

SOUTHEAST ASIA

The economies of Southeast Asia have generally performed better than expected during the last 6 months, with consumer demand and exports in particular strengthening. Investment and imports, however, remain weak. Inflation is not an issue in most countries. The forecast remains cautiously optimistic, with GDP growth of 3.8% expected in 2002, up from 3.4% in *ADO 2002*, and 4.6% in 2003, up from the earlier forecast of 4.3%.

MACROECONOMIC ASSESSMENT

The economies of Southeast Asia have generally turned in a better performance over the last 6 months than expected at the release of *ADO 2002* in April. Figures for the first half of the year indicate that GDP growth for 2002 will be higher than previously thought, at 3.8% on average against 3.4% in *ADO 2002*. Consumer demand (constituting a large bulk of domestic demand) and exports in particular have strengthened. On the other hand, investment and imports, with a few exceptions, remain weak. Particularly worrisome is the situation of private investment in some countries that have a great deal of excess capacity and that are still plagued by financial problems derived from the Asian financial crisis. In some cases, such as the Philippines, the fiscal deficit is becoming an issue of serious concern. Inflation is not an issue in most countries, and for this reason governments are generally following accommodative monetary policies. On the whole, the subregion has recently also followed expansionary fiscal policies, while most countries in the subregion enjoy healthy current account surpluses. The biggest problem on the horizon for most of them is the prospect of a deceleration in the US economy that would translate into lower exports.

Indonesia's GDP expanded by 3.5% in the second quarter of 2002 from a year earlier. Data for the same quarter show a moderately strong performance in manufacturing, up by 2.5% from the second quarter of 2001. Within the services sector, transport and communications showed 8.2% growth. Household spending rose by 6.3% from the second quarter of 2001, but gross domestic capital formation fell by 1% during the quarter as business confidence remained weak.

The Malaysian economy grew by 2.5% year on year in the first half of 2002. Better than expected external demand conditions than in 2001 and continued pump priming of the economy were the key factors in this. Consumer and business confidence has improved in recent months. Second quarter private consumption increased by 5.6% with respect to the second quarter of 2001 and public consumption rose by 15.5%. On the other hand, gross fixed capital formation weakened by 2.1% in this quarter. On the supply side, the major contributor

A large part of domestic demand is consumption driven.



Selected Economic Indicators, Southeast Asia, 1999–2003

	1999	2000	2001	2002		2003	
				ADO 2002	Update	ADO 2002	Update
GDP Growth (%)							
Average	3.8	6.0	2.0	3.4	3.8	4.3	4.6
Cambodia	6.9	7.7	6.3	4.5	5.0	6.1	6.0
Indonesia	0.9	4.8	3.5	3.0	3.2	3.6	4.4
Lao People's Dem. Rep.	7.3	5.8	5.7	5.8	5.8	6.1	5.8
Malaysia	6.1	8.3	0.4	4.2	4.5	5.8	5.0
Myanmar	10.9	6.2	—	—	—	—	—
Philippines	3.4	4.4	3.2	4.0	4.0	4.5	4.5
Singapore	6.9	10.3	-2.0	3.7	3.9	6.5	5.6
Thailand	4.4	4.6	1.8	2.5	3.8	3.0	4.0
Viet Nam	4.7	6.1	5.8	6.2	5.7	6.8	6.2
Inflation (%)							
Average	8.1	2.5	5.1	5.7	5.0	4.4	3.9
Cambodia	0.0	0.5	0.0	2.0	2.0 ^a	3.0	3.0 ^a
Indonesia	20.5	3.7	11.5	13.1	11.8	7.7	7.0
Lao People's Dem. Rep.	134.0	27.1	7.8	6.5	6.5 ^a	6.0	6.0 ^a
Malaysia	2.8	1.6	1.4	2.3	2.5	2.8	2.3
Myanmar	11.4	—	—	—	—	—	—
Philippines	6.7	4.4	6.0	5.0	4.5	6.0	5.0
Singapore	0.1	1.3	1.0	0.4	0.1	1.4	1.3
Thailand	0.3	1.6	1.7	2.0	0.7	2.2	1.5
Viet Nam	0.1	-0.6	0.8	3.0	4.0	4.0	4.5
Current Account Balance (% of GDP)							
Average	9.9	8.8	7.2	5.0	5.7	4.0	4.9
Cambodia	-7.8	-7.6	-6.4	-5.9	-5.9 ^a	-5.1	-5.1 ^a
Indonesia	4.1	5.0	3.9	1.5	3.8	0.7	3.5
Lao People's Dem. Rep.	-8.9	-8.3	-6.9	-8.0	-8.0 ^a	-8.0	-8.0 ^a
Malaysia	15.9	9.4	7.8	5.3	5.1	2.6	4.9
Myanmar	-0.2	-0.1	—	—	—	—	—
Philippines	9.7	11.3	6.5	2.0	3.4	1.5	2.1
Singapore	20.0	17.2	20.9	19.8	19.6	19.0	17.9
Thailand	10.1	7.7	5.4	4.1	3.8	3.0	2.5
Viet Nam	4.1	1.6	1.5	0.3	-1.2	-0.2	-2.4

— Not available.

^a ADO 2002 forecast.

Sources: ADO database; staff estimates.

to GDP growth was the services sector. In the second quarter of 2002, the sector achieved broad-based expansion of 4.5%. Fiscal support for infrastructure projects provided stimulus to the steady 2.9% growth of the construction sector. Manufacturing, on the other hand, posted an increase of 5.6% in the second quarter, after a decline of 2.3% in the first.

During the first half of 2002, GDP in the Philippines expanded by 4.1%. Agriculture, industry, and services strengthened by 3.5%, 2.9%, and 5.3%, respectively. On the demand side, GDP growth was driven mainly by strong personal consumption expenditures, which rose by 3.6%. Capital formation, on the other hand, contracted by 4.6%. Nevertheless, while public construction declined by 1.5% during the first 6 months of the year, private construction increased by 4.2%.

Following a contraction of 2% in 2001, Singapore recorded a 1.2% year-on-year growth rate in the first half of 2002 and a better than expected performance during the second quarter, of 3.9%, after four consecutive quarters of contraction.

This was mainly on account of a small upturn in external demand as electronics exports—the major export subsector in the economy—recovered slightly while the fall in domestic demand stabilized. Nevertheless, manufacturing activity expanded at its slowest pace in 6 months in August, indicating that faltering demand in the US is hindering a full recovery. Overall domestic demand, driven predominantly by slightly higher household spending, still contracted by 2.5% in the first half of the year, though this was an improvement on the 8.7% full-year decline in 2001. While private consumption recovered somewhat (but still down by 1.5% on a year earlier), gross fixed capital formation fell by 10.2% year on year, mainly because of the continued contraction in residential investment. During the second quarter of 2002, some recovery was seen in private investment in transport, machinery, and equipment. Hence, Singapore's growth essentially stemmed from a positive contribution of net exports to GDP in the first half of the year. But the recovery remains fragile.

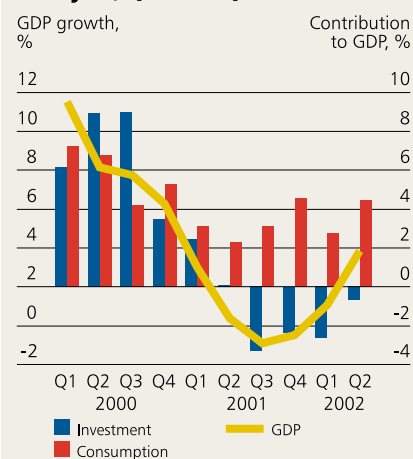
On the supply side, manufacturing posted 5% year-on-year growth during the first half of 2002, mainly as a result of a strong performance in the chemicals subsector (which surged by 60%) as external demand was robust and capacity expanded in pharmaceuticals and petrochemicals. With falling prices and weak demand, the decline in electronics continued, albeit at a much more moderate rate than in 2001. For the first 6 months of 2002, the fall in electronics output decelerated to 5.6% from 21.3% in the same period of 2001. The services sector, which is particularly important for Singapore, also showed a mixed performance. Transport and communications grew by 5.4% year on year during the first half of 2002, but the financial sector contracted by 4.6% in the same period due to weak equity markets and reduced regional demand for insurance and investment services. Construction shrank by a further 9.6% during the first half of 2002 as both private and public construction declined.

Thailand's overall economic situation improved markedly over the first half of 2002. The economy expanded by 4.5% year on year during this period, compared to 1.8% growth in the first half of 2001. On the domestic front, private consumption has provided an important boost to the economy due to the recovery in tourism (despite a slowdown in the number of visitors, tourism income has risen as spending per head has started to increase), easier access to bank credit (e.g., lower restrictions on obtaining a credit card), higher farm incomes, the positive effect of special sales promotions, low interest rates, and the benefits of countercyclical policies implemented in late 2001. While the latter two will most likely remain in the near future, the special sales promotions will end. It is encouraging, though, that car sales rose by 28.4% year on year during the second quarter. Although excess capacity still remains large in the private sector—running at around 58%—construction activity contributed to some increase in private investment. On the supply side, agriculture experienced a growth rate of 3.7% during the first half of 2002, while manufacturing expanded by 5.4%.

In Viet Nam, real GDP in the first half of 2002 grew by an estimated 6.7% on a year-on-year basis, according to official figures. On the demand side, domestic demand continued to be the main source of economic expansion during this period. It was led by the strong performance of private consumption due to an increase in rural incomes resulting from both higher output and better prices, and from strong private investment. On the supply side, the best-performing sector was industry with estimated output growth of 9.4%. The agriculture sector is estimated to have grown by 4% and the services sector by 5.9%.

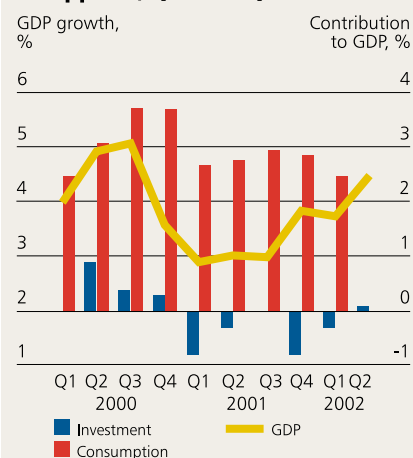
Fiscal deficits remain common throughout the subregion. Indonesia's budget deficit for 2002 is targeted at 2.5% of GDP. To achieve this, the Government has tightly controlled expenditures for development purposes and has raised the revenue target. The remaining deficit (around Rp43.1 trillion) is to be financed

Contributions to GDP Growth, Malaysia, Q1 2000-Q2 2002



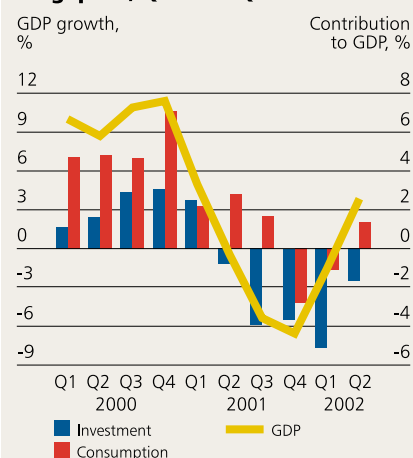
Source: www.aric.adb.org.

Contributions to GDP Growth, Philippines, Q1 2000-Q2 2002



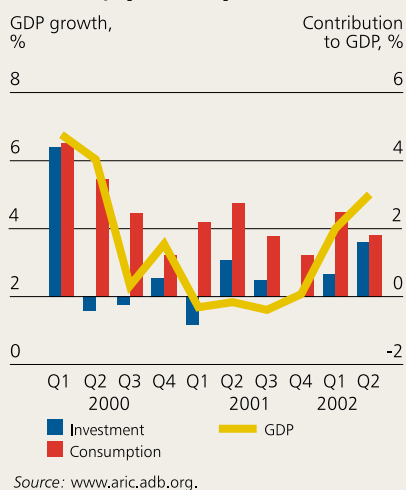
Source: www.aric.adb.org.

Contributions to GDP Growth, Singapore, Q1 2000-Q2 2002



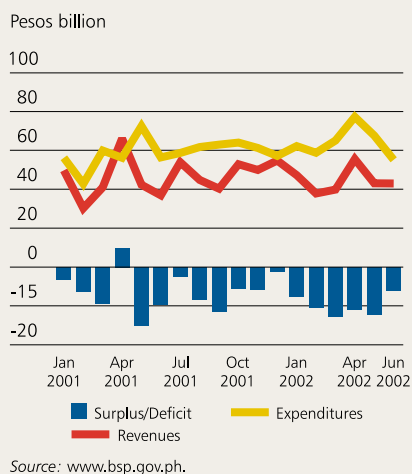
Source: www.aric.adb.org.

Contributions to GDP Growth, Thailand, Q1 2000-Q2 2002



After the Government's efforts at restoring fiscal discipline, the situation in the Philippines deteriorated significantly during the first half of 2002.

Fiscal Position, Philippines, January 2001-June 2002



by a combination of foreign and domestic sources. This poses a challenge. The Government, however, has demonstrated considerable resolve in the past 2 years in meeting its goals through expenditure control, privatization, and asset sales.

As of July 2002, the Government of the Lao PDR had executed 57.1% of the budget for the present fiscal year, suggesting some bunching of expenses in the final quarter of the fiscal year (i.e., July–September). Capital expenditures account for 58% of total expenditures to date, which indicates a slight improvement in the balance between capital and current spending.

Malaysia's federal government deficit in 2001 was 5.5% of GDP, higher than the target of 4.7%. The reason was the announcement of two stimulative packages during the year. The Government continues with its fiscal stimulus program, though it has been scaled back. As of the first quarter of 2002, the Government posted a deficit of RM1.3 billion and deteriorated further to RM4.0 billion at the end of the second quarter. Despite the country's historically higher spending during the second half of the year, steady economic recovery and higher oil prices should help improve the fiscal balance in the second half of 2002.

After the Government's efforts at restoring fiscal discipline and controlling the budget deficit in 2001, the situation in the Philippines deteriorated significantly during the first half of 2002. For the first 7 months of the year, the Government incurred a deficit of P133.1 billion, already exceeding the P130 billion target for the whole year. The main reason for the persistent budget deficit is, on the one hand, the low level of tax collection; on the other, an increase in expenditures to prepare the country for the possible negative effects of an El Niño later in 2002 and 2003 (e.g., new irrigation systems). The Government now characterizes the original deficit as a "fighting target" to signify that fiscal discipline remains a priority while acknowledging that the target is likely to be exceeded. Although the increasing deficit is not a problem of excessive spending, the Government is reprioritizing public capital works and contemplating expenditure cuts to offset revenue slippages. Some initiatives to improve efficiency have borne immediate results, including the widening use of electronic procurement, which has yielded substantial budget savings by greater transparency in the awarding of public contracts.

Singapore's 2002/03 budget introduced a series of tax adjustments to attract business and skilled human resources. Beginning in 2003, corporate and personal income taxes will be reduced to 22% from 24.5% and 26%, respectively, and further down to 20% in 3 years. On the other hand, the goods and services tax will rise from 3% to 5%, effective January 2003. The increase in consumption tax will be complemented by a 5-year offsetting package of assistance measures valued at S\$4.1 billion, targeted at the two thirds of Singaporeans who are not currently paying taxes. These measures will cause the 2002/03 fiscal balance to move from a surplus of S\$900 million to a deficit of S\$190 million. These steps, in particular the aggressive income tax reduction and a package of preferential tax treatment for expatriates, are expected to further consolidate Singapore's economic recovery.

Despite an expansionary budget for 2002, Thailand's fiscal deficit for the fiscal year ending in October 2002 is expected to be approximately B170 billion, or 3.2% of GDP, while the original estimate was B200 billion. The reason for the improvement is the higher than expected level of revenue collection, amounting to an additional B53.2 billion during October 2001–June 2002; projected revenue for the total fiscal year is expected to be B30 billion above target. The fiscal stimulus package implemented in 2001—which included the establishment of a revolving "village fund" of B75 billion, the creation of a national health care program, a 3-year moratorium on interest payments for indebted farmers, and a reduction in corporate income tax—represented an important fiscal effort for the

country. However, total public debt stood at 56.3% of GDP in February. Public debt has risen substantially during the last few years, although over two thirds of the increase is attributable to financial sector restructuring, while the other third is related to expansionary fiscal policies and the creation of safety nets to cope with the 1997 Asian financial crisis.

As a result of the improvement in the tax management collection system, tax revenue in Viet Nam during the first half of the year increased by 8.5% year on year, and is reported as having achieved 53% of the target for the whole year. Improved tax management was especially notable in the area of customs: revenues strengthened by 24.8% in spite of the weak trade performance in the first half of 2002. On the other hand, expenditures were 9.5% higher. The targeted deficit for 2002 is equivalent to 5.3% of GDP. However, the deficit may exceed the Government's target if banking and SOE reforms are fully implemented, due to the associated adjustment costs.

Inflation has been low in Southeast Asia, with the exceptions of Indonesia and, especially, Myanmar. Indonesia's CPI in July 2002 was 10% higher than in July 2001. While prices of clothing, food, and health services rose less than the average, prices of housing and the cost of transport and communications increased much more. The strengthening of the rupiah against the US dollar contributed to some dampening of inflationary pressures. Monetary policy has tightened since the end of 2001. From May 2001 until May 2002, narrow and broad money grew by 8% and 5%, respectively, considerably below the rise in nominal GDP. The relatively slow expansion in the monetary aggregates is a noticeable change from mid-2001 when money supply figures routinely showed double-digit growth. Reflecting tighter monetary policy, central bank discount rates rose slightly in mid-2002, in spite of the decline in inflation.

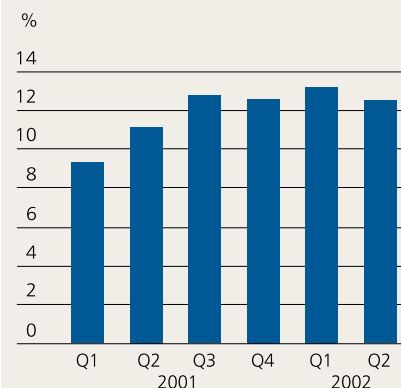
The monetary stance remains generally prudent in the Lao People's Democratic Republic (Lao PDR). The official inflation target is 6% for 2002, although July estimates show that inflation is running at around 9.5% and has accelerated during the year. Higher inflation is due to a number of factors, including the seasonal weakness of the kip against the baht and an increase in public utility prices as part of overall public expenditure reform. However, the Bank of the Lao PDR expects increased inflation to be temporary, since the kip remained relatively stable throughout August.

In Malaysia, inflation has remained low. During the second quarter of 2002, the CPI rose by 1.9% compared to the second quarter of 2001. The most significant price increase—6.4%—was registered in transport and communications. Given this stable environment, monetary policy has been very accommodative. Interest rates were low and stable with the average base lending rate of commercial banks and finance companies at 6.39% and 7.45%, respectively, at the end of June. This, together with excess liquidity, has led to higher bank lending, especially to the household sector.

In June 2002, year-on-year inflation in the Philippines decelerated to 3% from 4.1% in December 2001 as prices of major commodities fell. This was the lowest rate recorded since January 2000. Food prices also declined due to an abundant supply of vegetables and fruits. With moderate inflation in the first half of 2002, the Bangko Sentral ng Pilipinas continued to pursue an accommodative monetary policy in an effort to spur economic recovery. Since the beginning of 2002, the Bangko Sentral has twice lowered its overnight borrowing rate, resulting in an overall reduction from 7.5% to 7% and in the overnight lending rate from 9.75% to 9.25%. This leaves real interest rates at around 4%. However, a cautious lending stance among banks and weak corporate demand for credit contributed to sluggish bank lending. Money supply (M3) grew by 5.2% in June 2002, year on year, which was lower than the average of 6.9% in 2001.

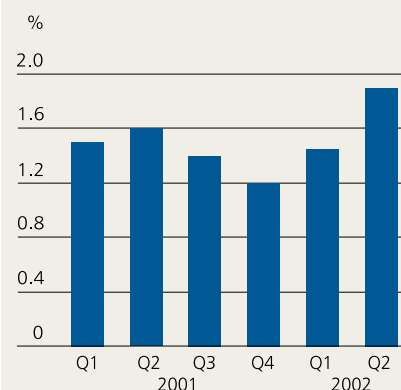
Inflation has been low in Southeast Asia, with the exception of Indonesia.

Inflation Rate, Indonesia, Q1 2001-Q2 2002



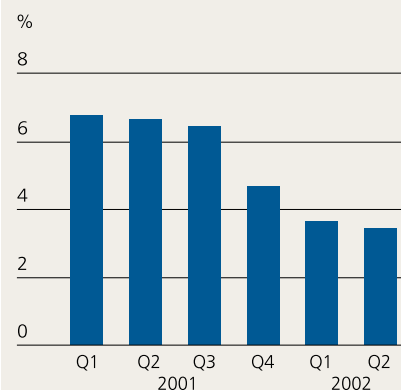
Source: www.bps.go.id.

Inflation Rate, Malaysia, Q1 2001-Q2 2002

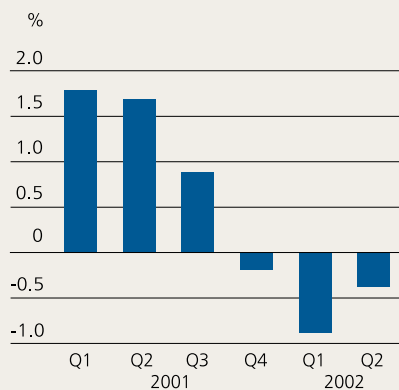


Source: www.bnm.gov.my.

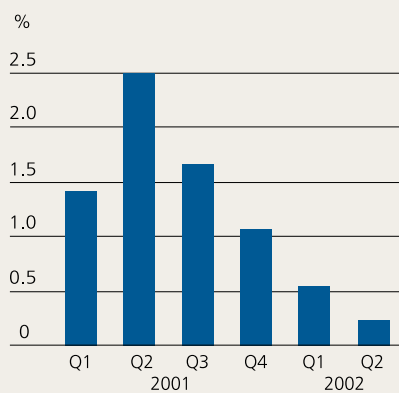
Inflation Rate, Philippines Q1 2001-Q2 2002



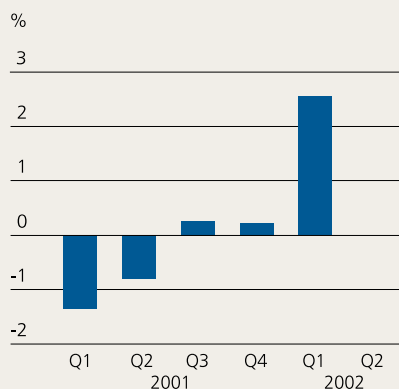
Source: www.census.gov.ph.

**Inflation Rate, Singapore,
Q1 2001-Q2 2002**

Source: Ministry of Trade and Industry, *Economic Survey of Singapore, Second Quarter 2002*.

**Inflation Rate, Thailand,
Q1 2001-Q2 2002**

Source: www.bot.or.th.

**Inflation Rate, Viet Nam,
Q1 2001-Q2 2002**

Source: International Monetary Fund, 2002, *International Financial Statistics*, CD-ROM, August.

Prices in Singapore declined by 0.7% year on year during the first 6 months of 2002. This was attributed to lower energy prices following deregulation in the energy sector, lower housing costs, and lower regional inflation. In view of this, the Monetary Authority of Singapore maintained a neutral stance that targeted a constant trade-weighted nominal effective exchange rate. Overall commercial bank lending declined by S\$2.5 billion in the first half of the year, indicating the weakness of the recovery. While growth of housing loans was sustained by low mortgage rates and easing housing prices, loans to the industrial and commercial segments slackened in tandem with the uncertain economic conditions. Domestic interest rates remained low in the first half of 2002 in light of monetary easing in the major industrial economies and low inflationary pressures.

Thailand's inflation remains in check, due to a somewhat stronger baht, large excess capacity, and a lack of demand pressure. Consumer prices rose by only 0.2% during the second quarter of the year, bringing inflation to an annual average of 0.4% for the first half of 2002. In June, the Bank of Thailand decided to keep its 14-day repurchase interest rate at 2%; deposit rates are at 2% while lending rates are at 7.1%. At the same time, the Government is encouraging state-owned banks to increase lending to SMEs and to the rural sector. Local banks are burdened with B600 billion of excess liquidity, partly due to their reluctance to lend money to companies for fear of adding to their NPLs. The Bank of Thailand has also eased the requirements on issuing credit cards. As of the end of June, Thai consumers had racked up B56 billion-worth of credit card bills this year, or about 1.4% of GDP.

Viet Nam's consumer price index rose by 2.9% during the first 6 months of the year, arising mainly from a 5.7% increase in the price of cereals and foodstuffs, which helped boost purchasing power in rural areas. Liquidity in the banking sector was low due to the high demand for cash for construction projects. The State Bank of Viet Nam increased its open market operations and planned to inject more liquidity in the economy through bond purchases. The Bank has also lowered the required reserve ratio on foreign currency deposits from 10% to 8% and removed the cap on interest rates for dong loans.

Southeast Asian exports have begun showing mild signs of recovery (though in some cases this is seen in slower declines). Indonesia's exports during the second quarter fell by 7.1% from the same period in 2001. Since mid-2001, both exports and imports have been falling. In May 2002, the total value of exports was 9% below the comparable figure for the same period of 2001 as a result of declines in both oil and gas exports (22%) and non-oil and gas exports (5.4%). The reduction in imports was even more pronounced, at 26%. The low level of non-energy imports suggests that business purchases for investment and reexporting remain quite weak. The net effect of the sharp fall in imports against a smaller decline in exports kept the current account balance positive. Net merchandise trade for the first half of 2002 was 19.2% higher than in 2001 and was one factor in strengthening the demand for the rupiah. Reports by the Investment Coordinating Board confirm the poor investment prospects. Through 30 June, only \$2.5 billion of foreign investment had been approved, roughly half of the amount approved last year. Domestic investment plans were also well below 2001 levels.

Malaysia's merchandise exports for the first 6 months of the year amounted to \$44.6 billion, or 0.2% above the level in 2001. ICT products remained the leading revenue earner, generating 57.4% of the country's total export earnings. Exports of electrical and electronic products grew by 2.3% during the first half of the year. Imports, on the other hand, amounted to \$38.6 billion, 2.4% above the 2001 level. The result is that Malaysia recorded an 11.7% decline in its trade surplus. The overall balance of payments picture for the first quarter of 2002 reflected an increase in reserves of \$1.8 billion. Both current and capital accounts

registered surpluses of \$1.9 billion and \$0.7 billion, respectively. Gross inflows of FDI amounted to \$0.9 billion in the second quarter, although, due to loan repayments by nonresident-controlled companies, FDI on a net basis amounted to only \$0.1 billion. The bulk of the FDI inflows was channeled into the oil and financial services sectors.

Philippine exports increased by 1.4% during the first half of the year while imports declined by 1.8%. The modest recovery of the global ICT market pulled up demand for semiconductors and electronic microcircuits (20.1%) and finished electrical machinery (21.4%).

External demand for Singapore's goods and services showed a slight improvement in tandem with a revival in global economic activity. Nevertheless, non-oil exports declined by 7.7% in the first half of the year, though this was only about half the steep 14.5% contraction seen during the same period in 2001. The improvement was attributed to a less severe fall in electronics-related exports and a rise in the sales of pharmaceuticals and petrochemicals. Non-oil reexports expanded by 1.1% in the first half of 2002. Imports registered a 4.5% decline, leading to a trade surplus of S\$12.3 billion for the first half of the year, while the current account posted a surplus of S\$16.1 billion.

In Thailand, while export volumes have improved, exports in value terms have fallen due to a weakening in export prices of a number of commodities, including electronics. The volume of exports rose by 9% during the first half of 2002. The volume of imports also increased, by 7.1%. The result for the first 6 months of the year is a trade and services surplus of about \$1.4 billion and a current account surplus of about \$2.9 billion. In terms of FDI, inflows were very low during the first few months of the year, amounting to only \$1.8 billion for the period February–June 2002.

During the first 8 months of the year, Viet Nam's exports contracted by 1.2% as oil exports, which historically account for about one fourth of the value of total exports, fell by 17.2%; coffee exports were also negatively affected by the continuing decline in world prices and by a sharp fall in export volume. Some manufacturing exports also contracted due to weak external demand: exports of electronics and computers, for example, dropped by 35% in value terms. The shoes, garments, textiles, and handicraft subsectors, however, recorded a strong performance, and seafood exports improved after a slow first half. Imports grew by an estimated 15% in the first 8 months of the year, led by a 23% import surge in the foreign-owned sector, reflecting the increase of capital inflows, mostly imports of machinery and equipment, steel, yarn, and chemicals. As a result, by end-August the trade deficit had climbed to \$1.7 billion.

POLICY DEVELOPMENTS

In order to ensure long-run growth, Southeast Asian governments will need to address a series of issues. In Indonesia, a draft of the 2003 budget was presented to Parliament in mid-August 2002. The budget called for an increase in tax revenues of 15.7%. A stronger tax effort is required to offset the expected decline in nontax revenues (oil, gas, forestry, privatization) and still allow for a small 2.9% rise in expenditures. Raising tax revenues has been difficult in the recent past and Indonesia's tax-to-GDP ratio is lower than in some of its DMC neighbors. The sharp reduction in subsidies will provide a measure of fiscal relief but this will demand continued political will to implement price increases for fuel and utility services. An open question is the degree to which local governments, which are now responsible for education, health, regional infrastructure, and rural roads, will respond to their new role and make the necessary investments. The overall deficit targets for 2002 and 2003 are in line with the announced policy of

moving toward a fully balanced budget in 2004. Meeting some of the continuing needs to improve governance in the financial markets, on 26 March 2002 the House of Representatives passed an anti-money-laundering law.

Malaysia has made significant strides in addressing corporate restructuring. The Corporate Debt Restructuring Committee has been successful in promoting restructuring efforts in large Malaysian companies burdened with heavy debts. The Malaysian asset management agency has achieved a recovery rate of 66% and is winding up its activities. Debt restructuring is being accompanied by asset sales and management revamping in some of the heavily indebted companies. However, Malaysia's capital controls policy may need to be reviewed in light of competitiveness pressure that may emerge as global growth picks up. Although capital control measures have been gradually relaxed since September 1998, international investors are still anxious over their inability to undertake foreign currency hedging strategies. These concerns will need to be addressed in the short to medium term, given the slowdown of FDI inflows.

There are no clear prospects for the introduction of necessary widespread economic reforms by the Government of Myanmar to correct macroeconomic imbalances and reduce poverty. It lacks the necessary policies, and its strategies are ad hoc and respond to a variety of problems in, at times, contradictory ways. Moreover, the capacity to implement policies is lacking. For example, the Government has declared the laudable intention of eliminating fiscal deficits over a 5-year period, but lacks the capacity and tools to actually do this. (Perhaps the Government should consider only reducing these fiscal deficits.) Myanmar's problems are as much structural as macroeconomic. The exchange rate continues to be grossly overvalued, with the official exchange rate at around MK6.8 to the dollar. However, by the end of April, the free market rate was over MK1,000. The dual exchange rate system is a problem since it distorts prices and resource allocation, stunts growth, and provides fertile ground for rent seeking. The ruling State Peace and Development Council (SPDC) is reluctant to accept the market-based rate for fear that debt repayments will become more difficult. The SPDC has stated that it will require international financial assistance amounting to \$1 billion–\$3 billion for this purpose. Efforts to increase exports will not be successful as long as the activities of the private sector remain restricted. On monetary policy, and given the little room to maneuver, the SPDC will continue monetizing the budget deficit. This puts pressure on inflation and since the SPDC wants to maintain stable nominal interest rates, real interest rates will remain negative. If the anti-money-laundering law introduced in June 2002 leads to further withdrawals of savings, the SPDC may decide to increase interest rates slightly.

The most important problem affecting the Philippine economy is the financing of the budget deficit. The deficit problem is one of systemic weakness in raising tax revenues, which remain well below potential. Remedial actions being taken include restructuring the Bureau of Internal Revenue using models of international best practice, simplifying the tax code, taking legal action against noncomplying taxpayers, and implementing an aggressive program of moral suasion targeting corporate lawyers. To cover the deficit, the Government will issue bonds worth \$300 million, mainly on the domestic market. In the banking sector, the crucial problem is the persisting high level of NPLs and nonperforming assets (NPAs). In resolving the issue, the Government needs to lead the way to adopt international best practice and pass the Special Purpose Asset Vehicle Bill, which provides for the creation of private sector asset management companies to acquire commercial banks' NPLs and NPAs. Congress is debating the Bill, which will establish the legal framework for asset management companies and will grant incentives, such as tax breaks, to buyers of bad loans and foreclosed assets. Recap-

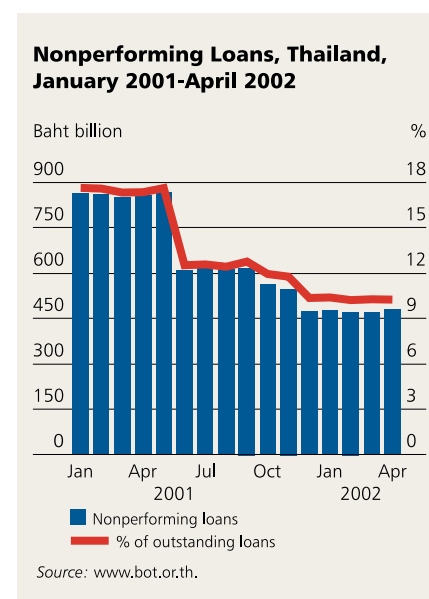
italization of banks is required in dealing with NPLs and NPAs, and specific capital adequacy rules are also needed.

With its efficient economic system and investment incentives, Singapore continues to attract foreign investment and to be considered as the regional headquarters for multinational corporations. However, some companies are considering the possibility of moving production to lower-cost destinations within the subregion. While the Government has been reformulating its development strategy toward a knowledge- and skills-intensive economy in recent years, government-linked companies have certain privileges and monopoly powers. In the future, therefore, the Government may need to take a less interventionist approach to industrial management and further reduce its shareholdings in these companies to nurture a business environment that promotes entrepreneurship and innovation.

The strong performance of the Thai economy during the last few months has been the result of several factors. First, the low interest rate environment has encouraged borrowing, especially from households. Second, some fiscal stimulus measures have had an impact. Third, the external environment during the first half of the year was positive. Despite this, there are important issues that deserve attention. Corporate restructuring and corporate governance improvements remain major issues, contributing to a lackluster investment environment that hampers economic activity. The Government needs to put further pressure on companies to restructure. In late June, it announced that the total estimated cost of restructuring and recapitalizing the financial sector after the 1997 financial crisis would reach B1.4 trillion (around \$350 billion). However, the impact of the Government's structural reform program has so far been limited. The B655 billion plan to privatize 18 companies in 2001–2003 has not progressed and to date only two companies have been sold—Internet Thailand for B400 million and the Petroleum Authority of Thailand for B32.2 billion. Overall, the restructuring of NPLs is moving slowly. As of March 2002, the Thai Asset Management Corporation (TAMC) had acquired B711 billion in NPLs (corresponding to a total of 4,629 accounts, 1,077 from single creditors and 3,552 from multiple creditors) from banks and their AMC's at an average price of one third of face value. The total amount restructured through June was B200 billion but the actual amount recovered was only B560 million, or less than 1%. This was mainly achieved by reducing the amount of accrued interest owed by debtors. Of the deals achieved, 35.6% are in the real estate sector, 23.8% in the manufacturing sector, and 13.9% in the financial sector. There are around 160,000 single-creditor loans of less than B50 million amounting to B250 billion. Their purchase has been delayed to help the TAMC focus on the larger loans. The TAMC has set as a target the restructuring of B500 billion in loans, including all single-creditor loans and half the multiple-creditor loans, by the end of 2002. It intends to reach a resolution on all loans in its portfolio by the end of 2003 and complete operations within 5 years instead of the original plan of 8 years. The TAMC reports that B132.7 billion-worth of loans have been resolved with a recovery rate of nearly one third of face value, as of April 2002.

In accordance with the roadmap to liberalize interest rates, following the establishment of a primary lending rate in dong in 2001, the State Bank of Viet Nam issued a decision to lift ceilings on lending interest rates in June 2002. The move should help commercial banks strengthen their risk management through pricing of loans according to the risk of the borrower. In addition, banking sector reform has continued. By the end of March 2002, about D1.5 trillion of NPLs, mostly collateralized, had been resolved at a discount of around 50%. July 2002 marks the second anniversary of the inauguration of the stock market in Viet Nam, where the number of listed companies had increased to 19 by the end of

The restructuring of NPLs in Thailand is moving slowly.



August and prices of individual stocks had started moving in different directions according to the performance of the listed companies, an indication that the market may be becoming more mature and breaking away from the monolithic growth trend of the first year. In an effort to boost transactions, trading has been conducted daily as opposed to three times a week and the trading band was widened in August from 2% to 3%. The market has also seen the more active participation of institutional investors, including foreign investors. It is anticipated that by the end of 2002, about 20–25 more companies will be listed on the stock market. In relation to a potential international bond issue, Standard and Poor's and Fitch recently rated Viet Nam's long-term foreign currency sovereign debt as BB-, implying an upgrade of the country's credit rating.

OUTLOOK FOR 2002–2003

The forecast for Southeast Asia for the whole of 2002 and for 2003 remains cautiously optimistic amid signs of some recovery in external markets during the first half of 2002, and continued strength in domestic consumption in most countries. Significant weaknesses and uncertainties, however, remain for the second half of 2002 and for 2003. These are the persistent weakness of private investment demand in nearly all economies and the uncertain recovery in external demand. Later in 2002 and 2003, these weaknesses could be highlighted by magnified weakness in industrial countries, thus further dampening export demand. Overall, the GDP growth forecast for 2002 is slightly higher than projected in *ADO 2002*—3.8% versus 3.4%—on account of the first half performance. For 2003, the forecast is only marginally higher than in *ADO 2002*.

For Indonesia, exports are expected to continue to recover, particularly with average oil prices expected to be higher in 2002 than in 2001, while consumption demand will be sustained—though at a lower rate of growth than in 2001. The investment outlook, however, remains uncertain. If the agriculture sector performs well, GDP growth in 2002 could reach 3.2%, slightly higher than in *ADO 2002*. The economy could strengthen further in 2003 to about 4.4% growth.

Malaysia's GDP growth is expected to reach 4.5% in 2002, further expanding by about 5% in 2003, or significantly lower than the 5.8% forecast in *ADO 2002*. This is mainly due to weaker than expected external demand for electronics in particular and some leveling-off in domestic demand as fiscal policy becomes more cautious, following relatively high budget deficits in the last few years.

Growth in Cambodia this year will be in the 4.5–5.5% range, slightly better than the forecast in *ADO 2002*, rising to 5.5–6.5% in 2003. For the Lao PDR, the GDP growth forecasts for both years remains similar to those in *ADO 2002*, namely, in the 5.5–6% range, which is below the Government's forecast of 6.3–6.5%.

The projections for the Philippines remain unchanged from *ADO 2002*, at 4% in 2002 and 4.5% in 2003. This is because of continued strength in consumer demand, some recovery in exports, and reasonable growth in the agriculture sector (in spite of the El Niño risk).

GDP growth in Singapore has been revised marginally upward for 2002 to 3.9% (from 3.7% in *ADO 2002*), but revised downward for 2003 to about 5.6% (from 6.5% in *ADO 2002*). The strength of the recovery continues to be uncertain as domestic factors have shown little dynamism and external demand was weak in the first half of 2002, though it improved in later months during that period. The economy could benefit from stronger oil prices. The contribution of domestic demand remains uncertain in 2003 as the goods and services tax is scheduled to increase in January 2003, along with some prices of services such as transport. On the other hand, the Government will probably continue to provide a fiscal stimu-

lus to the economy to support domestic consumption and investment demand for housing and infrastructure.

The Thai economy has shown definite signs of recovery, particularly during the second quarter of 2002. Both domestic factors and a pickup in external demand have contributed to a better than earlier expected performance of the economy. Thus, the economy is forecast to post GDP growth of about 3.8% for 2002 as a whole, up from an *ADO 2002* forecast of 2.5%. As corporate restructuring reforms accelerate in 2003 and the domestic investment climate improves, the economy should grow at a rate of about 4% in 2003 (3% in *ADO 2002*), in spite of expected moderation in export growth. This, however, is still well below the Thai economy's potential.

GDP growth in Viet Nam should remain at 5.7% in 2002 and 6.2% 2003. While the strong export performance of 2001 is unlikely to be maintained (as already evident in the first half of 2002), domestic demand—both investment and private consumption—should continue to maintain the momentum in the economy. Higher oil prices will also benefit the economy.

For 2002, inflation in the subregion will be around 5%, down from 5.1% in 2001, except in Indonesia, where inflation is well above the average, at almost 12% in 2002, and where the rate will decline to around 7% next year. In most of the other countries, inflation will run at less than 5% in 2002 and 2003.

Exports from the subregion—except for Indonesia where exports are forecast to decline by 3%—will likely see a marked improvement in 2002 over the 2001 level, and reach an average growth rate of 3.5%. In 2003, all countries are expected to register growth, at an average of 7.6%. The situation of imports is similar and only Indonesia will see a contraction this year (12%). Import expansion in the subregion as a whole is forecast to average 4.6% in 2002 and 9.7% in 2003.