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# CONTENTS

# ACRONYMS AND NOTES

| | |
|---|---|
| ADB | Asian Development Bank |
| *ADO* | *Asian Development Outlook* |
| ASEAN | Association of Southeast Asian Nations |
| CARs | Central Asian republics |
| CPI | consumer price index |
| DMC | developing member country |
| ECB | European Central Bank |
| EU | European Union |
| FDI | foreign direct investment |
| f.o.b. | free on board |
| FY | fiscal year |
| GDP | gross domestic product |
| IBRA | Indonesian Bank Restructuring Agency |
| IMF | International Monetary Fund |
| ICT | information and communications technology |
| NIEs | newly industrialized economies |
| NPL | nonperforming loan |
| OECD | Organisation for Economic Co-operation and Development |
| PRC | People's Republic of China |
| R&D | research and development |
| SBI | Sertifikat Bank Indonesia (Bank Indonesia Certificate) |
| SME | small and medium enterprise |
| SOE | state-owned enterprise |
| US | United States |
| VAT | value-added tax |
| WPI | wholesale price index |
| WTO | World Trade Organization |

Billion is 1,000 million.
Trillion is 1,000 billion.
Unless otherwise specified, the symbol $ means United States dollars; dollars are current US dollars.
— means that data are not available.
Quarterly growth figures are relative to the previous quarter on a seasonally adjusted annualized rate (unless otherwise specified). When rates relate to the same period in the previous year, they are denoted as year on year.

This *Asian Development Outlook 2001 Update* is based on the latest data made available at publication.

This *Update* does not cover all the developing member economies on the same chapter-by-chapter basis as was used in the *Asian Development Outlook 2001*. Hence, some of the smaller economies are dealt with in subregional overviews.

# FOREWORD

The economic outlook for developing Asia and the Pacific has changed significantly since the *Asian Development Outlook 2001* was published in April 2001. The 11 September terror attacks on the United States and the subsequent military response have exacerbated a global economic slowdown that was already more severe than was expected in April. Accordingly, this *Asian Development Outlook 2001 Update* reviews macroeconomic trends in the developing member countries of the Asian Development Bank (ADB) and revises April's economic forecasts for 2001 and 2002. An attempt has been made, in close cooperation with ADB staff in operations, to incorporate preliminary assessments of the economic impact of the attacks and the subsequent military response on the economies of developing Asia and the Pacific. However, events are still unfolding. There is a high level of uncertainty in the global environment and the economic outlook is changing by the day. The *Update* nevertheless is cautiously optimistic that, on the whole, developing Asia and the Pacific will continue to register healthy economic growth in 2001 and 2002 when compared with other regions in the world.

The *Update* was prepared by ADB's Economic Analysis and Research Division (EDAN), in collaboration with the Programs Departments and Office of Pacific Operations. The *Update* was put together by a team led by Brahm Prakash, Assistant Chief Economist (EDAN), comprising Cindy Houser, Sailesh Jha, Christine Kuo, Purnima Rajapakse and assisted by Charissa Castillo and James Villafuerte. Under the guidance of Charles Adams, the chapter "Outlook for Developing Asia and the Pacific" was prepared by Cindy Houser. Purnima Rajapakse processed and finalized the chapters on the subregions and individual economies. The contributors included Padmini Desikachar (Viet Nam), Yu-shu Feng (Thailand), David Green (Indonesia), Cindy Houser (Republic of Korea; Taipei,China; and the Newly Industrialized Economies), Sailesh Jha (Malaysia and Southeast Asia), Abid Hussain (Pakistan), Rezaul Khan (Bangladesh), Christine Kuo (Hong Kong, China; and Singapore), Xuelin Liu (Philippines), Elisabetta Marmolo (India), Long Yun Peng (People's Republic of China), Purnima Rajapakse (South Asia), Diwesh Sharan (Papua New Guinea and Pacific island developing member countries), and Tao Zhang and Masaaki Nagata (Central Asian republics, Azerbaijan, and Mongolia).

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I take this opportunity to thank all contributors, and earnestly hope that readers will find the *Update* useful. ADB welcomes feedback on the *Update* via telephone (++632 632 4444), fax (++632 636 2444), or email (ado2001update@adb.org).

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Manila
November 2001

# OUTLOOK FOR DEVELOPING ASIA AND THE PACIFIC

*The global slowdown in economic activity is turning out to be deeper, more synchronized across major economies, and more persistent than expected in April 2001 when the* Asian Development Outlook 2001 (ADO 2001) *was released. In addition, and beyond the immediate loss of life and property, the 11 September terror attacks on the United States and subsequent military actions have disrupted economic activity and adversely affected sentiment toward the economic outlook. Thus, this* ADO 2001 Update *(the* Update*) anticipates that the global recovery previously expected to begin in late 2001 will be delayed and only become firmly established by the middle of 2002. As a consequence, near-term projections for growth in developing Asia and the Pacific (the developing member countries of the Asian Development Bank) have been revised downward.*

*Against a background of considerable uncertainty, a number of significant downside risks to the economic outlook remain and may have intensified. These include those associated with the synchronized nature of the global slowdown, the current account imbalance in the United States, the fragile condition of the Japanese economy, and the possibility of further disruptions to economic activity in the aftermath of the 11 September attacks. The attacks added to an already uncertain outlook for global trade and have increased risk aversion, raising the cost of capital market access for some vulnerable countries. There are reasons, nevertheless, for cautious optimism related to the underlying strength and resilience of the global economy, the considerable macroeconomic stimulus already initiated, and the intention of policymakers to take additional measures as needed to mitigate the severity of the slowdown.*

*Based on this assessment, real economic growth in developing Asia and the Pacific is now expected to fall from 7.0 percent in 2000 to 3.4 percent in 2001, with a modest rebound in 2002 and stronger performance in 2003. Underlying the economic slowdown across the region in 2001 is a large diversity in economic performance, with the newly industrialized economies undergoing the sharpest slowdown, while the People's Republic of China and India sustain relatively robust growth.*

*The first part of this chapter appraises recent developments in, and the outlook for, the three major world economies. The second part reviews recent economic developments in the region, summarizes the current 2001-2002 forecasts—as revised from the* ADO 2001 *forecasts—and assesses the risks to those forecasts.*

# External Economic Developments and Outlook

## Introduction

The 11 September terror attacks on the United States (US) impacted a world economy in which the pace of activity was slowing to a surprising degree. The slowdown in global economic performance in the first half of 2001 was sharper and more synchronized across major economies than expected at the time of *ADO 2001*. The deterioration of the information, communications, and technology (ICT) sector that began in mid-2000 in the US broadened to other sectors by mid-2001 and deepened into a general demand-driven global cyclical slowdown. Aggressive monetary easing (especially in the US) as well as "new economy" relationships were initially expected to bring about rapid adjustments that would result in a relatively swift rebound in 2001 and a return to reasonably robust expansion in 2002. However, the magnitude of the reduction in US demand and its spillover effects to Europe and Japan were underestimated. Moreover, the extent to which world trade would be reduced was not anticipated. Then, amid signs of yet further weakening in the global economy, the September attacks abruptly disrupted US economic activity and significantly increased uncertainty over future global economic conditions. Box 1.1 reviews the global macroeconomic effects of the attacks.

Prior to the attacks, policymakers in the three major economies of the US, Japan, and the euro area (European Union members except Denmark, Sweden, and United Kingdom) had become increasingly confronted, as 2001 wore on, with negative economic news, such as deteriorating corporate profits, falling stock prices, rising unemployment, and faltering investor (and eventually consumer) confidence. Short-term interest rates began to fall in many economies as the focus shifted from inflationary pressures (which were ebbing) to the possibility of recession.

Optimism that US economic activity would rebound in the third quarter of 2001 had faded by midyear as did subsequent hopes for a modest US rebound in late 2001. Moreover, in the second quarter of 2001, economic conditions in Japan deteriorated significantly, and the pace of economic activity in the euro area slowed substantially. It is uncommon for these three major world economies—which together account for about 45 percent of world output and absorb nearly 50 percent of total exports from developing Asia and the Pacific—to be in simultaneous, mutually reinforcing slowdowns. Further, downward revisions to US productivity data (made before the attacks) reignited the debate about long-term trend growth prospects and further weakened the earnings outlook. With investor and consumer confidence then further shaken and financial markets falling sharply after the 11 September attacks, policymakers began to consider additional macroeconomic measures to preempt further weakening of the world economy. Together, these negative factors suggest that the slowdown in the global economy is likely to be sharper and more persistent than projected in *ADO 2001*, with recovery only beginning to take hold by the middle of 2002.

## Recent Developments in the Three Major World Economies

*Output and Employment.* The US economy was the first to slow, followed by Japan, and then the euro area. US real gross domestic product (GDP) growth, which fell to 1-2 percent, quarter on quarter, in the three previous quarters, further slowed to 0.3 percent in the second quarter of 2001. With US investment in a fourth (and exports in a third) consecutive quarterly contraction, consumption—which to that time had held up well—slowed to 2.5 percent growth in the second quarter of 2001, its smallest expansion in four years. As a consequence of these developments, manufacturing production shrank by about 4.0 percent in July 2001 relative to a year earlier, and shed over 860,000 jobs over the 12 months. This contributed to an increase in the unemployment rate from 4.0 percent in December 2000 to 4.5 percent in July 2001. In October 2001, with industrial production contracting for nearly a year, the unemployment rate jumped to 5.4 percent. According to data released by the Commerce Department on 31 October, because of the severe disruption to economic activity in September, the US economy contracted by 0.4 percent in the third quarter, year on year.

In Japan, the modest 2000 acceleration in growth had been expected to become a sustained, if mild, expansion that would bolster near-term economic prospects for developing Asia and the Pacific. Instead, economic activity weakened sharply in the first quarter of 2001, contracted by an annualized 3.2 percent, quarter on quarter, in the second quarter, and is expected to have contracted again in the third. The unexpected severity of the global ICT slowdown strongly affected the economy, which experienced double-digit contractions in export and private investment demand in the first and second quarters of 2001 after strong performance in the last quarter of 2000. Consumption sustained quarter-on-quarter growth of 2.0 percent in the second quarter but this is expected to have slowed to less than 1.0 percent growth in the third quarter as consumer confidence deteriorated along with the global outlook. With weak demand, industrial production has been on a downward trend for most of 2001, contracting by 11.7 percent in August 2001 from a year earlier. The unemployment rate reached a postwar high of 5.0 percent in the same month.

The euro area was expected to be relatively unaffected by the ICT correction in the US. However, real GDP growth, strong in the first quarter of 2001, slowed markedly in the second. This was due to slowing growth of exports to the US and Asia and to weakening domestic demand as high oil and food prices, slowing job growth, and declining equity values (particularly in telecommunications) impacted profits and real incomes. Consumption growth slowed from 3.2 percent, quarter on quarter, in the first quarter of 2001 to 2.4 percent in the second. Both gross fixed capital formation and exports contracted in the second quarter of the year after modest growth in the first. Annual industrial production growth, which slowed from 8.2 percent in December 2000 to 0.9 percent in April 2001, was negative by 1.1 percent in August 2001. The unemployment rate remained stable through July 2001 as slowing economic activity interrupted the gradual reduction in

### Box 1.1 **Macroeconomic Effects of the 11 September Attacks and Related Events: A Qualitative Assessment**

The attacks on the US on 11 September 2001 and subsequent events, such as cases of anthrax contamination, warnings of possible further terror attacks, military actions in Afghanistan, and other related events have broad economic and noneconomic global implications. Focusing on the macroeconomic effects, it is difficult to disentangle the quantitative impact of the attacks from other influences on an already weakening world economy. However, it is possible to identify, qualitatively, direct and indirect channels of impact, identify policy responses, and assess the probable net effects on the world economy. Box 1.2 reviews the impacts of these events on developing Asia.

**Direct Effects**

- ***Destruction.*** Beyond the horror and tragedy of the attacks is a significant economic loss. Estimates of insurance losses, US government compensation to victims' families, and job losses at services catering to the World Trade Center area add up to perhaps as much as $100 billion. Yet this amounts to a relatively small impact on overall world productive capacity, which will disproportionately affect New York-based firms or branches in the finance sector.
- ***Disruption.*** In the weeks following the attacks, air traffic, financial market activity, entertainment events, retail business, and even manufacturing were curtailed for varying time periods. As a result, economic activity in the US and its main import markets will be reduced in the third and perhaps the fourth quarter of this year.
- ***Increased costs.*** Increased security and insurance costs may have a broader impact over a longer period. In many areas of government and business such as transport, postal services, retail trade, and hospitality services, increased security measures are adding to costs and slowing delivery. Airlines have reported 10-fold insurance premium increases but many are receiving some type of government assistance in meeting these and other costs. More generally, commercial insurance rates are rising. In the US, rates are increasing by about 75 percent on average for property insurance (particularly in urban areas), by 20-40 percent for workers' compensation insurance (particularly for workers in large office buildings), and by as much as 50 percent for large event insurance (such as sports and entertainment).

**Indirect Effects**

- ***Disruption to financial markets.*** Due to the attacks, global financial markets suffered immediate turbulence (resulting in large price swings for stocks, bonds, and currencies) and disruption (temporarily reducing the ability of governments and firms to issue new debt). Although the turbulence has abated somewhat, the lingering effects of fear of further attacks, concern about the ongoing military response, and the extent of damage to the US and world economies are elevating risk aversion, resulting in a shift to safe assets. This has, so far, lowered short-term Treasury bond yields, caused severe stock market corrections from which there has only been partial recovery in some cases, and increased the risk premiums for emerging-market borrowers. If these heightened concerns persist, capital flows to developing Asia and the Pacific, already slowing in the first half of 2001, may be further affected.
- ***Loss of confidence.*** Consumer confidence was weakening in many economies prior to the attacks. However, they appear to have caused significant erosion, globally, of confidence in certain sectors—such as travel due to security concerns—and to have caused a further general, global deterioration of confidence in near-term economic prospects. With global air travel down by as much as 30 percent since 11 September, the world's airline industry may be facing $10 billion or more in losses as a result. Hotel occupancy rates are down sharply worldwide. Retailers in the US are offering deep discounts to maintain sales volumes and predicting weak Christmas holiday sales. However, the magnitude and duration of a dampening effect on consumer spending from the attacks are unknown, particularly with lingering concerns over biological attacks and ongoing military operations.
- ***Downturn in business sentiment.*** Private investment, already contracting prior to the attacks in much of the world, is likely to suffer in the near term as businesses delay spending because of increased uncertainty and downward revisions to earnings projections. However, the attacks may also stimulate investment needs in certain areas, such as personal and corporate security. Yet it is unclear what the longer-term effects on business investment, particularly globally, will be.

**Policy Responses**

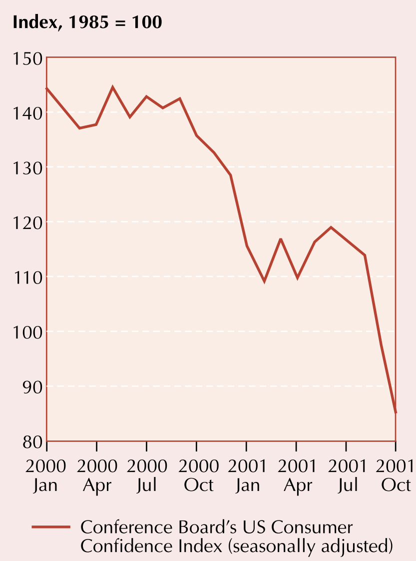
- ***Injection of liquidity.*** The US Federal Reserve, European Central Bank, Bank of Japan, and other monetary authorities provided much liquidity to financial markets to ensure continued settlement and other basic transaction functions immediately after the attacks. Traditional monetary stimulus, in the form of target interest rate cuts, was provided across the globe when the US financial markets reopened the week after the attacks. The US, for example, had cut the Federal Funds rate target by a full percentage point within a month of the attacks.

- ***Fiscal stimulus.*** Fiscal stimulus packages are still being developed, most notably in the US, where the Government, through mid-October, had provided about $45 billion in stimulus with additional tax and spending packages likely. Although fiscal responses in the euro area and Japan may be more limited, the authorities in several economies in Asia have passed or have proposed supplementary budgets since 11 September, including those of Hong Kong, China; Republic of Korea; Malaysia; Singapore; and Taipei,China. Many of them are also adopting elements of assistance to specific industries that include direct provision of funds and guarantees to reduce risk exposure for insurance providers.
- ***Increased international aid.*** Increased international aid funds are being made available to certain developing countries perceived as vulnerable to adverse impacts from the attacks and subsequent events.

Overall, in a macroeconomic sense, the attacks can be viewed as (i) causing a supply shock that was briefly severe in terms of disruption but that may have more moderate though longer-term consequences for transaction costs, and (ii) creating an additional demand shock in the midst of a preexisting global economic downturn. The indirect effects on aggregate demand have dominated the direct effects on aggregate supply with the result that the global disinflationary cyclical slowdown in economic activity has become more pronounced. An indication of this is the impact on oil prices, which initially surged after the attacks on fears of supply disruption but have since fallen to new lows for the year as signs of weakening demand became apparent, although an additional factor is the shift in the composition of spending away from energy-intensive activities such as air travel. Other commodity prices also weakened significantly after 11 September. In addition, job losses, particularly in the airline industry in the US, accelerated significantly in the wake of the attacks and expectations are that the unemployment rate in the US will soon reach around 6 percent, a level last seen in 1994.

There have been several preliminary attempts to provide quantitative assessments of the economic impact of the 11 September attacks, despite (i) the extraordinary level of uncertainty about the near-term global economic outlook, (ii) the difficulty in precisely separating the impact of the attacks from the underlying dynamics of the constantly evolving world economic outlook, and (iii) the ongoing nature of related events. An 11 October 2001 *Asian Wall Street Journal* article "Terror's Toll Continues to Mount," estimates that for the US alone, the direct and indirect effects (excluding loss of life and property) will cause the US economy, which had been expected to grow at an annual rate of 1.0 percent in the second half of 2001, to shrink at an annual rate of 1.0 percent. Hence the US recovery (and thus the global recovery), which had been expected in the fourth quarter, will be delayed. The baseline assumption of the *Update* is that the US recovery will be under way by mid-2002, a delay of two or three quarters, but it is difficult to attribute this delay entirely to the attacks since, immediately prior to them, there were indications that the US economy was weakening faster than expected. Nevertheless, it seems likely that the impact of the attacks on general global economic activity will last well into 2002, with significant costs in terms of lost output and income.

***Consumer confidence in the US plunged right after the terror attacks***




*Source: Bloomberg*

unemployment that was evident in 1999 and 2000. Overall, despite recent weakening of economic activity (particularly in tourism and travel as a result of the September attacks) and declining consumer and business confidence, it is likely that the euro area economy continued to grow, although at a low level, in the third quarter of 2001.

***By the second quarter of 2001, the three major economies were simultaneously weak...***

| | 2000Q4 | 2001Q1 | 2001Q2 |
|---|---|---|---|
| | | percent | |
| **Euro Area** | | | |
| Real GDP growth rate | 2.4 | 2.0 | 0.4 |
| Unemployment rate | 8.5 | 8.4 | 8.4 |
| Consumer price inflation rate | 2.6 | 2.6 | 3.0 |
| **Japan** | | | |
| Real GDP growth rate | 2.4 | 0.5 | -3.2 |
| Unemployment rate | 4.8 | 4.8 | 4.9 |
| Consumer price inflation rate | -0.6 | -0.9 | -0.7 |
| **United States** | | | |
| Real GDP growth rate | 1.9 | 1.3 | 0.3 |
| Unemployment rate | 4.0 | 4.2 | 4.5 |
| Consumer price inflation rate | 3.4 | 2.9 | 3.2 |

*Note*: GDP growth rates are seasonally adjusted annualized changes from the previous quarter. Unemployment rates are the average of seasonally adjusted monthly rates. Quarterly inflation rates are 12-month rates from the quarter's last month.

*Sources: European Central Bank, September 2001, Monthly Bulletin (online), available: www.ecb.int/pub/pdf/mb200109en.pdf; Government of Japan (online), available: www.stat.go.jp/English/19.htm; US Government, www.fedstats.gov*

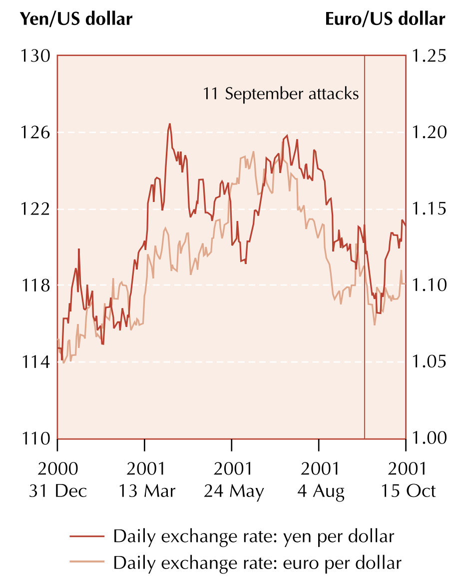
As economic activity, particularly investment, slowed more than expected in the US, Japan, and the euro area, imports, especially of ICT products, shrank more rapidly than anticipated. The International Monetary Fund's October 2001 *World Economic Outlook (WEO)* projects that goods and services import volume growth in the seven leading industrial economies will slow from 11.5 percent in 2000 to 4.6 percent in 2001 rather than the 7.2 percent forecast in May 2001.[1] Overall, shrinking imports in these seven economies are matched in the developing world so that the October 2001

[1] International Monetary Fund, October 2001, *World Economic Outlook: The Information Technology Revolution* (online), available: www.imf.org/external/pubs/ft/weo/2001/02/index.htm. WEO uses purchasing power parity weights to aggregate individual country statistics into regional and world statistics. The seven economies are Canada, France, Germany, Italy, Japan, United Kingdom, and United States.

*WEO* projects that growth of the volume of world trade in goods and services will slow sharply from a quite rapid pace of 12.4 percent in 2000 to 4.0 percent or less in 2001. The October 2001 *WEO* also projects that, amid rising risk aversion, net private capital flows to all developing economies, shrinking since 1996 and at about zero in 2000, will turn slightly negative for the first time in over a decade.

Despite reduced global trade and capital flows and a weakening US economy, the US dollar strengthened against many currencies in the first half of 2001, based on a favorable medium-term economic outlook, but it began to weaken in July 2001 as faith in a quick economic rebound faded. In the wake of the attacks, the US dollar depreciated against both the yen and the euro but subsequently rebounded. Overall, as of 15 October 2001, the dollar had appreciated by 5.5 percent against the yen and by 3.4 percent against the euro since end-December 2000.

***The dollar appreciated against the yen and the euro, recovering from a postattack fall...***

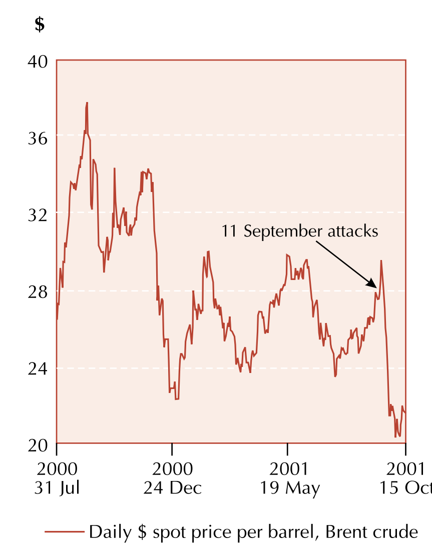



*Source: Datastream, Global Economics Database*

***Inflation.*** Price pressures, still present throughout much of the first half of 2001, eased somewhat in the US and euro area in the third quarter. In the US, consumer prices rose by 2.6 percent in September 2001 from a year earlier, down from a 3.2 percent increase in June as falling energy prices offset somewhat rising food, housing, and medical costs. In the euro area, annual consumer price inflation eased from 3.0 percent in June to 2.5 percent in September 2001. In Japan, prices continued to drop—by 0.8 percent in September 2001 from a year earlier. US annual producer price inflation for finished goods fell from 4.8 percent in January to 1.6 percent in September 2001 while prices for crude materials, which rose by 35.5 percent in 2000, fell at a seasonally adjusted annualized rate of 29.9 percent in the first nine months of 2001, a larger swing in prices than in all of the 1990s.

Commodity prices, on a general downward trend throughout 2001, fell quite sharply after the September attacks. Oil prices in particular, which had eased only slightly in the first half of 2001, fell significantly in late September, having temporarily surged immediately following the attacks. The Brent crude spot price was up by about $2 per barrel (/bbl) to $29.55/bbl on 14 September 2001 from a week earlier, approaching highs seen earlier in the year but not the 2000 high of over $37/bbl. By 2 October, however, as expectations of world recession began to dominate fears of supply disruption, the Brent crude spot price had slipped to $20.40/bbl, rebounding slightly to $21.78/bbl by 15 October 2001, a drop of 26.3 percent from the previous month and 33.3 percent from a year earlier.

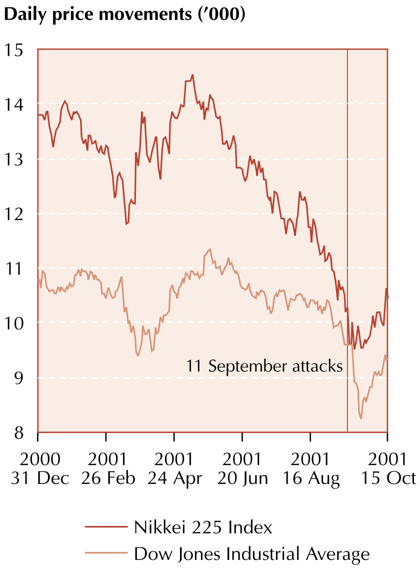
***...while oil prices fell to a new low, after a brief surge following the attacks***




*Source: Datastream, Global Economics Database*

***Financial Markets.*** Stock prices in the US were generally falling through August 2001 after a rally in April and May 2001. With US corporate profits plunging by double digits for three straight quarters, productivity data being revised downward, and investor and consumer confidence faltering, expectations for future earnings and thus stock prices were subsiding. Then, amid increased uncertainty and heightened recession fears in the wake of the attacks on the US, stock markets underwent steep corrections in September while experiencing significant volatility. The Dow Jones Industrial Average,

***Major stock markets rebounded from steep postattack corrections...***




*Source: Datastream, Global Economics Database*

which was down by 11.0 percent through 10 September 2001 from end-December 2000, reopened on 17 September and fell by 14.3 percent over the week to 21 September, representing a drop of 23.6 percent since end-December 2000. The Nikkei 225 Index fell by 30.7 percent and the Dow Jones Euro STOXX 50 by more than 39 percent through 21 September 2001 from end-December 2000. By 15 October, however, the Dow Jones Industrial Average had nearly regained its postattack losses while the Nikkei 225 and the Dow Jones Euro STOXX 50 had moved ahead of their pre-attack levels.

Short-term interest rates in the US started to fall from 2000 highs after the Federal Funds rate target was slashed, in a series of Federal Reserve actions, from 6.5 percent in January 2001 to 2.0 percent in early November. Rates on three-month Treasury securities have matched these cuts closely. In the aftermath of the September attacks, there was a flight to short-term Treasury securities, further driving yields down. The benchmark 10-year US Treasury note yield, however, rose from 4.8 percent in January 2001 to 5.4 percent in early July 2001 but then fell back by 21 September as confidence in a quick economic rebound slipped.

In Japan, short-term interest rates continued to hover above zero and 10-year government bond yields edged down by about 30 basis points from the beginning of the year to 1.3 percent in August 2001. In the euro area, short-term rates have dropped by much less than in the US as the European Central Bank (ECB) refrained from aggressive action both when the Federal Reserve was raising rates in 2000 and then cutting them in 2001. The ECB refinance rate was cut from 4.75 percent to 3.75 percent in three actions, the third in September 2001. However, long-term rates have not moved down.

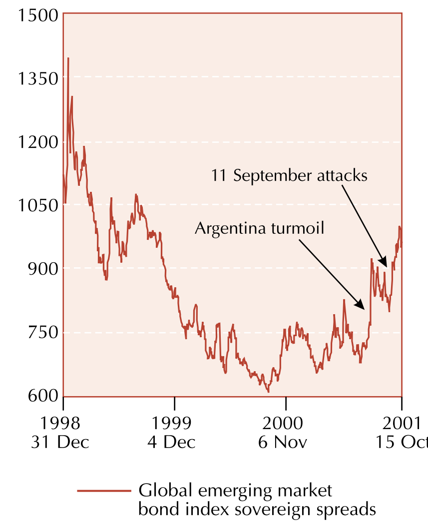
Although still below 1999 levels, sovereign debt risk premiums for developing countries, generally stable in early 2001, began to rise in the third quarter of 2001. These premiums (as measured by the difference or spread between the composite yield on sovereign debt instruments included in J.P. Morgan's Global Emerging Market Bond Index and the yield on US Treasury securities), increased by 20 percent in July 2001 as renewed fears about the weak fiscal position of the Argentine Government sharply increased interest rate spreads on Argentine sovereign debt (which holds a 20.4 percent weight in the Index) and had a contagion effect on other countries as well, particularly in Latin America. By comparison, the 10 percent increase in the composite spread in the month following the attacks was relatively modest. However, that trend has not reversed, unlike the brief surge in oil prices, the corrections in major stock markets, and the fall in the dollar immediately after the attacks.

***Policy Developments.*** Except for US monetary policy, macroeconomic stimulus in the three major economies was modest through August 2001. However, with the terror attacks on the US impacting a weakening economy, officials moved more aggressively in September in an attempt to stabilize economic conditions. The Federal Reserve had begun to respond to evidence of a rapidly slowing economy in January 2001 with a cut of 50 basis points in the Federal Funds rate target. This was followed by a series of further reductions, the latest a 50 basis point cut on 6 November 2001. These cuts lowered mortgage rates, stimulating a refinancing boom that increased disposable income, but notably they have not boosted equipment investment—because of past overinvestment and excess inventories. The fiscal response in the US was initially more muted, consisting mainly of tax rebates in the second half of 2001. However, emergency packages totaling $45 billion in funds for relief to key businesses, infrastructure repair, enhanced security measures, and possible antiterrorism operations were put together in the second and third weeks of September 2001 and an additional package of about $75 billion-$100 billion was being debated in Congress in mid-October 2001.

In Japan, where policy rates were already near zero and past fiscal stimulus packages have burdened the Government with high debt levels, the authorities focused on structural reforms (including fiscal tightening) to address long-term economic weakness. However, having eased its monetary stance earlier in the year, the Bank of Japan took additional stabilizing measures, such as a 15 basis point cut in its overnight discount rate, an increase in its target for bank reserves, and interventions to stabilize the exchange rate, in the immediate aftermath of the September attacks.

In the euro area, where the economy only began to slow in the second quarter of 2001 and inflation remained above target, macroeconomic policy was less accommodative through August. The ECB eased its target rate by 100 basis points, most notably with a 50 basis point cut on 17 September, when the New York stock exchanges reopened. This action was taken the same day as actions by the Federal Reserve, the Swiss National Bank, the Bank of Canada, and was joined, a day later, by the Bank of England and others. While fiscal policy continued to evolve within the framework of the euro area's 1997 Stability and Growth Pact, there were indications in late September that France, Germany, and Italy might exceed their fiscal deficit targets.

***...but risk premiums were generally already rising***



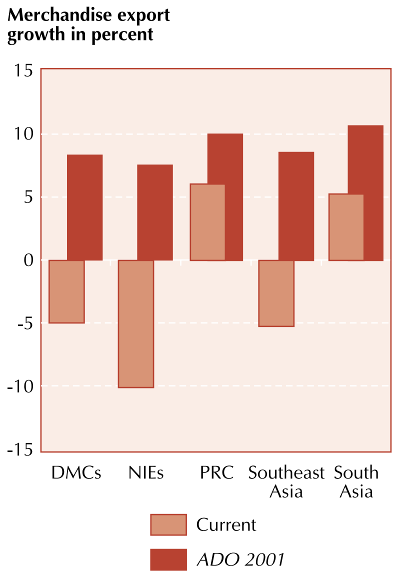

*Source: www.jpmorgan.com*

## Projections for 2001 and Outlook for 2002

Based on economic performance in the first three quarters of 2001, the baseline real GDP growth projections of the *Update* for 2001 and forecasts for 2002 have been adjusted downward to reflect a weaker than anticipated global economy. Economic activity is now expected to remain quite subdued in the near term with a global recovery beginning in 2002, perhaps as early as the second quarter. Conditions are expected to strengthen throughout the second half of 2002 and into 2003, when the effects of fiscal and monetary stimulus measures make themselves felt, investment (particularly in the ICT sector) rebounds, and global trade growth accelerates. Current expectations are for US GDP growth to be only 1.0 percent in 2001 and 1.0-1.5 percent in 2002. In Japan, a 0.5 percent contraction in 2001, and a similar contraction to zero growth in 2002, are expected. Euro area growth is expected to be 1.8 percent in 2001 and 1.8-2.3 percent in 2002.

The revised projections represent a fairly significant downgrade from *ADO 2001*. It should be noted, however, that the relatively low projections for year-on-year growth in 2002 mask a gradual pickup during the course of the year and that, by the second half, a strong recovery is expected to be

***Exports have been sharply weaker in 2001 than expected***




*Sources: ADO 2001, staff estimates*

under way that will continue into 2003. The forecasts do not incorporate the effects of any further policy measures that the three major economies may take to help mitigate the slowdown and short-run effects of the September attacks. Both through actions and words, policymakers in the three economies have indicated a clear intention to avoid a sharp and prolonged slowdown.

## Developing Asia and the Pacific

### Introduction

The terror attacks and subsequent actions are likely to have a significant impact on developing member countries (DMCs), which, to varying degrees, were already adversely affected by an unexpectedly strong drop in external demand (Box 1.2). As a result, real GDP growth in developing Asia and the Pacific is expected to slow from 7.0 percent in 2000 to 3.4 percent in 2001, a significant downward revision from the 5.3 percent projection given in *ADO 2001*. These aggregates mask different experiences, however, with the NIEs being marked down very sharply, Southeast Asia significantly, and South Asia less so, while the People's Republic of China (PRC) projection is unchanged.

The largest revisions to the *ADO 2001* forecasts involve projections of trade performance. This is because (i) the contraction of the global ICT sector—on which many DMCs are highly dependent—was sharper than expected; (ii) the US slowdown evolved into a deeper, wider, and more prolonged global slowdown—in part as a result of the attacks; and (iii) trade was disrupted by the attacks. The value of DMC exports, which grew by over 20 percent in 2000, was initially expected to slow to growth of just over 8 percent in 2001. Instead, it is now projected to contract by 5.0 percent before rebounding to growth of about 6 percent in 2002. Similarly, the value of merchandise imports, which grew by almost 25 percent in 2000 and was forecast at over 11 percent for 2001, is now projected to contract by more than 3 percent in 2001 before recovering to growth of 7.2 percent in 2002. Overall, the aggregate DMC current account, in surplus since 1997, is expected to remain positive but to fall as a share of GDP from 3.4 percent in 2000 to 2.3 percent in 2001 but to further erode in 2002 as recovery fuels import demand.

Financial market developments across the region have, with few exceptions, been influenced by the downward trend in US stock markets, by aggressive Federal Reserve interest rate cutting, by postattack volatility, and, to a more limited degree, by increased uncertainty and risk aversion. In addition, in some DMCs, internal political conditions and slow reform progress have, at times, adversely affected financial market performance. Many DMCs have undertaken expansionary macroeconomic policies in response to the slowdown in external demand, particularly after the 11 September attacks,

***Growth in developing Asia and the Pacific will slow significantly more in 2001 than originally anticipated...***

| | 2000 | 2001 | | 2002 | |
|---|---|---|---|---|---|
| | | Current | *ADO 2001* | Current | *ADO 2001* |
| **Gross Domestic Product** (annual percentage change) | | | | | |
| Developing Asia and the Pacific | 7.0 | 3.4 | 5.3 | 4.5 | 6.1 |
| Newly Industrialized Economies | 8.4 | 0.1 | 4.3 | 2.7 | 5.6 |
| Central Asian Republics, Azerbaijan, and Mongolia | 7.8 | 7.7 | 3.3 | 5.5 | 4.8 |
| People's Republic of China | 8.0 | 7.3 | 7.3 | 7.0 | 7.5 |
| Southeast Asia | 5.2 | 2.4 | 4.0 | 3.3 | 4.8 |
| South Asia | 5.1 | 5.2 | 5.8 | 5.7 | 6.5 |
| India | 5.2 | 5.6 | 6.2 | 6.3 | 7.0 |
| The Pacific | -1.6 | -0.5 | 3.4 | 2.5 | 5.0 |
| Crisis-Affected Economies[a] | 6.9 | 2.1 | 3.9 | 3.4 | 5.1 |
| **Current Account Balance** (percentage of GDP) | | | | | |
| Developing Asia and the Pacific | 3.4 | 2.3 | 2.6 | 1.5 | 2.5 |
| Newly Industrialized Economies | 4.9 | 4.8 | 4.6 | 4.1 | 5.0 |
| Central Asian Republics, Azerbaijan, and Mongolia | 2.5 | 2.6 | 2.6 | 3.6 | 3.6 |
| People's Republic of China | 1.5 | 0.9 | 1.2 | 0.3 | 1.0 |
| Southeast Asia | 5.9 | 2.8 | 3.6 | 1.8 | 3.0 |
| South Asia | -1.1 | -1.6 | -1.7 | -1.9 | -1.5 |
| India | -0.5 | -0.9 | -1.2 | -1.0 | -1.0 |
| The Pacific | 5.4 | — | — | — | — |
| Crisis-Affected Economies[a] | 4.3 | 2.6 | 2.8 | 1.8 | 2.3 |

— not available.

[a] Indonesia, Republic of Korea, Malaysia, Philippines, Thailand.

but the magnitude of these measures varies widely across countries. It is expected that the modest impact of this stimulus will begin to be felt by early 2002, that the general level of uncertainty will fall, and that security concerns will ease as the ramifications of the attacks and related events unfold. As a result, tourism will slowly begin to rebound and risk aversion will begin to fall, leading to a gradual increase in capital flows. This, combined with a slow recovery in the ICT sector, is expected to initiate the modest beginnings of a regional economic recovery by the middle of 2002, which should be well under way in the second half of the year and continue to strengthen in 2003. Thus, forecast overall DMC growth in 2002, at 4.5 percent (down from 6.1 percent in *ADO 2001*), will be stronger than in 2001 but somewhat below potential.

## Recent Developments and Projections for 2001

*Output, Employment, and Inflation.* Recent economic performance in DMCs attests to their level of integration into the world economy, their diversity, and their postcrisis strength. After a year of relatively strong, primarily export-driven GDP growth, the region's economic expansion is proceeding at a slower rate than in 2000 and than expected in *ADO 2001*, in step with the major world economies. Unemployment is, thus, on the rise to varying degrees, notably in the NIEs, and inflation is generally weaker than was expected in *ADO 2001*, with deflationary conditions in some DMCs. Yet a sharp drop in exports, the main engine of growth for many DMCs, has not prevented the region from posting strong performance relative to other developing regions of the world, in part because of generally stronger macroeconomic fundamentals. This contrasts with 1998 when performance was, relatively, weak. The impact of the 11 September attacks on DMC output and employment in 2001, although not yet quantifiable, should be most significant in those economies with large tourism sectors such as Cambodia, Maldives, Nepal, and Thailand, and those for which the disruptions to trade would be most significant, such as Hong Kong, China; Pakistan; and Singapore.

DMCs are showing a wide range of trends that, to some extent, limits generalization. Although export performance is affected in most of the region, economic performance in the NIEs, which account for over 35 percent of GDP in developing Asia and the Pacific and are the most dependent on exports of goods and services, is deteriorating the most. The NIEs' real GDP growth, at 8.4 percent in 2000, is expected to be almost flat in 2001, revised down from the *ADO 2001* forecast of over 4 percent. This slowdown in the NIEs is at its most severe in external and investment demand, which are contracting overall, although consumption growth has generally slowed. Thus, output and employment have been hardest hit in manufacturing. The 2001 projection for Southeast Asia deteriorated less dramatically relative to 2000 and to the *ADO 2001* outlook (except for Malaysia) but was nevertheless significant, and this slowdown is broad based with export, investment, and consumption growth all slowing. Southeast Asia's real GDP growth is now expected to slow from 5.2 percent in 2000 to 2.4 percent in 2001 rather than to the 4.0 percent projected in *ADO 2001*. However, the Philippines, partly because of improved agricultural performance, and Indonesia, in part because of a peaceful change of government, have suffered less of a slowdown than Malaysia, where ICT exports are more important.

Although the 2001 projection is still for reasonably robust South Asian growth of more than 5 percent, this has been revised downward moderately because of weak export growth, adverse weather conditions, and the sharp negative impact on tourism of the heightened security concerns in the wake of the 11 September attacks. In contrast, the 2001 projection for the PRC has remained unchanged, despite weaker export growth, because of strong domestic demand and strong foreign investment in conjunction with imminent World Trade Organization accession. In the Pacific subregion, which experienced a contraction in economic activity in 2000 partly because of unrest

Box 1.2 **Impact on Developing Asia and the Pacific of the 11 September Attacks**

There are two main avenues through which the effects of the terror attacks could be generally felt in developing Asia and the Pacific. First, global commerce could be affected. Trade in goods may be adversely impacted over a long period by increased transaction costs, although the magnitude of this effect is not expected to be large. However, trade in services (particularly tourism but also potentially banking) is being hit by security concerns. In addition, the general worsening of confidence might further dampen global commerce, placing additional downward pressure on export volumes and commodity prices. Indeed, commodity prices were sharply lower after the attacks.

Second, capital flows are likely to fall as risk premiums rise as a result of the attacks. Thus, businesses would be hit by reduced revenues and reduced access to capital at the same time, conditions that are likely to lead to the failure of weak companies. Although these trends were already evident in the global economic slowdown, availability and terms of financing have become even tighter after 11 September for both governments and private firms. Portfolio investment inflows were already sharply lower prior to the attacks but many DMCs that experienced steep stock market corrections immediately following them have had only partial recoveries. Foreign direct investment, which does not respond as quickly to changing conditions, is still expected to be higher for developing Asia and the Pacific in 2001 than in 2000, primarily because of flows to the PRC, but it may fall in 2002 because of the impact of uncertainty on current investment planning. Finally, although net loan repayments from DMCs since the 1997 financial crisis have substantially reduced external debt burdens, risk premiums have been rising in some countries in the wake of the attacks, although not to the same degree as other regions, such as Latin America.

The extent to which DMCs are affected will depend on (i) how much they depend on global commerce, and (ii) how much they are (or are perceived to be) vulnerable to heightened political uncertainty or the possible disruptive effects of actions related to the global antiterror campaign. For those economies with high merchandise exports to GDP ratios (such as the NIEs and Malaysia), the impact of the delayed recovery in global trade will mean a longer period of significantly lower growth. However, these are relatively high-income countries that are better able to cope with cyclical downturns. For those countries with relatively large tourism industries, however, the attacks represent a new and significant adverse shock. Anecdotal evidence suggests that there have been many cancellations across the region, particularly in DMCs with existing or previous security problems. Finally, risk premiums are rising on both sovereign and private debt in those countries that have relatively high debt burdens, particularly Indonesia, Pakistan, and Philippines.

| | **Tourism Receipts as Percent of GDP, 2000** |
|---|---|
| Cambodia[a] | 6.4 |
| Thailand | 5.8 |
| Malaysia | 5.1 |
| Hong Kong, China | 4.8 |
| Philippines[a] | 3.4 |
| Nepal[a] | 3.2 |
| Indonesia[a] | 2.9 |
| Singapore[b] | 2.0 |
| Sri Lanka[a] | 1.5 |
| People's Republic of China | 1.5 |
| Korea, Republic of | 1.5 |

[a] 1999 data.
[b] Singapore tourist revenue refers only to official hotel receipts.

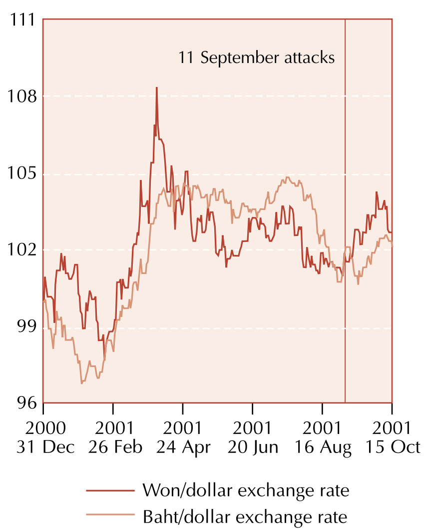
| | **Merchandise Exports[a] as Percent of GDP, 2000** |
|---|---|
| Singapore | 149.5 |
| Hong Kong, China | 124.6 |
| Malaysia | 109.9 |
| Taipei,China | 63.9 |
| Thailand | 56.7 |
| Philippines | 53.7 |
| Cambodia | 44.5 |
| Indonesia | 40.5 |
| Korea, Republic of | 38.4 |
| Sri Lanka | 33.5 |
| People's Republic of China | 23.1 |

[a] Merchandise exports are customs trade data.

*Sources: IMF, IFS CD-Rom (October 2001); CEIC Data Company Ltd; ADB, Key Indicators 2001; World Bank, World Development Indicators 2001; www.cbc.gov.tw*

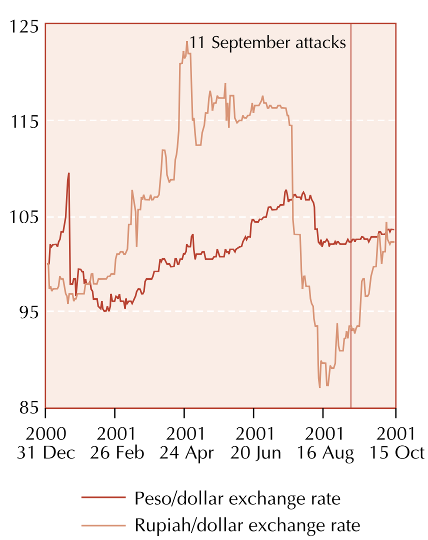
***The dollar appreciated against many Asian currencies in 2001 with the attacks having varying impacts...***

**Index, 31 Dec 2000 = 100**




*Source: Datastream, Global Economic Database*

**Index, 31 Dec 2000 = 100**




*Source: Datastream, Global Economic Database*

in the Fiji Islands and Solomon Islands, the 2001 real GDP projection has been revised downward to a contraction of 0.5 percent from the 3.4 percent forecast in *ADO 2001*. This is largely because of continued uncertainty in these two countries and in Papua New Guinea (which is expected to experience a second year of recession) and because of slower external trade in goods and services as a result of the global slowdown and the 11 September attacks. In the Central Asian republics (CARs) and Azerbaijan, the strong growth performance of 2000 is expected to be repeated in 2001 because of rising oil and gas production.

*External Sector.* Although the 2001 slowdown in DMC economic activity of over 3 percentage points is sharper than expected, it is still less severe than the 5.7 percentage point drop during the crisis year of 1998. In contrast to the extreme corrections to domestic demand and substantial capital outflows suffered by many DMCs during that period, the current situation is better characterized as an ICT sector correction that deepened into a global cyclical slowdown. As such, the primary source of weakness lies in trade rather than capital flows, and the shock is global and more evenly spread among regions, rather than severe and concentrated in developing Asia and the Pacific. The additional impact of the terror attacks (Boxes 1.1 and 1.2) will be felt by most DMCs through external sector channels, such as slowing exports of goods and services (including tourism) and reduced private capital flows.

Within the context of aggregate DMC exports falling by 5.0 percent in 2001, the NIEs—heavily dependent on electronics exports—are expected to suffer a contraction of about 10 percent, whereas the exports of the PRC and South Asia—more diversified and more traditional—are expected to expand but at a significantly slower rate than in 2000. The CARs, Azerbaijan, and Mongolia will also see export growth slow, primarily because of slowing global commodity demand. However, similar to the NIEs, Southeast Asia is experiencing a projected contraction of merchandise exports of 5.3 percent in 2001 after growth of 18.6 percent in 2000. A similar picture emerges on examination of expected import performance. The NIEs—once again, the economies with the greatest reduction in import-intensive expenditures, investment, and exports—are unexpectedly seeing projected reductions in imports of over 10 percent this year, while both the PRC and South Asia are expected to record larger import levels than in 2000.

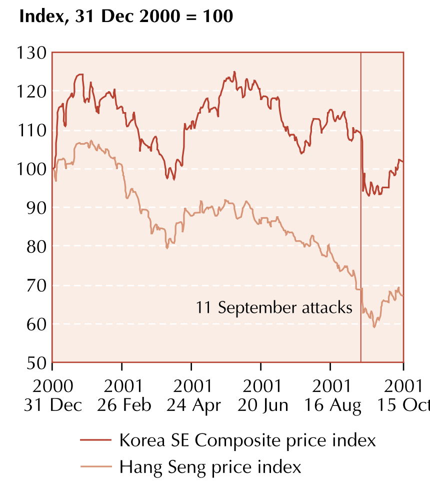
*Financial Markets.* The US dollar has appreciated against most regional currencies through the first nine and a half months of the year. The exceptions are those with fixed or linked exchange rates such as PRC; Hong Kong, China; and Malaysia. Several regional stock markets have mirrored developments in the US, rallying in March and April, and generally falling thereafter, with particularly steep losses amid heightened volatility in September. Notably, the PRC's Shanghai A Share Index was down significantly through 21 September and even the B Share Index, which was opened to local investors in February 2001 and which rose quite rapidly through May, has since suffered a sharp correction. Interest rates are also generally falling, particularly short-term rates. The exceptions are Indonesia (where rates are rising) and the PRC (where rates are unchanged).

With greater uncertainty and risk aversion, some DMCs have seen net private capital outflows, because of portfolio investment outflows combined with weak foreign direct investment. In addition, as economic activity has slowed, demand for foreign credit has fallen while existing loans continue to be paid down so that many economies are making large net repayments of private credit. The crisis-affected economies of Indonesia, Republic of Korea, Malaysia, Philippines, and Thailand are expected to experience net private capital outflows again in 2001, having only returned to net inflows in 2000 after large net outflows in the wake of the financial crisis. However, net outflows are still well below levels experienced in 1998 and 1999. The PRC, in contrast, enjoyed an improved level of net inflows primarily because of increased foreign direct investment. Moreover, most DMCs have not witnessed significant increases in bond spreads. The DMCs that have been the most affected by the increased risk aversion in international financial markets are Indonesia, Pakistan, and Philippines.

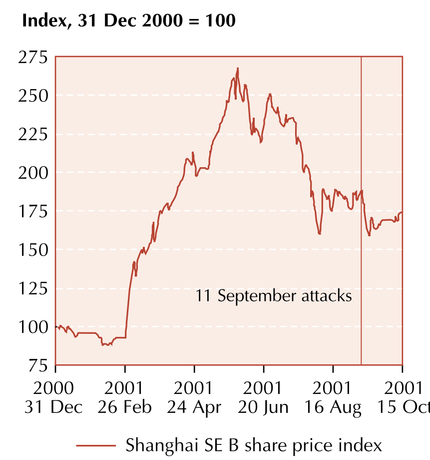
***Policy Developments.*** In general, DMC macroeconomic policies have become more accommodative as economies have weakened and inflation has eased, particularly after 11 September. The largest total reductions in official interest rate targets since December 2000 have been in the Philippines (475 basis points), after a series of sharp increases in late 2000, and Hong Kong, China (400 basis points), due to the currency link. Rates are higher in Indonesia because of concerns about high inflation and in Thailand because of attempts to discourage refinancing of foreign debt in domestic markets. In most cases, monetary easing has not led to a significant expansion in credit. Many banks are still constrained by relatively high levels of nonperforming loans.

In terms of fiscal policy, the PRC may be the most aggressive and successful, having pursued an expansionary policy that is widely regarded as having helped buttress domestic demand during a time when export demand was weakening. The country perhaps hardest hit by the slowdown, Singapore, with a limited domestic sector, undertook very little monetary or fiscal stimulus prior to 11 September but announced in mid-October 2001 a second supplementary stimulus package, which amounts to about 7 percent of GDP. Malaysia also announced a second fiscal stimulus package in October of 1.3 percent of GDP. In other countries, such as India and the Philippines, fiscal constraints have limited the use of additional stimulus packages. For its part, the Republic of Korea has resorted to a mix of fiscal and monetary policy, and most significantly, to a series of efforts to safeguard its corporate sector by guaranteeing bonds and taking steps to facilitate additional credit extension to corporate debtors. In many economies, because of significantly weakening economic conditions, continued stock market corrections, and political uncertainty, progress in structural reform has been constrained as officials focused more on near-term stability. For example, asset management companies made little headway in 2001 in disposing of nonperforming loans.

***...whereas regional stock markets only partly recouped their postattack losses***




*Source: Datastream, Global Economics Database*

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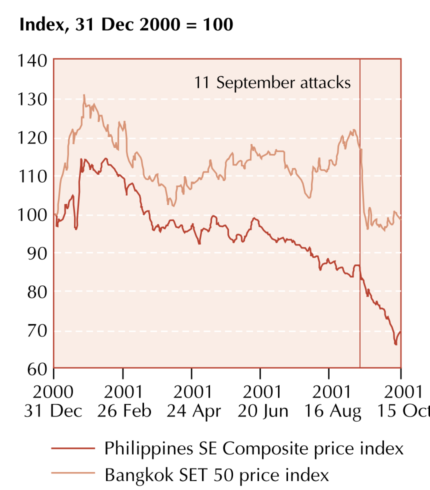
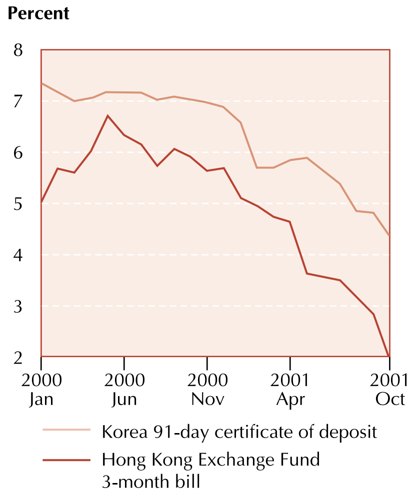



*Source: Datastream, Global Economics Database*

***Short-term interest rates generally fell...***

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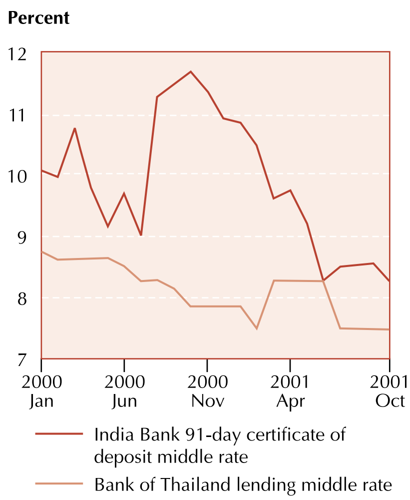
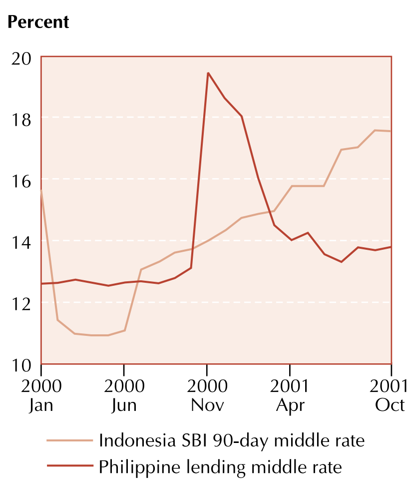



*Source: Datastream, Global Economics Database*




*Source: Datastream, Global Economics Database*

## Outlook for 2002: Assumptions and Risks

The forecasts assume a modest pickup in DMC growth performance from about 3.4 percent in 2001 to nearly 5 percent in 2002. This is based on the assumption that exports of goods and services (including tourism) will bottom out by end-2001 or early 2002, build slowly during the middle part of 2002, and show strong growth momentum in the latter part of the year so that, by 2003, expansion in exports from the region, and hence in GDP, will be robust. This is expected to be across all major subregions but strongest in the NIEs, which as a group should accelerate from virtually no improvement in 2001 to almost 3 percent growth in 2002. Southeast Asia is expected to see a more moderate pickup as exports recover in 2002 but, particularly for the economies of Indonesia, Philippines, and Thailand, domestic demand remains constrained. In contrast, PRC economic growth is forecast to moderate slightly under the assumption that lower net export earnings counteract the positive impact of continued macroeconomic stimulus. South Asia is forecast to experience a modest acceleration of growth as export expansion strengthens and agriculture recovers from drought conditions. The Pacific subregion should move from contraction to growth in 2002 on the strength of a global recovery and increased political stability. However, after the 11 September attacks, the CARs, Azerbaijan, and Mongolia may see growth slow in 2002 because of concern about stability in some countries.

In terms of external developments, DMC exports are expected to recover to close to 6 percent growth in 2002 as world trade, particularly in ICT

***In general, monetary policy in developing Asia and the Pacific has been accommodative…***

| **Official Interest Rate** | **Current (percent)** | **Change from December 2000 (basis points)** |
|---|---|---|
| Philippines Reverse Repurchase Rate | 8.75 | -475 |
| Hong Kong, China Bank Prime Rate | 5.50 | -400 |
| Singapore Three-month SIBOR | 2.28 | -411 |
| Taipei,China Official Discount Rate | 2.50 | -213 |
| India Bank Rate | 6.50 | -150 |
| Korea Overnight Call Rate | 4.00 | -125 |
| PRC One-Year Working Capital | 5.85 | 0 |
| Thailand 14-Day Repurchase Rate | 2.50 | 100 |
| SBI One-Month Rate | 17.58 | 316 |
| *Memorandum items:* | | |
| US Federal Funds Rate | 2.00 | -450 |
| European Central Bank Refinance Rate | 3.75 | -100 |
| Japan Overnight Call Rate | 0.01 | -24 |

*Sources: J. P. Morgan, 26 October 2001, Global Central Bank Watch, p. 5 (online), available: www.jpmorgan.com; www.mas.gov.sg* products, is fueled by the expected recovery in US consumption and investment demand. This should be accompanied by acceleration in DMC import growth of 7.2 percent as manufacturing rebounds. Because of a prolonged period of aggressive inventory corrections and capacity consolidations in the ICT industry (together with continued innovation), when retail sales begin to pick up (perhaps as early as the second quarter of 2002), DMC exports should begin to rise and investment in new capacity should reemerge. Although the pace at which the ICT sector will expand over the next few years is unlikely to match rates experienced in early 2000, it is still widely regarded as a growth industry for which expansion should be relatively robust over the medium term.

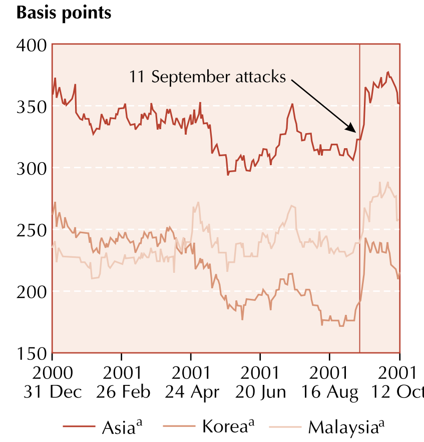
As the recovery begins in 2002, the overall DMC balance on current account is expected to remain in surplus, although it is likely to narrow as imports, particularly of capital goods, increase. The region should also see only limited increases in net private capital inflows in 2002 both because of debt repayments and because of a reduced global appetite for investment in emerging markets. This is a potential drag on long-term growth. Despite the expected pickup in economic activity, regional inflation is not expected to accelerate noticeably in 2002 relative to 2001 because world and regional GDP is still anticipated to be well below potential. Although some tendency toward expansionary policy may persist in the first half of 2002, as the recovery gets under way, governments will likely quickly shift to more neutral stances.

This outlook involves several key assumptions. First, whereas *ADO 2001* assumed a short, sharp, US economic slowdown, the current view is that the slowdown will be longer, deeper, and broader across sectors. The US economy is expected to stabilize in early 2002 but the recovery may not become firmly established until mid-2002. Second, Japan, which had been expected to expand slowly, will remain weak in the near term but will not significantly weaken further. Third, the euro area, which had been expected to remain strong, will experience an economic slowdown that will be relatively brief and shallow so that, as the US economy recovers, so will the euro area. Fourth, oil prices will remain stable, inflation will be subdued, and there will be no major exchange rate realignments. Fifth, despite recent disturbances, financial markets will continue to function in an orderly fashion and risk premiums will remain well below 1998 levels. Sixth, the level of uncertainty over the economic outlook will subside as current events unfold, volatility in market indicators subsides, and clear economic trends are reestablished. It is further assumed that macroeconomic policy will be further eased, particularly in the US, as needed to mitigate the effects of the slowdown.

As compared to the global environment at the time of *ADO 2001*, uncertainty over global conditions has increased sharply and significant downside risks are in evidence, although upside risks are present. The significant near-term risks are external.

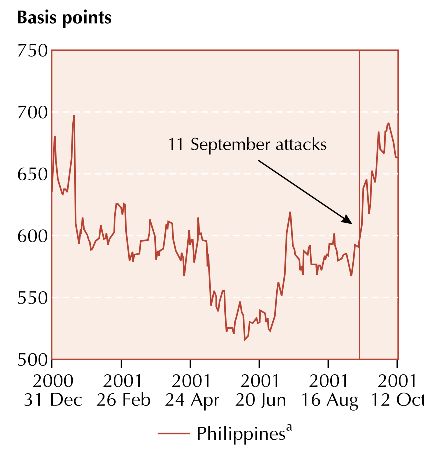
First, because of the synchronized nature of the downturns in the US, Japan, and the euro area, there is a risk that the three major economies will be in a downward spiral of shrinking trade and faltering confidence in which all the engines of growth stall. This could lead to a prolonged period of global

***...and risk premiums were moderately higher in general after the 11 September attacks***



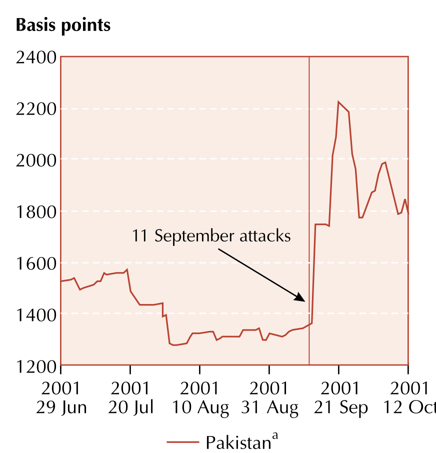

[a]Global emerging market bond index composite sovereign spreads

Source: www.jpmorgan.com




[a]Global emerging market bond index composite sovereign spreads

Source: www.jpmorgan.com




[a]Global emerging market bond index composite sovereign spreads

Source: www.jpmorgan.com

## Table 6. Balance of Payments on Current Account

(percent of GDP)

| | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | | 2002 | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Current | *ADO 2001* | Current | *ADO 2001* |
| Newly Industrialized Economies | 0.1 | 1.9 | 7.4 | 6.3 | 4.9 | 4.8 | 4.6 | 4.1 | 5.0 |
| Hong Kong, China | ... | ... | ... | ... | ... | ... | ... | ... | ... |
| Republic of Korea | -4.4 | -1.7 | 12.7 | 6.0 | 2.4 | 2.7 | 1.9 | 1.7 | 1.1 |
| Singapore | 14.1 | 19.0 | 24.8 | 25.9 | 23.6 | 24.0 | 24.0 | 22.5 | 25.0 |
| Taipei,China | 3.9 | 2.4 | 1.3 | 2.9 | 2.9 | 3.4 | 2.5 | 2.7 | 3.0 |
| People's Republic of China | 0.9 | 4.1 | 3.1 | 1.6 | 1.5 | 0.9 | 1.2 | 0.3 | 1.0 |
| Central Asian Republics, Azerbaijan and Mongolia | -5.8 | -4.5 | -5.5 | -1.3 | 2.5 | 2.6 | 2.6 | 3.6 | 3.6 |
| Southeast Asia | -5.4 | -3.5 | 4.7 | 6.7 | 5.9 | 2.8 | 3.6 | 1.8 | 3.0 |
| Indonesia | -3.4 | -2.3 | 4.3 | 4.1 | 5.2 | 2.1 | 2.9 | 0.6 | 1.3 |
| Malaysia | -4.4 | -5.9 | 13.2 | 15.9 | 9.4 | 5.2 | 5.5 | 4.7 | 3.2 |
| Philippines | -4.8 | -5.3 | 2.4 | 10.0 | 12.5 | 4.9 | 8.0 | 4.5 | 5.0 |
| Thailand | -8.1 | -2.0 | 12.7 | 10.0 | 7.5 | 3.8 | 6.5 | 2.3 | 5.6 |
| Viet Nam | -9.9 | -6.5 | -4.6 | 4.1 | 1.7 | 2.0 | -0.1 | -3.0 | -1.9 |
| South Asia | -2.3 | -2.2 | -1.4 | -1.7 | -1.1 | -1.6 | -1.7 | -1.9 | -1.5 |
| Bangladesh | -4.0 | -2.1 | -1.1 | -1.4 | -1.0 | -2.0 | -1.5 | -2.5 | -1.8 |
| India | -1.2 | -1.3 | -1.0 | -1.0 | -0.5 | -0.9 | -1.2 | -1.0 | -1.0 |
| Pakistan | -7.3 | -5.9 | -3.0 | -3.6 | -2.1 | -2.2 | -1.7 | -2.5 | -1.0 |
| The Pacific | 5.0 | -2.7 | 1.1 | 2.0 | 5.4 | — | — | — | — |
| Pacific Island DMCs | ... | ... | ... | ... | ... | — | — | — | — |
| Papua New Guinea | 5.5 | -5.3 | 0.6 | 1.4 | 7.8 | 3.8 | -3.5 | 3.5 | -3.4 |
| **DMCs** | **-1.4** | **0.8** | **4.2** | **3.7** | **3.4** | **2.3** | **2.6** | **1.5** | **2.5** |

— data not available.
... data not applicable.

# STATISTICAL NOTES

Summary tables on output, inflation, and components of the balance of payments are presented for 14 developing member countries and five subregions of the Asian Development Bank (ADB). These tables contain historical data from 1998 to 2000, preliminary estimates for 2001, and forecasts for 2002. Most historical data are obtained from ADB's statistical database system, official country sources, statistical sites on the Internet, and online data service providers. Statistical publications of the International Monetary Fund (IMF) and World Bank are also used. Estimates for 2001 and forecasts for 2002 are based on available quarterly data. Data refer to calendar years, except for Bangladesh, India, and Pakistan, where fiscal year data are reported.

Subregional averages have been computed for output growth, inflation, and the ratio of the current account balance to gross domestic product (GDP). Subregional averages of output growth and inflation are weighted arithmetic means of the individual country data using the average of 1995-1996 nominal GDP in US dollars as weights. This weighting system has been adopted in order to assign a more realistic share to the crisis-affected countries as compared to using contemporaneous nominal GDP in US$. The subregional average of the current account to GDP ratio is based on the ratio of the overall subregional current account balance to the overall subregional nominal GDP in US dollars. Except for the Central Asian republics and Azerbaijan, which have a variable country coverage depending on the specific data, all the subregional averages are computed based on the complete enumeration of countries included in the *Asian Development Outlook 2001*.

For the Central Asian republics, Azerbaijan, and Mongolia, the coverage for the subregional averages varies depending on the availability of data. For GDP and inflation, the averages cover CARs and Azerbaijan but exclude Mongolia; the comparative figure from *ADO 2001*, however, includes Mongolia but not Azerbaijan. For the components of the current account, the averages exclude Azerbaijan and the Kyrgyz Republic but include Mongolia.

Subregional averages for output and inflation are also presented for Pacific Island DMCs (which excludes PNG). However, due to data limitations, subregional averages for the components of the balance of payments are not presented.

**Growth rates of GDP** are valued at constant market prices except for India and Pakistan where GDP at constant factor cost is used. For Papua New Guinea, the growth rate is based on GDP at constant purchaser's value.

**Inflation rates** are generally based on the consumer price index (CPI) and reflect period averages except for Indonesia and Viet Nam with end-of-period inflation rates. The inflation rate for Hong Kong, China; Pakistan; and Singapore are fiscal year; while that for India is also fiscal year based on the wholesale price index (WPI).

**Growth rates of merchandise exports and imports** are derived from the balance-of-payments accounts for which data are from official sources. These figures are on a free-on-board (f.o.b.) basis. For Hong Kong, China the export and import growth figures in the text refer to growth of exports obtained from the national income accounts at constant market prices. This are different from the growth of merchandise exports and imports in the tables, which are in nominal US dollar terms.

**Current account balance as percent of GDP** is the ratio of the current balance in US dollars to nominal GDP in US dollars. The current account balance is the sum of the balance of trade, net trade in services and factor incomes, and current official and private transfers. In the case of Bangladesh, the current account balance does not include official transfers.

**Tables and charts for the chapter "Outlook for Developing Asia and the Pacific"** were generated using data obtained from the following sources: CEIC Data Company Ltd.; *Global Data Watch* of J.P. Morgan (August-October 2001); Global Economics Database of Datastream; *International Financial Statistics* of IMF (October 2001); *World Development Indicators* 2001 of the World Bank; *World Economic Outlook* of IMF (October 2001); and official sources. Other data are staff estimates. Short-term interest rates give the yield of three-month certificate of deposits or government bonds (whichever is available). Exchange rates are average of period market exchange rates. Stripped spreads are the rate differentials between the rate of return of private placements and the rate of return of corresponding government bonds. The following websites were also used as data sources: www.cnn.com; interactive.wsj.com; www.iif.com.

**Charts for individual country chapters and subregional overviews** were computed or generated from data obtained from CEIC Data Company Ltd.; *IMF Article IV* (various issues, several countries); Global Economics Database of Datastream; and official sources. Except for Papua New Guinea (which uses IMF data), the data on GDP growth are obtained from official sources. Data on the components of domestic demand (investment and consumption) for the PRC, Indonesia, and Malaysia are obtained from official sources. Data on fiscal deficits for Bangladesh, India, Pakistan, and PNG are obtained from official sources. Data on capital flows for PRC, and data on the stock market for the Republic of Korea are obtained from IMF. Unemployment rates for Hong Kong, China are obtained from official sources.