

The *Asia Economic Monitor* (AEM) is a semiannual review of emerging East Asia's growth and policy issues. It covers the 10 members of the Association of Southeast Asian Nations; People's Republic of China; Hong Kong, China; Republic of Korea; and Taipei, China. This issue includes a special chapter on the impact of the global financial crisis on emerging East Asia's financial systems.

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## Highlights

### Recent Economic Performance

- Economic growth in emerging East Asia continued to slow in the second half of 2008, as the global financial crisis deepened and economic activity contracted in major industrial countries.
- Inflation peaked across most of emerging East Asia during the third quarter as sharp declines in oil and other commodity prices followed tightening credit conditions.
- The balance of payments remained in surplus across much of the region through the third quarter, even as current account balances narrowed and net capital flows declined.
- Stock markets across the region continued their downward slide in the second half of 2008 as the global crisis triggered massive sell-offs.
- Most emerging East Asian currencies depreciated against the US dollar on flight-to-safety, particularly since mid-September, while local currency bond market yield curves shifted downward.
- With the prospect of slowing growth, policy makers in the region have begun to ease monetary and fiscal policies.

### Outlook, Risks, and Policy Issues

- The external economic environment for developing Asia is likely to worsen, as major industrial economies contract further, global financial conditions remain constricted, and world trade growth slows sharply.
- The deteriorating external environment will hurt developing Asia's immediate growth prospects—aggregate GDP growth is forecast to fall to 5.8% in 2009 from this year's estimated 6.9%.
- Economies in emerging East Asia will grow at 5.7% in 2009, down from 6.9% this year.
- Major risks to the outlook include (i) a sharper or prolonged global recession, (ii) persistent financial stress with volatile capital flows, (iii) further tightening of external and domestic funding conditions, and (iv) excessively volatile conditions in foreign exchange markets.
- The coming year will be a difficult one for developing Asia but it will be manageable if countries respond decisively to restore confidence in the financial system and real economy, and collectively to avoid the effects of contagion.

## Acronyms, Abbreviations, and Notes

ABMI	Asian Bond Markets Initiative
ADB	Asian Development Bank
ADO	Asian Development Outlook
AEM	Asia Economic Monitor
AIG	American International Group
ASEAN	Association of Southeast Asian Nations
ASEAN+3	ASEAN plus People's Republic of China, Japan, and Republic of Korea
ASEAN-4	Indonesia, Malaysia, Philippines, Thailand
BIS	Bank for International Settlements
CDO	collateralized debt obligation
CDS	credit default swap
CGF	Credit Guarantee Fund
CGIM	Credit Guarantee and Investment Mechanism
CPI	consumer price index
ECB	European Central Bank
EU	European Union
FDI	foreign direct investment
Fed	Federal Reserve
G3	US, eurozone, Japan
G7	Group of Seven industrialized economies
G20	Group of 20
GDP	gross domestic product
H1	first half
H2	second half
HKMA	Hong Kong Monetary Authority
IDR	Indonesian rupiah
IMF	International Monetary Fund
ISM	Institute for Supply Management
IT	information technology
JCI	Jakarta Composite Index
KLCI	Kuala Lumpur Composite Index
KOSPI	Korean Stock Price Index
Lao PDR	Lao People's Democratic Republic
MSCI	Morgan Stanley Capital International Inc.
m-o-m	month on month
MYR	Malaysian ringgit
NEER	nominal effective exchange rate
NIE	newly industrialized economy
NPL	nonperforming loan
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
OREI	Office of Regional Economic Integration
PCOMP	Philippine Composite Index
PRC	People's Republic of China
Q2	second quarter
q-o-q	quarter on quarter
RMB	renminbi
SBV	State Bank of Viet Nam
SET	Stock Exchange of Thailand
STI	Straits Times Index
TWSE	Taiwan Stock Exchange Index
UK	United Kingdom
US	United States
y-o-y	year on year

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

The *Asia Economic Monitor* December 2008 was prepared by the Office of Regional Economic Integration of the Asian Development Bank and does not necessarily reflect the views of ADB's Board of Governors or the countries they represent.

- With the balance of risks shifting from rising inflation to slowing growth, monetary policy must remain flexible enough to allow growth stimulus where appropriate while keeping inflation expectations firmly anchored.
- Fiscal policy could hold center stage for many emerging East Asian economies in mitigating/minimizing effects of deteriorating external economic conditions on growth prospects.
- Policy makers in many emerging East Asian economies need to deepen and broaden structural reforms to rebalance the sources of growth from an over-reliance on exports to domestic demand.

## Global Economic Crisis: Impact and Challenges for Emerging East Asia's Financial Systems

- In recent months, the ripple effects of the global financial crisis have reached Asian shores, and the region's financial systems have come under increased pressure as a result.
- The region's policy makers still have the opportunity to be proactive rather than reactive, and to forestall emerging threats to financial stability.
- Three sets of short-term policy responses are needed to bolster the foundations of financial stability:
  - close monitoring of the region's financial systems and the identification of both weak financial institutions and systemic vulnerabilities;
  - provision of adequate foreign currency as well as domestic liquidity to systemically critical financial institutions so that credit continues to flow into the economy; and
  - prevention of the effects of slowing economic growth from spilling over onto the region's banking systems.
- In the longer-term, reforms of regulation and oversight of financial systems should aim to
  - strengthen transparency and accountability;
  - enhance sound regulation and prudential oversight;
  - mitigate the procyclicality of financial markets;
  - broaden and deepen financial markets to enhance resilience; and
  - reinforce cross-border cooperation.



## About the Asian Development Bank

ADB, based in Manila, is dedicated to reducing poverty in the Asia and Pacific region through inclusive economic growth, environmentally sustainable growth, and regional integration. Established in 1966, it is owned by 67 members – 48 from the region. In 2007, it approved \$10.1 billion of loans, \$673 million of grant projects, and technical assistance amounting to \$243 million.