/€1 on 29 May 2003. The dollar has since strengthened to over $1.10/€1. The dollar depreciated by about 2.3% against the yen over the January–September 2003 period. The trade-weighted price-adjusted broad dollar index appreciated by 2.3% over the same period.

Bond markets in the first half of 2003 reflected the expectations for monetary policies, but they also mirrored the developments in stock markets. After hitting a 45-year low in mid-June 2003 and following the 25 basis point policy rate cut by the Federal Reserve Bank on 25 June and its signal that deflation is unlikely, bond prices started to fall and yields surged by more than 100 basis points on 10-year US treasury bills within about a month. These yields are expected to stay at around 4.5% for the remainder of 2003. The yield curve in the US has thus steepened significantly over the past few months. At the long end of the market, rates are likely to be higher in the US than in the euro zone, while the reverse is probable at the short end. The US bond market situation also reflects expectations for the huge US treasury financing requirements over the medium term.

Bond market developments are a source of serious concern. US 10-year treasury bills are the benchmark for corporate bonds and mortgage rates. If yields were to rise rapidly, housing refinancing in the US and consumer spending could slow significantly, while at the same time capital spending, already weak, would become more expensive. Higher mortgage rates would affect the housing market, lowering prices and leading to the possible bursting of what some are calling a housing bubble. In the case of the US and in particular Japan (where public debt is very high), debt servicing could become a major burden. The euro zone economies would also be affected by higher long-term rates, although perhaps to a lesser extent. The bond market will thus have to be closely watched over the next few months.

To some extent, in a related development, the earlier fall in bond yields, low short-term interest rates, and a more positive outlook on a recovery in industrial countries spurred a second quarter rally in most major stock markets both in the industrial countries themselves and in many developing countries, particularly in Asia. Although price-earnings ratios in the US remain well above historic averages, the developments on stock markets are a positive sign. However, a strengthening stock market rally could further depress bond prices.

Low yields in major financial centers in the first half of 2003 led investors to seek higher returns in emerging markets. Hence, risk premiums for developing Asian borrowers decreased somewhat and inflows of capital increased significantly. Developing Asian stock markets and bond issuers benefited from these developments. Even with stock markets improving in industrial countries and bond yields rising, capital availability for developing Asian countries should not be a major issue, but the cost of capital could increase somewhat in 2004. Hence, spreads in emerging markets might widen a little as yields become more attractive in mature markets.

Regional Trends and Prospects for Developing Asia

ADO 2003 concluded that "the Asia-Pacific region will remain a bright spot on the world economic map". Developments in the region over the first three quarters of 2003 confirm this assessment. These demonstrate the generally strong economic fundamentals of the region and its increased resilience against shocks. Significant economic shocks characterized the first half of 2003. These included the uncertainties relating to the conflict in Iraq and higher oil prices, while the destabilizing impact of the SARS epidemic directly and indirectly affected many economies in the region. These shocks were felt at the same time as the Group of Seven leading industrial countries experienced a substantial slowdown in their economic recoveries.

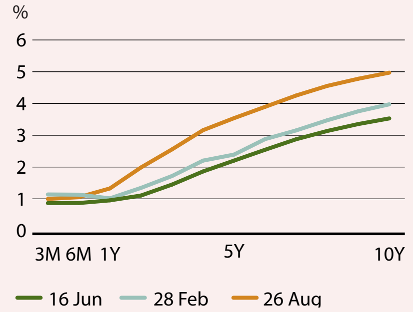
While great diversity in performance across countries remains, economic growth for the region as a whole is projected at a robust 5.3% for 2003, unchanged from the *ADO 2003* forecast. Average inflation will remain low at 2.4%. Finally, the current account surplus for developing Asia is forecast at a comfortable 2.7% of aggregate GDP.

Following a strong performance in the first half of the year, GDP growth projections for 2003 have been significantly raised for PRC, Kazakhstan, Pakistan, and Thailand. Among the larger economies, high growth is still slated for India (6%) and Viet Nam (6.9%), in line with the *ADO 2003* projections. In the PRC, as well as in South Asia, growth was evenly spread between domestic and external demand. In the PRC, a surge in private and public investment was also supported by robust consumer demand. Upward revision of Thailand's projected GDP growth in 2003 is partly the result of a progressive recovery in private investment activity. The dynamism in investment is also a major factor in Viet Nam's rapid growth. In South Asia, domestic factors were the main drivers of growth, particularly as agricultural output and incomes are on the upswing with a return of normal weather in the region. External factors played an increasingly supportive role as South Asia's current account surplus is projected at 0.8% of GDP. While export growth has generally been strong in South Asia, it has been offset by increased imports, with the strengthening in the current account balance in most countries largely resulting from marked increases in worker remittances. In India, the current account surplus is expected to moderate from the 2002 level to about 0.4% of GDP. Developments to date indicate a continuation of a large capital account surplus.

In Southeast Asian countries (except Singapore), consumer demand remained strong in the first half of 2003, while the contribution of investment and net exports to growth was mixed. In Indonesia, Malaysia, and Philippines, lower investment (level and growth) had a negative impact on growth in the second quarter. In contrast to most other countries, net exports have negatively affected the economy of the Philippines, as its mainstay exports—electronics—have been performing poorly.

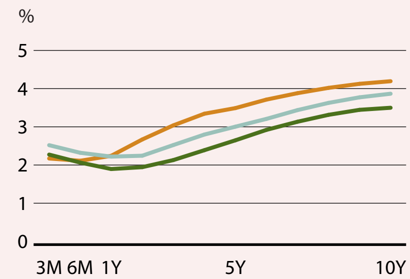
Economic growth has been significantly scaled back for Korea and Singapore, as domestic demand in both countries weakened dramatically.

US Yield Curves, 2003



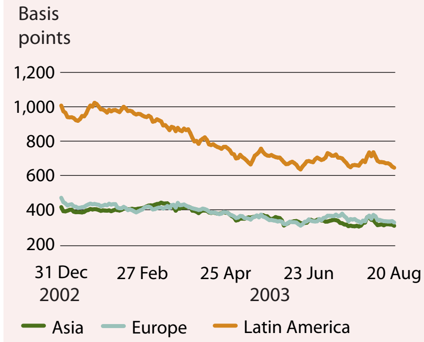
Note: Data for 3 and 6 months refer to US Treasury Actives; all other maturities refer to US Government Strips.
Source: Bloomberg L.P. downloaded 26 Aug 2003.

Euro Benchmark Yield Curves, 2003



Source: Bloomberg L.P. downloaded 26 Aug 2003.

Sovereign Risk Spreads



Source: www.jpmorgan.com downloaded 26 Aug 2003.

Table 1.2 Selected Economic Indicators, Developing Asia, 2002–2004, %

Item	2002	2003		2004	
		ADO 2003	*Update*	*ADO 2003*	*Update*
GDP Growth					
Developing Asia	5.6	5.3	5.3	5.9	6.1
East Asia	6.5	5.6	5.6	6.2	6.5
Southeast Asia	4.1	4.0	3.9	4.8	4.9
South Asia	4.2	5.7	5.8	6.1	6.1
Central Asia	7.3	5.8	7.5	5.8	5.9
The Pacific	-0.3	2.4	2.5	2.5	2.7
Inflation Rate (CPI)					
Developing Asia	1.5	2.5	2.4	2.7	2.6
East Asia	-0.1	1.1	1.0	1.4	1.5
Southeast Asia	4.1	4.2	3.1	4.0	3.5
South Asia	3.7	4.9	5.5	5.0	4.9
Central Asia	11.3	13.9	10.4	14.2	9.8
The Pacific	7.1	6.3	8.9	-	5.1
Current Account Balance/GDP					
Developing Asia	4.1	2.9	2.7	2.6	2.4
East Asia	4.1	3.0	2.4	2.7	1.9
Southeast Asia	7.8	6.3	6.1	6.0	6.7
South Asia	0.9	0.0	0.8	0.0	0.6
Central Asia	-1.3	-4.2	-1.5	-5.1	-2.4
The Pacific	0.5	-	-	-	-

- = data not available; CPI = consumer price index; GDP = gross domestic product.

Sources: *ADO* database; staff estimates.

For Korea, this was due to falling consumption demand and the impact on investment of geopolitical uncertainties; for Singapore, it stemmed from a combination of the SARS fallout and structural issues. In Singapore, the contribution of consumption and investment to economic growth in the first two quarters of 2003 was negative. In both countries, net exports will provide sufficient stimulus to achieve GDP growth in 2003. Both Hong Kong, China and Taipei,China, which have been facing major restructuring problems in their economies over the past few years, will also see their growth performance in 2003 determined mainly by improvements in net exports as domestic demand in both economies remains depressed.

In Central Asia, high subregional growth continues to be driven mainly by large investments in oil and gas production facilities in some of the exporting countries. However, both the Kyrgyz Republic and Tajikistan also scored credible gains underpinned by strengthened macroeconomic management and structural reforms in their economies.

A very distinctive and notable feature of economic developments in the region over the past 2 years has been the emergence of the PRC as a major growth engine for intraregional trade. This trend accelerated for most countries in the first half of 2003. For economies in East Asia, the PRC has become the largest export market while for those in Southeast Asia, the PRC has become an important export destination. Typically, for all these regional economies, the share of total exports going to the PRC

Table 1.3 Quarterly GDP Growth, Selected DMCs, %

Economy	Q1 2002	Q2 2003	Q3 2002	Q4 2002	Q1 2003	Q2 2003
China, People's Rep. of	7.6	8.0	8.1	8.1	9.9	6.7
Hong Kong, China	-0.6	0.8	3.4	5.1	4.5	-0.5
Korea, Rep. of	6.2	6.6	5.8	6.8	3.7	1.9
Taipei,China	0.9	3.7	5.2	4.5	3.5	-0.1
Indonesia	2.7	3.9	4.3	3.8	3.4	3.8
Malaysia	1.3	4.0	5.8	5.4	4.6	4.4
Philippines	3.8	4.1	3.8	5.8	4.5	3.2
Singapore	-1.5	3.8	3.8	3.0	1.7	-4.2
Thailand	3.9	5.1	5.8	6.2	6.7	5.8
India[a]	6.3	5.3	5.2	2.3	4.9	-
Sri Lanka	0.5	3.0	5.9	6.2	5.5	-

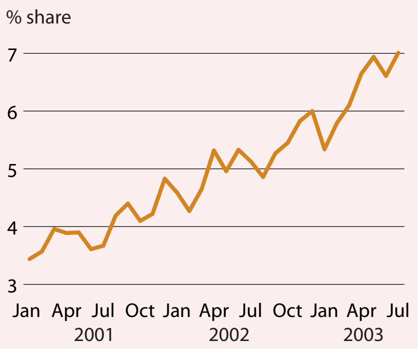
- = data not available. [a] Converted to calendar year basis.

Sources: People's Rep. of China: *China Monthly Economic Indicators*, July 2003; Hong Kong, China: www.info.gov.hk/censtad; Rep. of Korea: www.bok.or.kr; Taipei,China: www.stat.gov.tw; Indonesia: www.bps.go.id; CEIC Data Company, Ltd.; Malaysia: www.statistics.gov.my; Philippines: www.nscb.gov.ph; Singapore: www.singstat.gov.sg; Thailand: www.nesdb.go.th; India: Central Statistical Organization; Sri Lanka: Central Bank of Sri Lanka.

has doubled since the start of 2000. The PRC has overtaken the US as the main export market for Korea, contributing significantly to the growth momentum of the Korean economy in the first half of 2003. Korean exports to the PRC soared at 47% year on year in the first 7 months of 2003. Taipei,China's exports to the PRC were growing even faster at 108.3%. For the ASEAN-5 countries (Indonesia, Malaysia, Philippines, Singapore, and Thailand), the share of the PRC export market rose from 3.0% at the beginning of 2000 to over 7.0% in July 2003. Again, on a year-on-year basis, exports of the ASEAN-5 to the PRC surged by 41.9% in the 7 months of 2003. In South Asia, where the export share of the PRC market is much lower, exports to the PRC shot up for Pakistan and, in particular, India, where exports to the PRC have surged at well over 50% year on year since the middle of 2002, albeit from a low base (even now the PRC accounts for only about 1% of India's exports). It should also be noted that exports of the PRC to these regional economies are also growing rapidly, but at a much slower pace than imports from them. These extraordinary figures indicate significant economic changes in the region as intraregional trade becomes a major force to be reckoned with. If these trends continue and regional economies continue to focus on policies to achieve faster growth in domestic demand, Asia's economic outlook should become less dependent on economic developments in the major industrial countries.

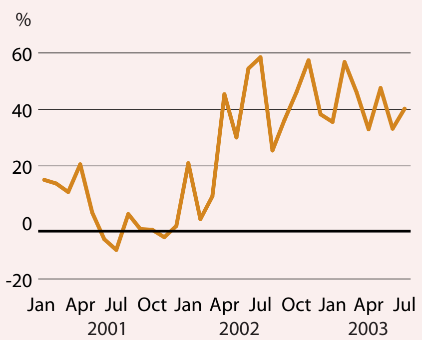
For the region as a whole, estimates of GDP growth incorporated a 14.1% expansion in exports in 2003, markedly above the 7.9% forecast of *ADO 2003* and the 9.5% growth recorded in 2002. Nevertheless, as imports, now projected to rise by 16.3%, largely offset this export expansion, the current account surplus is projected to be about 2.7% of GDP (about $104 billion for the year), well below the 4.1% of GDP surplus

Share of Exports to PRC, ASEAN-5



Source: CEIC Data Company, Ltd.

Growth Rate of Exports to PRC, ASEAN-5



Source: CEIC Data Company, Ltd.

Growth Rate of Exports to PRC, East Asia

Source: CEIC Data Company, Ltd.

estimated for the region in 2002. Though the current account balance is moderating, official reserves in the first half of 2003 increased at about the same rate as in this period a year ago, rising by about $115 billion.

ADO 2003 noted the rapid accumulation of foreign exchange reserves in the region. This trend continued, in some cases strongly so, in the first half of 2003. The large increases in many country's official reserves in the past 18 months have fostered more rapid monetary expansions, despite efforts at sterilization, and also put upward pressure on floating exchange rates. Currencies appreciated against the dollar in most countries without a fixed exchange rate, from January to September 2003. Moreover, in all countries with large reserve gains, residents are now adjusting their normal payment practices as a hedge and this appears to be a factor in the pace of reserve accumulation.

On the macro policy front, an important feature of recent economic developments in Asia, further demonstrated in 2003, is the determined and judicious use of short-term demand management policies. Relatively low inflation has allowed monetary authorities to progressively lower interest rates, although the impact appears to have been stronger on consumer spending than on business investment in many economies. With a few exceptions, notably the PRC, where the Government implemented some monetary tightening in line with perceived overheating, monetary policies continued to be loosened in 2003 and, in several countries, the positive response of investment started to be felt, particularly in Thailand. More important, fiscal policies have been quite expansionary in most of developing Asia over recent years—originally born out of the financial crisis and subsequently implemented to mitigate the impact of the global economic slowdown.

Many countries in the region have announced programs for a period of fiscal consolidation, to reduce their budget deficits and bring down high public debt to GDP ratios. In South Asia, with the exception of India, some fiscal consolidation was accomplished in 2003. However, the need to respond rapidly to the economic shocks (of the Iraq conflict, oil prices, and SARS) has generally delayed such consolidation efforts in most economies in both East Asia and Southeast Asia as many governments introduced supplementary budgets or stimulus packages in the first part of the year. Supplementary budgets were introduced in Hong Kong, China; Korea; Malaysia; Philippines; Singapore; Taipei,China; and Thailand. While these stimulus programs were an appropriate policy response, fiscal consolidation will again need to be a priority as the underlying growth momentum strengthens in 2004.

The immediate outlook for many countries in Asia continues to indicate rather weak business investment, with important exceptions such as the PRC, Viet Nam and, to some extent, Thailand. While substantial overcapacity still exists in many economies, a variety of factors are causing business investors to hesitate. In East Asia and Southeast Asia, the aftermath of the Asian financial crisis of 1997-98 is still very much felt though to varying degrees. The economies of Hong Kong, China; Singapore; and Taipei,China are going through a period of deep structural transformations that has affected investment. In Southeast Asia, financial sector restructuring after the crisis, particularly banking sector reform, is still a work in progress, affecting lending to businesses. Various institutional, legal, and policy constraints still weigh on the investment climate in most countries of the region. Moreover, political uncertainties linked to upcoming national elections in several countries are probably causing a wait and see attitude over investment. In South Asia, especially in India, relatively large budget deficits, which have continued into 2003 despite some fiscal consolidation, resulted in some crowding-out of private investment. In short, to accelerate growth over the medium term, structural reforms require high priority in many Asian economies.

Against this background, GDP forecasts for developing Asia as a whole have been increased to 6.1% in 2004, compared to 5.9% in *ADO 2003*. Higher forecast growth reflects mainly a strong performance of the PRC economy, which is now projected to expand at close to 8.0% in 2004, in addition to a significant improvement in some of the Southeast Asian economies, particularly Singapore and Thailand. The outlook for the Pacific could also be somewhat better than forecast earlier. Except in Central Asia, and the Lao People's Democratic Republic, inflation is projected to remain quite low, particularly in East Asia and Southeast Asia. Reflecting the projected stronger recovery in the major industrial countries, export growth for the region in 2004 is now forecast to be higher at about 11%. Similarly, imports will expand faster, thus leading to a somewhat smaller current account surplus, for the region as a whole, of 2.4% of GDP in 2004 compared to the 2.6% forecast in *ADO 2003*. Growth in developing Asia will thus continue to improve in 2004, approaching the average growth rate for the period 1981–1996. While in East Asia and Southeast Asia the performance will remain below these historical averages, it appears that GDP growth in South Asia will be trending up but still remain below the targets set by most countries to substantially reduce the incidence of poverty.

Assessment of Risks and Uncertainties to the 2003–2004 Outlook for Developing Asia

ADO 2003 identified three sets of risks and uncertainties for developing Asia: global economic, geopolitical, and SARS-related. All of these continue to be relevant at the end of the third quarter of 2003 albeit in a somewhat different setting.

First of all, on the positive side and as discussed in Part 3, the impact of SARS was relatively limited, except in Hong Kong, China and in Singapore, and most Asian economies appear to be rebounding rapidly. This will have a positive impact on the outlook for developing Asia in the second half of 2003, thus adding to the positive effect of somewhat stronger activity in the major industrial countries. A recurrence of SARS is of course not excluded, but the impact should be milder as governments are now better equipped to deal with such epidemics and travel monitoring mechanisms remain in place or have even been improved since the SARS epidemic finished. The lack of information and uncertainties that largely caused the economic impact of the SARS epidemic would thus probably be attenuated in any recurrence.

With regard to geopolitical uncertainties, the threat of terrorism remains of course an issue for developing Asia as shown by the recent bomb explosions in Jakarta. Because of their dependence on tourism as well as on foreign direct investment, many countries in the Asia and

Pacific region are particularly vulnerable to terrorist acts. While the direct impact of the conflict in Iraq appears to have been rather limited, as predicted in *ADO 2003*, oil markets have clearly not settled down. In addition to a rather tight demand-supply situation and low stock levels, the risk premium on oil prices is likely to remain high over the forecast period.

While current global economic uncertainties remain similar to those identified in *ADO 2003*, a somewhat different perspective might color the outlook for the remainder of 2003 and for 2004. First of all, the danger of deflation, which had been identified as a risk, appears to be increasingly fading, but still not totally excluded. In fact, the increase in yields on US treasuries discussed above suggest that inflationary expectations are somewhat rising in parallel with expectations for a stronger recovery starting in the third quarter of 2003. The—so far—mild upward pressure on long-term rates is perhaps more strongly driven by the realization of the need to finance a huge and increasing US budget deficit. Long-term interest rates are thus being pushed up in still a very weak upswing phase of the business cycle in the US. Were long-term rates to increase significantly, this could stall the recovery itself. Higher long-term rates would also affect prospects for a strong recovery in the euro zone and in Japan. In the latter, a significant increase in servicing its large public debt would be a particular issue. The sharp swings in financial markets in the first half of 2003 are probably signs that many uncertainties still underlie the world economy. The risks of a continued weak and unbalanced recovery in major industrial countries remain real, particularly if budget deficits are allowed to balloon. These risks are intensified by the uneven nature of the recovery, with the US economy expected to grow much faster than the euro zone and Japan. The above developments point to the dollar not adjusting much compared to its current value against the euro and the yen, and this in spite of the large US twin (fiscal and current account) deficits.

Finally, a distinct feature of the mild recovery in industrial countries has been the lack of job creation in the major industrial countries. Unemployment rates in these economies are either rising or remain stubbornly high. In the US economy where the recovery has taken a stronger hold over the past few months, jobs continue to be lost, mainly because growth is being fueled by significant productivity increases. While this development is positive for corporate profitability, it raises concerns for the prospects of continued strong consumption spending, which has been the main driving force of US economic growth. If production continues to rise without job creation, even employed workers might anticipate lay-offs and reduce spending and borrowing. Hence, there is a risk that private spending might weaken before the economy starts creating jobs. This could dampen the recovery once again. A decrease in consumer spending in the US would directly impact Asian countries, which are major exporters of consumer goods to the US market.

East Asia

The outbreak of severe acute respiratory syndrome (SARS) disrupted East Asia's economic growth in the second quarter of 2003. Reflecting differences in macroeconomic and structural conditions, expansion varied across economies. Except in the People's Republic of China (PRC), where gross domestic product (GDP) grew by 8.2% for the first half of 2003 and the economy is showing signs of investment overheating, growth in most East Asian economies remains subdued. Some nascent signs of a rebound, however, have emerged. East Asia is expected to grow by 5.6% in 2003 and by 6.5% in 2004, as the adverse effects of SARS disappear, expansionary macroeconomic policies continue, and international economic conditions strengthen.

Macroeconomic Developments

GDP Growth

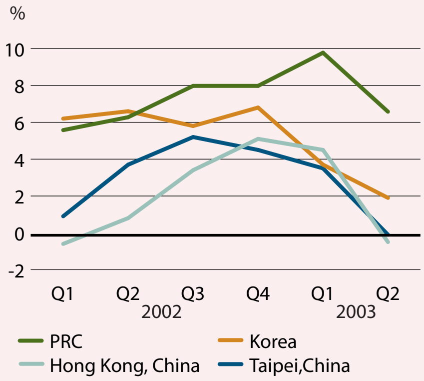
The economies of East Asia experienced a diverse performance in the first quarter of 2003. Growth reached an impressive 9.9% in the PRC. The Hong Kong, China economy also showed signs of recovery, where GDP grew by 5.1% in the fourth quarter of 2002 and by 4.5% in the first quarter of 2003. In Taipei,China, first quarter 2003 GDP increased by 3.5%, while Mongolia's total industrial output rose by 3.1%. In contrast, falling consumer demand caused the Republic of Korea (Korea) economy to fall into recession in the first half of 2003, as it experienced two successive quarters of contraction, on a seasonally adjusted quarter-on-quarter basis.

Growth was seriously disrupted by the outbreak of SARS, mainly in the second quarter. The economies of the PRC; Hong Kong, China; and Taipei,China were among the world's worst affected. In the second quarter, GDP growth dropped to 6.7% in the PRC; Hong Kong, China's nascent recovery halted abruptly as GDP contracted by 0.5%; and Taipei,China's GDP contracted by 0.1%.

Consumption bore the brunt of the SARS impact. Growth in retail sales in the PRC fell from 9.2% in the first quarter to 6.7% in the second, while in Hong Kong, China consumer spending declined by 2.2% in the second quarter. In Taipei, China, it contracted by 1.8% over the same period.

SARS particularly affected services (see Part 3). While the services sector in the PRC grew by 4.2% in the first half of 2003, its industry sector expanded by 11.6%. The services sector growth rate in Taipei, China was

GDP Growth, East Asia



Sources: *China Monthly Economic Indicators*, July 2003; www.info.gov.hk/censtatd; www.bok.or.kr; www.stat.gov.tw.

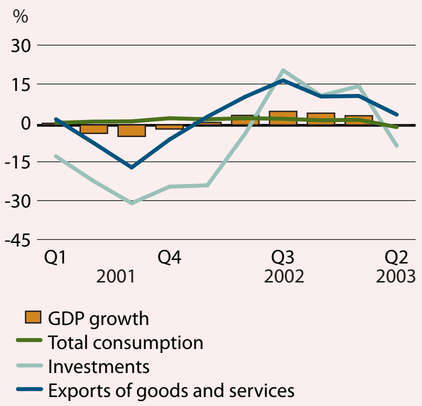
Table 2.1 Selected Economic Indicators, East Asia, 2002–2004, %

Item	2002	2003		2004	
		ADO 2003	*Update*	*ADO 2003*	*Update*
GDP Growth					
Average	6.5	5.6	5.6	6.2	6.5
China, People's Rep. of	8.0	7.3	7.8	7.6	7.9
Hong Kong, China	2.3	2.0	2.1	4.0	4.8
Korea, Rep. of	6.3	4.0	3.1	5.3	5.0
Mongolia	3.9	5.0	5.0	5.2	5.2
Taipei,China	3.5	3.7	3.1	3.9	4.4
Inflation Rate (CPI)					
Average	-0.1	1.1	1.0	1.4	1.5
China, People's Rep. of	-0.8	0.5	1.0	1.0	1.5
Hong Kong, China	-3.0	-1.5	-2.8	0.5	0.5
Korea, Rep. of	2.7	4.0	3.4	3.5	2.7
Mongolia	1.7	5.0	5.0	5.0	5.0
Taipei,China	-0.2	0.4	-0.1	0.6	0.5
Current Account Balance/GDP					
Average	4.1	3.0	2.4	2.7	1.9
China, People's Rep. of	2.9	1.6	0.2	1.5	-0.1
Hong Kong, China	10.8	11.5	12.0	8.5	9.0
Korea, Rep. of	1.3	0.0	0.3	-0.3	0.1
Mongolia	-16.1	-13.4	-13.4	-12.1	-12.1
Taipei,China	9.2	7.9	7.9	8.0	8.0

CPI = consumer price index; GDP = gross domestic product.

Sources: *ADO* database; staff estimates.

GDP Growth by Expenditure Account, Taipei,China



Source: www.stat.gov.tw.

reduced from 2.2% year on year to 0.2% between the first and second quarters. The economy of Hong Kong, China was particularly affected because of its role as a subregional financial, aviation, and logistics services center. Services exports there were dealt a severe blow, with a 12.6% growth rate in the first quarter of 2003 plummeting to a 14.7% contraction in the second. The number of incoming visitors plunged by 58% in the second quarter year on year after surging by more than 20% in the previous quarter. The hotel room occupancy rate in April and May was only about a quarter of the normal 80% plus rate.

Mongolia's limited direct exposure to SARS did not prevent it from suffering from reduced tourism, transport, and trade as the PRC is Mongolia's largest trading partner, although industrial output showed resilience, growing by 5.9% in April year on year. For example, the first SARS case in Mongolia coincided with the beginning of the construction season. Consequently, concerns over SARS prompted the Government to delay the expected arrival of thousands of construction workers from the PRC in April–May. SARS also disrupted "Visit Mongolia" year in which increased revenue from tourism was expected. Tourist arrivals fell substantially in April–May, and the number of international flights declined from 89 to 39.

The economic impact of SARS will continue to be felt for some time, although signs of recovery in affected sectors have been apparent since the removal of the PRC; Hong Kong, China; and Taipei,China from the list of SARS-affected areas by the World Health Organization in June and July.

Despite SARS, the PRC economy grew by 8.2% in the first half of 2003. Strong investment growth more than offset the impact of SARS on consumption. Total fixed asset investment in this period reached CNY1.9 trillion (US$234 billion), up by 31.1% from the same period of 2002, and representing the strongest improvement since 1994. Rising investment has contributed around half of the PRC's GDP growth in recent years. In the first half of 2003, this contribution reached a new high of around 60%.

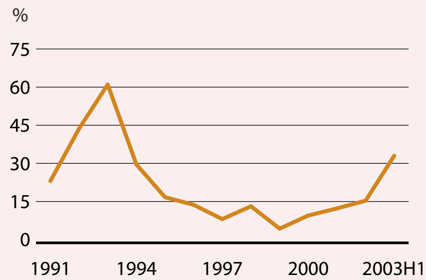
Several signs of investment overheating in the PRC have emerged, however. The rise in fixed asset investment has been accelerating. After a 17% increase in 2002, such investment rose by 31% in the first half of 2003, approaching the level seen in the 1992–93 economic bubble. The recent investment expansion, however, was mainly fueled by large infrastructure projects and, especially, increased housing mortgage loans from commercial banks, a relatively new phenomenon in the PRC. Investment in real estate increased by 34% in the first half of 2003. (The experiences of many countries have shown that rapid real estate investment can lead to the creation of asset bubbles.) The rapid growth of prices of raw materials and of other production inputs also suggests overheating. In the first half of 2003, the price index of real estate, land prices, and raw materials rose by more than 4%. The average price of steel products went up by more than 10% and shortages of electricity were reported in 19 provinces by July 2003. Another warning sign is that broad-based money supply (M2) and outstanding lending increased rapidly in the first 6 months of 2003. By the end of June, M2 had grown by 20.8% year on year and the volume of medium- to long-term loans by 28.9%, 8.3 percentage points higher than in the same period of 2002. Outstanding loans in the first half-year rose by CNY1,781 billion, close to the total lending increase in 2002. In response, the People's Bank of China has taken measures to counter investment overheating (see Policy Developments, below).

Investment spending in Hong Kong, China presents a dramatic contrast to that in the PRC. Total investment fell by 5.3% in the second quarter of 2003, in which time total expenditure on building and construction shrank by 7.2%. Private expenditure on building and construction also fell as existing projects (such as Container Terminal No. 9) were close to completion and no new projects came on stream. Public expenditure fell with heavy cuts to the Public Housing Program and the winding down of major railway projects. The unpromising business environment dampened expenditure on machinery, equipment, and computer software.

The sluggish construction investment in Hong Kong, China reflected weak property market conditions. Government policy measures implemented in late-2002 only provided a short-lived boost to the market in January. The number of transactions fell in February. However, other, longer-term factors are also present. Commercial property markets remained weak through further consolidation and downsizing in the corporate sector in an uncertain business environment. Industrial property markets reflected the continued downsizing of local manufacturing activity, while concerns over job security and falling property prices depressed residential property investment. The number of transactions, however, has increased moderately since May.

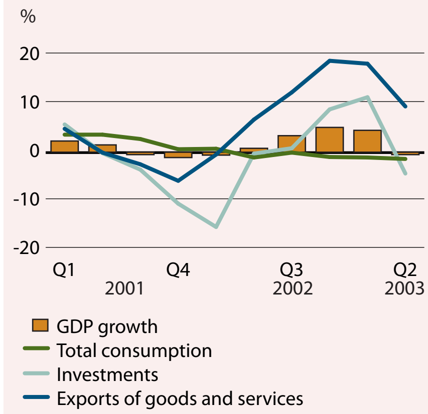
Investment has also been weak in Korea. Heavy restructuring after the 1997-98 Asian financial crisis caused the financial markets to reduce

Growth of Nominal Investment in Fixed Assets, PRC



Sources: *China Statistical Yearbook 2002*; *China Monthly Economic Indicators*, July 2003.

GDP Growth by Expenditure Account, Hong Kong, China



Source: www.info.gov.hk/censtatd.

GDP Growth by Expenditure Account, Korea

Source: www.bok.or.kr.

corporate sector lending and significantly increase consumer credit. This fueled a rise in private consumption and boosted GDP growth. GDP expanded at a relatively solid pace of 6.3% in 2002. However, the economy weakened substantially and fell into recession in the first half of 2003 as increased household debt resulted in slower private consumption growth, which was further affected by stricter regulation of consumer credit from the second half of 2002 after 2 years of rapid expansion. In the first half of 2003, private consumption contracted due to a series of unanticipated shocks such as the fall in semiconductor prices, the US$1.2 billion accounting fraud at SK Global and the associated instability of financial markets, and concerns over the nuclear policy of the Democratic People's Republic of Korea. Declining private consumption and sluggish investment drove the Korean economy into recession: seasonally adjusted data show that GDP contracted by 0.4% and by 0.7% quarter on quarter for the first and second quarters, respectively. On a year-on-year basis, however, GDP grew moderately by 3.7% in the first quarter and 1.9% in the second. The current economic recession, in fact, owes more to weak domestic demand in services than in industry: services sector growth plunged from 7.4% in 2002 to 1.3% in the first quarter of 2003 and to 1.0% in the second quarter, while the growth rate of industrial production fell from 6.1% to 5.8% and to 3.3% over this period. This is unusual, since industrial production is normally more sensitive than services output to business cycles, and is a reflection of the fact that services are affected mainly by domestic demand, rather than by exports.

East Asia continues to grapple with unemployment problems. Weak demand, SARS, and structural adjustments in some economies have contributed to rising unemployment. In the PRC, rapid economic growth has been insufficient to absorb surplus agricultural labor, new labor-market entrants, and workers laid off from uncompetitive state-owned enterprises (SOEs). According to official statistics, which underestimate the problem, registered urban unemployment rose from 4.0% at end-2002 to 4.2% by end-June 2003. The inclusion of laid-off SOE workers still without work would raise this figure to about 7.2%. In addition, with 10 million young urban residents and tens of millions of jobless farmers seeking work in cities, the unemployment rate could be much worse. In the second quarter of 2003, however, construction and manufacturing employed, respectively, 254,000 and 220,000 more people than in the first quarter. Overall, 64,000 more people were officially employed in urban areas in the second quarter of 2003 than in the first, despite SARS.

Hong Kong, China's unemployment rate reached 8.6% in the second quarter, a three-decade high. Job losses were especially severe in the services sector. In Taipei,China, average unemployment was 5.0% in the first half of 2003. While SARS exacerbated the faltering labor market in Hong Kong, China and in Taipei,China, more deep-rooted problems that are harder to address also contributed, such as the relocation of firms to the PRC and changing economic structures.

Korea's seasonally adjusted unemployment rate rose from 3.1% in January to 3.6% in June 2003, after declining since 1998. These figures may understate the actual figure, because many potential workers in Korea tend not to participate in the labor market in recessions. Employment growth began to turn negative from the second quarter of 2003, mainly due to the contraction in services, particularly the labor-intensive sectors dependent on domestic demand such as wholesale and retail trade, and restaurants and lodging. The abrupt reversal of consumer credit caused private consumption to collapse, which led to the contraction of services output. Slow labor demand was a major factor in the fall of the nominal wage growth rate from around 11% in 2002 to about 8% in the second quarter of 2003, year on year. Real wage growth declined from 8.5% in 2002 to 4.9% in the second quarter of 2003, year on year.

Fiscal Situation

In the PRC, the growth of fiscal revenue fell from 36.7% in the first quarter to 20.0% in the second. A strengthening economy helped push revenues up by 27.4% in the first half of the year, significantly higher than the 9.2% rise recorded in the same period in 2002. Revenue growth also accelerated due to rapid increases both in tariff collection in line with higher imports and in taxes on enterprise income, of 39.8% and 30.4%, respectively. Fiscal expenditures in the first half of 2003 were 16.5% higher than in the same period a year earlier. Spending on health care, social security, and various subsidies grew rapidly in the first 6 months of 2003. In particular, the PRC central Government spent CNY1.3 billion (US$157 million) on SARS control, and local governments allocated over CNY10 billion (US$1.2 billion) by the end of June in combating SARS. In May, the Ministry of Finance and the State Administration of Taxation announced that taxes and fees levied on some sectors, including catering and hotels, would be reduced or waived between 1 May and 30 September to help offset the impact of SARS. The central Government promised free medical treatment to farmers and poor urban residents who contracted SARS, which helped prevent SARS from spreading to rural areas. The central Government also adopted a series of policies to support medical staff treating SARS patients by granting subsidies and temporary exemptions from personal income tax.

SARS has had a strong impact on Hong Kong, China's fiscal situation. It prompted the authorities to switch fiscal policy priority from addressing the budget deficit to stimulating the economy. In April, they announced a HK$11.8 billion (US$1.5 billion) SARS relief package, equivalent to 1% of GDP. The package includes rent concessions on government-owned properties; temporary waivers of rates, sewage, and water charges; salary tax rebates; and government guarantees of up to HK$3.5 billion-worth of bank loans to help businesses pay salaries. Support for sectors worst affected by SARS included a 1-year waiver on license fees for business activities in tourism, catering, entertainment, and transport. The package will be funded from fiscal reserves and will thus not contribute to the deficit as such. However, SARS has also reduced revenue by depressing economic growth. This has aggravated Hong Kong, China's fiscal problems. Heavily reliant on property-related revenue, government revenue has dwindled in the past 5 years as property values declined. At the same time, increased spending on public services, education, health, and welfare added to budgetary pressure. Over the past decade, public spending has increased from about 15% of GDP to over 20%. Large fiscal reserves have, however, allowed the authorities to remain free of external debt.

Similarly, weak economic growth since 2001 has dampened revenue flows in Taipei,China, while ever-higher welfare costs and the need to stimulate the economy have increased government expenditure. In July 2003, the Taipei,China authorities allocated NT$50 billion (US$1.5 billion) to deal with SARS, 40% of which is for assisting industries affected by SARS, and 60% for the disease's prevention and treatment. In November 2002, the authorities announced a NT$58 billion program of public works designed to stimulate domestic growth through road construction, agricultural and educational spending, and urban development.

Korea's fiscal policy stance changed to help boost the economy in response to weakening economic performance. The economy suffered somewhat from the reduced subregional travel that SARS induced. The central bank earmarked W385 billion (US$315 million) in loans to financial institutions to help support trade financing. In addition, the National Assembly approved a supplementary economic stimulus package of W4.5 trillion (about 0.8% of GDP). Tax deductions for corporate capital investments were not only extended beyond their initial expiry date of June 2003 until December 2003, but also the deduction rate was increased from 10% to 15%. In addition, special tax rates for luxury goods such as automobiles were lowered. Tax measures have been tightened to reduce the possibility of a loose monetary policy stance causing real estate price hikes. For example, the Government now calculates capital gains tax rates on actual market prices instead of reported prices by traders, which were previously significantly undervalued.

Mongolia's tax laws were amended to promote rural economic activity and to offset high prices and shortages of imported goods resulting from the SARS outbreak. This kept revenue below initial estimates. Although the deficit increased by US$16 million in the first quarter of 2003, the post-1991 debt continued to be serviced. However, notwithstanding high-level talks with the Russian Federation in July, the settlement of Mongolia's pre-1991 debt of MNT10.5 billion to the Russian Federation remains unresolved. Mongolia has been seeking a way to cancel this debt along the lines taken by the Russian Federation in relation to the Eastern European economies. Given the substantial size of the debt, it is perhaps not surprising that discussions have been slow and that no consensus has yet been reached. Current negotiations between the two countries aim to produce a mutually acceptable solution. However, the process is fraught with difficulties, as resolution requires significant political commitment as well as technical expertise.

Money and Prices

Monetary policies remained accommodative in most economies, although some moderate tightening occurred. In the PRC, the broad money supply (M2) rose by 20.8% in the year to end-June 2003. Total yuan deposits grew by 23.3% and total yuan loans increased by 23.1%. There are some concerns that the rapid expansion of M2 and loans may lead to economic overheating and further weakening of the banking sector unless this expansion is handled appropriately. These concerns have prompted action by the People's Bank of China (see Policy Developments, below).

The authorities in Taipei,China maintained a broadly expansionary monetary policy while domestic inflationary pressure remained subdued. Interest rates continued falling with the overnight interbank call rate declining to 1.16% in June. In the first 7 months of 2003, M2 expanded at an average rate of 2.64%, and M2 plus bond funds grew by 4.05%.

Korea loosened its monetary policy stance. Despite falling international and domestic long-term interest rates, the Monetary Policy Committee of the Bank of Korea kept its key call-rate target steady at 4.25% from May 2002 until May 2003, when it lowered the target to 4.00%, then to 3.75% in July. Short-term interest rate cuts and the rise of long-term rates steepened the yield curve in August. Some commentators attribute the relatively easy credit that has been available to households as the cause of apartment price rises. For this reason, the Bank of Korea was reluctant to lower the call rate despite the incipient economic recession in the second quarter. Apartment prices will continue to be one of the important variables that will affect the monetary policy stance in the near future of Korea, and although the explosive growth of bank lending to households has slowed, the sluggish pace of lending to large corporations continued, resulting in a rise in lending to small and medium enterprises (SMEs). In the first half of 2003, bank lending increased by W0.8 trillion for large corporations, by W26.6 trillion for SMEs, and by W13.9 trillion for households.

Mongolia's monetary policy is also accommodative. M2 accelerated rapidly by 38.1% in July year on year, while the togrog depreciated by 3.0% in June 2003 compared to the same month in 2002.

Price changes in East Asia reflect different economic outcomes. Strong growth in the PRC saw deflation abate and inflation return. The consumer price index (CPI) rose by 0.6% year on year in the first half of 2003. While prices of clothing, transportation, communications, and household appliances fell, those for food, medicine, education, and housing increased. Ex-factory prices, raw material purchasing prices, and real estate prices were particularly buoyant in the first half of 2003, rising by 2.9%, 5.4%, and 4.9%, respectively. These figures add weight to suggestions of investment overheating in the PRC.

In contrast, deflation continued in Hong Kong, China. The Composite Consumer Price Index fell by 2.5% in the second quarter year on year, and further by 4.0% in July. This marked the 56th consecutive month of consumer price deflation. Various factors contributed, not the least of which was the ongoing substantial decline in property prices. SARS and government relief measures, such as recent various concessions on public utilities, also contributed to deflation. The weakening of the Hong Kong dollar against other currencies in line with the US dollar decline, higher import prices, and the firming up of the commodity market were insufficient to offset these effects. Price pressures also remained weak in Taipei, China, as the CPI decreased by 0.16% in the first half of 2003.

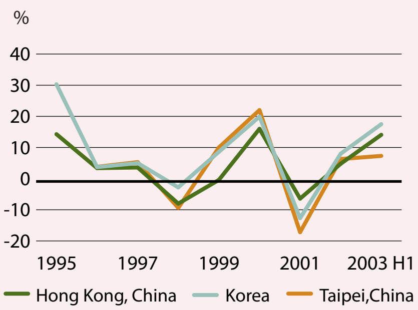
The CPI in Korea rose by 4.1% in the first quarter of 2003, but then slowed to 3.3% in the second quarter. While the housing price index appeared to stabilize in the first quarter (with a 1.2% increase from December 2002 to March 2003) after a 16.4% rise in 2002, it then rose by 3.3% in the second quarter. In particular, Seoul's apartment price index declined by 0.8% in the first quarter of 2003 after soaring by 30.8% in 2002, before rising by 3.3% in the second quarter. Mongolia's inflation, while moderate in historical terms, is still relatively high, rising by 5.7% in the first 4 months of 2003, partly due to disruption in supplies from the

SARS-affected PRC. While demand conditions play a major role in determining current price changes in other East Asian economies, supply-side constraints seem to be a more important factor in Mongolia.

External Sector Developments

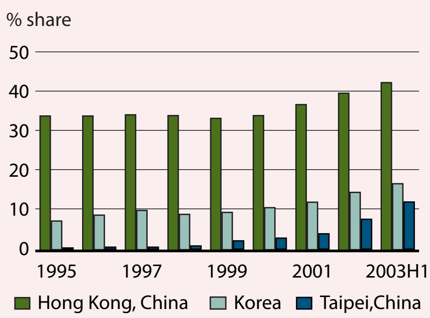
While domestic demand has been patchy or weak in East Asia (except in the PRC), export growth has been strong in most economies. This is partly because SARS has affected the movement of people more severely than the movement of goods. In the PRC, exports surged by 34.0% in the first half of 2003 while imports rose by 44.5% over the same period. The PRC's trading activities have provided considerable momentum for export expansion in other East Asian economies, as well as in Southeast Asia. It has emerged as the largest export market—or one of the largest—for all other East Asian economies and is one of the fastest growing export markets for Southeast Asian countries. This has spurred economic growth in both subregions. More important, the process has become a driving force behind economic integration among East Asian and Southeast Asian economies. Bolstered by PRC demand, merchandise exports, and especially reexports, from Hong Kong, China boomed. In the first half of 2003, the volume of Hong Kong, China's reexports of goods rose by 19.4% year on year. This more than offset the decline of domestic exports and lifted overall export growth in volume terms to 16.5% in the first half of 2003.

Growth Rate of Total Exports, East Asia



Source: CEIC Data Company, Ltd.

Share of Exports to PRC, East Asia



Source: CEIC Data Company, Ltd.

Year on year, Korea's exports climbed by a healthy 21.0% in the first quarter, by 14.6% in the second, and by 16.0% in July. Exports to the PRC were particularly strong, growing by 47.0% in the first 7 months of 2003. SARS was more damaging to export growth in Taipei,China, however, where exports grew by only 3.6% in the second quarter, substantially lower than the 11.4% of the first quarter. However, in June, export orders recovered to register double-digit growth. Taipei,China's exports to Hong Kong, China and the PRC increased by 18.4% in the first half of 2003, accounting for 33.2% of that economy's total exports.

Most East Asian economies have accumulated large foreign exchange reserves. Due to faster import growth, the PRC's trade surplus of US$4.5 billion in the first half of 2003 was US$8.9 billion less than in the corresponding period of 2002. However, foreign direct investment (FDI) inflows do not seem to have been damaged by SARS. Contractual FDI and actual FDI increased by 40.3% and 34.3%, respectively, in the first half of 2003, year on year. With a continuous trade surplus and FDI inflows, the PRC's foreign exchange reserves reached US$346.5 billion by end-June 2003, 21% higher than at the end of 2002. In Korea, weaker domestic demand and stabilized oil prices since April lowered import growth from a year-on-year 30.9% in the first quarter to 12.0% in the second. This resulted in the current account switching from a deficit of US$1.7 billion in the first quarter to a surplus of US$2.6 billion in the second. Foreign exchange reserves increased from US$121.0 billion at the end of 2002 to US$132.9 billion at the end of July. The accumulation is largely due to portfolio investment inflows and foreign loans.

Hong Kong, China's widening trade surplus and significant reduction in net outflows of portfolio investment assisted its balance-of-payments account in the first quarter of 2003, creating an overall surplus of US$10.4 billion (or 3.5% of GDP). Reserve assets correspondingly strengthened by the same amount over this period. The economy's foreign exchange reserves totaled US$114 billion at the end of June 2003. Mongolia's first quarter export value increased by 12.4% compared to the same period in 2002 due to higher exports of copper concentrate and textile products. The corresponding increase for total imports was 45.3%, triggered by growing imports of oil, machinery, equipment, transport vehicles, and spare parts. However, SARS reduced Mongolia's imports from the PRC in the second quarter. International reserves declined by about 16% to US$294.2 million in May 2003 from end-2002.

While large foreign exchange reserves can cushion adverse currency or balance-of-payments shocks, continued accumulation also carries a cost. Often foreign exchange reserves are invested in low-risk financial assets, while countries pay higher interest for foreign debt. While the purchase of foreign exchange by central banks can help maintain a lower exchange rate, it can also reduce the capital imports that are needed for long-term economic growth. Furthermore, countries cannot accumulate foreign exchange forever. When countries switch policies, the resulting exchange rate appreciation may cause substantial adjustments in the export sector, which may have built up excess capacity under the low exchange rate regime. East Asian policy makers therefore need to carefully evaluate the suitable level of foreign exchange reserves and the best ways to manage the reserves.

Policy Developments

Increasing fiscal deficits and emerging signs of economic recovery prompted some East Asian governments to contemplate fiscal tightening in late 2002 and early 2003. The SARS outbreak, however, forced most of them to set aside fiscal consolidation and focus on dealing with the epidemic and stimulating the economy. In line with generally subdued price pressures and weak growth, monetary policy remained accommodative in Korea; Mongolia; and Taipei,China. While Hong Kong, China's currency board arrangement limited its monetary independence, monetary policy has been tightened somewhat in the PRC recently.

The PRC Ministry of Finance outlined five measures for dealing with SARS and strengthening economic growth. First, it assigned budgetary priority to fighting SARS, combating floods, providing disaster relief, developing rural and old industrial areas, and developing the western region. In addition to dealing with SARS, from the beginning of 2003 the Government provided a total of CNY801 million (US$96.5 million) to support nationwide efforts fighting floods and droughts. Second, it aimed to improve the export tax rebate policy, channeling any revenue surplus in 2003 into this area. Third, it took steps to strengthen revenue collection and reduce tax evasion. Fourth, it imposed a freeze on the expenses of all departments except health, water conservation, and those fighting SARS and natural disasters. Fifth, it continued rural tax reform to reduce the financial burdens faced by farmers.

Rising unemployment in several economies of East Asia has prompted action from governments. The PRC Government has placed priority on strengthening the social safety net, social security and labor market reform, and creating jobs in the private sector. It also broadened its official definition of "unemployed" to include those earning less than the local basic living allowance. The new classification is a response to criticism over the country's statistical methods. The Hong Kong, China Government announced enhanced employment measures in June 2003, worth US$715 million, to ease youth unemployment. Other measures include the Youth Pre-employment Training Program, the Youth Work Experience and Training Scheme, and the Graduate Employment Training Scheme. The Government aims to create 33,350 employment/training opportunities for young people in 2004, and 39,000 opportunities for other age groups. So far, 16,500 people have started working/training under these programs.

The Government of Taipei,China's Plan of Employment Expansion through Public Services, which started in June 2003, also aims to reduce unemployment. The Executive Yuan[1] recently approved a special budget of NT$20 billion to create employment opportunities. About 60,000 jobs had been created by end-August 2003. While these programs may increase employment, their effect is temporary and limited. These measures also intensify fiscal pressures and widen budget deficits. Sustained employment growth ultimately requires stronger economic growth.

On the monetary policy front, the People's Bank of China expressed concern that indications of overheating may be a prelude to renewed inflation, and therefore slowed the approval procedure for real estate loans. Similar curbs are planned for automobile loans. It issued new rules forbidding banks to issue mortgages to people for properties that are still being planned or constructed to reduce the number of loan defaulters and to cool a property market that many believe is in danger of overheating. The deposit reserve requirement ratio increased to 7% from 6% effective 21 September 2003.

The PRC exchange rate remained stable at CNY8.28/US$1 in the first half of 2003. While the PRC resisted calls by several governments to allow its currency to appreciate, a decline in export rebates resulted in an effective appreciation of the currency. In light of increased foreign exchange reserves, the State Administration of Foreign Exchange announced that, from 1 September, foreign trade companies would be allowed to retain their foreign exchange incomes in full in foreign exchange accounts. The State Administration has granted qualified foreign institutional investor status to international investment banks and security companies including UBS Ltd., Nomura Securities Co. Ltd., Citigroup Global Markets Ltd., Morgan Stanley International Ltd., and Goldman Sachs Co. The minister of commerce is also encouraging domestic companies to increase their imports. In addition, the Government is encouraging PRC companies to invest abroad to ease the pressure of rapidly increasing reserves.

The China Banking Regulatory Commission was established in 2003 to take over supervisory power from the People's Bank of China. It will not adopt the new, strict Basel II accord proposals. The Basel Committee on Banking Supervision, the global rule-setting body for central bankers and financial regulators, is drawing up an accord that will keep the minimum capital requirement for banks at 8.0%. This is a level that many debt-ridden PRC banks are still unable to reach. The PRC will thus continue to implement the old 1988 accord, at least for a few years, after the G10 group of leading industrial countries starts implementing the new capital rule in 2006.

East Asian governments continue to implement structural reforms. In early August, the PRC Government announced plans to accelerate the restructuring of traditional heavy industrial bases in the northeast. Priority will be given to intensifying reform efforts, opening more sectors to global competition, continuing to adopt market-oriented policies, and introducing new technologies. The State-owned Assets Supervision and Administration Commission (SASAC), created in March 2003, will accelerate SOE reforms and provide an institutional framework to improve SOE corporate governance. Under this framework, about 2,000–3,000 SOEs will be declared bankrupt within the next 5 years with most of the income that it has recovered used to support firms' laid-off workers. To ensure efficiency and avoid disputes, SASAC is drafting wide-ranging rules for state asset management and supervisory schemes. The position, salary, and relative awards and penalties of SOE managers will be more closely connected to their actual performance.

Hong Kong, China and the PRC signed a Closer Economic Partnership Agreement (CEPA) on 29 June 2003. It stipulates cutting tariffs on Hong Kong, China-manufactured exports, increasing access of the services sector in Hong Kong, China to the PRC, and enhancing bilateral cooperation in trade and investment. Under CEPA, about 273 types of goods manufactured in Hong Kong, China will receive tariff-free entry into the PRC from 1 January 2004. Tariff-free status will be extended to other manufactured goods by 1 January 2006. The agreement's overall impact on manufacturing in Hong Kong, China is likely to be modest, given the sector's small size. As the economy's factories have relocated to the PRC to benefit from lower costs, manufacturing's share of economic output has fallen. Furthermore, domestic exports account for only about 10% of total merchandise exports; the bulk of exports are reexports. CEPA may have a deeper impact on services, however. Under CEPA, about 18 services subsectors in the PRC will be open to Hong Kong, China firms, including advertising, telecommunications, construction, tourism, banking, insurance, and professional services. In these subsectors, Hong Kong, China companies will gain access to the PRC ahead of the deadlines stipulated in the PRC's World Trade Organization (WTO) accession agreement.

On balance, CEPA would appear to favor Hong Kong, China, given its open economic regime. However, the agreement may prove invaluable to the PRC as it will help better prepare it for the increased competition after more substantial opening up under WTO obligations. The entry of services firms into the country will also provide the PRC with much-needed skills in areas such as law, accountancy, and financial services.

East Asian economies have experienced various difficulties since the Asian financial crisis. All have subsequently shown much dynamism and flexibility in carrying out structural adjustment. Difficult challenges still lie ahead in the next few years. In the PRC, for example, rapid economic growth has provided benefits, but it has also been accompanied by widening income disparities between rural and urban residents. For example, the per capita income of rural residents increased by 2.5% while that of urban residents rose by 8.4% in the first half of 2003, compared to the corresponding period of the previous year. The income earned by farmers from working in cities accounted for about 70% of the total annual increase in their incomes. Farmers' incomes were also adversely affected by the SARS outbreak. According to a survey conducted by the National Bureau of Statistics in mid-June, only 23.3% of the rural migrant laborers who had returned to their villages in the SARS period had since returned to work in cities. This will make it difficult to fulfill the Government's objective of increasing rural income by 4% this year. Reforming SOEs is also an ongoing and difficult task. In the first half of 2003, investment in private, collective, and state-owned sectors grew by 24.3%, 34.0%, and 32.8%, respectively, year on year. Given the prevailing inefficiency of SOEs, the continued increase in SOE investment may have drained resources from more productive areas.

As in other economies, Hong Kong, China's structural adjustments have created winners and losers. Unskilled workers are experiencing tough times because of the availability of cheap labor in the PRC. Falling property prices have hurt property developers and owners, particularly those struggling to repay mortgages on properties bought at boom prices. However, lower asset prices will increase Hong Kong, China's attractiveness for business and investment in the long run. In the coming decade, Hong Kong, China faces mounting concerns about its future economic role in the region as infrastructure and other conditions improve in the PRC.

Taipei,China shares many of Hong Kong, China's problems. While the property market has not undergone a similar drastic adjustment, its economic integration with the PRC has strengthened. This provides both opportunities and challenges. Lower production costs have lured firms to relocate to the PRC, leading to a "hollowing out" of manufacturing and increased unemployment. The movement of goods and services between the two economies has also led to some price convergence, contributing to deflation in Taipei,China. Despite increased competition from the PRC, the economic future of Hong Kong, China and of Taipei,China lies firmly anchored in their proximity to that country.

Korea has witnessed much debate over labor-market reform recently. Industrial production rose by only 0.7% in July as strikes hit the automobile industry. The new Government is perceived to be more supportive of labor unions than the previous one, and labor movements won victories on various issues. Bitter debates continue over matters such as a 5-day work week and labor participation in firm management. It will not be an easy task for the Government to design policies reconciling the need for economic reform and labor-movement concerns.

Mongolia's privatization program proceeded according to schedule. In 2003, three SOEs were offered for sale. The sales are expected to be completed by the end of the year, boosting government revenues. Funded by the European Bank for Reconstruction and Development (EBRD), and in preparation for the privatization of the state-owned airline, MIAT, a 12-month management contract was awarded to a foreign company. Some smaller state assets are also scheduled for privatization in 2003.

In 2002, the Mongolian Parliament approved two new land laws to be implemented in 2003. The first extends the system of quasi-ownership of urban and peri-urban land by establishing renewable, inheritable, and tradable long-term possession and use leases that can be pledged as collateral. The second allows every Mongolian family to privately own a small parcel of land. The laws remain controversial despite a start in implementation. The allocation of leases, through auction and at the discretion of local authorities, remains a concern due to the lack of sophisticated dispute-resolution procedures and the possibility that a wealthy few will dominate the market leases.

A persistent high incidence of poverty and widening economic inequality burden Mongolia. Furthermore, increased migration to a few population centers—particularly in and around the capital city, Ulaanbaatar, for better access to essential social services and market opportunities—has created new and urgent challenges for social and human development.

Outlook for 2003–2004

East Asian economies are recovering from the economic disruption caused by SARS. Consumer and business confidence are improving. Globally, there are signs of a firmer recovery in the US, and some improvements in Europe and Japan. These developments will benefit the economies of East Asia and lift their growth rates in the second half of 2003 and in 2004.

The economic impact of SARS in the PRC should diminish in the third quarter of 2004. Economic growth in the PRC will strengthen toward the end of the year. GDP is forecast to grow by 7.8% in 2003 and by 7.9% in 2004, compared to 7.3% and 7.6%, respectively, forecast in *ADO 2003*. The Hong Kong, China economy is expected to pick up from the second half of 2003, bolstered by strong exports to the PRC. Government spending will further boost growth. GDP is expected to grow by 2.1% in 2003, and accelerate to 4.8% in 2004.

There are indications that commercial activity in Taipei,China is rebounding since it was declared SARS-free. Expanding public expenditure will also lift the economy in the second half of the year. GDP is expected to expand by 3.1% in 2003. A broad recovery in both domestic and external demand will accelerate this rate to 4.4% in 2004. Korea's overall GDP growth rate is expected to stay at around 3% in 2003, improving to around 5% in 2004 as the recovery phase continues. In Mongolia, growth will be 5.0% in 2003, and 5.2% in 2004.

Economic performance will vary between sectors. In the PRC, rapid investment in real estate will cool as the People's Bank of China has taken measures to prevent a real estate bubble from developing. Strong FDI inflows and domestic private sector investment will continue. As a result, investment will remain robust for the remainder of 2003 and in 2004. Several developments suggest that consumption will resume its modest expansion. For example, the Ministry of Commerce recently adopted measures to revitalize the food and beverage and accommodation industries, such as publicizing and implementing the standards of "green" (environmentally friendly) hotels and restaurants and hotels ratings, advocating sanitary dining habits, and launching a series of marketing activities in the second half of 2003. Continued government measures to alleviate the impact of SARS, such as tax reduction for the hospitality sectors, will also help revive consumption spending in 2003.

The PRC's strong import demand will boost exports in other East Asian and Southeast Asian economies, particularly that of Hong Kong, China. Tourism in Hong Kong, China has begun to pick up since the lifting of the WHO SARS travel advisory on 23 May. Visitor numbers from the PRC are rapidly recovering, partly as a result of the lifting of some travel restrictions for PRC tourists. Shop and restaurant customer numbers are also recuperating. Exports are forecast to grow by 16.5%, and imports by 13.5%, in 2003. Private consumption will remain subdued in 2003, however, since household confidence has suffered from falling property prices and high unemployment. Overall, investment spending in the economy, as represented by gross domestic fixed capital formation, is forecast to increase by 0.6% in real terms in 2003. Expenditure on building and construction will continue to decline in 2003. New construction works in the private sector will be delayed by sluggish property market conditions. Cuts to the Public Housing Program and the imminent completion of the construction of the KCR West Rail will further dampen construction output in the public sector.

A recovery in consumer demand and a pickup in investment will help the Hong Kong, China economy bounce back in 2004. In 2003–2004, the economy will maintain its sizable current account surplus. The deficit on the merchandise trade account is likely to narrow this year, before widening once again in 2004. The services balance will remain substantially in surplus. Overall, the current account surplus is forecast to fall from about 12% of GDP in 2003 to around 9% in 2004.

Due to weak growth in the first half of 2003 in Taipei, China, private consumption is expected to grow by just 1.6% in 2003. It will strengthen markedly in 2004, to 4.7%, as domestic demand improves and unemployment begins to fall. Export expansion in Taipei,China is set to strengthen in late 2003 and in 2004 on the back of a strong rise in exports to the rest of Asia, particularly the PRC. Macroeconomic policies will remain accommodative in 2003 and 2004. Domestic investment will firm up, aided by the improvement of the domestic investment environment, stronger trading partner growth, and government employment and public investment packages. Gross fixed capital formation is projected to rise by just 3.0% in 2003, and by 6.2% in 2004. The trade surplus will narrow in line with increased import demand.

Although the Korean economy suffered a worse than expected recession in the first half of 2003, the pace of decline has slowed recently. Both industrial and services output growth rates improved in May and June. Many of the adverse conditions that occurred in the first quarter appear to be dissipating. For example, oil prices have stabilized, and semiconductor prices are on the rise. Financial market uncertainties resulting from problems experienced by credit card companies and SK Global have decreased. Strong demand in the PRC and strengthening global economic conditions will boost Korea's export growth. Domestically, it seems likely that adjustments in household credit, particularly credit card loans, will proceed at a more gradual pace, thus helping stabilize private consumption. Expansionary macroeconomic policies may also boost the economy from the second half of 2003 onward. These factors are expected to improve the quarter-to-quarter growth rate in the second half of the year, although the year-on-year rate is not expected to be much higher than that of the first half. GDP growth in 2003 at 3.1% will be substantially lower than projected in *ADO 2003*. Private consumption might increase by less than 1% in 2003, before fully recovering in 2004. The expected recovery of the global economy, particularly in the information and communications technology industries, will help Korea's export performance, although domestic demand will also boost imports, reducing the current account surplus from 0.3% of GDP in 2003 to 0.1% in 2004.

Inflation in most East Asian economies will remain subdued, although deflation remains a major issue in Hong Kong, China. The inflation rate in the PRC is forecast at 1.0% in 2003 and 1.5% in 2004 in spite of strong domestic demand, and the ongoing monetary reform that will widen financial institutions' channels for lending in the next 2 years. Reduced aggregate demand pressure in Korea will help stabilize inflation rates from 3.4% in 2003 to 2.7% in 2004. Given the weak consumer sentiment and heavy discounting prevalent in Hong Kong, China, deflation will persist in 2003. Temporary government economic relief measures, such as lower water and sewerage charges, will further contribute to deflation. As a result, prices in Hong Kong, China are expected to fall by 2.8% in 2003. Firming economic conditions and the end of government relief measures next year suggest that consumer prices are likely to rise by a moderate 0.5% in 2004.

Taipei,China is unlikely to face significant inflationary pressures until late 2003 as long as domestic demand remains sluggish. Marginally higher housing costs and lower subregional inflation, coupled with lower demand for labor and low upward movement in wages, will also contain inflationary pressure. As a result of these factors, consumer prices will fall by about 0.1% in 2003. Stronger domestic and international demand for goods and services are expected to revive price pressure in 2004, lifting inflation to an annual average of 0.5%.

The unemployment rate in Hong Kong, China will remain high in 2003 as new graduates and school leavers enter the job market in the next few months, and is forecast to average 8.0% for 2003 as a whole. Government employment and training initiatives will only offer minimal and temporary relief to the labor market. Most employers also remain cautious about recruitment. Unemployment will recede to 7.5% in 2004 in line with improved economic conditions. High unemployment will remain a major issue in all East Asian economies except Korea.

Revenues from a few key commodities, such as copper, gold, and cashmere, are the main sources of the Mongolian Government's fiscal revenues and the country's foreign exchange earnings. This narrow base makes Mongolia highly vulnerable to the whims of nature and to price volatility in world commodity markets. In the short term, the major economic concern is whether macroeconomic stability can be achieved, against increasing pressure for more expansionary fiscal and monetary policies in the run-up to the June 2004 general elections. The forecasts for the Mongolian economy remain unchanged from *ADO 2003*.

The PRC's exports are forecast to rise by around 25% in 2003 and by around 15% in 2004 for several reasons. First, the payment of tax rebates on exports will be accelerated, though the rebate rate will be reduced. Second, despite some temporary SARS-induced setbacks, the PRC is still one of the most popular destinations for FDI in the world—indeed, it has become the largest FDI destination in the world. This will stimulate exports since foreign-invested firms produce over half of all exports.

Third, the weakening of the US dollar will improve the competitiveness of PRC exports to non-US markets as the yuan is pegged to the dollar.

Imports into the PRC are expected to grow faster than exports, increasing by about 36% in 2003 and by about 25% in 2004 due to surging demand stemming from its robust economic performance as well as from lower tariffs and reduced import barriers associated with WTO accession. Average tariff rates were lowered from 12.7% to 11.5% in 2002. Only eight categories of commodities needed import licenses in 2003, compared to 12 in 2002. The PRC will also require more imports for use in its fast-growing manufacturing sector. Since imports will increase faster than exports in the coming 2 years, the current account will record a surplus of about 0.2% of GDP in 2003 and a deficit of 0.1% of GDP in 2004.

Downside risks in the subregion have been reduced over the past few months but remain significant. (These are analyzed in Part 1 of this *Update*.) Particular concerns include the security situation in the subregion and the possibility of another SARS outbreak. These pose major risks to these forecasts.

Endnote

[1] The government structure of Taipei,China consists of the Office of the President, the National Assembly, and five branches (called "yuan"), namely the Executive Yuan, the Legislative Yuan, the Judicial Yuan, the Examination Yuan, and the Control Yuan.

Southeast Asia

The economies of Southeast Asia showed a mixed performance in the first half of 2003. This stemmed from different levels of strength in domestic demand and in the external sector, as well as from the varying impacts of the SARS epidemic. Investment remained generally weak due to a continuing uncertain business environment. Inflation is not an issue in most countries. The subregion's economic prospects are still primarily dependent on external developments, in particular, the strength of the recovery in the US, euro zone, and Japan. The subregion is forecast to grow by 3.9% in 2003 and by 4.9% in 2004.

Macroeconomic Assessment

GDP Growth

The countries of the Southeast Asian subregion continued to vary in terms of economic performance in the first 6 months of 2003, with Cambodia, Lao People's Democratic Republic (Lao PDR), Thailand, and Viet Nam experiencing relatively higher economic growth. For countries where quarterly data are available, quarter-on-quarter figures show a contraction for the Philippines in the first quarter of 2003 and no growth in the second, while Singapore experienced a severe contraction in the second quarter, mainly as a result of the outbreak of SARS. (See Part 3 for a fuller analysis of the impact of SARS on the subregion.) In the first half of 2003, quarterly expansion was strongest in Indonesia. While consumption remained a major factor in GDP strengthening (except in Cambodia and the Lao PDR), the contribution from investment continued to decline in the first half of 2003 in the subregion as a whole. External demand is recovering in general, though in Singapore and Thailand services exports were hard hit in the second quarter by SARS. Despite a fairly expansionary monetary and fiscal policy stance in the subregion, inflation remained subdued, generally coming in lower than the *ADO 2003* projections (with the notable exception of the Lao PDR). In most countries in the subregion (Cambodia and Viet Nam excepted), merchandise export and import growth was somewhat lower in the first half of 2003 than projected in *ADO 2003*. The aggregate current account surplus for the subregion is projected at about 6.1% of GDP in 2003.

GDP growth in Cambodia decelerated slightly in both 2001 and 2002, and a turnaround is unlikely this year. Riots in January in Phnom Penh and the outbreak of SARS had adverse impacts on the economy, particu-

Table 2.2 Selected Economic Indicators, Southeast Asia, 2002–2004, %

Item	2002	2003		2004	
		ADO 2003	*Update*	*ADO 2003*	*Update*
GDP Growth					
Average	4.1	4.0	3.9	4.8	4.9
Cambodia	5.5	5.0	5.0	5.5	5.5
Indonesia	3.7	3.4	3.4	4.0	4.0
Lao People's Dem. Rep.	5.9	6.0	5.5	6.5	6.0
Malaysia	4.1	4.3	4.1	5.1	4.9
Myanmar	-	-	-	-	-
Philippines	4.4	4.0	4.0	4.5	4.5
Singapore	2.2	2.3	0.5	4.2	4.5
Thailand	5.3	5.0	6.0	5.5	6.0
Viet Nam	6.4	6.9	6.9	7.1	7.1
Inflation Rate (CPI)					
Average	4.1	4.2	3.1	4.0	3.5
Cambodia	3.3	3.5	3.0	4.0	3.5
Indonesia	11.9	10.0	6.6	8.5	6.2
Lao People's Dem. Rep.	10.6	8.0	14.0	7.0	10.0
Malaysia	1.8	1.9	1.3	2.2	2.6
Myanmar	-	-	-	-	-
Philippines	3.1	4.5	4.0	4.5	5.0
Singapore	-0.4	0.5	0.4	1.0	1.2
Thailand	0.7	1.3	1.4	1.6	1.6
Viet Nam	4.0	5.0	4.0	5.0	4.0
Current Account Balance/GDP					
Average	7.8	6.3	6.1	6.0	6.7
Cambodia	-9.8	-8.9	-11.0	-9.3	-11.2
Indonesia	4.3	3.0	3.0	3.3	3.3
Lao People's Dem. Rep.	-5.6	-5.7	-4.0	-7.1	-5.0
Malaysia	7.6	6.3	6.2	5.7	7.2
Myanmar	-	-	-	-	-
Philippines	5.0	2.0	2.0	2.5	2.5
Singapore	21.5	21.5	20.8	19.3	22.0
Thailand	6.1	4.1	4.1	4.5	4.5
Viet Nam	-2.8	-3.7	-6.2	-5.2	-5.8

- = data not available; CPI = consumer price index; GDP = gross domestic product.

Sources: *ADO* database; staff estimates.

larly tourism—the number of tourist arrivals declined by 17% in the first 6 months of 2003 compared to the same period in 2002. The run-up to the general elections in July delayed investment decisions, especially in the private sector. Nevertheless, agriculture is expected to recover, having experienced a contraction in 2002, while the industry sector should maintain its solid growth, albeit at a slower pace. So far in 2003, the garment subsector has recorded a strong export expansion, following an increase in the country's export quota to the US.

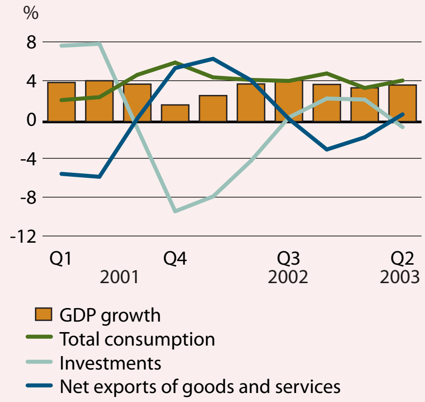
The Indonesian economy withstood the October 2002 Bali bombings relatively unscathed. GDP growth rates in the last quarter of 2002 and the first quarter of 2003 were higher than the prior-year figures. GDP grew faster in the first half of the year than in the same period in 2002 at a modest rate of 3.6%. The transport and communications subsector led the expansion, growing by 7.3%, while manufacturing posted a disappointing 2.5% growth rate. Meanwhile, household spending grew at a steady year-on-year rate of 4.7%, maintaining the trend of the last 2 years. Investment spending, which has been quite erratic over this same period, contracted in the second quarter of 2003, although this was not enough to offset the large gain in the first quarter. Nevertheless, the prognosis for investment has been clouded by the terrorist attack in Jakarta in August 2003. Through 31 July 2003, US$4.7 billion of foreign investment had been approved, or 46.3% higher than the corresponding period in 2002. Its translation into actual expenditure will, however, depend on developments in the investment climate. Although private capital inflows have gained momentum through the sale of some state assets, FDI remains limited in view of investors' concerns over security, underutilization of capital, and poor governance.

In the Lao PDR, the vital tourism subsector—though still difficult to analyze given the lack of data—is likely to have been significantly affected by the SARS epidemic in the first half of 2003. Consequently, GDP growth in 2003 is likely to slow somewhat to 5.5%, from a 5.9% expansion in 2002.

The Malaysian economy grew by 4.5% in the first half of 2003, significantly faster than the growth in the same period in 2002, but at a gradually slower pace (on a quarter-on-quarter basis) from the third quarter of 2002. Growth continued to be driven by aggregate domestic demand expanding by 4.4% in the first half of 2003, boosted by a $1.9 billion economic stimulus package in late May (although the package will more strongly impact growth in the second half of the year) and the central bank's decision to cut interest rates by 50 basis points to 4.5%, a 10-year low. Total consumption expenditure remained robust, rising by 5.6% in the first two quarters of 2003, largely due to public sector consumption, which grew strongly by 12.2% in the first half of 2003, which in turn was supported by higher expenditure on salaries, defense, and supplies. Gross fixed capital formation improved somewhat from a 5.1% contraction in the first half of 2002, but to only a 2.0% increase in the first half of 2003. Despite weak export growth resulting from the decline in electrical and electronic exports, external demand has increased its contribution since import decelerated in the first half of 2003. On the supply side, all sectors except for services and construction improved in comparison with the same period in 2002. The resource-based industries registered the highest sector growth rates in the first half of 2003, with mining at 7.4% and agriculture at 7.0%; services showed a modest 3.6%. Performance in the services sector was epitomized by contraction of the hotel and restaurant subsector, which was adversely affected by the SARS outbreak.

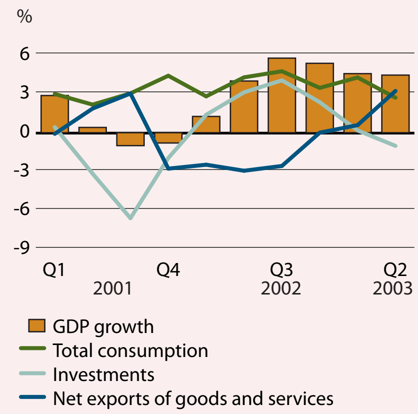
Despite a slight slowdown in GDP expansion to 3.9% in the first half of 2003, the Philippine economy remains relatively resilient, as shown by several indicators. Growth in gross national product accelerated to 4.8% in the first half of 2003 from 3.3% the year before, fueled by the surge in overseas worker remittances, which pushed up net factor income from abroad by nearly 18%. Also, a significant part of the deceleration in GDP is attributed to exogenous factors, including the effect of El Niño on agriculture, where growth decelerated to 2.3% in the first half of 2003 from 3.5% in the same period in 2002. In addition, after posting an exception-

Contribution to GDP Growth, Indonesia



Sources: www.bps.go.id; CEIC Data Company, Ltd.

Contribution to GDP Growth, Malaysia

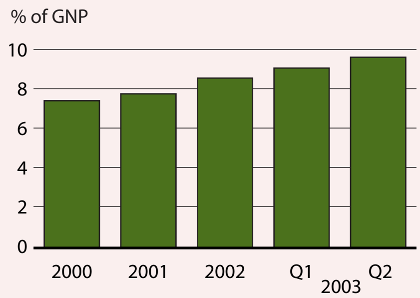


Source: www.statistics.gov.my.

Contribution to GDP Growth, Philippines

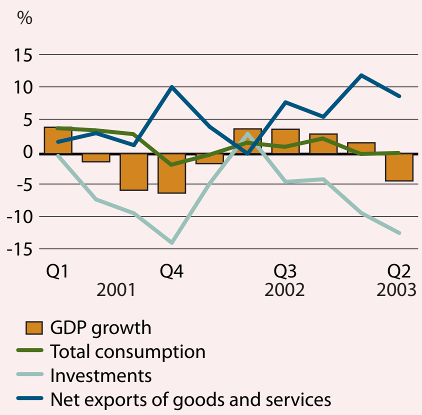
Source: www.nscb.gov.ph.

Overseas Workers' Remittances, Philippines



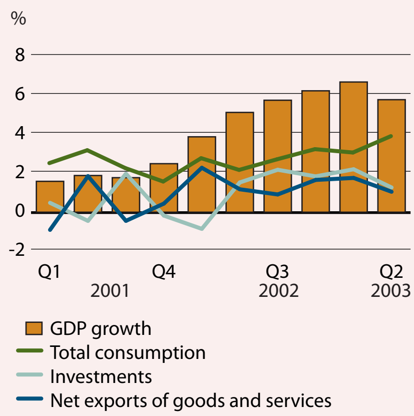
Source: www.bsp.gov.ph.

Contribution to GDP Growth, Singapore



Source: www.singstat.gov.sg.

Contribution to GDP Growth, Thailand



Source: www.nesdb.go.th.

ally high rate of 51% in 2002, it was natural that the expansion in mining and quarrying would slow. Finally, robust strengthening in food manufacturing underpinned the manufacturing sector, which rose at a faster rate in the first half of 2003 than in the same period in 2002. However, the continuing decline in public construction expenditure remains a concern, and was deep enough to result in a second quarter contraction in total fixed investment.

Singapore's economy stalled in the second quarter of 2003, falling by 4.2% from growth of 1.7% in the previous quarter. This was due both to weak external and domestic conditions. External demand grew by only 4.8% in the second quarter, down from 13.6% in the first, due to the SARS epidemic and the consequent fall in tourism earnings. Meanwhile, uncertainties over the global economy saw domestic private investment fall sharply for the fourth consecutive quarter, by 11%. While public consumption improved slightly in the second quarter, private consumption rose by only 0.2%, down from 0.9% in the first quarter. On the supply side, industries in both the goods and services sectors weakened in the second quarter of 2003. Weak manufacturing and construction activity contributed to a 7.0% decline in industrial output. Among the services sectors, hotels and restaurants were hardest hit and plunged by 33%, reflecting the impact of SARS. The economy remains fragile as retail sales have staged only a sluggish recovery, and visitor arrivals to Singapore were still 10% down year on year in August, indicating a prolonged impact from the SARS epidemic.

In Thailand, the momentum associated with the solid GDP growth of 5.3% achieved in 2002 carried through to the first half of 2003, despite a weaker global economic environment. The 6.2% recorded in the fourth quarter of 2002 was surpassed in the first quarter of 2003, with an outturn of 6.7%, though by the second quarter of 2003 the momentum had slowed somewhat to 5.8%. Domestic demand accounted for the bulk of this first half growth. This is also reflected in a second quarter decline of 13.9% in output of the hotels and restaurants subsector. The negative impact of SARS was felt in the fall in real services exports by 29.9% in the second quarter. Nonetheless, nominal merchandise exports continued their healthy progress, averaging 11.8% in the first half of 2003, given the improved external conditions.

Viet Nam was the fastest growing economy in the subregion in the first half of 2003, registering an estimated 6.9% annualized GDP growth. Despite some adverse impact of SARS, the services sector in general posted growth of 6.4% in the first half of 2003, which was higher than the growth during the same period in the previous year (5.9%). SARS affected tourist inflows mainly in April/May. As a result, tourist and business hotels experienced low occupancy, and to a certain extent tourist-related services including transport were affected. However, SARS did not affect local consumption. The vigorous economic expansion was buoyed by domestic demand that was led by both consumption and investment. Retail sales recorded a year-on-year rise of 10.5%. Total investment in the first half of the year is estimated at 34% of GDP, representing an increase of 20.5% on a yearly basis, due to robust performances of the nonstate and foreign-owned sectors, which rose by 24.5% and 22.0%, respectively, year on year. Continuing broad-based economic expansion and further improvement of the legal framework and administrative procedures have made the business environment more attractive to investment from both private domestic and foreign sources. On the supply side, industry and construction—the sector mainly responsible for the strong growth—posted an increase of 16.1% year on year.

Fiscal Situation

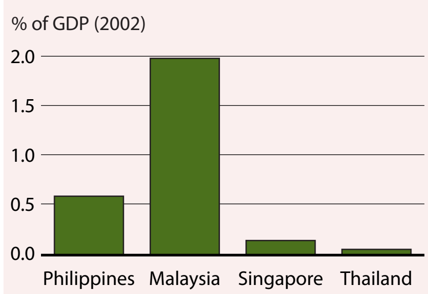
Fiscal deficits remained prevalent throughout the subregion. The fiscal situation of Cambodia remains a serious concern. Despite steady improvements in revenues—which reached 11.1% of GDP in 2002—the central government deficit breached 6.0% of GDP in 2001 and in 2002. Recent developments have not augured well in this area. Revenue collection in the first 5 months of 2003 reached only 35% of the total budget, less than the target of 42%, due to a fall in revenues from trade- and tourist-related activities. Meanwhile, donor-supported capital expenditures have been disbursed faster than programmed. Election-related spending may have caused part of the fiscal slippage.

The Indonesian Government has not announced any fiscal stimulus package in 2003. The tight fiscal stance of the last 2 years continued in the first half of 2003, when the overall deficit in the state budget was Rp2.5 trillion, or only 7.3% of the total planned deficit for the year. This was mainly because oil prices fared better than assumed in the budget and because subsidies and development expenditures were delayed. Nevertheless, no change has been made to the Government's deficit target of 1.8% of GDP for the full year, because of higher spending in the second half of the year, and possibly weaker revenue performance and unbudgeted costs.

In the Lao PDR, current revenues amounted to 13.4% of GDP and total expenditures to 18.2% of GDP in FY2002 (ended 30 September 2002). The Government has filled the budget gap of 4.8% of GDP largely with grants and concessional loans. Based on the preliminary estimates of the Ministry of Finance for the first 6 months of FY2003 however, tax collections remain significantly below target, with revenues reaching only 11.3% of GDP so far in FY2003. In response to the emerging shortfall, the Government introduced a series of measures at end-May 2003, of which the main points are (i) the reimposition of import duties and excise and turnover taxes on imported petroleum products; (ii) the introduction of a new, inflation-based excise tax on luxury goods (e.g., mobile phones); and (iii) the reimposition of fees and the collection of other service charges, including stamp duty.

The Malaysian Government announced a major stimulus package of $1.9 billion in May 2003, equivalent to 2.0% of GDP. The measures, aimed at providing relief to SARS-affected industries, included tax exemptions, extra government spending, and a cut in the central bank's intervention rate. The 7-month exemption given to hotels and restaurants under the stimulus package until December 31 will involve 940 hotels and 2,600 restaurants. While the economy is likely to show resilience for the rest of 2003, increased expenditure and lower revenue will likely widen the forecast government deficit to 6.0% of GDP from the 4.0% projected in *ADO 2003*. Although businesses continue to complain about the 28% corporate tax rate, fiscal pressures may make the Government less willing to cut taxes in the near future.

Relief and Fiscal Stimulus Packages for SARS, Selected Economies



Sources: www.nscb.gov.ph; www.statistics.gov.my; www.singstat.gov.sg; www.bot.or.th.

In the Philippines, the fiscal deficit is the Achilles heel of macroeconomic management. Thus, the recent improvement in the national Government's budget balance is significant and needs to be maintained. Continued progress in revenue collections allowed the Government to contain its budget deficit to P79.6 billion in the first half of 2003, well below the first half year deficit target of P102.2 billion. While this is a welcome development, no change has been made to the *ADO 2003* forecast of a 4.5% deficit of GDP for the year.

The relief package announced in August by the Government of Singapore will widen the fiscal deficit to S$2.3 billion or 1.4% of GDP in FY2003 (ending 31 March 2004), much higher than the S$900 million shortfall estimated by the Government in February this year. It will be an unprecedented third consecutive year of fiscal deficit for Singapore. The major component of the fiscal measures is a S$600 million plan to accelerate public infrastructure projects in FY2003 and FY2004, thereby helping the construction sector, which has experienced a contraction for nine straight quarters despite heavy government spending. The Government will also set aside S$100 million for a tourism recovery fund and S$40 million for a fund for unemployed Singaporeans. The anticipated budget deficit has forced the Government to postpone cuts in both corporate and income taxes, which currently have a top rate of 22%. Meanwhile the proposed 2% increase in January 2003 to 5% in the Goods and Services Tax was deferred to 2004; an increase of only 1%, to 4%, was applied.

In Thailand, the budget deficit for FY2003 (ending 30 September 2003) is expected to fall to just 0.7% of GDP, significantly lower than the 2.2% recorded in FY2002. This is mainly the result of buoyant tax receipts, accruing from strengthening economic growth. Tax revenue grew by more than 11% in the first 8 months of FY2003, reaching 70% of the annual target. The fiscal package for the SARS-affected industries announced in May amounted to B3 billion (0.1% of GDP), providing further fiscal stimulus to the economy in FY2003.

In Viet Nam, due to continued strong economic growth in the first half of 2003 and to strengthened tax management, total revenue in the first half of the year was estimated to have grown by 9.5% on a yearly basis, equaling 52% of the target for the whole year. Expansionary fiscal policy was maintained in the first half of the year in order to maintain the current investment level, to meet the expenses of ongoing reforms, and to finance preparations for the Southeast Asia Games in November. Total fiscal expenditure in the first half of 2003 grew by 14% year on year, accounting for 45.2% of the projected target for the whole year. As a result, the fiscal deficit is expected to widen to 4.8% of GDP from 3.5% in 2002.

Money and Prices

Inflation is not an issue in most of the countries in the subregion except for the Lao PDR. Generally low inflation and international interest rates have encouraged central banks in the subregion to continue their very accommodative monetary policies. The primary target has been domestic investment, which has been faltering in many countries. Some economies, however, are still constrained by a weak financial sector, which has limited the supply of credit.

Following a rise in 2002 due to poor agricultural performance, year-on-year inflation in Cambodia decelerated in the first 7 months of 2003 to 1.6%, from 3.3% in 2002. This stemmed partly from a stable exchange rate, slightly lower growth in money supply, and a sharp drop in real estate prices. It can also be attributed to seasonal factors, reflecting the fact that the main rain-fed rice crop is harvested in December–January.

Declining food prices and some appreciation in the rupiah helped reduce inflationary pressure in Indonesia in the first half of 2003. In the 12 months to July 2003, the CPI had risen by 5.8%, the lowest increase seen in 4 years. At its current pace, inflation is projected to average 6.6% in 2003, well below the *ADO 2003* forecast of 10.0%. Due to this favorable development, the yield on the 1-month Bank Indonesia Certificate (SBI) fell from 11.0% in January to 9.1% in early August. Over this period, the rupiah appreciated by about 5% against the US dollar.

Inflation in the Lao PDR was recorded at 16.3% year on year in the first quarter of 2003, with some improvement to 15.0% in July. If prudential monetary and fiscal policies are not closely observed, inflation may once again pose a serious threat to macroeconomic stability. A number of factors are responsible for the higher prices, including greater bank borrowing for a widening budget deficit, increased food prices, and depreciation of the kip.

Year on year, CPI inflation in Malaysia slowed to 1.0% in July from 1.7% in January 2003, due mainly to a slower rate of price increases for transport and communications. Monetary policy was further loosened as Bank Negara Malaysia lowered its 3-month intervention rate by 50 basis points to 4.5% in May. Since the Malaysian ringgit is pegged to the US dollar, it depreciated against most subregional currencies in the first 8 months of 2003, in the range of 0.2% to 2.1%.

Inflation year on year in the first 8 months of 2003 averaged 3.0% in the Philippines, well below the full year target of 4.5–5.5% set by the Bangko Sentral ng Pilipinas (BSP). Inflation has been stable even though the peso/US$ rate depreciated by about 4% in the first 8 months of the year, indicating that the exchange rate pass-through has been significantly reduced. Lower than expected inflation, greater exchange rate flexibility, and falling international interest rates allowed BSP in July 2003 to reduce its policy rates each by a quarter percentage point—overnight borrowing (to 6.75%) and lending (to 9.0%). The generally accommodative monetary policy stance has helped bank lending recover and grow by 3.9% year on year for the first 6 months of 2003 as compared to a contraction of 0.9% in 2002.

In Singapore, inflation averaged 0.4% in the first half of 2003 year on year, slightly higher than the 0.2% in the fourth quarter of 2002. On 10 July 2003, the Monetary Authority of Singapore recentered the exchange rate policy band at the lower level of the Singapore dollar leaving the width of the policy band unchanged, so allowing the Singapore dollar to depreciate slightly against the US dollar (by less than 0.5%), giving some spur to exports. The 3-month Singapore dollar interbank rate eased from 0.81% at end-2002 to 0.63% at end-June. Reflecting the weakening of the Singapore dollar as well as lower domestic interest rates, overall monetary conditions remained expansionary in the first half of 2003, and are expected to remain accommodative for the second half of the year, given the sluggish economic recovery.

Inflation remained low in the first half of 2003 in Thailand. The CPI rose by 1.7% year on year in June, while core inflation (which excludes food and energy items) rose by only 0.2% over the same period; core inflation continued decelerating to register zero growth in August. Overall inflation would have been much lower had it not been for the sharp rise in food prices (4.9% year on year) as a result of unfavorable weather conditions. Inflation is expected to remain low for the remainder of 2003. The Bank of Thailand (BOT) has an official policy of inflation targeting, and monetary policy is aimed at keeping core inflation within the 0–3.5% range. Faced with the risk of deflation—with core inflation hovering around zero—BOT cut its benchmark 14-day repurchase rate by 50 basis points, to 1.25%, in June. This move was also a response to concerns relating to high levels of capital inflows triggered by interest rate differentials that were leading to a rapid appreciation of the baht. The nominal exchange rate against the US dollar appreciated by more than 3%, from January through July.

Though it is still difficult to analyze given the lack of data, rapid credit growth is emerging as a concern in Viet Nam because of significant liquidity provision by the State Bank of Viet Nam (SBV) to state-owned commercial banks. SBV aims to keep inflation below or equal to 5.0% in 2003 despite rapid credit growth; it is being helped by declining food prices. Overseas remittances to the country through SBV reached US$1.1 billion in the first half of 2003, an increase of around 12% compared to the same period in the previous year. The rise was mainly attributed to better oversight of the foreign exchange market by SBV, particularly in terms of better recording of remittances. The dong generally remained steady against the US dollar in the first 6 months, depreciating by 0.6% in this period

External Sector Developments

The economies of Southeast Asia generally exhibited sizable current account surpluses, except for Cambodia, Lao PDR, and Viet Nam. However the surpluses are lower than those projected in *ADO 2003*, and have declined. The subregion as a whole will have a total surplus of US$35 billion, or 6.1% of aggregate GDP.

US customs data indicate that exports from Cambodia to the US—which takes in roughly 65% of the country's total merchandise exports—surged by about 34% in the first half of this year, largely due to the expansion of the garments quota. Import growth in the first half of 2003 was also vigorous, partly due to increases of intermediate goods for the garment industry. The current account deficit, excluding official transfers, should rise above 10.0% of GDP again in 2003. Foreign exchange reserves in May 2003 were reported at US$664.4 million—about 3.4 months of imports—differing little from the US$663.1 million at end-2002.

Total merchandise exports from Indonesia rose by 10.5% year on year in the first half of 2003, reaching US$30.4 billion, driven mainly by the oil and gas sector, where exports rose by 23.0% year on year, due mainly to higher oil prices and strong demand for gas. Imports increased at a faster pace, by 16.8% to US$16.3 billion year on year. Nonetheless, the net merchandise trade balance for the year is likely to remain at around US$25–26 billion in surplus, as was the case in 2001–2002.

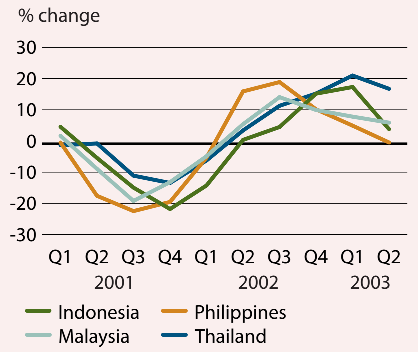
Exports grew by 3.6% in 2002 in the Lao PDR. Exports are expected to continue growing in 2003 on account of reduced tariffs in the PRC and Viet Nam, strengthening world commodity prices, and the implementation of Normal Trade Relations status by the US. Nevertheless, the Government's target of 10.0% annual export growth in 2003–2004 appears somewhat optimistic. Imports continued to fall in the first quarter of 2003, by 3.4%, following a contraction in 2002 of 1.8%. This trend, however, is likely to reverse itself as exports are expected to grow and as a significant share of imports constitutes inputs to export production. In addition, the further lowering of tariffs under the ASEAN Free Trade Area (AFTA) could lead to higher import growth. On balance, the Lao PDR's current account is expected to narrow moderately compared to the 2002 outturn and the *ADO 2003* projection, to 4.0% of GDP in 2003.

In Malaysia, while the current account continues to post a surplus, the capital account is registering a deficit, putting the overall balance in slightly positive territory for the first half of 2003. Although exports of electrical and electronic products, the largest contributor to total merchandise exports, decreased by 6.1% in the first 6 months of the year, the export growth of 6.9% was supported by a surge in chemical products and metal manufactures, which grew by 27.5% and 29.3%, respectively, year on year. Total merchandise imports declined by 1.6% as against the same period in 2002. Among the trading partners, the PRC became a net importer, allowing Malaysia to record a marginal net trade surplus with the PRC in the second quarter of 2003; the share of exports to the PRC in exports increased to 6.2% in July 2003 from 3.1% in 2000. On the capital account, the balance turned to a deficit of RM8.2 billion in the first quarter of 2003 from a surplus in the first quarter of the previous year as a result of a net outflow of FDI, representing Malaysian investments overseas and acquisition of foreign interests by Malaysian companies. Portfolio investment, on the other hand, recorded a lower net outflow of RM0.7 billion in the first quarter of 2003 when compared to a net outflow of RM2.9 billion in the year-earlier quarter.

The Philippines recorded a trade deficit of US$1.5 billion in the first half of 2003, compared to US$0.19 billion in the same period in 2002. Imports for the first 6 months of the year grew by 9.9% but exports by only 2.1%, due mainly to a decline in electronics exports, which account for 65% of total export revenue. This is primarily a result of poor sales to the US. However, the surge in overseas worker remittances in the first 6 months of 2003 should ensure a current account surplus for the whole year. The overall balance of payments is projected to be in deficit in 2003 due to the rise in residents' investment abroad and the slowdown in FDI, both of which are expected to continue throughout the year in the wake of greater domestic political uncertainties. Despite the good management of debt and its generally benign profile—long maturity, little bunching, and a high proportion of official development assistance—the growing debt burden of the economy needs policy makers' attention. These problems are likely, if anything, to worsen, with the Government's increasing tendency to finance development through debt rather than tax revenues.

Singapore's total merchandise exports decelerated significantly year on year to only 6.0% expansion in the second quarter of 2003 from 16.7% expansion in the first. Although all major trade components either regis-

Growth Rate of Total Exports, Southeast Asia



Source: CEIC Data Company, Ltd.

tered slower growth or contracted in the second quarter, the receipts from travel services plummeted by 46.1%. Imports also contracted, by 0.3% in the second quarter, switching from 9.7% growth in the first. Taken together, the current account surplus fell slightly to S$11.1 billion in the second quarter, from S$11.8 billion in the first. Nevertheless, the current account surplus more than compensated for the net outflow of S$6.2 billion on the financial account, which largely reflected portfolio investments and net outflows from the "other investment" account.

In Thailand, the rebound in exports in the second half of 2002 accelerated in 2003. Exports of goods and services rose by an impressive 18.0% in the first quarter of 2003, but slowed to 9.5% growth in the second quarter due to a SARS-induced 24.7% decline in services. Recent strengthening in goods exports has been driven by increased demand from the PRC (particularly for fruits and vegetables) and from ASEAN countries. The share of exports to the PRC has increased significantly over last few years, from 4.1% in 2000 to 7.1% in July 2003. Imports of goods and services also continued to grow strongly in 2003, increasing by 13.0 in the first 6 months of the year. The pickup in domestic demand associated with rapid economic expansion was the main factor. A merchandise trade surplus of US$2.5 billion was posted for the first half of 2003. The current account surplus totaled US$3.8 billion, but the balance of payments recorded a deficit of about US$1.1 billion in the first half of the year due to a net outflow on the capital account. The slight increase in nonbank flows, including portfolio investment, was offset by significant commercial bank outflows.

External debt totaled US$55.7 billion at end-June 2003, down from US$59.5 billion at end-2002. The debt stock has been trending downward since 1997. The ratio of public sector debt to private sector debt also continued to fall in 2003. This drop is in line with government efforts to repay loans from multilateral agencies such as the International Monetary Fund (IMF), World Bank, and ADB. Indeed, Thailand paid off the last of the loan arranged by IMF in July 2003, 2 years ahead of schedule. With a comfortable current account surplus, growing international reserves, and declining foreign debt levels, particularly private sector short-term debt, external vulnerability has fallen considerably since the financial crisis.

Total merchandise exports in the first half of 2003 for Viet Nam were estimated at US$9.8 billion, representing an increase of 32.6% on a yearly basis, which was due mainly to healthy growth of major export items, namely crude oil, textiles and garments, fisheries products, and footwear. The 35.7% increase in crude oil exports was largely attributable to higher global oil prices. Soaring textile and garments exports, at 66.4%, were mainly the result of a surge in sales prior to the imposition of a quota by the US on Viet Nam's textile and garment exports. Imports totaling US$12.2 billion, however, exceeded exports, pushing the trade deficit to US$2.4 billion. The strong growth in imports is attributable to (i) demand from industry, including export processing and preparations for the upcoming Southeast Asia Games to be held in December; (ii) higher prices; and (iii) a more liberal import regime than in previous years. Tourist arrivals fell steeply, due to the SARS epidemic. The Vietnamese Tourism Authority estimates output loss of about US$570 million in the tourism sector as a result.

Policy Developments

In order to ensure long-run economic growth and minimize short-term macroeconomic volatility in their economies, Southeast Asian governments will need to address a series of policy issues. On the domestic front, financial restructuring and reform still have some way to go in several countries. Fiscal consolidation is also an important issue to be addressed.

Cambodia was recently admitted to WTO, during the Cancun meeting in September 2003. The Cambodian Government also signed bilateral trade agreements with various trading partners, including Australia, EU, and Japan in June–July 2003. In the trade agreements, Cambodia pledged to cut import tariffs on agricultural and nonagricultural products and liberalize its services sector. In the area of fiscal reform, in June 2003 the Government had discussions with World Bank, IMF, and ADB on an integrated fiduciary assessment and public expenditure review, which outlined the following reforms to support economic growth and poverty reduction: (i) strengthening resource mobilization, (ii) reducing fiduciary risk to public funds, (iii) rationalizing public expenditure policy and management to better focus on high priorities, and (iv) accelerating civil service reform. Better fiscal management will become doubly important when Cambodia's debt service increases substantially after 2004.

The Indonesian Parliament passed several laws aimed at rapid resolution of labor problems, and attracting investments in the first half of 2003. The law on labor, approved in April, would provide corporations with flexibility in hiring and firing workers as well as provide workers with stronger bargaining power. It guarantees minimum standards on working conditions, workers' right to strike, and severance and compensation payments. On other structural issues, Parliament passed a Law on Anti-Money Laundering to enhance transparency and overall governance. Progress has been made with regard to the sale of state-owned assets, with the sale of 51% of Bank Danamon in May 2003 and the initial public offering of 20% of Bank Mandiri, Indonesia's largest bank, in July 2003. In addition, the Government is likely to raise around US$1 billion from the sale of three more banks over the rest of 2003, with much foreign interest evident. The Government is also advancing the financial sector regulatory reform agenda. Under the proposed institutional arrangements for the Financial Services Authority (OJK), Bank Indonesia (BI) will be the lender of the last resort, but retain the banking sector oversight authority until OJK is established. BI's focus has recently been on facilitating the real sector recovery process through lower interest rates. In 2004, BI plans to initiate the implementation of the Basel Core Principles, which incorporate market and operational risks in the calculation of the capital-adequacy ratio.

While macro stability and rising inflation are major concerns in the Lao PDR, there was a positive development with regard to the external debt owed to the Russian Federation, which accounted for almost 70% of the Lao PDR's long-term debt. In June 2003, the two governments agreed to write off 70% of the Lao PDR debt and service the remaining debt, valued at US$378 million, over a period of 33 years at a preferential interest rate. This improved the Lao PDR's debt service capacity significantly. The country's debt service capacity should also be improved by the planned construction of the 1,070 megawatt Nam Theun 2 hydropower plant. Though there are uncertainties over financing the project, which requires a total investment of about US$1.1 billion, the plant would significantly increase revenues for the country through sales of electricity to Thailand.

The decline of FDI to Malaysia has become a priority concern to the Government. FDI inflow has been weakening over the past few years. To tackle the issue, a plan to relax rules governing ownership of companies and property by foreigners has been announced. This policy change will mark a significant change in the Government's 30-year policy of trying to promote the economic interests of the Malay majority by requiring foreign companies to have a 30% stake held by Malay interests. In addition, the central bank lifted capital controls that directly limited the operations of foreign banks and multinationals in the country. Since the early 1980s, the central bank had required foreign multinationals operating in Malaysia to raise a minimum of 50% of their banking credit from local sources. While the lifting of capital controls will only affect the 12 locally based foreign banks, helping reverse their declining market share, it will force local banks to pursue more innovative strategies to retain their share of the market.

Fiscal consolidation is the primary macroeconomic challenge facing the Philippines. Recognizing this, the Government is in the process of implementing several measures, including (i) strengthening monitoring of large taxpayers, (ii) undertaking intensive audits on tax payments, (iii) filing bills in Congress on inflation-indexing of excise taxes and on redefining automobiles to remove excise tax loopholes, (iv) improving VAT collection, and (v) rationalizing fiscal incentives to minimize revenue leakages. Meanwhile, a bill has been prepared to restructure the Bureau of Internal Revenue (accounting for about 80% of budget revenue), which will lead to the establishment of an autonomous revenue authority. Significant efforts have also been made in financial sector reform. In January 2003, the Government introduced the Special Purpose Vehicle Act (SPV), designed to address the problem of constrained intermediation resulting from the high level of nonperforming assets of commercial banks, which now amount to 15.2% of total loans. The SPV gives to the private sector tax and accounting incentives to purchase NPLs. Further progress in cleaning the banks' balance sheets will not only improve their operations, but also pave the way for a larger presence of global investment banks in the Philippines. Better fiscal management and a reinvigorated financial sector should help spur private investment, which has not recovered from the Asian financial crisis. A persistently low investment rate is the most critical risk to higher, sustainable economic growth.

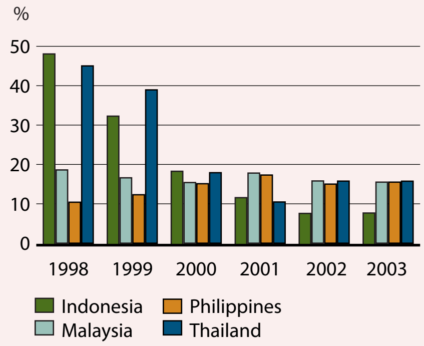
In Singapore, the Economic Review Committee, established in late 2001, announced recommendations in key areas in early 2003, to promote restructuring of the economy. Data from the US Department of Commerce on returns to US companies show that the economy no longer provides a rate of return superior to the Asian average.

Singapore signed free trade agreements with Australia, European Free Trade Association, New Zealand, and US in the first half of 2003. Discussions on free trade are ongoing with Canada, PRC, and Mexico. The agreement with the US brought preferential access to the local banking sector while waiving quantitative restrictions on wholesale and full foreign bank licenses for US-based banks.

In Thailand, there is a need to continue with reforms to further consolidate growth. The completion of banking and corporate sector restructuring remains vital for the recovery of business investment and the medium-term prospects for the economy. Unlike consumer spending, business investment has played only a limited role in the economic recovery. One reason is that over the past year, the pace of reform seems to have slowed somewhat, in the financial and corporate sector restructuring programs, after significant progress following the Asian financial crisis. The Government recently admitted that its target of reducing the banks' NPLs to 10.0% of total lending by end-2003 is unlikely to be met. Total NPLs now amount to B777 billion (approximately US$18.5 billion), or 16% of total bank lending. There has also been very limited progress in the development of the nonbank financial sector and capital markets. The key role played by exports in sustaining strong growth is seen in Thailand's continued program of trade liberalization. Recently, the Government started pursuing negotiations for free trade agreements on a bilateral basis with several key trading partners. These include an accord on closer economic relations and a free trade agreement with Australia, both of which are scheduled to be completed in October, and free trade agreements with PRC, India, and US.

Reform efforts to strengthen the banking sector in Viet Nam continued. In early June, in the second round of the Government's recapitalization program to help the five state-owned commercial banks raise their capital-adequacy ratios, the Ministry of Finance allocated D2.9 trillion (US$184 million) to four of them, and in the third round, in August, the Ministry allotted D2.1 trillion (US$135 million) to three of them. Meanwhile, reform efforts are continuing, so as to enhance Viet Nam's external competitiveness, to nurture the rapidly growing number of domestic private enterprises, and to further the country's regional and global economic integration. The Government has already carried out various policy measures under the framework of AFTA and of the bilateral trade agreement with the US. These are significant steps in Viet Nam's quest for WTO membership in 2005. The Government has made vigorous efforts to implement the public administration reform program and has achieved encouraging results in all the main areas covering legal and institutional, organization, and administrative procedures. The last element includes computerization and electronic-government initiatives, improving the quality of public officials, and decentralization.

Nonperforming Loan Ratios, Southeast Asia



Sources www.bi.go.id; www.bnm.gov.my; www.bsp.gov.ph; www.mas.gov.sg; www.bot.or.th.

Outlook for 2003–2004

The *Update* outlook for Southeast Asia for 2003 and 2004 is broadly in line with the *ADO 2003* projections that had sought to take into account the likely impact of SARS on countries in the subregion. However, projected average inflation for Southeast Asia is now notably reduced—from 4.2% to an estimate of 3.1% in 2003 and from 4.0% to 3.5% projected for 2004. This is because of faster than expected stabilization progress being made by Indonesia where inflation averaged nearly 12% in 2002. GDP growth for the subregion is now forecast at 3.9% versus 4.0% in

ADO 2003, because of weaker than projected performance in Lao PDR, Malaysia, and Singapore that is only partly offset by better than expected growth in Thailand. The subregion's current account surplus in 2003 is now expected to be 6.1% of GDP versus 6.3% forecast in *ADO 2003,* and well below the 7.8% of GDP surplus recorded in 2002.

GDP growth in 2004 is now forecast at 4.9%, marginally higher than the 4.8% projection in *ADO 2003*. All countries are expected to improve on or maintain their 2003 GDP growth performance, though current projections for the Lao PDR and Malaysia are trimmed and those for Singapore and Thailand edged up as compared to *ADO 2003*. The 2004 projection for the current account surplus for the subregion has been raised to 6.7% of GDP, from 6.0% in *ADO 2003*, as strengthened estimates for Malaysia and Singapore more than offset some estimated weakening in the current account developments in Cambodia and Viet Nam.

The outlook for 2003–2004 remains favorable in Cambodia, even though the country faces numerous challenges. GDP growth is expected to decline from 5.5% in 2002 to 5.0% in 2003, mainly due to lower tourist arrivals in the early months of the year, but then to increase modestly to 5.5% in 2004 as the world economy consolidates its recovery. However, economic expansion has not been broad-based and is concentrated mainly in garment exports and tourism. The expected phasing out of garment quotas with the expiry of the Multifiber Arrangement by end-2004 will therefore put part of this expansion at risk over the medium term. Moreover, the country is expected to face tougher competition in foreign markets. The exchange rate is expected to be stable. Meanwhile, inflation is forecast to reach 3.0% and 3.5% in 2003 and 2004, respectively. Macroeconomic stability and implementation of reforms in various sectors will be the major factors contributing to an improved investment climate and sustainable economic growth.

The fallout from recent terrorist attacks is likely to further cloud the investment climate in Indonesia. Economic growth is predicted to decelerate in the second half of 2003, bringing the full year average to 3.4%. Fiscal options in the future will be limited due to resource and debt constraints and unpredictable developments in the privatization program. For 2003, inflation is forecast to average 6.6%, aided by a fairly stable rupiah that has resulted from a strong current account surplus and hefty international reserves. The more favorable external environment and the absence of any further shocks should be enough to push the economy to higher growth of 4.0% in 2004.

GDP growth has been revised down by 0.5% to 5.5% in 2003 and to 6.0% in 2004 for the Lao PDR due to the onset of the SARS epidemic and higher than expected inflation outcomes. Despite the laudable fiscal measures introduced in May, inflation is still expected to remain in double digits in 2003 and 2004, though its acceleration should significantly diminish. Nevertheless, vigilance in the conduct of fiscal and monetary policies and the continued implementation of reforms in various sectors is going to be essential if macroeconomic stability is to be sustained in 2003 and 2004.

In Malaysia, the accommodative monetary policy and the fiscal stimulus package supported steady growth in the first 6 months of 2003. The economy is, however, projected to expand by only 4.1% in 2003 and by 4.9% in 2004, slightly less than projected in *ADO 2003*, because of the uncertain economic outlook in key export markets. Exports are projected to grow at a slower rate of 6.4% in 2003, rather than the 8.1% projected in *ADO 2003*, due to the weak growth in electronic and electrical exports in the first half of 2003. External demand became the major driver of economic growth in the second quarter of 2003 and, given the declining trend in investment and consumption, global recovery is key for the economy gaining momentum. The fiscal deficit is projected at 6.0% of GDP in 2003, or wider than the 4.0% projected in *ADO 2003*; the fiscal stance is expected to be expansionary in 2004, as a general election must be held by January 2005. The Government is not expected to balance the budget in the near term while the global economic recovery remains fragile and external uncertainties persist.

Political uncertainty, the continuing civil strife in the large southern island of Mindanao, and slow progress in key economic legislation and policy reforms complicate the economic outlook for the Philippines. Nevertheless, the economy's resilience, the prospects for an improvement in the fiscal deficit, and progress in financial reform, are likely to support a GDP growth rate of around 4.0% for the whole of 2003, in line with the forecast made in *ADO 2003*. In 2004, this is expected to accelerate to 4.5% with agricultural growth expected to pick up and investment to strengthen as the global economic environment improves further. However, without a stronger recovery in output, unemployment is likely to remain at around 10% in 2003–2004. In view of the recent fiscal revenue measures, it is expected that the budget deficit will be contained at around 4.5% of GDP for 2003 and fall slightly to 4.0% of GDP in 2004. In 2004, the current account is expected to remain in surplus, with an export pickup and continued strong overseas worker remittances.

The Government of Singapore will continue its expansionary policies and this, along with the end of the SARS epidemic, is expected to provide a more favorable environment for the second half of 2003. However, the steeper than expected 4.2% GDP contraction in the second quarter will bring down the 2003 GDP growth forecast to only 0.5% for the year compared to the 2.3% projected in *ADO 2003*. As a result, unemployment continues to remain high—the authorities forecast 4–5% for 2003. Recovery of investment demand is key for Singapore to regain its economic momentum. GDP growth is expected to strengthen in 2004 to 4.5% after the severe drop in 2003, though this prospect will be greatly affected by external events.

Thailand is the only Southeast Asian country where the *ADO 2003* forecast has been upgraded significantly—from 5.0% to 6.0%. Like most other countries, the recovery in global demand will be the main factor in growth in 2004, at 6.0%. Private consumption spending is expected to remain high for the remainder of this year and in 2004, supported by historically low interest rates. Despite some slowdown in the second quarter of 2003, investment spending and exports are also expected to strengthen in the second half of the year, and to improve further in 2004. Growth prospects still very much depend on external developments as exports have been a major factor driving the economy, although domestic demand has played an important role in recent years.

Viet Nam's full year GDP growth in 2003 should mirror the estimated first half performance, with an outturn of 6.9%. What may constrain future expansion is the widening current account deficit. The current account deficit is projected to widen considerably to 6.2% of GDP in 2003 from 2.8% in 2002. The imposition of the US quota will hurt exports of garments and textiles to the country, though a 10% export expansion is still projected. Heavy import demand will be sustained by reductions in the tariff level under the AFTA commitment and rising import requirements of an expanding industry sector. Nevertheless, FDI, private remittances from overseas Vietnamese, and overseas development aid should readily cover the current account deficit. Meanwhile, the Government is expected to maintain its expansionary fiscal policy to meet the costs of ongoing and forthcoming reform and additional infrastructure projects. Given these considerations, GDP growth in 2004 is expected to rise somewhat to 7.1%.

South Asia

A recovery in growth in South Asia in 2003 appears on track as a return to normal weather conditions boosts agricultural production, as external demand strengthens, and as political and security conditions stabilize. A rebound in agricultural incomes and growing confidence are underpinning strengthening domestic demand. The prospect of a stronger global economy augurs well for somewhat accelerated growth in 2004, though progress in fiscal consolidation and structural reforms will be necessary in all countries to sustain rapid, broad-based growth.

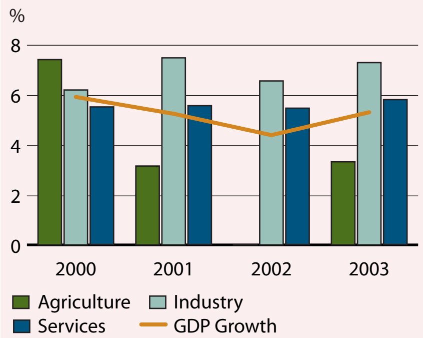
Macroeconomic Assessment

GDP Growth

The relatively large share of agriculture in output and employment in the economies of South Asia makes GDP growth vulnerable to the vagaries of the weather. This was amply demonstrated in 2002[1] when adverse weather conditions caused a decline in agricultural output in India, stagnation in Bangladesh, and low growth in Nepal; this held overall South Asian GDP growth to only 4.2%. Favorable weather conditions supported by a strengthening in external and domestic demand indicate that South Asian economic growth in 2003 will be 5.8%, marginally better than *ADO 2003* forecast of 5.7%. The impact of the SARS epidemic on the subregion's economies in the first half of 2003 appears to have been negligible. Inflation remains moderate in the subregion, though an expected pickup in the subregional average rate in 2003, mainly due to agricultural and oil price pressures, is now projected to come in at 5.5% (above the 4.9% *ADO 2003* forecast). Balance-of-payments developments in 2003 are generally favorable, with strong export growth and current account balances, aided by solid gains in worker remittances. International reserves have increased in all countries and there has been upward pressure on some exchange rates against the US dollar.

In Bangladesh, GDP growth for FY2003 (year ended 30 June 2003) is estimated to have increased to 5.3% from 4.4% in FY2002. This was led by the agriculture and industry sectors, aided by higher domestic and external demand. Increased agricultural output reflected a recovery in foodgrain production, with the latter increasing by 4.1% compared to a 3.2% decline in FY2002, mainly due to favorable weather. Industrial output is estimated to have increased to 7.3% growth in FY2003 from

GDP Growth by Sector, Bangladesh



Source: Bangladesh Bureau of Statistics.

Table 2.3 Selected Economic Indicators, South Asia, 2002–2004, %

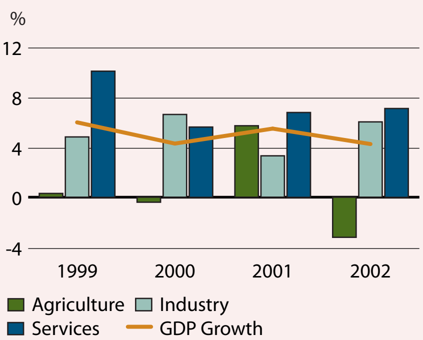
Item	2002	2003		2004	
		ADO 2003	*Update*	*ADO 2003*	*Update*
GDP Growth					
Average	4.2	5.7	5.8	6.1	6.1
Afghanistan	-	-	-	-	-
Bangladesh	4.4	5.2	5.3	5.8	5.7
Bhutan	7.7	-	-	-	-
India	4.3	6.0	6.0	6.3	6.3
Maldives	6.0	4.2	4.2	2.8	2.8
Nepal	-0.5	1.5	2.3	3.5	3.5
Pakistan	3.4	4.5	5.1	5.0	5.0
Sri Lanka	4.0	5.0	5.0	5.5	5.5
Inflation Rate (CPI)					
Average	3.7	4.9	5.5	5.0	4.9
Afghanistan	-	-	-	-	-
Bangladesh	2.4	3.8	5.1	4.5	4.5
Bhutan	2.7	-	-	-	-
India[a]	3.6	5.0	5.8	5.0	5.0
Maldives	0.9	-	-	-	-
Nepal	2.9	5.0	4.5	5.0	5.0
Pakistan	3.5	4.0	3.1	5.0	4.0
Sri Lanka	10.2	8.5	6.5	7.0	6.0
Current Account Balance/GDP					
Average	0.9	0.0	0.8	0.0	0.6
Afghanistan	-	-	-	-	-
Bangladesh	0.4	-1.3	0.6	-2.5	-1.2
Bhutan	-1.7	-	-	-	-
India	0.7	0.1	0.4	0.2	0.6
Maldives	-6.9	-	-	-	-
Nepal	-7.2	-5.0	-9.4	-5.0	-5.0
Pakistan	4.8	2.2	5.9	0.9	4.0
Sri Lanka	-1.6	-3.5	-2.5	-4.5	-3.0

- = data not available; CPI = consumer price index; GDP = gross domestic product.

[a] Wholesale price index.

Sources: *ADO* database; staff estimates.

GDP Growth by Sector, India



Source: http://www.mospi.nic.in.

6.5% in FY2002 with more robust manufacturing activity. The upturn in medium- and large-scale manufacturing output during the first 10 months of FY2003 (to 5.2% from 4.1% in the corresponding period of FY2002) was due to a recovery in the export-oriented chemicals, processed foods, and knitwear and garment industries; small-scale manufacturing, power generation, and gas production are estimated to have experienced even faster growth. Construction activity moderated due to an ongoing oversupply of commercial buildings and apartments, and overall investment activity increased only marginally.

The Indian economy appears poised for a strong recovery in FY2003 (year ending 31 March 2004). Growth declined to 4.3% in FY2002 from 5.6% a year earlier, though performance was mixed across sectors. A sharp 3.2% decline in the important agriculture sector caused by drought masked a 6.0% upturn in the industry sector and continued vigorous growth in services output. With an apparent normal monsoon through September 2003, agricultural growth appears to be rebounding while manufacturing growth momentum in the early months of FY2003 remains powerful. Buoyant industrial performance continues to be supported by strong growth in merchandise exports and a construction boom.

The improved security situation in Nepal following a cease-fire agreement on 23 January 2003 facilitated a moderate economic recovery in the second half of FY2003 (year ended 15 July 2003). The GDP growth rate for the year is provisionally estimated at 2.3%, based on some revival in manufacturing, export trade, and tourist arrivals. Tourist arrivals from India in January–August 2003 were up by about 33% from the same period a year earlier and may represent some diversion from other markets due to SARS. In FY2002, GDP fell by 0.5%, the worst outcome in the past two decades, as a result of the escalation in the insurgency, an irregular monsoon, and weak external demand.

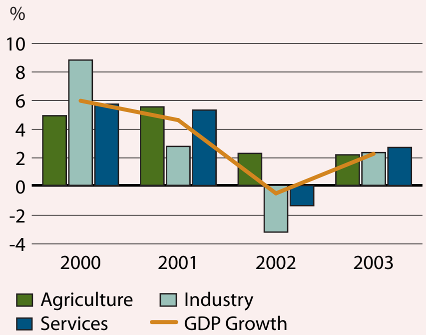
Pakistan's economic performance showed a sharp, broad-based improvement in FY2003 (year ended 30 June 2003) with GDP growing by 5.1% (3.4% in FY2002), the fastest pace in the last 6 years. This reflected an accelerated expansion in large-scale manufacturing, a revival of growth in major crops (output had fallen in the previous 2 years), and strengthening in the services sector. The broad advance was built on favorable weather conditions, strong export performance (especially in textiles), and the payoff from programs of macroeconomic and structural reforms undertaken in recent years. Gross fixed investment, however, remained stagnant at 13.1% of GDP, an all-time low. This stagnation appears explained in part by excess industrial capacity and perhaps also by the political uncertainty generated by the confrontation between the Government and the opposition over constitutional amendments.

Sri Lanka's economic performance in 2003 made a promising start with GDP up by 5.5% in the first quarter. The SARS outbreak in East Asia and the conflict in Iraq had little impact on the economy. Services output grew by 7.6% in the first quarter accounting for more than 70% of growth as tourism and shipping continued their resurgence from the impact of the 2001 bombing of the international airport. Notably, industrial production grew by 5.4% in the first quarter; electricity output was up by 20% and with none of the load shedding that had adversely affected the economy in 2002. Agriculture, which had largely recovered from the 2000–01 drought in 2002, grew by about 1% in the quarter but turned in a mixed performance: paddy production was solid but plantation crops showed poor results. A positive leading indicator was the 7.6% increase in the construction industry, ending five quarters of decline.

Fiscal Situation

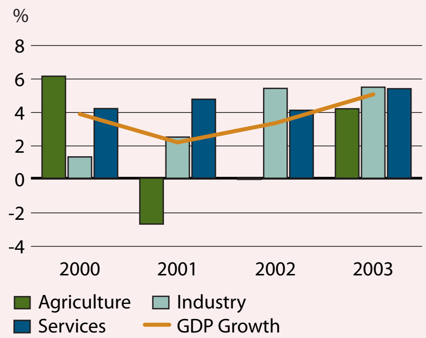
Fiscal consolidation remains a major area of concern in South Asia as wide deficits and high debt levels are commonplace. However, Bangladesh improved its budgetary performance in FY2003. Revenue fell short of the original target but is estimated to have risen by 12.4% to 10.4% of GDP; the gain reflected revenue measures adopted in the budget and improved tax administration in a growing economy. Despite higher than planned current expenditure caused mainly by higher interest payments,

GDP Growth by Sector, Nepal



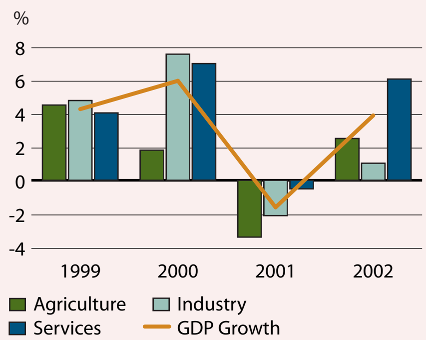
Source: *Economic Survey, FY2002/2003*, available: http://www.mof.gov.np/publication/budget/2003/survey.php.

GDP Growth by Sector, Pakistan



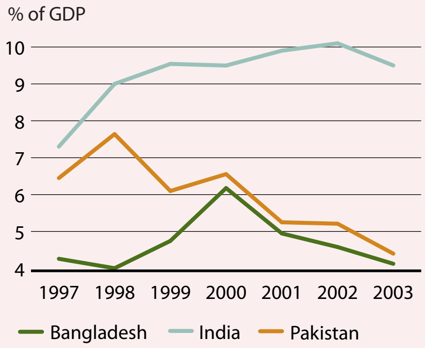
Source: *Economic Survey 2002–03*, available: http://www.finance.gov.pk/survey/home.htm.

GDP Growth by Sector, Sri Lanka



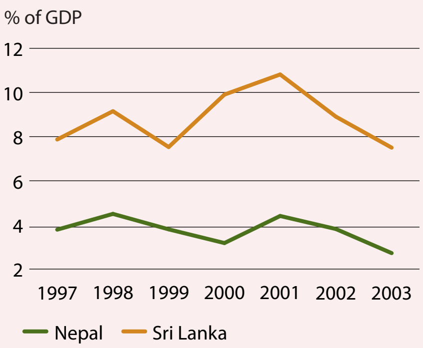
Source: http://www.centralbanklanka.org.

Fiscal Deficit



Sources: *ADO* database; http://www.rbi.org.in; http://www.finance.gov.pk; staff estimates.

Fiscal Deficit



Sources: Central Bank of Sri Lanka, *Annual Report 2002*, available: http://www.centralbanklanka.org/annual.html; http://www.mof.gov.np; staff estimates.

overall expenditure was held slightly below the budget target, as low-priority development projects were pruned. As a result, the overall deficit for FY2003 is estimated at 4.2% of GDP, lower than the 4.6% of GDP outturn in FY2002.

India's fiscal deficits in FY2002 (year ended March 2003) remained large. The central government deficit (including privatization funds) is provisionally estimated at 5.9% of GDP, against an original target of 5.3%. The deficit of the state governments is estimated at 4.7% of GDP, indicating that the consolidated general government deficit was 10.1% of GDP for the year. Total government debt (center and states combined) was 75.5% of GDP at end-FY2002. The central government budget for FY2003 envisages only a small improvement in the central government deficit to 5.6% of GDP. Data for the first quarter of FY2003 (April–June 2003) indicate a 16% decline in total revenue from a year earlier but also lower spending that offset the impact on the deficit. A major reform, namely the introduction of VAT in FY2003 to replace the states' general sales taxes, was postponed. In view of the low prevailing interest rates, various programs are under way to refinance the outstanding debts of central and state governments to reduce interest costs.

In Nepal, the Government revised the FY2003 (year ended 15 July 2003) budget at midyear to account for lower economic activity in the first half of the fiscal year: tax revenue, external aid, expenditure, and the overall deficit were all revised downward. After the announcement of the cease-fire, economic activity and tax collection improved. Revised estimates indicate that revenue collection exceeded the revised budget target of 11.9% of GDP and domestic financing was contained within the planned level of 2% of GDP. Capital spending, however, was under budget, reflecting continued implementation constraints at the local level.

The Government in Pakistan tightened fiscal policy in FY2003, resulting in a decline in the overall fiscal deficit to 4.4% of GDP, compared to 5.2% of GDP in FY2002. Tax revenues, which met the budget target, increased to 13.7% of GDP with broad-based gains resulting from recovery in domestic economic activity and a sharp increase in imports as well as reforms of tax administration. Development expenditure was lower than planned and reflected continued problems with the implementation capacity of the Government.

Fiscal performance in Sri Lanka in the first 5 months of 2003 shows certain weakness, particularly in terms of the revenue targets. VAT did not perform up to expectations but other revenue sources were compensatory. Less than budgeted spending on the capital side underlines the need for addressing long-standing aid utilization issues, but this was offset by some current account overspending. Keeping spending on track and improving VAT performance are issues if the targeted improvement in the overall deficit to 7.5% of GDP from 8.9% of GDP in 2002 is to be achieved.

Money and Prices

Monetary policy has continued to be generally accommodative in South Asia in 2003 to foster economic growth. This has been facilitated by sustained low world interest rates, the general absence of price pressures, and underutilized domestic production capacity.

In Bangladesh, broad money (M2) growth increased to 15.6% in

FY2003 (up from 13.1% in FY2002), mainly due to a sharp rise in the net foreign assets of the banking system, buoyed by gains in overseas worker remittances. Growth in domestic credit in this period moderated due to reduced budgetary financing and a more cautious attitude toward private sector lending by commercial banks. The banks' commercial lending rate remained steady at about 12%. Monetary policy restraint by Bangladesh Bank was achieved by sterilization of international reserve accumulations through the sale of treasury bills; these rates were allowed to rise from 5% to 7% to reflect market conditions.

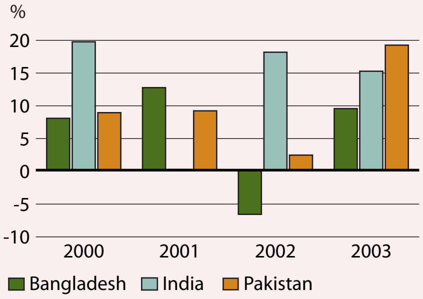
Money supply (M3) growth in India moderated to 12.2% in the year to June 2003, after growing by 15.1% in the year to March 2003. Monetary policy has continued to be aimed at maintaining easy liquidity conditions to foster economic growth but high real interest rates and risk-adverse banks restrained private credit growth. The continuation of a large overall payments surplus has meant that the Reserve Bank of India (RBI) continues to intervene in the foreign exchange market, accompanied by sterilization operations, to contain rate volatility and limit the appreciation of the Indian rupee. Reflecting signs of Nepal's economic recovery, broad money (M2) growth increased to 8.1% in FY2003 (up from 4.4% in FY2002) mainly due to increased private sector credit. However, broad money growth was still much lower than the 12.0% target rate. To support the economic recovery, the Nepal Rastra Bank lowered cash reserve requirements by 1 percentage point in August 2002.

In an environment of stable prices, the State Bank of Pakistan (SBP) continued to pursue an easy monetary stance in FY2003 to stimulate investment and growth. Interest rates maintained a steep downward trend and the average lending rate charged by banks on overall advances declined by 554 basis points (bps) to 7.6% over FY2003; the lending-deposit rate spread fell by 327 bps. Despite SBP's policy of partial sterilization of foreign exchange purchases in the interbank market, broad money supply increased by 17.6% in FY2003, compared to 15.4% in FY2002, an uptick triggered exclusively by a larger expansion in the banking system's net foreign assets.

In Sri Lanka, a core objective of the central bank is further progress toward price stability, though bank policy rates have been adjusted downward as inflation moderates to foster investment and growth. Over the first 7 months of 2003, the money supply (M2) increased by 6.1%, in line with the central bank's program target of about 13.5% expansion in M2 for the entire year, which aims to slow inflation to about 6.5%. Domestic credit to the private sector was the source of most of the money supply expansion in this period, while commercial banks' average prime lending rate fell by about 390 bps to 10.4%.

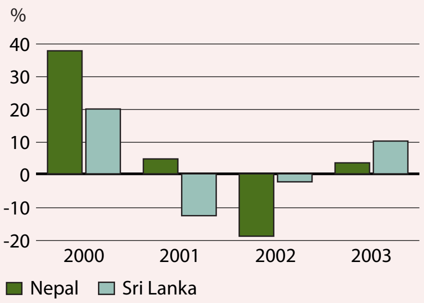
Price developments have varied throughout the subregion, though inflation is generally moderate and is not a major policy issue except in Sri Lanka. In Bangladesh, annual average inflation moved up to 5.1% in FY2003 from 2.4% in FY2002. Food prices were the main driving force. Inflation has also picked up in India where the wholesale price index was 5.4% higher than a year earlier in the first quarter of FY2003. Higher global oil prices and effects from the past drought on certain agricultural products were the main causes of the rise. Average inflation in Pakistan moderated to 3.1% in FY2003 from 3.5% in FY2002, as comfortable supplies of both food and manufactured goods, as well as exchange rate appreciation, offset oil price pressures. In Sri Lanka, the 12-month moving average of CPI inflation fell to 6.1% by June 2003 from over 12% a year earlier. The slowing of food price increases was a major factor, but the Government also intervened to smooth local oil prices during the weeks preceding the conflict in Iraq.

Export Growth



Sources: *ADO* database; http://www.rbi.org.in; http://www.sbp.org.pk.

Export Growth



Sources: Central Bank of Sri Lanka, *Annual Report 2002*, available: http://www.centralbanklanka.org/annual.html; Nepal Rastra Bank; staff estimates.

External Sector Developments

South Asian export growth for 2003 is estimated to be 14.7%. Solid export gains were recorded by most countries in the subregion, whereas in 2002 strong performance in India essentially accounted for the subregion's marked 11.5% export expansion. In Bangladesh, preliminary data show that exports increased by 9.4% in FY2003. Exports showed a marked pickup after February and were broad based, with garment exports recording a modest increase in value since April as strong volume growth offset low unit values. India's exports staged a vigorous revival and grew by 18.0% in FY2002. Customs data indicate that export growth moderated to about 11% year on year during April–June 2003 (first quarter FY2003). Capacity expansion and competitive pricing have boosted traditional exports, such as textiles, light manufactures, and jewelry. Preliminary estimates indicate that Nepal's exports increased by 3.3% in FY2003 (year ended 15 July 2003) after their sharp 19% fall in the previous year. The improved performance was mainly due to an upsurge in readymade garment exports that overcame declines in woolen carpet and pashmina exports. Exports to India fell by about 5% as quantitative restrictions on some major exports (set in the renewed Nepal-India trade treaty) took hold. Pakistan's exports grew by 19.1% in FY2003, substantially exceeding the target and representing a strong recovery from the small 2.3% increase in the previous year. Export gains were broad based and reflected increases in both volume and the dollar price. Movement to higher-value textile items and elimination of under-invoicing as the currency appreciated appear to have aided the strong performance. Sri Lanka's exports increased by 18% in the first 7 months of 2003 compared to the same period a year earlier. Export performance was boosted by a major recovery in industrial exports, including garments and machinery, but agricultural exports contracted, due mainly to a drop in tea exports.

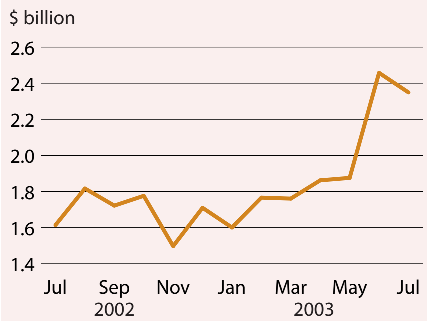
Imports to South Asia in 2003 are now expected to grow by about 12.5%, a somewhat larger increase, as with exports, than envisaged in *ADO 2003*. In Bangladesh, imports are estimated to have risen by 10.3% in FY2003 with the entire expansion taking place in the second half of the year. There were large rises in imports of rice, edible oils, sugar, and petroleum products that offset a decline in capital goods imports. Imports to India grew by 13.6% in FY2002 (year ended March 2003). Higher capital goods and food imports helped raise non-oil imports by about 8%, while oil imports (about one fourth of the total) were up by about 27%. Preliminary customs data for April–June 2003 indicate quite rapid import growth, with oil imports up by nearly 18% and non-oil imports up by about 31% from a year earlier. Nepal's imports are estimated to have grown by 15.2% in FY2003 after a 10.9% drop in the previous year. The revival appears to largely reflect increased imports of machinery and raw materials used in export production and higher oil prices. Imports to Pakistan are estimated to have increased by 21.1% in FY2003, largely due to increased oil prices and a marked expansion in raw materials imports. Sri Lanka's imports rose by 8% in the first 7 months of 2003. Most of the increase was due to greater imports of intermediate goods used in export production, though imports of consumer durable goods have also risen.

Current account balances are expected to remain relatively healthy in 2003 for South Asia, averaging about 0.8% of GDP. In Bangladesh, despite an estimated increase in the trade deficit to $1.9 billion and a continued services deficit, strong growth in worker remittances maintained the FY2003 current account balance (excluding grants) in surplus estimated at $310 million or 0.6% of GDP. India's current account surplus substantially strengthened to $3.7 billion or 0.7% of GDP in FY2002, almost entirely due to a widening of the invisibles surplus resulting from robust growth in information and communications technology earnings and worker remittances. Based on high growth expected in merchandise exports and a considerable surplus on the invisibles account, it is expected that the current account surplus will be 0.4% of GDP in FY2003. Preliminary estimates show Nepal's current account deficit to be 9.4% of GDP in FY2003, despite some revival in tourism and continued large worker remittances. The deficit was well above that recorded a year earlier and the *ADO 2003* projection, due to increased imports and only a marginal improvement in exports. Pakistan's current account surplus markedly strengthened to $4.0 billion or 5.9% of GDP in FY2003. Much of the improvement was due to higher worker remittances, though lower interest payments were also important. In Sri Lanka, the trade deficit narrowed by about 16% to $824 million in the first 7 months of 2003. The projected current account deficit has been reduced by a percentage point to 2.5% of GDP.

The general strengthening in balance-of-payments developments in South Asia has been reflected in reserve holdings and exchange rates. In Bangladesh, a strengthened current account more than offset a deficit on the financial account and raised the estimated FY2003 overall surplus above the $365 million level recorded a year ago. Official reserves increased by $305 million over the first 11 months of the year, i.e., to end-May, and were buoyed in June by the release of a large ($308 million) World Bank development credit. At end-June 2003, official reserves were nearly $2.5 billion (bringing import cover temporarily to about 3 months). At end-May 2003, the Bangladesh Government stopped setting an official band for the taka, effectively adopting a floating exchange rate. Subsequent market rates through July were little changed.

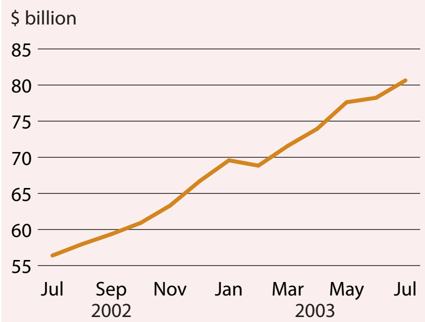
India's overall payments surplus was estimated at $17 billion in FY2002. Official foreign currency reserves increased by $20.8 billion in the year, following an $11.5 billion gain a year earlier, and amounted to $71.9 billion at end-March 2003. Subsequently, foreign currency reserves went up by $10.7 billion through 29 August 2003, pointing to continued balance-of-payments strength in FY2003. Capital account developments, including very large inflows from nonresident Indians, have underpinned these historic large increases in reserves. However, valuation gains on foreign currency assets added about $4 billion to reserves in FY2002. A favorable interest rate differential and the expectations of an Indian rupee appreciation appear to be the main driving forces behind the accretion in foreign reserves. The Indian rupee/US dollar rate appreciated by

Foreign Exchange Reserves, Bangladesh



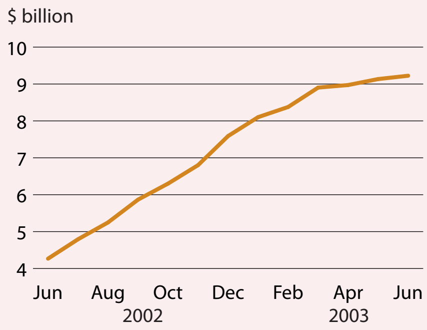
Source: http://www.bangladesh-bank.org.

Foreign Exchange Reserves, India



Source: http://www.rbi.org.in.

Foreign Exchange Reserves, Pakistan



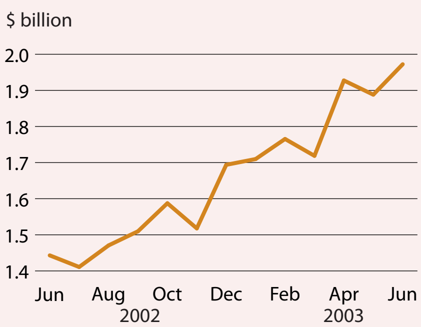
Source: http://www.sbp.org.pk.

about 2.3% in FY2002, and by about 3.4% in the first 5 months of FY2003 through August 2003.

In Nepal, despite the weakening in the current account balance, the overall balance of payments in FY2003 is estimated to have been in surplus equal to about 1.5% of GDP, due to higher foreign aid and unrecorded inflows. Official foreign exchange reserves increased to over $1 billion, equivalent to about 8 months of imports of goods and services. In Pakistan, due mainly to the large current account surplus and an increase in FDI, partly boosted by privatization proceeds, SBP's official foreign exchange reserves increased by $5.2 billion in FY2003 to $9.5 billion at fiscal year-end. The Pakistan rupee appreciated by about 4% against the US dollar in FY2003, but the real effective exchange rate remained essentially unchanged. Sri Lanka's gross official reserves went up by $278 million over the first 6 months of 2003 to nearly $2.0 billion at end-June. While the average exchange rate against the US dollar was largely stable in this period, it depreciated markedly against the euro, pound sterling, and yen.

Policy Developments

Foreign Exchange Reserves, Sri Lanka



Source: http://www.centralbanklanka.org.

The main policy issues in South Asia relate to the fiscal consolidation needed to address high budget deficits and large government debt to GDP ratios, as well as strengthening the revenue base and improving expenditure efficiency to create space for undertaking expanded poverty-reducing expenditure policies. Maintaining sound macroeconomic policies and continuing structural and governance reforms are also at issue.

During the second half of FY2003, the Government of Bangladesh further strengthened macroeconomic management with renewed emphasis on structural reforms. In particular, fiscal policy was tightened through enhanced revenue measures and expenditure restraint, while monetary policy was restrained through the greater use of market-based instruments to manage liquidity. On the structural front, utility tariffs and energy prices were revised upward, while Bangladesh Bank was granted greater autonomy and authority to conduct monetary and exchange rate policy and to supervise the banking sector. Having improved the institutional capacity of Bangladesh Bank and developed a more market-based monetary framework to control inflation, the Government floated the taka at the end of May 2003 with a view to enhancing competitiveness and strengthening resilience to external shocks. Also in the second half of FY2003, the Government formulated its interim poverty reduction and development strategy—the National Strategy for Economic Growth, Poverty Reduction and Social Development—after broad public consultations. The key strategic elements include pro-poor economic growth, human development, women's advancement, social safety nets, and participatory governance. The Strategy facilitated the Government agreeing to new lending programs with the World Bank and IMF. Accordingly, the budget for FY2004 seeks to boost revenue and increase spending on infrastructure and human capital, buttressed by the greater availability of concessional aid. Notwithstanding these advances, progress has been slow on much-needed governance reforms and structural reforms in the state-owned enterprise and banking sectors.

The Indian Parliament passed the Fiscal Responsibility and Budget Management Bill (FRB) in August 2003. The FRB spells out the responsibility of the central Government for ensuring fiscal sustainability, intergenerational equity in fiscal management, and long-term macroeconomic stability. It also seeks to remove fiscal impediments to the effective conduct of monetary policy and prudential debt management and to enhance transparency in fiscal operations of the central Government. These goals are to be achieved mainly through rule-based fiscal discipline, including required annual limits on central government deficits, borrowings, and debt with an objective of eliminating the revenue deficit by FY2008. For implementation of the targets, the FRB assigns to the finance minister the responsibility for reviewing quarterly fiscal trends in relation to the budget; allows the Government to take appropriate measures for increasing revenue or reducing the expenditure in response to deviations from targets; and makes it binding on the finance minister to seek prior approval and explain to Parliament any deviation, spelling out budgetary implications and remedial measures.

In the monetary and credit policy announced for FY2003, RBI has reduced the cash reserve ratio from 4.75% to 4.5% and the bank rate from 6.25% to 6.0%. Despite these measures, the existing prime lending rate remains high at 10.5–11%, given an inflation rate of around 5.0%. Although monetary policy aims at expanding the flow of credit and boosting domestic investment, credit availability remains an issue, partly due to high real interest rates and partly due to credit rationing for non-prime borrowers by risk-adverse commercial banks. In the area of structural reform, the Electricity Act of 2003 sought to promote competition, efficiency, and commercial viability in the power sector. The Act includes de-licensing of thermal power generation, removal of control on captive power generation, introduction of open access in transmission and distribution networks, recognition of electricity trading as a legitimate economic activity, transparency in subsidy management, and creation of an Appellate Tribunal. The Electricity Act requires the Government to prepare (and periodically update) a National Electricity Policy and a Tariff Policy.

Nepal's FY2004 budget announced on 17 July 2003 focuses on the implementation of the recently approved Tenth Five-Year Plan and introduces a strategic theme of public-private partnership. Other key elements of the FY2004 budget include revision of customs and excise duties, tax concessions for the export sector, and divestiture of some major public enterprises. To improve prioritization of development expenditure, a Medium-Term Expenditure Framework was introduced. The Immediate Action Plan for 2003, a concept introduced in 2002 to prioritize and expedite reform programs, seeks to expand further efforts to devolve management of schools and subhealth posts, expand rural electrification through transfer of distribution management to local communities, allocate more resources to less developed regions, and establish a Poverty Alleviation Fund. Privatization and liquidation of several public enterprises have been initiated. Key financial reforms have also begun, including introduction of external management teams in the two large government-controlled banks, operational review and preparation of restructuring plans for the Agricultural Development Bank and the Nepal Industrial Development

Corporation, and establishment of a debt recovery tribunal, although not yet operational.

In Pakistan, the FY2004 budget, announced on 7 June 2003, is the first budget of the elected Government that came into power in November 2002. The budget reflects the Government's commitment to continue structural reforms initiated in 2002 by the previous administration. This commitment was demonstrated by a further reduction in corporate tax rates for private and banking companies by 2 and 3 percentage points, respectively, as announced last year; and further progress in phasing out excise duties and eliminating tax exemptions, particularly in the area of income tax. The budget also envisages a reduction in the overall fiscal deficit to 4.0% of GDP in FY2004 (from 4.4% in FY2003). Moreover, the budget provides incentives for private investment, particularly in housing and construction. Although the Government has more or less stayed on course in implementing structural reforms, there has been some slowdown. For instance, the general sales tax (GST) has not been extended to services and some amendments have been made in the Income Tax Ordinance 2001, partially reversing the process of reducing the discretionary powers of tax officials. However, the greatest concern is that the losses of public sector enterprises are not being adequately tackled, particularly those of the two state-owned power utilities that are huge drains on government resources.

Sri Lanka's policy efforts are based on a comprehensive framework for economic growth and poverty reduction that is supported by new lending agreed in 2003 with international finance institutions. Key elements of the framework, which will be implemented over 3 years, are fiscal consolidation; strengthening macroeconomic policy and institutions; and reforms in public enterprises, labor regulations, and the trade regime. Consistent with the framework and the Fiscal Management and Responsibility Act of December 2002, the budget deficit for 2003 was targeted at 7.5% of GDP. Postponement of the extension of VAT to the retail and wholesale sectors in the year, however, added pressure to achieving this objective. In March, the central bank strengthened its ability to regulate the money supply by introducing open-market operations. Structural reforms have been continued in several areas including several amendments to labor laws that were passed in January 2003 and the privatization of the Sri Lanka Insurance Corporation that was completed in April.

Outlook for 2003–2004

The present forecast for South Asian economic performance is marginally improved from that made in *ADO 2003*. That forecast assumed normal weather conditions, improved political stability and security in subregional countries, and some improvement in global economic growth; those assumptions have held true to date and remain necessary in the medium term. Projected growth in subregional GDP for 2003 has been slightly revised from 5.7% to 5.8%. No change is made to the *ADO 2003* projection of a pickup in subregional growth to 6.1% in 2004. Balance-of-payments outcomes are now generally seen to be somewhat healthier than forecast in *ADO 2003*.

The outlook for FY2004 in Bangladesh is for GDP growth to accelerate to 5.7%, with a further upturn in both domestic and external demand. The current account of the balance of payments is likely to move to a deficit of 1.2% of GDP from the surplus of 0.6% of GDP in 2003, as import growth outstrips export growth and growth in worker remittances is more subdued due to a slowing in the number of registered workers leaving for abroad. The rate of inflation is likely to moderate from 5.1% in 2003 to 4.5% in 2004, mostly due to the greater availability of foodgrains and more favorable oil prices, which will offset an expected slight depreciation of the exchange rate on account of the likely deterioration in the trade balance.

The projected outlook for the Indian economy remains essentially that given in *ADO 2003*. A revision was made in the inflation forecast to 5.8% for FY2003. With an expected recovery in agricultural production, GDP was—and is—projected to grow by 6.0% in FY2003. The *ADO 2003* projection of slightly higher GDP growth of 6.3% for FY2004, reflecting the upswing in the Indian business cycle and further strengthening in the world economy, is maintained, as is the inflation forecast at 5.0%. The current account surplus is now projected to be 0.6% of GDP in FY2004, up from 0.4% of GDP now estimated for FY2003.

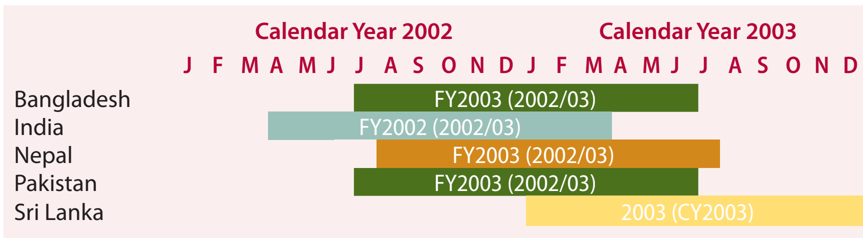
Economic prospects in Nepal crucially depend on progress in peace talks and the security situation as well as developments in political relations between the Government and its parliamentary opposition. On the assumption of no serious deterioration in the security situation and normal weather conditions, the economy is projected to grow by about 3.5% in FY2004. In the same year, export growth is expected to strengthen and import growth to slow. The projected improvement in the current account deficit to 5.0% of GDP mainly depends on further recovery in tourism and continued increase in worker remittances. Higher aid and other capital inflows should result in a small overall balance of payments surplus. With the exchange rate peg, inflation follows price developments in India and is expected to be about 5%.

Given recent trends, Pakistan's economy should be able to maintain GDP growth of at least 5.0% in FY2004, with a pickup in investment activity. Continued sound macroeconomic policies and favorable supply-side conditions indicate that the 4.0% inflation target should be achieved. Export and import growth are likely to moderate but remain relatively strong at about 12% and 10%, respectively. The surplus on the current account in FY2004 is expected to decline but remain sizable at about 4% of GDP because worker remittances are likely to be sustained at about FY2003 levels (the shift to banking system channels is now completed) and because external grants and payments for support operations in Afghanistan are likely to decline but remain significant.

Economic developments in Sri Lanka indicate that the *ADO 2003* projection of 5.0% GDP growth in 2003 will be achieved, and no change has been made in the 5.5% projection for 2004. Recovery in export performance, however, has been appreciably stronger than was anticipated (2003 exports are now expected to be up by 10.0% rather than the 6.5% in *ADO 2003*) and projected growth in 2004 is now raised from 9.0% to 11.0%. This development has lowered the projected current account deficit to 2.5% of GDP in 2003 and to 3.0% in 2004. Moreover, tight financial policies combined with increased domestic food production have slowed price increases more quickly than was anticipated and downward adjustments have been made in projected inflation to 6.5% in 2003 and 6.0% in 2004. In general, the economy has appreciably strengthened, buoyed by improvements in both external and domestic demand, though the present optimistic outlook assumes continued progress on peace negotiations with the Liberation Tigers of Tamil Eelam and continued adherence to the framework of macroeconomic and structural policies finalized in early 2003 that is being supported by international finance institution lending.

Endnote

[1] Annual data for the subregion as a whole given in the table Key Indicators and the text are based on averaging varying fiscal year reporting periods by countries as indicated by the following assignment and in the graphic below. For 2003, in Bangladesh FY2003 ended on 30 June 2003, in India FY2003 ends on 31 March 2004, in Nepal FY2003 ended on 15 July 2003, in Pakistan FY2003 ended on 30 June 2003, and in Sri Lanka the fiscal year 2003 ends on 31 December 2003.



Central Asia

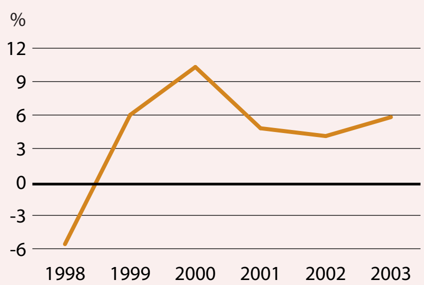
High world prices for the subregion's major commodity exports and rising FDI in oil- and gas-exporting economies are helping sustain subregional economic growth, at 7.5%, in 2003. This impressive figure, however, disguises large variations within the subregion. It also masks the persistent poverty, environmental challenges, and structural weaknesses that need addressing to make growth sustainable and less vulnerable to external circumstances.

Macroeconomic Assessment

GDP Growth

High world prices for the subregion's major commodity exports, combined with continued strength of the Russian Federation's economy, contributed to a strong economic performance by the Central Asian republics (CARs) in the first half of 2003. Oil prices reached a high of $31 per barrel in the first quarter of 2003 and remained at relatively high levels in the second and third quarters. Natural gas prices have been rising since the last quarter of 2002, primarily as a result of low stock levels in the US. There has been a strong recovery in cotton fiber prices in the last 15 months and the continued global demand for gold has kept prices at high levels. The Russian Federation's economy, the CARs' largest trading partner, grew by 4.3% in 2002 and by 7.2% in the first 6 months of 2003. Strong FDI inflows in the oil and gas sector in the subregion's hydrocarbon-exporting countries and better agricultural performance in some CARs strengthened subregional domestic demand. As a result of these positive developments, subregional economic growth in the first half of 2003 was estimated at about 8% and for 2003 as a whole it is forecast at 7.5%. The *ADO 2003* forecast made in April this year anticipated that subregional growth in 2003 would slow to 5.8%, mainly because of an expected moderation in investment and production activities in the oil and gas sector.

GDP Growth, Russian Federation



Source: www.eiu.com.

The average subregional figure, however, masks large variations across countries.[1] The three main oil and gas exporters (Azerbaijan, Kazakhstan, and Turkmenistan), benefiting from higher oil and gas prices and increased investment activity, achieved double-digit GDP growth rates in the first half of 2003 while Tajikistan also recorded high growth of 8.6%. In contrast, the Kyrgyz Republic reported only 2.3% GDP growth in January–June 2003, having suffered from a decline in agricultural output due to adverse weather conditions. Uzbekistan, while benefiting from

Table 2.4 Selected Economic Indicators, Central Asia, 2002–2004, %

Item	2002	2003		2004	
		ADO 2003	Update	ADO 2003	Update
GDP Growth					
Average	7.3	5.8	7.5	5.8	5.9
Azerbaijan	10.6	9.5	9.5	8.0	8.0
Kazakhstan	9.4	6.0	9.5	6.2	7.0
Kyrgyz Republic	-0.5	5.2	5.2	4.5	5.0
Tajikistan	9.1	7.1	6.0	5.0	4.0
Turkmenistan	8.6	7.5	10.0	7.5	7.5
Uzbekistan	3.2	3.5	3.2	4.0	3.0
Inflation Rate (CPI)					
Average	11.3	13.9	10.4	14.2	9.8
Azerbaijan	2.8	3.2	3.0	2.9	2.7
Kazakhstan	5.9	5.9	6.4	5.4	5.4
Kyrgyz Republic	2.0	-	3.5	-	3.5
Tajikistan	12.2	10.0	14.5	6.0	5.0
Turkmenistan	8.8	-	-	-	-
Uzbekistan	24.2	30.0	19.5	32.0	20.0
Current Account Balance/GDP					
Average	-1.3	-4.2	-1.5	-5.1	-2.4
Azerbaijan	-12.6	-15.0	-19.5	-18.0	-21.0
Kazakhstan	-1.8	-1.5	1.5	-1.8	0.4
Kyrgyz Republic	-2.0	-3.4	-3.4	-5.6	-4.8
Tajikistan	-2.7	-4.0	-5.3	-4.0	-5.7
Turkmenistan	2.1	-	5.0	-	4.6
Uzbekistan	2.8	-	-1.0	-	-1.4

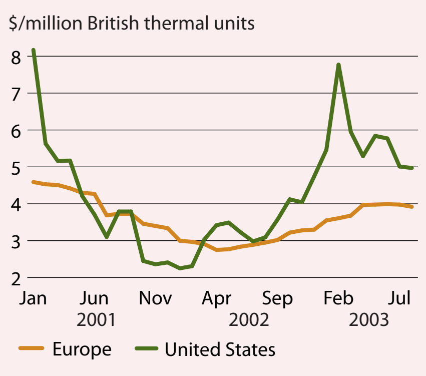
- = data not available; CPI = consumer price index; GDP = gross domestic product.

Sources: *ADO* database; staff estimates.

higher gold and cotton prices and a reportedly good wheat harvest, still grew by only 3.8% in this period. This was due to a slowdown in industrial and retail trade activities, as both sectors are still suffering from stringent regulations and controls imposed by the Government since July 2002. Moreover, the quality of economic expansion in Central Asia, in terms of its impact on poverty levels and lower vulnerability to external circumstances, continues to be of concern. Efforts at necessary diversification of the production structure, away from commodity production and toward growth in employment-generating manufacturing, light engineering, and services, have been limited and are still to yield substantial results.

The first 6 months of 2003 have seen significant activity in the oil and gas sector with a 25-year agreement for exports of up to 80 billion cubic meters of natural gas from Turkmenistan to the Russian Federation; a pickup in the construction of the Baku-Tbilisi-Ceyhan oil pipeline in Azerbaijan; the start of an ADB-supported feasibility study for the Turkmenistan-Afghanistan-Pakistan natural gas pipeline; and the Russian Federation's offer to rehabilitate and expand gas pipeline capacity in the Kyrgyz Republic and Uzbekistan. Kazakhstan has further expanded its oil production and exports in 2003 by increasing its use of the Caspian Sea pipeline. Also, there was news of active Russian and Iranian interest

Natural Gas Prices



Source: www.worldbank.org/prospects/pinksheets/.

in, and some movement on, financing of large hydroelectric projects in Tajikistan. These developments augur well for future investment activity in the subregion, diversification of export markets, and closer integration of the CARs with global markets. Appropriate policy support for private sector growth would stimulate private sector activity in the light engineering and services industries that are supportive of FDI in the hydrocarbon and energy-exporting sectors, as well as enhance prospects for inclusive economic growth.

Financial Policies and Prices

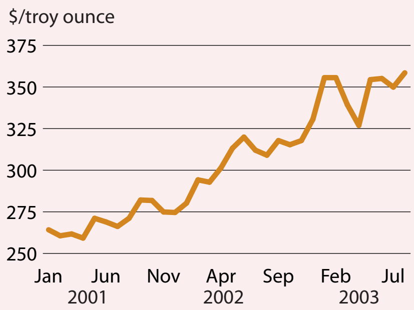
With fairly tight monetary and fiscal policy regimes in place across the subregion, inflationary pressures generally remained subdued (at about 3–5% annualized in Azerbaijan, Kazakhstan, and Kyrgyz Republic) in the first half of 2003; relative price stability is expected to be maintained in these countries through the end of the year. However in Tajikistan, where the Government had set a 7.0% target for the year-end, inflation was officially reported at 17% in the first 6 months and is likely to remain in double digits for the remaining months. According to official data, inflation in Uzbekistan remained at a moderate 4.2% in this period, though prices of basic goods and services are unofficially reported to have increased more sharply due to shortages that emerged from the tightening of border controls and severe import compression since the second half of 2002. In Turkmenistan, the Government's policy of free delivery of basic goods and services such as electricity, housing, and water, and heavy subsidies for basic necessities such as flour, salt, and petroleum have kept inflationary pressures repressed. While Kazakhstan's tight fiscal policy stance has helped keep inflation at bay, its very strong economic and financial fundamentals indicate that some loosening in policy may now be appropriate to address its critical infrastructure needs and employment generation.

External Sector Developments

The three major oil and gas exporters reported exceptionally strong export growth of 31%, 40%, and 25%, respectively, in the first 6 months of this year.[2] At the same time, these countries also saw their imports increase correspondingly with plant and equipment for the oil and gas sector accounting for the dominant share. Azerbaijan's current account deficit rose in the first quarter of 2003. Kazakhstan, however, ran a current account surplus of 4.0% of GDP and strengthened its international reserves by over $1 billion to $4.7 billion in the 6 months to June 2003.[3]

Uzbekistan, which is itself a major producer of natural gas and oil but not a large hydrocarbon exporter, officially reported export growth of 41% in the first half of 2003, based on an increase both in volumes and prices of its gold and cotton exports. Tajikistan's exports declined by 0.6% in this period despite higher volumes and prices for its cotton exports, which account for more than a fifth of its total exports. Revenue growth of aluminum exports, accounting for more than 55% of its total exports, was limited by continuing softness in global prices. Total trade turnover declined by 1.1% as a result of a 16% reduction in its trade with Confederation of Independent States countries. Tajikistan's external debt has improved with the favorable outcome of its negotiations with

Gold Prices



Source: www.worldbank.org/prospects/pinksheets/.

the Russian Federation in December 2002. In the absence of any significant FDI inflows, the Kyrgyz Republic, which is one of the most heavily indebted CARs, again needed to borrow externally to finance its current account deficit. This increased its total external debt to $1.7 billion in June 2003, about 108% of GDP. The Government hopes to secure an external debt write-off of about $0.5 billion by the Paris Club members in the first quarter of 2004, based on successfully completing its current poverty reduction and growth facility program with IMF.

Exchange rates, which are generally market determined in the subregion, remained broadly stable in the first half 2003. Even with strong revenue flows from oil and gas exports, Azerbaijan and Kazakhstan avoided a major appreciation in their real exchange rates as efforts to sterilize foreign exchange earnings in offshore funds, specially designated to receive oil revenues, were continued. In Uzbekistan, the long-standing spread between the official and market exchange rates virtually disappeared by end-June 2003, largely as a result of tight import restrictions and rising export earnings from higher cotton and gold prices. The Government has now committed to bring about current account convertibility by November 2003, thereby eliminating the dual exchange rate system. In Turkmenistan, however, there is still no indication that the multiple exchange rate system will be abolished, despite some appreciation in the market exchange rate, which reflects an apparent improvement in the balance of payments.

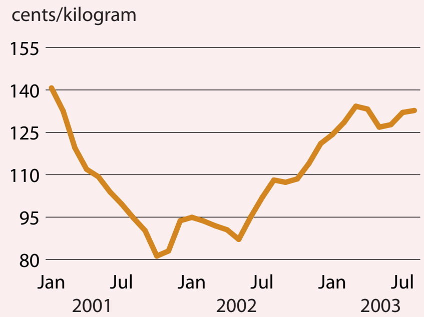
Policy Developments

Prospects for private sector growth in the CARs are quite positive in the engineering, raw-materials processing, and services sectors, either to support investments in oil and gas or to meet the demands of an expanding agriculture sector that is now being steadily privatized across the subregion. Some signs of emerging private sector activity in these three sectors are already visible, and this activity can be strengthened by well-designed policy support and by government recognition of the key role of public-private partnerships both in building a physical, social, and financial infrastructure and in putting in place incentives and regulatory mechanisms. The expansion of private small and medium enterprises in manufacturing and services will not only help achieve much-needed diversification of the production structure but also yield a more inclusive type of economic growth with a greater positive impact on employment and poverty reduction.

Significant policy advances have been made over the past decade in most countries of the subregion, as part of comprehensive economic programs sponsored by international finance institutions. However, the financial sector—more specifically commercial banking—which has an important role in fostering private sector growth, remains weak and underdeveloped in most CARs. In Tajikistan especially, but in the Kyrgyz Republic and Turkmenistan as well, confidence in the banking sector is generally lacking and deposits have been declining in real terms. Credit for new investments and for small and medium enterprises is still highly controlled and is far short of demand, except perhaps in Kazakhstan, which has recently adopted measures to improve the flow of credit for these activities. Strengthening the financial sector in the CARs, particularly banking, while putting in place the required supervisory and regulatory capacity that will create greater confidence in the system, remains perhaps one of the more critical policy advances required for promoting private sector growth. A subregional initiative that avoids duplication in training capacities for central and commercial banking skills, that helps to standardize subregion-wide prudential norms and banking practices, and that creates a subregional clearing system supporting capital mobility and facilitating subregional trade, could make an effective contribution to achieving sustainable and inclusive growth.

The importance of subregional cooperation in raising growth rates, reducing poverty, and safeguarding the environment has been formally and repeatedly recognized by the political leadership in Central Asia. Many steps have been implemented in establishing subregional organizations and institutional mechanisms. Nevertheless, greater commitment is still needed to ensure that benefits from subregional cooperation accrue, especially in the areas of facilitating intrasubregional trade flows, strengthening transport infrastructure, and harnessing subregional energy resources. With average tariff levels in the CARs of 5–15% as a result of reforms already implemented, gains from further tariff reductions are unlikely to be large. However, growth prospects for smaller landlocked economies, such as the Kyrgyz Republic and Tajikistan, depend crucially on free and easy transit through neighboring countries for access to export markets. Thus, removing the host of nontariff barriers, border controls, and frequent transit stoppages by rent-seeking officials would yield substantial benefits. This issue could be very usefully addressed as part of a subregional cooperation agenda. It would be important, however, to demonstrate that this effort would result in a win-win outcome for all the CARs. Development of subregional physical infrastructure and energy capacities would require substantial investment that will be forthcoming only if the Central Asian governments demonstrate a willingness to enter into long-term subregional agreements that also involve some of their neighbors from outside the subregion.

Cotton (A Index) Prices



Source: www.worldbank.org/prospects/pinksheets/.

Economic Outlook

Economic growth is expected to remain generally buoyant in the last few months of 2003 with an outturn of 7.5% for the year as a whole, in line with that achieved in 2002. With oil supplies forecast to remain relatively tight for the remaining months of this year and demand for natural gas showing no signs of weakening, the subregion will benefit from continued firmness in energy export prices in 2003. The Kyrgyz Republic is likely to improve on its first half performance with gold production, which had been seriously disrupted by a major accident at the Kumtor gold mine, expected to return to normal levels, thus pushing up industrial growth in the second half of the year. Uzbekistan can expect to benefit from a positive investor response if the Government adheres to its declared program of achieving current account convertibility by November, but failure to do so could result in strong negative sentiment that will push growth rates down and exacerbate both fiscal and external imbalances. Inflation in the subregion is expected to remain at the two-digit level in 2003. The subregional current account balance is forecast to improve over the estimates presented in *ADO 2003*, mainly due to a movement to a surplus in Kazakhstan.

Oil prices are forecast to decline in 2004 to a range of $24–26 per barrel, while capacity constraints in the existing pipeline systems will also begin to slow further increases in subregional exports of natural gas. Accordingly, GDP in the CARs is forecast to expand by 5.9% in 2004, which can be seen as a sustainable growth trend. This performance could be substantially improved if Uzbekistan actually undertakes its currency and trade reforms in 2003, if the Kyrgyz Republic improves its domestic resource mobilization, and if greater FDI flows are attracted to infrastructure sectors as a result of subregional cooperation efforts.

The risks to the 2004 economic performance arise from increasing political instability associated with presidential succession in Azerbaijan and electoral outcomes in Kazakhstan; continuing security concerns and border closures in Turkmenistan and Uzbekistan; and a worsening of the political and security situation in Afghanistan and Iraq, which could have a strong negative spillover impact on the subregion.

Endnotes

[1] The problem of reconciling officially reported data with estimates provided by other sources and of determining a plausible scenario of economic performance in some CARs is substantial. This issue continues to create significant difficulties, particularly in the case of Turkmenistan and Uzbekistan where official data are either unavailable or have often shown large variations from those reported by agencies such as IMF or the Economist Intelligence Unit. ADB estimates have been used in reaching subregional figures and these may not reconcile with officially reported data.

[2] Azerbaijan exports are for January–May.

[3] Turkmenistan does not release current account figures or data on its foreign exchange reserves; information on Uzbekistan's balance of payments is also very limited.

The Pacific

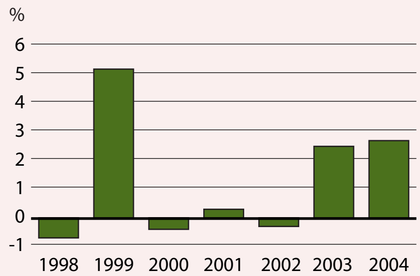
Economic activity in the first half of 2003 suggests a slight recovery from the weak performance of the past few years, mainly reflecting improved weather conditions, continued strength in international commodity prices, and a resilient performance in tourism. The subregion is projected to achieve a modest economic recovery in the medium term. The main risks to this forecast arise from continuing political instability within the subregion and global economic uncertainties.

Macroeconomic Assessment

GDP Growth

According to revised estimates, aggregate GDP of Pacific developing member countries (PDMCs) actually contracted by 0.3% in 2002 compared to the 0.9% increase estimated in *ADO 2003*. Growth estimates for 2002 of five larger PDMCs—Fiji Islands, Federated States of Micronesia, Kiribati, Papua New Guinea, and Vanuatu—have been revised downward, with a particularly sharp decline for Papua New Guinea, the largest economy in the subregion. Overall, positive demand factors such as the strengthening of international commodity prices and some improvements in tourism seem to have been neutralized by supply constraints associated with adverse weather conditions and reduced production from natural resources. In particular, worse than previously estimated mineral production in Papua New Guinea and agricultural production in several other countries are among the major factors in the downward adjustment. On the other hand, growth estimates for the Cook Islands and Samoa have been revised upward due to country-specific factors. The net result is that the declining trend in average per capita real GDP in the Pacific continued for the third year in succession, adversely affecting poverty in the subregion.

GDP Growth, 1998–2004



Sources: *ADO* database; staff estimates.

A weak statistical database constrains economic reporting in the Pacific. Therefore, economic analysis relies substantially on qualitative information and is subject to cautious interpretation. Evidence collected in the first half of 2003 tends to confirm a slight increase in aggregate economic activity in the subregion, in line with the *ADO 2003* forecasts. Agricultural production generally improved in this period, reflecting higher international prices of most major agricultural exports of Pacific countries and relatively good weather conditions. Petroleum and mineral production, which is critical for Papua New Guinea, also gained from

Table 2.5 Selected Economic Indicators, The Pacific, 2002–2004, %

Item	2002	2003		2004	
		ADO 2003	*Update*	*ADO 2003*	*Update*
GDP Growth					
Average	-0.3	2.4	2.5	2.5	2.7
Cook Islands	2.2	1.5	1.8	3.2	0.2
Dem. Rep. of Timor-Leste	-1.1	-2.3	-3.0	1.3	1.0
Fiji Islands	3.8	5.7	5.0	3.6	4.1
Kiribati	1.0	2.5	2.5	2.3	1.8
Marshall Islands, Rep. of	4.0	3.0	3.0	2.0	2.0
Micronesia, Fed. States of	-0.2	2.4	2.4	1.5	1.5
Nauru	-	-	-	-	-
Papua New Guinea	-2.7	1.0	1.5	2.0	2.0
Samoa	1.8	3.6	3.5	3.5	3.5
Solomon Islands	-4.0	2.0	5.0	3.0	5.0
Tonga	1.6	2.5	1.9	2.7	2.6
Tuvalu	2.0	2.0	2.0	1.8	1.8
Vanuatu	-2.8	1.3	1.3	2.2	2.2
Inflation Rate (CPI)					
Average	7.1	6.3	8.9	-	5.1
Cook Islands	3.9	3.4	2.4	3.4	1.8
Dem. Rep. of Timor-Leste	2.0	2.0	3.0	2.0	3.0
Fiji Islands	0.7	3.0	3.8	3.6	2.5
Kiribati	3.2	-	-	-	-
Marshall Islands, Rep. of	2.0	2.5	2.5	-	-
Micronesia, Fed. States of	0.2	1.5	1.5	-	-
Nauru	-	-	-	-	-
Papua New Guinea	11.8	9.0	13.8	5.0	6.9
Samoa	8.1	3.5	4.7	5.0	3.1
Solomon Islands	9.0	8.0	8.0	-	6.0
Tonga	10.0	10.0	10.5	-	7.5
Tuvalu	2.6	3.0	2.5	-	2.5
Vanuatu	2.0	2.5	2.5	2.5	2.5
Current Account Balance/GDP					
Average	0.5	-	-	-	-
Cook Islands	6.3	5.9	5.9	-	-
Dem. Rep. of Timor-Leste	10.0	-12.2	5.6	-7.3	-6.4
Fiji Islands	-3.5	-3.7	-3.7	-1.6	-1.6
Kiribati	7.7	1.1	-21.5	-	-12.5
Marshall Islands, Rep. of	29.7	-	-	-	-
Micronesia, Fed. States of	3.7	-	-	-	-
Nauru	-	-	-	-	-
Papua New Guinea	0.4	-	4.7	-	2.8
Samoa	1.8	-1.4	-1.5	-	-
Solomon Islands	-3.5	6.5	6.5	-	-
Tonga	5.3	-	-	-	-
Tuvalu	-	-	-	-	-
Vanuatu	-2.1	-0.3	-0.3	-1.1	-1.1

- = data not available; CPI = consumer price index; GDP = gross domestic product.

Sources: *ADO* database; staff estimates.

higher international prices. After an initial global decline due to the conflict in Iraq and the outbreak of SARS, tourism picked up by the end of June, favoring growth in the subregion. While other sectors manifested a mixed performance, in aggregate terms, demand conditions remained moderately firm and forecasts for GDP growth have been lifted slightly to 2.5% for 2003 and to 2.7% for 2004.

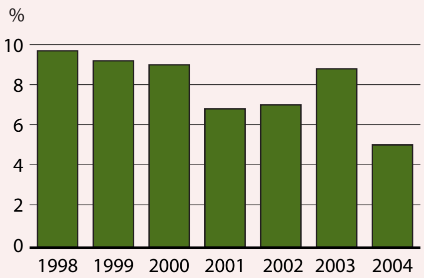
Several country-specific factors contributed to economic growth in the Pacific in the first half of 2003. In Papua New Guinea, activities increased in the mineral and petroleum sector due to a solid response by producers to continuing higher international prices and tax incentives related to exploration. Generally strong consumer demand in the Fiji Islands was associated with intensified construction activities and a resilient performance in tourism. In the first quarter of 2003, the economy in Solomon Islands showed signs of a reasonably strong rebound as many conflict-affected activities gradually resumed, despite continuing law and order problems. Reflecting these developments, labor market conditions improved slightly in these three countries. At the same time, however, economic activities continued to slow in Timor-Leste due to a drought and to the scaling-down of the international presence associated with United Nations activities, worsening already critical unemployment conditions. On the positive side, work started on the Bayu-Undan liquefied natural gas project, which is likely to become a major source of foreign exchange earnings for Timor-Leste. The smaller Pacific economies that depend on trust funds and external sources of revenue, particularly Kiribati and Tuvalu, witnessed a fall in government spending and domestic demand due to reductions in income from international financial markets and lower licensing fees, such as from fishing and for the use of the ".tv" Internet domain address (in Tuvalu). In Kiribati, Nauru, and Tuvalu, political uncertainty contributed to weaker economic activity in the first half of the year. The remaining PDMCs exhibited varying performances.

Financial Policies and Prices

Although data are sketchy, official government statistics suggest that in the first few months of 2003, actual fiscal balances were better than expected in some of the larger PDMCs, including Fiji Islands, Papua New Guinea, Samoa, Timor-Leste, and Vanuatu. With some exceptions, revenue performance was stronger than forecast and, in some cases, expenditures were slightly lower than budgeted. The better than projected revenue performance reflected improvements in the production and export bases of several countries—particularly agriculture, minerals and, in the case of Papua New Guinea, petroleum—and increases in indirect taxes, while the lower expenditure levels mainly reflected start-up delays in planned activities, cash constraints, and, at times, improved controls over the use of public money. In Solomon Islands, the Government made some effort to improve fiscal management, and revenues exceeded their budgeted level in the first quarter of 2003. However, much remains to be done to restore fiscal stability, and the country continues to face a substantial budget deficit, huge arrears, and high official debt.

In contrast, the smaller PDMCs experienced fiscal constraints and generally higher than expected budget deficits in the first quarter of

Inflation Rate, PDMCs

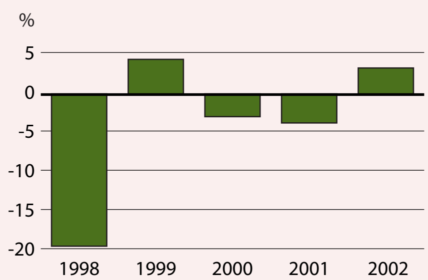


Sources: *ADO* database; staff estimates.

Merchandise Export Growth, PDMCs

Source: *ADO* database.

Merchandise Import Growth, PDMCs



Source: *ADO* database.

2003, mainly due to their reliance on external sources of revenue, such as licensing fees and trust funds.

While official fiscal data for the first half of 2003 are still not available for the majority of PDMCs, in view of the improvements in some larger countries, the overall picture of the Pacific subregion in the first quarter of 2003 suggests a slight reduction in the fiscal deficit. However, great caution should be exercised in interpreting this trend, since data refer only to the first few months of the year.

Available data covering the first 6 months of 2003 suggest that inflation accelerated in many PDMCs, especially in Papua New Guinea, for which the annual estimate included in *ADO 2003* has now been revised from 9.0% to 13.8%. Price dynamics were mostly determined by factors such as increases in some indirect tax rates, the lagged effect of currency depreciation, and high petroleum prices. On the other hand, improved food supply conditions helped inflation to decelerate in Samoa in 2003 from the 2002 level, although by a lesser extent than estimated in *ADO 2003*. Inflation in the remaining PDMCs, particularly those which use foreign currencies such as the US or Australian dollar, generally remained low. Overall, the subregional average inflation rate is revised to 8.9% in 2003, against the forecast of 6.3% given in *ADO 2003*.

External Sector Developments

The overall balance of payments for PDMCs presented a varied picture in the first few months of 2003. Reflecting the good agricultural season and higher international prices of primary commodity exports, the trade balance showed some improvement in Fiji Islands, Papua New Guinea, Solomon Islands, and Vanuatu in the first quarter of 2003 compared to the previous quarter. However, the picture changes when compared to the same period of 2002. In Papua New Guinea, for which data for the first 6 months of 2003 are available, exports rose sharply while imports declined significantly. At the same time, the kina, as well as most other PDMC currencies, appreciated in nominal and real effective terms against the US dollar. Earnings from tourism improved in the Cook Islands and Samoa, while they remained comparable to those of 2002 in the Fiji Islands, reflecting the fact that the Pacific subregion continues to be regarded as a relatively safe destination. While external reserves improved in Solomon Islands and Tonga from the 2002 level, the position declined in Cook Islands, Fiji Islands, Papua New Guinea, Samoa, and Vanuatu.

Policy Developments

Political instability and weak governance continued to beset the Pacific subregion in the first half of 2003. Among Fiji Islands, Papua New Guinea, Solomon Islands, and Vanuatu, common policy issues were related to fiscal management and macroeconomic stability, governance, and social development. Timor-Leste progressed slowly but steadily in building new institutions and capacity, and in establishing a national legal and regulatory framework. The governments of the Fiji Islands and Papua New Guinea pursued special measures to promote investments and boost activities in their key sectors by offering tax and nontax incentives. As a result, these countries experienced some acceleration in private investment (Fiji

Islands) and exploration activities (Papua New Guinea). Solomon Islands struggled to overcome its huge fiscal problems as well as the need to restore law and order, while political uncertainty persisted in Vanuatu, due to continuing threats to the stability of the Government.

The governments of Samoa and Tonga continued to make progress on reforms, but with varying degrees of depth and success. While Samoa initiated reforms to reduce the size of government, improve financial sector supervision, and offer government land intermediation, the focus of reforms in Tonga was on public enterprises and improved management of public finance. In the Cook Islands and Tuvalu, some gains from recent reforms were lost due to policy reversals associated with political instability and fiscal difficulties.

In the first half of 2003, the primary focus of the governments of the Marshall Islands and Federated States of Micronesia was on negotiations related to the finalization of the new Compact of Free Association with the US. The negotiations, relating to both countries, include a 20-year package involving assistance in key sectors such as health and education, the establishment of a sustainable trust fund, and new accountability measures. During these 6 months, Kiribati faced problems related to fiscal management, while Nauru continued to be characterized by severe political instability, in the context of increasing economic and financial problems.

Some important developments in terms of Pacific subregional integration occurred in the first 6 months of the year. In particular, the Pacific Island Countries Trade Agreement (PICTA), which provides for a gradual move toward free trade among 14 Pacific island countries over a 10-year period, came into force in April. Economic ministers of Pacific countries agreed at the 2003 Forum Economic Ministers Meeting that a core aim of economic policies in the Pacific should be to address poverty. While the meeting highlighted the need for improving governance, institutional development, and macroeconomic stability, without strong political will in each country substantial progress will be unlikely.

Outlook for 2003–2004

Agriculture, mining, and marine-based primary commodities are the main production and export bases of the PDMCs. With the exception of the smaller countries, the subregion is expected to continue receiving a positive stimulus from the likely strengthening in commodity prices. Papua New Guinea in particular is expected to benefit from relatively firm oil prices. Tourism, another critical income-earning sector for the Pacific, is likely to continue expanding in 2003 and 2004, following the end of the conflict in Iraq and (apparently) the SARS epidemic. Tourism-related industries are also expected to contribute to economic growth in the months ahead. Earnings from trust funds could also improve, with an expected rebound in the major stock markets. Accordingly, the forecasts for economic growth in 2003 and 2004, which include a projection for both Papua New Guinea and Solomon Islands to emerge out of recession, have been marginally upgraded from those in *ADO 2003*.

Factors in the rise in inflation in the first half of 2003 are unlikely to change significantly over the rest of the year. Accordingly, the subregional average inflation forecast for 2003 has been revised upward to 8.9%, along with a sharp upward revision in the case of Papua New Guinea. However, in 2004, the inflationary trend in that country is expected to subside with some improvements in macroeconomic stability; most other PDMCs could experience lower inflationary pressure, as oil prices may decline somewhat and prices in the PDMCs' main trading partners may remain low. Thus, the forecast is for moderate inflation in 2004. The pressures on the current account that were seen in 2002 are expected to ease in 2003, based on improved export performance in the larger PDMCs and the slightly improved outlook for the global economy, regional trade, and—particularly—tourism. However, the current account outlook for 2004 remains highly uncertain, due to major risks associated with continuing global economic uncertainties and subregional political instability.

Assessing the Impact and Cost of SARS in Developing Asia

Introduction

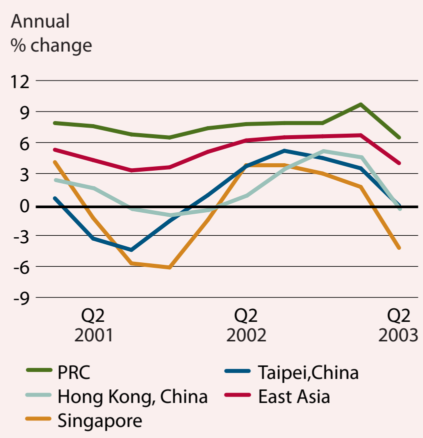
Irrespective of the actual cost of severe acute respiratory syndrome (SARS) from a health risk perspective, it is clear that the epidemic has inflicted much economic cost on East and Southeast Asia's economies.[1] As Figure 3.1 demonstrates, gross domestic product (GDP) weakened sharply in the second quarter across much of the region, co-incident with the SARS outbreak.

Even assuming that SARS is indeed over and that there are only very modest economic spillover effects remaining in the second half of 2003, analysis points to a total cost for the East and Southeast Asian economies as a whole of about US$18 billion in nominal GDP terms for 2003, that is, about US$2 million per person infected by SARS. However, the overall loss in demand and in business revenue, as measured by total final expenditure, is estimated at nearly US$60 billion, showing that GDP losses would have been much higher had it not been for cuts in imports in SARS-affected economies. The scenario could easily have proved much worse had SARS been a more communicable disease, highlighting the potential scale of shocks emanating from serious, and increasingly global, health issues.

It is also noticeable that the economic costs imposed by even this relatively contained international health problem have been significant across a large part of Asia and not just in the countries in which SARS cases were actually reported. Tourism plummeted across the region. If the outbreak had been more prolonged, losses in export orders would have become a serious threat as well. Fortunately, most governments involved saw the need for determined action to bring SARS under control fast—and they were largely successful.

Whatever means are used to measure the economic costs, there can be no doubt about the large and immediate impact that news of SARS had on the public around the world (certainly the intense global media coverage ensured that news traveled fast). More puzzling, however, is that reactions among markets were probably much greater than most analysts would have envisaged had they been given information about SARS beforehand. The number of cases was actually quite small in a populous region (Table 3.1). It soon became apparent that outside a small, high-risk group, the spread of the disease was not very rapid and could be contained.

Figure 3.1 GDP Growth, East Asia



Source: Datastream.

Table 3.1 Number of SARS Cases Reported by the World Health Organization, 2003

	PRC	Hong Kong, China	Singapore	Taipei,China	Viet Nam	World
17 Mar	-	95	20	-	40	167
31 Mar	806	530	91	10	58	1,622
14 April	1,418	1,190	158	23	63	3,169
28 April	2,914	1,557	199	66	63	5,050
12 May	5,013	1,683	205	184	63	7,447
26 May	5,316	1,726	206	585	63	8,202
9 Jun	5,328	1,753	206	680	63	8,421
23 Jun	5,326	1,755	206	692	63	8,459
	% Change from Two Weeks Earlier					
	PRC	**Hong Kong, China**	**Singapore**	**Taipei,China**	**Viet Nam**	**World**
31 Mar	-	458	355	-	45	871
14 April	76	125	74	130	9	95
28 April	106	31	26	187	0	59
12 May	72	8	3	179	0	47
26 May	6	3	0	218	0	10
9 Jun	0	2	0	16	0	3
23 Jun	0	0	0	2	0	0

Notes: The mortality rate of the SARS outbreak was 9.6% of cases. Hong Kong, China had the highest infection rate, at 0.026% of population. In comparison, the mortality rate of the 1918–19 influenza pandemic in the US was 2.5% of cases (with an infection rate of 28% of population). M. Billings. *The Influenza Pandemic of 1918*. Stanford University web site, available: http://www.stanford.edu/group/virus/uda/.

Source: Oxford Economic Forecasting.

Indeed, in Viet Nam, the outbreak was stabilized within 1 month, helped by prompt quarantining. Excepting Taipei,China, all economies had more or less stabilized cases by the beginning of May.

Why was the reaction to the news of SARS so serious? Most probably, this was initiated by uncertainty over the nature of the disease coupled with lack of confidence in the more optimistic prognoses that seemed untenable after data became available. Also perhaps the presentation and understanding of the data were poor, a problem that should be reviewed and addressed by governments and public health organizations. Out of all the risks being assessed in early 2003—geopolitical, economic, social—neither a global health scare nor a shock centered on East and Southeast Asia was uppermost in any analysis, perhaps another reason for SARS to create such a sharp impact.

SARS has highlighted just how damaging an unexpected, and seemingly uncontrolled, international health threat may be in today's global economy. If SARS had been a much more contagious disease (such as influenza), then the number of cases would have risen rapidly and significantly in many countries. The spread of the economic impact would also have been very rapid and much higher. SARS was (fortunately) more amenable to being brought under control largely because it was not easily spread. Contagion rates are clearly a critical part of any health-risk assess-

Box 3.1 Chronology of World Health Organization Travel Advisory Notices

2 April	Travel advisory on Hong Kong, China and Guangdong: "consider postponing all but essential travel"
23 April	Travel advisory extended to Beijing, Shanxi, and Toronto
28 April	Viet Nam removed from list of affected countries
29 April	Travel advisory on Toronto lifted
8 May	Travel advisory extended to Tianjin, Inner Mongolia, and Taipei
21 May	Travel advisory extended to all of Taipei,China
23 May	Travel advisory on Hong Kong, China and Guangdong lifted
30 May	Singapore removed from list of areas with local transmission of SARS
13 June	Travel advisory on Inner Mongolia, Shanxi, and Tianjin lifted
17 June	Travel advisory on Taipei,China lifted
23 June	Hong Kong, China removed from list of areas with local transmission
24 June	Travel advisory on Beijing lifted; Beijing removed from list of areas with local transmission
5 July	Taipei,China removed from list of areas with local transmission

ment: rapid and accurate information is essential in this context (Box 3.1). Government responses to SARS were also fairly rapid and pronounced, mitigating the damage—but almost certainly these responses would have proved insufficient had SARS been highly contagious.

Even though it was soon obvious that SARS was not as contagious and dangerous compared to the 1918–19 influenza pandemic, panic that it might turn out to be, led to a rapid buildup of fear. This was sufficient to cause economic dislocation and losses running into billions of dollars. The realization of the enormous scale of such threats is already encouraging policy makers to review the costs of eliminating, or at least reducing, some of the known root causes of such disease outbreaks, including weaknesses in public health and safety systems. Such costs may be low in comparison with the potential cumulative economic losses attributable to serious health scares.

In the following section, the general mechanisms by which the effects of events, such as SARS, are transmitted into the economies concerned are reviewed. The reasons why differential impacts were to be expected across the affected economies are examined next. In the following section, the economic losses attributable to SARS are assessed using the Oxford Economic Forecasting model. Finally, some conclusions and policy implications are presented.

Channels of Transmission of the SARS Shock

Public health risks such as SARS create an economic shock through a number of channels of transmission. The most important channel is through the dampening of tourism and of consumer confidence. They fall rapidly as news breaks, cutting services exports and consumer spending, which, in turn, creates secondary effects on the local economy. These secondary effects include employment loss, lowered investment, and reduced import demand. The impact spreads to other countries even without any direct connection to the initial driving factor—in this case, SARS—via the impact on confidence and reduced import demand.

Sentiment is a fickle variable, especially for tourism. Tourists can rapidly switch destinations or cancel trips reacting to news, and recovering confidence can be a difficult task. Consumers can only switch behavior on a smaller scale and less rapidly, as some purchases are essential, such as basic foods and supplies, while others are autonomous, such as rents (Table 3.2). However, the consumer can quickly cut back on nonessential items, such as leisure activities, and, for a time, may even cut spending on essential items if there is a temporary high-risk alert. A more serious and prolonged threat would not only reinforce existing apprehension but impact other sectors as well, such as exports and investment.

A chain of effects may be discerned for events such as SARS as follows:

- Inflows of foreign tourists to an affected country will fall sharply, and the average spending may also decline if stays are shorter and high-spending visitors stay away. But outbound (and local) tourism will also be affected both by concerns over travel and general retrenchment on the part of local consumers. This means cuts on both sides of the balance-of-payments services account and more losses in travel-related jobs. In addition, restrictions on travel and movement of people may be applied—possibly including quarantining—and this implies further losses in spending and tourism.

Table 3.2 Breakdown of Consumer Spending, Selected Economies, 2001

	PRC	Korea, Rep. of	Taipei,China	Thailand	United States
Food	28.1	14.6	20.9	25.1	7.1
Alcohol & tobacco	3.9	2.3	3.7	6.6	2.1
Clothing & footwear	10.1	3.9	4.1	11.0	5.1
Rent, water, fuel & power	10.3	17.5	18.3	9.2	17.2
Household goods & services	8.3	4.4	5.8	6.9	5.0
Health Expenditure	6.5	7.6	8.9	7.1	17.1
Recreation, education, & culture	13.0	13.0	19.2	8.1	11.5
Transport & communications	8.6	16.7	11.9	16.2	13.2
Other goods & services	11.3	20.0	7.2	9.7	21.7
Total Private Consumption	100.0	100.0	100.0	100.0	100.0

Sources: *Statistical Yearbook of the Republic of China* (web site); *China Statistical Yearbook*; Republic of Korea National Accounts (www.bok.or.kr); Thailand Annual National Accounts (www.nesdb.go.th); OECD National Accounts.

- Consumers will curb shopping trips and, especially, visits to restaurants and other leisure activities that are seen as both high risk and nonessential—and the perceived threat to jobs and incomes will add to local consumer caution.
- Government spending probably increases, linked to efforts to control the problem, and spending may be boosted further by fiscal packages to help those businesses most affected through, for example, tax breaks.
- Export orders and delivery will be hampered—by reduced numbers of visitors at trade fairs and cancellation of such fairs and conventions, reduced overall business travel, and general disruption to transport, affecting goods shipments as well as movements of people. This will create further repercussions on import demand as well.
- Business confidence and investment prospects will deteriorate, but this very much depends on the expected duration of the problem: if it is seen as a repeated threat, the consequences will be much more serious than if it is seen as a short-lived temporary phenomenon. Lower investment rates will impinge on growth in the capital stock.
- In fairly extreme cases, working days and production could be lost due to sickness, restrictions, and fear of contact—implying another round of effects on businesses and consumers caused by both the direct implications for trade and incomes and the fact that work time losses would reflect an escalation in the serious nature of the event, further eroding confidence.

The above channels will impact GDP growth. The following effects are also expected:

- Some prices would be boosted in the short run by supply problems (e.g., fresh food products) while others (e.g., hotel prices) would fall on plummeting demand.
- A deteriorating economic outlook, especially if coupled with longer-term concerns about repeated disease outbreaks and their consequences, would probably weaken financial markets and investment-linked capital inflows.

By the time SARS was brought under control in June, the impact of the outbreak had only reached the first three channels above (tourism, consumption, and government spending, though secondary effects will have influenced other variables as well). This should limit both the scale and the duration of the SARS effect in 2003. However, there are still some doubts about the other channels of contagion (exports and investment) given the longer time lags involved in such reactions and the lack of definitive data at this point. However, it can probably be safely assumed that any impacts on other channels will be less significant because of the fairly rapid rebound already being seen in the worst affected variables, i.e., tourism and retail sales. The direct SARS effect on working time and output has been negligible and specific SARS-related changes in other secondary variables (such as financial conditions and overall inflationary patterns) have been, and will remain, small and temporary (with some exception in the case of Hong Kong, China's inflation rate, where an existing, serious deflation problem has become worse).

Why Would SARS Impact Some Countries More than Others?

Several factors explain why some economies were more vulnerable and susceptible to the effect of SARS than others. These include:

- structural issues, such as the relative shares of tourism and consumption in GDP and the composition of consumer spending;
- initial conditions (consumer sentiment susceptibility); and
- government spending responses.

Economic Structures

Tourism and Services. Table 3.3 shows the relative importance of foreign tourism in 12 Asian economies (though the figures do not include local tourism and thus underestimate the importance of the tourism sector). Noticeably, East Asia is far less tourism dependent than Southeast Asia—with Hong Kong, China a significant exception, which added substantially to the impact of SARS on that economy.

While SARS reduced foreign tourist inflows, local residents also cut their travel and tourism abroad and thus *net* tourism receipts may be less affected, or even affected positively. The historic data for net tourism in Table 3.3 show a rather different vulnerability per country than the gross tourist receipts alone. Indeed, if effects on outbound and inbound tourism were symmetric, then economies such as the Republic of Korea (Korea); Taipei,China; and even Hong Kong, China may appear to be net beneficiaries of a tourism slump. This is, of course, not the case as losses in tourism spending, jobs, and investment would probably still be registered because local consumers would not switch all their cut in foreign spending into local services and goods, that is, the "substitution" would not be one

Table 3.3 Tourism Exports, 2001

	"Gross" US$ million	% of GDP	"Net" US$ million	% of GDP
East Asia				
PRC	17,792	1.5	3,883	0.3
Hong Kong, China[a]	7,930	4.8	-4,572	-2.8
Korea, Rep. of	6,292	1.5	-1,293	-0.3
Taipei,China[b]	4,229	1.5	-2,727	-1.0
Southeast Asia				
Cambodia	149	4.4	114	3.3
Indonesia	5,276	3.6	1,870	1.3
Lao PDR	104	5.9		
Malaysia	6,863	7.8	4,249	4.8
Philippines[a]	1,723	2.4	499	0.7
Singapore	5,111	6.0	-70	-0.1
Thailand	7,075	6.1	4,151	3.6
Viet Nam[b]	1,482	4.3		

[a] 2000. [b] 2002.

Note: "Gross" tourism exports = business and personal travel credits; "Net" tourism exports = travel credits less travel debits.

Sources: Data from IMF *Balance of Payments Yearbook*; Central Bank of China.

for one. So from the business point of view, many companies would still register SARS-related losses. This measurement problem also exposes a serious weakness in using GDP to indicate "losses" as this is based on net trade. In many cases, it may be true that businesses have suffered heavy losses due to reduced total demand for domestic products, despite relatively lower reductions in net exports. A more appropriate measure of overall economic costs may thus be total final expenditure on domestic goods (taken here to be the sum of domestic demand plus exports). This indictor may be more relevant in evaluating the impact of SARS on business. This issue will be reviewed later in the presentation of the full estimates of SARS losses.

SARS also affected other services sectors, such as transport services. Figure 3.2 reports the importance of trade in services in some Asian economies. It highlights the importance of services in economies such as Hong Kong, China and Singapore. This may have led to greater vulnerability to SARS in these economies. The data in Table 3.3 and Figure 3.2 also show that the economies with larger shares of the tourism sector do not necessarily have a higher GDP share of the services export sector. This indicates that analysis focusing on the tourism sector alone may not be sufficient in analyzing the impact of SARS.

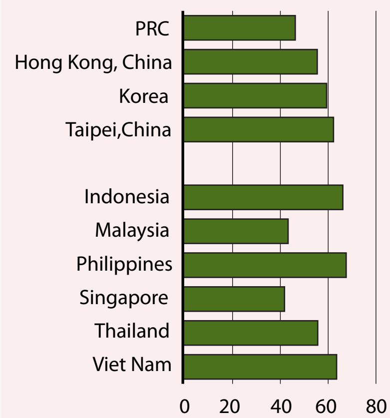
Figure 3.2 Services Exports and Imports, Selected Economies, % of GDP, 2001

Sources: Data from IMF *Balance of Payments Yearbook*; Central Bank of China.

Consumption Patterns. In addition to tourism effects, local consumer confidence was influenced by the SARS scare. However, the evidence seems to point to a rather subdued SARS effect, with little or no sign of losses that can be attributed to SARS in some economies. While it seemed that bars, restaurants, and other leisure industry outlets were hard hit due to local spending cuts as well as tourism losses—and this news was widely covered in the press—total consumption data point to only a small overall impact. This may suggest that consumers did not translate the implied sentiment problem into significant spending cuts. Furthermore, in large economies SARS was relatively confined in terms of its geographical spread. In the PRC, for example, the major affected areas were only Guangdong province and Beijing. The impact on consumption would surely have been more severe had SARS been more widespread.

The impact of SARS on GDP is dependent on the overall importance of consumption in the economy. Consumer spending is a fairly low share of GDP in the PRC (47%). If consumption is a high proportion of GDP, then this exacerbates the impact on GDP of consumer cutbacks: Hong Kong, China and Taipei,China are much more sensitive than the PRC in this respect (Figure 3.3).

Figure 3.3 Consumer Spending, % of GDP, 2002



Sources: Oxford Economic Forecasting; IMF, *International Financial Statistics.*

Initial Conditions

The global economy had been weathering other negative factors in the first half of 2003, such as the conflict in Iraq and its possible effects, as well as the overall weakness in some economies and job markets. In Asia, sentiment was dampened by regional terrorism, especially after the October 2002 Bali bombings. Thus, susceptibility to any shock was probably high in the first half of 2003. The initial economic conditions were very unfavorable in certain cases because of weakening consumption growth from late 2002—for example, Hong Kong, China; Singapore; and Taipei,China. In contrast, the PRC's economy started out 2003 robustly, supported mainly by strong investment and exports. In spite of being hard hit by SARS in April and May, consumption seemed to be recovering well in June. Consumption and the wider economy have also been only slightly damaged in Thailand where no SARS cases were reported but the large tourism sector still suffered from the threat of SARS in the second quarter. Strong economic momentum and consumer and investor confidence before SARS helped take Thailand over this hurdle, along with efforts on the part of the Government and businesses to reassure both visitors and residents.

Thus, looking at the quarterly growth rates, the impact of SARS would appear greater in those economies that were already weak, such as Hong Kong, China; Singapore; and Taipei, China, rather than those with strong growth momentum, such as the PRC and Thailand.

Recent statistics in the PRC; Singapore; and Taipei,China point to a deterioration in consumption of about 1 to 2 percentage points in the second quarter versus the first quarter of 2003. Thailand was similarly affected, due to tourism losses and sentiment problems rather than actual SARS cases. In Hong Kong, China, given the weaker base-year figure for the first quarter, the SARS impact on consumption can also be crudely estimated at about 2 percentage points. But even economies that had neither SARS cases nor significant tourism effects, such as Korea, recorded a poor first half performance in 2003 year on year. Indeed, Korea's figures look remarkably similar to those for Singapore and Taipei,China. This is not mainly due to SARS, though. Korean consumers, after rapid credit-fueled spending in recent years, turned cautious for a variety of domestic reasons, including a sharp drop in credit availability and an impending crisis over the nuclear policy of the Democratic People's Republic of Korea. SARS in neighboring economies may have exacerbated these negative impacts on consumer sentiment in these economies. Indeed, part of the explanation for the weakness in consumption in Hong Kong, China; Singapore; and Taipei,China is also related to ongoing concerns over weak economic growth and rising unemployment, not SARS in itself.

This analysis highlights the importance of disentangling the impact of SARS from the various other factors at work in the first half of 2003, including the conflict in Iraq, high oil prices, and other regional geopolitical issues.

Government Spending Responses

SARS prompted governments in Asia to implement medical and public health measures to prevent and control the spread of the disease. Moreover, many fiscal policy packages have been implemented to stimulate economies.

It is often difficult to mobilize a rapid and effective response through fiscal policy, though modest changes can be made to offer tax offsets and aid to particularly hard hit sectors (in the case of SARS, tourism and retailing businesses). Due to the time lags involved, the impact of fiscal measures may appear not at the same time as the event, but with a delay of perhaps a few months.

Box 3.2 illustrates the reported economic responses of five governments affected by the SARS crisis. On the whole they show a relatively cautious response with most of the increased spending being used to

Box 3.2 Government Economic Measures after the SARS Outbreak

People's Republic of China

April/May Price control/monitoring of SARS-related drugs and goods.

May Temporary reductions/waivers of taxes and administrative fees for SARS-affected industries, including catering and hotels.

Free medical treatment to farmers and poor urban residents who contracted SARS.

Subsidies and temporary exemptions from personal income tax to medical staff treating SARS patients.

Interest subsidies for air transport and tourism sectors.

Hong Kong, China

23 April 2003 The authorities announced a HK$11.8 billion (US$1.5 billion) economic relief package, representing 1% of Hong Kong, China's GDP. The package included the following measures for a limited period:

- temporary reductions/waivers of taxes and administrative fees;
- a job creation scheme; and
- a loan guarantee scheme.

Taipei,China

April/May The authorities announced spending of NT$50 billion (US$1.4 billion) to help meet medical costs and business losses related to the SARS outbreak.

Singapore

17 April 2003 The Government decided to implement a S$230 million (US$132 million) SARS relief package, including:

- temporary reduction/waiver of various administrative fees for tourism and transport sectors; and
- relief measures for airlines.

Malaysia

21 May 2003 The Government announced a RM7.3 billion (US$1.92 billion or 2% of GDP) economic package aimed to assist sectors significantly affected by SARS. Funded from the federal budget and contributions from Bank Negara Malaysia and other financial institutions, the economic package included:

- a reduction of Bank Negara Malaysia intervention rates by 50 basis points for cheaper loans;
- foreign investment guidelines to be more investor-friendly;
- support for tourism-related industries;
- promotion of microcredit schemes and cheaper housing loans; and
- support for job training.

compensate tourism-related industries for the losses incurred by SARS. However, Malaysia's package was more ambitious in the sense that it included measures for the wider economy, although this was adopted rather late in the second quarter. In the PRC, the monthly data suggest that the pace of investment growth by the Government was stepped up during the second quarter of 2003. The impact of fiscal stimulus is likely to be more apparent in the second half of the year

Recent Data and Forecasts: A Pre- and Post-SARS Comparison

Recent Statistical Releases

Recent statistical releases and a comparison of pre- and post-SARS conditions shed some light on the impact of SARS. A number of developments can be spotted from recent statistical releases. SARS-affected economies experienced drops in retail sales growth in the order of 5–10%, with a sharp, but not complete, bounce back in June. Countries such as Thailand, dependent on tourism but free from a SARS outbreak, experienced a similar profile, though to a much more modest extent.

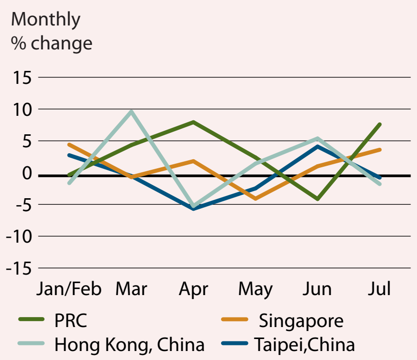
Data on merchandise exports provide few indications of any decisive change in trend at the onset of SARS (Figures 3.4 and 3.5). In the short term, the PRC's export performance appears to have been barely dented, while the exports of the non-SARS economies also show little sign of deteriorating from the early 2003 trends. For Hong Kong, China; Singapore; and Taipei,China the data are more suggestive of a small impact on exports in April–May, that had ended by June.

Recent data confirm the impact of SARS on tourism. April tourist arrivals collapsed by between 20–70% for the economies hit by SARS, while the other economies in the region saw declines of 15–35% (Figures 3.6 and 3.7). The month of May saw a further deterioration in tourism across the region, with a particularly severe drop in Taipei,China. But with the outbreak coming under control, June's arrivals data showed smaller declines, notably in Hong Kong, China and in Singapore. This pattern was broadly repeated in the retail sales figures.

Because data on tourist arrivals are more rapidly available than tourism receipts, the trends established can be used as a guide to the short-term performance of the tourist sector as a whole. That is, these data can be taken as a reasonable proxy for likely swings in US dollar tourism receipts in the second quarter of 2003, largely representing the impact of SARS. Table 3.4 shows rough estimates of the costs to the region's foreign tourism industries of the SARS outbreak. This is done by linking the monthly profile of arrivals so far this year to tourism receipts from previous years. With the SARS outbreak apparently over by June, it is assumed that the year-on-year change in arrivals will smoothly return to zero by the end of the year (Figure 3.8). Using this "rule of thumb", we can determine the change in tourist arrivals for 2003 as a whole and work out approximate figures for the lost revenue relative to 2002's outcome. The estimating method is relatively simple, but nevertheless provides some crude indications of the cost of SARS on tourism.

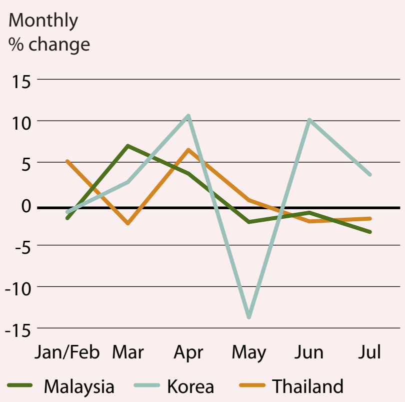
It is assumed that other factors, such as the conflict in Iraq, would have led to a 5% drop in the growth rates of tourist arrivals during 2003 as a whole. As Table 3.5 indicates, this loss alone might still have permitted a small increase in East and Southeast Asia's tourism revenue relative to 2002. Comparing this figure with the prospective revenue loss, including SARS, provides an estimate for the cost of SARS itself. For East and Southeast Asia as a whole, this amounts to nearly $15 billion or 0.5%

Figure 3.4 Seasonally Adjusted Exports, Selected Economies, 2003



Source: Generated from Datastream's seasonal adjustment package.

Figure 3.5 Seasonally Adjusted Exports, Selected Economies, 2003



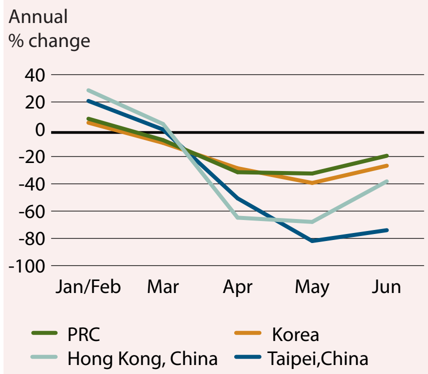
Source: Generated from Datastream's seasonal adjustment package.

Table 3.4 Costs of SARS for Foreign Tourism

Assuming:	Forecast Growth of Visitor Arrivals (%)	Estimated Change in Tourism Revenues Relative to 2002 (US$ billion)
PRC		
Repeat of 2002 growth	10.0	2.0
Iraq conflict effects but no SARS	5.0	1.0
Continuance of SARS (May extrapolation)	-22.9	-7.7
End to SARS in June (August assumption)	-9.6	-4.0
Singapore		
Repeat of 2002 growth	0.6	0.0
Iraq conflict effects but no SARS	-4.4	-0.2
Continuance of SARS (May extrapolation)	-53.6	-2.8
End to SARS in June (August assumption)	-25.6	-1.3

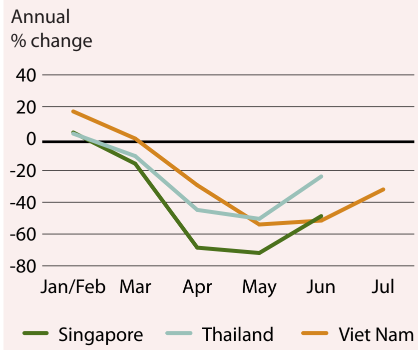
Source: Oxford Economic Forecasting.

Figure 3.6 Visitor Arrivals, East Asia, 2003



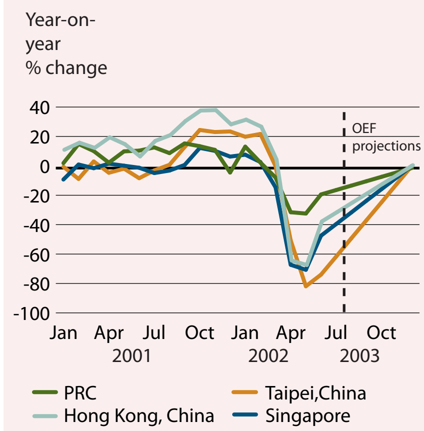
Source: Oxford Economic Forecasting.

Figure 3.7 Visitor Arrivals, Southeast Asia, 2003



Source: Oxford Economic Forecasting.

Figure 3.8 Tourist Arrivals, East Asia and Singapore



Source: Oxford Economic Forecasting.

of GDP. This is a weighted average and reflects the fact that tourism is a relatively small part of the PRC economy; the scale of the losses in the more tourism-dependent economies are much greater as a share of GDP, exceeding 1% in Hong Kong, China; Malaysia; Singapore; and Viet Nam.

These estimates of the costs of SARS focus on lost foreign tourism receipts only and so show only a part of the overall picture. However, they provide a useful starting point in predicting the scale of likely business losses. A more comprehensive analysis of the economic costs of SARS will not only need to assess the impact on other parts of the services account but also the direct impact on consumer spending and the indirect repercussions of the shock on trade and investment (which are discussed later).

Overall, the latest evidence tends to support the view that the main channels of the SARS economic impact were tourism and related service industries, such as air travel. Consumption and other variables were caught up in the backwash; they did not play a lead role in initiating the disturbance to the economies affected.

Pre- and Post-SARS Economic Forecasts

Table 3.6 gives the changes to GDP growth and inflation forecasts over the last 10 months and gives an idea of the possible impact of SARS. So perhaps these changes could be taken as crude estimates of SARS-related losses? In short, no. The changes seen in the forecasts also take account of a number of other factors independent of SARS, such as the conflict in Iraq, the PRC's much stronger than expected economic start to 2003, changing perceptions about the speed of the US recovery, and the unexpected collapse of Korean consumer spending. In the case of the PRC, the ADB forecast for 2003 growth is now higher than it was pre-SARS—the

Table 3.5 Expected Tourism Revenue Change from 2002 Level (US$ billion)

Assuming:	Repeat of 2002 Growth	Iraq Conflict, no SARS	Iraq Conflict and SARS Outbreak	SARS Outbreak Only	SARS Outbreak (% of GDP)
PRC	2.0	1.0	-4.0	-5.0	-0.4
Hong Kong, China	0.8	0.4	-2.3	-2.7	-1.7
Korea	0.3	-0.1	-0.9	-0.8	-0.2
Taipei,China	0.2	0.0	-1.2	-1.2	-0.4
Indonesia	-0.1	-0.4	-0.9	-0.5	-0.2
Malaysia	0.3	-0.1	-1.8	-1.7	-1.7
Philippines	0.1	0.0	-0.2	-0.2	-0.3
Singapore	0.0	-0.2	-1.3	-1.1	-1.2
Thailand	0.6	0.2	-1.1	-1.3	-0.9
Viet Nam	0.2	0.1	-0.2	-0.4	-1.0
Total	4.3	1.0	-13.9	-14.9	-0.5

Note: The first three data columns indicate the change in tourism revenue from the 2002 level under three different scenarios. First, if tourism had grown as fast in 2003 as in 2002; second, an estimate of the increase in tourism revenue assuming the effects of the conflict in Iraq but no SARS; and third, an estimate of the increase in tourism revenue assuming both the effects of the conflict in Iraq and SARS. The difference between the first two data columns gives an indication of the costs for Asian tourism of the Iraq conflict, while the difference between the second and third data columns gives an indication of the impact of the SARS outbreak (shown in data column four).

Source: Oxford Economic Forecasting.

undoubted costs of the outbreak were offset by the unforeseen strength in GDP growth in the first quarter. In contrast, in the case of Singapore, the fall in the 2003 ADB forecast to 0.5% from 4.0% reflects not only the impact of SARS but also heightened concerns over domestic structural issues and some disappointment with the pace of US recovery.

Isolating the SARS Losses

In the context of unexpected shocks like SARS, a global macroeconomic model provides valuable technical information that can help analysts distinguish between those variable changes that were predicted by the usual explanatory factors versus those changes that remained unexplained. With data now available, we can compare the "unexplained" changes in key economic variables between the first and second quarters of 2003 in order to identify the SARS impact in the second quarter and, by effectively reversing this impact, we can then run a counterfactual simulation on the Oxford Economic Forecasting model to estimate what GDP growth, consumer spending, and other variables might have been if the SARS epidemic had not occurred. The difference between this counterfactual and the model's current set of forecasts provides an estimate of the total cost of SARS to the East and Southeast Asian economies in terms of overall GDP losses. This estimate takes account of not just the direct economic effects of SARS, such as the tourism and consumption losses, but also the indirect impacts. For example, the relationships within the model allow for the repercussions of consumer spending on investment, exports, and

Table 3.6 Changes to GDP and Inflation Forecasts

	2003 GDP Growth		2003 CPI Inflation
	Official	ADB	ADB
PRC			
Pre-SARS	7.0	7.2	0.5
Mid-SARS		7.3	0.5
Post-SARS		7.8	1.0
Hong Kong, China			
Pre-SARS	3.0	2.8	-2.7
Mid-SARS		2.0	-1.5
Post-SARS	2.0	2.1	-2.8
Taipei,China			
Pre-SARS	3.7	3.5	0.3
Mid-SARS		3.7	0.4
Post-SARS	3.1	3.1	-0.1
Singapore			
Pre-SARS	2.0–5.0	4.0	0.1
Mid-SARS		2.3	0.5
Post-SARS	0.0–1.0	0.5	0.4
Korea			
Pre-SARS	5.0	5.5	3.1
Mid-SARS		4.0	4.0
Post-SARS	3.5	3.1	3.4
Thailand			
Pre-SARS	4.0–5.0	4.3	0.7
Mid-SARS		5.0	1.3
Post-SARS	4.0–5.0	5.2	1.3
Malaysia			
Pre-SARS	6.0–6.5	5.0	2.5
Mid-SARS		4.3	1.9
Post-SARS	4.5	4.1	1.3

CPI = consumer price index.

Sources: Official forecasts are from government sources. For ADB, pre-SARS forecasts are ADB's forecasts from *ADO* database, December 2002; mid-SARS forecasts are ADB's forecasts from April 2003 (*ADO 2003*); post-SARS forecasts are ADB's forecasts from September 2003 (*ADU 2003*).

imports of goods, employment, and prices. On the assumption that a SARS epidemic does not recur, and tourism recovers by late 2003, losses will largely be confined to 2003.

The results are tabulated in Tables 3.7 and 3.8. The total GDP losses (in US$ billion) estimated by the "model scenario" method are typically larger than the losses indicated in the previous analysis of the likely impact of SARS on tourism receipts. However, for a few economies, this may not be the case as the tourism analysis was only looking at the effect on the inflows of tourist receipts, not taking account of the net position after allowing for cuts in tourism outflows and other imports. Cuts in imports of services (and goods) are allowed for in the final model estimates. Indeed, lower than expected imports have been an important factor in the second quarter GDP data being generally better than many anticipated.

Table 3.7 Costs of SARS for East and Southeast Asian Economies in 2003[a]

	Consumer Spending		GDP		TFE	
	$ billion	% of GDP	$ billion	% of GDP	$ billion	% of GDP
PRC	4.2	0.3	6.1	0.5	17.9	1.3
Hong Kong, China	3.4	2.2	4.6	2.9	12.0	7.6
Korea	0.1	0.0	0.3	0.1	6.1	1.2
Taipei,China	1.8	0.6	1.3	0.5	4.6	1.6
Indonesia[b]			0.3	0.1	1.9	0.9
Malaysia[b]			0.4	0.4	3.0	2.9
Philippines[b]			0.0	0.0	0.6	0.7
Singapore	0.6	0.7	2.7	3.0	8.0	9.0
Thailand	1.0	0.7	1.9	1.4	4.5	3.2
Viet Nam[b]			0.4	1.1	0.4	1.1
Total			18.0	0.6	59.0	2.0

GDP = gross domestic product; TFE = total final expenditure (sum of domestic demand plus exports).

[a] Calculated using the Oxford Economic Forecasting model (technical model estimates based on Q2 data).

[b] No figure for consumer spending is given as no significant change could be attributed to SARS in the second quarter.

Source: Oxford Economic Forecasting.

The overall loss in total final expenditure is also estimated. This may be a more appropriate way of looking at the cost of SARS and total business losses. The losses in total final expenditure terms correspond more closely to many of the initial SARS impact estimates. As mentioned earlier, this may be a better indicator for reflecting the impact of SARS on business.

The analysis reveals that SARS has caused significant losses in several Asian economies, although it has not proved as catastrophic as some feared back at the height of the outbreak in April. The result points to the cost of SARS in terms of lost GDP in nominal terms as being about US$18 billion for developing Asia as a whole, a loss of about 0.6 percentage points for 2003's growth rate for the region. The total final expenditure cost is likely to be close to US$60 billion, about 2 percentage points of GDP. Losses could be put higher still if SARS has created a long-tail problem for investment and exports prospects. These economic costs are very high compared to the actual scale of the disease—representing about US$2 million per person infected based on the GDP estimate, and US$6 million using the total final expenditure estimate. Had the disease lasted two quarters instead of one, with continuing impacts into late 2003 and early 2004, the losses could easily have been two or three times the figures quoted.

The outcomes reflect the scale of each factor in the economy concerned. For the two economies of Hong Kong, China, and Singapore, large losses in services exports are of much greater consequence than a similar percentage loss in services exports for PRC; Korea; or Taipei,China. In addition, the consumer impact on Hong Kong, China was clearly much greater than that seen elsewhere, although the second quarter results for

Table 3.8 Summary Costs of SARS for East and Southeast Asian Economies in 2003 (% of GDP)

	Estimated Loss of Tourism Revenue	Change in ADB 2003 GDP Forecast[a]	OEF Model GDP Loss	OEF Model TFE Loss
PRC	0.4	0.6	0.5	1.3
Hong Kong, China	1.7	-0.7	2.9	7.6
Korea	0.2	-2.4	0.1	1.2
Taipei,China	0.4	-0.4	0.5	1.6
Indonesia	0.2	0.0	0.1	0.9
Malaysia	1.7	0.0	0.4	2.9
Philippines	0.3	0.0	0.0	0.7
Singapore	1.2	-3.5	3.0	9.0
Thailand	0.9	0.9	1.4	3.2
Viet Nam	1.0	0.0	1.1	1.1
Total	0.5	-0.3	0.6	2.0

GDP = gross domestic product; OEF = Oxford Economic Forecasting; TFE = total final expenditure (sum of domestic demand plus exports).

[a] Change in 2003 forecast pre- and post-SARS (ADB estimates).

Source: Oxford Economic Forecasting; staff estimates.

that economy were generally better than many had feared. On the whole, the consumer results have been at the better end of estimates, largely because there was some opportunity for sales to rebound in June after SARS started to fade. The tourism rebound, in contrast, looks likely to take some time to fully materialize as recent data point to an emerging upturn but not yet a full recovery.

Even based on a quite favorable interpretation of the data and forecasts, the GDP losses for some economies are estimated to be very large: for Hong Kong, China and for Singapore up to 3% of GDP looks likely to have been lost to SARS. This rises to 7–9% for losses in total final expenditure, which more closely reflects actual business losses. The GDP losses for some other economies are small because of the offsetting large decline in imports (Korea; Malaysia; Taipei,China). For the PRC, the still quite low level of foreign tourist receipts versus strong merchandise exports also limited the visible costs, though the consumer spending shortfall attributable to SARS may be around US$4 billion. The PRC's total expenditure loss may have been as high as US$18 billion, or 1.3% of GDP. Nevertheless, the impact of SARS in the PRC seems to be moderate. This is confirmed by the recent statistical releases in the PRC that point to a strong economic recovery from the end of the second quarter. High government spending, continued strong investment, and buoyant exports all helped mitigate the epidemic's adverse impact on consumption and tourism.

Overall, the assessment provides a fairly comprehensive indication of the likely economic costs of the SARS outbreak across Asia. But there may be yet further losses linked to potentially long-lasting, or "long-tail", problems, such as delayed effects on exports and investment that are not currently identifiable. For example, investors may become wary of the threat posed by health issues. To reduce such long-term negative impacts, it is crucial that Asian governments take measures to minimize the risk of another outbreak of SARS or other contagious diseases.

Conclusions and Policy Implications

Estimating the impact of an event such as SARS is a difficult and imprecise "science". Indeed, estimates will remain subject to many errors even after all the data become available. Imperfections have to be accepted but analysts can learn from experience, create "rules of thumb", and use this knowledge to gain useful insights that can be called upon when forecasting other major economic events.

Using the data for the second quarter, it is possible now to be more precise in defining the cost of SARS to developing Asia. Similar to results from some earlier attempts, the analysis of this section reveals that SARS has caused significant losses in several Asian economies, although it has not proved as catastrophic as some feared back at the height of the outbreak in April. The result points to the cost of SARS in terms of lost GDP in nominal terms as being about US$18 billion for East and Southeast Asian economies, a loss of about 0.6 percentage points for 2003's growth rate for these economies. The total final expenditure cost is likely to be close to US$60 billion, about 2 percentage points of GDP. Losses could be put higher still if SARS has created a long-tail problem for investment and exports prospects. These economic costs are very high compared to the actual scale of the disease—representing about US$2 million per person infected based on the GDP estimate, and US$6 million using the total final expenditure estimate. Had the disease lasted two quarters instead of one, with continuing impacts into late 2003 and early 2004, the losses could easily have been two or three times the figures quoted.

SARS disrupted short-term economic prospects but also served as a wake-up call to governments and public health organizations. The experience of dealing with SARS carries long-term lessons. In view of the high costs imposed by health scares, countries need to take proactive and forward-looking measures to reduce the risks and costs of SARS and outbreaks of other contagious diseases. A few general points may be noted:

- The experience of dealing with SARS shows that rapid economic growth must be accompanied by social development, including adequate investment in public goods, such as primary health care and education.
- Financing and governance in the health sector should be strengthened to improve efficiency and effectiveness, particularly in rural areas where many of the poor cannot afford health services. The weakness of the PRC's rural health system was a particular concern. Had the disease spread into underequipped rural areas, the consequences could have been dire. Much work needs to be done to strengthen health and other infrastructure in rural PRC and in other developing countries. Even the more sophisticated health care systems in Canada; Singapore; and Taipei,China, where the case numbers were low, proved to have deficiencies, and the aim now must be to maintain public confidence. Efforts also need to continue in improving the systems for monitoring

health risks and operation of health checks on travelers in the event of outbreaks of serious, contagious diseases, and for the management of hospital rapid reaction and isolation units.

- Changes in building regulations may have to be considered with reference to the outbreak in one particular building (Amoy Gardens) in Hong Kong, China, where evidence seems to point to public health hazards within the building structure and maintenance. This would impose some costs in terms of refurbishments and new construction. Given the problems of the property sector in Hong Kong, China since 1998, such changes may require some initial government subsidies to spur rapid action.
- It is worth noting that much of the cost of SARS fell directly on businesses in the region, not governments. This may suggest that local businesses or business organizations may be more willing to support (and finance) policies aimed at curbing health risks. Some of the costs of new health and safety programs might also be recouped via contributions from companies.
- A good communications strategy based on transparent, accurate information is very important during crises. As a general point, rapid statistical analysis should be published to improve predictions of contagion rates. This is critical both for the marshaling of government and medical resources and for informing the public. Economic analysis of the experience of SARS needs to be widely disseminated to improve the understanding of the impact of SARS-type shocks and the feasibility of spending increases aimed at reducing such health risks. Costs of implementing new policies can be compared to the cost of the SARS outbreak.
- Regional cooperation is essential to contain diseases such as SARS. In a globalized world, it does not take long for something like SARS to move across borders and to spread worldwide. Given the high spillover costs to other countries from the SARS outbreak, it is beneficial for countries that were not directly affected to contribute in the prevention, control, and treatment of SARS. In a sense, institutions combating contagious diseases have become a global public good and require international efforts. The burden, of course, needs to be appropriately shared to avoid "free riding".
- Faced with clearly global health threats, there has to be a global rapid-response mechanism with a particular focus on highly contagious diseases. Research into these diseases, preventive measures, and their treatment are tasks requiring global coordination, as is the task of coordinating action when outbreaks threaten. Fortunately, organizations to do this are established and were brought into focus by the outbreak of SARS. Their role was fairly successful given the infrequent nature of the event and impossibility of running serious rehearsals. A large part of the costs involved must fall on the wealthier countries: they can hardly be imposed on developing countries, where the limited amounts of money available locally must be spent on improving basic health care and public health standards. The latter are part of the solution to the problem although they appear rather "low technology" and pedestrian compared to leading-edge medical research. The problems and costs imposed by outbreaks may be global but the heavy burden of the

costs of prevention (even though this is a global public good) may fall unequally on developing countries. It is clearly more fair and appropriate that international institutions should assist with at least part of these additional costs.

- The analysis reveals that impact of SARS appears to be greater in those economies that were already weak before the SARS outbreak, than those with strong growth momentum. Overall strengths of an economy help it guard against adverse shocks such as SARS.

These recommendations are clearly not exhaustive. Although the details of specific projects and costs cannot be examined on a country-by-country basis here—such as upgraded hospital facilities, sewage and water treatment plants, building regulations, and food standards—if a single, short-lived health scare has cost East and Southeast Asia an estimated US$18 billion in GDP in nominal terms and nearly US$60 billion in overall loss in demand and in business revenue, as measured by total final expenditure, then new measures look more cost effective than most people would have believed before the SARS event.

Endnote

[1] For the purposes of this part of the *Update*, East and Southeast Asia comprises the People's Republic of China; Hong Kong, China; Indonesia; Republic of Korea; Malaysia; Philippines; Singapore; Thailand; Taipei,China; and Viet Nam.

Statistical Notes and Tables

The Statistical Appendix presents six selected economic indicators, gross domestic product (GDP) growth (A1), inflation rate (A2), merchandise export and import growth (A3 and A4), and current account and fiscal balance as percentages of GDP (A5 and A6), for 41 developing member countries (DMCs) of the Asian Development Bank. The DMCs are grouped into five subregions: East Asia, Southeast Asia, South Asia, Central Asia, and the Pacific. These six tables are a subset of the accounts included in the Statistical Appendix of *Asian Development Outlook 2003* (*ADO 2003*).

These tables contain historical data from 2000 to 2002 and forecasts for 2003 and 2004. *Update* forecasts are compared to forecasts provided in *ADO 2003*. For economies where update forecasts are not available, which include Bhutan, Maldives, and Myanmar, projections from *ADO 2003* are used. Historical data are obtained from the ADB statistical database system, official country sources, statistical publications, internal documents of the International Monetary Fund (IMF) and the World Bank, and other data service providers. Projections for 2003 and 2004 are staff estimates. For Bangladesh, Nepal, and Pakistan, 2003 values are official preliminary estimates. Data in the tables are either on a calendar year or fiscal year basis. For selected countries, the majority of their accounts are reported on a fiscal year basis (see table on left). However, some of their accounts are recorded on a calendar year basis, as follows: GDP data for Bhutan; GDP and current account data for Cook Islands; and prices for Marshall Islands. Other DMCs record their data in calendar year except for government finance, which are reported on a fiscal year basis: Hong Kong, China and Singapore (fiscal year ending 31 March); Democratic Republic of Timor-Leste; Samoa; and Taipei,China (fiscal year ending 30 June); and the Lao People's Democratic Republic (Lao PDR), and Thailand (fiscal year ending 30 September).

Fiscal Years, Selected Economies

Ending 31 March
India
Myanmar

Ending 30 June
Bangladesh
Bhutan
Cook Islands
Pakistan
Tonga

Ending 15 July
Nepal

Ending 30 September
Marshall Islands
Federated States of Micronesia

Regional averages for DMCs are provided in all tables, except for fiscal balance as a percentage of GDP. Data for Afghanistan, Myanmar, and Nauru are excluded in the computation of subregional averages due to measurement problems. For inflation (A2), Timor-Leste is excluded in the computation of the averages for the Pacific and developing Asia.

Averages for merchandise export and import growth (A3 and A4) are computed on the basis of a consistent sum, which means that where there are missing data for a given year, corresponding data, if there are any, are also excluded in averaging the other year. For the other tables, growth rate of GDP (A1), inflation (A2), and current account balance as a percentage of GDP (A5), levels of gross national income (GNI) at current US$ using the World Bank Atlas method were used as subregional weights to calculate the subregional and regional averages. The same weights were used in the computation of regional averages in *ADO 2003*. Tables on growth rate of merchandise exports and imports (A3 and A4) do not use weights in the computation of averages.

The GNIs, in current US$, for ADB's DMCs from 2000 to 2001 were obtained from World Bank data query (http://devdata.worldbank.org/data-query/). The same weights used in *ADO 2003* are applied in the computation of regional averages, with 2001 as the most recent data at that time. Data for 2001 are used as weights for 2003 and 2004. GNIs for four of the DMCs are unavailable, namely: Cook Islands; Marshall Islands; Taipei,China; and Tuvalu. For these economies, weights are estimated.

Table A1: Growth Rate of GDP. This shows annual growth rates of GDP valued at constant market prices, factor costs, or basic prices. GDP at market prices is the aggregation of the value added of all resident producers at producers' prices including taxes less subsidies on imports plus all nondeductible value-added or similar taxes. Other valuations for GDP use gross payments to factors of production and amounts receivable by the producer from the purchaser for a unit of a good or service exclusive of taxes payable and inclusive of subsidies receivable on products, excluding transport charges invoiced separately by the producer. These valuations respectively refer to factor costs and basic prices. Most DMCs use constant market price valuations. South Asian countries predominantly use constant factor costs, including Bhutan, India, Nepal, Pakistan, and Sri Lanka while Maldives' GDP valuation is at basic prices. Among the Pacific economies, Fiji Islands, Solomon Islands, Tuvalu, and Vanuatu employ constant factor cost valuation.

Table A2: Inflation. Except for India, which reports a wholesale price index and Solomon Islands, which uses a retail price index, the annual inflation rates presented are based on consumer price indices. For most DMCs, the reported inflation rates represent period averages except for Bhutan, Cook Islands, Timor-Leste, and Viet Nam, which use end-of-period data. For Tonga, consumer price index data are reported as average-of-period instead of end-of-period as presented in *ADO 2003*. The data for Singapore is on a calendar year basis, yet the base year used for the computation of inflation rates is November 1997–October 1998. The consumer price indices of the following countries are for a given city or group of consumers only: Cambodia is for Phnom Penh, Marshall Islands is for Majuro, and Nepal is for urban consumers.

Tables A3 and A4: Growth Rates of Merchandise Exports and Imports. The annual growth rates of exports and imports, in terms of merchandise goods only, are shown in this table. Data are in million US$, primarily obtained from the BOP account of each DMC. Exports in general are reported on a free-on-board (f.o.b.) basis. In this case, exports are valued at the customs frontier of the exporting country plus export duties and the costs of loading the goods onto the carrier unless the latter is borne by the carrier. It excludes the cost of freight and insurance beyond the customs frontier. For Cambodia, exports refer to domestic exports. Import data are reported either on an f.o.b. or c.i.f. (cost, insurance, freight) basis. On a c.i.f. basis, the value of imports includes the cost of international freight and insurance up to the customs frontier of the importing country. It excludes the cost of unloading the goods from the carrier unless it is borne by the carrier. For Cambodia, imports only refer to retained imports, referring to total imports net of reexports and including project aid imports and an estimate of unrecorded imports. Retained imports are those goods that are kept in the country for domestic use.

For East Asia, all economies report imports on an f.o.b. basis except for Mongolia which records them on a c.i.f. basis. Imports are valued on an f.o.b. basis for Indonesia, Malaysia, and Viet Nam while the rest of the Southeast Asian countries' imports are valued on a c.i.f. basis. Bhutan, India, and Nepal record imports on a c.i.f. basis while Bangladesh, Maldives, Pakistan, and Sri Lanka value them on an f.o.b. basis. For all the Central Asian economies, all imports are costed on an f.o.b. basis. Most of the Pacific countries report imports on an f.o.b. basis while imports of Cook Islands, Papua New Guinea, and Samoa are recorded on a c.i.f. basis. For Tuvalu, import growth rates are based on customs transactions while in *ADO 2003* data were unavailable for this indicator.

Table 5: Balance of Payments on Current Account (% of GDP). The current account balance is the sum of the balance of trade for merchandise, net trade in services and factor income, and net transfers. In the case of Bangladesh, Cambodia, Lao PDR, Mongolia, Thailand, and Viet Nam, official transfers are excluded from the current account balance. In this table, the reported current account levels are divided by GDP at current prices in US$, except for the Philippines where GNP in current US$ is used.

Table 6: Overall Budget Surplus/Deficit of Central Government (% of GDP). The overall budget surplus/deficit is the residual between central government revenues and expenditures. The difference, computed as a share of GDP, is presented in this table. Data variations may arise due to statistical discrepancies, e.g., balancing items for both central and local governments, and differences in the concept used in the individual computations of revenue and expenditure as compared with the calculation of the fiscal balance. For the Fiji Islands, the computation of budget balance includes the proceeds from the sale of assets. For Kazakhstan, privatization proceeds were treated as financing items rather than revenues in 2002. Some off-budget accounts are included in the computation of the fiscal balance for Turkmenistan.

For PRC, India, Mongolia, and Tajikistan, transactions are those reported by both central and local governments or consolidated government while Azerbaijan and Kazakhstan transactions are those recorded by the general government.

Government revenues comprise all nonrepayable receipts, both current and capital, other than grants. Grants are counted for countries such as Bhutan, Maldives, Nepal, Philippines and all Pacific countries. In some countries, other revenue items are included and excluded in the reported revenue figures: the social security fund is included for the Republic of Korea, the Oil Fund is excluded for Azerbaijan, sales from assets are excluded for the Fiji Islands, and privatization proceeds are excluded for Sri Lanka. For Bangladesh, India, Indonesia, Malaysia, Pakistan, Philippines, Sri Lanka, Thailand, and Viet Nam, government revenue consists of tax and nontax revenues.

Government expenditures comprise all nonrepayable payments to both current and capital expenses. For Bhutan, Cambodia, Lao PDR, Maldives, Pakistan, Nepal, and Sri Lanka, net lending is included in the computation of expenditures. Pakistan's expenditures do not include one-off expenditure items.

Table A1 Growth Rate of GDP (% per year)

Item	2000	2001	2002	2003		2004	
				ADO 2003	*Update*	*ADO 2003*	*Update*
East Asia	8.1	4.4	6.5	5.6	5.6	6.2	6.5
China, People's Rep. of	8.0	7.3	8.0	7.3	7.8	7.6	7.9
Hong Kong, China	10.2	0.5	2.3	2.0	2.1	4.0	4.8
Korea, Rep. of	9.3	3.1	6.3	4.0	3.1	5.3	5.0
Mongolia	1.1	1.0	3.9	5.0	5.0	5.2	5.2
Taipei,China	5.9	-2.2	3.5	3.7	3.1	3.9	4.4
Southeast Asia	6.2	1.7	4.1	4.0	3.9	4.8	4.9
Cambodia	7.0	5.7	5.5	5.0	5.0	5.5	5.5
Indonesia	4.9	3.4	3.7	3.4	3.4	4.0	4.0
Lao People's Dem. Rep.	5.8	5.8	5.9	6.0	5.5	6.5	6.0
Malaysia	8.5	0.3	4.1	4.3	4.1	5.1	4.9
Myanmar	13.7	11.1	-	-	-	-	-
Philippines	4.4	3.0	4.4	4.0	4.0	4.5	4.5
Singapore	9.4	-2.4	2.2	2.3	0.5	4.2	4.5
Thailand	4.6	1.9	5.3	5.0	6.0	5.5	6.0
Viet Nam	6.1	5.8	6.4	6.9	6.9	7.1	7.1
South Asia	4.5	5.0	4.2	5.7	5.8	6.1	6.1
Afghanistan	-	-	-	-	-	-	-
Bangladesh	5.9	5.3	4.4	5.2	5.3	5.8	5.7
Bhutan	5.3	6.6	7.7	-	-	-	-
India	4.4	5.6	4.3	6.0	6.0	6.3	6.3
Maldives	4.8	3.4	6.0	4.2	4.2	2.8	2.8
Nepal	6.0	4.6	-0.5	1.5	2.3	3.5	3.5
Pakistan	3.9	2.2	3.4	4.5	5.1	5.0	5.0
Sri Lanka	6.0	-1.5	4.0	5.0	5.0	5.5	5.5
Central Asia	8.2	10.8	7.3	5.8	7.5	5.8	5.9
Azerbaijan	11.1	9.9	10.6	9.5	9.5	8.0	8.0
Kazakhstan	9.8	13.5	9.4	6.0	9.5	6.2	7.0
Kyrgyz Republic	5.4	5.3	-0.5	5.2	5.2	4.5	5.0
Tajikistan	8.3	10.2	9.1	7.1	6.0	5.0	4.0
Turkmenistan	17.6	20.5	8.6	7.5	10.0	7.5	7.5
Uzbekistan	3.3	4.1	3.2	3.5	3.2	4.0	3.0
The Pacific	-0.4	0.3	-0.3	2.4	2.5	2.5	2.7
Cook Islands	7.9	5.1	2.2	1.5	1.8	3.2	0.2
Dem. Rep. of Timor-Leste	15.0	17.0	-1.1	-2.3	-3.0	1.3	1.0
Fiji Islands	-3.2	4.0	3.8	5.7	5.0	3.6	4.1
Kiribati	1.6	1.8	1.0	2.5	2.5	2.3	1.8
Marshall Islands, Rep. of	-2.0	-1.5	4.0	3.0	3.0	2.0	2.0
Micronesia, Fed. States of	6.3	0.6	-0.2	2.4	2.4	1.5	1.5
Nauru	-	-	-	-	-	-	-
Papua New Guinea	-1.2	-3.4	-2.7	1.0	1.5	2.0	2.0
Samoa	6.9	6.2	1.8	3.6	3.5	3.5	3.5
Solomon Islands	-13.3	-10.1	-4.0	2.0	5.0	3.0	5.0
Tonga	6.5	0.8	1.6	2.5	1.9	2.7	2.6
Tuvalu	3.0	4.0	2.0	2.0	2.0	1.8	1.8
Vanuatu	2.7	-2.1	-2.8	1.3	1.3	2.2	2.2
Average	7.1	4.1	5.6	5.3	5.3	5.9	6.1

- = data not available.

Table A2 Inflation (% per year)

Item	2000	2001	2002	2003		2004	
				ADO 2003	*Update*	*ADO 2003*	*Update*
East Asia	0.5	1.1	-0.1	1.1	1.0	1.4	1.5
China, People's Rep. of	0.4	0.7	-0.8	0.5	1.0	1.0	1.5
Hong Kong, China	-3.7	-1.6	-3.0	-1.5	-2.8	0.5	0.5
Korea, Rep. of	2.3	4.1	2.7	4.0	3.4	3.5	2.7
Mongolia	8.1	8.0	1.7	5.0	5.0	5.0	5.0
Taipei,China	1.3	0.0	-0.2	0.4	-0.1	0.6	0.5
Southeast Asia	2.3	4.6	4.1	4.2	3.1	4.0	3.5
Cambodia	-0.8	0.2	3.3	3.5	3.0	4.0	3.5
Indonesia	3.7	11.5	11.9	10.0	6.6	8.5	6.2
Lao People's Dem. Rep.	25.1	7.8	10.6	8.0	14.0	7.0	10.0
Malaysia	1.6	1.4	1.8	1.9	1.3	2.2	2.6
Myanmar	-0.2	21.2	-	-	-	-	-
Philippines	4.4	6.1	3.1	4.5	4.0	4.5	5.0
Singapore	1.3	1.0	-0.4	0.5	0.4	1.0	1.2
Thailand	1.6	1.6	0.7	1.3	1.4	1.6	1.6
Viet Nam	-0.6	0.8	4.0	5.0	4.0	5.0	4.0
South Asia	6.3	3.7	3.7	4.9	5.5	5.0	4.9
Afghanistan	-	-	-	-	-	-	-
Bangladesh	3.4	1.6	2.4	3.8	5.1	4.5	4.5
Bhutan	3.6	3.6	2.7	-	-	-	-
India	7.2	3.5	3.6	5.0	5.8	5.0	5.0
Maldives	-1.2	0.7	0.9	-	-	-	-
Nepal	3.5	2.4	2.9	5.0	4.5	5.0	5.0
Pakistan	3.6	4.4	3.5	4.0	3.1	5.0	4.0
Sri Lanka	1.5	12.1	10.2	8.5	6.5	7.0	6.0
Central Asia	17.2	13.5	11.3	13.9	10.4	14.2	9.8
Azerbaijan	1.8	1.5	2.8	3.2	3.0	2.9	2.7
Kazakhstan	13.2	8.4	5.9	5.9	6.4	5.4	5.4
Kyrgyz Republic	18.7	6.9	2.0	-	3.5	-	3.5
Tajikistan	32.9	38.6	12.2	10.0	14.5	6.0	5.0
Turkmenistan	8.3	6.0	8.8	-	-	-	-
Uzbekistan	28.0	27.2	24.2	30.0	19.5	32.0	20.0
The Pacific	9.1	6.9	7.1	6.3	8.9	-	5.1
Cook Islands	1.7	9.4	3.9	3.4	2.4	3.4	1.8
Dem. Rep. of Timor-Leste	3.0	0.0	2.0	2.0	3.0	2.0	3.0
Fiji Islands	1.1	4.3	0.7	3.0	3.8	3.6	2.5
Kiribati	0.4	6.0	3.2	-	-	-	-
Marshall Islands, Rep. of	1.6	1.7	2.0	2.5	2.5	-	-
Micronesia, Fed. States of	1.7	1.8	0.2	1.5	1.5	-	-
Nauru	-	-	-	-	-	-	-
Papua New Guinea	15.6	9.3	11.8	9.0	13.8	5.0	6.9
Samoa	1.0	3.8	8.1	3.5	4.7	5.0	3.1
Solomon Islands	8.6	8.0	9.0	8.0	8.0	-	6.0
Tonga	6.2	7.3	10.0	10.0	10.5	-	7.5
Tuvalu	5.3	1.8	2.6	3.0	2.5	-	2.5
Vanuatu	2.5	3.7	2.0	2.5	2.5	2.5	2.5
Average	2.2	2.4	1.5	2.5	2.4	2.7	2.6

- = data not available.

Table A3 Growth Rate of Merchandise Exports (% per year)

Item	2000	2001	2002	2003		2004	
				ADO 2003	*Update*	*ADO 2003*	*Update*
East Asia	22.0	-5.8	12.0	8.3	17.6	9.2	12.1
China, People's Rep. of	27.9	6.8	22.4	10.0	25.0	12.0	15.0
Hong Kong, China	16.0	-5.8	4.9	6.5	16.5	6.2	13.5
Korea, Rep. of	21.2	-14.0	7.5	8.0	12.5	8.0	7.4
Mongolia	18.0	-2.7	0.5	8.0	8.0	8.0	8.0
Taipei,China	21.8	-17.3	6.4	7.4	7.1	7.8	7.3
Southeast Asia	19.5	-10.3	4.4	6.8	7.2	8.7	7.8
Cambodia	44.6	10.8	17.0	7.0	14.0	6.5	14.0
Indonesia	27.6	-12.3	-1.5	3.0	3.0	5.5	5.5
Lao People's Dem. Rep.	9.6	-6.2	3.6	5.2	5.2	5.6	5.6
Malaysia	17.0	-10.6	6.1	8.1	6.4	10.2	7.2
Myanmar	36.8	30.0	-	-	-	-	-
Philippines	9.0	-16.2	10.1	6.0	6.0	7.0	7.0
Singapore	20.0	-11.0	3.2	7.5	9.6	10.2	9.2
Thailand	19.5	-6.9	5.7	6.6	6.6	7.5	7.5
Viet Nam	25.2	6.5	7.4	9.1	10.5	8.4	9.0
South Asia	17.2	1.2	11.5	13.6	14.7	14.7	15.4
Afghanistan	-	-	-	-	-	-	-
Bangladesh	7.9	12.6	-6.7	9.5	9.4	10.5	13.5
Bhutan	9.1	-12.9	-1.8	-	-	-	-
India	19.6	0.1	18.0	15.1	15.1	16.6	16.6
Maldives	18.8	1.4	21.2	-	-	-	-
Nepal	37.5	4.5	-19.0	5.0	3.3	10.0	10.0
Pakistan	8.8	9.1	2.3	12.0	19.1	10.0	12.0
Sri Lanka	19.8	-12.8	-2.4	6.5	10.0	9.0	11.0
Central Asia	44.6	1.8	8.3	6.5	8.6	2.8	5.7
Azerbaijan	75.5	13.7	12.7	9.8	17.9	-5.9	-0.2
Kazakhstan	55.1	3.5	12.0	5.1	5.1	4.3	4.3
Kyrgyz Republic	10.4	-6.0	3.7	13.9	12.4	-	2.3
Tajikistan	18.3	-17.3	7.3	11.3	9.6	10.5	7.8
Turkmenistan	111.7	4.7	8.5	-	19.0	-	14.1
Uzbekistan	0.9	-6.1	-5.7	-	-	-	7.0
The Pacific	-0.7	-13.0	-5.8	-	-	-	-
Cook Islands	38.7	100.9	-39.0	-	-	-	-
Dem. Rep. of Timor-Leste	-90.4	-20.0	50.0	20.0	16.7	16.7	14.3
Fiji Islands	-4.2	-8.4	2.6	9.2	9.2	8.3	8.3
Kiribati	-60.3	25.0	15.6	20.8	11.5	-	8.6
Marshall Islands, Rep. of	19.1	11.8	-	-	-	-	-
Micronesia, Fed. States of	-11.0	26.4	-1.2	-	-	-	-
Nauru	-	-	-	-	-	-	-
Papua New Guinea	7.3	-14.4	-9.2	-	17.9	-	-1.7
Samoa	-24.9	10.8	-7.9	-	32.2	-	-
Solomon Islands	-53.8	-32.6	7.7	7.8	7.8	-	-
Tonga	-9.5	3.4	57.4	-	-	-	-
Tuvalu	-	-	-	-	-	-	-
Vanuatu	1.6	-24.1	1.1	20.1	20.1	5.0	5.0
Average	21.1	-6.8	9.5	7.9	14.1	9.3	10.9

- = data not available.

Table A4 Growth Rate of Merchandise Imports (% per year)

Item	2000	2001	2002	2003		2004	
				ADO 2003	*Update*	*ADO 2003*	*Update*
East Asia	28.4	-6.6	10.3	9.6	21.3	10.5	17.1
China, People's Rep. of	35.2	8.1	21.3	12.0	36.0	14.0	25.0
Hong Kong, China	18.6	-5.5	3.1	5.9	14.2	6.7	15.0
Korea, Rep. of	36.2	-13.4	7.7	9.0	14.8	9.0	8.6
Mongolia	19.8	3.8	8.3	6.0	6.0	5.3	5.3
Taipei,China	25.9	-23.7	3.1	11.5	5.1	10.0	7.3
Southeast Asia	25.2	-9.5	4.3	7.8	7.0	9.6	10.1
Cambodia	33.8	6.9	13.2	6.0	10.0	6.0	10.0
Indonesia	31.9	-14.1	0.4	1.0	1.0	4.5	4.5
Lao People's Dem. Rep.	-3.2	-2.3	-1.8	4.7	2.0	7.5	4.0
Malaysia	26.3	-10.3	8.1	8.8	5.1	11.3	11.9
Myanmar	-10.9	17.8	-	-	-	-	-
Philippines	14.5	-4.5	6.2	5.0	5.0	5.8	5.8
Singapore	22.0	-14.0	0.1	9.8	8.1	11.6	13.1
Thailand	31.3	-2.8	4.4	7.0	7.0	8.0	8.0
Viet Nam	34.5	6.0	19.5	13.1	22.3	12.0	10.0
South Asia	7.3	-1.8	7.5	11.0	12.5	11.5	12.1
Afghanistan	-	-	-	-	-	-	-
Bangladesh	4.8	11.4	-8.7	3.5	10.3	7.5	15.0
Bhutan	14.0	6.1	-4.0	-	-	-	-
India	7.0	-2.8	13.6	11.8	11.8	12.2	12.2
Maldives	-3.4	1.3	-0.5	-	-	-	-
Nepal	22.0	-0.3	-10.9	5.0	15.2	10.0	10.0
Pakistan	-0.1	6.2	-7.5	14.0	21.1	10.0	10.0
Sri Lanka	22.4	-18.4	2.2	9.0	9.0	12.0	12.0
Central Asia	12.5	14.3	0.2	6.3	7.5	5.3	8.1
Azerbaijan	7.4	-4.8	24.5	7.5	32.9	3.8	9.7
Kazakhstan	21.2	23.5	2.0	6.0	6.0	5.7	5.7
Kyrgyz Republic	-8.0	-13.1	25.4	10.6	12.7	-	5.7
Tajikistan	20.3	-7.3	6.5	4.0	5.0	3.7	6.1
Turkmenistan	16.6	36.3	-9.8	-	-1.4	-	12.0
Uzbekistan	-0.9	1.6	-13.5	-	-	-	13.0
The Pacific	-2.9	-3.7	3.3	-	-	-	-
Cook Islands	18.1	13.0	-8.7	-	-	-	-
Dem. Rep. of Timor-Leste	83.2	-0.9	-13.9	-15.9	-8.1	0.0	-9.4
Fiji Islands	-8.7	-4.2	13.5	10.4	10.4	4.9	4.9
Kiribati	-2.7	12.1	18.3	2.0	23.1	-	-11.0
Marshall Islands, Rep. of	-20.6	-10.6	-	-	-	-	-
Micronesia, Fed. States of	12.3	-3.5	-9.9	-	-	-	-
Nauru	-	-	-	-	-	-	-
Papua New Guinea	-7.0	-7.2	2.5	-	6.0	-	0.7
Samoa	-8.2	21.7	5.8	-	6.1	-	-
Solomon Islands	-16.0	-12.4	-26.5	6.2	6.2	-	-
Tonga	12.8	-4.1	2.2	-	-	-	-
Tuvalu	6.0	-	-	-	-	-	-
Vanuatu	-7.6	0.9	-0.4	10.2	10.2	5.0	5.0
Average	25.3	-6.8	8.2	8.9	16.3	10.3	14.8

- = data not available.

Table A5 Balance of Payments on Current Account (% of GDP)

Item	2000	2001	2002	2003		2004	
				ADO 2003	*Update*	*ADO 2003*	*Update*
East Asia	2.5	2.8	4.1	3.0	2.4	2.7	1.9
China, People's Rep. of	1.9	1.5	2.9	1.6	0.2	1.5	-0.1
Hong Kong, China	5.5	7.5	10.8	11.5	12.0	8.5	9.0
Korea, Rep. of	2.7	2.0	1.3	0.0	0.3	-0.3	0.1
Mongolia	-17.8	-16.6	-16.1	-13.4	-13.4	-12.1	-12.1
Taipei,China	2.9	6.4	9.2	7.9	7.9	8.0	8.0
Southeast Asia	8.2	7.2	7.8	6.3	6.1	6.0	6.7
Cambodia	-12.3	-9.7	-9.8	-8.9	-11.0	-9.3	-11.2
Indonesia	5.3	4.9	4.3	3.0	3.0	3.3	3.3
Lao People's Dem. Rep.	-8.4	-7.0	-5.6	-5.7	-4.0	-7.1	-5.0
Malaysia	9.4	8.3	7.6	6.3	6.2	5.7	7.2
Myanmar	-	0.0	-	-	-	-	-
Philippines	7.9	1.7	5.0	2.0	2.0	2.5	2.5
Singapore	14.5	19.0	21.5	21.5	20.8	19.3	22.0
Thailand	7.6	5.4	6.1	4.1	4.1	4.5	4.5
Viet Nam	1.7	1.5	-2.8	-3.7	-6.2	-5.2	-5.8
South Asia	-1.0	-0.1	0.9	0.0	0.8	0.0	0.6
Afghanistan	-	-	-	-	-	-	-
Bangladesh	-1.1	-2.3	0.4	-1.3	0.6	-2.5	-1.2
Bhutan	6.1	0.2	-1.7	-	-	-	-
India	-0.8	0.2	0.7	0.1	0.4	0.2	0.6
Maldives	-8.2	-9.2	-6.9	-	-	-	-
Nepal	-5.3	-5.3	-7.2	-5.0	-9.4	-5.0	-5.0
Pakistan	-0.4	0.6	4.8	2.2	5.9	0.9	4.0
Sri Lanka	-6.5	-1.6	-1.6	-3.5	-2.5	-4.5	-3.0
Central Asia	2.0	-3.5	-1.3	-4.2	-1.5	-5.1	-2.4
Azerbaijan	-3.5	-0.9	-12.6	-15.0	-19.5	-18.0	-21.0
Kazakhstan	3.7	-5.6	-1.8	-1.5	1.5	-1.8	0.4
Kyrgyz Republic	-5.6	-1.3	-2.0	-3.4	-3.4	-5.6	-4.8
Tajikistan	-6.4	-7.0	-2.7	-4.0	-5.3	-4.0	-5.7
Turkmenistan	-	-2.5	2.1	-	5.0	-	4.6
Uzbekistan	2.9	-1.6	2.8	-	-1.0	-	-1.4
The Pacific	4.4	3.7	0.5	-	-	-	-
Cook Islands	-2.6	6.3	6.3	5.9	5.9	-	-
Dem. Rep. of Timor-Leste	21.2	11.7	10.0	-12.2	5.6	-7.3	-6.4
Fiji Islands	-5.5	-3.0	-3.5	-3.7	-3.7	-1.6	-1.6
Kiribati	13.3	3.2	7.7	1.1	-21.5	-	-12.5
Marshall Islands, Rep. of	21.4	38.2	29.7	-	-	-	-
Micronesia, Fed. States of	-5.9	-7.5	3.7	-	-	-	-
Nauru	-	-	-	-	-	-	-
Papua New Guinea	10.2	9.6	0.4	-	4.7	-	2.8
Samoa	5.0	-2.7	1.8	-1.4	-1.5	-	-
Solomon Islands	-15.8	-15.2	-3.5	6.5	6.5	-	-
Tonga	-6.6	-8.5	5.3	-	-	-	-
Tuvalu	-	-	-	-	-	-	-
Vanuatu	1.8	-2.3	-2.1	-0.3	-0.3	-1.1	-1.1
Average	2.8	3.0	4.1	2.9	2.7	2.6	2.4

- = data not available.

Table A6 Overall Surplus/Deficit of Central Government (% of GDP)

Item	2000	2001	2002	2003		2004	
				ADO 2003	*Update*	*ADO 2003*	*Update*
East Asia							
China, People's Rep. of	-2.8	-2.6	-3.0	-2.8	-2.8	-2.6	-2.6
Hong Kong, China	-0.6	-5.0	-5.6	-5.7	-7.0	-4.2	-5.8
Korea, Rep. of	1.3	1.3	3.9	1.0	2.7	2.0	3.2
Mongolia	-7.7	-4.5	-5.7	-6.0	-6.0	-6.0	-6.0
Taipei,China	-1.3	-2.5	-3.0	-2.5	-3.3	-2.5	-2.6
Southeast Asia							
Cambodia	-5.0	-5.5	-6.5	-6.1	-5.3	-5.7	-5.3
Indonesia	-1.6	-2.3	-1.7	-1.8	-1.8	0.0	-1.2
Lao People's Dem. Rep.	-6.0	-7.6	-4.8	-8.6	-7.8	-8.7	-7.3
Malaysia	-5.7	-5.5	-5.6	-4.0	-6.0	-2.5	-2.5
Myanmar	-	-	-	-	-	-	-
Philippines	-4.1	-4.0	-5.2	-4.5	-4.5	-4.0	-4.0
Singapore	2.5	-1.8	-0.1	-0.6	-1.4	2.5	-0.2
Thailand	-2.2	-2.6	-1.4	-2.2	-0.7	-2.0	-1.0
Viet Nam	-4.8	-3.8	-3.5	-5.3	-4.8	-4.6	-4.9
South Asia							
Afghanistan	-	-	-	-	-	-	-
Bangladesh	-6.2	-5.0	-4.6	-3.9	-4.2	-5.2	-4.8
Bhutan	-4.1	-11.8	-6.8	-6.0	-6.0	-	-
India	-9.5	-9.9	-10.1	-9.5	-9.5	-9.0	-9.0
Maldives	-4.4	-4.7	-7.3	-	-	-	-
Nepal	-3.3	-4.5	-3.9	-4.0	-2.8	-4.0	-4.0
Pakistan	-6.6	-5.2	-5.2	-	-4.4	-	-
Sri Lanka	-9.9	-10.8	-8.9	-7.5	-7.5	-6.5	-6.5
Central Asia							
Azerbaijan	-2.2	-2.1	-2.2	-	-	-	-
Kazakhstan	-0.1	-0.4	-2.8	-2.0	-	-1.9	-
Kyrgyz Republic	-9.2	-5.0	-5.9	-4.7	-4.9	-4.3	-4.2
Tajikistan	-0.6	-0.1	-0.1	-0.5	-0.9	-	-
Turkmenistan	0.3	-0.9	-	-	-	-	-
Uzbekistan	-2.4	-1.5	-1.8	-1.5	-	-1.5	-
The Pacific							
Cook Islands	-1.9	1.5	0.3	-2.5	-2.5	-	-
Dem. Rep. of Timor-Leste	-	-6.8	-5.6	-4.7	-7.3	-	-5.9
Fiji Islands	-3.4	-6.5	-7.0	-4.0	-4.0	-	-2.8
Kiribati	26.3	7.6	21.4	-12.9	-	-	-
Marshall Islands, Rep. of	8.9	17.2	9.1	8.8	8.8	-	-
Micronesia, Fed. States of	-6.6	-5.8	2.4	1.7	1.7	-	-
Nauru	-	-	-	-	-	-	-
Papua New Guinea	-2.4	-3.7	-4.1	-2.3	-2.0	-	-1.8
Samoa	-0.7	-2.3	-2.1	-1.9	-1.9	-	-1.4
Solomon Islands	-4.1	-11.5	-12.2	-0.3	-0.3	-	-
Tonga	0.8	-0.9	0.9	-2.9	-2.9	-	-2.0
Tuvalu	32.2	-42.8	84.7	-6.5	-6.5	-	-
Vanuatu	-7.1	-3.7	-1.5	0.4	0.4	-	0.5

- = data not available.