ASIAN DEVELOPMENT Outlook 2002 UPDATE

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FOREWORD

The *Asian Development Outlook 2002 Update* reviews macroeconomic trends in the developing member countries of the Asian Development Bank and revises the economic forecasts for the region for 2002 and 2003 that were made in the *Asian Development Outlook 2002*, published in April this year. The 2002–2003 economic outlook for developing Asia and the Pacific as a whole has not changed significantly since then. However, East Asia, Southeast Asia, and Central Asia had a stronger than expected performance in the first half of 2002, while South Asia and the Pacific had weaker than expected performance.

The *Update* was prepared by staff of the Asian Development Bank. The overall preparation of the *Update* was coordinated by the Economics and Research Department (ERD) in collaboration with the regional departments and the resident missions of ADB. The *Update* was put together by a team led by J.P. Verbiest, Assistant Chief Economist (Macroeconomics and Finance Research Division) assisted by Cindy Houser, and comprising Douglas Brooks, Emma Fan, Jesus Felipe, Charissa Castillo, and James Villafuerte. The chapter "Developing Asia and the World" was prepared by Cindy Houser. The subregional chapters were written by Douglas Brooks (South Asia), Emma Fan (East Asia), Jesus Felipe (Southeast Asia), Valerie Reppelin-Hill (Central Asia), and Diwesh Sharan (the Pacific). Selected individual country contributions were made by Douglas Brooks (Republic of Korea), Emma Fan (Hong Kong, China), Jesus Felipe (Thailand), David Green (Indonesia), Naved Hamid (Pakistan), Christine Kuo (Singapore), Yeo Lin (Taipei,China), Xuelin Liu (Philippines), Hiranya Mukhopadhyay and Sudipto Mundle (India), Alessandro Pio (Viet Nam), Purnima Rajapakse (Bangladesh), and Min Tang (People's Republic of China).

Production of the *Update* was coordinated by Charissa Castillo and James Villafuerte. Statistical support was provided by Emma Banaria, Veronica Bayangos, Heidee Lozari, Maritess Manalo, Ma. Olivia Nuestro, Aludia Pardo, and Pilipinas Quising. Secretarial services and proofreading were rendered by Eva Olanda assisted by Bang Cabellon. The manuscript was copy edited by Jonathan Aspin. Typesetting was carried out by Mercedita Cabañeros and computer graphics were generated by Anna Maria Juico. Book and cover design were conceptualized by Ram Cabrera.

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I take this opportunity to thank all contributors, and hope that readers will find the *Update* useful. ADB welcomes feedback on the *Update* via telephone (++632 632 4444), fax (++632 636 2444), or email (ado2002update@adb.org).

Ifzal Ali
Chief Economist
Economics and Research Department

Manila
September 2002

CONTENTS

iii	Foreword
v	Acronyms and Abbreviations
vi	Definitions
3	Developing Asia and the World
17	East Asia
27	Southeast Asia
39	South Asia
49	Central Asia
55	The Pacific
61	Statistical Appendix

ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
ADO	*Asian Development Outlook*
ASEAN	Association of Southeast Asian Nations
CARs	Central Asian republics
CCPI	composite consumer price index
CIS	Commonwealth of Independent States
CPI	consumer price index
DMC	developing member country
ECB	European Central Bank
EU	European Union
FDI	foreign direct investment
f.o.b.	free on board
FY	fiscal year
GDP	gross domestic product
IBRA	Indonesian Bank Restructuring Agency
ICT	information and communications technology
IFI	international financial institution
IMF	International Monetary Fund
LIBOR	London interbank offered rate
NPA	nonperforming asset
NPL	nonperforming loan
OECD	Organisation for Economic Co-operation and Development
PRC	People's Republic of China
R&D	research and development
SBI	Sertifikat Bank Indonesia (Bank Indonesia Certificate)
SME	small and medium-sized enterprise
SOE	state-owned enterprise
US	United States
VAT	value-added tax
WPI	wholesale price index
WTO	World Trade Organization

DEFINITIONS

The classification of economies in the *Asian Development Outlook 2002 Update*, by major analytic or geographic groupings such as industrial countries, developing countries, Africa, Latin America, Middle East, Europe, and transition economies generally follows the classification adopted by the International Monetary Fund (IMF). However, the IMF classification refers to Latin America as developing countries in the western hemisphere.

For purposes of *ADO 2002*, the following apply:

- **Developing Asia** refers to 41 developing member countries (DMCs) of the Asian Development Bank discussed in *ADO 2002*, including the Democratic Republic of East Timor.
- **East Asia** comprises People's Republic of China; Hong Kong, China; Republic of Korea; Mongolia; and Taipei,China.
- **Southeast Asia** comprises Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam.
- **South Asia** consists of Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.
- **Central Asia** comprises Azerbaijan, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.
- **The Pacific** covers Cook Islands, East Timor, Fiji Islands, Kiribati, Marshall Islands, Federated States of Micronesia, Nauru, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu.
- **Euro area** comprises Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, and Spain.

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.
- — means that data are not available.
- Quarterly growth figures are relative to the previous quarter on a seasonally adjusted annualized rate (unless otherwise specified). When rates relate to the same period in the previous year, they are denoted as year on year.
- This *Asian Development Outlook 2002 Update* is based on data available up to 12 September 2002.

ASIAN DEVELOPMENT

Outlook

2002 UPDATE

PART 1

DEVELOPING ASIA AND THE WORLD

DEVELOPING ASIA AND THE WORLD

The economic performance of the Asian Development Bank (ADB) developing member countries (DMCs or developing Asia) in the first half of 2002 met expectations overall as the Asia and Pacific region took advantage of a recovery in export growth as well as continued domestic demand expansion. Developing Asia's economic growth is expected to strengthen from an average pace of 3.7% in 2001 to 5% in 2002—up slightly from the 4.8% forecast at the time of the release, in April 2002, of the *Asian Development Outlook 2002 (ADO 2002)*. For 2003, the recovery should continue to build strength at about the same pace as envisaged in *ADO 2002* (currently 5.7% as compared to 5.8% in *ADO 2002)*, as external demand stimulus moderates while investment gradually strengthens.

The somewhat enhanced 2002 outlook is not uniform across developing Asia. While export performance has generally improved, the impact has been offset by adverse weather conditions in South Asia, reinforced by strong investment growth in Central Asia, and strengthened by relatively robust consumption expansion in East Asia and Southeast Asia. In the Pacific DMCs, the outlook has deteriorated, in part because of macroeconomic instability.

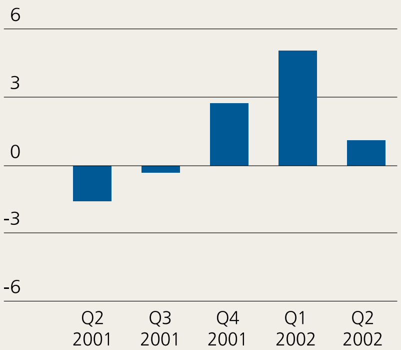
Although ADB expects the developing Asia recovery to continue to strengthen over 2002–2003, short-term uncertainty about the sustainability of the world economic expansion is tempering enthusiasm. In addition to deteriorating business sentiment in industrial economies, rising oil prices and financial sector turbulence are amplifying the risk of a return to world economic recession. Developing Asia's recovery is vulnerable to such an event. However, given the fact that the fundamentals in the region are generally healthier than in 1997, it is unlikely that a significantly weaker global economy would trigger a systemic crisis in developing Asia.

Economic growth in the region recovers.

Sources: ADO database; staff estimates.

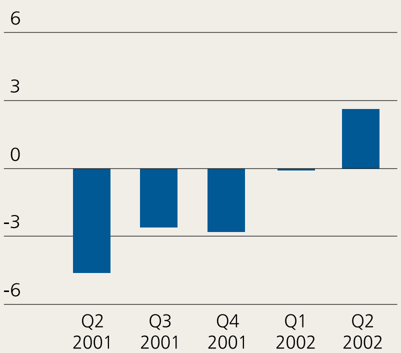
Global recovery pauses ...

United States
GDP growth, %



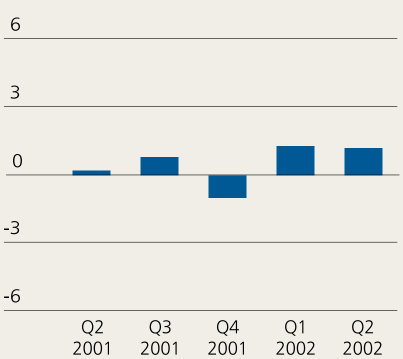
Source: www.fedstats.gov.

Japan
GDP growth, %



Source: www.stat.go.jp.

Euro Area
GDP growth, %



Source: www.europa.eu.int.

Note: For the above figures, quarterly growth rates are seasonally adjusted and annualized from previous quarter.

SHORT-RUN EXTERNAL CONDITIONS

Short-Run Conditions in Major Markets. The pace of United States (US) economic growth slowed appreciably in the second quarter of 2002. In the third quarter of the year, buffeted by a volatile downward spiral in equity prices, consumer and business sentiment was deteriorating and new orders for goods and services were stagnating. Thus, as compared to an *ADO 2002* baseline view that US real gross domestic product (GDP) would grow by about 3.0% in 2002 and in 2003, this *Update* is based on a lower baseline assumption of US economic growth in 2002 with some strengthening in 2003 (Table 1.1). Canada is expected to continue to grow faster than 3.0% a year while political uncertainty and financial sector turmoil will affect economic performance in Central and South America.

Table 1.1 **Baseline Assumptions on External Conditions, 2002–2003**

Item	2002	2003
US GDP growth (%)	2.00 – 2.50	2.75 – 3.25
Japan GDP growth (%)	-0.50 – 0.00	0.75 – 1.25
Euro area GDP growth (%)	0.75 – 1.25	2.25 – 2.75
US Federal Funds rate (%, end period)	<2.00	—
Spot oil prices ($/barrel, Brent crude, average)	>$25	—

— Not forecast.

In tandem with evidence of moderating US economic growth, there are increasing concerns that the momentum of growth will ease in Japan, despite strong export performance in the first half of 2002. Continued weakness in domestic demand, in part because of fiscal restraint, and a less optimistic view of export growth over the short term, expressed in mid-August 2002 by the Bank of Japan, translate into a more conservative baseline assumption for the Japanese economic outlook in 2002–2003. Despite relatively weak global demand, Australia is expected to grow faster than any of the Group of Seven (G7) leading industrial economies over 2002–2003 with economic performance in New Zealand somewhat more moderate but still relatively robust.[1]

Similarly, with business and consumer sentiment in the euro area affected by events in the US, heightened uncertainty about the economic outlook prompted the European Central Bank to shift to a more neutral stance in August 2002. Concern over the impact of flooding in Germany in August is also weighing on sentiment. Thus, it is now assumed that the euro area, which avoided an economic recession in 2001, will experience weaker economic growth in 2002 than the 1.5% increase of 2001, before rebounding in 2003. Economic growth in the United Kingdom, the highest among the G7 economies in 2001, should moderate somewhat in 2002 before rebounding in 2003.

Short-Run Developments in World Trade in Goods and Services. In the first half of 2002, world trade was slowly recovering from its worst growth performance in two decades in 2001 when, as the World Trade Organization (WTO) reports, the value of world merchandise exports fell by 4% and the value of world services exports declined by 1%. During the first half of 2002, the seasonally adjusted

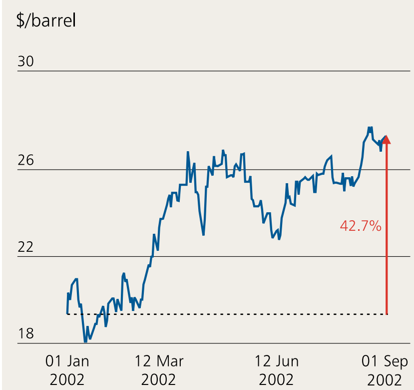
[1] G7 consists of Canada, France, Germany, Italy, Japan, United Kingdom, and United States.

value of US merchandise imports grew at an annualized pace of 7.2% from the second half of 2001.[2] The value of US services imports grew even more rapidly.

While this would suggest a faster pace of growth of world trade than previously expected, other advanced economies have not exhibited the same improvement. For example, the seasonally adjusted value of merchandise imports of the G7 economies in the first 5 months of 2002 shrank at an annualized rate of 2.4% from the previous 5 months.[3] Overall, it is likely that the value of world trade in goods and services will return to positive growth in 2002 but at a slower pace than the average growth rate of 6.5% experienced over 1990–2000. Given the apparent slowing of the rate of world economic growth, it is likely that the sluggish pace of world trade expansion will persist into 2003.

Consistent with a recovery in world economic activity and trade that is both sluggish and uneven across sectors, trade price trends since the beginning of 2002 have been mixed. Most significantly, oil prices rose markedly since the beginning of the year, although the average price over the first 8 months of 2002 ($23.90 a barrel) was still below the average 2001 price ($24.30 a barrel). Higher prices are, in part, a result of conservative Organization of Petroleum Exporting Countries (OPEC) production quotas and, in part, a result of concern over the stability of the world oil supply.

... alongside rising crude oil prices.



Source: Brent spot prices, CEIC Data Company, Ltd.

Other commodity prices rose in the first 8 months of 2002, particularly gold prices (up over 17% in early September 2002 from a year earlier) and wheat (up over 40% from a year earlier). However, many metals prices have fallen, including aluminum (down over 5% in early September from a year earlier). Manufacturing prices are also still weak. For example, reflecting waning hopes of a rapid recovery in the information and communications technology (ICT) sector, semiconductor chip (DRAM 128-mb)prices were below $1.50 in early September 2002, despite having surged to over $4.00 late in the first quarter of 2002.

Financial Markets. Generally favorable conditions in world financial markets in the first quarter of 2002 gave way to significant turbulence in the second quarter, triggered by a deterioration of confidence in US equity market fundamentals. Equity market adjustments were most severe in the US (where the Dow Jones Industrial Average lost about 17% of its value from the beginning of the year through early September) and in Europe (where the Dow Jones Euro STOXX 50 lost over 33% of its value during the same period).

In credit markets, short-term interest rates, after steep declines through much of the world in 2001, remained low and stable through the first 8 months of 2002. Long-term rates fell in tandem with the shift out of equity markets. The benchmark 10-year US Treasury Note yield fell from about 5.0% on 10 January 2002, to below 4.0% in early September 2002. Amid heightened risk and risk aversion, however, corporate and emerging market sovereign risk premiums edged up, particularly for low-grade corporate bonds and for certain sovereign

[2] Excluding intra-European Union (EU) trade, by value the US accounted for 23.5% of 2001 world merchandise imports and 15.4% of 2001 world exports, while the EU accounted for 18.2% and 18.4% of 2001 world imports and exports, respectively. The US is thus, by far, the largest single source of net external demand for goods. The 2001 US merchandise trade deficit of $450 billion was equal to nearly 50% of the combined merchandise exports (excluding reexports) of the top 10 developing Asia exporters (People's Republic of China [PRC]; Hong Kong, China; Republic of Korea (hereafter Korea); Taipei,China; Singapore; Malaysia; Thailand; India; Indonesia; and Philippines). Sources: World Trade Organization (WTO) *Annual Report 2002*, page 23, www.wto.org; US Government, www.bea.gov.

[3] WTO calculates that these countries accounted for over 50% of the value of 2001 world merchandise imports and over 45% of the value of world exports. Sources: WTO *Annual Report 2002,* page 23, www.wto.org; Organisation for Economic Co-operation and Development (OECD), statistical database, www.oecd.org.

Weighted average exchange value of the US dollar falls.

Source: www.economy.com.

bonds perceived as vulnerable, such as those of countries in South America. Nevertheless, for most investment grade and sovereign bonds, yields fell overall.

In contrast to financial market trends in the wake of the events of September 11, 2001, financial inflows into the US weakened, as investors appeared to be reevaluating the attractiveness of US investments. The US dollar began to depreciate relative to most major currencies after mid-April 2002, losing over 5% of its weighted average value in a 3-month period and igniting fears of a major correction in currency markets, before recovering in late July 2002. This represented the largest broad-based depreciation since a nearly 7.0% drop in a 4.5 month period beginning in late August 1998 and came after the weighted average exchange value of the US dollar rose by nearly 8% over 1999–2000.

REVIEW OF SHORT-RUN DEVELOPMENTS AND OUTLOOK FOR DEVELOPING ASIA

Recent Economic Developments. Economic indicators for developing Asia improved on balance in the first half of 2002 as the region continued to shake off the economic doldrums of late 2000 and early 2001. Of 10 major DMC economies (accounting for over 90% of DMC economic activity), virtually all had steady, improving, and even quite strong economic growth by the second quarter of 2002 (Table 1.2), while several DMCs in central Asia (Azerbaijan, Kazakhstan, Tajikistan, and Turkmenistan) continued to post the highest economic growth rates in developing Asia.[4] Overall, economic indicators in the first half of 2002 have been somewhat stronger than expected at the time of *ADO 2002*, in which a relatively slow-building recovery was anticipated.

Table 1.2 **Quarterly Real Gross Domestic Product, Selected DMCs**
(% change from same quarter in previous year)

DMC	Q1 2001	Q2 2001	Q3 2001	Q4 2001	Q1 2002	Q2 2002
China, People's Rep. of	8.1	7.7	7.1	6.7	7.6	8.0
Hong Kong, China	2.3	1.6	-0.3	-0.9	-0.5	0.5
India	1.5	3.5	5.3	6.2	6.4	—
Indonesia	4.8	3.8	3.1	1.6	2.2	3.5
Korea	3.7	2.9	1.9	3.7	5.8	6.3
Malaysia	3.0	0.4	-0.9	-0.5	1.1	3.8
Philippines	2.9	3.0	3.0	3.9	3.7	4.5
Singapore	5.0	-0.5	-5.4	-6.6	-1.5	3.9
Taipei,China	0.6	3.3	-4.4	-1.6	1.2	4.0
Thailand	1.7	1.8	1.6	2.1	3.9	5.1

— Not available.
Sources: ARIC web site (www.aric.adb.org); Central Statistical Office, India; *Census of Statistics,* Hong Kong, China; *National Statistics of Taiwan,* Taipei,China.

Part of the stimulus for the improvement in economic growth came from an improvement in external demand. The substantial contractions in export values in the second half of 2001 and early 2002 gradually gave way to recovery and, in some cases, renewed strength. However, for many DMCs, exports in January–

[4] The 10 major DMCs are PRC; Hong Kong, China; Korea; Taipei,China; Singapore; Malaysia; Thailand; India; Indonesia; and Philippines.

Table 1.3 **Merchandise Exports, Selected DMCs, 2002**
(free-on-board value in $, % change from same period in previous year)

DMC	Jan	Feb	Mar	Apr	May	Jun	Jan–Jun	July	Jan–Dec[a] *ADO 2002*	Jan–Dec[a] *Update*
China, People's Rep. of	29.2	0.8	3.5	17.3	18.4	17.8	14.1	28.1	6.0	10.0
Hong Kong, China	-12.2	-9.1	2.3	2.5	-1.8	8.0	-1.6	9.8	1.6	3.9
India	18.2	0.8	1.0	18.2	3.9	12.8	8.6	17.7	9.9[b]	6.9
Indonesia	-16.4	-11.8	-13.4	-0.4	-3.2	4.6	-6.9	3.0	10.5	-3.0
Korea	-10.0	-17.4	-6.1	8.8	6.6	0.0	-3.1	19.4	7.0	10.0
Malaysia	-2.1	-14.9	4.0	6.5	3.7	5.8	0.4	15.1	7.0	5.5
Pakistan	-7.9	-13.3	-0.9	6.9	6.7	1.3	-1.1	19.3	3.3[b]	4.6
Philippines	-8.9	-6.3	-0.7	22.4	12.2	12.3	4.3	23.0	3.0	4.0
Singapore	-10.2	-23.1	-13.1	6.6	0.1	2.0	-6.5	17.9	5.0	5.5
Taipei,China	-1.4	-20.5	-2.3	0.1	8.8	8.9	-1.0	14.8	5.5	8.0
Thailand	-6.4	-8.1	-4.6	1.1	4.3	4.5	-1.5	7.7	4.0	2.7

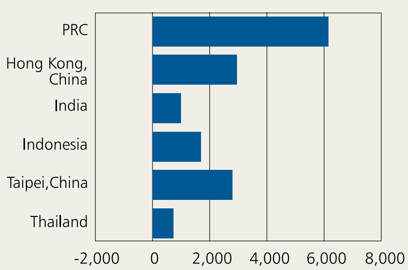
[a] Staff forecast.
[b] Fiscal year forecasts converted to calendar year forecasts.
Sources: Institute of International Finance, www.iif.com; staff estimates.

June 2002 were still lower than in the first half of 2001 (Table 1.3). Only the People's Republic of China (PRC) and India among the large countries experienced robust expansion of exports from the year-earlier period. Nevertheless, there was a clear general improvement in export momentum by June 2002 and evidence of acceleration in July 2002 that provided substantial support to economic recovery. The pace of export expansion was faster than *ADO 2002* forecasts in PRC, Kyrgyz Republic, Philippines, and Tajikistan, leading to an upward revision of export forecasts for those countries. Forecasts of export performance were raised in Hong Kong, China; the Republic of Korea (hereafter Korea); Pakistan; Singapore; and Taipei,China—despite weak performance in the first half—because of evidence of significant strengthening of growth momentum early in the second half of the year. The pace of recovery in exports was slower than *ADO* forecasts in other DMCs, resulting in downward revisions.

Domestic demand was the main source of growth in the first two quarters of 2002 in DMCs such as Korea and Malaysia, where both consumption and investment were expanding, and in Kazakhstan, where investment expanded rapidly. However, domestic demand remained relatively weak in other DMCs such as Hong Kong, China and Taipei,China where structural constraints and fiscal restraint affected the outcome. In PRC, India, Indonesia, and Thailand, there was a balance between the contributions of domestic demand and external demand. Nevertheless, for most of the region, domestic demand expansion was not uniform across expenditure categories as gross capital formation continued to contract or posted low growth (Hong Kong, China; Indonesia; Philippines; Singapore; and Taipei,China). The slow recovery in investment in the region is a consequence of several factors, including an uncertain global recovery, excess manufacturing capacity, poor profit performance, liquidity constraints for small and medium-sized businesses in some DMCs, and persistent weakness in some real estate markets.

In keeping with a recovery driven by exports and private consumption, in which investment remains weak, import growth lagged behind export growth in

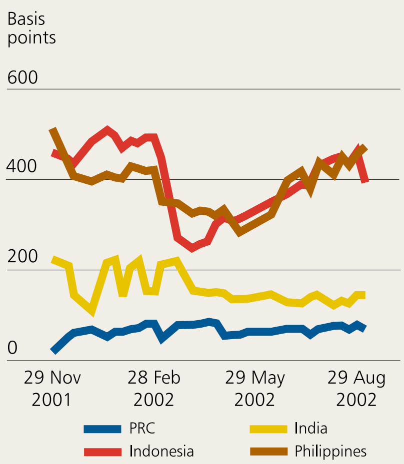
Trade balances strengthen in some DMCs ...



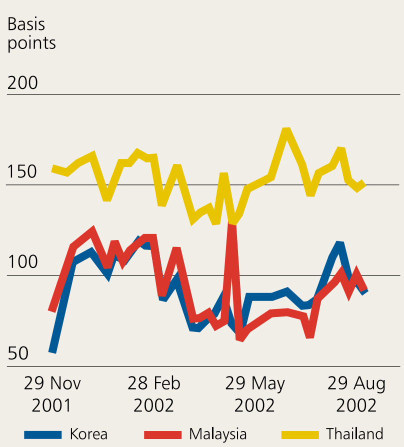
Change in trade balance in first half 2002 from first half 2001, $ million

Source: www.iif.com.

... while sovereign spread movements are mixed.



Source: Business Monitor International. *Asia Weekly Financial Alert*, various issues.



Source: Business Monitor International. *Asia Weekly Financial Alert*, various issues.

many DMCs (Table 1.4), contrary to what one might expect in the early stages of a recovery. The PRC stands out for its impressive counter-trend growth in merchandise exports; its rapid, if somewhat less impressive, growth in imports; and its large and growing trade surplus, which, on its current trend, could reach $40 billion or more for the whole of 2002. India also displayed a growing trade surplus on the strength of more rapid growth in exports than in imports. For Indonesia; Taipei,China; and Thailand, the increased trade surplus resulted from a more rapid contraction in imports than in exports as export growth momentum returned only in the second quarter. Korea, Malaysia, Pakistan, and Singapore exhibited modest trade balance deteriorations.

Table 1.4 **Merchandise Imports of Selected DMCs**
(value in $ millions, free on board)

DMC	Jan–Jun 2001	Jan–Jun 2002	% change
China, People's Rep. of	110,958	122,426	10.3
Hong Kong, China	98,726	94,553	-4.2
India	22,208	23,123	4.1
Indonesia	15,844	12,150	-23.3
Korea	72,488	70,731	-2.4
Malaysia	35,397	36,286	2.5
Pakistan	4,934	5,061	2.6
Philippines	15,255	15,921	4.4
Singapore	59,980	55,943	-6.7
Taipei,China	53,641	50,193	-6.4
Thailand	28,071	26,875	-4.3

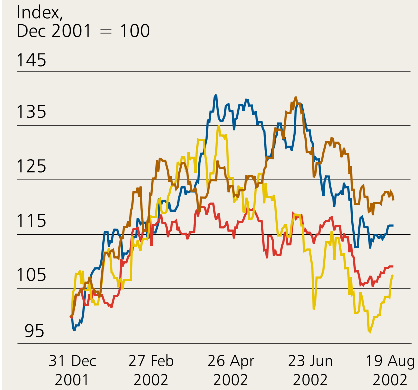
Source: Institute of International Finance, www.iif.com.

Financial conditions were supportive of an expansion in private consumption in much of developing Asia in the first half of 2002. For the most part, short-term interest rates were stable and relatively low. As compared to 2001, monetary authorities were relatively inactive in credit markets in developing Asia through early September 2002, with Hong Kong, China; India; and Taipei,China making no adjustments in interest rates; the Philippines and Thailand making 25 basis point cuts; the PRC cutting by 54 basis points; and Korea raising its official interest rate by 25 basis points. Long-term bond yields edged down in the first part of the year but began to drift up again in April 2002 concurrently with the fall of US yields and an improvement in sentiment concerning the outlook in developing Asia. At end-August 2002, sovereign spreads were wider than at end-2001 in the PRC (by 30%), Philippines (by 12%), and Indonesia (by 6%) but down in others, especially Pakistan, where the spread fell by more than 50% from the beginning of the year through the end of August.

Equity market performance in developing Asia was mixed but substantially better than in North America, South America, or Western Europe, in which there were double-digit losses virtually across the board in the first 8 months of 2002. This is in part because during the 1997 financial crisis bubbles in Asian stock markets burst; after this, investors priced a reassessment of the quality of corporate governance and accounting in Asia into equity prices. Thus, the mixed performance of equity markets in developing Asia reflects, in part, country-specific factors. Stock market gains in Indonesia, Korea, Malaysia, and Thailand may reflect investor optimism about improvements in economic fundamentals and prospects, while the reverse is true for Hong Kong, China; Philippines; Singapore; and Taipei,China.

Accompanying relative regional strength in equity markets and weakness of the US dollar against the euro and the yen, currencies in some DMCs tended to strengthen both against the dollar (Table 1.5) and in real effective terms (Indonesia; Korea; Singapore; Taipei,China; and Thailand). This was in contrast to the real effective depreciation that these DMCs experienced in 2001. Currencies in other DMCs, however, were broadly stable or remained fixed against the dollar but tended to depreciate in real effective terms (PRC; Hong Kong, China; India; Malaysia) in contrast to their experience of appreciation in real effective terms in 2001 (except for Hong Kong, China).

While stock markets improve in some DMCs ...



Notes: Indonesia: Jakarta Stock Exchange Composite Index; India: Bombay Stock Exchange Index 200; Korea: Korea Stock Exchange Composite Index; Thailand: SET.
Source: CEIC Data Company Ltd.

Table 1.5 **Nominal Exchange Rate, Selected DMCs**
(% change; - = depreciation of local currency)

	2000	2001	Jan–Aug 2002
Bangladesh	-5.6	-5.3	-1.2
India	-6.9	-2.9	-0.5
Indonesia	-21.4	-9.9	10.0
Korea	-9.1	-3.8	10.5
Pakistan	-10.5	-2.6	1.1
Philippines	-19.5	-1.3	-0.8
Singapore	-4.1	-6.3	5.4
Taipei,China	-7.2	-6.1	2.6
Thailand	-12.8	-1.3	4.8
Viet Nam	-3.4	-3.6	-1.7

Sources: ARIC web site (www.aric.adb.org); CEIC Data Company Ltd.

... they decline in others.

Notes: Hong Kong, China: Hang Seng Index; Philippines: Philippine Stock Exchange Composite Index; Singapore: Straits Times 55; Taipei,China: Taiwan Stock Exchange Composite Index.
Source: CEIC Data Company Ltd.

2002–2003 Outlook. The basic contour of the *ADO 2002* outlook for developing Asia of a gradual strengthening of economic growth over the medium term—which nevertheless falls short of historical trend performance—remains in shape. A review of recent DMC economic performance clearly indicates an improvement in economic conditions, demonstrates some surprisingly strong performance in many DMCs in the first half of 2002, and merits a slight upward revision to the 2002 forecast for developing Asia (Table 1.6). Expected 2002 economic performance has strengthened for East Asia, Southeast Asia, and Central Asia but weakened for South Asia and the Pacific. For 2003, the pace of external demand expansion is expected to moderate. Moreover, with scant evidence of a sustained recovery in investment spending in many DMCs, improvement in domestic demand is expected to be modest so that the 2003 forecast has been revised slightly downward. However, inflation is now expected to be somewhat more subdued and current account surpluses are expected to be rather more persistent over the forecast period.

In East Asia, Korea is growing significantly more in 2002 than expected at the time of *ADO 2002*, based primarily on strong growth in consumption and a modest recovery in investment and exports. However, more balanced growth is expected over the remainder of the forecast period. The PRC and Taipei,China are growing

Table 1.6 **Selected Economic Indicators, Developing Asia, 2000–2003**

Indicator	2000	2001	2002 *ADO 2002*	2002 *Update*	2003 *ADO 2002*	2003 *Update*
Gross Domestic Product (%)						
Developing Asia	7.0	3.7	4.8	5.0	5.8	5.7
East Asia	8.2	3.9	5.2	5.7	6.2	6.1
Southeast Asia	6.0	2.0	3.4	3.8	4.3	4.6
South Asia	4.2	4.8	5.4	3.9	6.4	5.7
Central Asia	8.7	10.7	5.7	6.2	6.4	5.7
The Pacific	-1.1	-1.2	1.9	1.1	2.6	2.1
Inflation (%)						
Developing Asia	2.3	2.9	3.1	2.8	3.3	3.0
East Asia	0.7	1.4	1.5	1.0	2.3	2.0
Southeast Asia	2.5	5.1	5.7	5.0	4.4	3.9
South Asia	6.2	3.7	4.1	5.4	4.8	4.9
Central Asia	17.0	13.6	10.0	10.8	5.6	8.2
The Pacific	9.6	7.0	6.0	7.6	3.1	6.6
Current Account Balance (% of GDP)						
Developing Asia	3.1	3.1	1.9	2.2	1.1	1.7
East Asia	2.3	2.5	1.8	1.8	1.0	1.2
Southeast Asia	8.8	7.2	5.0	5.7	4.0	4.9
South Asia	-1.0	-0.2	-1.7	-0.4	-1.9	-0.6
Central Asia	-0.5	-4.2	-4.5	-4.1	-4.9	-4.4
The Pacific	3.7	2.7	0.2	0.2[a]	3.0	3.0[a]

[a] *ADO 2002* forecast.
Sources: ADO database; staff estimates.

somewhat faster than forecast, primarily on the basis of unexpected strength in export demand, which is expected to moderate over the next several months so that growth forecasts for 2003 are largely unchanged.

In Southeast Asia, most economies are growing faster than anticipated in *ADO 2002*, despite a slower than expected recovery in exports. With investment showing only limited signs of recovery, however, most of this appears to be driven by public and private consumption expansion. The subregion is expected to experience moderate strengthening of economic growth in 2003 as the recovery in investment strengthens.

In South Asia, economic performance in Pakistan was better than expected in fiscal 2002 (ending June 2002) but adverse weather conditions (particularly both drought and flooding in India), relatively weak external demand, and political unrest shaved expectations for the subregion's overall economic performance in 2002. The subregion's economic outlook for 2003 has deteriorated somewhat, primarily because of the lingering effects of adverse weather conditions and a more subdued outlook for external demand.

In Central Asia, robust expansion of investment and exports (in real terms, despite weakness in commodity prices early in the year) significantly improved the 2002 outlook, while continued macroeconomic instability dampened the 2002 outlook for the Pacific. Because the pace of export expansion is expected to slacken in Central Asia, economic growth is likely to moderate slightly in 2003 while the outlook for the Pacific will strengthen with improved macroeconomic stability.

LONG-RUN TRENDS AND ISSUES FOR DEVELOPING ASIA

Long-Run Growth. As highlighted in *ADO 2002*, economic growth over 1997–2001 and expected economic growth in 2002–2003 are generally below historical trends (see *ADO 2002*, Table 1.3, page 19). Although it is expected that developing Asia will move closer to long-run trend growth over the remainder of the forecast period, considerable uncertainty remains over the strength of that long-run trend relative to past performance. Beyond 2003, the external foundations for developing Asia's long-term growth appear to be strong. Despite recent downward revisions, US productivity growth performance indicates that long-term growth of about 3.0% is a reasonable expectation. This is in spite of a worrisome return to US federal fiscal deficits over the next few years, which pose a risk to long-term interest rates and, hence, investment spending. A gradual strengthening in the euro area and Japan is also anticipated. Moreover, world trade is expected to return to a rate of expansion more in line with its average over the previous decade. The specific outlook for the electronics industry, in which developing Asia is a strong net exporter, is for global growth of about 9% a year over the next decade.[5]

The regional and national foundations for long-run growth are also gradually emerging. It is important for investment, which has been weak over the past several years, particularly in Southeast Asia, to strengthen. This is apparent from a cursory examination of investment and economic growth rates (Table 1.7). Although there is no deterministic relationship between savings rates and investment rates or between investment rates and growth rates in the short run (especially since the composition and efficiency of investment varies across countries and time), there is a general tendency for low savings rates (i.e., high consump-

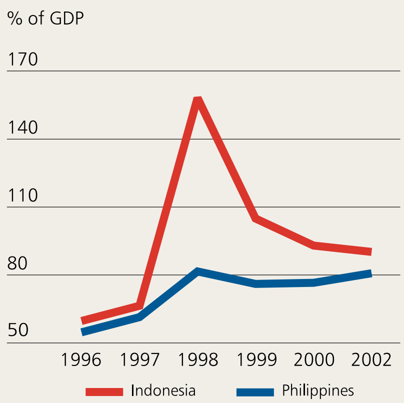
Table 1.7 **GDP Growth, and Savings and Investment Shares, Selected DMCs, 1996–2001 average** (%)

DMC	GDP Growth	Savings/GDP	Investment/GDP
China, People's Rep. of	8.3	40.1	37.8
Korea[a]	8.0	33.5	31.8
Malaysia[a]	7.9	45.2	33.4
India	5.9	22.9	24.0
Taipei,China	5.7	26.1	23.7
Bangladesh	5.2	19.7	21.5
Thailand[a]	5.0	32.5	28.0
Philippines[a]	4.6	18.9	20.4
Indonesia[a]	4.6	26.9	23.2
Pakistan	3.8	12.5	17.1

[a] Crisis-affected economy.
Note: For crisis-affected economies, years of contraction were excluded from averages.
Source: ADO database.

[5] Andrew C. Gross and Edward D. Hester. 2002. *The Global Electronic Industry.* Business Economics. National Association of Business Economists. July, pp. 59–65.

External debt is high in some DMCs.



Source: www.iif.com.

tion rates) to be associated with low rates of growth. In this regard, there are favorable signs that the region is moving toward a higher and more sustainable growth trajectory. The recent cyclical surge in the relative importance of public and private consumption to economic growth—with exports, investment, and the magnitude of economic growth relatively weak—may be giving way to a return to more uniform contributions from all expenditure components, especially investment.

Policy Implications. For efficient private investment to resume, particularly in the manufacturing and services industries, it is important for fiscal policy to gradually shift to a more neutral stance as evidence of a recovery in external demand, foreign investment, and domestic investor confidence becomes clearer. Over the last several years, particularly in East Asia and Southeast Asia, there has been a general tendency toward deteriorating fiscal balances (Table 1.8). Rising public debt obligations have accompanied the increased tendency toward fiscal deficits. For many DMCs, such as PRC; India; Korea; Singapore; and Taipei,China, this is primarily in the form of domestic debt, sometimes representing a significant proportion of total domestic debt. In contrast, for others, such as Indonesia and the Philippines, total external debt has increased relative to GDP since 1996, a significant portion of which is public sector debt. Debt service as a share of earnings from exports of goods and services plus income from abroad was above 15% in 2001 for India, Indonesia, Pakistan, Philippines, and Thailand. In addition to existing debt obligations, high levels of nonperforming loans (NPLs) in many DMCs represent a contingent liability that further impacts on the fiscal position of governments.

Risks to the Outlook. The most significant risk over the forecast period is that, over the short term, external demand weakens noticeably. This could happen if the US recovery stalls and the world economy slips back into recession. However, such an event would probably not have as severe an impact on most of developing Asia as the 2001 global recession. This is because such a recession would likely be a consumer-led slowing of aggregate demand rather than an investment-led one. As such, it would not impact on the ICT sector as disproportionately—and hence on East Asia and Southeast Asia—as did the last recession. Indeed, having suffered through a prolonged period of weakness extending back to the fourth quar-

Table 1.8 **Overall Budget Surplus/Deficit (-) of Central Government, Selected DMCs, 1996–2001** (% of GDP)

DMC	1996	1997	1998	1999	2000	2001
Bangladesh	-4.6	-4.3	-4.1	-4.8	-6.2	-6.1
China, People's Rep. of	-1.4	-1.5	-2.1	-2.9	-2.8	-2.6
Hong Kong, China	2.9	6.6	-1.8	0.8	-0.6	-5.2
India	-4.1	-4.8	-5.1	-5.4	-5.7	-5.7
Indonesia	1.0	0.5	-1.7	-2.8	-1.6	-2.3
Korea	0.3	-1.5	-4.2	-2.7	1.1	1.3
Malaysia	0.7	2.4	-1.8	-3.2	-5.8	-6.7
Pakistan	-6.4	-6.4	-7.6	-6.1	-6.5	-5.3
Philippines	0.3	0.1	-1.8	-3.6	-3.8	-3.8
Taipei,China	-1.3	-1.6	0.1	-1.3	-4.8	-4.3
Thailand	0.7	-1.8	-7.6	-11.2	-3.2	-2.1

Source: ADO database.

ter of 2000, and with current inventories very low, the ICT sector, currently expected to recover only gradually, presents the possibility of unexpectedly strong growth when a recovery in investment in both industrial and developing Asian economies is firmly established.

A related risk is that oil price spikes occur either because of renewed instability in the Middle East or because of seasonal surges in demand in the coming winter season in the Northern hemisphere. Oil prices have already risen significantly since the beginning of the year and are not expected to fall substantially before 2003 because of generally tight supply conditions and heightened concern about supply disruptions in the Middle East. A sustained surge in oil prices would adversely impact on the sustainability of the world economic expansion.

In contrast to the possibility of rising oil prices, a third risk involves a threat of price deflation, which has become of increasing concern in recent years because of a general global trend of low and falling inflation: deflation can inhibit economic growth with its ability, for example, to suppress consumption, squeeze profit margins, and increase debt burdens. Deflation is accelerating in Japan, while all the G7 countries except the United Kingdom are expected to have inflation of less than 2% in 2002. The risk of general global deflation is still relatively low because of continued price inflation for services. Moreover, as of now, only Hong Kong, China among DMCs is experiencing general deflation. Yet PRC; Singapore; and Taipei,China have very low inflation rates. In addition, of more significance for the relatively open economies of developing Asia, is the deflationary trend in prices of traded goods and services. According to International Monetary Fund (IMF) statistics, the price deflator, in US dollars, for world trade in goods and services was negative in 1996–2001 and is expected to remain negative in 2002. If falling prices squeeze profit margins for developing Asia's exporters, the recovery in investment could be inhibited.

A final risk to the region is the risk of weakness in the financial sector, which may continue to inhibit a recovery in investment and thus a return to higher trend growth. With relatively high external debt levels in some DMCs and high estimated ratios of NPLs to total loans in PRC (19%); Indonesia (12.1%); Malaysia (11.5%); Philippines (17.3%); Singapore (8.0%); Taipei,China (7.8%); and Thailand (10.5%), the region's vulnerability to financial sector weakness is clear.[6] Moreover, these NPL ratios may be regarded as conservative estimates, especially when the large bad debt portfolios held by asset management companies are considered. Nevertheless, the risk of systemic financial sector crisis in the region is still generally quite low.

[6] Nonperforming loan figures are from DBS Economic-Market Research. 2002. *Macroeconomic Focus and Strategy*. 14 June, p. 4, Table 1.

EAST ASIA

During the first half of 2002, economic expansion in the East Asian subregion as a whole was more robust than had been projected in *ADO 2002.* Although downside risks are increasing, growth in all East Asian economies is expected to be sustained during the remainder of 2002, and to edge up further in 2003. East Asia is now forecast to expand by 5.7% in 2002, as compared to the original forecast of 5.2% in *ADO 2002*. Growth is forecast to reach 6.1% in 2003, slightly lower than the 6.2% previously expected.

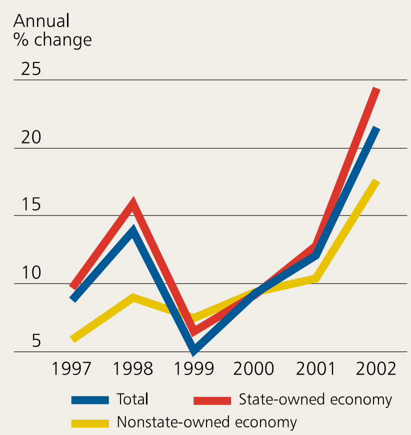
MACROECONOMIC ASSESSMENT

Economic activity strengthened across all East Asian economies in the second quarter of 2002, but rates varied significantly among economies. The PRC and Korea posted among the highest growth rates in Asia, spurred by strong domestic demand and rising external demand. In the PRC, growth in the first half of 2002 reached 7.8% year on year as GDP rose by 8% in the second quarter. Korea's economic recovery started in late 2001 and gathered momentum in 2002. Real GDP grew by 5.8% in the first quarter and by 6.3% in the second, equivalent to annualized growth of 6.1% for the first half of 2002. The economy of Taipei,China also showed signs of rebounding. GDP increased by 1.2% in the first quarter, ending three consecutive quarters of contraction, and further strengthened to 4% in the second. The economy of Hong Kong, China grew slowly by 0.5% year on year in the second quarter of 2002, after contracting for three consecutive quarters. Growth in Taipei,China and Hong Kong, China was supported by strong export recovery. Domestic demand in these two economies, however, continues to be weak. Preliminary data for Mongolia indicate that the economy is performing better than in 2001, due to more favorable weather conditions.

The divergent economic performances in East Asia were in part the result of differences in domestic demand. In the PRC, increases in urban household incomes boosted domestic consumption. The per capita income of urban residents rose by 17.5% in the first half of 2002, partly attributable to the implementation of pay rises for government employees and retirees that were approved by the Government in March and October 2001. Retail sales of consumer goods grew by 8.6% in the first 6 months of the year. The surge of investment particularly has been an important driver of domestic demand. Fixed investment grew by 21.5% over the same period, underpinned by strong growth in the state-owned, collective, and private sectors. Investment in the state-owned sector was bolstered by a rapid disbursement of Treasury bond investment funds, which reached Y76.2 billion by the end of June 2002, or nearly half the total amount planned for 2002.

The surge of investment has been an important driver of domestic demand.

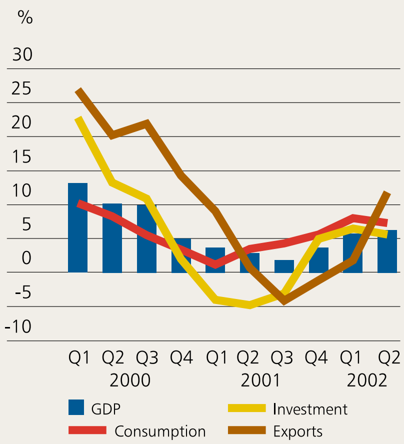
Growth of Nominal Fixed Investment, People's Republic of China, 1997-H12002



Sources: Asian Development Bank, 2002, *Country Economic Review, People's Republic of China; China Statistical Abstract 2002;* PRC National Statistical Bureau, *China Statistical Yearbook 2001*, China Statistics Press.

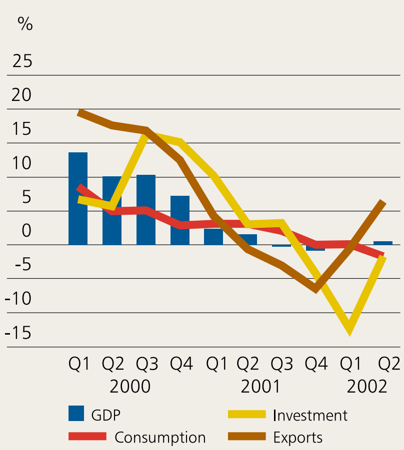
Divergent economic performances were partly due to differences in domestic demand.

Growth Rates of GDP and its Expenditure Components, Korea, Q1 2000-Q2 2002



Source: www.bok.or.kr.

Growth Rates of GDP and its Expenditure Components, Hong Kong, China, Q1 2000-Q2 2002



Source: www.info.gov.hk.

This compares to 30% of the total disbursed over the same period in 2001. Private investment reflected an acceleration of investment in real estate, which expanded by 32.9% in the first half of the year due to increasing housing mortgage loans from commercial banks.

The current strength of the Korean economy also owes much to strong domestic demand, in contrast to the beginning of previous expansions. Private consumption was up by 8.0% in the first 6 months, year on year. In the second quarter, fixed investment rose at an estimated 5.6% year on year. Domestic demand has been fueled by a reduction in excise taxes as well as a sharp rise in construction activities. The robust recovery in the economy, and greater economic flexibility resulting from corporate and banking sector restructuring in recent years, contributed to a decline in the unemployment rate to 2.7% as of June 2002.

By comparison, domestic demand in Taipei,China and Hong Kong, China remained sluggish, dampened by record high unemployment, falling earnings, deflation, and the languid performance of asset markets. Weak consumer sentiment is evident in Hong Kong, China, with real consumption spending falling by 2.4% in the second quarter year on year. Real investment spending contracted by 1.7% in the second quarter from a year earlier. In Taipei,China, private consumption increased by only 1.6% and 2.4% in the first and second quarters of 2002, respectively. Investment was particularly weak, with gross fixed investment contracting by 5.4% in the second quarter of 2002, following a 14.4% fall in the first quarter. Investment over the past 2 years in Hong Kong, China and Taipei,China has been held back by uncertain growth prospects, significant excess capacity, and the relocation of manufacturing production to the PRC.

The weak domestic demand in Hong Kong, China partly reflects the prolonged impact of the Asian financial crisis. Hong Kong, China's property market, for example, continued to weaken. As of June 2002, prices had fallen by about 60% since the third quarter of 1997. Between December 2001 and March 2002, prices for residential buildings fell by 1.1% while prices for offices fell by 4.1%, after both had dropped by 12% in 2001. The wealth effect resulting from declining property prices has depressed domestic demand in the short term. Promising signs are beginning to emerge, however. Mortgage lending rose for the fourth consecutive month in June with refinancing loans surging by 29.2% from the previous month. In addition, residential property sales have picked up in recent months. The Government resumed sales of subsidized public housing in July following a 10-month moratorium, albeit scaled back to avoid competing with the private sector and further depressing the real estate market. Demand for commercial property, however, continued to fall during the first half of 2002 in the wake of more corporate downsizing, suggesting that the property slump may still take some time to abate.

In Mongolia, preliminary data indicate that total industrial output grew by 14.2% year on year during the first 7 months of 2002. While no data on agriculture are available, a slight recovery in the livestock sector is expected due to the mild winter. Overall growth in the first quarter of 2002 appears more promising than it was in the equivalent period in 2001.

Due to the pursuit of expansionary fiscal policies, fiscal deficits increased in most of East Asia's economies. In the PRC, public expenditures were 17.8% higher in the first half of 2002 than in the same period a year earlier. Fiscal revenues, however, grew by only 9.2% in the first half of 2002 year on year, significantly lower than the 27% growth recorded in the first half of 2001. Revenue growth slowed, due mainly to lower stamp duties resulting from falling stock market prices, increased tax rebates for exporters, and reduced import duties following tariff reductions after the country's WTO accession. As a result, the budget deficit rose from 2.6% of GDP in 2001 to a targeted 3% in 2002. Concern over the shortfall in revenue collection has led the Government to step up its efforts to crack down on smuggling and to close tax loopholes. In Hong Kong, China, the 2002/03 budget released on 6 March 2002 included a partial waiver of property tax payments by households for 1 year, as well as several other waivers on fees and public service charges. Weak economic growth and these tax relief measures caused the budget deficit to swell to 5.2% of GDP in fiscal year 2001/02 (which ended in March 2002). In Taipei,China, the weak economy, combined with a number of tax incentives, led to a decline in general government revenues of 22.3% in 2001, while they increased by only 3.2% in the first 7 months of 2002 year on year. The public debt to GDP ratio increased from 28.8% by the end of 2001 to 29.2% in June 2002. Korea is the exception, in that its consolidated fiscal balance for the first half of 2002 was in surplus to the tune of about 2.7% of GDP.

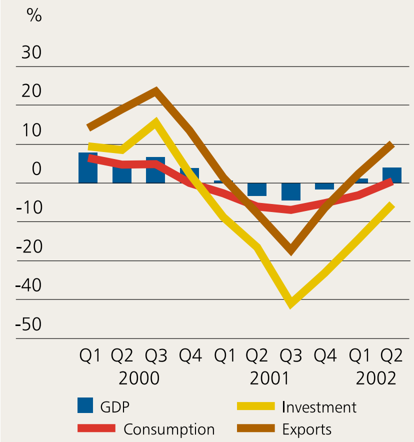
Monetary policies have generally been expansionary in East Asia. Due to continued deflation, the PRC central bank reduced the deposit rate by 25 basis points and the lending rate by 50 basis points in February 2002, after holding them unchanged for more than two and a half years. Money supply (M2) was up by 14.7% at the end of June 2002 from a year earlier. Liquidity in the banking system remains high as deposits in both local and foreign currencies far outpace loans. In Taipei,China, the central bank cut its official discount rate by 25 basis points to 1.875% in June 2002. The average prime lending rate of the five leading domestic banks declined from 7.38% in December 2001 to 7.23% in July. In Hong Kong, China, interest rates remain at historically low levels in line with those in the US. The 3-month Hong Kong dollar interbank offered rate (HIBOR) declined from 6.57% in the fourth quarter of 2000 to 1.81% in the second quarter of 2002. Bank lending to households surged in Korea, thus boosting private consumption. This contrasted with greater lending to firms in previous expansion periods. One noteworthy feature of recent bank lending to households in Korea has been the rapid increase in the use of credit cards, a trend promoted by the Government. This not only facilitated household consumption spending, but also pushed up fiscal revenues, since more transactions are recorded.

Despite expansionary monetary policies, deflation remains an issue in East Asia. Taipei,China's CPI showed very little movement in the first 7 months of 2002. Deflation is showing few signs of abating in Hong Kong, China. The general price level, as measured by the composite consumer price index (CCPI), had been falling for 44 consecutive months as of June 2002. The CCPI was 2.9% lower in the first half of 2002 than a year earlier. In the PRC, the CPI dropped by 0.8% in the first half of this year. Macroeconomic conditions are only part of the reason behind deflation in the PRC and Hong Kong, China; structural factors also exert an influence. Tariff reductions after the PRC's WTO accession contributed to the fall in prices, while Hong Kong, China's deflation partly reflects weakening property prices.

Among East Asian economies, Korea stands out in that inflationary pressures mounted as the economy recovered strongly. During the second quarter of 2002, the price index rose by 2.7% year on year as a result of price hikes for some petroleum and agricultural products, and of the continued upward trend in property rental prices. Inflationary pressures also came about because of increased capacity utilization in manufacturing, from 73.2% in 2001 to 76.3% in the first half of 2002. Wages, led by construction and some services, were up by 8.4% year on year in the first quarter of 2002.

Weak economic conditions and structural changes have made unemployment a feature of the economic landscape of Hong Kong, China and Taipei,China. The seasonally adjusted unemployment rate for the former climbed to a record high of 7.8% in the 3 months ending July 2002. The effects of more extensive corporate downsizing and layoffs were felt, and employers remain

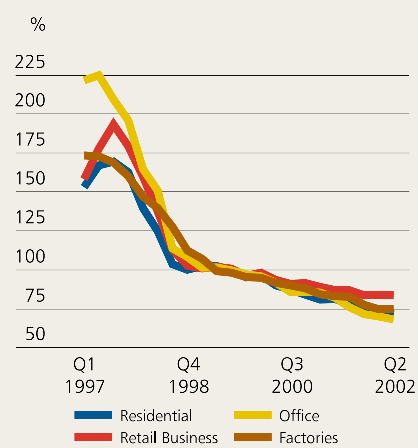
Growth Rates of GDP and its Expenditure Components, Taipei,China, Q1 2000-Q2 2002



Source: www.stat.gov.tw.

Property prices continued to weaken in Hong Kong, China.

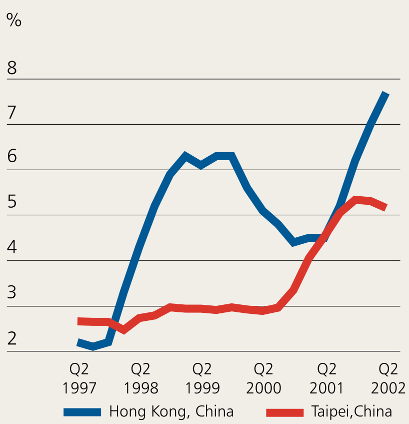
Property Price Index by Type, Hong Kong, China, Q1 1997-Q2 2002 (1999=100)



Source: CEIC Data Company Ltd.
Note: Data refer to average for the quarter.
Q2 2002 comprises April and May only.

Weak economic conditions and structural changes have made unemployment a feature of the economic landscape of Hong Kong, China and Taipei,China.

Unemployment, Hong Kong, China and Taipei,China, Q2 1997-Q2 2002



Sources: www.info.gov.hk; CEIC Data Company Ltd.
Note: Data are end-of-period unemployment rates, seasonally adjusted.

cautious about recruiting new staff. The average nominal wage index fell by 0.8% during the year ending March 2002. The seasonally adjusted unemployment rate in Taipei,China reached a historical high of 5.2% in the first 6 months of 2002, and average monthly earnings for industry sector workers fell by 1% over this period. Wage restraints, rising unemployment, and wealth erosion resulting from falling asset prices have undermined household incomes in both these economies.

In contrast to the varying trends in domestic demand, export growth strengthened in all subregional economies, except Mongolia. In the first half of 2002, PRC exports were 14.1% higher, year on year. Growth in exports to the US; ASEAN countries; Hong Kong, China; and Korea more than offset a slowdown in exports to Japan and the EU. Imports grew more slowly than exports, but were still 10.4% higher in the first half-year compared to a year earlier. As a result, the overall trade surplus amounted to $13.4 billion. FDI to the PRC also grew significantly. Contracted FDI inflows increased by 31.5% to reach $44 billion in the first half of 2002, while actual FDI inflows grew by 18.7% to $24.6 billion over the same period. Due to a wider trade surplus and larger FDI inflows, the foreign exchange reserves increased to $242.8 billion by the end of June 2002, or 14.4% higher than at the end of 2001.

Much of Taipei,China's economic recovery stemmed from the growth of exports in ICT products. While total exports rose by 5.8% in the second quarter of 2002, exports of infomation and communication products increased by 10.8%. Due to weak domestic demand, imports increased by only 2.5% on a yearly basis during this period. Consequently, the trade surplus amounted to $4.3 billion for the second quarter of the year—an increase of 34.1% on the same period in 2001. The external sector is also strengthening in Hong Kong, China. The value of merchandise exports grew by 2.8% year on year in the second quarter, after declining for four consecutive quarters. This pickup was mainly driven by exports to other economies in Asia and the Pacific, with total merchandise exports to East Asia growing by 9% in the second quarter. Exports to North America have also strengthened in recent months. The value of merchandise imports rose marginally by 0.7% in the second quarter. Services exports expanded by 4.6% in the second quarter of 2002 year on year, while services imports remained weak. Consequently, the total trade surplus in the first half of 2002 was more than twice as high as a year earlier.

In Korea, exports of ICT products surged. This contributed to Korea's high export growth of 20.4% in August year on year, with 5.1% expansion in the second quarter of 2002, in strong contrast to the 11.1% contraction in the first quarter. Imports also shifted to positive territory in the second quarter in response to growth in domestic demand and increased exports. As a result, the merchandise trade surplus for the first half of 2002 was $7.7 billion, compared to $5.1 billion in the second half of 2001.

Exports from Mongolia rose by only 1.6% in the first 7 months year on year. The value of copper exports, the country's main export commodity, declined by 10.5% due to falling international copper prices, despite an 8.1% increase in the volume exported. The average price of copper concentrate per ton for the first 7 months in 2002 was 17% lower than over the same period in the previous year. Imports increased by 26.4%. The trade deficit accordingly rose to $164.2 million.

Closer economic integration among the PRC; Hong Kong, China; and Taipei,China is clearly evident, and trade among these three economies is thriving. In Taipei,China, export orders from Hong Kong, China increased by 11.3% year on year in the first half of 2002, which is by far the highest among Taipei,China's trading partners. Much of Hong Kong, China's export rebound has come on the back of strong demand from its biggest export market, the PRC,

Selected Economic Indicators, East Asia, 1999–2003

	1999	2000	2001	2002		2003	
				ADO 2002	*Update*	*ADO 2002*	*Update*
GDP Growth (%)							
Average	7.6	8.2	3.9	5.2	5.7	6.2	6.1
China, People's Rep. of	7.1	8.0	7.3	7.0	7.4	7.4	7.5
Hong Kong, China	3.4	10.2	0.6	2.1	1.4	4.8	3.5
Korea, Rep. of	10.9	9.3	3.0	4.8	6.0	6.0	5.8
Mongolia	3.2	1.1	1.5	3.0	3.0[a]	4.9	4.9[a]
Taipei,China	5.4	5.9	-2.2	2.8	3.0	4.0	4.0
Inflation (%)							
Average	-0.7	0.7	1.4	1.5	1.0	2.3	2.0
China, People's Rep. of	-1.4	0.4	0.7	1.0	0.5	1.5	1.5
Hong Kong, China	-4.0	-3.8	-1.6	-0.8	-2.7	0.6	0.5
Korea, Rep. of	0.8	2.2	4.1	3.5	3.1	4.0	3.5
Mongolia	10.0	8.1	11.2	6.0	6.0[a]	5.0	5.0[a]
Taipei,China	0.2	1.3	0.0	0.7	0.3	2.1	1.5
Current Account Balance (% of GDP)							
Average	3.3	2.3	2.7	1.8	1.8	1.0	1.2
China, People's Rep. of	1.6	1.9	1.7	1.0	1.0	0.4	0.4
Hong Kong, China	—	—	—	—	—	—	—
Korea, Rep. of	6.0	2.7	2.0	1.9	1.1	0.7	0.0
Mongolia	-13.7	-17.2	-16.7	-14.7	-14.7[a]	-13.4	-13.4[a]
Taipei,China	2.9	2.9	6.7	3.9	6.1	3.4	7.0

— Not available.
[a] *ADO 2002* forecast.
Sources: ADO database; staff estimates.

which absorbed 37.8% of the economy's total exports by value in the first half of 2002. Hong Kong, China's tourism growth also benefited from a large inflow of PRC visitors after the PRC Government relaxed its quota restrictions on the number of its citizens allowed to visit Hong Kong, China. Consequently, total tourist arrivals in Hong Kong, China reached 7.5 million in the first half of 2002, 12.8% higher than a year earlier.

The closer economic integration among these three economies has spurred structural changes. Reexports from Hong Kong, China have grown rapidly to account for more than 90% of its total exports. Its reexports consist mainly of goods shipped from the PRC to other destinations. Services exports have outpaced merchandise exports, partly as a result of the need to cater for increased reexports. In recent years, manufacturing facilities in both Hong Kong, China and Taipei,China have been relocating to the PRC to take advantage of low labor costs. This has induced both economies to adopt a greater services sector orientation. While these structural changes will bring significant long-term benefits, the process of adjustment can be arduous in the economies that are losing manufacturing capacity. Employment in manufacturing has steadily fallen from about 234,000 in March 2000 to about 197,000 in March 2002. This continual shrinkage of manufacturing employment has exacerbated Hong Kong, China's unemployment problem during the current economic downturn.

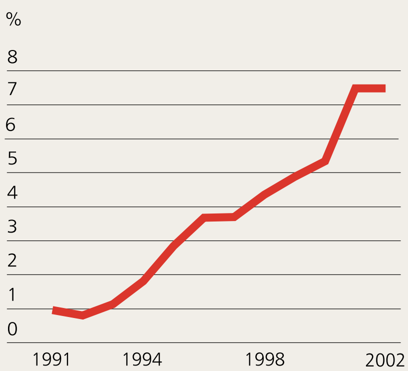
POLICY DEVELOPMENTS

Governments in East Asian economies have pursued expansionary macroeconomic policies over the past few years. The PRC Government carried out its fifth year of fiscal expansion in 2002 by issuing long-term construction bonds worth Y150 billion ($18 billion). The funds will be used to finance a number of areas, including projects in the western region, technological improvement of key enterprises, projects to divert water from the south to the north to supplement the water resources of Beijing and Tianjin, rural infrastructure, and universities and other higher education facilities.

The authorities in Hong Kong, China face the challenges of balancing the budget and reforming the taxation system. They consider the deficit, which is above 5% of GDP, to be structural rather than merely cyclical. In other words, economic recovery alone will not bring the budget back into balance. The authorities are obliged to eliminate a structural deficit under the provisions of the Basic Law. To curtail government expenditures and raise revenues, the 2002/03 budget released in March proposed to cut civil servants' wages by 4.75% from 1 October 2002, but, in July, the Legislative Council settled on cuts of only 1.6–4.4%. The budget also proposed measures to raise revenues, such as levying a HK$18 per person land departure tax from 2003/04. Overall, the 2002/03 budget proposed keeping expenditure growth below the 3% forecast real GDP growth by capping real spending increases to an average of 1.5% a year between 2003/04 and 2006/07. Even then, the budget will not be balanced until 2005/06, and success still requires higher economic growth and spending constraints. This realization has led to debate about reforming Hong Kong, China's tax system. Government revenues have traditionally relied heavily on property-related incomes. Since 1997, property prices have plummeted and the volume of property transactions has declined. This has resulted in lower land premiums, stamp duties, and property taxes. Sluggish economic growth and prolonged deflation have further drained revenues. Much of the debate on taxation reform has centered on the need to reduce the degree to which fiscal revenues depend on real estate. The authorities have contemplated introducing a broad-based consumption tax. However, they are unlikely to introduce new taxes in the current weak economic conditions. The authorities are also reluctant to jeopardize the economy's low tax status.

The increasing level of NPLs has become a concern in Taipei,China, among others.

Nonperforming Loan Ratios of Domestic Banks, Taipei,China, 1991-Q2 2002



Source: www.cbc.gov.

Taipei,China also faces constraints on further fiscal expansion. Legal restrictions on the size of the public debt and government borrowing make it difficult for the authorities to increase public spending. At the same time, the President's promise not to raise taxes in the next 2 years has made raising revenues difficult. Consequently, the authorities have reduced certain tax breaks enjoyed by high-tech companies.

The increasing level of NPLs has become a concern for several East Asian economies. In Taipei,China, the NPL ratio of domestic banks was about 7.5% in the second quarter of 2002, slightly lower than the 8% in the first. In Mongolia, NPLs were about 8.4% of total loans outstanding. By the end of June 2002, the official estimate of the ratio of NPLs to total loans of the four state-owned commercial banks in the PRC was 23.1%. Banks in the PRC have been taking measures to reduce their NPLs, and the NPL ratio is lower than the 25.4% estimated at the end of 2001.

The authorities of Taipei,China have also taken steps to reduce NPLs. In 2001, a NT$140 billion Financial Restructuring Fund was set up, and asset management companies (AMCs) were established to deal with NPL problems. The Fund was already stretched by 2002, so that the Ministry of Finance proposed to increase its size. This may necessitate lifting the current 40% ceiling of the public debt to GDP ratio and the 15% ratio of new government borrowing to accumulated borrowing. The development of AMCs is still at an embryonic stage in the economy, though. AMCs are designed to serve as an intermediary tool for the authorities to deal with NPLs. The ultimate goal is to develop the secondary market through which NPLs can be traded, and for the authorities to be able to use financial asset securitization to deal with NPL problems. Given the conservative attitude and small trading volume that AMCs currently generate, it will be some time before they play a significant role in dealing with the NPL problem.

As a result of robust economic recovery in the first few months of 2002, the Korean Government felt confident enough to reduce the planned rate of expenditure in the first half of the year from 53% of the full-year budget to 50%. This year is the first one since the Asian financial crisis that a supplemental budget has not been implemented by mid-year in Korea.

Various reforms to strengthen and liberalize economies have been adopted in East Asia. The PRC, for example, has been taking steps to fulfill its WTO obligations. The general tariff rate has been lowered from 15.3% to 12.0% over the past few months. The categories of import products that require quota licenses have been reduced from 33 to 12. The number of industries open to foreign investment has been increased from 186 to 262. The opening up of the services sector has intensified. The Government has approved 14 joint ventures in health facilities, 12 for law firms, one joint-venture travel agency, and 10 foreign-funded logistics companies. These areas had previously been largely off limits to foreign investment. Commercial banks in the PRC have been encouraged to provide more credit to small and medium-sized enterprises (SMEs). Anticipated pressure from greater competition after WTO accession has prompted domestic commercial banks to accelerate reforms, provide better services, and improve corporate governance. Steps taken by the banks include shifting portfolios from SOE lending to increasing lending to consumers, and reallocating resources from less-developed areas to more advanced regions and cities. In Korea, the financial system has been strengthened, with NPLs forming just 2.5% of total loans in the banking system, and 4.6% in all financial institutions (excluding loans held by the Korean Asset Management Corporation).

The PRC economy would benefit from further promotion of SME development. More than 99% of domestic enterprises in the PRC are SMEs, and most are privately owned. SMEs produce 60% of industrial output, make up 40% of the tax and profit base, account for 60% of exports, and employ 75% of the urban workforce. However, their development is hindered by a lack of access to financing, with commercial banks reluctant to provide credit to SMEs, and access to capital markets highly restricted. By contrast, the state-owned sector still absorbs a large portion of available credit. Despite its declining relative importance, investment in this sector increased by 24.4% in the first half of 2002, compared to a 19.4% increase for the private sector and 15.8% for the collective sector. In June 2002, the Government enacted the Law on the Promotion of Small and Medium-sized Enterprises. The Law states that the Government will establish an SME development fund to encourage local governments, private entrepreneurs, and financial institutions to invest in SMEs. While this may help improve SMEs' access to financing, fundamental improvement can only come from reform of the financial institutions and markets.

Privatization is under way in Mongolia. The state-owned Trade and Development Bank, Mongolia's main commercial bank for international transactions, was sold to foreign investors in May 2002. The fuel importer, NIC (Neftimport Concern) and the Agricultural (Khaan) Bank are likely to be the next companies sold. Reforms have been carried out to improve the investment environment, including setting up free economic zones. The Mongolian economy still faces important challenges. Over one third of the population live below the poverty line, and inequality is rising. Economic growth is constrained by climatic conditions and the vagaries of commodity prices: copper, gold, and cashmere account for over 80% of Mongolia's exports. This narrow base makes the economy highly vulnerable to natural disasters and price volatility in the world's commodity markets.

OUTLOOK FOR 2002–2003

The prospects for East Asia in 2002 and 2003 are brighter than assessed in *ADO 2002*. However, there will be notable variation among economies. The PRC is likely to maintain robust growth on the back of both strong domestic and export demand. The economy is forecast to expand by 7.4% in 2002 and by 7.5% in 2003, compared to the *ADO 2002* forecast of 7% for 2002 and 7.4% for 2003. In Korea, the growth forecast for 2002 has been revised upward from 4.8% to 6% because of its strong performance in the first half of the year. Growth will be slightly weaker at 5.8% in 2003, however, compared to the forecast of 6% due to subsiding domestic demand. Continued weak domestic demand and an uncertain global economic recovery will affect economic recovery in Hong Kong, China. GDP is forecast to increase by 1.4% in 2002, lower than the 2.1% expected in *ADO 2002*. A rebound will take place from early 2003, and the economy will grow by 3.5% in 2003, weaker than the 4.8% forecast. The economy of Taipei,China is expected to experience moderate 3% growth in 2002, slightly stronger than the 2.8% forecast. The 4% forecast for 2003 is consistent with the expectations of *ADO 2002*. The Mongolian economy is expected to expand by a modest 3% in 2002 and by 4.9% in 2003, as reflected in *ADO 2002*, on the back of a recovery in domestic production and higher commodity prices.

Domestic demand will vary among East Asian economies in the second half of 2002. Demand in the PRC will be strong. Consumption growth will be lifted by salary increases for civil servants and strong demand for housing and car purchases. The growth of public investment in the PRC is likely to moderate in the second half of 2002. However, the strengthening of FDI inflows and domestic private investment will continue over the next 2 years, as economic reform and liberalization proceed.

In Korea, domestic demand is likely to weaken. Domestic demand has been fueled by a reduction in the special excise tax, a sharp rise in residential construction due to government support for housing, and increased construction associated with the soccer World Cup and the Asian Games. The impact of these factors will gradually taper off in the second half of 2002. Exports and fixed investment expansion will help counteract relatively lower consumption spending and construction investment. Domestic demand will likely remain subdued in Hong Kong, China and Taipei,China in 2002. High unemployment in these two economies will persist into the second half of the year, with wages likely to stay flat. Weak labor market conditions could curtail consumer spending, while the uncertain outlook for the domestic and international economy could hold back domestic investment. In Hong Kong, China, the depressed property market will continue for the remainder of 2002, further dampening investment spending. Investment growth is expected to pick up in 2003 as the economy recovers and as property prices firm.

The weak inflationary pressures experienced in the first half of 2002 prompted a downward revision of price forecasts for all East Asian economies compared to the *ADO 2002* figures. The inflation rate in the PRC is forecast to be subdued at 0.5% in 2002 and 1.5% in 2003, on account of large excess capacity in manufacturing and greater competition after WTO accession. Inflationary pressures will be contained by high unemployment and wage restraint in Taipei,China in 2002. The CPI is expected to increase by 0.3% in 2002 and by 1.5% in 2003. Deflationary pressures in Hong Kong, China are unlikely to abate in 2002 due to weak domestic demand and the floundering property market. The CCPI is expected to decline by 2.7% for 2002 as a whole, and remain largely unchanged in 2003. In Korea, inflationary pressures are expected to rise, as collective bargaining over wages will be concentrated in the second half of 2002. The CPI is expected to rise by 3.1% for 2002 as a whole, and register a 3.5% increase in 2003. The forecasts, however, are still lower than the 3.5% and 4% expected for Korea in 2002 and 2003 in *ADO 2002*.

East Asia's export sector will continue to strengthen over the next 2 years. Exports from the PRC are forecast to rise by 13% in 2002 and 10% in 2003, as against the 6% and 10% expected in *ADO 2002*. Strong export growth in the PRC will be underpinned by the relocation of labor-intensive, export-orientated production from other economies to the PRC. Increased Multifiber Arrangement quotas on PRC apparel and textile exports will also enlarge the PRC's share of the world market. Imports in the PRC are forecast to grow slightly faster than exports at 14% in both 2002 and 2003, due to tariff reductions and the expansion of domestic production. As a result, the current account surplus will decline to about 1% of GDP in 2002, narrowing further to 0.4% of GDP in 2003. In Korea, export growth will play an important role in propelling the economy as growth in domestic demand gradually subsides. Export growth will be robust, but the growth rate may moderate given that exports recovered from a low base this year. Imports will pick up as the recovery progresses. The current account surplus in Korea is expected to decline to $5.0 billion in 2002, and the surplus is likely to disappear in 2003.

As the 10th largest trading economy in the world, Hong Kong, China's recovery hinges on export performance. The prospects for export growth are looking brighter as its trading partners' economic activities pick up, particularly those of the PRC and the US; together they absorbed 55% of the economy's total exports in 2002. A rebound of the US economy will not only benefit the economy's exports directly, but also increase reexports through higher export demand from the PRC. Export growth will also drive the economic recovery of Taipei,China. The strengthening of export performance will filter through to other parts of the economy, lifting overall performance. While export expansion in all East Asian economies is likely to continue throughout 2002 and 2003, the uncertain pace of the US recovery poses significant downside risks for economic growth in East Asia over the next 2 years. Nevertheless, the robust economic growth of a number of Asian economies, especially that of the PRC, will help mitigate the risks associated with the uncertainty surrounding the US economic recovery.

SOUTHEAST ASIA

The economies of Southeast Asia have generally performed better than expected during the last 6 months, with consumer demand and exports in particular strengthening. Investment and imports, however, remain weak. Inflation is not an issue in most countries. The forecast remains cautiously optimistic, with GDP growth of 3.8% expected in 2002, up from 3.4% in *ADO 2002*, and 4.6% in 2003, up from the earlier forecast of 4.3%.

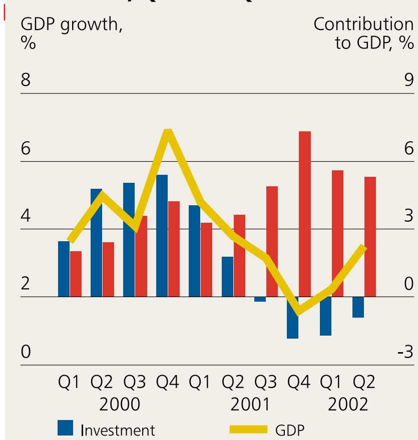
MACROECONOMIC ASSESSMENT

The economies of Southeast Asia have generally turned in a better performance over the last 6 months than expected at the release of *ADO 2002* in April. Figures for the first half of the year indicate that GDP growth for 2002 will be higher than previously thought, at 3.8% on average against 3.4% in *ADO 2002*. Consumer demand (constituting a large bulk of domestic demand) and exports in particular have strengthened. On the other hand, investment and imports, with a few exceptions, remain weak. Particularly worrisome is the situation of private investment in some countries that have a great deal of excess capacity and that are still plagued by financial problems derived from the Asian financial crisis. In some cases, such as the Philippines, the fiscal deficit is becoming an issue of serious concern. Inflation is not an issue in most countries, and for this reason governments are generally following accommodative monetary policies. On the whole, the subregion has recently also followed expansionary fiscal policies, while most countries in the subregion enjoy healthy current account surpluses. The biggest problem on the horizon for most of them is the prospect of a deceleration in the US economy that would translate into lower exports.

A large part of domestic demand is consumption driven.

Indonesia's GDP expanded by 3.5% in the second quarter of 2002 from a year earlier. Data for the same quarter show a moderately strong performance in manufacturing, up by 2.5% from the second quarter of 2001. Within the services sector, transport and communications showed 8.2% growth. Household spending rose by 6.3% from the second quarter of 2001, but gross domestic capital formation fell by 1% during the quarter as business confidence remained weak.

Contributions to GDP Growth, Indonesia, Q1 2000-Q2 2002



Source: www.aric.adb.org.

The Malaysian economy grew by 2.5% year on year in the first half of 2002. Better than expected external demand conditions than in 2001 and continued pump priming of the economy were the key factors in this. Consumer and business confidence has improved in recent months. Second quarter private consumption increased by 5.6% with respect to the second quarter of 2001 and public consumption rose by 15.5%. On the other hand, gross fixed capital formation weakened by 2.1% in this quarter. On the supply side, the major contributor

Selected Economic Indicators, Southeast Asia, 1999–2003

	1999	2000	2001	2002		2003	
				ADO 2002	*Update*	*ADO 2002*	*Update*
GDP Growth (%)							
Average	3.8	6.0	2.0	3.4	3.8	4.3	4.6
Cambodia	6.9	7.7	6.3	4.5	5.0	6.1	6.0
Indonesia	0.9	4.8	3.5	3.0	3.2	3.6	4.4
Lao People's Dem. Rep.	7.3	5.8	5.7	5.8	5.8	6.1	5.8
Malaysia	6.1	8.3	0.4	4.2	4.5	5.8	5.0
Myanmar	10.9	6.2	—	—	—	—	—
Philippines	3.4	4.4	3.2	4.0	4.0	4.5	4.5
Singapore	6.9	10.3	-2.0	3.7	3.9	6.5	5.6
Thailand	4.4	4.6	1.8	2.5	3.8	3.0	4.0
Viet Nam	4.7	6.1	5.8	6.2	5.7	6.8	6.2
Inflation (%)							
Average	8.1	2.5	5.1	5.7	5.0	4.4	3.9
Cambodia	0.0	0.5	0.0	2.0	2.0[a]	3.0	3.0[a]
Indonesia	20.5	3.7	11.5	13.1	11.8	7.7	7.0
Lao People's Dem. Rep.	134.0	27.1	7.8	6.5	6.5[a]	6.0	6.0[a]
Malaysia	2.8	1.6	1.4	2.3	2.5	2.8	2.3
Myanmar	11.4	—	—	—	—	—	—
Philippines	6.7	4.4	6.0	5.0	4.5	6.0	5.0
Singapore	0.1	1.3	1.0	0.4	0.1	1.4	1.3
Thailand	0.3	1.6	1.7	2.0	0.7	2.2	1.5
Viet Nam	0.1	-0.6	0.8	3.0	4.0	4.0	4.5
Current Account Balance (% of GDP)							
Average	9.9	8.8	7.2	5.0	5.7	4.0	4.9
Cambodia	-7.8	-7.6	-6.4	-5.9	-5.9[a]	-5.1	-5.1[a]
Indonesia	4.1	5.0	3.9	1.5	3.8	0.7	3.5
Lao People's Dem. Rep.	-8.9	-8.3	-6.9	-8.0	-8.0[a]	-8.0	-8.0[a]
Malaysia	15.9	9.4	7.8	5.3	5.1	2.6	4.9
Myanmar	-0.2	-0.1	—	—	—	—	—
Philippines	9.7	11.3	6.5	2.0	3.4	1.5	2.1
Singapore	20.0	17.2	20.9	19.8	19.6	19.0	17.9
Thailand	10.1	7.7	5.4	4.1	3.8	3.0	2.5
Viet Nam	4.1	1.6	1.5	0.3	-1.2	-0.2	-2.4

— Not available.
[a] *ADO 2002* forecast.
Sources: ADO database; staff estimates.

to GDP growth was the services sector. In the second quarter of 2002, the sector achieved broad-based expansion of 4.5%. Fiscal support for infrastructure projects provided stimulus to the steady 2.9% growth of the construction sector. Manufacturing, on the other hand, posted an increase of 5.6% in the second quarter, after a decline of 2.3% in the first.

During the first half of 2002, GDP in the Philippines expanded by 4.1%. Agriculture, industry, and services strengthened by 3.5%, 2.9%, and 5.3%, respectively. On the demand side, GDP growth was driven mainly by strong personal consumption expenditures, which rose by 3.6%. Capital formation, on the other hand, contracted by 4.6%. Nevertheless, while public construction declined by 1.5% during the first 6 months of the year, private construction increased by 4.2%.

Following a contraction of 2% in 2001, Singapore recorded a 1.2% year-on-year growth rate in the first half of 2002 and a better than expected performance during the second quarter, of 3.9%, after four consecutive quarters of contraction.

This was mainly on account of a small upturn in external demand as electronics exports—the major export subsector in the economy—recovered slightly while the fall in domestic demand stabilized. Nevertheless, manufacturing activity expanded at its slowest pace in 6 months in August, indicating that faltering demand in the US is hindering a full recovery. Overall domestic demand, driven predominantly by slightly higher household spending, still contracted by 2.5% in the first half of the year, though this was an improvement on the 8.7% full-year decline in 2001. While private consumption recovered somewhat (but still down by 1.5% on a year earlier), gross fixed capital formation fell by 10.2% year on year, mainly because of the continued contraction in residential investment. During the second quarter of 2002, some recovery was seen in private investment in transport, machinery, and equipment. Hence, Singapore's growth essentially stemmed from a positive contribution of net exports to GDP in the first half of the year. But the recovery remains fragile.

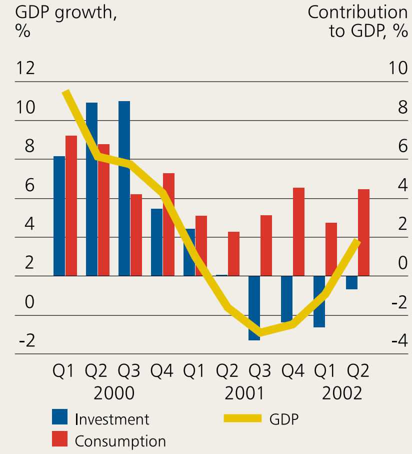
On the supply side, manufacturing posted 5% year-on-year growth during the first half of 2002, mainly as a result of a strong performance in the chemicals subsector (which surged by 60%) as external demand was robust and capacity expanded in pharmaceuticals and petrochemicals. With falling prices and weak demand, the decline in electronics continued, albeit at a much more moderate rate than in 2001. For the first 6 months of 2002, the fall in electronics output decelerated to 5.6% from 21.3% in the same period of 2001. The services sector, which is particularly important for Singapore, also showed a mixed performance. Transport and communications grew by 5.4% year on year during the first half of 2002, but the financial sector contracted by 4.6% in the same period due to weak equity markets and reduced regional demand for insurance and investment services. Construction shrank by a further 9.6% during the first half of 2002 as both private and public construction declined.

Thailand's overall economic situation improved markedly over the first half of 2002. The economy expanded by 4.5% year on year during this period, compared to 1.8% growth in the first half of 2001. On the domestic front, private consumption has provided an important boost to the economy due to the recovery in tourism (despite a slowdown in the number of visitors, tourism income has risen as spending per head has started to increase), easier access to bank credit (e.g., lower restrictions on obtaining a credit card), higher farm incomes, the positive effect of special sales promotions, low interest rates, and the benefits of countercyclical policies implemented in late 2001. While the latter two will most likely remain in the near future, the special sales promotions will end. It is encouraging, though, that car sales rose by 28.4% year on year during the second quarter. Although excess capacity still remains large in the private sector—running at around 58%—construction activity contributed to some increase in private investment. On the supply side, agriculture experienced a growth rate of 3.7% during the first half of 2002, while manufacturing expanded by 5.4%.

In Viet Nam, real GDP in the first half of 2002 grew by an estimated 6.7% on a year-on-year basis, according to official figures. On the demand side, domestic demand continued to be the main source of economic expansion during this period. It was led by the strong performance of private consumption due to an increase in rural incomes resulting from both higher output and better prices, and from strong private investment. On the supply side, the best-performing sector was industry with estimated output growth of 9.4%. The agriculture sector is estimated to have grown by 4% and the services sector by 5.9%.

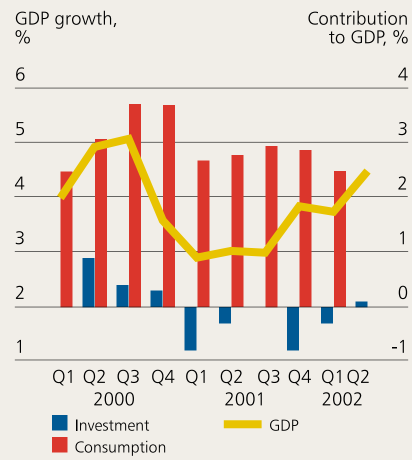
Fiscal deficits remain common throughout the subregion. Indonesia's budget deficit for 2002 is targeted at 2.5% of GDP. To achieve this, the Government has tightly controlled expenditures for development purposes and has raised the revenue target. The remaining deficit (around Rp43.1 trillion) is to be financed

Contributions to GDP Growth, Malaysia, Q1 2000-Q2 2002



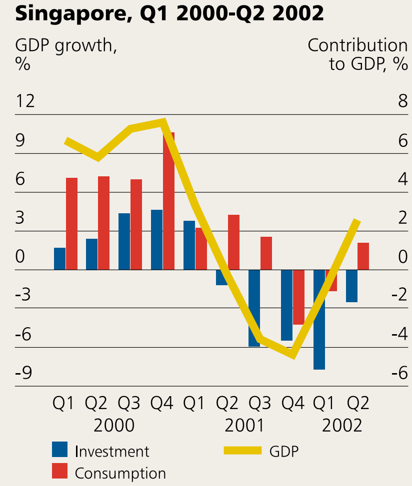
Source: www.aric.adb.org.

Contributions to GDP Growth, Philippines, Q1 2000-Q2 2002



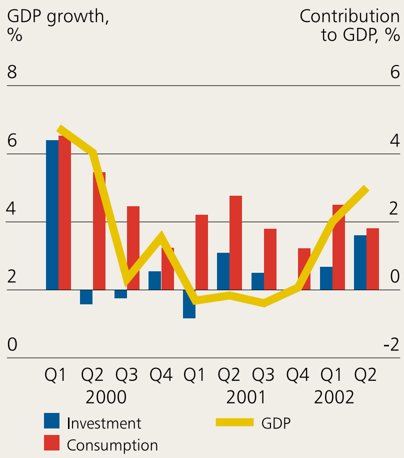
Source: www.aric.adb.org.

Contributions to GDP Growth, Singapore, Q1 2000-Q2 2002



Source: www.aric.adb.org.

Contributions to GDP Growth, Thailand, Q1 2000-Q2 2002



Source: www.aric.adb.org.

by a combination of foreign and domestic sources. This poses a challenge. The Government, however, has demonstrated considerable resolve in the past 2 years in meeting its goals through expenditure control, privatization, and asset sales.

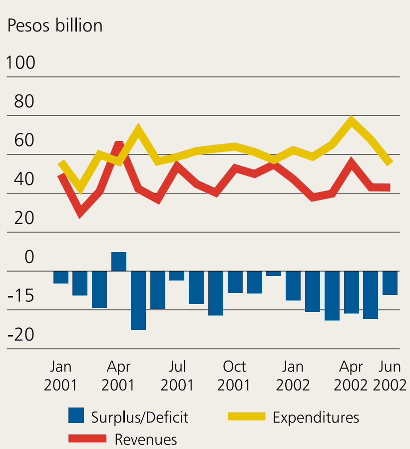
As of July 2002, the Government of the Lao PDR had executed 57.1% of the budget for the present fiscal year, suggesting some bunching of expenses in the final quarter of the fiscal year (i.e., July–September). Capital expenditures account for 58% of total expenditures to date, which indicates a slight improvement in the balance between capital and current spending.

Malaysia's federal government deficit in 2001 was 5.5% of GDP, higher than the target of 4.7%. The reason was the announcement of two stimulative packages during the year. The Government continues with its fiscal stimulus program, though it has been scaled back. As of the first quarter of 2002, the Government had achieved a surplus of RM2.4 billion. Despite the country's historically higher spending during the second half of the year, steady economic recovery, higher oil prices, and the encouraging figures for the first quarter should help improve the fiscal balance in 2002.

After the Government's efforts at restoring fiscal discipline and controlling the budget deficit in 2001, the situation in the Philippines deteriorated significantly during the first half of 2002. For the first 7 months of the year, the Government incurred a deficit of P133.1 billion, already exceeding the P130 billion target for the whole year. The main reason for the persistent budget deficit is, on the one hand, the low level of tax collection; on the other, an increase in expenditures to prepare the country for the possible negative effects of an El Niño later in 2002 and 2003 (e.g., new irrigation systems). The Government now characterizes the original deficit as a "fighting target" to signify that fiscal discipline remains a priority while acknowledging that the target is likely to be exceeded. Although the increasing deficit is not a problem of excessive spending, the Government is reprioritizing public capital works and contemplating expenditure cuts to offset revenue slippages. Some initiatives to improve efficiency have borne immediate results, including the widening use of electronic procurement, which has yielded substantial budget savings by greater transparency in the awarding of public contracts.

After the Government's efforts at restoring fiscal discipline, the situation in the Philippines deteriorated significantly during the first half of 2002.

Fiscal Position, Philippines, January 2001-June 2002



Source: www.bsp.gov.ph.

Singapore's 2002/03 budget introduced a series of tax adjustments to attract business and skilled human resources. Beginning in 2003, corporate and personal income taxes will be reduced to 22% from 24.5% and 26%, respectively, and further down to 20% in 3 years. On the other hand, the goods and services tax will rise from 3% to 5%, effective January 2003. The increase in consumption tax will be complemented by a 5-year offsetting package of assistance measures valued at S$4.1 billion, targeted at the two thirds of Singaporeans who are not currently paying taxes. These measures will cause the 2002/03 fiscal balance to move from a surplus of S$900 million to a deficit of S$190 million. These steps, in particular the aggressive income tax reduction and a package of preferential tax treatment for expatriates, are expected to further consolidate Singapore's economic recovery.

Despite an expansionary budget for 2002, Thailand's fiscal deficit for the fiscal year ending in October 2002 is expected to be approximately B170 billion, or 3.2% of GDP, while the original estimate was B200 billion. The reason for the improvement is the higher than expected level of revenue collection, amounting to an additional B53.2 billion during October 2001–June 2002; projected revenue for the total fiscal year is expected to be B30 billion above target. The fiscal stimulus package implemented in 2001—which included the establishment of a revolving "village fund" of B75 billion, the creation of a national health care program, a 3-year moratorium on interest payments for indebted farmers, and a reduction in corporate income tax—represented an important fiscal effort for the country. However, total public debt stood at 56.3% of GDP in February. Public debt has risen substantially during the last few years, although over two thirds of the increase is attributable to financial sector restructuring, while the other third is related to expansionary fiscal policies and the creation of safety nets to cope with the 1997 Asian financial crisis.

As a result of the improvement in the tax management collection system, tax revenue in Viet Nam during the first half of the year increased by 8.5% year on year, and is reported as having achieved 53% of the target for the whole year. Improved tax management was especially notable in the area of customs: revenues strengthened by 24.8% in spite of the weak trade performance in the first half of 2002. On the other hand, expenditures were 9.5% higher. The targeted deficit for 2002 is equivalent to 5.3% of GDP. However, the deficit may exceed the Government's target if banking and SOE reforms are fully implemented, due to the associated adjustment costs.

Inflation has been low in Southeast Asia, with the exceptions of Indonesia and, especially, Myanmar. Indonesia's CPI in July 2002 was 10% higher than in July 2001. While prices of clothing, food, and health services rose less than the average, prices of housing and the cost of transport and communications increased much more. The strengthening of the rupiah against the US dollar contributed to some dampening of inflationary pressures. Monetary policy has tightened since the end of 2001. From May 2001 until May 2002, narrow and broad money grew by 8% and 5%, respectively, considerably below the rise in nominal GDP. The relatively slow expansion in the monetary aggregates is a noticeable change from mid-2001 when money supply figures routinely showed double-digit growth. Reflecting tighter monetary policy, central bank discount rates rose slightly in mid-2002, in spite of the decline in inflation.

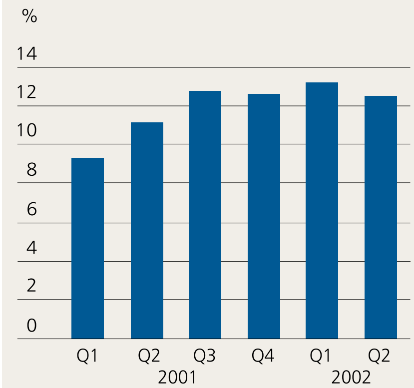
The monetary stance remains generally prudent in the Lao People's Democratic Republic (Lao PDR). The official inflation target is 6% for 2002, although July estimates show that inflation is running at around 9.5% and has accelerated during the year. Higher inflation is due to a number of factors, including the seasonal weakness of the kip against the baht and an increase in public utility prices as part of overall public expenditure reform. However, the Bank of the Lao PDR expects increased inflation to be temporary, since the kip remained relatively stable throughout August.

In Malaysia, inflation has remained low. During the second quarter of 2002, the CPI rose by 1.9% compared to the second quarter of 2001. The most significant price increase—6.4%—was registered in transport and communications. Given this stable environment, monetary policy has been very accommodative. Interest rates were low and stable with the average base lending rate of commercial banks and finance companies at 6.39% and 7.45%, respectively, at the end of June. This, together with excess liquidity, has led to higher bank lending, especially to the household sector.

In June 2002, year-on-year inflation in the Philippines decelerated to 3% from 4.1% in December 2001 as prices of major commodities fell. This was the lowest rate recorded since January 2000. Food prices also declined due to an abundant supply of vegetables and fruits. With moderate inflation in the first half of 2002, the Bangko Sentral ng Pilipinas continued to pursue an accommodative monetary policy in an effort to spur economic recovery. Since the beginning of 2002, the Bangko Sentral has twice lowered its overnight borrowing rate, resulting in an overall reduction from 7.5% to 7% and in the overnight lending rate from 9.75% to 9.25%. This leaves real interest rates at around 4%. However, a cautious lending stance among banks and weak corporate demand for credit contributed to sluggish bank lending. Money supply (M3) grew by 5.2% in June 2002, year on year, which was lower than the average of 6.9% in 2001.

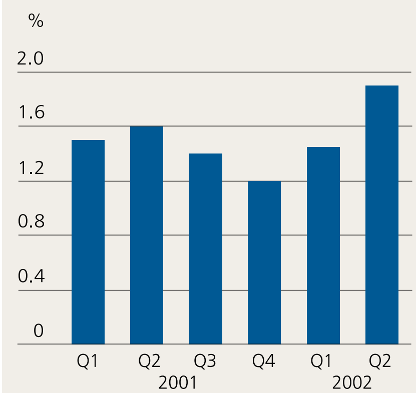
Inflation has been low in Southeast Asia, with the exception of Indonesia.

Inflation Rate, Indonesia, Q1 2001-Q2 2002



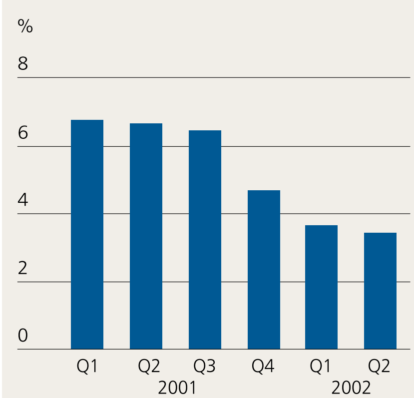
Source: www.bps.go.id.

Inflation Rate, Malaysia, Q1 2001-Q2 2002



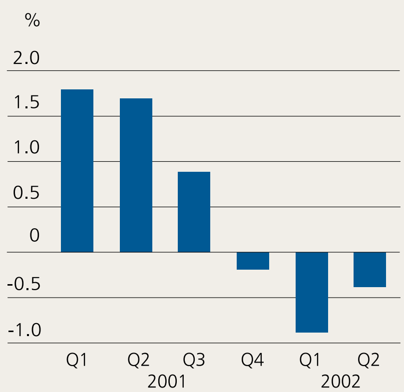
Source: www.bnm.gov.my.

Inflation Rate, Philippines Q1 2001-Q2 2002



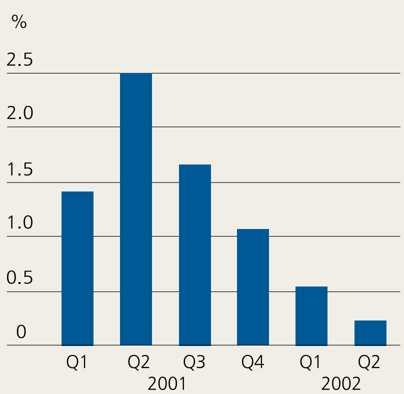
Source: www.census.gov.ph.

Inflation Rate, Singapore, Q1 2001-Q2 2002



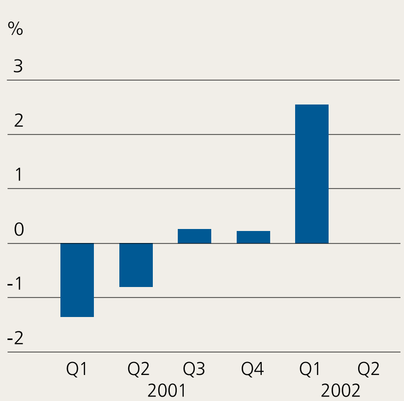
Source: Ministry of Trade and Industry, *Economic Survey of Singapore, Second Quarter 2002.*

Inflation Rate, Thailand, Q1 2001-Q2 2002



Source: www.bot.or.th.

Inflation Rate, Viet Nam, Q1 2001-Q2 2002



Source: International Monetary Fund, 2002, *International Financial Statistics,* CD-ROM, August.

Prices in Singapore declined by 0.7% year on year during the first 6 months of 2002. This was attributed to lower energy prices following deregulation in the energy sector, lower housing costs, and lower regional inflation. In view of this, the Monetary Authority of Singapore maintained a neutral stance that targeted a constant trade-weighted nominal effective exchange rate. Overall commercial bank lending declined by S$2.5 billion in the first half of the year, indicating the weakness of the recovery. While growth of housing loans was sustained by low mortgage rates and easing housing prices, loans to the industrial and commercial segments slackened in tandem with the uncertain economic conditions. Domestic interest rates remained low in the first half of 2002 in light of monetary easing in the major industrial economies and low inflationary pressures.

Thailand's inflation remains in check, due to a somewhat stronger baht, large excess capacity, and a lack of demand pressure. Consumer prices rose by only 0.2% during the second quarter of the year, bringing inflation to an annual average of 0.4% for the first half of 2002. In June, the Bank of Thailand decided to keep its 14-day repurchase interest rate at 2%; deposit rates are at 2% while lending rates are at 7.1%. At the same time, the Government is encouraging state-owned banks to increase lending to SMEs and to the rural sector. Local banks are burdened with B600 billion of excess liquidity, partly due to their reluctance to lend money to companies for fear of adding to their NPLs. The Bank of Thailand has also eased the requirements on issuing credit cards. As of the end of June, Thai consumers had racked up B56 billion-worth of credit card bills this year, or about 1.4% of GDP.

Viet Nam's consumer price index rose by 2.9% during the first 6 months of the year, arising mainly from a 5.7% increase in the price of cereals and foodstuffs, which helped boost purchasing power in rural areas. Liquidity in the banking sector was low due to the high demand for cash for construction projects. The State Bank of Viet Nam increased its open market operations and planned to inject more liquidity in the economy through bond purchases. The Bank has also lowered the required reserve ratio on foreign currency deposits from 10% to 8% and removed the cap on interest rates for dong loans.

Southeast Asian exports have begun showing mild signs of recovery (though in some cases this is seen in slower declines). Indonesia's exports during the second quarter fell by 7.1% from the same period in 2001. Since mid-2001, both exports and imports have been falling. In May 2002, the total value of exports was 9% below the comparable figure for the same period of 2001 as a result of declines in both oil and gas exports (22%) and non-oil and gas exports (5.4%). The reduction in imports was even more pronounced, at 26%. The low level of non-energy imports suggests that business purchases for investment and reexporting remain quite weak. The net effect of the sharp fall in imports against a smaller decline in exports kept the current account balance positive. Net merchandise trade for the first half of 2002 was 19.2% higher than in 2001 and was one factor in strengthening the demand for the rupiah. Reports by the Investment Coordinating Board confirm the poor investment prospects. Through 30 June, only $2.5 billion of foreign investment had been approved, roughly half of the amount approved last year. Domestic investment plans were also well below 2001 levels.

Malaysia's merchandise exports for the first 6 months of the year amounted to $44.6 billion, or 0.2% above the level in 2001. ICT products remained the leading revenue earner, generating 57.4% of the country's total export earnings. Exports of electrical and electronic products grew by 2.3% during the first half of the year. Imports, on the other hand, amounted to $38.6 billion, 2.4% above the 2001 level. The result is that Malaysia recorded an 11.7% decline in its trade surplus. The overall balance of payments picture for the first quarter of 2002 reflected an increase in reserves of $1.8 billion. Both current and capital accounts registered surpluses of $1.9 billion and $0.7 billion, respectively. Gross inflows of FDI amounted to $0.9 billion in the second quarter, although, due to loan repayments by nonresident-controlled companies, FDI on a net basis amounted to only $0.1 billion. The bulk of the FDI inflows was channeled into the oil and financial services sectors.

Philippine exports increased by 1.4% during the first half of the year while imports declined by 1.8%. The modest recovery of the global ICT market pulled up demand for semiconductors and electronic microcircuits (20.1%) and finished electrical machinery (21.4%).

External demand for Singapore's goods and services showed a slight improvement in tandem with a revival in global economic activity. Nevertheless, non-oil exports declined by 7.7% in the first half of the year, though this was only about half the steep 14.5% contraction seen during the same period in 2001. The improvement was attributed to a less severe fall in electronics-related exports and a rise in the sales of pharmaceuticals and petrochemicals. Non-oil reexports expanded by 1.1% in the first half of 2002. Imports registered a 4.5% decline, leading to a trade surplus of S$12.3 billion for the first half of the year, while the current account posted a surplus of S$16.1 billion.

In Thailand, while export volumes have improved, exports in value terms have fallen due to a weakening in export prices of a number of commodities, including electronics. The volume of exports rose by 9% during the first half of 2002. The volume of imports also increased, by 7.1%. The result for the first 6 months of the year is a trade and services surplus of about $1.4 billion and a current account surplus of about $2.9 billion. In terms of FDI, inflows were very low during the first few months of the year, amounting to only $1.8 billion for the period February–June 2002.

During the first 8 months of the year, Viet Nam's exports contracted by 1.2% as oil exports, which historically account for about one fourth of the value of total exports, fell by 17.2%; coffee exports were also negatively affected by the continuing decline in world prices and by a sharp fall in export volume. Some manufacturing exports also contracted due to weak external demand: exports of electronics and computers, for example, dropped by 35% in value terms. The shoes, garments, textiles, and handicraft subsectors, however, recorded a strong performance, and seafood exports improved after a slow first half. Imports grew by an estimated 15% in the first 8 months of the year, led by a 23% import surge in the foreign-owned sector, reflecting the increase of capital inflows, mostly imports of machinery and equipment, steel, yarn, and chemicals. As a result, by end-August the trade deficit had climbed to $1.7 billion.

POLICY DEVELOPMENTS

In order to ensure long-run growth, Southeast Asian governments will need to address a series of issues. In Indonesia, a draft of the 2003 budget was presented to Parliament in mid-August 2002. The budget called for an increase in tax revenues of 15.7%. A stronger tax effort is required to offset the expected decline in nontax revenues (oil, gas, forestry, privatization) and still allow for a small 2.9% rise in expenditures. Raising tax revenues has been difficult in the recent past and Indonesia's tax-to-GDP ratio is lower than in some of its DMC neighbors. The sharp reduction in subsidies will provide a measure of fiscal relief but this will demand continued political will to implement price increases for fuel and utility services. An open question is the degree to which local governments, which are now responsible for education, health, regional infrastructure, and rural roads, will respond to their new role and make the necessary investments. The overall deficit targets for 2002 and 2003 are in line with the announced policy of moving toward a fully balanced budget in 2004. Meeting some of the continuing needs to improve governance in the financial markets, on 26 March 2002 the House of Representatives passed an anti-money-laundering law.

Malaysia has made significant strides in addressing corporate restructuring. The Corporate Debt Restructuring Committee has been successful in promoting restructuring efforts in large Malaysian companies burdened with heavy debts. The Malaysian asset management agency has achieved a recovery rate of 66% and is winding up its activities. Debt restructuring is being accompanied by asset sales and management revamping in some of the heavily indebted companies. However, Malaysia's capital controls policy may need to be reviewed in light of competitiveness pressure that may emerge as global growth picks up. Although capital control measures have been gradually relaxed since September 1998, international investors are still anxious over their inability to undertake foreign currency hedging strategies. These concerns will need to be addressed in the short to medium term, given the slowdown of FDI inflows.

There are no clear prospects for the introduction of necessary widespread economic reforms by the Government of Myanmar to correct macroeconomic imbalances and reduce poverty. It lacks the necessary policies, and its strategies are ad hoc and respond to a variety of problems in, at times, contradictory ways. Moreover, the capacity to implement policies is lacking. For example, the Government has declared the laudable intention of eliminating fiscal deficits over a 5-year period, but lacks the capacity and tools to actually do this. (Perhaps the Government should consider only reducing these fiscal deficits.) Myanmar's problems are as much structural as macroeconomic. The exchange rate continues to be grossly overvalued, with the official exchange rate at around MK6.8 to the dollar. However, by the end of April, the free market rate was over MK1,000. The dual exchange rate system is a problem since it distorts prices and resource allocation, stunts growth, and provides fertile ground for rent seeking. The ruling State Peace and Development Council (SPDC) is reluctant to accept the market-based rate for fear that debt repayments will become more difficult. The SPDC has stated that it will require international financial assistance amounting to $1 billion–$3 billion for this purpose. Efforts to increase exports will not be successful as long as the activities of the private sector remain restricted. On monetary policy, and given the little room to maneuver, the SPDC will continue monetizing the budget deficit. This puts pressure on inflation and since the SPDC wants to maintain stable nominal interest rates, real interest rates will remain negative. If the anti-money-laundering law introduced in June 2002 leads to further withdrawals of savings, the SPDC may decide to increase interest rates slightly.

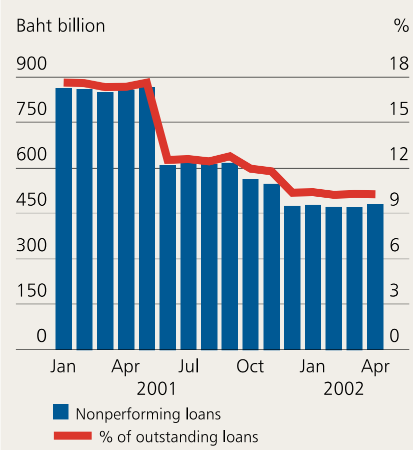
The most important problem affecting the Philippine economy is the financing of the budget deficit. The deficit problem is one of systemic weakness in raising tax revenues, which remain well below potential. Remedial actions being taken include restructuring the Bureau of Internal Revenue using models of international best practice, simplifying the tax code, taking legal action against noncomplying taxpayers, and implementing an aggressive program of moral suasion targeting corporate lawyers. To cover the deficit, the Government will issue bonds worth $300 million, mainly on the domestic market. In the banking sector, the crucial problem is the persisting high level of NPLs and nonperforming assets (NPAs). In resolving the issue, the Government needs to lead the way to adopt international best practice and pass the Special Purpose Asset Vehicle Bill, which provides for the creation of private sector asset management companies to acquire commercial banks' NPLs and NPAs. Congress is debating the Bill, which will establish the legal framework for asset management companies and will grant incentives, such as tax breaks, to buyers of bad loans and foreclosed assets. Recapitalization of banks is required in dealing with NPLs and NPAs, and specific capital adequacy rules are also needed.

With its efficient economic system and investment incentives, Singapore continues to attract foreign investment and to be considered as the regional headquarters for multinational corporations. However, some companies are considering the possibility of moving production to lower-cost destinations within the subregion. While the Government has been reformulating its development strategy toward a knowledge- and skills-intensive economy in recent years, government-linked companies have certain privileges and monopoly powers. In the future, therefore, the Government may need to take a less interventionist approach to industrial management and further reduce its shareholdings in these companies to nurture a business environment that promotes entrepreneurship and innovation.

The strong performance of the Thai economy during the last few months has been the result of several factors. First, the low interest rate environment has encouraged borrowing, especially from households. Second, some fiscal stimulus measures have had an impact. Third, the external environment during the first half of the year was positive. Despite this, there are important issues that deserve attention. Corporate restructuring and corporate governance improvements remain major issues, contributing to a lackluster investment environment that hampers economic activity. The Government needs to put further pressure on companies to restructure. In late June, it announced that the total estimated cost of restructuring and recapitalizing the financial sector after the 1997 financial crisis would reach B1.4 trillion (around $350 billion). However, the impact of the Government's structural reform program has so far been limited. The B655 billion plan to privatize 18 companies in 2001–2003 has not progressed and to date only two companies have been sold—Internet Thailand for B400 million and the Petroleum Authority of Thailand for B32.2 billion. Overall, the restructuring of NPLs is moving slowly. As of March 2002, the Thai Asset Management Corporation (TAMC) had acquired B711 billion in NPLs (corresponding to a total of 4,629 accounts, 1,077 from single creditors and 3,552 from multiple creditors) from banks and their AMCs at an average price of one third of face value. The total amount restructured through June was B200 billion but the actual amount recovered was only B560 million, or less than 1%. This was mainly achieved by reducing the amount of accrued interest owed by debtors. Of the deals achieved, 35.6% are in the real estate sector, 23.8% in the manufacturing sector, and 13.9% in the financial sector. There are around 160,000 single-creditor loans of less than B50 million amounting to B250 billion. Their purchase has been delayed to help the TAMC focus on the larger loans. The TAMC has set as a target the restructuring of B500 billion in loans, including all single-creditor loans and half the multiple-creditor loans, by the end of 2002. It intends to reach a resolution on all loans in its portfolio by the end of 2003 and complete operations within 5 years instead of the original plan of 8 years. The TAMC reports that B132.7 billion-worth of loans have been resolved with a recovery rate of nearly one third of face value, as of April 2002.

The restructuring of NPLs in Thailand is moving slowly.

Nonperforming Loans, Thailand, January 2001-April 2002



Source: www.bot.or.th.

In accordance with the roadmap to liberalize interest rates, following the establishment of a primary lending rate in dong in 2001, the State Bank of Viet Nam issued a decision to lift ceilings on lending interest rates in June 2002. The move should help commercial banks strengthen their risk management through pricing of loans according to the risk of the borrower. In addition, banking sector reform has continued. By the end of March 2002, about D1.5 trillion of NPLs, mostly collateralized, had been resolved at a discount of around 50%. July 2002 marks the second anniversary of the inauguration of the stock market in Viet Nam, where the number of listed companies had increased to 19 by the end of

August and prices of individual stocks had started moving in different directions according to the performance of the listed companies, an indication that the market may be becoming more mature and breaking away from the monolithic growth trend of the first year. In an effort to boost transactions, trading has been conducted daily as opposed to three times a week and the trading band was widened in August from 2% to 3%. The market has also seen the more active participation of institutional investors, including foreign investors. It is anticipated that by the end of 2002, about 20–25 more companies will be listed on the stock market. In relation to a potential international bond issue, Standard and Poor's and Fitch recently rated Viet Nam's long-term foreign currency sovereign debt as BB-, implying an upgrade of the country's credit rating.

OUTLOOK FOR 2002–2003

The forecast for Southeast Asia for the whole of 2002 and for 2003 remains cautiously optimistic amid signs of some recovery in external markets during the first half of 2002, and continued strength in domestic consumption in most countries. Significant weaknesses and uncertainties, however, remain for the second half of 2002 and for 2003. These are the persistent weakness of private investment demand in nearly all economies and the uncertain recovery in external demand. Later in 2002 and 2003, these weaknesses could be highlighted by magnified weakness in industrial countries, thus further dampening export demand. Overall, the GDP growth forecast for 2002 is slightly higher than projected in *ADO 2002*—3.8% versus 3.4%—on account of the first half performance. For 2003, the forecast is only marginally higher than in *ADO 2002*.

For Indonesia, exports are expected to continue to recover, particularly with average oil prices expected to be higher in 2002 than in 2001, while consumption demand will be sustained—though at a lower rate of growth than in 2001. The investment outlook, however, remains uncertain. If the agriculture sector performs well, GDP growth in 2002 could reach 3.2%, slightly higher than in *ADO 2002*. The economy could strengthen further in 2003 to about 4.4 % growth.

Malaysia's GDP growth is expected to reach 4.5% in 2002, further expanding by about 5% in 2003, or significantly lower than the 5.8% forecast in *ADO 2002*. This is mainly due to weaker than expected external demand for electronics in particular and some leveling-off in domestic demand as fiscal policy becomes more cautious, following relatively high budget deficits in the last few years.

Growth in Cambodia this year will be in the 4.5–5.5% range, slightly better than the forecast in *ADO 2002*, rising to 5.5–6.5% in 2003. For the Lao PDR, the GDP growth forecasts for both years remains similar to those in *ADO 2002*, namely, in the 5.5–6% range, which is below the Government's forecast of 6.3–6.5%.

The projections for the Philippines remain unchanged from *ADO 2002*, at 4% in 2002 and 4.5% in 2003. This is because of continued strength in consumer demand, some recovery in exports, and reasonable growth in the agriculture sector (in spite of the El Niño risk).

GDP growth in Singapore has been revised marginally upward for 2002 to 3.9% (from 3.7% in *ADO 2002*), but revised downward for 2003 to about 5.6% (from 6.5% in *ADO 2002*). The strength of the recovery continues to be uncertain as domestic factors have shown little dynamism and external demand was weak in the first half of 2002, though it improved in later months during that period. The economy could benefit from stronger oil prices. The contribution of domestic demand remains uncertain in 2003 as the goods and services tax is scheduled to increase in January 2003, along with some prices of services such as transport. On the other hand, the Government will probably continue to provide a fiscal stimulus to the economy to support domestic consumption and investment demand for housing and infrastructure.

The Thai economy has shown definite signs of recovery, particularly during the second quarter of 2002. Both domestic factors and a pickup in external demand have contributed to a better than earlier expected performance of the economy. Thus, the economy is forecast to post GDP growth of about 3.8% for 2002 as a whole, up from an *ADO 2002* forecast of 2.5%. As corporate restructuring reforms accelerate in 2003 and the domestic investment climate improves, the economy should grow at a rate of about 4% in 2003 (3% in *ADO 2002*), in spite of expected moderation in export growth. This, however, is still well below the Thai economy's potential.

GDP growth in Viet Nam should remain at 5.7% in 2002 and 6.2% 2003. While the strong export performance of 2001 is unlikely to be maintained (as already evident in the first half of 2002), domestic demand—both investment and private consumption—should continue to maintain the momentum in the economy. Higher oil prices will also benefit the economy.

For 2002, inflation in the subregion will be around 5%, down from 5.1% in 2001, except in Indonesia, where inflation is well above the average, at almost 12% in 2002, and where the rate will decline to around 7% next year. In most of the other countries, inflation will run at less than 5% in 2002 and 2003.

Exports from the subregion—except for Indonesia where exports are forecast to decline by 3%—will likely see a marked improvement in 2002 over the 2001 level, and reach an average growth rate of 3.5%. In 2003, all countries are expected to register growth, at an average of 7.6%. The situation of imports is similar and only Indonesia will see a contraction this year (12%). Import expansion in the subregion as a whole is forecast to average 4.6% in 2002 and 9.7% in 2003.

SOUTH ASIA

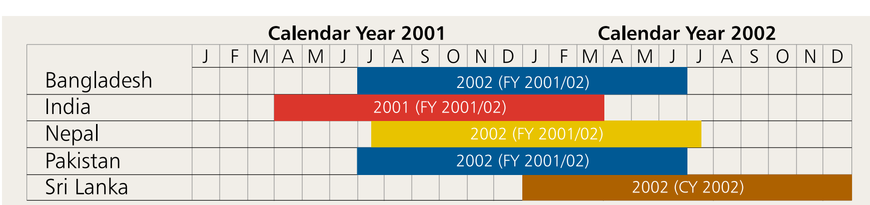
South Asian economic performance has been negatively affected by abnormal weather patterns, the global slowdown, and security concerns. Expansionary fiscal policies and accommodative monetary policies have helped partly counteract those influences. With expectations of mild global recovery and more normal weather, the subregion's performance should continue to improve, although at a more subdued pace than previously expected.

MACROECONOMIC ASSESSMENT

Economic growth and development in South Asia are less dependent on trade and capital flows than in East Asia or Southeast Asia. However, the relatively large share of agriculture in output and employment makes the subregion more dependent on the vagaries of the weather. In Afghanistan and Pakistan, the disruptions connected with military operations in the former play an important role, while internal security concerns are more prominent in Nepal.

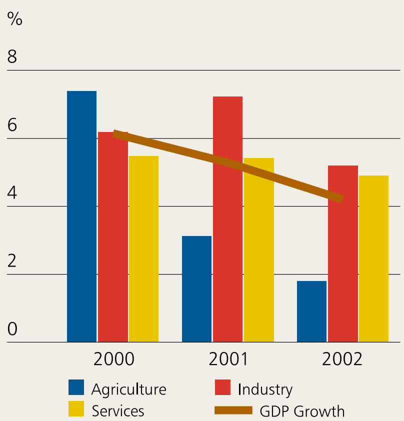
In South Asia, both floods and drought have impaired agricultural production, while the global economic slowdown has lowered export performance for the countries with a fiscal year ending in June 2002.[1] Political unrest and conflicts are also taking their toll. Consequently, real GDP growth in the subregion is now expected to be about 3.9% for 2002, well below the *ADO 2002* forecast of 5.4%. Afghanistan is an exception, since a sharp production rebound, which could easily be of 10% or more from the current deteriorated economic base, is expected. In Bangladesh, real GDP growth for 2002 (year ended June 2002) is expected to have moderated to 4.2% from 5.2% in 2001 due to lower agriculture sector growth and a slowdown in exports. In India, real GDP grew by 5.4% in 2001 (year ended March 2002), up from 4.0% growth in 2000. Manufacturing GDP grew by only 2.8% in 2001, compared to 6.7% in 2000, while growth rates of 5% or more were

[1] 2001 refers to fiscal year 2001/02, ending on 20 March, in Afghanistan and on 31 March in India; 2002 refers to fiscal year 2001/02, ending on 30 June in Bangladesh and Pakistan, and on 15 July in Nepal. In Sri Lanka, the fiscal year coincides with the calendar year. See the graphic below for a visualization of the overlapping fiscal years.



Bangladesh sector growth remains depressed.

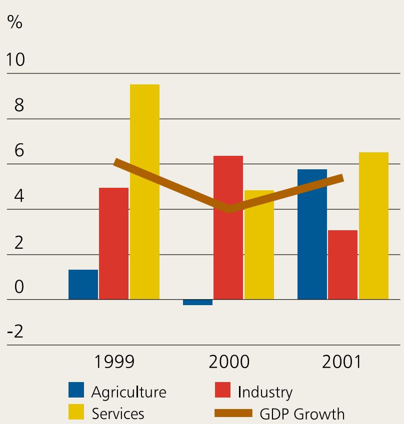
GDP Growth by Sector, Bangladesh, 2000-2002



Sources: *ADO* database; staff estimates.

With a significant improvement in the agriculture sector, the Indian economy recovers.

GDP Growth by Sector, India, 1999-2001



Sources: *ADO* database; www.nic.in.stat.

achieved in agriculture, forestry, and fishing; and services sectors (trade, hotels, and transport and communications; financing, insurance, real estate, and business services; and community, social, and personal services). More significant recovery is now also evident in the services sector, and to a lesser extent, in manufacturing. However, expectations that the mild recovery of a few months ago would be sustained have been belied by drought conditions that are prevailing in many parts of India as a consequence of delayed monsoon rains. Now, floods will also affect 2002 output (year ending March 2003).

The continued escalation of the insurgency, the irregular monsoon, and weak external demand have further exacerbated the economic downturn that Nepal has been facing since June 2001. These disruptions have adversely affected the performance of several key sectors, such as manufacturing, tourism, and exports. Real GDP growth is estimated to have fallen sharply from 4.7% in 2001 to 0.8% in 2002 (year ending July 2002). Meanwhile, the economy of Pakistan demonstrated great resilience during 2002 in the face of external shocks generated by the September 2001 attacks in the US, subsequent military operations in Afghanistan, heightening tensions with India, and the global slowdown. The real GDP growth rate was estimated at 3.6% in 2002 (year ending June 2002) compared to 2.5% in 2001 and the *ADO 2002* estimate of 3%. The improvement in GDP growth performance was mainly due to the agriculture sector, which performed better than in the previous year, despite a continuing drought. Growth in the agriculture sector in 2002 is estimated at 1.4% in contrast to a contraction of 2.6% in 2001. In the first quarter of 2002, the Sri Lankan economy grew marginally by 0.1%, an improvement when compared to a contraction in the latter half of the previous year. The impact of some of the negative phenomena of 2001, such as severe drought, prolonged power cuts, and low global economic growth that continued in the first few months of 2002, has ameliorated. The agriculture sector, which had been affected by drought, recovered during the first half of the year. However, the sluggish growth in the economies of Sri Lanka's main export markets—the US and EU—adversely affected manufacturing and industrial growth, with both exports and imports declining considerably in the first half of the year.

The fiscal arena remains a major area of concern in South Asia, with large fiscal deficits commonplace. In Bangladesh, during January–June 2002, a rigorous mobilization drive, effective monitoring and enforcement, and a moderate pick-up in domestic production partly offset the subdued performance in customs duty and other import-based taxes due to the decline in imports. Nevertheless, given the unfavorable external environment and political transitions in the country during the year, overall revenue growth in 2002 at 14.5% still only brought the total to 9.6% of GDP, which was below target. However, the lower revenue intake was more than offset by cuts in both current and annual development program expenditures. As a result, the overall fiscal deficit for 2002 was reduced to 4.4% of GDP from the projected level of 5.5%. India experienced a shortfall of 4% in total revenue receipts in 2001 compared to the original budget estimate. This pushed the central Government's fiscal deficit to 5.7% of GDP, against the budgeted target of 4.7%. Fiscal imbalances at the state level are equally a cause for concern. The ratio of the states' outstanding debt to GDP is now estimated to be 25.6% and the combined fiscal deficit of the central and state governments amounts to almost 10% of GDP. The resulting heavy recourse to market borrowing by the central and state governments has continued to place upward pressure on real interest rates. In Nepal, the sharp deceleration in economic growth in 2002 has had a major negative impact on the Government's fiscal position. As a result of disruptions to manufacturing, a fall in imports, and a sharp downturn in tourism, revenue collections were less than 12% of GDP, below the budget target of about

13%. While recurrent expenditures and the fiscal deficit were maintained in line with budget targets, development spending fell sharply and domestic borrowing increased significantly.

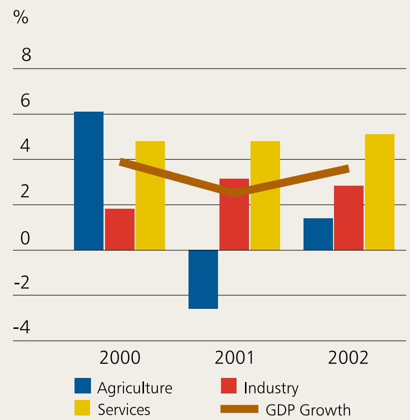
Security concerns also had large fiscal implications for Pakistan. Consolidated expenditures of the federal and provincial governments rose by 20%, while revenues improved by only 12%. As a result, the fiscal deficit in 2002 is estimated to be 7% of GDP (or 5.7% after adjusting for one-off expenditures incurred in 2002, including bonds issued to public sector banks to settle past income-tax refund claims and an equity injection into the Karachi Electric Supply Corporation). Development expenditures showed a large increase of 35% over 2001, but fell still short of the budget target. Current expenditures increased by 6.2%, mainly due to higher defense spending. Government revenues strengthened in 2002, mainly on account of large rises in nontax revenues and surcharges on petroleum and gas. Nontax revenues surged by 52%, due to large payments received for the use of the country's civil aviation facilities by the coalition forces for operations in Afghanistan, while receipts from surcharges increased by 47%. In Sri Lanka, the fiscal deficit target of 8.5% of GDP is unlikely to be achieved due to the shortfall in tax revenues occurring as a result of the sharp decline in imports and price reduction measures introduced by the Government in July 2002.

Monetary policy has remained generally accommodative in South Asia, to facilitate economic expansion. However, lack of confidence among investors has also failed to lead to significant growth in private sector borrowing. In Bangladesh, although monetary conditions remained loose, the rate of money supply (M2) growth declined to 13.1% in June 2002 from 16.6% in June 2001. Notwithstanding a recent increase in government borrowing from the banking sector, this decline in growth was due to a sharp deceleration in credit growth to the public sector, reflecting greater efforts to contain the public sector deficit. The main contributor to the growth in broad money during this period was a sharp rise in net foreign assets of the banking system, reflecting an upward trend in foreign reserves. Credit growth to the private sector also picked up marginally during this period. Money supply (M3) in India grew by 14.3% in 2001, down from 16.8% a year earlier. Deposits of commercial banks grew by 14.6%, while currency in circulation grew by 15.2%, mainly on account of higher agricultural activity and larger procurement of foodgrains. Money supply growth rose to 17% during the first quarter of 2002 (April–June 2002). Excess liquidity stemming from slack demand conditions relative to monetary growth led to a decline in interest rates. Nevertheless, the prime lending rate has been changed little because of inflationary expectations arising from the recent setback in agriculture. In Pakistan, the large accumulation of foreign exchange reserves in 2002 led to a substantial expansion in the money supply, as the State Bank of Pakistan adopted an easy monetary policy to revive growth. Money supply increased by 15.2% in 2002 compared to 9.0% in 2001, as the discount rate was lowered from 14% in June 2001 to 9% by January 2002 and kept unchanged at that level for the next 5 months. However, this did not result in an expansion of demand for credit by the private sector, as security concerns dampened the investment climate. In Sri Lanka too, despite growth in broad money supply of 16%, credit to the private sector has been low. The Central Bank has reduced the repurchase and reverse repurchase rates by 150 basis points during the year, and the yield for short-term credit has shifted downward.

Price levels have displayed a varied performance throughout the subregion. The annual average rate of inflation in Bangladesh edged up to 2.3% in May 2002 from 1.6% in December 2001. While low food prices depressed the overall index, prices of nonfood items accelerated more sharply due to a rise in administered

Improvement in Pakistan's GDP growth was mainly due to agriculture, despite continuing drought.

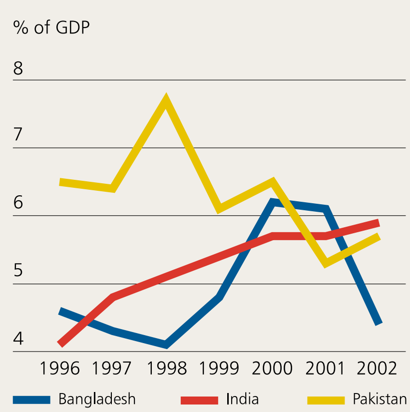
GDP Growth by Sector, Pakistan 2000-2002



Sources: ADO database; *Pakistan Economic Survey 2001-02*.

The fiscal arena remains a major area of concern, with large deficits commonplace.

Fiscal Deficit, Selected South Asian Countries, 1996-2002



Sources: ADO database; Bangladesh Resident Mission, *Quarterly Economic Update*; Reserve Bank of India, 2002, *RBI Bulletin*, August; *Pakistan Economic Survey 2001-02*.

Selected Economic Indicators, South Asia, 1999–2003

	1999	2000	2001	2002		2003	
				ADO 2002	*Update*	*ADO 2002*	*Update*
GDP Growth (%)							
Average	5.7	4.2	4.8	5.4	3.9	6.4	5.7
Afghanistan	—	—	—	—	—	—	—
Bangladesh	4.9	5.9	5.2	4.5	4.2	5.7	5.4
Bhutan	7.3	5.7	6.0	6.5	6.0	6.5	6.5[a]
India	6.1	4.0	5.4	6.0	4.0	6.8	6.0
Maldives	7.4	4.6	2.1	2.0	2.0	—	4.0
Nepal	4.5	6.1	4.7	3.5	0.8	5.0	3.5
Pakistan	4.2	3.9	2.5	3.0	3.6	5.0	4.5
Sri Lanka	4.3	6.0	-1.3	3.5	2.8	5.5	5.5[a]
Inflation (%)							
Average	4.2	6.2	3.7	4.1	5.4	4.8	4.8
Afghanistan	—	—	—	—	—	—	—
Bangladesh	8.9	3.9	1.6	2.4	2.4	2.6	2.9
Bhutan	9.2	3.6	3.6	4.5	4.5[a]	5.2	5.2[a]
India	3.3	7.1	3.6	4.0	6.0	5.0	5.0
Maldives	3.0	-1.2	0.7	—	—	—	—
Nepal	11.3	3.5	2.4	5.0	3.0	5.0	5.0
Pakistan	5.7	3.6	4.4	5.0	2.8	5.0	5.0
Sri Lanka	5.9	1.2	11.0	8.5	8.5[a]	6.0	6.0[a]
Current Account (% of GDP)							
Average	-1.6	-1.0	-0.2	-1.7	-0.4	-1.9	-0.6
Afghanistan	—	—	—	—	—	—	—
Bangladesh	-1.4	-1.0	-2.1	-2.5	0.6	-2.1	-0.2
Bhutan	-25.9	-30.6	-27.5	—	—	—	—
India	-1.1	-0.6	0.3	-1.0	-0.9	-1.5	-0.9
Maldives	-14.6	-9.5	-10.9	—	—	—	—
Nepal	-3.3	-4.5	-4.4	-5.0	-7.0	-5.0	-5.0
Pakistan	-4.1	-1.9	-0.9	-3.6	2.2	-3.1	1.0
Sri Lanka	-3.6	-6.5	-3.4	-6.5	-6.5[a]	-7.5	-7.5[a]

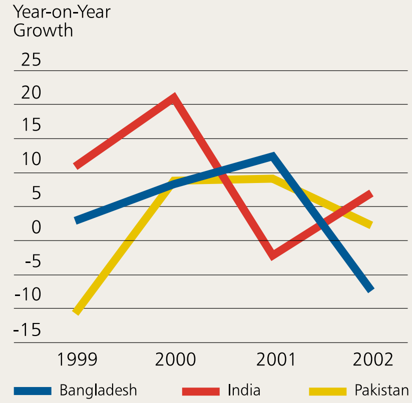
— Not available.
[a] *ADO 2002* forecast.
Sources: ADO database; staff estimates.

prices from the beginning of this year. Annual inflation in India, as measured by changes in the CPI for industrial workers, was higher at 4.7% in May 2002 compared to 2.5% in May 2001. The annual inflation rate based on the wholesale price index declined from 5.3% in June 2001 to 2.2% in June 2002, but a recent hike in prices of petrol and diesel is pushing this index back up. In Nepal, the inflation rate recorded a slight increase to 3% in 2002 from the 2001 rate of 2.4%. In contrast, the trend of declining inflation in recent years in Pakistan was sustained in 2002. The inflation rate fell to 2.8% from 4.4% in 2001, due to a comfortable supply of essential commodities, weaker international prices for petroleum in the first half of the year, lower prices of cotton, and appreciation of the Pakistan rupee. In Sri Lanka, inflation continues to be high despite lower petroleum prices in the first half of the year. Average inflation for the 12-month period ending in June 2002 was 12.3% compared with 11% in December 2001.

Export growth in South Asia has slowed to an annual pace of 4.7% (reflecting mainly the second half of 2001), affected by slower economic growth in major export markets and in the subregion itself. In some South Asian countries, it was negative. In Bangladesh, notwithstanding a brief upturn during the middle and end of 2002, year-on-year export earnings declined by 7.4%, mainly on account of the global downturn, the economic fallout from the September 11 attacks, and growing infrastructure constraints. The decline in export earnings was broad based, affecting all major export categories except jute goods and agricultural products. India's exports have also slumped recently, largely due to the global slowdown: they were up by 18.2% in April 2002 compared to April 2001, but in the following month growth had declined sharply to only 3.9% over May 2001. Though exports are likely to grow faster this year than last year, the recovery is likely to fall short of the 11% export growth projected in *ADO 2002*, mainly because of a weaker than expected recovery in the global economy. Exports from Nepal are estimated to have declined by 15% in 2002 after having grown, on average, by above 20% over the last 3 years. Exports of key merchandise items such as woolen carpets, ready-made garments, and *pashmina* products (to countries other than India) have declined significantly due to supply disruptions as well as to the slowdown in demand abroad. Export growth to India also slowed in 2002 from the levels of previous years, due to the delay in the renewal of the Nepal-India Trade Treaty of 1996. Tourist arrivals in Nepal declined by about 40%, resulting in an estimated 33% decline in tourism receipts. Pakistan's exports grew by a small margin of 2.2% (from $8.9 billion to $9.1 billion in 2002) in contrast to an increase of 9.1% in 2001. Sri Lanka's exports continued to decline during the first half of 2002. Exports fell to $2.0 billion compared with $2.4 billion during the first half of 2001. The poor performance was due to lower industrial imports in the country's main export markets, the US and EU, where the recovery has been slower than expected.

Export growth has slowed.

Export Growth, Selected South Asian Countries, 1999-2002



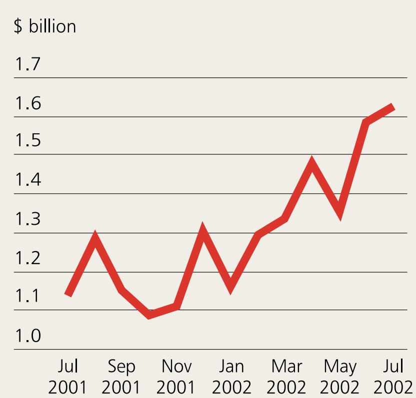
Sources: *ADO* database; Reserve Bank of India, 2002, *RBI Bulletin,* August; www.sbp.org.pk; Bangladesh Bank 2002, *Monthly Current Economic Trends*, June.

Import growth in the subregion has also been lower, or its decline sharper, than previously expected. Available data in Bangladesh indicate that during the first 10 months of fiscal 2002, year-on-year imports declined by 7.1%, as exporters' demand for industrial raw materials and intermediate goods dropped. However, reflecting the pickup in exports during May and June 2002, imports in terms of letters of credit opened for the whole year declined by only 4.1%. In India, imports are unlikely to grow as rapidly as earlier projected, since the recovery of domestic economic activity noted in early calendar year 2002 may not be sustained. Nepalese imports are estimated to have declined by about 8% in 2002 due to weaker demand for industrial raw materials, lower oil prices, and reduced aid-related imports. In Pakistan, total imports declined by 7% in 2002 (from $10.2 billion to $9.5 billion), in contrast to an increase of 6.3% in 2001. In Sri Lanka, imports declined as well, falling by 10% to $2.9 billion in the first half of 2002.

Subregional improvement in the balance of payments has generally pushed up holdings of foreign reserves.

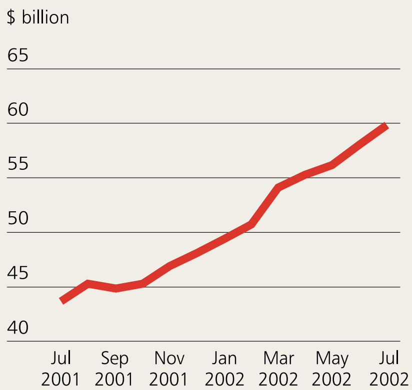
The expected sharper contraction in imports than exports has improved the picture for the subregion's current account balances. In Bangladesh, the decline in imports somewhat offset the decline in exports and led to a narrowing of the trade deficit to $2.1 billion during the first 10 months of 2002 from $2.2 billion during the corresponding period of 2001. The lower trade deficit was accompanied by a substantial 34% increase in overseas workers' remittances due, in large measure, to efforts taken by the Government to encourage the flow of remittances through official channels. As a result, the current account balance (excluding official grants) for the first 10 months of 2002 moved to a surplus of $139 million from a deficit of $766 million in the corresponding period of the preceding year. In India, a surge in inflows of invisibles during 2001 resulted in a small surplus on the current account. In Nepal, the fall in exports and tourism income was not offset by a drop in imports and steady growth of workers' remittances from abroad. The current account balance, therefore, remained in deficit at about 7% of GDP. Pakistan's net current transfers increased to $5.7 billion in

Foreign Exchange Reserves, Bangladesh, July 2001-July 2002



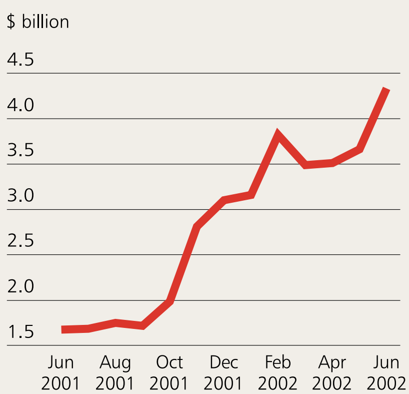
Source: www.bangladesh-bank.org.

Foreign Exchange Reserves, India, July 2001-July 2002



Source: www.rbi.org.in.

Foreign Exchange Reserves, Pakistan, June 2001-June 2002



Source: www.sbp.org.pk.

2002 due to a sharp rise in workers' remittances and official transfers in the post-September 2001 period. The balance of payments improved significantly during 2002 due to these remittances, larger inflows of foreign grants, and receipts for the use of civil aviation facilities by the coalition forces. Excluding official transfers, the current account posted a surplus of $1.3 billion compared to a deficit of $0.5 billion in 2001. There was also a substantial reduction of 16.6% in the deficit on the services account, mainly reflecting receipts of about $350 million for logistics support provided for operations in Afghanistan. As exports declined at a much faster rate than imports in Sri Lanka, the trade deficit there widened by about 11% to $863 billion in the first half of 2002.

The general improvement in the balance of payments in the subregion in 2001 has pushed up holdings of foreign reserves in most countries. In Bangladesh, the substantially higher current account more than offset a somewhat lower financial account balance resulting from lower FDI inflows and a sharp increase in short-term capital outflows. This led to an overall balance-of-payments surplus of $81 million in 2002, compared to a deficit of $368 million in 2001. Following improvement in the overall balance, foreign exchange reserves climbed to $1.6 billion at the end of July 2002 from $1.3 billion at the end of December 2001. India's foreign exchange reserves have been increasing steadily from $42 billion in March 2001 to $60 billion in July 2002. Despite the large rise in reserves, the nominal exchange rate of the Indian rupee depreciated by about 4% from April 2001 through March 2002 and by a further 2.4% by 1 August 2002. In Nepal, despite the deterioration in the external accounts, gross official reserves, as of mid-July 2002, remained at a comfortable level of about $1.1 billion, equivalent to about 7 months of imports. Pakistan's overall surplus on the balance of payments made possible a substantial increase in the foreign exchange reserves so that, as of end-June 2002, central bank reserves stood at $4.3 billion compared to $1.7 billion on 30 June 2001.[2] Sri Lanka's gross official reserves position strengthened to $1.4 billion in June 2002 from $1.3 billion at end-2001.

POLICY DEVELOPMENTS

Throughout South Asia, governments continue to grapple with the problems of fiscal deficits and of trade growth that is lower than targeted to achieve sustainable poverty-reducing economic growth. During the second half of 2002, the Government of Bangladesh made concerted efforts to address the imbalances caused by the pursuit of expansionary fiscal and monetary policies in the past, and to remove some of the trade-distorting administrative measures introduced to stem the decline in international reserves earlier in the year. In addition to steps taken to instill budgetary discipline, the Government revoked the right of commercial banks to meet their reserve requirements in foreign exchange in an attempt to improve the effectiveness of monetary operations. Foreign exchange and trade restrictions—such as enhanced margin requirements on letters of credit and increased import duties and surcharges introduced earlier in the year to restrict imports—have also been eased. Following the Government's success in reducing the fiscal deficit in 2002, the deficit for 2003 has been targeted to within sustainable limits (4% of GDP) so that it would no longer be a source of instability in the economy. With this end in view, an Expenditure Review Commission and a Revenue Reform Commission have been set up. The 2003 budget also introduces major reforms in the import duty structure, restarting the tariff liberalization process that had been stalled since the mid-1990s. During the second half

[2] The country's total foreign exchange reserves, including reserves held by commercial banks, stood at $6.3 billion as of end-June 2002 compared to $3.3 billion a year earlier.

of 2002, the Government also made significant efforts to prepare, on the basis of broad public consensus, a National Strategy for Economic Growth and Poverty Reduction that would provide the basis for future development planning. Notwithstanding these reform measures, progress has been slow on much-needed governance and structural reforms in the SOE and banking sectors. The more recent closure of a major state-owned jute mill could, however, signify a willingness on the part of the Government to address the problems posed by nonviable state-owned enterprises.

In India, the medium-term economic outlook is also mixed. The 10th Plan Approach Paper for 2002–2007 sets a target growth rate of 8% to ensure rapid and continuing poverty reduction. However, the current lower growth rate indicates that it could be difficult to achieve the 8% growth target without significant structural adjustments, especially fiscal adjustments, over the medium term. The state governments are now implementing a program of fiscal consolidation. However, fiscal reform in the central Government has slackened with the introduction of VAT having been postponed to April 2003 from April 2002.

On the trade front, the Government of India announced several measures in its Export-Import Policy for 2002–2007 aimed at augmenting exports. Transaction costs have been significantly reduced because numerous procedures have been simplified. Important policy initiatives included the removal of quantitative restrictions on most exports, permission for overseas banking units to set up in special economic zones, and other export promotion schemes. The abolition of the licensing regime for rough diamonds should help India emerge as a major international center for diamond cutting and trading. The introduction of a new eight-digit commodity classification for imports will go a long way to eliminating classification inconsistencies and should, therefore, reduce rent-seeking opportunities and improve tariff administration efficiency.

Lack of reforms in the Indian power sector has received major attention in recent years. The central Government is now implementing the Accelerated Power Development and Reform Program, which has begun yielding results. Twelve states have set up electricity regulatory commissions and many of them have started rationalizing tariffs.

On the monetary front, the Reserve Bank of India (RBI) announced its monetary and credit policy for 2002, adopting a cautious expansionary stance that progressively reduces interest rates. Toward this end, the cash-reserve ratio has been reduced further from 5.5% to 5.0% and the RBI has indicated that it may also reduce the bank rate if necessary. To introduce flexibility in the interest rate structure, commercial banks are being encouraged to introduce a flexible interest rate system for all new deposits, with rates reset at 6-monthly intervals, and to keep the fixed rate option open. Thus, banks may offer longer-term deposits with 6-monthly reset conditions and at the same time offer a fixed rate for similar maturities, the interest rate on which may be higher or lower depending on the period of deposit and the banks' perceptions of the outlook for inflation and interest rates over the longer term. Banks have been advised to put such a flexible rate system in practice as early as possible, and devise schemes for encouraging depositors to convert their existing long-term fixed rate deposits into variable rate deposits. Furthermore, the ceiling rate on export credit in foreign currency is being reduced from the present LIBOR plus 1.0 percentage point to LIBOR plus 0.75 percentage point. The RBI has also expressed its concern over the excessive variation in commercial bank lending rates for prime borrowers and others. Banks are now required to declare their prime lending rate and the maximum spread.

In response to the current political and fiscal difficulties, the Government of Nepal has begun to implement an Immediate Action Plan. A key element of the Plan is prioritization of public investments, including discontinuation of low priority projects or programs, ensuring adequate and timely flow of resources to priority projects. The Plan also includes measures to improve public service delivery and enhance transparency and accountability of the public sector. The 2003 (July 2002–June 2003) budget focuses on addressing the security situation (with increased budget allocation) and implementation of the Plan, and the Government is now finalizing the 10th Five-Year Plan, which embodies its poverty reduction strategy.

The Government of Pakistan continued with tax reforms aimed at bringing about a more rational tax regime; the structure of taxes has significantly changed in recent years. Reforms include reducing corporate tax rates, introducing a self-assessment scheme for income tax, reducing or eliminating withholding taxes, reducing import tariffs, and extending the base of the general sales tax. The Government also circulated for comments a fiscal responsibility law, which requires the Government to progressively reduce its borrowing, so that after 5 years it will meet all its current expenditures from revenue receipts. Also, it will be bound to bring down the level of public debt to 60% of GDP in 10 years, from 111% in 2001, aided in part by recent Paris Club rescheduling. The Government's fiscal stabilization efforts have so far relied mostly on cutting expenditures, which has had detrimental effects on economic growth. Efforts for better revenue mobilization have not been very successful because of problems with the tax administration systems. Initial steps in this area have recently been taken, such as setting up a Large Taxpayers Unit in Karachi and constituting the high-level Supervisory Council to determine the policies of the Central Board of Revenue.

The Government of Sri Lanka is undertaking several reform measures, including revision of labor legislation which has been a bottleneck to attracting foreign investors. The intention of the Government is to present the amendments to various items of legislation to Parliament in the latter part of 2002.

OUTLOOK FOR 2002–2003

For the rest of this year and next, South Asian economic performance should continue to improve, although at a more subdued pace than predicted in *ADO 2002*, with expectations of mild global recovery and more favorable weather. In Bangladesh, the GDP growth rate in 2003 (year ending June 2003) is expected to improve to 5.4%, due to a measured recovery in both external and domestic demand. This is, however, slightly lower than the growth forecast in *ADO 2002* due to the reduced pace of recovery in the global economy. The current account balance is likely to move marginally into deficit in 2003, from a small surplus of around 0.6% of GDP in 2002, as stronger export growth is likely to be accompanied by a pickup in imports due to the import-dependent domestic and export-oriented manufacturing sectors. A higher trade deficit is also likely to be accompanied on the current account by more subdued growth in worker remittances due to a decline in the number of registered workers leaving to work abroad. The annual rate of inflation is likely to accelerate from around 2.4% in 2002 to around 2.9% in 2003 due to higher domestic demand, a further increase in administered utility prices, and the one-off impact of higher rates and fees introduced in the 2003 budget. In India, with reduced agricultural production and only moderate growth in major export markets, real GDP is expected to grow by 4% in 2002 (year ending March 2003) and 6% in 2003. Inflation is likely to be around 6% and 5% in those years, and the current account deficit is projected at 0.9% of GDP.

Macroeconomic prospects in Nepal in the short to medium term depend on how the security and political scenarios develop. On the assumption of an improved security situation and normal weather conditions, the economy is expected to grow by 3.5% in 2003 (year ending July 2003). Exports are expected to increase only slowly because of the continued security problems and uncertainties about external demand in third countries. This in turn will adversely affect the output of the manufacturing sector. A major upturn in tourism in the short term is also unlikely unless the security and political environment significantly improves. Though the expected recovery of exports in 2003 will be matched by import growth, the current account deficit is forecast to improve slightly to 5% of GDP. Inflation will remain moderate at 5%.

If current trends are sustained in Pakistan, the economy should be able to realize the growth target of 4.5% in 2003 (year ending June 2003). Recent rains have improved the outlook for the agriculture sector and have replenished the major water reservoirs for the first time in 3 years. It is estimated that agricultural growth will increase to 3% in 2003. The upturn observed in large-scale manufacturing in the last quarter of 2002 (April–June) is expected to continue and growth in the industry sector is expected to strengthen to 5%. The services sector may also get a boost from election spending. Inflation is expected to accelerate to 5%, as economic activity picks up. The fiscal deficit in 2003 should decline significantly, but the budgetary deficit target of 4.4% for 2003 seems very ambitious and may not be achieved. Both exports and imports seem to have bottomed out and to have experienced a significant upturn in the last quarter of 2002, which is likely to continue in 2003. With anticipated revival of domestic economic activity, imports will also increase. However, the trade deficit is likely to remain at around $1 billion, or 1.5% of GDP. Remittances are likely to be sustained at the high level achieved in 2002, as these have mostly resulted from a shift from informal to regular banking channels. Overall, the surplus in the current account in 2003 is likely to be lower than it was in 2002.

Growth for 2002 in Sri Lanka will likely be about 2.5–3%, lower than the initial estimate of 3.5% in *ADO 2002*. The fiscal balance is expected to worsen by about 1% of GDP due to lower tariff collections from reduced imports and the July price-reduction measures, unless significant expenditure cuts are made in the latter part of the year. A major concern is the financing of the budget deficit due to the delay in realization of foreign loans and privatization proceeds. Hence the Government will have to adopt domestic financing, which will have an impact on interest rates in the future. Peace talks on the conflict in the northeast of the island are likely to raise confidence and provide a mild stimulus to the economy. Depending on the outcome of these talks and political stability, the economy is expected to pick up significantly in early 2003.

CENTRAL ASIA

Subregional growth was better than expected in the first half of 2002 largely due to rapid growth in investment and production. Higher oil and gas prices in the second half of the year will benefit the energy exporters of Azerbaijan, Kazakhstan, and Turkmenistan. Some slower growth might be expected in the latter part of the year as the economy of the Russian Federation weakens, the effects of the heavy rains on the cotton crop in the early part of the year are felt, and non-oil commodity prices stabilize.

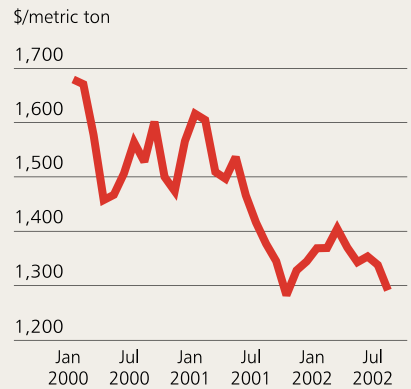
MACROECONOMIC ASSESSMENT

The global economic slowdown in 2001 weakened demand and exerted downward pressure on international prices of several of the subregion's major export commodities including cotton, oil, and nonferrous metals. The attacks in the US in September 2001 also created additional uncertainties in the countries neighboring Afghanistan. Despite these unfavorable external circumstances, the majority of countries continued the process of economic recovery that had been under way for the 3 preceding years. Weighted average GDP growth in the subregion was 8.7% in 2000 and 10.7% in 2001. Preliminary figures indicate that real GDP grew by a weighted average of 8.4% in the first quarter of 2002, just slightly lower than the year earlier figure of 8.6%.

The impact of softening commodity prices in 2001 (except for gold) was offset to varying degrees in different countries through increases in production. The oil sector, which is still in a phase of investment-led expansion, is the main engine of economic growth in both Kazakhstan—the subregion's largest economy—and Azerbaijan. In Kazakhstan, real GDP continued to expand at a double-digit rate—10.7% in the first quarter of 2002—fueled by a high level of investment in the oil sector and by rising oil export volumes. Growth was more modest in Azerbaijan (4.7% compared to 8.2% a year earlier) due to various capacity constraints. In Turkmenistan, real GDP growth was 10.8% for the first quarter of the year, owing to strong performance in both the industry and agriculture sectors. Industrial performance is dominated by the gas sector, in which production increased sharply as new fields came on stream. Cotton export revenue in Turkmenistan increased despite weak international prices, as processed cotton exports rose substantially from the level of a year earlier. The subregion experienced heavy rains in early 2002, putting an end to a 3-year drought. As a result, agricultural production started to recover slowly. At the same time, increased production of processed cotton benefited Tajikistan and Uzbekistan, which registered GDP growth of 9.3% and 3.1%, respectively, during January–March 2002 (up from 7.9% and 2.8% in the same period a year earlier).

A marked deterioration in current account balances is partly due to a fall in commodity prices ...

Aluminum Prices, January 2000-August 2002



Sources: CEIC Data Company Ltd.

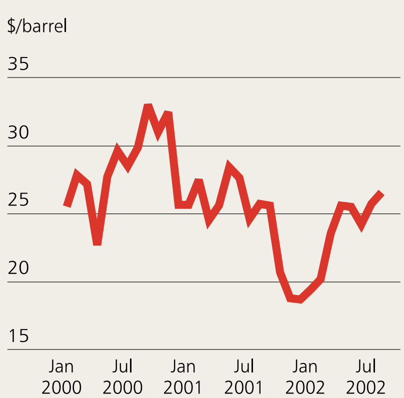
Selected Economic Indicators, Central Asia, 1999–2003

	1999	2000	2001	2002		2003	
				ADO 2002	*Update*	*ADO 2002*	*Update*
GDP Growth (%)							
Average	5.1	8.7	10.7	5.7	6.2	6.4	5.7
Azerbaijan	9.5	11.1	9.9	10.0	9.1	11.0	8.5
Kazakhstan	2.7	9.8	13.2	7.0	7.5	6.0	6.0
Kyrgyz Republic	3.7	5.4	5.3	4.5	4.4	4.5	4.2
Tajikistan	3.7	8.3	10.3	6.0	8.0	5.0	6.0
Turkmenistan	16.0	17.6	20.5	11.0	11.0	11.0	11.0
Uzbekistan	4.4	4.0	4.5	4.0	2.0	5.0	3.0
Inflation (%)							
Average	15.5	17.0	13.6	10.0	10.8	5.6	8.2
Azerbaijan	-8.5	1.8	1.5	1.8	2.5	2.0	2.5
Kazakhstan	8.3	13.2	8.4	6.6	5.6	5.6	5.9
Kyrgyz Republic	35.9	18.7	6.9	7.5	4.1	5.5	4.7
Tajikistan	27.5	32.9	38.6	8.9	13.0	7.6	11.0
Turkmenistan	23.5	7.4	5.6	8.5	8.5	7.5	7.5
Uzbekistan	26.0	28.2	26.4	18.0	22.5	—	13.5
Current Account Balance (% of GDP)							
Average	-4.3	-0.5	-4.2	-4.5	-4.1	-4.9	-4.4
Azerbaijan	-13.1	-3.2	-0.9	-3.0	-6.0	-5.0	-9.7
Kazakhstan	-1.4	2.3	-7.8	-4.5	-6.6	-4.7	-6.0
Kyrgyz Republic	-14.4	-5.6	-0.9	-6.3	-3.8	-6.5	-5.4
Tajikistan	-3.4	-6.6	-7.0	-6.2	-4.2	-5.5	-4.5
Turkmenistan	-18.0	-13.9	-1.5	—	—	—	—
Uzbekistan	-1.0	1.4	-0.6	—	-1.2	—	-2.0

— Not forecast.
Sources: ADO database; staff estimates.

... notably crude oil, from a Brent average of $28.30 a barrel in 2000 to $24.40 in 2001.

Crude Oil Prices, January 2000-August 2002



Sources: CEIC Data Company Ltd.

The Kyrgyz Republic is the only notable exception to the GDP pattern, with real GDP declining by 4.9% in the first half of 2002, prompted mostly by a sharp decline in gold production after record levels were seen in 2001. Although, in the past, the agriculture sector has generally helped alleviate the country's heavy dependence on gold, the sector grew only moderately in the first quarter of 2002 because of late sowing due to climatic and seasonal factors.

Fiscal balances have continued to strengthen in the subregion, helped by improved revenue collection due to higher tax revenues from commodity exports and to prudent expenditure management. Azerbaijan, Kazakhstan, and Tajikistan have so far reported budget surpluses equivalent to 3.3%, 3.7%, and 2.8% of GDP, respectively, for the first quarter of 2002. In Turkmenistan and Uzbekistan, according to official reports, the state budget is close to balance. However, the true state of the fiscal balance remains unclear, as many fiscal transactions are conducted through off-budget funds. The Kyrgyz Republic is again the exception, with a budget deficit equivalent to 5.6% of GDP for the first quarter of 2002. The sharp slowdown in GDP has dampened revenue collection, while the Government has little scope to reduce social spending given high and widespread poverty levels.[1]

[1] In addition, the budget figures for the Kyrgyz Republic include the Public Investment Program, but not for other countries. Hence, the figures are not strictly comparable.

Inflation, though varying greatly across the subregion, improved in the first quarter of 2002 from a year earlier. This was mainly the result of stronger fiscal positions and tight monetary stances. However, it remains a matter of concern in Tajikistan and Uzbekistan, with annual inflation reaching 26.2% and 24.5%, respectively, in the first quarter of the year. Among the main factors pushing up consumer prices are high food prices owing to shortages caused by earlier droughts in Tajikistan, and rising utility prices in Uzbekistan. The other economies of the subregion experienced much lower inflation rates, ranging from 1.9% in Azerbaijan to 5.6% in Kazakhstan, over the same period.

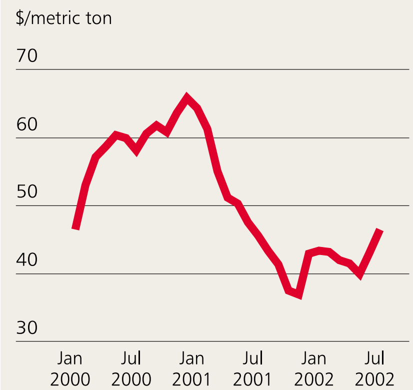
Exchange rate stability was maintained in the first quarter of 2002. The currencies of Kazakhstan and the Kyrgyz Republic remained stable, while those of Azerbaijan and Tajikistan experienced marginal depreciation. In Turkmenistan, large hard currency inflows from gas exports enabled the Government to maintain the official exchange rate and stabilize the spread between the official and black market rates, which, however, remains extremely wide. In Uzbekistan, as part of an IMF staff monitored program, the Government has promised to narrow the rate between the official and black market rates. While the commercial rate (the rate at which the public can buy dollars through licensed exchange bureaus) has been substantially depreciated and is now almost equivalent to the curb market rate, progress in the depreciation of the official rate has been gradual and there is still considerable uncertainty over the possible reunification of official and market rates this year.

Trade balances in the subregion generally worsened in the first quarter of 2002 compared to a year earlier. Export earnings remained stagnant or decreased slightly as a result of weaker commodity prices. Imports increased significantly, specifically in Azerbaijan and Kazakhstan where oil sector developments pushed up import volumes (primarily capital technology and services imports). Turkmenistan is a notable exception with a sharp increase in its trade surplus for the first quarter of the year, owing to a robust year-on-year rise in both export volume and prices, as Turkmenistan was able to negotiate a slightly higher price for its gas exports to two key markets: the Russian Federation and Ukraine. The Commonwealth of Independent States (CIS) countries, in particular the Russian Federation, remain the main trading partners for nearly all the countries in the subregion.

In 2001, there was a marked deterioration of the current account balance in the subregion. This was caused by a combination of a fall in commodity prices (most notably crude oil, from a Brent average of $28.30 a barrel in 2000 to an average of $24.40 a barrel in 2001) and a sharp acceleration in import expenditure growth. The current account deficits are not a cause of concern for Azerbaijan and Kazakhstan as they can be easily covered by rising FDI inflows, mostly in the oil and gas sector. In other countries, however, FDI inflows remained very low, making their overall external position much weaker. Governments have to rely on credit from international financial institutions (IFIs) and bilateral donors to cover their external deficits. As a result, external debt stocks have risen rapidly, reaching 110% and 97% of GDP in the Kyrgyz Republic and Tajikistan, respectively, in 2001. The corresponding high level of debt service obligations is likely to put a serious strain on government budgets, thereby threatening prospects for growth and poverty reduction over the medium term. External debt management is therefore a key policy issue and both countries have been working closely with IMF to develop and implement a debt-reduction strategy. The Government of Tajikistan reduced its debt to the Russian Federation by about $50 million in 2001, while the Government of the Kyrgyz Republic successfully concluded a debt rescheduling agreement with the Paris Club in March 2002, reducing its debt service burden for 2002–2004 from about $100 million to $5.5 million.

While cotton prices started to recover in early 2002 they are still off their recent highs.

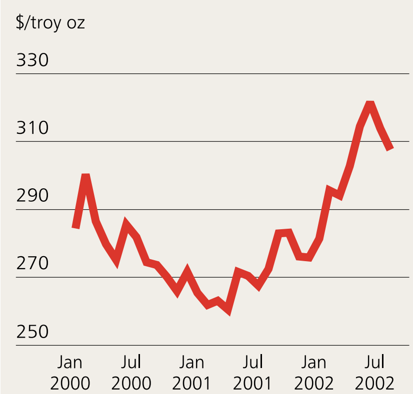
Cotton Prices, January 2000-July 2002



Sources: www.fao.org.

The notable exception to softening commodity prices is gold, the price of which has been steadily increasing since the first quarter of 2001.

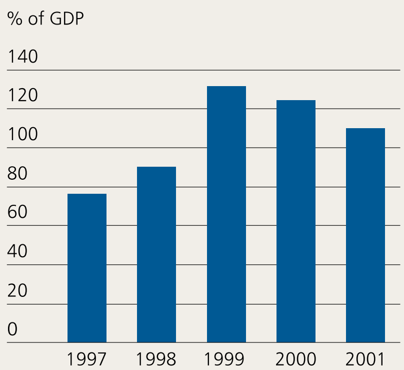
Gold Prices, January 2000-August 2002



Sources: CEIC Data Company Ltd.

External debt stocks have risen to 110% of GDP in the Kyrgyz Republic ...

External Debt, Kyrgyz Republic, 1997-2001



Source: Asian Development Bank, *Country Strategy and Program Update (2003-2005): Kyrgyz Republic,* September 2002.

POLICY DEVELOPMENTS

The events of September 11, 2001 in the US and the ensuing campaign against terrorism have led to heightened international interest in the subregion. A number of reform measures encompassing both policy and structural elements have been implemented over the past year in most subregional countries as part of comprehensive programs sponsored by IFIs. In Azerbaijan, while an IMF poverty reduction and growth facility (PRGF) has been ongoing since the summer of 2001, the World Bank approved a second structural adjustment credit program worth $60 million in March 2002. In Tajikistan, the Government is currently negotiating with IMF on a new PRGF, subject to the successful review of a six-month staff monitored program (January–June 2002). IMF also implemented a staff monitored program in Uzbekistan from January to June 2002. A final review is expected in September and, if successful, this may lead to the finalization of a regular program in the fourth quarter of the year. Even Turkmenistan, whose relations with IFIs have been extremely limited in recent years, has sought to revive its relations with them.

Reform measures have achieved some positive results, most notably in terms of the restoration and maintenance of macroeconomic and financial stability. However, the reform process is far from complete. Among the most important items remaining on the agenda are much-needed improvements in the investment and business climate and in external debt management, along with a further deepening of structural and social sector reforms. The lack of private sector development in the non-oil sector remains a source of concern in Azerbaijan and Kazakhstan, where poverty levels remain high despite robust GDP growth. Both countries have established state oil funds to better manage their increasing oil revenues, but their level of social sector spending seems inadequate to achieve their respective development objectives. Private sector involvement is even more limited in Turkmenistan and Uzbekistan, as both governments have largely preferred state-led development so far. The persistence of very restrictive exchange rate regimes in both countries has further dampened private sector growth.

OUTLOOK FOR 2002–2003

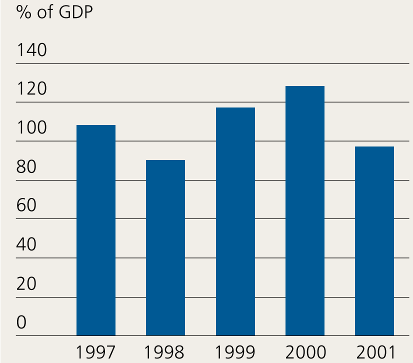
Economic growth in Central Asia has started to slow, following an impressive performance in 2000 and 2001. Real GDP growth for 2002 is currently projected at 6.2%, down from 10.7% in 2001, but somewhat higher than the *ADO 2002* growth forecast of 5.7%. Growth will continue to be driven by increases in commodity production and exports, particularly oil and gas. Higher commodity prices (most notably oil and nonferrous metals) contributed positively to growth in the first three quarters of 2001, but price declines in the fourth quarter had a dampening impact, which will continue to be felt in 2002. Some commodity prices, particularly oil, have started to recover since the beginning of 2002, and have contributed to the improved outlook in the first half of the year. Oil and gas prices are expected to rise further during the second half of the year, thus supporting growth in Azerbaijan, Kazakhstan, and Turkmenistan. However, an expected slowdown of the Russian Federation's economy in 2002 is likely to negatively impact growth performance, as the country is a key export market for the subregion. In addition, the heavy rains that hit the subregion at the start of the year are likely to have benefited the grain crop but to have damaged the cotton crop. This will negatively affect agriculture output growth in Uzbekistan in the latter part of 2002 and in early 2003, since most of the cotton harvest is processed the following year. The slowdown in agricultural output in Tajikistan and Turkmenistan (the other main cotton producers) should be offset by sustained industrial growth, driven mostly by aluminum production in the former and gas exports in the latter. As for the Kyrgyz Republic, gold production is not expected to rebound until 2003. As a result, growth will likely be driven mainly by agriculture in 2002 and is expected to slow to 4.4% (down from 5.3% in 2001 and an *ADO 2002* forecast of 4.5%), before picking up to around 4.2% in 2003 (against a forecast of 4.5% in *ADO 2002*).

Inflation in the subregion is likely to decrease further in 2002 and 2003, against the backdrop of a tight monetary stance. Average consumer price inflation is expected at 10.8% in 2002 (compared to 10% in *ADO 2002*) and 8.2% in 2003 (5.6% in *ADO 2002*). The fiscal stance remains generally fragile. The budget surpluses recorded for the first quarter of 2002 are misleading, as governments tend to be in arrears. Budget deficits ranging from 1% of GDP (Azerbaijan) to about 5% (for the Kyrgyz Republic) are expected in 2002. The tax base in most countries remains extremely narrow and, as a result, government budgets remain heavily dependent on a few commodities.

The deterioration of the subregional current account balance is set to continue in 2002–2003, albeit at a more moderate rate. Import expenditures (including services imports linked to oil and gas expansion) will continue to accelerate while export revenues will grow moderately, as oil prices firm somewhat in the second half of the year, barring any unexpected supply stock. Export revenues are expected to grow in 2002, albeit at a slower rate than anticipated in *ADO 2002*. Given the lack of improvement expected in the trade and current account positions, debt servicing is likely to become more difficult in already indebted countries such as the Kyrgyz Republic and Tajikistan.

... and 97% of GDP in Tajikistan.

External Debt, Tajikistan, 1997-2001



Source: Asian Development Bank, *Country Strategy and Program Update (2003-2005): Tajikistan,* September 2002.

THE PACIFIC

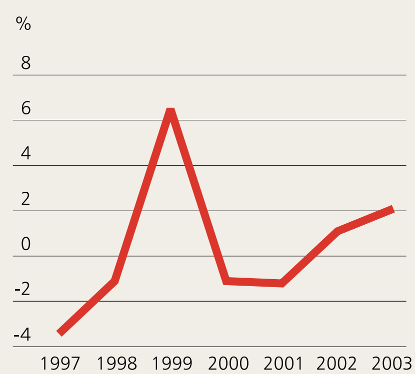
During the first half of 2002, the economic performance of the Pacific was subdued, which highlights both its urgent need for sociopolitical stability and its vulnerability to external developments. The subregion is expected to record a more modest recovery over the medium term than anticipated in *ADO 2002*. However, recovery will largely depend on political stability in Melanesia and developments in the global economy.

MACROECONOMIC ASSESSMENT

A more modest recovery than forecast in *ADO 2002* is expected over the medium term.

According to revised official figures, the Pacific DMCs contracted by a weighted average rate of 1.2% in 2001, which is sharper than the *ADO 2002* estimated contraction of 0.8%. This reflected greater weakness in Melanesia[1]—which accounted for 85% of the subregion's 2001 GDP—because of a sharper than expected contraction in Solomon Islands that was only partially mitigated by an upward revision of estimated economic growth for the Fiji Islands; the contraction of the Papua New Guinea economy—the largest in the subregion—was about the same as previously estimated. In addition, growth estimates were revised downward in the Polynesia group (particularly Cook Islands, Samoa, and Tonga) while most of the Micronesia group's estimates (except for the Federated States of Micronesia) were unchanged. Overall, the picture remains of a subregion that suffered a second year of weak performance in 2001 with only a slightly slower contraction in Melanesia than in 2000 and slower growth in Micronesia and Polynesia.

Real GDP Growth, Pacific DMCs, 1997-2003



Sources: *ADO* database; staff estimates.

These trends generally continued in the first half of 2002 with Melanesian economic performance improving, but at a slower pace than forecast in *ADO 2002*. In Papua New Guinea, the agriculture sector remained subdued because of a delay in harvesting some major crops (mainly coffee), largely reflecting the disruptions accompanying the national elections, while the declining trend in minerals persisted. In Solomon Islands, weak economic management continued to forestall the rebuilding of the economy. A currency devaluation and quick revaluation in March–April 2002 highlighted policy uncertainties. In addition, delays in payments of wages caused unrest among government employees. In contrast, the Fiji Islands experienced a broad-based economic expansion, which exceeded earlier expectations and reflected sound economic management.

At the same time, economic activity was generally slower than expected in the relatively fast-growing Polynesian group. Samoa, the largest member of the group, witnessed a sharp and broad-based slowdown in economic growth during

[1] Melanesia refers to Fiji Islands, Papua New Guinea, Solomon Islands, and Vanuatu; Micronesia refers to Kiribati, Marshall Islands, Federated States of Micronesia, and Nauru; and Polynesia refers to Cook Islands, Samoa, Tonga, and Tuvalu.

Selected Economic Indicators, The Pacific, 1999–2003

	1999	2000	2001	2002		2003	
				ADO 2002	*Update*	*ADO 2002*	*Update*
GDP Growth (%)							
Average	6.5	-1.1	-1.2	1.9	1.1	2.6	2.1
Cook Islands	5.8	9.8	-3.3	2.5	1.4	3.3	2.4
East Timor	—	—	—	—	—	—	—
Fiji Islands	9.7	-2.8	2.6	3.5	4.4	4.7	4.7[a]
Kiribati	2.1	-1.7	1.5	2.8	2.8[a]	2.5	2.5[a]
Marshall Islands	-0.2	0.7	0.6	0.7	0.7[a]	—	—
Micronesia, Federated States of	0.2	4.4	1.1	3.3	0.3	0.7	-0.9
Nauru	—	—	—	—	—	—	—
Papua New Guinea	7.6	-1.3	-3.4	1.2	0.0	1.8	1.1
Samoa	2.6	6.9	6.5	5.0	2.0	5.0	3.0
Solomon Islands	-1.3	-14.0	-10.1	-5.0	-6.0	0.0	2.0
Tonga	2.9	6.5	0.5	2.9	1.6	2.6	2.5
Tuvalu	3.0	3.0	4.0	3.0	3.0[a]	3.0	3.0[a]
Vanuatu	-2.5	3.7	-0.5	0.7	0.7[a]	1.9	1.9[a]
Inflation (%)							
Average	9.3	9.6	7.0	6.0	7.6	3.1	6.6
Cook Islands	1.4	3.1	8.7	2.5	4.0	—	2.5
East Timor	—	—	—	—	—	—	—
Fiji Islands	2.0	1.1	4.3	3.0	2.5	—	3.6
Kiribati	1.8	0.4	6.0	2.7	5.0	2.7	4.0
Marshall Islands	1.7	-1.9	2.0	2.3	2.3[a]	—	2.3
Micronesia, Federated States of	1.9	1.8	2.0	2.6	0.5	2.6	1.5
Nauru	—	—	—	—	—	—	—
Papua New Guinea	14.9	15.6	9.3	8.3	11.2	5.0	9.3
Samoa	0.2	1.0	4.0	3.0	7.0	—	4.0
Solomon Islands	10.4	8.6	8.0	8.0	8.5	6.0	7.2
Tonga	3.9	4.9	6.3	10.0	10.0[a]	5.0	5.0[a]
Tuvalu	3.8	5.3	1.8	1.5	1.5[a]	2.1	2.1[a]
Vanuatu	2.1	2.5	3.9	4.5	3.0	4.0	4.0[a]

— Not available.
[a] *ADO 2002* forecast.
Sources: ADO database; staff estimates.

this period, reflecting irregular weather conditions and the completion of many construction activities.

In sector terms, performance was uneven during the first half of 2002. Agriculture and fisheries generally across the subregion, and construction and public works particularly in the smaller economies, provided a positive stimulus to economic activity; on the other hand, the performance of the major tourism sector was modest, except for the Fiji Islands, which showed strong growth of about 20% in visitor arrivals during the first half of the year. However, declines in many other sectors offset these positive developments. Further, political instability and social unrest continued to constrain economic activities in Melanesia. Low international commodity prices also contributed to subdued economic performance.

Reflecting the weaker than expected economic growth in 2001, the subregional estimate for inflation has also been revised downward slightly to 7% for 2001, compared to the *ADO 2002* estimates. However, inflation is expected to have risen in the first half of 2002, largely reflecting a rise in Papua New Guinea, Samoa, and Tonga. While inflation in Samoa reflected irregular weather and food supplies, in Papua New Guinea and Tonga it partly reflected a depreciation of their respective currencies. A sharp deterioration in the fiscal conditions in Papua New Guinea also contributed to a rise in inflationary expectations in the country. In contrast, inflation in the Fiji Islands fell, alongside an improvement in supply conditions and a reappearance of macroeconomic stability. There was no significant movement in inflation among the other countries.

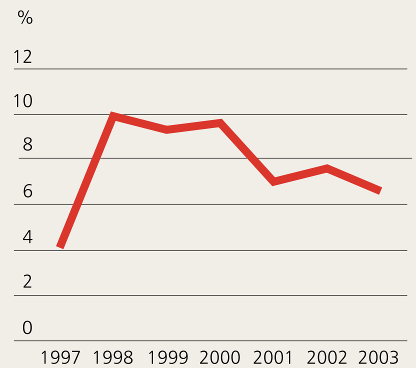
For most Pacific DMCs, the external accounts for the first half of 2002 were not available at the time of writing. However, domestic factors such as elections or delays and disruption in export-oriented activities are expected to have caused weak export performance in the first half of the year. In particular, Papua New Guinea recorded a current account deficit in the first quarter of 2002, having recorded surpluses for more than 10 quarters in a row. Low international commodity prices also contributed to weak export performance in the subregion during the first half of 2002. Some improvement in these prices was seen around the middle of the year, which is likely to be reflected in the outcomes for the second half of the year. Overall, with imports expected to have generally remained steady in most Pacific DMCs during the first half of 2002, trade balances remained under pressure. The Fiji Islands presented a notable exception, recording robust growth in exports, which was faster than growth in imports.

The overall balance on the external account manifested a mixed performance in the subregion. While the position in Solomon Islands reached a precariously low level, that in Tonga improved significantly with the release of the first tranche of an ADB program loan. Most other Pacific DMCs are expected to have maintained reasonable external reserves, though some at levels lower than at the end of 2001.

Weak global economic performance in 2001 and continued uncertainty surrounding recovery in 2002 led to an easing of fiscal and monetary policies in the Pacific. A major development in Melanesia during the first half of 2002 was a sharp deterioration in government finances in Papua New Guinea, mainly due to preelection expenditures, which led to monetary easing and necessitated a supplementary budget from the new Government to control the overall budget deficit in 2002. Further, the fiscal position of Solomon Islands remained precarious, associated with significantly higher than budgeted expenditures, large payments arrears—domestic as well as international—and excessive easing of monetary conditions. The 2002 Solomon Islands budget, introduced in March 2002, proposed to substantially reduce payroll and recurrent expenditures, but implementation has, so far, been extremely weak. More positively, during the first half of 2002, new government budgets for 2002–2003 were introduced in three DMCs in Polynesia—Cook Islands, Samoa, and Tonga. All three budgets target modest budget deficits and reaffirmed government commitment to reforms.

Inflation in early 2002 largely reflects price rises in Papua New Guinea, Samoa, and Tonga.

Inflation Rate, Pacific DMCs, 1997-2003



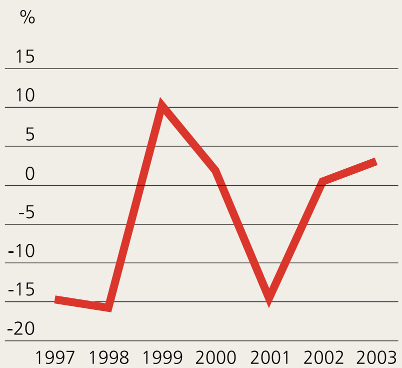
Sources: *ADO* database; staff estimates.

POLICY DEVELOPMENTS

A major policy challenge for the larger Melanesian economies in the first half of 2002 was the restoration of business confidence following periods of political instability and ethnic conflict. Weak economic management adversely affected the achievement of these goals in Papua New Guinea due to national elections, and in Solomon Islands due to lack of political commitment. A new Government was formed in Papua New Guinea in August 2002, which announced its commitment to fiscal responsibility and to removing barriers to investment and economic growth. However, the Government also initiated a review of the privatization process, which it temporarily suspended. Thus, there is an element of uncertainty in the business community in Papua New Guinea as the full policy direction of the new Government may take time to unfold. In contrast, business confidence in the Fiji Islands improved, due to broad-based growth and

Domestic factors and low international commodity prices contributed to weak export performance.

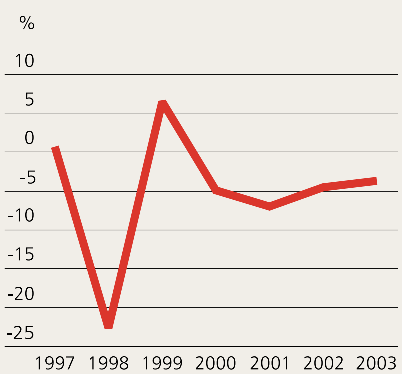
Merchandise Export Growth, Pacific DMCs, 1997-2003



Sources: ADO database; staff estimates.

Trade balances remained under pressure in the first half of 2002.

Merchandise Import Growth, Pacific DMCs, 1997-2003



Sources: ADO database; staff estimates.

macroeconomic stability in the first half of 2002. While the business climate improved in the Fiji Islands, it has yet to be reflected in investment levels. Overall, investors across Melanesia still seem to be watching developments. Vanuatu has also been facing major sociopolitical unrest in 2002, which represents a serious threat of economic crisis.

The Polynesian economies made good progress in continuing or launching economic and public sector reform programs during the first half of 2002. Samoa, with good results from reforms in the last few years, launched its 2002–2004 Strategy for the Development of Samoa to enhance the sharing of the benefits of reforms by the community at large. Tonga reaffirmed its commitment to recently initiated reforms, which include measures in the areas of civil service, taxation, private sector development, and privatization of public enterprises. The Cook Islands and Tuvalu continued the reforms and prudent management of their economies.

The key policy issue for the small Micronesian economies, as well as Tuvalu, was the building up and careful management of trust funds that can provide long-term support for essential public expenditures. However, the value and returns from trust funds suffered during the first half of 2002 in the wake of uncertain and often weakening global financial markets. In the case of the Marshall Islands and the Federated States of Micronesia, progress was made in the Compact of Free Association negotiations with the US during this period. Significant aid from Australia is helping Nauru finance some essential activities and develop a strategy to address its myriad problems, including weak economic management, large government debt, and continuing budget deficit.

At the subregional level, progress was made on the Pacific Island Countries Trade Agreement (PICTA) during the first half of 2002. By August 2002, 11 out of 14 PICTA countries had signed the agreement and four had ratified it. Subregional policy discussions focused on sustainable development, public-private partnerships, a ban on kava-based pharmaceutical products by some European countries, global climate change and greenhouse gas emissions, transnational crimes, and two OECD initiatives related to money laundering and harmful tax practices.

OUTLOOK FOR 2002–2003

The general trend forecast in *ADO 2002* was for a return to positive growth for the subregion in 2002. However, economic performance in most Pacific DMCs in the first half of the year is expected to have been weaker than forecast, with the Fiji Islands a notable exception among the larger economies. Economic activity in Papua New Guinea remained subdued and the fast-growing economy of Samoa slowed during this period. These developments, coupled with continued uncertainty about the global economic outlook, led to a downward revision of the subregion's 2002 forecast to a modest weighted average growth rate of 1.1%. Recovery in agriculture is expected to lead growth. Overall, almost all economies are expected to record real GDP expansions in 2002; Solomon Islands is the only one likely to record a significant decline.

The forecast for weighted average inflation in the subregion in 2002 has been revised upward to 7.6%, which reflects largely the significant upward revisions for Papua New Guinea and Samoa. Exports are expected to pick up and the current account position to improve in Papua New Guinea in the second half of 2002, following the end of the election process, while some improvement in commodity prices was seen around the middle of the year. The Solomon Islands economy faces a major risk of further macroeconomic instability in 2002 due to continued weakness in economic management. Papua New Guinea may also face macroeconomic instability this year if the new Government cannot contain the fiscal deficit to the level projected in the supplementary budget introduced on 28 August 2002.

Because of these developments and continued uncertainty about the global economy, the growth forecast for the subregion for 2003 has been revised downward slightly to a weighted average rate of 2.1%. However, this still represents a modest strengthening relative to 2002, as expected in *ADO 2002*. The inflation forecast for the subregion has been revised upward to a weighted average rate of 6.6% in 2003. The balance of payments performance for 2003 remains highly uncertain and vulnerable to external developments.

ASIAN DEVELOPMENT

Outlook

2002 UPDATE

STATISTICAL APPENDIX

STATISTICAL NOTES

Summary tables on output, inflation, and components of the balance of payments are presented for 32 developing member countries and the five subregions of the Asian Development Bank (ADB). These tables contain historical data from 1999 to 2001, preliminary estimates for 2002, and forecasts for 2003. Most historical data are obtained from ADB's statistical database system, official country sources, statistical sites on the Internet, and online data service providers. Estimates for 2002 are based on available quarterly data while forecasts for 2003 are staff estimates. Except for Bangladesh, India, Federated States of Micronesia, Myanmar, Nepal, and Pakistan where fiscal year data are reported, the data are reported on a calendar year basis. For Bhutan, Marshall Islands, and Sri Lanka, except for national income accounts, data refer to fiscal year.

Subregional averages are presented for output growth, inflation, and the ratio of the current account balance to gross domestic product (GDP). These averages are contrasted with comparable figures in *ADO 2002*. For economies where updated figures are not available, the *ADO 2002* figures were used in the computation of averages. These subregional averages are weighted means of the individual country data using the average of 1995–1996 nominal GDP in US dollars as weights.

Afghanistan, East Timor, Myanmar, and Nauru are excluded from these averages. Where numbers are not available, averages are computed on the basis of a consistent set of sums. The following countries are excluded from this update: Bhutan, Cambodia, Lao PDR, Maldives, Mongolia, and Myanmar. For Central Asia, Turkmenistan had no updated current account balance. For Southeast Asia, Viet Nam had no updated current account balance. For the Pacific DMCs, Kiribati, Marshall Islands, Tuvalu, and Vanuatu had no updated GDP figures while the Marshall Islands, Tonga, and Tuvalu had no updated inflation figures.

Growth rates of GDP are valued at constant market prices except for Azerbaijan, Bhutan, Fiji Islands, India, Pakistan, Solomon Islands, Sri Lanka, and Tuvalu where GDP at constant factor cost is used. For Papua New Guinea, the growth rate is based on GDP at constant purchaser's value.

Inflation rates are generally based on the consumer price index (CPI) and reflect period averages except for Indonesia and Viet Nam with end-of-period inflation rates. The inflation rates for Hong Kong, China; Pakistan; and Singapore are on a fiscal year basis; while that for India, also fiscal year, is based on the wholesale price index (WPI).

Growth rates of merchandise exports and imports are derived from the balance-of-payments accounts for which data are from official sources. These figures are on a free-on-board (f.o.b.) basis. For Hong Kong, China and India the export and import growth figures in the text refer to growth of exports obtained from the national income accounts and converted into US dollars. The Bank of the Lao PDR, which handles trade figures, revised actual figures from 1999 onward. This is in connection with the technical assistance provided by IMF.

Current account balance as percent of GDP is the ratio of the current balance in US dollars to nominal GDP in US dollars. The current account balance is the sum of the balance of trade, net trade in services and factor incomes, and current official and private transfers. For Bangladesh, Cambodia, Lao PDR, Nepal, and Pakistan official transfers are excluded.

Tables and charts for the chapter "Outlook for Developing Asia and the Pacific" were generated using data obtained from the following sources: Asia Recovery Information Center (ARIC) Database; CEIC Data Company Ltd.; and the Institute of International Finance. The following web sites were used as data sources: www.ecb.int; www.economy.com; www.fedstats.gov; www.stat.go.jp; www.oecd.org; and official sources. Other data are staff estimates. The weighted average exchange value of the US dollar is computed against currencies of a broad group of US trading partners, including the currencies of the euro area countries: Argentina; Australia; Brazil; Canada; Chile; Colombia; Hong Kong, China; India; Indonesia; Israel; Japan; Korea; Malaysia; Mexico; Philippines; the Russian Federation; Saudi Arabia; Singapore; Sweden; Switzerland; Taipei,China; Thailand; United Kingdom; and Venezuela. The data originated from the Federal Reserve Board.

Charts for individual country chapters and subregional overviews were generated from data obtained from the ARIC Database; CEIC Data Company Ltd.; Institute of International Finance; and official sources. Except for the Pacific DMCs (which use International Monetary Fund data), the data on GDP growth are obtained from official sources. Data on the contribution of components of domestic demand for selected DMCs are obtained from official sources.

Table A1 **Growth Rate of GDP** (%)

	1999	2000	2001	2002		2003	
				ADO 2002	*Update*	*ADO 2002*	*Update*
East Asia	7.6	8.2	3.9	5.2	5.7	6.2	6.1
China, People's Rep. of	7.1	8.0	7.3	7.0	7.4	7.4	7.5
Hong Kong, China	3.4	10.2	0.6	2.1	1.4	4.8	3.5
Korea, Rep. of	10.9	9.3	3.0	4.8	6.0	6.0	5.8
Mongolia	3.2	1.1	1.5	3.0	3.0[a]	4.9	4.9[a]
Taipei,China	5.4	5.9	-2.2	2.8	3.0	4.0	4.0
Southeast Asia	3.8	6.0	2.0	3.4	3.8	4.3	4.6
Cambodia	6.9	7.7	6.3	4.5	5.0	6.1	6.0
Indonesia	0.9	4.8	3.5	3.0	3.2	3.6	4.4
Lao People's Dem. Rep.	7.3	5.8	5.7	5.8	5.8	6.1	5.8
Malaysia	6.1	8.3	0.4	4.2	4.5	5.8	5.0
Myanmar	10.9	6.2	—	—	—	—	—
Philippines	3.4	4.4	3.2	4.0	4.0	4.5	4.5
Singapore	6.9	10.3	-2.0	3.7	3.9	6.5	5.6
Thailand	4.4	4.6	1.8	2.5	3.8	3.0	4.0
Viet Nam	4.7	6.1	5.8	6.2	5.7	6.8	6.2
South Asia	5.7	4.2	4.8	5.4	3.9	6.4	5.7
Afghanistan	—	—	—	—	—	—	—
Bangladesh	4.9	5.9	5.2	4.5	4.2	5.7	5.4
Bhutan	7.3	5.7	6.0	6.5	6.0	6.5	6.5[a]
India	6.1	4.0	5.4	6.0	4.0	6.8	6.0
Maldives	7.4	4.6	2.1	2.0	2.0	—	4.0
Nepal	4.5	6.1	4.7	3.5	0.8	5.0	3.5
Pakistan	4.2	3.9	2.5	3.0	3.6	5.0	4.5
Sri Lanka	4.3	6.0	-1.3	3.5	2.8	5.5	5.5[a]
Central Asia	5.1	8.7	10.7	5.7	6.2	6.4	5.7
Azerbaijan	9.5	11.1	9.9	10.0	9.1	11.0	8.5
Kazakhstan	2.7	9.8	13.2	7.0	7.5	6.0	6.0
Kyrgyz Republic	3.7	5.4	5.3	4.5	4.4	4.5	4.2
Tajikistan	3.7	8.3	10.3	6.0	8.0	5.0	6.0
Turkmenistan	16.0	17.6	20.5	11.0	11.0	11.0	11.0
Uzbekistan	4.4	4.0	4.5	4.0	2.0	5.0	3.0
The Pacific	6.5	-1.1	-1.2	1.9	1.1	2.6	2.1
Cook Islands	5.8	9.8	-3.3	2.5	1.4	3.3	2.4
East Timor	—	—	—	—	—	—	—
Fiji Islands	9.7	-2.8	2.6	3.5	4.4	4.7	4.7[a]
Kiribati	2.1	-1.7	1.5	2.8	2.8[a]	2.5	2.5[a]
Marshall Islands	-0.2	0.7	0.6	0.7	0.7[a]	—	—
Micronesia, Federated States of	0.2	4.4	1.1	3.3	0.3	0.7	-0.9
Nauru	—	—	—	—	—	—	—
Papua New Guinea	7.6	-1.3	-3.4	1.2	0.0	1.8	1.1
Samoa	2.6	6.9	6.5	5.0	2.0	5.0	3.0
Solomon Islands	-1.3	-14.0	-10.1	-5.0	-6.0	0.0	2.0
Tonga	2.9	6.5	0.5	2.9	1.6	2.6	2.5
Tuvalu	3.0	3.0	4.0	3.0	3.0[a]	3.0	3.0[a]
Vanuatu	-2.5	3.7	-0.5	0.7	0.7[a]	1.9	1.9[a]
Developing Asia	6.4	7.0	3.7	4.8	5.0	5.8	5.7

— Not available.
[a] *ADO 2002* forecast.

Table A2 **Inflation** (%)

	1999	2000	2001	2002		2003	
				ADO 2002	*Update*	*ADO 2002*	*Update*
East Asia	-0.7	0.7	1.4	1.5	1.0	2.3	2.0
China, People's Rep. of	-1.4	0.4	0.7	1.0	0.5	1.5	1.5
Hong Kong, China	-4.0	-3.8	-1.6	-0.8	-2.7	0.6	0.5
Korea, Rep. of	0.8	2.2	4.1	3.5	3.1	4.0	3.5
Mongolia	10.0	8.1	11.2	6.0	6.0[a]	5.0	5.0[a]
Taipei,China	0.2	1.3	0.0	0.7	0.3	2.1	1.5
Southeast Asia	8.1	2.5	5.1	5.7	5.0	4.4	3.9
Cambodia	0.0	0.5	-0.5	2.0	2.0[a]	3.0	3.0[a]
Indonesia	20.5	3.7	11.5	13.1	11.8	7.7	7.0
Lao People's Dem. Rep.	134.0	27.1	7.8	6.5	6.5[a]	6.0	6.0[a]
Malaysia	2.8	1.6	1.4	2.3	2.5	2.8	2.3
Myanmar	11.4	—	—	—	—	—	—
Philippines	6.7	4.4	6.0	5.0	4.5	6.0	5.0
Singapore	0.1	1.3	1.0	0.4	0.1	1.4	1.3
Thailand	0.3	1.6	1.7	2.0	0.7	2.2	1.5
Viet Nam	0.1	-0.6	0.8	3.0	4.0	4.0	4.5
South Asia	4.2	6.2	3.7	4.1	5.4	4.8	4.9
Afghanistan	—	—	—	—	—	—	—
Bangladesh	8.9	3.9	1.6	2.4	2.4	2.6	2.9
Bhutan	9.2	3.6	3.6	4.5	4.5[a]	5.2	5.2[a]
India	3.3	7.1	3.6	4.0	6.0	5.0	5.0
Maldives	3.0	-1.2	0.7	—	—	—	—
Nepal	11.3	3.5	2.4	5.0	3.0	5.0	5.0
Pakistan	5.7	3.6	4.4	5.0	2.8	5.0	5.0
Sri Lanka	5.9	1.2	11.0	8.5	8.5[a]	6.0	6.0[a]
Central Asia	15.5	17.0	13.6	10.0	10.8	5.6	8.2
Azerbaijan	-8.5	1.8	1.5	1.8	2.5	2.0	2.5
Kazakhstan	8.3	13.2	8.4	6.6	5.6	5.6	5.9
Kyrgyz Republic	35.9	18.7	6.9	7.5	4.1	5.5	4.7
Tajikistan	27.5	32.9	38.6	8.9	13.0	7.6	11.0
Turkmenistan	23.5	7.4	5.6	8.5	8.5	7.5	7.5
Uzbekistan	26.0	28.2	26.4	18.0	22.5	—	13.5
The Pacific	9.3	9.6	7.0	6.0	7.6	3.1	6.6
Cook Islands	1.4	3.1	8.7	2.5	4.0	—	2.5
East Timor	—	—	—	—	—	—	—
Fiji Islands	2.0	1.1	4.3	3.0	2.5	—	3.6
Kiribati	1.8	0.4	6.0	2.7	5.0	2.7	4.0
Marshall Islands	1.7	-1.9	2.0	2.3	2.3[a]	—	2.3
Micronesia, Federated States of	1.9	1.8	2.0	2.6	0.5	2.6	1.5
Nauru	—	—	—	—	—	—	—
Papua New Guinea	14.9	15.6	9.3	8.3	11.2	5.0	9.3
Samoa	0.2	1.0	4.0	3.0	7.0	—	4.0
Solomon Islands	10.4	8.6	8.0	8.0	8.5	6.0	7.2
Tonga	3.9	4.9	6.3	10.0	10.0[a]	5.0	5.0[a]
Tuvalu	3.8	5.3	1.8	1.5	1.5[a]	2.1	2.1[a]
Vanuatu	2.1	2.5	3.9	4.5	3.0	4.0	4.0[a]
Developing Asia	2.4	2.3	2.9	3.1	2.8	3.3	3.0

— Not available.
[a] *ADO 2002* forecast.

Table A3 **Growth Rate of Merchandise Exports** (%)

	1999	2000	2001	2002		2003	
				ADO 2002	*Update*	*ADO 2002*	*Update*
East Asia	5.8	22.0	-5.8	5.0	9.2	8.7	9.4
China, People's Rep. of	6.1	27.9	6.8	6.0	13.0	10.0	10.0
Hong Kong, China	-0.1	16.1	-5.9	1.6	3.9	6.2	7.5
Korea, Rep. of	9.9	21.2	-14.0	7.0	10.0	10.0	14.0
Mongolia	-1.7	18.2	-17.4	9.4	9.4[a]	7.7	7.7[a]
Taipei,China	9.9	21.8	-17.3	5.5	8.0	8.0	5.0
Southeast Asia	8.9	19.6	-10.1	6.1	3.5	9.7	7.6
Cambodia	17.9	53.2	9.9	7.6	7.6	7.8	7.8
Indonesia	1.7	27.6	-12.1	10.5	-3.0	8.0	8.0
Lao People's Dem. Rep.	1.5	2.6	-0.3	8.5	8.5[a]	8.5	8.5[a]
Malaysia	16.8	17.0	-8.8	7.0	5.5	11.9	4.8
Myanmar	42.7	7.6	—	—	—	—	—
Philippines	19.1	9.0	-16.2	3.0	4.0	6.0	4.5
Singapore	4.5	20.4	-11.9	5.0	5.5	10.0	10.5
Thailand	7.4	19.6	-7.0	4.0	2.7	9.0	7.0
Viet Nam	23.2	25.2	6.5	8.5	3.0	12.0	8.0
South Asia	5.4	18.2	-0.4	7.2	4.7	12.9	9.2
Afghanistan	—	—	—	—	—	—	—
Bangladesh	2.9	8.3	12.4	-8.0	-7.4	10.0	5.0
Bhutan	-5.9	9.2	-1.8	—	—	—	—
India	10.9	21.0	-2.2	11.0	7.0	14.0	9.0
Maldives	-4.3	18.8	-1.7	—	—	—	—
Nepal	18.2	42.4	3.7	5.0	-15.0	10.0	5.0
Pakistan	-10.7	8.8	9.1	-0.3	2.2	7.6	10.0
Sri Lanka	-3.9	19.8	-12.8	7.0	7.0[a]	15.0	15.0[a]
Central Asia	10.4	33.8	-2.2	10.1	2.3	5.5	3.6
Azerbaijan	51.2	81.3	7.9	—	4.8	—	9.1
Kazakhstan	2.0	55.1	-1.8	11.6	5.0	5.2	5.0
Kyrgyz Republic	-13.5	10.4	-6.0	2.8	5.1	3.4	3.1
Tajikistan	13.7	18.5	-17.3	8.8	13.0	8.7	12.5
Turkmenistan	93.3	11.7	5.0	6.0	6.0	6.0	6.0
Uzbekistan	-10.0	0.9	-6.1	—	-4.7	—	-1.1
The Pacific	10.3	1.9	-14.5	8.5	0.5	6.5	3.1
Cook Islands	10.7	155.5	-25.5	—	-24.2	—	—
East Timor	—	—	—	—	—	—	—
Fiji Islands	19.2	-0.7	-16.5	7.7	6.8	12.8	12.8[a]
Kiribati	49.8	-33.6	-33.2	2.7	2.7[a]	20.8	20.8[a]
Marshall Islands	-4.0	9.7	5.1	—	—	—	—
Micronesia, Federated States of	-9.4	-11.0	26.4	—	-14.7	—	—
Nauru	—	—	—	—	—	—	—
Papua New Guinea	9.1	7.3	-13.7	10.9	-0.7	1.9	0.0
Samoa	-3.5	-25.4	11.1	—	—	—	—
Solomon Islands	6.5	-53.8	-32.8	13.7	-14.8	40.4	1.5
Tonga	1.7	-9.9	3.7	6.2	6.2[a]	—	—
Tuvalu	—	—	—	—	—	—	—
Vanuatu	-26.3	2.3	-15.5	6.6	15.0	10.0	10.0[a]
Developing Asia	6.9	21.1	-6.9	5.5	7.0	9.2	8.7

— Not available.
[a] *ADO 2002* forecast.

Table A4 **Growth Rate of Merchandise Imports** (%)

	1999	2000	2001	2002		2003	
				ADO 2002	*Update*	*ADO 2002*	*Update*
East Asia	9.6	28.4	-6.5	7.7	9.4	11.6	11.0
China, People's Rep. of	15.8	35.4	8.2	10.0	14.0	14.0	14.0
Hong Kong, China	-2.7	18.7	-5.4	1.9	3.0	7.8	7.3
Korea, Rep. of	29.1	36.2	-13.3	12.0	13.1	14.0	15.0
Mongolia	-2.6	21.2	-9.7	4.9	4.9[a]	6.2	6.2[a]
Taipei,China	6.2	25.9	-23.7	8.0	6.5	10.0	5.5
Southeast Asia	8.0	24.2	-9.0	7.0	4.6	11.2	9.7
Afghanistan	—	—	—	—	—	—	—
Cambodia	27.0	37.1	3.4	6.0	6.0	6.5	6.5
Indonesia	-4.2	31.9	-13.5	10.0	-12.0	10.0	8.0
Lao People's Dem. Rep.	0.3	2.7	-0.4	11.0	11.0[a]	11.0	11.0[a]
Malaysia	12.8	26.2	-7.6	10.0	9.0	16.1	8.5
Myanmar	-2.9	-12.6	—	—	—	—	—
Philippines	4.2	3.8	-6.2	2.5	3.0	4.0	4.0
Singapore	9.0	22.2	-14.0	6.0	7.0	11.1	12.3
Thailand	16.9	31.3	-2.8	5.0	4.1	9.2	10.0
Viet Nam	1.1	34.5	6.0	10.0	9.0	13.0	10.0
South Asia	11.0	3.6	1.0	9.3	4.1	12.6	8.9
Afghanistan	—	—	—	—	—	—	—
Bangladesh	6.6	4.8	11.4	-5.0	-5.9	6.0	3.8
Bhutan	74.7	14.0	16.3	—	—	—	—
India	17.2	1.7	1.1	13.0	6.9	14.5	9.5
Maldives	13.6	-3.4	2.0	—	—	—	—
Nepal	-10.3	20.2	-0.9	5.0	-8.0	5.0	5.0
Pakistan	-6.7	-0.1	6.3	0.2	-7.0	6.2	7.0
Sri Lanka	1.5	22.4	-18.4	15.0	15.0[a]	14.0	14.0[a]
Central Asia	-3.6	11.9	12.0	10.9	6.3	14.3	7.2
Azerbaijan	-16.9	7.4	-4.8	—	20.0	—	27.8
Kazakhstan	-15.3	21.2	20.0	11.7	5.2	15.3	5.3
Kyrgyz Republic	-27.6	-8.2	-14.4	4.8	9.8	5.9	10.5
Tajikistan	-4.4	20.6	-7.3	4.5	7.0	3.8	6.0
Turkmenistan	30.0	16.6	32.0	12.0	12.0	15.0	15.0
Uzbekistan	10.0	-0.9	1.6	—	2.4	—	2.3
The Pacific	6.5	-4.9	-7.0	14.3	-4.5	-1.1	-3.7
Cook Islands	9.8	22.5	-8.0	—	-17.3	—	—
East Timor	—	—	—	—	—	—	—
Fiji Islands	25.1	-5.4	-12.1	1.9	1.9[a]	6.1	6.1[a]
Kiribati	24.0	-13.6	-9.0	7.3	7.3[a]	2.0	2.0[a]
Marshall Islands	4.2	-1.3	2.9	—	—	—	—
Micronesia, Federated States of	-3.0	12.3	-3.5	—	0.0	—	—
Nauru	—	—	—	—	—	—	—
Papua New Guinea	-0.1	-7.0	-6.4	26.0	-7.9	-6.1	-13.2
Samoa	19.3	-8.3	21.1	—	—	—	—
Solomon Islands	-25.1	-8.6	-19.4	4.4	-27.2	6.4	-2.5
Tonga	-28.9	12.8	-4.3	8.0	8.0[a]	—	—
Tuvalu	—	—	—	—	—	—	—
Vanuatu	9.3	-7.7	4.3	0.8	5.6	0.9	0.9[a]
Developing Asia	9.0	24.7	-6.5	7.6	7.4	11.6	10.4

— Not available.
[a] *ADO 2002* forecast.

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

	1999	2000	2001	2002		2003	
				ADO 2002	*Update*	*ADO 2002*	*Update*
East Asia	3.3	2.3	2.7	1.8	1.8	1.0	1.2
China, People's Rep. of	1.6	1.9	1.7	1.0	1.0	0.4	0.4
Hong Kong, China	—	—	—	—	—	—	—
Korea, Rep. of	6.0	2.7	2.0	1.9	1.1	0.7	0.0
Mongolia	-13.7	-17.2	-16.7	-14.7	-14.7[a]	-13.4	-13.4[a]
Taipei,China	2.9	2.9	6.7	3.9	6.1	3.4	7.0
Southeast Asia	9.9	8.8	7.2	5.0	5.7	4.0	4.9
Cambodia	-7.8	-7.6	-6.4	-5.9	-5.9	-5.1	-5.1
Indonesia	4.1	5.0	3.9	1.5	3.8	0.7	3.5
Lao People's Dem. Rep.	-8.9	-8.3	-6.9	-8.0	-8.0[a]	-8.0	-8.0[a]
Malaysia	15.9	9.4	7.8	5.3	5.1	2.6	4.9
Myanmar	-0.2	-0.1	—	—	—	—	—
Philippines	9.7	11.3	6.5	2.0	3.4	1.5	2.1
Singapore	20.0	17.2	20.9	19.8	19.6	19.0	17.9
Thailand	10.1	7.7	5.4	4.1	3.8	3.0	2.5
Viet Nam	4.1	1.6	1.5	0.3	-1.2	-0.2	-2.4
South Asia	-1.6	-1.0	-0.2	-1.7	-0.4	-1.9	-0.6
Afghanistan	—	—	—	—	—	—	—
Bangladesh	-1.4	-1.0	-2.1	-2.5	0.6	-2.1	-0.2
Bhutan	-25.9	-30.6	-27.5	—	—	—	—
India	-1.1	-0.6	0.3	-1.0	-0.9	-1.5	-0.9
Maldives	-14.6	-9.5	-10.9	—	—	—	—
Nepal	-3.3	-4.5	-4.4	-5.0	-7.0	-5.0	-5.0
Pakistan	-4.1	-1.9	-0.9	-3.6	2.2	-3.1	1.0
Sri Lanka	-3.6	-6.5	-3.4	-6.5	-6.5[a]	-7.5	-7.5[a]
Central Asia	-4.3	-0.5	-4.2	-4.5	-4.1	-4.9	-4.4
Azerbaijan	-13.1	-3.2	-0.9	-3.0	-6.0	-5.0	-9.7
Kazakhstan	-1.4	2.3	-7.8	-4.5	-6.6	-4.7	-6.0
Kyrgyz Republic	-14.4	-5.6	-0.9	-6.3	-3.8	-6.5	-5.4
Tajikistan	-3.4	-6.6	-7.0	-6.2	-4.2	-5.5	-4.5
Turkmenistan	-18.0	-13.9	-1.5	—	—	—	—
Uzbekistan	-1.0	1.4	-0.6	—	-1.2	—	-2.0
The Pacific	1.3	3.7	2.7	0.2	—	3.0	—
Cook Islands	-2.2	-2.6	-2.5	—	6.2	—	—
East Timor	—	—	—	—	—	—	—
Fiji Islands	-4.1	-3.6	-4.4	-2.4	—	0.0	—
Kiribati	17.4	11.2	4.4	-6.5	—	1.1	—
Marshall Islands	-5.5	7.4	14.3	—	—	—	—
Micronesia, Federated States of	2.7	7.2	-6.2	—	-3.8	—	0.0
Nauru	—	—	—	—	—	—	—
Papua New Guinea	4.2	10.2	9.6	2.7	7.4	5.7	12.3
Samoa	2.2	0.9	-3.1	—	—	—	—
Solomon Islands	7.5	-17.4	-11.7	-7.3	—	3.3	-9.4
Tonga	-0.6	-6.3	-8.2	-8.1	—	—	—
Tuvalu	—	—	—	—	—	—	—
Vanuatu	-5.3	1.0	-2.1	0.3	-0.9	1.0	1.0
Developing Asia	3.8	3.1	3.1	1.9	2.2	1.1	1.7

— Not available.
[a] *ADO 2002* forecast.