

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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## 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 Asian economic outlook. Nonetheless, continued global monetary tightening and elevated energy prices could somewhat cloud the external economic environment.

*Continued overleaf*

## Acronyms, Abbreviations, and Notes

ADB	Asian Development Bank
AEM	Asia Economic Monitor
AMC	asset management company
ARIC	Asia Regional Information Center
ASEAN	Association of Southeast Asian Nations
ASEAN5	Indonesia, Malaysia, Philippines, Singapore, Thailand
bbl	barrel
bp	basis point
BOJ	Bank of Japan
BOT	Bank of Thailand
CAR	capital adequacy ratio
CBC	Central Bank of China (Taipei, China)
CLI	composite leading indicator
ECB	European Central Bank
GDP	gross domestic product
IMF	International Monetary Fund
IT	information technology
JCI	Jakarta Composite Index
KLCI	Kuala Lumpur Composite Index
Korea	Republic of Korea
KOSPI	Korean Stock Price Index
Lao PDR	Lao People's Democratic Republic
LEERS	Linked Exchange Rate System
M2	broad money
mbd	million bbl/day
NPL	nonperforming loan
NYMEX	New York Mercantile Exchange
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
ROA	return on assets
SET	Stock Exchange of Thailand
STI	Straits Times Index
TWSE	Taiwan Stock Exchange Index
US	United States
US FED	US Federal Reserve
VAT	value-added tax
WHO	World Health Organization
WTO	World Trade Organization
y-o-y	year-on-year

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

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- 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.