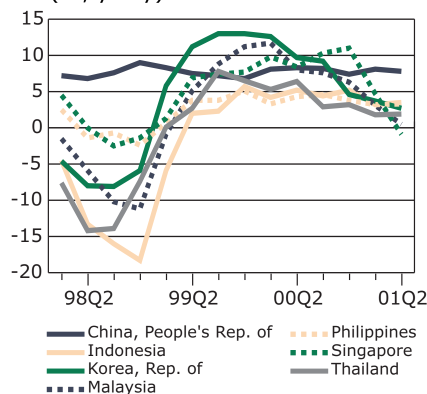
Asia's Growth and Recovery—A Regional Update

Growth and Recovery in 2001

Figure 1: **Real GDP Growth** (%, y-o-y)



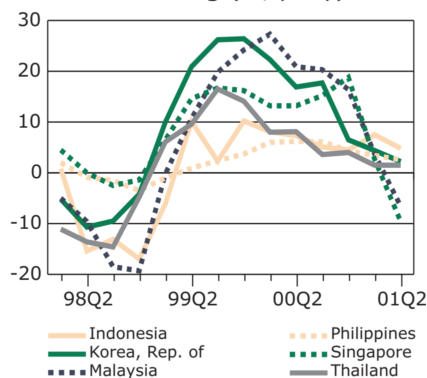
Source: ARIC Indicators, National Bureau of Statistics (PRC), and Ministry of Trade and Industry (Singapore).

Real Sector Developments

Since the second half of 2000, with the notable exception of the People's Republic of China (PRC), growth has slowed across East Asia (i.e., the 10 Association of Southeast Asian Nations [ASEAN] countries, plus the Republic of Korea [Korea] and the PRC) (Figure 1). Predictably, the stronger a country's links to the global economy through trade and capital flows, the greater has been the impact on domestic growth. Similarly, countries with heavier dependence on electronics exports have seen a larger dip in growth.

In the first half of this year, the five crisis-affected countries (Indonesia, Korea, Malaysia, Philippines, and Thailand) taken together grew by 2.9 percent. This represents a deceleration from the 5.6 percent growth they achieved in the preceding six months and the average growth of 6.9 percent reached in the previous two years. Outside these five, Singapore saw its gross domestic product (GDP) growth plummet to 1.8 percent in the first half of 2001 from 10.7 percent in the preceding six months and an average growth of close to 8 percent in the previous two years. The impact of the global slowdown on the PRC, meanwhile, has been limited, partly because of its lower dependence on exports, especially information technology (IT) exports, and partly because of fiscal stimulus measures. As a result, it posted strong growth of 7.9 percent in the first half of the year. For the other ASEAN members (Brunei Darussalam, Cambodia, Lao People's Democratic Republic, Myanmar, and Viet Nam), quarterly or half-yearly data on GDP are not available. As they are less dependent on external trade and investment, it is possible that these countries have weathered the global slowdown better than most other East Asian countries. Yet, it is unlikely that they have been completely insulated from the regional slowdown as they have significant trade and investment links with the rest of East Asia.

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



Source: ARIC Indicators and Ministry of Trade and Industry (Singapore).

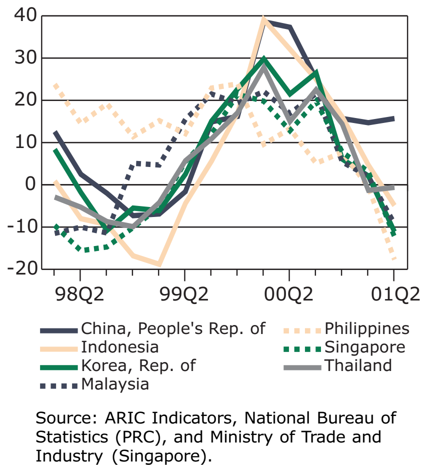
Confirming one of the tentative conclusions of the June Asia Recovery Report (ARR) Update, the recent growth deceleration cuts across sectors, but is most visible in manufacturing (Figure 2). Korea's manufacturing sector grew by only 3.2 percent in the first half, compared to an average growth of more than 18 percent in the previous two years. In Malaysia, the manufacturing sector actually shrank by 1.6 percent in the first half, compared to an average growth rate of 17.4 percent in the previous two years. Similarly, Singapore's manufacturing shrank by 3.9 percent in the

Figure 3: **Growth of Merchandise Exports (constant prices) and Real GDP** (%, y-o-y)

Indonesia | **Korea, Rep. of** | **Malaysia** | **Philippines** | **Singapore** | **Thailand**

Source: ARIC Indicators and Ministry of Trade and Industry (Singapore).

Figure 4: **Growth of Merchandise Exports, Dollar Value** (%, y-o-y)

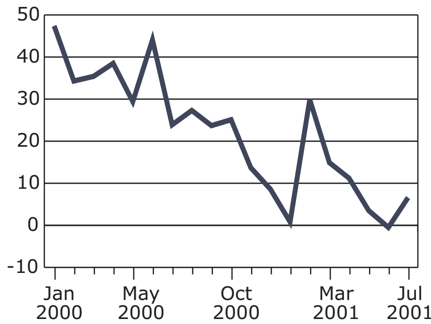


Source: ARIC Indicators, National Bureau of Statistics (PRC), and Ministry of Trade and Industry (Singapore).

first six months of this year, a huge setback from an average growth of more than 14 percent in the previous two years. Even in the Philippines, a country that has experienced only a modest growth deceleration, manufacturing sector growth has almost halved from 5.6 percent in 2000 to 3 percent in the first half of 2001.

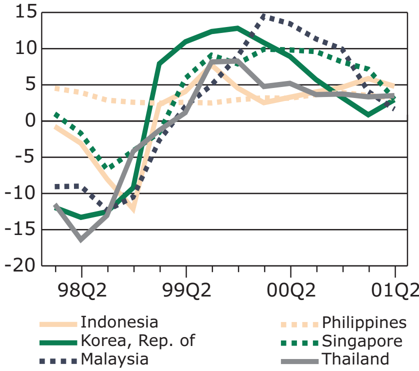
The sharp cuts in growth rates were driven mainly by external factors. A slowing world economy and decelerating world trade growth have hurt the demand for East Asian exports. Exports played a key role in reviving the region's growth in the aftermath of the 1997 financial crisis, but are now leading the economic downturn (Figure 3). Taken together, the dollar value of exports of the five crisis-affected countries (which account for about 60 percent of East Asia's exports) declined by 3.8 percent in the first half of this year, compared to 19 percent growth in 2000 (Figure 4). Outside the five crisis-affected countries, Singapore saw its export growth fall to 4.8 percent in the first half of 2001 from more than 15 percent

Figure 5: **Growth of Merchandise Exports, Dollar Value—PRC** (%, y-o-y)



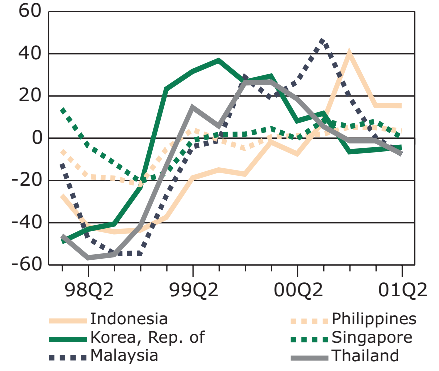
Source: Bloomberg.

Figure 6: **Growth of Real Private Consumption Expenditure** (%, y-o-y)



Source: ARIC Indicators and Ministry of Trade and Industry (Singapore).

Figure 7: **Growth of Real Gross Domestic Investment** (%, y-o-y)



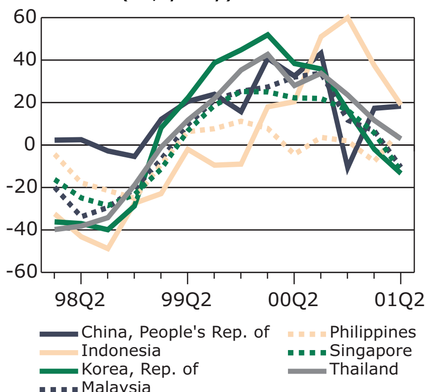
Note: Data for Singapore refer to gross fixed capital formation.
Source: ARIC Indicators and Ministry of Trade and Industry (Singapore).

during the preceding six quarters. For some time, the PRC's exports did hold up against the regional trend of slump, but in more recent months they have been showing distinct signs of slowing (Figure 5).

To varying degrees, decelerating export demand has been accompanied by softening domestic demand, especially private demand (Figures 6 and 7). Slowing growth and the sharp decline in stock prices since the beginning of 2000 are adversely affecting both consumer confidence and business investment. Private domestic demand is weakening as a result. This is especially so in Korea, Malaysia, Singapore, and Thailand. In the PRC and Indonesia, domestic demand remained steady. In the Philippines, no significant deceleration in private consumption is noticeable, while domestic investment continues to be subdued.

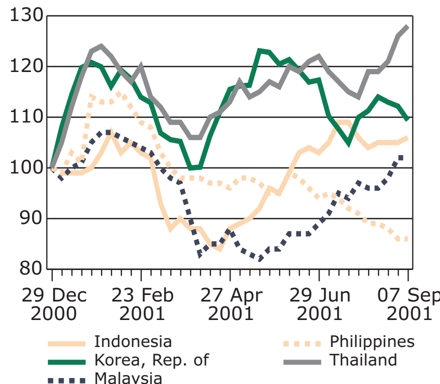
Declining export growth and slowing domestic economic activity have been accompanied by softening demand for imports (Figure 8). The dollar value of imports of the five crisis-affected countries, in fact, contracted by 0.7 percent in the first half of the year, compared to an average growth of 28 percent in the previous six quarters. Despite sluggish exports, softening imports enabled countries to keep their trade balances in surplus. In the first half of this year, the combined trade balance of the five crisis-affected countries amounted to $13 billion. Import compression is taking place as import-intensive processing exports, which dominate the manufacturing sectors of many East Asian economies, are taking a beating. Even imports of goods unrelated to processing exports are softening as consumer demand is weakening.

Figure 8: **Growth of Merchandise Imports, Dollar Value** (%, y-o-y)



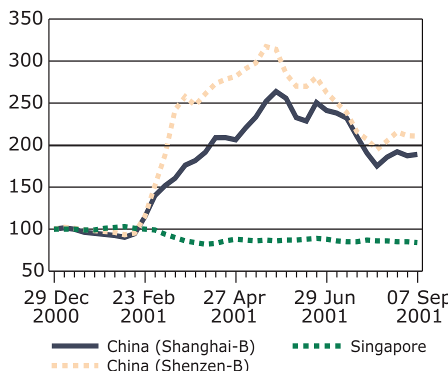
Source: ARIC Indicators and Ministry of Trade and Industry (Singapore).

Figure 9a: **Composite Stock Price Indexes—Five Crisis-Affected Countries*** (last week of 2000Dec=100, in local currency)



*Weekly averages of JCI (Indonesia), KLCI (Malaysia), PCOMP (Philippines), KOSPI (Korea), and SET Index (Thailand).
Source: REMU staff calculations derived from Bloomberg.

Figure 9b: **Composite Stock Price Indexes—Other East Asian Countries*** (last week of 2000Dec=100, in local currency)



*Weekly averages of Shanghai-B (PRC), Shenzen-B (PRC), and SESALL (Singapore).
Source: REMU staff calculations derived from Bloomberg.

Asset Market Developments

In the first two months of this year, regional equity prices regained some of the ground lost in 2000. Since then, however, reflecting global stock market trends and the slowdown of economic activity in the region that point to prospects of diminished corporate earnings in the immediate future, most regional equity prices have either remained subdued or declined (Figures 9a, 9b, 10a and 10b). The PRC and Thailand have been the notable exceptions to this trend, although in recent months stock prices have also declined somewhat in the PRC. Most regional equity markets have thus not seen much respite from the hammering they received in 2000. The setting up of a centralized asset management company to resolve the bad loans of the banking sector has however, helped to improve market sentiment and boost stock prices in Thailand.

Most regional currencies, after weakening against the dollar in the first quarter, remained stable in the second quarter (Figures 11a and 11b). Compared to end-2000, the Brunei dollar and Singapore dollar have depreciated by 1 percent; the Philippine peso, Lao kip, and Korean won by 2 percent; and the Thai baht and Vietnamese dong by 3 percent. The Indonesian rupiah depreciated by about 16 percent between end-2000 and mid-July, but since then has appreciated by about 25 percent on the back of the smooth changeover of political leadership.

These exchange rate movements reflect several factors: weakness of the yen, the region's slumping exports and slowing economies, sporadic outbreaks of social and political unrest, and more generally the shift toward more flexible exchange rate regimes in the aftermath of the 1997 crisis. A decline in capital flows to several East Asian economies (Box 1) has also put pressure on exchange rates.

The PRC and Malaysia, whose currencies have been pegged to the US dollar, were the notable exceptions to the trend of regional currency depreciations. As exports from Malaysia were slowing and the country's foreign exchange reserves were falling at the rate of about $800 million per month between December 2000 and May 2001, there was speculation that the Malaysian ringgit's peg to the US dollar would be broken. This speculation was also fuelled by overall weaknesses in the regional currencies. Since then, however, with the stabilization of the country's foreign exchange reserves at about $26 billion-27 billion, such speculation has subsided. In the face of huge foreign exchange reserves of about $180 billion, continued strong growth, and an almost closed capital account, the PRC's exchange rate has not come under pressure in recent months. However, sporadic weakening of the yen did raise concerns in the People's Bank of China, the country's central bank, about the exchange rate and competitiveness of the country's exports.

Box 1: **Private Capital Flows to the Five Crisis-Affected Countries**

Private capital flows were at the heart of the 1997 Asian financial crisis. The large and abrupt flight of capital led to a downward economic spiral in several countries as financial contagion swept across the region. Private capital flows to the five crisis-affected countries turned positive in 2000 according to Institute of International Finance (IIF) estimates (Box Table 1). But now there are fears that the global economic slowdown, aggravated by domestic concerns, could once again cause a deterioration of private capital flows to the crisis-affected countries, and thereby magnify their economic downturn. In fact, the IIF has forecast that $3.5 billion of private capital will flow out of the five crisis-affected countries this year—in contrast to the net inflow of about $5 billion in 2000. The IMF's May World Economic Outlook, meanwhile, sees the net outflow from these five countries increasing from $10 billion in 2000 to $16.8 billion in 2001.

The primary reason for the expected reversal between 2000 and 2001 is a substantial decline in foreign equity investment. Slower income growth in industrialized economies is likely to lower their appetite for investing abroad. In particular, investment flows from these countries to support production that was outsourced to emerging markets in the past two decades as a result of global restructuring are likely to fall. Lower foreign direct investment (FDI) flows to the five crisis-affected countries are also due to the fact that attractive opportunities to purchase local assets have now become more difficult to find. Further, some countries have been buffeted by political uncertainty, which, together with slow progress in structural reform, has shaken the confidence of foreign investors.

Across the five crisis-affected countries, there are large variations (Box Table 2). Korea is expected to be the hardest hit by the fall in portfolio investment, a factor the IIF also attributes to dampened enthusiasm of foreign investors caused by protracted corporate restructuring. The Korean equity market also has the largest share of IT stocks making it vulnerable to the recent volatility of NASDAQ. Private capital outflows from Malaysia were substantial in the first quarter of 2001. Large portfolio equity outflows may continue this year due to its reduced weight in emerging market indexes and incomplete corporate restructuring. In addition, the cyclical downturn in the global electronics market will adversely affect FDI flows to Malaysia. In the Philippines, concerns over peace and order have contributed to the fall in equity flows. The decline in portfolio investment has also been significant in the first five months of 2001.

Repayments to commercial banks are expected to remain the main source of outflows of private capital this year. However, these continue to shrink and this trend is expected to accelerate in 2002. The net outflows in commercial bank transactions are also indicative of subdued credit demand, which is to some extent explained by reduced trade credit following the slowdown in exports. In Thailand, the fall in debt repayments partly reflects the refinancing of external foreign-currency obligations in baht by domestic banks and corporations. Meanwhile, Indonesia has had the highest net outflows to other private creditors. These represent repayments resulting from earlier bond issues by domestic private firms and also withdrawals of deposits by nonresidents from local banks.

Capital outflows are certainly not helpful when the affected countries are experiencing slowdowns in their recovery. However, the projected swing of capital flows between 2000 and 2001 is modest compared with the reversal that occurred during the 1997 crisis. Moreover, the external payments positions of most East Asian countries are more robust now than they were in 1997, making an economic tailspin similar to that of 1997-1998 only a remote possibility.

The IIF expects net private capital outflows from the region to be short-lived, with FDI and portfolio investment recovering in 2002. In fact, net private capital inflows to the five crisis-affected countries are forecast to reach a postcrisis high of $12.4 billion next year. Only Indonesia and Thailand are predicted to experience continued capital outflows next year. The reversal is, of course, contingent on a turnaround in the US and with it the global and regional economies in 2002. While most foresee such a change in fortune, it is by no means guaranteed. Domestic concerns including the reluctance to push ahead with reforms in some regional economies may also delay the return of private capital.

Box Table 1: **Capital Flows to the Five Crisis-Affected Countries** ($ billion)

	1995	1996	1997	1998	1999	2000e	2001f	2002f
Net Private Flows	94.4	119.5	5.1	-37.8	-2.3	5.0	-3.5	12.4
Equity Investment, Net	15.5	16.8	5.2	17.8	30.8	24.0	12.2	17.6
Direct Investment, Net	4.4	4.8	6.8	13.3	15.3	13.0	8.7	10.5
Portfolio Investment, Net	11.0	12.0	-1.7	4.5	15.4	11.0	3.5	7.1
Private Creditors, Net	78.9	101.3	-0.1	-55.6	-33.1	-19.0	-15.7	-5.2
Commercial Bank Credit, Net	64.9	69.6	-17.4	-48.7	-28.8	-15.2	-10.5	-2.7
Nonbank Credit, Net	14.0	31.8	17.4	-6.9	-4.3	-3.8	-5.2	-2.6

e=estimate; f=forecast.
Source: IIF, Capital Flows to Emerging Market Economies, May 2001.

Continued next page

Box 1: **Private Capital Flows to the Five Crisis-Affected Countries** (Cont'd)

Box Table 2: **Capital Flows to Individual Countries** ($ million)

	1995	1996	1997	1998	1999	2000	Jan-March 2000	Jan-March 2001
Indonesia								
Net Private Flows	10,253	11,511	-338	-13,846	-9,922	-9,990	-1,951	-2,841
Net Direct Investment	4,346	6,194	4,677	-356	-2,745	-4,551	-1,474	-1,238
Other Private Flows[1]	5,907	5,317	-5,015	-13,490	-7,177	-5,439	-477	-1,603
Official Flows	336	-522	2,880	9,971	5,353	3,217	1,285	-87
Net Capital Flows	10,589	10,989	2,542	-3,875	-4,569	-6,773	-666	-2,928
Republic of Korea[2]								
Net Private Flows	17,793	24,409	-13,884	-13,027	9,354	12,123	11,929	-5,078
Net Direct Investment	-1,776	-2,345	-1,605	673	5,136	3,476	419	404
Net Portfolio Investment	11,591	15,185	14,295	-1,878	8,676	12,110	9,192	1,622
Other Private Flows[1]	7,978	11,569	-26,574	-11,822	-4,458	-3,463	2,318	-7,104
Official Flows	-519	-485	15,806	9,660	-6,924	143	159	5
Net Capital Flows	17,273	23,924	1,922	-3,368	2,430	12,266	12,088	-5,073
Malaysia[3]								
Net Private Flows	5,180	9,180	546	-3,461	-8,381	-7,312	780	-3,290
Private Long-Term	4,172	5,079	5136	2,165	1,553	1,874		
of which net direct investment	3,327	3,528	3,648	1,860	2,473	1,762	468	282
Private Short-Term	1,008	4,101	-4,590	-5,626	-9,934	-9,185		
Official Long-Term	2,451	297	1,651	545	1,763	1,036	-33	77
Net Capital Flows	7,631	9,477	2,197	-2,916	-6,618	-6,276	813	-3,367
Philippines[2,4]								
Net Direct Investment		1,338	1,113	1,592	1,427	1,584	977	523
Net Portfolio Investment		2,179	-351	80	6,270	45	-339	-1,490
Other Flows (Net)[5]		7,558	5,831	-1,194	-9,513	-8,475	-1,240	-2,438
Net Capital Flows		11,075	6,593	478	-1,816	-6,846	-602	-3,405
Thailand								
Net Private Flows			-7,623	-15,483	-13,541	-9,515	-3,626	-2,153
Net Direct Investment			3,298	7,361	5,855	3,372	729	439
Net Portfolio Investment			4,386	352	384	-134	273	-95
Other Private Flows[1]			-15,307	-23,196	-19,780	-12,753	-4,628	-2,497
Official Flows			3,280	5,741	5,633	-499	139	-297
Net Capital Flows			-4,343	-9,742	-7,908	-10,014	-3,487	-2,450

Notes:

[1] Includes portfolio investment for Indonesia. Other private flows (net) cover capital flows arising from medium- and long-term debt, trade credits and short-term debt, and changes in nonresident accounts in the banking system. In Korea, other private flows were obtained as the difference between the category "other investment flows" and the category "official flows," both of which are reported. In Thailand, net capital flows are taken to be equal to the capital and financial account. Other private flows were obtained as a residual.

[2] Comparative data for 2001 and 2000 are January-April for Korea and January-May for the Philippines.

[3] Bank Negara Malaysia has adopted the conceptual coverage of the Balance-of-Payments Manual 5th Edition (BPM5) in the first quarter of 2001. Hence there is no breakdown of net private capital flows into long term and short term. However, the other categories are comparable across time.

[4] Beginning January 2000, conceptual coverage of the BPM5 was adopted by the Bangko Sentral ng Pilipinas. Corresponding figures for 1999 were adjusted accordingly. However, this definition was not extended to earlier years although the total "net capital flows" is comparable across time.

[5] For the Philippines, net capital flows are taken to be equal to the capital and financial account. The category "other flows" was obtained as a residual. Official flows could not be segregated on a consistent basis up to 1995.

Sources: Bank Indonesia; Bank of Korea web site; Department of Statistics Malaysia web site; International Department, Bank Negara Malaysia; Bangko Sentral ng Pilipinas and its web site; and Bank of Thailand web site.

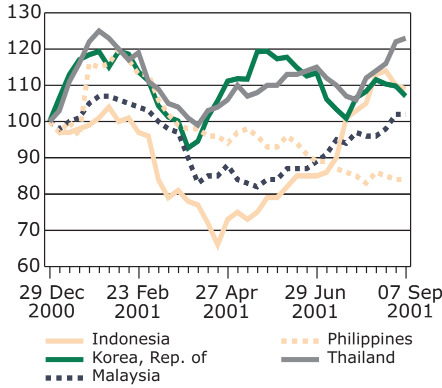


Figure 10a: **Composite Stock Price Indexes—Five Crisis-Affected Countries*** (last week of 2000Dec=100, in dollars)

*Weekly averages of JCI (Indonesia), KLCI (Malaysia), PCOMP (Philippines), KOSPI (Korea), and SET Index (Thailand). The exchange rates used in the conversion to dollars are from the New York Composite Index.
Source: REMU staff calculations derived from Bloomberg.

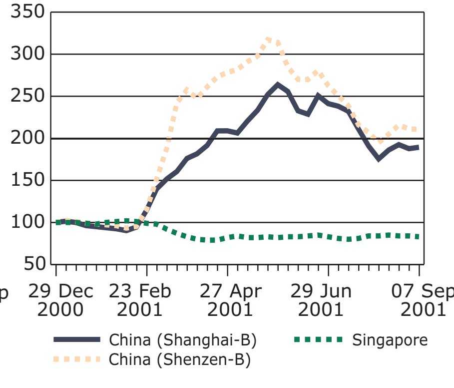


Figure 10b: **Composite Stock Price Indexes—Other East Asian Countries*** (last week of 2000Dec=100, in dollars)

*Weekly averages of Shanghai-B (PRC), Shenzen-B (PRC), and SESALL (Singapore). The exchange rates used in the conversion to dollars are from the New York Composite Index.
Source: REMU staff calculations derived from Bloomberg.

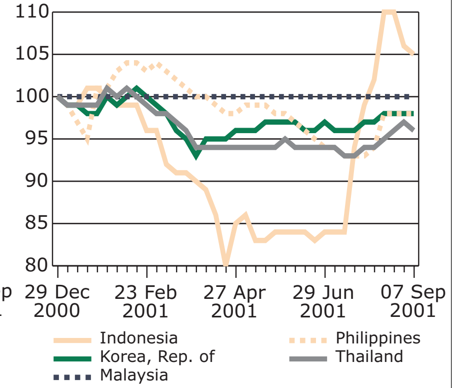


Figure 11a: **Exchange Rate Indexes—Five Crisis-Affected Countries** (weekly average, last week of 2000Dec= 100, in dollars/local currency)

Source: REMU staff calculations derived from Bloomberg.

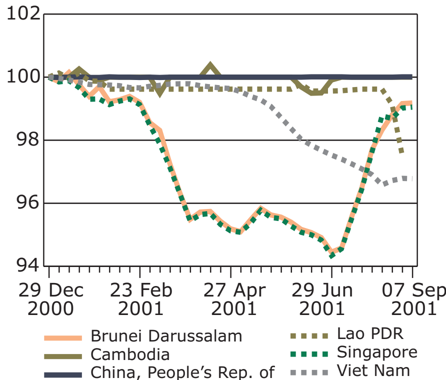


Figure 11b: **Exchange Rate Indexes—Other East Asian Countries** (weekly average, last week of 2000Dec=100, in dollars/local currency)

Source: REMU staff calculations derived from Bloomberg.

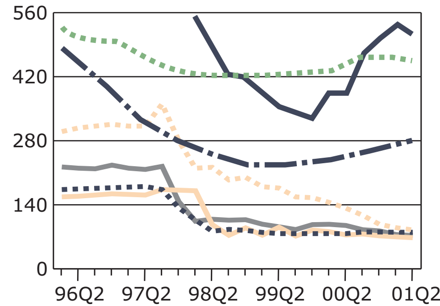


Figure 12: **Office Property Rents** (dollars per square meter per annum)

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

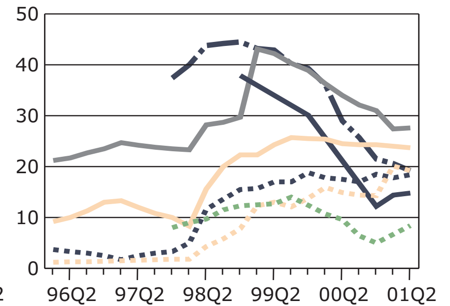


Figure 13: **Office Property Vacancy Rates** (%)

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

As the worsening economic conditions took their toll on property markets around the region, office rentals in most major cities in East Asia continued to decline in the second quarter of the year (Figure 12). This decline ranged from 2.8 percent in Singapore to 8.5 percent in Manila. The corresponding declines in office rentals in Jakarta and Bangkok were 6.6 percent and 4.1 percent, respectively. Movements in office vacancy rates, have, however, been more varied. They increased in Singapore and Kuala Lumpur, declined in Manila and Shanghai, and remained more or less unchanged in Beijing, Jakarta, and Bangkok (Figure 13).

Fiscal and Monetary Policies

With some exceptions, East Asian countries have responded to the economic slowdown with modest fiscal stimuli.[1] The PRC, Korea, Malaysia, Singapore, and Thailand introduced fiscal stimulus measures in their original budget proposals for 2001 and/or subsequently announced supplementary spending packages, whereas Indonesia and Philippines were constrained by their relatively high public debt stock. Many countries now run fiscal deficits (Figure 14).

Monetary response has been more mixed than the fiscal response. While short-term nominal interest rates have been reduced somewhat in Korea, Philippines, and Singapore, they have remained more or less unchanged in Malaysia, and increased in Indonesia (Figure 15). However, since December 2000, real interest rates have fallen in most of these countries (Figure 16). In a reversal of its earlier accommodative monetary policy, Thailand in early June increased the bank deposit rate from 1.5 percent to 2.5 percent. Since bank lending rates have not been raised subsequently, the macroeconomic rationale of the country's monetary policy is ambiguous.

It is too early to judge the macroeconomic effects of these fiscal and monetary policy responses. Given continued strong growth in the PRC

[1] See ARR June Update.

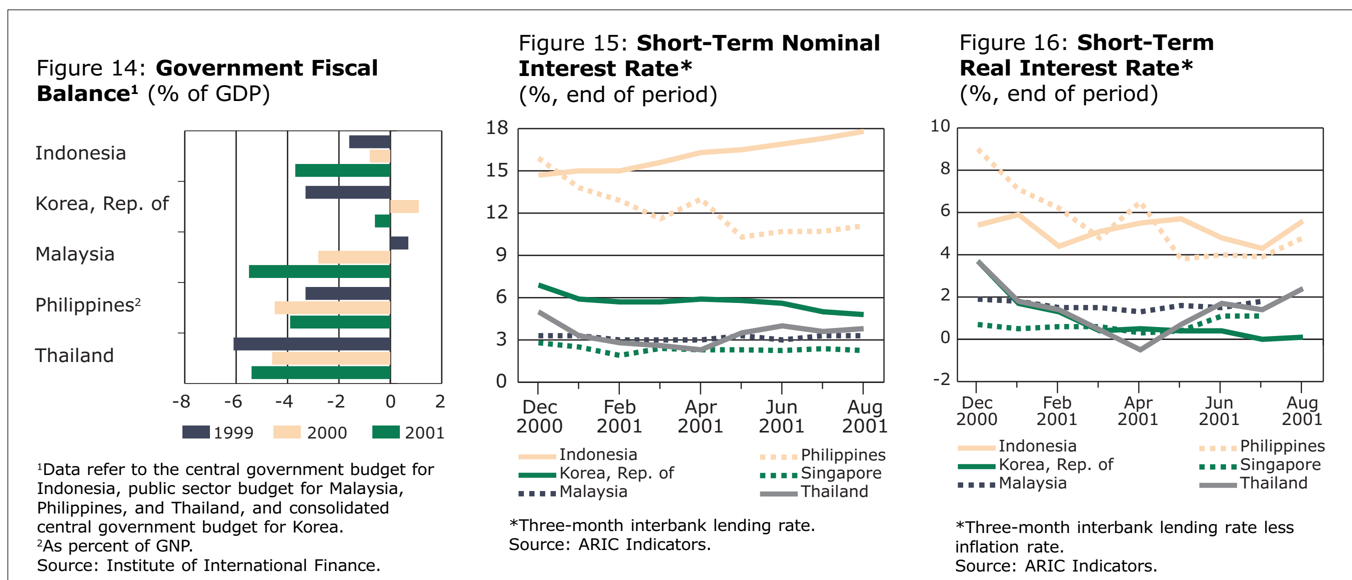


Figure 14: **Government Fiscal Balance[1]** (% of GDP)

[1]Data refer to the central government budget for Indonesia, public sector budget for Malaysia, Philippines, and Thailand, and consolidated central government budget for Korea.
[2]As percent of GNP.
Source: Institute of International Finance.

Figure 15: **Short-Term Nominal Interest Rate*** (%, end of period)

*Three-month interbank lending rate.
Source: ARIC Indicators.

Figure 16: **Short-Term Real Interest Rate*** (%, end of period)

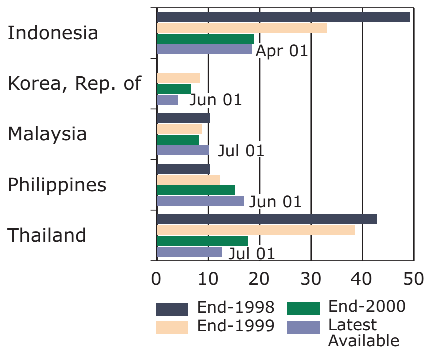
*Three-month interbank lending rate less inflation rate.
Source: ARIC Indicators.

amid slowing exports, it appears that fiscal stimulus measures have helped the country to counter, at least partially, the externally induced slowdown in the economy. However, it is not yet clear whether fiscal expansions have had similar effects on other countries. In any case, one should not expect large effects from modest fiscal expansions in many of these economies, which are highly open to foreign trade and exceptionally prudent in their savings habits. Their high marginal propensities to save and import yield a small multiplier effect for a given fiscal stimulus. Equally important, some governments have found it difficult to implement the fiscal stimulus measures that were planned at the beginning of the year. Korea is a case in point.

The Korean Government had planned to run a small fiscal deficit in 2001 compared to a surplus of about 1 percent of GDP in 2000. The Government also wanted to increase its expenditure by 11.3 percent and frontload two thirds of this expenditure during the first half of the year. However, available data show that because government revenues increased faster than expected and actual spending fell far short of planned levels, in the first quarter of the year the budget was actually in surplus, equivalent to about 2 percent of GDP. Such experiences show that countries habitually accustomed to prudent fiscal policies find it difficult to implement expansionary fiscal policies at short notice, just as countries accustomed to lax fiscal policies find it difficult to control fiscal imbalances. Coupled with small multiplier effects, such fiscal inertia makes fiscal policy less effective for short-term stabilization purposes in many East Asian economies.

As the June ARR Update mentioned, countercyclical fiscal expansion should be pursued cautiously in East Asia because of the likely need for significant fiscal support in the future for recapitalization and restructuring of banking systems. It would be preferable to use fiscal resources to address deep-rooted structural problems rather than fritter them away on countercyclical fiscal stimulus measures. Moreover, in countries such as Indonesia, Philippines, and Thailand, there have been sharp increases in public debt levels due to their fiscal deficits of recent years. Public sector debt is running at about 90 percent of GDP in Indonesia, about 70 percent in the Philippines, and about 50 percent in Thailand. Even in the PRC, once quasi-fiscal expenditures, which are not included in the official budget, are taken into account, the public sector deficit could be as high as 8 percent of GDP, and the government debt stock about 50 percent of GDP. These debt levels, although modest, could easily get out of hand if caution is not exercised.

Figure 17: **NPLs of Commercial Banks*** (% of total commercial bank loans)



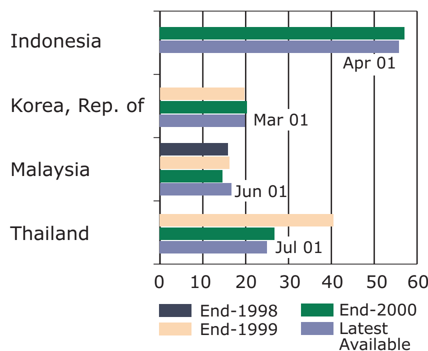
*Banking sector for Indonesia. Data on NPLs exclude those transferred to AMCs. The NPL criteria for Korea were changed in December 1999, so no comparable data are available prior to that date. NPLs are on a three-month accrual basis.
Source: ARIC Indicators.

Financial and Corporate Restructuring

Slowing growth, subdued asset markets, and political uncertainties have constrained the pace of financial and corporate restructuring in some countries during the first half of this year. In recent months, the nonperforming loan (NPL) ratios of the banking sector have declined only in Korea and Thailand. In Indonesia, they remained more or less unchanged whereas they continued their upward trend in the Philippines and even reversed their declining trend in Malaysia (Figure 17). As previous ARRs have cautioned, the transfer of problem loans from banks' balance sheets to asset management companies (AMCs) accounts for a significant part of the postcrisis improvement in NPL ratios. When NPLs still held by AMCs are added to those in the banking system, the picture is even less promising. These aggregate NPL ratios continue to be much higher than those in bank balance sheets alone—about 56 percent in Indonesia, 25 percent in Thailand, and in the 15-20 percent range in Korea and Malaysia (Figure 18). The Philippines does not have AMCs but the NPL ratio in the country's banking sector has shown an upward trend for the last year or so. At about 17 percent now, it is comparable to the aggregate NPL ratios in Korea and Malaysia.

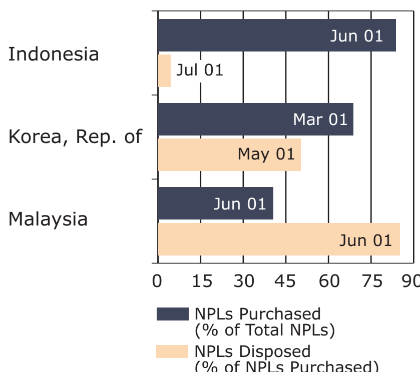
The high aggregate NPL ratios primarily reflect the slow pace of disposal of assets by the AMCs. Also contributing in some countries is the reentry of previously resolved loans as NPLs. Indonesia is a striking example, with the Indonesian Bank Restructuring Agency (IBRA) able to dispose of only about 4 percent of the NPLs it acquired from banks (Figures 19 and 20).

Figure 18: **NPLs Including Transfers to AMCs** (% of total loans)



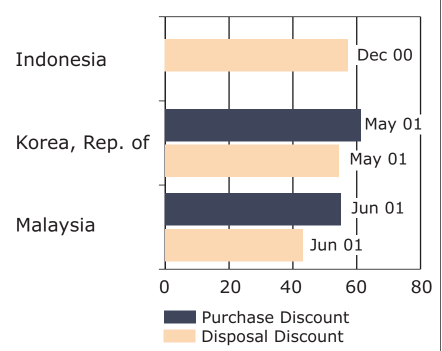
Source: ARIC Indicators.

Figure 19: **NPLs Purchased and Disposed of by AMCs*** (%)



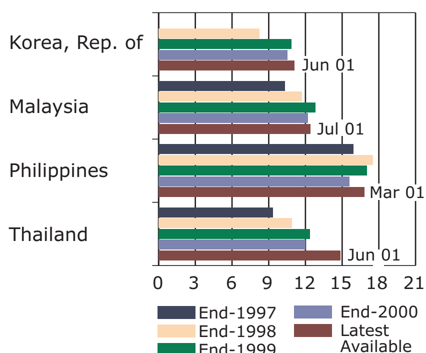
*Refer to those by IBRA in Indonesia, KAMCO in Korea, and Danaharta in Malaysia, as of the dates indicated.
Source: ARIC Indicators.

Figure 20: **Discount Rates on NPL Purchases and Disposals by AMCs*** (%)



*Refer to those by IBRA in Indonesia, KAMCO in Korea, and Danaharta in Malaysia, as of the dates indicated.
Source: ARIC Indicators.

Figure 21: **Capital Adequacy Ratios of Commercial Banks** (%)

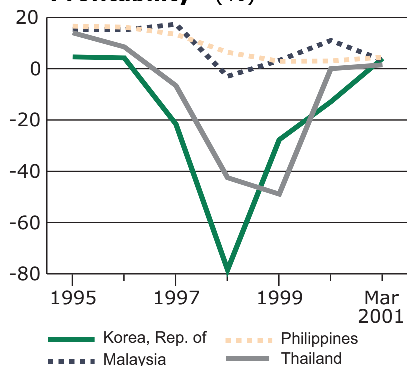


Source: ARIC Indicators.

In Thailand, many loans that were earlier rescheduled are now becoming nonperforming anew. Such NPLs are increasing as a proportion of total NPLs in the banking system. Thailand's private banks have set up their own AMCs, for which asset disposal data are somewhat scanty, hence it is difficult to evaluate progress. In June this year, the new Government established a centralized AMC, the Thai Asset Management Corporation (TAMC), which will acquire about half of the banking system's NPLs, including all (B1.1 trillion) of the State banks' NPLs and about one quarter (B250 billion) of private banks' NPLs by the end of 2001. A law that provides TAMC with a powerful legal framework for the management and resolution of distressed loans has also been passed. Although the Philippines did not set up an AMC in the aftermath of the 1997 crisis, several banks have publicly endorsed the formation of a State-organized AMC, because of the recent rise in NPL ratios in bank balance sheets. The Government has resisted such a proposal citing as reasons fiscal constraint and the need for limiting moral hazard. Meanwhile, a proposal to set up a private sector AMC is also being considered.

With the exception of Indonesia, capital adequacy ratios (CARs) of commercial banks among the five crisis-affected countries continue to exceed the 8 percent Basle norm (Figure 21). The Philippine banking system leads the way with a CAR of about 17 percent, while Korea, Malaysia, and Thailand maintain CARs exceeding 10 percent. In Indonesia, for the seven banks that have been recapitalized with the assistance of IBRA, the CAR was about 11 percent as of June 2001. However, CARs for the other banks are much lower. Indonesia's target is to reach an 8 percent CAR for the banking system as a whole by the end of this year.

Figure 22: **Banking Sector Profitability*** (%)



*Data refer to average return on equity of commercial banks. Data for Malaysia calculated from Bloomberg data.
Source: Web sites of the Financial Supervisory Service, Bangko Sentral ng Pilipinas, Stock Exchange of Thailand, and Bloomberg.

The profitability of banks, as measured by the average return on equity, has generally improved in the first quarter of this year. The profitability of the banking systems of crisis-affected countries is now in positive territory (Figure 22). However, caution should be exercised in interpreting these profitability figures, as they tend to be lagging rather than leading indicators of banking sector health. The sharp recovery of economic activity during the postcrisis years of 1999 and 2000 has contributed to the recent improvement in bank profitability. By the same token, the current economic slowdown will cut into bank profitability sooner or later. The reentry of previously restructured loans as NPLs in bank balance sheets is an indication that loan repayments by bank borrowers are being adversely affected by the current economic slowdown in some countries. This will impact bank profitability, unless countries push ahead with a fundamental restructuring of their corporate sectors.

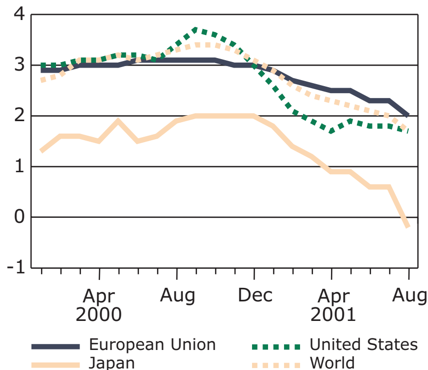
As the March ARR and its June update had mentioned, progress in restructuring the corporate sector has proceeded much slower than in the financial sector. In general, the crisis-affected countries have gone some way toward reducing their excessive debt-equity ratios, rescheduling corporate debt, and lengthening debt maturity. Yet, in most countries, operational restructuring of troubled businesses has not kept pace with debt restructuring.[2] What is even more important, a sort of "reform reluctance" or "reform fatigue" is slowly emerging in some countries, most visibly in Korea. To varying degrees, "reform reluctance" and "policy drift" can be found in other countries too, although these manifest in different forms (see domestic risks below).

Risks to Regional Growth and Recovery

External Risks

In recent months, external risks to growth in the region's economies have increased, with the current global economic slowdown turning out to be deeper, longer, and more broad-based than anticipated. With the major industrialized countries continuing to slow, projections of growth among them have been revised down for both this year and the next. The International Monetary Fund (IMF) now places world GDP growth for 2001 at 2.7 percent (down from its 3.2 percent forecast of May this year) and for 2002 at 3.6 percent (down from 3.9 percent in May this year). Similar downward revisions of world GDP growth are being made by other forecasters (Figure 23). Consensus Economics now forecasts the average GDP growth rate of about 70 countries it covers in its surveys for 2001 to be 1.7 percent (lower than its 2.2 percent forecast of May this year). The comparable number for 2002 is 2.6 percent, down from the 3 percent forecast of May this year. These numbers are higher than the rates posted during the previous global recession years of 1975 (1.9 percent), 1982 (1.2 percent), and 1991 (1.4 percent), but are close to that posted in 1998 at the height of the Asian crisis. However, this year's slowdown has been triggered by the industrialized countries, as opposed to that of 1998, which was driven by the developing countries.

Figure 23: **Monthly Consensus Forecasts of 2001 GDP Growth** (%, y-o-y)



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

Underlying these forecasts, which were made before the 11 September attack on the US, is the expectation that the aggressive interest rate reductions by the US Federal Reserve Board (FED) and $38 billion advance tax refund by the US Government would enable the global economy to

[2] See ARR June Update for a more detailed discussion of these issues.

start reviving in the last quarter of this year. A further easing of monetary policy by the European Central Bank (ECB) in the coming months as European inflation comes down is also expected to aid global recovery. While such an outcome is a possibility, there are other factors that suggest the global upturn could be further delayed as well as more subdued. The balance of risks is still weighing on the downside.

First, the current global slowdown has been caused by a boom-bust cycle in investment, mainly in the IT sector, and is hence mainly structural in nature. Unlike previous downturns, it has not been caused by a contraction in consumer demand after central banks raised interest rates to reign in inflation. Led by the IT sector, the overinvestment that caused the current downturn was perhaps far more "excessive" than in earlier business cycles. Even after the 32 percent plunge in the United States' new orders for electronic goods in the year to June, further declines in capital spending in the months ahead cannot, therefore, be ruled out as firms respond to continued weak profits and excess capacity. The fact that many, including the IMF, hold the view that technology stock prices are still overvalued is another pointer that further correction in the stock market and business investment may be in order. In investment-led downturns, interest rate cuts tend to be less effective in reviving growth until excess capacity and debts have been reduced. As a result, such downturns tend to be deeper and more prolonged as it takes longer to purge financial excesses and overcapacity than it does to deplete inventory and tame overconsumption and inflation. Reflecting some of these concerns, the FED has cautioned that risks are weighted toward conditions that may generate further economic weaknesses in the US economy.

Second, the global economic slowdown is much more synchronized across countries than most earlier ones (see Box 2). Most economies across the world are slowing together as they have become more interdependent through trade and investment, with multinational companies operating global supply chains. Slower growth in one part of the world is feeding through to other parts at a faster pace than in most earlier episodes of global downturn. Coupled with further correction in worldwide IT investments, such a shock-propagation process may generate internal dynamics in the global economy that may lead to a self-reinforcing and a more protracted overshooting of the current downturn. There is already some evidence that such a process is at work: Europe, which only a few months ago was considered to be insulated from the US slowdown, has since been adversely affected. Many US firms, in turn, are now complaining that their profits are declining because of weak demand in Europe. If this process gathers pace in the coming months, the current slowdown may turn out to be sharper as well as longer than anticipated. In Japan, meanwhile, there is also growing concern that the global slowdown may combine with the proposed banking system reforms to further slow the economy.

Box 2: **Synchronized Global Slowdown**

United States

At present, the global economy is experiencing one of its worst synchronized slowdowns, spearheaded by the US. Economic news from the US continues to shift the weight of evidence toward a less encouraging economic outcome over the next few months than was first thought. The 11 September attack on the US has further added to the downside risks. It is now turning out that there is much more than a swift inventory adjustment to the current US slowdown.

Consumer spending and the housing sector have held up reasonably well until now. But, US manufacturing continues to contract (it has contracted for 12 straight months up to July 2001, the longest stretch of weakness since the 1990-1991 recession), corporate profits are falling (by 14.7 percent in the second quarter of this year, the worst corporate performance since the third quarter of 1991 when the US economy was in recession), the stock market is sliding (the Dow Jones Industrial Average had lost about 10 percent of its value even during the three months preceding the 11 September incident), the unemployment rate is increasing (in fact, it jumped from 4.5 percent in June to 4.9 percent in July), and, above all, business investment continues to weaken on the back of a collapse in technology share prices and the deterioration in the economic situation.

Even consumer confidence, which has been resilient until now, is showing signs of weakening: the index of US consumer confidence declined in both July and August, after hitting a six-month high of 118.9 in June. It seems unlikely that the housing sector can continue to hold consumer spending aloft for much longer. Some fear that the residential market is stretched. Even if the US housing market continues to expand from already high levels, other parts of the construction sector may slow. As the economic downturn affects the revenue bases of state and local governments, fiscal pressures will constrain their spending on construction, which was a key source of growth for the construction industry in the first half of the year. Moreover, the continued weakness in business investment, especially in the areas of telecommunications, computers, and software, poses the biggest hurdle to a quick US upturn. Business spending on equipment and software has declined for three straight quarters, the first time that has happened since 1982-1983. The downturn in business spending on equipment is now spreading to commercial real estate and nonresidential construction.

In the first two quarters of 2001, US GDP grew at a year-on-year (y-o-y) rate of 2.5 percent and 1.2 percent, respectively. The corresponding annualized quarter-on-quarter (q-o-q) growth rates were much lower: 1.3 percent in the first quarter and 0.2 percent in the second. Most expect full year US GDP growth in 2001 to be about 1.5 percent. Reflecting the continued weaknesses of the US economy, GDP growth for 2002 has also been marked down. For example, Consensus Economics has reduced the 2002 US growth prediction to 2.8 percent, from its 3.5 percent and 3 percent forecasts made in January and May this year. The IMF's most recent forecast of US GDP growth for 2002 is even lower at 2.5 percent.

Japan

Emerging trends in Japan, the second largest economy in the world, are not encouraging either. Successive Tankan Surveys of recent months have painted a bleak picture of the country's immediate economic prospects. Investor and business confidence continues to slide, and as yet there are no signs of any reversal of the three-year long deflation. Conventional policy options of fiscal stimulus and monetary easing (except money supply, which the Bank of Japan liberalized recently) seem to have hit their limits, with nominal interest rates close to zero and successive doses of fiscal stimulus in recent years producing only marginal impacts on growth but at the cost of a large buildup of public debt. It appears that the Japanese economy is increasingly being caught between a rock and a hard place—a "liquidity trap" on the one hand and a "public debt trap" on the other. Meanwhile, revised GDP data for the first two quarters of this year show that the economy has just about escaped from falling into its fourth recession in the last decade.

Against this background, growth projections for Japan for the whole of 2001 have been consistently revised downwards. Consensus Economics now predicts Japan's GDP will contract by 0.2 percent in 2001, down from its 1.8 percent and 0.9 percent growth forecasts of January and May this year. The most recent IMF forecast also places Japan's GDP growth in 2001 at –0.2 percent, down from its 0.6 percent forecast of May 2001. The forecasts for Japan's GDP growth in 2002 are not encouraging either: Consensus Economics places it at 0.6 percent (down from the 1.5 percent forecast of May this year), and the IMF at 0.5 percent (down from 1.5 percent forecast in May).

Europe

Data released from Europe in recent months have confirmed that the current global slowdown is not restricted to the US (and Japan) but is more broad-based and synchronized among the major industrial countries. Close on the heels of the US, Europe reported a mere 0.1 percent (q-o-q) second quarter GDP growth following 0.5 percent first quarter growth. Industrial production in Europe has declined since the beginning of the year, and there is no sign of a reversal of this trend any time soon. Leading economic indicators for most major countries in Europe continue to trend lower, and the latest declines in the Information Und Forshung (IFO) Survey suggests that what has, so far, been an industrial recession in Germany could spread to other sectors as well. Overall, it now turns out that the adverse effect of the US slowdown on Europe is actually larger than earlier anticipated.

Growth projections for Europe for 2001 and 2002 have been revised down as a result. Consensus Economics predicts 2001 GDP growth in the European Union (EU) to be 2 percent, compared to 2.9 and 2.5 percent forecast in January and May this year. Similarly, the EU's 2002 growth has been downscaled to 2.5 percent (compared to 2.8 and 2.7 percent in January and May this year). The most recent IMF projection of the EU's growth are: 2 percent for 2001 (down from 2.4 percent in May this year), and 2.4 percent for 2002 (down from 2.8 percent in May this year).

Third, until now, contagion from the recent crises in the emerging market economies of Latin America and Europe has been prevented from infecting other parts of the world. However, despite important policy adjustments in the past month, Argentina continues to encounter severe market pressure. At around 1,600 basis points, the spread on Argentina's bonds is uncomfortably high, and the country is continuously losing bank deposits and international reserves. A deterioration in Argentina's situation could spill over to Brazil, whose currency has already depreciated by about 20 percent this year. As for Turkey, since the lira was floated in May this year, the currency has lost cumulatively 60 percent while domestic interest rates have remained at 90 percent—some 50-60 percent above officially projected inflation for the next 12 months. These developments are putting the country's fiscal policy on an unsustainable path. Meanwhile, political uncertainty continues, with the ruling government coalition plagued by internal disputes and disagreements on the reform program. Reflecting some of these concerns, the IMF has recently cautioned that the risks of financial crises emanating from Argentina, Brazil, and Turkey engulfing emerging markets across the globe are still very real. In a similar vein, the World Bank has cautioned that the probability of a financial crisis has risen for countries such as Argentina, which is in its third year of recession. The World Bank believes that even if the Latin American countries get their house in order, they still have to live with a significant deterioration in the external environment.

Last, the 11 September attack on the US has added another element of uncertainty to the already weakened global and regional economies. Although it is too early to unravel the full ramifications of these unprecedented events, early assessments suggest that the economic costs could be manageable. If there are strong and coordinated policy responses, the worst economic effects would pass quickly. If not, recession will be increasingly likely in an already weakened US economy. It is important to distinguish between the short-term and long-term effects of these events. The short-term effects are bound to be negative as investors and consumers shift to a more conservative posture in response to the uncertainty created. But it is the longer-term impact that is more significant in influencing the economic outlook.

The economic fallout could include a protracted weakening of investor sentiment toward the US economy. This would not augur well for New York's financial services industry, which accounts for about 3 percent of the US GDP, and the stock market, which has been weak for most of this year. On 17 September, when the US stock market opened after a long gap, the Dow Jones index dropped by more than 7 percent, the largest one-day percentage drop since the October 1987 Wall Street crash. A continued

weakening of the stock market could adversely affect US consumer confidence and business investment. Another outcome of these events could be increased unrest in the Middle East and consequent increases in international oil prices, although the Organization for Petroleum Exporting Countries (OPEC) has assured that it would take corrective action if oil prices moved above an acceptable level.

It is, however, encouraging that central banks of the G7 countries have assured that they would be ready to provide ample liquidity as well as coordinate their monetary policies to stabilize the world financial system. The FED has so far injected about $118 billion of liquidity into the financial markets, and has announced that it will provide additional funds if required. In addition, it has also established a $90 billion swap line with ECB, the Bank of England, and Canadian Central Bank, to ensure that banks in their countries can draw dollars through their own central banks in case of shortages. In another significant step, on 17 September, the FED and ECB cut interest rates by 50 basis points each. Both the central banks have also left the door open for further rate cuts. The IMF has also assured that it is closely monitoring the situation and stands ready to assist as appropriate. Moreover, US fiscal policy will likely be more supportive of aggregate demand. US legislators will back any emergency resources needed to meet immediate needs as well as longer-term resource needs for reconstruction of the infrastructure. So far, $40 billion has been approved to help rebuild devastated infrastructure and fight terrorism.

Despite these policy responses, the full economic implications of the 11 September crisis for the global economy would ultimately depend on how events unfold in the coming weeks. If the US response turns out to be a short and swift military action based on international cooperation, the adverse effects on the global economy would be over quickly. If, however, the military response turns out to be long and drawn out, the effects would be more long lasting.

Domestic Risks

On the domestic front, for much of the previous year, elections, impeachments, and indictments have cast serious doubts on East Asia’s political stability. Against that backdrop, the recent restoration of political stability in Indonesia, Philippines, and Thailand is a major plus for East Asia’s economic prospects. The most dramatic change has occurred in Indonesia, where a new President is in office after about three years of unstable political conditions and civil strife. The new Government has swiftly concluded negotiations with the IMF that should improve the prospects of rolling over debt and inflow of foreign capital to the country.

Though far less pronounced, political risk has also declined in the Philippines and Thailand. But with hints of "reform reluctance" or "reform fatigue" creeping in, conflicting messages on the direction of economic policy and the reform process have become common in some of these countries.

In Thailand, the new Government was quick to put in place a centralized AMC to help restructure the banking system. However, instances such as the rift over the country's interest rate policy earlier this year do not augur well for the independence of economic institutions that is crucial for investor confidence in the country. Several ministerial statements also appear to have questioned the need for market-oriented reforms. Moreover, authorities seem to be considering the relaxing of prudential norms such as capital adequacy requirements for banks.

The passage of the Philippines' long delayed power sector reform bill in June this year was a welcome initiative by the new Government. This was followed by the issuance of a new Medium-Term Development Plan. However, in August, the continued weakness in the peso made the Government somewhat uneasy with the flexible exchange rate regime that the country adopted in the aftermath of the 1997 financial crisis. After raising reserve requirements sharply and reducing the amount of dollars that residents can freely purchase over-the-counter from banks (from $10,000 to $5,000), the Government has cautioned that it may even consider imposing capital controls. Sentiments such as this may jeopardize the scheduled introduction of formal inflation targeting by the end of this year.

As for Korea, concerns are being raised that all the three parties involved in the reform process—the government, the *chaebols*, and the labor unions—are showing reluctance to push ahead with the more difficult and politically challenging reforms ahead. The inability to strike a deal between General Motors and Daewoo after two years of negotiations and the time taken to resolve the problems of Hynix Semiconductor, the world's third largest computer memory chipmaker, are examples of the emerging reform fatigue in the country. Similarly, the planned merger of the two largest banks, Kookmin Bank and Housing and Commercial Bank, scheduled for November this year is fraught with difficulties as labor unions are still showing opposition. Even after all the reforms of recent years, the country's economic activity remains dominated by the *chaebols,* to which banks' exposure continues to be high. The Government faces the dilemma of choosing between intensifying reform and preserving the status quo for fear of undermining stability. With campaigning for the presidential elections at the end of 2002 about to start, it is becoming increasingly difficult for the present administration to push ahead with the remaining reform agenda.

Regional Economic Prospects

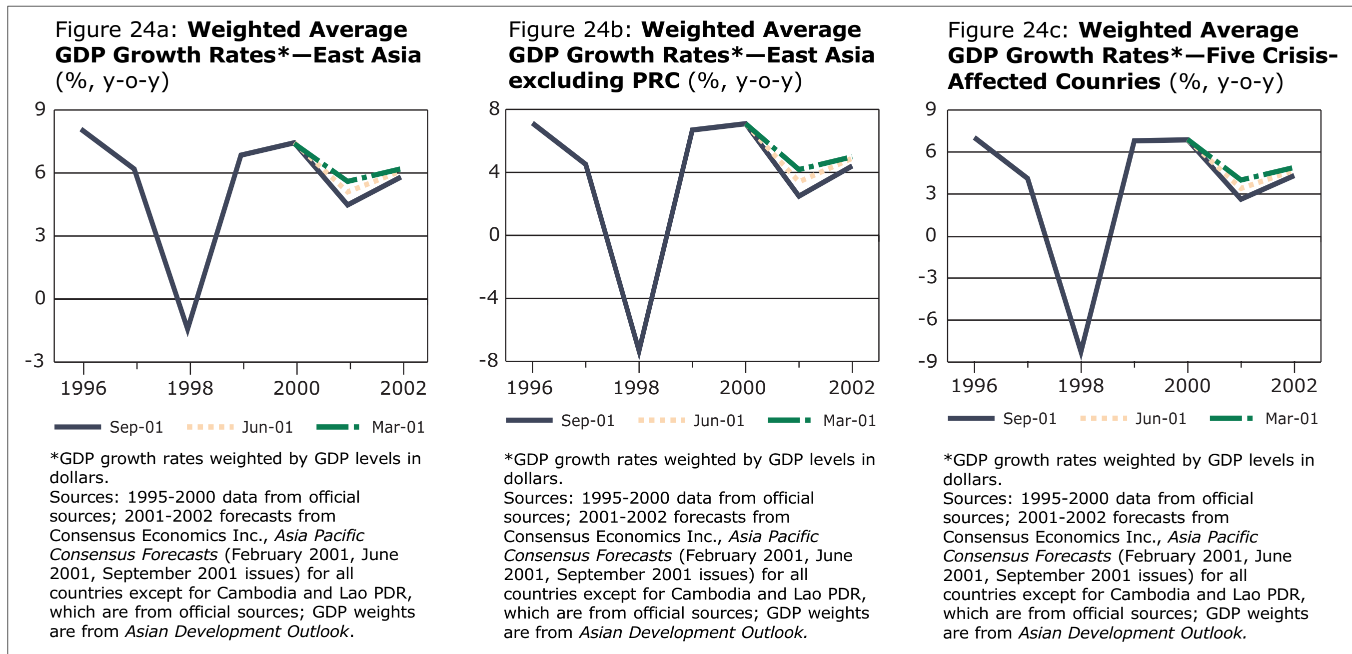
Given these emerging trends, there is a growing consensus that: (i) the current regional downturn is likely to be more prolonged than earlier expected, (ii) growth is expected to pick up only in the first half of next year, rather than in the later part of this year as earlier anticipated, and (iii) next year's rebound in growth will also be more subdued than was previously thought. Reflecting these reassessments, growth projections for this year and the next have now been marked down for most countries in the region.

Based on the September Consensus Economics report, which does not yet incorporate the implications of the 11 September attack on the US into its forecasts, the average 2001 growth projection for East Asia as a whole is 4.4 percent, down from 5.1 percent predicted in the June ARR Update and 5.6 percent reported in the March ARR (Table 1 and Figure 24a). This not only compares poorly with the 7.4 percent growth achieved in 2000 but is also the second lowest average growth rate achieved by the region (after the 1.4 percent GDP contraction in 1998 at the height of the Asian crisis) in the last two decades. Excluding the PRC, East Asia's

Table 1: **Annual GDP Growth Rates—East Asia**

						Mar-01 ARR		Jun-01 ARR		Sep-01 ARR		Sep-01 Forecast Range	
	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2001**	**2002**	**2001**	**2002**	**2001**	**2002**
Cambodia	7.0	3.7	1.8	5.0	5.0			5.0	6.0	**6.1**	**6.3**		
China, People's Rep. of	9.6	8.8	7.8	7.1	8.0	7.7	8.1	7.7	8.0	**7.6**	**7.9**	6.9-7.9	7.5-8.5
Indonesia	7.8	4.7	-13.1	0.8	4.8	3.6	4.3	2.9	3.9	**3.0**	**3.9**	1.5-3.8	1.5-5.0
Korea, Rep. of	6.8	5.0	-6.7	10.9	8.8	4.4	5.3	3.9	5.3	**2.9**	**4.7**	1.6-3.5	2.1-6.7
Lao PDR	6.9	6.9	4.0	7.3	5.7	6.0	6.5	6.0	6.5	**5.7**	**6.5**		
Malaysia	10.0	7.3	-7.4	6.1	8.3	5.2	6.1	3.2	5.5	**0.7**	**4.5**	-1.5-2.2	2.7-6.9
Philippines	5.8	5.2	-0.6	3.4	4.0	2.7	3.4	2.6	3.5	**2.5**	**3.4**		
Singapore	7.6	8.5	0.1	5.9	9.9	5.3	6.1	3.7	5.9	**-0.6**	**4.7**	-2.3-1.5	2.4-6.8
Thailand	5.9	-1.4	-10.8	4.2	4.4	3.5	4.3	2.8	4.3	**1.9**	**3.4**	1.2-2.5	1.5-4.5
Viet Nam	9.3	8.2	5.8	4.8	6.8	6.1	6.4	5.8	6.1	**5.9**	**6.1**		
East Asia	8.1	6.2	-1.4	6.9	7.4	5.6	6.2	5.1	6.1	**4.4**	**5.7**		
East Asia, excluding PRC	7.1	4.5	-7.3	6.7	7.1	4.2	5.0	3.4	4.9	**2.4**	**4.3**		
Five Crisis-Affected	7.0	4.1	-8.3	6.8	6.9	4.0	4.9	3.4	4.7	**2.5**	**4.2**		

Sources: 1996-2000 from official sources; 2001-2002 data from Consensus Economics, Inc., *Asia Pacific Consensus Forecasts* (February 2001, June 2001, and September 2001 issues) for all countries except for Cambodia and Lao PDR, which are from ADB, *Asian Development Outlook* (for March and June update) and official sources (for September 2001 update).
Note: *Asian Development Outlook* weights (1995/1996 dollar GDP levels) were used to calculate composite growth.



*GDP growth rates weighted by GDP levels in dollars.
Sources: 1995-2000 data from official sources; 2001-2002 forecasts from Consensus Economics Inc., *Asia Pacific Consensus Forecasts* (February 2001, June 2001, September 2001 issues) for all countries except for Cambodia and Lao PDR, which are from official sources; GDP weights are from *Asian Development Outlook*.

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*GDP growth rates weighted by GDP levels in dollars.
Sources: 1995-2000 data from official sources; 2001-2002 forecasts from Consensus Economics Inc., *Asia Pacific Consensus Forecasts* (February 2001, June 2001, September 2001 issues) for all countries except for Cambodia and Lao PDR, which are from official sources; GDP weights are from *Asian Development Outlook.*

average growth in 2001 is now placed at 2.4 percent, lower by 1 percentage point compared to the June forecast (Table 1 and Figure 24b). Within these countries, the average growth rate of the five crisis-affected countries is now predicted to be 2.5 percent (Table 1 and Figure 24c). This forecast is 1.5 percentage points lower than the March forecast, and 0.9 percentage point lower than the June forecast. Similar downward revisions were also made to official projections of growth in most countries (Table 2).

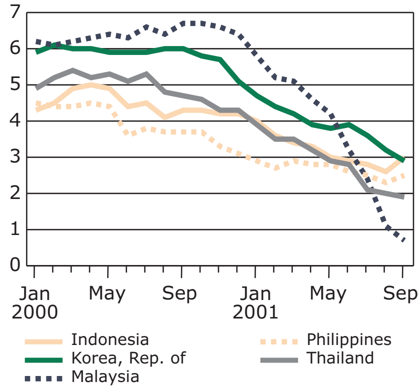
Table 2: **Revisions in Official Growth Projections for 2001** (%)

	May 2001	Latest
China, People's Rep. of	7.0	7.0
Indonesia	4.5 to 5.5	3.5
Korea, Rep. of	5.0 to 6.0	4.0 to 5.0
Malaysia	5.0 to 6.0	5.0 to 6.0
Philippines	3.8 to 4.3	3.3 to 3.8
Singapore	3.5 to 5.5	0.5 to 1.5
Thailand	3.0 to 4.5	2.0 to 3.0

Source: Various country data.

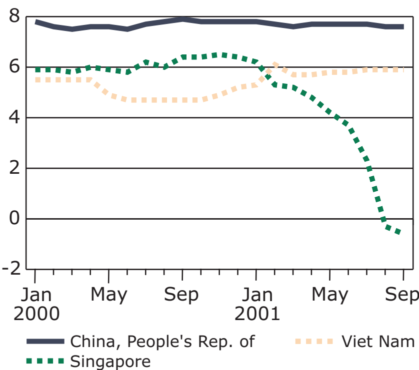
Growth rates have been revised most sharply for Singapore, Malaysia, and Korea, reflecting their high dependence on exports, the US market, and global electronics demand (Table 1 and Figures 25a and 25b). The latest Consensus Economics (September 2001) projection is for growth of −0.6 percent for Singapore (compared to 3.7 percent predicted in June

Figure 25a: **Monthly Consensus Forecasts of 2001 GDP Growth—Five Crisis-Affected Countries**
(%, y-o-y)



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

Figure 25b: **Monthly Consensus Forecasts of 2001 GDP Growth—Other East Asian Countries**
(%, y-o-y)



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

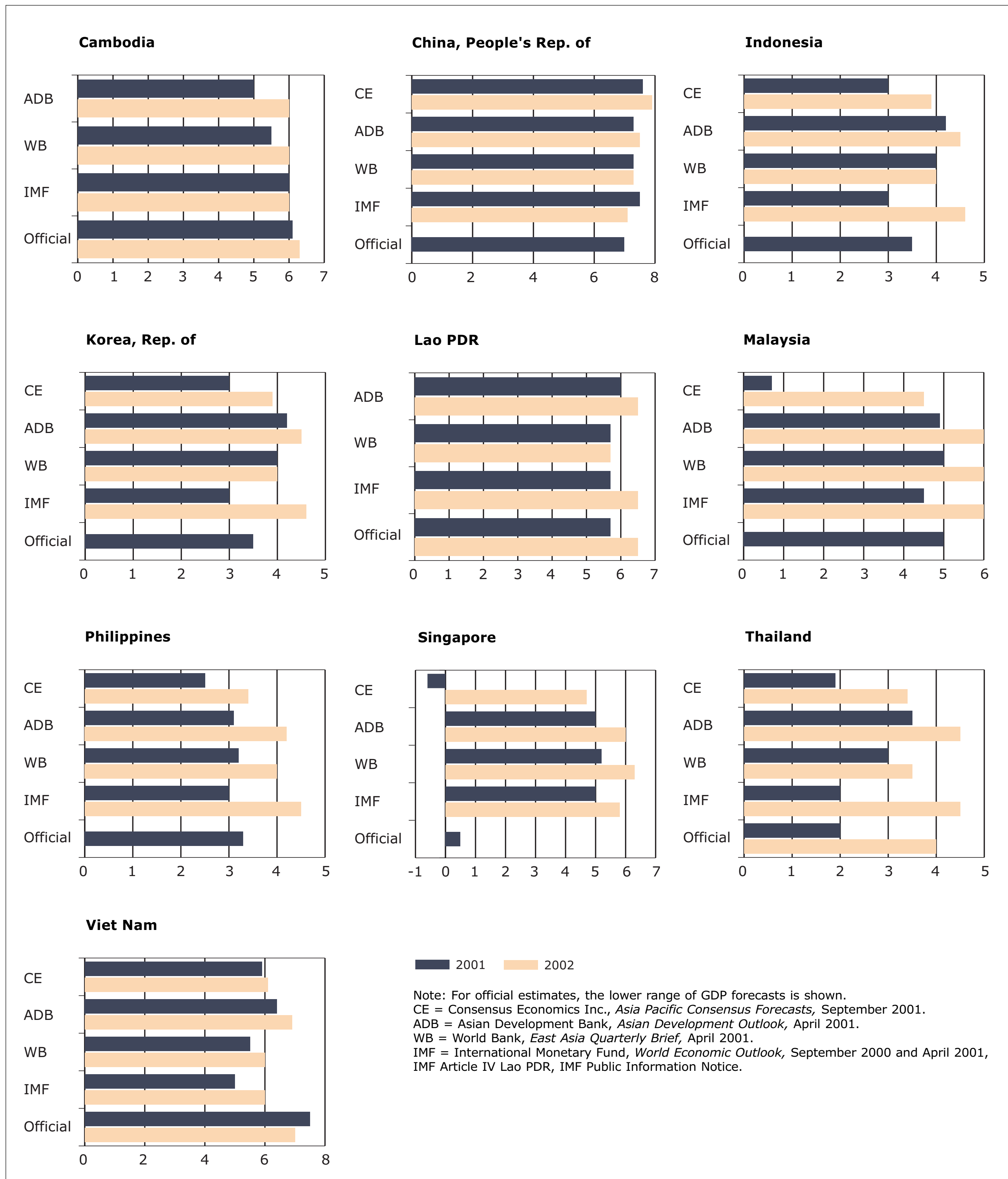
and 5.3 percent in March), 0.7 percent for Malaysia (compared to 3.2 percent in June and 5.2 percent in March), and 2.9 percent for Korea (compared to 3.9 percent in June and 4.4 percent in March). At the time of the March ARR, Consensus Economics had projected 2001 growth of 3.5 percent for Thailand. That forecast was revised down to 2.8 percent in June and to 1.9 percent now. The comparable downward revision for the Philippines is smaller: 2.5 percent now compared to 2.6 percent in June and 2.7 percent in March. Indonesia's 2001 GDP growth forecast is more or less unchanged at 3 percent compared to 2.9 percent in June.

The rebound in global growth and world trade is now expected to be both delayed and more subdued than anticipated. As a result, growth in the regional economies is likely to pick up next year but will still be below the growth rate trend. Latest growth projections from various sources generally confirm this assessment (Figure 26). Reflecting this, the 2002 average growth forecast for East Asia (computed from the country-level forecasts from Consensus Economics) has now been scaled down to 5.7 percent (Table 1). This compares to a 6.1 percent forecast made at the time of the June ARR Update and 6.2 percent at the time of the March ARR. The corresponding revision for the region excluding the PRC stands at 4.3 percent now compared to the 4.9 percent prediction made in June and the 5 percent prediction of March. The five crisis-affected countries are now expected to grow at an average rate of 4.2 percent in 2002, compared to earlier forecasts of 4.7 percent in June and 4.9 percent in March. Among these countries, growth rates predicted for 2002 range from 3.4 percent for the Philippines and Thailand to 4.7 percent for Korea.

Coming so soon after the 1997 crisis, both the sharper-than-expected slowdown this year and the slower-than-expected rebound next year raise concerns about the robustness of the region's recovery from the crisis. So does this year's deterioration in private capital inflows to the region. In fact, the years since the onset of the Asian crisis represent the most turbulent half decade in East Asia's recent economic history, with the severe recession in 1998 followed by a sharp slowdown now. Fortunately, however, judged by several prudential indicators, most countries in the region are now more resilient to a 1997-type financial crisis. Perceived sovereign credit risks have also fallen for some countries (Table 3). The movement toward more flexible exchange rate regimes by several countries since the 1997 crisis should also enable them to adjust to external shocks more smoothly.

Almost all the countries in the region now run current account surpluses, and in most countries foreign exchange reserves have improved significantly and cover or more than cover the entire short-term external

Figure 26: **Comparative 2001 and 2002 GDP Growth Forecasts for East Asian Countries** (%)



Note: For official estimates, the lower range of GDP forecasts is shown.
CE = Consensus Economics Inc., *Asia Pacific Consensus Forecasts,* September 2001.
ADB = Asian Development Bank, *Asian Development Outlook,* April 2001.
WB = World Bank, *East Asia Quarterly Brief,* April 2001.
IMF = International Monetary Fund, *World Economic Outlook,* September 2000 and April 2001, IMF Article IV Lao PDR, IMF Public Information Notice.

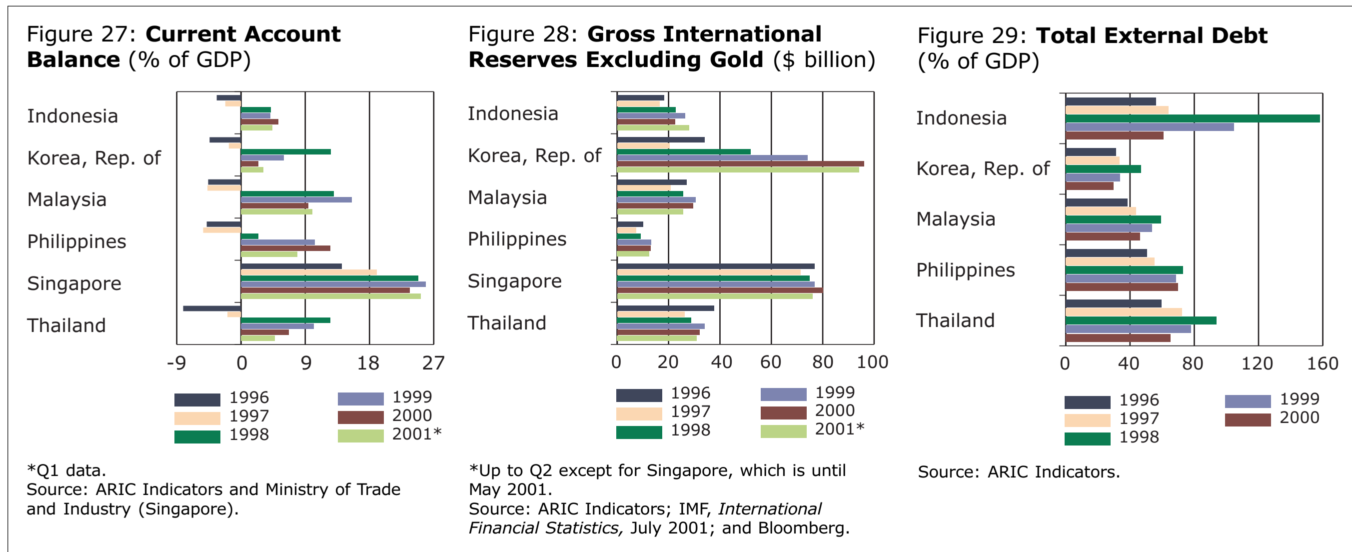


Figure 27: **Current Account Balance** (% of GDP)

*Q1 data.
Source: ARIC Indicators and Ministry of Trade and Industry (Singapore).

Figure 28: **Gross International Reserves Excluding Gold** ($ billion)

*Up to Q2 except for Singapore, which is until May 2001.
Source: ARIC Indicators; IMF, *International Financial Statistics,* July 2001; and Bloomberg.

Figure 29: **Total External Debt** (% of GDP)

Source: ARIC Indicators.

debt (Figures 27 and 28). For most countries, the ratio of money supply to foreign exchange reserves (using both M2 and reserve money)—another indicator of the vulnerability of a country to a currency crisis—has also improved in recent years. In the financial sector, CARs are now above the 8 percent Basle norm (with the exception of Indonesia) and bank profitability is slowly recovering from the beating it received during the crisis years. The external debt to GDP ratios have also declined from their peak levels in 1998 (Figure 29).

However, none of these improvements in prudential indicators should make countries complacent about the broader agenda of economic reforms and restructuring initiated in the aftermath of the 1997 crisis. As the current downturn and a whole set of emerging market crises of the past decade have amply demonstrated, in a highly integrated global economy, countries have to be on guard almost all the time. There simply is no room for policy drift. It would be in the best interests of the region's economies to push ahead with the remaining agenda of financial and corporate restructuring. Over the short run, that would enable them to strategically position themselves to take advantage of the improvements in the external environment that would follow the global recovery sooner or later. Over the longer term, it would also improve their resilience to future shocks. The recent restoration of political stability in Indonesia, Philippines, and Thailand provide renewed opportunities to consolidate their reform and restructuring efforts. Meanwhile, Korea, which has perhaps made the most progress in financial sector restructuring in the aftermath of the 1997 crisis, needs to get over its "reform fatigue" and complete the more difficult phases of the remaining reform agenda.

Table 3: **Foreign Currency LT Sovereign Credit Ratings**

	Item	PRC	Indonesia	Korea	Malaysia	Philippines	Singapore	Thailand	Viet Nam
Moody's	Current Outlook	Stable	Stable	Stable	Stable	Negative	Stable	Stable	Stable
	Ratings	A3 10-Sep-93	B3 20-Mar-98	Baa2 16-Dec-99	Baa2 17-Oct-00	Ba1 18-May-97	Aa1 18-Jan-96	Baa3 22-Jun-00	B1 9-Jul-98
		Baa1 8-Nov-89	B2 9-Jan-98	Baa3 12-Feb-99	Baa3 14-Sep-98	Ba2 12-May-95	Aa2 24-May-94	Ba1 21-Dec-97	Ba3 17-Apr-97
		A3 18-May-88	Ba1 21-Dec-97	Ba1 21-Dec-97	Baa2 23-Jul-98	Ba3 1-Jul-93	Aa3 20-Sep-89	Baa3 27-Nov-97	
			Baa3 14-Mar-94	Baa2 10-Dec-97	A2 21-Dec-97			Baa1 1-Oct-97	
				A3 27-Nov-97	A1 15-Mar-95			A3 8-Apr-97	
				A1 4-Apr-90				A2 20-Sep-89	
				A2 18-Nov-86					
Standard & Poor's	Current Outlook	Stable	Stable	Positive	Stable	Negative	Stable	Stable	
	Ratings	BBB 21-Jul-99	CCC+ 21-May-01	BBB 11-Nov-99	BBB 11-Nov-99	BB+ 21-Feb-97	AAA 6-Mar-95	BBB- 8-Jan-98	
		BBB+ 14-May-97	B- 2-Oct-00	BBB- 25-Jan-99	BBB- 15-Sep-98	BB- 2-Jul-93	AA+ 6-Sep-91	BBB 24-Oct-97	
		BBB 20-Feb-92	SD 17-Apr-00	BB+ 18-Feb-98	BBB+ 24-Jul-98		AA 24-May-89	A- 3-Sep-97	
			CCC+ 31-Mar-99	B+ 22-Dec-97	A- 17-Apr-97			A 29-Dec-94	
			SD 30-Mar-99	BBB- 11-Dec-97	A 23-Dec-97			A- 26-Jun-89	
			CCC+ 15-May-98	A- 25-Nov-97	A+ 29-Dec-94				
			B- 11-Mar-98	A+ 24-Oct-97					
			B 27-Jan-98	AA- 3-May-95					
			BB 9-Jan-98	A+ 1-Oct-88					
			BB+ 31-Dec-97						
			BBB- 10-Oct-97						
			BBB 18-Apr-95						
Fitch IBCA	Current Outlook	Stable	Stable	Stable	Stable	Stable	Stable	Stable	
	Ratings	A- 11-Dec-97	B- 16-Mar-98	BBB+ 30-Mar-00	BBB 7-Dec-99	BB+ 8-Jul-99	AA+ 18-Nov-98	BBB- 24-Jun-99	
			B+ 21-Jan-98	BBB 24-Jun-99	BBB- 26-Apr-99			BB+ 14-May-98	
			BB- 8-Jan-98	BBB- 19-Jan-99	BB 9-Sep-98				
			BB+ 22-Dec-97	BB+ 2-Feb-98	BBB- 13-Aug-98				
			BBB- 4-Jun-97	B- 23-Dec-97					

Notes: A positive/negative outlook suggests that a long/intermediate-term movement (i.e., an upgrade/downgrade) is likely. A stable outlook means that the rating is not currently subject to change.
*Please refer to Annex in Regional Overview of the *Asia Recovery Report,* March 2001 for a description of ratings.
Sources: Web sites of Moody's, Standard and Poor's, and Fitch.