Asia-Pacific
Economic Cooperation

1999 APEC Economic Outlook

APEC Economic Committee (EC)

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FOREWORD

Since 1995, the Economic Committee has produced *APEC Economic Outlook* annually. *The 1999 APEC Economic Outlook* is the fifth in this series. The major focus of this year's Outlook is the Asian crisis. The Asian crisis has had wide-ranging, far-reaching impacts on APEC economies, and thus has been a central concern for the APEC community.

This year's Outlook reviews economic developments and prospects in the APEC region in the wake of the crisis, and discusses some key issues arising from the crisis. It concludes that the upward trend observed to date in APEC economies will continue in the second half of 1999 through the year 2000, although the crisis continues to have impacts on APEC economies. It also provides a summary of the trends of various key economic indicators to demonstrate how APEC economies have performed through the Asian crisis period.

Each year, one member economy takes on the coordinator role for the preparation of the Outlook. The first Outlook was prepared under the leadership of Japan in 1995, followed by the US (1996), Korea (1997), and China (1998). This year, Chile has taken on the challenging task. The APEC Economic Outlook is unique in that it is produced by collaborative efforts by all member economies. While the coordinator economy bears the heaviest responsibility, all member economies make significant contributions by providing their individual reports and updated data to the coordinator economy. Many economies also spend time and energy reviewing draft reports prepared by the coordinator economy and provide useful comments to improve the quality of the final product.

Particular thanks are due to the Chilean team led by Dr. Alvaro Garcia Hurtado (former Minister of Economy). The shorter-than-usual APEC cycle this year has made the preparation of this year's Outlook particularly difficult. I would like to express my appreciation for the great efforts of Messrs. Pablo Furche of Chile's Ministry of Economy and Hideyuki Ibaragi of Japan's Economic Planning Agency, who worked hard to finalize the report under the very tight schedule. Mr. Bradley Crofts, Director (Program) at the APEC Secretariat, skillfully saw the report through to publication.

Mitsuru Taniuchi

M. Taniuchi

Chair, APEC Economic Committee
Tokyo, September 1999

1999 APEC
ECONOMIC OUTLOOK

Introduction

The effects of the Asian crisis largely determined this last year economic outlook, although these effects varied depending on the economies. Analysing the APEC region development in 1998, as a whole, we can observe a deceleration in GDP growth, increases in unemployment levels and weakening in trade accounts.

Notwithstanding, these negative effects, signs of recovery are showing in several APEC economies. While some economies have started their recovery process before others or the speed of their recovery has been faster, it is important to state that the worst of the crisis has already passed.

The principal challenges which arise after the crisis, are the need to continue towards open trade and investment, putting aside protectionism "temptations", implement the necessary structural changes in order to count with sounder financial and economic systems, and develop and adequate social network which can help reduce the effects of this type of crisis on the population.

The analysis shows that:

♦ The traditional economic indicators were not able to predict the crisis, therefore more investigation is required to provide better economic indicators.

♦ The most affected economies were those which maintained excessive foreign debt and short term capital inflows, coupled with domestic imbalances.

♦ The future requires the correct combination of openness, good domestic regulations and an adequate international financial system

This report will attempt to provide new visions, and account for the need to continue research, especially on the social and productive sector impact. These will turn out to be key elements to ensure social sustainability and competitiveness for development.

APEC Region in the World Economy 1998

	Population			GDP			Per Capita
	(Million)	Ratio (%)		US$ (bn)	Ratio (%)		GDP US$
		APEC	World		APEC	World	
Western Hemisphere	435.7	17.4	6.95	9675.0	59.2	33.05	22,205
Canada	30.3	1.2	0.48	603.8	3.7	2.06	19,926
Chile	14.8	0.6	0.24	72.9	0.4	0.25	4,920
Mexico	95.8	3.8	1.53	424.5	2.6	1.45	4,431
Peru	24.8	1.0	0.40	62.8	0.4	0.21	2,532
United States	270.0	10.8	4.31	8511.0	52.1	29.08	31,522
Northeast Asia	1449.6	57.8	23.15	5505.1	33.7	18.81	3,798
China	1248.1	49.8	19.93	960.9	5.9	3.28	770
Hong Kong, China	6.7	0.3	0.11	166.0	1.0	0.57	24,828
Japan	126.5	5.1	2.02	3806.0	23.3	13.00	30,087
Korea	46.4	1.9	0.74	310.1	1.9	1.06	6,683
Chinese Taipei	21.9	0.9	0.35	261.6	1.6	0.89	11,945
Southeast Asia	445.2	17.8	7.11	472.3	2.9	1.61	1,061
Brunei Darussalam	0.3	0.0	0.01	4.9	0.0	0.02	15,313
Indonesia	204.0	8.3	3.26	103.1	0.6	0.35	505
Malaysia	22.2	0.9	0.35	73.3	0.4	0.25	3,304
Philippines	75.2	3.0	1.20	65.1	0.4	0.22	866
Singapore	3.8	0.2	0.06	84.4	0.5	0.29	22,205
Thailand	61.5	2.5	0.98	116.9	0.7	0.40	1,901
Viet Nam	78.1	3.1	1.25	24.6	0.2	0.08	315
Oceania	27.0	1.1	0.43	421.9	2.6	1.44	15,655
Australia	18.9	0.8	0.30	365.1	2.2	1.25	19,317
New Zealand	3.8	0.2	0.06	52.7	0.3	0.18	13,868
Papua New Guinea	4.3	0.2	0.07	0.0	0.0	0.01	962
Russia	147.1	5.9	2.35	276.5	1.7	0.94	1,880
APEC	2504.5		40.00	16350.8		55.86	6,529
World	6261.3			29271.1			4,675

Source: Data is submitted by member economies
Note: Global Nominal GDP was in the order of US$29 trillion in 1998 (FMI April 1999)

Chapter 1

ECONOMIC TRENDS AND PROSPECTS IN THE APEC REGION

1.1 Recent Economic Trends in the APEC Region

Overview of the recent developments and short-term prospects

Many of the APEC member economies have been making intense efforts to adjust themselves to the new economic environment opened up by the outbreak of the Asian Crisis in 1997.

For those economies in the Northeast and Southeast Asia, which were first to be severely hit by the Crisis, the efforts are finally bearing fruit. Indicators that have been revealed in 1999 show that there are signs of a gradual reversal of the steep downtrend; the recovery is in sight. The upward trend observed in APEC economies will continue in the second half of 1999 through 2000, though the crisis continues to impact on APEC economies. The developing economies in the Western Hemisphere and Russia, which had suffered from the impacts of the Asian Crisis relatively later, are expected to see favorable changes in 2000.

Table 1.1.- Real GDP Growth in the Apec Region (% per annum)

			IMF		Average	
	1997	1988	1999	2000	80-89	90-99
Western Hemisphere	4.1	3.8	3.2	2.3	2.8	2.6
Northeast Asia	3.1	-0.8	0.5	2.2	5.1	3.0
Southeast Asia	4.6	-5.5	0.6	3.2	5.4	5.3
Oceania	3.3	4.3	3.1	3.2	3.2	3.1
Russia	0.8	-4.6	-7.0	0.0	0.0	-5.9
APEC	3.7	1.9	2.1	2.3	3.6	2.7
World	4.2	2.5	2.3	3.4	3.4	3.1

Source: IMF and member economies

For the developed economies in the Western Hemisphere, which have shown robust growth even in the aftermath of the Asian Crisis, the challenge has been to sustain the low-inflationary growth in 1999 and beyond. The success so far has contributed in securing a favorable environment for the recovery of the crisis-affected economies. Difference in the impact of the Asian Crisis led to the difference in the performance of the economies in Oceania. These economies are, however, expected to make a transition to a more sustainable growth path during 2000.

The APEC member economies as a whole is expected to show a slight pick up in the real GDP growth rate: After recording 1.9% in 1998, forecast is for a 2.1% growth in 1999, and 2.3% growth in 2000.

Real GDP Growth

The overall trend in 1998 was rather somber. Almost all APEC member economies suffered a drop in their growth rates, and some even recorded negative figures. The only exceptions were the United States and Australia, whose strong and stable economies were able to withstand the successive crises that erupted in the Asian financial systems. In particular, the growth rate in the APEC region in 1998 was 1.9% i.e. 1.8 percentage points lower than in 1997, a figure that is undoubtedly one of the worst in the decade *(1997:* 3.7%; *1996:* 4.3%*)*.

Table 1.2.- Real GDP Growth in the APEC Region

	1997	1998	Average (92-98)
Western Hemisphere	**4.1**	**3.8**	**3.2**
Northeast Asia	**3.1**	**-0.8**	**2.7**
Southeast Asia	**4.6**	**-5.5**	**5.2**
Oceania	**3.3**	**4.3**	**3.9**
Russia	**0.8**	**-4.6**	**-6.7**
APEC	**3.7**	**1.9**	**3.0**
Source: Member economies			

Despite most of the **Western Hemisphere** economies saw sharp contractions in their real GDP growth rates, the overall Hemisphere growth rate only experienced a slight downfall from 4.1% in 1997 to 3.8% during 1998 *(1996: 3.4%; 1995: 2.1%)*. The main reason for this slight contraction was the controlled growth rate of the United States economy whose product amounts over the 52% of global GDP for the APEC region and a 88% of the hemisphere production.

Table 1.3.- Real GDP Growth in the Western Hemisphere

	1997	1998	Average (92-98)
Western Hemisphere	**4.1**	**3.8**	**3.2**
Canada	**4.0**	**3.1**	**2.8**
Chile	**7.1**	**3.4**	**7.6**
Mexico	**7.0**	**4.8**	**3.0**
Peru	**6.9**	**0.3**	**5.0**
United States	**3.9**	**3.9**	**3.1**
Source: Member economies			

In the United States, the largest economy in the region, real GDP grew by 3.9% in 1998. In addition to performing identically as in 1997, the United States economy managed to grow uninterruptedly for the seventh year running *(1996: 3.5%; 1995: 2.3%)*. This was followed by a 4.5% growth in the first quarter of 1999.

Canada, which had achieved a 4.0% growth rate in 1997 dropped to a 3.1% growth rate in 1998 *(1996: 1.7%; 1995: 2.8%)*. Among the key factors prompting this drop in real GDP growth were several problems related to a decrease in consumer demand growth and a reduction in the housing construction sector, among other reasons. The economy is thus expected to grow by 2.8% in 1999 and by 2.3% in 2000.

In this Hemisphere, Latin American economies (Mexico, Chile and Peru) suffered decreased growth rates in 1998. Chile was hit by the crisis in East Asia, and its growth rate fell from 7.1% in 1997 to 3.4% in 1998. This is the lowest growth rate recorded by Chile in the 1990s. In 1999, first half are expected to record very low or outright negative growth rates, and these are expected to recover later in the year to end 1999 with a growth rate ranging from 0.5%.

Mexico grew in real terms by 4.8% in 1998, 2.2 percentage points below 1997 (1996: 5.2%; 1995: -6.2%). Insofar as projections are concerned, in late 1998 and during Q1 of 1999, the Mexican economy began to decelerate as a result of the prevailing instability of the financial markets during 1998 and the drop in international oil prices. The real annual growth rate observed in Q1 of 1999 thus amounted to 1.9%.

Peru, in turn, saw its GDP grow by 0.3%, in stark contrast with the 6.9% growth rate registered in 1997 *(1996: 2.4%; 1995: 7.3%)* affected by the Niño climatic fluctuations and the East Asian Crisis. In Q4 of 1998 the Peruvian economy was seriously affected by the East Asian crisis, which reduced capital inflows to the domestic economy.

The economies of the **Northeast Asia** region experienced an overall contraction of -0.8% in its GDP growth rate. This figure contrasts with growth rates observed in the past *(1996: 5.8%; 1997: 3.1%).*

Table 1.4.- Real GDP Growth in the Northeast Asia

	1997	1998	Average (92-98)
Northeast Asia	3.1	-0.8	2.7
China	8.8	7.8	11.0
Hong Kong, China	5.3	-5.1	3.7
Japan	1.4	-2.8	1.0
Korea	5.0	-5.8	5.0
Chinese Taipei	6.8	4.8	6.1
Source: Member economies			

Economic growth in Japan decelerated during 1998 and it ended up in negative figures with a rate of -2.8% *(1997: 1.4%; 1996:5.1%)*; during fiscal year FY 1998 –1.9%. However, in fiscal year 1999, the GDP is expected to reach positive figures again, at 0.5%, a fact that is already beginning to show up in some Japanese economic indicators. This incipient recovery is seen as a reaction to the measures implemented by the government, particularly those to increase public works, stabilize the financial system and lower taxes, among others.

China whose economy represents 5.9% of the APEC region, saw its real GDP continued to grow at a relatively high speed in 1998. The growth rate reached 7.8%, one percentage point lower than that of 1997 *(1996: 9.6%, 1995: 10.5%)*. The facts are that after the growth rate slowed down in the middle of the year due to weaker internal demand and falling exports, a huge public infrastructure investment initiative took place in China reviving the economy in the fourth quarter of 1998. In order to maintain this trend, Chinese government announced that it would continue to implement active financial policy while exploring various ways to push forwards the structural adjustment of national economy. In the first half of 1999, GDP grew at the rate of 7.6%. For 1999 as a whole, China's real GDP is forecast to increase by about 7.0%.

Hong Kong, China and Korea also recorded negative growth figures. Hong Kong, China saw its GDP fell by -5.1% in 1998 *(1997: 5.3%; 1996: 4.5%)*. With the economy adjusting flexibly to the adversities from within the region and beyond, GDP is expected to rebound to a growth of 0.5% in 1999. Korea is the other NIE that showed negative GDP growth in 1998; it went from a 5.0% growth rate in 1997 to -5.8% in 1998 *(1996: 7.1%; 1995: 8.9%)*.

However, in the first quarter of 1999, the Korean economy has made a slow comeback, which raises hopes that it will end 1999 with over 4.0% growth rate as a result of the upsurge that is now being felt in almost all sectors of the Korean economy.

Included among the economies recording positive growth this year, Chinese Taipei saw its real GDP growth drop from 6.8% in 1997 to 4.8% in 1998 *(1996: 5.7%; 1995: 6.0%)*. Against this backdrop, growth projections for 1999 have been revised upwards to 5.1%.

Southeast Asian economies suffered strong decelerations in their GDP growth rates during 1998. In fact, and following the declining trend observed since 1995, the GDP growth rate for the whole Southeastern Asia region fell to -5.5% *(1995: 8.1%; 1996:7.0% and 1997:4.6%)*. This figure finds its explanation in that all economies in this region, with no exception, experienced a contraction in their growth rates.

Table 1.5 Real GDP Growth in the Southeast Asia

	1997	1998	Average (92-98)
Southeast Asia	4.6	-5.5	5.2
Brunei Darussalam	4.0	1.0	1.7
Indonesia	4.9	-13.7	4.2
Malaysia	7.7	-6.7	6.3
Philippines	5.2	-0.5	3.1
Singapore	7.8	1.3	7.4
Thailand	-0.4	-8.0	4.4
Viet Nam	8.2	5.8	8.3

Source: Member economies

According with this, the economy that fared the worst by far was Indonesia. It suffered strongly under the aftershocks of the financial turbulence created by the crisis, and its GDP receded by -13.7% as compared to a 4.9% growth in 1997 *(1996: 7.8%; 1995: 8.2%)*. This major drop in its GDP figures are due to decreased private investment and domestic consumption. In spite of this trend, progress achieved in the financial sector and in Indonesia’s economic performance in the second half of 1998 show that strides are already being made toward macroeconomic stabilization. In fact, the economy grew by 1.3% in Q1 of 1999 compared with Q4 of 1998.

During 1998 Malaysia underwent its first drop in GDP since 1995, ending the year with a real rate of -6.7% *(1997: 7.7%; 1996: 8.6%)*. The Malaysian economy is now entering a recovery phase with rising domestic demand and increased public and private spending, which could spur GDP to grow by 1.0% in 1999.

In 1998 the Philippines suffered not only the effects of the Asian financial crisis, but also the havoc wreaked by the *El Niño* climatic fluctuations, which dragged real GDP growth down to -0.5%, a full 5.7 percentage points below 1997 figures *(1996: 5.8%; 1995: 4.7%)*. Hard pressed, the fiscal and monetary authorities have announced several measures to reverse this trend and mitigate its effects on the population. Thus, the GDP is expected to grow between 2.6% and 3.2% in 1999, and between 4.8% and 5.4% in 2000.

Singapore also suffered a reduction in its real growth, albeit still on the positive side, plummeting from 7.8% in 1997 to 1.3% in 1998 its lowest growth figure during this decade (the lowest pre-crisis rate had been 6.2% in 1992).

During 1998, Thailand economy experienced an 8% contraction in its GDP as a result of the restructuring and adjustment of its economic and financial system. This real GDP growth rate of -8.0% confirms the tendency towards recession this economy has experienced in recent years, with rates of 8.8% for 1994, 8.6% for 1995, 5.5% in 1996 and -0.4% in 1997. During the first months of 1999 some signs of recovery have been observed that lead to expect a slight growth at the end of the period.

Viet Nam grew by 5.8% in 1998, whereas between 1991 and 1997 growth averaged approximately 8.0% *(1997: 8.2%; 1996: 9.3%)*. This confirms the downward trend in GDP growth, which reached an annual level of 4.0% during the first quarter of 1999.

Brunei Darussalam, in 1998 registered a slow growth of real GDP of 1.0% compared to 3.5% in 1996 and 4.0% in 1997. The decline is the result of the fiscal consolidation measures adopted by the government earlier in the year and the depressed world oil prices which adversely affected petroleum sector.

The only region within the APEC which showed an increase in its GDP growth rate was **Oceania**, reaching growth of 4.3% during 1998 against a 3.3% in 1997 *(1996: 3.5%; 1995: 4.2%)*. This increase was pushed-up by the Australian expansion that took place in 1998.

Table 1.6.- Real GDP Growth in the Oceania

	1997	1998	Average (92-98)
Oceania	3.3	4.3	3.9
Australia	3.6	5.0	4.0
New Zealand	2.0	-0.3	3.0
Papua New Guinea	-4.6	2.5	4.5
Source: Member economies			

In New Zealand, 1998 ended with a negative GDP growth rate of -0.3%, i.e. 2.3 percentage points below its 1997 figures *(1997: 2.0%; 1996: 3.2%)*. In contrast, Australia's real GDP growth rate rose from 3.6% in 1997 to 5.0% in 1998.

Papua New Guinea, real GDP growth rate increased by 2.5% after the severe recession in1997 *(1997: -4.6%; 1996: 3.9%)*.

On the contrary, in Russia, during 1998, the GDP fell in real terms by 5.4 percentage points, reaching a rate of -4.6% *(1997: 0.8%; 1996: -3.5%)*. This drop in output in any case was not larger than the average growth rate for the past seven years which is a -6.7%.

Inflation

Over the past year, inflation did not present an identical picture for the different APEC member economies. In 1997 most of the APEC economies recorded lower increases in CPI rates than in 1996. In 1998, however, although a large number of economies had low and relatively stable inflation rates, many others suffered from inflation rates higher than in 1997. The Asian economic crisis had impacts on the inflation rates in some economies as devaluation of their currencies caused the increase in import prices.

Table 1.7.- Increases in CPI in the APEC Region			
	1997	1998	Average (92-98)
Western Hemisphere	**2.9**	**2.3**	**3.4**
Northeast Asia	**2.2**	**0.9**	**2.4**
Southeast Asia	**6.3**	**21.5**	**8.2**
Oceania	**0.4**	**0.9**	**1.9**
Russia	**111.0**	**184.4**	**644.6**
APEC	**5.5**	**5.4**	**10.0**
Source: Member economies			

In general terms for the APEC economies, although price increase rates remained relatively low and stable, inflation on a regional scale was not as low as in 1997. The main reason is that inflation rates increased in many economies, especially in Indonesia and Russia, which reached inflation rates of 77.6% and 127.8% respectively.

General price level trends in the region can be partly explained by the fact that APEC member economies share some common elements that help keep inflation under control, while other factors create an upward pressure on the price levels. The first group includes narrow changes in the price of commodities, low prices for raw materials, the stability of most currency exchange rates *vis-à-vis* the dollar and the contraction of local demand, among others. On the other hand, the common factors affecting economies suffering inflationary pressures include poor climate conditions caused by *El Niño* and *La Niña*, which laid crops to waste, shrunk supply and raised prices –coupled with the price increases for other foodstuffs; these developments fueled inflationary processes that became very difficult to control.

The sharp currency devaluation in some economies in Southeast Asia at the height of financial crisis in 1998 was an added factor behind the acceleration in inflation in those economies.

Inflation in **Western Hemisphere** economies during 1998 was lower than the observed in 1997. CPI increase for this area reached an 2.3% against the 2.9% experienced the year before. This reduction in inflation is explained, as it has been in recent years, by the reductions in increase in CPI in the United States.

In this line, the United States once again managed to bring inflation down, yielding an overall deceleration of price increases that has remained stable throughout the 1990s with the sole exception of 1995 and 1996. In 1998 inflation reached 1.6%, i.e. 0.7 percentage points less than in 1997 *(1997: 2.3%; 1996: 2.9%)*.

Table 1.8.- Increases in CPI in Western Hemisphere			
	1997	1998	Average (92-98)
Western Hemisphere	**2.9**	**2.3**	**3.4**
Canada	**1.6**	**0.9**	**4.9**
Chile	**6.0**	**4.7**	**14.7**
Mexico	**15.7**	**18.6**	**20.9**
Peru	**6.5**	**6.0**	**11.7**
United States	**2.3**	**1.6**	**2.5**
Source: Member economies			

Canada, in turn, saw its CPI rise by 0.9% in 1998, the lowest rate recorded since the mid-1950s (except for 1994, when the CPI rose by 0.2% due to the cutback in tobacco taxes).

Despite its low exchange rate, Canada has managed to keep inflation under control thanks to the worldwide collapse of commodity prices. In fact, the authorities decided to expand the target range for inflation by 1%-3% up to 2001, with inflation rates expected to grow by 1.1% in 1999 and 1.6% in 2000.

As was the case last year, the developing economies of Latin America kept charting different inflationary courses. Chile attained a 38-year low of 4.7% in 1998, accomplishing the target established by the Central Bank for last year. It continued on a downward inflationary slope that has been its trend since the beginning of the decade. This inflation rate, down 1.3 percentage points since 1997 (6.0%), was the result of a very tight monetary policy, among other things. Consequently, inflation is expected to total 4.3% in 1999.

In Mexico, however, inflation climbed from 15.7% in 1997 to 18.6% in 1998. Inflation is nonetheless expected to abate somewhat in 1999; in fact, inflation during the first half of the year was 4.87%, the lowest figure for this period since 1994.

Peru brought its inflation rate down from 6.5% in 1997 to 6.0% in 1998. The seasonal effects of *El Niño* on the price of foodstuffs during the first quarter of 1998 were neutralized towards the end of the year. For 1999, inflation should settle somewhere between 5.0% and 6.0%.

In 1998, **Northeast Asia** economy also showed a lower inflation rate than in 1997 (1998: 0.9%, 1997: 2.2%). Low inflation was observed both in Japan and China.

Japan has recorded low, controlled inflation throughout the 1990s. Although prices rose in 1997 compared to 1996 due to an excise tax increase, inflation rate returned to a stable trend by posting 0.2% for fiscal year 1998. Low trend of the inflation in Japan is due to the sluggish economic activities in general and the effects of deregulation. In fact, inflation for 1999 is barely expected to reach 0.1%.

In 1998, the CPI of China was down by 0.8% from 1997, with the prices of services rising by 10.1% over 1997. It is estimated that the CPI will be around zero in 1999.

Table 1.9.- Increases in CPI in Northeast Asia

	1997	1998	Average (92-98)
Northeast Asia	2.2	0.9	2.4
China	2.8	-0.8	10.4
Hong Kong, China	5.8	2.8	7.3
Japan	1.8	0.6	0.9
Korea	4.5	7.5	5.5
Chinese Taipei	0.9	1.7	3.0

Source: Member economies

Hong Kong, China also saw its CPI descend during 1998, falling to 2.8% from 5.8% in 1997 *(1996: 6.3%; 1995: 9.1%)*. Low inflation here is basically a reflection of the swift adjustment process of the local economy, helped by generally soft world commodity prices and low inflation in the major supplier economies. In fact, inflation has been negative so far in 1999: -1.8% in the first quarter and -4.0% in the second quarter.

Korean economy underwent a climbing price level during 1998 after a decade in the opposite direction. Inflation, which shot up to 7.5% *(1997: 4.4% and 1996: 4.9%)*, was caused by a strong increase in prices during the first half of the year due to a devaluation. However, the massive contraction in domestic demand, declining international prices for raw materials and a stable exchange rate between the Korean won and the U.S. Dollar should once again result in consumer price stability in 1999, with inflation expected to reach 1.7%.

After posting its lowest inflation figure of recent years, Chinese Taipei saw its CPI jump from 0.9% in 1997 to 1.7% in 1998. The CPI is expected to remain subdued throughout 1999.

A major contribution to the inflation rate of the overall APEC region was made by the **Southeast Asian** economies, which recorded a CPI increase of 21.5% in 1998 against 5.5% in 1996 and 6.3% in 1997. This sharp increase in prices is mainly explained by high inflation observed in Indonesia, that reached 77.6 percent during 1998.

In 1998, Indonesia suffered heavily under the burden of inflation, with an annual average of 77.6%. This is in stark contrast with the picture observed throughout the 1990s, when the Indonesian economy enjoyed one-digit inflation rates with the exception of the 10.3% inflation posted in 1997. In terms of projections, inflation became negative in March and April 1999 (-0.2% and -0.7%, respectively) and therefore the final inflation figures for fiscal year 1998/99 are expected to reach 45.4%.

Table 1.10 – Increases in CPI in the Southeast Asia

	1997	1998	Average (92-98)
Southeast Asia	6.3	21.5	8.2
Brunei Darussalam	1.7	-0.4	2.5
Indonesia	10.3	77.6	18.1
Malaysia	2.7	5.3	3.8
Philippines	5.9	9.7	8.1
Singapore	2.0	-0.3	1.8
Thailand	5.6	8.1	5.4
Viet Nam	3.6	9.2	9.6

Source: Member economies

After experiencing a downward trend during the last eight years, in 1998 Malaysia registered the highest inflation rate in recent years at 5.3% (compared to 3.5% in 1996 and 2.7% in 1997). Inflationary strains nevertheless eased off in late 1998 due to falling domestic demand and lower pressures on wages following higher unemployment.

The Philippines also suffered from rising inflation in 1998, up to 9.7% from 5.9% in 1997. In the 1990s, the Philippines posted two-digit inflation (18.7%) only in 1991. All things considered, the Philippines managed to achieve its goal of containing inflation at one-digit levels for the entire period (9.7%) which, although higher than the average inflation rate for 1997, was still within the target range of 9.25% to 9.75% set by the authorities. From double-digit levels in January 1999 (11.5%), inflation rate has reverted back to single digit posting the lowest rate at 6.7% in May.

Singapore (along with China) was the only APEC economy with actual deflation during 1998. Prices there fell by 0.3% after rising from 1.4% in 1996 to 2.0% in 1997. Consumer prices have continued to decrease in 1999, with inflation at -0.6% in the first half of the year, basically as a result of lower costs in transportation, communications and housing.

In Thailand, the inflation during 1998 increased from 5.6% in 1997 to 8.1%. However, by the end of 1998 the level of prices experienced a drop, mainly due to the strengthening of the baht, a weak demand and the fall, in terms of US dollars, of import prices. This way, inflation is expected to reach a figure between the 2% and 4% for 1999.

Viet Nam, in turn, ended 1998 with inflation at 9.2%, that is, 5.6 percentage points above 1997 levels (3.6%). This economy was in the process of clamping down on inflation ever since it reached 14.4% in 1994. It succeeded in doing so in 1995, 1996 and 1997.

In Brunei Darussalam, inflation rate has been kept stable. It experienced negative inflation in 1998 with the CPI decreasing slightly by 0.4%, following the 1.7% increase in 1997.

During 1998 the **Oceania** economy suffered a slight rise in its price level. It reached 0.8% from 0.4% observed in 1997, driven by Australia's experience. Looking at the facts, Australian inflation was the cause of that figure.

In the past few years, despite its strong economic growth, Australia has experienced subdued inflationary pressures, with inflation rate falling from 2.6% in 1996 to 0.3% in 1997, before edging up slightly to 0.9% in 1998. Inflation in New Zealand dropped from 0.8% in 1997 to 0.4% in 1998, thus maintaining the trend of low, controlled inflation that has been observed over the past few years. This price trend is expected to keep up during 1999–through March 1999 prices have already fallen by 0.1%. In Papua New Guinea, the weakening of the kina, together with the large increase in the money supply, led to the acceleration in inflation rate to 10% in 1998.

Table 1.11.- Increases in CPI in Oceania

	1997	1998	Average (92-98)
Oceania	0.4	0.8	1.9
Australia	0.3	0.9	1.9
New Zealand	0.8	0.4	1.7
Papua New Guinea	3.9	10.0	7.8
Source: Member economies			

In the case of Russia, the financial crisis fueled inflation to the extent that it hit three-digit figures in 1998, rising to 127.8% (1997: 114.9%; 1996: 147.9%). The jump into hyperinflation began in the second half of 1998 (August-September), with prices rising by 40% as a result of a sharp depreciation of the *ruble* that led to a steady rise in the prices for imported consumer items.

Unemployment

Despite some economies that showed sharp increases of their unemployment levels while others succeeded at controlling it, the overall unemployment for the APEC economy in 1998 was 4.6%, almost the same as in 1997.

Table 1.12.- Unemployment Rates in APEC Region			
	1997	1998	Average (92-98)
Western Hemisphere	**5.1**	**4.6**	**5.9**
Northeast Asia	**3.1**	**3.3**	**2.8**
Southeast Asia	**5.6**	**6.2**	**4.8**
Oceania	**6.9**	**6.7**	**7.6**
Russia	**11.2**	**12.3**	**7.2**
APEC	**4.4**	**4.6**	**4.0**
Source: Member economies			

Following the trend to lower unemployment rates observed since 1992 in the **Western Hemisphere** region, 1998 saw a rate of 4.6% *(1997: 5.1% and 1996: 5.8%)*, which once again was strongly influenced by the effect of the United States economic performance.

Although generally speaking the APEC member economies had to cope with a difficult year in terms of unemployment, some were able to reduce their joblessness ratio. In the United States, unemployment has continued to shrink as has been the case since 1992. In fact, the 4.5% figure attained in 1998 was the lowest since 1969 *(1997: 4.9%; 1996: 5.4%)*. Together with stable inflation, and despite a slight increase in unit labor costs, the unemployment rate is expected to end 1999 at an even lower level than in 1998.

During 1998, Canada experienced a lower unemployment rate than in 1997. In fact, the 8.3% unemployment rate in 1998 follows the decreasing trend initiated in 1992, when the rate, that then was 11.3%, began to fall to 9.7% in 1996 and 9.2% in 1997. Nevertheless, the outlook for this year is not expected to be very cheerful as it has been so far.

Table 1.13.- Unemployment Rates in Western Hemisphere			
	1997	1998	Average (92-98)
Western Hemisphere	**5.1**	**4.6**	**5.9**
Canada	**9.2**	**8.3**	**9.9**
Chile	**6.1**	**6.2**	**6.8**
Mexico	**3.2**	**2.8**	**3.9**
Peru	**7.7**	**7.7**	**8.4**
United States	**4.9**	**4.5**	**5.8**
Source: Member economies			

The situation in Latin America is rather disparate. In Chile, unemployment has risen due to the financial crisis and the adjustment package set in motion to counteract its effects. Unemployment in 1998 was 6.3% *(6.1% in 1997 and 6.5% in 1996)*, climbing to 8.2% in March 1999. Mexico, in turn, was able to lower its unemployment levels to an average 2.8% in 1998, thanks to a steady increase in the active work force (particularly in commerce, agriculture and industry). In Peru, meanwhile, the unemployment rate in the Lima metropolitan area receded from 7.7% in 1997 (third quarter) to 7.7% in 1998.

Rise in unemployment rates observed in Japan and Korea during 1998. In **Northeast Asia,** unemployment level to increase from 3.1% in 1997 to 3.3% in 1998.

Table 1.14.- Unemployment Rates in Northeast Asia			
	1997	1998	Average (92-98)
Northeast Asia	3.1	3.3	2.8
China	3.1	3.1	2.8
Hong Kong, China	2.2	4.7	2.7
Japan	3.4	4.1	3.1
Korea	2.6	6.8	3.0
Chinese Taipei	2.7	2.7	2.1
Source: Member economies			

Furthermore, and continuing with the trend observed in recent years and enhanced by the contraction in the demand for labor caused by the economic downswing, unemployment in Japan reached 4.3% in FY 1998. Unemployment reached an all-time high of 4.9% in June 1999. However, a modest comeback of the economy will serve to stabilize unemployment at 4.3% in 1999.

In China, with the deepening reform of the state-owned enterprises, structural unemployment remains the problem facing the government. However, in 1998, great headway was made in the reemployment program, which enable 6.09 million laid-off staff and workers of the state-owned enterprises to find new jobs. By the end of 1998, the registered unemployment rate in the urban areas was 3.1%, which was on a par with the rate of the previous year. For 1999, the registered unemployment rate in the urban areas is estimated to be 3.5%.

Hong Kong, China saw its unemployment rate climbing steadily from 2.2% in 1997 to 5.7% in the fourth quarter of 1998, and further to 6.2% in the first quarter of 1999. But the unemployment rate fell back slightly to 6.1% in the second quarter of 1999.

In Korea unemployment reached 6.8% in 1998 (2.6% in 1997). Despite the economy having started to pick up, unemployment is expected to stay around the 6.5% mark in 1999.

In turn, and due to changes in the job structure and the financial crisis of 1997, Chinese Taipei recorded unemployment rates of 2.7% in 1998, anyway, is higher than the average rate for the period 1992-1998 that was 2.05%.

Employment prospects for the developing economies are not very encouraging. Almost all these economies have suffered adverse unemployment effects as a result of the crisis (either outright recessions or deceleration of growth). According with this, unemployment rate for the **Southeast Asian** economy was 6.0%, 0.4 percentage points higher than in 1997 and 0.8 percentage points higher than the rate observed in 1996 *(1997: 5.6%; 1996: 5.2%).*

Table 1.15 Unemployment Rates in the Southeast Asia

	1997	1998	Average (1992-1998)
Southeast Asia	5.6	6.0	4.7
Brunei Darussalam	5.0	5.1	4.6
Indonesia	4.3	5.1	4.5
Malaysia	2.7	3.9	3.1
Philippines	8.7	10.1	9.4
Singapore	1.8	3.2	2.1
Thailand	3.5	4.0	2.9
Viet Nam	8.5	6.6	3.0

Source: Member economies

In Malaysia, a contraction in the real economy brought a rise in unemployment to about 3.9% in 1998 *(2.7% in 1997 and 2.5% in 1996)*, which is still below the full employment mark of 4%. In the Philippines unemployment rose to 10.1% in 1998, prompted by a severe recession in agriculture and industry. Employment has picked up somewhat in the first quarter of 1999, with the joblessness rate at 9.0%.

The labor market in Singapore was strongly affected since its 3.2% unemployment rate for 1998 was clearly higher than its 2.1% average in the past 7 years. This is mostly due to the steep fall in business demand and the consolidation of local business operations.

Thailand unemployment reached a rate of 4.0% during 1998, 0.5 percentage points higher than the previous year *(1997: 3.5%; 1996: 2.0%)*. The situation is not expected to change in 1999, with a projected rate of unemployment similar to that of 1998. In Viet Nam, urban unemployment rates 6.6%.

Brunei Darussalam unemployment reached a rate of 5,1% in 1998 *(1997: 5,0%; 1996: 5,0%)*.

During 1998, **Oceania** saw its unemployment level to reduce from its 6.9% level in 1997 to 6.7%. The reduction was mainly explained by the good Australian economic performance, which led its economy to reduce unemployment from 8.5% in 1997 to 8.0% in 1998.

Table 1.16.- Unemployment Rates in Oceania

	1997	1998	Average (92-98)
Oceania	6.9	6.7	7.6
Australia	8.5	8.0	9.3
New Zealand	6.7	7.7	7.6
Papua New Guinea	n.a.	n.a.	n.a.
Source: Member economies			

In Australia, unemployment dropped to 8.0% in 1998, the lowest since 1990 *(1997: 8.5%; 1996: 8.5%)*. In contrast with this, New Zealand experienced a softening in the labor market due to slow growth in recent times and the economic contraction of 1998. The unemployment rate for 1998 was 7.7% *(1997: 6.7%; 1996: 6.0%)*.

In Russia, a contraction in the real economy brought about a rise in unemployment to 12.3% in 1998 *(11.2% in 1997 and 9.9% 1996)*.

Current Account Balances and Capital Flows

Running the largest current account deficit in the region in absolute terms, the United States is one of the economies whose deficit rose in 1998 –although it is small compared with its GDP. The U.S. current account deficit reached US$233 billion in 1998. This accounts for 2.6% of the GDP and represents an increase of 0.8 percentage points compared with the previous year (-1.8% in 1997).

This rate has climbed steadily since the first quarter of 1998, when the deficit stood at 0.6%. During the 1990s, the United States has managed to keep the deficit relatively under control in GDP terms, fluctuating between 0.9% and 1.8%, which is precisely why the 1998 figure has attracted some attention. This increase in the deficit is partly due to enhanced domestic demand resulting from a greater accumulation of capital gains. In 1998, the capital account amounted to US$237 billion of net foreign investment in the U.S. compared to the US$225 billion posted in 1997. In this regard, both U.S.-bound and U.S.-originated FDI figures are quite significant. In 1998, U.S. investments abroad totaled US$ 132 billion, whereas foreign investments in the U.S. amounted to US$196 billion (US$93 billion in 1997). Of the latter, portfolio investments were the biggest source for investments in the U.S., followed by direct investments.

In Canada, residents keep spending more than what they earn abroad, with the deficit reaching US$16.4 billion (-2.0% of GDP) in 1998 due to the shrinking trade surpluses. However, everyone agrees that the deficit should decrease in 1999 (US$15.1 billion) and then again in 2000 (US$11.9 billion).

In Latin America, the current account deficit in Chile deepened to 6.3% of the GDP. This was mostly the result of falling revenues due to the slump in the price of copper and other raw materials. The belated effect of a deceleration in the growth of exports, as well as the price drop suffered by leading export items, caused Chile to record a negative trade balance of US$ 2.5 billion. Both the current account and the trade deficits are expected to decrease in 1999. The current account deficit should be in the neighborhood of 5% of the GDP by the end of the year, whereas the trade balance deficit should shrink drastically since the drop in imports has been accompanied by rising export values. By the end of 1998, the capital account showed a surplus amounting to 4.3% of the GDP thanks to lower net flows from portfolio investments (less issues of ADRs and bonds). Finally, it should be underscored that FDI grew by 6.4% in 1998.

In 1998, the current account deficit in Mexico more than doubled the one recorded in 1997, reaching 3.8% of the GDP (US$15.9 billion). The sharp upsurge in the deficit is largely explained by the trade balance, which in 1998 recorded a US$7.7 billion deficit as against a US$623.6 billion surplus in 1997. This turn of events is largely accounted for by the falling international oil prices (hence lower oil revenues), an expansion of the domestic economy that led to increased imports of consumer and capital goods, and a steady growth in manufacturing exports that required increasing quantities of imported intermediate goods. All these factors led to a rise in the current account deficit. Fortunately, the trade balance deficit in the first quarter of 1999 seems to be going back to normal, that is, 34% lower than the one registered in the same period last year. The capital account posted a US$16.23 billion surplus in 1998, amounting to 4.0% of the GDP, whereas FDI amounted to 2.0% of the GDP.

The current account deficit in Peru rose from 5.0% in 1997 to 6.0% in 1998, principally as a result of the growing trade balance deficit. This heavier deficit is accounted for by a slack in exports intimately related to worsening terms of trade and the *El Niño* occurrence. Peruvian authorities estimate that the current account deficit will amount to 5.0% of the GDP in 1999. In 1998, foreign direct investments net of privatization revenues accounted for 3.0% of the GDP–the highest inflow of capital in recent years, surpassing even pre-crisis figures. Mining, telecommunications and banking have been attractive targets for foreign direct investments and are expected to remain appealing over time.

During 1998, Japan posted a current account surplus as it has throughout the decade. Its current account surplus for fiscal year 1998 amounts to ¥15.2 trillion or 3.1% of the GDP (3.2% for the calendar year), increased from ¥12.9 trillion in FY 1997. The increased surplus is due chiefly to a drastic drop in imports as a result of the sharp decline in imports price and the economic depression. Since exports are expected to fall due to slower global growth, the current account surplus is expected to decrease slightly. In turn, the capital account deficit dropped slightly in nominal term but kept almost flat as a percentage of the GDP, thereby reaffirming Japan's role as a supplier of capital. These deficits have in fact declined slightly from ¥15.3 trillion (3.0%) in FY1997 to ¥14.7 trillion (3.0%) in FY1998.

In 1998, the current account surplus of China reached US$ 29.3 billion, accounting for approximately 3.0% of the GDP, and down slightly comparing with the US$29.7 billion (3.3% GDP) in 1997. The continuous merchandise trade surplus was the main reason for sustainable current account. However, current account surplus is forecast to decrease slightly in 1999 basically as a consequence of the slower growth of global economy and weakening export competition in global market due to appreciated Chinese currency in real term.

Departing from its strong deficit trend throughout the 1990s, Korea went from a US$6.2 billion deficit in 1997 to a US$40.05 billion surplus in 1998. This is explained by Korea's huge international trade surplus. In 1998, exports dropped slightly by 2.8%, whereas imports plummeted 35.5%, hence the record-breaking current account surplus. Korea saw FDI rising by 21.25% for 1998, whereas in the first quarter of 1999 it has already committed 389 FDI ventures for a total US$2.0 billion.

Chinese Taipei, in turn, also has a current account surplus, although in this case figures have been steadily decreasing since 1996. The current account surplus for 1998 was 1.4% of the GDP as against 2.7% in 1997. The financial account, however, shifted course from a net capital outflow of US$8.38 billion in 1997 to a net inflow of US$1.789 billions in 1998. In FDI terms, Chinese Taipei is going to great lengths to enhance its insertion in the international investment scene; it has set out to promulgate and review its laws and regulations along international guidelines in order to draw more foreign investment to its shores. In 1998, US$0.2 billion flowed into Chinese Taipei as FDI (mostly from the British Virgin Islands, the United States and Japan), whereas another US$3.8 billion left Chinese Taipei for the same purpose. The financial account shifted from a net capital outflow position to one of net capital inflows in 1998

The developing economies in Southeast Asia have made their way from deficits to surpluses in 1998.

Indonesia also followed suit and in 1998 it obtained its first current account surplus since 1980, amounting to US$4.4 billion. In any event, this surplus is only expected to be temporary since it originated from a sharp drop in imports rather than from an increase in exports. In 1998, the capital account ended up with a US$3.7 billion deficit due to the massive flight of private capital, which largely exceeded capital inflows.

Malaysia recorded a strong current account surplus for the first time since 1989, which amounted to 13.7% of the GDP for 1998 (-5.4% in 1997). This unprecedented surplus is accounted for by the favorable impact of rapidly falling imports. In turn, the short-term capital account evidenced a net capital outflow for the second year in a row, totaling RM 21.7 million.

Although its surplus was more modest than elsewhere in the region, in 1998 the Philippines also recorded its first current account surplus of the decade, US$1.3 billion accounting for 2.0% of the GDP, as against -5.3% in 1997.

Singapore continues to register very high current account surpluses, with a credit balance of US$29.5 billion in 1998 as against US$22.3 billion in 1997, amounting to 20.07% and 15.4% of GDP respectively. The rising surplus is basically the result of an improving trade balance thanks to the drop in imports. A point worth mentioning is that the current account has already posted a S$6.9 billion surplus in the first quarter of 1999 alone. Singapore secured direct investment commitments in manufacturing amounting to S$7.8 billion in 1998 (principally from the U.S., Japan and Europe) and it has already secured S$1.7 billion in investment commitments during the first quarter of 1999.

As in the case of Malaysia, in 1998 Thailand posted its first current account surplus of the decade that reached US$14.3 billion that represent 12.3% of the GDP, against a deficit of 2.0% observed in 1997. The factors that led to this surplus were the imports, that fell much more than the exports during the year, and the net surplus in the service account and transfers owed to higher revenues for concept of tourism. Undoubtedly, this result highlights after years with fiscal deficit. Although this year it is expected to be lower, surplus will once again be attained and will be between 6% and 9% of GDP.

The current account deficit in Australia reached 4.8% of GDP in 1998, compared with 3.2% in 1997. This largely reflected a deterioration in the balance of trade, coming from continued weak net exports and weaker terms of trade. Strength in domestic demand underpinned strong growth in imports while exports growth slowed as a result of the East Asian crisis. In New Zealand, the current account deficit shrunk slightly from -7.1% in 1997 to -6.0% in 1998. This small improvement is accounted for by the decrease in the investment income deficit and a concurrent increase in the merchandise trade surplus.

In Russia current account registered a surplus of 0.9% in 1998, which is the same as 1997 and represents a decrease with respect to previous years' surpluses *(1995: 2.3%; 1996: 2.9%)*.

1.2 Economic Prospects for 1999

In 1999 the whole world, and particularly the APEC economies, will continue to experience the impact of the economic and financial crisis, which mainly expressed itself through a contraction or reduction of GDP growth rates in most of the member economies in 1998. Even so, a reversal in the downtrend exhibited by economic activity is anticipated for the second half of 1999, both at global and regional levels.

Table 1.17.- Forecasting GDP Growth in APEC Region

	IMF		Average	
	1999	2000	80-89	90-99
Western Hemisphere	3.2	2.3	2.8	2.6
Northeast Asia	0.5	2.2	5.1	3.0
Southeast Asia	0.6	3.2	5.4	5.3
Oceania	3.1	3.2	3.2	3.1
Russia	-7.0	0.0	n.a.	-5.9
Apec	2.1	2.3	3.6	2.7
World	2.3	3.4	3.4	3.1

Source: IMF and Member economies

In this case, the IMF estimates that world economic growth will reach around 2.3% in 1999, and 3.4% in the year 2000. Acknowledging the impact of the crisis, most of the APEC economies have started to implement measures to boost their economic activities; such measures began to yield results in some economies during the first half of 1999 while, among the remainder of the members, a slight improvement in economic indicators is expected as of the second half of the year. All these data have been taken into account in the 1999 and 2000 projections. The upward trend observed in APEC economies will continue in the second half of 1999 and through 2000, though the crisis continues to impact on APEC economies. In fact, IMF estimates for the APEC economic growth as a whole reach around 2.1% in 1999 and 2.3% in the year 2000. Estimates for the year 2000 could have been higher, but they didn't because of the contraction experts expect in the United States economy *(1999: 3.3%; 2000: 2.2%).*

This outlook is specifically reflected in the economic situation of each APEC member economy.

For the **Western Hemisphere** economy the IMF projects a growth rate of 3.2% for 1999 and 2.3% for the year 2000, while in 1998 it reached a 3.8% growth rate. This expected downfall in the region growth rate is due, as mentioned above, to the contraction projected for the United States economy during year 2000.

Table 1.18.- Forecasting GDP Growth in Western Hemisphere

	IMF		Average	
	1999	2000	80-89	90-99
Western Hemisphere	3.2	2.3	2.8	2.6
Canada	2.6	2.5	2.9	2.0
Chile	2.0	4.6	3.7	6.7
Mexico	2.0	3.0	2.3	3.2
Peru	4.5	6.5	0.3	3.9
United States	3.3	2.2	2.8	2.6
Source: IMF and Member economies				

Undoubtedly, the United States and its economic performance, that accounts for the 52% of economic activity in the region, has a large influences on the overall economic trend in the APEC region. The United States is expected to maintain its good performance in terms of growth over the next years. Indeed, private agents predict a 3.8% growth for 1999, and a 2.5% growth for the year 2000, while official government predictions indicate a growth rate of around 3.9% for 1999 and 2.4% for 2000. The IMF is estimating a 3.3% growth rate for 1999 and 2.2% for 2000.

Canada, thanks to the incipient recovery of the Asian economies, to economic growth in the United States, and to a slight increase in commodity prices, will exhibit a strong and sustained growth rate, although somewhat below the 3.1% it registered in 1998. Thus, a real growth rate of 3.2% in the GDP is anticipated for 1999, and 2.6% for the year 2000. IMF projections are 2.6% for 1999 and 2.5% for the year 2000.

1999 will be a difficult year for Latin America, but with hopes of recovery for the beginning of the new millennium. Chile is currently experiencing an economic downturn going from the 10.6% growth rate recorded in 1995 to 3.4% in 1998. Chile has made efforts to correct its current account situation for the coming period, and it has continued to reduce its inflation rates; in spite of the low price of its exports, the recovery in Asia should help to increase its export volumes. Nevertheless, the Chilean economy is expected to grow between 2.0% and 3.0% in 1999, to resume its sustained growth path in the year 2000 with rates that will vary between 5.0% and 6.0%. The IMF estimates that the Chilean economy will grow at a rate of 2.0% in 1999, and 4.6% in the year 2000.

Mexico, having experienced an expansion process as of 1996 (5.2% growth rate compared to -6.2% in 1995) and which, as a result of the crisis, fell in 1998 to 4.8% (7.0% in 1997), has openly expressed its intention of reaching an average GDP annual growth rate of 5.0%, and a single-digit inflation rate. In this sense, the Mexican authorities are making significant efforts to maintain fiscal discipline and control inflation rates, expecting a downturn in the economy, with 3.0% growth in real terms in 1999, to then reach 5.0% rate in the year 2000. The IMF, on the other hand, estimates 2.0% growth for 1999, and 3.0% for 2000.

In Peru, based on export and investment performances, the authorities estimate 3.0% growth rate for 1999, and 5.5% and 6.0% for 2000 and 2001, respectively. The IMF estimates growth rates of 4.5% for 1999 and 6.5% for the year 2000.

Since 1998, **Northeast Asian** economies have been experiencing an important recuperation of their GDP growth rates. In fact, during 1998 the GDP growth rate for the whole area was -0.8% and the IMF projects a rate of 0.5% for 1999 and 2.2% for the year 2000.

Japan, accounting for roughly one quarter of regional economic activity, is making efforts to overcome the contraction in its GDP, which during dropped by 2.8% in 1998. These efforts translate into government-implemented measures to reactivate economic activities. An example is the thrust given to public works through supplementary budgets approved for 1998 and initial budgets approved for 1999 in an attempt to reactivate the economy. Furthermore, Japanese authorities have also implemented measures such as tax reductions and major reforms of the financial system. In this sense, changes have been made to legislation which establishes the recapitalization scheme and the general framework used to address the problems of the banking system. This has led to a rapid restructuring of this sector, contributing to the stabilization of the banking system. Legislative measures include those to recapitalize the banking system and to deal with some of the weaknesses that affect the sector through options such as temporary nationalization, bridge banks, and disposal or liquidation of banks that went bankrupt. In fact, under this scheme some banking institutions have already been nationalized and fifteen of the largest banks in the system have received injections of public funds for their recapitalization, which already amount to 7.4 trillion *yen*. Due to the series of efforts implemented by the authorities a real GDP growth is expected to be 0.5% for fiscal year 1999. The IMF, on the other hand, estimates a -1.4% contraction for 1999, followed by a 0.3% growth in the year 2000.

Table 1.19.- Forecasting GDP Growth in Northeast Asia

	IMF		Average	
	1999	**2000**	**80-89**	**90-99**
Northeast Asia	0.5	2.2	5.1	3.0
China	6.6	7.0	9.6	9.7
Hong Kong, China	-1.3	3.1	7.2	3.5
Japan	-1.4	0.3	3.8	1.5
Korea	2.0	4.6	7.9	5.5
Chinese Taipei	3.9	4.8	8.1	6.0

Source: IMF and Member economies

In China, stemmed by the huge investment mainly in infrastructure, the GDP registered a growth rate of 7.8% in 1998. To expand domestic demand will be a policy adopted by China to promote its economy in the coming a few years. The government projects growth rates of 7.0% for 1999 and 7.0-8.0% for year 2000-2002. The IMF estimates growth rates of 6.6% for 1999 and 7.0% for the year 2000.

Hong Kong, China, is expected to experience an economic recovery after the 5.1% contraction recorded in 1998. This recovery is expected to take place once global and regional financial markets are stable again. While overall exports of goods are expected to improve during 1999, exports of services should rebound in line with the recovery in inbound tourism. Domestic consumption is also expected to revive along with the pick up in asset prices and the gradual improvement in economic conditions. These positive developments, together with the spending by Government, should help to boost economic growth in 1999. Thus, forecasts hold that economic activity will remain relatively stagnant in the first half of 1999, to be followed by positive rates in the second half. Therefore, the real GDP growth rate for 1999 is anticipated at 0.5%; this would signify considerable progress compared to the -5.1% recorded in 1998. The IMF is less optimistic about 1999, estimating a -1.3% growth rate, and 3.1% for the year 2000.

Substantial economic growth is anticipated for Korea in 1999, based on the implementation of expansive monetary and fiscal policies seeking to help it in its economic recovery. In fact, policies already implemented have succeeded in increasing private and public spending, and therefore total expenditure is expected to increase by 4.1% this year. An important factor in this recovery, in addition to the policies implemented, is the trust that economic agents feel with regard to the world outlook. This will be reinforced this year by a the reduced inflation rate, estimated at 1.8% for 1999 and 2.0% for 2000. Thus, the Korean economy is expected to experience a full recovery in 1999, reaching a over 4.0% growth rate, and it is supposed to begin a new phase of sustained growth in 2000. IMF estimates for 1999 anticipate a growth rate of 2.0%, and of 4.6% for 2000.

For Chinese Taipei, after the two percentage-point drop in its GDP rate in 1998, GDP growth is expected to reach 5.1% rate in 1999, and an average rate ranging between 5.3% and 5.8% for the period 2000–2002. The IMF, on the other hand, anticipates growth rate of 3.9% for 1999 and 4.8% for 2000.

Southeast Asian economies, in 1999 are still suffering from the impact of the crisis, but have begun to turn around the situation so as to stop the process of economic deceleration and/or contraction. There are two common applicable factors: controlled inflation and stable currency exchange rates whether they were actually achieved in the first half of 1999 or are now implementing reforms to achieve them in the near future. If they achieve these two objectives, the economies in the region should be able to witness their recovery through enhanced domestic demand and increased exports, leading their GDP to higher growth levels.

Table 1.20 Forecasting GDP Growth in the Southeast Asia

	1999	2000	Average 80-89	90-99
Southeast Asia	0.6	3.2	5.4	5.3
Brunei Darussalam (*)	0.6	1.5	n.a.	1.2
Indonesia	-1.1	3.3	5.3	4.6
Malaysia	0.9	2.0	5.8	6.3
Philippines	2.0	3.0	2.0	2.6
Singapore	0.5	4.2	7.4	6.9
Thailand	1.0	3.0	7.4	5.2
Viet Nam	3.5	4.5	5.0	7.3

Source: IMF and member economies; (*) Asian Development Bank

As mentioned above, Southeast Asian economies will experience a slight increase in their economic activity during 1999. Although in some cases this will not be enough to show positive growth rates, it will be sufficient to significantly diminish their contraction rates. These economies are expected to show positive growth rates during the year 2000, initiating a process of full recovery toward their pre-crisis GDP rates. In fact, these economies saw a GDP growth rate of –5.3% for the whole region in 1998, while the IMF projects a rate of 0.6% in 1999 and 3.2% in year 2000.

Indonesia recorded a rate of growth of 1.3% in the first quarter of 1999, evidencing the process of macroeconomic stabilization that began in the second half of 1998, and which stands in strong contrast with the 13.7% plunge in its GDP in the same period. This improvement in economic activity has been preceded by controlled inflation, low interest rates and a stable currency exchange rate, which led to a review of projections for 1999 and 2000. Projections prepared by the Bank of Indonesia for 1999 show that the anticipated recovery of economic activity this year, although helpful, will not be enough to achieve positive growth rates, with the economy showing a contraction of between 2.0% and 1.0%. The IMF, however, estimates that the Indonesian economy will contract at a rate of -1.1% in 1999, followed by a 3.3% growth rate in 2000.

Malaysia is also entering a period of GDP recovery in 1999, fuelled by higher domestic demand and an increase in private and public spending. The Malaysian authorities anticipate 1% growth in 1999, in contrast to -6.7% registered in 1998. This is, therefore, a clear expression of economic recovery. IMF growth projections for the Malaysian economy are 0.9% and 2.0% for 1999 and 2000, respectively.

The Philippines, which in recent years experienced a slowdown in economic growth (5.8% in 1996, 5.2% in 1997 and -0.5% in 1998), has decided to give priority to recovering its economy in 1999. To this end, it has implemented three measures: re-focusing its fiscal policy that will stimulate domestic demand and fund anti-poverty programs, centering monetary policy on reducing inflation (in order to avoid pressures on its currency), and designing a reform process to allow the implementation of structural changes. Thus, in February 1999, the Philippine authorities set growth goals at between 2.6% and 3.2% for 1999, and between 4.8% and 5.4% for the year 2000. The IMF, on the other hand, estimates a growth rate of 2.0% and 3.0% for 1999 and 2000, respectively.

Singapore exhibited a positive growth rate in the first quarter of 1999, mainly thanks to the recovery of the manufacturing sector. Furthermore, and thanks to the effects caused by reduced interest rates and the improvement of expectations in the United States and Europe, in addition to the improved performance of Japan, Singapore is expected to improve slightly. Therefore, its own growth expectations should be adjusted to between 0 and 2%. IMF growth projections for Singapore are set at 0.5% in 1999, and 4.2% in 2000.

In Thailand, the progress attained in resolving economic and financial progress led the experts to project a gradual recovery of the economy with a real GDP growth rate between 0.8% and 1.3% for 1999. These experts agree that the increase in government spending, easing of monetary policy in order to encourage the real sector to recover, expansion in world growth and trade and progress in financial and debt restructuring are the main factors to explain the recovery of the Thai economy. IMF projects a growth rate of 1.0% in 1999 and 3.0% for year 2000.

Viet Nam experienced a drop in its growth rate during 1998, from 8.2% in 1997 to 5.8% in 1998 (which is still high) and, although the Vietnamese authorities have attempted to return to the 8.0% growth rate (the average achieved in recent years), they have been unsuccessful because of the low price obtained by Vietnamese export goods and scarce international demand for these products. However, they anticipate a 4.0% to 5.0% growth in 1999, and 5.0% to 6.0% in 2000. The IMF estimates that the Vietnamese economy will grow at rates of 3.5% in 1999 and 4.5% in the year 2000.

Like the Western Hemisphere economy, growth will also be slower in the **Oceania** economy during 1999 and the year 2000. The GDP growth rate for 1998 was 4.3% and the IMF projects a rate of 3.1% for 1999 and 3.2% during the year 2000. This slight recuperation from 1999 to 2000 is mainly because of the improved performance of the New Zealand economy.

Table 1.21.- Forecasting GDP Growth in Oceania

	IMF		Average	
	1999	2000	80-89	90-99
Oceania	3.1	3.2	3.2	3.1
Australia	3.1	3.2	3.5	3.2
New Zealand	2.7	3.3	1.8	2.2
Papua New Guinea	n.a.	n.a.	1.6	4.4

In this case, New Zealand, its economy began to overcome the contraction experienced in 1998 (-0.3% growth rate) only in the second half of that year, which leads to expectations of a sustained expansion of the GDP in 1999. Different factors will contribute to this situation: the employment rate is already growing in 1999, and the anticipated unemployment rate at year-end is expected to be 6%; inflation is supposed to drop in 1999 and should end the year within the range of 0 to 3% established by the New Zealand Reserve Bank. For all the above reasons, after the 1.3% growth exhibited in the second half of 1998, growth is expected to continue during 1999, reaching an average rate of 3.0% in the period 1999-2001. IMF annual growth estimates are placed at 2.7% for 1999, and at 3.3% for the year 2000.

The Australian economy is expected to grow solidly though at a more moderate pace than in 1998. Domestic demand is expected to remain strong in 1999, led by continuing growth in private consumption arising from strong employment growth and on-going real wages growth. IMF projections point to 3.1% growth in 1999, followed by 3.2% in 2000.

1998 Russia experienced a contraction in its product, high inflation and unemployment rates and, in few words, a generalized instability of the economy. The evident signs of reversal in market reforms, tight fiscal policy, a banking sector crisis and the deterioration of households incomes suggest that real growth rate will contract sharply in 1999. Despite the collapse of industrial production seemed to ease to the end of 1998, the general impact of the crisis on the whole economy has made the experts to worsen their outlooks for 1999. Indeed, the IMF is now projecting a 7.0% contraction in 1999, followed by a growth rate of 0% in year 2000.

As indicated in lasts paragraphs, in 1998 most of the APEC member economies experienced a year of strong economic contraction or deceleration, low export prices, and unemployment. All of the above are expressions of the contagion that spread the crisis throughout all economies in a globalized world. In this sense, it is important to note that most of the affected economies have adopted measures to reverse the situation, and have found some common solutions which, if they prove effective, could lead to the "contagion" of good results to other economies. However, some risks remain:

1. *The situation in Japan.* During the fiscal year 1998, Japan experienced a strong negative impact on its GDP, which contracted by 1.9%. Since Japan accounts for 23% of APEC economic activity, its economy will necessarily have an impact on the other economies that form part of APEC, either on their financial markets, exports, inflation, unemployment or other aspects. Japan has announced a series of measures to turn the situation around and it plans to implement them in 1999. These measures include an expansive fiscal policy, tax reductions, and a deep reform in the Japanese financial system. Progress has been made in recapitalizing and stabilizing the banking system, by allocating public funds to this end and, among other measures, efforts are being made to stabilize the Japanese *Yen*. Therefore, the government is committed to implementing these measures to ensure recovery in 1999.

2. *The financial crisis in Russia*. Although the Russian *ruble*, suffered strong pressures in 1998, it only collapsed fully in August 1998. This gave rise to a grave situation at the financial and real levels. The GDP contracted by 4.6%, inflation increased to 127.8%, and unemployment reached 12.3%. Faced with the instability of the *ruble* and its resulting effects, foreign lenders refused to make funds available to Russia until it accepted to implement structural reform policies in its financial system. This led to significant capital flight from emerging markets (many of them located in Asia), with severe down pressures on their currencies and the price of their assets. Therefore, it is vital for Russia to revert this situation in the course of 1999 and to stabilize its currency and domestic market, so as to ease the pressures on the rest of the markets and boost growth in the region once more.

3. *Exchange rate.* Most of the economies affected by the financial crisis have experienced a common problem of currency volatility, with macroeconomic effects. Some of the affected economies have apparently not yet stabilized, leading authorities in these economies to implement tough monetary policies in 1999 oriented to stabilization. Success in resuming the growth process in the affected economies will depend in part on the way in which these monetary policies are implemented and the final result obtained through these measures.

4. *United States economy.* For as long as the US economy remains the significant source of growth in the global economy, a sharp reversal in US economic performance–the so-

called “hard landing” scenario–would have a major impact on global and regional growth projections. Although this risk has abated somewhat in recent months, there remains a possibility of a change in investor sentiment leading to a sharp fall in US equity prices with consequential effects being felt in the economy more widely. A return to healthy growth rates in Japan and Europe would ameliorate the consequences of a hard landing in the US economy, if it occurred.

5. *Protectionism*. A notable feature of the domestic policy responses to the recent economic crisis has been the absence of protectionist measures. As APEC Leaders and Ministers have noted on many occasions, the potential of trade and investment liberalization to contribute to economic recovery would be severely undermined by protectionist measures that restrict trade and investment flows.

6. *Maintaining the momentum of structural reform.* The recovery of economic performance in many of the region’s economies could ease the pressure to maintain the momentum of structural reform. Such an outcome would undermine the sustainability of recent improvement in economies’ performance, and could increase the risk that deep and prolonged economic crisis will recur.

1.3 International Financial Crisis

1.3.1 The Financial Crisis its Causes and Evolution

In recent decades, growth rates in South East Asia were among the highest in the world. The vigor of the Newly Industrialized Economies of Asia (the NIEs, that is, Korea, Chinese Taipei, Singapore and Hong Kong, China), four ASEAN economies (Thailand, Malaysia, Indonesia and the Philippines) and, more recently China and Viet Nam, made the region produce almost one third of the world's GDP in recent years. In terms of international trade, the region has also shown a significant performance and it has become one of the most important trade partners for most economies.

From 1990 to 1996, four ASEAN economies grew at an average rate of over 8.0% while maintaining high levels of domestic savings, one-digit inflation rates and low unemployment rates. This strong growth relied in part on high investment levels, which sometimes exceeded levels of domestic saving, and hence sometimes required considerable external funding. Thus, current account deficits represented–for several years–close to 8.0% of the GDP in Thailand and Malaysia.

Several factors played a role in causing the crisis, including unsustainable exchange rate regimes and risky debt management practices. A crucial observation is that weak supervisory capacity, connected lending and, at times, corrupt credit practices rendered the financial sectors of the crisis economies fragile. As a result, investment was increasingly misallocated. The gains from decades of growth had been very real, but growth rates on the eve of the crisis do not appear to have been sustainable. Some external developments may also have played a role.

In 1997, the bubble burst. Stock markets fell, and widespread losses–in some cases, outright defaults–appeared, revealing the low profitability of past investments projects. Non-performing loans, already rising before the currency crisis, escalated, threatening many financial institutions with bankruptcy. In addition, the firms, banks, and investors that had relied heavily on external borrowing were left with a large stock of short-term, foreign currency-denominated, unhedged foreign debt that could not be easily repaid. The exchange rate crisis that followed made the problem worse: the real burden of debt denominated in foreign currencies rose sharply as the currencies depreciated, thereby leading to further financial crisis for banks and firms. The free fall of currencies was intensified by the sudden rush of firms, banks and investors to cover their previously unhedged liabilities in foreign currency. In turn, this accelerated depreciation aggravated the original foreign currency debt problem creating a vicious circle.

A detailed chronology of the Asian crisis is provided in Annex 1 and *1998 APEC Economic Outlook*. The recovery of most of the affected economies has been remarkable.

As of June 1999, the financial crisis that began in East Asia in mid-1997 had apparently begun to recede. Continued economic recovery appeared to depend in large part on initiatives to introduce and implement reforms particularly in banking. The recovery of the financial sector in the most affected regions needs to be underlined, as well as the fact that signs of improvement and stability are evident in al economies. In this sense, the IMF issued a warning stating that signs of improvement in some Asian economies should not make those nations hold off on reforming their financial systems, which are necessary to strengthen banks and adjust their corporate debt, because this could open up the possibility for new economic crises. The IMF further stated that it intended to call on investors to do the same.

The following has been observed in many APEC economies:

- Gradual and continual trends in the direction of an appreciation of their currencies.
- Significant reductions in nominal interest rates–in some cases–to levels below the ones existing prior to the crisis.
- Interest rate decreases consistent with exchange rate stability and a return to market stability, which has made it possible to give the economies the impulse they needed to start their recovery.
- Stock markets showing a sustained bullish trend in the first half of 1999, with increases in excess of 30% in some economies.
- Reduced current account imbalances, although in many cases this adjustment is due to reduced imports.
- Efforts to strengthen and restructure the financial and corporate sectors.

1.3.2 The Causes of the Asian Crisis

Studies of the Asian crisis suggest that while no single factor by itself can explain the collapse, a range of factors interacted to generate the crisis. This range encompasses factors that were sources of increased vulnerability (such as weakness in financial structure) and those that were more proximate causes, that is, events or news that lead economic agents to reassess their positions (such as a devaluation in a country that adversely affects the international competitiveness of other economies)[1].

Most explanations for the Asian crisis emphasize the fundamental weaknesses of the major affected economies, particularly unsustainable exchange rate regimes, inappropriate reliance on short-term capital, and financial sector weaknesses. In addition, some explanations emphasize the role of volatile international financial flows, which can be destabilizing.

In spite of high saving rates, the investment boom in the East Asian region led to large and growing current account deficits financed primarily through the accumulation of short-term, foreign currency-denominated and unhedged liabilities by the banking system. Exchange rate regimes entailing fixed but adjustable pegs to the dollar exacerbated the problem in two ways. First, they led to real currency appreciation's (as a result of the 1995-98 appreciation of the dollar) that worsened current account deficits. Second, the promise of fixed exchange rates led borrowers to discount the possibility of future devaluation, and thereby led them to underestimate the cost of foreign capital. At the center of each crisis was this kind of regime. Also, while budget deficits were apparently low, the implicit and explicit government guarantees of a bailout of the financial system in a crisis implied large and growing unfounded public liabilities that emerged once the currency crisis triggered a wider banking crisis.

Concern among investors about the commitment of governments to structural reforms intensified policy uncertainty, contributing to widespread capital outflows. Although fundamentals likely triggered the crisis, currency and stock markets may also have overreacted, with panic, herd behavior and a generalized increase in risk aversion producing a sudden reversal of capital flows, exacerbating the crisis.

Financial sectors of the crisis economies were prone to fragility due to the prevalence of corrupt credit practices with loans often politically directed to favored firms and sectors. In addition, regulation and supervision of crisis country banking systems were notably weak. Moreover, moral hazard derived from implicit or explicit government bailout guarantees of financial institutions.

Such financial sector weaknesses contributed to a lending boom and over-investment in projects and sectors that often were risky and of low profitability, such as real estate and other non-traded sectors; excessive capacity accumulated in some traded goods sectors. Prior to the crisis, speculative purchases of assets in fixed supply fed an asset price bubble, with equity and real estate prices rising beyond levels warranted by fundamentals.

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1 Among the key studies that discuss these issues in depth are the following:

- IMF (1999*) IMF Supported Programs in Indonesia, Korea and Thailand : A Preliminary Assessment*, T. Lane, *et. al*., IMF.
- IMF (1998) *World Economic Outlook*, May, IMF.
- OECD (1998) *OECD Economic Outlook*, June 1998, OECD.
- World Bank (1998) *East Asia: The Road to Recovery*, IBRD.

Domestic and international capital liberalization unaccompanied by appropriate regulation and supervision may have aggravated the original distortions by allowing banks and firms to borrow more and at lower rates in international capital markets.

Empirical studies confirm that the return to capital fell sharply in the East Asia region as the result of excessive investment. Studies document a rapid build-up of fixed assets throughout Asia between 1992 and 1996 with particularly rapid growth in Indonesia and Thailand. With most of the growth financed with debt, high levels of corporate leverage were already prevalent in 1996, well before the currency crisis increased the burden of foreign debt. At the same time, moderate to low profitability severely impaired the ability of many Asian firms to meet their interest payment obligations.

The sharp reversal of capital flows to the East Asian region in the second half of 1997 is clearly evident in the data. Net private flows to five Asian crisis economies (Thailand, Korea, Indonesia, Malaysia and the Philippines), which averaged $89 billion per year in 1995-96, reversed dramatically in 1997, which saw a net outflow of $6 billion. This sharp reversal, amounting to more than 10 percent of the GDP of the five crisis economies, occurred in the second half of 1997 as foreign investors fled and international banks sharply contracted their short term loans. Commercial banks accounted for three-quarters of this reversal, withdrawing $29 billion in 1997. While equity investments also fell in 1997, the decisions by international commercial banks not to roll over their loans to Korea, Thailand and Indonesia severely exacerbated the financial crisis and the currency collapse. In 1998, it is estimated that net private outflows were even larger than in 1997, about $25 billion, driven again by large-scale bank withdrawals.

The drastic reversal of capital flows necessitated a severe adjustment of the current accounts of the affected economies. Current account deficits can only be sustained as long as foreign lending is available to finance them. The withdrawal of needed financing therefore resulted in higher domestic interest rates, depreciated currencies, and sharp economic contraction, producing a substantial decline in imports and large current account swings in the crisis economies. The aggregate current account balance of the five crisis economies moved from a deficit of $54 billion in 1996 to a deficit of $25 billion in 1997 (with most of the adjustment in the second half of the year) and an estimated surplus of $66 billion in 1998. As private capital flows have fallen sharply, the role of financing external obligations has been transferred to the official sector (IMF, multilateral and bilateral official creditors) and to foreign reserves: while in 1996 the Asian five made small net transfers to official creditors, they received net official flows of $31 billion and $28 billion in 1997 and 1998 respectively. Moreover, while in 1995 and 1996, net private inflows in excess of current account imbalances led to sharp increases in foreign exchange reserves, the turnaround of capital flows in 1997 led to a loss of foreign exchange reserves equaling $31 billion.

While the reversal of capital flows in 1997 was partly explained by the fundamentals and policies followed by the crisis economies, its size and concentration in the second half of 1997 suggest that, in addition to the debtors' excessive reliance on short-term bank debt, investor flight, especially by commercial banks, could have made the crisis worse. The calls for greater private sector involvement in crisis resolution (as in the G-7 report on financial architecture from June 1999) recognize that the private sector needs to be involved in preventing financial crises and, if they do occur, needs to contribute constructively to their containment and orderly resolution.

1.3.3 Effects of the Crisis on the World Economy

The following are some of the main consequences of the international crisis on the world economy:

1. The Asian crisis had a strong real impact on the international economy and on APEC, especially during 1998. That year, world growth was well under the 4% recorded in 1996 and 1997. Recent estimates by the IMF indicate that international economy grew at 2.3% last year, i.e. 2.0% less than indicated in previous projections for 1998 which were prepared prior to the onset of the crisis (*the world growth projection of the IMF on October of 1997 was 4.3%*). An important fact worth mentioning is that, although the crisis caused a significant downturn in economic activity levels, the world economy will continue to grow at rates higher than the ones recorded in the early nineties. In the APEC region, however, growth in 1998 amounted to 1.9%, i.e. 1.8% less than in 1997, a figure that is one of the worst in the decade.

2. The downswing in global economic activities was reflected in a general reduction in the price of raw materials, more specifically, in copper, gold, oil and some types of wood that are particularly in demand in the regions most affected by the crisis[2]. The negative impact on the price of raw materials was enhanced by a decrease in international inflation rates, a circumstance that has been present throughout the decade and that was reinforced by the crisis.

3. This contributed to a deceleration in economies dedicated primarily to producing raw materials and that trade mainly with South East Asian economies.

4. A rise in the number of bankruptcies in the production and banking sector.

5. World trade continued to grow albeit at a reduced pace. According of the World Economic Outlook of the IMF (May of this year), world trade diminished its growth rate from 9.9% in 1997 to 3.3% in 1998.

6. Increased numbers of people living in poverty, a fact that translates into the intake of an insufficient diet, reduced access to health care and higher school dropout rates. This point, together increases in unemployment in the economies most affected by the crisis, increased the risk of social and political crises in some cases.

7. In some economies, the abrupt and prolonged economic slump produced by the crisis unleashed severe social and political crises and also triggered problems of legitimacy for the government authorities. The most dramatic case was Indonesia, where drastic adjustments led to major social unrest.

8. The Asian crisis induced a decrease in capital inflows to emerging markets, and higher financing costs, although capital is now returning.

9. Falls in the emerging stock markets, although they have now recovered significantly.

2 Price of petroleum drop down 32.1% on 1998, and the price of the other commodities fell 14.8%.

1.4 The policy response to the crisis in international cooperation

1.4.1 IMF Policies during the Crisis

IMF has been playing a central role in assisting the crisis-affected economies by providing them with financial and technical assistance.

At the onset of this current turbulent period, the goal of the IMF was to reestablish trust in the three most severely affected Asian economies, namely, Indonesia, Korea and Thailand. The method implemented involved a combination of financial support and economic policy requirements, which had two main components:

- Macroeconomic policy, specifically a tight monetary policy aimed at defending local currencies and restraining capital flight, coupled with fiscal adjustment measures to counter an initial deterioration of fiscal positions.

- Substantial structural reforms that included: reforming the banking system, breaking-up monopolies, eliminating trade barriers and reforming the corporate management system.

(a) IMF Supported Measures in the Asian Economies

Monetary policy

Monetary policy in the IMF programs is designed to balance two objectives: namely to avoid a depreciation-inflation spiral and to maintain the macroeconomic stability. In Korea and Thailand, monetary policy was eventually tightened to prevent the large initial currency depreciations from initiating depreciation – inflation spirals. In contrast to these economies, monetary policy in Indonesia was not too tight. On the contrary, the authorities lost control of money and credit, and nominal interest rates and exchange rate were driven by market risk premia while underlying real interest rates remained negative.

A frequently asked question on the monetary policy in the IMF programs is whether its program's successful stabilization in Thailand and Korea caused monetary condition too tight, contributing excessively to the contraction in economic activity. Some argue that this measure is inefficient because lack of trust is reflected in the high-risk premium demanded by investors. This caused problems for local banks and companies, which were unable to meet their financial commitments.

However, the fact that the currencies of Korea and Thailand recovered by mid-1998 as interest rates declined to pre-crisis levels suggests that economic stability is being restored with the implementation of IMF programs. Furthermore, the IMF itself has reviewed its measures in the crisis-affected Asian economies. It examined evidence on various monetary indicators and concluded that monetary tightening in Thailand and Korea was not extreme in relation to other crisis elsewhere. As IMF itself admitted, this is not to deny that monetary tightening had a cost for real economy. But it should be noted that the alternative would almost certainly have been more costly.

Fiscal policy

In the fiscal policy front, the initial IMF programs included fiscal adjustment measures to offset a weakening of fiscal positions with the aim of supporting external adjustment without an excessive squeeze on the private sector's financing, and to make room for the costs of bank restructuring and social safety nets.

Some criticize the recessive effects that this policy generates in economies that are undergoing a crisis. Also some argue that restructuring the banks gives rise to a long-term commitment and therefore it is perhaps unnecessary to demand immediate fiscal surpluses.

If these deficit targets had been implemented under the macroeconomic conditions that emerged, they would have implied an excessively contractionary policy. However, beginning early in 1998, as the recession deepened and current accounts shifted into large surpluses owing to sagging domestic demand and large currency depreciation's, fiscal policy became increasingly oriented toward supporting economic activity. The Fund relaxed its fiscal targets, allowing deficits in all three economies to increase considerably in order to accommodate part of the effects of the automatic stabilizers and the exchange rate depreciation on the fiscal positions.

Structural policy

Since financial sector vulnerabilities had played a major role in causing the crisis, financial sector restructuring stood at the top of the structural reform agenda and formed the centerpiece of the IMF supported programs. Under this program, institutions that were evidently insolvent were cleaned up or close down, and other institutions were also examined comprehensively to assess and, if necessary, strengthen their balance sheets.

Although no one questions the fact that several banks in Indonesia, Korea and Thailand required some form of intervention, there is question whether the abruptness with which this process was carried out made the problem worse and encouraged a run on the banks that ended up by affecting even solvent banks.

IMF argues that, as a vicious circle of growing problems in the financial sector and worsening macroeconomic environment had rapidly evolved, there was no alternative to the reactive approach that characterized its measures. It also points out that failure to begin to address the weakness of financial institutions early on would have implied a continuing rapid deterioration of financial sector conditions with attendant macroeconomic consequences.

(b) IMF Intervention and Moral Hazard

An additional concern is whether the assistance packages provided by the IMF could involve an increased moral hazard by encouraging the disappearance of incentives for monitoring by investors. Similarly, it could induce businesses to take more risk they can rely on the eventual bailout through the IMF.

However, the IMF and some economists have responded by pointing out that such arguments are not valid. Private investors have had to bear significant losses in their positions in Asia and other emerging markets and banks, despite IMF warranties, have suffered important losses in their loan portfolios. Moreover, the rigidity of IMF assistance programs translates into an important political cost for those who made the decisions that led to the crisis.

Furthermore, it is necessary to compare the cost of the distortions generated by the moral hazard stemming from the IMF intervention with the alternative of allowing economies and their creditors to freely negotiate the debts. This is an option that could have even more serious consequences for the economy. Likewise, in the highly integrated global economy, the risk of contagion increases when the IMF fails to intervene. Therefore, an institution capable of acting quickly in a crisis is needed, so as to prevent the crisis from spreading and involving the International Financial System. Under the current circumstances and in the absence of extensive reform of the international finance system, the IMF is still the organization that is best qualified to do so.

1.4.2 International Financial Rescue Packages

In response to the severity of the South East Asian crisis, international finance organizations and some developed economies granted unprecedented assistance packages to try to contain the crisis in Asia.

The IMF has guided and managed the international response to the financial crisis. Furthermore, it has coordinated its work with other international finance organizations to provide economic resources to the economies more heavily affected by the crisis. It approved financial assistance to support reform programs in Korea, Indonesia and Thailand. It helped the most seriously stricken economies to organize economic reform programs to address the structural problems made evident by the crisis. The World Bank also allocated a large amount of resources to the economies affected by the financial crisis in support of the IMF-led effort. The World Bank adopted multiple strategies, including support for structural reforms to reestablish high growth levels, economic assistance to low income economies during the crisis and it is working to reestablish the international flow of capital.

Table 1.23.- International Assistance (in US$ billions)

	IMF	World Bank and Asian Development Bank	Bilateral Assistance	Total
Korea	16.1	8.0	23.2	47.4
Indonesia	12.3	10.1	20.	42.4
Thailand	3.9	2.7	10.5	17.1
Total	32.3	20.8	53.7	106.9

Source: International Monetary Fund

The Asian Development Bank acted in close coordination with its member economies, the IMF and the World Bank to develop policies designed to overcome the crisis. These efforts culminated in loans and support for several of the economies affected by the crisis.

1.4.3 APEC's Response to the Crisis

The Asian financial and economic crisis has been a central concern for the APEC community since its onset. The crisis calls for the close collaboration and participation of the industrialized economies and emerging market economies to restore the economic stability in the APEC region. APEC has played a major role in this regard notably in promoting cooperation between developed and developing economies in responding to the crisis. Leaders noted in Vancouver that, as the region's most comprehensive economic forum, APEC is particularly well suited to play a pivotal role in fostering the kind of dialogue and cooperation on a range of policies and develop initiatives to support and supplement the efforts made by various fora in the international community. APEC's response to the crisis is examined in the following section.

Role of APEC in responding to the crisis

International financial institutions such as IMF, World Bank and Asian Development Bank and the governments of industrialized economies played, and continue to play, a major role in providing short-term financial assistance and technical assistance to crisis-affected economies. APEC Leaders recognize the central role of the international financial institutions and are "resolved to work together to address shared challenges" presented by the crisis.

APEC has played a unique role in assisting the economic recovery in the region utilizing its unique membership and approach:

- APEC consists of all the major economies of the Asia-Pacific region, including most of the crisis-affected economies. Those economies are characterized by their dynamic and fast growing economic activities.

- APEC is providing a forum for the most powerful economic Leaders in the world to exchange information and views on various issues in the region.

- Its activities cover initiatives in broad areas such as trade and investment, economic and technical cooperation, and cooperation on various sectoral issues including the Finance Ministers process.

- Based upon its comparative advantage and its mandate, APEC is focused on reinvigorating growth and investment in the region through liberalizing and facilitating trade and investment as well as strengthening the functioning of markets. APEC is also well placed to provide economic and technical cooperation to support activities in these areas.

Types of APEC response to the crisis

There are many types of initiatives which address the difficulties arising from the crisis and support the economic recovery in affected economies in the region. The following are examples.

1. Fostering a dialogue and cooperation on a range of policies through the APEC Leaders Meeting

The APEC Leaders Meeting provides a unique and valuable opportunity for to the APEC community to discuss the various issues related to the crisis at the highest level of the governments.

- APEC Economic Leaders met first after the outbreak of the crisis in Vancouver in November 1997. The crisis and its implication for the regional economy were at the top of their agenda. Leaders endorsed the Manila framework, which was set up by Finance Deputies in the region, and called for its rapid implementation. Leaders also agreed that the financial turmoil presented new challenges to the international financial system requiring new responses. Leaders stressed that they would not respond to the crisis with increased trade protection but would move ahead with APEC's liberalization. Leaders also asked two among them, President Clinton and Prime Minister Hashimoto, to work on the global aspects of the financial instability by drawing in non-APEC members.

- ♦ At their November 1998 meeting in Kuala Lumpur, Economic Leaders resolved to work together to support an early and sustained recovery in the region and agreed to pursue a cooperative growth strategy. Under this strategy, Leaders called for growth-oriented prudent macroeconomic policies, strengthening social safety nets, strengthening financial systems including trade finance, accelerating corporate sector restructuring, catalyzing the return of private capital flows into the region, developing long-term measures to strengthen the international financial system and made a renewed commitment to the Bogor goals of achieving free and open trade and investment within APEC.

2. Enhancing the economic recovery through liberalizing trade and investment and strengthening markets

Financial instability and recession might easily have sparked pressure for increased protectionism, but APEC's collective commitment to open markets has helped forestall any such response. At the their meetings in Vancouver and Kuala Lumpur, Leaders, noting that open markets bring significant benefits, reiterated the need for liberal and open markets and an enabling environment for investment. They also reaffirmed that APEC will continue to pursue trade and investment liberalization to foster further growth.

At the Ministerial meeting in Kuala Lumpur, Ministers reaffirmed their commitment to achieve APEC's trade and investment liberalization goals through the process of individual and collective actions. Ministers viewed trade and investment liberalization as an important element in restoring confidence in the region and in stimulating economic growth.

Strengthening markets, a central theme of New Zealand's 1999 APEC chairmanship, is directly related to efforts to prevent a recurrence of the financial crisis. A key element is the effort by economies to develop a set of principles for competition policy and regulatory reform. Another important element is to strengthen financial markets in the region.

Under the Finance Ministers process, various collaborative initiatives have been undertaken to strengthen regional financial markets. These initiatives include:

(a) strengthening financial market supervision;
(b) promoting pension reform;
(c) improving credit rating agencies and disclosure;
(d) promoting the development of deep, liquid and mature domestic bond markets;
(e) strengthening corporate governance;
(f) continuing work to design a Voluntary Action Plan for Supporting the Freer and Stable Capital Flows;
(g) establishing a privatization forum; and,
(h) considering further the issue of appropriate exchange rate arrangements.

3. Setting up the framework for international and regional cooperation to respond to the crisis

A notable example in this area, was APEC contribution to setting up the "Manila Framework" for enhancing regional cooperation to promote financial stability. Finance and Central Bank Deputies from 14 Asia-Pacific economies in the region met in Manila in November of 1997, three months after the outbreak of the crisis and agreed on the framework, which includes the following initiatives: (a) a mechanism for regional surveillance to complement global surveillance by IMF; (b) enhanced economic and technical cooperation particularly in strengthening domestic financial systems and regulatory capacity; (c) measures to strengthen the IMF's capacity to respond to financial crises; and (d) a cooperative financing arrangement that would supplement IMF resources. Successive meetings are held periodically to check the progress in its initiatives and review the economic situation in the region.

APEC Finance Deputies will report to APEC Leaders in September 1999 on issues relating to the reform of the international financial system. This report will form the basis of any APEC contribution to the discussion on reforming the international financial system.

4. Exchanging information and views on the crisis and its implications to the economic activities in the region

A number of APEC fora, in addition to APEC Finance Ministers, have reviewed the crisis and its effects.

♦ The Economic Committee has responded to challenges posed by the Asian crisis, undertaking two research projects focusing on the crisis which are complementary. The *1999 APEC Economic Outlook* surveys recent developments and the short-run outlook of APEC economies in the wake of the crisis. *APEC Economies beyond the Asian Crisis*, the centerpiece of the Committee's two-year work program, examines the long-term implications of the crisis and explores forward-looking responses.

♦ The Economic Committee's Infrastructure Workshop held a Public-Business Sector Dialogue focusing on the impact of the crisis on infrastructure development and plans to undertake further analytical work on it.

♦ The fourth APEC Investment Symposium in September 1998 in Kuala Lumpur included a session on the impact of the crisis on investment trends and government policy responses.

♦ At the SME Ministers meeting in April 1999 in Christchurch, New Zealand, Ministers cited the profound effect of the regional crisis on smaller firms. They stressed four ways to promote SME growth through; (a) Enhancing management performance through education; (b) Reducing barriers to trade and regulatory compliance costs; (c) Improving capital markets and SMEs' access to them; and (d) Strengthening linkages to assist regional business.

♦ Energy Ministers met in October 1998 in Okinawa and reviewed the impact of the crisis on the future energy supply/demand outlook and instructed the Energy Working Group to hold a business/government workshop to develop recommendations on the sector's role in improving investor confidence and mobilizing new capital flows.

- ♦ The Tourism Working Group is conducting a two-part survey to assess the impact of the crisis on regional tourism and will try to identify strategies that might offset negative impacts.

- ♦ In response to the credit crunch resulting from the crisis, 15 institutions signed a protocol agreement in November 1997 setting out a framework for technical cooperation among export credit agencies and export financing institutions with respect to private infrastructure projects.

- ♦ Women's Affairs Ministers, meeting in October 1998 in Manila, highlighted the disproportionate impact of the financial crisis on female businesses and workers and the need to consider women's economic interests in devising recovery strategies.

5. Addressing the social impacts of the crisis

- ♦ A Virtual Social Safety Net Task Force was established to exchange inventories and information on available technical assistance and social safety net programs.

- ♦ Social safety net issues are being taken up by the Human Resource Development Working Group (HRD).

- ♦ Australia will extend its Asia Recovery Information Center to collect, catalogue and disseminate information and analysis on social safety net issues in crisis-affected economies, with an initial focus on children.

- ♦ A World Bank paper on social safety nets in the APEC region was presented to APEC Finance Ministers in May.

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Chapter 1: Appendix 1

Landmarks of the Asian crisis

Highlights of the Asian Crises

1997

July 2	Faced with a grave financial crisis, the Central Bank of Thailand announced that it would implement a “dirty float” system for the baht, which was immediately devalued by 18%. This was the real trigger for the Asian crisis.
July 11	The Central Bank of the Philippines broadened the flotation range for the peso after the currency fell by 6.4%.
July 11	The Bank of Indonesia widened the exchange rate intervention band from 8% to 12%.
July 24	The Malaysian ringgit hit a 38-month low vis-à-vis the dollar.
August 8	The Malaysian government announced that it would no longer defend the ringgit.
August 11	The international community, through the International Monetary Fund (IMF), went to Thailand’s rescue and granted a US$17.2 billion loan. This offer is the heaviest financial bailout package since 1995, when the IMF lent Mexico US$ 40 billion.
August 11	News that Malaysia would assist Thailand with US$1 billion prompted a run on the local currency (ringgit), which fell to its lowest value in the past 41 months.
August 12	The Singapore dollar dropped by 1.5%, to its lowest level in three years.
August 14	The bank of Indonesia decide to abandon the managed floating exchange rate system and adopted the free-floating system through removing exchange rate intervention band.
August 19	The c) maintained its lending rate at 5.5%.
September 3	In today’s events, the Central Bank of Thailand had to step into the market when the local currency hit a new all-time low at 37 bahts to the dollar. The baht rose slightly thereafter and ended the trading session at 36 bahts to the dollar, down 4.5% compared to the previous day.
September 3	The Philippine peso dropped amid rumors that monetary controls could be relaxed by the Monetary Board, falling by 3%.
September 16	Indonesia announced that it would postpone projects intended to

	shrink the public deficit.
October 8	Indonesia has placed itself voluntarily under IMF tutelage.
October 8	So far in 1997, the Indonesian rupiah has suffered the sharpest depreciation (56%), followed by the Thai baht (40%), the Philippine peso (33%), the Malaysian ringgit (28%) and the Singapore dollar, which fell to a 42-month ow and accumulated a 11.6% devaluation against the dollar.
October 14	The Vietnamese dong has been depreciated by 5% after the State Bank of Viet Nam decided to broaden the dollar's fluctuation margin from 5% to 10%. This allowed the dong to be traded at 12,293 units per dollar, i.e. a *de facto* devaluation of 5%.
October 14	Thailand agreed to a US$2.8 billion budget cutback in its struggle to meet the requirements agreed to with the International Monetary Fund (IMF). The country must achieve a budget surplus amounting to 1% of the GDP.
October 21	Massive resignation of the 48-member Thai Cabinet.
October 21	The Asian Development Bank drastically lowered its growth projections for Thailand from 6.1% to 1.9%, a clear reflection of the grim economic outlook for the region.
October 23	The Hang Seng index–leading indicator for the Hong Kong, China stock exchange–recorded its deepest plunge in ten years (10.4%) and accumulated a 23% drop this week.
October 27	The Mexican peso surpassed the mark of Mx$8/US$1, scoring the biggest drop among the emerging currencies (6.5%). Therefore, the Central Bank of Mexico sold US$200 million to hold back its currency. The Mexican Stock Exchange slid back 13.34% to 4,263.89 points, its lowest level since 18 June of this year, dragged down by the overall restlessness in the world markets. This was the biggest drop in percentage terms since 20 October 1987, when the stock market lost 13.43% amid a crisis in the international financial markets.
October 27	The Lima (Peru) Stock Exchange crumbled along with the other regional stock markets, in its sharpest fall since the Mexican "Tequila" effect. The general index dropped 6.44% to 1,826.77 points, whereas the blue-chip index plummeted 7.31% to 2,691.64 points.
October 31	A US$23 billion bailout package led by the IMF, with the participation of the Asian Development Bank, the World Bank and several economies, was announced to Indonesia.
November 5	The Korean stock exchange fell by 10%, pushed down by soaring interest rates and panic-stricken brokers.

November 7	Asian securities nosedive as a result of the recent Korean stock market crash.
November 20	Amid general uncertainty over whether Korea will receive an IMF loan or not, the Malaysian stock market fell 13% and the Korean won dropped 2.9%.
November 25	The yen fell to a 5-year low against the dollar.
November 27	The IMF agreed to extend a US$ 3.9 billion credit facility to Thailand over the next 34 months.
December 9	The IMF is considering financial aid for Russia.
December 15	Korea eliminated the dollar exchange rate band.
December 19	The Asian Development Bank announced emergency aid packages for Indonesia and Korea, totaling US$3.5 billion and US$4 billion respectively.
December 24	The IMF, together with the United States and 12 other economies, agreed to provide Korea with a US$10 billion bailout package to alleviate its beleaguered economy. The Indonesian rupiah fell to a new all-time low after breaking news that the country's short-term debt was much larger than originally estimated.
December 29	The Korean Parliament passed economic reforms, among which the creation of a regulatory entity for banking and finance stands out.
December 31	The Indonesian Finance Ministry announced several reforms to consolidate and/or merge seven existing banks into three banking institutions by July 1998.
1998	
January 2	Leading US and European banks announced additional grace periods for Korean borrowers to repay an estimated US$15 billion in short-term loans that had matured last 31 December.
January 5	Thailand announced that it would ask the IMF to ease the terms of its US$17 billion package since its currency, the baht, had fallen to less than half its mid-1997 value. Prime Minister Chuan Leekpai said that Thailand would try to soften IMF demands to generate a budget surplus in 1998.
January 7	Asian currencies plummet to new all-time lows. The Indonesian rupiah, the Philippine peso and the Malaysian ringgit dropped by 12.8%, 9.8% and 7.2%, respectively.
January 12	One of the largest independent involvement banks in Hong Kong,

	China, namely Peregrines Investments Holdings, was being liquidated.
January 16	International lenders have finally drawn up a plan to defer Korea's short-term debt until 31 March.
January 16	In Indonesia, President Suharto reached an agreement with the IMF to restate its budget and announced additional economic reforms, including the dismantling of key monopolies and the closing of banks overburdened by debt.
January 27	Indonesia requested a temporary freeze on the repayment of corporate debt.
January 29	The Korean government and a group of 13 international banks agreed on a plan to extend the maturity of approximately US$24 billion in short-term loans to the Korean system from one to three years.
February 3	The renewed confidence of foreign investors helped the Asian stock market to recover ground, led by a 23% increase in the Malaysian stock exchange.
February 6	Thailand announced the absorption of three financial institutions.
February 16	The Indonesian rupiah suffered a 21.3% depreciation amid civil unrest fired by the spiraling prices of staple goods.
February 18	It was announced that unemployment in Indonesia amounts to 14.7% of the total population.
February 23	The region's stock markets crumbled after the G-7 Finance Ministers failed to offer any solution to the Asian crisis at their recent meeting in London.
March 5	The Indonesian rupiah fell 14% amid rumors that the IMF may suspend the disbursement of US$3 billion scheduled for 12 March.
March 25	The Asian markets rose slightly as they have throughout the month of March.
April 24	Japan announced its largest fiscal encouragement package in history, to support projects amounting to slightly over 3% of its GDP.
May 8	The rupiah fell by 10.8% amid fears of a social explosion in Indonesia.
May 19	The Indonesian rupiah dropped 16% due to erupting violence.
May 26	The Korean stock index fell 6.5% amid rumors of an impending recession, union unrest.
May 26	President Yeltsin signed an austerity package to stabilize the budget

	and reduce spending. The Finance Minister announced spending cutbacks of US$10 billion.
June 8	The Japanese yen dropped by fears of an economic recession in Japan.
June 12	Japan is now in recession after two quarters of negative growth.
June 16	Korean stock exchange reaches an 11-year low. The Asian markets sagged as a result of fears of a possible devaluation of the Chinese RMB.
June 18	Korea announced that it would liquidate 55 insolvent companies under an IMF agreement.
June 18	The IMF postponed the delivery of a new US$670 million tranche of a US$9.2 billion loan to Russia, arguing that problems persist in the implementation of reforms, particularly in the fiscal realm.
June 19	Russia applied to the IMF and other lenders for another aid package amounting to between US$10 to US$15 billion.
June 22	In an unprecedented move, the Chinese government ordered the closedown of the Hainan Development Bank for having defaulted on its debts.
June 23	President Yeltsin introduced a plan to fight the crisis, which includes budget cuts and radical changes to the taxation systems.
June 25	The IMF approved the delivery of a US$670 million tranche under a US$9.2 billion loan to Russia, in spite of which Russian stock prices fell once again.
July 13	Hard hit by the Asian crisis, and further aggravated by its own internal structural weaknesses, Russia secured an unprecedented US$22.6 billion in financial aid for 1998 and 1999, on the condition that it reduce its budget deficit by half.
July 16	The IMF announced US$ 6 billion in fresh aid funds for Indonesia.
July 19	President Yeltsin approved by decree some of the initiatives under the anti-crisis plan rejected by the Duma, such as the proposals to increase tax collections.
August 11	Speculations of a potential depreciation of the Chinese currency plunged the Asian stock markets to all-time lows.
August 12	The Russian Central Bank curtailed banking activities, particularly currency transactions, to defend the ruble.
August 14	President Yeltsin insisted that the ruble will not be depreciated and urged the Duma to hold a special session to review the anti-crisis plan.

August 17	The Russian government carried out a *de facto* devaluation of the ruble.
August 18	The Moscow stock exchange lost 9% and the ruble fell by 7%.
August 27	"Black Thursday", the Latin American financial markets fell sharply: In Argentina stocks dropped 10.6% and in Brazil, 10%. The Russian stock market reached an all-time low and the ruble has lost roughly 50% of its value since 17 August. Malaysia and Korea announced that their Gross Domestic Product had fallen for the second quarter running, thereby joining other economies or regions now officially in recession, such as Japan, Thailand, Indonesia and Hong Kong, China.
September 1	Malaysia introduced selective exchange controls to insulate the economy from further deterioration and to regain monetary independence.
September 8	Brazil announced US$3.4 billion in budget cuts for this year.
September 9	Bank of Japan lowered its key interest rate to 0.25%.
September 28	Fourteen banks and securities corporations, coordinated by the Federal Reserve of New York, structured a US$3.625 billion bailout for arbitrage fund Long Term Capital Management.
September 29	Federal Reserve lowered its interest rate by a quarter of a percentage point to 5.25%.
October 15	In a surprise move, the US Federal Reserve lowered the interest rate to 5%.
October 28	Brazil announced a plan that includes spending cutbacks and tax hikes amounting to US$84 billion.
November 10	ECLAC estimated that Latin America would grow by almost 2.6% in 1998.
November 13	Brazil, the world's eighth largest economy, announced a fiscal adjustment plan. Newly elected President Cardoso delivered a letter of intent to the IMF, to apply for a financial aid program to offset the US$30 billion drop in Brazilian reserves.
November 16	An encouragement package for the Japanese economy was announced for a record-breaking sum of US$196 billion.
November 16	The United States and Japan announced a US$10 billion aid plan for Asia.
November 17	The United States Federal Reserve cut its interest rate to 4.74%.

November 23	The Dow Jones closed at an all-time high of 9,374.7 points.
December 3	Concerted interest rate drops in the Euro region. Austria, Belgium, Finland, France, Germany, Ireland, Luxembourg, the Netherlands, Portugal and Spain aligned their rates at 3%.
December 21	Japan announced a 5.3% increase in spending to fight the recession.
December 24	The Duma passed the draft Russian budget for 1999 in the first of four voting sessions.
1999	
January 6	Governor of Minas Gerais and former president Itamar Franco, an opponent of Cardoso, decreed a moratorium on his State's US$12.7 billion debt with the Brazilian Treasury. A political crisis was unleashed and fear is rampant that the powerful states of Rio de Janeiro and Rio Grande do Sul will follow suit.
January 6	Thailand is considering the possibility of privatizing telecommunications, energy and transportation, sectors considered of key significance for the country. This is a new government strategy.
January 10	Unemployment in the United States reached 4.3% in December, a 28-year low, according to figures provided on Friday by the Labor Department.
January 13	The Chairman of the Central Bank of Brazil, Gustavo Franco, announced his resignation "on personal and professional grounds". Successor Francisco Lopes disclosed the establishment of a broader dollar exchange band. The US currency immediately rose to the top of the band, which established limits of 1.20 and 1.32 reals. Currency flight was calculated at US$1.1 billion.
January 14	The Central Bank of Brazil stepped in to maintain its currency within the established limits. Currency flight is now at US$1.8 billion.
January 14	After Gitic, China's second largest intermediation company officially requested to be declared bankrupt, the Government warned the international banking system not to lend funds to Chinese financial institutions without first securing official authorization.
January 14	This Thursday, financial rating agency Standard and Poor's lowered its rating for Brazil's US$58.1 billion long-term dollar debt to B+, and for its US$250 billion local currency debt to BB-. This drop in rating is due to the high cost of loans since debt issues are affected by a higher interest rate.
January 15	The Central Bank of Brazil revoked the limits to the currency exchange band, allowing a clear float for the dollar.

January 21	The Brazilian currency depreciated once again despite Wednesday's legislative victory. The dollar closed at 1.72 reals, up 8.86% since Wednesday.
January 22	The Central Bank of Brazil intervened to defend the real for the first time since Friday the 15th, after its steady devaluation stirred up concerns for the future of Brazil. The dollar closed at 1.72 reals.
February 11	US agency Moody's decided to maintain its risk rating for the Mexican debt after several months discussing a potential lowering of said score.
February 21	The Group of Seven more industrialized economies backed the proposal to create a global forum to allow for the regular exchange of information among the principal financial regulators.
February 25	The Russian 1999 budget act became effective today. This law is a fundamental part of the government's plan to cope with the financial crisis and regain the confidence of foreign investors and the International Monetary Fund. The IMF has refused to resume financial aid for Russia, overburdened by a US$145 billion foreign debt, until it receives accurate information on how the Russian government plans to use said funds.

Chapter 1: Appendix 2

Summary Tables and Figures

Real GDP Growth in the APEC Region
(Percent change per annum except as indicated)

	1992	1993	1994	1995	1996	1997	1998	1999	2000
Western Hemisphere	2.6	2.4	3.7	2.1	3.4	4.1	3.8	3.2	2.3
Canada	0.9	2.3	4.7	2.8	1.7	4.0	3.1	2.6	2.5
Chile	12.3	7.0	5.7	10.6	7.4	7.1	3.4	2.0	4.6
Mexico	3.6	2.0	4.4	-6.2	5.2	7.0	4.8	2.0	3.0
Peru	-1.7	6.4	13.1	7.3	2.4	6.9	0.3	4.5	6.5
United States	2.7	2.3	3.5	2.3	3.5	3.9	3.9	3.3	2.2
Northeast Asia	2.9	2.4	2.5	3.2	5.8	3.1	-0.8	0.5	2.2
China	14.2	13.5	12.6	10.5	9.6	8.8	7.8	6.6	7.0
Hong Kong, China	6.3	6.1	5.4	3.9	4.5	5.3	-5.1	-1.3	3.1
Japan	1.0	0.3	0.6	1.5	5.1	1.4	-2.8	-1.4	0.3
Korea	5.1	5.8	8.6	8.9	7.1	5.0	-5.5	2.0	4.6
Chinese Taipei	6.8	6.3	6.5	6.0	5.7	6.8	4.8	3.9	4.8
Southeast Asia	6.4	7.4	8.1	8.1	7.0	4.5	-5.5	0.6	3.2
Brunei Darussalam	-1.1	0.5	1.8	2.0	3.5	4.0	1.0	0.6	1.5
Indonesia	7.2	7.3	7.5	8.2	7.8	4.9	-13.7	-1.1	3.3
Malaysia	7.8	8.3	9.2	9.5	8.6	7.7	-6.7	0.9	2.0
Philippines	0.3	2.1	4.4	4.7	5.8	5.2	-0.5	2.0	3.0
Singapore	6.2	10.4	10.5	8.7	6.9	7.8	1.3	0.5	4.2
Thailand	8.1	8.3	8.8	8.6	5.5	-0.4	-8.0	1.0	3.0
Viet Nam	0.0	8.1	8.8	9.5	9.3	8.2	5.8	3.5	4.5
Oceania	2.5	4.2	5.3	4.2	3.5	3.3	4.3	3.1	3.2
Australia	2.5	3.8	5.2	4.3	3.6	3.6	5.0	3.1	3.2
New Zealand	0.9	5.1	6.0	4.0	3.2	2.0	-0.3	2.7	3.3
Papau New Guinea	13.8	16.6	5.2	-3.6	3.5	-4.6	2.5	n.a.	n.a.
Russia	-14.5	-8.7	-12.7	-4.0	-3.4	0.9	-4.6	-7.0	0.0
APEC	2.7	2.4	3.1	2.7	4.3	3.7	1.9	2.1	2.3

Source: Member economies, except forecast (IMF)

Increases in CPI in APEC Member Economies
(Percent change per annum)

	1992	1993	1994	1995	1996	1997	1998
Western Hemisphere	3.9	3.5	2.8	4.6	3.9	2.9	2.3
Canada	1.5	1.8	0.2	2.2	1.6	1.6	0.9
Chile	12.7	12.2	8.9	8.2	6.6	6.0	4.7
Mexico	15.5	9.8	7.0	52.0	27.7	15.7	18.6
Peru	56.7	39.5	15.4	10.2	11.8	6.5	6.0
United States	3.0	3.0	2.6	2.8	2.9	2.3	1.6
Northeast Asia	2.7	3.2	3.5	2.3	1.8	2.2	0.9
China	6.4	14.7	24.1	17.1	8.3	2.8	-0.8
Hong Kong, China	9.6	8.8	8.8	9.1	6.3	5.8	2.8
Japan	1.6	1.3	0.7	-0.1	0.1	1.8	0.6
Korea	6.2	4.8	6.2	4.5	4.9	4.5	7.5
Chinese Taipei	4.5	2.9	4.1	3.7	3.1	0.9	1.7
Southeast Asia	4.8	5.9	6.6	6.3	5.5	6.3	21.5
Brunei Darussalam	1.3	4.3	2.4	6.0	2.0	1.7	-0.4
Indonesia	4.9	9.8	9.2	8.6	6.5	10.3	77.6
Malaysia	4.7	3.6	3.7	3.4	3.5	2.7	5.3
Philippines	8.6	7.0	8.3	8.0	9.1	5.9	9.7
Singapore	2.3	2.3	3.1	1.7	1.4	2.0	-0.3
Thailand	4.1	3.3	5.0	5.8	5.9	5.6	8.1
Viet Nam	0.0	5.2	14.4	12.7	4.5	3.6	9.2
Oceania	1.1	1.8	2.0	4.5	2.7	0.4	0.9
Australia	1.0	1.8	1.9	4.6	2.6	0.3	0.9
New Zealand	1.3	1.4	2.8	2.9	2.6	0.8	0.4
Papau New Guinea	4.3	4.9	2.9	17.3	11.6	3.9	10.0
Russia	2609.0	939.9	315.1	231.3	121.8	111.0	184.4
APEC	20.6	15.5	8.7	8.4	6.1	5.5	5.4

Unemployment Rates in the APEC Region
(Percent change per annum)

	1992	1993	1994	1995	1996	1997	1998
Western Hemisphere	6.9	6.6	6.1	6.2	5.8	5.1	4.6
Canada	11.3	11.2	10.4	9.5	9.7	9.2	8.3
Chile	6.7	6.6	7.8	7.4	6.5	6.1	6.2
Mexico	2.8	3.4	3.6	6.3	5.5	3.2	2.8
Peru	9.7	10.3	9.0	7.6	7.0	7.7	7.7
United States	7.5	6.9	6.1	5.6	5.4	4.9	4.5
Northeast Asia	2.3	2.6	2.8	2.9	3.0	3.1	3.3
China	2.3	2.6	2.8	2.9	3.0	3.1	3.1
Hong Kong, China	2.0	2.0	1.9	3.2	2.8	2.2	4.7
Japan	2.2	2.5	2.9	3.2	3.4	3.4	4.1
Korea	2.4	2.8	2.4	2.0	2.0	2.6	6.8
Chinese Taipei	1.5	1.5	1.6	1.8	2.6	2.7	2.7
Southeast Asia	3.5	3.5	4.1	5.4	5.2	5.6	6.0
Brunei Darussalam	4.5	4.1	3.6	4.9	5.0	5.0	5.1
Indonesia	2.7	3.1	4.4	7.2	4.9	4.3	5.1
Malaysia	3.7	3.0	2.9	2.8	2.5	2.7	3.9
Philippines	9.8	9.3	9.5	9.5	8.6	8.7	10.1
Singapore	2.0	1.9	2.0	2.0	2.0	1.8	3.2
Thailand	3.0	2.6	2.6	2.6	2.0	3.5	4.0
Viet Nam	n.a.	n.a.	n.a.	n.a.	6.0	8.5	6.6
Oceania	9.1	9.0	7.9	6.8	6.8	6.9	6.7
Australia	10.8	10.9	9.7	8.5	8.5	8.5	8.0
New Zealand	10.3	9.1	7.4	6.2	6.0	6.7	7.7
Papau New Guinea	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Russia	n.a.	n.a.	7.8	9.1	9.9	11.2	12.3
APEC	3.2	3.3	3.9	4.3	4.3	4.4	4.6

Current Account Balances as a Share of GDP
(Percent change per annum)

	1992	1993	1994	1995	1996	1997	1998
Western Hemisphere							
Canada	-3.6	-3.9	-2.4	-0.8	0.6	-1.8	-2.0
Chile	-2.3	-5.7	-3.1	-2.1	-5.4	-5.3	-6.2
Mexico	-6.7	-5.8	-7.0	-0.6	-0.6	-1.8	-3.8
Peru	-5.0	-5.6	-5.3	-7.3	-5.9	-5.0	-6.0
United States	-0.9	-1.3	-1.8	-1.6	-1.7	-1.8	-2.6
Northeast Asia							
China	1.3	-2.0	1.4	0.2	0.9	3.3	3.0
Hong Kong, China	5.3	7.0	1.2	-4.3	-1.4	-3.5	0.4
Japan	3.0	3.1	2.8	2.1	1.4	2.3	3.2
Korea	-1.5	0.1	-1.2	-2.0	-4.9	-1.9	13.1
Chinese Taipei	4.0	3.2	2.7	2.1	4.0	2.7	1.4
Southeast Asia							
Brunei Darussalam	66.4	62.9	68.6	57.6	50.0	48.9	44.6
Indonesia	-2.2	-1.5	-1.7	-3.4	-3.5	-2.3	3.8
Malaysia	-3.8	-4.8	-6.4	-8.0	-5.1	-5.4	13.7
Philippines	-1.6	-5.5	-4.6	-4.4	-4.8	-5.3	2.0
Singapore	12.0	7.3	16.2	16.9	15.9	15.4	n.a.
Thailand	-5.7	-5.1	-5.6	-8.1	-7.9	-2.0	12.3
Viet Nam	0.0	-7.1	-8.0	-11.0	-10.3	-6.8	-4.1
Oceania							
Australia	-3.7	-3.3	-5.1	-5.4	-3.9	-3.2	-4.8
New Zealand	-2.7	-1.2	-2.2	-3.1	-4.1	-7.1	-6.0
Papau New Guinea	2.2	12.8	10.8	13.6	5.9	-2.4	-1.1
Russia	n.a.	6.9	4.2	2.3	2.8	0.7	1.8

Short-term Interest Rate (%)
(Percent change per annum)

	1992	1993	1994	1995	1996	1997	1998
Western Hemisphere							
Canada	6.7	5.0	5.7	7.2	4.4	3.6	5.1
Chile	5.5	6.5	6.4	6.1	7.3	6.8	9.7
Mexico	16.8	11.8	20.1	48.7	27.3	19.8	n.a.
Peru	117.8	74.1	31.3	28.2	26.5	26.3	37.1
United States	3.5	3.1	4.4	5.7	5.2	5.2	4.9
Northeast Asia							
China	8.1	8.8	9.0	9.0	9.7	7.7	6.3
Hong Kong, China	3.9	3.4	4.8	6.2	5.5	7.1	8.1
Japan	4.4	2.9	2.2	1.2	0.6	0.6	0.7
Korea	16.4	13.0	12.3	12.4	12.4	13.3	15.1
Chinese Taipei	7.2	6.8	6.8	6.7	5.8	6.8	6.8
Southeast Asia							
Brunei Darussalam	6.0	5.8	6.0	6.5	6.5	7.0	5.3
Indonesia	12.0	8.7	9.9	13.6	14.1	30.5	64.1
Malaysia	8.0	6.5	5.5	6.8	7.4	8.7	6.5
Philippines	16.1	12.3	13.6	11.3	12.4	13.1	15.3
Singapore	2.5	2.3	3.6	3.4	3.4	4.1	n.a.
Thailand	7.0	5.5	6.3	10.5	12.0	24.0	3.1
Viet Nam	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Oceania							
Australia	6.5	5.2	5.7	7.7	7.2	5.4	5.0
New Zealand	6.7	6.3	6.7	9.0	9.3	7.7	7.3
Papau New Guinea	8.9	6.3	6.9	17.4	14.4	9.9	21.1
Russia	n.a.	n.a.	n.a.	168.0	85.8	31.5	39.9

Exchange Rate (Local Currency/US$)

	1992	1993	1994	1995	1996	1997	1998
Western Hemisphere							
Canada	1.2	1.3	1.4	1.4	1.4	1.4	1.5
Chile	362.6	404.2	420.2	396.8	412.3	419.3	460.3
Mexico	3.1	3.1	3.4	6.2	7.6	7.9	9.9
Peru	1.3	2.0	2.2	2.3	2.5	2.7	2.9
United States	126.7	111.2	102.2	94.1	108.8	121.0	130.9
Northeast Asia							
China	5.5	5.8	8.6	8.4	8.3	8.3	8.3
Hong Kong, China	7.7	7.7	7.7	7.7	7.7	7.7	7.7
Japan	126.7	111.2	102.2	94.1	108.8	121.0	130.9
Korea	788.4	808.1	788.7	774.7	844.2	1415.2	1207.8
Chinese Taipei	26.2	26.4	26.5	26.5	27.5	28.7	33.5
Southeast Asia							
Brunei Darussalam	1.6	1.6	1.5	1.4	1.4	1.7	1.6
Indonesia	2030.0	2087.0	2200.0	2308.0	2383.0	4650.0	8025.0
Malaysia	2.6	2.7	2.6	2.5	2.5	3.9	3.8
Philippines	25.5	27.1	26.4	25.7	26.2	29.5	40.9
Singapore	1.6	1.6	1.5	1.4	1.4	1.5	n.a.
Thailand	25.4	25.3	25.2	25.0	25.3	31.4	41.4
Viet Nam	n.a.	106040.0	10955.0	10970.0	11100.0	11600.0	13297.0
Oceania							
Australia	6.0	8.2	-7.1	-1.3	5.3	5.2	18.2
New Zealand	1.9	1.8	1.7	1.5	1.5	1.5	1.9
Papau New Guinea	1.0	1.0	1.0	0.8	0.8	0.7	0.5
Russia	0.2	0.9	2.2	4.6	5.1	5.8	9.7

Chapter 2

CRISIS AND RECOVERY IN THE APEC MEMBER ECONOMIES

2. Evolution of Macro and Trade Indicators

The so-called 1997 "Asian crisis" has had a profound impact upon most of APEC Member Economies. Given the outstanding economic performance of several Asian economies, which experienced very high growth rates for a number of years, the Asian Crisis came as a surprise, moreover traditional indicators did not provide any warning signs at all.

The first section of this chapter provides a summary of the trends of key economic indicators which will demonstrate how the various APEC economies have evolved through the Asian crisis period. However, data at the time of printing this document is still not available to provide solid facts related to the crisis recovery. As a close substitute to this exercise, the 1999 Pacific Economic Cooperation Council (PECC) forecasts, supplemented by others when necessary, have been used.

The economic indicators used and the rationale for their selection are the following: (i) Real sector (output and export growth rates) and the external sector (Balance of Payments components) indicators are useful to provide a synthetized view of APEC member economies performance, the crisis impact and their recovery. (ii) External and internal vulnerability indicators are useful to examine the presence of macroeconomic fundamentals failures related to the crisis. (iii) The outcome and consequences of the crisis could be observed by the changes in exchange rates and the effect upon social cost variables (unemployment and real wages).

The following is a summary of the evolution of these key variables:

1. Most APEC member economies had an outstanding economic performance prior to 1997 with high economic growth and very high export growth rates. This situation drastically changed during 1997-98. Several APEC member economies were in recession (two or more quarters of negative growth). There has also been a severe contraction of exports for most.

   However, the worst seems to have passed for many APEC member economies. Today, almost all economies show positive export growth rates, and a few of them are reaching export peak levels.

2. For most APEC member economies, external sector disequilibrium indicators (current account deficit, trade deficit) have not exceeded critical levels.

3. There are several indicators associated with the external vulnerability of an economy. In the recent crisis the following were observed:

   a) The relative magnitude of foreign direct investment and portfolio investment flows received by Asian APEC economies were relatively lower than those going to Latin American APEC economies prior to 1997.

b) In a world where financial flows are much larger than trade flows, the old relative measurement of R* (international reserves) in terms of months of imports are less relevant. In this respect, preliminary findings suggest:

    (i) The level of R* should be in the range of 2.5 to 3.0 times (or higher than) the inflow of financial capital (F_k*). When the indicator F_k*/R* increases over 0.40, then, a developing economy is increasing its (probability of) external vulnerability.

    (ii) When the short run external debt is higher than R*, then, a developing economy is increasing its external vulnerability.

    (iii) In the case of APEC Asian member economies which were hardest hit by the financial crisis, the evolution of the M_2 /R* indicator provides little evidence that local agents strayed away from their domestic currency.

4. Indicators associated to the internal vulnerability of an economy show the following:

    a) Prior to the 1997 crisis, most APEC member economies had relatively low inflation rates (single digit level) and had fiscal budget surpluses. Their internal macroeconomic vulnerability indicators showed no problems. As a consequence of the 1997 crisis, some APEC member economies are today facing deficits (higher than 3% GDP) and only two APEC economies are experimenting sharp increases in their inflation indexes.

    b) There had been a credit boom in Asian APEC member economies prior to 1997. Most Asian APEC economies had annual credit growth rates higher than 19%, and some of them, had credit expansion rates higher than 25% per year. In 1998 there was a drastic reduction in credit growth rates and many economies were subjected to a credit crunch (negative growth rates).

5. The inflow of foreign financial resources generated pressures for the appreciation of the domestic currency. The required adjustment following the 1997 crisis has reversed this appreciation. Using the US dollar as the reference currency, it can be observed that after 1997-98 most APEC economies had real exchanges rates which are higher than those prevailing five years ago (1994).

6. Information related to social cost variables is scarce. Several Asian APEC economies usually had unemployment rates around 2%. At the end of 1998, these same economies had experienced sharp increases in their unemployment figures. Moreover, scarce data and real exchange rate depreciation figures suggest real wages reduction of 10%.

The second section of this chapter provides desegregated shares values for export market destination of APEC member economies. Many APEC economies were exporting similar type of goods to the same markets. The evolution of relative shares of APEC exports to two specific markets, the United States and Japan, could give some indication of international competitive pressures.

In this respect the following is observed:

(a) There are two APEC economies, which had a significant increase in their export share in the United States' market: these were Mexico and China. On the other hand, economies, which had significantly decreased their export share to the U.S. market, were Japan and Chinese Taipei.

(b) China had significantly increased its export share in the Japan market. Economies, which had decreased their export share to Japan, were Korea, Indonesia, Australia, Canada and Chinese Taipei.

(c) Diversification of export market destination has been thought to be a mechanism to reduce external vulnerability. There were a few APEC member economies that have this type of pattern: Chile, China, Indonesia and Peru. However, given the observed results, this export market diversification pattern did not help these economies to neutralize the effect of the Asian crisis.

2.1 Evolution and recovery of selected macroeconomic indicators

In this section, the evolution and recovery of several macroeconomic indicators will be examined. These are real sector, balance of payments, external vulnerability variables, internal vulnerability variables, exchange rates, and social costs.

2.1.1 Real sector

The purpose of this section and the one to follow is to provide a synthetic view of APEC member performance, the crisis impact and its recovery.

(a) Economic (GDP) Growth

Using information of 16 APEC member economies, it could be observed that they experienced the following economic growth (GDP) performance:

(i) Period 1990-96

Seven member economies had average annual growth rates higher than 7%: Chile, China, Indonesia, Korea, Malaysia, Singapore and Thailand. Five member economies had average annual growth rates in the 3% to 6% ranges: Australia, Mexico, China, Peru, the Philippines, Hong Kong, China and Chinese Taipei. The remaining four member economies had positive annual growth rates but lower than 3% year. These were Canada, Japan, New Zealand, and the United States.

(ii) Period 1997-98

Eight member economies showed nil or negative annual growth rates: Indonesia, Japan, Korea, Malaysia, the Philippines, Singapore, Thailand and Hong Kong, China.

Using the 1990-96 (annual) average economic growth as a benchmark, present growth (1998-Q4) and PECC growth forecasts for 1999, an idea of the impact of the crisis upon a given economy can be assessed.

Most APEC economies show positive growth rates forecast for 1999. There are two exceptions for which the 1999 forecast are for negative growth: Russia (-7%) and Indonesia (-3%).

In order to have an idea on the real magnitude of the Asian crisis; we have calculated the 1998 output gap with respect to the previous GDP highest level as a reference indicator. APEC member economies having the largest reduction of GDP were the following (Table 2.1): Indonesia (-15%), Thailand (-8%), Malaysia (-7%), Korea (-6%), Hong Kong, China (-5%), and Japan (-3%).

However, 1999 PECC forecasts show a significant recovery and therefore, the forecast for the GDP gap is reduced in most economies. We can affirm that the worst part of the crisis seems to be over and most of the APEC member economies are recovering from the trough.

(b) Export Growth

Repeating this same type of analysis, but by applying now average export growth (instead of GDP growth), we had information from 18 APEC member economies. Their export growth[1] performance by period was the following:

(i) Period 1990-96

Nine APEC member economies had double digit (higher than 11%) annual export growth rates[2]: China, Korea, Malaysia, Mexico, Papua New Guinea, Peru, Russia, Singapore and Thailand. The remaining nine APEC member economies showed single digit annual export growth rates that were generally higher than 5% year.

(ii) Period 1997-98

All APEC member economies had a contraction (negative growth rates) of exports during this period. There were nine eight APEC member economies showing negative export growth rates in the double-digit range: Australia, Chile, Japan, Malaysia, Papua New Guinea, Peru, Russia and Singapore.

Furthermore, when the most recent quarter was considered (1998-Q4), many APEC member economies had negative export growth rates. Eight APEC member economies showed positive export growth rates: Canada, Korea, Malaysia, Mexico, Peru, the Philippines, the United States, and New Zealand.

[1] Export growth rates refer to constant dollar value of export growth.
[2] If Viet Nam is included, the number of APEC member economies increases to eleven.

Table 2.1.- Economic Growth of Apec Member Economies

(Annual growth rates;%)

	Average Growth 1990-96	Crisis Period, 1997-98: Lowest Quarterly Growth	Crisis Period, 1997-98: Number of Quarters with negative growth	Present Growth 1998-Q4 (Q3)	Present Output Gap 1998 (%GDP 99)	Economic Growth *1999 forecast*	GDP Gap Forecast *1999 (%GDP)*
Australia	3.3	2.2	0	5.0	4.4	2.8	2.9
Brunei	n.a.	n.a	n.a.	n.a.	n.a.	n.a.	n.a.
Canada	1.5	2.1	0	2.1	2.8	3.1	3.0
Chile	9.1	-3.0	1	-3.0	3.2	0.5	0.5
China	10.5	6.8	0	7.8	6.7	7.4	6.9
Hong Kong, China	4.9	-6.8	4	-5.7	-5.4	0.5	-4.9
Indonesia	8.5	-19.5	4	-19.5	-15.5	-2.5	-18.0
Japan	2.7	-3.6	5	0.0	-3.0	0.0	-3.0
Korea	9.0	-6.8	3	-6.8	-5.9	3.5	-2.6
Malaysia	10.4	-8.6	3	-8.6	-7.0	2.0	-5.1
Mexico	3.0	4.3	0	5.0	4.5	2.5	2.4
New Zealand	2.6	-1.2	3	-0.3	-0.3	3.0	2.6
Papua New Guinea	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Peru	4.3	-2.6	2	3.0	0.7	3.2	3.1
Philippines	3.3	-1.9	3	-1.9	-0.5	2.2	2.2
Russia	n.a.	n.a.	n.a.	n.a.	n.a.	-6.5	n.a.
Singapore	10.0	-1.5	2	-1.5	1.5	1.5	1.5
Chinese Taipei	6.3	3.7	0	3.7	4.1	5.0	4.8
Thailand	10.1	0.0	n.a.	0.0	-8.4	0.9	-9.0
United States	2.3	3.5	0	4.1	3.6	3.5	3.4
Vietnam	n.a.	n.a.	n.a.	n.a.	n.a.	4.0	n.a.

Source: IFS, each reporting economy, Pacific Economic Outlook 1999-2000, and Forecast from Goldman & Sachs

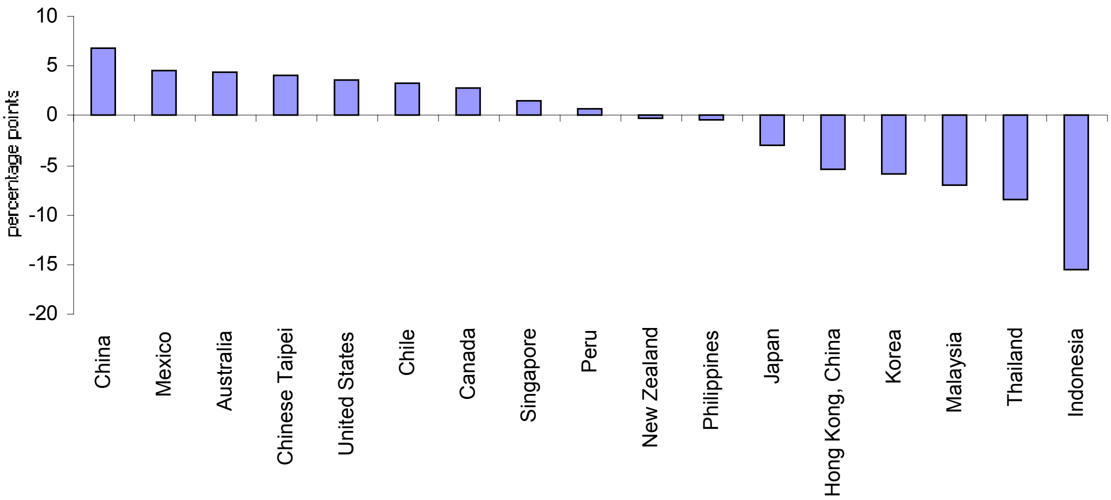
Notes:

(1) Quarterly data corresponds to annual growth rates with respect to the same quarter one year before.

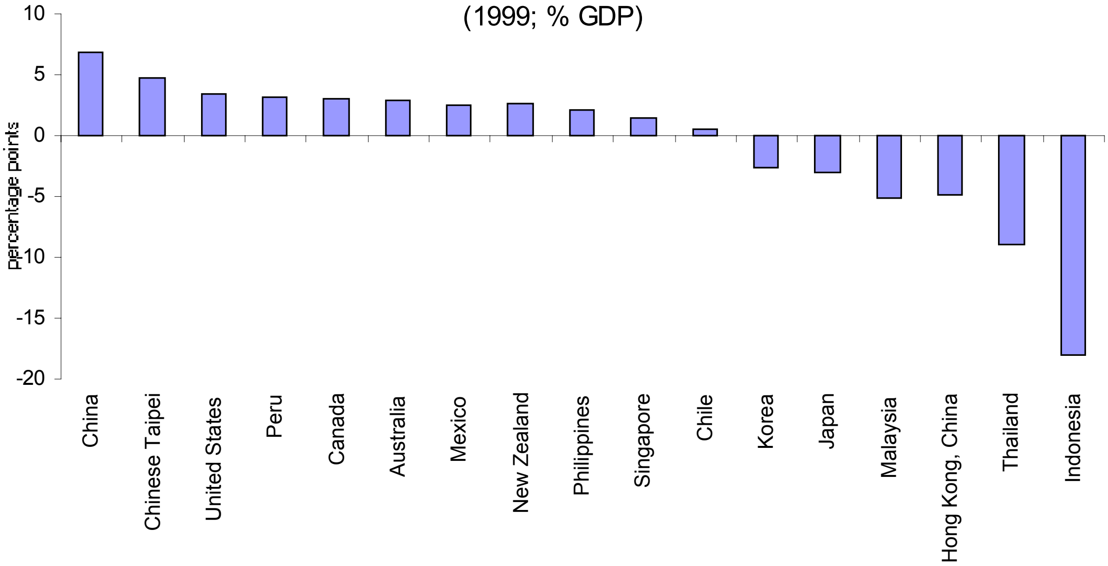
(2) Negative figures correspond to the gap level (%GDP) lower than the previous annual GDP peak level. Positive figures correpond to the %GDP higher thar GDP peak of the crisis year expresed as percetage of 1999's GDP.

(3) Data for Chinese Taipei correspond to Gross national Product.

Graph 2.1a.- Present Output Gap
(1998; % GDP)



Graph 2.1b.- Output Gap Forecast
(1999; % GDP)



Using a measure of the export gap as a reference indicator, which we define as the percentage difference between the level of exports and the previous export peak level, the following is observed in the most recent quarter (1998-Q4) (Table 2.2): There are six negative export gap indicators in the double digit range: Chile, Japan, Peru, Singapore, Papua New Guinea and Russia. There are only four positive export gap indicators: Canada, Mexico, the Philippines, and New Zealand. This means that these four economies already have had export levels higher than in the past.

Considering now the 1999 PECC export forecast, most APEC member economies should show an export improvement performance, and almost all APEC economies show positive export growth rates. At the same time, there are now five APEC economies reaching export peak levels: Canada, New Zealand, Mexico, the Philippines and Thailand, while two APEC economies have negative exports gaps in the double-digit range: Japan and Singapore.

(c) Synthesis

Most APEC member economies had an outstanding economic performance prior to 1997, with high economic growth and very high export growth rates. This situation drastically changed during 1997-98. Several APEC member economies were in recession (two or more quarters of negative growth). Moreover, there was a severe contraction of exports for many APEC member economies.

However, the worst is over for many APEC member economies. Using the quarter export level of the last available data, 1998-IV, we can observe the following. There are four APEC member economies which show the highest export level in their history: New Zealand, Canada, Mexico and United States. There are five APEC member economies whose 1998-IV export level is the third highest in their history (equivalent quarter):, Indonesia, Korea, Peru, the Philippines, and Thailand. Remaining APEC member economies have export levels equivalent to those they had five years ago (1994).

Table 2.2.- Exports Growth of APEC Member Economies
(annual growth rates; %)

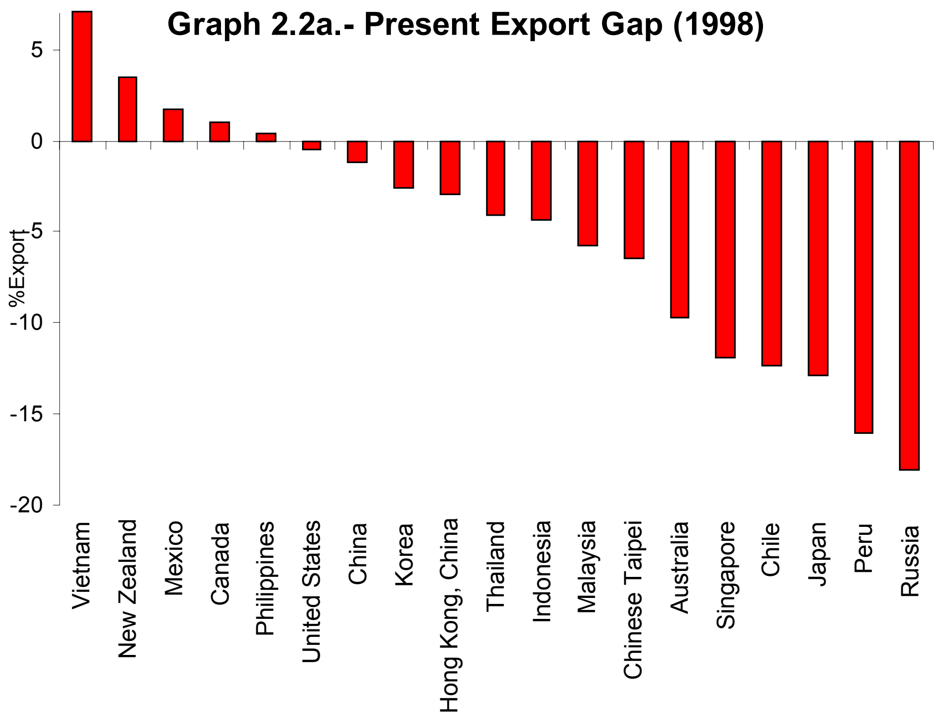
Economies	Average	Crisis Period : 1997 - 1998		Present Growth	Present Export Gap*	Export Growth Forecast	Export Gap Forecast*
	1990-96	Lowest Quarterly Growth	Number of Quarters with Negative Growth	1998 Q4(Q3)	1998Q4 (% Export)	1999	1999 (% Export)
Western Hemisphere							
Canada	6.9	-0.1	1	4.2	1.0	8.5	7.5
Chile	9.6	-19.6	4	-11.2	-12.3	7.0	-5.3
Mexico	13.0	3.8	0	7.1	1.8	7.8	6.9
Peru	11.9	-26.7	3	7.8	-16.0	14.0	-2.2
United States	6.0	-3.1	2	1.5	-0.5	4.8	3.8
Northeast Asia							
China	17.0	-9.7	2	-9.7	-1.2	-7.0	-9.3
Hong Kong, China	12.4	-9.6	3	-9.6	-9.6	-2.9	-7.6
Japan	5.0	-11.0	4	-3.6	-12.9	1.8	-11.3
Korea	10.9	-8.4	3	1.1	-2.6	0.8	-2.1
Chinese Taipei	7.4	-13.0	4	-13.0	-6.5	3.5	-3.3
Southeast Asia							
Brunei Darussalam	-1.9	n.a.	n.a.	n.a	n.a.	n.a.	n.a.
Indonesia	9.1	-8.8	1	-8.8	-4.3	0.2	-4.1
Malaysia	15.6	-11.7	3	7.0	-5.8	0.2	-5.5
Philippines	9.5	1.6	0	1.6	0.4	15.6	13.2
Singapore	13.4	-12.8	6	-9.5	-11.9	1.5	-10.6
Thailand	13.7	-6.4	5	-1.8	-4.1	4.8	0.3
Vietnam	22.8	n.a.	n.a.	n.a	7.1	0.0	0.0
Oceanía							
Australia	4.9	-11.6	4	-7.4	-9.7	5.5	-4.4
New Zealand	6.3	-1.8	1	3.5	3.5	4.2	10.3
Papua New Guinea	14.3	-44.8	6	-10.9	-62.3	n.a.	n.a.
Russia	11.4	-22.1	7	-22.1	-18.0	n.a.	n.a.

Source: IFS, Goldman & Sachs and reporting economies

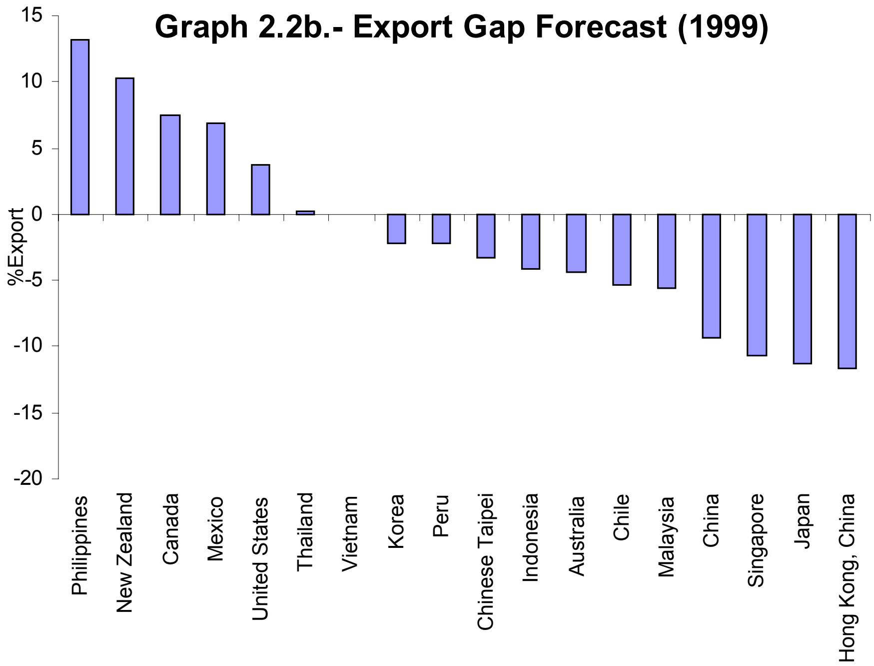
Notes:

(1) Quarterly data growth corresponds to annual growth rates measured with respect to the same quarter one year before.

(*) Negative figures correspond to the gap level (% export) lower than the previous export peak level. Positive figures correspond to the % e
higher than the previous export peak of the crisis year.



Graph 2.2a.- Present Export Gap (1998)
%Export
5
0
-5
-10
-15
-20
Vietnam
New Zealand
Mexico
Canada
Philippines
United States
China
Korea
Hong Kong, China
Thailand
Indonesia
Malaysia
Chinese Taipei
Australia
Singapore
Chile
Japan
Peru
Russia



Graph 2.2b.- Export Gap Forecast (1999)
%Export
15
10
5
0
-5
-10
-15
-20
Philippines
New Zealand
Canada
Mexico
United States
Thailand
Vietnam
Korea
Peru
Chinese Taipei
Indonesia
Australia
Chile
Malaysia
China
Singapore
Japan
Hong Kong, China

2.1.2 Balance of Payments

The current account deficit (CAD) has been considered to be a key indicator of an eventual crisis. The observed pattern of the balance of payments for most developing economies seems to suggest that a current account deficit in the range of 3% to 4% of GDP may be sustainable for a long period of time. CAD higher than 6% (GDP) for more than two years may suggest that a developing economy has to adjust in order to avoid a future balance of payments (or foreign exchange) crisis. However, there have been a few economies showing large CAD for many years without ending in an external sector crisis.

During the 90s most of APEC member economies had CAD below the 6% (GDP) level. Considering the two years prior to 1997, only the following three APEC member economies had CAD higher than 6% (GDP): Thailand, Malaysia and Peru (Table 2.3). On the other hand, there are five APEC member economies showing a current account surplus during most of the 90s: China, Japan, Russia, Singapore, and Chinese Taipei.

In general, APEC member economies, especially those with larger deficits, have reduced their external disequilibrium position during 1997 and 1998. Some APEC member economies like Thailand and Korea show CAD improvements (reductions) equal or higher than 3% (GDP). Most APEC member economies have achieved by 1998 (1997) CAD below 4% (GDP).

A similar situation is observed in the trade balance. During the 90s, specially considering the 1994-96 period, there are nine APEC member economies which show (in general) a trade surplus: Canada, Indonesia, Japan, Malaysia, New Zealand, Papua New Guinea, Russia, and Chinese Taipei. There is only one APEC member economy, the Philippines, which had trade deficits in the double-digit range.

In short, for most APEC member economies, external sector disequilibrium indicators had not exceeded critical levels. On the contrary, many APEC member economies showed persistent positive trade balances and current account surpluses.

Table 2.3.- Trade Balance, Current Account and Capital Account (%GDP)

	Trade Balance			Current Account Balance			Capital Account Balance		
	Largest Deficit (1995-1996)	1997	1998	Largest Deficit (1995-1996)	1997	1998	Largest Superavit (1995-1996)	1997	1998
Western Hemisphere									
Canada	4.4	2.8	2.2	-0.8	-1.5	-2.1	1.0	0.9	0.6
Chile	-1.6	-1.7	-4.3	-5.4	-5.3	-7.2	n.a.	n.a	n.a
Mexico	2.0	0.2	-1.7	-0.7	-1.9	-3.6	n.a.	n.a	n.a
Peru	-3.7	-2.7	-3.9	-7.3	-5.0	-6.0	0.1	-0.1	n.a
United States	-2.5	-2.4	-2.9	-1.8	-1.9	-2.7	0.0	0.0	0.0
Northeast Asia									
China	n.a.	4.5	5.5	n.a.	3.3	3.0	0.0	2.5	0.0
Hong Kong, China	-4.3	-3.5	-0.4	n.a.	-3.7	n.a	n.a.	n.a	n.a
Japan	1.8	2.4	3.1	1.4	2.3	n.a	0.0	-0.1	n.a
Korea	-3.1	-0.7	14.1	-4.7	-1.8	13.5	-0.1	-0.1	n.a
Chinese Taipei	6.5	5.1	4.0	4.0	2.7	1.4	-0.2	-0.1	-0.1
Southeast Asia									
Brunei Darussalam	n.a.	n.a	n.a	n.a.	n.a	n.a	n.a.	n.a	n.a
Indonesia	2.6	4.7	28.3	-3.4	-2.3	8.5	n.a.	n.a	n.a
Malaysia	-0.1	4.0	14.6	-9.7	-4.9	3.5	-0.2	-0.2	n.a
Philippines	-13.7	-13.5	-2.8	-4.8	-5.3	1.1	0.0	0.0	n.a
Singapore	1.1	1.2	17.1	15.9	15.4	19.5	-0.1	-0.2	n.a
Thailand	-5.1	1.0	13.4	-8.0	-2.0	13.3	n.a.	n.a	n.a
Vietnam	n.a.	n.a	n.a	n.a.	n.a	n.a	n.a.	n.a	n.a
Oceania									
Australia	-1.2	0.5	-1.5	-5.6	-3.2	-4.9	0.2	0.2	0.2
New Zealand	0.7	1.2	1.6	-4.1	-7.1	-6.1	8.3	4.2	5.2
Papua New Guinea	n.a.	n.a	n.a	n.a.	n.a	n.a	n.a.	n.a	n.a
Russia	5.4	4.0	2.3	2.3	0.8	0.1	-0.1	-0.2	n.a

Source : IFS (International Financial Statistics), Goldman & Sachs and reporting economies.

2.1.3 External Vulnerability

This section and the next one provide several vulnerability indicators that are useful to examine the presence of macroeconomic fundamental failures related to a crisis.

Financial flows are a key variable related to a financial crisis. In general, financial flows are pro-cyclical. In this way, financial flows may magnify the evolution of the economic cycle.

With the large increase in capital market integration in the 1990s, a broad set of vulnerability indicators has been to be found relevant. In addition, new inter-relationships among these indicators suggest that an isolated examination of some of them (such as measures of relative international reserves) can be highly misleading in terms of providing signals of an impending financial crisis. It should also be noted that in the broader framework of recent studies it has become harder to generalise across a range of countries and therefore to predict financial crises. In part, this is due to the increasing importance of explanations based on informational frictions and herd behaviour as these involve factors that are inherently difficult to predict. The discussion here focuses on some of the major indicators[1].

One possible story is as follows. Liberalization of the capital account ("capital account convertibility") could generate a big inflow of foreign lending; this inflow induces an appreciation of the exchange rate and the expansion of domestic spending. A dynamic reinforcing cycle begins; the sharp increase of domestic expenditure generates excess demand, which stimulates economic growth. But at the same time, there is an increase in the price of non-tradable. Then, currency appreciation and the price increase of non-tradable (houses, offices, land) has a positive effect upon real wealth; each economic agent feels richer and therefore, increases its level of expenditure. And a new spending cycle begins.

Foreign lending provides the basis for the expansion of domestic credit boom. Therefore, when foreign credit is reduced or cut, the whole process is brought to an abrupt stop.

What stops the inflow of financial capital? In some models, foreigners feel that the country's economic growth is weakening, and that there is an increasing probability that there will be a financial crisis (foreign exchange and/or banking crisis). Deterioration of macroeconomic fundamentals plus the outflow of financial capital becomes a self-fulfilling crisis.

There are two types of agents which are involved in a foreign exchange crisis. On one side are foreign creditors who have provided loans to the domestic economy. The type of indicators these agents may watch are related to the relative amount of international reserves (R^*) that the domestic economy has; e.g., the relationship between foreign capital flows (F^*_K) and R^*, and the external debt (D^*) ratio with respect to R^*.

On the other hand, domestic agents are also concerned about a foreign exchange crisis. If the probability of devaluation has increased significantly, it is highly convenient to run away from domestic currency. An indicator showing the potential domestic pressure on foreign exchange

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1 Further examination of these issues in the context of a broader sample of countries can be found in the following studies:
IMF (1998) *Perspectives on the Recent Currency Crisis Literature*, WP/98/130.
IMF (1997) *Leading Indicators of Currency Crises*, WP/97/79.
IMF (1998) *World Economic Outlook*, May edition.

is M_2/R^*, where M_2 is money M_1 (money and checking accounts) plus timedeposits.

Increasing external vulnerability indicators F^*_K/R^*, D^*/R^*, M_2/R^*, should have an increasing trend prior to the crisis. Then, these types of indicators could be used as early signals of an eventual crisis.

In other words, the relative level of international reserves R* becomes a sort of insurance against a financial crisis. This is especially the case for developing economies. Most developed industrial economies, given the depth of their domestic financial capital markets, are not required to have this type of insurance. Graph 2.3 provides the empirical illustration of this situation. Developed industrial countries like the United States, Japan, Canada and Australia have a level of international reserves below 5% (GDP). On the other hand many developing APEC member economies have a level of R* higher than 10% (GDP): Chile, China, Malaysia, Peru, Thailand. There are two outstanding cases where the level of R* is impressively high: Singapore (74% GDP) and Hong Kong, China (53% GDP) (Table 2.4).

The old relative measurement of R* in terms of months of imports is less relevant in a world where financial flows are much larger than trade flows. Therefore, alternative measures like short term capital flows and M_2 related to R* have become the indicators that most economic agents are watching today (see Table 2.4).

Let us now look at financial flows. There are several different types of financial flows: Short-run financial inflows (SRFI) and outflows (SRFO); foreign direct investment (FDI); investment from abroad (IFA) which includes FDI, equity and debt securities liabilities; financial account (FA) which is the net sum of the balance of FDI, portfolio investment and other investment transactions.

In order to examine whether or not Asian economies received a relatively high level of financial flows prior to 1997, we will use the average of Latin American APEC member economies as a benchmark. Considering first, FDI, it is observed the following (Table 2.5): If FDI is measured as a percentage of GDP there are only three Asian APEC member economies having higher values than the Latin American benchmark: China, Malaysia, and Singapore. When FDI is measured as a percentage of exports, only China has a higher value than the Latin American benchmark. Now, when portfolio investment is considered, all Asian APEC economies have figures that are smaller than the Latin American benchmark.

In short, the relative magnitude of foreign direct investment and portfolio investment flows received by Asian APEC economies were relatively lower than those going to Latin American APEC economies prior to 1997.

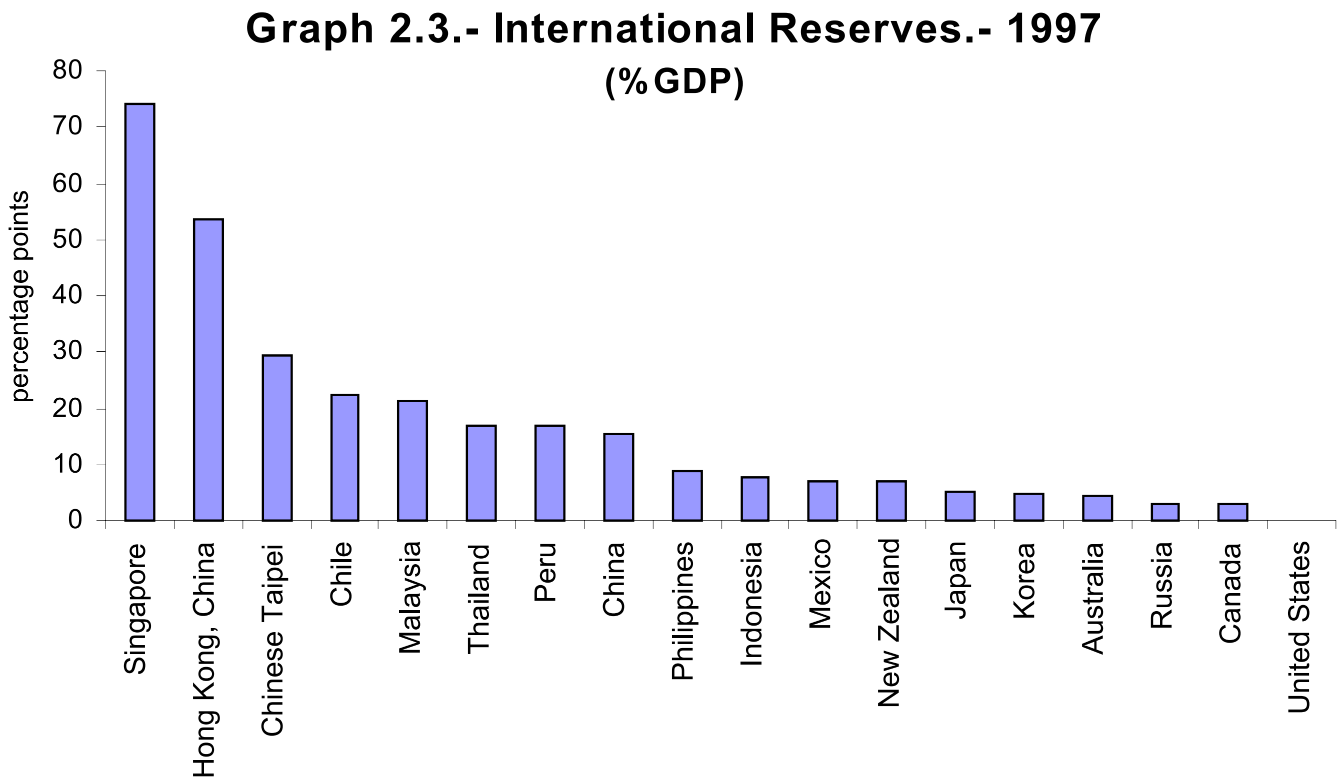
Let us now focus on short run capital flows, F^*_K, and its relative magnitude with respect to international reserves R*.

Considering the APEC member economies, the F^*_K/R^* indicator has the following values: There are three APEC member economies having a negative indicator (that is, these countries provide foreign lending) prior to 1997: Japan, Singapore, and Malaysia. Two of the APEC member economies, which are developed industrial economies, have F^*_K/R^* indicators higher than 1.0: the United States and Australia.

Table 2.4.- International Reserves of APEC Member Economies

	Level (US$ Billions)			Reserves/GDP (%)			Month of Imports			Short Term Capital Flows / Reserves (%)			M_2/ Reserves		
	1996	1997	1998	1996	1997	1998	1996	1997	1998	1996	1997	1998	1996	1997	1998
Western Hemisphere															
Canada	20	18	23	3	3	4	1	1	1	6	31	7	23.2	29.2	24.0
Chile	15	17	16	21	22	n.a.	11	11	11	7	14	n.a.	1.5	1.5	1.7
Mexico	19	29	32	6	7	n.a.	3	3	3	72	15	n.a.	3.1	2.8	2.6
Peru	11	11	10	17	17	n.a.	16	15	14	2	2	n.a.	1.0	1.0	1.2
United States	64	59	71	1	1	1	1	1	1	393	502	253	51.0	59.8	56.0
Northeast Asia															
China	106	140	145	13	15	15	10	13	13	2	5	n.a.	5.1	4.5	5.0
Hong Kong, China	64	93	90	41	53	54	4	5	6	n.a.	n.a.	n.a.	3.9	2.9	3.4
Chinese Taipei	88	84	90	32	29	35	11	9	11	-1	-10	-3	4.4	4.2	4.3
Japan	217	220	215	5	5	6	8	9	10	-19	13	-19	15.8	14.1	13.7
Korea	34	20	52	7	5	n.a.	3	2	7	45	70	n.a.	5.1	8.7	3.1
Southeast Asia															
Brunei Darussalam	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Indonesia	18	17	23	8	8	n.a.	5	4	9	27	-16	n.a.	5.3	5.8	2.1
Malaysia	27	21	26	27	21	n.a.	4	3	5	-1	-1	n.a.	2.5	3.5	2.1
Philippines	10	7	9	12	9	14	4	2	4	53	8	n.a.	3.6	5.7	3.5
Singapore	77	71	75	83	74	n.a.	7	7	9	-11	-15	n.a.	0.8	0.9	0.1
Thailand	38	26	29	20	17	n.a.	7	6	9	9	17	n.a.	3.5	4.8	3.6
Vietnam	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a	n.a	n.a
Oceanía															
Australia	14	17	15	4	4	4	3	3	3	142	67	15	12.8	10.9	11.1
New Zealand	6	4	4	9	7	n.a.	5	4	4	64	5	n.a.	5.5	7.6	0.0
Papua New Guinea	1	0	0	n.a.	n.a.	n.a.	5	3	n.a.	12	-7	n.a.	1.8	3.2	n.a
Russia	11	13	8	3	3	3	n.a.	n.a.	n.a.	86	132	109	2.9	2.6	3.7

Source: IFS


Graph 2.3.- International Reserves.- 1997
(% GDP)
percentage points
80
70
60
50
40
30
20
10
0
Singapore
Hong Kong, China
Chinese Taipei
Chile
Malaysia
Thailand
Peru
China
Philippines
Indonesia
Mexico
New Zealand
Japan
Korea
Australia
Russia
Canada
United States

For the APEC Member developing economies the following could be said as a preliminary observation: The level of R* should be in the range of 2.5 to 3.0 times the inflow of financial capital. When the indicator F^*_K/R^* increases over 0.40, then, a developing economy is increasing its (probability of) external vulnerability. This 0.4 boundary coefficient implies that a sudden flight of short run financial capital would put pressure on less than 40% of international reserves. Using the 1994-96 period this is the case of the following APEC Member (developing) Economies having F^*_K/R^* indicators increasing over 0.40: Indonesia, Korea, the Philippines, Thailand.

A similar analysis could be used with the D*/R* indicator, with a breakdown of short run (less than a year) and total external debt D*. Looking only at developing APEC member economies and using the short run D*/R* indicator in the 1994-96 period, the following is observed: There are four APEC Member (developing) economies having a short run D*/R* indicator higher than 1.0: Indonesia, Korea, Mexico, Thailand (Table 2.6).

With respect to the M_2/R^* indicator, it is interesting to observe what happened in the case of Mexico from 1994 to 1997. During 1994, the M_2/R^* indicator was 12.3; after the Mexican crisis (December 1994) this indicator decreased to the range of 3 to 4. In this case, there is a combination of domestic agents changing their portfolio composition away from domestic currency plus the exchange rate devaluation effect, which explains the reduction of M_2/R^*.

In the case of APEC Asian member economies which were mostly affected by the financial crisis, the following evolution of the M_2/R^* indicator (during 1994-97) is observed: (i) M_2/R^* indicators are in the range of 3.0 to 6.0 for most economies: Indonesia, Malaysia, the Philippines, Thailand; (ii) these indicators increased throughout the 1994-97 period.

The M_2/R^* could also be in general, a useful indicator of the depth of the domestic financial sector (see Graph 2.4). The United States, Japan, Canada and Australia have M_2/R^* indicators higher than 10; this implies that these economies have substantial domestic resources, and do not have an urgent need of foreign resources. The situation is clearly different for most APEC member economies.

Table 2.5.- Comparative Evolution of Financial Flows for Asia and Latin America APEC Member Economies

	Direct Investment (%GDP)									Portfolio Investment (%GDP)								
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1990	1991	1992	1993	1994	1995	1996	1997	1998
Latin America (1)	1.0	1.4	1.1	1.2	3.0	3.4	3.5	3.3	n.a.	-1.1	3.1	4.4	6.0	1.7	-2.5	3.3	1.3	n.a.
Northeast Asia																		
China	0.9	1.1	2.3	4.6	6.2	5.4	5.1	5.0	4.8	-0.1	0.1	0.0	0.5	0.6	0.1	0.2	0.7	n.a.
Hong Kong, China																		
Chinese Taipei	-2.4	-0.4	-0.5	-0.8	-0.5	-0.5	-0.7	-1.0	-1.4	-0.6	0.0	0.2	0.5	0.4	0.2	-0.4	-2.9	-1.1
Japan	-1.6	-0.9	-0.4	-0.3	-0.4	-0.4	-0.5	-0.5	-0.6	0.3	1.3	-0.7	-1.7	-0.6	-0.7	-0.9	0.7	n.a.
Korea	-0.1	-0.1	-0.1	-0.2	-0.4	-0.4	-0.5	-0.4	n.a.	0.0	1.0	1.9	3.0	1.6	2.5	3.1	3.2	n.a.
Southeast Asia																		
Brunei Darussalam																		
Indonesia	1.0	1.2	1.3	1.0	0.8	1.9	2.5	2.1	n.a.	-0.1	0.0	-0.1	1.1	2.2	2.0	2.2	-1.2	n.a.
Malaysia	5.5	8.3	8.9	7.8	6.0	4.8	5.1	5.2	n.a.	-0.6	0.4	-1.9	-1.1	-2.3	-0.5	-0.3	-0.3	n.a.
Philippines	1.2	1.2	0.4	1.6	2.0	1.5	1.6	1.3	n.a.	-0.1	0.2	0.1	-0.1	0.4	1.6	6.4	0.7	n.a.
Singapore	9.5	10.0	1.8	4.3	6.2	3.5	3.6	4.8	n.a.	-2.8	-2.1	5.0	-8.5	-14.1	-9.6	-9.3	-11.3	n.a.
Thailand	2.7	1.9	1.8	1.3	0.6	0.7	0.8	2.2	n.a.	0.0	-0.1	0.8	4.3	1.7	2.4	1.9	2.8	n.a.
Vietnam																		

	Direct Investment (% Exports)									Portfolio Investment (%Exports)								
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1990	1991	1992	1993	1994	1995	1996	1997	1998
Latin America	5.9	9.1	7.8	7.3	15.5	11.8	11.9	13.0	n.a.	-6.6	20.6	30.4	38.0	8.8	-8.7	11.4	5.0	n.a.
Northeast Asia																		
China	5.6	6.1	13.0	30.0	27.9	25.2	27.6	24.8	24.8	-0.4	0.3	-0.1	3.0	2.8	0.5	1.0	3.8	n.a.
Hong Kong, China																		
Chinese Taipei	-5.8	-1.0	-1.3	-2.0	-1.4	-1.3	-1.7	-2.4	-3.2	-1.5	0.1	0.5	1.3	1.0	0.4	-1.0	-6.8	-2.7
Japan	-15.8	-9.1	-4.1	-3.6	-4.0	-5.6	-5.7	-6.1	n.a.	2.9	13.4	-7.6	-18.4	-6.3	-9.1	-10.1	7.7	n.a.
Korea	-0.4	-0.4	-0.5	-0.8	-1.3	-1.4	-1.7	-1.2	n.a.	0.1	4.0	7.1	10.5	4.9	8.9	11.0	10.7	n.a.
Southeast Asia																		
Brunei Darussalam																		
Indonesia	3.7	4.4	4.9	4.1	3.2	7.5	9.9	8.5	n.a.	-0.3	0.0	-0.2	4.5	8.2	8.2	8.9	-5.0	n.a.
Malaysia	6.9	10.0	11.2	8.8	6.0	5.4	6.5	7.1	n.a.	-0.8	0.4	-2.4	-1.2	-2.3	-0.6	-0.3	-0.3	n.a.
Philippines	6.0	5.5	2.0	6.4	7.4	5.3	5.3	3.8	n.a.	-0.6	1.1	0.4	-0.4	1.5	5.8	21.1	2.1	n.a.
Singapore	5.8	6.6	1.1	2.6	3.7	2.3	2.6	4.2	n.a.	-1.7	-1.4	3.2	-5.1	-8.4	-6.5	-6.8	-9.9	n.a.
Thailand	8.2	5.8	5.4	3.5	1.6	2.2	2.5	6.3	n.a.	-0.1	-0.3	2.5	12.3	4.5	7.5	6.3	8.1	n.a.
Vietnam																		

Source: IFS.

(1) Chile, Mexico and Peru

2.1.4 Internal Vulnerability

The classical hypothesis of financial crisis would stress on the one hand the standard internal macroeconomic disequilibrium variables: inflation and the fiscal deficit. On the other hand, the variables pointed out are to boom lending or domestic credit expansion and their eventual consequences: bad loans and (sharp) stock price increases. Let us look separately at each of these variables.

In the two years prior to 1997 (1995-6) there are only three APEC member economies showing inflation rates in the double-digit range: Mexico, Peru and Russia. The majority of APEC member economies has single digit inflation rates, and in general, lowers than 6%. During 1997 and 1998, there are only two economies where the crisis has generated a sharp increase of the inflation rate in the double-digit range: Indonesia and Russia.

The fiscal budget indicators for many APEC member economies were in significant surplus during the years prior to 1997. These economies were Chile, Indonesia, Korea, Malaysia, New Zealand, Peru, the Philippines, Singapore and Thailand. After 1997, several of these countries have significant fiscal deficits (higher than 3% GDP). (In some economies, contingent liabilities—reflecting implicit or explicit government guarantees to the financial system—did rise in the run-up to the crisis.)

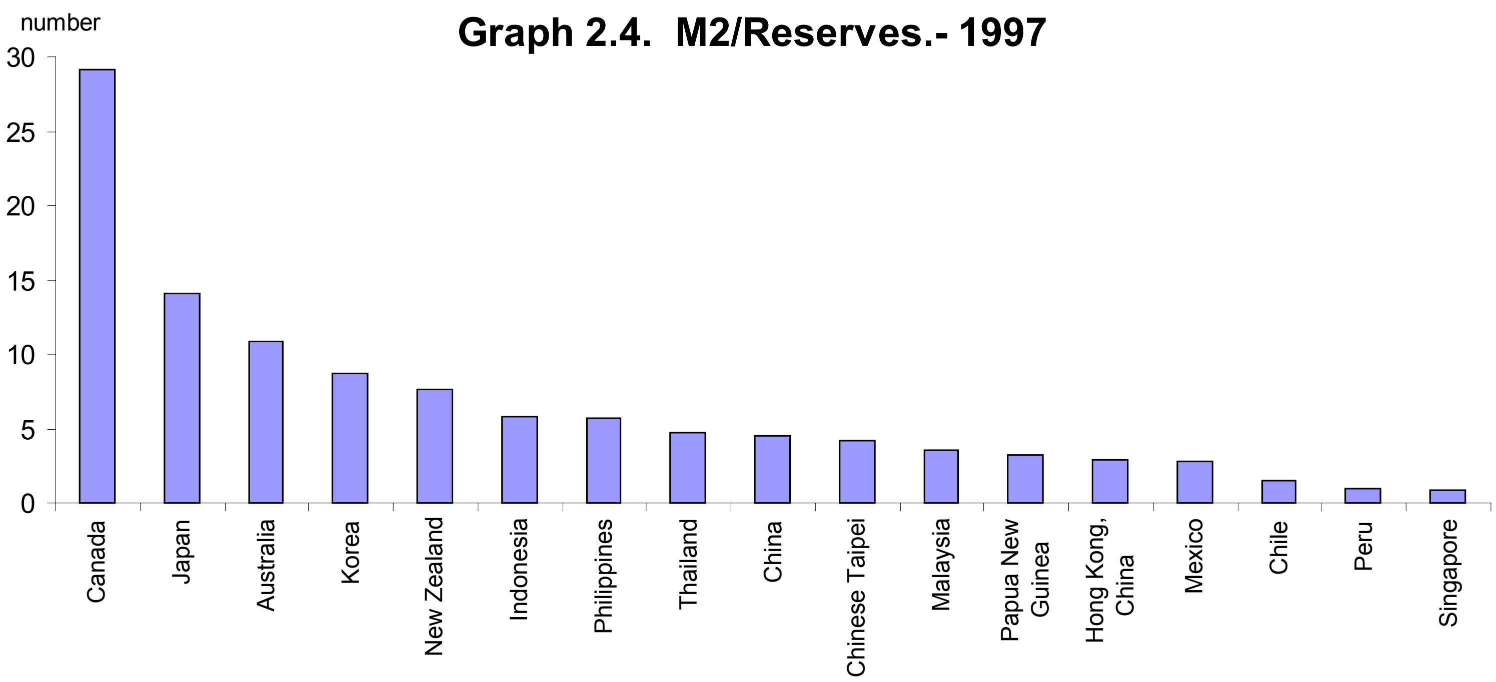
In other words, the internal macroeconomic (vulnerability) indicators, such as inflation and the fiscal balance, did not indicate major problems. As a consequence of the 1997 crisis, there are some APEC member economies facing high fiscal deficits (higher than 3% of GDP), and only two APEC member economies are having a sharp increase in inflation.

A domestic credit boom is a phenomenon that is always present in financial crisis. We will use again the Latin American APEC member economies as a benchmark to compare with the credit expansion of Asian APEC economies; as a second benchmark, three developed non-Asian economies will be used: the United States, Canada and Australia (Table 2.7). We will consider two different periods (see Graph 2.5).

Table 2.6.- External Debt of APEC Member Economies

	Total Debt (US$ Billions)			Total Debt / GDP (%)			Month of Exports			Short Term Debt / Reserves (%)			Total Debt / Reserves		
	1996	1997	1998	1996	1997	1998	1996	1997	1998	1996	1997	1998	1996	1997	1998
Western Hemisphere															
Canada	n.a	n.a	n.a	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Chile	15	21	22	22	27	n.a.	12	15	18	52	61	64	1.0	1.2	1.4
Mexico	60	62	63	18	15	n.a.	8	7	6	138	96	89	3.1	2.1	2.0
Peru	8	10	12	13	15	n.a.	16	17	25	60	62	93	0.8	0.9	1.2
United States	n.a	n.a	n.a	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Northeast Asia															
China	116	131	146	14	15	15	4	4	4	13	13	12	110.7	93.6	100.7
Hong Kong, China	207	212	170	134	122	102	13	12	11	268	181	143	3.2	2.3	1.9
Chinese Taipei	22	26	23	8	9	9	2	3	2	21	26	20	0.3	0.3	0.2
Japan	n.a	n.a	n.a	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Korea	100	94	72	21	21	n.a.	9	8	6	198	292	63	2.9	4.6	1.4
Southeast Asia															
Brunei Darussalam	n.a	n.a	n.a	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Indonesia	56	58	48	24	27	n.a.	13	12	11	188	213	115	3.0	3.5	2.1
Malaysia	22	28	23	22	28	n.a.	3	4	4	41	70	43	0.8	1.3	0.9
Philippines	13	20	18	16	24	27	8	9	7	77	164	107	1.3	2.7	1.9
Singapore	189	195	136	204	202	n.a.	18	19	15	228	251	158	2.5	2.7	1.8
Thailand	70	59	46	38	38	n.a.	15	12	10	121	148	95	1.9	2.2	1.6
Vietnam	2	2	2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Oceanía															
Australia	52	53	60	13	13	16	15	13	14	185	167	214	3.6	3.1	3.9
New Zealand	9	11	11	14	17	n.a.	8	10	11	83	145	167	1.5	2.5	2.6
Papua New Guinea	0	0	0	n.a.	n.a.	n.a.	1	2	4	9	35	62	0.3	0.9	2.1
Russia	57	72	76	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	235	249	442	5.1	5.5	9.7

Source: Member Economies, BIS and IFS


Graph 2.4. M2/Reserves.- 1997
number
30
25
20
15
10
5
0
Canada
Japan
Australia
Korea
New Zealand
Indonesia
Philippines
Thailand
China
Chinese Taipei
Malaysia
Papua New Guinea
Hong Kong, China
Mexico
Chile
Peru
Singapore

(i) Period 1990-96

Latin American APEC economies have an annual average credit expansion of 16%; this rate is higher than 11% for Canada and Australia and only 7% for the United States (when considering the 1994-96 period). In general, the Asian APEC member economies have annual credit growth rates larger than the figures above and in most cases over 19% per year. There are three Asian APEC member economies, which had credit growth rates higher than 25% per year: Malaysia, the Philippines and Thailand.

(ii) Period 1997-98

Focusing specifically on 1998, it is observed that there was generally a drastic reduction in credit growth rates, and in many cases negative credit growth, in part reflecting a credit crunch. Only the United States and Australia have credit growth rates similar to the ones they had in the previous period. Latin American APEC member economies have declining positive annual credit growth rates in the 3% to 5% ranges. Several Asian APEC member economies show negative credit growth rates: Hong Kong, China, Japan, Indonesia, Malaysia, and the Philippines.

There is another interesting difference with respect to domestic credit among the APEC regions. In Latin American economies domestic credit is around 30% GDP. In the three industrial developed economies the following domestic credit percentages % GDP are observed: Australia: 80% of GDP; Canada: 70% of GDP; and the United States: 45% of GDP. On the other hand, in most Asian APEC member economies, domestic credit has a relative level higher than 100% GDP; this is the case of China, Hong Kong, China, Japan, Malaysia, Singapore, and Thailand. Therefore a credit crunch in these last economies should have a deeper contractionary impact (Table 2.7).

In short, there has been a credit boom in Asian APEC member economies prior to 1997; most Asian APEC economies had annual credit growth rates higher than 19%, and some of them, had credit expansion rates higher than 25% per year. Given the relative high level of domestic credit, the credit crunch observed after 1997 should have a deep contractionary effect in these Asian APEC economies.

One of the possible consequences of a credit boom is a sharp increase in the demand for domestic stocks; this excess demand pushes stock prices up. In an environment where the economy is growing in a sustained manner of over 7% per year, exports are annually expanding at double-digit rates, foreigners are anxious to invest, and a stock speculative bubble may develop. Let us then, review the evolution of stock prices prior to 1997 of APEC member economies.

Table 2.7.- Bank Lending to Private Sector of APEC Member Economies

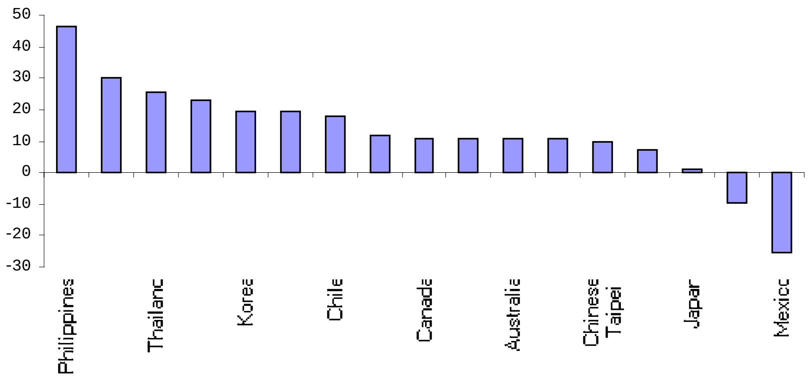
(Annual Growth, %)

	Average Credit Growth (%) 1990-93	Average Credit Growth (%) 1994-96	Credit Growth (%) 1996	Credit Growth (%) 1997	Credit Growth (%) 1998	Credit (%GDP) 1996	Credit (%GDP) 1997	Credit (%GDP) 1998
Latin America	16.2	16.0	2.6	4.7	2.9	30.6	30.9	n.a.
Australia	4.1	10.6	6.5	9.8	10.6	n.a.	80.7	n.a.
Canada	5.8	10.9	10.3	12.3	0.6	64.5	70.1	69.5
United States	0.0	7.0	3.2	7.1	8.3	44.7	46.2	48.5
Northeast Asia								
China	n.a.	n.a.	n.a.	n.a.	n.a.	91.6	101.1	n.a.
Hong Kong, China	22.4	11.1	4.7	5.3	-19.8	328.5	306.6	257.0
Japan	2.0	1.2	1.0	-1.2	-1.0	115.2	114.1	n.a.
Korea	13.8	19.5	14.4	16.8	0.9	61.8	69.8	n.a.
Chinese Taipei	23.4	11.8	8.9	9.2	8.1	164.4	165.2	166.0
Southeast Asia								
Brunei Darussalam	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Indonesia	25.7	19.5	12.5	21.4	-15.6	55.4	61.0	n.a.
Malaysia	15.6	29.9	21.5	23.7	-8.7	93.5	107.6	n.a.
Philippines	15.3	46.3	37.2	22.6	-14.4	49.0	56.5	48.0
Singapore	13.3	22.9	14.2	10.5	8.1	97.3	100.3	n.a.
Thailand	26.3	25.4	8.3	13.4	-12.7	100.0	116.3	n.a.
Vietnam	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

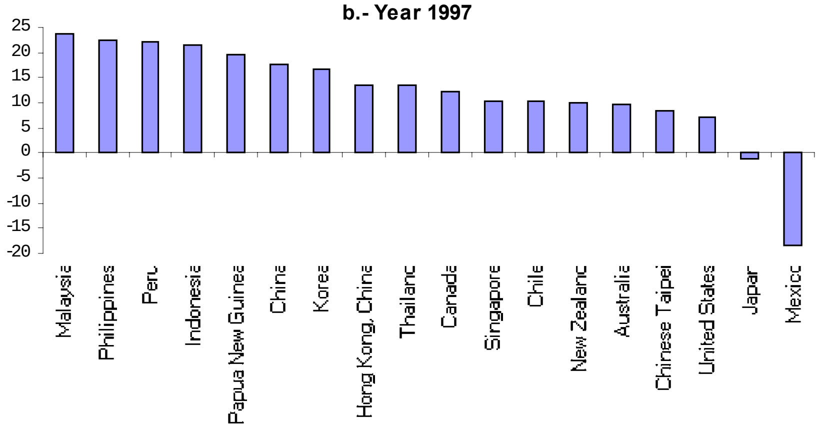
Source: IFS

Graph 2.5.- Real Annual Domestic Credit Expansion (%)

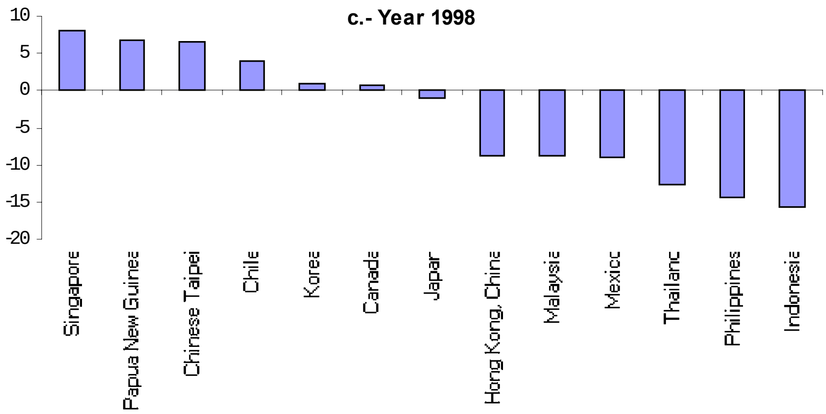
a.- Period (1994-96)



b.- Year 1997



c.- Year 1998



Using the first quarter of 1993 as the starting level, Table 2.8 provides APEC member economies comparative quarter average peak stock level (with respect to 1993-I) prior to year 1997. There are five APEC economies whose stock peak level is more than twice the starting level: Chile, Hong Kong, China, Indonesia, Peru, and the Philippines. Most APEC economies show increases higher than 50% of stock values in around three years: Canada, Korea, Malaysia, Mexico, Singapore, Thailand, Chinese Taipei, and the United States.

Doubling the stock level in a three year span could be considered as a signal of a speculative environment. However, among the five APEC economies showing this type of situation there are two Latin American economies: Chile and Peru; these economies show a doubling of stock levels in a one year span. On the other hand, several Asian economies, which have experienced a severe contraction, are not included in this set of five economies. Therefore, there is evidence in general that stock prices did increase in a fast way, but it would seem that there is not a strong evidence of a speculative bubble in those economies that were hardest hit.

Table 2.8. APEC Member Economies Comparative Quarter Average Peak Stock Level with respect to 1993-I, prior to 1997
(1993-I = 100)
Range of Increase of Peak Stock Level (Quarter Peak Level)

100 – 150	150 – 200	Over 200
Australia (1996-IV) Japan (1996-II) New Zealand (1996-IV)	Canada (1996-IV) Korea (1994-IV) Malaysia (1996-IV) Mexico (1996-IV) Singapore (1996-I) Thailand (1994-IV) Chinese Taipei (1994-IV) United States (1996-IV)	Chile (1994-IV) Hong Kong, China (1996-IV) Indonesia (1996-II) Peru (1996-IV) Philippines (1996-III)

Source: Bloomberg.

Another way to examine the speed of increase of stock levels of APEC economies is to compare their evolution with respect to a benchmark; the U.S. Dow Jones will be used as a benchmark. Prior to year 1995, there are 11 APEC economies whose stock levels increase more than 20% than the rate of increase of the benchmark (U.S. Dow Jones) (see Table 2.9). In fact there are five APEC economies showing a rate of relative increase larger than 40% the Dow Jones rate: Chile, Indonesia, Malaysia, Peru, and Philippines. It is interesting to observe that already in 1995 the stock level of some Asian APEC economies started having slower rates of increase than the Dow Jones; this is specially the case of Thailand and Korea (see Graph 2.6).

Now we will compare the highest and lowest values of stocks during the 1996-98 period (see Table 2.10). The existing evidence shows the following (Table 2.10): (i) There were two APEC member economies where the ratio of the highest and lowest values was higher than five are: Russia and Thailand. (ii) There were three APEC member economies where the ratio of the highest and lowest values was in the 3 to 5 range: Indonesia, Korea, and the Philippines.

It should be pointed out that there has been a recovery of stock values during 1999. In some cases, the percentage recovery with respect to the lowest value is in the triple-digit level

(Korea, Russia); in most cases the percentage recovery with respect to the bottom is more than 50% (see Table 2.10). However, in most Asian APEC economies, the latest 1999 (March) stock levels are still more than 30% below the peak value achieved prior to the crisis (Table 2.10).

There are several Asian APEC economies, which had a sharp stock decline; in a few cases, the evolution of the stock level could be considered to be a leading indicator of a future crisis. However, in many other cases the stock evolution is either coincident or lagging with respect to the economic crisis cycle. This last situation is related to the full surprise that the sudden eruption of the crisis generated. It could be observed that the agencies providing country risk evaluation indicators have changed them only the appearance of the crisis

Table 2.9. APEC Member Economies having Stock Levels Increasing at a higher rate than the United States Stock Exchange

Range of Higher Relative Stock Level Increase

Year	**0 to 20%**	**20% to 40%**	**Over 40%**
1993	Australia	Indonesia	Peru
	Canada	Philippines	
	Hong Kong, China		
	Japan		
	Korea		
	Malaysia		
	Mexico		
	New Zealand		
	Singapore		
1994	Australia	Hong Kong, China	Chile
	Canada	Korea	Indonesia
	New Zealand	Mexico	Malaysia
		Singapore	Peru
		Thailand	Philippines
		Chinese Taipei	
1995	Hong Kong, China		Chile
	Korea	Indonesia	Peru
	Malaysia		Philippines
	Thailand		
1996	Hong Kong, China		Peru
	Indonesia	Chile	
	Malaysia	Philippines	
	Mexico		
1997	Chile		Peru
		Mexico	

Source: Bloomberg.

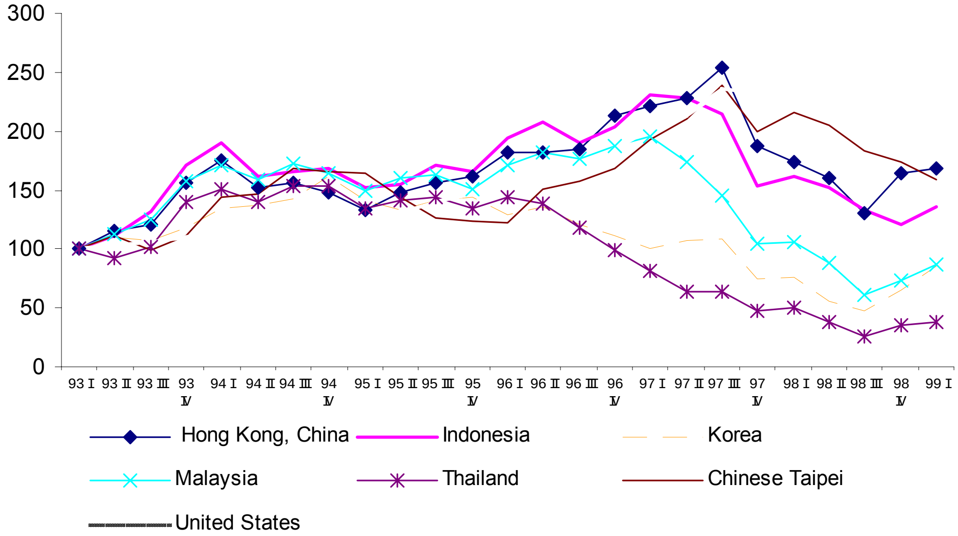
Table 2.10.- APEC Member Economies Stock Market Index Level

	Before Asian Crisis Average Level		Crisis Period		Present Level	After Crisis (March 1999)	
			Highest Value	Lowest Value		Distance to Peak	Recovery from
	1990-93	1994-96	1996-97	1997-98	March 1999	(%)	Bottom (%)
Australia	1597	2126	2779	2299	2967	7	29
Brunei Darussalam	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Canada	3546	4642	7210	5336	6598	-8	24
Chile	41	122	157	71	118	-25	68
China	n.a.	1690	6019	2946	2872	-52	-3
Hong Kong, China	4933	11002	16673	6660	10942	-34	64
Indonesia	379	521	741	257	394	-47	53
Japan	22732	19448	22667	12880	15837	-30	23
Korea	680	911	987	280	619	-37	121
Malaysia	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Mexico	1277	2629	5369	2856	4930	-8	73
New Zealand	1546	2131	2627	1669	2147	-18	29
Papua New Guinea	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Peru	622	1291	2269	1160	1470	-35	27
Philippines	1247	2848	3448	1082	2028	-41	87
Russia	n.a.	185	1142	173	667	-42	286
Singapore	1236	1874	2163	805	1518	-30	89
Chinese Taipei	5056	5930	10117	6251	6882	-32	10
Thailand	844	1286	1415	207	352	-75	70
United States	3105	4681	8259	6392	9786	18	53
Vietnam	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: Member Economies, Bloomberg

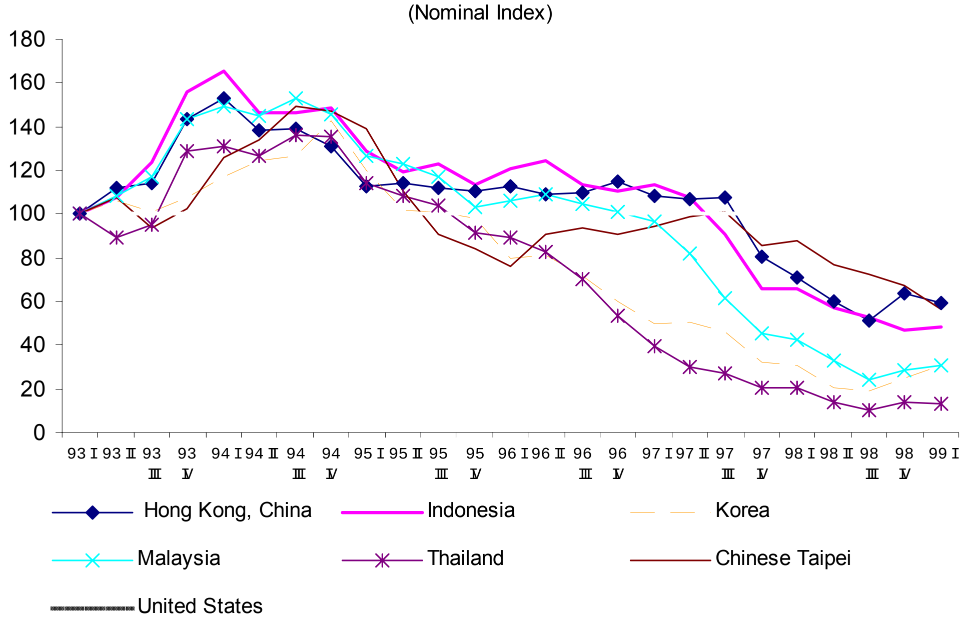
Graph 2.6a.- Comparative Evolution Stock Market

(Nominal Index)



Graph 2.6b.- Normalized to US - Stock Market Evolution

(Nominal Index)



2.1.5 Exchange Rate

The sudden reduction of foreign financial flows generates two distinct but inter-related problems. On one hand, there is an external disequilibrium problem producing a critical foreign exchange bottleneck, while on the internal side, there is a contraction of domestic credit. The local economy has to implement adjustment programs; fiscal, monetary and exchange rate policies become the main policy tools.

To face the foreign exchange bottleneck, several APEC member economies implemented devaluation policies, trying in this way to increase their relative international competitiveness. However, some economies have followed a fixed nominal exchange rate policy pegged to the US dollar: China and Hong Kong, China.

There is a wide dispersion in the range of nominal devaluations of the APEC economies when the average exchange rate of year 1998 is compared with the average exchange rate of year 1997; the US dollar is used as the reference foreign currency. APEC economies having a nominal 1998 exchange rate depreciation higher than 30% than the 1997 exchange rate are (Table 2.11): Indonesia, Korea, Malaysia, the Philippines, Russia, and Thailand. See Table 2.11 for the range of nominal devaluations of other APEC member economies.

Nominal devaluations have an important financial impact; foreign currency debtors are severely hurt. However, from the international competitiveness point of view what really matters is the evolution of the *real* exchange rate; changes in the real exchange rate is the mechanism for generating changes in relative prices, and in this way, stimulating a reallocation of resources.

Therefore, let us examine the present level (1999-I) of the real exchange rate[3] of APEC member economies compared with the one existing before the crisis (1997-II):

(i) There are three economies having a real depreciation higher than 30%: Indonesia, Malaysia and the Philippines. (ii) There are six economies having a real depreciation in the 10% to 30% ranges: Australia, Korea, New Zealand, Peru, Singapore, and Thailand. (iii) On the other hand, four economies have had a real appreciation: China; Hong Kong, China; Japan; and Mexico.

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3 The real exchange rate is measured with respect to the US dollar (in constant terms).

Table 2.11. APEC Member Economies Nominal Devaluation
with respect to the U.S. Dollar
(Exchange Rate 1998 / Exchange Rate 1997)

Fixed Nominal Exchange Rate	**Range of Nominal Devaluation**		
	0 to 10%	**10% to 30%**	**Over 30%**
China Hong Kong, China	Australia Canada Japan Peru	Brunei Darussalam Chile Mexico New Zealand Singapore Chinese Taipei	Indonesia Korea Malaysia Philippines Russia Thailand

Source: IFS

A real depreciation tends to be associated with a reduction of real wages. Then, countries, which have achieved the largest real depreciations, are the ones, which may have incurred the largest social costs.

It is interesting to compare the present level (1999-I) of the real exchange rate with that one prevailing five years ago (1994-I) just before the significant increase of financial inflows. This is the information provided in Table 2.12. The following is observed: (i) there is only one economy, Indonesia that has a real depreciation higher than 30%. (ii) There are four APEC member economies that have real depreciations in the 10% to 30% ranges: Korea, Malaysia, Mexico, and Thailand. (iii) Most APEC member economies have a real depreciation in the 0 to 10% range (see Table 2.12). (iv) On the other hand, there are three APEC economies having real appreciations: China, Chile, and Hong Kong, China.

As it was mentioned previously, the inflow of foreign financial resources generates pressures for the appreciation of the domestic currency. The required adjustment following the 1997 crisis has reversed this appreciation phenomenon. Most APEC economies have now real exchange rates which are higher than those prevailing five years ago (1994).

Table 2.12. Present Level (1999-I) of the Real Exchange Rate of APEC Member Economies Relative to the Level of 1994-I (Real Exchange Rate 1999-I / Real Exchange Rate 1994-I)[1]

Range of Real Appreciation			**Range of Real Depreciation**		
10 to 30%	**Higher than 30%**		**0 to 10%**	**10 to 30%**	**Over 30%**
Chile Hong Kong, China	China		Australia Canada Japan New Zealand Peru Philippines Singapore Chinese Taipei	Korea Malaysia Mexico Thailand	Indonesia

[1] the real rate is measured with respect to the US dollar (in constant terms).
Source: IFS

2.1.6 Social Costs

The reduction of an unsustainable macroeconomic disequilibrium requires adjustment. Economic adjustment implies social costs; i.e., reduction in the standard of living. This is generated by the increase in unemployment and the contraction of real wages. Unfortunately, the information related to these variables is scarce.

Several Asian APEC economies were used to have unemployment rates around 2%. At the end of 1998, these same economies have experienced sharp increases in unemployment. For ex. Korean unemployment has reached 8%. The unemployment rate in Hong Kong, China is 5.7%, while Japan, Singapore and Thailand have unemployment rates around 4.5%.

There is only one economy, Korea, where the existing data shows a real wage reduction of 10% in 1998 with respect to 1997. It should be pointed out that Korean real wages were increasing at 7.5% per year in the 1990-95 period.

In some cases, a real depreciation of the exchange rate may proxy for real wage contraction. Several APEC economies had real deprecations larger than 10%: Indonesia, Malaysia, New Zealand, the Philippines, Thailand, Korea and Singapore.

2.2 Export market destination of APEC member economies

This section provides desegregated share values for export market destination of APEC member economies. In this way it could be observed for each APEC economy its main trade partners as well as the relative increase or decrease of international competitiveness of a given economy.

The two largest APEC economies, the United States and Japan, represent the two most important country markets of destination for most APEC member economies. The evolution of relative shares of APEC exporting economies to these two countries, could be a measure of the relative increase or decrease of international competitiveness of a given economy.

Many APEC economies are exporting similar type of goods to the same markets. The incorporation of China into the world economy could have generated competitive pressures for Asian APEC economies. This is the type of evidence that will be examined in this section.

Table 2.13 provides the evolution of APEC exports member economies to the United States during the 90s. The following is observed. There are two APEC economies which have had a significant increase in their export share in the United States' market: these are Mexico and China. Mexico increased its APEC export share to the U.S. market from 6.1% (1990) to 14.7% (1997), while China's APEC export shares increased from 8.3% (1990) to 12.3% (1997). (It should be noted that China's statistical system for reporting export destinations changed substantially over this period; as a result, these figures may overstate the increase in China's share of exports to the United States and Japan).

On the other hand, economies that had significantly decreased their export share to the U.S. market, are Japan and Chinese Taipei. Japan's export share decreased from 29.7% (1990) to 19.6% (1997), while Chinese Taipei's export share decreased from 7.2% (1990) to 5.0% (1997).

Table 2.14 provides the evolution of APEC exports member economies to Japan during the 90s. The following can be observed: China has significantly increased its APEC export share in the Japan market; its share increased from 15.3% (1990) to 26.9% (1997).

Economies, which had decreased their export share to the Japan market, are Korea, Indonesia, Australia, Canada, and Chinese Taipei. Korea's export share decreased from 20.5% (1990) to 17.4% (1997); Indonesia's export share went down from 12.1% (1990) to 7.9% (1997); Australia's export share decreased from 11.6% to 7.8%; Canada's export share went down from 7.9% to 5.0%; Chinese Taipei's export share decreased from 9.2% to 7.3%.

Table 2.13a.- Exports of Goods of APEC Member Economies to USA (Millions of US$)

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Western Hemisphere	**115,993**	**131,913**	**143,749**	**162,194**	**188,804**	**221,040**	**247,943**	**268,691**	**n.a.**
Canada	95,388	95,744	103,971	116,779	134,229	151,379	163,680	177,011	n.a
Chile	1,453	1,596	1,649	1,655	2,012	2,375	2,560	2,711	2,390
Mexico	18,418	33,912	37,420	43,059	51,855	66,336	80,541	87,379	75,915
Peru	734	661	709	701	708	950	1,162	1,591	1,591
Northeast Asia	**156,481**	**161,006**	**173,574**	**185,197**	**219,041**	**240,158**	**237,093**	**250,346**	**n.a.**
China	5,180	6,190	8,590	6,960	21,460	24,710	26,680	32,690	n.a
Hong Kong, China	19,787	22,349	27,529	31,107	35,131	37,778	38,299	40,874	40,632
Japan	90,322	91,538	95,793	105,405	117,560	120,859	111,943	117,108	n.a
Korea	19,446	18,608	18,090	18,138	20,553	30,404	33,305	30,122	n.a
Chinese Taipei	21,746	22,321	23,572	23,587	24,337	26,407	26,866	29,552	29,376
Southeast Asia	**27,916**	**30,170**	**36,526**	**42,230**	**51,552**	**59,840**	**61,434**	**65,707**	**n.a.**
Brunei Darussalam	76	26	28	29	43	36	46	53	6
Indonesia	3,365	3,509	4,419	5,230	6,179	6,476	6,795	7,520	n.a
Malaysia	4,986	5,808	7,594	9,580	12,448	15,313	14,245	14,625	2,401
Philippines	3,095	3,144	3,832	4,370	5,143	6,160	6,966	8,815	7,560
Singapore	11,170	11,636	13,370	15,034	18,094	21,551	23,010	22,978	21,813
Thailand	5,224	6,046	7,284	7,987	9,549	10,113	10,061	11,341	10,156
Vietnam	0	0	0	0	95	191	311	375	469
Oceanía	**5,799**	**5,536**	**5,865**	**6,848**	**8,615**	**10,108**	**11,958**	**11,532**	**n.a.**
Australia	4,533	4,181	3,775	3,443	3,399	3,430	3,898	4,710	n.a
New Zealand	1,236	1,319	1,335	1,305	1,355	1,484	1,466	1,706	1,761
Papua New Guinea	30	36	61	103	113	102	184	165	103
Russia	n.a	n.a	694	1,998	3,748	5,092	6,411	4,951	n.a
TOTAL	**306,190**	**328,625**	**359,713**	**396,469**	**468,011**	**531,147**	**558,428**	**596,276**	**n.a.**

Table 2.13b.- Share of APEC Exports of Goods to USA (%)

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Western Hemisphere	**37.9**	**40.1**	**40.0**	**40.9**	**40.3**	**41.6**	**44.4**	**45.1**	**n.a.**
Canada	31.2	29.1	28.9	29.5	28.7	28.5	29.3	29.7	n.a.
Chile	0.5	0.5	0.5	0.4	0.4	0.4	0.5	0.5	n.a.
Mexico	6.0	10.3	10.4	10.9	11.1	12.5	14.4	14.7	n.a.
Peru	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	n.a.
Northeast Asia	**51.1**	**49.0**	**48.3**	**46.7**	**46.8**	**45.2**	**42.5**	**42.0**	**n.a.**
China	1.7	1.9	2.4	1.8	4.6	4.7	4.8	5.5	n.a.
Hong Kong, China	6.5	6.8	7.7	7.8	7.5	7.1	6.9	6.9	n.a.
Japan	29.5	27.9	26.6	26.6	25.1	22.8	20.0	19.6	n.a.
Korea	6.4	5.7	5.0	4.6	4.4	5.7	6.0	5.1	n.a.
Chinese Taipei	7.1	6.8	6.6	5.9	5.2	5.0	4.8	5.0	n.a.
Southeast Asia	**9.1**	**9.2**	**10.2**	**10.7**	**11.0**	**11.3**	**11.0**	**11.0**	**n.a.**
Brunei Darussalam	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	n.a.
Indonesia	1.1	1.1	1.2	1.3	1.3	1.2	1.2	1.3	n.a.
Malaysia	1.6	1.8	2.1	2.4	2.7	2.9	2.6	2.5	n.a.
Philippines	1.0	1.0	1.1	1.1	1.1	1.2	1.2	1.5	n.a.
Singapore	3.6	3.5	3.7	3.8	3.9	4.1	4.1	3.9	n.a.
Thailand	1.7	1.8	2.0	2.0	2.0	1.9	1.8	1.9	n.a.
Vietnam	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	n.a.
Oceanía	**1.9**	**1.7**	**1.6**	**1.7**	**1.8**	**1.9**	**2.1**	**1.9**	**n.a.**
Australia	1.5	1.3	1.0	0.9	0.7	0.6	0.7	0.8	n.a.
New Zealand	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	n.a.
Papua New Guinea	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	n.a.
Russia	n.a.	n.a.	0.2	0.5	0.8	1.0	1.1	0.8	n.a.
TOTAL	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**n.a.**

Source: IFS (International Financial Statistics) and reporting economies.

Table 2.14a.- Exports of Goods of APEC member Economies to Japan (Millions of US$)

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Western Hemisphere	**59,055**	**57,585**	**56,807**	**57,042**	**64,067**	**77,467**	**80,077**	**77,912**	**n.a.**
Canada	7,135	6,249	6,199	6,585	7,142	8,788	8,221	8,050	n.a
Chile	1,399	1,644	1,707	1,502	1,976	2,906	2,496	2,676	1,799
Mexico	1,506	1,241	794	700	988	928	1,363	1,156	692
Peru	436	326	295	361	474	501	390	480	193
United States	48,580	48,125	47,813	47,893	53,487	64,344	67,607	65,550	n.a
Northeast Asia	**40,602**	**45,866**	**46,238**	**41,732**	**65,628**	**84,804**	**87,827**	**82,832**	**n.a.**
China	9,010	10,250	11,680	5,780	21,580	28,460	30,890	31,820	n.a
Hong Kong, China	4,680	5,307	6,260	6,959	8,437	10,594	11,829	11,414	9,119
Japan	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Korea	18,574	21,120	19,458	20,016	25,390	32,606	31,449	27,907	n.a
Chinese Taipei	8,338	9,189	8,894	8,977	10,221	13,157	13,659	11,691	9,324
Southeast Asia	**26,875**	**29,780**	**30,475**	**33,146**	**37,285**	**45,713**	**48,921**	**47,351**	**n.a.**
Brunei Darussalam	1,285	1,543	1,233	1,287	1,079	1,220	1,269	1,279	306
Indonesia	10,923	10,767	10,761	11,172	11,465	12,348	12,885	12,707	n.a
Malaysia	4,506	5,458	5,401	6,113	7,010	9,199	10,484	9,882	1,507
Philippines	1,616	1,763	1,738	1,817	2,024	2,742	3,668	4,192	3,242
Singapore	4,580	5,115	4,823	5,521	6,771	9,218	10,251	8,839	7,224
Thailand	3,965	5,134	5,685	6,299	7,756	9,525	9,417	8,837	6,177
Vietnam	0	0	834	937	1,179	1,461	947	1,615	1,481
Oceanía	**12,349**	**13,459**	**14,252**	**14,699**	**16,218**	**18,349**	**17,682**	**17,886**	**n.a.**
Australia	10,502	11,546	10,844	10,618	11,701	12,282	12,187	12,503	n.a
New Zealand	1,496	1,552	1,460	1,520	1,699	2,269	2,188	2,169	1,663
Papua New Guinea	351	361	379	557	550	626	403	280	142
Russia	n.a	n.a	1,569	2,005	2,267	3,173	2,905	2,935	n.a
TOTAL	**138,881**	**146,690**	**147,772**	**146,619**	**183,198**	**226,333**	**234,507**	**225,981**	**n.a.**

Table 3.14b.- Share of APEC Exports of Goods to Japan (%)

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Western Hemisphere	**42.5**	**39.3**	**38.4**	**38.9**	**35.0**	**34.2**	**34.1**	**34.5**	**n.a.**
Canada	5.1	4.3	4.2	4.5	3.9	3.9	3.5	3.6	n.a.
Chile	1.0	1.1	1.2	1.0	1.1	1.3	1.1	1.2	n.a.
Mexico	1.1	0.8	0.5	0.5	0.5	0.4	0.6	0.5	n.a.
Peru	0.3	0.2	0.2	0.2	0.3	0.2	0.2	0.2	n.a.
United States	35.0	32.8	32.4	32.7	29.2	28.4	28.8	29.0	n.a.
Northeast Asia	**29.2**	**31.3**	**31.3**	**28.5**	**35.8**	**37.5**	**37.5**	**36.7**	**n.a.**
China	6.5	7.0	7.9	3.9	11.8	12.6	13.2	14.1	n.a.
Hong Kong, China	3.4	3.6	4.2	4.7	4.6	4.7	5.0	5.1	n.a.
Japan	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Korea	13.4	14.4	13.2	13.7	13.9	14.4	13.4	12.3	n.a.
Chinese Taipei	6.0	6.3	6.0	6.1	5.6	5.8	5.8	5.2	n.a.
Southeast Asia	**19.4**	**20.3**	**20.6**	**22.6**	**20.4**	**20.2**	**20.9**	**21.0**	**n.a.**
Brunei Darussalam	0.9	1.1	0.8	0.9	0.6	0.5	0.5	0.6	n.a.
Indonesia	7.9	7.3	7.3	7.6	6.3	5.5	5.5	5.6	n.a.
Malaysia	3.2	3.7	3.7	4.2	3.8	4.1	4.5	4.4	n.a.
Philippines	1.2	1.2	1.2	1.2	1.1	1.2	1.6	1.9	n.a.
Singapore	3.3	3.5	3.3	3.8	3.7	4.1	4.4	3.9	n.a.
Thailand	2.9	3.5	3.8	4.3	4.2	4.2	4.0	3.9	n.a.
Vietnam	0.0	0.0	0.6	0.6	0.6	0.6	0.4	0.7	n.a.
Oceanía	**8.9**	**9.2**	**9.6**	**10.0**	**8.9**	**8.1**	**7.5**	**7.9**	**n.a.**
Australia	7.6	7.9	7.3	7.2	6.4	5.4	5.2	5.5	n.a.
New Zealand	1.1	1.1	1.0	1.0	0.9	1.0	0.9	1.0	n.a.
Papua New Guinea	0.3	0.2	0.3	0.4	0.3	0.3	0.2	0.1	n.a.
Russia	n.a.	n.a.	1.1	1.4	1.2	1.4	1.2	1.3	n.a.
TOTAL	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**n.a.**

Source: IFS (International Financial Statistics) and reporting economies.

It should be pointed out that for a majority of Asian APEC member economies, the most important export market destination is the Asian region (even excluding Japan); table 2.15 provides this information for year 1996 (prior to the crisis). Given the Asian regional focus of the 1997 crisis, it could be argued that those economies whose exports have as a main market destination the Asian region, would be relatively more affected by the crisis. APEC economies whose Asian (excluding Japan) APEC export market destination share is higher than 40% are (Table 2.15): Hong Kong, China, Japan, Chinese Taipei, Malaysia, Singapore, Viet Nam, Australia, and Papua New Guinea.

The United States has been an APEC economy, which has had a relatively high growth during the 1998-99 period, quite the opposite of Japan. It can be argued that APEC member economies whose main export market destination is the United States should today be experimenting a good export (and economic) performance. There are two economies where the United States represents an export share higher than 80%: Canada and Mexico. The third economy is the Philippines where this share is over 30% (Table 2.15).

Diversification of export market destination has been thought to be a mechanism to reduce external vulnerability. There are a few APEC member economies, which show this type of pattern (Table 2.15): Chile, Peru, China, Korea, and Indonesia. However, given the observed results, this export market diversification pattern has not been much help to neutralize the impact of the Asian crisis.

Table 2.15.- Main Export Shares of Apec Member Economies (Year 1996; %)

	United States	Japan	America Apec	Asia Apec	EU	Rest of the world	**Total**
Western Hemisphere							
Canada	80.9	4.1	0.7	4.6	5.7	4.0	100.0
Chile	16.6	16.2	4.0	16.8	23.9	22.5	100.0
Mexico	83.8	1.4	3.2	1.2	3.7	6.8	100.0
Peru	19.7	6.6	6.4	17.0	26.6	23.7	100.0
United States		11.0	32.2	18.0	20.9	17.9	100.0
Northeast Asia							
China	17.2	19.9	1.6	35.3	15.4	10.7	100.0
Hong Kong, China	21.2	6.5	1.9	46.6	14.9	8.8	100.0
Japan	27.3		2.4	44.8	15.4	10.1	100.0
Korea	22.6	21.3	3.0	19.6	14.4	19.1	100.0
Chinese Taipei	23.0	11.7	1.9	41.5	13.5	8.4	100.0
Southeast Asia							
Brunei Darussalam	1.9	53.5	0.0	21.1	17.6	5.9	100.0
Indonesia	13.7	26.0	1.2	35.2	15.0	9.0	100.0
Malaysia	18.2	13.4	1.0	45.5	13.7	8.1	100.0
Philippines	33.9	17.9	1.4	26.2	17.9	2.7	100.0
Singapore	18.4	8.2	0.7	49.5	13.0	10.1	100.0
Thailand	18.0	16.8	1.3	34.4	15.9	13.5	100.0
Vietnam	4.1	12.4	0.7	53.7	11.1	18.0	100.0
Oceania							
Australia	6.5	20.2	2.1	46.8	10.9	13.5	100.0
New Zealand	10.2	15.3	2.3	43.1	14.6	14.5	100.0
Papua New Guinea	6.8	15.0	0.0	51.0	16.7	10.5	100.0
Russia	7.6	3.5	0.2	8.7	32.4	47.7	100.0
Total	**22.9**	**9.6**	**9.4**	**29.1**	**15.7**	**13.3**	**100.0**

Source: IFS (International Financial Statistics) and reporting economies.

AUSTRALIA

The Australian economy performed strongly in 1998, despite difficult trading conditions in Asia and uncertainty in the world economy. Strong economic growth was accompanied by solid gains in employment and low inflation.

REAL GDP GROWTH

Real GDP increased by 5.1% in 1998 following 3.6% growth in 1997. Growth was consistently strong, with Australia recording five consecutive quarters of growth of 1.0% or higher up to the December quarter 1998.

Business investment rose by 7.1% in 1998, the sixth year of strong growth. However, business investment slowed through the year, and fell by 2.4% over the year to the December quarter. Falls in investment were driven predominantly by slower investment in the resources sector, which has been hit by the weak world trading environment. However, the recovery of business confidence to pre-Asian crisis levels, coupled with low nominal and real interest rates and sound corporate profits provides a supportive investment environment.

Dwelling investment rose by 9.6% in 1998 after 14.7% growth in 1997, reflecting low interest rates and high levels of housing affordability.

Private consumption rose by 4.3% in 1998, following 3.4% growth in 1997. The strength in consumption reflected low interest rates, solid employment growth and rising household wealth.

Underlying public final demand rose by 3.3% in 1998 after rising by 2.3% in 1997. This outcome reflected strong increases in public consumption in 1998, which rose by 5.5%.

INFLATION

Australia achieved an exceptionally good inflation performance in 1998, with the consumer price index (CPI) rising by 1.6% through the year to the December quarter 1998. Continuing low inflation despite a significant decline in the Australian dollar reflected continuing competitive pressures in the Australian economy and in the world.

EMPLOYMENT

The unemployment rate fell significantly towards the end of 1998 to reach 7.6% in December 1998. Employment grew by 2.1% through the year to December 1998.

Wages, as measured by average weekly ordinary-time earnings for full-time adults, rose by 4.2% through the year to the December quarter 1998. Average weekly earnings (all employees), however, rose by 1.9% through the year to the December quarter 1998.

CURRENT ACCOUNT

The current account deficit rose to 5.0% of GDP in 1998 from 3.1% in 1997. This reflected a deterioration in the balance of trade, coming from weak exports and poorer terms of trade.

The onset of economic difficulties in several East Asian economies in 1997 meant that export demand remained subdued while import demand was solid due to ongoing strong domestic demand. A feature of Australia's export performance in the first half of the economic downturn in East Asia was a significant diversion of exports, particularly commodities, away from the troubled East Asian economies and toward faster growing economies elsewhere.

Unlike previous episodes in Australia when the current account deficit has increased significantly as a percentage of GDP, growth in the net income deficit has been subdued.

FOREIGN INVESTMENT

Net external debt was 41.0% of GDP (or US$145.4 billion) at the end of December 1998, below the peak of 41.9% at the end of December 1992. The public sector accounts for approximately 21% of this total, while approximately 79% of Australia's net foreign debt is owed by business/private sector borrowers. The build-up in foreign debt is a result of ongoing current account deficits reflecting a structural saving-investment imbalance. This is being addressed through fiscal policy focussing on reducing the public sector's call on national saving while other policies have been implemented to improve the efficiency and effectiveness of investment.

Gross external debt was 61.3% of GDP (or US$208.1 billion) at the end of September 1998.

Foreign direct investment in Australia was 28.3% of GDP (or US$96.2 billion) at the end of September 1998.

EXCHANGE RATE

Since 1983, Australia has had a floating exchange rate. The Reserve Bank may undertake foreign exchange market operations when the market threatens to become excessively volatile or when the exchange rate has clearly 'overshot' a level consistent with underlying economic fundamentals. However, these operations are invariably aimed at stabilizing market conditions and are not undertaken in accordance with a specific exchange rate target.

The Australian dollar depreciated (in nominal terms) during 1998 by 6% against the US dollar and by 14% against the Japanese yen. On a trade-weighted basis, the Australian dollar depreciated by around 11% in 1998, with falls against most major currencies. The Australian dollar depreciating against some of the East Asian currencies during 1998, as these currencies regained some ground.

FISCAL POLICY

Total General Government net lending returned to surplus in the 1997-98 financial year (data is not available on a calendar year basis). This improvement was mainly due to the elimination of the Commonwealth Government's fiscal deficit. Further improvement is expected in 1999-2000, with the Commonwealth Government expected to record a fiscal surplus of 0.8% of GDP.

MONETARY POLICY

The Reserve Bank of Australia has the primary responsibility for the conduct of monetary policy. The formal objectives of monetary policy require the Reserve Bank Board to conduct monetary policy in a way that will best contribute to price (currency) stability, the maintenance of full employment, and the economic prosperity and welfare of the people of Australia. Price stability is regarded as a precondition for achieving the last two objectives and in pursuit of this goal the Reserve Bank has a commitment to hold inflation to between 2% and 3%, on average, over the course of the economic cycle.

In pursuit of this objective, the Reserve Bank targets a publicly announced overnight cash rate target (the intermediate objective) which is determined by the Reserve Bank Board. The Reserve Bank Board does not target intermediate financial aggregates. Between mid 1996 and December 1998, six reductions in the target cash rate were announced, leading to a 2.75% fall in the overnight cash rate to a target of around 4.75%.

Falling nominal overnight cash rates contributed to real short-term (overnight) interest rates (as deflated using the underlying rate of inflation) falling by around 30 basis points during 1998. The fall in real short-term interest rates in 1998 was similar (in magnitude) to that recorded in 1997, when a 100 basis point reduction in the overnight cash rate underpinned reductions in real short-term interest rates. Lower nominal long-term interest rates have underpinned reductions in real long-term interest rates of around 100 basis points in 1998 and 70 basis points in 1997.

MEDIUM-TERM OUTLOOK

(Forecasts for the Australian economy are only available on a July to June financial year basis)

The outlook for the Australian economy is for continued solid growth and low inflation. Following very strong growth in 1997-98 and 1998-99, growth will slow somewhat to around 3% in 1999-2000 in light of the weak world economy. Solid domestic economic growth is expected to be underpinned by private consumption resulting from rising household wealth and continuing solid employment growth.

After six years of strong growth, growth in business investment is expected to be flat in 1999-2000 reflecting the maturity of the investment cycle and below-trend world growth. Nevertheless, business investment is expected to be around its long-term average share of GDP.

The outlook is for the current account deficit to decline moderately in 1999-2000 due to a gradual pick-up in growth in Australia's export markets and a slight increase in the terms of trade.

Inflation is expected to stay subdued. The consumer price index (CPI) is expected to increase by 2% in 1999-2000.

MAIN STRUCTURAL REFORMS

Tax Reform

The Australian Government is implementing a program to reform the taxation system. The program addresses indirect taxes, personal income taxation, the welfare system and business taxation, and will involve changes to the financial relations between the Federal Government and the States and Territories. The new tax system will begin in July 2000, subject to the necessary legislative changes.

Financial Sector Reform

The Australian Government is implementing a program to reform the financial system. Stage I of the reform program, which included the rationalization of the regulatory structure, initiatives to balance prudential and competition objectives, and moves to promote efficiency, competition and confidence in the payments system, has been implemented. Stage II is now in the process of being implemented, the major objective of which is to facilitate the transfer of State and Territory regulated financial institutions to the Commonwealth's regulatory regime.

Corporate Sector Reform

The Corporate Law Economic Reform Program is modernizing Australia's Corporations Law and giving it an economic focus by introducing world's best practice in business regulation. The program is addressing reform of regulatory requirements regarding fundraising, takeovers, directors' duties, corporate governance, financial reporting and conduct and disclosure practices in financial markets. The focus is on providing the regulation necessary for well-functioning markets, without compromising efficiency.

Competition Policy

Australia has a sophisticated and cohesive competition policy which has undergone significant development in recent years. The policy is based on the recommendations in the 1993 Hilmer Report, which followed a comprehensive review of competition policy in Australia. The national competition policy consists of six elements.

1. Universal application of the competitive conduct rules contained in the Trade Practices Act 1974 to all sectors of the Australian economy including government business activities and those of the unincorporated sector (e.g., the professions).

2. The review of legislation which restricts competition to ensure that such restrictions are necessary to achieve the objects of the legislation and that there is a net benefit to the community as a whole as a result of the restriction.

3. Structural reform of public monopolies where a government has decided to introduce competition or undertake privatisation.

4. Enabling access to services provided by means of significant infrastructure facilities.

5. Price oversight of government businesses with a high degree of market power.

6. Competitive neutrality principles which state that government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership.

Australia: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	307.2	297.5	338.6	363.9	406.6	405.7	365.1
Real GDP	2.5	3.8	5.2	4.3	3.6	3.6	5.0
Total Consumption	2.3	1.3	4.0	4.5	2.9	3.4	3.8
Private Consumption	2.7	1.7	4.0	5.0	3.0	3.5	4.4
Government Consumption	0.9	0.4	3.9	3.1	2.8	3.2	2.0
Total Investment	2.8	4.7	13.1	3.2	5.3	11.3	4.8
Private Investment	5.1	7.3	14.8	4.3	7.2	13.4	7.7
Government Investment	-3.5	-3.2	7.2	-0.8	-2.9	2.8	-8.4
Exports of Goods and Services	5.3	8.0	8.9	5.1	10.5	11.7	-0.8
Imports of Goods and Services	7.0	4.1	14.1	7.9	8.2	10.0	6.0
Fiscal and External Balances (% of GDP)							
Budget Balance (1)	-4.1	-5.0	-4.2	-3.0	-1.7	-0.6	0.2
Merchandise Trade Balance (f.o.b.)	-0.3	-0.5	-1.3	-1.4	-0.2	0.4	-1.7
Current Account Balance	-3.7	-3.3	-5.1	-5.4	-3.9	-3.2	-4.8
Capital Account Balance	0.3	0.1	0.1	0.2	0.2	0.2	0.2
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	1.5	1.6	0.8	1.6	2.4	1.5	0.7
CPI	1.0	1.8	1.9	4.6	2.6	0.3	0.9
M2	5.4	7.5	8.2	8.3	9.4	9.3	6.8
Short-term Interest Rate (%)	6.5	5.2	5.7	7.7	7.2	5.4	5.0
Exchange Rate (Local Currency/US$)	6.0	8.2	-7.1	-1.3	5.3	5.2	18.2
Unemployment Rate (%)	10.8	10.9	9.7	8.5	8.5	8.5	8.0
Population (millions)	17.6	17.8	18.0	18.2	18.4	18.6	18.9

Notes: (1) Calculated are as financial year basis so that, for example, 1994 figures equal financial year 1994-1994.

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	4.25	3.1			3.2	3.0	3.2			3.4	3.25				
Real Exports	2.0				4.5	5.0				7.0	9				
Real Imports	5.0				4.4	4.0				6.0	4				
CPI	1.25	1.5			1.4	2.0				2.8	2.25				

Note: The IMF forecast is from the World Economic Outlook (IMF, April 1999). The OECD forecast is from the OECD Economic Outlook (OECD, June 1999).

BRUNEI DARUSSALAM

REAL GDP GROWTH

The year 1998 registered a slow growth of real GDP of 1.0% compared to 3.5% in 1996 and 4.0% in 1997. The decline was the result of the fiscal consolidation measures adopted by the government earlier in the year and the depressed world oil prices which adversely affected the petroleum sector. The effect of the former was a decline in the construction sector, the second largest contributor to the real GDP growth. This also had a spill-over effect on related sectors namely transport and communication, retail, wholesale and restaurant, banking, insurance and finance. Mid-way through the year, however, the government announced a supplementary development allocation to boost the construction sector as well as an additional monthly cost of living allowance (COLA) for civil servants.

The fall in the prices of both crude oil and liquefied natural gas, by some 37% and 25% respectively over the previous year, whilst maintaining oil production at around 150,000 to 160,000 barrels per day showed the contribution of the oil sector to GDP to continue declining. The GDP at current prices increased from BND$8,051.0 million in 1997 to an estimated BND$8,110 million in 1998. The contribution of the non-oil sector, which comprised the government and the non-oil private sectors, to the nominal GDP increased from 64.4% to 66.5% during the same period.

INFLATION

Brunei's dependence on imports renders it susceptible to external inflationary conditions. Certain subsidies, including public utilities, play a part in controlling inflationary pressures. Inflation, as measured by the rate of increase in the consumer price index (CPI) was just under 1.0% in 1998. The government's efforts to reduce import duties on some consumer items, the moderate inflation rate of neighbouring trade partners as well as cheaper commodities from ASEAN countries due to the depreciation of regional currencies and the opening up of the retail trade contributed to this price stability. However, the effect of the relatively stronger Brunei dollar *vis-à-vis* the regional currencies saw an increasing number of local consumers spending away in the neighbouring countries.

EXTERNAL TRADE

Brunei's major exports are crude oil and natural gas, which account for some 90% of the total exports. Re-export items and garments accounted for the rest. Japan remains Brunei's major trading partner, accounting for some 55% of total exports. Other export markets include the Republic of Korea, Thailand and Singapore. In 1998, some of the exports to both Korea and Thailand have been deferred due to the financial crisis affecting these countries.

In 1996, imports increased by 15.3% over those of 1995, but this was reduced to 10.3% in 1997 to B$3,154 million. The main imports included machinery and transport equipment, food, chemicals and manufactured articles. Brunei's imports remained subdued in 1998. This was attributed to the slowdown in the construction sector, following the initial budget cut as well as the appreciation of both the US and European currencies causing imports of commodities from these countries to be more expensive.

The overall trade balance continued to be more favourable in 1998. Even though the increase in exports of crude oil and natural gas has slowed down, imports have fallen much further.

EMPLOYMENT

The total population of Brunei in 1998 was estimated at 324,000, growing at around 3.1%. The labour force grew at 1.5% in 1998 compared to 3.4% in 1997. The slowdown in the construction sector, which spilled over to the other mainly services sectors have seen an increasing number of migrant workers, mainly from the Southeast Asian region, returning home. Female labour force participation rates have been on the rise in recent years, another factor in the increase in the growth of the labour force. The development of local skills and entrepreneurs are given much emphasis in the current Seventh National Development Plan (1996-2000) which aims to meet the challenge of a more diversified economy.

FISCAL POLICY

The government has run a budget deficit in recent years, reflecting somewhat higher outlays in infrastructure and additional domestic demand. The budget balance in 1998 is estimated to register a deficit of 6% of the GDP. The government will continue to adopt a more moderate expenditure during the current plan. Some potential government agencies would be corporatised and a number of projects, which were traditionally undertaken by the government, have now either been privatised or commercialised. The authorities are presently stepping up efforts to increase alternative sources of revenues to supplement the falling oil and gas revenues.

MACROECONOMIC OUTLOOK

GDP is not expected to pick up strongly in 1999 with world oil prices continuing to be depressed. However, the non-oil sector, particularly construction and service-related activities, is expected to be boosted as Brunei is preparing itself to host three major events, namely the Southeast Asian Games in 1999, the APEC Summit in 2000 and in 2001, *Visit Brunei Year*. The government's contribution would ensure the stability of economic growth at around 1% to 2%.

Inflation is expected to be maintained at around 2%. In addition, tight fiscal policies to prevent further a build up of inflationary pressures and enforcement of government regulations on prices of essential goods and services will continue.

The trade balance is expected to be favourable during the year. Exports are expected to increase by 6.5% in 1999 while imports are forecast to increase by 2.5%.

ECONOMIC POLICIES AND MEASURES TAKEN TO ADDRESS THE CRISIS

- The formation of a Brunei Darussalam Economic Council with membership from public and private sector to expedite private sector development;
- Maintaining a prudent fiscal policy but injecting sufficient capital outlays to sustain the growth in the private sector;

- Promoting privatisation policies to enhance management's efficiency and productivity and to reduce the size of the public sector;

- Maintaining price stability;

- Improving the investment climate to encourage FDI; and

- Establishing niche industries and enhancing human resources development;

- Realising Brunei's role in the BIMP-EAGA region in such areas as a service hub for trade and tourism and a financial services center.

Brunei Darussalam: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	4.0	4.1	4.4	5.0	5.3	4.8	4.9
Real GDP	-1.1	0.5	1.8	2.0	3.5	4.0	1.0
Total Consumption							
Private Consumption							
Government Consumption							
Total Investment							
Private Investment							
Government Investment							
Exports of Goods and Services	9.5	-5.6	-7.1	3.0	8.3	8.3	-13.3
Imports of Goods and Services	-0.4	4.0	26.5	10.5	15.3	-10.3	-17.6
Fiscal and External Balances (% of GDP)							
Budget Balance	-5.0	0.3	0.5	0.1	3.1	2.4	6.0
Merchandise Trade Balance (f.o.b.)	31.2	26.9	10.1	8.3	1.9	12.2	12.6
Current Account Balance	66.4	62.9	68.6	57.6	50.0	48.9	44.6
Capital Account Balance	-63.4	-47.1	36.5	-47.1	36.5	-52.0	-44.7
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	0.3	-0.2	-0.3	3.6	0.4	0.7	-0.2
CPI	1.3	4.3	2.4	6.0	2.0	1.7	-0.4
M2	4.3	10.7	38.6	7.3	-2.3	-1.1	
Short-term Interest Rate (%)	6.0	5.8	6.0	6.5	6.5	7.0	5.3
Exchange Rate (Local Currency/US$)	1.6	1.6	1.5	1.4	1.4	1.7	1.6
Unemployment Rate (%)	4.5	4.1	3.6	4.9	5.0	5.0	5.1
Population (millions)	0.3	0.3	0.3	0.3	0.3	0.3	0.3

Source: Data are as submitted by member economies, unless otherwise specified.

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2001				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	2.3					2.5					3.0				
Real Exports	6.5					7.3					8.2				
Real Imports	2.5					3.4					4.0				
CPI	2.2					2.5					3.0				

CANADA

REAL GDP GROWTH

Real GDP growth increased a robust 4.0% in 1997 before slowing to 3.1% in 1998. Growth in the second and third quarters of last year was held back by strike-related disruptions in many important industries (for example, the GM auto strike in the U.S., labour unrest in southern Ontario's construction industry, and the Air Canada strike). However, output surged 4.6% (annual rate) in the fourth quarter, due in part to inventory accumulation and a strong export performance. This momentum carried forward into 1999, with real GDP increasing 4.2% in the first quarter. Consumer spending, housing and business investment, and strong exports (to the U.S.) all contributed to this performance.

Looking ahead, the consensus forecasts calls for real GDP to increase slightly in 1999 (to 3.2%), before falling off slightly in 2000 (to 2.6%). This forecast represents a dramatic improvement as compared to the outlook at the end of last year. Continued strength in the U.S. and the improved position of many Asian economies has brightened the overall outlook for Canada.

Consumer demand grew 4.2% in 1997, but fell to 2.8% in 1998. After posting a very strong second quarter (largely financed through lower savings), consumer expenditures slowed in the last half of the year, registering no growth in the final quarter of 1998. However, buoyed by a surge in purchases of big-ticket items, consumer expenditures advanced 5.1% (annual rate) in the first quarter of 1999. Looking ahead, there is some concern over Canada's rising debt-to income ratio and low savings rate. As a result, the consensus forecast calls for slowing growth in personal expenditures in 1999. This forecast could be revised upwards if employment growth picks up later in the year.

Business investment in machinery and equipment (M&E) was quite strong last year, posting 9.5% growth in 1998. This was spurred in particular by strong investment in computers and other office equipment. Elsewhere, investment in non-residential construction remained virtually unchanged in 1998 after posting a robust 14.0% gain in 1997. Looking ahead, several factors suggest that growth in real fixed business investment will remain healthy but nonetheless slow from the fast pace of the previous two years. In the first quarter of 1999, M&E investment advanced 8.9%, but growth in non-residential construction declined 1.1% (still its best performance in a year and a half).

Residential construction declined in 1998, with housing starts falling an estimated 7% in 1998. Several factors contributed to this decline, including lower immigration, declining consumer confidence, and regional factors such as a lengthy builders' strike in Ontario. However, the new year began on a very positive note, with investment in housing rising 16.6% (annual rate) with strength in new housing, renovations and resales. Despite the solid first quarter in 1999, the Canadian Mortgage and Housing Corporation forecasts housing starts to stabilize in 1999 before increasing in 2000. Historically low mortgage rates, combined with further expected gains in personal disposable income, are expected to support activity in 1999. Finally, renovation activity is expected to be boosted by the relatively high housing resales over the past few years.

International trade was a major source of growth for the Canadian economy in 1998. Real export growth was 8.2% in 1998, slightly below the performance in 1997. On the other hand, after increasing 14.6% in 1997, real import growth slowed to 5.8% in 1998. Canada's exports have been sustained by the strong American economy, which now accounts for approximately 85% of total Canadian exports. Exports to Asia decreased sharply in 1998, with the significant decline in commodity prices hitting key export-oriented industries such as forestry, farming and mining. Since Canada is a net exporter of these products, the plunge in commodity prices led to a deterioration in Canada's terms of trade, and a fall in Canada's trade surplus on a nominal basis.

The strong U.S. economy boosted Canada's trade sector early in 1999. Export growth (8.5%) more than doubled import growth (4.2%) in the first quarter of the year, leading to a significant improvement in Canada's trade surplus. Early indicators suggest that net exports will continue to contribute to overall GDP growth in the upcoming year.

FOREIGN DIRECT INVESTMENT

Foreign direct investment (FDI) in Canada exceeded C$217 billion in 1998, a gain of more than 10% from 1997. Most of this investment continues to be sourced from the United States, which accounted for nearly 70% of the total FDI stock in 1998 (up from 64% in 1990). However, over this time frame the proportion of FDI in resource-based industries has dropped, falling from 30% in 1990 to 26% in 1998. The largest gains have occurred in services and retailing (from roughly 7.5% to 9.5%) and other industries (from 29.5% to 31%). The proportion of FDI in finance and insurance sectors has remained largely unchanged this decade, accounting for 19% of total FDI in 1998.

Canadian Direct Investment Abroad (CDIA) continued to grow at a substantially faster rate than FDI, reaching nearly C$240 billion in 1998 and increasing by over 16% from the previous year. There has been a significant trend in the industrial distribution of CDIA toward the finance and service sectors (up from 37% in 1990 to 44% in 1998). There has also been a dramatic shift in the geographical location of investment away from traditional destinations and increasingly towards non-OECD countries. Although nearly 53% of CDIA in 1998 was to the U.S., this was down 8.5 percentage points from 1990. CDIA in non-OECD countries rose by roughly 10 percentage points to 23% over this same period.

INFLATION

Since 1991, the Federal Government and the Bank of Canada have jointly announced an official target range for the inflation rate. This target range has been gradually lowered since it was first announced and presently stands at 1% to 3%. In February 1998, the commitment to maintain inflation within the 1% to 3% target range was extended until 2001. The appropriate long-run target for monetary policy will be determined by the end of 2001.

Despite a lower exchange rate, inflation was contained in 1998, partially as a result of the collapse in world commodity prices. For 1998 as a whole, the annual average of the all-items consumer price index (CPI) increased 0.9%. With the exception of 1994 (when inflation was low due to a large cut in tobacco taxes), this is the lowest annual rate of inflation since the mid-1950s. In addition, the core inflation rate–which excludes the volatile food and energy prices as well as indirect taxes–remained within the lower half of the bank's target throughout 1998. The consensus forecast calls for consumer prices to rise by 1.3% in 1999 and 1.6% in 2000.

EMPLOYMENT

Employment increased by 453,000 in 1998, the best year so far this decade for job creation. Moreover, two-thirds of the jobs created in 1998 were full-time positions. After beginning the year at 8.5%, the unemployment rate fell steadily through much of the year, reaching 7.8% by January 1999. However, thus far this year, the employment picture has softened. In the first six months of 1999, employment has only increased by 76,000 jobs, with the public sector (most notably health, social services and education) and manufacturing offsetting losses elsewhere. Self-employment has remained virtually unchanged throughout 1999.

CURRENT ACCOUNT

Canadian residents continued to spend more than they earned abroad on goods, services, investment income and transfers in 1998. After posting an exceptional surplus of C$4.5 billion in 1996, the current account deficit widened throughout 1997 and 1998, with a deficit of C$16.4 billion (or 1.8% of GDP) last year. A falling surplus in the trade on goods (in nominal dollars) was responsible for the widening deficit. Although domestic demand for imports slowed in 1998, it still slightly outpaced growth for exports. Elsewhere, the deficit in services narrowed in 1998 (largely due to an improvement in the travel account) while the deficit on investment income reached C$30.2 billion (approaching the record level set in 1995).

In the first quarter of 1999, the current account narrowed substantially to C$5.4 billion (SAAR)–its best result in two years. This improvement was due to a sharp rise in Canada's merchandise trade surplus ($30.8 billion). Elsewhere, the deficit on trade in services fell to an 11-year low, while Canada's deficit on investment income increased slightly. Looking ahead, the consensus forecast anticipates the current account deficit to average C$9.8 billion in 1999 and C$7.8 billion by 2000.

MONETARY CONDITIONS

After a 50 basis point hike in the bank rate in January 1998, official interest rates remained steady until the Bank of Canada intervened in August to shore up investor confidence in the Canadian dollar. Plunging commodity prices and the Asian crisis caused a substantial decline in the Canadian dollar, which posted a series of all-time-record lows in August. As a consequence, the Bank of Canada increased the bank rate a full percentage point (to 6.0%) on 27 August 1998. However, the Bank of Canada subsequently made five separate 25 basis point cuts over the September 1998 to May 1999 period, more than reversing the 100 basis points increase of August 1998.

Long-term interest rates continued to decline more or less steadily in 1998 in line with the strong fundamentals in the economy, and briefly stood at historically low levels, but have risen along with the US rates so far in 1999.

EXCHANGE RATE

The Canadian dollar is a freely floating currency. However, the central bank will occasionally intervene to ensure orderly market conditions prevail.

As did many other currencies, the Canadian dollar encountered intense selling pressures through much of July and August of last year. Indeed, the dollar closed at an all-time low of US63.31¢ on 27 August 1998, down nearly eight full cents from its recent peak in March. The Canadian dollar's weakness stemmed from political and economic instability in the Asian economies and elsewhere, which prompted a flight of international capital to the "safe haven" US dollar. The Asian crisis also slashed the demand for and prices of commodities, which added to the pressure on the currency as there was a widespread view that it was closely linked to commodities.

The Canadian dollar has gradually recovered, trading above the US69¢ barrier early in May. The dollar has been supported by an improved outlook in the Asia-Pacific region, which has led to a modest firming in commodity prices (particularly crude oil).

FISCAL POLICY

At the federal level, the budget was in the black for the first time since 1969, with a surplus of C$3.5 billion recorded in the fiscal year 1997-98. In February 1999 the federal government announced that a balanced budget would be achieved for 1998-99, representing the first time in nearly 50 years that the federal government has posted back-to-back balanced budgets or better. Furthermore, the federal government projects balanced budgets or better for the next two fiscal years. With these results, the federal debt-to-GDP ratio will fall from a peak of 71.9% in 1995-96 to 61.7% by 2000-01.

Canada's provincial governments have also made substantial progress toward balancing their budgets. Seven provincial governments–Prince Edward Island, New Brunswick, Nova Scotia, Quebec, Manitoba, Saskatchewan and Alberta–have already announced intentions to balance their budgets in this fiscal year.

Canada has a somewhat stricter definition of the balanced budget than do most other large industrial economies. Indeed, Canada's measure of financial requirements corresponds more closely to the deficit/surplus measures used in these economies. Under this definition, the federal government had a financial surplus of C$12.7 billion in 1997-98 (or 1.5% of GDP). Furthermore, sizeable surpluses are expected over the next three years.

MEDIUM-TERM OUTLOOK

Canada's near-term economic prospects remain solid. The most recent consensus forecast calls for real GDP to increase by 3.2% in 1999 and 2.6% in 2000. This forecast represents a considerable improvement as compared to estimates towards the end of 1998. At the beginning of the year, the consensus forecast had called for real GDP growth of only 2.0% in 1999, more than a full percentage point lower than the current forecast. Forecasters are now more optimistic as Asian economies continue to improve, the US economy is still displaying continued strong growth, and there has been a firming in commodity prices.

Canada: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and major components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	577.92	561.95	562.00	588.07	611.59	631.19	603.78
Real GDP	0.91	2.30	4.73	2.77	1.70	3.95	3.10
Total Consumption	1.55	1.31	1.88	1.40	1.51	2.91	2.48
Private Consumption	1.76	1.82	3.14	2.14	2.49	4.16	2.76
Government Consumption	1.03	0.06	-1.24	-0.53	-1.12	-0.52	1.69
Total Investment	-1.27	-2.67	7.38	-1.87	6.50	13.91	3.59
Private Investment	-1.43	-2.78	7.38	-1.68	8.16	16.89	3.43
Government Investment	-0.33	-2.00	7.38	-2.92	-3.07	-5.28	4.87
Exports of Goods and Services	7.88	10.94	13.11	9.04	5.76	8.45	8.23
Imports of Goods and Services	6.22	7.37	8.29	6.21	5.82	14.59	5.80
Fiscal and External Balances (% of GDP)							
Budget Balance	-8.00	-7.60	-5.60	-4.50	-2.20	0.90	1.30
Merchandise Trade Balance (f.o.b.)	1.29	1.83	2.71	4.60	5.37	2.91	2.25
Current Account Balance	-3.63	-3.93	-2.37	-0.79	0.58	-1.75	-1.95
Capital Account Balance	1.23	1.50	1.37	0.88	1.02	0.93	0.59
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	1.30	1.20	1.20	2.60	1.50	0.70	-0.40
CPI	1.52	1.80	0.20	2.16	1.63	1.61	0.93
M2 $ Millions	3.52	2.88	2.16	3.97	3.08	-0.34	0.04
Short-term Interest Rate (%)	6.74	4.97	5.66	7.22	4.35	3.61	5.05
Exchange Rate (Local Currency/US$)	1.209	1.290	1.366	1.372	1.364	1.385	1.484
Unemployment Rate (%)	11.30	11.20	10.40	9.50	9.70	9.20	8.30
Population (millions)	28.38	28.70	29.04	29.35	29.67	30.01	30.30

Source: Data are as submitted by member economies, unless otherwise specified.

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	3.2	2.6			2.9	2.6	2.5			2.8					
Real Exports					6.8					6.1					
Real Imports					4.9					6.5					
CPI		1.2			1.0		1.6			1.9					

Note: The official forecast refers to the private sector consensus forecast. The IMF forecast is from *the World Economic Outlook* (IMF, April 1999). The OECD forecast is from the *OECD Economic Outlook* (OECD, June 1999).

CHILE

The Chilean economy has not been immune to the effects of the world financial crisis. These effects have been stronger as of the second half of last year and are still present during the first half of this year. At the same time that Chile was undergoing an adjustment process in its economy, the country was also facing other problems, which contributed to increasing financial crisis troubles. Amongst these problems were the worst drought of the century, which has affected agricultural and electrical sectors; the presence of the *El Niño* current, and the fall in the prices of the main export products. Nevertheless, it is necessary to remark that the Chilean economy, despite the financial crisis, had a positive growth rate during last year.

REAL GDP GROWTH

In 1998, Chilean GDP growth rate was 3.1%, which is lower than the 1997 rate and the previous years' average. This reflects the effects of the financial crisis on the economy. As of the third quarter of 1998, some economic indicators began to register a contraction of the economy, caused in part by the adjustment process made in order to control the current account deficit. In fact, GDP contracted by 2.8% in the last quarter of 1998 and by 2.3% in the first quarter of 1999.

The forecast for GDP growth for this year is approximately 0.5%. During the first semester, growth rate will be negative. However, the economy should start a strong recovery as of the second. According to most international forecasts, Chile will be one of the few Latin-American countries with a positive growth rate during this year.

Regarding investment, during 1998 gross fixed-capital formation represented 31.7% of GDP. This rate is slightly higher than that of the previous year.

Chilean exports last year totaled US$14,895 million, which is 12.5% lower than 1997. They were seriously affected by the drop in prices of major export products caused by the contraction of demand in most of the main trade partnerships. On the other hand, imports fell 4.5% with respect to 1997, mainly due to adjustment measures taken by the monetary authorities, which tended to reduce the internal consumption.

INFLATION

Inflation in 1998 was 4.7%, the lowest in the last 38 years, accomplishing the central bank's goal for last year. The inflation target was 4.3% for 1999, but due to lower than expected inflation rates in the first months of the year, it is expected to reach a lower percentage. The declining inflation trend of the past few years is being sustained.

EMPLOYMENT

The unemployment rate has been increasing. In 1998, the average unemployment rate was 6.3%, which is 0.2% higher than in 1997. However, unemployment reached 9.8% in May. This situation is expected to revert, and it is anticipated Chile will gradually recover previous unemployment levels.

TRADE ACCOUNTS

Last year, the current account deficit represented 6.2% of GDP. Although this is a high rate, it is expected to fall to between 3% and 4%. The main reason for the deficit is the decrease in the economy's income due to low export prices of copper and other raw materials.

The trade balance had a negative result of US$2.495 million caused by a strong increase in imports, especially during the first quarter, and the drop in the value of exports. This deficit should be substantially reduced this year as imports have dropped 28% in first five months, and the volume of exports has continued to increase.

The capital account had a positive balance last year that represented 4.3% of GDP. This was mainly caused by a decrease in net portfolio investment inflows due to lower ADR and bonds emissions.

GROSS EXTERNAL DEBT

Foreign debt reached US$31,546 millions in 1998. This was an increase in absolute terms with respect to previous year, although a decrease in relative terms. The business/private sector is responsible for 81.8% of foreign debt.

Mid and long term liabilities account for 94.9% of foreign debt. It is important to remark that since 1994, the central bank had no liability with the IMF. On January 1999, foreign debt represented 43% of GDP. If international reserves are discounted, it is equivalent to a little more than one year's exports.

FOREIGN DIRECT INVESTMENT

Despite the convoluted international situation, foreign direct investment increased by 6.4% during last year. This is notable because investors kept their trust in the stability, safety and profitability of long-term projects in the Chilean economy.

EXCHANGE RATE

The real exchange rate depreciated by 3% last year. This was a change in the real peso appreciation trend of the last eight years.

FISCAL POLICY

In 1998, and after continuous cuts, fiscal expenditure increased by 6.2%, a lower rate than previous years. The fiscal budget closed with a 0.4% surplus, which although lower than previous years, is still positive, despite the reduction in government incomes.

MONETARY POLICY

Interest rates were progressively increased during last 1998, as a way to adjust the economy, reduce excess consumption and counteract financial crisis effects. This is how the monetary stance reached 14% in September 1998 after which it started to fall steadily. This rate is used as a reference by the financial sector to set the rate in which their operations are done. It was increased to reduce the gap between rates, and after that to begin to push both of them down. In June 1999, the central bank reduced it to 5%, a rate lower than the one before the crisis. This is expected to contribute to an acceleration of the economy's recovery process.

MEDIUM-TERM OUTLOOK

GDP is expected to grow by around 5% this year. However, next year the economy should expand between 4% and 5.5%. Unemployment is likely to increase over last years' average, although this situation will be temporary and should begin to fall when the economy starts its recovery.

Last year's economic adjustment corrected the excessive current account deficit. For this reason, this year's deficit will oscillate between ranges considered acceptable by the economic authorities. The export sector will continue facing low prices for its main products during this year. However, due to the fast recovery of some trade partners, the volume of exports may increase. On the other hand, it is not likely that imports will achieve last year's level because of the slow-down in world and local economy. We can also expect an increase in real exchange rates, which will favor exports and limit imports.

MAIN STRUCTURAL REFORMS

It is important to state that Chile has not made its structural reforms as a consequence of the financial crisis. Some adjustments have been made, such as transitory increases in interest rates and a reduction of bank reserves. However, Chile has not made modifications in its exchange rate and financial systems, nor has it asked for IMF cooperation.

Chile has made several structural reforms in recent years. Some of them were privatizations. Chile has privatized most public utilities and is promoting private investment in infrastructure. For instance, the majority of infrastructure projects, needed for the development of the economy, are being financed with private capital, and telecommunications, electricity, and air transportation are completely private. Also, in the short-term, the privatization process of ports, plus water and sewerage services must be completed.

Chile continues to be committed to trade liberalisation. In 1998, parliament approved a unilateral tariff reduction across the board. After this, tariffs will be reduced from 11% to 6% on a 1% annual basis. The Chilean economy has continued with its commercial policy, expanding already existing trade agreements.

Parliament has also approved a Safeguard Law. Its objective is to put into effect protection measures, allowed by the World Trade Organization (WTO), which could be used if a specific product is being imported in such increased quantities and conditions as to cause, or threaten to cause, serious damage to the domestic industry. Safeguards shall be applied for one year, renewable only for one additional year. The Chilean Safeguard Law is completely consistent with the WTO, in fact, it does not use all the provisions contemplated by this organization.

As a way to accelerate the economy's recovery process, the government announced further measures in June. These measures include the advance launching of some investment projects, tax benefits for new house-buyers, incentives for hiring young people, and a protection program for unemployed workers. These measures are aimed at fighting unemployment, especially in the most sensitive sectors.

Finally, the educational system is undergoing reform led by the government. Although this may not be classified as a structural reform of the economy, it will have positive economic effects because it will allow the economy to operate with a better qualified and thus more productive labor force.

Chile: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	41.9	44.5	50.9	65.2	69.2	77.1	72.9
Real GDP	12.3	7.0	5.7	10.6	7.4	7.1	3.4
Total Consumption	12.7	7.0	7.4	9.2	8.8	8.0	3.5
Private Consumption	13.8	7.4	8.2	9.8	9.4	8.3	3.5
Government Consumption	5.6	4.3	1.9	4.2	4.0	5.1	3.9
Total Investment	21.8	21.1	0.8	34.2	5.9	11.5	-1.4
Private Investment							
Government Investment							
Exports of Goods and Services	13.9	3.5	11.6	11.0	11.8	10.1	5.9
Imports of Goods and Services	21.8	14.2	10.1	25.0	11.8	12.9	2.1
Fiscal and External Balances (% of GDP)							
Budget Balance	2.3	2.0	1.7	2.6	2.3	1.9	0.5
Merchandise Trade Balance (f.o.b.)	1.7	-2.2	1.4	2.1	-1.6	-1.7	-3.4
Current Account Balance	-2.3	-5.7	-3.1	-2.1	-5.4	-5.3	-6.2
Capital Account Balance	1.4	5.8	4.2	2.1	6.2	5.5	7.2
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	11.8	10.6	12.6	9.3	1.7	4.5	2.2
CPI	12.7	12.2	8.9	8.2	6.6	6.0	4.7
M2	39.7	33.3	30.1	22.5	26.9	54.7	13.4
Short-term Interest Rate (%)	5.5	6.5	6.4	6.1	7.3	6.8	9.7
Exchange Rate (Local Currency/US$)	362.6	404.2	420.2	396.8	412.3	419.3	460.3
Unemployment Rate (%)	6.7	6.6	7.8	7.4	6.5	6.1	6.2
Population (millions)	13.5	13.8	14.0	14.2	14.4	14.6	14.8

Source: Data are as submitted by member economies, unless otherwise specified.

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	+-0.5	2.0				4.5/5.5	4.6								
Real Exports															
Real Imports															
CPI	+-4.3	4.5					4.2								

Note: The IMF forecast is from the World Economic Outlook (IMF, April 1999).

THE PEOPLE'S REPUBLIC OF CHINA

In an effort to reduce the impact of the Asian financial crisis and the historically serious flood disaster, China enforced a series of policies aimed mainly at increasing the investment to expand domestic demand. As a result, China's economy as a whole maintained its momentum in 1998.

REAL GDP GROWTH

China's economy continued to grow at a relatively high speed in 1998. Real GDP reached US$960.91 billion[1], up by 7.8% a rate which was one percentage point lower than that of 1997. A breakdown of the figure shows that the value-added of primary industry was up by 3.5%; that of the secondary industry up by 9.2%; and that of tertiary industry up by 7.6%. The social labor productivity rose by 6.9% over 1997.

The total retail sales of consumer goods amounted to US$352.14 billion, up by 6.8% compared with 1997. With the deflation factor taken into account, actual growth was 9.7%.

In 1998, China's total investment in fixed assets amounted to US$343.73 billion, up by 14.1% from 1997. This increase constituted the main pull for the growth of the national economy. In addition, the investment structure improved further as greater efforts were made to increase investment in infrastructure construction as well as in the western regions. In 1998, the investment in the western regions went up by 31.2% compared with the year before, at a rate which was higher than those of the eastern and central regions by 14.9 and 16.8 percentage points respectively.

China's exports slowed down markedly in the face of the Asian financial crisis; its imports dropped, too, as a result of the restrictions in factors such as domestic demand. In 1998, a surplus of US$43.6 billion in tangible merchandise trade was registered which accounted for 4.5% of the GDP.

In the first half of 1999, GDP grew at the rate of 7.6%. For 1999 as a whole, China's real GDP is forecast to increase by about 7.0%.

INFLATION

In 1998, the CPI was down by 0.8% from 1997, with the prices of services rising by 10.1% over 1997. It is estimated that the CPI will be around zero in 1999.

EMPLOYMENT

By the end of 1998, employment was 699.57 million, 3.57 million more than at the end of the previous year. Of the total, 32.32 million people were in urban private enterprises, up by 5.63 million over the year before. In 1998, great headway was made in the re-employment program, which enabled 6.09 million laid-off staff and workers of state-owned enterprises to find new jobs. By the end of 1998, the registered unemployment rate in the urban areas was 3.1%, which was on a par with the rate of the previous year.

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[1] US$ 1 = RMB 8.2789 the same below

The income of the urban and rural residents increased steadily, and their living standard continued to rise. With the falling prices taken into account, the actual growth of the per-capita disposable income of urban residents was 5.8%, and that of rural residents was 4.3%. The registered unemployment rate in the urban areas is estimated to be 3.5% in 1999.

CURRENT ACCOUNT

In 1998, the current account surplus of China reached US$29.3 billion, accounting for approximately 3.0% of GDP, and down slightly compared with US$29.7 billion in 1997. The merchandise trade surplus stood at US$43.6 billion in 1998, up by US$3.3 billion over 1997. China's imports and exports totaled US$324 billion, down by 0.4% from the year before, exports totaled US$183.8 billion, up by 0.5%, and imports totaled US$140.2 billion, down by 1.5%. In 1998, the RMB exchange rates were stable and foreign reserves continued to rise, reaching US$145 billion by the year-end, up by US$5.1 billion over the previous year-end.

In the first seven months of 1999, China's exports declined 2.8% while imports increased 16.6%. However, the trade surplus remains stable and reached US$11.3 billion by the end of July 1999. Thus, for 1999 as a whole, China's exports are forecast to grow at the rate of -1.5% while imports grow by more than 10%. Foreign reserves increased to US$147 billion by the end of June 1999.

GROSS EXTERNAL DEBT

By the end of 1998, China's registered foreign debts balance was US$146.04 billion[2], up by US$15.08 billion over the previous year. Of the foreign debts, long-and medium-term debts amounted to US$128.70 billion, up by US$15.88 billion over the previous year; the short-term debts amounted to US$17.34 billion, down by US$800 million from the previous year. New foreign borrowing in 1998 totaled US$45.66 billion, and the repayments of the principal and interest of foreign debts amounted to US$42.78 billion.

By the end of 1998, China's registered foreign debts balance was up by 11.5% from 1997 and the liability ratio (balance of foreign debts/GDP) stood at 15.2%, which was below the internationally recognized warning level.

FOREIGN DIRECT INVESTMENT

In 1998, foreign capital actually utilized in China reached US$58.9 billion, with foreign direct investment (FDI) amounting to US$45.6 billion, up slightly over the US$45.3 billion in 1997. Among the economies that made direct investment in China, Hong Kong, China ranked first, accounting for 40.6% of the total, followed by the USA, accounting for 8.6%, and then by Singapore and Japan, accounting for 7.5% respectively. An improvement was registered in the channeling of FDI, with more investment, about US$1 billion, going respectively into real estate development, social services and the production and supply of electricity, gas and water.

In the first quarter of 1999, FDI totaled US$7.34 billion, down by 14.6% from the corresponding period of 1998. In the first half of 1999, FDI reached US$18.6 billion, decreased by 9.2%.

[2] The figure does not include debts of Hong Kong SAR, Macao and Chinese Taipei.

EXCHANGE RATE

In the face of the Asian financial crisis, China has enforced a policy of maintaining the stability of RMB. In addition, there has been a favorable balance in China’s current account for five consecutive years; inflation has been held in check; FDI has continued to flow in; and there are ample foreign reserves. All this made it possible for RMB to remain stable in 1998, with its exchange rate against the US dollar, standing at US$1: RMB 8.2789 at the year-end, slightly up by 9 basic points over the previous year-end.

FINANCIAL POLICY

In 1998, particularly in the second half of the year, China formulated an active financial policy and issued long-term state bonds valued at US$12.08 billion to increase the input in infrastructures. Consequently, the investment in fixed assets has accelerated noticeably, constituting the major factor contributing to China’s economic growth. Total fiscal revenue reached US$119 billion, up by 13.9% over the previous year; while total expenditure came to US$130.1 billion, up by 16.7%. The fiscal deficits of the central government amounted to US$11.6 billion, equivalent to 1.5% of the GDP, a proportion which was slightly higher than in the previous year. State bonds amounting to US$47 billion were issued in 1998 (not including the special bonds issued by the Ministry of Finance to the four major wholly state-owned commercial banks), compared with US$29.1 billion issued in 1997.

In 1999, China will continue to implement its active financial policy. It will increase the deficits to a proper degree, and the central government will issue more long-term state bonds to the commercial banks. China will focus on infrastructure projects such as agriculture, forestry, water conservancy, transportation, telecommunications, environmental protection, construction and transformation of urban and rural power networks, and the construction of grain reserves depots directly under the central government. Further efforts will be made to channel investment into the central and western regions. In the first five months of 1999, total fiscal revenue reached US$50.3 billion, US$10 billion more than the same period of the previous year; while total expenditure came to US$42.6 billion, up by US$6.2 billion. In 1999, the deficits of the central budget will be bigger, projected to reach US$18.15 billion. However, from medium and long term points of view, the government needs to adhere to the principle of basically balancing revenue and expenditure, to pursue a moderately tight financial policy, and to reduce the deficits gradually.

MONETARY POLICY

As China’s economy has been growing at a reasonable speed and the inflation rate has come down steadily for the last two years, the focus of the country's financial policy has shifted to the promotion of economic growth. Since 1 May 1996, the central bank has lowered the interest rate seven times in succession, and at the same time, has enforced a steady monetary policy. However, in spite of all this, the growth rate of China’s M2 came down from 19.6% in 1997 to 15.3% in 1998 as a result of the impact of the Asian financial crisis and the restrictions in domestic demand.

MEDIUM-TERM PROSPECTS

1999-2002 is the key period for China in the switch-over of its economic system from a planned economy to a market economy; therefore, the macro economic policies of the government will give greater emphasis to the correct handling of the relationships of three things: reform, development and stability. It can be expected that the government's main objectives in this period will be to maintain a low inflation rate, to develop the economy at a moderately high speed, and to confine the unemployment rate within acceptable limits while the reform is deepened and the restructuring is under way.

Economic Growth: To expand domestic demand will be a long-term policy adopted by China to promote its economy. In 1999-2002, domestic demand (consumption and investment) will be steadily on the rise. After 2000, in view of the fact that the impact of the financial crisis will gradually diminish, and the international environment, particularly the peripheral environment, will gradually improve, China's economic growth rate is expected to average around 7%, and its CPI to be around 3% in this period.

Current Account: In 1999-2002, China will continue to have a favorable trade balance. However, the adverse balance in service is unlikely to be eliminated completely, although the tourist trade, which is expected by the government to grow rapidly, may help alleviate the imbalance. The payments in the current account may be basically balanced. As the financial crisis has not produced a direct impact on China's financial market, and the Chinese government has pursued an active policy to introduce foreign investment, FDI is expected to rise steadily after 2000. The foreign reserves will be relatively ample.

Investment: It is anticipated that in the next few years, investment in fixed assets will continue to be the main driving force in China's economic growth. With the expansion of domestic demand and the implementation of an active financial policy, investment in the state sector will increase; at the same time, the investment in the non-state sector will also pick up gradually. The estimated average increase in the investment in fixed assets will be 12% or so in 1999-2002.

Employment: In each year of the period between 1999 and 2002, the increase in the working population will be over 11 million, of whom 85% will enter the labor market. As the reform of the state-owned enterprises forges ahead, and the economic restructuring quickens its pace, the employment pressure will become even greater, with the registered unemployment rate expected to be 3.5% or so. It thus follows that developing the economy to create more employment outlets, deepening labor market reform and stepping up the building of a social security system will all be hard tasks facing the Chinese government in the future.

MAJOR STRUCTURAL REFORMS

Reforms already launched:

1. Reform of the state-owned enterprises has been deepened.

    - Adjustment and reorganization have been carried out in the textile, coal, oil, petrochemical, metallurgical and national defense industries.

2. The social security system made rapid progress.

   - Re-employment centers have been set up in all the state-owned enterprises where staff and workers have been laid off. Up to now, 99% of the laid-off staff and workers of the state-owned enterprises have used the re-employment service centers.

3. Programs of basic retirement insurance, funds for pensions raised on the basis of overall planning, and funds for medical expenses for serious diseases raised on the basis of overall planning were brought into effect. Significant headway has been made in the reform of the financial system.

   - Branches of the People's Bank of China at provincial level have been closed; nine trans-provincial branches have been set up.
   - A vertical management system has been introduced in the Security Supervision Commission.
   - The Insurance Supervision Commission has been set up to supervise the insurance business.
   - Branches of the state-owned commercial banks have been being closed, merged or adjusted.
   - Quota control over loans by the state-owned commercial banks has been removed, management based on the assets to liabilities ratio carried out, and the system classifying loan quality into five grades enforced.
   - Special bonds valued at US$32.6 billion have been issued for the purpose of recapitalizing the wholly state-owned commercial banks so as to enhance their capability to prevent financial crises.

Reforms to be launched:

1. Financial reforms will be undertaken

   - To perfect the management system and the system that will ensure separate operation of the banking, securities, insurance and trust businesses; to implement the responsibility system for financial supervision;
   - To accelerate the reform of the state-owned commercial banks, to see that the banks exercise the right to operate independently, and to carry out the work of setting up branches by economic region and by business;
   - To set up, step by step, financial assets management companies to take charge of the bad credit assets of the banks; to enforce a rigorous responsibility system to ensure the quality of new bank loans;
   - To run the policy banks well so as to implement the industrial policies of the state, and to raise the efficiency in the use of funds; and

- ♦ To standardize and safeguard financial order in accordance with law, and to check up on non-bank and local financial institutions to eliminate financial crises and maintain financial stability.

2. To increase export to balance external account measures will be taken

- ♦ To further expand the exports handled by production enterprises themselves; to development international tourism to increase non-trade exchange earnings; and

- ♦ To raise the export tax-refunding rate by 2.56 percentage points on the average in 1999.

China: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	483.00	601.10	540.90	697.60	816.90	903.00	960.90
Real GDP	14.20	13.50	12.60	10.50	9.60	8.80	7.80
Total Consumption	14.20	9.30	8.00	9.20	9.30	6.10	6.80
Private Consumption	14.30	9.40	7.70	10.10	9.60	5.80	6.10
Government Consumption	13.60	9.10	9.10	5.90	8.40	7.20	8.90
Total Investment (1)	12.90	24.90	15.60	15.50	10.40	7.10	14.40
Private Investment							
Government Investment							
Exports of Goods and Services (2)	18.20	8.00	31.90	22.90	1.50	20.90	0.50
Imports of Goods and Services (3)	26.30	29.00	11.20	14.20	5.10	2.50	-1.50
Fiscal and External Balances (% of GDP)							
Budget Balance	-0.97	-0.85	-1.23	-1.00	-0.78	-0.78	-1.50
Merchandise Trade Balance (f.o.b.)	0.87	-2.03	0.99	2.41	1.51	4.46	5.48
Current Account Balance	1.33	-1.98	1.42	0.23	0.89	3.29	3.03
Capital Account balance	-0.05	3.91	4.68	4.74	4.89	2.54	0.00
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	7.90	14.60	19.50	13.10	6.10	1.50	-1.30
CPI	6.40	14.70	24.10	17.10	8.30	2.80	-0.80
M2	31.30	32.40	34.50	29.50	25.30	19.58	15.30
Short-term Interest rate (%)	8.10	8.80	9.00	9.00	9.72	7.65	6.34
Exchange Rate (Local Currency/US$) (4)	5.50	5.76	8.62	8.35	8.31	8.28	8.28
Unemployment Rate (%)	2.30	2.60	2.80	2.90	3.00	3.10	3.10
Population (millions)	1172.0	1185.0	1199.0	1211.0	1224.0	1236.0	1248.1

Notes:
(1) Real Investment in Fix Assets Growth;
(2) Current Price;
(3) Current Price;
(4) 3 months inter-bank rate.

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	7	6.6	7.1	7.0	7.2	7.0	6.7	7.1	6.5	6.8	7-8				
Real Exports		-3.0	0.0					6.6							
Real Imports		7.0	7.8					8.4							
CPI	0	0.5		2.0	-1.0	3.0	2.0		3.0	1.0					

Note: The LINK forecast is from the World Outlook (Proyect LINK, May, 1999); growth projection for 1998 is for GNP. The IMF forecast is from the World Economic Outlook (IMF, April 1999). The ADB forecast is from the Asian Development Outlook (1999). The OECD forecast is from the OECD Economic Outlook (OECD, June 1999).

HONG KONG, CHINA

As a small and open economy with close economic links with the rest of East Asia, Hong Kong, China was inevitably vulnerable to shocks from the regional financial turmoil. The economy suffered a severe set-back in 1998. Domestic demand slackened considerably during the year, as local sentiment was depressed by volatility in the financial markets and a slump in asset prices. External demand was hard hit by the fall-off in demand in the region. As the ripple effect of the setback spread over, the economy remained weak in the first quarter of 1999. Yet visible improvements have been observed in the economy on both the domestic and external fronts since the second quarter.

REAL GDP GROWTH

Real GDP contracted by 5.1% in 1998, reversing the robust growth of 5.3% in 1997. Analysed by main GDP component, all but government spending had declined. Over the course of 1998, the decline in GDP began to taper off in the fourth quarter, falling by 5.7% from the previous year, smaller than the 6.8% decease in the third quarter. The year-on-year decrease moderated further to 3.4% in the first quarter of 1999. On a seasonally adjusted quarter-to-quarter basis, the decline in real GDP likewise narrowed, from 1.4% in the third quarter of 1998 to 0.6% in the fourth quarter and further to only 0.3% in the first quarter of 1999.

On domestic demand, consumer spending decreased by 6.7% in 1998. While spending on most goods suffered a large setback, spending on food and services were relatively more stable. Consumer spending was still weak in the early part of 1999, amidst higher unemployment and moderating incomes. Yet the year-on-year rate of decline moderated from a 9.1% decrease in the fourth quarter of 1998, to 4.8% in the first quarter of 1999. The improvement should have continued since, as consumer confidence was gradually restored on the rebound in share prices and steady revival in the residential property market.

Overall investment spending declined by 6.6% in 1998. Expenditure on machinery and equipment was held back by high interest costs and an uncertain business outlook. Building and construction activity was still rather intensive in the first half of 1998, but has slowed down considerably since then. This was related in part to the completion of the Airport Core Programme, and in part to the property market slump which dampened private sector building activity. Overall investment spending fell further by 24.4% in the first quarter of 1999 compared with a year earlier. There were nevertheless more new private sector building projects commencing in 1999, as the residential property market has revived since late 1998.

On external trade, total exports fell by 4.3% in 1998. This was due to the marked decline in exports to East Asia, which together accounted for around half of Hong Kong, China's total exports. Imports shrank even more, by 7.2% in 1998, as retained imports were much reduced as a result of the economic downturn. Although inbound tourism picked up visibly in the second half of 1998, exports of services still recorded a decrease of 6.5% for the whole of 1998. Imports of services fell by 0.6% in 1998, due to the setback in overall business activity. Yet export performance improved visibly in the first half of this year, contributed to the pick-up in exports to the United States and to a number of East Asian markets. The year-on-year decrease in total exports moderated to around 2% in the second quarter of 1999, from a 9.6% decline in the fourth quarter of 1998. With inbound tourism sustaining a recovery, exports of services rebounded to an increase of 1.4% in the first quarter of 1999 over a year earlier, and the growth momentum should have continued since. Meanwhile, imports of services in the first quarter of 1999 were virtually unchanged from a year earlier.

With the improvement in overall economic activity already evident in the first half of 1999, a more visible revival is envisaged in the second half of the year. For 1999 as a whole, real GDP is forecast to grow by 0.5%. Domestically, consumer spending should continue to recover from the low level of last year. Although private sector investment may remain slack until the overall business outlook turns distinctly better, public sector building and construction activity should gather momentum in the latter part of the year. Externally, exports of goods and services should continue to improve, as the East Asian economies recover and the situation in other overseas markets holds steady. The growth momentum of inbound tourism is also expected to continue.

CONSUMER PRICES

Consumer price inflation eased distinctly over the course of 1998 and turned negative towards the end of the year. For 1998 as a whole, the composite consumer price index (CPI) rose by an average of only 2.8%, markedly down from the 5.8% increase in 1997. It fell by 2.9% in the first half of 1999 over a year earlier. This reflected the expeditious adjustment in domestic costs and prices, which had continued amidst the economic downturn brought about by the regional financial turmoil. The freeze in government fees and in a number of public utility charges also contributed. Moreover, imported inflation was subdued, helped by the generally soft world commodity prices and low to negative inflation in the major supplier economies. As the adjustment process is expected to continue into the rest of this year, the composite CPI is forecast to decline by an average of 2.5% in 1999.

EMPLOYMENT

The labour market slackened markedly over the past year or so, with the seasonally adjusted unemployment rate rising from 2.5% in the fourth quarter of 1997 to 6.2% in the first quarter of 1999, and the underemployment rate from 1.3% to 3.0%. Apart from corporate downsizing and retrenchment caused by the economic downturn, there was also a easing in the manpower resource balance following a faster growth in labour supply than in labour demand. Labour wages in money terms had moderated, from a year-on-year increase of 7% in late 1997 to virtually no change in March 1999.

Yet along with a gradual improvement in overall business conditions, there was some pick-up in employment growth in the more recent months. In line with this, the seasonally adjusted unemployment rate and the underemployment rate both edged down slightly, to 6.1% and 2.9% respectively in the second quarter of this year.

CURRENT ACCOUNT

The combined visible and invisible trade account turned to a small surplus of HK$4.6 billion in 1998, equivalent to 0.4% of GDP in that year, after deficits in the preceding few years. The economic downturn in 1998, coupled with the winding down of the Airport Core Programme, reduced import demand markedly. The significantly reduced visible trade deficit was more than offset by the continued sizeable surplus in the invisible trade account.

The visible trade deficit continued to narrow in the first half of 1999, to 4.0% of the total imports in that period, from 9.3% in the same period last year. This was due to reduced intake of goods for local use. As imports of both goods and services are expected to pick up in the second half of this year, the combined visible and invisible trade account is projected to return to a small deficit of HK$3.5 billion for the whole of 1999, equivalent to only 0.3% of GDP.

EXCHANGE RATE

Throughout 1998 and the first half of 1999, the exchange rate of the Hong Kong dollar against the US dollar remained stable at around the linked rate of 7.80. Subsequent to the introduction of technical measures to strengthen the currency board arrangements in Hong Kong, China in September 1998, the Hong Kong dollar exchange rate traded within a narrow range of HK$7.740-HK$7.759 to US$1. The stable Hong Kong dollar is underpinned by the robustness of the linked exchange rate regime, sound economic fundamentals, a well-supervised and generally healthy banking sector, fiscal prudence and strong reserves.

The market exchange rate of the Hong Kong dollar against the US dollar closed the second quarter of 1999 at HK$7.756 to US$1. The Effective Exchange Rate Index of the Hong Kong dollar fell by 4.4% during 1998, before rising by 2.3% during the first six months of 1999.

FISCAL POLICY

In fiscal year 1998-99, the Government incurred a deficit of HK$23.3 billion, largely as a result of a package of relief measures announced in June 1998. The full-year effect of the tax concessions introduced in the 1998 budget and the further one-off tax concessions introduced in the 1999 budget, together with the effect of the economic downturn, mean that revenue is likely to decline further in fiscal year 1999-2000.

On the other hand, in order not to jeopardize the prospects for economic recovery, the Government has not cut back on its spending plans. New and improved services continue to be introduced, particularly in the areas of education, health and social welfare. Infrastructural spending is also being sustained at a high level.

The fiscal deficit is thus expected to rise to HK$36.5 billion in fiscal year 1999-2000.

MONETARY POLICY

The primary objective of Hong Kong, China's monetary policy continues to be maintaining stability in the external value of the Hong Kong dollar against the US dollar, at a fixed rate of HK$7.80 to US$1.

FOREIGN DIRECT INVESTMENT

The total stock of inward foreign direct investment (FDI) in Hong Kong, China amounted to HK$732 billion (US$95 billion) at end-1997, representing an increase of 17% over end-1996. The United Kingdom remained the largest source of inward FDI, accounting for 25% of the total. It was followed by mainland China (with a 19% share), the United States

(18%), and Japan (13%). Of the total, 93% was in the non-manufacturing sectors, particularly banking and finance, and the wholesale, retail and import/export trades.

There is no official data on Hong Kong, China's outward FDI. Based on statistics released by some of the host economies, Hong Kong, China is known to have invested heavily in East Asia, particularly in the mainland of China. As at end-March 1999, the cumulative value of Hong Kong, China's realized direct investment in mainland China amounted to US$142 billion, accounting for 52% of the total FDI there.

MEDIUM-TERM OUTLOOK

The economy of Hong Kong, China has been adjusting promptly to the adversities from within the region and beyond. Wages and earnings have softened. Property prices and rentals have fallen substantially from their peaks in 1997. Both the cost of living and the cost of doing business have come down significantly. But most important of all is the fact that the economic fundamentals of Hong Kong, China remained strong, as exemplified by its prudent budgetary management, sound monetary system, and a generally healthy banking sector. Companies have been adapting effectively to the changing business environment. All these are providing a solid base for continued recovery of the economy.

Over the medium-term, local consumer spending is expected to show faster growth than in 1999, as the labour market gradually improves and the negative impact of the regional financial turmoil on willingness to spend gradually dissipates. Overall investment spending is expected to recover steadily. Building and construction activity should progressively revive, on the back of the pick-up in private sector building output, and the boost to public sector civil engineering output from implementation of the priority railway projects. Strengthened economic activity and improved profits position resulting from the reduced cost of doing business should induce greater intake of machinery and equipment by the private sector. Export performance should also be more positive over the medium term, given the steady revival expected for the East Asian markets, sustained growth in the United States, and gradual pick-up in the European economies. Real GDP is projected to grow by a trend average of 3.5% per annum over the medium term.

MAIN STRUCTURAL REFORMS

Seeing an economic downturn, the Government introduced the largest tax concession ever in February 1998. More relief measures, aimed at boosting domestic demand, stabilising the property market, easing the credit and liquidity squeeze, and boosting tourism, were announced in June 1998. Furthermore, a Task Force on Employment was set up in May 1998 to monitor the progress of measures to tackle unemployment and create jobs.

With a view to fostering Hong Kong, China's economic development in the longer term, the government has set in train a series of measures to promote the application of science and technology, to support industrial and commercial development, to enhance physical infrastructure and human resources, and to achieve a more efficient and cost-effective government. In the 1999/2000 Budget, further measures were announced to strengthen financial services, to promote information technology, and to bolster tourism.

Also, the government has been operating a Services Promotion Programme which looks systematically and comprehensively at the services sector of the economy, and identifies ways to further entrench the role of Hong Kong, China as the premier services centre in

Asia. It is also operating a Helping Business Programme which reviews ways to help the business sector by cutting red tape, reducing the cost of compliance, identifying activities for transfer to the private sector, and introducing new and improved services in support of the business community.

Hong Kong, China: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	100.7	116.0	130.8	139.2	154.1	173.6	166.0
Real GDP	6.3	6.1	5.4	3.9	4.5	5.3	-5.1
Total Consumption	8.3	6.9	6.4	1.7	4.6	6.2	-5.9
Private Consumption	8.5	7.5	6.7	1.6	4.7	6.7	-6.7
Government Consumption	7.2	2.2	3.9	3.2	4.0	2.4	0.7
Total Investment	11.5	0.3	24.8	18.2	-1.5	13.3	-14.2
Private Investment	12.3	-4.3	26.1	17.6	-4.5	17.1	-14.7
Government Investment	5.2	29.3	17.1	22.0	17.1	-5.5	-11.1
Exports of Goods and Services	18.3	12.7	9.8	11.0	5.5	5.1	-4.6
Imports of Goods and Services	20.8	12.0	13.5	12.7	4.4	6.9	-6.6
Fiscal and External Balances (% of GDP)							
Budget Balance	2.8	2.1	1.1	-0.3	2.2	6.5	-1.8
Merchandise Trade Balance (f.o.b.)	-4.3	-3.3	-8.4	-14.1	-11.9	-12.2	-6.6
Current Account Balance	5.3	7.0	1.2	-4.3	-1.4	-3.5	0.4
Capital Account Balance							
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	9.7	8.5	6.9	2.5	5.9	7.2	0.8
CPI	9.6	8.8	8.8	9.1	6.3	5.8	2.8
M2	14.3	26.9	18.7	15.1	19.3	9.9	9.8
Short-term Interest rate (%) (1)	3.9	3.4	4.8	6.2	5.5	7.1	8.1
Exchange Rate (Local Currency/US$)	7.7	7.7	7.7	7.7	7.7	7.7	7.7
Unemployment Rate (%)	2.0	2.0	1.9	3.2	2.8	2.2	4.7
Population (millions)	5.8	5.9	6.0	6.2	6.3	6.5	*6.7*

Source: Data are as submitted by member economies, unless otherwise specified.
Notes: (1) 3-month HIBOR average

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	0.5	-1.3		-0.5	0.0		3.1		2.0	4.0	3.5				
Real Exports	-2.1														
Real Imports	-1.4														
CPI	-2.5	-2.2		-1.5	-0.5		0.0		1.0	1.5	3.0				

Note: Trade official real GDP forecast for the period 2000-02 in the forecast trend growth rate during 1999-2002. The corresponding price forecast is in terms of the GDP deflator. The IMF forecast is from *World Economic Outlook* may 1999. The ADB forecast is from the *Asian Development Outlook 1999*. The OECD forecast is from the *OECD Economic Outlook* June 1999

INDONESIA

The year 1998 was, for Indonesia, one of prolonged financial instability and crisis which negatively affected the performance of the Indonesian economy. Production declined significantly as a result of accelerated inflation and high interest rates. The inflation was provoked by imported inflation stemming from accentuated rupiah depreciation and domestic supply shortages.

In response to this aggravated condition, a broad-based policy package was implemented, with the financial support of the IMF. The policy package included: (i) a tightening of monetary policy, with sharply higher interest rates and strict control over central bank net domestic assets; (ii) an adjusted fiscal framework that took into account the less favorable outlook for growth and allowed for the cost of bank restructuring, as well as expenditures to cushion the impact of the crisis on the poor; (iii) an action program for the restructuring of the banking system; and (iv) a number of additional measures constituting a far-reaching structural reform and adjustment program to improve efficiency.

With consistent implementation of the policy package, signs of early recovery started to emerge in the first quarter of 1999. The economy has bottomed out, the rupiah strengthened, inflation pressures subsided, the interest rate continued to decline and the stock market rebounded.

REAL GDP GROWTH

The financial turbulence had a negative impact on economic activities, resulting in a deep contraction of GDP by 13.7% in 1998, as compared with 4.9% growth in 1997. The contraction was primarily seen in a sharp decline in private investment and lower household consumption. The weakened household consumption was brought about by a loss of purchasing power stemming from accelerated inflation and sharp rupiah depreciation. Private investment contracted due to a deterioration in cash flows as the external debt burden increased substantially, notwithstanding higher interest rates and limited access to bank credit from both domestic, as well as overseas banks.

However, the most recent evidence shows that the recovery process is underway. On the annualized quarterly basis, the economy grew by 5.4% in the first quarter, followed by 1.8% growth in the second quarter. On the annual basis, the real GDP grew by 1.8% in the second quarter as compared with previous year, confirming the first year to year pick up in growth since the fourth quarter of 1997.

INFLATION

In 1998 the annual inflation rate reached 77.6% as compared with 10.3% in 1997. The accelerated inflation was mainly reflected in higher prices of food and other essential items. These conditions were aggravated by disturbances in the distribution system and supply shortages due to adverse weather, which had led to a poor harvest.

After recording a skyrocketing inflation rate in 1998, inflationary pressure subsided in the first half of 1999. In January 1999, monthly inflation reached 2.97% and fell to 1.2% in February, and even turned into deflation in the four subsequent months, that is, -0.18% in March, -0.68% in April, -0.28% in May, and -0.34% in June 1999.

EMPLOYMENT

With deepening contractions in the economy during 1998, the unemployment rate in Indonesia increased substantially as a direct result of an unstoppable wave of layoffs in a number of sectors. The immense pressure originating from rising production costs on the one hand, and shrinking domestic market absorption on the other, had caused a large number of entities to downscale their operations. In the meantime, minimum real wages dropped as a result of the rising inflation. The open unemployment figure, which reached 4.3 million in 1997, climbed to 5.1 million in 1998, equal to 5.5% of the total labor force. If estimated underemployment, of as many as 8.6 million people, were counted as unemployment, unemployment would have totaled 13.7 million.

BALANCE OF PAYMENT

In 1998, the deficit in Indonesia's overall balance of payments (BOP) position narrowed to around US$612 million as compared to a deficit of US$2.5 billion in 1997. The deficit stemmed from a deficit in the capital account of around US$4.6 billion (4.4% of GDP) while the current account recorded a surplus of around US$3.9 billion (3.8% of GDP). This capital account deficit was due to huge private capital outflows, which offset official capital inflows (around US$9.9 billion) originating from foreign assistance. The net private capital outflows (including FDI) recorded a deficit of US$14.5 billion. In the first quarter of 1999, the capital account recorded a surplus of US$762 million. The surplus was attributed to the increase in official capital (net) by $3.5 billion, while the private capital (net) still posted an outflow of US$2.7 billion.

However, the overall external payments position in the first quarter of 1999 is expected to record a surplus of US$2.2 billion. The balance of payments surplus is driven by surpluses in the current account (around US$1.4 billion) and the capital account (around US$762 million) as net official inflows surpassed net private outflows.

EXCHANGE RATE

During the first quarter of 1998, the exchange rate was subjected to speculative attacks. It plummeted from Rp 4,650 per US dollar in December 1997 to around Rp 16,000 per US dollar on January 22, 1998. However, at the end of April 1998, it strengthened to Rp 8,325 as the market positively responded to the central bank's policy to raise the Bank Indonesia Certificate (SBI) rate and the government' attempts to settle private sector debt. The social unrest occurring in May 1998 undermined confidence in the economy and led to renewed pressure on the rupiah which fell to its lowest level of around Rp 16,800 per US dollar in mid-June.

Entering the second quarter of 1998, the rupiah rate strengthened from an average of Rp 14,300 per US dollar in July to averages of Rp 12,000 and Rp 10,900 in August and September, respectively. The authorities' strict adherence to strong monetary discipline, the renewed financial support from the international financial institutions, and the successful national debt restructuring brought a positive impact in the exchange market.

The rupiah exchange rate continued to strengthen significantly in the subsequent months, from a level of Rp 10,700 per US dollar at end-September to a range of Rp 7,500 to Rp 8,000 at the end of 1998, despite increased social and political tensions.

Entering 1999, the rupiah faced additional pressures stemming from various internal and external factors. After some rebound to around Rp 8,500, in early March the rupiah declined to about Rp 9,000 per US dollar. Upon the announcement of the bank restructuring on March 13, 1999 the rupiah strengthened and reached the range of Rp 8500 to Rp 8,800.

Currently, the rupiah is strengthening in the range Rp 6,700 to Rp 7,000, as there is growing optimism about the prospect of the economy and the peaceful completion of the June Parliamentary elections.

FISCAL POLICY

For fiscal year (FY) 1998/99, the overall balance recorded a deficit of 2.2% of GDP, an increase from the deficit of 0.8% in FY1997/98. Total central government expenditures witnessed a small (approximately 1.2% of GDP) increase between FY1997/98 and FY1998/99. This net increase is more than accounted for by two crisis-related factors. First, with the currency depreciation, government interest payments on the external debt increased by about 0.7% of GDP. Second, as explained below, spending on social safety net measures was increased. The net expenditure effects of these two developments outweighed the crisis-prompted cuts elsewhere in government spending (for example in development expenditures), which were cut by more than 0.3% of GDP.

Looking at the 1999/2000 budget, there are four main budgetary objectives. First, the budget incorporates a high-quality targeted fiscal stimulus to support demand, especially through higher development spending. Second, steps are being initiated to rebuild the revenue base over the medium term. Third, gross interest costs of bank restructuring approximately 3% of GDP have been incorporated in the budget. Fourth, the traditional principle of avoiding domestic bank financing for regular budgetary operations will remain, if necessary, by invoking contingency measures. Government bonds are to be issued only for bank recapitalization. The overall budget deficit is projected at nearly -4.4% of GDP in 1999/2000.

MONETARY POLICY

To stabilize the exchange rate and to reduce the inflation rate, a tight monetary stance was adopted to compensate for the excess supply of money stemming from the large scale liquidity support to commercial banks. As the tight money policy stance was adopted, interest rates on one-month SBIs rose sharply from 22% in January to 58% on May 7, 1998. Subsequently, deposit rates rose substantially, to roughly 60%. To enhance the effectiveness of open market operations (OMO) and to activate the secondary market, Bank Indonesia initiated a new SBI auction system by announcing on July 29, 1998, the target quantity of SBI (central bank certificates) intended to be sold. In addition, Bank Indonesia also directly intervened in the rupiah money market in order to achieve its base money target.

As inflationary pressures subsided and the rupiah strengthened, some pressures have been taken off the monetary policy, permitting a gradual reduction of interest rates within the context of the overall monetary policy program. The benchmark SBI auction rates declined subsequently to around 37% at the end of December. Entering 1999, interest rates have showed a continued declining trend. In the 30 June 1999 auction, SBIs reached 18.84%, bringing about a decline in deposit rates (one month) to around 20%.

MEDIUM-TERM OUTLOOK

Over the past six months, the key macroeconomic indicators of the Indonesian economy have shown that the worst of the crisis is over and the road to economic recovery has picked up. These positive achievements were further supported by the peaceful parliamentary elections in June, which in turn prompted the run-up in the stock market as confidence in Indonesia's economic prospects started to recover. Against these recent developments, the Indonesian economy in 1999 is projected to experience a much lower contraction rate as compared with the unprecedented negative growth of 13.7% last year.

The inflation rate by the end of 1999 is projected to be lower than 10%. The projected single digit inflation rate is likely since during the first six months the cumulative inflation rate has only reached 2.73%. Assuming the monthly inflation rate for the next seven months will be below 1%, the end year inflation rate is therefore estimated to reach around 8% or 9%.

In step with decelerated inflation, it is estimated that the rupiah exchange rate will stabilize with a range of Rp 6,000 to Rp 6,500 by the end of 1999. Meanwhile, domestic interest rates are expected to reach around 10% to 15% .

Against this background, two short-term scenarios are presented to project the growth of the Indonesian economy. The optimistic scenario is based on the assumption that progress in the bank and corporate restructuring program will proceed smoothly, that capital will begin to flow in at the third quarter of 1999, and a peaceful coalition government can be formed to ensure political stability. Under this optimistic scenario, real GDP growth is projected to be close to 0%.

In contrast, the downside scenario is based upon the assumption of a slower bank recapitalization and corporate restructuring process; difficulties in reaching consensus to form a strong coalition government; and a possible delay of disbursement of foreign borrowings. Under this scenario, the growth rate is projected to be around -2%.

MAIN STRUCTURAL REFORM

Monetary

Bank Indonesia, with support from the IMF, set quantitative targets for base money and its components, namely net international reserves (NIR) and net domestic assets (NDA), which have served as operational guidelines. With a view to strengthening the credibility of the policy among market players, the targets and performance have been made transparent through periodic announcements.

To achieve the quantitative target, on 29 July 1998, Bank Indonesia changed the auction system of Bank Indonesia Certificates (SBIs) whereby the emphasis was shifted from an interest rate target to a quantitative target.

Banking

The banking restructuring program was one of the priorities of the government's economic agenda. To restore confidence, the government continued its guarantee program for the safety of deposits up to the year 2000 and broadened the scope of the guarantee to include rural development banks.

In rehabilitating the soundness of the banking system and enhancing its resilience, as well as precluding a recurrence of bank runs in the future, the government continued the banking restructuring program that it had begun in the early 1999. The program rests on four pillars of policy, namely: (i) measures to restructure banks, primarily through a recapitalization program, (ii) measures to fix internal conditions, (iii) measures to improve bank regulations and law enforcement, and (iv) measures to strengthen supervision functions.

Improvement of the Legal, Regulatory, and Supervisory Framework

In line with the bank restructuring agenda, amendments of the banking law were approved by the parliament on 16 October 1998. These new amendments strengthened the legal power of IBRA (Indonesia Banking Restructuring Agency) and the AMU (Asset Management Unit). In addition, a new central bank law, which provides for greater independence for the central bank (Bank Indonesia), was enacted by the parliament on 16 April 1999. Furthermore, a law covering foreign exchange movements and the exchange rate system was passed. This bill allows Bank Indonesia to monitor capital flows and to implement the exchange rate system adopted by the government.

External Debt

One of the important steps in solving the corporate debt overhang, besides recovering access to international sources of fund, was the Frankfurt Agreement which was reached on 4 June 1998. The Frankfurt Agreement covers interbank debt settlement, trade financing, and private corporate debt.

To resolve the corporate debt overhang, the government has set up the Indonesian Debt Restructuring Agency (INDRA). The government has also provided INDRA with facilities to speed up the negotiation process between debtors and creditors through the Jakarta Initiative.

Institutions

To upgrade the institutional and the legal framework of Indonesia’s economy, the government issued a number of new laws. The new laws included legislation dealing with bankruptcy, anti-monopoly, banking, and the establishment of a commercial court.

Social Safety Net

The government initiated a number of measures to alleviate the adverse effects of the crisis, particularly on the poor and low-income families. On the fiscal front, the government raised expenditures that were associated with the social safety net and the subsidies on oil-based fuel, electricity, medicine, and foodstuffs.

Indonesia: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	139.1	158.0	176.9	202.2	227.3	218.0	103.1
Real GDP	7.2	7.3	7.5	8.2	7.8	4.9	-13.7
Total Consumption			7.1	11.2	8.9	5.9	-4.1
Private Consumption	3.5	6.5	7.8	12.6	9.7	6.6	-2.9
Government Consumption	5.8	0.1	2.3	1.3	6.6	0.1	-14.4
Total Investment			13.8	14.0	-3.0	8.6	-40.9
Private Investment							
Government Investment							
Exports of Goods and Services	14.7	6.6	9.9	7.7	7.6	7.8	10.6
Imports of Goods and Services	6.6	4.4	20.3	20.9	6.9	14.7	-5.4
Fiscal and External Balances (% of GDP)							
Budget Balance	-0.3	0.6	0.9	2.2	1.2	-3.7	
Merchandise Trade Balance (f.o.b.)	4.8	5.4	4.6	2.8	1.5	4.4	
Current Account Balance	-2.2	-1.5	-1.7	-3.4	-3.5	-2.3	3.8
Capital Account Balance							
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	5.4	8.9	7.8	9.9	8.7	11.9	83.3
CPI	4.9	9.8	9.2	8.6	6.5	10.3	77.6
M2	20.2	22.0	20.2	27.6	29.6	23.2	62.4
Short-term Interest Rate (%)	12.0	8.7	9.9	13.6	14.1	30.5	64.1
Exchange Rate (Local Currency/US$)	2,030	2,087	2,200	2,308	2,383	4,650	8,025
Unemployment Rate (%)	2.7	3.1	4.4	7.2	4.9	4.3	5.1
Population (millions)	186.0	189.1	191.5	194.8	198.2	200.4	*204.0*

Source: Data are as submitted by member economies, unless otherwise specified.

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	-2.7/ 0	-1.1		0.0	-3.0	3.0	3.3		2.0	3.0	4.2				
Real Exports	-6.7					2.2					6.6				
Real Imports	-4.9					2.4					9.7				
CPI	8 / 10	28.2		17.0	30.0	5.4	10.0		9.5	12.0	7.2				

Note: The IMF forecast is from the *World Economic Outlook* (IMF, April 1999). The ADB forecast is from the *Asian Development Outlook* (1999). The OECD forecast is from the *OECD Economic Outlook* (OECD, June 1999).

JAPAN

A second consecutive decline of real GDP has been recorded in fiscal year (FY) 1998. Supported by the government's measures in fiscal, monetary, and structural policy, positive growth is projected for FY1999.

REAL GDP GROWTH

The annual growth rate of real GDP dropped to -1.9% in FY1998 (April 1998 to March 1999), following -0.4% in FY1997. Since late 1997, difficulties in the financial system in the domestic market had reduced the confidence of households and the business sector, which resulted in a decline of domestic demand. In FY1998, private consumption increased only modestly by 0.1%, as the rise in unemployment weakened the sentiment of households and the rate of increase of wages has dropped. Private investment for plants and equipment dropped sharply, by 12.4% in FY1998. Due to the large decline of exports to Asian economies, total exports of goods and services declined by 3.7% in FY1998, while total imports of goods and services also declined by 7.5%.

In early 1999, some indicators showed that economic activities have begun to stabilize, supported by various government policy measures, while the overall economic situation remains very severe. In the first quarter of 1999, real GDP increased by 2.0% on a quarter to quarter basis (seasonally adjusted). The government has made considerable efforts to restore economic activities. Public works were substantially increased in supplementary budgets for FY1998 and the initial budget for FY1999 to boost the domestic demand. Financial markets have been settled as a result of the progress of the government's measures for stabilizing the financial system. Expansionary monetary policy is reflected in a low and stable short-term interest rate. On the other hand, the rising unemployment rate and declining investment for plants and equipment reveal the still-severe economic situation.

In FY1999, the growth rate of real GDP is expected to be around 0.5%. This projection reflects the active government policy actions, including measures for stabilizing the financial system, those for stimulating demand such as tax deduction and increased public works, and those for supporting employment and business activities.

INFLATION

The rate of increase in the consumer price index (CPI) has been very stable, reflecting the sluggishness of overall economic activities and effects of deregulation. The increase in CPI was only 0.2% in FY1998, and is expected to stay very low in FY1999. Weakness in domestic demand is also reflected in the negative growth of the domestic wholesale prices index (WPI). The rate of increase in WPI was -2.1% in FY1998. In FY1999, it is again expected to be negative, reflecting the modest recovery of overall economic activities.

EMPLOYMENT

The prolonged economic slump has had serious impacts on the labor market, raising the number of unemployed and putting downward pressure on wages. The unemployment rate has exceeded 4% and recorded a historical high of 4.9%, in June of 1999. In FY1998, the number of employed declined by 0.9%, and unemployment rate rose to an annual average of

4.3%. Compensation of employees was also expected to decline by 1.1% in FY1998. In FY 1999, the severe situation of the labor market is expected to continue.

TRADE ACCOUNTS

Reflecting sluggish domestic demand, imports dropped sharply in the first half of 1998 and remained flat in the later half of the year. Exports to the Asian economies have dropped significantly since late 1997, affected by the slowdown of economic growth in those economies, while exports to the US and EU had increased constantly. The current account surplus increased to 15.2 trillion yen (3.1% of GDP) in FY1998 from 12.9 trillion yen (2.6% of GDP) in FY1997. The increase in current account surplus in FY1998 was mainly attributed to the sharp drop in imports due to the economic slump and a fall in commodity prices. In FY1999, the current account surplus is expected to decline slightly. This projection assumes a decrease in export values due to the slower growth of the world economy and the increase in imports value due to the recovery in the petroleum price. The capital account deficit decreased from 15.3 trillion yen in FY1997 to 14.7 trillion yen in FY1998.

GROSS EXTERNAL DEBT

Net external assets have increased constantly, reflecting the current account. In calendar year (CY) 1998, gross external assets amounted to 345 trillion yen and gross external debts were 212 trillion yen. Consequently, net external assets totaled 133 trillion yen, which is equivalent to around one quarter of GDP.

FOREIGN DIRECT INVESTMENT

In FY1998, foreign direct investments (FDI) outflow from Japan dropped by 21% from FY1997. It was notable that FDI outflow to the United States shrunk almost by half in FY1998, while that to Asia also declined by 44% due to the impact of the crisis. The amount of total FDI outflow was 5.2 trillion yen in FY1998, following 6.6 trillion yen in FY1997. FDI inflows to Japan increased significantly in FY1998 and reached 1.3 trillion yen, which is almost double the amount in FY1997.

EXCHANGE RATE

The Japanese yen slipped by 20% from mid-1997 to mid-1998. The yen rose in late 1998 and almost returned to the level of mid 1997. In 1999, the yen has been stable at around 120 yen/US dollar.

FISCAL POLICY

Fiscal policy has played a major role in supporting weak economic activity through various measures including tax cuts and an increase in expenditure for infrastructure investment. In April and November 1998, the government launched two major economic stimulus packages. The total amounts of those packages were over 16 trillion yen and around 27 trillion yen respectively. Fiscal measures such as tax cuts and the increase in expenditure for infrastructure investment are included in the packages. To implement the packages, government expenditures were increased by a series of supplementary budgets for FY1998 and the budget for FY1999. The expenditure of the initial budget for the general account of the central government will increase by 5.4% in FY1999 over FY1998. The amount of tax cuts in the central and local governments totals more than 9 trillion yen, including permanent reductions in both personal and corporate income tax.. The total amount of public bonds is expected to increase to around 327 trillion yen (66% of GDP) in FY1999, up from 299 trillion yen in FY1998.

MONETARY POLICY

With the prolonged sluggish growth of the economy, the official discount rate has been at a historical low of 0.5%, since September 1995. In FY1998, the short-term interest rate was lowered further by the actions of the Bank of Japan (BOJ). Facing the severe economic situation, the Bank of Japan lowered its target for the overnight call rate from around 0.5 to around 0.25% in September 1998 in order to prevent the economy from falling into a deflationary spiral. The BOJ also took further action in February 1999 to lower initially its target for the call rate to around 0.15% and sought subsequently to reduce the rate as far as possible. Reflecting the actions of the BOJ, short-term interest rates declined in late 1998 and early 1999, and have been virtually zero since early March 1999. Long-term interest rates rose in late 1998 partly reflecting the increase in the issue of public bonds. The rise of long-term interest rates provoked serious arguments about the risk of damage to still fragile economic activities. However, long-term interest rates began to decline in early 1999 as the overall economic activity remained sluggish and short-term interest rates dropped further.

MEDIUM-TERM OUTLOOK

The cabinet approved the economic plan in July of 1999 which outlines the long-term perspective of the Japanese economy and society up to 2010. In the annex to the economic plan, the prospects of the main economic indicators up to 2010 are given as follows:

- Real growth rate: around 2% (a potential growth rate)
- Inflation rate: around 2%
- Unemployment rate : more than 3.5% less than 4.5%

MAIN STRUCTURAL REFORMS

Substantial efforts have been made to resolve the bad loan problems in the financial sector. The legislation for the recapitalization scheme and the comprehensive framework for dealing with banking problems has enabled fast restructuring in the banking sector and has contributed to the stabilization of the financial system. The legislated measures include the use of public funds to recapitalize the banking system and ways to address banking sector weaknesses through financial administrators, bridge banks, temporary nationalization and the purchasing of the assets of financial institutions. Under this new framework, some major banks are temporarily nationalized. In late March 1999, fifteen of the major banks received injections of public funds amounting to 7.4 trillion yen for recapitalization.

Japan: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	3,725.0	4,293.0	4,700.0	5,144.0	4,595.0	4,195.0	3,806.0
Real GDP	1.0	0.3	0.6	1.5	5.1	1.4	-2.8
Total Consumption	2.1	1.3	2.0	2.2	2.8	1.1	-0.9
Private Consumption	2.1	1.2	1.9	2.1	2.9	1.0	-1.1
Government Consumption	2.0	2.4	2.4	3.3	1.9	1.5	0.7
Total Investment	-2.9	-2.4	-1.3	2.4	12.3	-2.1	-9.1
Private Investment	-7.5	-8.1	-3.4	3.3	13.5	1.3	-12.1
Government Investment	15.1	15.5	3.9	0.2	9.3	-10.5	-0.7
Exports of Goods and Services	4.9	1.3	4.6	5.4	6.3	11.6	-2.3
Imports of Goods and Services	-0.7	-0.3	8.9	14.2	11.9	0.5	-7.5
Fiscal and External Balances (% of GDP)							
Budget Balance	-3.3	-4.5	-5.7	-6.7	-6.6	-5.9	
Merchandise Trade Balance (f.o.b.)	3.3	3.3	3.1	2.6	1.8	2.4	3.2
Current Account Balance	3.0	3.1	2.8	2.1	1.4	2.3	3.2
Capital Account Balance	-2.7	-2.5	-1.9	-1.3	-0.7	-2.9	-3.5
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	1.7	0.6	0.2	-0.6	-1.4	0.1	0.3
CPI	1.6	1.3	0.7	-0.1	0.1	1.8	0.6
M2	0.6	1.1	2.1	3.2	3.3	3.1	4.0
Short-term Interest Rate (%)	4.4	2.9	2.2	1.2	0.6	0.6	0.7
Exchange Rate (Local Currency/US$)	126.7	111.2	102.2	94.1	108.8	121.0	130.9
Unemployment Rate (%)	2.2	2.5	2.9	3.2	3.4	3.4	4.1
Population (millions)	124.5	124.7	125.2	125.5	125.8	126.0	126.5

Source: Data are as submitted by member economies, unless otherwise specified.
Notes: (1) Budget balance refers to general government. It excludes the social security.
(2) Short-term interest rate refers to 3-month certificates of deposit (CDs).

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	0.5	-1.4			-0.9		0.3			0.0	2.0	0.3			
Real Exports	1.5				1.5					3.9					
Real Imports	3.4				-0.5					2.1					
CPI	0.1	-0.2			-0.7		-0.2			-0.6	2.0	-0.2			

Note: The official figures for 1999 refer to FY1999 (April 1999 to March 2000) and figures for 2000-2002 refer to FY1999-2010. The IMF forecast is from the World Economic Outlook (IMF, April 1999), figures for the period 2000-2002 refer to 2000 only. IMF revised its forecasts of real GDP growth to 0.2% for 1999 and 1% for 2000 (August 1999). The OECD forecast is from the OECD Economic Outlook (OECD, June 1999), figures for the period 2000-2002 refer to 2000 only.

REPUBLIC OF KOREA

BACKGROUND: RECOVERY FROM THE ECONOMIC AND FINANCIAL CRISIS

Korea, facing a severe currency and financial crisis in late 1997, was forced to turn to the IMF for emergency funds. As part of the bailout conditions, the IMF required the Korean government to pursue macroeconomic stabilization and major structural reforms. The Korean government implemented drastic reforms in the corporate, financial and labor sectors in order to promote transparency, efficiency and flexibility. As the economic reforms were successfully implemented, the foreign exchange market began showing signs of improvement, resulting in the stabilization of the exchange rate and interest rates. The Korean economy began to show considerable improvement in the industrial activity indicators in early 1999.

REAL GDP GROWTH

A deepening contraction of private consumption, shrinking investment and sluggish export growth caused GDP in the first quarter of 1998 to contract by 3.9%. GDP continued its fall in the second and third quarters and 1998 posted a record low decline of 6.8%. However, events have dramatically changed as a faster-than-expected recovery is now underway. The economy grew 4.6 % in the first quarter of 1999, is expected to grow more than 6% in the first half of 1999 and is forecast to grow as much as 7% for the entire year, though official 1999 growth estimates remain at 4.3%. This upward trend is to continue in 2000 with the expected growth rate set at around 5%. The growth of the economy will occur largely due to the recovery of consumption helped by expansionary fiscal and monetary policies and improvements.

Private consumption, that had contracted 11.7% in the first half of 1998 due to the massive unemployment caused by the economic downturn, has continually improved since the beginning of this year. Private consumption recorded a 6.3% increase during the first quarter of 1999 compared to a 9.9% decrease recorded in the first quarter of 1998.

Facility investment recorded a 46.5% decrease over the first three quarters of 1998 due to the fall in domestic demand and economic restructuring. However, in May 1999, facility investment advanced a record 43.4% on a year-on-year basis, along with the economic recovery. Construction orders also increased, by 89.6%. Economic recovery has tended to be driven by consumption in the past months, but from May rising investment also began playing a significantly positive role.

INFLATION

After a sharp rise in the first quarter of 1998, prices showed remarkable stability for the rest of the same year, due to the stable exchange rate of the Korean won against the US dollar, the sharp contraction in domestic demand and the decline in international raw material prices. In November 1998, the year-on-year rates of increase of producer prices and consumer prices eased to 11% and 6.8%, respectively.

Thanks to the steady won/dollar exchange rate and a continued fall in the prices of raw materials, consumer prices remained stable in the first half of 1999, with only a 0.7%

increase from January to May 1999. Meanwhile, producer prices declined an average of 3.4% in the first half from the same period of a year earlier.

EMPLOYMENT

By December 1998, the number of employed workers fell by 5.6%. The number of employees in the agriculture, forestry and fishery sectors fell by 1.8%, while the number of employees in the manufacturing and services sectors fell by 12.5% and 4.0%, respectively. The overall unemployment rate increased to 7.8% (seasonally adjusted 7.9%) by the end of 1998 as a consequence of the economic recession and restructuring in the public and private sectors that effectively blocked the hiring of new workers.

However, thanks to the improving economic conditions, by May 1999, the unemployment rate decreased to 6.5%, after peaking at 8.7% in February. Despite the recent improvements, comprehensive efforts are needed to ensure an adequate social safety net to meet the social challenges of unemployment, an inevitable by-product of the restructuring process.

CURRENT ACCOUNT

The current account balance was reversed from an US$6.2 billion deficit in 1997 to a US$40.05 billion surplus in 1998. The unprecedentedly large surplus was almost entirely due to a sharp decline in imports. Exports decreased by 2.8%, while imports plummeted 35.5% in 1998. The service balance was also in surplus due to a surplus in the travel balance. With the increase in remittances by foreign residents of Korea, the current transfers balance also recorded a significant surplus.

However, from January to June 1999, the current account surplus was reduced to US$13.6 billion from US$21.0 billion recorded in the same period of the previous year due to the recovery of the domestic economy and an increase in imports. Also, the service account balance reversed, becoming a deficit due to the increasing number of Koreans travelling overseas and increasing freight costs caused by increasing imports.

GROSS EXTERNAL DEBT

Korea's total external liabilities, defined as long term debt plus short term debt including both public and private sectors, were diminished for the first half of 1999. As of end of January 1999, Korean external liabilities posted US$147.03 billion, down by US$2.32 billion from December 1998. In line with the downturn in January, external liabilities reached US$145.43 billion in February, US$142.7 billion in the end of April 1999. In March 1999, there showed a slight increase in external liabilities that amounted to US$145.52 billion. This was mainly due to the rise of short-term debt, which was up 0.9% from February. In March, short-term debt occupied 21.9% in total external liabilities.

EXCHANGE RATE

Following its huge depreciation in the end of 1997, the won quickly recovered to the won/dollar rate of 1300-1400 by the second quarter of 1998 and continued to slowly appreciate to a won/dollar rate of 1,200s in June 1999. The continued strength occurred despite the strong dollar and weak yen. The won has been strengthening mainly due to the continuous current account surplus and the rise in foreign capital inflow coming from FDI.

FOREIGN DIRECT INVESTMENT

From January to December 1998, total FDI in Korea amounted to US$8.9 billion, a 21.25% increase over a year earlier. As the restructuring process in every field of Korean economy has been going well, FDI flowed into main industries such as the electronics, telecommunications, petrochemical and financial services.

In the first quarter of 1999, there were 389 committed foreign direct investments that provided a total investment of US$2.0 billion. This is a 26.3% increase in the total number of cases and a 250.3% increase in the total amount of FDI in comparison to the first quarter of 1998. In addition FDI amounted to US$811 million in April 1999, a 10.36% increase over the previous month. During the first quarter of 1999, foreign investment through acquiring newly issued stocks and participation in capital increase, amounted to 321 committed cases of FDI that equaled a total amount of US$1,512 million and accounted for 75.4% of the total foreign investment.

FISCAL POLICY

In order to bring the economy out of recession and to accelerate the restructuring process, the Korean government has redirected its policy focus to one of expansionary fiscal measures. The second supplementary budget passed in September increased the deficit target for 1998 to 5% of GDP. Fiscal policy in 1999 will be mainly focused on stimulating the real economy. The government had previously projected a budget deficit of 5% of GDP in 1999 but thanks to rising tax revenues, that projection has been revised to 4% of GDP. Revenues are expected to surpass previous estimates by 5 trillion won (US$4.29 billion).

The increased tax revenue will be used to reduce the budget deficit and support wage earners and the poor. The government had earlier expected the government budget to strike a balance in 2006, but it expects to achieve a balanced budget two to three years earlier than expected if the economy continues along its path to recovery.

MONETARY POLICY

Monetary policy has been eased substantially with rates now well below their pre-crisis levels. Interest rate policy has continued to be conducted in a flexible manner with upward and downward adjustments being implemented based on existing situations. Interest rates have been reduced significantly to support the recovery from the currency crisis. One-day call interest rates recorded 6.35%, 5.55%, 4.98% and 4.78% respectively from the months of January to April 1999. This is in striking contrast with interest rates of 25.34% in January and 25.2% in February 1998. In line with the decline in interest rates, the 91-day CD yield rate and the 3-year corporate bond yield have been on a similar trend for the first half of 1999. M2 money supply has grown steadily for the first half of 1999. In detail, M2 increased 26.3% in January, 29.9% in February, 33.6% in March and 34.5% in April.

Low interest rates are expected to continue for the last half of 1999. The central bank will pay greater attention to the stable management of the money supply in light of a recent surge in liquidity at non-bank financial firms and a jump in the inflow of foreign stock investment funds. The sharp rise in liquidity could increase the total money supply, spark a rise in asset prices and thus fuel inflationary expectations. In order to keep any inflationary pressures from materializing, the central bank will closely monitor the movement of funds among financial markets, wages, stock prices and real estate prices.

MEDIUM-TERM OUTLOOK

Despite the slowing growth of the world economy, the Korean economy is expected to enjoy positive growth of 7% in 1999. As stated earlier, this is largely the result of the government's expansionary fiscal and monetary policies. In particular, due to the expansionary policies that have been activated recently, private and government expenditure will increase slightly. With steady recovery from the crisis, the Korean economy is estimated to grow by nearly 5% in 2000. However, the strength and speed of recovery and the resumption of sustainable growth will greatly depend on both domestic confidence in the restructuring programs and the international economic environment

Korea's current account surplus will fall to around US$7 billion in the second half of 1999, and the economy is expected to attain its current account surplus target of US$20 billion for 1999. Helped by the rapid economic recovery, private consumption is expected to surge by 6.4% in 1999, compared with a decline of 9.6% a year earlier. Annual consumer price inflation is forecast to be 1.8% in 1999, much lower than the 3% set in the latest consultation with the IMF, and 2.0% in 2000. Unemployment is targeted to be reduced to 6.0% in 1999 and to stay at around 6.0% during 2000.

Through furthering the reach of the market mechanism in its economy, Korea will strive to maximize its growth potential. By 1999, the Korean economy will restore full economic stability and the year 2000 will mark the beginning of a new phase of sustainable growth with increased productivity and global competitiveness.

MAIN STRUCTURAL REFORMS

Financial sector restructuring

The Korean government continues its efforts to consolidate and recapitalize the banking sector. As of January 1999, five commercial banks have had their operations suspended and 99 other financial institutions have been closed. The government has mobilized fiscal resources totaling 64 trillion won to support viable financial institutions for recapitalization and the disposal of non-performing loans. Meanwhile, the banks have intensified their own rehabilitation efforts, including mergers and acquisitions. Most significantly, Korea First Bank was auctioned off to a U.S.-based consortium, and a similar deal for Seoul Bank is near conclusion. The integration and coordination of the supervision and prudential regulation of the financial sector have been furthered by the formation of the Financial Supervisory Service on 1 January 1999.

Corporate sector restructuring

A number of non-viable firms have been forced to close, while the process of corporate workouts with creditor banks has begun for viable firms. The top five *chaebol* and their creditor banks have formulated capital structure investment plans that focus on reducing debt-equity ratios and the swap of affiliates between groups. Important progress has been also made in restructuring the 58 other top *chaebol* under the debt workout framework established in collaboration with the World Bank. Institutional standards for corporate governance, transparency and accountability have been greatly improved.

Public sector reform and labor market flexibility

Public sector reform has been advanced by the downsizing of government bodies. Labor market flexibility has been enhanced through the Tripartite Accord between labor, business, and government.

Capital market liberalization

The government completely removed the foreign equity ownership ceiling in May 1998; allowed complete freedom for foreign investors to make hostile mergers and acquisitions from May 1998; rendered complete freedom for foreigners to invest in local bonds and short-term money market instruments, and liberalized foreign exchange transactions from April 1999.

Korea: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	307.9	332.8	380.7	456.5	484.6	442.6	310.1
Real GDP	5.1	5.8	8.6	8.9	7.1	5.0	-5.8
Total Consumption	6.8	5.3	7.0	7.2	6.9	3.5	-12.1
Private Consumption	6.6	5.7	7.6	8.3	6.7	3.1	-12.7
Government Consumption	7.6	3.0	4.4	2.8	7.1	5.7	-9.1
Total Investment	0.8	5.2	11.8	11.7	7.1	-3.5	
Private Investment							
Government Investment							
Exports of Goods and Services	6.6	7.3	16.8	30.3	3.7	5.0	-2.8
Imports of Goods and Services	0.3	2.5	22.1	32.0	11.3	-3.8	-35.5
Fiscal and External Balances (% of GDP)							
Budget Balance	-0.7	0.3	0.5	0.4	-0.3	0.0	-4.9
Merchandise Trade Balance (f.o.b.)	-0.7	0.6	-0.8	-1.0	-3.2	-0.5	12.9
Current Account Balance	-1.5	0.1	-1.2	-2.0	-4.9	-1.9	13.1
Capital Account Balance	2.1	0.8	2.7	3.6	4.8	0.3	-1.3
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	6.1	5.1	5.5	5.6	3.4	2.4	7.9
CPI	6.2	4.8	6.2	4.5	4.9	4.5	7.5
M2	18.4	18.6	15.6	15.5	16.2	19.3	19.0
Short-term Interest Rate (%)	16.4	13.0	12.3	12.4	12.4	13.3	15.1
Exchange Rate (Local Currency/US$)	788	808	789	775	844	1,415	1,208
Unemployment Rate (%)	2.4	2.8	2.4	2.0	2.0	2.6	6.8
Population (millions)	43.7	44.2	44.6	45.1	45.6	46.2	46.4

Source: Data are as submitted by member economies, unless otherwise specified.

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	4.3	2.0		2.0	4.5		4.6		4.0	4.3					
Real Exports	2.4			2.0	6.0				6.0	7.5					
Real Imports	20.5			15.0	12.0				18.0	13.0					
CPI	1.7	1.8		2.0	2.5		2.0		3.0	2.3					

Note: The IMF forecast is from the *World Economic Outlook* (IMF, April 1999). The ADB forecast is from the *Asian Development Outlook* (1999). The OECD forecast is from the *OECD Economic Outlook* (OECD, June 1999).

MALAYSIA

REAL GDP GROWTH

In 1998, Malaysia's real GDP recorded a contraction for the first time since 1985 of 6.7% against a 7.7% growth in 1997. Consequently, per capita income in nominal terms declined to RM11,835 from RM12,051 in 1997. The contraction in real GDP, however, has been accompanied by a significant improvement in the external payments position, due to the sharper decline in import volume relative to export. The current account position of the balance of payments turned around to record a surplus of 13.7% of gross national product (GNP) from a deficit of 5.4% of GNP in 1997. This has led to a significant improvement in the external reserves position from RM59.1 billion at the end of 1997 to RM99.4 billion at the end of 1998, which was adequate to finance 5.7 months of retained imports.

During the year, output of all major sectors in the economy with the exception of the mining and services sectors were adversely affected by declining demand, excess supply or supply constraints. The most affected were the construction and manufacturing sectors which recorded a contraction of 24.5% and 10.2% (1997: +9.5%; +12.5%), respectively.

Aggregate domestic demand declined by 20.6% in current prices in 1998 (1997: +9.6%) due to cutbacks in private sector expenditure (-26.4%), while public sector expenditure contracted at a lower rate of 0.9%. The decline in private sector expenditure was attributed to the decrease in private investment and consumption. Public sector consumption, which mainly comprises the operating expenditure undertaken by the Government, declined by 1.5% in 1998, largely due to lower expenditure on supplies and services.

Private investment fell sharply by 53.3% in 1998, due to sluggish demand, excess production capacity, higher cost of financing as well as uncertainties created by the volatile financial markets. Public sector investment declined slightly by 0.3% mainly due to the 7.5% decline in Non-Financial Public Enterprises (NFPEs') investment.

Malaysia's net external trade position improved significantly in 1998, with a surplus of RM58.4 billion, against a deficit of RM45 million in 1997, largely attributed to declining imports. Exports of goods in ringgit terms increased by 29.8% (1997: 12.1%) due to higher export prices as a result of the depreciation of the local currency. Imported goods in ringgit terms increased at a slower rate of 3.3% (1997: 12%), reflecting declines in both volume and lower international prices for most major imports, which largely offset the impact of the depreciation of the ringgit. However, the value of imports in US dollar terms decreased substantially by 26.2% in 1998 for all categories of imports, following the weak domestic demand conditions and the reduction in import of inputs for manufacturing exports.

INFLATION

Inflation was higher in 1998, largely due to the impact of ringgit depreciation on prices of imported food as well as exportable local commodities such as palm oil. The consumer price index (CPI) increased by 5.3% (1997: 2.7%). Underpinning this higher rate of inflation was the 8.9% increase in the CPI for food items. On monthly basis, however, the annualized rate of increase in overall CPI has decelerated from 6.2% in June to 5.3% in December, due to the pegging of ringgit at RM1=US$0.2632 (US$1=RM3.80) on 2

September 1998 and slowdown in domestic demand, over capacity in production and less pressure on wages as unemployment rate increased.

EMPLOYMENT

The rate of unemployment increased to 3.9% in 1998 (1997: 2.6%), below the full employment level of 4% largely due to the contraction of the real economy. Total employment declined by 3% to 8.5 million in 1998 (1997: 4.6%), as the number of retrenched workers reported increased sharply to 83,865 during 1998 (1997: 18,863 workers) and was more pronounced in the construction, manufacturing and agricultural sectors. Nevertheless, the number of workers reported to be retrenched declined from as high as 12,335 in July 1998 to 5,556 in December, as the real economy stabilized in the fourth quarter of 1998.

TRADE ACCOUNT

The merchandise surplus rose to a record high of US$17.7 billion in 1998, due mainly to a reduction in import volume, particularly of capital goods. The expansion in the trade surplus was the result of the stronger expansion of merchandise exports compared with merchandise imports. The stronger expansion in exports was primarily due to valuation gains from the depreciation of the ringgit as international prices for most of Malaysia's major exports were lower while export volume remained stable. While that of imports, slower increased reflects declines in both volume and lower international prices which offset the impact of the weaker ringgit.

The trade surplus rose to an unprecedented level of RM58.4 billion in 1998, far exceeding the previous high of RM13.3 billion recorded in 1987. Export receipts grew by 29.8% in ringgit terms due in large part to the depreciation of the ringgit against most major currencies. Growth in imports declined to 3.3% in ringgit terms. By the end of 1998, the trade account had been in surplus for 14 consecutive months since November 1997 due to the sustained strong export growth in ringgit terms.

Reflecting the favorable valuation impact of the rapid decline in imports, the current account recorded an unprecedented surplus of RM36.1 billion in 1998 or 13.7% of GNP (1997: -5.4% of GNP). This was a significant turnaround from a deficit position of RM14.2 billion in 1997 and was the first current account surplus since 1989.

The long-term capital account declined to RM10.9 billion in 1998 (1997: RM19 billion) due to the decline in net borrowing by the NFPEs as well as lower foreign direct investment. The short-term capital account recorded a substantial net outflow for the second successive year amounting to RM21.7 billion. The overall balance of payments position recorded a large surplus of RM40.3 billion in 1998.

GROSS EXTERNAL DEBT

Malaysia’s overall external debt situation remained manageable in 1998 resulting from the Government’s prudent external debt management strategy. Malaysia’s total external debt outstanding declined by 6.4% to RM159.8 billion in 1998 (1997: RM170.8 billion). The ratio of external debt to GNP declined to 60.9% in 1998 (1997: 65.4%), entirely due to reduction in short-term debt. The share of short-term debt to total external debt declined to

18% at end-1998 (25% at end-1997). This makes Malaysia less vulnerable to credit outflows over the short-term.

FOREIGN DIRECT INVESTMENT

Net foreign direct investment (FDI) shrunk to RM11.6 billion in 1998 from RM19.1 billion in 1997. The FDI was channeled mainly into the manufacturing sector (60%), the oil and gas sector (23%) and the services sector (14%). The value of proposed investment continued to remain significant in 1998, amounting to RM12.7 billion (1997: RM14.4 billion). The bulk of the investment were from the United States (51.6%), Japan (9%), the Netherlands (8.6%), Singapore (6.4%) and the United Kingdom (4.9%).

EXCHANGE RATE

During 1998, the ringgit recorded a mixed performance against the major currencies depreciating marginally by 0.2% (1997: -31.4%) against the composite basket of currencies of Malaysia's major trading partners. The ringgit appreciated by 2.3% against the US dollar and by 1.8% against the pound sterling. However, ringgit depreciated by 2.7% against Swiss franc, 4% against the Deutsche mark and 9.7% against the Japanese yen.

FISCAL POLICY

The fiscal policy during the early 1998 period focused on strengthening macroeconomic stability and restoring investor confidence. The government adopted counter-cyclical measures to revitalize the domestic economy. In July 1998, a fiscal stimulus package was announced involving an additional allocation of RM7 billion for projects with strong linkages within the domestic economy, short gestation period, and expenditures to meet socio-economic objectives.

Tax measures that were implemented in 1998 and announced in the 1999 Budget aimed at reducing the cost of doing business and providing tax incentives to boost exports. Tax incentives and exemptions were also introduced to expedite the shift to higher value-added and technology-intensive industries, especially for exports.

Several policy initiatives were introduced during 1998, including the establishment of National Economic Action Council (NEAC) and the formulation of the National Economic Recovery Plan (NERP). The NERP aimed at stabilizing the ringgit, restoring market confidence, maintaining financial market stability, strengthening economic fundamentals, continuing the equity and socio-economic agenda and revitalizing the affected sectors of the economy. Major policy decisions that have also been implemented include measures to address the problem of non-performing loans (NPLs) and to recapitalize the banking system that were announced in July 1998.

Total revenue collected by the Federal Government declined by an estimated 13.7% to RM56.7 billion in 1998 (1997: RM65.7 billion), largely due to a 33.9% drop in indirect tax. However, the direct tax collection declined marginally at 1.4%. Operating expenditure increased by an estimated of 4.7% to RM46.7 billion, due to higher debt service charges following the depreciation of the ringgit. The overall financial account of the public sector recorded a deficit of about RM4.7 billion (-1.8% of GNP) in 1998, against a surplus of RM17.3 billion (1997: 6.6% of GNP).

MONETARY POLICY

Monetary policy in 1998 can be classified into three phases, namely the adjustment phase from the outbreak of the crisis to early 1998; followed by the stabilization phase up to July; and subsequently, the recovery phase.

The most important objective of the policy during the first phase was to improve liquidity distribution and remove distortions in the intermediation process, thereby enabling the banking institutions to reduce their lending rates. The central bank has lowered the statutory reserve requirement (SRR) from 13.5% to 10% on 16 February, followed by another reduction to 8% on 1 July. A number of other initiatives have also been implemented to ensure the efficient management of liquidity and increase the efficiency of loan intermediation. Procedures were introduced on 30 April to make money market operations more transparent and to promote efficient liquidity management.

Following the introduction of the exchange control measures and the fixed exchange rate on 2 September 1998, additional monetary measures were introduced to improve the liquidity flows in the banking system to generate lending activities, as well as to ensure that viable businesses continued to received financing at lower cost. Consequently, the SRR was reduced to 6% on 1 September, and then again to 4% on 16 September. Similarly, the 3-month intervention rate was reduced from 9.5% to 8% on 3 September to 7.5% on 5 October, and to 7% on 9 November. As a result of the easing of monetary policy, the average BLR of the commercial banks and finance companies declined further from 11.70% and 14.17% respectively in August 1998, to 8.04% and 9.50% by November 1998.

MEDIUM-TERM OUTLOOK

The Malaysian economy is entering the recovery phase in 1999. **Real GDP** growth is expected to increase to 1% generated mainly by stronger domestic demand with the anticipated increase in private and public sector expenditures. Public sector investment and consumption are expected to increase significantly. Private sector expenditure is also expected to pick-up reflecting the better performance in both private investment and consumption.

The external sector, however, is expected to exert a lower net expansionary impact on real GDP and nominal GNP growth, as the surplus in the external payments current account position is envisaged to be smaller. Although exports are forecast to improve, imports are expected to increase at relatively stronger rate in tandem with the recovery in domestic demand and the need to replenish stocks.

With the mild recovery in overall aggregate demand, output of all sectors of the economy, with the exception of the construction and mining sectors, are expected to record mild to moderate growth.

Inflation is expected to be maintained below 4% in 1999. The absence of inflationary pressures from abroad due to a moderate appreciation of the ringgit, and low inflation in the industrial countries and lower commodity prices, particularly petroleum prices, would help to curb domestic price pressures.

The **unemployment** rate is also expected to remain low following the economic recovery. However, in view of the higher entrants into the labour market, the unemployment rate is expected to increase to 4.5%.The pressure for wage increases is also expected to remain moderate as adjustments in the labour market continue in 1999.

The **current account** surplus of the balance of payments is expected to decline to RM29.5 billion or 11% of GNP in anticipation of lower surplus in the merchandise account and improvement in the services account.

The Federal Government is expected to record a higher fiscal deficit of RM16.1 billion in 1999, with the expectation of lower revenue performance and stronger fiscal stimulus to spearhead economic recovery. However, the policy of fiscal prudence and discipline will continue to be maintained to ensure that the revenue will be sufficient to meet the operating expenditure. The budget deficit of the Federal Government's is expected to be at 6% of GNP to be financed from domestic and international sources.

MAIN STRUCTURAL REFORM

To address the problem of NPLs and to recapitalize the banking system, the Government has established an asset management company, known as Pengurusan Danaharta Nasional Berhad (Danaharta); a special purpose vehicle, known as Danamodal Nasional Berhad (Danamodal); and Corporate Debt Restructuring Committee (CDRC). As at 15 March 1999, Danaharta, the asset management company, has acquired and is managing gross non-performing loans (NPLs) amounting to RM15.1 billion. The CDRC has received 48 applications involving debt totaling RM22.7 billion. A rehabilitation fund was set up in 1998, for small and medium industries (SMIs) with an initial allocation of RM750 million to assist SMIs which are viable but have temporary cash flow problems and NPLs.

To ensure that there are sufficient funds to finance economic recovery, banking institutions were required to disburse loans to priority sectors such as construction or purchase of residential properties costing RM250,000 and below as well as for hire purchase of passenger cars. Several funds have also been established, such as the Small and Medium Industry Fund (RM1.5 billion), Export Credit Refinancing Facility (RM3 billion), Special Scheme for Low and Medium Cost Houses (RM2 billion) and Fund for Food (RM1 billion).

On 2 September 1998, the government introduced selective capital control and fixed the ringgit exchange rate to RM1=US$0.2632 with the aim to establish a stable exchange rate regime and, therefore, domestic prices, as well as to insulate the economy from adverse global developments. These measures eliminated access to ringgit by speculators by reducing the offshore market in ringgit and bringing the market for ringgit back to Malaysia.

The government has also embarked on additional measures to enhance the competitiveness of Malaysia's exports, reducing imports and strengthening the services account of the balance of payments. The measures include giving tax incentives to companies in the manufacturing, agriculture and services sectors. Tax incentives were also given to assist the business/private sector in reducing their cost of exports and warehousing. To reduce imports, the government discouraged the import of construction machinery and equipment, given the excess supply of used construction machinery and equipment within the country.

Malaysia: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (Billion US$)	56.9	61.2	74.3	86.1	98.6	71.0	73.3
Real GDP	7.8	8.3	9.2	9.5	8.6	7.7	-6.7
Total Consumption	3.2	6.0	9.8	8.9	4.9	4.8	-10.3
Private Consumption	3.0	4.6	9.9	9.3	6.0	4.7	-12.4
Government Consumption	4.0	10.7	9.9	7.3	1.4	4.8	-3.5
Total Investment	10.0	14.8	17.1	19.9	9.8	8.5	-44.9
Private Investment	0.5	19.1	27.9	25.3	13.4	8.4	-57.8
Government Investment	28.0	8.5	-0.6	8.7	1.1	8.6	-10.0
Exports of Goods and Services	6.2	17.2	22.5	17.6	7.2	10.8	-0.7
Imports of Goods and Services	1.2	19.1	27.7	21.4	4.2	10.2	-18.3
Fiscal and External Balances (% of GDP)							
Budget Balance (1)	-0.8	0.2	2.3	0.9	0.8	2.5	-1.9
Merchandise Trade Balance (f.o.b.) (1)	5.8	5.0	2.5	0.1	4.3	4.3	26.4
Current Account Balance (1)	-3.8	-4.8	-6.4	-8.0	-5.1	-5.4	13.7
Capital Account Balance (1)	6.9	8.4	-8.2	-10.4	5.7	7.3	4.2
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	4.1	2.7	5.4	5.1	5.1	2.5	8.5
CPI	4.7	3.6	3.7	3.4	3.5	2.7	5.3
M2	19.1	22.1	14.7	24.0	19.8	22.7	1.5
Short-term Interest Rate (%)	8.0	6.5	5.5	6.8	7.4	8.7	6.5
Exchange Rate (Local Currency/US$)	2.6	2.7	2.6	2.5	2.5	3.9	3.8
Unemployment Rate (%)	3.7	3.0	2.9	2.8	2.5	2.7	3.9
Population (millions)	18.6	19.0	19.5	20.7	21.2	21.7	22.2

Source: Data are as submitted by member economies, unless otherwise specified.
Notes:
(1) Percentage of GNP

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	1.0	0.9		0.7	0.5		2.0		2.7	3.5					
Real Exports															
Real Imports															
CPI	4.0	3.6		4.2	4.0		5.0		3.8	4.5					

Note: The IMF forecast is from the *World Economic Outlook* (IMF, April 1999). The ADB forecast is from the *Asian Development Outlook* (1999). The OECD forecast is from the *OECD Economic Outlook* (OECD, June 1999).

MEXICO

During 1998, world financial markets were characterized by a high degree of uncertainty and volatility. Overall, Mexico was affected by two external events: the collapse of oil prices, which generated strong pressures on the government's fiscal accounts, and tighter liquidity conditions that resurfaced in international financial markets following the Russian financial crisis. Despite these events, the Mexican economy showed significant strength, maintaining strong growth, containing inflation and sustaining employment levels.

REAL GDP GROWTH

In 1998, GDP grew 4.8% in real terms. GDP in current prices reached US$424,524 million in 1998. The increase in GDP is largely explained by an expansion of private investment, which grew 16.9% in real terms during the year. Total gross fixed investment grew 10.7% in real terms in 1998. This increase was partially offset by the decline in public fixed investment, which decreased by 20.4% in real terms.

Private consumption was positively influenced by the increase in disposable income resulting from employment growth and higher average real wages in many sectors. Private consumption increased 6.4% in real terms for the year. At the same time, primary public expenditures–defined as total public sector expenditures other than interest payments on public debt–decreased by 1.1% in real terms in 1998.

GDP growth was also driven by the export sector. Merchandise exports increased by 6.4% in 1998, mainly due to non-oil exports, which grew 11.3%.

In terms of sectoral performance, the primary sector (agriculture, livestock, fishing and forestry) grew 0.5% in real terms in 1998, the industrial sector (mining, manufacturing, construction and electricity) grew 6.6% in real terms, while the services sector (which includes commerce, transportation, storage, communications, and financial services) expanded at a real rate of 4.4%.

As expected, during the first quarter of 1999 the Mexican economy slowed down, mainly reflecting the instability of financial markets experienced at the end of 1998 and the drop in international oil prices. The annual real GDP growth rate registered during the first three months of 1999 was 1.9%.

INFLATION

In 1998, financial market volatility along with uncertainty regarding the approval by the Mexican Congress of the proposed financial reform legislation and the 1999 budget adversely affected the peso/dollar exchange rate. The significant depreciation of the peso, coupled with mid-year wage hikes and increases in the prices of basic consumer goods generated upward pressures of the price level. Thus the 1998 inflation rate of 18.61% was higher than the official forecast of 15%.

In 1999 the increase in the general price level showed signs of slowing down. Inflation for the first quarter of the year was 4.87%, the lowest level registered in this period since 1994.

EMPLOYMENT

Employment growth continued to show a positive trend in 1998. The number of permanent workers insured by the Mexican Institute of Social Security (IMSS) reached 10,140,861, an increase of 303,504 permanent workers. If urban temporary workers are included, the total number of insured workers increased by 759,952 in 1998.

The number of permanent insured workers in the commercial and services sectors increased 101,305 and 65,317 workers, respectively, or 5.5 and 1.8% respectively. In the industrial sector, employment increased by 153,744 workers, or 3.8%. On the other hand, the number of insured workers in the farming sector fell by 21,339 workers in 1998, a 5.1% decrease.

The increase in employment levels led to a reduction in the open unemployment rate during 1998. In December 1998 the unemployment rate was 2.6% or 0.2 percentage points lower than the level registered in December 1997. In 1998, the average unemployment rate was 3.2%, a decrease of 0.5 percentage points from the 1997 average rate, and the lowest rate since 1992.

TRADE ACCOUNT

In 1998, the trade balance registered a deficit of US$7,742.2 million, a sharp contrast with the US$623.6 million surplus observed in 1997. The change in the trade balance in 1998 can be explained by: (1) the reduction in the international price of oil that resulted in lower oil export revenues, (2) the expansion of the domestic economy that led to increased imports of consumer and capital goods, and (3) the fact that the continued increase in exports of manufactured goods required greater import levels of intermediate goods. Total merchandise trade for 1998 was US$242,742.8 million, or 57% of GDP.

Total exports increased 6.4% in real terms in 1998, mainly due to the behavior of non-oil exports, which grew 11.3%. The most dynamic component of non-petroleum exports was manufactured goods, which increased by 11.7% in 1998. Total exports value in 1998 was US$117,500.3 million.

Even though import growth was significant in 1998, it had slowed compared with 1997. Imports grew 14.1% and totaled US$125,242.5 million for 1998, 8.6 percentage points lower than in 1997. This slower rate of growth was largely explained by the depreciation in the peso/dollar exchange rate. Imports of consumer goods increased by 19.1%, while imports of capital and intermediate goods increased by 14.6% and 13.7% respectively.

The current account deficit in 1998 was US$15,786.3 million. This figure was more than double the deficit registered in 1997. The current account deficit was of 3.8% of GDP. The trade balance explains, to a large extent, the increase in the current account deficit.

The capital account registered a surplus of US$16,230.4 million in 1998, 467.6 million more than the surplus registered in 1997. Inflows of foreign capital in 1998 were mainly due to foreign direct investment. FDI was US$10,337.5 million and foreign portfolio investment reached US$1,292.8 million during the year. The surplus in the capital account amounted to 4.0% of GDP, while FDI amounts to 2.0% of GDP.

During the first three months of 1999, the trade balance registered an accumulated deficit of US$1,151.5 million, 34.0% lower than the level shown during the same period of 1998.

Total exports grew 6.5% in real terms despite the fact that oil-related exports fell 23.1%. Total imports grew 4.1%, with capital imports growing 10.0%.

GROSS EXTERNAL DEBT

On 31 December 1998, net public sector external debt totaled US$82,222 million, an increase of US$2,927 million with respect to 1997. Net public sector external debt was 19.1% of GDP at the end of 1998. On 31 March 1999 net public debt had decreased to US$81,655.0 million, or 18.7% as a proportion of GDP.

Mexico's access to the international capital markets was significantly constrained in 1998. The Federal Government obtained approximately one-third of the resources obtained in 1997, due to the adverse effects of the financial crises in Southeast Asia, Latin America and Russia. The government's limited access to the capital markets, coupled with the fall in international oil prices, led the Mexican authorities to draw down in October 1998 the entire amount of the US$2,661 million that it had negotiated in November 1997 with 33 international financial institutions. The purpose of the liquidity facility was precisely to provide a funding source for the government in situations of significant volatility in the international markets. In March 1999 the government agreed to refinance most of the liquidity facility.

The amortization schedule for 1999 is manageable, and most of the principal payments due relate to non-market debt, which will be refinanced through multilateral and bilateral sources. For the last three quarters of 1999, total debt payments amount to US$9,558.2 million. Non-market debt amortization for the three last quarters of the year amount to US$8,714.60 million, while market debt due amounts to US$843.6 million.

Improved market sentiment has allowed the Mexican government to successfully carried out two sovereign bond issues in 1999, one in February and one in March, equivalent to US$2,000 million.

EXCHANGE RATE

The uncertainty and volatility in the international financial markets that took place in 1998 led to a significant depreciation of Mexican peso. On 10 September, the interbank rate-selling price closed at 10.6500 pesos per US dollar, the highest level of the year.

It should be noted that the Mexican peso floats freely against other currencies. The flexible exchange rate policy has proven to be an efficient means to avoid the accumulation of external imbalances and to discourage short-term capital inflows.

The exchange rate showed a more stable behavior during the last quarter of 1998, despite market volatility resulting from speculative attacks on the Brazilian real in October and November and from the large decline in international oil prices at the end of November. Thus, the interbank spot exchange rate closed the year at 9.9080 pesos per US dollar, 22.85% higher than the 1997 level. However, after the devaluation of the Brazilian real, once again the exchange rate depreciated. On 14 January 1999 the peso/dollar exchange rate reached 10.6400 pesos per US dollar.

In recent months overall market sentiment has improved considerably. In particular, Mexico has benefited from higher oil prices, the market's recognition of the economy's strong fundamentals, and the continued strength of the US economy. As a result, the peso has appreciated considerably. On 19 May 1999 the interbank rate selling price was 9.3150 pesos per US dollar.

FISCAL POLICY

The collapse of oil prices had a strong impact on the Mexican economy because government revenues largely depended on oil-related activities. During 1998, 32.6% of total public sector revenues were oil related. The reduction in the average price of the Mexican oil mix in 1998, from an estimate of US$15.50 per barrel back in November 1997 to an actual price of US$10.16 per barrel, translated into lower fiscal revenues of 1.3% of GDP. Despite the fall in oil prices and its effects on public revenues the public sector deficit in 1998 was only equivalent to 1.24% of GDP, lower than the official estimate of 1.25%.

Two sets of factors enabled Mexico to reach this result. (1) The three budgetary adjustments implemented during the year totaling 0.79% of GDP, and (2) higher non-oil tax revenues resulting from both strong economic activity and improved tax collection.

In 1998, public revenues decreased by 8.1% in real terms, and the ratio of oil-related revenues to total revenues decreased from 36.4% in 1997 to 32.6% in 1998. Tax revenues increased by 9.8% in real terms during 1998, due mainly to expanded economic activity and to the efforts carried out to increase the number of tax payers (income tax collections increased by 4.0% and value added tax collections grew by 5.2%, both in real terms).

Public sector net budgetary expenditures totaled 823,859 million pesos in 1998, 5.4% less in real terms than in 1997. Primary expenditures, defined as total public sector expenditures other than interest payments on public debt, decreased 1.1%.

The 1999 budget, as approved by Congress last December, contemplates a fiscal deficit equivalent to 1.25% of GDP, confirming the government’s firm determination to maintain strict fiscal discipline.

MONETARY POLICY

In accordance with its constitutional mandate to ensure price stability, Banco de México’s monetary policy during 1998 was geared towards containing the adverse effects caused by the volatility in international financial markets. On 11 March 1998, Banco de México modified its monetary policy from neutral to restrictive, by establishing a “short,” the mechanism Banco de México uses to reduce market liquidity.

In August and September, the central bank carried out additional measures. Banco de México reduced the daylight overdraft capacity of commercial banks in the payments system and established a compulsory deposit by commercial banks in the central bank. Moreover, in order to reduce interest rate exposure, Banco of México twice offered interest rate swaps to commercial banks. Under the swap agreement, the central bank paid a floating rate, whereas commercial banks paid a fixed rate.

The monetary base, defined as the sum of bills and coins in circulation and bank deposits with the central bank grew to 131,528 million pesos in December 1998, a 1.8% increase in real terms from the level at the end of 1997.

MAIN STRUCTURAL REFORMS

The structural reforms implemented by the Mexican government since 1994 have two main objectives. Firstly, to promote the participation of the private sector in a number of economic activities, and secondly, to establish a sound regulatory framework that provides certainty and fosters private investment and growth.

One of the most important structural reforms being implemented in Mexico is the strengthening of the financial sector. Following the 1995 crisis, the Mexican government implemented various programs in order to restructure the financial system. With this in mind, various capitalization schemes, debtor support programs and regulatory and supervisory reforms were implemented.

Financial sector reforms continued in 1998. The IPAB, a new entity similar to the FDIC in the United States, was created. This entity will help strengthen the Mexican banking system by: (1) establishing a clear legal framework to manage FOBAPROA's liabilities and divest its assets efficiently and (2) the promotion of market discipline by gradually limiting deposit insurance. Moreover, Congress amended financial legislation to allow foreign investors to hold majority shares in the capital of banks, regardless of their size. This measure will foster the capitalization of institutions, strengthening their financial conditions and reducing their vulnerability.

In 1998, the National Banking and Securities Commission introduced regulation that increased required contingent reserves to at least 60% of non-performing loans or 4% of the total loan portfolio, whichever is larger. Supervision of financial institutions was reinforced to ensure that they would comply with the required capitalization and liquidity ratios at all times.

In 1998 the government continued its efforts geared towards further opening of key sectors of the economy such as telecommunications, electricity, ports, airports and railroads.

MEDIUM-TERM OUTLOOK

Mexico is an open economy with sharp income inequalities that have to be overcome. In this sense, the Mexican government's main economic objectives are to attain an average annual GDP growth rate of 5% with inflation kept within single digits, and to turn these achievements into a better standard of living for the Mexican population.

Given the difficult global environment, in 1999 the Mexican governments expects the economy to decelerate and grow 3.0% in real terms. However, in 2000 economic activity is expected to pick up with a growth in GDP of 5.0% in real terms.

The 1999 and 2000 budget contemplates a fiscal deficit equivalent to 1.25 and 1.00% of GDP respectively, confirming the government's firm determination to maintain strict fiscal discipline. The current account deficit is expected to decrease from 3.8% of GDP in 1998 to 2.2 and 3.2% of GDP in 1999 and 2000, respectively. The deficit is expected to be financed almost entirely by foreign direct investment.

The containment of inflation is another important goal. Through the maintenance of sound monetary policies the Mexican government expects the inflation rate to be of the order of 13% in 1999 and 10% in 2000.

Mexico: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP(billion US$)	363.6	403.2	420.7	286.8	334.8	394.3	424.5
Real GDP	3.6	2.0	4.4	-6.2	5.2	7.0	4.8
Total Consumption	2.5	1.4	2.4	-6.7	-1.1	5.7	
Private Consumption	1.8	0.1	-0.4	-6.4	-0.7	6.3	6.4
Government Consumption	8.7	11.1	5.4	-10.3	-1.9	1.8	-1.1
Total Investment	8.2	-5.1	4.3	-17.0	6.8	20.9	10.7
Private Investment							
Government Investment							
Exports of Goods and Services	8.1	12.3	16.5	31.9	20.1	14.7	6.4
Imports of Goods and Services	24.4	8.1	20.6	9.1	23.4	22.7	14.1
Fiscal and External Balances (% of GDP)							
Budget Balance	1.4	0.7	-0.3	-0.2	-0.2	-0.8	-1.2
Merchandise Trade Balance (f.o.b.)	-4.4	-3.3	-4.4	2.5	2.0	0.2	-2.0
Current Account Balance	-6.7	-5.8	-7.0	-0.6	-0.6	-1.8	-3.8
Capital Account Balance	7.3	8.1	3.5	5.4	1.0	3.6	4.0
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	14.4	9.5	8.3	37.9	30.7	17.7	13.8
CPI	15.5	9.8	7.0	52.0	27.7	15.7	18.6
M2	20.3	13.4	21.3	38.7	28.2	21.7	1.8
Short-term Interest Rate (%)	16.8	11.8	20.1	48.7	27.3	19.8	
Exchange Rate (Local Currency/US$)	3.1	3.1	3.4	6.2	7.6	7.9	9.9
Unemployment Rate (%)	2.8	3.4	3.6	6.3	5.5	3.2	2.8
Population (millions)	85.6	87.3	89.0	91.1	92.8	94.3	*95.8*

Source: Data are as submitted by member economies, unless otherwise specified.

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	3.0	2.0			3.2	5.0	3.0			3.7					
Real Exports					7.8					5.6					
Real Imports					8.8					8.1					
CPI	13.0	16.7			15.0	10.0	11.2			10.5					

Note: The IMF forecast is from the World Economic Outlook (IMF, April 1999). The OECD forecast is from the OECD Economic Outlook (OECD, June 1999).

NEW ZEALAND

REAL GDP GROWTH

In 1998, the economy contracted by 0.3% from the previous year. The weakness in overall GDP was confined to the first half of 1998, when the economy contracted by 1.6%. The Asian crisis led to a weakening in exports to Asia whilst a domestic drought in 1997/98 hit agricultural production and exports. At the same time, domestic demand was subdued reflecting weak confidence and the lagged effects of previously tight monetary policy. The economy rebounded strongly in the second half of 1998, growing by 1.3%. Much of the recovery was due to a rebound in agricultural exports from their earlier lows.

During 1998, domestic demand contracted by 0.1%, down on the 3.4% growth seen in the previous year. Growth in private consumption expenditure slowed to 1.6%, although this was relatively robust in the context of a contracting economy. Consumption growth was strongest for durable goods, supported by a recovery in motor vehicles following the removal of tariffs, and services. Investment weakened, contracting by 1.6% over the year, dragged down by a collapse in residential investment.

Net exports made a negative contribution to growth in 1998 as import growth outstripped only modest growth in exports. Export growth was hampered by a weakening in Asian markets, particularly reflected in poor tourism and forestry exports over the first half of the year, and a drought affecting primary production.

The first quarter of 1999 saw the economy continue to record solid growth. Seasonally adjusted GDP rose 0.7% in the March 1999 quarter. Strong domestic demand was the prime contributor to GDP in the quarter. Private investment registered a particularly strong quarterly rise, while private consumption recorded a sturdy increase over the quarter.

The strong domestic economy was primarily responsible for a surge in imports in the March quarter. This surge in imports more than offset robust quarterly growth in exports so that net exports continued to make a negative contribution to GDP.

INFLATION

Inflationary pressures moderated further during 1998 in line with a weak economy. Non-tradeable inflation eased, particularly as price pressures emanating from the housing market reduced. There were few signs of the earlier depreciation of the New Zealand dollar feeding through into domestic prices either, as a slack domestic economy limited firms' ability to increase prices. Weak international commodity prices and further tariff reductions have also helped to offset the inflationary impact of the lower exchange rate. Consumer prices rose by 0.4% in the year to December 1998, down from 0.8% a year earlier. Excluding credit services charges, annual inflation was 1.1% in December 1998.

This trend has continued through the early part of 1999. Consumer prices fell by 0.1% in the year to March 1999, and annual inflation excluding credit services charges eased to 1.0% in March.

EMPLOYMENT

Slowing growth of recent years, and the contraction in 1998, were reflected in a further softening of the labour market over 1998. During 1998 the number employed fell by an annual 0.6%, compared with 0.4% employment growth in 1997. This was reflected in a rise in the unemployment rate to 7.7% at the end of 1998.

The economic recovery resulted in a seasonally adjusted quarterly rise in employment of 0.9% in the March 1999 quarter. Accordingly, the unemployment rate fell to 7.2%.

Wage pressure, which tends to lag employment, moderated only slightly over the course of 1998. Ordinary time wages increased by 3.3% in the year to December 1998, compared with 3.4% growth in the previous year. Growth in private sector wages slowed more, to 3.1% in 1998 from 3.4% in the previous year, whereas public sector wage growth increased slightly.

Wage growth eased in the first quarter of 1999. Growth in ordinary time wages fell to 2.9% in the year to March 1999. Growth moderated in both private sector and public sector wages.

CURRENT ACCOUNT

The current account deficit narrowed slightly over the course of 1998 to 6.1% of GDP, down from 7.1% a year earlier. A key contributor to the narrowing deficit was a narrowing of the investment income deficit. This reflected a fall off in returns to overseas investors on their investments in New Zealand, as the domestic economy slowed, and some improvement in returns to New Zealand residents on their overseas investments. Also contributing to the better result in 1998 was an increase in the merchandise trade surplus, which rose as a share of GDP to 1.6% from 1.2% in December 1997 (in 1997 New Zealand also imported a frigate, which temporarily depressed the trade surplus and hence the current account).

The first quarter saw the current account deficit widen to 6.5% of GDP. Improved returns to overseas investors and a weakening in the trade balance were primarily responsible for the widening in the current account deficit.

Statistics New Zealand are currently moving towards compiling the balance of payments data according to the IMF standards (fifth edition), and to compiling a quarterly capital account.

EXCHANGE RATE

The New Zealand dollar (NZD) depreciated through much of 1998, continuing the trend seen since early 1997. Against the US dollar, the New Zealand dollar (NZD) fell to below US$0.50 in the third quarter of 1998, down from US$0.58 at end-1997 and a peak of around US$0.71 at end-1996. Through the final quarter of 1998 and early 1999 the New Zealand dollar has steadily appreciated, back to the US$0.53 to 0.55 range. On a trade-weighted basis, the NZD depreciated to a low of 55 in the fourth quarter of 1998, from a peak of around 69 in April 1997. By early-July the TWI had recovered to around 57.5.

GROSS EXTERNAL DEBT

New Zealand's gross external debt was US$53.7 billion (103.2% of GDP) in March 1999, down from US$62.7 billion (100.4% of GDP) in March 1998.

FOREIGN DIRECT INVESTMENT

Foreign direct investment into New Zealand was US$2.4 billion in the year to March 1998, up from US$1.9 billion in the previous year. The key components of foreign direct investment were reinvested earnings and other long-term capital investment inflows, predominantly long-term loans. Equity capital investment, however, fell off in the year to March 1998. New Zealand direct investment abroad in the year to March 1998 was a net investment of US$0.4 billion, largely representing reinvested earnings. This was the first time in three years that New Zealand parent enterprises did not dis-invest in their overseas subsidiaries.

FISCAL POLICY

The government has consistently achieved operating surpluses since 1994. In the fiscal year to June 1998, an operating surplus (on an accruals basis) of 2.6% of GDP was recorded. The operating surplus is expected to fall slightly in the year to June 1999, but will be significantly boosted by the government's gain on the sale of Contact Energy Limited. Lower tax revenue and increased expenses as a result of the slowing economy, however, have lowered the fiscal surplus excluding asset sales.

The size of the current account deficit and continued risks in the international environment make New Zealand relatively vulnerable to swings in investor confidence. To help maintain investor confidence in the economy, over 1998 the government has reduced its spending intentions for the fiscal years to June 1999 and June 2000 by a total of NZ$750 million (around US$420 million). Many of the changes were focussed on improving the medium-term fiscal position and included lowering the superannuation wage floor from 65% to 60% of the average wage.

Total government expenses represented 34.6% of GDP in the fiscal year to June 1998, up from 34.3% in the previous fiscal year. Government expenses are expected to increase modestly as a share of GDP over the year to June 1999.

MONETARY POLICY

The Reserve Bank of New Zealand is an independent central bank and is responsible for maintaining price stability in the New Zealand economy. Since December 1996, price stability has been defined as annual consumer price inflation (excluding credit services) between 0% and 3%. Prior to December 1996, price stability was defined as annual inflation of between 0% and 2%.

The Reserve Bank eased monetary policy through 1997 and 1998 as inflationary pressures eased and the amount of spare capacity in the economy increased. The easing in monetary policy initially occurred through a fall in the exchange rate, reflecting New Zealand's then rising current account deficit, a weaker outlook for world growth, and falling commodity prices. Domestic interest rates remained relatively high until June 1998 when it became apparent that the domestic economy was struggling. From a peak of 10%, 90-day rates fell to a low of around 4% in late 1998 and early 1999.

More recently the Reserve Bank has adopted an overnight cash rate (OCR) target for implementing monetary policy. The OCR was first set in March at 4.5%, and has remained unchanged since then.

MEDIUM-TERM OUTLOOK

Following on from the economic recovery seen in the second half of 1998, economic activity is expected to expand at a steady rate through 1999. Lower interest rates, along with much improved confidence on the part of both businesses and consumers, is expected to sustain the domestic economy. Exports are also expected to strengthen, benefiting from the sharply lower exchange rate over the past two years and a more stable world environment. However, export growth is likely to be constrained somewhat by the effect of a second drought that occurred in 1998/99. As the amount of excess capacity in the economy declines, and as corporate profitability improves, business investment is also expected to increase. Over the next three years, growth is expected to average around 3%.

Employment growth is expected to show a modest improvement over 1999, lagging the recovery in the economy. Beyond 1999, however, employment growth is expected to rise and the unemployment rate fall back towards the 6% mark. Inflation is expected to lift as the amount of spare capacity in the economy is used up. Nevertheless, inflation is expected to remain well within the Reserve Bank of New Zealand's target band for inflation (0% to 3%).

Looking forward, the external trade position, and the current account, are unlikely to show any significant improvement, as export growth is to a large extent offset by stronger demand for imports. However, the importation of a frigate (valued at 0.6% of GDP) in September 1999 will temporarily increase the current account deficit.

MAIN STRUCTURAL REFORMS

The Asian crisis has not led to a renewed reform agenda in New Zealand. However, it has highlighted the need for New Zealand to maintain a flexible economy that is able to adjust quickly to changing circumstances.

Over the past year the government has continued with its policy of tax and tariff reductions. In July 1998 personal income tax rates were lowered, as previously announced. Tariff reductions have also continued, and in May 1998 the tariff on motor vehicles was removed and the restriction on parallel importing removed. Also announced in 1998 was the intention to eliminate all tariffs by 2006. Other policies pending implementation include opening up the employers' account of the compulsory accident insurance scheme to competition. This is scheduled to occur from 1 July 1999.

New Zealand: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	39.5	42.8	50.6	59.4	65.0	64.6	52.7
Real GDP	0.9	5.1	6.0	4.0	3.2	2.0	-0.3
Total Consumption	0.6	1.7	4.2	4.3	4.0	3.6	1.1
Private Consumption	-0.1	2.3	5.6	4.6	4.4	2.9	1.6
Government Consumption	3.1	-0.5	-1.0	2.9	2.4	6.2	-1.0
Total Investment	1.6	14.8	16.7	12.0	6.2	3.1	-1.6
Private Investment	7.3	21.8	16.7	13.9	4.1	0.3	-0.3
Government Investment	-16.7	-14.1	17.1	1.9	20.0	19.1	-8.1
Exports of Goods and Services	2.7	5.9	10.3	3.7	3.7	2.9	1.2
Imports of Goods and Services	8.3	5.8	13.2	8.9	8.3	4.0	3.0
Fiscal and External Balances (% of GDP)							
Budget Balance (1)	-7.0	-1.1	0.9	3.1	3.6	2.0	2.6
Merchandise Trade Balance (f.o.b.)	4.1	4.0	2.7	1.5	0.8	1.2	1.6
Current Account Balance	-2.7	-1.2	-2.2	-3.1	-4.1	-7.1	-6.1
Capital Account Balance	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	1.6	2.7	1.5	2.7	1.9	0.1	1.6
CPI	1.3	1.4	2.8	2.9	2.6	0.8	0.4
M2	3.5	1.4	10.6	5.5	9.3	5.8	2.4
Short-term Interest Rate (%)	6.7	6.3	6.7	9.0	9.3	7.7	7.3
Exchange Rate (Local Currency/US$)	1.86	1.84	1.68	1.52	1.45	1.51	1.86
Unemployment Rate (%)	10.3	9.1	7.4	6.2	6.0	6.7	7.7
Population (millions)	3.53	3.58	3.63	3.69	3.74	3.78	3.80

Source: Data are as submitted by member economies, unless otherwise specified.
Notes: (1) Budget balance refers to government accrual operating balance, June years

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	1.6	2.7			2.6	2.4	3.3			3.5	2.6				
Real Exports	4.1				4.0	4.6				6.6	4.6				
Real Imports	2.7				7.4	2.2				5.1	3.3				
CPI	1.5	1.0			0.8	1.2	1.4			1.9	1.4				

Note: The official figures for 1999 refer to March year 1999/00, the figures for 2000 refer to March year 2000/01, while the figures for 2000-2002 refer to the average for the three years to March 2002. The IMF forecast is from the World Economic Outlook (IMF, April 1999). The OECD forecast is from the OECD Economic Outlook (OECD, June 1999), the CPI figures refer to forecasts for the GDP deflator.

PAPUA NEW GUINEA

The economy of Papua New Guinea has come under severe strain since mid-1997, owing in large part to a significant worsening of the external environment. A balance of payment crisis, which emerged in 1994, was temporarily redressed during 1995-96, following implementation of an adjustment program. However, the onset of a drought in the second half of 1997 coupled with a slump in regional demand and international prices for Papua New Guinea’s key commodity exports led to a sharp contraction of output and the emergence of a large external current account deficit.

REAL GDP GROWTH

For 1998 it is estimated that total real GDP (in US dollars) will decline by 28.6%. This decline reflects the depreciation of the average annual value of the Kina by 43.7% against the US dollar over 1998 and a deterioration in Papua New Guinea's terms of trade.

The non-mineral and non-oil sector is expected to decline by 32.9% while the mineral and oil sector is anticipated to experience a smaller, but still significant, contraction of 9.6%.

All sectors of the economy experience declines in output except for the mining and quarrying sector which is anticipated to grow by 11.1%.

For 1998 it is projected that the relative importance of each sector will remain broadly the same though the contribution of the important renewable resources sector will decline by 34.8% due to the overhang of the impact of the drought, the fall in export prices and the partial loss of export markets.

INFLATION

As a result of the eroded external value of the Kina the average rate of inflation (all-items CPI) in 1998 rose to 13.6%. Inflationary pressures were also exacerbated by a large fiscal imbalance as expenditures exceeded budgeted levels and lower than projected revenue inflows. In the absence of official foreign borrowing to fund the 1998 budget the government was forced to resort to domestic financing of the budget.

EMPLOYMENT

Latest data from the Bank of Papua New Guinea’s employment survey indicates that formal employment in the labour market excluding mining and petroleum and the North Solomons Province declined by 5.1% in 1998. Declines were recorded in all regions, except Lae and Madang/Wewak regions. By industry, there were declines in all sectors, except the retail and finance/business services sector.

By comparison, the building/construction sector contributed significantly to the slump in the level of employment, with a 6.7% decline in the March quarter, 1.2% in the June quarter, a 6.9% decline in the September quarter and 10.7% in the December quarter, resulting in an overall decline of 20.3% in 1998. The negative growth reflected the completion of most civil and building construction projects and lack of new projects, which impacted negatively on the transportation, wholesale, and manufacturing sectors. Lower employment in the agriculture/forestry/fisheries sector reflected the lack of demand for logs in the Asian market, a slow recovery of some cash crops following the drought in 1997 and cyclone in the first quarter of 1998.

TRADE ACCOUNTS

The balance of payments moved into a substantial deficit in 1998. The current account recorded a surplus as a result of lower imports and reduced investment. Significant capital outflows, particularly private capital, more than offset the current account surplus.

GROSS EXTERNAL DEBT

Papua New Guinea's total external debt outstanding at the end of 1998 was K5,279 million compared to K4,362 million at end-1997. Official sector external debt totaled K2,705 million at the end of 1998 while the private sector external debt outstanding was K2,574 million. The increase was due to growth in both official and private sector external debt. Growth in official external debt resulted from continued drawdown of existing loans combined with the depreciation of the Kina against the currencies of PNG's major trading partners while the growth in the private sector external debt was due to loan drawdowns by the mineral sector and the construction of the Hanjung power plant. The mineral sector accounted for 52.7% of total private external debt.

Papua New Guinea's total external debt service payment was K659 million in 1998. The official sector debt services payments were K314 million and the private sector external debt services payments were K345 million.

The ratio of debt service to current account receipts deteriorated to 16% in 1998 from 15% in 1997, due to the significant increase in stock of debt outstanding, which more than offset a strong growth in the current account receipts. The ratio of Papua New Guinea's external debt outstanding to nominal GDP was higher in 1998 due to substantial growth in the stock of debt, which more than offset a growth in nominal GDP.

EXCHANGE RATE

Over 1998, the trade weighted nominal exchange rate fell by 17% (and by 11% and 16% against the Australian and US dollar respectively). The depreciation against the US dollar was a reflection of the strength of the US dollar, attributed to a number of factors including economic growth in the US and currency turmoil in Asia.

The level of international reserves also fell as the Bank of PNG intervened to stabilize the Kina and maintain market confidence combined with high overseas public debt service payments.

FISCAL POLICY

In 1998, a deterioration in revenue receipts accompanied by an increase in expenditure pressures saw the budget deficit increase by 2.5% of GDP from the 1997 outturn.

MONETARY POLICY

The Bank of Papua New Guinea is tasked with the goal of promoting monetary stability and a sound financial environment in support of sustainable medium growth of economic activity in the non-mining and non-petroleum private sector.

Over 1998 monetary and credit conditions were tightened in response to the pressure on the economy's external position. Strong private sector credit growth originated from the large volume of lending by the largest commercial bank the PNG Banking Corporation, whose lending rose by K303.2 million (68.6%) between December 1997 and September 1998.

Domestic interest rates were raised aggressively peaking at 26% in mid-1998. Commercial bank interest rates responded by rising simultaneously. In August 1998 a non-interest cash reserve requirement was imposed on the liquid assets of commercial banks in an attempt to constrain their lending activities and restrain pressures on the exchange rate.

MEDIUM-TERM OUTLOOK

In 1999, the Papua New Guinea's government projections are as follows:

- Economic growth: -5.6%.
- Annual increase in consumer prices: 8%.
- Export and import of goods and services: -1.0% and -11.8%, respectively.

For the period 2000-2001, they are as follows:

- Economic growth rate of 3.7% and 9.3% respectively
- Average annual increase for consumer prices of 4% in both 2000 and 2001.

MAIN STRUCTURAL REFORMS

Indirect Tax Reforms and Trade Reforms

The Government is pursuing simultaneously trade and indirect tax reforms. Consistent with APEC and WTO membership movement towards greater trade liberalization is progress under the auspices of reduction in tariffs as well as excises. Revenue neutrality will be ensured by the introduction of a value-added tax. The implementation of these reforms began on 1 July 1999.

Public Sector Reforms

Restructuring of the public service has commenced with the intention of reducing the wage bill and increasing productivity. A reduction in the size of the public service by around 10% is envisaged over the medium-term.

Financial Sector Reforms

Specific objectives of the financial sector reforms include: (i) ensuring improved fiscal and financial programming; (ii) enhancing institutional support in the Bank of Papua New Guinea and the Department of Treasury and in the market for government securities; and (iii) liberalizing foreign exchange controls.

In addition to the foregoing, the government will be embarking on a program to revitalize institutions and facilities that provide credit lines to rural and informal enterprises.

The Impact of the Asian Financial Crisis on Papua New Guinea

The impact of the Asian financial crisis has manifested itself in balance of payments pressure and rapid depreciation of the currency. Prices of Papua New Guinea's export commodities, particularly in oil, copper and logs, have all fallen dramatically. Log volumes have also declined due to contraction in demand in the main export markets of Korea and Japan.

Estimates of the total net shock range from 5% of GDP to as high as 15% of GDP. The government instituted only one measure in direct response; this was a reduction in the average export tax on log exports by eliminating the bottom bracket (K0 - K130 per cubic meter) of the marginal log export tax. This intention of the interim measure was to mitigate the adverse impact on the logging industry, which is a significant employer and foreign exchange earner for Papua New Guinea.

Papua New Guinea: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	4.4	5.1	5.5	5.1	5.3	4.8	4.1
Real GDP	13.8	16.6	5.2	-3.6	3.5	-4.6	2.5
Total Consumption							
Private Consumption							
Government Consumption							
Total Investment							
Private Investment							
Government Investment							
Exports of Goods and Services							
Imports of Goods and Services							
Fiscal and External Balances (% of GDP)							
Budget Balance	-5.5	-6.0	-2.8	-0.5	0.5	0.1	-2.9
Merchandise Trade Balance (f.o.b.)	14.4	29.1	24.9	28.5	19.4	13.9	19.1
Current Account Balance	2.2	12.8	10.6	13.6	5.9	-2.5	1.6
Capital Account Balance	-3.5	-14.2	-11.2	-8.8	0.8	0.4	-4.7
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	2.9	2.8	5.6	18.5	5.9	3.4	10.3
CPI	4.3	5.0	2.9	17.3	11.6	3.9	13.6
M2	9.5	10.0	2.7	11.1	32.5	13.3	3.8
Short-term Interest Rate (%)	6.5	6.0	10.8	21.5	9.2	14.5	21.2
Exchange Rate (Local Currency/US$)	0.97	0.98	1.08	1.28	1.32	1.45	2.08
Unemployment Rate (%)							
Population (millions)	3.78	3.86	3.95	4.04	4.14	4.23	4.33

Source: Data are submitted by member economies, unless otherwise stated. Figures for nominal and real GDP are from Asia Development Outlook1999 (ADB 1999).
Note: (1) Treasury Bill rate

PERU

Peru is a diversified economy. Copper, gold, fish meal and textiles are the main export products and the manufacturing sector accounts for around 20% of GDP. Energy production is also being stepped up while considerable additional investment is targeting the mining sector.

A new Extended Fund Facility Agreement was signed for 1999-2001. The government is pursuing major structural reforms, including the privatization of remaining public enterprises and a concession program. Reducing the incidence of poverty remains a high priority for the government.

REAL GDP GROWTH

During 1998 a drastic reduction in the terms of trade (the largest in the last 40 years) and the impact of *El Niño* have joined to widen the external imbalance and reduce the economic growth to 0.3%. Fishing and agricultural sectors were the most affected, specially during the first quarter of 1998. In the last quarter of 1998, the Peruvian economy was also affected by the international financial crisis, which reduced capital flows to the domestic economy.

In 1999 GDP is expected to increase by around 3% with respect with 1998. Fishing will recover its normal level and domestic demand is expected to resume its long-term growth trend by the last quarter of the year.

INFLATION

The annual inflation rate dropped to 6.0% in 1998 from 6.5% a year earlier. The temporary effect of *El Niño* on food prices during the first quarter of 1998 was reversed in the second half of the year. For 1999, the inflation has been targeted to be within a range of 5.0% to 6.0%.

EMPLOYMENT

Unemployment in the Lima Metropolitan area remained at the same level as the previous year (7.7%).

CURRENT ACCOUNT

The current account deficit increased from 5.0% in 1997 to 6.0% of GDP in 1998, due basically to the increase in the trade balance deficit. The higher deficit was in response to the decrease in exports (16%, in US dollar terms), which was related to the reduction in the terms of trade and the *El Niño* phenomenon. In 1999, a current account deficit of around 5% of GDP is expected.

FOREIGN DIRECT INVESTMENT

The resource sector has been an important factor attracting foreign direct investment to Peru, especially in the mining, telecommunication and banking sectors. In 1998 foreign direct investment, excluding privatization receipts, amounted to 3.0% of GDP. This level of capital inflow is higher than that received the previous year, despite the international financial crises.

EXCHANGE RATE

Market forces determine Peru's exchange rate. Central bank interventions in the exchange market are consistent with non-inflationary growth of the monetary base. In 1998, nominal depreciation of the domestic currency (*Nuevo Sol*) was 15.4%. In real terms, it implied a significant depreciation of 11.6%.

FISCAL POLICY

Peruvian fiscal accounts have showed a primary surplus since 1991. In 1998, the primary surplus was 1.1% of GDP compared with a primary surplus of 1.8% in the previous year. For 1999 it is expected a primary surplus of 0.9% of GDP.

The reduction of the primary surplus is related to the slow-growth of GDP and the decrease in the terms of trade, which caused a decline in the current revenues of the public sector.

The Peruvian government is currently involved in the promotion of private investment via an outstanding concession process, which began in 1997. This process includes the energy, communications and tourism activities.

MONETARY POLICY

Peru's monetary authorities target an inflation range. To reach this goal, control of monetary aggregates has been applied since 1990, with the monetary base allowed to grow in line with demand for money to avoid inflationary pressures. Monetary instruments include: exchange rate intervention; open market operations; rediscounts; and reserve requirements.

MEDIUM-TERM OUTLOOK

Economic growth is projected to reach 3.0% for the year 1999. A growth of 5.5% and 6.0% is expected for years 2000 and 2001 respectively, based on the predicted performance of exports and investment. The inflation rate should continue to fall in 1999 and the goal is to reach international levels in the following years. The temporary widening of the trade deficit in 1998 will be reversed in 1999 and the current deficit is projected to reach less than 5% of GDP by the year 2002. Long-term capital inflows will continue to be the main financing source of the current account deficit.

MAIN STRUCTURAL REFORMS

The government will continue the program of structural reforms that was started in the early 1990s. In 1998, structural reforms included the concession on public services. This process and the privatization of the remaining public enterprises will continue during 1999. Other areas to be covered include the regulatory framework, financial sector reform, and social programs such as in education, health, and poverty alleviation.

Peru: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	41.60	41.20	50.20	59.00	61.00	65.20	62.80
Real GDP	-1.70	6.40	13.10	7.30	2.40	6.90	0.30
Total Consumption	-0.60	4.20	9.70	8.50	1.50	4.10	-0.20
Private Consumption	-1.00	4.50	9.70	8.10	1.50	4.00	-0.40
Government Consumption	2.90	1.30	9.90	12.40	1.60	5.10	1.80
Total Investment	-3.90	13.40	28.90	20.30	-3.30	12.40	-1.50
Private Investment							
Government Investment							
Exports of Goods and Services	4.40	1.70	17.70	6.90	10.20	12.70	3.30
Imports of Goods and Services	7.40	1.10	25.60	26.80	0.60	11.30	0.10
Fiscal and External Balances (% of GDP)							
Budget Balance (1)	-3.30	-2.70	-2.40	-2.90	-1.00	0.10	-0.70
Merchandise Trade Balance (f.o.b.)	-0.80	-1.50	-2.00	-3.70	-3.30	-2.60	-3.90
Current Account Balance	-5.00	-5.60	-5.30	-7.30	-5.90	-5.00	-6.00
Capital Account Balance (2)	5.50	6.00	11.00	7.70	7.20	7.70	4.40
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	60.80	48.00	19.20	12.40	9.60	8.60	5.50
CPI (3)	56.70	39.50	15.40	10.20	11.80	6.50	6.00
M2 (4)	60.50	50.00	72.20	33.00	21.90	25.60	-2.40
Short-term Interest Rate (%) (5)	117.80	74.10	31.30	28.20	26.50	26.30	37.10
Exchange Rate (Local Currency/US$) (6)	1.25	1.99	2.20	2.26	2.45	2.66	2.93
Unemployment Rate (%) (7)	9.70	10.30	9.00	7.60	7.00	7.70	7.70
Population (millions)	22.40	22.70	23.10	23.50	23.90	24.30	24.80

Notes:
(1) Budget balance refers to the non-financial public sector;
(2) Capital account balance includes exceptional financing;
(3) End of period;
(4) Excludes deposits in foreign currency;
(5) Short-term interest rate is the discount rate in domestic currency (end of period);
(6) Average of the period;
(7) Refers to Lima Metropolitana and the third quarter of the year.

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	3.0	4.5				5.5/6.0	6.5								
Real Exports															
Real Imports															
CPI		4.7					4.5								

Note: The IMF forecast is from the World Economic Outlook (IMF, April 1999).

PHILIPPINES

REAL GDP GROWTH

The combined effects of the Asian financial crisis and weather disturbances (for example, *El Niño*) pushed down the growth of gross domestic product by -0.5% in 1998. The GDP contraction was caused by a 6.6% drop in agricultural production and the decline in construction and construction-related manufacturing activities. The latter two sectors were disadvantaged by high interest rates and volatile exchange rates during the early part of 1998. The growth of the services sector remained steady with transportation and communications, private services and finance contributing to the expansion. The strong growth of net factor income from abroad pulled the overall output (gross national product) up by 0.1%.

On the expenditure side, the growth of personal and government consumption, though slower, remained positive. Investments as well as trade (exports and imports) in goods and services, however, shrank. Investors remained cautious despite some improvement in the macro-economic environment during the latter part of the year. Real merchandise exports and non-merchandise exports both declined by 1.01% and 35.6%, respectively.

INFLATION

The inflation rate reached double-digits in May 1998 at 10.1% and peaked at 11.2% in November 1998 as a result of supply shortages brought about by adverse weather conditions. Nonetheless, the average inflation rate for the year (9.7%) was contained at the single-digit level. While higher than the previous year's average, this was still within the target set for the year at 9.25%-9.75%. From double-digit levels in January 1999 (11.5%), inflation rate has reverted back to single digit posting the lowest rate at 6.7% in May 1999.

EMPLOYMENT

The total number of people employed rose from 27.7 million in 1997 to 27.9 million in 1998. Following the structural transformation of the economy, labor shifted away from agriculture. The services sector absorbed 44% of the total employed while the agriculture sector hired 39.2%. The industrial sector only absorbed 16.4% of the total employed.

The economic slowdown led to a double digit average unemployment rate of 10.1% in 1998 as employment from the agriculture and industry sectors dropped. For the first quarter of 1999, the unemployment rate slightly improved to 9.0%.

TRADE ACCOUNTS

The Philippine current account balance registered a surplus of US$1.3 billion in 1998 after posting deficits during the last seven years. Increased exports of goods and services to some extent benefited from the peso depreciation and global integration of the Philippines' economy. Imports continued to decline. Merchandise exports have continued to outpace imports in terms of growth since 1996. In 1998, merchandise exports grew by 17% while imports fell by 19 %, and further narrowed down the trade deficit to only US$28 million. Demand for electronics and semi-conductors remained strong with the entry of new producers and the introduction of new product lines. Exports of machinery and transport equipment also grew substantially. A weaker peso and the Asian crisis further weakened import demand.

Merchandise exports maintained its growth momentum increasing by 15.2% in the first quarter of 1999 while imports continued on its downward trend declining by 7.5% during for the same period.

Net foreign investments also increased significantly (119.4%), a reversal from the previous year's decline of 78.3%. Foreign direct investments rose by 40.3% while portfolio investments rebounded from a 80.7% reduction in 1997 to a 165% increase in 1998. Thus, from an estimated US$3.3 billion deficit in 1997, the balance of payments recovered appreciably and posted a surplus of US$1.4 billion. This helped build up the gross international reserve position to US$10.8 billion by the end of 1998. The vulnerability of the balance payments situation to external shocks arising from external reversals in unpredictable sources of financing indicates the importance of further increasing exports and attracting higher levels of long-term investment.

GROSS EXTERNAL DEBT

Total foreign exchange liabilities was recorded at US$47.8 billion. The bulk of foreign exchange liabilities comprised of medium and long-term loans (85%). The public sector accounted for 51.2% of the total liabilities, followed by the private sector with 25.3% and the banking sector with 23.4%. More than half came from bilateral sources.

EXCHANGE RATE

The country's exchange rate policy continues to support a freely-floating exchange rate system. The exchange rate is determined by market forces with some scope for occasional action by the Philippine Central Bank [*Bangko Sentral ng Pilipinas* (BSP)]. On such occasions, the BSP enters the market largely to provide indicative guidance and to preserve orderly market conditions.

After the depreciation of the peso in July 1997, the BSP implemented a number of measures to stabilize the currency. Among these are the tightening of the overbought position of banks and relaxing of the oversold position; the requirement of prior approval for the sale of non-deliverable forwards, the introduction of a volatility band and the Currency Risk Protection Program (CRPP), among others. From a peak of P43.78 per US dollar in September 1998, the peso-dollar rate stabilized to about P39.07 per US dollar by December. The peso further strengthened during the first quarter of 1999 with an average exchange rate of P38.7 per US dollar.

FISCAL POLICY

In 1998, the fiscal policy was redirected to help contain the effects of the Asian financial crisis. The bulk of the funds were channeled to building farm-to-market roads, irrigation, low-cost housing projects and other capital expenditures. Total government expenditures reached P512.5 billion, an increase of 9% over the 1997 level of P470.3 billion.

The crisis affected revenue collection. Total revenues declined by 2.0% as a result of the decline in non-tax revenues by 23.1% which in turn offset the increase in tax revenue collection of 1.1%. Thus, the overall budget deficit for the year amounted to P50 billion equivalent to 2.1% of GDP.

MONETARY POLICY

The monetary policy was directed at restoring confidence in the peso. In the period following the Asian financial crisis, the *Bangko Sentral ng Pilipinas* (BSP) raised its overnight and borrowing rates to curb speculation in the foreign exchange market. Banking reserves were likewise increased. With stable prices, however, reserve requirements were gradually reduced. The containment of the budget deficit to a manageable level led to a gradual decline in interest rates to 13.4% by December 1998 from a peak of 19.1% in January 1998.

MEDIUM-TERM OUTLOOK

The priority for the Philippines' economic policy is to attain economic recovery while consolidating stabilization measures and protecting the poor from the effects of the crisis. In the pursuit of these goals, the following measures shall be undertaken: adoption of a fiscal policy that will stimulate domestic demand and fund anti-poverty programs; continued focus of monetary policy on reducing inflation and preventing renewed pressure on the peso; and vigorous pursuit of a broadened structural reform agenda to underpin the recovery and sustain economic growth.

The stability of the foreign exchange market, improved outlook in agriculture production, continued infusion of capital, the institution of timely reforms in the financial and banking systems are expected to contribute to better prospects for economic recovery. The agriculture, fishery and forestry sectors are expected to grow between 3.0% and 3.5% in 1999; and 3.5% and 4.1% in 2000. Meanwhile, the industry sector is expected to grow between 1.4% and 2.0% in 1999; and 5.0% and 5.6% in 2000. Overall GDP growth is expected to be between 2.6% and 3.2% in 1999; and 4.8% and 5.4% in 2000. Meanwhile GNP is projected to increase by 3.0% and 3.7% in 1999; and 5.7% and 6.1% in 2000 (as of 19 February 1999). The inflation rate is expected to be maintained in single-digit levels in 1999 and 2000.

MAIN STRUCTURAL REFORMS

The Philippines continued to pursue trade and investment liberalization policies notwithstanding the crisis. Continuous rationalization of the tariff structure has been undertaken with the end-in-view of attaining a uniform 5% duty by 2004.

Moreover, investments continued to be encouraged with the passage of RA 8556, (Financing Company Act of 1998), increasing the foreign equity participation to 60% of the voting stock of a financing company; EO II (Third Regular Foreign Investment Negative List issued on 11 August 1998) delisted private domestic construction contracts from the Negative List allowing up to 100% foreign equity participation. Likewise, the downstream oil industry was liberalized with the passage of RA 8479 on 10 February 1998, (The Downstream Oil Industry Deregulation Act of 1998), which removed the restrictions on the importation/exportation of crude oil and refined petroleum products.

Moreover, reforms were put in place to further strengthen the banking sector. These included: (a) further capital increase ranging from 20 to 60% over 1998 minimum levels to be completed by year 2000; (b) a 2% general loan loss provisioning requirement; (c) a stricter specific loan loss provisioning requirement; (d) consolidated supervision of banking units and their affiliates; (e) enhanced disclosure requirements; and (f) more stringent bank licensing requirements.

In addition, a major restructuring of the tax system was undertaken with the passage of the Comprehensive Tax Reform Program (CTRP) on 11 December 1997. CTRP introduced changes in the area of corporate taxation and simplified the administration of taxes.

The liberalization of the retail trade sector is being deliberated by Congress. The deregulation of the power sector is also being considered. The privatization program has already covered hotels, banks, an airline, a steel firm, mining companies, and a petroleum refinery, among others.

Philippines: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	53.0	54.4	64.1	74.1	82.8	82.2	65.1
Real GDP	0.3	2.1	4.4	4.7	5.8	5.2	-0.5
Total Consumption							
Private Consumption	3.3	3.0	3.7	3.8	4.6	5.0	3.4
Government Consumption	-0.9	6.2	6.1	5.6	4.1	4.6	-2.1
Total Investment	7.8	7.9	8.7	3.5	12.5	11.7	-16.4
Private Investment							
Government Investment							
Exports of Goods and Services	4.3	6.2	19.8	12.0	15.4	17.2	-14.3
Imports of Goods and Services	8.7	11.5	14.5	16.0	16.7	13.5	-14.3
Fiscal and External Balances (% of GDP)							
Budget Balance	-1.2	-1.5	1.0	0.6	0.3	0.1	-1.9
Merchandise Trade Balance (f.o.b.)	-8.9	-11.4	-12.2	-12.1	-13.7	-13.5	0.0
Current Account Balance	-1.6	-5.5	-4.6	-4.4	-4.8	-5.3	2.0
Capital Account Balance	3.5	5.2	7.1	4.6	13.4	8.0	1.5
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	7.9	6.8	10.0	7.6	7.7	6.1	10.4
CPI (% Change) 1994=100	8.6	7.0	8.3	8.0	9.1	5.9	9.7
M2	11.0	24.6	26.8	25.2	15.8	20.5	8.0
Short-term Interest Rate (%)	16.1	12.3	13.6	11.3	12.4	13.1	15.3
Exchange Rate (Local Currency/US$)	25.5	27.1	26.4	25.7	26.2	29.5	40.9
Unemployment Rate (%)	9.8	9.3	9.5	9.5	8.6	8.7	10.1
Population (millions)	65.3	67.0	68.6	70.3	71.9	73.5	75.2

Source: Data are as submitted by member economies, unless otherwise specified.

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	2.6-3.2	2.0		2.4	2.5	4.8-5.4	3.0		4.0	4.5					
Real Exports															
Real Imports															
CPI		8.5		8.5	7.5		6.0		7.0	4.5					

Note: The IMF forecast is from the World Economic Outlook (IMF, April 1999). The ADB forecast is from the Asian Development Outlook (1999). The OECD forecast is from the OECD Economic Outlook (OECD, June 1999).

RUSSIA

The Russian economy in 1998 was affected by financial and economic crisis.

The macroeconomic situation in 1998 was characterized by the following: a decline in production; crisis in the banking and financial sectors; a reduction in investment in fixed capital; a fall in the exchange rate; a reduction in the volume of trade, that is, a decline in exports and imports; a deterioration in the balance of payments; acceleration in the rate of inflation; a reduction in real income; and a deterioration of the financial situation of enterprises in the real sector.

REAL GDP GROWTH

For 1998 as a whole, real gross domestic product (GDP) declined by 4.6%.

The development of GDP in 1998 was marked by a decline in all sectors, particularly in agriculture and construction.

From 1997 to 1998, elements of GDP were affected by the sharp fall in demand due to the crisis. All the main elements of final demand recorded negative growth:

- In 1998 the final consumption of goods and services was reduced by 2.5%, compared with growth of 2.4% in 1997.
- The final consumption of households was reduced by 3.7%.
- The physical volume of payable services to the population fell by 2.4%.

The economic situation was worsened by inefficient use of savings as much of the savings were kept in foreign currencies. In addition to a reduction in real income, households tended to reduce their investment in the domestic market. Gross savings of the households in 1998 fell more than threefold (from 0.8% of GDP in 1997 to 2.5% in 1998).

Because of the deteriorated budget situation, nominal costs on the final consumption of state institutions reduced.

Gross capital accumulation declined in 1998 at a much larger rate than other components of demand.

Opportunities for attracting financial resources in the real sector of the economy were limited by measures taken by the Bank of Russia (which increased the discount rate and standby rates) and the crisis in bank liquidity.

Budgetary deterioration reduced the share of consolidated budget revenues, that are the sources of financing of investments. In 1998 it fell to 19.7% against 20.7% in 1997. This is the largest drop among the capital embedded in the federal budget facilities account (from 9.5% in 1997 to 5.5%).

As a result of the worsening of the investment climate in 1998, gross accumulation of capital was reduced by 12.9%.

There was a decline of 5.2% in the volume of industrial production

The depth of decline of industrial production reached a maximum in September 1998, declining 14.5% in comparison to that of August 1997 (11.5 %).

As from October, there has been a marked trend towards the stabilization of the industrial situation. Since the end of 1998, the volume of industrial production has begun to recover in terms of the growth rate against the same period of a previous year. It recorded -11.1% in October, -9.1% in November and -6.6% in December.

MONETARY POLICY

Deep financial and general economic crisis affected the conditions of the monetary-credit sector.

In spite of the increase in significant volumes of new credit (volume of external debt for 1998 was enlarged by US$13 billion), gold and currency reserves for 1998 were reduced to US$5.6 billion (31.3%).

After a sharp contraction of the money supply in July and August by 2.3% and 4.6% respectively, as a consequence of the foreign currency intervention by the Bank of Russia in the exchange market, money supply for September-December grew by 31.7% according to the operative data of the Bank of Russia. The growth in money supply occurred through the increase in the share of available money from 34.9% in the beginning of 1998 to 41.5% in the beginning of 1999.

The velocity of money turnover was increased.

In the midst of the worsening financial condition of enterprises and the increasing payment crisis of the bank system, lending continued to be volatile. From December 1997 till December 1998, the volume of rouble credits to enterprises, organizations and physical persons was reduced by 39.8%.

INFLATION

The financial crisis has caused a significant acceleration in inflation. In the second half of August-September a situation of hyperinflation nearly occurred: consumer prices increased by 40%. Faster rise in prices began after a sharp devaluation of the exchange rate of the rouble. This has caused price increases in imported consumer goods. The situation called for tighter management of the price of domestic products. In recent months the government has managed to avoid galloping price increases and stabilized the consumer market situation.

The inflation rate was at 4.5% in October; at 5.7% in November, and at 11.6% in December. For 1998 as a whole, the consumer price index stood at 184.4 %.

EMPLOYMENT

In 1998 negative trends in the social sector grew. For the year as a whole real income was reduced by 18.5%, in comparison to 1997 when its firm growth was noted.

As a result, the average real monthly wage of a worker was reduced by 13.8%.

In 1998 the economic crisis had large impacts on employment. A significant reduction in labour demand continued.

By the end of 1998, the number of employed in the economy was 63.3 million, a reduction of 1.0 million over the whole year. Using ILO's calculation method, the total number of unemployed at the end of 1998 was 8.93 million, an increase of 12.4% or 0.8 million.

CURRENT ACCOUNT

In 1998 the balance of payments worsened.

The worldwide price reduction on fuels, a significant increase in the percentage of payments to nonresidents, as well as the influence of the financial and economic crisis in Russia have brought about a sharp, nearly three fold, reduction in the positive balance of the current account, compared with 1997.

With the decline of the positive balance of trade, the deficit in the balance of services has been reduced two fold compared with 1997. In connection with this, net export (the balance on operations with goods and services) increased slightly against that of 1997. The negative balance in profits from investments, labour payment and current transfers increased by 1.4 times.

A significant portion of the Russian economy's export-oriented sector experienced changing external demand which rendered a direct negative influence on internal demand, in both consumption and investment demand.

FOREIGN INVESTMENT

In 1998 the investment climate in Russia remained unfavorable. The total volume of investments in fixed capital to the account of all sources of financing was reduced to 1997 levels (6.7%).

According to the State Statistic Committee of Russia, in 1998 the volume of all kinds of foreign investments in the economy of Russia reached US$11.8 billion. The volume of direct foreign investments reached US$3.4 billion, an increase of 63% in comparison to 1997.

For 1998 the volume of attracted portfolio investments totaled US$0.19 billion, a reduction of 71.9 % compared with 1997.

A significant share of foreign investments was received in the form of credits from international financial organizations. The volume of other foreign investments in 1998 reached US$8.2 billion, an increase of 31%.

TRADE ACCOUNTS

Russia's international trade in 1998 was constrained by the influence of negative trends in the development of the world economy.

Russia's international trade volume for 1998 (with provision for officially non-registered exports and imports) reached US$133.4 billion (82.4% of 1997's figure), including exports: US$73.9 billion (83.6%), and imports: US$59.5 billion (80.9 %).

Russia: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	85.6	182.4	271.9	338.3	418.8	436.0	276.5
Real GDP	-14.5	-8.7	-12.7	-4.0	-3.4	0.9	-4.6
Total Consumption	-5.2	-1.0	-3.1	-2.7	-3.1	3.0	-2.8
Private Consumption	-3.0	1.2	1.2	-2.8	-4.7	5.4	-4.0
Government Consumption	11.8	-6.4	-2.9	1.1	0.8	-2.4	0.1
Total Investment	-36.9	-29.4	-31.2	-10.8	-20.6	-3.6	-27.6
Private Investment					-19.0	-5.0	-27.3
Government Investment					-34.5	11.7	-29.9
Exports of Goods and Services	-20.0	-2.1	4.9	7.2	0.6	1.1	1.6
Imports of Goods and Services	-36.0	-9.4	9.4	8.1	-2.3	3.1	-11.9
Fiscal and External Balances (% of GDP)							
Budget Balance				5.8	7.9	7.8	4.3
Merchandise Trade Balance (f.o.b.)		8.5	7.0	6.0	5.4	4.0	2.9
Current Account Balance		6.9	4.2	2.3	2.8	0.7	1.8
Capital Account Balance		-0.2	-4.0	3.0	-1.6	1.3	2.0
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	1490.0	888.1	307.7	178.2	44.1	16.5	9.8
CPI	2609.0	939.9	315.1	231.3	121.8	111.0	184.4
M2	766.3	514.2	294.7	225.8	133.7	129.8	121.0
Short-term Interest Rate (%)				168.0	85.8	31.5	39.9
Exchange Rate (Local Currency/US$)	0.2	0.9	2.2	4.6	5.1	5.8	9.7
Unemployment Rate (%)			7.8	9.1	9.9	11.2	12.3
Population (millions)	148.3	148.0	147.9	147.6	147.1	146.4	147.1

Source: Data are as submitted by member economies, unless otherwise specified.

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP		-7.0			-1.0		0.0			2.0					
Real Exports															
Real Imports															
CPI		100.5			80.0		20.2			80.0					

Note: The IMF forecast is from the World Economic Outlook (IMF, April 1999). The ADB forecast is from the Asian Development Outlook (1999). The OECD forecast is from the OECD Economic Outlook (OECD, June 1999).

SINGAPORE

REAL GDP GROWTH

The Singapore economy slipped into a recession in 1998 as a result of the regional economic crisis. Growth for the whole year, however, remained positive at 1.5%. The sharp slowdown from the 8% registered in 1997 can be attributed to three key factors. First, deepening recessions in 1998 in most parts of Asia led to a slump in Singapore's external demand. Non-oil domestic exports and re-exports to these Asian markets shrank by 10% and 13% respectively. Second, erosion of our cost competitiveness as a result of the sharp depreciation in the regional currencies exacerbated the decline of our exports. Third, global over-capacity in the electronics industry contributed to the decline in the manufacturing sector.

However, the economy picked up modestly in the first quarter of 1999 to register a growth of 1.2%. Growth momentum was robust on the back of strong growth in the manufacturing sector. The transport and communications sector also improved slightly, boosted by an increase in visitor arrivals. Nonetheless, the other major sectors, namely, construction, commerce, and financial and business services, declined in the first quarter.

The manufacturing sector shrank by 0.5% in 1998, against growth of 4.5% a year ago. Support for the sector came largely from strong growth in the chemicals industry, on the back of restructuring and capacity expansion in the pharmaceuticals segment and steady expansion in the petrochemicals segment. Most of the other industries performed poorly. Although initially shielded from the regional storm by a nascent recovery in the global electronics cycle and healthy demand in the US and EU economies, the electronics industry was later affected by excess capacity in semiconductors and disk drives.

In the first quarter of 1999, however, the sector grew by 6.5%, after contracting for the previous three quarters. The electronics industry saw a strong turnaround, expanding by 14%. Stronger demand from the United States saw output of computers and computer peripherals rise. The semiconductor segment also rose as oversupply receded with the pickup in the global electronics industry. The chemicals products industry grew by 19% with increases in both the petrochemicals and pharmaceuticals segments. However, the other industries like machinery and equipment, fabricated metal products and rubber/plastic products, and electrical machinery and apparatus continued to contract.

Activity in the construction sector moderated to 3.9% in 1998, compared to a robust 15% a year earlier. The sector contracted by 9% in the first quarter of 1999, significantly sharper than the 5.3% decline registered in the previous quarter.

The commerce sector performed poorly in 1998, shrinking by 4.0% in 1998, down from a growth of 5.7% a year earlier. Entrepôt trade contracted in line with slower regional growth, while domestic trade was affected by the fall-off in visitor arrivals, bearish consumer sentiment and belt-tightening in the face of increased economic uncertainty. In the first quarter of 1999, the commerce sector showed some improvement along with the bottoming out in domestic and regional economies. The sector's contraction moderated to 2.1% in the first quarter of 1999, from -6.3% in the preceding quarter.

The transport and communications sector turned in a healthy growth of 5.5% in 1998, with support coming from a relatively resilient communications segment and a modest year-end recovery in air transport. Helped by the pick-up in manufacturing, as well as improved visitor traffic, the sector grew by 5.7% in the first quarter of 1999, higher than the 4.7% of the preceding quarter.

The financial and business services sector grew by a modest 3.1%, down from 11% a year earlier. In the first quarter of 1999, the sector contracted by 0.6%. The financial services sub-sector shrank sharply by 5.3%, after a 0.5% decline in the last quarter of 1998, partly due to a high base a year ago. The decline was also due mainly to poor lending sentiment to non-bank customers in the domestic and offshore markets.

INFLATION

Consumer prices fell by 0.3% in 1998, marking the first annual decline since a 1.4% contraction during the last recession in 1985/6. A firm exchange rate *vis-à-vis* regional currencies, muted inflationary pressures in international commodities, cautious consumer sentiment and very competitive pricing in the face of weak retail demand from both locals and visitors helped to lower prices.

Consumer prices continued to decline in the first quarter of 1999, falling by 0.6% on a year-on-year basis. The decline was mainly due to lower costs of transport and communications, as well as housing costs.

EMPLOYMENT

The labour market slackened considerably in 1998. The average unemployment rate rose to 3.2%, up from the average level of 1.9% over the past nine years. Total employment chalked up a net loss of 23,400, the first full-year decline in employment since the 1985/6 recession. This compares with net employment gains of 120,300 in 1997. With the sharp fall-off in business demand and the consolidation of local business operations, the number of retrenched workers reached an all-time high of 29,100 in the year, exceeding the 19,529 retrenched in 1985. The manufacturing sector, particularly the electronics industry, bore nearly two-thirds of the lay-offs. The services sector accounted for 30% of the retrenchments, mainly in wholesale and retail trade, real estate and business services, hotels and restaurants and financial institutions.

The labour market remained weak in the first quarter. Total employment is estimated to have contracted by 17,800, compared to a decline of 6,300 in the fourth quarter of 1998. The largest net job loss was in the construction workforce, followed by commerce, manufacturing, financial and business services and transport and communications. About 2,800 workers were retrenched[3] in the first quarter, a significant drop compared with the 8,013 laid off in the preceding quarter. In line with the pick-up in the manufacturing sector, only 28% of the total retrenched workers were from the manufacturing sector. This is a sharp contrast to previous years where manufacturing accounted for more than two-thirds of total retrenchments. Instead, the majority of the workers laid off were from the services sectors (61%), namely, in financial institutions, wholesale and retail trade, real estate and business services and hotels and restaurants. The seasonally adjusted unemployment rate eased to 3.9% in March 1999, from 4.4% in December 1998, partly due to the pick-up in economic activity and a drop in retrenchment in the first three months of this year.

[3] From a survey of private sector establishments with at least 25 employees.

CURRENT ACCOUNT

Singapore continued to register a current account surplus in 1998. The surplus rose from S$22.3 billion in 1997 to reach S$29.5 billion in 1998. This was largely due to the improvement in trade balance as a result of a fall in imports. The current account continued to register a surplus of S$6.9 billion in the first quarter of 1999.

EXCHANGE RATES

Against the backdrop of the Asian financial crisis, the Singapore dollar weakened against the major currencies, but strengthened against most regional currencies in 1998. Despite some volatility in the movements of the Singapore dollar against the US dollar, the Singapore dollar depreciated by an average 11% against the US dollar, following a depreciation of 5% the previous year, ending the year at S$1.66 per US dollar. On the other hand, the Singapore dollar strengthened against the regional currencies as they continued to slide against the US dollar, particularly in the first three quarters of 1998. It appreciated by 210% against the Indonesian rupiah, 32% against the Korean won, 20% against the Thai baht and 3.5% against the New Taiwan dollar. It also appreciated by 25%% against the ringgit to end the year at S$0.44 per ringgit. However, the Singapore dollar depreciated against the currencies of most industrialised countries in the first quarter of 1999. It weakened by 6.1% against the Japanese yen, 3.4% against the US dollar, and 0.9% against the Pound Sterling. The Singapore dollar also depreciated against most regional currencies. It weakened by 9.6% against the Korean won, 3.1% against the Thai baht, and 3.4% each against the Hong Kong dollar, the New Taiwan dollar and the Malaysian ringgit. Against the rupiah, the Singapore dollar strengthened by 5.4%.

FISCAL POLICY

Fiscal policy in 1998 continued to be aimed at supporting sustained, non-inflationary economic growth. Against the volatile regional setting, the government responded with further fiscal measures, following the fiscal year 1998 (FY98)[4] budget, to cut business costs and stimulate the economy.

Although both the government's operating revenue and operating and development expenditures declined, the former for the first time in many years, revenues remained sufficient to finance expenditures. The decline in government expenditure was largely the result of civil service variable wage adjustments in line with a policy of wage restraint, and softening tender prices and construction costs.

While the government observes a balanced budget to ensure that it lives within its means, it is not opposed to incurring temporary budget deficits and drawing on its accumulated surpluses to implement essential relief measures to ameliorate the impact of an economic downturn, as well as to continue infrastructural investments. Nonetheless, the objective remains to return to a balanced budget as quickly as possible and to maintain a balanced budget over the medium-term.

The key priorities in government expenditure are to promote economic growth, and to develop and nurture the human resources of the nation. Hence, expenditure priorities are aligned with strong emphases on education, economic infrastructure, basic health and

[4] FY98 represents the period 1 April 1998 to 31 March 1999.

national security. As in previous years, the bulk of expenditure in 1998 was allocated to social and community services (38%), comprising mainly education and health, and security (34%). Economic services accounted for another 21%. At the same time, funding for the arts was increased by 22% to encourage greater appreciation of culture and the arts.

In all, total expenditure in 1998 amounted to S$24.8 billion, a decrease of S$1.1 billion or 4.1% over 1997. As a percentage of nominal GDP, it remained largely unchanged at 18% in 1998. Operating revenue totaled S$28.2 billion, down by S$2.4 billion. The result was a fiscal surplus of S$3.4 billion (or 2.4% of nominal GDP), S$1.3 billion less than the S$4.7 billion surplus in 1997. The budget surplus, which took into account contributions to the Central Provident Fund (CPF) Pre-Medisave Top-up Scheme, stood at S$3.4 billion.

Despite the budget surplus of S$3.4 billion for the calendar year 1998, the budget for the fiscal year (FY98) registered a slight deficit of S$0.5 billion. This is due mainly to the slowdown in revenue collections as a result of the S$2 billion Off-Budget package in June 1998 and the S$10.5 billion cost-cutting package in November 1998.

The cost-cutting package implemented in January 1999 resulted in a significant easing of cost pressures in the first quarter. Helped by wage cuts and healthy productivity growth, the Unit Labour Cost (ULC) of the overall economy fell by 10% in the first quarter. Manufacturing Unit Business Cost (UBC) fell by 13% in the first quarter, more than the 4.4% decline in the preceding quarter. Besides the 17% drop in the ULC of the manufacturing sector, services costs declined by 6.9% due to lower charges for various services, namely, trade and transport, interest and financial services, utilities, rental of premises, telecommunications, port and warehousing. The government rates and fees component of the UBC also fell by a hefty 38%, due to the continued fall in industrial property prices and property tax rebates for industrial properties.

MONETARY POLICY

Monetary policy remained focused on maintaining price stability as a sound basis for sustained economic growth. This objective was achieved through an exchange rate policy aimed at price stability and sustainable growth.

In 1998, in response to the increased volatility and uncertainty of financial markets, the band within which the Singapore dollar can fluctuate has been widened. The subdued inflationary environment has also allowed the Monetary Authority of Singapore (MAS) to manage the exchange rate more flexibly. In 1998, although the Singapore dollar weakened against the US dollar, it appreciated against the currencies of most regional economies. Hence, against a trade-weighted basket of currencies of the major trading partners, the Singapore dollar appreciated slightly in 1998.

In the first quarter of 1999, the Singapore dollar continued to depreciate against the currencies of most industrialized countries (with the exception of the Euro which was launched on 4 January 1999). In addition, the Singapore dollar fell against most regional currencies, with the exception of the rupiah.

FOREIGN DIRECT INVESTMENT

The manufacturing sector attracted a healthy total of S$7.8 billion of investment commitments in 1998, despite the economic crisis. Foreign investors, led by the US, and followed by Japan and Europe, displayed their confidence with a commitment of S$5.2 billion. The commitments were mainly in the electronics and chemicals industries, with projects including wafer fabrication, semiconductors, petrochemicals, DRAMs, CD-ROMs and capacitors.

Manufacturing investment commitments totaled S$1.7 billion in the first quarter of 1999, of which 88% were from foreign sources, namely, Europe, the US and Japan.

MEDIUM-TERM OUTLOOK

The global economic climate has improved in the last few months, although uncertainties remain. Bolstered by the lagged effects of the interest rate cuts late last year and strong consumer sentiment, the US and EU economies are likely to continue growing, albeit with some moderation. The Japanese economy, propped up by expansionary fiscal measures and monetary policy, is showing signs of being on the mend. The regional economies are bottoming out, although the turnaround in the real economy remains patchy.

In Singapore, the economy registered positive growth in the first quarter, largely on the back of a strong pick-up in the manufacturing sector. The transport and communications sector also improved slightly, boosted by an increase in visitor arrivals. Forward-looking indicators such as the composite leading index and business expectations have improved somewhat. However, a number of sectors remained weak. The construction, commerce and financial and business services continued to decline in the first quarter.

The overall optimistic sentiment masks the latent risks in the global economy. The recent strength in industrial production and our exports to the regional economies are heavily reliant on the continued strength of the developed economies, in particular, the US. Despite its current dynamism, potential stress points still exist in the US economy. The sustainability of high rates of economic growth in the face of a tight labour market and rising trade deficit remains a challenge. In the EU, growth is expected to moderate this year as stock-building unwinds and investment growth slows in response to more cautious business sentiment. The convalescence of the Japanese economy also remains fraught with challenges. In the region, even as countries take on the painful tasks of restructuring and reforms, socio-political stresses could potentially jeopardise recovery in their economies. Hence, the external outlook, while improved, remains fragile.

Taking into account all the above factors, the 1999 GDP growth forecast for Singapore has been revised from -1% to 1% to 0%.

Singapore: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	49.7	58.4	70.9	85.2	92.7	96.3	84.4
Real GDP	6.2	10.4	10.5	8.7	6.9	7.8	1.3
Total Consumption			6.7	5.8	10.0	7.0	
Private Consumption	6.8	10.8	7.3	4.8	7.2	6.7	
Government Consumption	7.3	1.0	3.8	10.7	23.5	8.1	
Total Investment			8.8	9.8	17.2	8.9	
Private Investment							
Government Investment							
Exports of Goods and Services	1.4	15.6	23.3	13.7	5.2	5.3	
Imports of Goods and Services	2.9	17.1	13.7	12.7	5.0	6.2	
Fiscal and External Balances (% of GDP)							
Budget Balance	4.9	5.9	7.4	6.1	6.0	1.1	-0.3
Merchandise Trade Balance (f.o.b.)	-3.7	-4.7	1.9	1.1	2.4	1.2	1.7
Current Account Balance	12.0	7.3	16.2	16.9	15.9	15.4	18.2
Capital Account Balance			-0.1	-0.1	-0.1	-0.2	-0.2
Economic Iindicators (% change from previous year, except as noted)							
GDP Deflator	1.0	5.5	3.8	2.6	1.4	1.4	
CPI	2.3	2.3	3.1	1.7	1.4	2.0	-0.3
M2	8.2	10.9	14.4	8.5	9.8	10.3	30.3
Short-term Interest Rate (%)	2.5	2.3	3.6	3.4	3.4	4.1	5.0
Exchange Rate (Local Currency/US$)	1.6	1.6	1.5	1.4	1.4	1.5	1.7
Unemployment Rate (%)	2.0	1.9	2.0	2.0	2.0	1.8	3.2
Population (millions)	3.2	3.3	3.4	3.5	3.6	3.7	3.8

Source: Data are as submitted by member economies, unless otherwise specified. Data for 1998 are from Asian Development Bank and International Monetary Fund.

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	0/1	0.5		1.0			4.2		4.0						
Real Exports															
Real Imports															
CPI		-0.1		0.5			1.1		2.0						

Note: The IMF forecast is from the World Economic Outlook (IMF, April 1999). The ADB forecast is from the Asian Development Outlook (1999).

CHINESE TAIPEI

In 1998, as the impact of Asian financial turmoil evolved, shrinking external demand started to hurt Chinese Taipei's exports. With domestic demand expansion also slowing down, the GDP growth rate in 1998 slipped to 4.8%, its lowest level since 1983. In mid-year, the government launched a number of policies aimed at increasing public investment as well as stimulating private investment. The "Economic Enhancement Plan" was initiated in February 1999, a mid- and long-term program tailored for reform in the financial system, corporate governance, land and housing measures, and labor related laws.

REAL GDP GROWTH

Real GDP grew by 4.8% in 1998, well below the targeted 6.7%. With exports in US dollars dropping by 9.4% in the year and domestic inventory investment put largely on hold, the real GDP growth rate decreased quarter by quarter to 3.7% in the fourth quarter of 1998 (1998/Q4) from a robust 7.1% in fourth quarter of 1997. As a result of 17% New Taiwan (NT) dollar depreciation in the year, per capita GNP in US dollars fell back to its 1995 level.

On the production side, industrial growth faltered to 3.7% in 1998, dragged down mainly by the sluggish manufacturing sector, which dropped from 5.1% in the first quarter to 1.9% in fourth quarter of 1998, the lowest rate since the third quarter of 1983.

A modest recovery of foreign demand is expected, as major Asian trading partners have been engaged in restructuring and the US economy has undergone adjustment for a soft landing. With the still rising non-performing loans and some concerns regarding the troubled listed companies, the economy in the first half of 1999 is expected to grow moderately. Yet signs for a bottoming out can be identified. Helped by an upturn in trade generated by a recovery in Asian economies, and the boost to domestic demand from the BOT projects and the replacement of information equipment for Y2K compliance, real GDP is projected to grow by 5.1% in 1999.

INFLATION

The consumer price index (CPI) rose by 1.7% and the wholesale price index (WPI) rose only 0.6% in 1998. Low international raw material prices, lower tariff rates, and stable service prices, including moderate growth in wages, have helped create a low inflation environment.

With stable world oil prices, the growing stronger NT dollar, and further tariff cuts for 1999 as a whole, the WPI is forecasted to decrease by 4.6%, and CPI to increase by 1.6%, with consideration of the lower pace of wage and rent increases and lower telecom fees.

EMPLOYMENT

The labor force was 9.3 million, with an overall participation rate of 58.0%. Total employment increased by 1.2% compared with the previous year, with the quarterly rate dropping from 1.8% in first quarter of 1998 to 0.5% in fourth quarter of 1998 under the crisis-hit economic climate. With respect to the employment structure, the service sector accounted for a record high of 53.2% of the total working population, which is one percentage point higher than that of 1997.

A historic decrease in average monthly employee earnings of the manufacturing sector occurred in fourth quarter of 1998 when profit margins declined. The unemployment rate remained at 2.7% in 1998, the highest in a decade. In January, the government launched the unemployment insurance program.

TRADE ACCOUNT

Trade contracted in 1998, as did the trade surplus. Total external trade as a proportion of GDP fell to 80% in 1998, compared with 81% in 1997. In 1998, the value of exports and that of imports amounted to US$110,178 million and US$99,647 million, respectively, reflecting decreases of 9.5% and 7.2% over the previous year. The shrinkage in exports was mainly due to the contraction of the Asian market. The decrease in imports was attributable to the slowdown in exports and domestic inventory investment.

In line with the decline in the trade surplus from US$14,365 million in 1997 to US$10,531 million in 1998, the current account surplus decreased from US$7,688 million to US$3,728 million over the same period. For many years, the services account has been in deficit. This deficit declined slightly from US$7,736 million in 1997 to US$7,393 million in 1998, resulting from reducing transportation and travel expenditure. The income account surplus narrowed from US$2,391 million in 1997 to US$1,454 million in 1998, the result of contracting investment profits on the central bank's foreign reserves and the increase in outward remittances of equity earnings by foreign investors. Net transfer payments decreased from US$1,332 million in 1997 to US$864 million in 1998, owing to the decrease in outward remittances made to support relatives abroad.

Chinese Taipei has been a capital exporting economy for many years, and thus its financial account, equivalent to the capital account in the old BOP version, has consistently recorded net capital outflows. However, this trend was reversed in 1998. The financial account registered a net inflow of US$1,789 million, from a net outflow of US$8,380 million in the previous year. This was mainly due to a decrease in investment abroad and an increase in the inward remittances of export proceeds previously retained overseas.

GROSS EXTERNAL DEBT

Gross external public debt, defined as debt with an original or extended maturity of more than one year repayable to external creditors by the public sector, reached a peak of US$6,290 million at the end of 1983. Since then, it continued to decline and had decreased to US$46.4 million by the end of 1998 from US$74.4 million at the end of 1997.

FOREIGN DIRECT INVESTMENT

Under the policy of promoting liberalization and globalization, Chinese Taipei is constantly striving to improve its investment environment for all sources.

Inward FDI amounted to US$3.3 billion in 1998, the second highest ever recorded, mainly from British possessions in Central America (this refers primarily to the British Virgin Islands) with 21.4%, the United States with 19.1% and Japan with 15.8%. The principal recipients of the investment were the electronic and electrical appliances industry; and the banking and insurance sector, which together accounted for 56.6% of the total.

Approved outward FDI amounted to US$3.3 billion in 1998. British possessions in Central America with a 55.8% share and the United States with 18.2% were the major recipients of capital from Chinese Taipei. The lion's share of the outward FDI went into the banking and insurance sector; and the electronic and electrical appliances industry; these two sectors accounted for 69.9% of the total.

EXCHANGE RATE

Throughout the late 1980s and into the 1990s, a floating exchange rate regime has been in operation. Only on a few occasions, where strong irrational expectations were in place, has the central bank intervened the market.

In 1998, the sharp decline of the Japanese yen, the outbreak of the Russian financial crisis in July, and the decrease in Chinese Taipei's exports caused expectations of NT dollar depreciation. The NT$/US$ exchange rate reached a low of 34.896 on 10 June.

Beginning in October 1998, expectations of NT dollar depreciation reversed under the background of sharp appreciation of the Japanese yen against the US dollar, the stabilizing Asian financial markets, the effect of the ban on non-delivery forward transactions, and continuing inflows of foreign capital into the economy. The NT dollar appreciated sharply to end the year at 32.216. If a comparison is made based on the trade weighted average exchange rate involving 15 major trading partners, the NT dollar depreciated by 10.9% in 1998.

FISCAL POLICY

Central government expenditure grew from NT$1,151.8 billion in 1997 to NT$1,225.3 billion in 1998, an increase of 6.4%. Meanwhile, central government revenue increased from NT$996.8 billion in 1997 to NT$1,025.2 billion in 1998, an increase of only 2.9%. To bridge the gap between revenue and expenditure, the government had to deplete surpluses from previous years and to issue new bonds.

In 1998, the most significant fiscal policy adopted was the implementation of the integrated income tax system, a revolutionary tax reform aiming to solve the double taxation of dividend income. It has helped to create a more favorable investment environment

Based on 1997 figures, NT$31.5 billion tax reduction will be created as a result of the introduction of the new system, generating a positive effect in boosting domestic demand and contributing to economic growth. Computed using the 1997 GDP scale, the measure will push up the growth rate by between 0.25 to 0.35 percentage points in the first year after implementation, while in a five to ten year period the boost will be between 1.5 to 2 percentage points as a result of the multiplier effect.

MONETARY POLICY

To cope with the slackening economy and the bearish stock and real estate markets, the central bank has adopted a moderately easy monetary policy since August 1998. During the period August 1998 through February 1999, the central bank lowered the rediscount rate four times, from 5.25% to 4.50%, and cut reserve ratios on three occasions. In addition, the central bank appropriated NT$240 billion from postal savings re-deposits to assist business and first-time home buyers. In 1998, M2 grew at an annual rate of 8.8%, which was within the 6% to 12% target range set for the year. The average overnight interbank call-loan rate in 1998 was 6.6%, lower than the 6.9% of the previous year.

Real interest rates, computed by subtracting CPI inflation rates from one-year time deposit rates, have been on a downward trend since 1990. The average real interest rate quoted by five leading banks in February 1999 was 3.47%, far below the 5.13% recorded at the end of 1997. As for nominal interest rates, both long-term and short-term rates have fallen considerably since February 1998.

MEDIUM-TERM OUTLOOK

The steady recovery of the Southeast Asian economies in coming years will help Chinese Taipei shake off its sluggish exports. Meanwhile, the efforts being made to expand domestic demand will also be take effect and stimulate economic growth.

In 1999, Chinese Taipei's government projections are as follows:

- Economic growth: 5.1%.
- Annual increase in consumer prices: 1.1%.
- Export and import of goods and services: 6.4% and 2.9%, respectively.

For the period 2000-2002, they are as follows:

- Average economic growth rate: between 5.3% and 5.8%.
- Average annual increase for consumer prices: lower than 3.0%.

MAIN STRUCTURAL REFORMS

Investment Policy

- Relaxation of the limit of single foreign investor's share in a listed company, from the previous 15% to 50%, and the total foreign investors' share in one listed company from 30% to 50%.

- Revision of the Cable TV Law, aiming to break the monopoly market structure by local business groups and also raise the foreign ownership limit from 20% to 50%.

- Revision of the Shipping Industries Law to lift the ban on foreign nationals or juridical persons operating a shipping agency, marine freight forwarding, and other related business in Chinese Taipei.

- Some prohibited items in the Negative List for Investment by Overseas and Foreign Nationals will be recategorized as restricted items.

Fiscal Policy

- Implementation of an integrated income tax system to eliminate double taxation.

- Revision of the Law Governing the Allocation of Government Revenue and Expenditures to increase the proportion of public finance available for local governments.

- Implementation of the plan to open the monopolized tobacco and alcohol market.

Financial Policy

- Amendment of the Banking Law to allow new products, and amendment of the Deposit Insurance Act to streamline the system.

- The application of credit rating requirements to the issuing company before unsecured corporate bonds can be offered.

- Adoption of capital adequacy requirements for securities firms; and streamlining the timeframe and quality of disclosures of listed companies.

Chinese Taipei: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	212.2	222.6	241.0	260.2	272.3	284.8	261.6
Real GDP	6.8	6.3	6.5	6.0	5.7	6.8	4.8
Total Consumption	7.8	6.4	6.4	4.6	6.0	7.3	6.3
Private Consumption	8.9	8.2	8.6	5.5	6.2	7.7	7.1
Government Consumption	4.5	0.6	-1.2	1.3	5.2	5.8	3.1
Total Investment	16.3	8.0	3.4	4.2	0.8	13.9	6.0
Private Investment	19.0	10.6	7.9	8.3	5.6	18.3	11.9
Government Investment	15.5	17.5	12.9	3.8	-0.5	1.1	-0.1
Exports of Goods and Services	5.3	7.2	5.5	12.8	7.1	8.7	2.8
Imports of Goods and Services	12.2	8.3	3.5	9.8	5.1	13.4	5.5
Fiscal and External Balances (% of GDP)							
Budget Balance (1)	-5.9	-6.0	-5.2	-5.2	-3.3	-2.2	-0.3
Merchandise Trade Balance (f.o.b.)	6.0	5.1	4.9	5.1	6.5	5.1	4.0
Current Account Balance	4.0	3.2	2.7	2.1	4.0	2.7	1.4
Financial Account Balance	-3.3	-2.1	-0.6	-3.1	-3.2	-2.8	0.7
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	3.9	3.5	1.9	1.9	2.7	1.9	2.6
CPI	4.5	2.9	4.1	3.7	3.1	0.9	1.7
M2	19.9	16.4	16.3	11.6	9.2	8.3	8.8
Short-term Interest Rate (%) (2)	7.2	6.8	6.8	6.7	5.8	6.8	6.8
Exchange Rate (Local Currency/US$)	26.16	26.38	26.46	26.48	27.46	28.70	33.46
Unemployment Rate (%)	1.5	1.5	1.6	1.8	2.6	2.7	2.7
Population (millions)	20.8	20.9	21.1	21.3	21.5	21.7	21.9

Notes:
(1) Fiscal year
(2) Short-term Interest rates are 31-90 days CP rates in the secondary market.

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	5.1	3.9	5.5	4.9	4.0	5.7	4.8	6.3		5.5	5.3-5.8				
Real Exports	6.4					3.9									
Real Imports	2.9					3.7									
CPI	1.1	0.8		1.9	0.0	1.9	1.3	2.6		1.7	3.0				

Note: Official according to DGBAS latest predicted value (may 20, 1999). The LINK forecast is from the World Outlook (Proyect LINK, May, 1999); growth projection for 1998 is for GNP. The IMF forecast is from the World Economic Outlook (IMF, April 1999). The ADB forecast is from the Asian Development Outlook (1999). The OECD forecast is from the OECD Economic Outlook (OECD, December 1998).

THAILAND

GDP

Real GDP contracted by a remarkable 8.0% in 1998 following a growth of -0.4% in the prior period. The decline was caused by a sharp contraction in domestic demand. Domestic expenditures represented a 23.5% contraction, following a 7.6% decline in 1997.

Total consumption contracted by 14%, against a growth of -0.5% in the previous year. Private consumption declined by 15.0%, compared with a growth of -0.4% in the previous year, as the economic contraction reduced the purchasing power and employment. Government consumption declined by 4.7%, in comparison with a 0.7% contraction in the previous year, as a result of a budgetary cut due to the government's emphasis on fiscal discipline and economic stability during the first half of the year.

Total investment also declined by 40.5%, compared to last year's decline of 19.4%. Private investment experienced a sharp reduction of 51.5%, which continued the decline of 24.8% of the last period, and mainly resulted from a sharp contraction in domestic demand, the Asian crisis and the slowdown of world economy. Public investment declined by 17.9%, against an expansion of 11.3% in the last period. Central and local government investment decreased sharply by 30.9% compared to a growth of 21.7% in prior period.

Gross national savings accelerated from the previous year owing to a rise in private savings, particularly household savings, due to the sharp contraction in consumption.

Export values in US dollar terms declined by 6.8% in 1998, compared to a 3.8% growth in the last period. This was due to: (1) a fall in world commodity prices and the increased price competition in the export market, (2) a shrinking demand from trading partners, and (3) the liquidity problems of exporters, particularly small- and medium- size exporters.

Import values in US dollars terms fell by 33.8% in 1998, compared to a -13.4% reduction in the last period. This was a result of (1) a reduction of 8.8% in rate of price increase, (2) a sharp contraction in domestic demand, both consumption and investment, and (3) a depreciation of the baht resulting in a substitution away from imported goods.

INFLATION

The consumer price index (CPI) rose by 8.1% in 1998 compared to 5.6% in 1997. Inflation accelerated during the first half of the year, averaging 9.7% per annum (p.a.), and decelerated in the second half of the year. The increase in inflationary pressure came from both food and non-food prices. Prices in the food category increased by 9.6%, up from 7% in the last period while prices in the non-food category increased by 7.3%, up from 4.6%.

In the latter half of the year, the inflation rate decelerated sharply owing to the strengthening of the baht and weak demand. The inflation rate in December declined sharply to 4.3%, with the average rate of 6.5% in the second half of the year.

EMPLOYMENT

Due to the economic crisis, the labor market saw a reduction in employment in 1998. Total employment recorded at 30.8 million, reflected a decline of 812,000 or 2.6% from the previous year. Within this total, the number of workers outside the agricultural sector fell by 618,000, or 3.6%, while those in the agricultural sector declined by 194,000 or 1.4%.

As a consequence of a seasonal fluctuation, the number of unemployed workers represented at 1.3 million, a 4.0% unemployment rate, increased from 3.5% of the last period. The sector in which there were large layoffs included construction, restaurant, hotel, small retail shops and electrical appliance repair.

The minimum wage rate was raised by approximately 3% from baht 157/day to baht 167/day in 1998, effective since 1 January 1998. However, the rate of growth of real wages was contracted by 4.46%, due to the economic contraction in 1998.

TRADE ACCOUNT

A current account surplus reported at 12.3% of GDP, compared to the deficit 2.0% in the last period. It improved considerably to a surplus of US$14.3 billion from a deficit of -US$3.1 billion in 1997. The balance of trade recorded a large surplus of US$12.2 billion as imports declined more sharply than exports. Along with the increased net surplus from the service and transfer account as a result of increased revenues from tourism, this enabled a surplus to be recorded in the current account this year.

The capital account is estimated to have registered a large deficit of about 16.8% of GDP, compared to a 15.6% deficit in the last period. This mainly resulted from the debt repayments of the private sector and offshore swap settlements.

Since the Thai economy has achieved progressive improvements through implementation of policies supported by the IMF, the confidence of foreign investors has gradually improved. Foreign direct investment (FDI) rose substantially by 27.0% from US$3,751.64 billion to US$4,792.50 billion (4.01% of GDP) in 1998 with increases in both equity participation and direct loans from the parent companies.

As a consequence, the structure of capital flow and external debt improved. Gross external debt was slightly decreased from US$93.4 billion, or 62.7% of GDP in 1997 to US$ 86.1 billion, or 73.65% of GDP in 1998. Capital in the form of loans was continuously replaced by FDI, while the short-term debt repayment in the private sector was replaced with inflows of long-term borrowing by the public sector. This resulted in the continuous decline in the private sector external debt outstanding and an increase in the proportion of long-term debt.

With size of the current account surplus exceeding outflows on the capital account, the balance of payments recorded a surplus of US$1.7 billion.

EXCHANGE RATE

In the beginning of 1998, the baht was rather volatile as it sharply depreciated from baht 47.25/ US$1 at the end of 1997, to the weakest level since the announcement of the floating exchange rate system of baht 56.06 per US dollar in January 1998. This was due to the depreciation of regional currencies as well as the continuation of high domestic and overseas demand for US dollars.

Since mid-February, the baht has consolidated. Favorable developments in some economic indicators: improved trade balance and current account; the abolition of the two-tier foreign exchange market; and the strengthening of confidence in Thailand's economic and financial restructuring policies have contributed to drawing in foreign capital. Moreover, regional currencies such as the Indonesian rupiah and Korean won regained strength in the period February to May. As a result, the baht has been appreciating significantly, fluctuating within a range of baht 38.50 to baht 41.04 to the US dollar between April and May.

In the second half of the year, the baht slightly depreciated in line with the Japanese yen, with the economic crises in Russia and Latin America. However, since September, the baht has appreciated and regained stability owing to signs of improvement regarding the economic crises, and other factors such as the de-leveraging of the short position on Thai baht by hedging funds in the US, the announcements of the Miyazawa financial support and American and Japanese financial support in the APEC meeting for the crisis-affected countries.

In 1998, the movements of the baht exhibited a strengthening trend, especially during the fourth quarter. The baht appreciated, passing the baht 36 per US dollar level for the first time in late November.

FISCAL POLICY

The fiscal policy implemented in 1998 can be divided into in two phases. In the earlier period, emphasis was placed on economic stabilization and regaining confidence. However, increasing evidence confirmed that the economy in the second quarter of 1998 was experiencing a more severe contraction.

In fiscal year 1998, the government recorded a cash deficit of baht 115 billion, or 2.4% of GDP, in comparison to a deficit of 1.0% of GDP in the year before. Although, a balanced budget was set for the fiscal year, revenue collection dropped with the weakening economy.

Government revenue fell by 13.8% from the previous year, mainly due to a 43.1% reduction in corporate income tax.

As for government expenditure, the budget was revised several times during the course of 1998, the last revision was reported at baht 830 billion. Of this, actual disbursement amounted to baht 666.4 billion or 82.3%. After including an additional baht 8.0 billion from the treasury reserves and the carry-all expenditure amounting to baht 160.9 billion from the previous fiscal year, total government expenditure was thus baht 835.3 billion, down 6.0% from 1997.

MONETARY POLICY

In 1998, businesses faced liquidity problems following the financial crisis that started in1997. Liquidity tightened remarkably as financial institutions became increasingly cautious in lending, for many reasons. First, the lack of public confidence in financial institutions caused large amounts of deposit withdrawals as well as debt recalls by overseas creditors. Secondly, the economic contraction and increased foreign debts burden due to the baht's depreciation had contributed to private businesses' inability to service their debts to financial institutions, resulting in the acceleration of the financial institutions' non-performing loans (NPLs) problem. Lastly, financial institutions could not implement the recapitalization necessary to match the increased NPLs.

Liquidity in the financial system has increased since the second quarter and became very high in the last quarter of 1998. This was the result of the ongoing process to strengthen financial institutions and the officials deposit guarantee scheme which helped restore public confidence in financial institutions.

The money market interest rate and bond repurchase rate were adjusted downward continuously over most of the year in line with increased liquidity. The average inter-bank lending rate gradually declined from 22.9% p.a. at the end of 1997 to 18.0% in the second quarter and to 3.8% in the fourth quarter of 1998. The one-day repurchase rate gradually decreased from 24.0% p.a. at the end of 1997 to 18.2% in the second quarter and to 4.4% in the fourth quarter of 1998.

MEDIUM-TERM OUTLOOK

As a result of the progress made in resolving economic and financial problems, the Thai economy is projected to recover gradually, with a growth rate of 1.0% in 1999. The recovery would become more apparent in the second half of the year. Economic stability is expected to improve further. Inflation is expected to average at -0.5 to 1.0%. External stability is projected to remain satisfactory.

The current account surplus is estimated to reach US$11.8 billion, slightly smaller than the previous year. The capital account will record a smaller deficit than the year before, and is expected to be US$8.3 billion, as a result of the prior completion of the unwinding of offshore swap obligations. Private debt repayments are expected to slowdown, in line with a decline in outstanding short-term debts. Thus balance of payments in 1999 is projected to register a surplus of US$3.5 billion.

Monetary conditions in 1999 are projected to improve. Liquidity in the money market remained high following the end of 1998. Capital inflows are estimated to increase which will further enhance the stability of the baht while a lower inflation rate will allow the authorities to maintain stimulative monetary and fiscal policy stance. Problems concerning financial institutions are expected to recede, in particular, as a result of progress in the recapitalization of financial institutions and debt restructuring in the business/private sector, which will help to regain the smooth functioning of the business sector. These efforts will further contribute to the reviving of the economy.

On the fiscal side, the policy objective of the government for fiscal year 1998/99 continues to be stimulating the economic recovery. The government has set a budget deficit policy with budgetary expenditure of baht 825 billion. The disbursement rate is expected to increase from the last period. Such a fiscal deficit is the policy stance appropriate for an economic condition in which financial market mechanisms are unable to operate efficiently. The stimulus from the fiscal policy will help accelerate economic recovery.

Government expenditure and loans from abroad will be targeted to relieve the adverse social effects of economic crisis, particularly through programs related to employment, health care, education, and rural development. In 1999, the unemployment rate is projected to be lower, falling from 4.0% to 3.1%.

MAIN STRUCTURAL REFORMS

Implementation of the14 August 1998 Announcement for Comprehensive:

- Intervened in the operations of banks: Liquidation, Merger.
- Restructure of Krung Thai Bank, the state-owned bank.
- Consolidation of Finance Company Sector - Implementation of Tier 1 and Tier 2 Capital Support Facilities.
- Associated Legal Measures: amend by emergency decree the Commercial Banking Law.

Additional Financial Sector Reforms

- Signing of new MOUs with all banks and all finance companies on recapitalization.
- Specialized State Financial Institutions (SFIs).
- Regulatory and Supervisory Framework.
- Comprehensive Deposit Guarantee.

Strategy to Facilitate Corporate Debt Restructuring

- Remove impediments to corporate debt restructuring.
- Establish Corporate Debt Restructuring Advisory Committee (CDRAC) to monitor restructuring process.
- Improve corporate disclosure and governance; bring accounting standards to international best practices.
- To date, a total amount of completed debt restructuring has increased by 19% from baht 156.9 billion in December 1998 to baht 187.4 billion in January 1999, corresponding to 12,004 debtors.

Legal and Procedure Reforms

- Enact amendments to the Bankruptcy Act. (Parliament passed these amendments at the beginning of 1999.)

Privatization Strategy

- Establish Office of State Enterprises and Government portfolio in MOF.
- Cabinet approved the Master Plan for State Enterprises Reform by establishing an overall strategy, principles for regulatory bodies, and the sequencing of divestitures.
- Approved a legal framework to enable privatization of public enterprises.

Market Opening Policy

- Foreign Ownership of Business Activities: amend the Alien Business Law to enhance competitiveness; increase transparency of criteria; contribute to increased liquidity in key sectors, and be consistent with international obligations.
- Foreign Ownership of Real Property (Land Code and Condominium Act); liberalize existing restrictions on foreign ownership of property.

Strengthening the Social Safety Net

- ♦ Infrastructure spending was increased to support priority areas in rural and urban sectors in order to augment broader agricultural production and industrial restructuring.
- ♦ The authorities accelerated the social investment program targeted at addressing many dimensions of unemployment.

Thailand: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	111.1	124.7	142.8	166.3	184.3	148.9	116.9
Real GDP	8.1	8.3	8.8	8.6	5.5	-0.4	-8.0
Total Consumption (1)			8.0	7.2	6.7	-0.5	-14.0
Private Consumption	7.8	8.7	8.2	7.9	6.2	-0.4	-15.0
Government Consumption	6.4	5.1	7.6	8.2	9.5	-0.7	-4.7
Total Investment (1)			11.1	12.3	5.4	-19.4	-40.5
Private Investment							
Government Investment							
Exports of Goods and Services	13.2	13.0	21.3	23.6	-1.9	3.8	-6.8
Imports of Goods and Services	5.5	12.0	17.6	30.5	0.6	-13.4	-33.8
Fiscal and External Balances (% of GDP)							
Budget Balance (2)	3.1	2.2	1.8	2.7	1.9	-1.4	-2.7
Merchandise Trade Balance (f.o.b.)	-3.6	-3.4	-2.6	-4.9	-5.1	-3.2	11.5
Current Account Balance	-5.7	-5.1	-5.6	-8.1	-7.9	-2.0	12.3
Capital Account Balance	8.5	8.4	8.4	12.9	16.5	-15.6	-16.8
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	4.2	3.4	4.7	6.3	4.8	5.5	9.0
CPI	4.1	3.3	5.0	5.8	5.9	5.6	8.1
M2	15.6	18.4	12.9	17.0	12.6	16.4	9.6
Short-term Interest Rate (%) (1) (2)	7.0	5.5	6.25	10.50	12.00	24.00	3.13
Exchange Rate (Local Currency/US$) (1)	25.4	25.3	25.15	24.95	25.34	31.37	41.37
Unemployment Rate (%)	3.0	2.6	2.6	2.6	2.0	3.5	4.0
Population (millions)	57.8	58.3	59.1	59.8	60.0	60.7	61.5

Sources: Ministry of Finance (1) Bank of Thailand
Notes: (1) Budget balance is on a Government Finance Statistic (GFS) basis.
(2) Short-term interest rate is the 1-day R/P rate for December of the given year.

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	1.0	1.0		0.0	1.0		3.0		2.5	3.5					
Real Exports															
Real Imports															
CPI	-0.5/1	2.5		3.0	2.5		4.0		5.0	3.5					

Note: The IMF forecast is from the World Economic Outlook (IMF, April 1999). The ADB forecast is from the Asian Development Outlook (1999). The OECD forecast is from the OECD Economic Outlook (OECD, June 1999).

UNITED STATES OF AMERICA

The United States enjoyed continued strong growth with declining inflation in 1998, extending the current expansion while continuing to build up the budget surplus.

GDP GROWTH RATE

Real GDP growth remained at 3.9% in 1998 as a whole, marking the seventh consecutive year of expansion. U.S. growth continued strongly in the first quarter of 1999, when it rose at a 4.3% annual rate.

In 1998, the largest contribution to income growth again came from the largest component, personal consumption expenditures, which rose 4.9%. This increase in household spending reflects rising incomes, rising stock-market values, and high levels of consumer confidence. During the year, measures of consumer sentiment reached record territory. After a drop brought on by a worldwide flight to safety and liquidity in the third quarter, the S&P 500 stock market index closed out 1998 at levels more than 25% higher than the beginning of the year. In the first half of 1999, the S&P 500 index rose another 12%.

Continued strength in investment also helped drive growth. Total investment rose 9.3% in 1998, led by large increases in private equipment purchases, which rose at a 16.5% clip over the year. Residential investment, which increased at a rate of 10.3%, responded to strong real income growth, rising stock-market wealth, and low mortgage rates. Over the current expansion as a whole, business fixed investment has accounted for an unprecedentedly large share in GDP, and it has held the rate of industrial capacity utilization below its long-run average.

The impact of this surge of private spending was partially muted, however, by a significant erosion in net exports linked to weak demand abroad. Strong domestic demand maintained double-digit growth in real imports, while real exports grew only 1.5%. Government consumption spending has also been restrained, posting only a 1% increase last year.

INFLATION

By every measure, inflation continued to remain remarkably subdued in 1998. The consumer price index (CPI) rose 1.6%, 0.7% less than its year-earlier rate. The GDP price deflator, a wider measure, showed a similar deceleration in prices from 1.9% to just 1.0% last year. In contrast, the so-called “core” CPI, which excludes the more volatile food and energy components, showed little deceleration in consumer prices over the previous year. The remarkable drop in oil prices last year, brought on by a collapse in world demand, no doubt played a beneficial role in limiting U.S. inflation. Aside from the influences of tobacco price hikes and prescription drug price inflation, core producer prices remained very stable last year. Prices of non-petroleum imports fell 3.5% in 1998, the third consecutive year of decline.

EMPLOYMENT

Non-agricultural jobs increased by about 2.8 million in 1998, and the unemployment rate averaged 4.5%, its lowest level since 1969. Service-producing industries expanded their payrolls by almost 3%, while manufacturing jobs declined steadily throughout the year and finished 1998 down 1%, probably due in part to the drop in net exports. Surprisingly, the historically low unemployment rate, which is heading even lower in 1999, has coincided with remarkably low and stable inflation, even though trend unit labor costs have shown slight acceleration. Real wages (measured by the employment cost index deflated by the CPI) rose 1.9% in 1998.

TRADE ACCOUNTS

The **current account** deficit grew to US$221 billion in 1998, or 2.6% of GDP (1997: 1.8%). The balance on goods and services was US$164 billion, as a merchandise trade deficit of US$247 billion was partially offset by a services surplus of US$83 billion. In the first quarter of 1999, the current account deficit was US$274 billion (seasonally adjusted annual rate), or 3.1% of GDP.

The U.S. **capital and financial accounts** recorded US$210 billion in net foreign investment into the United States in 1998, compared with a US$286 billion inflow in 1997. (These figures exclude the change in official reserve assets–which rose US$6.8 billion in 1998–as well as the statistical discrepancy.) Net private investment into the U.S. totaled US$238 billion. Portfolio investment (purchases of stocks and bonds) was the largest source of net private investment into the United States (US$161 billion), followed by direct investment (US$61 billion).

EXCHANGE RATE

The US dollar rose fairly steadily on world markets from 1995 through 1997, following the strong expansion of the U.S. economy. In 1998, the US dollar rose in real terms against a trade-weighted worldwide average of other currencies over the first eight months of the year, then fell towards the end of the year. Overall, the US dollar held virtually steady over the year. Through mid-1999, the US dollar has risen slightly.

FOREIGN DIRECT INVESTMENT

In 1998, the United States became a net recipient of direct investment. U.S. direct investment abroad rose 21% in 1998 to US$133 billion, but foreign direct investment in the U.S. rose nearly 80%, rising from US$109 billion to US$193 billion. Europe remains the largest recipient of to U.S. direct investment abroad and the largest provider of foreign direct investment in the U.S.

FISCAL POLICY

In fiscal year 1998, the Federal government ran a surplus for the first time in almost 30 years, capping six years of dramatic budget improvement, and the fiscal year surplus was the largest as a share of GDP since 1957. State and local government finances remained in good shape, and a combined measure of aggregate budget balance grew to 2.6% of GDP, due equally to declining expenditures and increasing revenues. Leaving aside the effect of the world financial crisis in the third quarter, which also worked to raise prices and reduce yields, interest rates on government securities, especially longer-term instruments, ended the year lower on average than in 1997.

MONETARY POLICY

Monetary policy began 1998 vigilant for signs of overheating, as the Federal Reserve adopted an asymmetric bias toward tightening as a precaution. In the midst of the world financial crisis in the third quarter, three cuts in the federal funds target rate in quick succession helped restore stability and maintain it through the rest of the year. Once the crisis had subsided, monetary policy returned to an unbiased stance. In June 1999, the Federal Reserve raised the federal funds rate by 25 basis points, but also adopted a symmetric stance on whether the next rate change would be up or down.

MEDIUM-TERM OUTLOOK

The prospects remain good for continued growth with low rates of unemployment and inflation. The economy shows no immediate signs of slowing. Productivity growth, which generally starts to slow during the end of an expansion, remains high. Inflationary pressure has yet to emerge. Inventories remain lean with respect to sales.

As of early July 1999, the consensus of private forecasters now expects growth to slow to a 3.0% annual rate in the final three quarters of 1999. If this private-sector consensus comes to pass, the growth rate for the year as a whole will be 3.9%, the same as the Administration's projection in its mid-session review. The private-sector consensus expects GDP to decelerate to a 2.5% annual rate of growth for 2000 as a whole. The Administration expects a similar deceleration, to 2.4%.

Both supply- and demand-side considerations argue for some moderation in real GDP growth from its rapid 4% annual pace of the past twelve quarters. The unemployment rate has fallen about 0.4 percentage point per year over this period, indicating that this growth rate is well above its potential. The labor market is very tight as indicated by low unemployment in April and strong increases in real wages. It is doubtful whether a further decline of the unemployment rate could be accommodated without inflationary consequences. Labor force growth has not kept up with demand in the past two years, nor can it be expected to keep up with growth at such a pace in the future. Finally, many components of demand which contributed to the rapid growth of the past few years are not those likely to be sustainable over the long-run, such as business demand for capital goods, and consumer's demand for durable goods.

The U.S. Administration projects U.S. long-run GDP growth at about 2.5% per year through 2005. This rate is consistent with growth for the 1990 business cycle as a whole and with labor force growth of about 1.2% and labor productivity growth of about 1.3%.

MAIN STRUCTURAL REFORMS

Developments in financial markets during the fall of 1998 prompted the President's Working Group on Financial Markets to call for constraining excessive leverage by improving transparency, enhancing private sector risk management practices, and developing more risk-sensitive approaches to capital adequacy. Efforts continue to reach agreement between the Administration and Congress on a specific formula for reforming bank regulation.

Reform in electricity and telecommunications continued in 1998, and a wave of mergers spread across numerous industries. Labor market policies focused on expanding education opportunities and worker training initiatives.

The drive to reform the Social Security system took on steam in 1998 and moved to center stage in 1999. Negotiations over specific formulae for restructuring are ongoing.

Unites States: Overall Economic Performance

	1992	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)							
Nominal GDP (billion US$)	6,244.5	6,558.1	6,947.0	7,269.6	7,661.6	8,110.9	8,511.0
Real GDP	2.70	2.32	3.46	2.28	3.45	3.93	3.88
Total Consumption			2.79	2.13	2.73	3.01	4.17
Private Consumption	2.80	2.93	3.28	2.67	3.19	3.39	4.88
Government Consumption	0.50	0.29	0.42	0.33	0.65	1.31	1.07
Total Investment	7.10	9.25	12.99	2.09	8.83	8.51	9.25
Private Investment							
Government Investment							
Exports of Goods and Services	6.60	2.90	8.23	11.26	8.51	12.78	1.52
Imports of Goods and Services	7.50	8.89	12.16	8.81	9.25	13.89	10.56
Fiscal and External Balances (% of GDP)							
Budget Balance	-4.70	-3.82	-2.69	-2.40	-1.44	-0.26	0.86
Merchandise Trade Balance (f.o.b.)	-1.50	-2.02	-2.39	-2.39	-2.50	-2.42	-2.90
Current Account Balance	-0.90	-1.30	-1.75	-1.56	-1.69	-1.77	-2.59
Capital Account Balance (1)		1.23	1.96	1.75	2.62	3.52	2.39
Economic Indicators (% change from previous year, except as noted)							
GDP Deflator	2.80	2.64	2.39	2.30	1.88	1.86	1.01
CPI	3.00	2.96	2.61	2.81	2.92	2.34	1.56
M2	1.90	1.13	1.38	2.07	4.85	4.96	7.39
Short-term Interest Rate (%) (2)	3.50	3.07	4.37	5.66	5.15	5.20	4.91
Exchange Rate (3)	126.65	111.20	102.21	94.06	108.78	120.99	130.91
Unemployment Rate (%)	7.50	6.90	6.10	5.60	5.40	4.94	4.48
Population (millions)	255.00	257.80	260.40	262.80	265.20	267.60	270.00

Notes:
(1) Capital account balance excludes change in official reserves and the statistical discrepancy
(2) Average 3-Month Treasury Bill market bid yield at constant maturity.
(3) Average exchange rate as reported in IMF, July 1999.

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	3.9	3.3			3.6	2.4	2.2			2.0					
Real Exports		3.6			2.7		6.9			5.7					
Real Imports		9.3			7.6		6.0			4.3					
CPI	2.2	2.1			1.1	2.4	2.4			1.5					

Note: The IMF forecast is from the World Economic Outlook (IMF, April 1999). The OECD forecast is from the OECD Economic Outlook (OECD, June 1999).

VIET NAM

The Viet Nam economy has achieved significant results during implementation of "The strategy on stabilisation and socio-economic development up to the year of 2000": inflation has declined from 67% in 1990 to less than 10%; average economic growth reached 8% per annum during 1991-1997, which has facilitated the improvement of the population's living standards; the 'open' economic policy has achieved important results, which has promoted trade and investment, etc. In recent years, however, especially since 1997, new difficulties have occurred. One of the reasons is the regional financial and monetary crisis. Negative effects of the crisis have become more serious during 1998-1999. In addition, the complicated changes in the global climate has also strongly affected Viet Nam. Recently storms, floods and droughts have become severe in Viet Nam.

REAL GDP GROWTH

In 1998, the GDP growth rate was the lowest recorded in the last decade, accounting for only 5.8%. Meanwhile, the average rate during 1991-1997 was 8% per annum. More concerning is that economic growth has tended to decline in recent years: it was 9.5% in 1995, 9.3% in 1996, and 5.8% in 1997. It is estimated that GDP grew only at 4% in the first quarter of 1999.

Agriculture is an important economic sector, which employs two-thirds of the labour force and produces one quarter of GDP. Value-added agriculture production increased by 2.7% in 1998, lower than that of 4.3% in 1997 and 4.4% in 1996. Food production increased tremendously, reaching 31.8 million tons, increasing by 1.2 tons in comparison with that of 1997, contributing to food security. Meanwhile, high level of rice exports was maintained at about 3.8 million tons in 1998.

The Industry and construction sector, accounting for one-third of GDP, has been facing difficulties due to low efficiency and competitiveness. Industrial gross output increased by 12.1%, of which the public sector increased by 7.9%, the business/private sector increased by 6.7% and the foreign-invested sector continues to grow quickly, reaching 23.3% which makes the foreign-invested sector account for one-third of industrial production, contributing to improvement of efficiency and competitiveness. Total development investment increased insignificantly.

The growth rates of the services sector declined significantly, especially trade, tourism, and transport. Retail sales value of goods and services of the domestic sector reached VND180,000 billion, an increase of 14.2% in nominal terms, but only by 4.6% in real terms. The main reason was the influence of factor prices.

Major features of the Viet Nam's economic performance in the first two quarters of 1999 are described as follows:

- GDP growth rate accounted for 4.5%, in which GDP contributed by agricultural economic sector grew 2.7 % ; by the industry and construction sector: 7.5%; by services: 2.8%.

- *Economic Success*. Many sectors and fields of business and production realized considerable achievements:

- The value of agriculture, forestry and fisheries output increased at a level higher than that in the same period of the previous year. Food production output in paddy equivalent increased by 410,000 tons in comparison with that in the same period of 1998.
- Export revenue increased from 2.7% in 1998 to 7.7% in 1999.
- Foreign invested industrial sector continues to grow rapidly.
- The value of the services sector output increased due to an increasing number of tourists pushing hotel and restaurant services also grew.

♦ *Shortages.* The economy, however, continues to face several major difficulties, and new challenges are emerging such as: economic efficiency is still low, and competitiveness remains weak. In context of the above factors, without reform, Viet Nam will lose momentum for development and for improving the sustainability of long-term growth. Therefore, Viet Nam's government has designed policies for State owned enterprises reform such as equitization and privatisation.

INFLATION

Inflation expressed in domestic CPI maintained a rate of 9.2%, of which:

- Food and foodstuff increased by	12.3%
- Beverage by	5.3%
- Garment, shoes and sandals	2.3%
- Housing and building materials	1.7%
- Domestic tolls and equipment	2.5%
- Pharmacy	8.7%
- Transport, post and communications	3.0%
- Education	9.6%
- Culture and sports	1.3%
- Other services	4.0%

EMPLOYMENT

In the context of reduction in growth rates of production and businesses and one million youths entering the labour force a year, the number of urban unemployed and rural underemployed is increasing.

According to results of a survey announced at the end of 1998, the unemployed and underemployed situation is as follows:

♦ The unemployment rate in urban areas in 1998 is 6.6% (for those above 15 years old) and 6.85% for those engaging in economic activities. Therefore, in comparison with that of 1997, the unemployment rate increased by 0.78% (for those above 15 years old), and 0.84% for those engaging in economic activities and has increased in all economic regions. The urban unemployment rate, especially, increased rapidly in the Red River Delta by 8.25%, (of which Ha Noi by 9.09%). The female unemployment rate is still higher. The survey results also show that the unemployment rate has tended to systematically increase from 1996 to 1998. Urban unemployment rate two-thirds of the provinces and province-equivalent cities has increased during recent years.

- ♦ Rural underemployment is evaluated through time-use rate. The survey results show that time-use rate of the population above 15 years old engaging regularly in economic activities during 12 months on average is 70.88%, a decline of 2.02% in comparison with that of 1997. For the labour force of working age, the working time-use rate is 71.13%, a decline of 2.01% in comparison with that of 1997. And for major activities in rural areas, working time-use for the whole economy is 61.37%. For the Red River Delta it is only 52.42%, the lowest in the economy. Of eight economic regions, only one region achieves working time-use rates above 75%.

EXPORT AND IMPORT

Exports in 1998 reached almost US$9.4 billion, increasing by only 2.4% in comparison with that of 1997. Growth rates in previous years were above 20%. The main reason is the strong decline in exports prices, especially the prices of crude oil and some agricultural products (the terms of trade has deteriorated-if prices remain at level of previous year, the exports value might increase above 10%). However, exports from foreign investment projects still increased by 11%, reaching US$2 billion, owing to the high quality of products and expansion of the market.

At the beginning 1999, export-import is still facing difficulties, however, exports in the first six months of 1999 increasing by 7.7% and imports decreasing 20% respectively in comparison with the same period in the previous year.

FOREIGN DIRECT INVESTMENT

By the end of 1998, Viet Nam issued licenses for more than 2000 FDI projects with total capital of US$35 billion. Disbursements reached US$14 billion, which significantly contributed to improvements in efficiency and competitiveness of the economy. At present, FDI projects produce about 10% of GDP and one-third of domestic industrial production output. However, as Viet Nam's main counterparts come from East Asia and as Southeast Asia, has been affected by the crisis, it has been very difficult for these economies to increase their commitments and to implement committed contracts. This has made it difficult for Viet Nam to raise capital as well as expand markets. Therefore, during 1998 new commitments received by Viet Nam were only US$4 billion, which equalled 50% of the level in 1996, (the year before the crisis) and disbursements were only US$1 billion which equalled one third of 1997 implementation.

Through six conferences, donors have committed US$13 billion to assist Viet Nam. The three largest donors, including Japan, the World Bank and the Asian Development Bank, account for 70% of total committed capital. ODA disbursement has improved, total disbursement during the past three years was US$3 billion, still slower than planned. ODA projects focus on improvement of the legal framework, human resource training, improvement of economic and social infrastructure and promotion of development of economic sectors.

EXCHANGE RATE

In the context of the devaluation of regional currencies from 30% to 80% during last two years, Viet Nam has realigned its official rates three times. In 1998, the realignment depreciated VND about 11%. This has contributed to lessen the price pressure from exports commodities from economies which strongly devaluated their currencies, such as Thailand, Indonesia and Korea.

At the same time, the government of Viet Nam has also implemented foreign exchange controls, export-import controls and controls of commercial credit for imports, in order to avoid debt shocks. Thanks to these consistent measures, outstanding short-term debt for short-term commercial credit activities reduced from US$1.5 billion in 1997 to about US$350 million in 1998.

The government has also controlled more strictly foreign borrowings, including government borrowings and private borrowings, because it relates to debt service capacity of the economy. At present, as a result of negotiations at Paris Club and London Club and strict control of borrowings and debt services, the total debt is about US$9 billion equivalent (excludes Russian debt in transferable roubles, which are under negotiations).

POLICY ADJUSTMENT

During 1997, 1998 and at the beginning of 1999, the government has issued many policy measures in order to stabilize the economy and stop the process of economic decline.

Facing continuous declining growth rates, the government has issued a series of new policies in order to bring about internal forces and to mobilize effectively foreign resources:

- To focus on agricultural and rural development, where 80% of the population lives and one third of GDP is produced; at the same time to favorably facilitate all economic sectors to invest in production and business development.

- To expand markets by promoting demand on the domestic markets and improving exports efficiency and to expand to new markets.

- To address urgent needs in financial, monetary and banking sectors in order to improve the effectiveness of banking activities.

- Reorganization and renovation of the state-owned enterprises (SOEs) which are divided into three categories:

  - Public interest and important SOEs which need to be maintained and to improve efficiency;
  - Nationally economic important SOEs which need to improve the efficiency of production and business
  - Medium and small scale enterprises, their ownership can be transferred and diversified; these SOEs account for one half of existing SOEs, their capital is small and operate inefficiently.

- To implement poverty alleviation programs, job generation

- To continue to implement administrative reforms and to improve capacity in governance and execution.

SHORT-TERM OUTLOOK

Economic growth in 1999 is expected to be 4.5% and for 2000 at about 5.5% and growth rates will continue to gradually improve, albeit difficult to reach growth rates of 9%-10% as that of mid-1990s.

Major obstacles to achieving higher growth rates include both subjective and objective reasons:

Objective reasons

The regional economic recovery will take place slowly and will be complicated; the prices of some Viet Nam export products will remain low (crude oil price fluctuates around US$12 per barrel, and the rice price continues to decline). In addition, the demand on international markets is not expected to increase rapidly, which will affect Viet Nam's exports.

Subjective reasons

This is the most important reason, which decides the speed of economic recovery. Efficiency and competitiveness of Viet Nam goods are still relatively low. The prices some commodities produced in Viet Nam are double those of imports. Meanwhile, during the process of implementation of the commitments for AFTA integration, (from now up to 2006) Viet Nam has to reduce tariffs to 0%-5%, which will make the competitition more severe.

Viet Nam: Overall Economic Performance

	1993	1994	1995	1996	1997	1998
GDP and Major Components (% change from previous year, excepted as noted)						
Nominal GDP (billion US$)	12.8	15.5	20.3	23.3	25.0	24.6
Real GDP	8.1	8.8	9.5	9.3	8.2	5.8
Total Consumption						
Private Consumption						
Government Consumption						
Total Investment						
Private Investment						
Government Investment						
Exports of Goods and Services	20.6	35.8	28.2	41.0	22.2	3.9
Imports of Goods and Services	39.3	48.5	43.8	38.9	-1.6	-2.3
Fiscal and External Balances (% of GDP)						
Budget Balance	-5.2	-2.3	-1.5	-1.3	-1.7	-1.5
Merchandise Trade Balance (f.o.b.)						
Current Account Balance	-7.1	-8.0	-11.0	-10.3	-6.8	-4.1
Capital Account Balance						
Economic Indicators (% change from previous year, except as noted)						
GDP Deflator						
CPI	5.2	14.4	12.7	4.5	3.6	9.2
M2	19.0	27.8	22.6	22.7	26.1	22.0
Short-term Interest Rate (%)						
Exchange Rate (Local Currency/US$)	10640	10978	11037	11032	11683	13297
Unemployment Rate (%)						
Population (millions)	71.0	72.5	74.0	75.4	76.7	78.1

Source: Asian Development Outlook (ADB, 1999)

Table 2. Forecasting Summary (% change from previous year)

	1999					2000					2000-2002				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	4.5	3.5		3.7		5.5	4.5		4.5						
Real Exports															
Real Imports															
CPI		8.0		8.0			6.0		7.0						

Note: The IMF forecast is from the World Economic Outlook (IMF, April 1999). The ADB forecast is from the Asian Development Outlook (1999).

ACRONYMS

ADB	Asian Development Bank
AFTA	Asia Free Trade Area
AMU	Asset Management Unit
BOJ	Bank of Japan
BOP	Balance of Payments
BOT	Balance of Trade
BSP	*Bangko Sentral ng Pilipinas*
CD	Certificate of Deposit
CDIA	Canadian Direct Investment Abroad
CDRAC	Corporate Debt Restructuring Advisory Committee
CDRC	Corporate Debt Restructuring Committee
COLA	Cost of Living Allowance
CPF	Central Provident Fund
CPI	Consumer Price Index
CRPP	Currency Risk Protection Program
CTRP	Comprehensive Tax Reform Program
FA	Financial Account
FDI	Foreign Direct Investment
FDIC	Federal Deposit Insurance Corporation
FOBAPROA	*Fondo Bancario para la Proteccion al Ahorro* (Banking Fund for Protection of Savings)
FY	Fiscal Year
GDP	Gross Domestic Product
GFS	Government Finance Statistic
GNP	Gross National Product
IBRA	Indonesia Banking Restructuring Agency
IFA	Investment From Abroad
IFS	International Financial Statistics
ILO	International Labor Organization
IMF	International Monetary Fund
IMSS	Mexican Institute of Social Security
INDRA	Indonesian Debt Restructuring Agency
IPAB	*Instituto para la Protección al Ahorro Bancario* (Institute for Protection of Bank Savings)
M_1	Money and checking accounts
M_2	M_1 (money and checking accounts) plus time deposits
MAS	Monetary Authority of Singapore
MOU	Memorandum of Understanding
NDA	Net Domestic Assets
NEAC	National Economic Action Council
NERP	National Economic Recovery Plan
NFPE	Non-Financial Public Enterprises
NIEs	Newly Industrialized Economies
NIR	Net International Reserves
NPL	Non-Performing Loan
OCR	Overnight Cash Rate
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development

OMO	Open Market Operations
PECC	Pacific Economic Cooperation Council
SBI	Bank Indonesia Certificate
SFI	State Financial Institution
SMI	Small and Medium Industry
SOE	State Owned Enterprises
SRFI	Short-run Financial Inflows
SRFO	Short-run Financial Outflows
UBC	Unit Business Cost
ULC	Unit Labour Cost
WPI	Wholesale Prices Index
WTO	World Trade Organization