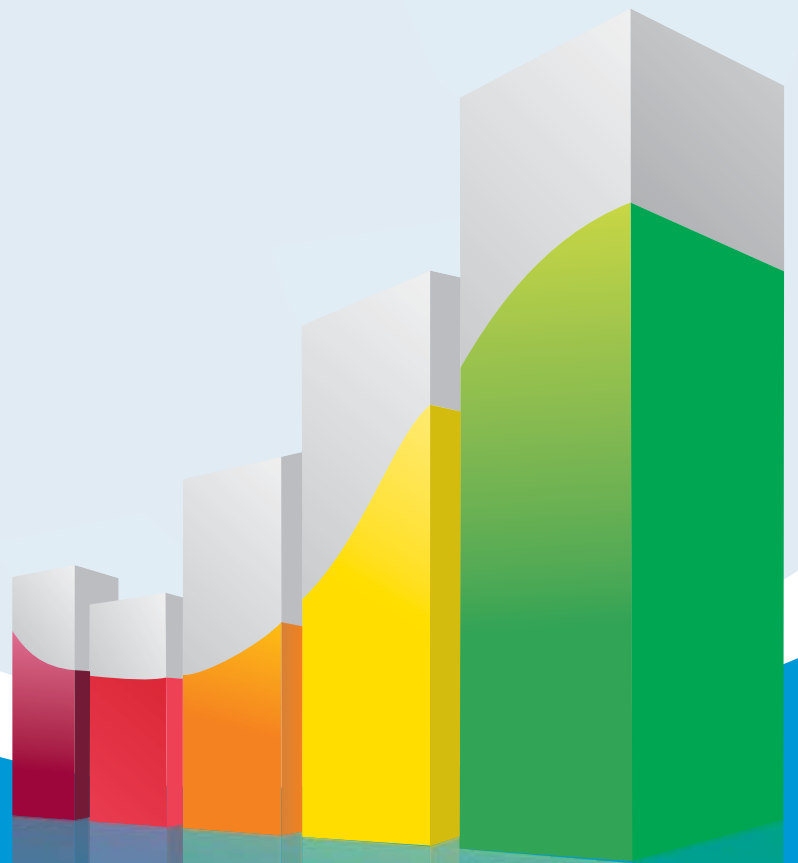


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Abbreviations and Acronyms

ADB	Asian Development Bank	NIE	newly industrialized economy
ADO	Asian Development Outlook	OECD	Organisation for Economic Co-operation and Development
ARCH	Autoregressive Conditional Heteroskedasticity	OPEC	Organization of the Petroleum Exporting Countries
ASEAN	Association of Southeast Asian Nations	OREI	Office of Regional Economic Integration
ASEAN+3	ASEAN plus the People's Republic of China, Japan, and Republic of Korea	PCOMP	Philippine Composite Index
ASEAN-4	Indonesia, Malaysia, Philippines, and Thailand	PRC	People's Republic of China
BI	Bank Indonesia	PMI	purchasing managers index
BIS	Bank for International Settlements	QE2	second round of quantitative easing
CPI	Consumer Price Index	QE3	third round of quantitative easing
DOLS	dynamic ordinary least squares	q-o-q	quarter-on-quarter
EMBI	Emerging Markets Bond Index	repo	reverse repurchase
G3	US, eurozone, Japan	RMSE	root mean square error
G20	Group of 20	saar	seasonally adjusted annualized rate
GDP	gross domestic product	SET	Stock Exchange of Thailand
HSI	Hang Seng Index	STI	Straits Times Index
IMF	International Monetary Fund	TED	treasury bill and eurodollar futures contract
JCI	Jakarta Composite Index	TWSE	Taipei, China's stock exchange
KLCI	Kuala Lumpur Composite Index	US	United States
KOSPI	Korean Stock Price Index	VNINDEX	Ho Chi Minh Stock Index
Lao PDR	Lao People's Democratic Republic	y-o-y	year-on-year
M2	broad money	\$	US dollars unless otherwise indicated
MSCI	Morgan Stanley Capital International		
m-o-m	month-on-month		

Emerging East Asia
**A Regional
Economic Update**

Highlights

Economic Performance

- Growth across emerging East Asia moderated in the first half of 2011 as authorities wrestled with rising inflation; domestic demand remains robust albeit with easing investment as NIEs drawdown inventory.
- Inflation continued to rise across much of the region, driven by higher commodity prices and strong economic recovery.
- Balance of payments surpluses narrowed on lower capital inflows, even as strong exports boosted current accounts.
- Emerging East Asia's stock markets were mixed in the first half as the region's growth moderated and monetary policies tightened.
- Most of the region's currencies continued to gain against the US dollar, but depreciated against a basket of trading-partner currencies.
- Bond yield curves mostly flattened as monetary authorities raised policy rates.
- Authorities across the region shifted focus to combating inflation, raising policy rates to counter price pressures.
- Strong fiscal balances in emerging East Asia and low foreign debt keep financial vulnerability low, while growth in bank lending slows in response to tightening monetary policies.

Outlook and Risks

- The external economic environment continues to weaken with an anemic US recovery, Japan's post earthquake contraction, and continuing uncertainty over some of Europe's sovereign debt.
- A weaker external environment plus tightening monetary and fiscal conditions in the region will likely moderate growth; aggregate GDP is expected to rise 7.9% in 2011 and 7.7% in 2012.

- The economic outlook is subject to four major risks: (i) rising inflation leading to wage-price spirals; (ii) a weaker than expected recovery in Japan and unresolved debt problems in the US and eurozone; (iii) increasing financial market volatility; and (iv) destabilizing capital flows.

Policy Issues

- With robust growth moderating only slightly, many emerging East Asian economies face the challenge of controlling inflation and managing capital inflows in a difficult external environment.
- Persistent and volatile changes in commodity prices are a challenge to inflation management; monetary policy will likely continue to tighten despite slow recovery in advanced economies.
- Exchange rates can help tackle inflation; with faster appreciation also contributing to rebalancing the sources of growth toward greater domestic and regional demand.
- Effectively managing capital flows remains a challenge—maximizing growth benefits while minimizing effects of volatile liquidity.
- Macroprudential supervision and financial regulation can be strengthened to help reinforce the region's financial stability; regional policy cooperation and advance policy coordination can ensure more balanced and sustained economic growth.

Managing Commodity Price Volatility and Inflation in Emerging East Asia

- Over the past 12 months, headline inflation in emerging East Asia has trended upward despite some moderation since the second quarter; sharp increases in commodity prices—especially food and energy—account for most of the rising inflation.
- A pragmatic approach to a range of policies may help policymakers manage the inflation impact of persistent and volatile changes in commodity prices.
- Using trends in global food and energy prices to project headline inflation may help define monetary policy in headline terms—making it easier to communicate inflation targets or objectives to the public.

- A more flexible monetary approach may be needed in response to potentially persistent and volatile commodity-driven inflation.
- Greater exchange rate flexibility can help mitigate the effects of global commodity price surges on domestic prices.
- Policymakers could use structural and fiscal policies to boost supply and increase economic flexibility when responding to commodity price changes.
- Market-based commodity price stabilization mechanisms and participating in commodity financial markets may help mitigate commodity price volatility.
- Greater cooperation to ensure (i) adequate trade in food and energy, (ii) effective commodity market regulation, and (iii) appropriate macroeconomic policy can help manage commodity price volatility and inflation.

Asia Economic Monitor July 2011

The *Asia Economic Monitor* is a semiannual review of emerging East Asia's growth and policy issues. It covers the 10 members of the Association of Southeast Asian Nations; the People's Republic of China; Hong Kong, China; Republic of Korea; and Taipei, China. This issue includes a special section on managing commodity price volatility and inflation in emerging East Asia.

About the Asian Development Bank

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

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

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