

A Year-End Economic Survey

Asia's Economic Performance Set to Outpace the World in 2004

Despite Asia's phenomenal growth rate, challenges remain

By Sherry Kennedy, NARO

Asian economies held on to the title of the “world’s fastest-growing region,” with an estimated regional gross domestic product (GDP) growth rate of 5.3% in 2003. The region’s economic performance was positive despite several external shocks, namely, the outbreak of the severe acute respiratory syndrome (SARS), war in Iraq, regional terrorist threats, and higher global oil prices.

The region’s ability to absorb these shocks and maintain a positive growth rate in light of cooling US and European economies—averaging between 1.6-1.9% and 0.4-0.6%, respectively—may be the ultimate proof that it has fully emerged from the 1997 financial crisis through a more resilient and sound performance.

The region’s overall economic growth, forecasted by the Asian Development Bank (ADB) to reach 6.1% in 2004, will continue

to be impacted by the performance of a few strong Asian economies, most notably the People’s Republic of China (PRC). Conversely, Asia’s growth will be affected by the region’s ability to manage existing challenges, including the failed trade talks in Cancun and future external shocks.

Resounding roar of red dragon throughout Asia

The PRC has made its mark as one of the world’s great development success stories. Poverty has been significantly reduced, most people are better off because of reforms, and progress is being made in achieving the Millennium Development Goals. The main engine of this growth, its economy, has maintained a remarkable pace over the past 2 decades. In the first half of 2003, despite SARS and the war in Iraq, the PRC saw a growth rate of 8.2%; foreign

direct investment attracted \$30.3 billion, up by 34% over 2002; exports grew by 34%; and imports by 44%. The country’s long-term economic targets are projected to do even better—a 7.2% annual GDP growth to 2020, a quadrupled GDP from the 2000 level to \$4 trillion by 2020, and an increase in the per capita GDP from \$1,000 to \$3,000 by 2020.

How has the PRC’s remarkable growth impacted the region? According to the *Asian Development Outlook (ADO) 2003 Update*, ADB’s annual publication on Asia’s economic forecast, a notable feature of economic development during the past 2 years has been the emergence of the PRC as a major catalyst for intraregional trade. For most countries this trend accelerated in the first half of 2003—the share of total regional exports going to the PRC has doubled since the start of 2000. For econo-

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BRIDGING THE GAP Road infrastructure linking poor inland provinces in the People’s Republic of China to the centers of trade and commerce are helping boost economic activities.

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In this publication, \$ refers to US dollars.

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mies in East Asia, the PRC has become the largest export market while in Southeast Asia, it has become an important export destination.

The PRC has overtaken the US as the main export market for the Republic of Korea (Korean exports to the PRC soared 47% year on year in the first 7 months), and contributed to the country's growth momentum in the first half of 2003. Taipei, China's exports grew even faster at 108.3%, while exports of the Association of East Asian Nations-5 (ASEAN-5) (Indonesia, Malaysia, Philippines, Singapore, and Thailand) to the PRC grew by 41.9% in the same period. The same theme was repeated in South Asia, although it has a much lower export share of the PRC market (for example, the PRC accounts for only 1% of India's current exports), averaging well over 50% year on year since the middle of 2002. If these trends continue, Asia's economic outlook should become less dependent on economic developments in the major industrial economies and thus less prone to downward slides during economic slowdowns outside the region.

Increased imports to the PRC have also led to a surge in the country's regional trade deficit, which is nearly equal to its trade surplus with the US, according to a World Bank report, *East Asia Half-Yearly Update*:

From Cyclical Recovery to Long-Run Growth, released in mid October: "Its combined trade deficit with Korea (Republic of Korea), Singapore, and Taiwan (Taipei, China) jumped from \$36 billion in mid 2002 to \$53 billion in mid 2003, and its trade balances with Japan and Southeast Asia have also moved into growing deficits."

Adding another layer to the PRC's controversial role in the current US trade balance is that its imports from across the world are largely for assembly and re-export.

If Asian countries stopped buying US debt, long-term US borrowing costs would skyrocket.
 —Charlotte Denny
The Guardian

The report also notes that the region is still highly dependent on exports and with the failure of the Cancun trade talks, protectionist interests may intensify, particularly if the US and Euro zone conduct bilateral agreements with individual or groups of countries at the exclusion of others. Optimism was raised, however, when leaders at the recent annual Asia-Pacific Economic Cooperation (APEC) summit, agreed to re-energize the Doha negotiations by working off the text developed at Cancun.

In addition to needed reforms in several areas, including financial, legal, judicial, regulatory, and public accountability, job creation is one of the key challenges facing the PRC. The country plans to create 15 to 20 million jobs annually to absorb new labor market entrants, unemployed workers from state-owned enterprises, and 150 million surplus agriculture laborers. The PRC Government has also placed priority on strengthening the social safety net and social security, promoting labor market reform, and creating jobs in the private sector. It has also broadened its definition of "unemployed" to include those earning less than the local basic living allowance.

On the monetary policy front, the People's Bank of China slowed the approval procedure for real estate loans as a counter measure to potential overheating and renewed inflation. Similar measures are planned for automobile loans and it has forbidden banks to issue mortgages for properties that are not fully constructed to reduce the number of loan defaulters and to cool a property market that may be in danger of overheating.

Although the PRC faces multiple challenges, the world may be heartened by its increasing ability to effectively recognize and implement programs to mitigate crises, as demonstrated by the SARS outbreak. National will and strong leadership will also be key factors in overcoming obstacles. Chinese President Hu Jintao's recent speech on the future of APEC was relevant not only to APEC but also for the PRC.

Selected Economic Indicators of Developing Asia, 2002-2004 (%)

	2003			2004	
	2002	2003	2003	2004	2004
Real GDP growth (annual % change)	56	53	53	59	61
Export growth (annual % change)	65	56	56	62	65
Import growth (annual % change)	41	40	39	48	49
Trade balance (annual % change)	42	57	58	61	61
FDI inflows (annual % change)	73	58	75	58	59
Government revenue (annual % change)	-03	24	25	25	27



FINANCE The development of the Asian financial market faces multiple challenges.

“An organization can maintain its vigor and grow from strength to strength only when it can keep pace with the times and innovate continuously.”

Potential Risks and Uncertainties in 2004

The ADO 2003, released in April, identified three risk areas for developing Asia that remain relevant to the region’s future growth: global economic, geopolitical, and SARS-related risks. These factors indicate that national economies are more closely linked than ever. A recent article in the United Kingdom’s *Guardian* revealed that the PRC and Japan alone bought \$95 billion worth of US Treasury bonds in the first half of 2003 as part of their intervention strategy. The article concluded: “If Asian countries stopped buying US debt, long-term US borrowing costs would skyrocket.”

The effects of SARS and its potential risks largely impacted Hong Kong, China and Singapore but most economies are rebounding rapidly. A recurrence of SARS, though not completely excluded, would likely have a milder impact due to the epidemiology and health infrastructure, which was implemented by governments and is still in place.

Geopolitical uncertainties—such as terrorism and the uncertainty of next year’s election outcomes in Indonesia, Republic of Korea, Malaysia, Philippines, and Thailand—remain vital issues for developing Asia. Increased incidents of terrorism could have a devastating impact on many econo-

mies that rely heavily on tourism and foreign direct investment. Indonesia and the Philippines remain the most vulnerable to terrorist activities and among the most indebted. They would both suffer dramatically from heightened terrorism because tourism represents 45% of GDP in Indonesia and in Southeast Asia in general. Lower tourism rates and reduced business confidence could decrease Indonesia’s growth by one percentage point.

The danger of deflation has decreased but cannot be completely excluded. The increase in yields on US Treasury bonds suggests that inflationary expectations are rising in parallel with expectations for a stronger recovery. The mild upward pressure on long-term rates is driven by the need to finance a large and increasing US budget deficit. Should long-term rates increase significantly, the recovery could stall. Higher long-term rates in the US would also affect prospects for a strong recovery in the Euro zone and in Japan. These risks are intensified by an uneven recovery, with the US economy expected to grow much faster than the Euro zone and Japan. These developments indicate that there may be little change in the dollar’s current value against the euro and the yen despite the large US twin (fiscal and current account) deficits.

Perhaps the most important outcome in meeting the challenges is for Asian countries to chart their own course.

A main feature of the mild recovery in industrial countries has been the lack of job creation in these economies. Unemployment rates are either rising or remain stubbornly high. In the US, this figure has decreased and shown signs of improvement in the fourth quarter. The recovery has taken a stronger hold in the second half of 2003 in their economy, although many jobs were lost mainly because growth is being fueled by significant productivity increases. While this is a positive development for corporate profitability, it raises concerns on the prospects of continued strong consumption spending, which has been the main driving force of US economic growth.

Why does this matter to Asia? If production continues to rise without job creation, even employed workers might anticipate lay-offs and reduce spending and borrowing. A decrease in consumer spending in the US would directly impact Asian countries, which are major exporters of consumer goods to the US market. Such interdependence typifies both global and intra-regional relationships, as the 1997 Asian financial crisis showed, through its devastating impact on economies within Asia and the Pacific. Since the crisis, major structural and policy weaknesses, particularly in the financial and corporate sectors, have been enhanced and important regional initiatives were implemented to protect against future shocks.

Regional Growth Linked to Regional Cooperation

Before 1997, East Asia’s regional integration initiatives focused largely on trade. The cross-country contagion that accompanied the crisis suggested common weaknesses in the financial and corporate sectors among several countries. Monetary and financial cooperation then became an important component to the ongoing regional trade integration agenda. ADB Vice-President Joseph Eichenberger (Operations 2) emphasized at a recent forum in the PRC the importance of shared high-quality and timely information on macroeconomic developments and capital flows, sound mechanism for surveillance, and a standing capacity to mobilize resources to protect against future shocks. He also cited the need “to confront directly the risks arising from financial integration, to adapt quickly and boldly and, by doing so to transform those risks into greater prosperity and shared stability.”

In all three areas—access to timely information, reliable surveillance, and capacity to mobilize resources—significant regional achievements have been observed in strengthening monetary and financial cooperation. The creation of the Manila Framework Group (MFG) in 1997, for instance, is of particular importance. The MFG—omprising the economies of East Asia, Australia, Canada, New Zealand, and US—focuses on economic surveillance and regional dialogue. Its surveillance work

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has been conducted regularly and intensively at a high level by finance and central bank officials, and has been supported by ADB, International Monetary Fund, World Bank, and Bank for International Settlements.

Another initiative was the Association of East Asian Nations+3 (ASEAN+3) Economic Review and Policy Dialogue, introduced in May 2000. This regional body meets at the ministerial level to examine macroeconomic risks, improvements in regional banking systems and corporate governance, and capital markets. In addition to bilateral currency swaps and support for the Asian Bond Market Initiative, many more initiatives are underway and are contributing greatly to the region's significant progress.

Among the many urgent challenges is the need to strengthen domestic financial sectors across Asia, particularly reducing nonperforming loans, diversifying sources of corporate finance, and consistently

implementing the new and often greatly improved laws and regulations that are now on the books.

But perhaps the most important outcome in meeting the challenges is for Asian countries to chart their own course. As Deputy Assistant Secretary of State Matthew Daley stated in his testimony to the House International Relations Committee on East Asia and the Pacific: "Change is always uneven and often unpredictable. However, real change is only lasting when it comes from within rather than being imposed from outside." ■

For more information visit: <http://www.adb.org/Documents/Books/ADO/2003/Highlights/default.asp>

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Bond Markets

Study on Guarantee Mechanisms to Provide Support for Asian Bond Market Initiative

Through a recently approved technical assistance (TA) grant, the Asian Development Bank (ADB) will explore better utilization of guarantee mechanisms to support development of domestic and regional bond markets in the ASEAN + 3 countries, comprising the 10 Association of Southeast Asian Nations (ASEAN) members, plus the People's Republic of China, Japan, and Republic of Korea.

The technical assistance will review and compare existing and past mechanisms, as well as regional and international best practices, and consider the most effective guarantee mechanism that could foster bond market development particularly in Indonesia, Malaysia, Philippines, and Thailand.

This assistance will support the work of the voluntary working group created under the Forum of Finance Ministers of

the ASEAN + 3 on Guarantee Mechanisms for the ASEAN Bond Market Initiative (ABMI), endorsed at the ASEAN + 3 deputies meeting in 2002. The ABMI emphasizes the promotion of greater access to the market by a wide variety of issuers and the creation of an environment conducive to domestic and regional bond market development.

The mismatch of debt maturity and currency and Asia's financing needs was identified as a major factor underlying the regional financial crisis that began in 1997. Although Asia has since made a remarkable recovery, mismatches remain a major source of financial vulnerability. The ASEAN + 3 and other forums have been trying to address the issue through the development of domestic and regional bond markets.

ADB has been a member of the voluntary working group on guarantee mecha-

nisms for the ASEAN + 3 since its inception in February. ADB's working group has identified several domestic guarantee agencies, and bilateral and multilateral institutions that provide local currency guarantees. However, few guaranteed local currency bond transactions take place in the market. The reasons vary, from lack of market acceptance for the guarantee to structural hurdles caused by processing lead-time.

This initiative is ADB's first concrete support for the ABMI. According to Masato Miyachi, ADB Senior Advisor, this is a critical first step in identifying the potential and limitations of facilities in an area where best practice models are rare. ■

The technical assistance is due to be completed by the end of April 2004. For more information, visit <http://www.adb.org/Documents/ADBBO/RETA/37352012.ASP>

News Briefs

Luxembourg: ADB's 62nd Member

Luxembourg's membership in ADB became effective on 25 September upon completion of all formalities, including payment of the first in-

stallment of its subscription to ADB's capital stock of 12,040 shares. ADB's authorized capital stock is 3,490, 994 shares equivalent to \$43.5 billion. ■

ADB's Public Sector Lending to Azerbaijan to Begin

ADB plans to extend loans averaging \$22 million per year to Azerbaijan over the next 3 years with public sector lending to begin this year, according to the the Country Strategy and Program (CSP) Update for 2004-2006.

Since joining ADB in 1999, Azerbaijan has received 10 technical assistance projects and two grants from the Japan Fund for Poverty Reduction. ADB's program will focus on four main sectors, with assistance planned for internally displaced

persons, agriculture and rural development, water sector, and road development. The total loan amount earmarked for the 3-year period is about \$70 million from the concessional Asian Development Fund resources and about \$40 million in funds from ADB's ordinary capital resources. The final amount will depend on ADB's resources and country performance, subject to the approval of ADB's Board of Directors. ■

For more information, visit <http://www.adb.org/Documents/News/2003/nr2003138.asp>

Children's Art Competition in Viet Nam: Inspiration for the Future

To celebrate the 10th anniversary of resumption of operations in Viet Nam, ADB together with the Viet Nam Fine Arts Association, will launch an art competition and exhibition for children between the ages of 6 and 14 under the theme "Viet Nam in 10 Years: My Vision."

Children will express their views, dreams, and wishes for Viet Nam's development in the next 10 years.

The competition will be held throughout the country with deadline for submissions on 15 December. After the deadline, a panel of judges including the Fine Arts Association's members and ADB will select 100 winning pieces of art.

Selected artwork will be exhibited at the Fine Arts Association Gallery in Hanoi from 16-27 January and an award ceremony

for the winners will be held on January 17th.

A staff member from ADB's Viet Nam Resident Mission best summarized the impetus behind this initiative: "If we consider how much progress Viet Nam has made in the last 10 years, we can be sure that in 10 more years, Viet Nam will be a very different place—we plan to draw inspiration from the visions and dreams that Viet Nam's future citizens will express through their artworks."

ADB has resumed operations in Viet Nam 10 years ago. During this period, it has provided 48 loans and 141 technical assistance grants for almost \$2.8 billion. ADB operations have supported poverty reduction and rural development, including irrigation and water resources management, forestry and rural infrastructure; improved education and health services; rehabilitate and build infrastructure. ■

2004 EVENT HIGHLIGHT

North American Consultations on Disclosure Policy Set

A comprehensive review of ADB's 1994 Policy on Confidentiality and Disclosure of Information (Disclosure Policy) and the complementary Information Policy and Strategy (Information Policy) is well under way, and is expected to conclude with a recommendation to the Board of Directors in the first half of 2004. The 11 city consultation tour will include stops in Washington, DC and Ottawa scheduled for the first quarter 2004.

Under the current Disclosure Policy, hundreds of documents are made available each year on-line and in hard copy. To create an improved system, the review will solicit views from a diverse group of stakeholders on various issues.

- How can we improve the provision of information about ADB operations to the public?
- What are your views on the ideal format and content of a new policy addressing both disclosure and information issues?

The Bank's Disclosure web site (<http://www.adb.org/disclosure>) provides a wealth of information including a Frequently Asked Questions (FAQ) section, which highlights some basic information such as the following.

What is the Disclosure Policy?

This policy governs the release of ADB information documents and seeks to strike a balance between an open and transparent policy and legal and practical constraints that in some cases limit disclosure.

What are the reasons for not disclosing some documents?

Certain documents are not disclosed because of legal and practical constraints such as staff information of a personal nature (i.e., medical files). ■

For more information on the North American consultations, contact Sherry Kennedy at skennedy@adb.org.

ADB Publications

Monetary and Financial Integration in East Asia: The Way Ahead

Volume 1: 50 British Pounds

Volume 2: 60 British Pounds

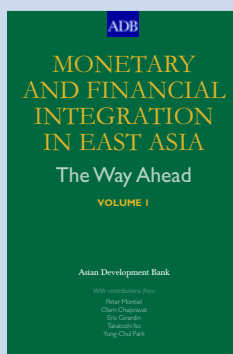
This two-volume book explores what is feasible and desirable in regional monetary and financial cooperation, and lays out a road map of policy options. It also addresses the following questions: Is there merit in formalizing and intensifying the process of regional information exchange and policy dialogue? Should the bilateral currency swap arrangements under the Chiang Mai Initiative (CMI) be expanded and multilateralized when the CMI is reviewed in 2004? Should a centralized reserve pooling arrangement at the

regional level be established? Should countries in the region aim at exchange rate policy coordination?

After extensive analysis of these issues, the book lays out recommendations for feasible and desirable forms of enhanced cooperation and actions for the short, medium, and longer term.

A joint publication of the Asian Development Bank and Palgrave Macmillan.

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Asian Development Bank
North American Representative Office
815 Connecticut Avenue, NW
Suite 325
Washington, DC 20006, USA

Tel: (202) 728-1500
Fax: (202) 728-1505
E-mail: naro@adb.org
Web Site: <http://www.adb.org/NARO>

Newsletter contacts:
Sherry Kennedy
Amir Tejpar

Asian Development Bank
North American Representative Office
815 Connecticut Avenue, NW
Suite 325
Washington, DC 20006
USA