Brunei Darussalam

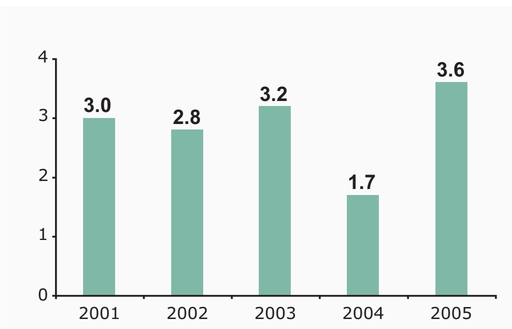
Sustained oil demand should result in economic growth this year at about the same pace as the estimated 3.6% in 2005. To diversify the economy, the government is stepping up efforts to encourage private-sector initiatives.

Economic Outlook: With the oil and gas sector contributing about 40% of GDP and 90% of exports, sustained oil demand is expected to drive modest but steady 3.6% economic growth in 2006—about the same pace as in 2005. Robust oil revenues are expected to spur domestic demand, especially investment in construction and trade. Higher export earnings are strengthening both government revenues and the current account surplus—which was estimated at about 70% of GDP in 2004. Inflation will likely remain low at about the 2005 level of 1%, in part because of the exchange-rate peg to the Singapore dollar and generally low inflation among main trading partners such as Japan and Korea.

Risks: According to some recent independent forecasts, the country faces a possible depletion of oil reserves as early as the next decade. Thus, economic growth is constrained by the limited capacity to either increase oil production or diversify the economy, which currently restricts the country's absorption of windfalls from oil. Another risk would be a prolonged downturn in the global economy, significantly reducing oil prices and demand, and causing public expenditure—currently about 50% of GDP—to be curtailed.

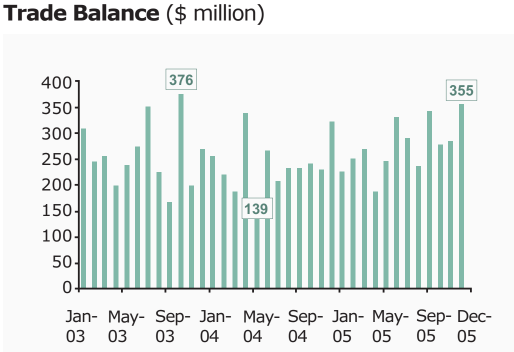
Policy Issues: Given the country's currency board system—under which the Brunei dollar is pegged to the Singapore dollar—monetary policy is not an option and fiscal policy remains the main policy lever. With huge oil revenues boosting private and government income, the fiscal surplus climbed from about 10% of GDP in 2003 to an estimated 20% in 2005. Despite the sharp increase, the government resisted calls for higher current expenditures, reducing the risk of an inflationary surge in domestic demand and increasing public savings against future needs. Continuing this policy would reduce external vulnerabilities, while the government tackles the challenge of diversifying the economy by: (i) negotiating economic partnership agreements (for example with Japan) and strengthening regional ties (Brunei Darussalam joined ADB in April 2006); (ii) encouraging SMEs and several private-sector initiatives, such as the "e-Brunei" project that will use current information and communications technology to improve the business environment; and (iii) floating the first Islamic Bond, in March 2006, to promote development of the financial sector.

GDP Growth (%)



Sources: Prime Minister's Office and *Brunei Darussalam Statistical Yearbook*.

Trade Balance ($ million)

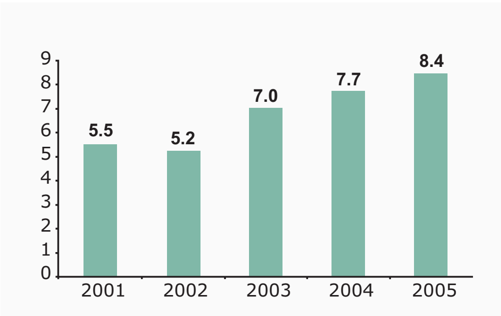


Source: *Direction of Trade Statistics*, May 2006 (International Monetary Fund).

Cambodia

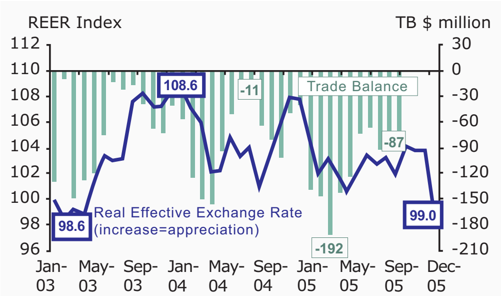
GDP growth is expected to slow to 6.3% this year after the 2005 peak of 8.4%. The country could build resilience to economic shocks by diversifying sources of growth beyond garments. While the fiscal outlook is improving, reducing inflation remains a challenge.

GDP Growth (%)



Sources: Ministry of Economy and Finance; National Institute of Statistics of Cambodia website; and *Asian Development Outlook 2006* (Asian Development Bank).

Trade Balance & Real Effective Exchange Rate[1]



[1]Jan 2003=100
REER = Real Effective Exchange Rate, TB = Trade balance
Sources: ARIC Indicators and *Direction of Trade Statistics*, May 2006 (International Monetary Fund) .

Fiscal and Monetary Indicators

	2002	2003	2004	2005
Central government fiscal balance (% of GDP)	-6.4	-6.9	-4.3	-3.1
Riel/$ (y-o-y, % change)	0.2	-1.6	-1.0	-1.9
Current account balance (% of GDP)	-8.8	-10.1	-9.9	-10.2

Source: *Asian Development Outlook 2006* (Asian Development Bank).

Economic Outlook: The high and accelerating growth of the past 3 years may not be sustainable, as intensified global competition will make it difficult for the garments sector to continue its rapid expansion. Preliminary data show that economic growth slowed in early 2006, with agricultural production leveling off after a 2005 rebound from the 2004 drought. GDP growth is expected to ease to 6.3% in 2006 from last year's exceptionally high 8.4%. Average inflation reached a 7-year peak of 5.8% in 2005, mainly due to an upsurge in food and oil prices. Data for early 2006 show inflation slightly decelerating to an average of 5.6% in the first 5 months of 2006.

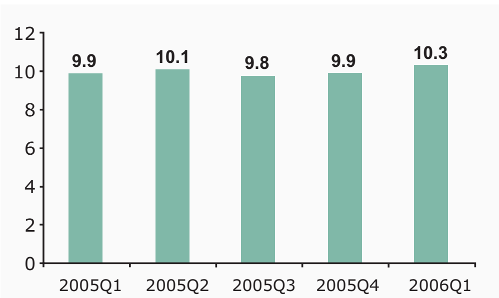
Risks: High export concentration in garments, especially to the US and the EU, exposes the economy to abrupt adjustments in external prices and foreign trade policies. A severe drop in demand for garments thus remains a major risk to sustained economic growth, suggesting the need to diversify into other sectors. Given its proximity to Thailand and Viet Nam, the risk of contagion from an avian flu outbreak persists. This is aggravated by inadequate government funds to prepare for a possible pandemic and the need to design an effective campaign to inform the population how to detect and contain the disease.

Policy Issues: Rolling back inflation remains a major challenge, especially as high dollarization reduces the effectiveness of monetary policy. To mitigate erosion of the riel's purchasing power, the National Bank of Cambodia is focusing on maintaining exchange-rate stability and keeping credit growth to programmed levels. On the fiscal side, efforts to improve revenue collection are showing results, with total revenues increasing to 11.6% of GDP in 2005 from 10.0% in 2000. Better revenue collection, coupled with initiatives to streamline expenditure, reduced the fiscal deficit to 3.1% of GDP in 2005, maintaining a trend that started in 2003. However, sustaining this trend remains a challenge given the need for large investment to improve social and economic infrastructure. To enhance export performance, the government introduced policies to facilitate trade by reducing administrative requirements needed to process international transactions. A strong push to pass market-friendly enterprise and investment laws remains a key factor in building an economic environment conducive to greater private-sector participation and increased economic diversification.

PRC

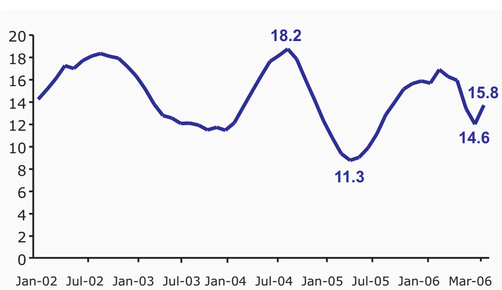
GDP growth is expected to accelerate further to 10.1% in 2006. Interest rate hikes, faster yuan appreciation against the US dollar, and further liberalization of capital outflows would help government efforts to restrain growth in liquidity and fixed investment.

GDP Growth (%)



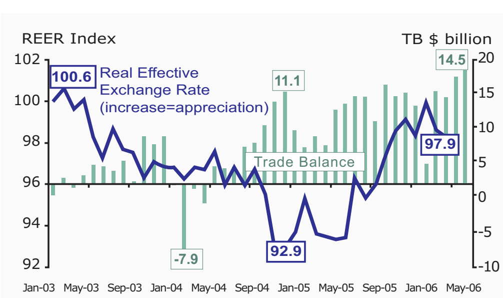
Source: ARIC Indicators.

Composite Leading Indicator (%)



Note: Figure shows the annualized six-month rate of change of the trend restored CLI.
Source: OREI staff calculations.

Trade Balance and Real Effective Exchange Rate[1]



[1]Jan 2003=100
REER = Real Effective Exchange Rate, TB = Trade balance
Source: ARIC Indicators.

Economic Outlook: GDP growth accelerated to 10.3% in 2006Q1. It is expected to ease slightly to 10.1% for all of 2006, as rapid investment and credit growth are restrained by monetary tightening. Though still strong, export growth is decelerating, while import growth is rebounding from a marked slowdown last year, caused by policies that suppressed oil imports, among other factors. The current account surplus is therefore expected to shrink after peaking at 7.0% of GDP in 2005. Inflation, gradually declining since mid-2004 (to 1.4% in May 2006), is likely to remain low despite expected increases in administered energy prices.

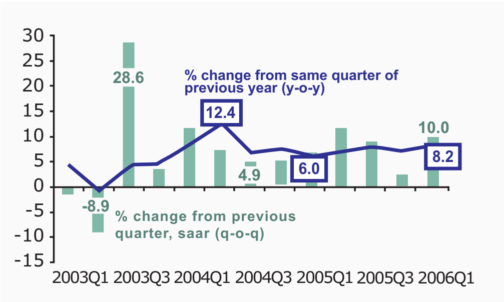
Risks: While the composite leading indicator supports a robust outlook, there are important risks. Externally, a disorderly unwinding of the global payments imbalance could destabilize the economy by sharply curtailing export growth and capital inflows. Higher oil prices could force further price increases. Domestically, there is a risk of the economy overheating. Despite recent progress in reducing NPLs, the rapid growth of corporate and local government debt raises concerns about bad-debt risks among banks. Recent increases in real estate prices are another source of concern. Finally, the threat of avian flu lingers despite several policy measures taken to prevent and mitigate the risk of a pandemic.

Policy Issues: With persistent foreign monetary inflows due to reserve accumulation that was only partly sterilized, M2 grew by 18.4% in June 2006, feeding accelerating investment growth. Foreign exchange reserves increased $56 billion in 2006Q1, and at this rate could reach the $1 trillion mark by the end of the year. The authorities responded in April 2006 by raising the 1-year benchmark lending rate by 27 basis points—to 5.85%—the first hike since October 2004. In June, the central bank raised its reserve-requirement ratio for commercial banks in a further attempt to curb lending—raising both deposit and lending rates would help this process. Large trade surpluses, despite the moderate strengthening of the real effective exchange rate since mid-2005, indicate that further yuan appreciation could help manage monetary conditions more effectively. A further liberalization of the capital account, building on recent moves to permit specified domestic institutions to invest abroad, would help slow reserve accumulation. The fiscal situation is manageable, due to consolidation in recent years. However, indications of rising local government liabilities should be closely monitored.

Hong Kong, China

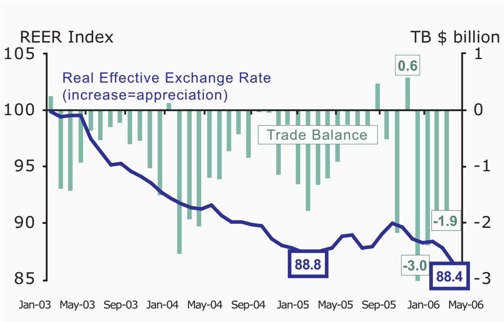
Although slowing from very high rates of growth over the past two years, a favorable external environment and strong domestic demand should sustain economic growth at a still high 6.5% in 2006. While the financial system remains robust, continued fiscal discipline is required as the population ages.

Quarterly GDP Growth (%)



saar = seasonally adjusted annualized rate.
Source: Census and Statistics Department of Hong Kong, China.

Trade Balance & Real Effective Exchange Rate[1]



[1]Jan 2003=100
REER = Real Effective Exchange Rate, TB = Trade balance
Sources: Census and Statistics Department of Hong Kong, China and OREI staff calculations based on data from the Hong Kong Monetary Authority.

Economic Outlook: The economy performed better than expected in 2006Q1, with GDP growing at 8.2%, as exports expanded at a rapid pace and domestic demand showed a significant recovery. Net exports continued to increase rapidly in 2006Q2, as the PRC economy grew above expectations. At the same time, although increasing interest rates—in tandem with US rate hikes—may have affected asset prices, the impact on the real economy seems to have been negligible. The contribution to growth in 2006Q1 from both private consumption and investment was remarkably high (investment grew at an 8.5% annual pace). Given these trends, GDP is expected to expand by 6.5% for the whole year. Inflation has edged up, increasing to 2.1% in May—compared with 1.0% average inflation for 2005—on the back of rising residential rental costs.

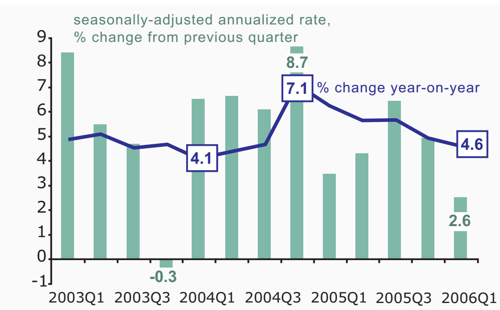
Risks: Given its high degree of openness, the economy remains vulnerable to external shocks. As local interest rates generally track closely the US rates under the Linked Exchange Rate System (LERS), a faster-than-expected increase in the US FED fund rates could start having a more direct impact on investment, reducing in turn domestic demand. While monetary policy is effectively tied to the US, the real economy is increasingly linked to the mainland by trade, financial, and tourism flows. Any economic slowdown, even minor, in the PRC, will therefore almost inevitably affect the growth prospects in Hong Kong, China, for the same reason that the strong GDP growth in 2006Q1 is largely determined by trends in the PRC. Domestically, another possible source of risk is the rapid increase in both commercial and residential real estate prices.

Policy Issues: In 2005, the Hong Kong Monetary Authority further refined the LERS by introducing measures designed to build market confidence in the exchange system at a time of increasing uncertainties in the external exchange rate environment. On the fiscal side, after running deficits in most of the years since FY1997/98, the economy posted a consolidated surplus in FY2005/06 (HK$14.0 billion), the result of strong revenue growth and cuts in government spending. Continued fiscal prudence is appropriate over the medium- to long-term as the population ages and increased demands on the government for related social services will likely stress public finances in the medium to long run—with rising health care costs and a shrinking revenue base as the size of the workforce declines.

Indonesia

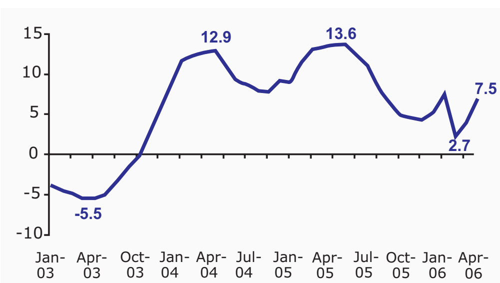
A revival of market confidence and an expansionary fiscal policy will likely sustain GDP growth at 5.4% this year. While a decline in inflation is encouraging, the capital account remains susceptible to shocks.

Quarterly GDP Growth (%)



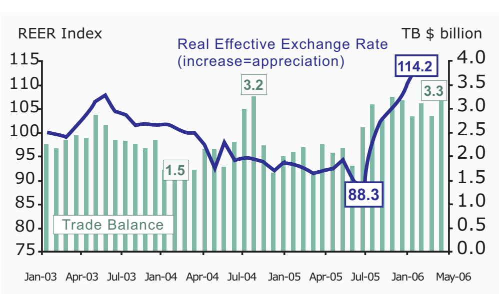
Source: ARIC Indicators.

Composite Leading Indicator (%)



Note: Figure shows the annualized six-month rate of change of the trend restored CLI.
Source: OREI staff calculations.

Trade Balance & Real Effective Exchange Rate[1]



[1]Jan 2003=100
REER = Real Effective Exchange Rate, TB = Trade balance
Source: ARIC Indicators.

Economic Outlook: Economic momentum slipped further in 2006Q1 as private consumption and investment remained weak. Expanding public expenditures, however, are expected to help sustain economic growth during the rest of the year. Growth in domestic demand is currently constrained by high interest rates, fuel costs, and overall inflation—also as a result of policies used to calm last year's financial sector turbulence. Still, those policies succeeded in restoring market confidence and economic momentum will likely return later in 2006 or early 2007. Aided by an appreciating rupiah/US dollar exchange rate through April 2006, inflation, though still high, is gradually decelerating after last November's 18.4% peak.

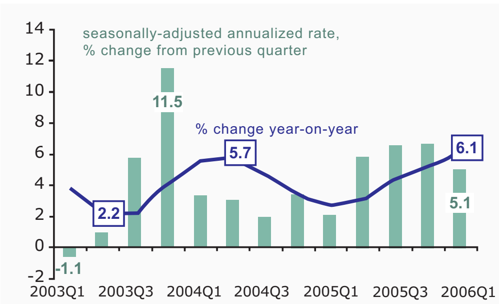
Risks: Although inflation is slowing, vulnerability to capital account volatility remains high. Thus a key risk is renewed inflationary pressures, either from further oil price increases, thereby worsening fiscal conditions (remaining subsidies are to be eliminated by end-2006), or a weak rupiah, especially if the depreciating trend against the US dollar—which began in May—continues. Recent deaths from a family cluster in North Sumatra have stoked fears of a human avian flu outbreak. With the highest number of victims in the region, delays in launching serious (particularly local government) prevention schemes, and small budget allocations to combat the disease, concern is rising. The spate of natural disasters has impacted the economy and social services, so any further disruptions could be another source of domestic risk.

Policy Issues: After inflation slowed in June, Bank Indonesia further reduced its policy rates in early July to stimulate consumer spending. On the fiscal front, government expenditure will likely expand due to a large carryover from 2005 and increased spending capacity of local governments. However, as debt-servicing requirements remain large, vulnerability to sovereign spread increases persists. This could affect the sustainability of expansionary fiscal policies. Increased labor productivity, an expansion of export markets, and an investment recovery would strengthen economic performance. To spur investment, the government announced a package of tax, regulatory, and other reforms in March 2006. However, institutional weaknesses and administrative bottlenecks pose challenges to its effective implementation.

Korea

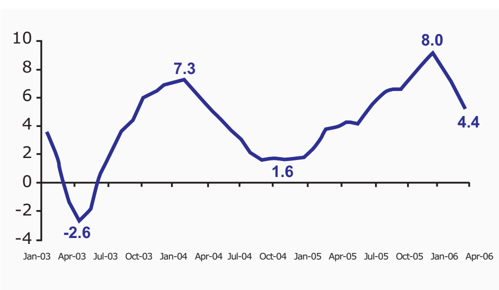
Sustained momentum in 2006Q1 should boost the pace of GDP growth to 5.1% this year from 4.0% in 2005. Despite rising energy costs, inflation eased slightly from 2.8% in 2005 to 2.6% in June 2006, aided in part by won appreciation.

Quarterly GDP Growth (%)



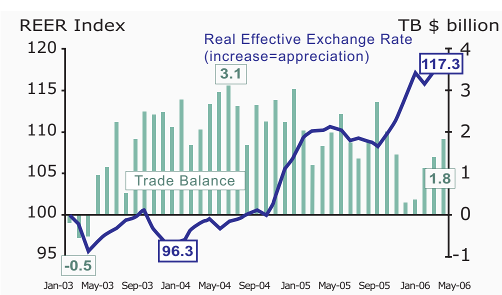
Source: National Statistical Office of Korea.

Composite Leading Indicator (%)



Note: Figure shows the annualized six-month rate of change of the trend restored CLI.
Source: National Statistical Office of Korea.

Trade Balance & Real Effective Exchange Rate[1]



[1]Jan 2003=100
REER = Real Effective Exchange Rate, TB = Trade balance
Sources: ARIC Indicators and National Statistics Office of Korea.

Economic Outlook: Stronger consumption growth and an improved export performance deepened the economic recovery in 2006Q1. These factors are expected to push GDP growth to 5.1% for the year, despite anemic growth in investment. Given the real won appreciation against the US dollar of about 7% from January through June 2006—following gains of about 26% between 2002 and 2005—and a rapid growth in imports, especially oil, the current account surplus is likely to decline sharply. Although inflation rose to 2.6% in June 2006, and could further increase marginally during the second half of the year—as cigarette taxes and public utility rates are expected to rise—the Bank of Korea recently lowered its inflation forecast for 2006 from 3% to 2.6%.

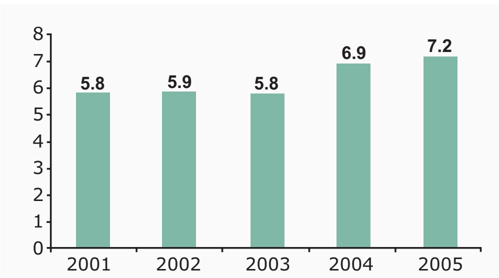
Risks: While headline performance has improved, the composite leading indicator suggests a possible loss of momentum. In addition, higher oil prices could reduce profit margins, particularly in the export sector, which is also pressured by a rising won and increasing wages. A disorderly adjustment of the global payments imbalance could exacerbate these trends and erode export demand. Domestically, a possible sharp correction of the real-estate boom could weaken spending by heavily indebted households, reduce construction activity, and increase NPLs in the banking system.

Policy Issues: The gradual withdrawal of monetary accommodation continued in early June 2006 with a fourth interest rate hike since October 2005 to 4.25%. Inflation has been maintained within its medium-term target range of 2.5–3.5%, helped by won appreciation that mitigated the pass-through effects of higher imported fuel costs. In addition, further improvement of the fiscal balance, which moved into surplus in 2005, is expected this year. Future policy actions should weigh the possibility of reemerging inflationary pressures—if oil prices continue to climb or the May–June currency weakness persists—against the risk of a softening economic recovery. Structurally, investment is constrained, in part, by problems in corporate governance, recently demonstrated by high profile government cases against both domestic and foreign firms and by labor market rigidities. As property prices are rising rapidly in some locations, bank loans for household mortgages and small business loans backed real estate collateral require close monitoring.

Lao PDR

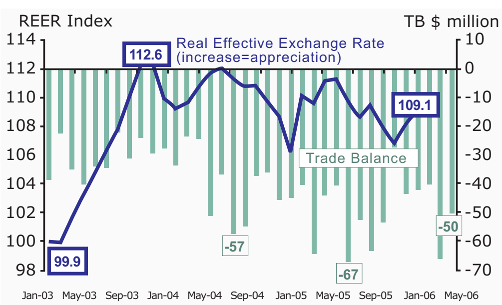
Recent trends in main economic indicators point to a solid GDP growth of about 7.3% this year. Tighter controls on bank lending may be required, however, as inflation is edging up, and additional measures to increase revenues are needed to ensure fiscal stability.

GDP Growth (%)



Sources: Bank of Lao PDR and *Asian Development Outlook 2006* (Asian Development Bank).

Trade Balance & Real Effective Exchange Rate[1]



[1]Jan 2003=100
REER = Real Effective Exchange Rate, TB = Trade balance
Sources: ARIC Indicators and *Direction of Trade Statistics*, May 2006 (International Monetary Fund).

Fiscal and Monetary Indicators

	2002	2003	2004	2005
Central government fiscal balance (% of GDP)	-5.3	-7.9	-5.8	-6.0
Kip/$ (y-o-y, % change)	-11.0	-5.6	2.6	-1.1
Current account balance (% of GDP)	-2.1	-2.6	-8.6	-8.1

Source: *Asian Development Outlook 2006* (Asian Development Bank).

Economic Outlook: With robust mining output and increased electricity sales to neighboring countries in early 2006, the strong economic growth of recent years will likely continue. GDP is forecast to expand by 7.3% in 2006, driven by investment—particularly the construction of the Nam Theun 2 hydropower project and several mining projects. Inflation decelerated to an average 7.2% in 2005, but rose again during the first 2 months of 2006 as food prices increased, reaching 8.5% in February. The kip appreciated by about 6% against the US dollar from January through June 2006 while it has stabilized against the Thai baht, leaving the exchange-rate environment relatively benign.

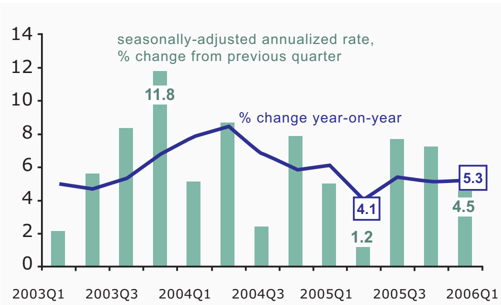
Risks: A sharp slowdown in demand for the country's exports—particularly timber and garments—is a significant external risk. Adverse weather conditions could also hurt agriculture, which is still largely concentrated in rain-dependent rice production. No recent outbreak of avian flu has occurred, and the risk of a pandemic has been lowered because of increased government preparedness. Nevertheless, contagion from neighboring countries remains a threat.

Policy Issues: While inflationary pressures remain a challenge—as a weak transmission process makes conventional monetary tools largely ineffective—the Bank of Lao PDR has set price stability as a clear target and appears determined to reverse the recent inflationary trend by using appropriate monetary policy. The risk of rapid money creation has been reduced while the decision to further control commercial bank lending should help maintain monetary stability. Tax administration has improved through better revenue collection and the authorities were able to contain the fiscal deficit at about 6% of GDP in 2005. A significant boost in revenues still is, however, required. Concrete steps to strengthen central control over revenue collection from the largely administratively decentralized provinces, and speedy implementation of tax measures passed by the National Assembly in 2005, would greatly help fiscal stability. Early expectations of a VAT regime—to be introduced by 2007—boosted economic sentiment, though concerns have recently emerged after the announcement of a delay until 2008. Thus, it is important that the government remains committed to the new VAT, along with other budgetary reforms, to improve the fiscal outlook.

Malaysia

Robust export growth should sustain economic expansion at about 5.5% this year. However, risks emanate from global factors that could slow external demand.

Quarterly GDP Growth (%)

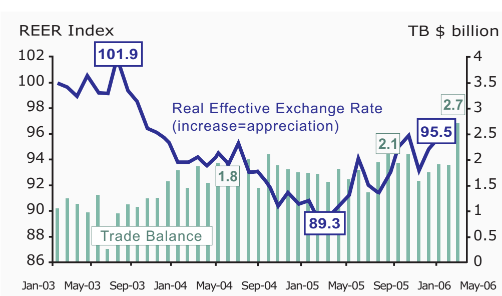


Source: ARIC Indicators.

Composite Leading Indicator (%)

Note: Figure shows the annualized six-month rate of change of the trend restored CLI.
Source: OREI staff calculations.

Trade Balance & Real Effective Exchange Rate[1]



[1]Jan 2003=100
REER = Real Effective Exchange Rate, TB = Trade balance
Sources: ARIC Indicators and Bank Negara Malaysia.

Economic Outlook: Despite easing growth momentum from 2005Q4 to 2006Q1, the economy is forecast to expand by 5.5% in 2006. Robust export growth should continue, based on moderating but still strong electronics exports and accelerating exports of commodities. High manufacturing capacity utilization and sharply rising import growth in capital goods will likely accelerate private investment growth throughout 2006. Sustained imports will also narrow the trade surplus. Inflation rose to 4.8% in March 2006—partly because of the February 2006 increase in retail fuel prices, but moderated to 3.9% in May 2006.

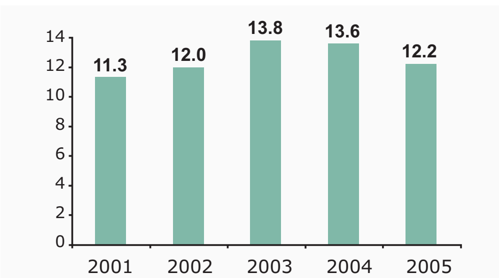
Risks: The composite leading indicator points toward a robust economic expansion. Yet, as a highly export-oriented economy, the country remains vulnerable to weakening external demand due to, for example, an abrupt correction of the global payments imbalance that could erode export performance, destabilize capital flows, and cause capital losses on reserve holdings. A sharp rise in interest rates abroad could also hurt economic growth by forcing a quicker pace of monetary tightening to avoid large capital outflows. Because of continuing avian flu outbreaks around the region, the threat of a pandemic persists, despite effective mitigation policies and the recent absence of any outbreak domestically.

Policy Issues: Indications of broadening economic growth and higher inflation led authorities to begin increasing policy interest rates in November 2005, signaling an end to monetary accommodation, rising by 75 basis points since then to 3.5%. During the January–May period, the ringgit rose by more than 3% against the US dollar—but it has been appreciating in real terms since March 2005. With robust economic growth, increasing inflationary pressure, and rising global interest rates, further policy tightening can be expected. Healthy revenue growth and reduced fuel subsidies should keep fiscal consolidation on track, despite expected increases in spending in line with the country's medium-term development plan. The plan aims to increase human capital and research and development, to address structural weaknesses constraining private investment, which is a concern as it has continued to decline (as a ratio to GDP) to low levels.

Myanmar

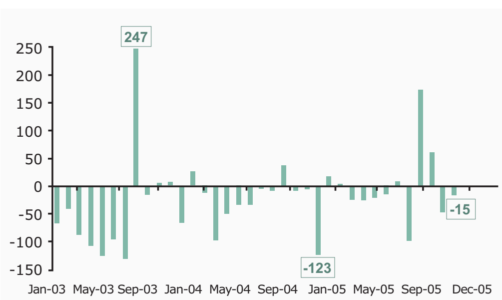
Gas exports are expected to continue to support GDP growth, but may be tempered by inflationary pressures and unpredictable economic policies.

GDP Growth (%)



Source: *Asian Development Outlook 2006* (Asian Development Bank).

Trade Balance ($ million)



Source: *Direction of Trade Statistics*, May 2006 (International Monetary Fund).

Fiscal and Monetary Indicators

	2002	2003	2004
Central government fiscal balance (% of GDP)	-3.6	-4.9	-6.0
Kyat/$ (y-o-y, % change)	1.5	8.2	7.0

Source: *Asian Development Outlook 2006* (Asian Development Bank).

Economic Outlook: Economic trends are difficult to assess, as independent estimates of GDP growth are much lower and inflation estimates higher than official estimates. However, in 2005, export growth in natural gas and continued foreign investor interest in the industry helped support the economy—a trend likely to continue in 2006. There are some prospects for expanding exports to PRC, India, and Thailand, despite continuing pressure caused by the US import ban. Inflation will likely continue to rise sharply this year due to high oil prices and a recent, major salary increase for public-sector employees and military personnel.

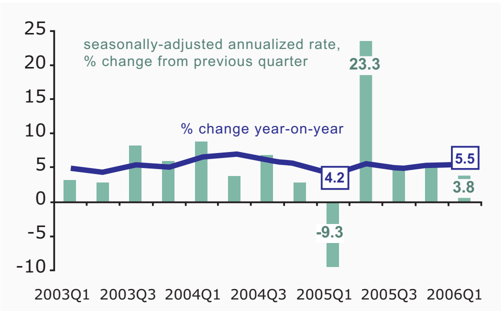
Risks: Myanmar suffers from a relatively narrow export base, both in terms of products (gas) and destination (Thailand). Any global shock that reduces energy prices or slows demand for gas could adversely affect the economy. Numerous structural weaknesses—including low productivity in agriculture—increase vulnerability. Avian flu is a significant threat domestically. With about 90 outbreaks in poultry confirmed since March 2006, the sector and related industries are at serious risk. Moreover, with Mandalay—a major trading hub—the focus of the outbreaks, the disease could easily spread. Accelerating inflation and uncertain employment prospects will continue to reduce consumer and investor confidence.

Policy Issues: The Central Bank of Myanmar and the country's commercial banks raised interest rates by two percentage points effective 1 April 2006. However, independent estimates put inflation in double digits. While inflationary pressures are partly due to an increase in demand for staple items, the October 2005 eightfold increase in administered fuel prices—to mitigate the higher cost of subsidies—worsened the situation. And a March 2006 decision to drastically raise salaries of public sector and military personnel between 5-fold and 12-fold also adds tremendous inflationary pressure. New data show that the central bank's claims on the government increased by 28% in 2005 with a similar trend likely in 2006Q1. Despite a considerable boost in tax revenues in 2004 and 2005, public sector expenditure has grown rapidly, resulting in an estimated fiscal deficit of 3% of GDP in 2005. Substantial efforts to curb inflationary deficit financing, together with greater policy predictability and improved quality of economic information, would enhance the environment for private economic activity. Rationalizing and reducing controls on foreign-exchange markets would also be extremely helpful in reducing distortions that inhibit private economic activity.

Philippines

Despite the uncertain investment climate, monetary tightening, and high oil prices, the economy remains resilient and growth should be sustained at about a 5.0% pace in 2006. Inflation, however, could still hover around 7%, requiring continued vigilance.

Quarterly GDP Growth (%)

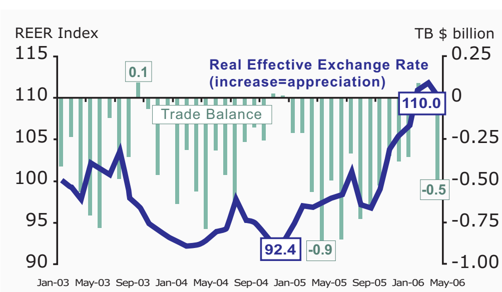


Source: National Statistical Coordination Board of the Philippines.

Composite Leading Indicator (%)

Note: Figure shows the annualized six-month rate of change of the trend restored CLI.
Source: OREI staff calculations.

Trade Balance & Real Effective Exchange Rate[1]



[1]Jan 2003=100
REER = Real Effective Exchange Rate, TB = Trade balance
Sources: ARIC Indicators and National Statistics Office of the Philippines.

Economic Outlook: Growth in consumption and exports sustained economic expansion in 2006Q1, while investment contracted for a fifth consecutive quarter. GDP growth for 2006 is forecast at 5.0%, supported by continued expansion of remittance-led consumption and by an improvement in IT exports. Investment, however, will likely remain constrained by limited progress in structural reforms, such as in the power sector. Continuing remittance flows and restrained import expansion should keep the current account in surplus, while average inflation from January to June 2006 reached 7.1%, mainly due to higher fuel prices and the recent VAT increases.

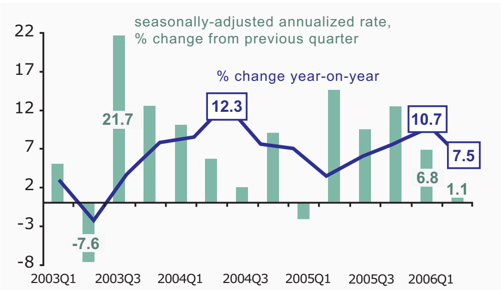
Risks: Apart from inflationary pressures arising from further increases in energy prices, risks include a possible slowdown in remittances that would crimp consumer spending and an abrupt correction in global payments imbalances that could reduce export growth and further erode investment. Heightened global financial uncertainty would likely reduce capital inflows, create currency instability, erase recent gains in foreign reserves, and increase the sovereign spread on external debt. Domestically, investor confidence could further decline with continued delays in structural reforms. With the NPL ratio down to 8.2% in April 2006, vulnerabilities in the domestic financial sector have been reduced. The banking sector, however, holds about 28% of the issuance of the public sector, exposing it to volatility in sovereign bond ratings and spreads.

Policy Issues: After three successive 25 basis-point hikes in the policy interest rate during 2005, the central bank maintained its policy rates in early 2006 based on evidence that current and expected inflation suggest it is decelerating. Policy rates will likely remain stable in the months ahead. On the fiscal front, higher revenues in 2006Q1 from an expanded VAT and stronger tax collections kept the target deficit of 2.1% of GDP for 2006 on track. Vulnerability can be further reduced through continued efforts to enhance revenues and maintain fiscal prudence.

Singapore

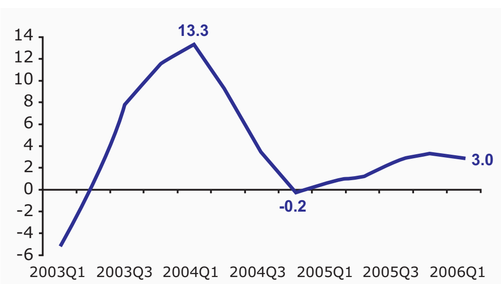
With sustained global economic expansion, the economy is set to continue its robust performance in 2006, growing by a projected 6.1%. Enhancing competitiveness and increasing economic diversification are key policy challenges for the economy.

Quarterly GDP Growth (%)



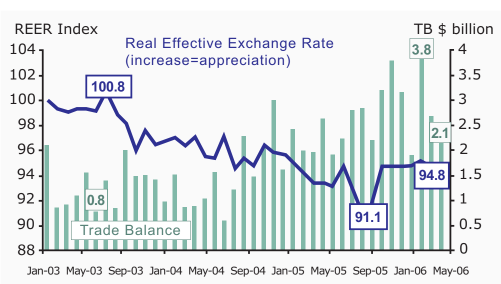
Source: Ministry of Trade and Industry of Singapore.

Composite Leading Indicator (%)



Note: Annualized two-quarter rate-of-change of trend-restored composite leading indicator.
Source: OREI staff calculations based on Ministry of Trade and Indusry data.

Trade Balance & Real Effective Exchange Rate[1]



[1]Jan 2003=100
REER = Real Effective Exchange Rate, TB = Trade balance
Source: ARIC Indicators.

Economic Outlook: Advance estimates suggest that GDP growth eased in 2006Q2 to 7.5% compared with the 10.7% expansion in 2006Q1. Growth momentum also slowed sharply. The economy moderated as manufacturing growth (10.2%) returned to normal after the exceptional 2006Q1 performance (20.2%). Robust demand for electronics exports and consumer spending sustained growth in the first half of 2006. Despite the very strong performance in the first half of 2006, growth is expected to continue to ease in the second half of the year. With US growth moderating, export momentum is slowing. This, combined with continued weakness in construction, is expected to affect growth. On balance, however, the economy is forecast to expand by 6.1% in 2006. Inflation has slowed in recent months, after peaking at 1.7% in January 2006.

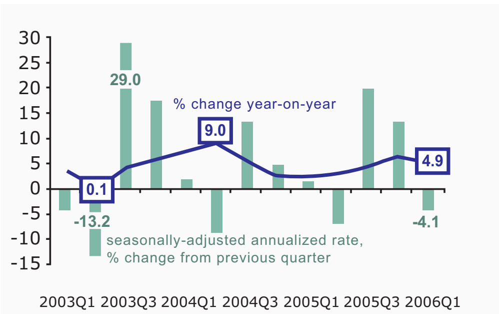
Risks: Although the composite leading indicator weakened recently, the export outlook remains positive due to strong regional leading indicators suggesting that export demand remains firm. Given the openness of the economy, risks could also come from a sudden adjustment to the global payments imbalance or any resultant sharp decline in world economic output.

Policy Issues: The Monetary Authority of Singapore (MAS) is maintaining a policy of gradual appreciation of the Singapore dollar's trade-weighted nominal effective exchange rate. In its April 2006 statement, MAS said its existing policy stance was appropriate to contain inflation, given the recent appreciation against the US dollar (about 5% between end-December 2005 and end-April 2006) and a rise in the domestic Singapore Interbank Offered Rate (from 3.25% at end-December 2005 to 3.55% at end-May 2006). On the fiscal front, after posting a modest surplus in FY2005, the government is expected to run a S$2.9 billion budget deficit excluding investment and interest income (-1.4% of GDP) in FY2006, largely due to a considerable increase in special transfers—used for economic restructuring and supporting older and lower-skilled workers. The mix between an expansionary fiscal policy and a slightly tight monetary policy seems appropriate for sustaining domestic demand and accommodating government efforts to restructure the economy to adapt to global trends. Over the longer term, a key challenge is to innovate and diversify into new sectors, thus maintaining or enhancing the country's competitive edge. This would also make the economy less dependent on the global IT cycle.

Taipei,China

Although GDP growth moderated in 2006Q1, the economy should expand by about 4.4% for the year, largely supported by robust external demand. Fixed investment needs to be stimulated to support the nascent recovery in domestic demand.

Quarterly GDP Growth (%)

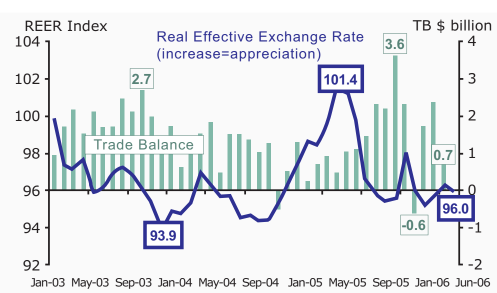


Source: Taiwan Directorate General of Budget Accounting and Statistics.

Composite Leading Indicator (%)

Note: Annualized two-quarter rate-of-change of trend-restored composite leading indicator.
Source: Council of Economic Planning of Taipei,China.

Trade Balance & Real Effective Exchange Rate[1]



[1]Jan 2003=100
REER = Real Effective Exchange Rate, TB = Trade balance
Sources: Bank for International Settlements and Ministry of Finance of Taipei,China.

Economic Outlook: GDP growth moderated from 6.4% in 2005Q4 (the fastest pace in six quarters) to 4.9% in 2006Q1. A sustained decline in fixed investment is of some concern, though the rate of decline has slowed significantly from -11.9% in 2005Q4 to -4.0% in 2006Q1. Still, output is expected to expand by 4.4% this year, largely supported by strong external demand, a depreciating real exchange rate, and an accommodative monetary policy. In recent months, however, high oil prices, along with rising food costs, have led to an increase in headline inflation.

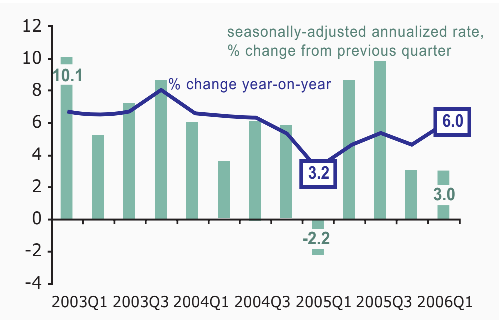
Risks: Given the economy's high export orientation, growth prospects inevitably depend on the external environment. A downturn in the electronics cycle, an outbreak of an avian flu pandemic, or an unexpected poor performance of the global economy (and the PRC in particular) would all adversely impact the island's exports and ultimately growth. Political uncertainty affects confidence, a critical factor in stimulating domestic or foreign investment.

Policy Issues: Since 2004, the Central Bank of China (CBC) has lagged somewhat behind US Federal Reserve policy rate hikes. Until recently, with a nascent recovery in domestic demand, official rates have been barely positive in real terms. However, the CBC hiked the key policy rate on 29 June 2006 by 12.5 basis points, against the backdrop of increased inflationary pressures—from high oil prices, an impending increase in domestic electricity rates, high domestic utilization rates, and low real interest rates—and the desire to return monetary policy to a more neutral stance. Rising public expenditures in recent years, coupled with an increase in public debt, limits the government's ability to use counter-cyclical fiscal policies. Robust GDP growth should enable the government to achieve greater fiscal consolidation and undertake tax reform. Continued liberalization of trade, investment, and tourism with the PRC could also help contribute to strong future growth.

Thailand

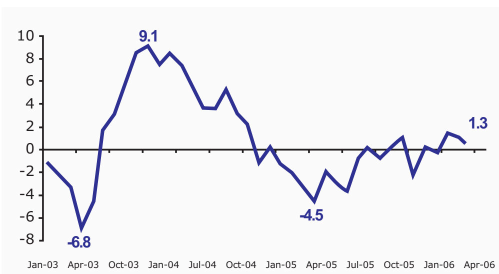
Sustained 2006Q1 growth suggests that GDP can be expected to expand at 4.7% for the whole of 2006. Persistent oil price increases, creating further inflationary pressures, and political uncertainties present major risks.

Quarterly GDP Growth (%)



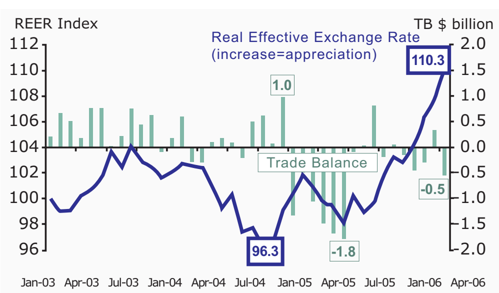
Source: National Economic and Social Development Board of Thailand.

Composite Leading Indicator (%)



Note: Figure shows the annualized six-month rate of change of the trend restored CLI.
Source: Bank of Thailand.

Trade Balance & Real Effective Exchange Rate[1]



[1]Jan 2003=100
REER = Real Effective Exchange Rate, TB = Trade balance
Sources: ARIC Indicators and Bank of Thailand.

Economic Outlook: In line with a sustained 2006Q1 expansion, GDP growth for the year is projected at 4.7%. Political uncertainties, higher inflation, and interest rate hikes hurt domestic demand in 2006Q2. Growth of exports and imports is mixed, with relatively high growth in February and May 2006. Overall, Thailand posted a trade deficit from January to May 2006. By end-May, foreign reserves were at $56.0 billion, up nearly $5.3 billion from December 2005. Inflation, which accelerated in the second half of 2005, averaged 5.7% during 2006Q1 and rose to 6.0% in 2006Q2, reflecting higher fuel prices.

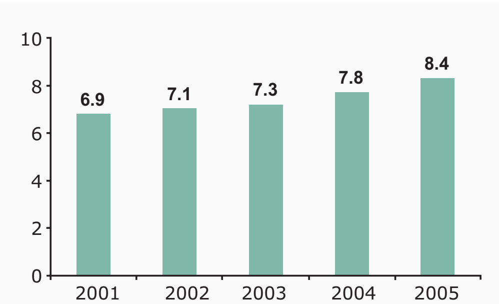
Risks: The composite leading indicator supports an outlook for sustained growth. But major risks remain. Thailand imports 90% of its oil, with manufacturing and transport accounting for a major portion of the country's GDP. Soaring oil prices may slow growth and worsen the trade balance. A disorderly correction of the global payments imbalances could affect export demand. With the Bank of Thailand (BOT) matching US Fed policy rate hikes to stabilize capital flows, domestic rates could move up further, jeopardizing an already weak domestic demand. Domestically, persistent political uncertainties could further reduce consumer and business confidence, as they have during the first half of the year. Delays in infrastructure and development spending can also be a downside risk for 2006.

Policy Issues: Since August 2004, BOT has gradually raised interest rates to match the US hikes. After increasing policy rates to 5.0% in early June 2006, further policy adjustments must balance efforts to contain inflation and stabilize capital flows against any evidence of a slowing economy. Political uncertainties have also slowed policy implementation. Delays in the infrastructure development program will result in a shortfall in public investment. Political uncertainty also temporarily halted negotiations on bilateral free trade agreements. In March 2006, the Supreme Administrative Court barred privatization of the state-owned electricity utility, EGAT, a key privatization goal. Significant progress in fiscal and structural policies is unlikely until after parliamentary elections are held again in late 2006.

Viet Nam

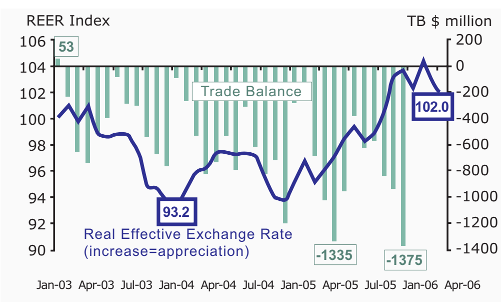
After exceptionally high 8.4% GDP growth in 2005, the economy is likely to expand by a more sustainable 7.8% in 2006. Further monetary tightening could help control credit growth and inflation.

GDP Growth (%)



Sources: Ministry of Finance and *Asian Development Outlook 2006* (Asian Development Bank).

Trade Balance & Real Effective Exchange Rate[1]



[1]Jan 2003=100,
REER = Real Effective Exchange Rate, TB = Trade balance
Source: ARIC Indicators and *Direction of Trade Statistics*, May 2006 (International Monetary Fund).

Fiscal and Monetary Indicators

	2002	2003	2004	2005
Central government fiscal balance (% of GDP)	-3.6	-4.3	-2.0	-2.3
Dong/$ (y-o-y, % change)	-3.6	-2.4	-0.8	-1.0
Current account balance (% of GDP)	-2.7	-6.4	-5.4	-3.6

Source: *Asian Development Outlook 2006* (Asian Development Bank).

Economic Outlook: Authorities announced that GDP expanded by 7.4% during the first half of 2006 compared with 7.6% over the same period last year. The slight easing of growth was due to lower oil production and agricultural output, caused by bad weather and animal disease. Still, growth is expected to accelerate in the coming months, as investment is bolstered by the successful conclusion of bilateral trade negotiations with the US paving the way for a likely quick accession to WTO. Full-year GDP growth is forecast at 7.8%. Inflation averaged 7.9% in the first 6 months of 2006, showing that continued price pressure persists despite a slight decelerating trend. In the first quarter of 2006, preliminary trade balance data shifted marginally into surplus ($60 million). This is partly due to slowing imports of intermediate goods, which has caused concern about a possible deceleration of domestic production in the months ahead.

Risks: With the US a primary destination for exports, a possible slowdown in US demand would adversely affect Viet Nam's economic growth. However, continuing trade expansion with the PRC and other Asian economies—where growth is forecast to remain strong—could mitigate this risk. Internally, poor infrastructure and high utility costs can adversely affect local firms, especially given the imminent entry into WTO. Given the limited exchange rate flexibility, further increases in oil prices would put pressure on inflation. An avian flu pandemic remains a risk with a potentially severe impact on agriculture, tourism, and health. The government is trying to mitigate potential effects of avian flu by upgrading monitoring systems and increasing public awareness to upgrade capacity to react quickly to control the disease.

Policy Issues: Last year's monetary tightening—as policy rates rose from 7.50% at end-2004 to 8.25% at end-2005—was unable to stop new credit, which expanded by a whopping 40% in 2005. Authorities are expected to try to curb credit growth this year by increasing interest rates further. The overall budget deficit was prudently managed at 2.3% of GDP in 2005, as oil receipts grew, tax administration improved, and the tax base expanded. Still, off-budget expenditures raise questions of fiscal sustainability. As the government's massive infrastructure plan for 2006–2010 could push inflation above forecasts, improving macroeconomic stability requires close coordination between monetary and fiscal policies. Faster implementation of the equitization process for state-owned enterprises would bolster private sector participation and boost economic growth.