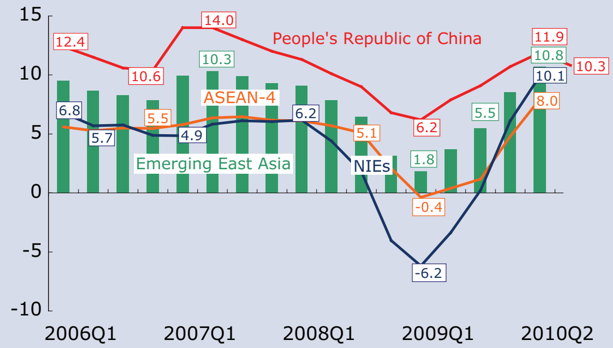
Recent Economic Performance

Growth and Inflation

Economic recovery in emerging East Asia continued to strengthen in the first half of 2010.

Emerging East Asia's economic recovery grew stronger in the first quarter of 2010 as a better external environment and stronger domestic demand contributed to higher growth in gross domestic product (GDP). Aggregate growth in the 10 largest economies in the region was 10.8% year-on-year[1] in the first quarter of 2010, much higher than the 8.5% growth recorded in the last quarter of 2009 **(Figure 1)**. The first quarter performance now brings the region's economies above pre-crisis peak GDP levels **(Figure 2)**. While impressive, the low base effect from the first quarter of 2009—the trough of the global recession—is partly responsible. In the first quarter of 2010, several economies achieved double-digit growth rates, with Singapore leading the region at 16.9%, followed by 13.3% in Taipei,China. Economic growth in Thailand and Malaysia reached double-digits and growth in the People's Republic of China (PRC) accelerated to 11.9% in the first quarter of 2010. Advance estimates show Singapore's growth in the second quarter was even stronger, accelerating to 19.3%. Continued strong growth in exports, retail sales, and industrial production suggests that the region's GDP growth was also buoyant in the second quarter of 2010 **(Figure 3)**, with PRC's second quarter growth remaining strong at 10.3%.

Figure 1: Regional GDP Growth[1]—Emerging East Asia[2] (y-o-y,%)



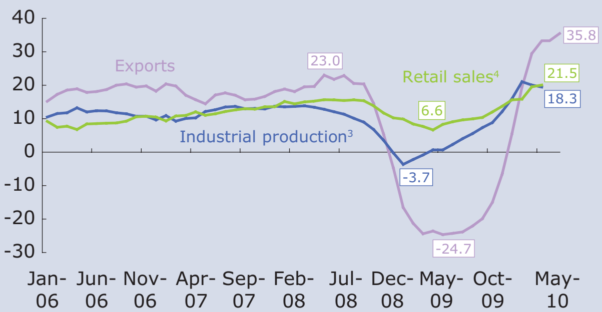
ASEAN-4 = Indonesia, Malaysia, Philippines, and Thailand; GDP = gross domestic product; NIEs = Hong Kong, China; Republic of Korea; Singapore; and Taipei,China.
[1]Weighted by gross national income (atlas method, current $). [2]Includes ASEAN-4, NIEs, Viet Nam, and People's Republic of China.
Source: OREI staff calculations based on CEIC data.

Figure 2: GDP Level Comparison—2010Q1 vs pre-crisis peak[1] (%)

GDP = gross domestic product.
Note: Seasonally-adjusted real GDP series was used. Only countries with official seasonally-adjusted GDP data are included.
[1]Pre-crisis peak period is 2008Q1 for all countries, except for Republic of Korea (2008Q2) and the Philippines (2008Q3).
Source: OREI staff calculations based on CEIC data.

[1]All growth figures are year-on-year unless otherwise indicated.

Figure 3: Exports, Industrial Production, and Retail Sales Growth[1]—Emerging East Asia[2]
(y-o-y, %)



y-o-y = year-on-year.
Note: Exports in $ value; industrial production and retail sales in local currency.
[1]3-month moving average. [2]Includes People's Republic of China; NIEs (Hong Kong, China; Republic of Korea; Singapore; and Taipei,China); and ASEAN-5 (Indonesia, Malaysia, Philippines, Thailand, and Viet Nam). [3]Does not include Hong Kong, China for which monthly data unavailable. [4]Does not include Malaysia and Philippines for which monthly data unavailable. Data on industrial production and retail sales until Apr 2010.
Source: OREI staff calculations based on CEIC data.

Figure 4a: Domestic Demand Growth—NIEs[1]
(y-o-y, %)

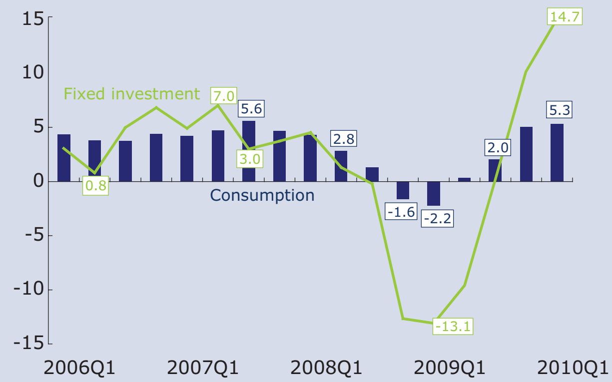
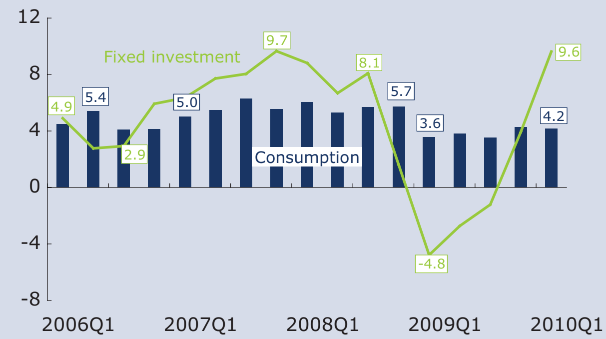


Figure 4b: Domestic Demand Growth—ASEAN-4[2]
(y-o-y, %)



y-o-y = year-on-year.
[1]Includes Hong Kong, China; Republic of Korea; Singapore; and Taipei,China.
[2]Includes Indonesia, Malaysia, Philippines, and Thailand.
Source: OREI staff calculations based on CEIC data.

Strong domestic demand and the revival of external demand are driving the recovery; both business sentiment and consumer confidence continue to improve.

In the first quarter of 2010, domestic demand was the largest source of GDP growth in the region **(Figures 4a, 4b)**. Consumption and investment accounted for all growth in the four middle-income economies of the Association of Southeast Asian Nations (ASEAN-4)[2] and almost all growth in the newly industrialized economies (NIEs).[3] Fixed investment growth in the NIEs surged 14.7% in the first quarter of 2010 compared with 9.5% the previous quarter. In ASEAN-4, fixed investment also expanded strongly, growing 9.6%, well above the 3.9% fourth quarter 2009 growth. Consumption also recovered in the first quarter of 2010, growing 5.3% and 4.2% in the NIEs and ASEAN-4, respectively. Domestic demand grew from both improved consumer confidence and macroeconomic stimulus **(Figure 5)**. In the PRC, continued strong retail sales suggests that private consumption remains strong as well **(Figure 6)**.

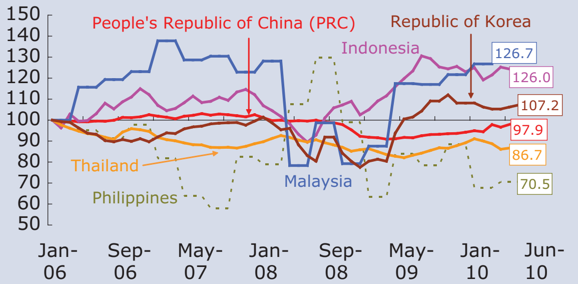
Largely due to rapid investment and economic stimulus, growth in the PRC was the fastest since the global financial crisis began.

In the PRC, the economy expanded at its fastest annual rate since 2007, growing 11.1% in the first half of 2010, from 10.7% in the fourth quarter of 2009. Growth was driven by strong investment and

[2]Indonesia, Malaysia, Philippines, and Thailand.

[3]Hong Kong, China; Republic of Korea (Korea); Singapore; and Taipei,China.

Figure 5: Consumer Confidence Indexes–Selected Economies (January 2006 = 100)



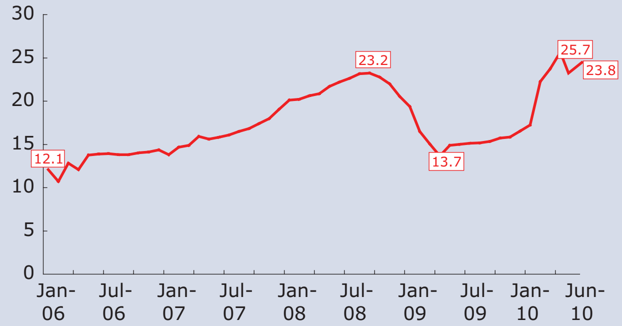
Notes: China Consumer Confidence Index for the PRC, Indonesia Consumer Confidence Index for Indonesia, South Korea Composite Consumer Sentiment Index (quarterly prior July 2008) for the Republic of Korea, Malaysia Consumer Sentiments Index (quarterly) for Malaysia, Consumer Confidence Index for the Philippines, and Thailand Consumer Confidence Index for Thailand.
Source: National Bureau of Statistics (People's Republic of China), Bank Indonesia (Indonesia), Korea National Statistical Office and Bank of Korea (Republic of Korea), Malaysia Institute of Economic Research (Malaysia), Bangko Sentral ng Pilipinas (Philippines), and The University of the Thai Chamber of Commerce (Thailand).

robust consumer spending. Fixed asset investment grew 25.5% in June, mostly from real estate **(Figure 7)**. Consumption remained robust as retail sales grew 23.8% in June. Exports, badly hit last year, have recovered strongly, expanding 40.9% in June **(Figure 8)**. However, a rapid increase in imports during the first quarter brought the trade surplus down sharply—by more than 40% during the first 6 months—compared with last year. This suggests net exports continued to subtract from GDP growth.

Economic recovery in the NIEs continued to gather steam, supported by the return of external demand and strong investment.

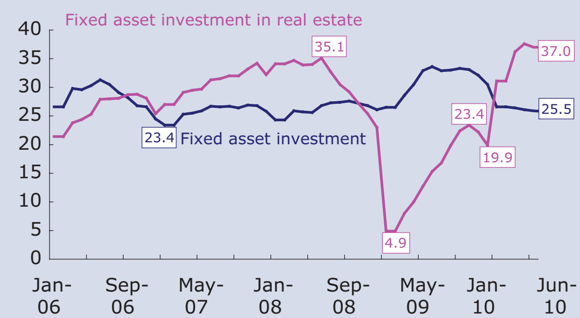
In aggregate, the NIEs grew 10.1% in the first quarter of 2010 compared with 6.1% the previous quarter. Singapore had the fastest growth, expanding 16.9% due to strong performance from the manufacturing sector, especially electronics. Advance estimates show Singapore's economy grew an even stronger 19.3% in the second quarter. Taipei,China also had a good first quarter, its economy growing 13.3%, the highest in 30 years. Strong private investment and recovering

Figure 6: Retail Sales Growth[1]—People's Republic of China (y-o-y, %)



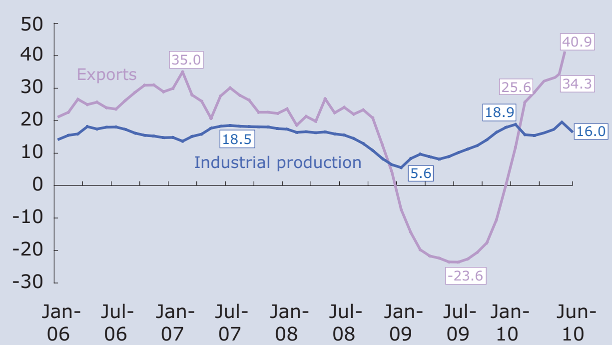
y-o-y = year-on-year.
[1]3-month moving average.
Source: OREI staff calculations based on CEIC data.

Figure 7: Fixed Asset Investment—People's Republic of China (nominal, year-to-date, y-o-y growth)



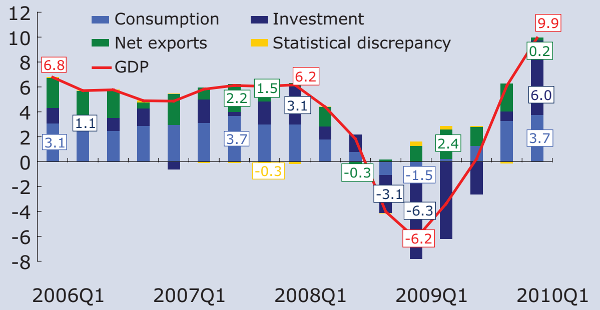
y-o-y = year-on-year.
Source: CEIC.

Figure 8: Exports and Industrial Production Growth[1]—People's Republic of China (y-o-y, %)



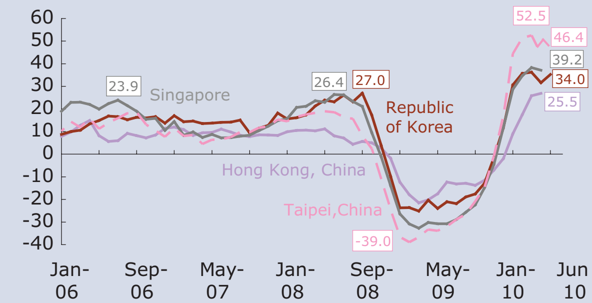
y-o-y = year-on-year.
Note: Exports in $ value; industrial production in local currency.
[1]3-month moving average. Data on industrial production until May 2010.
Source: OREI staff calculations based on CEIC data.

Figure 9: Contributions to GDP Growth—NIEs[1]
(y-o-y, %, percentage points)



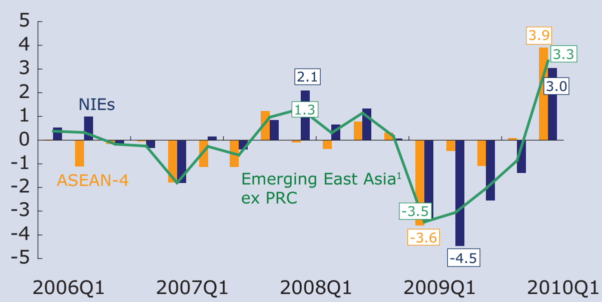
GDP = gross domestic product, y-o-y = year-on-year.
[1]Refers to Hong Kong, China; Republic of Korea; Singapore; and Taipei,China.
Source: OREI staff calculations based on CEIC data.

Figure 11: Merchandise Export Growth[1]—NIEs
($ value, y-o-y, %)



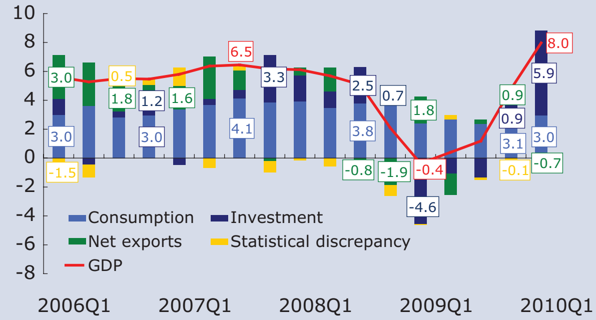
y-o-y = year-on-year.
[1]3-month moving average. Data for Hong Kong, China and Singapore until May 2010.
Source: OREI staff calculations based on CEIC data.

Figure 10: Contribution of Changes in Inventories to GDP Growth—ASEAN-4 and NIEs
(y-o-y, %, percentage points)



GDP = gross domestic product, PRC = People's Republic of China, y-o-y = year-on-year.
[1]Refers to ASEAN-4 (Indonesia, Malaysia, Philippines, and Thailand) plus NIEs (Hong Kong, China; Republic of Korea; Singapore; and Taipei,China). Weighted by gross national income (atlas method, current $).
Source: OREI staff calculations based on CEIC data.

Figure 12: Contributions to GDP Growth—ASEAN-4[1] (y-o-y, %, percentage points)



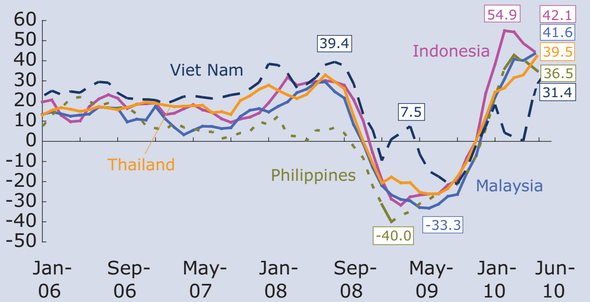
GDP = gross domestic product, y-o-y = year-on-year.
[1]Refers to Indonesia, Malaysia, Philippines, and Thailand.
Source: OREI staff calculations based on CEIC data.

exports drove the growth surge. In the first quarter, Hong Kong, China and Republic of Korea (Korea) grew 8.2% and 8.1%, respectively. Investment and consumption powered the NIEs' growth **(Figure 9)**. Growth in investment was largely due to restocking—after running down inventories last year **(Figure 10)**. The NIEs also benefited from the recovery in world trade, with exports rebounding strongly, growing 36.2% in May 2010 **(Figure 11)**.

After suffering its biggest slowdown last year since the 1997/98 Asian financial crisis, ASEAN-4 returned to robust growth in the first half of 2010.

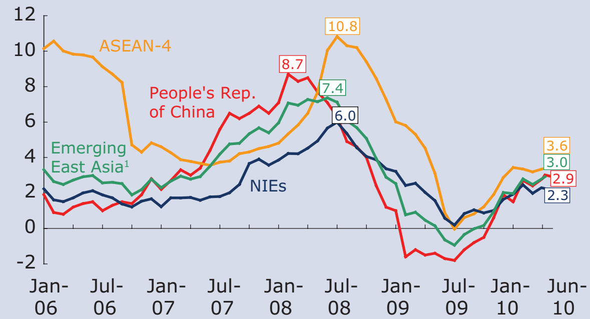
ASEAN-4 economies grew 8.0% in the first quarter of 2010, up from 4.8% the previous quarter. Like the NIEs, growth was driven mainly by investment and consumption **(Figure 12)**. Inventory restocking was a large part of the investment across the region. The economies of Thailand and

Figure 13: Merchandise Export Growth[1]—ASEAN-4 and Viet Nam ($ value, y-o-y, %)



y-o-y = year-on-year.
[1]3-month moving average. Data for Indonesia, Malaysia, Philippines, and Thailand until May 2010.
Source: OREI staff calculations based on CEIC data.

Figure 14: Headline Inflation (y-o-y, %)



ASEAN-4 = Indonesia, Malaysia, Philippines, and Thailand; NIEs = Hong Kong, China; Republic of Korea; Singapore; and Taipei,China; y-o-y = year-on-year.
[1]Refers to ASEAN-4, NIEs, People's Republic of China, and Viet Nam. Weighted using gross national income (atlas method, current $).
Source: OREI staff calculations based on CEIC data.

Malaysia performed best, with GDP expanding 12.0% and 10.1%, respectively. More open, they benefited from the upswing in global demand **(Figure 13)**. The Philippine economy grew 7.3% in the first 3 months of the year, boosted by election-related government spending and investment. And in Indonesia, GDP grew 5.7% in the first quarter with private consumption and investment as the main contributors.

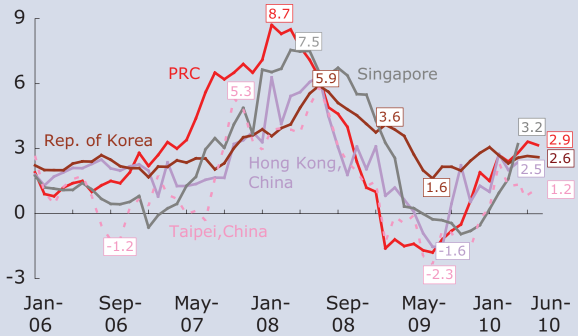
Among the other ASEAN economies, Viet Nam's growth improved in the first half of 2010 after a major slowdown last year.

Viet Nam grew 6.4% in the second quarter of 2010, up from 5.8% in the first quarter. Cambodia's economy contracted 2.0% in 2009 after growing 6.7% in 2008. In the Lao People's Democratic Republic (Lao PDR), GDP grew 6.5% in 2009 due to construction related to the South East Asian games and higher mineral production. GDP in Brunei Darussalam contracted for the second year in a row, falling 1.2% in 2009 due to lower oil and gas output. And in Myanmar, economic growth is expected to grow to 4.4% in 2009 from 3.6% in 2008.

As recovery strengthened, inflation across the region edged upward, but remains manageable.

Headline inflation has increased across all of emerging East Asia. But it is still relatively low and by and large manageable. In May, prices rose by 3.0% across the region, mainly due to higher inflation in the PRC, Viet Nam, and Singapore **(Figures 14, 15a)**. Viet Nam continues to post the highest inflation rate in the region—8.7% in June **(Figure 15b)**. Core inflation has also begun to pick up across much of emerging East Asia **(Figures 16a, 16b)**. Low interest rates and the strong economic recovery have also pushed up housing prices in the region **(Figures 17a, 17b)**.

Figure 15a: Headline Inflation—NIEs and PRC (y-o-y, %)



PRC = People's Republic of China, y-o-y = year-on-year.
Source: OREI staff calculations based on CEIC data.

Figure 15b: Headline Inflation—Selected ASEAN Economies (y-o-y, %)

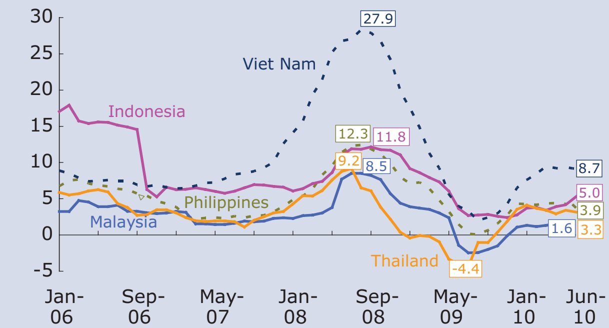


Figure 16a: Core Inflation—NIEs (y-o-y, %)

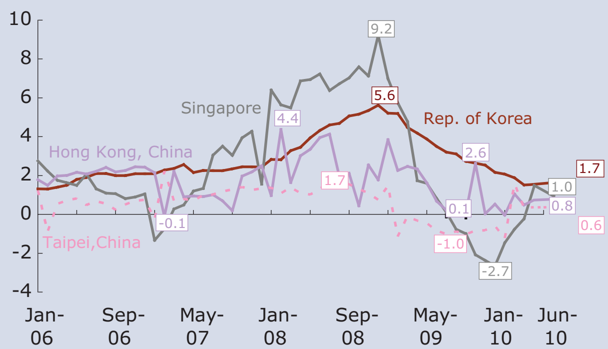
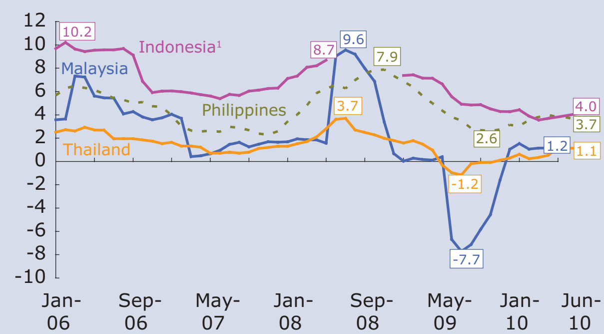


Figure 16b: Core Inflation—ASEAN-4 (y-o-y, %)



y-o-y = year-on-year.
Note: Official figures, except for Hong Kong, China (excluding food and utilities); Singapore (excluding food and private transport); and Malaysia (excluding food, fuel, and utilities).
[1]Series break due to unavailability of data.
Source: OREI staff calculations based on CEIC data.

Figure 17a: Housing Prices[1]—PRC, Indonesia, Malaysia, and Thailand (%, y-o-y growth)

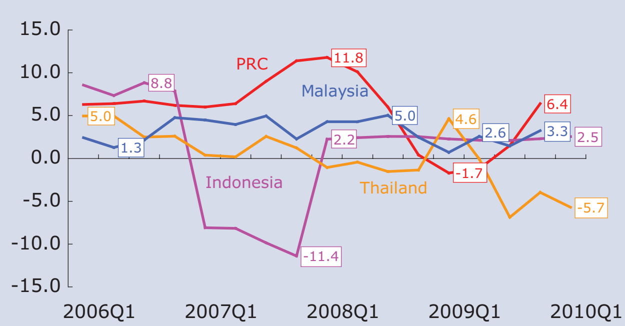
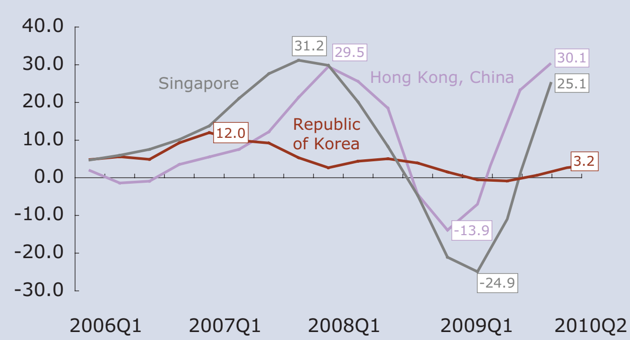


Figure 17b: Housing Prices[2]—NIEs[3] (%, y-o-y growth)[4]



y-o-y = year-on-year.
[1]Data for People's Republic of China (PRC) and Indonesia refer to residential property price index; Thailand refers to housing price index. Data for PRC and Malaysia as of 2009Q4. [2]Data for Hong Kong, China; and Singapore refer to residential property price index; Republic of Korea refer to housing price index. Data for Hong Kong, China and Singapore until 2010Q1. [3]Excludes Taipei,China for which data is unavailable. [4]3-month average for Hong Kong, China; and Republic of Korea.
Source: OREI staff calculations based on CEIC data.

Balance of Payments

Balance of payments were strong across the region as current accounts remained in surplus and capital continued to flow into the region.

Across the region, balance of payments were healthy in the first quarter of the year **(Tables 1a, 1b, 1c)**. The NIEs had an overall balance of payments surplus of 8.6% of GDP, below the 14.3% in the second half of 2009. Both current and capital and financial accounts showed smaller surpluses. In ASEAN-4, the overall balance of payments also showed smaller surplus in the first quarter of 2010 compared with the second half of 2009. Still, in line with continuing surpluses overall, most emerging East Asian economies added significantly to their foreign exchange reserves. An exception was Viet Nam, where low levels of reserves continued to fall, with the import cover—2.5 months as of December 2009—a cause for concern **(Table 2)**.

However, with imports rising faster than exports, trade surpluses in many emerging East Asian economies narrowed somewhat in the first half of the year.

For ASEAN-4, the current account surplus remained at 5.3% of GDP in the first quarter of 2010. Although the trade surplus narrowed as imports expanded faster than exports, a better net services balance offsets the smaller net goods balance **(Figures 18, 19)**. In the NIEs, the smaller trade balance led to a narrowing of the current account surplus to 5.3% in the first quarter. The PRC had a trade surplus of about $20 billion in May. But smaller surpluses early in 2010 should bring PRC's current account surplus down for the first half. PRC's cumulative trade balance in the first half of 2010 was about $55.3 billion compared with $96.2 billion during the same period last year.

Table 1a: Balance of Payments—ASEAN-4 (% of GDP)

	2000–2004 Average	2004H1	2004H2	2005H1	2005H2	2006H1	2006H2	2007H1	2007H2	2008H1	2008H2	2009H1	2009H2	2010Q1
Current Account	**4.2**	**2.0**	**4.0**	**0.7**	**2.7**	**4.1**	**6.4**	**5.6**	**6.8**	**4.5**	**3.0**	**7.1**	**5.3**	**5.3**
Net goods balance	8.3	5.8	7.9	3.6	6.4	6.3	8.1	6.9	7.8	5.7	4.7	7.8	7.0	6.3
Net services	-2.1	-1.3	-1.7	-1.4	-1.9	-0.9	-0.8	-0.4	-0.2	-0.4	-0.8	-0.3	-0.6	0.2
Net income	-3.6	-3.9	-3.6	-3.5	-4.1	-3.3	-3.0	-2.8	-2.7	-2.6	-2.6	-2.3	-2.6	-2.6
Net transfers	1.4	1.4	1.3	1.9	2.3	2.0	2.0	1.9	1.8	1.7	1.7	1.9	1.5	1.4
Capital and Financial Account	**-1.8**	**0.6**	**2.2**	**3.2**	**-1.9**	**1.6**	**-1.9**	**1.1**	**-2.3**	**2.8**	**-6.7**	**-4.5**	**0.3**	**1.3**
Capital account	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Net direct investment	0.9	0.9	1.3	2.7	1.8	1.8	1.4	1.0	0.5	0.5	0.0	0.5	-0.5	0.7
Net portfolio investment	0.2	1.5	3.0	2.1	0.6	1.9	1.6	4.3	-2.2	0.8	-5.7	-1.3	1.6	3.4
Net other investment	-2.9	-1.9	-2.1	-1.7	-4.4	-2.2	-5.0	-4.2	-0.7	1.4	-1.0	-3.7	-0.8	-2.8
Net errors & omissions	-0.4	0.9	-0.9	-0.8	-0.4	-0.1	-1.0	-0.2	-0.7	0.1	-0.4	0.7	-1.1	-3.5
Overall Balance	**2.0**	**3.4**	**5.4**	**3.1**	**0.4**	**5.6**	**3.5**	**6.5**	**3.8**	**7.4**	**-4.1**	**3.3**	**4.5**	**3.1**

ASEAN-4 = Indonesia, Malaysia, Philippines, and Thailand; GDP = gross domestic product.
Source: *International Financial Statistics*, International Monetary Fund; and CEIC.

Table 1b: Balance of Payments—NIEs (% of GDP)

	2000–2004 Average	2004H1	2004H2	2005H1	2005H2	2006H1	2006H2	2007H1	2007H2	2008H1	2008H2	2009H1	2009H2	2010Q1
Current Account	**5.2**	**5.5**	**7.4**	**4.9**	**5.6**	**4.3**	**6.4**	**5.7**	**6.4**	**4.1**	**5.5**	**9.5**	**7.5**	**5.3**
Net goods balance	4.7	5.2	6.7	4.7	5.9	4.2	5.5	4.2	5.0	1.6	1.5	6.1	5.2	2.4
Net services	0.5	0.8	0.5	0.5	0.8	0.7	1.0	1.3	1.8	2.0	2.8	2.3	2.0	1.8
Net income	0.6	0.2	0.9	0.4	-0.5	0.3	0.5	0.8	0.3	1.2	1.7	1.6	0.9	1.8
Net transfers	-0.6	-0.8	-0.7	-0.7	-0.6	-0.8	-0.6	-0.7	-0.6	-0.7	-0.4	-0.5	-0.7	-0.7
Capital and Financial Account	**-1.2**	**1.3**	**-3.0**	**0.3**	**-4.4**	**-1.3**	**-3.1**	**-4.3**	**-4.6**	**-1.1**	**-7.4**	**1.0**	**7.1**	**2.6**
Capital account	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	0.0	0.0	0.2	0.4	0.3	0.3
Net direct investment	0.5	-0.5	0.1	1.3	-0.1	0.5	0.2	-0.1	-1.5	-0.9	1.9	-0.2	-0.4	-0.1
Net portfolio investment	-2.7	-6.5	-0.4	-4.5	-0.5	-2.8	-5.4	-5.1	-4.5	-4.0	-6.7	-2.0	-2.2	-1.6
Net other investment	1.3	8.4	-2.5	3.9	-3.6	1.2	2.3	1.0	1.4	3.8	-2.8	2.8	9.4	4.1
Net errors & omissions	0.5	0.8	0.7	0.2	0.6	0.0	-0.1	0.8	0.9	-0.2	0.7	0.2	-0.2	0.7
Overall Balance	**4.5**	**7.5**	**5.1**	**5.4**	**1.8**	**3.0**	**3.1**	**2.2**	**2.8**	**2.9**	**-1.1**	**10.7**	**14.3**	**8.6**

NIEs = Hong Kong, China; Republic of Korea; Singapore; and Taipei,China; GDP = gross domestic product.
Source: *International Financial Statistics,* International Monetary Fund; and CEIC.

Table 1c: Balance of Payments—People's Republic of China (% of GDP)

	2000–2004 Average	2004H1	2004H2	2005H1	2005H2	2006H1	2006H2	2007H1	2007H2	2008H1	2008H2	2009H1	2009H2
Current Account	**2.4**	**0.9**	**5.7**	**6.8**	**7.4**	**7.7**	**10.6**	**10.8**	**10.4**	**9.6**	**9.6**	**6.3**	**5.9**
Net goods balance	2.9	0.7	4.9	5.5	6.3	6.7	9.0	9.0	9.0	6.7	9.0	5.6	4.7
Net services	-0.5	-0.7	-0.4	-0.4	-0.4	-0.5	-0.2	-0.2	-0.2	-0.2	-0.3	-0.8	-0.5
Net income	-0.9	-0.3	-0.1	0.5	0.5	0.3	0.8	0.9	0.6	1.9	0.1	0.8	1.0
Net transfers	0.9	1.2	1.2	1.2	1.0	1.1	1.0	1.2	1.1	1.2	0.9	0.7	0.7
Capital and Financial Account	**2.8**	**7.9**	**4.1**	**3.9**	**1.9**	**3.3**	**-2.1**	**6.0**	**-0.8**	**3.6**	**-2.1**	**2.9**	**3.0**
Capital account	0.0	0.0	0.0	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net direct investment	3.0	3.6	2.1	2.3	3.6	2.6	1.7	3.4	3.5	2.0	2.1	0.7	0.7
Net portfolio investment	-0.2	3.3	-0.7	-0.1	-0.3	-2.5	-2.5	-0.3	1.2	1.0	0.9	0.9	0.7
Net other investment	0.0	1.0	2.7	1.5	-1.5	3.0	-1.4	2.8	-5.6	0.5	-5.2	1.1	1.6
Net errors & omissions	0.4	-0.9	1.7	-0.5	2.5	-0.7	2.2	0.9	0.1	0.9	0.3	-0.4	-1.2
Overall Balance	**5.6**	**7.9**	**11.4**	**10.1**	**11.8**	**10.3**	**10.6**	**17.7**	**9.7**	**14.1**	**7.8**	**8.7**	**7.7**

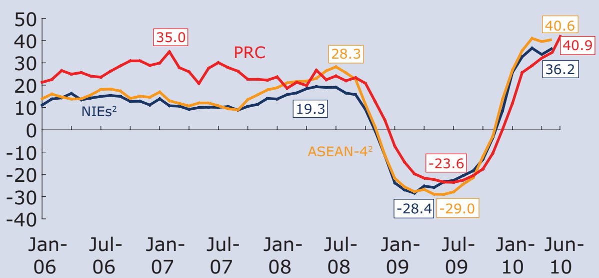
GDP = gross domestic product.
Source: *International Financial Statistics,* International Monetary Fund; and CEIC.

Table 2: Total Reserves (excluding gold)

	Value ($ billion)					% Change (y-o-y)				% Change (m-o-m)			
	Jun-09	**Sep-09**	**Dec-09**	**Mar-10**	**Jun-10**	**Sep-09**	**Dec-09**	**Mar-10**	**Jun-10**	**Mar-10**	**Apr-10**	**May-10**	**Jun-10**
Brunei Darussalam	0.9	1.3	1.4	—	—	82.7	80.7	—	—	—	—	—	—
Cambodia	2.6	2.8	2.9	3.0	—	18.9	24.4	27.4	—	1.9	3.4	—	—
China, People's Rep. of	2135.2	2288.5	2416.0	2463.5	—	20.0	23.9	25.9	—	0.9	—	—	—
Hong Kong, China	206.9	226.8	255.7	258.8	256.1[3]	41.3	40.1	38.9	24.9	0.2	0.2	-1.2	—
Indonesia	55.4	60.0	63.6	69.2	73.4	9.0	28.1	31.5	32.6	3.1	9.6	-5.4	2.3
Korea, Republic of	231.7	254.2	269.9	272.3	274.1	6.1	34.2	32.0	18.3	0.6	2.4	-3.1	1.5
Lao People's Democratic Republic	0.6	0.7	0.7	—	—	10.4	11.8	—	—	—	—	—	—
Malaysia	91.2	94.8	95.4	94.0	93.3	-13.4	4.7	7.5	2.3	-1.6	0.7	-0.5	-1.0
Myanmar	—	—	—	—	—	—	—	—	—	—	—	—	—
Philippines	34.8	37.5	38.8	39.6	41.6	14.2	16.8	14.9	19.5	-1.3	2.5	0.9	1.3
Singapore	173.2	182.0	187.8	197.1	200.0	7.8	7.8	18.6	15.5	4.9	3.2	-2.5	0.8
Taipei,China	317.6	332.2	348.2	355.0	362.4	18.2	19.4	18.3	14.1	0.7	0.7	0.7	0.6
Thailand	118.3	129.1	135.5	141.1	140.2[3]	29.0	24.7	24.0	—	1.6	2.3	-2.9	—
Viet Nam	20.3	18.8	16.4	—	—	-21.3	-31.2	—	—	—	—	—	—
Emerging East Asia	**3388.5[1]**	**3628.7[1]**	**3832.3[1]**	**3893.6[2]**	**1441.1[4]**	**17.7[1]**	**23.3[1]**	**25.3[2]**	**17.4[6]**	**1.0[2]**	**1.9[5]**	**-1.6[4]**	**0.8[6]**
Japan	996.2	1028.1	1022.2	1015.3	1019.6	5.5	1.3	1.9	2.4	-0.8	0.3	-0.6	0.8
East Asia	**4384.7[1]**	**4656.8[1]**	**4854.5[1]**	**4908.9[2]**	**2460.7[4]**	**14.8[1]**	**17.9[1]**	**19.7[2]**	**10.7[6]**	**0.6[2]**	**1.2[5]**	**-1.2[4]**	**0.8[6]**

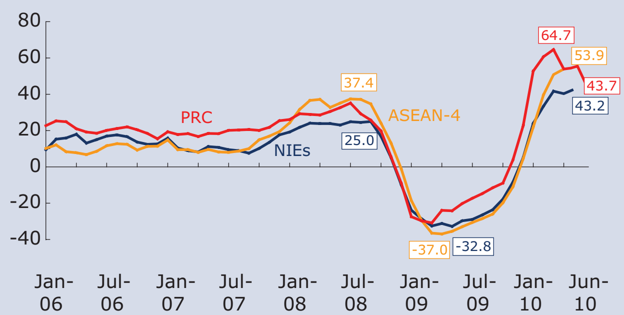
m-o-m = month-on-month, y-o-y = year-on-year, — = data unavailable.
[1]Excludes Myanmar as data unavailable. [2]Excludes Brunei Darussalam, Lao People's Democratic Republic, Myanmar, and Viet Nam as data unavailable. [3]May 2010. [4]Excludes Brunei Darussalam; Cambodia; People's Republic of China; Lao People's Democratic Republic; Myanmar; and Viet Nam as data unavailable. [5]Excludes Brunei Darussalam; People's Republic of China; Lao People's Democratic Republic; Myanmar; and Viet Nam as data unavailable. [6]Excludes Brunei Darussalam; Cambodia; People's Republic of China; Hong Kong, China; Lao People's Democratic Republic; Myanmar; Thailand; and Viet Nam as data unavailable.
Source: *International Financial Statistics,* International Monetary Fund; CEIC; and national sources.

Figure 18: Merchandise Export Growth[1]—PRC, NIEs, and ASEAN-4 ($ value, y-o-y, %)



PRC = People's Republic of China, y-o-y = year-on-year.
[1]3-month moving average. [2]ASEAN-4 includes Indonesia, Malaysia, Philippines, and Thailand; NIEs include Hong Kong, China; Republic of Korea; Singapore; and Taipei,China. Data for ASEAN-4 and NIEs until May 2010.
Source: OREI staff calculations based on CEIC data.

Figure 19: Merchandise Import Growth[1]—PRC, NIEs, and ASEAN-4 ($ value, y-o-y, %)

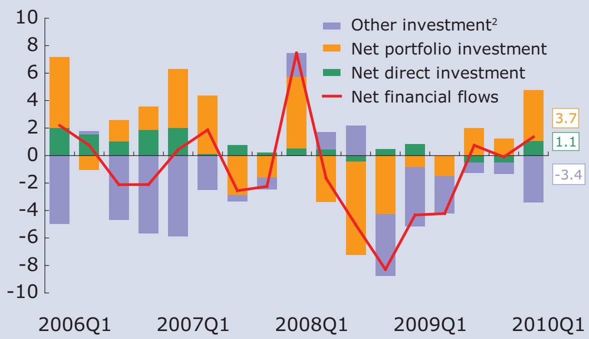


PRC = People's Republic of China; ASEAN-4 = Indonesia, Malaysia, Philippines, and Thailand; NIEs = Hong Kong, China; Republic of Korea; Singapore; and Taipei,China; y-o-y = year-on-year.
[1]3-month moving average. Data for NIEs until May 2010. Data for ASEAN-4 until Apr 2010.
Source: OREI staff calculations based on CEIC data.

Growing confidence in the sustainability of the region's economic recovery led to increased capital flows in the first half of 2010.

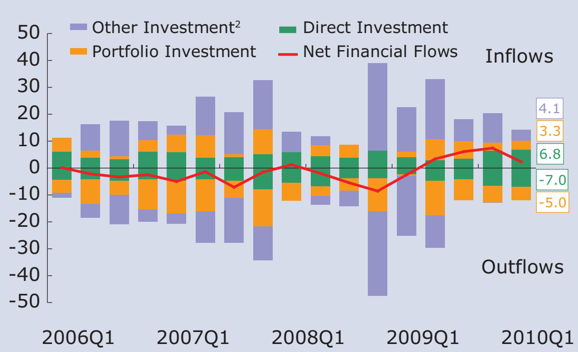
Capital inflows to the region resumed during the first quarter of 2010 with increased confidence in the region's stability and growth. As a result, ASEAN-4 economies posted larger surpluses in capital and financial accounts, mostly due to higher inflows of portfolio investments. Foreign direct investment into the region also resumed **(Figure 20)**. While the NIEs continued to record surpluses in capital and financial accounts in the first quarter of 2010, slower "other investment" inflows left a smaller surplus compared with the fourth quarter of 2009 **(Figure 21)**.

Figure 20: Net Financial Flows—ASEAN-4[1]
(% of GDP)



GDP = gross domestic product.
[1]ASEAN-4 = Indonesia, Malaysia, Philippines, and Thailand. [2]Other investment includes financial derivatives.
Source: OREI staff calculations based on data from *International Financial Statistics,* International Monetary Fund; and national sources.

Figure 21: Financial Account Flows—NIEs[1]
(% of GDP)



GDP = gross domestic product.
[1]NIEs = Hong Kong, China; Republic of Korea; Singapore; and Taipei,China. [2]Other investment includes financial derivatives.
Source: OREI staff calculations based on data from *International Financial Statistics,* International Monetary Fund; and national sources.

Financial Markets and Exchange Rates

After strong gains through March 2010, most emerging East Asian stock markets retreated on the back of the sovereign debt crisis in Europe.

In the first half of 2010, stock markets in the PRC and the NIEs gave up some of the gains from last year **(Figures 22a, 22b, 22c)**. However, ASEAN-4 market indexes continued to rise. PRC markets lost more than a quarter of their value, the biggest drop in the region **(Figure 23)**. Despite recent setbacks, emerging East Asia's equity markets remain comfortably above crisis levels. Stock markets in advanced economies also declined, with the FTSE 100, Dow Jones Industrial Average, and Nikkei 225 all falling during the same period.

Most of the region's currencies appreciated against the US dollar during the first half of 2010, although some have retrenched lately in response to the sovereign debt crisis in Europe.

After the strong gains in the region's currencies in 2009, most appreciated more modestly against the US dollar in the first half of 2010 **(Figure 24)**. The crisis in several eurozone countries caused many of the region's currencies to retreat somewhat against the dollar after April. The Malaysian ringgit gained most, appreciating about 6.4% while the Korean won had the largest depreciation, dropping 4.9%. The Vietnamese dong continued to weaken against the US dollar due to high current account deficits and declining foreign reserves. Against a broader basket of currencies, most of the region's currencies appreciated in both nominal and real terms during the first 5 months of the year, mainly due to the large drop in the euro. Malaysia had the strongest appreciation in nominal effective exchange rate, while the PRC had the largest gains in terms of real effective

Figure 22a: Composite Stock Price Indexes—PRC[1] (last daily price, 2 January 2008 = 100, local index)

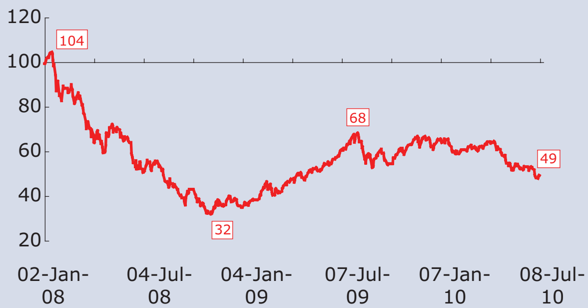


Figure 22b: Composite Stock Price Indexes—NIEs[2] (last daily price, 2 January 2008 = 100, local index)

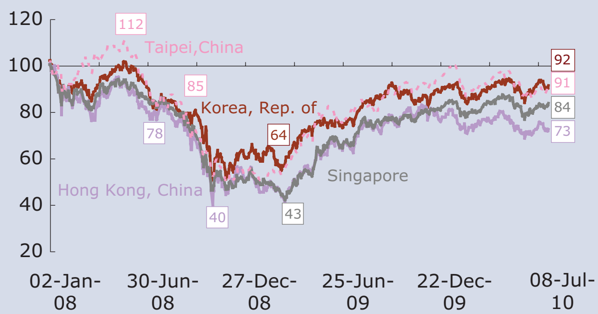
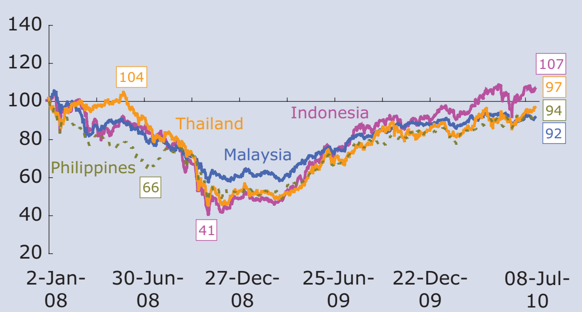
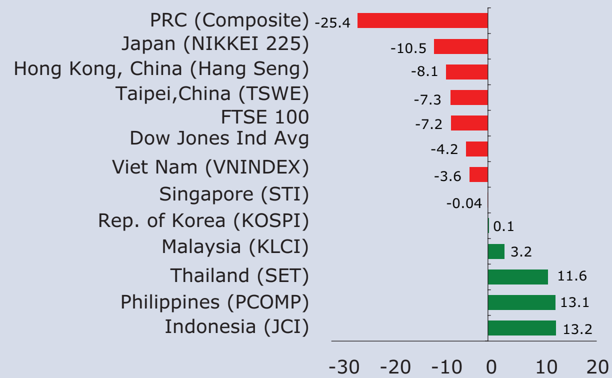


Figure 22c: Composite Stock Price Indexes—ASEAN-4[3] (last daily price , 2 January 2008 = 100, local index)



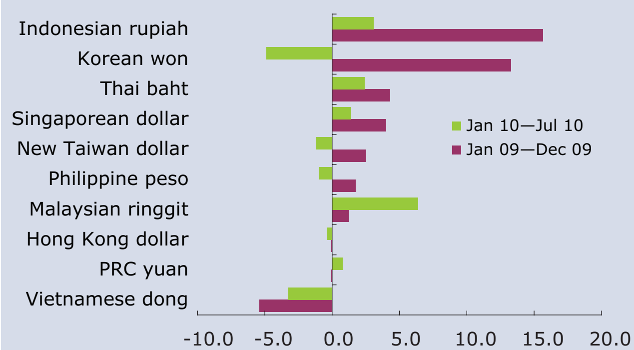
PRC = People's Republic of China.
[1]Daily stock price indexes of combined Shanghai and Shenzhen Composite, weighted by their respective market capitalization. [2]Daily stock price indexes of Hang Seng (Hong Kong, China); KOSPI (Korea); STI (Singapore); and TWSE (Taipei,China). [3]Daily stock price indexes of JCI (Indonesia), KLCI (Malaysia), PCOMP (Philippines), and SET (Thailand).
Source: OREI staff calculations based on Reuters data.

Figure 23: Stock Price Indexes[1]
(4 January 2010 to 8 July 2010, % change)



PRC = People's Republic of China.
[1]Closing as of 8 July 2010.
Source: OREI staff calculations based on data from Reuters and Bloomberg.

Figure 24: Change in Exchange Rate[1]
(% change vs. $)



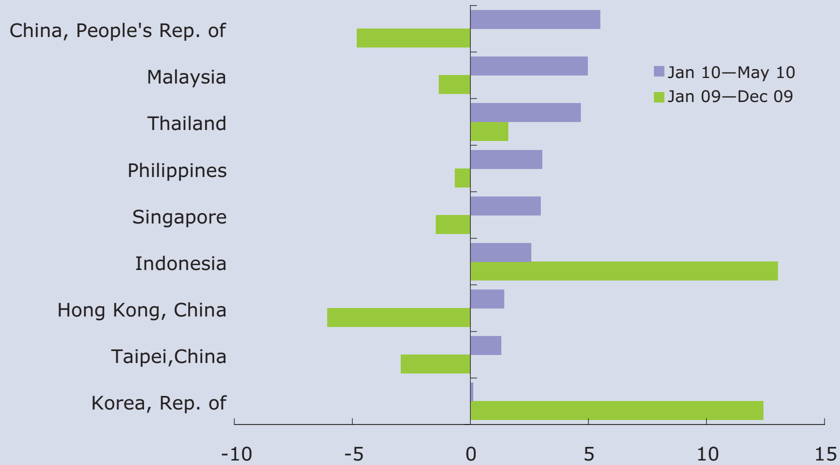
PRC = People's Republic of China.
[1]Closing as of 8 July 2010, based on the local currency value per $. Negative values indicate depreciation of local currency.
Source: OREI staff calculations based on Reuters data.

exchange rate. At the other end, Korea had the smallest appreciation in both nominal and real effective exchange rates **(Figures 25, 26)**.

Bond yields in emerging East Asia generally fell in the first half of 2010 as capital continued to flow in.

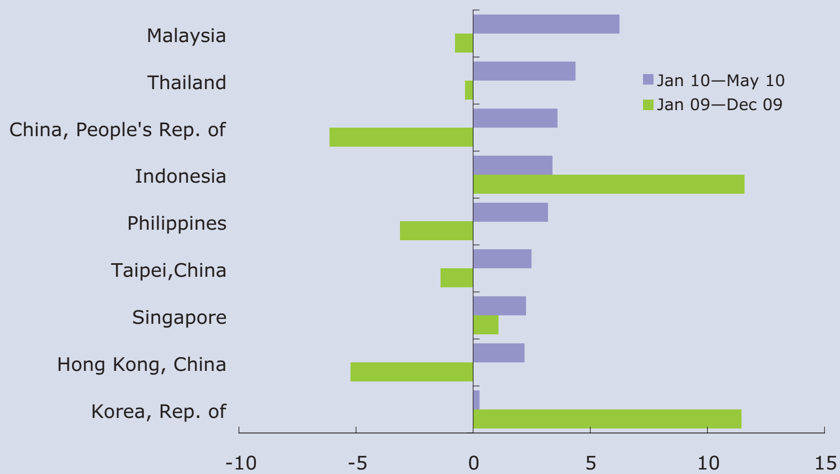
Bond yield curves shifted downward in most emerging East Asian markets in the first half of the year **(Figures 27a, 27b, 27c, 27d, 27e, 27f)**. In the PRC; Malaysia; and Hong Kong, China;

Figure 25: Change in Real Effective Exchange Rate[1] (%)



[1]Consumer price index (CPI)-based.
Source: OREI staff calculations based on data from the Bank for International Settlements.

Figure 26: Change in Nominal Effective Exchange Rate (%)



Source: OREI staff calculations based on data from the Bank for International Settlements.

Figure 27a: Benchmark Yields—People's Republic of China (% per annum)

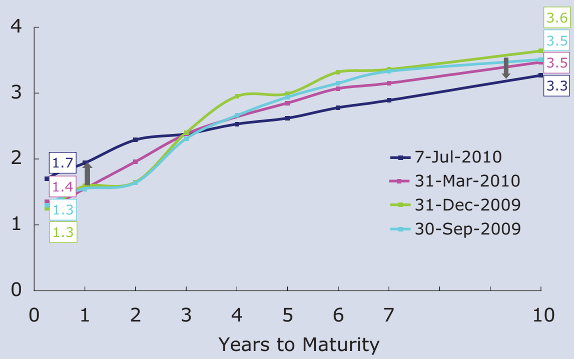


Figure 27b: Benchmark Yields—Hong Kong, China (% per annum)

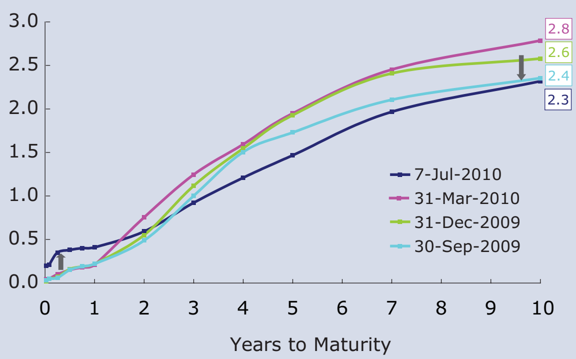
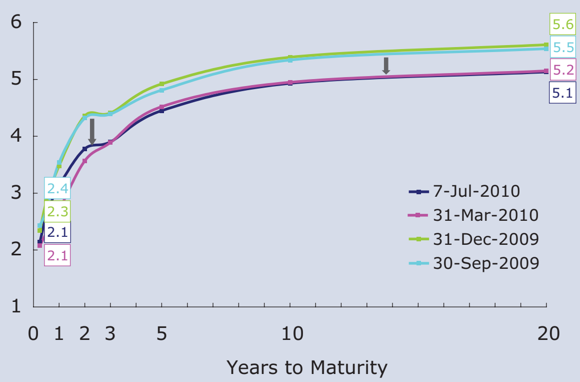


Figure 27c: Benchmark Yields—Republic of Korea (% per annum)



Source: Bloomberg.

Figure 27d: Benchmark Yields—Indonesia (% per annum)

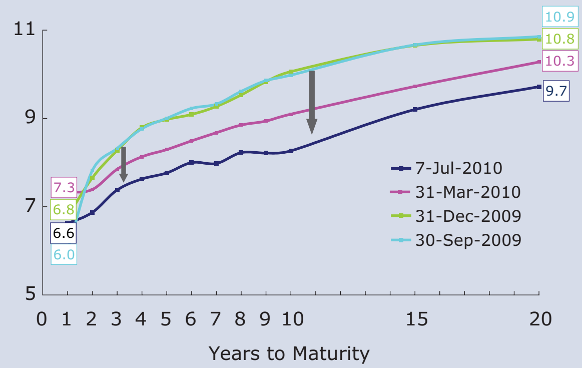


Figure 27e: Benchmark Yields—Malaysia (% per annum)

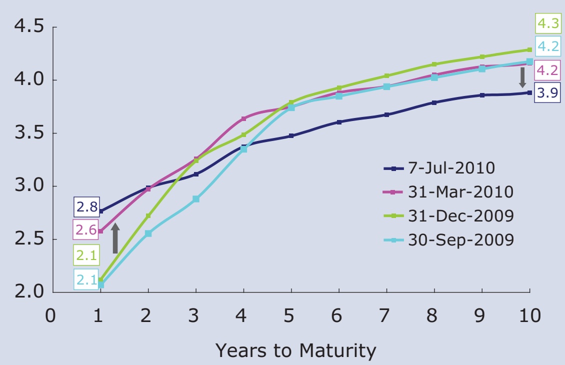
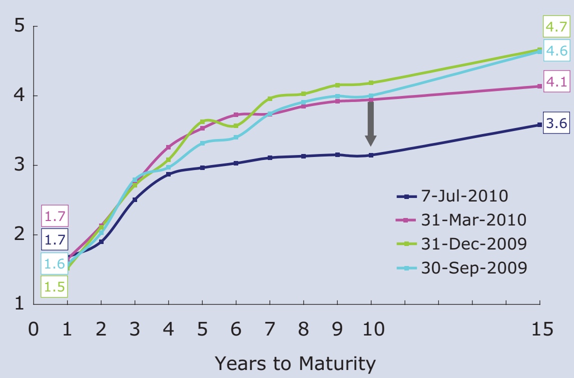


Figure 27f: Benchmark Yields—Thailand (% per annum)



yields at the lower end of the curve increased, but yields for longer maturities declined. This led to a flattening of yield curves in general, as markets anticipated tighter monetary policy to stem inflation. For other economies, the downward shift merely accented the lower risk attributed to the region and greater foreign investor interest in the region's bonds.

Monetary and Fiscal Policy

As recovery gathered momentum, some economies have begun to unwind policy stimulus.

Some economies in the region are recovering faster than others. And in several economies where the recovery is strong, central banks have begun to tighten monetary policy. Still, increased uncertainty over the global economic outlook following the sovereign debt crisis in several European Union (EU) countries may have delayed tightening in some emerging East Asian economies. As economic recovery in the region strengthens further, more economies are planning to unwind fiscal stimulus and begin reducing budget deficits beginning the latter part of this year **(see *Unwinding Policy Stimulus: Options for Emerging East Asia,* page 45)**.

Malaysia; Taipei,China; Korea; and Thailand have raised policy rates, while some others have used alternative tools to tighten monetary policies.

Malaysia increased its policy rate by 25 basis points (bp) three times—from 2.00% to 2.75%—while Taipei,China increased its policy rates by 12.5 bp to 1.375% in June. The latest countries to tighten monetary policy are Korea and Thailand, which both raised their policy rates by 25 bp to 2.25% and 1.50%, respectively, in July **(Figures 28a, 28b)**. The Monetary Authority of Singapore also signaled it would tighten monetary policy by allowing a gradual, modest appreciation of the Singapore dollar (the exchange rate is its preferred monetary policy tool). Although Viet Nam kept policy rates unchanged, it allowed lending rates to rise by lifting lending caps for medium- and long-term loans. In the PRC, authorities used administrative measures to slow down lending, especially in real estate. They also placed quantitative limits on new bank lending in

Figure 28a: Policy Rates[1]—PRC; Hong Kong, China; Rep. of Korea; and Taipei,China (% per annum)

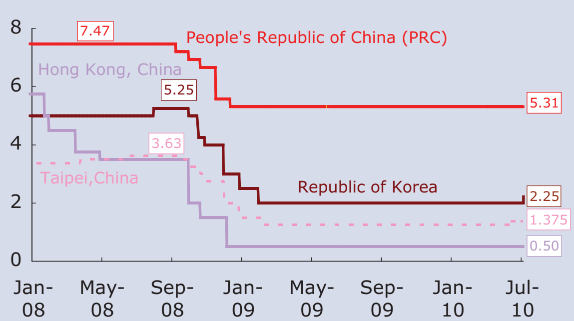
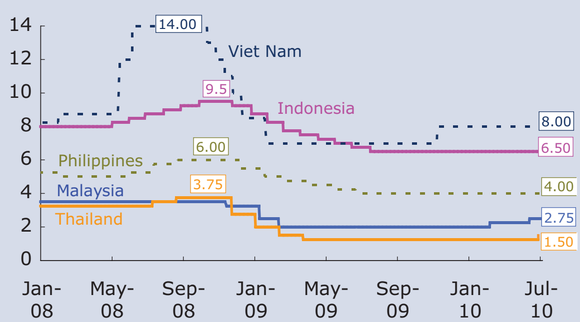


Figure 28b: Policy Rates[2]—ASEAN-4 and Viet Nam (% per annum)



[1]Hong Kong base rate (Hong Kong, China); Korea base rate (Republic of Korea); 1-year lending rate (People's Republic of China); and discount rate (Taipei,China). [2]Bank Indonesia (BI) rate (Indonesia); overnight policy rate (Malaysia); reverse repurchase (repo) rate (Philippines); 1-day repo rate (Thailand); and prime rate (Viet Nam).

Source: Bloomberg, Datastream, and State Bank of Viet Nam website.

2010 to CNY7.5 trillion. In addition, the People's Bank of China raised the reserve requirements for banks. And to discourage speculation in the property market, authorities increased minimum downpayments required for home purchases and reintroduced taxes on properties sold within five years of purchase. The recent move of making the yuan more flexible could lead to monetary tightening if the currency appreciates. While other economies have opted to keep policy rates unchanged for the time being, improving economic conditions suggest they may consider tightening policies soon.

Although several economies have plans to reduce fiscal deficits in 2010, fiscal policy overall continues to be accommodative.

Viet Nam's fiscal deficit—the highest in the region—is expected to fall from 11.8% of GDP in 2009 to 8.3% in 2010. Similarly, Malaysia has also moved to tighten fiscal policy, aiming to reduce its fiscal deficit of 7.0% in 2009 to 5.3% in 2010, partly through the elimination of several subsidies. Most other economies in the region also plan to trim deficits, but their overall fiscal stance will still remain expansionary **(Table 3)**. Cambodia and Indonesia are also expecting to run higher fiscal deficits. While higher fiscal deficits brought increased public debt, overall, public debt levels in the region remain manageable **(Table 4)**.

Financial Vulnerability

Emerging East Asia's financial systems remain stable, with only limited impact from the sovereign debt crisis in Europe.

Concerns over possible sovereign debt defaults in several highly-indebted European countries created some turmoil in emerging East Asia's financial markets. Fortunately, the region's financial systems have been relatively untouched by the crisis. There are few signs of distress in the region's banking systems—with the spread of the interbank rate over government yields showing a brief aberration with no significant rise in credit default swap (CDS) spreads for the region's banks. The strong fiscal and external positions across

Table 3: Fiscal Balance of Central Government (% of GDP)

	2000–2004 Average	2004	2005	2006	2007	2008	2009[2]	2010[3]
Cambodia	-5.7	-4.1	-2.5	-2.7	-2.9	-2.8	-5.9	-7.4
China, People's Rep. of	-2.2	-1.3	-1.2	-1.0	0.6	-0.4	-2.8	-2.8
Hong Kong, China[1]	-2.4	1.7	1.0	4.0	7.7	0.1	0.8	-1.5
Indonesia	-1.5	-1.0	-0.5	-0.9	-1.3	-0.1	-1.6	-2.1
Korea, Rep. of	-1.3	-2.1	-2.5	-2.6	0.4	-2.1	-3.9	-3.0
Malaysia	-5.0	-4.1	-3.6	-3.3	-3.2	-4.8	-7.0	-5.3
Philippines	-4.5	-4.0	-2.7	-1.1	-0.2	-0.9	-3.9	-3.6
Singapore	-0.1	-0.1	0.7	0.0	3.0	0.1	-1.1	-1.1
Taipei,China[1]	-2.7	-2.8	-0.6	-0.3	-0.4	-0.9	-4.0	-4.0
Thailand[1]	-1.2	0.3	0.2	0.1	-1.1	-0.3	-4.8	-3.8
Viet Nam[4]	-4.9	-4.9	-3.6	-1.2	-5.5	-4.1	-11.8	-8.3

Data updated as of 09 July 2010.
[1]Fiscal year. [2]2009 deficit figures are actual, except for Cambodia; People's Republic of China; Hong Kong, China; and Republic of Korea. [3]2010 budget estimates and government targets of respective economies, except Cambodia (International Monetary Fund projection); Republic of Korea; and Viet Nam. [4]State budget balance for 2000-2005. 2005-2010 figures are from *Asian Development Outlook 2010*, Asian Development Bank.
Source: *Asian Development Outlook (various issues)*, ADB; *Article IV* consultation reports, International Monetary Fund; national sources; and CEIC.

Table 4: Public and External Debt (% of GDP)

	2000–2004 Average	2004	2005	2006	2007	2008	2009	2010
Public Sector Debt								
China, People's Republic of	24.0	23.6	17.8	16.5	20.2	17.7	21.0p	—
Hong Kong, China	2.4	2.4	2.2	1.8	1.5	1.3	3.4	—
Indonesia[1]	71.1	55.2	45.6	39.0	35.1	33.2	31.1p	31.0p
Korea, Republic of[1]	20.7	23.7	27.6	30.1	29.7	29.0	32.6	—
Lao People's Democratic Rep.	77.6	88.2	79.7	64.6	60.7	55.2	57.2e	60.9p
Malaysia[2]	42.1	45.7	43.8	42.2	41.7	41.5	53.7	—
Philippines[3]	86.7	95.4	82.2	73.3	63.1	64.3	65.3	—
Singapore	96.8	100.7	99.1	92.4	90.5	95.9	113.1	—
Taipei,China[1]	28.0	29.6	30.2	29.6	28.8	29.8	33.1	—
Thailand	52.8	48.0	46.4	40.3	37.4	38.2	43.8	48.5p
Viet Nam	40.5	42.4	44.5	44.1	46.3	44.4e	47.5p	49.2p
External Debt								
Brunei Darussalam	9.6	8.7	7.7	7.0	7.5	7.9	12.0	—
Cambodia	27.2	25.7	24.6	21.5	21.9	16.0	22.2	—
China, People's Republic of	8.1	6.7	6.8	6.0	7.0	4.6	4.5	—
Hong Kong, China	128.9	138.6	141.6	153.6	173.2	176.3	182.9	—
Indonesia	57.5	42.5	40.5	29.2	26.8	20.6	18.4	—
Korea, Republic of	22.3	20.3	19.1	23.1	26.7	26.4	34.4	—
Lao People's Democratic Rep.	64.9	59.9	62.7	55.1	57.5	45.6	41.0	—
Malaysia	43.2	44.4	44.7	41.5	39.6	27.3	31.5	—
Myanmar	59.5	52.4	42.7	35.7	24.3	9.0	5.2	—
Philippines	78.0	76.9	73.9	60.1	52.5	36.4	40.2	—
Singapore	266.6	270.9	261.4	238.3	265.1	259.7	249.5	—
Taipei,China	14.1	24.6	22.2	18.3	19.5	15.6	14.8	—
Thailand	38.3	26.3	24.8	22.3	17.0	12.0	13.8	—
Viet Nam	29.3	33.2	31.7	31.4	35.3	31.2	29.4	—

e = estimate, GDP = gross domestic product, p = projection, — = unavailable.
[1]Central government debt. [2]Federal government debt. [3]National government debt.
Source: *Article IV* consultation reports, International Monetary Fund (Public debt projections); CEIC (Public debt); and Joint External Debt Hub database (External debt).

much of the region have allowed financial systems to weather the crisis and retain investor confidence. Still, there remain concerns that the crisis in Greece could widen to engulf other European economies.

With few exceptions, countries in the region have robust fiscal and external positions.

While expansionary fiscal policy in the region has resulted in higher budget deficits, levels remain manageable **(Table 5)**. Although Viet Nam's deficit of 11.8% in 2009 is high, it is expected to decline to 8.3% in 2010. Generally, public sector debt as a percent of GDP remains low across emerging East Asia. Both fiscal balances and public debt are much better in the region compared with affected European economies **(Figure 29)**. Except for Cambodia, Lao PDR, and Viet Nam, the external position of the region's economies remains strong. High current account deficits and low foreign reserves

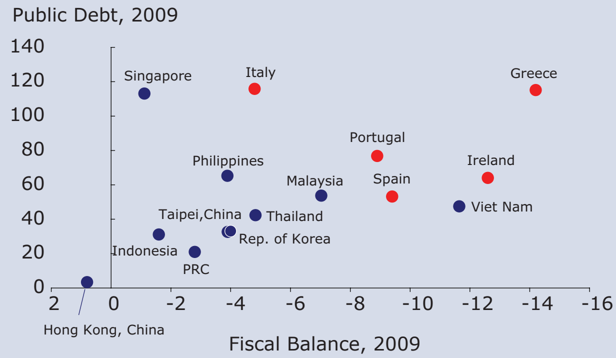
Table 5: Financial Vulnerability (%)

	Inflation Rate (latest available)	**Fiscal Balance/ GDP** (2009)[1]	**Public Sector Debt/ GDP[2]** (latest available)[3]	**Current Acct./ GDP** (latest available)	**External Debt GDP[4]** (2009)	**Short-Term External Debt/ Reserves** (2009)[5]	**Foreign Reserves** (number of months of imports)[6]	**Foreign Liabilities/ Foreign Assets[7]** (latest available)	**Loans/ Deposits of Banks[8]** (latest available)
Brunei Darussalam	1.2 (Dec09)	3.7	—	35.0 (2009)	12.0	41.3	6.6 (Dec09)	5.0 (Apr10)	58.3 (Apr10)
Cambodia	6.7 (Mar10)	-5.9	—	-10.7 (2009)	22.2	3.1	4.9 (Apr10)	42.1 (Apr10)	75.9 (Apr10)
China, People's Rep. of	2.9 (Jun10)	-2.8	21.0 (2009)	6.1 (H209)	4.5	6.2	24.6 (Mar10)	43.6 (Apr10)	73.3 (Apr10)
Hong Kong, China	2.5 (May10)	0.8	3.4 (2009)	6.3 (Q110)	182.9	39.3	7.9 (May10)	67.2 (Feb10)	52.4 (Feb10)
Indonesia	5.0 (Jun10)	-1.6	31.0 (2010)	1.0 (Q110)	18.4	48.2	7.5 (May10)	48.4 (Apr10)	76.3 (Dec09)
Korea, Rep. of	2.6 (Jun10)	-3.9	32.6 (2009)	0.6 (Q110)	34.4	60.9	8.6 (May10)	244.4 (Feb10)	123.2 (Feb10)
Lao People's Democratic Republic	4.8 (May10)	-7.8	60.9 (2010)	-11.8 (2009)	41.0	36.7	2.8 (Dec09)	46.8 (Dec08)	48.8 (Dec08)
Malaysia	1.6 (May10)	-7.0	53.7 (2009)	16.6 (Q110)	31.5	18.3	7.8 (Jun10)	115.0 (Apr10)	76.7 (May10)
Myanmar	7.7 (Mar10)	—	—	-1.0 (2009)	5.2	10.7	4.7 (Jun07)	—	38.0 (Jan10)
Philippines	3.9 (May10)	-3.9	65.3 (2009)	4.4 (Q110)	40.2	38.0	10.5 (Jun10)	49.6 (Apr10)	78.3 (Apr10)
Singapore	3.2 (May10)	-1.1	113.1 (2009)	16.8 (Q110)	249.5	63.2	8.6 (Jun10)	95.1 (Apr10)	78.4 (Apr10)
Taipei,China	1.2 (Jun10)	-4.0	33.1 (2009)	9.8 (Q110)	14.8	11.9	19.6 (Jun10)	52.7 (Apr10)	60.6 (Apr10)
Thailand	3.3 (Jun10)	-4.8	48.5 (2010)	6.7 (Q110)	13.8	9.7	10.6 (May10)	94.8 (Apr10)	94.8 (Apr10)
Viet Nam	8.7 (Jun10)	-11.8	49.2 (2010)	-7.4 (2009)	29.4	36.7	2.5 (Dec09)	94.4 (Dec09)	105.9 (Dec09)

GDP = gross domestic product, — = unavailable.
[1]Budget ratios are 2009 actual for Indonesia; Malaysia; Philippines; Singapore; Taipei,China; and Thailand; IMF *Article IV* consultation reports' 2009 estimates for Brunei Darussalam and Lao People's Democratic Republic; *Asian Development Outlook* estimates for Cambodia; People's Republic of China (PRC); Hong Kong, China; Republic of Korea; and Viet Nam. Overall primary balance (excludes interest and investment income) for Brunei Darussalam; overall balance (including grants) for Lao People's Democratic Republic; and state budget balance for Viet Nam. Data on a fiscal year basis for Hong Kong, China; Lao People's Democratic Republic; Taipei,China; and Thailand. [2]Central government debt for Indonesia; Republic of Korea; and Taipei,China; federal government debt for Malaysia; and national government debt for the Philippines. [3]Data are projections for PRC, Indonesia, Lao People's Democratic Republic, Thailand, and Viet Nam from IMF *Article IV* consultation reports. [4]Total external debt includes cross-border loans from the Bank for International Settlements (BIS) reporting banks and BIS reporting banks to nonbanks, total multilateral loans, total official trade credits, and international debt securities as defined in the Joint External Debt Hub. [5]Short-term external debt includes loans and credits and debt securities due within a year as defined in the Joint External Debt Hub. Total reserves data for Myanmar as of Jun 2007. [6]Refers to total international reserves minus gold over a 12-month moving average of imports (cif) until the latest month when data is available. Imports data may be earlier, during, or later than period indicated. [7]Foreign liabilities and assets of banking institutions, deposit money banks, and other depository corporations. [8]Loans to private sector and non-financial institutions; and deposits (demand, time, savings, and foreign currency), bonds, and money market instruments (when available), of banking institutions, deposit money banks, and other depository corporations of each economy. For Malaysia, ratio covers total loans excluding loans sold to Danaharta and total deposits of the banking system.
Source: CEIC; national sources; *Asian Development Outlook 2010*, Asian Development Bank; Joint External Debt Hub, BIS-IMF-OECD-WB; *International Financial Statistics, Direction of Trade Statistics* and *Article IV* consultation reports, International Monetary Fund.

in Cambodia, Lao PDR, and Viet Nam are causing concern. Nevertheless, the level of external debt in these three countries remains manageable, and most of the external debt in Lao PDR and Viet Nam is from multilateral and official lenders and on concessionary terms.

Figure 29: Public Debt and Fiscal Balances—Emerging East Asia[1] and Selected eurozone Countries (% of GDP)



GDP = gross domestic product, PRC = People's Republic of China.
[1]Does not include Brunei Darussalam, Cambodia, Lao People's Democratic Republic, and Myanmar, for which data are not available.
Source: National sources; *Asian Development Outlook* (various issues), Asian Development Bank; *Article IV* reports, International Monetary Fund; and CEIC.

The region's banking systems remain healthy with ample capital cushions and strong profitability.

Major banks across the region maintain strong capital cushions with risk-weighted capital adequacy ratios well above 10% **(Table 6)**. Bank profitability has been largely unaffected by the global economic crisis. With recovery gaining strength, bank profitability should in fact improve. By boosting liquidity and reducing policy rates, authorities also helped boost bank profits **(Tables 7, 8)**. That nonperforming loans have not increased significantly also helped. Nonperforming loans are expected to remain low as economic conditions improve **(Table 9)**. In Indonesia, Malaysia, and Thailand, financial stocks outperformed stock market indexes. This was also true for the PRC. But in the NIEs—and the Philippines—financial stock prices lagged behind the overall market **(Figures 30a, 30b)**. Banks

Table 6: Risk-Weighted Capital Adequacy Ratios[1] (% of risk-weighted assets)

Economy	2000–2004 Average	2004	2005	2006	2007	2008	2009[2]	2010[3]
China, People's Rep. of	-2.3[4]	-4.7	2.5	4.9	8.4	12.0	10.0	—
Hong Kong, China	16.1	15.4	14.8	14.9	13.4	14.7	16.8	17.0
Indonesia	18.7	19.4	19.3	21.3	19.3	16.8	17.4	19.2
Korea, Republic of	10.7	11.3	12.4	12.3	12.0	12.7	14.6	15.0
Malaysia	13.4	14.3	13.6	13.1	12.8	12.2	14.9	14.6
Philippines	17.0	18.7	17.7	18.5	15.9	15.7	16.0	—
Singapore	17.7	16.2	15.8	15.4	13.5	14.7	16.5	—
Taipei,China	10.5	10.7	10.3	10.1	10.6	10.8	11.6	—
Thailand	13.2	13.0	14.2	14.5	15.4	14.1	16.1	16.7

— = unavailable.
[1]Based on official risk-adjusted capital adequacy ratios and applied to commercial banks for most economies except Hong Kong, China (covers authorized institutions) and the Philippines (covers universal and commercial banks). Data for the Philippines is on a consolidated, not solo, basis. [2]Data for People's Republic of China as of Nov 2009; Singapore as of Sep 2009. [3]Data for Malaysia as of May 2010; Thailand as of Apr 2010; Hong Kong, China and Republic of Korea as of Mar 2010; Indonesia as of Feb 2010. [4]Average of 2000 and 2002–2004 figures. Figure for 2000 is ratio for state commercial banks.
Source: National sources and *Global Financial Stability Report April 2010,* International Monetary Fund.

Table 7: Rate of Return on Commercial Bank Equity (% per annum)

Economy	2000–2004 Average	2004	2005	2006	2007	2008	2009[1]	2010[2]
China, People's Rep. of[3]	—	13.7	15.1	14.9	16.7	17.1	—	—
Hong Kong, China[4]	14.9	17.2	16.7	16.7	21.3	13.0	14.4	—
Indonesia	16.2	22.8	16.7	16.2	17.8	13.4	35.9	—
Korea, Republic of	7.2	18.0	20.3	15.6	16.2	9.0	6.6	—
Malaysia	16.2	16.3	16.8	16.2	19.7	18.5	13.0	—
Philippines	5.9	7.6	9.5	11.5	11.8	7.2	11.4	5.0
Singapore	9.6	11.6	11.2	13.7	12.9	10.7	11.0	—
Taipei,China	4.1	8.8	4.4	-7.3	2.6	-0.7	4.3	—
Thailand	13.3	19.4	16.5	10.2	2.8	12.2	10.9	10.3

— = unavailable.
[1]Data for Indonesia, Malaysia, and Singapore as of Sep 2009. [2]Data for Thailand as of Apr 2010; Philippines as of Mar 2010. [3]Total banking industry, except for 2006, which refers only to four listed state-owned banks. [4]Locally-incorporated banks.
Source: National sources and *Global Financial Stability Report April 2010,* International Monetary Fund.

Table 8: Rate of Return on Commercial Bank Assets (% per annum)

Economy	2000–2004 Average	2004	2005	2006	2007	2008	2009[1]	2010[2]
China, People's Rep. of	0.2	0.5	0.6	0.9	0.9	1.0	1.1	—
Hong Kong, China[3]	1.2	1.7	1.7	1.8	1.9	1.8	1.5	1.3
Indonesia	2.2	3.5	2.6	2.6	2.8	2.3	2.6	2.9
Korea, Republic of	0.4	0.9	1.2	1.1	1.1	0.5	0.4	—
Malaysia	1.3	1.4	1.4	1.3	1.5	1.5	1.2	—
Philippines	0.8	1.0	1.1	1.3	1.4	0.8	1.2	0.6
Singapore	1.1	1.2	1.2	1.4	1.3	1.0	1.1	—
Taipei,China	0.3	0.6	0.3	-0.4	0.1	-0.1	0.3	—
Thailand	0.7	1.3	1.3	0.8	0.2	1.0	0.9	0.9

— = unavailable.
[1]Data for Malaysia and Singapore as of Sep 2009; People's Republic of China as of Jun 2009. [2]Data for Thailand as of Apr 2010; Hong Kong, China and the Philippines as of Mar 2010; Indonesia as of Feb 2010. [3]Net interest margin of retail banks. Year-to-date annualized.
Source: National sources and *Global Financial Stability Report April 2010,* International Monetary Fund.

also have sufficient provisions for nonperforming loans **(Table 10)**. Moody's upgraded Korea's long-term foreign currency sovereign bond rating from A2 to A1, while Standard and Poor's raised Indonesia's rating from BB- to BB. Ratings for the rest of the region's economies remained unchanged **(Figures 31a, 31b, 31c, 31d)**.

As the region's economies recover, bank lending has accelerated, with the exception of the PRC.

With economic conditions in 2009 still uncertain, emerging East Asia's banks were more cautious in extending loans. This is especially true in the NIEs, which recorded much slower loan growth. However, banks have become more accommodative as economic conditions improve. In particular, bank lending in Hong Kong, China staged a strong recovery **(Figure 32a)**. Lending

Table 9: Nonperforming Loans of Commercial Banks (% of total loans)

Economy	2000–2004 Average	2004	2005	2006	2007	2008	2009[1]	2010[2]
China, People's Rep. of	21.0	13.2	8.6	7.1	6.2	2.5	1.6	—
Hong Kong, China[3]	4.0	1.6	1.4	1.1	0.9	1.2	1.3	1.2
Indonesia	10.2	4.5	7.6	6.1	4.1	3.2	3.3	3.5
Korea, Republic of	3.1	2.0	1.3	0.9	0.7	1.2	1.2	1.4
Malaysia[3]	8.9	6.8	5.6	4.8	3.2	2.2	1.8	1.9
Philippines[3]	14.8	12.7	8.5	5.7	4.4	3.5	3.0	3.4
Singapore	5.3	5.0	3.8	2.8	1.5	1.7	2.3	—
Taipei,China	5.2	2.8	2.2	2.1	1.8	1.5	1.2	—
Thailand[3]	13.5	10.9	8.3	7.5	7.3	5.3	4.8	4.6

— = unavailable.
[1]Data for Singapore as of Sep 2009. [2]Data for Malaysia as of May 2010; Philippines as of Apr 2010; Hong Kong, China; Republic of Korea; and Thailand as of Mar 2010. [3]Reported nonperforming loans are gross classified loans of retail banks.
Source: National sources and *Global Financial Stability Report April 2010,* International Monetary Fund.

Table 10: Bank Provisions to Nonperforming Loans (%)

Economy	2000	2008	2009[1]	Economy	2000	2008	2009[1]
China, People's Rep. of	—	116.4	155.0	Philippines	43.7	86.0	93.1
Hong Kong, China	—	71.5	68.3	Singapore	—	109.1	91.0
Indonesia[2]	—	96.9	111.0	Taipei,China	24.1	76.6	95.7
Korea, Republic of	59.5	146.3	139.9	Thailand	—	97.9	99.4
Malaysia[3]	57.2	88.9	95.6				

— = unavailable.
[1]Data for Hong Kong, China and Singapore as of Sep 2009. [2]Values for Indonesia are write-off reserves on earning assets to classified earning assets ratio. [3]Values refer to general, specific, and interest-in-suspense provisions.
Source: National sources and *Global Financial Stability Report April 2010,* International Monetary Fund.

Figure 30a: Ratio of Financial Stock Price Index to Overall Stock Market Index—ASEAN-4
(January 2006 = 100)

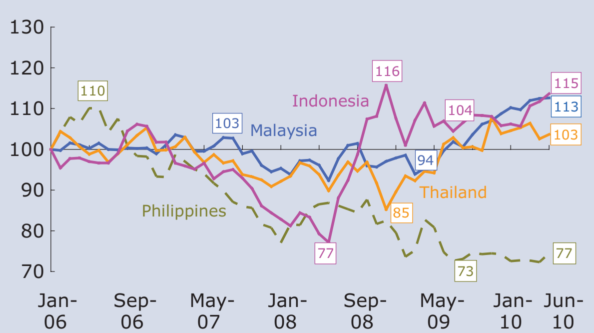
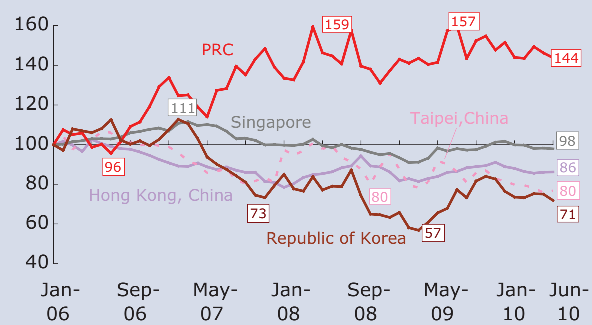


Figure 30b: Ratio of Financial Stock Price Index to Overall Stock Market Index—NIEs and PRC
(January 2006 = 100)



NIEs = newly industrialized economies, PRC = People's Republic of China.
Source: OREI staff calculations using Reuters data.

Figure 31a: S&P Sovereign Ratings—ASEAN-4 and Viet Nam (long-term foreign currency)

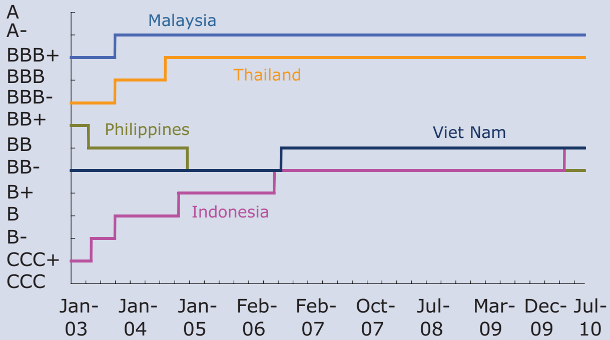


Figure 31c: Moody's Sovereign Ratings—ASEAN-4 and Viet Nam (long-term foreign currency)

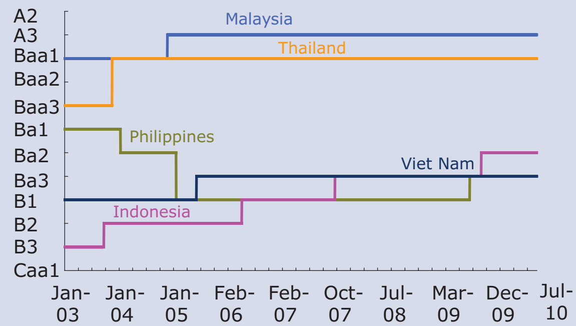


Figure 31b: S&P Sovereign Ratings—NIEs and the PRC (long-term foreign currency)

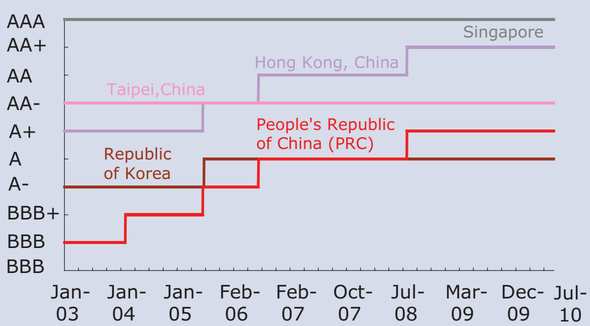
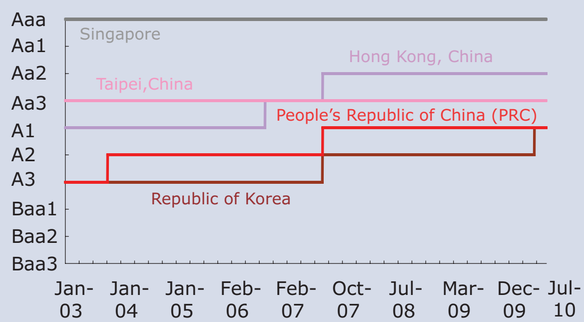


Figure 31d: Moody's Sovereign Ratings—NIEs and the PRC (long-term foreign currency)



NIEs = newly industrialized economies, S&P = Standard and Poor's.
Source: Bloomberg.

Figure 32a: Bank Lending Growth[1]—NIEs (%, y-o-y)

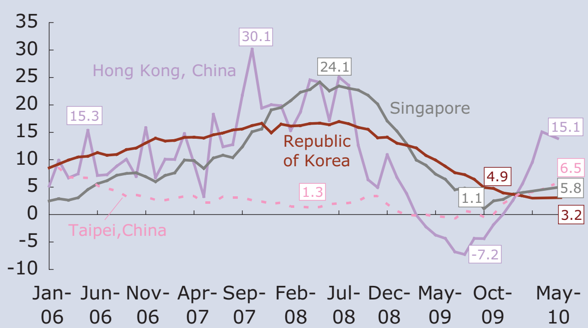
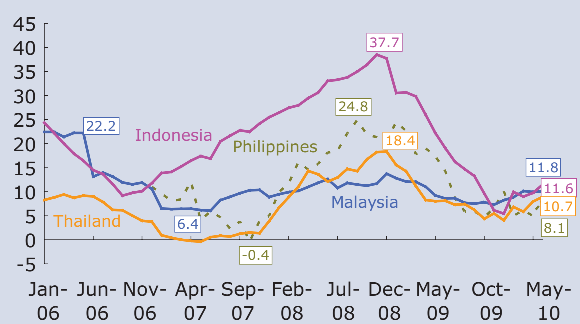
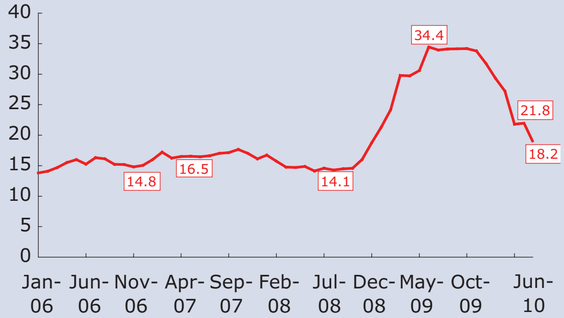


Figure 32b: Bank Lending Growth[2]—ASEAN-4 (%, y-o-y)



NIEs = newly industrialized economies, y-o-y = year-on-year.
[1]Data for Hong Kong, China refer to authorized institutions' loans and advances; Republic of Korea to commercial and specialized bank loans; Singapore to domestic banking unit loans and advances; and Taipei,China to domestic bank loans and advances. [2]Data for Indonesia refer to commercial bank loans; Malaysia to commercial bank loans and advances; Philippines to commercial and universal bank loans net of RRAs (reverse repurchase arrangements), starting in 2007; and Thailand to commercial bank loans. Data for Indonesia and the Philippines are as of Apr 2010.
Source: OREI staff calculation using data from CEIC and Bank of Korea website.

Figure 33: Bank Lending Growth—People's Republic of China (%, y-o-y)



y-o-y = year-on-year.
Data refers to financial institution loans.
Source: CEIC and People's Bank of China.

growth also slowed among ASEAN-4 economies in 2009, but showed some signs of recovery recently **(Figure 32b)**. In the PRC, loan growth slowed in June 2010 to 18.2% compared with last year's torrid 31.7% pace **(Figure 33)**. The drop in loan growth was partly due to government measures to reduce real estate speculation (see Figure 17a). Concerns over real estate bubbles also cover Hong Kong, China and Singapore (see Figure 17b). Banks in Malaysia and Taipei,China hold relatively high exposure in real estate **(Figure 34)**. In line with the increase in bank lending, some of the region's banks have been reducing securities as a proportion of their total assets **(Table 11)**.

Figure 34: Real Estate Loans[1]—ASEAN-4, NIEs, and PRC (% of total loans)

NIEs = newly industrialized economies, PRC = People's Republic of China.
[1]Data for Hong Kong, China includes loans for building, construction, property development, and investment of all authorized institutions; for Indonesia, property loans of commercial and rural banks; for Republic of Korea, real estate, renting and leasing loans of commercial and specialized banks; for Malaysia, sum of loans for purchase of residential and non-residential property, and for purchase of fixed assets other than land and buildings, of the banking system; for the Philippines, banking system loans for real estate, renting, and business activities; for Singapore, business loans for building and construction, and housing and bridging loans for consumers of domestic banking units; for Taipei,China, real estate loans of all banks; and for Thailand, loans for real estate activities, renting and business, and loans for land, for provision of dwelling, and for purchase of real estate for others by commercial banks. [2]Data for Malaysia; Singapore; and Taipei,China as of May 2010; Indonesia as of Apr 2010; People's Republic of China; Hong Kong, China; Republic of Korea; and Thailand as of Mar 2010.
Source: OREI staff calculations using data from People's Bank of China, Hong Kong Monetary Authority, Bank Indonesia, Bank Negara Malaysia, Bangko Sentral ng Pilipinas (Philippines), Monetary Authority of Singapore, Bank of Thailand, and CEIC.

Table 11: Securities Investment to Total Bank Assets of Commercial Banks (%)

Economy	2000–2004 Average	2004	2005	2006	2007	2008	2009	2010[1]
Hong Kong, China	16.9	19.2	19.6	20.2	17.7	17.8	23.2	23.6
Indonesia	16.5	19.3	17.3	23.6	26.5	18.9	21.0	16.1
Korea, Republic of	23.2	20.8	22.1	20.2	18.6	16.5	16.7	17.2
Malaysia	12.7	10.6	9.6	9.3	11.9	14.6	15.9	15.6
Philippines[2]	23.8	32.6	30.1	23.7	21.2	23.9	23.8	30.2
Singapore	16.9	17.1	16.5	15.9	15.8	14.8	17.4	17.0
Taipei,China	9.6	7.6	7.4	8.1	7.5	7.1	6.1	5.7
Thailand	15.2	16.0	16.0	15.8	15.9	13.7	16.3	15.7

[1]Data for Malaysia; Singapore; and Taipei,China as of May 2010; Hong Kong, China; Philippines; and Thailand as of Apr 2010; Republic of Korea as of Mar 2010; Indonesia as of Feb 2010. [2]Financial assets (net of allowance for credit losses) as a ratio of total assets of commercial banks.
Source: OREI staff calculations using data from national sources and CEIC.

Economic Outlook, Risks, and Policy Issues

External Economic Environment

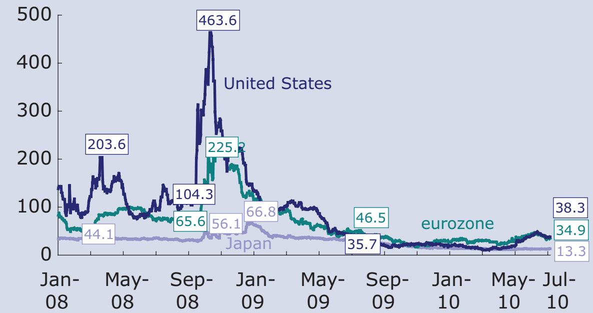
The overall external environment for emerging East Asia remains positive, although the sovereign debt crisis in Europe casts some doubt over the strength of its recovery.

Recovery in advanced economies continued in the first half of 2010. In the first quarter, economic activity continued to rebound sharply in the United States (US) and Japan, but growth in the eurozone was weaker. Early indicators showed a modest but steady recovery in advanced economies in the second quarter. However, the European sovereign debt crisis depressed business sentiment and consumer confidence, resulting in recent financial market turbulence. Fiscal consolidation in many advanced economies, particularly those in Europe, could further constrain domestic demand. Also, increased public debt, continuing high unemployment, and weak household balance sheets continue to hamper private consumption. And tight credit and the uncertain outlook may weaken business investment. The International Monetary Fund (IMF) now projects GDP in advanced economies to grow 2.6% in 2010 and 2.4% in 2011—after declining 3.2% in 2009. The 2011 growth is about half a percentage point below the average growth rate of 2.8% in advanced economies from 1980 to 2007.

Renewed financial stress and heightened risk premia emanating from Europe have added uncertainties to the recovery outlook for advanced economies.

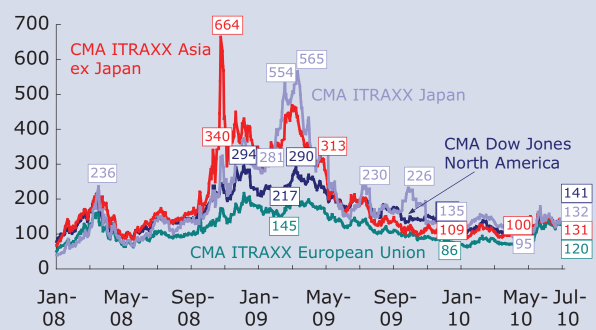
Since April, global financial markets have again been under stress due to concerns over fiscal sustainability and the strength of economic recovery. The TED spread—which measures the difference between interbank rates and short-term government bond yields—began rising again, though still far below the levels following the collapse of Lehman Brothers in September 2008 **(Figure 35)**. Credit default swaps—the cost of insuring against defaults—also rose significantly for both sovereign and corporate paper, indicating default risk increased, particularly in southern Europe **(Figure 36)**. Financial volatility has increased markedly in recent months

Figure 35: TED Spreads[1]–G3



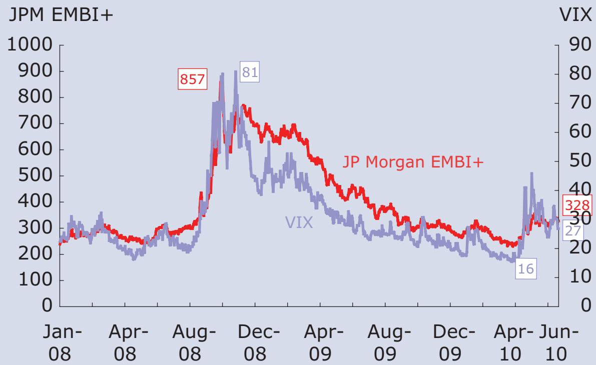
[1]Difference between 3-month LIBOR (London Interbank Offered Rate) and 3-month government debt (e.g. Treasury bills).
Source: OREI staff calculations based on Bloomberg and Datastream data.

Figure 36: Credit Default Swap Indexes
(investment grade, senior 5-year)



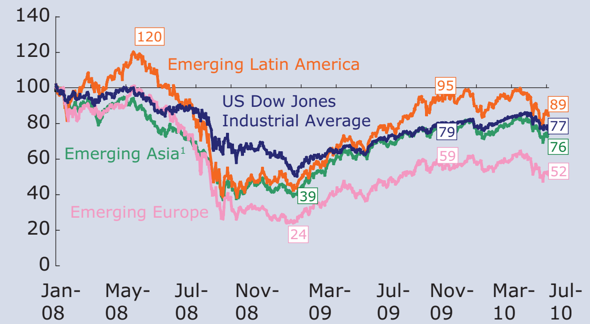
Source: Datastream.

Figure 37: Equity Market Volatility and Bond Spreads



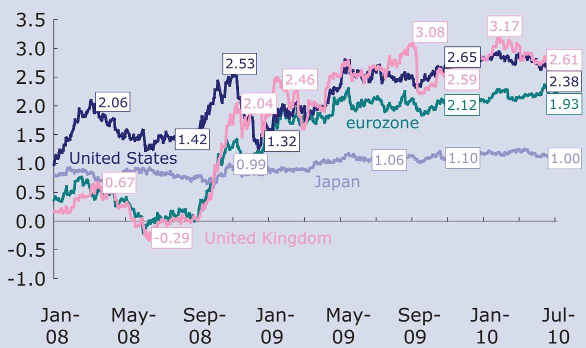
VIX = Chicago Board Options Exchange Volatility Index, JPM EMBI+ = JP Morgan Emerging Markets Bonds Indices Plus.
Source: Bloomberg.

Figure 39: MSCI Indexes (2 Jan 2008 = 100)



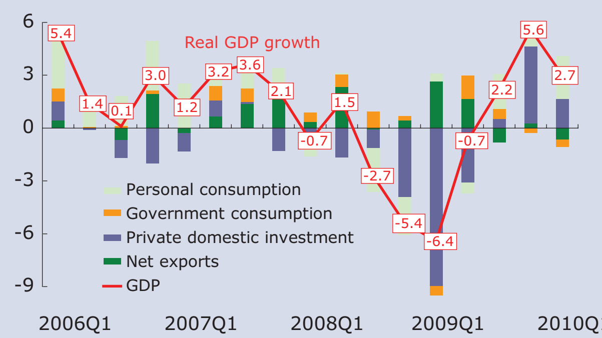
[1]Includes People's Republic of China; India; Indonesia; Republic of Korea; Malaysia; Pakistan; Philippines; Taipei,China; and Thailand.
Source: Morgan Stanley Capital International (MSCI) Barra and Datastream.

Figure 38: 10-year and 2-year Government Bond Yield Spreads (% per annum)



Source: Datastream.

Figure 40: Contributions to Growth—US
(seasonally adjusted, annualized, q-o-q, % change)



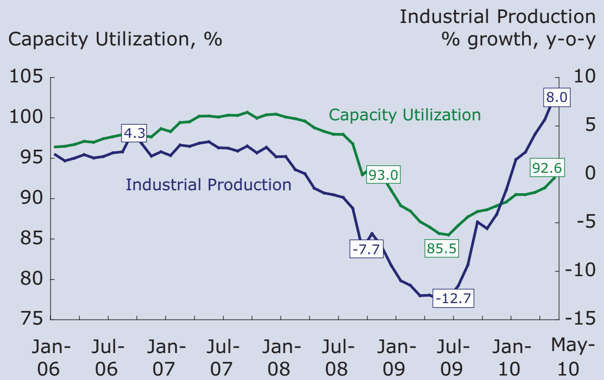
US = United States, GDP = gross domestic product, q-o-q = quarter-on-quarter.
GDP figure for 2010Q1 is third estimate as of 25 Jun 2010.
Source: US Bureau of Economic Analysis.

(Figure 37). With the increased uncertainty, yield curves have flattened **(Figure 38)**. Global stock markets also fell from their peaks in April 2010 **(Figure 39)**. A package of emergency measures announced by the European Union and the IMF calmed financial markets, though certain market segments remain under strain. How much the financial turbulence will impact growth remains highly uncertain.

In the US, the "Great Recession" has ended and gradual recovery is underway, driven by stronger private consumption and restocking of inventories.

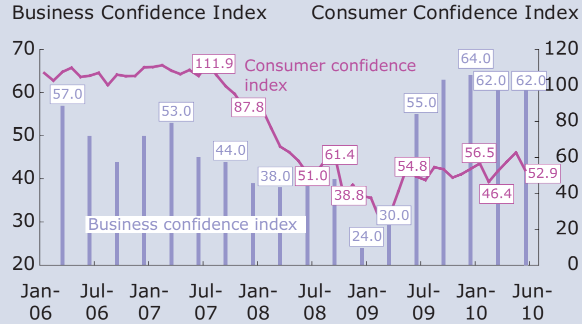
The US economy grew 2.7% (q-o-q, seasonally-adjusted annualized rate) in the first quarter of 2010, following the strong 5.6% rate in the fourth quarter of 2009 **(Figure 40)**. Private consumption strengthened, growing 3.0% in the first quarter compared with 1.6% in the fourth quarter. Non-residential fixed investment continued to pick up,

Figure 41: Industrial Production Growth and Capacity Utilization Rate—US



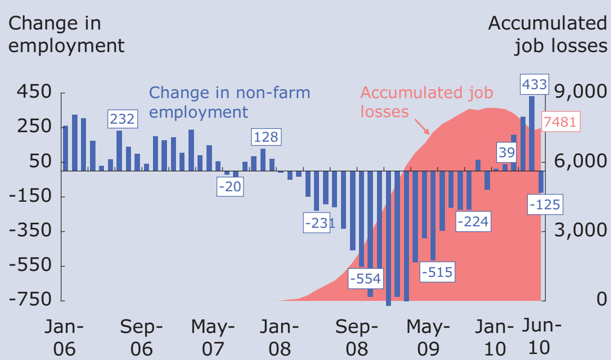
US = United States.
Source: Board of Governors of the US Federal Reserve System.

Figure 43: Business and Consumer Confidence Indexes—US



US = United States.
Note: Consumer confidence (1985 = 100). A business confidence index above 50 means there are more positive than negative responses. Consumer confidence index is monthly; business confidence index is quarterly.
Source: Datastream.

Figure 42: Change in US Non-Farm Employment and Accumulated Job Losses[1] (in thousands)



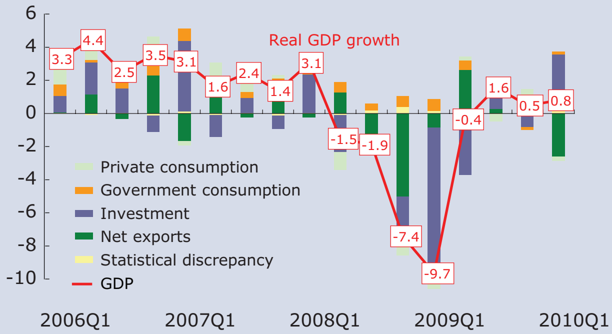
US = United States.
[1]Accumulated job losses since December 2007. Preliminary figures for May and June 2010.
Source: OREI staff calculations based on data from the US Bureau of Labor Statistics.

growing 2.2%. Private businesses' inventories increased in the first quarter—after being drawn down in previous quarters—contributing 1.9 percentage points to growth. Leading indicators show the modest and steady recovery will continue through the rest of 2010. Industrial production grew 8.0% and capacity utilization continued to grow in May **(Figure 41)**. The labor market is also improving with employment increasing (even if unemployment remains high) **(Figure 42)**. Business and consumer confidence have remained high throughout the first half **(Figure 43)**. However, housing remains weak, with residential fixed investment falling 10.3% in the first quarter. Sustained high unemployment, continued household deleveraging, and increased fiscal deficits indicate the return to trend growth will be a gradual and drawn-out process. The US economy is projected to grow 3.0% in 2010.

The recovery in the eurozone is likely to become more fragile as a result of the sovereign debt crisis and the need for fiscal austerity.

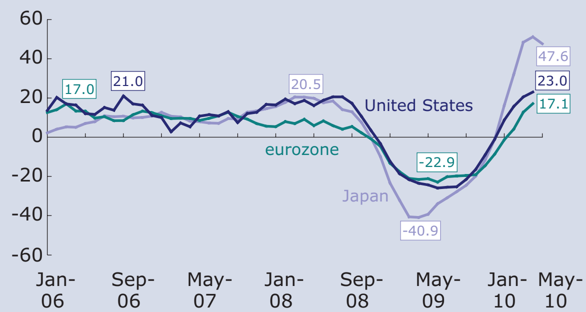
In the first quarter of 2010, the economy grew 0.8% (q-o-q, seasonally-adjusted annualized rate), after inching up 0.5% in the fourth quarter **(Figure 44)**. The weak performance was due to falling private demand and shrinking net exports, balanced somewhat by restocking, which contributed 3.2 percentage points to growth. Looking ahead, the euro's recent decline will likely provide a boost to the region's exports **(Figure 45)**. Private demand may be heading for a slight upturn as economic sentiment remains buoyant **(Figure 46)**. For example, in March, retail sales and industrial production finally began to grow y-o-y **(Figure 47)**. However, financial

Figure 44: Contributions to Growth[1]—eurozone
(seasonally adjusted, annualized, q-o-q, % change)



GDP = gross domestic product, q-o-q = quarter-on-quarter.
[1]2010Q1 figure is Eurostat second estimate.
Source: Eurostat website.

Figure 45: Merchandise Export Growth[1]—eurozone,[2] Japan, and US
(y-o-y, %)



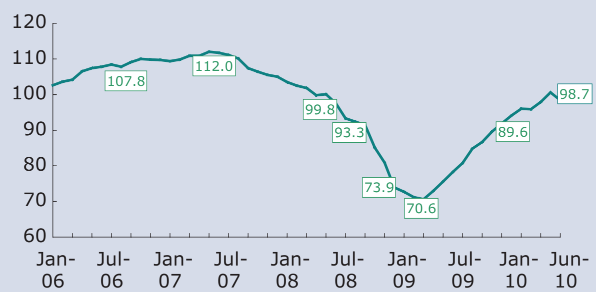
US = United States.
[1]3-month moving average. [2]Refers to Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia, and Spain. Data for eurozone and US until Apr 2010.
Source: OREI staff calculations based on CEIC data.

market disruption has already forced highly indebted European economies to tighten fiscal policies earlier than they would have liked to, which is expected to slow growth in those countries. Thus, the recovery is likely to be fragile and weak, growing a mere 0.8% in 2010.

Partly due to strong demand from emerging East Asia, Japan should return to solid growth after a sharp decline last year.

The Japanese economy grew 5.0% (q-o-q, seasonally-adjusted annualized rate) in the first quarter of 2010, continuing the modest recovery evident since the second quarter of 2009. Growth was broad-based with net exports, consumption, and private investment all contributing to the better performance **(Figure 48)**. As in the previous three quarters, net exports contributed most—2.7 percentage points—to first quarter growth, while restocking added another 0.6 percentage points. Leading indicators suggest GDP growth should continue throughout 2010 and into 2011. In the second quarter, industrial production continued to grow and the purchasing managers index remained high **(Figure 49)**. Exports were also up, driven by strong demand from the PRC and the rest of the region. Unemployment is generally

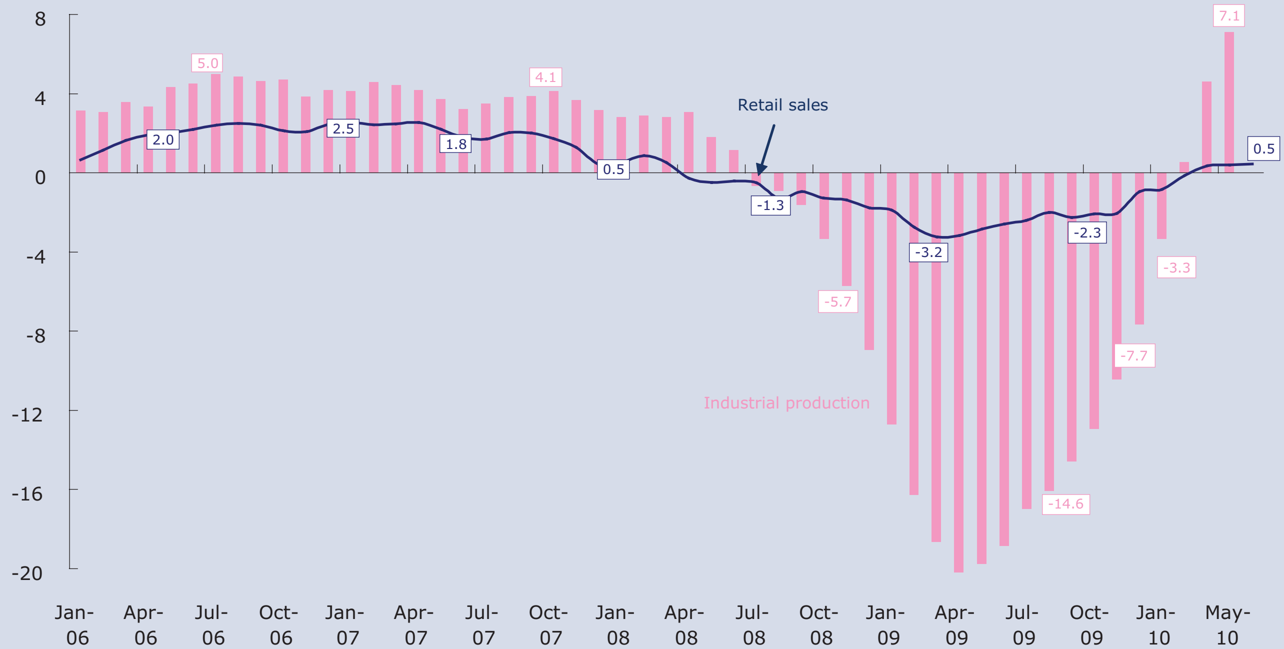
Figure 46: Economic Sentiment Indicator[1]—eurozone[2]



[1]The economic sentiment indicator is a composite index of business and consumer confidence indicators based on surveys of economic assessments and expectations in the eurozone. [2]Refers to Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia, and Spain.
Source: Datastream.

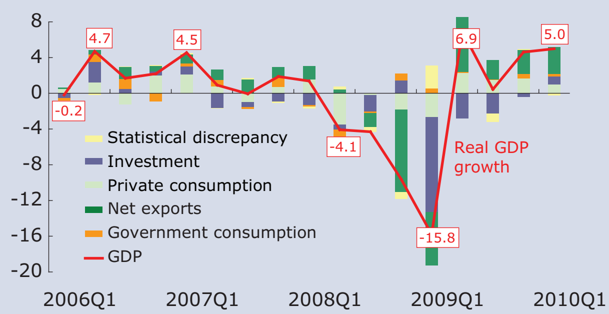
down, though it rose marginally from 5.1% to 5.2% in May. Business and consumer confidence are slowly returning **(Figure 50)**. This is critical to Japan. Private demand must improve to sustain the recovery, as thus far growth has been largely driven by external demand. Japan is forecast to grow 2.8% in 2010, compared with the 5.2% contraction in 2009.

Figure 47: Retail Sales and Industrial Production¹—eurozone



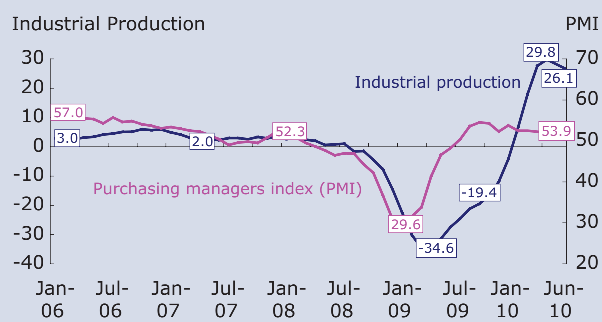
¹Working-day adjusted, year-on-year growth rate of 3-month moving average.
Source: OREI staff calculations based on CEIC data.

Figure 48: Contributions to Growth¹—Japan
(seasonally adjusted, annualized, q-o-q, % change)



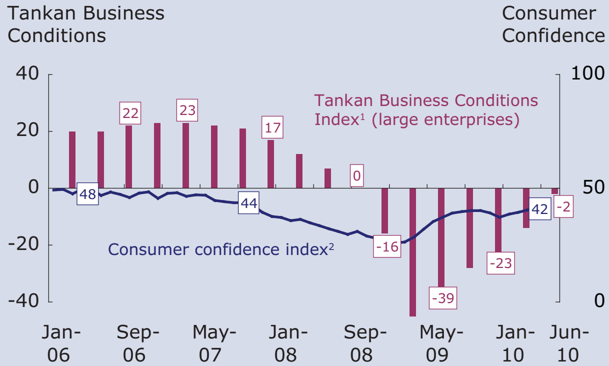
GDP = gross domestic product, q-o-q= quarter-on-quarter.
¹2010Q1 figures are 2nd preliminary estimates as of 10 Jun 2010.
Source: Cabinet Office, Government of Japan.

Figure 49: Industrial Production¹ and Purchasing Managers Index²—Japan



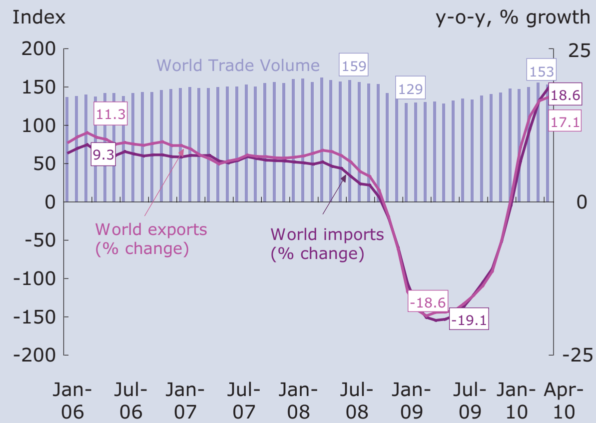
¹Year-on-year growth of 3-month moving average. ²Refers to Manufacturing PMI; seasonally-adjusted series.
Source: Bloomberg and OREI staff calculations based on CEIC data.

Figure 50: Business and Consumer Sentiment Indexes—Japan



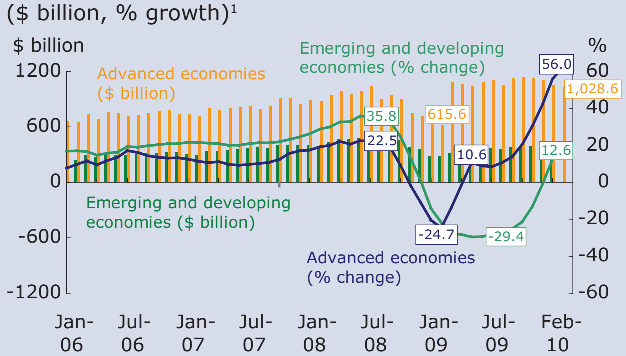
[1]Quarterly survey. A positive figure indicates that there is higher percentage of companies that report favorable business conditions from those that say conditions are unfavorable. [2]Monthly survey. A figure above 50 indicates positive consumer sentiment, while a number below 50 indicates negative consumer sentiment.
Source: Datastream.

Figure 52: World Trade Volume (seasonally-adjusted index, % growth)[1]



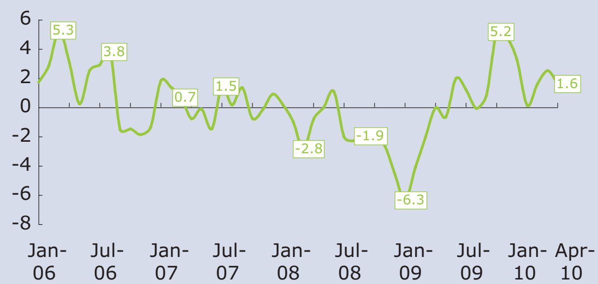
[1]Year-on-year (y-o-y) growth rates of 3-month moving average.
Source: CPB Netherlands Bureau for Economic Policy Analysis.

Figure 51: Imports—Advanced Economies; Emerging and Developing Economies
($ billion, % growth)[1]



[1]Year-on-year (y-o-y) growth rates of 3-month moving average.
Source: *International Financial Statistics,* International Monetary Fund.

Figure 53: New Information Technology Orders[1]—G3[2] (% change)

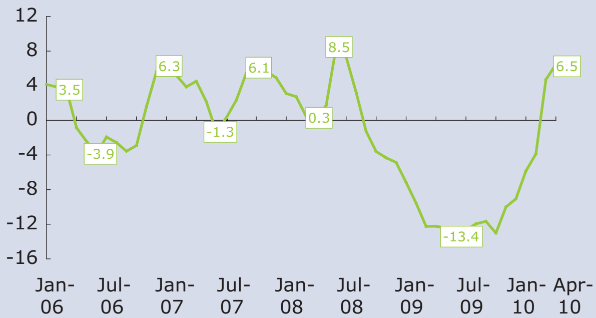


[1]Seasonally-adjusted, 3-month moving average, month-on-month. [2]eurozone, Japan, and United States.
Source: OREI staff calculations based on national sources.

After the collapse beginning late 2008, world trade has rebounded strongly and should normalize further.

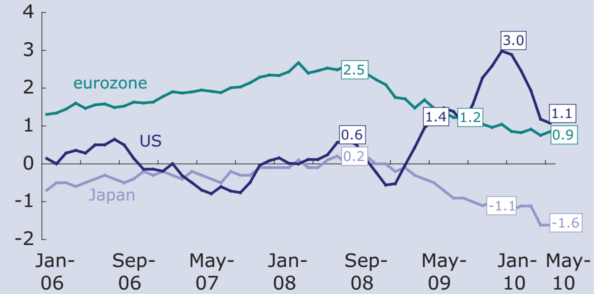
Imports from both advanced and emerging economies were far stronger in the first quarter of 2010 after bottoming out during the first half of 2009 **(Figure 51)**. Estimates from the CPB Netherlands Bureau for Economic Policy Analysis also showed world trade volume growing 17.0% in April 2010 **(Figure 52)**. Demand for high-tech products is also recovering gradually, in line with improved global economic conditions. New information technology (IT) orders in G3 economies continue to grow **(Figure 53)**, and sales of computer hardware and software are also improving **(Figure 54)**.

Figure 54: Computer and Software Sales[1]—G3[2] (y-o-y, % change)



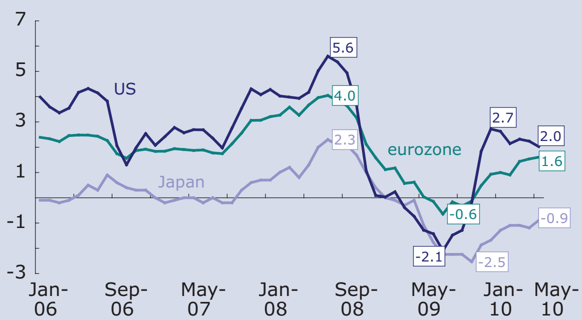
[1]3-month moving average of year-on-year (y-o-y) growth in sales values.
[2]Refers to eurozone, Japan, and United States.
Source: Datastream and Eurostat.

Figure 56: Core Inflation—eurozone,[1] Japan, and US (y-o-y, %)



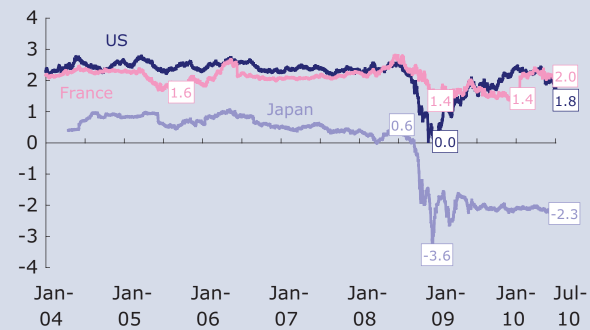
US = United States, y-o-y = year-on-year.
[1]Refers to Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia, and Spain.
Source: OREI staff calculation using data from CEIC.

Figure 55: Headline Inflation—eurozone,[1] Japan, and US (y-o-y, %)



US = United States, y-o-y = year-on-year.
[1]Refers to Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia, and Spain.
Source: OREI staff calculation using data from CEIC.

Figure 57: Implied Inflation Expectations[1]—US, Japan, and France (percentage points)

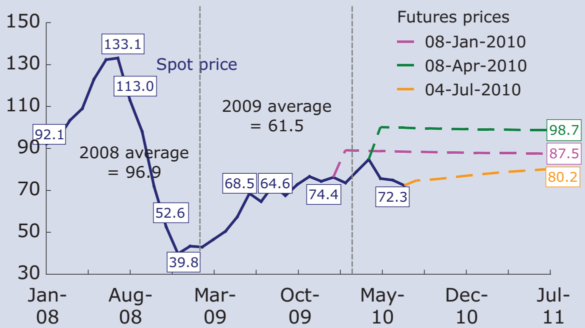


US = United States.
[1]Implied inflation expectation is the difference between the yield of a 10-year bond and a 10-year inflation-linked bond.
Source: Bloomberg.

Inflation in advanced economies, although edging up, remains tame given excess capacity and stable commodity prices.

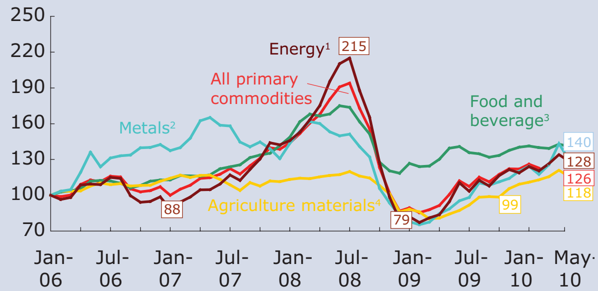
Although the recovery has added some upward price pressures in advanced economies, inflation should remain subdued as excess capacity and output gaps remain **(Figure 55)**. It appears that in the short term, disinflationary or deflationary pressures dominate, as core inflation continued to trend downward in recent months **(Figure 56)**. Inflation expectations are well anchored **(Figure 57)**. Crude oil prices have been relatively stable over the past few months, driven by two conflicting forces: a positive outlook for emerging economies and an increasingly uncertain outlook for advanced economies. Oil futures suggest that prices for crude will rise only slightly—to around $80 in July 2011—from the current spot level of about $72 **(Figure 58)**. Other commodity prices have also been gradually rising as the global economy recovers **(Figure 59)**.

Figure 58: Brent Spot[1] and Futures Prices
($ per barrel)



[1]Monthly average of daily spot prices. As of 08 July 2010.
Source: Datastream.

Figure 59: Primary Commodity Price Indexes
(Jan 2006 = 100)



[1]Crude oil, natural gas, coal. [2]Copper, aluminum, iron ore, tin, nickel, zinc, lead, uranium. [3]Cereal, vegetable oils, meat, seafood, sugar, bananas, oranges, coffee, tea, cocoa. [4]Timber, cotton, wool, rubber, hides.
Source: OREI staff calculations based on data from *IMF Primary Commodity Prices,* International Monetary Fund.

Regional Economic Outlook

Despite the uncertainty emanating from Europe, emerging East Asia's V-shaped recovery is firmly on track; however, growth will likely taper in 2011.

The external environment has become more uncertain for the region as the sovereign debt crisis casts some doubt on the strength of the global recovery. Nevertheless, the economic recovery in emerging East Asia remains firmly on track as solid domestic demand complements the return of exports in supporting growth across the region. Given the strong performance in the first half of 2010 and continued growth momentum, emerging East Asian economies are expected to grow at an aggregate 8.1% in 2010 **(Table 12)**. However, growth will likely moderate to 7.2% in 2011, as the region's governments begin to unwind policy stimulus and the restocking cycle is completed. Furthermore, the region will face a more fragile external environment in 2011, which could reduce demand for the region's exports and dampen business sentiment and consumer confidence **(Box 1)**.

The PRC should continue its strong growth, although measures to prevent overheating will likely temper growth into 2011.

Following a very strong first quarter, recent measures to slow credit growth and cool speculation in the property market will likely lead to slower investment in the coming quarters. However, consumer spending is expected to take up some of the slack—retail sales grew by a robust 23.8% in June. Exports are also rebounding strongly—growing 40.9% in June—but this is expected to slow in the coming months as the yuan gradually appreciates and growth in export demand slows. Other leading indicators signal continued robust growth for the rest of 2010. Industrial production has been strong, expanding 16% in June (see Figure 8). The manufacturing purchasing managers index (PMI) for the PRC moved down to 49.6 in June 2010, after remaining above 50 since April 2009, indicating that manufacturing activity has started to slow **(Figure 60)**. As a result, economic growth is expected to moderate somewhat for the rest of the year, bringing 2010 growth to GDP to 9.6%. This moderation is likely to continue in 2011, leading to a forecast GDP growth of 9.1%.

Table 12: Annual GDP Growth Rates (%, y-o-y)

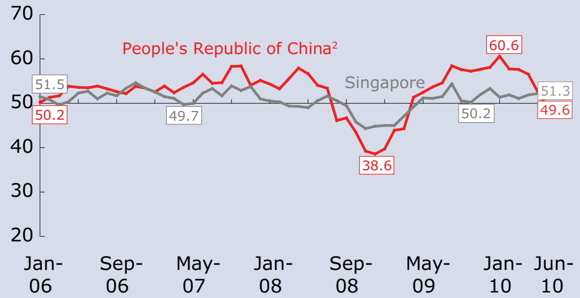
	2000–2007 Average	2004	2005	2006	2007	2008	2009	2010Q1	2010Q2	ADB Forecasts	
										2010	2011
Developing Asia[e]	**7.5**	**7.9**	**8.0**	**8.9**	**9.6**	**6.6**	**5.2**	**—**	**—**	**7.9**	**7.3**
Emerging East Asia[1,2]	**7.8**	**8.0**	**8.2**	**9.3**	**10.4**	**6.7**	**5.2**	**10.8**	**—**	**8.1**	**7.2**
ASEAN[1,2]	**5.5**	**6.5**	**5.7**	**6.1**	**6.6**	**4.4**	**1.3**	**9.0**	**—**	**6.7**	**5.3**
Brunei Darussalam	2.2	0.5	0.4	4.4	0.2	-1.9	-1.2	—	—	1.1	1.5
Cambodia	9.5	10.3	13.3	10.8	10.2	6.7	-2.0	—	—	4.5	6.0
Indonesia[3]	5.1	5.0	5.7	5.5	6.3	6.0	4.5	5.7	—	6.0	6.0
Lao PDR	6.7	7.0	6.8	8.7	7.8	7.2	6.5	—	—	7.0	7.5
Malaysia	5.6	6.8	5.3	5.8	6.5	4.7	-1.7	10.1	—	6.8	5.0
Myanmar[3, e]	9.1	5.0	4.5	7.0	5.5	3.6	4.4	—	—	5.2	5.5
Philippines[4]	5.1	6.4	5.0	5.3	7.1	3.7	1.1	7.3	—	5.0	4.6
Thailand	5.1	6.3	4.6	5.1	4.9	2.5	-2.2	12.0	—	5.5	4.5
Viet Nam	7.6	7.8	8.4	8.2	8.5	6.3	5.3	5.8	6.4	6.5	6.8
Newly Industrialized Economies[1]	**5.0**	**5.9**	**4.8**	**5.7**	**5.7**	**1.9**	**-0.8**	**10.1**	—	**6.2**	**4.5**
Hong Kong, China	5.3	8.5	7.1	7.0	6.4	2.2	-2.8	8.2	—	5.4	4.3
Korea, Rep. of	5.2	4.6	4.0	5.2	5.1	2.3	0.2	8.1	—	5.5	4.6
Singapore[5]	6.3	9.2	7.4	8.6	8.5	1.8	-1.3	16.9	19.3	12.5	5.0
Taipei,China	4.4	6.2	4.7	5.4	6.0	0.7	-1.9	13.3	—	5.9	4.0
China, People's Rep. of	10.5	10.1	11.3	12.7	14.2	9.6	9.1	11.9	10.3	9.6	9.1
Japan	1.7	2.7	1.9	2.0	2.4	-1.2	-5.2	4.6	—	2.8	1.4
US	2.6	3.6	3.1	2.7	2.1	0.4	-2.4	2.4	—	3.0	2.6
eurozone	2.1	2.2	1.7	3.0	2.7	0.5	-4.1	0.8	—	0.8	1.0

e = ADB estimates, FY = fiscal year, GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic, US = United States, and y-o-y= year-on-year.
— = not available.
[1]Aggregates are weighted according to gross national income levels (atlas method, current $) from the World Bank's *World Development Indicators.* [2]Excludes Myanmar for all years as weights are unavailable. Quarterly figures exclude Brunei Darussalam, Cambodia, Lao PDR, and Myanmar for which quarterly data is not available. [3]For FY April–March. Figures are ADB estimates as reflected in *Asian Development Outlook 2010*. [4]Figures for 2004–2006 are not linked to the GDP figures prior to 2003 due to National Statistics Office revisions of sectoral estimates. [5]Revised its base year from 2000 to 2005 beginning 2010Q1. Figures for 2010Q1 and 2010Q2 are advance estimates from the Ministry of Trade and Industry.
Source: *Asian Development Outlook 2010*, Asian Development Bank; Eurostat website (eurozone); Economic and Social Research Institute (Japan); Bureau of Economic Analysis (US); and CEIC.

The newly industrialized economies (NIEs) will likely return to solid growth this year and are expected to moderate slightly in 2011.

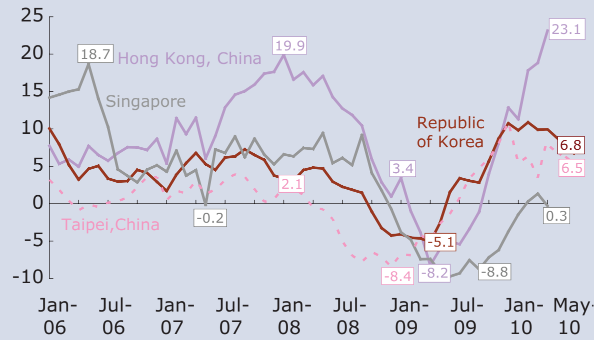
The NIEs, after being badly battered by the global economic crisis in the early part of 2009, have recovered as quickly as they fell. A rebound in investment has helped support this growth recovery. Improving investment also helped support industrial production, which soared 27.9% in May **(Figure 61)**. Consumer spending has also started picking up with retail sales showing robust growth **(Figure 62)**. Exports have improved significantly, but may lose momentum as growth in external demand slows. As a result,

Figure 60: Manufacturing Purchasing Managers Indexes (PMI)[1]



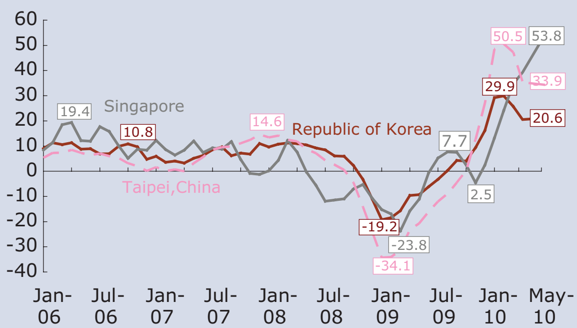
[1]Value above (below) 50 indicates that manufacturing activity is expanding (contracting). [2]Seasonally-adjusted.
Source: CEIC and Datastream.

Figure 62: Retail Sales Growth[1]—NIEs (y-o-y, %)



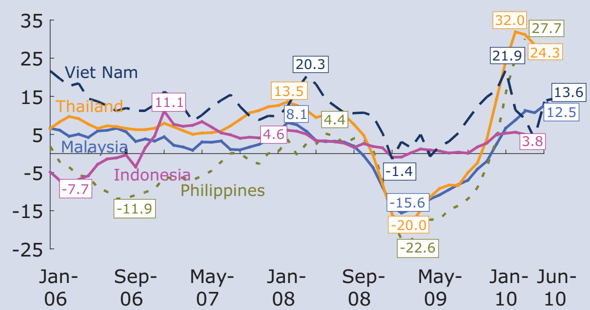
y-o-y = year-on-year.
[1]3-month moving average.
Source: OREI staff calculations based on CEIC data.

Figure 61: Industrial Production Growth[1]—NIEs (y-o-y, %)



y-o-y = year-on-year.
[1]3-month moving average.
Source: OREI staff calculations based on CEIC data.

Figure 63: Industrial Production Growth[1]—ASEAN-4 and Viet Nam (y-o-y, %)



y-o-y = year-on-year.
[1]3-month moving average.
Source: OREI staff calculations based on CEIC data.

both Singapore and Taipei,China are forecast to grow much faster in 2010 at 12.5% and 5.9%, respectively, largely due to an impressive first quarter performance. Korea and Hong Kong, China are expected to grow at a slightly slower rate of 5.5% and 5.4%, respectively. In 2011, growth in the NIEs is expected to moderate to 4.5% from 6.2% in 2010.

ASEAN-4 economies are likely to grow robustly in 2010, before slowing slightly in 2011.

Economic prospects for the four middle-income ASEAN economies look good for 2010 after a tough 2009—their worst performance since the 1997/98 Asian financial crisis. Malaysia and Thailand led the way with double-digit growth in the first quarter. Exports of ASEAN-4 have recovered, growing 40.6% in May. However, this is expected to moderate in the coming months due to the slowdown in growth in external demand. Leading indicators showed continued improvement, with strong industrial production growth **(Figure 63)**. Rising consumer confidence should further support growth (see Figure 5). GDP growth in Malaysia is forecast at 6.8% and Indonesia at 6.0%. The Philippine economy is expected to grow 5.0% with Thailand's economy expanding 5.5%. Growth is expected to be weaker in 2011, with the ASEAN-4 economies in aggregate forecasted to grow 5.3%.

On the back of the strong rebound in trade, growth in other ASEAN economies should also strengthen.

Growth in the first half of 2010 indicates Viet Nam is on track to reach its targeted 6.5% growth for the year. Cambodia's economy was badly affected by the global crisis, as garment exports and tourism fell in 2009. However, in 2010, tourist arrivals and garment exports are forecast to recover, helping the economy to grow an estimated 4.5%. The Lao PDR economy is expected to accelerate 7.0% in 2010 on the back of stronger world commodity prices. In Brunei Darussalam, higher energy prices should help the economy grow by 1.1%.

Inflation is likely to rise further with the strong economic recovery, but should remain manageable across most of the region.

Strong economic growth across the region is expected to bring higher inflation in 2010. Several economies have seen their inflation rates move above their long-run average levels (see Figure 66). However, this rise is expected to be limited as continued output gaps and withdrawal of policy stimulus will help temper inflationary pressures. As a result, inflation will not likely pose a threat to growth forecasts (see Figure 14).

Balance of payments surpluses across the region are expected to narrow as imports grow faster than exports.

Although export growth through June 2010 has been strong for the region as a whole, a less supportive external environment means export growth will likely moderate for the remainder of the year. At the same time, strong growth in domestic demand will continue to support imports. Thus, current account surpluses are expected to narrow. However, capital and financial accounts are expected to improve in 2010. Strong economic growth in the region and rising interest rates from unwinding stimulus will likely attract capital inflows. The PRC's move to make its exchange rate more flexible could also encourage further inflows in anticipation of further appreciation. However, the stronger capital account balance is not expected to offset a weaker current account balance, leading to smaller overall balance of payments for the next 12 to 18 months.

Risks to the Outlook

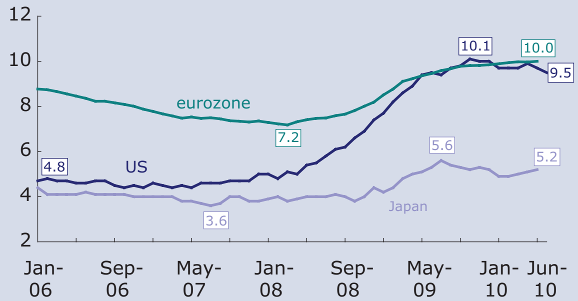
The economic outlook is subject to three major risks: (i) a disruption in the recovery in advanced economies; (ii) destabilizing capital flows; and (iii) unintended policy errors or an inappropriate policy mix when unwinding stimulus.

While the outlook for emerging East Asia has remained positive, the external environment has become less supportive and more uncertain, and risks have increased somewhat. The sovereign debt crisis in recent months is a reminder of how quickly confidence can wane and how quickly authorities must be prepared to act.

Private demand in advanced economies may not pick up the slack from the withdrawal of policy stimulus, stalling their recovery.

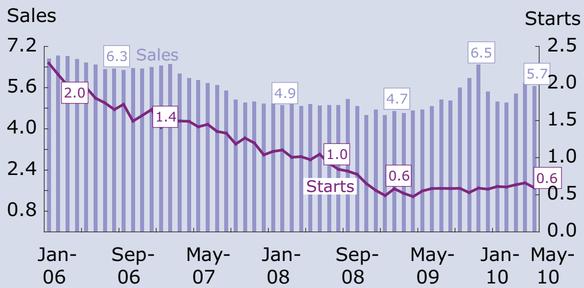
There are many uncertainties hovering over recovery in advanced economies. While government stimulus helped them out of recession, private demand appears lagging. In the G3, private consumption grew much slower than the overall economy. Household deleveraging could cut into consumer spending. Slack demand could slow inventory replenishment, which has

Figure 64: Unemployment Rate—eurozone,[1] Japan, and US (seasonally adjusted, % of labor force)



US = United States.
[1]Refers to Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia, and Spain. Data for eurozone and Japan until May 2010.
Source: US Bureau of Labor Statistics, European Central Bank, and CEIC.

Figure 65: Private Housing Starts[1] and Existing Home Sales[2]—US (million units)



US = United States.
[1]Seasonally-adjusted levels. [2]Seasonally-adjusted and annualized.
Source: CEIC.

driven recent growth. Despite the improvement in GDP, unemployment remains stubbornly high and the US housing market has shown little improvement **(Figures 64, 65)**. Moreover, fiscal consolidation in many advanced economies, accelerated by market pressures, could put a significant break on growth. Despite huge rescue packages, interest rate spreads in Europe remain high and financial stress could escalate, affecting confidence and financing costs and thus reducing final demand further.

Large and volatile capital flows could have a destabilizing effect on emerging East Asia.

Robust growth across emerging East Asia suggests it will unwind policy stimulus earlier than other parts of the world, offering higher yields and currency appreciation that would encourage carry trades. The uneven pace of recovery between the region and others implies that capital inflows to Asia could surge again, adding pressure on asset prices and regional currencies and complicating macroeconomic management. However, financial turbulence and uncertainty, exemplified by the European sovereign debt crisis, also suggest that risk appetite could change dramatically. Therefore capital flows to emerging economies could become volatile, destabilizing financial markets—at least in the short term—and could hurt the real economy as well. Any shock, economic or political, could result in a loss of confidence and thus destabilize growth prospects.

Bad timing, a wrong policy mix, or inappropriate pace in unwinding stimulus could derail emerging East Asia's recovery.

As the recovery gains traction, how to time and craft exit strategies takes center stage. The high degree of uncertainty about the strength of the global recovery could delay policy unwinding in the region, which could lead to a gradual build-up of inflationary pressures and may imply more aggressive tightening later. On the other hand, if the fear of sovereign default spreads to the region, bond yields could rise significantly, which might entice policymakers to unwind fiscal stimulus prematurely. Should capital inflows excessively fuel asset prices and domestic liquidity, central banks may have no option but to tighten money supply, damaging fragile private demand. Inadvertently, policymakers may be forced into wrong exit strategies. If the policy mix for unwinding stimulus is not carefully crafted or paced appropriately, macroeconomic stability could be undermined and the recovery might not be sustained.

Policy Issues

A well–designed exit strategy from unprecedented policy stimulus is critical to sustain the region's recovery.

The economic recovery in the region is firmly on track and some economies have already started to roll back the extraordinary policy stimulus implemented from late 2008. Considerable differences in the pace of recovery within the region suggest each economy will have to craft its own path of unwinding policy stimulus. The global economic crisis may have led to a synchronized downturn, but the rebound and recovery vary and are multi-speed. This suggests authorities will have to carefully assess the menu of policy strategies to normalize macroeconomic policy based on country-specific economic conditions. In designing exit strategies, policymakers should pay attention to the three dimensions of these strategies: timing, policy mix, and the pace of implementation. A special section, "Unwinding Policy Stimulus: Options for Emerging East Asia," discusses these issues in greater detail.

With a few exceptions, it is now time to begin unwinding policy stimulus.

In principle, the withdrawal of monetary and fiscal stimulus should proceed at a rate commensurate with the strength of each economy's recovery, unless there are either compelling concerns about policy sustainability that would call for a more rapid adjustment, or risks to the recovery that would point toward a more cautious approach. The relatively rapid bounce-back in the region's economies would suggest a rapid unwinding to avoid the risk of inflationary pressures building up. This would be true especially for economies where output gaps are narrowing quickly. However, large output gaps in some economies and high levels of uncertainty about the strength of the global recovery point to the need for a more cautious "wait-and-see" approach to exit strategies. Therefore, taking risks into account, policymakers would not withdraw stimulus until the recovery is more certain and, in so doing, would effectively be "buying" insurance against the recovery faltering. Policymakers should constantly assess risk factors and fine-tune their exit strategies and implementation accordingly.

In terms of policy mix, it appears that a "Money First" strategy—in which policymakers normalize monetary policy first and consolidate fiscal policy subsequently—is more appropriate for most of emerging East Asia.

Unwinding stimulus in emerging East Asia must be calibrated both to specific regional economic conditions and the potential external spillovers from "normalization" in advanced economies. In advanced economies, the mix of fiscal tightening, while keeping interest rates low, could create a wave of "search for yield" capital outflows and depreciating exchange rates—complicating macroeconomic management and reducing external demand in emerging East Asia. With robust fiscal positions in the region, it is not necessary for emerging East Asia to unwind fiscal stimulus first. In contrast, a "Money First" strategy would allow fiscal policy to continue to support domestic demand in the near term.

Considering the need to rebalance the region's sources of growth, it is better to unwind monetary stimulus through a judicious mix of currency appreciation and interest rate adjustments rather than entirely through policy rate hikes.

Moreover, the region could adopt a strategy which keeps interest rates at relatively low levels, while currencies are allowed to appreciate at somewhat faster rates. This strategy of "Money First—with somewhat faster appreciation" would be able to support domestic demand, address inflationary pressures, and help facilitate global rebalancing. Such an exit strategy is not an alternative to undertaking structural reforms required to reduce the region's high dependence on external demand, and in essence, buys time for reforms to be implemented.

The pace at which economies unwind stimulus should depend on the speed of recovery as well as evolving risks.

Unwinding policy stimulus depends on economic conditions in each economy, and ultimately needs to be based on several key factors: the size of output gaps, the forward momentum of recovery, the outlook for inflation, and the uncertainty of the recovery. Output gaps have been narrowing rapidly across emerging East Asia, with some economies having already seen them closed. With the exception of Viet Nam, recovery across the region continues to gain momentum. Monthly data show a strong recovery momentum in the second quarter—particularly in the PRC; Hong Kong, China; Korea; Philippines; and Taipei,China. Inflation is picking up—particularly in the PRC; Hong Kong, China; Singapore; Thailand; and Viet Nam—where it is now above the 10-year average. Increased uncertainty over the external environment poses questions over the strength of the recovery in several economies in the region, which policymakers should err on the side of caution when deciding the pace of unwinding policy stimulus.

Managing capital flows effectively requires an array of policy measures, including sound macroeconomic management, flexible exchange rates, resilient financial systems, and in some cases, possibly temporary, well-targeted capital controls.

While the return of capital flows is welcome, short-term capital flows could pose a risk to macroeconomic and financial stability. There is no magic solution to effectively managing capital flows. Each policy option has its merits and shortcomings. An appropriate mix includes currency flexibility, clear and stable monetary and fiscal policy, and an appropriate regulatory and supervisory framework that can prevent asset bubbles from forming (see *Asia Capital Markets Monitor* April 2010). Under certain circumstances, temporary and targeted capital controls could be considered as part of the policy mix to avoid destabilizing capital flows. The ultimate aim is to ensure macroeconomic and financial stability. However, authorities must be cautious that capital controls can have deleterious long-term and multilateral repercussions.

Box 1: Impact of Euro Debt Crisis on Emerging East Asia

The Greek sovereign debt crisis took a sharp turn for the worse in April and early May, when it became increasingly doubtful whether the Greek government could repair its public finances. Also, the lack of political solidarity and unanimity from fellow Euro area members to address the problem did little to boost confidence. There was a sense of déjà vu when sharp swings in foreign exchange, equity, credit default swap (CDS), and interbank markets all pointed toward heightened financial stress. Many feared that the problem could spread, and that the very government meant to save the economy from collapsing risked pulling the economy back down. More disturbing is that the private sector remains unable to assume the role as main driver of growth. The contagions did not spare emerging East Asia's financial markets; albeit at this stage, the impact on the region's economies is likely to be minimal.

The region's stock markets and currencies fell sharply. There were net withdrawals of funds by foreigners from the equity markets during the height of the crisis in early May. As usual, when investors panic, they rush to the safety of the US Treasuries and other safe havens. In the People's Republic of China (PRC) and Hong Kong, China, where there was little change in their exchange rates because of the pegged exchange rate regimes, the stock markets fell by 11% and 6%, respectively. Other markets in the region fell between 4% and 8%.[1] The sell-off in the US and Japan was more dramatic—down about 10%. Meanwhile, the sharp depreciations in some currencies eroded gains made earlier in the year. By early June, the region's currencies had fallen in the range of over 8% (in the Republic of Korea) to 1% (in Thailand). Nonetheless, these reversals were far from the troughs recorded in the first quarter of 2009. In contrast, the yen strengthened 2%, while the euro declined by 16%, with more than half of the decline coming in May alone.

Unlike the eurozone, there is little evidence to suggest the region's banking systems are facing liquidity problems, or that balance sheets are under stress. Unlike during the peak of the global financial crisis, this time there were few signs of distress in the region's banking systems and interbank markets. Only Singapore saw a blip in the spread between interbank rates and government debt securities—rising from 3.2 basis points (bp) in end-April to 12.4 bp in early June (in contrast to the 120 bp spread during the global financial crisis). In addition, bank profitability remains good, capital positions remain solid, and there has been no significant increase in nonperforming loans as was feared during the global recession.[2]

There has been no marked rise in default risk among the region's banks. Based on CDS spreads, Asian banks are far from the levels during the peak of the global financial crisis **(Figure B1.1)**. In contrast, the CDS spreads of some European banks are even higher than those during the height of the global financial crisis. This implies that the severity of a potential euro sovereign debt default will be felt mostly by European banks, not the region's banks. The corollary is that banks in the region do not appear to have any significant exposure to the euro debt market.[3] The region's banking systems also appear to be well insulated from secondary impact of potential European banking troubles. Note that HSBC and Standard Chartered, two European banks with key presence in the region, have seen spreads rise, but not to the extent of their European counterparts. In addition, the impact of possible fund withdrawal by the European banks on domestic liquidity is likely to be small. The region's banking systems remain flush with liquidity with loan-to-deposit ratios averaging 74%.[4]

The region is not in any immediate likelihood of facing a sovereign

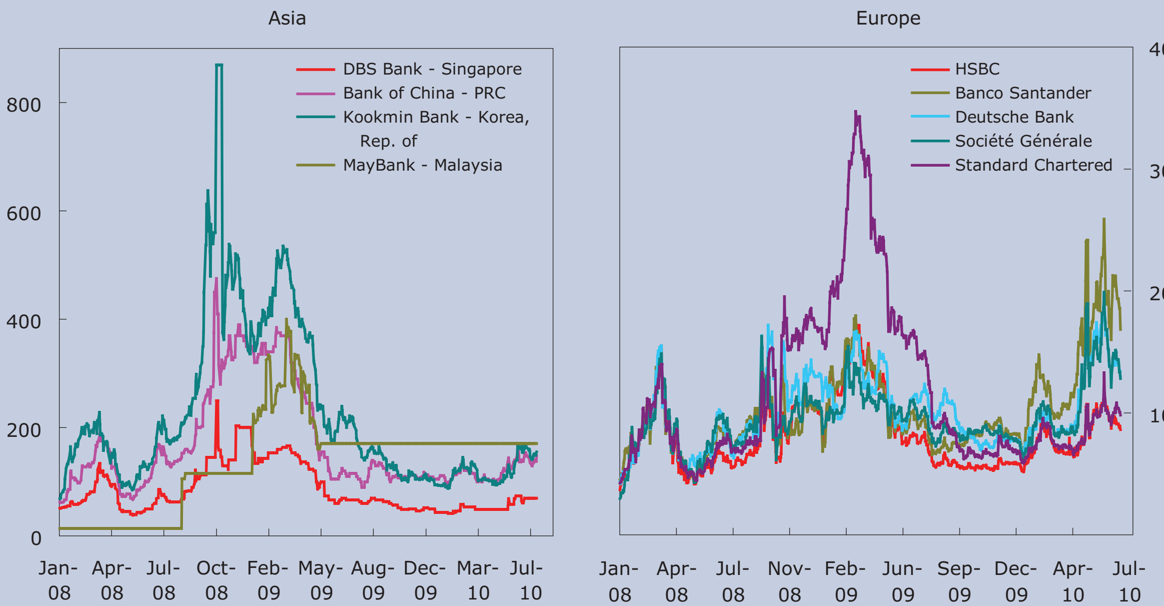
[1]Only the Philippine and Thai markets gained in response to domestic politics.

[2]For more details, please refer to Financial Vulnerability, page 18.

[3]*The Economist* (1 May 2010) estimates that foreign banks hold €164 billion and €198 billion of Greek and Portuguese assets (including government bonds), respectively. Of these, the bulk is held by eurozone banks—72% and 74%, respectively. If "rest of the world" in their calculations is taken to mean Asia (there is no specific breakdown for Asia), then Asian banks hold 15% (€25 billion) and 17% (€35 billion) of these assets, respectively. This implies Asian banks' exposure to the Greek and Portuguese investments is very small—only 0.4% of the banks' combined total assets.

[4]Korea's loan-to-deposit ratio is the exception at 124% at end-January 2010. (For more details, see Table 5: Financial Vulnerability).

Figure B1.1: Credit Default Swap Spreads—Selected Asian and European Banks
(Senior 5-year, basis points)



PRC = People's Republic of China.
Source: Datastream and Bloomberg.

debt problem. Few economies in the region exhibit the combination of weaknesses—high public debt level, chronic fiscal deficit, and structural uncompetitiveness—near the levels faced by Portugal, Ireland, Italy, Greece, and Spain (PIIGS). Public debt to GDP ratios are below 60%, with the exception of the Philippines (65%) and Singapore (113%)[5] **(Table B1)**. Fiscal deficits remain below 5% of GDP, despite fiscal pump priming and the remnants of last year's economic slowdown. Viet Nam's and Malaysia's fiscal deficits stand out at 11.8% and 7.0%, respectively. Most starkly, while the region's economies have been running current account surpluses,[6] the PIIGS have recorded the opposite. Moreover, most emerging East Asian economies own more foreign assets than foreigners own emerging East Asian assets—the region is less dependent on foreign capital. All these differences seem to have been reflected in the variations of the CDS spreads between the sovereign Greek and Portuguese bonds (in particular) against the region's sovereign bonds **(Figure B1.2)**.

The impact of the euro debt crisis on emerging East Asia's real sector is thus far limited. Yet if a default were to occur in the eurozone, the snowballing effects of far more aggressive budget tightening, further sharp falls in the euro, heightened financial market volatility, and risk aversion could pose a significant downside risk to the region's growth. The small and open economy of Malaysia and the newly industrialized economies of Singapore; Hong Kong, China; and Taipei,China are most susceptible to lower external demand and a larger growth contraction as the recent recession clearly showed

[5]Singapore's high ratio is attributed to large bond issuance to cater to the needs of the Central Provident Fund and to develop the domestic bond market.

[6]Viet Nam stands out here but this can be partly explained by its current stage of economic development which tends to absorb much foreign resources. Malaysia may have a high fiscal deficit, but it has had very large current account surpluses, and its public debt is still at a reasonable level.

Table B1: Fiscal Position, Current Account Balance, and Net International Investment Positions—Emerging East Asia and Selected eurozone Countries (% of GDP)

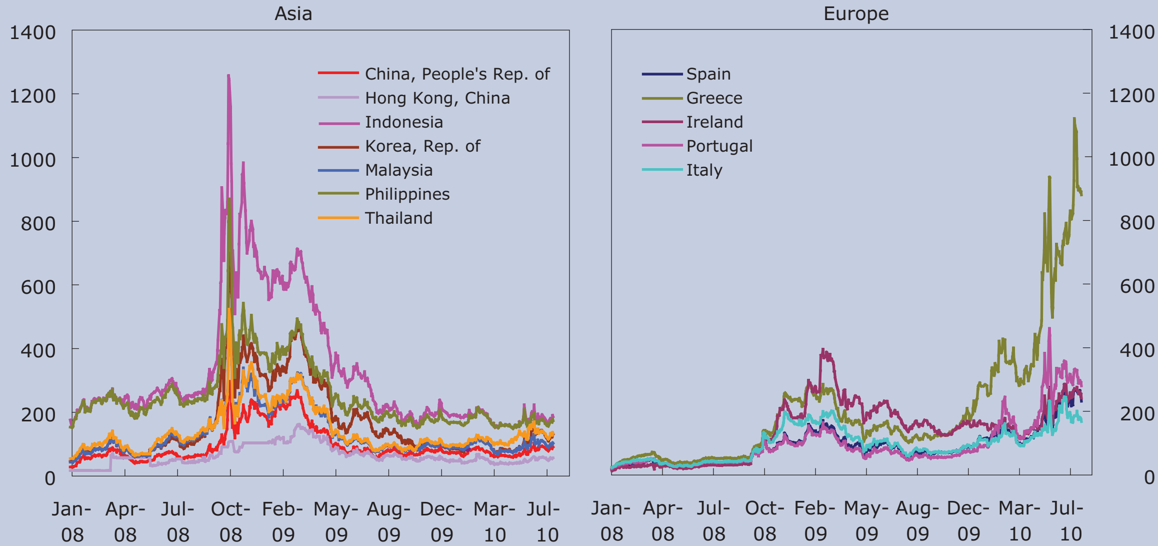
	Public Debt[1]	Fiscal Balance[2]	Current Account Balance	NIIP[4]
	2009	2009	2000—2009[3]	2008
Emerging East Asia				
Brunei Darussalam	—	—	42.4	—
Cambodia	—	-5.9	-4.6	-17.7
China, People's Republic of	21.0	-2.8	5.5	33.6
Hong Kong, China	3.4	0.8	9.6	352.9
Indonesia	31.1[p]	-1.6	2.3	-28.6
Korea, Republic of	32.6	-3.9	1.8	-17.8
Lao People's Democratic Republic	57.2[e]	—	—	—
Malaysia	53.7	-7.0	13.1	17.4
Myanmar	—	—	—	—
Philippines	65.3	-3.9	1.5	-16.1
Singapore	113.1	-1.1	18.5	101.7
Taipei,China	33.1	-4.0	7.1	143.2
Thailand	43.8	-4.8	3.2	-5.1
Viet Nam	47.5[p]	-11.8	-2.6	—
eurozone				
Greece	115.1	-14.2	-9.4	-86.3
Ireland	64.0	-12.6	-2.3	-55.2
Italy	115.8	-4.8	-1.7	-20.3
Portugal	76.8	-8.9	-9.3	-91.8
Spain	53.2	-9.4	-6.2	-97.1

e = estimate, GDP = gross domestic product, p = projection, — = not available.
[1]Refers to central government debt (Indonesia; Republic of Korea; Taipei,China); federal government debt (Malaysia); national government debt (Philippines); general government debt (Greece, Ireland, Italy, Greece, Spain). [2]2009 deficit figures are actual, except for Cambodia; People's Republic of China; Hong Kong, China; Republic of Korea; and Viet Nam, sourced from *Asian Development Outlook 2010*, Asian Development Bank. Figures are on calendar year basis except for Hong Kong, China; Lao People's Democratic Republic; Taipei,China; and Thailand. [3]Simple averages only. [4]Refers to net international investment position. Figures for Hong Kong, China; Republic of Korea; Greece and Spain refer to their 2009 positions.
Source: *Asian Development Outlook* (various issues), Asian Development Bank; *Article IV* consultation reports, International Monetary Fund (Public debt projections); CEIC; Eurostat; and national sources.

(Figure B1.3). Also, Hong Kong, China; Singapore; and Malaysia are the three economies in the region with the largest export exposure to the EU, though this has declined over the years. The PRC, Indonesia, and Philippines, on the other hand, could rely more on domestic demand for growth and have relatively moderate export exposure to the EU.

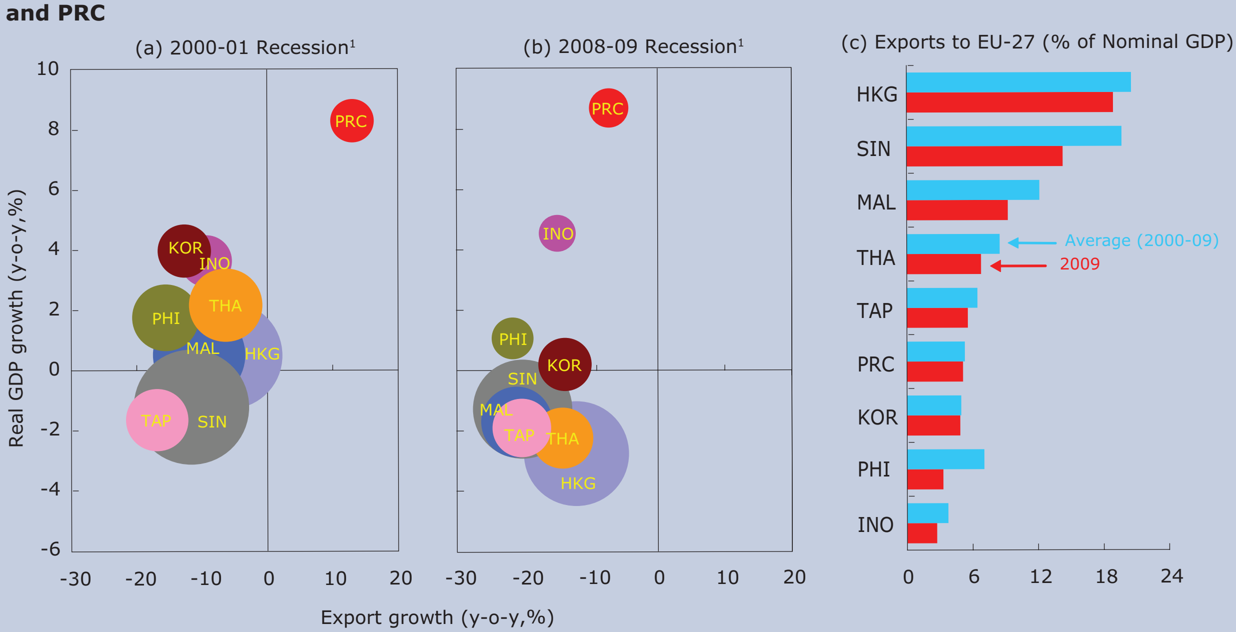
A notable contrast between this recession and previous ones is that the strong Asian recovery has been driven primarily by the region's own domestic demand. Also, the strong rebound in trade across emerging East Asia—both in exports and imports—has been driven importantly by intraregional trade. This means the region can be confident of its ability to boost its other engines of growth and make further headways in rebalancing the economy. A strengthening currency provides a further nudge in this direction. If the euro debt problem is resolved in an orderly manner, capital will return and the region's currencies will strengthen. Policymakers should take this positively as a condition that supports their rebalancing strategy, but with the added fillip of containing inflationary pressures and deterring further capital inflows, without resorting to policy rate hikes (for further discussion, see Special Section: Unwinding Policy Stimulus: Options for Emerging East Asia, page 45).

Figure B1.2: Credit Default Swap Sovereign Spreads—Emerging East Asia and Selected Eurozone Countries (Senior 5-year, basis points)



Source: Datastream.

Figure B1.3: GDP Growth, Export Growth, Trade Openness and Trade Exposure—ASEAN-4, NIEs, and PRC



GDP = gross domestic product; y-o-y = year-on-year; PRC = People's Republic of China; ASEAN-4 (INO = Indonesia; MAL = Malaysia; PHI = Philippines; and THA = Thailand); NIEs (HKG = Hong Kong, China; KOR = Republic of Korea; SIN = Singapore; and TAP = Taipei,China).

Note: Real GDP is in local currency, while exports and trade openness are in $ value.

[1]The size of the bubble denotes Trade Openness (% of GDP). 2001 Trade Openness figure is used for 2000-01 recession and 2009 for 2008-2009 recession.

Source: OREI staff calculations based on data from CEIC and *Direction of Trade Statistics* and *International Financial Statistics,* International Monetary Fund.