

II. RECENT ECONOMIC PERFORMANCE

A. Regional Overview

6. The GMS is one of the world's fastest-growing subregions. With the exception of Thailand, which was directly affected by the Asian financial crisis, growth has remained about 4% or higher in all of the economies for the past decade. GDP growth in all six economies was robust in 2002, ranging from 5.5% in Cambodia to 7.0% in Viet Nam (Table A2.1, Figure A2.1).¹ The GNP-weighted average growth for GMS in 2002 was higher than 6%, significantly higher than the average of 4.8% recorded in 2001. This figure is likely to have increased in 2003. Available data suggest that the trend of strong growth has continued in 2003 despite the outbreak of the Severe Acute Respiratory Syndrome (SARS) epidemic and the uncertainties induced by war in Iraq.

7. All economies except Cambodia are expected to have grown by about 6% or higher in 2003, with Viet Nam again topping the list at 7.1%. Cambodia's growth is likely to be about 5%, because of security concerns in early 2003 and ongoing political uncertainties. Various domestic and external factors have played a role in continuing this growth trend in 2003. Factors contributing to growth have been strong consumer spending, improved agricultural output induced by favorable weather, increased exports, and fiscal stimulus packages in many economies.

8. Except for Myanmar and Lao PDR, consumer price inflation remained low and manageable in the GMS economies during 2003 (Table A2.2, Figure A2.2). The low inflation resulted from a variety of factors including improved food supply, relatively stable exchange rates, and slow growth in money supply. Although inflation remains endemic in Myanmar, Lao PDR subdued some of its inflationary pressures late in 2003 by introducing a range of restrictionary fiscal measures.

9. All GMS economies except Thailand continued to have fiscal deficits during 2003, partly reflecting higher expenditures aimed at stimulating the economy (Table A2.3, Figure A2.3). Thailand posted its first surplus since the Asian financial crisis began. Difficulties in raising government revenues largely account for ever-increasing budget deficits in Lao PDR, Cambodia, and Myanmar. Difficulties with revenue collection continue to pose a threat to macroeconomic stability in Lao PDR and Myanmar; in Cambodia, the impact of revenue collection problems is mainly felt through the constraint it places on the Government's capacity to implement social and other expenditure programs.

10. In the external sector, exports surged in all economies in 2002 except for Myanmar. This trend has largely carried over to 2003, despite SARS and other global uncertainties. The increase has been particularly impressive in Thailand, Viet Nam, and Yunnan Province of PRC, due largely to improved external demand and, for Viet Nam, to high crude oil prices.

11. All economies except Thailand continue to run current account deficits, although none of the deficits appear nonsustainable (Table A2.4, Figure A2.4). Net foreign direct investments (FDI) in Thailand, Lao PDR, and Viet Nam increased sharply in 2003, after having slowed in almost all GMS economies in 2002.

¹ Myanmar's Ministry of National Planning and Economic Development reports 9.7% growth in 2002, but independent estimates are about 6%.

B. Cambodia

12. Cambodia's economy grew by 5.5% in 2002, down from 6.3% in 2001. Growth for 2003 is projected to have slowed to about 5% due to the impact of political uncertainties, the January 2003 riots, and the SARS outbreak. Although a growth rate of about 5% should be considered healthy, the trend has been consistently downward since 1999. The slowdown is significant, considering that growth averaged 7.3% from 1999 to 2002. The national elections, held in July 2003, have not yet resulted in formation of a new government. This continues to undermine investor confidence.

13. Cambodia faces a persistent and growing budget deficit, mainly because of difficulties in raising adequate revenues. In 2002, government revenues were only 11.1% of GDP, while expenditures accounted for 17.7%. The share of tax revenues was a low 7.8% of GDP. The budget deficit for 2003 is likely to exceed the Government's target of 6% of GDP, and may exceed 7%, particularly given the boost in spending associated with the national elections.

14. Inflation remains manageably low, increasing from 3.3% in 2002 to 1.2% in 2003 due to rises in the price of major food items and some utilities.

15. The trade deficit widened from \$240 million in 2001 to an estimated \$564 million in 2002. Imports grew by 6.5% compared with export growth of 6.0%. This produced a current account deficit of 8.1% of GDP, which was financed through official transfers and capital inflows, mainly concessional loans and FDI.

16. The riel continued to remain broadly stable against the dollar, but it constitutes only a small share of the money stock in this heavily dollarized economy. Estimates of the degree of dollarization vary, but many suspect it could be as high as 90% or more of the money stock.

17. Foreign currency reserves as the third quarter of 2003 ended were more than \$0.7 billion, sufficient to cover more than 3 months of imports.

C. Lao PDR

18. The Government estimates that GDP growth in fiscal year (FY) 2003 (the FY ended 30 September) was 5.9%, little changed from the growth rate the previous 2 years. This is a favorable outcome given the SARS outbreak, which affected tourism to some extent. Concerns about the effect of unusually low rainfall on rice production in the upland areas were alleviated when late August and September rains broke the drought.

19. In FY2003, the Government's overall budget deficit was 7.8% of GDP. Government revenue as a share of GDP was 13.8%, while expenditure was 21.6%. The Government introduced a package of revenue and expenditure measures in late May 2003. The petroleum tax rate was doubled and excise tax rates on beer and tobacco were raised. On the expenditure side, the Government cut capital spending in projects considered ineffective or inefficient. These measures should help prevent a future deficit overrun, but further reform measures and improvements in revenue collection will be necessary.

20. Inflation was 10.6% in 2002, but rose to 15.5% in 2003. For the first quarter of 2003, inflation averaged 16.3%, then rose to almost 18% in the second quarter. Aside from the depreciation of the kip against the baht, price increases for basic necessities such as food, water, and electricity, as well as petroleum prices, contributed to this increase. But recent

monthly figures suggest that inflation has started to decrease, in line with Government efforts to reign in the budget deficit. Inflation dropped to 13.7% in November, and appears to have stabilized. Although this is an improvement over the first half of the year, it nevertheless suggests a continued need for close monitoring of inflationary pressures.

21. After dropping in 2002, both exports and imports grew strongly in 2003. In the first half of 2003, merchandise exports grew by 23%, while imports grew by 16%. The main contributors to this increase in exports were hydropower, timber, and garments which, combined, comprise about 80% of total exports. Lao PDR's traditional markets are Thailand, Vietnam, and European Union countries such as France, Germany, and Belgium where preferential trade arrangements drive much of the trade.

22. PRC has recently begun to emerge as an important destination for Lao exports, particularly forestry and agricultural products. Exports to PRC grew by about 50% in the first half of 2003 compared with the same period in 2002—from \$12 million to \$18 million. The United States (US) could also become a significant trading partner should Lao PDR be granted Normal Trade Relations in the near future.² The merchandise trade deficit is estimated to have decreased from about \$200 million in 2002 to \$140 million, while the current account deficit is estimated at about \$57 million.

23. The kip depreciated by more than 10% against the dollar in 2003. The exchange rate is currently stable at about 10,500 kip to the dollar. Foreign exchange reserves increased to more than \$190 million by mid 2003, which was sufficient to cover more than 4 months of imports of goods and services.

24. The value of foreign direct investment inflows for FY2003 rose by 67%, from \$93 million in FY2002 to \$155 million. This sharp increase is attributable to a gradual recovery in developing and improved domestic investment conditions, particularly improvements in the approval process. The main investors were from the region—Thailand, Viet Nam, and Malaysia—plus Australia. PRC is now emerging as a major investor, doubling its approvals from FY2002 to FY2003.

D. Myanmar

25. Data on Myanmar is sparse, and concerns have been raised over their reliability. Independent estimates suggest that economic growth for 2002 was about 6%, although the Ministry of National Planning and Economic Development reports 10% growth. In either case, that is down from the 11.3% reported in 2001. Growth in 2003 is unlikely to meet the Government's target of 10%.

26. Inflation averaged 57% in 2002, and appears to have eased somewhat in 2003, with year-on-year inflation in September 2003 of 24%.

27. Government estimates suggest that the fiscal deficit decreased from 5.9% of GDP in FY2001 to 4.1% in FY2002. The accelerating inflation rate brings the reliability of this estimate into question.

28. Because of both the political and economic situations, FDI has continuously declined over the past 4 years.

² Regular updates on progress in Lao People's Democratic Republic (PDR)'s movement toward Normal Trade Relations (NTR) status with the United States (US) can be found at <http://www.us-asean.org/laos.asp>.

29. Gross official reserves are estimated to have increased from about \$620 million in 2002 to \$780 million in 2003. That would be sufficient to cover about 4 months of imports.

E. Thailand

30. The momentum associated with the solid growth of 5.2% in 2002 more than carried through to 2003. Growth for the first half of 2003 averaged a robust 6.3%, increased to 6.6% in the third quarter and shot up to 7.8% in the fourth. The sharp increase in the final quarter resulted in overall growth for 2003 of 6.7%. Thailand is now growing at rates not seen since the Asian financial crisis. Strong private consumption spending, coupled with a remarkably resilient export performance, drove most of the expansion in 2003.

31. For the first time since the Asian financial crisis, the budget recorded a surplus amounting to 0.6% of GDP for FY2003 (ending 30 September 2003), and a cash surplus of 0.6% of GDP, including the nonbudgetary balance. This is a massive turnaround from the deficit of 2.2% of GDP in FY2002. The surplus was mainly the result of buoyant tax receipts, accruing from strong economic growth.

32. After growing by almost 20% in the first half of 2003, export growth slowed but remained healthy at 11% in the third quarter of 2003. Similarly, import growth of 15.5% in the first half of 2003 moderated to 11.8% in the third quarter. Strong growth in both exports and imports in the fourth quarter resulted in exports growing by 18.6% in 2003, and import growth of 17.1%. This produced a merchandise trade surplus of \$4.2 billion for 2003, up from the \$2.7 billion recorded in 2002.

33. Aided by a recovery in tourism in the second half of 2003, the current account surplus increased to \$5.6 billion for the first 9 months of 2003—18% higher than that of a year before. For 2003 as a whole, the current account surplus is expected to be about 6% of GDP, similar to that in 2002. But the overall balance of payments swung slightly into deficit (\$322 million) for the first three quarters of 2003, wiping out the \$3.1 billion surplus of a year before after prepayment of the International Monetary Fund (IMF)-led “crisis” loan package.

34. Inflation increased but continued to remain low in 2003. Consumer price inflation rose by 1.8%, while “core” inflation (excluding food and energy items) rose by only 0.2%.

35. The baht firmed in 2003, and ended the year at less than 40: 1 to the dollar. By early February 2004, the baht was trading closer to 39: 1. Foreign currency reserves rose to end 2003 at slightly less than \$41 billion, which is more than twice the level of short-term debt, and equivalent to almost 7 months of imports.

36. Net flows of foreign equity investment also rose sharply in 2003. During the first 9 months, net equity flows totaled \$1.1 billion, up from \$292 million for all of 2002. Japan was the largest net investor, accounting for 44% of the foreign investment, followed by the European Union, with 34%. Most investments were in manufacturing and trade-related activities.

F. Viet Nam

37. GDP grew by an impressive 7.1% in 2003, up from 6.5% in 2002, making Viet Nam’s economy one of the world’s fastest growing. Strong consumption and investment spending,

coupled with robust export performance, underpinned this performance. Strong growth is expected to continue in 2004, remaining higher than 7%.

38. Strong growth also resulted in increased collection of government revenues. In 2003, revenues increased by 11.8%. The value-added tax contributed 29% of the revenues, corporate income tax about 28%, and trade taxes about 21%. Government spending also increased as a result of reform measures associated with bank recapitalization in the first half of 2003, and recently in conjunction with hosting the Southeast Asian Games. Total Government expenditure in 2003 rose by 16.1%. This resulted in an overall budget deficit of 4.7% of GDP in 2003, up from 3.5% in 2002.

39. Exports increased by \$19.3 billion in 2003, while imports rose by \$22.6 billion, causing a \$3.1 billion trade deficit. Strong import growth in 2002 turned the current account into deficit for the first time in 3 years. That trend continued into 2003. The increased trade deficit contributed to 5.7% of GDP—almost double the account deficit in 2003.

40. Inflation remains low and manageable, despite rapid economic growth. The consumer price index increased by only 1.8% in the first half of 2003, and was expected to average less than 4% for the entire year. That is about the same as in 2002.

41. The exchange rate remained relatively stable in 2003, with the dong depreciating against the dollar by an average of only 3.5%.

42. FDI commitments continued to increase in 2003, rising by almost 40% in the first 9 months compared with the same period in 2002.

43. Gross international reserves, including gold, increased to about \$4.6 billion by the end of 2003, covering more than 2 months of imports.

G. Yunnan Province, PRC

44. Data for Yunnan, as a PRC province, are limited compared with data for GMS member countries.³ Yunnan's growth averaged a robust 9.3% from 1992 to 2001. Growth remained higher than 10% yearly from 1992 to 1996, and then the trend went downward. 2001 growth slowed to 6.5%, and similar growth was expected in 2002.

45. Per capita income in 2002 was \$2,881—second in terms of purchasing power parity only to that of Thailand. Purchasing power parity more than doubled from 1992 to 2002, and has increased faster than that of other GMS members.

46. Despite robust growth Yunnan Province has experienced deflation over the past few years. Consumer prices fell by 0.9% in 2002. The slowdown in growth since the mid-1990s may account for the deflation to some extent, as consumer price inflation had averaged higher than 20% in the high growth years of the mid-1990s. Similarly, the average growth in broad money over the deflation years of 2000–2002 was less than 16%, compared with about 34% from 1994 to 1996.

³ The People's Republic of China's (PRC) National Bureau of Statistics of China, however, publishes the *China Statistical Yearbook Yunnan Province, PRC* that contains a range of provincial information.