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International Economic Survey

Overview

Global economic and financial conditions have improved significantly after two years of economic and financial turbulence in emerging markets and a marked slowdown in the world economy. In the industrial countries, accommodating policies, low inflation, buoyant equity markets and relatively strong employment in key developed economies have contributed to domestic demand expansion and reduced the effects of external shocks from the financial crisis in the emerging economies. In the Asian emerging economies, sustained fiscal and monetary stimulus has helped spur demand growth with these economies recovering more strongly than expected. Financial markets have settled, and capital flows have resumed to a number of emerging markets. The economic downturn in Russia and Brazil has leveled off. International oil prices have recovered from their lows at the end of 1998 while declines in the prices of other commodities have been contained. In 1999, world output is expected to grow to 3% from 2.5% in 1998. The advanced countries are expected to register a growth rate of 2.8% in 1999 (1998: 2.2%), while the developing countries are expected to recover gradually from the sharp deceleration in 1998 to reach a growth of 3.5% (1998: 3.2%). Meanwhile, the countries-in-transition are expected to return to a positive growth rate of 0.8% from a contraction of 0.2% in 1998.

World inflation has been brought to its lowest level in 40 years, declining to about 5% in 1999 (1998: 5.8%). In the advanced economies, inflation remains subdued and is expected to decline marginally to 1.4% in 1999 from 1.5% in 1998, while in the developing countries inflation is likely to decrease significantly to 6.7% (1998: 10.3%). The countries-in-transition can, however, expect

a further rise in the inflation rate to 39.3% (1998: 20.9%), through price effects associated with exchange rate weaknesses.

World Trade Growth

Depressed domestic demand in the crisis-affected countries, lower growth in some key industrial economies and excess capacities will continue to restrain **global trade** to 3.7% in 1999 (1998: 3.6%). Imports of the advanced economies are expected to grow moderately to 5.9% (1998: 4.8%), with the United States continuing to absorb a substantial amount of imports, including from Asia. With the economic situation looking brighter for Japan, and a strengthening of growth in Europe, import trends will gradually rise, albeit modestly. Exports of the advanced economies, on the other hand will decline to 3% (1998: 3.3%).

Imports of the developing countries are expected to rise modestly to 1.1% following a contraction of 1.3% in 1998. Exports are expected to decline to 2.4% (1998: 4.9%). Asia's recovery will lead to a significant rise in import growth. Exports will continue to make a strong showing due to sustained improvements in competitiveness, bottoming out of commodity prices and continuing demand from North America. On the other hand, difficulties faced by Russia and Brazil in particular will have adverse effects on their neighbouring countries in terms of trade between and among them.

International Financial Flows

Net private capital flows (comprising net direct investment, net portfolio investment and other short-term and long-term net investment flows) to emerging market economies are projected to remain low in 1999 at US\$68.3 billion

(1998: US\$66.2 billion), that is one-third of the highest level achieved in this decade at US\$214 billion in 1996. There are some signs of confidence returning to emerging markets and a pickup in private capital flows to US\$118.5 billion is projected for 2000, notwithstanding the increased caution of financial institutions following the recent financial crises and Y2K problems that could limit market access to borrowers.

Net flows to emerging Asia will continue to remain negative at around US\$30 billion in 1999. This is however an improvement when compared to the negative balance of US\$44.3 billion in 1998. Outflows are however projected to balance inflows in 2000. Net inflows to **Latin America** are expected to decline to US\$47.2 billion in 1999 (1998: US\$73.8 billion) but rebound considerably in 2000 to US\$63 billion.

World foreign direct investment (FDI) which increased by 39% in 1998 to reach US\$644 billion, is expected to remain the major source of private capital flows to emerging markets in 1999. The increase was largely due to a substantial increase in cross-border mergers and acquisitions among developed country firms. FDI flows to developing countries declined from US\$173 billion in 1997 to US\$166 billion in 1998 and is projected to fall further to US\$103 billion in 1999 as direct investment in China and Brazil moderates.

FDI flows into **East, South and Southeast Asia** in 1998 registered US\$77.3 billion compared to US\$88 billion in 1997. The growth momentum of FDI into most of South Asia, particularly India, was not maintained in 1998. The financial crisis had a significant impact on FDI flows to countries in Southeast Asia as evidenced by the substantial reduction of inflows to Malaysia, Singapore and particularly Indonesia from US\$19.5 billion in 1997 to US\$10.5 in 1998. In contrast, rising levels of mergers and acquisitions have resulted in higher inflows to **Thailand** at US\$7 billion, an increase of US\$3 billion from 1997.

Korea received its largest volume of FDI inflows at US\$5.1 billion in 1998 (1997: US\$2.8 billion) on account of a more liberal policy towards foreign investment and corporate sales of assets. **China** accounted for well over half of total FDI in the region in 1998 at US\$45.5 billion. Regional investment in China is declining, however, and direct investment is expected to fall to around US\$30-US\$35 billion in 1999.

FDI inflows into **Latin America** and the **Caribbean** exceeded US\$71 billion in 1998, a 5% increase over the previous record set in 1997. Private capital flows increased by 53% or US\$29 billion to Brazil. FDI flows into the **Russian Federation** fell drastically in 1998 from US\$6 billion 1997 to US\$2 billion as creditor banks and other investors scaled back drastically their financial exposures given poor sentiments over macroeconomic policy. FDI inflows into other **Central and Eastern European countries** however, reached a new level, increasing to US\$16 billion in 1998 from US\$13 billion, as businesses become confident about prospects for a majority of these countries to reach agreement with the European Union (EU) about membership.

Financial Markets

In the financial markets in **industrial countries**, long-term interest rates have risen significantly in 1999. US government bond yields firmed through June on concerns that continued strong growth would prompt tightening of interest rates. Subsequently, federal funds rates were raised twice; in June and August 1999 by 25 basis points each to 5.25% and the discount rate was increased by 25 basis points to 4.75%. Long-term interest rates were also raised in Germany and **France** by over 100 basis points to around 5.00%, in line with US rates increases and some strengthening of activity in the euro area, while in the **United Kingdom** short-term interest rates were raised in September 1999 by 0.25 percentage point to 5.25% to keep inflation below the target level of 2.5%. Equity markets peaked around mid-July, reaching new all-time highs in some cases, but have since weakened. In foreign exchange markets, the Japanese yen rose sharply, and the euro less so, from mid-July to mid-August 1999 on perceptions that economic activity in Japan and the euro area would become relatively stronger than in the United States.

In the **Asian financial markets**, short-term interest rates have dropped considerably below pre-crisis levels by end-August except in Indonesia, where they remain at around the July 1997 level. In Hong Kong SAR, Korea and Singapore, short-term interest rates have firmed somewhat since lows in April, and in Korea long-term interest rates have risen even more. In foreign exchange markets, the Indonesian rupiah had appreciated strongly since early 1999, reflecting progress with

reform measures but has subsequently depreciated due to problems in the banking sector. The appreciation of the Korean won has been limited, reflecting official intervention and corporate sector difficulties. Equity markets, moved up strongly from January to early-July 1999, with the largest gains in China (140%), Indonesia (80%) and Korea (75%). Equity prices have since then fallen in all markets, partly in response to rising US interest rates. In the **emerging markets**, sentiment continued to improve until May 1999, but has since deteriorated somewhat primarily on concerns about higher US interest rates. Gross market financing flows have fallen and the outlook for capital markets access for lower rated emerging market borrowers may remain difficult in the rest of 1999.

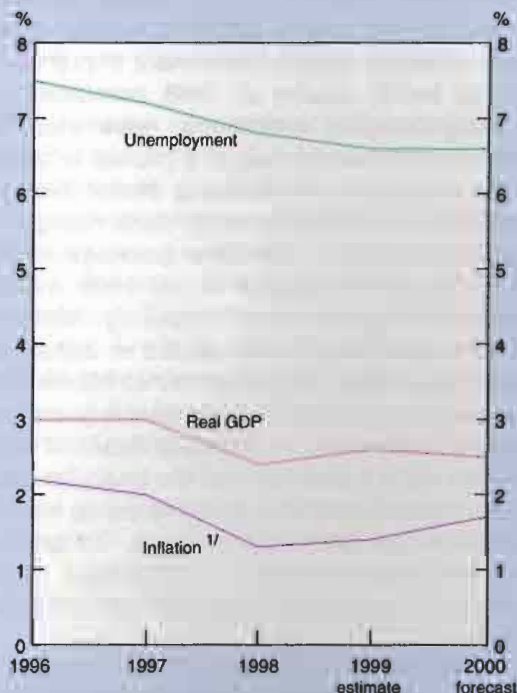
Economic Situation in Industrial Countries

In the **United States (US)**, economic expansion was stronger than expected and has continued into its ninth year. Output has been driven mainly by strong domestic demand, particularly in business investment and household consumption, supported by buoyant equity prices. Real domestic consumption expenditures have demonstrated extraordinary strength owing to rapid income growth, rising wealth and declines in interest rates in 1998 and early 1999. Residential construction and housing markets remain strong, while commercial real estate markets have been relatively tight. However, the momentum of the US economy is expected to slow down marginally in 1999 as business investment respond to low capacity utilisation in manufacturing, residential construction tapers off and spending moderating due to waning wealth effects and increased interest rates. Real GDP growth in 1999 is expected to moderate slightly to 3.7% (1998: 3.9%).

Despite a tight labour market, inflation development in the US has been mixed. Generally, gains in labour productivity and growth in manufacturing capacity have managed to contain price increases. Consumer price inflation for 1999 is expected to rise to 2.2% (1998: 1.6%).

Robust economic activity in the US has produced tight labour markets, edging down the unemployment rate to 4.3% in the first half of

Chart 3.1
Industrial Countries -
Major Economic Indicators



1/ Consumer prices

Sources: IMF World Economic Outlook, September 1999
and national sources

1999, the lowest in almost thirty years. Labour demand has remained very strong especially in the services sector, with widespread labour shortage experienced in the construction, computer and information technology, retail trade and agriculture sectors. Employment and wages in the manufacturing sector however, began declining since 1998 as export demand weakened. The unemployment rate in 1999 is expected to drop slightly to 4.3% (1998: 4.5%).

The current account deficit had widened in 1998. Given the lagged impact of the financial crises in emerging markets, demand for US exports is expected to be low due to continued weakness in demand from its major trading partners in Asia, as well as, from Latin America and Japan. Consequently, in 1999, the current account deficit of the US is expected to widen even further and to reach US\$316 billion or 3.5% of GDP (1998: -US\$221 billion or 2.6% of GDP).

After five consecutive quarters of decline, signs have emerged in **Japan** that the slowdown in economic activity has bottomed out. The economy has stabilised and by the third quarter, business confidence and market sentiment have turned around. Massive public investment implemented since the fourth quarter of 1998, combined with improving financial conditions, have stabilised private demand and brought a pickup in output. The contraction in the housing sector has also halted, with the rate of housing starts rising since the second quarter. The fiscal package totaling 500 billion yen introduced in mid-1999 will also support employment and retraining. Monetary conditions continued to be eased in Japan with interest rates effectively at zero since March 1999, thereby supporting credit intermediation and relaxed financing constraints. To expedite financial sector restructuring, a framework for the financial sector which includes financial support for ailing financial institutions has been put in place. To promote corporate restructuring, a package of tax and regulatory measures was announced in July 1999.

While macro-policies have remained supportive, and bank recapitalisation has eased financial sector constraints, business investment is not expected to recover significantly, as firms still suffer from excess capacity. Consumer confidence could still be fragile as household incomes continued to be affected by stagnating incomes and employment cutbacks. In 1999, real GDP is expected to rise to 1% after a contraction of 2.8% in 1998.

Consumer prices have been edging down substantially since 1998 and Japan is expected to experience deflation reaching 0.4% (1998: 0.6%). The unemployment situation remains severe by Japanese standards. With restructuring and restrained capital spending by corporations, the unemployment rate is expected to reach 5% in 1999 (1998: 4.1%).

Export volumes declined throughout 1998 and into a large part of 1999 as trade with Asia slows down. Exports to other parts of the world have similarly waned. However, export growth is still expected to remain broadly stable with imports showing a gradual increase following a significant contraction in 1998. The current account surplus is expected to widen slightly to US\$143 billion or 3.4% of GDP (1998: US\$121 billion or 3.2% of GDP).

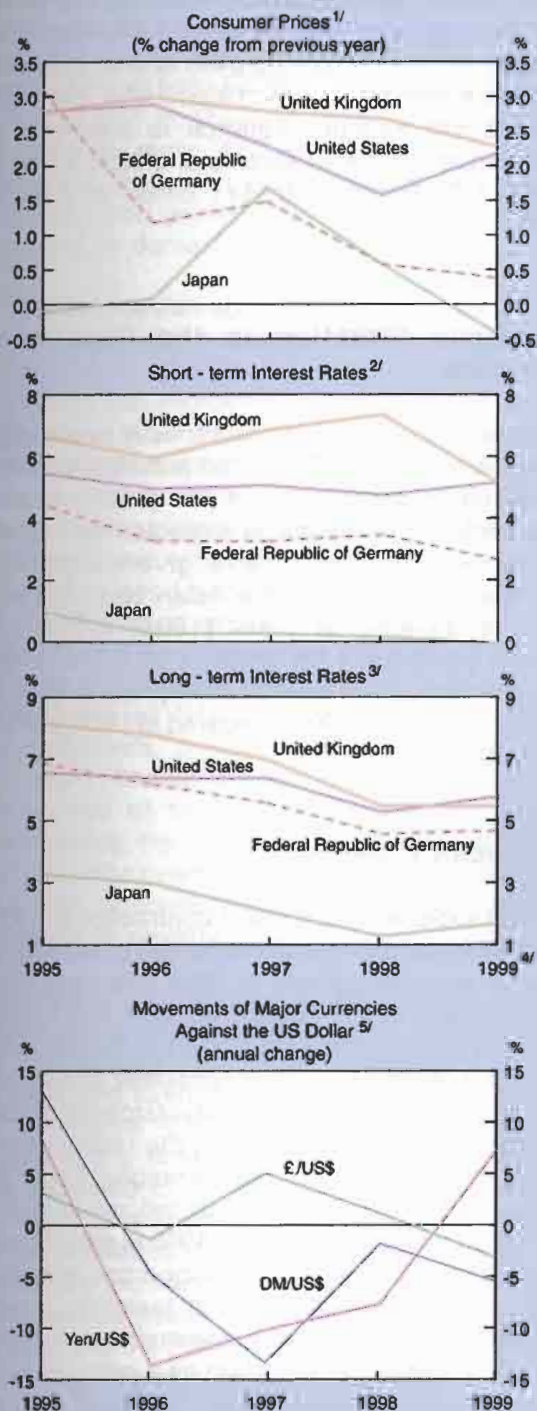
In much of the **European Union (EU)**, growth have begun to accelerate owing to a revival of consumer confidence and improving business sentiment. As imports from the crisis-affected countries increase, a gradual recovery in export markets has also been felt. Real GDP is estimated to moderate to average 2% (1998: 2.7%), with the rate of inflation declining marginally to 1.3% (1998: 1.4%). The unemployment rate in the EU area has also been declining gradually due to labour market reforms, including changes to unemployment benefits, labour taxation systems and wage determination process, as well as relaxation in job protection legislations. It is expected that the new employment pact approved by the European Council would support national reform programmes thereby possibly inducing the level of unemployment to drop further to 9.1% (1998: 9.6%).

In the **United Kingdom (UK)** output which was almost flat in the first quarter of 1999, expanded by 0.6% in the second quarter driven by strong consumption growth and a better performance in the services sector. Stronger than expected consumption was however, offset by a significant decline in net exports and weaker investment, particularly in private business investment. Growth is expected to continue to rise slightly in the second half of 1999 as further growth in consumption together with the fall in inventories will indicate improvements in demand. Growth is expected to slow down to 1.1% (1998: 2.2%), as domestic demand gradually moderates and external demand weakens due to the strengthening of the pound sterling.

Inflation is expected to be contained at 2.3% in 1999 (1998: 2.7%) as monetary and fiscal conditions tighten and the pound sterling continues to strengthen. The recent economic situation together with intense price competition has resulted in a faster rise in employment particularly in the service sector. However, employment in the manufacturing sector is expected to fall significantly during the rest of the year thereby contributing to a marginal increase in the unemployment rate to 4.8% in 1999 from 4.7% in 1998.

UK's trade deficit is projected to widen further in 1999, due to a sharp drop in export volumes which is estimated to grow at only 0.4% (1998: 3.1%) compared to an import growth of 5.3% (1998: 8.4%). As the trade deficit continues

Chart 3.2
Current Trends in Key Economic Determinants
in Industrial Countries



1/ 1999 figures are estimates.

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

3/ Average yield on Government bonds.

4/ Up to July 1999

5/ End of period except for 1999, up to June.

Sources: IMF World Economic Outlook, September 1999 and other reports.

to widen against a background of weakening demand in major export markets notably Germany, the current account is expected to record a deficit of US\$19 billion or 1.3% of GDP. This compares with a surplus of US\$2 billion or 0.2% of GDP in 1998.

In Germany, economic activity remained slow in the first half of 1999, due to weak export demand associated with the crisis in emerging markets and stagnant investment activity. The latter has been adversely affected by uncertainty about tax reforms, thereby offsetting private and public consumption. Exports are expected to recover in the course of 1999, as world trade growth picks up, while investment activity is projected to improve as the government implements its fiscal consolidation and tax reform package. GDP growth is expected to be 1.4% (1998: 2.3%), reflecting a sharp weakening of external demand as well as slowdown in domestic demand due to lagged effects of the fiscal tightening and inventory drawdown by firms.

Although increasing energy taxes and rising wages, coupled with slower productivity growth are expected to translate into rising unit labour cost, inflationary pressure in Germany is very small and consumer price inflation is expected to remain subdued at 0.4% (1998: 0.6%). With GDP growth now slowing and some labour-shedding arising from wage pick-up, the strong employment growth recorded in the second half of 1998 is likely to stagnate in 1999. However structural unemployment is expected to improve marginally to 9.1% in 1999 (1998: 9.4%).

Germany's current account has been in deficit for almost a decade, reflecting mainly the economic costs of unification. For 1999, the current account deficit is expected to narrow to US\$0.2 billion, almost 0% of GDP (1998: -US\$4 billion or 0.2% of GDP). Export growth is expected to decline to 0.3% in 1999 (1998: 6.5%), due mainly to weak export markets, particularly in Asia and Russia. Import growth is projected to decrease to 2.6% in 1999 (1998: 8%), reflecting slowing economic activity.

In France, the economy recorded a slower growth in the first half of 1999 after recording the fastest growth for a decade in 1998. Output expansion is expected to moderate to 2.5% (1998: 3.2%), as industrial production slows down given

weaker demand from abroad. Inflation is expected to be contained at 0.5% (1998: 0.7%), due to increasing price competition, resulting from the launch of the euro, and by the gradual liberalisation of the EU utility market.

France still has the highest level of unemployment in EU. Despite a pick-up in domestic demand, particularly in the services and construction industries, the unemployment rate is only expected to decline slightly to 11.3% in 1999 (1998: 11.6%).

Table 3.1

**Selected Industrial Countries:
Major Economic Indicators**

	Industrial Countries	United States	Japan	Germany	United Kingdom
Growth of Real GDP (%)					
1996	3.0	3.4	5.0	0.8	2.6
1997	3.0	3.9	1.4	1.8	3.5
1998	2.4	3.9	-2.8	2.3	2.2
1999*	2.6	3.7	1.0	1.4	1.1
2000 [†]	2.5	2.6	1.5	2.5	2.4
Inflation[‡] (%)					
1996	2.2	2.9	0.1	1.2	3.0
1997	2.0	2.3	1.7	1.5	2.8
1998	1.3	1.6	0.6	0.6	2.7
1999*	1.4	2.2	-0.4	0.4	2.3
2000 [†]	1.7	2.5	0.0	0.8	2.2
Unemployment (%)					
1996	7.5	5.4	3.3	8.9	7.4
1997	7.2	4.9	3.4	9.9	5.7
1998	6.8	4.5	4.1	9.4	4.7
1999*	6.6	4.3	5.0	9.1	4.8
2000 [†]	6.6	4.5	5.8	8.6	5.3
Current Account Balance (US\$ billion)					
1996	49	-129	66	-6	-1
1997	76	-143	94	-1	10
1998	-24	-221	121	-4	2
1999*	-127	-316	143	-	-19
2000 [†]	-118	-325	138	6	-23

[‡] Consumer prices

* Estimates

[†] Forecast

Sources: IMF World Economic Outlook, September 1999; OECD Economic Outlook, June 1999.

Weaknesses in external demand, particularly from European countries will affect the balance of trade in 1999 and 2000. The trade surplus is estimated to decline in 1999, reflecting significant decline in growth in exports at 1.5% compared to 6.3% in 1998. Import growth is also expected to decline sharply to 2.2% (1998: 7.9%). For 1999, the current account balance is expected to experience a reduced surplus of US\$37 billion or 2.6% of GDP (1998: US\$41 billion or 2.8% of GDP).

Economic Situation in the Developing Countries

Growth for developing countries is expected to increase to 3.5% (1998: 3.2%) with inflation rates projected to decrease to 6.7% (1998: 10.3%). The trade performance is expected to register a modest growth in 1999 given improving economic conditions in the Asian countries with exports growing at 2.4% (1998: 4.9%) and imports growing at 1.1% (1998: -1.3%). The current account deficit is expected to improve slightly to US\$63.2 billion in 1999 compared to US\$78 billion in 1998.

The ASEAN Economies

After experiencing a sharp contraction in 1998, the ASEAN economies are expected to experience positive economic growth in 1999. There has been a turnaround in the current account and foreign reserves position following stability in the exchange rate markets, a rebound in consumer confidence and improving industrial activity. Growing market confidence is also reflected in the recent strong rise in the stock market indices ranging from 19% in the Philippines to 52.3% in Indonesia during the period from end December 1998 to early August 1999. The implementation of supportive monetary and fiscal measures aimed at restoring growth has been largely successful in stimulating economic activity. External factors such as a rebound in oil prices, the pick-up in the Japanese economy, as well as, the continued strength of the US economy have assisted the recovery process. In 1999, the four most affected ASEAN economies, namely Indonesia, Thailand, Malaysia and the Philippines are expected to register a GDP growth of 1.4% (1998: -9.8%).

Inflationary pressures in the ASEAN countries are expected to remain subdued with relatively stable currencies, over capacity in industries and weak labour markets. The average inflation rate which was at a record high of 27.7% in 1998 is expected to decline markedly in 1999, ranging from 22.7% (1998: 59.6%) in Indonesia to 0.5% (1998: 8.1%) in Thailand. The current account position in most ASEAN economies though remaining in surplus is expected to narrow with positive import growth projected in 1999 following recovery in domestic demand.

The **Indonesian** economy is expected to bottom out in 1999 with a smaller GDP contraction of 0.8% (1998: -13.7%). Growth prospects are enhanced with improving market sentiment, higher agricultural incomes and recovering consumption demand. Inflationary pressures are expected to ease steadily in 1999 to reach 22.7% (1998: 59.6%) given declining interest rates and reduced supply side constraints especially improved rice availability following a good harvest. With the strengthening of the Rupiah at around Rp.7,000 to Rp.8,000 per US\$, the external current account is expected to show a surplus in 1999 of about 2.4% of GDP (1998: 4% of GDP). Despite these positive developments, a sustained recovery remains uncertain. Challenges still remain, such as the slow pace of financial and corporate sector restructuring, the need for large infusions of foreign aid, the large overhang of short-term private debt, the high unemployment rate, as well as, the increase in poverty levels.

Given a turn around in agricultural output, continued growth in services and a bottoming out in the industrial sector, the **Philippines** economy is estimated to show strong GDP growth of 2.2% in 1999 (1998: -0.5%). An expansionary monetary policy and a strong boost from fiscal spending are expected to result in a pick-up in domestic demand. This is reflected in the positive growth in the domestic oriented industries, as well as, continued increase in imports of consumer and intermediate goods. The inflation rate is expected to ease to 8.5% (1998: 9.7%) with slower increase in food prices due to higher agricultural output. Improved external demand especially for electronics goods is expected to lead to a surplus in the trade balance in 1999 amounting to 2.2% of GDP (1998: 2%).

The **Singapore** economy is expected to register strong growth in 1999 at 4.5% (1998: 0.3%) due

Table 3.2

**Selected ASEAN Countries:
Major Economic Indicators**

	1998	1999 ^a	2000 ^a
Gross Domestic Product Growth (%)			
Brunei	1.0	2.5	4.0
Indonesia	-13.7	-0.8	2.6
Philippines	-0.5	2.2	3.5
Singapore	0.3	4.5	5.0
Thailand	-9.4	4.0	4.0
Vietnam	3.5	3.5	4.5
Inflation Rate (%)			
Brunei	2	1.0	2.0
Indonesia	59.6	22.7	5.7
Philippines	9.7	8.5	6.0
Singapore	-0.3	0.2	0.6
Thailand	8.1	0.5	2.0
Vietnam	7.7	7.6	6.0
Current Account Balance (% of GDP)			
Brunei	42.9	37.8	41.7
Indonesia	4.0	2.4	0.7
Philippines	2.0	2.2	0.8
Singapore	20.9	21.1	20.4
Thailand	12.8	8.8	5.9
Vietnam	-3.9	-5.0	-3.9

^a Estimates

^a Forecasts

Source: IMF World Economic Outlook, September 1999; ADB Outlook for 1999 and 2000.

mainly to external factors such as the robust US economy and recovery in the regional economies. The recovery in the global electronics industry, as well as domestic measures to cut costs and increase competitiveness have also contributed to the stronger outturn. The manufacturing and financial and business **services sectors have** provided the impetus to growth. Inflation is expected to increase to 0.2% (1998: -0.3%) due to the higher prices for food and education. The current account surplus is expected to continue to strengthen reaching 21.1% of GDP (1998: 20.9%). However several downside risk factors exist. These include a weak construction sector, a possible increase in retrenchments due to restructuring of manufacturing operations by multinational

companies and a large overhang in the property market. In combination with several external uncertainties, including the situation in Indonesia, the republic's growth potential for the next two to three years could still be limited.

After experiencing a severe recession in the past two years, the **Thai** economy is expected to show a growth of 4% in 1999 (1998: -9.4%). The recovery is most evident from the rise in industrial output, increase in export volume as well as a pick-up in domestic consumption. Financial market conditions have improved with exchange rates stabilising which has permitted considerable easing in monetary policy. To further stimulate economic activity, Thailand has implemented a fiscal package amounting to US\$3 billion that makes available funding to help businesses especially the small and medium-sized enterprises. Tariffs on 625 products were also reduced. Inflation is expected to fall to 0.5% (1998: 8.1%), the lowest in more than five years. The current account is estimated to remain in surplus, accounting for 8.8% of GDP (1998: 12.8%). However, a sustained recovery depends on the extent of implementation of the stimulus package, the continued pace of export revival and the successful completion of financial and corporate sector restructuring process.

North East Asian Economies

Growth in China, South Korea, Taiwan and Hong Kong SAR as a group is expected to rebound in 1999 as the recovery process in these countries continue to gather momentum. Economic recovery is being assisted by the stability in the financial market, strengthening exchange rates, supportive fiscal policies and improvements in confidence, both locally and in the region more generally. GDP growth for these countries is expected to range between 1.2% (Hong Kong SAR) to 6.5% (South Korea). Inflation is expected to be low ranging between -3.1% (Hong Kong SAR) to 1% (Taiwan).

Growth in **China** is expected to moderate to 6.6% in 1999 (1998: 7.8%) due to weaker private demand, deflationary pressures, capital outflows and higher unemployment. Consumer prices are expected to decline due to weak consumer sentiment combined with excess capacity, over production and inventory build-up by the state

owned enterprises. The deflationary pressure is expected to exacerbate with consumer prices registering a sharp decline of 1.5% (1998: -0.8). Export growth is expected to deteriorate to -1.3% (1998: 3.4%) while imports are expected to register 2.4% (1998: 3.5%). As a result, the trade surplus is forecast to reach US\$20.0 billion in 1999, a decrease of 54.1% (1998: US\$43.6 billion). The current account balance will remain in significant surplus although reduced to US\$17.8 billion (1998: US\$32.6 billion). China's external vulnerability is limited however, due to its large foreign exchange reserves, moderate foreign debt and regulated capital movements.

In **South Korea**, the recovery that began in the second half of 1998 is expected to continue with growth registering 6.5% in 1999. (1998: -5.8%). The recovery is being supported by a competitive exchange rate, low inflation, and a decline in interest rates to below pre-crisis levels and an expansionary fiscal stance. Capital inflows have also picked up strongly. Uncertain consumer

Table 3.3

North East Asian Countries: Major Economic Indicators

	1998	1999*	2000 [†]
Gross Domestic Product Growth (%)			
China	7.8	6.6	6.0
Hong Kong SAR	-5.1	1.2	3.6
South Korea	-5.8	6.5	5.5
Taiwan	4.9	5.0	5.1
Inflation Rate (%)			
China	-0.8	-1.5	1.5
Hong Kong SAR	2.6	-3.1	1.0
South Korea	7.5	0.7	2.8
Taiwan	1.7	1.0	1.2
Current Account Balance (US\$ billion)			
China	32.6	17.8	13.3
Hong Kong SAR	1.1	2.5	4.0
South Korea	40.0	23.6	15.2
Taiwan	3.5	6.5	8.3

* Estimates

† Forecasts

Source: National sources, IMF World Economic Outlook, September 1999, EIU

FEATURE ARTICLE 1

Results of the Sixth APEC Finance Ministers Meeting (Langkawi, Malaysia, 15-16 May 1999)

The Finance Ministers of the Asia Pacific Economic Cooperation (APEC) met for the sixth time in Langkawi, Malaysia on 15-16 May 1999 to review the economic and financial situation in the region and explore ways to strengthen economic fundamentals aimed at accelerating the region's recovery and to meet long-term challenges. In the wake of the region's financial crisis, the Ministerial gathering underscored the importance of individual and collective roles in contributing to regional and global stability. In this connection, efforts in the crisis-affected economies would continue to focus on macroeconomic and structural reforms particularly in the financial and corporate sectors, while in other member economies, it entailed efforts at maintaining conditions for sustainable growth.

Pursuing the Cooperative Growth Strategy

In November 1998 in Kuala Lumpur, a Cooperative Growth Strategy was endorsed by APEC Economic Leaders as a framework that would guide the region in meeting the challenges of ensuring macroeconomic stability and restoring growth in the region. At their meeting in Langkawi, Finance Ministers concluded that the strategy has yielded significant progress in promoting recovery and growth, and in keeping markets open. In the period ahead, such cooperation will be strengthened and deepened, consistent with achieving APEC's goals of free and open trade and investment by 2010 and 2020. Ministers also reaffirmed the value of peer surveillance within APEC economies and the benefits to be derived from greater cooperative efforts at the micro level, particularly in financial and capital markets.

Restructuring Financial and Corporate Sectors

An important element underpinning the recovery process of the crisis affected member economies in Asia is accelerating financial and corporate restructuring. In most of the crisis-affected economies financial and corporate restructuring has progressed and it was underscored that among others, a sustained return of capital would hinge upon orderly corporate and financial restructuring,

sound macroeconomic management, improved efforts to enhance corporate governance and an environment conducive to foreign direct investment. It was also agreed that the role of the international community to accelerate corporate and financial sector restructuring was important, especially in the context of technical and financial support.

Developing Financial and Capital Markets

Central to restoring the confidence of domestic and international investors and the return of capital flows are sound financial systems, enhanced corporate governance and improved accounting, transparency and disclosure standards. Within APEC, progress has been made to further develop capital markets. A Voluntary Action Plan for Supporting Freer and Stable Capital Flows (VAP) is now at the second stage of development. Two studies undertaken during Phase II of the VAP showed that an important lesson from the recent financial crisis in Asia was the need for practical guidelines for monitoring capital flows, including short-term flows. A final report that would include specific proposals for achieving freer and stable capital flows will be tabled at the Seventh Ministerial Meeting in Brunei Darussalam in the year 2000.

As part of APEC's response to the Asian financial crisis, high priority was given to domestic measures undertaken to strengthen corporate governance. Ministers approved recommendations contained in the report "Strengthening Corporate Governance in the APEC Region" and urged member economies to take early and comprehensive implementation of reforms to enhance corporate governance, particularly through application of measures incorporated in the Action Plan of the Report. In the year 2000, several economies are expected to report on progress taken by them to strengthen corporate governance in their jurisdiction.

Education and training were crucial to strengthen the body of skilled professionals that had direct relevance to corporate governance issues. Consistent with APEC's emphasis on technical cooperation, Australia will provide a compendium of its corporate governance training facilities, which it would make available to participants from the APEC region. Directly contributing to efforts at strengthening corporate governance is the need to strengthen the quality of auditing and accounting standards, and in this regard, economies were urged to move towards the adoption of practices that meet or exceed international standards. The

work of the International Accounting Standards Committee (IASC) to develop a full range of accounting standards was recognised as an important guide to both private and public sectors in this area.

Insolvency law reforms are also deemed vital to the speedy restructuring of business and financial sectors and to improve future management of credit flows to private borrowers. To develop a fuller appreciation of the need for strong insolvency laws and procedures, Australia has undertaken to host a joint APEC-OECD workshop on insolvency law later in 1999.

Another important APEC focus is on the development of domestic debt markets in order to promote more efficient financial intermediation. A key priority is to develop deeper, long-term, more stable and transparent debt markets in Asia to recycle the very significant Asian savings, which stand at more than 30% of GDP. As a first step, a compendium of sound practices and the establishment of a web site to facilitate information sharing among member economies was set up. Further work will include developing reliable benchmark yield curves, improving securities clearing and settlement systems and addressing the issues of lack of liquidity and inadequate risk assessment.

Revitalising Infrastructure

In 1997, Finance Ministers adopted a set of voluntary principles to facilitate private sector participation in infrastructure. Since then, the changed circumstances have posed a financing challenge for several economies in the region. As investment requirements for infrastructure projects are still sizeable, it is imperative that the private sector should remain involved in the delivery of infrastructure projects. In this connection, Ministers noted the benefits to be gained from unbundling infrastructure services and introducing competition. There was also agreement on the importance of accelerating the development of domestic capital markets, particularly bond markets, to avoid currency and maturity mismatches when financing projects in the future.

International Dialogue on the Financial Architecture

Ministers underscored the important role of the international community to strengthen the

international financial architecture to complement efforts at the national and regional levels to ensure a stable environment for growth and recovery. They further emphasised that recommendations that have been made at several fora be implemented on an urgent basis. While they recognised that full reform of the international financial architecture will take time, Ministers agreed that the momentum must be maintained even though stability has returned to the financial markets.

Inclusion of industrialised, developing and emerging market economies, and the international financial institutions and regulatory bodies has not only contributed to the dialogue on strengthening the international financial architecture but will encourage ownership of agreements that emanate from such discussions. An ongoing mechanism for inclusive dialogue between industrial, developing, and emerging market economies to build consensus on major economic and financial policy issues in the future is considered a vital element of the on-going process. Ministers therefore urged that key emerging markets be included in the Financial Stability Forum (FSF). They also emphasised the importance of completing the FSF's work on highly leveraged institutions (HLIs), offshore centres, and short-term capital flows as early as possible.

Strengthening Financial Systems

Since 1994, APEC Finance Ministers have focused their efforts on strengthening domestic financial systems. Recognising that sound banking supervision is important in ensuring financial stability, an initiative to assess the adequacy of banking sector supervisory regimes was approved by the APEC Finance Ministers Meeting in Kananaskis, Canada, in May 1998. In 1999, a survey was conducted to assess the adequacy of the supervisory regimes of member economies. The survey results showed that member economies have achieved a high degree of compliance with the requirements of the Basle Core Principles for Effective Banking Supervision. Due to the importance of APEC's work in this area, Ministers will receive regular reports on progress of APEC member economies towards strengthening supervisory systems. To reduce gaps in the implementation of measures to improve supervision, regular exchange of views and greater interaction among APEC bank supervisors was deemed important. Meetings by bank supervisors

from APEC and SEACEN economies are important in facilitating such kinds of information sharing.

To strengthen financial systems at the national and global level, commitment to human resource development in the regulatory and supervisory area is deemed vital. A core of well-qualified bank supervisors was also considered essential to the maintenance of a strong and well-supervised banking system. In this regard, Ministers agreed that the capacities of supervisory and regulatory authorities in the APEC area should be upgraded continually, particularly in the areas of market risk and consolidated supervision. To assist economies meet fully the Basle Core Principles on Banking Supervision, APEC training initiatives would also include experience sharing and practical knowledge by those economies relatively advanced in meeting the said Core Principles. These programmes will be organised through seminars and courses.

A mechanism to track progress by member economies in implementing various action plans and principles that have been adopted over the years will be developed in 1999. As a first step, measures undertaken by member economies in adopting international standards/codes/best practices to strengthen their financial systems will be compiled.

Enhancing Transparency and Disclosure Standards

A more effective functioning of markets requires that standards of transparency and disclosure be applied to both the public and private sectors. APEC has made progress towards enhancing transparency and disclosure standards particularly through efforts to develop bond markets and strengthen corporate governance. In addition, a large number of member economies have adopted the comprehensive format for fuller disclosure of information on foreign reserves as part of the Special Data Dissemination Standards (SDDS).

The need for appropriate transparency by market participants, including HLIs, was also recognised. Ministers looked forward to reviewing the results of the Financial Stability Forum's work, the International Organisation of Securities Commissions' (IOSCO) report and reports of other private and public-sector bodies on issues relating to transparency and disclosure.

Credit Rating Agencies

Prior to the eruption of the financial crisis in Asia, APEC began an initiative on promoting the development of credit rating agencies (CRAs) in recognition of the important role played by CRAs in the development of capital markets. In Kananaskis in 1998, Ministers discussed the performance of CRAs in the light of the Asian financial crisis. APEC Economic Leaders, also in 1998, called for a review of the practices of international rating agencies to promote their effectiveness and to contribute to sustainable capital flows.

Based on a report prepared by the Philippines on the outcome of the APEC Consultative Workshop held in Manila in February 1999, Ministers agreed that further work on this initiative is necessary and should in fact, contribute to the broader context of international architecture discussions. This was particularly relevant in the area of strengthening transparency and disclosure standards by all market participants. As a first step, a survey on the codes of conduct and practices used by various CRAs would be carried out. The survey would cover various issues, including (a) transparency and accountability of the ratings process; (b) conflicts of interest; (c) credibility and reliability of ratings; and (d) unsolicited ratings. As a corollary, member economies would take action to strengthen information and disclosure standards. These include efforts to foster a credit culture, promote alternative sources of information about credit risks and actively participate in international initiatives to harmonise accounting and disclosure standards.

Enhancing the Roles of the International Financial Institutions (IFIs)

Ministers noted that further improvements in coordination and collaboration among the IFIs would strengthen the effectiveness of their response to crises. IFIs were urged to explore ways to improve their surveillance programmes and modus operandi. As a first step, the establishment of the Financial Sector Liaison Committee by the IMF and the World Bank should facilitate effective collaboration in the provision of advice on financial sector issues. In addition, the establishment of the Contingent Credit Line (CCL) would be helpful to countries adopting good policies but still threatened by contagion.

Involvement of the Private Sector in Crisis Containment and Management

Ministers agreed that the actions of private sector creditors are critical in resolving a financial crisis. Cooperation between economies, the private sector and the international financial institutions is important to enhance crisis prevention and resolution. Emerging market economies should maintain appropriate communication with their private creditors. At the same time, there is need for further practical work to systematically engage the private sector in crisis prevention and resolution. It was noted that some constructive proposals have been discussed in a number of international fora. In the IMF for example, the use of collective action clauses in sovereign bond issues is being studied.

Mitigating the Impact of the Crisis on the Poor

Ministers supported further collaborative action within APEC to exchange information and analysis on strategies to mitigate the impact of the crisis on the poor. This collaboration will be based on a study that was coordinated by Malaysia and the World Bank on the experience in East Asia and that of crisis-affected Latin American economies. This study has provided important

lessons on ways to mitigate the impact of future crises on the poor and the vulnerable. Some of these include: the need for greater coordination among the relevant national agencies, and between these agencies and international financial institutions in the design of programmes; the importance of having the best possible safety nets in place even before a crisis occurs; and the institutional capacity to rapidly adjust programmes and introduce measures in times of crises, as well as the need to improve the monitoring of programmes. In particular, the work of Finance Ministers will focus on promoting sound design and adequate internal financing of national social safety nets that take into account the cultural, economic, institutional and social situation of the individual economies.

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To prepare for the computer date change on 1 January 2000, the meeting agreed on the need for economies to continue to upgrade and test their computers. This is in order to enhance public confidence and reduce the risk of economic and financial disruptions. In the months remaining to the year 2000, efforts of APEC member economies would be increasingly directed toward planning for possible contingencies that may arise at the time of the century date change.

FEATURE ARTICLE 2

Progress in the Financial and Corporate Sector Restructuring Process in the Asian Crisis Affected Economies.

Central to the efforts undertaken by the East Asian crisis-affected economies, namely Indonesia, Korea, Thailand and Malaysia to restore confidence and stimulate economic activity were the financial and corporate sector restructuring measures.

These measures were instituted in line with the economic adjustment programs agreed with the International Monetary Fund (IMF) which had put together financial assistance packages for the above mentioned economies except Malaysia which pursued restructuring programmes without IMF assistance. Good progress has been made in implementing financial sector restructuring programs in all these countries, with more stringent prudential standards in place, bank recapitalisation proceeding smoothly and plans adopted for the privatisation of state-owned institutions. On the corporate side, however, reform measures have lagged behind although most legal impediments to corporate restructuring have been eliminated, perhaps due to the fact that restructuring frameworks are voluntary in nature. The pace of implementation and the effectiveness of the financial and corporate sector restructuring measures however varied across countries, due to political commitments, social obligation and public reactions to the changes introduced.

In **Indonesia**, the pace of financial reconstruction has been slower than in the other Asian countries. Indonesia created the Indonesian Bank Restructuring Agency (IBRA) to deal with the most illiquid and insolvent banks, established the Asset Management Unit (AMU) under the IBRA to acquire non-performing loans from frozen or merged banks, implemented a recapitalization scheme for under capitalised banks, and closed non-viable banks. In November 1997, the government had closed 16 private national banks. When the IBRA was formed in January 1998, 54 problem banks were placed under its supervision. Of this, 7 had their operations suspended in April 1998, while another 7 banks were placed under IBRA management. In August 1998, 3 of the 7 banks under IBRA management suspended operations. Four state banks, including the EXIM Bank were merged to create the new Bank Mandiri. In September 1998,

the government announced a recapitalisation program involving the use of public funds. Under this program the government provides 80% of the funds needed to attain a 4% capital adequacy ratio while the banks must find the remaining 20%. In March 1999, the Government announced a package of measures targetting private national banks. Of the 128 private national banks, 38 were closed and seven nationalized while 9 banks received injections of public funds. The remaining 74 smaller private banks have been assessed as adequately capitalised. The AMU has made little progress with asset disposals. The banking law has been revised to allow 100% foreign ownership.

The estimated cost of rehabilitating the banking sector is about 330 trillion rupiah. The government is expected to issue bonds totaling US\$68 billion for this purpose. Though there has been some progress with financial system reform, many issues such as improvement in information disclosure by banks and greater transparency in the government administration of the banking sector still need to be addressed.

With regard to corporate restructuring, some 125 firms with US\$17 billion in foreign debt and 1 trillion rupiah in domestic claims, have signed up under the Jakarta Initiative. The Jakarta Initiative, formed in November 1998, offers a set of suggested principals for voluntary debt restructuring deals between creditors and debtors. This agreement is designed to avoid bankruptcy procedures by encouraging out-of-court settlements through mediation between creditors and debtors. Agreements have also been reached with 17 smaller firms. But significant progress has yet to be made. Corporate restructuring has been slow as corporate debtors and foreign creditors – who hold 60% of corporate debt – have not agreed on external debt resolution. Domestic banks are largely under-capitalised and the bankruptcy and foreclosure laws have not been enforced. For a large part of 1999, political uncertainty has also slowed down the pace of debt agreements.

In **Korea**, the rehabilitation and consolidation of the banking sector is generally well advanced. The restructuring is carried out under the guidance of the Financial Supervisory Commission set up in April 1998, and involved consolidation, purchase

of non-performing loans and recapitalisation. Five of the 26 commercial banks that operated at end 1997 have been closed, while steps were taken to nationalise two banks. Negotiations have been underway with prospective foreign buyers since late 1998, for the sale of these two nationalised banks. The rest of the commercial banks are engaged in various forms of restructuring, including mergers and raising additional capital. For recapitalisation of the banks, public funds are being injected, so that banks can attain and maintain capital ratios of 10%. Of the 30 merchant banks, 16 have been closed, merged or suspended and the remaining 14 are being closely monitored. The focus of attention now is with the non-bank financial intermediaries such as the investment trust companies that are heavily exposed to the large *chaebols*. Korea has made good progress in the proposal of non-performing loans. The Korean Asset Management Corporation (KAMCO) has purchased more than 60% of the target amount of non-performing loans from the banking sector.

Public funds totaling more than 64 trillion won have been allocated for financial sector restructuring. Expenditure on the restructuring of the banking system has become a drain on fiscal resources and the financial institutions may have to rely on their own efforts in the future.

With regard to corporate restructuring, five of the biggest *chaebols* are undergoing restructuring under the Capital Structure Improvement Plans. These plans require the five *chaebols* to reduce their ratios of debt to equity by the end of 1999. In addition, the government has promoted exchanging businesses with other *chaebols* and shedding non-core businesses. As with the small and medium-sized enterprises, 79 have entered into debt workouts; with 71 having reached agreement on their workout plans. Six plans for the remaining SMEs are being finalised, after dropping out of the workout process.

In Thailand, the program for restructuring the financial sector included measures to improve financial supervision, reform financial infrastructure,

develop capital markets and restructure corporations. The Financial Restructuring Agency (FRA) and the Asset Management Company (AMC) were established to resolve the 58 failed financial companies and dispose of their assets. Of the 58 companies, 56 were closed and their assets taken over by the FRA to be auctioned. Several rounds of auctions of the assets were conducted by the FRA throughout 1999 and are expected to be completed before the end of the year. A market-led strategy of recapitalising the remaining financial institutions was initially adopted. However, given that potential investors were wary, the Bank of Thailand (BOT) had to intervene in four banks and seven finance companies. Recognising that government support is needed, a plan to recapitalise troubled financial institutions was announced in August 1998 with an injection of about 300 billion baht of public funds. The main components of the plan are the consolidation of commercial banks and finance components and injections of public funds for recapitalisation. As part of this plan, the BOT took over two additional banks and five more finance companies, bringing the number of intervened financial institutions to 18. Mergers and restructuring of government-owned entities with intervened financial institutions and privatisation of three nationalised banks are proceeding. Recapitalisation of private banks is also progressing. Legal and regulatory framework for supervising financial institution is being revised.

With regard to corporate restructuring, the Thai government had established the Corporate Debt Restructuring Advisory Committee (CDRAC) to coordinate debt workouts. As of early 1999, CDRAC was involved in debt restructuring of 293 companies and had already disposed of loans belonging to 56 companies. The commercial banks are however slow in addressing the debt workout given the large size of non-performing loans. In Thailand, small and medium-sized enterprises account for more than two-thirds of aggregate corporate debt and hence restructuring will take time. Revisions of the bankruptcy law and foreclosure procedures as well as the creation of a bankruptcy court were passed in March 1999 and these are expected to quicken the pace of restructuring.

and corporate sentiment, tight credit conditions for smaller companies and a stable won is expected to contain inflationary pressures in second half of the year. Inflation is expected to average 0.7% (1998: 7.5%). Unemployment remains high at 7% (1998: 6.8%), thereby dampening wage demands. Internal recovery has benefited from positive external conditions. Aided initially by a sharp depreciation of the won, exports are now being stimulated by growing demand. Stable foreign exchange rates, low interest rates and moderate wage levels have also helped to boost exports. Export earnings are expected to rise by about 3% to US\$136 billion in 1999 while imports are projected to surge by 22% to US\$114 billion. The current account surplus is expected to register US\$23.6 billion or 5.9% of GDP (1998: US\$40 billion or 12.5% of GDP).

The recent earthquake in **Taiwan** is expected to dampen growth in the short-term with the economy expected to grow at 5% in 1999 (1998: 4.9%). The factories that supported the electronic industry were largely undamaged by the earthquake although widespread power cuts and damaged infrastructure is expected to curb production at some facilities for a short period. Inflation is also expected to decline to 1% (1998: 1.7%) due to soft world commodity prices and relatively weak domestic demand. Although regional recovery will have a positive impact on exports, this will however be moderated by the effects of the earthquake on the electronics industry. Exports are expected to increase by 7.3% (1998: 0.5%). Imports are projected to grow slightly by 4% (1998: 3.2%) due to lower investor confidence following the earthquake. Overall, the current account surplus, boosted by the trade surplus, is expected to rise to US\$6.5 billion or 2.3% of GDP (1998: US\$3.5 billion or 1.3% of GDP).

In **Hong Kong SAR**, growth for 1999 is expected to register 1.2% (1998: -5.1%) as economic activity stabilises following the sharp downturn amidst the Asian financial crisis. Signs of an economic turnaround are still tentative although developments in the financial markets have been encouraging, with stock market and real estate prices recovering. The downward pressure on the Hong Kong dollar has receded and interest rates have declined close to rates on U.S. dollar denominated assets. Other factors expected to add to the improved economic environment include slower declines in export and retail volumes, a pick up in consumption

sentiment and tourism and a stabilisation in the unemployment rate. Consumer prices which declined sharply in the first half of 1999 is expected to moderate by the end of the year. Inflation will still be negative in 1999 at 3.1% (1998: 2.6%). Export growth is expected to improve slightly registering -1.2% compared to the contraction of 4.6% in 1998, due to increased exports to a number of East Asian markets. Imports growth is also expected to register -1.3% (1998: -6.5%) as domestic consumption strengthens. The current account balance is projected to increase to US\$2.5 billion or 1.5% of GDP (1998: US\$1.1 billion or 0.7% of GDP).

Other Developing Countries

Latin America

Latin America is expected to experience a sharp economic slowdown in 1999 as a result of low commodity prices, soaring public debt, high unemployment, currency depreciation and slower capital inflows. GDP growth for the region is estimated at 0.1% (1998: 2.2%) though performances at the individual country levels are mixed. Inflation is expected to decline to 9.8% (1998: 10.6%).

Economic growth in **Mexico** is expected to remain positive though lower at 3% in 1999 (1998: 4.6%) due largely to the lagged effect of the financial crisis. The main engine of growth is expected to come from non-oil exports reflecting strong demand from its main trading partners in North America. In Mexico, exports account for about 27% of GDP with over 80% of total exports being traded within NAFTA. A continued pick up in private consumption and public sector investment in infrastructure facilities is also expected to provide some stimulus for economic activity. Inflation is expected to rise to 17.1% (1998: 16.7%) while the external current account deficit is projected to narrow to 2.3% of GDP (1998: -3.8% of GDP).

The **Argentinian** economy is expected to slide into a deep recession in 1999 with GDP contracting by 3% (1998: 3.9%). Low prices, especially for agricultural commodities and industrial goods are expected to contribute towards weak domestic demand. Following the devaluation of the Brazilian real in January 1999, the Argentinean economy, which has a fixed exchange rate regime, is likely

to face a more competitive trade environment. In 1999, the current account is estimated to remain in deficit, accounting for 4% of GDP (1998: -4.9% of GDP). A price deflation of 0.8% is projected in 1999 (1998: 0.9%).

In **Brazil**, real GDP is expected to contract by 1% in 1999 (1998: 0.1%), a rate considered much better than originally envisaged. A strong increase in agricultural output, strengthened investor and consumer confidence, as well as improved output performance are expected to account for the improved economic outlook. Consumer price inflation should be contained at around 4.6% (1998: 3.8%) reflecting the low pass through effect of the exchange rate depreciation on prices. Brazil devalued its currency, the real, in mid-January 1999, following a round of capital flight. The trade balance is expected to continue to show a deficit at 3.8% of GDP in 1999 (1998: -4.3%) as a result of recovery in international oil prices and weaknesses in the prices of Brazil's major commodity exports.

Venezuela, is expected to plunge into deeper recession in 1999. The oil-based economy is estimated to contract by 7.6% (1998: -0.7%) despite the recovery in oil prices. Uncertainties about constitutional reforms to be introduced by the new government and a large public sector deficit of around 7% of GDP in 1999 have isolated investors and increased unemployment to record high levels. Though the inflation rate has declined to 24.4% (1998: 35.8%), it remains high relative to the other Latin American countries. The recent increase in oil prices is expected to improve the external balance position of the country.

Middle East, Africa and South Asia

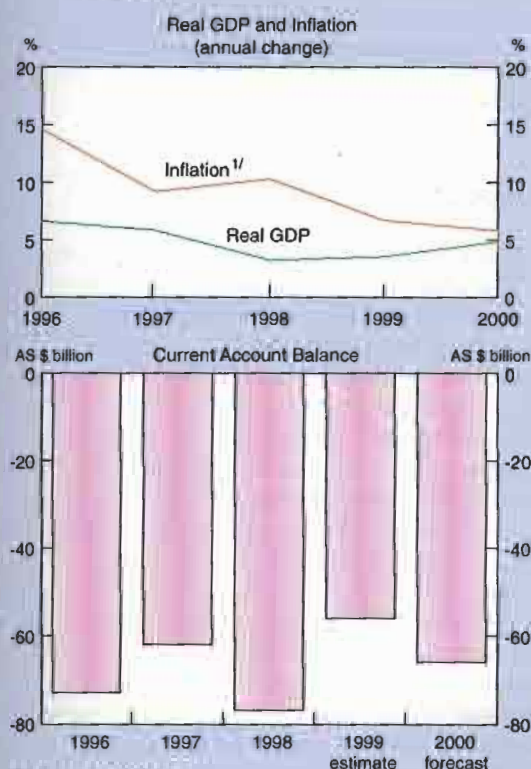
Growth in other developing countries of the Middle East, Africa and South Asia is expected to continue to register positive growth though at a lower rate. The increase in global oil prices from US\$11.15 in January to about US\$21.13 per barrel in October 1999 has helped to improve the external balances, fiscal positions, and short-term growth prospects of oil-exporting countries in the Middle East and Africa. However, continuing weakness of non-oil commodity prices is expected to constrain growth in many countries, especially in Africa.

In the **Middle East**, economic growth is expected to remain moderate with GDP projected at 1.8%, albeit slower than the rate achieved in 1998 of 3.2%. Inflation is expected to decline to 18.3% in 1999 from a high of 23.6% in 1998 due to overall improvements in economic conditions in the majority of the countries in the region. Exports are expected to decline 0.2%, an improvement from the 0.7% contraction in 1998. Imports are also expected to contract to 1.8% after registering strong growth in 1998 at 6%. The current account deficit for Middle East is expected to improve registering US\$6 billion compared with US\$20 billion in 1998.

In **Saudi Arabia**, following declines in oil prices since early 1998, GDP growth is projected to contract by 2% (1998: 1.6%). Inflation is expected to increase to 1.5% (1998: -0.2%). Exports are expected to decline to US\$35 billion (1998: US\$42.5 billion) due to lower oil output while imports are envisaged to decline marginally to US\$23 billion (1998: US\$24 billion). In **Turkey**, the contraction that began in the second quarter of 1998 appears to have bottomed out. GDP is currently projected at 1.2% (1998: 2.8%). Inflation although declining, continues to remain high at 60.4% (1998: 84.6%). The earthquake that occurred in August is expected to influence the overall macroeconomic outlook. The total cost of the earthquake is expected to be US\$9-13 billion. The budget deficit for 1999 is estimated at US\$20 billion due to increased public expenditure in public infrastructure and tax losses or tax payment postponement. The current account balance for Turkey is expected to be in deficit of US\$1 billion or 0.6% of GDP (1998: -US\$1.87 billion or 0.9% of GDP).

GDP in **Africa** is expected to grow by around 3.1% in 1999 (1998: 3.4%). However, countries like Kenya, Sudan, Ghana, Tanzania, Tunisia, and Uganda have been performing particularly well and growth rates of between 2.1% to 7% is projected for these countries. This is due to the implementation of sound macroeconomic policies and in some cases more favourable weather conditions. Inflation is forecast at 9%, up from 8.7% in 1998. Export volumes are expected to grow at 2.9% after contracting 0.7% in 1998 while the import volumes are also expected to improve, growing at 3.4% compared to 2.8% in 1998. The fall in oil prices in 1998 and the slow down experienced in Asia had led to the weakening of the current account position especially for the oil exporting countries. The fall in gold prices has

Chart 3.3
Developing Countries -Major Economic Indicators



also had an impact for countries such as South Africa. The current account deficit for Africa is expected to decline to US\$17.1 billion compared to US\$19.6 billion in 1998. Economic growth in **South Africa** is expected to improve slightly to 0.7% following the downturn in 1998. Growth is supported by renewed financial market confidence, lower interest rates, and improved prospects for exports to Asia. Inflation is projected to decline marginally to 6.5% (1998: 6.9%). Exports are expected to improve on account of improved demand from Asian and European economies growing at 2.2% (1998: 0.4%). Imports meanwhile are expected to show a slight improvement growing at a modest rate of 4 % compared to 3.7% in 1998. Growth for **Nigeria** is projected to decline by 0.5% (1998: 1.9%) due to lower oil prices in 1998 and early 1999 and following the sharp reduction in oil production in Nigeria associated with lower OPEC quotas. However the situation is expected to improve with higher oil prices and the improving export and public sector revenues. Inflation is expected to increase to 12.5% compared to 10% in 1998.

In the **South Asian** region, overall growth is expected to improve in 1999 due primarily to improved macroeconomic policies and the improving economic conditions of the countries

Table 3.4
Developing Countries:
Major Economic Indicators

	1998			1999 ^a			2000 ^a		
	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	3.2	10.3	-77	3.5	6.7	-56.0	4.8	5.8	-6.6
By region									
Africa	3.4	8.7	-19	3.1	9.0	-19.0	5.0	6.9	-15.0
Asia	3.7	8.0	51	5.3	3.1	26.0	5.4	3.5	12.0
Latin America	2.2	10.6	-89	0.1	9.8	-56.0	3.9	7.6	-56.0
Middle East	3.2	23.6	-20	1.8	18.3	-6.0	3.1	13.1	-6.0

¹ Consumer prices-weighted average

² US\$ billion

^a Estimate

¹ Forecast

Sources: IMF World Economic Outlook, September 1999, EIU

affected by the Asian crisis. Inflation in South Asian countries is expected to moderate slightly between the range of 5% to 8%. The external sector is projected to improve as exports are expected to increase moderately to US\$55.7 billion (1998: US\$50.9 billion). Imports are also expected to increase to US\$71.1 billion (1998: US\$64.3 billion) due to improved domestic demand primarily in India and Pakistan. The current account deficit is expected to increase slightly to US\$ 12.5 billion (1998: -US\$10.1 billion).

India is expected to continue registering strong growth at 5.7% (1998: 5.8%) reflecting a strong rebound in agriculture and increased domestic demand. **Pakistan's** growth is expected to decline marginally to 3.1% (1998: 3.3%). Inflation is expected to drop to 6.1% from 7.8% in 1998 due to government efforts in curtailing rising inflation through better distribution channels.

Economic Situation of Countries-in-Transition

The recent crises in emerging markets have widened the differences between the stronger and weaker transition economies. Exports, which have been the main contributory factor to growth in recent years, have slowed throughout the region, most strongly in countries with substantial trade links with **Russia**. Growth in the countries of transition is expected to resume in 1999 to register 0.8% (1998: -0.2%) while the consumer prices are expected to see a sharp increase to 39.3% in 1999 (1998: 20.9%).

After some modest growth in 1997 and early 1998, economic activity in **Russia** weakened in the wake of the 1998 financial crisis. Continuing economic and political uncertainties have led to further capital flight in 1999 and a sharp decline in foreign direct investment compared with pre-crisis levels. However, since the second half of 1999, there have been several positive developments in Russian economy including pick up in the industrial output, stabilisation of the rouble, easing of foreign exchange market pressures as well as the continued financial support from IMF. GDP is therefore expected to pick up and to record a zero growth rate (1998: -4.6%). Inflation is expected to increase sharply to 88% (1998: 28%). Exports are expected to moderate slightly to US\$72.1 billion (1998: US\$74.8 billion) while imports are projected to decline to US\$46.1 billion due to import substitution following

the depreciation of the rouble (1998: US\$56.8 billion). The implementation of the IMF support programme has brought about an improvement in revenue performance with Russia's current account surplus expected to improve significantly to US\$11.4 billion in 1999 from US\$2.3 billion in 1998.

Prospects For 2000

Compared to the situation a year ago, prospects for the world economy have appreciably improved. The financial markets have been calm for a major part of 1999 with equity markets generally buoyant in most industrialised countries and recovering in the East Asian region. The spillover effect of the Russian crisis on Europe was short lived while the impact of the financial crisis in **Brazil** has been mainly confined to the Latin American region. In Asia, most of the crisis-affected countries have rebounded more strongly than earlier anticipated. As they adjust, the Asian emerging economies are expected to have a substantial impact on each other as trade among them expands, thereby reinforcing the recovery. Recent improvements in economic confidence and activity have been followed by a broader pick-up in domestic demand with growth as a whole becoming more firmly entrenched towards the end of 1999. Growth in emerging Asia is expected to gather momentum in 2000, thereby contributing to the overall positive outlook for the global economy.

Against this background and in the absence of renewed tensions in the financial markets, the global economy is projected to expand at about 3.5% in 2000, although outlook across countries and regions will vary considerably. In line with this improved world economic outlook, world trade is projected to increase to 6.2%. Meanwhile, inflation is projected to decline further to 4.1%.

In the **industrial countries**, economic activity is projected to expand 2.5% with inflation expected to pick up to 1.7%. The **US** economy is forecast to slowdown to 2.6% due to a tighter fiscal stance. With slackening output, the unemployment rate is projected to rise to 4.5% and this together with a moderation in inflation expectations, may help to lessen the increase in domestic prices. Import growth may also slacken as domestic demand weakens but exports may progressively improve as foreign markets strengthen. However, the current account deficit is projected to widen to US\$325 billion given that imports will continue to exceed exports.

In **Japan**, despite the recent moderate improvement in the financial markets and a recovery in consumer and business confidence, a sustained recovery is not yet assured. Growth in the Japanese economy is projected at around 1.5% if the turnaround in business investment and supportive macroeconomic policies are sustained. In this connection, a new stimulus public sector package could provide further impetus to ensure that the recovery is well established. The strengthening of the yen in recent months would however limit the contribution of external sector to growth prospects.

In **Europe**, economic activity is projected to improve gradually in the near term owing to robust growth in consumption and investment, supported by stronger export demand benefiting mainly from the recovery in Asia. For the EU area, growth is projected to pick up to 2.7% in 2000, with inflation remaining stable around 1.5%. Unemployment in the EU area will continue to decline to reach 8.8%. Economic growth in the **UK** is projected to pick up strongly to 2.4 % driven mainly by the strong growth in public investment. Inflation will remain low while unemployment rate is expected to rise to 5.3%. In **Germany**, output growth is projected to increase to 2.5% with recovery in European economic activity and a pick up in the world trade growth. The inflation rate is expected to remain subdued at 0.8% and unemployment rate declining to 8.6%. Growth in **France** is projected to remain above its major neighbours mainly due to domestic demand. GDP growth is projected to increase by 3% with a rise in inflation by 1.1% resulting from stabilisation of oil and commodity prices and a narrow output gap. The unemployment rate is projected to fall in 2000 to 10.7% reflecting the positive effect of the new 35-hour-week law and the extension of the youth employment scheme.

Growth in the **developing countries** is projected to improve to 4.8% in 2000 with improvements in the Asian economies amidst a general recovery of world economic growth. Stronger growth is projected for the ASEAN economies as recent pick-up in economic activity is expected to be followed by a strong increase in domestic demand. The macroeconomic policy measures being put in place and the financial and corporate sector restructuring efforts are envisaged to further strengthen the economic fundamentals in the respective countries and generate investor confidence. The ASEAN-4 countries are projected to register a strong GDP growth of 3.6% in 2000.

Indonesia is projected to emerge out of the two-year recession and record a positive growth of almost 2.6% in 2000 while its inflation rate is envisaged to decline sharply to 5.7%. In the **Philippines**, the sustained implementation of the structural reform agenda will push growth to 3.5% with inflation declining to 6%. The real GDP in **Singapore** is projected to grow by 5%, following the pick-up in regional economies and concerted measures taken to develop its financial services and manufacturing sectors. Consumer prices will rise marginally by 0.6%. **Thailand's** progress in implementing the economic and structural reforms is expected to show results through a sustained GDP growth of 4% in 2000. Meanwhile, the expected increase in domestic consumption is envisaged to lead to an increase in the inflation rate to 2% in 2000.

Growth prospects in the **North East Asian** economies is projected to improve as the measures and structural reforms introduced during the crisis work their way through the economy. In **China**, economic growth is forecast to moderate slightly to 6% on account of deflation which will continue to have negative effect on earnings and growth. In **South Korea**, economic growth will continue to remain strong but at a lower rate of 5.5%. GDP growth in **Taiwan** is forecast to improve to 5.1% with the post - quake reconstruction boom and improving conditions in the Asian region. **Hong Kong SAR's** economic growth is projected to reach 3.6% brought about by positive growth in external trade, the pick up in exports to a number of East Asian countries and increased domestic demand.

The **Latin American** economies are projected to recover strongly in 2000 with an overall growth rate of 3.9% amidst an environment of declining consumer prices. The economies of the countries in recession, namely **Argentina**, **Brazil** and **Venezuela** are projected to turnaround with GDP growth rates of 1.5%, 4% and 1.6% respectively. The **Mexican** economy is forecast to grow by 5% as a result of economic and structural policy measures being taken to sustain the steady growth pattern. The inflation rate for the region is projected to decrease to 7.6% due to the tight monetary policies. At the individual country level, the inflation rates are forecast to be 0.6% for **Argentina**, 4.8% for **Brazil**, 11.2% for **Mexico** and 17.3% for **Venezuela**.

Economic growth for **Middle East** is projected to register 3.1% as oil prices are expected to stabilise, thereby improving earnings. In **Africa**,

growth is expected to improve significantly to almost 5% partly due to the structural reforms being carried out in a number of African countries and significant improvements in agricultural output. Countries such as **Ghana, Tunisia and Uganda** are expected to record impressive growth ranging 6% to 7% due to the recovery in agricultural output and increased import demand from the US and European markets. In **South Asia**, growth is projected to improve ranging from 4% to 5.5% with **India, Pakistan and Bangladesh** continuing to show marked improvements in the economy due to strong economic policies.

In **Russia**, following the improvements in the second half of 1999 and the outcome of implementation of the stabilisation and reform programs, GDP growth is projected to improve to 2%.

Challenges Ahead

While the near-term outlook for the global economy is generally good, important challenges remain to be addressed. Macroeconomic instability has persisted in much of the world economy, and the uneven pattern of growth among the major industrial countries is a serious concern. Much will depend on the timing and extent of the slowdown in the US, as well as the ability of Japan and Europe to sustain stronger growth and support global activity. In recent months, concerns about the external debt situation of the US have led to downward pressure on the dollar. Further preemptive monetary tightening could lead to a sharper than expected decline in stock market prices, although this could be balanced by a diversification of portfolio investments from US markets as other countries begin enjoying renewed growth.

For global financial markets, there also exists a potential for adverse reactions due to actual or perceived uncertainty on the state of preparedness among countries and sectors on Y2K readiness. Failures to accommodate the computer date change could have direct real effects on economic activity through possible disruption to production in key sectors and reversals of capital flows.

Although situations in emerging financial markets have improved, some emerging market economies remain fragile and vulnerable to shifts in market sentiment. The sustainability of their recoveries

could be affected if the US economy experiences a significant slow down without a marked improvement in the Japanese economy and a sustained strengthening in Europe. Thus far in Japan, the rebound is not yet assured, especially given the yen's strong performance since July. The Japanese authorities also continue to face formidable challenges involving not just questions about the degree and form of further support to nurture the emerging recovery, but also the need to balance these short-term requirements and longer-term policy objectives. To support domestic demand and economic adjustment, the authorities are expected to maintain a level of stimulus, at least until recovery on private demand takes a firm hold. On the other hand, the large deficits incurred during the current downturn have raised concerns about the sustainability of the trend thereby putting pressure on long-term interest rates.

In most of the euro area, there has been little progress with fiscal consolidation since 1997 and tax burdens are at or close to historic peaks. To put government finances on a sounder footing and to improve prospects for a lasting revival of growth, most countries need to progressively eliminate their structural deficits and some countries with particularly heavy debt burdens or particularly adverse demographic prospects need to aim for structural surpluses. The further reduction of structural deficits, together with the reductions of tax burdens needed to improve incentives for employment and job creation, will require wide ranging reforms to contain the growth of expenditures, especially spending on subsidies, pensions, and welfare payments.

The challenge facing the ASEAN economies is the sustainability of the recovery pattern in the long run. The recent favourable macroeconomic developments, high costs involved in rehabilitating the banking sectors and the large public sector deficits could weaken the support for the financial and corporate sector restructuring agenda. Significant political commitment is therefore required to see the reform process through and ensure that the growth process is not derailed. Apart from this, the crisis has left over capacity in many of the ASEAN economies, high unemployment levels, increasing government debts and rising incidences of poverty. The right mix of economic and social policies is needed to be put in place in order to ensure continuing recovery that can withstand future macroeconomic shocks.