East Asia Update

March 2006

Solid Growth, New Challenges

Special Focus:

Climate Change and East Asia - Challenges and Opportunities

East Asia and Pacific Region

The World Bank

CONTENTS

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EAST ASIA AND PACIFIC REGIONAL UPDATE

Summary

Growth in Emerging East Asia eased modestly from 7.5 percent in 2004 to 6.8 percent in 2005.[1] The slower pace of activity was most clear in the Newly Industrialized Economies and in some of the middle income economies of South East Asia. But it was not universal. Growth accelerated in Indonesia and Vietnam, and continued at very high rates in China. In addition, while the moderation in activity in the NIEs and South East Asia occurred in the first part of 2005, activity was generally rebounding in the latter part of the year. Indeed growth for 2005 as a whole generally turned out higher than we had expected six months ago. The prospects for 2006 also look reasonably firm, with aggregate regional growth expected to exceed 6.5 percent for a third year in a row. (Table 1).

While it is true that most of the risks to the outlook discussed in previous reports remain, recent evidence suggests that some have at least moderated over the last six months. In other words, the outlook is a bit brighter, at least in the near term. Large and rising global macroeconomic imbalances continue to loom as a potential source of instability and a risk to future growth. But, in the near term at least, growth in the US remains robust, while it is picking up in Europe and has rebounded quite strongly in Japan - this last of particular relevance for the rest of East Asia. Similarly, while authorities in China continue to watch for signs of economic overheating and over-capacity, the threat of a sharp cyclical downturn in China has receded, at least in the near term. Growth in China continues at high rates, and has even accelerated in recent months, while inflation remains subdued. Global high tech demand slowed in late 2004 and early 2005, causing a downturn in tech-reliant East Asian export growth, but then rebounded strongly in the second half of the year.

High oil prices clearly played a large role in moderating growth in 2005. While the report assumes that oil prices have now peaked, they are still expected to average 10 percent higher in 2006 than in 2005, so that some of the adverse impact is still likely to be playing out in 2006. Nevertheless, the real surprise has been that the highest real oil prices in more than 25 years did not inflict more serious economic damage, with growth not falling below 4 percent in any of the main economies of the region. At the same time, several economies in the region have taken action to reduce costly and regressive subsidies on fuel, which will strengthen government fiscal positions, while also encouraging consumers and firms to adapt to a world of more costly oil prices, both of which should be good for macroeconomic stability and growth in the medium term.

Many East Asian economies began tightening monetary policy last year, which should help forestall the danger of rising oil prices becoming embedded in a sustained rise in core inflation. That too should help underpin the conditions for growth in the medium-longer term. Lastly, 2005 also saw a sharp downturn in some types of capital inflows to East Asia, in particular in loans and short term capital inflows, which had risen dramatically in 2004. This seems to have occurred as the spread between East Asian and US interest rates narrowed, and as a move towards modestly greater exchange rate flexibility in China and Malaysia discouraged short term speculative capital inflows that had been banking on large capital gains from revaluation of these currencies. Perhaps a little counter-intuitively, the downturn in these kinds of short term flows is also a likely net positive, as it may help avert the emergence of euphoria, excessive risk taking and speculative 'bubbles' in domestic financial markets, of the sort that accompanied sustained and large capital inflows in the run-up to the 1997-98 financial crises.

Table 1. East Asia Economic Growth

	2004	2005	2006	2007
Emerging East Asia	7.5	6.8	6.6	6.3
Develop. E. Asia	8.5	8.2	7.8	7.5
S.E. Asia	5.9	5.1	5.3	5.7
Indonesia	4.9	5.6	5.5	6.2
Malaysia	7.1	5.3	5.5	5.7
Philippines	6.0	5.1	5.3	5.6
Thailand	6.2	4.5	5.0	5.2
Transition Econ.				
China	10.1	9.9	9.2	8.5
Vietnam	7.7	8.4	8.0	7.5
Small Economies	5.7	5.2	5.1	4.9
Newly Ind. Econ.	6.1	4.8	4.9	4.6
Korea	4.6	4.0	5.0	4.8
3 other NIEs	7.3	5.4	4.8	4.4
Japan	2.3	2.8	2.8	2.1

World Bank East Asia Region; March 2006. Consensus Forecasts for NIEs other than Korea.

The improvement in near term trends described in preceding paragraphs should not be taken as a reason to underplay the challenges and risks that persist. The World Bank's November 2004 *East Asia Update* noted the large number of successful political elections in the region that year, and the spread of representative government they evidenced. Recent sharp political

[1] Emerging East Asia comprises Developing East Asia (China, Indonesia, Malaysia, Philippines, Thailand, Vietnam and some smaller economies) and four Newly Industrialized Economies or NIEs (Hong Kong, Korea, Singapore and Taiwan, China).

tensions in Philippines and Thailand remind us that the consolidation of representative institutions in a climate of political stability is a task that will take persistent efforts over a long period to accomplish.

Emerging East Asia's exceptional economic openness has been one of the conditions for its great economic success. The region's exports exceed $2 trillion and the share of its trade to GDP is now the highest in the world, exceeding even that of the European Union. But openness also makes the region ever more sensitive to broad global or cross-border trends, be these economic, political, environmental, health related or of some other type, requiring countries to confront many of these complex challenges simultaneously, fashioning responses in collaboration with many partners. This report touches on three of these challenges.

The first is successful multilateral trade liberalization under the Doha Round. East Asia is now a major constituent of the world trading system and is also the region that stands to gain the most from a successful round. Greater openness in services, could, in particular, provide a new engine for income and productivity gains in East Asia.

The second is the risk of avian influenza and a potential human influenza pandemic, which in a bad or worst case scenario could impose an enormous cost in human suffering and economic losses. Strong actions to delay or avert this threat are needed at national, regional and global levels.

The third is the problem of greenhouse gas emissions and the danger of global climate change. East Asia is an important emitter of greenhouse gases, and likely to become more of one over time, while at the same time one of the regions likely to be more affected by the potential ill effects that could flow from climate change. The Special Focus in this report on *"Climate Change and East Asia"* looks at possible implications of climate change for East Asia and at some national and international measures to adapt to and mitigate climate change in cost effective ways that governments in the region can pursue.

Finally, the report also touches on two areas of economic performance and social policy that are of growing importance in competitive open economies: technological innovation and social protection. The absorption, generation and application of knowledge is a crucial driver of productivity and development. The report looks at some empirical measures of knowledge creation in East Asia, emphasizing both its fast growth but also the diversity of experiences around the region. The discussion prefaces more detailed work on knowledge creation in East Asia that we plan to undertake in coming months.

Governments in East Asia are looking at ways to improve social protection, that is, at improving the methods available to people to better manage various kinds of risks. Better social protection can help households address new vulnerabilities in fast changing open economies, it can enhance productivity growth by facilitating more flexibility in labor markets, and it is central to strengthening old age security over coming decades, a time when most populations in the region will be aging quite quickly.

The rest of this summary provides some more information on the main cross-country trends and policy issues discussed in this report. Developments at the country level are discussed in the "Country Sections" at the back of the report, while fuller Country Briefs are available at the website associated with this report.[2]

East Asia Regional Outlook

- ***Growth***. After slowing in the first half of the year, growth rebounded in the second half of 2005 in much of East Asia. As so often in this region, recovery in the second half was mostly led by exports, supported by renewed strength in the high tech sector and also, to some extent, an upturn in the growth of China's imports from the region. Private consumption growth also gained momentum. A more worrying outcome, though, was a weakening in 2005 fixed investment growth in the economies outside China, dipping to only (a simple average) 3.4 percent from 8.5 percent in 2004. Fixed investment spending in the region outside China has been erratic and generally weak ever since the financial crises of 1997-98 and the dotcom crash of 2001, averaging zero growth in 2001-03, for example. The rebound in 2004 was thus encouraging as the first widespread, significant growth in investment in many years. In 2005, though, investment is likely to have been dampened by the impact of rising oil prices, heightened uncertainty about economic prospects and the start of monetary tightening. Several of these factors such as high oil prices and higher interest rates are likely to persist for a while. Carefully designed and sustained policy and institutional reforms to improve the investment climate are thus more important than ever.

- ***Poverty***. Our most recent estimates suggest a stronger outcome for poverty reduction in East Asia in 2005 than had been expected six months ago. For the region as a whole, poverty at the $1 a day level fell to 8 percent of the population in 2005, down from 9.1 percent in 2004. At the $2 a day level, poverty is estimated to have fallen to a little over 31 percent in 2005, down from just over 34 percent in 2004. The number of poor at the $2 level

[2] http://www.worldbank.org/eapupdate/ .

is estimated at some 585 million in 2005, down by 51 million from the previous year. Clearly, sustained strong economic growth has provided an indispensable foundation for the broad declines in poverty seen in most East Asian economies in recent years. But progress in poverty reduction at the broad national level sometimes occurs unevenly, with particular social groups or geographical regions doing less well than overall trends. Governments in the region are therefore pondering policies that can foster poverty reduction in more targeted and potentially cost effective ways. In China, for example, the new Five Year Plan reflects a significant shift in development priorities towards agriculture and the rural areas, where the vast majority of the poor live. In Vietnam, the five year planning process is accompanied by efforts to make resource allocation more pro-poor. In Indonesia the government has moved decisively towards abolishing fuel subsidies, a traditional but very costly and regressive approach to providing a measure of social protection for the poor, moving instead towards an approach of targeted cash transfers to help shield the poor from the impact of higher fuel prices. A later section of this report provides a more detailed look at social protection issues in East Asia.

- ***The avian and human influenza threat.*** Since our last November 2005 Update there have been outbreaks of the highly pathogenic avian influenza H5N1 virus ("bird flu") in poultry and wild birds in another 31 countries. In East Asia there was a poultry outbreak in previously unaffected Myanmar, as well as further outbreaks in China and Indonesia. In Thailand and Vietnam, however, no new outbreaks have been reported since October-November 2005, a success attributed to aggressive action taken by these countries to stamp out the disease through culling and vaccination. There were also 42 confirmed new human cases of avian influenza reported to WHO worldwide so far in 2006, of which half were in East Asia, nearly all in China and Indonesia. The economic impact of bird flu in the affected East Asian economies has been fairly limited at the overall macroeconomic level, though of course more severe in agriculture, in rural communities and in the upstream and downstream industries to the poultry sector. However there remains great concern that genetic changes will allow the virus to achieve the capacity for sustained and efficient transmission from human to human, leading to a human influenza pandemic with much higher levels of illness, death and economic and social costs. A November 2005 global partners conference in Geneva identified key components of a global action plan to control avian influenza in animals and simultaneously limit the threat of a human influenza pandemic. These included a stress on country leadership based on integrated prevention and control plans, control of the epidemic at source among birds, strengthening of surveillance, containment and preparedness and a transparent communications policy. A subsequent International Ministerial Pledging Conference in Beijing in January secured pledges of some $1.9 billion in grants and credits to provide resources for technical agencies and developing countries in meeting the threat of avian and human pandemic influenza. With some progress having been made on mobilizing financial resources, a key focus is now on preparation, appraisal and implementation of integrated programs at the country level.

The international and regional environment

- ***Developed economies***. While the doubling of oil prices between 2003 and 2005 has undoubtedly slowed world growth, the extent of that impact has been surprisingly limited. Growth among the developed OECD countries eased from 3.1 percent in 2004 to a still healthy 2.7 percent in 2005, and is even expected to strengthen mildly to 2.9 percent in 2006, the result of a mild slowing in the U.S. being offset by recovery in Japan and Europe. In the United States fourth quarter growth was unusually low in the wake of Hurricanes Katrina and Rita, but monthly indicators in early 2006 for unemployment claims, new job creation, manufacturing orders and production were all strong. Corporate survey data suggest that business investment spending in particular should be a prominent driver for US growth in 2006, supported by high corporate profits, still relatively low longer-term borrowing costs and rising capacity utilization. GDP growth is expected to run at a robust 3.4 percent in 2006. In *Japan* growth picked up from 2.3 percent in 2004 to 2.8 percent in 2005, well above earlier consensus forecasts for the year, confirming assessments that the economy has finally emerged from its more than decade-long stagnation. Growth in Japan is also expected to run at close to 3 percent in 2006 with broad based support from consumers, business investment and exports.

- ***China***. China's economy grew 9.9 percent in 2005, down slightly from 10.1 percent in 2004, although growth was accelerating in the latter part of the year.[3] The composition of growth also changed over the course of the year, shifting from net exports to strengthening domestic demand. Net exports made a strong contribution to growth in the first half, reflected in the country's trade surplus surging to over $100 billion for the year as a whole. In the second half the contribution

[3] These growth rates use a new revised dataset for China's national income accounts in recent years. The new data is discussed further in Box 2 below. On the old data GDP growth was an estimated 9.4 percent in 2005, and 9.5 percent in 2004.

of net exports shrank, however, as export growth slowed and imports revived, fueled in part by stronger domestic investment and consumption. Merchandise import growth rose from 12 percent in the first quarter to 22 percent in the fourth. Importantly for regional growth, China's imports from other East Asian economies also gathered momentum in the second half of 2005 after having dipped sharply in the first.

- ***Trade Policy Developments.*** The Sixth WTO Ministerial meeting in Hong Kong last December achieved only modest results, although it did set out a road map for the conclusion of the Doha round of global trade talks. Despite slow progress so far, WTO Director General Pascal Lamy is confident that a substantial agreement can indeed be reached in the limited time remaining. The key steps required are movement by the European Union on agricultural market access, by the United States on agricultural domestic support and by emerging market economies on industrial tariffs and services. Recent World Bank studies suggest that East Asian economies stand to secure substantial economic gains from services liberalization in particular. Liberalization of sectors such as retail and wholesale trade, logistics, the professions (a part of business services), air transport and electricity generation is expected to yield the largest gains, in particular because these services provide important inputs for production in the rest of the economy. Finally, recent news suggests that Vietnam's negotiations for accession to the WTO are progressing well, raising prospects for completion of the process this year.

- ***Oil.*** After climbing steadily for almost two years, world oil prices fluctuated in a range in the last quarter of 2005 and the first quarter of 2006. Oil prices are expected to gradually decline from current levels, averaging $59 per barrel in 2006 and $54 in 2007. (It is worth noting, though, that the forecast average price in 2006 would still be 10 percent higher than in 2005). While demand-supply factors are fairly evenly balanced at present, over time it is expected that growing supply capacity will gain the upper hand over demand. Nevertheless, given the unusually narrow margin of effective spare production capacity in OPEC at present, the market remains vulnerable to concerns about politically driven supply disruptions. World oil demand growth slowed sharply in 2005, falling to a little over 1 million barrels per day from a record 3 mb/d in 2004. Oil demand growth fell in China, where electricity generators were shifting to coal and hydro power capacity, and in South East Asia, where retail product prices have risen sharply in economies like Indonesia and Thailand which eliminated or reduced fuel subsidies during 2005. Higher oil prices are estimated to have generated an average income loss due to worse terms of trade of about around 0.5 percent a year in 2004-06. Significant net oil importers like Cambodia, Korea, Lao PDR, Philippines and Thailand are estimated to have experienced even higher losses of 1-1.5 percent of GDP on average in this period. The ultimate impact on growth, while significant, is likely more muted than suggested by these first order terms of trade effects, since most economies are also able to support expenditures through some reductions in national savings rates, running down of current account surpluses, drawing on foreign reserves or access to foreign financing.

- ***Balance of payments.*** Foreign exchange reserves in emerging East Asia increased by $241 billion, rather lower than the $336 billion rise in 2004. Most of the accumulation occurred in China, where reserves increased by a little over $200 billion, about the same as in 2004. In most of the other main economies of the region reserve accumulation fell sharply compared to 2004. The slowdown in reserve accumulation could not be attributed to changes in the region's current account surplus, which in fact increased substantially to an estimated $235 billion in 2005 from $183 billion in 2004, a change mainly due to a near doubling in China's current surplus. The main factor behind the slowdown in reserve accumulation was instead a sharp fall in net capital inflows to the region. Since net foreign direct investment (FDI) inflows to East Asia rose, while net portfolio capital flows were reasonably stable, the major swing occurred in the "other" category of the capital account, comprising instruments such as loans, short term deposits, trade credits and financial derivatives, among others. These other flows (together with errors and omissions) are estimated to have swung from net inflows of around $118 billion in 2004 to a net outflow of perhaps $60 billion in 2005. The outflow on the capital account appears to be related, first, to the narrowing or reversal of the spreads between East Asian and US interest rates, as a result of monetary tightening in the US. Second, the change in China and Malaysia from a pegged exchange rate regime to a 'crawling' appreciation against the dollar seems to have dissipated expectations of large capital gains to be made from a revaluation of those currencies, leading to a reversal of large earlier inflows of speculative short term capital.

- ***Inflation and Interest Rates.*** Short term interest rates in much of emerging East Asia have been rising over the course of the past one and a half years as central banks in the region have tightened monetary policy to avert both potential increases in core inflation and excessive exchange rate volatility. Headline consumer price inflation rates trended higher in several economies, fueled principally by higher oil prices and policy decisions to allow more pass through of fuel costs to consumers. Headline CPI inflation in Indonesia picked up to 17-18 percent at the end of 2005 and in early 2006, while in Thailand it rose to 5-6 percent during this period. Year-on-year rates of core price inflation also picked up in these two economies. Monetary policy tightening is however expected to prevent a persistent or longer term increase in core inflation. By early 2006 the three month on three month rates of core inflation had eased in both economies.

Domestic trends and policy issues

- ***Financial sector trends and issues***. Most indicators of financial sector performance in East Asia also continued to improve over the course of 2005, including measures of asset quality, capital adequacy and bank profitability. Non-performing loans (NPLs) continued to move lower in most economies, supported by gradual improvements in corporate profitability in the region, as well as remaining financial and corporate restructuring activities. Bank interest margins, a key determinant of profitability, generally edged upwards in 2005, though less quickly than in 2004. The similar pattern held for capital adequacy.

- ***Corporate sector trends and issues***. The financial health of East Asian corporations has continued to improve on several dimensions in recent years. Median debt-equity ratios and interest coverage ratios for listed companies have generally fallen significantly in the post crisis period (2001-04) compared to the period of the crisis and its immediate aftermath (1997-00), as a result of corporate debt restructuring, a significant paying down of debt by firms and strengthening exchange rates. Korea and Thailand have seen some the largest declines in corporate indebtedness. Corporate profitability as measured by median Return on Assets (ROA) has also been recovering from the sharp declines suffered in the crisis, but the pace of recovery has often been slow, with ROAs remaining below pre-crisis levels in the majority of cases. Overall, while corporate finances are moving in the right direction, there remain areas of vulnerability, for example still low interest coverage in economies like Indonesia and the Philippines, a still gradual pace in the improvement of corporate profitability and, linked to the latter, a continued hesitation in undertaking new business investment on a substantial and sustained scale. A focus on policy and institutional reforms to strengthen the investment climate clearly remains a priority for policy makers in the region. Governments are also increasingly interested in ways of efficiently fostering greater innovation, technological upgrading and absorption of knowledge from abroad.

- ***Innovation in East Asia.*** The generation and application of new technology is widely acknowledged to be a crucial driver of economic growth and development. By various measures the level of technological development in East Asia now exceeds that in other developing regions by a wide margin, even though 15-20 years ago it was very similar. Patents provide one measure of the results or output of innovation. The number of patents registered at the US Patent Office by emerging East Asian economies increased from 197 per year in 1981-84 to 12135 in 2001-04, while those registered by selected Latin American countries increased from 101 to 228. At the same time there are also wide differences in technological development between East Asian economies. At the head of the league, Taiwan, China now produces some 30 patents per 100,000 people, about as many as Japan and the United States. Another group including Korea, Hong Kong and Singapore generates around 8-10 patents per capita per year, similar to the performance of the developed OECD countries in the mid 1980s, although only about half the average OECD level today. Economies such as China, Indonesia, Philippines and Thailand bring up the rear with patents per capita in the 0.01-0.07 range, (although patenting in China is rising very rapidly from a low base).

- ***Social Protection in East Asia.*** Governments in East Asia are looking at ways to improve social protection, that is, at improving the methods available to people to better manage various kinds of risks. There are several potential economic and social benefits. First, better social protection can be good for productivity growth, by facilitating job turnover and reallocation of labor to more efficient uses. Second, it can help reduce vulnerability to poverty*:* even as poverty continues to fall, a significant proportion of the population in East Asia remains vulnerable to the risk of becoming poor, as a result of factors such as unexpected health problems, large adjustments in labor markets due to industrial restructuring, or natural disasters. A third factor is that East Asia's population is rapidly aging. The question of old age security and putting in place effective pension systems will quickly grow in political importance. Clearly, East Asian economies need to look for home grown solutions that build on East Asian advantages such as relatively flexible labor markets and on traditions such as self reliance and family orientation. There are a variety of ideas that countries are experimenting with, drawing on experience –positive and negative- from within the region and from around the world. These include conditional cash transfer schemes, possible work related transfer programs, a range of options for expanding health insurance coverage, and ideas for strengthening old age security and funding pension coverage in financially sustainable ways.

EAST ASIA AND PACIFIC REGIONAL UPDATE

East Asia regional outlook

Growth – Brightening Outlook, Near Term

Growth in Emerging East Asian eased modestly from 7.5 percent in 2004 to 6.8 percent in 2005, an outcome that, however, constitutes one of the stronger results for growth over the last decade. (Table 1, Exhibit 1). The slower pace of activity was most clear in the Newly Industrialized Economies and in some of the middle income economies of South East Asia. But it was not universal. Growth accelerated in Indonesia and Vietnam, and continued at very high rates in China. In addition, while the moderation in activity in the NIEs and South East Asia occurred in the first part of 2005, activity was generally rebounding in the latter part of the year. Indeed growth for 2005 as a whole generally turned out higher than we had expected six months ago. The prospects for 2006 also look reasonably firm, with aggregate regional growth expected to exceed 6.5 percent for a third year in a row.

While it is true that most of the risks to the outlook discussed in previous reports remain, recent evidence suggests that some have at least moderated over the last six months. In other words, the outlook is a bit brighter, at least in the near term. Large and rising global macroeconomic imbalances continue to loom as a potential source of instability and a risk to future growth. But, in the near term at least, growth in the US remains robust, while it is picking up in Europe and has rebounded quite strongly in Japan - this last of particular relevance for the rest of East Asia. Similarly, while authorities in China continue to watch for signs of economic overheating and over-capacity, the threat of a sharp cyclical downturn in China has receded, at least in the near term. Growth in China continues at high rates, and has even accelerated in recent months, while inflation remains subdued. Global high tech demand slowed in late 2004 and early 2005, causing a downturn in tech-reliant East Asian export growth, but then rebounded strongly in the second half of the year.

High oil prices clearly played a large role in moderating growth in 2005. While the report assumes that oil prices have now peaked, they are still expected to average 10 percent higher in 2006 than in 2005, so that some of the adverse impact is still likely to be playing out in

Exhibit 1

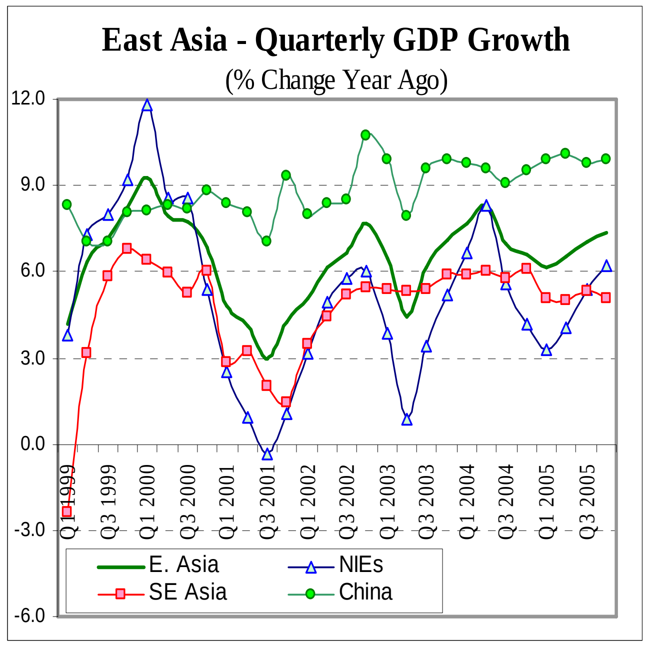


Table 2. Growth in Real GDP and Components of Aggregate Demand (% change year ago)

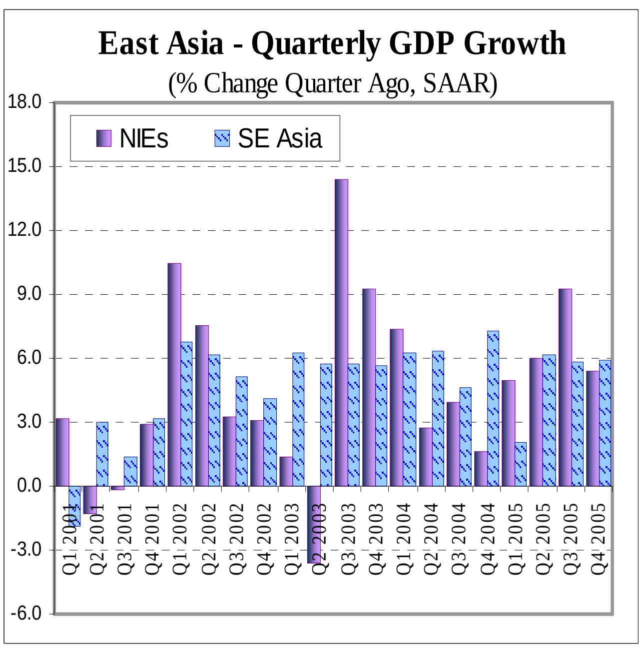
		Indonesia	Malaysia	Philippines	Thailand	Hong Kong	Korea	Singapore	Taiwan, China	Average*
GDP	2004	4.9	7.1	6.0	6.2	8.6	4.6	9.2	6.1	6.6
	2005	5.6	5.2	5.1	4.4	7.3	4.0	6.4	4.1	5.3
	2005 H1	5.9	5.3	4.9	3.9	6.7	3.0	4.5	2.7	4.6
	2005 H2	5.3	5.2	5.3	5.0	7.9	4.9	8.1	5.4	5.9
Priv.Consump.	2004	5.1	10.5	5.8	5.9	7.3	-0.5	8.6	3.9	5.8
	2005	4	9.2	4.9	4.4	3.7	4.0	2.5	3.0	4.5
	2005 H1	3.6	8.8	4.9	4.6	3.4	2.1	2.1	2.8	4.0
	2005 H2	4.3	9.6	5.0	4.3	3.9	4.3		3.2	4.9
Investment	2004	14.1	3.1	4.2	13.8	3.0	1.9	10.2	17.5	8.5
	2005	9.9	4.7	-3.0	11.1	3.9	2.1	-1.9	0.5	3.4
	2005 H1	14.9	4.5	-4.1	14.7	2.7	1.2	-4.4	8.9	4.8
	2005 H2	5.5	5.0	-1.8	7.8	5.1	2.9		-6.4	2.6
Exports	2004	11.1	16.3	14.1	9.6	15.8	19.7	20.6	14.8	15.3
	2005	8.6	8.3	2.3	3.9	11.2	8.8	11.0	6.9	7.6
	2005 H1	11.5	8.6	2.6	0.6	9.8	6.4	..	2.5	6.0
	2005 H2	6.1	8.1	2.1	7.7	11.4	11.1		11.2	8.2

* Simple average of 8 economies. Source: Haver Analytics, national data sources and World Bank staff estimates.

2006. Nevertheless, the real surprise has been that the highest real oil prices in more than 25 years did not inflict more economic damage, with growth not falling below 4 percent in any of the main economies of the region. At the same time, several economies in the region have taken action to reduce costly and regressive subsidies on fuel, which will strengthen government fiscal positions, while also encouraging consumers and firms to adapt to a world of more costly oil prices, both of which should be good for macroeconomic stability and growth in the medium term.

Many East Asian economies began tightening monetary policy last year, which should help forestall the danger of rising oil prices becoming embedded in a sustained rise in core inflation. That too should help underpin the conditions for growth in the medium-longer term. Lastly, 2005 also saw a sharp downturn in some types of capital inflows to East Asia, in particular in loans and short term capital inflows, which had risen dramatically in 2004. This seems to have occurred as the spread between East Asian and US interest rates narrowed, and as a move towards modestly greater exchange rate flexibility in China and Malaysia discouraged short term speculative capital inflows that had been banking on large capital gains from revaluation of these currencies. Perhaps a little counter-intuitively, the downturn in these kinds of short term flows is also a likely net positive, as it may help avert the emergence of euphoria, excessive risk taking and speculative 'bubbles' in domestic financial markets, of the sort that accompanied sustained and large capital inflows in the run-up to the 1997-98 financial crises.

Exhibit 2



Interestingly, the growth outcome for 2005 was significantly higher than the 6.2 percent growth projected in our last East Asia Update six months ago. The principal source of the difference was statistical in nature: a recent revision of national accounts data in China substantially increased the measured level of GDP, boosted average growth in 1994-2004 by around 0.4 percentage points a year on average and also led to an upward revision of growth in 2005. The revisions increased measured GDP growth in China in 2004 from 9.5 to 10.1 percent, and helped boost the estimate of growth in 2005 from 9.2 percent to 9.9 percent. (The revisions to China's data are discussed in more detail in Box 2 later in this report).

But not all of the upward revision for East Asian growth in 2005 was due to purely statistical reasons. After slowing towards the end of 2004 and in early 2005, growth in China picked up in the second half, led by domestic investment and consumption spending. Growth in Vietnam exceeded our earlier projection by a wide margin. Growth also rebounded in the second half of 2005 in several other East Asian economies, particularly among the Newly Industrialized Economies (NIEs) – Hong Kong, Korea, Singapore and Taiwan, China. (Table 2 and Exhibit 2). Year on year growth in the eight largest economies outside China picked up to 5.9 percent in the second half of 2005, from 4.6 percent in the first. As so often in East Asia, the second half recovery was principally export led, supported by renewed strength in high tech exports and also to some extent an upturn in Chinese import growth from the region. Private consumption growth also gained momentum.

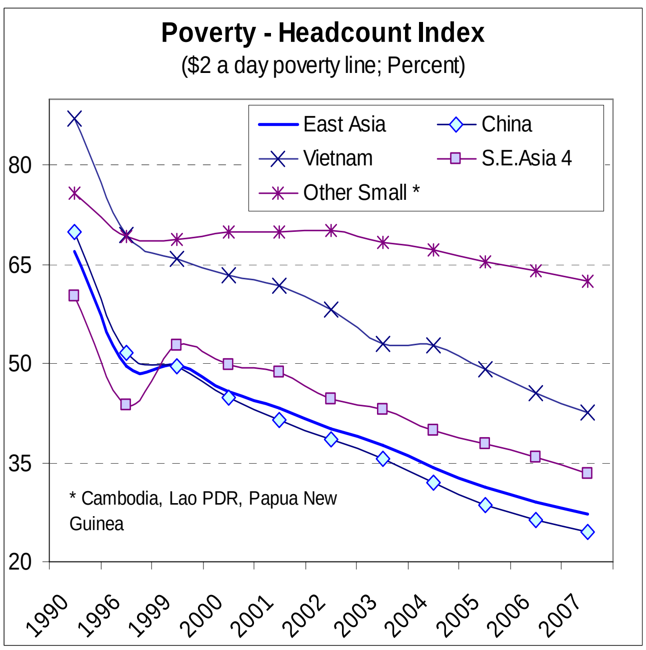
A more worrying outcome, though, was a weakening in 2005 fixed investment growth in the economies outside China, which dipped to only 3.4 percent from 8.5 percent in 2004. (Table 2). Fixed investment spending in the region outside China has been erratic and generally weak ever since the financial crises of 1997-98 and the dotcom crash of 2001, averaging zero growth in 2001-03, for example. The rebound in 2004 was thus encouraging as the first widespread and significant growth in investment in many years, supported by a number of favorable factors such as low interest rates, rising capacity utilization, stronger corporate balance sheets and rising corporate sales and profits. In 2005, though, investment is likely to have been dampened by the impact of rising oil prices, heightened uncertainty about economic prospects and the start of monetary tightening. Several of these factors such as high oil prices and higher interest rates are likely to persist for a while. Carefully designed and sustained policy and institutional reforms to improve the investment climate are clearly more important than ever.

Poverty Reduction and Human Development

Our most recent estimates suggest a stronger outcome for poverty reduction in East Asia in 2005 than had been expected six months ago. For the region as a whole, poverty at the $1 a day level fell to 8 percent of the population in 2005, down from 9.1 percent in 2004. At the $2 a day level, poverty is estimated to have fallen to a little over 31 percent in 2005, down from just over 34 percent in 2004. The number of poor at the $2 level is estimated at some 585 million in 2005, down by 51 million from the previous year. (Exhibit 3; Appendix Tables 7, 8).

Clearly, sustained strong economic growth has provided an indispensable foundation for the broad declines in poverty seen in most East Asian economies in recent years. But, as the review of individual country experiences below suggests, progress in poverty reduction at the broad national level sometimes occurs unevenly, with particular social groups or geographical regions doing less well than overall trends. Governments in the region are therefore pondering policies that can foster poverty reduction in more targeted and potentially cost effective ways. In China, for example, the new Five Year Plan reflects a significant shift in development priorities towards agriculture and the rural areas, where the vast majority of China's poor live. In Vietnam, the five year planning process is being accompanied by efforts to make resource allocation more strongly pro-poor. In Indonesia the government has moved decisively towards abolishing fuel subsidies, a traditional but very costly and regressive approach to providing a measure of social protection for the poor, shifting instead towards an approach of targeted cash transfers to help shield the poor from the impact of higher fuel prices. A later section of this report provides a more detailed look at social protection issues in East Asia.

Exhibit 3



In *China* the recently completed 10th Five Year Plan period (2001-2005) saw an acceleration in the pace of poverty reduction compared to the previous plan period. The number of poor at a consumption poverty line of $2 a day fell by 156 million (29 percent), which represented four-fifths of the total number of people lifted out of poverty in East Asia during this period. This contrasts with a decline in poverty of only about 8 percent between 1996 and 2000 (the 9th Five Year Plan period). Poverty reduction also accelerated during the course of the 10th plan period, with the largest declines occurring in 2004 and 2005. This can be traced to two developments. The first was a recovery in grain production in 2004-05, after declines in the preceding three years. The second is a reduction and progressive elimination of agricultural taxes and fees paid by rural households, a process that began in 2001 but picked up steam in 2004 and 2005. Average expenditures on agricultural taxes and fees by rural households fell by over 60 percent in 2005.

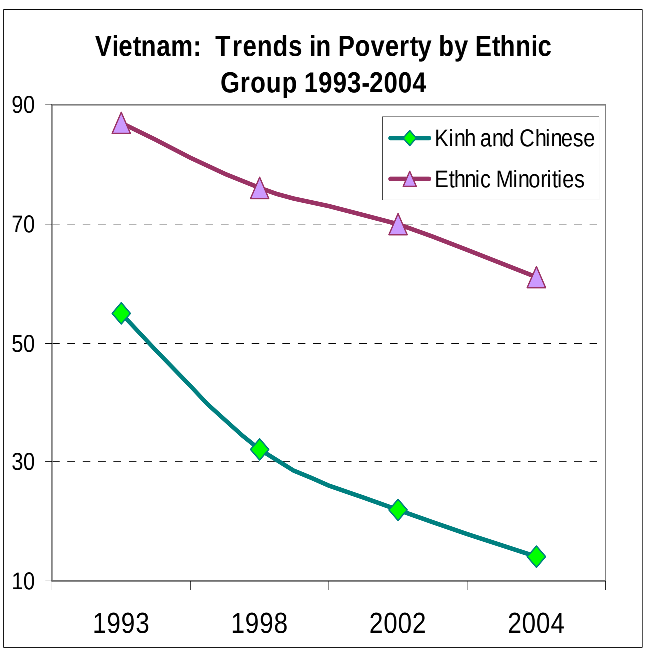
A problematic aspect of recent performance is that poverty reduction among the very poor has been rather less than among the somewhat less poor. The number of absolute poor (people with an income of less than about 70 cents a day) fell from 29.3 to 23.7 million, a decrease of 19 percent, rather less than at the $2 a day level. Preliminary analysis by the World Bank indicates that, in part, slower poverty reduction for this group may result from the fact that, after China's past success in reducing poverty through broad-based growth and poor-area development initiatives, a growing fraction of the absolute poor remain so not only for reasons of geography and remoteness, but for a variety of other more household-specific causes. Such households tend to be more dispersed, rather than concentrated in particular villages, and are correspondingly harder to reach.

Looking forward, the 11th Five Year Plan adopted by the National People's Congress in March 2006 indicates a significant shift in the government's priorities towards improving incomes and welfare in the countryside. According to the budget tabled at the Congress, the central government plans to spend 339.7 billion yuan (US$42 billion) on agriculture, rural areas and farmers in 2006, a 14.2 percent increase on last year, representing 21.5 percent of the increase in all central government spending. A large part of the increased spending under the new initiative will be directed towards education and health services in the countryside, including several billion yuan in supplementary funding for tens of millions of poor primary and junior middle school students and free nine-year compulsory education for rural students. The costliness of access to basic services is indeed likely to be an important factor explaining the unusually high level of savings among China's poor, as precautionary saving for uninsured health (and other) shocks, savings to finance educational costs, and life-cycle savings to fund old-age living expenses. The central government also plans to double subsidies for farmers if they join a state-backed medical cooperative fund designed to reduce the financial burdens of farmers. Other elements of the plan include increased subsidies for farmers and further government investment in rural public works. In addition the package calls for elimination of all agricultural taxes.

Poverty reduction has been exceptionally rapid in *Vietnam* as well, averaging 3.5 percentage points a year using national poverty lines.[4] The Vietnamese experience is especially interesting because it appears to have avoided many of the increases in inequality that have accompanied fast growth elsewhere. The Gini index of income inequality for the economy as a whole, at 0.37 is only slightly higher than in 1998 when it was 0.35. Living standards have increased at a similar pace in urban and rural areas. The fast reduction in poverty coincides with a massive shift out of agriculture. The proportion of the working-age population who were farmers declined from half in 1998 to less than 40 percent in 2004. Those who stayed in agriculture also saw their incomes from farming rise substantially. This trend was driven by robust growth in the agricultural sector, at roughly 4 percent annually during the past six years.

There is also a narrowing of the gender gap in a number of respects. There is now little difference between the net enrolment rates for girls and boys throughout the school system prior to tertiary education. In 2004, 66 percent of girls and 61 percent of boys in the relevant age group were enrolled in upper secondary education. Women in Vietnam participate only slightly less actively in the labor force than do men. Among people in the 15-to-64 age group, 83 percent of men and 80 percent of women were employed in the 12 months preceding the most recent household survey. Data on earnings suggest that the gender gap is closing; while being a female worker in the early 1990s implied earning more than 30 percent less than a man, in 2004 this gender gap in earnings had diminished to 17 percent.

Exhibit 4



[4] The national poverty lines are not comparable to the 1993 PPP-dollar-denominated international poverty lines of $1 or $2 per day reported elsewhere in this Brief.

Progress on poverty reduction has not been equally well balanced along all dimensions, however. Poverty is much lower among the Kinh (the majority ethnic group in Vietnam) and Chinese populations than among ethnic minorities. In 2004 14 percent of the Kinh and Chinese people were living in poverty (using national poverty lines), compared to 61 percent of ethnic minority people, based on the national expenditure poverty line of about $1.80 per day. (Exhibit 4). Though accounting for only 13 percent of the total population, ethnic minorities now constitute 39 percent of the poor. Their poverty is deeper, too, than that of other groups. The poverty gap index for ethnic minorities is 19.2, compared to only 2.6 for Kinh people.

In *Indonesia* poverty is estimated to have fallen to 16 percent of the population by early 2005 using the national expenditure poverty line of about $1.50 per day, down from a peak of 23 percent in 1999, in the aftermath of the financial crisis. However, since the poverty estimates for 2005 were conducted in February of that year, they do not reflect the impact on poverty of two important developments in the year: first, the government's decision to reduce fuel price subsidies and allow increases in fuel prices, and, second, large recent increases in rice prices.

Like numerous developing countries, Indonesia has traditionally tried to provide a measure of social protection for the poor by subsidizing some basic commodities, in this case fuel. However sharp increases in world oil prices in 2004 and 2005 boosted the fiscal cost of fuel subsidies from $3.5 billion in 2003 to $7.7 billion in 2004 and a projected $15 billion in 2005 (in the absence of reform). The fiscal cost of the subsidy in 2004 was larger than Indonesia's total public spending on education and 3.5 times its public health spending. The fuel subsidies were also highly regressive, benefiting a person in the top decile of the income distribution more than five times as much as a person in the bottom decile.

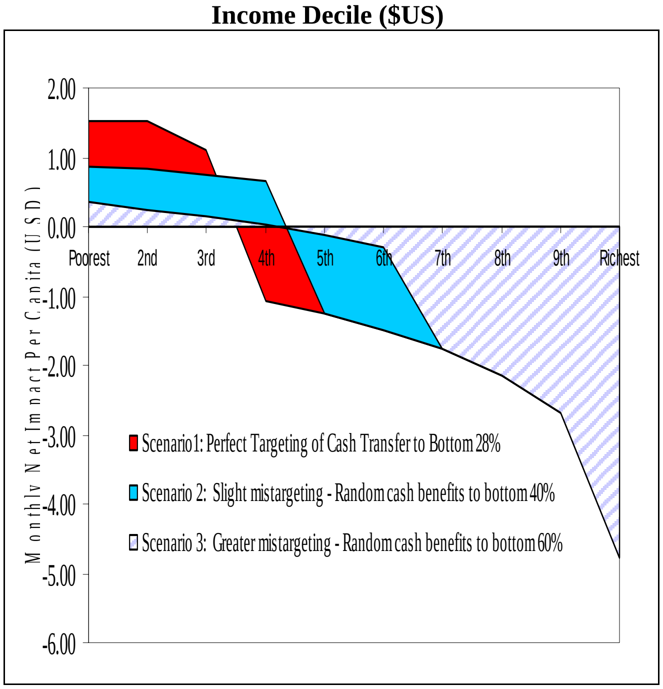
Indonesia's government took bold actions to address these problems, reducing the fuel subsidy and increasing fuel prices by 29 percent and 114 percent in March and October respectively, yielding estimated budgetary savings of $5 billion in 2005. The government reallocated funds from the fuel subsidy to rapidly put into place an unconditional cash transfer (UCT) program to mitigate the impact of the fuel price increase on the poor. This program is now the world's largest ever cash transfer program in coverage and total volume of transfers. The UCT program was targeted to 15.5 million poor and near-poor households in Indonesia (some 28 percent of the national population and in excess of the poverty rate of 16 percent). The size of the transfer is about 30 USD per household every 3 months, to be continued for 1 year in 4 tranches.

Currently the government has fully disbursed the first tranche and is in the process of disbursing the second quarterly tranche. It has indicated that the program will last one year, after which it may transition into a Conditional

Cash Transfer (CCT) program. Considering that the program was prepared in a matter of months, it has performed remarkably well. The initial implementation was accompanied by press reports about poor targeting, leakages and lack of crowd control at cash disbursement points. The government took quick action to remedy potential problems, including the commissioning of an early assessment of the first tranche disbursement. The assessment points to overall satisfactory results. Regional targeting and transfer of funds worked on time and beneficiaries expressed satisfaction with the program. The sharp rise in retail fuel prices also passed without major public protest. The assessments did note some problems, however, such as poor local targeting. The government is taking prompt corrective action to try and remedy any remaining problems in implementation.

For poor recipients, the cash transfer more than compensates the losses incurred as a result of the fuel price increase. Ex-ante simulations suggest the poverty head count ratio would have increased by 6 percentage points to 23 percent in the absence of a compensation program. Poor household that did receive the UCT, ended up with a net increase in consumption. Simulations indicate that for recipients in the poorest two quintiles, consumption rose by between 8 and 18 percent if the household received the UCT. Non-recipients lost around 5 percent of their monthly per capita expenditure as a result of the combined effect of the fuel price increases. (Exhibit 5). Even under assumptions of moderate mis-targeting (e.g. with cash benefits randomly distributed to the bottom 40 percent instead of the targeted bottom 28 percent), the UCT program should prevent an increase in the poverty rate due to the fuel price increase.

Exhibit 5
Monthly per capita Impact of the UCT Program by Income Decile ($US)



The Government also used reallocations from the fuel subsidy to finance 3 other major poverty programs. In the education sector, the newly funded program aims at canceling school fees at participating elementary and junior secondary schools while also offering targeted scholarships to poor students (US$650 million in 2005). In rural development, the government financed direct grants to some 13,000 poor villages (US$350 million in 2005; annual grant of about US$25,000 per village). The program is meant to generate labor intensive employment and improve village infrastructure through a bottom-up decision making process. In health care, the fuel subsidy savings were reallocated to a program that supports basic health care and also offers targeted health insurance coverage to the poor for inpatient care at 3rd class hospital beds (US$400 million in 2005).

Rice accounts for some 24 percent of consumption expenditures of the poor in Indonesia. The 46 percent increase in the domestic price of rice between January 2005 and January 2006 is therefore a matter of concern. Based on past experience, this sharp price rise may have moved more than 8 million people temporarily below the poverty line.

In *Cambodia* a recent Poverty Assessment finds that about 35 percent of people live below the country's poverty line of about US$1.30 a day, compared to about 47 percent in 1993. Non-income indicators such as ownership of consumer durables, housing quality and schooling also indicate that the living standards of the population, including the poor, improved over this period. However, while poverty reduction has been widespread, it has not been uniform. The indigent or extreme poor have experienced significantly slower growth in real consumption than the average poor. The proportion of indigent among the poor and the magnitude of their consumption shortfall from the poverty line remain as substantial and acute today as in 1993. The rural poverty headcount fell by a more modest 22 percent over the 1993-2004 period compared to a 60 percent reduction in Phnom Penh and 44 percent in other urban regions. Analyses in the Poverty Assessment suggest that accelerating poverty reduction in Cambodia is largely about fostering agricultural productivity. The evidence gathered points to secure property rights as the principal determinant of agricultural productivity, and to equitable access to common property resources as an important income source and safety net for the poor. Other important determinants are rural infrastructure and human capital. Better governance is an important consideration in securing improvements in these areas.

The Avian and Human Influenza Threat

Last November's East Asia Update noted the spread of the highly pathogenic avian influenza (HPAI) H5N1 virus ("bird flu") from East Asia, where 10 countries had experienced outbreaks since the end of 2003, to several countries in Europe and Central Asia (Russia, Kazakhstan, Turkey, Romania and Croatia). Since then bird flu outbreaks among poultry and wild birds have occurred in another 31 countries, virtually all in February and March 2006.[5] These included 11 new outbreak countries in Europe and Central Asia, 3 in South Asia, 4 in the Middle East and North Africa, 3 in Sub-Saharan Africa and 8 in Western Europe.

In East Asia, where the present bird flu pandemic began, recent trends have been mixed. Two new East Asian economies reported bird flu outbreaks in recent months, Myanmar among poultry in March and Hong Kong among a small number of wild birds in January. China reported three outbreaks among poultry since last November, the last at the start of February 2006 in Shanxi province. In Indonesia high numbers of poultry deaths also continued to be recorded in Central and East Java in February-March 2006. In Thailand and Vietnam, however, no new outbreaks have been reported since October-November 2005, a success attributed to aggressive action taken by these countries to stamp out the disease through culling, and 'ring vaccinating' around outbreaks. Malaysia, which had also taken strong action to quickly stamp out outbreaks in August-November 2004, experienced a new outbreak among poultry in February 2006, reinforcing the need for high continuing vigilance.

There were 42 confirmed new human cases of avian influenza reported to WHO worldwide so far in 2006, bringing the total since 2003 up to 185. (Table 3). Half of the new 2006 human cases were in East Asia, nearly all in Indonesia and China. Worldwide, somewhat over half of human bird flu cases since the start of the epidemic have resulted in death. Nearly all of the human cases so far are considered to be the result of transmission from birds or other animals to humans. The economic impact of bird flu in the affected East Asian economies has been fairly limited so far at the overall macroeconomic level, though of course more severe in agriculture, in rural communities and in the upstream and downstream industries to the poultry sector. However there remains great concern that genetic changes will allow the virus to achieve the capacity for sustained and efficient transmission from human to human, leading to a human influenza pandemic with much higher levels of illness, death and economic and social costs.[6] The changes may occur through antigenic drift, the natural process of mutation and 'coding errors' in genetic material as the virus replicates, or through antigenic shift, a more abrupt change where the H5N1 virus in a co-infected human exchanges genetic material (or 'reassorts') with a circulating human influenza virus strain that has developed the ability for human-to-human transmission. Reassortment could also occur through intermediate mammalian species such as pigs or other large domestic animals.

Policy Responses

The gravity of the threat posed by avian and human pandemic influenza has made action to prevent or mitigate the threat a high priority for policy makers. Among numerous recent international meetings to plan a response, two are particularly notable.

In November 2005 a global meeting in Geneva co-sponsored by the World Health Organization, Food and Agriculture Organization, World Organization for Animal Health and World Bank identified key components of a global action plan to control avian influenza in animals and simultaneously limit the threat of a human influenza pandemic:

- *Control at Source in Birds*. Improving veterinary services, emergency preparedness plans and control campaigns, including culling, vaccination and compensation.
- *Surveillance*. Strengthening early detection and rapid response systems for animal and human influenza; building and strengthening laboratory capacity.
- *Rapid Containment.* Support and training for the investigation of animal and human cases and clusters, and planning and testing rapid containment activities.
- *Pandemic Preparedness.* Building and testing national and global pandemic preparedness plans; strengthening health system capacity, training clinicians and health managers.
- *Integrated Country Plans.* Developing integrated national plans across all sectors to provide the basis for coordinated technical and financial support.
- *Communications.* Factual and transparent communications, in particular risk communication, is vital.

In January 2006 an International Ministerial Pledging Conference in Beijing co-sponsored by the Government of the People's Republic of China, the European Commission, and the World Bank secured pledges of some $1.9 billion in grants and credits to provide resources for technical agencies and developing countries in meeting the threat of avian and human pandemic influenza. Of the total, $285 million was pledged to various UN and

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[5] World Organization for Animal Health (OIE): http://www.oie.int/downld/AVIAN%20INFLUENZA/A_AI-Asia.htm

[6] A growing number of studies attempt to develop scenarios of the economic impacts of a global human influenza pandemic. A brief survey of some of the relevant issues was provided in the November 2005 World Bank East Asia Update. The most detailed recent study is provided by Warrick McKibbin and Alexandra Sidorenko. (February 2006). "Global Macroeconomic Consequences of Pandemic Influenza." Lowy Institute for International Policy. http://www.lowyinstitute.org/PublicationGet.asp?i=345. This study finds that a "mild" pandemic could be associated with a median loss of 0.9 percent of GDP among the 9 East Asian economies it includes. In a "severe" scenario the median loss among the nine could rise to 8.4 percent of GDP, while in an "ultra" scenario it could be as much as 18 percent of GDP.

Table 3. Confirmed Human Cases of Avian Influenza A/H5N1Reported to WHO

	2003-04		2005		2006		Total		Fatality
	Cases	Deaths	Cases	Deaths	Cases	Deaths	Cases	Deaths	Rate (%)
East Asia	49	35	95	41	21	18	165	94	57.0
Cambodia			4	4	1	1	5	5	100.0
China			8	5	8	6	16	11	68.8
Indonesia			17	11	12	11	29	22	75.9
Thailand	17	12	5	2			22	14	63.6
Vietnam	32	23	61	19			93	42	45.2
Other					21	11	21	11	52.4
Azerbaijan					7	5	7	5	71.4
Iraq					2	2	2	2	100.0
Turkey					12	4	12	4	33.3
Total	49	35	95	41	42	29	186	105	56.5

Source: Confirmed cases reported to World Health Organization as of March 24, 2006.

regional technical agencies. Some $600 million was allocated to specific developing regions, the bulk to Asia, the epicenter of the avian flu pandemic so far. Another $750 million was available as unrestricted funds available to countries meeting eligibility criteria. The latter total includes a new World Bank funding facility of $500 million, the Global Program for Avian Influenza Control and Human Pandemic Preparedness and Response (GPAI). Countries eligible for concessional IDA credits or grants can apply such funds in their avian influenza response and preparedness efforts, while other countries will be eligible to borrow on standard IBRD terms. A grant for Kyrgyzstan was approved in February and some 20 countries are at present preparing to draw on this facility. The World Bank is also putting in place arrangements for a multi-donor trust fund to handle some of the resources pledged in Beijing.

With some progress having been made on mobilizing financial resources, a key focus of attention is now on preparation, appraisal and implementation of integrated programs at the country level. The results of current efforts to strengthen animal and human health system capacities should prove a good long term investment not just in dealing with the immediate problem of avian and human pandemic influenza, but also in addressing the broader long term problem of communicable diseases, which includes the resurgence of many old existing diseases as well as the emergence of new diseases. In short the response to avian and human pandemic influenza also needs to be seen as part of the broad development agenda. Much the same could be said for the response to the December 2004 Asian tsunami, which underlined the importance of integrating disaster prevention and natural disaster risk management as integral parts of development plans, poverty reduction strategies and investment projects, rather than as special activities related to humanitarian emergencies. (See Box 1 for an update on Asian Tsunami recovery efforts).

Box 1. Asian Tsunami: Progress Report and Lessons

The first anniversary of the December 26, 2004 Asian Tsunami provided an opportunity to evaluate progress on recovery efforts. By most accounts, and especially in relation to outcomes in other recent natural and manmade disasters, the post-tsunami recovery effort has several successes to its credit. Rescue and relief activities proceeded well, with no major outbreak of disease, starvation or violence. The outpouring of financial aid from official and private sources was unprecedented, reaching $13.1 billion, compared to identified recovery needs of $10 billion across 12 countries in Asia and Africa. By mid-2005, most of the affected countries, including Indonesia and Thailand in the East Asia and Pacific region, were in transit from relief to reconstruction.

After a slow start, the pace of reconstruction has picked up markedly since September 2005 in the Aceh and Nias areas of Indonesia, the areas worst affected by the tsunami, though critical gaps are still apparent. About 20,000 houses have been completed, and another 15,000 houses are expected to be finished by end-April. Each months, about 3,500 – 5,000 houses are now being built. Faster than expected progress has also been achieved in getting children back to school, restoring the health care network, replacing fishing boats, and restoring farmland and fishing ponds. Among key gaps, 40-50000 families still remain in tents or barracks. Although the construction sector is booming, livelihoods remain a severe problem particularly for women, of whom 21 percent are unemployed. There also remains a “missing middle” of infrastructure at the district level that is not keeping pace with housing construction, including local and feeder roads, drainage, water and sanitation, waste management, power connectivity, and sea defense

Despite the overall success, the on-going post-tsunami recovery process has revealed a number of points that need to be addressed in this and future emergencies. Foremost among these is the need for adequate funding of relief and strong coordination of the transition from relief to reconstruction. The large number of official and non-governmental players has made coordination and accountability especially challenging, although the establishment of national agencies dedicated to post-tsunami recovery has begun to address this problem.

The international and regional environment

East Asian export growth slowed from a strong pace close to 30 percent (in nominal US dollar terms) in mid 2004 to a more moderate 15-20 percent pace in 2005. (Exhibit 6). Individual country experiences varied considerably however. China's export growth slowed through much of 2005, down from a 30-40 percent range in 2004 to a still healthy pace near 20 percent by the end of 2005. The moderation appears linked to an appreciation of China's trade weighted exchange rate during the year, as well as the imposition of anti-dumping measures on Chinese textile and apparel exports in the US and EU markets. Export growth among the NIEs and the South East Asian economies had also slowed in late 2004 and early 2005, due to a leveling out in global high tech demand growth and a slowing in China's imports, an important market for the rest of Asia. Export growth in these economies picked up the latter part of 2005, though, due to a rebound in global high tech markets and reviving domestic demand and import growth in the Chinese market. Prospects for East Asian exports in 2006 look reasonably firm, based on solid projected growth in the US, Japan and China, as well as renewed growth in global high tech markets.

Developed country trends

While the doubling of oil prices between 2003 and 2005 has undoubtedly slowed world growth, the extent of that impact has been surprisingly limited. World growth slowed from the exceptional 3.8 percent rate experienced in 2004, but still reached a healthy 3.3 percent pace in 2005. Growth among the developed OECD countries eased from 3.1 percent in 2004 to a still healthy 2.7 percent in 2005, and is even expected to strengthen mildly to 2.9 percent in 2006, the result of recovery in Japan and Europe offsetting a mild slowing in the U.S. (Table 4).

In the *United States* high oil prices, rising short-term interest rates, cooling housing markets and a disruptive hurricane season contributed to slowing growth to 3.5 in 2005 percent from 4 percent in 2004. The slowdown was not as marked as it could have been, because low long-term interest rates boosted domestic demand, and the cumulative effect of past dollar depreciations improved net exports. In the fourth quarter of 2005, in the immediate aftermath of hurricanes Katrina and Rita, growth fell to its lowest rate in over two years, dipping to only 1.1 percent in annualized terms, with sharp declines in household consumption and in residential and business fixed investment. (Exhibit 7). The fourth quarter dip appears to have been an aberration though. Monthly indicators in early 2006 for unemployment claims, new job creation, manufacturing orders and production were all strong. Private sector payrolls expanded at strong rates of over 200,000 jobs in both January and February. Corporate survey data suggest that business investment spending in particular should be a prominent driver for US growth in 2006, supported by high corporate profits, still relatively low longer term borrowing costs and rising capacity utilization. GDP growth is expected to run at a robust 3.4 percent in 2006.

Exhibit 6

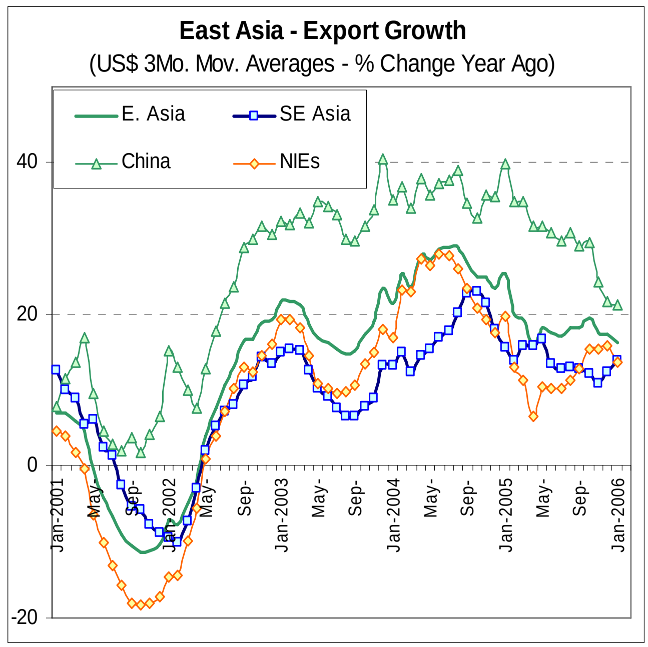
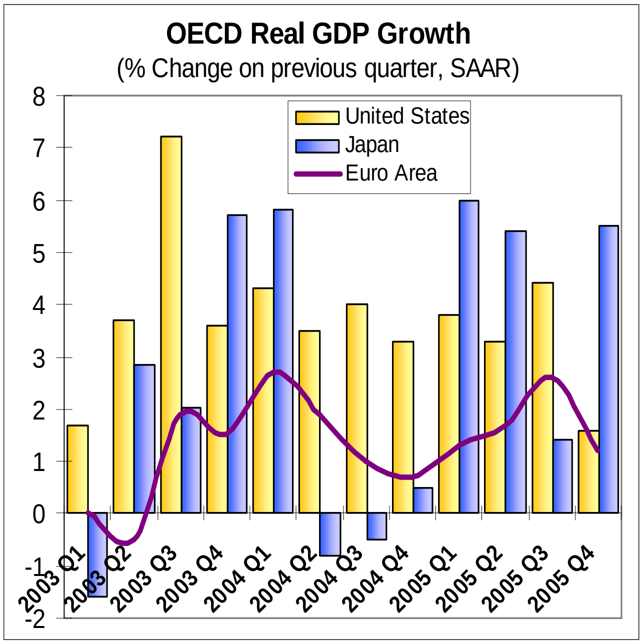


Table 4. International Economic Environment

	2004	2005	2006	2007
% Change from previous year, except interest rates				
GDP Growth				
World	3.8	3.3	3.3	3.2
World (PPP Weights)	4.9	4.3	4.3	4.1
OECD	3.1	2.7	2.9	2.7
United States	4.0	3.5	3.4	3.3
Euro Area	1.9	1.4	2.1	1.7
Japan	2.3	2.8	2.8	2.1
Australia	3.6	2.5	3.2	3.4
World Trade (Volume)	10.3	6.5	8.4	7.5
CPI Inflation - G7 [a/]	2.1	2.6	2.2	1.8
Oil Price - $/bbl	37.7	53.4	59.0	56.0
- % Change	30.6	41.5	10.5	-5.1
Non-oil Commodity Prices	17.5	13.4	-3.7	-7.2
LIBOR (US$. 6 Mo.)	1.6	3.6	5.1	5.2

Source: World Bank DEC Prospects Group update 3/9/06. a/ In local currency, aggregated using 1995 weights.

Exhibit 7



In *Japan* growth picked up from 2.3 percent in 2004 to 2.8 percent in 2005, well above earlier consensus forecasts for the year, confirming assessments that the economy has finally emerged from its more than decade long stagnation. Growth has been broad based. Consumer confidence and spending have benefited from tighter labor markets, an upturn in wages and an ending of consumer price deflation (which should dissipate expectations of further declines in consumer prices). Rising consumer confidence and income have also provided a boost for residential investment. Business investment has been notably strong, supported by plentiful corporate profits and low borrowing costs. Robust export growth rounds out the list of factors contributing to 2005's Japanese expansion. All of these supportive trends were in evidence in the fourth quarter of 2005 when GDP growth jumped to 5.5 percent in annualized quarter on quarter terms.

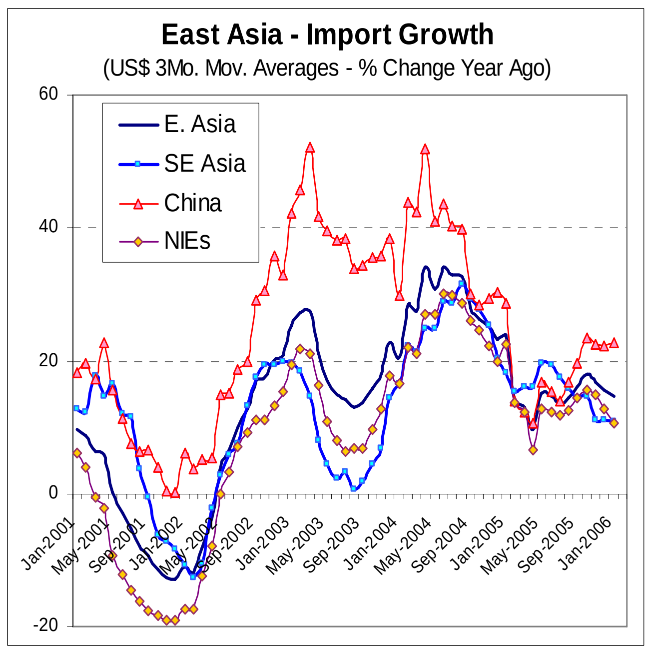
Growth in the Euro Area decelerated from 1.9 percent in 2004 to only 1.4 percent in 2005, touching an unexpectedly weak 1 percent in the fourth quarter (seasonally adjusted annual rate). Consumer spending has been particularly weak, reflecting poor labor market trends. Export and business investment are more favorable, however, and these are expected to spearhead stronger growth in 2006, which is expected to reach a little over 2 percent.

China

China's economy grew 9.9 percent in 2005, down slightly from 10.1 percent in 2004, although growth appeared to be accelerating in the latter part of the year.[7] The composition of growth also changed over the course of the year, shifting from net exports to strengthening domestic demand. Net exports made a strong contribution to growth in the first half, reflected in the country's trade surplus surging to over $100 billion for the year as a whole. In the second half the contribution of net exports shrank, however, as export growth slowed and imports revived, fueled in part by stronger domestic investment and consumption.

Nominal fixed asset investment (FAI) growth edged up during 2005, reflecting the fading impact of policy tightening measures that had been undertaken in 2004, as well as still favorable financing conditions. FAI growth for the year as a whole was around 26 percent, not much lower than in 2004. The rebound in industrial FAI is broad-based, covering all industries except communications and electronics. The latter industries have been particularly attractive to foreign direct investment inflows, which, however, leveled off in 2005. Nominal retail sales have been growing steadily at 13-14 percent (yoy) since 2004, with declining consumer price inflation allowing for a pick up in real retail sales growth from 10.2 percent in 2004 to 12 percent in 2005.

Exhibit 8



Merchandise exports growth in US dollar terms slowed to 22 percent in the fourth quarter of 2005 from 35 percent in the first quarter. The slower trend was broad based, affecting most important categories of China's

[7] These growth rates use a new revised dataset for China's national income accounts in recent years. The new data is discussed further in Box 2 below. On the old data GDP growth was an estimated 9.4 percent in 2005, and 9.5 percent in 2004.

exports. Textile and clothing, comprising about 15 percent of total merchandise exports, surged in the early and middle part of the year after the end of the Agreement on Textiles and Clothing and the removal of export quotas on these items at the start of the year. Growth of these items slowed in the fourth quarter, however, as recent anti-dumping import restrictions in the U.S. and E.U. took hold. More generally China's exchange rate also experienced a trade weighted appreciation of about 10 percent over the course of 2005. A small part of this was due to the minor managed appreciation of the yuan against the dollar after July, but most of it reflected the strength of the dollar against other main currencies last year. The leveling out of FDI flows noted above may also have been a factor in easing electronics exports (in the machinery and transport equipment category).

At the same time, China's merchandise import growth rose from 12 percent in the first quarter to 22 percent in the fourth, underpinned by strengthening domestic demand and appreciation of the trade weighted exchange rate. (Exhibit 8). Of note from the perspective of impacts on the rest of the world economy, growth in imports of crude materials accelerated to 30-35 percent in the second half of the year, contributing to solid demand growth and rising prices in global primary commodity markets (reviewed below). Growth in imports of machinery and transport equipment also picked up from a 10 percent pace in the first half to 24 percent in the fourth quarter, a turnaround of importance for other East Asian economies, which are major suppliers of capital equipment, parts and components to China. (Exhibit 9). After dipping sharply in the first half of 2005, China's imports from other East Asian economies did indeed pick up in most cases in the second half. (Exhibit 10).

Exhibit 9

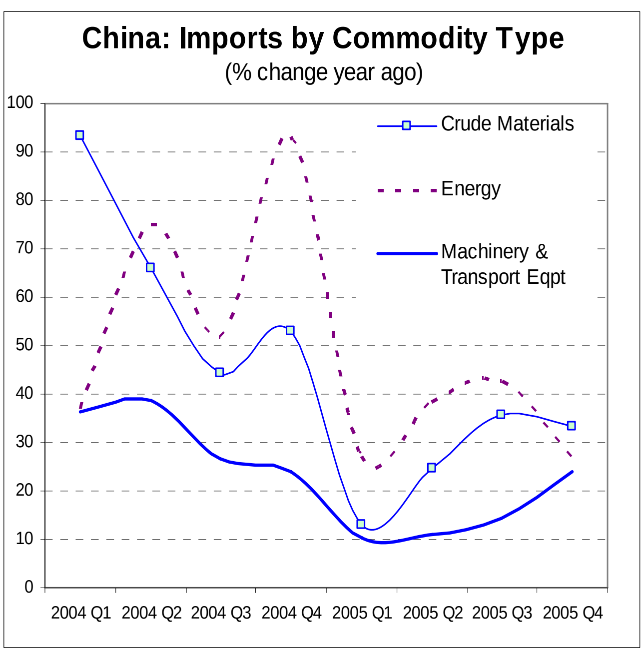
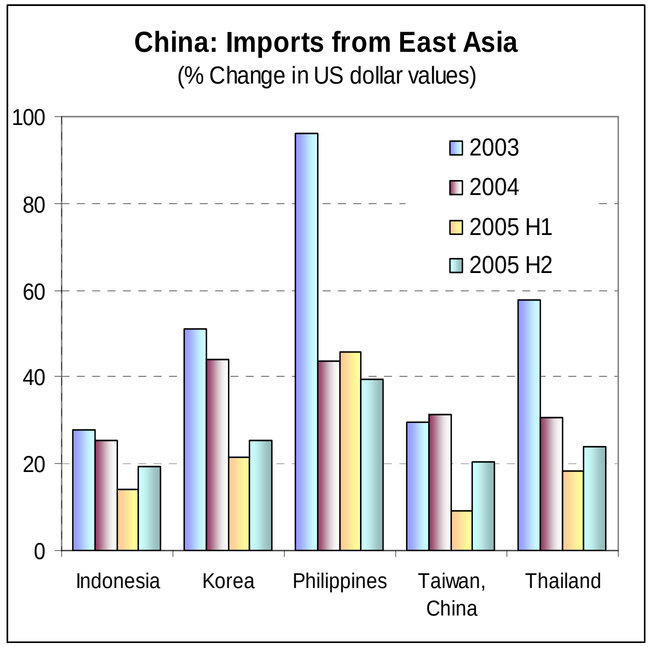


Exhibit 10



Box 2. China's Revised GDP Data

China's National Bureau of Statistics recently issued revised national accounts data for the period 1993-2004, on the basis of the country's first Economic Census, conducted in 2005 The new data showed several important changes:

First, the economy is much larger than previously estimated. GDP in 2004 was estimated as 16.8 percent larger than previously thought. Economic growth was also about 0.4 percentage points per year faster on average over the 12 year period.

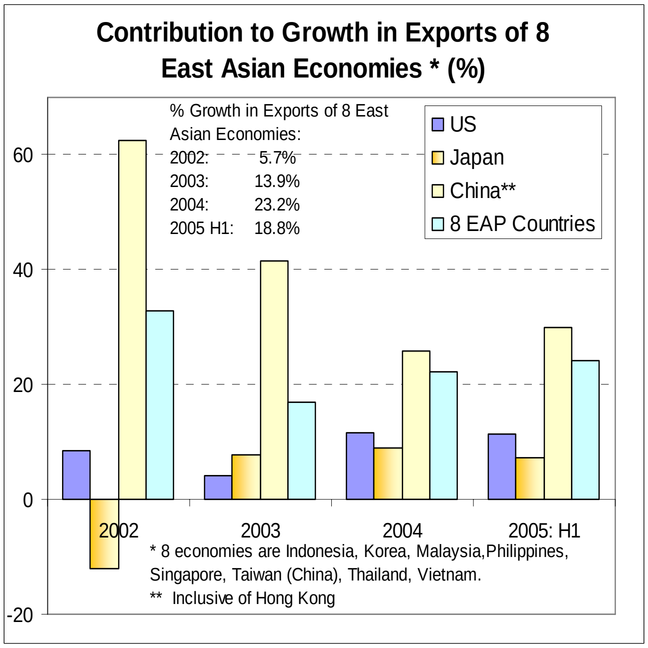
Second, the structure of the economy looks less extraordinary in several dimensions. A full 93 percent of the upward revision in GDP came from a revision of value added in services, as new firms and activities in that sector are now better captured. The share of services in GDP in 2004 was revised up 8.8 percentage points to 40.7 percent, while the shares of primary and secondary sectors declined by 2.2 and 6.6 percent, respectively. The share of services in the economy still remains low compared to other economies at China's level of per capita income.

Third, price rises make up two-thirds of the revision to GDP, largely because of higher price increases in the services than in other sectors. This implies that China has experienced 10 percent more real exchange rate appreciation than previously estimated (using the GDP price deflator).

Lastly, while information on the expenditure components of the new GDP data has yet to be released, economists expect that most of the increase in GDP will be attributed to higher consumption. However, while the share of investment in GDP will be less than 45 percent using the old data for 2004, it will likely remain over 40 percent, still very high compared to other economies.

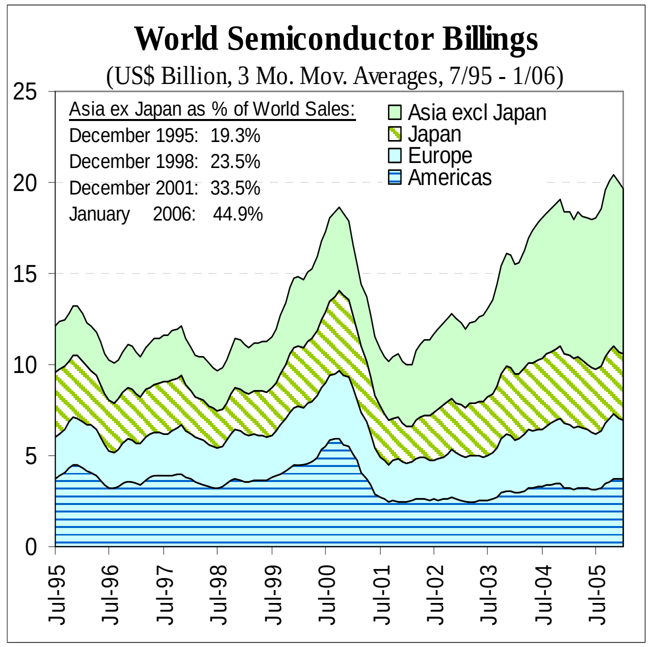
Viewed from the perspective of other East Asian economies, a large share of the growth in their exports in recent years has been to China, as well as among themselves. In the first half of 2005, for example, exports to China (including Hong Kong) contributed 30 percent of the growth in the exports of 8 other main East Asian economies. (Exhibit 11). Exports to each other contributed another 24 percent of overall export growth for these 8 economies at this time.

Exhibit 11



although growth will likely be at more moderate rates than during the 2003 and early 2004 cyclical rebound from the dot com crash. As noted in an earlier section, business investment in the developed world is likely to show robust growth in coming quarters, supported by strong corporate profits, and about half of capital spending these days comprises high tech equipment and software. With solid income growth and improving labor market conditions in many parts of the world economy, consumer high tech spending should also continue to expand.

Exhibit 12



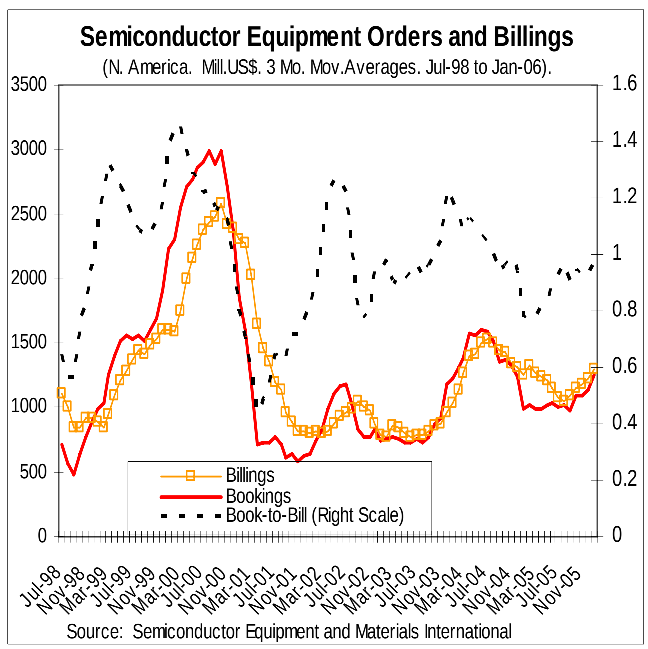
Commodity markets

High tech cycle

Global high tech markets saw renewed strong growth in activity in the second half of 2005, following a period of flat activity extending from mid 2004 to mid 2005. World semiconductor sales rose 13.6 percent in dollar terms between June and December 2005, before a modest easing in the first two months of 2006. (Exhibit 12). World sales in dollar terms now exceed the previous peak reached at the height of the dot com bubble in mid 2000. Sales growth was particularly strong in North America and in Asia ex Japan. Reflecting the emergence of East Asia as the preferred global location for assembly and manufacture of electronic and other high tech goods, about 45 percent of world semiconductor sales are now in Asia ex Japan. Among other indicators, North American semiconductor equipment bookings rebounded in the last quarter of 2005 (Exhibit 13). High tech industrial production showed strong quarter on quarter growth in the latter part of 2005 in both developed economies and in East Asia. East Asian high tech exports were also strong in the second half of the year.

Looking forward, the prospects for continued expansion in high tech markets seem reasonably good,

Exhibit 13



In general industry inventories and capacity levels do not appear to be excessive. In the semiconductor sector the Semiconductor Industry Association notes that overall capacity utilization increased from 90 percent to 92 percent in the fourth quarter of 2005, while utilization of leading-edge capacity (defined as facilities capable of producing 0.12-micron and finer geometries) increased from 97 percent to 99 percent. With recent forecasts suggesting that capital expenditures will grow between 4 and 6 percent in 2006, and semiconductor end markets expected to grow by about 8 percent in the year, the SIA does not foresee any excess capacity issues in 2006. [8]

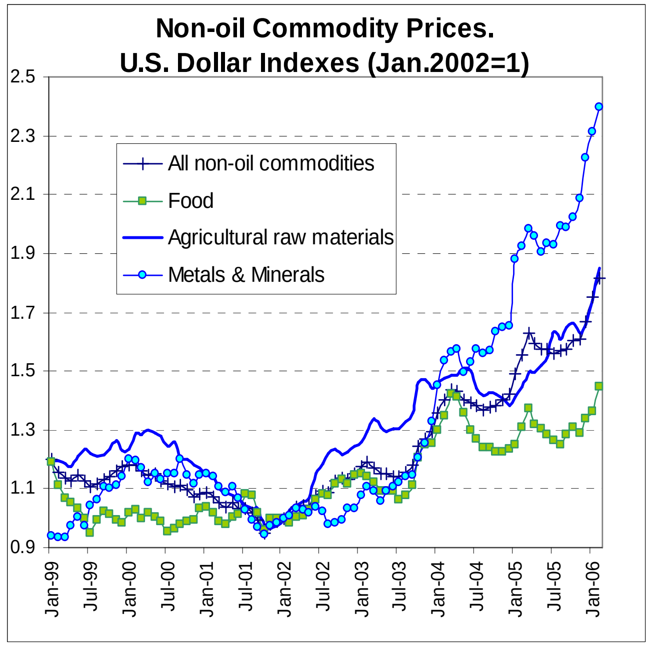
Non oil commodity markets

The cyclical upswing in non-oil commodity prices that began in 2002 appears to have entered upon a new leg in recent months. The Bank's non oil commodity index had been relatively flat in the middle part of 2005, after having risen by around 60 percent since the start of 2002. Prices renewed their upswing after August though, increasing nearly 16 percent in dollar terms by February 2006, with all major categories of commodities – metals and minerals, food and agricultural raw materials – joining in. (Exhibit 14). This pattern seems broadly consistent with the slowdown in world growth that occurred in late 2004 and the first part of 2005, followed by stronger growth in the second half of the year.

Metals and minerals prices have shown most buoyancy over the last six months, climbing about 20 percent in dollar terms. Prices for metals like copper and zinc have surged to record levels on expectations that markets will remain tight this year, due to chronically low inventories, strong demand (notably from China, where import growth revived in late 2005 and early 2006), and various supply difficulties. An exporter of both minerals and oil like Papua New Guinea has therefore enjoyed multiple terms of trade gains from higher mineral exports, on top of gains from higher oil prices. In a mineral exporting oil importer like Mongolia, on the other hand, high copper prices have helped defray the bill for more costly oil. In industrial economies like Korea that import both minerals and oil, higher prices have added to the income losses arising from higher oil prices.

Among agricultural raw material exports of interest to East Asian economies such as Indonesia, Malaysia, Thailand and Vietnam, rubber prices rose 28 percent in the six months to February 2006, supported by weather related supply shortages in Malaysia and Thailand, continued growth in demand from China and Japan and high oil prices, which have pushed synthetic rubber prices higher. Price movements for food commodities of particular interest to East Asian economies have also been on the rise, though usually at more moderate rates than metals and rubber. Coffee is a significant export in economies such as Indonesia, Lao PDR, Papua New Guinea and Vietnam. Coffee price rose 10-20 percent in the six months to February (depending on type), due in part to weather related supply problems in Brazil and Vietnam, which together now account for about half of global supplies. Prices for rice, a significant export item in economies such as Thailand and Vietnam, were up about 7 percent in the last six months. Prices for edible oils, a significant export item in economies such as Indonesia, Malaysia and Thailand have, were also up 7-8 percent over this period.

Exhibit 14



Oil markets

After climbing quite steadily for almost two years, world oil prices appear to have entered a more uncertain phase in the last quarter of 2005 and the first quarter of 2006, fluctuating in a range between \$55 and \$63 a barrel (in monthly average terms). [9] (Exhibit 15). Having spiked in the wake of Hurricane Katrina in the United States, prices fell by more than \$5 a barrel in the fourth quarter of 2005 as a result of releases from IEA and US emergency reserves, and reduced demand. Prices spiked once more to around \$63 in January 2006 because of concerns about politically

[8] SIA. (March 2, 2006). "January Chip Sales up 7 percent over 2005". http://www.sia-online.org/pre_release.cfm?ID=398

[9] This reference price is an average of Brent, Dubai and West Texas Intermediate (WTI) crudes. This average has generally been lower than the more widely reported WTI price, which averaged over \$61.5 in February, for example. Exceptionally strong demand for light crudes like WTI over the past two years, limited light crude production capacity among OPEC Arab members and limited refining capacity for light crudes have boosted the price differential for light crudes over heavier crudes like Dubai. The WTI-Dubai differential averaged over \$7 a barrel in 2005, compared to a more normal \$3-4. The price differential fell back to \$4 in February 2006, suggesting some easing in underlying market imbalances.

based supply disruptions in producing countries like Iran and Nigeria, as well as weather related production difficulties in some other countries, before easing back to less than $60 in February. In real terms (relative to the U.S. consumer price index) crude oil prices over the last 6-9 months have remained 25-30 percent less than previous record levels in the 1979-80 oil price shock. (Exhibit 16). Although real prices at these levels have had less of an adverse impact on the world economy than generally expected, significant increases beyond this level could be expected to exact a more severe cost than hitherto.

Exhibit 15

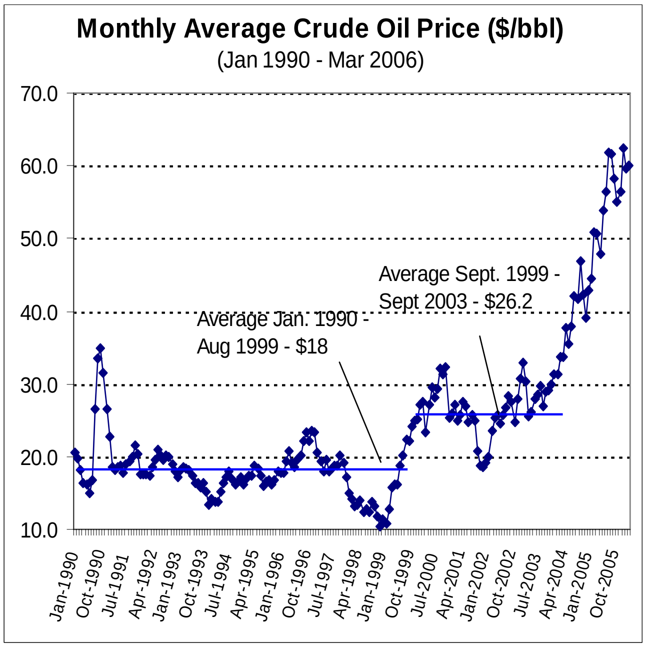
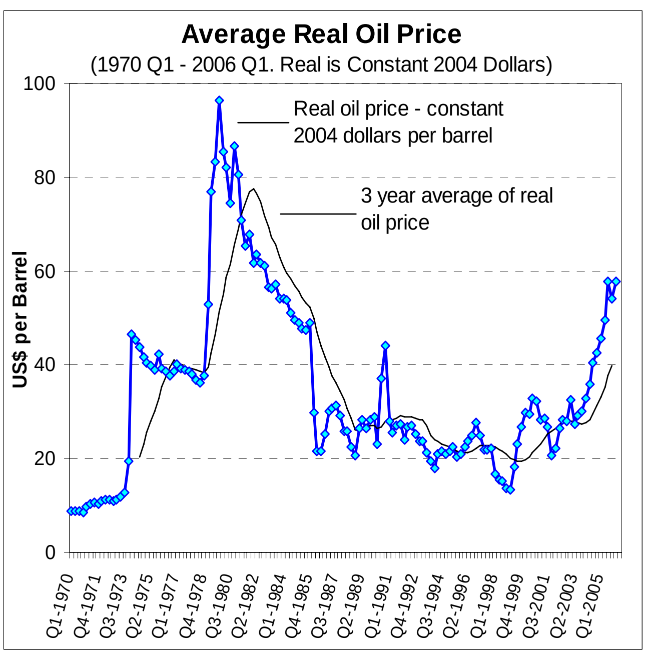


Exhibit 16



Looking forward, World Bank projections look for oil prices to gradually decline from current levels, averaging $59 per barrel in 2006 and $54 in 2007. (Note however that the forecast 2006 price would still be around 10 percent higher than the average price in 2005). Underlying the expectation of gradual declines from current levels is the view that, while demand-supply factors are fairly evenly balanced at present, over time growing supply capacity will gain the upper hand over demand. Nevertheless, given the unusually narrow margin of effective spare production capacity in OPEC at present, the market remains highly vulnerable to concerns about politically driven disruptions of supply, for example an escalation of conflict with Iran, or internal political instability in a major OPEC oil producer, or to other unexpected supply or demand shocks.

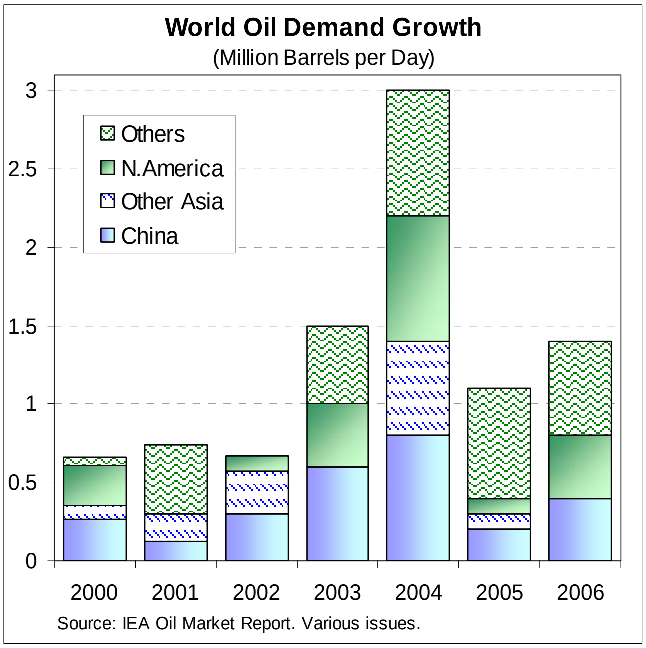
On the demand side of the market, continued robust world economic growth is likely to support increases in world oil demand of 1-2 mb/d (million barrels per day) in the near term. Such increases would be significantly greater than demand growth in the early part of this decade, but would, however, be rather less than the record 3 mb/d demand increase seen in 2004, which was a primary driver for the surge in oil prices at that time. (Exhibit 17). The International Energy Agency (IEA) has in fact scaled back its estimates of world demand growth compared to six months ago. Demand growth slowed quite sharply in 2005, falling to a little over 1 mb/d. In China severe power shortages in 2004 had caused a sharp rise in demand for oil for power generation, but in 2005 demand for oil for this purpose fell sharply as coal and hydro powered generation capacity came on line. Recent information also suggests that oil demand growth has slowed sharply in South East Asia, where retail product prices have risen sharply in economies like Indonesia and Thailand which eliminated or reduced fuel subsidies during 2005. (These policy changes were discussed in detail in the November 2005 East Asia Update). Looking forward, the IEA projects a world demand increase of 1.4 mb/d in 2006, led by stronger demand growth in faster growing parts of the world economy such as China and North America. The continued adjustment to the removal of fuel subsidies is however expected to curb demand growth in other Asian economies. The projected 2006 demand increase for the world is rather less than the 1.75 mb/d increase projected six months ago.

Supply disruptions played a bigger role in supporting price increases during 2005. Non OPEC oil production remained flat at 50.1 mb/d due to the impact of Hurricanes Katrina and Rita on US Gulf Coast production, as well as unexpected production difficulties in the FSU, the North Sea and elsewhere. During 2006, however, planned capacity expansions in the U.S., Canada, Brazil, Norway, Russia, Azerbaijan and several African countries should result in non OPEC supply increasing by 1.3 mb/d, almost sufficient to cover the entire expected increase in world demand, leaving the projected net call on OPEC production almost unchanged.[10] Sustainable OPEC production is in

[10] International Energy Agency. Oil Market Report. February, March 2006.

fact also projected to increase by 1 mb/d, which should allow a build up in global inventories or in the margin of spare production capacity. Overall investment spending on upstream production capacity is now estimated to be rising at 13-15 percent, up from 5-7 percent earlier. [11]

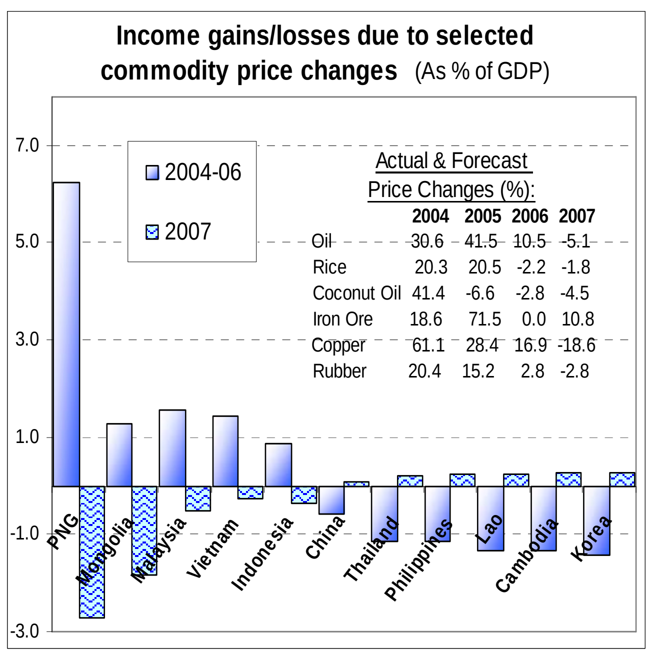
Exhibit 17



In East Asia higher oil prices are estimated to have generated an average income loss due to worse terms of trade of about around 0.5 percent a year in the three years 2004-06. Within the region net oil exporters such as Malaysia, Vietnam and Papua New Guinea are estimated to have received windfall gains from 0.6 percent of GDP a year (Malaysia) to a little over 2 percent a year (Papua New Guinea). These gains were further augmented by rising prices for these economies' non-oil commodity exports. (Exhibit 18). On the other hand significant net oil importers like Cambodia, Korea, Lao PDR, Philippines and Thailand are estimated to have experienced terms of trade losses from higher oil prices of 1-1.5 percent of GDP on average in these three years. For an economy like Thailand, there was some offset from higher prices for its non-oil commodity exports. China is estimated to have experienced more moderate income losses of about 0.4 percent of GDP per year. The ultimate impacts on growth, while significant, are likely somewhat more muted than these first order terms of trade effects, since most economies are also able to support expenditures through some reductions in national savings rates, running down of current account surpluses, drawing on foreign reserves or access to foreign financing.

Looking forward, World Bank projections are for both oil and non-oil commodity prices to show modest declines in 2007. This would imply some reversal of the income effects experienced in the last few years, with some relief for the net oil and commodity importers, and losses for the net commodity exporters. Such losses would be a particular concern for some of the smaller low income economies that are heavily dependent on a few primary commodities for export revenues. For a net oil and non-oil commodity exporter like Papua New Guinea, losses could amount to 2-3 percent of GDP in 2007. How well net commodity exporters are able to manage this more difficult environment will depend in part on how prudently they managed their resources during the preceding 'fat' years. Here the indications are that some of the small net commodity exporters have indeed used the terms of trade based income gains of recent years to increase net savings and start reducing liabilities, rather than, as might have occurred in previous decades, to increase consumption or wasteful and unprofitable investments. In Papua New Guinea, for example, the government fiscal balance moved from deficit to a surplus around 2 percent of GDP in 2005. The government is using the surplus to pay down debt arrears, restructure debt to longer term maturities and to finance its stake in the PNG-Australia Gas Pipeline project. In Mongolia the government's fiscal balance has swing from a deficit of 6 percent of GDP in 2002 to a surplus near 3 percent of GDP in 2005. In Timor Leste the government has established a Petroleum Fund to collect all petroleum revenues and manage them in a transparent and prudent manner.

Exhibit 18



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[11] Claude Mandil. "The Implications of the Oil Market Events of 2005". (February 2006). http://www.iea.org/Textbase/speech/2006/Mandil/InstituteEconAffairs.pdf.

Trade policy developments

WTO developments

The Sixth WTO Ministerial meeting in Hong Kong last December achieved only modest results, although it did set out a road map for the conclusion of the Doha round of global trade talks. There is recognition, though, that it will be extremely challenging to achieve consensus on the most divisive issues remaining in the negotiations (e.g., agricultural market access), especially given a very tight timetable if the negotiations are going to be completed before the expiry of the Trade Promotion Authority (TPA) in the US in July 2007.[12]

- In *agriculture*, the structure of formulas for market access and domestic support is taking shape. Export subsidies are to be phased out by 2013, with frontloading of cuts.
- On *non-agriculture market access (NAMA)* agreement was reached to adopt a so-called Swiss formula for tariff reduction commitments (meaning that higher tariffs will be subject to deeper cuts).
- On *services,* the Ministerial declaration adopted weakened language on developing countries' participation in negotiations – a pity since many developing countries would gain far more from services than from agricultural and manufactures liberalization. We look at potential gains for East Asia below.
- On *special and differential treatment* for least developed countries, the main result is agreement that developed-countries will provide duty and quota free access on a lasting basis by 2008, covering at least 97 percent of tariff lines. Lack of 100 percent coverage diminishes the value of this agreement for LDCs since it will allow exclusion of key products in which LDCs are competitive.

Despite the only modest progress in Hong Kong, WTO Director General Pascal Lamy is confident that a substantial agreement can indeed be reached in the limited time remaining: "Let me also tell you the widest shared secret in Geneva: All key players know they will have to move. The European Union knows it will have to move on agriculture market access. The United States knows it will have to move on agriculture domestic support. Emerging-market countries like Brazil, India, and South Africa know they will have to move on industrial tariffs and services. The good thing is that all of them have said they will move "in concert." All this makes me believe we could soon see the shape of a final deal." [13]

Vietnam's WTO Accession

Recent news suggests that Vietnam's negotiations for accession to the WTO are progressing well, raising prospects for completion of the process this year. Completion of the necessary bilateral agreements requires Vietnam and the other Members to agree on a variety of market-opening measures, including but not limited to lowering of key tariffs and increasing access for foreign telecommunications and financial services providers. As it moves towards completion of these negotiations, Vietnam is also preparing to enact the results of the agreements reached into domestic law. In the past acceding countries only had to agree on a timetable for legal implementation over a transition period. Recently however WTO Members have raised the bar on newly acceding countries by requiring them to implement WTO-compatible laws and regulations *prior* to accession. Since the Vietnamese National Assembly currently meets only twice a year, in May and October, virtually all of the remaining necessary implementing legislation will have to be ratified during the May/June session of 2006, a challenging legislative agenda.

Notwithstanding the challenges, the Vietnamese government at the highest levels has indicated that it is prepared to do whatever it takes to assure that WTO obligations are promptly implemented. The benefits of WTO membership for Vietnam are many. The first and perhaps most important is access to the Dispute Settlement Body, which would allow Vietnam to challenge other Members' antidumping practices. Vietnam is the target of many antidumping suits (e.g., catfish in the US and footwear in the EU) and cannot benefit from an international arbitrator. The second is the need of investors for consistent, predictable rules in Vietnam that can be assured with WTO membership (although so far Vietnam has received plenty of FDI despite non-membership). A third is that Vietnam would benefit from the expiry of the Agreement on Textiles and Clothing and the consequent elimination of textile and apparel quotas at the start of 2005, whereas at present it continues to be bound by its bilateral textile agreement with the United States.

Services trade negotiations: What's in it for East Asia?

Liberalization of services trade is one of the important proposals under negotiation in the present Doha Round of global trade talks. Yet many East Asian countries remain cautious. They perceive themselves as having relatively few service export interests outside tourism and the movement of natural persons, and fear that concessions in 'defensive' areas would see their services sectors overrun with foreign multinationals, to the detriment of indigenous firms. They have been strongly in favor of developing an emergency safeguard mechanism in services to protect

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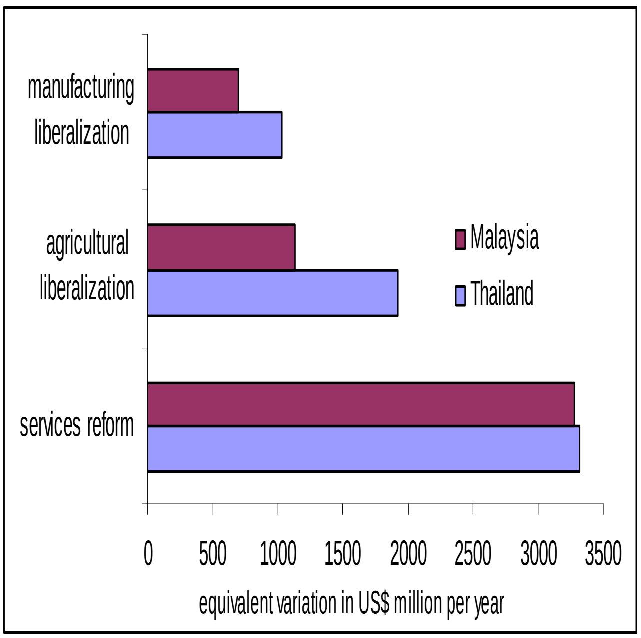
[12] Congress has given authority to the President to negotiate trade agreements (with a yes/no vote from Congress but no interference in the terms of the agreements) until July 2007.

[13] Pascal Lamy. (2006). "The Doha Development Agenda: Sweet Dreams or Slip Slidin' Away?" February 17. Speech at the Institute for International Economics, Washington D.C..http://www.iie.com/publications/papers/paper.cfm?ResearchID=598

against this outcome. Recent World Bank research suggests however that East Asian countries stand to secure substantial economic gains from services liberalization. The gains to Malaysia and Thailand, for example, could far exceed those from agricultural or manufacturing trade liberalization. (Exhibit 18).

There are three potential sources of gain from full services trade reform. First, there are potential benefits from greater foreign participation in the local economy. For example, a recent study estimates that loosening controls on foreign entry and operations in the distribution sector in Malaysia could reduce the cost of distribution services by around 8 per cent, while greater foreign entry in professional services could cut costs in that sector by 12 percent.[14] Similarly, loosening the remaining foreign equity limits in ports and local shipping in Vietnam would do much to improve the quality of its poor infrastructure base in this area.[15]

Exhibit 18
Welfare implications of Services Liberalization



Second, there are benefits from removing general regulatory impediments that impede the operations of both locally-and foreign owned businesses. For example, restrictions on foreign and domestic participation in wholesale and retail trade in Thailand may have raised real resource costs in the sector by about 4 percent each. Given the size and key role of the distribution sector, these restrictions would impose a significant economy-wide cost.

Third, there are benefits from regulatory reforms that promote competition among both locally-owned and foreign businesses, especially where such competition can encourage market participants to find new, lower cost ways of doing business. For example, reforms to Thailand's regulatory regime in electricity generation that encourage such competition could reduce the costs of electricity generation by up to 11 percent.[16]

Countries are sometimes concerned about job losses that might occur when services sectors are opened to foreign competition. However research suggests that the healthy underlying rates of growth in East Asia of 5-8 percent would be more than adequate to create new jobs that offset such job losses. In Thailand, a growth rate as low as 2.6 percent would be sufficient to ensure that employment pressures translated into a slower rate of employment growth in the worst affected sectors, rather than an absolute contraction in employment. The comparable figures are 2 percent in Vietnam, and less than a percent in Malaysia.

Which sectors would yield the largest gains from liberalization? The studies cited here suggest that the policy priorities appear to be in retail and wholesale trade, logistics and the professions (a part of business services), both because these sectors are large, and because trade barriers in these sectors raise costs and reduce productivity in other parts of the economy which use these services as business inputs. Reform in air passenger transport and electricity generation could also yield significant welfare gains, in this case not because these sectors are large in themselves, but because the trade barriers in these sectors tend to be cost-escalating in the rest of the economy. The fact that cuts in services trade barriers lead to increased productivity in the rest of the economy has an important implication for the strategy of trade liberalization: most of the gains from services opening can be gained by unilateral liberalization; they do not depend on the rest of the world also liberalizing its own services sectors. This is a different situation from that in agriculture and manufactturing, where more of the potential gains depend on securing greater market evidence abroad. (See, for example, Dee 2004a; *op. cit*).

Balance of payments trends and financial markets

Foreign exchange reserves in emerging East Asia continued to rise in 2005, but at a significantly slower pace than in the recent past. Reserves in the region's nine largest economies increased to $1697 billion by the end of 2005, an increase in absolute terms of $241 billion, which however

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[14] Dee, P. 2004a, 'Measuring the cost of regulatory restrictions on services trade in Malaysia', background paper for the study 'Improving the investment climate by reducing the regulatory burden in Malaysia', World Bank, September.

[15] Dee, P., Duc, L.T. and Hiep, D.T. 2005, 'Evaluating Vietnam's WTO accession offer in services', World Bank, May.

[16] Dee, P. 2004b, 'Cost of services trade restrictions in Thailand', background report to the 'Productivity and investment climate assessment in Thailand', World Bank, September.

was rather smaller than the increase of $336 billion seen in 2004. (Exhibit 19 and Table 5). In growth terms, emerging East Asian reserves grew by 16.6 percent in 2005, down from 30 percent in 2004.

As Table 5 indicates, most of the reserve accumulation in the region was contributed by China, where reserves increased by a little over $200 billion, about the same as in 2004. In most of the other main economies of the region, however, reserve accumulation fell sharply compared to 2004, or, more broadly, compared to the recent period of large reserve accumulation in 2002-04.

Exhibit 19

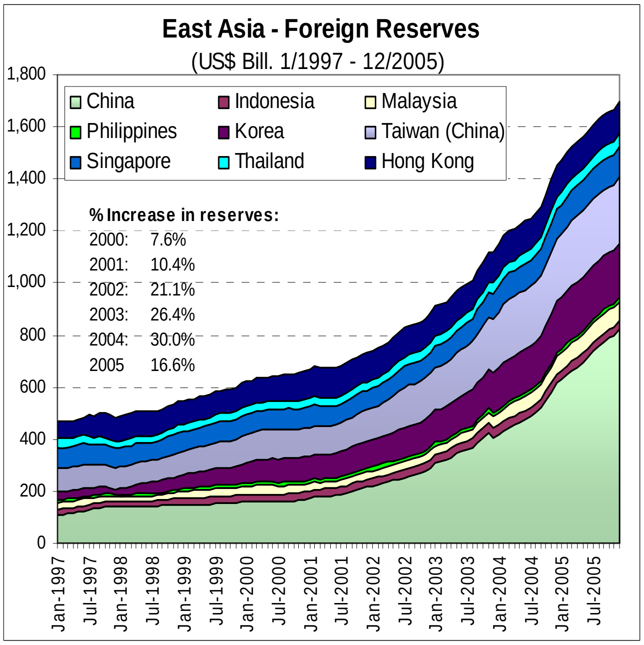


Table 5. Change in Reserves (US$ Bill.)

	2002	2003	2004	2005
East Asia	154.3	234.1	335.7	241.2
China	75.5	117.0	206.3	207.0
S.E. Asia	13.3	18.0	28.9	7.0
Indonesia	4.0	4.3	0.0	-1.6
Malaysia	3.7	10.4	21.8	3.8
Philippines	-0.1	0.3	-0.5	2.8
Thailand	5.7	3.0	7.6	2.0
NIEs	65.4	99.1	100.5	27.1
Hong Kong	0.7	6.5	5.2	0.7
Korea	18.6	33.9	43.7	11.3
Singapore	6.6	13.7	16.5	3.6
Taiwan, China	39.4	45.0	35.1	11.6

Turning next to look at proximate causes, the main factor resulting in the reduced pace of reserve accumulation in East Asia in 2005 appears to be a significant decline in net capital inflows to the region. As a matter of definition the change in a country's foreign exchange reserves is equal to the sum of the balances on its current account and its capital account (together with any errors and omissions). Tables 6 and 7 below summarize regional current accounts and capital accounts respectively (the latter derived simply as the difference between the change in reserves and the current account).

Table 6. Current Account Balances (US$ Bill.)

	2002	2003	2004	2005
East Asia*	125	161.1	183.3	235.6
China	35.4	45.9	68.7	129.1
S.E. Asia	27.2	30.6	25.7	19.3
Indonesia	7.8	8.1	1.6	0.9
Malaysia	8	13.3	14.9	20.6
Philippines	4.4	1.3	2.3	1.7
Thailand	7	7.9	6.9	-3.7
NIEs	62.3	84.6	88.9	87
Hong Kong	12.4	16.5	15.9	21
Korea	5.4	11.9	28.2	16.6
Singapore	18.9	26.9	26.3	33.2
Taiwan, China	25.6	29.3	18.5	16.2

* Estimates for China, Malaysia, Philippines and Hong Kong in 2005. Indonesia data for 2004 and 2005 are in new BOP format.

Table 7. Net Capital Inflows (US$ Bill.)*

	2002	2003	2004	2005
East Asia	29.2	73	152.4	5.6
China	40.1	71.1	137.6	77.9
S.E. Asia	-13.9	-12.6	3.2	-12.3
Indonesia	-3.8	-3.8	-1.6	-2.5
Malaysia	-4.3	-2.9	6.9	-16.8
Philippines	-4.5	-1	-2.8	1.1
Thailand	-1.3	-4.9	0.7	5.7
NIEs	3	14.5	11.6	-59.8
Hong Kong	-11.7	-10	-10.7	-20.3
Korea	13.2	22	15.5	-5.3
Singapore	-12.3	-13.2	-9.8	-29.6
Taiwan, China	13.8	15.7	16.6	-4.6

* Sum of all capital account flows plus errors and omissions. Derived as change in reserves less current account.

Looking first at emerging East Asia's aggregate current account balance, Table 6 indicates that it increased substantially to an estimated $236 billion in 2005 from $183 billion in 2004. At the regional level that was almost sufficient by itself to finance the change in the region's foreign exchange reserves in 2005. The largest increase occurred in China, where the current account surplus almost doubled to an estimated $129 billion, the result mainly of a sharp decline in import growth in the first half even as export growth came in at 30 percent year on year for much of the year (in nominal dollar terms). Malaysia's current account surplus also surged, in part as a result of higher prices for oil and other primary commodity exports, as well as slower import growth. In the majority of other main economies current account balances fell in 2005, due in part to surging oil import bills, but were still sufficiently large to cover the reduced pace of foreign reserve accumulation in the year.

The much more striking change in the region's balance of payments was however in its capital flows. Table 7 indicates that regional net capital inflows of all kinds (together with errors and omissions) fell from $152 billion in 2004 to a mere $6 billion in 2005. The decline in net inflows (or increase in net outflows) occurred in all the main economies other than the Philippines and Thailand. Disentangling the various kinds of capital flows, Table 8 suggests that net foreign direct investment (FDI) inflows actually rose, with significant gains in South East Asia and some of the NIEs, while net portfolio capital flows were reasonably stable. The major swing thus occurred in the "other" category of the capital account, comprising instruments such as loans, deposits, trade credits and financial derivatives, among others. Other flows (together with errors and omissions) swung from net inflows of around $118 billion in 2004 to a net outflow of perhaps $60 billion in 2005. Most of the main economies in the region experienced this swing in other inflows to varying degrees.

Table 8. Net Capital Flows by Type (US$ Bill.)*

	FDI		Portfolio		Other**	
	2004	2005	2004	2005	2004	2005
East Asia	49.4	77.7	-14.8	-12.1	117.8	-59.8
China	53	50	19.7	10	64.9	17.9
S.E. Asia	2.4	9.7	13.7	13.8	-12.9	-35.8
Indonesia	-1.5	2	4.4	6.1	-4.5	-10.6
Malaysia	2.6	0.7	8.9	-3.2	-4.6	-14.3
Philippines	0	1.1	-1.7	2.1	-1.1	-2.1
Thailand	1.3	3.3	2.1	4	-2.7	-1.6
NIEs	-6	18	-48.2	-35.9	65.8	-41.9
Hong Kong	-11.7	7.7	-39.3	-16.3	40.3	-11.7
Korea	4.6	0	8.6	-1.3	2.3	-4
Singapore	6.3	14.6	-11.3	-13.7	-4.8	-30.5
Taiwan, China	-5.2	-4.3	-6.2	-4.6	28	4.3

* Estimates for China, Malaysia, Philippines and Hong Kong.
** Inclusive of errors and omissions.

The turnaround in other capital inflows to emerging East Asia is consistent with a number of key macroeconomic and financial developments in the region. As discussed further in the next sub-section on financial markets, short term interest rates in East Asia have for some years been higher on average than U.S. dollar short term rates. With the tightening of U.S. monetary policy after mid 2004, however, this differential in interest rates has been eroded and in several cases even reversed, removing one important incentive for short term deposit inflows to the region. Second, substantial speculative short term capital flows were attracted to East Asia in 2004 by the prospect of capital gains to be made from exchange rate revaluation or floating in countries with hitherto pegged exchange rates, such as China and Malaysia. However both China and Malaysia undertook small revaluations of their currencies in mid 2005, followed by a gradual or 'crawling' appreciation at variable rates. This has introduced a modicum of uncertainty about the future course of these exchange rates, rather than the 'one way bet' that appeared to exist previously, which may have contributed to dissipating some of the speculative fever that existed earlier.

Financial markets

Short term interest rates in emerging East Asia have been rising over the course of the past one and a half years as central banks in the region have tightened monetary policy to avert both potential increases in core inflation and excessive exchange rate volatility. Countries such as Hong Kong, Thailand and Singapore began raising policy interest rates after the middle of 2004, along with the turn to monetary tightening in the United States. Others joined in over the course of 2005. In Indonesia the turn to tightening came in the third quarter, after a narrowing spread with U.S. rates contributed to capital outflows, a fall in reserves and a significant weakening of the currency. The Bank Indonesia policy rate was raised in a number of steps to 12.75 percent by year end, which successfully stabilized the exchange rate and staunched capital outflows. In Korea and Malaysia monetary tightening began even later, towards the end of 2005.

Table 9. Inflation (% change year ago)

	2005 Q1	2005 Q2	2005 Q3	2005 Q4	Latest Month
	"Headline" Consumer Price Inflation				
China	2.8	1.7	1.3	1.4	0.9
Indonesia	7.8	8.0	8.4	17.8	17.9
Korea	3.2	3.0	2.4	2.5	2.3
Malaysia	2.5	3.0	3.4	3.3	3.4
Philippines	8.4	8.2	7.1	6.9	7.6
Thailand	2.8	3.7	5.6	6.0	5.6
	"Core" Inflation				
China	0.6	0.3	0.9	1.1	1.0
Indonesia	6.8	7.1	6.9	6.6	9.3
Korea	3.1	3.0	2.5	2.0	1.9
Philippines	7.4	8.0	7.5	6.6	6.1
Thailand	0.6	0.7	1.1	2.2	2.4

Headline consumer price inflation rates have trended higher in several economies of the region, fueled principally by higher oil prices and policy decisions to allow more pass through of fuel costs to consumers, as well as demand pressures arising from several years of generally robust growth since 2001. Indonesia's bold policy decision to slash fuel subsidies contributed to a sharp rise in year on year headline CPI inflation to 17-18 percent at the end of 2005 and in early 2006, for example, while in Thailand it picked up to 5-6 percent during this period. (Table 9). Year on year rates of core price inflation also picked up in these two economies. Monetary policy tightening is however expected to prevent a persistent or longer term increase in core inflation. By early 2006 the three month on three month rates of core inflation had eased in both Indonesia and Thailand.

Exhibit 20

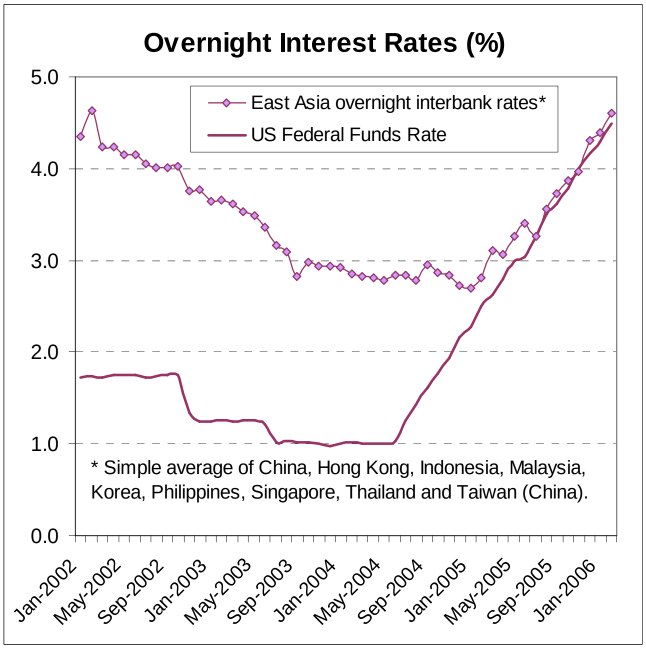
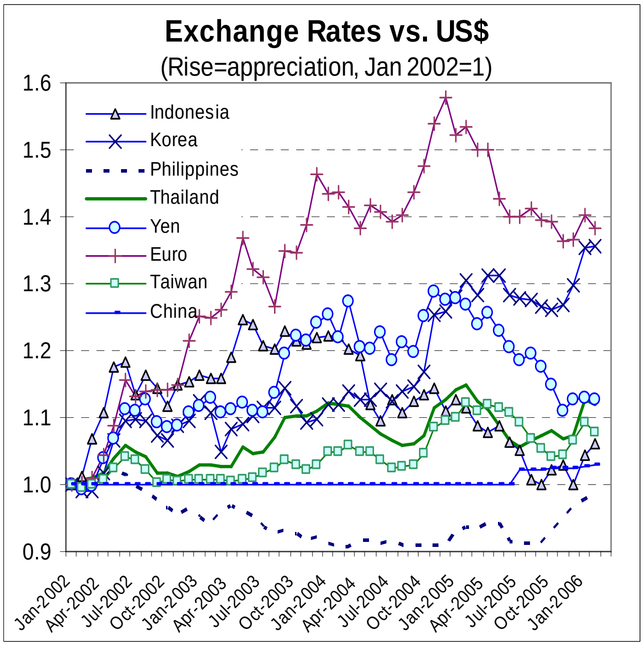


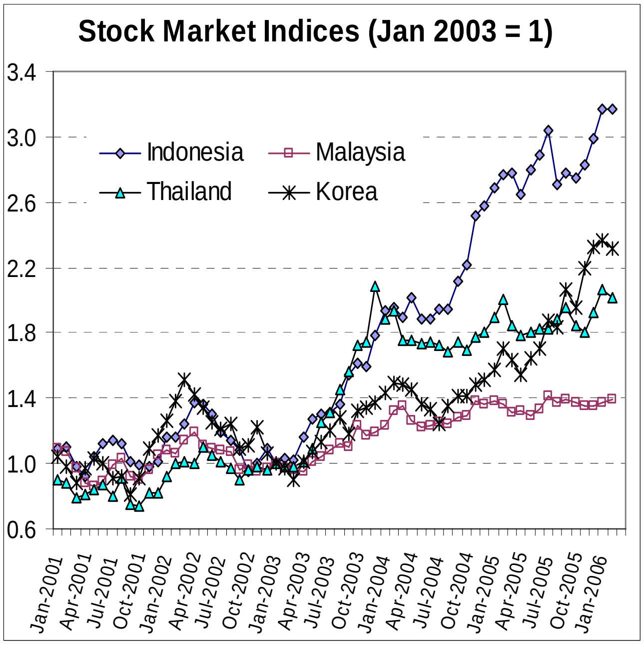
Exhibit 21



Despite the rise in short term East Asian interest rates, the positive spread between these rates and U.S. interest rates has generally narrowed or reversed. (Exhibit 20). As noted above, narrower or negative spreads with U.S. rates are likely to have contributed to a sharp slowing in the pace of capital inflows to the region in 2005, as well as to some moderation in the appreciation of East Asian currencies against the U.S. dollar. Thus most economies with some form of managed floating exchange rate regime experienced some depreciation against the dollar in the first part of the year, before some renewed appreciation towards the end of 2005 and early in 2006. (Exhibit 21). The median percent change in the exchange rate of these currencies against the dollar between the start of 2005 and February 2006 was approximately zero.

Despite higher short term interest rates, robust growth and improving corporate profitability have supported continued gains in most regional stock markets. Equity indexes in the nine major economies (including China) rose on average by 16-17 percent in local currency terms between the start of 2005 and February 2006. This followed average gains of about 12 percent in 2004 and 42 percent in 2003. The best performing stock market in the whole period since the start of 2003 has been Indonesia, followed by Korea and then Philippines and Thailand in joint third place. (Exhibits 22 and 23).

Exhibit 22



Spreads on global emerging market debt have fallen dramatically since 2001-2002, when, at points, average spreads were as high as 1000 basis points. Since then a search for higher yields among global investors, improving conditions in many economies and growing confidence in the sustainability of reform policies have all contributed to sustained and dramatic declines in average spreads, which fell to as low as 180 basis points by early March 2006. In East Asia spreads in the main economies have fallen to about 116 basis points on average (compared to 200 in Latin America). In economies such as China, Korea, Malaysia and Thailand, spreads have dropped to less than 75 basis points.

Exhibit 23

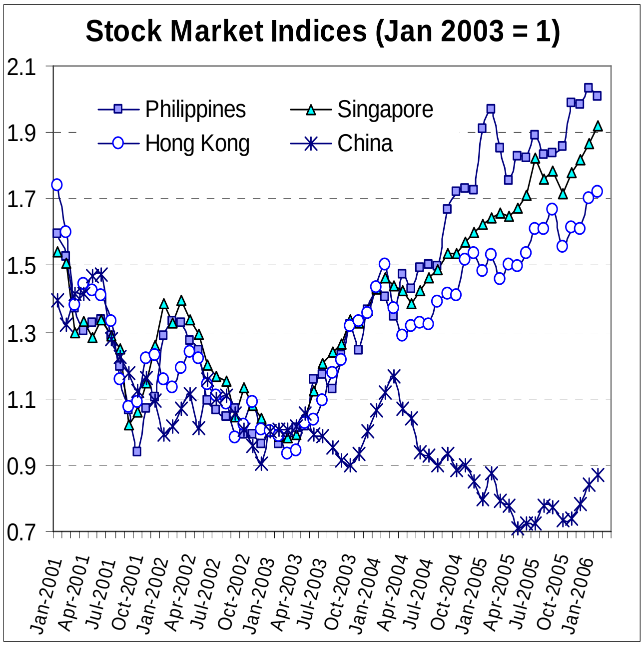
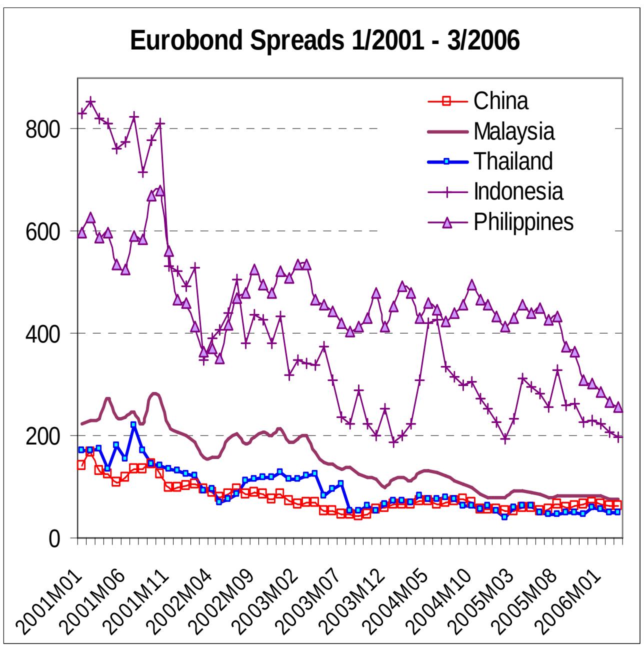


Exhibit 24



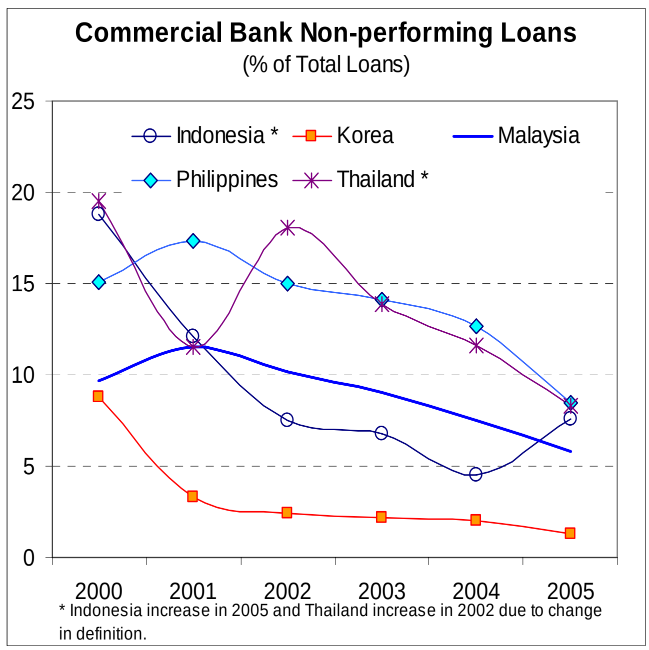
Spreads in Indonesia and Philippines have traditionally been much higher because of higher external and public sector indebtedness, as well more persistent concerns about macroeconomic and political stability, but have also been trending lower over the last 4-5 years. The last few months saw further steep decline in Philippines' spreads, as fiscal outcomes have turned much better than expected. (Exhibit 24). Vietnam successfully issued its first international bond in October 2005, increasing the size of the issue from a planned $500 million dollars to $750 million because of stronger than expected market interest. The ten-year dollar-denominated bonds were priced to yield 7.125 percent or 256 basis points above comparable ten-year US Treasuries. Since then the spreads have tightened considerably, with the yield coming down to 6.374 percent in early March.

Domestic trends and policy challenges

Recent financial sector trends and issues

Most indicators of financial sector performance in East Asia continued to improve over the course of 2005, including measures of asset quality, capital adequacy and bank profitability. Non-performing loans (NPLs) continued to move lower in most economies, supported by gradual improvements in corporate profitability in the region (see discussion in preceding section), as well as remaining financial and corporate restructuring. (Indonesia was an exception, where tighter loan classification rules contributed to an increase in the reported NPL ratio of commercial banks). (Exhibit 25). As Table 10 indicates, bank interest margins, a key determinant of profitability, generally edged upwards in 2005, though to a much lower extent than in 2004. The same pattern held for capital adequacy.

Exhibit 25



Among developments at the country level:

- *China.* Under the terms of its WTO accession agreement *China* is due to fully open its banking sector to foreign competition by the end of 2006. Various efforts are underway to strengthen the domestic banking system before this event. Last year three of the four large state owned commercial banks (SOCBs) were recapitalized and restructured, with a public capital infusion of $75 billion, and a carving out of non-performing loans, which were transferred to asset management companies. In October one of the four, China Construction Bank, completed a high profile public offering on the Hong Kong stock exchange, and two others are due to make public offerings in 2006. It is hoped that equity and management participation by strategic foreign investors will help strengthen corporate governance, management and operational efficiency at the Chinese banks. Responding to more stringent regulations on capital adequacy and risk management, second tier banks have also speeded up efforts to replenish capital, restructure bad debt and bring in foreign equity participation. About 15 second tier banks have received foreign participation and more are in the process of doing so. As regards overall asset quality of commercial banks, reported NPLs of commercial banks fell to 8.6 percent of total loans at the end of 2005 from 13.2 percent at the end of 2004, mainly as a result of public recapitalization of the largest SOCBs, although private sector estimates of the level of bad debts are generally considerably higher. Standard and Poor's, for example, estimates impaired assets at about 25 percent of the credit portfolio.[17]

Efforts to strengthen China's capital markets have also gained pace, in particular reforms to achieve floating of the existing large blocks on non-tradable shares on the A-share market. The China Securities Regulatory Commission (CSRC), in conjunction with local governments, is pushing listed companies to complete share restructuring within the next six months. By the end of 2005 421 listed companies had completed intra-shareholder negotiations to floating their non-tradable shares - these accounted for 31 percent of the total listed companies, and 35 percent of the total capitalization of China's stock market. Another 400-500 listed companies are in the process of negotiation and are expected to complete this exercise by a May 2006 target date. CSRC expects to start permitting new IPOs by mid-2006, with at least 2/3 of the listed companies having completed the share reform. The floating of non-tradable shares would clearly increase the volume of available investment instruments in the Chinese capital market.

- In *Indonesia* 2005 was a challenging year for the banking sector. Net interest margins narrowed slightly to 5.6 percent by the end of 2005, due to rising deposit rates, increased competition between banks, and a narrowing spread with lending rates. Bank profitability as measured by Return on Assets and Return on Equity also dipped because of increased loan loss provisioning as a result of more stringent regulations on loan classification. Net interest margins and profitability measures remain high relative to most other East Asian economies though. Tighter loan classification also contributed to an increase in the reported NPL ratio of commercial banks from less than 5 percent at the end of 2004 to 7.6 percent at the end of 2005. The reclassification particularly affected state owned banks, whose NPL ratio was close to 15 percent at the end of 2005. On the policy front a new package of central bank regulations issued in January 2006 looks to strengthen various aspects of corporate governance and risk management in the banking sector. A number of measures to develop the country's financial safety net have also been implemented, including the launching of the Indonesian deposit insurance company in October 2005 and the establishment of a central bank emergency lending facility for systemic banks in December 2005.

Table 10. Financial Sector Ratios

	1998	2002	2003	2004	2005
		Interest Margins (%)			
East Asia	0.5	3.1	3.2	3.7	3.8
Indonesia	-8.3	4.1	4.6	5.9	5.6
Korea	1.5	2.9	2.8	2.8	2.7
Malaysia	4.0	3.3	3.1	3.0	3.1
Philippines	5.7	3.4	3.5	4.3	4.5
Thailand	-0.3	1.8	2.0	2.5	3.0
		Capital Adequacy Ratios			
East Asia	6.4	14.8	14.6	15.0	15.2
Indonesia	15.7	22.4	19.4	19.4	19.3
Korea	8.2	10.5	10.4	11.3	13.0
Malaysia	11.8	13.2	13.8	14.3	13.1
Philippines	17.5	15.6	16.0	17.4	18.4 [a]
Thailand	10.2	13.0	13.4	12.4	13.3

[a] September 2005. Source: National sources.

- *Korea's* domestic banks have continued to strengthen their financial position. The non-performing loan ratio fell to 1.2 percent at the end of 2005 from 1.9 percent in 2004. The non-performing loan ratio hit record lows for all categories, including corporate, household, and credit card loans. A drop in provisioning for non-performing loans and a sharp increase in non-operating income from securities investment gains drove up bank net income in 2005 by 52.4 percent a record Won 13.4 trillion. As a result of increased net income, the average capital adequacy ratio rose to a record 13 percent in December 2005 from 12.1 percent at the end of 2004. The financial health of the non-bank sector also improved. The combined profits of the six credit card companies also returned to positive territory during the course of 2005, thanks to a rise in credit card purchases and a decline in the delinquency ratio. The average credit card delinquency ratio declined to 9.8 percent at end 2005, down from 18.2 percent at the end of 2004.

[17] Standard and Poor's. Asia-Pacific Banking Outlook. January 2006.

- In *Malaysia* asset quality of the banking system strengthened further in 2005, but profitability stagnated. The commercial banks' NPL ratio declined further to 5.8 percent, from 7.5 percent at end-2004. NPLs of finance companies and merchant banks also fell. The capital position of the banking system remained strong, although with the risk-weighted capital ratio (RWCR) edged down to 13.1 percent, from 14.3 percent at end-2004, on account of stronger growth in risk-weighted assets driven by the inclusion of market risk in the capital adequacy framework (effective April 1, 2005) and higher lending. Pre-tax profits of the banking system remained unchanged from last year's level of RM12.6 billion. Meanwhile, the financial system is becoming more diversified, including through the development of Islamic financial institutions and products. Recently, the sub-sector has been further liberalized by allowing for the entry of new foreign players. The authorities are also strengthening regulations and supervision measures specific to Islamic financial transactions. In addition, the Islamic Financial Services Board (IFSB) is developing prudential, regulatory, and disclosure standards for Islamic finance with a view to promoting uniformity in best practices on the governance of Islamic financial institutions worldwide.

- Asset quality and profitability in the *Philippines* banking system continues to improve**.** The commercial bank NPL ratio fell to 8.5 percent by end 2005, much lower than the 2004 ratio of 12.7 percent. There was also a significant 19.8 percent reduction in the wider class of problem assets. Banks also increased provisioning levels. NPL and NPA coverage ratios at end 2005 were 78.4 percent and 42.1 percent respectively, significantly better than at end 2004. Net interest margins improved from 4.2 percent at end 2004 to 4.5 percent at end 2005. Banks continued to deploy the bulk of incremental deposits to government securities and credit growth to the private sector increased only marginally. In terms of policy developments, the central bank continues to develop regulations designed to facilitate transition to the Basel II international capital standards framework by 2007. Important issuances in the last six months include guidelines on risk management and on financial reporting.

- *Thailand's* official NPL numbers fell into single digits for the first time since before the Asian financial crisis, dipping to 8.3 percent at end 2005 from 11.6 percent at end 2004. NPLs declined in loans to most sectors, with the exception of construction and real estate. General retained earnings turned positive for the first time since 1998 and net profits were up approximately 19 percent since end 2004. Interest margins picked up to 3 percent from 2.5 percent at the end of 2004. On the policy front, the central bank continued to take steps toward its implementation of Basel II by end 2008. BOT has requested that all financial institutions prepare and submit by June 2006 their Basel II implementation plans as well as extensive explanations of the methods they plan to use to measure and control risk.

- In *Vietnam*, credit growth, which had climbed to over 40 percent by end-2004, slowed to under 30 percent towards the end of 2005. Given the growing demand for financial intermediation, the main concern with credit growth refers to its quality. Credible estimates of Non-Performing Loan (NPLs) are not yet readily available. However, based on projections from IAS audit data of the four large State Owned Commercial Banks (SOCBs), which make up over 70 percent of all credit to the market, the level of NPLs was estimated to be around 15% of all credit to the economy and over 7% of GDP. In April 2005, the State Bank of Vietnam (SBV) enacted a new set of standards on loan classification, which if applied and enforced fully, will bring the measure of loan quality closer to international practices. The SBV also enacted a new regulatory framework on capital adequacy, which is to be phased-in over three years. The current estimates of capital adequacy of the major banks are well below internationally accepted safe standards. The quality of risk management at the banks is weak, but is improving with the implementation of new credit processes, procedures, and systems. In terms of banking sector infrastructure, the bank payment system has vastly improved in recent years, reducing float (from up to 30 days in mid-1995 to less than 24 hours today), accelerating circulation of funds and increasing efficiency and convenience. There are now more than 1,100 ATMs in Vietnam, 2.1 million credit and debit cards and 17 banks offering credit cards. In addition, the strengthened payment system has facilitated over 20 percent growth in inward (formal) remittances to Vietnam, reaching over $4 billion in 2005.

Recent corporate sector trends and issues

Corporate data from the East Asian economies affected by the financial crises of 1997-98 suggest that the financial health of listed companies has continued to improve on several dimensions in recent years. Since corporate financial statement information for 2005 is still incomplete, the discussion in this section looks at trends through 2004, while the next East Asia Update in October will bring the story up to date through 2005.

Table 11 shows that median corporate debt-equity ratios for listed companies have generally fallen significantly in the post crisis period (2001-04) compared to the period of the crisis and its immediate aftermath (1997-00), as a result of corporate debt restructuring, a significant paying down of debt by firms and strengthening exchange rates. (The burden of foreign currency denominated debt soared due to massive devaluation of local currencies during the crisis). In general debt levels have also fallen well below those in the pre-crisis period 1994-96. Korea has seen the most dramatic reductions in firm indebtedness, with median debt equity ratios for listed companies now only around one third of pre-crisis levels (although small and medium enterprises still remain more prone to excessive debt levels). Thailand has also seen substantial declines in debt to below pre-crisis levels.

Broadly speaking, lower debt-equity ratios should render firms less vulnerable to volatile economic conditions that could drive them into insolvency and unable to service their debts (which will also generally leave firms cut off from external financing and unable to invest and expand operations in better times). While debt-equity ratios look at the structure of the firm's balance sheet, interest coverage ratios measure the impact of debt on the firm's income statement, showing the number of times the firm's profits cover interest payments on debt. (A low ratio indicates that firms are vulnerable to shocks that reduce profits and leave them unable to service debt). Table 11 shows that interest coverage has also generally improved in the post crisis period, with Korea and Thailand again showing the biggest gains. However interest coverage remains relatively low in Indonesia and the Philippines.

Table 11. Corporate Financial Ratios
(Listed Companies)

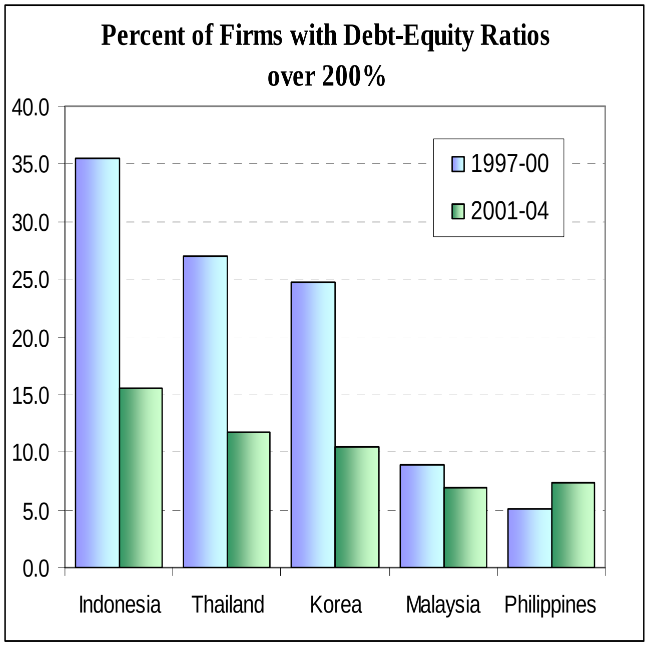
	1994-96	1997-00	2001-04	2003	2004
Debt to Equity Ratio (Median,%)					
East Asia	87	98	54	52	52
Indonesia	71	140	65	64	68
Korea	181	123	60	53	49
Malaysia	49	54	39	40	40
Philippines	39	61	51	45	55
Thailand	94	113	58	59	47
USA	56	64	65	63	54
Interest Coverage Ratio (Median)					
East Asia	4	1	3	4	4
Indonesia	3	1	2	2	2
Korea	1	2	3	3	4
Malaysia	6	3	4	5	5
Philippines	5	1	1	1	2
Thailand	3	2	6	7	9
USA	7	7	6	5	6
Return on Assets (Median, %)					
East Asia	8	3	5	5	5
Indonesia	9	4	5	4	4
Korea	6	5	5	5	5
Malaysia	8	3	4	4	4
Philippines	8	2	2	2	4
Thailand	7	3	8	8	9
USA	8	9	7	7	8

Source: Worldscope and World Bank staff estimates.

It is the case that average or mean debt-equity ratios in East Asia are generally higher than the medians shown in Table 11. This indicates the presence of a certain number of firms with extremely high levels of debt (in other words that the frequency distribution for firms' debt-equity ratios is skewed to the right). The proportion of firms with extremely high debt has however also been falling over time in most economies. (Exhibit 26).

Corporate profitability as measured by median Return on Assets (ROA) has generally been recovering from the sharp declines suffered in the crisis, but the pace of recovery has often been slow, with ROAs remaining below pre-crisis levels in the majority of cases. In part the gradual pace of improvement in profits may be linked to external shocks, in particular the dot com crash and steep downturn in the world high tech industry in 2001, which came on the heels of the financial crisis and severely affected growth in the very open and high tech dependent East Asia region. While information on corporate results in 2005 is only partial at present, it seems likely that profitability in the year may also have been hampered by high oil prices. The gradual pace of recovery in profitability is consistent with the only slow and erratic recovery of investment in the region.

Exhibit 26



Overall, while debt-equity ratios, interest coverage ratios and profitability have been moving in the right direction, there remain areas of vulnerability in the regional corporate picture, for example still relatively low interest coverage in economies like Indonesia and the Philippines, a still gradual pace in the improvement of corporate profitability and, linked to the latter, a continued hesitation in undertaking new business investment on a substantial and sustained scale.

A focus on policy and institutional reforms that can help entrepreneurs and firms address these vulnerabilities is clearly a priority for policy makers in the region. Many specific actions can be taken immediately to both cut the costs of doing business and to reduce uncertainty, corruption and arbitrariness by simplifying business regulation, cutting red tape and improving the transparency of procedures. Reforms to improve cost effective delivery of infrastructure and logistics services should yield high dividends. Continued efforts to address remaining private sector balance sheet vulnerabilities through financial and corporate restructuring remain worthwhile. Finally governments in the region are increasingly interested in ways of efficiently fostering greater innovation, technological upgrading and absorption of knowledge from abroad. We plan to study this subject in more depth in coming reports, but the next section at least introduces the subject by looking at some key empirical innovation trends in East Asia.

Before that, though, we look briefly at corporate sector developments at the country level:

- *China*. In recent years China has undertaken major efforts to restructure and reform state owned enterprises (SOEs), including a wave of privatization or 'ownership transformation' over the last 2-3 years. The number of SOEs has fallen from over 42000 at the end of 2002 to a little over 29000 at the end of 2005, while SOE employment has dropped from some 26 million to 19 million over the same period. As a result of restructuring efforts, SOE profit to sales margins rose to 7.5 percent in 2005 from 5.4 percent in 2002. The increase in SOE profits has also sparked debate on the need for a policy to govern dividend payments by SOEs (to their sole shareholder, the government), which would provide the government with greater flexibility in allocating SOE profits more efficiently, according to national needs.

Significant amendments to China's Company Law came into effect at the start of 2006. These include measures to strengthen shareholder rights and corporate governance, and to make it easier to start a new business by lowering minimum capital standards limited liability companies. How to find appropriate modalities for ownership transformation remains the subject of much debate and experimentation, especially on sensitive questions such as acquisition of ownership by existing managers or insiders. Perhaps not surprisingly for an economy undergoing such rapid structural change, a significant debate over the direction of reform policy emerged in local media over the past year, with many claims that the country has gone too far in the direction of markets and private property, while ignoring social "*gong ping*" (fairness, equity, justice).

The question of fostering "independent innovation" is prominent on the agenda for coming years. The State Council released its *"National Outline Plan for Medium and Long Term Development of Science and Technology (2006-2020),"* which emphasizes the central role of enterprises in undertaking innovation. A set of detailed policies was also announced, including increased budget support, tax incentives, improving financial services to hi-tech sectors, government procurement, protection of intellectual property rights; incentives for talented people; education reform; construction of innovation centers and international cooperation.

- *Indonesia*. Indonesia currently has one of the least business-friendly environments in the region - ranking below China, Malaysia, the Philippines, Thailand and Vietnam in terms of the ease of starting a business, weak contract enforcement, complex tax procedures, rigid labor regulations, corruption, a weak legal system and plenty of red tape. The government recognizes the problems and has made the investment climate one of its five priority reform areas. A new draft Investment Law is to be sent to Parliament soon. It creates a unified national law for both domestic and foreign investment, establishes the principle of equal treatment regardless of national origin and stipulates a clear non-discretionary investment negative list. A new Investment Climate Policy Package on March 1 streamlines procedures to start a business, resolves overlapping authorities between central and local governments, cancels a variety of bothersome local and regional taxes, accelerates customs clearance and aims to cut corporate income taxes from the current 30 percent to 25 percent by 2010. Other areas of progress include the President's high profile anti-corruption campaign, which has resulted in the prosecution of a number of current and former officials, judges and state owned banks.

- *Malaysia*. Efforts to improve the quality of Malaysian listed companies continued, including regulatory changes and tax incentives to encourage mergers and acquisitions (M&As), and measures to enhance the corporate governance and operational performance of Government-Linked Companies (GLCs). Khazanah, the Government's professionally managed investment holding company, has been entrusted with overhauling the management and functioning of leading publicly listed companies in which it has large equity stakes. Khazanah is reviewing the management of these listed companies, and introducing performance-based employment contracts. More difficult reforms lie ahead, including the possibility of sizeable lay-offs. Meanwhile corporate earnings growth slowed to around 7 percent in 2005, about half the rate previously expected. The recent performance of some of the largest GLCs has also been disappointing. Malaysian Airlines reported losses of RM1.3 billion (over $347 million) in 2005, the worst performance in 5 years. In January 2006 shares in Proton Holdings plunged to their lowest level in four years after Volkswagen called off plans to assemble and sell vehicles via the Malaysian carmaker. Meanwhile, the country's power monopoly, Tenega, is grappling with debts of around RM30 billion ($7.95 million), making it the largest borrower in foreign currency. Despite the downturn in corporate performance, the private sector raised $1.13 billion in fresh financing from 79 new initial public offerings in 2005. The ringgit bond market also continued to grow strongly in 2005, as companies sought to take advantage of the low interest rate environment. By end-2005, total outstanding ringgit bonds amounted to $109 billion, more than 20 percent higher than at end-2004, of which 56 percent were corporate bond issues.

- *Philippines*. The first quarter 2006 Business Expectations Survey conducted by the Central Bank showed a significantly more optimistic outlook than at any time since the survey began in 2002. Business confidence improved in all sectors with the construction and services firms being most positive about prospects in 2006. The most important reason for greater optimism was the improvement in the government's fiscal position in 2005, due to success in compressing expenditures, implementation of the expanded value added tax and improving tax collection. Two out of the three international ratings agencies also revised the sovereign debt outlook for the Philippines to positive in acknowledgment of the more favorable fiscal situation.

- *Vietnam*. The new Unified Enterprise and Investment Laws passed in 2005 should contribute to a substantial improvement in the investment climate in Vietnam. The laws are designed to create a level playing field for all types of businesses. Both private domestic enterprises and foreign invested enterprises will be governed by the same legislation. SOEs have been given a period of four years to move under its ambit. Foreign enterprises will be subject to the same registration procedures as domestic firms, and will be able to choose the form of corporate entity that is most suitable on business grounds. At present, they are only allowed to operate as limited liability companies. Foreign enterprises will be allowed to restructure, expand, or diversify their business rather than being limited to the specific lines in which their business was initiated. The ownership cap of 30 percent is proposed to be removed for most business lines. Around 38,000 new businesses were registered in Vietnam in 2005, and FDI commitments reached a record level of $6.3 billion. In January 2006 Intel announced plans to invest in a $600 million chip making plant in Vietnam.

Still, there is much more that could be done to improve the investment climate. Firm exit remains an issue. The bankruptcy law was amended in 2004 with the intention of facilitating firm restructuring, exit and debt recovery, but it does not yet provide an efficient mechanism to recycle assets back into the economy. Tax administration remains a burden for the private sector, though the recent piloting of tax self-assessment has been viewed favorably. There has been progress in the unification of corporate income tax rates for domestic and foreign enterprises, but complex incentive schemes remain in place. They are deemed to be redundant in most cases not transparent and prone to abuse. Recognizing these problems efforts are underway to simplify the incentive regime.

Some 2,400 SOEs have been partially privatized (or "equitized") since 2001. The equitization process has improved over time. Evaluations are being conducted by outside evaluators, and share sales are taking place at market values through auctions at the securities trading centers. The percentage of shares sold to non-employees or outsiders, including foreigners, has also increased. The percentage of SOEs that did not sell any shares to outsiders came down from 52 percent in 2003 to 29 percent in 2005. The proportion of equity sold to outsiders rose from less than 9 percent in 2004 to 14 percent in 2005. Almost 90 percent of equitized SOEs experienced a better financial performance after equitization.

Innovation in East Asia

The generation and application of new technology, knowledge or ideas is widely acknowledged to be a crucial driver of economic growth and development. Emerging East Asia provides an exceptionally rich body of experience in this regard. The level of technological development in East Asia by various measures now exceeds that in other developing regions by a wide margin, even though 15-20 years ago it was very similar. At the same time there are also wide differences in technological development between East Asian economies, as well as in the policies and strategies they have pursued to facilitate the acquisition and absorption of knowledge.

New ideas can be absorbed from abroad or created at home. With about 90 percent of world research and development being done in the developed world, technology transfer from the rich countries remains the primary mode by which developing countries acquire new ideas. Such technology transfer can occur through a variety of channels, including trade in goods (in particular trade in capital equipment), foreign direct investment flows, formal purchase or licensing of patented technology, movement of people between countries and disembodied idea flows that occur via modern telecommunications and media.[18]

Although developing countries rely preponderantly on absorption of knowledge from advanced countries, one of the key distinguishing marks of successful development is the emergence, in addition, of an indigenous idea or knowledge producing sector, reflected in, among other things, a significant volume of research and development (R&D) being undertaken by business firms on a systematic long term basis, as well as by academic bodies and public sector researchers.. Economies such as Korea, Singapore and Taiwan, China already devote 2 percent or more of GDP to R&D, i.e. at advanced economy levels.

In this section we provide a brief partial view of some quantitative trends in the emergence of indigenous knowledge production or innovation capabilities in East Asian economies. This may serve as an introduction to more detailed work on innovation in East Asia that the World Bank plans to undertake in coming months.

Patents provide one measure of the *output* of innovation (while R&D spending is commonly viewed as a

[18] There is some evidence that such 'disembodied idea flows' (proxied by international telephone traffic) have a larger impact on income and productivity than trade flows: Wei-kang Wong. "How good are embodied and disembodied idea flows in bridging income gaps and idea gaps?" Berkeley.http://iber.berkeley.edu/wps/econ/wkwong_minigrant.pdf

measure of an *input* to innovation). The total number of patents registered by emerging East Asian economies at the US Patent Office increased from 197 per year in 1981-84 to 12135 in 2001-04. Over the same period the number of patents registered by selected Latin American countries increased from 101 to 228. Table 12 shows patents relative to population (patents per 100,000 people). In the mid 1980s the number of patents per 100,000 people in East Asia, Latin America and Emerging Europe was similar, in the region of 0.05. By 2001-04, though, as a result of the rapid growth in innovative activities in the region, patents per capita had risen to 0.66, some 9-15 times the levels in the other two developing regions.

Table 12. Patents per 100,000 Population

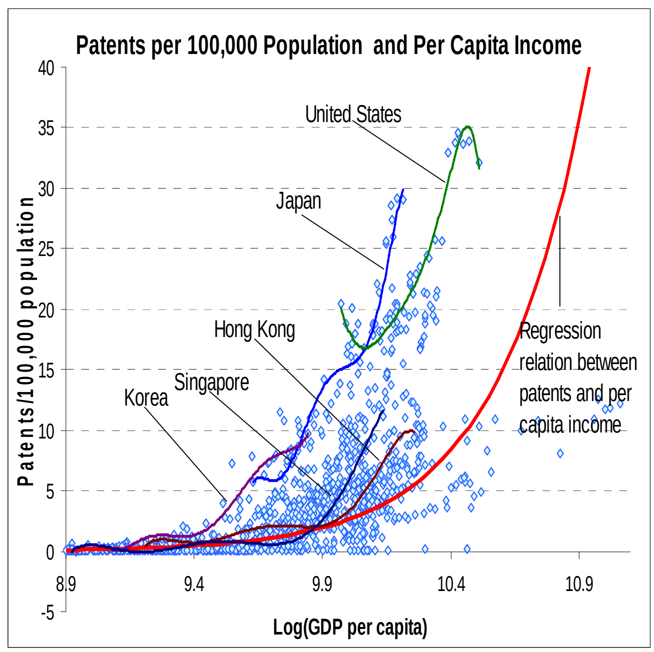
	1985-88	1993-96	2001-04	% Change 1993-96 - 2001-04
East Asia & Pacific	0.04	0.20	0.66	225.6
China	0.00	0.00	0.03	636.0
Hong Kong	1.67	3.65	9.32	154.9
Indonesia	0.00	0.00	0.01	132.4
Korea	0.20	2.59	8.67	235.4
Malaysia	0.02	0.08	0.28	238.6
Philippines	0.01	0.01	0.02	377.2
Singapore	0.31	1.86	9.87	431.7
Taiwan, China	1.81	9.24	30.17	226.6
Thailand	0.00	0.02	0.07	276.0
Latin America	0.03	0.03	0.04	49.3
Emerging Europe	0.06	0.03	0.08	133.7
OECD	9.83	12.83	19.00	48.1
Japan	12.62	18.75	28.54	52.2
United States	18.47	24.50	33.56	37.0
Australia	2.80	2.99	5.26	76.3

Source: US Patent and Trademark Office.

Table 12 also shows the wide variation in innovation activities across countries in East Asia. At the head of the league, Taiwan, China now produces some 30 patents per 100,000 people, about as many as Japan and the United States, the best performers among the developed economies. Another group including Korea, Hong Kong and Singapore generate around 8-10 patents per capita per year, similar to the performance of the developed OECD countries in the mid 1980s, although only about half the average OECD level today. Further down the scale, Malaysia generates 0.2-0.3 patents per capita, similar to Korea in the mid 1980s. Finally, countries such as China, Indonesia, Philippines and Thailand bring up the rear with patents per capita in the 0.01-0.07 range, (although patenting in China is rising very rapidly from a low base).

There is of course a systematic relationship between innovation activity (as measured by patents) and the level of development, as measured by per capita income: richer countries generally have higher innovation activities. Exhibits 27 and 28 show a scatter diagram of patents per capita versus per capita income (in PPP terms), using an annual panel data set over the period 1977-2004. The exhibits include an estimated regression relationship between patents and income. (The sample is shown in two exhibits, to permit display of greater detail at different scales). According to this relationship, each doubling of per-capita income is accompanied by a 7-8 fold rise in patents per capita. Factually, patents per capita in Singapore are 30 times those in Malaysia, even though Singapore's per capita income (in PPP terms) is only about 3 times higher than Malaysia's. There are similar non-linearities in most other measures of the innovation process. Korea's per capita GDP (in PPP terms) exceeds Thailand's by around 2 ½ times, but its expenditure on R&D (as a percentage of GDP) exceeds Thailand's by nearly 25 times. Scientific and technical articles per capita in Taiwan, China are more than 40 times greater than in China.

Exhibit 27

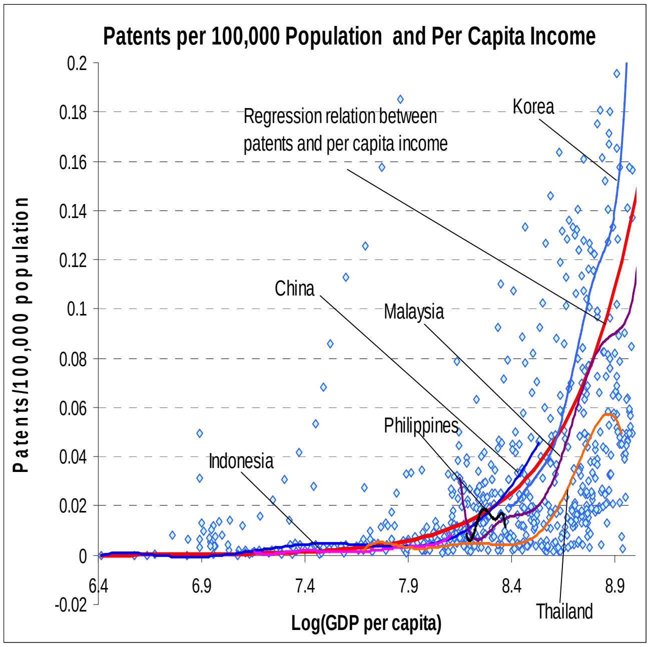


The exhibits also pick out the trajectories of patents and income for individual countries over time. Exhibit 27 shows that the East Asian 'miracle' economies such as Korea, Singapore and Hong Kong have consistently generated innovation levels much higher than predicted by their income levels alone. The same is true of Japan and the United States. Exhibit 28 shows that Malaysia and China have generally innovated at around the levels predicted by income, although, in recent years, China's patenting has accelerated to levels a little higher than predicted by income alone.[19] Indonesia, Philippines and Thailand, on the other

[19] Recent research suggests several reasons for the acceleration in Chinese patenting: (i) higher R&D spending, which accelerated from 0.5 percent of GDP in the 1990s to 1.3 percent by 2003; (ii) strengthening of China's Patent Law in 1992 and 2000; (iii) the vast influx of foreign direct investment to China, which has greatly

hand, have tended to perform below the predicted level. These calculations provide interesting suggestions for further research, to look in particular at the policies and institutions that encourage high innovation performance in some economies and underperformance in others.

Exhibit 28



Social Protection in East Asia

Does East Asia need Social Protection?

Does East Asia need better methods of social protection, that is, ways to better manage various kinds of risks facing its people? [20] Traditionally, East Asian governments have done little to intervene directly in this area, focusing instead on promoting fast growth and investing in education and health. They have avoided the pitfall of over-regulating labor markets or over-taxing labor, and, as a result, have enjoyed lower unemployment rates and higher employment rates than other regions. (Exhibits 29, 30). Cultural values have instead placed the primary responsibility for social protection on informal mechanisms such as family and community ties to provide a safety net and to help the vulnerable.

Exhibit 29

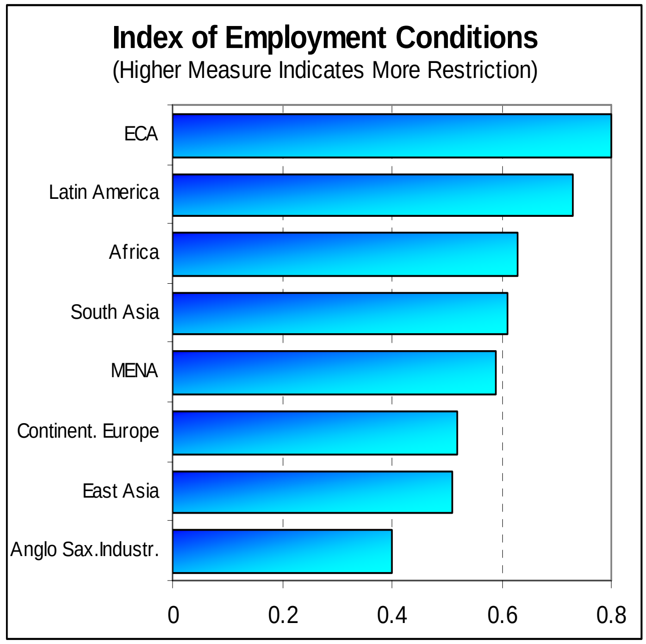
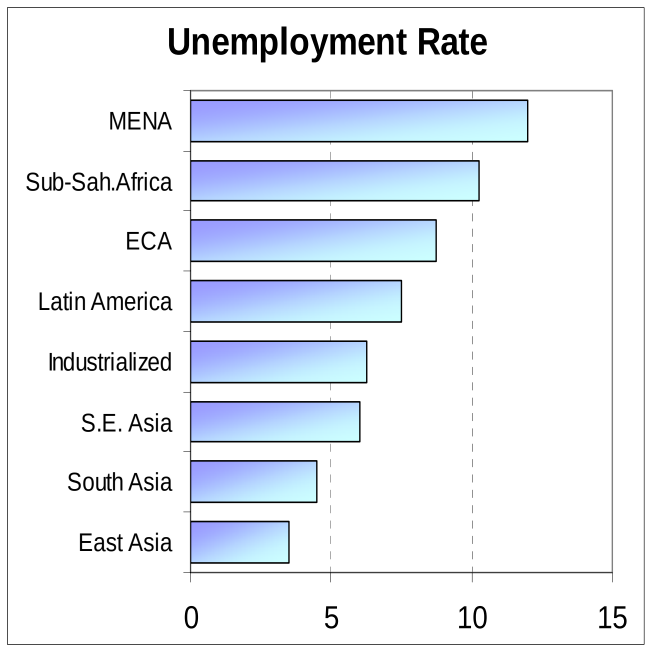


Exhibit 30



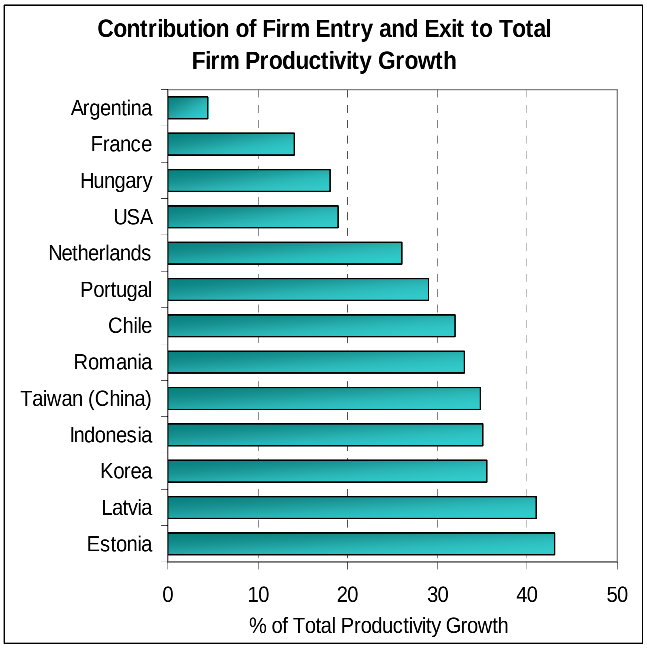
There are broadly three reasons why East Asian economies might benefit from a more explicit approach to social protection. The first is perhaps under-appreciated, that *social protection can be good for growth.* The reason is that reallocation of labor between firms and industries, job turnover and the entry and exit of firms plays a critical role in productivity growth. Such 'creative destruction' boosts productivity by reallocating labor to more productive uses and by increasing market contestability. A recent cross-country study finds that East Asian economies like Korea,

increased the market value of intellectual property for both foreign and domestic firms; (iv) the rapid relative growth of 'complex industries' like electronics and machinery, which involve many separately patentable sub-products and processes; (v) the acceleration of enterprise reform after the mid 1990s, which has greatly strengthened private property rights vis-à-vis state owned enterprises. See Albert Hu and Gary Jefferson. (August 2005). "A Great Wall of Patents: What is Behind China's Patent Explosion?" http://www.shufe.edu.cn/jjxy/international/papers/China_patent_explosion_-_Aug_05.pdf

[20] This section draws extensively on Ana Revenga: "Social Protection in East Asia". Presentation for 10th ASEAN Finance Ministers' Meeting. Siem Reap, Cambodia. April 2006.

Taiwan (China) and Indonesia perform better than most other countries in terms of the pace and efficiency of labor re-allocation.[21] As Exhibit 31 indicates, entry and exit by firms contributes around a third of labor productivity growth in the East Asian economies, among the higher shares across countries. However, while high job turnover is good for productivity growth, it can have adverse effects on individuals who have to switch jobs, especially those who lack skills for new emerging jobs. Social protection policies can help dampen these consequences by facilitating exit from old jobs and entry into new ones, and by helping smooth their incomes during the transition.

Exhibit 31



The second main reason for a new focus on social protection is that, even as poverty continues to fall in East Asia, *vulnerability to poverty* remains high; a significant proportion of the population faces the risk of becoming poor, even if it is not observed to be poor at a point in time. Households remain subject to many shocks, some with large adverse consequences for welfare that can push families unexpectedly into poverty. Evidence from many countries suggests that there is a lot of 'churning' in and out of poverty. In Indonesia, for example, 38 percent of the poor in 2004 were not poor in 2003, and half the population experience at least one episode of poverty in the course of a year. In China this kind of *transient poverty* accounts for 40 percent of total poverty.

The kinds of shock that can plunge people into poverty are both idiosyncratic and systemic. Among the most important are:

[21] Eric Bartelsman, John Haltiwanger and Stefano Scarpetta. (2004). "Microeconomic Evidence of Creative Destruction in Industrial and Developing Countries".

- *Health shocks*. In China, a recent Bank study finds that large health shocks on average reduce household income by 12.4 percent, while increasing medical expenditures by 17.6 percent.[22] In Indonesia 25 percent of households describe death or serious illness in the household as the most serious shock they have faced.

- *Job Loss*. In addition to the normal job turnover discussed earlier, households in the region also sometimes face large adjustments in labor markets due to industrial restructuring brought on by economic reforms, or, for example, the macroeconomic shock caused by the financial crises of 1997-98. In China as many as 19 percent of households have been affected by SOE retrenchment. Those most at risk of retrenchment were workers with lower levels of education and skills, precisely those who have more difficulty finding jobs in the growing private sector. Many suffer long periods of unemployment: the mean completed spell of unemployment is 18 months, but the expected duration, when adjusted for incomplete spells, is as high as 47 months. Many find re-employment but at significantly lower wages for retrenched older workers, independent of their education and skills. In Indonesia 15 percent of households reported job loss or employment problems during the financial crisis.

- *Natural Disasters.* Informal, community-based and private mechanisms are often overwhelmed by large natural disasters. The effect on household assets and income opportunities can be huge and long lasting. An analysis of the impact of the Kobe earthquake on affected households, for example, showed that it took many years for many to recover pre-earthquake levels of welfare.[23]

The third reason for a greater focus on social protection is *population aging*: East Asia's population is rapidly aging. Unlike the US or Europe, which got rich before they grew old, East Asia is growing old before it gets equivalently rich. The ratio of 20-59 year olds to those over 60 in the region is expected to by more than a half between 2005 and 2030. This means that the question of old age security and putting in place effective pension systems will quickly grow in importance.

What kind of Social Protection for East Asia?

Clearly East Asian economies need to look for home grown solutions that build on East Asian advantages such as relatively flexible labor markets and on traditions such as self reliance and family orientation. Solutions need to minimize equity-efficiency tradeoffs and to fit changing

[22] Adam Wagstaff and Magnus Lindelow. (2005). "Health Shocks in China: Are the Poor and Uninsured Less Protected?" World Bank Policy Research Working Paper 3740.

[23] Yasuyuki Sawada and Satoshi Shimizutani. (2004). "How Do People Cope With Natural Disasters? Evidence from the Great Hanshin-Awaji Earthquake." ESRI Discussion Paper Series No.101. Cabinet Office. Tokyo, Japan

East Asian conditions, for example the existence of large informal sectors, rapid urbanization and population aging. There are a range of options, drawing on experience from with the region and from around the world.

- *Conditional Cash Transfers (CCTs).* CCT programs are a new and innovative approach to basic social assistance. They provide money to poor families contingent upon certain behavior, usually investments in human capital such as sending children to school or bringing them to health centers on a regular basis. As such, they seek to address both traditional short-term income support objectives, as well as promote the longer-term accumulation of human capital. Evaluation results reveal that this innovative design has been quite successful in addressing a number of issues such as poor poverty targeting, disincentive effects, and limited welfare impacts. There is clear evidence of success from the first generation of programs in Brazil (the Bolsa Familia, now covering 25 million people), Colombia, Mexico (the Oportunidades program covering 19 million people) and Nicaragua in increasing enrollment rates, improving preventive health care and raising household consumption. In East Asia Indonesia and Cambodia are experimenting with CCTs, although we do not yet have evaluation of the results. As noted elsewhere in this report, Indonesia recently replaced an inefficient and regressive form of social protection through fuels subsidies with a temporary Unconditional Cash Transfer. It is considering replacement of this temporary measure with a CCT scheme.

- *Work-Linked Transfers.* East Asia generally makes less use of Unemployment Insurance than other countries at similar income levels, and it may still not be an attractive option, given large informal sectors and the prevalent work ethic. Nevertheless there is evidence (for example from the Baltic countries) that a well designed mechanism to provide some income security in case of unemployment can facilitate more job turnover and hence higher productivity growth. In some models a scheme with a low level of severance pay that is paid out regardless of cause of separation can be effective in reducing the uncertainties that hinder job turnover. In countries with large informal sectors, on the other hand, it may be worth considering some draw down of savings from self-insurance or mandatory savings schemes during an unemployment episode, as in Chile.

- *Health Insurance.* The region is experimenting with multiple approaches to expanding health coverage. One model that seems to be working is Thailand's universal coverage "30 baht' scheme, which has sharply increased health utilization rates among the poor while reducing out of pocket spending. The success was made possible through prior investments in health care infrastructure (for example, every rural sub-district has a staffed health center), and through long and careful technical preparation of the reforms. A more problematic example is China where insurance coverage is minimal among the poorest 25 percent of households, and even for those covered provides only limited protection. At the same time perverse incentives for health care providers have led to rising overall health spending linked to unnecessary use of drugs, tests and expensive procedures. In Indonesia a proposed new Social Security Law that includes health coverage also raises some concerns about long run financial sustainability and possible adverse impacts on employment if it is financed through higher payroll taxes.

- *Old Age Security.* The political demand for effective pension coverage is likely to grow as population aging proceeds. Although saving rates are high, long term and contractual savings schemes are under developed in most countries. Well managed and regulated pension funds can help fill this gap, contribute to the development of capital markets and indirectly help sustain growth rates needed to keep up with a historically unprecedented aging process. Expansion to the informal sector needs to be done in a measured way, for example through voluntary participation in well regulated defined contribution schemes, as recently proposed in Thailand and Vietnam. In general there is a need to expand coverage in only a financially sustainable way, avoiding the creation of large unfunded liabilities (as might occur with public defined benefit schemes), or attempts to mandate increased contributions, which could distort labor markets and increase informality. An example of unsustainable coverage expansion is China's rural pension scheme, which is already failing.

Can East Asia Afford Social Protection?

East Asia spends less as a share of GDP on social protection than Eastern/Central Europe, and in the same range as Latin America and the Middle East/North Africa. In many countries the main social safety net is via product subsidies (e.g. on fuel and rice), and is often fragmented among many schemes. In Thailand, for example, a multiplicity of small schemes each reaches only a small number of beneficiaries, providing meager benefits and leaving gaps and unmet needs. Countries can therefore make some headway by consolidating multiple schemes into a more coherent program. There is also significant scope for moving from product subsidies to more targeted and equitable cash transfer schemes, as in Indonesia.

A major challenge is how to finance pensions, especially with aging populations. Three main approaches to funding mandated pensions are represented in Asia: partially funded defined benefit schemes (Korea, Thailand); centrally managed defined contribution schemes (Malaysia, Singapore); and decentralized private defined contribution schemes (Hong Kong). Appropriate policies can also help increase the expected benefits of funding pensions, for example by fostering proper diversification of portfolios, (including international investment), providing governance arrangements that limit political capture of pension funds and proper accounting rules that reflect fiscal liabilities more transparently.

COUNTRY SECTIONS

Major Economies [24]

China

China's GDP growth hardly slowed in 2005, with domestic demand firmly taking the lead over net trade in the second half. GDP growth was 9.9 percent in 2005, 0.2 percentage point lower than in 2004. Investment was supported by still-robust profit developments and a relaxed monetary policy. Consumption, although still lagging GDP growth, was supported by strong income growth, especially in urban areas. While China's trade surplus of over $100 billion for the year grabbed the headlines, the contribution of net trade to growth had already turned negative by the end of last year, and this pattern continued in the first two months of 2006.

In 2005, monetary policy was strongly influenced by foreign exchange market considerations. M2 growth was buoyed by PBC purchases of foreign exchange, stemming from continued surpluses on the balance of payment—$209 billion in 2005— which were only partly sterilized. The resulting liquidity drove down inter-bank interest rates to low levels in line with the goal of discouraging non-FDI capital inflows. The trend of falling inter-bank rates was in sharp contrast to international rates, notably US rates, which moved upwards for most of the year. Combined with the introduction of some flexibility in the exchange rate regime in July, when a "managed floating exchange rate regime…with reference to a basket of currencies" was introduced, this has helped deterring non FDI capital inflows, which declined in the second half of 2005. Since the July move, the exchange rate strengthened less than 1 percent against the US dollar.

The overall outlook for China's economy remains benign, although rebalancing growth will take time. In 2006, China will benefit from solid export demand, while profit and credit developments suggest that investment remains robust. Price pressures should remain limited with more moderate commodity price developments and strong increases in potential GDP. Internationally, risks include a disorderly adjustment in global imbalances and trade tensions, even though China's trade surpluses are likely to come down. The main domestic risk is that abundant liquidity will re-fuel bank credit and investment. Fixed asset investment grew 26 percent in 2005, in nominal terms, not much slower than in 2004. However, changing the composition of domestic demand, one of the government's key economic objectives, may take time. Looking for more balanced economic growth, the government would like to rely more on domestic demand and less on exports. Within domestic demand, the government would like to boost consumption while keeping investment growth in check, in order to raise living standards and avoid problems of overinvestment and overcapacity. However, a dramatic pickup in consumption is not likely soon, despite some positive impact of past and planned tax cuts. This is largely because it is difficult to significantly boost rural income growth in China without much faster migration out of rural areas. Rebalancing the composition of demand will have to rely to a large extent on policies addressing structural issues, including public finance measures, financial sector reform, dividend policy and corporate governance, and these take time.

For macroeconomic policy, the good overall outlook implies that the "prudent" stance announced last year is appropriate for this year as well. Monetary policy could in the short run focus on absorbing some of the excess liquidity to reduce the risk of excessive credit growth. This task may be complicated somewhat by active financial innovation, with hefty issuance of short term corporate notes, asset-backed securities, and financial bonds. Its impact should be closely watched and taken into account when judging monetary and financial conditions. The overall fiscal stance needs little change for now, but a shift towards social spending away from capital spending, is needed to redress China's macroeconomic and structural imbalances. Over time, with a rebalanced economy that relies more on services and consumption, tax revenues may come under pressure. That should be countered by reforms in the tax structure and administration, and medium-term expenditure restraint.

Recent GDP revisions moderate, but do not substantially change, the perspective on China's main structural challenges. The revision of the national accounts data followed China's first Economic Census conducted in 2004. They include a 16.8 percent upward adjustment of (production side) GDP for 2004, as well as historical adjustments back to 1993 and higher growth rates over 1993-2004. Most of the upward adjustment came from a revision of value added in services, as new firms and activities are now better captured. Nevertheless, China still shows a heavy reliance on industry and investment and a lower than normal share of services in GDP. Interestingly, 2/3rd of the GDP revision came from higher price increases, which implies that China's *real* exchange rate has appreciated by 10 percent more than previously thought.

The new 11th Five Year Plan (2006-10) signals a change to more balanced growth, with more attention to rural areas, the environment, and income distribution. The target of "*Doubling per capita GDP of 2000 by 2010*" should not be very difficult to achieve. However, with local government growth targets significantly higher than the national ones, there is a risk that, to achieve these high

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[24] More detailed individual Country Briefs for the major economies can be found at the World Bank website: http://www.worldbank.org/eapupdate/

growth rates, local spending is likely to continue to be directed at investment rather than at the social services needed for a harmonious society and a more balanced economy. The target of "*Reducing energy intensity of the economy by 20 percent*" over the next five years is very ambitious and would require raising energy prices and taxing energy.

An important objective in the plan is the "*Construction of the new socialist countryside*", largely focused on improving agricultural productivity. The government wants to improve service delivery and infrastructure, reduce production and transportation costs; speed up technological progress, including higher crop yields; improve administrative, financial and other institutions in rural areas; reduce farmers' tax burden; and finance compulsory education.

Much of the progress in farmers' income relies on better infrastructure, crop shifts to higher value added products, and fewer agricultural workers through out-migration. That is because agricultural yields per *mu* are already very high in China, prices have by and large reached international prices, and the agricultural taxes and most fees on farmers have already been abolished.

The government's plans for more social spending, notably on basic education, and to expand the health insurance system may be the best option for raising living standards in rural areas—as opposed to income improvement. The reason is that these measures, apart from resulting in better educated, healthier people in rural areas, would also increase freely disposable income and reduce precautionary savings by households.

Indonesia

The Indonesian economy ended 2005 with overall GDP growth of 5.6 percent, the highest rate in nine years. However, by year-end the growth story was mixed. The year had started strong with growth well over 6 percent but by the third quarter, economic activity had slowed as interest rates rose and consumers adjusted to increases in fuel prices (114 percent in October alone, and 143 percent for the year). The slowdown reflected a difficult economic adjustment needed to bring Indonesian energy prices closer to market prices, a vital step to sustainable and higher longer-term growth. The depth of the slowdown was mitigated by surprisingly strong exports and by an expansionary fiscal policy (including a program of cash transfers to the poor) that held up growth in the 4^{th} quarter. Expansionary fiscal policy will also limit the pace of contraction during the first half of 2006, before higher consumer and investment spending raise growth in the second half. Currently interest rates are high and likely to remain restrictive for at least the first half, but are expected to fall later in the year as inflationary momentum slows, adding further to the economic recovery. In sum 2006 is likely to be the mirror image of 2005, with the growth cycle bottoming in the first quarter before rising later in the year.

There was also good progress in non-economic areas. The anti-corruption campaign continued with a growing number of prosecutions (and convictions) for corruption, with the Anti-Corruption Commission playing a leading role in this regard, including, most recently, a proposal for fundamental civil service reform. The Supreme Audit Agency continued breakthrough audits (including dissemination of results) on government agencies and public enterprises. In addition a peaceful process of regional direct elections has continued with the electorate frequently rejecting incumbents. Moreover rebuilding in Aceh has gained momentum. Fifteen months after the Tsunami, houses are being built in large numbers, the school year started on-time, and health services are available in most affected areas. However, Aceh's greatest hope for sustainable recovery is the peace agreement between the Indonesian Government and GAM, which so far has been implemented without major disruptions. 2006 will be a crucial test for both the success of the reconstruction effort and the peace agreement.

The waning months of 2005 also brought a reshuffle in the Economic Team. Former Finance Minister Boediono took the Economic Coordinating Minister portfolio and the Planning Minister Sri Mulyani moved to Finance. The new team completed two policy packages by end-February, one on infrastructure and the other on investment climate, with a third on financial sector reform under development. The investment and infrastructure packages address policy issues in corporate regulation, tax, customs, labor and infrastructure that have been under review for some time. However, the packages also demonstrate a willingness to tackle a number of difficult decisions that had been on hold and provide a time-bound matrix with clearly defined Ministerial responsibilities. The investment package adds additional political commitment through its issuance as a Presidential instruction. Highlights of the investment package include: completion of the investment law and reductions in red tape; business friendly revisions to the tax law; and improved procedures in customs. The infrastructure package includes continued progress on public private partnerships, including a risk sharing framework (allowing contingent liabilities on budget), improved coordination mechanisms and progress on sectoral issues in anticipation of an Infrastructure Summit. A third package addressing issues in the financial sector is expected in the next month to address weaknesses in state-owned banks; to deepen the bond market; and to resolve long standing monetary issues between the Ministry of Finance and Bank Indonesia. The reaction to the new economic team has been positive with the Indonesian Rupiah strengthening dramatically and the stock market at historic highs. The recent policy packages have also been well-received. However, as implementation has been problematic in recent years, and there is some uncertainty whether the government will be able to fully deliver on the new policy packages.

Fiscal and monetary policies were central to economic outcomes in 2005. By year end, the central government budget deficit stood at 0.5 percent of GDP, while the debt-to-GDP ratio improved to 47 percent from 55 percent in 2004, and from close to 100 percent at its post-crisis high. The lower fiscal deficit in 2005 builds on the track record in recent years of low deficits and a rapidly improving debt-to-GDP ratio, but also reflects low spending in early 2005, especially on capital projects. These low disbursements resulted from delays as the administration and Parliament changed in late-2004 and from efforts to improve fiscal management (e.g., reorganization of the Ministry of Finance and new public financial management systems) in 2005. As noted above, by the fourth quarter of 2005 fiscal policy had turned expansionary and should continue as such in 2006. However, regional governments' share of total public expenditures is expected to increase dramatically from 2005 to 2006. Currently, one-third of central government expenditures are transferred to the regions. With their own resources, regional governments are now responsible for half of total spending and implicitly higher shares of capital spending. There was some build up reserves by regional governments in the banking system in 2005, leading to concerns that this will continue in 2006 (especially early in the year) reducing the needed fiscal stimulus. Monetary policy has also played an important role. Through August 2005, Indonesia did not raise domestic administered interest rates in line with rising world rates, causing depreciation of the rupiah, a loss in reserves, and sharply higher long term interest rates. Beginning in September 2005, administered rates were increased aggressively (up by 5 percentage points in a series of moves) which restored stability to the Rupiah, allowing for a buildup in reserves (now higher than a year ago). Current projections are for the interest rate to be reduced in line with falling inflationary expectations later in the year, adding to the stimulus at that point.

The Bank projects a growth of 5.5 percent in 2006. The current slowdown should bottom out in the first half, mitigated by strong government spending from reduced subsidies and net exports (partly driven by markedly lower fuel imports). In the second half, government spending should remain strong with overall growth picking up on higher private investment and a recovery in consumer durable spending. Good progress on infrastructure, investment and financial reforms would reinforce this underlying trend and crowd in private investment earlier and stronger. Assuming good progress on the reform agenda and a favorable global environment, growth should accelerate to above 6 percent in 2007.

Korea

After decelerating through much of 2004, growth in Korea accelerated through the course of 2005, supported by both external and domestic demand. Growth picked up from a year on year pace of 2.7 percent in the first quarter to 5.2 percent in the fourth. Growth was particularly strong in the third and fourth quarters, reaching quarter on quarter annualized rates of 7-8 percent, led by a sharp rebound in exports, reflecting renewed strength in global demand for IT-related products. Private consumption also strengthened through the year, supported by stronger jobs growth and the positive wealth effects of surging stock prices. The recovery in consumption and global electronics demand has filtered into corporate sector activity, resulting in a surge in facilities investment. Construction investment was however restrained in the latter half of the year, against a background of government measures to curb speculative transactions in real estate last August.

Inflation has been subdued, in part due to the strengthening of the won. Core inflation came down to 1.7 percent in February 2006, well below the lower range of the Bank of Korea's medium term target of 2.5-3.5 percent. However, the central bank projects that the strong economic recovery and persistently higher oil prices will drive core inflation above the mid-point of its target range in the second half of this year. Housing prices have also rebounded moderately since November, after restrictive government measures had stabilized the real estate market between August and October. As a result housing prices in the Seoul Metropolitan area have increased for seven years in a row through 2005.

The Bank of Korea (BOK) commenced monetary tightening last October when it raised its target for the benchmark call rate (uncollateralized call rate) from 3.25 percent to 3.5 percent, in response to latent inflationary pressures and the rebound in real estate prices. The BOK continued to raise its target by 25 basis points in December and February of this year, sending the rate to 4.0 percent. Given the accelerating economic recovery, Korea's government has no plan to frontload expenditure in the first half of 2006, as had done in 2005. The fiscal balance inclusive of the social security fund is expected to remain in a surplus of less than 1 percent in 2006.

Surpluses on both the current and capital accounts of the balance of payments have continued to swell the foreign exchange reserves, which reached US$216 billion in February 2006, about 10 months of imports and almost 3 times the country's short term debt outstanding. Meanwhile in March the government relaxed restrictions on capital outflows in order to mitigate the chronic over-supply of dollars in the foreign exchange market. Korea and Japan concluded a two-way bilateral swap arrangement to upgrade the Chiang Mai Initiative on regional financial cooperation in February.

Korea's domestic banks continued to strengthen their financial position. The average non-performing loan ratio of the banks fell to 1.2 percent at the end of 2005 from 1.9 percent at the end of 2004. Supported by an increase in net income of over 50 percent, the average capital adequacy ratio rose to a record 13 percent at the end of 2005. In addition, the six credit card companies have been improving in financial health. They recorded a combined net profit in 2005 for the first time in three years, thanks to a rise in credit card purchases and a fall in the delinquency ratio. Their average capital adequacy ratio rose to 19 percent at the end of 2005, thanks to higher profits and capital increases.

The year 2006 is expected to see further consolidation of commercial banks and rising participation of foreign banks in the sector. A U.S.-based private equity fund is set to sell Korea Exchange Bank, and creditor banks of LG card are also set to sell their stakes, as both domestic and foreign banks have shown great interest in acquiring these financial institutions. Meanwhile, large Korean commercial banks are moving into the universal banking business by setting up financial holding companies or acquiring non-bank financial institutions in order to diversify their income sources. The Capital Market Consolidated Act, which will tear down walls dividing non-banking businesses, is expected to expedite the trend of universal banking, as well as promote the country as a regional financial hub.

A moderate acceleration of both consumption and investment is expected to result in overall GDP growth of 5 percent in 2006, compared to 4 percent in 2005. Growth in private consumption should pick up, backed by improving labor market conditions. In addition, given the ample liquidity in the hands of large companies and financial institutions, the recent monetary tightening is unlikely to decelerate growth of facilities investment. Construction investment is likely to increase moderately, with reduction of speculative housing investment largely offset by increased supply of public housing to stabilize the housing market. However, external shocks such as a further large strengthening of won and persistent high oil prices could pose a substantial downside risk to the highly open economy, with significant consequences for highly indebted sectors such as small and medium sized enterprises and the households. (The ratio of household debt to GDP had risen to 63 percent at the end of 2005). On the other hand, in a more favorable external environment, improved business confidence could result in a sharp rise of corporate spending, supported by the highly strengthened financial position of large companies and banks.

As the economic recovery has become firmer, a greater focus of economic policy has been on longer term issues, including wealth and income disparities resulting from booming real estate prices and rising dualism in labor markets, and the rapid aging of society. This year, the government will substantially increase spending for redistributive and social welfare functions, to help those on lower incomes gain access to loans to buy homes. The government also introduced a corporate pension scheme at the end of 2005, in order to complement the national pension fund.

Malaysia

The Malaysian economy expanded by 5.3 percent in 2005, and the outlook remains broadly positive. In 2005, real GDP expansion was supported mainly by strong growth in manufacturing output (4.9 percent), spurred by the recovery in the production of electronic and electrical (E&E) products in the latter part of the year, and sustained activity in the services sector (6.5 percent), following robust growth in consumption, and in trade and business services, including finance. Exports of goods and services grew by 8.4 percent in 2005, supported by higher exports of manufactured products, minerals, especially crude oil and LNG, and higher growth in tourism receipts. Imports of goods and services grew by 7.6 percent. Aggregate domestic demand expanded by 7.3 percent in 2005, reflecting sustained growth in private consumption (9.2 percent) and higher public consumption (5.9 percent). Gross fixed capital formation (including changes in stocks) expanded by 4.7 percent. Looking ahead, despite some softening in aggregate domestic demand, partly from rising inflation and higher interest rates, a further increase in the global demand for E&E products is expected to raise overall growth to 5½ percent in 2006 and 5.7 percent in 2007.

Average consumer price inflation accelerated to 3.0 percent in 2005, more than double the rate in 2004 (1.4 percent). Consumer prices increased by 3.4 percent in the second half of 2005, reflecting mainly the lingering effects on transportation and gross rents, fuel, and power categories from the upward adjustment in retail prices of petroleum products in August. CPI inflation moderated slightly in January 2006, to 3.2 percent (year-on-year), but is expected to pick-up again in the coming months, following further retail price increases in petroleum products in late February 2006 and possible increases of 5-10 percent in power tariffs later on in the year. Core inflation doubled in 2005, but still remained relatively low, averaging less than 2 percent.

International reserves declined by about 12½ percent in the last months of 2005, but have since partly recovered. Net international reserves of Bank Negara Malaysia (BNM) fell by about $10 billion between August and end-December 2005, to $70.5 billion (RM266.4 billion). This decline reflected slower inflows of portfolio investment and much higher outflows from the acceleration in the liquidation of securities purchased by foreign investors since July 2005 (when the peg to the U.S. dollar was abandoned), as the subsequent appreciation of the ringgit turned out to be much less than expected. By mid-March 2006, net international reserves had recovered slightly to $72.9 billion (RM275.2 billion), equivalent to an import coverage of 7.9 months of retained imports and over 6.7 times short-term external debt. Total external debt declined to $51.3 billion (39.8 percent of GDP), of which just under a quarter comprised short-term debt (17.3 percent of net international reserves).

Fiscal consolidation continued in 2005, despite lower revenues. The overall fiscal deficit of the Federal Government declined to 3.8 percent of GDP in 2005 (4.3 percent of GDP in 2004). The deficit was financed domestically, although as a percent of GDP, total outstanding debt of the Federal Government declined to 45.7 percent of GDP. The 2006 Budget targets a further reduction of the overall fiscal deficit to 3.6 percent of GDP, but the introduction of a goods and services tax (GST), which was to replace the existing sales and service taxes on January 1, 2007, has been indefinitely postponed to allow more time for preparations.

The monetary policy stance has been tightened. Reflecting the recent increases in inflation, prospects for a possible further increase in the coming months, a widening interest rate differential with the U.S., and a recent surge in outflows of short-term capital, the BNM raised its Overnight Policy Rate (OPR) twice in the last three months, 3.25 percent. As a result, the daily weighted average overnight interbank rate moved up recently, to a range of 3.24 percent – 3.28 percent.

The asset quality of the banking system strengthened further, and profitability improved modestly. The ratio of non-performing loans (NPLs) of the banking system declined further to 5.8 percent at end-2005.[25] Also, the capital position of the banking system also remained strong, with the risk-weighted capital ratio (RWCR) ending the year at 13.1 percent, while the core capital ratio (CCR) improved to 10.2 percent. Meanwhile, gross operating profits of the banking system increased modestly, to RM13.1 billion, from last year's level of RM12.6 billion. The annualized returns on average assets and equity of the banking system in 2005 were 1.4 percent (same as in 2004) and 16.9 percent, respectively.

The financial system is becoming more diversified. The rapid growth of the Islamic financial system in recent years has led the authorities to: i) complement the Basel II initiatives on the identification of credit, market, and operational risks with specific Shariah compliant measures; ii) require all Islamic banking institutions to have a Shariah Committee to ensure that products and services are Shariah-compliant; and iii) require Islamic financial institutions to establish appropriate internal audit functions.[26] The Islamic Financial Services Board (IFSB) is also developing prudential, regulatory, and disclosure standards.

The performance of the corporate sector was lackluster. The stock market was subdued in 2005, as share prices in the Kuala Lumpur Composite Index (KLCI) listed on Bursa Malaysia ended 2005 at 899.79, 0.8 percent lower than a year earlier. The Malaysian bourse lagged well behind all regional comparators, except the Shanghai composite (-8.3 percent). Stock market sentiment was negatively affected by higher global oil prices, increasing domestic inflation, and the ensuing expectation of higher interest rates which would dampen consumer spending and corporate earnings. At around 7 percent, corporate earnings in 2005 were about half the rate expected by most analysts at the beginning of the year. Efforts were continued to improve the quality of listed Malaysian companies, including by introducing incentive measures to encourage mergers and acquisitions (M&A), and enhancing the corporate governance of Government-linked companies (GLCs) and improving their operational performance.[27] With regard to the latter, because of their size and the fact that they operate in key sectors of the economy, more commercialization of GLC operations could have a significant impact on overall corporate profitability, investment, and growth. The management and functioning of the GLCs, are being overhauled, including through changes in the boards and management, and the introduction of performance-based employment contracts.[28] Meanwhile, in January 2006, shares in Proton Holdings plunged to their lowest level in four years after Volkswagen AG called off plans to assemble and sell vehicles via the local carmaker. More recently, Malaysian Airlines reported losses of over $347 million in 2005, the worst performance in five years.[29]

The Malaysian Islamic Capital Market continued to exhibit strong growth. As of October 28, 2005, the number of Shariah-compliant stocks listed on Bursa Malaysia had risen to 857, representing a market capitalization of more than $105 million (60 percent of the total market), while by end-November 2005, total outstanding Islamic corporate bonds issued had risen to $31 billion (28 percent of total).

Philippines

The Philippine economy recorded another relatively strong performance in 2005. Public sector deficits and debt were reduced in real terms and the VAT reform law, passed in May 2005, was fully implemented by February 2006 following a number of challenges and delays. Progress on implementation of the fiscal reform program, coupled with the economy's resilience to various shocks—ongoing political tensions, higher oil prices, agricultural slowdown—boosted financial markets as reflected in a stronger peso, higher private capital inflows, and falling borrowing costs and spreads for the public sector. Improved tax administration and governance are now needed to ensure that recent policy reforms translate into sustained deficit and

[25] In January 2006, the ratio edged up marginally, to 5.9 percent.

[26] Under Shariah injunctions, interest is prohibited, and all financial transactions have to be accompanied by genuine trade and business related transactions.

[27] A ten-year GLC Transformation Program was launched in July 2005.

[28] There are 57 listed GLCs (including subsidiaries), and they represent nearly 40 percent of stock market capitalization. They operate in electricity, telecommunications, airlines, and airport services.

[29] The company has recently announced a restructuring plan to return to profitability.

debt reduction as well as more effectively implemented public resources for infrastructure and social programs.

GDP grew by 5.1 percent in 2005 while GNP growth was 5.7 percent. Although growth slowed relative to 2004, the period marked the first in a decade of two successive years of growth higher than 5 percent. Private consumption drove economic growth, expanding by nearly 5 percent helped by strong remittance flows, that amount to about 13 percent of GNP (not including the considerable remittances entering via informal channels). By contrast, investment and export performance were disappointing. Gross capital formation fell in 2005 by 4.3 percent, with a steeper decline in durable equipment investment. Weak global demand for Philippine electronic products led to a general slowdown in exports, which, coupled with weak investment, slowed import demand. Public consumption contracted in the second half of 2005 as government tightened expenditures to contain its deficit. Droughts brought on by El Niño in the first half depressed growth in the agriculture sector to 2 percent. Industry, propelled by strong manufacturing activity in the chemicals, furniture and fixtures, and petroleum industries, grew by 5.3 percent. The service sector continued to lead overall output growth, expanding by 6.3 percent and contributing over 47 percent to overall GDP.

Despite the economy's relatively robust growth in the last two years, unemployment remains high at 10.7[30] percent, while a fifth of those classified as employed are underemployed. Of the 750,000 jobs created last year, only about 13 percent were in the formal sector with paid wages and salaries, whereas 42 percent were for unpaid family workers and the rest were self employed. More than a third of the jobs created were in the agricultural sector, but given its sluggish growth, productivity in the sector has remained low. The number of Filipinos deployed overseas in 2005 was close to one million bringing the total to above 8 million, of which about 3 million are Filipino residents.

Average inflation in 2005 increased to 7.6 percent reflecting higher oil prices and power tariff adjustments, and notwithstanding appreciation of the peso. As of February, inflation remained at 7.6 percent. In September and October, the central bank raised its key overnight borrowing and lending rates reflecting the higher price environment and ongoing adjustments by the U.S. Federal Reserve. However, the market determined 91-day Treasury bill rate remains below prevailing inflation at 5.25 percent.

The national government deficit declined to 2.7 percent of GDP in 2005 from 3.9 percent in 2004 mainly as a result of expenditure tightening. Despite the passage of a number of revenue bills in 2004 and 2005, revenue improvements contributed only 0.3 percent to the deficit reduction, whereas expenditure cuts, distributed across the major spending categories, contributed 0.9 percent. Nonetheless, 2005 marked the first time since the Asian crisis that the tax effort improved, with tax revenue increasing from 12.4 to 12.7 percent of GDP. The centerpiece of the Arroyo Administration's fiscal reform program, the VAT reform bill, was passed in mid-2005. But its implementation was delayed from July to November (for the expansion of the base to include previously exempted items), and to February 2006 (for the increase in the VAT rate from 10 to 12 percent). To finance last year's deficit, the government borrowed close to $4 billion in foreign funds, of which over three-quarters where sourced from the international bond market.

The consolidated public sector deficit (CPSD) fell from 4.8 percent of GDP in 2004 to an estimated 2.8 percent in 2005, reflecting in particular improvements in the performance of the National Power Corporation (NPC) following three successive tariff adjustments. NPC reduced its deficit from 1.5 percent of GDP in 2004 to an estimated 0.1 percent in 2005, aided in part by the transfer of some of its debt to the National Government. The national government debt dropped to 73 percent of GDP while non-financial public sector debt is estimated at 84 percent, down from over 100 percent in 2003.

The current account surplus through the first three quarters of 2005 reached $1.2 billion, as a trade deficit of about $6 billion was countered by substantial remittances, which for the full year jumped by 25 percent. Net portfolio investment increased to about $2.1 billion in 2005 versus a net outflow in 2004. Foreign direct investment grew to $1.1 billion after two years of slump and was derived mainly from equity capital into real estate and manufacturing. However, these flows remain far smaller than elsewhere in East Asia. The combined strength of the current and financial accounts resulted in a balance of payment surplus of $2.4 billion at the end of year, higher than the balance in the last five years combined. Gross international reserves reached a record high of $20.6 billion by February 2006.

Bond spreads have steadily fallen over the past year reflecting both the liquidity in the global market as well as improving sentiment regarding the Philippines; two of the three major credit rating agencies recently revised their outlook from negative to stable. In the first week of January, the government secured $2.2 billion in foreign borrowings with maturities ranging up to 25 years at 333.4 basis points above comparable US treasury paper, down from over 500 basis points in a similar issuance a year ago. This amount represents the bulk of government borrowing from the global bond market for the year, targeted at $3.1 billion.

Despite the encouraging economic performance and improved market confidence, political concerns remain significant, stemming from allegations of corruption and coup threats. The declaration of a state of national

[30] As of January 2006. Unemployment was 8.1 percent under the new definition of unemployment: people without work and currently available for work and seeking work, or people without work and currently available for work but not seeking work

emergency in the last week of February, subsequently withdrawn and ostensibly to undermine coup attempts, did not disturb the markets. However, the budget for 2006 had yet to be passed as of mid-March as legislative inquiries and the debate on charter change occupied considerable congressional attention.

Thailand

Economic growth slowed down to 4.5 percent in 2005 relative to 6.1 percent in 2004. The tsunami, the drought, the unrest in the South and a large rise in oil prices took their toll on the confidence of consumers and investors last year. Tourism receipts grew by only 0.5 percent compared to almost 30 percent a year earlier. Domestic retail prices of petrol and diesel rose more than 30 percent last year as increases in world oil prices were judiciously passed through to the consumers.

GDP growth is projected to be around 5 percent in 2006. The terms of trade is expected to be more favorable this year, and world demand for key Thai exports (integrated circuits, computers, and hard disk drive) is expected to be buoyant. Import growth is likely to slow down, in line with slower growth in investment. Total domestic demand (household consumption and investment), will decelerate further relative to last year, as real interest rates rise and continued political uncertainty will delay public investments and dampen consumer and investor confidence.

Headline inflation rose to 4.5 percent in 2005 compared to 2 percent in 2004. This was largely due to jump in retail prices of oil and the rise in food prices due to drought. Core inflation has also risen. However, headline inflation is expected to ease to slightly less than 4.0 percent in 2006 provided monetary policy remains tight; the Bank of Thailand has been raising interest rates and further rises are likely.

The fiscal situation remains strong. The Government is running and will continue to run a balanced budget. Revenue collection is buoyant. Public debt as a share of GDP remains below 48 percent of GDP and is expected to continue declining over the next few years.

Thailand's external situation remains robust At the end of 2005, external reserves stood at US$52 billion (3.1 times short-term external debt), and total external debt has fallen to around 29 percent of GDP as of November 2005. The current account turned to a deficit of 2.2 percent of GDP in 2005, but this deficit is expected to fall in 2006. This is because import-growth will decline in line with declining investment growth, while the balance on services is likely to show a larger surplus than last year, given the ongoing recovery in tourist receipts. .

Total investment growth slowed in 2005, and is expected to slow further this year. The slow down was due to lower-then-expected pace of implementation of mega projects and a deceleration of private investment growth. Only 2.4 percent of the US$46 billion five-year (2005-09) public infrastructure mega-projects program was disbursed (see more below). Private investment grew at 11 percent in 2005, slower than in 2004, though foreign direct investment grew strongly reaching US$9.2 billion i.e. a growth of 21 percent relative to 2004. Private investment is projected to grow by 9 percent this year, given higher oil prices, rising interest rates, appreciating real exchange rates and more recently more political uncertainty.

The Government's plan to spend US$46 billion on large infrastructure projects in the next 4 years will likely take longer to be fully implemented. This program covers urban mass rapid transit, highways, power, low-income housing, water systems, education and health sectors and is expected to be financed by external borrowing to the extent of 17.5 percent (or US$7.9 billion) and significant private sector participation. The expected disbursement is likely to be about half the original plan for mega-projects.

Export earnings growth slowed last year but is expected to pick up this year as external demand for Thai exports becomes more favorable. Export volume last year has grown at half the rate in 2004 and only robust export prices (increasing by 10 percent in the first half), have kept export value up by 15 percent. This is a slowdown compared to more than 20 percent growth in the previous years. The dampened volume growth was in line with the downward trend of the global electronics demand in the first half of last year. This had limited the growth of integrated circuit exports, Thailand's key export. Tourism receipts were depressed following the tsunami in December 2004, and the southern unrest has not helped either. Exports volume this year should register higher growth than last year's as the global demand for Thailand's key products are on the uptrend. However, export prices will not be as robust as last year, hence, total export earnings are expected accelerate only slightly higher than last year's rate.

Private consumption growth has slowed too and is unlikely to be a major driver that it has been, over the next few years. Apart from the dip in consumption resulting from the large rise in oil prices, there is a more secular decline coming from the saturation of demand for consumer durables. Last year, household consumption grew by only 4.4 percent compared to 5.9 percent in 2004. Growth was particularly slow in the consumption of agricultural products, hotel and restaurants, and was negative for vehicles and transport services, latter largely due to oil prices. Higher household debt is constraining further debt-financed expenditures, and current political uncertainty is putting an additional damper on spending.

For the medium term, Thailand will have to focus on improving competitiveness to raise return to private investment and to sustain high export growth rates. They have to be the drivers if growth of 6 percent and more is to be maintained over the medium term.

The Government is preparing the 10th Five-Year National Development Plan (FY2007-2011) and it is hoped that actions to boost more efficient private investment will be taken. The Office of the National Economic and Social Development Board is responsible for drafting the Plan. The Plan has three pillars which groups together the earlier 5 areas that were expressed in its initial concept note. The three pillars are (1) Economic Capital, (2) Social Capital, and (3) Natural Resources. The final draft of the Plan is scheduled to be submitted to the Cabinet for approval in September 2006 and Plan will be effective in October 2006.

Vietnam

GDP is estimated to have grown by 8.4 percent in 2005, the highest level in nine years. This strong performance has been accompanied by a continuation of Vietnam's remarkable success in reducing poverty, which by now has declined to under 20 percent. Even though macroeconomic policymaking in 2005 was complicated by supply shocks, external and internal balances were maintained at manageable levels. Rising international commodity prices while benefiting exports and government revenues added to inflationary pressures.

Real GDP originating in the industrial sector is estimated to have risen to 10.6 percent in 2005, with the manufacturing sub-sector growing by 13 percent. Construction activity picked up especially in the second half of the year to record an increase of 10.8 percent. Services sector growth strengthened to record 8.5 percent in 2005. The main areas of expansion included retail trade, and sub-sectors related to tourism such as hotels, restaurants and transport.

Agricultural production is estimated to have grown by around 4 percent despite the resurgence of avian influenza and drought conditions in parts of the country. It is estimated that in 2005 the direct impact of avian influenza amounted to around 0.1 percent of GDP. While the real impacts of avian influenza outbreaks appear minimal for now, this is an area requiring a high level of vigilance by the authorities. The outbreaks have had non-negligible impacts on inflation in the short-term, as they have resulted in rises in the prices of poultry products, with knock-on effects on prices of substitute meat products.

Investment continued to remain strong rising from 38.4 percent of GDP in 2004 to 38.9 percent in 2005, according to MPI data. As in recent years, private sector investment showed rapid expansion. An additional 40,000 new businesses were registered in 2005, representing an increase of 9 percent in number and 45 percent in registered capital. Revised estimates show a steep rise in FDI commitments from 4.2 billion dollars in 2004 to 6.3 billion dollars in 2005. Disbursements, including domestic borrowing by joint ventures, reached 3.3 billion dollars implying an increase of 15 percent over the past year.

On the external front, export earnings grew by 22 percent in 2005. Crude oil exports, benefiting from high international prices, rose 30 percent in value terms. Rice exports reached a record of 5 million tons, and with the help of better prices, 1.5 billion dollars in value. The main manufactured export, garments, after being flat in the first half of 2005, recovered in the second half to grow by 10 percent over the whole year. Destination data for 2005 reveals that garment export growth to the US slowed to 5.2 percent, but experienced growth of over 18 percent in the EU and Japanese markets. In the first two months of 2005, overall exports have grown at a robust 28 percent y-o-y, with garments growing by 45 percent y-o-y.

Compared with the first half of 2005, imports slowed down in the second half. Their growth rate over the entire year stood at 15.4 percent. Part of the slowdown was due to the softening of international commodity prices, which were a key driver of the 25 percent growth rate of imports during 2004. Imports of machinery which had picked up in the first four months of 2005 have since flattened out, showing almost no change compared with 2004.

The trade deficit (f.o.b. basis), is estimated to have narrowed to under 2 percent of GDP in 2005, compared with 5 percent in 2004. With overseas remittances expected to have ranged from 3.5 to 4 billion dollars, the current account deficit is likely to have narrowed to around 1 percent of GDP, down from 3.8 percent in 2004. The deficit is mainly financed through ODA and non-debt-creating FDI inflows. Foreign exchange reserves have risen from 7 billion dollars at end-2004 to 7.7 billion dollars in 2005, representing around 10 weeks of imports of goods and non-factor services.

Vietnam successfully issued its first international bond in October, 2005. Initially, the government had decided to raise 500 million dollars, but given a stronger than expected market interest, the amount was increased to 750 million dollars. The ten-year dollar-denominated bonds were priced to yield 7.125 percent or 256 basis points above comparable ten-year US Treasuries. Since then the spreads have tightened with the yield coming down to 6.374 percent in early March. The proceeds from the bonds were on-lent to Vinashin, the shipbuilding SOE which is reported to have secured large export orders.

The prospects for completing WTO accession in 2006 appear bright. This is on account of strong progress on bilateral negotiations with the US, the factor which was mainly responsible for Vietnam missing its target of accession by end-2005. Reportedly, contentious issues relate to the opening up of the telecommunication and financial sectors, as well as trading and distribution rights.

Supply side shocks stemming from the outbreak of avian influenza, bad weather conditions, and hardened international commodity prices continued to impact on inflation in 2005. Inflation remained at over 8 percent on a year-on-year basis for most of 2005, and stood at 8.4 percent in February 2006. While food price inflation showed a downward trend in 2005, the prices of non-food items crept upwards.

Fiscal outturn through the year was solid. Revenues outperformed expectations mainly due to high oil prices. However, spending was higher as well on account of oil subsidies, salary increases, and larger capital expenditures. Overall, the budget deficit (excluding on-lending) is estimated to have ranged between 1 to 1.5 percent of GDP. This is below the planned level of 2.3 percent of GDP in 2005, but higher than the level of 0.8 percent attained in 2004. Public debt, including items that are akin to government guaranteed debt, stood at around 43 percent of GDP at end-2005. Given its highly concessional nature, servicing this level of debt is not a burden.

Credit growth which had climbed to 42 percent by end-2004 slowed to under 30 percent towards the end of 2005. Given the growing demand for financial intermediation, the main concern with credit growth refers to its quality. In recent months the central bank has particularly highlighted risks related to property loans. With real estate transactions coming to a virtual halt in recent months, there have been concerns about the ability of builders to service their loans. The other risk that the central bank has emphasized relates to the so-called "rate race" between banks for attracting deposits. As higher deposit rates translate into higher lending rates, an assessment of the repayment capacity of borrowers needs even more attention. To bring the assessment of loan portfolios closer to international standards, banks have started to implement Decision 493. However, differences between the central bank and the commercial banks on the interpretation of this regulation, has slowed its implementation.

As a first step towards equitization, Vietcombank, one of the larger state owned commercial banks (SOCBs), successfully issued convertible bonds worth 1.3 trillion dong (820 million dollars). The state's shareholding in the bank is to be gradually reduced to around 70 percent at first, and eventually to 51 percent by 2010. Under current regulations foreign holding of shares is limited to 30 percent with a single institutional investor allowed a maximum of 10 percent. Two other SOCBs are also likely to issue bonds in the coming months to shore up their capital before equitization. Equitization of all SOCBs is to be completed by 2010.

Accompanied by a per-capita real GDP growth that has averaged around 6 percent per year over the last 12 years, Vietnam has had almost unparalleled success in poverty reduction. The general poverty rate has fallen from 58.1 percent in 1993 to 19.5 percent in 2004, implying an average decline of 3.5 percentage points per year.

Smaller Economies

Cambodia

Cambodia's economy showed unexpected strength in 2005 with 7.0 percent GDP growth, an expansion of international trade, and stable fiscal and monetary performance, despite an increase in consumer price inflation to 6.7 percent because of higher oil prices. The growth drivers in 2005 were garments and textiles, tourism, construction, and agriculture. Garment exports, the country's largest foreign exchange earner, increased by 10.6 percent to US$2.2 billion, of which 71 percent was shipped to the U.S. and 23 percent to EU markets, both of which had effectively restricted garment imports from China in mid-2005. Tourist arrivals expanded by 35 percent compared to 2004. GDP growth in 2006 is projected to decline slightly to 6.0 percent, while inflation should return to a more normal level of about 3.5 percent.

The narrow base of growth remains a concern, however, though Cambodia has made efforts to diversify its economy through development of small and medium enterprises. The microfinance institution loan portfolio grew by about 50 percent to US$60 million in 2005, while credit to the private sector as a whole expanded 21.3 percent. Trade facilitation has improved and special economic zones were introduced. The legal and regulatory framework for investment was substantially improved in 2005 due to the adoption of the Law on Commercial Enterprises, passage of the amended Law on Concessions, and issuance of the sub-decree for the Law on Investment. Approvals for new FDI rose from an estimated US$121 million in 2004 to US$216 million in 2005.

On the fiscal front progress tax revenues grew from 11.3 percent of GDP in 2004 to 11.7 percent in 2005, with particularly significant growth in VAT and customs duties. Non-tax revenue collections were somewhat disappointing, falling as a percentage of GDP, although the Ministry of Economy and Finance has established a Non-Tax Revenue Department to develop policy and strategy. Total expenditure fell from 16.3 percent of GDP in 2004 to 14.8 percent in 2005, owing to a decline in externally-financed capital spending. The net impact was a notable fall in the overall fiscal deficit (excluding grants) from -5.1 to -3.1 percent of GDP. In 2006 revenues are projected to increase further to 12.2 percent of GDP while expenditures are also expected to return to recent levels by growing to 17.1 percent of GDP.

In the external sector both export and import growth moderated in 2005, and growth is expected to slow further in 2006. The current account deficit (excluding transfers) remained steady at 10.3 percent of GDP in 2005 and is expected to grow slightly to 11.7 percent in 2006. Gross foreign reserves continued to expand, reaching US$923 million (up from US$809 million in 2004). The exchange rate remained relatively stable at 4,150 riel per US$ (end of period).

The monetary sector saw broad money increase by about 20 percent in 2005, with the same growth projected for 2006. The government continued to pursue financial sector reform, including privatization of the state-owned Foreign Trade Bank and adoption of the Law on Negotiable Instruments and Payment Transactions, which aims to improve payment transactions, eliminates legal uncertainties, and reduce payment system risks.

The Bank's Poverty Assessment 2006, based on new survey data, indicates that poverty has fallen over the last decade: the percentage of Cambodians living below the national poverty line fell from 47 percent in 1993/4 to 35 percent in 2004, owing in large part to the restoration of peace and stability as well as high growth. At the same time, inequality has increased as measured by Cambodia's Gini coefficient, which is up from 0.35 to 0.42 over the same period, making Cambodia one of the more unequal countries in the region. Both garments and tourism, Cambodia's main sources of growth, are concentrated in Phnom Penh and Siem Reap, respectively, while the economic linkages between urban centers and rural areas have been limited. The most important link may have been in the form of remittances. However, only 13 percent of rural households received remittances from family members working in the cities.

Fiji

The slowdown in economic growth from 4.1 percent in 2004 to an estimated 1.7 percent in 2005 mainly reflects the effects of the loss of preferential trade arrangements in the garment industry. Growth is projected to increase marginally to 2 percent in 2006 and 2.4 percent in 2007 led by growth in agriculture, fisheries and forestry, and the private sector.

Inflation in 2004 and 2005 has been kept within the target band of 2-3 percent, but higher inflation of 4 percent is projected for 2006 reflecting the lagged impact of higher oil prices.

The external position improved in 2005 as the current account deficit narrowed, aided by strong growth in tourism earnings and remittance inflows. Official remittance receipts reached about 6.5 percent of GDP (about US$174 million in 2004), overtaking earnings from some traditional economic sectors.

Fiji's main foreign exchange earner, the tourism industry continued to boom in 2005 (tourist arrivals in the year to August increased by an estimated 11 percent). The robust performance is expected to continue in 2006, supported by increasing accommodation and flight capacities.

Total garment exports declined further during 2005 as a result of the expiry of the US preferential trade agreement in early-2005. However, the extension of the SPARTECA (TCF Provisions) Scheme for another seven years and the provision of other international assistance is expected to somewhat stabilize the industry.

Sugar production levels continued to improve during 2005, partly attributable to more reliable cane supply to the mills and relatively lower mill breakdowns. The issue of expiring land leases remains a concern. The sugar industry is projected to grow by 4 percent in 2006.

The fiscal deficit widened from 3.3 percent of GDP in 2004 to 4.3 percent in 2005 as additional expenditure was redeployed to several ministries and departments. A slightly lower deficit of 4 percent of GDP is forecast for 2006. Total public sector debt remains at slightly above 50 percent of GDP.

The Government of Fiji introduced the Reconciliation, Tolerance and Unity Bill in 2005 which, among other things, would allow those involved in the 2000 coup to apply for amnesty. Although the Government proposed the bill as an attempt to heal the divisions created by the 2000 coup, it has been subjected to widespread criticism, including from the military, the police, and numerous non-government advocacy groups. The proposed bill has been widely debated but has been put on hold until after the May 2006 General Elections.

Lao PDR

Real GDP growth in Lao PDR rose to 7 percent in 2005, from 6.4 percent in 2004. All sectors grew rapidly – with industry growing fastest but from a low base. The share of industry is now more than 25 percent of GDP. The stimulus of large projects in mining and power sectors more than offset the dampening effects of high international oil prices and the expiry of the Multi-Fiber Agreement (MFA) quota system.

The economy is projected to grow at 7.1 percent in 2006 and to continue growing steadily at 6-7 percent in the future. However, a large part of this growth comes from increased foreign investment flows in hydropower and mining: without large projects and increased investment and exports in these sectors real growth would have been about one third lower. Therefore, promoting growth in sectors other than mining and hydropower is increasingly important for ensuring stable growth in the long-run. The government's efforts in liberalizing trade and improving the investment climate are thus steps in the right direction.

The poverty headcount in Lao PDR has fallen from 46 percent of the population in 1992/3, to 39 percent in 1997/8 and to 33.5 percent by 2002/3. Even though the population grew by one million people over this period, the absolute number of poor fell from about 2.1 to 1.9 million. World Bank staff projections indicate that there is potential for Lao PDR to continue these positive trends, with simulated poverty headcount rates of between 23 and 28 percent in 2010.

Macroeconomic conditions have remained broadly stable. CPI inflation fell from 15.5 percent in 2003 to 7.2 percent in 2005 – although it picked up in mid-2005, driven by higher oil prices and higher rice prices due to floods. The kip exchange rate has been stable while reserves equal three months of imports. The balance of payments held up well in 2005, despite some adverse shocks. A surge in mining exports offset the impact of oil prices. But the imports associated with the NT2 project have caused the current account deficit to plunge to 15 percent of GDP, offset by capital inflows, principally from foreign direct investment.

While the cash budget deficit has been kept within the 4 percent (of GDP) target, the fiscal position has remained under pressure due to weak revenue collection combined with the ongoing lack of realism in revenue projection, plus the pressures to increase the wage bill (which grew by 24 percent in FY2004-05). Delays in implementing key tax measures contributed to negative budget pressures. High public external debt remains a concern (falling since 2002 but still very high at 83 percent of GDP in 2004 or 55 percent in NPV terms). The crude cash rationing used to control the budget deficit has resulted in budgetary distortion – with non-wage recurrent expenditures increasingly squeezed – and built up of arrears to Government suppliers. One positive contribution to fiscal revenues has however resulted from a recent decision to eliminate temporary exemptions to the prevailing tax/duty rates on gasoline and diesel, recovering more than $7 million of budget revenues. The government was also able to increase the fuel levy, revenues from which are earmarked for the road fund and are essential for supporting road maintenance.

Progress has been made with structural reform, although major challenges remain. Some positive steps have been taken to strengthen the investment climate and to further liberalize the trade regime. However, reform of the largely state-owned banking sector remains slow. Progress with State-Owned Enterprise (SOE) restructuring remains gradual, despite better recent progress in the utilities sector. On the fiscal side, Government has recently started implementing a Public Expenditure Management Strengthening Program (PEMSP), and progress has been made in rolling out a new Government Financial Information System (GFIS). On the tax side, a new Customs Law has been approved, addressing a number of WTO-related issues, but major challenges remain concerning central-local fiscal relations.

Since 2000Government, with ADB, the World Bank and the IMF assistance, has embarked on an ambitious banking sector restructuring program with three broad objectives: restructuring the two SCBs; strengthening bank supervision; and improving the overall banking environment. The focuses are on the operational restructuring of two SCBs and increased transparency. The focus is on the operational restructuring of SCBs and increased transparency. Independent International Accounting Standard (IAS) audits for two SCBs were completed for the period 2001-2003 and draft audits for 2004 are being finalized. Progress has been made in stabilizing the financial conditions of SCBs, with a clamp down on lending to SOEs and a significant reduction in the growth of NPLs. Very recently, however, credit growth at the SCBs has been growing fast, because of large credits to mining and energy projects; these credits caused a significant tightening of the liquidity position of the two main SCBs. Corrective action has been taken and the largest disbursements have been frozen; however the risk of further deterioration remains high given continued pressure for non-commercial lending and slow NPL resolution. The newly approved operational policies and procedures, especially in the credit underwriting process, are not well adhered to. Moreover the governance of SCBs has not been strengthened. The current compositions of the Board of Directors, without independent directors, lack checks and balances. The MOF has not monitored progress of SCB restructuring and has not actively exercised its ownership role in appointing qualified directors to the SCBs' boards as stipulated in the Governance Agreements.

Gradual progress was made in monitoring the performance of the remaining State-Owned Enterprises (SOEs) and in preparing restructuring plans to return loss-makers to commercial viability. Implementation of many restructuring plans has lagged however. Many SOEs do not yet have functioning Boards in place or competent directors; and few SOEs have regular annual audits. For the future, the priority is to move the SOE reform program into more active implementation. The new draft 6th Five-Year National Social and Economic Development Plan (NSEDP) for 2006-10 indicates that the Government will, over the next five years, "complete the restructuring and reform of SOEs from the center to the provinces and the districts" and that "only a small number of key SOEs that are important for the national economy will be kept".

The draft NSEDP recognizes the key role of the private sector in growth and poverty reduction. In late 2005 the National Assembly approved a new Enterprise Law that creates a level playing field for private businesses, significantly simplifies regulations and procedures to start up a business, moves from licensing to registration as the main principle, envisages a transparent "negative list" of the sectors where entry of private business is conditional, and creates a one-stop-shop for business registration. Semi-annual business forums are to be held, the first scheduled for April, 2006. Lao PDR continues implementation of the AFTA agreement and the last tranches of products have been moved to the Inclusion List, as required by the accession process. They will be approved by the National Assembly Standing Committee later this year.

Mongolia

Economic growth accelerated in 2004 and 2005 (up from 5.6% in 2003 to 10.6% in 2004 and an estimated 6.2% in 2005), thanks to sustained favorable weather conditions, higher commodity prices in the world market, especially those for gold and copper, greater capital inflows and expansion in the livestock, transportation and telecommunications sectors. Foreign direct investment (FDI) continued, particularly into the banking, mining, and textile sectors (estimated to be US$93 million in 2004 and US$110 million in 2005). A recovery in the agricultural sector and continued robust growth in the mining and service sectors also helped. Meanwhile, the processing industry was stagnant and the manufacturing sector was very seriously affected by the expiration of the *Agreement on Textiles and Clothing* at the beginning of 2005 that led to closures of textile and garment firms and relocation of their activities to China. Textile industry value added decreased by 41 percent in 2005.

Given the favorable conditions in the mining and livestock sectors, total exports increased by 21% in 2005 while imports increased by 12.5%. Hence the trade deficit fell from 9.4% in 2004 to 5% of GDP in 2005. With sustained capital inflows, including private investment and official capital inflows, net international reserves have almost doubled (from US$164 million to US$298 million as of end 2005, which is equivalent to about 13.5 weeks of imports). The togrog/US dollar exchange rate depreciated at the margin in 2005 by 1 percent, although, over the past 12 months, the nominal and real effective exchange rates have remained stable.

Meanwhile, inflationary pressures which emerged in the economy in 2004 (estimated to be at 11 percent) were contained to an estimated single-digit level of 9.5% in 2005. A tightening of monetary policy in the second half of 2005 helped contain inflation. Broad money grew at a rate of 20.3 and 31.4 percent (estimate) in 2004 and 2005 respectively.

Fiscal consolidation has continued in 2005. The overall government deficit fell from 6 percent in 2002 to 1.4 percent in 2004 and to an estimated 2.7% budget surplus in 2005. This improved fiscal performance is due to the boom in copper and gold prices that resulted in a jump in government revenues (tax and profit from the state-owned copper company), but also to improved budget execution. In addition, deployment of the Government Financial Management Information System (GFMIS) contributed towards better fiscal discipline and tighter budgetary controls. Total government revenue (including grants) reached 37.5 percent of GDP in 2005 while total expenditures were reduced from 41.7 in 2004 to 34.9 percent of GDP in 2005. The authorities have been successful in avoiding any large overruns in public expenditures so as to keep the fiscal budget in check. However, this has been made possible by a reduction of the envisaged public investment program and much needed recurrent expenditures. Capital expenditures have decreased as a proportion of GDP from 6.7 percent in 2003 to 3.9 percent in 2005. In addition, capital maintenance expenditures have decreased even more rapidly, with a share in total capital expenditures going from 12 percent in 2000 to 5.3 percent in 2005 and a planned 2.7 percent in 2006.

Mongolia's public external debt remains high but sustainable (at about US$1.38 billion in 2005, equivalent to 74 percent of GDP and about 45 percent of GDP in NPV terms). Public domestic debt remains very limited (4.5 percent of GDP at end-2005). All foreign loans are concessional, implying a low risk and cost for the Government as of 2005. A Debt Sustainability Analysis was jointly conducted by the IMF and the World Bank in June 2005. After the settlement of the pre-1991 Russian Debt, which was equivalent to 10 times GDP, the outstanding stock of external debt was equivalent to 91 percent of GDP as of end-2004 and 55 percent in net present value terms, placing Mongolia at a moderate risk of debt distress over the medium term. Under the baseline scenario of sustained economic growth and fiscal deficit of 3 percent range financed solely by concessional loans, Mongolia's external debt ratios would decline substantially in the long term. However, stress tests suggest the debt could become unsustainable if there were especially negative terms of trade shocks. Moreover, this does not allow for large scale non-concessional loans. Mongolia and China reached a framework agreement at end 2005 on a package loan of $300 millions to be extended at concessional terms.

Government's recent decision to join *Extractive Industries Transparency Initiative* (EITI) is an important signal of its commitment towards greater transparency in one of Mongolia's crucial sectors. This will help to initiate a public dialogue on questions related to the management of the mining sector in general and mining revenue management in particular, which contributes significantly to the budget. In addition, the government proposed important amendments of the Tax Law and Minerals Law which were submitted to Parliament. The parliament has promulgated a revised Public Procurement Law that envisages greater decentralization of procurement, improved oversight mechanisms, and greater disclosure. On the anti-corruption front, Mongolia joined the UN convention on Anti-corruption and both the anti-corruption and anti-money laundering draft laws have been sent to Parliament.

Papua New Guinea

The momentum of the recent economic recovery was maintained in 2005 with real GDP expanding by about 3 percent and non mineral GDP by an estimated 3.5 percent, buoyed by continued strong global commodity prices particularly for minerals and anchored by the maintenance of fiscal discipline and stable monetary policies. These factors in turn provided a platform for expansion in private sector credit, for the first time in four years. Real GDP is expected to increase by 3.5 percent in 2006.

Consolidation of recent efforts to maintain fiscal discipline mainly through strict expenditure controls were an underlying factor as were interest savings due to lower domestic interest rates in the budgetary outcome of a surplus equivalent to about 2 percent of GDP, compared to the budgeted deficit of 1 percent of GDP. Windfall tax revenues from higher than budgeted oil and gold prices also contributed to this favorable outcome. Government also continued to make progress in reducing domestic payments arrears from earlier periods and restructure its domestic debt obligations from shorter to longer term maturities. In line with these developments public sector debt continued to decline from 55 percent of GDP in 2004 to about 50 percent of GDP in 2005, while the ratio of public external debt declined from 32 percent of GDP to 27 percent of GDP over the same period.

Despite a continued resurgence in imports in 2005 the trade balance remained in surplus, fueled by high global commodity prices. The pick-up in imports reflected growing domestic demand and underlying improvements in consumer confidence. The current account remained in surplus, equivalent to an estimated 4.2 percent of GDP. For 2006 a similar outcome is presently expected. The currency remained stable during 2005, appreciating by about 1 percent against the U.S. dollar.

The downward trend in inflation experienced since 2003, when it averaged 14 percent, continued in 2005 with inflation estimated at 1 percent over the year. Continued monetary easing in 2005 resulted in further declines in Treasury bill yields from about 5 percent to less than 4 percent over the year. Commercial bank interest rates mirrored these developments with the average lending rate approaching 10 percent by year-end. The strong fiscal stance together with these monetary policy developments set the stage for an expansion of about 20 percent in private sector credit, the first increase since 2001. External reserves increased slightly over the year to about US$800 million, equivalent to nearly six months of non-mineral imports.

Political Developments. Political stability has been maintained and the coalition government now stands to be the first since independence to complete its term in office. The Enhanced Cooperation Program with Australia—which was designed to provide direct personnel support to Papua New Guinea to stem the long term deterioration in law and order and to strengthen economic management—has been streamlined and reinstated, following an earlier Supreme Court ruling which had disrupted it.

Solomon Islands

With the restoration of law and order and stabilization of social conditions (largely attributable to the continued presence of the Regional Assistance Mission to Solomon Islands - RAMSI - since 2003), macroeconomic stability has been maintained and small improvements in service delivery have been made. Work on structural reforms has also started, but implementation prospects are difficult to predict in view of the political calendar. Parliament was dissolved in December 2005 and preparations are underway for national elections in April 2006. Pressure for federalization persists, especially leading up to the elections. Concerns remain regarding the viability of a federal system given the fragility of central government finances and limited capacity of provincial governments.

Economic growth slowed from 5.5 percent in 2004 to 4.4 percent in 2005, and is forecast to remain slightly below 5 percent in 2006, reflecting the anticipated slowdown in logging. The reopening of the palm oil plantations and the rehabilitation of the gold mine in early-2005 should support non-logging growth. Inflation in 2005 persisted at around 7 percent, largely due to higher oil prices.

After enjoying a large surplus of about 8 percent of GDP in 2004, the Government budget was closer to balance, recording a deficit of 0.5 percent of GDP in 2005. A wider deficit of about 4 percent of GDP is projected for 2006, reflecting rising recurrent costs, declining donor funds for budget support and lower tax receipts from logging.

Public debt has declined since 2003 but the debt situation remains fragile. Central government debt (including arrears) fell from 122 percent of GDP in 2003 to about 89 percent in 2005, and its external debt also declined from 71 to 62 percent of GDP in the same period. In mid-October 2005, the Government met with its major creditors (the Honiara Club) to renegotiate the terms of its external debt. Some bilateral and commercial creditors who attended the meeting agreed to help lower the Government’s debt burden while Government agreed to observe good budget practices and advance in implementing economic reforms.

The external position weakened in 2005 as the current account recorded a deficit of 11 percent of GDP, largely reflecting higher oil prices and non-oil imports, the latter boosted by investment projects. The deficit is anticipated to widen to 14 percent in 2006. Gross reserves amounted to US$78.5 million at end-2005, nearly 5 months of projected import cover. Despite the prospective current account deficit, nominal reserves are expected to remain relatively stable, aided by an increase in FDI linked to the two major projects underway.

A number of important reforms are high on the policy agenda. The proposed Foreign Investment Bill, a step towards regulatory reform aimed at promoting and facilitating private investment, was endorsed by Parliament in December 2005. A tax reform is currently being considered, and the introduction of a Value-Added Tax is envisaged.

Timor Leste

Timor-Leste has made solid progress in nation-building, maintaining peace and unity, converting its petroleum wealth into a sustainable source of revenue for future generations, and restoring public services. The country now faces the challenges of building on this progress in the context of very limited human resources, embryonic institutions, slow growth of the non-petroleum economy, and high levels of poverty and unemployment.

Subsequent to the ratification of the Timor Sea Treaty in March 2003, development of the Bayu-Undan oil and gas field has proceeded and liquids production began in April 2004. In January 2006, the Governments of Timor-Leste and Australia reached an agreement to evenly share revenues emanating from the Greater Sunrise oil and gas field for 50 years, thus postponing a decision on the delimitation of the maritime boundary between the two countries. A Petroleum Act, a Petroleum Taxation Law, and a Petroleum Fund Law were promulgated in early FY06. Separately, in February 2006, the Government of Timor-Leste launched bidding for the licensing of near-shore oil exploration.

Having embraced the principle of transparent management of petroleum revenues well before the launch of the Extractive Industries Transparency Initiative, Timor-Leste is a pilot country for EITI. The Petroleum Fund Law establishes a savings policy aimed at preserving the real value of petroleum wealth by spreading expenditures over an infinite horizon, safeguarding a sustainable budget in perpetuity. In September 2005, the Government established a Petroleum fund to collect all revenues from petroleum. Annual withdrawals of the sustainable income have to be approved by Parliament and are integrated into regular budget processes. An Investment Advisory Board was created in late 2005, and two quarterly reports have been released on time. In the context of historically high oil prices and the acceleration of offshore production, Timor-Leste's petroleum revenues have risen from $41 million in FY04 to about $266 million in FY05, more than three times the $74 million spent in the FY05 budget and more than twice the revised FY06 budget of $130 million. Petroleum revenues are projected to jump sharply in the medium term. As a result, already large budget surpluses are projected to increase in parallel, reflecting not only the prudent savings policy but also constrained budget execution capacity. By end-December 2005, the Petroleum Fund had accumulated deposits amounting to $370 million.

While petroleum GDP is thus growing rapidly, developments in the non-petroleum sector have been much weaker. After declining by about 6 percent per year during 2002-03, non-petroleum GDP is estimated to have grown modestly during 2004-05. But with population growing at around 3.9 percent, non-petroleum GDP per capita likely declined even in the recent period, and is estimated at US$366 in 2004. Non-petroleum exports, essentially consisting of coffee, are estimated at $8 million in 2005. However, including revenue and royalties from oil and gas, as well as international aid, Timor-Leste's current account surplus is estimated at about $275 million in 2005 and is projected to rise sharply in the medium term in line with estimates of higher petroleum revenue. Inflation fell to about 1 percent in 2005, aided by the use of the U.S. dollar as the national currency. The overall wage level remains relatively high in comparison with neighboring countries, undermining competitiveness and limiting job creation for unskilled labor. Unemployment in the capital, Dili, where about a quarter of the formal labor force resides, is estimated at about 27 percent, and youth unemployment is a particular problem. Unemployment rates in the rest of the country are much lower, with the national rate estimated at 8.5 percent, reflecting the prevalence of self-employed and subsistence workers and a relatively small formal labor force.

Promotion of trade and investment has begun with the establishment in July 2005 of the *Instituto de Apoio do Desenvolvimento Empresarial*, the domestic investment promotion agency, and TradeInvest Timor-Leste, the foreign investment and export promotion agency, which has received several proposals to date. Financial sector activity continues to expand, with bank deposits increasing to 28 percent of non-petroleum GDP at end-December 2005 and bank loans reaching 25 percent of non-oil GDP.

APPENDIX TABLES

Appendix Table 1. Quarterly Real GDP Growth - % Change Year Ago

	China	Hong Kong	Indonesia	Korea	Malaysia	Philippines	Singapore	Taiwan (China)	Thailand	East Asia
Q1 2000	8.5	16.1	4.1	13.1	11.7	5.3	9.6	8.0	6.5	9.3
Q2 2000	8.7	12.4	4.5	9.4	8.5	6.1	8.2	5.2	6.1	7.9
Q3 2000	8.6	12.5	5.3	8.2	8.4	7.2	10.0	6.5	2.4	7.7
Q4 2000	7.9	9.3	7.5	4.3	7.1	5.3	9.7	3.6	4.0	6.8
Q1 2001	9.1	2.4	4.4	3.5	2.9	1.3	4.1	0.6	1.7	4.8
Q2 2001	8.7	1.6	6.1	3.7	0.2	2.0	-1.3	-3.1	2.2	4.1
Q3 2001	8.1	-0.3	3.9	3.4	-1.2	1.4	-5.6	-4.6	2.1	2.9
Q4 2001	7.6	-1.0	1.0	4.6	-0.5	2.3	-5.0	-1.5	2.7	4.3
Q1 2002	8.8	-1.0	3.4	6.5	1.3	4.2	-0.4	1.3	4.5	5.1
Q2 2002	9.2	0.4	4.1	7.0	4.2	4.6	5.0	4.2	5.0	6.1
Q3 2002	9.3	2.9	5.2	6.8	6.0	3.3	4.7	6.1	5.8	6.7
Q4 2002	9.1	4.8	4.7	7.5	5.8	5.5	2.8	5.3	6.0	7.7
Q1 2003	10.8	4.4	4.9	3.8	4.9	4.5	5.0	3.4	6.8	6.4
Q2 2003	8.4	-0.7	5.2	2.2	4.7	4.1	-0.8	0.1	6.6	4.4
Q3 2003	10.1	4.0	4.6	2.3	5.3	4.8	5.5	4.2	6.7	6.1
Q4 2003	10.4	4.8	4.2	4.1	6.7	4.6	9.2	5.9	8.0	7.1
Q1 2004	10.4	8.1	4.1	5.3	7.8	6.3	8.0	7.6	6.7	7.7
Q2 2004	10.2	12.4	4.4	5.5	8.4	6.5	12.7	9.0	6.4	8.3
Q3 2004	9.8	6.8	4.6	4.7	6.7	6.2	8.3	5.5	6.3	6.9
Q4 2004	10.1	7.5	7.1	3.3	5.8	5.3	8.1	2.5	5.3	6.6
Q1 2005	9.9	6.0	6.3	2.7	6.2	4.6	3.4	2.5	3.2	6.1
Q2 2005	10.1	7.3	5.6	3.3	4.4	5.2	5.7	3.0	4.6	6.5
Q3 2005	9.8	8.3	5.6	4.5	5.3	5.0	7.6	4.4	5.3	7.0
Q4 2005	9.9	7.6	4.9	5.2	5.2	6.0	8.6	6.4	4.7	7.4

Source: Haver Analytics and national sources. Quarterly data for China is estimated using new annual production side GDPdata.

Appendix Table 2: East Asia: Merchandise Export Growth

(US $; % change form a year ago)

	2003	2004	Q4 2004	Q1 2005	Q2 2005	Q3 2005	Q4 2005	Sep-05	Oct-05	Nov-05	Dec-05	Jan-06
East Asia (9)	19.0	25.6	23.5	19.3	17.6	18.3	17.3	17.5	19.6	15.9	16.4	16.8
SE Asia	10.9	17.6	18.1	15.9	13.4	12.7	12.5	10.4	10.4	11.7	15.4	14.5
Indonesia	6.8	13.8	23.6	32.2	25.7	11.8	20.2	3.2	15.3	20.1	25.5	22.5
Malaysia	11.3	20.8	16.1	13.7	10.8	8.3	13.2	8.3	13.2	12.4	13.9	13.1
Philippines	2.9	9.5	11.6	3.3	3.3	4.1	3.5	0.9	-3.2	-1.5	16.8	-0.7
Thailand	17.9	19.9	19.7	12.9	12.3	23.1	9.7	23.5	8.8	10.9	9.4	16.6
China	34.6	35.4	35.6	34.8	30.9	29.1	21.7	25.8	29.6	18.6	18.2	28.1
NIEs	14.2	22.8	17.6	11.4	10.3	12.8	15.8	14.2	16.5	15.4	15.4	10.1
Hong Kong	11.8	15.8	14.9	10.3	12.6	13.0	10.4	17.5	12.1	11.8	7.0	4.7
Korea	19.3	31.0	21.2	12.7	9.0	15.4	11.6	17.8	11.9	12.2	10.8	4.3
Singapore	15.2	24.6	22.3	14.7	13.4	14.7	31.0	10.2	29.5	30.0	33.3	32.4
Taiwan (China)	10.4	20.7	11.9	7.8	6.0	7.1	14.2	8.5	16.6	10.7	15.4	5.2

Appendix Table 3. East Asia and the Pacific: GDP Growth Projections

	1999	2000	2001	2002	2003	2004	2005	Forecast 2006	Forecast 2007
East Asia	6.5	7.9	4.1	6.5	6.3	7.5	6.8	6.6	6.3
Developing East Asia	6.1	7.5	6.2	7.5	8.4	8.5	8.2	7.8	7.5
South East Asia	3.3	5.9	2.4	4.7	5.5	5.9	5.1	5.3	5.7
Indonesia	0.8	5.4	3.8	4.4	4.7	4.9	5.6	5.5	6.2
Malaysia	6.1	8.9	0.3	4.4	5.6	7.1	5.3	5.5	5.7
Philippines	3.4	6.0	1.8	4.4	4.5	6.0	5.1	5.3	5.6
Thailand	4.4	4.8	2.2	5.3	7.0	6.2	4.5	5.0	5.2
Transition									
China	7.6	8.4	8.3	9.1	10.0	10.1	9.9	9.2	8.5
Vietnam	4.8	6.8	6.9	7.1	7.3	7.7	8.4	8.0	7.5
Small Economies	8.6	3.0	1.7	2.5	4.9	5.7	5.2	5.1	4.9
Cambodia	12.6	8.4	5.5	5.2	7.0	7.7	7.0	6.0	6.0
Timor-Leste		15.4	16.6	-6.7	-6.2	1.8	3.2	4.0	4.5
Lao PDR	7.3	5.8	5.8	5.8	6.1	6.4	7.0	7.1	6.0
Mongolia	3.2	1.1	1.0	4.0	5.6	10.6	6.2	6.3	5.6
Fiji	9.2	-2.8	2.7	4.3	3.0	4.1	1.7	2.0	2.4
Kiribati	9.5	1.6	1.8	1.0	2.5	1.8	..	..	..
Marshall Islands	0.6	0.9	5.5	4.0	1.8	0.4	3.5	4.0	3.5
Micronesia, Fed. Sts.	-3.1	8.4	0.3	1.1	5.1	-3.8	0.3	1.0	10.0
Palau	-5.4	0.3	1.3	-3.5	-1.3	4.9	5.5	5.7	..
Papua New Guinea	7.5	-1.2	-2.3	-1.0	2.9	2.9	3.0	3.5	3.5
Samoa	2.1	6.8	7.1	4.4	1.8	3.1	3.0	3.0	3.5
Solomon Islands	-0.5	-14.3	-9.0	-2.4	5.6	5.5	4.4	4.8	4.4
Tonga	2.3	5.2	1.8	2.1	2.9	1.6	2.5	..	..
Vanuatu	-3.2	2.7	-2.7	-4.9	2.4	3.0	2.8	2.6	2.4
East Asia NIEs	7.2	8.5	1.0	5.1	3.2	6.1	4.8	4.9	4.6
Hong Kong (SAR)	3.4	12.4	0.6	1.8	3.2	8.6	7.3	5.3	4.5
Korea	9.5	8.5	3.8	7.0	3.1	4.6	4.0	5.0	4.8
Singapore	7.2	10.0	-2.3	4.0	2.9	8.7	6.4	6.0	5.2
Taiwan (China)	5.7	5.8	-2.2	4.2	3.4	6.1	4.1	4.1	4.1
Japan	0.2	2.8	0.2	0.1	1.8	2.3	2.8	2.8	2.1

Source: World Bank data and staff estimates. East Asia is the sum of Developing East Asia and the Newly Industrialized Economies.

Appendix Table 4: Primary Commodity Prices

(US Dollars - % change from a year ago)

			Actual							Projections	
Commodity	**1980-90**	**1991-98**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Crude oil average	0.0	-5.7	38.3	56.2	-13.7	2.4	15.9	30.6	41.5	10.5	-5.1
Non-Energy Commodities	-0.8	0.4	-11.2	-1.4	-9.1	5.3	10.2	17.5	13.4	5.4	-3.1
Agriculture	-1.9	0.8	-13.9	-5.7	-9.1	8.6	9.6	10.5	7.9	2.1	-1.4
Cocoa	-7.3	4.0	-32.3	-20.2	18.0	66.4	-1.5	-11.5	-0.8	4.0	1.3
Coffee, arabica	-3.6	12.6	-23.2	-16.2	-28.5	-1.2	4.3	25.3	42.7	2.7	-5.1
Coconut oil	-1.4	10.6	12.0	-38.9	-29.4	32.4	11.0	41.4	-6.6	-2.8	-4.5
Palm oil	-3.0	12.3	-35.0	-28.8	-7.9	36.6	13.6	6.3	-10.4	-0.3	0.2
Rice, Thai, 5%	0.8	2.1	-18.3	-18.5	-14.6	11.0	3.0	20.3	20.4	-2.2	-1.8
Sugar, world	16.4	-2.8	-29.8	30.6	5.6	-20.3	3.0	1.1	37.8	14.7	4.0
Logs, Malaysia	1.9	3.4	15.2	1.5	-16.3	2.7	14.5	5.4	3.0	10.8	2.2
Sawnwood, Malaysia	4.1	-0.1	24.1	-1.0	-19.1	9.4	4.6	5.5	13.2	4.8	4.3
Rubber, RSS1, Singapore	-1.7	0.5	-12.9	6.2	-13.8	33.0	41.5	20.4	15.2	2.7	-2.9
Metals and minerals	2.9	-2.6	-2.3	12.6	-9.6	-3.1	12.7	37.1	26.7	12.3	-6.2
Tin	-6.7	-0.7	-2.5	0.6	-17.5	-9.5	20.5	73.9	-13.3	18.6	-8.6
Copper	4.3	-4.1	-4.9	15.3	-13.0	-1.2	14.1	61.1	28.4	16.9	-18.6

Source: World Bank DEC Prospects Group. Projections as of 2/15/06

Appendix Table 5: East Asia: Exchange Rates (LCU/$)

	China	Indonesia	Korea	Malaysia	Philippines	Singapore	Taiwan, China	Thailand	Yen
Mar-2005	8.28	9480.00	1024.30	3.80	54.79	1.65	31.53	39.15	107.35
Apr-2005	8.28	9570.00	1002.50	3.80	54.35	1.65	31.28	39.57	105.89
May-2005	8.28	9495.00	1002.50	3.80	54.37	1.66	31.36	40.51	108.08
Jun-2005	8.28	9713.00	1024.40	3.80	55.92	1.68	31.62	41.29	110.40
Jul-2005	8.11	9819.00	1028.30	3.75	56.11	1.66	32.00	41.73	112.22
Aug-2005	8.10	10240.00	1031.00	3.77	56.16	1.68	32.75	41.34	111.30
Sep-2005	8.09	10310.00	1038.00	3.77	56.06	1.69	33.19	41.00	113.15
Oct-2005	8.08	10090.00	1042.70	3.77	55.06	1.69	33.55	40.77	115.70
Nov-2005	8.08	10035.00	1036.30	3.78	54.00	1.69	33.52	41.22	119.63
Dec-2005	8.07	10330.00	1013.00	3.78	53.07	1.66	32.85	41.07	117.97
Jan-2006	8.06	9895.00	971.00	3.75	52.34	1.62	31.99	39.08	117.71
Feb-2006	8.04	9730.00	969.00	3.71	52.09	1.62	32.46	39.31	117.98

Appendix Table 6: East Asia: Foreign Reserves Minus Gold (US$ Billion)

	China	Indonesia	Malaysia	Philippines	Thailand	Hong Kong (SAR)	Korea	Singapore	Taiwan, China	Total
Dec-1996	107.039	19.281	27.009	9.905	37.810	63.808	33.201	76.847	88.038	462.938
Dec-1997	142.762	17.396	20.788	7.178	26.254	92.804	20.369	71.289	83.502	482.341
Dec-1998	149.188	23.516	25.559	9.273	28.825	89.650	51.975	74.928	90.341	543.255
Dec-1999	157.728	27.257	30.588	13.282	34.063	96.236	73.987	76.843	106.200	616.185
Dec-2000	168.278	29.394	29.523	13.090	32.016	107.542	96.131	80.132	106.742	662.848
Dec-2001	215.605	28.016	30.474	13.476	32.363	111.155	102.753	75.375	122.211	731.428
Dec-2002	291.128	32.039	34.222	13.329	38.055	111.896	121.343	82.021	161.656	885.689
Dec-2003	408.151	36.296	44.607	13.655	41.077	118.360	155.282	95.746	206.632	1119.806
Dec-2004	614.500	36.320	66.418	13.116	48.665	123.540	198.994	112.232	241.738	1455.523
Dec-2005	821.514	34.724	70.203	15.927	50.692	124.246	210.317	115.794	253.290	1696.707

Source: Haver Analytics, Datastream

Appendix Table 7: Regional Aggregates for Poverty Measures in East Asia

	$1 –a-day			$2-a-day		
	Mean Consumption (1993 PPP$/month)	**Headcount Index (%)**	**Number of Poor (mill.)**	**Headcount Index (%)**	**Number of Poor (mill.)**	**Population (mill.)**
EAP						
1990	68.03	28.8	456.9	66.9	1,060.8	1585.4
1996	99.84	14.7	252.1	49.6	851.2	1716.0
1999	101.93	15.5	274.7	49.9	884.7	1772.4
2000	113.40	13.8	247.8	45.8	819.9	1789.6
2001	121.48	12.9	233.7	43.2	780.0	1805.6
2003	139.64	10.6	194.3	37.5	689.3	1838.0
2004	149.40	9.1	169.1	34.3	635.6	1853.7
2005	161.91	8.0	149.7	31.3	584.5	1868.5
2006	173.80	7.2	136.0	29.0	547.1	1883.9
2007	185.75	6.6	124.5	27.2	516.3	1899.4
EAP less China						
1990	96.44	21.8	96.3	59.1	261.2	442.1
1996	136.25	10.4	51.3	44.6	219.6	492.1
1999	123.58	10.9	56.3	50.7	261.1	514.5
2000	132.13	10.2	53.0	48.4	252.5	522.2
2001	135.55	9.6	50.7	47.3	250.4	529.3
2003	145.68	7.7	42.2	41.9	228.6	545.7
2004	148.83	6.5	35.9	39.7	219.9	553.8
2005	154.23	5.8	32.7	37.6	211.1	560.8
2006	160.19	5.1	28.9	35.5	201.7	568.5
2007	166.44	4.5	25.7	33.3	191.8	576.3
S.E.Asia 4						
1990	82.33	17.8	56.0	60.3	189.7	314.6
1996	111.23	7.9	27.5	43.6	152.7	350.2
1999	97.26	10.1	36.9	52.8	193.5	366.2
2000	102.89	9.2	34.4	49.9	185.5	372.0
2001	104.27	8.6	32.4	48.7	183.7	377.2
2002	111.40	7.0	26.9	44.7	171.3	383.4
2003	114.48	7.1	27.5	43.0	167.3	389.2
2004	120.32	5.4	21.3	40.0	158.0	395.3
2005	125.11	5.0	20.0	37.9	151.8	400.4
2006	130.06	4.4	17.8	35.7	145.0	406.1
2007	135.54	3.8	15.6	33.3	137.2	411.8
Lower Income EA (Cambodia, Laos, PNG, Vietnam)						
1990	45.21	47.7	40.3	84.6	71.6	84.6
1996	64.62	24.6	23.7	69.4	66.9	96.4
1999	68.68	19.1	19.5	66.5	67.6	101.6
2000	71.72	18.1	18.7	64.9	67.0	103.2
2001	74.40	17.5	18.3	63.7	66.7	104.8
2002	75.76	16.9	18.1	60.9	65.2	107.0
2003	81.56	13.5	14.7	56.4	61.3	108.7
2004	81.81	13.2	14.6	56.1	62.0	110.4
2005	86.06	11.4	12.7	52.9	59.3	112.2
2006	90.17	9.8	11.2	49.8	56.7	113.9
2007	94.09	8.7	10.1	47.2	54.6	115.8

Appendix Table 8: Poverty in East Asia - Country Estimates

		$1 –a-day		$2-a-day			
	Mean Consumption (1993 PPP$/month)	Headcount Index (%)	Number of Poor (mill.)	Headcount Index (%)	Number of Poor (mill.)	Gini Coefficient	Population (mill.)
Cambodia							
1990	55.95	32.5	3.4	76.3	7.9	--	10.3
1996	66.43	24.2	2.8	69.3	8.1	--	11.7
1999	70.67	21.0	2.6	66.6	8.3	--	12.5
2000	70.42	22.6	2.9	67.8	8.6	--	12.7
2001	71.88	21.4	2.8	66.8	8.7	--	13.0
2002	70.76	23.7	3.1	68.1	9.0	--	13.3
2003	74.33	18.9	2.6	64.6	8.7	--	13.5
2004	76.55	19.0	2.6	63.9	8.8	41.7	13.8
2005	79.42	17.3	2.4	62.1	8.7	--	14.1
2006	81.76	16.3	2.3	60.7	8.7	--	14.4
2007	84.45	15.3	2.2	58.9	8.6	--	14.6
China							
1990	57.05	31.5	360.6	69.9	799.6	36.0	1,143
1996	85.20	16.4	200.8	51.6	631.6	39.3	1,224
1999	93.07	17.4	218.4	49.6	623.6	42.6	1,258
2000	105.69	15.4	194.8	44.8	567.4	43.9	1,267
2001	115.65	14.3	183.0	41.5	529.6	44.9	1,276
2002	126.79	13.0	167.4	38.5	495.2	45.7	1,285
2003	137.09	11.8	152.2	35.7	460.7	--	1,292
2004	149.65	10.3	133.2	32.0	415.7	--	1,300
2005	165.21	8.9	117.0	28.6	373.5	--	1,308
2006	179.69	8.1	107.1	26.3	345.4	--	1,315
2007	194.16	7.5	98.8	24.5	324.5	--	1,323
Indonesia							
1990	61.58	20.6	36.7	71.1	126.7	28.9	178.2
1996	86.62	7.8	15.4	50.5	99.6	36.5	197.2
1999	66.80	12.0	24.9	65.1	135.0	31.0	207.4
2000	72.53	9.9	20.9	59.5	125.3	--	210.5
2001	73.44	9.2	19.7	58.7	125.2	--	213.2
2002	81.72	7.2	15.5	53.5	115.6	34.3	216.2
2003	84.59	7.2	15.8	51.5	113.0	--	219.4
2004	88.29	4.7	10.5	47.2	105.2	--	222.7
2005	92.67	4.4	9.9	44.4	100.5	--	226.1
2006	96.56	3.8	8.7	41.9	96.2	--	229.5
2007	100.85	3.3	7.7	39.3	91.4	--	232.9
Laos							
1990	39.16	53.0	2.2	89.6	3.7	--	4.2
1996	48.27	41.3	2.0	83.1	4.1	--	4.9
1999	51.56	36.6	1.9	80.5	4.2	--	5.3
2000	53.31	33.9	1.8	79.4	4.3	--	5.4
2001	55.48	31.3	1.7	77.4	4.3	--	5.5
2002	56.91	28.1	1.6	75.0	4.2	34.6	5.7
2003	57.06	27.9	1.6	74.9	4.3	--	5.8
2004	61.40	22.9	1.4	71.1	4.2	--	5.9
2005	64.23	20.0	1.2	68.6	4.2	--	6.1
2006	67.27	17.6	1.1	66.0	4.1	--	6.2
2007	69.70	15.4	1.0	63.9	4.1	--	6.4

Appendix Table 8: Poverty in East Asia - Country Estimates (Continued)

		$1 –a-day		$2-a-day			
	Mean Consumption (1993 PPP$/month)	**Headcount Index (%)**	**Number of Poor (mill.)**	**Headcount Index (%)**	**Number of Poor (mill.)**	**Gini Coefficient**	**Population (mill.)**
Malaysia							
1990	195.32	2.0	0.4	18.5	3.4	--	18.2
1996	261.87	0.8	0.2	13.1	2.8	--	21.1
1999	271.70	< 0.5	--	12.6	2.9	--	22.7
2000	304.27	< 0.5	--	9.7	2.3	--	23.3
2001	304.09	< 0.5	--	9.7	2.3	--	23.8
2002	310.00	< 0.5	--	9.2	2.2	--	24.3
2003	326.10	< 0.5	--	8.0	2.0	--	24.7
2004	354.20	< 0.5	--	6.2	1.6	--	25.1
2005	366.86	< 0.5	--	5.5	1.4	--	25.5
2006	381.06	< 0.5	--	4.7	1.2	--	25.9
2007	396.57	< 0.5	--	3.9	1.0	--	26.2
PNG							
1990	82.18	29.7	1.2	59.4	2.3	--	3.9
1996	93.15	24.6	1.1	54.4	2.5	48.4	4.6
1999	78.37	30.7	1.5	61.6	3.1	--	5.0
2000	71.90	35.3	1.8	65.0	3.3	--	5.1
2001	66.41	38.0	2.0	69.2	3.6	--	5.3
2002	63.41	39.2	2.1	70.4	3.8	--	5.4
2003	63.51	39.7	2.2	70.7	3.9	--	5.6
2004	63.63	39.0	2.2	70.7	4.0	--	5.7
2005	63.77	38.9	2.3	70.2	4.1	--	5.9
2006	64.34	38.7	2.3	70.0	4.2	--	6.0
2007	64.86	38.7	2.4	69.7	4.3	--	6.2
Philippines							
1990	90.32	19.1	12.0	53.5	33.5	--	62.6
1996	107.15	14.8	10.6	46.5	33.4	--	71.9
1999	107.20	13.5	10.0	46.9	34.9	--	74.4
2000	106.93	13.5	10.3	47.2	36.0	46.2	76.3
2001	106.10	13.5	10.5	46.7	36.3	--	77.9
2002	109.12	12.4	9.9	45.1	35.9	--	79.5
2003	106.35	13.1	10.6	45.6	36.9	44.5	81.1
2004	110.72	11.7	9.6	43.5	35.8	--	82.4
2005	114.26	10.8	9.0	41.9	35.1	--	83.7
2006	118.45	9.6	8.2	40.0	34.0	--	85.1
2007	123.17	8.4	7.3	38.1	32.9	--	86.5
Korea							
1990	301.09	< 0.5	--	< 0.5	--	29.88	42.87
1996	480.46	< 0.5	--	< 0.5	--	29.71	45.52
1999	450.06	< 0.5	--	< 0.5	--	30.00	46.62
2001	519.96	< 0.5	--	< 0.5	--	--	47.35
2002	557.51	< 0.5	--	< 0.5	--	--	47.62
2003	545.12	< 0.5	--	< 0.5	--	--	47.85
2004	537.13	< 0.5	--	< 0.5	--	--	48.08
2005	553.91	< 0.5	--	< 0.5	--	--	48.29
2006	576.95	< 0.5	--	< 0.5	--	--	48.50
2007	599.80	< 0.5	--	< 0.5	--	--	48.69

Appendix Table 8: Poverty in East Asia - Country Estimates

		$1 –a-day		$2-a-day			
	Mean Consumption (1993 PPP$/month)	Headcount Index (%)	Number of Poor (mill.)	Headcount Index (%)	Number of Poor (mill.)	Gini Coefficient	Population (mill.)
Thailand							
1990	102.88	12.5	7.0	47.0	26.1	43.8	55.6
1996	143.92	2.2	1.3	28.2	16.9	43.4	60.0
1999	123.50	3.1	1.9	33.6	20.7	--	61.7
2000	125.42	5.2	3.2	35.6	22.0	43.2	61.9
2001	131.21	3.6	2.2	32.0	19.9	--	62.3
2002	139.38	2.4	1.5	27.7	17.6	42.2	63.5
2003	145.46	1.6	1.1	24.0	15.3	--	64.0
2004	151.76	1.8	1.2	23.7	15.4	42.5	65.1
2005	157.04	1.7	1.1	22.8	14.8	--	65.1
2006	163.31	1.3	0.9	20.6	13.5	--	65.7
2007	170.33	1.0	0.6	17.8	11.8	--	66.2
Vietnam							
1990	41.73	50.8	33.6	87.0	57.6	--	66.2
1996	63.66	23.6	17.7	69.4	52.2	--	75.2
1999	68.90	16.9	13.4	65.9	52.0	--	78.9
2000	73.16	15.2	12.1	63.5	50.7	--	79.9
2001	76.62	14.6	11.8	61.8	50.1	--	81.0
2003	85.63	9.9	8.3	52.9	44.3	--	83.8
2004	85.31	9.9	8.4	52.8	44.9	--	84.9
2005	90.20	7.9	6.8	49.1	42.3	--	86.1
2006	94.96	6.2	5.4	45.5	39.7	--	87.3
2007	99.48	5.1	4.5	42.5	37.6	--	88.6

Notes for Appendix Tables 7 and 8

The poverty lines in Tables 7 and 8 are set at $1.08 and $2.15 per person per day (in 1993 PPP$) for all countries. For most countries, 1993 World Bank PPP estimates are used. The PPP for the Philippines is from the Penn World Tables, while that for PNG is the 1996 World Bank PPP. PPPs for Vietnam, Lao PDR and Cambodia have been further adjusted using a calorie price ratio between Indonesia and Vietnam. Projections are based on World Bank growth rate forecasts for 2003-2004. Wherever possible, the projections utilize information on sectoral GDP growth rates, changes in the food CPI relative to the general CPI, changes in the GDP deflator relative to the CPI, and changes in the consumption-income ratio. The projections assume that there is no change in relative inequalities *within* sectors. For China, the projections are done separately for rural and urban China, and then aggregated using population shares. Estimates for all countries except Malaysia and China are based on surveys of household consumption. The estimates for Malaysia and China use income surveys. For China, a survey-based estimate of mean consumption is used in conjunction with the income Lorenz curves to derive poverty estimates. These poverty estimates differ from those commonly found in national poverty assessments for two main reasons. First, country assessments use national poverty lines that differ from the uniform international poverty lines used here. Second, national poverty lines also typically allow for spatial cost of living differentials within countries, but such adjustments are omitted here to maintain a consistent methodology across countries. For instance, in the case of Thailand, these differences explain why the above estimates indicate a small increase in poverty between 1998 and 2000 (in spite of adjusting the CPI by the change in the national poverty lines over this period), while national poverty line-based estimates indicate a decline. Also for Thailand, the 2002 estimate is based on a longer consumption module, which could lead to a small overestimation of consumption relative to 2000. Poverty estimates for the Philippines for the years 2001 and 2002 are an average of a “forward” projection using survey data for 2000 and a “backward” projection using survey data for 2003.

Appendix Table 9: NPLs in the Commercial Banking System of the Crisis-Affected Countries
(% of total loans)

	1997	1998	1999	2000	2001	2002	2003	2004				2005			
	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec
Indonesia a/	7.2	48.6	32.9	18.8	12.1	7.5	6.8	6.3	6.2	5.6	4.5	4.4	7.0	7.9	7.6
Korea b/	6.0	7.3	13.6	8.8	3.3	2.4	2.2	2.5	2.2	2.1	2.0	1.9	1.7	1.5	1.3
Malaysia c/		10.6	11.0	9.7	11.5	10.2	9.0	8.3	7.7	8.1	7.5	7.2	6.7	6.1	5.8
Philippines d/	4.7	10.4	12.3	15.1	17.3	15.0	14.1	14.0	13.8	13.9	12.7	11.3	9.2	9.5	8.5
Thailand e/	..	45.0	41.5	29.7	29.6	34.2	30.6	29.6	29.6	28.2	28.0	27.3	26.7	25.8	24.0
excl. AMCs	..	45.0	39.9	19.5	11.5	18.1	13.9	13.0	13.0	12.1	11.6	11.1	10.6	10.2	8.3

(a) Excludes IBRA's AMC; (b) Excludes KAMCO/KDIC. The NPL ratio increased in 1999 due to the introduction of stricter asset classification criteria (forward looking criteria); (c) Excludes Danaharta. NPL series used by Bank Negara Malaysia, which is net of provisions and excludes interest in suspense; (d) From September 2002 onwards, the NPLs ratios are based on the new definition of NPLs (as per BSP Circular 351) which allows banks to deduct bad loans with 100 percent provisioning from the NPL computations; (e) Includes transfers to AMCs but excludes write-offs. (Note that the jump in headline NPLs in December 2002 was a one-off increase, reflecting a change in definition and did not affect provisioning requirements).

Special Focus

Climate Change and East Asia: Challenges and Opportunities

Introduction

On June 7th, 2005 the national science academies of the G8 nations plus Brazil, China and India, three of the largest greenhouse gas emitters in the developing world, signed a statement on the global response to climate change. The statement stressed that scientific understanding of climate change is now sufficiently clear to justify nations taking prompt action. Greenhouse gas emissions are a global public "bad", and as acknowledged by the World Bank mitigating the effects of climate change is critical in addressing the Bank's core objectives of poverty alleviation and sustainable development. The Intergovernmental Panel on Climate Change (IPCC) estimates that if atmospheric CO2 concentrations were to double from pre-industrial levels, "developing countries would suffer economic costs of 5-9 percent of GDP[31], several times higher than industrialized countries, and the poor in the Bank's borrowing countries would be at the greatest disadvantage." Addressing climate change thus requires serious implementation efforts of global endeavors such as the United Nations Framework Convention on Climate Change (UNFCCC)[32] and national actions as well.

The East Asia and the Pacific region (EAP) is arguably the most diverse in the world in terms of climate change. While the region is still largely rural, most of its gross domestic product (GDP) and its mega cities, especially in China, are located on the coast – prime candidates to be impacted by sea level rise and weather related disasters. Many EAP countries are formed by islands, and climate change is likely to significantly impact them. Some Pacific Island nations may even disappear. While climate change impacts on some EAP sectors are difficult to predict, climate change is likely to affect renewable natural resource - intensive or dependent sectors such as agriculture, forestry, and fisheries. As with other forms of pollution, the effect of greenhouse gas emissions is likely to be felt more acutely by EAP's poor, who are also more dependent on natural resources for their livelihood and more vulnerable. Yet, EAP countries also share part of the responsibility for worsening climate change. While most EAP nations contribute minimally to greenhouse gas emissions, the region's industrialized countries are at least in part to blame for the long run cumulative contribution to climate change. Moreover, the rapidly industrializing economies of the region are increasingly responsible for a significant share of current global emissions. While adaptation can assist in diminishing the impacts of climate change in EAP countries, unless mitigation is undertaken by large regional emitters their cumulative contribution to climate change will continue to increase in the future. It is thus difficult to perceive a solution to climate change without involving major East Asia and Oceania countries such as China, Japan, Republic of Korea, Indonesia, and Australia.

Since climate change science and policy are constantly evolving, climate change policy making is a learning process that needs to be flexible to incorporate new information. Nonetheless, global attention to climate change indicates a genuine concern about its impact, and the need for flexibility should not be a pretext for leniency. Given the potential catastrophic consequences, precaution is advisable even if standard tools of economic analysis may be biased against climate change related interventions. The purpose of this note is to provide a snapshot of the main climate change related issues of relevance to the region and the regional relevance in terms of climate change to the rest of the world.

The Science

Certainties and Uncertainties

The cause of global warming has not been free of controversy. Global warming occurrence, humanity's contribution to it, and the extent of its likely consequences have been deeply disputed. Yet, as stated by Robert Watson, the World Bank's Chief Scientist: "… there is no doubt the Earth's climate is warming, about 0.6 degrees Celsius over the last 100 years. Not only have we seen the land areas warm[er], but also the oceans, and both the satellite data and the land data are now both showing a

[31] From http://www4.worldbank.org/legal/legen_int/legen_climate.html

[32] Over 160 countries have joined the UNFCCC aimed at confronting climate change. The Convention places the heaviest burden for fighting climate change on industrialized nations, since they, as a group, are by far the major source of past and current greenhouse gases (carbon dioxide, methane, nitrous oxide, and several other) emissions. These industrialized nations are listed in the UNFCCC's Annex I, which includes Japan, Australia, and New Zealand from the EAP region. The Kyoto Protocol, adopted in 1997, strengthens the Convention by committing Annex I Parties to individual, legally-binding targets, to limit or reduce their greenhouse gas (GHG) emissions. Only Parties to the UNFCCC that have also become Parties to the Kyoto Protocol (i.e. by ratifying, accepting, approving, or acceding to it) are bound by the Protocol's commitments. It should be noted that Australia, Croatia and the United States of America (USA) are the only Annex I countries that have not joined the Kyoto Protocol.

warming. We have also seen changes in precipitation and sea level. The key question is whether the observed warming is due to human activities or whether it could be ascribed to natural phenomena. The Intergovernmental Panel on Climate Change (IPCC), in its last major report, said that most of the observed warming was, indeed, due to human activities…Therefore, the large majority of scientists do believe the Earth's climate is warming, and do believe that human activities are primarily responsible." According to the IPCC, at current trends in greenhouse gas emissions growth, global temperatures are expected to rise between 1.4 and 5.8º C (2.5 to 10.4º F) by 2100.

Such temperature changes are likely to have impacts on the sea level, precipitation patterns, water supply, ecosystems, and overall human development. In addition, higher climate variability may cause an increase in the frequency of extreme weather events and weather related disasters. As recent natural disasters and Figure 1 below in general illustrate, poor countries and the poorest people are most vulnerable to the impacts of climate change. If broken down by countries and over time, human contribution to global warming, however, has been very uneven. Since greenhouse gas emissions are largely the results of the combustion of fossil fuels (coal, oil, and gas), developed countries have traditionally been major contributors to global warming. Yet, several important questions remain: To what extent are natural disasters attributable to climate change? Is there a "point of no return" and, if so, how far are we from it? How much can we contribute to reverse the trend? These are key questions, but the current state of knowledge, coupled with the increased fear of a "climate surprise"[33], underscores the need to incorporate the precautionary principle in policy making and is leading nations to increase efforts to mitigate global warming.

Adaptation

Impacts

EAP is one of the most vulnerable regions to climate change impacts. Due to its geography, it is one of the regions most at risk from natural disasters, both relative to its land area and the proportion of population affected. Since 1950, natural disasters have affected more than 3.4 million people and caused over 1,700 fatalities in the Pacific Islands alone. As Tables 1 and 2 indicate, the economic and social impacts of disasters can be significant and long lasting.

While scientific information on a direct cause and effect relationship between certain natural disasters and climate change is evolving, the available evidence points towards the increasing frequency and intensity of extreme weather events in the region. In fact, 10 of the 15 most extreme events reported over the past half a century occurred in the last 15 years. Hurricane strength cyclones have increased systematically in the southwest Pacific, a trend also observed globally over the past 30 years (Bettencourt et al. 2006). In addition to more frequent and intense cyclones, the EAP region is also affected by a change in prevailing climate conditions. For example, compared to the past, the Central Equatorial Pacific is experiencing more intense rain (about a 30% change) and a hotter climate (0.6^{o} C). Sea surface temperatures have increased by about 0.4 C (Hay et al. 2003). As the EAP region is also climatically diverse, the region is particularly vulnerable to multiple climate change impacts.

While the present path of development in EAP is placing more fixed infrastructures and economic activity within the coastal zone, this trend may offer limited scope for adjustments against the region's diverse climatic hazards such as floods, droughts, sea-level rise, and storm surges. The likelihood of damage to infrastructure and loss of human life because of unexpected extreme events will thus rise. Recent estimates indicate that a 1-5 meter sea level rise would impact the region's GDP between 1.7 and 8.3 percent, respectively. Countries most affected would be Vietnam (10.2-36.2 percent); China (2.4-10.8 percent), Indonesia (1.9-8.1 percent), Thailand (1.4-22.6 percent), and Cambodia (1.1-11.2 percent) (Buys et. al. forthcoming).

According to the IPCC (2001), the tropical areas of Southeast Asia are most vulnerable:

- Model-based projections of the mean annual number of people who would be flooded by coastal storm surges are of the order of 15 to 40 million in South East Asia for mid-range scenarios of a 40-cm sea level rise by the 2080s (Greenpeace 2005).
- The expected impact on agricultural productivity in tropical Asia due to temperature rises; increased sediment runoff of surface rivers; increased soil loss, land slips, and slides in EAP highlands; increased frequency and intensity of typhoons, floods and droughts are all key sources of production losses

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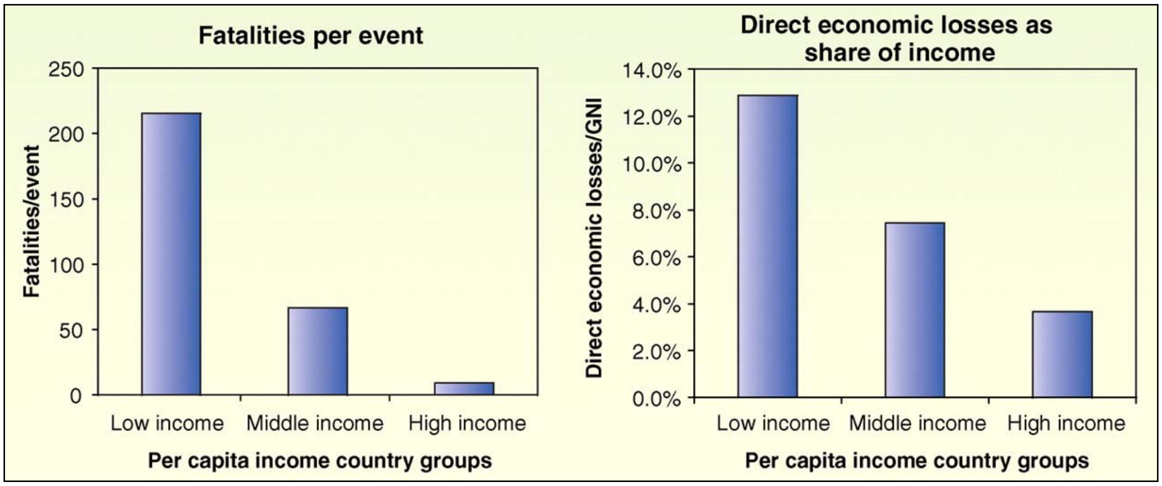
[33] A *climate surprise* is defined by the IPCC as a rapid, non-linear response of the climatic system to anthropogenic climate forcing (global warming). Climate surprises are low-probability, high-consequence extreme events, such as a rapid deglaciation of polar ice sheets.

Figure 1. Fatalities per event and direct economic losses as % of Gross National Income. 1980 to 2004



Source: Abstracted with permission from J. Linnerooth-Bayer et al., SCIENCE 309:1044-1046. Copyright [2005] AAAS.[34]

Table1: Reported disasters in the Pacific Islands (1950 – 2004)

	Number	Fatalities	Population affected	Reported Losses (2004 US$M)
Windstorms	157	1,380	2,496,808	$5,903.90
Droughts	10	0	629,580	$137.00
Floods	8	40	246,644	$94.80
Earthquakes	17	53	22,254	$330.60
Others	15	274	21,520+	$60,000
TOTAL	207	1,747	3,417,006	$6,526.30

Source: Bettencourt et al. 2006

Table 2: Estimated economic and social impact of disasters in selected Pacific Island countries (1950 – 2004)

Country	Number of disasters reported	Reported losses in 2004 (US$m)	Average population affected		Average impact on GDP	
			In disasters years	In all years	In disasters years	In all years
Fiji	38	$1,174.6	10.8%	5.1%	7.7%	2.7%
Samoa	12	$743.4	42.2%	6.1%	45.6%	6.6%
Vanuatu	37	$384.4	15.5%	4.5%	30.0%	4.4%
Tonga	16	$171.1	42.0%	5.3%	14.2%	1.8%
Guam	11	$3,056.3	3.7%	0.5%	n/a	n/a

Source: Bettencourt et al. 2006

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(Kurukulasuriya and Rosenthal 2003). In the Philippines, the weather disasters mentioned were responsible for over 80% of the total rice losses from 1970 to 1990, costing up to US$39.2 million in 1990 alone (Lansigan et al. 2000).

- Climate change impacts on ecosystems (including coral reefs) and on human health are also expected to be significant in South East Asia (IPCC 2001 and Greenpeace 2005).

Measures

Given the long lifetime of atmospheric greenhouse gases, their stock will continue to accumulate for some time into the future regardless of international agreements for greenhouse gas emissions mitigation. This makes adaptation at the national level a necessity. Adaptation measures can be classified into two main categories: "no-regret actions" which are interventions that address current challenges independent from considerations on future climate change impacts; and "specific responses" to climate change impacts. No-regret actions are viewed as the best approach; since they are autonomous from climate change uncertainties as these influence little the net benefits from such actions. They can be clustered into the following:

- Disaster preparedness - Among the main policy lessons emerging from experience with disasters in recent years is the importance of integrating disaster prevention and natural disaster risk management as parts of development plans, poverty reduction strategies and investment projects. The most effective instruments for risk management of natural hazards are those that address current risks. The adverse consequences of storm surges, king tides, tsunamis and cyclones in the EAP region need to be addressed through hazard mapping, vulnerability assessments and assets-at-risk inventories. Coastal assets and infrastructure can be currently better protected rather than repaired after damage from extreme events. (Bettencourt et al. 2006). From an economic standpoint, risk management efforts have proven far more cost effective than repairing future damages. For example, the impact of cyclone Heta which hit Samoa in 2004 translated into 9% of GDP, compared with 230% of cyclone Val in 1991. Although the two cyclones are not directly comparable, as stated in Bettencourt et al. (2006): "the effects of cyclone Heta would have been far worse without an investment in risk management of natural hazards during the 1990s (World Bank 2004). Shoreline protection systems designed to cyclone standards performed well, with relatively minor damage, compared to sub-standard coastal protection in adjacent areas."

Table 3: Adaptation through Sectoral Measures

Adaptation Option	***Purpose***	***Implications on climate change Adaptation***
Crops Diversification	Promoting farm-level risk management, increasing productivity, defending against pest/disease	In dry and temperate areas, the new crop mix may include new types of agriculture that require less water and are less vulnerable to high temperatures / water salinity.
Land and Water Conservation practices	Conserving soil moisture, prevent erosion, increasing production per unit of evapotranspiration, reducing run-off , etc.	In dry and temperate areas, water saving measures including small reservoirs can assure less variability in production during drought periods. In tropical areas, land contouring and terracing can reduce run-off, preventing soil erosion and production losses.
Improvement of Agricultural Water Management	Increasing water efficiency and productivity, improving irrigation water distribution, etc.	In dry and temperate areas, agricultural water management can withstand rainwater shortages.
Modernization of farm operations and development of extension services	Improving means, awareness and knowledge of farmers to increase productivity.	In dry and temperate areas, the adoption of new irrigation technologies (drip and sprinkler) saves water. Everywhere, on farm practices to cope with climate extremes can be taught to farmers.
Improving forecasting mechanisms	Assist planning	Forecasting of extreme weather events highly strengthens farmers' ability to cope.

Source: adapted from Kurukulasuriya, P. and Rosenthal, S. 2003

- Climate Proofing: At the country level, climate change risks should be recognized alongside other risks that are routinely assessed. (Burton and van Aalst 2004). A recently published report by the Asian Development Bank provides "climate proofing" application case studies in different projects of Micronesia and Cook Islands (a road infrastructure project, a breakwater project, two projects for the protection of inland and coastal communities) and National Development Plans. (Hay et al. 2005).

While no-regret actions are the "low hanging fruits" of adaptation, when specific climate change impacts are certain – as in the case of sea level rise – targeted responses may be inevitable. Table 3 illustrates climate change adaptation through sectoral level actions. Most actions aiming at increasing water efficiency in agriculture, promoting soil conservation and enhancing productivity - hence contributing to poverty reduction - can offer protection against potential climate change impacts as well.

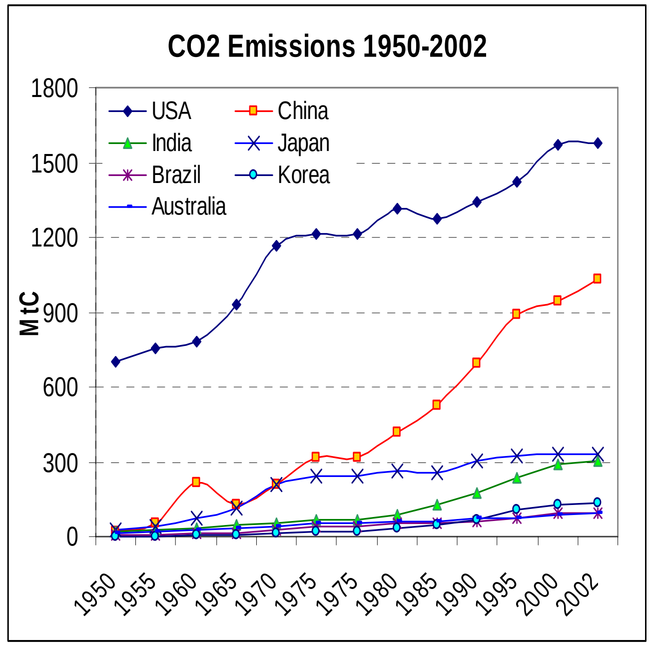
Regarding financing of adaptation measures, the Global Environment Fund (GEF) supports interventions that increase the resilience of countries and their vulnerable citizens, businesses, and ecosystems to adverse impacts of climate change. Ensuring the political will to include such adaptation measures into national development plans requires successful awareness based on local consultation and thorough data collection and analysis. Over the years, guidance on adaptation has evolved through a series of staged approaches. In order to facilitate a phased approach to adaptation, the GEF has helped countries to submit national communications to the UNFCCC, including national greenhouse gas inventories, vulnerability and adaptation assessments, and capacity building. Recently, GEF has begun moving into a second phase of supporting pilot and demonstration projects. These projects provide real benefits that have been useful for developing, testing, and institutionalizing rational approaches to local problems such as flooding, erosion and water scarcity.

Mitigation

Impacts

Since climate change is related to cumulative greenhouse gas emissions, EAP countries, especially the industrialized ones, share part of the responsibility for the worsening of climate change. Moreover, since the region congregates large current global emitters, including from the developing world, the need for a mitigation effort in EAP is key. China, for example, is responsible for almost 15 % of the world's total annual emissions (excluding land use change) and, as depicted in Figure 2, the gap between the country and the world's largest emitter, the USA, is rapidly closing. If compared to emissions from other large developing countries, China's emission growth path is striking. Although China's continuous increase in total CO2 emissions and other greenhouse gases during the last decade is debatable[35], China has steadily ranked second in the greenhouse gas emitters list, almost triple the next East Asian country – Japan. In addition to China and Japan, Republic of Korea, Australia and Indonesia also figure among the 20 top emitters in total CO2 emissions.

Figure 2



Of course, if the unit of accounting is greenhouse gas emissions per capita, given its large population, China's world ranking falls considerably (ranked 97). As depicted in Figure 3, China's per capita contribution to climate change in 2002 is well below some developed countries but still above other large developing economies.

In terms of sectoral contributions to greenhouse gas emissions, as suggested by Figure 4 the energy sector, including transport and consumer electricity use, is by far the main contributor in most EAP large emitters. The energy sector contributes to over 70 percent of total emissions of large EAP emitters, indicating that energy efficiency and energy sources mix of these economies can be main drivers for total greenhouse gas emissions reduction in EAP. Slash-and-burn and other unsustainable agricultural practices also play an important role in other developing countries of the region.

[35] Streets et al. 2001 report a reduction in total CO2 and CH4 emissions in the period 1996/7 – 2000.

Figure 3

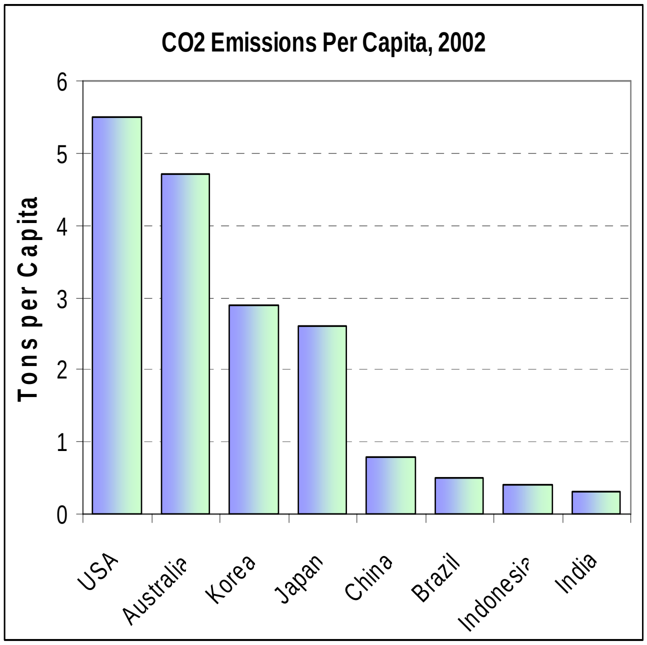
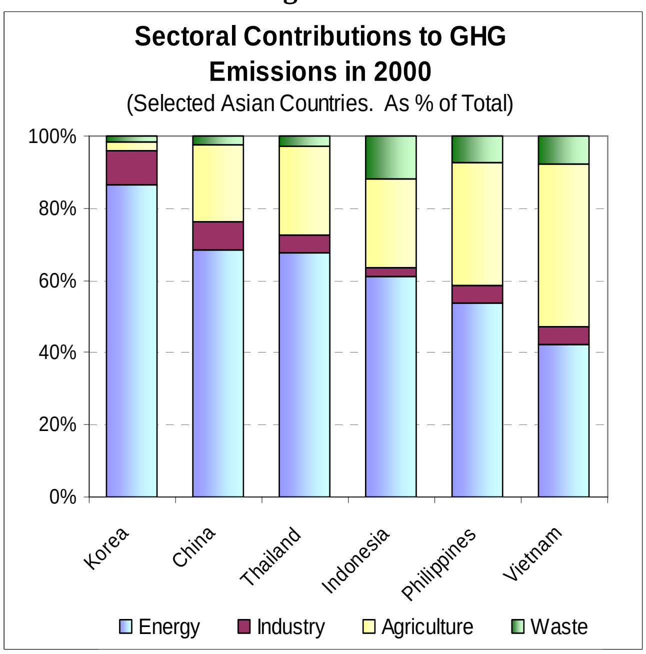


Figure 4



Measures

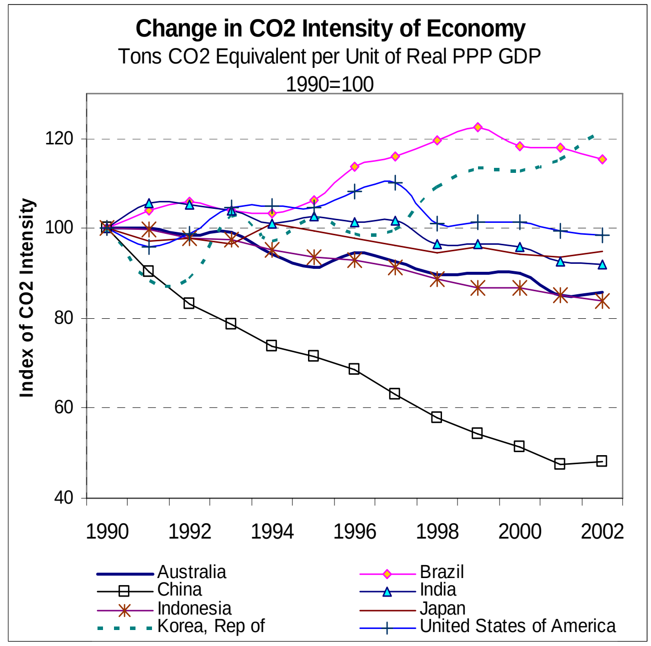
Greenhouse gas emission reductions can be achieved through national measures and internationally based measures.

National Measures

There are a number of national measures that can be undertaken, which improve local pollution problems and contribute positively to greenhouse gas emissions reduction. China, for example, is engaging in several ways from the highest planning tools (its 5 year plan) to actual measures on the ground.

While China's starting point was of a highly inefficient CO2 intensive economy, progress in a decade has been remarkable even as compared to other large emitters. The country's CO2 intensity has decreased by more than 50 percent as depicted in Figure 5. According to its national data, China seems to be acting effectively on energy demand through energy saving regulations, changes in energy subsidies and incentives structures.

Figure 5



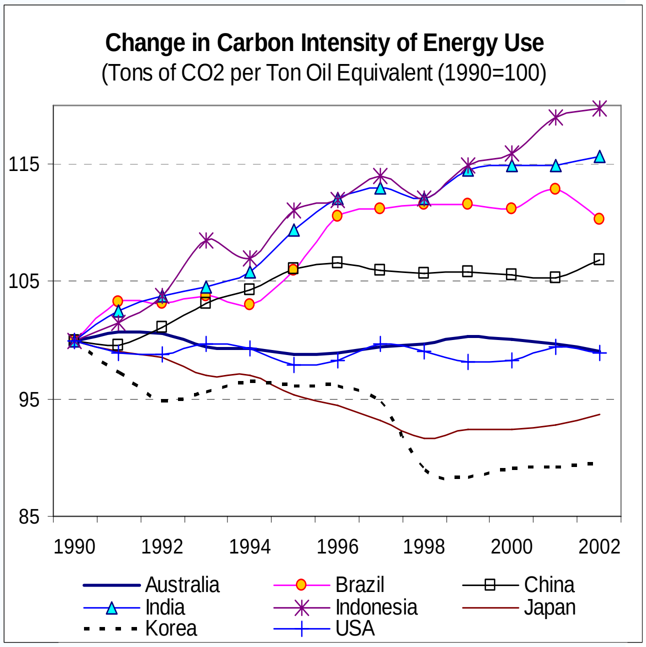
Yet, on the supply side the fossil fuel carbon intensity embedded in the energy sources mix is still reliant on highly polluting coal (between 60 and 70 percent). As illustrated by Figure 6, China's carbon intensity of energy use grew since 1990, reflecting a steady – or even increasing – coal centered energy mix (Zhang 2000). Nonetheless, China has:

- Enacted the March 2005 Renewable Energy Law which promotes the "greening" of China's energy mix. Through a national renewable energy requirement, the law is expected to boost renewable energy use up to 60 GW or 10 percent in the next decade. If enforced, this law would be a breakthrough towards a cleaner energy mix, bringing about both a reduction in local pollution and a reduction in the energy supply risk through diversification (Feng Fei 2006).

- Promoted the closure of small, inefficient industrial plants; the improvement of energy end use efficiency and coal quality; the switching of many residential fuel users from coal to gas and electricity; and the promotion of technological progress in energy–intensive sectors (Streets et al. 2001).

China aims to reduce by 20 percent its energy use per unit of GDP by 2010, while increasing its GDP by four times with only twice as much energy use by 2020. Main drivers of these achievements would be a shift towards less energy intensive industrial sectors and regulation on the energy consumption standards in the building and transportation sectors, since the latter sectors are expected to gradually increase their relative contribution to total GDP against a decreased share of the industrial sector (Feng Fei, 2006). Moreover, completing energy price liberalization and raising energy taxes to reflect environmental costs, accelerating the adoption and domestic use of efficient energy production technologies, promoting environmentally-sustainable city designs and transport systems are but a few measures that China can take to further climate change mitigation while diminishing the impact of local pollution and securing additional economic gains.

Figure 6



While the actions planned or implemented by China provide some good examples to other countries of the region, the EAP region as a whole also has great potential for investing in hydropower and changing its dependency on intensive greenhouse gas emitting fuel sources. Beyond contributing towards higher energy security and diminishing local pollution, hydropower projects not involving large dam construction are also eligible investments under the Clean Development Mechanism (CDM) discussed below. EAP has significant hydropower potential. The region's hydropower contribution to electricity generation (20 percent in 2002) is lower than in all developing countries (26 percent) and in the world (22 percent). In 2003, China used 15 percent of the country's technically exploitable hydropower potential, while Indonesia, Malaysia, and Vietnam exploited 2.5 percent, 6 percent, and 19 percent of their technical potentials, respectively. As mentioned in World Bank (2005): "By comparison, France, Japan, and the United States used 91 percent, 74 percent, and 51 percent of their technical hydro potential, respectively. With high electricity demand growth expected over the next decade, the aggressive development of hydropower could bring considerable environmental and economic rewards." As illustrated by China's current efforts and mentioned in the above report: "non-hydropower renewables present a similar prospect, albeit at a smaller scale, in EAP. They accounted for 1.3 percent of EAP's generated electricity in 2002 (0.6 percent in China) compared to 12.8 percent in the European Union and 2.1 percent globally. EAP countries have the opportunity today to lay the foundations for significant scale-up of renewable energy over the coming decades".

Internationally Based Measures

The Kyoto Protocol which entered into force in 2005 commits industrialized (Annex I) country signatories to reduce in the period of 2008-2012 their greenhouse gas emissions by an average of 5.2 percent compared with their 1990 emissions. The Kyoto Protocol establishes several flexible "mechanisms" to help industrialized countries meet these commitments. Among these mechanisms, CDM is of particular relevance to developing countries[36]. CDM allows Annex I countries to invest in greenhouse gas emission reduction projects or carbon sinks (e.g. a reforestation project) in non Annex I countries and to claim the resulting Certified Emission Reductions (CER) from the investment. CDM offers important opportunities for climate change mitigation and sustainable development in EAP's developing countries. For example, the energy sector can benefit through the adoption of improved efficiency programs and renewable energy options. Programs to reduce greenhouse gas from industrial operations and methane emissions from urban landfills also qualify under the CDM. A number of governments and private companies have already entered the carbon market which is projected to grow rapidly in the coming years.

The World Bank's involvement in the carbon market can help developing countries establish the necessary institutions and procedures that allow public and private players to enter the market. The Bank can also help grow the market by linking private sector buyers of carbon credits with financially strapped climate-friendly projects in developing countries. In effect, carbon finance is becoming a significant contributor to environment-related project activities in EAP and the World Bank is assisting countries to better define their approaches to ownership and treatment of CERs under the CDM. To date, Emission Reductions Purchase Agreements

[36] Besides CDM, other mechanisms include *Joint Implementation* (JI) and *International Emissions Trading* (IET). Yet, these are less relevant to developing countries. See UNFCCC for a detail discussion (http://unfccc.int/2860.php).

(ERPAs) have been signed in diverse sectors including energy efficiency relating to cement production in Indonesia, wind and geothermal power in the Philippines, and hydroelectric power, coal mine methane, and the incineration of HFC-23 in China. Due to its size, the latter is described in Box 1.

Box 1: HFC-23 Reduction in China

The unprecedented economic growth in China has been accompanied by a significant increase in greenhouse gas emissions, especially from industrial processes. One of the most potent greenhouse gases emitted in China is Trifluoromethane (HFC-23), a by-product released in the production of HCFC-22, which has 11,700 times the global warming potential of carbon dioxide measured in tons of carbon dioxide equivalent, or TCO2e. The China HFC-23 Emissions Reduction Project supports China's participation in global efforts to mitigate human-induced climate change. The project has led to the largest carbon finance transaction ever undertaken globally with the purchase of CERs, corresponding to approximately 18 million TCO2e per year through ERPAs with two Chinese chemical manufacturing companies. The companies will install incineration facilities to destroy HFC-23 emissions using their own resources. The World Bank will aggregate funds of $930 million to purchase the CERs generated by the project. Approximately 70 percent of this transaction will be financed by private capital. CER's large volume from the project will inject much-needed liquidity into the primary and secondary global carbon market which, before the project, stood at $400 million, well below the projected level of $20-30 billion that is eventually expected by 2012 from the market mechanisms for greenhouse gas reduction. China is planning to set aside a portion of the net revenues of this transaction in a "clean development fund" to promote climate change mitigation projects.

UNFCCC provides the main framework to addressing climate change at the global level. While developing countries do not have any obligations to reduce emissions under the Kyoto Protocol, EAP's main emitters are gradually becoming more active in international cooperation on greenhouse gas reductions through the Kyoto Protocol and otherwise. The recently announced Asia-Pacific Partnership on Clean Development and Climate is one such example bringing together Kyoto Protocol countries, Annex I non Kyoto Protocol parties and EAP main emitters. AP6 is an international non-treaty agreement between Australia, India, Japan, China, South Korea, and the United States launched on January 12 2006 at the Partnership's inaugural Ministerial meeting in Sydney. Foreign, Environment and Energy Ministers from partner countries agreed to co-operate on development and transfer of technology which enables reduction of greenhouse gas emissions. The agreement outlines "a ground-breaking new model of private-public taskforces to address climate change, energy security and air pollution." Member countries of this endeavor account for around 50% of the world's greenhouse gas emissions, energy consumption, GDP and population. Unlike the Kyoto Protocol, this agreement allows member countries to individually set their goals for reducing emissions, with no mandatory enforcement mechanism.

As with adaptation measures GEF supports developing countries in their efforts to address climate change mitigation. GEF climate change mitigation projects fall under four categories: 1) elimination of barriers to energy efficiency and energy conservation; 2) adoption of renewable energy by reducing barriers and implementation costs; 3) reduction of the long-term costs of low greenhouse gas emitting energy technologies; and 4) support for the development of sustainable transport. GEF allocates and disburses globally about US$250 million per year for climate change mitigation.

The Way Forward

Climate change may have profound impacts both globally and regionally for EAP. The region's geographical and economic diversity imply that it will face a wide range of impacts. The region's GDP is likely to be significantly impacted by climate change, albeit in an uneven fashion among countries. As with other public "bads", the poor are more likely to be the most vulnerable to climate change. By definition, climate change is not equitable, and regardless of uncertainties countries may be better served by taking a precautionary stand in climate change related issues. A host of actions to adapt and mitigate climate change can be taken which are cost effective and make economic and environmental sense. The good news is that the region is increasingly aware of climate change and is taking action both nationally and globally. Yet, there are still many more opportunities for implementing measures that are economically sensible, improve the local environment, and contribute to the global common good. Countries in East Asia and the Pacific must do much more; the stakes are very high.

This Special Focus was prepared by Dan Biller and William Nicholas Bowden of the World Bank's East Asia and the Pacific Region Environment & Social Development Sector Department and Gretel Gambarelli of the World Bank's Agriculture & Rural Development Department (ARD). Comments from Homi Kharas, Julien Labonne, Neeraj Prasad, Maria Teresa Serra and David Wheeler are gratefully acknowledged. Except where noted, figures are based on data from the Climate Analysis Indicators Tool (CAIT). Senior authorship is not assigned.

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Cambodia: Key Indicators

	2001 Year	2002 Year	2003 Year	2004 Year	2005 /pr Year	2006 /p Year	2007 /p Year
Output, Employment and Prices							
Real GDP (% change, previous year)	5.5	5.2	7.0	7.7	7.0	6.0	6.0
Industrial production index (1993=100)	..	..	..	..	..	..	..
(% change, previous year)	..	..	..	..	..	..	..
Unemployment rate (%)	1.8	..	..	1.0	..	..	..
Real wage growth (%)	..	..	..	..	..	..	
Consumer price index (end-of-peroid % change)	0.7	3.7	0.5	5.6	6.7	3.5	3.5
Public Sector							
Government balance (% GDP)	-5.4	-6.6	-6.6	-5.1	-3.1	-4.8	-4.7
Domestic public sector debt (% GDP)	..	..	..	..	..	..	..
Foreign Trade, BOP and External Debt							
Trade balance (US$ million)	-523	-563	-533	-718	-1,031	-1,261	-1,353
Exports of goods, (US$ million)	1,571	1,755	2,027	2,476	2,707	2,931	3,172
(% change, previous year)	12.1	11.7	15.5	22.1	9.4	8.3	8.2
Key export, Garments (% change, previous year)	17.2	15.8	19.7	22.6	10.6	10.0	10.0
Imports of goods, (US$ million)	2,094	2,318	2,560	3,193	3,738	4,192	4,525
(% change, previous year)	8.0	10.7	10.4	24.7	17.1	12.1	7.9
Current account balance (US$ million, excl. off. transfe	-347.0	-357.0	-450.0	-486.0	-553.0	-680.0	-668.0
(% GDP)	-9.2	-8.7	-10.3	-10.0	-10.3	-11.7	-10.5
Foreign direct investment (US$ million)	142.0	139.1	74.3	121.2	216.0	227.0	249.0
Total Debt Oustanding (US$ million)	2,395.0	2,626.0	2,874.0	3,110.0	3,208.0	2,388.0	2,615.0
(% GDP)	63.2	64.3	66.1	63.7	59.5	40.9	41.2
Short-term debt (US$ million)	223.9	216.8	221.4	220.0	220.0	220.0	220.0
Debt service ratio (% exports of g&s)	2.9	2.6	2.6	2.1	1.9	1.5	1.6
Reserves, Gross ($US million)	548	663	737	809	923	970	1,063
(months of imports of goods and services)	2.7	3.0	3.0	2.7	2.5	2.4	2.5
Financial Markets							
Domestic credit (% change, previous year)	-4.1	8.6	28.3	33.0	10.9	10.0	10.0
Short-term interest rate (One year US dollar loans: rates	16.5	16.2	17.3	16.0	16.0	15.0	14.0
Exchange rate (end-period)	3,900	3,935	3,980	4,031	4,116	4,219	4,250
Real effective exchange rate (1990=100 and + = appn)	113.5	114.8	106.8	107.0	..	..	
(% change, previous year)	5.2	1.1	-7.0	0.2	..	..	
Stock market index (end-period, Aug 88=100)	..	..	..	..	..	..	
Memo: Norminal GDP in US$ million	3,787	4,083	4,349	4,884	5,391	5,835	6,350

pr = preliminary result
p = projection

China: Key Indicators

	2001	2002	2003	2004	2005	2006 /p	2007/p			2005			2005		2006
	Year	Year	Year	Year	Year	Year		Q1	Q2	Q3	Q4	Nov	Dec	Jan	Feb
Output, Employment and Prices															
GDP (% change previous year)	8.3	9.1	10.0	10.1	9.9	9.2	8.5	9.9	10.0	9.9	9.9	..	..	..	..
Industrial production index (value-added)	8.7	10.0	12.8	11.5	11.4	10.5	9.5	16.2	16.6	16.1	16.7	16.6	16.5	16.2	..
Unemployment rate (%) /1	3.6	4.0	4.3	4.2	4.2	4.4	..	..	..	..	..	..	..	..	..
Real wage growth	15.2	15.5	12.0	10.5	..	..	..	12.1	11.5	12.1	..	..	..	..	..
Consumer price index (% change, previous year)	0.7	-0.8	1.2	3.9	1.8	1.8	1.6	2.8	1.7	1.3	1.4	1.3	1.6	1.9	0.9
Public Sector															
Government balance (% GDP)	-3.1	-3.4	-2.5	-1.7	-1.2	-1.1	..	..	..	..	..	..	..	..	..
Domestic public sector debt (% GDP)/7	19.4	21.2	22.4	20.9	19.2	18.1	..	..	..	..	..	..	..	..	..
Foreign Trade, BOP and External Debt															
Trade balance ($US billion)	22.5	30.4	25.6	32.0	101.9	133.0	142.0	16.5	23.1	28.8	33.6	10.4	11.1	9.5	2.5
Exports of goods ($US billion)	266.1	325.6	438.4	593.4	762.0	897.0	989.0	155.9	186.5	204.1	215.6	72.1	75.4	65	54.15
(% change, previous year)/2	7.2	22.4	34.6	35.4	28.4	17.7	10.2	34.7	31.0	29.1	21.7	18.4	18.3	28.1	22.3
Key export (% change, previous year) /3	10.0	23.9	35.9	37.0	29.0	18.6	10.7	34.7	31.4	29.5	22.8	19.2	19.1	29.7	..
Imports of goods ($US billion)	243.6	295.2	412.8	561.4	660.1	764.0	847.0	139.4	163.4	175.3	182	61.7	64.3	55.5	51.7
(% change, previous year)/2	8.2	21.2	39.8	36.1	17.6	15.8	10.8	12.3	16.1	19.1	22.1	20.9	22.3	25.4	29.6
Current account balance ($US billion)	17.4	35.4	45.9	68.7	129.1	148.8	143.1	..	..	..	..	..	..	..	..
(% GDP)	1.3	2.4	2.8	3.6	5.6	5.6	4.7	..	..	..	..	..	..	..	..
Foreign direct investment (US$ billion)/4	46.9	52.7	53.5	60.6	53.0	55.0	55.0	13.4	15.2	14.6	..	..	..	..	..
Total external debt ($US billion)	170.1	168.3	193.3	228.8	..	..	..	..	..	..	..	..	..	..	..
(% GDP)	14.5	13.3	11.8	11.8	..	..	..	..	..	..	..	..	..	..	..
Short-term debt ($US billion)	41.6	47.9	73.0	96.9	..	..	..	..	..	..	..	..	..	..	..
Debt service ratio (% exports of g&s)	8.1	8.4	7.6	3.6	3.0	2.4	..	..	..	..	..	..	..	..	..
Reserves, including gold ($US billion)	216.3	292.0	409.2	615.5	820.6	1046.5	1257.6	664.2	..	..	..	..	..	..	..
(months of imports of goods and services)	9.4	10.5	10.6	12.0	13.0	13.6	14.0	13.8	14.3	14.8	..	..	..	..	..
Total reserves excl. gold ($US billion)	215.6	291.1	408.2	614.5	818.9	1044.7	1255.9	663.2	715.0	772.3	..	..	..	..	..
Financial Markets															
Domestic credit (% change, previous year, nominal)	13.6	29.3	19.6	9.2	11.5	11.4	..	8.8	10.2	11.4	10.7	11.5	10.7	..	..
Short-term interest rate (less than 20 days)/5	3.2	2.7	2.7	3.3	3.3	..	..	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Exchange rate (end-period)	8.3	8.3	8.3	8.3	8.1	7.9	..	8.3	8.3	8.1	8.1	8.1	8.1	8.1	8.0
Real effective exchange rate (+ = appn) 2000=100	104.3	102.6	96.7	95.0	90.3	88.4	..	92.5	94.0	97.5	..	99.72	..	..	..
(% change, previous year)	4.3	-1.6	-5.8	-1.8	..	..	..	-1.2	-2.4	1.0	..	..	..	..	..
Stock market index (Dec. 19, 1990=100), close/6	1870.4	1358.6	1154.0	871.8	787.0	..	..	886.0	787.0	787.0	..	..	..	..	..
Memo: GDP (US$ billion)	1324.8	1453.8	1641.0	1931.7	2305.4	2657.1	3044.7	458.4	507.5	553.0	710.3	..	..	..	..

p = projection

1/ Official unemployment only, not including laid-off workers
2/ Norminal growth rate
3/ Manufactured exports
4/ Gross FDI
5/ Central Bank loans to financial institutions
6/ Shanghai Stock Exchange High Comprehensive Index (A share, Dec.19, 1990 =100)
7/ Includes treasury bond, policy financial bond and other financial bond (end-period outstanding)

Fiji: Key Indicators

	2001 Year	2002 Year	2003 Year	2004 Year	2005 /e Year	2006 /p Year	2007/p Year
Output, Employment and Prices							
GDP (% change previous year)	2.7	4.3	3.0	4.1	1.7	2.0	2.4
Tourist arrivals ('000)	348.0	397.9	430.8	507.0	532.0	565	610
(% change, previous year)	18.3	14.3	8.3	17.7	4.9	6.2	8.0
Unemployment rate (%)	..	..	..	..	..	..	..
Real wage growth (%)	..	..	..	..	..	..	..
Consumer price index (% change, previous year)	4.3	0.8	4.2	2.8	2.4	4.0	3.8
Public Sector							
Government balance (% GDP)	-6.7	-5.6	-6.0	-3.2	-4.3	-4.0	-0.5
Domestic public sector debt (% GDP)	39.3	42.9	46.2	46.7	48.9	..	..
Foreign Trade, BOP and External Debt							
Trade balance (Customs data, US$million)	-255.1	-313.1	-438.7	-634.9	-701.4	-754.2	-671.0
Exports of goods (Customs data, US$million)	512.6	478.9	608.7	642.5	682.7	746.1	853.2
(% change, previous year)	0.6	-6.6	27.1	5.6	6.2	9.3	14.4
Key export: Sugar (% change in value, previous year)	8.0	-48.8	46.1	-7.1	10.7	0.0	-16.3
Imports of goods (Customs data, US$million)	767.7	792.0	1047.4	1277.4	1384.1	1500.3	1524.2
(% change, previous year)	0.4	3.2	32.2	22.0	8.3	8.4	1.6
Current account balance (US$million)	-117.3	-53.3	-161.5	-429.9	-355.1	-384.7	-254.3
(percent GDP)	-7.1	-2.9	-7.2	-16.4	-12.6	-12.9	-8.0
Foreign direct investment (US$million)	42.6	20.6	26.5	93.8	..	..	..
Total external debt (US$million)	241	280	357	367	353	..	..
(% GDP)	14.6	15.5	15.9	14.0	12.6	..	..
Short-term debt (US$million)	15.9	36.7	86.1	86.1	86.1	..	..
Debt service ratio (% exports of g&s)	2.0	1.9	1.7	1.7	1.8	..	..
Reserves, including gold (US$million)	366	359	424	478	556	..	..
(months of imports of goods and non factor services)	4.3	3.6	3.1	3.8	3.9	..	..
Financial Markets							
Domestic credit (private, % change, previous year)	-5.6	5.0	16.8	18.0	18.4	..	..
Short-term interest rate	1.25	1.25	1.19	1.75	..	..	..
Exchange rate (end-of-period)	2.31	2.06	1.72	1.65	1.74	..	..
Real effective exchange rate (1995=100 and + = appn)	87.7	88.3	93.3	95.1	96.2	..	..
(% change, previous year)	0.3	0.6	5.7	1.9	1.2	..	..
Stock market index (end-period, Aug 88=100)	..	..	..	..	..	..	..
Memo: GDP in US$ million	1655	1811	2243	2627	2810	2979	3170

e = estimate
p = projection

Indonesia: Key Indicators

	2001 Year	2002 Year	2003 Year	2004 Year	2005 /e Year	2006 /p Year	2007 /p Year	2005 Q1	Q2	Q3	Q4	2005 Nov	Dec	2006 Jan	Feb
Output, Employment and Prices															
GDP (% change previous year) /1	3.8	4.4	4.9	5.1	5.6	5.5	6.2	6.3	5.6	5.6	4.9	..	..	..	..
Industrial production index (2000=100)	104.7	107.7	113.6	117.3	121.9	..	..	118.8	118.1	125.0	125.8	..	..	..	..
(% change, previous year)	4.7	2.8	5.5	3.3	3.9	..	..	6.5	3.8	0.4	5.2	..	..	..	..
Unemployment Rate (%)	8.1	9.1	9.5	9.9	10.3	10.6	..	..	..	..	..	..	..	..	..
Real Wage Growth (%)	10.7	1.0	7.1	0.3	..	..	..	..	..	..	..	..	..	..	..
Consumer price index (% change, previous year)	12.5	11.5	6.8	6.1	10.5	15.4	7.7	8.8	7.4	9.1	17.1	18.4	17.1	17.0	17.9
Public Sector															
Government balance (% GDP) /2	-2.9	-1.1	-1.7	-1.0	-0.5	-1.1	-0.5	..	..	..	..	..	..	..	..
Domestic public sector debt (% GDP)	37.9	33.8	29.9	26.7	23.4	19.4	18.2	..	..	..	..	..	..	..	..
Foreign Trade, BOP and External Debt															
Trade balance (million$US)	22,696	23,513	24,563	21,552	22,785	26,869	27,139	35,066	37,972	38,861	38,181	..	..	..	..
Exports of goods, ($millionUS)	57,364	59,165	64,109	72,167	86,641	95,306	104,478	20,026	21,394	21,738	23,066	..	..	..	..
(% change, previous year)	-12.3	3.1	8.4	12.6	20.1	10.0	9.6	1.0	6.8	1.6	6.1	..	..	..	..
Key Exports, (% change, previous year) /3	2.2	-8.7	-3.6	16.1	15.3	18.1	16.8	24.2	16.1	27.1	22.8	..	..	..	..
Imports of goods, ($millionUS)	34,668	35,652	39,546	50,615	63,856	68,437	77,339	-15,040	-16,578	-17,123	-15,115	..	..	..	..
(% change, previous year)	-14.1	2.8	10.9	28.0	26.2	7.2	13.0	1.3	1.4	1.4	1.3	..	..	..	..
Current account balance ($millionUS)	6,900	7,823	8,106	3,109	2,997	3,947	3,338	505	311	-1,078	1,191	..	..	..	..
(percent GDP)	4.8	3.8	3.4	1.2	1.1	1.1	0.8	0.7	0.4	-1.5	1.6	..	..	..	..
Foreign Direct Investment (million US$) /4	-5,878	145	-950	-3,408	-3,118	..	..	-732	-680	-961	-745	..	..	..	..
Total external debt (million $US)	134,045	132,254	134,320	138,951	131,565	132,338	134,452	134,937	136,290	135,736	133,482	133803	133,482	..	..
(% GDP)	81.7	64.9	55.2	54.6	46.8	37.5	33.9	..	..	..	..	..	..	..	..
Short-term debt (million $US)	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Debt service ratio (% exports of g&s)	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Reserves, including gold ($US billion)	28,018	32,046	36,253	36,303	..	..	..	35,705	33,798	30,172	34,579	33094	34,579	34930	..
(months of imports of goods and services)	6.5	7.6	7.0	5.6	..	..	..	..	..	..	..	..	..	..	..
Financial Markets															
Domestic credit (% change, previous year)	5.4	4.7	5.3	17.8	15.5	..	..	15.4	27.2	15.4	13.0	13.4	11.1	..	..
Short-term interest rate /5	17.6	12.9	8.3	7.4	9.2	..	..	7.4	8.0	9.3	12.0	12.3	12.8	12.8	12.74
Exchange rate (average period)	10,261	9,311	8,500	8,938	9,704	..	..	9,302	9,550	9,995	9,999	10,067	9,841	9,448	9230
Real effective exchange rate (1990=100 and + = appn)	63.2	76.9	80.8	76.6	80.3	..	..	73.3	74.8	74	..	..	..	..	..
(% change, previous year)	-4.7	21.7	5.2	-5.2	..	..	..	-6.6	-3.9	-3.4	..	..	..	..	..
Stock market index (end-period, Aug 88=100)	392.0	424.9	653.0	753.0	1162.0	..	..	1,080	1,122	1,079	1,162	1096.6	1162.64	1232.3	1230.7
Memo: GDP in US$ million (based on Ex.rate eop.)	161,950	212,282	246,516	254,298	281,276	353,138	396,566	67,736	69,244	70,383	73,684	..	..	..	..

/1 Based on GDP 2000 base
/2 Central Government budget, Indonesia fiscal, April-March, until the year FY1999. Covers only 9 months April-December in FY2000 and, starting FY2001, changes to January-December.
/3 Crude oil exports
/4 FDI starting 2004 using new classification
/5 One month Bank Indonesia Certificates

Korea: Key Indicators

	2001	2002	2003	2004	2005	2006 p/	2007 p/	2005				2004		2005	
	Year	Year	Year	Year	Year	Year	Year	Q1	Q2	Q3	Q4	Nov	Dec	Jan	Feb
Output, Employment and Prices															
GDP (% change, previous year)	3.8	7.0	3.1	4.6	4.0	5.0	4.8	2.7	3.3	4.5	5.2	..	..	..	..
Industrial production index (2000=100)	100.7	108.8	114.5	126.2	134.1	..	..	127.1	131.6	130.4	147.3	150.1	148.2	140.4	..
(% change, previous year)	0.7	8.0	5.3	10.2	6.2	..	..	3.5	3.5	7.2	10.4	11.8	11.3	6.4	..
Unemployment rate (%)	4.0	3.3	3.6	3.7	3.7	..	..	4.2	3.6	3.6	3.5	3.3	3.5	3.7	..
Norminal wage (% change)	5.7	11.5	9.4	6.5	6.4	..	..	7.4	7.4	5.3	5.7	6.5	4.2	..	..
Real wage growth (% change previous year)	1.6	8.5	5.7	2.8	3.5	..	..	4.1	4.3	2.8	3.1	4.0	1.5	..	..
Consumer price index (% change, previous year)	4.1	2.8	3.5	3.6	2.8	..	..	3.1	3.0	2.4	2.5	2.4	2.6	2.8	2.3
Public Sector															
Government balance (% GDP) 1/	1.2	3.3	1.1	0.7	..	..	..	-2.8	-3.3	5.0	..	..	..	..	..
Consolidated central government debt (% GDP) 2/	18.2	19.5	22.9	26.1	..	..	..	..	..	..	..	..	..	..	..
Foreign Trade, BOP and External Debt															
Trade balance ($US billion) 3/	9.3	10.3	15.0	29.4	23.5	..	..	6.3	6.1	5.1	6.1	2.0	1.5	.6	.5
Exports of goods ($US billion) 3/	150.4	162.5	193.8	253.8	284.6	..	..	66.8	69.7	71.1	77.0	25.9	25.7	23.4	24.0
(% change, previous year) 3/	-12.7	8.0	19.3	31.0	12.1	..	..	12.7	9.0	15.4	11.6	12.2	10.8	4.3	17.4
Imports of goods ($US billion) 3/	141.1	152.1	178.8	224.5	261.1	..	..	60.5	63.6	66.1	70.9	25.9	25.7	23.4	24.0
(% change, previous year) 3/	-12.1	7.8	17.6	25.5	16.3	..	..	14.7	15.1	20.7	14.9	17.8	15.6	17.6	27.5
Current account balance ($US billion)	8.0	5.4	11.9	28.2	16.6	..	..	5.9	2.6	2.6	5.4	2.2	.5	3.0	..
(% GDP)	1.7	1.0	1.8	4.2	..	..	..	3.3	1.3	1.3	..	..	..	..	..
Foreign direct investment, net (US$ billion) 4/	1.1	-0.2	0.1	4.6	0.0	..	..	-0.7	1.2	-0.4	-0.1	-0.2	0.2	0.2	..
Total external debt ($US billion)	128.7	141.5	157.6	172.3	..	..	..	179.8	183.1	187.3	..	..	..	..	..
(% GDP)	26.7	25.8	25.9	25.3	..	..	..	25.0	23.3	23.7	..	0.0	0.0	0.0	0.0
Short-term debt ($US billion)	40.3	48.2	50.8	56.3	..	..	..	63.4	66.0	67.9	..	0.0	0.0	0.0	0.0
Debt service ratio (% exports of g&s) 5/	12.6	10.0	8.1	10.0	8.4	..	..	..	..	..		..	..	..	..
Usable reserves ($US billion)	102.8	121.3	155.3	199.0	210.3	..	..	205.4	204.9	206.7	210.3	208.2	210.3	216.9	215.9
(months of imports of goods and services)	7.2	7.9	8.6	8.8	8.0	..	..	8.4	8.1	7.7	7.5	7.3	7.2	8.2	..
Financial Markets															
Domestic credit (% change, previous year) 6/	13.8	18.2	9.3	2.4	..	..	..	1.3	5.4	6.8	..	..	..	..	..
Short-term interest rate 7/	4.7	4.2	4.0	3.6	3.3	..	..	3.3	3.3	3.3	3.5	3.5	3.7	3.7	3.9
Exchange rate (end-period)	1313.5	1186.2	1192.6	1035.1	1011.6	..	..	1015.5	1025.4	1041.1	1011.6	1033.5	1011.6	964.6	970.9
Real effective exchange rate (+ = appn)	80.5	84.5	84.1	84.8	..	..	..	92.9	96.2	96.0	..	97.7	..	..	..
(% change, previous year)	-5.1	5.0	-0.4	0.8	..	..	..	13.4	14.1	12.5	..	11.2	..	..	..
Stock market index (1/4/1980=100)	693.7	627.6	810.7	895.9	1379.4	..	..	965.7	1008.2	1221.0	1379.4	1297.4	1379.4	1399.8	1371.6
Memo: GDP (US$ billion)	481.8	548.7	608.5	681.2	..	..	..	179.8	196.9	197.8	..	..	..	..	..

p = projection

1/ Consolidated central government. Excludes privatization proceeds. Starting 2000, includes the civil service pension fund.
2/ Domestic & external debt. In 2003-06, W49 trillion in government-guaranteed KDIC/KAMCO bonds will be converted to treasury bonds.
3/ Trade figures are on a customs-clearance basis.
4/ Foreign direct investment is on a net basis as reported in the BOP.
5/ source: IMF
6/ source: IMF IFS
7/ Overnight repo rate (end-of-period).

Lao PDR: Key Indicators

	2001 Year	2002 Year	2003 Year	2004 /e Year	2005 /p Year	2006 /p Year	2007 /p Year
Output, Employment and Prices							
GDP (% change previous year)	5.8	5.8	6.1	6.4	7.0	7.1	6.0
Industrial production index (1993=100)	..	..	..	..	..	..	..
(% change, previous year)	..	..	..	..	..	..	..
Unemployment rate (%)	..	..	..	..	..	..	..
Real wage growth (%)	..	..	..	..	..	..	..
Consumer price index (% change, previous year)	7.5	10.6	15.5	10.5	7.2	6.8	5.0
Public Sector 1/							
Government balance, after grants (% GDP)	-4.4	-4.0	-5.7	-3.4	-3.5	-4.0	-3.9
Domestic public sector debt (% GDP)	..	..	..	..	..	..	..
Foreign Trade, BOP and External Debt							
Trade balance (US$ million)	-288	-263	-244	-478	-457	-461	-550
Exports of goods (US$ million)	362	370	450	500	659	749	782
(% change, previous year)	5.8	2.2	21.6	11.1	31.8	13.7	4.4
Key Export (% change, previous year)	12.1	1.7	23.4	12.9	26.6	15.5	..
Imports of goods (US$ million)	650	633	694	977	1,116	1,210	1,332
(% change, previous year)	-9.4	-2.6	9.6	40.8	14.2	8.4	10.1
Current account balance (US$ million)	-146	-131	-174	-361	-430	-365	-463
(% GDP)	-8.3	-7.2	-8.0	-14.0	-15.0	-12.0	-13.8
Foreign direct investment (US$ million)	24	60	42	256	265	205	327
Total external debt (million US$ million)	1,458	1,614	2,171	2,530	2,910	3,179	3,428
(% GDP)	82.7	88.8	101.5	101.2	102.9	102.4	102.1
Short-term debt (US$ million)	..	..	..	..	..	..	..
Debt service ratio (% exports of g&s)	15.8	14.0	14.3	18.2	19.7	25.7	26.5
Reserves, excluding gold ($US million)	134	196	214	227	226	246	267
(months of imports of goods and services) 2/	2.9	3.1	3.7	3.4	3.1	3.1	3.2
Financial Markets							
Domestic credit (% change, previous year)	69.3	-48.0	10.5	20.6	18.8	..	..
Short-term interest rate 3/	22.7	21.4	24.9	16.0	..	..	..
Exchange rate (everage)	8,913	10,115	10,572	10,613	10,591	10,600	10,800
Exchange rate (end-period)	9,490	10,680	10,467	10,377	10,768	10,800	11,000
Real effective exchange rate (2000=100 and + = appn)	102.1	97.3	97.6	103.2	102.7	102.7	102.7
(% change, previous year)	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Stock market index (end-period, Aug 88=100)	..	..	..	..	..	..	..
Memo: GDP (US$ million)	1,762	1,818	2,138	2,501	2,828	3,104	3,358

Sources: Recent IMF data and projections
e = estimate
p = projection
1/ Fiscal year basis
2/ Excluding large projects
3/ Treasury bill rate

Malaysia: Key Indicators

	2001 Year	2002 Year	2003 Year	2004 Year	2005 Year	2006 p/ Year	2007 p/ Year	2005 Q1	Q2	Q3	Q4	2005 Nov	Dec	2006 Jan	Feb
Output, Employment and Prices															
GDP (% change, previous year)	0.3	4.4	5.4	7.1	5.3	5.5	5.7	6.2	4.4	5.3	5.2	..	..	..	..
Industrial production index (1993=100)	95.9	100.3	109.6	122.0	127.1	..	..	124.7	124.4	128.2	131.2	132.2	129.3	127.5	..
(% change, previous year)	6.9	2.3	3.3	4.5	4.2	..	..	6.6	2.4	2.6	..	6.6	2.4	2.6	..
Unemployment rate (%)	3.7	3.5	3.6	3.6	..	..	..	3.5	3.1	3.8	..	..	..	..	..
Real wage growth (%)	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Consumer price index (% change, previous year)	1.4	1.8	1.0	1.5	3.0	..	..	2.5	3.0	3.4	3.3	3.3	3.3	3.4	..
Public Sector															
Government balance (% GDP) /1	-5.5	-5.6	-5.3	-4.3	-3.8	-3.6	-3.0	2.3	-2.2	-0.6	..	..	..	..	..
Domestic public sector debt (% GDP) 1/	..	..	..	40.5	39.4	39.3	39.7	..	..	..	..	..	..	..	..
Foreign Trade, BOP and External Debt															
Trade balance ($US billion) /2	14.2	14.3	21.4	21.2	26.3	37.6	40.9	6.6	6.0	6.2	7.6	2.3	2.5	2.5	..
Exports of goods ($US billion) /2	88.0	94.1	104.7	126.5	141.0	160.2	179.9	32.3	34.4	36.6	37.7	11.5	13.1	11.6	..
(% change, previous year)	17.9	6.9	11.3	20.8	11.4	13.6	12.3	13.7	10.8	8.3	13.2	12.4	13.9	13.1	..
Key export: Electronics (% change, previous year)	-17.3	6.7	-2.6	20.8	19.1	..	..	9.7	21.6	19.2	24.7	25.6	28.3	..	..
Imports of goods ($US billion) /2	73.7	79.8	83.3	105.3	114.6	122.6	139.0	25.7	28.4	30.4	30.2	9.2	10.6	9.1	..
(% change, previous year)	21.3	8.2	4.4	26.4	8.9	7.0	13.4	10.1	8.0	9.4	8.1	6.5	8.7	10.5	..
Current account balance ($US billion)	7.3	8.0	13.3	14.9	20.4	23.7	26.0	5.5	4.7	5.1	..	..	..	..	..
(% GDP)	8.3	8.4	12.9	12.6	15.5	16.1	16.0	18.1	14.9	14.8	..	..	..	..	..
Foreign direct investment (US$ billion)	0.3	1.3	1.1	2.6	3.3	..	..	0.0	0.7	-0.4	..	..	..	..	..
Total external debt ($US billions) 3/	45.6	48.9	49.1	52.8	51.8	..	..	52.8	52.3	53.9	51.8	..	..	..	..
(% GDP)	51.9	51.3	47.3	44.6	39.7	..	..	43.3	42.2	42.1	39.7	..	..	..	..
Short-term debt ($US billion) 3/	6.3	8.5	8.8	11.5	12.2	..	..	10.7	11.4	13.5	12.2	..	..	..	..
Debt service ratio (% exports of g&s)	6.8	6.6	6.2	4.4	..	..	..	5.5	4.1	4.3	..	..	..	..	..
Reserves, including gold ($US billion)	30.5	34.2	44.9	66.7	70.5	77.6	87.6	72.4	75.2	79.7	70.1	72.9	70.5	71.8	..
(months imports of goods)	4.2	4.5	6.5	7.6	7.4	7.6	7.6	8.5	7.9	7.9	7.0	7.9	6.6	7.9	..
Financial Markets															
Domestic credit (% change, previous year)	2.2	8.2	11.3	11.2	13.9	..	..	10.5	15.7	13.9	13.9	..	..	..	..
Short-term interest rate /4	3.1	2.9	2.9	2.8	2.9	..	..	2.8	2.8	2.9	3.0	2.9	3.2	3.2	..
Exchange rate (end-period)	3.8	3.8	3.8	3.8	3.8	..	..	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.7
Real effective exchange rate (1990=100, + = appn)	92.8	92.9	85.4	80.5	..	..	..	78.2	80.0	82.3	..	84.3	..	..	..
(% change, previous year)	5.5	0.1	-8.1	-5.8	..	..	..	-2.3	-1.7	1.0	..	6.5	..	..	..
Stock market index (4/4/1986=100)	696.1	646.3	793.9	907.4	899.8	..	..	871.4	888.3	927.5	899.8	896.1	899.8	914.0	928.9
Memo: GDP (US$ billions)	88.0	95.3	104.0	118.3	130.6	..	..	30.5	31.6	34.1	34.5	..	..	..	..

p = projection

1/ Federal government
2/ Customs-clearance basis
3/ Source: Treasury and Bank Negara Malaysia
4/ 3-month interbank rate

Philippines: Key Indicators

	2001	2002	2003	2004	2005	2006 /p	2007 /p	2005				2005			2006	
	Year	Year	Year	Year	Year	Year	Year	Q1	Q2	Q3	Q4	Oct	Nov	Dec	Jan	Feb
Output, Employment and Prices																
GDP (% change, previous year) 1/	3.0	4.4	4.5	6.0	5.1	5.3	5.6	4.6	5.2	4.5	6.1	..	..	..	..	..
Industrial production index (1994 = 100)	192.1	188.8	204.1	221.0	250.5	..	..	222.0	244.4	255.4	280.3	285.8	277.1	278.0	..	..
(% change, previous year)	8.4	-1.7	8.1	8.3	13.3	..	..	9.8	12.3	13.6	15.6	18.0	16.1	12.9	..	..
Unemployment rate (%) 2/	9.8	10.2	10.2	10.9	10.3	..	..	11.3	12.7	10.9	10.3	10.3	..	..	10.7	..
Nominal wage (% change) 3/	7.2	10.3	0.0	3.6	7.7	..	..	7.1	16.1	8.3	8.3	..	..	..	..	..
Real wage (% change) 3/	1.0	7.0	-3.8	-0.2	..	..		..	..	..	..	..	..	..	..	..
Consumer price index (% change, previous year)	6.8	3.0	3.5	6.0	7.6	7.8	5.0	8.5	8.2	7.1	6.9	7.0	7.1	6.7	6.7	7.6
Public Sector																
Government balance (% GDP) 4/	-4.0	-5.3	-4.7	-3.9	-2.7	-1.9	-1.5	-5.2	-0.3	-3.1	-2.5	..	..	..	..	..
Domestic public sector debt (% GDP) 5/	32.7	34.4	35.7	35.4	..	..	..	..	37.0	..	..	..	..	..	..	..
Foreign Trade, BOP and External Debt																
Trade balance ($US billion) 6/	-0.7	0.4	-5.5	-6.4	-5.8	..	..	-1.5	-2.2	-2.4	0.4	..	..	..	..	..
Exports of goods ($US billion) 6/	31.2	34.4	35.3	38.7	40.2	..	..	9.3	9.6	10.3	11.0	..	..	..	..	..
(% change, previous year)	-16.2	10.0	2.8	9.6	3.9	..	..	4.5	3.1	3.3	4.7	..	..	..	..	..
Key export: Electronics, semiconductors (% change)	-24.7	11.3	34.5	11.2	3.0	..	..	3.4	0.3	3.7	4.4	..	..	..	..	..
Imports of goods ($US billion) 6/	32.0	34.0	40.8	45.1	46.0	..	..	10.8	11.9	12.7	10.6	..	..	..	..	..
(% change, previous year)	-4.5	6.2	20.1	10.6	2.0	..	..	1.4	3.0	9.6	-6.2	..	..	..	..	..
Current account balance ($US billion)	1.3	4.4	1.4	2.1	1.7	2.3	2.8	0.7	0.4	0.2	0.5	..	..	..	..	..
(% GDP)	1.9	5.7	1.8	2.4	1.7	2.0	2.3	3.0	1.6	0.7	1.8	..	..	..	..	..
Foreign direct investment (US$ billion)	1.1	1.7	0.2	0.1	1.1	..	..	0.4	0.1	0.3	0.3				..	..
Total external debt ($US billion) 7/	51.9	53.6	57.4	54.8	..	..	..	55.4	56.0	55.5	..	..	..	..	..	..
(% GDP)	72.9	69.8	72.5	63.7	..	..	..	62.4	61.1	59.0	..	..	..	..	..	..
Short-term debt ($US billion) 7/	6.0	5.6	6.2	5.0	..	..	..	5.5	6.1	6.2	..	..	..	..	..	..
Debt service ratio (% of exports of g&s and receipts)	15.8	16.4	16.9	13.8	13.5	..	..	16.3	10.3	..	..	..	..	..	..	..
Reserves, including gold ($US billion) 8/	15.7	16.4	17.1	16.2	18.4	..	..	16.7	17.7	18.5	18.1	18.1	18.1	18.5	20.5	20.6
(months of imports of g&s and receipts) 8/	4.6	4.7	4.3	3.8	3.7	..	..	3.6	3.3	3.9	3.9	3.9	3.8	3.9	4.3	4.4
Financial Markets																
Net Domestic credit (% change, previous year)	2.0	5.5	4.8	9.5	-3.9	..	..	4.3	1.0	2.1	-3.9	0.7	0.0	-3.9	..	..
Short-term interest rate 9/	10.0	7.2	7.0	7.1	7.3	..	..	7.0	7.2	7.2	7.8	7.6	7.9	7.7	7.7	8.2
Exchange rate (period average)	51.0	51.6	54.2	56.0	55.1	53.0	54.0	55.0	54.7	56.0	54.6	55.7	54.6	53.6	52.6	51.8
Real effective exchange rate (1990=100)	101.8	102.2	89.0	85.2	..	..	..	87.2	89.9	89.7	93.8	92.0	95.6	..	..	..
(% change, previous year)	-4.9	0.4	-12.9	-4.4	..	..	..	4.9	5.0	3.3	10.4	7.1	12.6	..	..	..
Stock market index 10/	1168.1	1018.4	1442.4	1621.7	1983.2	..	..	2018.1	1902.7	1968.6	2052.3	1960.2	2100.7	2096.0	2145.4	2123.0
Memo: GDP (US$ billion)	71.2	76.8	79.2	86.1	97.6	113.8	122.7	22.1	23.7	23.7	28.2	..	..	..	..	..

e = estimate
p = projection

1/ GDP growth revised in Sep 2005
2/ Using old methodology
3/ Non-agriculture, National Capital Region
4/ National government
5/ Total public sector domestic debt, source: BSP/DOF
6/ Balance of payment basis
7/ source: BSP estimates (public and private external debt)
8/ source: BSP GIR end of period, import cover is avg
9/ Interbank call rate

Thailand: Key Indicators

	2001	2002	2003	2004	2005 e/	2006 p/	2007 p/	2005				2005		2006	
	Year	Year	Year	Year	Year	Year	Year	Q1	Q2	Q3	Q4	Nov	Dec	Jan	Feb
Output, Employment and Prices															
GDP (% change, previous year)	2.2	5.3	7.0	6.2	4.5	5.0	5.2	3.2	4.6	5.4	4.7	..	..	..	..
Industrial production index (2000=100)	102.7	112.0	127.6	142.4	155.5	..	..	152.2	152.7	156.7	160.3	158.1	162.9	156.4	..
(% change, previous year)	2.7	9.1	13.9	11.6	9.2	..	..	6.4	11.6	11.6	7.3	7.8	6.2	5.8	..
Unemployment rate (%)	3.3	2.4	2.2	2.1	1.8	..	..	2.5	2.0	1.3	1.5	1.2	1.4	..	..
Real wage growth (%) 1/	-0.57	-1.5	0.4	-0.4	2.4	..	..	3.4	4.1	1.9	-0.03	..	..	..	..
Consumer price index (% change, previous year)	1.6	0.6	1.8	2.8	4.5	..	..	2.8	3.7	5.6	6.0	5.9	5.8	5.9	5.6
Public Sector															
Government balance (% GDP) 2/	-2.4	-1.4	0.4	0.1	-0.6	..	..	-1.0	4.8	-0.1	-5.7	..	..	..	..
Domestic public sector debt (% GDP) 3/	39.9	38.8	37.1	38.2	38.1	..	..	35.3	36.2	37.7	38.1	37.6	38.1	..	..
Foreign Trade, BOP and External Debt															
Trade balance (US$ million)	2,494	2,739	3,759	1,460	-8,578	-8,686	-9,362	-3,132	-4,986	289	-749	-201.5	-175.8	-388.1	..
Exports of goods (fob, US$ million)	63,070	66,092	78,105	94,941	109,211	125,592	145,059	24,684	26,300	29,794	28,433	9,677.8	9,352.0	8,807.0	..
(% change, previous year)	-7.1	4.8	18.2	21.6	15.0	15.0	15.5	12.6	13.8	22.7	11.0	13.8	11.7	14.5	..
Key exports: Rice and rubber (% change in US$, previous yr)	-8.1	15.9	37.1	32.5	-1.1	..	..	5.5	-9.0	4.9	-4.9	5.3	-6.4	5.9	..
Imports of goods (cif, US$ million)	60,576	63,353	74,346	93,481	-117,788	-134,279	-154,420	27,816	31,286	29,504	29,182	9,879.3	9,527.8	9,195.1	..
(% change, previous year)	-3.0	4.6	17.4	25.7	26.0	14.0	15.0	28.0	34.0	22.8	19.7	13.7	26.0	0.4	..
Current account balance (US$ million)	6205	7,008	7,965	6,865	-3,714	-3,336	-4,195	-1,406	-4,457	1,239	911	441.3	401.4	504.4	..
(% GDP)	5.4	5.5	5.6	4.2	-2.1	-1.9	-2.3	-3.2	-10.5	2.8	2.0	..	..	..	..
Foreign direct investment, net (US$ million) 4/	3,873	1,023	1,882	835	2,697	..	..	285	1,223	504	685	193	361	..	..
Total external debt (US$ million) 5/	67,509	59,459	51,783	51,312	50,871	..	..	50,661	51,115	51,588	50,871	..	..	..	..
(% GDP)	56.1	48.8	40.3	35.7	31.8	..	..	34.1	33.6	33.1	32	..	..	..	..
Short-term debt (US$ million) 5/	13,389	11,919	10,904	12,174	16,655	..	..	14,195	15,814	16,708	16,655	..	..	..	..
Debt service ratio (% exports of goods and services) 6/	20.8	19.6	16.0	8.5	9.8	..	..	12.8	8.1	9.4	9.3	..	..	..	..
Reserves, including gold (US$ million)	33,048	38,924	42,148	49,832	52,066	..	..	48,681	48,357	49,795	52,066	50,749	52,066	53,229	54,403
(months of imports of goods)	6.5	7.4	6.8	6.4	5.3	..	..	5.3	4.6	5.1	5.4	5.1	5.5	5.8	..
Financial Markets															
Domestic credit (% change, previous year) 6/	-4.6	3.6	4.3	7.4	7.7	..	..	6.8	6.1	7.5	7.7	..	..	..	..
Short-term interest rate (average period) 7/	2.5	2.0	1.3	1.0	1.6	..		1.0	1.2	1.8	2.5	2.4	2.8	3.3	..
Exchange rate (average period)	44.4	43.0	41.5	40.2	40.2	..	..	38.6	40.0	41.3	41.0	41.1	41.0	39.6	..
Real effective exchange rate (1994=100)	78.1	79.6	78.0	77.7	79.0	..	..	79.1	78.4	78.5	80.1	80.3	79.9	81.4	..
(% change, previous year)	-5.1	2.0	-2.1	-0.3	1.6	..	..	-0.2	-0.6	2.3	5.0	5.9	3.5	3.8	..
Stock market index (Dec 1996=100)	303.9	356.5	772.2	668.1	713.7	..	..	681.5	675.5	723.2	713.7	667.8	713.7	762.6	744.1
Memo: GDP (US$ billion)	115.5	126.9	142.9	161.7	175.2	179.3	184.1	44.5	42.3	43.4	46.4	..	..	..	..

e = estimate
p = projection

1/ Average wage of employed person from Labour force survey, National Statistical Office.
2/ Cash balance of central government.
3/ Include domestic central government (CG) debt, domestic debt of non-financial state enterprise and Financial institutions Development fund (FIDF) debt.
4/ Non-Bank FDI
5/ Source: Bank of Thailand
6/ Include those extended by financial institutions
7/ Average interest rates on time deposits of less than 6 months (percent per annum).

Vietnam: Key Economic Indicators

	2001 Year	2002 Year	2003 Year	2004 Year	2005 e/ Year	2006 p/ Year	2007 p/ Year
Output, Employment and Prices							
GDP (% change previous year)	6.9	7.1	7.3	7.7	8.4	8.0	7.5
Industrial production index (% change, previc	14.6	14.5	15.5	16.0	17.2	16.5	16.5
Unemployment rate (%, urban areas)	6.3	6.0	5.8	5.6	5.3	5.5	5.5
Consumer price index (% change, period-end	0.8	4.0	3.0	9.5	8.4	8.0	7.0
Public Sector							
Government balance (% GDP)	-2.9	-1.9	-2.0	-1.4	-1.4	-1.6	-1.6
Domestic public sector debt (accumulated, %	5.5	6.3	6.8	7.5	8.3	9.2	10.5
Foreign Trade, BOP and External Debt							
Trade balance ($US million)	-1,135	-3,027	-5,107	-5,451	-4,648	-6,314	-7,979
Exports of goods, ($US million)	15,027	16,706	20,149	26,503	32,233	37,390	43,373
Exports of goods (% change, previous year)	4.0	11.2	20.6	31.5	21.6	16.0	16.0
Key exports, (value, % change) - crude oil	-10.8	4.6	16.8	48.3	30.3	25.0	25.0
Imports of goods, ($US million, cif)	16,162	19,733	25,256	31,954	36,881	43,704	51,352
Imports of goods (% change, previous year)	3.2	22.1	28.3	26.5	15.4	18.5	17.5
Current account balance ($US million)	672	-418	-1,946	-1,702	-473	-979	-1,253
Current account balance (percent GDP)	2.1	-1.2	-4.9	-3.8	-0.9	-1.6	-1.9
Foreign direct investment ($US million)	1,250	2,045	1,900	1,900	2,350	2,650	3,120
Total external debt -DOD- ($US billion)	12.3	12.2	13.3	15.5	16.9	19.3	21.6
as percent of GDP	37.8	34.8	33.7	34.2	32.1	32.2	32.2
Debt service ratio (% exports of g&s)	10.6	8.6	7.9	6.2	5.2	5.0	5.0
Reserves, including gold ($US million)	3,390	3,695	5,620	6,314	7,730	9,500	11,600
Reserves (in weeks of imports of g&s)	8.3	7.2	8.9	8.1	8.6	9.5	10.3
Financial Markets							
Credit to the economy (% change, period-end	21.4	22.2	28.4	41.7	30.0	28.0	25.0
Short-term interest rate (3-M deposits, period-	5.9	7.0	6.3	6.7	7.7	7.5	7.5

Source: GSO, SBV, IMF and WB
e = estimate
p = projection