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International Economic Survey

Overview

The world economy grew by 4.1% in 1996 and is expected to grow at 4%-4.5% in 1997, the fastest expansion in a decade. Despite the acceleration in growth this year, global inflation is projected to remain relatively subdued with governments more committed to maintaining inflation at low levels. The positive scenario for stronger global growth is also due to fewer signs of tensions and imbalances that typically presaged significant downturns of the business cycles in the past. World trade volume is projected to expand by 7.7% in 1997, compared with 6.3% in 1996, but below the exceptional performance in the 1994-95 period. Imports of developing countries and countries-in-transition are expected to outpace exports for the sixth consecutive year while exports from developed countries and the Newly Industrialised Economies (NIEs) will improve strongly on account of the favourable external environment for the major exporting countries.

The projection for global growth is being underpinned by continuing strong growth in the United States (US) and the United Kingdom (UK) and gradually strengthening recoveries in Japan and Canada. The industrial countries as a group is expected to register growth of 2.9% in 1997 (1996: 2.4%), the highest since 1989. Performance, however, varies considerably between North America and Western Europe and within the European Union (EU), with the UK maintaining its strong growth path, while Germany, France, Italy and several smaller continental European countries are still projected to experience relatively weak domestic demand.

Growth in the developing countries as a whole will moderate to 6.2% in 1997 (1996: 6.5%), while countries-in-transition are expected to expand at 2.4% (1996: 0.1%). Growth in developing Asia

unlike in recent years, is expected to be slightly less buoyant in 1997 at 7.6% (1996: 8.2%) with some countries projected to experience a setback following the recent turmoil in financial markets in Southeast Asia. Despite the projected slowdown, Asia will continue to be the fastest growing region in the world.

World Trade

World trade growth is expected to rise to 7.7% in 1997. The strong performance expected in 1997 is attributable to the robust economic activities in the US and UK and a strong internal trade performance among the economies of the EU as well as an expansion of imports into Latin America and developing countries of Asia. Consistent with its strong economic expansion, **US** exports and imports are expected to grow faster than the rate recorded in 1996. **Japan** is also expected to experience a marked improvement in its export performance with exports of goods exceeding 11.5% in 1997. Export growth is also projected to pick up in **Germany, France** and a number of **smaller European countries** brought about by the associated depreciation of their currencies against the US dollar. Trade prices are expected to be fairly stable in 1997, although exchange rate changes in Japan and the UK are likely to affect the terms of trade, especially of key export prices. Overall non-fuel primary commodities prices are expected to increase by 2.1% compared to a contraction of 1.3% in 1996, while price of oil is expected to drop by 4.8% to an average of US\$19.44 per barrel in 1997 from US\$20.42 in 1996.

Export growth of the developing countries is expected to be lower in 1997 at 7.6% (1996: 9.5%) while that of import will escalate to 10.5% (1996: 7.9%). **Asia** will continue to lead overall

growth in trade despite some moderation of growth in 1997. Exports from Asia are expected to accelerate substantially to 9.2% (1996: 4.4%) owing to a recovery in global demand for electronics. Imports will also record an increase of 9.1% (1996: 6.8%). In **Africa**, owing to deterioration in commodity prices and recent decline in oil prices, export growth will drop to 5.9% in 1997 (1996: 10.5%). Imports on the other hand will show a sharp increase of 7.6% (1996: 1.5%). Exports from the **Latin American** countries are expected to slow down to 7.7% (1996: 11.8%) while imports will increase by 15.4% (1996: 11.5%). Meanwhile, in the **Middle East** both exports and imports are expected to slow down to 5.4% and 9%, respectively (1996: 17.6%; 10.2%).

International Financial and Capital Markets

The performance of the **capital markets** in industrial countries has been favourable in response to declining inflation rates, efforts towards fiscal consolidation, continued strong growth in the US and UK, and the projected strengthening of economic activities in other key countries. The improved macroeconomic environment coupled with ample liquidity have constrained volatility in the major markets. The capital markets in the US have been major recipients of capital inflows due to high yields on dollar assets and low interest rates in Japan and Europe. Some high yielding currencies in Europe and in the dollar bloc countries were also strengthened by capital inflows.

In the major industrial countries, the conduct of monetary policy in 1997 during the first seven months of 1997 reflected the divergence in the economic cycles in the individual countries. Interest rates have been raised gradually in the US and in the UK in order to pre-empt inflationary pressures. Within Europe, low inflation, efforts towards fiscal tightening, and commitment towards the Economic and Monetary Union (EMU) were important factors that have led to easier monetary policy. However, in the US and UK, a modest tightening of monetary conditions is expected over the next four to six months. Federal funds rates have been raised gradually in the US since May 1997 and is forecast to be at 5.75% by end-1997 (June 1997: 5.50%). An interest rate rise of 25 or 50 basis points in the US is not likely to have a major impact on the performance of the world economy. A long

period of tightening is also not likely. In the UK, the minimum lending rate has been raised to 6.75% at end-July 1997 from 6.25% in the first quarter of the year. The rate is projected to rise further to a range of 7.00% to 7.25% by the end of 1997. Meanwhile in Germany, the discount and Lombard rate is projected to be maintained at current low levels until the end of 1997 in order to ensure continued recovery. In the case of Japan, given uncertainties over the effects of fiscal consolidation on private expenditure and the increase in consumption tax, official discount rates are expected to be maintained at the current low rate of less than 1%.

In 1997, the **foreign exchange markets** experienced a sharp increase in volatility in the exchange rates of the major currencies. Despite large current account deficits, the US dollar and the pound sterling have strengthened markedly against the Japanese yen and the deutsche mark. Strong recovery in the US and UK economy coupled with slow recovery in the European economies and Japan have contributed to the strengthening of the dollar and the pound sterling, as were the uncertainties about the EMU, the fragility of the financial sector in Japan and the slower growth of the East Asian economies. The robust growth experienced by the US and UK has also attracted strong investments, and at the same time significantly reduced the flow of funds to other regions. This in turn has contributed to the rally in the capital markets in both the US and the UK. The Japanese yen is expected to remain firm against the US dollar in the remaining months of 1997 mainly due to Japan's weak fiscal position vis-a-vis the US and expectations of a further widening of its trade surplus with the US. Meanwhile, in the short term, the dollar is expected to remain strong against the deutsche mark as there are concerns over Germany's ability to meet the EMU criteria on fiscal deficit. Over the longer term, the deutsche mark is expected to strengthen as economic recovery gains strength. The Bundesbank is also likely to resist further weakening of the deutsche mark.

In Latin America, a reduction in the volatility of the Mexico new peso and the Brazilian real is expected in 1997. The turbulence in emerging foreign exchange markets is, however, expected to have a negative impact on equity markets in the region. The Bovespa index fell by 15% between 11 and 18 July 1997 and other Latin American

equity markets like those in Argentina, Chile and Mexico which have strong trade links to Brazil, may be affected.

In ASEAN, the Thai baht was subjected to substantial pressures since mid-May 1997 following a sharp slowdown in exports, a large current account deficit, a build up in short-term debt, a glut in the property sector and weaknesses in the domestic financial system. In early July, Thailand introduced a more freely floating exchange rate regime. The baht depreciated nearly 29% against the U.S. dollar during the 2 May to 30 September period while the stock market index also dropped by about 18% during the same period. Spill over effects from the financial crisis in Thailand were subsequently felt by several countries in the region, where the local currencies also became targets of speculative attacks. This inadvertently led to the depreciation in the value of the Philippine peso by 23%, the Malaysian ringgit by 21%, the Indonesian rupiah by 26% and the Singapore dollar by nearly 7% against the U.S dollar between 30 June to 30 September 1997. The weakness in the currency markets was accompanied by volatility and declines in the region's stock markets with the stock market index in the Philippines decreasing by 27%, Indonesia by 25%, Singapore by nearly 3% and in Malaysia, the Kuala Lumpur Composite Index fell by 24% during the 30 June to 30 September period.

Global **foreign direct investments (FDI)** flows are expected to grow further in 1997 boosted mainly by access to expanding markets, technological advancements, competitive pressures, privatisation and national government policies promoting FDI. The FDI flows that increased for the fifth consecutive year reached US\$349 billion in 1996. The exact figure could be higher, amounting to US\$1.4 trillion if all capital raised by investing companies domestically and in overseas financial markets are included. FDI is expected to remain strong in 1997. FDI flows into developed countries accounted for almost 60% (US\$208 billion) of global FDI. The US maintained its position as the single largest recipient country among the developed countries.

FDI flows into developing countries increased by almost 30% to a new record of US\$129 billion in 1996. While the same rate of increase may not be attained in 1997, FDI flows are still expected to remain strong. Asia, excluding Japan, accounted

for more than half of these FDI flows at US\$81 billion, a 25% improvement over 1995. China which attracted US\$42 billion, was the world's second biggest FDI recipient after the US, thereby retaining its top position among developing countries for the fifth straight year. FDI in China for 1997 is forecast to at least match last year's flows due to government efforts to promote FDI to mid-west provinces which have rich natural resources. Actual foreign investments into China for the first seven months of 1997 totalled US\$26 billion, up by 15.8% compared with the same period in 1996. Investment into Singapore, Hong Kong China, South Korea and Taiwan increased by 27% to US\$15 billion. Singapore fared the best, with investment flows amounting to US\$9 billion.

In ASEAN, despite intense global competition, the region continues to attract a sizeable amount of foreign direct investments, with FDI into Thailand, Indonesia, Malaysia and the Philippines growing by 43% to US\$17 billion in 1996. A major share of investments comes from Japan, Europe, the US and the NIEs. However, proportionally, ASEAN countries including Vietnam, Laos and Myanmar, have seen their share of investments into Asia drop from 61% during 1990-1991 to half of that in the 1994-1996 period. The fall can be attributed to capacity constraints, infrastructure bottlenecks and competition from other Asian countries offering low labour costs and attractive incentives to foreign investors. For the South Asian and West Asian regions, the level of FDI flows is expected to remain modest. An increasing number of these Asian economies are actively encouraging FDI into infrastructure projects. India, for instance, received a total of US\$2.6 billion in investment flows, representing a growth of 34% over 1995.

While Asia's developing economies account for an increasing proportion of investment inflows, they have also become significant sources of capital, particularly in other Asian economies. In 1996, developing countries invested US\$51 billion overseas, about 15% of all outward bound investment, with Asian economies accounting for US\$46 billion. Hong Kong, China alone supplied US\$27 billion. Asia's least developed countries are benefiting from industrial restructuring in the Asian industrialising economies. Bangladesh for example received 80% of its investment from neighbouring countries. Intra-ASEAN investments have also increased to US\$13.4 billion with Vietnam as a major destination of investment.

FDI flows into Latin America and the Caribbean rose by 50% to reach US\$39 billion in 1996. Most of the investments were concentrated in selected countries and in specific industries such as automobiles in Mexico and Brazil, natural resources in Chile and privatisation projects in Argentina and Peru. In 1997, the Latin American and Caribbean economies will continue to experience strong FDI interests.

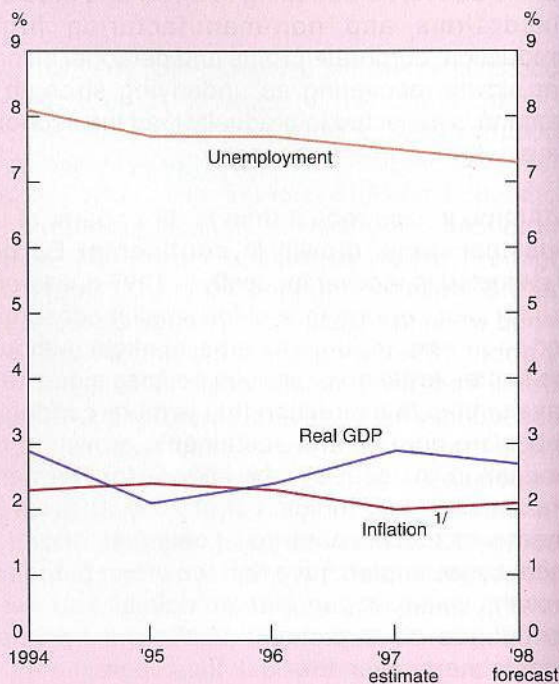
The **equity markets** in industrial countries have been performing strongly, influenced by subdued inflation and low interest rates. The European markets are showing good performance levels with the UK markets being the strongest. In the US, equity markets are outperforming most other industrial country markets owing to the large capital inflows from investors in search of high yielding markets. On the other hand, equity markets in Canada are lagging behind the US while some pick up have been observed in prices in France and Germany. However, Japanese equities have lagged behind other G-7 countries because of concerns regarding the health of the financial sector.

Economic Situation of the Industrial Countries

Output

Growth in the industrial countries is expected to show a further improvement to 2.9% in 1997 compared with 2.4% in 1996 and 2.1% in 1995. Growth prospects across the industrial countries are at their best for nearly a decade. In the **United States (US)**, the economy has continued into its seventh consecutive year of expansion, combining solid output growth with full employment while containing inflationary pressures and moving towards diminishing fiscal imbalances. Factors underpinning the exceptional performance of the economy included underlying improvements in long-term economic efficiency, the flexibility of labour and product markets as well as some temporary factors that had restrained inflation. The index of industrial capacity utilisation has been trending upwards during 1996 and is expected to remain above³ its long-term average in 1997. It is expected that continued tightening of monetary policy and further progress in reducing the budget deficit would establish a firm basis for sustaining the current economic expansion. To guard against

Chart 3.1
Industrial Countries -
Major Economic Indicators



1/ Consumer prices

Sources :IMF World Economic Outlook , September 1997
and national sources

the risk of the emergence of price pressure, the Federal Reserve has been tightening monetary policy moderately. Further tightening is likely given the high degree of resource utilisation, the underlying strength of aggregate demand, and the likelihood that factors that had restrained inflation in the recent past - including slowly rising labour costs, the appreciation of the US dollar and increased external competition, with weak growth in other major countries - would diminish in the period ahead. Real GDP growth in 1997 is projected to be at 3.7% (1996: 2.8%).

In **Japan**, after stagnating for four years, the economy strengthened in late 1996 and early 1997 due to a pick up in domestic demand and a recovery in net exports. Subsequently however, the pace of recovery slackened following a prolonged negative impact brought about by the increase in consumption tax effective April 1997. A rebound is projected towards the end of 1997, but GDP growth for 1997 as a whole is now

expected to substantially moderate to 1.1% (1996: 3.5%), given the restraining influences of fiscal policy. Investment will largely continue its upward trend however, broadening to small and medium-sized firms and non-manufacturing firms. Production, corporate profits and personal income are slowly recovering as underlying strength of demand is expected to gradually lead the economy as a whole.

Although less robust than in other parts of the industrial world, growth in **continental Europe** is expected to recover modestly in 1997 due largely to improved performance of the smaller economies and strong expansion in external markets. Although the implementation of various policies since 1995 have shifted in a direction that is more conducive to a more durable and sustainable growth in the medium term, for 1997, the outlook for Germany, France and Italy indicate a prolonged recovery phase. In these countries, continued efforts at fiscal consolidation have had the effect of braking growth, while labour market rigidity and weak confidence have brought about extraordinary sluggishness over the last four years.

In **Germany**, recovery resumed during 1997, but growth for the most part remained unbalanced: a high reliance on export growth, with weak domestic demand. Business investment especially in machinery and equipment and consumption may pick up towards the end of the year however. Real GDP is expected to grow by 2.3% in 1997 (1996: 1.4%) given correction of the real exchange rate and the growth of foreign demand which had boosted exports, strengthened manufacturing activity, and improved the investment climate. However, entrenched structural weaknesses, especially in the labour market, and uncertainties about the ability of Germany to meet the Maastricht criteria by end of 1997 are expected to restrain overall economic expansion. In **France**, increasing consumer and business confidence and firm foreign demand had led to a resumption in growth. GDP growth is expected to increase by 2.2% in 1997 (1996: 1.5%), but this is heavily dependent on continued foreign demand and easy financial conditions. Tensions in financial markets in the run up to the introduction of the euro could however, dampen growth in the short to medium term.

In contrast to the slow down that has characterised the major continental European economies in recent years, economic expansion

in the **UK** has approached its sixth year with GDP projected to reach 3.3% in 1997 (1996: 2.3%). The expansion has been due to buoyant consumer spending and business investment, supported by strong job creation and a recovery in the housing market. Higher retail sales, manufacturing output and gross fixed investments have offset a weakening in the growth of export volume due to the strong pound. In the smaller European countries like **Austria, Belgium, Sweden and Switzerland**, growth prospects are less robust. Domestic demand has been weak in all these countries but exports are projected to support expansion as will strong business investment. GDP growth in these countries are projected to range from almost 1% to about 3%. In **New Zealand** and **Australia**, the growth momentum since 1996 is expected to accelerate in 1997, against a background of easy monetary conditions and low inflationary pressures. Growth in New Zealand is expected at 2.8% in 1997 (1996: 2.7%), while in Australia, investment-led pick up should maintain growth at 3.5% in 1997 (1996: 4%).

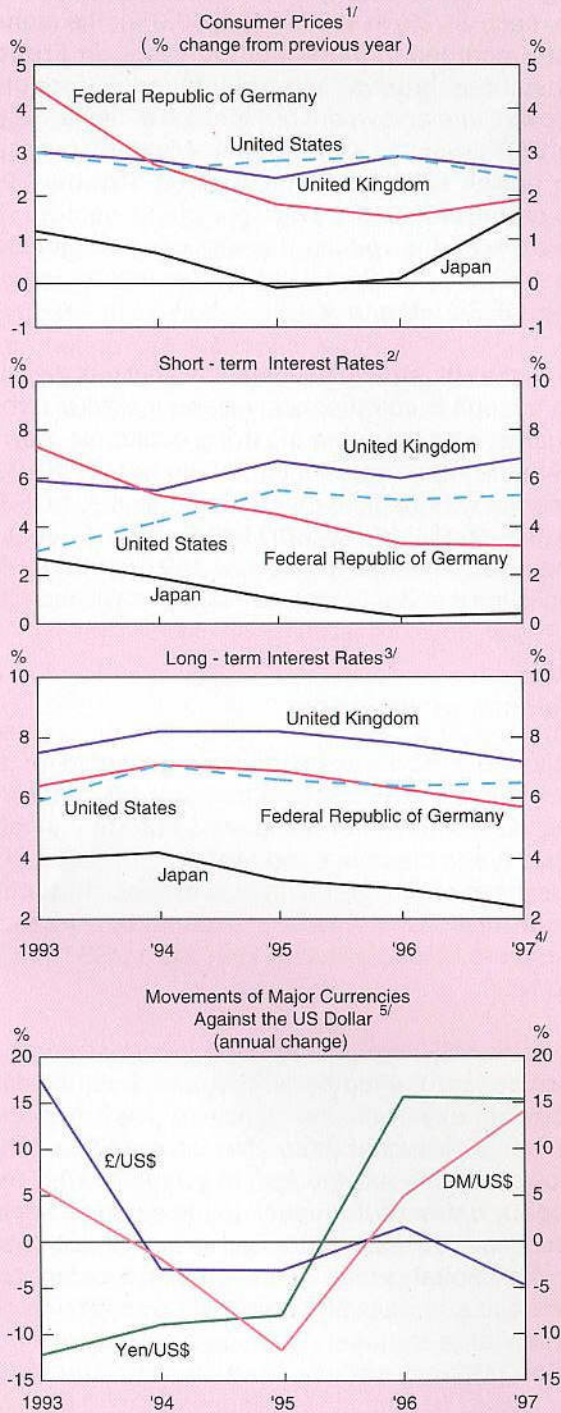
Inflation

Across the industrial world, inflation has been subdued in recent years, and is expected to remain at generally low levels. Monetary authorities in the industrial countries have been sensitive to underlying pressures on wages and prices as economic growth gradually strengthens. Consumer price inflation in the industrial countries as a group is expected to be contained at 2% in 1997 (1996: 2.3%).

In the **US**, consumer spending has been gaining momentum, fuelled by the combination of strong labour markets, relatively faster wage growth and rising household incomes. Consumer price inflation has declined to 2.4% in 1997 (1996: 2.9%). In **Japan**, consumer prices are projected to rise because of the effect of the increase in consumption tax, but is expected to stabilise in the medium term brought about by structural changes on the supply side. Inflation is projected to level off at 1.6% (1996: 0.1%).

In **Germany**, the effective depreciation of the deutsche mark is causing concerns that price pressures will rise as foreign inputs become more expensive for German firms. Consumer price inflation in Germany is expected to rise marginally to 1.9% in 1997 (1996: 1.5%) also due to higher

Chart 3.2
Current Trends in Key Economic Determinants in Industrial Countries



1/ 1997 figures are estimates.

2/ Averages of interest rates weighted by the average US dollar value.

3/ Average yield on Government bonds.

4/ Until June 1997

5/ End of period except for 1997, up to June.

Sources : IMF World Economic Outlook, September 1997.

import prices from EU trading partners. In **France**, consumer price inflation is likely to be affected by the depreciation of the franc to a more stable rate, but wage and price inflation are likely to remain low due to slack in the goods and labour market. In 1997, inflation is expected to decline to 1.1% (1996: 2%).

Inflation in the **UK** is expected to remain low in the short-term due to strong appreciation of the sterling since mid-1996 and the 0.25 percentage point increase in base rates in May 1997. There

Table 3.1

Selected Industrial Countries - Major Economic Indicators

	Industrial Countries	United States	Japan	Germany	United Kingdom
Growth of Real GDP (%)					
1994	2.9	3.5	0.6	2.9	4.3
1995	2.1	2.0	1.4	1.9	2.7
1996	2.4	2.8	3.5	1.4	2.3
1997 ^a	2.9	3.7	1.1	2.3	3.3
1998 ^f	2.7	2.6	2.1	2.8	2.6
Inflation¹ (%)					
1994	2.3	2.6	0.7	2.7	2.4
1995	2.4	2.8	-0.1	1.8	2.8
1996	2.3	2.9	0.1	1.5	2.9
1997 ^a	2.0	2.4	1.6	1.9	2.6
1998 ^f	2.1	2.8	0.7	2.3	2.7
Unemployment (%)					
1994	8.1	6.1	2.9	9.6	9.3
1995	7.7	5.6	3.1	9.4	8.2
1996	7.7	5.4	3.3	10.3	7.5
1997 ^a	7.5	5.1	3.4	11.3	5.8
1998 ^f	7.3	5.3	3.2	11.2	5.7
Current Account Balance (US\$ billion)					
1994	8.0	-133.5	130.6	-19.7	-2.5
1995	34.6	129.1	111.4	-21.0	-5.8
1996	11.8	-148.2	65.8	-17.6	-0.7
1997 ^a	9.0	-176.0	91.0	-10.0	-4.0
1998 ^f	-7.0	-203.0	93.0	1.0	-13.0

¹ Consumer prices

^a estimates

^f forecasts

Sources: IMF World Economic Outlook, September 1997; and OECD Economic Outlook, June 1997

has been however, evidence of rising wages, particularly in the rapidly growing services sector. To stem inflationary pressures, a further increase in base rates can be expected during the remainder of 1997. For 1997, inflation is expected to be at the inflation target range of 2.6% (1996: 2.9%). In several other European countries like **Denmark, Finland, Iceland, Ireland, the Netherlands and Norway** there is some risk that upward pressures on wages and prices will emerge. However, monetary policies will be used to contain these pressures and inflation in these countries is expected to range between 1% and 3%. In **Australia**, inflation is expected to remain subdued at 1.9% in 1997 (1996: 2.7%), while in **New Zealand**, the rate is expected to decline to 1.4% (1996: 2.3%).

Unemployment

Labour market performance across the industrial countries continues to vary, with unemployment remaining high in the EU, particularly in France, Germany and Italy. The unemployment rate for EU as a whole is expected to decline by a mere 0.3 percentage point to 11.1% in 1997 (1996: 11.4%). In some countries, including the US, UK, Denmark, Finland, Ireland and the Netherlands, cyclical unemployment has been reduced to levels averaging below 10% and tightening labour markets could translate into rising wage pressures. Strong growth in job creation has been recorded particularly in the US, Canada and New Zealand.

In the **US**, the unemployment rate is estimated at around 5.1% in 1997 (1996: 5.4%). The US has entered a tight labour market situation, but increases in labour costs are still relatively modest. The demand for labour has drawn many workers into the labour force in particular, into the computers, transportation and financial services industry. In **Japan**, the unemployment rate is estimated at 3.4% in 1997 as job creation has been negatively affected by uncertainties about the strength of the recovery and continued industrial restructuring.

In **Germany**, unemployment still remains a major concern even though the recovery has been gaining momentum. In the western states, a pick-up in economic activity has helped to create more jobs, while in the eastern states, unemployment has worsened reflecting the unsuccessful tax reform process which had a negative impact on investment.

Even so, structural weaknesses in the labour market had contributed to lower employment, and increases in the unemployment rate to historically high levels. Unemployment in Germany is expected to reach 11.3% in 1997 (1996: 10.3%), the highest rate recorded in more than 30 years. In **France**, despite a gradual strengthening of economic growth, unemployment is expected to rise to 12.6% in 1997 (1996: 12.4%). The government is expected to launch a "job creation plan" in October 1997 to create 500,000 jobs in the public sector. This is expected to reduce the rate of unemployment to 12.3% in 1998, still one of the highest among the OECD countries.

In the **UK**, structural unemployment has declined as a result of comprehensive labour market reform against a background of strong economic growth. With the labour market tightening further in 1997, unemployment is expected to decline to 5.8% (1996: 7.5%). In **Australia**, unemployment is expected to remain at 8.6% in 1997 (1996: 8.6%), while in **New Zealand**, unemployment is expected to slow down to around 6% (1996: 6.1%).

Balance of Payments

Current account imbalances of some of the major industrial countries are expected to widen further in 1997, but to remain generally smaller than the imbalances experienced in 1980s. The current account deficit in the seven major **industrial countries** as a whole is expected to increase further to US\$43 billion in 1997 from US\$32 billion in 1996.

In the **US**, despite the continuing strength of the dollar, the balance of trade has widened considerably, with the deficit in 1997 expected to be 10% higher than that recorded in 1996. However, this has been partly ameliorated by a slightly better performance in the services sector. The exports sector performed strongly, particularly in the capital goods and automotive categories, as well as robust sales of civilian aircraft. Imports of capital goods have also risen but strong domestic demand has not resulted in any significant increases of consumer goods imports. However, the US is projected to again experience substantial widening of trade deficits with China, Japan and several other Asia Pacific rim countries. In addition, the trade-weighted dollar's appreciation as a result of robust economic growth will also lead to further deterioration in net exports.

In **Japan**, after declining to 1.4% of GDP in 1996, the current account surplus is expected to increase as the depreciation of the yen since 1995 has continued to boost exports. Japan's trade surplus with the US is likely to account for more than 2.5% of nominal GDP. The current account surplus is also surging because of slow import growth due to sluggish domestic demand caused by fiscal tightening and an increase in the consumption tax.

Germany's exports picked up considerably in 1996 as the weakening deutsche mark and declining unit labour costs boosted German competitiveness. This trend is expected to continue in 1997 as the deutsche mark remains weak and growth in other European countries strengthening, bringing about a merchandise trade surplus to US\$84 billion (1996: US\$73 billion). The current account deficit is expected to narrow to US\$10 billion (1996: -US\$17.6 billion). A weaker franc/dollar rate, low wage increases and stronger demand in western Europe are expected to boost **France's** exports in 1997. But a recovery in private consumption and stronger business investment will increase imports as well. The trade surplus is expected to amount to US\$18 billion in 1997 (1996: US\$15.9 billion) with the current account surplus increasing to US\$26 billion (1996: US\$20 billion).

In **UK**, export growth is expected to slow down to 5.7% in 1997 compared with 6.9% in 1996, due in part to the strong pound. Import growth is expected to remain fairly strong at 7.2% (1996: 8.5%) as the UK economy outpaces that of its major trading partners. As a result, the trade deficit is expected to widen from US\$18.9 billion in 1996 to about US\$24 billion in 1997. However, the current account deficit is expected to widen to US\$4 billion in 1997 or 0.5% of GDP (1996: -US\$0.7 billion or 0.1% of GDP). In **Australia**, faster growth and exchange rate appreciation are expected to contribute to a deterioration in the current account, while in **New Zealand** the stronger than expected growth and higher demand may lead to balance of payment pressures.

Progress to the Economic and Monetary Union

The establishment of the **Economic and Monetary Union (EMU)** in Europe scheduled for 1 January 1999 will mark the conclusion of a 40-

year long process for closer economic integration and to promote a more stable financial climate in Europe. A single currency, the euro will represent a major shift in the international monetary system and could emerge as a major international currency whose role may eventually match that of the US dollar as a means of payment and as an international reserve asset.

The EMU will mean a single domestic monetary policy for the EU with uniform money-market interest rates and a single exchange rate policy. This is expected to lower transaction costs and generate long-term efficiency as well as produce lower real interest rates and promote investment on the back of commitment to price stability and prudent fiscal policies. Only those member economies which fulfil a number of obligations as set out in the Maastricht Treaty, including a good track record of monetary and budgetary stability will be able to adopt the euro. Compliance with inflation, interest rate, and exchange rate stability criteria in order to avoid disruptions, notably on unemployment, has now been achieved by all those EU members that plan to participate initially. It seems likely that a number of countries, including France and Germany, may not fully achieve the 3% fiscal deficit target in 1997, owing to relatively large margins of economic slack. As at end September 1997, 11 countries, except Britain, Denmark, Sweden and Greece, are expected to join the EMU on 1 January 1999.

The rest of the world has a strong interest in the establishment of the EMU and the euro. A successful EMU is expected to lessen fears of globalisation and the risk of a protectionist backlash to Europe's high unemployment problem. It will change the environment in Europe to become a better place to trade and invest and should boost the demand for euro as an international transaction currency. However, the stability of the euro will depend strongly on several factors including the credibility and consistency of policies in member countries. Ultimately, it is important that the value of the euro properly reflects the economic fundamentals of the participating countries.

Economic Situation of Developing Countries

Real GDP growth in the developing countries is expected to remain relatively buoyant at 6.2% (1996: 6.5%) with the inflation rate expected to

decline to 10% in 1997 (1996: 13.2%). The rapid expansion in the Asian region is projected to moderate to 7.6% (1996: 8.2%). The marked strengthening of activity in 1996 in several countries in other regions is expected to be sustained in 1997. In addition, the broadening of economic growth to an increasing number of the lower income countries represents a positive development. Risks to growth arising from policy imbalances have been significantly reduced as most developing countries continue to adhere to generally prudent fiscal policies while maintaining low or declining inflation. On the other hand, a number of countries have experienced large external imbalances in addition to the existence of fragile banking systems. These are downside risks to near term growth outlook. It also underscores the need for some cooling down of domestic demand pressures as well as financial sector reforms. These short-term difficulties should not, however, significantly affect the generally positive long term prospects of the developing countries, as long as macroeconomic stability is maintained and the necessary reforms are put in place.

The ASEAN Economies

The bout of speculative attacks on the ASEAN regional currencies beginning mid-May 1997 is expected to slow down the economic growth of the region to 6% in 1997 (1996: 7.1%). The inflation rate, however, is also expected to fall to 5.3% in 1997 (1996: 5.6%) given the continued prudent monetary and fiscal measures adopted by countries like Indonesia, Malaysia and the Philippines.

Output

Brunei's gross domestic product is expected to grow at a rate of 3.5% in 1997 (1996: 2.8%). Public sector-led growth especially in the construction and services sector is expected to largely contribute to the further development of the economy. Strong growth is expected especially in the transport, tourism and telecommunications sectors given the government's policy of diversifying the economy. **Indonesia's** economic growth is expected to slowdown to 7% in 1997 (1996: 7.8%). The depreciation in the value of the rupiah is expected to affect import prices as well as the country's foreign debt. However, the general strengthening of world industrial activity and trade

will have a positive effect on the economy. The **Malaysian** economy is expected to grow at a sustainable rate of 8% in 1997 (1996: 8.6%), led by the continued double-digit growth in the manufacturing and construction sectors. The services sub-sectors of transport and finance are also expected to show strong growth prospects.

In the **Philippines**, the economy is expected to maintain a steady growth at a rate of 5.6% in 1997 (1996: 5.7%). The manufacturing, services

Table 3.2
ASEAN: Gross Domestic Product
Inflation and Current Account Balance

	1996	1997 ^a	1998 ^f
Gross Domestic Product Growth (%)			
ASEAN	7.1	6.0	7.5
Brunei	2.8	3.5	5.0
Indonesia	7.8	7.0	7.7
Malaysia	8.6	8.0	7.0
Philippines	5.7	5.6	6.5
Singapore	7.0	6.5	7.5
Thailand	6.4	2.5	3.5
Vietnam	9.3	8.8	8.2
Inflation rate (%)			
ASEAN	5.6	5.3	6.2
Brunei	2.0	3.0	3.0
Indonesia	6.5	6.0	6.5
Malaysia	3.5	2.6*	—
Philippines	8.4	6.3	7.0
Singapore	1.4	2.0	2.0
Thailand	4.8	9.5	5.0
Vietnam	4.5	8.5	11.0
Current Account Balance (% of GDP)			
Brunei	-1.9	-1.4	-4.7
Indonesia	-3.4	-3.6	-3.6
Malaysia (% of GNP)	-5.2	-5.0	-4.0
Philippines	-4.5	-4.2	-4.1
Singapore	15.0	15.0	16.0
Thailand	-7.9	-5.0	-3.0
Vietnam	-12.4	—	—

^a Estimates

^f Forecasts

* For the period Jan.-Sept. 1997

Source: ASEAN Macroeconomic Outlook (Draft) 1997-98
IMF World Economic Outlook, September 1997
Asian Development Outlook for 1997 and 1998

and agricultural sectors are expected to contribute towards this growth. The outward looking reforms introduced in the recent years are expected to strengthen the economy and make it globally competitive. Efforts are also being made to allow the selective privatization of services traditionally undertaken by the government. **Singapore's** economy is projected to grow about 6.5% in 1997 (1996: 7%) led by a recovery in manufacturing exports, continuing strong construction activity and a buoyant financial sector. The turnaround in the global electronics demand has contributed to the recovery in Singapore's manufacturing sector in 1997, the output of which is expected to increase by 9.3%.

In **Thailand**, economic growth is projected to slow down considerably to 2.5% in 1997 (1996: 6.4%) as a result of the currency crisis and marked decrease in the growth of exports and imports. The measures under a financial package agreed under the IMF programme are expected to bring about structural reforms and improve export performance as well as stabilise the economy. In **Vietnam**, the output growth is expected to slowdown to 8.8% (1996: 9.3%) due to poor industrial performance, stockpile of key goods such as steel, petroleum products and fertiliser and tight credit at domestic banks saddled with bad debts.

Inflation

Inflation is expected to be maintained at a relatively low level for several of the ASEAN economies. In **Brunei**, the Consumer Price Index is expected to be stabilised at 3% (1996: 2%) due to reduced import duties on almost 700 consumer items since April 1995, price controls on some basic necessities and subsidized gas and utility rates. In **Indonesia**, prudent fiscal and monetary measures to keep domestic demand in check as well as government's efforts to eliminate bottlenecks in the supply side, both in terms of production capacity and distribution of goods, are expected to ease inflationary pressures in 1997 to 6% (1996: 6.5%). In **Malaysia**, the inflation rate for the period January to September 1997 was 2.6% (1996: 3.5%). To curb potential inflationary pressures from the fall in the value of the ringgit and consequent higher import values, measures are being taken to increase the production of local goods including foodstuffs to replace imports as well as measures to reduce the costs of doing

business. In 1997, the inflation rate in the **Philippines** is forecast to average 6.3% (1996: 8.4%) especially with the easing of the food supply shortages following the recovery of the agricultural sector. Inflation in **Singapore** is likely to remain low at 2% in 1997 (1996: 1.4%). Due to the depreciation of the Thai baht and coupled with the measures under the IMF financial package, the inflation rate in **Thailand** is projected to increase to 9.5% in 1997 (1996: 4.8%). The inflation rate in **Vietnam** is expected to increase to 8.5% (1996: 4.5%) due to increases in fuel and electricity prices, salary rises for state employees and a depreciating dong.

Trade and Balance of Payments

The depreciation in the values of the major ASEAN currencies is expected to affect the current account position of the ASEAN economies in 1997. In **Brunei**, the fall in world oil prices is expected to affect export earnings as the hydrocarbons constitute a major export component. Brunei's trade balance however is expected to improve slightly in 1997. **Indonesia** is expected to face short-term trade problems as the depreciation effects of its currency filter into its imports. Import volumes are expected to drop substantially given the rupiah crisis and also recent changes in import customs inspection regulations. In 1997, the current account deficit is forecast to be 3.6% of GDP (1996: -3.4% of GDP). In **Malaysia**, the gross exports is expected to grow at a slower rate of 6.0% in 1997 (1996: 6.5%). The fall in the export prices of manufactured goods and commodities like rubber, sawn timber and sawlogs account for the reduced export values. Imports, however, are anticipated to show a higher growth rate of 6.6% in 1997 (1996: 1.5%) especially due to a strong increase in the import of capital goods by 19.8% (1996: -5.7%). The current account deficit is expected at 5% of GNP in 1997 (1996: -5.2% of GNP). In the **Philippines**, the current account deficit is projected to narrow to 4.2% of GDP in 1997 (1996: -4.5%). This is attributed largely to the structural reforms being undertaken including the liberalisation of trade, foreign exchange and financial transactions. In 1997, merchandise imports are expected to decelerate to 10.9% (1996: 22.3%) while merchandise exports are expected to accelerate to 22.9% (1996: 17.7%). **Singapore** is expected to see an increase in non-oil exports in 1997 due to rising demand for high-tech

electronic products such as semi conductors, disk drives and printed circuit boards. Almost 70% of Singapore's non-oil exports comprise electronic products. The recovery in exports is expected to maintain the current account surplus at 15% of GDP in 1997 (1996: 15%). After reaching 7.9% in 1996, the current account deficit in **Thailand** is expected to narrow to 5% of GDP in 1997. The macroeconomic adjustment measures to be put in place in the aftermath of the exchange rate crisis are expected to improve export performance and stabilize the economy. In **Vietnam**, measures are being taken to promote export growth especially rice exports which is the major foreign exchange earner. The current account deficit is expected to widen in 1997 (1996: -12.4%).

Economic Cooperation

ASEAN Finance Ministers (AFMM) had their first formal meeting in Phuket, Thailand on 1 March 1997 and agreed on the importance of concrete and pragmatic cooperation in the area of finance to realise ASEAN's goal of greater economic integration. The Ministers discussed various global and regional economic developments, financial issues in international fora and financial sector liberalisation. On macroeconomic policy cooperation, the Finance Ministers agreed that regular consultations on macroeconomic and financial matters are important given changes in the global economy.

Ministers signed a "Ministerial Understanding on ASEAN Cooperation in Finance" providing framework for enhancing cooperation within existing institutional arrangements in several areas of finance including banking and finance; financial and capital market; customs matters; insurance matters; taxation and human resource development. The ASEAN Agreement on Customs was also signed aimed at further enhancing ASEAN cooperation in customs activities, to expedite the early realisation of AFTA and facilitate greater intra-regional trade and investment flows.

ASEAN economic cooperation was further consolidated when the ASEAN Economic Ministers (AEM) Informal Meeting held on 20 November 1996 in Manila decided that a Working Committee be formed to draft the Framework Agreement on the ASEAN Investment Area (WCAIA). The draft Framework Agreement is to be submitted to AEM's 30th meeting to be held in September/October

1998. The ASEAN Investment Area (AIA) is expected to facilitate investments into the region by encouraging freer flow of capital, skilled labour/ professional and technology and is targetted to be realized by 2010. The draft will cover aspects relating to investment promotion, facilitation and liberalisation. It was agreed that the investment liberalisation programme to be adopted under the AIA be less structured, with no categorisation of industrial sectors, emphasise unilateral action and flexible time frame but still within the overall time frame of 2010. Member countries would undertake a coordinated effort in promoting ASEAN as a regional investment location. The AIA would call for a more active ASEAN private sector role in matters relating to investment activities.

Further progress was achieved in the efforts to realise the ASEAN Free Trade Area (AFTA), with the transfer of the second package of manufactured products and the first package of unprocessed agriculture products from the Temporary Exclusion List to the Inclusion List of the CEPT Scheme, effective January 1997. The revised number of total ASEAN tariff lines increased to 46,132 in January 1997 from 44,752 in January 1996. With this transfer, 91% of the total ASEAN tariff lines are now under the CEPT scheme. The remaining tariff lines will be phased in by January 2000.

With the satisfactory implementation of tariff reduction, ASEAN is concentrating on the elimination of non-tariff barriers such as customs surcharges, technical requirements, product characteristics and monopolistic measures. The ASEAN Chambers of Commerce and Industry would liaise with their industry associations to gather information on non-tariff barriers which restrict expansion of trade.

ASEAN Sub-Regional Arrangements

The three ASEAN sub-regional groupings have adopted a more focussed approach in implementing their economic cooperation initiatives to realise optimum benefits of public - private sector partnerships. Emphasis is placed on the importance of clear and well-defined rules and regulations, greater transparencies in government policies, further liberalisation and deregulation efforts to facilitate cross-border flows of investments and resources, increased accessibility as well as

enhancing the effectiveness and efficiency of sub-regional institutional mechanisms and organisational processes.

In the **Indonesia-Malaysia-Singapore Growth Triangle (IMS-GT)** which recently incorporated the Indonesian provinces of Bengkulu, Jambi, Lampung, South Sumatra and West Kalimantan, the need to develop seamless travel particularly for sea travellers in the region was recognised. Collaborative efforts in harmonising the Customs-Immigration-Quarantine Port (CIQP) procedures are being initiated to strengthen regional travel and tourism links and develop cruise and marine tourism. In the **Brunei-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA)**, initiatives have been taken to eliminate travel tax and harmonize cross-border arrangements. Brunei has introduced the 72 hours transit visa and with effect from April 1997, all land and sea travellers from Indonesia, the Philippines and Thailand can now enter Brunei Darussalam without a visa for more than 14 days stay. In addition, measures are being undertaken to improve air-services, land communication and ferry services within the sub-regions. Indonesia has exempted its citizens from the **Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT)** provinces visiting other member areas from paying fiscal tax which would greatly increase the flow of Indonesian tourists. Task Forces have been established in **BIMP-EAGA** and **IMT-GT**, to review and strengthen the institutional mechanisms and organizational processes of cooperation.

The private sector has shown encouraging interests in developing the sub-regions as reflected in the number of Memorandum of Understandings (MOUs) signed which amount to RM11.1 billion in the **IMT-GT** and RM1 billion in the **BIMP-EAGA**. However, the implementation of the MOUs has faced several obstacles especially in the fisheries and agro-industry sectors. The problems encountered include procedural constraints impeding the movement of goods at border crossings, high freight charges in the ASEAN region, inadequate transportation facilities and services, legal constraints regarding land lease and land tenure system and lack of transparency in rules and regulations especially regarding the imports of agricultural products.

Notwithstanding the above, the private sector in the sub-regions has proceeded to promote the

regions as well as enhance information dissemination. In the **IMS-GT**, the Joint Business Council (JBC) Guidebook on Investment Opportunities was launched and a JBC Homepage established. In the **BIMP-EAGA**, an "International Business Seminar on BIMP-EAGA" and a seminar on "Opportunities in BIMP-EAGA" were held in Malaysia and Indonesia respectively. A "BIMP-EAGA Investment Promotion Seminar" was held in Tokyo, in March 1997, the first outside of EAGA.

New areas of cooperation being initiated in the sub-regional growth areas include the establishment of the IMS-GT Research and Development Centre in Penang, Malaysia; the establishment of a special telecommunication zone in IMT-GT; a two year tourism rolling plan for the IMS-GT; an infrastructure study for the IMS-GT region to be funded by the ADB; the establishment of a Regional Training Centre in Davao, Philippines; a compendium on Labour Market Information and Pre-Departure orientation training programme for BIMP-EAGA; establishment of centres of excellence in human resource development in BIMP-EAGA as well as cooperation and collaboration on sharing of expertise and training resources in BIMP-EAGA.

In terms of financial resources to promote investments in the sub-regions, Growth Funds have been recommended to be established. In the **IMT-GT**, there is a proposal to set up a Growth Fund which is to be private-sector driven, self-sustaining and concentrating on providing assistance for the promotion of small and medium scale enterprises in the region. In the **IMS-GT**, a similar fund may be established after the needs of the private sector have been examined. In the **BIMP-EAGA**, several funding proposals are actively being packaged by the private sector in the member countries. The Working Group on Capital Formation and Financial Services has issued guidelines for endorsement of the funding proposals in order to ensure total commitment from the promoters of the fund.

The North East Asian Economies

The North East Asian economies, comprising China, South Korea, Hong Kong, China and Taiwan, as a group, are expected to register moderate growth in 1997. China, however, is the exception with the growth rate maintained at a robust rate

of over 9%. Overall GDP growth for the other three countries will range between 5.3% to 6.2%.

Output

In 1997, GDP growth in **China** will be maintained at a high level of 9.5% (1996: 9.7%), following the robust performance of the export sector. Industrial output will increase by 11.6% with fixed asset investment rising by 13.5%. The domestic market is expected to grow with retail sales to consumers and sale of capital goods recording growth of 12% and 8.3%, respectively. In **South Korea**, growth is expected to moderate at 6% (1996: 7.1%). The slowdown of the economy partly reflects the effects of economic problems such as slowing wage rises, strikes over labour reforms and the increasing number of corporate debt defaults which have dampened consumption and corporate investment. Corporate failures in early

1997 and the subsequent debt defaults resulted in instability in the financial community and had slowed down investment. Financial institutions had, however, tightened their credit lines. Confidence improved in the second half of 1997, boosted by rising exports following higher prices of key export items, such as semiconductors, steel and petrochemical products. **Taiwan** will continue to enjoy rapid economic growth of about 6.2% in 1997 (1996: 5.7%), based on continued private consumption growth, increases in gross domestic investment and a steady rise in the export sector. In June 1997, industrial output rose at an annualised rate of 5.3% while export orders rose by 6%. The services sector is forecast to continue its brisk expansion in 1997 at 7.5%. **Hong Kong, China's** performance continues to be impressive as the changeover to China sovereignty has proceeded smoothly. Buoyed by rising property and stock prices, private consumption expanded rapidly while investment spending also benefited from increased construction activity. Growth for 1997 is estimated at 5.3% (1996: 4.9%), boosted mainly by a positive contribution from the external sector and a robust recovery in domestic demand.

Table 3.3

North East Asia: Gross Domestic Product, Inflation and Current Account Balance

	1996	1997 ^e	1998 ^f
Gross Domestic Product Growth (%)			
China	9.7	9.5	10.0
Hong Kong, China	4.9	5.3	5.0
South Korea	7.1	6.0	6.0
Taiwan	5.7	6.2	6.4
Inflation Rate (%)			
China	6.1	4.5	4.0
Hong Kong, China	6.0	7.1	6.5
South Korea	5.0	4.5	4.1
Taiwan	3.1	2.8	3.4
Current Account Balance (US\$b)			
China	3.9	2.5	- 9.4
Hong Kong, China	- 1.1	- 2.2	- 0.4
South Korea	- 23.7	- 20.0	- 17.3
Taiwan	10.5	9.9	9.4

^e Estimate

^f Forecast

Sources: National sources, IMF World Economic Outlook September 1997.

Inflation

Inflation in the North East Asian economies as a whole is expected to moderate, ranging from 3%-7%. Inflation in **China** is expected to moderate to 4.5% in 1997 (1996: 6.1%), due to higher food supplies following successive bumper grain harvests, as well as reflecting the tightening of credit to state owned enterprises. Inflation in **South Korea** is forecast to fall back to 4.5% (1996: 5%) as aggregate demand pressures continue to soften, import prices remain stable, and upward pressure on wages diminishes. The inflation rate in **Taiwan** is expected to be 2.8% (1996: 3.1%). Inflationary pressure has been minimal as increases of the average monthly earning in manufacturing did not exceed consumer price inflation. An oversupply of job applicants in the service sector has also dampened upward pressure on wages, helping to keep inflation at a low level. In **Hong Kong, China** inflation was suppressed sharply in the first half of the year by declining food prices, with the CPI at 5.9%. The inflation rate is likely to edge higher with stronger domestic activities in the second half. For the whole of 1997, inflation is forecast at 7.1% (1996: 6%).

Trade and Balance of Payments

The trade performance of North East Asia is expected to be generally good, boosted by surges in export in the second half of 1997. The current account position is, however, mixed with China and Taiwan recording surpluses while Korea and Hong Kong, China continuing to incur deficits.

Trade developments in **China** during the first half of 1997 point to a continued strong position in the merchandise account. The trade surplus for the first eight months widened to US\$25.5 billion. Exports had increased by 24.1% compared with the same period last year while imports rose only 1.5%. The current account is expected to remain in surplus at 0.3% of GDP in 1997. In **South Korea**, with export growth being more sustained during the second half of 1997, accompanied by a moderation in imports, the current account deficit is likely to be reduced to slightly below US\$20 billion (1996: US\$24 billion). In **Taiwan**, strong export growth will bring about a further rise in the merchandise trade surplus to around US\$19 billion in 1997 (1996: US\$18.1 billion). However, a weaker surplus on incomes and a higher deficit on services and current transfers will curb the current account surplus to US\$9.9 billion in 1997. **Hong Kong, China's** exports, which had a relatively moderate performance in early 1997, are expected to pick up following increased demand by China for raw materials for outward processing and U.S. demand for imports. The current account will continue to be in deficit at US\$2.2 billion (1996: -US\$1.1 billion).

Other Developing Countries

Output

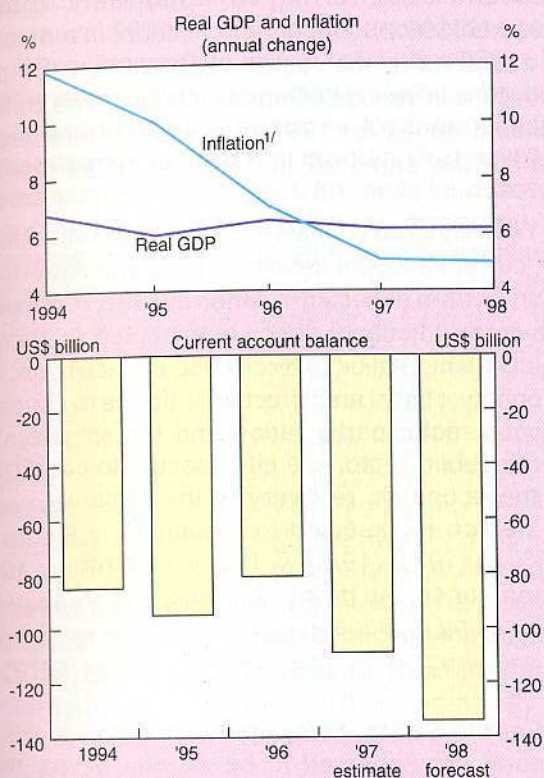
Overall growth in other developing countries from South Asia, Latin America, Africa and the Middle East is expected to moderate slightly in 1997. The decline in the growth rates is largest in the case of Africa from 5.2% in 1996 to 3.7% in 1997, while changes in the other regions are less marked. In the **South Asian** region, overall growth rates will be lower than in 1996, primarily on account of a significant slowdown in **Pakistan** in the wake of last year's balance of payments crisis and subsequent adjustment measures.

Pakistan is expected to record a growth rate of 3.1% in 1997 (1996: 5.1%). In **India**, with agriculture performance benefiting from a favourable monsoon, growth for 1997 is projected at 6.6%. In **Sri Lanka**, with the end of the drought and the power shortages, growth which had declined to 3.8% in 1996 is expected to recover to 6% in 1997. Growth in **Bangladesh** is expected to reach 5.7% in 1997 due partly to an increase in agricultural production.

Growth in the **Latin American** economies is projected to reach 4.1% in 1997 (1996: 3.4%). The implementation of disciplined financial policies, adoption of fiscal and structural reforms to increase private sector participation and reduce the size of the public sector are all expected to contribute to the economic recovery of the region. Growth in **Mexico** is expected to remain fairly strong at 4.5% in 1997 (1996: 5.1%) with strong export performance and pickup in foreign capital inflows. The easing of monetary policy in 1997 is expected to help the recovery of domestic demand as well as encourage growth. **Argentina** is likely to be the fastest growing economy in Latin America. GDP is estimated to increase by 6% in 1997 (1996: 4.4%) reflecting continued progress with reforms, the environment of stable prices and associated gains in private sector confidence. **Brazil's** economy is targetted to expand by 3.5% in 1997 (1996: 2.9%) reflecting the success of the Real Plan launched in July 1994. Sharp decreases in inflationary pressures together with the privatisation of Brazil's state-owned enterprises which encourage direct and portfolio investment are expected to contribute to its growth. **Venezuela's** economy is set on a recovery path with GDP projected to grow at 3.7% in 1997 (1996: -1.6%). The recovery is expected to be largely due to high levels of foreign investment. In **Chile**, however, further slowdown in growth rate to 5.5% is expected in 1997 (1996: 7.2%) as a result of higher interest rates and sharp deterioration in terms of trade due to weaker exports.

Average growth for the **Middle East** region is expected to be maintained in the 4%-5% range in 1997, despite a slight decline in oil prices. Tighter fiscal policies, more prudent monetary policies and successful implementation of structural reforms have provided the foundation for improved macroeconomic performance in the region. The

Chart 3.3
Developing Countries - Major Economic Indicators



1/ Median estimate

Source : IMF World Economic Outlook, September 1997

strongest expansions are taking place in **Egypt**, the **Islamic Republic of Iran**, **Jordan**, **Lebanon**, **Turkey** and **Yemen**, with growth rates in 1997 projected to be in the 5%-7.5% range. In **Saudi Arabia**, economic growth is expected to slow down to 1.8% in 1997 compared with 2.4% in 1996, owing to expectations of lower energy prices.

In **Africa**, growth is projected to weaken to 3.7% in 1997 following the relatively encouraging outcome of 5.2% in 1996. The reversal was mainly the result of severe drought in much of North Africa and political uncertainties in some countries. Output in **Morocco**, **Algeria** and **Tunisia** have been adversely affected. In **Nigeria**, despite a slower-than-expected recovery in industrial output, growth will show a slight increase to reach 3.6% in 1997 (1996: 2.4%). In **South Africa**, the economy is expected to slow down to 2.2% in 1997 compared to 3.1% in 1996. In **Kenya**, the outlook is less favourable with growth expected to decline to 3.5% (1996: 4.2%). Elsewhere in Africa, the CFA franc zone countries will see continued recovery following implementation of stronger macroeconomic and structural policies while in countries of **sub-Saharan Africa**, growth is expected to remain in the 5%-5.5% range.

Table 3.4

Developing Countries: Output, Inflation and Current Account Balance

	1996			1997 ^e			1998 ^f		
	Real GDP (%)	Inflation ¹	Current Account Balance ²	Real GDP (%)	Inflation ¹	Current Account Balance ²	Real GDP (%)	Inflation ¹	Current Account Balance ²
Developing Countries	6.5	13.2	-81.0	6.2	10.0	-109.0	6.2	8.9	-134.0
By region									
Africa	5.2	25.0	-9.0	3.7	14.8	-9.0	5.0	7.9	-11.0
Asia	8.2	6.6	-42.0	7.6	5.8	-42.0	7.4	5.9	-42.0
Latin America	3.4	20.5	-38.0	4.1	13.5	-63.0	4.4	10.3	-80.0
Middle East	4.8	24.8	8.0	4.6	22.1	6.0	4.2	24.2	-1.0

1 Consumer prices-weighted average

2 US\$ billion

e Estimate

f Forecast

Sources: IMF World Economic Outlook, September 1997

Inflation

Within the **South Asian** countries, inflation is expected to remain moderate at 7.1% in **India** (1996: 7.3%) although the large fiscal deficit remains a risk factor for inflation. In both **Pakistan** and **Bangladesh**, inflation is expected to rise to 11.2% and 4.9% in 1997 from 10.4% and 3.9% in 1996, respectively. With improvement in food supplies, inflation in **Sri Lanka** is expected to subside to single digit in 1997 compared with the inflation rate of 15.9% in 1996.

Inflation in most **Latin American** economies has fallen to exceptionally low levels through the pursuit of prudent fiscal and monetary policies. In 1997, the inflation rate for the region is expected to decrease further to 13.5% (1996: 20.5%) with Mexico at 21.4% (1996: 34.4%); Brazil at 8% (1996: 11.1%); Chile at 6.1% (1996: 7.4%). Argentina's prices are expected to remain relatively stable at 1.1% (1996: 0.2%) while the inflation rate for Venezuela is projected to decrease substantially to 47.1% (1996: 99.9%).

In **Africa**, substantial improvement is expected with inflation declining from 25% in 1996 to 14.8% in 1997. The majority of the countries will experience a slowdown in inflation with countries like Cameroon and Algeria, recording impressive results and others like Cote d'Ivoire, Tunisia, Morocco and Uganda maintaining a low level of inflation. In **Nigeria**, inflation remains high although easing to 18% in 1997 from 29.3% in 1996.

Inflation in the **Middle East** region is expected to remain steady, at 22.1% (1996: 24.8%). In **Turkey**, inflation is expected to remain at 79% (1996: 82.3%). In **Jordan**, inflation is expected to decline to 4% (1996: 6.5%), while in **Kuwait**, inflation continues to remain very low at 1.2%. In **Saudi Arabia**, the government's commitment to maintain the value of the rial and to reducing liquidity will ensure underlying long term price stability. Inflation is expected to decline even further to less than 1% in 1997 (1996: 1%).

Trade and Balance of Payments

The trade performance of this group of developing countries is expected to moderate in 1997. Exports from **Africa** are expected to grow

by 5.9% reaching US\$115 billion in 1997 (1996:US\$108.6). Imports will grow at a faster rate of 7.6%, rising to US\$106.7 billion (1996:US\$99.2). The current account in a number of countries in the region widened in 1996 due to decline in various commodity prices. The current account deficit for 1997 is, however, forecast to remain the same as in 1996, at US\$9 billion.

With significant capital inflows and growth picking up, current account deficits of the **Latin American** countries are expected to widen in 1997. In **Mexico**, the current account deficit is expected to worsen to of 1.8% GDP (1996: -0.6% of GDP) as the economy continues its growth. Similarly, current account deficits are also expected to widen in **Argentina** to 2.8% of GDP (1996: 1.9% of GDP), in **Brazil** to 4.6% of GDP (1996: 3.2%). However in **Chile**, the deficit in the current account is expected to improve to 3.4% of GDP in 1997 (1996: -4.1% of GDP). Similarly, in **Venezuela** the current account deficit is expected to improve to 6% of GDP in 1997 (1996: -9% of GDP).

For the **South Asian economies** as a group, imports are expected to be slightly higher than exports, resulting in a deficit in the balance of trade of about US\$17.4 billion (1996:-US\$16 billion). The current account deficit is however expected to remain at US\$2.6 billion, similar to that recorded in 1996. In the **Middle East**, external trade is expected to moderate in 1997. With the growth in imports outpacing that of exports, the balance of trade will dip to US\$21.3 billion from US\$26.2 in 1996. The current account surplus will also drop to US\$6 billion (1996: US\$8 billion).

Prospects for 1998

A strong expansion of the world economy expected in 1997 is forecast to continue in 1998 with output growth at 4.3%, a pace which might be sustainable for several years. In the medium-term, world GDP could rise 4.5% until 2002, compared with 3.75% in the years since 1970. In 1998, growth will mainly be driven by improved performance in developing countries and a stronger recovery in the countries-in-transition, even as growth in the industrial countries is forecast to slow down. Output in the **industrial countries** is forecast to moderate slightly in 1998 to 2.7% as growth in the US economy slows to a more

sustainable pace, while the negative effects of fiscal retrenchment in the EU which began since 1993 and in Japan since 1997 continue to restrain stronger economic activity. Economic growth in the **US** is forecast to reach 2.6% in 1998 with inflation forecast to rise slightly to 2.8%, reflecting the slowdown of the economy to a sustainable level attributable to a moderation in consumer spending and a slow down in business investment. Economic activity in **Japan** is projected to accelerate in 1998 to 2.1%, supported by continued improvement in labour market conditions and further increases in net external demand. Growth in the **EU** countries as a whole is forecast to increase by 2.8% in 1998 with average inflation of 2.2%, slightly higher than in 1997. Unemployment in the EU is projected to decline to 10.7% in 1998 from 11.1% in 1997, with jobless levels remaining close to post war peaks in Germany and France. Output in both **Germany** and **France** are projected to rise by 2.8% and 2.1%, respectively. Growth in both countries will again be driven by expansion of exports and strong private consumption which would support aggregate demand. Unemployment in Germany and France will drop marginally to 11.2% and 12.3% in 1998, respectively. Growth in the **UK** is forecast to moderate to 2.6% in 1998 following efforts to slow the economy down to a more sustainable pace. Further tightening in the labour markets which could trigger wage and demand pressures will cause the inflation to rise slightly to 2.7% in 1998.

The North East Asian economies as a group is projected to continue its high growth of between 7%-8% in 1998. **China's** economy is forecast to grow at 10% in 1998 attributed to tight monetary policy, the introduction of more flexible interest and exchange rates, as well as more stable prices following several bumper harvests. In **South Korea**, economic growth is forecast at 6% in 1998 although in the near term, growth is expected to slow down on account of weaknesses in the corporate and financial sectors. In **Taiwan**, GDP growth is expected to reach 6.4% in 1998 due to continued private investment growth and a steady rise in exports. **Hong Kong**, **China's** economy is expected to grow at a healthy rate of 5% in 1998. Any negative impact from measures taken by the new Special Administrative Region (SAR) government to cool the property market is likely to be modest.

The prospect for developing countries in 1998 remains broadly favourable against a background

of continuing growth in world trade and international capital flows. Growth for developing countries in 1998 is forecast at around 6%-6.5%. In **Africa**, growth is projected to recover to 5% in 1998. Even so, economic prospects remain uneven across countries. Countries as Cote d'Ivoire, Mali, Ethiopia, Senegal, Botswana, Malawi and Uganda will continue to benefit from implementation of stronger macroeconomic and structural policies. On the other hand, in **South Africa**, sustained reform and stabilisation will be required to enhance growth while in **Nigeria**, major structural reforms need to be put in place.

Economic growth in the **Middle East** is expected to be maintained at 4.2%, with inflation remaining at a steady rate. Adherence to policies of macroeconomic stabilisation and structural reforms has put the countries on a sound footing to meet economic challenges in the near and medium term. With tighter fiscal policies, progress toward fiscal consolidation has been strong, particularly among the oil exporting countries. Efforts will continue to be made by these countries to diversify production base and encourage greater participation by the private sector in petroleum refining and petrochemicals. In **South Asia**, growth is projected at 6.8%, with **India**, **Pakistan** and **Bangladesh** all expected to sustain and improve their growth performance on the back of mutually reinforcing fiscal measures and structural reforms.

Economic growth in the ASEAN economies is expected to improve to 7.5% in 1998, resulting from measures to restore confidence in the economic fundamentals in the region. Inflation is expected to be kept at a manageable level of 6.2% with continued tight monetary and fiscal policies. In **Brunei**, growth is projected to accelerate to 5% as the government proceeds to intensify its diversification efforts. Inflation will remain at below 3% in 1998. **Indonesia** is forecast to continue its stable growth path at 7.7% in 1998 supported by higher export growth and high levels of investments. Inflation is targetted at 6.5% through a combination of tight monetary policy and a conservative budget. The **Malaysian** economy is expected to grow at a sustainable rate of 7.0% in 1998 with measures to strengthen macroeconomic stability and restore investor's confidence in the financial markets. In the **Philippines**, the GDP is projected to grow at 6.5% in 1998. Growth will emanate from the industrial and the services sectors. The inflation

rate is expected to pick-up to 7% in 1998. In **Singapore**, GDP growth is forecast to improve to about 7.5% in 1998, based on stronger prospects for the electronics sector as well as a projected buoyant growth of the services sector. Inflation is likely to remain stable at 2%. In **Thailand**, measures are being taken to deregulate and reform the financial sector, encourage the development of the financial institutions and instruments and foster savings growth. A slow recovery is expected in 1998 with GDP projected to grow at 3.5%. The aftermath of the currency crisis is expected to increase the inflation rate to 5% in 1998. The GDP in **Vietnam** is projected to grow at a moderate rate of 8.2% in 1998 with inflation at 11%.

In **Latin America**, with the improved economic fundamentals of the current recovery which started in mid 1996 and the continued fiscal and monetary restraint, a steady growth is expected to be maintained. Real GDP in 1998 for the region is projected to grow at 4.4%, with Mexico targetted to grow at 4.1%, Brazil at 4%, Chile at 6%, Argentina at 4.5% and Venezuela at 5%.

Issues in the Global Economy

While global outlook for 1997 and 1998 is generally favourable, there are some risks and fragilities which may affect world economic and financial conditions. The main areas of concern include the risk of **overheating, fiscal imbalances, uncertainties about the Economic and Monetary Union, the high structural unemployment in Europe** and the **globalisation of financial markets**. More closer to home was the Thai baht crisis which erupted in July 1997 and caused spillover effects on other regional economies.

Although in recent years, world inflation has subsided substantially to levels not observed since the early 1960s, price pressures could reemerge, especially in European countries that have reached almost full capacity in product and labour markets, as well as asset markets. The strong financial position of the corporate sector has resulted in very buoyant equity markets in North America and Europe. While this reinforces a positive outlook for capital investment, current prices in the stock markets are very high and in some cases not fully justified by underlying conditions. Therefore, should a major correction occur, especially if brought on

by rises in long-term interest rates in the United States, financial markets everywhere could be affected. This will have a knock-on effect on business confidence and investment in Japan and prospects of a stronger recovery in continental Europe. In Japan, such a situation could further aggravate an already weak banking system. In Southeast Asia, difficulties in the property sector could have resulted in a financial crisis in some countries if pre-emptive measures had not been taken at an earlier stage.

Fiscal imbalances seem to be the biggest threat to financial stability in almost all regions and most countries have therefore stepped up efforts to contain the fiscal deficits. Structural reforms would be needed to be implemented more broadly in all regions to avoid obstacles to full utilisation and efficient allocations of resources and to make economies more resilient to adverse developments. Among the industrial countries, labour market reform, privatisation and reduction in subsidies remain very high priorities.

The approaching deadline for the advent of single currency for the EMU has prompted the monetary authorities of the European countries towards tighter budgetary policies and easier monetary conditions. However, there are uncertainties and the related risks of tensions in the financial market as not all economies in Europe are on the same track. Most of the largest fiscal deficits is borne by the members of the European Union, including countries that have experienced the largest unemployment rates and weakest growth performances in recent years. The industrialised countries have had limited success in addressing their budget balance and structural unemployment rates which continue to remain very high in many countries. It is expected that only 11 countries will join the EMU by 1 January 1999. The introduction of the euro would have implications for trade, investment and reserves management in the rest of world, especially with the evolution of a tripolar international monetary system, the foreign exchange market and risks associated with reserve management due to a reduction in the types of currency available internationally.

High structural unemployment remains a major problem in the EU. It has been attributed to a variety of labour market laws such as high unemployment benefits, too high minimum wages

and restrictive rules concerning hiring and firing together with high payroll taxes which have had the effect of discouraging both employers from hiring workers and workers from actively seeking jobs. The weakness of employment growth since several years is likely to persist and unemployment is projected to remain above 11% in 1997, compared to the overall industrial country's rate of about 7.5%. Several EU countries have made attempts to reform their labour markets, but have had limited success in reducing unemployment, largely due to the reluctance of key EU countries including Germany, France and Italy to comprehensively restructure their labour markets. However, in some other EU countries, unemployment has declined significantly, notably in the UK, Netherlands, Denmark and Ireland as a result of the comprehensive reforms introduced, beginning in the early 1980s. Persistent high unemployment rates in Europe have continued to push and politicise labour and welfare issues on to the international trade agenda.

The globalisation of financial markets and strong push for further liberalisation and deregulation in Eastern Europe, Latin America and Asia (including Korea and Japan) in the last four years, while bringing many benefits, have also in several cases exposed fragile financial systems and poorly developed prudential regulatory and supervisory systems. Though the impact on trading and financial relationships varied considerably in the affected countries, financial crisis in Mexico, Brazil, Japan, Korea, the Czech Republic and Thailand over the 1994-97 period have not only caused disruptions in domestic and regional financial markets, but

in several cases, have spilled into markets abroad thereby posing broader systemic risks.

The severe downward pressure on the baht in Thailand since mid-May 1997 caused significant spillover effects on the other economies in the region, notably Indonesia, Malaysia and the Philippines. As in the Mexico crisis, this demonstrates the tendency for a crisis in one country to have contagion effects on other countries where risk factors are perceived as being present. These episodes of foreign exchange market pressures also led to negative pressures on the equity markets in the region. To ensure international monetary stability, efforts are now underway in various international and regional fora to put in place a network of cooperative arrangement, including improving supervisory and regulatory capacity.

The importance of promoting good governance is a priority for several international financial organisations, including the IMF, World Bank and the OECD. The focus on good governance is related to efforts by countries to maintain private sector confidence considered essential for sustained economic growth. Good governance encompasses improvements in management of public resources, including reform of treasuries, budget preparation, tax administration, accounting and audit procedures and the creation of a transparent and stable economic and regulatory environment. Governance issues will now be taken into account during Article IV Consultations as well as in IMF's relations with countries borrowing money.

FEATURE ARTICLE 1

Financial Issues in the Global Economy

Introduction

Significant changes are taking place in the global economy brought about by the liberalisation and globalisation of finance, trade, technology and information flows. While these changes have spread benefits and opportunities, a significant number of countries remain marginalised. In the case of those developing countries that have opened up to the twin forces of globalisation and liberalisation, the rewards have been increasing flows of investment, trade and technology. At the same time, globalisation has brought certain types of risks with potentially negative consequences for development. The loss of policy autonomy in some policy areas and instability and disruptions resulting from financial openness have sometimes required difficult macroeconomic adjustments at the individual country level. On the other hand, it has given substantial impetus to the promotion of sound policies and fostered stronger regional and international cooperation.

International and Regional Efforts to Strengthen the Stability of the Global Financial System

The force of globalisation has increased the risks of systemic contagion and in this connection, efforts to foster global financial stability have received strong support in various regional and international fora. The Group of Seven Industrialised Countries (G7) and the Group of Ten Advanced Countries (G10) for instance, have drawn up measures to enhance the soundness of their financial systems. To ensure that their efforts to promote financial stability enjoy the support of a wider international community, the G10 and a number of emerging market economies - Argentina, Hong Kong China, Indonesia, Korea, Mexico, Poland, Singapore and Thailand - set up a Working Party to develop a concerted strategy outlining the main elements of robust financial systems: sound macroeconomic and structural policies; solid legal, accounting and market infrastructure; effective corporate governance and market discipline; and sound supervisory and regulatory systems. The Working Party also recognised the role of international supervisory

groupings, international financial institutions and market channels for assisting national authorities in strengthening their financial systems.

International cooperation in promoting financial stability advanced another step when the Basle Committee on Banking Supervision of the Bank for International Settlements (BIS) worked closely with the supervisory authorities in emerging economies to develop a set of "Core Principles for Effective Banking Supervision". Enhancing the financial system is also a priority of the Asia Pacific Economic Cooperation (APEC) fora. The Core Principles are now being studied by APEC with a view to adopt and apply them at the level of individual member economies. At the international level, the Interim Committee of the International Monetary Fund (IMF) has expanded the mandate of the institution to include surveillance of financial institutions in member countries. In the World Bank and in the Asian Development Bank, enhanced banking supervision as well as guidelines on governance issues will henceforth form part and parcel of new lending programmes.

Among several Asian and Pacific countries, cooperation in the area of financial sector supervision is also gaining momentum. The Executive Meeting of East Asia and Pacific Central Banks (EMEAP) hold regular meetings to review means of strengthening cooperation to enhance financial stability, including sharing information, techniques and experiences to upgrade the technical understanding of banking supervision issues. In the capital market area, the International Organisation of Securities Commissions or IOSCO, is drafting guidelines to promote exchange of information in emergency situations, enhancing cooperation between supervisory authorities and harmonising regulations in response to the internationalisation of securities markets. The globalisation of insurance business has also provided the basis for efforts of the International Association of Insurance Supervisors or IAIS, to develop international standards for insurance supervision.

Finance Ministers of the Association of South East Asian Nations (ASEAN) at their inaugural meeting in Phuket, Thailand on 1 March 1997 recognised the need for regulators and supervisors to keep pace with developments in the marketplace and agreed in March 1997 that the national and regional infrastructure for supervising and regulating financial institutions and markets be continually upgraded. Recognising that these

changes will affect the region, including to ensure that future shocks to the financial system are avoided in a timely manner, ASEAN central banks and monetary authorities have set up a Forum to examine ways and means to improve national supervision through greater information sharing and harmonisation of some supervisory practices at the regional level. In addition, Finance Ministers from Asia and Europe (ASEM-FNMM) at their first meeting in Bangkok, Thailand on 19 September 1997 agreed to improve arrangements for exchange of information on financial supervision and regulation, operation of financial markets, and management of payments systems thereby joining other regional and multilateral processes aimed at enhancing global financial stability.

Mitigating the Negative Effects of Freer Capital Flows

Capital flows have long been regarded as both a sign and a cause of economic success. It is now broadly accepted that an open and liberal system allowing freer flow of capital, supported by sound macroeconomic policies enhances economic welfare and prosperity in recipient countries. The sharp rise in capital flows to a number of developing countries is evidence of this recognition. Freer capital flows, especially foreign direct investments, have allowed many developing countries to draw on foreign savings, thereby accelerating their catch up process beyond what would be possible if these countries had to depend only on domestic resources. To sustain these flows, many developing countries are expected to continue with sustainable growth-oriented policies. However, as experienced by many developing countries in recent years, capital mobility can mean problems too.

Financial openness and freer cross-border flows of capital, especially round-tripping of short term capital by large global players have been found to strongly influence movements in asset prices. Entities such as hedge funds, can deploy massive leverage, increasing their capacity to take speculative positions. Excessive speculation by these entities, especially if done in concert with other important participants in the global financial markets, can endanger a country's financial system, and as shown in the Mexican and Thai cases, can also rapidly lead to a contagion effect impacting entire groups of countries. To protect emerging economies from excessive currency speculation, Malaysia has proposed that the IMF take action

to control the activities of unscrupulous market traders. The IMF has been encouraged to examine the feasibility of introducing a system of ethical standards that could be adopted by such market players as well as help national authorities to better supervise 'abusive' speculation.

This proposal is based on the fact that cooperative international action is essential to reinforce sound domestic policy measures which are taken to mitigate the negative effects of freer capital flows. Funding arrangements such as the ASEAN Swap Arrangements or the IMF's New Arrangements to Borrow (NAB) or the multi-billion-dollar networks of swaps among Asian Central banks will continue to be essential elements of closer international cooperation. An excellent example of effective cooperation between Asia and the IMF was demonstrated in the financial package for Thailand in August 1997. To build upon this unique example of regional solidarity, nine Asian countries, the United States and the IMF will discuss the setting up of an Asian Standby Facility.

To bolster market confidence in individual economies, increased transparency is vital as timely and accurate economic information will improve the functioning of markets. This would also provide a basis for more effective early warning systems intended to help avert a crisis or at least contain the fall out when it does happen. An important step towards greater transparency and disclosure has taken shape in the form of the IMF's Special Data Dissemination Standard (SDDS). In ASEAN, important steps were taken towards transparency in March 1997 when Finance Ministers underscored the need to raise the existing spirit of cooperative dialogue on economic and financial matters to a higher level of mutual surveillance. The computerised information network linking the 18 APEC member economies since April 1997, is another useful supplement towards greater transparency of economic and financial information among its members economies. The ASEM-FNMM also agreed to study the development of a framework for establishing a computerised communication network among the Finance Ministers to facilitate improved information sharing about macroeconomic and financial developments and policies. All these efforts are in recognition of the fact that financial openness and accountability of policy making, and of transparency to achieve policy credibility and confidence building, would be greatly reinforced by promoting a code of good practices. Rules should not only apply to governments, but also to capital market participants.

Liberalisation of the Capital Account

The world economy has generally benefited from an open and liberal system of capital movements. In September 1997, the Interim Committee of the IMF agreed that the institution's Articles of Agreement be amended to remove capital controls. The promotion of liberalisation of capital movements would be carried out in an orderly manner, properly sequenced and tailored to the capacity and circumstances of individual countries. Developing countries in particular, have been concerned about the ability to employ certain kinds of short-term controls in situations where the integrity of the domestic financial system is in danger of being destabilised. Using prudential-based controls would be appropriate in such circumstances.

Combatting Financial Crimes: Fraud and Money Laundering

Following the rapid rise in the number of financial centres in the world, money laundering has become a serious issue that concerns not only the members of the Organisation of Economic and Development Cooperation (OECD), but also between APEC economies and the newly established ASEM-FNMM. Money laundering can pose a threat to the financial integrity of countries and the fight against this crime is being spearheaded by the OECD's Financial Action Task Force (FATF). Several countries in Asia are now members of the FATF, or have taken steps to adopt the Forty FATF Recommendations on tackling money laundering.

The European Single Currency

From 1 January 1999 a large part of the European Union (EU) will have a single currency, the euro. As the Economic and Monetary Union (EMU) will create one of the world's largest economic areas, ASEAN Finance Ministers have been following with interest developments in the EU as it progresses towards monetary union, noting that the euro will assume a key role (other than the dollar and the yen) as a global currency for trade, investment and reserves management. Finance Ministers from Asia discussed these issues with their counterparts at the First Asia-Europe Finance Ministers Meeting noting the determination of the EU to ensure a smooth and orderly transition to the euro. The Ministers further agreed that

every opportunity will be offered within the framework of the International Financial Institutions, bilateral contacts, and interregional discussions to keep the Asian side fully informed about the implications for the financial markets of the forthcoming introduction of the euro.

Financing Infrastructure Development

In recent years, the rapidly growing infrastructure investment needs of Asia have increasingly exceeded the financing capability of governments. Private financing is being sought from both domestic and foreign sources to meet this huge financing need. In addition, there is recognition of the fact that private sector involvement can improve the quality and efficiency of infrastructure provision. APEC Finance Ministers recognised that investment and financing constraints in several economies have limited the active involvement of the private sector in infrastructure development. They also recognised the crucial roles of well developed domestic financial and capital markets in mobilising and making available long-term capital for infrastructure. To stimulate private sector participation in infrastructure development and to promote the development of capital markets, the Ministers agreed on a set of voluntary principles. These are: sound macroeconomic environment; stable and transparent legal framework and regulatory systems; sectoral policies that promote competition; and well-developed market infrastructure.

Conclusion

Due to the linkages between stability of international financial system and macroeconomic policy, as well as the potential for spillover effects in an environment of globalised and innovative financial and capital markets, Ministers, policy makers, regulators, supervisors and market participants have been increasing their vigilance on these issues not only within the domestic context but also in the relationships between and among countries. In short, while responsibility for policies rested in the first instance with national authorities, the influence of trends and developments in the international financial system on macroeconomic management cannot be disregarded. International action and cooperation can forestall or deal with threats to the stability of the system, thereby fostering welfare in the new global economy.