Contents

Economic Performance in the First Half of 2004 3
  Real Sector Developments 3
  Financial Markets 5
  Monetary and Fiscal Policies 7
Financial Restructuring and Prudential Indicators 10
  Nonperforming Loans of Banks 10
  Capital Adequacy and Bank Profitability 11
  Asset Resolution by Asset Management Companies 11
  Trends in Bank Credit 12
  Prudential Indicators 13
Economic Outlook, Risks, and Policy Issues 15
  External Economic Environment 15
  Regional Economic Outlook 17
  Individual Country Outlook 19
  Risks and Policy Issues 22
Box: Private Capital is Starting to Return 14

Highlights

Growth and Restructuring in the First Half of 2004

- East Asia’s synchronized economic growth that started in the second half of 2003 continued in the first half of this year, despite the sharp rise in world oil prices.

- Strong first half economic growth was driven by the combination of a rapid increase in exports and continued strength in domestic demand.

- Robust growth along with increases in world prices of oil and other commodities led to a gradual increase in inflation in the region.

- East Asia’s stock markets and currencies generally remained flat or weakened since the beginning of this year.

- Private capital is starting to return to the five crisis-affected countries.

- In most crisis-affected countries, banks’ nonperforming loan ratios continued to fall and asset management companies made further progress in corporate debt restructuring.

- East Asia’s prudential indicators remained strong in the first half: most major countries ran current account surpluses, foreign exchange reserves were sizable, and external debt indicators improved.

Economic Outlook

- The December 2003 AEM’s upbeat economic assessment for East Asia has brightened further with:
  - healthier economies in the US and Japan,
  - buoyant intra-regional trade, and
  - continued strength of domestic demand in most East Asian countries.

- East Asia’s synchronized economic growth is, however, expected to peak this year, close to its post-crisis high of 7.5% in 2000, and moderate somewhat next year as growth in the major industrial countries and the PRC slows to more sustainable levels:
  - The July survey by Consensus Economics Inc.\(^1\) projects East Asia’s average GDP growth for 2004 at 7.3%, higher than the December 2003 forecast of 6.6%.
  - East Asia’s average GDP growth in 2005 is expected to slow somewhat to a still robust 6.5%.

\(^1\)A private institution that collates forecasts from about 200 economic and financial forecasters from more than 70 countries.
Risks and Policy Issues

- These forecasts are subject to three main near-term risks: continued high oil prices, larger-than-expected increases in US interest rates, and a hard landing for the PRC economy.

- The key challenge facing macroeconomic management in East Asia over the next year or so is to sustain the robust GDP growth at a time when US interest rates and domestic inflation rates are rising, developments that would require tightening of macroeconomic policies in the region.

- An appropriate response could be a combination of a modest tightening in fiscal policy, greater exchange rate flexibility, and expeditious completion of financial and corporate restructuring.

- The major objective of this policy mix is to minimize the required increases in domestic interest rates so that private investment and consumption are not unduly affected while inflation is kept under control.