

NEWLY INDUSTRIALIZED ECONOMIES

The trade-oriented economies of Hong Kong, China; Republic of Korea; Singapore; and Taipei, China—the NIEs—are suffering disproportionately from the current weakness in the world economy just as they were the big gainers from the 1999-2000 ICT boom. With global economic recovery delayed, in part because of the 11 September attacks on the US, growth performance for 2001 is now projected to be near zero with a softer rebound in 2002 than anticipated in ADO 2001.

Economic Indicator (percent)	1998	1999	2000	2001		2002	
				Current	ADO 2001	Current	ADO 2001
GDP growth	-2.9	7.8	8.4	0.1	4.3	2.7	5.6
Inflation rate	4.6	-0.1	1.1	2.1	2.2	1.9	2.5
Export growth	-8.6	5.3	19.5	-10.1	7.5	6.3	9.5
Import growth	-19.5	7.5	25.0	-10.6	7.3	6.8	10.7
Current account/GDP	7.4	6.3	4.9	4.8	4.6	4.1	5.0

Economic Assessment. With export demand weaker than anticipated, Hong Kong, China; Singapore; and Taipei, China are now expected to experience contractions in real GDP in 2001 rather than slowdowns in growth. The Republic of Korea (hereafter Korea) is expected to sustain positive, although lower, growth on the strength of domestic demand. The subregion will barely grow in 2001, in sharp contrast to 2000 when the NIEs were propelled to more than 8 percent real GDP growth on the back of rapid expansion of ICT exports. With weak economic performance, unemployment is rising in all the NIEs (apart from Korea), although rates are still below 1999 averages (except in Taipei, China, where seasonally adjusted unemployment was at a historic high of 5.3 percent in September 2001).

Indeed, whereas the 2001 slowdown for Korea, which accounts for about 50 percent of the NIEs' real GDP, is much more muted than in the 1998 financial crisis, the contraction in Taipei, China, which accounts for more than 25 percent of the NIEs' real GDP, was unexpected and represents the worst economic performance in two and a half decades. In Korea, domestic demand strengthened somewhat in the first half of 2001, in part because of fiscal stimulus measures. In contrast, domestic demand in Taipei, China weakened over the same period due to significant political and economic uncertainties. Hong Kong, China and Singapore—small, open economies for which exports (including reexports) are over 200 percent of real GDP—face double-digit percentage point swings from strong GDP growth in 2000 to a contraction in 2001.

Alongside weaker economic activity, inflationary pressures are easing, although only in the third quarter in the case of Korea, where inflation is higher than was expected in ADO 2001 and higher than in 2000 because of

stronger domestic demand. In Singapore and Taipei, China inflation is lower than in 2000 and lower than expected in *ADO 2001*. In Hong Kong, China, instead of the anticipated inflation, the deflationary conditions of 2000 remain in place.

Korea is faring somewhat better than the other NIEs because, as a larger economy, it has a larger domestic market and a more diversified export sector, whereas the other NIEs are somewhat more dependent on the hard-hit ICT sector or trade-related services. However, all are feeling the adverse effects of the sharper than expected correction in the global electronics industry. This impacted both demand and investment in the NIEs' export-driven electronics sectors. In addition, as the global slowdown became deeper, longer, and broader, trade in all sectors began to slow sharply. In 2000, the growth of merchandise export values ranged from 16.0 percent in Hong Kong, China to 21.8 percent in Taipei, China. Instead of a mere slowing of export growth momentum in 2001 as anticipated in *ADO 2001*, severe export contractions are now expected, ranging from 5.9 percent in Hong Kong, China to 16.0 percent in Taipei, China.

Gross fixed investment growth is forecast to remain positive but low in Hong Kong, China—propped up by public infrastructure spending—but to be negative in the other three economies. The overall 2001 NIEs' current account surplus is expected to be wider than was forecast in *ADO 2001* because imports are contracting more rapidly than exports. However, with somewhat stronger net capital outflows, the pace of reserve accumulation is slowing in Korea and Taipei, China. More recently, the 11 September attacks and subsequent events have eroded consumer and investor confidence, which is delaying the global economic rebound that would restore export demand, which, in turn, would revive investment in export-driven sectors.

Finance sector performance was weak among the NIEs in the first three quarters of 2001, although Korea fared a bit better. The Korean won, which had depreciated by about 10 percent in 2000 against the US dollar, depreciated by a further 2.2 percent through 15 October 2001. The Hong Kong dollar remained linked to the US dollar but the New Taiwan and Singapore dollars, which had depreciated by about 5 percent and 3 percent, respectively, in 2000 against the US dollar, each fell further by about 4 percent through 15 October. Similarly, Korea's stock market, which experienced the largest correction in 2000, posted a modest gain of 1.9 percent through 15 October 2001 whereas the other stock markets followed the NASDAQ further down. The NIEs all experienced sharp stock market corrections after the September attacks but had rebounded somewhat by 15 October.

In credit markets, official interest rates were cut to varying degrees in the NIEs through early October 2001. However, with finance sector weakness in Korea and Taipei, China and high levels of uncertainty over the business outlook, these cuts had a very limited impact on credit expansion. In Hong Kong, China, policy rate cuts matched the Federal Reserve's 400 basis point cuts from end-December 2000 through early October 2001, lowering the prime rate to 5.5 percent. In Singapore, which uses exchange rate adjustments to achieve its inflation target, the overnight repurchase

agreement rate fell by 158 basis points to 0.90 percent from December 2000 through 15 October 2001. Korea and Taipei, China cut official rates by 125 and 213 basis points, respectively, through early October. In Korea, historically low interest rates have ignited a real estate boom while corporations struggle to obtain new lending. In Taipei, China, bank claims on the private sector fell in the first three quarters of the year. However, in both economies the total value of bonds outstanding rose over the same period.

Each of the NIEs has also undertaken fiscal and other stimulus measures, including tax cuts and rebates as well as supplementary budgets. The packages are expected to provide some cushion against the economic slowdown. The actions of the Government of Korea to ensure the bond market's smooth functioning by guaranteeing some corporate debt falling due and in need of refinancing in early 2001 were critical to short-run macroeconomic stability there.

Forecast. Global economic conditions deteriorated significantly in the third quarter of 2001. The September attacks accentuated the downward trend in the subregion's exports, adversely affected tourism, provoked sharp stock market corrections, and led to additional monetary and fiscal stimulus in the four economies. The anticipated global turnaround, which was receding even before September, is now expected to begin only in 2002, and may further delay recovery in the electronics sector. *ADO 2001* expected this recovery to be evident in the second half of 2001 but it may not now appear until the middle of 2002. Consequently, the contraction of exports (and therefore manufacturing) is not expected to bottom out until late 2001 or early 2002 and only slowly gather momentum thereafter. In addition, tourism may be weak for at least several months, which will particularly affect the economies of both Hong Kong, China and Singapore. Even with fiscal stimulus measures already in place in the NIEs, domestic demand—particularly investment—is expected to have only limited strength until mid-2002. Thus economic performance is expected to be very weak in 2001, improve moderately in 2002, but strengthen significantly in 2003.