



# ASIA ECONOMIC MONITOR

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Asian Development Bank

The *Asia Economic Monitor* (AEM) is a semi-annual 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 regulatory reform in emerging East Asia.

**Download the AEM at:** <http://www.aric.adb.org/asia-economic-monitor/>

The *Asia Economic Monitor* July 2009 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.

## 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 6265  
+63 2 632 4444

#### **Facsimile**

+63 2 636 2183

#### **E-mail**

[aric\\_info@adb.org](mailto:aric_info@adb.org)

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# Highlights

## Recent Economic Performance

- Economic growth in emerging East Asia dropped sharply in the first quarter of 2009, but early indicators suggest the pace of decline slowed during the second quarter.
- The slowdown in growth, coupled with lower oil and food prices, helped inflation to decline across the region.
- The balance of payments turned positive again in the first quarter of 2009 as current account surpluses grew and capital outflows moderated.
- Emerging East Asia's stock markets rebounded strongly, rising 68% over their November 2008 troughs.
- Several currencies in the region appreciated against the US dollar as investors' risk appetite began to return.
- Bond yield curves for most emerging East Asian economies shifted upward and steepened in recent months.
- With growth slowing and inflation falling, authorities continued to ease monetary and fiscal policies.
- The region's banking systems appear capable of weathering the economic storm, with prudential indicators strong and lending continuing to grow.

## Outlook, Risks, and Policy Issues

- The overall external environment for emerging East Asia remains difficult and uncertain, with the recession in advanced economies continuing and global financial conditions improving yet tight.
- Emerging East Asia has entered the transition from recession to recovery, with GDP growth sourced more from domestic stimulus than a resurgence in external demand.
- Emerging East Asia could see a V-shaped recovery, with growth dipping sharply in 2009 before regaining last year's pace in 2010.
- Major risks to the outlook include (i) a more prolonged recession and weaker recovery than expected in developed countries; (ii) unintended consequences of economic stimulus or premature policy tightening; (iii) falling inflation becoming deflation; and (iv) non-economic events with low probabilities, but potentially large impacts.

*Continued overleaf*

## Acronyms, Abbreviations, and Notes

ACC	additional capital charge
ADB	Asian Development Bank
ADO	Asian Development Outlook
AEM	Asia Economic Monitor
AFMM+3	ASEAN+3 Finance Ministers Meeting
ASA	ASEAN Swap Arrangement
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
BCP	Basel Core Principles
BIS	Bank for International Settlements
BI	Bank Indonesia
BOE	Bank of England
BSA	bilateral swap agreement
BSP	Bangko Sentral ng Pilipinas
CAR	capital adequacy ratio
CMIM	Chiang Mai Initiative Multilateralization
ECB	European Central Bank
FSAP	Financial Sector Assessment Program
FSA	Financial Services Authority
FSF	Financial Stability Forum
Fed	Federal Reserve
G3	US, eurozone, Japan
G7	Group of Seven advanced economies
G20	Group of 20
GDP	gross domestic product
GP	general provisioning
H1N1	Influenza A
HKMA	Hong Kong Monetary Authority
IAS	international accounting standards
ICP	Insurance Core Principles
IOSCO	International Organization of Securities Commissions
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
M2	broad money
MPS	macro-prudential supervision
MSCI	Morgan Stanley Capital International Inc.
m-o-m	month-on-month
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
PMI	purchasing managers' index
Q2	second quarter
q-o-q	quarter-on-quarter
repo	reverse repurchase
SET	Stock Exchange of Thailand
SIV	special investment vehicle
SME	small- and medium-sized enterprise
STI	Straits Times Index
TWSE	Taiwan Stock Exchange Index
UK	United Kingdom
US	United States
VaR	value-at-risk
y-o-y	year-on-year

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

- Given the tentative nature of the expected recovery, it is critical that authorities stay the course in supporting domestic demand and growth.
- Monetary policy in the region needs to remain expansionary until the recovery gains substantial traction or large inflationary pressures reemerge.
- Ensuring that fiscal stimulus is implemented effectively and efficiently is key to bolstering domestic demand in the face of continued weakness in the external environment.
- Even as the immediate impact of the global crisis works itself out, authorities should continue with deeper, more comprehensive structural reforms needed to rebalance growth toward greater domestic demand.

## Beyond the Crisis: Regulatory Reform in Emerging East Asia

- The unprecedented financial crisis has prompted a reassessment of regulatory systems worldwide—to cover a wider set of market segments and institutions, especially those deemed systemically important.
- Emerging East Asia should actively participate in designing the new global financial architecture—particularly given the specific reform agendas that have emerged in forums such as the G20.
- Regulatory reform should eliminate gaps and overlaps, avoid regulatory arbitrage, increase transparency, and improve coordination among relevant authorities.
- There is no “one-size-fits-all” regulatory structure; yet there is growing acceptance that an integrated approach to macro-prudential oversight and financial stability is needed.
- Capital adequacy requirements must be increased and supplemented by a forward-looking assessment of risks stemming from liquidity, high leverage, and pro-cyclicality.
- System-wide, macro-prudential supervision must be developed to complement existing micro-prudential regulation.
- A key challenge for the region's regulators is how to encourage and manage financial market development without stifling innovation.
- Emerging East Asian economies should reinforce cooperation on enhancing financial stability by accelerating regional initiatives.

## About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries substantially reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two-thirds of the world's poor: 1.8 billion people who live on less than \$2 a day, with 903 million struggling on less than \$1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.