

The *Asia Economic Monitor* (AEM) is a semiannual review of East Asia's growth, financial and corporate sector restructuring, and emerging policy issues. It covers the 10 Association of Southeast Asian Nations member countries plus the People's Republic of China and the Republic of Korea.

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Highlights

Growth and Restructuring in 2004

- Driven by a combination of rapid increase in exports and continued strength in domestic demand, East Asia recorded strong growth in the first three quarters of the year.
- This growth, coupled with high commodity prices, including oil prices, has led to a rise in inflation across the region, although it has moderated in recent months.
- The region's stock markets have in general rebounded sharply in recent months, following weak performance in the middle of the year.
- Net private capital flows to the five crisis-affected countries are set to reach a postcrisis high this year.
- Reflecting the broad weakness of the US dollar and robust balance of payments, East Asian currencies have appreciated against the dollar except the Indonesian rupiah and the Philippine peso.
- Current account surpluses and strong capital inflows have led to a sizable increase in East Asia's foreign exchange reserves.
- Continued progress in financial and corporate restructuring and improved prudential indicators have further reduced East Asia's financial vulnerability.

Economic Outlook

- With most industrial countries posting robust growth, the external environment facing East Asia has continued to be favorable this year. It is expected to be less favorable in 2005, as growth in the US and Japan slows from this year's high level and the global electronics sector softens.
- Domestic demand in East Asia, which was robust in 2004, is also expected to slow next year.
- Despite high oil prices and some loss of momentum, this year East Asia's growth is likely to be the highest since the 1997 financial crisis. In 2005, growth is expected to moderate somewhat, but will still be solid:
 - The December Survey by Consensus Economics Inc.¹ projects East Asia's average GDP growth for 2004 at 7.6%.
 - In 2005, East Asia is forecast to grow by 6.5%.

Continued overleaf

Acronyms, Abbreviations, and Notes

ADB	Asian Development Bank
AEM	Asia Economic Monitor
AMC	asset management company
ARIC	Asia Recovery Information Center
ASEAN	Association of Southeast Asian Nations
BB	book-to-bill
CAR	capital adequacy ratio
CLI	composite leading indicator
DRAM	dynamic random access memory
GDP	gross domestic product
IBRA	Indonesian Bank Restructuring Agency
IIF	Institute of International Finance
IMF	International Monetary Fund
ISM	Institute of Supply Management
IT	information technology
JCI	Jakarta Composite Index
KAMCO	Korea Asset Management Corporation
KLCI	Kuala Lumpur Composite Index
KOSPI	Korean Stock Price Index
Lao PDR	Lao People's Democratic Republic
LPS	Indonesia Deposit Guarantee Corporation
NASDAQ	National Association of Securities Dealers Automated Quotation
NBFI	nonbank financial institution
NPL	nonperforming loan
OECD	Organization for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
PCOMP	Philippine Composite Index
PRC	People's Republic of China
REMU	Regional Economic Monitoring Unit (ADB)
ROA	return on assets
SARS	Severe Acute Respiratory Syndrome
SET	Stock Exchange of Thailand
SPV	special purpose vehicle
STI	Straits Times Index (Singapore)
TAMC	Thai Asset Management Corporation
q-o-q	quarter-on-quarter
y-o-y	year-on-year
B	baht
P	peso
Rp	rupiah
¥	yen

Note: "\$" denotes US dollars unless otherwise specified.

The *Asia Economic Monitor* December 2004 was prepared by the Regional Economic Monitoring Unit of the Asian Development Bank and does not necessarily reflect the views of ADB's Board of Governors or the countries they represent.

Risks and Policy Issues

- Forecasts for 2005 are subject to three main risks, two external and one internal: continued high oil prices, a disorderly adjustment of the US current account deficit, and a hard landing for the PRC economy.
- The key policy challenge facing East Asia over the next year or two is to sustain robust growth at a time when US interest rates and domestic inflation rates are on an upward path.
- Against the emerging global and regional economic backdrop, an appropriate policy response should have three key components: tighter fiscal and monetary policies, greater exchange rate flexibility, and structural reforms to invigorate private investment.