Southeast Asia

Brunei Darussalam
Cambodia
Indonesia
Lao People's Democratic Republic
Malaysia
Myanmar
Philippines
Singapore
Thailand
Viet Nam

Brunei Darussalam

Oil and natural gas production is estimated to have declined in 2009, resulting in a moderate contraction in GDP. Inflation remained low and the current account surplus large. A forecast return to modest economic growth in 2010 is based on higher global demand and prices for hydrocarbons, the start of output from a new methanol plant, and a pickup in construction. As oil and gas reserves are depleted, the main development challenge is to diversify into new sources of growth.

Economic performance

The economy contracted by 1.9% in 2008 as oil and natural gas production, which accounts for 70% of GDP, fell by 6.2% (Figure 3.22.1). The significant contraction in hydrocarbon production, for a second year in a row, reflected the aging of the country's oil fields and a government decision to use reserves more sparingly to extend the life of energy production. Growth in the nonenergy sector slowed to 2.4%, from 8.5% in 2007, mainly due to the impact of the global downturn on trade, tourism, and manufacturing (predominantly clothing).

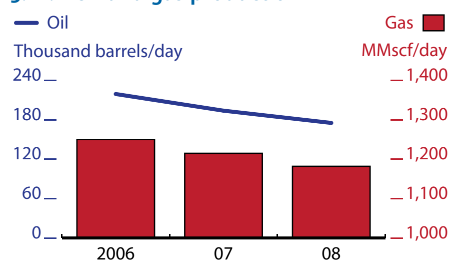
GDP contracted by 2.8% year on year in the first quarter of 2009 (the latest period for which data are available). Oil and gas production fell by a further 6.7%, and growth slowed in the nonenergy sector. For the full year, GDP is projected to have contracted by 1.2% (Figure 3.22.2). The estimated decline in hydrocarbon production was likely offset to some extent by increased government services output associated with efforts to expedite capital spending. Construction activity benefited from the government spending, and services such as retail trading, transportation, and recreational services likely picked up last year as consumer confidence improved in line with the better overall economic outlook.

Inflation moderated to 1.8% in 2009, from 2.7% in 2008, reflecting softer commodity prices and subdued domestic demand. Food, which accounts for 29% of the consumer price basket, was the main contributor to inflation, increasing by 2.3% (down from 5.0% in 2008), while transport costs, which account for 23% of the price basket, rose by 2.1% (versus 1.6% in 2008). A broadly stable Brunei dollar, which is linked to the Singapore dollar, helped contain inflation.

Available data indicate that the budget fell into deficit (by $81.9 million) in the second quarter of FY2009 (ended 31 March 2010) after a $392.1 million surplus in the first quarter, and a surplus of $3.9 billion in FY2008. The turnaround in the fiscal position was caused by a slump in revenue from oil and gas (taxes, dividends, and royalties) and an increase in both current and capital expenditure.

High oil prices in recent years have contributed to substantial current account surpluses. The surplus increased to an estimated $7.2 billion in

3.22.1 Oil and gas production



MMscf = million standard cubic foot.

Source: Department of Economic Planning and Development. 2009. *Brunei Darussalam Key Indicators*. http://www.depd.gov.bn

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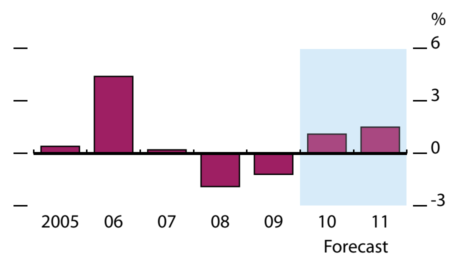
3.22.2 GDP growth



Source: Asian Development Outlook database.

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3.22.1 Selected economic indicators (%)

	2010	2011
GDP growth	1.1	1.5
Inflation	1.7	1.5
Current account balance (share of GDP)	33.0	31.0

Source: ADB estimates.

This chapter was written by Purnima Rajapakse of the Southeast Asia Department, ADB, Manila.

2008 (50.4% of GDP) as the value of merchandise exports (almost entirely oil and gas) shot up by 37.5% to $10.5 billion. Merchandise imports rose by 22.5% to $2.4 billion. During the first quarter of 2009, the current account surplus narrowed as the value of hydrocarbon exports fell and imports of food and machinery, transport equipment, and other manufactured items rose.

Preliminary trade data for all 2009 indicate that exports (in decreasing share) to Japan, Indonesia, the Republic of Korea, and Australia, which accounted for 87% of Brunei's exports, dropped by 45%, while imports (also in decreasing share) from Singapore, Malaysia, Japan, the People's Republic of China, and Thailand, which account for 73% of total imports, declined by 1.2%. As a result, the current account surplus is likely to have narrowed to a still comfortable 35.0% of GDP in 2009. International reserves at the end of 2009 amounted to $1.4 billion.

Economic prospects

The aging of oil and gas fields, coupled with consequent stoppages in production for maintenance and repairs, suggests that hydrocarbon production will remain subdued in the forecast period. As for the nonenergy sector, recent efforts to diversify the economy will support growth, but the extent of that support depends on how fast that projects under the national development plan, Rancangan Kemajuan Negara 2007–2012, are rolled out. Growth projections are based on the assumption that there will be no sharp decline in oil and gas production in the forecast period and no letup in efforts to expedite projects under the national plan.

The economy is forecast to grow by 1.1% in 2010 and 1.5% in 2011, the recovery based on an expected gradual rise in global demand for energy, higher oil and gas prices, and the startup in the first half of 2010 of a large methanol plant under construction for the past 6 years. Construction activity relating to Pulau Muara Besar port and a power transmission line from Sarawak to Brunei, as well as the likely start of construction on some agri-processing projects, will also support growth.

Foreign direct investment is expected to pick up as the recovery in Asian economies strengthens, joining the rise in public investment scheduled under the development plan. Private consumption is likely to increase modestly with improved domestic economic prospects.

Inflation is forecast to edge up to 1.7% in 2010 before moderating to 1.5% in 2011. Its evolution depends largely on movements in global prices of food, most of which is imported. Price pressures will be contained by government subsidies on basic foods, fuel, housing, education, and health services, and by expected stability of the Brunei dollar against the US dollar during the forecast period.

The current account surplus is seen narrowing slightly, but staying at over 30% of GDP, underpinned by exports of hydrocarbons and methanol and likely increases in tourist arrivals and income from foreign assets. Growth in imports is projected to more than offset higher exports, reflecting increases in the machinery and equipment that are needed to maintain and upgrade hydrocarbon facilities, together with growth in construction materials for government infrastructure projects.

3.22.1 Development challenges

Proven reserves of oil are sufficient for about another 20 years of production, and of gas for about 30 years. The main long-term challenges are therefore to diversify the economy away from dependence on hydrocarbons, during exploration for new oil and gas fields.

Some progress on diversification has been achieved, despite the small size of the domestic market, but weaknesses in institutional capacity and the business environment need to be overcome before new industries can become an important source of growth.

While the government has accumulated abundant financial resources to promote diversification, slow progress in implementing government-funded projects points to a need to improve the bureaucracy's capacity.

As for the private sector, the World Economic Forum's Global Competitiveness Index for 2009/10 indicates that, although the country's overall ranking is relatively high at 32 out of 133 countries, it ranks poorly on several indicators including the number of procedures required to start a business (ranked 126); time required to start a business (126); and financing through local equity markets (117).

To promote private sector development, the government has announced plans to privatize a range of government services and is making efforts to modernize the financial sector. These include developing a modern payment and settlement system, drafting laws relating to capital market development, and introducing laws to vest a future monetary authority with relevant powers to supervise the financial system. Progress in streamlining procedures for businesses is likely to remain important to diversify the economy.

Cambodia

Declines in clothing exports, tourism receipts, and construction caused by the global recession brought about a contraction in GDP last year. Inflation faded, then turned up by year-end. Despite the adoption of an expansionary fiscal policy to cushion the impact of the slump, poverty incidence likely increased. This demonstrates a need to diversify sources of growth and to better target fiscal policy. The improved global outlook this year paves the way for moderate rates of economic growth during the next 2 years.

Economic performance

After growth that averaged 9.1% from 1998 to 2008, the economy contracted by an estimated 2.0% in 2009 (Figure 3.23.1). The shrinkage reflected output declines in three of the four drivers of growth: garment exports, tourism receipts, and construction, which together account for over one-third of GDP.

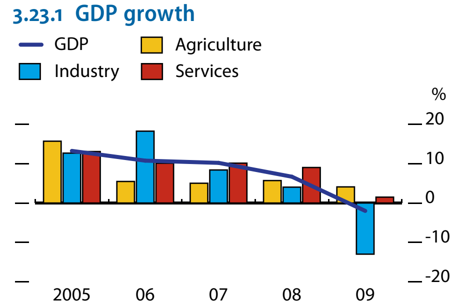
In contrast, the primary sector, the economy's fourth driver producing about 30% of GDP, maintained trend growth and served as a social safety net for many laid-off workers. Agricultural output expanded by an estimated 4%, mainly a result of favorable rains. Fisheries production received a boost from aquaculture and marine fishing expanded by about 9%, while growth in livestock and forestry-related production is estimated to have remained at around trend rates.

Growth in services slowed to 1.5%, principally a reflection of a decline in tourism receipts as global travel waned, and of border tensions with Thailand, a country through which many tourists transit. Total tourist arrivals rose by 1.7% in 2009 (to 2.2 million), pushed up by increases of about half from neighbors the Lao People's Democratic Republic and Viet Nam. However, the number of higher-spending tourists from the Republic of Korea (hereafter Korea) and Japan fell by 26% and 11%, respectively.

Industrial output last year fell by an estimated 13.0%. Data from the United States (US) Department of Commerce showed that US garment imports from Cambodia plummeted by 20.9% in dollar terms in 2009 (Figure 3.23.2) because of lower overall US demand and a loss of market share to competitors such as Bangladesh. (The US accounts for 70% of Cambodia's garment exports.) Construction is estimated to have contracted by 10%, reflecting a sharp decline in inflows of construction-related foreign direct investment (especially for large projects, including those funded from Korea), and a slowdown in residential construction.

Heading into 2009, inflation decelerated from very high levels, such as 35.6% in May 2008 (Figure 3.23.3), as world oil and food prices fell and domestic monetary policy was tightened in mid-2008. Weakening domestic demand in 2009 further subdued price pressures, so that the consumer

3.23.1 GDP growth



Source: Asian Development Outlook database.
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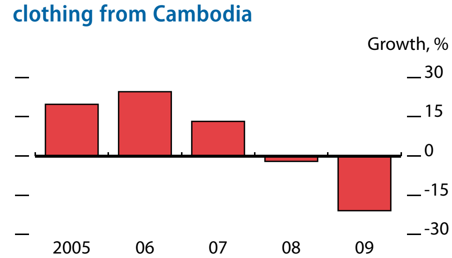
3.23.2 United States imports of textiles and clothing from Cambodia



Source: Office of Textiles and Apparel. http://otexa.ita.doc.gov (accessed 1 March 2010).
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This chapter was written by Eric Sidgwick and Poullang Doung of the Cambodia Resident Mission, ADB, Phnom Penh.

price index on average in 2009 was 0.7% below prior-year levels. By December, though, year-on-year inflation had returned at a rate of 5.3%. The real effective exchange rate of the riel appreciated by about 2% during 2009.

After clear signs that inflation was dissipating, and in response to the economic slump and very low growth in broad money (3.7% at end-March), the National Bank of Cambodia, the central bank, in early 2009 lowered the minimum reserve requirement on banks' foreign currency deposits and introduced a new method of calculating minimum reserves that, in effect, increased banks' liquidity. As a result, broad money growth accelerated to 36.8% by end-December 2009 (Figure 3.23.4), driven by a buildup in foreign currency deposits (the economy is heavily dollarized).

Private sector credit growth, however, decelerated from 55% at end-2008 to 6.5% at end-2009 (Figure 3.23.5), attributable to subdued economic activity and increasingly risk-averse behavior of banks. The banks grew more cautious as property values declined (most loans are collateralized on property) and their nonperforming loans rose to 4.8% of total loans at end-2009 from 3.7% a year earlier.

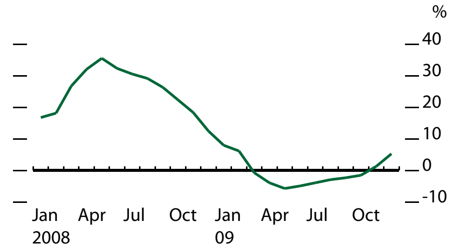
The government took a more expansionary fiscal stance to stimulate the slowing economy. It raised total expenditure to an estimated 17.6% of GDP, above the budgeted allocation of 16.1%. Measures included temporary tax relief for the tourism and garment industries; increases in locally financed spending on rural infrastructure; elimination of tariffs on fertilizers and imports of agricultural machinery; and $10 million for retraining laid-off garment workers. The government also awarded large increases in wages and allowances to civil servants and military personnel, so that its wage bill jumped from 3.4% of GDP in 2008 to 4.7% in 2009.

Increased public outlays, at a time that revenue was eroded by the economic slump, pushed out the overall budget deficit to an estimated 5.9% of GDP in 2009, double the 2008 gap (Figure 3.23.6). An expansionary fiscal stance was appropriate given the weakness in aggregate demand, though the policy's impact on the economy generally and on poverty reduction specifically was likely hindered by inadequate targeting. Furthermore, in a reversal from recent years, the government drew down its deposits in the banking system to help fund the budget deficit. This large injection of riel liquidity (equivalent to 1.4% of GDP) risked undermining macroeconomic stability.

In the external accounts, preliminary data show a 17.0% fall in merchandise exports in 2009, mostly stemming from the drop in garment exports to the US. Imports contracted by 16.3%, on lower oil prices and cooling consumption. Tourism receipts likely declined. The current account deficit (excluding official transfers) narrowed to an estimated 10.7% of GDP (or 5% including official transfers). Foreign direct investment inflows fell by an estimated 27% to $593 million, reflecting the financial crisis and global recession, but donor inflows remained buoyant, and international reserves increased to around $2.4 billion, equivalent to more than 4 months of projected imports.

An analysis conducted by multilateral organizations in late 2009 concluded that Cambodia's external public debt remains sustainable and that the risk of debt distress is moderate. Such debt at year-end was estimated at $3.2 billion (up slightly from end-2008), largely on concessional terms. Most external private debt is in the form of trade credits.

3.23.3 Inflation



Source: CEIC Data Company (accessed 1 March 2010).
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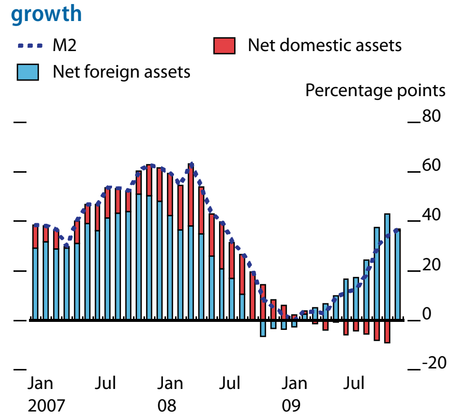
3.23.4 Contributions to money supply growth



Source: CEIC Data Company (accessed 1 March 2010).
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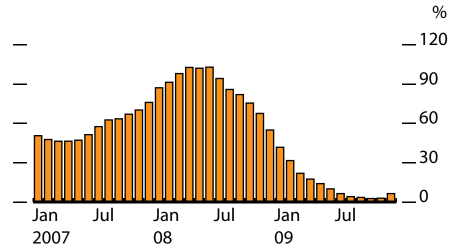
3.23.5 Growth of private sector credit



Source: CEIC Data Company (accessed 1 March 2010).
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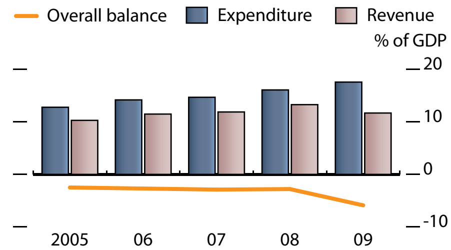
As a result of surging food prices in 2008 and the economic contraction in 2009, it is likely that the incidence of poverty has risen above the 30% rate recorded in 2007. In addition to the short-term relief measures that it introduced last year, the government began preparations for a social safety net system that will involve the expansion of targeted conditional cash transfers and labor-intensive public works programs.

In other policy areas, some progress was made under the public financial management reform program, most notably in enhancing the credibility of the budget through improved medium-term macroeconomic and expenditure frameworks as well as better budget, cash, and debt management. The authorities are implementing a program to restructure and transfer certain roles and responsibilities to provinces, districts, and communes; and to institute fiscal arrangements at those levels to promote transparent and accountable local development and improved service delivery.

Among efforts to enhance the business climate, the authorities extended the reach of financial services; improved the transparency of the financial system; finalized drafts of new laws on commercial contracts, finance, and insurance; and established a commercial arbitration center. An automated customs-processing system is being extended from the port of Sihanoukville to cross-border points.

3.23.6 Fiscal indicators



Source: Asian Development Outlook database.

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Economic prospects

If global economic growth is in line with the *Asian Development Outlook 2010* assumptions and if the weather allows for reasonable crops in Cambodia, GDP is projected to rebound by 4.5% in 2010 (Figure 3.23.7). The assumed lift in US consumer spending will likely result in only a mild recovery in demand for Cambodian garments, however, owing to the industry's loss of competitiveness to other suppliers. The pace of decline in garment exports to the US did ease, though, heading into 2010 (Figure 3.23.8).

Growth in services is projected to resume at around 5% in 2010. Forward bookings suggest fairly weak growth in arrivals of higher-spending tourists, although arrivals of less free-spending tourists are expected to continue to increase. Other services are projected to recover moderately, on a gradual pickup in domestic consumer and business sentiment.

Construction activity will likely grow at a moderate rate of about 4%, as appetite for bank credit gradually recovers and inflows of foreign direct investment, particularly from Korea, resume for some projects. Agricultural output is projected to expand by 4.7%, assisted by efforts to increase irrigation and the greater availability of high-yield seeds.

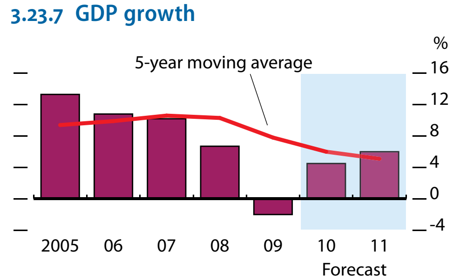
Fiscal policy is expected to be less stimulatory this year than last. The 2010 budget aims to narrow the deficit to 5.2% of GDP, to be achieved by raising tax revenue to 9.7% of GDP (from 9.0% in 2009) and rolling back the public sector wage bill a bit. Assuming a similar proportion of external financing as in 2009, this would enable a reduction in the drawdown of government deposits at banks to 0.6% of GDP. Revenue will get a lift from the strengthening of economic activity and new taxes on luxury vehicles and property.

3.23.1 Selected economic indicators (%)

	2010	2011
GDP growth	4.5	6.0
Inflation	5.0	5.0
Current account balance (share of GDP)	-16.3	-17.0

Source: ADB estimates.

3.23.7 GDP growth



Source: Asian Development Outlook database.

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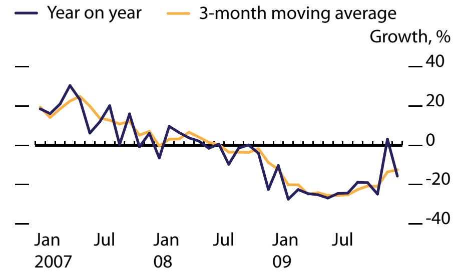
The planned reduction in fiscal stimulus, coupled with relatively low inflation pressures, is likely to presage an accommodative monetary policy stance, although the monetary authorities have indicated that they will adjust policy if inflation quickens faster than anticipated.

In 2011, a return to higher—though still below trend—growth in garment exports and tourism, together with some expansion of nongarment manufacturing and a pickup in other services subsectors, is projected to raise GDP growth to around 6%. The extent and timing of exploitation of oil and gas reserves discovered offshore are uncertain, but are not expected to have an impact on GDP before 2012 at the earliest.

Inflation of around 5.0% is projected for the forecast period, assuming no renewed surges in oil or food prices or sharper depreciation of the dollar, and assuming a reduction in domestic financing of the budget deficit in 2010. With imports expected to recover faster than exports, the current account deficit is seen widening to around 16% and then 17% of GDP in the next 2 years (Figure 3.23.9). An increase in equipment imports for infrastructure projects will more than offset gradually rising exports. Gross international reserves are expected to remain at over $2.1 billion by end-2010, equivalent to about 4 months of import cover.

This broadly positive outlook is predicated on the government resuming a path of fiscal consolidation, with a higher revenue effort matched by improved targeting of expenditure, and the maintenance of low inflation. Slippage in these areas would put the forecasts at risk. On the upside, growth prospects would be enhanced if key structural reforms were deepened so as to improve the functioning of public administration, to accelerate trade and transport facilitation with neighboring countries, and to attract more private investment.

3.23.8 United States imports of textiles and clothing from Cambodia



Source: Office of Textiles and Apparel. http://otexa.ita.doc.gov (accessed 15 March 2010).

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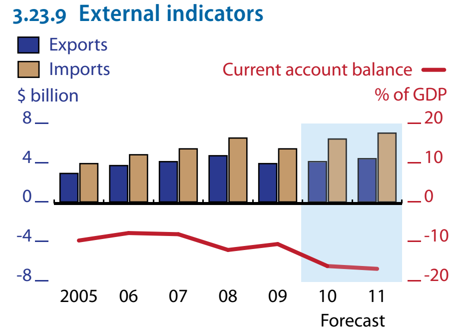
3.23.9 External indicators



Source: Asian Development Outlook database.

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Development challenges

The hit taken by three of the four drivers of growth and, probably, poverty reduction during the global recession demonstrates the need for Cambodia to accelerate the diversification of its sources of growth and to open more opportunities to participate in such growth, especially in rural areas where most of the poor live. The likely increase in poverty also shows a need to institute a social safety net to better protect the most vulnerable during economic slumps.

Among the key challenges to achieving these objectives are improving the competitiveness of garments and tourism, diversifying crops and increasing crop yields, and improving linkages between farmers and markets. Effective implementation of the agricultural and rural development agenda will require a greater degree of coordination among relevant government agencies, and between these agencies and evolving subnational administrations.

While the legal framework for greater private sector development is, on paper, taking shape, more needs to be done to implement laws and regulations and, more generally, to create an environment to attract higher levels of employment-generating investment.

Indonesia

The global recession had only a moderate impact on this large economy: growth was maintained, mainly due to increases in private consumption and government expenditure. Inflation eased to low levels. Economic activity is forecast to quicken this year and return to prerecession levels in 2011, based on strengthening domestic demand and supportive macroeconomic policies. Despite economic achievements over recent years, raising investment in infrastructure and generating enough jobs remain major challenges.

Economic performance

Growth slowed during the global recession, but not precipitously, reflecting the economy's relatively low dependence on exports (equal to 30% of 2008 nominal GDP) and large domestic market. The slowdown bottomed in the second quarter of 2009, and the economy rebounded in the fourth, assisted by a pickup in exports and prices of export commodities, as well as by stimulatory fiscal and monetary policies. For the year, GDP increased by 4.5% (Figure 3.24.1), only about 1 percentage point below the average expansion in the previous 5 years.

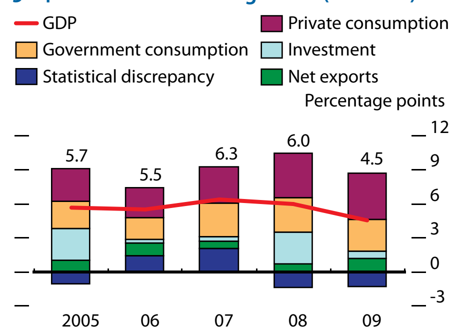
Private consumption grew by 4.9% in 2009, to contribute the majority of GDP growth (2.8 percentage points). It was driven by good harvests (which bolstered rural incomes), low inflation, government cash transfers to poor households early in 2009, election-related spending, and tax cuts (adopted as part of a fiscal stimulus package).

The government boosted its consumption spending by 15.7% (a second consecutive year of double-digit increases), which contributed 1.3 percentage points to GDP growth. Alongside efforts to raise the rate of budget disbursement to stimulate the economy, the fiscal stimulus package was an important factor in higher public spending. Election-related outlays in the first half and pay increases for civil servants also contributed.

Growth in investment slowed in the face of the world financial crisis and poor global outlook. Fixed investment rose by a modest 3.3%, due to increased outlays on buildings and infrastructure. Investment in machinery and equipment slumped by 9.2%, although the pace of its contraction moderated in the fourth quarter (Figure 3.24.2). As for international trade, imports of goods and services contracted faster than exports, generating positive net exports and contributing just over 1 percentage point of GDP growth.

On the supply side, growth of agriculture was solid at 4.1% (though slower than in 2008). Harvests were good, but demand softened for exports of natural rubber and palm oil. Growth in manufacturing production also eased from 2008, to 2.1%. After a drop in late 2008 and early 2009, the manufacturing production index started to edge up

3.24.1 Contributions to growth (demand)



Sources: Asian Development Outlook database; Statistics Indonesia. http://www.bps.go.id (accessed 15 March 2010).

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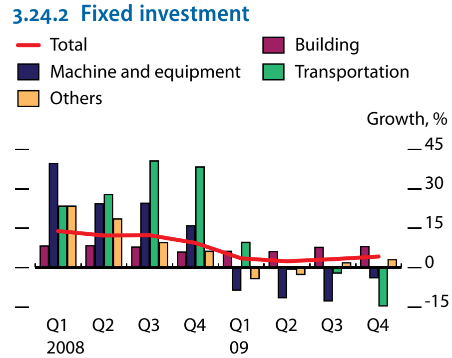
3.24.2 Fixed investment



Source: CEIC Data Company (accessed 15 March 2010).

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This chapter was written by Jörn Brömmelhörster and Priasto Aji of the Indonesia Resident Mission, ADB, Jakarta.

(Figure 3.24.3). Higher production of coal and copper lifted mining output by 4.4% (but crude oil output fell by about 3% to 301 million barrels in 2009). Construction expanded by 7.1%, bolstered by the investment in buildings and by government spending on infrastructure.

Growth in services moderated to 5.7%, but this sector (accounting for about 45% of GDP) still contributed more to total growth than industry and agriculture together. Transport and communications continued to outpace most other services subsectors, expanding at double-digit rates.

Lower prices for export commodities as well as softer demand drove down merchandise exports by 14.4% in United States (US) dollar terms last year. Merchandise imports fell at nearly double that rate, reflecting lower prices, weak investment in machinery and equipment, and a fall in exports of manufactures (which require imported inputs). Monthly data show exports and imports turning up in late 2009 as prices and demand recovered (Figure 3.24.4). The sharper slide in imports than exports generated a $35.2 billion trade surplus, and contributed to a current account surplus equivalent to 2.0% of GDP (the trade surplus outweighing a decline in current transfers and higher income and services deficits).

Net foreign direct investment inflows plunged by about 43% to $5.3 billion in 2009, but portfolio investment rose strongly in a sign of improved investor confidence. The overall balance of payments recorded a substantial surplus. International reserves, which had declined to $50.6 billion in October 2008, rebounded to $66.1 billion by end-2009, representing 6.5 months of imports and government foreign debt payments. The government entered into currency swap agreements totaling more than $30 billion that it could tap, if needed, to further bolster the external position.

The good harvests, an appreciating rupiah, and lower global food and fuel prices paved the way for inflation to abate to its lowest in almost a decade. Inflation decelerated from 12.1% year on year in September 2008 to 2.8% in December 2009, averaging 5.0% in 2009.

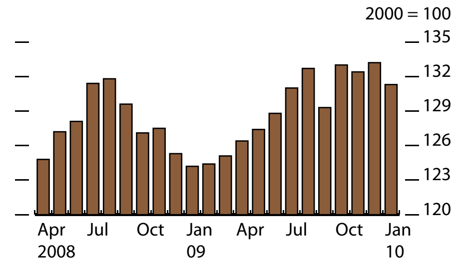
The unemployment rate declined slightly from 8.1% in February 2009 to 7.9% in August 2009, but employment in the formal sector increased by just 0.8%, or 260,000 jobs in this period. Lower (notably food) inflation and government cash payments for poor households in early 2009 contributed to a decline in poverty incidence by about 1 percentage point to 14.1% in the 12 months to March 2009.

As inflation and economic activity slowed, Bank Indonesia, the central bank, lowered its policy interest rate by 300 basis points from November 2008 to August 2009 to 6.5% (Figure 3.24.5). However, because commercial banks lagged in reducing their interest rates, these cuts had little impact on lending. Growth in credit slowed to about 10% in 2009, and growth in broad money supply eased to 12.4% by year-end.

Financial indicators strengthened as the year progressed. The rupiah appreciated against the US dollar by 18.2% in 2009, recovering from a depreciation in late 2008. Capital inflows picked up, along with the economy, from March. Yields on government bonds fell significantly, stock prices climbed, and credit default swaps returned to levels seen before the crisis (Figure 3.24.6).

To counter the impact of the global recession, the government rolled out a fiscal stimulus package costing Rp73.3 trillion, or about

3.24.3 Manufacturing production index



Source: CEIC Data Company (accessed 26 March 2010).

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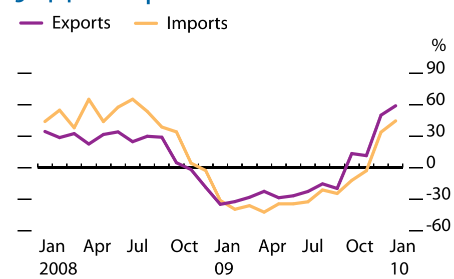
3.24.4 Trade performance



Note: Based on customs data.

Source: CEIC Data Company (accessed 5 March 2010).

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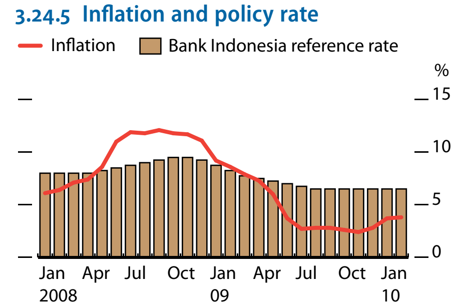
3.24.5 Inflation and policy rate



Sources: Bank Indonesia. http://www.bi.go.id; CEIC Data Company (both accessed 5 March 2010).

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1.4% of GDP. It consisted of tax breaks and subsidies to support private consumption and businesses (84% of the total stimulus) and labor-intensive infrastructure works. Efforts to raise the budget disbursement rate succeeded in getting much of the package implemented.

At the same time, lower international fuel prices allowed for a reduction in spending on fuel subsidies, so that total spending was less than budgeted. Revenue fell by about 15%, trimmed by lower corporate profits and commodity prices. The budget outcome was a deficit of 1.6%, widening from 0.1% in 2008, but smaller than the budgeted deficit of 2.4%.

Funding for the stimulus package was augmented by unspent budget resources from 2008 and from bond issuance. The government insured itself against a worsening financial climate by securing access to $5.5 billion through 2010 in contingency financing from development partners, only a small part of which was used in 2009. The contingency agreements helped restore confidence in financial markets, and the government was able to raise about $13.7 billion from domestic and international debt markets in 2009.

Still, the debt-to-GDP ratio of the national government fell to 28% in 2009, maintaining a decline that has cut the ratio by half in 5 years (Figure 3.24.7). An expanding economy, fiscal consolidation, and lower interest rates have helped bring down the debt burden. Reflecting improvements in the country's public and external positions, Standard & Poor's raised its long-term foreign currency credit rating for Indonesia's sovereign debt to BB from BB- in March 2010. Fitch Ratings upgraded its rating to BB+ from BB (one notch below investment grade) in January this year.

Some progress was made in addressing constraints to growth. A regional tax law finalized last year clarifies and limits new taxes that can be levied by regional governments, and a new export finance agency was established to provide lower-cost export credit to small and medium-sized businesses.

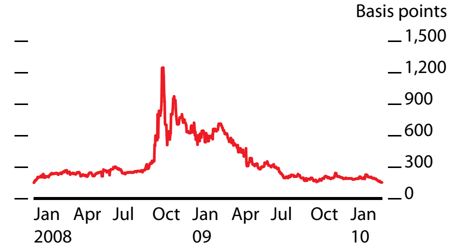
Efforts were stepped up to improve power supplies. Electricity demand is growing by at least 8% a year, and the state power company, which operates 85% of generating capacity and has a monopoly on transmission and sales, has struggled to meet it. A law introduced in 2009 allows private investors and local authorities to generate, transmit, and sell electricity without having to work with the state firm.

Economic prospects

Forecasts assume that the government will implement the major policies outlined during the 2009 national elections, including following through with the recently formulated National Medium-Term Development Plan 2010–2014. They also assume that monetary policy will be generally accommodative to growth, the rupiah will average about Rp9,400/$1, and that weather conditions will be normal.

The medium-term plan envisages average annual GDP growth of 6.3%–6.8% over 2010–2014, as well as, by 2014, a reduction in the unemployment rate to 5%–6% and a decline in poverty incidence to 8%–10%. The plan's focus is on ameliorating infrastructure, the bureaucracy, governance, and the investment climate. It calls for

3.24.6 Credit default swaps



Source: Bloomberg (accessed 16 March 2010).

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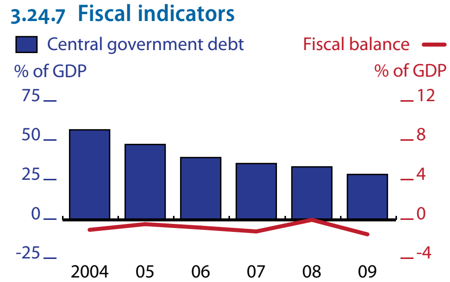
3.24.7 Fiscal indicators



Sources: Directorate General of Debt Management. http://www.dmo.or.id (accessed 1 March 2010); *Asian Development Outlook* database.

Click here for figure data

3.24.1 Selected economic indicators (%)

	2010	2011
GDP growth	5.5	6.0
Inflation	5.6	6.2
Current account balance (share of GDP)	1.4	0.6

Source: ADB estimates.

a substantial increase in development expenditure, which implies ambitious targets for funding from the private sector and public–private partnerships.

The 2010 budget aims to support the economic recovery, increase outlays on infrastructure, and sustain social spending. In September 2009, Parliament adopted a budget with a deficit target of 1.6% of GDP. However, taking into account rising world oil prices that will lead to a higher allocation for energy subsidies, the government proposed a revised budget with a wider deficit of 2.1% of GDP. This revised budget assumes a 15% rise in electricity charges at midyear, but no increase in administered fuel prices at any point during the year.

Budget revenue will benefit from higher rates of economic activity this year. Offsetting this to some degree will be a reduction in the corporate tax rate from 28% to 25% and tax breaks to encourage companies to list on the stock exchange and to invest in priority sectors, such as oil and natural gas. Unspent funds from 2009 (totaling the equivalent of $4.1 billion) will contribute to financing this year's budget.

Monetary policy is expected to remain generally accommodative, with inflation projected to stay within Bank Indonesia's 4%–6% target band in 2010. In March 2010, the central bank left the policy rate at 6.5%, for the seventh month in a row. The monetary authorities are also adjusting regulations to spur lending and encourage banks to lower their lending rates, in an effort to stimulate sluggish growth in credit.

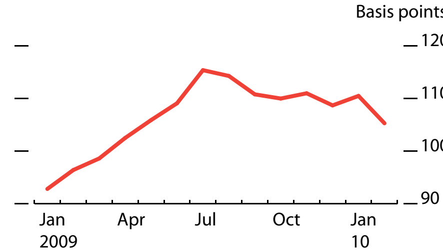
Against this policy background, private consumption is forecast to grow by at least 5.5% this year, benefiting from a stronger labor market, increases in real wages, and relatively high prices for agricultural commodities. Bank Indonesia's consumer confidence index showed a trend increase during 2009, though it subsequently dipped (Figure 3.24.8).

Investment will strengthen in light of improved global trade and financial conditions, the country's record of solid growth, and the upgrades in its credit rating. Foreign direct investment is expected to rebound and domestic investment will be encouraged by the quickening pace of economic activity, tax breaks, a better market for raising equity capital, and improved credit availability. Fixed capital investment is forecast to grow by at least 6% in 2010, accelerating to about 9% in 2011. Net exports are expected to make a relatively small contribution to GDP growth in the forecast period, given that higher exports of goods and services will be accompanied by higher imports.

Based on the above factors, GDP growth is forecast to rise to 5.5% in 2010 and about 6.0% in 2011 (Figure 3.24.9). Growth may exceed this if the government can accelerate its rollout of infrastructure investment.

In value terms, merchandise exports in January 2010 soared by 59%, and imports by 45%, from depressed levels in the prior-year month. For the full year, exports are forecast to rise by about 11%, based on the forecast increase in world trade and firm prices for commodity exports. Stronger domestic demand will propel imports by about 16%. Consequently, the trade surplus will narrow (Figure 3.24.10) and the current account surplus is forecast to contract to 1.4% of GDP in 2010 and 0.6% in 2011. Higher inflows of direct and portfolio investment should keep the overall balance of payments in surplus.

3.24.8 Consumer confidence index



Source: CEIC Data Company (accessed 26 March 2010).
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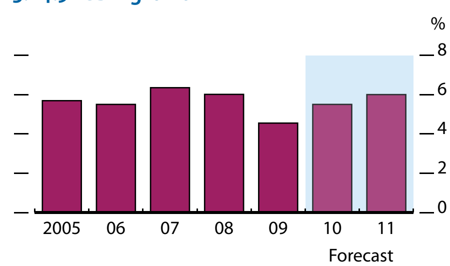
3.24.9 GDP growth



Source: Asian Development Outlook database.
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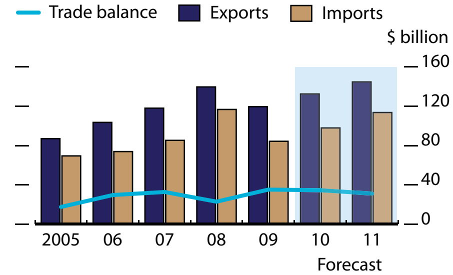
Rising domestic demand and higher global prices for oil and commodities this year will put upward pressure on inflation, countered somewhat by a projected appreciation of the rupiah. Food prices depend heavily on the weather, and in this regard earlier concerns about the impact of an El Niño weather pattern that could reduce food production have been alleviated, in part by increases in food stocks. Inflation in 2010 is forecast at 5.6% (it averaged 3.8% in the first 2 months), accelerating to 6.2% next year.

Domestic risks to the forecasts are headed by oil prices. A significantly higher global oil price than assumed, at a time that the authorities plan to keep fuel prices steady, would propel the cost of government subsidies. This would push out the budget deficit or lead to cuts in other spending, or a bit of both. Policy slippage and natural disasters are also a risk.

3.24.10 Merchandise trade



Source: Asian Development Outlook database.

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Development challenges

Since 2004, Indonesia has achieved 5.5% average growth, maintained a surplus in its current account, guarded a strong fiscal position, reduced external debt, and nearly doubled international reserves. Inflation, though, has averaged a high 8.5% since 2004, even if it has come down from the double-digit rates of 2005–2006 (Figure 3.24.11).

These solid fundamentals provided good underlying support in the face of the global recession. However, the moderate pace of growth over an extended period has not generated sufficient jobs to absorb the unemployed, underemployed, and new entrants to the labor market.

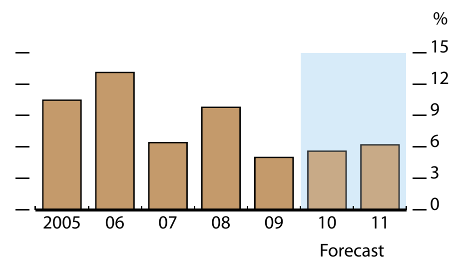
Furthermore, about 70% of those who are employed work in the informal sector, where wages and job security are low. The International Labour Organization estimates that in 2006 there were 52.1 million workers (about 55% of the total employed) earning no more than the equivalent of about $1 a day, and a further 7.9 million (8.2%) earning no more than $2 a day. Income inequality, as measured by the Gini coefficient, has increased from 0.32 in 2004 to 0.37 in 2009.

Insufficient job creation is a consequence of lackluster growth in the tradable sector, particularly labor-intensive manufacturing. That, in turn, is largely caused by weaknesses in the business environment (problems include legal and regulatory uncertainty and governance issues), and deficient infrastructure (such as roads, ports, and electricity supply).

Investment in infrastructure has dropped to the equivalent of about 3.5% of GDP in the past 3 years, from 7% before the Asian crisis, lagging such investment in faster-expanding economies. The government's investment coordinating agency estimates that $150 billion is needed to build and upgrade infrastructure in 2010–2014, of which the public sector could supply one-third.

Bridging that gap with private investment will require, among other things, faster progress in developing public–private partnerships, closer alignment of national and local regulations (which are sometimes in conflict), and overcoming hurdles related to acquisition of land for infrastructure projects.

3.24.11 Inflation



Note: 2005 = 100.

Sources: International Monetary Fund. International Financial Statistics online database (accessed 1 February 2010); ADB estimates.

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Lao People's Democratic Republic

Rising production of copper, gold, and silver coupled with stimulative government policies helped the economy maintain solid growth in 2009. The pace of growth is forecast to step up in both 2010 and 2011, underpinned by expansion in the mining and hydropower industries. Inflation, curtailed in 2009, will pick up this year. Rapid increases in credit have raised macroeconomic and banking system risks. Longer-term challenges involve diversifying sources of growth and generating more employment.

Economic performance

Given limited financial links with industrial countries and firm demand from neighbors for its main exports, the economy was relatively unscathed by the global slump, posting GDP growth of 6.5% in 2009. This outturn, a little below 7.5% average growth of the previous 5 years, was supported by significant increases in mineral production, a recovery in the price of copper in the second half of the year, and expansionary government policies.

Industrial production surged by about 17% and contributed most of the growth in GDP (Figure 3.25.1). This jump stemmed from mining, construction, hydropower, and, to a lesser degree, the small manufacturing subsector. Several mining and power projects continued the expansion works that had already been planned for the year, although a few other projects that depended on foreign investment were postponed when global financial flows dried up. Hydropower output rose by 2%.

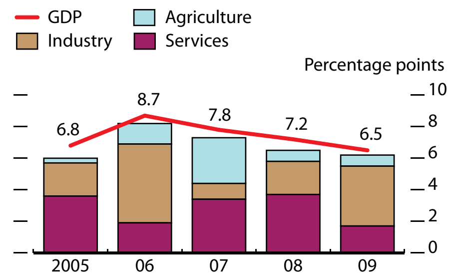
Output of copper from the country's two main mines rose by about 40% to 121,560 tons in 2009 from 2008's level, gold output rose by about 39% to 161,800 ounces, and silver production more than doubled to 496,000 ounces. It was the first full year of production from the Phu Kham copper and gold mine, which started operating in April 2008. The recovery of global copper prices in the second half also stimulated mine production.

Construction was spurred by the building of roads, sports facilities, and hotels for the Southeast Asian Games held in Vientiane in December 2009 and for the 450th anniversary of Vientiane as the capital, which is being celebrated during 2010.

Agriculture, which accounts for a third of GDP but employs more than 70% of the workforce, expanded by 2.3%, reflecting better crop yields from improved rice varieties, growth in fisheries and livestock, and expansion of plantations (for tree crops such as coffee and natural rubber) and contract farming (especially of corn and cassava).

Growth in the services sector was moderate at 4.4%. The Southeast Asian Games attracted visitors from neighboring countries late in the year, but tourism from industrial economies was damped by recession in Europe, Japan, and the United States. Growth of service industries such

3.25.1 Contributions to growth (supply)



Note: Contributions to growth based on GDP at constant basic prices.

Source: Asian Development Outlook database.

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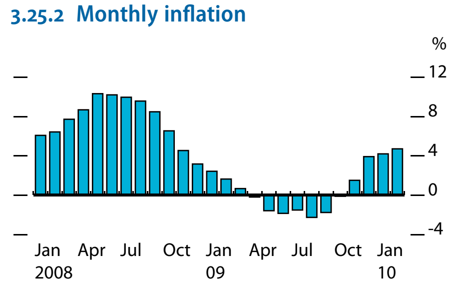
3.25.2 Monthly inflation



Source: CEIC Data Company (accessed 15 March 2010).

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This chapter was written by Christopher Hnanguie and Soulinthone Leuangkhamsing of the Lao Resident Mission, ADB, Vientiane.

as retailing, hotels, and restaurants decelerated, although the expansion of banking and finance services continued at a robust pace.

The government stepped up spending in 2009, to cushion the economy from the impact of the global recession and to build facilities for the Southeast Asian Games. Total spending grew to the equivalent of just over 21% of GDP in FY2009 (ended 30 September 2009). A previously approved hike in public sector wages contributed to the increase. Revenue was dented by the drop in copper prices in the first half of the fiscal year, but recovered in the second half as copper prices turned up. The government moved to offset the loss in copper revenue by raising excise taxes on luxury items, cigarettes, and alcohol. Excluding grants, the budget deficit widened to 5.9% of GDP in 2009 from 5.0% in 2008.

In addition to higher expenditure from the budget, the Bank of the Lao PDR, the central bank, funded significant off-budget direct lending for public infrastructure projects.

Inflation was curtailed by lower global oil and food prices, and was zero in 2009, compared with 7.3% over the previous 5 years. For the first 7 months of 2009, the consumer price index fell before turning up in the last 2 months and rising by 3.9% year on year in December (Figure 3.25.2). The kip depreciated by 2.5% against the Thai baht (Thailand is the Lao PDR's biggest trading partner).

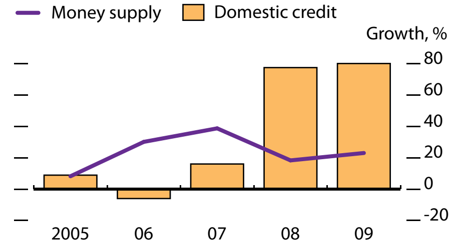
Rapid growth in credit—at a pace of about 80% in both 2008 and 2009 (Figure 3.25.3)—raised concerns that it could fuel inflation and lead to a rise in nonperforming loans at banks. Contributory factors included the central bank's lending for infrastructure projects and increasing monetization of the economy, while during 2009, the central bank lowered its policy interest rate from 7.0% to 4.0%. Growth in money supply (M2) picked up to about 23.0% in 2009.

Lower prices for export commodities, notably copper, coffee, and corn, trimmed the value of total merchandise exports by an estimated 10.0% in dollar terms in 2009. Clothing exports fell by about 13% because of weak demand in industrial countries. Merchandise imports declined by an estimated 13.0%, mainly a result of lower international oil and food prices and a fall in imports of machinery. With imports declining faster than exports, the trade deficit shrank and the current account deficit narrowed to 11.8% of GDP. Gross international reserves edged up to $644 million (Figure 3.25.4), sufficient for about 4 months of nonresource import cover.

Progress was achieved in some policy reforms in 2009. The recentralization of treasury, customs, and tax functions to the central government from the provinces was completed and other public finance management reforms made advances. Implementation of a value-added tax law promulgated in January 2009 was delayed to this year because of the global recession.

In changes that should improve the investment climate, business registration procedures were simplified and the government continued to implement trade-related reforms in its efforts to join the World Trade Organization. The National Assembly approved a new unified investment promotion law that will abolish cumbersome licensing procedures and harmonize investment incentives for domestic and foreign investors. However, implementation of this law, and other reforms, is slow.

3.25.3 Monetary indicators



Source: Asian Development Outlook database.

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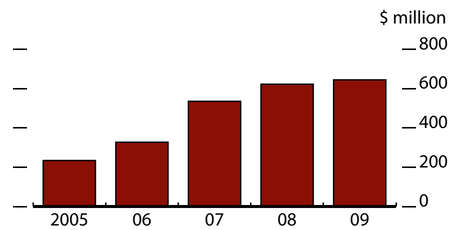
3.25.4 International reserves



Source: Asian Development Outlook database.

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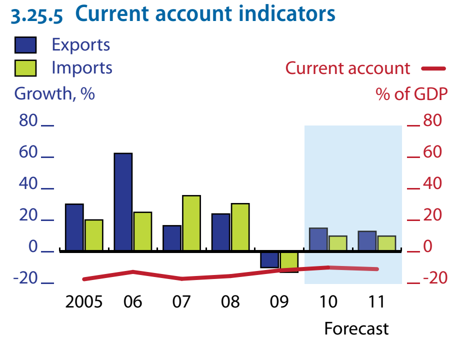
3.25.5 Current account indicators



Source: Asian Development Outlook database.

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3.25.1 Selected economic indicators (%)

	2010	2011
GDP growth	7.0	7.5
Inflation	5.6	6.0
Current account balance (share of GDP)	-10.0	-11.0

Source: ADB estimates.

Economic prospects

Growth is projected to pick up in the forecast period, underpinned by increases in investment and buoyant prices for export commodities, particularly copper and gold. The two major mining companies plan substantial investment, some hydropower projects delayed last year are being revived, and several other substantial mining and power projects are under consideration.

The country's biggest hydropower project, the 1,088 megawatt Nam Theun 2 plant, ramped up production in March 2010, a move that will more than double the country's power exports to more than $300 million in 2010. The Lao PDR exports about 80% of its electricity to Thailand. Clothing shipments are expected to recover this year as markets in Europe and the United States pick up.

Moderate growth is forecast in the services sector, supported by an increase in tourist arrivals as recession recedes in industrial countries and by an expected rise in visitors from neighboring countries as a carryover from the national capital's celebrations. Agriculture is envisaged to record slight growth, with some concerns for 2010 over a lack of rain in the north early in the year.

The government has budgeted a substantial increase in spending in FY2010, much of it directed at capital works. Revenue should rise quite strongly, too, supported by buoyant prices for copper and gold exports, rising income from hydropower exports, and the new value-added tax. The fiscal deficit is forecast to widen.

However, a firmer stance is expected on monetary policy, in the context of a rebound in imported inflation. The central bank aims to curb M2 money supply growth to 10% in 2010 and the government has committed to reining in the rapid growth in credit. Furthermore, the central bank has phased out direct lending for off-budget infrastructure.

On the balance of these factors, GDP growth is forecast to rise to 7.0% in 2010, quickening to 7.5% in 2011 as construction starts on several more power plants.

Inflation is seen accelerating to average 5%–6% in the forecast period, owing to upward pressure from higher global oil and food prices, recent rapid growth in credit, the depreciation of the kip against the baht, and, for 2010, the value-added tax. In the first 2 months of 2010 inflation averaged 4.5%.

Merchandise exports are forecast to rise by about 15.0% in 2010 (Figure 3.25.5), underpinned by buoyant copper and gold prices and rising exports of hydropower, in particular from Nam Theun 2. Exports will get a fillip from rebounding growth in the Thai economy, which contracted in 2009. Imports are projected to increase at a slower rate than exports, and the current account deficit should narrow slightly.

External public debt declined to 52% of GDP at end-2009 from 81% at end-2004, but is projected to rise slightly in the medium term as the government borrows to fund its equity stakes in some large projects. Although the stock of debt remains high, debt service is manageable, given that most is on concessional terms.

Aiming to broaden funding sources for the public and private sectors, the government plans to launch a small stock exchange at the end of this year, with assistance from other Asian exchanges.

3.25.1 Development challenges

The near-term challenge is to maintain low inflation, a stable exchange rate, and adequate foreign reserves at a time that very high rates of credit growth and generally expansionary policies have raised the level of risk to these achievements.

Now that inflation has turned up again, rapid rates of credit growth would likely fuel price pressures. Expansionary policies, if continued in 2010 as the economy picks up pace, could spur imports to an extent that depletes foreign reserves and jolts the exchange rate.

Excessive growth of credit, or an abrupt credit slowdown, would undermine the quality of bank loan portfolios, particularly as new private banks enter the market. The banking system remains vulnerable: state-owned commercial banks, which have a 60% share of banking assets, need to further strengthen capital positions and improve banking practices, including risk management. Central bank oversight capacity should be reinforced, especially in the context of the increasing number of banks.

Diversifying the economy's sources of growth and generating jobs to absorb the growing labor force remain major longer-term challenges. Mining and hydropower boost growth but offer few jobs. Reliance on mining puts economic growth and public revenue at the mercy of downswings in global metal prices.

Hence it will be important to build a fiscal framework that channels revenue from hydropower and mining into projects that expand the productive capacity of the economy, and into reducing poverty.

The private sector has the potential to generate more employment, if the government steps up efforts to ameliorate the business environment. The country has slipped in the World Bank's *Doing Business 2010* ranking to 167 of 183 countries, and in Transparency International's 2009 Corruption Perceptions Index to 158 of 180 countries.

Malaysia

A plunge in exports wounded this trade-sensitive economy in 2009. The impact of weak exports spread to private investment, which fell sharply, and to private consumption, which was nearly flat. Fiscal stimulation packages provided some buffer for aggregate demand. Economic growth will rebound during the forecast period, underpinned by a recovery in exports and rising incomes. Annual inflation is set to pick up from low levels. The government plans renewed efforts to encourage private investment.

Economic performance

Heavily reliant on external trade, the economy was slammed by the global recession in 2009. GDP dropped by 6.2% in the first quarter on a year-on-year basis, after which the pace of contraction eased before the economy expanded in the fourth quarter. On a quarter-on-quarter basis, GDP started to grow after the first quarter (Figure 3.26.1). For the full year, GDP contracted by 1.7%, compared with average growth of 5.8% over the previous 5 years.

The downturn was widespread, and declines in exports and investment were accompanied by considerably slower growth in government and private consumption. Exports in volume terms fell by 10.1%, reflecting depressed demand in most major markets. This was offset by a 12.5% contraction in import volumes, as net exports registered growth for the year. Fixed investment fell sharply by 5.5%, with many firms canceling or deferring investment decisions. Investment acted as the major drag on GDP in 2009 (Figure 3.26.2). Growth in private consumption, which accounts for around one-half of GDP, slowed to just 0.8% owing to job losses and reduced rural incomes on the back of depressed agriculture commodity prices.

In terms of supply, agriculture grew by a slight 0.4% as depressed export prices for palm oil and natural rubber damped production. Output from industry fell and caused GDP to decline (Figure 3.26.3). Mining and quarrying output declined by 3.8% in response to lower condensate and crude oil prices. Manufacturing, which is dominated by the export-oriented electrical and electronic subsector, contracted by 9.3% due to the downturn in export markets. Construction, however, increased by 5.7% for the year, supported by government stimulus measures. Growth of services eased to 2.6%, in line with subdued domestic economic activity.

Underpinning the upturn in the fourth quarter was a turnaround in exports and investment as industrial economies replenished depleted inventories and business sentiment improved on the back of a pickup in external demand and a gradual recovery in private consumption.

3.26.1 Quarterly GDP growth

saar = seasonally adjusted annualized rate.

Sources: Bank Negara Malaysia. 2010. *Monthly Statistical Bulletin*. January. http://www.bnm.gov.my; CEIC Data Company (accessed 23 March 2010).

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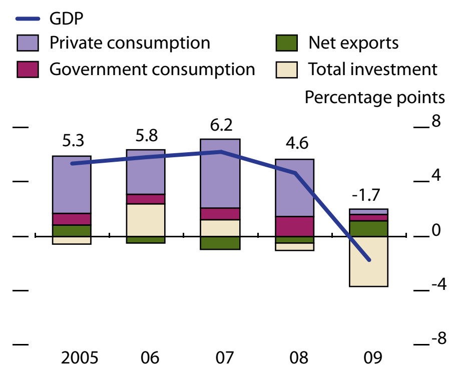
3.26.2 Contributions to growth (demand)



Sources: Bank Negara Malaysia. 2010. *Monthly Statistical Bulletin*. January. http://www.bnm.gov.my; CEIC Data Company (accessed 23 March 2010).

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This chapter was written by Purnima Rajapakse of the Southeast Asia Department, ADB, Manila.

The labor market bottomed in the first quarter, when the unemployment rate peaked at 4.0%. The rate then fell to 3.5% by the fourth quarter. Most layoffs were in manufacturing.

Inflation decelerated to 0.6% in 2009 from 5.4% in 2008. This stemmed from falling global commodity prices, slower domestic demand, and the base effect of an increase in administered fuel prices in June 2008. Consumer prices fell for 6 months of last year (Figure 3.26.4). However, month-on-month inflation was pushed up steadily from August 2009 by the effect of fiscal stimulus measures on domestic demand, a gradual rise in commodity prices, and the low-base effect of the fall in global food and fuel prices late in 2008. After falling sharply, producer prices also picked up later in the year, to 1.8% in December 2009. In the first 2 months of 2010, consumer prices rose by an average of 1.3%, while producer prices increased by 4.2% in January.

Malaysia's current account surplus declined to $32.0 billion in 2009 (16.7% of GDP) from $38.9 billion in 2008. This was mainly attributable to a reduced trade surplus, which offset higher net receipts on services and lower net income payments. Merchandise exports fell by about 21%. All major categories of exports declined in value relative to 2008, with electrical and electronic exports, which account for 41% of export earnings, recording a decrease of about 11%.

The export decline was only partly offset by a 21% fall in merchandise imports, since the value of exports outweighs those of imports. The decline in imports was mainly due to a sharp contraction in imports of intermediate goods, most of which are used in making electrical and electronic products for exports. Exports and imports picked up during the second half of 2009 (Figure 3.26.5).

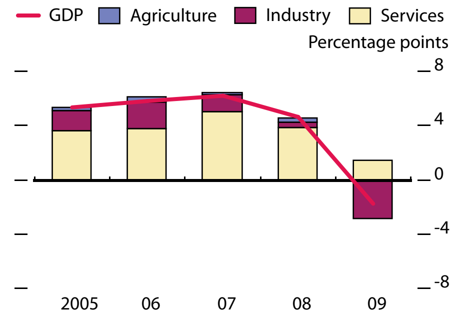
The improvement in the services account was largely attributable to higher receipts from tourism offsetting marginally higher payments on transportation. The narrower deficit in the income account was mainly due to lower outflows of profits and dividend payments. The lower current account surplus was accompanied by a smaller deficit in the financial account as a turnaround in portfolio investments, from a large outflow to a modest inflow, and a modest decline in direct investment outflows offset significantly higher outflows on account of other investments.

As a result of these developments, the overall balance of payments recorded a surplus of $3.9 billion in 2009 compared with a deficit of $5.5 billion in 2008. External reserves at the end of 2009 amounted to $96.8 billion, or 8 months of retained imports and 4.4 times short-term external debt.

The ringgit, having depreciated by 5.0% against the dollar during the first 3 months of 2009—when increased risk aversion and deleveraging activities by international investors increased the demand for dollars—has since appreciated (Figure 3.26.6). At the end of 2009, the ringgit had appreciated by 1.2% against the dollar on an easing of risk aversion. For the first 2 months of 2010, the ringgit further appreciated by around 1% against the dollar.

While the recovery in the second half of 2009 was largely attributable to external developments, the economy also benefited from expansionary fiscal and monetary stances. An RM7 billion fiscal stimulus package (1% of GDP) in November 2008, focusing mainly

3.26.3 Contributions to growth (supply)



Sources: Bank Negara Malaysia. 2010. *Monthly Statistical Bulletin*. January. http://www.bnm.gov.my; CEIC Data Company (accessed 23 March 2010).

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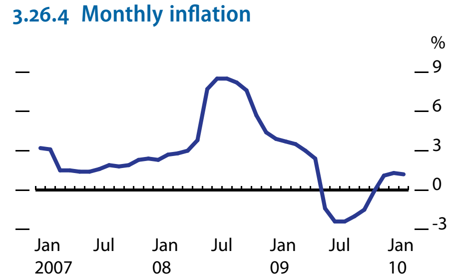
3.26.4 Monthly inflation



Sources: Bank Negara Malaysia. 2010. *Monthly Statistical Bulletin*. January. http://www.bnm.gov.my; CEIC Data Company (accessed 23 March 2010).

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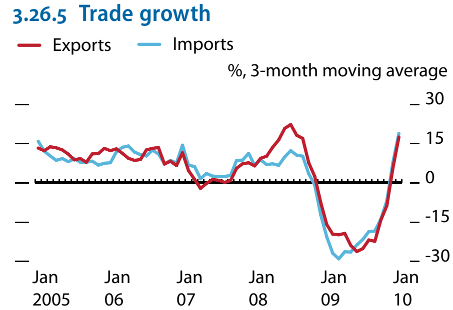
3.26.5 Trade growth



Source: CEIC Data Company (accessed 17 March 2010).

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on infrastructure-related projects, was followed in March 2009 by a RM60 billion (9% of GDP) set of measures to be implemented over 2 years. The second package includes additional spending measures (RM15 billion), loan guarantee funds (RM25 billion), equity investments (RM10 billion), public–private partnerships and other off-budget projects (RM7 billion), and tax incentives (RM3 billion). As of January 2010, over 95% of stimulus expenditure under the first package had been spent, and 42% under the second.

The central government fiscal deficit in 2009 widened to an estimated 7.0% of GDP (Figure 3.26.7), the deepest gap since the 1997–98 Asian financial crisis (although the actual deficit in 2009 was smaller than the target of 7.4%). Capital expenditure increased by 15.5% relative to 2008 as the government accelerated project implementation under the stimulus packages and the Ninth Malaysia Plan 2006–2010. Operating outlays also rose, due in part to increased domestic debt service payments, while revenue declined slightly.

As a result of the deeper fiscal deficit, the ratio of central government debt to GDP increased from 41.5% at end-2008 to about 54% a year later. Concerns over the size of the fiscal deficit and an apparent lack of a fiscal consolidation plan led in June 2009 to the first local currency debt downgrade since the 1997–98 crisis. Most of the public debt is domestic—only 3.8% was external debt at end-2009.

Bank Negara Malaysia, the central bank, maintained an accommodative monetary policy stance in the context of low inflation and weak economic activity. It reduced the overnight policy interest rate to 2.0% in February 2009 (Figure 3.26.8) and the bank reserve ratio to 1.0% in March 2009. These actions brought down the average lending rate from 5.9% in December 2008 to 4.8% in December 2009. Notwithstanding lower lending rates, loan growth of the banking system slowed to 7.8% by end-2009, from 12.8% the previous year. Loan indicators rebounded late in 2009 reflecting improved consumer and business sentiment.

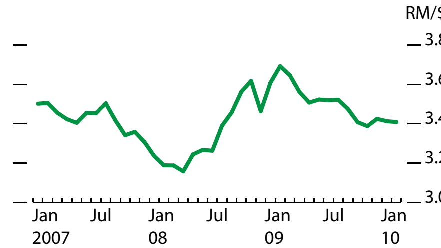
Most of Malaysia's banking sector assets are domestic, and banks had limited exposure to troubled foreign financial institutions or toxic assets. As a result, banking soundness indicators remained healthy and net nonperforming loans fell slightly to 1.8% of total loans in December 2009 from 2.2% a year earlier.

Long-term bond yields (10-year maturity) climbed from 3.1% to 4.3% during 2009, marking investor concerns over the increased supply related to the larger fiscal deficit. The stock market rebounded, along with other markets in Southeast Asia, to end the year up 45%.

Economic prospects

A considerable amount of the fiscal stimulus funding from 2009 remains to be spent in 2010. Still, fiscal policy will be less stimulatory this year than last as the government begins a much-needed fiscal consolidation process. Subsidies will be reduced, discretionary spending cut, and efforts put into making public services more efficient. The 2010 budget implies a 14% across-the-board cut in operating expenditure and a 4.5% cut in development expenditure, aiming to narrow the fiscal deficit to 5.6% of GDP in 2010.

3.26.6 Nominal exchange rate



Sources: Bank Negara Malaysia. 2010. *Monthly Statistical Bulletin*. January. http://www.bnm.gov.my; CEIC Data Company (accessed 22 March 2010).

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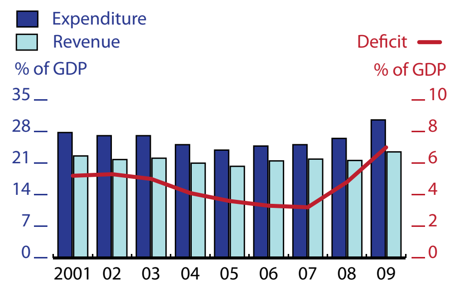
3.26.7 Government finance



Sources: Bank Negara Malaysia. 2010. *Monthly Statistical Bulletin*. January. http://www.bnm.gov.my; ADB estimates.

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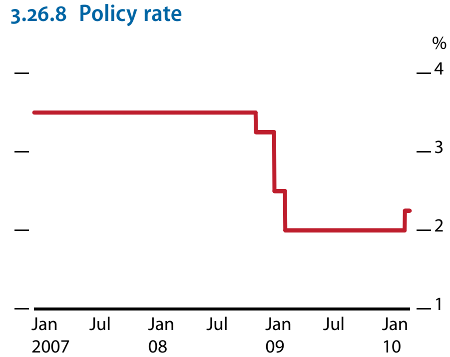
3.26.8 Policy rate



Source: Bloomberg (accessed 25 March 2010).

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3.26.1 Selected economic indicators (%)

	2010	2011
GDP growth	5.3	5.0
Inflation	2.4	3.0
Current account balance (share of GDP)	14.0	13.8

Source: ADB estimates.

On the monetary front, the authorities in March 2010 raised the policy interest rate to 2.25% in light of the improved domestic economic outlook. The increase was aimed at normalizing monetary conditions and preventing risks of financial imbalances from undermining economic recovery. Monetary policy remains accommodative given considerable excess capacity in the economy.

A likely appreciation of the ringgit in the forecast period due to a balance-of-payments surplus should offer the central bank some flexibility to wait until a firmer recovery in credit demand emerges before further raising interest rates. Additionally, the central bank could raise its reserve ratio for banks if it feels a need for policy tightening.

The positive sequential momentum in GDP growth during 2009 sets a solid basis for recovery to continue in 2010 and 2011. GDP growth is forecast to rebound to 5.3% in 2010 before easing to 5.0% in 2011 (Figure 3.26.9). In 2010 the recovery will be underpinned by growth in exports, driven by strong regional demand, particularly from the People's Republic of China, and inventory restocking by industrial countries, as well as the lagged effects of the stimulus packages. Growth will also benefit from the base effect of a sharp contraction in GDP during the first half of 2009. The government's index of leading indicators showed solid gains headed into 2010 (Figure 3.26.10).

The more moderate growth expected in 2011 stems from the factoring out of the base effect of lower growth in the first half of 2009, which will boost growth in 2010, and more moderate growth forecast for next year in some Asian trading partners. The impact of inventory restocking in industrial countries will likely dissipate in 2011, but exports will get support from the forecast stronger global trade recovery.

Higher export growth will, in turn, spur employment and incomes and feed into private consumption. Public consumption and investment are, however, likely to be damped by the reining back of the fiscal deficit, while private investment is expected to rise only gradually due to excess capacity in the economy.

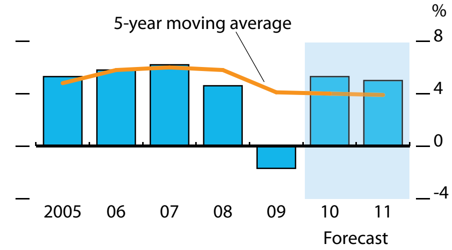
This excess capacity, coupled with the likely appreciation of the ringgit, suggests that inflation pressures will be fairly subdued. Inflation is expected to move up to 2.4% in 2010 and to quicken to 3.0% in 2011 (Figure 3.26.11), on the back of higher domestic demand, a rise in global commodity prices, a rise in some administered prices, and the disappearance from the year-on-year comparison of the high price base in 2008.

The current account surplus is forecast to narrow to about 14% of GDP in 2010 and a touch below that in 2011 (Figure 3.26.12). Exports will benefit from higher global commodity prices—particularly for crude oil, palm oil, and rubber—and a recovering global economy. Imports are likely to outpace exports in the context of Malaysia's dependence on imported inputs for its manufacturing export industries and a pickup in domestic demand.

A lower trade surplus during the forecast period is likely to be reinforced by a further deterioration in the income balance because of increased outflows of profit and dividend payments, while the services account is likely to show a small surplus from a steady increase in tourist arrivals.

Malaysia's reliance on external markets (both exports and imports of goods and services are equivalent to more than 100% of GDP) implies that

3.26.9 Annual GDP growth



Source: Asian Development Outlook database.

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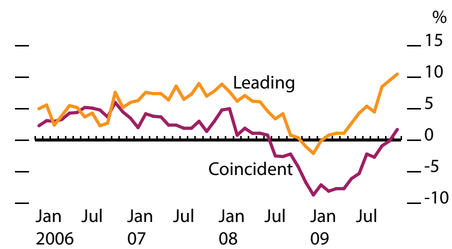
3.26.10 Growth of leading and coincident indexes



Source: CEIC Data Company (accessed 22 February 2010).

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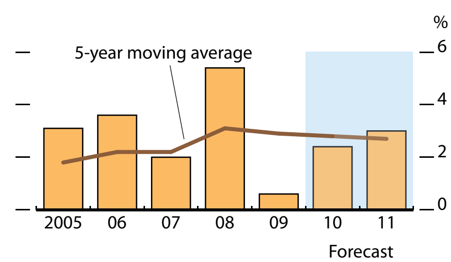
3.26.11 Inflation



Source: Asian Development Outlook database.

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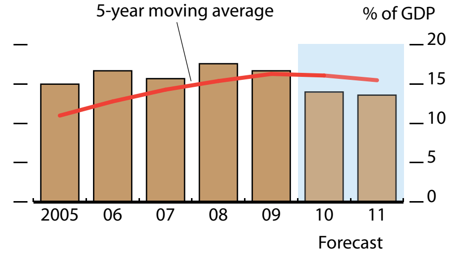
the main downside risk to the forecasts is a slower than expected global recovery. The high level of international reserves and strong banking sector position the economy relatively well to deal with any renewed bout of global instability, provided it is short.

On the domestic front, there is a risk that the planned withdrawal of stimulus measures could prove to be premature if the recovery in either domestic private or external demand is not sustained.

3.26.12 Current account balance



Source: Asian Development Outlook database.

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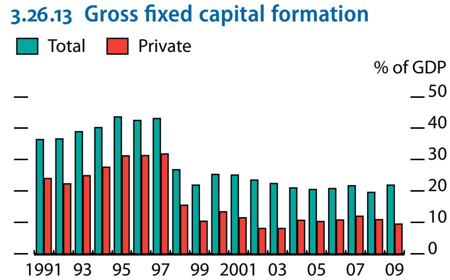
Development challenges

The economic pain caused by the global recession has led to renewed debate on the need to reduce dependence on external markets. However, given the limited size of the domestic market, policy makers seem to accept that Malaysia will need to continue to embrace globalization, alongside perhaps a structural shift in the economy to produce a more diversified range of goods for exports. There is also a growing sense that the economy seems to be caught in a "middle-income trap": unable to remain competitive as a low-cost producer, but also struggling to move up the value chain as a producer of knowledge-intensive products.

Economic growth, while impressive, has slowed and private investment, averaging about 30% of GDP just before the Asian financial crisis, has fallen to around 9.5% of GDP (Figure 3.26.13). These indicators point to the need to address deficiencies in the investment climate and to reappraise the role of public sector companies that compete with the private sector.

3.26.13 Gross fixed capital formation



Sources: Treasury Malaysia. Ministry of Finance. *Economic Report 2009/2010*. http://www.treasury.gov.my; CEIC Data Company (accessed 22 March 2010).

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The government is well aware of the need to modernize the economy. In March this year the Prime Minister announced a New Economic Model, which calls for an overhaul of the country's 4-decades-old affirmative action policies, in order to improve the investment climate and build a more competitive economy. To this end, the Prime Minister outlined plans for privatization of state-owned companies, sales of government land, a reassessment of subsidies, a further review of existing restrictions on foreign investment in services, and education reform. The New Economic Model is to provide the foundation for the formulation of the 10th Malaysia Plan (2011–2015), which is expected to be unveiled in June this year.

In April 2009 the government announced a series of measures that relaxed some rules on foreign investment in Malaysian companies and property, on initial public offerings, and on the financial sector. Most notable among these was the relaxation of a 30% *bumiputra* (ethnic Malay) equity requirement for investment in 27 services subsectors, including health and social services, tourism, transport, and business services.

While these are welcome developments, the unfinished agenda is long. The 27 subsectors are generally the relatively less important ones within the sectors. Liberalization of the entire sector is more likely to bring about a significant increase in private investment. Moreover, the services sector is controlled by a licensing system, and relaxing Foreign Investment Committee requirements do not remove the need for obtaining licenses from the relevant ministries, which may stipulate different *bumiputra* ownership limits to those stipulated by the committee. Investment climate surveys in Malaysia have frequently identified anticompetitive practices and the regulatory burden as major constraints on firms' activities and investments.

Myanmar

Modest rates of economic growth in recent years reflect policy weaknesses, compounded by some fallout from the global recession in 2009, and cyclone damage to agriculture in May 2008. Growth is forecast to edge higher, supported by a modest increase in private consumption, government spending, and investment in natural gas production. Inflation pulled back in 2009, but is expected to accelerate in the forecast period. While the government has taken some initial steps to liberalize the economy, the list of impediments to development remains long.

Economic performance

Growth slowed to an estimated 3.6% in the fiscal year ended 31 March 2009 (FY2008) from 5.5% in FY2007 (official GDP growth estimates, which are considerably higher than these nonofficial ones, are inconsistent with variables closely correlated with economic growth, such as energy use and fertilizer applications).

Myanmar was not directly hit by the global recession, given its absence of financial and trade links with industrial countries. However, exports and private consumption were reduced by the combined effect of economic slowdowns in neighboring economies, a collapse in commodity prices, and the impact of Cyclone Nargis, which inflicted severe human loss and considerable damage to agriculture in parts of the Ayeyarwady and Yangon divisions in May 2008.

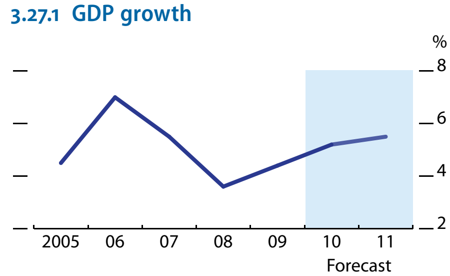
Agriculture (including fisheries, forestry, and livestock) accounted for around two-fifths of GDP, one-fourth of exports, and over one-half of total employment in FY2008. Industry, including export-oriented natural gas production, contributed 23% of GDP, and services the rest. Official data indicate a decline in natural gas production in FY2008, reflecting a slowdown in demand from Thailand.

More recently, economic growth picked up to an estimated 4.4% (Figure 3.27.1) in the fiscal year ended 31 March 2010 (FY2009), in tandem with recovery in demand from neighboring countries and a partial upturn in agricultural production in areas damaged by the cyclone. Gas production probably rose, to meet increased demand from Thailand. Private consumption, however, was subdued because of weakness in remittances from Myanmar workers in recession-hit Malaysia, Singapore, and Thailand, and because of stagnant rural incomes as farmgate prices remained depressed.

Paddy production, the predominant crop, is estimated to have increased by 2.5% in FY2008 and by 2.7% in FY2009. Production in FY2009 was hampered by drought in the central region and by residual soil salinity in cyclone-affected areas.

Inflation pulled back sharply from 29% year on year in March 2008

3.27.1 GDP growth



Source: Asian Development Outlook database.

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This chapter was written by Purnima Rajapakse of the Southeast Asia Department, ADB, Manila.

to 2.5% in September 2009, largely a result of a sharp drop in food and fuel prices, slower domestic economic activity, and reduced monetization of the fiscal deficit. Higher global commodity prices likely propelled inflation to about 6.5% by March 2010, leaving the FY2009 year-average rate at 7.9% (Figure 3.27.2).

The external current account fell into deficit in FY2008 (estimated at 2.5% of GDP) from a surplus of 0.6% of GDP in FY2007, owing to lower export volumes and declines in export prices of agricultural products. This gap narrowed to about 1.0% in FY2009 (Figure 3.27.3), when a contraction in imports more than offset declines in gas exports (due to lower prices) and in remittances. The fall in imports in part stemmed from the winding down of construction at the new capital city, Naypyidaw. Inflows of foreign direct investment into the energy sector helped lift international reserves to about $5 billion at end-FY2009 (Figure 3.27.4), equivalent to 8 months of imports.

The consolidated fiscal deficit in FY2009 (covering the central government and state economic enterprises) widened to an estimated 3.7% of GDP from 3.4% in FY2008. Current expenditure was driven up by higher interest payments on domestic debt, spending to repair cyclone damage, and a 35% public sector wage increase in January 2010. Revenue growth was sluggish. The revenue-to-GDP ratio at about 7% is low by international standards, while social spending at around 1% of GDP is extremely low.

In FY2008, the authorities moved away from routinely monetizing the fiscal deficit and financed about one-third of it through issues of Treasury securities. The government issued a new 2-year Treasury bond in January 2010 with a view to increasing the use of domestic saving for deficit financing. This move is expected to go some way to containing the inflation impact of future fiscal deficits. However, the practice of valuing exports of state enterprises at the official exchange rate of MK6/$1 (as opposed to the market rate of about MK1,000) leads to significant distortions because domestic revenue available for spending is hugely undervalued.

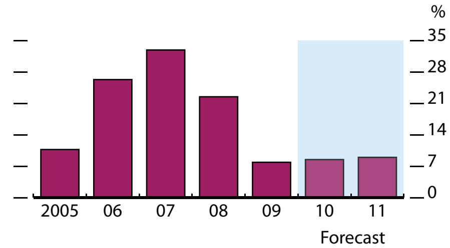
As for monetary policy, administratively determined nominal interest rates remained at their 2006 levels through 2009—17% for lending and 12% for bank deposits—despite the easing of inflation. Consequently, real interest rates in the formal banking sector are among the highest in the world. While this has, to some extent, helped bring back more domestic saving into the formal banking system, it could have significant implications for bank soundness as borrowers' debt-servicing capacity deteriorates.

Economic prospects

Projections for the economy are based on assumptions of normal weather. They also assume that a national election scheduled for 2010 will, at the very least, bring about a more conducive environment for economic reforms, and that there will be no regression of the limited reforms seen so far.

On this basis, GDP growth is expected to edge up to 5.2% and then to 5.5% in the next 2 fiscal years. In FY2010, private consumption will be supported by the public sector wage hike, while public consumption is

3.27.2 Inflation



Source: Asian Development Outlook database.
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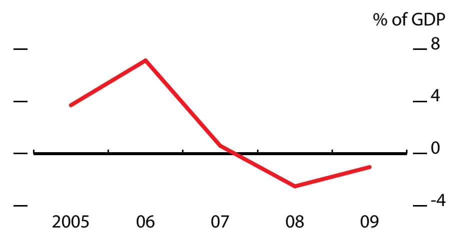
3.27.3 Current account balance



Source: Asian Development Outlook database.
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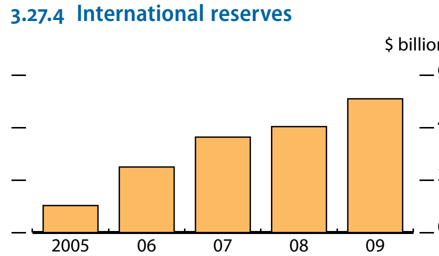
3.27.4 International reserves



Source: Asian Development Outlook database.
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likely to pick up due to expenditure related to the election. In FY2011, a modest increase in rural incomes owing to forecast rises in exports and prices of cash crops will underpin private consumption.

Public investment will rise if the government goes ahead with planned increases in expenditure on infrastructure. The authorities have indicated that they will use part of the SDR202 million ($309 million) allocated in 2009 by the International Monetary Fund for infrastructure. Inflows of foreign private investment are expected for the development of two new gas fields, Shwe and Zawtika, and the construction of an oil and gas pipeline project from Myanmar to the People's Republic of China. Aid disbursements for cyclone victims are scheduled to be stepped up prior to the completion of the humanitarian relief effort in July this year.

From the supply side, agricultural output is expected to gradually pick up. The rebound in neighboring economies is seen increasing demand for gas, which will underpin industrial output.

Inflation is projected to accelerate to 8.5%–9.0% in the forecast period, reflecting somewhat higher domestic demand and increased world prices for oil and foodstuffs. A modest increase in exports of gas and food crops is to be offset by increased imports of capital equipment and construction materials. The current account deficit is projected to widen to about 2%.

3.27.1 Selected economic indicators (%)

	2010	2011
GDP growth	5.2	5.5
Inflation	8.5	9.0
Current account balance (share of GDP)	-1.8	-2.1

Source: ADB estimates.

3.27.1 Development challenges

In the late 1980s, Myanmar began a process of gradually unwinding state ownership and control of the economy. These changes have improved efficiency and growth in some parts of the economy, but reforms have often been piecemeal, without an apparent strategy to overcome the many structural impediments to realizing the economy's potential. The country has lagged behind its neighbors in living standards (Box figure) and poverty reduction, and the agenda of required reforms remains extensive.

A gradual liberalization of agriculture has prompted more farmers to grow cash crops. However, the sector faces acute shortages of credit. Farmers invariably have to turn to informal sources of finance, at interest rates of 5%–12% a month. The shortage of credit, in turn, leads to a glut of paddy for sale at harvest times, resulting in very low farmgate prices. The credit shortage also means that farmers are unable to afford adequate farm inputs and have reduced the intensity of land cultivation, leading to a reduction in farm yields and fewer rural jobs.

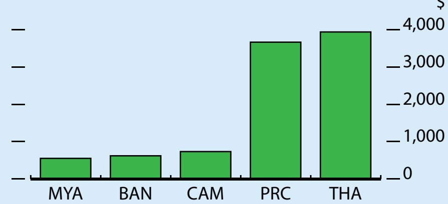
Banking system assets are below levels of a decade ago, and 70% of all private financing requirements are sourced from the informal sector. Broadening access to formal finance requires moving toward market-determined interest rates, relaxing the deposit-to-capital ratio for banks, easing stringent collateral requirements, and lifting administrative controls on the expansion of new bank branches.

Stimulating competition among banks would improve banking services. In this context, the priorities should be to eliminate regulatory forbearance toward state banks, allow state banks to operate on a commercial basis, and move away from a segmented system whereby only certain banks can operate in certain sectors.

The government floated proposals to some business groups in early 2010 to sell various state assets, such as the fuel distribution network, some ports and buildings, and the international airline. This has the potential to facilitate development of the private sector. Enterprises that remain in state ownership need to be modernized and allowed to operate on a commercial basis, which would promote competition and increase their contribution to the budget.

Addressing low levels of government revenue generation requires a broadening of the tax base and fewer tax exemptions. Now that investment spending on the capital city has peaked, there should be room for increased outlays on development and social projects. Unification of the multiple exchange rates would create additional fiscal resources and reduce incentives for informal activity.

Per capita GDP, 2009



BAN = Bangladesh; CAM = Cambodia; PRC = People's Rep. of China; MYA = Myanmar; THA = Thailand.

Note: Fiscal year for Bangladesh and Myanmar. End-year market rate used for Myanmar.

Source: Asian Development Outlook database.

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Philippines

Consumption spending, both private and public, offset weakness in investment and net exports last year, enabling modest economic growth. Remittances from overseas workers and expansionary macroeconomic policies supported consumption. Growth is forecast to quicken this year, based on increases in private consumption and a rebound in both exports and investment. After elections in May 2010, one of the challenges for the new administration will be to strengthen the fiscal position and improve the investment climate.

Economic performance

In the face of the global recession, the economy grew by 0.9% in 2009, compared with average growth of 5.5% over the previous 5 years. (Gross national product, which includes remittances from nearly 9 million Filipinos working abroad, rose by 3.0%.) GDP maintained slight growth throughout 2009 on a year-on-year basis, picking up in the fourth quarter (Figure 3.28.1), as industrial output rebounded from a slump.

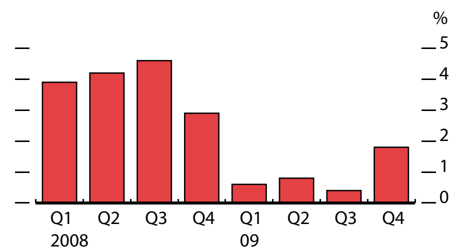
Buoyed by remittances from overseas workers, private consumption grew by 3.8% (compared with 4.7% in 2008) to remain the biggest contributor to GDP growth on the demand side. Remittances rose by 5.6% to $17.3 billion in 2009, with double-digit increases in November and December when workers sent additional amounts to their families who had been devastated by tropical storms.

Significantly higher government consumption spending (up by 8.5%) and a fiscal stimulus package helped support aggregate demand. The government provided cash transfers and emergency employment programs to vulnerable groups as the economy slowed. It also increased spending on infrastructure to compensate for a slump in private construction.

However, the impact of the global financial crisis and recession depressed investment, in fixed capital by 3.5% and in durable equipment by 11.4% (although the pace of contraction slowed in the second half). The ratio of fixed investment to GDP resumed its decline (Figure 3.28.2), after some improvement in 2007 and 2008. Total investment dragged down GDP growth, as did net exports.

On the supply side, services (accounting for 50% of GDP in 2009) expanded by 3.2% and was the only production sector to contribute to GDP growth (Figure 3.28.3). Retail trading, assisted by the growth in remittances, picked up during the year. So did communications, finance, and business process outsourcing. By contrast, industrial production fell by 2.0%, in its first contraction since 2001. Manufacturing, the biggest industry subsector, shrank by 5.1%, with weaker external demand for

3.28.1 Quarterly GDP growth



Sources: Asian Development Outlook database; National Statistical Coordination Board. http://www.nscb.gov.ph (accessed 29 January 2010).

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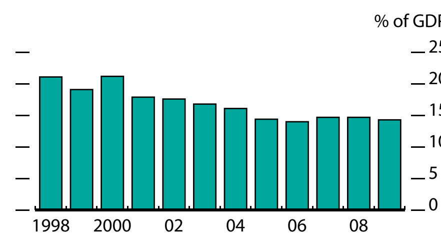
3.28.2 Gross fixed capital formation



Sources: Asian Development Outlook database; National Statistical Coordination Board. http://www.nscb.gov.ph (accessed 29 January 2010).

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This chapter was written by Teresa Mendoza of the Philippines Country Office, ADB, Manila.

electronic products and clothing a major factor. Public construction increased as the fiscal stimulus was launched, though private construction fell. Production from the fairly small mining industry rose by about 20% in 2009.

Agriculture, representing a declining share of GDP but still accounting for one-third of employment, suffered from severe tropical storms, which reduced rice output by nearly 14% in the fourth quarter from the year-earlier period. Overall, agricultural output was flat for the year.

Employment grew, mainly in services, but fell short of the 1.1 million increase in the labor force, so that the unemployment rate rose to 7.5% in 2009 (the rate of underemployment was 19.1%). Pressure on under- and unemployment was mitigated to some extent by the deployment of about 1.3 million workers overseas in the first 11 months of 2009, 12% higher than the prior-year period.

Lower international prices for oil and commodities, coupled with the soft domestic demand, pulled down consumer prices (Figure 3.28.4), so that inflation averaged 3.2% in 2009. It picked up to 4.4% in December, on the back of rising prices for oil and for food (owing to weather damage to agriculture).

The slump in global trade cut merchandise exports by just over 22% to $37.5 billion, the lowest value since 2003. Exports of electronic goods and clothing were particularly affected. Merchandise imports fell by about 24% to $46.4 billion, reflecting the weakness in exports (materials for manufactured exports are imported) and in investment, and lower prices for oil and commodities.

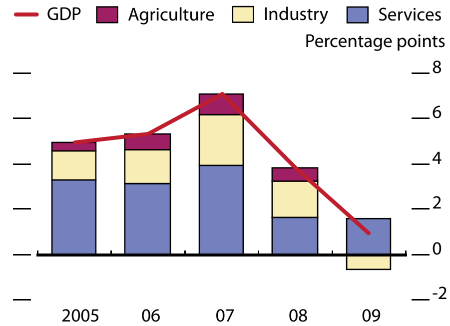
By November, though, trade grew on a year-on-year basis (Figure 3.28.5), from a low base in the prior-year month. In the last 2 months of 2009, the rebound in exports was driven by electronics; that in imports by capital goods, materials for manufactured exports, and higher oil prices. With the fall in the value of merchandise imports outpacing that of exports, the trade deficit shrank.

The current account recorded a large surplus of $8.6 billion (5.3% of GDP), benefiting from the narrower trade gap, growth in remittances, and an expansion of earnings from business process outsourcing. Portfolio investment recorded an inflow of $1.4 billion, a reversal from outflows of $3.8 billion in 2008. Net foreign direct investment remained low by subregional standards. The overall balance of payments recorded a substantial surplus, and the stronger external position contributed to a 2.4% appreciation of the peso against the United States dollar in 2009.

Gross international reserves stood at $45.7 billion as of February 2010 (Figure 3.28.6), representing a high 9.3 months of import cover and 10.2 times short-term external debt (based on original maturity). Reserves were boosted by higher government borrowings on global financial markets to fund the fiscal stimulus.

That stimulus focused on extra spending for infrastructure and for social protection measures. Government expenditure, other than for interest payments on the large public debt, rose to 14.9% of GDP from 13.5% in 2008. Concurrently, tax revenue fell by 6.4%, eroded by weaker economic growth and provision of tax exemptions and reductions in 2009 (forgone revenue was estimated at about 0.6% of GDP). Poor investment sentiment stymied planned sales of government assets. In

3.28.3 Contributions to growth (supply)



Sources: Asian Development Outlook database; National Statistical Coordination Board. http://www.nscb.gov.ph (accessed 29 January 2010).

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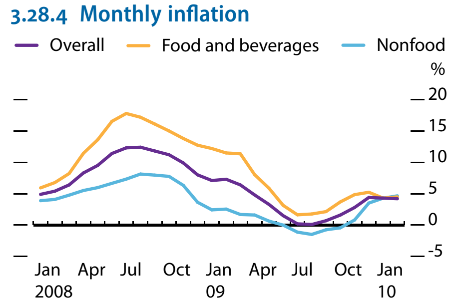
3.28.4 Monthly inflation



Sources: National Statistics Office. http://www.census.gov.ph; CEIC Data Company (both accessed 10 March 2010).

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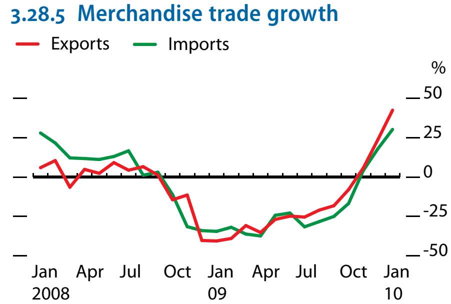
3.28.5 Merchandise trade growth



Note: Based on customs data.

Sources: National Statistics Office. http://www.census.gov.ph; CEIC Data Company (both accessed 11 March 2010).

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these circumstances, the fiscal deficit widened to 3.9% of GDP, from 0.9% of GDP in 2008 (Figure 3.28.7).

As the economy sagged and inflation waned, Bangko Sentral ng Pilipinas lowered its policy interest rates in steps by 200 basis points from December 2008 to July 2009, taking the overnight borrowing rate to 4.0%, the lowest in about two decades (Figure 3.28.8). The central bank also supported banking system liquidity and depositor confidence by, among other changes, reducing commercial bank reserve requirements and increasing the ceiling on deposit insurance.

Growth in bank lending slowed in the early part of the year, then picked up as economic conditions improved. Broad money (M3) growth decelerated to 8.3% year on year in December 2009, from nearly double that rate a year earlier.

Economic prospects

The outlook assumes that there is a smooth political transition in 2010 following presidential and legislative elections scheduled for May, and that the new government pursues credible economic and fiscal programs.

Fiscal policy will likely be less stimulative in 2010, given budget constraints and plans by the current administration to trim the fiscal deficit to 3.5% of GDP. Spending on social services is budgeted to rise (in nominal terms), but the amount set aside for infrastructure is lower than last year. There are risks on the revenue side. More tax exemptions were approved early in 2010, and additional tax breaks are proposed, even though the country's low tax collection is a chronic constraint on the budget.

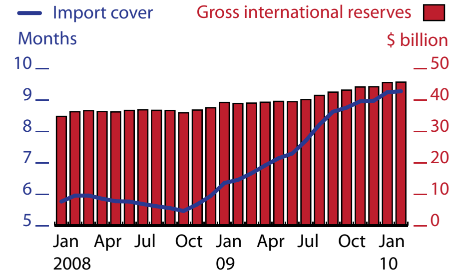
Monetary policy is expected to support the recovery while the authorities gradually unwind the liquidity-boosting measures put in place during the global financial crisis. The central bank increased the lending rate to banks under a rediscounting facility and reduced the size of its peso rediscounting window in the first quarter of 2010.

Private consumption will likely remain the main driver of growth in the next 2 years, underpinned by remittances (expected by the central bank to rise by about 6% in 2010), a firmer labor market, and stronger consumer confidence. Election-related spending will provide a boost through May. Exports will grow in line with the global recovery and, on a net basis, are expected to contribute modestly to GDP growth.

Investment is forecast to rebound from last year's low levels now that the external and domestic outlooks have improved (businesses might be cautious until the May elections, though). Investment pledges reported by government agencies in the fourth quarter of 2009 nearly trebled from the prior-year period, and the index of business confidence rose to a 2-year high in the first quarter of 2010 (Figure 3.28.9). Property companies have laid out aggressive expansion plans to meet anticipated strong demand for office space, mainly from business process outsourcing firms, and for housing (stimulated by remittances and low interest rates).

Services will benefit from stronger growth in private consumption as well as election-related spending. Higher levels of external trade will continue, more specifically, to stimulate wholesale trade, storage, and transport. The association representing business process outsourcing

3.28.6 Import cover and reserves



Source: Bangko Sentral ng Pilipinas. http://www.bsp.gov.ph (accessed 12 March 2010).

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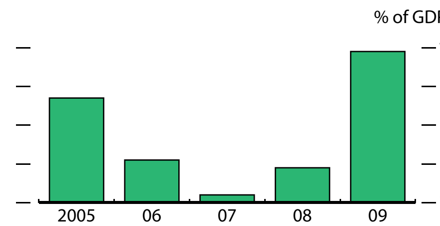
3.28.7 Fiscal deficit



Source: Bureau of the Treasury. http://www.treasury.gov.ph (accessed 12 March 2010).

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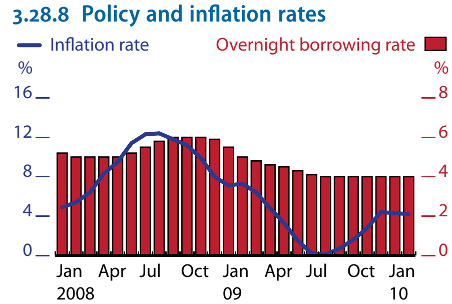
3.28.8 Policy and inflation rates



Sources: Bangko Sentral ng Pilipinas. http://www.bsp.gov.ph; CEIC Data Company (both accessed 12 March 2010).

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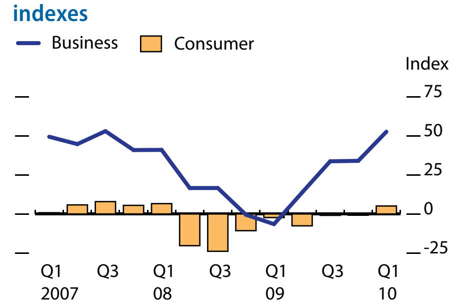
3.28.9 Business and consumer expectations indexes



Note: Composite consumer expectations index for the next 12 months; business expectations index for the next quarter.

Source: CEIC Data Company (accessed 30 March 2010).

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firms expects that growth in the industry's revenue this year will exceed last year's 19% gain. Rapid expansion has raised employment in outsourcing to about 450,000 from about 100,000 over the past 5 years, and some firms are extending into more value-added services fields.

Manufacturing is projected to recover gradually in tandem with the improvement in external demand, particularly for electronic products. Agriculture, still rebuilding after last year's storms, was hit by an El Niño drought in the early months of 2010, which curtailed crop yields in some areas. The government planned rice imports of 2.4 million tons in 2010 (up from 1.8 million tons in 2009), but it might need to raise this target.

The drought has also reduced hydropower output. Electricity supplies for the largest island of Luzon, which accounts for about two-thirds of GDP, were interrupted in the first quarter when a lack of rain for hydropower coincided with maintenance shutdowns and technical problems of other plants. Mindanao, the second-largest island, has been worse hit because hydropower accounts for about 55% of its electricity supplies.

On drawing these strings together, GDP is forecast to increase by 3.8% in 2010 (Figure 3.28.10), still below potential and under the 5.5% recorded in 2004–2008.

Growth is seen accelerating to 4.6% in 2011, when a stronger global recovery is expected to give impetus to exports and remittances. The forecast is subject to more uncertainty than usual, since the new administration's economic and fiscal policies will have an important bearing on the momentum of growth.

Inflation is forecast to rise to 4.7% this year, owing to the impact of the drought, which is putting some upward pressure on food prices, and higher prices for imported oil and commodities. Electricity charges look set to increase as producers seek to cover rising costs, and suppliers turn to more expensive oil-based power generation to compensate for shortfalls in hydropower. Inflation averaged 4.2% in the first 2 months of 2010.

External trade will be considerably stronger this year. Merchandise exports surged by nearly 43% and imports by 30% in January 2010 (both from low bases in the prior-year month). For the full year, growth of imports will likely outpace exports, widening the trade deficit. Taking into account higher remittances and business process outsourcing income, the current account is expected to record a surplus, although it will moderate from 2009 to around 3.3% of GDP in 2010–2011.

In the context of improved global financial market conditions, the government raised $2.6 billion from bond issues overseas in the first 2 months of 2010, securing about half its external borrowing target for 2010. The authorities also plan to issue bonds targeted at overseas Filipino workers. Borrowing costs for external debt have broadly declined to levels of before the financial crisis. Moody's upgraded its sovereign credit rating for the Philippines in July 2009, from B1 to Ba3, citing the resilience of the financial system and of the external payments position during the global recession.

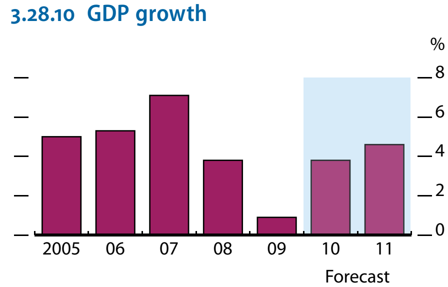
Risks to the forecasts come from the impact on agriculture and food prices of a more severe El Niño, and the impact on trade and growth

3.28.1 Selected economic indicators (%)

	2010	2011
GDP growth	3.8	4.6
Inflation	4.7	4.5
Current account balance (share of GDP)	3.3	3.2

Source: ADB estimates.

3.28.10 GDP growth



Sources: Asian Development Outlook database; National Statistical Coordination Board. http://www.nscb.gov.ph (accessed 29 January 2010).

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from slower than projected recovery in the global economy. Significant fiscal slippage could unsettle financial markets and raise the country's risk premium. It will be important that the new government commit to a medium-term plan to strengthen the fiscal position.

Development challenges

Although the economy maintained some growth during the global recession, the slowdown in 2009, coming just after the surge in food and fuel prices in 2008, has made the attainment of the Millennium Development Goals more challenging. One-third of the population was poor even before the last 2 difficult years.

Over a long period, the Philippines has invested less in social sectors and infrastructure than most of its neighbors, in large part a result of the tight fiscal situation, high levels of public debt, and a business climate that hampers private investment. Gross domestic investment fell to the equivalent of 14.0% of GDP in 2009, the lowest rate on record.

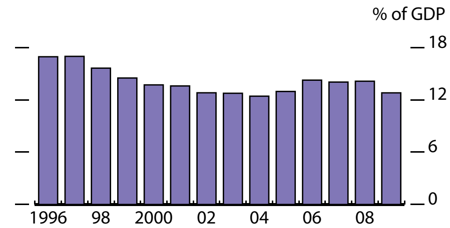
Fiscal resources are severely constrained by weak revenue generation. Tax revenue as a share of GDP, also lower than among most of its neighbors, declined to 12.8% in 2009 (Figure 3.28.11). That decline reflected not only the temporary effect of lower tax collections during the economic slowdown, but also a long-term erosion of the tax base due mainly to tax exemptions. National government debt rose to 57.3% of GDP in 2009 (Figure 3.28.12), and interest payments on the debt absorb about 20% of total budget outlays, crowding out development expenditures.

Reversing the structural erosion of taxes and reducing government debt to release budget funds for development expenditure will require renewed efforts at tax reform by the new administration. That could include rationalization of fiscal and investment incentives (they cause large losses of tax revenue), and indexation of excise taxes to inflation. Enhancing tax administration is equally important, including cracking down on tax evaders and enforcing anticorruption programs in tax and customs agencies.

Higher private investment, too, could play a more significant role in upgrading infrastructure and, more generally, the productive capacity of the economy. Saving is not the main constraint (Figure 3.28.13), since national saving has steadily risen, bolstered by remittances.

Rather, sluggish private investment reflects infrastructure deficiencies, particularly in power and transport, and weaknesses in governance and the policy climate. According to the World Economic Forum, the global competitiveness ranking of the Philippines in 2009/10 fell to 87 (out of 133 countries) from 71 (out of 134) in 2008/09, putting it below India, Indonesia, and Viet Nam, among others. The report cited corruption, inefficient bureaucracy, policy instability, and inadequate infrastructure as the main reasons for the low ranking.

3.28.11 Tax revenue



Sources: CEIC Data Company; Bureau of the Treasury. http://www.treasury.gov.ph (both accessed 12 March 2010).

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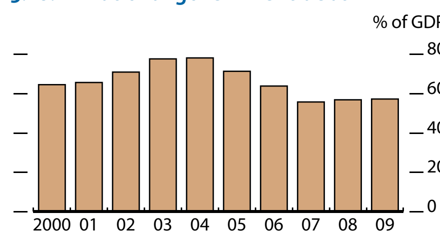
3.28.12 National government debt



Sources: CEIC Data Company; Bureau of the Treasury. http://www.treasury.gov.ph (both accessed 12 March 2010).

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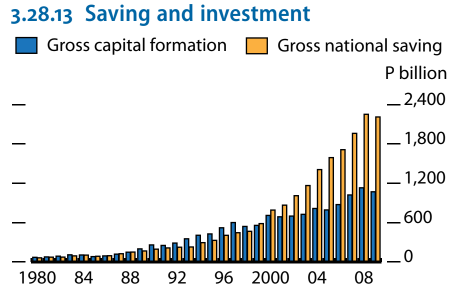
3.28.13 Saving and investment



Source: CEIC Data Company (accessed 30 March 2010).

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Singapore

Global headwinds buffeted this export-oriented economy in 2009. The slump in trade and dwindling capital flows knocked down private consumption and investment. Fiscal and monetary stimulus policies went some way to temper the contraction in GDP. Growth is forecast to rebound strongly this year, as the impact of the pickup in global trade and finance spreads through the economy. Inflation is expected to edge higher. The government, turning its attention to a decline in industrial productivity, will invest in upgrading the economy and its workforce.

Economic performance

The world financial crisis and slump in global trade had a deep impact on this exceptionally open economy (exports of goods and services represent over 200% of GDP). From the first quarter of 2008 to the first quarter of 2009, GDP fell by 9.5%. By the fourth quarter of 2009, though, the economy was growing again on a year-on-year basis (Figure 3.29.1), the recovery fueled by a rebound in exports. That late lift contained the 2009 full-year GDP contraction to 2.0%, not as severe as had been expected earlier in 2009.

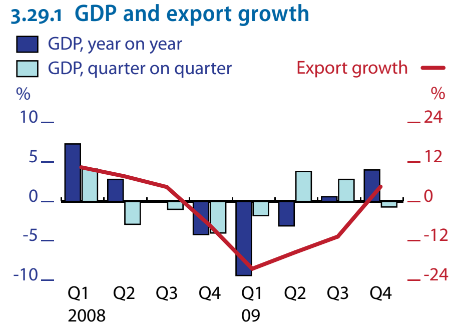
Singapore's total trade in goods and services in volume terms fell by nearly 12% last year, the sharpest fall in at least 3 decades. The slump in trade, which started in 2008, sent shockwaves through the economy, battering most manufacturing and services industries, weakening the labor market, and severely denting consumer and business confidence. Private consumption and investment fell from 2008's levels.

Private consumption declined by 0.5%, undermined by the fall in consumer confidence, job layoffs, and lower incomes. (Per capita gross national income in nominal terms fell by 6.5%.) To counteract the weakness in private consumption, the government ramped up its expenditure, lifting public consumption by 8.3%.

The biggest drag on GDP on the demand side came from investment which, measured as gross fixed capital formation, fell by 3.1% in 2009 (Figure 3.29.2), carried down by a 5.3% drop in private investment. That latter decline more than offset the impact of a 14.4% rise in public sector investment, as the government accelerated infrastructure works, such as mass transit rail lines. While investment in equipment fell by 14.6%, that in construction rose by 13.1%, largely stemming from the public infrastructure spending and the continued building of the large casino-entertainment projects, Resorts World Sentosa and Marina Bay Sands.

The economic rebound in the fourth quarter, when GDP rose by 4.0% year on year, was spurred by a 4.5% rise in real exports (imports fell by 1.8%). Higher exports and a generally better international environment

3.29.1 GDP and export growth



Source: CEIC Data Company (accessed 11 March 2010).

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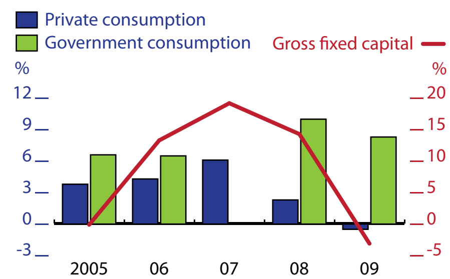
3.29.2 Growth in consumption and investment



Source: CEIC Data Company (accessed 11 March 2010).

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This chapter was written by Arief Ramayandi of the Economics and Research Department, ADB, Manila.

raised consumer and investor sentiment—fixed investment increased by 8.3% and consumption by 6.2% in the October–December period.

On the production side, weakness in domestic demand and a fall in tourist arrivals caused wholesale and retail trading to contract by 9.1%, and transport and storage to fall by 7.0% (Figure 3.29.3). The freezing up of international financial markets and investment flows was reflected in a 1.4% decline in financial services. Manufacturing production, which is heavily export oriented, fell by 4.1%. However, construction expanded by 16.0%, a third consecutive year of double-digit growth. Business services and information and communications grew slightly.

Employment fell by about 14,000 in the first half of 2009, predominantly in manufacturing, raising the seasonally adjusted unemployment rate to 3.3% for the period. When economic activity rebounded in the fourth quarter, employment also started to recover, particularly in services industries such as retailing and hotels. The unemployment rate fell to 2.1% in the fourth quarter.

The weakness in domestic demand, coupled with lower prices for oil and commodities, pulled inflation down to just 0.6% in 2009, from 6.6% in 2008. The consumer price index fell for 7 months, year on year (Figure 3.29.4).

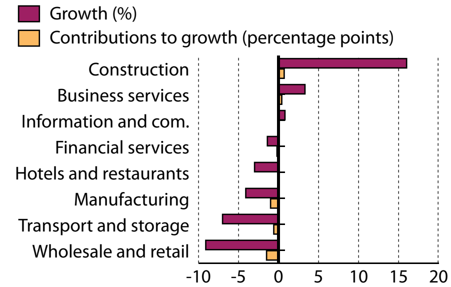
In the context of low inflation and contracting GDP, the Monetary Authority of Singapore maintained the effective loosening of monetary policy that it adopted in October 2008 by allowing a depreciation of the nominal effective exchange rate. The Monetary Authority sets policy by managing the Singapore dollar in a trade-weighted band against a basket of currencies, rather than by setting interest rates. In October 2008 it changed a 3-year-old policy of allowing a "modest and gradual" appreciation of the Singapore dollar against the currency basket to a target of zero appreciation, and in April 2009, lowered the center of the trade-weighted band. Liquidity in the economy remained high and broad money (M2) grew by a relatively strong 11.3% in 2009.

An expansionary budget for FY2009 (ended 31 March 2010) included a S$20.5 billion stimulus package. Notable measures were a Jobs Credit Scheme to curb layoffs by offering employers a temporary wage subsidy, and a Special Risk-Sharing Initiative to assist firms facing a squeeze on credit with access to funds. Other elements of the package were cuts in corporate income taxes and rebates on personal income taxes, and additional assistance for low-income earners. The programs performed fairly well in stimulating the economy.

As it turned out, spending on several stimulus measures fell short of the budgeted amounts, in large part because the economic performance turned up earlier than expected. Similarly, revenue held up better than previously anticipated. The overall fiscal deficit was equivalent to 1.1% of GDP, compared with a small surplus in 2008.

In United States dollar terms, merchandise imports dived by 23.3% last year, outpacing a 20.3% drop in merchandise exports (weak domestic demand cut imports, as did the slump in manufacturing industries, which use mainly imported materials). The decline in trade bottomed in the first quarter of 2009 (Figure 3.29.5). External balances for goods, services, and income remained in surplus, so that the current account surplus was barely changed from 2008, at 19.1% of GDP. International reserves rose by about 8% to US$187.8 billion, or 7 months of import cover.

3.29.3 Contributions to growth (supply), selected sectors, 2009



Source: Singapore Ministry of Trade and Industry. 2009. *Economic Survey of Singapore*. http://www.singstat.gov.sg

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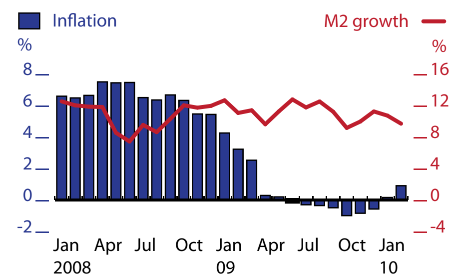
3.29.4 Inflation and money supply (M2)



Source: CEIC Data Company (accessed 24 March 2010).

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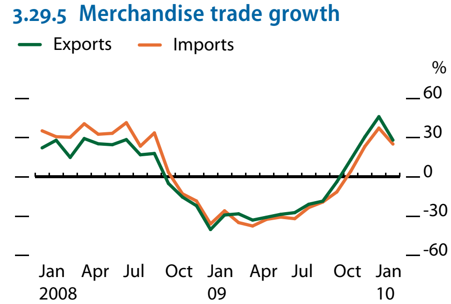
3.29.5 Merchandise trade growth



Source: CEIC Data Company (accessed 30 March 2010).

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Economic prospects

The recovery in world trade projected in ADO 2010 and pickup in financial flows bode well for Singapore's outlook. In particular, the economy will benefit from the V-shaped recovery in Asia, a region that accounted for about 60% of Singapore's total exports in 2008 (Figure 3.29.6). The share of exports shipped to industrial economies, including Japan, was about 30%.

Merchandise exports surged by 35% and imports by 31% on a customs basis in the first 2 months of 2010, from a relatively low base in the prior-year period. Stronger external demand for goods and services will have spillover effects throughout the economy. Indeed, manufacturing production rose by just over 29% in the first 2 months of this year.

Fiscal policy has shifted focus from dealing with the recession and the immediate recovery to the medium- and long-term goals of upgrading the economy and reducing dependence on foreign labor. The fiscal stimulus is being gradually removed. The Jobs Credit Scheme will be phased out by the third quarter of 2010 and the program to help firms obtain credit will finish by year-end. The FY2010 budget allocates more for education and research and development programs aimed at raising productivity. The fiscal deficit is expected to be similar to last year's outcome, at 1.1% of GDP. Monetary policy is expected to remain generally accommodative this year.

Investment is forecast to rebound in 2010, stimulated by the better global trade and financial climate and an accommodative monetary environment. Business confidence already recovered in the second half of 2009 (Figure 3.29.7). In particular, investment is expected to strengthen in financial and business services, tourism, and manufacturing. Construction investment will be supported by strong demand for residential property and the infrastructure projects (the casino-entertainment projects were largely completed in early 2010).

Private consumption will recover from last year's weakness, benefiting from growth in employment and incomes and from the income effect of higher equity and property prices. Net exports are expected to contribute to GDP growth in the forecast period.

Taking these factors into account, GDP is forecast to rebound to 6.3% growth in 2010 (Figure 3.29.8), and to expand by about 5.0% in 2011 (the pace easing because of 2010's higher base). The outcome in both years depends heavily on the global economic recovery.

The expected level of GDP for the next 2 years is below the output trend since 2001 (Figure 3.29.9). Upward pressure on domestic prices from the demand side will therefore remain subdued. Inflation is forecast to speed up a little to 2.3%, on rising international prices for oil and commodities and the low base set in 2009. (In the first 2 months of 2010, the consumer price index rose by an average of 0.6%.) Inflation is forecast to slow to about 2.0% in 2011 as the low-base effect dissipates.

The rebounds in domestic demand and in exports will likely mean slightly stronger growth in merchandise imports (21.0%) than exports (19.5%) this year. This variation will contribute to a narrowing in the current account surplus as a share of GDP, to a still-substantial 18.0%. In 2011, this surplus is likely to rise, to about 21.0% of GDP.

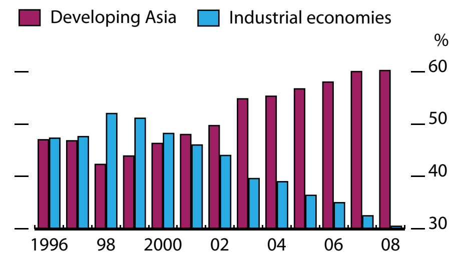
Strong demand for residential property in the second half of 2009,

3.29.1 Selected economic indicators (%)

	2010	2011
GDP growth	6.3	5.0
Inflation	2.3	2.0
Current account balance (share of GDP)	18.0	21.0

Source: ADB estimates.

3.29.6 Share of exports by trading partner



Source: CEIC Data Company (accessed 11 March 2010).
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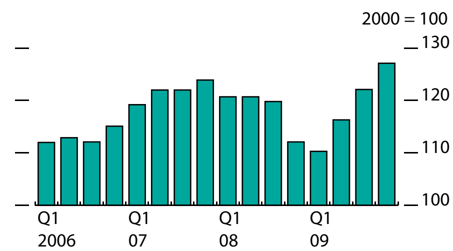
3.29.7 Business confidence index



Source: CEIC Data Company (accessed 11 March 2010).
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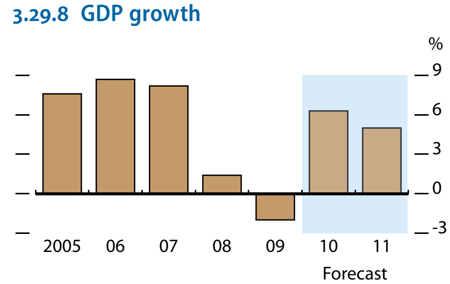
3.29.8 GDP growth



Sources: Singapore Department of Statistics. http://www.singstat.gov.sg (accessed 11 March 2010); ADB estimates.
Click here for figure data

accompanied by rising prices (Figure 3.29.10), was driven both by an upturn in market confidence as the domestic outlook brightened, and by inflows of foreign capital. The government moved to contain speculation in housing by imposing new stamp tax on homes sold within 1 year of purchase and by capping housing loans at 80% of a property's value. A significant number of housing projects are in the construction stage, which indicates that supply will pick up next year. This should ease pressure on prices, provided that speculation is contained.

Development challenges

Labor productivity has declined over recent years in construction, manufacturing, and some services, especially business services, hotels and restaurants, and wholesale and retail trading (Figure 3.29.11).

A government-appointed Economic Strategies Committee noted in a report this year that Singapore's productivity in manufacturing and services, in absolute terms, is 55%–65% that in the United States and Japan. Hong Kong, China's productivity levels rank higher than Singapore's in construction and services.

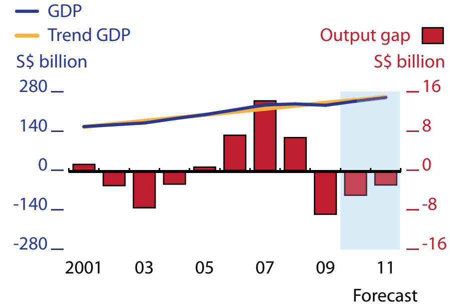
The report observed that a large part of Singapore's average 5% economic growth over the past decade had been achieved through expansion of the labor force, including foreign workers, who now make up almost one-third of the workforce. GDP growth averaged 8% from 2004 to 2007, a period when the increase in foreign workers accelerated. However, average labor productivity tends to decline if industries employ an increasing number of workers, while keeping other factors of production, and levels of innovation, relatively steady. Easy access to low-cost labor from abroad provides little incentive for Singapore's employers to invest in productivity improvements, the report noted. Moreover, there are "physical and social limits" to the number of foreign workers the country can accommodate.

Responding to the report, the government in February this year laid out a strategy to drive growth through a greater focus on productivity, rather than on an increasing labor force. It sets a goal of achieving productivity increases of 2%–3% a year over the next decade, more than double the rate of the past decade. This higher rate, even with slower labor force expansion, would enable the economy to grow by 3%–5% a year and to raise real incomes by one-third in 10 years. The FY2010 budget committed to spend S$5.5 billion over the next 5 years on training, on tax incentives for companies to upgrade and automate operations, on stimulating research and development, and on encouraging mergers and acquisitions.

At the same time, the government will increase levies on companies that employ low-skilled foreign workers, to encourage them to put more emphasis on productivity improvements by making labor more costly. The levies will be increased gradually over several years, starting in July 2010.

Although the higher levies are to be phased in, there is a risk that this more restrictive approach could increase domestic production costs, given that the labor market is tight. That could put a strain on companies still striving to recover from recession.

3.29.9 Actual versus trend GDP



Sources: Singapore Department of Statistics. http://www.singstat.gov.sg (accessed 11 March 2010); ADB estimates.

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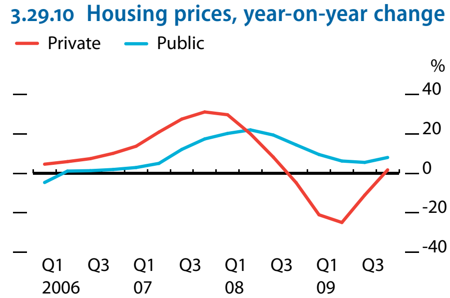
3.29.10 Housing prices, year-on-year change



Note: Public refers to resale price index of housing administered by the Housing Development Board.

Source: CEIC Data Company (accessed 11 March 2010).

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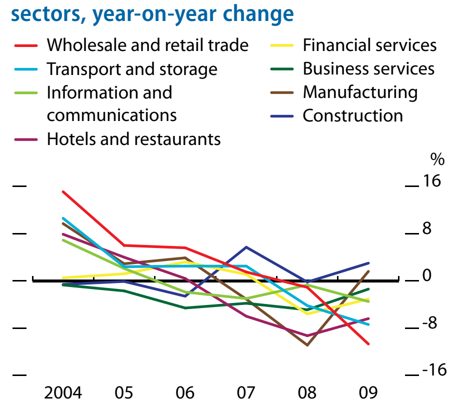
3.29.11 Labor productivity in selected sectors, year-on-year change



Sources: Singapore Department of Statistics. 2009. *Yearbook of Statistics of Singapore*; 2010. *Monthly Digest of Statistics*. February. http://www.singstat.gov.sg

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Thailand

Fractious politics aggravated the impact of the global recession on this economy, which contracted steeply in 2009 despite expansionary fiscal and monetary stances. Consumer prices fell over the year. The pace of recovery is expected to be moderate in 2010, in light of political tensions that will likely cause some delays in a government infrastructure program. Inflation will quicken and the current account is likely to record a surplus. Economic growth is forecast to pick up in 2011, based on stronger exports and investment.

Economic performance

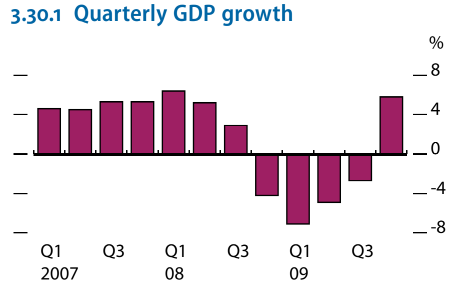
The impact of the global recession, coupled with a fractious domestic political setting, caused this economy to contract by 2.3% in 2009, the deepest decline in Southeast Asia last year. A steep slide in exports led to cutbacks in manufacturing and in investment. Then, antigovernment street protests in April 2009, coming after a long period of rising political tensions, eroded consumer sentiment and aggravated a decline in tourism prompted by recession in industrial countries. GDP contracted for 4 consecutive quarters year on year, then sprang back in the fourth quarter of 2009 (Figure 3.30.1).

Manufacturing production fell by 5.1% in 2009, a result of the slide in export demand. Worst-hit industries were those making capital goods and higher-technology products such as automobiles and electrical appliances. These industries led the recovery in the fourth quarter, when export demand rebounded. Construction activity started to pick up in the second quarter as the government accelerated public works under two fiscal stimulus packages aimed at cushioning the impact of the global forces on the economy. For the full year, though, construction output was flat. Total industrial output fell by 4.3% (Figure 3.30.2).

Weak consumer confidence and declining tourist arrivals contributed to a 0.4% fall in services output last year. Tourist arrivals fell for most of the year, then rebounded in the fourth quarter, but still showed a full-year decline of about 3%. The services subsectors of hotels and restaurants and transport and communications fell particularly sharply from the fourth quarter of 2008 through the third quarter of 2009. Even agriculture had a bad year in 2009, with production down by 0.6% owing, on the one hand, to price declines, notably for paddy, cassava, maize, and natural rubber, and, on the other, to pest infestations.

Private consumption contracted by 1.1% in 2009, crimped, particularly in the first half, by the weaker labor market, declines in farm incomes, and the political strife. Consumer sentiment improved in the second half, when the government rolled out fiscal stimulus measures, employment started to pick up, and prices for farm products bottomed. In contrast

3.30.1 Quarterly GDP growth



Source: CEIC Data Company (accessed 23 February 2010).
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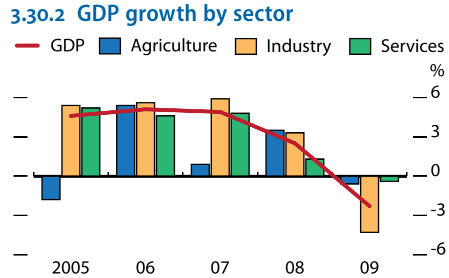
3.30.2 GDP growth by sector



Source: CEIC Data Company (accessed 23 February 2010).
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This chapter was written by Luxmon Attapich of the Thailand Resident Mission, ADB, Bangkok.

to private consumption, public consumption spending rose by 5.8% in 2009, as the government ratcheted up its outlays, including the stimulus measures.

Investment was a major drag on GDP in 2009. Fixed capital investment fell by 9.0%, and the private sector segment dropped even more sharply, by nearly 13% (government fixed investment rose by about 3%). Fixed investment in construction was virtually flat, but that in equipment fell by 13.4% as companies cut back on expansion and reequipment plans. The contraction in private fixed investment slowed in the fourth quarter (Figure 3.30.3).

Net exports were positive in 2009 because real imports fell much more sharply than exports.

An expansionary fiscal policy played an important role in moderating the recession. The first stimulus package of B116 billion ($3.4 billion) was implemented from March 2009. It included monthly cash payments of B2,000 a person for about 9 million low-income earners, assistance for the aged, and extra spending on skills training and public health programs. Businesses received tax breaks for small and medium-sized firms and the property and tourism industries, and certain businesses were given access to concessional loans. Altogether, this package was valued at the equivalent of 1.3% of GDP.

A second stimulus package that could cost as much as B1.43 trillion ($42 billion) is being implemented over 3 fiscal years starting from October 2009. This program, named Thai Khem Kaeng, or Strong Thailand, covers public investment mainly in infrastructure such as transportation, water, and energy, as well as extra funding for health, education, and tourism. The planned outlays represent about 5% of GDP for each of the 3 years.

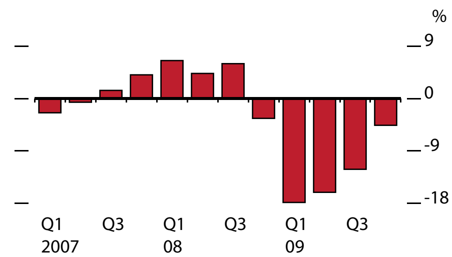
State enterprises are responsible for driving around one-third of the infrastructure program over the 3 years. Most of the funding for the infrastructure will be off budget, sought from domestic debt markets and public–private partnerships, supplemented by budget funds. However, disbursement of the Thai Khem Kaeng program got off to a slow start in the fourth quarter of 2009.

Additional government spending in FY2009 (ended 30 September 2009), at a time of subdued growth in revenue, widened the budget deficit to the equivalent of 4.3% of GDP, from just 0.4% in FY2008.

Lower prices for imported oil and commodities, and weak domestic demand, brought down inflation in 2009 from high levels in the prior year. Government concessions introduced in 2008 to help those on low incomes (such as free electricity, water supply, and public transportation) contributed to downward pressure on prices. The consumer price index fell for much of the year, then turned up late in the year (Figure 3.30.4) when oil prices rose.

Fading inflation and the weak economy prompted the Bank of Thailand to cut its policy interest rate by 250 basis points, to 1.25%, between early December 2008 and April 2009. Credit growth was sluggish, though—private credit rose by only 3% in 2009, and most of that was for households. The government directed state-owned financial institutions to step up their lending, particularly to small businesses facing a credit squeeze.

3.30.3 Private fixed investment growth



Source: CEIC Data Company (accessed 23 February 2010).

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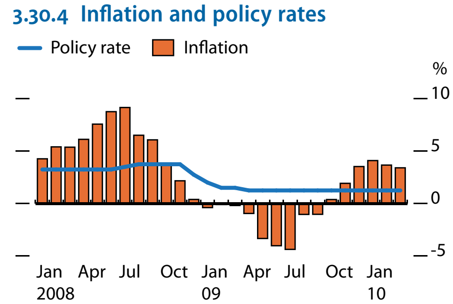
3.30.4 Inflation and policy rates



Source: CEIC Data Company (accessed 8 April 2010).

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Merchandise exports fell by 13.9% in US dollar terms last year, reflecting the slump in external demand (Figure 3.30.5), especially in industrial countries (exports to the People's Republic of China and India were little changed from 2008). Sharp falls were recorded in both manufactured and agricultural exports. The slide hit bottom in the first half, and by November exports had rebounded on a year-on-year basis. Imports tumbled by nearly 25% in 2009, a result of the slump in manufactured exports (which require imported raw materials), weak domestic demand, and lower prices for oil and commodities.

Partly as a consequence of the steep drop in imports, the trade balance showed a record surplus of $19.4 billion. With balances in services, income, and transfers close to 2008 levels, the trade surplus pushed up the current account surplus to the equivalent of 7.7% of GDP. Net outflows in the capital account slowed last year from 2008 to $1.3 billion. By year-end, foreign reserves were up by nearly 25% to $138.4 billion, or 10.6 months of import cover (Figure 3.30.6).

Large current account surpluses during the year contributed to a 4.1% appreciation of the baht against the US dollar in 2009 (Figure 3.30.7), and a rise of about 0.4% in its nominal effective exchange rate. The Bank of Thailand in August eased regulations on Thai investment in foreign securities to facilitate capital outflows and ease upward pressure on the baht. The Thai stock market hit its nadir in March 2009 and rallied strongly (up by 63% over the year), in line with other Asian markets.

Nevertheless, Standard & Poor's lowered Thailand's local currency debt rating from A to A- in April 2009, while Fitch downgraded the long-term foreign currency rating to BBB that month, on the ground that political uncertainty undermined the ability of the government to implement policies.

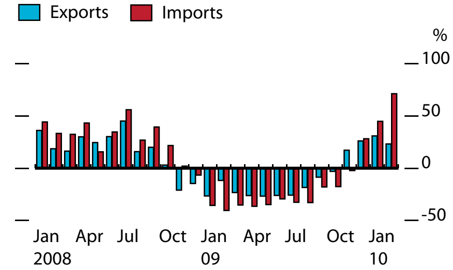
Economic prospects

The forecasts assume that there will be no severe political disruptions in the next 2 years, and that national elections to be held later in 2010 will go smoothly.

It is also assumed that a serious legal wrangle, which led to the suspension of $12 billion of projects at the Map Ta Phut industrial estate on Thailand's eastern seaboard, and has created uncertainty about environmental regulations, will be resolved soon. The new Thai constitution that came into effect in 2007 requires that certain industries conduct health impact assessments on new projects. But laws to implement this provision were not put in place and the assessments not done. In a case backed by residents and environmental activists, a Thai court ruling in September 2009 suspended the projects, which are mainly in petrochemicals, steel, and power plants. Some were later allowed to proceed, but most remained suspended in March 2010. The government is working to resolve the problem so the projects can proceed this year, and so new investors face a more certain regulatory environment.

On this basis, the economy is expected to recover this year, but probably at the mild pace of about 4.0% (Figure 3.30.8), even though it comes off a low base (GDP in 2009 was barely above that of 2007). Growth is forecast to pick up to 4.5% in 2011 as exports and investment strengthens.

3.30.5 Merchandise trade growth



Note: Based on customs data.
Source: CEIC Data Company (accessed 31 March 2010).
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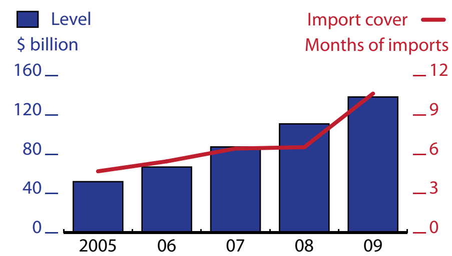
3.30.6 Gross international reserves



Sources: Bank of Thailand. http://www.bot.or.th (accessed 8 March 2010); *Asian Development Outlook* database.
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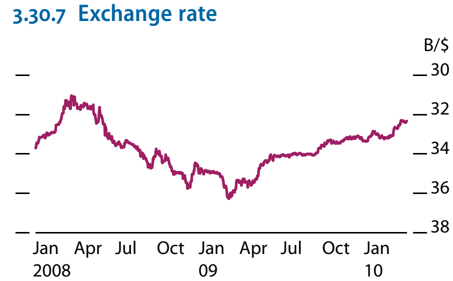
3.30.7 Exchange rate



Source: Bloomberg (accessed 31 March 2010).
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3.30.1 Selected economic indicators (%)

	2010	2011
GDP growth	4.0	4.5
Inflation	3.5	3.0
Current account balance (share of GDP)	4.0	2.0

Source: ADB estimates.

The rebound in exports that started late last year will accelerate in 2010, boosting manufacturing production, employment, and investment. Industries like electronic products, household appliances, and motor vehicles are benefiting from inventory restocking in industrial economies and strong growth in many Asian countries.

Private consumption is forecast to rise by about 3% this year. It is getting support from growth in employment and wages (minimum wages were raised in January 2010), increases in rural incomes based on higher prices for agricultural products, and rising consumer confidence (Figure 3.30.9). Sales of automobiles soared by just over 60% in January, and motor cycle sales jumped by 24% (from a low base in the prior-year period).

Investment will recover from last year's low levels, and is expected to move up by about 6% in 2010, quickening in 2011. Stronger export demand has led to a rise in industrial capacity utilization (Figure 3.30.10), which, if continued, will pave the way for an expansion of capacity in industries such as food processing, petroleum products, and construction materials.

Interest rates are expected to stay relatively low, and growth in credit is edging up this year. The infrastructure program should stimulate private investment, particularly in construction and buildings materials. The Board of Investment reported a surge in applications for investment incentives late last year, and the index of business confidence has turned up. Nevertheless, the recovery in investment will be constrained for at least part of 2010 by uncertainties over the election and the Map Ta Phut issue.

Political protests in the streets of Bangkok during March and April 2010 set back the recovery in tourism, but arrivals for 2010 are still expected to rise from last year's levels.

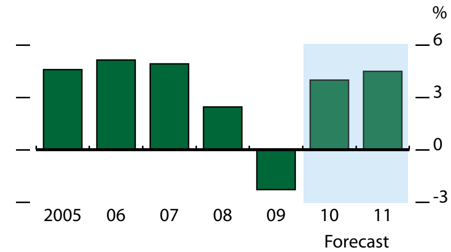
Fiscal policy will be expansionary this year, with the extent of the stimulation depending in large part on the ability to disburse budget and infrastructure funds. The government has budgeted for a reduction in spending in FY2010 and an increase in revenue, with a deficit target of 2.7% of GDP. The budget will be supplemented by the off-budget spending on the Thai Khem Kaeng program. Furthermore, the budget proposed for FY2011 (starting in October 2010) includes a significant increase in spending over the FY2010 level.

However, disbursement of the Thai Khem Kaeng program has sputtered. Of B486 billion ($14.5 billion) allocated for FY2010, only about 22% was disbursed in the October 2009–March 2010 fiscal half-year. The government will need to accelerate disbursement of the infrastructure program if it is to meet its target spending for FY2010.

Political tensions have caused delays as meetings on investment projects were postponed. The government is likely to be cautious in approving projects and disbursing funds during periods of disruption. Moreover, cases of alleged corruption have delayed disbursement in health and education projects.

Merchandise exports are forecast to increase by 16.0% in 2010 and merchandise imports by 26.0% from last year's low base. (Customs based exports rose by 27% and imports by 58% in the first 2 months of 2010.) The trade surplus is projected to decline and the current account surplus will fall to a still sizable 4.0% of GDP this year.

3.30.8 GDP growth



Source: Asian Development Outlook database.

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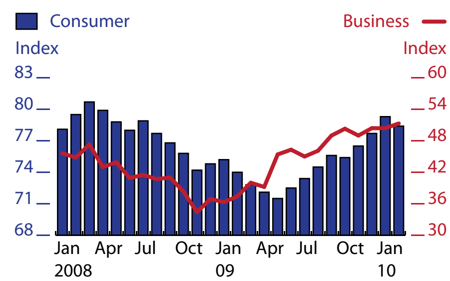
3.30.9 Consumer and business attitudes



Note: A reading of less than 100 for consumer confidence and less than 50 for business sentiment denotes a deterioration.

Source: CEIC Data Company (accessed 31 March 2010).

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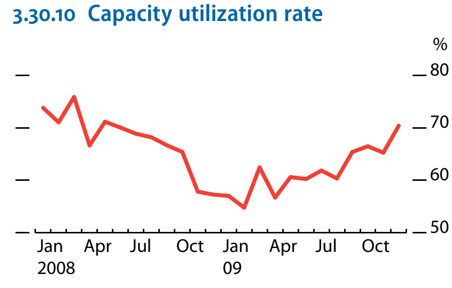
3.30.10 Capacity utilization rate



Source: Bank of Thailand. http://www.bot.or.th (accessed 5 March 2010).

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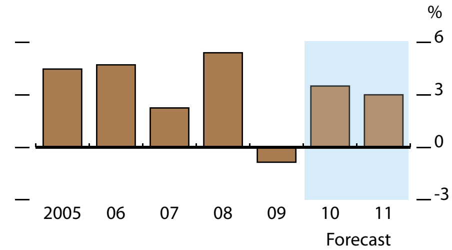
Inflation is forecast to rise to 3.5% in 2010 (Figure 3.30.11), due mainly to higher food and fuel prices. The rate for the first quarter was 3.7%, but core inflation, excluding food and energy prices, remained within the central bank's target range. The government again extended the fee-free electricity, water, and public transportation for low income earners, this time through to June 2010.

The Bank of Thailand is expected to gradually move its policy interest rate up to more normal levels, from the exceptionally low level set in 2009. It also appears likely to favor a moderate appreciation of the baht against the US dollar, in line with other Asian currencies, as a means of keeping inflation in check. In February 2010 the central bank eased foreign-exchange rules on overseas investment and hedging transactions in a further move that is expected to facilitate capital outflows.

Downside risks to the forecasts from domestic factors are headed by the political tensions and uncertainty, which if prolonged, could further delay fiscal implementation and hamper policy making in general. More significant disruptions would hurt consumer and investor sentiment, and fiscal revenue. On the other hand, a more settled political situation and resolution of the Map Ta Phut issues would likely spur stronger growth.

3.30.11 Inflation



Source: Asian Development Outlook database.
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Development challenges

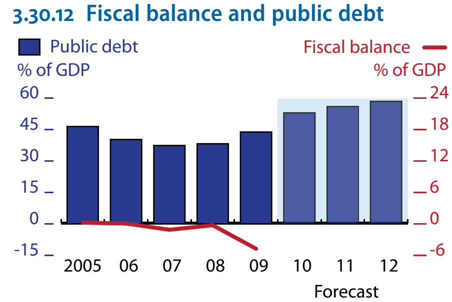
Investment in infrastructure has lagged during the past 4 years, in large part a result of the political turbulence. Thailand's rank in terms of infrastructure in the 2009 IMD World Competitive Yearbook fell to 42 of 55 countries, from 39 in the previous year. A $40 billion "megaprojects" infrastructure plan prepared in 2005 was only partly implemented. The challenge is to do better with the Thai Khem Kaeng program, which also involves about $40 billion in projects, although they are mostly smaller and more manageable than the previous plan.

Reforms in the regulatory environment to encourage public–private partnerships would increase the private sector's contribution to infrastructure. The establishment of a high-level committee on public-private partnership issues chaired by the deputy prime minister has been an important step in this direction. What is needed now are clear policy framework guidelines for assessing bankable projects, and transparent regulations and procedure for private sector participation.

The government has the scope to borrow to fund much of its contribution to infrastructure. Public debt is at manageable levels—it rose last year to the equivalent of 43.9% of GDP (90% domestic) and is projected to peak at 58.5% in 2012 (Figure 3.30.12), then decline as economic growth accelerates. Total external debt has declined to about 27% of GDP, from over 70% a decade ago, and foreign reserves have increased by $100 billion in this period.

Still, the fiscal deficit and public debt need to be reined in when economic growth is stronger and sustained. (At this stage, the government aims to run budget deficits through 2014.) Broadening the tax base would be helpful in this regard.

3.30.12 Fiscal balance and public debt



Sources: Bank of Thailand. http://www.bot.or.th (accessed 8 March 2010); *Asian Development Outlook* database.
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Viet Nam

Substantial and timely policy responses helped the economy weather the global recession, allowing for reasonably high economic growth in 2009. GDP growth is projected to accelerate in 2010 and 2011, although not to the rapid rates seen in 2001–2007. Devaluation and inflation pressures built up in late 2009, in part a result of economic stimulus policies. Inflation is forecast to accelerate in 2010. The authorities face a challenge to ratchet up economic growth while safeguarding macroeconomic stability.

Economic performance

Growth slowed sharply in the first quarter of 2009 as the impact of the global recession intensified. Spurred by a strong fiscal and monetary stimulus, the economy picked up over the rest of the year (Figure 3.31.1), putting full-year growth at 5.3%, the slowest since 1999.

On the demand side, the expansionary fiscal and monetary policies supported both consumption and domestically financed investment. Net exports improved because imports fell more steeply than exports (though the country is still a net importer in real terms). But foreign-financed investment declined owing to a downturn in foreign direct investment (FDI) inflows.

As for the sectors of production, agriculture (including forestry and fisheries) expanded by 1.8%, weaker than its average growth of about 4% in 2004–2008. The main cause was a poor summer–autumn rice harvest, which largely offset an abundant winter–spring harvest.

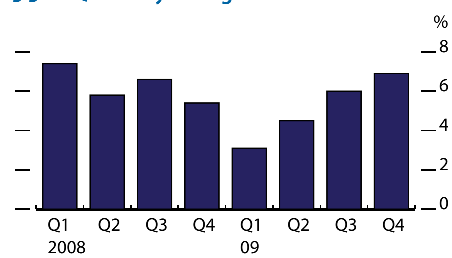
Industry grew by 5.5%, slowing from rates of about 10% in most recent years. Declining demand for exports as a result of the global recession weighed on manufacturing production. However, construction got a boost from the government's policy stimulus, and output of crude oil rose by 9.8% to 16.4 million metric tons, as new fields came on stream.

Services expanded by 6.6%, the pace easing a little from recent years. The expansionary policies and generally buoyant consumption bolstered financial services and domestic trade. At the same time, declines in foreign trade and tourist arrivals hurt the transport industry, and tourism-linked services such as hotels.

Businesses shed labor early in 2009 as the economy sagged, then, when many reversed course, employment picked up in the second half. The proportion of people living below the official poverty line declined to an estimated 12.3% in 2009 (from 13.4% in 2008), despite the global recession, suggesting the positive impact of government support programs.

Inflation pulled back abruptly last year, suppressed by the domestic economic slowdown and lower world commodity prices. Year-average

3.31.1 Quarterly GDP growth



Source: General Statistics Office of Viet Nam. http://www.gso.gov.vn (accessed 15 March 2010).
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This chapter was written by Dao Viet Dung, Yumiko Tamura, Chu Hong Minh, and Nguyen Luu Thuc Phuong of the Viet Nam Resident Mission, ADB, Ha Noi.

inflation slowed to 6.9% from 23.0% in 2008 (Figure 3.31.2). Toward the end of 2009, though, rapid growth of money supply and a depreciation of the exchange rate stoked inflation again, and by March 2010 the consumer price index was rising at a year-on-year rate of 9.5%.

When the global recession hit the economy in late 2008, the State Bank of Viet Nam (SBV), the central bank, loosened monetary policy significantly. It slashed the base rate from 14.0% in October 2008 to 7.0% in February 2009 and sharply reduced the reserve-requirement ratio for banks' domestic currency deposits. Late in 2009, however, the SBV raised the base rate to 8.0% (Figure 3.31.3) in an effort to reduce devaluation pressure on the dong.

Lending interest rates fell to single digits in early 2009. The lower rates, coupled with interest-rate subsidies launched in February 2009 as part of the stimulus package, prompted rapid growth of credit and money supply. Bank credit to the economy expanded by 39.6% and M2 money supply by 29.0% in 2009 (Figure 3.31.4). Many banks started experiencing a shortage of liquidity in late 2009, partly a result of a slowdown in growth of deposits due to expectations of rising inflation. A subsequent tightening of bank credit continued into 2010.

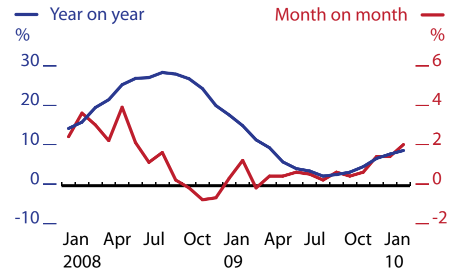
Expansionary fiscal measures adopted in the first half of 2009 included tax reductions and deferrals, additional financial assistance to poor households, a 4 percentage point interest-rate subsidy on short- and medium-term bank loans for certain sectors, and a hike in capital expenditure. The measures, as approved, totaled the equivalent of $8.5 billion, or 8.8% of GDP. About 70% of these measures were actually implemented, given financing and other constraints. Still, the overall fiscal deficit jumped to an estimated 11.8% of GDP, from 4.1% in 2008 (Figure 3.31.5).

Viet Nam's foreign exchange market remained turbulent in 2009. Declines in exports, tourist arrivals, remittances, and capital inflows reduced the supply of foreign exchange, while rapid growth of credit increased demand for it. The shortage of foreign currency in the formal market that had emerged in late 2008 persisted, despite extensive interventions by the central bank. The SBV widened the dong's trading band against the United States (US) dollar to 5% around its reference rate in March 2009, but kept the rate itself roughly unchanged until November 2009 (Figure 3.31.6).

Sales of foreign exchange by the central bank, as well as a deterioration in the balance of payments, cut into official foreign reserves, raising expectations of a devaluation. Exporters began hoarding foreign currency, and capital flight (mostly in the form of speculative imports and residents shifting their portfolio toward gold and US dollar-denominated assets) intensified. The spread between the black market rate and the SBV's reference rate increased to more than 15% in November 2009.

In response, the SBV devalued its reference rate by 5.4% and narrowed the trading band to ±3.0% in November 2009. In February 2010, it devalued the reference rate by another 3.4%, lowered the reserve-requirement ratio for foreign exchange deposits, and introduced a 1% cap on dollar deposit rates for non-individuals. The SBV also ordered that gold-trading floors in Viet Nam and residents' gold trading accounts abroad be closed by 30 March 2010. The government instructed several

3.31.2 Monthly inflation



Source: General Statistics Office of Viet Nam. http://www.gso.gov.vn (accessed 15 March 2010).

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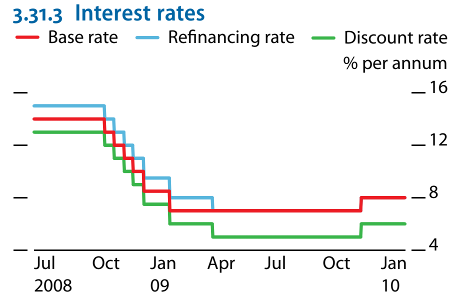
3.31.3 Interest rates



Source: State Bank of Viet Nam.

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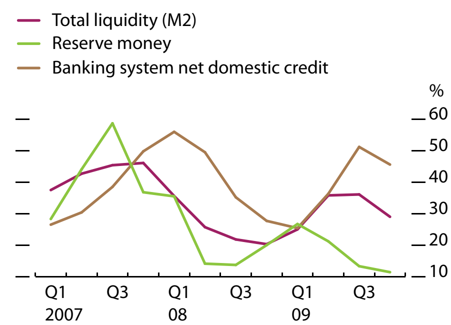
3.31.4 Growth of money and banking indicators



Source: State Bank of Viet Nam.

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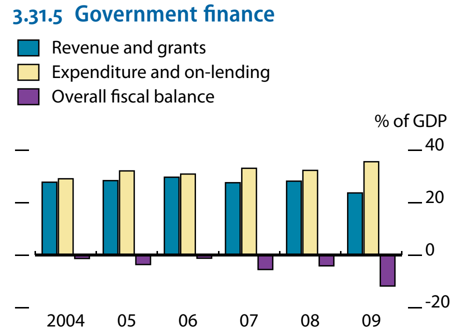
3.31.5 Government finance



Note: Data include expenditure financed by official development assistance and by issuance of sovereign debt but exclude amortization of debt and lending through the Viet Nam Development Bank and Bank for Social Policies.

Source: Ministry of Finance of Viet Nam.

Click here for figure data

large state-owned enterprises to sell their foreign exchange (to the government). These measures reduced capital flight and improved the availability of foreign exchange. Consequently, the spread between the black market rate and the SBV's reference rate decreased to 3.5% in February 2010.

Weaker external demand reduced exports in 2009, particularly for rice, coffee, rubber, and shoes. Total exports fell by 8.9% in US dollar terms, and imports by 13.3%, the latter brought down by weaker economic activity and lower global commodity prices. (The start of domestic oil refining contributed to declines in exports of crude and imports of refined products.)

A sharply narrower trade deficit reined in the current account deficit to 7.4% of GDP in 2009 from 11.8% in 2008 (Figure 3.31.7). The overall balance of payments recorded a deficit, and gross official reserves dropped to an estimated $15 billion (equivalent to 2.8 months of imports, the lowest since 2004 on this basis) (Figure 3.31.8), from $23.0 billion a year earlier.

In the business environment, Viet Nam's ranking in the World Bank's *Doing Business 2010* report declined to 93 of 183 countries listed, from 87 in 2008. Aware of shortcomings, the government took steps to improve governance and the business environment in 2009. On the former, it adopted a national anticorruption strategy and consolidated most public debt management in one department within the Ministry of Finance.

On the latter, it strengthened the regulatory framework for small and medium-sized enterprises, simplified procedures for business registration, and eased some restrictions on foreign investment.

Equitization (partial privatization) of VietinBank was completed in 2009 and equitization plans for Vietnam National Petroleum Company and Vietnam Steel Corporation were approved in early 2010. Government efforts to reduce administrative procedures by about a third should benefit the business climate.

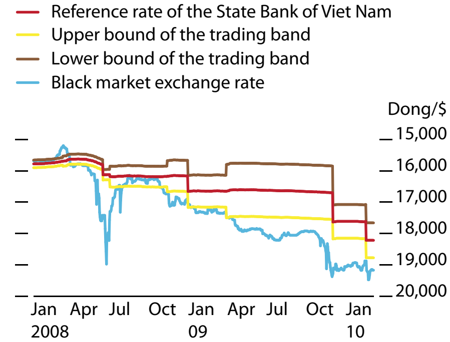
Economic prospects

As Viet Nam completes the Socio-Economic Development Plan 2006–2010, aimed at raising the economy to middle-income status (Box 3.15.1), the challenge is to ratchet up economic growth while safeguarding macroeconomic stability.

Fiscal policy has been tightened somewhat: the 2010 budget targets a narrower overall fiscal deficit of 8.3% of GDP. On the monetary side, interest rate subsidies on short-terms loans have been ended, but subsidies are maintained for medium-term loans to selected sectors at a reduced level of 2 percentage points. The central bank also removed interest rate caps on medium- and long-term loans in February 2010, enabling banks to raise lending rates. In addition to the increase in the central bank's base interest rate in late 2009, the authorities set a target for credit growth in 2010 at 25%, below the actual growth rate of 39.6% last year.

Forecasts are based on the assumption that the government will do the following: tighten monetary and fiscal policies further during 2010 to limit inflation and devaluation pressures, and keep the policies

3.31.6 Exchange rates



Sources: State Bank of Viet Nam; ADB observations.

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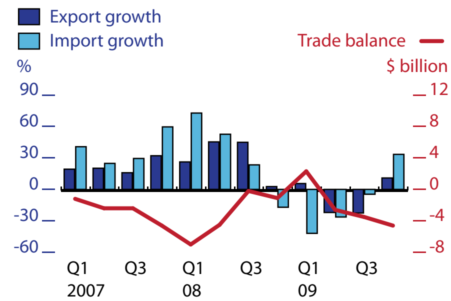
3.31.7 Trade indicators



Sources: State Bank of Viet Nam; ADB estimates.

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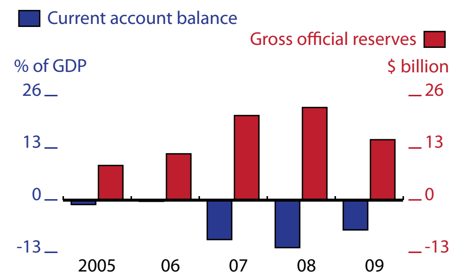
3.31.8 Current account and reserves



Sources: State Bank of Viet Nam; ADB estimates.

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3.31.1 Achieving middle-income status

Under the World Bank's classification, developing countries graduate from "low income" to "lower middle income" when per capita gross national income reaches $976. In Viet Nam it stood at $890 in 2008, according to the World Bank.

moderately tight in 2011; not resort to administrative measures to control inflation; and maintain stability of the banking system.

On these assumptions, GDP growth is projected to accelerate to 6.5% in 2010 and to 6.8% in 2011 (Figure 3.31.9). Expected increases in remittance inflows and incomes will speed up growth of private consumption. Improvement and consolidation of global financial conditions will bring about an upturn in FDI inflows and foreign-financed investment. At the same time, growth of public consumption and domestically financed investment will moderate due to the decline in budget spending and tighter bank credit.

The strengthening of external demand is set to spur growth of agriculture and manufacturing in both 2010 and 2011. Oil output will likely stay at about 16.5 million metric tons in 2010 but slip in 2011 as output at old fields declines. Construction will be damped by the weakening of domestically financed investment. The services sector will benefit from the projected expansion of foreign trade and increase in tourist arrivals.

Inflation in 2010 is forecast to accelerate to average about 10.0%, on account of the rapid growth of money supply in 2009, the dong devaluations, and projected pickup in economic activity and world commodity prices in 2010. Inflation rose to 8.5% year on year in the first quarter of 2010. Assuming monetary and fiscal policies are tightened this year, inflation could ease to about 8.0% in 2011 (Figure 3.31.10).

Exports will pick up in 2010 as external demand strengthens. Tourism and remittance flows are projected to rise in line with improvements in the performance of industrial economies. However, imports will rise more than exports because of the projected acceleration of domestic growth and higher import prices.

Trade with the People's Republic of China is expected to expand rapidly now that a free trade agreement between the PRC and the Association of Southeast Asian Nations has come into force from 1 January this year.

On these factors, the current account deficit is forecast to widen slightly to 7.6% of GDP in 2010.

FDI inflows will rebound, as global financial conditions improve. Inflows of portfolio investment will likely remain small and outflows of short-term capital will probably moderate. The capital account is expected to be in surplus and the overall external position to be close to balance—provided that confidence about medium-term macroeconomic stability is restored—leaving official reserves little changed.

In 2011, an expected quickening of growth in exports, tourism, and remittances will pull the current account deficit back to about 5.5% of GDP (Figure 3.31.11). Capital inflows should also pick up as the global recovery gathers momentum. The overall balance of payments is expected to be in surplus in 2011, lifting official reserves.

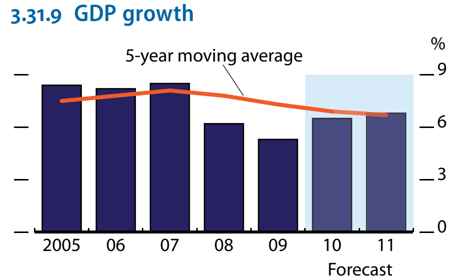
Domestic risks to the outlook are mostly on the downside. If monetary and fiscal policies are not tightened adequately, inflation could spurt above the forecast rate and the current account deficit would deteriorate (GDP growth in 2010 would likely exceed the forecast). Such circumstances might well require an abrupt tightening of policies in 2011, pulling GDP growth below the forecast. Two episodes of high inflation

3.31.1 Selected economic indicators (%)

	2010	2011
GDP growth	6.5	6.8
Inflation	10.0	8.0
Current account balance (share of GDP)	-7.6	-5.5

Source: ADB estimates.

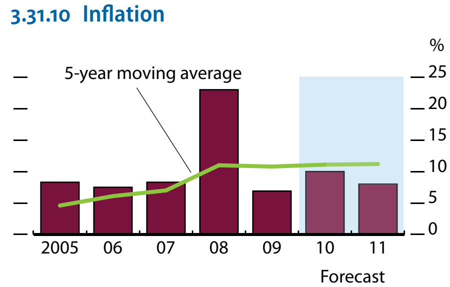
3.31.9 GDP growth



Source: Asian Development Outlook database.

Click here for figure data

3.31.10 Inflation



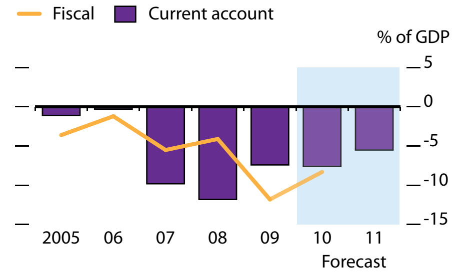
Source: Asian Development Outlook database.

Click here for figure data

within 3 years (it averaged 23% in 2008) would also erode business and consumer confidence, and hinder poverty reduction.

There have been some official proposals to use administrative measures such as price controls and import restrictions to curb inflation and devaluation pressures. Controls might limit price rises and imports, although they, too, might damage foreign investor confidence (and would likely lead to shortages).

3.31.11 Fiscal and current account deficits



Source: Asian Development Outlook database.

Click here for figure data

Development challenges

The end of subsidies on short-term loans and expected tightening of monetary policy will squeeze some borrowers and could lead to a rise in nonperforming loans, adding to stresses in the banking system. It will be necessary, therefore, to manage the slowdown in growth of credit and money supply through an orderly rise in interest rates, rather than a shortage of liquidity in the banking system. In this context, the elimination of caps on interest rates on medium- and long-term loans was a step in the right direction.

Shortages of foreign exchange in the formal market, which undermine confidence in the currency, fuel inflation, and hurt investment, should be addressed through a combination of tighter monetary policy and increased exchange-rate flexibility.

Over the medium term, it will be important to improve the legal and institutional framework for monetary policy. Maintaining price stability should be the primary goal of monetary policy, and the SBV should be given enough operational autonomy to pursue this goal effectively.

Large strides have been taken to raise the efficiency of the economy and ease supply-side constraints to growth, but more needs to be done on this front. Infrastructure bottlenecks, deficiencies in the legal and regulatory framework for the private sector, and shortages of labor skills remain.

It is estimated that investment in infrastructure over the next 10 years will cost the equivalent of 11% of GDP each year. Only about half could be met from the budget. Clearly it would be helpful to create policy and legal frameworks that encourage private sector participation in infrastructure through public–private partnerships.

Improvements in economywide efficiency also require greater efforts to restructure state-owned enterprises, which employ a substantial proportion of available resources in this economy but do not always use them efficiently.