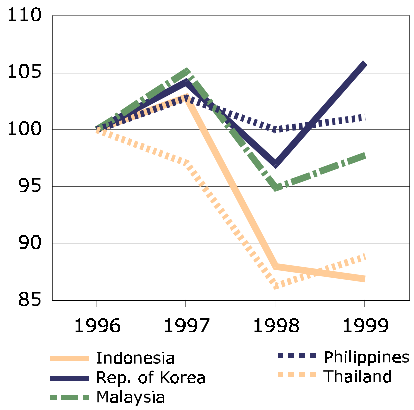
Tracking Asia's Recovery—A Regional Overview

The Recovery Process—Asset Markets and the Real Sector

Figure 1: **GDP per Capita Index** (1996=100)

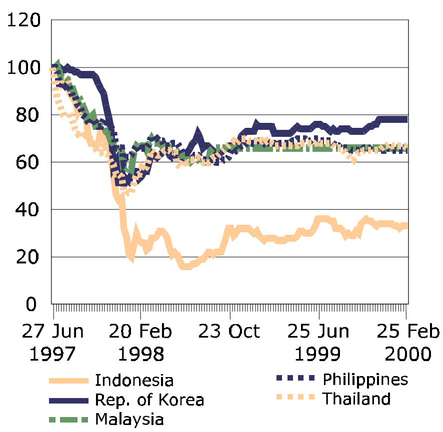


Note: 1999 data on population are ADB staff forecasts.
Sources: ADB, Key Indicators of Developing Asian and Pacific Countries; various national sources.

Following more than a decade of stellar growth, Thailand's GDP contracted in 1997. The other affected economies (Indonesia, Republic of Korea, henceforth Korea, Malaysia, and the Philippines) grew more slowly in 1997 and by early 1998 output had begun to contract. By the end of that year, GDP had nose-dived by 13.2 percent in Indonesia, 10.4 percent in Thailand, 7.5 percent in Malaysia, 5.8 percent in Korea and 0.5 percent in the Philippines. But this dramatic reversal of fortunes proved short-lived. Most economies bottomed out and started picking up in late 1998 or early 1999. And as the year progressed, economic recovery gathered momentum. Korea turned in an outstanding performance in 1999 by growing at 10.2 percent. The growth performance of Malaysia, Thailand and the Philippines was more moderate at 5.4 percent, 4.0 percent and 3.2 percent, respectively. Indonesia's growth performance at 0.23 percent was also positive but slow.

While recovery is tangible, it is not yet broad-based. There are variations in the pattern of recovery across countries, and across the components of aggregate demand and supply. As is usually the case, recovery in financial markets has preceded recovery in the real sector.

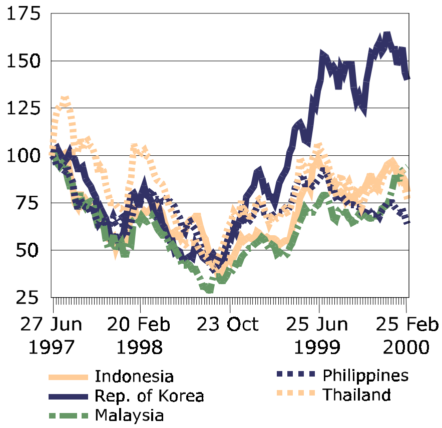
Figure 2: **Exchange Rate Index** (weekly average, last week of 1997June=100, $/local currency)



Source: ARIC Indicators.

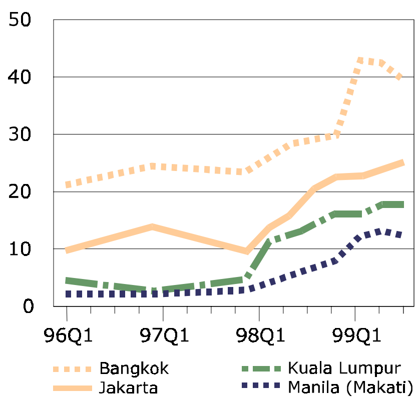
Also, per capita incomes have yet to climb back to their pre-crisis levels in Indonesia, Malaysia, the Philippines and Thailand. One way to gauge the extent of the recovery is to compare per capita income levels in local constant prices with the pre-crisis levels (Figure 1). For all countries, but Thailand, 1997 is the most recent peak in GDP per capita incomes. In Thailand, 1996 is the peak. By the end of 1999, only Korea had a level of GDP per capita that exceeded its previous peak. In all other economies GDP per capita still has lost ground to make up. Mainly because it did not fall so much, the Philippines has the shortest way to go, and may regain or exceed its most recent peak by the end of 2000. Malaysia may take another two years, with full recovery of lost income taking even longer in Thailand and Indonesia. Even then GDP per capita

Figure 3: **Composite Stock Price Index*** (last week of 1997June= 100, in local currency)



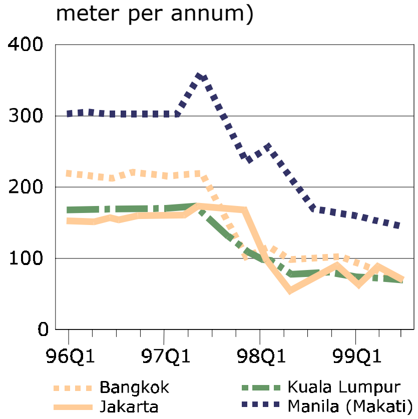
*Weekly averages of JCI (Indonesia), KOSPI 200 (Korea), KLCI (Malaysia), PHISIX (Philippines) and SET Index (Thailand).
Source: ARIC Indicators.

Figure 4a: **Office Vacancy Rates in Major Cities** (%)



Source: Jones Lang LaSalle, Asia Pacific Property Digest, October 1999.

Figure 4b: **Office Rents in Major Cities** (US$ per square meter per annum)



Source: Jones Lang LaSalle, Asia Pacific Property Digest, October 1999.

in the affected countries would remain well below what would have been achieved if growth had continued unabated.

ASSET MARKET RECOVERY. Following their initial precipitous collapse, exchange rates stabilized and, in early 1998, began to recover some of the ground they had lost (Figure 2). Subsequently, the volatility in exchange rate movements that accompanied their collapse and partial recovery dissipated. Today, in nominal terms, the value of local currencies has steadied, but they still buy 20 to 35 percent fewer US dollars than before the crisis in Korea, Malaysia, the Philippines and Thailand, and 70 percent fewer dollars in Indonesia.

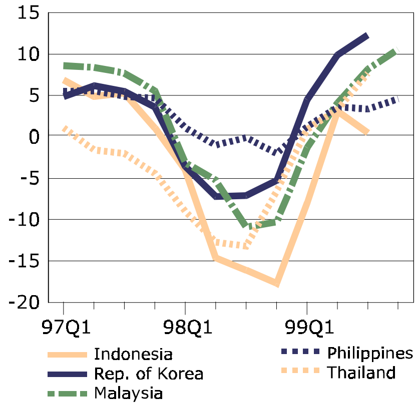
Stock markets fell to their lowest point around the third quarter of 1998 (Figure 3). Since then they have recovered strongly, and all but the Philippine market made stellar gains in 1999. In part, these gains have been driven by the additional liquidity generated by current account surpluses and lower interest rates. Corporate earnings growth is, however, yet to validate more bullish expectations. Despite their rebound, stock market indexes in most economies are still about 10-35 percent lower than their pre-crisis levels in local currency terms and about 40-75 percent lower in US dollar terms. Only in Korea have markets fully recovered both in local currency terms (around +40 percent) and in US dollars (+10 percent). The picture of the recovery is, therefore, sensitive to whether returns are measured in local currency or dollars.

Recovery in the markets for physical assets is yet to begin. Property markets remain generally depressed. Office vacancy rates have started to stabilize and fall. However, rents continue to soften (Figure 4). Loan assets also remain heavily discounted. Early signs of recovery in property markets have emerged in Korea (page 28).

THE REAL SECTOR. The pace of recovery in the crisis-hit Asian countries (Figure 5) has caught almost all by surprise. Since the beginning of 1999, the Consensus Economics' forecasts[1] of 1999 economic growth rates in the affected countries have been revised upwards almost every month (Figure 6). For example, the January forecast of the 1999 real economic growth rate in Korea was about 1 percent. This figure doubled in February, doubled again in May, and increased by more than one half again in August

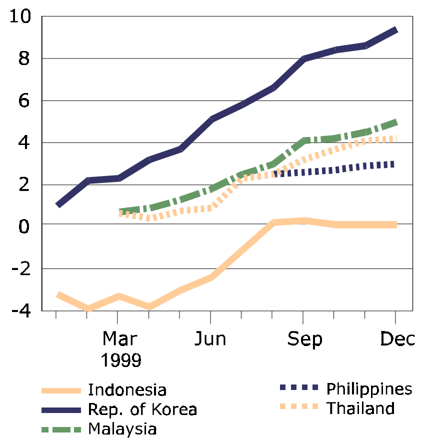
[1]Asia Pacific Consensus Forecasts, Consensus Economics Inc., United Kingdom.

Figure 5: **Real GDP Growth**
(% y-o-y)



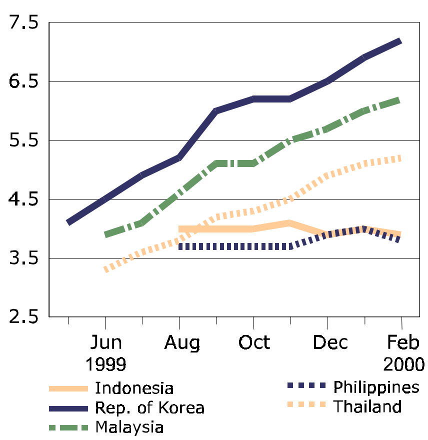
Source: ARIC Indicators.

Figure 6: **Consensus Economics Forecast of 1999 GDP Growth** (%)



Source: Consensus Economics Inc., Asia Pacific Consensus Forecasts, various issues.

Figure 7: **Consensus Economics Forecast of 2000 GDP Growth** (%)



Source: Consensus Economics Inc., Asia Pacific Consensus Forecasts, various issues.

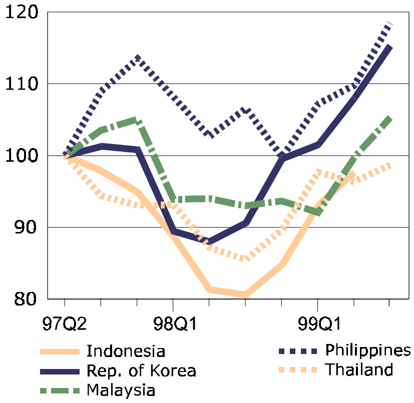
to reach more than 6.6 percent. The December growth forecast for Korea was 9.4 percent, which turned out to be below actual performance. The 1999 growth forecast was revised upwards for Indonesia as well—from a contraction of more than 2 percent predicted in June, to a 1 percent contraction forecast in July, to a 0.3 percent growth projected in September. Similar upward revisions have been made for year 2000 forecasts (Figure 7).

Recovery has also been uneven. It has been most pronounced in Korea, so strong in fact that there are now latent inflationary pressures in the economy. In Malaysia and Thailand, it has been less spectacular but nevertheless impressive. Despite accommodating monetary policies and substantial deficit spending measures, inflationary pressures remain muted in both these economies. Economic activity in the Philippines did not contract to the same extent as in the other countries. To some degree, this explains the apparently mild recovery of output that has occurred there. In Indonesia, where political developments have had a decisive influence on the economy, output has only now stabilized after collapsing in 1998.

On the supply side, the agricultural sector has rebounded following the devastation of the El Niño and La Niña weather phenomena. This has benefited mainly the Philippines, Indonesia and Thailand. However, except in Indonesia and the Philippines, it is the industrial sector, particularly the manufacturing sector, that has led the recovery process. The strong recovery in the industrial sector is attributable to a rebound in export demand. The industrial production indexes of all the affected countries, except Indonesia and Thailand, now exceed pre-crisis levels (Figure 8). However, with the exception of Korea, industrial output remains below capacity in all these countries, with the gap being greatest in Indonesia.

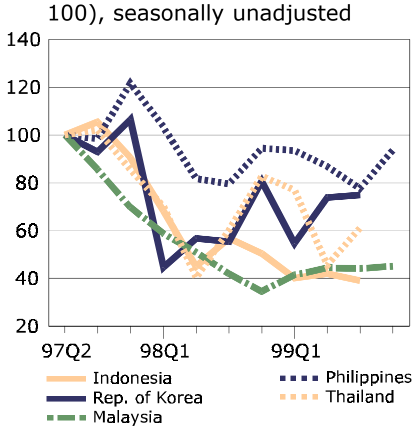
On the demand side, the recovery has been led by public consumption expenditures reflecting the accommodating fiscal stance of governments since the middle of 1998. But the recovery is not yet broad-based. Private consumption expenditure has lagged except in Korea where recovery began in early 1999. Elsewhere, retail sales and private consumption are now on a gradual upswing. Real investment in plant and equipment continues to be depressed (Figure 9) although demand is now beginning to pick up in Korea, the Philippines and Thailand. Until the middle of 1998, exports from the affected countries remained weak (Figure 10).

Figure 8: **Industrial Production Index*** (1997Q2=100), seasonally adjusted



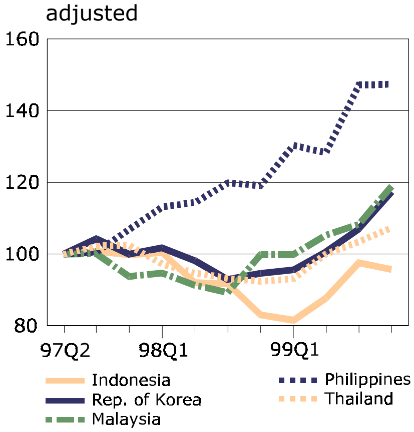
*Manufacturing for Indonesia, the Philippines, and Thailand.
Source: ARIC Indicators.

Figure 9: **Real Gross Domestic Investment Index** (1997Q2=100), seasonally unadjusted



Source: ARIC Indicators.

Figure 10: **Quarterly Export Index** (1997Q2=100), seasonally adjusted



Source: ARIC Indicators (data from national sources).

The exception was the Philippines where overall exports did not suffer, mainly because of the country's reliance on the booming US market. The strong recovery in exports since then reflects a global upswing in the electronics sector that has driven the demand for semi-conductors, and computer and electronics products. Now that Y2K concerns have passed, there is a possibility that this demand may soften somewhat. Other than that, the prospects for exports remain good. Strengthening import demand since the end of 1998, except in Indonesia, suggests that further strengthening of demand and output is in the pipeline (Figure 11).

FORCES DRIVING THE RECOVERY. What are the factors that explain Asia's surprisingly quick bounce-back? Two general considerations are worth bearing in mind.

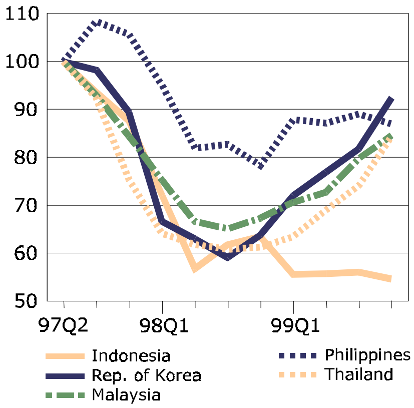
First, it is worth recalling that Asia's fast growth has been punctuated by abrupt slowdowns even before the recent crisis. In 1985, growth slowed sharply across East and Southeast Asia. In Korea, growth nose-dived at the beginning of the 1980s. Oil price shocks in the 1970s also took their toll. Contrary to popular perception, growth in Asia has not always followed a smooth path. But what has consistently set the economies of the region apart from others is their capacity for recovery. In no small part, this has been due to the resilience of their economic structures and the pragmatic policies of their governments. These factors also play a part in explaining the ongoing recovery.

Second, financial crises do not of themselves destroy the capacity for growth. Although they may exact a heavy toll in terms of lost output, and trigger social reversals, accumulated experience suggests that most economies recover, with growth resuming its previous course after a painful interval of three or four years. To the extent that self-fulfilling panic and irrational pessimism play a role in amplifying financial crises, as the pendulum of expectations swings back to a more balanced position, recovery usually begins.

Together, market resilience, pragmatic policies and a more realistic assessment of Asia's potential go a long way in explaining the recovery itself as well as its rapid progress.

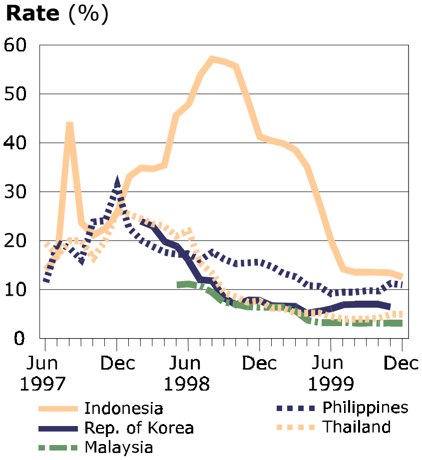
The sudden and large withdrawal of capital experienced by the affected economies in 1997 and 1998 delivered a massive deflationary shock, which, initially, may have been aggravated by

Figure 11: **Quarterly Import Index** (1997Q2=100), seasonally adjusted



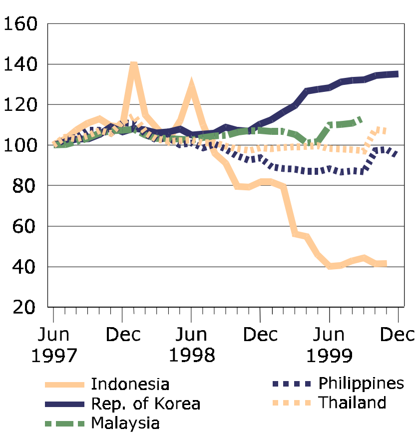
Source: ARIC Indicators (data from national sources).

Figure 12: **3-Month Interbank Rate** (%)



Source: ARIC Indicators.

Figure 13: **Real Bank Credit*** (1997June=100), seasonally adjusted



*Claims on the private sector: deposit money banks.
Source: ARIC Indicators.

contractionary demand policies. Whatever the reasons for the shock, it ultimately required an increase in net exports and an accompanying shift of resources from the non-traded to traded goods sectors of the affected economies. As domestic demand contracted, adjustments in factor markets were also called for. The relative price changes needed to facilitate these adjustments have been made surprisingly smoothly. In general, increases in unemployment rates have been contained, real labor costs have fallen and real exchange rates have adjusted to accommodate the needed reallocation of resources. While these adjustments have caused pain and some social reversals, a more protracted process would have ultimately proved more disruptive, increased social costs and hindered recovery.

After a painful bout of austerity, a move to more accommodating monetary policies and large deficit spending programs helped the recovery. Most of the affected economies now have unprecedented fiscal deficits. Short-term nominal interest rates have also come down sharply and are now either below their pre-crisis level or close to it (Figure 12). But, except in Korea and more recently Malaysia, the more accommodating monetary stance is not yet reflected in the growth of the stock of private sector credit (Figure 13). In part, this is because non-performing loans (NPLs) have reduced the stock as they have been removed from the balance sheets of banks and converted into other instruments. Trends in the flows of new loans are much more encouraging. Lower interest rates have also undoubtedly eased the distress experienced by businesses and helped support recovery in regional equity markets.

The investor panic (both foreign and domestic) that triggered the Asian crisis has now come to an end. Partly, this is because whatever capital was going to be withdrawn has now been pulled out. In fact, the flight of capital had more or less abated by the middle of 1998. Although net transfers from banks have remained in negative territory, flows of direct equity and portfolio investment were, in general, sufficient to stem the outflow of capital in 1999. This has gone a long way to easing constraints on domestic absorption. Capital inflows are expected in 2000, according to the Institute of International Finance. To a large degree, better-informed domestic investors led foreign investors back into the region's equity markets. Just as the recession tended to be worse than expected when capital was fleeing the region, the recovery now is coming faster than expected by most observers.

There are other factors, too, that have worked in favor of recovery.

External developments have helped Asia get back on its feet. They have followed an unexpectedly benign course. Only 12 months ago, deflationary risks cast their shadow over the global economy and there seemed to be a distinct threat of a further round of competitive devaluation. But the global economy has shown itself to be more resilient than even the most optimistic could have hoped. The latest World Economic Outlook issued by the International Monetary Fund (IMF, October 1999) suggests that global output growth in 1999 may have reached 3 percent, only a shade below the 3.1 percent averaged since 1990.

The US economy has played an important role in supporting global demand during the recent turbulent times. Over the past two years, the United States has accounted for more than 50 percent of the growth of global demand. This has been reflected in record US current account deficits. Last year, GDP growth in the United States was estimated to be 4 percent. US growth is being propelled by strong private sector demand. Demand in the United States has remained strong while inflationary pressures, helped by lower commodity prices and a strong dollar, have so far been astonishingly muted. A ballooning US trade deficit has proved to be an important buffer against global recession, and this has helped prime demand for goods and services produced in Asia.

Growth in Japan declined by nearly 3 percent in 1998. While there have been some signs of improving economic confidence, including a sharp appreciation of Japanese equity values, growth in 1999 largely reflects earlier deficit spending measures. Positive growth in the first half of 1999 helped stimulate recovery in the region. However, the return to negative growth in the second half of the year weakened the stimulus to regional exports that otherwise would have been created by the stronger yen. A further substantial fiscal stimulus package introduced in late 1999 should also support Japanese growth in 2000.

Emerging market economies have generally recovered well following the tumult of 1998 and early 1999. The deflationary threat that has been hanging over the People's Republic of China (henceforth PRC) now seems to be lifting. Reform measures designed to tackle deep-seated inefficiencies in economic organization, and promote longer-term growth, initially suppressed demand. However, massive fiscal stimulus measures and an accommodating monetary policy have helped to support domestic demand. Stronger export growth starting in the second half of 1999 has also contributed to growth. Growth in 1999 was about 7.3 percent. Stronger export demand is expected to take over from domestic demand in sustaining economic momentum in 2000, with growth expected to remain between 7 and 8 percent. Stability in regional currencies has been helped by the stable value of the renminbi and by Hong Kong, China's careful management of the Hong Kong dollar's link to the US dollar.

Luck has played a role in Asia's recovery, just as it compounded underlying difficulties in 1997. In particular, more favorable weather conditions have raised agricultural output, especially in Indonesia and the Philippines. The negative effects of the global electronics downturn that occurred from 1996 through 1998 have now been reversed. Rising global electronics demand and prices have helped boost Korean, Malaysian and Thai exports. But rising oil prices have been something of a mixed blessing. They have worked in favor of net exporters of fuel, such as Indonesia, but against net importers, such as Korea, the Philippines and Thailand.

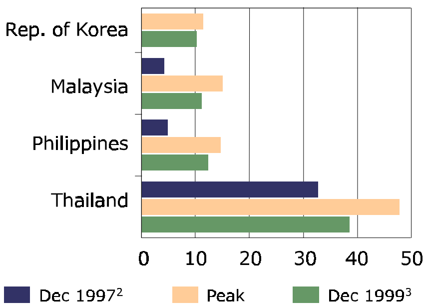
Finally, recovery is now being supported by the strong trade links that exist among the regional economies. To an extent, renewed growth within the region will become self-propelling as the benefits of expanded demand spill across borders.

Medium Term Aspects—Bank and Corporate Restructuring

(These issues are dealt with at greater length in the Bank and Corporate Restructuring section starting on page 62.)

The initial conditions of, and approaches to, financial and corporate sector rehabilitation differed somewhat among the crisis-hit economies. These problems were least severe in the Philippines and most severe in Indonesia. Indonesia, Korea and Malaysia have chosen a government-led approach to the restructuring of the banking sector, while Thailand has favored a more market-oriented approach. In the Philippines, there have been some signs of stress in the banking sector, but circumstances have not warranted any explicit bank restructuring measures. In most economies, a more decentralized approach to corporate sector restructuring has been followed. The role of government has been to provide a framework and set the rules within which debtors and their creditors can reach voluntary agreement. In Korea, the influence of the *chaebols* has required that government take a more direct role in the restructuring process.

Figure 14: **Non-performing Loan Ratio[1]** (%)



[1]Data on non-performing loans for Malaysia and the Philippines cover the banking sector only while those for Korea and Thailand cover all financial institutions.
[2]June 1998 for Thailand.
[3]September 1999 for Korea.
Source: ARIC Indicators.

The systemic banking crisis in the region led to sharp increases in the NPL ratios in the affected countries (Figure 14). In terms of removing bad loans and restoring bank capital, Malaysia and Korea have made the most progress. The private sector led approach followed in Thailand initially created some uncertainty, but now seems to be delivering results. NPLs are trending downward, and new capital is being infused into the system in response to looming regulatory deadlines. In the Philippines, until recently, the NPL ratio was increasing because of the weaknesses of thrift banks. But now it has started to fall. The situation in Indonesia remains highly problematic. Most banks are insolvent and operating only with the support of Bank Indonesia, the country’s central bank.

Bank privatization programs have progressed slower than envisaged, and reforms targeting non-bank financial intermediaries have lagged behind those targeting banks. On average, state ownership of assets has increased to 50 percent or more (about 75 percent in Indonesia) as asset management companies have purchased assets from banks. The asset management companies have, however, been slow in re-selling those assets. There is an urgent need to put these assets to productive use and to raise revenue to tackle the rising debt burden.

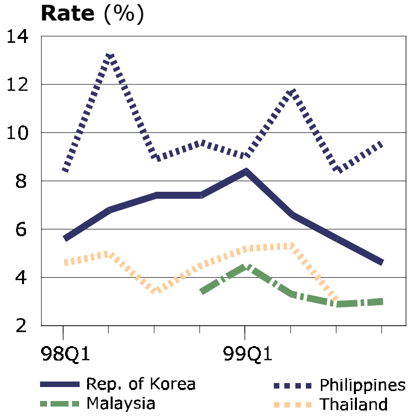
In all five countries, progress on the resolution of corporate debt is slower than banking sector restructuring. Nevertheless, there are increasing signs of progress with a growing number of cases being resolved either within voluntary frameworks or outside them. In many instances, however, such settlements do not seem to have been accompanied by the operational restructuring needed to ensure durable profitability. There have also been isolated cases of bailouts. Again, progress in Indonesia lags behind that in the other countries.

Looking ahead, further resources for the re-capitalization of banks will need to be found in Indonesia and possibly also in Thailand. In Indonesia, this could present formidable fiscal problems. Given the more modest scale of the capital deficits in Korea and Malaysia, economic recovery should go a long way in healing bank balance sheets. In the Philippines, the private sector is being left to address additional capital needs. Over the longer term, the future safety of financial sectors in the affected economies will depend on further strengthening regulatory and supervisory systems, and improving banking and corporate governance.

Longer Term Aspects—Social Recovery, Governance and Competitiveness

An important challenge confronting the affected countries is to achieve sustained recovery in the social sector. The crisis has demonstrated forcefully that informal safety nets provide inadequate protection in the current potentially turbulent environment. This is one reason why social recovery is lagging behind economic recovery. While social support systems in the region have been strengthened significantly, much more remains to be done. As these economies move forward, institutional arrangements must be found that better protect the most vulnerable and least well-off. More generally, continuing investments in the health, education and general welfare of the broad mass of the population should be a matter of priority. In these matters, an approach that empowers people rather than provides unsustainable subsidies is most likely to reconcile legitimate social objectives with economic efficiency and dynamism. While some growth may be possible without these changes, it will inevitably be of lower quality, more difficult to sustain and more vulnerable to adverse shocks.

Figure 15: **Unemployment Rate** (%)

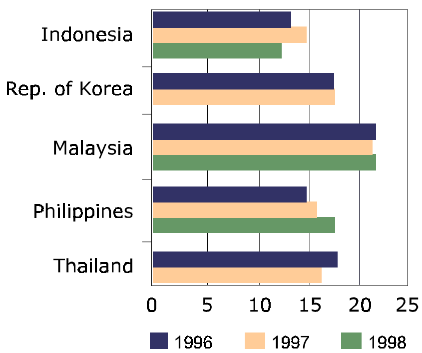


Source: ARIC Indicators.

Although the results are mixed, several social indicators also show signs of turnaround and recovery. The recent decreases in unemployment levels are encouraging (Figure 15). But they are still above the pre-crisis levels of 1996. Public health and education expenditures have also increased somewhat in Malaysia and Korea (Figure 16 and Figure 17). Private consumption levels also started to recover in 1999.

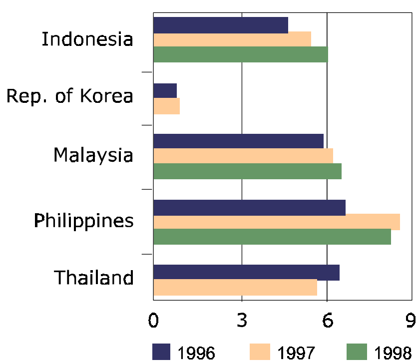
Issues of governance in the public and corporate sectors have been brought to the fore by the crisis. Too much has probably been made of the deficits that clearly existed before the crisis. Fast growth coexisted with these shortcomings prior to the crisis and growth has now resumed with only modest changes. But this is no reason for complacency. Good governance can and does

Figure 16: **Government Expenditure on Education**
(% of total budget)



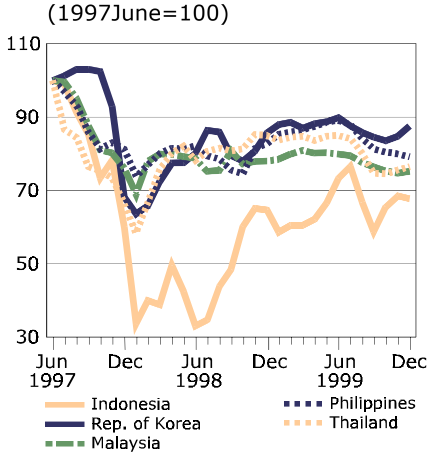
Source: ARIC Indicators.

Figure 17: **Government Expenditure on Health**
(% of total budget)



Source: ARIC Indicators.

Figure 18: **Real Effective Exchange Rate Index***
(1997June=100)



*Traded vs. nontraded goods prices.
Source: ARIC Indicators.

contribute significantly to both the quantity and quality of growth. In an increasingly interdependent global economy, good practices are likely to assume greater importance in assuaging investor concerns. Governments have a key role to play in developing institutional frameworks conducive to good governance and ensuring that they function effectively.

After the sharp appreciation of real effective exchange rates since the beginning of 1998, issues related to competitiveness have also resurfaced (Figure 18). While the affected countries have focused on getting back on their feet, competition from other countries within the region and outside has continued to intensify in key export markets. On a global scale, excess capacity is now apparent in a number of sectors. Prices of electronics and electrical machinery and equipment, telecommunications equipment, computer equipment and office machines, and transportation equipment have all fallen sharply in recent years. And prices of exports from East Asian nations have fallen more sharply than those from other regions. This, no doubt, contributed to the 1998 contraction in the nominal dollar value of exports from the affected countries. Electronics prices have recovered since then, indicating that the prices of these products are quite sensitive to the balance between supply and demand. Partly because of the recovery in electronics, export growth rates recovered strongly in 1999 in all five countries except Indonesia. Export volumes have been buoyed by strong world demand, but have also responded, although with a lag, to depreciated real exchange rates.

There are, however, competitive pressures facing Indonesia and, to a lesser degree, Thailand and the Philippines in markets for labor-intensive exports. These may increase with the entry of the PRC into the World Trade Organization (WTO), although that would also provide new opportunities for trade. With intensifying export competition, the region's major trading partners may give in to pressures to apply anti-dumping and other protective measures to limit the market penetration of Asian exports. Another potentially serious challenge arises from the failure of the Seattle Ministerial Conference of the WTO. The lack of consensus on further liberalization of trade on a most-favored nation basis through multilateral negotiations may encourage countries to focus on strengthening regional ties on a discriminatory basis. These preferential arrangements carry the potential of trade diversion and may further limit the market access of the affected countries in regions such as the Americas and Europe.

Going forward, in order to sustain a recovery of international trade it will be essential for regional economies to improve their access to markets overseas. This may require a more focused and coordinated voice in negotiations over multilateral trade liberalization. Domestic constraints also need to be addressed. Wise investments in education and human resources as well as infrastructure, and further deregulation of investment and liberalization of trade policies will help achieve this. Moving resources from activities in which comparative advantage is fading into others where opportunities are expanding is a perpetual challenge.

Recovery Prospects and Risks

MEDIUM TERM PROSPECTS. Having proved overly pessimistic in 1999, the accepted view now is that recovery will be consolidated and possibly strengthened in 2000. Consensus Economics expects growth to slow down in Korea, falling to 7.2 percent, after the pronounced recovery that has already taken place there. The range of projection is, however, rather wide from 5.8 to 9.0 percent reflecting the underlying uncertainties. On the other hand, the Indonesian economy is expected to grow by 3.9 percent, also with a wide range of 2.7 to 5.5 percent. Growth is also expected to accelerate in Malaysia, the Philippines and Thailand. Three factors underlie these reassuring assessments. First, monetary and fiscal policies are expected to remain accommodating. Second, favorable conditions in the global economy are expected to continue. Third, output is still somewhat below potential and as the gap is closed, growth will be supported. With uncertainty lifting, domestic sector private demand is expected to play a stronger role in propelling growth in 2000 than it has done so far. While public consumption is expected to stabilize as governments focus on fiscal consolidation, private sector demand and real investments are expected to pick up. Net exports may shrink a bit, as imports rise with the general tide of economic activity.

In 2000, financial markets should be driven more by fundamentals than liquidity. Although stock markets have softened somewhat since early this year (except in Malaysia), there should be less volatility in the future. Financial markets in the affected countries should be more attractive to investors seeking less risk and provide diversification opportunities. Real estate prices should also start to nudge up.

Solid growth should ease the pains of bank and corporate restructuring. Rising demand should improve credit flows in the economy and cash flow positions of banks and corporates. These developments should make domestic assets more attractive to foreign as well as domestic investors. The fiscal position of governments should also improve. Finally as the recovery consolidates and becomes more sustained, social recovery should also progress further.

RISKS. Tangible as the recovery process is, it remains prone to risks in both the domestic and global economic environment. On a positive note, contagion and financial volatility in the global economy seem to have faded through 1999, and the affected countries of Asia are now in a much better position to withstand any future shocks. In all five affected economies, foreign exchange reserve positions have strengthened considerably over the past 12 months. The calm response in global financial markets to the devaluation of the Brazilian real in early 1999 marked a return to more orderly market dynamics. The recent Ecuadorian default hardly registered at all in Asian markets. Spreads on Asian debt have narrowed throughout 1999 in response to improving regional economic conditions.

EXTERNAL RISKS. External risks are also receding, although they cannot be entirely discounted. The global economic environment is expected to be favorable. The United States is enjoying the longest period of economic expansion it has ever had. However, an unexpected “hard landing” in the United States or a slip back into recession in Japan would set regional prospects back.

Recent US performance has raised questions about long-held assumptions regarding macroeconomic relationships. One view is that underlying structural changes are allowing the US economy to sustain faster growth than before (for any given inflation target). A conjunction of falling inflation rates and accelerating growth seems to support this proposition. Proponents of this view claim that rapid technological advance and demographic and institutional shifts, which make for much more flexible labor markets, are the pillars of the so-called New Economy.

As yet, it would seem the Federal Reserve Board (Fed) is not quite persuaded by this thesis. Whatever changes may be taking place in the US economy, the view of the Fed appears to be that the current alignment of unemployment, growth and inflation is not sustainable. Concerned by latent inflationary pressures, the Fed has gradually raised overnight borrowing rates. Between June 1999 and March 2000 the Fed raised the federal funds rate by 100 basis points. Recent economic data, particularly those that indicate there was an acceleration of growth in the final quarter of 1999, suggest that further short-term interest rate increases may be in the pipeline for the near future. In crucial ways, US prospects hinge on the stability of beliefs about asset prices and earnings growth, and in the capacity of the Fed to steer the US economy through to calmer waters. These are reasons enough to be cautious about US prospects.

If, for whatever reason, the current bullish mood were to change, growth could dip precipitously. Past experience and most valuation models suggest that, despite some softening in February 2000, US equities have risen in price to the point of being grossly overvalued. If productivity growth reverts to trend and the time-tested relationships between earnings growth and asset values reassert themselves, US asset prices could tumble. While such a reversal would certainly instigate a more accommodating monetary policy by the Fed, consumption and investment demand would slump. This would have adverse consequences not just for US growth but for global demand and trade, and possibly for global asset markets as well.

A second potential risk to US growth and economic stability would be an increasing reluctance by non-residents to finance the ballooning US current account deficit. This could happen for reasons that are quite independent of views about the durability of the "New Economy." A shift in sentiment away from US dollar assets, say because of rising returns elsewhere in the world, would inevitably depress US asset prices and squeeze domestic demand. In these circumstances, the Fed could face difficult choices.

Meanwhile, it is unlikely that the Japanese economy will grow faster in 2000 than it did in 1999 unless there is a stronger than anticipated recovery in private sector demand. Growth is expected to remain positive but be somewhat less than 1 percent.

Japan has embarked on a complex banking and corporate restructuring and reform program. Substantial fiscal resources have been devoted to this program. Over the medium term, restructuring efforts will help remove ingrained inefficiencies and establish a strong foundation for future growth. However, the more immediate impact of reform is likely to be deflationary. More retrenchments are likely as the operational and financial restructuring of troubled businesses continues. But once this difficult adjustment process has been completed, a reinvigorated financial and corporate sector should help propel the Japanese economy forward.

Growth in Europe is expected to pick up in 2000. Risks to growth in Europe include the possibility of a sharp reduction in US equity prices that may carry over into European markets. Some monetary tightening in the Euro area is also possible. In the United Kingdom, interest rates have been raised in response to strong demand. Early this year, the European Central Bank is likely to be forced to notch up overnight rates in response to moves by the Fed in the United States.

Among the emerging market economies, the PRC is clearly the most important for the affected countries. As the PRC begins the complex task of liberalizing its trade and investment regimes, under its bilateral trade agreement with the United States and with a view to its possible entry into the WTO, the pain of restructuring may be expected to increase before efficiency benefits are realized. While the closer integration of the economy of the PRC into the global economy may pose challenges for some other labor-intensive producers in Asia, easier access to the country's vast market will present enormous opportunities.

The risks of a devaluation of the renminbi now seem to be fading as economic activity picks up in the PRC. But a future devaluation cannot be ruled out completely. If the renminbi were devalued, it would exert modest pressure for depreciation on other currencies in the region. On the positive side, global market conditions are expected to improve for commodity-exporting developing countries over the course of the year. The anticipated acceleration of global growth in 2000 should provide stronger support for commodity prices in 2000. As a result, primary commodity producers may enjoy terms of trade gains for the first time in several years. For developing economies as a whole the IMF predicts terms of trade gains of about 1 percent in 2000 (IMF, World Economic Outlook, October 1999). This, in turn, should create favorable demand conditions for export-oriented East Asian economies, including those affected by the crisis.

DOMESTIC RISKS. As the recovery takes hold, concern is mounting that it may be used as a pretext to postpone or cancel reforms. This is a risk brought about by the swift rebound. Some have suggested that a more cautious approach to reform is now needed to allow growth to take firmer root. They point out that the initial impact of restructuring is likely to be deflationary as retrenchments and bankruptcies occur, and that this could disrupt the recovery. The argument then runs that since growth can ease debt burdens, it should be accorded a higher priority than reforms. Only once growth is more firmly established should reforms proceed. In an environment where growth is more firmly anchored, it is suggested, reforms will meet with less resistance and entail lower costs.

While this reasoning has its appeal, much depends on the severity of the underlying difficulties, and the rate of economic growth that can realistically be expected. While the expected fast growth in Korea and Malaysia may go a long way to resolving their debt problems, the projected growth for Indonesia and Thailand is likely to have much less of a remedial effect. If the expected growth did not take place, and reforms were deferred, debts would escalate further and make the entire restructuring process much more painful than it might otherwise be. In these circumstances, newly replenished bank capital could also be put at risk.

A "growth first" strategy is not only risky, it may invite a recurrence of problems at a later date, particularly if underlying structural difficulties are not tackled. Also the high public debt and fiscal deficits in the affected countries limit the feasibility of this approach. Accumulated experience would seem to indicate that the best chances for durable recovery require perseverance with reform. Encouraging economic activity by postponing or canceling needed but difficult reforms can exact a high cost in terms of a reduction in long-run potential growth. A sensible middle road is to combine reform with policies that provide needed, and affordable, support for demand. However, rising public debt levels may soon limit the room for maneuverability in fiscal policy, and rising global interest rates may require less accommodating monetary policies.

LONGER TERM PROSPECTS. Looking beyond the next year or two, an important issue is whether the crisis will have lingering effects on Asia's potential for growth. Has the crisis permanently blunted Asia's potential?

Those who are pessimistic about growth prospects point to the institutional weaknesses that the crisis has brought into sharp relief. Since strengthening and modernizing institutions is a timeconsuming activity, and there is a great deal of uncertainty about whether the needed changes can and will be made, Asia’s prospects for growth are diminished. Growth that rests on the rapid accumulation of capital may also be more difficult in the future, because diminishing returns and inefficiencies may set in quickly, especially in the presence of weak financial and corporate sectors. Other factors that could permanently damage growth prospects would include protectionism in the industrialized countries and the breakdown of the world trading system.

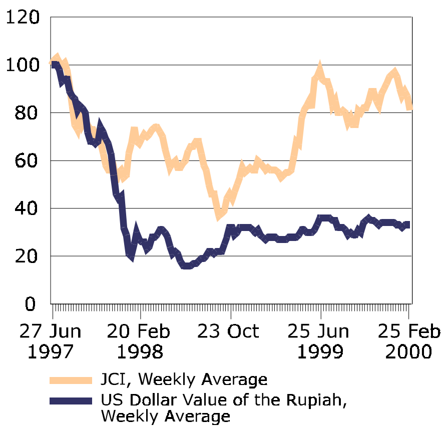
While growth pessimists’ views cannot be immediately discounted, they are not justified on the basis of broad historical experience. If reforms are continued, in the long run, the crisis may indeed appear to be a relatively moderate disturbance in Asia's rise and dynamism.

Over the long term, there is likely to remain ample high-yielding projects in the crisis economies and good potential for high rates of economic growth. Accumulated evidence shows that policy and institutional structures make a big difference to growth. With continued high rates of savings, sound macroeconomic policies, investments in education and infrastructure, and openness to trade and foreign investment, growth in Asia should revert to its long-run trend. For some economies, growth may slow naturally because of the changing demographic profile or simply because the potential for growth tends to diminish at higher levels of income. It bears underlining that fast economic growth is vital if poverty is to be eradicated and broad-based gains in living standards are to resume.

Indonesia Update

Asset Markets

Figure 1: **Exchange Rate and Stock Price Indexes**
(last week of 1997June=100)



Source: ARIC Indicators.

Positive political developments underpinned exchange rate stability.

The rupiah has strengthened to about 7,450 per US dollar, underpinned by improvements in domestic political conditions and a nascent recovery in the real sector. Although the rupiah now seems to be less vulnerable and volatile than before, trading levels during the last week of February 2000 represent a depreciation of about 67 percent in US dollar terms from its end-June 1997 level (Figure 1).

Stock market performance mirrored the regional trend.

The Jakarta Composite Index (JCI) began an unrelenting decline of more than 15 months following the onset of the crisis. This ended in the last quarter of 1998. In 1999, the index gained about 70 percent in local currency terms and about 90 percent in US dollar terms. This recovery suggests the possibility of more robust earnings growth ahead, but the JCI may also have been supported by improving perceptions of the region as a whole. By the end of February 2000, the JCI was about 20 percent lower in rupiah terms and 70 percent lower in US dollars than the end-June 1997 level.

The property market remains weak.

Both office and residential property markets crashed during the first half of 1998, with surging vacancy rates (Table 1) and rapidly falling rentals in Jakarta. Although office and residential rents in US dollar terms stabilized and recovered somewhat during 1999, on average they remained at one third of their pre-crisis levels. High levels of vacancy depressed property prices which, together with a reluctance on the part of current owners to accept massive losses, kept property transactions thin.

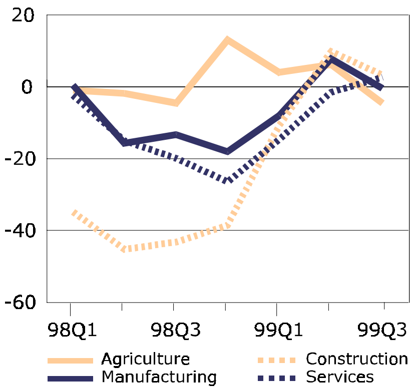
Table 1: **Property Vacancy Rates in Jakarta** (%)

	98Q2	98Q3	98Q4	99Q1	99Q2	99Q3
Office Property	15.6	20.0	22.3	22.3	24.3	25.7
Retail Property	…	…	…	…	16.4	…

… = not available.
Source: Jones Lang LaSalle, Asia Pacific Property Digest, various issues.

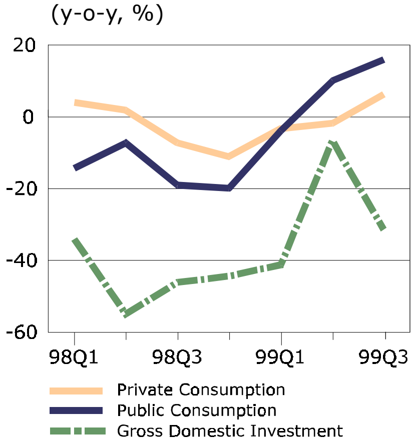
The Real Sector

Figure 2: **Sectoral Growth**
(y-o-y, %)



Source: ARIC Indicators.

Figure 3: **Growth of GDP Expenditure Components**
(y-o-y, %)



Source: ARIC Indicators.

Real sector recovery is slow and fragile.

Following a dramatic output contraction of 13.2 percent in 1998, some signs of recovery emerged in the second quarter of 1999. But the recovery process failed to gather momentum in the subsequent quarters. Real GDP growth for the full calendar year was only 0.23 percent (Table 2), the lowest among the affected countries.

Table 2: **GDP Growth and Projections** (%)

	1997	1998	1999	2000
Official[1]	4.5	-13.2	0.23	3.0–4.0
ADB[2]	—	—	—	4.0
IMF[3]	—	—	—	2.6
World Bank[4]	—	—	—	3.0
Consensus Economics[5]	—	—	—	3.9

[1]Bank Indonesia, Policy Implementation in 1999 and Policy Direction for 2000, January 2000; Statistics Indonesia, February 2000.
[2]ADB, Asian Development Outlook team, February 2000.
[3]IMF, World Economic Outlook, October 1999.
[4]World Bank, East Asia Pacific Brief, 31 January 2000.
[5]Consensus Economics Inc., Asia Pacific Consensus Forecasts, February 2000.

Sectoral performance is uneven.

Recovery in agriculture following the end of the El Niño-induced drought was the main source of GDP growth in 1999 (Figure 2). After a strong recovery in the second quarter of 1999, the manufacturing sector contracted again in the third quarter. Despite substantial gains in international competitiveness as a result of the rupiah's real depreciation, there are, as yet, no signs of an export-led recovery in manufacturing. The construction sector posted positive growth during the second and third quarters of 1999, owing primarily to public sector investment in infrastructure projects. However, given high vacancy levels and depressed prices in the property market, private sector construction activity remains depressed.

Growth in public consumption supported output in 1999.

Public consumption helped support output in 1999. Having shrunk in 1998, and over the first half of 1999, private consumption also picked up strongly in the third quarter (Figure 3). However, prospects for private consumption growth remain uncertain with sharp declines in real wages, uncertain job prospects and the drying up of consumer credit. Domestic investment collapsed in 1998, and continued to contract sharply in 1999. Given the low level of capacity utilization in manufacturing, the slump in the real estate sector and a fragile business climate, it is unlikely that investment will recover any time soon. Net exports contributed positively to growth in 1999, but this was due to severe import compression rather than to export growth *per se*.

Fiscal and Monetary Developments

The budget deficit widened, but more slowly than originally projected.

As private demand collapsed, fiscal policy became strongly expansionary from the middle of 1998. For the 1999/2000 fiscal year, the consolidated budget deficit was initially projected to reach 6.8 percent of GDP. To date, however, the actual deficit has been lower than this projection because of a slow disbursement of development funds, slow progress in bank restructuring and windfall fiscal revenues brought about by higher oil prices. Consequently, the deficit is now expected to be only 3.8 percent of GDP for fiscal year 1999/2000.

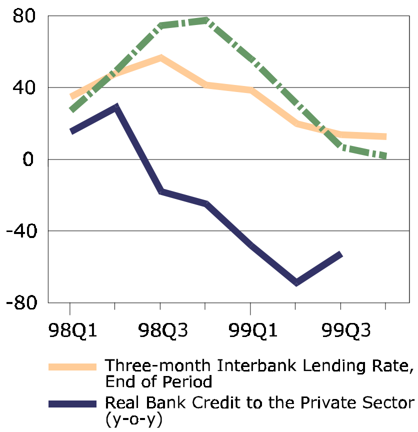
Large fiscal deficits will lift government debt to a record high.

Concessionary official loans, proceeds from privatization and asset sales by the Indonesian Bank Restructuring Authority (IBRA) have made an important contribution to the resources available to the public sector, but much of the widening budget deficit has been financed through bond issues. Consequently, public debt, including bonds issued to finance bank restructuring, is estimated to have increased to around 62 percent of GDP by the third quarter of 1999, compared to 25 percent when the crisis began. Part of the increase was due to the currency depreciation as the major portion of the central government debt is foreign debt. With debt levels set to rise even higher, concerns about public debt financing are likely to emerge.

Inflation is under control.

The monthly rate of inflation (year-on-year) peaked at 82 percent in September 1998 and then declined steadily to about 1.7 percent in December 1999. Plummeting inflation has been the result

Figure 4: **Short-term Interest Rate, Real Bank Credit Growth and Inflation Rate** (%)



Source: ARIC Indicators.

of the strengthening of the rupiah, an easing of domestic supply bottlenecks, particularly in agriculture, and the slowing of money supply growth. The slower growth in money supply has been due both to a conscious attempt by Bank Indonesia, the country's central bank, to regain control of money supply, and the impact of capital outflows.

Interest rates have also fallen.

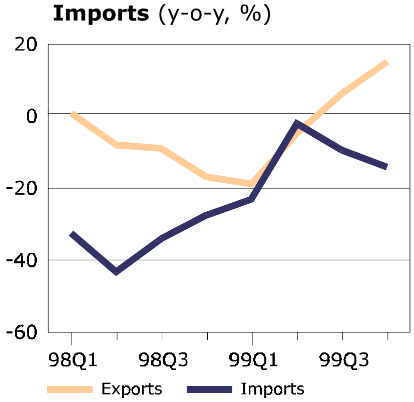
With greater stability in the value of the rupiah and declining inflation, the Indonesian authorities have cut domestic interest rates to support economic recovery. Following successive cuts in Bank Indonesia's statutory lending rate, the three-month interbank rate fell to below 13 percent at the end of 1999, from more than 50 percent in the middle of 1998 (Figure 4). Real interest rates are now positive.

But despite interest rate cuts the contraction in real credit continues.

Despite an accommodating monetary policy, bank credit extended to the private sector continues to contract in real terms. Bank balance sheets remain too weak to support lending, and credit demand is subdued. Lending is unlikely to resume until the debt-ridden banks have been sufficiently recapitalized and satisfactory progress has been made in corporate debt restructuring.

The Balance of Payments

Figure 5: **Growth of Merchandise Exports and Imports** (y-o-y, %)



Source: ARIC Indicators.

Import contraction has slowed and exports are edging up.

As imports contracted at an even quicker pace than exports, a current account surplus amounting to 3.5 percent of GDP is expected for 1999. This is about 1.3 percentage points higher than the ratio in 1998 and reflects general weaknesses in domestic demand. Merchandise exports grew in the third and fourth quarters of 1999 (Figure 5). This largely reflects the impact of increased world fuel prices on the value of Indonesia's oil exports.

Net FDI and portfolio capital flows remain negative.

Since the crisis began, there has been an outflow of both short-term and long-term private capital from Indonesia. Outflows of foreign direct investment (FDI) and portfolio capital continued in 1999. Approvals for FDI inflows for the first half of 1999 were only a tiny fraction of what Indonesia had received in earlier years. Despite official capital inflows, mostly funds made available under an emergency assistance program coordinated by the International Monetary Fund, the capital account remained in the red in 1999.

The external reserve position has gained strength.

As a result of falling imports and associated current account surpluses, international reserves started to rise from the second quarter of 1998. Capital inflows from official sources have also contributed to an accumulation of foreign exchange reserves. Reserves had reached US$26.3 billion as of end-June 1999.

External debt climbed to US$145 billion by end-September 1999.

External debt has climbed steadily since the onset of the crisis and is now about US$30 billion higher than at the end of 1997. The external debt to GDP ratio has escalated even more sharply, as a result both of the depreciation of the rupiah and the contraction in real income. Total external debt as a percentage of GDP had reached almost 110 percent by the end of September 1999. The debt service ratio increased from 44.6 percent in 1997 to 55.5 percent in 1999.

Financial and Corporate Sector Developments

There has been very little progress on bank restructuring.

The Indonesian banking system remains technically insolvent. IBRA embarked on a multi-billion dollar rehabilitation program in early 1998. But the implementation of the program came to an abrupt halt in August 1999 with the outbreak of the Bank Bali scandal, a month after IBRA had taken over management of the bank. According to Bank Indonesia, the non-performing loan (NPL) ratio had declined to 37 percent by the end of 1999 from 50 percent a year earlier, but independent estimates put the NPL ratio at as high as 80 percent. The stock of bank credit has been shrinking from mid-1998, both in nominal and real terms. This is hardly surprising as the banking system is in complete disarray.

Financing bank restructuring is a major fiscal challenge.

Financing banking sector re-capitalization is a major challenge faced by the Indonesian authorities. Many independent analysts believe that the government's total exposure to the banking system could be as high as Rp500-600 trillion, or 50-60 percent of GDP. As at the end of 1999, restructuring bonds worth Rp599 trillion had been issued. By the middle of 1999, Rp170 trillion had been extended in the form of liquidity support, of which only Rp10 trillion had been repaid.

Corporate restructuring is painfully slow.

Progress with corporate restructuring has been slow. As of December 1999, 323 firms, with a combined external debt of over US$23 billion and domestic debts of Rp14.7 trillion, had applied to work with the Jakarta Initiative task force to reach voluntary settlements rather than go through bankruptcy procedures. Standstill agreements have been reached for only 58 firms, accounting for US$3 billion in foreign debt and Rp2.2 trillion in domestic debt. The Frankfurt Agreement/Indonesian Debt Restructuring Agency scheme, which aims to provide liquidity and guarantee access to foreign exchange for indebted corporations, has also made limited headway. Initially, the scheme was not very popular among corporations and it was revised in October 1999 to better reflect the prevailing exchange rate situation and settlements outside the scheme. The slow pace of corporate restructuring has pushed the government to take action to speed up the reform process. In January 2000, IBRA was given a broad mandate to file insolvency petitions. The government has likewise signified its intention to play a more direct role in the Jakarta Initiative task force. Stricter disclosure rules and other reforms are also planned to improve corporate governance.

Prospects and Policy Issues

The economic outlook remains fragile.

The Indonesian economy remains vulnerable to external shocks. In particular, should oil prices fall and regional growth falter, Indonesia's nascent recovery could be stillborn. The political situation, which was volatile until recently, had created an uncertain investment climate for domestic and foreign investors alike. As yet, Indonesia has not really benefited from improved international competitiveness gained through the depreciation of the rupiah. Fiscal pump priming, which has been the prime mover of recovery so far, cannot be sustained indefinitely against a backdrop of growing fiscal imbalances and rapidly escalating debt. The latest forecast by Consensus Economics (February 2000) projects that the Indonesian economy will grow by 3.9 percent in 2000 with a wide range from 2.7 to 5.5 percent reflecting continuing uncertainty. The actual outcome will depend on how quickly private sector demand recovers, which, in turn, will be influenced by perceptions about how effectively underlying difficulties in the banking and corporate sectors are tackled and on continued political stability.

Bank restructuring is 'number one' on the reform agenda.

Speeding up and sustaining the recovery process depends crucially on the rejuvenation of the moribund banking system. Reducing NPLs and recapitalizing banks are essential to restoring credit flows. Given the sheer magnitude of the needed financial commitment, it is unlikely that banking sector restructuring can be successfully completed without drawing on foreign capital and expertise. To attract new investors, confidence must quickly be restored in both Bank Indonesia and IBRA.

Revamping enforcement mechanisms is vital for speedy corporate restructuring.

Although there has been some progress recently, much remains to be done in corporate restructuring. Despite new bankruptcy laws, and promised further legal reforms, corporate debtors appear to feel a lack of pressure to enter restructuring agreements. Clearly, the threat of bankruptcy is not yet seen as credible, and there are insufficient economic incentives (and sanctions) for debt resolution. The traditional business culture of Indonesia is now hampering debt settlement efforts. Reforms aimed at strengthening regulation and supervision must be matched by a commitment to their dispassionate and effective enforcement.

The high cost of bank restructuring may jeopardize fiscal consolidation.

Increasingly, there will be constraints on the use of fiscal resources to support domestic demand. Bank restructuring will create heavy fiscal obligations, leaving little room for maneuver in other areas. To meet heavy debt servicing costs, fiscal consolidation will soon be required. Given the need for continued public support for social sectors, tax reforms aimed at more efficient resource mobilization are needed.

There is a need for more formal social safety net mechanisms.

The human costs of the crisis have proved to be less dramatic than originally feared. Nevertheless, they have not been trivial and have warranted concerted policy actions. With a view to the longer term, more formal social safety net arrangements need to be worked out. Quite apart from the unarguable considerations of social justice, these schemes are important for ensuring the social and political stability needed for speedy recovery and durable growth.

Indonesia: Selected ARIC Indicators

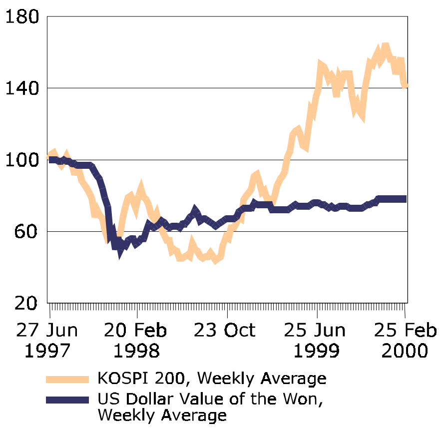
	1996	1997	1998	1999	98Q1	98Q2	98Q3	98Q4	99Q1	99Q2	99Q3	99Q4
Output and Prices												
GDP Growth (%)	8.0	4.5	-13.2	0.23	-4.0	-14.6	-16.1	-17.7	-8.0	3.1	0.5	...
Private Consumption Expenditure Growth (%)	9.7	7.8	-3.3	...	4.0	1.9	-7.2	-11.0	-3.3	-1.8	6.4	...
Public Consumption Expenditure Growth (%)	2.7	0.1	-15.4	...	-14.3	-7.3	-19.0	-19.9	-3.9	10.1	16.0	...
Gross Domestic Investment Growth (%)	...	6.3	-44.8	...	-34.0	-54.9	-46.1	-44.4	-41.2	-6.5	-31.3	...
Agricultural Sector Growth (%)	...	1.0	0.8	...	-0.9	-1.8	-4.5	13.2	4.0	6.2	-4.5	...
Manufacturing Sector Growth (%)	11.6	5.3	-11.9	...	0.6	-15.7	-13.3	-18.0	-7.9	7.9	-0.4	...
Construction Sector Growth (%)	12.8	7.4	-40.5	...	-34.8	-45.3	-43.2	-38.5	-10.6	9.9	3.3	...
Services Sector Growth (%)	6.8	5.6	-16.3	...	-2.3	-15.0	-19.9	-26.4	-14.6	-1.4	2.7	...
Exports of Goods and Services Growth (%)	7.6	7.8	11.2	...	57.5	21.8	22.7	-40.4	-44.3	-38.8	-39.9	...
Imports of Goods and Services Growth (%)	6.9	14.7	-5.3	...	23.4	8.7	4.4	-46.4	-52.9	-50.1	-49.3	...
Inflation Rate (%)	8.0	6.7	57.6	...	27.2	49.5	74.5	77.5	56.0	30.9	6.7	1.7
Unemployment Rate (%)	4.9	4.7	5.5	...	5.5	...	...	...	6.4	...	...	...
Monetary and Fiscal Accounts												
Growth of Broad Money, M2 (%)	27.2	25.2	63.5	...	54.9	84.5	70.5	66.0	34.1	8.8	18.5	...
Three-month Interbank Lending Rate (%)[1]	...	25.8	41.3	12.6	34.8	47.9	56.7	41.3	38.6	19.9	13.6	12.6
Growth in Real Bank Credit to Private Sector (%)[1]	14.5	17.2	-25.0	...	15.3	29.0	-17.9	-25.0	-48.1	-68.8	-52.5	...
Average Stock Price Index (JCI)	585.9	607.1	418.3	543.1	474.7	449.2	392.0	357.4	402.0	566.0	590.4	614.0
Central Government Fiscal Balance as % of GDP	...	-0.8	-2.1	...	...	...	...	...	...	...	...	...
Central Government Debt as % of GDP	24.3	25.0	71.5	...	36.7	48.8	62.1	71.5	68.7	63.9	61.6	...
Government Expenditure on Education (% of Total)	13.2	14.8	12.3	...	...	...	...	...	...	...	...	...
Government Expenditure on Health (% of Total)	4.6	5.3	6.0	...	...	...	...	...	...	...	...	...
External Account, Debt, and Exchange Rates[2]												
Growth of Merchandise Exports (US$, FOB, %)	9.7	7.3	-8.5	-0.7	0.9	-8.0	-8.9	-16.8	-18.8	-4.7	6.3	15.2
Growth of Merchandise Imports (US$, CIF, %)	5.7	-2.9	-34.4	-12.5	-32.4	-43.2	-34.0	-27.5	-22.9	-2.0	-9.4	-14.1
Current Account Balance as % of GDP	...	-2.3	2.2	...	...	...	...	...	...	...	...	...
Foreign Direct Investment (US$ Billion)	6.2	4.7	-0.4	...	-0.5	0.4	-0.1	-0.1	-0.2	-0.9	...	...
Net Portfolio Investment (US$ Billion)	5.0	-2.6	-2.0	...	-3.5	1.8	0.0	-0.3	-0.5	...	...	...
Gross Int'l Reserves (GIR) Less Gold (US$ Billion)[1]	18.3	16.6	22.7	...	15.8	17.9	19.7	22.7	25.2	26.3	...	...
Total External Debt (US$ Billion)[1]	...	...	150.8	...	...	...	...	...	...	...	145.2	...
Total External Debt as % of GDP	...	...	160.2	...	...	...	...	...	...	...	106.3	...
Real Effective Exchange Rate (1995=100)[3]	109.6	104.6	52.7	74.6	42.7	47.5	48.3	72.2	68.2	76.7	76.8	76.6
Average Exchange Rate (Local Currency to US$)	2342.3	2909.4	10013.6	7854.9	9433.4	10460.8	12252.1	7908.3	8730.5	7977.5	7501.3	7210.5

Note: All growth rates are on year-on-year basis.
... = not available.
[1]End of period.
[2]Data on merchandise exports and imports, capital flows and external debt are from national sources. Gross International Reserves are from *International Financial Statistics*, International Monetary Fund. FDI refers to net FDI by non-residents.
[3]Trade weighted using WPI for trading partners and CPI for the home country.
Sources: See *Statistical Sources* of the ARIC Indicators section of this web site.

Republic of Korea Update

Asset Markets

Figure 1: **Exchange Rate and Stock Price Indexes** (last week of 1997June=100)



Source: ARIC Indicators.

Strong economic recovery supported a stable won.

As foreign capital returned and export growth gathered momentum, the won appreciated significantly since early 1998 (Figure 1). In 1999, the Korean currency settled in a narrow band around 1,190 to the US dollar. Despite its gains, compared to its end-June 1997 value, the won has depreciated by about 22 percent against the US dollar.

The KOSPI 200 has surpassed its pre-crisis level.

Stock prices collapsed in late 1997 and declined steadily through to the third quarter of 1998. But by April 1999, the Korea Stock Price Index 200 (KOSPI 200) had more than regained lost ground and, in local currency terms, had surpassed its pre-crisis level of end-June 1997. This is the strongest equity market rebound among the five affected countries. Equity values have been buoyed by expectations of a fast recovery in earnings, and solid progress in banking and corporate restructuring. In US dollar terms, too, the KOSPI 200 has surpassed its pre-crisis level of end-June 1997 and is now about 10 percent higher.

The property market began to show early signs of recovery.

Signs of recovery can now be seen even in the property market. Office and residential property rents in Seoul increased by 7 and 3 percent respectively on a year-on-year-basis in the third quarter of 1999. The office property vacancy rate also fell to 4 percent at the end of September 1999. In addition to the improved economic outlook, the opening of the real estate market to foreign buyers is helping this recovery in the property sector.

The Real Sector

Real GDP in 1999 surpassed its pre-crisis level in domestic currency terms.

After contracting for four consecutive quarters, aggregate output in the Korean economy started to recover from the first quarter of 1999. In 1999, real GDP grew by an astonishing 10.2 percent

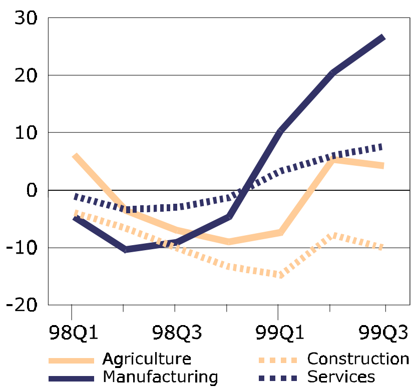
(Table 1), taking real income above its pre-crisis level in domestic currency terms.

Table 1: **GDP Growth and Projections** (%)

	1997	1998	1999	2000
Official[1]	5.0	-5.8	10.2	6.0
ADB[2]	—	—	—	7.5
IMF[3]	—	—	—	5.5
World Bank[4]	—	—	—	6.0
Consensus Economics[5]	—	—	—	7.2

[1]Ministry of Finance and Economy, Republic of Korea, Korea Economic Update, 24 January 2000; Korea Herald, 2 March 2000.
[2]ADB, Asian Development Outlook team, February 2000.
[3]IMF, World Economic Outlook, October 1999.
[4]World Bank, East Asia Pacific Brief, 31 January 2000.
[5]Consensus Economics Inc., Asia Pacific Consensus Forecasts, February 2000.

Figure 2: **Sectoral Growth**
(y-o-y, %)



Source: ARIC Indicators.

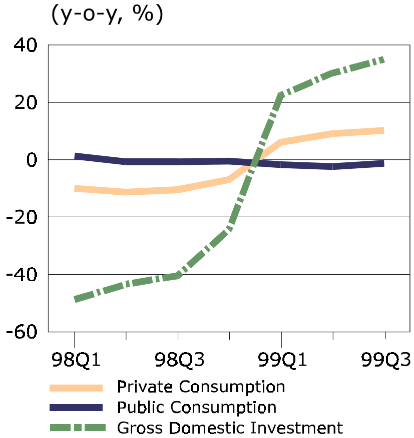
Manufacturing activity spurred recovery.

Manufacturing output rebounded in the first quarter of 1999 (Figure 2). Buoyant demand for exports, especially electronic equipment and parts, underpinned growth. A competitive real exchange rate, a cyclical recovery in global electronics demand, strong US growth, and improving conditions in Japan and the ASEAN countries all helped to boost exports. Services activity also started to turn around from the first quarter of 1999 as domestic demand recovered. Although construction languished throughout 1999, it may pick up now with the recent improvement in the property market.

Growth in domestic demand backed export-led recovery.

Having collapsed in 1998, private consumption revived in 1999 (Figure 3). Falling interest rates, improving labor market conditions and a fast improving economic outlook helped restore consumer confidence. Public consumption, however, declined as state-owned enterprises were privatized and increased emphasis was placed on the use of public funds to support bank and corporate restructuring.

Figure 3: **Growth of GDP Expenditure Components**
(y-o-y, %)



Source: ARIC Indicators.

But recovery of fixed investment lags.

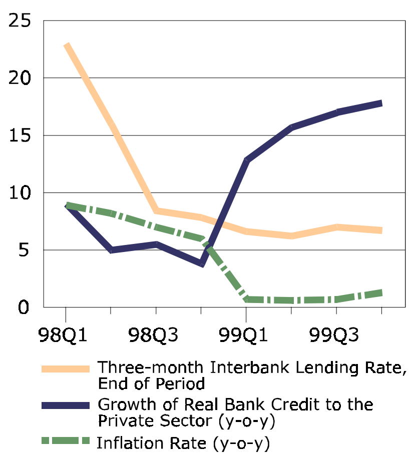
Gross domestic investment increased sharply in 1999. But much of this growth was caused by inventory buildup after stocks had fallen to a low point in 1998. While domestic investment in machinery and equipment began to expand from the first quarter of 1999, investment in buildings and structures continued to contract. Overall, the growth of gross fixed investment remained subdued.

Fiscal and Monetary Developments

The high cost of financial restructuring contributed to a widening fiscal deficit.

The central government fiscal deficit for 1999 is expected to be around 3 percent of GDP. This ratio is slightly less than that incurred in 1998 and, because of buoyant tax revenues, is also below the initial target of 4 percent. Nevertheless, this deficit is high by historical standards. The large deficit partly reflects increased expenditures on public works and social safety net programs and, in 1998, revenue contraction due to the recession. However, the key contributing factor has been the high cost of bank re-capitalization. The bulk of the fiscal deficit has been financed through government borrowing and has led to a sizable increase in government debt.

Figure 4: **Short-term Interest Rate, Real Bank Credit Growth and Inflation Rate** (%)



Source: ARIC Indicators.

Stabilization of the won paved the way for monetary easing.

Once the exchange rate had been stabilized in early 1998, the policy focus shifted quickly to stimulating growth through expansionary macroeconomic policies. Successive interest rate cuts helped to revive domestic demand and eased liquidity pressures on debt-ridden companies. A more accommodating monetary stance also helped to revive real bank credits to the private sector (Figure 4).

Excess capacity in many sectors kept inflation in check.

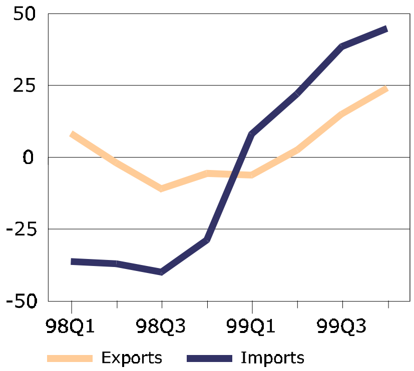
Despite monetary easing, the monthly inflation rate (year-on-year) declined continuously from a double-digit level in early 1998 to below 1 percent for most of 1999. Exchange rate stability, excess industrial capacity and falling world commodity prices have helped keep inflation in check.

Balance of Payments

Exports and imports surged.

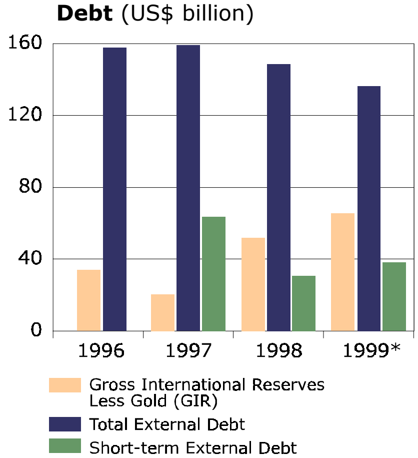
Both exports and imports of goods and services grew strongly in 1999. Merchandise exports performed strongly, and more than erased 1998's contraction. Imports also reversed the losses of

Figure 5: **Growth of Merchandise Exports and Imports** (y-o-y, %)



Source: ARIC Indicators.

Figure 6: **International Reserves, External Debt and Short-term External Debt** (US$ billion)



*GIR data as of end-September 1999.
Source: ARIC Indicators.

1998 and surged in response to the quick recovery in domestic demand (Figure 5). Despite fast import growth, the current account remained in surplus.

FDI inflows more than doubled from the pre-crisis level.

Following the relaxation of restrictions on foreign investment in 1998 the volume of net foreign direct investment (FDI) inflows, according to national sources, reached US$5.4 billion in 1998, almost double the level of 1997. Net FDI inflows in 1999 could surpass US$7 billion. Portfolio investment is also expected to record a sizable net inflow in 1999, against a net outflow of US$1.9 billion in 1998.

A large current account surplus augmented foreign reserves.

Despite large repayments of both private and official external debt, significant FDI and portfolio investment inflows led to a capital account surplus of US$0.58 billion in 1999, against a deficit of US$3.25 billion in 1998. This, together with a large current account surplus amounting to US$25 billion, had boosted external reserves to over US$65 billion by the end of September 1999. Reserves were two times the country's short-term external debt.

The level of short-term foreign debt declined to a more manageable level.

Total external debt had declined to US$136.4 billion (about 30 percent of GDP) by the end of 1999 from US$148.7 billion (46 percent of GDP) a year earlier (Figure 6). The term structure of debt also lengthened. Short-term debt amounted to only about 28 percent of total debt by the end of 1999, compared to a much higher 39.9 percent at the end of 1997.

Financial and Corporate Sector Developments

Government-led financial restructuring shows significant progress.

Significant progress has been made in financial restructuring. By the middle of 1999, of the 26 commercial banks operating in 1997, five had been closed, five merged, and many had undergone rehabilitation. Others are currently undergoing rehabilitation. The government's efforts to recapitalize troubled banks and replace non-performing loans (NPLs) by better quality assets had helped to increase the risk weighted capital adequacy ratio (CAR) for commercial banks to a respectable 9.8 percent by the middle of 1999. Likewise, there was an improvement in the NPL position. The NPL ratio for the banking system as a whole had fallen to 6.2 percent by September 1999. In part, this reflects the operations of the government-owned asset management company KAMCO. This company has removed a substantial amount of bad loans from two commercial banks, Korea First Bank and Seoul Bank. But the NPL ratio for non-bank financial institutions remained high at about 20 percent in late 1999. For the financial sector as a whole, the NPL ratio stood at 10.1 percent at the end of September 1999.

But the public cost of financial restructuring has been enormous.

The public cost of financial restructuring has been enormous. It is estimated that by November 1999 the government had already spent US$47 billion, over 10 percent of GDP in 1999, on restructuring commercial banks.

And corporate restructuring has lagged.

As elsewhere in the region, corporate restructuring has lagged behind financial restructuring. Although plans for debt resolution are far advanced, their full implementation is still awaited. Some progress has nevertheless been made. As of August 1999, 48 percent of total disclosed corporate debt had been settled. Of this, 40 percent had been settled out of court and 8 percent through court settlements. Part of the reason for the comparatively slow progress on debt resolution is that legal procedures for insolvency, although recently reformed, still give significant advantages to debtors. A reluctance by investors to inject fresh capital, which is usually a crucial part of debt restructuring packages, is also slowing down the process.

Restructuring Daewoo presents a key challenge.

In July 1999, Daewoo, the country's second largest conglomerate, nearly collapsed in the face of mounting debt payments. The total debt of its 12 affiliates covered by the ongoing debt restructuring efforts is estimated to be a colossal US$76.5 billion, equivalent to 19 percent of Korea's GDP in 1998. The resolution of Daewoo's financial troubles is, in and of itself, a massive challenge. Daewoo's failure suggests that it is unrealistic to think that Korea can simply grow out of its current difficulties. Structural reforms are needed.

Prospects and Policy issues

Economic prospects for 2000 look bright.

Korea's prospects for continued economic expansion in 2000 look bright. Given the catch-up element in the 10.2 percent growth rate achieved in 1999, the latest Consensus Economics (February 2000) projections now expect GDP growth in 2000 to be in a range between 5.8 and 9 percent, with a mean of 7.2 percent. The structural reforms implemented so far are making Korea a more open, competitive and market-driven economy, and have contributed significantly to improved market confidence. Moving forward, private investment in fixed capital, in particular, is expected to pick up. However, the current account surplus in 2000 is likely to narrow as import demands continue to expand at a fast rate. Provided external conditions remain broadly favorable, and more headway is made with reforms, the external payments position should not give any cause for concern.

But inflationary pressures are likely to trigger further monetary tightening.

Following brisk growth, latent signs of inflationary pressures could be detected in late 1999. By the end of 1999, capacity utilization rates in manufacturing industries had already reached their pre-crisis levels and wages had started to rise. Reflecting these pressures, inflation began to edge up. Inflationary pressures have continued to mount in early 2000, so much so that in early February, the authorities increased the base lending rate by 25 basis points. While higher interest rates will make the restructuring of debt-ridden companies more difficult, and will not be welcomed by banks that are struggling to reduce their NPL levels, unchecked inflation could risk derailing longer-term recovery prospects.

Fiscal deficits will remain, but are no cause for alarm.

There remains a question mark over how much more public money will be needed to recapitalize Korea's banking system. It seems certain that as a consequence of the debt servicing burdens created by banking sector recapitalization and restructuring efforts, fiscal deficits are likely to persist for some years to come. The risks to inflation and debt sustainability posed by these deficits will depend on a variety of factors. However, provided the momentum of recovery does not falter, they are unlikely to cause serious difficulties on either front. A consolidation of recent economic gains should not only strengthen public sector revenues, but also indirectly ease fiscal burdens as growing cash surpluses help debtors meet their loan obligations and lift the pressures on banks' balance sheets. While the government's resolve to bring the deficit under control is needed and welcome, this should entail a careful consideration of public expenditure priorities rather than cuts across the board.

Complex issues related to Korea's evolving industrial structure remain.

There are still significant risks to the restructuring process. Even if corporate debts can be efficiently and equitably resolved within a reasonable timeframe, important questions remain about the characteristics of the industrial and financial system that is likely to emerge. Reforms ought to be directed toward ensuring that formal and informal barriers to entry to key sectors of the economy are reduced, and that greater competition is fostered. It is still possible that the process of industrial rationalization that is now underway may serve to entrench the positions of favored *chaebols*. For example, there are concerns that the Korean government's current attempt to forge "core competencies" within *chaebols* may lead to greater anti-competitive influences by big conglomerates. Assets that are now in public hands must be returned to the private sector in a transparent and efficient way to mitigate the burden on taxpayers, and to lessen moral hazard. In many areas of corporate and financial governance, Korea lags behind its partners in the Organisation for Economic Co-operation and Development. To close these gaps, Korea's ambitious reform agenda must now be effectively implemented.

Republic of Korea: Selected ARIC Indicators

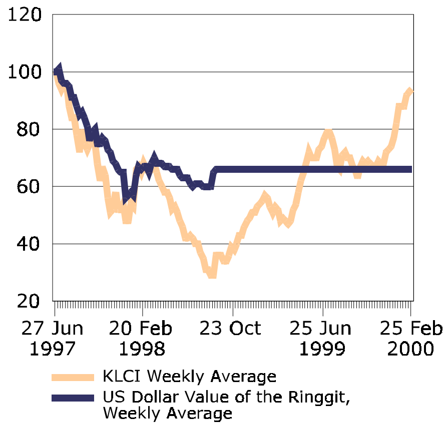
	1996	1997	1998	1999	98Q1	98Q2	98Q3	98Q4	99Q1	99Q2	99Q3	99Q4
Output and Prices												
GDP Growth (%)	6.8	5.0	-5.8	10.2	-3.6	-7.2	-7.1	-5.3	4.5	9.9	12.3	…
Private Consumption Expenditure Growth (%)	7.1	3.5	-9.6	…	-9.9	-11.2	-10.4	-6.9	6.2	9.1	10.3	…
Public Consumption Expenditure Growth (%)	8.2	1.5	-0.1	…	1.3	-0.7	-0.6	-0.4	-1.7	-2.3	-1.3	…
Gross Domestic Investment Growth (%)	…	-7.5	-38.6	…	-48.7	-43.3	-40.4	-24.2	22.5	30.3	35.1	…
Agricultural Sector Growth (%)	3.3	4.6	-6.3	…	6.2	-3.5	-7.0	-9.0	-7.4	5.3	4.2	…
Manufacturing Sector Growth (%)	6.8	6.6	-7.2	…	-4.6	-10.4	-9.1	-4.7	10.3	20.4	26.8	…
Construction Sector Growth (%)	6.9	1.4	-9.0	…	-3.9	-6.6	-10.1	-13.3	-14.8	-7.8	-10.0	…
Services Sector Growth (%)	6.2	5.2	-2.2	…	-1.0	-3.4	-3.0	-1.3	3.3	6.0	7.6	…
Exports of Goods and Services Growth (%)	11.2	21.4	13.3	…	25.7	13.2	8.0	8.8	10.3	15.1	22.2	…
Imports of Goods and Services Growth (%)	14.2	3.2	-22.0	…	-27.2	-25.5	-25.9	-9.0	27.0	26.9	32.0	…
Inflation Rate (%)	4.9	4.4	7.5	0.8	8.9	8.2	7.0	6.0	0.7	0.6	0.7	1.3
Unemployment Rate (%)	2.0	2.6	6.8	6.3	5.6	6.8	7.4	7.4	8.4	6.6	5.6	4.6
Monetary and Fiscal Accounts												
Growth of Broad Money, M2 (%)	15.8	14.1	27.0	28.4	12.1	16.3	24.8	27.0	33.7	27.1	26.9	28.4
Three-month Interbank Lending Rate (%)[1]	…	…	7.8	6.7	23.0	16.0	8.4	7.8	6.6	6.2	7.0	6.7
Growth in Real Bank Credit to Private Sector (%)[1]	14.2	13.2	3.8	17.8	9.0	5.0	5.5	3.8	12.8	15.7	17.0	17.8
Ratio of Non-performing Loans to Total Loans (%)[2]	…	…	10.5	…	…	…	…	10.5	…	11.3	10.1	…
Average Stock Price Index (KOSPI 200)	90.6	67.8	47.1	95.4	58.3	43.0	36.5	50.6	65.8	90.1	113.1	112.6
Central Government Fiscal Balance as % of GDP	0.03	-0.02	-4.2	…	…	…	…	…	…	…	…	…
Central Government Debt as % of GDP	…	…	15.9	…	…	…	…	…	…	…	…	…
Government Expenditure on Education (% of Total)[3]	17.2	17.6	…	…	…	…	…	…	…	…	…	…
Government Expenditure on Health (% of Total)	0.8	0.9	…	…	…	…	…	…	…	…	…	…
External Account, Debt, and Exchange Rates[4]												
Growth of Merchandise Exports (US$, FOB, %)	4.3	5.0	-2.8	9.8	8.4	-1.8	-10.8	-5.5	-6.1	2.5	15.2	24.2
Growth of Merchandise Imports (US$, CIF, %)	12.3	-2.2	-36.1	28.3	-36.2	-37.0	-39.9	-28.7	8.1	22.1	38.6	44.9
Current Account Balance as % of GDP	-4.4	-1.7	12.6	…	16.1	14.2	11.9	9.1	6.9	6.5	…	…
Foreign Direct Investment (US$ Billion)	2.3	2.8	5.4	…	0.5	1.2	2.2	1.6	1.4	1.8	2.6	…
Net Portfolio Investment (US$ Billion)	15.2	14.3	-1.9	…	3.8	0.6	-3.9	-2.4	1.0	4.1	-1.4	…
Gross Int'l Reserves (GIR) Less Gold (US$ Billion)[1]	34.0	20.4	52.0	…	29.7	40.8	46.9	52.0	57.4	61.9	65.4	…
Total External Debt (US$ Billion)[1]	157.5	159.2	148.7	136.4[p]	…	…	…	148.7	145.5	141.4	140.9	136.4[p]
Total External Debt as % of GDP	30.3	33.4	46.4	…	…	…	…	46.4	42.3	38.9	36.9	…
Short-Term External Debt as % of Total[1]	…	39.9	20.6	28.0[p]	…	…	…	20.6	21.9	22.7	24.8	28.0[p]
Short-Term External Debt as % of GIR	…	312.3	59.1	50.0	…	…	…	59.1	55.5	51.8	53.5	50.0
Real Effective Exchange Rate (1995=100)[5]	104.3	98.6	78.0	87.3	67.5	78.6	84.2	81.7	88.1	89.2	86.3	85.6
Average Exchange Rate (Local Currency to US$)	804.5	951.3	1401.4	1188.2	1605.7	1394.6	1326.1	1279.3	1196.3	1188.9	1195.0	1172.5

Note: All growth rates are on year-on-year basis.
[p] = Preliminary. … not available.
[1]End of period.
[2]Non-performing loans cover all financial institutions.
[3]1996 refers to fiscal year 1995/96 and 1997 to fiscal year 1996/97.
[4]Data on merchandise exports and imports, external debt and capital flows are from national sources. Gross International Reserves are from *International Financial Statistics*, International Monetary Fund. FDI refers to net FDI by non-residents.
[5]Trade weighted using WPI for trading partners and CPI for the home country.
Sources: See *Statistical Sources* of the ARIC Indicators section of this web site.

Malaysia Update

Asset Markets

Figure 1: **Exchange Rate and Stock Price Indexes**
(last week of 1997June=100)



Source: ARIC Indicators.

The easing of selective exchange controls has not provoked capital flight.

The replacement of selective exchange controls by a tax on capital gains did not trigger massive outflows of capital, as some had feared. Over the third and fourth quarters of 1999 portfolio outflows of only US$2.2 billion were recorded. In early 2000, inflows of US$1.8 billion were recorded. Selective exchange controls do not seem to have had the deleterious effects that many had predicted, but the jury is still out on their overall efficacy.

The KLCI is rapidly approaching its pre-crisis level.

Lower interest rates and a recovery package introduced in the middle of 1998 set the stage for stock market stabilization and recovery. The Kuala Lumpur Composite Index (KLCI), which had plummeted by over 70 percent in August 1998 in local currency terms from its peak, has recovered substantially (Figure 1). In the first two months of 2000, the Malaysian stock market continued to perform strongly while stock markets in the other affected countries softened. By the end of February 2000, the KLCI had almost reached its pre-crisis level of end-June 1997 in local currency terms. In terms of the US dollar, however, it was still 40 percent lower.

But the property market remains in the doldrums.

The Malaysian property market was among the worst hit in the region. As foreign capital fled the country and domestic demand contracted, vacancy rates surged (Table 1) and property prices and rentals plummeted. The deterioration began slowing down toward the end of 1998. There is, however, still no sign of a rebound.

Table 1: **Property Vacancy Rates in Kuala Lumpur** (%)

	98Q2	98Q3	98Q4	99Q1	99Q2	99Q3
Office Property	11.6	13.6	15.5	15.7	17.0	17.0
Retail Property	...	...	...	...	12.8	...

... = not available.
Source: Jones Lang LaSalle, Asia Pacific Property Digest, various issues.

The Real Sector

Real GDP grew by 5.4 percent in 1999, but per capita incomes are still well below the pre-crisis level.

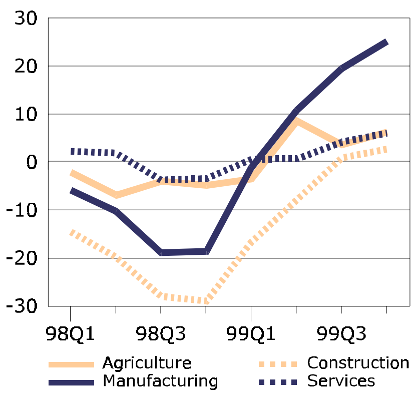
Real GDP contracted by 7.5 percent in 1998. However, by the second quarter of 1999 output was beginning to reverse earlier declines. Growth accelerated throughout the remainder of the year, culminating in an annual growth of 5.4 percent (Table 2). Despite this strong rebound, real GDP per capita is still around 7 percent lower than the 1997 level.

Table 2: **GDP Growth and Projections** (%)

	1997	1998	1999	2000
Official[1]	7.5	-7.5	5.4	5.8
ADB[2]	—	—	—	6.0
IMF[3]	—	—	—	6.5
World Bank[4]	—	—	—	4.8
Consensus Economics[5]	—	—	—	6.2

[1]Ministry of Finance, Malaysia, 2000 Budget Speech, 25 February 2000.
[2]ADB, Asian Development Outlook team, February 2000.
[3]IMF, World Economic Outlook, October 1999.
[4]World Bank, East Asia Pacific Brief, 31 January 2000.
[5]Consensus Economics Inc., Asia Pacific Consensus Forecasts, February 2000.

Figure 2: **Sectoral Growth**
(y-o-y, %)

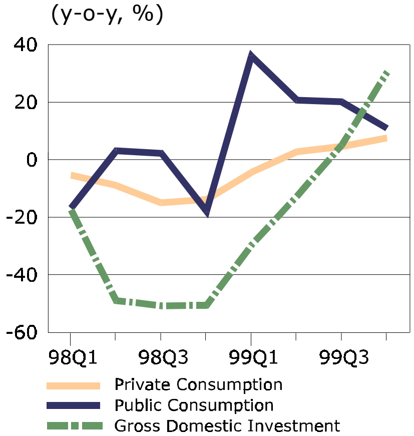


Source: ARIC Indicators.

Export-oriented manufacturing drove the recovery.

As part of its selective exchange control policy, introduced in September 1998, Malaysia pegged its currency to the dollar. By the end of 1999, this had led to a trade-weighted depreciation of the ringgit by about 25 percent in real terms compared to the pre-crisis level in the second quarter of 1997. This, together with a cyclical recovery in global export markets, has propelled Malaysian exports and economic recovery. In US dollar terms, merchandise exports grew by 15.7 percent in 1999. From the second quarter of 1999, the agricultural sector also registered strong growth (Figure 2), largely because of favorable weather conditions. While the construction sector contracted through much of 1999, its output grew a little in the third and fourth quarters, helped by public spending programs on housing.

Figure 3: **Growth of GDP Expenditure Components**
(y-o-y, %)



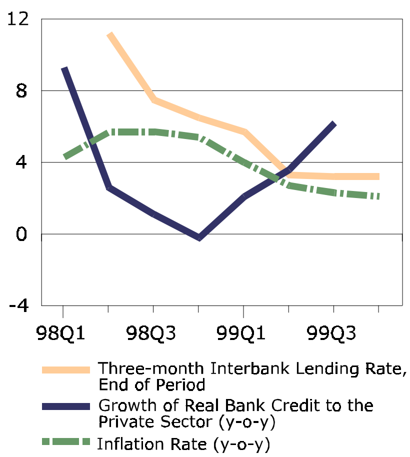
Source: ARIC Indicators.

Recovery in private sector demand has been slower but it is gathering momentum.

Private domestic consumption began to recover from the second quarter of 1999 (Figure 3) in response to improving economic conditions, strengthening expectations of recovery and better employment prospects. Various barometers of consumer sentiment have since shown strong growth. However, given the glut in the property market and excess capacity in most sectors, recovery in private investment demand has been slow. Nevertheless, business sentiment is improving, and this has recently been reflected in strengthened demand for imported capital goods.

Fiscal and Monetary Developments

Figure 4: **Short-term Interest Rate, Real Bank Credit Growth and Inflation Rate** (%)



Source: ARIC Indicators.

Deficit spending measures helped prime recovery.

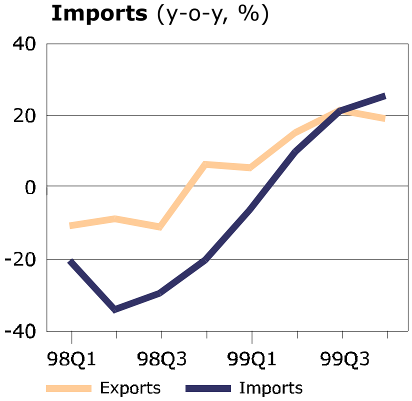
Deficit spending measures initiated in late 1998 also helped prime recovery. Much of this spending has been directed to the social sectors and to building infrastructure in rural areas. Malaysia's federal government fiscal deficit in 1999 increased to about 3.2 percent of GDP. Revenue shortfalls and the costs of financial restructuring have also contributed to the deficit. Federal government debt increased from 31.9 percent of GDP in 1997, to 36.2 percent in 1998, and to 38.3 percent in the third quarter of 1999.

Lower interest rates have supported recovery.

Nominal interest rates fell steadily from mid-1998 through to October 1999 (Figure 4). Lower interest rates have considerably eased the burden of debtors and are helping nurse banks' balance sheets back to health. The stock of real bank credits is also starting to increase slowly.

The Balance of Payments

Figure 5: **Growth of Merchandise Exports and Imports** (y-o-y, %)



Source: ARIC Indicators.

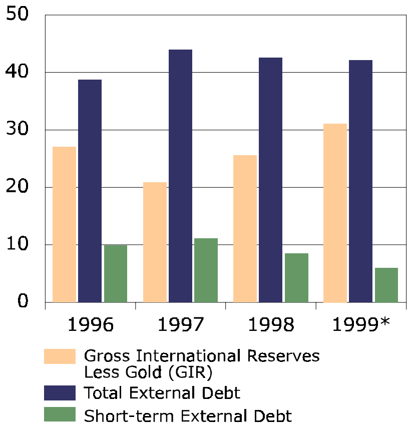
Strong export performance boosted the current account surplus to a record level.

Boosted by strong export performance (Figure 5), the trade surplus surged in 1999 and reached a record level of RM72.3 billion. After allowing for a larger deficit in the services account due to increased net payments of investment income, an unprecedented current account surplus of RM42 billion (14 percent of GDP) is expected in 1999.

Capital outflows partly offset the widening current account surplus but the external reserve position remains strong.

As a consequence of the repayment of debts, some repatriation of funds that had been locked in by exchange controls, and some-

Figure 6: **International Reserves, External Debt and Short-term External Debt** (US$ billion)



*GIR data as of end-September 1999.
Source: ARIC Indicators.

what subdued long-term private flows, Malaysia's capital account posted a deficit in 1999. Despite net capital outflows, the record surplus on the current account led to an increase in Malaysia's foreign exchange reserves. Foreign exchange reserves stood at about US$31 billion as of end-September 1999, about five times the country's short-term external debt, and six times its monthly import requirements. Total external debt stood at US$42.1 billion at the end of 1999, down by US$0.5 billion from the end of 1998 (Figure 6). The share of short-term external debt in total external debt continued to decline in 1999, standing at 14.3 percent at the end of 1999.

Financial and Corporate Sector Developments

Government led financial restructuring has been effective.

The Malaysian government has taken an active role in restructuring the troubled banking system. It created agencies for the acquisition and management of bad debts (Danaharta) and for the recapitalization and rehabilitation of illiquid financial institutions (Danamodal). Danaharta's program has helped reduce the non-performing loan (NPL) ratio of the banking system (measured on a three-month accrual basis) to 11.7 percent by the end of November 1999, from a peak of just under 15 percent in November 1998. By end-October 1999, Danamodal had also provided over RM8 billion to re-capitalize 10 banking institutions that were deemed viable. The risk-weighted capital adequacy ratio of the banking system stood at 12.5 percent as of December 1999. Improvements in the asset quality of bank portfolios and stronger capital backing have helped the renewal of lending.

But corporate restructuring has been slow.

However, corporate restructuring has proceeded slowly in Malaysia. Voluntary agreement has been reached on just over one-third of the debt referred to the Corporate Debt Restructuring Committee (CDRC), a government agency set up in the aftermath of the crisis tasked with debt restructuring. About 9 percent of the debt referred to the CDRC has been subsequently passed on to

Danaharta. For the most part, agreements have focused on debt restructuring. Operational restructuring has not kept pace. Debt renegotiations and settlements are also proceeding outside of the framework of the CDRC. Self-declared bankruptcies have increased, and a number of companies have applied for reorganization within the scope of the Companies Act. Mergers and acquisition activity has picked up. But there is still concern that debtors are being favored over creditors, and this is slowing adjustment. Also, while Danaharta has disposed of some foreign exchange loans, at about 50 percent of their face value, and auctioned some property, the disposal of the assets under its custodianship has barely begun.

Prospects and Issues

Malaysia will consolidate recovery in 2000, with domestic demand becoming the main engine.

The latest Consensus Economics (February 2000) projections suggest that the Malaysian economy is likely to grow by 6.2 percent in 2000, with a wide range from 5–7.6 percent. As uncertainty lifts, private consumption and investment demand will be the main contributors to growth in 2000. Net exports will fall as imports surge. As a consequence, Malaysia's current account surplus will contract, but is likely to remain in the black. The overall balance of payments situation will remain strong. After a brief dip, foreign direct investment is expected to revert to trend. Prospects of strong nominal earnings growth, and expectations of a ringgit appreciation, will attract portfolio investors. There is likely to be broad-based recovery in asset markets as well as the real economy. However, some sectors, such as property, in which excess capacity is likely to persist for some time, will remain behind the curve.

Growth will do much to heal residual difficulties in the banking and corporate sector.

This year promises consolidation of the banking sector, and further progress on corporate debt restructuring. The lead banks and the composition of the amalgamated entities that will emerge by the end of 2000 are now known. Additional measures to strengthen banking and corporate sector governance are also likely. In particular, the forebearance extended to the banking sector during the crisis is now likely to be wound back. Economic growth will go a long way in generating the cash surpluses businesses need to service their debt. The stock of real private sector credit is set to expand in 2000 as both the capacity of banks to lend and the demand for loans increase. The fiscal costs of banking sector recapitalization and debt acquisition are likely to turn out to be somewhat lower than originally anticipated.

Growth may provide an opportunity for a return to a more balanced and sustainable fiscal stance.

Deficit spending measures helped kick-start recovery in Malaysia. A substantial deficit is again programmed for 2000, with spending focused on capital projects and the social sector. The acceleration of growth and low interest rates should help keep debt in check. A stronger revenue position will facilitate a return to a more balanced budgetary position.

Further interest rate easing is unlikely.

Selective exchange controls in 1999 allowed interest rates to fall. Interest rates might have fallen even further but for the sterilization of foreign asset inflows. Now, however, the scope for interest rates to fall further is being reduced. Indeed, global interest rates are likely to edge up in 2000, which may eventually put upward pressure on ringgit interest rates to maintain the Malaysian currency's peg to the dollar. Despite the possibility of rising real interest rates, domestic demand for credit is likely to revive as incomes expand and expectations improve. Consumer price inflation, which slowed with the contraction of domestic demand, can now also be expected to edge up.

The benefits of the exchange rate peg are soon likely to diminish, and the costs to increase.

Going forward, Malaysia faces a number of challenges. Having replaced exchange controls by a tax on capital gains, the focus has now shifted to the durability of the exchange rate peg. It is now widely accepted that the ringgit is grossly undervalued in real terms. In large measure, this has helped propel Malaysia's exports. However, the benefits of an artificially depreciated real exchange rate are likely to prove temporary and could eventually lead to a serious misallocation of resources. Soon pressures will mount for an appreciation of the real exchange rate. If balance of payments surpluses are not sterilized, these may manifest themselves in accelerating inflation, with relative prices moving in favor of non-tradeables. On the other hand, sterilization may tempt speculative capital inflows as interest rates edge up. While a replay of 1997 is not in the offing, persistent undervaluation of the ringgit could induce serious distortions. The Malaysian authorities are soon likely to review the advantages of a more flexible exchange rate regime, or consider revaluation of the ringgit.

Underlying issues of competitiveness need to be tackled if the aspirations of Vision 2020 are to be realized.

As Malaysia leaves the crisis behind, issues of long-run competitiveness and productivity growth are likely to resurface. At one level, addressing these long-term challenges will entail timely and well-directed investments in learning and education. At a deeper level, there is a need to address issues related to industrial policy and organization as well as ownership structures. Currently, the internationally competitive segment of Malaysia's manufacturing industry is largely foreign owned and controlled. Strengthening local capacities to compete in international markets is likely to require a shift to policies that allow markets to play a bigger role in determining the ownership and control of wealth, and decisions on what is produced. A positive development that would contribute to Malaysia's aspirations of becoming a fully industrialized nation by 2020 would be to build on the recent relaxation of ownership requirements for manufacturing projects.

Malaysia: Selected ARIC Indicators

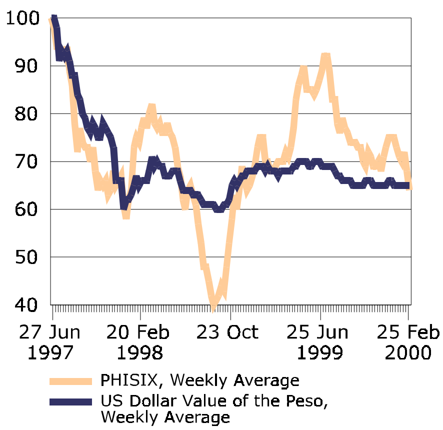
	1996	1997	1998	1999	98Q1	98Q2	98Q3	98Q4	99Q1	99Q2	99Q3	99Q4
Output and Prices												
GDP Growth (%)	10.0	7.5	-7.5	5.4	-3.1	-5.2	-10.9	-10.3	-1.3	4.1	8.2	10.6
Private Consumption Expenditure Growth (%)	6.9	4.3	-10.8	2.5	-5.4	-8.9	-14.9	-13.8	-4.3	2.8	4.6	7.6
Public Consumption Expenditure Growth (%)	0.7	7.6	-7.8	20.1	-16.8	3.1	2.3	-17.9	36.0	20.8	20.2	11.0
Gross Domestic Investment Growth (%)	5.8	11.2	-42.9	-6.0	-17.3	-49.0	-50.8	-50.5	-29.6	-12.6	5.1	30.5
Agricultural Sector Growth (%)	4.5	0.4	-4.5	3.9	-2.1	-6.9	-4.0	-4.8	-3.5	8.6	3.6	6.3
Manufacturing Sector Growth (%)	18.2	10.4	-13.7	13.5	-5.8	-10.3	-18.9	-18.6	-1.1	10.8	19.5	25.2
Construction Sector Growth (%)	16.2	10.6	-23.0	-5.6	-14.5	-19.8	-28.0	-29.0	-16.6	-7.9	0.9	2.7
Services Sector Growth (%)	8.9	9.9	-0.8	2.8	2.2	1.9	-3.7	-3.4	0.6	0.7	4.2	6.0
Exports of Goods and Services Growth (%)	9.2	5.4	-0.2	13.8	-1.4	1.0	-2.9	2.5	1.4	12.5	19.4	21.0
Imports of Goods and Services Growth (%)	4.9	5.7	-19.4	11.6	-10.0	-24.9	-23.6	-18.0	-8.7	9.1	20.6	27.0
Inflation Rate (%)	3.5	2.7	5.3	2.8	4.3	5.7	5.7	5.4	4.0	2.7	2.3	2.1
Unemployment Rate (%)	2.5	2.6	3.2	3.4	...	...	...	3.4	4.5	3.3	2.9	3.0
Monetary and Fiscal Accounts												
Growth of Broad Money, M2 (%)	24.3	17.4	-1.4	11.6	10.0	6.8	2.8	-1.4	3.6	13.2	17.0	...
Three-month Interbank Lending Rate(%)[1]	...	...	6.5	3.2	...	11.2	7.5	6.5	5.7	3.3	3.2	3.2
Growth in Real Bank Credit to Private Sector (%)[1]	20.9	19.8	-0.2	...	9.3	2.6	1.1	-0.2	2.1	3.6	6.2	...
Ratio of Non-performing Loans to Total Loans (%)[2]	...	4.1	13.4	...	7.0	8.9	12.8	13.4	13.0	12.4	12.0	...
Average Stock Price Index (KLCI)	1134.1	978.9	517.7	692.0	657.7	565.4	381.1	466.7	556.1	707.0	763.2	741.8
Central Government Fiscal Balance as % of GDP	0.7	2.4	-1.8	-3.2	...	...	...	...	...	...	...	...
Central Government Debt as % of GDP	35.3	31.9	36.2	...	30.6	31.3	30.7	36.2	36.8	38.6	38.3	...
Government Expenditure on Education (% of Total)	21.4	21.3	21.4	...	30.4	20.2	23.2	17.8	33.7	23.3	19.6	...
Government Expenditure on Health (% of Total)	5.9	6.2	6.5	...	4.9	6.6	6.9	6.7	5.9	6.1	5.5	...
External Account, Debt, and Exchange Rates[3]												
Growth of Merchandise Exports (US$, FOB, %)	6.0	0.3	-6.9	15.7	-10.7	-8.7	-10.9	6.5	5.5	15.3	21.5	19.2
Growth of Merchandise Imports (US$, CIF, %)	1.0	0.2	-25.9	12.5	-20.3	-33.9	-29.3	-20.2	-6.1	10.0	21.4	25.6
Current Account Balance as % of GDP	-4.8	-5.3	13.0	...	6.4	11.3	17.4	16.5	16.5	19.1	...	...
Private long-term capital (US$ Billion)	...	...	2.2	...	1.1	0.7	-0.2	0.6	0.3	0.6	...	...
Private short-term capital (US$ Billion)	...	...	-5.3	...	-2.3	-1.2	-1.1	-0.6	...	...	...	...
Gross Int'l Reserves (GIR) Less Gold (US$ Billion)[1]	27.0	20.8	25.6	...	19.8	19.7	20.7	25.6	27.1	30.6	31.1	...
Total External Debt (US$ Billion)[1]	38.7	43.9	42.6	42.1	43.2	42.2	40.1	42.6	42.2	42.7	43.6	42.1
Total External Debt as % of GDP	38.4	44.0	58.8	53.3	47.9	51.2	53.0	58.8	57.8	57.7	56.9	53.3
Short-Term External Debt as % of Total[1]	25.7	25.2	19.9	14.3	25.1	22.8	19.1	19.9	19.7	18.5	17.1	14.3
Short-Term External Debt as % of GIR Less Gold	36.9	53.7	33.2	...	54.6	48.9	37.0	33.2	30.6	25.8	23.9	...
Real Effective Exchange Rate (1995=100)[4]	106.5	105.5	86.8	87.6	84.8	88.9	86.4	87.1	89.4	89.7	87.2	84.1
Average Exchange Rate (Local Currency to US$)	2.5	2.8	3.9	3.8	4.0	3.8	4.1	3.8	3.8	3.8	3.8	3.8

Note: All growth rates are on year-on-year basis.
... = not available.
[1]End of period.
[2]Non-performing loans cover the banking sector only.
[3]Data on merchandise exports and imports, external debt and capital flows are from national sources. Gross International Reserves are from *International Financial Statistics*, International Monetary Fund. FDI refers to net FDI by non-residents.
[4]Trade weighted using WPI for trading partners and CPI for the home country.
Sources: See *Statistical Sources* of the ARIC Indicators section of this web site.

Philippines Update

Asset Markets

Figure 1: **Exchange Rate and Stock Price Indexes**
(last week of 1997June=100)



Source: ARIC Indicators.

The peso lost some ground in 1999 and early 2000, but has stayed above the lows reached in 1998.

By the end of 1999, the peso was worth about 4 percent less in US dollar terms than when the year started. Weak overseas investor interest, a ballooning public sector deficit and a move of interest rate differentials in favor of the US dollar all worked against the peso. However, despite the mild depreciation, the peso has exhibited a broad stability in its value. It has proved to be much less sensitive to developments elsewhere than it had been during the previous two years. Between end-June 1997 and end-February 2000 the peso lost about 35 percent of its value against the dollar (Figure 1).

The PHISIX's performance has been mixed.

The Philippine Stock Exchange Composite Index (PHISIX) surged between the third quarter of 1998 and the first half of 1999 (Figure 1). But a substantial portion of the gains has been lost since then. At the end of February 2000, the PHISIX hit a 15-month low, and the index was 36 percent below its end-June 1997 level in peso terms and 58 percent below in US dollar terms. Increases in US interest rates, low investor confidence due to slow pace of reforms and, more recently, a scandal involving allegations of insider trading and stock price manipulation underpinned the disappointing stock market performance.

High vacancy rates put downward pressure on property prices and rents.

Even though the pre-crisis real estate boom had been less pronounced in the Philippines than elsewhere in the region, the crisis took its toll in this sector too. Office property vacancy rates in the prime business districts of Metro Manila soared from below 5 percent in early 1998 to over 13 percent in the middle of 1999 (Table 1). High vacancy rates put downward pressure on property prices and rents.

Table 1: **Property Vacancy Rates in Prime Business District in Manila** (%)

	98Q2	98Q3	98Q4	99Q2	99Q3	99Q4
Office Property	4.3	5.8	7.8	13.3	12.1	13.8
Retail Property	...	...	9.3	11.0	13.0	12.6

... = not available.
Source: Jones Lang LaSalle, Asia Pacific Property Digest, various issues.

The Real Sector

Real GDP in 1999 exceeded the 1997 level, but lags behind in per capita terms.

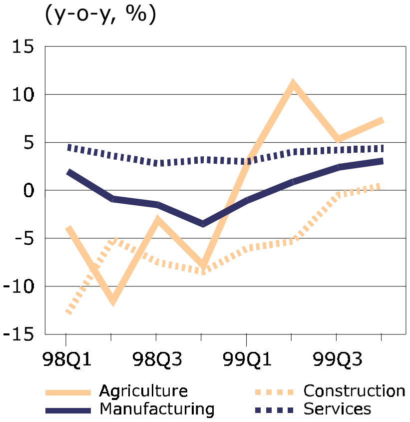
After contracting a little in 1998, aggregate output began to expand in the first quarter of 1999. For the year as a whole, GDP grew by 3.2 percent (Table 2). An increase in remittances by overseas Philippine workers supported GNP growth of 3.6 percent. While the level of real GDP in 1999 was 2.7 percent higher than in 1997, the labor force has since grown by over 4 percent, leaving output per worker trailing its 1997 level.

Table 2: **GDP Growth and Projections** (%)

	1997	1998	1999	2000
Official[1]	5.2	-0.5	3.2	4.0-5.0
ADB[2]	—	—	—	4.0
IMF[3]	—	—	—	3.5
World Bank[4]	—	—	—	3.5
Consensus Economics[5]	—	—	—	3.8

[1]National Economic Development Authority, 1999 Economic Performance and 2000 Prospects, 28 January 2000.
[2]ADB, Asian Development Outlook team, February 2000.
[3]IMF, World Economic Outlook, October 1999.
[4]World Bank, East Asia Pacific Brief, 31 January 2000.
[5]Consensus Economics Inc., Asia Pacific Consensus Forecasts, February 2000.

Figure 2: **Sectoral Growth**
(y-o-y, %)

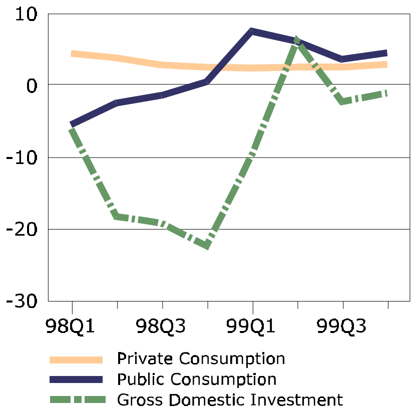


Source: ARIC Indicators.

Growth in 1999 emanated largely from agriculture and services.

The agricultural sector recovered from the adverse effect of the 1998 El Niño-induced drought (Figure 2). The services sector, accounting for over 40 percent of the economy, remained resilient to the economic slowdown in 1998, and grew faster in 1999. The manufacturing sector registered modest positive growth from the second quarter of 1999, driven mainly by strong exports. The construction sector continued to contract in 1999 due to the depressed property market and sluggish private investment.

Figure 3: **Growth of GDP Expenditure Components** (y-o-y, %)



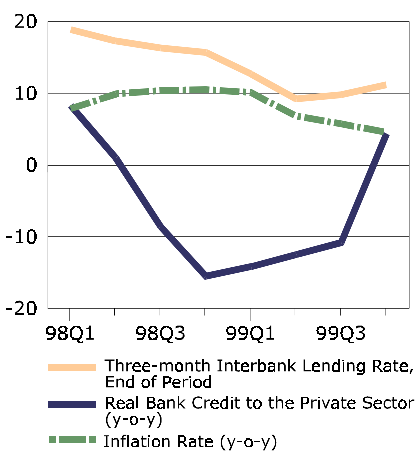
Source: ARIC Indicators.

Fiscal pump priming underpinned recovery.

Although there was buoyant growth in merchandise exports in 1999, supported largely by the electronics sector, a sharp contraction in services exports meant that, overall, exports grew by a disappointing 1.8 percent in 1999 in real peso terms. However, net exports grew more strongly as import demand continued to contract. Private consumption expenditure, which accounts for nearly 80 percent of Philippine GDP, grew by 2.7 percent, allowing the private savings rate to reclaim some of the ground lost in 1998. Public consumption posted strong growth of 5.5 percent as a result of deficit spending measures (Figure 3). Excess production capacity in a number of sectors, sluggish domestic demand and concerns about ongoing corporate restructuring kept private investment muted.

Fiscal and Monetary Developments

Figure 4: **Short-term Interest Rate, Real Bank Credit Growth and Inflation Rate** (%)



Source: ARIC Indicators.

Fiscal deficit overshot its target.

In 1999, the central government's fiscal deficit increased considerably to around 3.7 percent of GDP. Enlarged expenditure, shortfalls in revenue collection and a deterioration in the finances of government-owned and controlled corporations (GOCCs) were the major reasons for the widening deficit. By the end of 1999, central government debt stood at around 58 percent of GDP.

Inflation moderated.

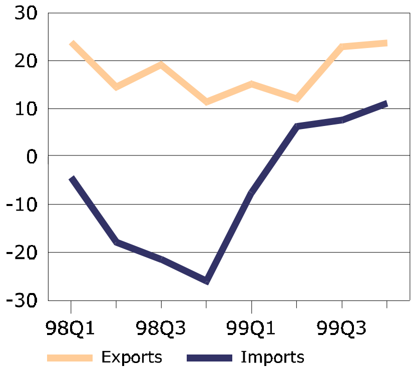
Inflationary pressures eased considerably in 1999 (Figure 4) despite large increases in the price of imported fuel, on which the Philippine economy is dependent. Food prices, which carry a substantial weight in the consumption basket, rose by 5.2 percent in 1999 compared to 8.8 percent in 1998.

Monetary policy was accommodating, but real credit shrank.

With greater stability in the peso exchange rate, Bangko Sentral ng Pilipinas, the central bank, was able to successively lower interest rates in 1999. Interest rates fell to their lowest point in the second quarter, but have since edged up a little, partly in response to rising interest rates in the United States and elsewhere. Despite an accommodating monetary policy, the real stock of private sector credit contracted during the year. This reflected both weak corporate investment demand and banks' reluctance to extend fresh credit because of a heavy burden of non-performing loans (NPLs). Towards the end of 1999, the flow of credit did, however, begin to expand once again.

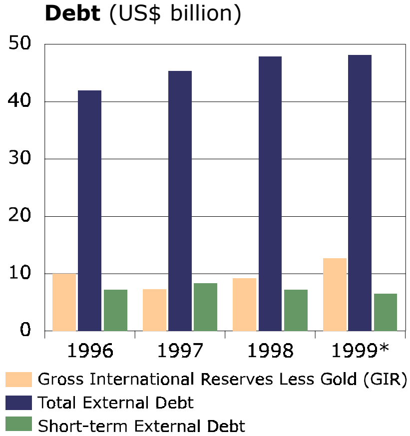
The Balance of Payments

Figure 5: **Growth of Merchandise Exports and Imports** (y-o-y, %)



Source: ARIC Indicators.

Figure 6: **International Reserves, External Debt and Short-term External Debt** (US$ billion)



*GIR data as of end-September 1999; total and short-term external debt data as of end-June 1999.
Source: ARIC Indicators.

Rebound in exports and stagnant imports helped boost the current account surplus.

Impressive growth of merchandise exports (Figure 5), principally electronics, rapid growth of income remittances, and stagnant imports underpinned a current account surplus in 1999. The trade balance, which is traditionally in deficit, posted a surplus of US$3.3 billion in the first 10 months of 1999.

FDI remained stable, but weak.

Net foreign direct investment inflows over the first 3 quarters of 1999 broadly matched their level in 1998. While there was some return of foreign portfolio capital following earlier withdrawals, the turnaround has been mild. Net official capital inflows increased, owing mainly to borrowings from the International Monetary Fund. An overall capital account surplus helped boost external reserves to about US$13 billion at the end of September 1999.

External debt remains high but short-term debt has been sharply reduced.

Total external debt as a percentage of GDP declined in 1999. Nevertheless, at 68.4 percent of GDP (as of the middle of 1999), it remains high compared to the other affected countries. To ease the debt-servicing burden, the government has successfully renegotiated a significant portion of its short-term debt to medium-term to long-term debt. As a result of these efforts, short-term debt had declined from 18.6 percent of total external debt at end-1997 to 13.6 percent by mid-1999. Short-term external debt had declined from about US$8.4 billion (116 percent of the country's foreign reserves) in 1997 to about US$6.5 billion (53.1 percent) by the second quarter of 1999, reducing the Philippines' vulnerability to external shocks (Figure 6).

Financial and Corporate Sector Developments

The banking system weathered the crisis reasonably well, but NPLs have grown.

There has been no systemic distress in the Philippine banking system following the collapse of the peso and other regional currencies in 1997 and 1998. But economic contraction following the onset of the crisis has triggered a significant increase in NPLs. The NPL ratio increased from 4.7 percent in December 1997 to peak at 14.6 percent in November 1999. It declined to 12.3 percent in December 1999, more as a result of a rise in the stock of bank credit than a reduction in the level of NPLs. The problems are largely confined to small and rural banks, although some of the larger commercial banks also carry abnormally large amounts of non-performing debt. However, with an average capital adequacy ratio of over 17 percent and low foreign debt exposure, the overall health of the banking system is not a cause for serious concern. High NPL ratios contributed to the stagnation of bank credit to the private sector for most of 1999.

The crisis did not lead to widespread corporate failures.

While corporate bankruptcies and referrals to the Securities and Exchange Commission (SEC) have increased since 1997, corporate failures have not been as widespread as in the other affected countries. In the Philippines, the scale of difficulties has not justified the creation of a specialized debt-restructuring agency. In 1997 and 1998, over 50 companies with total liabilities of P109 billion petitioned the SEC for a suspension of payments. In 1999, the number of petitions declined to 12 in the first ten months and the total debt involved declined to P19 billion, suggesting corporate financial conditions are improving. The debt restructuring process has, however, been painfully slow.

Prospects and Policy Issues

Supported by revitalized domestic demand, the Philippine economy is likely to grow at a higher rate.

The latest Consensus Economics (February 2000) projection for growth in the Philippine economy in 2000 is 3.8 percent, which is close to the lower end of the range of official projections of between 4 and 5 percent GDP growth. Since the government's commitment to fiscal consolidation leaves limited scope for fiscal pump priming, the impetus for growth must now come from private investment and consumption. Net exports are unlikely to contribute significantly to growth if imports recover together with domestic demand. On the supply side, the contribution of agriculture to growth will diminish in 2000, requiring a much stronger performance from the manufacturing sector. Progress on structural reforms, including corporate restructuring, trade and investment liberalization, and an improvement in governance in both the public and private sectors would do much to restore investor confidence and help support growth.

The government aims to reduce the fiscal deficit in 2000.

Fiscal targets were successively breached in 1999. The government is now committed to a substantial reduction in the deficit. If revised targets were to be breached again in 2000, this could exert pressure on interest rates and slow economic growth. Success in achieving the targets hinges very much on sustained economic recovery, more effective revenue mobilization and a restructuring of the finances of GOCCs. Recent experience with tax reform and GOCCs restructuring suggests that these are not only technically but also politically difficult exercises, and could take much longer to achieve than currently estimated. The fiscal consolidation should not be achieved at the expense of spending on social sectors and public capital investment.

Recent concerns about renewed inflationary pressure and rising global interest rates narrow the scope for further monetary easing.

Inflation in the Philippines remains comparatively high and exerts a perennial upward pressure on the real exchange rate. Oil companies raised fuel prices recently in response to sharply rising world prices and higher fuel prices will soon percolate through to the general price level. Traditionally, such increases have elicited claims for additional wages, and risk inflationary pressures from the cost side. Further increases in US dollar interest rates, and interest rates elsewhere in the global economy, which seem a distinct possibility, may also exert pressure for a peso depreciation in a context where the current account surplus may narrow. The confluence of these factors has persuaded the authorities to raise domestic interest rates. In an attempt to curb speculative activities in the foreign exchange market and reduce the volatility of the exchange rate, Bangko Sentral ng Pilipinas has recently imposed a three-month holding period requirement on proceeds of foreign investments held in peso time deposits.

Efforts to reduce NPLs need to be supported by revamping the legal framework for handling insolvency.

The existing legal framework for handling insolvency cases is a major constraint to expeditious debt restructuring and settlement. Under the current law on Suspension of Payments, the SEC has the quasi-judiciary power to make a decision on whether or not to rehabilitate a petitioning debtor. Creditors only play a passive role during the process. Overall, the bias against creditors in the legal framework of insolvency is a key factor in the slow process of corporate debt restructuring and settlement. New rules and procedures for SEC-administered processes for suspension of payments have been drafted and are now being debated. Other reform measures are also being considered. The success of any effort to reduce NPLs by an expeditious restructuring and liquidation of debts will depend on full-fledged reforms relating to insolvency law and practices.

Structural weaknesses in the banking system call for faster reforms.

Part of the reason why the Philippines did not experience a systemic banking crisis was that its banking sector enjoyed better financial health than those of its neighboring countries. Nevertheless, there remain significant structural weaknesses in the Philippine banking system that require urgent reform. A reluctance to repeal the Banking Secrecy Laws remains a serious impediment to strengthening bank supervision. The momentum in reforms needs to be continued and enhanced in the areas of prudential standards, disclosure, supervision, and bank exit and resolution procedures. This requires not only strengthening the regulatory framework, but also ensuring compliance and enforcement.

The social impacts of the crisis are a cause for concern.

Although not as severe as in Thailand and Indonesia, the social impacts of the crisis in the Philippines have been significant. On a year-on-year basis, unemployment rates for most of 1999 were still higher than their respective levels in 1997. Real wages remained depressed. Through these effects, the crisis has added to the country's poverty problems. The education of children from poor families has also been affected. It is still too early to assess the longer-term impacts of the crisis. So far, the government response to these adverse social impacts has been limited. The government has proposed allocating at least 20 percent of the national budget and 20 percent of all overseas development aid to basic social services over the 1999-2004 period. However, its ability to do this depends on whether it can successfully consolidate its fiscal position in the coming years.

Governance problems worry investors.

It is estimated that a sizeable amount of public expenditure in the Philippines is diverted to uses other than those for which it was intended. This misallocation of public resources not only has adverse fiscal consequences, but also deprives the economy of needed physical and social infrastructure. In the private sector, too, concerns over governance are mounting. Recent revelations of insider trading, and the slow pace at which referrals to the SEC are being handled worry potential investors, as does the way in which foreign investment projects are sometimes handled.

Philippines: Selected ARIC Indicators

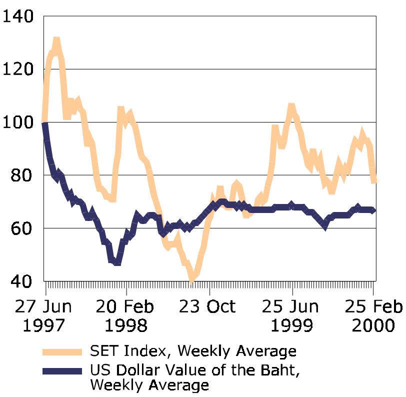
	1996	1997	1998	1999	98Q1	98Q2	98Q3	98Q4	99Q1	99Q2	99Q3	99Q4
Output and Prices												
GDP Growth (%)	5.8	5.2	-0.5	3.2	1.1	-1.0	-0.1	-2.0	1.2	3.6	3.4	4.6
Private Consumption Expenditure Growth (%)	4.6	5.0	3.4	2.7	4.5	3.9	2.9	2.6	2.5	2.6	2.6	3.0
Public Consumption Expenditure Growth (%)	4.3	4.6	-2.1	5.5	-5.4	-2.4	-1.3	0.6	7.6	6.2	3.7	4.6
Gross Domestic Investment Growth (%)	12.5	11.7	-16.4	-2.1	-6.0	-18.2	-19.1	-22.3	-9.7	6.2	-2.2	-1.0
Agricultural Sector Growth (%)	3.8	4.0	-6.6	6.6	-3.8	-11.5	-3.1	-7.8	2.9	11.1	5.3	7.4
Manufacturing Sector Growth (%)	5.6	4.2	-1.1	1.4	2.0	-0.9	-1.5	-3.5	-1.0	0.9	2.4	3.1
Construction Sector Growth (%)	10.8	16.3	-8.5	-2.8	-12.8	-5.1	-7.5	-8.5	-6.0	-5.3	-0.5	0.5
Services Sector Growth (%)	6.4	5.4	3.5	3.9	4.5	3.6	2.8	3.2	3.0	4.0	4.2	4.4
Exports of Goods and Services Growth (%)	15.4	17.2	-21.0	1.8	-4.5	-19.4	-21.4	-34.8	-11.4	2.1	7.2	10.3
Import of Goods and Services Growth (%)	16.7	13.5	-14.7	-2.7	5.8	-12.5	-15.7	-32.8	-17.9	0.4	1.8	8.0
Inflation Rate (%)	9.0	5.9	9.7	6.7	7.9	9.9	10.4	10.5	10.1	6.8	5.7	4.6
Unemployment Rate (%)	7.4	7.9	10.1	9.7	8.4	13.3	8.9	9.6	9.0	11.8	8.4	9.6
Monetary and Fiscal Accounts												
Growth of Broad Money, M2 (%)	23.2	26.1	8.5	...	18.0	19.3	15.0	8.5	10.8	9.6	10.2	...
Three-month Interbank Lending Rate (%)[1]	...	31.4	15.7	11.2	18.9	17.3	16.3	15.7	12.7	9.2	9.8	11.2
Growth in Real Bank Credit to Private Sector (%)[1]	38.8	20.1	-15.5	4.4	8.3	1.0	-8.6	-15.5	-14.2	-12.5	-10.8	4.4
Ratio of Non-Performing Loans to Total Loans (%)[2]	2.8	4.7	10.4	12.3	7.4	8.9	11.0	10.4	13.2	13.1	13.4	12.3
Average Stock Price Index (PCOMP)	3054.2	2595.2	1799.0	2168.7	2029.2	2044.0	1431.3	1691.7	2003.4	2381.5	2285.4	2004.6
Central Government Fiscal Balance as % of GDP	0.3	0.1	-1.9	-3.7	...	...	...	...	...	...	...	...
Central Government Debt as % of GDP	53.2	55.8	56.1	57.8	...	...	...	56.1	...	...	...	57.8
Government Expenditure on Education (% of Total)[3]	14.5	15.8	17.6	...	...	...	...	...	...	...	...	...
Government Expenditure on Health (% of Total)[3]	6.6	8.6	8.2	...	...	...	...	...	...	...	...	...
External Account, Debt, and Exchange Rates[4]												
Growth of Merchandise Exports (US$, FOB, %)	17.7	22.8	16.9	18.8	23.9	14.5	19.2	11.5	15.2	12.1	22.9	23.8
Growth of Merchandise Imports (US$, FOB, %)	20.8	12.7	-17.5	3.6	-4.3	-17.8	-21.4	-25.9	-7.5	6.3	7.7	11.2
Current Account Balance as % of GDP	-4.8	-5.3	2.0	...	-0.6	0.6	2.8	4.6	7.4	5.1	12.7	...
Foreign Direct Investment (US$ Billion)	1.52	1.25	1.75	...	0.25	0.25	0.22	1.04	0.47	0.15	0.10	...
Net Portfolio Investment (US$ Billion)	2.10	-0.41	0.26	...	0.37	0.02	-0.26	0.14	0.26	0.37	-0.14	...
Gross Int'l Reserves (GIR) Less Gold (US$ Billion)[1]	10.0	7.3	9.2	...	7.8	9.0	9.0	9.2	11.4	12.3	12.7	...
Total External Debt (US$ Billion)[1]	41.9	45.4	47.8	...	45.7	45.8	46.4	47.8	48.6	48.1	...	...
Total External Debt as % of GDP	50.6	55.3	73.3	...	61.0	65.5	70.5	73.3	71.8	68.4	...	...
Short-Term External Debt as % of Total[1]	17.2	18.6	15.0	...	19.4	17.8	17.2	15.0	14.0	13.6	...	...
Short-Term External Debt as % of GIR Less Gold	71.9	116.1	77.9	...	113.1	90.4	88.5	77.9	59.6	53.1	...	...
Real Effective Exchange Rate (1995=100)[5]	110.4	111.0	94.0	100.7	91.5	97.2	92.6	94.7	102.2	105.1	100.5	95.0
Average Exchange Rate (Local Currency to US$)	26.2	29.5	40.9	39.1	40.7	39.4	42.9	40.6	38.7	38.0	39.3	40.4

Note: All growth rates are on year-on-year basis.
... = not available.
[1]End of period.
[2]Non-performing loans cover the banking sector only.
[3]Central government expenditure on health and education refers to budget figures.
[4]Data on merchandise exports and imports, external debt and capital flows are from national sources. Gross International Reserves are from *International Financial Statistics*, International Monetary Fund. FDI refers to net FDI by non-residents.
[5]Trade weighted using WPI for trading partners and CPI for the home country.
Sources: See *Statistical Sources* of the ARIC Indicators section of this web site.

Thailand Update

Asset Markets

Figure 1: **Exchange Rate and Stock Price Indexes** (last week of 1997June=100)



Source: ARIC Indicators.

There was a mild depreciation of the baht in 1999.

The baht fell sharply in mid-1997 in response to investor panic. As the panic abated and market confidence improved, the baht regained some of the ground it had earlier lost. In 1998, the baht appreciated by about 30 percent (Figure 1). In 1999, the baht depreciated somewhat. Successive US dollar interest rate increases have on each occasion shaved a little off the value of the baht. In February 2000, the baht was still about 35 percent lower than its end-June 1997 value.

Stock market recovery has been hesitant.

After hitting a record low in the third quarter of 1998, the Stock Exchange of Thailand (SET) index began a steady recovery, thanks largely to the return of foreign investors. By the middle of 1999, the SET index had regained in local currency terms a substantial portion of the value lost since the onset of the crisis. Since then, however, the SET index has surrendered part of these gains. Concerns about slow progress on financial and corporate restructuring have continued to plague the market. By the end of February 2000, the SET index was still 23 percent short in baht and about 50 percent short in US dollar terms of its end-June 1997 level, which itself was at a substantial discount to the level of the SET index in 1996.

The property market vacancy rate bottomed out.

Bangkok's property markets, both office and residential, stabilized in the second half of 1999. The office property vacancy rate peaked in the first quarter of the year, thereafter showing a mild decline (Table 1). By late 1999, the average rental rate was still less than half that in the second quarter of 1997 in US dollar terms.

Table 1: **Office Property Vacancy Rate in Bangkok** (%)

	98Q2	98Q3	98Q4	99Q1	99Q2	99Q3
Vacancy Rate	28.2	28.7	29.7	43.1	42.2	40.3

Source: Jones Lang LaSalle, Asia Pacific Property Digest, various issues.

The prospect of an immediate recovery remains bleak, with over-supply expected to depress property prices and rentals for many years to come.

The Real Sector

Real GDP grew at 4 percent in 1999, but income remains substantially lower than its pre-crisis level.

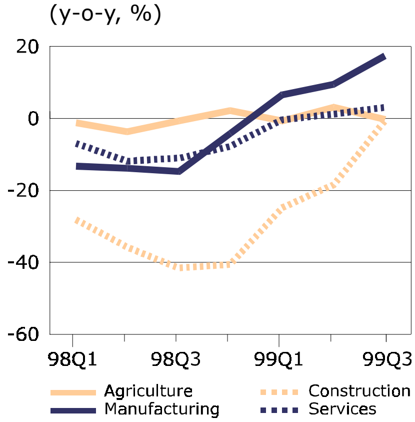
The quick economic turnaround in 1999 took many by surprise. After seven consecutive quarters of contraction, the economy began to expand in the first quarter of 1999, albeit from a low base. As the year progressed, this economic momentum was maintained. The growth rate for 1999 reached 4 percent (Table 2). While this outcome is welcome, it still leaves the level of real GDP per capita about 11 percent short of its level in 1996.

Table 2: **GDP Growth and Projections** (%)

	1997	1998	1999	2000
Official[1]	-1.8	-10.4	4.0	4.5
ADB[2]	—	—	—	4.5
IMF[3]	—	—	—	4.0
World Bank[4]	—	—	—	7.0
Consensus Economics[5]	—	—	—	5.2

[1]Revised Economic Forecast for the Thai Economy, 29 February 2000.
[2]ADB, Asian Development Outlook team, February 2000.
[3]IMF, World Economic Outlook, October 1999.
[4]World Bank, East Asia Pacific Brief, 31 January 2000.
[5]Consensus Economics Inc., Asia Pacific Consensus Forecasts, February 2000.

Figure 2: **Sectoral Growth**
(y-o-y, %)

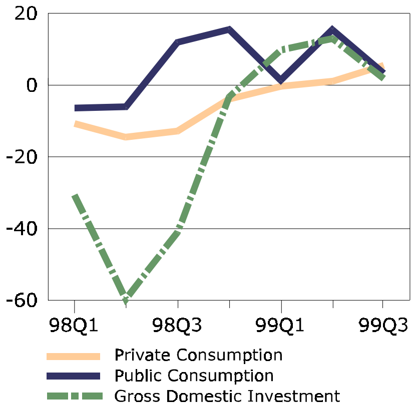


Source: ARIC Indicators.

The manufacturing sector led the recovery.

Manufacturing has been the main engine in driving output growth (Figure 2). Growth and investment in export-oriented industries such as electronics were particularly strong. Exports have benefited from a cheaper baht (in real, trade-weighted terms) and strong external demand. Agricultural production, which was severally affected by El Niño-induced droughts in 1998, also picked up slightly in 1999. But, as in other affected economies, the construction sector acted as a major drag on growth, as high vacancy rates persisted in both office and residential property markets.

Figure 3: **Growth of GDP Expenditure Components** (y-o-y, %)



Source: ARIC Indicators.

Deficit spending and, in the second half of 1999, private consumption demand provided the impetus to growth.

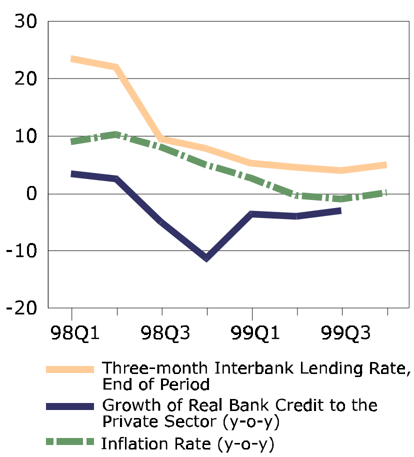
Public consumption expanded throughout 1999, although at a somewhat slower rate than in the second half of 1998 (Figure 3). Public investment also registered impressive growth. Together, these components of public expenditure provided the key impetus to output growth in the first half of 1999. Helped by a temporary reduction in value-added tax in early 1999, private consumption demand began to expand in the second quarter. It has since picked up momentum. Gross domestic investment also grew in 1999, mainly as a result of public investment and inventory accumulation. Private fixed investment remained in the doldrums because of the low level of capacity utilization in the economy and the slow pace of financial and corporate restructuring.

Fiscal and Monetary Developments

The budget deficit widened.

Deficit spending measures and a recession-induced contraction in fiscal revenues have caused the central government's fiscal deficit to increase steadily. It is estimated that the deficit will have reached 3 percent in 1999. Central government debt too is increasing. As a percentage of GDP, it has risen from 6.3 percent at the end of 1997 to 20.6 percent at the end of the third quarter in 1999. Total public sector debt, which includes non-financial public enterprise debt and debt related to financial sector restructuring, is much higher. It increased from 15 percent of GDP in 1996 to over 50 percent in 1999 and is expected to increase further.

Figure 4: **Short-term Interest Rate, Real Bank Credit Growth and Inflation Rate** (%)



Source: ARIC Indicators.

Monetary policy continues to accommodate recovery.

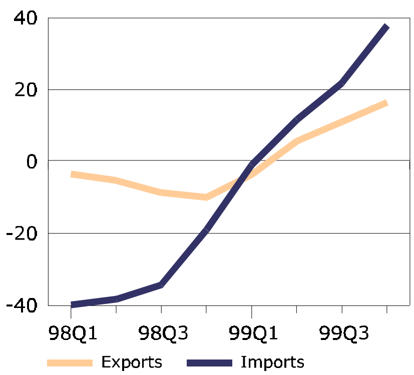
The stabilization of the exchange rate and strengthening of the external position set the stage for a relaxation of monetary policy. The Bank of Thailand reduced its overnight re-purchase rate from a peak of more than 25 percent in late 1997 to less than 1 percent by mid-1999. By the end of December 1999, the three-month interbank lending rate was 5 percent, over 18 percentage points lower than that at the end of March 1998 (Figure 4). Despite monetary easing, inflation, after peaking in mid-1998, declined persistently, bottoming out in the third quarter of 1999. The inflation rate in 1999 was a mere 0.3 percent, compared to 8.1 percent in 1998. Subdued inflation reflects excess capacity in the economy, lower food prices and a stable baht.

Monetary easing has yet to be reflected in domestic credit expansion.

Despite successive cuts in interest rates, outstanding real bank credit shrank throughout 1999, although at a slower pace than before. Excess capacity in many sectors and a high level of indebtedness in the corporate sector led to sluggish private investment and weak credit demand. With a high level of non-performing loans (NPLs), banks have been more cautious than before in extending new credit. Increasingly, firms are issuing corporate bonds to finance new investment. By the end of 1999, the real stock of commercial bank credit is estimated to have shrunk by over 4 percent from a year ago.

Balance of Payments

Figure 5: **Growth of Merchandise Exports and Imports** (y-o-y, %)



Source: ARIC Indicators.

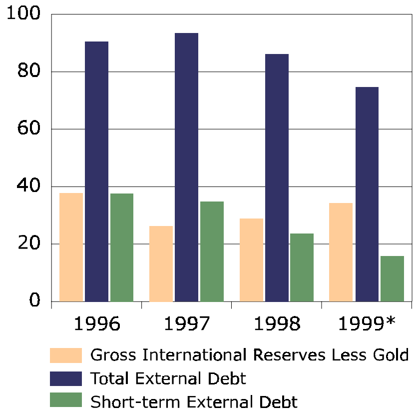
Booming exports underpinned a strong current account surplus.

Exports and imports both started to recover in the second quarter of 1999 (Figure 5). For the full year, merchandise imports grew by 17.6 percent and merchandise exports by 7.2 percent. As imports grew from a lower and much depleted base, a trade surplus of US$8.9 billion was recorded in 1999. Boosted by a positive services account balance, the current account surplus reached US$11.2 billion, or about 9 percent of GDP.

Despite continued FDI inflows and renewed portfolio investment, the capital account balance remained negative in 1999.

Thailand continued to attract a steady flow of foreign direct investment in 1999, albeit at a slower rate than in 1998. Reflecting a reassessment of Thailand's prospects and improved investor sentiment, net portfolio inflows started in the first quarter of 1999 and continued throughout the remainder of the year. Official borrowing linked to the recovery program also continued to supplement foreign exchange reserves throughout the year. However, because of the continued repayment of debts, large capital outflows also occurred. These were sufficient to generate an estimated overall deficit on the capital account of over US$9 billion.

Figure 6: **International Reserves, External Debt and Short-term External Debt** (US$ billion)



*Short-term external debt data as of end-September 1999.
Source: ARIC Indicators.

But the current account supported an increase in reserves.

While the capital account deficit partially offset the current account surplus, the balance of payments remained in surplus in 1999. This had increased the country's external reserves to around US$34 billion by the end of 1999, from US$28.8 billion a year earlier (Figure 6). The reserves were adequate to finance over eight months of imports.

The maturity structure of the external debt profile continues to improve.

The repayment of short-term debt led to an improvement in the maturity structure of Thailand's external debt profile. Short-term debt as a percentage of total external debt declined from 37.3 at the end of 1997 to 27.2 at the end of 1998 and 19.9 at the end of the third quarter of 1999. The level of total external debt also declined during 1999. But at over 60 percent of GDP, the level of external debt remains high.

Financial and Corporate Sector Developments

Market-led financial restructuring has proved to be slow, but the pace is now beginning to quicken.

The approach to financial restructuring has been much more market-oriented in Thailand than in either Korea or Malaysia. The Thai authorities have to a large extent left the banks to resolve their NPLs on their own. The government has set terms for re-capitalization that place a heavy responsibility on existing owners. Limited public financial support is made available, provided that private investors inject capital, and target capital adequacy ratios and provisioning standards are met. Banks have also been encouraged to set up their own private asset management companies to help remove NPLs from their balance sheets, and to recover values. This approach has proved to be slow in resolving NPLs. By June 1999, the NPL ratio still stood at close to 50 percent. But the second half of 1999 witnessed a dramatic decline in NPLs, which had fallen to 38.5 percent by the year's end. This positive development may be explained by a number of factors. Low interest rates and real sector recovery took some pressure off debt-ridden companies. The faster pace of corporate debt restructuring helped reduce the NPL ratio.

Slow corporate restructuring mirrors slow financial restructuring.

Corporate restructuring has mainly taken the form of voluntary negotiations and out-of-court settlements following the so-called Bangkok approach. This process has been slow. By September 1999, about B1.9 trillion in credit, equivalent to approximately three-quarters of Thailand's total NPLs, had entered the restructuring process. About 60 percent of the total NPLs originate with 700 large companies. The government has set up the Corporate Debt Recovery Advisory Committee (CDRAC) to deal with these high-profile cases. So far only one-fifth of the total debt under CDRAC's purview has been successfully restructured. The government has left the resolution process of the remaining NPLs, shared by nearly 400,000 medium and small firms and individual borrowers, to debtors and creditors themselves. Here restructuring is proceeding at snail's pace, due to the ineffective legal framework for insolvency, poor enforcement and the bias that remains in favor of debtors.

Prospects and Policy Issues

GDP growth is likely to accelerate in 2000.

The Thai economy has turned the corner. The latest Consensus Economics (February 2000) projections suggest that Thailand could grow at about 5 percent in 2000 with most forecasts contained in a range of 4–6 percent. Deficit spending measures and export growth have so far underpinned the recovery. While households are now beginning to spend more, private investment also needs to rebound to ensure a sustained and more broadly based recovery. Strengthening market confidence is reflected in a stable baht and the return of private capital. While the current account surplus may be expected to come down with an acceleration in growth, Thailand's external reserve position will continue to improve if recovery attracts more foreign capital. Although prospects may be improving, the government still faces many challenges and growth could yet falter.

Slow financial restructuring could hamper recovery.

The slow pace of bank and corporate restructuring remains the major stumbling block to continued recovery. Although NPLs have of late shown an encouraging decline, they remain high and the most problematic cases are yet to be resolved. Powerful debtors are successfully stalling and resisting creditors' claims, and anecdotal evidence suggests that the incidence of "strategic defaulting" remains high by those who are able to service their debt but choose not to. The widely acknowledged virtue of a market-led approach to restructuring is that it militates against moral hazard problems. But these benefits only follow where there are sanctions that can compel action on voluntary resolution, and where there is a framework that allows acquisitions and mergers to proceed expeditiously on market terms. In Thailand, creditors do not yet appear to be sufficiently empowered. The framework of insolvency is still biased in favor of debtors and the costs of pursuing bankruptcy actions are high. In these circumstances, voluntary renegotiation of debts is often the preferred way forward, but because debtors face no credible threats they typically hold the upper hand in negotiations. If this situation continues and high NPL ratios persist, it could jeopardize the much hoped for recovery in private investment and again put bank capital at risk. It would also imply that the changes needed at the managerial and operational levels to put Thailand's businesses on a more competitive footing are likely to be a long time coming. For all these reasons, steps are urgently needed to effectively tilt the resolution processes in favor of creditors.

Macroeconomic policies should continue to support expansion and recovery.

Sizeable excess capacity, subdued inflation, low interest rates and a stable exchange rate provide further scope for accommodating macroeconomic policies. The stock of real credit is yet to expand. Monetary tightening could damage the financial health of the banking and corporate sectors. There is also a need to continue government spending on social safety net programs until a decisive turnaround in employment and in social conditions is achieved. Add to this the possibility that further fiscal support for banking sector re-capitalization may be needed, and there is little likelihood of a quick return to budgetary surpluses. The risks of moderate fiscal deficits crowding out private sector demand are low in a context where current account surpluses are likely to endure and there is an excess of domestic savings over investment. Nevertheless, over the medium term, measures will be needed to consolidate Thailand's fiscal position.

Further structural reforms are needed to revitalize the private sector.

As part of its recovery program, Thailand has undertaken a number of key reforms. Restrictions on foreign investment in key sectors, new insolvency laws, the accelerated implementation of privatization plans and trade liberalization are notable examples. It is important to build on these initial steps, and to ensure that the reforms are effectively implemented. The temptation to defer further reforms until growth is more firmly rooted should be resisted. Issues related to long-term export competitiveness also need to be addressed.

Thailand: Selected ARIC Indicators

	1996	1997	1998	1999	98Q1	98Q2	98Q3	98Q4	99Q1	99Q2	99Q3	99Q4
Output and Prices												
GDP Growth (%)	5.9	-1.8	-10.4	4.0	-9.0	-12.7	-13.2	-6.6	0.9	3.3	7.7	...
Private Consumption Expenditure Growth (%)	6.8	-0.8	-10.6	...	-10.6	-14.5	-12.8	-3.9	-0.3	1.1	5.5	...
Public Consumption Expenditure Growth (%)	11.9	-3.6	4.0	...	-6.4	-6.0	11.9	15.5	1.4	15.5	3.4	...
Gross Domestic Investment Growth (%)	...	-21.7	-34.8	...	-30.6	-59.7	-41.0	-3.3	9.8	13.0	1.8	...
Agricultural Sector Growth (%)	3.8	-0.5	-0.3	...	-1.2	-3.7	-0.7	2.2	-0.7	3.2	-0.2	...
Manufacturing Sector Growth (%)	6.7	0.1	-11.6	...	-13.3	-13.8	-14.8	-4.1	6.6	9.5	17.4	...
Construction Sector Growth (%)	7.2	-26.6	-36.8	...	-28.1	-35.8	-41.6	-40.6	-24.8	-18.4	-0.6	...
Services Sector Growth (%)	5.3	-1.1	-9.4	...	-6.9	-11.9	-11.0	-7.7	-0.4	1.2	3.1	...
Exports of Goods and Services Growth (%)	-5.5	8.4	6.7	...	15.0	8.9	5.7	-1.2	-1.8	7.6	13.3	...
Import of Goods and Services Growth (%)	-0.5	-11.4	-23.8	...	-28.5	-29.8	-23.5	-11.8	8.5	23.2	21.6	...
Inflation Rate (%)	5.8	5.6	8.1	0.3	9.0	10.3	8.1	5.0	2.7	-0.4	-1.0	0.1
Unemployment Rate (%)	1.1	0.9	4.4	...	4.6	5.0	3.4	4.5	5.2	5.3	3.0	...
Monetary and Fiscal Accounts												
Growth of Broad Money, M2 (%)	12.6	16.5	9.7	...	15.7	13.8	12.7	9.7	8.6	5.8	1.9	...
Three-month Interbank Lending Rate(%)[1]	...	26.0	7.8	5.0	23.5	22.0	9.5	7.8	5.3	4.5	4.0	5.0
Growth in Real Bank Credit to Private Sector (%)[1]	9.4	13.6	-11.3	...	3.4	2.5	-5.0	-11.3	-3.6	-4.0	-3.0	...
Ratio of Non-Performing Loans to Total Loans (%)[2]	...	...	45.0	38.5	...	32.7	39.7	45.0	47.0	47.4	44.4	38.5
Average Stock Price Index (SET)	1167.9	597.8	353.9	421.1	473.1	361.5	246.0	335.0	357.1	461.8	450.5	415.0
Central Government Fiscal Balance as % of GDP	1.0	-0.3	-2.8	...	...	...	...	...	...	...	...	...
Central Government Debt as % of GDP	...	6.3	14.5	...	5.5	9.1	10.2	14.5	18.4	19.5	20.6	...
Government Expenditure on Education (% of Total)[3]	17.6	16.2	...	...	...	...	...	...	...	...	...	...
Government Expenditure on Health (% of Total)	6.4	5.7	...	...	...	...	...	...	...	...	...	...
External Account, Debt, and Exchange Rates[4]												
Growth of Merchandise Exports (US$, FOB, %)	-1.9	4.1	-6.9	7.2	-3.4	-5.2	-8.6	-9.9	-3.6	5.7	11.1	16.5
Growth of Merchandise Imports (US$, CIF, %)	0.6	-13.7	-33.7	17.6	-39.8	-38.2	-34.2	-18.9	-1.0	11.7	21.9	38.0
Current Account Balance as % of GDP	-8.1	-2.0	12.7	...	16.5	10.2	12.5	11.7	10.8	8.6	9.3	...
Foreign Direct Investment (US$ Billion)	2.3	3.7	7.1	...	2.0	2.6	1.4	1.0	1.0	2.2	1.1	...
Net Portfolio Investment (US$ Billion)	...	3.9	-0.2	...	0.2	-0.1	-0.3	-0.01	0.3	0.3	0.3	...
Gross Int'l Reserves (GIR) Less Gold (US$ Billion)[1]	37.7	26.2	28.8	34.1	26.9	25.8	26.6	28.8	29.2	30.7	31.6	34.1
Total External Debt (US$ Billion)[1]	90.5	93.4	86.2	74.6	91.7	88.1	86.7	86.2	83.9	80.7	78.7	74.6
Total External Debt as % of GDP	49.8	62.0	76.8	...	70.8	75.1	78.7	76.7	70.4	66.4	66.1	...
Short-Term External Debt as % of Total[1]	41.5	37.3	27.2	...	34.2	32.2	30.1	27.2	24.5	21.8	19.9	...
Short-Term External Debt as % of GIR Less Gold	99.7	133.1	81.4	...	116.6	110.0	98.2	81.4	70.2	57.2	49.6	...
Real Effective Exchange Rate (1995=100)[5]	109.2	102.4	90.0	93.5	77.3	92.5	93.5	96.8	97.3	97.5	91.9	87.2
Average Exchange Rate (Local Currency to US$)	25.3	31.4	41.4	37.8	47.1	40.3	41.1	37.0	37.1	37.2	38.4	38.8

Note: All growth rates are on year-on-year basis.
... = not available.
[1]End of period.
[2]Non-performing loans cover all financial institutions.
[3]Central government expenditure on health and education refers to budget figures for 1995/96 and 1996/97, respectively.
[4]Data on merchandise exports and imports, external debt and capital flows are from national sources. Gross International Reserves are from *International Financial Statistics*, International Monetary Fund. FDI refers to net FDI by non-residents.
[5]Trade weighted using WPI for trading partners and CPI for the home country.
Sources: See *Statistical Sources* of the ARIC Indicators section of this web site.