The Asia Economic Monitor (AEM) is a semiannual review of emerging East Asia’s growth, financial vulnerability, and emerging policy issues. It covers the 10 Association of Southeast Asian Nations members; People’s Republic of China; Hong Kong, China; Republic of Korea; and Taipei, China.

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How to reach us
Asian Development Bank
Office of Regional Economic Integration
6 ADB Avenue, Mandaluyong City
1550 Metro Manila, Philippines
Telephone
+63 2 632 5458
+63 2 632 4444
Facsimile
+63 2 636 2183
E-mail
aric_info@adb.org

Highlights

Economic Performance in the First Half of 2006
• Emerging East Asia’s economic growth likely accelerated in the first half of 2006. In the first quarter of the year, the region posted average GDP growth of 8.1%—higher than the previous quarter’s 7.7% figure; available indicators suggest that GDP continued to grow at a brisk pace in the second quarter as well.
• Faster export growth—driven by an increasingly broad-based expansion among industrial economies and by a rebound in the global demand for IT products—benefited economies across the region.
• As for domestic sources of growth, while a rapid increase in investment added significant stimulus to the PRC’s strong growth, investment generally increased in ASEAN and the NIEs but contributed much more modestly to the expansion.
• Higher energy prices continued to create or accentuate inflationary pressures across the region: in the PRC and NIEs, inflation remained relatively subdued—though it has inched up in recent months, while in many ASEAN economies, it was either trending up strongly or remained at elevated levels.
• Even as the region maintained strong growth, most stock markets, after soaring through mid-May, suffered from a global correction in risk appetite and plummeted over the following month, erasing much of the year’s gains and adding volatility to regional currencies.
• Balance of payments positions were stronger across emerging East Asia, as current account balances improved and capital inflows increased. Coupled with official interventions in exchange markets, this led to a build-up of foreign exchange reserves.
• Despite the mid-May market jitters, financial vulnerability indicators suggest improved resilience of most emerging East Asian economies to possible financial shocks; in some economies, however, banks’ exposure to real estate is rising.

Outlook, Risks, and Policy Issues
• Looking ahead, sustained and broad-based economic expansion in major industrial countries and the rebound in the global IT industry should augur well for the emerging East Asia economic outlook. Nonetheless, continued global monetary tightening and elevated energy prices could somewhat cloud the external economic environment.
On balance, the current assessment is that in 2006 emerging East Asia is likely to post an average GDP growth of 7.5%—higher than in 2005. In 2007, the region’s average growth is forecast to slow, in part because of easing growth in US, Japan, and PRC, yet remain a healthy 6.9%.

In the PRC, growth is expected to be 10.1% this year and 9.0% in 2007. A domestic demand recovery in Korea should push average GDP growth in the NIEs up to 5.1% this year, which will then likely slow to 4.7% in 2007. GDP growth in ASEAN is expected to be 5.5% this year, rising slightly to 5.7% in 2007 mainly as a result of country-specific factors that will boost domestic demand, such as a recovery from the effects of the August 2005 mini-financial crisis in Indonesia.

This favorable outlook is subject to two types of risks: (i) near-term cyclical risks and (ii) deeper, structural, low probability but high impact risks.

A sharp fall in external demand, correction of an overheating PRC economy, higher-than-expected energy prices, and a significant deterioration in global financial conditions constitute the first risk category, while a sudden and disruptive adjustment of the global payments imbalances and an outbreak of an avian flu pandemic belong to the second.

Against the backdrop of the prospects for robust growth and higher inflation, emerging East Asia’s policy options for managing near-term risks comprise a combination of further monetary tightening—through interest rate hikes or currency appreciation, or both, and in some cases, additional efforts to narrow fiscal deficits and reduce public debt. For example, in the PRC, both interest rate hikes to cool domestic demand and currency appreciation to address external imbalances are appropriate. At the same time, increasing exposure of banks to real estate in some economies needs close monitoring and appropriate measures to reduce risks.

To address deeper vulnerabilities, the region’s policy priorities should be to (i) boost domestic demand—consumption in the PRC and investment in most other economies, (ii) increase exchange rate flexibility, (iii) improve the region’s energy efficiency, and (iv) prepare for the possibility of an avian flu pandemic.

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

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