

2 International Economic Performance and Cooperation

ECONOMIC REPORT 2012/2013





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Overview

Modest global growth

The world economic growth momentum picked up gradually in the first quarter of 2012. The stronger-than-expected performance was partly due to the easing of financial stress and improving investor confidence in the euro area following several policy actions taken by the European Union (EU) leaders. The second bailout programme for Greece and conclusion of its debt restructuring plan; the increase in the combined lending capacity of the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM); and the European Central Bank's (ECB) injection of additional funds for long-term refinancing operations alleviated financial market tensions. In addition, improved consumption spending backed by better employment and credit conditions in the United States (US) contributed to moderate global growth. Meanwhile in Asia, the Japanese economy rebounded strongly supported by robust domestic demand. The resumption of supply chains disrupted by the floods in Thailand led to higher industrial production in Asia.

Global economic activity, however, moderated during the second quarter of 2012. The stabilising effects of the policy actions taken in the euro area were temporary and the crisis deepened with heightened political, banking sector and sovereign debt problems. In the US, job growth decelerated and the unemployment rate remained high. Emerging markets, including Brazil, China and India have been affected by the weaker external environment and slower domestic demand as a result of capacity constraints and policy tightening undertaken in 2011.

The global economic outlook for the second half of 2012 continues to be challenging. Manufacturing activity in the major economies has trended down as reflected in the manufacturing Purchasing Managers Indices (PMIs). The manufacturing PMI for the euro area, Japan, the Republic of Korea (ROK) and the US remained below 50 points in July and August, while the official index for China fell to 49.2 points in August for the first time in 2012. In addition, global confidence continued to be adversely affected despite the consensus

TABLE 2.1

Real Gross Domestic Product (GDP) for Selected Economies 2011 – 2013

		Change (%)	
	2011	2012 ¹	2013 ²
World	3.9	3.5	3.9
Advanced economies	1.6	1.4	1.9
United States	1.8	2.0	2.3
Euro area	1.4	-0.6 – -0.2	-0.4 – 1.4
Japan	-0.8	2.4	1.5
Emerging and developing economies	6.2	5.6	5.9
China	9.3	7.5	8.5
Republic of Korea	3.6	3.0	3.8
India	7.1	6.1	6.5
ASEAN			
Singapore	4.9	1.5 – 2.5	3.9
Thailand	0.1	5.2 – 6.2	7.5
Indonesia	6.5	6.5	6.6
Philippines	3.9	5.0 – 6.0	4.7
Vietnam	5.9	6.0	6.3
Malaysia	5.1	4.5 – 5.0	4.5 – 5.5

¹ Estimate.² Forecast.

Source: International Monetary Fund, Asian Development Bank and national authorities.



reached at the EU summit in late June to address the euro area crisis as implementation details of the proposed measures remained uncertain.

In the US, concerns about the fiscal cliff are expected to weigh on consumption and investment that will keep growth on a weak trajectory. Weaker export demand from the euro area and the US is likely to affect the trade performance and growth in export-reliant emerging economies. Furthermore, the recent increase in food prices, particularly for wheat, corn and soya bean due to drought in the US and Russia if prolonged, are expected to impact consumption and increase inflation globally.

In view of increasing vulnerabilities which pose significant downside risks to growth, major economies have initiated stimulus measures to support economic activities. Since July, central banks in Brazil, China, the euro area, the ROK and the United Kingdom (UK) have lowered their policy rates to improve credit and liquidity conditions. In September 2012, the US Federal Reserve Board (the Fed) embarked on the third round of quantitative easing (QE). These measures along with more support from the ECB and core euro area countries to resolve the euro area crisis, including the Outright Monetary Transactions (OMTs) programme to purchase unlimited amount of sovereign bonds are expected to reduce uncertainties and boost investor confidence.

Overall, despite the volatile environment, the International Monetary Fund (IMF), in its July 2012 World Economic Outlook (WEO) Update has forecast global growth at 3.5% for 2012 (2011: 3.9%). Emerging and developing economies will continue to lead growth with a robust expansion of 5.6% (2011: 6.2%), while the advanced economies will remain sluggish at 1.4% (2011: 1.6%) with the euro area periphery in recession. However, as more recent indicators of economic activity show continued weakness in the third quarter and the downside risks to world growth appear to be elevated, it is likely that world growth for 2012 will be slightly lower.

Global Economic Performance

Asia continues to drive growth

The **US** economy continued to grow at a moderate pace of 2.4% during the first half of 2012 (January – June 2011: 1.9%). Growth was mainly supported by higher private investment and moderate consumer spending. Private investment grew at a solid rate of 12.9% (January – June 2011: 4.2%) boosted by non-residential and residential investment which expanded 11.2% and 9.9% (January – June 2011: 7.1%; -5.2%), respectively. Consumer spending expanded at a slower pace of 1.9% (January – June 2011: 2.9%) due to subdued employment growth in the second quarter. The unemployment rate remained high at 8.2% (January – August 2011: 9%). The continued contraction in government consumption and investment of 2.3% (January – June 2011: -2.8%) at all levels of government further impacted growth.

On the supply side, manufacturing activity moderated as reflected by the drop in manufacturing PMI by the Institute for Supply Management to 52.2 percentage points during the first eight months of 2012 (January – August 2011: 56.6 percentage points), the lowest reading since 2009. This was mainly due to the contraction in new orders from Europe and the slowdown in demand from China. Similarly, the non-manufacturing PMI fell to 54.5 percentage points (January – August 2011: 55.4 percentage points). Meanwhile, retail sales which account for more than two-thirds of the economy posted a moderate growth of 5.3% (January – August 2011: 8.2%) as consumers became more cautious. The housing industry gained traction during the first seven months of 2012. Housing starts, building permits and sales of new houses registered a double-digit growth of 25.4%, 26.2% and 20% (January – July 2011: -2.1%; -3.9%; -8.9%), respectively, the highest levels recorded since 2010. This was mainly supported by stable house prices and record low interest rates.

Meanwhile, inflation has been trending down from a high of 3.9% in September 2011 to 1.7% in August 2012 due to lower prices of commodities



and a weak labour market which discouraged wage increases. In view of low inflationary pressures and the need to stimulate growth, the Fed has committed to maintaining its policy rate extremely low between 0.00% and 0.25% for an extended period through mid-2015. In September 2012, the Fed launched QE3 through an open-ended mortgage-backed securities purchases programme to boost the economic recovery and improve labour market conditions. This programme will inject an additional USD40 billion into the economy each month. In addition, the payroll tax cut which expired in February has been extended to December 2012 to further support the economy. However, the prolonged euro area debt crisis and concerns of a fiscal cliff due to tax increases and spending cuts that are scheduled to come into effect at the beginning of 2013 are expected to impact the US economy's growth momentum in 2012. Overall, growth for 2012 is expected at 2% (2011: 1.8%).

In the **euro area**, Gross Domestic Product (GDP) contracted marginally by 0.3% during the first half of 2012 (January – June 2011: 2%) as it continued to be affected by the sovereign debt and banking crises. Slower export growth and high unemployment constrained household spending and weighed on growth. In July, the unemployment rate stood at 11.3%, the highest level since 1995. At the same time, reduced government spending and tax increases aimed at containing debt levels also impacted household consumption. The consumer confidence indicator contracted sharply to an average of 20.7 points (January – August 2011: -11.8 points), the lowest level in almost three years. Manufacturing activity slowed down significantly as reflected in the contraction of the Markit Eurozone Manufacturing PMI which averaged 46.3 points (January – August 2011: 54.7 points). This was largely due to the sharp decline in output and new orders. Inflation edged up to 2.6% (August 2011: 2.5%) due to rising energy prices, which include fuel, gas and electricity. The ECB has undertaken various measures to ease financial stress and restore business and consumer confidence in the region. These include the

injection of EUR489 billion in December 2011 and EUR530 billion in February 2012 in the longer-term refinancing operations which offer three-year loans at a very low interest rate, and the OMTs in September 2012 that allow unlimited purchase of sovereign bonds of euro area countries. In July, the interest rate for refinancing operations was reduced to a historic low of 0.75% and the overnight deposit rate lowered to 0.00% to encourage banks to invest in the real economy and lend to each other. For 2012, the euro area's economy is expected to contract between 0.6% and 0.2% (2011: 1.4%).

Germany recorded a modest growth of 1.1% (January – June 2011: 3.8%) mainly driven by resilient domestic demand and exports. Employment creation was stable and the unemployment rate improved to 5.5%

TABLE 2.2

Inflation Rate for Selected Economies 2011 – 2012

	Change (%)	
	2011	2012 ¹
World	4.4	4.0
Advanced economies	2.7	2.0
United States	3.2	2.1
Euro area	2.7	2.0
Japan	-0.3	0.0
Emerging and developing economies	7.2	6.3
China	5.4	3.3
Republic of Korea	4.0	3.4
India	8.6	8.2
ASEAN		
Singapore	5.2	3.5
Thailand	3.8	3.9
Indonesia	5.4	6.2
Philippines	4.8	3.4
Vietnam	18.7	12.6
Malaysia	3.2	2.0 - 2.5

¹ Forecast.

Source: International Monetary Fund and national authorities.



(July 2011: 5.9%). Export growth slowed to 4.8% (January – June 2011: 14.6%) due to weaker regional demand but continued to contribute to the positive economic performance. Inflation remained low at 2.2% (August 2011: 2.5%) due to easing prices of education and communication services. Amid continued uncertainties and financial tensions related to the euro area crisis and weaker external demand, Germany's economy is expected to grow 0.7% in 2012 (2011: 3%).

In the first half of 2012, **France** posted a marginal growth of 0.3% (January – June 2011: 1.9%) supported by investment and export activities. The services sector grew modestly contributed by information and communication services (4.1%) and business services (3.3%) (June 2011: 1.4%; 7.1%), while manufacturing output contracted 3.1% (June 2011: 3.8%), particularly due to lower orders of vehicles. The unemployment rate rose to 10.3% (July 2011: 9.6%) as a result of corporate restructuring in the automobile industry and transport services. The inflation rate remained stable at 2.4% (August 2011: 2.4%) as lower food prices offset higher prices of energy and tourism-related services. France's GDP is projected to grow 0.5% in 2012 (2011: 1.7%).

Growth declined in the peripheral euro area economies – **Greece** (-6.4%), **Italy** (-2%), **Portugal** (-2.8%) and **Spain** (-1%) (January – June 2011: -7.7%; 0.9%; -0.8%; 0.9%) as the sovereign debt crisis and ailing banks continued to affect their economic performance. Financial strains also led to a substantial increase in the 10-year government bond yields of the peripheral economies, resulting in a significant weakening in business and consumer confidence. Spain recorded the highest unemployment rate at 25.1% (July 2011: 21.7%), followed by Greece, 23.1% (May 2011: 16.8%), Portugal, 15.7% (July 2011: 12.5%) and Italy, 10.7% (July 2011: 8.2%). It is anticipated that the GDP growth in Greece, Italy, Portugal and Spain will contract 4.7%, 1.4%, 3.3% and 1.8%, respectively in 2012 (2011: -6.9%; 0.4%; -1.7%; 0.4%).

The GDP of the **UK** contracted marginally by 0.4% in the first half of 2012 (January – June 2011: 1.1%) largely driven by the decline in the construction and manufacturing sectors. The construction sector shrank 6.3% (January – June 2011: 1.9%), the sharpest contraction since the global financial crisis in 2009, due to substantial declines in public construction and the completion of major Olympics construction projects. Meanwhile, manufacturing output contracted 2% (January – June 2011: 3.2%) on account of weaker demand for pharmaceutical products, food, beverages and tobacco. The services sector, which accounts for more than three-quarters of the economy moderated 0.9% (January – June 2011: 1.3%), largely due to lower output in business and financial services. The inflation rate stood at 2.5% (August 2011: 4.5%) on account of higher transport, clothing and footwear prices. Given the tight credit conditions and fiscal consolidation, the Bank of England approved the third quantitative easing initiative of GBP50 billion in July to stimulate growth. For 2012, the UK economy is expected to grow marginally by 0.5% (2011: 0.8%).

GDP growth in **Japan** rebounded 3% in the first half of 2012 (January – June 2011: -1%) underpinned by solid domestic demand. Private consumption grew at a faster pace of 3.5% as household consumption rose 3.5% following higher household income, expectation of lower global commodity prices and better corporate profits which improved job opportunities. Meanwhile, public investment surged 6.8% due to continued spending on post-tsunami rebuilding efforts. Exports rose 4.7% (January – June 2011: 8%) following stronger demand from the US market despite the strengthening yen.

On the supply side, growth was mainly driven by the services sector. The wholesale and retail subsector rebounded 0.4% (January – June 2011: -2.3%) primarily due to an increase in the sales of food and beverages, and motor vehicles following the reintroduction of government incentives to purchase fuel-efficient cars. Similarly, the manufacturing sector also expanded as indicated by increases



in the indices of industrial production for motor vehicles, industrial machinery and food production. This was also reflected in the manufacturing PMI which averaged 50.6 points (January – June 2011: 49.7 points). The unemployment rate fell to 4.3% (July 2011: 4.7%) as companies in the manufacturing sector, transport, medical and welfare subsectors started to rehire after recovering from the earthquake-related disaster.

Japan experienced inflation of 0.3% in the first half of 2012. However, the Consumer Price Index (CPI) declined 0.4% in July 2012 (July 2011: 0.2%) following lower prices of housing, transport and communication, as well as furniture and household goods. The Bank of Japan (BOJ) continued with its accommodative monetary policy by keeping the policy rate between 0.00% and 0.10% to sustain economic growth. In addition, the BOJ has undertaken an asset purchase programme of JPY70 trillion from July 2012 to June 2013, which includes buying of Japanese government and corporate bonds and equities to boost asset prices. The Japanese economy is expected to grow 2.4% in 2012 (2011: -0.8%) mainly contributed by robust domestic demand.

China registered a slower GDP growth of 7.8% in the first half of 2012 (January – June 2011: 9.6%) following weaker external demand. Growth in exports moderated to 9.2% (January – June 2011: 24%) due to lower demand, particularly from the EU. Overall growth continued to be driven by domestic demand, albeit at a slower pace. Private consumption grew at a moderate pace despite higher per capita income of urban and rural households at 13.3% and 16.1% (January – June 2011: 13.2%; 20.4%), respectively. The consumer confidence index declined 1.9% to average 102.6 points (January – June 2011: 104.6 points). Investment in fixed assets, however, increased 20.4% (January – June 2011: 25.6%) largely attributed to the implementation of the government's low-cost housing plan. Similarly, private investment in real estate grew 16.6% (January – June 2011: 32.9%) mainly due to strong demand for residential units.

Growth in the manufacturing sector moderated as reflected in the marginal expansion of the manufacturing PMI which averaged 51.4 points (January – June 2011: 52.4 points), impacted by lower orders from overseas. Retail sales grew at a slower rate of 14.4% (January – June 2011: 16.8%) following sluggish motor vehicle sales as the government imposed restrictions on car purchases to ease traffic congestion and pollution. The CPI eased to 2% (August 2011: 6.2%) due to moderating food prices. The People's Bank of China (PBOC) reduced the deposit reserve requirement ratio for large financial institutions in February and May 2012 to 20%. Similarly, the PBOC has lowered the policy rate twice since January to 6.00% in July to spur growth and investment. As part of the initiatives to mitigate the impact of the economic slowdown, the government has also approved several large infrastructure projects. China's GDP is projected to grow 7.5% in 2012 (2011: 9.3%).

In the **ROK**, GDP grew at a slower pace of 2.5% during the first half of 2012 (January – June 2011: 3.8%) as exports decelerated significantly due to lower demand from China and the EU. Export growth slowed sharply to 0.6% (January – June 2011: 23.7%) largely on account of weak demand for semiconductors and steel products. Private consumption growth moderated to 1.3% (January – June 2011: 2.9%) due to lower household consumption as reflected in the consumer sentiment index which fell to an average of 101.5 points (January – June 2011: 102.8 points). Private investment, particularly in manufacturing facilities moderated to 2.2% (January – June 2011: 8.9%).

Meanwhile, value-added in the manufacturing sector also moderated to 3.3% (January – June 2011: 8.6%) following lower production of metal products and general machinery as reflected in the manufacturing PMI which averaged 50.7 points (January – June 2011: 52.3 points). Growth of the wholesale and retail trade subsector moderated to 3.1% (January – June 2011: 7%) mainly due to weakening domestic demand as consumers



curtailed spending following concerns over weak economic growth. The unemployment level was sustained at 3.1% (July 2011: 3.3%) due to higher employment opportunities in health, social welfare and education services. The CPI moderated to 1.2% (August 2011: 4.7%) largely attributed to lower prices of food and non-alcoholic beverages, housing, utilities and transport. The government has introduced two stimulus packages in a span of two months in June and September amounting to USD7 billion and USD5.2 billion, respectively, to boost consumer spending. These packages include tax breaks on personal income, house purchase and domestic sales on automobiles and large electronics appliances. Similarly, the Bank of Korea revised its policy rate from 3.25% to 3.00% in July, the first time in 13 months to sustain domestic demand. The ROK's growth for 2012 is expected to expand moderately by 3% (2011: 3.6%).

GDP growth in **India** expanded at a slower pace of 5.4% during the first half of 2012 (January – June 2011: 8.6%) mainly due to weak investment activities, lower manufacturing and agriculture output. High interest rates and retrospective tax changes and regulations impacted investor sentiment. Industrial output was constrained by inefficient infrastructure facilities; energy shortages; and lack of skilled labour. However, the economy benefited from the strong growth of 10.4% (January – June 2011: 9.7%) in the financing, insurance, real estate and business services subsector. Inflation, as measured by the wholesale price index, eased slightly during the first quarter of 2012 to 7.4% from an average of 9.5% in 2011. This prompted the Reserve Bank of India (RBI) to reduce its main policy rate by 50 basis points to 8.00% in April 2012, the first reduction in three years. However, inflation edged up to 7.5% in the second quarter of 2012. The main inflationary pressures include rising food prices, the weak rupee and the persistent fiscal deficit.

In September 2012, the government announced the liberalisation of foreign direct investment (FDI) in retail trade, aviation and broadcasting

services to boost investment growth. Additionally, the RBI reduced the cash reserved ratio by 25 basis points to 4.50% to increase liquidity in the banking system. India is expected to register a slower growth of 6.1% in 2012 (2011: 7.1%) partly due to subdued investment activities and a slowdown in external demand. Inadequate rainfall following the late arrival of the Southwest Monsoon in June is also expected to reduce agriculture output and impact negatively on growth.

Australia recovered from the devastating floods of late 2010 and early 2011 to register a strong GDP expansion of 4% during the first half of 2012 (January – June 2011: 1.5%). Growth was mainly supported by robust investment in the mining sector and higher household consumption. Household consumption increased on account of heavy retail discounts in the first quarter of 2012 and government payments to households in the second quarter of 2012. The mining industry; financial and insurance; and professional, scientific and technical services were the major contributors to output growth. The unemployment rate has remained low at around 5% since 2010 mainly due to job creation in the mining industry. Inflation eased to 1.4% (January – June 2011: 3.5%), reflecting softening global oil prices, lower house prices and exchange rate appreciation. Overall growth for 2012 is expected at 3% (2011: 2%).

In **New Zealand**, GDP growth is projected to expand 2.3% in 2012 (2011: 1.4%) mainly driven by private consumption and fixed investment. Private consumption is expected to grow moderately as households continue to remain cautious and focused on saving and repaying debt. Fixed investment is anticipated to increase, particularly for post-earthquake reconstruction projects. Inflation is expected to remain low at 1.2% (2011: 4%) due to the decline in prices of global commodities. The Reserve Bank of New Zealand has kept the main policy rate at 2.50% since March 2011, as part of efforts to boost confidence after the earthquake in February 2011.



The Association of Southeast Asian Nations (ASEAN) economies continued to remain resilient during the first half of 2012 on account of strong domestic demand despite slower exports. The GDP of **Indonesia** expanded 6.3% (January – June 2011: 6.5%) mainly driven by robust investment and government spending. Capital investment rose 11.2% largely contributed by the expenditure on imported transport equipment, while public consumption grew 6.5%. On the supply side, growth was mainly driven by a double-digit expansion of 10.2% in the transport and communication subsector. Inflation stood at 4.6% (August 2011: 4.8%) mainly due to higher basic food prices. Bank Indonesia has maintained its policy rate at 5.75% since February 2012 to support economic growth. For 2012, the economy is expected to grow 6.5% (2011: 6.5%).

The **Philippines'** economy grew at a faster pace of 6.1% (January – June 2011: 4.2%) primarily due to higher government spending in infrastructure and buoyant household consumption, which grew 13.7% and 6.1%, respectively. Inflation eased to 3.8% (August 2011: 4.7%) mainly attributed to lower oil prices. Bangko Sentral ng Pilipinas reduced its policy rate by 25 basis points to 3.75% in July 2012 to sustain economic growth. The Philippines' credit rating was raised to BB+ by Standard & Poor's in July, the highest level since 2003, reflecting the country's improved fiscal position, sustained growth in remittances and strengthening external position. The GDP growth is projected between 5% and 6% for 2012 (2011: 3.9%).

The GDP of **Thailand** grew 2.2% (January – June 2011: 3%) mainly driven by strong domestic consumption. Private consumption increased 4.1% following post-flood recovery programmes and income support policies undertaken by the government which helped to boost consumer confidence. Private investment rose 10.5% mainly due to higher imports of machinery and equipment to repair the factories, as well as the acceleration of post-flood construction projects. Inflation eased further to 2.7% (August 2011:

4.3%), reflecting a slower increase in the prices of consumer products. The Bank of Thailand has maintained its policy rate at 3.00% since January 2012 to support a firm recovery of the economy. For 2012, GDP is expected to grow between 5.2% and 6.2% (2011: 0.1%).

The GDP growth of **Singapore** moderated to 1.7% (January – June 2011: 5%) mainly attributed to slower manufacturing output and services activities. Manufacturing output increased moderately by 1.8% (January – June 2011: 3.9%) mainly contributed by the biomedical and transport engineering industries. The wholesale and retail trade subsector contracted 0.4% (January – June 2011: 3.4%) largely due to the slowdown in retail sales. Inflation increased at a slower pace of 4% (July 2011: 5.4%) as housing and transport costs began to trend lower. The Monetary Authority of Singapore tightened its monetary policy in April 2012 to curb inflation through strengthening the Singapore dollar. For 2012, growth is expected between 1.5% and 2.5% (2011: 4.9%).

The GDP of **Vietnam** grew 4.4% (January – June 2011: 5.6%) attributed to the strong performance in the services, manufacturing and construction sectors. Inflation eased significantly from a peak of 23% in August 2011 to 5% in August 2012 on account of fiscal and monetary policy tightening measures, including a total of 600 basis points in policy rate hikes to 15.00% in 2011. In tandem with easing inflation, the State Bank of Vietnam has lowered its policy rate by a total of 500 basis points since March 2012 to 10.00% in July to stimulate economic growth. For 2012, Vietnam's economy is expected to grow 6% (2011: 5.9%).

The GDP in **Myanmar** is expected to register a strong growth of 6% in 2012 (2011: 5.5%) largely supported by foreign investment in the energy sector as well as higher exports of commodities and natural gas. Its two largest investors are China and Thailand, which together account for USD25 billion worth of investments. The ongoing political and economic reforms are expected to



attract foreign participation in trade and investment. The easing of economic sanctions imposed by advanced countries as well as the resumption of assistance and concessionary financing from international financial institutions have helped to support the economic revitalisation.

The GDP growth in **Cambodia** is expected to expand 6.2% in 2012 (2011: 6.1%) largely on account of increased merchandise exports to the US and the EU. Growth will also be supported by the expansion in the services sector following higher tourist spending. Growth in other ASEAN economies, namely Brunei Darussalam and Lao PDR is expected to remain strong at 3.2% and 8.4% (2011: 1.9%; 8.3%), respectively.

Growth in the **Middle East and North Africa (MENA)** region is projected to expand 5.5% in 2012 (2011: 3.5%) benefiting from higher oil production, increasing domestic demand and rebounding economic activities in Libya. The **oil exporting countries**, including Iraq, Kuwait, Qatar and Saudi Arabia are expected to grow 4.8% (2011: 4%). Iraq's growth is expected to remain strong at 11.1% (2011: 9.9%) mainly driven by investment in oil and infrastructure projects as well as an increase in government capital spending. However, Qatar's growth is forecast to moderate to 6% (2011: 18.8%) because of receding crude oil and natural gas production rates. Kuwait and Saudi Arabia's growth are expected at 6.6% and 6% (2011: 8.2%; 6.8%), respectively due to an increase in oil production and government spending. Libya's economy is expected to rebound significantly by 76.3% (2011: -61%) due to higher oil production following increasing demand from the EU. Libya is also expected to gain from the sanctions on Iranian and Syrian oil supplies. In addition, effective from May 2012, some international oil companies have resumed operations in Libya. Syria's economy is expected to contract 8.1% (2011: -3.4%) due to continuing social and political unrest since March 2011. Meanwhile, the **oil importing countries**, including Egypt, Jordan, Lebanon and Tunisia are expected to grow 2.2% (2011: 2%). In Egypt and Tunisia, growth is projected at 1.5% and

2.2% (2011: 1.8%; -0.8%), respectively due to increased government spending on subsidies and wages.

The **Sub-Saharan Africa** region is expected to expand 5.4% in 2012 (2011: 5.2%) underpinned by new natural resource production coming onstream notably in Angola, Niger and Sierra Leone; the rebound from drought in eastern Africa; and strong post-conflict recovery in Côte d'Ivoire. Favourable international commodity prices and increased export diversification towards emerging Asian markets will also contribute to the expansion. Growth in South Africa is forecast to moderate to 2.7% (2011: 3.1%) due to weaker exports to advanced countries. In Nigeria, growth is expected to remain steady at 7.1% (2011: 7.2%) mainly supported by service industries, particularly telecommunications. Angola is expected to grow 9.7% (2011: 3.4%) mainly because of higher oil production after supply disruptions in oil fields in 2011.

Growth in the **Commonwealth of Independent States (CIS)** is projected to remain steady at 4.1% in 2012 (2011: 4.9%) mainly supported by stable growth in energy exporters such as Kazakhstan and Russia. Russia is expected to register a steady growth of 4% (2011: 4.3%). Domestic consumption, boosted by rising real wages and strong credit growth, will provide the main impetus to the economic expansion. Consumer price inflation increased to 5.9% in August from 4.2% in January 2012 fuelled by higher utility tariffs and food prices. In an effort to curb rising inflation, the Russian Central Bank increased the policy rate to 8.25% in September 2012 after maintaining it at 8.00% since December 2011. Meanwhile, the unemployment rate fell further to 5.9% (January – July 2011: 7%) due to better labour market conditions, following increases in wages and employment. Russia's full participation as the 156th member of the World Trade Organisation (WTO) in August 2012 is expected to have a positive impact on the economy. In Kazakhstan, GDP growth is expected to moderate to 5.9% (2011: 7.5%) due to lower industrial output,



particularly in the construction and mining sectors. However, government investment in development projects will continue to support growth.

Growth in the **Latin America and Caribbean** region is projected to moderate to 3.4% in 2012 (2011: 4.5%) due to policy tightening in the past and the effect of a weaker external environment, and lower commodity prices since May 2012. Economic activity in Brazil is expected to remain subdued with GDP increasing at a slower pace of 2.5% (2011: 2.7%), reflecting weak investment and business confidence, and lower trade volume. This is also due to the ongoing decline in Brazil's manufacturing sector that suffers from structural competitiveness problems, including infrastructure bottlenecks and shortage of skilled labour. As a result, the industrial production index contracted 3.7% during the first seven months of 2012 (January – July 2011: 1.5%). In August 2012, to ease the infrastructure bottlenecks, Brazil launched a USD66 billion stimulus package to spur investment for infrastructure, particularly roads and railways, and to boost investor confidence. The government also announced that it would sell concessions in public transport projects. Taxes on cars and home appliances were reduced to boost consumption. Inflation receded from a peak of 7.3% in September 2011 to 5.2% in August 2012, above the Banco Central do Brasil target of 4.5%. The central bank has also reduced the main policy rate by a total of 500 basis points since August 2011 to a record low of 7.50% in August 2012 in an effort to support stimulus measures by the government in the slowing economy.

In Mexico, growth is forecast to remain stable at 3.9% in 2012 (2011: 3.9%) supported largely by private consumption. Sustained growth in employment contributed to steady disposable incomes. The inflation rate increased to 4.4% in July 2012 (July 2011: 3.6%) due to increases in food prices, especially grain and livestock, and a weaker peso. The Banco de Mexico has kept its policy rate unchanged at 4.50% since July 2009.

Investment Flows

Global FDI rose despite uncertainties

Global FDI flows increased significantly by 16.4% to USD1.5 trillion in 2011 (2010: 1.9%; USD1.3 trillion). This increase was supported by higher profits of transnational corporations (TNCs) and relatively high economic growth in developing countries, despite the uncertainties in the advanced economies. Greenfield investments remained flat but continued to account for the bulk of FDI (60%) while cross-border mergers and acquisitions (M&As) rose significantly by

TABLE 2.3

FDI Inflows by Selected Host Regions and Major Host Economies 2010 – 2011

	USD billion		Change (%)
	2010	2011	
World	1,309	1,524	16.4
Top 5 recipients			
United States	197.9	226.9	14.7
China	114.7	124.0	8.1
Belgium	81.2	89.1	9.7
Hong Kong, China	71.1	83.2	17.0
Brazil	48.5	66.7	37.5
Advanced economies	618.6	747.9	20.9
Europe	356.6	425.3	19.3
European Union	318.3	420.7	32.2
Japan	-1.3	-1.8	-38.5
Developing economies	616.7	684.4	11.0
Asia and Oceania	386.2	424.8	10.0
India	24.2	31.6	30.6
ASEAN	93.1	116.8	25.5
Singapore	48.6	64.0	31.7
Indonesia	13.8	18.9	37.0
Malaysia	9.1	12.0	32.0
Thailand	9.7	9.6	-1.0
Vietnam	8.0	7.4	-7.5
Transition economies	73.8	92.2	25.0
Southeast Europe	4.0	6.7	67.5
Commonwealth of Independent States	69.0	84.5	22.5

Source: United Nations Conference on Trade and Development.



53%. FDI in the primary and services sectors increased sharply by 46% and 15%, respectively, accounting for a larger share of 14% (2010: 11%) and 40% (2010: 39%) of total FDI. The value of FDI projects in manufacturing rose 7%, with a lower share of 46% (2010:50%).

FDI inflows increased across all major economic groupings in 2011. Flows to developed countries increased 20.9% to USD747.9 billion (2010: 2%; USD618.6 billion) due to a robust recovery of investment flows to the US amounting to USD226.9 billion (2010: USD199.9 billion) that constituted 30% (2010: 32%) of the total inflows to the developed countries. Inflows to the EU surged 32% to USD420.7 billion (2010: -11%; USD318.3 billion). This strong turnaround was contributed by the restructuring of the financial institutions. The EU financial institutions continued to offload overseas assets to repay the loans they received during the financial crisis, and also to strengthen their capital base to meet the tougher targets set by the ECB.

Developing and transition economies continued to account for more than half of global FDI at 45% and 6%, respectively as their combined inflows rose 12% to USD776.6 billion (2010: 17%; USD690.5 billion). FDI to developing countries increased 11% to USD684.4 billion (2010: 19%; USD616.7 billion), while FDI in the transition economies increased 25% to USD92.2 billion (2010: 2%; USD73.8 billion).

Driven by greenfield investment opportunities and lower production costs, FDI inflows to the developing regions of East Asia and Southeast Asia rose 14% to USD335.5 billion (2010: 42%; USD294.1 billion), accounting for 22% (2010: 22%) of the global inflows. Inflows to East Asia experienced a 9% increase to USD219 billion (2010: 26%; USD201.4 billion) while FDI to Southeast Asia increased 26% to USD116.6 billion (2010: 96%; USD92.8 billion). The United Nations Conference on Trade and Development (UNCTAD) World Investment Report 2012 highlighted that four ASEAN economies, namely Brunei, Indonesia, Malaysia and Singapore saw a considerable rise in FDI inflows in 2011 reaching

a combined total of USD96 billion (2010: USD72 billion). Malaysia's FDI inflows accelerated 31.5% to USD12 billion (2010: 526%; USD9.1 billion). As China continues to experience rising wages and production costs, the relative competitiveness of ASEAN in manufacturing sector has been enhanced. Accordingly, some foreign investors in China's coastal regions are relocating to Southeast Asia.

FDI flows to China, the largest recipient among developing nations, reached USD124 billion in 2011 (2010: USD114.7 billion). FDI flows to the services sector surpassed the manufacturing sector for the first time due to higher inflows to non-financial services. Rising wages and production costs led to a slowdown of flows to manufacturing. It is also expected that FDI in the financial sector will continue to grow as China continues to open its financial markets, and as foreign banks expand their presence.

FDI flows to South Asia rose 23% to USD38.9 billion in 2011 (2010: -25%; USD31.7 billion) mainly due to high FDI inflows of USD31.6 billion (2010: USD24.2 billion) to India, following a significant increase of investment in the mining sector from the EU. FDI flows to Africa were at USD42.7 billion (2010: USD43.1 billion), marking a third successive year of decline. Cross-border M&As and greenfield investments by foreign TNCs decreased. The decline in FDI flows to the African continent was caused largely by the fall of inflows to North Africa due to the political instability in Egypt and Libya. In contrast, inflows to Sub-Saharan Africa increased to USD37 billion in 2011 (2010: USD29 billion). Overall, despite the decline in the total FDI to Africa, the prospects are brightening due to the growth of FDI in services such as banking, retail and telecommunications.

Outflows of FDI from developed countries rose sharply by 25% to USD1.2 trillion in 2011 (2010: 15.4%; USD989.6 billion). While all three major investor blocs in the developed economies – the EU, Japan and North America contributed to this increase, the driving factors differed for each. FDI from the US was driven by a record level of reinvested earnings (82% of total FDI



outflows). The increase in FDI outflows from the EU was driven by cross-border M&As. An appreciating yen improved the purchasing power of Japanese TNCs, resulting in a doubling of their FDI outflows, with net M&A purchases in Europe and North America rising 132%.

Outward FDI from developing economies declined 4% to USD383.8 billion in 2011 (2010: 49%; USD400.1 billion), although their share in global outflows remained high at 23%. Flows from East and Southeast Asia were largely stagnant at USD240 billion (2010: 38%; USD243 billion) with a 9% decline (2010: 38%) from East Asia, while outward FDI from West Asia increased significantly by 54% to USD25.4 billion (2010: 8%; USD16.5 billion) due to the increased oil revenue. FDI outflows from Latin America and the Caribbean remained volatile, decreasing 17% to USD99.7 billion in 2011 after increasing 121% in 2010. This volatility is caused by the large amount of funds (70%) going into the offshore financial centres.

The UNCTAD World Investment Report 2012 forecast a slower FDI growth in 2012, with flows levelling at USD1.6 trillion (2011: USD1.5 trillion). The risks to FDI growth in 2012 include the fragility of the advanced economies, uncertainties in the business environment and lower growth in major emerging economies. However, longer-term projections show a moderate but steady rise, with global FDI reaching USD1.8 trillion in 2013 and USD1.9 trillion in 2014, barring any macroeconomic shocks.

Trade Flows

Trade flows decelerate further

The volume of global trade is projected to expand at a slower pace of 3.8% in 2012 (2011: 5.9%). The further slowing of trade in 2012 is due to lower demand from advanced economies, following the escalating crisis in the euro area and slower growth in the US. These developments will also adversely affect emerging and developing economies and lead to moderate growth in their exports at 5.7%

(2011: 6.6%). The main contributing factors are declining commodity prices and the slower pace of expansion in China. However, import growth to emerging and developing economies is anticipated to remain strong at 7.8% (2011: 8.8%). Export growth in developed economies is expected to be lower at 2.3% (2011: 5.4%), while import growth is estimated to slowdown to 1.9% (2011: 4.4%).

The **US** total trade increased 5.1% to USD2,886.4 billion during the first seven months of 2012 (January – July 2011: 15.7%; USD2,746.7 billion). Exports rose 5.5% to USD1,278.4 billion (January – July 2011: 16%; USD1,211.2 billion), while imports increased 4.7% to USD1,608 billion (January – July 2011: 15.5%; USD1,535.5 billion). Major exports comprised automotive vehicle parts and engines, petroleum products, pharmaceutical preparations as well as civilian aircraft. Imports included crude oil, industrial machines, apparel and household goods as well as computers and accessories. The trade deficit remained high at USD329.7 billion (January – July 2011: USD324.4 billion). Major export destinations were Canada with a share of 19%, Mexico (13.9%), China (6.9%), Japan (4.5%), the UK (3.7%) and Germany (3.2%). For 2012, exports are projected to increase 4% (2011: 6.7%), while imports expand 3% (2011: 4.9%).

Total trade for the **euro area** continued to grow at a significantly slower pace of 5.6% to USD2,786.6 billion (January – July 2011: 16.1%; USD2,638.5 billion) due to the protracted sovereign debt and banking crises. The major trading partners were Switzerland, Turkey, the UK and the US. Exports grew 8.8% to USD1,420 billion (January – July 2011: 15.5%; USD1,305.6 billion), comprising mainly machinery and vehicles, and energy. Meanwhile, imports increased 2.5% to USD1,366.6 billion (January – July 2011: 16.8%; USD1,332.9 billion), which included energy and chemicals. For 2012, exports are projected to grow 2.1%, while imports contract 0.2%.

Total trade of **Japan** expanded further by 6.3% to USD995.7 billion (January – July 2011: 15.2%; USD936.5 billion) following full recovery in the manufacturing supply chain and significantly



TABLE 2.4

Exports and Imports for Selected Countries January – July

	Exports			Imports			Total Trade		
	USD billion		Change (%)	USD billion		Change (%)	USD billion		Change (%)
	2011	2012		2011	2012		2011	2012	
United States ¹	1,211.2	1,278.4	5.5	1,535.5	1,608.0	4.7	2,746.7	2,886.4	5.1
Euro area	1,305.6	1,420.0	8.8	1,332.9	1,366.6	2.5	2,638.5	2,786.6	5.6
Japan	462.9	476.2	2.9	473.6	519.5	9.7	936.5	995.7	6.3
China ²	1,222.6	1,309.1	7.1	1,130.0	1,188.5	5.1	2,352.5	2,497.6	6.2
Singapore ²	272.3	273.2	0.3	244.5	253.7	3.8	516.7	526.9	2.0

¹ Includes goods and services as at end July.

² January – August.

Source: World Trade Organisation and national authorities.

higher petroleum imports. Exports increased 2.9% to USD476.2 billion (January – July 2011: 7.9%; USD462.9 billion) as exports to the US outpaced the slowdown in exports to China, the EU, ROK and Taiwan. The main exports were motor vehicles, electrical machinery and manufactured goods such as iron, steel and rubber products. Meanwhile, imports rose 9.7% to USD519.5 billion (January – July 2011: 23.4%; USD473.6 billion), following higher demand for fossil fuels to offset lower nuclear power production. The appreciation of the yen against the US dollar and lower global commodity prices also contributed to higher imports. In terms of trade direction, China remained Japan's major market with a share of 19.4%, followed by ASEAN (15.4%), the US (12.8%) and the EU (9.8%). Japan's exports of goods and services are projected to increase 3.1% while imports are expected to rise 7.4% in 2012.

Total trade of **China** grew slower at 6.2% to USD2,497.6 billion (January – August 2011: 25.4%; USD2,352.5 billion) following weaker demand from key export markets, increased labour costs and slower private consumption. Total exports moderated 7.1% to USD1,309.1 billion (January –

August 2011: 23.6%; USD1,222.6 billion), while total imports grew 5.1% to USD1,188.5 billion (January – August 2011: 27.5%; USD1,130 billion). Major exports included mechanical and electrical products, high-tech products such as aerospace and scientific instruments, automatic data processing machines, garments and clothing as well as mobile phones. Imports included mechanical and electrical products, crude oil, iron ore and motor vehicles. China's main trading partners were the EU (14.6%), of which Germany contributed the most at USD108.2 billion, the US (12.5%), ASEAN (10.1%) and Japan (8.8%). Within ASEAN, Malaysia was the largest trading partner with a share of 23.7% or USD60 billion followed by Thailand with 17.9% or USD45.2 billion.

Total trade of **Singapore** expanded 2% to USD526.9 billion (January – August 2011: 20.7%; USD516.7 billion) with exports and imports growing 0.3% and 3.8% (January – August 2011: 20.6%; 20.8%), respectively. Major exports included refined petroleum products, electrical machinery and chemicals. Imports comprised machinery and transport equipment, crude petroleum as well as chemicals and chemical products. Singapore's main



trading partners were China, the EU, Indonesia and Malaysia. For 2012, exports are projected to increase 2.3%, while imports 12.1%.

International Economic Cooperation

Coordinated policy responses

The prolonged global financial and economic uncertainties have called for a greater policy coordination and action for crisis prevention and resolution. Inter-regional cooperation with global decision-making plays a vital role in restoring investor confidence and ensuring financial stability to achieve sustainable growth. In addition to enhancing financial safety nets, international cooperation has initiated financial and fiscal reforms for a firm global recovery.

International financial institutions including the IMF and the World Bank Group (WBG), and economic forums such as the Group of Twenty (G20) play an important role in guiding members to manage the challenges posed by the financial crisis. The **IMF** has undertaken various measures for crisis prevention and resolution to restore global economic growth through strengthening of lending capacity as well as enhancing surveillance and technical assistance. The IMF has increased its lending resources through a new round of bilateral borrowing. As of June 2012, 37 member countries including China, France, Germany, Italy and Japan have pledged bilateral commitments of USD456 billion. Malaysia has committed to contributing USD1 billion to this facility. The additional resources will be treated as the second line of defence, which will only be drawn if the IMF existing credit lines to borrow fall below the threshold of SDR100 billion.

In March 2012, the IMF approved a new EUR28 billion loan with an immediate disbursement of EUR1.7 billion for Greece under the Extended Fund Facility (EFF) to restore competitiveness and growth, fiscal sustainability and financial stability. Portugal also received its fourth disbursement of EUR1.5 billion in July 2012 under its three-year EFF arrangement for EUR29.3 billion, bringing

the total disbursed to EUR21.1 billion. Meanwhile, the IMF has approved the distribution of SDR700 million (part of total profit of SDR6.9 billion gained from gold sales) to all member countries. The IMF encouraged all members to return the distributed amounts to subsidise the Poverty Reduction and Growth Trust (PRGT), which aims at supporting the Low Income Countries (LICs). As of September 2012, 116 countries including Malaysia, representing 84.6% of the proposed distribution have agreed to return their portion to support the LICs.

In response to the global crisis, the IMF has strengthened its surveillance capabilities. Towards this, in 2012, the IMF plans to conduct the Financial Sector Assessment Program (FSAP) in 18 countries including Malaysia. Meanwhile, consistent with the recommendation of the IMF's recent FSAP for Spain, the Eurogroup (a meeting of the finance ministers of the euro area) released EUR30 billion in July 2012 to strengthen its banking sector. Furthermore, in July 2012, the IMF Executive Board approved a new mechanism on bilateral and multilateral surveillance. Through this mechanism, the annual bilateral IMF consultation will incorporate multilateral surveillance to ensure coverage of spillovers from members' policies that may have an impact on global stability. In addition, the IMF has initiated the Pilot External Sector Report to broaden the focus of external sector surveillance to include current account, capital account, reserve accumulation, measures on capital flows, and foreign assets and liabilities.

In terms of technical assistance, the IMF has opened its fourth Africa Regional Technical Assistance Centre in Mauritius to focus on strengthening the capacity of African governments and institutions to design and implement sound macroeconomic policies. This Centre will serve 13 countries across southern Africa and the Indian Ocean. Additionally in Asia, the IMF has set up a new regional office in Bangkok in collaboration with the Government of Thailand, to support technical assistance for Lao PDR and Myanmar. This new office is expected to commence operations in September 2012. The IMF is also developing three new Topical Trust Funds in the areas of sustainable debt strategies



for the LICs; strengthening macroeconomic management skills of Africa's mid and high-level government officials; and monitoring financial vulnerabilities in emerging countries.

The **WBG** is continuously working towards alleviating global poverty. The WBG financial commitments amounted to USD53 billion in the financial year (FY) 2012 (FY2011: USD57.4 billion). These commitments were channelled through its agencies including the International Bank for Reconstruction and Development (IBRD) with USD20.6 billion and the International Development Association (IDA) with USD14.7 billion. Meanwhile, the International Finance Corporation (IFC) has committed over USD15 billion for initiatives towards leveraging the private sector in creating jobs, encouraging innovation and addressing development challenges. The IFC focuses on the poorest countries and regions especially in Sub-Saharan Africa, with investment increasing to USD4 billion. The WBG also issued USD2.3 billion in guarantees through the Multilateral Investment Guarantee Agency (MIGA), its political risk insurance arm. The issuances of these guarantees will support 51 projects around the world.

At the regional level, **ASEAN** Member States continue to achieve significant progress in delivering the commitments made to deepen the market integration under the Roadmap for Monetary and Financial Integration of ASEAN. The ASEAN Finance Ministers have pledged to undertake concrete steps in realising the goals of the ASEAN Economic Community (AEC) by 2015. The most significant achievement for 2012 is the operationalisation of the ASEAN Infrastructure Fund Limited, a corporate entity established in Labuan that provides loans for infrastructure projects.

In an effort to increase capacity building among ASEAN Member States, the Second Municipal Finance Training Certification (MFTC) Programme under the ASEAN-World Bank Infrastructure Financing Network was held in June 2012. The MFTC programme was designed for local government officials, specifically to modernise budgetary policies, implement procedures and institutional reforms, and gain new financial management skills. Under the

customs cooperation, the ASEAN Finance Ministers signed a new ASEAN Agreement on Customs in March 2012 in Phnom Penh, Cambodia. The agreement will enhance trade facilitation within the AEC.

In May 2012, the **ASEAN+3** (China, Japan and ROK) Finance Ministers and Central Bank Governors' Meeting agreed on strengthening the Chiang Mai Initiative Multilateralisation (CMIM) framework which encompassed the initiative to double the size of the CMIM from USD120 billion to USD240 billion; increasing the IMF de-linked portion to 30% in 2012; and introducing a crisis prevention function known as the CMIM Precautionary Line. In addition, the Meeting also agreed to enhance the Asian Bond Markets Initiative (ABMI) by drawing a new ABMI Roadmap+ to produce tangible outcomes and to widen the scope of discussion. The ABMI continues to build on existing initiatives, namely the Credit Guarantee Investment Facility, promotion of Asian bonds to institutional investors, regional settlement intermediaries, and the common bond issuance programme. Meanwhile, the ABMI working groups are also embarking on new initiatives such as enhancing financial access to consumers and small and medium enterprises through cross-border bond transactions.

The **Asia-Pacific Economic Cooperation (APEC)** continues to provide an avenue to discuss issues of common concerns and initiatives for capacity building among member economies. The 19th APEC Finance Ministers' Meeting held in August 2012 in Moscow, Russia discussed the current economic outlook and policy challenges for the APEC region with a focus on fiscal sustainability for long-term economic growth; financial policy measures to address the impact of natural disasters; and financial literacy and education as a continuation of the financial inclusion initiative that began in 2011. In particular, Malaysia shared its experiences on financial inclusion initiatives. Additionally, the Finance Ministers endorsed the establishment of the Asia-Pacific Financial Forum (APFF) proposed by the APEC Business Advisory Council. The APFF is envisioned to be a platform for public-private sector collaboration to help the region develop sound, efficient and integrated markets as well as complement various ongoing regional initiatives.



ASEAN Infrastructure Fund – Strengthening Regional Integration

Infrastructure development in the Association of Southeast Asian Nations (ASEAN) is still inadequate despite the region's decades of high economic growth. Rapid growth has exerted pressure on existing infrastructure, underscoring the need for greater infrastructure development. The Asian Development Bank (ADB) has estimated that ASEAN Member States will need over USD60 billion per year during 2010 – 2020 in financing infrastructure requirements¹.

Infrastructure development is critical in accelerating ASEAN regional growth and integration. It is well recognised that sound infrastructure is a prerequisite to attract investment, expand international trade, and stimulate domestic consumption further. Adequate infrastructure is also necessary to facilitate sustained economic growth and address poverty alleviation in the region. Additionally, infrastructure development gaps among ASEAN Member States must be narrowed for a more inclusive growth in the region.

While ASEAN faces large infrastructure deficits, it also holds significant regional savings. In this context, the proposal to mobilise ASEAN savings into regional infrastructure development was first mooted by Malaysia at the 10th ASEAN Finance Ministers' Meeting in Cambodia in 2006. Malaysia has since chaired a series of High-Level Task Force Meetings comprising ASEAN Senior Finance Officials to explore the best framework and mechanism to establish the ASEAN Infrastructure Fund (AIF). In essence, the AIF is an innovative regional cooperation and integration initiative, which promotes the use of ASEAN savings to finance infrastructure development.

In September 2011, nine ASEAN Member States and the ADB reached a consensus to provide equity contributions in three tranches amounting to USD485.2 million for the AIF. Of this total, Malaysia contributed USD150 million. The equity contribution will be augmented with hybrid capital after four to five years of operation. Once the AIF has established a credible track record, bonds will be issued. Bond issuance is an important feature of the AIF's business model, as it is designed to tap the region's substantial foreign exchange reserves while maintaining reserve eligibility based on the AIF's expected high investment grade credit rating and sufficient liquidity.

TABLE 1

Equity Contribution

Shareholder	1 st tranche (2012)	2 nd tranche (2013)	3 rd tranche (2014)	Total
USD million				
Brunei Darussalam	3.4	3.3	3.3	10.0
Cambodia ¹	0.1	-	-	0.1
Indonesia	40.0	40.0	40.0	120.0
Lao PDR ¹	0.1	-	-	0.1
Malaysia	50.0	50.0	50.0	150.0
Philippines	5.0	5.0	5.0	15.0
Singapore	5.0	5.0	5.0	15.0
Thailand	5.0	5.0	5.0	15.0
Vietnam	3.4	3.3	3.3	10.0
ADB	50.0	50.0	50.0	150.0
GRAND TOTAL				485.2

¹ One-time payment.

¹ Asian Development Bank (ADB) – ADB Institute (ADBI), 2009, *Infrastructure for a Seamless Asia*, Manila.



To operationalise the fund, the ASEAN Infrastructure Fund Limited was incorporated on 24 April 2012 in Labuan, Malaysia under the Labuan Companies Act 1990. The primary aim of the company is to provide loans to ASEAN Member States for financing infrastructure projects in transport, telecommunications and utilities areas. During its initial years of operation, the AIF will focus only on sovereign projects, including Public-Private Partnerships.

Parallel to this development, Malaysia's leadership role in co-chairing the AIF Board of Directors along with Indonesia reflects its commitments towards promoting regional economic growth and integration. Apart from being the largest shareholder, along with the ADB, the establishment of the AIF has raised Malaysia's profile and strengthened its reputation as a progressive and proactive ASEAN member.

Prospects for 2013

Growth remains modest

The outlook for the global economy is expected to remain modest in 2013 with marginally higher projections for growth and lower unemployment in most regions. The growth of the euro area is projected to be between -0.4% and 1.4% (2012: -0.6% – -0.2%) aided by the implementation of coordinated policy measures to resolve the sovereign debt and banking crises. Meanwhile, the US economy is expected to maintain its growth momentum to record a moderate expansion of 2.3% (2012: 2%). However, this is contingent upon policymakers avoiding the fiscal cliff and addressing the federal debt ceiling issues to restore fiscal sustainability and mitigate risks of financial market disruptions. Japan's economy is projected to continue expanding, albeit modestly at 1.5% (2012: 2.4%) as post-earthquake reconstruction efforts wind down.

Growth in emerging and developing economies is expected to remain strong at 5.9% (2012: 5.6%) partly due to monetary easing and fiscal policy measures. Asia, particularly China, India and ASEAN Member States will continue to lead growth. This region is expected to benefit from resilient domestic consumption and initiatives undertaken to accelerate investment, particularly in infrastructure projects.

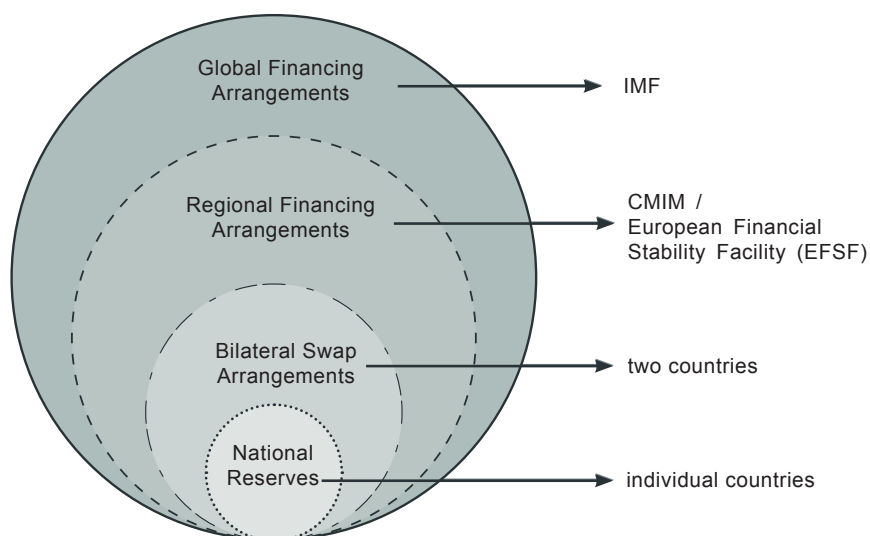
Inflation in advanced economies is projected to remain subdued at 1.6% (2012: 2%) with energy and base metal prices remaining flat. However, increasing food prices are expected to keep inflation at 5.6% (2012: 6.3%) in emerging and developing economies. World trade is projected to grow 5.1% (2012: 3.8%) contributed by increasing intra-trade in emerging and developing economies. Against these developments and based on the IMF WEO July 2012 Update, the global economy is expected to grow 3.9% in 2013 (2012: 3.5%). However, given that downside risks to world trade and growth remain elevated, realising this level of growth remains a challenge.

The Chiang Mai Initiative Multilateralisation – Strengthening Regional Financial Safety Net

The Chiang Mai Initiative Multilateralisation (CMIM) is a regional financial safety net of growing importance within the global financial system. It is designed to provide short-term liquidity support arrangements for ASEAN+3 member countries during a financial crisis. The CMIM is a self-managed reserve pooling arrangement by member countries, governed by a single agreement. Prior to the CMIM, short-term liquidity support arrangements in the region were through a network of bilateral swap arrangements between two contracting countries for an agreed period of time.

CHART 1

The Global Financial Safety Net



Source: ASEAN+3 meetings and IMF papers.

The CMIM agreement was signed on 24 December 2009 and came into effect on 24 March 2010. At the time of establishment, the CMIM framework included a total reserve pool amounting to USD120 billion with 80% contributed by the Plus Three countries (China, Japan and ROK) and 20% by ASEAN countries. Based on this ratio, ASEAN countries have committed to contributing USD24 billion, with Malaysia contributing USD4.6 billion.

The establishment of the CMIM complements the existing financial arrangement under the International Monetary Fund (IMF). The CMIM has a provision for the IMF linked and IMF de-linked portion. The IMF de-linked portion, which is currently set at 20% of the maximum drawdown, allows for quick disbursements when a country is facing a short-term liquidity problem. The balance of 80% will only be released once the country is on an IMF programme (IMF linked portion).

In assisting the CMIM Executive Level Decision-Making Body (ELDMB)¹ determine the eligibility of countries in accessing the CMIM facilities, the ASEAN+3 Macroeconomic Research Office (AMRO) Limited was established in Singapore in April 2011. AMRO is responsible for monitoring macroeconomic and financial conditions as well as identifying emerging vulnerabilities in the ASEAN+3 economies.

¹ ELDMB comprises ASEAN+3 Finance and Central Bank Deputies.



Given the continued uncertainties in the global economic environment, the 15th ASEAN+3 Finance Ministers and Central Bank Governors' Meeting on 3 May 2012 in Manila agreed to further strengthen the CMIM through:

- i) doubling the size of the reserve pool from USD120 billion to USD240 billion;
- ii) increasing the IMF de-linked portion to 30% in 2012 with a view to increasing it to 40% in 2014 subject to review if necessary;
- iii) lengthening the maturity and supporting period for the IMF de-linked portion from 90 days to six months and from one year to two years, respectively; and for the IMF linked portion from 90 days to one year and from two years to three years, respectively; and
- iv) introducing a crisis prevention facility known as the "CMIM Precautionary Line (CMIM-PL)".

The CMIM-PL is designed with reference to the new IMF programme known as the IMF Flexible Credit Line (FCL) and the IMF Precautionary Credit Line (PCL). These facilities were adopted in recognition of the importance of having precautionary measures to mitigate the impact of a financial crisis spreading globally within a short time. The CMIM-PL will be implemented on a flexible basis by applying five qualification criteria, namely external position and market access; fiscal policy; monetary policy; financial sector soundness and supervision; and data adequacy. In addition, a country will be evaluated by the ELDMB after taking into consideration a country's economic report and analysis by AMRO.

The CMIM will continue to improve its operations taking into account recent experiences from other crisis-affected regions such as the euro area. In this regard, options are open for the CMIM to further increase its pool of reserves and the IMF de-linked portion, in line with the expanding role and capability of AMRO as a regional surveillance unit. Towards this, continuous efforts are undertaken to strengthen AMRO's capacity and capability, including the initiative to establish it as an international organisation.

The CMIM has evolved into a comprehensive financial arrangement by providing both crisis resolution and prevention functions as well as macroeconomic surveillance required to overcome and prevent future financial crises. The CMIM is expected to fulfil its objective of enhancing financial stability and market confidence as well as attracting further investment in the region.

Source: Economic Report 2007/2008 "Regional Cooperation in East Asia: Chiang Mai Initiative"; and www.amro-asia.org.