Asia-Pacific
Economic Cooperation

2003 APEC Economic Outlook

APEC Economic Committee

Published by:
APEC Secretariat, 35 Heng Mui Keng Terrace, Singapore 119616
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Website: http://www.apec.org

APEC#203-EC-01.1   ISSN 0218-9763

TABLE OF CONTENTS

Appendix: Individual Economy Reports

TABLES AND FIGURES

Chapter 1

Chapter 2

Annex 1

Annex 2

FOREWORD

The *2003 APEC Economic Outlook* is the ninth in a series produced by the Economic Committee. The Economic Committee Chair's Office prepared the first chapter on the *Economic Performance and Prospects in the Region* with the active participation and support of the APEC Secretariat and member economies, while Thailand led the structural chapter under the theme of Specialized Financial Institutions (SFIs).

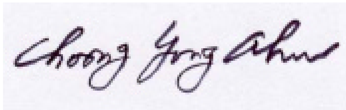
The first chapter of the *2003 APEC Economic Outlook* reviews and analyzes recent developments in, and future prospects of, APEC economies and the global economy. It reports that the global economy recorded slightly higher growth rate in 2002 than in the previous year. Forecasting institutions projected that the global economic growth rates for the whole of 2003 is likely to be 2.0 percent to 2.5 percent and 3.5 percent for 2004, compared to 2.4 percent in 2002. It concludes, however, that the recent improvements to the non-economic environment and short-term macroeconomic stimuli will not translate into a robust recovery unless sufficient underlying economic momentum is regained. This momentum will depend on how far major economies alleviate their structural imbalance problems, such as cumulative non-performing loans, diverging external imbalances, over-investment in information and telecommunication technology sectors and inflated share prices, and how structural reforms are going to take place effectively.

In Chapter 2, structural issues are pursued to explore the role and development of SFIs to a greater extent with the ultimate aim of delivering SFIs' best practices. Thailand examines and analyzes the impact of SFIs on the socio-economic development of participating APEC economies. The report includes a comparative study on SFIs that investigates differences and similarities among 42 specialized financial institutions operating in eight economies. As a consequence, the role of SFIs has been reviewed in a comparative perspective and is considered to be an outstanding alternative to SFIs are commercial banks for those who lack access to other formal sources of credit.

The preparation of this year's *Outlook* has involved particular challenges. In addition to the macroeconomic developments and policy measures dealt with in this chapter, we address other important issues, such as the outbreak of SARS, the counter-terrorism measures undertaken by APEC member economies, and the development of knowledge-based economies (KBE), which might have substantial impacts on recent economic performances and prospects in the APEC region. In this context, the *2003 APEC Economic Outlook* annexes some special information on KBE indicators, the economic impact of SARS on the APEC region, and economic consequences of terrorism as well as individual economy reports with information on their structural reforms.

This year's *Outlook* report was carried out as a collaboration of distinguished experts. Particular thanks are due to Mr Perames Vudthitornetiraks and Ms Kirutcha Tintamusik for preparing the structural chapter. Thanks are also due to the research team that prepared the

performance and perspective chapter, most notably to Professor Nam Doo Kim who developed successive drafts of documents for consideration by member economies. Special thanks go to Mr Stephen Joske and Dr Peter Thurlow for their invaluable contribution in drafting Annex I and II. Special thanks are also due to Mr Charles Jose, program director for the APEC Secretariat, who has taken responsibility for seeing this report through publication. Last but not least, I thank Dr Sangkyom Kim who has assisted me in my role as chair of the Committee and taken particular responsibility for coordinating the final editing and publication.



Choong Yong Ahn
Chair, APEC Economic Committee
Seoul, October 2003

CHAPTER ONE

ECONOMIC PERFORMANCE AND PROSPECTS IN THE APEC REGION

1. OVERVIEW

The global economy showed hesitant recovery during 2002 and the first half of 2003. Having suffered an economic slowdown and mild recession during 2001, the global economy recorded slightly higher growth rates in 2002 than in the previous year. World trade grew strongly in major economies from the first quarter of 2002. Rebounding external trade growth, in turn, made a crucial contribution to economic growth in the APEC region. In particular, some Asian economies, including China, Viet Nam and Korea, saw vigorous economic growth in 2002. However, the recovery power of the APEC region as a whole has not been strong enough to absorb the newcomers to the labor market. Therefore, employment conditions did not improve substantially throughout 2002 and unemployment rates rose in most member economies.

At the start of 2003, APEC economies faced some non-economic shocks: geopolitical risks, especially in Iraq, and epidemic issues that might have had a negative impact on global economic activities. In particular, the severe acute respiratory syndrome (SARS) affected almost every economy in the Asia Pacific region. These issues may also have negatively affected economic activities in the APEC region as a whole. The USA's recovery was more fragile and somewhat weaker than expected during the first half of 2003, and in Japan, volatile movements in exports have not broadened into a genuine recovery.

As the situation in Iraq has stabilized and SARS has been brought under effective control, we expect the global economy to gradually regain strength, heading for another US–led rebound over this year and the next. The US economy is expected to improve gradually in the coming months and rebound strongly by the end of this year. North America's recovery should provide enough impetus to boost economic growth in the rest of the world, particularly in Asia (excluding Japan) and Oceania.

Forecasting institutions are projecting that global economic growth rates for the whole of 2003 should be 2.0 percent to 2.5 percent, and 3.5 percent for 2004, compared to 2.4 percent in 2002. Around the fourth quarter of 2003, the APEC economy is expected to escape the short-term slowdown seen in the first half of 2003, moving towards much stronger economic growth.

However, the recent improvements in the non-economic environment and short-term macroeconomic stimuli will not translate into a robust recovery unless sufficient underlying economic momentum is regained. This momentum will depend on how far major economies alleviate their problems of structural imbalance such as cumulative non-performing loans (NPLs), diverging external imbalances, over-investment in information and telecommunication technology (ICT) sectors and inflated share prices, and how effective support is being provided by structural reforms.

In addition to the macroeconomic developments and policy measures dealt with in this chapter, we address other important issues, such as the outbreak of SARS, the counter-terrorism measures undertaken by APEC member economies and the development of knowledge-based economies (KBEs), which might have substantial impacts on recent economic performances and prospects in the APEC region. Thus, this chapter addresses in annexes some special issues on KBE indicators, the economic impact of SARS on the APEC region and economic consequences of anti-terrorism as well as individual economy reports with structural reforms.

2. RECENT ECONOMIC TRENDS

2.1 Weak Economic Recovery

The APEC economy as well as the global economy recorded higher growth rates in 2002 than in 2001, but the growth momentum of this uprising phase was relatively weak compared to the usual cyclical patterns. According to International Monetary Fund (IMF) estimates, the world economy grew 1.9 percent in 2002, up from 1.2 percent in 2001. The GDP growth rate of APEC as a whole was 2.4 percent in 2002 compared to 0.7 percent in 2001. Early in 2002, the economic recovery in the region was led by the US, with active private consumption and business investment as well as expanded government spending.

Most of the member economies registered higher real GDP growth rates in 2002 than the previous year. However, the growth performances were highly differentiated by member. While *China, Viet Nam* and *Korea* recorded growth rates of over 6.0 percent, many other economies showed moderate rates of 3.0 percent to 5.0 percent and a few members had very low rates of below 2.0 percent.

Table 1.1
Real GDP Growth (percent)

	1997	1998	1999	2000	2001	2002
Western Hemisphere						
Canada	4.2	4.1	5.4	4.5	1.5	3.4
Chile	7.4	3.9	-1.1	5.4	3.1	2.1
Mexico	6.8	5.0	3.6	6.6	-0.2	0.9
Peru	6.7	-0.5	1.0	3.1	0.6	5.2
The United States	4.4	4.3	4.1	3.8	0.3	2.4
Northeast Asia						
China	8.8	7.8	7.1	8.0	7.3	8.0
Hong Kong, China	5.1	-5.0	3.4	10.2	0.5	2.3
Japan	1.8	-1.1	0.1	2.8	0.4	0.2
Korea	5.0	-6.7	10.9	9.3	3.1	6.3
Chinese Taipei	6.7	4.6	5.4	5.9	-2.2	3.6
Southeast Asia						
Brunei Darussalam	3.6	-4.0	2.6	2.8	3.0	3.2
Indonesia	4.9	-13.3	0.8	4.9	3.4	3.7
Malaysia	7.3	-7.4	6.1	8.3	0.4	4.1
The Philippines	5.2	-0.6	3.4	4.4	3.0	4.4
Singapore	8.5	-0.9	6.4	9.4	-2.4	2.2
Thailand	-1.3	-10.5	4.4	4.6	1.9	5.3
Viet Nam	8.2	5.8	4.8	6.8	6.8	7.0
Oceania						
Australia	3.8	5.3	4.5	2.8	2.7	3.6
New Zealand	2.0	-0.2	4.0	4.0	2.7	4.4
Papua New Guinea	-3.9	-3.8	7.6	-0.8	-3.4	-0.5
Russia	1.8	-4.9	5.4	10.0	5.0	4.3
APEC	3.9	2.0	3.6	4.0	0.7	2.4
WORLD	3.5	2.3	3.0	4.0	1.2	1.9
WORLD*	4.2	2.8	3.6	4.7	2.3	3.0

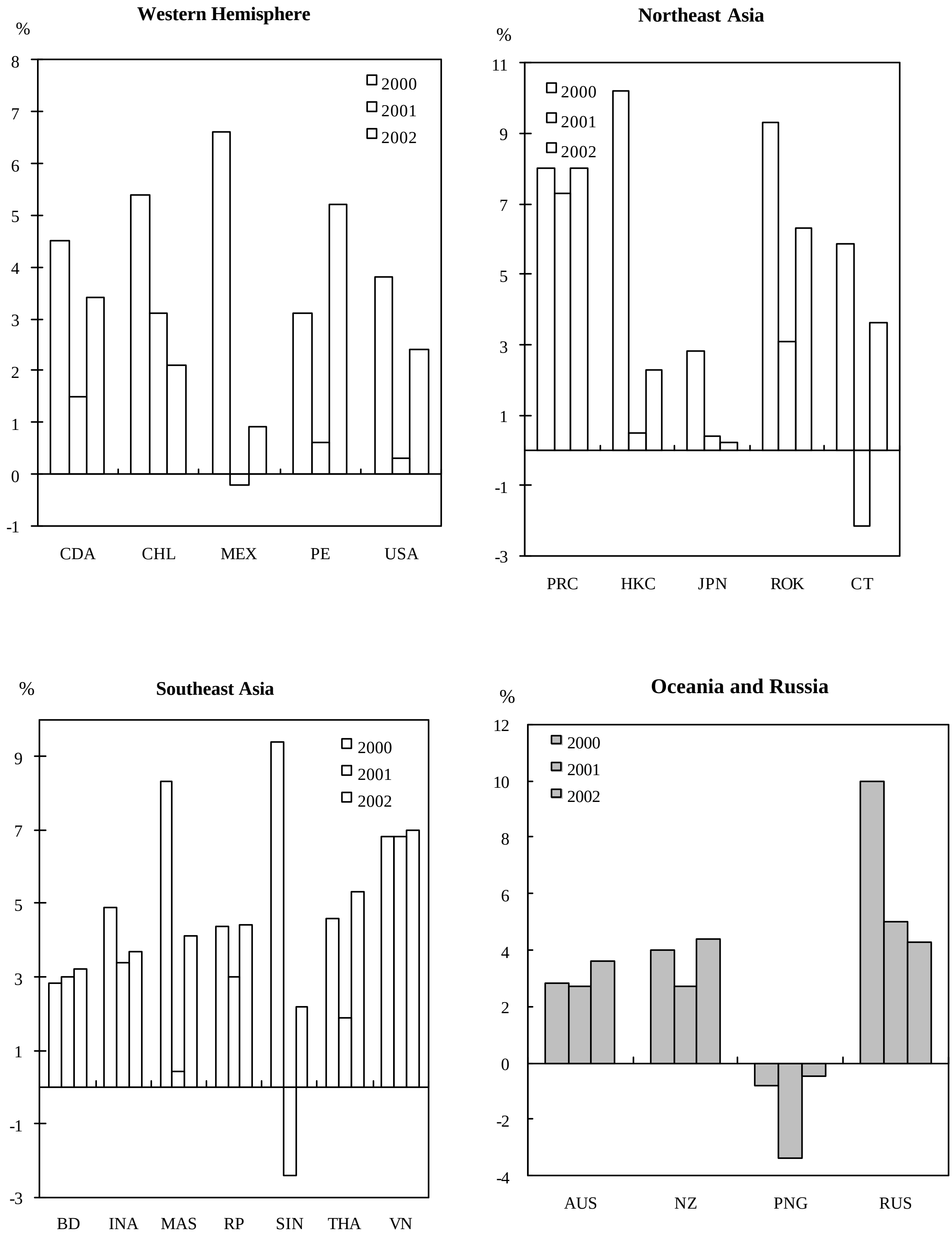
Note: The APEC-wide and sub-regional averages were calculated using the previous year's nominal GDP, valued at market exchange rates, as weights.

* Using the previous year's GDP valued at purchasing power parity (PPP) exchange rates as weights.

Sources: Individual Economy Reports. IMF, *World Economic Outlook*, April 2003

Figure 1.1

Real GDP Growth (percent)



As the world ICT market slowed in the second half of 2002, especially in the US and other Organization for Economic Cooperation and Development (OECD) economies, general economic activities calmed in late 2002 and in 2003. Due to these unfavorable external economic conditions, the APEC economies most dependent on ICT production were hit the hardest. *Singapore* and *Chinese Taipei* recorded low growth rates of 2.0 percent to 4.0 percent in 2002, higher than the near-absent growth of 2001.

In the *US*, the underlying economic theme of 2002 was recovery from the contraction of the previous year. Consumption continued to be the prime engine for recovery in 2002, rising 3.1 percent for the year. Expenditure on consumer durables was especially strong, in large part because of strong motor vehicle sales. Zero-percent financing offers and other aggressive sales promotions sent automobile sales soaring to more than 18 million units at an annual rate in July and August. Largely as a result, expenditure on consumer durables accounted for more than 1.7 percentage points of GDP growth in the third quarter. Consumption of nondurable goods was especially strong in the first quarter, rising 7.9 percent at an annual rate but tailing off afterward. Finally, consumption of services remained robust, accounting for about 1 percentage point of GDP growth in each quarter of the year. Non-residential investment was one of the weakest components of demand in 2002. Business fixed investment fell 5.7 percent, in large part because of a precipitous 16.4 percent fall in investment in structures.

The *Japanese* economy bottomed out in early 2002, supported by export growth and a prompt end to the decline in production. The recovery of the US economy and the preceding recovery of the Asian economies contributed to the expansion of exports. Thereafter, its impact has gradually spread throughout the economy and the economy had been edging toward recovery. While the economy has leveled out, uncertainty remains. Real GDP growth in 2002 was 0.2 percent, whereas that of 2000 and 2001 was 2.8 percent and 0.4 percent, respectively. As for short-term prospects, the economy is expected to move towards an incipient recovery if recovery in the US and other economies sustains. In addition, the environment surrounding the economy, such as the developments of stock prices, and the US economy, are showing signs of change.

The economy of *China* continued to perform well in 2002. The GDP in 2002 increased by 8.0 percent in comparable prices (0.07 percentage points faster) over the previous year due to the continued stimulation of domestic demand and the implementation of a proactive fiscal policy and stable monetary policy. In particular, secondary industry was at US$640.09 billion, with a growth rate of 9.9 percent. The growth rates in primary and tertiary industries were 2.9 percent and 7.3 percent, respectively. Investment in fixed assets enjoyed relatively rapid growth, with investment in fixed assets for the whole economy in 2002 reaching US$521.93 billion, an increase of 16.1 percent from the previous year. Consumer demand rose steadily, mirroring the continued improvements in real income and living standards. Total retail sales of consumer goods were US$494.30 billion in 2002, a growth of 8.8 percent year-on-year.

As one of the fastest growing economies, *Viet Nam's* GDP growth has been picking up since 1999. It has increased from 4.8 percent in 1999 to 6.8 percent in 2000, leveling out at 6.8 percent and 7.0 percent in 2001 and 2002, respectively. Consumption is one of the most important factors contributing to the growth of an economy. From 2000 to 2002, there was satisfactory consumption growth in Viet Nam. After three years of decrease (5.7 percent in 1997, 4.3 percent in 1998 and 1.8 percent in 1999), consumption growth rates started to increase in 2000 with 3.2 percent. The rate continued to increase, by 4.6 percent in 2001 and 5.8 percent in 2002. The private consumption growth rate has increased since 2000 (3.1 percent), with 4.5 percent in 2001 and 5.8 percent in 2002. The growth rate for government consumption was 5.0 percent in 2000, reaching 5.5 percent in 2001 and 2002. Total investment from 2000 to 2002 increased slightly to 10.1 percent in 2000, 10.3 percent in 2001 and 10.6 percent in 2002. The 2000–2002 growth rates were especially noteworthy in consideration of the 1.2 percent rate in 1999. This high investment growth played an important part in stimulating domestic demand. Investment growth has also been an important source of GDP growth in the last few years.

Korea also continued and accelerated its brisk recovery in 2002, with GDP growing by 6.3 percent compared to 3.1 percent in 2001. Buoyant private consumption made the strongest contribution to GDP growth in the first half of 2002. Although the pace of consumption growth slowed in the second half, a rapid increase in exports offset the slowdown in consumer spending and construction investment. In 2003, however, the Korean economy slowed down rapidly as both consumption and investment turned subdued as business and consumer confidence plunged in response to the deterioration of economic conditions at home and abroad. In the first quarter of 2003, the international economic environment worsened, mainly as a result of higher international oil prices due to the war in Iraq, mounting uncertainties about the recovery of major economies and concerns over the North Korea's nuclear problem. Internally, the stability of the financial market was hit by concerns about possible defaults on loans to households.

The *Chinese Taipei* economy was in recovery in 2002. With investment and consumption rebounding from their troughs a year earlier, real GDP growth rose to 3.59 percent from -2.18 percent in 2001. Both domestic and international research institutions repeatedly raised their forecasts for growth rates of the economy during the year. Global and domestic forces spurred the economic recovery in Chinese Taipei. In the international sphere, the steady recovery of the US economy and the global boost to information and communications industries had a significant impact on Chinese Taipei’s export-led production. Merchandise exports grew 6.3 percent, with ICT exports expanding by 2.4 percent after shrinking 20 percent the previous year. The rise in export sales helped lift the industrial production index 6.4 percent.

Hong Kong, China’s economy, following a distinct slowdown in 2001, revived progressively under the impetus from the external sector over the course of 2002. Its GDP was still down by 0.6 percent in real terms in the first quarter of 2002 over 2001. Along with a resurgence in external trade, GDP resumed growth at 0.8 percent in the second quarter, followed by distinctly faster growth of 3.4 percent in the third quarter and 5.1 percent in the fourth quarter. For 2002 as a whole, GDP grew 2.3 percent in real terms, up from 0.5 percent growth in 2001.

In line with improved macroeconomic indicators such as the exchange rate, inflation and interest rates, the *Indonesian* economy continued to recover in 2002. The economy posted a modest 3.7 percent growth in 2002 and it had an unbalanced structure. This unbalanced structure of growth was reflected in the large continuing dependence on consumption, while investment, exports, and imports contracted during that year. Consumption remained the main driving force, owing its resilience to lower inflation and interest rates as well as increased government spending.

Singapore’s economy expanded 2.2 percent in 2002 after contracting by 2.4 percent in 2001. The recovery was primarily due to a turnaround in external demand. At the sector level, the performance was mixed—the manufacturing, wholesale trade, retail trade, transport and communications sectors registered higher growth while the other major sectors deteriorated. The manufacturing sector was the best performing sector with a growth of 8.3 percent, a sharp reversal from the 12.0 percent contraction of 2001.

Despite the challenging external environment, the *Malaysian* economy gained momentum in 2002 and registered growth of 4.1 percent. Economic growth was broad-based, driven by strong domestic demand and reinforced by improved export performance. Low interest rates, improved access to financing and the significant improvement in commodity prices provided strong stimulus for private sector expenditure. In 2002, macroeconomic policy was focused on mitigating the rising uncertainties emanating from the external environment and enhancing the long-term fundamentals of the economy. The government played a pivotal role in sustaining growth by providing the necessary support for private and external demand. This support was broadly channeled into two directions: direct expenditure, which had a positive effect on private consumption, and the provision of an enabling environment conducive to enhancing consumer confidence and facilitating a recovery in investment activities by businesses. The latter was made possible by reducing selected taxes to encourage consumption, implementing policies to improve employment prospects, adopting an accommodative monetary stance, and instituting measures to improve access to financing.

In 2002, *Thailand's* economy grew at a rate of 5.2 percent, the highest growth rate since the 1997 crisis. The economic growth in 2002 was boosted by both domestic and external demand, while the growth in 1999 and 2000 was mainly supported by external demand. In particular, private consumption and investment grew by 4.7 and 13.3 percent, respectively. Public consumption also increased by a moderate 0.5 percent. Public investment, however, fell by 6.8 percent. Meanwhile, export and import volumes rose by 10.9 and 11.3 percent, respectively.

Amidst the global and local uncertainties of 2002, *the Philippine* economy saw sustained growth in the year 2002. Real gross domestic product grew by 4.4 percent, 1.4 percentage points higher than its 2001 growth performance and well within the government's growth forecast of 4.0 percent to 4.5 percent in 2002. Every production sector grew robustly in 2002, with industry and services surpassing their previous year's gains and agriculture bucking the effects of a mild *El Niño*. Gross national product (GNP) also expanded strongly, by 4.5 percent in 2002. The growth acceleration in 2002 was accounted mainly by the GDP and GNP growths of 5.8 percent and 7.8 percent, respectively, in the fourth quarter.

In 2002, *Brunei Darussalam's* real GDP grew an estimated 3.2 percent–up from the 3.0 percent estimated growth in the previous year. Almost all sectors recorded improved performance. The oil sector grew at 2.9 percent, up from 1.5 percent during the same period last year, and the non-oil sector grew at 3.6 percent in 2002 compared to 4.8 percent in 2001. The government sector grew at 2.2 percent in 2002, 0.7 percent down from the year before, and the private sector grew at 5.0 percent compared to 6.8 percent during 2001. The improved performance of the oil and gas sector for 2002 was attributed to increased production of crude oil and liquefied natural gas (LNG) as well as higher crude oil prices. Production of crude oil increased by 4.1 percent from 195,065 barrels per day in 2001 to 203,021 barrels per day in 2002. However, activities in the agricultural sector slowed in 2002 compared to the previous year. The agricultural production index contracted by 5.0 percent in 2002 compared to a 14.2 percent growth in 2001.

Growth in the *Australian* economy was strong in 2002, reflecting an environment of strong consumption and investment despite a softening in the rural sector. Real GDP increased 3.6 percent in 2002 (calendar year average terms) following growth of 2.7 percent in 2001. Throughout 2002, the Australian economy remained resilient in the face of a weak world economy and one of the most extensive droughts in Australian meteorological records. The external sector subtracted from GDP growth in 2002, reflecting strong growth in domestic demand compared with our major trading partners and significantly reduced rural exports due to the drought. Net exports subtracted 2.6 percentage points from GDP growth in 2002 after contributing 1.3 percentage points to growth in 2001.

New Zealand's was one of the fastest growing economies in the OECD, expanding 4.4 percent in calendar 2002. This performance stemmed from a combination of robust domestic demand and strong export growth. The domestic strength was underpinned by rising house prices, ongoing employment growth, strong inward migration and supportive interest rates. Key drivers of the export growth were a good agricultural growing season and some unwinding of stock levels.

Preliminary estimates of economic activity in *Papua New Guinea* (PNG) indicate that total real

GDP declined by 0.5 percent in 2002, following a revised decline of 3.4 percent in 2001. The decline in the growth rate was due to the continued depressed levels of activity in the mineral, building and construction, retail and wholesale, and electricity, gas and water sectors.

Following the short-lived slowdown in 2001, the *Canadian* economy surged ahead in 2002, with real GDP growing by a robust 3.4 percent. Canada's resilient performance reflects strong economic fundamentals, large tax cuts and an increasingly competitive business sector.

The *Chilean* economy experienced a modest expansion in 2002, with a growth rate estimated at 2.1 percent. This slow path was in part a consequence of the mild recovery of global economic activity and international trade. Consequently, the export sector posted a more modest performance than expected, mainly due to supply factors in mining and to the somewhat greater than expected impact of problems affecting several Latin American economies.

The *Mexican* economy grew by 0.9 percent in 2002, a rate that was uneven across the economic sectors. The growth rate of sectors closely linked to external markets was weaker than that of the sectors associated with domestic sources of demand. This situation, along with the uncertainty that characterized the international financial markets, continued to delay the consolidation of the recovery process that the Mexican economy saw in the second half of 2002. GDP in the services sector increased 1.6 percent in real terms, while GDP in the industrial sector showed no real variation compared to 2001. GDP in the agricultural sector declined 0.4 percent in real terms as compared to 2001.

Peru's real GDP grew by 5.3 percent in 2002, driven by favorable growth, both in primary sectors, which expanded 6.4 percent, and non-primary sectors that grew 4.8 percent. These results reflect, the positive impact of more dynamic non-primary sectors, in particular manufacturing and construction, with the latter driven by several house building programs that were launched during 2002 and, for the second consecutive year, the impact of mining activities at Antamina, which accounted for about 1.0 percent of the annual GDP growth.

Russia's GDP growth slowed to 4.3 percent in 2002. In particular, growth in business investment and industrial production continued to slow. While the service sector boomed, fuelled by real wage increases of above 15.0 percent, industrial growth was concentrated in the oil, metal and food processing sectors, with the rest of industry mostly stagnating.

2.2 Increasing Unemployment

Due to weak economic recovery in 2002, APEC employment conditions showed little improvement. In most economies, employment increased by only a small number of workers and unemployment rates rose during 2002. In *the US; Canada; Japan; Mexico;* and *Singapore*, unemployment rates in 2002 were higher than the previous year. This was because the employment response lagged behind production activity and the momentum of economic growth was not strong enough this time to absorb the newcomers to labor markets. Exceptional economies were *Australia; New Zealand; Korea; Thailand; Viet Nam;* and *Russia*, whose unemployment rates fell substantially in 2002.

Although the *US* labor market improved in 2002, most major labor indicators showed little progress over the course of the year. The unemployment rate hovered between 5.5 percent and 6.0 percent throughout the year after rising 1.9 percentage points in 2001. Non-farm payroll employment in 2002 was similarly weak, with 463,000 jobs lost during the year, compared with 1.8 million jobs lost the previous year. As in past business cycles, the decline in manufacturing employment has been especially pronounced. Another feature of previous business cycles that has recurred in the past two years is the increase in the number of workers who report a long unemployment spell. Like the overall unemployment rate, the number of workers unemployed for 26 weeks or more rose in 2001 and remained high in 2002. In other ways, however, the recent behavior of the labor market has been different from that in past business cycles. One difference is the high fraction/number of job losers who reported a permanent rather than temporary lay-off in 2001—almost 90 percent. This may reflect structural changes in the labor market during the past two decades, with more firms using temporary workers rather than adding regular staff. When demand falls, the firm severs the relationship with temporary workers rather than placing a regular worker on temporary layoff.

In *Japan*, the number employed each month fell throughout 2002 compared with the same month of the previous year. The decline continued for more than 12 months. The unemployment rate remained at over 5.0 percent during 2002 and reached 5.5 percent in January 2003, the same rate as August and October 2002. The employment situation remains severe, with the unemployment rate remaining at a high level, though movements of an incipient recovery can be seen in some areas. It is estimated that some 80 percent of the unemployed lost their jobs due to structural factors in the first half of 2002. It is also projected that it will take time for both the "mismatch of employment" (vacancies and unemployment occur simultaneously because of the shortage of qualified applicants), and unemployment based on structural factors, to decrease. Therefore, it is expected that unemployment will remain high for the time being.

Table 1.2
Unemployment Rates (percent)

	1997	1998	1999	2000	2001	2002
Western Hemisphere						
Canada	9.1	8.3	7.6	6.8	7.2	7.6
Chile	6.1	6.3	9.8	9.2	9.1	9.0
Mexico	3.7	3.2	2.5	2.2	2.5	2.7
Peru	7.7	7.8	8.0	6.5	8.9	8.7
The United States	4.9	4.5	4.2	4.0	4.8	5.8
Northeast Asia						
China	3.1	3.1	3.1	3.1	3.6	4.0
Hong Kong, China	2.2	4.7	6.2	4.9	5.1	7.3
Japan	3.4	4.1	4.7	4.7	5.0	5.4
Korea	2.6	7.0	6.3	4.1	3.8	3.1
Chinese Taipei	2.7	2.7	2.9	3.0	4.6	5.2
Southeast Asia						
Brunei Darussalam	4.2	4.7	4.5	4.7	5.6	3.5
Indonesia	4.7	5.5	6.4	6.2	8.1	9.1
Malaysia	2.4	3.2	3.4	3.1	3.6	3.5
The Philippines	8.7	10.1	9.8	11.2	11.1	11.4
Singapore	1.8	3.2	3.5	3.1	3.3	4.4
Thailand	2.2	4.4	4.2	3.6	3.3	2.4
Viet Nam	6.0	6.9	7.4	6.4	6.3	6.0
Oceania						
Australia	8.2	7.7	7.0	6.3	6.7	6.3
New Zealand	6.6	7.5	6.8	6.0	5.3	5.2
Papua New Guinea						
Russia	10.8	11.9	12.9	10.5	9.0	8.0

Sources: Individual Economy Reports; IMF, *World Economic Outlook*, April 2003; Global Insight Inc., *World Outlook*, June 2003.

China's efforts for improving employment have been strengthened. By the end of 2002, 737.4 million people were employed, 7.15 million more than the previous year. Of these employed, 247.8 million were in urban areas, an increase of 8.4 million year on year. By the end of 2002, 4.1 million employees were laid off from state-owned enterprises–1.05 million fewer people than the last year. By the end of the year, the urban registered unemployment rate was 4.0 percent, 0.4 percentage points higher than 2001. Unemployment will remain an important long term issue in China.

In 2002, *Chinese Taipei's* employment saw a rebound to 0.8 percent growth from the previous year's contraction. However, as the increase in labor demand was not sufficient to absorb the expansion of the labor force, the unemployment rate for the year rose to an historic high of 5.2 percent. In Chinese Taipei, knowledge-based employment has been growing in line with the development of the knowledge-based economy, with its ratio of total employment rising from 23.0 percent in 1992 to 28.9 percent in 2002. Between 1992 and 1997, such employment increased at an average annual rate of 4.4 percent. Although it slowed to 2.6 percent between 1997 and 2002, this was still above the economy-wide average.

Hong Kong, China's labor market remained slack in overall terms in 2002. Yet, some improvement was seen in the latter part of the year, mainly because total employment picked up due to an upturn in economic activity. For 2002 as a whole, the unemployment rate averaged at 7.3 percent, markedly higher than 5.1 percent in 2001. The seasonally adjusted unemployment rate surged in the early part of the year–from 6.2 percent in the fourth quarter of 2001, to 7.0 percent and 7.7 percent, respectively, in the first two quarters of 2002–amidst extensive downsizing and lay-offs in the corporate sector. It then fell back somewhat in the latter part of the year to 7.4 percent in the third quarter and 7.2 percent in the fourth quarter. Upon the outbreak of SARS, the seasonally adjusted unemployment rate soared to a new high 8.6 percent in the second quarter of 2003, with particularly pronounced increases observed in the tourism and consumption-related sectors.

In *Indonesia*, the number of newly created jobs fell well short of the number of people entering the workforce. This was due to the relatively low economic growth. Moderate economic growth of 3.7 percent is estimated to absorb only 0.8 million workers, out of 1.7 million new entrants into the labor force in 2001. Consequently, the open unemployment rate rose from 8.1 percent in 2001 to 9.1 percent in 2002. Furthermore, the number of unemployed in 2002 reached 38 million, 28.9 million of whom were underemployed and 9.1 million were openly unemployed. Domestic labor problems and issues of illegal Indonesians working abroad added to employment hardships in 2002.

Singapore's labor market remained soft in 2002 due to a slow economic recovery in external demand. A second consecutive year of below-trend growth saw total employment contracting by 22,900 in 2002 after the marginal decline of 100 in 2001. This was attributable to the persistent decline in employment in good-producing industries. Retrenchments, however, slowed from 25,800 in 2001 to 19,100 in 2002. Supported by higher seasonal hiring at year-end, the overall seasonally adjusted unemployment rate declined to 4.2 percent in December 2002. For the whole year, the unemployment rate averaged 4.4 percent, compared to 3.3 percent in 2001.

Malaysia's recovery in economic activity led to a moderate expansion in the labor force of 3.1 percent to 10.2 million in 2002 compared to 9.8 million the previous year. The labor market remained favorable with the unemployment rate declining slightly from 3.6 percent to 3.5 percent in 2002, a rate still below the full employment level. The positive changes were also reflected in a significant decline in the number of retrenched workers and a higher demand for labor. The total number of retrenched workers fell by 30.6 percent to 26,457 workers in 2002. During the same period, a total of 162,787 vacancies were created, indicating a significant increase of 23.8 percent compared with 6.5 percent in 2001.

In *Thailand*, the labor force expanded by 1.3 percent, whereas the number of employed increased by 2.9 percent, reflecting the strong economic growth of 2002. Consequently, the unemployment rate dropped to 2.4 percent in 2002 compared with 3.3 percent in 2001. With continuing economic growth in 2003, the unemployment rate is expected to drop further, to 2.08 percent.

In *the Philippines*, around 30.1 million workers were employed as of 2002, 3.1 percent more than in 2001, as the government embarked on various programs to achieve full employment. Services and agriculture recorded increased employment levels while industry posted a slight decline with the reduction in employment in manufacturing, and mining and quarrying. Some 906,000 new jobs were created, but this figure is still lower than the 2001 level of 1.7 million new jobs. Services and agriculture were the main job creating sectors, but jobs were lost in manufacturing. However the labor market, was unable to generate enough jobs to keep pace with the labor force. The latter grew by 3.4 percent during the year. The number of unemployed rose by 6.0 percent, thereby increasing the unemployment rate further, to 11.4 in 2002 percent from 11.1 percent in 2001. The country's labor situation eased during the first half of 2003 as the average unemployment rate declined, to 11.4 percent from 12.1 percent during the same period in 2002.

In *Viet Nam* employment steadily increased thanks to high economic growth. The unemployment rate in urban areas was 6.4 percent in 2000, 6.3 percent in 2001 and 6.0 percent in 2002. During the last 10 years, Viet Nam's population growth rate has fallen significantly, with an average annual growth rate of only 1.7 percent. The population was 77.6 million in 2000, 78.7 million in 2001 and 79.7 million in 2002.

The total population of *Brunei Darussalam* grew by 2.4 percent in 2002, to 340,800. Total employment grew by 3.6 percent in 2002, to 158,000, due to the favorable economic growth, with 5,200 new jobs being created. The unemployment rate was 4.6 percent in 2002, down from 5.6 percent in 2001.

Australian employment grew by 1.9 percent in 2002, while the unemployment rate fell steadily over the year, from 6.7 percent in the first quarter of 2002 to 6.1 percent in the last quarter of that year. Wages, as measured by average weekly ordinary-time earnings for full-time adults and average weekly earnings for all employees, rose 4.8 percent and 3.9 percent respectively through the year to the last quarter of 2002. The wage cost index rose by 3.4 percent through the year to the last quarter of 2002.

In *New Zealand*, three years of relatively strong economic growth have improved its labor market outcomes. Initially, employment growth was in the agricultural and manufacturing sectors, but more recently it has spread more into the health, education and community services sectors. The unemployment rate has fallen to 4.7 percent—the lowest rate since the late 1980s.

Canada's economic recovery since 2001 has also led to improved labor market conditions. During 2002, the Canadian economy created 560,000 new jobs. This represents the largest number of jobs created over any 12-month period on record (from 1976) and the fastest growth rate in 15 years (3.7 percent). This trend has continued in 2003, albeit at a slower pace: in the first four months of 2003, more than 48,000 jobs were created. The unemployment rate, however, has remained steady at around 7.5 percent since the first quarter of 2002 as labor force participation rates have increased markedly.

In *Chile*, job creation has tended to consolidate. Better labor market conditions are occurring amidst relatively stable wages and modest growth in average productivity. Both elements have helped the labor market to adjust to the slack observed in recent years, as have modest pay increases in the public sector. Unemployment was 7.6 percent of the workforce in the moving quarter ending January 2003—the lowest rate since early 1999.

Mexico's labor markets reflected the weakness of both the industrial sector and investment demand. The number of employees registered with the Mexican Institute of Social Security, a measure of employment in the formal sector of the economy, saw a moderate increase of 61,500 workers during 2002, reaching 12.22 million workers at the end of December 2002. Similarly, the unemployment rate averaged 2.71 percent during 2002, 0.25 percentage points higher than the average for 2001.

2.3 Continued Disinflation or Deflation

Reflecting the weakness of aggregate demand and substantial output gaps in member economies, APEC economies continued the trend of disinflation or deflation during 2002. In most APEC member economies, inflation rates fell to a very low level and some Asian economies recorded negative inflation rates in 2002. In terms of consumer price inflation, almost all the member economies recorded the lower inflation rates in 2002 than in 2001. In particular, *Brunei Darussalam; China; Hong Kong, China; Japan; Singapore;* and *Chinese Taipei;* showed minus inflation rates, that is, deflation. *Malaysia; Mexico; New Zealand; Papua New Guinea;* and *Viet Nam* were exceptions to the trend of falling inflation rates, but their inflation rates were still very low.

Table 1.3

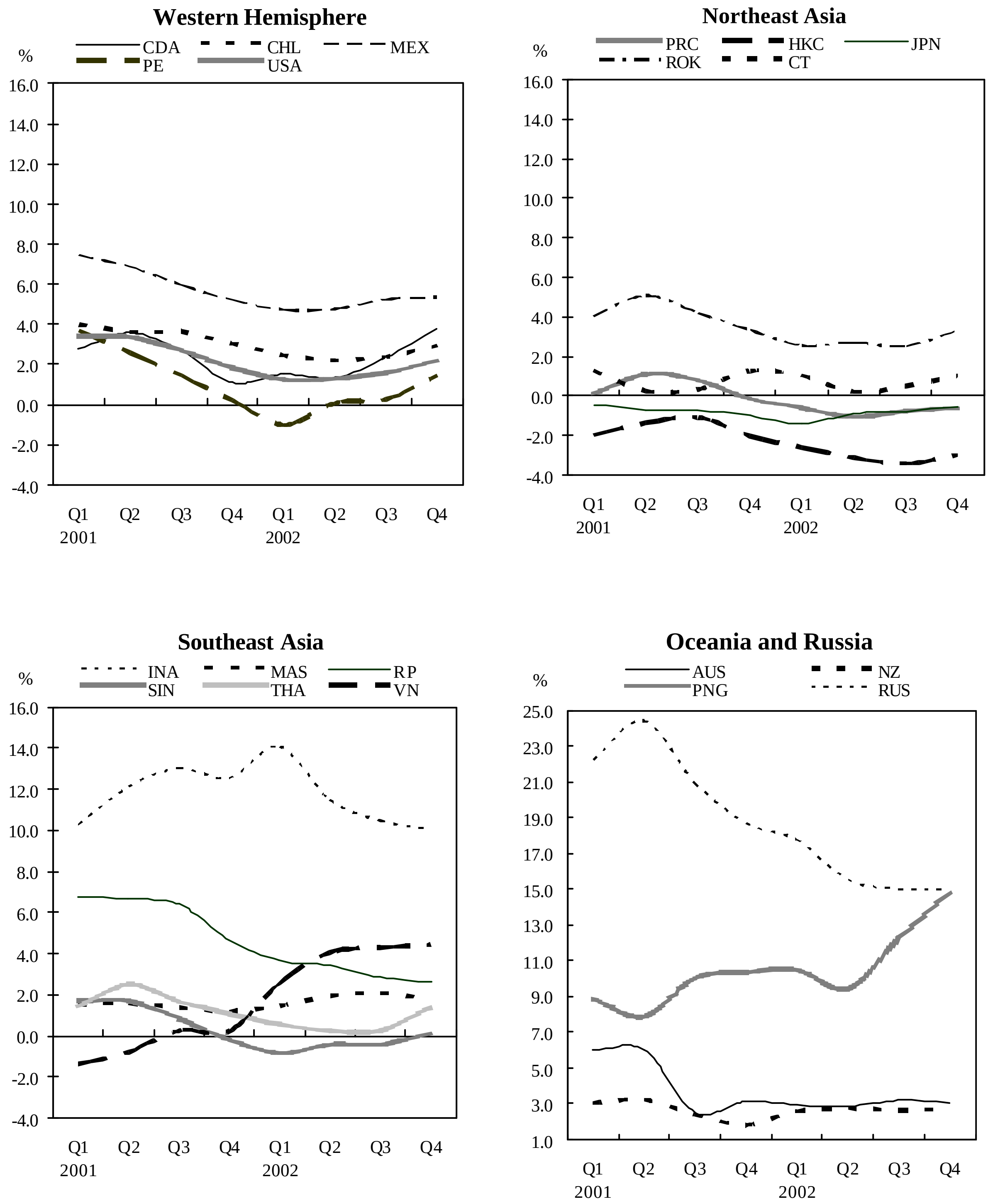
Consumer Price Inflation (percent)

	1997	1998	1999	2000	2001	2002
Western Hemisphere						
Canada	1.6	1.0	1.7	2.7	2.5	2.3
Chile	6.0	5.1	3.3	3.8	3.6	2.5
Mexico	15.7	18.6	12.3	9.0	4.4	5.7
Peru	8.5	7.3	3.5	3.8	2.0	0.2
The United States	1.7	1.6	2.7	3.4	2.8	1.6
Northeast Asia						
China	2.8	-0.8	-1.4	0.4	0.7	-0.8
Hong Kong, China	5.8	2.8	-4.0	-3.8	-1.6	-3.0
Japan	1.8	0.6	-0.3	-0.7	-0.7	-0.9
Korea	4.4	7.5	0.8	2.3	4.1	2.7
Chinese Taipei	0.9	1.7	0.2	1.3	-0.0	-0.2
Southeast Asia						
Brunei Darussalam	1.7	-0.4	-0.1	1.3	0.6	-2.3
Indonesia	11.6	77.6	2.0	9.4	12.6	10.0
Malaysia	2.7	5.3	2.8	1.6	1.4	1.8
The Philippines	5.9	9.7	6.7	4.4	6.1	3.1
Singapore	2.0	-0.3	0.0	1.3	1.0	-0.4
Thailand	5.6	8.1	0.3	1.6	1.6	0.7
Viet Nam	3.6	9.2	0.1	-0.6	0.8	4.0
Oceania						
Australia	0.3	0.9	1.5	4.5	4.4	3.0
New Zealand	0.8	0.4	0.5	4.0	1.8	2.7
Papua New Guinea	3.9	13.6	14.9	15.6	10.3	14.8
Russia	14.7	27.8	85.7	20.8	18.6	15.1

Sources: Individual Economy Reports. IMF, *World Economic Outlook*, April 2003

Figure 1.2

Consumer Price Inflation (percent, per annum)



Source: IMF, International Financial Statistics, June 2003.

In 2002, the *US* inflation rate rose slightly compared to that of 2001. The consumer price index (CPI) rose 2.4 percent in 2002, compared to 1.6 percent in 2001. The core CPI, which excludes volatile food and energy prices, increased 1.9 percent. Broader measures of inflation also remained low—the chain-weighted price indexes for GDP and personal consumption expenditure increased 1.1 percent and 1.4 percent respectively on a year-on-year basis.

Japan's CPI in 2002 fell by 0.9 percent from the preceding year, showing a four-year decline for the first time since the current time series began in 1970. It is suspected that the decline was mainly due to a fall in the prices of industrial products such as durable goods and food products. Taken together, these movements show that the Japanese economy has been in a mild deflationary phase.

Market prices in *China* were stable throughout the year of 2002. The consumer price index of the year 2002 was down by 0.8 percent over the previous year, with a rate of–1.0 percent in urban areas and -0.4 percent in rural areas. As shown by components of the price index of goods and services, manufacturing prices of industrial products declined by 2.2 percent. The purchasing price of raw materials, fuel and power declined by 2.3 percent, and the price of fixed-asset investment rose by 0.2 percent.

Intensifying competition in *Chinese Taipei's* domestic market, the effect of increased production on fruit and vegetable prices, and the falling imported consumer goods' prices and residential rents caused Chinese Taipei's CPI to fall slightly for the second consecutive year to -0.2 percent in 2002. However, the core CPI, excluding fresh food and energy prices, rose by 0.69 percent.

Hong Kong, China's overall consumer prices, as measured by the Composite Consumer Price Index, fell by 3.0 percent in 2002, nearly double the 1.6 percent fall of 2001. Yet, to a large extent, this was due to the rates concession and the waiver of water and sewage charges granted by the government during the year. Meanwhile, domestic cost pressure continued to ease, along with a softening of labor wages and property rentals. Local retailers lowered the prices of their goods and services further, in face of subdued consumer demand and keen competition in the retail market. While import prices stayed soft in overall terms externally, the decline flattened out over the past year on a weaker US dollar and a rebound in world commodity prices. In the first and second quarters of 2003, the Composite CPI remained on a downtrend, declining by 2.0 percent and 2.5 percent respectively over the previous year. The short-term economic forecasts announced at end-August put the composite CPI decrease at 3.0 percent for 2003 as a whole.

In *Indonesia*, significant strengthening of the rupiah and weak aggregate demand helped put inflation on a downward trend in 2002. CPI inflation during 2002 declined to 10.03 percent, much lower than the 12.5 percent in 2001 but the highest among Asian members in 2002. Inflationary pressures originated in government policy on prices and incomes. The pressure also resulted from supply shocks, mainly caused by the reduced food supply and disruptions to the distribution network following floods early in the year.

The *Singapore* CPI fell by 0.4 percent in 2002 compared with a 1.0 percent increase a year ago. Domestic sources of the drop were responsible for 0.1 percent of the decline in the CPI while external factors reduced the CPI by 0.3 percent. The main factors contributing to the fall in overall prices were energy prices and accommodation costs. In particular the 2.2 percent fall in housing costs, reflected both lower electricity tariffs and housing costs.

Malaysia's inflation remained subdued in 2002. The CPI's slight increase of 1.8 percent was attributed to low import prices and excess capacity in several sectors of the economy. Producer prices were, however, higher, in tandem with the sharp recovery in commodity prices of crude palm oil, crude petroleum, and rubber during the year. The Producer Price Index rose by 4.4 percent compared with a decline of 5.0 percent in 2001.

The Philippines' average inflation rate in 2002 slowed to 3.1 percent from 6.1 percent in 2001––the lowest rate in 15 years. It was also lower than the 2002 monetary policy target of 4.5 percent to 5.5 percent. Prudent monetary policy, ample food supply from domestic production and timely importation of key food items such as rice contributed to the slowdown in inflation. The cost of manufactured products was tempered by the reduction in tariffs on their inputs. The liberalization of retail trade and deregulation of the domestic oil industry also heightened competition. Decelerating inflation rates were observed in all commodity groups, with inflation in: fuel, light and water slowing down from 12.3 percent in 2001 to 4.8 percent in 2002; housing and repairs from 6.8 percent to 4.9 percent; and food from 4.1 percent to 1.9 percent. Inflation rates for the first half years averaged 2.9 percent, lower than the 3.5 percent average posted in the same period in 2002, despite an increase in prices in June by 3.4 percent due to increased prices of food and electricity. The low inflation rate reflects the continued absence of significant demand-pull pressures on consumer prices as well as positive supply-side factors, particularly the downtrend of international oil prices and the weakening *El Niño* phenomenon.

In *Brunei Darussalam*, the CPI showed a deflation of 2.3 percent during 2002. This was brought about by decreases in the major group indices for transport and communication (9.5 percent); clothing and footwear (1.7 percent); and housing (1.3 percent). The major group indices for food and miscellaneous, however, increased by 0.3 percent and 0.2 percent, respectively.

In *Viet Nam*, CPI inflation was -0.6 percent in 2000, 0.8 percent in 2001 and 0.4 percent in 2002. The GDP deflator was 4.0 percent in 2000, 2.1 percent in 2001 and 5.1 percent in 2002.

The *Australian* CPI increased by 30 percent through the year to the last quarter of 2002. Various one-off factors have contributed to inflation over that period, in particular higher fuel prices and some drought-related increases in food prices. There were also substantial increases in housing costs and higher insurance premiums.

In *New Zealand*, strong demand and high levels of capacity utilization saw non-tradable inflation running at close to 40 percent at the end of 2002. However, the appreciation in the currency and muted world export and import prices provided an offset by reducing inflationary pressures in the tradable sector. CPI inflation in the first quarter of 2003 was 0.4 percent, taking annual inflation to 2.5 percent, but staying in the top half of the Reserve Bank's 1.0 percent to 3.0 percent target band.

Papua New Guinea's headline inflation rate for 2002 was 14.8 percent, compared to 10.3 percent in 2001. The upward trend in CPI inflation that began in 2001 continued into 2002, as significant downward pressure on the kina contributed towards the upward movements in consumer prices.

Domestic inflation in *Canada* has remained within the Bank of Canada's inflation target bands of 1.0 percent to 30 percent over the last five years. Since mid-2002, however, total CPI inflation has moved up, from 2.1 percent in July 2002 to 4.6 percent in February 2003, and has been outside the inflation-control target range.

In *Chile*, CPI inflation was 2.8 percent in 2002. This figure was mainly due to changes in public transportation fares, the fluctuating exchange rate and the price of some perishable goods and fuels.

Mexico's annual inflation rate, measured by the National Consumer Price Index, stood at 5.7 percent at the end of 2002, a figure higher than both the original 4.5 percent inflation target for the year and the 4.4 percent inflation rate registered in 2001. The most important events that influenced price behavior during 2002 were: the downward rigidity of services prices; the partial elimination of electricity subsidies; a significant increase in the price of domestic gas, driven by the evolution of international oil prices; and the volatile behavior of agricultural product prices.

Russian inflation continued to decline gradually, supported by the continuing real appreciation of the ruble against the US dollar. The central bank's recent inflation targeting also points to enhanced determination to stem inflation.

2.4 Rebounding External Trade

Growth momentum of major economies amplified external trade in 2002. According to the IMF *World Economic Outlook* (April 2003), the world trade volume of goods and services increased by 2.9 percent in 2002, while it had only increased by 0.1 percent in the previous year. In particular, East Asian economies were sensitive to demand growth in major markets. Trade volume began to increase strongly in the region. Rebounding trade growth, in turn, made a crucial contribution to economic growth in the APEC region.

Comparing trade performance by sub-region or economy in the APEC region, some economies in Northeast and Southeast Asia were outstanding, with fast growth of exports and imports as well as gross domestic products in 2002. *China*, *Korea*, *Thailand* and *Viet Nam* recorded double-digit increases to exports and imports. The trade volume of *Brunei Darussalam*, *Indonesia* and *Papua New Guinea* contracted in 2002. In contrast, member economies in Oceania and the Western Hemisphere did not increase their trade volume substantially. In all the members in these regions, except *New Zealand* and *Peru*, exports of goods and services increased at a rate of less than 2.0 percent or even fell in 2002.

As the *United States'* growth in domestic demand still outpaced that of its major trading partners, US exports performed very poorly compared with imports. Exports fell 1.6 percent while imports grew 3.7 percent. This discrepancy between the rates of growth in exports and imports led to an increase in the US trade deficit and net exports exerted a drag on GDP growth in every quarter of the year.

Table 1.4
Trade of Goods and Services (percent)

	Export						Import					
	1997	**1998**	**1999**	**2000**	**2001**	**2002**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**
Western Hemisphere												
Canada	8.3	9.1	10.0	8.0	-3.8	0.8	14.2	5.1	7.8	8.2	-5.8	0.8
Chile	11.2	5.9	6.9	7.5	6.1	1.3	12.9	5.4	-14.6	10.1	3.2	0.5
Mexico	10.7	12.1	12.4	16.4	-3.6	1.4	22.7	16.6	14.1	21.5	-1.5	1.6
Peru	13.1	5.6	7.6	7.9	6.7	6.3	12.2	2.3	-15.2	3.6	2.7	2.5
The United States	12.3	2.1	3.4	9.7	-5.4	-1.6	13.7	11.8	10.9	13.2	-2.9	3.7
Northeast Asia												
China*	20.9	0.5	6.1	27.8	6.4	22.3	2.5	-1.5	18.2	35.8	8.2	21.2
Hong Kong, China	5.0	-3.9	4.0	16.5	-1.6	9.2	6.8	-6.3	-0.2	16.8	-1.5	7.1
Japan	11.3	-2.3	1.5	12.4	-6.1	8.2	1.2	-6.8	3.0	9.2	0.1	2.0
Korea	21.4	14.1	15.8	20.5	0.7	14.9	3.2	-22.1	28.8	20.0	-3.0	16.4
Chinese Taipei*	5.3	-9.4	10.0	22.0	-17.2	6.3	11.8	-8.5	5.8	26.5	-23.4	4.9-
Southeast Asia												
Brunei Darussalam	3.3	-21.7	31.2	52.7	1.4	-0.7	3.1	-13.7	-3.1	-1.8	14.2	-0.5
Indonesia	7.8	10.6	-31.8	26.5	1.9	-1.2	14.7	-5.4	-40.7	21.1	8.1	-8.3
Malaysia	5.5	0.5	13.2	16.1	-7.5	3.6	5.8	-18.8	10.6	24.4	-8.6	6.1
The Philippines	17.2	-21.0	3.6	17.7	-3.4	3.6	13.5	-14.7	-2.8	4.0	3.5	4.7
Singapore*	-0.2	-12.0	5.4	20.0	-11.0	3.2	0.7	-23.3	9.3	24.1	-15.5	0.1
Thailand	7.2	8.2	9.0	17.5	-4.1	10.9	-11.3	-21.6	10.5	27.3	-5.5	11.3
Viet Nam	26.6	1.9	23.3	25.5	3.8	11.3	4.0	-0.8	2.1	33.2	3.4	19.4
Oceania												
Australia	11.5	-0.2	4.6	10.8	1.5	-0.2	10.5	6.0	9.2	7.1	-4.1	11.6
New Zealand	3.9	1.6	8.1	6.4	2.4	5.9	2.2	1.4	12.0	0.1	1.6	8.7
Papua New Guinea*	-14.8	-16.1	9.1	7.3	-13.7	-14.7	-1.6	-27.0	-0.1	-7.0	9.3	-12.8
Russia	1.1	1.9	9.5	9.8	3.6	10.2	3.1	-13.6	-9.6	20.2	19.2	19.1

Note: * Based on merchandise exports and imports.
Sources: Individual Economy Reports; IMF, *World Economic Outlook*, April 2003; ADB, *Asian Development Outlook*, April 2003

Japan's exports of goods and services dropped sharply by 6.1 percent in 2001 compared with the previous year, but in 2002, they showed dramatic recovery at 8.2 percent growth. Recently, exports to Asia have been declining, especially to China, due to the effects of SARS. Exports to the US as a whole remained flat, although they have decreased recently in reaction to a rise in exports of automobiles on May 2003. Imports in 2002 increased by 2.0 percent compared with the previous year. Recently, imports from Asia have increased moderately as a whole, as imports from China, ASEAN and NIEs increased moderately. Imports from the US have been on a decreasing trend, although the monthly fluctuation has become wider.

China's foreign trade increased rapidly in 2002. Exports rose to US$325.6 billion, up by 22.3 percent over the previous year. Imports also surged 21.2 percent to US$295.2 million, driven by domestic consumption and spending on infrastructure, as well as market-opening related to China's entry into the WTO. The trade surplus reached US$30.4 billion in 2002.

Chinese Taipei's goods exports in value terms expanded by 6.3 percent to US$130.6 billion in 2002, mainly due to strong growth in its exports to East Asian economies, including mainland China; Hong Kong, China; and The Republic of Korea. Imports in value terms rose by 4.9 percent to US$112.5 billion, owing to an increase in induced demand from exports and the lower base of the previous year. The goods trade balance showed a surplus of US$18.1 billion for the year, the highest on record.

Hong Kong, China's exports of goods registered notable growth at 8.6 percent in real terms in 2002, with growth picking up to the double-digit range in the third and fourth quarters of the year. In the first half of 2003, total exports of goods remained robust, surging by 16.5 percent in real terms over a year earlier, trade performance being relatively unaffected by SARS. Continued robust demand in mainland China and improved external price competitiveness brought about by a weaker US dollar were the key factors underpinning the robust performance of merchandise exports. Exports of services had an even stronger performance than exports of goods in 2002, with a double-digit growth of 11.7 percent in real terms. There was a further double-digit growth in the first quarter of 2003, mainly bolstered by inbound tourism and offshore trade. However, with the severe blow SARS dealt to inbound tourism and the travel-related sectors, and notwithstanding offshore trade sustaining robust growth, exports of services still plummeted by 14.7 percent in real terms in the second quarter year-on-year.

In *Thailand*, exports rebounded strongly in 2002. Exports valued at US$66.9 billion, expanded by 5.7 percent. Likewise, imports amounted to US$63.4 billion, up by 4.6 percent. The remarkable pick-up in exports and imports together with a decline in export and import prices also contributed to a surge in the export and import volume, which increased by 10.9 percent and 11.3 percent respectively. In 2003, export growth in value terms is expected to remain high at 9.5 percent, following improvements in the economic conditions of major trading partners, particularly the strong momentum for the growth in regional economy. Meanwhile, imports are likely to grow by 11.5 percent as a result of increases in domestic and foreign demands.

The Philippines' merchandise exports reached US$34.38 billion in 2002, up by 10.1 percent from 2001. Increasing intra-regional trade in Asia, particularly with China; Hong Kong, China; the Republic of Korea; Malaysia; Singapore; Chinese Taipei; and Thailand supported the strong export performance. The successful penetration of exports to these new markets compensated for the slack demand from its traditional partners, the United States and Japan. Imports grew by 6.2 percent in 2002 after contracting by 4.5 percent in 2001. Increased demand for electronic inputs by export-oriented industries contributed to this growth.

For *Viet Nam*, 2001 was a year of great decline in exports and imports. The export growth rate of goods and services was 25.5 percent in 2000, 3.8 percent in 2001 and 11.3 percent in 2002. The growth rate of imports was 33.2 percent in 2000, 3.4 percent in 2001 and 19.4 percent in 2002.

Exports from *Brunei Darussalam* in 2002 increased by 1.6 percent, to BN$6.63 billion, from BN$6.52 billion in 2001. Exports of both oil and gas, and non-oil and gas sectors in 2002 were at BN$5.83 billion and BN$793.8 million respectively. The value of non-oil and gas exports increased by 14.0 percent from BN$695.3 million to BN$793.8 million. Liquefied natural gas (LNG) exports decreased by 7.0 percent, from BN$2.81 billion in 2001 to BN$2.60 billion in 2002. However, petroleum exports increased by 8.0 percent from BN$2.89 billion in 2001 to BN$3.14 billion in 2002.

Australia's exports (at current prices) fell 2.3 percent in 2002, while the export volume fell 0.2 percent in 2002. Imports increased 6.8 percent (at current prices) in 2002, while import volumes increased 11.6 percent in 2002 (which included significant expenditure on civil aircraft). The terms of trade increased 2.3 percent in 2002, following a 1.2 percent rise in 2001. The trade balance worsened by A$13.9 billion in 2002 to record a trade deficit of A$11 billion.

Chile's export projections for 2002 were also corrected downward due to lower sales abroad of some specific products including copper and non-traditional exports. Thus, goods exports by volume rose about 3 percent for the year. Annual copper exports by volume fell about 2.5 percent in 2002. Non-copper exports continued to be the strongest performers amongst foreign sales. The main non-copper exports rose about 5.5 percent while other or non-traditional exports increased somewhat more than 7 percent.

During 2002, *Mexico*'s foreign trade registered a modest expansion. Total exports amounted to US$160.7 billion, 1.4 percent higher than in 2001. This moderate increase was due to a boost in petroleum-related exports of 13.1 percent and an expansion of 0.4 percent in non-petroleum exports. Total imports during 2002 amounted to US$168.7 billion, 0.2 percent higher than in 2001. This result is mainly attributable to the modest recovery of economic activity and domestic demand, as well as the moderate rebound of manufacturing exports, which tend to use imported inputs.

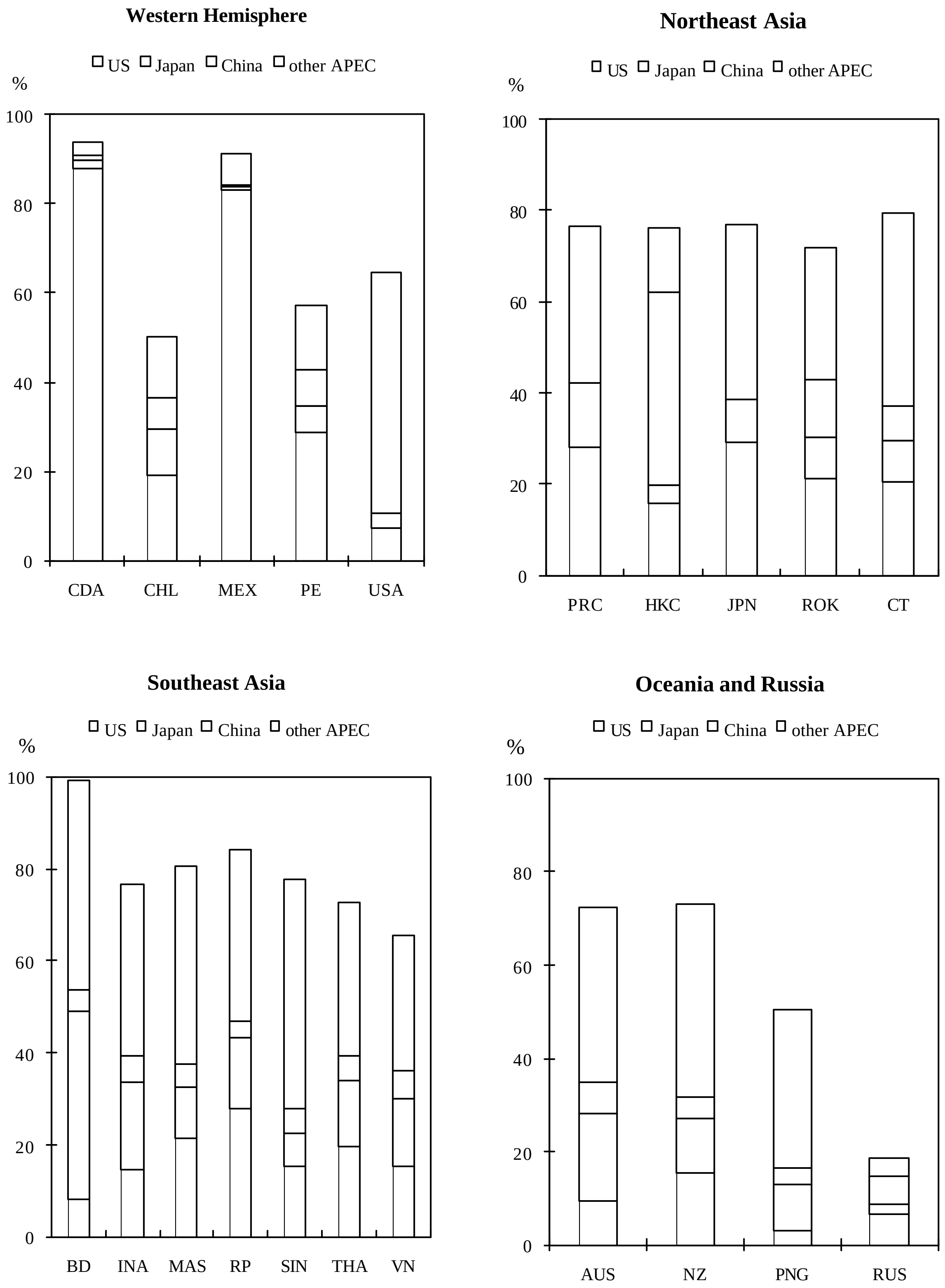
With functional integration in the APEC region there has been a trend of growing interdependency for the last decade in terms of the weight of intra-APEC trade. APEC export dependency on APEC markets themselves was as high as 73.7 percent in 2002, with many APEC members exporting more than 75 percent of their goods to other member economies. The degree of dependence in 1992 was 68.3 percent. The share of the US market for APEC members' exports rose from 22.2 percent to 25.6 percent and that of the Chinese market from 4.2 to 6.5 percent. In the case of Japan, whose economy has stagnated during the last decade, the share declined a little, from 8.7 percent to 7.2 percent.

Table 1.5
Direction of Trade (percent)

From \ To	APEC: Western Hemisphere 1992	2002	APEC: Northeast Asia 1992	2002	APEC: Southeast Asia 1992	2002	APEC: Oceania 1992	2002	APEC: Total 1992	2002	EU 1992	2002
Western Hemisphere												
Canada	78.4	88.4	8.2	4.2	0.9	0.6	0.5	0.3	88.1	93.6	7.7	4.2
Chile	18.8	23.5	28.7	24.2	2.0	1.6	0.3	0.4	49.7	50.2	31.5	23.2
Mexico	83.7	88.8	2.4	1.9	0.4	0.4	0.1	0.2	86.6	91.3	7.4	3.6
Peru	28.5	36.6	23.6	18.5	1.3	1.4	0.4	0.5	53.8	57.4	28.0	21.0
The United States	30.0	37.9	21.2	18.3	5.4	6.0	2.3	2.2	59.3	64.7	24.1	20.8
Northeast Asia												
China	11.2	31.3	61.2	36.4	5.1	6.1	0.9	1.9	81.1	76.4	9.3	15.2
Hong Kong, China	25.5	18.1	40.0	49.9	6.6	7.0	1.6	1.1	73.7	76.2	17.1	13.3
Japan	32.0	32.2	21.3	28.8	12.1	13.3	2.5	2.4	68.2	76.9	19.7	14.7
Korea	27.3	25.1	29.0	32.9	11.7	11.4	1.6	1.9	69.7	71.8	12.7	12.7
Chinese Taipei	31.8	22.6	31.3	43.4	10.4	11.9	2.0	1.4	75.4	79.4	16.1	13.0
Southeast Asia												
Brunei Darussalam	0.9	8.3	69.4	60.8	25.9	18.8	2.2	11.4	98.5	99.4	0.2	1.9
Indonesia	14.2	16.3	48.7	37.4	13.3	19.0	2.4	3.9	78.6	76.7	14.5	13.7
Malaysia	20.1	22.9	26.9	28.9	29.6	26.0	2.3	2.6	78.9	80.5	15.3	12.6
The Philippines	41.1	30.2	28.5	37.7	5.6	14.9	1.3	1.2	76.6	84.1	19.4	16.8
Singapore	22.1	16.2	21.9	28.8	24.3	29.6	3.1	3.2	71.5	77.9	15.8	12.5
Thailand	24.3	21.7	27.5	30.2	12.7	17.9	1.8	2.7	66.3	72.8	20.6	14.8
Viet Nam	0.1	16.8	46.2	27.8	19.0	12.6	0.7	7.9	69.6	65.6	8.3	24.8
Oceania												
Australia	10.8	11.7	43.5	41.2	14.1	12.1	6.7	7.3	75.1	72.5	13.3	11.5
New Zealand	15.8	19.4	27.4	24.9	7.3	7.7	18.8	20.6	69.5	73.0	15.3	15.0
Papua New Guinea	2.1	3.3	31.1	17.2	7.1	4.6	41.0	25.2	81.3	50.3	0.0	9.0
Russia	2.3	7.1	12.3	10.1	1.4	1.3	0.0	0.0	16.1	18.5	50.7	36.9
APEC	32.1	36.4	25.4	25.7	8.7	9.2	2.1	2.1	68.7	73.7	18.5	15.1

Source: IMF, *Direction of Trade Statistics*, June 2003. (www.imf.org)

Figure 1.3
Export Market Composition (percent, 2002)



2.5 Widening External Imbalances

Due to the differences in the pace of economic growth and trade performances among APEC members, balance of payments in the current account continued to vary widely among major economies. Members from the Western Hemisphere and Oceania registered high deficits with the exception of *Canada* and *Papua New Guinea*. In Asia, each member recorded a large surplus and most saw a rise in the ratio of current account surpluses to their GDPs. In the case of *Hong Kong, China; Singapore; and Chinese Taipei*, current account surpluses accounted for 10.9 percent, 21.5 percent and 9.1 percent of their GDPs, respectively, in 2002.

In *the United States*, the current account deficit increased sharply to US$481 billion in 2002, or 4.6 percent of GDP, from 3.9 percent of GDP in 2001. The US has run a current account deficit for most of the past two decades, indicating that the US is consuming and investing more than it is producing. That is, US investment has been outpacing domestic saving. One factor contributing to high US investment relative to saving during the last decade is the rapid increase in US productivity relative to that in many other economies, which makes the US a good place to invest.

The surplus in *Japan's* trade in goods and services doubled in 2002, mainly reflecting the increase of exports. Recently, it has been flat. The surplus in the current account balance is expected to remain roughly flat (2.7 percent of nominal GDP), since as well as exports will increase in fiscal year (FY) 2003.

China's trade surplus in 2002 reached US$30.4 billion, bringing about a big surplus in the current account in the same year. In addition, foreign direct investment (FDI) in China increased rapidly. The actual value of FDI utilization was US$52.7 billion, up by 12.5 percent over the previous year. Thus, China's foreign exchange reserves continued to increase. By the end of 2002, the total amount of the foreign exchange reserves reached US$286.4 billion, US$74.2 billion more than the previous year.

Chinese Taipei's current account balance recorded a surplus of US$25.7 billion, hitting a historic high. The current account surplus rose to 9.1 percent of GDP, as exports expanded faster than imports. While the trade in services has always shown a deficit, the deficit has narrowed since 1996 and it shrank to US$3.9 billion in 2002 from US$5.2 billion in the previous year. The overall balance of payments posted a record-breaking surplus of US$33.7 billion in 2002, thanks to a sizable current account surplus and a huge financial account inflow. External debt jumped 31.2 percent from US$34.3 billion in 2001 to US$45.0 billion in 2002. Most of the increase was in private debt, and was mainly attributable to the increased issuance of euro-dollar convertible bonds by local firms.

Table 1.6
Current Account Balance (percent of GDP)

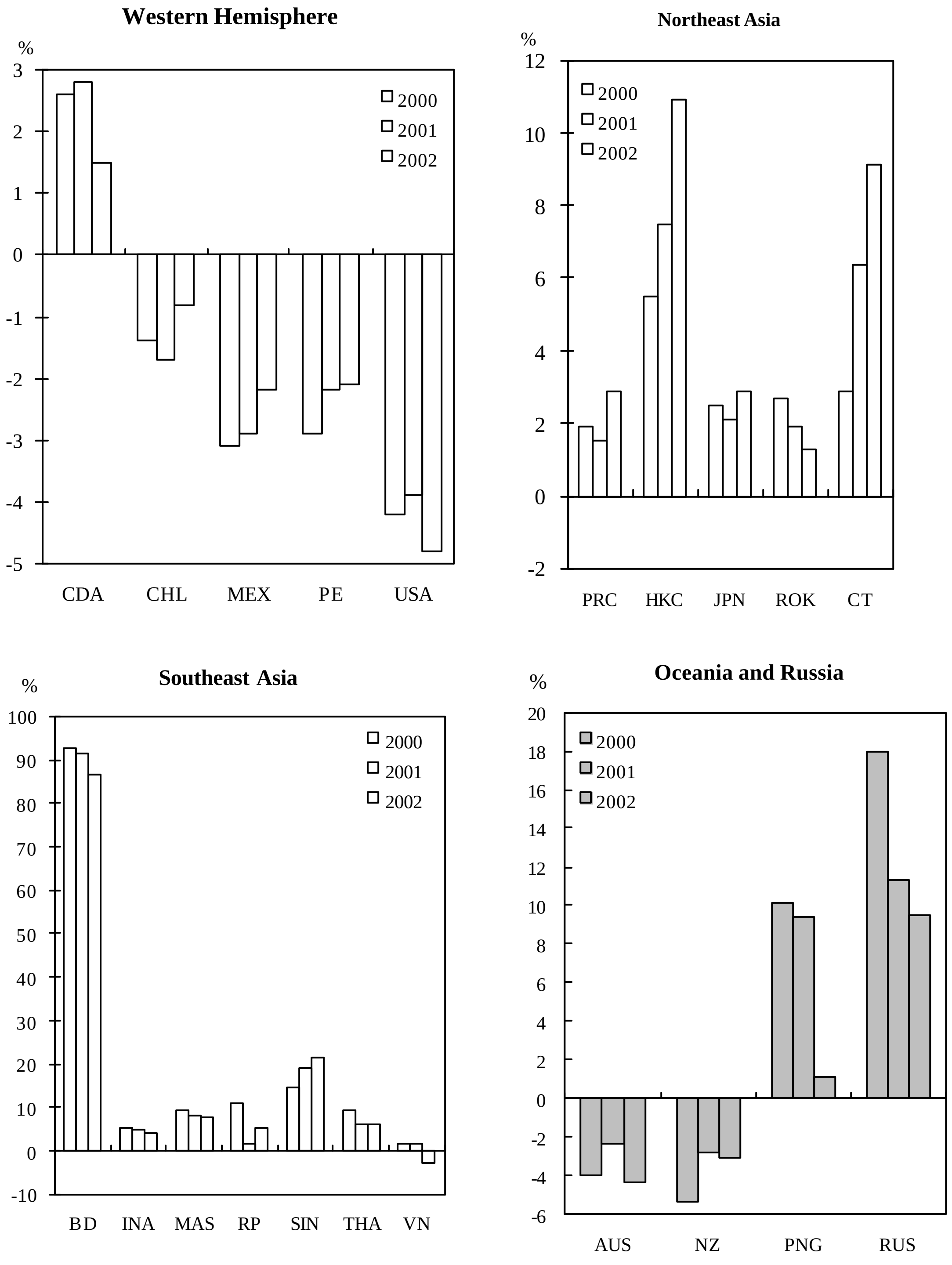
	1997	1998	1999	2000	2001	2002
Western Hemisphere						
Canada	-1.3	-1.2	0.2	2.6	2.8	1.5
Chile	-5.0	-5.7	-0.1	-1.4	-1.7	-0.8
Mexico	-1.9	-3.8	-2.9	-3.1	-2.9	-2.2
Peru	-5.8	-6.0	-2.9	-2.9	-2.2	-2.1
The United States	-1.5	-2.3	-3.2	-4.2	-3.9	-4.8
Northeast Asia						
China	3.3	3.0	1.1	1.9	1.5	2.9
Hong Kong, China	-3.5	2.7	7.5	5.5	7.5	10.9
Japan	2.2	3.0	2.6	2.5	2.1	2.9
Korea	-1.7	12.7	6.0	2.7	1.9	1.3
Chinese Taipei	2.4	1.3	2.9	2.9	6.4	9.1
Southeast Asia						
Brunei Darussalam	51.7	53.8	62.6	92.8	91.6	86.5
Indonesia	-2.3	4.3	4.1	5.3	4.7	3.9
Malaysia	-5.9	13.2	15.9	9.4	8.3	7.6
The Philippines	-5.2	2.3	9.5	11.1	1.8	5.4
Singapore	15.6	22.6	18.7	14.5	19.0	21.5
Thailand	-3.1	14.4	12.4	9.3	6.2	6.1
Viet Nam	-6.9	-4.6	4.1	1.7	1.5	-2.8
Oceania						
Australia	-3.1	-5.0	-5.7	-4.0	-2.4	-4.5
New Zealand	-6.5	-4.0	-6.3	-5.4	-2.8	-3.1
Papua New Guinea	-2.4	1.6	4.3	10.1	9.4	1.1
Russia	0.0	0.1	12.6	18.0	11.3	9.5

Sources: Individual Economy Reports;

ADB, *Asian Development Outlook*, April 2003; OECD, *OECD Economic Outlook*, June 2003; IMF, *World Economic Outlook*, April 2003

Figure 1.4

Current Account Balances (percent of GDP)



Hong Kong, China's current account yielded a further sizable surplus of HK$137.3 billion (US$17.6 billion) in 2002, equivalent to 10.9 percent of GDP in that year. However, concurrently there was a substantial net outflow of financial non-reserve assets in the capital and financial account, totaling HK$194.2 billion (US$24.9 billion) or 15.4 percent of GDP. This was largely attributable to a substantial net portfolio investment outflow, which in turn was partly due to increased holding of overseas debt securities by residents in Hong Kong, China, conceivably seeking a higher return amidst the low interest rate environment.

Indonesia's overall balance of payments in 2002 improved to a surplus of US$5.0 billion compared with the previous year's deficit of US$2.1 billion. The surplus in the current account in 2002 was estimated to reach US$7.5 billion (4.3 percent of GDP), compared to the previous year's surplus of US$6.9 billion (4.7 percent of GDP). The improved current account was mainly due to better export performance. The improved capital account was mainly due to successful foreign debt restructuring.

Singapore's overall balance of payments turned in a small surplus of US$2.3 billion in 2002, following the US$1.6 billion deficit in 2001. This was mainly due to an expansion in the current account surplus, which more than compensated for the slightly larger outflow from the capital and financial account. Both the goods and services accounts showed an improvement. Reflecting these developments, Singapore's official foreign reserves rose by US$2.8 billion to reach US$142.7 billion as at the end of 2002. Singapore has no official foreign debt.

Malaysia's overall balance of payments strengthened further to record a larger surplus in 2002. The improvement reflects the sustained strong current account surplus and declining net outflows in the financial account. The current account surplus narrowed marginally but remained large at RM27.3 billion (8.1 percent of GNP). Malaysia's total external debt increased by 7.0 percent to RM186.6 billion (US$49.1 billion) as at the end of 2002. This was largely due to the increase in both the private sector's short-term and the Federal Government's debt. However, external debt as a percent of GDP decreased to 51.7 percent in 2002 from 52.2 percent in 2001 (60.6 percent in 1997). At this level, the debt position remained within prudential limits.

In 2003, *Thailand's* trade balance will remain in surplus. At US$2.5 billion it will be slightly lower than the 2002 surplus of US$3.5 billion, as the import value starts to grow at a higher rate than the export value. Consequently, the current account is expected to register a surplus of US$5.3 billion in 2003 (3.9 percent of GDP), compared to a surplus of US$7.6 billion (6.0 percent of GDP) last year. As of March 2003, Thailand's gross external debt amounted to US$55.7 billion, down from US$58.9 billion in 2002.

The Philippines' balance of payments reversed to a surplus of US$660 million in 2002 from a deficit of US$192 million in 2001. This was spurred mainly by the strong performance of the current account, which offset, in part, the weakness in the capital and financial account. The current account surplus more than tripled to US$4.19 million in 2002 from US$1.32 million in 2001. The combined effects of higher net inflows to the income account, the positive gains in the trade-in-goods account, and higher net inflows from current transfers strengthened the current account position. The Philippines' total outstanding external debt rose by 2.9 percent to reach US$53.9 billion in 2002.

For *Viet Nam*, inflow of FDI is one of the most important sources of economic development. In 2002, FDI projects were producing about 13 percent of GDP and 36 percent of gross industrial output, funding 450,000 employees. However from 1997 FDI inflows decreased since Viet Nam's main FDI partners are from East Asia, which Suffered from the Asian Financial Crisis. FDI inflows in the first half of 2002 fell by 55 percent to less than US$500 million.

Australia's current account deficit increased to A$32.6 billion or 4.5 percent of GDP in 2002, up from A$16.8 billion or 2.4 percent of GDP in 2001.

New Zealand's current account deficit fell from 6.6 percent of GDP in the first 2000 quarter to 2.2 percent of GDP in the first quarter of 2002–its lowest level as a proportion of GDP in 13 years. The improvement was largely driven by an improvement in the goods and services balance. However, the impact of lower commodity prices and a higher dollar on export incomes, and increased demand for imports on the back of the strong domestic economy, has seen the current account deteriorate to 3.1 percent of GDP in the year to December 2002. A further increase in the current account deficit to around 5.0 percent of GDP is likely over 2003 and 2004.

Papua New Guinea's overall deficit in the balance of payments was K239 million in 2002, compared to a surplus of K708 million in 2001. The deficit was due to deterioration in the current account, which more than offset a lower deficit in the capital account.

Canada's current account has improved dramatically from the deficits of the 1990s, due in part to significant improvements in government finances. The current account moved into surplus late in 1999 and the surplus has continued to increase despite the US slowdown. In 2002, the current account balance as a share of GDP was 1.5 percent, up from 0.2 percent of GDP in 1999. Canada's net foreign debt is now below that of the US. With continuing budgetary and current account surpluses expected in Canada and continuing deficits anticipated in the US, Canada's net foreign debt should continue to fall and the gap *vis-à-vis* the US should continue to widen.

In 2002, *Chile*'s balance of payments posted a current account deficit of about US$600 million. Meanwhile, the trade balance posted a US$2.44 billion surplus. Net foreign currency holdings increased by US$17 million to total of US$16.45 billion. The increase was largely due to profits from portfolio management that were countered by parity and price adjustments. The only exchange transaction was the purchase of US$7.2 million from the treasury.

Mexico's trade balance for 2002 registered a deficit of US$7.99 billion, 19.7 percent lower than in 2001. The factoring service balance registered a deficit of US$12.3 billion in 2002; a modest decrease as compared to 2001. The non-factoring services balance recorded a deficit of US$4.0 billion in 2002, US$490.6 million higher than in 2001. Similarly, the surplus in the tourism balance amounted to US$3.95 billion, an increase of US$176.2 billion with respect to 2001, while the balance of transfers registered a surplus of US$10.3 billion, 10.0 percent higher than in 2001. In this context, the current account deficit during 2002 totaled US$14.1 billion, equivalent to 2.2 percent of GDP. This deficit was significantly lower than that registered in 2001 of US$18 billion (2.9 percent of GDP).

Russian exports rose in value terms driven by higher export volumes. With import growth moderating, the current account surplus remained above 9.0 percent of GDP, though decreasing somewhat in 2002.

2.6 Foreign Exchange Markets

A decade-long trend of a strong *US* dollar reversed in 2002. Since the second quarter of 2002, the US dollar has depreciated rapidly. It weakened notably from the third quarter of 2002, somewhat rebounding in the second quarter of 2003. A large part of the adjustment has fallen on the euro, against which the dollar lost 25.1 percent of its value up to late June 2003. The exchange rate of the dollar to the euro rose 1.1511 at late June 2003 from 0.8620 at January 2002 when the European Monetary Union launched the euro as the legal currency in the Euro zone. The dollar has also fallen by about 10.0 percent against the Japanese yen. In nominal terms, during 2002, the dollar depreciated close to 18.0 percent against the euro and about 10.0 percent against the yen.

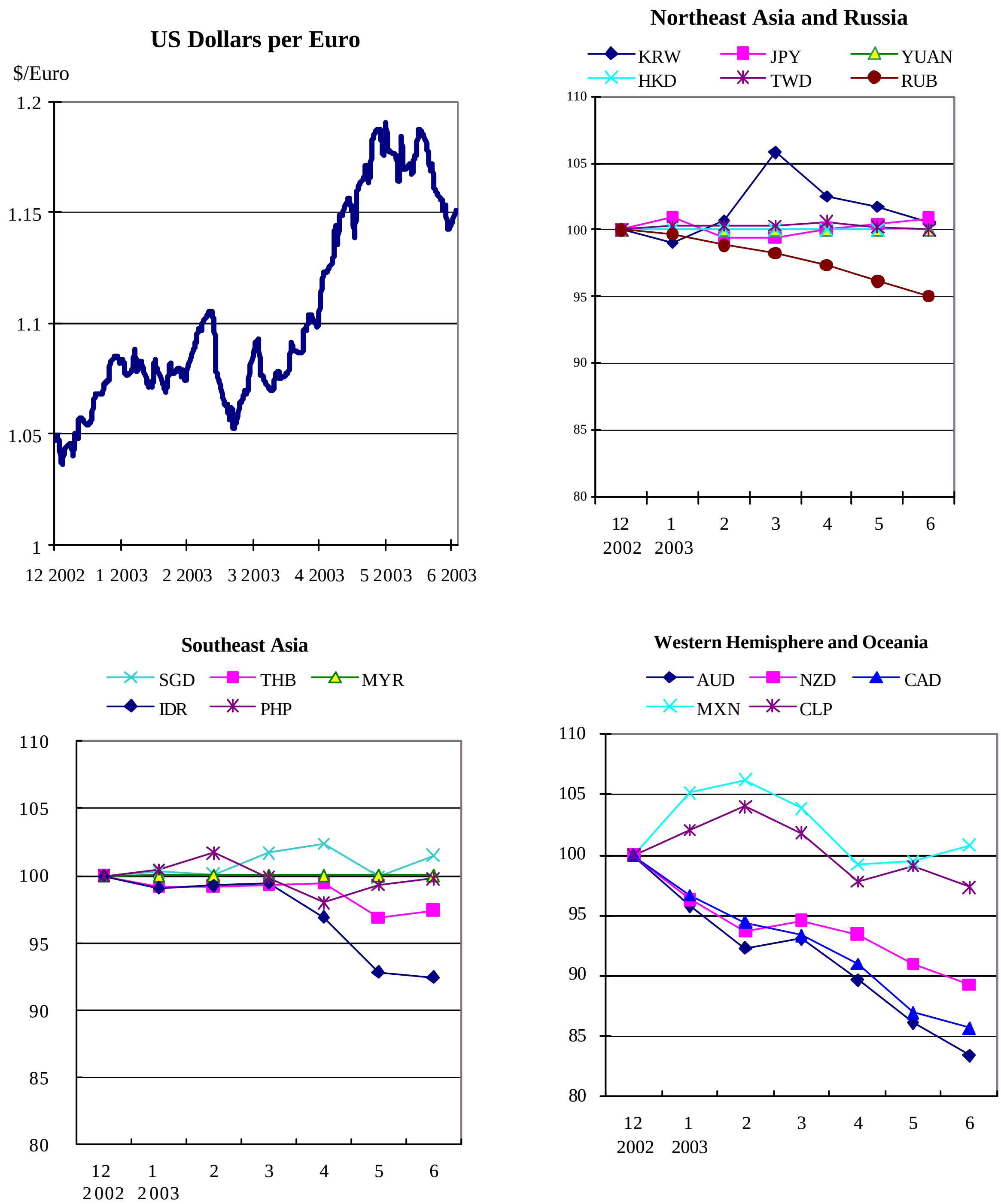
Since early 2002 when several bouts of effectively sterile official intervention by the Bank of Japan on the foreign exchange market failed to prevent the *Japanese* yen from appreciating, domestic price levels were depressed. Entering the year 2003, however, the exchange rate of the yen stopped its one-sided appreciation, oscillating within a relatively narrow band.

China; Hong Kong, China; and *Malaysia;* kept their exchange rates stable using either fixed exchange rate regimes or another forms of a pegged system. The exchange rate of the *China's* yuan against foreign currency remained stable. By the end of 2002, one US dollar was equal to 8.277 yuan. The *Hong Kong* dollar remained stable against the US dollar, staying close to the convertibility rate of HK$7.8/US$1 in the first seven months of 2003. Reflecting a weakening of the US dollar against other major currencies, the nominal effective exchange rate for the *Malaysian* ringgit decreased to 101 as of end-July 2003, compared with an average of 104.1 in 2002.

In the first half of 2003, most East Asian currencies and the *Russian* ruble increased against the *US* dollar, with *Singapore* the exception. The *Thai* baht, *Indonesian* rupiah, *Korean* won (after the depreciation of the first quarter of 2003) and *Russian* ruble recorded appreciations of between 3.0 percent and 8.0 percent against *US* dollar.

In *Chinese Taipei*, the NT dollar to US dollar exchange rate fluctuated around 35 from the beginning of 2003 to mid-April due to alternating bullish and bearish factors, including inflows of foreign funds to the Taipei stock market and the weakening of the Japanese yen. The NT dollar started to appreciate in late April in line with the softening of the US dollar as investors pulled money out of the US market after a series of corporate accounting scandals that seriously undermined investor confidence. The NTD/USD exchange rate reached 33 on July 17, the highest level for the year. The NT dollar's depreciation during this period largely offset its appreciation in the second quarter, pushing the currency back to the same level as at the beginning of the year. It subsequently fluctuated within a narrow range to end the year at 34.58 to the US dollar, a slide of 2.2 percent from 33.81 at year-end 2001.

Figure 1.5
Foreign Exchange Rates*



Note: *Indices (December 2002 = 100) were calculated, based on domestic currencies per US dollar.
Numbers in the first chart represent US dollars per euro.

During 2002, the *Indonesian* rupiah exchange rate appreciated noticeably and exhibited greater stability as compared to the previous year. This was driven by improved fundamentals, such as a turnaround of balance of payments performance from deficit to surplus; regional and sentiment factors; and occasional Bank Indonesia intervention in the market to reduce fluctuations. On average, the rupiah gained 9.8 percent in 2002. Looking at economic fundamentals, predictions for the exchange rate have been based on the improved performance of the Indonesia's economy, including the balance of payments in 2002. For the whole of 2003, the exchange rate is expected to move within the range of Rp 8,400 to Rp 8,600 per US dollar.

Reflecting the decline of the greenback, the *Singapore* dollar appreciated by 6.6 percent against the US dollar in 2002. Compared with the US dollar-pegged currencies of other major trading partners, the *Singapore* dollar showed similar strength. It also gained 6.6 percent against the *Hong Kong* dollar and the *Malaysian* ringgit. The relative stability of the nominal effective exchange rate in 2002 implied that the significant appreciation of the *Singapore* dollar against the US dollar, and currencies linked to it, was accompanied by weakness *vis-à-vis* the currencies of other important trading partners. The Singapore dollar lost 9.9 percent against the euro, 3.4 percent against the pound sterling and 3.6 percent against the yen.

The exchange rate of the *Malaysian* ringgit has been pegged to the US dollar at RM3.80 per USD since 2 September 1998. In 2002, the ringgit depreciated against most major and regional currencies in tandem with the weaker US dollar. The dollar generally weakened because of concerns over the pace of the US economic recovery as well as heightened geopolitical tensions in the Middle East. Consequently, the ringgit depreciated 15.4 percent against the euro, 9.5 percent against the pound sterling and 6.2 percent against the Japanese yen. The ringgit peg continues to provide an environment of predictability and stability to facilitate economic activities and is supported by strong economic fundamentals. These include a strong current account surplus, higher international reserves, low inflation as well as a strong and well capitalized banking sector.

The average exchange rate of the *Thai* baht appreciated to 43.0 baht per US dollar in 2002, compared with 44.5 baht per dollar in 2001. In 2003, the baht is expected to appreciate to 42.5 baht per dollar.

The average *Philippine* peso-dollar exchange rate for 2002 stood at P51.60 per dollar, a depreciation of 1.2 percent against the 2001 average of P50.99 per dollar. The depreciation of the peso mirrored concerns over potential risks in the international financial markets, as the tension in the Middle East, the economic recovery of the United States, threats of terrorism and the domestic challenges confronting the Philippine economy, particularly the huge budget deficit.

The average *Brunei* dollar exchange rate with respect to the US dollar, was generally down, by 4.8 percent from 1.84 in January 2002 to 1.75 in December 2002. The Japanese yen *vis-á-vis* the Brunei dollar on average deteriorated by 3.7 percent from 1.39 in January 2002 to 1.44 in December 2002.

The currency of every member economy in the Western Hemisphere and Oceania appreciated sharply against the US dollar with the exception of the Mexican peso. Notably, the Canadian, Australian and New Zealand dollars gained 12.0 percent to 20.0 percent against the US dollar in the first half of 2003.

Since 1983, *Australia* has had a floating exchange rate. During 2002, the Australian dollar appreciated (in nominal terms) by 10.8 percent against the US dollar, and depreciated 5.5 percent against the euro and 0.3 percent against the Japanese yen. The Australian dollar appreciated 20 percent against the US dollar in the first half of 2003.

The exchange rate of the *New Zealand* dollar generally appreciated in 2002. On a trade-weighted basis, the exchange rate moved to just under the 60 mark by the end of the year 2002, up from a low of around 48 following 11 September 2001. The biggest gains have been against the US dollar, with the NZ dollar rising from a low of just under US$0.40 in late 2000 to around US$0.59 in late June 2003.

In *Chile*, trends in the exchange rate shifted in the second half of 2002. From late August to early October, the Chilean peso, depreciated quickly due to lack of liquidity in the spot market amidst general uncertainty and an apparent overreaction to political and economic conditions in Brazil. From mid-October to through mid-December, the peso recovered strongly, thanks to improving terms of trade and sovereign spread, better conditions in major world stock markets, and the completion of negotiations for a free trade agreement with the United States.

In case of *Mexico*, the exchange rate of the Mexican peso recorded was Ps. 10.395 per US dollar at end of 2002, a depreciation of 13.48 percent as compared to the end of 2001. Since the second quarter of 2003, the peso stopped depreciating, keeping movement relatively stable around 10.3 pesos per US dollar.

The *Canadian* dollar has, in recent years, experienced downward pressure as a result of weakness in world commodity prices and flights to the quality of the US dollar. The Canadian dollar began 2001 at close to US$0.67 but has trended downward since then, remaining around US$0.64 in 2002. Since the beginning of 2003, however, the Canadian dollar has gained significant strength *vis-à-vis* the US dollar.

The *US* dollar is expected to continue to depreciate against most other major currencies. After a first-half-year slide, the trade-weighted value of the dollar against industrial economies' currencies is expected to rebound briefly as the market focuses on growth differentials between the United States and other industrialized economies. *World Outlook* (June 2003) of Global Insight is forecasting that over the year 2003 the value of the trade-weighted dollar will fall 8.0 percent *vis-à-vis* industrial economy currencies. Against the euro, the US dollar is projected to reach US$1.15 per euro at the end of 2003 and US$1.20 per euro at the end of 2004. Against the *Japanese* yen, the US dollar is expected to continue fluctuating around 120 yen per US dollar in the short term. The US dollar should weaken against the yen in the long term, partly reflecting the higher rate of inflation in the United States.

World Outlook (June 2003) of Global Insight also is warning that a hard landing for the US dollar could lead to competitive currency depreciation, generating additional deflationary pressures in the global economy. There is a high risk that the US dollar could be substantially weaker than is usually projected, due to various factors weighing it down, especially the large US current account deficit.

2.7 World Commodity Markets

Since the first quarter of 2002 with its incipient economic recovery, world prices of primary commodities started to rise after the sharp decline of the second half of 2001. This was driven mainly by a series of supply-side shocks. For the year as a whole, the overall index of primary commodity prices rose by over 3.0 percent in US dollar terms, partly reversing the decline of 2001. The increase through the year 2002, particularly in the second half, was much greater, with petroleum and non-fuel primary commodity prices rising by 50 percent and 17 percent, respectively, in December 2002 in relation to 2001.

Higher oil prices came in 2002, that is, early in the recovery stage whilst inflation trends were generally benign. This was an unusual phenomenon–at least from the viewpoint of business cycles. Spot oil prices steadily climbed from US$20 per barrel in December 2001 to US$30 per barrel in December 2002 for Brent crude.

Oil price hikes, at least until late 2002, appear to have been related mainly to market perceptions of potential supply disruptions rather than to an actual shortage of supply. The increased tensions between the United States and Iraq over UN arms inspections sparked concern over the possibility of military action in the region where close to two-thirds of the world's proven crude oil reserves are located. Consequently, petroleum prices rose sharply despite a significant expansion in global production during the year.

Furthermore, entering 2003, oil prices had surged to US$34.3 by February. Apart from a rising war-premium, this increase also reflected the supply shortfalls caused by strikes in Venezuela and Nigeria, the demand boost from unusually cold weather in North America and Japan, and unusually low OECD crude oil stocks. In the early stages of the war in Iraq, oil prices plummeted and were hovering around US$25 per barrel by early April 2003.

As the war in Iraq has ended without significant spillovers to neighboring countries and limited damage to production facilities, Iraq's production capacity can be expected to restore to pre-war levels of about 2.8 million barrels per day reasonably soon. Venezuelan and Nigerian output is also expected to recover following the resolution of current political tensions, as long as production facilities have not incurred major damage. In such circumstances, crude oil could well stabilize at a level significantly below US$30 a barrel.

In these circumstances, many institutions, including the OECD, are expecting oil prices to stay around US$25 per barrel over the coming year, the mid-point of the range targeted by the Organization of Petroleum-Exporting Countries (OPEC). According to *World Outlook* (June 2003) projections of Global Insight, oil prices in terms of the benchmark Western Texas Intermediate (WTI) spot price will fall to between US$20 and US$30 in the second half of 2003, following the anticipated resumption of Iraqi oil output and further recovery of Venezuela's oil exports. Average annual oil prices will be US$29 per barrel in 2003 and US$24 per barrel in 2004 and 2005.

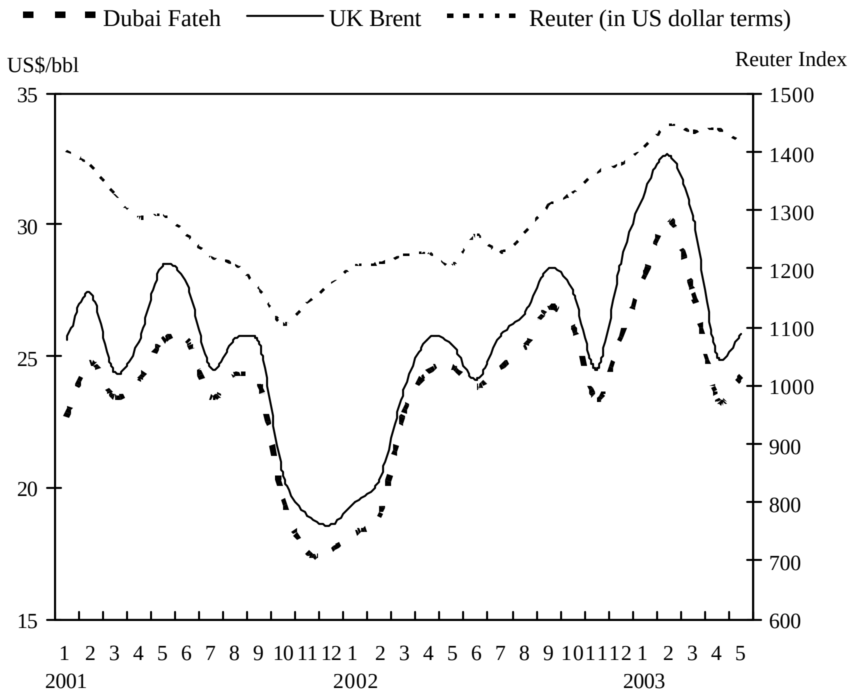
Table 1.7

Forecast Oil Prices

	2000	2001	2002	2003***	2004***
OECE import oil price (US$/bbl)*	28.0	23.6	24.1	26.0	25.0
Change in oil price (percent)	62.1	-15.8	2.4	7.8	-3.8
Change in non-oil commodity prices**	3.1	-8.6	-0.3	9.5	5.1

Notes: * Based on average cost, insurance and freight (cif) prices per barrel as calculated by the International Energy Agency.
** In terms of total Hamburg commodity price index, excluding energy.
*** OECD projections.
Sources: OECD Economic Outlook, June 2003

Figure 1.6
World Oil Prices and Commodity Prices



Sources: IMF, International Financial Statistics, June 2003; Reuters

3. POLICY RESPONSE AND ECONOMIC PROSPECTS

3.1 Expansionary Fiscal Policy

Looking at macroeconomic policies to stimulate economic recovery, member economies maintained an expansionary fiscal stance during the period up to 2002. The public deficits of major OECD economies have already reached the high level of 3.0 percent to 6.0 percent of GDP in 2003. During 2001 and 2002, most members experienced a deterioration in government financing, with a shift of budget balances from surpluses to deficits, or an increasing budget deficit.

This marked deterioration stems from a cyclical weakness in tax receipts, but also reflects a serious worsening in the underlying position of public finances. Structural factors of deficits are associated with aging in many economies. In addition, the reform of pension and health care systems is too slow, while many economies have to start consolidating their fiscal position immediately. Therefore, running a prudent fiscal policy is essential for stabilizing policies because it will help avoid premature hikes in long-term interest rates. However, at present there may be little room for maneuver left in fiscal policies.

Fiscal positions have deteriorated sharply in the course of the downturn since 2001, both for cyclical and for structural reasons. Looking forward, the OECD overall fiscal deficit is expected to widen further in 2003, partly because of built-in stabilizers. As well, additional *ex ante* stimulus is likely to accrue from a further increase in the cyclically adjusted deficit amounting to a little under 0.5 percent of GDP. The fiscal stance is set to loosen in the *United States* in particular. In *Japan*, the stance is expansionary this year, reflecting the increase in expenditures in the fiscal year 2002 supplementary budget and the planned tax cuts in the FY 2003 budget. *Australia*, *Canada*, *Korea*, *and New Zealand* are expected to continue recording budget surpluses.

US fiscal policy maintained an expansionary stance in 2002, including income tax-reductions and measures to promote business investment. After four years of surplus, the unified Federal budget recorded a deficit of US$158 in fiscal year 2002 (1.5 percent of GDP). The return of the deficit was primarily due to five factors: the lingering effects of the recession of 2001; the stock market plunge; increased Federal expenditure necessitated by the war on terrorism; an additional tax cut in May 2003; and the cost of homeland security.

Table 1.8
Budget Balances (percent of GDP)

	1997	1998	1999	2000	2001	2002
Western Hemisphere						
Canada	0.2	0.1	1.7	3.1	1.8	1.3
Chile	-5.0	-5.7	-0.1	-1.4	-1.7	-0.8
Mexico	-0.7	-1.3	-1.1	-1.1	-0.7	-1.2
Peru	0.2	-0.8	-3.2	-3.2	-2.5	-2.3
The United States	-0.3	1.0	1.6	2.3	0.4	-2.4
Northeast Asia						
China	-0.8	-1.5	-2.1	-2.8	-2.6	-3.0
Hong Kong, China	6.5	-1.8	0.8	-0.6	-5.0	-4.9
Japan*	-5.6	-7.4	-8.6	-7.0	-6.6	N.A.
Korea	-1.5	-4.2	-2.7	1.3	1.3	3.8
Chinese Taipei	2.5	1.2	0.5	-1.3	-2.5	-3.0
Southeast Asia						
Brunei Darussalam	-0.02	1.6	0.7	17.4	6.0	-4.2
Indonesia	-0.2	-1.6	-3.7	-1.6	-2.8	-1.7
Malaysia	2.4	-1.8	-3.2	-5.8	-5.5	-5.6
The Philippines	0.1	-1.8	-3.7	-4.0	-4.0	-5.2
Singapore	11.8	3.4	3.5	2.5	-1.8	-0.1
Thailand	-1.3	-2.5	-2.8	-2.3	-2.6	-2.9
Viet Nam	4.0	2.5	5.0	5.0	5.0	5.0
Oceania						
Australia	-1.0	0.2	0.7	2.1	0.9	-0.1
New Zealand	1.9	2.5	1.7	1.3	1.2	1.9
Papua New Guinea	0.1	-1.8	-2.6	-2.0	-3.6	-4.2
Russia	-7.7	-5.9	-1.1	2.4	2.9	1.4

Note: * Refers to fiscal year (April to March)

Sources: Individual Economy Reports; ADB, Asian Development Outlook, April 2003; OECD, OECD Economic Outlook, June 2003.

Japan's fiscal imbalances remain most worrying, with a deficit exceeding 7.0 percent of GDP in 2002 and a rapidly rising gross public debt ratio that exceeded 140.0 percent of GDP at the end of 2002. In 2003, the deficit is to widen a bit further, reflecting the spending increases enshrined in the FY 2002 supplementary budget for public works and unemployment benefits as well as the tax cuts built into the FY 2003 budget. Considering the serious situation of the economy, a supplementary budget of 4.5 trillion yen was passed by the Diet in February 2003 based on the "Program to Accelerate Reforms" formulated in December 2002. The program contains measures to build a safety net in preparation for Japan's economic and social structural transformations and public investment. Consequently, the government's revenue and expenditure structure is becoming increasingly rigid. To promote fiscal structural reform, the government will concentrate funding in areas that will lead to future development. The FY 2003 budget of 81 trillion yen was formulated, and the amount of general account expenditures was increased by 0.7 percent from the FY 2002 initial budget.

China also maintained an expansionary fiscal policy. The fiscal balance in 2002 was minus US$37.43 billion and the total fiscal expenditure was US$265.93 billion, up 16.4 percent year-on-year. In line with WTO commitments, the Chinese government cut the overall tariff rate from 15.3 percent to 12.0 percent. During the process of finance system reform, stock trade taxes were reduced from 0.4 percent (A share market) and 0.3 percent (B share market) to 0.2 percent in both markets. The pause before reducing state-owned shares also had negative impact on revenue. In 2002, the total fiscal revenue reached US$228.50 billion, up by 15.4 percent year-on-year.

In *Chinese Taipei,* the sluggishness of the economy and various tax-cutting measures during recent years has squeezed government revenue. In addition, the growth of social expenditure and the massive funding required for reconstruction after the devastating earthquake of 1999 have greatly increased the burden of government expenditure, resulting in a substantial widening of the fiscal deficit. In 2002, the ratio of the public deficit to annual expenditure stood at 13.8 percent (3.3 percent of GDP). In addition, with the government depending increasingly on raising public debt to cover expenditure, outstanding debt climbed to 31.5 percent of GNP.

Hong Kong, China's financial results for 2002–03 (ending 31 March 2003) showed a deficit of HK$61.7 billion or 4.9 percent of the forecast GDP for 2002 as compared with the anticipated budgeted deficit of HK$48.2 billion. The 2003–04 budget forecasts a deficit of HK$67.9 billion, equivalent to 5.3 percent of the forecast GDP for 2003. The budgeted government expenditure represents a growth of some 11.0 percent in real terms over 2002–03.

Indonesia's government budget during 2002 reflected financial consolidation to ensure medium-term fiscal sustainability. However, the deficit narrowed much more than expected, mainly due to lower development spending outcome. The fiscal deficit for 2002 is estimated to stand at 1.7 percent of GDP, lower than the budgeted 2.5 percent. The 2003 state budget aimed at controlling the deficit while seeking to ameliorate the negative impact of the Bali incident by accommodating a strong public interest in fiscal stimulus. The budget deficit is forecast to be 1.8 percent of GDP, virtually unchanged from the preliminary realization for 2002. Control of the 2003 deficit would be achieved through a continued increase in budget revenues (mainly tax collections) and through belt-tightening measures (largely cuts in oil/gas subsidies) and lower domestic debt servicing.

In *Singapore*, an expansionary fiscal policy stance was maintained in 2002, as the economic recovery from the recession in 2001 remained weak. The sizeable off-budget packages announced in 2001 were generally continued through 2002 to alleviate the burden on households and businesses.

The 2002 *Malaysian* budget remained expansionary to support growth momentum. Fiscal incentives and expenditure allocations were targeted at increasing domestic capacities to enhance long-term growth prospects. The actual out-turn for revenue collected in 2002 was significantly higher than the initial projections on account of improved economic activities and increased efficiency in tax collection. Nevertheless, higher expenditure resulted in a deficit of RM20.3 billion (5.6 percent of GDP) for the year 2002 compared with an original budget estimate of RM18.8 billion (5.1 percent of GDP).

Sustained improvements in revenue collections enabled *the Philippines* to post a fiscal deficit of P210.74 billion, P12.3 billion lower than the revised deficit target of P223.04 billion. The full-year deficit was approximately 5.2 percent of the nominal GDP in 2002. Government revenues collected in 2002 amounted to P567.14 billion while total disbursements reached P777.88 billion. The government continued to implement reform measures aimed at strengthening the enforcement of tax laws and increasing revenue recovery.

In 2002, the *Brunei Darussalam* budget continued to be increased, to stimulate growth. Increases in expenditure allocations were targeted to build domestic capacities and encourage foreign direct investment to accelerate the economic diversification programme. Government expenditure thus showed an increase of 17.4 percent from BND 3.78 billion in 2001 to BND 4.44 billion in 2002. The revenue collected in 2002 fell by 1 percent, from BND 4.23 billion in 2001 to BND 4.17 billion in 2002, due to an overall decrease in tax collection and non-tax revenues. Overall the country experienced a budget deficit of BND 267.7 million in 2002 compared to the surplus of BND 449.7 million recorded in 2001.

Australia's budget returned to cash surplus in 1997–98, and the 2003–04 budget provided the sixth cash surplus since then. In the 2003–04 financial year, the government expects to see an underlying cash surplus of around 0.3 percent of GDP (or 0.1 percent measured on an accrual basis). This is lower than the projected cash surplus of 0.5 percent of GDP (or an accrual surplus of 0.3 percent of GDP) forecast in the 2002–03 budget, after the government's announcement of US$2.4 billion of personal income tax reductions, with effect from July 1, 2003. The expected outcome for the 2002–03 underlying cash balance is an estimated surplus of 0.5 percent of GDP.

New Zealand has been running an operating surplus since the June 1994 fiscal year. As a percentage of GDP, government operating expenses fell from 41.6 percent in 1992–93 to 29.8 percent in the 2001–02 financial year. The operating balance before revaluations and accounting changes is estimated to be 3.1 percent of GDP for 2002–03, rising to 4.0 percent of GDP in 2006–07 as tax revenue growth remains higher than expense growth through the forecast horizon. By 2006–07 the persistent operating surpluses are expected to reduce net Crown debt (including the NZ Super Fund assets) to below 3.0 percent of GDP.

Following the election of the new government in early August 2002 in *Papua New Guinea*, a supplementary budget was introduced. It contained major adjustments aimed at restoring fiscal macroeconomic stability, following unprecedented levels of expenditure in the first half of 2002.

Canada's federal government has now recorded five consecutive surpluses for the first time in over 50 years. The surplus in 2001–02 was US$8.2 billion in Canada. Furthermore, Canada was the only member of the G-7 country to run a total government sector surplus in 2002. Federal surpluses have helped to reduce the federal debt by US$47.6 billion since 1996–97. This has also lowered the federal net debt-to-GDP ratio from 67.5 percent in 1995–96 to 44.5 percent in 2002–03. With the commitment to balanced budgets in each of the next two fiscal years, the federal net debt-to-GDP ratio is forecast to decline to about 40 percent in 2004–05.

During the third quarter of 2002, *Chile's* fiscal accounts posted an overall deficit, of -1.2 percent of GDP, accumulated in annual terms. With this result, fiscal figures approached the objectives set during the recent budget debate (including an accounting deficit of 0.9 percent in 2002), thus reversing the increasing tendency of the annual deficit. Spending with a macroeconomic effect was also adjusted, with annual growth reaching 3.8 percent in the third quarter compared to 7.7 percent during the first half of 2002. Public investment increased by almost 20 percent in the first half of the year but fell 0.4 percent, in annual terms during the third quarter. The fourth quarter of 2002 experienced additional spending limits to meet budgetary constraints for the full year.

In *Mexico*, fiscal discipline will remain the cornerstone of the 2003 budget. In particular, the fiscal package approved by Congress is consistent with an overall public sector deficit equivalent to 0.5 percent of GDP. Federal government revenues comprised 71.3 percent of total budgetary revenues, while revenues of agencies and entities under direct budgetary control comprised the remaining 28.7 percent. Federal government revenues totaled Ps. 989,281.9 million during 2002, an increase of 0.3 percent in real terms as compared to revenues recorded in 2001. This increase was primarily attributable to the 6.1 percent increase in tax revenues mentioned above.

3.2 Supportive Monetary Policy

In the APEC region, monetary policy has remained accommodative and thus supportive to the economic recovery for 2002 and 2003. Against a background of low inflation and widening output gaps, many central banks have brought down policy-controlled interest rates to historical lows. Low interest rates have helped contain the size of the downturn.

Given the lags associated with monetary policy, monetary policies will continue to support demand in the course of 2003 and 2004. There is clearly more scope for further interest rate cuts in some economies, although monetary policy alone cannot put economies back on a balanced and sustainable growth path. Monetary conditions appear well adapted to the current situation in most member economies, including the *United States*. In *Japan*, more aggressive liquidity provisions combined with a decisive restructuring of the financial sector are advisable. Money market rates are assumed to remain low for some time, before rising as the recovery firms.

Faced with signs of a sluggish growth, the *US* monetary authority continued to ease monetary conditions. The Federal Reserve reduced the target federal funds rate 11 times in 2001, (a total of 4.75 percentage points) to 1.75 percent. The Federal Reserve then held the funds rate steady through most of 2002, until a 0.5 percent cut on 6 November brought the rate down to 1.25 percent. In the *United States*, short-term interest rates are at their lowest levels in over four decades due to a cumulative 5.25 percent cut in the Federal Reserve’s target rate in 2001 and 2002. The Federal Reserve lowered the target rate by another 0.25 percent to 1.0 percent on 25 June 2003. This monetary easing significantly supported investment and consumption, particularly the consumption of autos and other durables. Following a large decline in 2001, the interest rate on 91-day treasury bills fell an additional 50 basis points in 2002 and ended the year at 1.2 percent. These reductions reflected the Federal Reserve’s efforts to stimulate the economy, which left real short-term rates (nominal rates less expected inflation) close to zero. The 10-year treasury bills ended the year at 3.9 percent compared to 5.2 percent at the end of 2001. Room for lowering the federal funds rate is now limited. Rather, as the recovery strengthens in 2004, it will be desirable to start moving the policy rate back towards neutrality.

In *Japan*, short-term interest rates have been almost zero since 1999. Liquidity injections have been stepped up several times. Even so, broad money has recently been expanding at a year-on-year rate of only about 2.0 percent, while private bank lending has continued to contract by 2.0 percent to 3.0 percent. While liquidity creation may have helped contain the acceleration of deflation, it has clearly not been sufficient to pull the general price level back up. In October 2002, the Bank of Japan decided to conduct money market operations aiming at the outstanding balance of current accounts held at the bank at around 15 to 20 trillion yen. Furthermore, in May 2003, the Bank of Japan decided to change the guideline for money market operations, and raised the target balance of current accounts held at the bank to around 27 to 30 trillion yen. Looking at short-term interest rates, the overnight call rate moved at low levels in 2002, reflecting the central bank's monetary easing policy, which was conducted several times throughout the year. The overnight call rate remained at its lowest level. Interest rates for two- and three-month contracts remained almost unchanged. Long-term interest rates remained at 0.7 percent, supported by strong demand from investors and other sources.

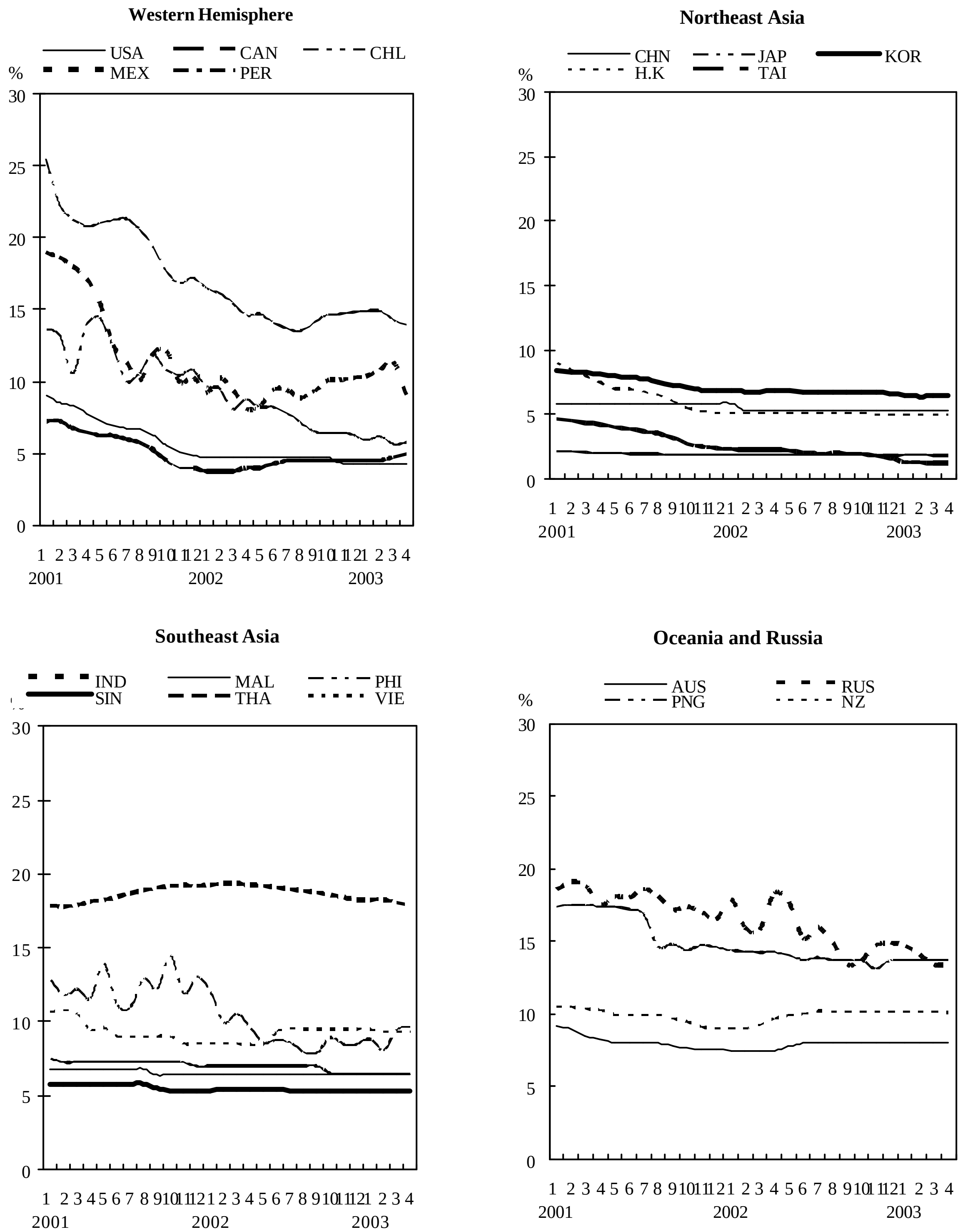
Table 1.9
Short-term Interest Rate (percent, per annum)

	1997	1998	1999	2000	2001	2002
Western Hemisphere						
Canada	3.3	4.7	4.7	5.5	3.8	2.6
Chile	6.8	9.6	6.0	5.4	4.5	2.3
Mexico	19.8	24.8	21.4	15.2	11.3	7.1
Peru	12.8	18.7	14.9	12.7	8.6	3.2
The United States	5.2	4.9	4.8	6.0	3.5	1.6
Northeast Asia						
China	7.7	6.3	5.6	5.6	5.6	5.6
Hong Kong, China	7.1	8.1	5.8	6.1	3.6	1.8
Japan	0.6	0.7	0.2	0.2	0.1	0.03
Korea	13.4	15.2	6.8	7.1	5.3	4.8
Chinese Taipei	6.9	6.6	4.8	4.7	3.7	2.1
Southeast Asia						
Brunei Darussalam						
Indonesia	30.5	64.1	26.0	12.5	17.6	12.9
Malaysia	7.8	9.4	4.1	3.2	3.1	2.9
The Philippines	13.1	15.3	10.2	9.9	9.9	5.4
Singapore	4.1	1.7	1.7	1.7	1.0	0.8
Thailand	22.4	13.6	1.5	1.8	2.1	2.0
Viet Nam	1.1	1.2	1.1	0.9	0.8	0.8
Oceania						
Australia	5.4	5.0	5.0	6.2	4.9	4.8
New Zealand	7.9	4.6	5.4	6.7	5.0	5.9
Papua New Guinea	-	19.0	22.7	15.7	10.2	15.5
Russia	32.0	41.8	39.7	24.4	17.9	15.7
LIBOR* (3-months US$)	5.8	5.6	5.4	6.5	3.8	1.8

Note: * London Inter-Bank Offer Rates on US dollar deposits.

Sources: Individual Economy Reports. IMF, *World Economic Outlook*, April 2003

Figure 1.7
Short-term Lending Rate (percent, per annum)



Source: IMF, International Financial Statistics, June 2003.

In *China*, the growth of the monetary supply was consistent with economic growth and the objects of monetary policy were achieved. By the end of 2002, the balances of the broad money supply (M2), the narrow money supply (M1) and cash in circulation (M0) reached US$2235.1 billion, US$856.34 billion and US$208.74 billion, respectively, and increased by 16.8 percent, 16.8 percent and 10.1 percent year-on-year, respectively.

Chinese Taipei's central bank maintained a loose monetary policy aimed at fostering economic growth in 2002. In the two years leading up to June 2003, the central bank cut the discount rate 15 times, reducing it by 3.375 basis points from 4.75 percent to 1.375 percent. Both long-term and short-term interest rates are at historic lows. With the economic recovery yet to feed through into stronger demand for funds, and with the continuous transfer of bank deposits into bond funds, growth of the M2 monetary aggregate was markedly slow. In 2002, M2 grew by 3.55 percent, near the lower end of the 3.5 percent to 8.5 percent target range, while M2 plus bond funds grew by 5.64 percent.

In *Hong Kong, China*, Hong Kong dollar interest rates softened during most of the first seven months of 2003. Reflecting ample liquidity in the banking system, short-term Hong Kong dollar inter-bank interest rates generally fell in the first seven months, except for a brief increase in March-April owing to concerns about the economic impact of the outbreak of SARS. Specifically, the three-month rate declined from 1.41 percent at end-December 2002 to 1.13 percent at end-July 2003. Its spread over the US dollar counterpart narrowed from 9 basis points to 3 basis points during the same period.

In *Indonesia*, 2002 ended with the good economic and monetary conditions, although economic recovery was lower than anticipated. Prudent monetary policy with fiscal consolidation supported by further advances in economic restructuring during 2002 has facilitated the way to economic and monetary stability. The exchange rate appreciated noticeably and moved steadily, while base money has been kept in check below its indicated target. Monetary conditions have been encouraging since early 2002. Base money was quite stable and below its indicated target, with the stronger and less volatile exchange rate contributing to reducing inflationary pressures. These conditions provided room for Bank Indonesia to gradually lower interest rates.

In *Singapore*, monetary policy remained neutral and the nominal effective exchange rate was allowed to follow a zero percent appreciation policy path within the new band. The neutral monetary policy stance was reaffirmed in the second half of the year as inflationary conditions remain subdued.

In 2002, *Malaysia's* monetary policy remained accommodative to support the economic recovery. The thrust of monetary policy focused on ensuring ample market liquidity and accessibility with low interest rates to support economic growth. The accommodative monetary stance was facilitated in turn by the absence of inflationary pressures. Bank lending recovered strongly in 2002 in line with the improving economy. The improved economic activity was also reflected in the growth of all monetary aggregates. M1, M2 and M3 had expanded strongly by 10.3 percent, 5.8 percent and 6.7 percent, respectively, as at the end of 2002.

Thailand continued to operate on accommodative monetary policy in order to maintain supportive economic conditions. In 2002, the Bank of Thailand reduced the 14-day repurchase rate (a policy instrument) twice, from 2.25 percent per annum (p.a.) to 2.0 percent per annum in January and from 2.0 percent p.a. to 1.75 percent p.a. in November 2002. In 2003 the inflation rate remained low, so there was no negative effect to further easing monetary policy to safeguard against uncertainties in economic conditions and support the growth process. In addition, a wider differential between domestic and foreign interest rates can cause volatility in short-term capital movements that may exert an adverse effect on economic recovery. The Bank of Thailand therefore decided to lower the 14-day repurchase rate by 0.5 percent p.a. from 1.7 percent p.a. to 1.2 percent p.a., effective on June 27, 2003.

The Philippines' monetary authorities focused on providing the appropriate liquidity conditions needed to support a non-inflationary growth path for the economy in 2002. In January 2002, the Bangko Sentral ng Pilipinas (BSP) adopted an inflation-targeting framework for monetary policy to promote a low and stable rate of inflation conducive to balanced and sustainable economic growth. Against a backdrop of benign inflation, the BSP reduced its policy interest rates three times (by a cumulative amount of 75 basis points) in the first quarter to 7.0 percent for its overnight borrowing rate and 9.2 percent for its overnight lending rates.

In *Brunei Darussalam*, monetary expansions in the domestic banking system decreased by 2.1 percent from June to November 2002. The contraction in broad money was due to the fall in demand deposits and quasi money by 0.5 percent and 3.4 percent, respectively. Interest rates remained low compared to other rates offered by commercial banks in the region. The lending rate to the prime borrowers of the commercial banks has remained unadjusted at 5.5 percent since September 2000.

The Reserve Bank of *Australia* has the primary responsibility for the direction of monetary policy. In pursuing the goal of medium-term price stability, the Reserve Bank has adopted the objective of keeping average inflation between 2.0 percent and 3.0 percent over the medium term.

The Reserve Bank of *New Zealand* is charged with maintaining price stability. The most recent Policy Targets Agreement was signed in September 2002 and requires the bank to maintain inflation in the range of 1.0 percent to 3.0 percent on average over the medium term. When it comes to implementing monetary policy, the Reserve Bank uses the Official Cash Rate (OCR) target. The OCR was reduced to 4.75 percent in November 2001. However, ongoing strength in the domestic economy saw this stimulus gradually withdrawn over the first half of 2002, with the Reserve Bank gradually raising the OCR to 575 percent by July 2002. A weakening outlook more recently has seen the OCR gradually lowered from April 2003 to reach 5.0 percent by July 2003.

The Bank of *PNG* maintained a neutral monetary policy stance over the first half of 2002, following improvements in the exchange rate and a lower than anticipated inflation outcome for the same period. Accordingly the bank maintained its signaling policy rate, the Kina Facility Rate (KFR), at 12.0 percent.

Canada's Federal Government and the Bank of Canada have maintained an official target range for the inflation rate since 1991. This target range was gradually lowered and is now 1.0 percent to 3.0 percent. The commitment to keep inflation within that target range was renewed in February 1998 and again in May 2001, with the latter commitment in effect until the end of 2006. The commitment to a low and stable inflation environment enables policy to best contribute to sustained economic expansion in Canada, thereby leading to the likelihood of lower unemployment and improved productivity. Between early 2001 and mid-January 2002, the Bank of Canada lowered its target for the overnight interest rate (its key policy instrument) on 10 occasions for a cumulative decrease of 3.7 percent. Since April 2002, however, the bank has increased its rate by 1.25 percent in response to strong growth in the economy.

In *Chile*, sluggish activity throughout 2002 encouraged the new monetary impulse applied early 2003. For most of 2002, interest rates on central bank notes fell significantly, with an increase in volatility in the last months of the year. Consistent with the reference rate and medium-term inflationary expectations, interest rates on short-term promissory notes were cut by about 37 percent from January to September 2002. Since then, they have held steady around the policy rate, although there is still some volatility.

In *Mexico*, the Banco de Mexico's primary objective is to seek the stability of the purchasing power of domestic currency. Consistent with this view, the board of governors established that the annual growth rate of the national consumer price index should fall to 3.0 percent by December 2003 as a medium-term objective in the Monetary Program of 2001, in line with the inflation rates of Mexico's main trading partners. Additionally, it was announced that the inflation target for 2002 should be no higher than 4.5 percent.

3.3 Progressive Structural Reform

To regain and sustain economic growth momentum, a renewed commitment to economic reform has been, and will be, important in many economies. Therefore, policymakers should push ahead with economic reforms without waiting for a fully-fledged recovery to materialize. Governments show a readiness to intervene in the short-run to support the economy, while at the same time providing economic agents with a sense of long-term direction and governance to establish confidence.

During the years 2002 and 2003, economies in the region made various efforts to enhance economic efficiency by reforming their economic structures. Recent major structural reform issues included labor market flexibility; financial system stability; the efficacy of financial supervisory institutions and asset management agencies to resolve non-performing loans; the healthcare and welfare system; the fair competition system; and the fiscal and taxation systems.

In Japan, the non-performing loan (NPL) problem continues to be one of the major challenges to structural reform of Japanese economy. With a view to accelerating structural reform, the government announced a "Comprehensive Policy Package for Accelerating the Structural Reform" in October 2002. As one part of this package the "Program for Financial Revival" was announced and its goal is to normalize the NPL problems by the end of FY 2004. By July 2003, all necessary measures in this program were implemented, including the adoption of a discounted cash flow-type method, conducting another round of special inspections, and introducing an early warning system. The good effect of the policy has already shown in major banks' balance sheets of FY2002. In addition, to resolve the NPL problems, it was necessary to continue a policy response that took an integrated approach to issues in the industrial and financial sectors. From this viewpoint, the role of the Industrial Revitalization Corporation of Japan, established in May 2003, is very important. There has been consensus building among creditors on business restructuring and its implementation by purchasing part of the loan assets of distressed but viable companies at their market price, after reviewing their rehabilitation plans. In March 2003, the government revised its "Three-Year Program for Promoting Regulatory Reform (FY 2001–FY 2003)." It is the second revision since the program was formulated in 2001. The revised program consists of 1,153 items including reinforcing the Fair Trade Commission through amending the surcharge system under the Anti-Monopoly Law. It also includes plans for promoting special zones for structural reform.

China will focus on accomplishing the following structural reform tasks in 2003: (1) Accelerating the restructuring of agriculture and the rural economy and doing everything possible to increase rural income; (2) Working hard to increase job opportunities and constantly improving the social security system; (3) Accelerating adjustment and improvement of the industrial structure in accordance with the requirements for taking a new road to industrialization; (4) Continuing with the implementation of market-oriented reform and rectifying and standardizing the order of the market economy; (5) Opening more widely to the outside world and making better use of both domestic and international markets and resources; and (6) Continuing to implement the strategy of rejuvenating China through science, technology and education, sustainable development, and promoting comprehensive progress in all social undertakings.

In *Korea*, the central aim of financial and corporate restructuring has been to raise the overall efficiency of the economy. That has been done by heightening the soundness and profitability of the corporate and financial sectors through the forced exit of ailing financial institutions and firms, improvement of the financial structure of financial institutions and companies capable of a turnaround, the putting in place of systems relating to management transparency, and so forth.

Chinese Taipei has made or is preparing some institutional measures for reforming its economic structure. Its main aims are to strengthen the banking system, to establish free ports, to improve the flexibility of its labor market and to improve the environment for FDI. Chinese Taipei will ease restrictions on the recruitment of overseas hi-tech personnel and introduce attractive new tax concessions for investors. At the same time, efforts will be focused on developing various high-tech industrial clusters, including an ICT cluster in the north, a nanotechnology cluster in the central region, and an optoelectronics cluster in the south. Maintaining its emphasis on developing a knowledge-based economy and promoting private investment, Chinese Taipei will step up the pace of privatization and deregulation while strengthening support for R&D and industrial innovation. To improve fiscal strength, *Chinese Taipei* has been taking vigorous steps to augment government revenues while scaling back government spending. A cabinet-level task force has been formed to explore all possibilities of fiscal reform and formulate plans for balancing fiscal revenues and expenditures within the next five to ten years. In July 2002, a Financial Reform Committee was set up to draft proposals for accelerating financial reconstruction over the next few years. It included formulating effective methods to reduce NPL ratios and improve the quality of bank assets, promoting vertical and horizontal mergers of financial institutions and paving the way for enhancement of financial asset liquidity. In July 2003, Chinese Taipei's legislature enacted crucial new laws on real-estate securitization, the establishment and management of free ports, agricultural finance and the organic law of the Executive Yuan's financial monitoring and management committee. Furthermore, in April 2003, Chinese Taipei launched a fiscal reform program to improve the structure of the fiscal system with the target of balancing fiscal revenues and expenditures by 2012.

Hong Kong, China is a free market economy, and thus the prime mover of economic restructuring is mainly the private sector. Yet the government is actively promoting the development of hard and soft infrastructure by investing heavily in education, upgrading economic infrastructure, promoting innovation and technology, improving the business environment, helping the business sector to develop new markets, protecting ecology and environment and improving quality of life. Along with enhancing strengths in the four core industries–finance, logistics, tourism and producer services sectors, the government is also aiming to assist the private sector to capitalize on the rapid development of China. Specifically, the government has entered into a Closer Economic Partnership Arrangement with China, and has pushed through several measures to improve boundary crossings, with a view to expediting economic integration with the Pearl River Delta region.

In *Indonesia*, some programs and acts were instituted for banking rehabilitation, effective anti-corruption measures and appropriate labor rights during 2002 and 2003. As a continuation of the banking policy pursued a year earlier, in 2002 Bank Indonesia focused its policy on three programs: banking rehabilitation, banking resilience, and bank intermediation. Under the banking rehabilitation program, the government continued to implement the state's guarantee program, although this guaranteed coverage will eventually be eliminated. In the area of banking supervision and regulations, the government aims to meet international standards as defined by the 25 Basle Core Principles. The structural reform programs, supported by improved macro-monetary conditions, have strengthened the banking system. This was reflected in a stronger capital structure, improved NPLs, stronger profitability, and recovery in bank intermediation. Banking efforts to restructure credit have reduced their gross NPL ratio to 8.3 percent (2.9 percent on a net basis), as compared to 12.1 percent (net 3.6 percent) in 2001. Although the overall net NPL ratio is below 5.0 percent, there were still 20 banks with a net

NPL ratio above 5.0 percent. On the profitability front, banking net interest income has risen to Rp 42.9 trillion compared to Rp 37.8 trillion the previous year, reflecting a wider spread between credit and deposit rates due to declining SBI rates. Indonesia has also made remarkable progress in legal and judicial reform. The Anti-Corruption Law was passed before the end of 2002 and the Wealth Commission has functioned well in an uncoercive role and should become an effective component of the Anti-Corruption Committee with enhanced investigatory power. Indonesia's House of Representatives has also passed an Anti-Money-Laundering Bill, appointed key officials and is close to launching its Financial Transactions Reporting and Analysis Unit.

The Philippines' financial policy emphasized strengthening of the banking system to secure efficient financial intermediation and restoring confidence in the stock market. "The General Banking Law of 2000" (GBL) (RA No. 879) aligned domestic banking standards with international best practices and improves regulatory oversight. The GBL also allowed foreign banks to acquire up to 100 percent of a domestic bank within seven years of the implementation of the law. The BSP continued to implement measures to improve prudential and supervisory regulation over the banking system. To address the non-performing assets problems of the financial sector, RA No. 9182, otherwise known as the Special Purpose Vehicle Act of 2002, was enacted on 10 January 2003. The law aims to encouraged private sector investments and eliminate barriers in the acquisition of non-performing assets. The law is expected to help in the rehabilitation of distressed businesses and improve the liquidity of the financial system. The implementing rules and regulations were issued on 19 March 2003.

Singapore is restructuring the economy in response to changes in the external environment and domestic economy. The key strategic thrusts include expanding external ties, maintaining competitiveness and flexibility, promoting entrepreneurship, upgrading manufacturing and services, and developing human capital. As economic restructuring will inevitably have a major impact on workers, with more frequent job displacements and higher structural unemployment, there is a need to manage the dislocation and difficulties, and help workers make these changes through retraining, job-matching, and more focused assistance. Through the structural reforms, Singapore aims to become a globalized, entrepreneurial and diversified economy, and sustain medium-term economic growth at 3.0 percent to 5.0 percent p.a..

In the past decade, *Thailand* has been influenced by the impact of globalization and technological development. Some essential structural reforms have been undertaken in several areas. First, bureaucratic reform in Thailand has been reshaped and downsized to increase its efficiency and effectiveness. Two major aims characterize the direction of bureaucratic reform– to modernize and to improve the efficiency of the civil service system by restructuring government organizations and restricting the number of government officials. Tax reform measures have been implemented to upgrade the tax system to international standards. Income taxes have been reformed by lowering tax burdens and simplifying compliance in line with other regional economies. Value-added tax refunds and duty drawback from exports have been further accelerated so exporters receive money back in a reasonable time. Furthermore, the tariff structure has gradually undergone further rationalization in view of global trade liberalization and the realization of the ASEAN Free Trade Area. The Thai government has also emphasized the important of restructuring corporate governance. In 2002, the "Good Corporate Governance Campaign" was initiated to create a transparent investment environment in Thailand. So far, new laws and regulations have been enacted covering investments, the system of property ownership for non-residents, and new taxation schemes. In conclusion, the Thai government is confident these fundamental reforms will ultimately enhance Thailand's economic growth and competitiveness.

In an effort to improve *Brunei Darussalam's* competitiveness, increase foreign direct investment, and help diversify its economy, the government has launched several important initiatives. Regulatory reforms have been made reducing the tax burden of new and expanding companies, lifting foreign ownership restrictions on industrial land, and promoting the development of offshore financial activities. Institutional reform has also been made to strengthen the corporate body responsible for spearheading economic development while strategic realignment of the civil service sector is currently being undertaken to improve the efficiency and effectiveness of public services. Due to the importance of human resource development, Brunei Darussalam, with the help of a team of international consultants, is in the process of formulating its new Human Resources Policy and Plan. In the Eighth National Development plan special emphasis is also placed on the promotion and development of human resources, ICT and science and technology, privatization, development of an offshore financial center and the tourism and hospitality industry.

In recent years, *Viet Nam* has been continuously carrying out a structural reform program along with economic renovation (*Doimoi*) in order to realize its industrialization and modernization strategy, stimulate economic growth, enhance the economy's competitiveness, and actively integrate into the regional and international economy. At the beginning of 2001, with financial supports from international organizations such as the International Monetary Fund (IMF), the World Bank and other donors, the government has approved the reform programme in seven areas: (1) trade policy; (2) improving the climate for enterprises; (3) reforming state-owned enterprises; (4) strengthening the banking system; (5) managing public resources; (6) formulating a legal sector strategy; and (7) reforming public administration.

In *Australia*, the Intergenerational Report 2002–03 informs the wide-ranging structural policy reforms of the 2003 budget. Following a review of Australia’s international taxation arrangements, the government has announced a package of reforms that continues its commitment to improve the international competitiveness of Australian business. The reforms include reduction in compliance costs associated with the controlled foreign company rules, reduction of tax on certain forms of foreign business income and gains, modernization of Australia’s taxation treaty network and better targeting of foreign investment fund rules. Proposed amendments to the Workplace Relations Act will simplify procedures and increase labor market flexibility in areas such as unfair dismissal cases. Under current arrangements, industrial disputes have fallen significantly. Enacting further reform will provide substantial dividends. Higher education reforms will establish a more efficient and responsive higher education sector lifting both productivity and participation. It should also enable the rapid utilization and transmission of new skills and production technologies, with a dynamic effect in increasing productivity. Health reforms will ensure that future governments can afford health support systems well into the future. The government has reaffirmed its commitment to universal health care through funding for new Health Care Agreements with the states. These agreements seek to improve the cost-effectiveness, accessibility and quality of services. Welfare reforms will assist those with disabilities and their families, and parents of children with special needs to participate in work and education.

In *New Zealand*, far-reaching structural reforms commenced in the mid-1980s were aimed at improving the microeconomic efficiency of the economy while simultaneously bringing greater macroeconomic stability. The reforms included the floating of the exchange rate; abolition of controls on capital movements; the removal of import quotas and reduction of tariffs (elimination of subsidies and other forms of protection and regulatory distortions on relative prices); putting government-owned trading entities on a commercial footing; extensive privatization of government-owned enterprises; major taxation reform to reduce distortions and create more efficient incentive structures; and greater transparency in the setting and operation of fiscal policy. Key transport sectors (land, sea and air) were also deregulated and measures were taken to promote a more flexible labor market. More recently, corporate law reforms have been undertaken to strengthen corporate governance and encourage greater financial disclosure by corporations. The Securities Amendment Act 2002, the Takeovers Amendment Act 2002 and the Securities Markets Amendment Act 2002 were passed on 1 December 2002 (Securities

Markets and Institutions Bill). The purpose of the bill was to promote confidence in the New Zealand market by increasing the effectiveness and efficiency of the law and regulatory institutions governing securities markets and aligning the law with international best practice.

Papua New Guinea's Structural Reform Program in the 2003 budget emphasized macroeconomic stability, international competitiveness, price and trade liberalization, taxation reforms, investment policy reforms, public expenditure management, and decentralization of responsibilities and finances from the national to the provincial and district levels.

Canadian economic efficiency and the competitiveness of the tax system has been significantly improved in recent years. In 2000, the government set out a plan to reduce taxes by US$100 billion over five years—the largest tax cut in Canadian history. The government's plan provided significant personal income tax reductions and strengthened the foundation for economic growth and job creation by creating a competitive environment for business investment. Specifically, all personal income tax rates were lowered and full indexation of the tax system was reinstated. By 2004–05, when the plan is fully implemented, federal personal income taxes will have been reduced by 21 percent on average. Canada has also implemented a number of significant structural reforms to its financial sector regulatory framework. For example, in 1999, Canada implemented a new foreign bank branch regime as well as a demutualization regime for the life and health insurance industry. In 2001, it implemented a new policy framework with a view to fostering the competitiveness of the sector, streamlining regulation and protecting consumers. Important changes included a new ownership regime for banks and the opening up of the payments system. Over the last three years, Canada has also put in place an anti-money-laundering and anti-terrorist regime that meets international standards and ranks near the top of a list of our international partners.

The *Chilean* government's structural reform policies aim at broadening the foundations for long-term growth and building social consensus. The government has developed and implemented a modern social agenda and, in particular, has guided its efforts to improve access to equity and efficiency in health and education while giving more explicit consideration to their links with economic growth. The government introduced a new fiscal rule in 2000 (the structural budget surplus rule) that puts a cap on expenditure with a view to maintaining a surplus of the structural budget of 1.0 percent of the GDP. This rule allows the government to pursue some degree of counter-cyclical fiscal policy, within prudent margins. In financial capital markets, the Chilean government is developing structural reforms to improve the institutional features to protect creditor and debtor rights. Progress in financing to SMEs is also a major area of the reforms implemented. Since 2001, a package of reforms has been adopted in order to modernize the capital market, and in 2003, tax and deregulatory measures were adopted to stimulate the development of the capital market.

Mexico's National Development Plan (PND), which was presented on 29 May 2001, contains a set of structural reforms to be implemented during the current administration. The objectives and economic impact of the financial, fiscal and budgetary reforms proposed are the following:

Table 1.10: Mexico's National Development Plan (PND)

Reforms	Objectives	Economic Impact
Financial Reform	▪ Promote domestic savings, with emphasis in popular and long-term savings. ▪ Speed the modernization of the financial system and facilitate the reactivation of bank lending. ▪ Deepen domestic stock and debt markets. ▪ Modernize development banks in order to accelerate the achievement of the social an economic goals set forth in the PND	▪ Increases domestic saving in a sustained and permanent basis. ▪ Establishes a more competitive financial system and provides more financing options to the private sector. ▪ Reduces the risk of systemic crises ▪ Increases the informational content of financial asset prices. ▪ Promotes the efficient allocation of resources to productive investment.
Fiscal Reform	▪ Maintain a solid fiscal stance and promote an allocation of resources that favors social and investment projects. ▪ Increase permanent and current expenditure. ▪ Reduce the dependency on oil-related revenues. ▪ Ameliorate the crowding-out of private investment. ▪ Improve tax compliance sources of revenue in order to attend social needs.	▪ Reduces the absorption of financial resources and increases the amount of resources available for private investment. ▪ Decreases the volatility of public sector income by limiting the government's dependence on oil-related revenues. ▪ Decreases the vulnerability of the economy to speculative attacks. ▪ Reduces the size of the informal sector of the economy. ▪ Diminishes economic distortions and generates a more competitive economic environment. ▪ Strengthens regional development. ▪ Increases the ability of the state to support social needs.
Budgetary Reform	▪ Modernize the budgetary approval process and its execution. ▪ Establish rules on medium-term fiscal policy. ▪ Increase the efficiency of public sector expenditures. ▪ Improve the account rendering process.	▪ Allows for the implementation of contra-cyclical polices in the medium term. ▪ Provides certainty over the medium-term fiscal stance. ▪ Strengthens the evaluation process of public expenditures. ▪ Increases the transparency of fiscal policy management.

In *Russia*, there has been some progress on structural reform. Electricity reform made substantial progress as the Duma approved the plan to split the monopoly electricity company along functional lines and to introduce competition in the sector. While the situation for small and medium-sized enterprises remains difficult, deregulation policies recently approved have led to some improvement in the business climate. The current revision of the bankruptcy law should help to make property rights more secure. There has also been some recent progress on railway and pension reform and the government has started to tackle regulatory, administrative and military reforms. While the reform process is taking time, the recent large investment by British Petroleum in the Russian oil sector suggests improving confidence among the international business community in the capacity of the current government to deliver on reforms.

3.4 Prospects for an Economic Recovery

The world economy is expected to head for another US-led rebound over this year and the next year. We expect the US economy to improve gradually in the coming months and rebound strongly by the end of this year. Its rebound should provide enough sparks to boost economic growth in the APEC region as well as in the rest of the world, particularly in Asia (except Japan) and Oceania.

The SARS outbreak has been brought under control and as the military situation in Iraq stabilizes, we expect the global economy to regain its strength gradually. The rapid end of the war in Iraq has already significantly improved the economic prospects of the United States, the Middle East and the rest of the world and has discouraged OPEC from pushing up oil prices. It is worth noting that the 25.0 percent post-Iraq decline in global oil prices by itself is a major boost to consumer discretionary income and business profits. The favorable outcome of the Iraq war has also reduced the geopolitical uncertainties that have been depressing consumer and business confidence for the past two years.

In terms of policy direction, monetary and fiscal easing in several countries, notably the United States, will continue to support demand, in a context of declining core inflation. If oil prices remain around US$25 per barrel, economic activities are expected to regain growth momentum.

OECD (June 2003) revealed the projections that real GDP in OECD would grow 2.5 percent in 2003 and 4.0 percent in 2004, compared to 2.4 percent in 2002. It also projected that world trade growth rates would be 5.9 percent this year and 8.8 percent next year, compared to 3.6 percent last year. The IMF (May 2003) is forecasting that the world economy will grow 3.2 percent and 4.1 percent in 2003 and 2004, respectively, up from 3.0 percent in 2002.

Disinflation is likely to continue in the near future. Inflation is generally low or decreasing in core terms. Although US inflation has tended to pick up a little, reflecting rising energy prices and stronger import prices resulting from a weaker dollar, it will remain moderate. As higher energy prices unwind, inflation should slow, consistent with the negative output gap prevailing over the entire projection period. In Japan, deflation is not expected to abate and the consumption deflator should continue to decline by about 1.5 percent per year.

Reflecting the uneven recovery, current account imbalances are projected to widen among members. The US current account deficit is set to rise by 0.7 percent of GDP between 2002 and 2004 to 5.5 percent of GDP, while the Japanese and euro area surpluses would increase by 1.0 percent and 0.2 percent of GDP respectively over the same period.

The United States economic growth is projected to pick up in 2003. The consensus of private forecasters, as of August 2003, is that there will be 2.3 percent GDP growth for the 2003 calendar year. In addition, private forecasters are predicting growth of 3.7 percent in 2004, in line with the administration's forecast of 3.7 percent. The growth rate of the economy over the long run is determined primarily by the growth rates of its supply-side components, which include population, labor force participation, productivity and the work week. Non-farm labor productivity is expected to grow at 2.1 percent a year on average, and the labor force is expected to grow at 1.0 percent at an annual rate.

The *Japanese* economy is not expected to sustain the growth performance recorded in 2002, when it grew by 2.5 percent during the year (but 0.3 percent year-on-year). Going forward, growth is expected to average 1.0 percent in 2003–2004, driven largely by exports as subdued wage growth and deteriorating employment prospects restrain household spending. Deflation nonetheless is expected to persists over the period and interest rates will remain low. With continuing large structural fiscal deficits of up to 8.0 percent of GDP, in part reflecting the ongoing fiscal costs associated with population aging, public debt continues to accumulate at an unsustainable rate.

Growth in *Asian member economies (except Japan)* should rebound in 2003 with OECD markets recovering. For the Asian APEC area as a whole, the current account balance remains in small deficit over the medium term, although in the absence of major changes in potential growth rates or trade openness and at broadly unchanged real exchange rates, there is little overall adjustment in the current external imbalances between regions.

China's major anticipated targets for economic and social development in 2003 are: an economic growth rate around 7.0 percent; an increase of the consumer price level by 1.0

percent; an increase to China's foreign trade by 7.0 percent; new job creation of no less than 8 million jobs; registered unemployment in urban areas of under 4.5 percent; and natural population growth of under 0.75 percent.

Table 1.11
Forecasts of GDP Growth (percent)

	2002	2003				2004				Medium-term	
		Official	IMF	OECD	ADB	Official	IMF	OECD	ADB	Official	GI*
Western Hemisphere											
Canada	3.4	3.2	1.9	2.7	–	3.5	3.0	3.4	–	3.0	3.1
Chile	2.0	3.6	3.3	–	–	4.2	4.5	–	–	3.0	5.5
Mexico	0.9	3.0	1.5	2.5	–	–	3.5	3.9	–	–	4.2
Peru	5.3	4.0	4.0	–	–	4.0	4.0	–	–	4.5	5.3
The United States	2.4	2.9	2.6	2.5	–	3.7	3.9	4.0	–	3.3	3.3
Northeast Asia											
China	8.0	7.0	7.5	7.7	7.3	–	7.5	7.1	7.6	7.0	6.6
Hong Kong, China	2.3	2.0	1.5	–	2.0	–	2.8	–	4.0	3.0	4.9
Japan	0.2	0.6	2.0	1.0	–	–	1.4	1.1	–	1.5over	2.0
Korea	6.3	3.1	2.5	5.2	4.0	–	4.7	6.0	5.3	–	6.0
Chinese Taipei	3.6	3.1	2.7	–	3.7	3.8	3.8	–	3.9	–	5.1
Southeast Asia											
Brunei Darussalam	3.2	3.2	5.1	–	–	4.5	0.1	–	–	–	2.4
Indonesia	3.7	3.5-4.0	3.5	–	3.4	–	4.0	–	4.0	–	5.3
Malaysia	4.2	4.5	4.2	–	4.3	–	5.3	–	5.1	7.5	5.3
The Philippines	4.4	4.2-5.2	4.0	–	4.0	4.9-5.8	4.0	–	4.5	5.8-6.7	5.5
Singapore	2.2	0-1.0	0.5	–	2.3	–	4.2	–	4.2	–	3.7
Thailand	5.2	4.5-5.5	5.0	–	4.2	–	5.1	–	5.5	5.0-5.5	5.4
Viet Nam	7.0	7.3	6.0	–	6.9	–	7.0	–	7.1	7.5	7.3
Oceania											
Australia	3.6	3.0	3.0	3.2	–	3.3	3.5	3.8	–	3.5	3.4
New Zealand	4.4	2.7	2.6	3.1	–	2.7	2.9	2.9	–	3.0	3.6
Papua New Guinea	-0.5	2.7	2.5	–	1.0	–	2.3	–	2.0	2.5	4.5
Russia	4.3	5.9	6.0	5.0	–	5.2	5.0	3.5	–	5.9	3.9
APEC	2.4	2.7	–	–	–	–	–	–	–	–	–
World	1.9	–	3.2	–	–	–	4.1	–	–	–	3.3

Note: *GI stands for Global Insight.

Sources: Individual Economy Reports; ADB, *Asian Development Outlook*, April 2003; Global Insight Inc., *World Outlook*, June 2003; IMF, *World Economic Outlook*, September 2003; OECD, *OECD Economic Outlook*, June 2003.

Table 1.12
Forecasts of Consumer Price Inflation (percent)

	2002	2003				2004				Medium-term	
		Official	IMF	OECD	ADB	Official	IMF	OECD	ADB	Official	GI*
Western Hemisphere											
Canada	2.3	2.4	2.8	3.7	–	2.2	1.7	2.1	–	1.8	1.6
Chile	2.5	2.5	3.4	–	–	2.4	3.0	–	–	–	3.0
Mexico	5.7	3.0	4.6	4.4	–	–	3.4	3.5	–	–	3.8
Peru	0.2	1.5	2.5	–	–	2.5	2.5	–	–	2.5	2.4
The United States	1.6	2.3	2.1	2.4	–	1.7	1.3	1.7	–	2.2	2.2
Northeast Asia											
China	-0.8	1.0	0.8	–	0.5		1.5	–	1.0	3.5	4.6
Hong Kong, China	-3.0	-3.0	-2.6	–	-1.5	–	-1.9	–	0.5	–	1.2
Japan	-0.9	-0.4	-0.3	-0.9	–	–	-0.6	-1.0	–	1.0	0.4
Korea	2.7	3.5	3.3	3.7	4.0	–	3.0	3.3	3.5	–	3.8
Chinese Taipei	-0.2	-0.1	0.1	–	0.4	0.5	0.8	–	0.6	–	1.6
Southeast Asia											
Brunei Darussalam	-2.3	-2.3	1.0	–	–	–	1.3	–		–	3.0
Indonesia	10.0	9.0	6.6	–	10.0	–	5.4	–	8.5	–	5.6
Malaysia	1.8	1.5	1.7	–	1.9	–	2.2	–	2.2	–	2.6
The Philippines	3.1	4.0-4.5	3.0	–	4.5	4.0-5.0	3.4	–	4.5	–	6.0
Singapore	-0.4	0.5-1.0	0.6	–	0.5	–	1.2	–	1.0	–	2.0
Thailand	0.6	1.6	1.4	–	1.3	–	0.1	–	1.6	2.4	2.3
Viet Nam	4.0	5.7	4.0	–	5.0	–	3.5	–	5.0	–	5.4
Oceania											
Australia	3.0	3.3	2.9	2.5	–	2.8	2.3	2.5	–	2.5	2.8
New Zealand	2.7	2.0	2.0	2.0	–	1.7	2.0	2.0	–	2.0	2.8
Papua New Guinea	14.8	13.8	17.2	–	9.0	–	8.0	–	5.0	–	8.1
Russia	15.1	12.0	14.4	14.0	–	–	12.9	–	–	–	10.3

Note: *GI stands for Global Insight.

Sources: Individual Economy Reports; ADB, *Asian Development Outlook*, April 2003; Global Insight Inc., *World Outlook*, June 2003; IMF, *World Economic Outlook*, 2003; OECD, *OECD Economic Outlook*, June 2003.

Table 1.13
Forecasts of Budget Balances (percent of GDP)

	2002	2003		2004	
		OECD	ADB	OECD	ADB
Western Hemisphere					
Canada	1.3	1.1	–	1.0	–
Chile	-0.8	–	–	–	–
Mexico	-1.2	–	–	–	–
Peru	-2.3	–	–	–	–
The United States	-2.4	-4.6	–	-4.2	–
Northeast Asia					
China	-3.0	-3.0	-2.8	-3.2	-2.6
Hong Kong, China	-4.9	–	-5.7	–	-4.2
Japan	N.A.	-7.7	–	-7.8	–
Korea	3.8	3.4	1.0	3.9	2.0
Chinese Taipei	-3.0	–	-2.5	–	-2.5
Southeast Asia					
Brunei Darussalam	-4.2	–	–	–	–
Indonesia	-1.7	–	-1.8	–	0.0
Malaysia	-5.6	–	-4.0	–	-2.5
The Philippines	-5.2	–	-4.5	–	-4.0
Singapore	-0.1	–	-0.6	–	2.5
Thailand	-2.9	–	-2.2	–	-2.0
Viet Nam	5.0	–	-5.3	–	-4.6
Oceania					
Australia	-0.1	0.2	–	0.5	–
New Zealand	1.9	0.8	–	0.5	–
Papua New Guinea	-3.8	–	–	–	–
Russia	1.4	0.1	–	1.0	–

Sources: Individual Economy Reports; ADB, *Asian Development Outlook*, April 2003; OECD, *OECD Economic Outlook*, June 2003.

Table 1.14
Forecasts of Export Increase (percent)

	2002	2003				2004			
		Official	**OECD**	**ADB***	**GI***	**Official**	**OECD**	**ADB***	**GI***
Western Hemisphere									
Canada	0.8	–	4.4	–	2.7	–	7.3	–	0.3
Chile	1.3	–	–	–	6.0	–	–	–	6.7
Mexico	1.4	10.4	5.2	–	-1.7	–	8.2	–	9.9
Peru	6.3	13.6	–	–	6.5	8.3	–	–	6.1
The United States	-1.6	–	4.0	–	8.5	–	9.0	–	11.7
Northeast Asia									
China*	22.3	–	–	8.3	13.5	–	–	9.2	16.5
Hong Kong, China	9.2	7.8	–	6.5	6.4	–	–	6.2	6.8
Japan	8.2	1.8	7.7	–	11.3	–	9.4	–	6.8
Korea	14.9	10.5	12.8	8.0	12.3	–	11.9	8.0	6.6
Chinese Taipei*	6.3	7.1	–	7.4	7.1	7.5	–	7.8	7.5
Southeast Asia									
Brunei Darussalam	-0.7	–	–	–	–	–	–	–	–
Indonesia	-1.2	1.0-1.5	–	3.0	5.1	–	–	5.5	7.7
Malaysia	3.6	7.0	–	8.1	8.2	–	–	10.2	6.5
The Philippines	3.6	5.2-5.7	–	6.0	7.4	4.6-5.1	–	7.0	6.4
Singapore*	3.2	–	–	7.5	11.8	–	–	10.2	10.9
Thailand	10.9	8.0	–	6.6	9.1	–	–	7.5	7.1
Viet Nam	11.3	14.8	–	9.1	15.4	–	–	8.4	13.1
Oceania									
Australia	-0.2	0.0	3.4	–	4.8	6.0	8.4	–	5.1
New Zealand	4.3	5.0	4.6	–	9.4	4.9	6.4	–	8.5
Papua New Guinea	-14.7	–	–	–	–	–	–	–	–
Russia	10.2	–	–	–	4.5	–	–	–	1.0

Note: * Based on merchandise exports.
Sources: Individual Economy Reports; ADB, *Asian Development Outlook*, April 2003; Global Insight Inc., *World Outlook*, June 2003; IMF, *World Economic Outlook*, April 2003; OECD, *OECD Economic Outlook*, June 2003.

Table 1.15
Forecasts of Import Increase (percent)

	2002	2003				2004			
		Official	**OECD**	**ADB***	**GI***	**Official**	**OECD**	**ADB***	**GI***
Western Hemisphere									
Canada	0.8	–	6.1	–	5.2	–	7.3	–	3.3
Chile	0.5	–	–	–	8.2	–	–	–	8.2
Mexico	1.6	8.3	4.8	–	1.4	–	8.2	–	10.4
Peru	2.5	9.9	–	–	5.4	5.2	–	–	7.7
The United States	3.7	–	6.4	–	8.2	–	9.0	–	4.2
Northeast Asia									
China*	21.2	–	–	1.0	17.6	–	–	14.0	18.2
Hong Kong, China	7.1	5.7	–	5.9	6.9	–		6.7	7.1
Japan	2.0	1.6	3.6	–	13.4	–	4.2	–	7.3
Korea	16.4	15.0	11.4	9.0	15.8	–	11.9	9.0	9.4
Chinese Taipei*	4.9	9.8	–	11.5	8.8	8.2	–	10.0	8.7
Southeast Asia									
Brunei Darussalam	-0.5	-18.1	–	–	–	–	–	–	–
Indonesia	-8.3	1.7-2.2	–	1.0	16.7	–	–	4.5	9.3
Malaysia	6.1	7.1	–	8.8	10.1	–	–	11.3	8.7
The Philippines	4.7	5.0-5.5	–	5.0	9.9	8.5-9.0	–	5.8	13.6
Singapore*	0.1	–	–	9.8	15.3	–	–	11.6	16.1
Thailand	11.3	9.9	–	7.0	10.0	–	–	8.0	7.3
Viet Nam	19.4	16.7	–	13.1	15.0	–	–	12.0	13.7
Oceania									
Australia	11.5	13.0	6.9	–	7.0	6.0	8.2	–	8.5
New Zealand	8.7	9.9	*6.3*	–	9.6	5.0	5.6	–	8.3
Papua New Guinea	-12.8	–	–	–	–	–	–	–	–
Russia	19.1	–	–	–	6.9	–	–	–	4.6

Note: * Based on merchandise imports.
Sources: Individual Economy Reports; ADB, *Asian Development Outlook*, April 2003; Global Insight Inc., *World Outlook*, June 2003; IMF, *World Economic Outlook*, April 2003; OECD, *OECD Economic Outlook*, June 2003.

Table 1.16 Forecasts of Current Account Balances (percent of GDP)							
	2002	2003			2004		
		OECD	IMF	ADB	OECD	IMF	ADB
Western Hemisphere							
Canada	1.5	2.0	1.6		2.2	1.6	–
Chile	-0.8	–	–	–	–	–	–
Mexico	-2.2	-2.5	–	–	-2.8	–	–
Peru	–	–	–	–	–	–	–
The United States	-4.8	-5.4	-5.1	–	-5.5	-4.7	–
Northeast Asia							
China	1.5	1.3	4.6	1.6	1.1	3.4	1.5
Hong Kong, China	10.9	–	13.9	11.5	–	14.3	8.5
Japan	2.9	3.1	2.9	–	3.9	2.9	–
Korea	1.3	0.3	1.6	0.0	0.2	1.8	-0.3
Chinese Taipei	9.1	–	8.5	7.9	–	8.8	8.0
Southeast Asia							
Brunei Darussalam	86.5	–	–	–	–	–	–
Indonesia	3.9	–	–	3.0	–	–	3.3
Malaysia	7.6	–	–	6.3	–	–	5.7
The Philippines	5.4	–	–	2.0	–	–	2.5
Singapore	21.5	–	23.7	21.5	–	23.0	19.3
Thailand	6.1	–	–	4.1	–	–	4.5
Viet Nam	-2.8	–	–	-3.7	–	–	-5.2
Oceania							
Australia	-4.4	-3.9	-5.2	–	-3.7	-4.8	–
New Zealand	-3.1	-4.6	-3.7	–	-4.6	-4.1	–
Papua New Guinea	-1.1	–	–	–	–	–	–
Russia	9.5	8.5	–	–	5.5	–	–

Sources: Individual Economy Reports; ADB, *Asian Development Outlook*, April 2003; IMF, *World Economic Outlook*, September 2003; OECD, *OECD Economic Outlook*, June 2003.

The forecast growth rate (in real terms) of *Hong Kong, China's* GDP for 2003 is now put at 2.0 percent. Overall economic activity began to bottom out towards the end of May, and has been turning progressively better in the ensuing months. *Hong Kong, China's* economy should continue to pick up in the rest of the year. The external sector should provide the main driver of growth on the back of firmer global demand, continued strong growth in China's economy, and the envisaged rebound in inbound tourism from the earlier severe setback. The domestic sector likewise looks set to recover as the impact of SARS dissipates and local consumer sentiment improves.

During 2003, *Korea's* GDP growth is forecast to stand at 3.1 percent and consumer price inflation at an average of 3.5 percent (core inflation of 3.2 percent) with a current account surplus of around US$2 billion. In the latter half of the year, GDP growth should increase while consumer prices slow their upward pace and the current account moves toward surplus. The unemployment rate is expected to reach 3.4 percent because of the recent economic slowdown.

As the upswing in domestic and foreign demand gains strength, *Chinese Taipei's* GDP growth rate is projected to rise to 3.1 percent in 2003, accompanied by continued price stability. Chinese Taipei's foreign trade will increase moderately in 2003 driven by the expansion of global trade. Merchandise exports and imports are forecast to grow 7.1 percent and 9.8 percent respectively, generating a trade surplus of US$16.3 billion. Trade of goods and services is projected to register real growth of 7.1 percent in exports and 5.1 percent in imports. Under the impact of the rising trend in international crude oil and raw-material prices, the growth rate of Chinese Taipei's wholesale price index is projected to climb to 2.2 percent in 2003. However, domestic market opening and tariff reduction as part of Chinese Taipei's WTO commitments will underpin the stability of consumer prices, which are forecast to show annual fall of 0.1 percent. Chinese Taipei will face increasing deflationary pressure.

Prospects for the recovery of the *Indonesian* economy are expected to improve slightly in 2003. Healthier indicators for monetary and macroeconomic stability should be maintained in 2003, enhancing market confidence over the course of economic recovery. As improved macroeconomic indicators are forecast to continue next year, overall economic growth in 2003 is projected at 3.5 percent to 4.0 percent, mainly due to private and government consumption. During 2004 and 2005 Indonesian economic growth is projected to grow around 4.0 percent to 5.5 percent. *Indonesia's* inflationary pressures in 2003 are forecast to ease further. There would be limited pressures from aggregate demand, a stronger exchange rate and lower inflationary expectations.

Singapore's economic performance in the first half of 2003 was affected by uncertainties arising from the war in Iraq and the outbreak of SARS. With the successful containment of SARS in Asia and elsewhere, most of the economic uncertainties have lifted. Business sentiments have thus improved and equity markets have rebounded. The external environment is also expected to pick up in the second half of 2003. Barring further unfavorable shocks, the Singapore economy is expected to grow by 0.0 to 1.0 percent in 2003.

With economic fundamentals remaining strong, as well as timely actions and pro-growth policies, *Malaysia's* GDP growth has the potential to be sustained at a rate of at least 4.5 percent in 2003. This projection is based on a modest world economic growth, some pick-up in the global electronics industry, and firm commodity prices. The estimate is also based on the expected pick-up in intra-regional trade in the second half of 2003, as governments in the region have announced economic relief packages to mitigate the impact of SARS and strengthen economic activities.

The *Thai* economy is expected to grow strongly at the rate of 4.5 percent to 5.5 percent in 2003, mainly led by the robustness of both domestic and external demand. The preliminary economic data in the first quarter posted the growth of 6.7 percent that was much greater than expected, as the impact of the US-war in Iraq seemed to be less. Also, the Thai economy has not been adversely affected by the SARS epidemic as previously predicted. It turned out that the impact of SARS was limited to April and the economy started to pick up in May. The accommodative monetary and fiscal policies, together with other government stimulus measures, will continue to accommodate growth.

The Philippines' economy is expected to sustain its growth momentum of 2002 with GDP projected to grow by 4.2 percent to 5.2 percent and GNP by 4.5 percent to 5.4 percent in 2003. The growth forecasts, however, are lower than was earlier projected amidst uncertainties in the global and domestic fronts. Agriculture is expected to grow 3.0 percent to 4.0 percent in 2003 as the government continues to implement *El Niño*-mitigating measures and other productivity enhancement measures like the distribution of high-yielding seeds. Other policies and program efforts will also be pursued to enhance agriculture lending and investments. Meanwhile, industry is projected to grow by 3.4 percent to 4.4 percent in 2003. Policies to boost mining, housing, and small and medium enterprises will support industrial growth in 2003.

Viet Nam's medium-term growth is expected to remain robust as domestic demand continues to expand. GDP is projected to grow 7.3 percent in 2003 and rise to around 7.5 percent in coming years.

Brunei Darussalam's economy is expected to grow by 4.5 percent in 2003 down from the earlier forecast of 5.0 percent to 6.0 percent. The population will continue to grow at a moderate growth rate of between 2.2 percent and 2.5 percent in the years ahead. Similarly, employment, migrant workers, and the unemployment rate will also expect to grow: by 2.5 percent, 5.0 percent and 8.0 percent, respectively.

For 2003–04, *Australia's* economic growth is forecast at 3.2 percent in year-average terms, with slower growth in non-farming production likely to be more than offset by a rebound in farming production. Employment growth is likely to slow after the very strong growth of 2002–03, with the unemployment rate remaining at around 6.0 percent over the coming year. Inflation is expected to decline to around the middle of the target band. The current account deficit as a share of GDP should narrow a little as the pace of domestic demand eases and global conditions gradually improve through the year. The headline CPI is forecast to slow to 2.2 percent in the year to June 2004, down from around 3.2 percent expected in the year to June 2003 and within the medium-term inflation target band. In 2003–04, the net export position is expected to improve, subtracting around 0.2 of a percentage point from GDP growth, down from an expected subtraction of 2.7 percentage points in 2002–03. The recovery in exports should be underpinned by subdued global growth and an assumed breaking of the drought, while the slowdown in imports reflects an expected slowdown in domestic demand. The current account deficit should narrow a little in 2003–04 to around 5.2 percent of GDP from around 5.7 percent of GDP in 2002–03.

Over the medium term, the *New Zealand* economy is expected to record GDP growth of about 3.0 percent, although the economy faces a number of 'headwinds' that are expected lead to a modest slowing in growth over the coming year. The fall in the commodity prices last year, moderate trading partner growth, the higher exchange rate, and the unwinding of an earlier interest rate stimulus are the main forces operating to slow growth. As these temporary factors recede in the latter part of the year, growth is expected to pick up, with domestic demand supported by lower interest rates and external demand boosted by trading partner growth returning to trend in 2004. Consumer price inflation is expected to remain inside the 1 percent to 3 percent target range over 2003 and 2004, the result of offsetting trends in tradables (staying low) and non-tradables inflation (staying high).

Economists expect *Canadian* real GDP growth will average close to 2.8 percent and 3.3 percent in 2003 and 2004, respectively. This is somewhat lower than earlier private sector estimates (incorporated in the February 2003 Budget) of 3.2 percent and 3.5 percent growth. Growth is expected to average around 3.0 percent after 2004. With the expected continued declines in energy prices and the disappearance of the impact of the insurance premium hikes, the Bank of Canada's latest *Monetary Policy Report* predicts core inflation to average around 2.5 percent in the second half of 2003. Core prices are projected to move down to about 2.0 percent and total CPI inflation is projected to fall below 2.0 percent by early 2004. Inflation is expected to remain at 2.0 percent (the mid-point of the Bank of Canada's inflation target bands) over the medium-term.

In *Chile*, specifically, unit labor costs and foreign inflation in US dollars are expected to rise more in the coming quarters than they did in the past two years. This would push core inflation, excluding regulated rates, gradually upward to around 3.0 percent in 2004, to the point where goods and factor market conditions permit the decompression of margins and reduce slack in the labor market.

Mexico's economic projections in the 2003 Economic Program project a real GDP growth rate of 3.0 percent; an inflation rate no higher than 3.0 percent; a current account deficit to GDP ratio equivalent to 2.8 percent; and an oil export platform of 1.86 million barrels per day. In the presence of lower external demand growth, the economic strategy for 2003 focuses on strengthening domestic sources of growth. Investment is expected to be the most dynamic component of aggregate demand, driven by relatively low levels of interest rates and the strong promotion of public projects.

Russia expects to maintain improved economic performance, robust economic growth, alleviated inflation, healthy fiscal position, and a stable balance of payments. The main contributing factors are growing investment in oil and utilities and strong private consumption. Despite high oil-driven capital inflows, inflation should continue to decline gradually, supported by the ongoing real appreciation of the ruble. Continuing strong domestic demand will sustain robust real GDP growth in 2003.

3.5 Summary and Risks

In this chapter, we reviewed recent development and future prospects on the APEC economy as well as the global economy. The global economy's cyclical rebound faced fresh difficulties and slowed temporarily in the first quarter of this year as the result of geopolitical uncertainties, high oil prices and the SARS outbreaks. In spite of monetary and fiscal easing in many economies, these difficulties brought about some loss of business and consumer confidence. Such an environment led to a new round of business cost-cutting and thin profit margins, labor market weakness, fragile growth, and hesitant international transactions and exchanges, resulting in the temporary slowdown of economic activities domestically and globally.

Looking forward, as the war in Iraq and SARS outbreaks are expected to end in the second quarter of 2003, the world economy is expected to head for a US-led rebound over the next few years. We expect the US economy to improve gradually to rebound by the end of this year. Its rebound should provide enough sparks to boost economic growth in the APEC region, particularly in Asia (except Japan) and Oceania. Supported by expansionary macroeconomic policies and low prices of oil and non-fuel primary commodities, a stronger recovery will finally get underway before the end of 2003 and then shift into a higher speed with sustainable strength next year. World trade will accelerate much faster over the next two to three years than it did in the last two to three years, and this in turn will contribute to economic growth.

However, many institutions and analysts are projecting the economic condition will improve only gradually. The APEC economy is expected to grow 2.5 percent in 2003 and 3.5 percent in 2004. Against this conservative outlook, the following factors remain that will restrain brisk recovery.

First, a major cyclical risk is that private consumption could wane before investment recovers. As consumers in many economies are saddled with heavy debts, business spending in this cycle is not expected to grow as briskly as in the previous business cycles. Weak consumption growth forecasts reflect the trend of worsening employment and sluggish income growth, and the recent pattern of deferring consumption during a period of deflation.

Second, considering the already-swollen fiscal deficits in major economies, there will be little room for maneuver left to increase discretionary public expenditure to stimulate domestic economies. Fiscal deficits in the OECD will reach 3.5 percent of GDP in 2003. The deterioration in the fiscal position has been particularly marked in the United States. Adjusting for the activity cycle, the change from 0.9 percent in 2001 to minus 2.9 percent in 2002 amounted to 3.8 percentage points of GDP. This constitutes the largest two-year fiscal expansion in decades and has brought concerns of longer-run fiscal sustainability. The US federal budget deficit is expected to rise to about 4.0 percent this year and next year, while the administration projects that the deficit will decline to 1.7 percent of GDP in 2008 under its policy proposals. Japan's fiscal status is also worrying, with a deficit again exceeding 7.0 percent of GDP in 2002 and a rapidly rising gross public debt ratio, which exceeded 14.0 percent of GDP at the end of 2002.

Third, another risk to the economic recovery is the trend of diverging external imbalances and the required exchange-rate adjustment process for major economies. In particular, the large current account deficit in the United States continues to rise and is set to widen to 5.5 percent of GDP by 2004. In contrast, Japan's current account surplus is expected to widen to 3.9 percent of GDP in 2004 from 2.1 percent in 2001.

Fourth, recognizing that after 11 September 2001 the recovery of the APEC economy has been very dependent on the US economy, more so than that of other regions, the possibility of sharp depreciation of the US dollar may be a major concern in this region. The trend of US current account deficits and the aggressive stance for improving external deficits could bring about serious concerns over trade disputes and tension on exchange-rate adjustments between US and other economies with huge trade surpluses. The US dollar has already depreciated substantially since March 2002. Furthermore, with the allegation that Asian trade partners have been implicitly manipulating exchange rates, the US and the EU are putting pressure on Asia to appreciate their currencies up to the level that reflects market forces. Such pressure on currency revaluation, and some other trade conflicts with anti-dumping and countervailing duties by major economies, could depress trade growth and economic recovery in the APEC region.

Fifth, geopolitical tension remains a latent source of major risks to future economic recovery. Although the military conflict in Iraq has largely abated, the international community may face new regional uncertainties from the Arab-Israeli conflict and the North Korean nuclear crisis. In particular, the deterioration of the nuclear issue and geopolitical instability in the Northeast Asia might have a negative effect on the international financial flows and external trade of the economies in the region.

CHAPTER 2

ROLE AND DEVELOPMENT OF SPECIALIZED FINANCIAL INSTITUTIONS

SECTION I: INTRODUCTION

Several aspects of financial development were studied in the past few years for a structural chapter in the APEC Economic Outlook undertaken by the Economic Committee (EC). In 2002, the topic of "Microbanking Development, Regulation, and Supervision" was examined and highlighted that microbanking activities are necessary, with varying degrees of importance, for the socio-economic development of both developed and developing economies. Microbanking activities particularly contribute to the five key areas: poverty reduction and safety nets; micro and small enterprises' development; rural development; gender considerations; and community empowerment. The study states that specialized financial institutions (SFIs) are one of the institutional features of microbanking, and they play a vital role in the APEC community.

In addition to the result of the 2002 study, the impact of SFIs on the economy as a whole has been significant since the emergence of the economic crisis in 1997. Evidents have proven that they helped in reviving the economy and cushioning the social impacts of the economic downturn in several APEC economies. In particular, SFIs played a leading role in providing funds to the grass-root and small businesses when normal lending is unavailable during the financial turmoil. Their role has become more recognised and considered to be an outstanding alternative to commercial banks for those who lacked access to other formal sources of credit.

Consequently, this has raised the questions of what are roles of specialized financial institutions, and why do they seem to fill the gaps in imperfect financial markets regardless of their stage of economic advancement. Therefore, the 2003 structural chapter of the Economic Outlook will focus on an institutional aspect of financial development, with an emphasis on "The Role and Development of Specialized Financial Institutions". The study is pursued to explore the role and development of specialized financial institutions in greater detail with the ultimate aim of delivering best practices of SFIs.

The Definition of Specialized Financial Institutions (SFIs)

The definition of specialized financial institutions (SFIs) is very broad and vague since there are a number of entities which have been established to operate certain services not offered by traditional financial institutions such as commercial banks. In the context of this study, SFIs are institutions established to provide various financial services to certain sectors of the economy. They usually work in markets that have not been adequately served by traditional financial institutions. In particular, they aim to be a source of funds for a specific group of potential customers, including those involved in agriculture, small and medium enterprises (SMEs), real estate and housing, exports, and offer a repository for savings, as well as help alleviate social problems. They may also offer a wide range of other services to customers who are neglected by traditional financial institutions. They conduct these activities under specific legislation and regulations. The institutions can be either government-sponsored or purely independent and self-sufficient. They may have an independent supervisory agency, and different prudential standards from commercial banks.

In other words, this study is centered on formal entities or institutions, which provide special services to their target customers to develop of different sectors of the economy: the informal institutions and mechanisms are excluded from this study.

The Scope of the Study

This study aims to present a descriptive survey, assessing the state of specialized financial institutions (SFIs) in the Asia Pacific region, as well as their regulatory and supervisory framework, and their role in the social and economic development of the APEC economies. The focus is on regulated institutions whose services have driven economic growth. These institutions are recognized by the member economy governments and related authorities. However, due to a lack of information, the details of each SFI are not included in this study. The study incorporates information from nine APEC economies, provided as inputs for drafting this paper through the completing of two questionnaires: Type A for government authorities and Type B for SFIs. The participating economies are Australia; Canada; Indonesia; Hong Kong, China; Japan; Mexico; the Philippines; Chinese Taipei; and Thailand.

The Outline of the Study

This paper is divided into four sections. The first section presents the literature review of the presence of SFIs in the financial system of both developed and developing economies. It examines the needs and evolution of SFIs in economies at different stages of development. The second section explores the state of SFIs of individual APEC economies. The topics covered are a brief history, objectives and scope of operations, supervisory and regulatory regimes, and the role of SFIs in the socio-economic development of the respective economies. The third section is the comparative study of the state of SFIs in APEC economies. It also discusses the importance of SFIs, the level of government intervention in SFIs, the difficulties faced by SFIs and the economic and social impacts of SFIs. The last section is the conclusion of the study along with some policy recommendations regarding the SFI best practices.

SECTION II: OVERVIEW OF SPECIALIZED FINANCIAL INSTITUTIONS

Given the stage of development of their financial markets and supporting financial infrastructure, many economies have found that normal financial intermediaries may not be able to provide services to meet the demand for credit of all sectors of the economy. The framework of setting up specialized financial institutions (SFIs) to serve sectors which lack access to normal lending channels is important in terms of addressing this market imperfection. In addition, the early stages of economic development and the foundations of the economy are major factors ratifying the need to create a mechanism which fosters economic growth as well as strengthening the economic foundation. This leads to the establishment of specialized financial institutions whose aim is to fill the gap in the financial system, thus promoting corporate growth and a more equitable income distribution.

SFIs exist in both developed and developing economies, and have a long history. Yet, the degree of importance and the pace of evolution vary greatly due to the pattern of economic development of each individual economy. In general, SFIs were initially set up with an informal and unregulated structure, aiming to serve certain groups of people, especially in the community or in certain areas. These SFIs usually had a limited scope of operations and served only their members. Services provided were mainly deposit and lending facilities with a focus on personal finance. Examples of these institutions are Savings and Loans Associations, and community development funds. Characteristic loans were small, short-term, and at high interest. In some cases, services provided from SFIs were similar to those of cooperatives. Subsequently, SFIs tended to be established to complement the economic development of the economy by supporting small and medium businesses, or key sectors of the economy. The scope of operations of SFIs was intended to cover a wide range of services not just personal finance, but other retail banking activities, including trade financing and business loans. It should be noted that, along with the development of SFIs dealing with businesses, SFIs dealing with personal finance also developed into a more structured and regulated financial institutions. Later, economic advancement led to the establishing of SFIs to support the growth and development of the economy as a whole. This resulted in even more complexly-structured SFIs being established, providing services only to niche markets such as secondary mortgages, credit guarantees, and risk insurance. It can be said that the deeper the economic development, the more complicated the structure of SFIs. At the later stages of evolution, the SFIs were regulated and supervised by the involved authorities, and mostly governed by specific legislation.

In particular, SFIs in developing economies were established partly to build local financial institutions and promote key industries as well as support the grass-roots and the underprivileged. Deena Khatkhate and Klaus-Walter Riechel (1980, 505) cited in Fry (1995, 363) states that “In developing countries, demand for even basic financial services has often not yet been appropriately articulated. In such situation, it appears desirable to generate through official intervention such special sources of supply that can meet social desirable, albeit partially dormant, private demand. For this purpose, developing countries have often established newly specialized financial institutions to satisfy the previously unmet demand. Operations of such institutions are generally insulated from competition by appropriate legislation and are even given substantial subsidies. Such actions are often defended by arguments that resemble those employed in the infant industry advocacy”. Consequently, the role of SFIs in developing economies is, therefore, more significant than in developed economies in terms of its contributions to strengthening economic and social foundations, and promoting higher growth.

To examine the role and development of SFIs in any economy, it is necessary to scrutinize the major factors influencing the role of SFIs in socio-economic development: the role of government, and the economies’ financial development.

Role of Government

Regarding government intervention in the financial sector, most governments have found it necessary to intervene in financial markets to a certain extent although the methods of intervention differ widely. Governments generally justify intervention in financial markets as a response to a combination of politically necessity and economic realities. On the political side, cultural and historical differences among economies play a huge role in determining the type of intervention mechanisms employed. On the economic side, intervention is justified by pointing to an imperfect market or market failure where the financial markets are not producing an efficient and cost effective allocation of the economy’s financial resources. In this case, the optimal outcome of allocation requires government intervention to correct the imperfections, and help foster sustainable economic development and growth.

Governments tend to be quite concerned about the performance of the financial market since the well-being of an economy relies heavily on the financial sector, which in turn affects the population’s living standard. To this end, politics and economics are inseparable and serve to dictate the choice of intervention mechanisms. A rational system for intervening in the financial sector is therefore a function of culture, stage of economic development, time-specific political realities, the expected future performance of financial markets and the overall performance of the economy.[1] Government interventions are usually initiated to address perceived shortages of funds flowing to a given sector of the economy or to stimulate certain types of spending viewed as beneficial to a society as a whole. The mechanisms of intervention tend to be numerous and complicated due to the complex nature of the financial market.

In most economies, government interventions have occurred over a period of time through legislative measures to support various government objectives, including measures to interfere in the financial sector. These measures generally result in a patchwork process of interventions rather than a coherent set of interventions. Such interventions influence the development and evolution of the financial sector of the individual economy. However, the degree of government intervention and the mechanisms used are not subject to the level of economic development. In developed economies such as Chinese Taipei and Japan, SFIs are mostly state enterprises established with a government mandate to support traditional sectors. The government plays a

[1] Draft Paper of ADB Project (T.A. 3355-THA) on Restructuring of Specialized Financial Institutions (December 2001)

vital role in facilitating and promoting the establishment of SFIs as a tool to encourage corporate growth and enhance the economic development plan. In some cases, these SFIs are used to cushion the impact of natural disasters. Likewise, SFIs in developing economies such as Thailand and Indonesia are mostly government-sponsored institutions, aiming to promote certain sectors of the economy as well as creating a better living standard of the majority of people. These SFIs have to implement government measures and run their businesses in line with government policies. These examples show the fact that member economy governments choose to participate in the financial sector at the level which is appropriate to the nature of their markets and needs, regardless of their stage of economic advancement. However, one might argue that economic development goes through several stages and government intervention may be more appropriate in the early stages of development than in later stages.

To this end, the role of government is critical to the success of SFIs. SFIs which are state enterprises usually implement government measures and follow a mandate. They are administered and managed by government representatives. Their operations are limited and subjected to the government approval and laws. Mostly, they are not profit-oriented institutions. In contrast, some SFIs which are not wholly government-owned and that operate on a commercial basis are managed by professionals and the level of government intervention is insignificant in terms of the freedom to conduct business and make day-to-day decisions. They are able to acquire private funds. The government only has a representative as Chief Executive Officer (CEO) and/or members of the board. In addition, SFIs which are privately-owned usually follow government rules and regulations. Their business policy and management are free from government intervention. They operate in accordance with government policies to promote or support certain sectors, and may obtain some privileges such as tax deductions in return. In other words, the management of an SFIs that is heavily dependent on government resources and which operates in a highly regulated financial market is unable to make lending decisions based on independent assessments of business risks and profits. The intermediaries' spreads often do not reflect the true costs and risks involved in long-term lending to higher risk projects. As a result, the role of government is very critical to the performance of such SFIs.

Furthermore, the role of the government influences the role of SFIs on the economy as a whole. In economies where SFIs are promoted by the government as alternatives to traditional financial institutions, it is certain that the role of SFIs is considerable and contributes to the development of target sectors or classes of a society.

Stages of Financial Development

Phases of financial development also direct the role of SFIs in the financial system. In less developed financial systems, commercial banks are the main financial intermediaries and they have a considerable influence on the financial allocation in most economies. They dominate the financial system and contribute much to the development of the overall financial system of the economy. This is particularly so in developing economies. However, there are segments of business and different classes of society who lack access to formal lending, thus leading to a need for special financial institutions dealing with these sectors of the economy. Therefore, at some point, the government will intervene in the financial system by establishing government-sponsored institutions to provide services to these sectors. Alternatively, the government may encourage the business/private sector to set up institutions to provide the necessary services.

In general, in the early stage, governments may find it necessary to create financial institutions in order to help develop the financial system, especially a bank-based financial system. The building of local financial institutions would partly lead to a firm foundation of the financial sector. A sound financial infrastructure is also essential for financial development. The provision of certain services offered by SFIs, such as credit guarantee adds to the creation of financial infrastructure. In this case, SFIs in the form of development banks are usually set up by the government to support the growth of the economy as well as rural development. Also, SFIs offering microfinance-related activities are established to address the market failure where the poor and the grass-roots lack access to credit.

However, in economies with market-based financial systems, the establishment of SFIs may be inappropriate or less important. Security markets play a vital role in domestic resource mobilization. Intermediation costs are, therefore, sharply reduced by the substitution for bank credit of direct transactions in securities, and by increased competition. As a result, a developed and open capital market is alternatively served as an efficient source of funds. In this case, SFIs may only be necessary in the sense that they provide services which are not offered by commercial banks such as political risk insurance for the export sector. Also, SFIs may be needed to help improve the well being of the rural poor and help generate a more equitable income distribution within the economy.

Moreover, in some economies, economic development has progressed more advanced than financial development. There is therefore a huge demand for funds, especially for key/high growth industries, and traditional financial institutions may not be able to meet those needs, especially those of small and medium enterprises and start-up businesses. Small and medium enterprises that have not had previous borrowing experience with formal commercial credits may have problems obtaining loans from private financial institutions. The lack of credit records and no structured information on credit histories limit a bank's ability to assess credit risk and hence price the loans it might make to this segment. Thus, SMEs find themselves isolated from formal lending channels. At a certain stage it is necessary to establish a kind of financial institution to particularly support these businesses, businesses that are the backbone of the economy. In turn, the growth and development of these businesses leads to a sustainable growth of the economy.

Consequences of SFIs

Turning to examine the consequences of the proliferation of SFIs, there are both advantages and disadvantages to their existence.

The first advantage of SFIs is that they help correct the market imperfection. SFIs provide a greater opportunity for certain sectors of the economy to get access to a formal source of funds, which is otherwise unavailable. The underprivileged, the grassroots and the poor, normally have no financial records, inadequate collateral, and low-income, thus making it difficult for commercial banks to assess their credit risk. Funds provided by SFIs, therefore, empower this section of society, and enhance their living standards, thus help alleviating social issues such as crime. Also, an increase in their wealth generates economic activity, thus contributing to economic growth and lessening inequitable income distribution.

Moreover, market imperfection impedes the growth of SMEs which are the backbone of most economies. SMEs need start-up capital and working capital but they lack access to formal lending channels. Apparently, private sector intermediaries do not lend to SMEs because they have no previous banking relationship, and they lack credit information and reliable business data, making it difficult to assess their creditworthiness. As a result, government-owned financial institutions are established to be an alternative source of funding for this sector of the economy since the growth and development of SMEs certainly reflects the overall economic performance of the economy.

Second, SFIs can be used as an arm of government to implement government policies in the financial sector. Government intervention is normally initiated to address a perceived shortage of funds flowing to a given sector of the economy or to stimulate certain types of spending viewed as beneficial to society as a whole. Invention can take the forms of spending programmes, credit programmes, and tax incentive programmes. These forms are undertaken by either direct assistance or through SFIs. In the case of intervention via SFIs, it is not necessary that such the SFIs be government-owned institutions. Private-owned or profit-oriented SFIs can also operate with an interest in supporting government measures, given that they received some government privileges such as tax incentives or credit guarantee mechanisms.

Third, SFIs provide certain services that are not offered by normal financial intermediaries. Usually, such services may not be proved as commercially as normal retail banking activities. For example, most SFIs which are banking institutions provide soft loans, loans with special types of collateral, and loans with special conditions made to certain segments of the society or for specific purposes. In addition, some complex financial services which need to be constructed in order to develop the financial infrastructure and the financial system as a whole (such as secondary mortgage institutions and international trade's risk insurance) are provided by SFIs. Thus these additional financial services meet the different needs of by business and society, thus encouraging the financial development of the economy.

Fourth, SFIs are proved to sustain economic growth and help alleviate social problems in many developing economies. For instance, economies faced with the economic crisis that broke out in 1997 found that their SFIs played a large role in reviving the economy and cushioning social impacts associated with the economic crisis during both the crisis and post-crisis periods. Thailand is a good example. SFIs in Thailand contributed significantly to the economic recovery by creating jobs and providing soft loans to suffering people and several collapsed business sectors, hence enhancing the economic growth rate and lowering the unemployment rate. Although it is difficult to measure the impact of SFIs in terms of addressing social issues, it is believed that without SFIs, the underprivileged and collapsed sectors might have found it even harder to get back on track. In addition, in some economies such as Chinese Taipei, government-owned financial institutions together with macroeconomic policies, have been conducive to rapid economic growth.

On the other hands the establishment of SFIs has some disadvantages to involved stakeholders.

First, government intervention through SFIs causes an uncompetitive financial market. Since the establishment of SFIs interrelates to government intervention, the level of government intervention is critical to the magnitude of the impact of SFIs on the economy as a whole. Fry (1995) states that government interventions through establishing government-owned institutions destroy any actual or potential competition in the financial market rather than addressing the market imperfection. Some researches claimed that specialized banks expropriate scarce resources to finance large and insufficient investments, causing small investment projects starve for funds, while the poor and the underprivileged still have a high demand for funds because SFIs lend deliberately to groups of people who have political links. Hence, SFIs may not achieve the goal of adequate and efficient distribution of credit.

Consequently, government efforts to direct the flow of capital to favoured industries, firms, or individuals frequently steer it away from a value-maximinizing use toward a lower-value or a "value-destroying" use (Beim & Calomiris, 2001). Government interventions seem to perform direct economic functions that competitive markets can perform better. This is especially true in economies with a bank-based financial system.

In addition, the use of government-owned financial institutions to dispense political patronage or to implement social welfare programmes may rapidly lead to insolvency. As SFIs have a selective credit policy and relaxed conditions for their target groups, this might cause an inadequate risk assessment and thus increasing number of bad loans in the financial system. A higher default rate reduces the net return to savers. This creates a wedge between deposit and loan rates, thereby impairing financial intermediation (Heffernan, 1996). Subsequently, it will reduce the stability of overall financial system.

Furthermore, it is argued that SFIs lead to serious fragmentation and segmentation of the credit market. Little competition among financial institutions together with poor allocation of funds leads to high intermediation costs. This problem was seen in several developing economies such as the Philippines where certain functional distinctions between commercial banks and specialized financial institutions were very clear.

Moreover, SFIs created to solve a perceived market imperfection may cause a suppression of financial development. Credit offered in a segmented domestic financial market often comes with very negative real interest rates, and non-favoured borrowers have to obtain funds from expensive and unstable informal markets. As a result, it usually leads to negative real interest rates for depositors. Therefore, financial repression becomes an obstacle to domestic savings and their efficient allocation, and financial intermediation languishes (Carlos Diaz-Alejandro, 1985, 7 cited in Fry, 1995, 365). To a certain extent, it would lead to a necessity for reforms that would improve the efficiency of financial intermediation, and to increase domestic resource mobilization.

In addition, the government may suppress the financial system if it owns some of large banks where credits are given in accordance with the government's direction with no pretense of a market system. Alternatively, the government may give strong guidance for SFIs that are privately owned, not just in lending decisions but also in hiring, funding, and all other aspects of bank management. Subsequently, political interference in management decisions limits the rate of financial innovation.

SECTION III: SPECIALIZED FINANCIAL INSTITUTIONS IN APEC ECONOMIES

3.1 Specialized Financial Institutions in Australia[2]

The Export Finance and Insurance Corporation (EFIC) is considered the only Specialized Financial Institution (SFI), as defined by this study, in Australia. The Australian government established the EFIC in its current form in 1991 under the *EFIC Act* (1991). The EFIC began operations in 1956 and was established to promote Australia's exports. Its main functions are trade finance and export credit insurance; it provides services such as credit guarantee, risk insurance, securitization, and lending facilities. EFIC's major customers are approximately 1,500 SMEs and large corporations. The Australian government appoints its CEO for a term of 3 to 5 years renewable. The Australian government also appoints the Board of Directors for five years, the board comprising government representatives (40 percent) and professionals from the private sector (60 percent).

The Australian government provided the EFIC's initial capital, but has not injected additional capital for the purpose of recapitalization. The EFIC's major sources of funds are foreign borrowings (65 percent) and local borrowings (28 percent); shareholders' funds and operational profit/loss make up the balance. EFIC does not pay tax or stamp duty on its trade finance business.

The EFIC is supervised in accordance with the terms of the *EFIC Act* rather than the prudential framework that applies to the Australian banking system. The supervising bodies are the Department of Foreign Affairs and Trade, and the Australian National Audit Office which conduct reviews at three-yearly and annual intervals respectively. The EFIC prices risk as Australian banks do, but occasionally it applies OECD pricing principles. Its fees resemble those of the banks. The EFIC operates under the constraint of high administrative costs

[2] This report is based exclusively on information provided by the Australian Treasury, and Export Finance and Insurance Corporation (EFIC).

associated with credit insurance. Otherwise, EFIC operates in accord with international best practice as expressed through Australian Accounting Standards.

The EFIC's social objectives are the environment and good governance, but it does not actively engage in any social projects.

In summary, the EFIC, considered the only SFI in Australia for the purposes of this study, was established by the Australian government to promote exports, thus enhancing Australia's economic development. While it operates independently of the Australian banking system's prudential framework it is subject to regular supervision and generally operates in line with best international practice.

3.2 Specialized Financial Institutions in Canada

In Canada, there are a number of crown corporations, which offer specialized financial products to certain niche markets. These crown corporations are wholly owned by the Government of Canada, and report to Parliament through a certain designated Minister. They are each have their own capital, and are required to financially self-sustaining and to submit annual reports, and are subject to scrutiny by the Auditor-General. However, their debt obligations are guaranteed by the Government of Canada.

A. The Business Development Bank of Canada (BDC)

In 1995 the Federal Business Development Bank (which was founded in 1975) and the Industrial Development Bank (which was founded in 1944) were merged to form the Business Development Bank (BDC). The BDC exists to support Canadian entrepreneurship by providing financial services and consulting services to the SME sector in Canada. The BDC is responsible to the Minister of Industry, and the loan portfolio at the end of 2002 was 6.7 billion Canadian dollars.

B. The Export Development Corporation (EDC)

The EDC provides financial services to the export sector, many of which are SMEs. It provides direct loans and lines of credit to buyers of Canadian exported products in other economies, as well as providing to Canadian businesses credit insurance, bonding and guarantees and political risk insurance. The EDC reports to the Minister for International Trade, and at the end of 2001 had a loan portfolio of 23.7 billion Canadian dollars.

EDC has been an active participant in the development of the Organisation for Economic Cooperation and Development (OECD) Arrangement on Guidelines for Officially Supported Export Credits, which disciplines the terms and conditions by which export credit agencies may support exports. EDC structures its support on commercial principles in accordance with the requirements of the WTO Agreement on Subsidies and Countervailing Measures; a small proportion of its business is done on terms consistent with the OECD Arrangement.

C. Canadian Commercial Corporation (CCC)

The CCC, which has existed since 1946, also aids Canadian exporters by supporting the proposal, bid, contract negotiation and project management processes. In particular, CCC offers to guarantee the contract to foreign buyers, thereby raising the credibility of Canadian firms. The financial services offered, however, is limited to offering working capital loans, and supporting foreign exchange transactions and hedging.

D. The Farm Credit Corporation (FCC)

The FCC, which started operations in 1959, offers financial services (lending, venture capital and insurance) to the agricultural sector in Canada. It reports to the Minister for Agriculture and Agri-Food, and had a loan portfolio of 8.8 billion Canadian dollars on 31 March 2003.

E. The Canadian Mortgage and Housing Corporation (CMHC)

The CMHC has a number of functions (including supporting technological innovation in housing, and supporting social housing and the specialized housing needs of certain groups such as the disabled and aboriginal peoples), but it also offers mortgage insurance. Mortgage insurance is offered to individual home purchases, which allows for a smaller down payment to be made at the time of purchase.

The CMHC also supports the development of a securitized mortgage market, by offering to insure mortgage portfolios, which are to be securitized by financial institutions. In this way, the CMHC helps to make the mortgage market more liquid in Canada, and ultimately supports consumers by allowing financial institutions to efficiently finance mortgage lending.

F. The Canada Student Loan Program

This program is not administered by a crown corporation, but directly by the Government of Canada. This program was set up in 1964 to supplement the other financial resources of eligible students in post-secondary institutions, thus making higher education more affordable. At that time the government guaranteed eligible loans to students, which the financial institutions financed and administered. As of 2000, however, the Government of Canada has directly financed and administered this lending. Certain provincial governments also support additional student loan programs. The outstanding sum of Canada student loans at the end of 2001 was 1.6 billion Canadian dollars.

3.3 Specialized Financial Institutions in Hong Kong, China

Hong Kong, China (HKC) does not have specialized financial institutions. However, the HKC government together with related organizations did set up some purpose-specific corporations to assist enterprises and individuals to gain better access to financing or obtain financial guarantees through the conventional authorized financial institutions.

The Hong Kong Export Credit Insurance Corporation (HKECIC) was established in 1966 as a government-owned corporation under the HKECIC Ordinance, providing export credit insurance and guarantee services mainly to small and medium enterprises (SMEs). In particular, its credit insurance service covers political and commercial risks, making the services provided by HKECIC more comprehensive than those offered by the authorized financial institutions in the private sector.

The Hong Kong Mortgage Corporation (HKMC) was established in 1997 as a government-owned corporation, with an aim of promoting the development of a secondary mortgage market in Hong Kong, China. It offers such services as mortgage purchase, mortgage insurance, issuance of debt securities to institutional and retail investors, and securitization of mortgages into mortgage-backed securities. As at end June 2003, the HKMC had mortgage loan assets of about US$41 billion, debt amount outstanding of about US$4.8 billion, and mortgage-backed securities of around US$334 million.

The above-mentioned corporations perform significant roles in economic and financial developments in Hong Kong, China, especially in respect of the export trade, property purchase and mortgage businesses, and the development of the debt securities market. They offer services assisting companies and individuals in the merchandise trade and property sectors to access financing through the conventional authorized financial institutions or obtaining financial guarantees that are not available in the market. Nevertheless, social aspect roles are not among their objectives.

In conclusion, the above-mentioned corporations in HKC were established in response to government policies on economic and financial developments. They are all operated as government-owned corporations. The government has representatives in the Advisory Board of the HKECIC, but they do not intervene in day-to-day management. The government also gives financial support to HKECIC, including the provision of initial capital and tax incentives and making advances to the corporation under the Hong Kong Export Credit Insurance Corporations Ordinance.

The government also gives financial support to the HKMC, including the provision of initial capital, recapitalized fund, on going financing support and status of special public sector entity under the Banking Ordinance.

3.4 Specialized Financial Institutions in Indonesia

The long history of specialized financial institution (SFIs) in Indonesia began in 1895. The People's Credit Banks (*bank kredit desa*: BKD) and Village Saving and Loan Institutions (*lumbung desa*) were established to be an alternative source of fund for farmers, and working class. They were known as village banks, farmer's banks or village trading banks. A number of this kind of institutions either banks or non-banks continued to expand in response to the demand for more funds and more diversified funding alternatives. Yet many non-bank institutions did not survive and were closed down as a result of shortage of capital and a high level of bad loans. They evolved from an informal community institution to a more regulated institution.

Currently, there are thousands of rural banks and village credit agencies operating in Indonesia. However, this study will examine only the framework of rural banks due to the availability of information. Also, the examples in the study will only cover some privately owned institutions as they form the majority. It should be noted that village credit agencies, which were formerly considered as non-bank institutions, are classified as rural banks under the current Banking Act of 1992.[3]

Most rural banks are purely owned by the private sector, while some of them are owned by regional governments,[4] and were established to serve the needs of grass-root people and small-scale businesses. Their core activities focus on retail banking and micro-banking activities, including deposit and lending facilities. The major customers for these banks are individuals and micro-enterprises. It is interesting that their target sectors are industrial, manufacturing and service, rather than agriculture. They all provide short-term loans with the loan period below two years. In addition, these banks are mostly small to medium-sized with no branches, thus showing that this kind of institution is established individually across Indonesia rather than being part of a 'chain'. Most rural banks have been faced with certain constraints on their capability and functions, such as lacking management skills and having limited access to new funding sources, poor credit monitoring, and inadequate human resource development. Nevertheless, their major difficulties are the intense competition with commercial banks and inadequate risk management.

[3] This Banking Act was amended by the Act No.10 of 1998.
[4] As of March 2003, 766 BPRs or 36% of total BPRs are owned by regional government.

Regarding their sources of fund, the central government did not provide start-up capital to these banks.[5] Most of them raise funds mainly through deposit taking. In some cases, they raise substantial funds by local borrowing. With regard to their operations, the president or CEO of these banks is mainly chosen by the majority of shareholders with a specific limitation on the service term, whereas members of the Board of Directors are mainly from the business/private sector. Consequently, they are quite independent in operating their businesses both in terms of business administration and policy. Their operations are not tied up with a government mandate. In other words, they are purely independent self-sufficient organizations. However, since they are established with the specific purpose of serving the poor and people in rural areas, they tend to have a more flexible lending policy and collateral valuation, which come with higher lending rates as well as higher charges and fees.

Moreover, the financial position of these rural banks is generally strong. The majority of them have continued to make a profit, while some of them have experienced losses since the emergence of the economic crisis in 1997. These banks manage to obtain a higher capital adequacy ratio than the requirement rate of 8 percent, while their outstanding credit as well as deposits have continued to expand.

In the realm of regulation and supervision, all rural banks follow the same prudential regulation as commercial banks with no limit on foreign borrowing and interest rate ceiling. Nevertheless, they have a higher loan-deposit ratio of 115 percent, compared with 110 percent for commercial banks. They also pursue the International Accounting Standard (IAS) without having independent financial auditor.[6] The Bank Indonesia (Central Bank) is the regulator and supervisor of the banking industry as a whole, including rural banks, whereas the Ministry of Finance will regulate and supervise non-bank institutions. This reinforces the fact that most SFIs were established under the Banking Act and not under a specific legislation.

In addition, the rural banks are not given any privilege from the government. There is no deposit insurance mechanism in spite of the fact that deposit taking is their major source of funds. However, rural banks may also participate in the government blanket guarantee program by fulfilling specific requirements such as a premium payment based on its total third party deposits. In this case, the government guarantees all third party deposits, excluding deposits from other banks and related parties. In addition, the government will protect them from bankruptcy or illiquidity if necessary.[7] The central bank also undertakes several schemes to improve regulation and supervision and provide better infrastructure for rural banks, as well as to help develop and strengthen rural banks themselves through technical assistance and training.

The impact of rural banks on the economy as a whole is critical although their role in the financial system is less than that of commercial banks in terms of assets and market share. In the view of small entrepreneurs and low-income people, rural banks have certainly contributed to an increase in their wealth and a better standard of living. However, since they are profit-oriented institutions and their core activity is to give loans to these particular sectors, it is

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[5] The capital for rural banks owned by regional government is provided by regional government itself but the operation is based on market approach with profit oriented and without any government subsidy in the lending sector.

[6] BPR with total assets equal to or more than Rp10 billion are required to be audited by an independent financial auditor.

[7] Based on the new Central Banking Act No. 23 of 1999, Bank Indonesia is not allowed to provide any liquidity loan when BPR has any liquidity problem and there is no more protection for BPR from bankruptcy. Bank Indonesia has issued an exit policy regarding troubled BPR. The exit policy states that BPR with CAR below 4% and cash ratio less than 3% should be put under special surveillance and must take specific actions. If the actions do not work within 6 months then the operation of rural banks may be frozen.

difficult to judge their contribution to social development of Indonesia. Also, none of them have been involved in social projects.

Along with these depository institutions, some state-owned institutions were established in 1990s to promote SMEs and export-related business in particular. They provide lending facilities and complex financial services such as securitization, credit guarantees, venture capital and trade financing. Most of their loans are short-term with an average maturity of one to three years. Their CEO is appointed by a government with a service term of five years. The institution supporting SMEs (*PT. Permodalan Nasional Madani*) is supervised by the Ministry of State-owned Enterprises and regulated by the Ministry of Finance, whereas the Export-Import Bank (*PT. Bank Ekspor Indonesia*) is supervised and regulated by the central bank with the Ministry of Industry and Trade. They operate under more relaxed prudential regulations but apply International Accounting Standard (IAS) with independent financial auditors. Both institutions engage in social projects aiming to support community development through soft loans and capacity building. Consequently, these government-sponsored institutions have both an economic and a social impact on the economy to a certain extent.

In conclusion, specialized financial institutions in Indonesia can be broadly classified into two types in terms of their services. The first type is depository institutions, such as rural banks, which offer retail banking services. They are self-sufficient private institutions whose functions are not mandated by the government. As a result, the level of government intervention is at a minimum. Rather, the competitive environment in banking industry itself and their own internal constraints make rural banks very volatile. It can be said that for their target sector, rural banks are an alternative to commercial banks, not institutions providing special services not offered by other financial institutions. Rural banks are widespread throughout Indonesia and play a vital role in developing micro-business and enhancing the quality of life of the poor. The second type of SFIs is non-depository institutions which focus on financing with complex financial innovations, including securitization, credit guarantee, and venture capital. Mostly, their target customers are SMEs and export businesses. They carry a government mandate to help develop Indonesia economically and socially.

3.5 Specialized Financial Institutions in Japan

The long history of specialized financial institutions in Japan began in 1936, when the Shoko Chukin Bank was established to support small and medium enterprises (SMEs) which were the backbone of the Japanese economy. Subsequently, a number of SFIs were established by the government to provide financial services to policy priority's areas. Yet some SFIs were abolished or merged in a process of consolidation and rationalization. Currently, there are nine SFIs operating in Japan.[8] All of them are governmental financial institutions with the legal status of special public corporation.[9] They have specific purposes and target customers. A couple of them aim to facilitate SMEs' financing with different types of services, while the others aim to promote international trade and cooperation, to sustain key industries such as fisheries, forestry and food, and to assist local government and a certain areas of Japan. In some cases, SFIs act as a safety net for unfavorable conditions such as a 'credit crunch' or natural disaster.

[8] The existing SFIs are the Development Bank of Japan; Japan Bank for International Cooperation; Japan Finance Corporation for Small Business; National Life Finance Corporation; Shoko Chukin Bank; Agriculture;, Forestry and Fisheries Finance Corporation; the Okinawa Development Corporation; Japan Finance Corporation for Municipal Enterprise; and the Government Housing Loan Corporation.

[9] According to the Ministry of Finance of Japan, a special public corporation is an entity based on special law to carry out under government supervision business duties necessary to implement government policy.

Services provided by all SFIs include lending facilities, credit guarantee, venture capital, and advisory services, except for the Shoko Chukin Bank which provides both deposit and lending services. The main sectors getting support from these SFIs are industrial and manufacturing sector, and the export sector, followed by the agriculture sector. In addition, SFIs are situated across Japan in order to facilitate access for businesses.

The government provided start-up capital for all SFIs. It also provides additional capital for the purpose of recapitalization to these institutions if necessary since most SFIs are not allowed to take deposits.

With respect to the supervisory regime, all SFIs have different supervisory agencies, and they differ from that of commercial banks. The Ministry of Finance cordially with relevant Ministries is the regulatory and supervisory agency for each SFI. The prudential regulations of each SFI vary greatly according to the nature of its functions. However, the core principles of banking practice underpin the general operations of all SFIs, including loan classification, collateral valuation and creditworthiness assessment. In addition, all debt securities issued by SFIs are rated by major credit rating agencies to ensure that the financial positions of these SFIs is sound, and public information disclosure is adequate. Thus, this allows them to keep the costs of funding low.

Since all SFIs are government-sponsored institutions, they can obtain government-guaranteed for both local and foreign borrowings, and a "Fiscal Investment and Loan Program (FILP)" privilege.

Examining the impacts of SFIs, the performance of SFIs shows that these institutions have contributed to corporate growth and strengthen those sectors that lack access to market sources of credit, thus enhancing the growth of the economy. Also, these SFIs have improved the quality of life, and maintained the stability of key food industries.

To conclude, SFIs in Japan are providing financial services to particular sectors with flexible conditions, aiming to promote entrepreneurship and enhance the socio-economic development of certain areas. Each SFI is regulated and operates under its governed law. One of the roles of SFIs is vital, in the sense that they offer additional services to the small and medium businesses, which are the foundation of the Japanese economy, thus boosting the corporate growth. Some SFIs such as the Japan Bank for International Cooperation and the Japan Finance Corporation for Municipal Enterprise have contributed to the local and regional development. In addition, they have put an emphasis on environmental issues, showing that social impact is also their concern.

3.6 Specialized Financial Institutions in Mexico

The classification of financial institutions in Mexico is somewhat complex. They are grouped by their functions and governing laws into different sectors of the Mexican financial system: the banking sector, the securities sector, the Credit Auxiliary Organizations and Activities' sector, the insurance and bonding sector, and the retirement fund system sector. To narrow the scope of this study, two sectors will be briefly described. First, the banking sector consists of bank and non-bank institutions, development banks (or 'second floor' banks); National Saving Patronage; and Public Trusts. Second, the Credit Auxiliary Organizations and Activities sector consists of factoring companies; financial leasing companies; credit unions; Loans and Savings Associations; Money exchange Houses; and General Deposit Warehouses.

In addition to the classification of financial institutions, the supervision of the Mexican financial system should also be looked at. Most formal financial institutions/entities in Mexico are regulated and supervised by the Ministry of Finance and Public Credit (SHCP) through different agencies/commissions, whereas the Mexican Central Bank (BANXICO) is in charge of regulating the whole financial system from the payment system's perspective.

Turning to examine Loans and Savings Associations in the Credit Auxiliary Organizations and Activities sector, which is the focus of this study since they are non-profit corporations with a legal capacity and provide banking services to target sectors. It should be noted that there is a great number of similar institutions operating in Mexico. Loans and Savings Associations or it 'People's Savings and Credit Entities', better known as 'Savings and Loan Societies (S&L Societies)' were formally established in 1993 under the Law of Organizations and Auxiliary Credit Activities. In the same year, finance companies were also established, with the main objective of promoting savings, granting credits and supporting investments in the collective interest of the shareholders in a particular sector (housing). Their major objectives are to promote saving and provide credits to their members, who are usually unable to acquire credit from commercial banks, as well as to small and medium enterprises. S&L Societies are set up privately without start-up funds from the government. The government is not involved in the management of the associations, the structure of the Board of Directors, or normal business operations.

S&L Societies and finance companies are regulated by both enabling legislation and rules issued by the Ministry of Finance and Public Credit together with the central bank. According to this legal framework, they are supervised by the National Banking and Securities Commission (the supervisory agency). In addition, the central bank will render its opinion to the National Banking and Securities Commission regarding the provision of liquidity and foreign exchange transactions, as well as empowering it to determine the acquisition or merger of all specialized financial institutions. They follow less complicated and more flexible regulatory requirements due to their simplified financial operations and comply with public information disclosure requirements. In the case of financial distress, a deposit insurance mechanism is arranged by the S&L societies themselves and, in some cases, by the government.

Although S&L Societies are being promoted by the government as popular banks, they do not have any advantages over other financial institutions. They are faced with several internal constraints, ranging from inadequate risk management, poor credit monitoring, a high level of non-performing loans (NPLs), poor corporate governance standard, and outdated IT equipment to poor human resource development. It is interesting that external forces such as competition with other financial institutions are not their problems. Consequently, the government has launched a scheme to transform S&L Societies: The People's Saving and Credit Law, enacted in 2001, had two main purposes: 1) modernize and restructure the popular credit and savings system so as to promote the efficiency of the new financial intermediaries, and guarantee transparency and security in its operations; and 2) establish an adequate supervision system for the new intermediaries through the adoption of sound accounting practices, enlarging the scope of operations, and enabling them to meet prudent financial standard and international practices .

As for the specialized financial institutions themselves, two important examples should be examined: *Nacional Financiera* (NAFIN) and the *Banco del Ahorro Nacional y Servicios Financieros* (BANSEFI). *Nacional Financiera* was created in 1934 and is considered as the development bank. Its objective is to promote the integral development and modernization of small and medium enterprises, stimulate the development of financial markets as the financial agent of the Federal Government in the negotiation, contracting and management of credits from abroad. NAFIN provides services such as: credit guarantee, foreign exchange, securitization, venture capital fund, lending facilities, trade financing, portfolio investment, advisory services, and training to its customers: micro-enterprises, small and medium enterprises and large corporations.

Additionally, NAFIN has the social objective of assisting financial disaster areas and enterprises that are not served by commercial banks. It engages in governmental measures to cushion social impacts by the development of schemes that provide certitude to financial markets.

BANSEFI was established in April 2002. Prior to its transformation, it had operated as *Patronato del Ahorro Nacional* since 1950. This state-owned institution has a mandate of promoting both the culture of savings and the development of the popular banking sector in Mexico, by offering high deposit rates, while charging low (or no) fees on some saving products. It offers saving products to low-income people and acts as a lender of last resort for popular banks. On the one hand, it offers deposit services, remittance services, portfolio investment, and an advisory service to individuals, who constitute 99 percent of its customers. On the other hand, BANSEFI provides technological services and training to other popular banks.

The authorities that supervise BANSEFI's operations (SHCP and BANXICO) have to make sure that this instruction follows the prudential regulations under the Basle Accord where applicable, applies the International Accounting Standard (IAS), and has an independent financial auditor.

BANSEFI has contributed to governmental social development programs such as OPORTUNIDADES, and PROCAMPO by providing formal financial services to people that were not previously able to access them. These programs promote development and the improvement of living standards of low income communities through training, capacity building, and technical assistance. In some cases, they engage in some government measures to cushion the social impact of certain events.

The importance of specialized financial institutions in Mexico was proved after the financial crisis of 1994, when the Mexican economy went through a recession. Several banks went bankrupt and past-due loans soared in remaining banks implying a scarcity of financing. In this context, the SFIs played a major role in improving access to credit, normally on a low scale though with a specialized focus (i.e., credit for housing, consumption, final purchase of automobiles, working capital, etc.).

3.7 Specialized Financial Institutions in the Republic of the Philippines

Several specialized financial institutions were established in the Republic of the Philippines since early in the twentieth century. They are the Development Bank of the Philippines (DBP), the Land Bank of the Philippines (LBP), rural banks (RBs) and non-stock savings and loan associations (NSSLAs).

The DBP and LBP are government financial institutions performing commercial bank functions aimed at promoting the development of their target beneficiaries. These banks aim to promote the agriculture sector, and rural development and housing by providing financial services to their target groups with special conditions. Notably, they focus on medium- and long-term credits. The DBP provides medium- and long-term financing to agricultural and industrial enterprises, while the LBP provides financial assistance to agricultural estates and individuals who are involved in the land reform program. Rural banks are mostly privately owned and operate across the Philippines with a large number of branches. They provide financial services to people in rural areas and the underprivileged and aim to promote rural development.

These development banks obtain government privileges in the form of tax incentives, and guaranteed borrowings. They are governed by specific legislation, but have the same regulatory and supervisory agency, the *Bangko Sentral ng Pilipinas* (Central Bank). There are different supervising divisions of the central bank responsible for different kind of institutions. Government-sponsored institutions consider inadequate risk management and poor corporate governance as their threats, while rural banks find government intervention affecting their operational effectiveness.

In addition to the establishment of financial institutions for development, a number of Non-Stock Savings and Loan Associations (NSSLAs) were established nationwide. Since the first establishment, an additional of 84 NSSLAs are operating across the nation. These entities are consumer thrift institutions that have their roots in providing mortgage finance and personal loans to the grassroots and low-income population. Their objectives are to enhance the quality of life of their members as well as to promote a savings culture among them. They are either non-governmental organizations (NGOs) or private limited companies. The supervisory and regulatory agency for NSSLAs is also the *Bangko Sentral ng Pilipinas* (Central Bank). There is no deposit insurance mechanism for these institutions. However, they obtain tax privileges from the government, as their objectives are to serve the poor and the underprivileged.

The impact of specialized financial institutions in the Philippines is quite significant. The DBP, LBP and RBs have contributed to the development of small and medium enterprises as well as rural areas. In addition, they have successfully implemented government measures related to land reform. Likewise, the NSSLAs are the major financial institutions providing funds to the grassroots, hence improving their quality of life. Together, these institutions generate economic activities in rural areas and contribute to the development of small businesses which, in turn, help in promoting economic growth of the Philippines as a whole.

In summary, specialized financial institutions of the Republic of the Philippines are either state enterprises or private limited companies which aim to promote particular sectors such as small and medium businesses related to agriculture and to provide funds to rural areas. All development banks obtain government privileges in the forms of tax incentives, guaranteed borrowing, and favored regulation. Regarding the Non-Stock Savings and Loan Associations, they are major depository institutions which provide simple deposit and lending services to their respective members who normally lack access to formal credits. All SFIs are regulated and supervised by different supervising divisions of the Central Bank. Their role is critical to rural development and the empowerment of the poor, thus promoting more equitable income distribution of the economy.

3.8 Specialized Financial Institutions in Chinese Taipei

Specialized financial institutions have long history in Chinese Taipei. The first SFI was established in 1935 to provide credits to traditional sectors related to agriculture, afterwards a number of SFIs were established to serve particular needs over time with the ultimate aim of supporting Chinese Taipei's economic and industrial plan. Currently, there are seven institutions considered as SFIs, namely: the Farmers Bank of China; the Land Bank of Taiwan, the Taiwan Cooperatives Bank; the China Development Industrial Bank; the Chiao Tung Bank; the Export-Import Bank; and the Industrial Bank of Taiwan. All of them were state-enterprises, except the China Development Industrial Bank and the Industrial Bank of Taiwan, which were private companies. However, the Chiao Tung Bank and the Farmers Bank of China were privatized in 1999. As a result, SFIs in Chinese Taipei are now a mix of state-enterprises, and public and private companies.

The objective of establishing of SFIs in Chinese Taipei was to enhance the economy's economic and industrial development, rather than to alleviate social issues. Their range of services is very broad, ranging from deposit and lending facilities, foreign exchange, credit guarantees, remittance services, trade financing portfolio investment, to an advisory service. The China Development Industrial Bank and the Industrial Bank of Taiwan also engage in securitization and venture capital, while the Export-Import Bank provides risk insurance services. Their target sectors are agro-business; high-tech intensive and manufacturing industry; property; and services. However, when considering types of customers of SFIs, each SFI has different target customers. The Chiao Tung Bank and the Taiwan Cooperatives Bank serve mainly individuals, whereas large corporations are the main customers of the Farmers Bank of China, the China Development Industrial Bank, and the Industrial Bank of Taiwan. The Land Bank of Taiwan focuses on SMEs.

Regarding the regulation and supervision of SFIs in Chinese Taipei, the Chiao Tung Bank, the Export and Import Bank and the Farmers Bank of China were established according to their own legislation, whereas the others were established under the Banking Law. The Central Bank and the Ministry of Finance cooperate as the supervisory agencies for most SFIs, and the Ministry of Finance is the regulatory agency. All SFIs follow the same prudential regulations as commercial banks with some extra regulations according to their legislation. For example, the Industrial Bank of Taiwan is required to give credits to the manufacturing sector of not less than 60 percent of its total outstanding credit. Loan classifications differ in terms of their overdue period. Maturity of loan repayment is subject to their lending purposes: some may provide loans with a long maturity up to 30 years, such as the Taiwan Cooperatives Bank. In addition, they employ the International Accounting Standard (IAS) with an independent financial auditor as well as meeting the public disclosure requirements.

Furthermore, the SFIs in Chinese Taipei, surprisingly, have not received significant privileges in the forms of tax incentives or guaranteed borrowing from the government. The industrial banks are able to invest in production-related enterprises, financial-related businesses and venture capital. Their business scope and investment ailing are both wider and higher than other SFIs.

Moreover, some SFIs have a different business policy from that of commercial banks. The Chiao Tung Bank, in particular, has both a lending policy and collateral valuation methods that differ from those of commercial banks. It also sets both lending and saving rates higher than market rates as well as charging higher fees. In doing banking business, the major threat to their operations is the fierce competition with commercial banks, particularly in agricultural sector. They also have some worry over rising NPLs.

With respect to their source of funds, the government provided initial capital to most SFIs, except the Industrial Bank of Taiwan and the China Development Industrial Bank. Besides, the Chiao Tung Bank and the Farmers Bank of China have been privatized. Also, except the Taiwan Cooperatives Bank and the China Development Industrial Bank, they are subsidized by both direct subsidy and concessional loans. However, the major source of funds for these SFIs, excluding the two industrial banks, is deposits, which account for more than 80 percent of the total funds. However, the government will not inject additional capital for the purpose of recapitalization of these SFIs. In cases of financial distress, the government will certainly give full support to these SFIs. A deposit insurance guarantee is also provided to SFIs' clients by the government.

The financial position of these SFIs between 1997 and 2001 was sound, with a very high capital adequacy ratio, thus showing that they were less affected by, and less vulnerable to, economic uncertainty or external shock. Most SFIs were bigger in size, both in terms of assets and equity. They all continued to make profits: only the Taiwan Cooperatives Bank and the Farmers Bank of China experienced a sharp decrease in revenues during this period. The NPL ratio is considered to be acceptable at the average rate of 6 percent, but with a rising trend. Nevertheless, during the Asian financial crisis in 1997, all SFIs were required to alter their operational procedures, especially the enforcement of risk management, to be in line with international practice.

Although all SFIs have to follow the government mandate to a certain extent, they are not required to have government representatives on of the Board of Directors, or as chairman of the Board. Usually, their CEOs are appointed either by the government, or by selection by the Board of Directors where the majority of Board members are from the public sector. Exceptionally, the Board of Directors of two industrial banks and the Chiao Tung Bank are wholly from the private sector. The Board of Directors has full power over normal operations but need government approval for launching new service or product. Nevertheless, all SFIs with the exception of industrial banks, agree that they have to implement certain government measures even if such measures are not in line with normal banking practice. However, such measures must have a huge long-term impact on the economic development of Chinese Taipei or help to revive the economy following a natural disaster or other unexpected circumstance.

Most SFIs in Chinese Taipei are aware of their social objectives but the level of involvement in social projects varies accordingly to their functions. In other words, the social objective seems to be indirect benefit of their normal operations. Their social aim is focused on improving the standard of living, and supporting community development. In general, they provide loans with special conditions, together with an advisory service, to their target groups. Loans or projects related to housing seem to be the most significant area. Some of them also engaged in specific projects aiming to cushion the social consequences of earthquake.

In conclusion, SFIs in Chinese Taipei certainly play a significant role in facilitating both enterprise and industrial development. They were established for specific purposes with start-up capital provided by the government in most cases. The government does not intervene much in their operations. Notably, they are flexible, able to provide a wide range of services similar to commercial banks, but under the supervision of the central bank and the Ministry of Finance. Their involvement in social projects depends on their institution type, but is not generally significant since all of them tend to promote industrial-oriented economic development rather than directly aiming to help alleviate social problems.

3.9 Specialized Financial Institutions in Thailand

Specialized financial institutions (SFIs) in Thailand were first established in the early twentieth century to promote activities in accord with the stage of economic development, such as: saving culture, home-ownership, and agricultural financing. Later, several institutions were set up to enhance the growth of the economy, especially for the potential growth sectors such as export and small and medium enterprises, and some were established to develop the financial market.

To date, there are eight SFIs in Thailand.[10] Their legal status is state-owned enterprises yet some of them are listed on the Stock Exchange of Thailand. They are governed by their own specific legislation and need Ministry of Finance approval when an amendment is necessary. The scope of operation of these SFIs is limited, as stated in their governed acts. In the early years, each SFI undertook only its core function, aiming to serve its target customers. For example, the Government Saving Bank (GSB) traditionally served as a ‘piggy bank’ and was known as a children’s bank, and the Government Housing Bank (GHB) originally provided housing loans to low-income customers. However, since the economic crisis in 1997, these SFIs have enlarged their operations to meet the demand for loans and engaged in several government measures aiming to uplift the grassroots and support particular sectors such as

[10] These institutions are: the Government Saving Bank (GSB); the Government Housing Bank (GHB); the Industrial Finance Corporation of Thailand (IFCT); the Bank for Agriculture and Agriculture Cooperatives (BAAC); the Small Industry Credit Guarantee Corporation (SICGC); the Export-Import Bank of Thailand (EXIM Bank); the, Secondary Mortgage Corporation (SMC); and Small and Medium Enterprise Development Bank of Thailand (SME Bank).

SMEs and real estate. For instance, the GSB have implemented a "People Bank" scheme which offers loans with flexible conditions to low-income people.

These SFIs are professionally managed, and comply with International Accounting Standards (IAS). Most SFIs follow similar prudential regulations to those of commercial banks. Nevertheless, since they are considered to be government arms to help address market distortions, their lending policy is more relaxed than that of the commercial banks. In particular, their policy has been significantly changed to revive the economy, or even accelerate economic growth in the post-crisis period.

Regarding the management of these SFIs, their Boards of Directors are composed of experts from both the business/private and the public sectors with an average maximum term of office of four years. The major sources of funds for these institutions are either deposit-taking or local borrowing. They are subsidized by the government, and obtain tax incentives with continued supportive measures. The regulatory and supervisory agency is the Ministry of Finance. However, the Bank of Thailand is their inspector, examining the performance of these institutions and reporting to the Ministry of Finance so as to ensure that the operations of these institutions meet international standards.

Since these SFIs operate under their enabling legislation, they have been faced with some difficulties related to their operational limitations. For example, they are prohibited from undertaking certain transactions even if they are capable of doing so. Some have to follow strict bureaucratic rules and regulations in acquiring necessary equipment and budgeting, while some have limitations on investment instruments. In addition, they have experienced some difficulties on the expertise of risk management's techniques, IT related issues, credit monitoring, and human resource development. Interestingly, they find themselves competing with commercial banks to a certain extent, especially for those SFIs offering retail banking, mortgage loans and SME financing.

Turning to examine the impact of SFIs in Thailand, all SFIs have social objectives (such as employment, community development, and improvement of standard of living) along with their business objectives. Some have engaged in several social projects, either in the form of soft loans, capacity building or technical assistance, as well as implementing several government measures. Consequently, most SFIs in Thailand play a vital socioeconomic development. This was especially important during the economic slowdown when the banking system did not function properly.

In conclusion, the purpose of establishing SFIs in Thailand is to correct market imperfections. Some people are neglected by traditional financial institutions, while small businesses are unable to get access to capital. As a result, each SFI has a mandate to serve its particular target group with the ultimate goal of help developing Thailand as a whole. All SFIs receive enormous privileges, thus the level of government intervention is significant. Certainly, the role of SFIs is important to the economic development in the sense that SFIs give a greater opportunity to SMEs, start-up businesses, and potential sectors. The social impact of SFIs, while hard to measure, is considerable as can be seen from the fact that SFIs have undertaken social projects, ranging from education loans, job opportunity loans, and the people's bank scheme, to environment and energy development, young investor training, and the rural poor's capacity building project.

SECTION IV: COMPARATIVE STUDY OF SPECIALIZED FINANCIAL INSTITUTIONS

This section investigates differences and similarities among 42 specialized financial institutions in the eight economies that provided inputs for the comparison. Findings in this section, therefore, only reflect the regime of SFIs in participating economies. However, since the samples are from both developed and developing economies and all SFIs of these economies included, the findings serve well in providing a broad framework and general understanding about the nature of SFIs, their development and roles in different stages of economic development. Also, this section incorporates views of ten government agencies involved in regulating and supervising SFIs. The comparison is made in various aspects, ranging from reasons for establishment, operation coverage, management, and supervisory regimes, to operational constraints.

4.1 Reasons for/Objectives of Establishment

The main objectives of establishing SFIs in most economies can be ranked as follows:
1) To promote particular sectors of the economy such as SMEs and the export sector;
2) To directly provide certain financial services to the target groups;
3) To provide more complex and tailor-made financial services that are not offered by commercial banks; and
4) To implement government measures aiming to alleviate economic and social problems.

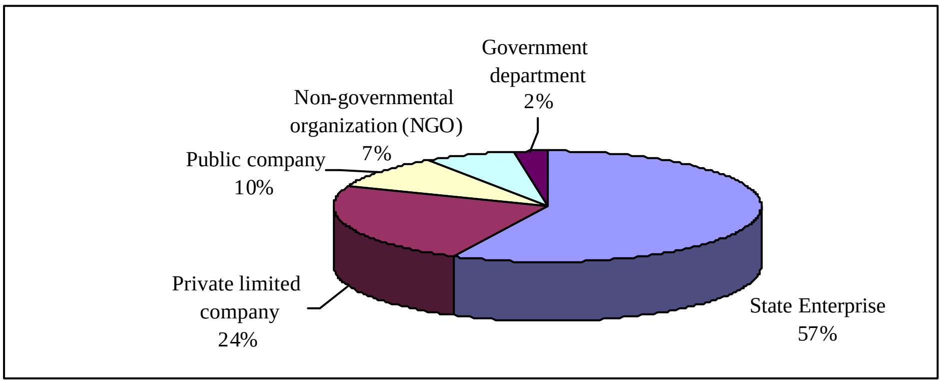
Apparently, most SFIs have a combination of objectives as mentioned above rather than having only one objective to strive for. They usually aim to support particular sectors by providing certain services to those respective sectors. SFIs operating with social aims tend to focus on enhancing the living standards of the poor and implementing government measures attempting to benefit the population. In addition, some SFIs are created by government to provide special services not offered by commercial banks. They generally offer complicated financial services and specialized in niche markets such as secondary mortgage, risk insurance, and credit guarantees.

These establishment objectives reinforce the belief that SFIs are purposely created to fill the gaps in the financial sector created where traditional financial institutions are unable to fulfil the demand for funds from certain sectors of the economy. Also, there is a need to provide greater access to funds for the poor and the grassroots. It is believed that the proliferation of SFIs would efficiently allocate resources in the economy, hence supporting its growth.

4.2 *Legal Status*

The legal status of SFIs falls into various categories: state-owned enterprises, private limited companies, public corporations, government departments, and non-governmental organizations (NGOs). The following chart (Chart 2.1) shows that state-owned enterprises form more than 50 percent of SFIs from the sample.

Chart 2.1: Legal Status of Specialized Financial Institutions



Interestingly, all SFIs in developed economies, such as Japan, are state enterprises, whereas the legal status of SFIs in developing economies is mainly a mixture of privately-owned institutions and government-sponsored enterprises. For instance, most SFIs in the Philippines and Indonesia are privately-owned institutions, while all SFIs in Thailand are government-sponsored institutions. In general, it should be noted that SFIs in the form of development financial institutions and 'purposed' banking institutions are usually government-sponsored financial institutions, whereas SFIs in the forms of 'thrifts' are private limited companies. This justifies, to a certain extent, the government creation of SFIs to promote rural development and support key industries, while it encourages the business/private sector to take part in microfinance activities.

In addition, most SFIs are established under specific legislation, especially those which are state enterprises. The governing law provides the framework and structure of each SFI, thus limiting its scope of operations, providing criteria for its management, and determining the financial issues of the institutions. SFIs that are banking institutions are usually governed by ordinary Financial Institution Acts together, in some cases, with specific regulations.

4.3 *Scope of services*

Services offered by SFIs vary greatly due to the nature of their operations. Development banks and industrial banks provide lending facilities, credit guarantees, trade financing, venture capital and advisory services. Housing banks concentrate on mortgage lending, securitization and risk insurance. Secondary mortgage corporations focus on mortgage insurance, securitization, issuance of debt and mortgage-backed securities, and advisory services. Depository institutions such as savings banks and Savings and Loans Associations provide only basic retail banking facilities, excluding foreign exchange. Rural banks also provide only simple retail banking transactions. SFIs dealing with the export sector offer specialized services to this sector, including trade financing, risk insurance, credit guarantees, and advisory services. Banking institutions dealing with SMEs provide a full range of lending facilities together with technical assistance.

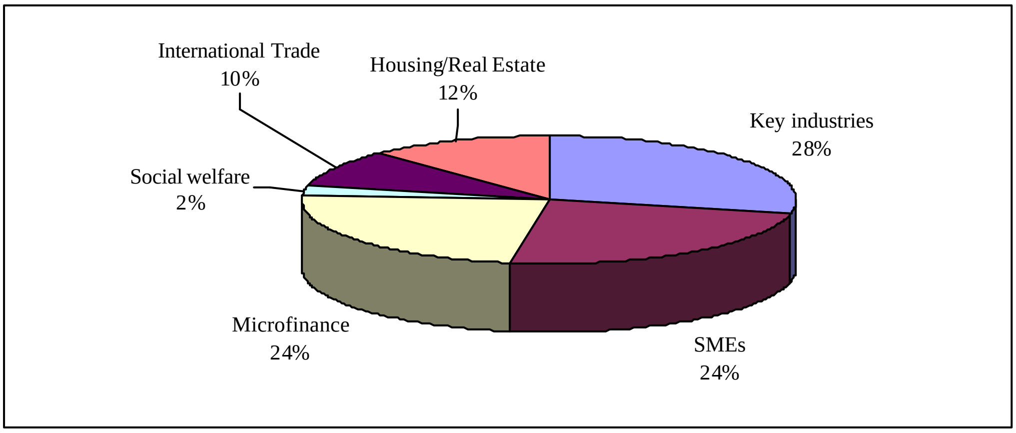
In addition, some SFIs have to implement government measures in addition to their normal services. For example, the Government Saving Bank of Thailand has undertaken a "People Bank Scheme," aiming to provide micro-credit to the poor.

Furthermore, one might question why retail banking is the service which is offered by most SFIs. It should be noted that deposit and lending facilities, and remittance services offered by SFIs are provided only on a small scale to the target groups, and only to members in the case of Savings and Loan Associations. Therefore, the competition between SFIs and commercial banks in this regard is less significant in terms of the magnitude and variety of services.

4.4 Target sectors/ Major customers

The three leading sectors that benefit from the establishment of SFIs are: key industries of respective economies including the hi-tech, manufacturing and agricultural industries; SMEs; and microfinance, respectively.

Chart 2.2: Target Sectors of Specialized Financial Institutions



In most economies, it is necessary to support and promote key and/or high-growth industries in order to sustain economic development. In Chinese Taipei and Japan, electronic and technology-related industries are the major contributors to their economic development and growth. Therefore, efficient business facilitation and sufficient financial support to these particular sectors is vital to the growth of the economy as a whole.

In addition, some industries, such as food and forestry related industries are 'preserved' industries which are linked to the well-being of the population, and to environmental issues. The government, therefore, protects and nurtures these sectors through the establishment of specialized financial institutions which provide both financing and technical assistance to these sectors particularly. A good example of this is Japan.

Furthermore, since small and medium enterprises (SMEs) are the backbone of most economies, the SME sector inevitably gains huge support from government through both financing and capacity-building to these businesses. Likewise, microfinance is considered to be important to most developing economies where the majority of people lack access to other formal lending channels. The establishment of SFIs providing microfinance-related services to the grassroots and people in rural areas are important for their empowerment and improvement in their living standards.

These reasons justify almost all SFIs concentrating on these particular three sectors.

4.5 Business Policies Compared with those of Commercial Banks

Most SFIs have selective credit policies intended for their target customers so some SFIs may find that their operation does not result in a large profit margin like that of a commercial banks. SFIs are not profit-maximizing institutions. Rather, they have a mandate to provide financial services for those who are unable to get credits from normal lending channels.

As a result, SFIs usually have lower lending rates and higher deposit rates in order to attract customers since they are riskier than commercial banks. They also charge lower fees. As a result, in some economies such as Thailand and Chinese Taipei, competition between commercial banks and SFIs are distinct. In turn, this makes it difficult to clearly identify types of services commercial banks or SFIs should provide so as to eliminate the overlapping and fierce competition.

Yet some SFIs which are not directly subsidized by the government tend to have higher lending rates and higher fees in order to be self-sufficient institutions, and manage higher risks associated with services provided. They operate based on a market approach. In spite of this fact, they still get customers in, as their specialization is one of a kind. SME Banks and Export-Import Banks of Thailand and Indonesia are good examples of this.

4.6 Management

The management of each SFI automatically reflects the status of that SFI. Those which are state enterprises tend to have government representatives as members of the board, and the president is chosen by the government. In this case, government interventions occur at all levels of decision-making, thus directing the success of the institution. However, the composition of the board is a mix of representatives from both the public and the business/private sector.

In contrast, the management of SFIs, which are privately-owned and public limited companies, is independent from government interference although they have to operate in line with government policies.

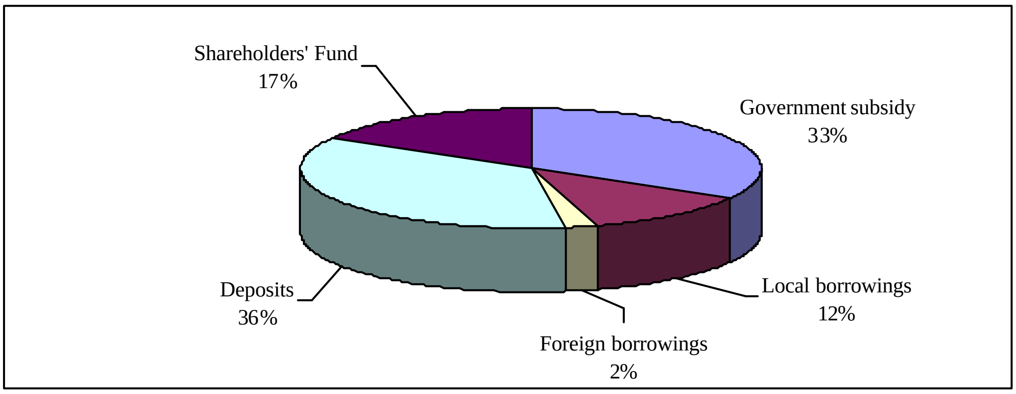
In addition, 40 percent of president and the board of directors in most SFIs have an average term of office of four years. These terms can be renewed, subject to the approval of relevant authorities.

4.7 Sources of Funds

The government provides initial capital to all government-sponsored financial institutions, while privately-owned SFIs raise funds through the issuance of corporate bonds and shareholders' capital. However, privately-owned SFIs usually have to comply with the government's regulations on minimum start-up capital.

The funding structure of each SFI differs, depending on its legal status and the nature of its operations. Depository institutions obtain funds mainly from deposit-taking, while borrowings are the major source of funds for SFIs who only provide lending facilities. Regarding state enterprises, funding is comprised mainly of seed capital from the government, and guaranteed local borrowings. Chart 2.3 shows the composition of major funding sources of sample SFIs.

Chart 2.3: Composition of Major Funding Sources of Sample SFIs



In the event of recapitalization, governments in most economies tend to provide additional capital to SFIs regardless of their status, if the collapse of that particular SFI would have an enormous effect on the majority of people and on more general financial stability. However, after the Asian crisis in 1997, several governments of developing economies such as the Philippines and Indonesia attempted to reduce their role in the operation of SFIs. Therefore, recapitalization of SFIs is considered on a case-by-case basis.

4.8 Regulatory and Supervisory Regimes

The supervisory regimes of SFIs in sample economies pursue a consistent approach: the central bank together with relevant ministries is the supervisory agency for SFIs. There is no separate authority to supervise SFIs. In practice, the relevant ministry, usually the Ministry of Finance, is the regulatory and supervisory agency of all SFIs, while the central banks examines the performance of SFIs and makes recommendations to the relevant ministries. Usually, there are different divisions in the central bank or under the Security and Banking Commission that supervises different types of SFIs. The Philippines is a good example: here certain divisions of the central bank deal with different kinds of SFIs. Additionally, examination of most SFIs in these economies is done mostly on an annual basis. However, examination can be undertaken more regularly if necessary.

With regard to prudential regulations, banking institutions follow the same regulations as commercial banks with some limitations on intra-group lendings and foreign borrowings, whereas other types of SFIs have more relaxed regulations. For example, they are not constrained by the reserve requirement, and capital adequacy ratio. Yet they are required to meet with the loan-loss provisioning set by the central bank, and other regulations as specified in their respective legislations. In addition, either the International Accounting Standard (IAS) or the National Accounting Standard is used for all SFIs in order to increase their transparency and corporate governance.

4.9 Privileges

SFIs in most economies obtain some kind of privileges from the government. State-owned SFIs are subsidized in the forms of grants, concessional loans, guaranteed borrowings, and tax incentives. They also benefit from favoured regulations either issued specially for facilitating the operations of SFIs or specified in their respective legislation. While other SFIs, including private SFIs, obtain tax incentives and continued supportive measures from the government.

In addition, most governments provide a deposit insurance scheme for depository SFIs which are state enterprises. For private depository SFIs, as in Indonesia, they can apply for a government blanket guarantee programme with some conditions.

4.10 Operational Constraints

SFIs in any economy are faced with different constraints due to their governing law and the stage of financial and economic development of their economy. SFIs which are state enterprises are restricted by their respective legislations. The prescribed activities in their governing law stop SFIs from engaging in other additional services, which otherwise, provide them with better risk management. Sometimes, the governing laws are not in line with the current pace of financial development, thus retarding financial innovation.

The stage of financial and economic development of their economy affects the operation of SFIs in terms of infrastructure and human resource development. Most SFIs in developing economies are constrained by their internal limitations, including high administrative costs, outdated IT, low-skilled and inadequately-trained personnel, and lack of expertise in certain areas of banking management. This has resulted in poor credit assessment and monitoring, inadequate governance standard, insufficient risk management, and incompetent personnel. In contrast, SFIs in developed economies do not have any problems regarding the operational efficiency, since these economies have personnel who are professional-trained in risk and banking management, have advanced technology and a sufficiently developed financial infrastructure. However, SFIs in both developing and developed economies face fierce competition with commercial banks, particularly in SME financing and microfinance. A high level of non-performing loans (NPLs) is also their major concern.

4.11 Involvement in Social Issues

Almost all SFIs have social objectives but they may not necessarily engage in social projects. They, however, can implicitly take their objectives into account when considering loan applications.

In developing economies, most SFIs engage in social projects. Some of them undertake social projects by providing soft loans to target sectors, while some of them offer only training and capacity-building programs. This is also true for privately-owned SFIs, as they have a mandate to support the grassroots and the poor.

In contrast, SFIs in most developed economies do not directly undertake social projects, but they are aware of social concerns such as the environment. Yet some of them implement government measures to alleviate the impact of natural disasters.

As far as social impact is concerned, it is difficult to measure such an impact quantitatively. However, it is widely accepted in developing economies that SFIs certainly contribute to rural and community development as well as job creation. SFIs also help empower the poor and the grassroots. This is justified by the fact that at a certain stage of financial development the establishment of SFIs is required in order to develop the financial sector as a whole, and to address market imperfections.

SECTION V: CONCLUSION AND RECOMMENDATIONS

In summary, the relevance of SFIs rests on the fact that they contribute to economic efficiency and to the sharing of prosperity, particularly in developing economies. They play a vital role in supporting the development of real sector and grassroots economy when normal lending seems to be non-existent, and the financial system works improperly. History has proven that imperfect market cause financial exclusion and market distortion. Traditional institutions are unable to provide all activities required by society. The poor, who are the majority, need a kind of flexible financial intermediary in order to get access to funds until they can meet the requirements of a more formal financial institutions. Likewise, key industries and certain fundamentally important sectors of the economy need to have a greater access to formal credits with flexible conditions, hence incubating and strengthening the growth of these sectors. The development and growth of these core elements of the economy ultimately accelerates economic growth and development.

As a result, the government intervenes the financial system through the establishment of specialized financial institutions. It is believed that SFIs help address market failure. To a certain extent, SFIs form an important link between the level of economic development and the stages of financial development of the economy as a whole. Government interventions in financial markets are usually complex. This is because financial markets play an important role in allocating a economy's financial resources, hence driving economic growth and development and mobilizing the economy's financial resources to support investment Therefore, interventions in financial markets should be undertaken when there is a clear market failure that prevents such financial resource allocation from occurring.

Regarding the regime of SFIs, since most SFIs are established by the government as a mechanism to correct market imperfections and foster economic growth and development, their authority derives from a government charter, which both defines their purpose and prescribes the powers given them to accomplish that purpose. The legislation also prescribes their governance regimes, including such basic matters as the qualifications and number of directors. Usually, they are regulated and supervised by relevant ministries. The central banks plays a role in making recommendations so as to ensure SFIs operate in line with banking standards.

Since government intervention in the financial sector interrelates to the establishment of SFIs, the degree of its intervention is critical to the success of SFIs themselves and its impact on the overall financial system. The proper role of the government, based on the analysis of given information and cases, can be achieved by pursuing the recommendations that follow.

First, government intervention should be undertaken only to address market distortions that the business/private sector cannot address. If the establishment of SFIs leads to an uncompetitive financial market, then such intervention does not correct the problem, rather it creates a market fragmentation and credit segmentation.

Second, government interventions always lead to a behavior change by private institutions and markets in response to such measures. To a certain extent, the government may need to adjust the original measure or undertake a new initiative in order to get favourable impacts. This may result in intervention activities not expected at the outset of the process. Thus, many would argue that government interventions should be carried out carefully and only in cases where private markets clearly are incapable of achieving competitive interactions and a competitive allocation of resources.

Third, mechanisms of intervention in financial markets must be well designed in order to prevent distortion of market-based incentives. Such distortions could result in the misuse of government provided preferential funds or a weakening of the incentives to repay. Therefore, government interventions should be well constructed, focused on achieving specific objectives and include an appropriate exit strategy. They also need regular monitoring and a continual review of the results of the interventions to assure the expected outcome. Amendments of specific legislations for SFIs are necessary if such laws prevent the growth and sustainability of SFIs.

Fourth, government agencies involved in regulating and supervising SFIs should ensure that the supervisory methods are in line with the changing business environment, and regular monitoring is undertaken appropriately. If possible, the supervisory guidelines and practices for all SFIs should be issued for the purpose of standardization.

The sustainability and self-reliance of the specialized financial institutions is also a core issue and should be looked at. Most SFIs whose main source of funds is deposit-taking tend to rely on government funds less than those SFIs whose major source of funds is direct subsidy and government guaranteed borrowings. These depository SFIs usually run their business the same way as commercial banks, and receive a small amount of government subsidy. Some of them make profits and operate professionally. In contrast, SFIs that provide only lending facilities such as credit guarantee corporations, secondary mortgage corporations, and development banks always depend on government assistance due to the fact that these SFIs are established to promote certain sectors of the economy. Yet some non-depository institutions such the export and import Banks are self-sufficient institutions. This brings the question of why the government has to intervene in the operation of SFIs if they are self-reliant institutions. In this case, involved authorities should consider the necessity of government intervention on the operations of SFIs and rethink whether it should allow SFIs to take deposits and be less dependent on government subsidy, thus enhancing the effectiveness and efficiency of SFIs. To a certain extent, without government assistance, these SFIs would inevitably develop themselves so as to be in line with the best practice and good governance.

Turning to examine recommendations to encourage best practices of SFIs, it is recommended that government-sponsored financial institutions in developing economies pursue a strategic business plan and not engage entirely in non-economic goals. A misguided strategy may lead to a high level of bad loans and financial instability of the financial sector as a whole. Also, all SFIs are encouraged to pursue good governance practices in order to increase their operational efficiency and their accomplishment of statutory goals and objectives. It is necessary that good governance is the foundation of every step of the work process, including decision-making.

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ANNEX A

Questionnaire TYPE A

"Role and Development of Specialized Financial Institutions"

A Survey of Government and Supervisory Agencies

"**Specialized Financial Institutions (SFIs)**"—*(in the context of this study) are institutions established with an aim to provide various financial services to certain sectors of the economy. They usually work in markets that have not been adequately served by traditional financial institutions. In particular, they aim to be a source of funds for specific potential customers, including agriculture, small and medium enterprises (SMEs), real estate and housing, exports, savings and public sector project finance as well as help alleviate social problem. They may also offer a wide range of services to customers who are neglected by traditional financial institutions. They may conduct certain activities according to their specified legislation and regulations. They can be either government-sponsored institutions or purely independent self-sufficient institutions. They may have independent supervisory agency and separate prudential standards from commercial banks.*

I. General Information

1. Please give the name of your economy: ______________________
2. Please give the name of your agency (who responsible to answer this survey):

   Ministry of Finance ________

   Central Bank ________

   Independent Agency (please specify) ______________________________

   Other (please specify) ______________________________

3. What is your responsibility regarding SFIs?

   ____

   ____

4. How many SFIs are under your supervision/regulation?___________________ institutions

II. Information about SFIs

5. Please indicate the name and date of the first SFI established in your economy and the reasons for its establishment.

Date of establishment: ___________________

Name of institution: ____

Purposes/Reasons for establishment:

____

6. Since the first SFI was established, have any other SFIs been established later on? (Y/N)
How many more have been established up to the present to date?

7. Are all these SFIs still operating? (Y/N)
If "no", please give numbers and names of those that were closed down and the major reasons of such termination?

If the Institution was abolished, what are the alternative arrangements to secure the social benefits associated with defunct institutions? (please describe briefly):

8. Please specify institutions which are currently considered to be SFI (by using the definition given)

Legal Status	Name of SFI	Purposes of Establishment	Total Number of Branches	Has the institution been privatized before?
Publicly-listed institution				
Privately held, limited company				
State Enterprise				
Non-Governmental Organization (NGO)				
Others *(please specify)*				

9. In general, has the role of SFIs in your economy changed over time? (Y/N)

10. Please provide the following information for the five years beginning from year-end 1997 to year-end-2001:

(In US$, otherwise please specify)

	1997	1998	1999	2000	2001
Real GDP					
GDP Growth (y-o-y) (%)					
Total assets of commercial banks					
Total assets of SFIs					
Total liabilities of commercial banks					
Total liabilities of SFIs					
Total equity of commercial banks					
Total equity of SFIs					
Total credit outstanding of commercial banks					
Total credit outstanding of SFIs					
Non-Performing Loans (NPLs) of commercial banks - Value					
-% of total credit outstanding					
	1997	1998	1999	2000	2001
Non-performing loans (NPLs) of SFIs - Value					
-% of total credit outstanding					
Total Deposit of Commercial Banks					
Total Deposit of SFIs					

11. Have SFIs in your economy ever faced a major solvency crisis or bankruptcy? (Y/N)
If "Yes", how did the government react? (please describe)

____

12. Do SFIs in your economy have its own legislation? (Y/N)
If "No", what is the legislation that SFIs are subject to?

Type of Legislation: Specific legislation ______
Financial Institution's Act ______
Public Company Act ______
Other (please specify) ___________________________________

III. Role of Government

13. Does the government require government representative(s) to work in SFIs that are state enterprises? (Y/N)

14. Does the establishment of SFIs in your economy serve the government's policies? (Y/N)
If "Yes", please mark the following policies:

1) Stimulate domestic demand and generate sufficient income and employment _______
2) Alleviate poverty problem _______
3) Promoting a particular sector (i.e. SMEs, manufacturing, agriculture) _______
4) Provide special financial services not offered by other financial institutions _______

Other (please specify) ____

15. Are there any particular sectors that government would like SFIs to focus on?

Industrial and manufacturing __________
Agriculture __________
Export/Import __________
Property/Real estate __________
Services __________
Other (please specify) __________

16. Does the government require a minimum start-up capital for SFIs? (Y/N)
17. Has the government provided initial capital to SFIs? (Y / N)
If "Yes", please list names of the institutions that government has provided initial capital to:
____

18. Has the government directly injected additional capital to SFIs for the purpose of recapitalization? (Y/N)
If "Yes", please liste the name of the institutions that government has directly injected additional capital to:
____

19. In cases where SFIs need funding from the government, in which form of assistance does government provide subsidies to SFIs? (please mark)

Recapitalization	________
Direct Subsidy	________
Concessional loans	________
Government guarantee	________
Other (please specify)	____________________________

A. Regulations and Supervision

20. Which supervisory agency is responsible for supervising the banking system as a whole? (Please mark):

Central Bank	___________
Ministry of Finance	___________
Other Ministry (please specify)	___________
Independent organization (please specify)	___________
Other (please specify)	___________

21. Which regulatory agency has the responsibility for regulating the banking system as a whole? (Please mark):

Central Bank	___________
Ministry of Finance	___________
Other Ministry (please specify)	___________
Independent organization (please specify)	___________
Other (please specify)	___________

22. Do you have a separate authority to regulate and supervise SFIs? (Y/N)

If "yes", please specify.

____

23. Do SFIs have the same supervisory and regulatory agencies as the above? (Y/N)

If "No", who is the supervisory agency for SFIs? ________________________________

who is the regulatory agency for SFIs? _________________________________

24. Are SFIs obliged to report to the supervisory authority with the same frequency and depth as commercial banks? (Y/N)

25. How often are SFIs required to be examined by supervisory agency or examining agency?

__________ (days/months/years)

26. Specific regulatory issues:

Regulations	Commercial Bank	SFIs
Loan-loss reserve (US$)		
Capital-adequacy ratio		
Loan-deposit ratio		
Loan loss provisioning		
Lending limits per account(US$)		
Lending rate ceiling (%)		
Foreign borrowing limits (US$)		
Interest rate ceiling (%)		
Public information disclosure requirement (i.e. financial statements, etc.) (Yes/ No)		

27. Are there any differences in setting deposit and lending rates on the SFIs compared to commercial banks? (Y/N)
If "Yes", what is/are the difference(s)? Please describe:
____
____

28. Is there a deposit insurance mechanism that protects the deposits of SFIs clients? (Y/N)

If "Yes", the deposit insurance is guaranteed by: (please mark)

SFIs itself __________

Government __________

Independent Organization __________

Other (please specify) __________

29. Are SFIs in your country required to obtain rating? (Y/N)

If "Yes", by whom? ____

B. Privileges & Constraints

30. Does the Government provide special privilege(s) for SFIs but not for commercial banks? (Y/N)
If "Yes", please mark the following privilege(s) that government provide:
Tax incentive(s)____________ Government bailouts________
Favored regulations____________Government guaranteed borrowings ________
Continued supportive measures __________Other (please specify) ____________________

31. Please rank the problem(s)/difficulties that SFIs have faced with: (zero represents this problem does not exist, one represents the least significance, and the maximum number represents the most significant):

Problem(s)	0 – maximum number
Inadequate risk management	
High administrative costs	
Poor credit delinquency monitoring	
High level of NPLs	
Difficulty in accessing new funding sources	
Regulatory difficulties	

Government intervention	
Competition with other financial institutions	
Lack of management skills	
Poor corporate governance standard	
Human resource development	
Outdated IT usage	
Other (please specify)	

32. What did the government do in order to solve the above constraint(s)? *(Especially the one you ranked as the most significant):*

____

____

III. Opinion from Government

33. Do you think SFIs in your economy have served the objective(s) of their establishment? (Y/N)
If "Yes", how do you evaluate the performance of the SFIs?

____

34. Do you think the role of SFIs in your economy help alleviate social problems? (Y/N)
If "Yes", how? (please discuss briefly):

____

____

35. Do you think SFIs in your economy have served the areas where commercial banks do not operate (e.g. lending to customers who have insufficient credit/guaranteed)? (Y/N)

36. Do you think the services that are provided by SFIs in your economy "compete" with commercial banks' activities? (Y/N)
If "yes", please describe which activities (e.g. deposit, lending, etc.) and sectors (e.g. industrial, agricultural, etc.)

____

____

37. What do you think about the current role of government regarding policies/operations of SFIs in your economy? (please mark):

Government should increase the degree of intervention regarding SFIs __________
Government should decrease the degree of intervention regarding SFIs __________
Government should remain in this degree of intervention regarding SFIs __________

38. Do you think that SFIs in your economy play significant role in the country's economic development? (Y/N)
If "Yes", how? (please discuss briefly):

____

ANNEX B

Questionnaire TYPE B

"Role and Development of Specialized Financial Institutions"

Survey of Specialized Financial Institutions

"**Specialized Financial Institutions (SFIs)**"—*(in the context of this study) are institutions established with an aim to provide various financial services to certain sectors of the economy. They usually work in markets that have not been adequately served by traditional financial institutions. In particular, they aim to be a source of fund for specific potential customers, including agriculture, small and medium enterprises (SMEs), real estate and housing, exports, savings and public sector project finance as well as help alleviate social problem. They may also offer a wide range of services to customers who are neglected by traditional financial institutions. They may conduct certain activities according to their specified legislation and regulations. They can be either government-sponsored institutions or purely independent self-sufficient institutions. They may have independent supervisory agency and separate prudential standards from commercial banks.*

IV. General Information

1. Please give the name of your institution.

____

2. When did your institution begin operations? ____________________
3. Please give your institution's mission statement.

____

____

____

____

4. What is the legal status of your institution? (please select one)

Publicly listed institution	__________
Privately held, limited company	__________
State Enterprise	__________
Non-Governmental Organization (NGO)	__________
Other (please specify)	______________________

5. Was the institution previously owned by the state? (Y/N)

   If "Yes", when was it privatized? ______________________

6. What percentage of the institution is owned by: (Please put the percentage for each of the following three catagories)
   i. Private sector (domestic) ______________________
   ii. Private sector (foreign) ______________________

iii. State/public/government entities ______________________

7. Has a significant portion of the ownership of the firm changed since its establishment? (Y/N)

If "Yes", please describe ____

____

8. Please specify the objectives of the establishment of your institution? (Please rank the importance of from 1 to 5, with 1 being the most important)

1) Source of fund for the underprivileged and the grassroots level ______

2) Promoting a particular sector (e.g. SMEs, manufacturing, agriculture) ______

3) Providing services to certain sector (e.g. export-import related, property) ______

4) Providing special financial services not offered by other financial institutions ______

5) Implementing certain government policies ________________________________

6) Other (please specify) ________________________________

9. What is the <u>main function</u> of your institution? (e.g., SME financing, credit guarantee, etc.)

____

10. What services do you provide? (Please mark where appropriate)

Deposit services	__________	Lending facilities	__________
Credit guarantees	__________	Remittance services	__________
Foreign exchange	__________	Trade financing	___________
Risk insurance	__________	Portfolio investment	___________
Securitization	__________	Advisory services	___________
Venture capital funds	__________	Other (please specify)	___________

11. What target sectors does your institution focus on? (please rank from 1 to 5, with 1 meaning the most important)

Type of Sector	Please rank from 1 to 5 (with 1 meaning the most important)					Amount of funds given to each sector in US$ (regardless the forms of financing given)
	1	2	3	4	5	
Industrial and manufacturing						
Agriculture						
Export/Import						
Property/Real estate						
Services						
Other (please specify)						

12. Who are your customers? (Please indicate in percentage)

Micro-enterprises ______________

Small and medium enterprises ______________

Large corporations ______________

Individuals ______________

13. How many total branches/representative offices do you have? ___________

Metropolitan area _____________

Provincial cities ______________

14. Please provide the number of employees in your institution. __________________

15. Has there been any significant change in number of employees due to changes in business strategy or unexpected economic circumstance? (Y/N)
If "Yes", please describe ____

____

____

16. Please provide your clients' information:

1) Total number of clients' accounts _______________

2) Types of client (please select one for each type):

i. Individuals	0 – 10%	______	10 – 20%	______
	20 – 50%	______	50 – 100%	______
ii. Group	0 – 10%	______	10 – 20%	______
	20 – 50%	______	50 – 100%	______
iii. Corporate	0 – 10%	______	10 – 20%	______
	20 – 50%	______	50 – 100%	______

3) Average loan repayment period (please put the percentage)

0 – 5 years _________

5 – 10 years _________

15 – 20 years _________

more than 20 years _________

4) Please provide the detail of each type of client:

Unit: US$, otherwise specified

Types of Customers	Individuals	Group	Corporate	Other (please specify)
1. Number of accounts				
2. Average annual income/revenue				
3. Average deposit size per account				
4. Average loan size per account				
5. Average loan repayment period				
6. Average of asset size of the clients'company	-	-		

Note: Group includes cooperatives, association, and other non-profit organization.

V. Operations

President/Chief Executive Officer (CEO)

18. How is the President/Chief Executive Officer (CEO) in your institution chosen?

Appointment by Government (Y/N)

Selection by board of directors or equivalent oversight committee(Y/N)

Vote by majority of shareholders (Y/N)

Hiring professional management (Y/N)

Other (Please specify) ______________________

19. How many years does the president/CEO serve in each term? _______________ years

20. Are there limitations in the number of terms that he/she can serve as president/CEO? (Y/N)

If "Yes", please describe ____

21. Does the president/CEO own any shares of the institution? (Y/N)

22. Has your president/CEO ever been changed before the end of the term? (Y/N)

If "Yes", for what reason? ____

By whom? ____

B. Board of Directors

23. What is the composition of the board of directors in your institution? (in percentage)

Government representatives _____ % Private sector ________%

How are they chosen? (please put in percentage)

Appointment by government ______ %

Shareholders' representatives ______ %

Vote by majority of shareholders ______ %

Other (Please specify) ______________________

24. How long is the board of directors' term? _______________

25. Are there limitations in the number of terms that he/she can serve as Board of Directors? (Y/N)
If "Yes", please describe ____

26. Does the chairman of the board own any shares of the institution? (Y/N)

27. Has your chairman of the board ever been changed before the end of the term? (Y/N)

If "Yes", for what reason? ____

By whom? ____

C. Source of Funds

28. Has the government provided initial capital to your institution? (Y/N)

29. Has the government directly injected additional capital to your institution for the purpose of recapitalization? (Y/N)

30. What is your funding source? (Please put in percentage)

i. Government subsidy ________%

in the form of - Seed capital ________%

- Direct subsidy ________%
- Concessional loans ________%
- Government guarantee ________%

ii. Local borrowing ________%

iii. Foreign borrowing ________%

iv. Deposit ________%

v. Shareholders' fund ________%

vi. Operation profit/loss _______%

vii. Other (please specify) ____________________________

D. Regulations and Supervision

31. Does your institution have its own legislation? (Y/N)

If "Yes", please specify the name of the enabling legislation.

____

If "No", please select the type of legislation appropriate to your institution and give its exact name:

Financial Institutions' Act ____

Public Company Act ____

Other (please specify) ____

32. Who is your supervisory agency?

Central Bank ____________ Ministry of Finance __________

Independent Organization _____________________

Other Ministry (please specify) _____________________

Other (please specify) ____________________

33. Is your supervisory agency the same as that of commercial banks? (Y/N)

34. How often has your organization been examined by supervisory agency ?
_________(days/months/years)

35. Are your regulatory agency and supervisory agency the same organization? (Y/N)
If "Yes" please specify.

____

If "No" please select where appropriate:

Your Organization	Regulatory agency	Supervisory agency
Central Bank		
Ministry of Finance		
Other Ministry (please specify)		
Independent organization		
Other (please specify)		

36. Please provide information about the prudential regulation of your institution and commercial banks:

Prudential Regulations	**Commercial Banks**	**Your Institution**
Capital-adequacy ratio		
Loan-deposit ratio		
Loan Loss Provisioning (%)		
Maximum amount of intra-group lending and related conditions		
Lending Limits		
Foreign borrowing Limits		
Other (please specify)		

37. If a debtor fails to make regular interest or principal payments, is the loan classified for accounting purposes as in default? (Y / N)

38. How many days/months pass before overdue loans are considered to be in default?(please indicate) _________ days/months

39. During the past three years, has the supervisory agency taken any actions against your institution because of financial soundness? (Y/N)

40. Does your institution apply the same accounting standard (referring to International Accounting Standard (IAS)) as commercial banks? (Y/N)

If "No", which type of standard are you using? _________________________

41. Do you have an independent financial auditor? (Y/N)

E. Business Practice

42. Is your lending policy different from that of commercial banks? (Y/N)

43. Does your institution have the practice regarding valuation of collateral differ from regular commercial banks' practice? (Y/N)

44. Does your institution have higher or lower lending rates compared with average commercial banks' lending rates? Why?

____

45. Does your institution have higher or lower deposit rates compared with average commercial banks' deposit rates? Why?

____

46. Does your institution have higher or lower charges/fees compared with average commercial banks' charges/fee? Why?

____

47. Does your institution have to implement certain government measures even when such an activity is not in line with regular commercial banks' lending practice? (Y/N)

48. Does your institution need government approval for launching new service /product? (Y/N)

49. Did your institution alter operational procedure or change terms and conditions attached to your financial services at the request or direction of government in response to the financial crisis in the period since 1997? (Y/N)

F. Operational Constraint(s)

50. Please rate the problem(s)/difficulties that your institution has been faced with: (one represents the most significance, and five represents the least significance).

Problem(s)	Does your institution face this type of problem? *(please mark)* (If yes, please rate its significance in the next column)	0	1	2	3	4	5
Inadequate risk management							
High administrative costs							
Poor credit delinquency monitoring							
High level of NPLs							
Difficulty in accessing new funding sources							
Regulatory difficulties							
Government intervention							
Competition with other financial institutions							
Lack of management skills							
Poor corporate governance standard							
Human resource development							
IT related issues							
Other (please specify)							

51. If your institution is constrained by enabling legislation and regulations,
 1) Will the government help eradicate such constraint? (Y/N)
 2) Please specify your constraint.
 ____
 ____
 3) How does the government solve such problem?
 ____
 ____

G. Privileges

52. Please specify the privilege(s) that your institution has received and rate the beneficial of each privilege: (one represents the most beneficial; five represents the least beneficial)

Privilege(s)	Does your institution have receive any type of privilege? (*please check*) (If yes, please rate it in the next column)	0	1	2	3	4	5
Tax incentive(s)							
Government bailouts							
Favoured regulations							
Government guaranteed borrowings							
Continued supportive measures							
Other (please specify)							

53. In the case of financial distress, will the government protect your institution from bankruptcy/ illiquidity? (Y/N)

VI. Financial Position

54. Please fill in the following table of financial position (in US$)

	1997	1998	1999	2000	2001
Total assets					
Total liabilities					
Total equity					
Total revenues - Non-interest revenues - Interest revenues					
Operating profit					
Net profit					
Non-performing loans (NPLs) - Value					
- % of total credit outstanding					
Re-entry NPLs - Value					
- % of total credit outstanding					
Total credit outstanding - Approved					
- Guaranteed					
- Transferred loans					
Total deposits - value					
- no. of accounts					
Capital-adequacy ratio					
% of firm's assets that are reserved for loan losses					

55. Did the institution's gross margins *(revenue less the material and labor costs of production)* decrease in the most recent accounting period from the previous accounting period? (Y/N)

If "Yes", by how much? US$_______________

56. In the past four years, in how many quarters (or reporting period of shortest length) have the institution not produced profits? _________________________

V. Role of SFIs in social aspect

57. Does your institution have a social objective? (Y/N)

If "Yes", Please specify.

____

58. Does your institution involve in any social project? (Y/N)

1) If "yes", please indicate the forms of your involvement in percentage as follows:

Normal loans __________ %

Loans with special conditions __________ %

Loan Guarantee __________ %

Other (please specify) ________________

2) In the case of a counseling service and services that help ensure that credit is used effectively, please indicate your involvement of each activity in terms of the size of capital contributed to such activity as follows:

Advisory services __________ %

Training or capacity building __________ %

Technical assistance __________%

Other (please specify) __________%

59. What areas of social sector does your institution involve itself in? (Please rank the importance from 1 to the highest number, with 1 meaning the most important.)

Education __________ Community development __________

Employment __________ Environment __________

Heath care related__________ Religious concerns __________

Gender __________ Standard of living __________

Other (please specify) ____

60. Please provide the information about the social project/scheme(s) that your institution involves in:

Name of Project/Scheme(s)	Objective of the Project/Scheme(s)	Date of Establishment	Amount of Fund (US$)

61. Does your institution engage in any specific government measures aiming to cushion social impacts due to changes in economic circumstances? (Y/N)
If "yes", please describe. ____

____

____

62. Do you agree that SFIs helps alleviate social problem in your economy? (Y/N)
If "yes", please specify the area helped most (e.g. providing housing mortgages to low-income people). ____

63. Please rate the level of involvement/commitment of your institution in support of improving social issues such as housing, education etc. (one represents the highest level)

1 2 3 4 5

64. How do you see the role of SFIs in your economy with respect to their services to customers who are neglected by traditional financial institutions. Please rate the level of significance with one meaning the most significance.

1 2 3 4 5

65. If there were no SFIs in your economy, would traditional (profit-oriented) financial institutions provide services offered by SFIs to the SFI's target groups? (Y/N)

ANNEX C

List of Participating Economies and Institutions

I. Participating APEC Economies

1. Australia
2. Canada
3. Hong Kong, China
4. Indonesia
5. Japan
6. Mexico
7. Republic of the Philippines
8. Chinese Taipei
9. Thailand

II. List of Government Agencies answered the Questionnaire Type A

Economy: Hong Kong, China
1. Hong Kong Special Administrative Region (HKSAR)
2. Hong Kong Monetary Authority (HKMA)

Economy: Indonesia
1. Bank Indonesia

Economy: Japan
1. Integrated answers from various Ministries and the Bank of Japan

Economy: Mexico
1. Ministry of Finance and Public Credit
2. Bank of Mexico

Economy: Republic of the Philippines
1. BANGKO SENTRAL NG PILIPINAS

Economy: Chinese Taipei
1. Ministry of Finance

Economy: Thailand
1. Ministry of Finance
2. Bank of Thailand

III. List of Specialized Financial Institutions answered the Questionnaire Type B

Economy: Australia
1. Australian Treasury, and Export Finance and Insurance Corporation (EFIC)

Economy: Hong Kong, China
1. Hong Kong Export Credit Insurance Corporation (HKECIC)
2. The Hong Kong Mortgage Corporation Limited (HKMC)

Economy: Indonesia
1. PT. BPR Artadamas Mandiri
2. PT. BRP OLYMPINDO PRIMADANA
3. PT. BPR PANCAMITRA INTIHARMONI
4. PT. BPR Prisma Mutiara Danarta
5. PT. BPR Pundimas Makmur
6. PT. BPR Syariah Amanah Ummah
7. PT. BPR ALSABA PRIMA
8. PT. PERMODALAN NASIONAL MADANI
9. PT. Bank Ekspor Indonesia (persero)

* Note: BPR stands for Bank Perkreditan Rakyat (Rural Bank)
PT stands for Perusahaan Terbatas (Limited Company)

Economy: Japan
1. National Life Finance Corporation (NLFC)
2. The Okinawa Development Finance Corporation
3. The Government Housing Loan Corporation
4. Japan Bank for International Cooperation (JBIC)
5. Japan Finance Corporation for Municipal Enterprises (JFM)
6. Japan Finance Corporation for Small Business
7. Development Bank of Japan
8. Agriculture, Forestry and Fisheries Finance Corporation
9. The Shoko Chukin Bank

Economy: Mexico
1. Banco del Ahorro Nacional y Servicios Financieros (BANSEFI)
2. Nacional Financiera, S.N.C

Economy: Republic of the Philippines
1. Forestry Savings and Loan Association, Inc
2. National Historical Institutes Savings and Loan Associations, Inc
3. BIR Savings and Loan Association, Inc
4. Bottlers Employees Savings and Loan Association, Inc

Economy: Chinese Taipei
1. Chiao Tung Bank
2. The Farmers Bank of China
3. Industrial Bank of Taiwan
4. Land Bank of Taiwan
5. Taiwan Cooperatives Bank
6. China Development Industrial Bank

Economy: Thailand
1. Bank for Agriculture and Agriculture Cooperatives (BAAC)
2. Small and Medium Enterprise Development Bank of Thailand (SME Bank)

3. Export-Import Bank of Thailand
4. Government Housing Bank
5. The Industrial Finance Corporation
6. Government Savings Bank
7. Secondary Mortgage Corporation
8. Small Industry Credit Guarantee Corporation

APPENDIX

INDIVIDUAL ECONOMY REPORTS

AUSTRALIA

Growth in the Australian economy was strong in 2002, reflecting an environment of strong consumption and investment despite a softening in the rural sector. Gross Domestic Product (GDP) grew by 5.5 percent through the year to the fourth quarter 2002. Unemployment fell steadily across the course of 2002, while inflation remained within the Government's target inflation range throughout 2002.

REAL GROSS DOMESTIC PRODUCT

Real GDP increased 3.6 percent in 2002 (calendar year average terms) following growth of 2.7 percent in 2001. Throughout 2002 the Australian economy remained resilient in the face of a weak world economy and one of the most extensive droughts in Australian meteorological records.

- Household consumption grew throughout 2002, underpinned by sustained income growth, solid wealth growth and low interest rates. Some slowing occurred towards the end of the year, but this could be attributed to a number of temporary factors: the run-up in oil and petrol prices; drought-related food price increases; and lower farm incomes.

- Dwelling investment grew strongly in 2002, reflecting very strong growth in new dwelling construction and a substantial increase in spending on alterations and additions. The prospect of a longer-than-expected period of low interest rates, strongly rising house prices and subdued returns from alternative investments has extended the current cycle longer than anticipated.

- Business investment rose solidly in 2002, with strong growth focused in the second half of the year. High capacity utilisation and solid growth in corporate profits have underpinned investment activity.

- Public final demand (abstracting from private sector net purchases of second-hand public sector assets) rose by 3.6 percent in 2002 after rising 1.4 percent in 2001. Growth was driven by strong public consumption.

- The external sector subtracted from GDP growth in 2002, reflecting strong growth in domestic demand compared with our major trading partners and significantly reduced rural exports due to the drought. Net exports declined by 2.6 percent in 2002, after increasing 1.3 percent in 2001.

INFLATION

The Australian consumer price index (CPI) increased by 3.0 percent through the year to the fourth quarter 2002. Various one-off factors have contributed to inflation over that period, in particular higher fuel prices and some drought-related increases in food prices. There have also been substantial increases in housing costs, reflecting the recent strength in the dwellings market, and higher insurance premiums.

EMPLOYMENT

Employment grew by 1.9 percent in 2002, while the unemployment rate fell steadily across the year, from 6.7 percent in the second quarter 2002 to be 6.1 percent in the fourth quarter that year.

Wages, as measured by average weekly ordinary-time earnings for full-time adults and average weekly earnings (all employees), rose 4.8 percent and 3.9 percent respectively through the year to the fourth quarter 2002. The wage cost index rose by 3.4 percent through the year to the fourth quarter 2002.

CURRENT ACCOUNT

The current account deficit increased to A$32.5 billion or 4.4 percent of GDP in 2002, up from $A16.6 billion or 2.4 percent of GDP in 2001.

Exports in current prices fell 2.3 percent in 2002, while export volumes fell 0.2 percent in 2002. Imports increased 6.7 percent in current prices in 2002, while import volumes increased 11.4 percent in 2002 (which included significant expenditure on civil aircraft). The terms of trade increased 2.2 percent in 2002, following a 1.5 percent rise in 2001. The trade balance worsened by A$14.3 billion in 2002 to record a trade deficit of A$11.0 billion.

EXCHANGE RATE

Since 1983, Australia has had a floating exchange rate. The Reserve Bank of Australia may undertake foreign exchange market operations when the market threatens to become excessively volatile or when the exchange rate is clearly inconsistent with underlying economic fundamentals. These operations are invariably aimed at stabilising market conditions rather than meeting exchange rate targets.

During 2002, the Australian dollar appreciated (in nominal terms) 10.8 percent against the US dollar. It depreciated 5.5 percent against the euro and 0.3 percent against the Japanese yen. The appreciation of the Australian dollar against the US dollar offset falls against some of Australia's other major trading partners, contributing to a 2.7 percent increase in the trade-weighted index.

FISCAL POLICY

The budget was returned to cash surplus in 1997–98. The 2003–04 budget provides the sixth cash surplus since that time. (Data are not available on a calendar year basis). This improvement has been mainly due to the elimination of the large Commonwealth Government budget deficits recorded in the first half of the 1990s.

In financial year 2003-04, the Commonwealth government is expecting to achieve an underlying cash surplus of around 0.3 percent of GDP (or 0.1 percent measured on an accrual basis). This is lower than the projected cash surplus of 0.5 percent of GDP (or an accrual surplus of 0.3 percent of GDP) forecast in the 2002–03 Budget, after the government's announcement of A$2.4 billion of personal income tax reductions, with effect from 1 July 2003. The expected outcome for the 2002–03 underlying cash balance is an estimated surplus of 0.5 percent of GDP (or 0.2 percent on an accrual basis).

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 currency stability, the maintenance of full employment, and the economic prosperity and welfare of the people of Australia. Price stability is regarded as a critical element in achieving these objectives. In pursuing the goal of medium-term price stability, the Reserve Bank of Australia has adopted, with agreement from the treasurer, the objective of keeping inflation between 2 and 3 percent, on average, over the cycle. The medium-term focus of the inflation target provides the bank with the flexibility to 'look through' temporary fluctuations in the CPI.

In pursuit of its objectives, the Reserve Bank of Australia targets a publicly announced overnight cash (interest) rate, determined by the Reserve Bank Board, to act preemptively against inflationary or deflationary pressures.

In response to growth in consumer spending and incomes and increases in wealth associated with rising housing prices, together with improved international economic conditions, the Reserve Bank of Australia increased the target cash rate to 4.5 percent in May and to 4.75 percent in June 2002.

MEDIUM-TERM OUTLOOK

In 2003–04[1], economic growth is forecast to be 3.25 percent in year-average terms, with slower growth in non-farm production likely to be more than offset by a rebound in farm production. Employment growth is likely to slow, after very strong growth in 2002–03, with the unemployment rate remaining around 6 percent over the coming year. Inflation is forecast to decline to around the middle of the target band. The current account deficit (CAD) as a share of GDP should narrow a little as the pace of domestic demand eases and global conditions gradually improve through the year.

Economic growth in Australia was strongest in mid-2002. Despite weakness elsewhere in the world, non-farm GDP grew by nearly 4 percent through the year to the fourth quarter 2002. Strong growth in domestic demand, particularly investment spending, offset weak external demand. Despite an expected easing in consumption and business investment, still-solid growth in domestic demand and a gradual recovery in external demand should underpin solid growth in the non-farm economy. Economic growth is expected to be around 3 percent in 2002–03.

Growth in final domestic demand is forecast to slow to around 3 percent in 2003–04, with slower growth in consumption and business investment and a fall in housing investment. A recovery in farm inventories will add to growth, while the net export subtraction is forecast to be around 0.25 percent, with stronger exports and slower import growth supporting the turnaround.

Net exports are expected to decline 2.75 percentage points in 2002–03. This reflects the impact of subdued global growth and a severe drought on our principal export sectors, together with the effects of strong domestic conditions on the demand for imports. In 2003-04 the net exports position is expected to improve, declining only 0.25 percent. The recovery in exports should be underpinned by subdued global growth and an assumed breaking of the drought, while the slowdown in imports reflects an expected slowdown in domestic demand.

The current account deficit (CAD) should narrow a little in 2003–04 to around 5.25 percent of GDP, from around 5.75 percent of GDP in 2002–03. A larger trade deficit in volume terms together with a slight increase in the net income deficit (NID) is expected to underpin the widening in the CAD in 2002–03, though low interest rates should help contain any increase in the NID.

Dwelling investment is forecast to decline by around 5 percent in 2003–04, following growth of around 18 percent in 2002-03. The expected fall in dwelling investment comes after a period of very strong growth in the construction of new dwellings and a solid pick-up in spending on alterations and additions.

[1] Forecasts for the Australian economy are only available on a financial year basis (i.e., July to June inclusive).

New business investment[2] is forecast to grow by a solid 7 percent in 2003–04, coming off a very strong 15 percent in 2002–03. The fundamental drivers of business investment remain strong. Capacity utilisation is at high levels and the outlook for the non-farm economy, although moderating, remains solid. In addition, corporate profits have grown very strongly over the past year and interest rates are around historically low levels.

The pace of household consumption expenditure is forecast to slow a little in 2003–04 to 3.25 percent, following solid growth of 3.75 percent in 2002–03. This expected moderation reflects slower growth in employment and in wealth accumulation, and slower growth in household borrowing. Household consumption growth in 2003–04 should continue to be supported by low interest rates and solid, albeit moderating, growth in household income.

Growth in employment is expected to slow through 2003–04, in line with slower growth in the non-farm economy. Rural employment is forecast to pick up if the drought breaks, but a full recovery may take some time. Employment growth is forecast to be 1.75 percent in year-average terms and 1.5 percent through-the-year to the second quarter of 2004. The expected moderation in employment growth is likely to see the unemployment rate remain around 6 percent over the next year. The expected slowdown in employment growth comes after very strong growth in the first half of 2002–03. Much of the strength appears to have been concentrated in retail and housing-related employment. The labour-intensive residential construction sector and construction-related parts of the manufacturing sector are expected to slow from around mid-2003. This is expected to provide more impetus to a generalised slowing in employment growth. The expected gradual recovery in rural and regional employment should provide a partial offset.

The headline CPI is forecast to slow to 2.25 percent in the year to June 2004, down from around 3.25 percent expected in the year to June 2003, and within the medium-term inflation target band. Looking ahead, inflation should decline once some of the temporary influences start to abate. While wages are expected to pick up a little in the first half of 2003, inflation expectations remain subdued and the pace of wages growth should ease over the course of 2003–04, in line with the anticipated easing in labour market conditions. With productivity growth expected to be solid, labour costs should remain well contained.

STRUCTURAL REFORM

The *Intergenerational Report 2002–03 (IGR)* released with the 2002 budget informs the wide-ranging structural policy reforms of the 2003 Budget. The IGR concluded that demographic trends would worsen fiscal deficits and structural rigidities, unless addressed in a timely way. (All reforms are subject to approval by the Australian Senate.)

Following a review of Australia’s international taxation arrangements, the Government has announced a package of reforms that continues its commitment to improve the international competitiveness of Australian business. The reforms include: reduction in compliance costs associated with the controlled foreign company rules; reduction of tax on certain forms of foreign business income and gains; modernization of Australia’s taxation treaty network; and better targeting of foreign investment fund rules.

[2] Private sector net purchases of second-hand public assets can have a significant impact on estimates of business investment and public final demand, despite the fact that these asset purchases have no impact on aggregate economic activity. Accordingly, the forecasts of new business investment abstract from these transactions.

The implementation of Australia's National Competition Policy, which over the past decade, drove reforms that intensified competition and raised productivity in sectors that trailed the global economy, is now largely completed. However, Australia continues to pursue reform in areas where it still lags behind world best practice: energy, water and transport. There is also considerable scope for reform in the communications sector. Australia is working to help competition reform through efforts to lower barriers to trade. Over the last two decades it has shifted to a more liberal foreign direct investment (FDI) regime in recognition that FDI has clearly generated higher productivity levels and faster productivity growth through intensifying competition in the sectors where it is prevalent.

Proposed amendments to the *Workplace Relations Act* will simplify procedures and increase labour market flexibility in areas such as unfair dismissal cases. Under current arrangements, industrial disputes have fallen significantly. Enacting further reform will provide substantial dividends.

Higher education reforms will establish a more efficient and responsive higher education sector lifting both productivity and participation. The reforms entail greater contributions from students, and an expansion of funding from Government for courses that meet Australia's education priorities. This should improve flexibility in responding to changing patterns of demand (including lifelong needs for retraining to improve labour participation choices). It should also enable more rapid utilisation and transmission of new skills and production technologies, with a dynamic effect in increasing productivity.

Health reforms will ensure that future governments can afford health support systems well into the future. The government has reaffirmed its commitment to universal health care through funding for new Australian Health Care Agreements with the states. These agreements seek to improve the cost-effectiveness, accessibility and quality of services.

Welfare reforms will assist those with disabilities and their families, and parents of children with special needs, to participate in work and education.

Annex I

AUSTRALIA: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002
GDP and Major Components (percent change, year over year - earlier period, except as noted)						
Nominal GDP (level in US$ billion)	394.5	357.8	393.9	374.4	345.2	404.5
Real GDP	3.8	5.3	4.5	2.8	2.7	3.6
Consumption	3.6	4.3	4.7	3.6	2.6	4.0
Private Consumption	4.0	4.6	4.9	3.2	2.9	4.0
Government Consumption	2.5	3.4	3.8	4.9	1.5	4.0
Investment	9.9	8.2	7.7	-0.1	-1.2	13.0
Private Investment	12.8	10.3	6.0	-0.3	-2.6	15.0
Government Investment	-1.2	-4.1	12.7	-1.2	5.1	3.3
Exports of Goods and Services	11.1	0.1	4.4	11.0	1.3	-0.2
Imports of Goods and Services	10.5	5.9	9.1	7.4	-4.1	11.5
Fiscal and External Balances (percent of GDP)						
Budget Balance**	-1.0	0.2	0.7	2.1	0.9	-0.1
Merchandise Trade Balance	0.4	-1.5	-2.5	-1.2	0.5	-1.3
Current Account Balance	-3.1	-5.0	-5.7	-4.0	-2.4	-4.4
Capital Account Balance	0.2	0.2	0.2	0.2	0.2	0.1
Economic Indicator (percent change, year over year - earlier period, except as noted)						
GDP Deflator	1.7	0.4	0.7	4.1	3.5	2.3
CPI	0.3	0.9	1.5	4.5	4.4	3.0
M3	9.31	6.75	9.41	7.63	8.84	9.68
Short-term Interest Rate (percent)^	5.4	5.0	5.0	6.2	4.9	4.8
Real Effective Exchange Rate (level, 1997=100)*	100.0	91.4	91.7	87.3	84.0	88.6
Unemployment Rate (percent)	8.2	7.7	7.0	6.3	6.7	6.3
Population (millions)	18.6	18.8	19.0	19.3	19.5	19.8

* OECD Main Economic Indicators
**Figures refer to financial year. Source: Budget Strategy and Outlook 2003-04, Budget Paper No. 1.
^ 90 Day Bank Accepted Bills, annual average

Annex II

AUSTRALIA: FORECAST SUMMARY (percent change from previous year)

	2002-03					2003-04				
	Official *	IMF	Link	ADB	OECD	Official	IMF	Link	ADB	OECD
Real GDP	3	3	N.A.	N.A.	N.A.	3.25	3.5	N.A.	N.A.	N.A.
Exports	0	N.A.	N.A.	N.A.	N.A.	6	N.A.	N.A.	N.A.	N.A.
Imports	13	N.A.	N.A.	N.A.	N.A.	6	N.A.	N.A.	N.A.	N.A.
CPI	3.25	2.9	N.A.	N.A.	N.A.	2.75	2.3	N.A.	N.A.	N.A.

*Official forecasts are based on financial years

Annex III

AUSTRALIA: MEDIUM-TERM TREND FORECAST (percent)

	2004-05 to 2006-07
Real GDP	3.5
CPI	2.5

* Australia forecasts on a financial year basis.

BRUNEI DARUSSALAM

REAL GROSS DOMESTIC PRODUCT REVIEW 2002

In 2002, Brunei Darussalam's real Gross Domestic Product (GDP) has shown improvement. It is estimated to have grown 3.2 percent, up from 3.0 percent estimated growth in the previous year. Almost all sectors recorded improved performance. The oil sector grew 2.9 percent, up from 1.5 percent during the same period last year. The non-oil sector grew at 3.6 percent in 2002 compared to 4.8 percent in 2001 (in which the government sector grew 2.2 percent compared to 2.9 percent and the private sector grew 5.0 percent compared to 6.8 percent during the same period). Although GDP growth in the same sectors in 2002 is lower than those in 2001, overall GDP growth was 0.2 percent higher than it was in 2001. The improved performance of the oil and gas sector in 2002 was attributed to increased production of crude oil and liquefied natural gas (LNG) as well as higher crude oil prices. Production of crude oil increased by 4.1 percent, from 195,065 barrels per day in 2001 to 203,021 barrels per day in 2002. Meanwhile, production of LNG increased by 0.3 percent from 968,124 MMbtu per day to 971,270 MMbtu per day during the same period. The Oil and Gas Production Index (OGPI) increased by 2.9 percent from 101.5 in 2001 to 104.5 in 2002. On average, the crude oil price rose by 2.8 percent in 2002 to US$25.37 per barrel from US$24.67 per barrel in 2001.

The overall performance of the construction activities and supply-related industries in 2002 showed signs of recovery compared to the previous year. The construction sector expanded by an estimated 7.5 percent in 2002 compared to a contraction of 8.6 percent in 2001. Total revenue from calibration on construction related activities increased by 15.6 percent from BN$146,187.5 in 2001 to BN$168,937.0 in 2002. Total development expenditure on construction related projects increased by 77.5 percent from BN$191.5 million to BN$339.9 million during the same period. Importation of all construction materials increased by 60.7 percent from 1,722,070 tonnes in 2001 to 2,767,446 tonnes in 2002. Furthermore, production of local cement increased by 2.9 percent from 227,363.0 metric tonnes to 231,696 metric tonnes during the same period. However, production of local bricks contracted by 8.4 percent in 2002 (from 67,240 million in 2001 to 61,599 million). Expenditure on the government housing loan scheme contracted by 2.8 percent from BN$88.0 million to BND85.5 million during the same period. Meanwhile, expenditure on the National Housing Scheme contracted by 23.2 percent, from BN$32.3 million in 2001 to BN$24.8 million in 2002.

Activities in the fisheries sector continued to provide the main impetus for GDP growth. The fisheries production index grew by 43.4 percent in 2002 compared to 35.5 percent in 2001 i.e. from 135.5 to 194.3, respectively. Production of the capture industry grew by 33.8 percent from 10,343 metric tonnes in 2001 to 13,834 metric tonnes in 2002. Meanwhile, production of the aquaculture industry grew by 20.1 percent, from 339.4 metric tonnes to 407.5 metric tonnes during the same period.

However, activities in the agricultural sector slowed down in 2002 compared to the previous year. The agricultural production index contracted by 5.0 percent in 2002 compared to a 14.2 percent growth in 2001, i.e., from 114.2 to 108.6, respectively. Output of the livestock industry such as production of broiler contracted by 10.9 percent in 2002 from 15,099 metric tonnes in 2001 to 13,449 metric tonnes. Production of cattle dropped by 82.8 percent from 1.5 metric tonnes to 2.3 metric tonnes. Similarly, production of goats decreased by 72.2 percent from 3.7 metric tonnes to 1.0 metric tonnes during the same period. Production of fresh milk decreased by 4.1 percent in 2002 from 120,648 litres in 2001 to 115,671 litres. However, production of eggs grew by 15.6 percent from 92 million eggs in 2001 to 106 million eggs in 2002. Production of buffaloes grew by 9.4 percent from 194 metric tonnes to 201 metric tonnes during the same period. Output of the crop industry (such as fruit production) decreased by 31.5

percent in 2002, from 4,140 metric tonnes in 2001 to 2,837 metric tonnes. Production of ornamental horticulture decreased by 27.7 percent in 2002, from 929,975 trees in 2001 to 672,159 trees. However, production of vegetables grew by 8.7 percent, from 8,919 metric tonnes in 2001 to 9,692 metric tonnes in 2002. Production of cut flowers grew by 5.7 percent in 2002, from 110,210 cut flowers in 2001 to 116,527 cut flowers. Likewise, the production of various plantations grew by 86.8 percent from 150.2 metric tonnes to 280.6 metric tonnes during the same period.

In the manufacturing and processing sector, the production index grew by 5.3 percent in 2002 compared to 11.8 percent in 2001, i.e., from 111.8 to 117.7, respectively. Production of garments increased by 5.1 percent from 4,997,429 dozen in 2001 to 5,252,153 dozen in 2002. Production of local switchboards increased by 25.0 percent from 1,371 units in 2001 to 1,714 units in 2002. Production of cables grew by 13.0 percent from 871,199 kg to 984,096 kg during the same period. Production of sawn timber grew by 12.3 percent, from 51,300 cubic metres in 2001 to 57,611 cubic metres in 2002. Meanwhile, processing activities in the fisheries sector grew by 34.5 percent from 273.0 metric tonnes in 2001 to 367.1 metric tonnes in 2002. However, production of roofing materials contracted by 15.1 percent, from 3,436 tonnes in 2001 to 2,918 tonnes in 2002.

The wholesale and retail sector showed improvement in 2002. The number of registered businesses and companies grew by 12.1 percent and 31.4 percent, from 2,839 and 222 in 2001 to 3,183 and 294 in 2002, respectively. Within the Bandar Seri Begawan municipal area, the number of miscellaneous licences issued increased by 5.6 percent from 1,429 in 2001 to 1,510 in 2002. The total number of miscellaneous licences issued by Temburong, Tutong and Belait District Offices grew by 13.6 percent, from 668 to 759 during the respective period. Furthermore, the difference between the value of re-exports at free-on-board (f.o.b) and the corresponding imports at cost-insurance-freight (c.i.f) increased by 44.9 percent from BN$1,688 million in 2001 to BN$2,417 million in 2002.

As a whole, the restaurant and hotel sector also showed improvement in 2002. The number of registered businesses and companies under the category of restaurants, cafés, fast-food outlets and coffee shops grew by 3.9 percent from 543 in 2001 to 564 in 2002. The import value of food and beverages grew by 4.8 percent and 115.2 percent in 2002 from BN$279.8 million and BN$20.0 million in 2001 to BN$293.3 million and BN$43.0 million, respectively.

On the other hand, the hotel occupancy rate declined slightly from 31 percent in 2001 to 30 percent in 2002, indicating the reduced number of tourists visiting Brunei Darussalam in 2002 that could be attributed to several international events that affected the tourism industry such as the 11 September 2001 attack on the United States of America as well as the April 2002 attack on Bali. Moreover, the tourism industry in Brunei Darussalam is still at the infancy stage during which efforts to promote this country to the outside world need to be carried out continuously.

The transport and communication sector made remarkable progress in 2002, with an estimated growth of 9.8 percent compared to a 5.9 percent contraction in 2001. The progress in 2002 was mainly attributed to the import duty reduction announced on 6 November 2001 from rates as high as 200 percent to a 20 percent flat rate on all motor vehicles and 15 percent on heavy vehicles. The total number of newly registered vehicles grew by 68.6 percent from 6,945 units in 2001 to 11,708 units in 2002.

The banking and finance sector once again made encouraging progress in 2002. Interest income from loan and advances grew by 3.5 percent from BN$430.8 million in 2001 to BN$446.0 million in 2002.

CONSUMER PRICE INDEX (CPI) FOR 2002

The consumer price index (CPI) for 2002 compared to 2001 recorded a deflation of 2.3 percent from 122.4 to 119.6. This was brought about by decreases in the major group indices for transport and communication by 9.5 percent; clothing and footwear by 1.7 percent; and housing by 1.3 percent. The major group indices for food; and miscellaneous, however, increased by 0.3 percent and 0.2 percent, respectively.

The 9.5 percent contraction in the Major Group Index for transport and communication was the result of 14.8 percent, 11.4 percent and 0.3 percent decrease in the sub-group indices for communication; private road transport; and public transport, respectively. The Sub-Group Index for other travel and transport rose by 27.4 percent. The lower communication sub-group Index (21.4 percent reduction in the cost of telephone bills) was mainly attributed to the reduction in the rental fees for commercial and telephone lines from BN$25.00 and BN$17.00 respectively to BN$13.00 per month as well as lower international call charges commencing 1 January 2002. Apart from cheaper costs for vehicle repairs; maintenance and purchase of spare parts; and other running costs, the import duty cut announced on 6 November 2001 (rates slashed from as high as 200 percent to a flat rate of 20 percent on all motor vehicles and 15 percent on heavy vehicles) contributed to the lower private road transport sub-group Index. The cost of purchasing vehicles fell by 22.5 percent, whereas the cost of repairs, maintenance and purchase of spare parts; and other running costs fell by 1.5 percent and 1.3 percent, respectively. The 0.3 percent contraction in the sub-group index for public transport was the result of 0.4 percent contraction in boat fares. Meanwhile, bus and taxi fares remained constant. A 20.2 percent increase in airfare charges commenced April 2002, the discount allowable to the travel agents was reduced. This reduction had contributed to the 27.4 percent increase in the sub-group index for other travel and transport.

The 1.7 percent decline in the major group index for clothing and footwear was the result of 3.4 percent and 2.1 percent decrease in the footwear; and ready-made clothing and accessories sub-group indices, respectively. Meanwhile, the sub-group indices for tailoring charges; and clothing materials increased by 0.2 percent and 0.1 percent, respectively. The sub-group index for haberdasheries (sewing materials) remained constant. The 3.4 percent contraction in the Sub-group index for footwear was the result of 16.2 percent and 0.7 percent reduction in the cost of other footwear and children's shoes, respectively. The cost of men's and women's shoes, however, increased by 2.6 percent and 2.2 percent, respectively. The 0.1 percent increase in the sub-group index for clothing materials was the result of 0.1 percent increase in the cost of ladies' clothing materials whereas the cost of man's materials contracted by 0.2 percent.

The 1.3 percent decrease in the major group index for housing was the result of a 2.4 percent decrease in the household goods and operation sub-group index whereas the sub-group index for accommodation increased by 0.2 percent. The Sub-Group Index for fuel and utilities remained constant. The 2.4 percent contraction in the Sub-Group index for household goods and operation was the result of 22.5 percent, 7.6 percent, 4.9 percent and 2.0 percent decrease in the cost of household furnishing; furniture; kitchen appliances and utensil; and crockery and cutlery, respectively. Meanwhile, the cost of household and electrical equipment; floor covering; household good and operation equipment; and audio, video equipments and musical instruments increased by 2.4 percent, 2.0 percent, 1.7 percent and 0.5 percent, respectively. The 0.2 percent increase in the sub-group index for accommodation was the result of 0.4 percent increase in the cost of maintenance and minor repairs whereas rental costs remained constant.

The 0.3 percent increase in the major group index for food was the result of a 4.4 percent increase in the fruits sub-group Index as well as an increase in the sub-group indices for coffee, tea and cocoa (+3.3 percent); non-alcoholic beverages (+2.7 percent); dairy products and eggs (+2.6 percent); rice and cereal products (+1.8 percent); sugar, sugar preserved and confectionery (+1.8 percent); cooking oil and fat (+1.4 percent); other food (+1.3 percent); and cooked food (+0.6 percent). However, the meat and meat products sub-group index decreased (by 2.1 percent) as did the sub-group indices for seafood and seafood products (-2.0 percent); and vegetables (-0.8 percent).

The 0.2 percent increase in the miscellaneous major group index was mostly accounted for by a 4.3 percent increase in the other sub-group index as well in the sub-group indices for personal care (+1.7 percent); medical and health, e.g., the cost of proprietary medicines and supplies(+1.0 percent); and personal effects and other personal goods (+0.2 percent). Meanwhile, the Sub-group indices for recreation and entertainment, e.g., the costs of toys and games; and the sub-group index for education, e.g., the costs of school textbooks and stationery contracted by 7.4 percent and 0.1 percent, respectively. The remaining sub-group indices such as cigarettes; and domestic services, remained unchanged.

The downward trend of the CPI over the year was also testimony to the stiff competition in the retail market in a domestic economy that saw an increasing number of retail outlets. In the external economies, the low inflation rate of the major import trading partners as well as the strength of Brunei Darusssalam's currency against the currencies of major import trading partners have, to a certain extent, had an impact on lowering the CPI as Brunei Darussalam still imports a large part of its necessities.

In 2002, most of Brunei Darussalam's imported goods came from the United States of America followed by Singapore, Malaysia, Japan and others. In 2002, most of Brunei Darussalam's trading partners experienced low inflation and even deflation. This was partly due to the relatively stable crude oil prices compared to 2001, which led to a moderation in inflationary pressures.

EMPLOYMENT

Total population of Brunei Darussalam grew to 340,800 in 2002, up 2.4 percent over 2001. The labour force also grew, increasing 2.5 percent in 2002 to 158.0 thousand compared with 154.2 thousand in 2001. Total employment grew by 3.6 percent in 2002 to 158.0 thousand as a result of a favourable economic growth performance of 3.2 percent where 5,200 new jobs were created. The overall labour force participation rate (LFPR) in 2002 was 69.0 percent. The female LFPR was at 59.1 percent and the male LFPR decreased from 79.1 percent to 78.9 percent. The unemployment rate was 4.6 percent in 2002, down from 5.6 percent in 2001.

FISCAL DEVELOPMENT

Government Revenue in 2002

Government revenue recorded a decrease of 1.4 percent (BN$58.73 million) from BN$4,232.58 million in 2001 to BN$4,173.85 million in 2002. Of this, 54.7 percent was tax revenue and the remainder 45.3 percent is non-tax revenue. The fall in total revenue was due to the decrease in both tax and non-tax revenues.

The tax revenue decreased by 1.0 percent (BN$23.13 million) from BN$2,306.34 million in 2001 to BN$2,283.21 million in 2002. Non-tax revenue also decreased by 1.9 percent (BN$35.61 million) from BN$1,926.25 million in 2001 to BN$1,890.64 million in 2002. The reduction in tax revenue was to a large extent a result of a decrease in income from corporate taxation especially that of oil and gas companies (a reduction of BN$38.75 million). The reduction on import duty on motor vehicles was clearly visible where the revenue from import duties decreased from BN$92.35 million in 2001 to only BN$28.4 million (a fall of BN$63.95 million) in 2002. Revenue from other sources of import duties (tobacco and others) also decreased quite significantly.

In non-tax revenue, a significant decrease was observed from a reduction in property income from other sources. It showed a reduction of BN$95.66 million. However, the contribution of the oil sector to non-tax revenue increased, especially in terms of dividends paid by oil companies. This revenue had slightly increased by BN$79.5 million from BN$1,108.91 million in 2001 to BN$1,188.41 million in 2002. Nevertheless, royalties from the oil and gas companies fell from BN$388.97 million in 2001 to BN$371.14 million in 2002.

Government Expenditure in 2002

Government expenditure showed an increase of 17.4 percent (BN$658.7 million) from BN$3,782.9 million in 2001 to BN$4,441.6 million reported in 2002. This significant increase was mainly due to an increase in all components of current expenditure, especially charged expenditure where there was an increase of BN$821.1 million, from BN$280.9 million in 2001 to BN$1,118.0 million in 2002.

On the capital expenditure side, there was a reduction primarily due to a decrease in OCSE of BN$393.4 million. However, development expenditure increased from BN$209.9 million in 2001 to BN$420.2 million in 2002. This was mainly due to the implementation of the start development projects under the Eighth National Development Plan (NDP). Capital expenditure that covers other charges special expenditure, development expenditure and investments in public enterprise declined by 18.9 percent or BN$209.2 million from BN$1,107.6 million in 2001 to BN$898.4 million in 2002.

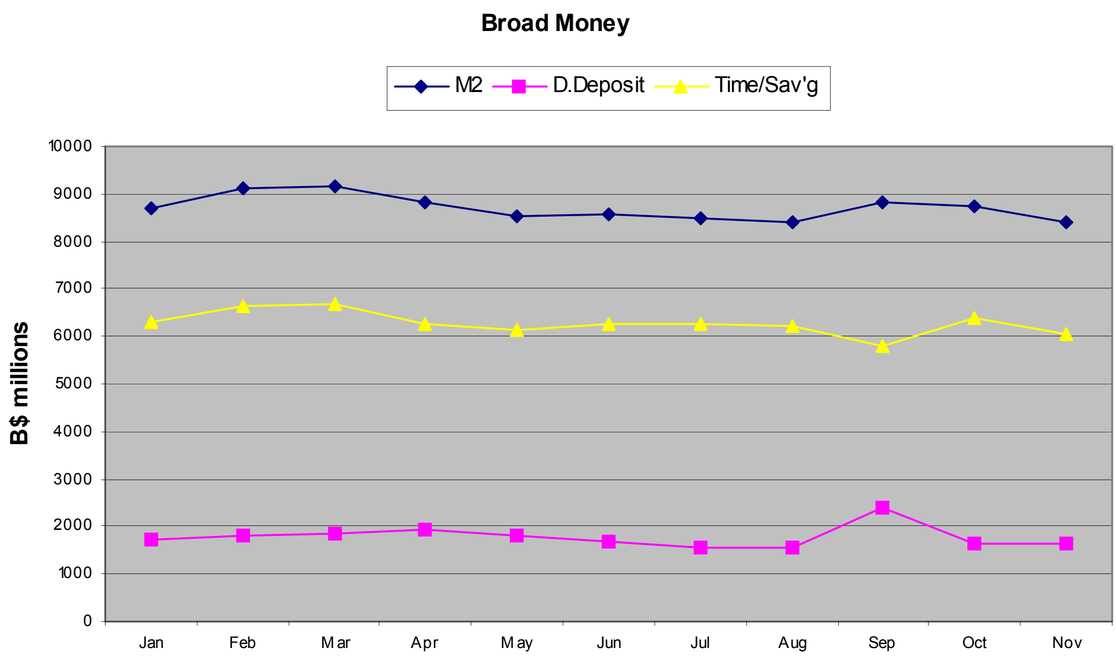
Current expenditure, which included personnel emoluments, other annually recurrent charges and charged expenditure, increased by 32.4 percent (BN$867.9 million) from BN$2,675.3 million in 2001 to BN$3,543.2 million in 2002.

Overall, the economy experienced a budget deficit of BND 267.7 million in 2002 compared to a surplus of BN$449.7 million recorded in 2001.

MONETARY DEVELOPMENT

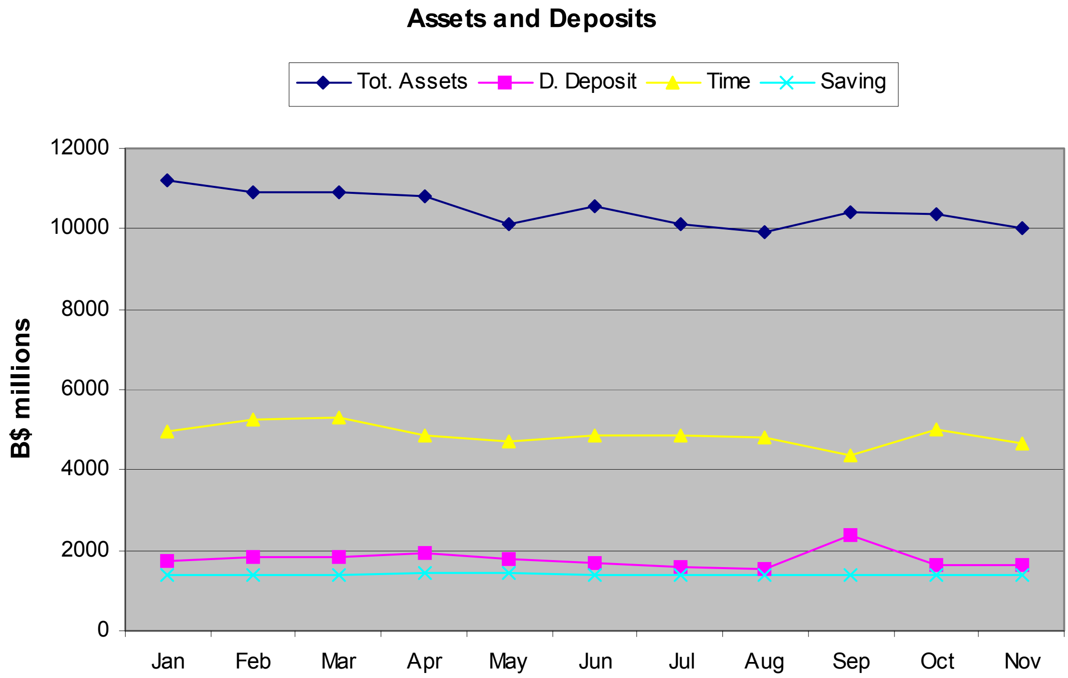
Money Supply

Overall, monetary expansions in the domestic banking system decreased by 2.1 percent from BN$8,569 million in June 2002 to BN$8,390 million in November 2002. The contraction in broad money was due to the fall in demand deposits and quasi money, each of which contracted by 0.5 percent from BN$1,666 million to BN$1,657 million and 3.4 percent from BN$6,270 millions to BN$6,055 million respectively.

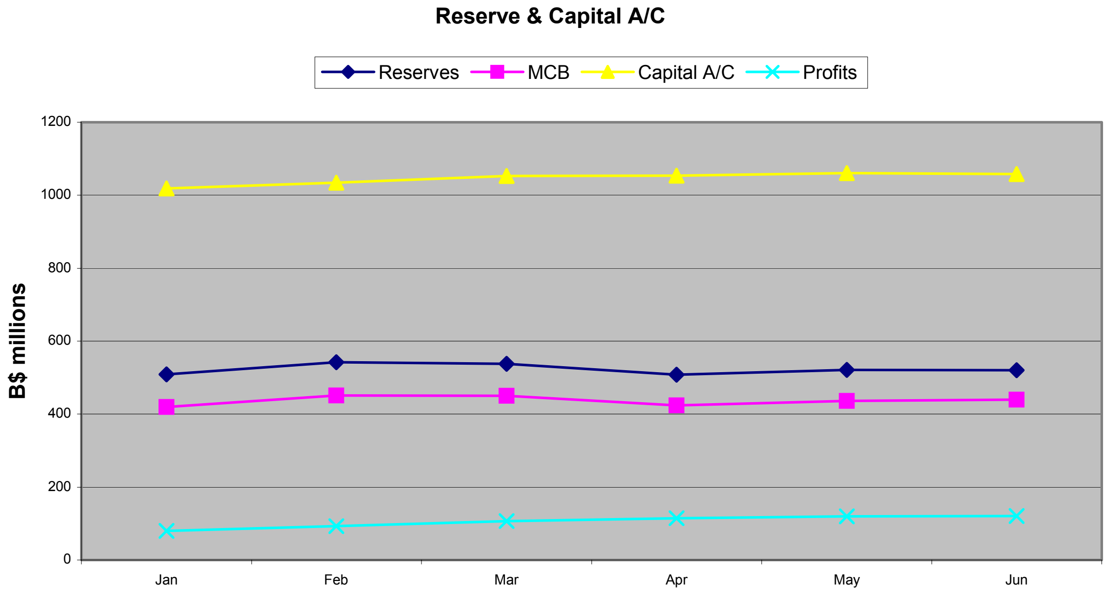


Assets

In response to the broad money contraction above, banking assets also decreased by 5.1 percent from BN$10,541 million in June 2002 to BN$10,008 million in November 2002. This was due to the outflow of investments, down by 14.1 percent from BND 5,129 million to BN$4,407 million. Liability components such as demand deposits were down by 0.5 percent from BN$1,666 million to BN$1,657 million, time deposits were down by 4.0 percent from BN$4,861 million to BN$4,666 million, and savings were down by 1.5 percent from BN$1,410 million to BN$1,389 million. Inflow investments to the banking system were also down, by 35.9 percent from BN$1,227 million to BN$787 million.



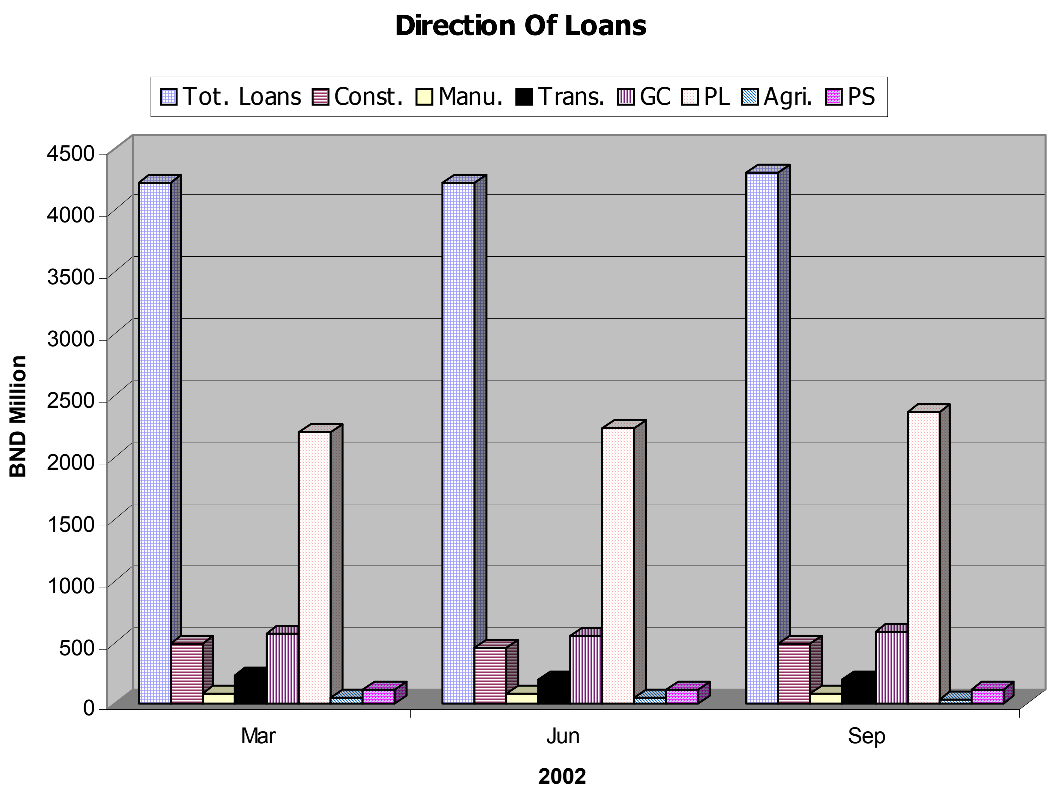
Bank Reserves



The commercial banks reserves generally increased by 2.3 percent from BN$508 million to BN$519 million from January 2002 to June 2002. The minimum cash balance (MCB) with the Brunei Currency Board also increased by almost 5.0 percent from BN$419 million to BN$440 million. The capital account, increased by 3.9 percent from BN$1,018 million to BN$1,058 million. Profits also increased by 51.8 percent from BN$79.61 million to BN$120 million.

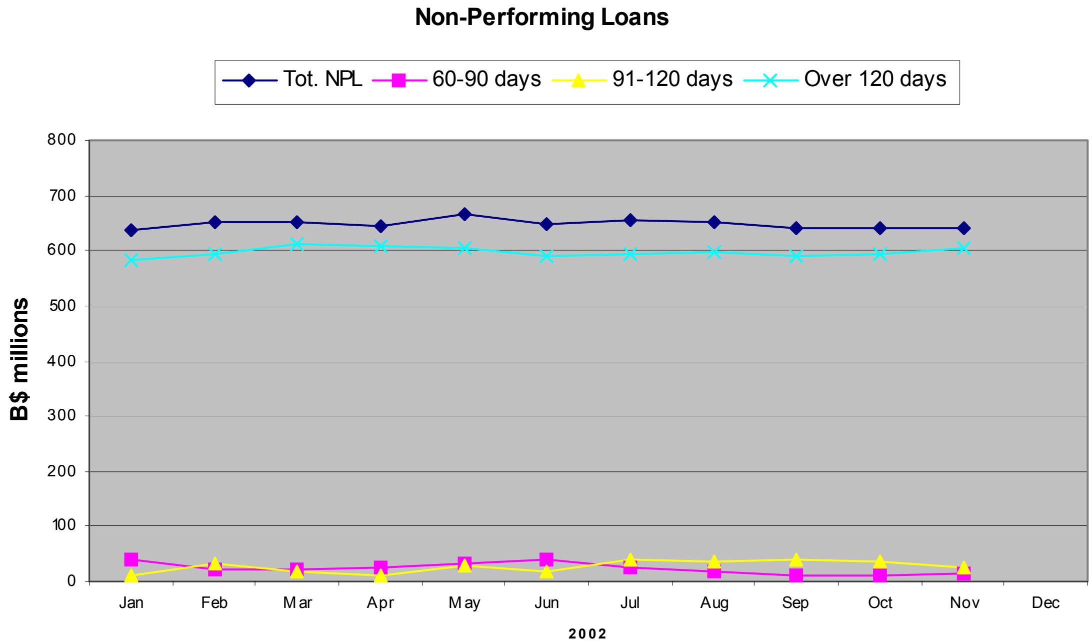
Loans

Total loan aggregates increased by almost 2 percent (BN$4,299 million) from June 2002 to September 2002. The increase was mainly due to increases in economic activities in the construction sector (5.6 percent from BN$464 million to BN$490 million); general commerce (4.3 percent from BN$557 million to BN$581 million); personal loans (5.8 percent from BN$2,237 million to BN$2,366 million) and professional services (1.7 percent from BN$118 million to BN$120 million). However, agriculture declined by 33.3 percent from BN$57 million to BN$38 million, manufacturing declined by 1.2 percent from BN$82 million to BN$81 million and transport declined by 3.0 percent from BN$199 million to BN$193 million.



Non-Performing Loans (NPL)

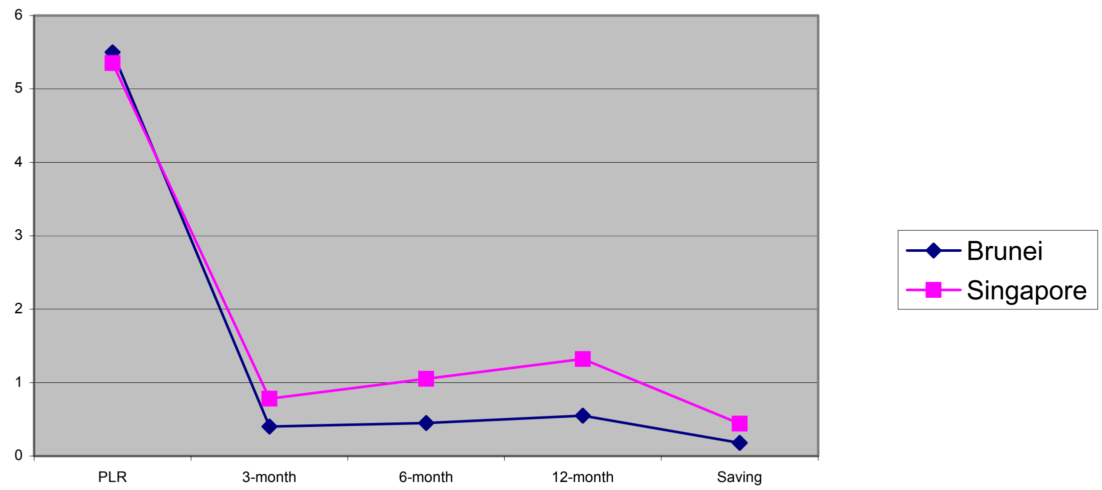
The total amount of non-performing loans increased by 0.8 percent from BN$636.92 million in January 2002 to BN$640.56 million in November 2002. The percentage of NPL to loans aggregates was almost constant at 15.1 percent on average. That figure is considered undesirable in lending activities and poses a risk to the banking system in the long run. Measures, therefore should be taken to reduce the level of risk by controlling the direction of loan disbursements and investing in more viable economic activities. The banking system has increased its bad and doubtful loans provisions by an average of 0.75 percent per month to scrutinize the stagnant NPL's percentage. From January 2002 to June 2002, the provision was increased from BN$303.48 million to BN$315.08 million, which was half of the total NPLs.



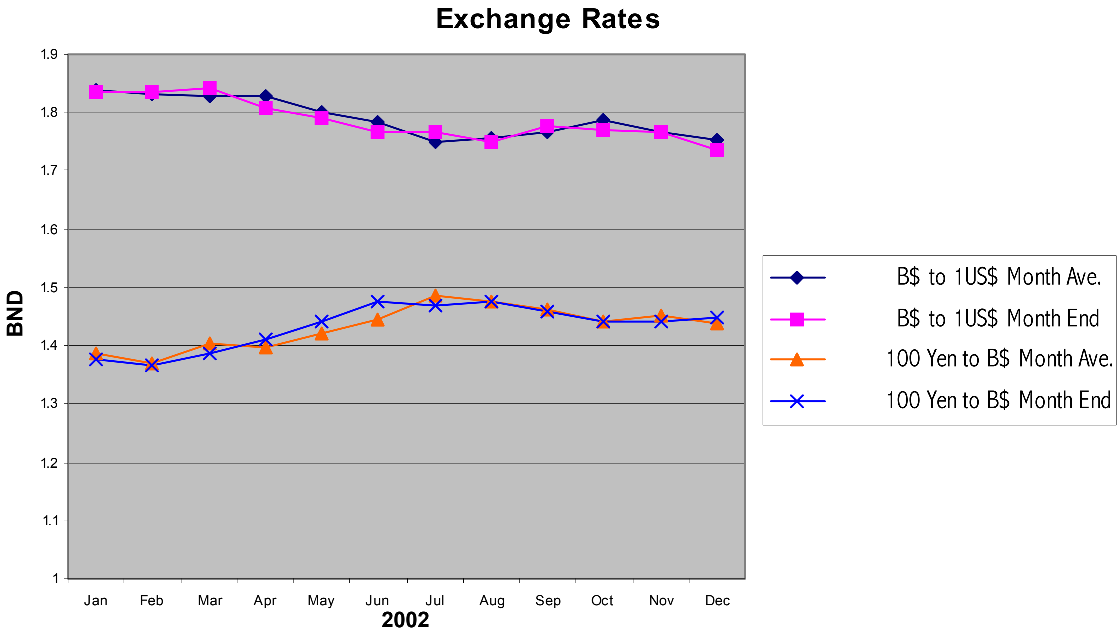
Interest Rates

Interest rates remained low compared to rates offered by other commercial banks in the region. The prime lending rate has remained unadjusted at 5.5 percent since September 2000. Other deposit rates slid continuously due to deteriorating global economic performance. From January 2002 to end of the year, 3-month deposit rates dropped by 20 percent from 0.5 to 0.4, 6-month deposit rates dropped 10 percent from 0.5 to 0.45 and 12-month deposits fell 45 percent from 1.0 to 0.55. Singapore's lending rate of 5.35 percent is unchanged since January 2002. Other deposits fell, by 28 percent (from 1.08 to 0.78) for 3-month deposit, a drop of 24 percent (from 1.38 to 1.05) for 6-month deposits, and an 18 percent drop (from 1.61 to 1.32) for 12-month deposit. The savings deposit rate was also down, falling by 47 percent from 0.83 to 0.44.

Interest Rates (Dec 2002)



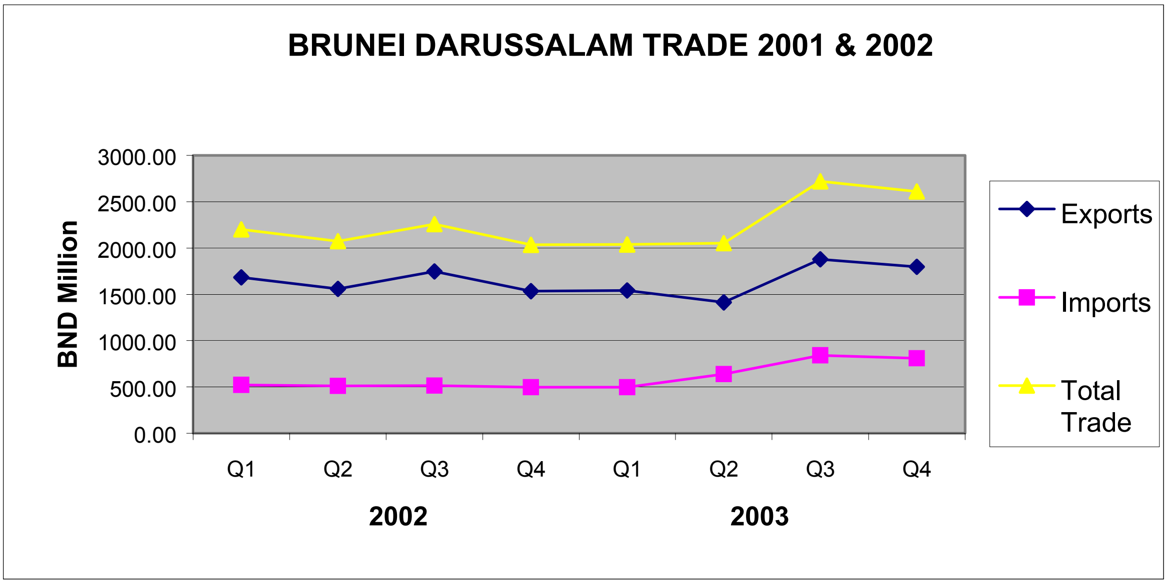
Exchange Rates



The exchange rate with respect to the US dollar was generally down by 4.8 percent from 1.8400 in January 2002 to 1.7522 in December 2002 and down further by 5.5 percent at EoP from 1.8350 to 1.7348. The decline of the US currency in market exchange was due to the apprehension about a possible war with Iraq, mixed US corporate earnings and spending plans and concern about the implications of a Bush stimulus package, all of which have pushed the dollar index lower. The Japanese yen *vis a vis* the Brunei dollar on average deteriorated by 3.7 percent from 1.3874 in January 2002 to 1.4388 in December 2002 and by 5.0 percent at EoP from 1.3781 to 1.4471

The growth of base money remains sluggish due to the contraction in the demand for deposits and quasi money. The total loan aggregates increased by 2 percent but assets declined by 5.1 percent. The decline was due to the decrease in deposits and the outflow of investments. The stagnant prime lending rate (at 5 percent since 2000) and the declining deposit rate reduces overall business activities such as lending and deposits. However, in the long run, the growth momentum of the economy is expected to pick up as a result of the implementation of the various programmes and projects under the Eighth National Development Plan and various other efforts to support and develop the business/private sector.

External Sector



<u>Total Exports for 2002</u>

Total exports in 2002 increased by 1.6 percent, to BN$6,628.7 million from BN$6,521.8 million in 2001. Exports in both oil and gas and non-oil and gas sectors in 2002 was BN$5,834.9 million and BN$793.8 million respectively. The value of non-oil and gas exports increased by 14.0 percent from BN$695.3 million to BN$793.8 million. Petroleum exports increased by 8 percent from BN$2,893.5 million in 2001 to BN$3,139.6 million in 2002. However, LNG exports decreased by 7 percent, from BN$2,814.9 million in 2001 to BN$2,603.5 million in 2002.

In 2002, Japan remained the dominant export market, accounting for 40 percent of total exports. Japan is followed by ASEAN (22 percent), Korea (12 percent) and the USA (8 percent). Brunei's exports to Japan decreased by 10.8 percent during this period compared to 2001. However there is an increase of 6.4 percent in exports to the USA and of 3.3 percent to ASEAN.

Export Markets in 2001 and 2002

	2001	**2002**	**Percent**
ASEAN	1443.28	1490.36	3.3
JAPAN	2998.97	2676.04	-10.8
KOREA	773.41	776.97	0.5
USA	491.7	523.3	6.4
OTHERS	814.4	1162.03	42.7

Total Imports for 2002

The total imports increased by 36 percent from BN$2,045.8 million in 2001 to BN$2,786.6 million in 2002, consisting of machinery and transport equipments, manufactured goods and food and live animals.

Import Market in 2001 and 2002

	2001	2002	Percent
ASEAN	1086.27	1099.99	1.26
EU	314.89	355.27	12.82
JAPAN	133.2	382.63	187.26
USA	190.03	514.6	170.80
OTHERS	352	434.07	23.32

With respect to the origin of imports in 2002, 39 percent of total imports were from ASEAN economies. Imports from the USA and Japan accounted for 18 percent and 14 percent, respectively and those from the European Union accounted for 13 percent.

Balance of Trade for 2002

The balance of trade decreased by 14 percent from BN$4,476 million in 2001 to BN$3,842.1 in 2002. This is attributed mainly due to increase in imports of 36 percent (from BN$2,045.8 million in 2001 to BN$2,786.6 million in 2002.)

ECONOMIC OUTLOOK FOR 2003

The performance of Brunei Darussalam's economy for the first half of 2003 will depend very much on the development of the oil and gas sector as well as the government's continued implementation of various programmes and projects of the Eighth National Development Plan. The production of crude oil and LNG is expected to be around 218,000 barrels per day and 1,052,002.9 MMbtu per day, respectively. However, various incidents around the globe have led to uncertainty in the world economy which may effect our economy in the short term. The war against Iraq has already affected the US economy and the world crude oil price has fallen from as high as around US$31.00 per barrel at the start of the war to as low as US$24.79 (Brent) recently. The oil and gas sector of the economy may be adversely affected from this development in terms of decreasing income from hydrocarbon exports. Likewise the outlook for the non-oil sector in the short term looks uncertain. The outbreak of SARS has already affected some non oil and gas sectors. Tourism and transport sectors in the region have already been badly affected by the SARS outbreak. Just recently Royal Brunei Airlines, Brunei Darussalam's national carrier has announced that it is reducing the number of flights to Singapore; Hong Kong, China; Darwin; and Shanghai due to low demand.

On the positive side, some non-oil sectors, particularly the construction and related sectors, will benefit from the BN$1 billion development budget allocated for 2003. The allocation will enable more Eighth National Development Plan programmes and projects to be implemented. The impact of the import tax reduction on vehicles in 2001 is expected to help spur further the growth in the transport and communication sectors. The endless efforts of the government to support the business/private sector through various schemes will have a positive effect on the mining and manufacturing, retail and wholesale sectors. Other economic activities such as banking and finance, insurance, real estate and other businesses will benefit from the positive spillover effects. The upward trend in the forestry and fisheries sectors since 2000 is expected to continue in 2003. Overall, the economy is expected to grow by 4.5 percent, down from the earlier forecast of 5 to 6 percent by end of 2003.

Brunei Darussalam's population will continue to grow at a moderate rate of between 2.2 percent and 2.5 percent in the years ahead. The population is likely to increase from 353,100 in 2002 to 361,900 in 2003. In the same period, the total labour force will increase by 3.0 percent from 161,400 in 2002 to 165,800 in 2003. Similarly, employment, the number of migrant workers and the unemployment rate are also expected to grow by 2.5 percent, 5 percent, and 8 percent respectively.

Human Resources Development (HRD) is one of the crucial elements in the implementation of the economy's five-year national development plan. As such, a sum of $250 million or 3.4 percent of Eighth Plan's total allocation has been allocated to the HRD Fund (HRDF). Its main objective is to facilitate training; retraining and other HRD related programs and projects aiming for better career development of the economy's human resources. Among other things, the HRDF includes special schemes for under- , post-graduate and specialized studies; and pre- and post-employment for local job seekers, as well as pre-retirement programs.

RECENT STRATEGIC INITIATIVES TO HELP ECONOMIC DEVELOPMENT

In an effort to improve Brunei Darussalam's competitiveness, increase foreign direct investment and hence help to diversify its economy, the government has launched several important initiatives which are described below.

With the help of a team of international consultants, the Brunei Economic Development Board has completed a study on how Brunei Darussalam could attract more foreign direct investment. Some challenges faced by Brunei Darussalam that were identified by the study include:

- Weak coordination among the public sector institutions which led to a slow decision making process.
- Lack of transparency in government laws and regulatory standards

The above challenges will provide further impetus for the government to provide more transparent and attractive policies and procedures, through the formulation of new laws and amendments of existing ones. To date, four new/amended laws were introduced to improve Brunei Darussalam's overall economic environment. In addition, 10 new laws have been introduced since 2000 especially to realise of Brunei Darussalam's objective of becoming an International Financial Centre.

Furthermore, a provision is being placed to accommodate the requirements of the business/private sector with respect to ownership of industrial land. Guidelines for participation in privatisation are being finalised.

Currently, the Prime Minister's Office is in the process of conducting a strategic alignment exercise for the whole of the civil service. It is hoped that through this exercise, the overall efficiency and effectiveness of the civil service will be improved.

Due to the importance of human resource development, the government, with the help of a team of international consultants, is in the process of formulating a new Human Resource Policy and Plan for Brunei Darussalam. In addition to this effort, special emphasis is also currently being placed on the promotion and development of human resource, ICT and science and technology, under the Eighth National Development Plan

Finally, the government is currently conducting a mid term review for its Eighth National Development Plan (2001–2005). It is expected to be completed by August 2003 and the findings of the review will include recommendations to not only further improve the implementation of the current development plan but also act as the basis for the formulation of next development plan.

Annex I

BRUNEI DARUSSALAM: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in US$ billion)	5.15	3.91	4.21	4.31	4.15	4.28
Real GDP	3.60	-3.99	2.56	2.83	3.00	3.22
Consumption	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Private Consumption	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Government Consumption	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Investment	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Private Investment	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Government Investment	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Exports of Goods and Services	3.26	-21.65	31.21	52.66	1.36	-0.69
Imports of Goods and Services	3.12	-13.65	-3.09	-1.82	14.19	-0.51
Fiscal and External Balance (percent of GDP)						
Budget Balance	-0.02	1.56	0.73	17.39	6.04	-4.15
Merchandise Trade Balance	10.66	13.14	29.04	64.85	60.16	50.13
Current Account Balance	51.68	53.78	62.63	92.82	91.64	86.46
Capital and Financial Non-reserve Assets Balance	-42.22	-52.41	-48.44	-49.16	-48.04	-50.6
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator						
CPI	1.69	-0.41	-0.09	1.25	0.58	-2.30
M2	-4.93	-1.35	3.06	25.94	-7.10	-1.37
Short-term Interest Rate (percent)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Real Effective Exchange Rate (level, 1997=100)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Unemployment Rate (percent)	4.20	4.70	4.50	4.70	5.60	3.50
Population (millions)	0.31	0.32	0.33	0.34	0.33	0.34

Annex II

BRUNEI: FORECAST SUMMARY (percent change from previous year)

	2002						2003					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	3.20	5.1	N.A.	N.A.	N.A.	N.A.	4.50	0.1	N.A.	N.A.	N.A.	N.A.
Exports	1.64	N.A.	N.A.	N.A.	N.A.	N.A.	3.70	N.A.	N.A.	N.A.	N.A.	N.A.
Imports	36.21	N.A.	N.A.	N.A.	N.A.	N.A.	-18.06	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	-2.30	1.0	N.A.	N.A.	N.A.	N.A.	N.A.	1.3	N.A.	N.A.	N.A.	N.A.

Annex III

BRUNEI: MEDIUM-TERM TREND FORECAST (percent)

	Period*
Real GDP	N.A.
GDP Deflator	N.A.

CANADA

REAL GROSS DOMESTIC PRODUCT GROWTH

After vigorous growth in the late 1990s and in 2000 the Canadian economy slowed noticeably in 2001, with real GDP growth advancing by just 1.5 percent in the year.

The slowdown in 2001, in large part, reflected a downturn south of the border, which was exacerbated by the tragic events of 11 September 2001. Despite the slowdown in 2001, Canadian real GDP growth remained above the G-7 average.

Following the short-lived slowdown in 2001, the Canadian economy has surged ahead in 2002: real GDP grew by a robust 3.4 percent in 2002. Canada's resilient performance reflects strong economic fundamentals, large tax cuts and an increasingly competitive business sector.

Economic activity is expected to continue to be strong over the coming years: the latest IMF economic outlook suggests that Canada will continue to lead the other G-7 economies in terms of economic growth in 2003 and will be second only to the US in 2004.

INFLATION

Domestic inflation has remained within the Bank of Canada's inflation target bands of 1 to 3 percent over the last five years.

Since mid-2002, however, total CPI inflation has moved up from 2.1 percent in July 2002 to 4.6 percent in February 2003 and has been outside the inflation-control target range.

According to the April 2003 Monetary Policy Report, however, the recent escalation in core and total CPI inflation can be attributed in large part to a combination of one-off (temporary) factors (energy prices and insurance premiums) and higher costs for key inputs.

According to the latest Monetary Policy Report, inflation is expected to remain near 3 percent through mid-2003 but inflationary pressures are expected to moderate over the second half, in tandem with the expected continued declines in energy prices and the disappearance of the impact of the insurance premium hikes. Core inflation is projected to move down to about 2 percent and total CPI inflation is projected to fall below 2 percent by early 2004.

EMPLOYMENT

Employment growth was strong through the late 1990s and into 2000. Consequently, the unemployment rate decreased from 9.1 percent in 1997 to 6.8 percent in 2000. The economic slowdown in 2001, however, reversed this trend. Employment growth was anaemic in the year and the unemployment rate increased to 7.2 percent in 2001.

The recovery in economic conditions since then has also led to an improvement in labour market conditions. During 2002 the Canadian economy created 560,000 new jobs. This represents the largest number of jobs created over any 12-month period on record back to 1976 and the fastest growth rate in 15 years (3.7 percent). Moreover, there were job gains in most sectors of the economy and over 60 percent of these new jobs were full-time.

This trend has continued in 2003, albeit at a slower pace: in the first four months of 2003 more than 48,000 jobs have been created. The unemployment rate, however, has remained roughly steady around 7.5 percent since the first quarter of 2002, as the labour force participation rates have increased markedly.

BALANCE OF PAYMENTS

The current account has improved dramatically from the deficits in the 1990s, due in part to significant improvements in government finances. The current account moved into surplus late in 1999 and the surplus has continued to increase despite the US slowdown. In 2002, the current account balance as a share of GDP was 1.5 percent, up from 0.2 percent of GDP in 1999.

GROSS EXTERNAL DEBT

Canada's net foreign debt as a share of GDP is down to its lowest level since the 1950s, from a peak of 44 percent of GDP in 1993 to below 19 percent in 2001. This reflects, in large part, the improvement in fiscal balances over recent years.

Canada's net foreign debt is now below that of the US. With continuing budgetary and current account surpluses expected in Canada, and continuing deficits anticipated in the US, Canada's net foreign indebtedness should continue to fall and the gap *vis-à-vis* the US continue to widen.

EXCHANGE RATE

The Canadian dollar has, in recent years, experienced downward pressure as a result of weakness in world commodity prices and flights to the quality of the U.S. dollar. The Canadian dollar began 2001 at close to 67 US cents but has trended downward since then, remaining around 64 US cents in 2002.

Sine the beginning of 2003, however, the Canadian dollar has gained significant strength *vis-à-vis* the US dollar.

The recent appreciation appears to be driven by higher levels of investor confidence in the Canadian economy.

FISCAL POLICY

The federal government has now recorded five consecutive surpluses—the first time in over 50 years. The surplus in 2001–02 was $8.2 billion in Canada. Furthermore, Canada was the only G-7 country to run a total government sector surplus in 2002.

Federal surpluses have helped to reduce the federal debt by $47.6 billion since 1996–97. This has also lowered the federal net debt-to-GDP ratio from 67.5 percent in 1995–96 to 44.5 percent in 2002–03. With the commitment to balanced budgets in each of the next two fiscal years, the federal net debt-to-GDP ratio is forecast to decline to about 40 percent in 2004–2005.

MONETARY POLICY

Since 1991, the Federal Government and Bank of Canada have maintained an official target range for the inflation rate. This target range was gradually lowered to 1 to 3 percent. The commitment to keep inflation within that target range was renewed in February 1998 and again in May 2001, with the latter commitment in effect until the end of 2006. The commitment to a low and stable inflation environment enables policy to best contribute to a sustained economic expansion in Canada, thereby leading to the likelihood of lower unemployment and improved productivity.

With the slowdown in global economic growth and a movement toward a position of excess supply becoming evident in early 2001, monetary policy began to ease in the United States and Canada at the beginning of that year. The US Federal Reserve dropped its Fed Funds rate eleven times for a total decline of 475 basis points during 2001. Between early 2001 and mid-January 2002, the Bank of Canada lowered its target for the overnight interest rate (its key policy instrument) on ten occasions for a cumulative decrease of 3.75 percent (or 375 basis points).

Since April 2002, however, the Bank has increased its rate by 125 basis points in response to strong growth in the economy.

MEDIUM-TERM OUTLOOK

Private sector economists expect Canadian real GDP growth will average close to 2.8 and 3.3 percent in 2003 and 2004 respectively. This is somewhat lower that earlier private sector estimates (incorporated in the February 2003 Budget) of 3.2 and 3.5 percent growth. Growth is expected to average around 3 percent after 2004.

With the expected continued declines in energy prices and the disappearance of the impact of the insurance premium hikes, the Bank of Canada's latest Monetary Policy Report predicts core inflation to average around 2.5 percent in the second half of 2003. Core prices are projected to move down to about 2 percent and total CPI inflation is projected to fall below 2 percent by early 2004. Inflation is expected to remain at 2 percent (the mid-point of the Bank of Canada's inflation target bands) over the medium term

Annex I

CANADA: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in CDN$ billion)	882.7	915.0	980.5	1065.0	1092.2	1142.1
Nominal GDP (level in US$ billion using nominal exchange rate)	647.4	660.8	661.0	716.8	735.3	737.4
Real GDP	4.2	4.1	5.4	4.5	1.5	3.4
Consumption						
Private Consumption	4.6	2.8	3.9	3.7	2.6	2.9
Government Consumption	-1.0	3.2	1.9	2.3	3.3	2.0
Investment						
Private Investment	18.1	2.8	7.2	6.9	0.4	1.6
Government Investment	-3.2	-0.7	12.7	3.0	11.5	8.7
Exports of Goods and Services	8.3	9.1	10.0	8.0	-3.8	0.8
Imports of Goods and Services	14.2	5.1	7.8	8.2	-5.8	0.8
Fiscal and External Balance (percent of GDP)						
Budget Balance	0.2	0.1	1.7	3.1	1.8	1.3
Merchandise Trade Balance	2.9	2.6	4.1	5.8	5.9	4.7
Current Account Balance	-1.3	-1.2	0.2	2.6	2.8	1.5
Capital and Financial Non-reserve Assets Balance	1.4	1.3	-0.4	-1.5	-1.6	-0.6
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	1.2	-0.4	1.7	3.9	1.1	1.1
CPI	1.6	1.0	1.7	2.7	2.5	2.3
M2	0.0	-0.7	2.8	7.1	5.2	6.3
90-Day Treasury Bill Rate (percent)	3.3	4.7	4.7	5.5	3.8	2.6
Canada-US Real Exchange Rate (level, 1997=100)	100.0	91.8	91.9	93.5	88.5	87.3
Unemployment Rate (percent)	9.1	8.3	7.6	6.8	7.2	7.6
Population (millions)	29.9	30.2	30.5	30.8	31.1	31.4

Annex II

CANADA: FORECAST SUMMARY (percent change from previous year)

	2003						2004					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	3.2	1.9	N.A.	N.A.	N.A.	N.A.	3.5	3.0	N.A.	N.A.	N.A.	N.A.
Exports	4.6	N.A.	N.A.	N.A.	N.A.	N.A.	6.5	N.A.	N.A.	N.A.	N.A.	N.A.
Imports	5.7	N.A.	N.A.	N.A.	N.A.	N.A.	7.5	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	2.4	2.8	N.A.	N.A.	N.A.	N.A.	2.2	1.7	N.A.	N.A.	N.A.	N.A.

Annex III

CANADA: MEDIUM-TERM TREND FORECAST (percent)

	2005-2008
Real GDP	3.0
GDP Deflator	1.8

Notes for Annex I

**** Forecast figures are based on December 2002 Private Sector Survey as incorporated in the February 2003 Budget**

1. Government consumption is total spending on goods and services.
2. Private investment includes investment in machinery and equipment, non-residential construction and residential construction.
3. Government investment is government gross capital formation.
4. The budgetary balance is on a national accounts basis for total government (calendar year basis)
5. The capital and financial non-reserve asset balance is total capital account balance - reserve assets.
6. The short-term interest rate is the 90-day Treasury bill rate.
7. The real effective FX rate is the Canada-US real exchange rate calculated as: 1/exp[log(pfx)+log(uspgdp)-log(pgdp)]

Variables and Source List

Nominal GDP (level in US$ billion)	v498086*pfx
Real GDP	v1992067
Consumption	
Private Consumption	v1992044
Government Consumption	v1992049
Investment	
Private Investment	v1992052
Government Investment	v1992050
Exports of Goods and Services	v1992060
Imports of Goods and Services	v1992063
Budget Balance	gbal
Merchandise Trade Balance	v114423*4
Current Account Balance	v114421*4
Capital and Financial Non-reserve Assets Balance	v114553- v114566
GDP Deflator	pgdp
CPI	pcpi
M2	v37198

CHILE

REAL GROSS DOMESTIC PRODUCT GROWTH

The Chilean economy experienced a modest expansion in 2002, with the rate of growth of gross domestic product (GDP) estimated at 2.1 percent. This slow path was in part a consequence of the mild recovery of economic activity and international trade globally. As a result, the export sector posted a more modest performance than expected. This was mainly due to supply factors in mining, and to the somewhat greater than expected impact of problems affecting several Latin American economies. The latter became apparent when non-traditional exports to other Latin American economies, by value, plunged in 2002, reversing the trends of the previous two years. For the same reasons, tourist flows were also weaker than forecast last year.

INFLATION

In late 2002, annual CPI inflation was 2.8 percent. This figure, which shifted significantly in the last four months of the year, was due to important movements in public transportation fares, the fluctuating exchange rate, the price of some perishable goods and fuels.

EMPLOYMENT

Job creation has tended to consolidate. In the last quarters of 2002, private employment has recovered. Better labor market conditions are occuring amidst relatively stable wages and modest growth in average productivity. Both elements have helped the labor market to adjust to the slack observed in recent years, including modest pay increases in the public sector. The national employment survey in the moving quarter ending in January 2003 recorded employment growth of 1.3 percent and a workforce rise of 0.9 percent since the same three month period a year ago. Unemployment thus affected 7.6 percent of the workforce, which is 0.4 percent down on the same period last year and 0.2 percent down on the preceding moving quarter. This measure of unemployment is the lowest since early 1999.

BALANCE OF PAYMENTS

In the external sector, export projections for 2002 were also corrected downward, due to lower sales abroad of some specific products, such as copper and the set of non-traditional exports. Thus, goods exports by volume rose about 3 percent for the year. Annual copper exports by volume fell about 2.5 percent in 2002. Non-copper exports continued to be the strongest performers amongst foreign sales. The main non-copper exports rose about 5.5 percent while other or non-traditional exports increased somewhat more than 7 percent.

In 2002 the balance of payments posted a current account deficit of about US$600 million. Meanwhile, the trade balance posted a US$2,444 billion surplus, with the value of imports falling 3.7 percent, end exports value, falling 2.1 percent.

The other current account components -services, income and transfers- posted total negative flows of US$3,047 billion in 2002, reducing the year's deficit by US$199 million. This lower deficit was mainly due to income on foreign investment, which fell because of lower international interest rates and less income due to direct investment in Chile, mainly lower profits from copper mining. Services posted a US$1,055 billion deficit, larger by US$137 million, mainly because incoming tourism remained depressed.

GROSS EXTERNAL DEBT

Net foreign currency holdings increased by US$17 million to total US$16,455.8 million. The increase was largely due to profits from portfolio management which were countered by partity and price adjustments. The only exchange transaction was the purchase of US$7.2 million from the Treasury.

EXCHANGE RATE

Trends in the exchange rate shifted in the last months of 2002. From late August to early October, the Chilean currency, the peso, depreciated quickly due to lack of liquidity in the spot market amidst general uncertainty and an apparent over-reaction to political and economic conditions in Brazil. Then, from mid-October through to mid-December, the peso recovered strongly thanks to improving terms of trade and sovereign spread, better conditions on the world's main stock markets, and completion of negotiations for a free trade agreement with the United States. The central bank's announcement that it would sell dollars on the spot market and issue dollar-indexed bonds in early October also brought the chances of riskier foreign exchange conditions under control. By the end of the year, Chile's peso was again highly volatile, mainly reflecting the likelihood of conflict in the Middle East, which has pushed parity up to 710 pesos per US dollar.

FISCAL POLICY

During the third quarter of 2002, public finances were corrected to comply with the annual budget, thus playing a less countercyclical role than during the first half of the year. In fact, during the third quarter, fiscal accounts posted an overall deficit, of -1.2 percent of GDP accumulated in annual terms. With this result, fiscal figures approached the objectives set during the recent budget debate (an accounting deficit of 0.9 percent in 2002), thus reverting the tendency of the annual deficit to increase.

Spending with macroeconomic effect also adjusted, with annual growth reaching 3.8 percent in the third quarter compared to 7.7 percent during the first half of 2002. Public investment, which after rising by almost 20 percent in the first half of the year fell 0.4 percent in annual terms during the third quarter. The fourth quarter of 2002 probably experienced additional spending limits, to meet budgetary constraints for the full year.

MONETARY POLICY

In the last quarters of 2002, monetary policy was guided by inflationary pressures under control, within the target range. Sluggish activity, which kept idle capacity unchanged throughout 2002 encouraged the new monetary impulse applied early this year.

For most of 2002, interest rates on central bank notes fell significantly, with an increase in volatility in the last months of the year. The sharp drop in long-term rates reflected several factors, particularly region-wide uncertainty prior to Brazil's elections, domestic activity's slow recovery, expectations about inflationary pressures, and trends in the relevant external rates.

Consistent with the reference rate and medium-term inflationary expectations, interest rates on short-term promissory notes (PDBCs) were cut by about 370 basis points from January to September; since then, they have held steady around the policy rate, although there is still some volatility.

Cuts to rates on central bank instruments led to similar declines in other fixed income instruments on the market, such as corporate bonds and bills of credit, which in the last quarter of 2002 hit historic lows.

MEDIUM-TERM OUTLOOK

It is projected that retail margins, which have been compressed through 2001 and 2002, should gradually return to normal, a shift that will cause core inflation, excluding movements in regulated rates, to rise modestly. Likewise, some cost pressures absent in recent years are expected to reappear over the projection horizon. Specifically, unit labor costs and foreign inflation in dollars are expected to rise more in the coming quarters than they have in the past two years. This would push core inflation, excluding regulated rates, gradually upward to around 3 percent in 2004, to the degree that goods and factor market conditions permit the decompression of margins and reduce slack in the labor market.

The copper price is expected to strengthen and average US$0.76 thus year, US$0.82 next year. Likewise, on average, the oil price is expected to drop from the US$25 to US$26 per barrel range this year to US$23 next year. This information suggests that on average the terms of trade should improve by almost 3 percent annually in 2003 and 2004, after the 1.3 percent increase last year.

The recovery in domestic spending apparent throughout last year should continue this year, although some components other than private consumption may take the lead in the short term. It is expected that consumption spending will gradually accelerate this year. On the investment side, idle capacity apparent in many sectors makes a vigorous recovery in the gross aggregate fixed capital formation rather difficult now. In fact, imports and domestic sales of capital goods, which are associated with investment in machinery and equipment, have tended to grow only slightly. For the future, the partial recovery in business returns makes the stronger performance of capital accumulation likely, especially in export and import substitute sectors where the recovery in indicators for returns has been strongest. All this, combined with the trajectory of public investment, which has not strayed significantly from forecasts, suggests that the fixed investment rate will increase slightly, above all next year.

Chile's fiscal accounts remain solid, with low public debt levels, suggesting a moderate impulse to aggregate demand this year. Lower external financial spreads should make it easier to keep real long-term interest rates low, so domestic financial conditions should continue to support a recovery in spending and activity for some time.

Altogether, export goods volumes are expected to rise by 4.0 percent to 5.0 percent this year. These figures should be higher in 2004, thanks to greater growth among trading partners. The recovery of the terms of trade should contribute to a rise in domestic income higher that in recent years. Progress towards greater financial stability in neighboring economies should also reduce local uncertainty, encouraging larger capital flows and the recovery of trade within the region. This set of data, along with today’s expansionary monetary conditions, should bring economic growth for this year to somewhere between 3 percent and 4 percent, similar to forecasts from January 2002.

Domestic demand, meanwhile, should rise from half to one point more per year on average than growth in activity in 2003 and 2004. This would keep the balance of payments’ current account deficit at about 1 percent of GDP. The latest survey of expectations by the central bank points to a mean projection of 3.4 percent growth for 2003, compared to 3.1 percent last January, while for 2004 the projection has remained at somewhat more than 4 percent.

Finally, by the end of 2003 CPIX is expected to reach 2.8 percent, 3.2 percent at the end of 2004 and 3.3 percent in the first quarter of 2005. Average core inflation will reach 2.7 percent in the next 12 months and 2.9 percent in the following 12.

Annex I

CHILE: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000 (1)	2001 (1)	2002 (2)
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (US$ million)	82,809	79,274	73,046	74,873	68,264,450	66,424
Real GDP	7.4	3.9	-1.1	5.4	3.1	2.1
Consumption (Real *)	6.5	4.3	-0.5	3.4	1.6	1.8
Private Consumption (Real *)	6.6	4.7	-1	3.5	2.7	1.7
Government Consumption (Real *)	5.8	2.2	2.5	2.8	3.1	2.4
Investment (Real)	9.4	2.2	-19.6	14	-7.6	2.3
Exports of Goods and Services	11.2	5.9	6.9	7.5	6.1	1.3
Imports of Goods and Services	12.9	5.4	-14.6	10.1	3.2	0.5
Fiscal and External Balances (percent of GDP)						
Budget Balance	1.8	0.4	-1.4	0.1	-0.3	-0.8
Merchandise Trade Balance	-2.7	-4.2	1.8	2.8	3	3.8
Current Account Balance	-5	-5.7	-0.1	-1.4	-1.7	-0.8
Capital Account Balance	9.8	4.5	-1.1	1.7	3.5	1.2
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	4	2.5	3.5	4.1	N.A.	N.A.
CPI	6	5.1	3.3	3.8	3.6	2.5
M2 (end of period) (3)	22.2	12.1	10.6	8.4	7	9.3
Short-term Interest Rate (4)	6.8	9.6	6	5.4	4.5	2.3
Real Effective Exchange Rate	-7.7	-0.2	5.5	4.5	11.5	1.7
Unemployment Rate (%)	6.1	6.3	9.8	9.2	9.1	9
Population (millions)	14.6	14.8	15	15.2	15.4	15.6

* Constant prices of 1996, except for 1996 figures

(1) Provisory figures

(2) Preliminary figures

(3) M2= M2A= Currency+ demand deposits in checking accounts of the non-financial private sector net of float + demand deposits not included in checking accounts + demand saving deposits + time deposits of the private sector
(4) Short-term interest rate is 90 days "Pagaré Reajustable del Banco Central" (PRBC)

(5) Forecast

Annex II

CHILE: FORECAST SUMMARY (percent change from previous year)

	2003						2004					
	Official	**IMF**	**ECLAC**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	3.6	3.3	3.5	N.A.	3.2	N.A.	4.2	4.5	N.A.	N.A.	4.0	N.A.
Exports	3.5	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Imports	6.0	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	2.5	3.4	2.9	N.A.	2-4	N.A.	2.4	3.0	N.A.	N.A.	N.A.	N.A.

Annex III

CHILE: MEDIUM-TERM TREND FORECAST (percent)

	Period*
Real GDP	N.A.
GDP Deflator	N.A.

* Please specify the forecasting period

THE PEOPLE'S REPUBLIC OF CHINA

REAL GROSS DOMESTIC PRODUCT

The economy of China continued to perform well. China's GDP in 2002 reached US$1237.09 billion, an increase of 8.0 percent in comparable prices over the previous year, and 0.7 percentage point faster, due to our continued stimulation of domestic demand and our unswerving implementation of a proactive fiscal policy and a stable monetary policy. The value-added of the second industry is US$640.09 billion, with a growth rate of 9.9 percent. The growth rates of primary and the tertiary industry are approximately equal to that of 2001, at 2.9 percent and 7.3 percent respectively.

The investment in fixed assets enjoyed a relatively rapid growth. Such investment in fixed assets for the whole economy reached US$521.93 billion in 2002, which was 16.1 percent up over the previous year, and the highest rate since 1996.

Consumer demand went up steadily, with the continued improvement of the living standard of the people. Total retail sales of consumer goods were US$494.30 billion, with a growth of 8.8 percent year-on-year. When the price factor is included, the growth rate would reach 10.2 percent. The living standards of people in towns and villages were improved steadily. The annual per capita governable income for the residents in cities and towns was US$930.70, with showing a real growth of 13.4 percent year-on-year. The per capita net income of residents in rural areas was US$285.87, with a real growth of 8.5 percent year-on-year, of which the per capita net income of cash was US$299.16, with a real growth of 4.8 percent year-on-year. The rates of growth income of these two groups are higher than that of 2001. The Engel coefficient of residents in urban and rural areas were 37.7 percent and 46.2 percent respectively, 0.2 and 1.5 percentage points lower, respectively, than last year.

In the first quarter of 2003, the major economic indicators reached the highest level since 1995. GDP grew by 9.9 percent. In the second quarter, the negative impact of the severe acute respiratory syndrome (SARS) outbreak on China's economy emerged. However, the robust growth in the first quarter balanced the impact. Economic growth in the first half of 2003 remain fast, up by 8.2 percent (YOY), 0.4 percentage point higher than in the first half of 2002.

INFLATION

Market prices were stable throughout 2002. The consumer price index (CPI) of the year 2002 was down by 0.8 percent over the previous year, with the rate minus 1 percent in urban areas and minus 0.4 percent in rural areas. Observed by components of price index of goods and services, the manufacturer's price of industrial products declined by 2.2 percent. The purchasing price of raw materials, fuel and power declined by 2.3 percent. The price of fixed-asset investment rose by 0.2 percent.

In the first half of 2003, CPI was slightly up by 0.6 percent, which was mainly driven by the food and services price.

EMPLOYMENT

The work done for improving employment was strengthened further. By the end of 2002, the total employees were 737.40 million, which were 7.15 million more than the previous year, of which 247.80 million employees were in urban areas, with an increase of 8.40 million year-on-year. By the end of 2002, the total number of laid-off employees of the state-owned enterprises (SOEs) was 4.10 million, 1.05 million less than the last year. By the end of the year, the urban registered unemployment rate was 4 percent, 0.4 percentage points higher than 2001. The unemployment will remain to be an important issue in the long run in China.

The social security system was further consolidated and improved. By the end of 2002, 147.31 million employees were registered in the Unemployment Insurance Program. The number of urban residents covered by the Subsistence Allowance System reached 20.54 million, among all the residents in urban areas who has the lowest income in China.

BALANCE OF PAYMENTS

The foreign trade kept high growth in 2002. Total volume of export and import of the year reached US$620.8 billion, up by 21.8 percent over the previous year. The total volume of export reached US$325.6 billion, up by 22.3 percent over the previous year. The total volume of import reached US$295.2 million, up by 21.2 percent over the previous year. Trade surplus of 2002 reached US$30.4 billion.

The international tourism industry experienced a steady development. In 2002, China received 97.91 million tourists from overseas, up by 10 percent year-on-year. The revenue of foreign currency of international tourism was US$20.4 billion, with a growth rate of 14.6 percent year-on-year. The Chinese tourists going abroad increased by 36.8 percent, of which 10.06 million people/times were private travelers, with a growth rate of 44.9 percent year-on-year.

The FDI increased rapidly. The actual value of utilization of foreign direct investments was US$52.7 billion, up by 12.5 percent over the previous year.

National foreign exchange reserves continued to increase. By the end of 2002, the total amount of the foreign exchange reserves reached US$286.4 billion, increased by US$74.2 billion than the previous year.

In the first half of 2003, the foreign trade reached US$376.1 billion, up by 39.0 percent over the same period of previous year, while the export grew by 34.0 percent, import grew by 44.5 percent. Trade surplus was US$4.5 billion, US$8.9 billion less than the same period of previous year.

The actual value of utilization of foreign direct investments increased 34.3 percent and reached 30.3 billion US dollars in the first half of 2003.

EXCHANGE RATE

The exchange rate of renmimbi (RMB) against foreign currency kept stable. By the end of 2002, 1 US dollar was equal to 8.2773 RMB. By 26 August 2003, 1 US dollar was equal to 8.2768, 7 RMB basic points appreciation, compared with the first day of 2003.

GROSS EXTERNAL DEBT

By the end of 2002, except Hong Kong, China; Macao; and Chinese Taipei, the recorded balance of the foreign debts amounted to US$168.54 billion. The share of the total recorded balance of the foreign debts to foreign reserve is 18.5 percent, 7.3 percentage points lower than that in 2001.

FISCAL POLICY

The statistics in the section does not include debt revenues. In 2002, situation was not in favor of enhancing revenue during the implementation of the fiscal budget. To implement her promise to WTO, Chinese government cut the overall tariff rate from 15.3 percent to 12 percent. During the process of finance system reform, stock trade taxes were reduced from 4 thousandth (A share Market) and 3 thousandth (B share Market) to 2 thousandth in both markets. The pause of reducing State-owned share also had negative impact on revenue. In 2002, the total fiscal revenue reached US$228.50 billion, up by 15.4 percent year-on-year. The total fiscal expenditure amounted to US$265.93 billion, up by 16.4 percent year-on-year. Fiscal balance in 2002 was minus US$37.43 billion.

MONETARY POLICY

The growth of monetary supply basically consisted with economic growth and the objects of monetary policy were basically achieved. By the end of 2002, the balances of the broad money supply (M2), the narrow money supply (M1), and cash in circulation (M0) reached US$2235.1 billion, US$856.34 billion and US$208.74 billion respectively, and up by 16.8 percent, 16.8 percent and 10.1 percent year-on-year, respectively, all are higher than that in 2001.

The savings and loans in financial institutions increased steadily. Savings and deposits in various forms in all banking institutions totaled US$2215.55 billion, up by 18.1 percent. The balance of loans issued by all financial institutions amounted to US$1689.00 billion, with an increase of 15.4 percent at comparable statistics.

MEDIUM-TERM OUTLOOK

The major targets of the economic and social development for China in 2003 are as the following:

- Economic growth rate around 7 percent
- The increase of the price level of consumer's goods and services by 1 percent
- An increase of the total volume of foreign trade by 7 percent.
- The new created employee position is not less than 8 million. The registered unemployment rate in urban areas is under 4.5 percent.
- The natural growth of population is under 7.5 thousandth.

Note:

1. The statistics of 2002 is quoted from the official statistics published by National Bureau of Statistics of China, which are preliminary data.
2. The statistics of Hong Kong Special Administration Region and Macao Special Administration Region is not included.
3. All statistics does not include the data of Taiwan Province.
4. The absolute values of GDP and the value-added of all sectors are calculated based on the current value, while the growth rates are calculated based on the comparable price.

Annex I

CHINA: OVERALL ECONOMIC PERFORMANCE

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
GDP and Major Components (percent change from previous year, except noted)										
Nominal GDP (billion US$)	601.1	540.9	697.65	816.9	903.0	960.9	991.1	1080	1159	1237.1
Real GDP	13.5	12.6	10.5	9.6	8.8	7.8	7.1	8.0	7.3	8.0
Total Consumption	9.3	8.0	9.2	9.3	6.1	6.8	7.9	10.4	8.07	10.2
Private	9.4	7.7	10.1	9.6	5.8	6.1	6.8	9.5	6.94	N.A.
Government	9.1	9.1	5.9	8.4	7.2	8.9	12.0	13.8	12.24	N.A.
Total Investment	24.9	15.6	15.5	10.4	7.1	14.4[1]	5.2	9.3	12.1[1]	16.1
Merchandise Exports	8.0	31.9	22.9	1.5	20.9	0.5[2]	6.1	27.8	6.4	22.3
Merchandise Imports	29.0	11.2	14.2	5.1	2.5	-1.5[3]	18.2	35.8	8.2	21.2
Fiscal and External Balances (percent of GDP)										
Budget Balance	-0.85	-1.23	-1.00	-0.78	-0.78	-1.5	-2.1	-2.8	-2.6	-3.0
MerchandiseTradeBalance (f.0.b.)	-2.03	0.99	2.41	1.51	4.46	5.48	2.9	2.23	1.6	2.5
Current Account Balance	-1.98	1.42	0.23	0.89	3.29	3.03	1.07	1.90	1.5	2.86
Capital Account Balance	3.91	4.68	4.74	4.89	2.54	0.00	0.01	0.18	3	2.61
Economic Indicators (percent change from previous year, except as noted)										
GDP Deflator	14.6	19.5	13.1	6.1	1.5	-1.3	-3.0	0.9	N.A.	N.A.
CPI	14.7	24.1	17.1	8.3	2.8	-0.8	-1.4	0.4	0.7	-0.8
M2	32.4	34.5	29.5	25.3	19.58	15.3	14.7	12.3	14.4	16.8
Short-term Interest rate (%)	8.8	9	9	9.72	7.65	6.34[4]	5.58	5.58	5.58	5.58
Exchange Rate(RMB/US$)	5.76	8.62	8.35	8.31	8.28	8.28	8.28	8.28	8.2766	8.2773
Unemployment Rate (%)	2.6	2.8	2.9	3.0	3.1	3.1	3.1	3.1	3.6	4.0
Population (millions)	1185.2	1198.5	1211.2	1223.9	1236.7	1248.1	1259.1	1265.8	1276.3	1284.5

[1] Real Investment in Fix Assets Growth

[2] Current price

[3] Current price

[4] 3 months inter-bank rate

Annex II

CHINA: FORECAST SUMMARY (percent change from previous year)

	2003					2001-2005				
	Official	IMF	LINK	ADB	OECD	Official	IMF	LINK	ADB	OECD
Real GDP	7 or so	7.5	N.A.	N.A.	N.A.	7	7.5	N.A.	N.A.	N.A.
Merch. Exports	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Merch. Imports	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	1	0.8	N.A.	N.A.	N.A.	3.5	1.5	N.A.	N.A.	N.A.

Annex III

CHINA: MEDIUM-TERM TREND FORECAST (percent)

	2001 – 2005
Real GDP	7
CPI	3.5

HONG KONG, CHINA

REAL GROSS DOMESTIC PRODUCT

The economy of Hong Kong, China, following a distinct slow-down in 2001, revived progressively under the impetus from the external sector over the course of 2002. However, the gross domestic product (GDP) was still down by 0.6 percent in real terms in the first quarter of 2002 over a year earlier. Then along with a resurgence in external trade, GDP resumed positive growth at 0.8 percent in the second quarter, followed by distinctly faster growth at 3.4 percent in the third quarter and 5.1 percent in the fourth quarter. For 2002 as a whole, GDP grew by 2.3 percent in real terms, up from a 0.5 percent growth in 2001. The Hong Kong, China's economy continued to display strong growth momentum at the beginning of 2003, with a solid growth of 4.5 percent in real terms in the first quarter over a year earlier. But the spread of the severe acute respiratory syndrome (SARS) had dealt a heavy blow to the economy, causing GDP to slacken to a 0.5 percent decline in real terms in the second quarter of 2003.

Hong Kong, China's exports of goods registered notable growth at 8.6 percent in real terms in 2002, with growth picking up to the double-digit range in the third and fourth quarters of the year. In the first half of 2003, total exports of goods remained robust, surging by 16.5 percent in real terms over a year earlier, trade performance being relatively unaffected by the SARS outbreak. Continued robust demand in the mainland of China (the Mainland) and improved external price competitiveness brought about by a weaker US dollar were the key factors underpinning the robust performance of merchandise exports. Exports of services had an even stronger performance than exports of goods in 2002, with a double-digit growth of 11.7 percent in real terms. There was a further double-digit growth in the first quarter of 2003, mainly bolstered by inbound tourism and offshore trade. However, with the severe blow to inbound tourism and the travel-related sectors of the SARS outbreak to exports of services plummeted by 14.7 percent in real terms in the second quarter over a year earlier, despite the sustained robust growth of offshore trade.

In the domestic sector, consumer spending fell by 1.3 percent in real terms in 2002, amidst much concern over employment and income conditions and with the distinct fall-off in the asset markets inflicting a negative wealth effect. There was some relative improvement at the beginning of 2003, but the spread of SARS since mid-March this year had completely choked off the tentative recovery. There was an extensive fall-off in April, and despite the steady pick-up in May and June (as the SARS threat receded), private consumption expenditure still fell by 2.2 percent in real terms in the second quarter compared to a year earlier, slightly down from the 2.0 percent decline in the first quarter.

Overall investment spending also shrank in 2002, by 4.3 percent in real terms, mainly brought about by a plunge in machinery and equipment intake amidst an uncertain business outlook. The local investment climate has remained subdued in recent months, under the continued drag from SARS.

The forecast growth rate in real terms for Hong Kong, China's GDP for 2003 is now put at 2 percent. Overall economic activity has begun to bottom out towards the end of May, and has been turning progressively better in the ensuing months. The Hong Kong, China economy should continue to pick up in the rest of the year. The external sector should provide the main driver of growth on the back of firmer global demand, continued strong growth in China's economy, and the envisaged rebound in inbound tourism from the earlier severe setback. The launch of the "individual visit" scheme for visitors from China's mainland to Hong Kong, China will be an added boost. The domestic sector likewise looks set to recover as the impact of the SARS outbreak dissipates and local consumer sentiment improves. The recovery will be aided by continued strong promotion by the affected trades and relaunch by the government. Sustained growth in external trade should also bring about beneficial spill-overs to the local economy in due course.

INFLATION

Overall consumer prices, as measured by the composite consumer price Index, came down by 3.0 percent in 2002, nearly double the 1.6 percent fall in 2001. Yet to a large extent, this was due to the rates concession and the waiver of water and sewage charges granted by the Government during the year. (Netting out the effect of these special relief measures, the rates of decline widened only modestly over the period.) Meanwhile, domestic cost pressure continued to ease, along with the softening of labour wages and property rentals. Local retailers lowered the prices of their goods and services further in face of subdued consumer demand and keen competition in the retail market. Externally, while import prices stayed soft in overall terms, the decline moderated over the past year, resulting from a weaker US dollar and a rebound in world commodity prices.

The Composite CPI continued to decline in the first two quarters of 2003, by 2.0 percent and 2.5 percent respectively over a year earlier. There was an accentuated decrease in May and June, mainly reflecting the impact of the outbreak of SARS on domestic demand and hence on consumer prices. The short-term economic forecast announced at end-August put the decrease in the Composite CPI at 3 percent for 2003 as a whole.

EMPLOYMENT

The labour market remained slack in overall terms in 2002. Yet some improvement was seen in the latter part of the year, mainly attributable to a pick-up in total employment upon an upturn in economic activity. For 2002 as a whole, the unemployment rate averaged at 7.3 percent, markedly higher than the 5.1 percent recorded in 2001. The seasonally adjusted unemployment rate surged in the early part of the year, from 6.2 percent in the fourth quarter of 2001 to 7.0 per cent and 7.7 percent respectively in the first two quarters of 2002. It increased further to a peak of 7.8 percent in May–July, amidst more extensive downsizing and lay-offs in the corporate sector. It then fell back somewhat in the latter part of the year, to 7.4 percent in the third quarter and 7.2 percent in the fourth quarter.

Total employment staged an upturn towards the end of 2002, to a year-on-year increase of 0.8 per cent in the fourth quarter, having worsened from a 1.0 percent decrease in the first quarter. Total labour force saw faster growth over the past year, with the year-on-year increase picking up to 2.0 percent in the fourth quarter, from 1.7 percent in the first quarter. The swing in the growth rate differential between total labour force and total employment pointed to a relative narrowing in the overall manpower resource balance, leading to a lower unemployment rate in the latter part of last year.

In the first quarter of 2003, the labour market visibly weakened further. The seasonally adjusted unemployment rate went up to 7.5 percent in the first quarter and significantly further, to 8.6 percent in the second quarter. While total labour supply showed some increase, total employment contracted over the period, as the outbreak of SARS curtailed business activity and dampened labour demand. The surge in unemployment, whilst occurring almost across-the-board, was particularly pronounced in the tourism and consumption-related sectors.

EXTERNAL TRADE ACCOUNTS

According to the merchandise trade statistics, Hong Kong, China's total exports of goods, at HK$1,560.5 billion (US$200.1 billion) in 2002, reverted to positive growth at 5.4 percent in value terms. Imports of goods likewise rebounded, rising by 3.3 percent in value terms to

HK$1,619.4 billion (US$207.6 billion) in 2002. As the value of total exports of goods rose faster than the value of imports of goods, the visible trade deficit reckoned on a GDP basis dwindled to HK$39.4 billion (US$5.1 billion) or 2.5 percent of the value of imports of goods in 2002. Together with an enlarged invisible trade surplus of HK$163.7 billion (US$21.0 billion), a combined surplus of HK$124.3 billion (US$15.9 billion), equivalent to 6.9 percent of the total value of imports of goods and services, was recorded in 2002.

Hong Kong, China's total exports of goods picked up further in the first half of 2003, by 14.7 percent over a year earlier to HK$802.0 billion (US$102.8 billion). Over the same period, imports of goods also rose markedly, by 13.4 percent to HK$835.4 billion (US$107.1 billion). Taken together, the visible trade deficit in the first half of 2003 (reckoned on a GDP basis) narrowed to HK$25.8 billion (US$3.3 billion) or 3.1 percent of the value of imports of goods. In the first half of 2003 along with an invisible trade surplus (reckoned on a GDP basis) of HK$72.1 billion (US$9.2 billion), there was a combined surplus of HK$46.3 billion (US$5.9 billion) or 5.1 percent of the total value of imports of goods and services.

BALANCE OF PAYMENTS

The current account yielded a further sizeable surplus of HK$137.3 billion (US$17.6 billion) in 2002, equivalent to 10.9 percent of GDP in that year. At the same time there was a substantial net outflow of financial non-reserve assets in the capital and financial account, totalling HK$194.2 billion (US$24.9 billion) or 15.4 percent of GDP. This was largely attributable to a substantial net portfolio investment outflow, which in turn was partly due to increased holding of overseas debt securities by Hong Kong, China residents, who were seeking higher return amidst the low interest rate environment. Overall, there was a deficit of HK$18.5 billion (US$2.4 billion) in the 2002 balance of payments account, equivalent to 1.5 percent of GDP, in 2002.

GROSS EXTERNAL DEBT

Hong Kong, China's external debt position remained sound, with external debt largely associated with normal operations of the banking sector and also with inward direct investment. Moreover, the government had no external debt. At end-December 2002, Hong Kong, China's gross external debt amounted to HK$2,739.6 billion (US$351.3 billion), equivalent to 217.5 percent of GDP. Of the total gross external debt at end-December 2002, 63.6 percent came from transactions of the banking sector, and 28.5 percent were debt liabilities to affiliated enterprises and direct investors under direct investment. Of the gross external debt of Hong Kong, China's banking sector, 97.3 percent were short-term liabilities, which were held mostly in the form of currency and deposits.

EXCHANGE RATE

The Hong Kong dollar remained stable against the US dollar in the first seven months of 2003, despite concerns over the protracted fiscal deficits, the outbreak of the severe acute respiratory syndrome (SARS), and market speculations about a widening of the official trading band of the renminbi. The market exchange rate stayed close to the convertibility rate of HK$7.8/US$1 during the period. The overall exchange value of the Hong Kong dollar, as measured by the trade-weighted nominal effective exchange rate Index, fell to 101 as of end-July from an average of 104.1 in 2002, reflecting the weakening of the US dollar against other major currencies.

FISCAL POLICY

The financial results for 2002–03 (ending on March 31) showed a deficit of HK$61.7 billion or 4.9 percent of the forecast GDP for 2002 as compared with the original budget deficit of

HK$48.2 billion. The fiscal reserves stood at HK$311.4 billion at end-March 2003, representing a decrease of HK$61.1 billion from the balance of HK$372.5 billion at end-March 2002. The fiscal reserves at end-March 2002 represented 16 months of government expenditure in 2002–03.

The 2003–04 budget forecasts a deficit of HK$67.9 billion, equivalent to 5.3 percent of the forecast GDP for 2003. The budgeted government expenditure represents a growth of some 11.0 percent in real terms over 2002–03.

In the remaining years of the Medium Range Forecast from 2004–05 to 2007–08, government expenditure is planned to fall at annual average rate of 1.6 percent in money terms, below the trend GDP growth rate of 3.5 percent a year in money terms over the period.

MONETARY POLICY

Hong Kong dollar interest rates eased during most of the first seven months of 2003. Largely reflecting ample liquidity in the banking system, short-term Hong Kong dollar interbank interest rates decreased in the first seven months, except for a brief increase in March-April due to concerns about the economic impact of the outbreak of SARS. Specifically, the three-month rate increased from 1.41 percent at end-December 2002 to a high of 1.63 percent in late April, before subsiding to close at 1.13 percent at end-July 2003. Its spread over the US dollar counterpart widened from 9 basis points to 37 basis points, but narrowed thereafter to close at 3 basis points during the same period. Despite the 25-basis-point cut in the US Federal Funds Target Rate in mid-2003, major banks in Hong Kong kept their best lending rates unchanged at 5 percent.

Hong Kong dollar narrow money increased strongly while broad money remained sluggish. Narrow money (seasonally adjusted) rose by 18.8 percent in the year to end-June, while broad money grew by only 0.5 percent. The rise in narrow money was attributable to the low opportunity cost of holding non-interest-bearing monetary assets as well as the buoyant stock market activity in the second quarter. The subdued growth in broad money was in line with weak economic conditions.

Domestic credit demand remained subdued, with loans for use in Hong Kong falling by 2.8 percent in June from a year ago. This mainly reflected the slack demand associated with high unemployment and persistent declines in property prices. The overall quality of the loan portfolio of banks continued to hold up well. The ratio of overdue and rescheduled loans to total loans for retail banks[1] stood at 3.64 percent at end-March 2003, compared with 3.59 percent at end-December 2002[2] Banks remained well-capitalised, with a 15.9 percent consolidated capital adequacy ratio for all locally incorporated authorised institutions in March 2003, well above the standard set by the bank for international settlements.

MEDIUM-TERM OUTLOOK

The outlook for the Hong Kong, China's economy beyond the short term remains positive. This is underpinned notably by further economic reform and development and on-going market liberalisation in the mainland China. China's accession to the WTO is opening up more opportunities for trade and investment. Moreover, the Closer Economic Partnership Arrangement between Hong Kong, China and the mainland China promises even more

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1 Retail banks comprise all the locally incorporated banks and a number of the larger foreign banks which are not locally incorporated but whose operations are similar to those of the locally incorporated banks, in that they operate a branch network and are active in retail banking.

2 Overdue & rescheduled loans refer to loans and bills overdue by more than three months and rescheduled loans.

opportunities. Hong Kong, China will continue to serve as an eminent foothold and conduit for business between the mainland China and the rest of the world. Also, the closer business links between Hong Kong, China and other economies in East Asia render added scope. For the medium-term period 2003–07 as a whole, the trend for the GDP growth rate, in real terms, is currently forecast at 3 percent.

STRUCTURAL REFORM

Hong Kong, China is a free market economy, and thus the prime mover of economic restructuring rests mainly with the business/private sector. Yet the government is actively promoting the development of hard and soft infrastructure by investing heavily in education; upgrading economic infrastructure, promoting innovation and technology; improving the business environment; helping the business sector to develop new markets, protecting ecology; and environment and improving quality of life.

On improving the business environment, the government continues to up-hold the principal of "big market, small government". The government also works to further reduce business costs by cutting red tape, embarking on de-regulation, streamlining procedures and enhancing administrative efficiency.

To enhance strengths in the four core industries—finance, logistics, tourism and producer services, the government strives to improve market structure and corporate governance, in addition to improving the legal system. The government continues to enhance information connectivity, upgrade the necessary infrastructure and promote tourism by investing in projects such as Disneyland theme park, enhance cultural, recreational, sports and arts activities as well as preserving and promoting our heritage and cultural relics.

To assist the business/private sector to capitalise on the rapid development of China, the government recently entered into a Closer Economic Partnership Arrangement with mainland China and arrived at an agreement to allow residents within Guangdong Province of China to visit Hong Kong, China in their personal capacity. The government shall continue to push through other measures that target to speed up and improve boundary crossings and expedite economic integration with the Pearl River Delta.

Annex I

HONG KONG, CHINA: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002
GDP and Major Components (percent change, year over year, except as noted)(1)						
Nominal GDP (level in billion US$)	174	165	161	165	163	162
Real GDP	5.1	-5.0	3.4	10.2	0.5	2.3
Consumption	6.5	-6.1	1.3	5.4	2.2	-0.8
Private Consumption	6.9	-6.7	1.3	5.9	1.6	-1.3
Government Consumption	2.4	0.7	3.1	2.0	6.1	2.4
Investment	12.6	-7.3	-16.6	11.0	2.7	-4.3
Private Investment	16.5	-7.0	-19.8	15.5	3.7	-4.8
Government Investment	-5.2	-9.7	0.6	-10.3	-2.3	-2.0
Exports of Goods and Services	5.0	-3.9	4.0	16.5	-1.6	9.2
Imports of Goods and Services	6.8	-6.3	-0.2	16.8	-1.5	7.1
Fiscal and External Balance (percent of GDP)						
Budget Balance	6.5	-1.8	0.8	-0.6	-5.0	-4.9
Merchandise Trade Balance	-11.8	-6.4	-3.5	-6.6	-6.9	-4.7
Current Account Balance	-3.5	2.7	7.5	5.5	7.5	10.9
Capital and Financial Non-reserve Assets Balance(2)	10.6	-6.6	-0.4	1.6	-4.8	-16.7
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator(1)	5.7	0.2	-5.8	-6.2	-1.9	-3.0
CPI	5.8	2.8	-4.0	-3.8	-1.6	-3.0
M2(3)	N.A.	11.6	8.8	7.8	-2.7	-0.9
Short-term Interest Rate (percent)(4)	7.1235	8.0605	5.8402	6.1146	3.5566	1.7857
Real Effective Exchange Rate (level, 1997=100)	100.0	107.7	100.6	95.8	95.7	92.0
Unemployment Rate (percent) (5)	2.2	4.7	6.2	4.9	5.1	7.3
Population (millions)(6)	6.5	6.5	6.6	6.7	6.7	6.8

Notes :

(1) Revised series incorporating the results of a technical revision to GDP as announced on 1 August 2002.

(2) Before the detailed breakdown of the capital and financial account was available for the reference year of 1998, net errors and omissions within the BoP identity were embedded in the net change in capital and financial non-reserve assets in 1997.

(3) As from June 2002, figures are compiled on the basis of the revised definition by including short-term Exchange Fund placements in the monetary aggregate. With the series backdated only to April 1997, percentage changes prior to 1998 are not available.

(4) Three-month HIBOR.

(5) As from August 2000, the "resident population' approach is adopted in place of the "extended de facto" approach for compiling the population figures, and a set of revised figures on total population, total labour force, total employment, numbers employed, numbers underemployed, and labour force participation rate backdated to 1996 is thus compiled. The unemployment rate is nevertheless generally unaffected.

N.A. Not available.

Annex II

HONG KONG, CHINA: FORECAST SUMMARY (percent change from previous year)

	2003						2004					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	2	1.5*	2.0	N.A.	0.8	2.0	N.A.	2.8*	4.0	N.A.	2.5	2.5
Exports#	9.2	6.1	6.5+	N.A.	7.8@	5.9@	N.A.	6.4	6.2+	N.A.	10.0@	7.1@
Imports#	7.1	6.0	5.9+	N.A.	6.5@	5.6@	N.A.	6.9	6.7+	N.A.	9.9@	6.7@
CPI	-3	-2.6*	-1.5	N.A.	-2.0	N.A.	N.A.	-1.9*	0.5	N.A.	-1.0	N.A.

Notes : # Referring to merchandise trade only.
+ Forecasts in US$ terms.
@ Comprising both goods and services.
N.A. Not available.

Sources : * IMF forecasts, *IMF Country Report* (September 2003)
ADB forecasts, *Asian Development Outlook 2003* (April 2003).
PECC forecasts, *Pacific Economic Outlook* (July 2003).

Annex III

HONG KONG, CHINA: MEDIUM-TERM TREND FORECAST (percent)

	2003-07
Real GDP	3
GDP Deflator	0

INDONESIA

During 2002 and to end of the first half of 2003, Indonesia's economic performance has made favorable progress as indicated by more stable monetary conditions, even though the modest expansion is still insufficient to reduce unemployment. Consistent monetary and fiscal policies, supported by progress of economic restructuring in several areas, have helped to achieve economic and monetary stability thus far. The exchange rate strengthened significantly with relatively little volatility and base money was under control and moved below its indicative target. These positive developments eased inflation pressures in 2002 and 2003, a notable shift from increases in the two previous years. Improved inflation prospects, controlled base money and a more stable and stronger exchange rate allowed room for the monetary authority to gradually and consistently ease interest rates, delivering positive signals that the economic recovery remained on track.

Looking ahead, the recovery prospects for the Indonesian economy are expected to further improve, albeit only modestly, in 2003. Healthier indicators for monetary and macroeconomic stability should be maintained in 2003, which hopefully will enhance market confidence in the prospects of economic recovery. However, there are a number of downside risks that should be closely watched, such as the potential for reversal of the capital flow and the resumption of inflationary pressures as economic activities move onto a stronger footing. Challenges also remain in further recovering the banking intermediation function, in line with continuous efforts to implement structural reforms and creating a more conducive environment in the real sector.

REAL ECONOMIC ACTIVITY

Following the favorable economic progress in 2002, the Indonesian economy continued to experience positive economic growth in the first half of 2003, supported by stable and conducive monetary conditions. The relatively stable and strengthening rupiah exchange rate, subdued inflation and lower interest rates have all contributed to providing a conducive environment for growth. The economy posted a 3.56 percent (year-on-year) growth in the second quarter of 2003, slightly improved from the 3.43 percent (y.o.y) level of growth in the first quarter. Consumption remained the main driving force, owing its resilience to lower inflation and interest rates, while the government's routine spending also picked up. Promising progress can be seen in investment, which reasonably improved in line with the declining interest rate trend.

Improved macroeconomic indicators are forecast to continue throughout the year, and with the impact of a number of global threats (such as the Iraq conflict and SARS outbreaks) diminishing, overall economic growth in 2003 is projected to move towards the upper band of 3.5 percent–4.0 percent compared to 3.7 percent in 2002. Increased consumer confidence and improved investment financing are expected to give strong contribution to the prospect of growth, while fiscal stimulus is also anticipated to help spur growth.

From the demand side, the prospects for economic growth will continue to rely on increased? consumption, while the share of investment will be bigger and exports will also rise. With increased expectations of an improved domestic economy, it is anticipated that consumption will continue growing as consumer confidence improves. Meanwhile, the estimation of rising investment is based on growing financial sources in the form of foreign capital investment as well as the issuing of new bonds and corporate stocks. Increased financing from the banking sector will also encourage investment. On the other hand, exports are still expected to grow significantly, since economic conditions in the more advanced economies are not expected to record significant improvement, while competition with other exporting economies is increasing. Imports are also forecast to rise, in line with higher exports and overall economic growth.

In sectoral terms, growth is envisaged across all economic sectors, with manufacturing, construction, electricity, trade, and transportation recording the strongest performances. In sectoral terms, it is envisaged growth will prevail across economic sectors with electricity, transportation (mainly the telecommunications sub-sector) and construction recording the strongest performances. In line with the government plan to resume a number of infrastructure projects, the construction and electricity sectors are expected to benefit the most. These projects would have a large multiplier effect on other sectors, increasing overall growth and generating new jobs. In the construction sector, property development (dominated by housing and shopping centers) is also forecast to expand appreciably, spurring demand for steel and cement. In the electricity sector, the development of new power and the continuation of several private power projects (in anticipation of rising demand for electricity in 2003 and beyond), will add to growth. In addition, the growth of manufacturing (which contributed the most in 2002) is forecast to accelerate in 2003. Growth in other sectors (such as trade, transportation and communications, and services) will be lower than last year, owing to the impact of the Bali tragedy. In the case of the communications sub-sector, growth should be sustained somewhat by the expansion of Indosat and Telkom.

INFLATION

Significant strengthening of the rupiah and weak aggregate demand helped put inflation on a downward trend in 2002. CPI inflation during 2002 declined to 10.03 percent, much lower than the 12.55 percent of last year. Inflationary pressures originated from?, among others, government policy on prices and incomes. These contributed 3.31 percent to the year's inflation, compared with 3.83 percent in 2001. Inflationary pressure also originated in supply shocks, mainly in reduced food supply and the disruptions to the distribution network due to floods early in the year. On the other hand, the public's expectations of inflation, which generally moved downward in 2002 as shown by several surveys, has help ease the inflationary pressures.

During the first half of 2003, CPI Inflation continued trending down, reaching only 1.23 percent (year-to-date). In line with the accelerating growth of GDP, aggregate supply rose fairly, compensating for the increase in aggregate demand. The minimum output gap resulting from this supply demand interaction help ease the inflationary pressure. At the same time, the appreciation in the rupiah exchange rate and decreasing rates of inflation in trading partners' economies also contributed to putting inflation on a downward path. Moreover, positive supply shocks, particularly in the food category originating from the big harvest in the second quarter of 2003, also helped reduce the pressure on prices. In addition to that, inflationary expectations both from consumers and producers have also followed the declining trend.

Inflationary pressures for the second half of 2003 are forecast to ease further. There should be limited pressures from aggregate demand, a stronger exchange rate and lower inflationary expectations. Low inflation originating in aggregate demand pressure is supported by the 2003 projection, i.e., economic growth in 2003will depend upon consumption, which tends to grow at a slower pace. In light of the forecast for a somewhat stronger rupiah in 2003, the overall exchange rate would not put pressure on inflation, while the expected subdued inflation in trading partners' economies will also work benignly toward domestic inflation. Moreover, the impact of the government's prices and incomes policies, which were previously expected to remain substantial, are now expected to be less significant, partly due to the postponement of the increase in the telephone tariff. The policy is forecast to contribute only 1.81 percent to inflation in 2003. After looking at the factors that are expected to influence the future movement of prices, the rate of inflation in the rest of 2003 should maintain its downward trend. The projections for inflation are: 6.5 percent (y.o.y) in the third quarter of 2003, and 6.4

percent (y.o.y) by the end of the year. These forecasts are lower than the target CPI inflation rate of 8 percent (plus or minus1 percent) set by Bank Indonesia

EMPLOYMENT

The labor market remained sluggish in 2002, as the number of newly created jobs fell well short of additions of new entrants to the work force due to relatively low economic growth. The moderate economic growth of 3.7 percent is estimated to have absorbed only 0.8 million of the 1.7 million new entrants into the labor force in 2001. Consequently, the open unemployment rate has risen, from 8.1 percent in 2001 to 9.1 percent in 2002. Furthermore, the number of unemployed in 2002 reached 38.0 million people, consisting of 28.9 million who are underemployed and 9.1 million who are openly unemployed. Domestic labor problems and issues of illegal Indonesians working abroad added to employment hardships in 2002.

In 2003, employment remains a challenge as the economy's population increases, demanding a respective increase in job opportunities. The anticipated economic growth may not create sufficient new jobs. Caution should be exercised in relation to the impact of implementation of the ASEAN Free Trade Agreement (AFTA) in 2003. The AFTA considerably increases competition among businesses in the ASEAN region, and may therefore have an unfavorable impact on employment in Indonesia because uncompetitive companies may have to close.

Nevertheless, the increase in investment, as already indicated in the data up to mid-2003, could contribute to increasing employment opportunities, while the new Labor Law is expected to create a more conducive labor environment.

BALANCE OF PAYMENTS

The overall balance of payments in 2002 improved compared with the previous year, following a wider current account surplus and a narrower capital account deficit. The balance of payments recorded a surplus of $4.0 billion, much better than the previous year's deficit of $1.38 billion. With this surplus, official international reserves stood at $32.0 billion by the end of 2002, equivalent to 6.6 months of imports and government debt servicing. The overall surplus in the current account in 2002 was estimated to reach $7.5 billion (4.3 percent of GDP), higher in US dollar terms than the previous years surplus of $6.9 billion (4.7 percent of GDP). The improved current account was mainly due to better export performance. In the case of the improved capital account, it was mainly due to successful foreign debt restructuring.

In 2003, the Indonesian balance of payments is forecast to weaken compared with the previous year. The overall surplus would narrow down to $3.2 billion from $4.0 billion in 2002, due to a smaller surplus on the current account. The $2.0 billion decline in the current account surplus would mainly be accounted for by a rise in the deficit on services of $1.72 billion, mainly due to declining receipts from tourism related to the Bali tragedy and the global spread of SARS. On the trade account, exports and imports are forecast to grow by 3.9 percent and 7.2 percent, respectively, in 2003 and the trade surplus should narrow by around $0.2 billion. As mentioned, the deficit on capital account would decline slightly in 2003, from $2.8 billion to $2.2 billion, largely due to net official flows. On this basis, official foreign exchange reserves are forecast to reach $35.2 billion at the end of 2003, equivalent to 6.9 months of imports and official foreign debt service payments.

EXTERNAL DEBT

Substantial progress has been made in this area as reflected by the improvement in some external debt burden indicators such as debt to GDP ratio, debt service ratio, and debt to export ratio by the end of year 2002. By end 2002, the ratios of debt to GDP, debt service, and debt to export reached 68.7 percent, 32.2 percent, and 194.01 percent respectively, reasonably improving compared to the ratios in the previous year, which were as high as 91.1 percent, 41.1 percent, and 200.7 percent respectively.

The government has made efforts to ease the public debt burden. The Paris Club arrangement has helped ease the burden through rescheduling arrangements that were achieved as a result of confidence in the government's commitment and the prospects for the Indonesian economy. Furthermore, the authorities also seek other ways to reduce the debt burden, such as the 'debt for nature' swap as well as the 'debt for development' swap. For business/private sector debt, the restructuring process is still in progress. In light of this, the government has extended the operational term of the Jakarta Initiative Task Force responsible for the restructuring of private debt.

Nevertheless, debt management will become even more challenging in the year to come as the government moves ahead with the plan to conclude the IMF program by the end of 2003. Within this scenario, the Paris Club will no longer be an avenue for public debt rescheduling. Hence, the amount of external debt servicing falling due in 2003 is estimated to reach $28.3 billion, consisting of $23.4 billion in principal and $4.9 billion in interest. Out of this total debt servicing, some $21.5 billion is attributed to business/private sector debt while the remaining $6.8 billion is a government liability. This amount is expected to decrease slightly in 2004 and 2005 as the amount of business/private sector debt is anticipated to decline. The debt to GDP ratio is expected to go down still further.

Anticipating the need to cover the government financing gap in the years ahead, measures have been taken to develop the domestic bond market. This is in line with a government debt management strategy aimed at lowering costs and minimizing risk by improving the maturity profile. In this regard, the Indonesian authorities have continuously been strengthening the regulatory framework and developing market infrastructure to enhance the liquidity in the secondary market. A decree setting out the procedures for issuing, buying and selling and administration of government securities has been issued, and government bonds auctions have begun. The above steps were taken and implemented forcefully and carefully to take on next year challenges of the post-IMF program. A deep and liquid government bond market will foster financial stability and will also provide government with a tool for effective management of debt and the opportunity to reduce dependence on foreign borrowing. The development of a/the government bond market will also facilitate the implementation of a sound and prudent monetary policy. The structure of the government debt was significantly improved with re-profiling maturities and the use of asset recovery funds to redeem the bonds. The authorities also intend to continue to reduce and re-profile the debts through exchange offers and debts buybacks.

EXCHANGE RATE

Following the noticeable appreciation during 2002, the first half of 2003 also witnessed further strengthening of rupiah exchange rate. Up to mid-2003, the rupiah had gained 8.16 percent (year to date from 2002) on a point-to-point basis to Rp8.693 per USD or 7.19 percent on average. Volatility increased, particularly in the second quarter of 2003. This strengthening is mainly driven by strong capital inflows as indicated from foreign exchange transactions between domestic banks and offshore counterparties. This inflow has significantly helped maintain the sufficiency of foreign exchange supply in the domestic market.

The appreciation of the rupiah was also attributable to other factors, including the improvements in risk indicators, a still-favorable interest rate differential, increasing diversity of investment alternatives in rupiah, and moral suasion from Bank Indonesia. This appreciation has created a positive momentum for the Indonesian economy. The rupiah exchange rate in real term was also strengthened, helping maintain the inflation rate in check. Nevertheless, caution has to be placed on the impact of the currency's appreciation on the competitiveness of Indonesian exports.

For the whole of 2003, on average, the exchange rate is expected to move within the range of Rp8,400 to Rp8,600 per US dollar. In general, the exchange rate is forecast to remain firm in 2003, although it will not strengthen as sharply as in 2002. Looking at economic fundamentals, the predicted exchange rate is made on the basis of an improved performance of the Indonesia's economy, including the balance of payments which remains in surplus. Other factors supporting the stronger exchange rate would be success in (official and private) debt restructuring; privatization of state-owned enterprises; and the divestment of Indonesian Bank Restructuring Agency (IBRA) assets, which would add to the supply of foreign exchange and provide positive sentiment. In addition, the market's views on Bank Indonesia's commitment to maintaining exchange rate stability are expected to continue. However, some risks down the road need to be monitored closely. Declining interest rate differentials as a result of the lowering of the interest rate may affect the interest of investors in holding assets in rupiah. Moreover, the likelihood of heightening political tensions ahead of the general election of 2004 and the increasing need of foreign exchange for with debt repayment and increases in imports also serve as risk factors to be watched vigilantly.

FISCAL POLICY

Implementation of the government budget during 2002 reflected financial consolidation to ensure medium-term fiscal sustainability. However, the deficit narrowed much more than expected, mainly due to lower development spending outcome. The fiscal deficit for 2002 is estimated to stand at 1.7 percent of GDP, lower than the budgeted 2.5 percent. On the revenue side, the tax ratio reached only 12.7 percent of GDP, mainly due to the under-performance of non-oil/gas income taxes and the value-added tax (VAT). Shortfalls in these tax revenues were offset by higher oil/gas revenues in line with the increase in world oil prices and other non-tax revenues. The overall revenue was 18 percent of GDP or roughly the same as the budgetary target.

On the spending side, actual routine spending was lower than budgetary allocations in almost all components of routine expenditure, except for interest payments on domestic debt. Actual development spending was below target due to low absorption capacity of foreign loans, especially for project loans. Realization of the regional budget did not face significant constraints and was roughly on-target. Total realized spending was 19.7 percent of GDP, or 4.7 percent lower than the initial budget plan. As regards the impact of government spending on the economy, the fiscal stimulus was the same as last year, namely 11.8 percent of GDP. From the monetary perspective, government spending in rupiah was quite conducive to supporting monetary control, having a lower net expansionary impact (Rp19.5 trillion) than the Rp32.2 trillion of 2001.

The 2003 state budget aimed at controlling the deficit while seeking to ameliorate the negative impact of the Bali incident by accommodating a strong public interest in fiscal stimulus. The budget deficit is forecast to be 1.8 percent of GDP, virtually unchanged from the preliminary figures for 2002. Control of the 2003 deficit should be achieved through a continued increase in budget revenues (mainly tax collections), and through belt-tightening measures (largely cuts in oil/gas subsidies) and lower domestic debt servicing.

On the financing side, government financing still relies on domestic non-bank sources such as privatization and IBRA assets sales with the balance met by foreign borrowing. In addition, government bonds are also expected to meet the government's financing needs. Furthermore, since the net contribution from these sources still falls short of the overall needs, the government plans for the first time since the 1997 crisis to use savings in the monetary system (*Sisa Anggaran Lebih*; SAL) amounting to Rp8.5 trillion. As regards the impact of government spending on the economy, the direct contribution of the government sector to GDP should increase over last year (11.8 percent) to 13.4 percent in 2003, of which 7.7 percent of GDP is consumption spending and 5.7 percent investment spending. As mentioned earlier, this increase is to be achieved mainly through significant cuts in fuel subsidies and reductions in domestic debt servicing. On the monetary side, the additional allocation for fiscal stimulus has caused a rupiah budgetary expansion of as much as Rp26.7 trillion. Most of this amount is forecast to originate from net foreign exchange inflows from the government sector (which reach Rp18.2 trillion); the remainder would be covered by a withdrawal of Rp8.5 trillion from the SAL.

MONETARY POLICY

Year 2002 closed with good growth in economic and monetary conditions, despite economic recovery being lower than anticipated. Prudent monetary policy, in parallel with fiscal consolidation and supported by further advances in economic restructuring during 2002, have facilitated economic and monetary stability. The exchange rate appreciated noticeably and moved steadily, while base money has been kept in check below its target range. Other monetary aggregates, M1 and M2, have also grown at moderate levels. These positive developments led to a lower inflation rate, after experiencing increases for two consecutive years. The sound inflation and exchange rate figures as well as controllable monetary aggregates allowed the monetary authority to cut the interest rate in support of economic recovery. Operationally, the monetary policy strategy was to optimize the use of available monetary instruments: open market operations (OMO) and foreign exchange intervention/sterilization were used to absorb excess liquidity in the context of a declining trend in SBI rates. This strategy was undertaken prudently so as not to sacrifice the long-term path to Bank Indonesia's inflation target.

Monetary conditions have been encouraging since early 2002. Base money was quite stable and below its target range; and the exchange rate was stronger and less volatile, all of which helped reduce inflationary pressures. These conditions provided room for Bank Indonesia to gradually lower interest rates, with due attention to the real interest rate and interest rate differentials. During the first half of 2003, the one-month SBI rate declined 340 bps, reaching 9.53 percent by the end of June 2003. This policy of bringing down interest rates was undertaken in line with efforts to revive bank intermediation and to raise public confidence in the prospects for economic recovery. This strategy is expected to encourage business players to restructure their balance-sheet and to take advantage of available financing resources (from both banks and the capital market) to raise their utilization and productive capacity.

Throughout the year 2003, monetary policy will be geared toward maintaining a downward trend in inflation and preserving exchange rate stability. Inflation is forecast to reach way below its 9 percent target in 2003, which reflects the commitment of achieving the medium-term inflation target. Base money will be directed towards achieving an average growth of 8.2 percent which would be adequate to meet the real needs of the economy. The absorption of excess liquidity consistent with the base money target would allow interest rates to decline further, albeit at a slower pace.

In operation, the efficient use of monetary instruments will be continued in 2003, including efforts to use foreign exchange intervention and sterilization to help absorb bank liquidity and minimize excessive fluctuations of the exchange rate. On a long-term basis, government bonds need to be considered as an alternative instrument to SBIs. Therefore, efforts should be continued to develop infrastructure of the secondary market for securities, mainly to enhance their effective use as monetary instruments.

BANKING POLICY AND DEVELOPMENTS

As a continuation of the banking policy pursued a year earlier, in 2002 Bank Indonesia focused its policy on three programs, namely banking rehabilitation, banking resilience, and bank intermediation. Under the banking rehabilitation program, the government continued to implement its guarantee program although gradually the guaranteed coverage will be eliminated. While under the bank recapitalization program, banks are obliged to register government bonds held in their investment, trade, and collateral portfolios.

With regard to strengthening banking resilience, measures were aimed at improving the banking infrastructure, enhancing the quality of bank management and strengthening prudential regulations. One critical, priority action to improve banking infrastructure is the plan to establish a deposit guarantee institution (*Lembaga Penjamin Simpanan*;LPS) in place of the existing guarantee scheme.

In the area of banking supervision and regulations, the aim is to meet international standards as defined by the 25 Basle Core Principles. Improvements in this regard include risk-based supervision, including incorporating market risk in measuring banks' capital adequacy. With the emergence of more complex banking products and services in more intense economic globalization, improvements to the banking system are vital. In this regard, Bank Indonesia is drawing up a 'Blueprint of Indonesian Banking Architecture,' with the objective of ensuring a more resilient banking system in the future that could withstand an ever-changing global environment, and fostering financial system stability. To promote financial stability, Bank Indonesia is designing a 'Blueprint of Financial System Stability' outlining the tasks of Bank Indonesia in promoting financial system stability, and a coordination framework for crisis prevention and resolution. Internally, Bank Indonesia prepared organizational aspects of the monitoring and surveillance of financial system stability.

To promote bank intermediation, several steps should be undertaken, mainly in the form of incentives to expand credits especially to small and medium enterprises which are considered to have driven economic growth to date. In this regard, efforts include the Micro credit Project, Development of Integrated Information Systems for Small Scale Business, and efforts (known as *Bazar Intermediasi*) to match business agents with the banking sector in several regions. To revive the economy,, particularly in conflict-hit areas/regions, Bank Indonesia has issued a regulation containing special criteria for measuring the quality of credit channeled to the microsector and *Usaha Kecil dan Menengah* (UKM) operating in those areas. In addition, as a support measure aimed at alleviating poverty, Bank Indonesia has cooperated with the Office of the Coordinating Minister of People's Welfare to encourage banks to expand credit to the low-income segment of society.

The policy aiming to strengthen banking resilience was also implemented through the establishment of banks operating under sharia principles. In this field, a number of initiatives and strategic steps have been taken. During 2002, the 'Blueprint of *Sharia* Banking Development in Indonesia' was completed. This will point the direction for *sharia* banking development in the future. It will also serve as a road map for Bank Indonesia, the Sharia Banking Institute and other sharia financial institutions to develop a competitive and efficient *sharia* banking system while adhering to prudent principles and encouraging the real sector activity through financing based on quasi-equity principles. In the forum of international cooperation, Bank Indonesia has been active in developing the International Islamic Financial Market (IIFM) as an institute to develop *sharia* money market instruments, and the Islamic Financial Services Board (IFSB), as an initiative to set *sharia* banking regulations and supervision.

The various policies mentioned above, supported by improved macro-monetary conditions, have strengthened the banking system. This was reflected in a stronger capital structure, improved NPLs, stronger profitability, and recovery in bank intermediation. As regards capital, the stronger capital structure is reflected in the system-wide capital adequacy ratio (CAR), which reached 22.49 percent at the end of 2002, 1.9 percent higher than the previous year. Efforts by the banks to restructure credit have reduced their gross NPL ratio to 8.3 percent (2.9 percent on a net basis), as compared to 12.1 percent (net 3.6 percent) a year earlier. Although the overall net NPL ratio is below 5 percent, there were still 20 banks with a net NPL ratio above 5 percent. On the profitability front, banks' net interest income has risen to Rp42.9 trillion as compared with Rp37.8 trillion in the previous year, reflecting a wider spread between credit and deposit rates due to declining SBI rates.

Rehabilitation of the banks, supported by macro-monetary conditions, has helped recover bank intermediation, which nevertheless has fallen short of expectation. Improved intermediation was reflected in higher outstanding bank credits, which rose by a favorable 17.4 percent. However, the highest growth (by composition) was recorded in consumer credit (36.5 percent). Working capital and investment credits increased by only 13.8 percent and 11.3 percent, respectively. This indicates that banks remained very cautious, preferring to extend short-term credits due to continued perceptions of high long-term credit risk. Looking at new credits, the amount of credit channeled by banks during 2002 reached Rp79.4 trillion, substantially above the Rp56.8 trillion in 2001. Since most of the corporate sector was still undergoing the restructuring process, banks were focusing their lending mostly on the retail and UKM sectors, as indicated by the larger amount of credit channeled to these sectors. Of the new credit extended during 2002, 41.1 percent went to the UKM sector.

In line with growth prospects and declining interest rates, Indonesia's banking sector is also forecast to improve in 2003. Mobilization of funds from third parties is expected to rise, especially in the form of demand and saving deposits. However, time deposits are forecast to be in tough competition with mutual funds (*reksa dana*), since the return on *reksa dana* is higher than on time deposits.

With regard to mobilizing deposits, credits are forecast to rise, in the form of both corporate and retail lendings. Surveys of 14 large banks in the systemically important bank (SIB) category, indicate that credit expansion by those banks in 2003 is likely to reach Rp83 trillion. Other surveys showed that 40 banks expect to see their lending growing by 5 percent on average in 2003. The rise in credit would be mainly extended for use as working capital and consumer credits; investment credit is expected not to grow significantly. UKM (SME) credit is forecast to increase by around Rp40 trillion, since most banks have diverted their credit policy from corporate to retail operations.

On capital side, the overall capital adequacy ratio (CAR) is forecast to slightly decline, but remain above the 8 percent level. This decline would stem from higher risk-weighted earning assets in line with the expansion of credit. It should be noted that, although the industry-wide net NPLs ratio is forecast to remain below 5 percent in 2003, there are several banks with net NPLs above 5 percent, due to various constraints in their restructuring of credits.

The *sharia* banks are also forecast to expand rapidly in 2003 as in the previous year. This growth is mainly driven by high market demand for *sharia* banking and under-utilized regional potential. Optimism in this regard is further supported by plans of *sharia* commercial banks (and *sharia* business units in conventional commercial banks) to expand their activities, and by plans of newly established banks to enter the *sharia* banking industry.

STRUCTURAL REFORMS

Banking and Corporate restructuring

The Indonesian government remains firmly committed to continue divesting banks under government ownership to restore private sector participation in the economy**.** The sale of a majority (51 percent) of Bank Danamon, one of the banks taken over by the Indonesian Bank Restructuring Agency (IBRA) was successfully concluded earlier in 2003. In addition, the government moves head with the plan to privatize several other banks. Moreover, July 2003 marked the initial public offering (IPO) of Bank Mandiri, the largest bank in Indonesia. The IPO has received an encouraging market response.

The Indonesian authorities have also made serious efforts to secure continual political support to conclude legal agreements with bank shareholders, including initiated legal action for non-compliant shareholders and commissioners.

The previous agreement's deadline, which will not be extended, is the end of June 2003. Twenty-eight bank owners have started to repay their debts achieving rates of repayment of between 30 percent and 70 percent. Two owners have repaid their debts fully and a release and discharge letter from the government will be issued. Several cases have been passed to the police department while a few other cases are now under consideration by the Attorney General's Office.

The Indonesian authorities will continue to move ahead vigorously with the financial reform program in order to conclude the process of building a sound financial safety net. The blanket guarantee of the domestic banking system will gradually be replaced by a well constructed and carefully planned deposit insurance plan. A team consisting of representatives from Bank Indonesia, the Ministry of Finance and the IBRA has been tasked with preparing the establishment of a deposit insurance institution. The team has proposed a draft act to establish the Deposit Insurance Institution with the objective of providing a strong legal basis for its operations as a going concern. To minimize the adverse impact of the termination of the blanket guarantee, its phasing-outwill be planned and synchronized with the development and performance of the national banking system to prevent an unnecessary loss of public confidence. Steps are also being taken to work on the transition to an integrated financial oversight body that guarantees that future investment in Indonesia is secure, safe and efficient.

LEGAL REFORMS

With regard to legal and judicial reform, Indonesia has also made remarkable progress in this area. The Anti-Corruption Law was passed before the end of 2002, and the Wealth Commission has functioned well in a non-coercive role and should become an effective component of the Anti-Corruption Committee which will have enhanced investigatory powers. Indonesia's House of Representatives has also passed an Anti-Money-Laundering Bill and appointed key officials, and is completing the establishment of the Financial Transactions Reporting and Analysis Unit. Combined with the recently passed Anti-Terrorism Law, it is believed that Indonesia has powerful new tools and is well equipped to combat terrorism.

Indonesia also recently passed a new labor law that will revoke Law No. 25/1997, which contained the previously deemed repressive labor policy that allowed the exploitation of workers. The new law also amends the controversial Labor Regulation No. 150/2000 on severance payments. The new law strikes an appropriate balance between protecting basic workers' rights and creating a favorable investment climate.

The year 2003 will see further development of the Commercial Court, which has jurisdiction over bankruptcy and intellectual property right cases. A number of steps have already been taken to strengthen the administration and procedures of the Court, and enhance the transparency of the court's decisions. The blueprint formulated in 2001 for the development of the Commercial Court and the subsequent revision in 2003 are key to this effort. Meanwhile, the Anti-Corruption Committee has made progress and a draft of a presidential decree to improve the procurement process is being finalized. Furthermore, the ratification of a new labor law and industrial relations will reduce uncertainty. In order to secure the political support for privatization of state-owned enterprises (SOEs) and to improve governance and transparency, the law on SOEs has been submitted to parliament.

MEDIUM-TERM OUTLOOK

In the medium term, the Indonesian economy is forecast to improve further, in line with the favorable outlook for the global economy, which will start to recover from the downturn. During 2004–05 Indonesian economic growth is projected to be around 4 percent to 5.5 percent, while average world output during 2004–07 is expected to grow by 4.5 percent annually, higher than in 2003 (3.7 percent). Along with the trend of increasing world economic growth, the price of non-oil products is anticipated to remain high. On the other hand, the medium-term oil price might slightly decline from its relatively high levels in 2002 along with the easing of the Middle East war tension and resolution of the political conflict in Venezuela. The expected decline in the oil price is in line with the forecast made by the IMF in the *World Economic Outlook* of April 2003, which projected a drop in average oil prices of up to 4.3 percent during 2004–07. As the global economy is expected to remain sluggish, this situation would drive the international interest rate down during 2003 and 2004.

To strengthen macroeconomic stability, Bank Indonesia will make efforts to reduce inflation gradually towards the medium-term inflation target of 6 percent to 7 percent by 2006. This target, and the time-frame for reaching it, is considered optimal in that inflation will edge down over reasonable period of time in such a way that achieving the target will not hinder the Indonesian economic recovery.

Annex I

INDONESIA: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002	2003*
GDP and Major Components (percent change, year over year, except as noted)							
Nominal GDP (level in US$ billion)	218	97.5	139.5	151.0	141.9	172.6	199.6
Real GDP	4.9	-13.3	0.8	4.9	3.4	3.7	3.5-4
Consumption	5.9	-4.1	4.3	3.9	4.8	5.5	5.2-5.7
Private Consumption	6.6	-2.9	4.6	3.6	4.4	4.7	4.3-4.8
Government Consumption	0.1	-14.4	0.7	6.5	9.0	12.8	12.8-13.3
Investment	8.6	-40.9	-18.2	13.8	7.7	-0.2	0.8-2.2
Private Investment	-	-	-	-	-	-	-
Government Investment	-	-	-	-	-	-	-
Exports of Goods and Services	7.8	10.6	-31.8	26.5	1.9	-1.2	1.0-1.5
Imports of Goods and Services	14.7	-5.4	-40.7	21.1	8.1	-8.3	1.7-2.2
Fiscal and External Balance (percent of GDP)							
Budget Balance	0.4	-1.7	-7.9	-5.1	-2,72	-1.7	-1.78
Merchandise Trade Balance	4.4	17.8	14	16.8	15.2	13.4	11.5
Current Account Balance	-2.3	4.3	4.1	5.3	4.7	3.9	2.2
Capital and Financial Non-reserve Assets Balance	-	-	-	-	-	-	-
Economic Indicators (percent change, year over year, except as noted)							
GDP Deflator	12.6	75	13.8	9.97	10.1	5.7	-
CPI	11.6	77.6	2	9.4	12.55	10.03	9
M2	23.2	62.14	11.9	15.6	12.99	4.72	-
Short-term Interest Rate (percent)/ SBI rate	30.5	64.1	26	12.53	17.62	12.93	13
Real Effective Exchange Rate Index (level, 1995=100)	74.41	68.92	77.46	66.25	73.52	86.12	-
Unemployment Rate (percent)	4.7	5.5	6.4	6.1	8.1	9.1	-
Population (millions)	201.1	204	204.9	203	-	-	-

* Projection: Notes: The nominal GDP projection for 2003 was calculated using an exchange rate assumption of Rp9000 per USD.
The Sharia Banking Institute (SBI) rate in 2003 is the rate used in the 2003 Indonesian budget projection.

Annex II

INDONESIA: FORECAST SUMMARY (percent change from previous year)

	2002						2003					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	3.7	3.5	N.A.	N.A.	N.A.	N.A.	3.5-4	4.0	N.A.	N.A.	N.A.	N.A.
Exports	-1.2	N.A.	N.A.	N.A.	N.A.	N.A.	1.0-1.5	N.A.	N.A.	N.A.	N.A.	N.A.
Imports	-8.3	N.A.	N.A.	N.A.	N.A.	N.A.	1.7-2.2	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	10.03	6.6	N.A.	N.A.	N.A.	N.A.	9	5.4	N.A.	N.A.	N.A.	N.A.

Annex III

INDONESIA: MEDIUM-TERM TREND FORECAST (percent)

	Period*
Real GDP	N.A.
GDP Deflator	N.A.

Note: (*) Please specify the forecasting period.

JAPAN

REAL GROSS DOMESTIC PRODUCT

The Japanese economy bottomed out in early 2002, supported by export growth and a prompt end to the decline in production. The recovery of the US economy and the preceding recovery of the Asian economies contributed to the expansion of exports. Thereafter, their impact has gradually spread throughout the economy, which was about to move towards recovery. Recently, however, the economy has become roughly flat, and uncertainty still remains.

Real GDP growth in 2002 is 0.2 percent, whereas that in 2000 and 2001 was 2.8 percent and 0.4 percent, respectively.

The economy remains roughly flat. The environment surrounding the economy, such as the developments in the stock market and the US economy, is showing signs of change. As for short-term prospects, the economy is expected to move towards an incipient recovery if the recovery in the US and other economies is sustained. On the other hand, attention should be given to the changes in stock prices and long-term interest rates as well as to developments in the overseas economy.

According to the "Fiscal 2003 Economic Outlook and Basic Stance for Economic and Fiscal Management" decided by the cabinet in January 2003 (hereinafter referred to as FY 2003 Economic Outlook), positive policy impacts from joint efforts by the government and the Bank of Japan (BOJ), including the supplementary budget for FY 2002 and tax reductions, will appear in FY 2003. Furthermore, the world economy is likely to have recovered, gradually, by around the middle of 2003. Accordingly, while there will be negative impacts coming from the acceleration of the structural reforms including disposal of non-performing loans (NPLs), it is expected that corporate sectors will show a gradual recovery and the Japanese economy will gradually move toward a moderate recovery centering on private demand. It is projected that real GDP growth in FY[1] 2003 will be about 0.6 percent.

INFLATION

In 2002, the corporate goods price index (CGPI)[2] (base year =2000) fell by 1.9 percent from the previous year. While that of electrical machinery and equipment fell by 7.8 percent, the CGPI continued to show moderation in terms of the year-on-year rate, led by moderation in intermediate goods such as steel products and paper, reflecting tighter market conditions for those goods.

The consumer price index (CPI) in 2002 fell by 0.9 percent from the preceding year, showing a four-successive-year decline for the first time since 1970, when the current time series began. The fall was mainly due to a fall in industrial products such as durable goods and food products.

Taken together, these movements show that the Japanese economy has been in a mild deflationary phase.

In FY 2003, while it is expected that prices will continue to fall, the rate of decline will be

[1] Fiscal year refers to the period from April 1 to March 31 of the next year.
[2] The Bank of Japan revised the"Wholesale Price Index (base year = 1995) the Corporate Goods Price In dex, intending to improve the precision of the price index by incorporating recent structural changes in t he Japanese economy, especially the radical changes surrounding prices such as the diversification of co mmodities and their prices.

slowed by an improvement in oversupply conditions. The average CGPI in FY 2003 is expected to fall by 0.9 percent and the average CPI is also expected to fall by 0.4 percent over the same period.

EMPLOYMENT

In 2002, the number of employed fell continuously throughout the year The decline continued for more than twelve months. The number of self-employed and family workers had decreased over the 35 months since February 2000, and the number of employees had declined for 16 months since September 2001.

The unemployment rate remained at a level of over 5 percent during 2002 and reached 5.5 percent in January 2003. This is the highest rate recorded, equalling the rates in August and October 2002.

The employment situation still remains serious, with the unemployment rate remaining at a high level, although signs of an incipient recovery can be seen in some areas.

It is estimated that approximately 80 percent of the unemployed lost their jobs as a result of structural factors in the first half of 2002. It is expected to take some time to shrink the "mismatch of employment" (vacancies and unemployment occur simultaneously because of the shortage of qualified applicants) and to decrease unemployment based on structural factors. Therefore, it is anticipated that unemployment will probably remain high for the time being.

According to the FY 2003 Economic Outlook, it is expected that the average unemployment rate in FY 2003 will rise slightly above the previous year's level (from 5.4 percent to 5.6 percent) due to the continuation of the severe employment and income situations as the structural reforms proceed.

BALANCE OF PAYMENT

Exports of goods and services dropped sharply, by 6.1 percent, in 2001 compared with the previous year, but in 2002, they showed dramatic recovery at 8.2 percent growth. Recently, exports to Asia have been declining, especially to China, due to the effects of the SARS outbreaks. Exports to the US as a whole have generally remained flat, although they have decreased recently in reaction to a rise in exports of automobiles in May 2003.

The outlook for exports is likely to increase moderately if the recovery in the US and other economies is sustained.

Imports in 2002 increased by 2.0 percent compared with the previous year. Recently, imports from Asia have increased moderately as a whole, as imports from China, ASEAN and NIEs increased moderately. Imports from the US have been on a decreasing trend, although monthly fluctuations have grown.

As for the short-term outlook, it is expected that corporate sectors will show a gradual recovery and the Japanese economy will also gradually move towards a moderate recovery, and that these trends will have positive impact on imports.

The surplus in the goods and services trade balance doubled in 2002, mainly reflecting the increase of exports. Recently, it has been flat.

The surplus in the current account balance is expected to remain roughly flat (2.7 percent of nominal GDP), since imports as well as exports will increase in FY 2003.

GROSS EXTERNAL DEBT

At the end of 2002, net external assets decreased to 175.3 trillion yen, down from 179.3 trillion yen in 2001. The external assets decreased 365.9 trillion yen following the decrease of the estimated asset value in foreign currency because of the high exchange rate and by the fall in prices of overseas stocks held by residents. Moreover, external liabilities decreased in 190.6 trillion yen following the decrease in the estimated asset value in foreign currency because of the high exchange rate and by the fall in prices of the Japanese stocks held by non-residents.

EXCHANGE RATE

The end-of-month exchange rate of the yen against the US dollar was 132.9 in January 2002, it appreciated to 118.0 in August, recovered to 119.4 in December and recovered further to 120.1 in July 2003.

The 2002 real effective exchange rate of the yen (March 1973=100) is 118.

FISCAL POLICY

Considering the serious situation of the economy, a supplementary budget of 4.5 trillion yen was passed by the Diet in January 2003, based on the “Program to Accelerate Reforms” which was formulated in December 2002. The program contains measures to build a safety net in preparation for Japan’s economic and social structural transformations and public investment.

As for the FY 2003 budget, the Cabinet decided on the Guidelines for Formulation of the FY 2003 Budget (hereinafter referred to as the FY 2003 guidelines) in November 2002. Strong growth in tax revenues brought on by high economic growth is no longer expected. In addition, the country’s rapidly aging population is raising government expenditures, while accumulation of outstanding government bonds is pushing up debt-servicing expenses.[3] As a result, the government’s revenue and expenditure structure is becoming increasingly rigid. To promote fiscal structural reform, the government will concentrate funding in areas that will lead to future development. The FY 2003 budget of 81 trillion yen was formulated, and the amount of general account expenditures increased by 0.7 percent from the FY 2002 initial budget.

MONETARY POLICY

In October 2002, the BOJ decided to conduct money market operations aiming at the outstanding balance of current accounts held at the bank at around 15 to 20 trillion yen. In addition, the BOJ decided to increase its outright purchase of long-term government bonds from one trillion yen per month to 1.2 trillion yen per month. Furthermore, the BOJ decided to extend maturities for bills purchased in bill purchasing operations from six months or less to a year or less.

Furthermore, in May 2003, the BOJ decided to change the guideline for money market operations, and raised the target balance of current accounts held at the bank to around 27 to 30 trillion yen.

Looking at short-term interest rates, the overnight call rate moved at low levels in 2002, reflecting the BOJ’s monetary easing policy, which was conducted several times throughout the year. It remained at the lowest level. Interest rates of two- and three- month contracts remained almost unchanged. Long-term interest rates remained at 0.7 percent, supported by strong demand from investors and other sources. The growth of the monetary base (monthly average

[3] Outstanding government bonds and borrowings as of 31 December 2002. amounted to 643 trillion yen.

balance) has remained high against the background of ample fund supplies from the BOJ, but growth has slackened. The growth of M2+CDs (monthly average balance) has remained at around the 2 percent level.

MEDIUM-TERM OUTLOOK

In January 2003, the Japanese government published its *Reform and Perspectives—FY2002 Revision*, which addressed the government's medium-term macroeconomic and fiscal policies. These are centered on the acceleration of structural reform, and included the economic and fiscal outlook for the next five years. In the document, the Intensive Adjustment Period, during which structural reforms will be promoted intensively, was extended for another year (to FY 2004), since domestic and international economic conditions had been more severe than was assumed. It is expected that real GDP growth will remain below one percent, and nominal growth will go even lower during the Intensive Adjustment Period to FY 2004, or at least in the near-term. As for fiscal policy, as a result of declining tax revenues and additional fiscal expenditures, the primary deficit for central and local governments is expected to be more than 5 percent of GDP in FY 2002, and it will most probably sustain that high ratio in FY 2003. However, through fiscal reform, the primary balance deficit will be reduced and its ratio to GDP is likely to fall by approximately half by around FY 2007. The government aims to achieve surplus in the primary balance in the early 2010s through the same level of effort as before to improve the fiscal balance and realize a sustainable economic growth led by private-sector demand.

OTHER PERTINENT INFORMATION

In October 2002, the government published the *Comprehensive Measures to Accelerate Reforms*, which contains measures pertaining to employment and SMEs. .

Subsequently, the Minister's Conference for Economic Countermeasures published the *Program to Accelerate Reforms* in the middle of December 2002. The economic impact of the measures and reforms on real GDP over the next year was estimated as approximately 0.7 percent growth.

In July 2002, the Headquarters for the Promotion of Special Zones for Structural Reform was established in the cabinet. The headquarters is aiming at setting special zones for structural reform where exceptions to regulations are introduced corresponding to the characteristics of the zone, promoting structural reform in areas such as education, agriculture, and social welfare, revitalizing local economies, and developing the Japanese economy. The Law on Special Zones for Structural Reform was promulgated in December 2002[4]. Local governments have submitted their Plans of Special Zones for Structural Reform for approval since the beginning of April 2003, and exceptions to regulations are applied in those areas where the Prime Minister authorizes the plan. 164 Special Zones for Structural Reform, which local governments applied for, applied were approved by August 2003.

Moreover, various legal and administrative measures for further acceleration of NPL disposal and corporate revival have been taken since the latter half of 2002, based on the *Comprehensive Measures to Accelerate Reforms* and the *Program for Financial Revival*. As to NPLs disposal, the Government of Japan implemented all necessary measures in line with the *Program for Financial Revival* in July 2003. In accordance with each bank's efforts, the good effects of implementation of the program are shown in major banks' balance sheets of FY2002. For corporate revival, the Industrial Revitalization Corporation of Japan was established in May 2003. The corporation facilitates consensus building among creditors on business restructuring

[4] The bill for partial revision was submitted to the Diet in March 2003.

and its implementation by purchasing part of loan assets of distressed but viable companies (at their market price) after reviewing their rehabilitation plans. The corporation, is expected to play an important role in accelerating a corporate revival which has been already promoted.

In March 2003, the BOJ decided that it would increase the maximum total amount of equity holdings it would purchase from commercial banks to three trillion yen from the current one trillion yen, and increase the maximum cumulative amount of equity holdings it would purchase from any one bank to 750 billion yen from the current 500 billion yen.

According to the balance of payments of the Bank of Japan, outward direct investment in 2001 increased compared with previous year. But outward direct investment in 2002 decreased. Inward direct investment in 2001 decreased a little compared with the previous year. But inward direct investment in 2002 increased compared with the previous year.

To reactivate the economy, it is essential to expand the amount of inward direct investment to Japan, since it is unduly small compared to other economies (in 2002, ratio to nominal GDP is 1.2 percent[5]). In January 2003, Prime Minister Koizumi, in a policy speech at the Diet, declared his intention to double it within five years.

In March 2003, The Japan Investment Council,[6] established as a ministerial level council and chaired by the prime minister, accepted a report issued by its Expert Committee concerning measures for promoting inward direct investment. In addition, the council published its implementation plan *Program for the Promotion of Foreign Direct Investment in Japan*. The plan includes 74 recommendations in five areas such as improvement of business environment to facilitate cross-border M&As, simplifying and speeding up administrative procedures, and consolidating the legal system concerning employment and the living environment.

In May 2003, the government established a single contact point the "Office of Invest Japan" in each ministries concerned to investment and Japan External Trade Organization (JETRO) based on the "Program for the Promotion of Foreign Direct Investment in Japan". Office of Invest Japan can indicate the division which is in charge of a particular procedure, and set up a system such a websites that investors can obtain information. Investors can obtain various types of information on investment procedures such as those related to corporate establishment, M&A, establishment of plants and stores.

In March 2003, the government revised its "Three-Year Program for Promoting Regulatory Reform (FY 2001–FY 2003)." It is the second revision since the program was formulated in 2001. The revised program consists of 1,153 items, such as reinforcement of the Fair Trade Commission through amendment of a surcharge system under the Anti-Monopoly Law. It also includes plans for promoting Special Zones for Structural Reform (see above).

On 27 June 2003, the government formulated the Third Phase of the Basic Policies, i.e., "Basic Policies for Economic and Fiscal Management and Structural Reform 2003" (hereinafter referred as basic policies 2003). The only viable path for achieving sustained economic growth is to promote structural reform and to realize a "revitalized Japanese economy" by improving the nature of the Japanese economy. Thus, upon assessing the past achievement of structural reforms, basic policies 2003 is being presented in a new form consisting of "Three Declarations" and "Seven Reforms".

[5] Estimated on stock basis. Source: Ministry of Finance (2002) *Regional Direct Investment Position*

[6] The Japan Investment Council was established in 1994 as a ministerial level council chaired by the pri s a ministerial level council chaired by the prime minister. The Expert Committee consists of experts fro m academia and industry, and officials from related ministries.

The government has clarified the following targets to be pursued: revitalization of the economy; ensuring the security of the people; and establishment of responsible fiscal balances for future generations. To this end, the government has decided to further strengthen structural reforms in the following seven areas: i) regulatory reform and special structural reform zones; ii) flow of funds and financial and industrial revitalization; iii) tax reform; iv) employment and human resource strategy; v) reform of the social security system; vi) eform of central and local government; and vii) reform of the budget formulation process.

Annex I

JAPAN: OVERALL ECONOMIC PERFORMANCE

	1997	**1998**	**1999**	**2000**	**2001**	**2002**
GDP and Major Components (percent change, year over year - earlier period, except as noted)						
Nominal GDP (in billion US$)	4,321	3,970	4,491	4,762	4,175	3,998
Real GDP	1.8	-1.1	0.1	2.8	0.4	0.2
Consumption	1.0	0.4	1.1	1.8	1.9	1.6
Private Consumption	0.9	-0.1	0.2	1.0	1.7	1.4
Government Consumption	1.0	2.1	4.4	4.7	2.6	2.3
Investment	0.8	-5.9	-2.1	3.8	-0.8	-6.2
Private Investment	5.2	-7.3	-4.8	9.4	0.3	-6.7
Government Investment	-10.0	-2.1	4.9	-9.7	-4.0	-4.8
Exports of Goods and Services	11.3	-2.3	1.5	12.4	-6.1	8.2
Imports of Goods and Services	1.2	-6.8	3.0	9.2	0.1	2.0
Fiscal and External Balances (percent of GDP)						
Budget Balance*	-5.6	-7.4	-8.6	-7.0	-6.6	N.A.
Merchandise Trade Balance	2.4	3.1	2.8	2.5	1.7	2.3
Current Account Balance	2.2	3.0	2.6	2.5	2.1	2.9
Capital and Financial Non-reserve Assets Balance	-2.9	-3.3	-1.2	-1.8	-1.2	-1.6
Economic Indicator (percent change, year over year - earlier period, except as noted)						
GDP Deflator	0.3	-0.1	-1.5	-1.9	-1.6	-1.6
CPI	1.8	0.6	-0.3	-0.7	-0.7	-0.9
M2	3.1	4.0	3.6	2.1	2.8	3.3
Short-term Interest Rate (CD New Rate, percent)	0.6	0.7	0.2	0.2	0.1	0.03
Real Effective Exchange Rate (level, 1997=100)**	100.0	102.1	114.7	118.9	105.8	99.9
Unemployment Rate (percent)	3.4	4.1	4.7	4.7	5.0	5.4
Population (millions)	126.2	126.5	126.7	126.9	127.3	127.4

* Refers to fiscal year (April to March)
** The calculation method of the real effective exchange rate was changed in February 2002, and the figures are retroactively revised accordingly.

Annex II

JAPAN: FORECAST SUMMARY (percent change from previous year)

	2003						2004					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	0.6	2.0	N.A.	1.0	0.5	N.A.	N.A.	1.4	N.A.	1.1	1.0	N.A.
Exports	1.8	0.6	N.A.	7.7	3.9	N.A.	N.A.	3.9	N.A.	9.4	3.3	N.A.
Imports	1.6	8.1	N.A.	3.6	3.2	N.A.	N.A.	4.7	N.A.	4.2	1.8	N.A.
CPI	-0.4	-0.3	N.A.	-0.9	-0.5	N.A.	N.A.	-0.6	N.A.	-1.0	-0.6	N.A.

-as of April 2003

Note:

The Official figure for 2003 refers to FY 2003 (from April 2003 to March 2004).
IMF: *World Economic Outlook* (2003)
OECD: *Economic Outlook 73* (2003)
PECC: *Pacific Economic Outlook 2003-2004* (2003)

Annex III

JAPAN: MEDIUM-TERM TREND FORECAST (percent)

	2005 or 2006
Real GDP	1.5 or over
GDP deflator	1.0

Note: The figure refers to FY2005 or FY2006
Source: *Reform and Perspectives - FY2002 Revision* (January 24, 2003)

REPUBLIC OF KOREA

REAL GROSS DOMESTIC PRODUCT

During 2002, the Korean economy registered a rapid GDP growth of 6.3 percent thanks to a sharp rise in export volume and buoyant private consumption. Goods exports rose by 17 percent (on a volume basis), led by a large upswing in exports to China. Private consumption rose to about 7 percent, reflecting increased incomes due to economic upturn, the easing of liquidity constraints with the expansion of household credit and the wealth effect of higher real estate prices. Facilities investment also increased from a year earlier but was still not as active as in previous economic upturns.

In 2003, however, the Korean economy slowed rapidly, with both consumption and investment becoming subdued as business and consumer confidence plunged in response to the deterioration of economic conditions at home and abroad. The international economic environment worsened in the first quarter, mainly as a result of higher international oil prices during the war in Iraq, mounting uncertainties about the recovery of major economies and concerns over North Korea's nuclear problem. Internally, the stability of the financial market was hit by concerns about possible defaults on loans to households and the rapid rise in the number of people black-listed by financial institutions as bad credit risks.

In the second quarter, no sooner had the uncertainties posed by the war in Iraq eased than the negative effect of the SARS outbreaks emerged. Domestically, credit card firms faced a liquidity crisis triggered by the SK Global accounting scandal while large-scale industrial unrest led to labor market instability.

GDP growth in the second quarter is estimated to have fallen to 1.9 percent, down from the already low 3.7 percent of the first quarter. For the first half as a whole, GDP growth is thought to have dropped to around 2.8 percent.

Domestically, neither consumer nor business confidence is expected to improve significantly in the second half of the year. Liquidity constraints on consumers are likely to continue and the cash flow of less credit-worthy companies will deteriorate as financial institutions tighten their credit screening procedures.

In the meantime, the global economy in the second half of 2003 is expected to improve compared with the first half as the easing of geopolitical risks helps economic agents regain confidence, international oil prices stabilize and a number of individual economic stimulus packages take effect at the individual economy level.

Considering these domestic and overseas economic conditions, the Korean economy will make a better showing in the second half than the first half. However, it is difficult to foresee a fully-fledged recovery of business activities because private consumption and facilities investments will continue to see a slow pace of growth as a result of labor and financial market unrest.

In the second half, GDP will mark a modest 3.3 percent growth rate—much lower than the potential GDP growth rate (roughly 5 percent). Accordingly, the annual growth rate will come in at 3.1 percent.

INFLATION

In the second quarter this year, consumer price inflation slowed down rapidly with the easing of factors (high oil prices and the seasonal mismatch of supply and demand for some agricultural products) that had pushed up the first quarter rise in the CPI above the 4 percent level. Core inflation, which is a variable used in the Bank of Korea's inflation targeting, moved in a stable manner, running within its target range of 3 percent, ±1 percent.

In the second half of 2003, core inflation is forecast to remain stable at a low 3 percent (year-on-year basis), continuing the trend from the first half. Consumer price inflation in the second half will also decline to close to 3 percent from 3.8 percent in the first quarter. Low demand side pressures, the decline in international oil prices and the appreciation of the Korean won against the US dollar will help hold prices stable.

BALANCE OF PAYMENT

The current account, which had been in the black since the end of the currency crisis in 1997, shifted into deficit in December 2002 and continued in the red until this April. This was mainly attributable to the sharp rise in imports due to the international oil prices hike, which acted to offset the continued briskness of export growth.

The current account, however, moved back into surplus from May onward, as exports continued to be brisk whereas the growth of imports slowed considerably due to sluggish domestic demand and lower international oil prices. For the first half of the year, the current account registered a modest surplus of around US$1 billion.

During the second half, exports (on a customs clearance basis) will increase steadily with the gradual recovery of the global economy. Imports (on a customs clearance basis) will slow their pace of growth substantially due to a fall in international oil prices and the still incomplete recovery of the domestic economy. The current account is expected to register a surplus of around US$1.5 billion for the second half of the year. The account is forecast to mark a surplus of US$2 billion to US$3 billion for 2003.

GROSS EXTERNAL DEBT

The gross external debt position of Korea as of the end of June 2003 was US$144 billion, an increase of US$13 billion compared with the previous year-end.

The short-term debt position was US$57.1 billion, an increase of US$7.3 billion, while the long-term debt position was US$86.9 billion, an increase of US$5.7 billion. Consequently, the short-term debt ratio rose to 39.6 percent from 38.0 percent at the end of 2002. The short-term debt ratio, which had shown an upward trend for the first four months of this year, declined in May and June. The sharp increase in Korea's short-term debt position this year has been largely due to the current account deficits. To meet the foreign currency needs of the non-financial sectors, banks increased their short-term borrowings because long-term borrowing conditions worsened due to increased geopolitical risks related to such issues as the North Korean nuclear program. The growth in trade-related credits has also played a part in the increased short-term debt.

Considering the recent improvement of the Korean current account balance and the large inflows of foreign funds investing in Korean securities, the growth of Korea's gross external debt position is expected to slow down for some time.

EXCHANGE RATE

The Korean won fell in February and March mainly due to concerns about the current account deficit caused by rising oil prices, the outflow of foreign stock investment funds and the growing geopolitical risk on the Korean peninsula. Recently, however, the won has appreciated with the decreased geopolitical risk on the Korean peninsula, the appreciation of the Japanese yen, and the inflows of foreign stock investment funds.

As of 22 August, the dollar/won exchange rate stood at 1,169.5, an appreciation of 1.4 percent compared with the end of last year.

MONETARY POLICY

In consultation with the government, the Bank of Korea set the inflation target for 2003 at 3 percent, ±1 percent, based on the annual rate of increase in core inflation.

In order to avoid an overly sharp contraction of economic activities, the Monetary Policy Committee (MPC) at the Bank of Korea on 13 May decided to lower its target for the overnight call rate from 4.25 percent to 4.0 percent. Although the current account was expected to improve gradually, there was heightened concern over a sharp slowdown of the domestic economy and employment amid lower inflation pressures.

On 12 June, the MPC decided to maintain the benchmark overnight call rate at its current level (4.0 percent) until its next meeting. The economic slowdown has continued mainly due to the contraction of domestic demand, which has more than offset the steady growth of exports. However, the economy is expected to improve gradually in the latter half of 2003 after the May interest rate cut takes effect and the supplementary budget boosts the economy. In the meantime, global economic conditions, especially those in the US, should assist recovery.

On 10 July, the MPC decided to lower its target for the overnight call rate from 4.0 percent to 3.75 percent for the inter-meeting period. In a related action, the committee also lowered the interest rate on liquidity adjustment loans of the Bank of Korea from 3.75 percent to 3.50 percent. In deciding to adjust its target rate, it was guided by the consideration that while prices had shown stable movements and the current account had shifted to a surplus, the domestic economy continued to slow down considerably and more resolute action on the part of monetary policy was necessary for sustainable growth and stability of the economy.

Looking ahead, monetary policy will be flexible, while a careful watch will be kept on economic activities, price movements, and the financial markets.

STRUCTURAL REFORMS

The central aim of financial and corporate restructuring has been to raise the overall efficiency of the economy. This has been done by heightening the soundness and profitability of the corporate and financial sectors through the forced exit of ailing financial institutions and firms, improving the financial structure of financial institutions and companies capable of a turnaround; and putting in place systems relating to management transparency.

Dealing first with financial sector restructuring, a considerable degree of success has been attained. A number of troubled financial institutions have exited the market, and, through the injection of public funds, other financial institutions have been recapitalized and purged of their bad loans. The financial system has been rehabilitated using these and other measures to improve financial structures to provide the foundation for the recovery of general business activities.

Total bad loans in the financial sector were greatly reduced from 103 trillion won as of the end of 1998 to 32 trillion won as of the end of last year. The weight of the financial sector's bad loans was also cut significantly, from 17.8 percent as of the end of 1998 to 3.9 percent as of the end of last year. Commercial banks' ratio of non-performing loans fell substantially, from 13.6 percent as of the end of 1999 to 2.4 percent as of the end of last year.

The financial structures and profitability of the banking industry have been improved with banks focusing on using public funds to support the recapitalization of financial institutions and the disposal of their bad loans. The average capital adequacy of commercial banks, in terms of the Basle Accord ratio, rose from 7.0 percent at the end of 1997 to 10.5 percent at the end of 2001. Although the commercial banks had accumulated large losses from 1997 onwards, in 2002 they recorded a total profit for the period (3.875 billion won).

This improvement has meant that financial institutions' credit intermediation function, which contracted sharply following the currency crisis because financial institutions avoided lending in their fear of further non-performing assets, has been regained. This is particularly with respect to the banks, thereby providing a backing for economic recovery.

Corporate sector restructuring, too, has borne fruit with the systematic construction of a corporate infrastructure. This has involved improving the systems associated with corporate bankruptcy and rehabilitation and the heightening of management transparency. At the same time, capital and financial structures have been strengthened by the reduction in debt-to-equity ratios.

Debt ratios in manufacturing (liabilities over equity capital) were brought down from 396.3 percent of the end of 1997 to 135.4 percent at the end of last year. Equity ratios in manufacturing (equity capital over total assets) rose over the same period from 20.2 percent to 42.5 percent.

Thanks to the pursuit of this financial and corporate sector restructuring, the Korean economy regained its dynamism after experiencing a deep downturn in the wake of the currency crisis. Just after the outbreak of the currency crisis, Korea's sovereign rating was reduced to below investment grade (speculative), but it regained its investment grade status at the beginning of 1999. In 2003, it was upgraded to an 'A' level by Moody's, Fitch IBCA, and Standard & Poors (S&P).

Annex I

KOREA: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002
GDP and Major Components (percent change, year over year - earlier period, except as noted)						
Real GDP	5.0	-6.7	10.9	9.3	3.1	6.3
Consumption	3.2	-10.1	9.4	6.7	4.2	6.2
Private Consumption	3.5	-11.7	11.0	7.9	4.7	6.8
Government Consumption	1.5	-0.4	1.3	0.1	1.3	2.9
Investment	-7.5	-38.4	29.5	11.2	-2.4	4.3
Private Investment	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Government Investment	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Exports of Goods and Services	21.4	14.1	15.8	20.5	0.7	14.9
Imports of Goods and Services	3.2	-22.1	28.8	20.0	-3.0	16.4
Fiscal and External Balances (percent of GDP)						
Budget Balance*	-1.5	-4.2	-2.7	1.3	1.3	3.8
Merchandise Trade Balance	-6.7	13.1	7.0	3.7	3.2	3.0
Current Account Balance	-1.7	12.7	6.0	2.7	1.9	1.3
Capital and Financial Non-reserve Assets Balance	2.8	-1.0	0.5	2.6	-0.8	0.3
Economic Indicator (percent change, year over year - earlier period, except as noted)						
GDP Deflator	3.2	5.0	-2.0	-1.1	2.5	1.7
CPI	4.4	7.5	0.8	2.3	4.1	2.7
M2	18.0	23.6	13.5	2.2	6.9	11.5
Short-term Interest Rate (CD New Rate, percent)	13.38	15.22	6.81	7.08	5.32	4.81
Real Effective Exchange Rate (level, 1997=100)**	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Unemployment Rate (percent)	2.6	7.0	6.3	4.1	3.8	3.1
Population (millions)	46	46.3	46.6	47.0	47.3	47.6

* Refers to fiscal year (April to March)
** The calculation method of real effective exchange rate was changed in February 2002, and the figures are retroactively revised accordingly.

Annex II

KOREA: FORECAST SUMMARY (percent change from previous year)

	2002						2003[2]					
	Official[1]	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	6.3	5.0	4.8	6.0	N.A.	5.2	3.1	2.5	4.0	5.2	N.A.	N.A.
Exports	14.9	N.A.	7.0[5]	5.4	N.A.	8.7	11.4[3]	N.A.	8.0[5]	12.8[7]	N.A.	N.A.
Imports	16.4	N.A.	12.0[6]	5.8	N.A.	11.8	13.1[4]	N.A.	9.0[6]	11.4[8]	N.A.	N.A.
CPI	2.7	2.7	3,5	3.3	N.A.	2.8	3.5	3.3	4.0	3.7	N.A.	N.A.

[1] Actual figures
[2] Data of forecast: The Bank of Korea -10 July 2003; IMF-April 2003; ADB-April 2003; OECD-23 April 2003
[3] Exports of Goods
[4] Imports of Goods
[5] Merchandise exports growth
[6] Merchandise imports growth
[7] Exports of goods and services
[8] Imports of goods and services

Annex III

KOREA: MEDIUM-TERM TREND FORECAST (percent)

	Period*
Real GDP	N.A.
GDP Deflator	N.A.

Note: (*) Please specify the forecasting period.

MALAYSIA[1]

REAL GROSS DOMESTIC PRODUCT GROWTH

Despite the challenging external environment, the Malaysian economy gained momentum in 2002 and registered a growth of 4.1 percent. Economic growth was broad-based, driven by strong domestic demand and reinforced by improved export performance. Low interest rates, improved access to financing and the significant improvement in commodity prices provided strong stimulus for private sector expenditure.

In 2002, macroeconomic policy was focused on mitigating the rising uncertainties emanating from the external environment and enhancing the long-term fundamentals of the economy. The government played a pivotal role in sustaining growth by providing the necessary support for private and external demand. This support was broadly channelled into two ways: direct expenditure, which had a positive effect on private consumption; and the provision of an enabling environment conducive to enhancing consumer confidence and facilitating a recovery in investment activities by businesses. The latter was made possible by reducing selected taxes to encourage consumption, implementing policies to improve employment prospects, adopting an accommodative monetary stance, and instituting measures to improve access to financing.

Domestic demand conditions strengthened significantly in 2002, sustained by the continued expansion in overall public sector spending and a marked increase in private consumption. Despite greater uncertainties prevailing in the external environment in the second half of the year, consumer confidence remained high throughout the year. Higher disposable incomes and the positive impact of the fiscal stimulus and low interest rates were reinforced by a stronger export performance and the sharp improvement in commodity prices. As the domestic economic recovery gained strength and with a greater inflow of FDI, private investment has somewhat improved in the second half of the year. Overall, growth in aggregate domestic demand (excluding stocks) strengthened to 4.2 percent from 2.5 percent in 2001.

Public sector expenditure remained the main driver of growth, although the pace of expansion moderated to 7.9 percent (2001: 15.6 percent), reflecting mainly on-going fiscal-stimulus-related spending and higher capital outlays by the non-financial public enterprises (NFPEs). Public consumption continued to register a strong increase of 12.2 percent (2001: 17.0 percent), due mainly to higher expenditure on emoluments and supplies and services. Higher expenditure on emoluments was mainly on account of the 10 percent salary adjustment and bonus payment to civil servants as well as the implementation of a new salary scheme, *Sistem Saraan Malaysia* (SSM), for employees in the public sector, effective November 2002. Higher expenditure on supplies and services was aimed at upgrading the government's administrative machinery to enhance its delivery system. Public investment, on the other hand, grew moderately by 4.6 percent (2001: 14.5 percent). The federal government's development expenditure was channelled mainly towards education and training to enhance human resource development and longer-term productive capacity-building projects, which includes infrastructure and information and communications technology, to facilitate the move towards a knowledge-based economy. Higher outlays were also expended on rural development, health services, low-cost public housing projects and housing for essential personnel.

After experiencing a contraction in 2001 (–3.3 percent), business/private sector expenditure recovered moderately with a growth of 2.3 percent in 2002. This was partly due to the strengthening of private consumption spending by 4.4 percent (2001: 2.4 percent), reflecting

[1] All information provided are as of July 2003, with exception of the IMF forecasts in Annex II. The IMF forecasts are as at September 2003.

improved consumer confidence in an environment of supportive fiscal operations by the government, low interest rates, stable employment prospects, and a recovery in external demand. The moderate decline in private investment in 2002 to –5.7 percent (2001:–19.9 percent) also contributed to the better performance of business/private sector expenditure. The recovery of private investment expenditure took place in the second half of 2002 with economic activities strengthening steadily in tandem with improving demand. This was reflected in higher imports of capital goods, an important gauge of investment activities, particularly imports of telecommunications and office equipment as well as construction and mining equipment.

In line with the recovery in national income, which turned around significantly by 8.7 percent (2001: –1.6 percent), gross national savings (GNS) increased strongly by 7.2 percent (2001: –14.0 percent) despite consumption spending registering higher growth of 8.7 percent (2001: 6.5 percent). Public sector savings increased slightly by 3 percent (2001: –3.4 percent), reflecting a relatively strong revenue collection against the increase in operating expenditure of the public sector. Business/private sector savings however turned around to strongly register a significant increase of 11.3 percent (2001: –22.5 percent) during the year. This was partly due to encouraging development in the household and corporate sectors that enjoyed stronger cash flows as a result of fiscal measures, salary increases, the recovery in external demand, and a sharp increase in commodity prices.

Overall, with gross national income increasing at a faster rate of 8.7 percent relative to gross national savings (7.2 percent), the share of GNS to GNP was sustained at 34.4 percent. This high rate of savings in comparison with regional economies has enabled Malaysia to support and finance its economic growth, mainly from domestic sources. At the same time, the recovery in private investment in the second half of the year contributed to the turnaround in gross domestic capital formation (including stocks), with an increase of 10.1 percent in 2002. Hence, the surplus in the savings-investment position was slightly reduced, as reflected by the smaller surplus in the current account of the balance of payments of RM27.3 billion or 8.1 percent of GNP (2001: 9 percent of GNP).

On the supply side, all sectors in the economy expanded, with the main impetus to growth emanating from the services and the manufacturing sectors. The services sector grew by 4.1 percent benefiting from strong domestic demand and an increase in tourist arrivals as well as a strong growth in the financial sector including bank lending. The manufacturing sector recovered strongly by 4.2 percent, due mainly to higher external demand, particularly for electronics. The growth in the construction sector remained strong at 2.3 percent in 2002, due to an increase in public projects and sustained housing activities. The agriculture sector registered higher growth at 3.0 percent, following higher output of rubber and increased fish landing. Value-added in the mining sector meanwhile grew by 3.7 percent as a result of higher demand and more favourable prices.

BALANCE OF PAYMENTS

The overall balance of payments strengthened further to record a larger surplus in 2002. The improvement reflects the sustained strong current account surplus and declining net outflows in the financial account. The current account surplus narrowed marginally but remained large at RM27.3 billion or the equivalent of 8.1 percent of GNP. While the services and income accounts improved, the outflow of current account transfers was large during the year.

The strong recovery in exports led to a continuing large surplus in the trade account. At the same time, profits and dividends accruing to Malaysian companies investing abroad turned around to record net inflows, leading to an improvement in the income account. In the services sector, the cumulative effects of policies to develop the sector resulted in a significant narrowing of the services account deficit to RM6 billion, or 1.8 percent of GNP.

The financial account showed an improvement with higher inflows of long-term capital, namely, foreign direct investment, despite a higher net portfolio outflow amidst general weakening of regional and global stock markets and heightened geopolitical risks.

The overall balance of payments recorded a surplus of RM14.2 billion or US$3.7 billion, after adjusting for errors and omissions of –RM1.2 billion. A significant component of the errors and omissions was the exchange revaluation gain (RM6.6 billion) from the revaluation of the international reserves of Bank Negara Malaysia due mainly to the appreciation of the euro and yen against the US dollar. Consequently, the net international reserves of Bank Negara Malaysia increased by RM14.2 billion to RM131.4 billion (US$34.6 billion) as at end-2002. Reserves increased further to RM140.9 billion (US$37.1 billion) as at the end of June 2003. This level of reserves represented 5.8 months of retained imports and was 4.3 times the short-term external debt. Malaysia's reserves are usable and unencumbered.

INFLATION

Inflation remained subdued in 2002. The consumer price index (CPI) increased slightly by 1.8 per cent which was attributed to low import prices and excess capacity in several sectors of the economy. Producer prices were, however, higher in tandem with the sharp recovery in commodity prices of crude palm oil, crude petroleum and rubber during the year. The producer price index (PPI) rose by 4.4 percent compared with a decline of 5 percent in 2001.

EMPLOYMENT

The recovery in economic activity led to a moderate expansion in the labour force by 3.1 percent to 10.2 million in 2002 compared to 9.8 million the previous year. The labour market remained favourable with the unemployment rate declining slightly from 3.6 percent to 3.5 percent in 2002, which is still below the full employment level. The positive changes were also reflected in a significant decline in the number of retrenched workers and higher demand for labour. The total number of retrenched workers fell by 30.6 percent to 26,457 workers in 2002. During the same period, a total of 162,787 vacancies were created, indicating a significant increase of 23.8 percent compared with 6.5 per cent in 2001.

GROSS EXTERNAL DEBT

Malaysia's total external debt increased by 7.0 percent to RM186.6 billion (US$49.1 billion) as at the end of 2002. This was largely due to the increase in the business/private sector's short-term and federal government debt. However, external debt as a percentage of GDP decreased to 51.7 percent in 2002 from 52.2 percent in 2001 (1997: 60.6 percent). At this level, the debt position remains within prudential limits.

The business/private sector's short-term external debt increased significantly by 33.0 percent to RM32.2 billion (US$8.5 billion), equivalent to 17.3 percent of total external debt and 24.5 percent of international reserves. This was largely on account of the increase in short-term borrowings by commercial banks, mainly to provide for their trade financing activities, revolving credits and inter-company loans.

Although the federal government's external debt increased significantly by 49.1 percent to RM36.3 billion (US$9.5 billion), it accounted for only a small share (19.4 percent) of total external debt. The increase was largely due to additional borrowings to finance the deficit. The government has also tapped the international markets by issuing global bonds to maintain a market presence as well as to take advantage of favourable market conditions. In addition, an international Islamic bond called Global Islamic Sukuk was also issued in consonance with the government's objective of developing Islamic banking and to provide impetus for the development of international finance based on Islamic principles.

EXCHANGE RATE

The exchange rate of the Malaysian ringgit has remained pegged to the US dollar at RM3.80 per USD since 2 September 1998. In 2002, the ringgit depreciated against most major and regional currencies in tandem with the weaker US dollar. The dollar generally weakened on account of concerns over the pace of the US economic recovery as well as heightened geopolitical tensions in the Middle East. Consequently, the ringgit depreciated 15.4 percent against the euro, 9.5 percent against the pound sterling and 6.2 percent against the Japanese yen. The ringgit also declined in the range of 2.4 percent to 14.1 percent against most regional currencies but appreciated against the Phillippine peso. Similarly, the ringgit depreciated by 4 percent in terms of its trade-weighted nominal effective exchange. However, the Malaysian economy remains reasonably insulated from the volatility in currency markets, as a large proportion of Malaysia's external transactions is conducted in US dollars.

The ringgit peg continues to provide an environment of predictability and stability to facilitate economic activities and is supported by strong economic fundamentals. These include a strong current account surplus, higher international reserves, low inflation as well as a strong and well capitalised banking sector.

FISCAL POLICY

Amidst continued uncertainties in the global economy, the 2002 budget remained expansionary to support the growth momentum. Fiscal incentives and expenditure allocations were targeted at increasing domestic capacities to enhance long-term growth prospects. The actual outturn for revenue collected in 2002 was significantly higher than the initial projections on account of improved economic activities and increased efficiency in tax collection. Nevertheless, higher expenditure resulted in a deficit of RM20.3 billion or 5.6 percent of GDP for the year 2002 compared with original budget estimate at RM18.8 billion or 5.1 percent of GDP.

MONETARY POLICY

In 2002, monetary policy remained accommodative to support the economic recovery. The thrust of monetary policy focused on ensuring ample market liquidity and accessibility with low interest rates to support economic growth. The accommodative monetary stance was, in turn, facilitated by the absence of inflationary pressures. Bank lending recovered strongly in 2002 in line with the improving economy. Loan applications and approvals turned around to increase by 14.1 percent and 9.7 percent respectively from negative growth rates of 8.7 percent and 6.8 percent respectively in 2001. There was a corresponding increase of 10.3 percent in loan disbursements in 2002, up from 3.5 percent in 2001. Of significance is the increase in lending to small businesses. Loans below RM500,000 extended to businesses rose by 4.7 percent in 2002, while business loans below RM100,000 grew at a double-digit rate of 17.8 percent. Lending to the household sector remained strong, with increases in loan approvals and disbursements of 13.5 percent and 21.1 percent respectively (2001: 11.5 percent and 14.5 percent respectively).

The improved economic activity was also reflected in the growth of all monetary aggregates. M1, M2 and M3 expanded strongly by 10.3 percent, 5.8 percent and 6.7 percent, respectively, at end of 2002 (end-2001: 3.2 percent, 2.2 percent and 2.9 percent respectively). M3 rose by RM31.6 billion in 2002 (2001: RM13 billion), with the main impetus of monetary expansion emanating from the increase in financing of business/private sector activity amounting to RM26.2 billion.

MEDIUM-TERM OUTLOOK

The global economic outlook continues to be affected by slower growth in the major industrial economies. World growth, particularly in the US is likely to be more modest than earlier expectations. On the regional front, the SARS (severe acute respiratory syndrome) outbreak has adversely affected specific sectors including the retail, travel and tourism-related sectors. The recent downward revisions on regional outlook reflect the varying impact of SARS among economies in the region. Such an outlook would certainly have an adverse impact on other economies, especially developing economies. In response, the Malaysian government announced a RM7.3 billion economic stimulus package in May 2003 to mitigate the impact of SARS and the conflict in Iraq. The package is expected to enhance the potential for supporting growth prospects in 2003. With economic fundamentals remaining strong as well as timely actions and pro-growth policies, GDP growth has the potential to be sustained at a rate of at least 4.5 percent in 2003. This projection is based on a modest world economic growth, some pick-up in the global electronics industry, and firm commodity prices. The estimate is also based on the expected pick-up in intra-regional trade in the second half of 2003, as governments in the region have also announced economic relief packages to mitigate the impact of SARS and strengthen economic activities.

Growth in private consumption is expected to improve to 6.6 percent with consumer confidence remaining steady in tandem with stable employment and income prospects for 2003. Consumption in the rural areas is expected to increase as commodity prices are forecast to remain high. In addition, the direct tax measures introduced in the 2002 budget as well as civil service salary adjustments will continue to have a sizeable multiplier impact from households with an increase in disposable incomes. At the same time, the high savings rate of about 34 percent gives further potential for increases in domestic consumption.

After two consecutive years of negative growth, private investment is expected to recover with a growth rate of 7.5 percent in 2003, supported by a steady inflow of foreign direct investment as well as increase in domestic investment activities. The financing gap is estimated to narrow with cash flow positions of corporations continuing to improve as reflected by an increasing number of companies reporting higher profits in 2002. The improved revenue position coupled with the narrowing of excess capacity in many sectors will provide the impetus for business/private sector investment activities to further strengthen in 2003. Private sector capital formation is expected to emanate mainly from new investment in the manufacturing sector, continued investment in on-going privatised infrastructure and utility projects, residential housing, down-stream agriculture-based industries, and the oil and gas sub-sector. Investment in the services sector is expected to be sustained, particularly in utility projects, tourism, information technology and research and development centres. Investment in logistics and support services, as well as the setting up of regional hubs for multinational operations, including operational headquarters, international procurement centers, and regional data processing, financial and customers service centres are expected to be stepped-up.

Taking cognisance of lingering uncertainties in the external environment, the consolidation of public sector expenditure will be gradual. As such, the expansion in public sector investment expenditure is projected to increase at a lower rate of 4.1 percent in 2003 (2002: 4.6 percent). The focus of the federal government's development expenditure allocation will continue to be in the social and economic services sectors, with special emphasis on education and upgrading of manpower skills, research and development, as well as agriculture and rural development programmes. Further consolidation is reflected in the lower allocation for consumption expenditure of 5.9 percent (2002: 12.2 percent). Most of the expenditure is for emoluments as well as higher outlays on supplies and services.

On the production side, growth is expected to be broad-based with all sectors envisaged to expand further. Value-added in the manufacturing sector is projected to increase by 5.0 percent in 2003 on the assumption that the global electronics sector will register a moderate growth. In the services sector, growth is anticipated at 4.4 percent on account of the expected sustained domestic demand and increased trade-related activities. The construction sector is projected to expand by 1.9 percent, reflecting sustained housing construction amidst lower spending on infrastructure projects by both the government and the business/private sector, following the completion of some of the on-going projects. The agriculture sector is expected to expand by 1.5 percent, due primarily to higher production of crude palm oil, rubber and other agriculture products. With a better outlook for petroleum and natural gas prices, growth in the mining sector is expected to be sustained at 4.5 percent, emanating from an increase in the production of natural gas and crude oil.

For the whole of 2003, inflation is expected to remain subdued at below 2 percent, although the increase in transportation costs and retail prices of several petroleum products has had some effect in pushing up the CPI slightly. The trend continued into the first four months of 2003, although CPI rose only 1.3 percent during that period. The increase in the prices of tobacco, transport and communications, as well as gross rent and fuels was partly offset by a decline in the prices of clothing and footwear. Capacity expansion programmes being undertaken in other sectors coupled with lower inflation abroad, are expected to mitigate any build-up of inflationary pressures.

The government remains committed to fiscal prudence to preserve long-term fiscal sustainability and flexibility. In this regard, fiscal policy for 2003 will emphasize fiscal consolidation that will allow the government to gradually reduce its direct interventionist role in the economy. Hence, the fiscal deficit in 2003 is budgeted to decline to RM15.5 billion or 4.0 percent of GDP. The current account is expected to continue to record a large surplus of RM17.4 billion, while development expenditure will continue to benefit rural development and social programmes to further raise the quality of life for all segments of society.

The moderate GDP growth of 2002 is expected to sustain a strong balance of payments position with a continued large current account surplus (7.9 percent of GNP) in 2003. The surplus in the trade account is expected to increase in line with moderate growth in exports (7 percent), particularly electrical and electronics exports and higher revenue from agricultural and mineral exports. As the contribution of agricultural and mineral exports is expected to be higher in 2003, this is not likely to be matched by a corresponding increase in imports, given that these exports have low import content. The increase in gross imports is therefore expected to be more moderate at 7.1 percent with imports of intermediate goods increasing by 6.8 percent. Excluding 'lumpy' imports, capital imports are expected to increase by 19.5 percent in line with the expected recovery in investment. The higher trade surplus is expected to be partially offset by the slightly higher services and income deficits.

The services account deficit is envisaged to amount to RM6.2 billion, improving marginally to 1.7 percent of GNP. Larger payments reflect higher freight and insurance in line with the expected expansion in trade activity. Positive developments include improvement in tourism receipts as well as higher earnings from port charges and education. Closer collaboration between the government and the business/private sector in export promotion; a wider spectrum of fields of study; and integrating information technology and research and development in course content are expected to enhance receipts from education. Port earnings are expected to increase, following efforts to promote the utilisation of domestic ports with the ports positioning themselves as distribution hubs for transshipment cargo. Innovative approaches such as a combined air/sea trans-shipment, access to information technology, and simplified and standardised customer procedures are expected to enable the ports to provide fast and flexible services.

In addition, gross receipts in the other services account are also expected to increase as expansion of the services sector has seen foreign direct investments being more diversified into services-related activities, including communications and information-related services. Similarly, incentives to lower the cost of doing business through deduction of expenses incurred in export promotion by professional services enterprises are expected to encourage local service providers to venture abroad and thus increase export earnings.

The income account deficit is expected to widen to 8.2 percent of GNP with the increase in profits and dividends accruing to non-residents, following the envisaged increase in exports.

The financial account is expected to be supported by continued inflows of funds for investment. A steady inflow of foreign direct investment in Malaysia is expected, mainly in the form of reinvestment of earnings of existing multinational companies for the upgrading of machinery and equipment as well as some new investment in the services sector. The investment incentives provided in the 2003 budget, including for the setting up of operational headquarters (OHQ), international procurement centres and regional distribution centres, are expected to attract higher value-added foreign direct investment (FDI) into the services sector. Meanwhile investment in the oil and gas sector is expected to remain high. Direct investment abroad is also likely to maintain its pace as a number of companies have indicated their interest in positioning themselves globally to provide greater synergy to their corporate activities.

The official sector is expected to record a net repayment of loans due to higher loan repayments by NFPEs following the maturing of several bonds and loans during the year. Short-term capital flows are expected to be volatile, responding to short-term sentiments and events.

Financial Sector Restructuring in Malaysia

The institutional arrangements put in place to restore stability in the financial system during the financial crisis of 1997-98 achieved many major milestones with the resilience of the Malaysian banking sector strengthened and efficiency improved to effectively support economic activities. Policies implemented over the years, for example in banking sector consolidation, have resulted in the banking system being better capitalised and placed on a stronger footing. In addition, the closure of the Corporate Debt Restructuring Committee (CDRC) in August 2002, marked an important milestone in Malaysia's financial restructuring initiatives since the crisis. During its four years of existence from 1998 to 2002, the CDRC had successfully resolved 48 cases involving debts of RM52.6 billion, representing some 65 percent of the cases under its auspices. Of these, 32 cases with debts totaling RM36 billion have been fully restructured. The resolution of the remaining 16 cases (with total debts amounting to RM16.6 billion) would further reduce the NPL level by two percentage points. Of significance is that debt restructuring has been accompanied by asset sales and the spinning off of non-core businesses, as well as management changes.

Danaharta, the national asset management company set up in 1998, has initiated recovery action on all non-performing loans (NPLs) in its portfolio totalling RM52.5 billion. The focus of Danaharta was to implement the recovery strategies through restructuring, settlement, foreclosure and schemes of arrangements in order to maximise the recovery of NPLs acquired. As at 31 December 2002, the average recovery rate achieved was 57 percent, with expected recovery proceeds totaling RM30.2 billion or 57 percent. Danaharta has stopped acquiring NPLs since 2001, and given its progress, is on track to unwind its operations in 2005.

Danamodal, a special-purpose vehicle that was also established in 1998 to recapitalise financial institutions, has not made any capital injection into a financial institution since 1999. To date, seven banking institutions have repaid RM5.5 billion leaving Danaharta's outstanding investments declining to RM2.1 billion from the RM7.1 billion (far less than the original estimate of RM16 billion) that it first injected into 10 institutions when it was first set up.

Apart from financial restructuring, Malaysia continued with efforts to strengthen corporate governance. These efforts first started in 1996 prior to the crisis, but have since been more focused and strengthened. Among many initiatives, amendments have been made to the listing requirements of the Kuala Lumpur Stock Exchange (KSLE) regarding the minimum content and accounting principles used in the financial reports as well as the required level of compliance with the Malaysian Code on Corporate Governance. Shareholder protection has also been promoted, with measures such as enhanced disclosure requirements and the establishment of a Minority Shareholder Watchdog Group. Directors of publicly-listed companies have been required to attend the Mandatory Accreditation Programme conducted by RIIAM, the training arm of the KSLE. Lately, the KLSE has also introduced the Continuing Educational Programme for PLC directors as part of efforts to promote greater awareness by board members of their obligations to promote the interest of all shareholders and stakeholders and their responsibility as the driving force for good corporate governance in the companies they lead.

Annex I

MALAYSIA: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in US$ billion)	74.2	74.5	79.2	90.2	87.9	94.9
Real GDP	7.3	-7.4	6.1	8.3	0.4	4.1
Consumption	4.6	-10.0	5.7	10.5	5.8	6.4
Private Consumption	4.3	-10.2	2.9	12.5	2.5	4.2
Government Consumption	5.7	-8.9	17.1	3.0	17.0	12.2
Investment	9.2	-43.0	-6.5	25.7	-2.8	0.2
Private Investment	9.4	-55.2	-23.1	32.6	-19.9	-6.1
Government Investment	8.4	-8.4	16.3	19.4	14.5	4.6
Exports of Goods and Services	5.5	0.5	13.2	16.1	-7.5	3.6
Imports of Goods and Services	5.8	-18.8	10.6	24.4	-8.6	6.1
Fiscal and External Balance (percent of GDP)						
Budget Balance	2.4	-1.8	-3.2	-5.8	-5.5	-5.6
Merchandise Trade Balance	3.6	24.4	28.6	23.1	20.9	19.1
Current Account Balance	-5.9	13.2	15.9	9.4	8.3	7.6
Capital and Financial Non-reserve Assets Balance						
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	3.5	8.5	0.0	4.9	-2.7	3.6
CPI	2.7	5.3	2.8	1.6	1.4	1.8
M2	22.7	1.5	13.7	5.2	2.2	5.8
Short-term Interest Rate (3 month weighted average Interbank)	7.78	9.43	4.08	3.19	3.13	2.92
Real Effective Exchange Rate (level, 1997=100)						
Unemployment Rate (percent)	2.4	3.2	3.4	3.1	3.6	3.5
Population (millions)	21.7	22.2	22.7	23.5	24.0	24.5

Annex II

MALAYSIA: FORECAST SUMMARY (percent change from previous year)

	2002						2003					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	4.1	4.2	4.2	N.A.	N.A.	N.A.	4.5	4.2	4.3	N.A.	N.A.	N.A.
Exports (Trade)	6.0	N.A.	6.1	N.A.	N.A.	N.A.	7.0	N.A.	8.1	N.A.	N.A.	N.A.
Imports (Trade)	8.3	N.A.	8.1	N.A.	N.A.	N.A.	7.1	N.A.	8.8	N.A.	N.A.	N.A.
CPI	1.8	1.8	1.8	N.A.	N.A.	N.A.	1.5	1.7	1.9	N.A.	N.A.	N.A.

Annex III

MALAYSIA: MEDIUM-TERM TREND FORECAST (percent)

	Average for 2001-2005
Real GDP	7.5
GDP Deflator	N.A.

MEXICO

REAL GROSS DOMESTIC PRODUCT GROWTH

National economic activity, as measured by gross domestic product (GDP), registered a moderate expansion during 2002. In spite of the more vigorous GDP growth recorded in the last nine months of the year the weakness of economic activity during the first quarter had a negative impact on the overall annual rate of GDP growth. As a result, the Mexican economy expanded at a real annual growth rate of 0.9 percent.

The rate of the GDP growth was uneven among different economic sectors. In particular, the rate of growth of the economic sectors closely linked to external markets was weaker than that of sectors associated with domestic sources of demand. This situation, along with the uncertainty that characterized the international financial markets, continued to delay the consolidation of the recovery process that the Mexican economy saw in the second half of 2002.

In this context, GDP in the services sector increased 1.6 percent in real terms, while GDP in the industrial sector showed no real variation, in each case compared to 2001. In contrast, GDP in the agricultural sector declined 0.4 percent in real terms compared to 2001.

INFLATION

The annual inflation rate, measured by the change in the national consumer price index (INPC), stood at 5.7 percent at the end of 2002, a figure higher than both the original 4.5 percent inflation target for the year and the 4.4 percent inflation rate registered in 2001. The most important events that influenced price behavior during 2002 were the following: the downward rigidity of prices of services; the partial elimination of electricity subsidies; a significant increase in the price of domestic gas, driven by the evolution of international oil prices; and the volatile behavior of agricultural product prices.

EMPLOYMENT

The labor markets reflected the weakness of the industrial sector and investment demand. The number of employees registered with the Mexican Institute of Social Security (IMSS), a measure of employment in the formal sector of the economy, registered a moderate increase of 61,495 workers over the level recorded at the end of 2001, reaching a total of 12,225,582 workers at the end of December 2002.

Similarly, the unemployment rate (TDA) averaged 2.71 percent of the economically active population during 2002, 0.25 percent higher than the average for 2001.

BALANCE OF PAYMENT

During 2002, Mexico’s foreign trade registered a modest expansion. Total exports amounted to US$160,682.0 million, 1.4 percent higher than in 2001. This moderate increase was due to a boost in petroleum-related exports of 13.1 percent and an expansion of 0.4 percent in non-petroleum exports, in each case with respect to 2001.

Within non-petroleum exports, manufacturing exports increased modestly at 0.4 percent during 2002, reflecting the weakness of external demand and, particularly, of the US economy. Within manufacturing, exports by the *maquiladora* industry increased 1.5 percent during 2002, while exports by non-*maquiladora* industry declined 0.8 percent during 2002, in each case as compared to 2001. On the other hand, exports in the extraction sector increased 0.2 percent, while agricultural exports contracted 1.9 percent during 2002, in each case as compared to 2001.

The substantial increase in petroleum-related exports reflected favorable developments in the price of Mexican oil in the international markets. In particular, the average price of the Mexican oil mix during 2002 stood at US$21.58 per barrel, US$3.01 higher than the 2001 average.

Total imports during 2002 amounted to US$168,678.9 million, 0.2 percent higher than in 2001. This result is mainly attributable to the modest recovery of economic activity and domestic demand, as well as the moderate rebound of manufacturing exports, which tend to use imported inputs.

During 2002, imports of consumption and intermediate goods increased 7.2 percent and 0.3 percent, respectively, while imports of capital goods declined 6.7 percent.

In this context, the trade balance for 2002 registered a deficit of US$7,996.8 million, 19.7 percent lower than in 2001. The non-oil trade deficit totaled US$22,473.7 at the end of December 2002, 1.2 percent less than in 2001.

The factoring services balance registered a deficit of US$12,281.5 million in 2002, a modest decrease as compared to 2001. The non-factoring services balance recorded a deficit of US$4,048.2 million in 2002, US$490.6 million higher than in 2001. Similarly, the surplus in the tourism balance amounted to US$3,947.0 million, an increase of US$176.2 million with respect to 2001, while the balance of transfers registered a surplus of US$10,268.8 million, 10 percent higher than in 2001.

In this context, the current account deficit during 2002 totaled US$14,058.3 million, equivalent to 2.2 percent of GDP. This deficit was significantly lower than that registered in 2001, both in dollar terms (US$18,008.0 million) and as a percentage of GDP (2.9 percent). As in previous years, the current account deficit was financed with long-term private external resources, concentrated mainly in foreign direct investment (FDI).

The capital account registered a surplus of US$20,337.5 million during 2002. This result was largely due to substantial inflows from the business/private sector. In particular, FDI during 2002 totaled US$13,626.5 million, a significant amount considering the increased volatility in international markets. This figure exceeds the FDI of US$12,887 million recorded in 2001, excluding the Banamex-Citigroup transaction. Accordingly, FDI financed 97.0 percent of the current account deficit during 2002.

Portfolio foreign investment registered a moderate inflow of US$46.0 million during 2002. This result was attributable to an inflow of US$149.6 million of foreign investment in the money market and an outflow of US$103.6 million of foreign investment in the Mexican stock market. In this context, total foreign investment amounted to US$13,672.6 million during 2002.

Net capital outflows associated with loans and deposits totaled US$3,883.6 million during 2002. Of this total, the non-financial public sector, development banks and commercial banks registered outflows of US$1,619.5 million, US$545.0 million and US$2,498.7 million, respectively, while the non-financial private sector recorded an inflow of US$779.6 million. The errors and omissions balance registered an inflow of US$770.3 million during 2002.

Mexico's net international reserves totaled US$47,984.0 million at 31 December 2002, an increase of US$7,104.1 million as compared to the end of 2001.

GROSS EXTERNAL DEBT

The outstanding amount of net public sector external debt at the end of 2002 was US$75,934.8 million, US$711.4 million lower than at the end of 2001. This decrease in net public sector external debt was due to the following factors:

- A US$1,521.1 million reduction in the outstanding amount of gross external debt as a result of: a) a net decrease in external indebtedness of US$3,242 million due to US$13,593.7 million of new borrowings and US$16,835.7 million of repurchases and amortizations and b) net upward accounting adjustments totaling US$1,720.9 million, principally due to the depreciation of the US dollar with respect to other major currencies in which debt is denominated and accounting for new liabilities associated with Pidiregas projects.

- A US$809.7 million decrease in the value of the federal government's international assets related to external debt. This decline reflects, on the one hand, the decrease in international assets derived from the release of collateral securing cancelled Brady Bonds and, on the other, the increase in assets that resulted from the interest accrued during the year, as well as from movements in interest rates and exchange rates associated with Brady Bond collateral.

During the year, the federal government's external debt policy was marked by the implementation of liability management operations aimed at reducing the cost of, and extending the amortization schedule of, external debt.

Of the US$16,835.7 million in purchases and amortizations during 2002, 18.8 percent corresponded to debt prepayments; redemptions and repurchases of Brady Bonds and floating rate notes; 25.1 percent to repayment of external trade-related financing; 20.2 percent to bonds; 14.5 percent to bank loans; 9.3 percent to loans from international financial organizations; 7.1 percent to debt associated with Pidiregas projects; and the remaining 0.5 percent to the maturity of restructured debt.

EXCHANGE RATE

During 2002, the free-floating exchange rate policy continued to demonstrate its importance as an instrument for absorbing shocks to the Mexican economy in an orderly manner. In particular, during 2002 the flexible regime contributed to achieve the following objectives: i) permitting gradual and frequent adjustments to external shocks (instead of less frequent but larger adjustments); ii) promoting a modification in the composition of capital inflows in favor of long-term capital outflows, such as foreign direct investment; and iii) avoiding the accumulation of unsustainable imbalances in the external sector by reflecting the fundamentals of the economy.

In this context, the weakness of the US dollar with respect to other major currencies and the expectation of a US economy affected by military conflict in the Middle East had a negative impact on value of the peso against the US dollar. In particular, as of the end of 2002, the spot exchange rate was Ps. 10.3950 per US dollar, a depreciation of 13.48 percent as compared to the end of 2001.

FISCAL POLICY

Excluding the accounting adjustment associated with the liquidation of *Banrural*,[1] the overall budget deficit for 2002 amounted to Ps. 37,672.6 million, Ps. 2,521.5 million lower than the target approved by congress for the year.

The 2002 public sector deficit of Ps. 75,606.6 million resulted from deficits of Ps. 135,098.0 million and Ps. 3,520.5 million attributable to the federal government and entities under indirect budgetary control, respectively, and a surplus of Ps. 63,011.9 million attributable to entities under direct budgetary control.

The public sector primary balance (defined as total public sector revenues less expenditures other than interest payments on public debt), registered a surplus of Ps. 108,965.1 million, 30.2 percent lower in real terms than the public sector primary balance registered in 2001. Excluding the liquidation of *Banrural* and the creation of *Financiera Rural*, the public sector primary balance amounted to Ps. 146,899.1 million, 6.0 percent lower in real terms than the public sector primary balance registered in 2001.

During 2002, consolidated public sector budgetary revenues totaled Ps. 1,388,166.7 million, 4.0 percent higher in real terms than 2001 consolidated public sector budgetary revenues. Among the components of consolidated public sector budgetary revenues, it is worth highlighting the following:

- Tax revenues registered a real increase of 6.1 percent during 2002, reflecting an increase in the collection of income taxes and the special tax on production and services (*Impuesto Especial sobre la Producción y Servicios*, or IEPS).
- Non-tax revenues of the federal government declined 13.0 percent in real terms in 2002 as compared to 2001, due to lower royalties and fees paid by *Petróleos Mexicanos* (PEMEX).
- Finally, the revenues of the public entities under direct budgetary control increased by 14.3 percent in real terms during 2002. This increase is mainly attributable to higher revenues obtained by PEMEX and the *Comisión Federal de Electricidad* (CFE).

Federal government revenues comprised 71.3 percent of total budgetary revenues, while revenues of agencies and entities under direct budgetary control comprised the remaining 28.7 percent.

Federal government revenues totaled Ps. 989,281.9 million during 2002, an increase of 0.3 percent in real terms as compared to revenues recorded in 2001. This increase was primarily attributable to the 6.1 percent increase in tax revenues mentioned above.

Revenues from agencies and entities under direct budgetary control in 2002 amounted to Ps. 398,884.8 million, 14.3 percent higher in real terms as compared to revenues recorded in 2001. This increase is mainly explained by higher revenues obtained by PEMEX and CFE.

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[1] The liquidation of *Banrural* and the creation of a new entity, *Financiera Rural*, will strengthen the rural financial system and enhance the federal government's support for rural development by establishing a transparent and efficient financial intermediation scheme. Moreover, these measures permanently resolve the structural fiscal problems generated by *Banrural's* operation. It is worth emphasizing that these operations do not impact the public sector borrowing requirements (PSBR), since they result in a change in the registration status of public sector liabilities, but not in the net amounts.
In particular, the resources directed to cover the Ps. 37,934.0 million of liabilities associated with *Banrural's* liquidation constitute a substitution operation between public sector entities and do not modify the PSBR. Specifically, these transactions translate into an increase in the federal government debt that is fully offset by a reduction in net indebtedness from development banks.

Overall, public sector revenues were Ps. 16,697.1 million lower than projected in the Revenue Law for 2002, mainly due to an overestimation of projected revenues associated with the fiscal measures approved by congress in December 2001. In particular, non-oil revenues registered a shortfall of Ps. 63,334.3 million, which was partly compensated for by higher than projected oil-related revenues of Ps. 13,593.2 million, by an increase in the revenues of public entities under direct budgetary control (other than PEMEX) of Ps. 14,452.0 million, and by higher than expected federal government non-tax revenues of Ps. 18,592.0 million

MONETARY POLICY

In accordance with its constitutional mandate, Banco de Mexico's primary objective is to seek the stability of the purchasing power of domestic currency. As a result, reaching and maintaining stability in price levels is one of Banco de Mexico's main goals. Consistent with this view, the Board of Governors established as a medium-term objective in the Monetary Program of 2001 that the annual growth rate of the INPC should fall to 3.0 percent by December 2003, in line with the inflation rates of Mexico's main trading partners. Additionally, it was announced that the inflation target for 2002 should be no higher than 4.5 percent.

Similarly, as part of the evolution of the inflation targeting scheme, the Board of Governors announced the following decisions during 2002: i) the long term inflation target was defined in terms of the INPC; ii) the long term objective is to attain, from December 2003 onwards, an annual inflation rate of 3.0 percent; iii) the long term inflation target was established along with a variability interval of plus/minus one percent; and iv) monetary policy decisions will be announced on predetermined dates through press releases that will explain, if applicable, the reasons behind any modification in policy.

In this context, on 8 February 2002, Banco de Mexico tightened its monetary stance by increasing the "short" from Ps. 300 million to Ps. 360 million. The change was to prevent the recently adopted fiscal reforms and the partial elimination of electricity subsidies from leading to an increase in inflationary expectations.

Banco de Mexico's timely action, together with the federal government's fiscal discipline, resulted in a downward trend of the annual core inflation rate. As a result, on 12 April 2002, Banco de Mexico reduced the "short" from Ps. 360.0 million to Ps. 300.0 million.

Nevertheless, in the face of the increased volatility in the international financial markets, Banco de México decided to raise the level of the "short" on two occasions during the second half of the year. These measures were taken to induce a downward movement in inflation expectations in the medium term and to foster the monetary conditions necessary for annual increases in consumer prices to converge with the inflation target of 3.0 percent for 2003. Banco de México has since increased the "short" again, from Ps. 300.0 million to Ps. 400.0 million on 23 September 2002, and, from 400.0 million to Ps. 475.0 million on 6 December 2002.

The monetary base, which consists of currency in circulation and deposits with the central bank, reached Ps. 263,937.0 million at 31 December 2002, 10.7 percent higher in real terms as compared to the end of 2001. This result led to an increase in the monetary base as a percentage of GDP, furthering the re-monetization of the economy that began in 1997.

The increase in the monetary base was largely due to the strengthening of economic fundamentals, which allowed inflation and domestic interest rates to remain at relatively low levels, as well as an increase in the cost of obtaining cash balances from financial intermediaries.

Net international reserves (defined as the difference between gross international reserves less Banco de México short-term liabilities) totaled US$47,984.0 million at the end of 2002. Similarly, Banco de México's net international assets totaled US$50,722.0 million at the end of 2002, US$5,865.0 million greater than their level at the close of 2001. The increase in international assets during 2002 was due to: (a) inflows of US$10,019.0 million associated with PEMEX's operations; plus (b) inflows totaling US$2,108.0 million associated with other Banco de México operations, less and (c) sales of US dollars to the federal government by Banco de México totaling US$6,262.0 million.

Banco de México's net domestic credit (defined as the difference between the monetary base and net international assets) registered an effective negative flow of Ps. 20,893.0 million during 2002. This result was primarily due to the significant increase in net international assets.

MEDIUM-TERM OUTLOOK

The main economic projections incorporated in the 2003 Economic Program approved by congress contemplates a real GDP growth rate of 3.0 percent; an inflation rate no higher than 3.0 percent; a current account deficit to GDP ratio equivalent to 2.8 percent; a real annual growth rate of the US economy of 2.5 percent; and an oil export platform of 1.86 million barrels per day.

As in previous years, the economic program establishes a zero net external indebtedness ceiling. Thus the public sector deficit will be financed entirely from the domestic market.

In 2003 fiscal discipline will remain the cornerstone of the economic program. In particular, the fiscal package approved by congress is consistent with an overall public sector deficit equivalent to 0.50 percent of GDP.

In the presence of lower external demand growth, the economic strategy for 2003 focuses on strengthening domestic sources of growth. Investment is expected to be the most dynamic component of aggregate demand, driven by relatively low levels of interest rates and by the strong promotion of public projects. Total investment, including business/private sector and public investment, is anticipated to grow at a real annual rate of 4.7 percent.

SPECIAL SECTION ON STRUCTURAL REFORMS

The National Development Plan (PND), which was presented by the President Vicente Fox, on 29 May 2001, contains a set of structural reforms planned to be implemented during the current administration.

The objectives and economic impact of the financial, fiscal and budgetary reforms proposed to be revised by the legislative branch during this administration are shown in the following table.

Reforms	Objectives	Economic Impact
Financial Reform	▪ Promote domestic savings, with emphasis in popular and long-term savings. ▪ Speed the modernization of the financial system and facilitate the reactivation of bank lending. ▪ Deepen domestic stock and debt markets. ▪ Modernize development banks in order to accelerate the achievement of the social an economic goals set forth in the PND	▪ Increases domestic saving on a sustained and permanent basis. ▪ Establishes a more competitive financial system and provides more financing options to the business/private sector. ▪ Reduces the risk of systemic crises ▪ Increases the informational content of financial asset prices. ▪ Promotes the efficient allocation of resources to productive investment.
Fiscal Reform	▪ Maintain a solid fiscal stance and promote an allocation of resources that favors social and investment projects. ▪ Increase permanent public sector current expenditure. ▪ Reduce the dependency on oil-related revenues. ▪ Ameliorate the crowding-out of private investment. ▪ Improve tax compliant sources of revenue in order to attend social needs.	▪ Reduces the absorption of financial resources and increases the amount of resources available for private investment. ▪ Decreases the volatility of public sector income by limiting the government's dependence on oil-related revenues. ▪ Decreases the vulnerability of the economy to speculative attacks. ▪ Reduces the size of the informal sector of the economy. ▪ Diminishes economic distortions and generates a more competitive economic environment. ▪ Strengthens regional development. ▪ Increases the ability of the State to support social needs.
Budgetary Reform	▪ Modernize the budgetary approval process and its execution. ▪ Establish rules on medium-term fiscal policy. ▪ Increase the efficiency of public sector expenditures. ▪ Improve the account rendering process.	▪ Allows for the implementation of contra-cyclical polices in the medium term. ▪ Provides certainty over the medium-term fiscal stance. ▪ Strengthens the evaluation process of public expenditures. ▪ Increases the transparency of fiscal policy management.

During 2001 and 2002, the federal government and congress have been working intensively to modernize and strengthen Mexico's financial sector. The most important laws and/or amendments to existing laws approved by congress are:

- *Ley de Instituciones de Crédito (en lo referente a la Banca de Desarrollo) y Leyes Orgánicas: Nacional Financiera* (NAFIN), Bancomext, *Banco Nacional de Obras y Servicios Públicos* (BANOBRAS), *Banco Nacional del Ejército, Fuerza Aérea y Armada* (BANJERCITO) *Banco del Ahorro Nacional y Servicios Financieros* (BANSEFI), and *Sociedad Hipotecaria Federal* (SHF). These reforms seek to modernize the development banks and increase their management efficiency while strengthening their corporate governance. The reforms also grant additional administrative powers to these institutions, which must be exercised within the guidelines of the overall public sector expenditure program (24 June 2002).

- *Ley de los sistemas de ahorro para el retiro* (LSAR). This reform authorizes non-affiliated workers to open individual retirement accounts; creates complementary savings accounts (*Fondos de Previsión Social*); provides more flexibility to the investment regime; and strengthens surveillance mechanisms (10 December 2002).

- *Ley de Instituciones de Crédito y Ley para Regular las Agrupaciones Financieras*. This reform sets formal deadlines for financial authorities in accordance with international standards for the resolution of private sector disputes.

- *Ley Federal para la Administración y Enajenación de Bienes del Sector Público*. The objective of this reform is to regulate the administration and purchase of goods by entities and agencies of the federal public administration (31 October 2002).

- *Ley Orgánica de la Financiera Rural*. This new law establishes the liquidation of *Banrural* and determines the administrative foundations of a new entity, *Financiera Rural*. This new entity will strengthen the rural financial system and enhance the federal government's support for rural development by establishing a more transparent and efficient financial intermediation scheme. Moreover, these measures will permanently resolve the structural fiscal problems generated by *Banrural's* operation (26 December 2002).

- *Reforma a la Ley de Transparencia y Fomento a la Competencia en el Crédito Garantizado*. This new law establishes the obligation of financial institutions to convey all relevant information regarding mortgage financing in a clear and simple manner, and creates mechanisms that promote competition among financial institutions that grant housing credit. It is also aimed at promoting bank lending by reducing transactions costs and interest rates as well as widening the options to secure credit transactions (13 June 2003).

As for fiscal reform aimed at strengthening the public finances of the federal government, the congress made significant amendments to the following laws: *Ley de Impuestos sobre la Renta* and *Ley de Impuesto Especial sobre Producción y Servicios* (1 January 2002).

Annex I

MEXICO: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in US$ billion)	400.9	421.0	480.5	580.8	623.9	637.2
Real GDP	6.8	5.0	3.6	6.6	-0.2	0.9
Consumption	6.0	5.0	4.4	7.4	2.2	0.9
Private Consumption	6.5	5.4	4.3	8.2	2.7	1.2
Government Consumption	2.9	2.3	4.7	2.0	-1.2	-1.3
Investment	21.0	10.3	7.7	11.4	-5.8	-1.3
Private Investment	23.5	13.8	7.2	8.7	-4.4	-2.8
Government Investment	10.1	-7.5	10.7	27.2	-13.0	7.3
Exports of Goods and Services	10.7	12.1	12.4	16.4	-3.6	1.4
Imports of Goods and Services	22.7	16.6	14.1	21.5	-1.5	1.6
Fiscal and External Balance (percent of GDP)						
Budget Balance	-0.7	-1.3	-1.1	-1.1	-0.7	-1.2
Merchandise Trade Balance	0.2	-1.9	-1.2	-1.4	-1.6	-1.3
Current Account Balance	-1.9	-3.8	-2.9	-3.1	-2.9	-2.2
Capital and Financial Non-reserve Assets Balance	4.2	4.4	2.8	3.0	3.9	3.2
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	17.7	15.4	15.3	12.2	6.3	4.6
CPI	15.7	18.6	12.3	9.0	4.4	5.7
M2	13.7	7.6	8.3	6.7	12.2	5.5
Short-term Interest Rate (percent)*	19.8	24.8	21.4	15.2	11.3	7.1
Real Effective Exchange Rate (level, 1997=100)	100.0	98.6	90.5	80.2	73.2	71.3
Unemployment Rate (percent)	3.7	3.2	2.5	2.2	2.5	2.7
Population (millions)	95.1	96.6	98.1	99.6	101.0	102.4

* 28 day Cetes.

Annex II

MEXICO: FORECAST SUMMARY (percent change from previous year)

	2002						2003					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	1.7	N.A.	N.A.	N.A.	N.A.	N.A.	3.0	1.5	N.A.	N.A.	N.A.	N.A.
Exports	2.4	N.A.	N.A.	N.A.	N.A.	N.A.	10.4	N.A.	N.A.	N.A.	N.A.	N.A.
Imports	1.0	N.A.	N.A.	N.A.	N.A.	N.A.	8.3	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	4.5	N.A.	N.A.	N.A.	N.A.	N.A.	3.0	4.6	N.A.	N.A.	N.A.	N.A.

Annex III

MEXICO: MEDIUM-TERM TREND FORECAST (percent)

	2003
Real GDP	3.0
GDP Deflator	3.7

NEW ZEALAND

REAL GROSS DOMESTIC PRODUCT

The New Zealand economy has performed strongly since 1999. Over 2002 New Zealand was one of the fastest growing economies in the OECD, expanding 4.4 percent in calendar year 2002. This strong growth came at a time of subdued global growth, and heightened geopolitical uncertainties following 11 September 2001.

This relative 'out performance' has stemmed from a combination of factors:

- New Zealand did not experience the excesses of the equity market bubble that are still working their way through a number of economies;
- While global growth was somewhat hesitant over 2001 and 2002, importantly for New Zealand, Australia, our major trading partner, has performed strongly;
- Two seasons of strong commodity prices and good growing conditions resulted in a record high in farm incomes, which stimulated rural spending; and
- Strong inward migration, and rising household incomes on the back of robust employment growth and stimulatory monetary conditions, helped boost consumer spending, and underpinned strength in the housing market and residential investment.

Three years of strong economic performance has also seen growth become increasingly broad-based, leading to a marked reduction in spare capacity, and increased pressure on resources.

In the first half of 2002, growth was underpinned by strength in exports, with services exports (tourism and the international education sector), and diary exports making substantial contributions. Consumption also made a substantial contribution to growth, benefiting from the stimulus provided by high farm incomes, and the strength of the labour market. In the latter part of the year total investment, including residential investment, was a major driver of growth, while a surge in imports due to strong domestic demand resulted in the external sector subtracting from growth. Partial indicators suggest that the domestic economy continued to grow steadily in the March 2003 quarter.

INFLATION

Strong domestic demand and high levels of capacity utilization, particularly in the construction sector, has seen non-tradable inflation running at close to 4 percent at the end of 2002. However, the appreciation in the New Zealand dollar and muted world export and import prices has provided an offset by reducing inflationary pressures in the tradable sector. CPI inflation in the March 2003 quarter was 0.4 percent, taking annual inflation to 2.5 percent, still in the top half of the Reserve Bank's 1 percent to 3 percent target band, but down from the 2.7 percent recorded in the year to December 2002.

CPI inflation is forecast to fall to below the mid-point of the Reserve Bank's target band over the coming year, as domestic pressures ameliorate, and the higher exchange rate and lower oil prices reduce pressures on imported inflation.

EMPLOYMENT

Three years of relatively strong economic growth have been reflected in labour market outcomes. Initially, employment growth was in the agricultural and manufacturing sectors, but more recently has spread more widely into the health, education and community services sectors. In the year to December 2002, employment grew 2.8 percent, and at 4.9 percent the unemployment rate has fallen to levels not seen since the late 1980s. Looking forward the unemployment rate is expected to increase to about 5.5 percent as the economy slows but then rebound in line with growth.

CURRENT ACCOUNT

The annual current account deficit reduced from 6.6 percent of GDP in the March 2000 quarter to 2.2 percent of GDP in March 2002—its lowest level as a proportion of GDP in 13 years. The improvement was largely driven by an improvement in the goods and services balance.

However, the impact of lower commodity prices and a higher dollar on export incomes, and increased demand for imports on the back of the strong domestic economy, has seen the current account deteriorate to 3.1 percent of GDP in the year to December 2002. A further increase in the current account deficit to around 5 percent of GDP is likely over 2003 and 2004.

EXCHANGE RATE

The exchange rate has generally appreciated over 2002. On a trade-weighted basis, the exchange rate moved to just under the 60 mark by the end of the year, up from the low of around 48 following 11 September 2001. By the middle of May the trade-weighted exchange rate increased to 61.5. The biggest gains have been against the US dollar, with the NZ dollar rising from a low of just under US$0.40 to around US$0.58 in mid-May.

GROSS EXTERNAL DEBT

New Zealand's total gross international debt position for the year to March 2002 was NZ$132 billion, although net debt was NZ$71 billion, down slightly from the previous year. After generally increasing since the beginning of the series in 1989, the net international debt position has remained relatively steady in level terms, more recently around NZ$100 billion. However, the steady net liability level combined with strong economic growth since 1999 has led to the fall in New Zealand's net liabilities as a proportion of GDP.

FISCAL POLICY

New Zealand has been running an operating surplus since the June 1994 fiscal year. Government operating expenses reduced as a percentage of GDP from 41.6 percent in 1992–93 to 29.8 percent in the 2001–02 financial year.

The operating balance before revaluations and accounting changes (OBERAC) is estimated to be 3.1 percent of GDP for 2002–03, rising to 4.0 percent of GDP in 2006–07, as tax revenue growth remains higher than expense growth through the forecast horizon.

Net government debt has fallen from 49 percent of GDP in 1992–93 to 16.8 percent in 2001–02.

Looking forward, it is expected that growing surpluses will contribute to building up financial assets to pre-fund future superannuation costs. Net debt is forecast to decrease to 14 percent of GDP in 2002–03, reducing further out to about 10 percent of GDP by 2006–07 (although if the assets of the newly-created New Zealand Superannuation Fund this ratio falls to about 3 percent), and gross debt fall to around 23 percent of GDP. Current fiscal strategy is geared toward running operating surpluses sufficient to meet the contributions to the New Zealand Superannuation Fund and keep gross debt below 30 percent of GDP.

MONETARY POLICY

The Reserve Bank of New Zealand (RBNZ) is an independent central bank and through the Reserve Bank Act 1989 it is charged with maintaining price stability in New Zealand. The Act requires that there be a Policy Targets Agreement between the Minister of Finance and the Governor of the Reserve Bank. The most recent Policy Targets Agreement was signed in September 2002, and requires the bank to maintain inflation in the range of 1 percent to 3 percent on average over the medium term. The agreement also stipulates that in pursuing its primary objective of price stability, the bank shall seek to avoid "unnecessary instability in output, interest rates, and the exchange rate".

When it comes to implementing monetary policy the reserve bank uses the Official Cash Rate (OCR) target. Like other central banks, the RBNZ successively cut rates in the period following 11 September, taking the OCR to 4.75 percent in November 2001. Ongoing strength in the domestic economy saw this stimulus gradually withdrawn over the first half of 2002, with the Reserve Bank gradually raising the OCR to 5.75 percent The OCR remained at this level until April 2003 when it was lowered to 5.5 percent. Subsequent reductions have taken the OCR to 5.0 percent.

MEDIUM-TERM OUTLOOK

Over the medium term, the New Zealand economy is expected to record GDP growth of about 3.0 percent on average, although the economy faces a number of "headwinds" that are expected lead to a modest slowing in growth over the coming year.

The fall in the commodity prices last year, moderate trading partner growth, the higher exchange rate and the unwinding of earlier interest rate stimulus are the main forces operating to slow growth. In addition a number of factors have emerged that are also expected to act as a temporary drag on growth. These include the effects of dry weather conditions on electricity production and farm output, travel disruptions and uncertainty due to the conflict in Iraq, and the outbreak of severe acute respiratory syndrome (SARS).

As these temporary factors recede in the latter part of the year growth is expected to pick up, with domestic demand supported by lower interest rates, robust income and wealth growth, and external demand boosted by trading partner growth returning to trend in 2004.

Domestic demand has been the main driver of growth over the first half of 2003. Private consumption growth has remained strong supported by labor income growth, rising house prices and high levels of net inward migration. Activity in the housing market and residential investment looks to have considerable momentum and is expected to hold up over most of 2003, providing support to durables consumption. Reflecting the relatively strong labour market, and two years of economy-wide profits and strong growth in domestic demand, business investment growth is expected to remain solid, particularly once uncertainty around the outlook dissipates.

As 2003 has progressed export volume growth has eased considerably and is expected to be sluggish over the remainder of the year. The conflict in Iraq and the outbreak of SARS affected services exports in the middle of the year; the lagged effect of the higher exchange rate is dampening demand for price sensitive commodities; and the dry weather in November/December is contributing to lower agricultural production. As these temporary forces unwind in the second half of 2003, the impact of the exchange rate appreciation works through, and a recovery in trading partner growth gathers momentum, export growth is expected to pick up.

Consumer price inflation is expected to remain inside the 1 percent to 3 percent target range over 2003 and 2004, the result of offsetting trends in tradables (staying low) and non-tradables inflation (staying high). The current account deficit is expected to widen over the short-term to beyond 5 percent over the next year from around 3 percent at the start of 2003, on the back of a fall in the goods and services surplus.

STRUCTURAL REFORMS

Far-reaching structural reforms commenced in the mid-1980s in New Zealand aimed at improving the microeconomic efficiency of the economy while simultaneously bringing greater stability to the macroeconomy. Following a prolonged period of poor economic performance in the wake of a long-term decline in New Zealand's terms of trade, coupled with inadequate policy responses, the mid-1990s saw output recover strongly.

From around 1984 onwards, the direction of economic policy in New Zealand turned away from intervention toward the elimination of many forms of government assistance. On the macroeconomic level, policies have aimed at achieving low inflation and a sound fiscal position while microeconomic reforms have been intended to open the economy to competitive pressures.

The reforms included the floating of the exchange rate; abolition of controls on capital movements; the removal of import quotas and reduction of tariffs; elimination of subsidies and other forms of protection; removal of regulatory distortions to relative prices; putting government-owned trading entities on a commercial footing; extensive privatisation of government-owned enterprises; major taxation reform to reduce distortions and create more efficient incentive structures; and greater transparency in the setting and operation of fiscal policy. The key transport sectors (land, sea and air) were also deregulated and measures were taken to promote a more flexible labour market. In addition, a range of corporate law reforms were undertaken to, among other matters, strengthen corporate governance and encourage greater financial disclosure by corporations.

The economy is now better placed than was the case in earlier periods to absorb economic shocks with minimum dislocation to output, employment, and financial stability. Reflecting this, the economy and financial system weathered the Asian crisis, the sharp fall in the NZD over 1998–99, and successive periods of adverse weather conditions with no signs of significant distress. Notwithstanding these gains, there is scope for further improvement.

There is a recognition within New Zealand that, while much has been achieved in liberalising and better equipping the economy, the authorities appreciate the need to keep policy frameworks under review to ensure that the economy remains competitive, dynamic, and well placed to cope with future economic shocks.

Financial Sector Structural Developments

Since 1984, New Zealand's financial sector has undergone a process of comprehensive deregulation. The principal objectives of deregulation have been to improve the efficiency of the financial sector by making it more competitive and to promote market discipline as the primary regulator of financial markets. Policy initiatives have therefore been directed at reducing impediments to competition. Interest-rate and other controls have been removed and regulatory and legislative distinctions between different institutional groups have been reduced.

In 1985 the rules surrounding foreign direct investment were eased, beginning with the removal of ceilings on foreign ownership in selected sectors, including the financial sector. During that year the government announced that it was willing to consider requests from foreign investors for up to 100 percent ownership in virtually all areas except rural land and air services.

Overseas-owned companies operating in New Zealand were given unrestricted access to the New Zealand capital market and New Zealand residents and companies were allowed to freely purchase foreign exchange for investment purposes. Steps were also taken to increase the depth of the local foreign exchange market, including allowing 100 percent foreign ownership of foreign exchange dealers. The decision was made to float the NZD in March 1985. From that time, the NZD has been allowed to float freely. There has been no official intervention in the currency market since 1985.

In 1987 a new bank licensing regime was introduced, enabling foreign banks and domestic non-bank financial institutions to seek registration as banks. New bank supervision arrangements were also introduced. These included the progressive introduction of regular prudential reporting requirements to enable the Reserve Bank of New Zealand (RBNZ) to monitor banks' financial performance and risk positions, minimum capital ratio requirements and limits on large exposures and connected exposures. These requirements were introduced between 1987 and 1991.

Over this period various other initiatives were taken to promote a more competitive and efficient financial sector, including the removal of government guarantees of trustee banks' deposits, the removal of regulatory constraints on trustee and savings banks, and the privatisation of government-owned or controlled banks.

The difficulties in the banking system over the late 1980s and early 1990s prompted the RBNZ to review aspects of its approach to banking supervision. As a result of this review, the RBNZ concluded that the New Zealand financial system would best be served by a combination of policies designed to strengthen market disciplines on the banking system and encourage bank directors and management to take full responsibility for the management of banking risks. These policies comprised:

- A comprehensive public disclosure regime for banks, requiring all banks to issue quarterly disclosure statements covering a wide range of financial and prudential information;
- Measures to encourage strong self-discipline by banks, including strengthening the duties of bank directors; and
- A system of banking supervision that avoided intrusive monitoring of banking risks and left the management of these risks entirely with banks' directors and senior managers.

The RBNZ monitors banks on a quarterly basis, principally on the basis of their public disclosure statements, and maintains a capacity to intervene in the financial system in order to resolve financial distress.

The RBNZ was also given the power to register additional banks. Since 1987, there have been no limits on the number of banks that can be registered and no differences in the treatment of resident and non-resident applicants, other than the requirement for the RBNZ to have regard for the law and regulatory requirements relating to bank entry in the applicant's country of domicile and their application to New Zealand banks. Until April 1987, New Zealand had four registered banks, previously known as trading banks. As at February 2002 there were 17 registered banks. Fifteen of these are subsidiaries or branch operations of foreign banks.

In February 1988, stamp duty was removed from all financial instruments except cheques, credit cards and the conveyance and leasing of commercial property. This initiative removed most of the distortions which the former duty regime imposed on different categories of financial instruments and institutional groups, encouraged development of secondary markets in financial instruments.

Monetary Policy

The Reserve Bank of New Zealand (RBNZ) Act 1989 stipulates that the Bank is to formulate and implement monetary policy directed to the objective of achieving and maintaining stability in the general level of prices. The act requires that there be a Policy Targets Agreement between the Minister of Finance and the Governor of the Reserve Bank.

The agreement requires the bank, in pursuing the price stability target, to seek to avoid unnecessary instability in output, interest rates and the exchange rate. The act contains certain provisions that enable the government to override the price stability objective and the Policy Targets Agreement, provided it is done in accordance with a set of procedures that would make the override publicly transparent.

The RBNZ acts with a considerable degree of autonomy. This operational independence has been formalised in the Reserve Bank Act 1989, which came into effect on 1 February 1990.

In May 2000, the government appointed Professor Lars E.O. Svensson of the Institute for International Economic Studies at Stockholm University to conduct an independent review of the operation of monetary policy in New Zealand. The report concludes that "monetary policy in New Zealand is currently entirely consistent with the best international practice of flexible inflation targeting, with a medium-term inflation target that avoids unnecessary variability in output, in interest rates, and the exchange rate".

Public Sector Financial Management

In 1994, the fiscal deficit in New Zealand was eliminated. Reform of the public sector financial management system was an integral component of this. Three key pieces of legislation now underpin New Zealand's public sector financial management system: the State Sector Act 1988; the Public Finance Act 1989; and the Fiscal Responsibility Act 1994.

State Sector Act 1988
This act defines the responsibilities of chief executives of departments and their accountability to ministers. The main objectives of the act are to improve productivity, to ensure that managers have greater freedom and flexibility to manage effectively and, at the same time, to ensure that managers are fully accountable to the government for their performance. This has led to the formulation of performance contracts between ministers and chief executives. These contracts specify expectations of performance and provide a basis for assessment, which may result in a combination of rewards or sanctions.

Public Finance Act 1989
The Public Finance Act 1989 provides the legislative basis for improving the quality and transparency of financial management and information. This is an essential component of the accountability arrangements established under the State Sector Act.

The driving principle behind the Public Finance Act is a move of focus from what departments consume to what they produce. Hence, budgeting and reporting are on an output basis rather than relying solely on information relating to how outputs are produced. Departments were made responsible for outputs (the goods and services they produce) while ministers were made responsible for selecting the output mix to achieve government outcomes (desired goals).

The act requires the Crown and all its sub-entities to report on a basis consistent with generally accepted accounting practice (GAAP). This has significantly improved the comparability and reliability of the financial information reported.

Consistent with the output focus, the Public Finance Act requires additional disclosures such as statements of intent and statements of service performance. The documents go beyond disclosure of financial information and require disclosure of objectives and service and financial management performance. In addition, the act specifies other Crown disclosures specific to the public sector, such as a statement of unappropriated expenditure and a statement of emergency expenditure or expenses or liabilities.

The Fiscal Responsibility Act 1994
In 1994, parliament enacted the Fiscal Responsibility Act, an Act to promote consistent, good quality fiscal management. Effective fiscal management contributes to the economic health and performance of the economy as a whole.

The act requires government to:

- Follow a legislated set of principles of responsible fiscal management, and publicly assess their fiscal policies against these principles. Governments may temporarily depart from the principles but must do so publicly, explain why they have departed, and reveal how and when they intend to conform to the principles;

- Publish a "Budget Policy Statement" well before the annual budget containing their strategic priorities for the upcoming budget, their short-term fiscal intentions, and long-term fiscal objectives. A "Fiscal Strategy Report" that compares budget intentions and objectives with those published in the most recent Budget Policy Statement is to be published in conjunction with the budget;

- Fully disclose the impact of their fiscal decisions over a three-year forecasting period in regular "Economic and Fiscal Updates"; and

- Require the treasury to prepare forecasts based on its best professional judgment about the impact of policy, rather than relying on the judgment of the government. It also requires the minister to communicate all of the government's policy decisions to the treasury so that the forecasts are comprehensive.

These requirements mean that the government has to be transparent about its intentions, and the short- and long-term impacts of its spending and taxation decisions. Such transparency is likely to lead governments to give more weight to the longer-term consequences of their decisions and, therefore, lead to more sustainable fiscal policy. This helps promote economic growth and gives people a degree of certainty about the ongoing provision of government services and transfers.

State-Owned Enterprises

In May 1986, the government announced a major programme for reform of government enterprises. The aim of the reforms was to improve the efficiency and accountability of the enterprises and reduce the government's exposure to business risk. To this end, the government restructured a large number of its departmental trading activities and established them as businesses operating on a basis as close as possible to private sector companies.

State-owned enterprises (SOEs) are required to operate on the basis of principles and procedures contained in the State-Owned Enterprises Act 1986. Under the act, the boards of SOEs have complete autonomy on operational matters. Competitive advantages and disadvantages, including barriers to entry, have been removed so that commercial criteria provide an objective assessment of performance and to increase efficiency. Under the act, SOEs have no responsibility for continuing non-commercial operations and the government is required to negotiate an explicit contract if it wishes an SOE to carry out such activities.

Boards of directors drawn from the business/private sector have been formed to manage SOEs. The SOEs borrow in their own names and on their own credit, in most cases without a guarantee or other form of credit support from the government.

Securities Law

As well as the Companies Act 1993, the key statute regulating the securities markets is the Securities Act 1978. Recent legislative amendments have widened the scope of the Securities Act.

On 1 July 2001, a takeovers code came into force. Among other things, this requires any person who makes an offer for 20 percent or more of a company to make that same offer to all shareholders.

The Securities Amendment Act 1988 provides for civil remedies against insider traders and requires the disclosure of "substantial security" holdings (i.e., an interest in 5 percent or more of the voting securities of an issuer).

The Securities Markets and Institutions Bill (SMI Bill): The Securities Amendment Act 2002; the Takeovers Amendment Act 2002; and the Securities Markets Amendment Act 2002 were passed on 1 December 2002 (these acts formed the Securities Markets and Institutions Bill). The purpose of the SMI Bill was to promote confidence in the New Zealand market by increasing the effectiveness and efficiency of the law and regulatory institutions governing securities markets and aligning the law with international best practice. The new legislation:

- Implements a continuous disclosure regime providing statutory backing for exchange listing rules;
- Sets up the Securities Commission as a civil public enforcement agency for insider trading; and
- Gives the Commission and the Takeovers Panel additional powers so as to increase their effectiveness and flexibility in exercising their monitoring and enforcement powers.

Competition Law

The purpose of the Commerce Act 1986, as amended by the Commerce Amendment Act 2001, is to promote competition for the long-term benefits of consumers within New Zealand. Very broadly, the act prohibits:

- Agreements that have the purpose or effect of substantially lessening competition;
- The use of a dominant position in a market to exclude competitors; and
- Business acquisitions that are likely to create or strengthen a dominant position in a market.

Annex I

NEW ZEALAND: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in NZ$ billion)	100,087	101,073	105,834	112,522	120,238	126,093
Real GDP (production based)	2.0	-0.2	4.0	4.0	2.7	4.4
Consumption	3.6	1.2	4.8	1.1	2.6	4.1
Private Consumption	2.4	2.1	3.9	2.0	2.3	3.9
Government Consumption	7.6	-1.9	7.7	-2.0	3.4	4.7
Investment	0.6	-5.2	4.4	7.4	-1.8	8.0
Private Investment	-0.3	-5.5	4.5	9.4	-1.5	8.8
Government Investment	10.4	1.7	6.8	-6.7	-1.2	-3.5
Exports of Goods and Services	3.9	1.4	8.3	6.7	2.1	7.6
Imports of Goods and Services	2.2	1.4	12.0	0.1	1.7	8.7
Fiscal and External Balance (percent of nominal GDP)						
Budget Balance (Operating balance - June years)	1.9	2.5	1.7	1.3	1.2	1.9
Merchandise Trade Balance	1.4	1.7	-0.7	1.3	2.9	1.0
Current Account Balance	-6.5	-4.0	-6.3	-5.4	-2.8	-3.1
Capital and Financial Non-reserve Assets Balance	NA	NA	NA	NA	NA	NA
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	0.4	1.5	-0.1	2.4	4.8	0.3
CPI	1.2	1.3	-0.1	2.6	2.6	2.7
M2 (qtr average)	2.0	12.4	10.2	-1.5	14.5	8.1
Short-term Interest Rate – 90 day bank bills (Dec qtr average)	7.9	4.6	5.4	6.7	5.0	5.9
Trade Weighted exchange rate (Dec qtr average)	63.9	56.0	54.4	47.8	49.5	56.5
Unemployment Rate (percent)	6.6	7.5	6.8	6.0	5.3	5.2
Population (millions)	3.80	3.83	3.85	3.87	3.91	3.98

Annex II

NEW ZEALAND: FORECAST SUMMARY (percent change from previous year)

	2003						2004					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	2.7	2.6	N.A.	3.1	N.A.	N.A.	2.7	2.9	N.A.	2.9	N.A.	N.A.
Exports	5.0	4.5	N.A.	4.6	N.A.	N.A.	4.9	5.4	N.A.	6.4	N.A.	N.A.
Imports	9.9	6.7	N.A.	6.3	N.A.	N.A.	5.0	5.0	N.A.	5.6	N.A.	N.A.
CPI	2.0	2.0	N.A.	2.0	N.A.	N.A.	1.7	2.0	N.A.	2.0	N.A.	N.A.

Annex III

NEW ZEALAND: MEDIUM-TERM TREND FORECAST (percent)

	2003-07
Real GDP	~3%
GDP Deflator	2%

PAPUA NEW GUINEA

A. DEVELOPMENTS IN 2002 AND OUTLOOK FOR 2003

GROSS DOMESTIC PRODUCT GROWTH

Preliminary estimates of economic activity in Papua New Guinea (PNG) indicate that total real gross domestic product (GDP) declined by 0.5 percent in 2002, following a revised decline of 3.4 percent in 2001. The decline in the growth rate was due to the continued depressed levels of activity in the mineral; building and construction; retail and wholesale; and electricity, gas and water sectors. In the mineral sector, the decline was due to lower production of mineral products, while the improvement in the agriculture/forestry/fisheries sector reflected higher production of coffee, copra oil, and logs combined with higher kina prices for all agricultural export commodities, logs and marine exports.

2003 Outlook

For 2003, the growth in real GDP was recently revised upwards from 1.8 percent projected in the government's annual budget to 2.7 percent, with growth in both the mineral and non-mineral sectors. The improved performance of the economy is primarily driven by the projected growth in the mineral sector, and the agricultural/forestry/fisheries sector, reflecting increased production and continued higher kina prices of most of PNG's main agricultural export commodities. This recovery is forecast to spillover into other sectors of the economy. Growth in the construction sector would be generated by the few large projects (such as the Napa Napa Oil refinery, the Wewak Tuna Processing plant), and major road maintenance and other infrastructure projects funded by international financial institutions and aid agencies.

EMPLOYMENT

According to the employment index constructed by the Bank of PNG (BPNG), total private non-mining and petroleum formal sector employment has declined by an annual rate of 0.9 percent since 1996 due to the decline in economic activity, while mining sector employment grew by an annual rate of 4.1 percent. In the first six months of 2002 total non-mining employment declined by 1.1 percent, while mining sector employment rose by 3.2 percent.

In 2003, some growth in employment is expected as a result of the improvement in the level of economic activity.

INFLATION

The annual headline inflation rate for 2002 was 14.8 percent, compared to 10.3 percent in 2001. The upward trend in the rate of inflation as measured by the consumer price index (CPI) that began in 2001 continued into 2002, as significant downward pressure on the kina contributed towards the upward movements in consumer prices. Towards the end of the year, seasonal demand for foreign currency contributed to import price pressure, as retail and wholesale companies accumulated inventories in anticipation of increased domestic demand during the festive season.

The annual trimmed mean underlying inflation rate was 15.6 in 2002, compared to 8.0 percent in 2001. The underlying inflation rate was higher than the annual headline inflation rate in 2002, because of the exclusion of a large downward movement in the seasonal prices for fruits and vegetables combined with selected price-controlled items, such as fuel and power and dwelling rentals.

Projection for 2003

The upward trend in the annual headline inflation rate reached 20.7 percent in March 2003, its highest level since 1998. This outcome was a result of a sharp depreciation of the kina against the currencies of PNG's major trading partners during the second half of 2002, which had a flow-on effect on domestic prices, including some price-controlled items. As a result of the higher than expected inflation outcome for March, which is expected to remain high in June 2003, the central bank revised its inflation forecast for 2003 upwards, from 9.0 percent forecast in January 2003 to 13.8 percent.

Inflation is still expected to trend downwards in the second half of the year, because of the following factors:

- Stability in the exchange rate to be sustained by continued favorable exports receipts from the non-mineral sector, and
- The positive impact of the tight monetary policy stance taken by the central bank on monetary conditions in the first seven months of 2003.

BALANCE OF PAYMENTS

The overall deficit in the balance of payments was K239 million in 2002, compared to a surplus of K708 million in 2001. The deficit was due to deterioration in the current account, which more than offset a lower deficit in the capital account. The outcome in the current account was the result of a lower surplus in the trade account combined with higher net service payments, which more than offset higher net transfer receipts.

There was a surplus in the trade account of K2,297 million in 2002, compared to a surplus of K2,940 million in 2001. The lower surplus was due to a decline in the value of merchandise exports combined with an increase in the value of merchandise imports. There was an improvement in the capital account due to a net inflow of private capital, reflecting the inflow of proceeds from the merger of Orogen Minerals Ltd and Oil Search Ltd. This resulted in the capital account recording a deficit of K112 million in 2002, compared to a deficit of K264 million in 2001.

At the end of 2002, the level of gross foreign exchange reserves was K1,378 (US$340) million, a decline of K214 million from the end 2001 level. This level of reserves was sufficient for 4.4 months of total import cover and 6.2 months of non-mineral import cover.

Outlook for 2003

Export volumes of most of PNG's major agricultural and mineral export commodities are projected to increase in 2003, with the exception of palm oil and rubber. The projected increases in production are mainly in responses to higher international prices. Production of gold and copper is expected to increase due to mining of high ore grades, while the commencement of production from the Moran Petroleum Development License (PDL5) and higher production from the Gobe oil field will contribute to higher exports of crude oil in 2003.

The other main factors underlying the balance of payments projections for 2003 are that:

- The exchange rate will remain stable;
- The International Monetary Fund (IMF) repurchases for 2003 were deferred to 2004;
- No new external loans will be obtained by the government to fund the budgetary financing gap;
- The Asian Development Bank (ADB) Public Sector Reform Program (PSRP) loan will be drawn down in late 2003;
- There will be a lower than budgeted draw down of concessional loans;

- Exclusion of the gas pipeline project and any new mineral projects; and
- There is no foreign currency component of asset sales.

Accordingly, the balance of payments for 2003 is projected to show a significant improvement, with an overall deficit of K18 million. This improvement reflects a higher surplus in the current account, attributed to increases in production and prices for the major agricultural and mineral exports. As a result the level of gross foreign exchange reserves for 2003 is projected to be US$337 (K1,259) million, sufficient for 4 months of total, and 6 months of non-mineral, import cover.

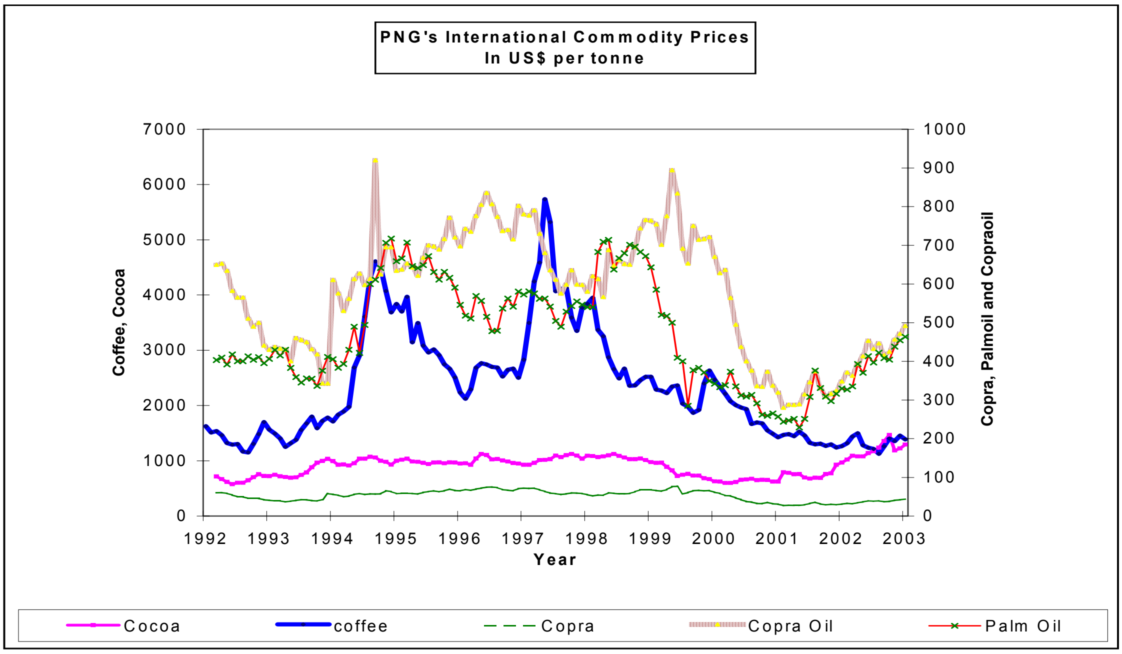
Direction of Trade

The volume of trade between Papua New Guinea (PNG) and the APEC member economies increased over the last two years. Terms of trade between APEC economies and PNG have been in PNG's favor since 1995, with the exception of 1997 and 1998. APEC has continued to become an important trading block for PNG, compared to the non-APEC trading partners.

Exports to the APEC economies as a share of total exports increased from 67.1 percent in 1995 to 81.4 percent in 2002, while imports from the APEC economies as a percent of total imports declined from 92.8 percent in 1995 to 73.9 percent during the same period.

International Commodity Prices

Information available indicates that prices of most of Papua New Guinea's agricultural export commodities continue to improve, due to increased international prices. The price for coffee has turned around since January 2003, driven mainly by speculations of lower production by major producers in South America due to the current wet weather and expectation of a frost in Brazil.



EXCHANGE RATE

In 2002, the daily average kina exchange rate weakened against all major currencies. It depreciated against the US dollar by 13.5 percent, the pound sterling by 17.0 percent, the euro by 17.6 percent, the yen by 10.6 percent and the Australian dollar by 17.5 percent.

In the first half of 2002, the kina depreciated by 4.4 percent and 13.5 percent against the US and Australian dollars, respectively. Although the trend continued in the second half of the year, the rate of depreciation slowed down to 0.9 and 1.1 percent against the respective currencies. This was partly due to the tight monetary policy stance taken by the central bank.

Other factors that had adverse impact on the foreign exchange market and the underlying pressure on the exchange rate during the second half of 2002 were:

- The effect of high government expenditure in the first half of 2002, that led to an increase in liquidity;
- The persistent current account deficit in the non-mineral balance of payments during the year, due to low export receipts from the agriculture sector and high net overseas remittances by individuals and companies;
- Increased forward transactions by importers, while exporters delayed their inflow of funds anticipating a further fall in the kina;
- Uncertainties created by the delay in formation of the government, disruption to the Porgera and Kutubu projects by landowners and the controversy over the value added tax (VAT) court ruling;
- Increase in reserve money as a result of net maturity of Treasury bills by the central bank and non-bank public;
- Downgrading of PNG's credit rating by an international ratings firm; and
- The delay in draw down of US$35.0 million loan from the ADB for the Public Sector Reform Programme (PSRP).

Since December 2002, the exchange rate has generally appreciated to above US$0.28/kina, due to significant inflows of export receipts by the agriculture and mineral sectors, and supported by low import demand.

EXTERNAL AND DOMESTIC PUBLIC DEBT

The stock of total external and domestic public debt totaling K8,182.9 million at end 2002, has declined to K7,774 million in March 2003 partly due to the appreciation of the kina, and large loan repayments for external loans. Despite this, the level of public debt, which represents around 65 percent of GDP, is already excessively high and unsustainable.

The level of government and central bank external debt as a percentage of GDP has increased sharply in recent years, partly because of loan disbursements from the IMF and multilateral and bilateral creditors under a structural adjustment program (SAP) completed in 2001, but mainly due to negative GDP growth and the real depreciation of the kina. At the end of 2002, the level of external public debt, excluding the balance of payments loan from the IMF, increased by 12.3 percent to K5,594.6 million, from K4,982.2 million in 2001. Approximately 60 percent of government external debt, which is concessional and has a long maturity profile, is owed to multilateral creditors. The remainder consists of bilateral debt (mainly to Australia and Japan) and commercial debt relating to the Yumi-Yet Bridges Program.

Government domestic debt mainly comprises of Treasury bills and inscribed stocks. The stock of total domestic debt at end-2002 was K2,588.3 million, which represents a 22.4 percent increase from the 2001 level of K2,115.1 million. The bulk of this debt (84 percent) is held in Treasury bills, while inscribed stocks accounted for 11 percent and the balance is other domestic debt. As at end-July 2003 the government has issued a net K435 million in Treasury bills, which increased the total issue to K2,605 million, while total inscribed stocks declined. This has increased the level of total domestic debt to 23 percent of GDP.

FISCAL POLICY

Following the election of the new government in early August 2002, a supplementary budget was introduced. The supplementary budget contained major adjustments aimed at restoring fiscal and macroeconomic stability, following unprecedented levels of expenditure in the first half of the year.

Preliminary estimates of the fiscal operations of the Government of Papua New Guinea for 2002 showed an overall deficit of K454 million, compared to a deficit of K359 million in 2001, which represent 4.1 percent of the projected nominal GDP. The higher deficit was due to the increased expenditure level, partly related to elections and other unbudgeted expenditures.

Total expenditure during 2002 was K3,669 million, 3.5 percent higher than in 2001, and 102.4 percent of the expenditure in the supplementary budget. The increase was due to higher recurrent expenditure, which more than offset a decline in development expenditure. The higher recurrent expenditure reflects the disbursement of school fees subsidies, grants to statutory authorities, increases in salaries and wages, election-related expenses, interest payments and unbudgeted expenses. The lower level of spending on developmental projects was partly related to a decrease in counter part funding by the government and slow implementation of projects by implementing agencies.

Total revenue, including grants, in 2002 was K3,214 million, 0.9 percent higher than the receipts collected in 2001 and representing 99.8 percent of the revenue in the supplementary budget. The increase was due to higher tax revenue from indirect tax receipts, which more than offset lower non-tax revenue and foreign grants.

The deficit, combined with the net loan repayments to external sources resulted in a domestic financing requirement of K621 million. The large positive financing from the banking and non-banking system reflected increased holdings of new Treasury bills issued by the government.

2003 National Budget

The 2003 national budget, which was passed by parliament in December 2002, aims to consolidate the fiscal adjustments introduced in the supplementary budget and restore it to a sustainable fiscal position. The adjustments would assist in achieving macroeconomic stability and provide the conditions necessary for sustainable economic growth. Growth may be achieved by redirecting expenditure towards productive areas that generate export revenue, create employment and maximise social welfare in the medium term. The budget deficit for 2003 is projected at 2.0 percent of GDP with reductions to 1.0 percent of GDP in the medium term.

The fiscal strategy for 2003 recognizes the difficult economic environment that PNG confronts, in particular the decline in revenue from the mineral sector and therefore the need to adjust expenditure, and introduce new revenue measures. The fiscal strategy encompasses the following adjustments to reduce expenditure:

- The freeze on wages and new recruitment;
- The reduction in education subsidies; and
- Cuts to the recurrent and development budgets including the Electoral Development Fund.

The original 2003 budget proposes to fund this deficit of K244 million and net external loan repayments of K135 million from domestic sources of K379 million, including proceeds from asset sales of K200 million. However, the preliminary outcome of the budget to June 2003 shows a substantial high level of domestic financing of the budget deficit is mainly from the issuance of new Treasury bills, combined with high external loan repayments. At the same time, the PSRP loan from the ADB was further delayed and there has been no success as yet in the sale of state assets. Accordingly, the Bank of PNG has forecast a much higher level of domestic financing for 2003 of around K620 million. This may result in a continuation of high level of interest rates on Treasury bills and domestic interest costs, whilst it continues to crowd out the private sector borrowing needs, which jeopardizes the government's export-led growth strategy and worsens the prospects for economic recovery.

MONETARY POLICY

The central bank is entrusted with the responsibility of formulating and implementing monetary policy in PNG, as stipulated in the Central Banking Act (CBA) 2000. As a requirement of this act the bank released two bi-annual Monetary Policy Statements in 2002, one in January and the other in July.

Monetary and Financial Market Development

The Bank of PNG maintained a neutral monetary policy stance over the first half of 2002, following improvements in the exchange rate and a lower than anticipated inflation outcome for the same period. Accordingly the bank maintained its signaling policy rate, the kina facility rate (KFR), at 12.0 percent. In the second half of the year, persistent growth in underlying and headline inflation, arising from high government expenditure and continued pressure on the exchange rate, combined with increased prospects for a more inflationary outcome in the December quarter of 2002 and first half of 2003, were the immediate factors that influenced the bank's decision to significantly tighten monetary policy. The KFR was raised by 2.0 percentage points on aggregate to 14.0 percent by the end of 2002. There were some corresponding increases in market interest rates, especially the Treasury bill rates.

Other factors that influenced the central bank's decision to tighten monetary policy in the second half of 2002 were:

- Pressure on the exchange rate emanating from a combination of sentiments related to the elections, a persistent deficit in the current account of the non-mineral sector, and increased government expenditure;
- The consecutive increase in underlying inflation and the large increase in the September quarter headline inflation rate, with further expectations of a higher inflation outcome in Q4 of 2002;
- The increase in liquidity following excessive government expenditure;
- Uncertainty arising from the election-related problems and the delay in the formation of the government;
- The controversy over the VAT, which caused major uncertainty about the government's ability to finance the budget;
- The declining level of foreign exchange reserves as the magnitude of intervention needed by the central bank to smooth out fluctuations in the exchange rate became unsustainable; and
- Further delay in the drawdown of the PSRP loan from the ADB.

Over the year to December 2002, average broad money supply (M3*) increased by 4.9 percent, compared to 10.8 percent in 2001, mainly due to increases in the net foreign assets of the banking system and high domestic credit to the government. This more than offset a decline of 8.0 in average net credit to the business/private sector, official entities and non-monetary financial institutions. The decline was attributed to lower demand for credit consistent with the depressed level of economic activity, and continued crowding out by the government through the issuance of new Treasury bills.

Outlook for 2003

The tight monetary policy stance was maintained in the first half of 2003, due largely to the following factors:

- The higher than expected inflation outcome for Q1 in 2003;
- The significant increase in financing of the 2003 budget from domestic borrowing;
- The net maturity of Treasury bills by the Bank of PNG which injects liquidity into the banking system, due to continuous crowding out by the government at auctions;
- The ability of the government to prioritize expenditures, implement and achieve the budget objectives within the parameters of the 2003 budget;
- The timing of the draw down of the delayed PSRP loan from the ADB; and
- Uncertainties relating to the continuation of the structural reform program by the government, particularly the privatization program, which is it is hoped will raise K200 million to finance the budget.

Although the Bank of PNG took a cautious approach towards raising interest rates due to depressed aggregate demand, the increased demand for domestic financing of the 2003 Budget has led to a faster increase in the Treasury bill rates. Under a scenario of higher than budgeted domestic financing in 2003 and net credit to the government of 5.7 percent, broad money supply is expected to grow by 3.1 percent, while reserve money is projected to decline by 2.4 percent in 2003. This growth in broad money is in line with developments in the real sector of the economy, the foreign exchange market, and can sustain a 1.1 percent growth in private sector credit. The central bank will maintain a cautious approach in allowing growth in reserve money, due to the high level of underlying liquidity and the excess capacity commercial banks currently have to increase lending and demand for foreign exchange, which may exert pressure on the exchange rate.

If the assumptions in the 2003 budget hold, and the economy achieves a real growth rate of 2.7 percent, the government may be able to fund its expenses through increased revenues. However, if the economy remains depressed and revenue declines, it would be prudent for the government to cut expenditure and not to resort to domestic financing, as the level of domestic debt has become unsustainable for the budget over the medium term. In the second half of 2003, the expected inflow of revenue from assets sales, combined with prudent fiscal management and their impact on macroeconomic and price stability should restore public confidence and form the basis for adjustment to the monetary stance. However, the central bank will continue to monitor developments in the key macroeconomic indicators and if the assumptions that underpin the downward trend in inflation hold and price stability is maintained, it will be able to gradually and cautiously ease monetary policy in the remaining part of 2003.

DEVELOPMENTS IN THE FINANCIAL SYSTEM

As at December 2002, the financial system in PNG consisted of 4 commercial banks, 6 finance companies, 17 savings & loans societies, 10 major superannuation funds and 6 life insurance companies. Over the last two years, 2 commercial banks were sold and amalgamated into the operations of the other 2 existing banks. The Bank of Hawaii was sold to the ANZ bank, while the government-owned commercial bank (PNG Banking Corporation or PNGBC) was sold to the privately-owned Bank of South Pacific (BSP) in 2002 under the government's privatization program.

In line with its new powers under the Banks Financial Institutions Act (BFIA) 2000, the central bank initiated enforcement actions against a number of institutions, including the former government-owned commercial bank and finance companies, in an attempt to rectify problems that threatened depositors funds or the overall stability of the financial system. The central bank also instituted caretaker management for a few large savings and loan societies under the Savings and Loan Societies Act, and liquidated 76 dormant societies as part of its revitalization program. Legal action was also taken against several 'fast-money' schemes that continued to solicit deposits from the public.

B. MEDIUM-TERM OUTLOOK

In February 2003 the IMF Article IV Mission concluded that PNG's macroeconomic development and prospects in the medium term are encouraging. The mission also highlighted the medium-term risks that the economy may face if no further progress is made on the structural reforms to support the government's Medium-Term Development Strategy (MTDS). Furthermore, there are already encouraging signals from the mineral sector for increased exploration activity and general support for the government's policy on export-oriented recovery program the agricultural sector. This would lead to an increase in much-needed foreign exchange, reduce imports through import replacement activities, and ensure sustainable growth prospects for PNG in future. It is recognized that growth in the business/private sector cannot be achieved without a reduction in inflation and domestic interest rates. A business climate that is conducive for private sector growth, among other things, requires the government to prioritize expenditure to areas that generate export growth and employment creation. A disciplined and sound fiscal regime would significantly contribute to the achievement of the price stability, and become a catalyst for the government's development objective.

Over the medium term, the economic challenges are expected to be somewhat different, though in many respects even more pressing and difficult. The important challenges are:

- The mining and petroleum sector has entered a period of long-term decline. This is particularly the case with petroleum. Mining and Petroleum real GDP is projected to contract sharply in 2005, 2006 and 2007; and
- The non-mining segments of the economy have performed poorly in recent years. While the immediate outlook is for a return to growth, this does not really provide comfort, as real per capita living standards will continue to fall without higher growth.

The challenges for economic management are very significant. The 2003 budget strategy aims to address short-term challenges, while at the same time providing a base for improving medium-term growth performance. The major challenge for economic management is to engineer rates of non-mineral growth much higher than the 1.6 percent projected for 2003 and the average of 2.5 percent per year estimated for the years 2004 to 2007. In order to be successful, a responsible mix of macroeconomic and structural policies over the next five years will be required.

C. STRUCTURAL REFORM PROGRAM

The government's Structural Reform Program (SRP) contained in the 2003 budget emphasizes macroeconomic stability; international competitiveness; price and trade liberalization; taxation reforms; investment policy reforms; public expenditure management; and decentralization of responsibilities and finances from the national to the provincial and district levels. It aims to address the difficult task of improving the overall governance framework. PNG has faced substantial challenges in seeking to stabilize the economy in the face of domestic and external shocks. The platform for a resilient economy has been continually undermined by the absence of sound institutions and administrative systems. The Public Sector Reform Program (PRSP), partly supported by the ADB, is an important element of the SRP.

Key components of the SRP are:

- The promotion of good governance;
- Improving economic management;
- Improving public sector performance; and
- Removing barriers to investment and export growth.

The following sections below provide more detailed analysis of the major structural reforms undertaken by the government over the last three years. *Detailed status and outcome information covering the above areas of the SRP is attached to this report as Annex 4.*

(i) Financial Sector Reform: Superannuation and Life Insurance

Under the government's financial sector reform program, the *Superannuation (General Provisions) Act*, which was passed in November 2000 and became effective on 9 May 2002, provides safeguards for the investment of contributors' funds by creating a licensing, prudential and supervisory regime for the PNG superannuation industry. The new act extends the requirement for mandatory contributions to all employees, with the exception of agricultural workers and an exemption of non-citizens for a five-year period. It limits a member's ability to access all their savings for non-retirement purposes such as unemployment and restricts access to savings for housing loans.

The new act specifies the duties and liabilities of trustees and directors of license holders, requires trustees of authorized superannuation funds to appoint licensed investment managers and fund administrators, and strengthens audit requirements. It also makes the Bank of PNG responsible for the licensing and prudential supervision of the superannuation industry.

The *Life Insurance Act* was also passed by parliament in November 2000 and took effect on 9 May 2002. The life insurance industry is relatively young and small in PNG. It is, however, important that the industry is regulated under a prudential regime. The Bank of PNG will be responsible for the licensing and prudential supervision of the life insurance industry.

New 'fit and proper person' requirements have been introduced under the Superannuation and Life Insurance Acts. The Bank of PNG has finalized the fit and proper requirements and implemented them in all financial institutions (banks and finance companies) regulated by the bank. It is envisaged that the same legislative requirements will apply, and the same fit and proper persons assessment processes will be adopted, for all financial institutions.

(ii) Insurance Complaints and Disputes Tribunal

The Office of the Commissioner of Insurance and the Papua New Guinea Insurance Council are in the process of establishing a Papua New Guinea Insurance Complaints and Disputes Tribunal in accordance with the provisions of the *Insurance Act 1995*. The functions of the proposed tribunal are to consider disputes and complaints referred to it by policy-holders of general insurance policies and affected third parties. To facilitate the establishment of the tribunal the Commissioner of Insurance has established a task force consisting of representatives from the insurance industry, the state solicitor's office, the treasury department, and the Insurance Commissioner's Office.

(iii) Competition and Regulatory Review

It is widely recognized that sound competition policy is a fundamental requirement for strengthening market forces and thereby encouraging economic development. The government intends to ensure that market forces bring about improved economic performance while guaranteeing an equitable sharing of the benefits of increased competition. Where it is not possible or practical to introduce or strengthen competition, it is important that a strong regulatory framework be put in place to ensure that the incentive for firms to abuse their market power is constrained.

The weak economic and regulation of state-owned enterprises over recent years has led to higher prices, a lower quality of goods and services, and a lack of innovative solutions to the difficulties faced in supplying services throughout Papua New Guinea. As part of the regulatory reform program, the new Independent Consumer and Competition Commission (ICCC) has replaced the Consumer Affairs Council and the Price Control Unit of the Department of Treasury. The ICCC will protect the interests of the people of Papua New Guinea with regard to the price, quality and reliability of basic and essential services and goods. It is introducing a new regime of regulatory contracts with state-owned enterprises, which will determine how prices are to be set, and specifies minimum service standards that must be met. In addition to its role as the economic regulator of monopoly industries, the ICCC prohibits anti-competitive behavior such as price-fixing and ensures competiton within industries by preventing any industry structure that would substantially lessen competition in a market.

(iv) Privatization of Public Enterprises

There is strong evidence that effective privatization attracts new investment and increases efficiency of all businesses concerned. The government will continue to pursue the sale of selected stat- owned assets since it believes that this will lead to higher tax revenues, greater investment in infrastructure, and an improved quality of public service provision. In order to reduce the significant debt burden, the government where possible will use proceeds from privatization to retire debt. However, for privatization to be successful, it must be accompanied by appropriate structural reforms that encourage competition. The regulatory framework administered by the ICCC will address these concerns. Elcom, Telikom and the Harbours Board were all offered for sale or lease during 2001 and 2002. However, as a result of the subdued investment climate, only Telikom and the Harbours Board have proceeded close to the point of privatization. The government is carrying out a review of the proposed Telikom and Harbours Board privatizations and it is expected that, subject to appropriate arrangements being negotiated, their privatization will be finalized during 2003.

The Harbours Board and Elcom were both corporatized during 2002, becoming PNG Harbours Ltd and PNG Power Ltd, respectively. The corporatization of Elcom will allow a strengthening of corporate performance prior to the future consideration of privatization. An interim liquidator was appointed to Post PNG at the end of 2001. After the severe financial difficulties faced by the business were addressed, control of Post PNG was returned to the board of directors. While the business is now in much improved financial health, the current investment environment does not allow consideration of a sale of Post PNG during 2003.

Given the continued downturn in the aviation sector, Air Niugini will remain under the government's ownership in 2003. The current focus is on improving management of the business, thereby allowing improved performance and efficiency. For those enterprises that have not yet been privatized, it is important that any internal problems they may have are resolved prior to being offered for sale at a later date. For this purpose, the Independent Public Business Corporation (IPBC), formerly the Privatization Commission has been established under its own Act. All state-owned enterprises have been vested into the IPBC, which will ensure that there are gains from improved management, at arm's length from political influence. Each entity that has been vested into the IPBC will provide regular reports on their status, thereby allowing the IPBC to pursue future privatizations once improvements in the management of the entities are apparent.

(v) Improving Forestry Management

The government recognizes that sustainable management and conservation of forest resources and bio-diversity is of paramount importance given that forestry resources play a key role in the livelihood of the rural population. This approach should be consistent with the government's objective of encouraging export led growth. The ongoing Forestry and Conservation Project involves a broad range of processes aimed at increasing landowners' participation in forest management, and institutional strengthening of the National Forestry Authority and the Department of Environment and Conservation.

Two independent reviews of the forestry projects were commissioned by the government during 2001 and completed. The main findings of this review were:

- That sustainable yields were being met;
- The National Forest Service were professional in the discharge of their responsibilities,
- The resource inventory is out of date and undermines sound resource planning;

- The National Forest Plan has expired and was not properly developed based upon provincial plans; and
- The formerly effective forest and conservation coordination and monitoring function under the Office of Environment and Conservation had ceased, severely undermining the process of sound resource-use planning and supervision.

Annex I

PAPUA NEW GUINEA: OVERALL ECONOMIC PERFORMANCE

	1998	1999	2000	2001	2002
GDP and Major Components (percent change, year over year, except as noted)					
Nominal GDP (level in US$ billion)	3.8	3.5	3.5	3.0	2.8
Real GDP					
Consumption					
Private Consumption	-5.2	21.2	N.A	N.A	N.A
Government Consumption	-1.8	0.9	N.A	N.A	N.A
Investment (total)	-5.2	-16.2	N.A	N.A	N.A
Private Investment	N.A	N.A	N.A	N.A	N.A
Government Investment	N.A	N.A	N.A	N.A	N.A
Exports of Goods and Services	5.6	-4.4	N.A	N.A	N.A
Imports of Goods and Services	0.3	1.5	N.A	N.A	N.A
Fiscal and External Balance (percent of GDP)					
Budget Balance	1.8	2.6	2.0	3.6	4.2
Merchandise Trade Balance	19.0	25.2	31.4	29.2	21.4
Current Account Balance	1.6	4.3	10.1	9.4	1.1
Capital and Financial Non-reserve Assets Balance	2.9	10.1	6.4	2.3	1.1
Economic Indicators (percent change, year over year, except as noted)					
GDP Deflator	-	-	-	-	-
CPI (Annual Headline)	21.8	13.2	8.9	10.5	14.8
Broad Money, M3	13.6	33.3	-12.5	4.2	9.7
Short-term Interest Rate (percent) (28 Day T/bill rate)	19.00	22.68	15.67	10.15	15.48
Real Effective Exchange Rate (level, 1997=100)	N.A	N.A	N.A	N.A	N.A
Unemployment Rate (percent)	N.A	N.A	N.A	N.A	N.A
Population (millions) from 2000 National Population Census			5.19		

Note: N.A. refers to data not available. Published real GDP data is only up to 1999.
Additional Information can be obtained from the websites of Bank of PNG (www.bankpng.gov.pg) and Department of Treasury (www.treasury.gov.pg).

Annex II

PAPUA NEW GUINEA: FORECAST SUMMARY (percent change from previous year)

	2002						2003					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	-0.5	N.A.	N.A.	N.A.	N.A.	N.A.	2.7	2.5	N.A.	N.A.	N.A.	N.A.
Exports	-0.3	-13.5	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Imports	1.2	-3.5	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
CPI (annual headline)	14.8	N.A.	N.A.	N.A.	N.A.	N.A.	13.8	17.2	N.A.	N.A.	N.A.	N.A.

Annex III

PAPUA NEW GUINEA: MEDIUM-TERM TREND FORECAST (percent)

	2004-2007
Real GDP of non-mineral sector	2.5
GDP Deflator	-

Annex IV:

STRUCTURAL REFORM PROGRAM

	Prior Actions	Proposed Measures
1. PROMOTING GOOD GOVERNANCE		
Strengthening policy, planning and coordination	A Central Agencies Coordinating Committee (CACC) was established to formulate and implement policies and coordinate the implementation of the reform program. Proper cabinet procedures were re-established. [The National Planning Committee (NPC) was re-established to ensure fiscal discipline and implementation of cabinet decisions.]	
Strengthening probity and oversight agencies	CACC has approved action plans to strengthen the Auditor General's Office and the Ombudsman Commission. An independent audit of the financial control systems in the Departments of Health and Education has been completed.	Action plan for strengthening of Department of Justice and the Attorney General Action plan for strengthening the Inspections Branch of the Department of Treasury
2. STRENGTHENING ECONOMIC MANAGEMENT		
Strengthening fiscal discipline to enhance macroeconomic stability	A mid-year review of the 2002 Budget was carried out. A supplementary budget was passed in September 2002 limiting the fiscal deficit to 3.4% of GDP and targeting a 1.0% deficit in 2003. Control was established over budget expenditures through public sector hiring freeze and improved monitoring system. The treasury has completed a review of Fiscal Transparency. Monthly revenue, payroll and debt reports are being produced. A quarterly Treasury Economic Monitor (TEM) is being produced. A draft Medium-Term Fiscal Strategy has been produced.	Pass 2003 budget targeting a 1% deficit Full cash warrants are to be released for the development budget as projected and for government priorities in 2003. Continued production of monthly revenue, payroll and debt reports, and quarterly Treasury Economic Monitor (TEM). Approval of a medium-term development strategy(MTDS) (2003–2007), incorporating a medium-term fiscal strategy to set a hard budget constraint and setting out government's strategic priorities Tabling in parliament of mid-year review of 2003 budget and proposed fiscal strategy (including fiscal framework) for 2004 by end of September 2003. Target a balanced budget in 2004 and 2.0% surplus by 2007
Translating fiscal discipline into improved allocation of resources		Carry out a public expenditure review (PER) with a view to identifying institutional reforms (including consideration of legislative amendments) to strengthen fiscal discipline and aid management and to guide the re-

	Prior Actions	Proposed Measures
		allocation of resources over the medium term Carry out a review of the development budget to with a view to reallocating resource to priorities identified in the MTDS and improving overall efficiency of project implementation Implementation of recommendations of the PER and review of the development budget in the 2004 budget
Improving debt management	A review of debt management was completed. The treasury has established a Public Debt Committee (PDC) to enhance debt and cash flow management. A debt management office has been established within the treasury. Net proceeds from privatisation have been used to retire domestic debt.	Development of a debt management framework (including: simplification of external debt portfolio, framework for undertaking new borrowings, assessment of portfolio risk profile, establishment of benchmarks for treasury bills and inscribed stock and the currency composition of external loans, monitoring of key debt ratios) Continued use of net privatization proceeds to retire domestic debt Continue move towards fully funding state superannuation commitments Establish a central register of the overall exposure of government; including direct government borrowings, guarantees and court actions Improve reporting of contingent liabilities (including guarantees) and include assessment of position in respect of contingent liabilities in the 2004 budget
Improving expenditure control		Ensure that departmental heads comply with their responsibilities under the Public Finances (Management) Act Ensure that departmental heads undertake reviews each month to ensure that there is no over spending or over commitment and collection of public moneys is according to approved plans and estimates Ensure that department heads submit reports on financial management as soon a practicable after the end of each quarter Carry out a review of office allocation including establishment of benchmarks and guidelines for the allocation of office space to ensure economy and avoidance of waste Review vehicle requirements of

	Prior Actions	Proposed Measures
		government and impose moratorium on purchase of new vehicles pending outcome of review
Improving budget management	The chart of accounts for health has been standardized for national and provincial governments.	Update the chart of accounts ensuring consistency with GFS Standardization of chart of accounts for national and provincial governments Strengthening of budget systems through the Financial Management Improvement Project (FMIP) Strengthen Financial Management Information Systems (FMIS)
3. IMPROVING PUBLIC SECTOR PERFORMANCE		
Building a performance-oriented Public Service	A Public Sector Reform Management Unit (PSRMU) has been established to provide centralized guidance and to support public sector reform. NEC has approved a medium-term Public Sector Reform Plan to establish systems and incentives for improved performance. Amendments to the Prime Minister and NEC Act, and the Public Services Management Act have been passed to strengthen performance management. NEC have directed that all departmental heads submit individual performance plans and reports. CACC has approved a strengthened performance monitoring and evaluation system for staff. NEC has approved a code of ethics and Business Conduct.	CACC approval of department performance reports and corporate plans for Departments of Health, Education, Works and Transport The new performance system is to be operational for the central agencies and the Departments of Health, Education, Works and Transport by December 2003. The DPM to issue revised general orders on the application of the Code to public servants.
Reorienting Personnel Management Systems and Processes	CACC has endorsed an action plan for DPM capacity building in its core activities. Pilot programs for integrated HRM and Payroll System are being implemented in the DPM and PMNEC. NEC has approved a revised process for selection, transfer and termination of department heads. NEC has approved the strengthening of the Public Service Commission (PSC)	Extension of the integrated HRM and Payroll System to Departments of Health and Education, and Police Legislative amendments to implement revised process for selection, transfer and termination of department heads Legislative amendments to ensure that PSC decisions on appeals of personnel matters become legally binding

	Prior Actions	Proposed Measures
Improving Delivery of Major Services	CACC has approved recommendations of Functional and Expenditure Reviews (FERs) of: Finance and Treasury, DPM, PMNEC, Health, Works and Transport, Attorney General's office. A Service Improvement Support Group (SIPG) has been established with provincial coordinators four pilot provinces.	CACC to approve Service Improvement Plans (SIPs) for basic services in four pilot provinces
4. REMOVING BARRIERS TO INVESTMENT AND ECONOMIC GROWTH		
Liberalizing and Promoting Trade	The implementation of a seven-year Tariff Reform Program commenced.	Continued implementation of the Tariff Reform Program
Investment liberalization		Review Immigration Act and streamline procedures for visa and work permit applications Amend the Investment Promotion Act; to shift from case-by-case approval of foreign investments to a simpler system of registration of business, with ex-post monitoring of investments
Competition and Regulatory Policy	A review of regulatory and competition policy has been completed. ICCC has been established to regulate SOEs, prices, service delivery and market conduct.	
Privatization	50.1% of PNGBC has been sold through a merger with BSP. Orogen and Oil Search have been merged. Legal and Financial due diligence exercises were completed for Elcom, Telikom, Post PNG, Harbours and the water assets. Elcom and Harbours Board have been corporatized. MVIL, Telikom and Harbours Board have progressed to the point of sale. The Independent Public Business Corporation (IPBC) has been established to manage those SOEs that have not been privatized or partially privatized.	

	Prior Actions	Proposed Measures
Financial Sector Reform	A Banks and Financial Institutions Act has been passed and provides for control and regulation of banks, financial institutions and bank holding companies. The Banks and Financial Institutions Act has been used to stop operation of pyramid schemes. A Life Insurance Act and a Superannuation Act have been passed providing for the BPNG to regulate the life insurance and superannuation industries. The superannuation industry is being deregulated to allow opting out of compulsory schemes.	

Public Expenditure Management Reporting

- Monthly cash flow reports
- Monthly debt management reports showing financing outturns reconciled against budget data, forward financing projections reconciled against cash flow projections, and changes in the stock of domestic and external debt
- Monthly revenue reports
- Monthly reports in payroll data showing number of employees by department and by payroll, and projections to the year-end, and explanation of any significant deviations from previous projections
- Quarterly publication of *Treasury Economic Monitor* covering economic developments (domestic activity, prices, monetary conditions, balance of payment and central government fiscal operations)
- Mid-year budget review (showing performance of the budget against projections and including adjustments as required)

PERU

REAL GROSS DOMESTIC PRODUCT

In 2002 real gross domestic product (GDP) grew by 5.3 percent, driven by favorable evolutions both in primary sectors, which expanded 6.4 percent, and non-primary sectors that grew 4.8 percent. These results reflect the positive impact of more dynamic non-primary sectors, in particular manufacturing and construction, with the latter driven by several house building programs that were launched during the year and, for the second consecutive year, the impact of mining activities at Antamina, which accounted for about 1 percent of the annual GDP growth.

During the year domestic demand grew 4.7 percent, after negative behavior from 1997 through 2001, excepting 2000. This growth was driven by greater private consumption expansion (up 4.4 percent) and investment (up 7.3 percent), and exports growing at a rate of 6.3 percent. Among other factors supporting business/private sector demand growth we find larger national disposable income, improved perceived consumer expectations since the second half of 2002, falling interest rates and greater loan placements by microfinance organizations. Another important consideration was the improving job creation indicators, reflected by a 4.4 percent rise in the economically active population working in Metropolitan Lima.

After four years of negative growth private investment recovered starting in the third quarter of 2002 as a consequence of greater construction activities, better corporate earnings, and improved expectations about future economic growth.

INFLATION

In 2002, the Central Reserve Bank of Peru adopted explicit inflation targeting as its monetary policy regime. The central bank set an annual inflation target of 2.5 percent within a range of plus or minus 1 percent. The actual inflation rate was 1.52 percent, near the lower limit of this target range.

Core inflation, which excludes products with highly volatile prices and is a measure of the overall trend of prices in the economy, was 1.69 percent (1.06 percent in 2001). This figure is basically accounted for by increases in foodstuffs and beverages where prices rose by 2.1 percent in 2002, compared with a 0.6 percent fall in 2001. The increase was mainly a consequence of higher bread prices. Non-core inflation increased 1.2 percent in 2002 (2.8 percent down in 2001) due to larger changes in the price of fuels and utilities rates.

EMPLOYMENT

The rate of unemployment in the urban area (8.7 percent) was lower than in 2001 (8.9 percent). This lower unemployment rate is explained by the increase of the employed labor force being partially compensated for by an increase in the labor share coefficient of working age people (14 years and over) actually working or looking for a job and a rise in the working-age population.

CURRENT ACCOUNT

In the foreign sector, the current account deficit reached US$1,206 million, equivalent to 2.1 percent of GDP, while the trade balance recorded a US$207 million surplus, the first one since 1990. Such an improvement reflected mainly the 5 percent growth of exports, compared to a 1 percent rise in imports and a 2.5 percent improvement in the terms of trade. Increased exports are explained by the recovery of export prices for gold and fishmeal as well as the impact of greater volume exports of copper and zinc from Antamina and larger gold production from the Yanacocha mine. Increased imports are a result of recovering consumer demand, a more dynamic domestic economy, increased oil prices, and purchases for the Camisea project.

Despite an improved trade balance, the current account deficit in the balance of payment remained close at 2001 level, due to a greater deficit in the services and factors rent balance.

CAPITAL INFLOWS

The financial account in the balance of payments recorded flows worth US$1,980 million, US$430 million higher than the previous year. In particular there were increased long-term capital flows towards the private sector (US$758 million) and government (US$657 million). Two sovereign bond issues worth US$1,886 million (US$1,391 million in February and US$495 million in December) were placed, of which US$902 million were used for a Brady bond swap.

Foreign direct investment rose from US$803 million in 2001 to US$2,205 million in 2002 which offset lower income from the sale of government assets. Total long-term private borrowing and direct investment reached US$2,914 million, above the US$1,844 million recorded in 2001. This flow exceeded the current account deficit of the balance of payments and the negative short-term capital flow of US$794 million. Better results in the private and government financial accounts made it possible to increase international reserves by US$985 million, thus increasing the total balance at the end of 2002 to US$9,598 million. This level of net international reserves was equivalent to 2.1 times external debt due in one year, 15 months' worth of imports, 5 times the monetary base balance and 65 percent of all the banking system liquidity, reflecting the country's greater capability to confront restrictive conditions in the international capital markets.

EXCHANGE RATE

Peru maintains a floating exchange rate regime. The exchange rate recorded a nominal 2.3 percent increase, closing 2002 at nuevo sol 3.52 per US dollar. In 2002 the nuevo sol had the lowest depreciation rate in Latin America.

In real terms, the nuevo sol appreciated by 0.6 percent during 2002. The 2.3 percent nominal nuevo sol–US dollar depreciation rate was partially offset by domestic inflation of 1.5 percent and a 1.3 percent lower foreign price index.

FISCAL POLICY

The overall public sector deficit fell to 2.3 percent of GDP in 2002 from 2.5 percent of GDP in 2001. This reduction was due mainly to lower financial expenses, which fell from 2.3 percent to 2.1 percent of GDP after lower international interest rates reduced foreign debt payments to US$1,002 million in 2002 from US$1,046 million in 2001.

The primary balance, showing non-financial transactions by government, excluding interest payments, was negative, at minus 0.3 percent of GDP, a ratio similar to that of 2001.

A number of administrative measures were introduced during the year to increase tax collection. Larger private companies were designated as withholding agents while a withholding system was enforced for sales of rice, sugar and ethylic alcohol. Tax collection on fuel sales was enforced together with improved oversight of tax payers involved in transactions with state agencies. In addition, the top income tax rate for individuals was raised and advance payment of income tax on the basis of net assets was introduced (for major tax payers), to become effective in 2003.

In July 2002, the legal framework for decentralization was enacted, with regional authorities elected in November. They started their mandate in 2003.

MONETARY POLICY

Since 2002, the Banco Central de Reserva's monetary policy has been conducted following a scheme of explicit inflation targeting. This target has been set at an annual 2.5 inflation rate, with a maximum tolerance of plus or minus1 percent.

Under the explicit inflation targeting scheme, the central bank's initiatives seek to prevent inflationary or deflationary pressures on the economy that may move the inflation rate away from the announced target. Towards this end, if the inflation rate is expected to rise above the announced target, the central bank will increase its reference interest rates and reduce bank liquidity. On the other hand, if the inflation rate were expected to fall below the announced target, the central bank will reduce its benchmark interest rates and expand bank liquidity.

For these initiatives to take place on a timely basis, a set of econometric models to forecast inflation and a group of relevant economic indicators is continuously monitored to anticipate pressures on the inflation rate. These indicators include the level of economic activity, the economic agents' expectations on the evolution of various macroeconomic variables, and liquidity and credit growth, among others.

The explicit inflation targeting arrangement has further contributed to transparency by communicating the inflation target to the public, and informing it about measures to reach the target and explaining their rationality. In particular, since 2002 the central bank publishes an *Inflation Report* three times a year (in January, May and September) analyzing the most likely future evolution of the inflation rate and announcing measures to be taken that will prevent movement away from the announced target.

Reduced interest rates throughout the year had a positive impact on recovering economic activity and propelled increased monitoring and credit aggregates. Total credit from the financial system to private industry grew from the middle of the year for a total 2.3 percent annual expansion. The larger growth was recorded in sol-denominated loans (up 10.3 percent) while the credit "dollarization" coefficient dropped from 77.9 percent in 2001 to 76.2 percent in 2002.

2003 AND MEDIUM-TERM OUTLOOK

During 2003, real GDP is expected to grow 4.0 percent lead by the non-primary sectors (4.1 percent). In the medium term, the growth of the Peruvian economy will be around 4.5 percent lead by the expansion of the primary sector (5.2 percent) associated with the implementation of the Camisea project.

The current account deficit is expected to maintain around 2.0 percent of GDP and will continue to be financed mainly by long-term capital inflows. The central bank's international reserves are expected to grow around US$350 million in 2003.

To avoid any negative impact on fiscal sustainability and to ensure the efficient use of public resources, the decentralization process has incorporated several rules to be observed by the regional governments, one of them being related to the requirement of the regional government to have the central government guarantee the issue of any new debt. Additionally, the new Law of Fiscal Responsibility and Transparency was enacted in May 2003, where it is stated, among other rules, that the 2003 and 2004 fiscal deficits can not be higher than 2.0 percent and 1.5 percent of GDP, respectively. After 2005, the deficit should be lower than 1 percent of GDP.

Monetary policy will continue to be conducted under the explicit inflation targeting scheme with a target of 2.5 percent and with a maximum tolerance of plus or minus 1 percent.

Annex I

PERU: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002
GDP and Major Components (percent change, year over year - earlier period, except as noted)						
Nominal GDP (level in US$ billion)	59.0	56.9	51.6	53.5	54.1	56.9
Real GDP	6.7	-0.5	0.9	3.1	0.6	5.3
Consumption	4.7	-0.5	0.1	4.0	1.6	4.1
Private Consumption	4.3	-0.8	-0.4	3.9	1.8	4.4
Government Consumption	7.6	2.5	3.5	5.1	-0.3	1.6
Investment	14.9	-2.0	-13.4	-3.7	-7.4	7.3
Private Investment	16.0	-2.4	-15.2	-2.1	-5.7	0.5
Government Investment	12.2	2.9	6.2	-14.9	-22.9	-5.0
Exports of Goods and Services	13.1	5.6	7.6	7.9	6.7	6.3
Imports of Goods and Services	12.2	2.3	-15.2	3.6	2.7	2.5
Fiscal and External Balances (percent of GDP)						
Budget Balance	0.2	-0.8	-3.2	-3.2	-2.5	-2.3
Merchandise Trade Balance	-3.0	-4.4	-1.4	-0.9	-0.5	0.4
Current Account Balance	-5.8	-6.0	-2.9	-2.9	-2.2	-2.1
Capital Account Balance	8.6	3.7	1.2	1.8	3.0	3.6
Economic Indicator (percent change, year over year– earlier period, except as noted)						
GDP Deflator	7.60	6.44	3.94	3.65	1.14	-0.02
CPI (end of period)	6.46	6.01	3.73	3.73	-0.13	1.52
M2 [1]	19.2	15.4	1.7	6.0	6.9	17.0
Short-term Interest Rate (percent) [2]	12.8	18.7	14.9	12.7	8.6	3.2
Real Effective Exchange Rate (level, 1994=100)	-1.0	0.4	10.9	-0.8	-4.2	-2.8
Unemployment Rate in the Urban Area (percent) [3]	N.A.	N.A.	N.A.	N.A.	8.9	8.7
Population (millions)	24.7	25.1	25.5	25.9	26.3	26.7

1 Average percentage change of banking sector's liquidity in domestic currency.
2 Average Interbank interest rate in domestic currency.
3 Since 2001 the INEI has been applying a new methodology to measure the unemployment rate which is not consistent with earlier data.

Annex II

PERU: FORECAST SUMMARY (percent change from previous year)

	2003					2004				
	Official	**IMF**	**Link**	**ADB**	**OECD**	**Official**	**IMF**	**Link**	**ADB**	**OECD**
Real GDP	4	4	N.A.	N.A.	N.A.	4	4.5	N.A.	N.A.	N.A.
Exports	13.1	11.1	N.A.	N.A.	N.A.	8.3	10.6	N.A.	N.A.	N.A.
Imports	9.9	6.9	N.A.	N.A.	N.A.	5.2	7.6	N.A.	N.A.	N.A.
CPI	1.5	2.5	N.A.	N.A.	N.A.	2.5	2.5	N.A.	N.A.	N.A.

Annex III

PERU: MEDIUM-TERM TREND FORECAST (percent)

	2004-2006
Real GDP	4.5
CPI	2.5

PHILIPPINES

REAL GROSS DOMESTIC PRODUCT GROWTH

Amidst the global and local uncertainties, which prevailed during the year, the Philippine economy exhibited sustained growth in the year 2002. Real gross domestic product (GDP) grew by 4.4 percent, 1.4 percent higher than its 2001 growth performance, and well within the government's growth forecast of 4 percent to4.5 percent in 2002. All production sectors grew robustly in 2002, with industry and services surpassing their previous year's gains and agriculture bucking the effects of a mild *El Nino*. Gross national product (GNP) also expanded strongly, by 4.5 percent in 2002. The growth acceleration in 2002 was accounted for mainly by the GDP and GNP growths of 5.8 percent and 7.8 percent, respectively, in the fourth quarter.

Services surged by 5.4 percent in 2002, well within the 5.0 percent to 5.5 percent growth projection and surpassing the 2001 growth of 4.3 percent. The continued popularity of mobile and Internet services and the increased role of information and communication technology in public governance boosted the growth in services. Liberalization policies in telecommunications and the retail trade also continued to benefit the transport, communication and storage, trade and private services sectors which posted better growth performance in 2002 compared to 2001. Finance and ownership of dwellings, and real estate also strengthened in 2002.

Industry grew by 3.7 percent, 0.2 percentage points higher than the high-end forecast of 3.5 percent, with all major industrial subsectors improving their performances during the year. Mining and quarrying recovered from a 6.5 percent decline in 2001, posting a high 51 percent increase in 2002. Said performance was boosted by the increased production of natural gas from the Malampaya projects, and higher output from copper and gold mines. The rebound in private construction for housing and malls halted the slump in construction, as housing finance reforms started to impact positively on the construction sector. The performance of manufacturing, however, remains checkered, growing by 3.5 percent in 2002 compared to 2.9 percent growth in 2001. Only the export oriented sectors, e.g., electrical machinery; and domestic oriented companies, e.g., food processing, expanded their outputs, while most of the intermediate goods sectors, e.g., paper and paper products, posted declines.

The agriculture, fisheries and forestry sector recovered from a third quarter decline to a 6.0 percent increase in the fourth quarter. This growth recovery pushed the overall agriculture sector's growth in 2002 to 3.3 percent. The distribution of high yielding seeds, expansion of irrigated lands, and the implementation of the quick turn-around planting scheme mitigated the slide in *palay* production brought about by a mild *El Nino*.

On the demand side, personal consumption expenditures and exports supported growth. Personal consumption expenditures rose by 4.1 percent, boosted by higher per capita income, along with low inflation. Higher net factor income from abroad also helped finance higher consumer spending. Government consumption likewise rose by 2.4 percent in 2002, from a decline of 5.3 percent in 2001. This was the result of higher personal services expenditures following the lifting of the hiring ban, which facilitated the hiring of more teachers and government personnel, in addition to the salary increases of military personnel. Exports recovered in 2002 with a growth of 3.6 percent, a reversal of the 3.4 percent decline in 2002. Increased exports of semiconductors and microcircuits (20.4 percent), which benefited from the global IT recovery, garments (5.0 percent), and agricultural exports such as desiccated coconut (34.6 percent) and centrifugal sugar (62.8 percent) contributed to this recovery.

While gross investments slipped, the growth in fixed investments (although lower than in 2001) indicates that business expectations were generally positive in 2002. Fixed investments expanded by 2.4 percent supported mainly by increased investments in durable equipment and breeding stocks which grew by 4.8 percent and 3.3 percent, respectively.

The economy continued to strengthen in the first quarter of 2003, notwithstanding the risks posed by the conflict in Iraq , the mild *El Nino*, and the outbreak of the severe acute respiratory syndrome (SARS) in neighboring economies. The GDP grew by 4.5 percent, and GNP expanded by 5.6 percent.

Services rose a brisk 5.6 percent during the first quarter of 2003 from 4.8 percent a year ago, with the more upbeat growth in finance, mainly insurance, ownership of dwellings and real estate and private services balancing the modest slowdown in communication. Low interest rates and programs implemented by housing agencies and government financial institutions propped up the growth in ownership of dwellings

Industry growth leaped to 4 percent from last year's growth of 2.1 percent as it continued to reap from programs supportive of mining, housing and SMEs. Consumer-oriented industries such as textiles, leather and footwear, led the expansion in manufacturing while increased copper production and high world market prices boosted mining output. Private construction, benefiting from policies easing housing finance, grew markedly, by 25.1 percent during the first quarter of 2003 compared to a 1.7 percent decline in the first quarter of 2002. But public construction fell 21.6 percent, stymied anew by the policy stance designed to arrest further expansion of the fiscal deficit. Exports also grew by 3 percent, rebounding from a 5.1 decline in the first quarter of 2002, and accounted for mainly by higher exports of semiconductors and garments.

Agriculture, fisheries and forestry, meanwhile, slowed down to 2.9 percent from 4.8 percent in 2002 as *El Nino* affected *palay* (–0.8 percent) and fisheries production (0.4 percent).

Domestic demand provided the much-needed linchpin for the growth in the first quarter, with private consumption (4.9 percent) rising at its fastest pace since 1998. Low inflation and the growing variety of consumer goods brought about by the policy of liberalizing retail trade helped stimulate domestic demand. Meanwhile, the continuing efforts of the government to meet the deficit target slashed government consumption by 0.5 percent.

Growth of investments in the first quarter of 2003 (21.2 percent) was due mainly to the stockpiling of oil. Growth of investments in durable equipment was also strong, particularly in agriculture, mining, telecommunications, and paper industries.

INFLATION

The average inflation rate in 2002 slowed to 3.1 percent from 6.1 percent in 2001, the lowest recorded in 15 years. This is also lower than the 2002 monetary policy target of 4.5 percent to 5.5 percent. Prudent monetary policy, ample food supply from domestic production, and timely importation of key food items such as rice, contributed to the slowdown in inflation. The cost of manufactured products was tempered by the reduction in tariffs on their inputs. The liberalization of retail trade and deregulation of the domestic oil industry also heightened competition. Decelerating inflation rates were observed in all commodity groups, with inflation in fuel, light and water slowing down from 12.3 percent in 2001 to 4.8 percent in 2002, housing and repairs from 6.8 percent to 4.9 percent, and food from 4.1 percent to 1.9 percent.

Inflation rates for the first half of 2003 averaged 2.9 percent, lower than the 3.5 percent average posted in the same period in 2002, despite an upturn in prices in June of 3.4 percent due to increases in prices of food and electricity. The low inflation rate reflects the continued absence of significant demand-pull pressures on consumer prices as well as positive supply-side factors, particularly the downtrend of international oil prices and the weakening *El Niño* phenomenon.

EMPLOYMENT

Around 30.1 million workers were employed as of 2002, 3.1 percent higher than in 2001 as the government embarked on various programs to achieve full and decent employment. Services and agriculture recorded increased employment levels while industry posted a slight decline with the reduction of employment in manufacturing, and mining and quarrying. Some 906,000 new jobs were created but the figure is still lower than the 2001 level of 1.7 million new jobs. Services and agriculture were the main job creators but industry suffered a reduction, as jobs were lost in manufacturing.

The labor market, however, was unable to generate enough jobs faster than the labor force was increasing. The latter grew by 3.4 percent during the year. The number of unemployed rose by 6.0 percent, thereby increasing the unemployment rate further to 11.4 in 2002 percent from 11.1 percent in 2001.

The economy's labor situation eased during the first half of 2003 as the average unemployment rate declined to 11.4 percent from 12.1 percent during the same period in 2002. Accordingly, the total number of unemployed declined by 5.8 percent in the first six months. Meanwhile, the total number of employed persons increased by 1.1 percent to 30.3 million. Employment gains were posted by services (3 percent), agriculture (1.25 percent) and industry (0.25 percent). External shocks like the SARS scare, and the Iraq conflict did not significantly affect the overall labor market performance, and this was reflected in the rise in employment in domestic tourism-related industries (such as hotels and restaurants, and transportation) in the second quarter. Jobs generated in the construction industry also increased, a reflection of the positive impact of policies on housing.

BALANCE OF PAYMENTS

The balance of payments (BOP) reverted to a surplus of US$660 million in 2002 from a deficit of US$192 million in 2001. This was spurred mainly by the strong performance of the current account, which offset in part the weakness in the capital and financial account. However, the BOP reversed to a deficit in the first four months of 2003 amidst geopolitical uncertainties caused by tension over Iraq and domestic concerns about the widening budget deficit. During this period, the BOP registered a deficit of US$519 million compared to a surplus of US$1.891 billion in 2002.

The current account surplus more than tripled, to US$4.197 million in 2002 from US$1.323 million in 2001. The combined effects of higher net inflows in the income account, the positive gains in the trade-in-goods account and higher net inflows from current transfers strengthened the current account position.

From a deficit of US$743 million in 2001, the trade balance reversed to a surplus of US$408 million in 2002. Merchandise exports reached US$34.383 billion in 2002, up by 10.1 percent from the 2001 level. Increasing intra-regional trade in Asia, particularly with China; Hong Kong, China; Korea; Malaysia; Singapore; Chinese Taipei; and Thailand, supported the strong export performance. The successful penetration of exports to these new markets compensated for the slack in demand from traditional partners, the United States and Japan. Electronics, garments, machinery and transport equipment remained the economy's top export earners. The implementation of an export strategy focusing on industry clustering to enhance the economy's competitive edge, and the adoption of an aggressive marketing program for old and new markets, as well as the development of small and medium enterprises helped in the export sector's recovery. Imports meanwhile, grew by 6.2 percent in 2002, after contracting by 4.5

percent in 2001. Increased demand for electronic inputs by export-oriented industries contributed to this growth.

Net inflows of income account grew by 24 percent in 2002, a turn-around from the 17.3 percent decline in 2001. The higher net surplus was accounted for by the continued remittances from overseas Filipino workers (OFWs), which reached US$7.171 billion in 2002. A 2.6 percent increase in the number of deployed OFWs, particularly medical workers, teachers, entertainers, caregivers, clerks, and service workers contributed to the increase in remittances. The investment income account, however, posted a net outflow of US$2.621 billion, 11 percent higher than in 2001. Higher transfers from migrant workers as well receipts in the form of gifts, grants and donations from individuals and non-government organizations contributed to the further improvement in the current transfers account.

However, the net capital and financial outflows widened from US$1.080 billion in 2001 to US$2.104 billion in 2002. The decline in the net inflow of direct investments, together with the net outflow in other investments, negated the positive impact of higher net inflow of portfolio investments. Non-residents' investment in equity capital increased by 50.5 percent, with the bulk coming from Japan following investments by a Japanese firm in a local brewery company in March. Equity funds were also channeled in other manufacturing companies, financial institutions, mining corporations and other construction companies. Other major sources of direct investments include the United States, Japan, the Netherlands and the United Kingdom. But the substantially lower net investments in inter-company loans, as well as equity investments by residents to their affiliates abroad, brought total direct investments to only US$1.026 billion, 10.2 percent below its 2001 level.

Meanwhile, net portfolio investments yielded a surplus of US$1.912 billion, 82 percent higher than the 2001 level. Non-resident investments in equity and debt securities mainly accounted for the higher net inflows. On the other hand, net outflows of other investments widened on account of withdrawals by non-residents of their maturing foreign currency deposits from their FCDU accounts in local banks as well as net deposits deposited abroad by non-banks.

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The strong net inflows from the income account kept the current account in surplus at US$342 million during the first four months of 2003. The current account surplus, however, was lower compared to the US$1.455 billion recorded in the same period in 2002. Higher OFW remittances continued to boost the income account, which grew by 13.1 percent. However, the trade in goods account reversed, to a deficit from a surplus following the surge in imports brought about by higher world oil prices and stockpiling of crude oil and raw materials in anticipation of supply disruption. The services account was also weaker because of higher freight expenditures and lower travel receipts.

Meanwhile, the capital and financial account reversed to a net outflow of US$612 million from January to April 2003 from a net inflow of US$1.734 billion in the first four months of 2002 of 2002 as investors kept a more cautious stance following a weak global economic outlook and uncertainties. The direct investment account reverted to a net outflow of US$39 million from a surplus of US$843 million while the portfolio investment posted a substantially lower net inflow of US$638 million compared to a net inflow of US$1.919 billion in the previous year.

The economy's gross international reserves (GIR), rose to US$16.2 billion as of end-December 2002, 3.3 percent or US$521 million higher compared to the end-December 2001 level of US$15.7 billion. As of end-June 2003, the economy's GIR stood at US$15.867 billion The GIR is adequate to cover 4.4 months' worth of imports of goods and payment of services and income. Net international reserves (NIR) level increased to US$12.8 billion as of end-December 2002 from the previous end-year's US$11.4 billion. As of June 2003, the NIR stood at US$12.354 billion.

GROSS EXTERNAL DEBT

The economy's total outstanding external debt rose by 2.9 percent to reach US$53.9 billion in 2002. Medium- and long-term loans (US$48.3 billion) accounted for 89.7 percent of the total external debt, with short-term debt accounting for the remaining. Half of total loans were availed of by the public sector particularly the national government. Japan, multilateral agencies, and the US continued to be the main sources of funds for the Philippines.

As of March 2003, the economy's total outstanding external debt rose to US$55.8 billion, up by 3.6 percent from the end-2002 level. The debt increase resulted from net inflows of US$1.7 billion, mainly from the public sector accounts, which are usually larger during the early part of the year. A weak dollar also led to foreign exchange revaluation adjustments resulting in an increased debt stock by US$0.2 billion.

EXCHANGE RATE

The average peso-dollar exchange rate for 2002 stood at P51.60/US$, a depreciation of 1.2 percent against the 2001 average of P50.99/US$. The depreciation of the peso mirrored concerns over potential risks in the international financial markets such as the tension in the Middle East, the economic recovery of the United States, threats of terrorism as well as domestic challenges confronting the Philippine economy, particularly the huge budget deficit. The movement of the peso, however, was less volatile in 2002 as indicated by the lower standard deviation of the daily peso-dollar exchange rate (P1.13) in 2002 as compared to that in 2001 (P1.57).

The peso weakened against the US dollar for the most part of the first quarter of 2003 but was generally stable. From an average of P53.52/US$ in December 2002, the peso depreciated to an average of P54.55/US$ in March 2003. Both external and internal factors, including the Middle East conflict and tension over North Korea; the weakened economic outlook as well as increased demand for US dollars by oil companies to fund their inventory build-up; security concerns in Mindanao; lingering concerns over the budget deficit and relative low domestic interest rates; contributed to the depreciation. Improved fiscal performance and higher OFW remittances in the second quarter strengthened the peso. The peso appreciated against the US dollar by 2.1 percent from the March 2003 level of P54.55/US$ to P53.41/US$ in June 2003.

FISCAL POLICY

Sustained improvements in revenue collections enabled the Philippines' government to post a fiscal deficit of P210.74 billion, P12.3 billion lower than the revised deficit target of P223.04 billion. The full-year deficit is approximately 5.2 percent of the nominal GDP in 2002. Government revenues collected in 2002 amounted to P567.14 billion while total disbursements reached P777.88 billion.

The government continued to implement reform measures aimed at strengthening the enforcement of tax laws and increasing revenue recovery. The Bureau of Internal Revenue (BIR) collected P394.55 billion, 1.5 percent higher than the 2001 level while the Bureau of Customs (BOC) collected P96.25 billion, slightly over (0.02 percent) the previous years' collections. Lower interest rates reduced interest-related tax collections by the BIR while increased amounts of non-dutiable imports and deferred duty payments reduced the collections by the BOC.

The growth in government expenditures in 2002 was due mainly to the increase in the internal revenue allotment to local government units (LGUs) given the "no lien-no holdback" policy mandated under the Local Government Code, and the need to support their programs on poverty alleviation, and law and order programs; higher capital outlays due to faster implementation of foreign-assisted projects; increased disbursements on personal services as a result of the salary adjustments of AFP and PNP personnel, new teaching positions and an increase in the veterans' pension. Savings generated from interest payments amounted to P6.1 billion as result of lower interest rates in both domestic and foreign markets.

The fiscal performance remained well on track during the first five months of 2003 with the deficit standing at P75.4 billion, 30 percent lower than the P107.5 billion budget gap recorded during the same period last year. The enforcement of revenue reform measures and prudent expenditure management policies continued to keep the fiscal deficit within target. The revenue enhancement measures in the BIR and the ongoing reforms in the BOC continued to keep revenues on track while keeping a tight reign on budgetary allotment. Government revenues rose by 15 percent, from P223.8 billion during the first five months of 2002 to P257.4 billion during the same period in 2003, due to the strong performance of the tax collecting agencies. Meanwhile, government expenditures grew minimally (0.4 percent) as the government adhered strictly to its expenditure program. Total government expenditures reached P332.74 billion during the first five months of 2003.

MONETARY POLICY

The monetary authorities focused on providing appropriate liquidity conditions needed to support a non-inflationary growth path for the economy in 2002. In January 2002, the Bangko Sentral ng Pilipinas (BSP) adopted the inflation-targeting framework for monetary policy, aimed at promoting a low and stable rate of inflation conducive to balanced and sustainable economic growth.

Against a backdrop of benign inflation, the BSP reduced its policy interest rates three times (by a cumulative amount of 75 basis points in the first quarter to reach 7 percent for its overnight borrowing rate and 9.25 percent for its overnight lending rates. These rates have kept steady throughout the year to foster a low market interest rate environment. As a result, the 91-day T-bill rate went down to an average of 5.4 percent in 2002 from an average of 9.9 percent in 2001. Commercial banking rates also declined from a range of 12.7 percent to14.2 percent in December 2001 to 8.1 percent to 10 percent in December 2002.
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The BSP likewise reduced in January 2002, by two percent, the liquidity reserve requirement on peso demand, savings, and time deposits and deposit substitute liabilities of universal banks, commercial banks and non-bank financial intermediaries with quasi banking functions. This restored the liquidity reserve to its pre-July 2001 level of 7 percent. Moreover, the BSP reduced the regular reserve requirement to 6 percent for demand deposits, deposit substitutes, negotiable order of withdrawal accounts (NOW) of thrift banks, and for demand deposits and NOW accounts of rural cooperative banks.

Furthermore, the BSP liberalized its rediscounting policy by opening up access to its regular rediscounting window from a selective credit instrument to a monetary policy instrument that implements the BSP's open market operations in managing liquidity in the system.

Domestic interest rates were generally higher during the first four months of 2003. The 91-day T-bill rates rose from 5.2 percent in January to 7.3 percent in April amidst concerns over the economic impact of the war in Iraq, the slowdown in global demand, and rising international oil prices. Rates charged on loans also rose, with average lending rates increasing from a range of 8.1 percent to 10 percent in January to a range of 10 percent to12 percent in April. However, by May and June 2003, the T-bill rates had declined to 6.6 percent and 5.6 percent, respectively. Lending rates also dropped to a range of 9.9 percent to 11.8 percent in May and 9.0 percent to 10.8 percent in June 2003.

As a pre-emptive response to inflationary risks arising from volatility of the peso, the BSP removed the three-tiered system for banks' placement with the BSP and increased the liquidity requirement for universal banks and commercial banks by one percent, effective 20 March 2003. Overnight reserve repurchase (RRP) transactions with the BSP were accepted at a uniform rate of 7 percent, while term RRPs, and special deposit accounts with BSP were paid the published rates for the corresponding tenors, i.e., at a certain spread over the overnight RRP rate. The liquidity reserve requirement was raised to 8 percent effective 21 March.

In June 2003, the Monetary Board restored the tiering scheme on bank's placements with BSP under the RRP and special deposit accounts (SDA) windows. Banks' placements with the BSP under the overnight RRP window will be applied 7 percent for the first ₱5 billion; 4 percent for additional amounts in excess of ₱5 billion but below ₱10 billion; and 1 percent for the amounts in excess of ₱10 billion. The restoration of the tiering scheme is expected to further enhance the liquidity situation and encourage banks to lend to the public instead of placing their excess funds with the BSP.

MEDIUM-TERM OUTLOOK

The economy is expected to sustain its growth momentum in 2002 with GDP projected to grow by 4.2 to 5.2 percent and GNP by 4.5 to 5.4 percent in 2003. The growth forecasts, however, are lower than earlier projected amidst uncertainties in the global and domestic fronts. Agriculture is expected to grow 3 percent to 4 percent in 2003 as the government continues to implement *El Nino* mitigating measures and other productivity enhancement measures like the distribution of high-yielding seeds. Policies and program efforts will also be pursued to enhance agricultural lending and investments. Meanwhile, industry is projected to grow by 3.4 percent to 4.4 percent in 2003. Policies that will boost mining, housing and small and medium enterprises will support industrial growth in 2003.

Services will continue to be the fastest growing sector, as it expands by 5.2 percent to 6.2 percent, led by telecommunications, trade and private services. Transport, communication and storage is expected to benefit form the government's efforts to reduce the cost of transport between Mindanao to Luzon. Communications will continue to ride on the rising demand for cellular phone services as new models flood the market and IT use expands in the business/private and public sectors. The government's move to boost tourism is seen to stimulate demand for private services. The extent of the impact of the outbreak of SARS on tourism and the airline business, however, has not yet been factored in the projections.

Inflation is expected to be stable and remain below the 2003 forecast of 4.0 percent to 4.5 percent (preliminary) on account of declining prices and adequate food supply.

STRUCTURAL REFORMS

The Philippine economy withstood global and domestic shocks as it benefited from policies designed to maintain macro-stability and to modernize and liberalize the various economic sectors.

Financial policy emphasized strengthening of the banking system to secure efficient financial intermediation and restoring confidence in the stock market. The General Banking Law (GBL) of 2000 (Republic Act (RA) No. 879) aligned domestic banking standards with international best practices and improves regulatory oversight. The GBL also allowed foreign banks to acquire up to 100 percent of a domestic bank within seven years of the law coming into effect.

The Bangko Sentral ng Pilipinas (BSP) continued to implement measures to improve prudential and supervisory regulation over the banking system by:

a. Aligning the economy's Tier 2 capital limits with international practice. (Tier 2 capital is defined as supplementary capital or additional internal resources available to the bank aside from shareholders' equity and retained earnings or Tier 1 core capital). The Monetary Board liberalized the Tier 2 limits to facilitate the increase in capital by banks in a difficult market.

b. Requiring bank directors and officers to attend corporate governance seminars to promote and enhance corporate governance and improve the quality of bank management;

c. Lowering the risk weighting from 100 percent to 75 percent for banks' small and medium enterprises (SME) and microfinance loan portfolios that meet prudential standards. This move seeks to promote the expansion of SME and micro-finance loans;

d. Allowing regular banks to establish microfinance-oriented branches as an exception to the general moratorium on the establishment of bank branches to further improve access of micro-enterprises to credit and other financial services;

e. Revising the definitions of the housing packages under the socialized and low-cost housing prescribed under Circular Letter dated 31 March 2001, following Memorandum Circular No. 02, Series of 2002, of the Housing and Urban Development Coordinating Council. Socialized housing packages shall refer to housing loans not exceeding P225,000 while low-cost housing shall consist of Level 1 (P225,000 to P500,000) and Level 2 (P500,000 to P2 million). Said redefinition aims to increase the number of housing loans that qualify as banks' alternative compliance to the Agri-Agra Law. The BSP had earlier expanded its rediscounting facility, among others, to socialized and low cost housing;

f. Reorganizing its Supervision and Examination Sector to strengthen further its regulatory and oversight functions through a shift from an industry specialization-based set up to a consolidated approach that would give supervising departments a total perspective of the operations of the banks under their supervision;

g. Launching the Philippine Payment System or PhilPass, a real time payments infrastructure system. The system allows BSP to monitor liquidity positions of participating banks throughout the day on a transaction-by-transaction basis, so settlements are made only when banks have sufficient funds; and

h. Approving the guidelines (Circular no. 280 dated 29 March 2001) for the adoption of the risk-based capital adequacy ratio (CAR) along with the criteria prescribed by the Bank for International Settlements (BIS) pursuant to Section 34 of the GBL of 2000. The law gives the Monetary Board the authority to prescribe the minimum ratio of a bank's net worth to total risk assets. This new ratio remains well above the BSP's 10 percent statutory floor and the BIS's eight percent standard.

To address the non-performing assets (NPAs) problems of the financial sector, RA No. 9182, otherwise known as the Special Purpose Vehicle Act of 2002, was enacted on 10 January 2003. The law aims to encouraged private sector investments and eliminate barriers in the acquisition of NPAs. The law is expected to help in the rehabilitation of distressed businesses and improve the liquidity of the financial system. The implementing rules and regulations were issued on 19 March 2003.

The Securities Regulation Code (SRC) or RA No. 8799 enacted in July 2000 aims to strengthen the regulatory framework over the securities market. Major provisions of the SRC, which are expected to enhance corporate governance, include the demutualization (public listing) of the Philippine Stock Exchange (PSE); the protection of minority shareholders; and the election of at least two independent directors to the board of the public corporation. With the demutualization of the PSE in August 2001, the PSE will become a publicly held corporation with diverse ownership governed by a majority of non-brokers, and managed by an independent and professional group. This will make the PSE more transparent as it will be subject to the rules on full disclosure.

The Philippines supported the global crusade against money laundering by enacting the Anti-Money Laundering Act of 2001 (RA No.9160) on 29 September 2001. This was later amended by RA No. 9194 enacted on 7 March 2003, which lowered the deposit threshold at which banking regulators may inspect to half a million pesos (about US$9,346) from four million pesos as provided for under RA 9160 in compliance with the rules of the Financial Action Task Force.

To maintain a healthy reserve position, meet legitimate dollar demand, and curb speculation, the BSP reopened the Currency Risk Protection Program (CRPP)[1] and expanded it to include net importers, registered foreign currency-denominated bonds, and loans from foreign currency deposit units (FCDUs) with original maturities longer than one year up to five years' official assistance.

The BSP also reduced the maximum amount of foreign exchange that authorized agent banks may sell to residents for any non-trade purpose without the need of appropriate documentation, from US$10,000 to US$5,000. Moreover, the BSP has required that the sale of foreign exchange of US$5,000 to any one individual shall not be done more than once in every 15-day period. The BSP is also strictly enforcing the rule requiring foreign exchange corporations that are affiliates/subsidiaries of banks to submit weekly reports on all foreign currency transactions above US$5,000 to ensure that there are underlying transactions behind banks' forex purchases and sales.

In agriculture, the Ginintuang Masaganang Ani Programs on rice, corn, high-value crops, livestock and fisheries serve as the main vehicles for channeling support to raise agricultural productivity and incomes, as well as ensure food security. These include the provision of the required infrastructure, increased access to modern inputs and technology, as well as credit and marketing support. The Comprehensive Agrarian Reform program is also being vigorously pursued to promote asset reform and facilitate its completion by 2008.

Liberalization and regulatory reforms continued to be pursued to stimulate trade, investments and production. The government generally adhered to its tariff reduction program. The average nominal tariff declined from 7.7 percent in 2001 to 6 percent in 2002. A number of Executive Orders were issued to reduce the duty on raw materials and intermediate inputs as well as equipment of the agriculture and fisheries sectors and manufacturing industries.

The Customs Valuation Law (RA 9135) shifted the system of import valuation from their book value to their transaction value, making the import valuation system more consistent with the WTO Agreement on Import Valuation.

[1] The CRPP is a hedging facility that is meant to limit the risk faced by eligible borrowers with existing uncovered dollar-denominated liabilities from possible peso depreciation. The facility is expected to reduce the demand of these borrowers for US dollars to cover or limit their foreign exchange risk. Reduced demand for US dollars will, in turn, ease the pressure on the supply of US dollars in the market (OA)/development assistance (DA), and other trade transactions of clients other than oil companies.

Policy reforms aimed at investment liberalization, deregulation and privatization continued to be at the forefront of the Philippines' efforts to increase local and foreign investments. Pursuant to RA 7042 (the Foreign Investments Act of 1991 (as amended)), the Fifth Regular Foreign Investment Negative List (5th RFINL; Executive Order (EO) 139) was issued on 22 October 2002. With this new policy, retail trade enterprises with a minimum paid-up capital of US$2.5 million but less than US$7.5 million were removed from the negative list, thus allowing 100 percent foreign ownership therein. On the other hand, practicing professions in agriculture and fisheries; manufacture, repair, storage, and distribution of products and/or ingredients requiring clearance from the Philippine National Police; and private radio communications networks were added to the negative list.

EO 95 (dated 15 April 2002) earlier amended the 4th RFINL (EO 286 s 2000) to allow non-Philippine nationals specifically authorized by the Secretary of National Defense to engage in defense-related manufacturing or repair activities, provided that a substantial percentage of output is exported.

The list of investment areas under the annual investments priorities plan has been made shorter and more focused. Pursuant to Section 8 of the Retail Trade Liberalization Act of 2000, a list of foreign retailers selling high-end or luxury goods, as well as the guidelines for the formulation thereof, was approved in 2001. Additions to the list have been approved in 2002.

Meanwhile, RA No. 9178 or the Barangay Micro Business Enterprises (BMBE) Act of 2002 enacted in November 2002 provides incentives and other benefits including exemptions from income tax and the minimum wage law to help micro-enterprises that need special assistance to grow and develop,.

On the civil aviation front, the implementing rules and regulations of EO 219, which establishes the domestic and international civil aviation liberalization policy, were finalized and published on 10 November 2001. EO 219 seeks to address the urgent need for the Philippines to improve air service availability, equality and efficiency through exposure to foreign markets and competition.

The Electric Power Reform Act (RA 9136) opened up the generation, distribution, and wholesale supply aspects of the electric power industry to private players. The deregulation of the power sector is expected to enhance the inflow of private capital to, and broaden the ownership base of, the industry as well as promote competition and efficiency within the sector.

Efforts were also undertaken to make government transactions more accessible, transparent and cost effective to business and consumers. These include the computerization of government frontline services such as the:

- Government Electronic Procurement System (G-EPS) of the Department of Budget and Management;
- Business Name Registration System (BNRS) of the Department of Trade and Industry;
- Electronic Filing and Payment System (eFPS) of the Bureau of Internal Revenue;
- e-Census online facility of the National Statistics Office;
- e-GSIS facility of Government Service Insurance System;
- SSS Online Inquiry System of Social Security System;
- SEC-iRegister of the Securities and Exchange Commission; and
- One-Stop Shop of Land Transportation Office.

The filing of export declarations by electronic companies in the Laguna and Cavite special economic zones was also automated.

The Government Procurement Reform Act (RA No. 9184, signed on 10 January 2003) provides for greater transparency in the procurement of goods and services, harmonizing and consolidating all government procurement laws into one unified law and streamlining existing procurement procedures and practices. The law applies to the procurement of infrastructure projects, goods and consulting services, regardless of source of funds, whether local or foreign, by all branches and instruments of government. The law penalizes fraud, conspiracy, connivance and collusion.

In a move to encourage participation of local companies in electronic commerce, the implementing rules and regulations for electronic authentication and signatures was signed on 28 September 2001. It provides for voluntary application by firms, and is expected to serve? as their common basis to verify and prove the legal validity and enforceability of electronic signatures and contracts.

ANNEX 1

PHILIPPINES: OVERALL ECONOMIC PERFORMANCE

	1996	1997	1998	1999	2000	2001	2002	IQ 2003
GDP And Major Components (percent change, year over year, except as noted)								
Nominal GDP (US$ million)[a]	84010	83499	66086	77225	75909	72043	77953	18625
Real GDP [a]	5.8	5.2	-0.6	3.4	4.4	3.0	4.4	4.5
Total Consumption								
Private Consumption [a]	4.6	5.0	3.4	2.6	3.5	3.6	4.1	4.9
Government Consumption [a]	4.1	4.6	-1.9	6.7	6.1	-5.3	2.4	-0.5
Total Investment [a]	12.5	11.7	-16.3	-2.0	5.5	13.6	-3.5	21.2
Exports of Goods and Services [a]	15.4	17.2	-21.0	3.6	17.7	-3.4	3.6	3.0
Imports of Goods and Services [a]	16.7	13.5	-14.7	-2.8	4.0	3.5	4.7	24.2
Fiscal And External [b] Balances (percent of GDP)								
Budget Balance [c]	0.3	0.1	-1.8	-3.7	-4.0	-4.0	-5.2	-5.8
Merchandise Trade Balance [c]	-13.5	-13.3	-0.04	6.4	9.1	-1.0	0.5	-3.1
Current Account Balance [c]	-4.7	-5.2	2.3	9.5	11.1	1.8	5.4	1.8
Capital Account Balance [c]	13.2	7.9	0.7	-2.3	-8.5	-1.5	-2.7	-1.7
Economic Indicators (percent change year over year earlier period, except as noted)								
GDP Deflator (% change)	7.7	6.0	10.7	8.0	6.3	6.6	4.9	5.7
CPI (% change) 1994=100 [d]	9.1	5.9	9.7	6.7	4.4	6.1	3.1	2.9
M2 (% change) [d]	15.8	20.5	8.0	19.3	4.8	6.9	9.5	2.5
Short-term Interest Rate (%) [d]	12.4	13.1	15.3	10.2	9.9	9.9	5.4	6.3
Exchange Rate (P/US$) [d]	26.2	29.5	40.9	39.1	44.2	51.0	51.6	53.5
Real Effective Exchange Rate Index [e]	90.5	88.1	69.0	74.0	68.8	64.1	63.8	58.3
Unemployment Rate (%) [d]	8.6	8.7	10.1	9.8	11.2	11.1	11.4	11.4
Population (millions)	71.9	73.5	75.2	76.8	78.4	80.1	81.8	81.8

As of 23 August 2003

Notes:

[a] Revised figures.
[b] Data on external balances are sourced from the Balance of Payment Accounts
[c] Revised as a result of revisions in data on nominal GDP
[d] January–June 2003
[e] January–April 2003

Sources: National Statistical Coordination Board; Bangko Sentral ng Pilipinas

Annex II

PHILIPPINES: FORECAST SUMMARY

	2003					2004				
	Official	**IMF**	**Link**	**ADB**	**OECD**	**Official**	**IMF**	**Link**	**ADB**	**OECD**
Real GDP	4.2-5.2	4.0	N.A.	4.0	N.A.	4.9-5.8	4.0	N.A.	4.5	N.A.
Exports	5.2-5.7	N.A.	N.A.	N.A.	N.A.	4.6-5.1	N.A.	N.A.	N.A.	N.A.
Imports	5.0-5.5	N.A.	N.A.	N.A.	N.A.	8.5-9.0	N.A.	N.A.	N.A.	N.A.
CPI [a]	4.0-4.5	3.0	N.A.	4.5	N.A.	4.0-5.0	3.4	N.A.	4.5	N.A.

as of 23 August 2003.

[a] Preliminary forecast

Annex III

PHILIPPINES: MEDIUM TERM FORECAST

	2003	**2004**	**2005**	**2006**
Real GDP	4.2-5.2	4.9-5.8	5.3-6.3	5.8-6.7
GDP Deflator	N.A.	N.A.	N.A.	N.A.

as of 23 August 2003.

RUSSIA

The positive dynamics of the most important microeconomic indicators of the development of Russian economy were maintained in 2002.

Economic growth continued at a stable pace. Real disposable money income of the population almost achieved its pre-crisis level, while retail trade turnover substantially exceeded it. Unemployment decreased. Financial stability, which was ensured by a budget surplus of expanded government revenue and favorable balance of payments, was maintained. Inflation rates decreased. Monetization of the economy increased. External debt was repaid in accordance with the adopted schedule, with rather limited external borrowings.

REAL GROSS DOMESTIC PRODUCT

In 2002 the volume of GDP increased by 4.3 percent as compared with the previous year. The growth of GDP was conditioned by the growth of industrial and agricultural production, construction, and expansion of services in the domestic and foreign trade. The volume of production in industry increased by 3.7 percent, in agriculture by 1.7 percent, in construction by 2.7 percent, and in transport by 4.4 percent.

Expenditure on final consumption increased by 6.9 percent, of which consumption by domestic households increased by 8.5 percent. and that of state institutions increased by 2.4 percent.

The growth rate of net exports of finished goods decreased, by 4.4 percent.

Gross accumulation increased by 1.6 percent and amounted to 21 percent of GDP, including the accumulation of fixed capital which increased by 2.9 percent and amounted to 18.0 percent.

INFLATION

The rate of inflation decreased during 2002. As a whole, in 2002 the growth in consumer prices amounted to 15.1 percent against 18.6 percent in 2001. The success in decreasing the consumer price index was achieved owing to budget and credit-monetary policy; improvements in financial discipline; and a reduction of non-payments and barter.

Pursuing a restrictive tariff policy in the sphere of natural monopolies also contributed to reducing inflation.

Higher prices were recorded in industry. In 2002 the increase in prices of industrial products producers amounted to 17.1 percent.

EMPLOYMENT

In 2002, number the total number employed increased, from 64.7 million people in 2001 to 65.1 million people in 2002 or by 0.4 million people.

In 2002 the number of unemployed citizens, calculated according to International Labour Organisation (ILO) methods, decreased, from 10.4 percent of the economically active population at the beginning of the year to 8 percent at the end of the year. Part of the increase in registered unemployment in 2002 (up to 1.3 million people) is attributed to the increase in the minimum amount of unemployment benefit, as determined by the ‘living wage’.

TRADE ACCOUNTS

The development of foreign economic activities in 2002 occurred amid conditions of increased business activity in the economy, an increase in domestic demand as well as the favourable world situation as a whole. Over 2002 the export of goods increased by 5.3 percent. Imports were characterized by sufficiently stable growth and increased by 13.4 percent. This growth was stimulated by a noticeable increase in domestic demand and real strengthening of the rouble.

At the same time the favourable trade balance, according to the assessment of 2002, amounted to US$46.3 billion.

Over 2002 almost US$19.8 billion of foreign investments were attracted to the Russian economy, 138.7 percent of the amount in 2001.

The volume of foreign direct investments for 2002 amounted to about US$4.0 billion, 0.6 percent more than the amount in 2001.

The volume of portfolio investments amounted to US$472 million, an increase of 4.6 percent as compared with 2001.

The volume of other investments amounted to US$15.3 billion, an increase of 55.8 percent against the level in 2001.

According to the evaluation of the Bank of Russia, the net-outflow of capital from the private sector decreased from US$16.2 billion in 2001 to US$11.7 billion in 2002.

GROSS EXTERNAL DEBT

According to data from the Ministry of Finance of Russia, by the end of 2002 Russia's gross external debt amounted to US$125.5 billion (which is US$17.9 billion less than the similar indicator for 2000), including loans of US$69.4 billion and securities of US$46.2 billion. External debt with a repayment period of one year or less amounted to US$5.8 billion. The debt to international financial organizations amounts to US$13.3 billion.

According to the data of the Central Bank of the Russian Federation, most of the gross external debt, US$55.3 billion, constitutes the debt of the former USSR.

EXCHANGE RATE

In 2002, Russia continued its policy of a floating exchange rate for the rouble. Over the year the exchange rate of the rouble remained relatively stable. On the whole, the supply of foreign exchange on the market prevailed over the demand. For most of the year the rouble exchange rate was characterized by growth.

Over the year the official exchange rate of the US dollar in relation to the Russian rouble, fixed by the Bank of Russia, increased by 5.5 percent, from 30.14 to 31.78 roubles for one dollar. The exchange rate fluctuated in the range of 30.14 to 31.86 roubles.

On the whole, over 2002 the strengthening of the rouble in real terms in relation to US dollar amounted to 6 percent (against 8.4 percent a year before). The real exchange rate of the rouble in relation to the euro and the real effective exchange rate of the rouble for the same period decreased by 6.9 percent and 2.9 percent respectively.

The continuation in 2002 of the floating exchange rate policy for the rouble confirmed its efficiency in present-day conditions.

FISCAL POLICY

Federal budget receipts for 2002, disregarding the single social tax, amounted to 17.1 percent of GDP.

The main factors in the growth of federal budget receipts were:

- Growth of the economy;
- A favourable foreign economic situation;
- Implementation of tax reforms that allowed expansion of the tax base with a reduction in the tax burden;
- Reform of customs tariffs; and
- Administrative measures increased the collection of taxes enabling a 6.7 percent increase in the average level of the collection of main tax revenues to the federal budget in 2002 as compared with 2000.

Two thirds of the growth in the collection of taxes is explained by decrease of tax rates and improvement of tax administration.

Federal budget expenditure in 2002, disregarding the single social tax, amounted to 15.8 percent of GDP.

The federal budget surplus amounted to 1.4 percent, while the primary surplus was 3.4 percent of GDP.

MONETARY POLICY

The dynamics of microeconomic indicators in 2002 reaffirms that the current monetary policy is adequate to realize the objectives of economic growth. Over 2002, gold and foreign exchange reserves increased; capital outflow reduced; stability of the exchange rate of national currency was ensured; and real interest rates were reduced.

The money supply in 2002 was considerably influenced by the high surplus in the economy's foreign trade balance.

An important factor in creating the demand for money was substantial growth of the extent of cash payments determined by the expansion of production volumes; improvements in the financial position of enterprises; and stabilization of the budgetary situation.

On the whole, according to the results in 2002, the growth of gold and foreign exchange reserves somewhat outstripped the similar indicator for 2001, and in absolute terms the growth of gold and foreign exchange reserves amounted to US$13.3 billion, US$3.9 billion more than in 2001.

During 2002 the Bank of Russia twice decided to reduce the rate. Over the said period the rate fell from 25 percent to 21 percent.

The volume of money supply (M2) as on 1 January 2003 increased by 32.3 percent over the level at the beginning of 2002. At the same time the growth rate of M2 decreased in real terms from 18.1 percent to 14.9 percent as compared with 2001, reaffirming that the demand for money in the Russian economy has slowed down alongside a decrease of average monthly rates of inflation, saturation level of economy with monetary funds increased, and non-monetary settlement forms reduced.

The situation in the financial securities market in 2002 remained stable. The return on government bonds for the year fell by 3 percent.

MEDIUM-TERM OUTLOOK

The main priorities of economic policy for 2003 are to increase the income level of the population, devise and realize measures to support economic growth, and shape the potential for the economy's stable development.

According to the assessment, in 2003 the GDP growth rate will amount to 5.9 percent, of which industrial production will contribute 5.8 percent, agriculture 1.0 percent, investments in fixed capital 9.2 percent, and inflation 12 percent.

Annex I

RUSSIA: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (US$ billion)	404.9	271.0	195.9	259.7	309.9	346.5
Real GDP	1.4	-5.3	6.4	10.0	5.0	4.3
Consumption	3.0	-1.5	-2.4	7.4	7.2	6.9
Private Consumption	5.4	- 2.4	-4.4	9.3	9.9	8.5
Government Consumption	-2.4	0.6	3.0	1.4	-0.8	2.4
Investment	-3.6	-28.7	8.5	31.9	19.3	1.6
Private Investment	-5.1	-29.6	9.6	36.8	19.1	0.5
Government Investment	-13.1	-20.6	-1.1	-2.4	21.0	11.9
Exports of Goods and Services	1.1	1.9	9.5	9.8	3.6	10.2
Import of Goods and Services	3.1	-13.6	-9.6	20.2	19.2	19.1
Fiscal and External Balance (percent of GDP)						
Budget Balance (federal)	- 7.7	-5.9	-1.1	2.4	2.9	1.4
Merchandise Trade Balance (f.o.b)	3.7	6.1	18.4	23.1	15.5	13.3
Current Account Balance	0.0	0.1	12.6	18.0	11.3	9.5
Capital and Financial Non – Reserve Assets Balance	2.7	1.6	-7.3	-8.4	-5.3	-4.0
Economic Indicators (percent change, year over year, except as noted)						
GDP deflator	15.6	18.1	73.9	38.9	17.8	15.2
CPI	111.0	184.4	136.5	120.2	18.6	115.8
M2	129.8	119.8	157.2	162.4	140.1	132.3
Short-term Interest Rate (percent)	32.0	41.8	39.7	24.4	17.9	15.7
Exchange Rate (Roubles/US$)	5.787	9.705	24.620	28.128	29.173	31.35
Unemployment Rate (percent)	10.8	11.9	12.9	10.5	9.0	8.0
Population (millions)	147.1	146.7	146.3	145.6	144.8	144.0

ANNEX II

RUSSIA: FORECAST SUMMARY (percent change from previous year)

	2002			2003		
	Official	**IMF**	**OECD**	**Official**	**IMF**	**OECD**
Real GDP	4.3	4.3	4.3	5.9	6.0	5.0
Exports	5.3	-	-	15.1	-	-
Imports	13.4	-	-	15.6	-	-
CPI	15.1	16.0*	15.1	12	14.4	14.0

ANNEX III

RUSSIA: MEDIUM-TERM TREND FORECAST (percent)

	2003	**2004**	**2005**	**2006**
Real GDP	5.9	5.2	5.9	6.0
GDP Deflator	15.2	9.8	9.1	8.5

* period average

SINGAPORE

REAL GROSS DOMESTIC PRODUCT GROWTH

The Singapore economy expanded by 2.2 percent in 2002, after contracting by 2.4 percent in 2001. The recovery was primarily due to a turnaround in external demand. At the sectoral level, the performance was mixed. The manufacturing; wholesale and retail trade; and transport and communications sectors registered higher growth while the other major sectors deteriorated. The manufacturing sector was the best performing sector with a growth of 8.3 percent, a sharp reversal from the 12 percent contraction the year before.

INFLATION

The general weakness of the global economy in 2002 as well as continuing over-capacity in the high-tech sector provided little impetus for an increase in prices of traded goods during the year. Imported inflation in 2002 was, consequently, weak. Domestic price pressures were also contained due to weak economic conditions and rising unemployment. Reflecting these developments, most broad measures of prices in Singapore fell in 2002.

The CPI fell by 0.4 percent in 2002, compared with a 1.0 percent increase a year ago. The drop was attributed to both domestic and external factors. Domestic sources were responsible for 0.1 percent of the decline in the CPI while external factors reduced CPI by 0.3 percent. The main items contributing to the fall in overall prices were energy prices and accommodation costs. The 2.2 percent fall in housing cost, in particular, reflected both lower electricity tariffs and accommodation cost. While the 1.0 percent decline in the transport and communications index was partly due to lower petrol prices, the reduction in road tax implemented during the year also helped to keep transport costs down.

EMPLOYMENT

Singapore's labour market remained soft in 2002 due to a slow recovery in external demand. A second consecutive year of below-trend growth saw total employment contracting by 22,900 in 2002, after a marginal decline of 100 in 2001. This was attributable to the persistent decline in employment in goods-producing industries. Retrenchments, however, slowed from 25,800 in 2001 to 19,100 in 2002. Supported by higher seasonal hiring at year-end, the overall seasonally adjusted unemployment rate declined to 4.2 percent in December 2002. For the whole year, the unemployment rate averaged 4.4 percent, compared to 3.3 percent in 2001.

BALANCE OF PAYMENT

Singapore's overall balance of payments turned in a small surplus of $2.3 billion in 2002, following the $1.6 billion deficit in 2001. This was mainly due to an expansion in the current account surplus, which more than compensated for the slightly larger outflow from the capital and financial accounts. Both the goods and services accounts showed an improvement. Reflecting these developments, Singapore's official foreign reserves rose by $2.8 billion to reach $142.7 billion as at end-2002 (equivalent to 8.2 months of current imports).

GROSS EXTERNAL DEBT

Singapore has no official foreign debt.

FISCAL POLICY

An expansionary fiscal policy stance was maintained in 2002, as the economic recovery from the recession in 2001 remained weak. The sizeable off-budget packages announced in 2001 were generally continued through 2002 to alleviate the burden on households and businesses.

MONETARY POLICY

Amid the economic uncertainties and disruptions to global financial markets in the aftermath of the September 11 attacks, the trade-weighted Singapore dollar nominal effective exchange rate (S$NEER) index tracked by the Monetary Authority of Singapore (MAS) was allowed to fluctuate within a wider band. As stability returned to financial markets at the beginning of 2002, a narrower policy band was restored. Monetary policy was maintained at a neutral stance and the S$NEER was allowed to follow a zero percent appreciation policy path within the new band. The neutral monetary policy stance was reaffirmed in the second half of the year as inflationary conditions remain subdued.

EXCHANGE RATE

Due to the continued decline in stock prices and the emergence of doubts over corporate governance in the US, investment flows into the economy slowed in 2002 despite the economic recovery. This allowed the current account to reassert its influence over the US dollar exchange rate. As the US monthly trade deficits reached record heights, the US dollar also lost its might in the foreign exchange market.

Reflecting the decline of the greenback, the Singapore dollar appreciated by 6.6 percent against the US dollar in 2002. Compared with the US dollar-pegged currencies of other major trading partners, the Singapore dollar showed similar strength. It also gained 6.6 percent against the Hong Kong dollar and the Malaysian ringgit.

The relative stability of the S$NEER in 2002 implied that the significant appreciation of the Singapore dollar against the US dollar and currencies linked to it was accompanied by weakness *vis-à-vis* the currencies of other important trading partners. The Singapore dollar lost 9.9 percent against the euro, 3.4 percent against the pound sterling and 3.6 percent against the yen.

The Singapore dollar also ended 2002 weaker compared to the Korean won by 3.9 percent. Against the New Taiwan dollar, however, it appreciated by 5.8 percent.

ECONOMIC OUTLOOK

Singapore's economic performance in the first half of 2003 was affected by uncertainties arising from the Iraq War and the outbreak of the severe acute respiratory syndrome (SARS). Since then, the outlook has improved somewhat. Oil prices have fallen with the end of the Iraq War. Assets markets in many economies have improved along with business sentiments. The SARS outbreaks have also been successfully contained. Barring a resurgence of SARS during the cold season, the Singapore economy is expected to grow by 0.0 percent to 1.0 percent in 2003.

STRUCTURAL REFORM

The external environment has changed rapidly, with increasing globalisation, technological advances and greater competition. Domestically, with the economy already at an advanced level, it will be more difficult to sustain high growth. To address these challenges, Singapore is restructuring the economy, following the recommendations of the Economic Review Committee.

The key strategic thrusts include:

a. Expanding external ties–embracing globalisation through the multilateral trading framework of the WTO, regional co-operation as well as bilateral Free Trade Agreements.
b. Maintaining competitiveness and flexibility–keeping the burden of taxes and the Central Provident Fund on the economy as low as possible, reviewing the labour market and wage system to make them more flexible, and pricing factors of production competitively.
c. Promoting entrepreneurship and Singapore companies–encouraging people to be innovative and improving the ability of firms to develop new ideas and businesses, tap new export markets and broaden the economic base.
d. Growing manufacturing and services–upgrading these sectors by improving cost competitiveness, equipping the labour force with relevant skills, and developing new capabilities and industries.
e. Developing human capital–investing in education, helping workers train and upgrade, and welcoming global talent to augment the indigenous talent pool.

Economic restructuring will inevitably have a major impact on workers, with more frequent job displacements and higher structural unemployment. We will need to manage the dislocation and difficulties, and help workers make these changes through retraining, job-matching, and more focused assistance. Through the structural reforms, Singapore hopes to become a globalised, entrepreneurial and diversified economy, and sustain medium-term economic growth at 3 percent to 5 percent per annum.

Annex I

SINGAPORE: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002
GDP and Major Components (percent change, year over year earlier period, except as noted)						
Nominal GDP (level in US$ billion)	95.4	81.9	81.4	91.5	84.9	87.0
Real GDP	8.5	-0.9	6.4	9.4	-2.4	2.2
Consumption	5.9	-1.8	7.9	14.8	3.6	1.7
Private Consumption	5.5	-4.2	8.2	14.0	2.3	0.9
Government Consumption	7.5	8.3	6.8	17.6	8.2	4.4
Investment	10.1	-6.0	-4.9	7.9	-5.8	-9.7
Private Investment	7.6	-9.2	-7.5	10.2	-9.0	-7.2
Government Investment	22.7	8.3	4.4	0.2	6.0	-17.4
External Demand	9.6	-5.3	9.0	14.2	-6.6	4.0
Fiscal and External Balances (percent of GDP)						
Merchandise Trade Balance	4.9	17.5	14.7	13.4	17.4	21.3
Current Account Balance	15.6	22.6	18.7	14.5	19.0	21.5
Capital and Financial Account Balance	-13.3	-23.1	-15.9	-2.3	-18.3	-18.2
Capital Account (Net)	-0.2	-0.3	-0.2	-0.2	-0.2	-0.2
Financial Account (Net)	-13.1	-22.8	-15.7	-2.1	-18.1	-18.0
Economic Indicator (percent change, year over year earlier period, except as noted)						
GDP Deflator	0.4	-2.4	-5.5	4.5	-1.2	0.2
CPI	2.0	-0.3	0.0	1.3	1.0	-0.4
M2	10.3	9.7	8.5	-2.0	5.9	-0.3
Short-term Interest Rate (3-month fixed deposits)	4.10	1.70	1.68	1.70	1.02	0.78
Unemployment Rate (percent)	1.8	3.2	3.5	3.1	3.3	4.4
Population (millions)	3.8	3.9	4.0	4.0	4.1	4.2

Annex II

SINGAPORE: FORECAST SUMMARY (percent change from previous year)

	2003			2004		
	Official	**IMF***	**Asia Pacific Consensus Forecast**	**Official**	**IMF***	**Asia Pacific Consensus Forecast**
Real GDP	0.0-1.0	0.5	1.0	N.A.	4.2	4.7
CPI	0.5-1.0	0.6	0.5	N.A.	1.2	1.1

All forecasts updated as at August 2003.
* As at September 2003

CHINESE TAIPEI

REAL GROSS DOMESTIC PRODUCT GROWTH

The Chinese Taipei economy was in recovery in 2002. With investment, consumption, and exports rebounding from their year-earlier troughs, real GDP growth rose to 3.59 percent from 2.18 percent in 2001. Both domestic and international research institutions repeatedly raised their forecasts for the economy during the year. The recovery was spurred by global as well as short-term and long-term domestic forces.

In the international sphere, the steady recovery of the US economy and the pepping up of information and communications industries worldwide had a significant impact on Chinese Taipei's export-led production. Merchandise exports grew 6.3 percent, with shipment of information and communications products expanding by 2.4 percent after shrinking 20.0 percent in 2001. The rise in export sales helped lift the industrial production index 6.4 percent.

In the domestic sphere, growth rates of private consumption and investment both improved, though the sluggishness of the stock market and the high level of unemployment dampened business and consumer confidence. Having slumped from 9,891 points in February 2000 to 3,782 in October 2001, the stock market index rallied moderately to 4,621 points in December 2002. Continued concern at the high level of non-performing loans, which prompted banks to adopt conservative lending policies, was partially balanced by the introduction of a series of industrial stimulus measures.

In its mid- to long-term industrial development policy, Chinese Taipei has been vigorously promoting the expansion of knowledge-intensive industries, the upgrading of traditional industries, and the adjustment of certain IT industries, with a view to achieving the optimum blend of competitive advantages in the industrial sector. The bolstering of domestic innovation and the establishment of sunrise industries has largely offset the exodus of less-competitive industries to offshore locations, enabling industrial production to grow at a sound pace and promising a fall in unemployment in the near future.

In 2002, domestic demand increased 1.04 percent, contributing 0.96 percent to the overall economic growth rate of 3.59 percent. Private investment grew 2.50 percent and private consumption 1.99 percent, contributing 0.30 and 1.23 percent, respectively, to overall growth. The need to implement spending cuts reduced government consumption by 0.20 percent, for a contribution of –0.02 percent to overall growth, while government investment shrank 13.14 percent, contributing –0.65 percent. Exports of goods and services climbed 9.98 percent, largely due to surging demand for electrical machinery and precision instruments. Imports grew 5.84 percent on the back of rising export-induced and domestic demand. Exports and imports translated into a 2.63 percent contribution by net foreign demand.

Both industry and agriculture were in better shape in 2002. Agricultural production increased 4.73 percent and accounted for 1.86 percent of GDP. Industrial output rose 5.04 percent and accounted for 31.05 percent of GDP, with manufacturing output up 6.26 percent to increase its share of GDP from 25.57 percent to 25.85 percent. The service sector grew 2.79 percent to generate 67.10 percent of GDP. Transportation and communications posted an expansion of 4.86 percent, due largely to the steady development of mobile telecommunications, while financial insurance and securities services grew a robust 8.8 percent.

INFLATION

Intensifying competition in the domestic market, the effect of a bumper crop on fruit and vegetable prices, and the falling prices of imported consumer goods and residential rents caused Chinese Taipei's consumer price index (CPI) to fall slightly for the second year in a row, at –0.2 percent in 2002. However, the core CPI, excluding fresh food and energy prices, rose by 0.69 percent. And despite the rising international prices of oil, raw materials, and steel products, the wholesale price index rose only fractionally by 0.05 percent.

EMPLOYMENT

In 2002, with the steady recovery of the global economy, employment rebounded to a growth of 0.8 percent from its previous year's contraction. But as the increase of labor demand was not sufficient to absorb the expansion of the labor force, the unemployment rate for the year rose to a historic high of 5.2 percent.

Also, the labor market has lacked sufficient flexibility to keep up with changes in the industrial structure, resulting in increased structural unemployment as traditional labor-intensive industries have struggled in the harsh economic climate.

In 2002, the average monthly earnings of labor in industry fell 1.2 percent, the first decrease on record. Among the unemployed, 48.2 percent had lost their jobs due to business closures or downscaling. Most were in the 35 to 54 age group, and were generally family supporters.

In Chinese Taipei, knowledge-based employment has been growing in line with the development of the knowledge-based economy, with its ratio of total employment rising from 23.0 percent in 1992 to 28.9 percent in 2002. Between 1992 and 1997, such employment increased at an average annual rate of 4.4 percent. Although it slowed to 2.6 percent between 1997 and 2002, that was still above the economy-wide average.

EXTERNAL TRADE ACCOUNT

Chinese Taipei's goods exports in value terms expanded by 6.3 percent to US$130.6 billion in 2002, mainly due to strong growth in its exports to East Asian economies, such as China; Hong Kong, China; and the Republic of Korea. Imports in value terms rose by 4.9 percent to US$112.5 billion, owing to an increase in induced demand from exports and the lower base of the previous year. The goods trade balance showed a surplus of US$18.1 billion for the year, the highest on record.

While Chinese Taipei's trade in services has always shown a deficit, the deficit has narrowed since 1996, and in 2002 it shrank to US$3.9 billion from US$5.2 billion in the previous year. The narrowing of the gap was mainly a result of a huge increase in net inward remittances related to merchanting and a decrease in travel payments. Services exports increased by 9.0 percent year-on-year to US$21.2 billion, due to an increase in exports of merchanting and other trade-related services. Trade-related services have become the key component of services exports since 1997 as global logistics activities by domestic industries gain increasing importance. Services imports increased by 1.9 percent to US$25.2 billion, due to increased payments for insurance services, royalties and license fees, and other business service expenditures.

The current account balance recorded a surplus of US$25.7 billion, hitting a historic high. The current account surplus rose to 8.9 percent of GNP, as exports expanded faster than imports.

The financial account recorded a huge inflow of US$8.4 billion in 2002, a striking turnaround from the preceding year's outflow of US$384 million, and resulting from the decreased claims in the banking and business/private sectors. Direct overseas investment by residents declined 10.8

percent from US$5.5 billion in 2001 to US$4.9 billion in 2002. Direct investment in Chinese Taipei by non-residents posted a net inflow of US$1.4 billion, a sharp reduction of 64.8 percent from the previous year, mainly because of the downturn in global direct investment and the higher base of the previous year. Portfolio investment exhibited a net outflow of US$9.4 billion in 2002, up from a net outflow of US$1.3 billion in 2001, mainly owing to an increase in the holding of foreign securities by residents.

The overall balance of payments posted a record-breaking surplus of US$33.7 billion in 2002, thanks to a sizable current account surplus and a huge financial account inflow.

GROSS EXTERNAL DEBT

External debt covers both public and private debt, broken down into long-term and short-term debt. External debt jumped 31.2 percent from US$34.3 billion in 2001 to US$45.0 billion in 2002. Most of the increase was in private debt, and was mainly attributable to the increased issuance of euro-dollar convertible bonds (ECBs) by local firms. The amount of external public debt has remained consistently low at less than US$0.1 billion since 1998. Year-on-year, long-term and short-term external private debt grew 36.1 percent and 29.7 percent, respectively, in 2002.

EXCHANGE RATE

The NT dollar (NTD) to US dollar exchange rate fluctuated around 35 from the beginning of the year to mid-April, due to alternating bullish and bearish factors, such as inflows of foreign funds to the Taipei stock market and the weakening of the Japanese yen. The NT dollar started to appreciate in late April in line with the softening of the US dollar as investors pulled money out of the US market after the outbreak of a series of corporate accounting scandals that seriously undermined investor confidence. The NTD/USD exchange rate reached 33.0 on July 17, the highest level for the year. After mid-July, the NT dollar depreciated in line with the rebound of the US stock market and the US dollar. The NT dollar's depreciation during this period largely offset its appreciation in the second quarter, pushing the currency back to the same level as at the beginning of the year. It subsequently fluctuated within a narrow range to end the year at 34.58 to the US dollar, a slide of 2.2 percent from 33.81 at year-end 2001.

FISCAL POLICY

In recent years, the sluggishness of the economy and various tax-cutting measures have squeezed government revenue, and the growth of social expenditure and massive funding required for reconstruction after the devastating earthquake of 21 September 1999 have greatly increased the burden of government expenditure, resulting in a substantial widening of the fiscal deficit. In 2002, the ratio of the public deficit to annual expenditure stood at 13.8 percent, or 3.3 percent of GDP, and with the government depending increasingly on raising public debt to cover expenditure, outstanding debt climbed to 31.5 percent of GNP. To improve this situation, Chinese Taipei has been taking vigorous steps to augment government revenues while scaling back government spending. A cabinet-level task force has been formed to explore all possibilities of fiscal reform and formulate plans for balancing fiscal revenues and expenditures within the next five to ten years.

MONETARY POLICY

In 2002, Chinese Taipei's Central Bank maintained a loose monetary policy aimed at fostering economic growth. In the two years up to June 2003, the central bank cut the discount rate 15 times, reducing it by 337.5 basis points from 4.75 percent to 1.375 percent. Both long-term and short-term interest rates are at historic lows.

With the economic recovery yet to feed through into stronger demand for funds and with the continuous transfer of bank deposits into bond funds, growth of the M2 monetary aggregate was markedly slow. In 2002, M2 grew by 3.55 percent, near the lower end of the 3.5 percent to 8.5 percent target range, while M2 plus bond funds grew by 5.64 percent.

To enhance the monetary transmission mechanism following interest rate cuts, the central bank has encouraged banks to introduce adjustable rate mortgages (ARMs) and adopt the new base-rate pricing system to remove the downward rigidity of prime rates. As of February 2003, 45 banks had adopted ARMs and 39 banks had changed their prime-rate pricing policy. These institutional changes are expected to make banks' lending rates more flexible, align them more closely with market benchmark rates, and reduce the cost of funds for the general public.

In addition, the central bank and the Ministry of Finance have worked together to carry out a series of financial reforms since 2001, culminating in the launch of the 2-5-8 Financial Reform Plan in September 2002. Backed by the great enlargement of the Financial Restructuring Fund, the plan sets a two-year target for the reduction of banks' non-performing loan (NPL) ratios to below 5 percent and the raising of their risk-based capital adequacy ratios to at least 8 percent. The response of banks in actively selling off collaterals and clearing bad loans from their books had already reduced the average NPL ratio from 8.04 percent in March 2002 to 6.12 percent at the end of the year.

MEDIUM-TERM OUTLOOK

Even though the situation in Iraq has stabilized and the epidemic of severe acute respiratory syndrome (SARS) has been brought under effective control, the global economic recovery is still showing signs of fragility and falling short of the expectations at the beginning of this year. However, as the upswing in domestic and foreign demand gains strength, Chinese Taipei's GDP growth rate is projected to rise to 3.06 percent in 2003, accompanied by continued price stability.

Driven by the expansion of global trade, Chinese Taipei's foreign trade will increase moderately in 2003. Merchandise exports and imports are forecast to grow 7.1 percent and 9.8 percent respectively, generating a trade surplus of US$16.3 billion. Trade in goods and services is projected to register real growth of 7.1 percent in exports and 5.1 percent in imports.

Due to the impact of SARS, the growth rate of private consumption turned negative in the second quarter 2003. Furthermore, with the negative wealth effect still persisting, there is unlikely to be a strong rebound in consumer spending in the near future. Private consumption is projected to record a real growth rate of 0.9 percent for the year.

Chinese Taipei is doing its utmost to improve its domestic investment environment for both local and foreign investors. In 2003, implementation of the *Challenge 2008* Six-Year National Development Plan will be in full swing, accompanied by a raft of other investment-promotion measures, such as tax breaks, cut-price land acquisition in industrial parks, low-interest loans, and so on. Also, the construction of the high-speed railway will enter its peak phase. As a result, the real growth of private investment is projected to rise to 1.6 percent for the year.

With the implementation of public works and public service job-creation programs, government consumption and investment will expand by 0.2 percent and 0.5 percent, respectively. Fixed investment by public enterprises will decrease 8.5 percent as major privatizations slow down the speed of investment expansion.

Under the impact of the rising trend in international crude-oil and raw-material prices, the growth rate of Chinese Taipei's wholesale price index is projected to climb to 2.2 percent in 2003. However, domestic market opening and tariff reduction as part of Chinese Taipei's WTO commitments will underpin the stability of consumer prices, which are forecast to show a yearly fall of 0.1 percent. Chinese Taipei will face increasing deflationary pressure.

STRUCTURAL REFORMS

In July 2002, Chinese Taipei set up a Financial Reform Committee to draft proposals for accelerating financial reconstruction over the next few years. Its remit includes formulating effective methods to reduce NPL ratios and improve the quality of bank assets; promoting vertical and horizontal mergers of financial institutions; and paving the way for enhancement of financial asset liquidity. Also, to meet the requirements of the New Basle Capital Accord, domestic banks will be required to take concrete steps to improve their risk management and corporate governance.

In July 2003, Chinese Taipei's legislature enacted crucial new laws on real-estate securitization, the establishment and management of free ports, agricultural finance, and the organic law of the Executive Yuan's financial monitoring and management committee. In addition, the government plans to scrap the US$3 billion cap on individual qualified foreign institutional investors' (QFII) investment in the stock market and will remove restrictions requiring QFIIs to remit money into Chinese Taipei within two years of their stock market investment application receiving approval. Furthermore, in April 2003, Chinese Taipei launched a Fiscal Reform Program to improve the structure of the fiscal system and with the target of achieving a balance of fiscal revenues and expenditures by 2012.

To boost employment, Chinese Taipei will place emphasis on improving the flexibility of its labor market, strengthening incentives for hiring older workers, enhancing vocational training, and expanding informal employment. Efforts on this front will be made with a view to revitalizing the labor market, heightening the quality of the labor force, and diversifying job creation.

To improve its environment for foreign direct investment, Chinese Taipei will ease restrictions on the recruitment of overseas hi-tech personnel and introduce attractive new tax concessions for investors. At the same time, efforts will be focused on developing various high-tech industrial clusters, including an information and communications (IC) cluster in the north, a nanotech cluster in the central region, and an optoelectronics cluster in the south. Maintaining its emphasis on developing a knowledge-based economy and promoting private investment, Chinese Taipei will step up the pace of privatization and deregulation while strengthening support for R&D and industrial innovation, with a view to opening up new business opportunities and raising the competitiveness and value-added of its manufacturing sector.

Annex I

CHINESE TAIPEI: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002
GDP and Major Components (percent change, year on year, except as noted)						
Nominal GDP (level in US$ billion)	290.2	267.2	287.9	309.4	281.2	281.9
Real GDP	6.68	4.57	5.42	5.86	-2.18	3.59
Consumption	6.99	6.06	3.13	4.18	0.70	1.63
Private Consumption	7.26	6.52	5.37	4.93	1.04	1.99
Government Consumption	5.87	4.12	-6.49	0.55	-1.02	-0.20
Investment	10.65	8.01	1.78	8.61	-20.61	-2.13
Private Investment	18.56	11.80	-0.68	15.74	-29.17	2.50
Government Investment	0.48	0.09	3.64	-4.66	-4.77	-13.14
Exports of Goods and Services	9.08	2.41	11.9	17.55	-7.77	9.98
Imports of Goods and Services	13.74	6.34	4.41	14.53	-13.87	5.84
Fiscal and External Balance (percent of GDP)						
Budget Balance of Central Government	2.51	1.23	0.51	-1.28	-2.53	-3.02
Merchandise Trade Balance	2.64	2.21	3.79	2.69	5.56	6.42
Current Account Balance	2.43	1.29	2.91	2.88	6.37	9.14
Capital and Financial Non-reserve Assets Balance	-2.62	0.87	3.14	-2.68	0.06	2.93
Economic Indicators (percent change, year on year, except as noted)						
GDP Deflator	1.68	2.64	-1.42	-1.73	0.57	-1.01
CPI	0.89	1.69	0.17	1.26	-0.01	-0.20
M2	8.26	8.76	8.33	7.04	5.79	3.55
Short-term Interest Rate (percent)**	6.85	6.56	4.77	4.73	3.69	2.05
Real Effective Exchange Rate (level, 1994=100)	96.65	92.43	87.95	90.94	86.70	85.80
Unemployment Rate (percent)	2.72	2.69	2.92	2.99	4.57	5.17
Population (millions)	21.58	21.78	21.95	22.13	22.28	22.39

**: O/N Call-Loan Rate

Annex II

CHINESE TAIPEI: FORECAST SUMMARY (percentage change from previous year)

	2002						2003					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	3.59	3.5	N.A.	N.A.	N.A.	3.5	3.06	2.7	N.A.	N.A.	N.A.	3.4
Exports	6.29	N.A.	N.A	N.A.	N.A.	N.A.	7.10	N.A.	N.A.	N.A.	N.A	N.A.
Imports	4.94	N.A.	N.A.	N.A.	N.A.	N.A.	9.80	N.A.	N.A.	N.A.	N.A.	N.A.
CPI	-0.20	-0.2	N.A.	N.A.	N.A.	N.A.	-0.09	0.1	N.A.	N.A.	N.A.	N.A.

Annex III

CHINESE TAIPEI: MEDIUM-TERM TREND FORECAST (percent)

	Period*
Real GDP	N.A
GDP Deflator	N.A

THAILAND

ECONOMIC OUTLOOK IN 2003

The Thai economy is expected to grow at the rate of 4.5percent to 5.5 percent in 2003, which will be mainly led by the robustness of both domestic and external demand. The impact of the US-Iraq war seemed to be less than anticipated, as the preliminary economic data in the first quarter of 2003 was better than expected. The effect of the severe acute respiratory syndrome (SARS) outbreak, however, is likely to be significant in the second quarter with further repercussions lasting well into the third quarter before the situation is expected to improve in the last quarter of 2003. In addition, the Thai economy is still facing other external risk factors, which are the uncertainty of the recovery of the major economies, the US, the European Union and Japan; and the depreciation of the US dollar.

REAL GROSS DOMESTIC PRODUCT

In 2002, the Thai economy grew at a rate of 5.2 percent, the highest growth rate of Thailand since the 1997 crisis. The economic growth in 2002 was boosted by both domestic and external demand, while the growth in 1999 and 2000 was mainly supported by external demand. Particularly, private consumption and investment grew by 4.7 and 13.3 percent, respectively. Public consumption also increased moderately, by 0.5 percent. Public investment, however, contracted by 6.8 percent. Meanwhile, export and import volumes rose by 10.9 and 11.3 percent in tandem.

The Thai economy should continue to expand by 4.5 percent to 5.5 percent in 2003, mainly supported by the growth in the first quarter of 6.7 percent. The impact of SARS would slow GDP growth in the second and third quarters. However, the economy should rebound in the fourth quarter, due to the lessening severity of SARS and the full disbursement of budgeted expenditure for the first quarter of FY 2004 (Oct 03–Sep 04).

Thailand's economic growth in 2003 will result from the balanced growth of private consumption, private investment, and net exports, as last year. Private consumption is forecast to increase at a rate of 4.8 percent. Strong consumer confidence and a low interest rate environment will be the main supporting factors for private consumption in 2003. Additionally, private investment is expected to grow by 11.5 percent, compared to 13.3 percent in 2002. The factor that will slow down private investment is the outbreak of SARS in the region. That adversely affected the tourism industry and the growth potential of Thailand's 11 major trading partners, causing some businesses to scale down investment. The low interest rate and government policies to stimulate the real estate sector, however, have encouraged strong growth in residential investment from 2002. Investment in machinery and equipment is also anticipated to pick up in 2003 for replacement and new investment in manufacturing sectors. In 2003, growth in the export volume of goods and services is expected to remain high at 9.4 percent following the improvements in economic conditions of Thailand's major trading partners. The economic recovery in the region, in particular, means that Thailand is likely to export more to the regional market (with current market share of around 34 percent). The import volume of goods and services in 2003 is expected to be maintained at a high growth of 9.5 percent due to increases in domestic and foreign demand. On the other hand, real government consumption and investment in 2003 are expected to remain low, with the growth rates of 2.1 and 2.5 percent, respectively.

INFLATION

Headline inflation in 2003 is projected to be 1.6 percent, compared to 0.7 percent last year. A rise in inflation is mainly due to an increase in oil and import prices.

EMPLOYMENT

In 2002, the labor force expanded by 0.93 percent, whereas the number of persons employed increased by 2.58 percent, reflecting the strong economic growth in 2002. Consequently, the unemployment rate dropped to 2.2 percent in 2002, compared with 3.2 percent in 2001. With continuing economic growth, the unemployment rate is expected to drop further, to 2.08 percent in 2003.

EXTERNAL TRADE ACCOUNT

High growth in export and import values is expected to prevail in 2003, as a result of sharp rises in export and import prices. The export value of goods and services will increase by 9.5 percent, compared with 5.7 percent in 2002, whilst the import value will grow by 11.5 percent, compared with 4.6 percent in 2002.

In 2003, trade balance will remain in a surplus of US$2.5 billion, slightly lower than the surplus of US$3.5 billion last year, as import value starts to grow at a higher rate than export value. Consequently, the current account is expected to register a surplus of US$5.3 billion (or 3.9 percent of GDP), compared with a surplus of US$7.6 billion (or 6.0 percent of GDP) last year.

GROSS EXTERNAL DEBT

As of March 2003, gross external debt amounted to US$55.7 billion, declining from US$58.9 billion in 2002. The drastic decline was mainly caused by an increase in private external repayments. The external debt was comprised of US$20.4 billion of public external debt and US$35.3 billion of private external debt. In addition, short-term debt was recorded at US$12.3 billion and the long-term debt stood at US$43.4 billion. Also, the international reserve was 3.1 times as much as the short-term external debt.

EXCHANGE RATE

The average exchange rate of the baht appreciated to 43.0 baht per US dollar in 2002, compared with 44.5 baht per US dollar in 2001. In 2003, the baht is expected to be slightly stronger, or appreciate to 42.5 baht per US dollar.

FISCAL POLICY

In FY 2002 (Oct 01–Sep 02), the government continued to implement an expansionary fiscal policy, in order to stimulate the sluggish economy affected by the global slowdown. The government net revenue (GFS basis) in FY 2002 was 840.5 billion baht while the budgetary expenditure was 972.2 billion baht, leading to a 131.6 billion baht budgetary deficit (2.5 percent of GDP). As the economy expanded favorably in the second half of FY 2002 and private sector spending started to become the driving force of the economy, the government has had to reduce its stimulation of the economy since January 2002. Thus the budget deficit turned out to be much lower than its initial plan of 3.6 percent of GDP.

However, it should be noted that the government has also employed a number of fiscal credit policies, which asked Specific Financial Institutions (SFI) or promote lending at grassroots level. The Village Fund and the People's Bank, a revolving fund at the village level and a microfinance scheme, are notable examples. Many of these programs aim at giving the poor easier access to capital and stimulate the economy at the grassroots level. These successful programs were reflected in high growth rates of private consumption and investment.

In FY 2003, the government continues to carry towards fiscal consolidation. To impose fiscal discipline, the government aims at reducing the budgetary deficit. As revenues have maintained their momentum from FY 2002, the budgetary deficit is expected to be as low as 90.1 billion baht or 1.6 percent of GDP at the end of the fiscal year. Uncertainty from the Iraq conflict and the SARS outbreak is projected to be short-lived and to have little effect on the fiscal projection.

With regards to public debt, as of the end of December 2002, outstanding public debt was 2.93 trillion baht or 50.47 percent of GDP. Public debt is expected to gradually come down as the government deficit reduces.

The government has realized the importance of fiscal sustainability in the medium term. It is publicly committed to realize a balanced budget by FY 2008, although it is highly likely that it will be able to close the deficit gap earlier. The government is also committed to keep the public debt to GDP ratio below 60 percent while debt servicing in the budget would not be higher than 16 percent.

MONETARY POLICY

Thailand continued to operate an accommodative monetary policy in order to maintain supportive economic conditions. In 2002, the Bank of Thailand (BoT) reduced the 14-day repurchase rate, a policy instrument, twice, from 2.25 percent to 2.00 percent in January and from 2.00 percent to 1.75 percent in November 2002.

As the inflation rate still remained low, there was no negative effect to further easing monetary policy to safeguard against uncertainties in economic conditions and support the growth process in 2003.

MEDIUM-TERM ECONOMIC OUTLOOK

In the medium-term (2004–06), the government has set the macroeconomic framework, including an economic growth rate of 5.5 percent per annum and an inflation rate of no greater than 2.4 percent per annum.

Economic growth in 2004–06 will be supported by the improved exports due to more favorable world economic and trade conditions. Private investment should pick up more firmly once problems in the financial sectors are resolved. One crucial factor supporting growth will be an improving productivity, which will enhance the economy’s competitiveness and increase investment efficiency. Meanwhile, private consumption will expand in line with improving income and better consumer confidence in economic prospects. Inflation will pick up to 205 percent by the end of the Ninth Plan as a result. As the economy grows at a faster rate, the current account surplus will get smaller, due mainly to the demand for imported capital goods. Although the current account will be in deficit from 2005, overall economic stability will be maintained.

The budget deficit will be gradually reduced as the business/private sector becomes more vitalized and market conditions encourage the business/private sector to play a leading role in improving the economy. The reduced budget deficit will help boost public confidence in the government’s effort to adhere to fiscal sustainability and thereby reducing public debts during the Ninth Plan.

Medium-Term Trend

	1999	2000	2001	2002	2003	2004-2006
Real GDP growth (%)	4.4	4.6	1.9	5.2	5.1	5.0-5.5
Private investment (%)	-3.3	16.8	4.7	13.3	12.6	9.0
Export value (% $US)	7.4	19.5	-6.9	5.7	10.7	8.0
Gross Domestic Product						
Billion Baht	4,637.1	4,916.5	5,123.4	5,430.5	5,673.0	6,592.7
Billion $US	122.5	122.4	115.2	126.3	131.9	153.3
Current account (% of GDP)	10.1	7.6	5.4	6.0	4.8	-0.4
Per capita income						
Baht per year	75,223.9	78,891.2	81,407	85,794	89,156	101,425.7
$US per year	1,987.9	1,964.3	1,829.4	1,995.0	2,073.4	2,529.8
Inflation (%)	0.3	1.5	1.6	0.7	2.3	2.4

Sources: National Economic and Social Development Board (NESDB); Ministry of Finance

THAI ASSET MANAGEMENT CORPORATION AND FINANCIAL REFORMS

The health of Thai financial institutions has been improved as the government has implemented several measures to restructure and strengthen the troublesome financial sector. The capital adequacy of the banking sector stays at a satisfactory level, with 14 percent of risk-weighted assets of which more than 8 percent is Tier 1 capital. In addition, non-performing loans have declined from their peak at 47 percent of total outstanding loans in 1999 to 10.3 percent at the end of 2002. Apart from the banks' own NPLs dealing, the Thai Asset Management Corporation (TAMC) has greatly contributed to the sharp reduction of NPLs in banking system as a large portion of NPLs has been transferred to the TAMC since July 2001.

The establishment of the TAMC, a centralized government AMC, aims at alleviating the problem of excessive non-performing loans efficiently. TAMC purchases bad loans from state-owned and private financial institutions and AMCs, then take the lead in dealing with non-performing assets, in particular the multi-creditors loan cases, and related corporate restructuring activities. This will reduce the pressure on commercial banks in dealing with the bad loans as well as making additional provision for further impairment of the assets. The banks could then be in good shape to provide new lending, thus supporting the economic expansion in the near future. As of December 2002, the total number of debtor cases transferred to the TAMC amounted to 5,524 cases, with a book value of 759.4 billion baht or 57 percent of total assets to be transferred. In addition, 2,209 cases with 501.4 billion baht (book value) of loans, about 66 percent of total transferred loans, have been concluded.

The government has planned to gradually privatize the four existing state-owned commercial banks. The plan to privatize two of four state-owned banks is expected to be concluded in the near future, while the other two banks were merged and the privatization plan is being formulated.

Several legal infrastructures such as the Central Bank Act Amendment draft and Financial Institution Act draft have been prepared to consolidate more comprehensive financial institution supervision.

CAPITAL MARKET DEVELOPMENT

In 2002, the Stock Exchange of Thailand (SET) was prospering due to the continuous economic recovery and political stability. The SET index recorded 356.48 points at the end of the year, an increase of 17.3 percent compared to 303.85 points in 2001. Total turnover value in the SET increased significantly to 2,047,442.23 million baht, up by 22.94 percent from the previous year.

The SET index for the first five months of the year 2003 recorded at 403.82 points with total turnover value of 673,992.76 million baht. The trading on the SET for the beginning of the year was volatile due to the war in Iraq and SARS epidemic. However, the positive outlook will support the SET Index's remaining stable at the current level.

Regarding the Thai Capital Market Master Plan launched on January 2002 in order to reinforce the strength of Thai capital market and increase its role as the alternative sources of fund for investor, many measures have been implemented while others are in the making. There are four significant measures contributing to the capital market development. Firstly, the government established the National Committee on Corporate Governance to set the policy framework for good governance and help promote good corporate governance. The evaluation and rating for good corporate governance is to be introduced to all market-related organizations as well. Secondly, to increase the quantity and quality of products on the market, a committee was set up and many tax incentives were provided to encourage the qualified companies to list on the SET and MAI. They are also in the process of enacting laws and regulations to support the launch of new products. At the same time, the government aims to expand the demand side by promoting the appropriate understanding of investment and risk management in capital markets to all related participants. Thirdly, the intermediary institutions have been encouraged to operate more effectively, with high quality and international competitiveness. Moreover, the government has a policy to extend the scope of business operations and to consider the rating guideline for financial intermediaries. Lastly, the SET has greatly developed the trading system to respond to all investor groups, and set up an information connection among the related agencies called "Information Portal". As a result, the progress of the Thai capital market Master Plan, together with the improved economic conditions, will certainly support the growth of the capital market throughout 2003.

STRUCTURAL REFORM

During the past years, Thailand, like other economies throughout the world, has been influenced by the impact of globalization and technological development. Competition for international investment and economic growth increased external pressures for structural reform in Thailand. Therefore, Thailand has undertaken essential structural reforms in several areas.

First of all, bureaucratic reform in Thailand has been reshaped and downsized to increase its efficiency and effectiveness. There are two major aims that characterized the direction of bureaucratic reform: to modernize and improve the efficiency the civil service system by restructuring government organizations; and restricting the number of government officials. In addition, changes were made to improve the quality and ethical values of civil servants by reformulating personnel recruitment to attract the most competent individuals into the service. This reform can improve efficiency and streamline the governmental structure in line with the current situation and to enable the public sector to better serve national economic and social development. At the same time, accelerating the enactment of legislation to facilitate bureaucratic restructuring can help to keep up with the global trends as well as changes in social and economic situations.

Decentralization policy is another reform that Thailand has adopted during the past year. This policy basically emphasizes local revenue collection and the decentralization of fiscal power to local authorities in order to achieve budget management that is more independent, and takes into consideration the needs (and appropriateness for development) of the locality. After the decentralization policy has been used, responsibilities of local authorities would range from the decision-making process, policy formulation, and procurement, to the appointment and removal of the local authorities, for the sake of transparency and efficiency as well as in response to the needs of the local people. As a result of the decentralization policy, local authorities will have greater independence with regard to local budget management and allocation, income acquisition, and management of local properties.

Besides the administrative reforms in Thailand, tax reform measures have been implemented to upgrade the Thai tax system to an international standard. Income taxes have been reformed toward lowering the tax burden and simplifying compliance in line with other regional economies. The value added tax (VAT) refunds and duty drawback from exports have been further accelerated so the exporters receive money back in due time. Furthermore, the tariff structure has gradually undergone further rationalization in view of global trade liberalization and the realization of the ASEAN Free Trade Area (AFTA). The tax restructuring has led to reduce productivity costs, thus enabling Thai industries to better compete in the global market.

Thai government has also emphasized the importance of restructuring corporate governance. In 2002, the “Good Corporate Governance Campaign” was initiated with the objective to create a transparent investment environment in Thailand. So far, new laws and regulations have been enacted covering investments, the system of property ownership for non-residents, and new taxation schemes. In addition, all these practices are geared toward the promotion of transparency and disclosure of information to improve the quality of Thai capital market participants and foreign investment.

In conclusion, the Thai government is confident these fundamental reforms will ultimately enhance Thailand’s economic growth and competitiveness.

Annex I

THAILAND: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in US$ billion)	150.8	111.8	122.5	122.4	115.2	126.3
Real GDP	-1.3	-10.5	4.4	4.6	1.9	5.3
Consumption						
Private Consumption	-1.4	-11.5	4.3	4.9	3.7	4.7
Government Consumption	-2.8	3.9	3.1	2.6	2.9	0.5
Investment						
Private Investment	-30.4	-52.3	-3.3	16.8	4.7	13.3
Government Investment	10.2	-28.7	-3.1	-9.7	-5.5	-6.8
Exports of Goods and Services	7.2	8.2	9.0	17.5	-4.1	10.9
Imports of Goods and Services	-11.3	-21.6	10.5	27.3	-5.5	11.3
Fiscal and External Balance (percent of GDP)						
Budget Balance (Cash basis)	-1.3	-2.5	-2.8	-2.3	-2.6	-2.9
Merchandise Trade Balance	-4.6	12.2	9.3	5.5	2.5	3.5
Current Account Balance	-3.1	14.4	12.4	9.3	6.2	6.1
Capital and Financial Non-reserve Assets Balance	-4.3	-9.7	-7.9	-10.2	-5.0	-4.7
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	4.3	9.2	-4.0	1.3	2.2	0.8
CPI	5.6	8.1	0.3	1.5	1.6	0.6
M2	4.3	4.7	4.8	5.0	5.2	5.3
Short-term Interest Rate (percent)	22.36	13.59	1.48	1.8	2.07	1.98
Real Effective Exchange Rate (level, 1997=100)	100	89.63	92.31	88.92	84.55	86.33
Unemployment Rate (percent)	2.2	4.4	4.2	3.6	3.2	2.2
Population (millions)	60.35	61.17	61.78	62.40	62.93	63.46

Sources: 1. National Economic and Social Development Board (NESDB)
2. The Ministry of Labor and Social Welfare.
3. Bank of Thailand

Annex II

THAILAND: FORECAST SUMMARY (percent change from previous year)

	2002						2003					
	Official	**IMF**	**ADB**	**OECD**	**PECC**	**Link**	**Official**	**IMF**	**ADB**	**OECD**	**PECC**	**Link**
Real GDP	5.2	3.2	3.7	N.A.	N.A.	N.A.	4.5-5.5	5.0	4.2	N.A.	N.A.	N.A.
Exports	5.7	1.8	N.A.	N.A.	N.A.	N.A.	9.5	6.0	N.A.	N.A.	N.A.	N.A.
Imports	4.6	2.9	N.A.	N.A.	N.A.	N.A.	11.5	9.1	N.A.	N.A.	N.A.	N.A.
CPI	0.7	1.7	N.A.	N.A.	N.A.	N.A.	1.6	1.4	N.A.	N.A.	N.A.	N.A

Annex III

THAILAND: MEDIUM-TERM TREND FORECAST (percent)

	Period*
Real GDP	5.0-5.5
GDP Deflator	2.4

Sources: National Economic and Social Development Board (NESDB) as of June 16, 2003.
Ministry of Finance

UNITED STATES OF AMERICA

INTRODUCTION

The US economy has expanded since the end of the 2001, albeit at a slower pace than in a typical recovery. However, the economy now appears poised for an extended period of strong growth accompanied by falling unemployment, rising living standards, low inflation, and moderate interest rates. Signals coming from a growing number of forward-looking indicators are reinforcing this view, which is shared by the Blue chip consensus of private sector forecasters.

Forecasters are recognizing, and markets are responding to, recent fiscal and monetary stimulus, the favorable underlying fundamentals of low inflation and strong productivity growth, and to the waning of negative influences on the economy. The quick and successful conclusion to the war with Iraq has lifted the pall of uncertainties that weighed on consumer and business long-term decision making. Consumer and investor confidence, badly shaken as geopolitical tensions mounted earlier in the year, has recovered. The stock market, which has been on an upward trend since March, is once again adding to, rather than reducing, household wealth.

Fiscal and monetary policies are focused on quickly returning the economy to sustainable, strong growth. The recently enacted fiscal relief package will boost consumer and business spending and will augment the United States' long-term growth potential. The monetary authorities have also indicated their desire to stimulate growth and provide insurance against the possibility of deflation. In June, the Federal Reserve reduced its target federal funds rate by 25 basis points to 1 percent, the lowest level since 1958.

The administration's economic projections for the mid-session review show growth increasing sharply beginning in June, leading to more jobs and rising incomes. This projection assumes the economy will be free of significant, new negative economic shocks.

A stronger economy seems likely given the powerful, positive forces at work and the fading of the negative factors that have held the economy back recently. However, predicting the exact timing of the shift from moderate to stronger growth is always problematic and might come later than forecast. The administration's economic projection balances the upside possibilities and downside risks and thus provides a prudent basis for forecasting the budget outlook.

POLICY ACTIONS

Fiscal Policy: In response to the sub-par expansion experienced to that point, the president's February budget proposed substantial tax relief for the American people. On 28 May, the president signed the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) which included all the key features of the president's proposal. The act accelerated many of the tax reductions passed in the 2001 Economic Growth and Tax Relief Reconciliation Act (EGTRRA) that were scheduled to take effect several years from now. The 2003 jobs and growth tax cut also reduced the tax rate on dividends and capital gains; and on the business side, it temporarily increased incentives designed to speed up investment.

The key provisions of 2003 act that will help propel the economy into self-sustaining growth include:

- Lower marginal income tax rates retroactive to January 2003;
- An increase in the alternative minimum tax (AMT);
- A reduction in the maximum tax rate on dividends; and
- A reduction in the maximum tax rate on net capital gains.

On the business side, the 2003 jobs and growth tax cut:

- Increased the bonus depreciation on qualified new investment to 50 percent from the 30 percent. This provision applies to new capital put in place by 1 January 2005; and
- Raised to US$100,000 from US$25,000 the maximum amount of new investment that can be expensed by small businesses. This provision applies to new capital put in place by the end of 2005.

Temporary expensing lowers the after-tax cost of acquiring new capital and thereby provides a stimulus to new investment when it is most needed to help achieve a self-sustaining expansion. All told, the business tax relief is estimated to be US$13 billion during the second half of this calendar year, of which US$10 billion will flow through corporations; business tax relief will total about US$49 billion in calendar year 2004 of which about US$37 billion will flow through corporations.

In addition to stimulating demand, many of the tax reductions enacted in the 2003 act will ease tax restraints on economic activity, thereby accelerating economic growth in the near-term, and raise the long-term level of economic activity:

- Reductions in marginal tax rates will reduce the disincentives facing individuals to work more, to earn more, to save more, and to invest more.
- Lower tax rates on dividends and capital gains will lower the after-tax cost of new investment and thereby lead to a higher rate of investment.
- Lower tax rates on dividends and capital gains will also reduce the distortions in the pattern of investment across economic sectors generated by the tax system so that the composition of this investment will be more appropriate, and therefore more productive.
- The reduction in the capital gains tax will encourage the relatively high risk, forward-looking investments that help sustain a vibrant economy.
- The tax rate reductions and the reductions in the taxes on dividends and capital gains will also combine to raise asset values across the economy. The existence but not the extent of this wealth effect is certain. Whatever the magnitude, the effect on the economy is to provide an additional source of stimulus. For both individuals and businesses, rising asset values will improve balance sheets. For individuals this can mean increased consumption levels; for businesses a stronger balance sheet may mean lower borrowing costs or greater flexibility to take advantage of new business opportunities.

In addition to those provisions already described, other provisions of the 2003 jobs and growth tax cut will further contribute to higher household after-tax incomes and further strengthen the economy. They include:

- An increase in the child tax credit to US$1,000 for 2003 and 2004; and
- A reduction in the marriage penalty.

The tax relief in the 2003 jobs and growth tax cut was front-loaded to provide the maximum boost to the economy when it is needed the most. During the second half of calendar year 2003, it is estimated the Jobs and Growth Act will lower individual and corporate net tax payments by a combined total of nearly US$50 billion, and during calendar year 2004 by about US$146 billion. On a fiscal year basis, during the six years 2003 through 2008 the act is estimated to provide a total of US$253 billion in tax relief, and during 2003–13 a total of US$268 billion. In addition, it provides US$20 billion in grants to states over FY 2003 and FY 2004.

The boost to household after-tax income from the 2003 jobs and growth tax cut will be substantial during the second half of 2003, providing about US$40 billion in tax relief. That, in turn, will boost consumer spending and saving. The increased consumer spending will help the economy maintain its momentum as businesses ramp up their investments in new plant and equipment. And the additional saving will improve household balance sheets and enable families to increase spending in the future.

Monetary policy: Very low inflation has enabled the Federal Reserve to pursue a monetary policy that provides the economy with additional stimulus. In November, the Federal Open Market Committee (FOMC) lowered its target federal funds rate from 1.75 percent to 1.25 percent. At its May meeting, the committee signaled its willingness to make further cuts to this already-low rate in the future. In response, interest rates, especially at the long end of the maturity spectrum, fell sharply. At its meeting in June, the committee reduced the funds rate to 1 percent. This was the thirteenth cut since the start of 2001when the rate stood at 6.5 percent.

Interest rates fell during the first half of this year in response to the weaker-than-expected economy and indications from the FOMC that monetary policy was focused on stimulating activity and avoiding deflation. The 3-month Treasury bill rate dropped from 1.2 percent in December to below 1 percent in late June. Rates declined even more at the longer end of the maturity spectrum. The yield on the 10-year Treasury note fell from 4.1 percent in December to 3.6 percent by the end of June. The last time long-term Treasury rates were this low was in the late 1950s. Long-term corporate bond yields also declined this year, reaching their lowest levels since the mid-1960s, and mortgage rates fell to the lowest levels since the late 1950s. Partly in response to the FOMC's actions, the money supply (M2) grew at an 8.7 percent annual rate during the first six months of 2003, up from 7.4 percent during the prior half year. More recently mortgage and 10-year treasury rates have increased roughly a percentage point from their late-June lows as signs of strength have emerged thus far in the third quarter.

RECENT DEVELOPMENTS

Real gross domestic product (GDP) grew at a 1.4 percent annual rate in the fourth quarter of 2002 and in the first quarter of 2003. The advance estimate (subject to revision) shows second-quarter growth picking up to a 2.4 percent annual pace. Growth in this neighborhood is well below the rate needed to stimulate robust business investment in new plant and equipment and to create sufficient new job opportunities for unemployed workers and entrants into the labor force.

There are gathering signs, however, that faster growth is in the offing. The Index of Leading Indicators rose 0.5 percent during the first 6 months of the year with the strongest signals coming from the rise in the stock market.

Elsewhere, there are further indications of an improving economy. Purchasing managers in manufacturing reported an increase in activity in July after four months of decline. In the non-manufacturing sector, purchasing managers reported a strong increase in activity in July. Business fixed investment grew at a 7 percent annual rate in the second quarter. *Business inventories* are lean compared with sales, suggesting that a pickup in overall final demand would be augmented by a rebuilding of inventories.

In the *labor market*, private sector employment continued to contract through July as rapid productivity growth allowed increased production demands to be met with a smaller workforce. The absence of job creation pushed the unemployment rate up to 6.2 percent in July compared with an average 5.9 percent in the fourth quarter. The labor market usually is a lagging indicator when economic activity picks up because businesses typically try to meet increased production demands with their existing workforce before hiring new workers. The rise in unemployment underscores the difficulties in predicting when an economic acceleration will take hold, and it underscores again the need for the recent fiscal and monetary policy actions designed to hasten that acceleration.

Consumer spending, which accounts for two-thirds of GDP, continues to underpin overall activity. Real consumer expenditures rose at a 2.7 percent annual rate in the first half of the year. Consumers continue to be willing to make big-ticket purchases, such as motor vehicles, boosted by widespread discounts and inexpensive financing incentives.

*Home sale*s remain at record levels, and these in turn have boosted consumer spending on furniture and appliances. In the second quarter, new home sales reached the highest level on record. Extraordinarily low mortgage rates have helped make home buying more affordable to the average family than at any time in the past three decades. The low rates have also enabled homeowners to refinance their higher-rate older mortgages through June. But refinancing activity waned in July reflecting the effects of higher mortgage rates.

Government spending on consumption and investment has been mixed. Because of the war with Iraq, federal defense spending increased 10 percent (not annualized) in the second quarter. At the state and local level, spending edged down slightly in the first half as these governments continued to cope with unexpected shortfalls of receipts and widening budget deficits.

Declining *net exports* have restrained overall growth for some time. Although the dollar has declined for the past year and a half, the positive effects of this on US exports have been more than offset by much faster growth in the US than in our trading partners. Consequently, our imports adjusted for inflation have grown more rapidly than our exports. Net exports continued to deteriorate in the first half. The dollar declined 7 percent against our major trading partners during 2002 and fell another 8 percent during the first seven months of 2003. At some point, the dollar's depreciation will help make US producers more competitive at home and abroad.

Inflation drifted lower during the first half of 2003, despite a short-lived surge in energy prices that occurred in the months leading up to the Iraq war. During the first 6 months of 2003, the overall consumer Price Index (CPI) rose at a 2.2 percent annual rate, down from 2.4 percent during 2002. Energy prices rose 15 percent during the first 6 months. Excluding the volatile food and energy components, the "core CPI" rose only 0.9 percent, down from 1.9 percent last year. Most of the rise in the CPI during 2003 was accounted for by rising service sector prices. Prices of non-food, non-energy goods in the CPI fell from December to June. While low inflation is desirable, inflation that is too low—or outright deflation—may be harmful. The pickup in economic activity expected in the coming months will help minimize the risks of deflation in the United States.

REVISED ECONOMIC ASSUMPTIONS

The economic assumptions for the mid-session review (MSR), summarized in Table 1**,** differ from those published about 6 months ago with the administration's 2004 budget in that they incorporate the fiscal, monetary, and economic developments discussed above. During the second half of this year, and into 2004 and 2005, growth is now projected to be somewhat stronger than anticipated earlier, while inflation and interest rates are now projected to be lower.

The unemployment rate is slightly higher in the near term than in the budget consistent with the higher current level. During the outyears, the mid-session review and budget forecasts of the key economic variables are quite close. The revised assumptions are very similar to those of the Blue chip consensus of private sector forecasts.

Real GDP, Potential GDP and Unemployment: Real GDP during the four quarters of 2003 is expected to rise 2.8 percent compared with 3.4 percent in the budget. All of the downward revision reflects the weaker-than-expected growth during the first half of this year; during the second half of 2003, projected growth in the MSR is stronger than in the budget. During 2004 and 2005, growth is now projected to be slightly higher than in the budget, reflecting the favorable effects from the 2003 jobs and growth tax cut and the lower interest rates. In the outyears, growth is expected to be 3.1 percent per year, the same as in the budget and equal to the administration's estimate of the United States' potential growth rate.

The unemployment rate is expected to decline to 5.1 percent by 2007, and remain at that low level. The administration estimates this level of the unemployment rate to be consistent with stable inflation. It is also the same as the blue chip private-sector consensus long-run, sustainable unemployment rate.

Inflation: As measured by the consumer price index, inflation during the four quarters of 2003 is projected to be 1.9 percent, about the same as in the budget. Inflation during the first quarter was higher than expected, largely due to the surge in energy prices, but for the year this is about offset by the subsequent decline in oil prices and consequent lower inflation. For the next few years, inflation is projected to be slightly below that anticipated in the budget because of the current very low inflation rate. Even as the expansion gathers momentum, the excess slack in labor and capital markets is likely to keep inflation under control. In the outyears, the CPI is projected to rise 2.3 percent per year; the broader GDP price index is projected to rise 1.8 percent yearly. These are the same inflation rates as in the budget.

Interest rates: Reflecting the recent cuts in the federal funds rate and the moderate growth in the economy, interest rates are currently significantly lower than anticipated in the budget. As economic activity picks up and private credit demand increases, rates are expected to rise. By 2008, the 91-day Treasury bill rate is expected to reach 4.3 percent, up from 0.9 percent at the end of June. The yield on the 10-year Treasury note is projected to rise to 5.3 percent by 2008, up from 4 percent in late July. These outyear rates are very close to those in the budget and are generally consistent with the interest rate expectations implicit in the yield curve.

Table 1: Economic Projections for the United States

		2002	2003	2004
Real GDP growth				
year-to-year	Official	2.4	2.3	3.7
	Blue Chip Consensus (July)	2.4	2.3	3.7
Q4 to Q4	Official	2.9	2.8	3.7
	Blue Chip Consensus (July)	2.9	2.7	3.7
GDP price index				
year-to-year	Official	1.1	1.6	1.2
	Blue Chip Consensus (July)	1.1	1.6	1.5
Q4 to Q4	Official	1.3	1.5	1.3
	Blue Chip Consensus (July)	1.3	1.6	1.6
Unemployment Rate				
	Official	5.8	5.9	5.6
	Blue Chip Consensus (July)	5.8	6.0	5.8
3-month Treasury bill rate				
	Official	1.6	1.2	2.0
	Blue Chip Consensus (July)	1.6	1.0	1.6
10-year Treasury note rate				
	Official	4.6	3.7	4.1
	Blue Chip Consensus (July)	4.6	3.7	4.3

VIET NAM

After some years of reducing growth rates due to the world-wide economic depression and the Asian financial crisis, since 2000 the economy of Viet Nam has recovered.

It is a notable point that GDP growth rate was only 4.8 percent in 1999, but it increased almost to 7.0 percent per year in the period 2000–02.

As it was in 2001, Viet Nam's GDP growth rate in2002 was relatively higher than most East Asian economies, ranked next to China's. Specifically, GDP growth rate in2002 reached 7.0 percent, which was contributed to by the industry and construction sector (3.4 percent), the agriculture sector (0.9 percent) and the service sector (2.7 percent). The largest contributor to GDP growth rate, the industry and construction sector still maintained its high growth rate at 9.4 percent. The agriculture sector's growth rate was 4.1 percent and growth in the service sector was 6.5 percent.

In recent years, the economy has been increasingly stable, the living standard has risen, and the investment environment has been gradually improved. Thus, it is estimated that forecasts for the coming years will be optimistic.

REAL GROSS DOMESTIC PRODUCT

In the period of 1996–2000, Viet Nam's annual GDP growth rate was about 7 percent. There had been a declining tendency in the economic growth in 1998 (5.8 percent) and 1999 (4.8 percent). However, there was a sign of recovery: the GDP growth rate increased from 4.8 percent in 1999 to 6.8 percent in 2000, and that rate was maintained in 2001 (6.8 percent) and in 2002 (7.0 percent). Viet Nam's medium-term growth is expected to remain robust and be sustained, as domestic demand continues to be expanded. GDP is projected to reach 7.3 percent in 2003 and should be higher, about 7.5 percent, in coming years.

Consumption is one of the most important factors contributing to the growth of an economy. In the period of 2000–02, there was a satisfactory total final consumption growth in Viet Nam. After three years of continuous decreases (5.7 percent in 1997, 4.3 percent in 1998, and 1.8 percent in 1999), consumption growth rates began to increase: in 2000 growth was 3.2 percent; in 2001it was 4.6 percent and in 2002 it reached 5.8 percent, all really significant increases. The private consumption rate has also increased since 2000 (3.1 percent), 2001 (4.5 percent) and achieved a high rate in 2002 (5.8 percent). The growth rate in government consumption was 5.0 percent in 2000 and reached 5.5 percent in 2001 and 2002.

Total investment over the period of 2000–02 increased slightly (10.1 percent in 2000, 10.3 percent in 2001, and 10.6 percent in 2002). The 2000–02 growth rate was quite impressive compared with the rate in 1999 (1.2 percent). This high growth rate of investment played an important part in stimulating domestic demand. Investment growth was also the main source of GDP growth in recent years. IN particular, private investment increased by 13.2 percent in 2000, 8.5 percent in 2001, and 10.1 percent in 2002. Government investment was 7.9 percent in 2000, 11.6 percent in 2001, and 11.0 percent in 2002.

2001 showed a great decline in Viet Nam's exports and imports. The export growth rate of goods and services was 25.5 percent in 2000, 3.8 percent in 2001, and 11.3 percent in 2002. The growth rate of imports was 33.2 percent in 2000, 3.4 percent in 2001, and 19.4 percent in 2002.

Based on Viet Nam's economic statistics, some major economic features in 2003 are projected as follows:

- GDP will grow at 7.3 percent
- Exports’ growth will be 14 percent to 15 percent
- Imports’ growth will be 15 percent to 16 percent
- CPI would be 5.7 percent

Besides these achievements, there were many difficulties, such as weak competitiveness in services sector and the growth rate of imports was much higher than that of exports. There will be many opportunities but also many challenges for Viet Nam to deal with in coming years.

INFLATION

The CPI was minus 0.6 percent in 2000, 0.8 percent in 2001, and 0.4 percent in 2002. GDP deflator showed 4.0 percent in 2000, 2.1 percent in 2001, and 5.1 percent in 2002.

	1999 (percent)	**2000 (percent)**	**2001 (percent)**	**2002 (percent)**
Total	0.1	-0.6	0.8	0.3
Foods and foodstuff	-1.97	-2.1	1.7	0.3
Beverage	2.61	0.3	1.0	0.7
Garment, shoes and sandals	1.90	0.4	0.7	0.1
Housing and building materials	2.52	4.7	0.8	0.5
Domestic tools and equipment	3.53	2.2	1.0	0.2
Pharmacy	4.15	3.3	-0.1	0.2
Transport, post and communications	1.59	1.7	-4.6	0
Education	3.85	3.9	3.6	0.3
Culture and sports	1.80	1.0	0.2	-0.1
Other services	3.13	4.1	1.2	0.3
Gold	-0.2	23.4	19.4	1.2
USD	1.1	8.4	2.1	0.1

EMPLOYMENT

During ten last years, Viet Nam has achieved a significant reduction in its population growth rate with an average annual growth rate of only 1.7 percent. The population was 77.6 million in 2000, 78.7 million in 2001, and 79.7 million in 2002. The unemployment rate (urban) was 6.4 percent in 2000, 6.3 percent in 2001, and 6.0 percent in 2002.

Poverty (measured by the new standard of food security) now accounts for only 16 percent of the population and this will reduce to less than 10 percent by the year 2005. However, living standards in mountain areas and ethnic groups was very low. The rate of unused working time of labor in rural areas is much higher than the urban unemployment rate. It is a result of low investment in rural areas. Another reason for the increasing the unemployment rate is that more than one million youths enter the labor force each year. In addition, there has been the lack of job opportunities, caused by the reduction in growth rates of production and business.

FOREIGN INVESTMENT

By the end of June 2002, Viet Nam had 3,348 effective FDI projects with a total capital of US$38.58 billion, and disbursement reached more US$20 billion, which contributed significantly to improving the efficiency and competitiveness of the economy. In the industrial sector, FDI has more than 2,100 projects with total capital of more than US$20 billion. In 2002, FDI projects were producing about 13 percent of GDP and 36 percent of industrial gross output and employing 450 thousand workers. However, from 1997, FDI inflow to Viet Nam decreased because, in the main, FDI partners come from East Asia, which was suffering from the financial crisis. FDI inflows in the first half of 2002 fell by 55 percent, to less than US$500 million. In 2000, the national assembly approved the New Revised Law on Foreign Direct Investment with many improved articles including:

- Foreign currency;
- Taxes and import duty;
- Land-use rights and mortgage of land-use rights;
- Management of joint venture companies; and
- Approvals and licensing.

In July 2000, the first Securities Trading Center in Ho Chi Minh City was opened and there will be a similar center in Ha Noi. After three years' trading, many experiences have been gained from this new market.

Through conferences, donors have committed to asset Viet Nam US$20 billion. The three largest donors, Japan, the World Bank (WB) and Asian Development Bank (ADB), account for 70 percent of total committed capital. (ODA) disbursement has improved, the total disbursement during recent years reaching US$10 billion. The ODA projects focus on improving the legal framework, human resource training, environmental protection, improvement of economic and social infrastructure, and promotion of development of economic sectors.

EXCHANGE RATE

In last few years, there has been a realignment which depreciated the Viet Nam dollar (VND) and now the VND is about 15,400 VND per 1 USD. The Government of Viet Nam continues implementing foreign exchange controls, export-import controls and control of commercial credit for imports, in order to avoid debt shocks. The government also controls foreign borrowing more strictly, including both government and private borrowing, because it relates to the debt service capacity of the economy.

Medium-Term Outlook

	Items	Unit	2001-2005
1	Annual GDP growth rate	percent	7.5
	Of which:		
	Agriculture, Forestry and Fisheries	percent	4.3
	Industry and Construction	percent	10.8
	Services	percent	6.2
2	Annual growth rate of Gross output of Agriculture, Forestry and Fishery	percent	4.8
3	Annual growth rate of Gross output of Industry and construction	percent	13.0
4	Annual growth rate of Gross output of Services	percent	7.5
5	Annual export of Commodities and Services	percent change	16.0
6	GDP share by sectors in 2005		
	Agriculture, Forestry and Fisheries	percent	20–21
	Industry and Construction	percent	38–39
	Services	percent	41–42
7	Total expenditure	percent change	5.5
8	Domestic saving	percent of GDP	28–30
9	FDI	billion USD	9–10
10	ODA	billion USD	10–11
11	Other investment inflow	billion USD	1–2
12	Total Investment inflow from abroad	billion USD	18–20
13	State Budget Revenue	percent of GDP	20–21
14	State Budget Revenue	thousand billion VND	620.0
15	State Budget Expenditure	thousand billion VND	720–750
16	Total Investment	thousand billion VND	830–850
17	Annual growth rate of Investment	percent	11–12
18	Total investment share of GDP	percent	31–32

STRUCTURAL REFORM

In recent years, Viet Nam has been continuously carrying out the structural reform program that along with economic renovation (*Doimoi*) in order to realize the economy's industrialization and modernisation strategy, and stimulate economic growth, as well as enhance the economy's competitiveness and actively integrate into the regional and international economy. At the beginning of the year 2001, with financial supports from some international organisation such as IMF, World Bank and other donors, the Government has approved the reform programme in seven areas: (1) trade policy; (2) improving the climate for enterprises; (3) reforming state-owned enterprises; (4) strengthening banking system; (5) managing public resources; (6) formulating a legal sector strategy and (7) reforming public administration. The government's program for formulating a legal sector strategy and reforming public administration has been expanded recently. At present, the structural reform program is being continuously promoted in both breadth and depth, as follows:

Integrating into the World Economy

The Government of Viet Nam has adopted a strategy of gradual integration with the world economy. For the coming years Viet Nam has committed—under the Asian Free Trade Area (AFTA), the Bilateral Trade Agreement with the United States (USBTA), and agreements with the World Bank and the IMF—to liberalize its trade and investment rules, abolish quantitative restrictions on all but five items, lower tariffs and gradually develop the transparent, rules-based trading and investment system that will be required for later entry into the WTO.

These trade policies will lead the way for a greater influx of new ideas, technologies, and opportunities for Vietnamese companies, and contribute to an increasingly competitive economy, in which productive investments generate new jobs by making the most of Viet Nam's comparative advantages.

Improving the Climate for Enterprise

With the resolution of the fifth party plenum on private sector development in March this year, the government has strongly reiterated its intention of making Viet Nam a truly mixed economy, with equal treatment of private, foreign and state enterprises.

The emergence of a vibrant private sector will be crucial to complement reform measures that are being taken in other areas. The World Bank estimates that if Viet Nam is to attain its long-term growth and employment goals, domestic private investment will need to almost double as a share of GDP over the coming decade. To do this, the climate for private domestic and foreign investors must continue to be improved, as it has been over the past two years.

The number of registered domestic companies has more than doubled since the new Enterprise Law came into effect on 1 January 2000. The non-farm private sector in Viet Nam now provides jobs for around 5 million people, with jobs provided by the "formal" domestic private sector accounting for one fifth of this.

Of the more than 35,000 enterprises that have registered since 2000, around 70 percent are new, while the remainder have moved from the informal to the formal sector. These enterprises have aggregate paid-up capital of VND 40 trillion (US$2.6 billion) equivalent to around 9 percent of Viet Nam's annual GDP. Although the data is highly incomplete experts estimate that employment in the formal private sector has almost doubled since early 2000.

Reforming State-Owned Enterprises

In 2001 the government announced a reform plan for state enterprises for the coming three years. This entails the divestiture of one third of the current 5600 state-owned enterprises (SOEs) as well as measures to make the remaining ones more competitive.

Since the beginning of 2001, a total of 325 enterprises have completed the reform process (including equitizations, sales, liquidations, assignments, and management contracts). Of these, 265 were previously under the direction of provincial and city people's committees, 42 under line ministries, and 18 under general corporations.

The equitization component of the program has proceeded at a slower pace than envisaged. As of May 2002, a total of 248 equitizations have been completed of which 177 were major equitizations where more than 65 percent of shares have been sold to non-state shareholders.

A further 190 SOEs are at various stages of the process. These include 156 equitization projects, 21 assignments, 7 sales, 4 management contracts, and two mergers. The elapsed time from the decision to equitize, i.e., setting up of an SOE Reform Committee, to the registration of the new company averages more than 500 days. The step in the process that takes the longest time is valuation. On average the valuation process takes 177 days. Of the 156 equitization projects in the pipeline, 75 have completed the valuation stage and 29 have started selling shares, as of May 2002.

Strengthening the Banking System

In 2001, the government adopted a comprehensive banking reform program that relies on market-based actions and coordinated implementation of state enterprise reform. The objective of the program is, in the short-term, to ensure the stability of the banking system, and in the medium-to-long term, to promote better mobilization of domestic resources by improving allocation of those resources to commercially viable activities, and expanding banking services throughout Viet Nam.

Implementation of the program is underway. The program has three main pillars: restructuring the joint stock banks; restructuring and commercialization of the State-owned banks; and improving the regulatory framework and enhancing transparency.

Restructuring of Joint Stock Banks (JSBs). The restructuring of non-state joint-stock banks (JSBs) has picked up momentum after a delayed start. As of April 2002, 10 JSBs had been closed or merged, reducing their number to 39. Several JSBs are also being rehabilitated with private shareholders providing additional capital. Four JSBs are under consideration by the State Bank of Vietnam (SBV) for listing on the stock exchange.

Restructuring of State-owned Commercial Banks (SOCBs). Implementation of detailed restructuring plans developed by Vietcombank (VCB), Incombank (ICB), Vietnam Bank for Agriculture and Rural Development (VBARD), and the Bank for Investment and Development (BIDV) are underway. The State Bank of Vietnam (SBV) has issued the decision that would govern the phased and conditional recapitalization of the SOCBs. Several SOCBS have established credit committees and others are in the process of establishing them. Financial audits of the four large SOCBs by international auditors using International Accounting Standards were completed in 2002.

Improving the Regulatory Environment. New rules for classifying non-performing loans (NPLs) consistent with international standards have been issued. The recognition of all NPLs using new rules is expected to be completed this year while the provisioning is expected to be phased. The SOCBs are still in the process of establishing "AMC subsidiaries", which will act as agents for the banks. NPLs will not be transferred to AMCs, rather these will act as consulting firms to the banks to assist with liquidation of collateral. Thus, these are not AMCs in the traditional sense with independent commercial incentives for loan recovery.

Managing Public Resources Better

As identified in the CPRGS, improved public spending management is an important instrument to reach marginalized groups who do not directly benefit from overall economic growth. In addition, fiscal transparency is vital for accountability to citizens for the use of public resources and accountability for the quality of overall public expenditure management.

Over the past five years, Viet Nam has implemented significant improvements in public expenditure management and in transparency of public spending–for example, by enacting the Budget Law in 1997 and removing the secrecy of budgetary information in 1999. Following the first joint Government-Donor Public Expenditure Review in 2000 (PER-2000), the government adopted, in 2001, a comprehensive program to strengthen public expenditure management. The aim is to improve comprehensiveness, consistency and transparency of budgetary information as well as equity and efficiency of public spending.

Formulating a Legal Sector Strategy

Viet Nam has announced that it plans to renew and modernize its legal framework to support the transition from a centrally planned to an open economy with equal opportunity for all. A well-functioning economy requires a legal system which clearly defines and effectively enforces legal rights, creates a “level playing field” for citizens and enterprises and is easily accessible to all–including the poor.

Much has been achieved during the past 10 years, and Viet Nam's legal system has continued to be the subject of rapid and dramatic change including vigorous implementation of the Enterprise Law: formation of a presidential-level judicial reform commission; and passage of a new law on organization of the courts which transfers local court administration from the government to the Supreme People's Court–a step agreed by experts to be essential to establishing the independence of courts and the rule of law.

Reforming Public Administration

A Master Program for Public Administration Reform (PAR) was approved by the prime minister in September 2001. It consists of four components: organizational restructuring; human resource reforms; institutional development; and public financial management reform. The vision is a more accountable, transparent, participatory and predictable public administration in Viet Nam.

The PAR Steering Committee, chaired by the Prime Minister, was established in late 1998. In 2000–01, the steering committee undertook a comprehensive review of public administration issues to find ways to accelerate the pace of reforms and bring PAR in line with economic and social reforms. The conclusions of this review formed the background for the current PAR Master Program.

All ministries have submitted annual PAR plans for 2002 to the prime minister. Drafts of five of the seven national programs were discussed at a workshop in Ha Noi in April 2002. Drafts have not yet been prepared on salary reform and downsizing. Progress in these two areas has been slower than in the other five. More analytical work and clearer responsibilities are needed in these areas.

Foreign Exchange Market

In 2001, the exchange rate of the VN dollar *vis-à-vis* the US dollar experienced an upward trend but unevenly. During the first four months, the rate depreciated by a modest amount (0.09 percent per month on average) and did not experience any fluctuations thanks to fairly stable supply and demand in the inter-bank foreign exchange market. From May to July, exchange rate increased strongly by 0.86 percent per month on average (with the exception of 1.24 percent in June alone). The strong depreciation in those months was mainly fuelled by the depreciation of regional currencies and others (Thai baht, Indonesian rupiah, Singapore dollar, euro and Japanese yen and so on), pressing for a decrease in VN dollar value. In addition, there were other reasons such as upward demand in foreign currency for import payments, and the deterioration of export earnings as a result of shrinking prices of Viet Nam's major export items in international markets. This trend was worsened by the expectation of the public and enterprises of further depreciation in the context of declining deposit rates in Viet Nam, which caused people to withdraw savings in VN dollars to convert into US dollar holdings.

From August to end-2001, the exchange rate depreciated at a slower pace than in May, June and July. As of 31 December 2001, the exchange rate had depreciated by 3.9 percent compared to end-2000; depreciating 0.19 percent per month on average in the last 5 months of 2001. During the last months of the year, in the context of further rate cuts by the US Federal Reserve, commercial banks in Viet Nam continued to lower interest rates in US dollars, thereby easing pressure for depreciation of the VN dollar.

During 2002, the VN$/US$ exchange rate in the inter-bank market crept up just 1.98 percent over months, significantly lower than the 3.9 percent change in 2001. In the meantime, domestic inflation rate was 4 percent while inflation rate in the US was 1.6 percent per year. This indicated a US$ depreciation against the VN$. This depreciation was attributable to the relative depreciation of US against the euro and some other hard currencies. Further more, demand for US dollars did not increase as the US dollar interest rate was considerably lower than that of the VN dollar. Additionally, a sweeping availability of overseas Vietnamese remittances and enlarging foreign currency-denominated loans subdued the foreign currency funding constraints that have been caused by the notable trade account deficit.

Progressive Structural Reform

In recent years, Viet Nam has been continuously carrying out the structural reform program that along with economic renovation (*Doimoi*) in order to realize the economy's industrialization and modernisation strategy, and stimulate economic growth, as well as enhance the economy's competitiveness and actively integrate into the regional and international economy. At the beginning of the year 2001, with financial supports from some international organisation such as IMF, World Bank and other donors, the Government has approved the reform programme in seven areas: (1) trade policy; (2) improving the climate for enterprises; (3) reforming state-owned enterprises; (4) strengthening banking system; (5) managing public resources; (6) formulating a legal sector strategy and (7) reforming public administration. The progressive structural reform of Viet Nam (stands in seven areas) is briefly as follows:

The Government of Viet Nam has adopted a strategy of gradual integration with the world economy. For the coming years Viet Nam has committed—under the Asian Free Trade Area (AFTA), the Bilateral Trade Agreement with the United States (USBTA), and agreements with the World Bank and the IMF—to liberalize its trade and investment rules, abolish quantitative restrictions on all but five items, lower tariffs and gradually develop a transparent rules based trading and investment system that will be required for later entry into the WTO.

With the resolution of the fifth party plenum on private sector development in March this year, the government has strongly reiterated its intention of making Viet Nam a truly mixed economy, with equal treatment of private, foreign and state enterprises.

In 2001 the government announced a reform plan for state enterprises for the coming three years. This entails the divestiture of one third of the current 5,600 SOEs as well as measures to make the remaining ones more competitive.

In 2001, the government adopted a comprehensive banking reform program that relies on market-based actions and coordinated implementation of state enterprise reform. The objective of the program is, in the short-term, to ensure the stability of the banking system, and in the medium-to-long term, to promote better mobilization of domestic resources by improving allocation of those resources to commercially viable activities, and expanding banking services throughout Viet Nam.

Over the past five years, Viet Nam has implemented significant improvements in public expenditure management and in transparency of public spending. In 2001 the government adopted a comprehensive program to strengthen public expenditure management. The aim is to improve comprehensiveness, consistency and transparency.

Viet Nam has announced that it plans to renew and modernize its legal framework to support the transition from a centrally planned to an open economy with equal opportunity for all. Viet Nam's legal system has continued to be the subject of rapid and dramatic change including vigorous implementation of the Enterprise law, formation of a Presidential level judicial reform commission, and passage of a new law on organization of the Courts which transfers local court administration from the government to the Supreme People's Court—a step agreed by experts to be essential to establishing the independence of courts and the rule of law.

A Master Program for Public Administration Reform (PAR) was approved by the Prime Minister in September 2001. It consists of four components: organizational restructuring; human resource reforms; institutional development; and public financial management reform. The vision is a more accountable, transparent, participatory and predictable public administration in Viet Nam.

Table 1: Short-term Interest Rate (percent per annum)

	1997	**1998**	**1999**	**2000**	**2001**	**2002**
Viet Nam	1.13	1.20	1.12	0.88	0.77	0.82

Source: State Bank of Vietnam

ANNEXES

Annex 1: Reform Actions (2001–2002)

2001

- Enhancing the scope for long-term planning among traders by drawing up export and import plans for the period 2001-2005, instead of the hitherto one year schemes (Decision 46/2001 dated 4 April 2001);

- Removing QRs multilaterally on all tariff lines of the following groups of products: liquor, clinker, paper, floor tiles, construction glass, some types of steel, and vegetable oil. (Decision 46/2001 dated 4 April 2001);

- Reducing the foreign exchange surrender requirement from 50 percent to 40 percent (Decision 61/2001/QD-TTg, 25 April 2001);

- Abolishing the quota allocation for rice exports and fertilizer imports (Decision 46/2001/QD-TTg 4 April 2001);

- Moving 713 tariff lines from the Temporary Exclusion List (TEL) to the Inclusion List (IL) (Decree 28/2001/ND-CP);

- Permitting all legal entities (companies and individuals) to export most goods without having to acquire a special license by revising the implementing decree of the Trade law (Decree 44/2001/ND-CP, 2 August 2001);

- Establishing an export support credit sourced from the State Development Assistance Fund, aiming to support enterprises, economic organizations and individuals to promote exports (Decision 133/2001/QD-TTg, 10 September 2001);

- Reducing the number of items that foreign invested enterprises (FIEs) have to export from 24 to 14, including such items as tiles, ceramics, footwear, electric fans, plastic products, and common paints (Decision No. 718/2001/QD-BKH);

- Permitting FIEs to engage in exports of coffee, minerals, certain wood products, and certain textiles and garments (Circular 26/2001/TT-BTM, December 2001);

2002

- Detailing a list of goods and tax rates for implementing the Agreement on the Common Effect Preferential Tariffs (CEPT) Scheme of ASEAN economies for the year 2002. Based on the schedule, 481 items were moved into Inclusion List with tariff lower than 20 percent. To date there are 5558 lines in the Inclusion List, 770 in the Temporary Exclusion List, 53 in the Sentitive Agricultural List and 139 in General Exclusion List (Decree 21/2002/ND-CP, February 2002).

- A government negotiation team has started working sessions on WTO accession in Geneva (April 2002).

Annex 2: Improving the Climate for Enterprise (2001–2002)

2001

- Increasing openness and information by establishing an Enterprise Information Center under MPI on enterprises registered under Enterprise Law (Decision 75/2000/QD-BKH of 28 February28, 2001);

- Approving two build-operate-transfer (BOT) projects in the energy sector: the Phu My 2.2 power plant with EdF led consortium of TEPCO and GEC (US$400 million) and the Phu My 3 combined cycle power project with BP (US$450 million), thereby creating precedents for more BOTs in infrastructure (January. 2001);

- Providing detailed guidelines and listing all necessary documentations for foreign invested enterprises to mortgage land-use rights and assets attached thereto to Vietnamese credit institutions and joint-venture banks (Inter-Circular 772 NHNN/TCDC, May 2001);

- Allowing overseas Vietnamese to hold land-use rights, and decentralizing control and monitoring of land-use rights to enhance the functioning of the real estate market (June 2001);

- Phasing out the dual pricing policy for overseas Vietnamese in aviation fares, electricity, and visa fees (Decision 114/2001/QD-TTg, 31 July 2001);

- Unifying train fares for foreigners, overseas Vietnamese, and Vietnamese nationals as of January 2002 (Decision 114/2001/QD-TTg, 31 July 2001);

- Amending Decree 17 dated 24 March 1999 to improve transparency and legalize the real estate market, by providing official regulations for sale, leas, mortgage and transfer of land-use rights (Decree 79/2001/ND-CP, November 2001);

- Giving overseas Vietnamese the right to own and dispose of property on Viet Nam, provided they have invested in, or otherwise contributed to the economy, or have been invited by the government to take up residence and work in Viet Nam (Decree No.81/2001/ND-CP effective 20 November 2001);

- Recognizing the importance of SMEs by updating the decree to support the development and continued growth of these enterprises by specifying regulations and support mechanisms (Decree 90/2001/D-CP, November 2001).

2002

- Amending the constitution of Viet Nam to provide the private sector: transport, trade, healthcare, telecommunications, industry, environment, and culture; and modify 13 current licenses into conditions to be fulfilled in the following sectors: Internet provision, advertisement, culture, healthcare and medicine (the decision is pending prime ministerial approval);

- Setting-up the website: "Investment Information and Opportunities in Vietnam" (www.khoahoc.vnn.vn/mpi_website) under MPI in partnership with MIGA, to provide timely and clear information to domestic and foreign investors. The site also includes an online investment application facility (January 2002);

- Permitting foreign portfolio investors to remit dividends from investments in domestic securities markets (Document 74/CV-Q1.NH, March 2002).

Annex 3: Reforming State-owned Enterprises (2001–2002)

***2001**

- Establishing a quarterly monitoring system for 200 large, highly-indebted SOEs, and revising a decision to clarify reporting requirements and introducing sanctions against late reporting;

- Issuing government's instruction for moratorium on establishing new SOEs by local people’s committees and line ministries until further notice (Official Dispatch 574/CP of June 25, 2001);

- Establishing the Financial Investment Company under the Enterprises Law, to represent the interests of the state as owner and co-owner of SOEs and issuing decree 63 on transforming SOEs into one-member limited liability companies are steps towards disentangling the complex ties between government and SOEs (October 2001);

- Equitized a total of 194 SOEs.

***2002**

- Allowing managers of equitizing enterprises to purchase shares in excess of the number of shares subscribes by employees, requiring 30 days public notice prior to announcement of equitization, and clarifying potential conflicts between the SOEs Law and the Enterprise Law (Decree expected to be issued by May 2002);

- Issuing Decree 41/2002/ND-CP, April 2002 on the policies toward employees made redundant because of SOE reform.

Annex 4: Strengthening the Banking System (2001–2002)

***2001**

- Providing guidelines for realization, either through sale or seizure of secured property, for recovery of debts by credit institutions (Joint Circular 03/2001, 23 April 2001);

- Simplifying procedures governing deferred L/Cs, by cutting the number of requirements from six to two, effective 10 June 2001;

- Adopting a detailed restructuring plan for the four large SOCBs including annual milestones (i.e., actions and targets) that need to be achieved to obtain phased re-capitalization funds from government;

- -Broadening the scope for financial leasing and improving regulations to create a more attractive operating environment for domestic and foreign leasing companies (Decree 16/2001/ND-CP, 17 May 2001);

- Freeing interest rates on foreign currency lending by banks in Viet Nam and off-shore banks (Decision 718/2001/QD-NHNN, 29 May 2001, and Decision 980/2001/QD-NHNN, 1 August 2001);

- Issuing guidelines for the implementation of the Ordinance on Commercial Paper from 1999, including on the form and language of, and conditions for guaranteeing and pledging commercial paper, and the respective obligations of the different parties to such commercial transactions (Decree 32/2001/ND-CP, 5 July 2001);

- Increasing autonomy of commercial banks by allowing them to set internal systems for clearing payment transactions without state bank involvement, but with state bank permission (Decree 64, 20 September 2001)

- Providing a framework for cross-border payment transactions, recognizing, for the first time, that international practices can be used to govern cross-border transactions if Vietnamese law does not require otherwise (Decree 64 and its implementing decision, 20 September 2001);

- Allowing all joint-venture and foreign banks operating in Viet Nam to take collateral in the form of land from local clients, i.e., in the form of land-use rights and land certificates (Decree 79/2001/ND-CP, effective 16 November 2001);

***2002**

- Establishing a National Register Agency for Secured Transaction under the Ministry of Justice to facilitate transactions by credit institutions and entitling third parties to access information related to secured transactions. The registry opened for business 12 March 2002;

- Enhancing the process for resolution of bad loans by allowing domestic commercial banks and credit organizations to sell collateral backing loans directly in the market at market determined prices instead of going through state-owned agencies (Directive 01/2002/CT-NHNN, January 2002);

- Bringing banking regulations closer to international accounting norms, by stating that should customers fail to repay an installment the entire loan can be accelerated and classified as overdue, and giving banks more discretion in setting interest rates on overdue debt (Decision 1627/2001/QD-NHNN, effective 1 February 2002);

- Permitting banks to make decisions on the terms of any given loan, including domestic banks' lending to foreign borrowers in Viet Nam, such as maturity and interest rate, and generally devize new forms of lending provided they are not forbidden by law, including, for the first time, the possibility of overdraft lending (Decision 1627/2001/QD-NHNN, effective 1 February 2002);

Annex 5: Managing Public Resources Better (2001–02)

2001

- Developing a detailed public expenditure management improvement action plan with a timetable for the next three years.

- Establishing an inter-agency working group to coordinate implementation of PER-2000 recommendations.

- Completing provincial PERs for Ho Chi Minh City and Quang Binh.

- Issuing a revised regulation (Prime Minister’s Decision 182/2001/QD-TTg) on fiscal transparency to allow more budgetary information to be made public and to enforce implementation by lower level of government.

- Initiating pilot development of MTEF for education sector.

- Adopting a decision (Prime Minister's Decision 192/QD-TTg) to expand Ho Chi Minh City's block grant budgeting pilot to other provinces and central agencies.

- Passing an amendment to the constitution to provide a full autonomy to provincial people's councils to approve and allocate its budget.

2002

- Posting, for the first time, budgetary information on the Ministry of Finance’s Website.

- Issuing a decree (Government's Decree 10/2002/ND-CP) on a new financial management mechanism for public service delivery agencies to provide greater degree of autonomy, flexibility and certainty to these agencies in managing their financial resources.

Annex I:

VIET NAM: OVERALL ECONOMIC PERFORMANCE

	1997	1998	1999	2000	2001	2002
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in US$ billion)	28	29.4	28.8	31.2	32.4	34.8
Real GDP	8.2	5.8	4.8	6.8	6.8	7.0
Consumption	5.7	4.3	1.8	3.2	4.6	5.8
Private Consumption	5.9	4.5	2.6	3.1	4.5	5.8
Government Consumption	4.0	3.2	-5.7	5.0	5.5	5.5
Investment	9.4	12.6	1.2	10.1	10.3	10.6
Private Investment	8.6	-0.9	-6.0	13.2	8.5	10.1
Government Investment	10.2	26.5	6.9	7.9	11.6	11.0
Export of Goods and Services	26.6	1.9	23.3	25.5	3.8	11.3
Import of Goods and Services	4.0	-0.8	2.1	33.2	3.4	19.4
Fiscal and External Balances (percent of GDP)						
Budget Balance	4.0	2.5	5.0	5.0	5.0	5.0
Merchandise Trade Balance	-8.6	-7.3	-0.7	-3.7	-3.5	-7.4
Other Economic Indicators (percent change, year over year, except as noted)						
GDP deflator	6.6	8.8	5.7	4.0	2.1	5.1
CPI	3.6	9.2	0.1	-0.6	0.8	4.0
M2	26.1	25.6	39.3	24.0	21.3	23.3
Unemployment Rate - Urban (percent)	6.0	6.9	7.4	6.4	6.3	6.0
Population (million)	74.3	75.5	76.6	77.6	78.7	79.7

Annex II

VIET NAM: FORECAST SUMMARY (percent change from previous year)

	2002			2003		
	Official	**IMF**	**ADB**	**Official**	**IMF**	**ADB**
Real GDP	7.1	5.3	6.2	7.3	6.0	6.8
Exports	10.0	N.A.	8.5	14.8	N.A.	12.0
Imports	19.4	N.A.	10.0	16.7	N.A.	13.0
CPI	4.0	4.1	3.0	5.7	4.0	4.0

ANNEX 1

INDICATORS OF A KNOWLEDGE-BASED ECONOMY

This chapter presents quantitative indicators of development in APEC economies relative to a fully developed knowledge-based economy.

This data was first presented in the APEC Economic Committee's report *Towards Knowledge-Based Economies in APEC,* of November 2000, and last updated in the *2002 Economic Outlook.*

WHAT IS A KNOWLEDGE-BASED ECONOMY?

A knowledge-based economy (KBE) is an economy in which the production, distribution, and use of knowledge are the main drivers of growth, wealth creation and employment across all industries. In this context, being a KBE means more than simply having a thriving "new economy" or "information economy" somehow separate from a stagnant "old economy". In a true KBE, all sectors have become knowledge-intensive; not just those usually called "high technology".

KBE refers essentially to the same thing as the wide sense of "new economy". The "new economy" was defined in the Economic Committee's report *The New Economy and APEC,* in October 2001, as:

> '…distinguished by the combination of structural policies and networked information and communication technologies. This mix increases the value of information available to individuals, firms, markets and governments, allowing each to act more efficiently, raising the return to knowledge skills, and demanding flexibility. The resulting transformation of activities yields higher overall productivity and economic well-being'.

Work by the OECD[1] confirms that economic growth is most sustainable for those economies strong in the four policy dimensions. These are:

1. *Innovation*

   Innovation and technological change are pervasive and supported by an effective national innovation system (i.e., a network of public and business private sector institutions whose activities and interactions initiate, import, modify, and diffuse new technologies and practices).

2. *Human Resource Development (HRD)*

   Human resource development is pervasive: education and training are of a high standard, widespread and continue throughout a person's working life and even beyond ('life long learning').

3. *Information and Communication Technology (ICT)*

   An efficient infrastructure operates, particularly in ICT, which allows individuals and businesses to readily and affordably access pertinent information from around the world.

[1] OECD, *The New Economy —Beyond the Hype* (Paris, 2001).

4. Business Environment

The business environment is supportive of enterprise and innovation. (The term "business environment" includes the economic and legal policies of government, and also the mix of enterprises operating in the economy.)

PRESENTATION OF INDICATORS

The characteristics of a range of APEC member economies relating to their KBE status are summarised here through the country charts in figure 1. Charts are presented for all those economies for which most of the indicators are available (17 economies in all). Details of the indicators used are given in table 1 and table 2.

The indicators are divided into groups corresponding to the four key dimensions of a KBE listed above, namely business environment, ICT infrastructure, innovation system, and human resource development. This presentation emphasises the overall message of a group of related complementary indicators, such as those on innovation systems. While each indicator in the group gives only a partial impression of the innovation system, the group as a whole gives an overall impression. This is appropriate for the qualitative comparison between groups of countries that is the focus of this study.

For all the indicators used, higher values indicate an economy's performance is more like that of a KBE. In the charts, each indicator is scaled against a reference value for that variable, so that the disparate numerical values can all be fitted onto a common scale. The reference value is the Organization for Economic Cooperation and Development (OECD) average for that indicator, so the value 1.0 represents the OECD average value for each indicator.[2] Where values are greater than 2.0, the numerical value is included in the chart. Where values are missing the data has not been available from the source used.

The data is for the latest year for which comparable data is available across APEC economies. Table 2 shows the year in which each variable was measured (as distinct from published) and the reference value (so that readers can work back to the numerical values).[3] Most of the data is for 2001 or 2002, and thus gives a reasonable comparative representation of the present situation. The indicator 'Internet users per capita' is shown for 1999 and 2002 to show developments in this indicator, as uptake rates are especially rapid.

Choice of Indicators

As discussed in the KBE report, the indicators are chosen to give a roughly equal number of indicators in each dimension. Within each dimension there is an attempt to represent the four phases of knowledge creation, acquisition, dissemination and use, so that the indicators complement rather than duplicate each other.

However, the choice of indicators is somewhat constrained by the availability of data– especially in a form comparable across APEC economies. The principal source of such publicly collated data is the *World Competitiveness Yearbook* (WCY). The WCY obtains many of its indicators already collated by specialist UN agencies such as UNESCO. Survey data such as that in the WCY has limitations due to sample selection and size, and is not officially endorsed by APEC economies. However, it is a useful and accessible source of comparable data.

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[2] The reference value shown on the charts is the simple (unweighted) average across all OECD economies, not only those which are members of APEC. It is intended as a reference value, and is independent of the sample set.

[3] Tables of numerical values are available on request from the APEC Secretariat.

A particularly pertinent source of data relevant to this analysis is the OECD publication *Science Technology and Industry Scoreboard*. Whilst the OECD does not include all APEC economies it has proven a reliable and useful indicator of a KBE. This indicator has not been updated this year as the latest edition of this publication is from 2001—with the next edition due late in 2003.

We have *not* attempted to calculate a single composite index of KBE status. The differing pictures created by the various groups of indicators (which do not always correlate tightly with one another) offer more valuable insights into the characteristics that require priority attention by particular economies, rather than a single index. Also, it is not obvious what relative weighting should be given to the various partial indicators when constructing a composite index.

The following commentary draws preliminary conclusions from a comparison of current data and that presented in the 2000 report (which uses data predominantly from 1997). It should be noted that the 2000 report considered fewer economies than this report, and consequently this analysis is limited to a comparison of the 13 economies identified in the 2000 report. The data from the 2000 report is also useful as it provides a longer series, whereas changes from one year to another are often too small to draw reliable conclusions.

COMMENTARY

The KBE status of APEC economies emerging from the data shows some developments since the KBE report of 2000. Improved performance against a number of indicators, particularly openness, education and the ICT indicators, demonstrates the impact of government policies promoting KBEs.

In many economies, indicators related to the business environment, namely "foreign direct investment", "openness to domestic and international competition", and "competition policy" have improved markedly since the 1997 survey. However, considerable scope still exists for improvement in the business environment of APEC economies, particularly in government transparency where there has been little improvement in regional performance against the OECD average.

The indicator "exports of high technology products" is particularly high for Hong Kong, China; Korea; Malaysia; the Philippines; Singapore; and Thailand. Foreign direct investment (FDI) remains particularly high in both Singapore and Chile. Thailand also experienced increased FDI between 1997 and 2002.

There has been a significant increase in the degree of openness perceived in the Chinese economy between 1997 and 2002. According to the indicator used in this paper (WCY Survey) China's openness has almost doubled in the last five years, reinforcing the view of China as an increasingly open economy by world standards. This improvement is likely to have resulted from the changes made in preparation for China's accession to the WTO.

Other APEC economies that have also made notable gains in the area of openness are Korea; Malaysia; Singapore, and Thailand. This may represent a return to more open economies in the South East Asian region, after the Asian financial crisis.

An interesting correlation also exists between those economies whose openness ranking has improved along with a reduction in unfair competition. This is particularly evident in China and Malaysia where greater openness appears to have developed concurrently with improved competition policy.

APEC economies continue to develop rapidly in the ICT category. Adoption of ICT technologies, such as mobile phones and the Internet, provides the enabling technology for a KBE, and it is here that APEC's convergence with the OECD average is most evident.

Korea's significant investment in ICT technology is having substantial pay-offs. Adoption of mobile telephone technology in Korea more than doubled between 1997 and 2002, Internet usage increased five-fold between 1999 and 2002 and the number of computers (per 1000 people) has tripled. The active national policy of promoting digitised information and technologies has proven central to Korea's developing KBE status.

Malaysia's ICT indicators are notably higher than those of other Asian and Latin American economies, also reflecting strong policy development in this field.

More broadly, the uptake of ICT technology is evident throughout all APEC economies. The number of mobile telephone subscribers more than doubled between 1997 and 2002 in all those APEC economies, for which comparable data is available. Computer usage has also increased rapidly, with seven economies actually exceeding the OECD average, reflecting the growing number of developed KBEs within APEC.

Cooperation in APEC economies between companies, and companies and universities continues to improve, although at a relatively slow pace. Cooperation is considered conducive to technological development and implementation in a KBE. Interaction and cooperation in these areas is most apparent in the developed economies of Australia; Canada; Hong Kong, China; New Zealand; Singapore: and the United States. Potential exists, however, for an increased contribution to innovation from research in APEC economies. The number of researchers (per 1,000 people) in APEC economies is still lagging behind the OECD average, and has not increased greatly since 1997.

An interesting development is the increased number of patents granted in many APEC economies. This indicator not only represents the development of innovations, but also reveals a growing consciousness of the need for intellectual property protection. Hong Kong, China; Korea; Japan; Singapore; and Chinese Taipei are rapidly pursuing protection of their innovations. The use of patenting in these economies demonstrates a growing awareness of the importance of knowledge as the driver of economic growth and development.

Also revealing a growing awareness of the potential of developing as a KBE is the increased expenditure on research and development. A marked increased in such expenditure is evident in Malaysia; Singapore; and Chinese Taipei.

A KBE will be unsustainable without long-term investment in basic education. The data reveals that the governments of Malaysia, Mexico and Thailand are particularly aware of this, with participation in secondary education increasing by more than 10 per cent between 1997 and 2001. The experience of the newly industrialised Asian economies also suggests that wider and deeper education is the key precondition before the other aspects can take off.

The most developed members of APEC are well on the way to being knowledge-based economies, as indicated by the proportion of current economic activity in those economies that is in some sense "knowledge intensive". Over 30 percent of their workforces are "knowledge workers"[4] and over 30 per cent of their GDP derives from "knowledge-based industries".[5] The

[4] As in the KBE report, we classify as a "knowledge worker" anyone whose occupation is reported to the International Labour Organisation (ILO) as falling into any of the following categories: managers and senior government officials, professional workers, or "associate professionals".

USA is by far the largest economy in APEC and remains one of the most dynamic "new economies". On several indicators the US ranks well above the reference level (the OECD average).

The indicators for the other more developed economies mostly cluster around the OECD average (1.00 on the vertical scale). This is closely related to the explicit and well-resourced economic strategies of Korea, Singapore and Chinese Taipei to become KBEs, a "natural" evolution from the industrial strategies they have successfully pursued.

The indicator profiles of the newly industrialised Asian economies and the Latin American economies are broadly similar to each other, and are beginning to show signs of developing as KBEs. It is increasingly evident that pro-active policies that promote an open and transparent business environment, ICT, innovation, and human resource development are necessary to transform these economies into fully developed KBEs.

[5] Following the OECD *Science Technology and Industry Scoreboard* (2001) we group high-tech and medium-high-tech manufactures, together with health and education, financial and other business services, and communications services as "knowledge-based industries".

TABLE 1: EXPLANATION AND SOURCES OF INDICATORS

Indicator	Significance for KBE	Details	Source
Business Environment			
KBIs (Knowledge-based Industries)	Indicates current status as a KBE.	Value added by "knowledge-based industries" as per cent of GDP. (KBIs as defined by OECD 2001 Scoreboard). Not available for all economies. Not updated in 2003.	OECD *Science Technology and Industry Scoreboard* 2001. Table: D5.1 & D5.2
Services Exports	Indicator of knowledge-intensity and size of service sector. Exportable services tend to be knowledge-intensive; Most developed economies tend to have higher proportion of service exports.	Exports of commercial services as per cent of GDP. Commercial services include transportation, travel, other private services and income. Data are not always fully comparable across economies.	World Competitiveness Yearbook 2003 Table 1.2.11 Source: World Trade Organisation Statistics 2002, www.wto.org
High Tech Exports	Indicator of knowledge intensity of manufacturing.	As percent of GDP. World Bank data give percent of manufactured good exports. Converted to percent of GDP using UN Trade data. "High tech" covers any product from certain sectors (similar to but not identical to those called "high tech" by OECD).	World Development Indicators 2003 Table:5.12
Foreign Direct Investment (FDI)	Indicates investor confidence in the economy. Also indicates openness to outside influence (and knowledge).	As percent of GDP.	World Competitiveness Yearbook 2003 Table 1.3.06 Source: IMF, Balance of Payments Statistics Yearbook 2002
Government transparency (rating)	Indicates clarity of policy and (to lesser extent) absence of cronyism - both elements of a KBE.	WCY Survey. Scale 1-10. A 10 rating indicates "the government communicates its policy intentions clearly".	World Competitiveness Yearbook 2003 Table 2.3.14
Financial institutions' transparency (rating)	Without reasonably high rating of financial institution transparency outside investment is deterred.	WCY Survey. Scale 1-10. A 10 rating indicates "financial institutions provide adequate information about their activities".	World Competitiveness Yearbook 2003 Table 3.3.17
Competition policy (rating)	Competition encourages innovation.	WCY Survey. Scale 1-10 A 10 rating indicates "government policy/legislation is efficient in preventing unfair competition in this	World Competitiveness Yearbook 2003 Table 2.4.09

Indicator	Significance for KBE	Details	Source
		economy".	
Openness (rating)	Openness to outside goods and services is an indicator of openness to outside ideas.	WCY Survey. Scale 1-10. A 10 rating indicates "national protectionism does not prevent foreign products and services from being imported"	World Competitiveness Yearbook 2003 Table: 2.4.03
Information an Communication Technology (ICT) Infrastructure			
Mobile Telephones per 1,000 people	Indicator of new technology take-up.	Number of mobile telephones subscribers per 1,000 inhabitants.	World Competitiveness Yearbook 2003 Table: 4.2.04
Telephone mainlines per 1,000 people	Primary indicator of domestic telecommunications capacity.	Number of telephone mainlines per 1,000 inhabitants.	World Competitiveness Yearbook 2003 Table: 4.2.02 Siemens International Telecom Statistics March 2003
Computers per 1,000 people	Indicates take-up of new ICT by business and broader community.	Number of computers (PCs, mainframes, etc) per 1,000 inhabitants.	World Competitiveness Yearbook 2003 Table: 4.2.09 Source: Computer Industry Almanac Inc. http://www.c-i-a.com
Internet users per capita	Indicates take-up of new ICT by business and broader community. Indicative of ability to engage in e-commerce and modern information collection and dissemination.	Number of Internet users per capita, as a percentage of total population.	1999 data: WITSA Digital Planet 2002 2002 data: World Competitiveness Yearbook 2003 Table: 4.2.10 Source: Computer Industry Almanac Inc. http://www.c-i-a.com
E-commerce	Indicates extent to which traditional industries are adapting to the digital economy.	Internet commerce (B2B +B2C) as a percentage of total commerce Not updated in 2003.	WITSA Digital Planet 2002 Page 44
Innovation system			
Researchers per 1,000 people	Indicates potential to create new (technical) knowledge.	Researchers (full time work equivalent) per 1,000 people.	World Competitiveness Yearbook 2003 Table: 4.3.07
Total expenditure on R&D (percent of GDP)	Indicates current effort to create new (technical) knowledge.	Gross annual expenditure on R&D (i.e., Business Expenditure on R&D + public expenditure on R&D) as a percentage of GDP.	World Competitiveness Yearbook 2003 Table: 4.3.03 Source: OECD Main Science and Technology Indicators 2002
Business Expenditure on R&D (BERD) (percent of GDP)	Commitment by enterprises to knowledge creation.	Business annual expenditure on R&D as a percentage of GDP.	World Competitiveness Yearbook 2003 Table: 4.3.04 (BERD US$ millions) and Table: 1.1.0 (GDP figures)

Indicator	Significance for KBE	Details	Source
			Source: OECD Main Science and Technology Indicators 2002
U.S Patents (per million population)	Industries which patent extensively mostly do so in USA (a major technology market) as well as at "home".	Number of US Patents awarded in specified year to residents of specified country (per million population).	US Patents Office ftp://ftp.uspto.gov/pub/taf/st_co_01.htm (13 May 2003) Population: World Bank World Development Indicators 2003. Table:2.1
Company co-operation (rating)	Partial indicator extent of knowledge networks	WCY Survey. Scale 1-10 A rating of 10 indicates "technological co-operation is common between companies".	World Competitiveness Yearbook 2003 Table: 4.2.15
Company-university co-operation (rating)	Partial indicator. Extent of knowledge networks	WCY survey. Scale 1-10. A rating of 10 indicates "knowledge transfer is highly developed between companies and universities".	World Competitiveness Yearbook 2003 Table: 4.5.13
Human resource development			
Secondary enrolments	Potential for skilled workforce in the future.	This UNESCO figure is the total enrolment, regardless of age, divided by the population of the official age group which corresponds to a specific level of education.	UNESCO Institute for Statistics http://portal.unesco.org/uis/ev.php (updated 14/5/2003)
Tertiary Education	Potential for highly skilled workforce in the future.	Percentage of population aged 25 to 34 that has attained at least tertiary education.	World Competitiveness Yearbook 2003 Table: 4.5.05 Source: Education at a Glance, OECD Indicators 2002, World Indicators 2002
Percent of "knowledge workers"	Indicates current status as a KBE.	As percentage of the labour force. Based on ILO occupational statistics–see text for details.	Calculated from International Labour Organisation (ILO) Labour Statistics. http://laborsta.ilo.org/cgi-bin/brokerv8.exe (13/5/03)
Human Development Index	Broad indicator of social development; KBE cannot develop unless all components of HDI are reasonably high.	UNDP index based on three indicators of human development: life expectancy at birth, educational attainment (measured by a combination of adult literacy and school enrolments) and GDP per capita at purchasing power parity. (max value =1.000)	United Nations Development Program, Human Development Report http://www.undp.org/hdr2003/pdf/hdr03_HDI.pdf (22/7/03)

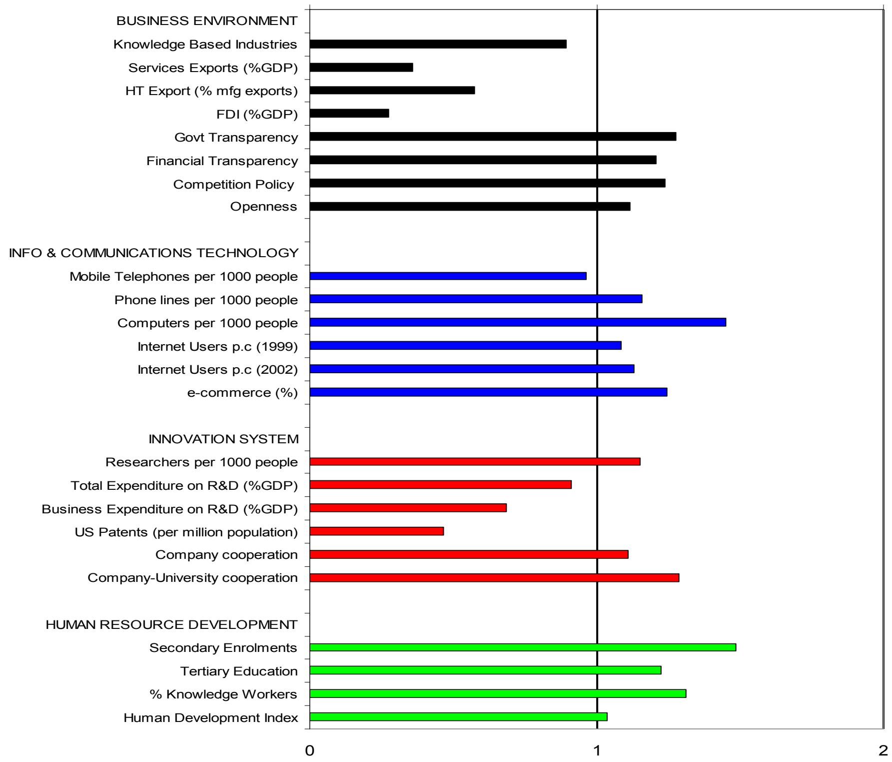
TABLE 2: DATA YEARS AND OECD REFERENCE VALUES

Indicators	Year	Ref.val.
Business Environment		
KBIs (% business sector VA)	1998*	37.22
Service exports (% GDP)	2001	12.31
High Tech exports (% mfg exports)	2001**	19.11
FDI (%GDP)	2001	4.48
Government Transparency	2003	5.45
Financial Transparency	2003	6.37
Competition Policy	2003	6.09
Openness	2003	6.97
ICT Infrastructure		
Mobile phones p.c.	2002	680.70
Phone lines p.c.	2001	544.20
Computers per 1000 people	2002	434.00
Internet users p.c. (year 1999)	1999	26.80
Internet users p.c. (year 2002)	2002	46.99
e-commerce (%)	2001	0.57
Innovation System		
Researchers per 1000 people	2001	4.32
Total Expenditure on R&D (%GDP)	2001	1.72
Business Expenditure on R&D (%GDP)	2001^	1.04
US patents (per million population)	2001	114.06
Company cooperation	2003	5.98
Company-University cooperation	2003	5.02
Human Resource Development		
Secondary enrolments	2000/01^^	108.36
Tertiary Education	2001	27.77
% Knowledge workers	2001#	28.70
Human Development Index	2000##	0.90

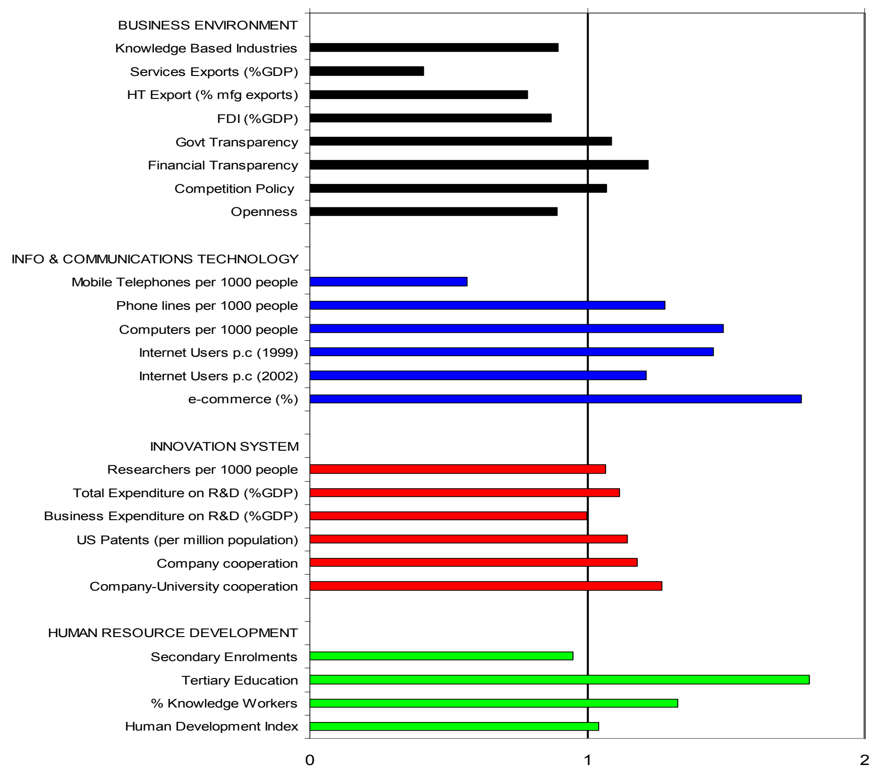
*Chinese Taipei, 2001
**Chinese Taipei, 2002. Figure provided by Chinese Taipei's Ministry of Finance, Monthly Statistics of Exports and Imports, May 2004.
^ GDP 2002
^^Chinese Taipei, 2002. Chinese Taipei's figure provided by Chinese Taipei (www.edu.tw). Hong Kong, China, 2002. Hong Kong, China's figure provided by the Education and Manpower Bureau, The Government of Hong Kong, China.
Russia, 1999; Chinese Taipei 2002. Chinese Taipei's figure provided by Chinese Taipei (www.dgbas.gov.tw)
Chinese Taipei, 2001. Chinese Taipei's figure provided by Chinese Taipei (www.dgbas.gov.tw)

FIGURE A.1 KBE INDICATORS FOR SELECTED APEC ECONOMIES

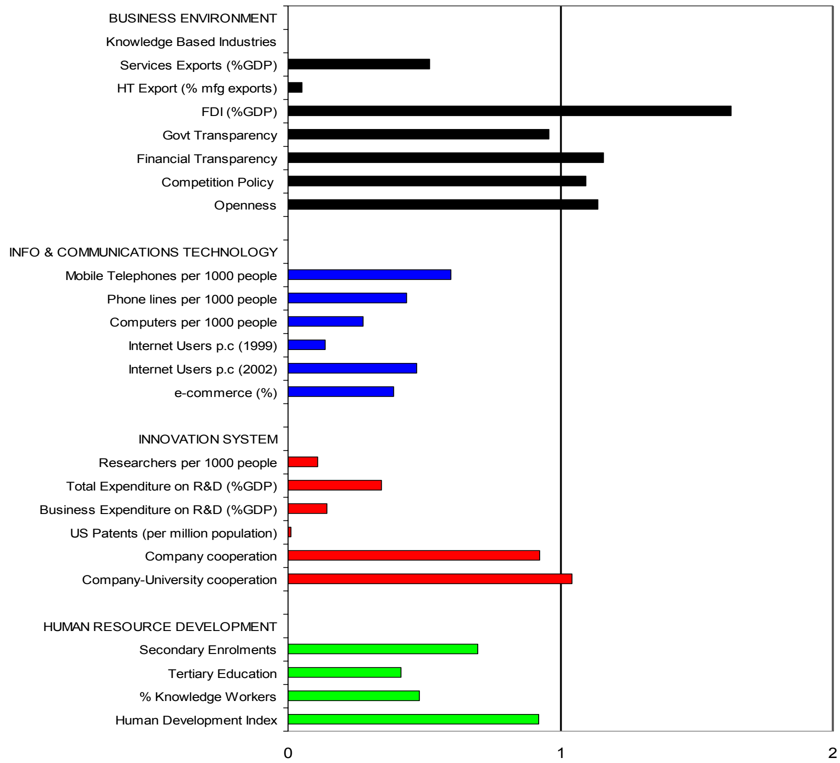
AUSTRALIA



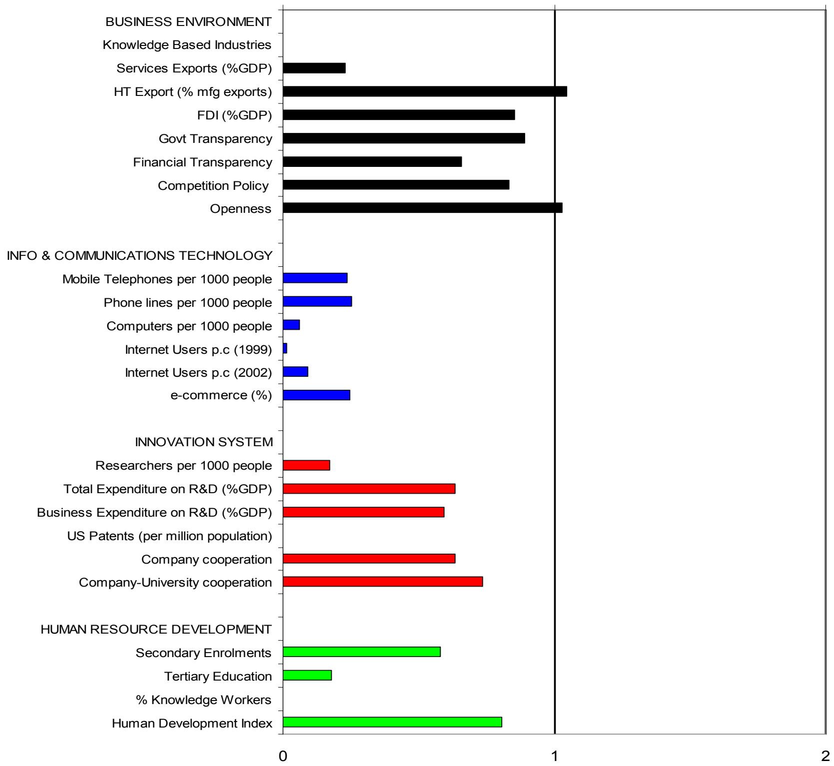
CANADA



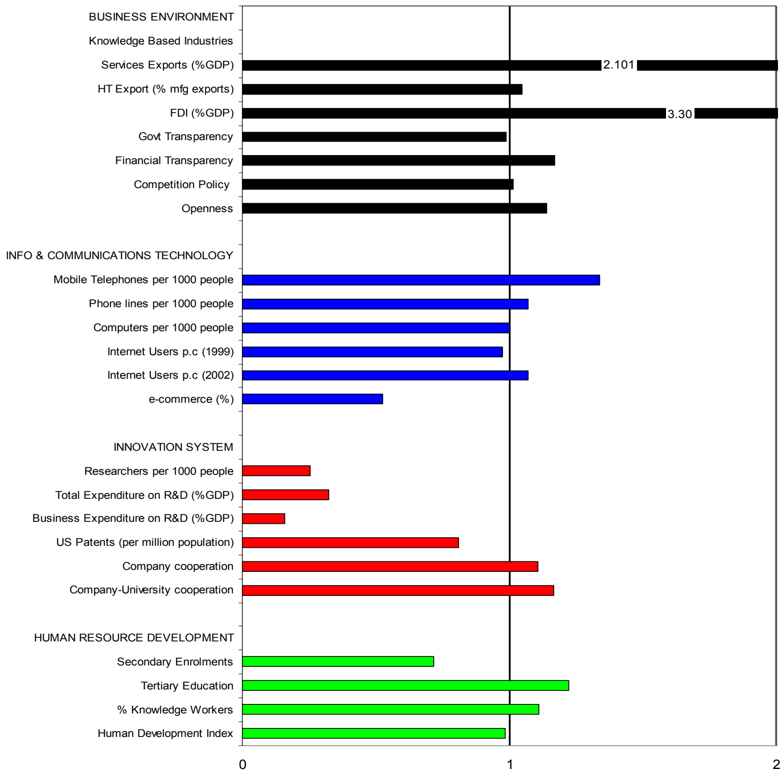
CHILE


BUSINESS ENVIRONMENT
Knowledge Based Industries
Services Exports (%GDP)
HT Export (% mfg exports)
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFO & COMMUNICATIONS TECHNOLOGY
Mobile Telephones per 1000 people
Phone lines per 1000 people
Computers per 1000 people
Internet Users p.c (1999)
Internet Users p.c (2002)
e-commerce (%)
INNOVATION SYSTEM
Researchers per 1000 people
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
0
1
2

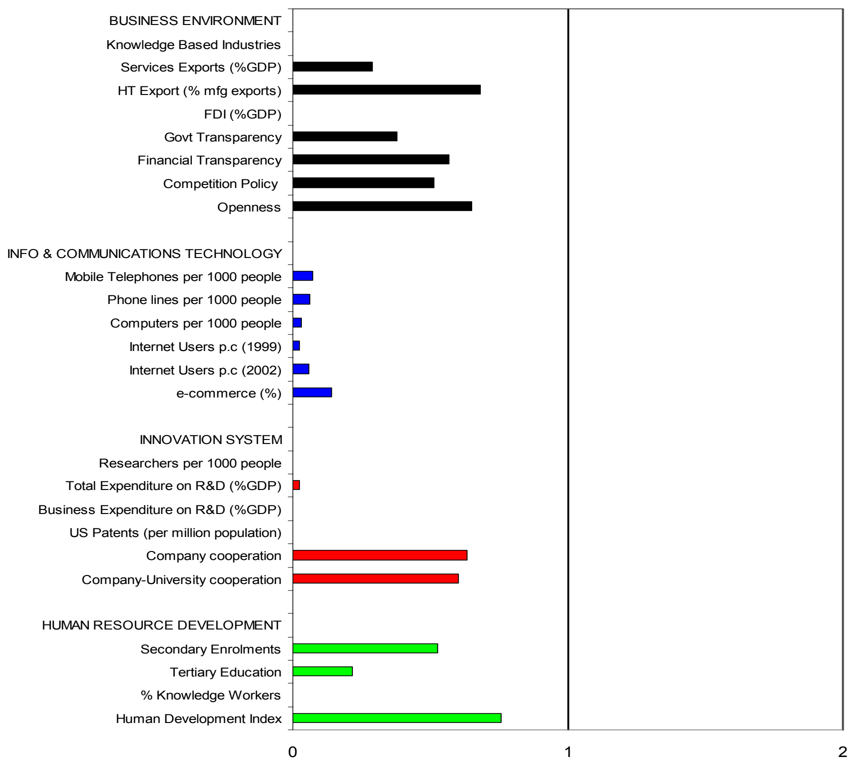
CHINA


BUSINESS ENVIRONMENT
Knowledge Based Industries
Services Exports (%GDP)
HT Export (% mfg exports)
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFO & COMMUNICATIONS TECHNOLOGY
Mobile Telephones per 1000 people
Phone lines per 1000 people
Computers per 1000 people
Internet Users p.c (1999)
Internet Users p.c (2002)
e-commerce (%)
INNOVATION SYSTEM
Researchers per 1000 people
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
0
1
2

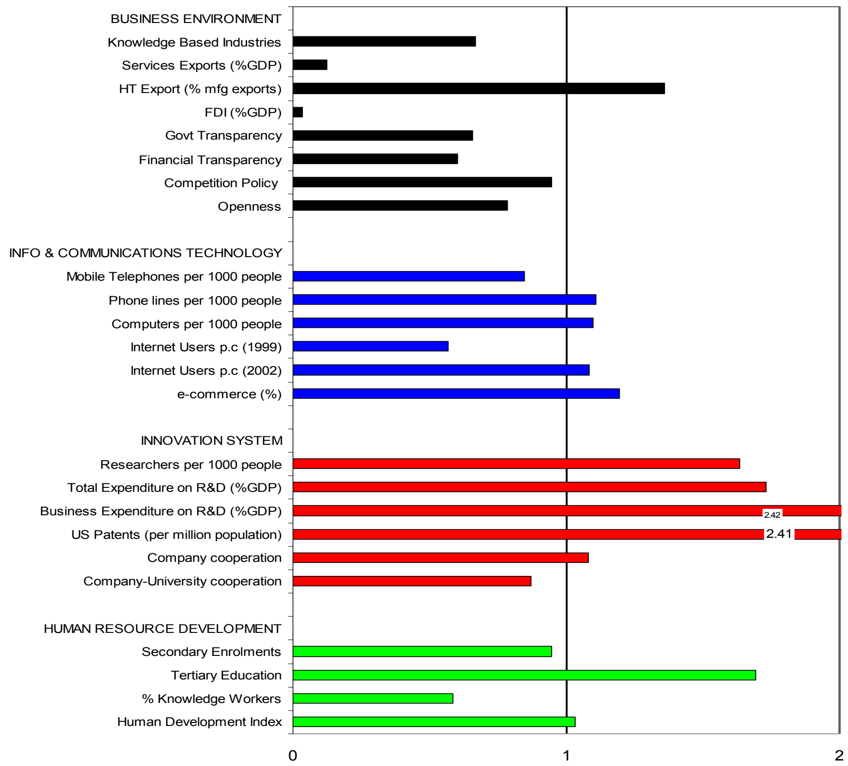
HONG KONG, CHINA



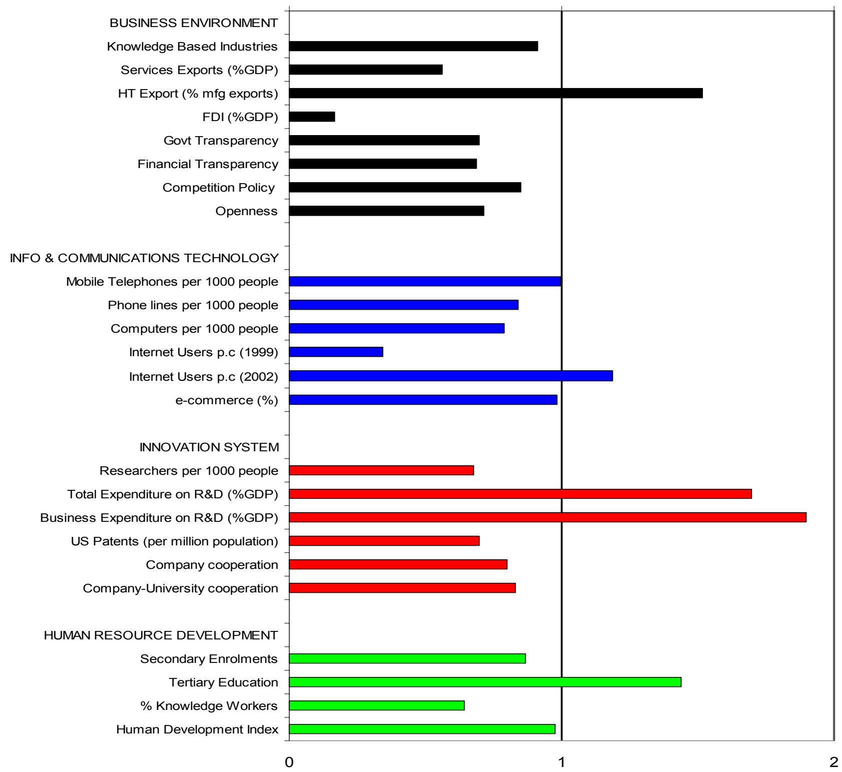
INDONESIA

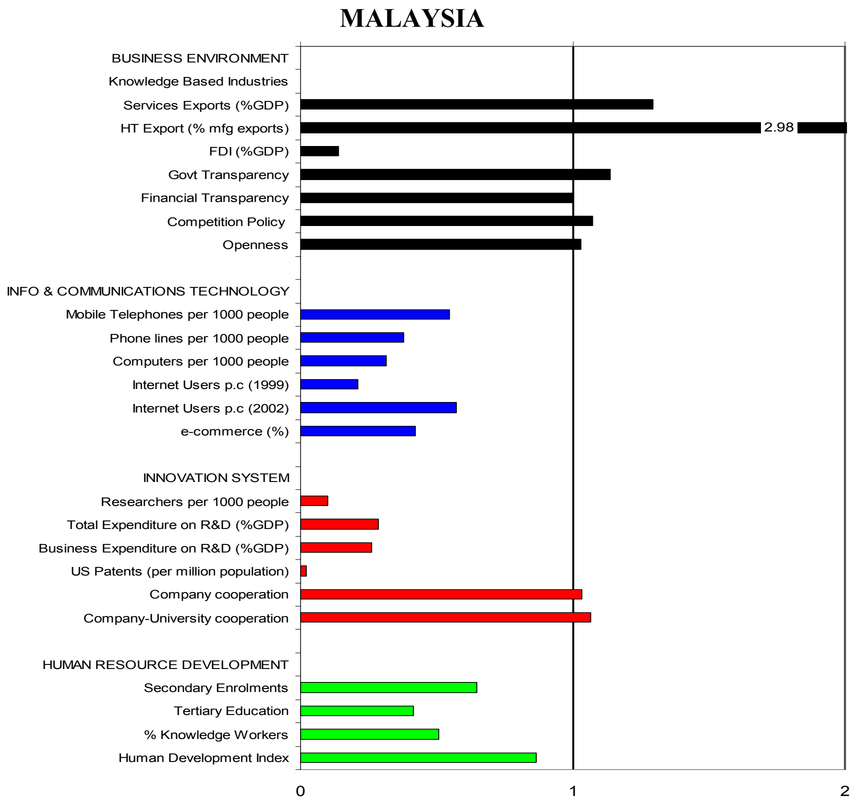


JAPAN

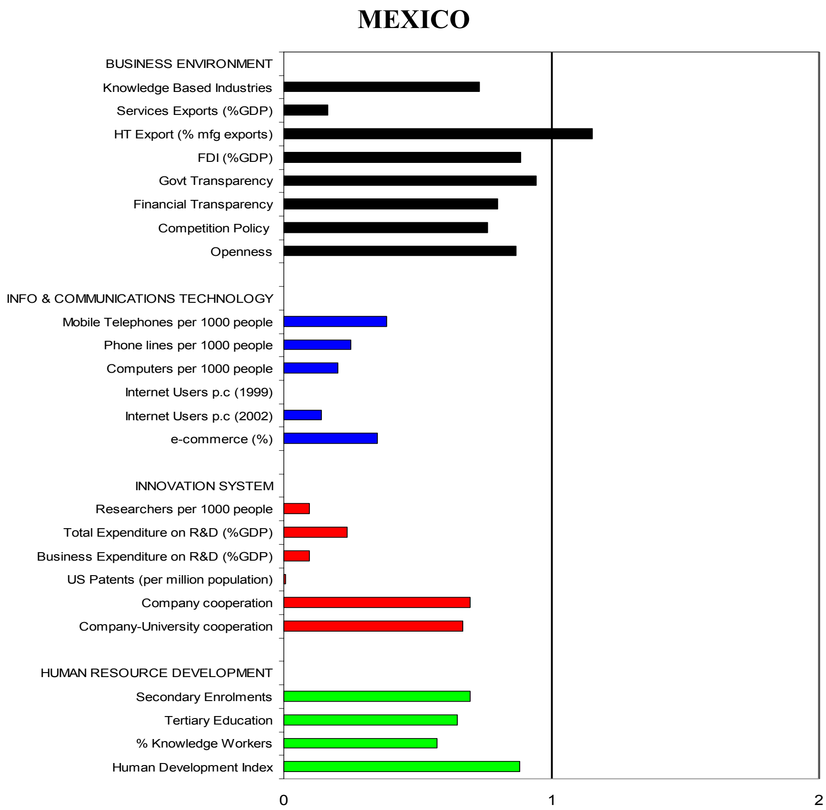


REPUBLIC OF KOREA



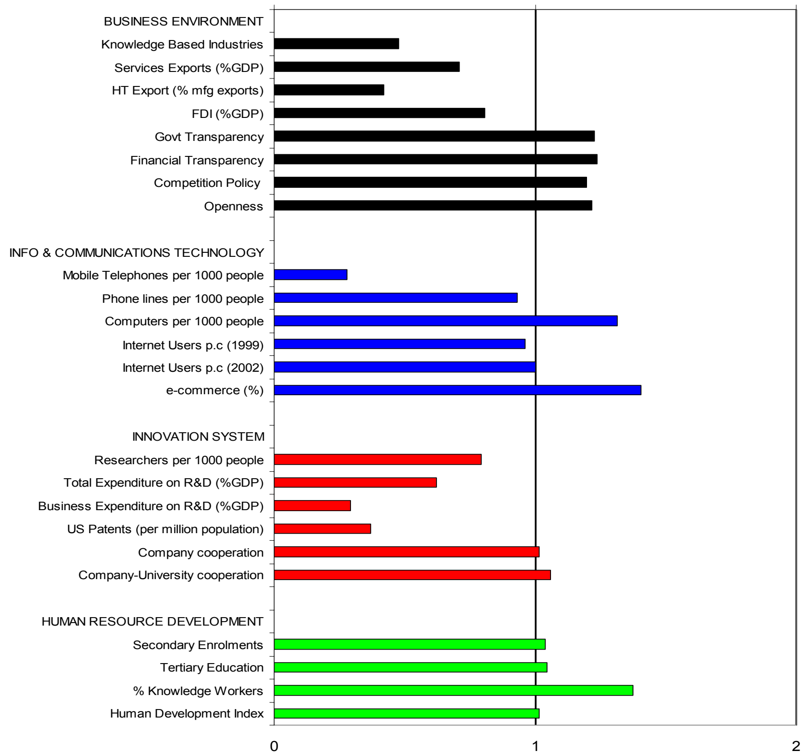


MALAYSIA
BUSINESS ENVIRONMENT
Knowledge Based Industries
Services Exports (%GDP)
HT Export (% mfg exports)
2.98
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFO & COMMUNICATIONS TECHNOLOGY
Mobile Telephones per 1000 people
Phone lines per 1000 people
Computers per 1000 people
Internet Users p.c (1999)
Internet Users p.c (2002)
e-commerce (%)
INNOVATION SYSTEM
Researchers per 1000 people
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
0
1
2

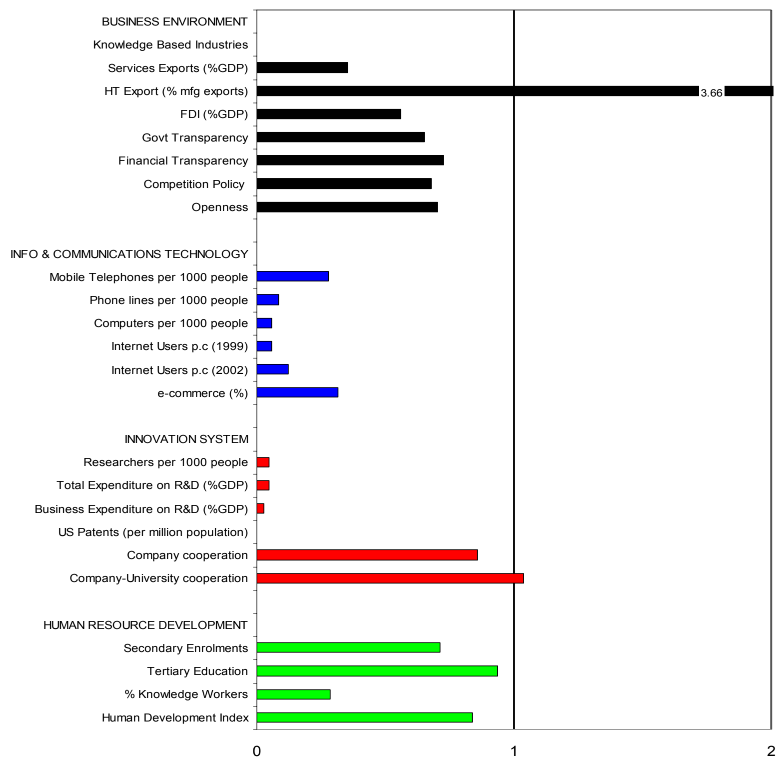


MEXICO
BUSINESS ENVIRONMENT
Knowledge Based Industries
Services Exports (%GDP)
HT Export (% mfg exports)
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFO & COMMUNICATIONS TECHNOLOGY
Mobile Telephones per 1000 people
Phone lines per 1000 people
Computers per 1000 people
Internet Users p.c (1999)
Internet Users p.c (2002)
e-commerce (%)
INNOVATION SYSTEM
Researchers per 1000 people
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
0
1
2

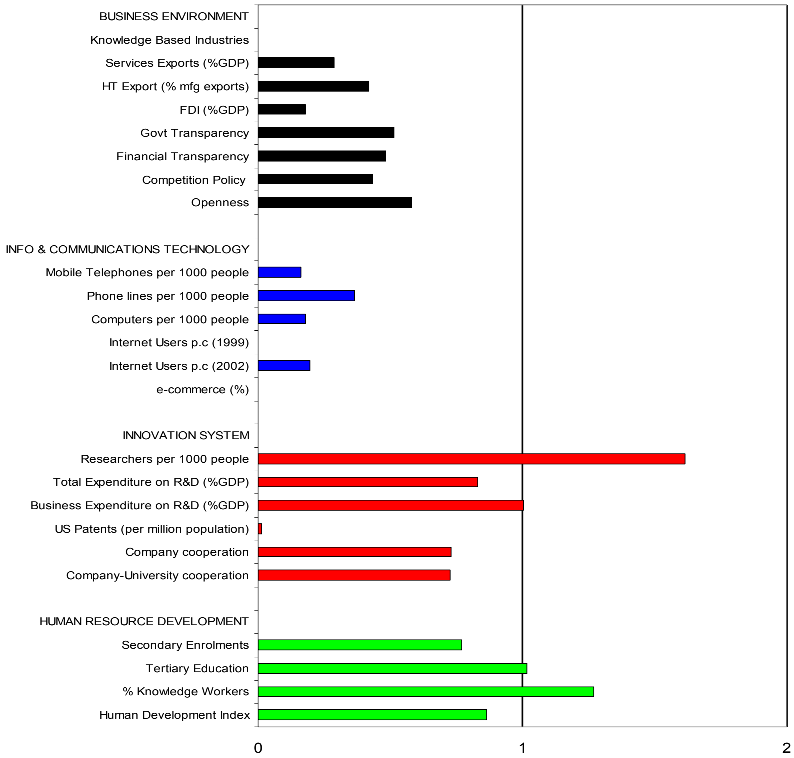
NEW ZEALAND



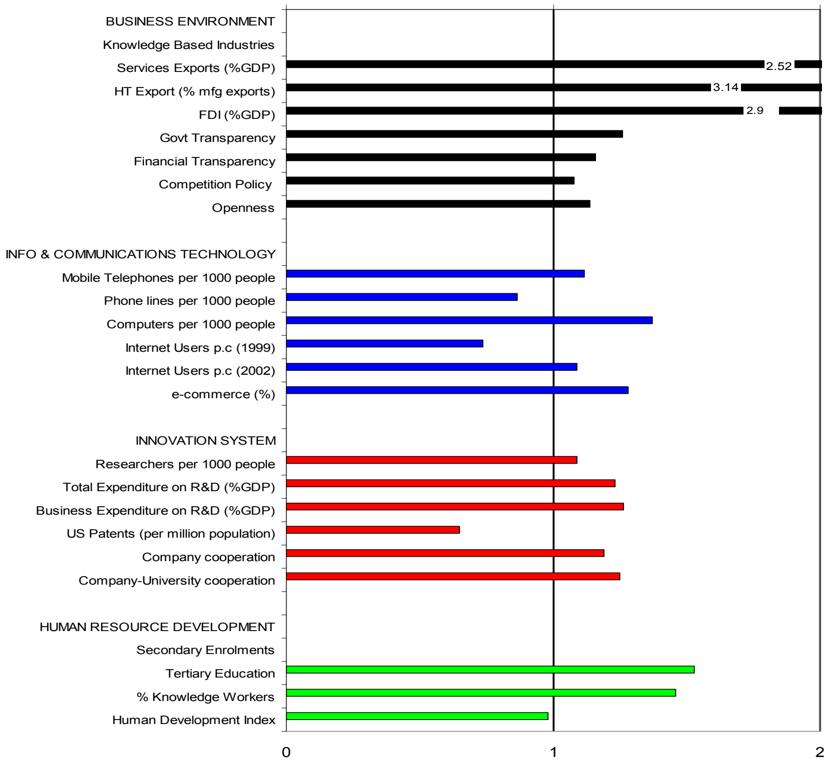
PHILLIPPINES



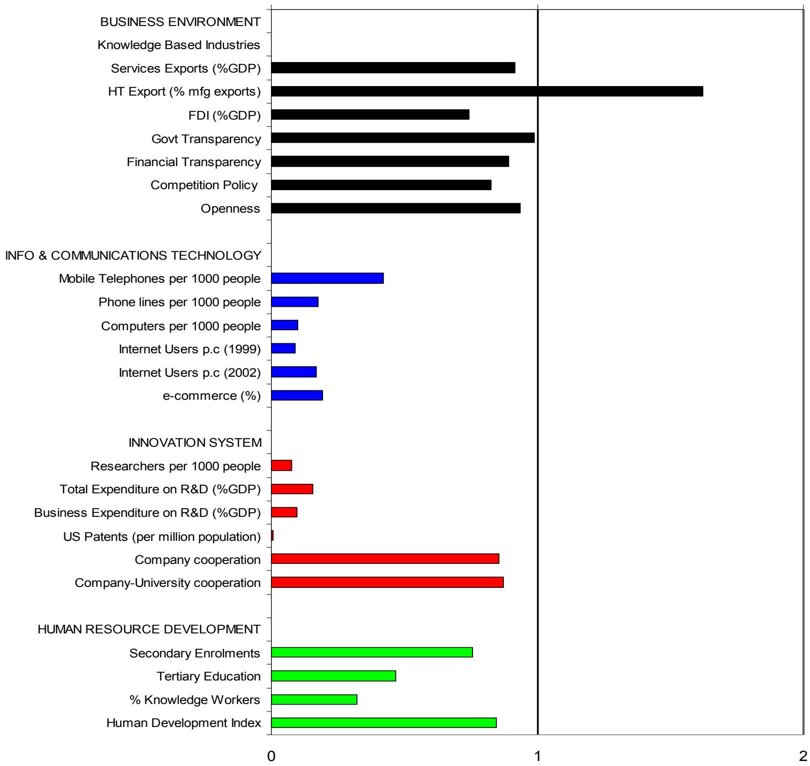
RUSSIA



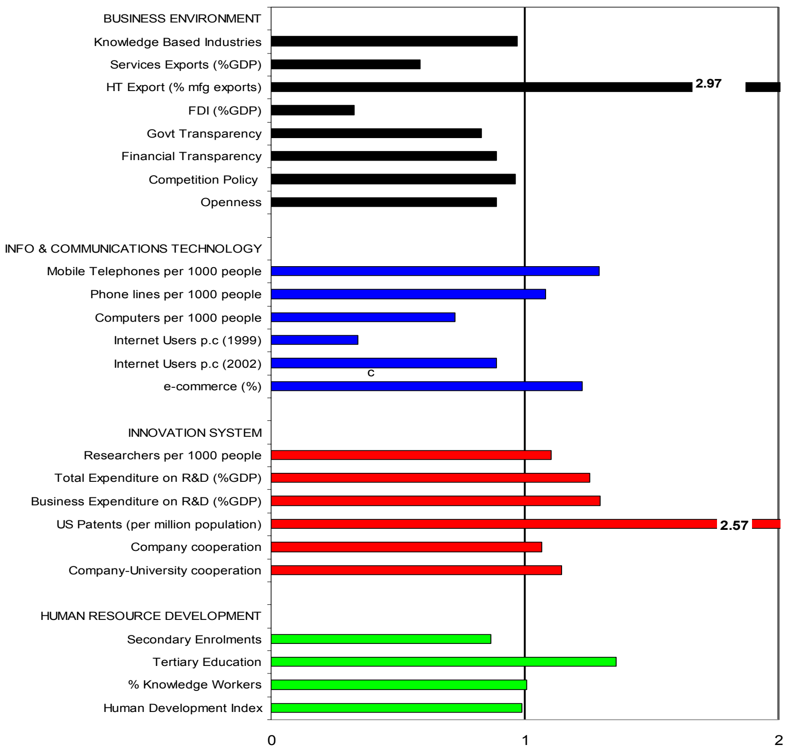
SINGAPORE



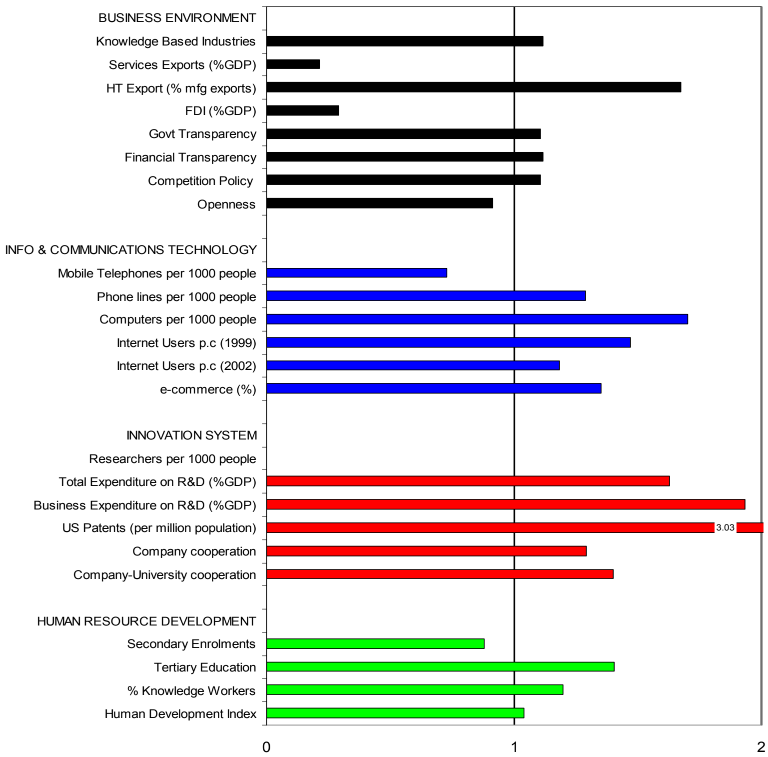
CHINESE TAIPEI



THAILAND



USA



BUSINESS ENVIRONMENT
Knowledge Based Industries
Services Exports (%GDP)
HT Export (% mfg exports)
FDI (%GDP)
Govt Transparency
Financial Transparency
Competition Policy
Openness
INFO & COMMUNICATIONS TECHNOLOGY
Mobile Telephones per 1000 people
Phone lines per 1000 people
Computers per 1000 people
Internet Users p.c (1999)
Internet Users p.c (2002)
e-commerce (%)
INNOVATION SYSTEM
Researchers per 1000 people
Total Expenditure on R&D (%GDP)
Business Expenditure on R&D (%GDP)
US Patents (per million population)
3.03
Company cooperation
Company-University cooperation
HUMAN RESOURCE DEVELOPMENT
Secondary Enrolments
Tertiary Education
% Knowledge Workers
Human Development Index
0
1
2

ANNEX 2

THE ECONOMIC IMPACT OF SARS ON THE APEC REGION

Summary: The severe acute respiratory syndrome (SARS)[1] outbreak has had a serious, but not overwhelming, economic impact on the APEC region. The economic cost has been estimated to be in the range 0.5 percent to 1.0 percent of annual GDP growth for many of the economies of the APEC region. However, just as the outbreak has been very uneven in its incidence, the economic impact has also been unequal across economies, and across sectors within economies. This report on the economic impact of SARS is derived from briefs that have been submitted from a number of APEC economies. The three subsections that follow discuss the extent of the outbreak, the economic impact, and policy responses.

1. The Extent of the SARS Outbreak

During the period from 1 November 2002 to 7 August 2003, on a worldwide basis, 8,422 people contracted SARS, of whom 916 died. The outbreak is now contained, and the last chain of transmission has been broken. However, according to the World Health Organization (WHO), a resurgence of SARS remains a distinct possibility. When SARS struck, it hit the APEC region disproportionately, and was concentrated almost exclusively within five economies (Canada; China; Hong Kong, China; Singapore and Chinese Taipei) in the APEC region. The APEC region accounted for 99 percent of the cases of SARS, and 99 percent of deaths due to SARS, worldwide. The five economies noted above accounted for 98 percent of cases and 99 percent of deaths of SARS within the APEC region. Thus, while SARS affected most APEC economies to some degree, the incidence of the disease was highly concentrated. Table 1 below gives the incidence of SARS over this period.

Table 1: The Incidence of SARS (1 November 2002 – 7 August 2003)

Economy	Cumulative Number of Cases	Number of Deaths
Australia	6	0
Canada	251	41
China	5327	349
Hong Kong, China	1755	300
Chinese Taipei	665	180
Indonesia	2	0
Republic of Korea	3	0
Malaysia	5	2
New Zealand	1	0
Philippines	14	2
Russian Federation	1	0
Singapore	238	33
Thailand	9	2
United States	33	0
Viet Nam	63	5
APEC Total	**8373**	**914**
Total non-APEC[2]	49	2
Global Total	**8422**	**916**

Source: WHO

[1] SARS may also be known as Atypical Pneumonia (AP).
[2] Includes Brazil, China, Macao, Colombia, Finland, France, Germany, India, Italy, Kuwait, Mongolia, Romania, South Africa, Spain, Sweden, Switzerland and the United Kingdom.

2. The Economic Impacts of SARS

The outbreak of SARS underscores one of the negative aspects of globalization. That is, with growing interdependence, each economy is more susceptible to the negative shocks that affect any other. Thus, increased vigilance and preparedness is called for.

The economic impacts of SARS can be difficult to assess since SARS was only one of many shocks affecting the APEC economies. The most apparent impact of SARS has been on the travel and tourism industry. However, prior to the outbreak, this industry was already suffering from the effects of several shocks, including the recent Iraq war. Thus it might be incorrect to attribute all of the downturn in the travel and tourism industry for all months to SARS. The connection between SARS and various other economic impacts may be hard to define as there were other, concurrent disturbances.

The economic consequences of SARS can be broken down into direct and indirect impacts. The direct impacts include lost output and productive time of the stricken, as well as the health care and crisis management costs.[3] The indirect effects include those that resulted from public behavioural changes resulting from the outbreak and the public's perception of it. The most immediate impact was the fear of contracting SARS causing people to reduce contact with others, particularly others perceived to be at risk. Thus, the obvious first impacts were reductions in travel to, from and through locations that were relatively harder hit. In their briefs, most economies focus on the indirect effects, particularly those affecting the travel and tourism industries. They report that the travel and tourism industries suffered substantial reductions in demand particularly during the months of March, April and May when the outbreak was at its peak. Table 2 gives some indication of the magnitude of the shock that hit the travel and tourism industries in several APEC economies.[4] What is less clear is how temporary or permanent this shock will prove to be. If, for example, the SARS outbreak has caused people to simply postpone trips, it will be temporary. However, if people diverted trips to other locations, or chose to forgo travel entirely, then the economic shock will prove to be more permanent.

Table 2: Indicative Data on the Reduction in Travel and Tourism

Economy	Travel or Tourism Data Cited	Impact
Australia	Number of inbound tourists, m/m percent change	April: - 8.5 % May: - 0.8%
Canada	Air Canada air travel to Asia, y/y percent change	March: - 18%
Hong Kong, China	Visitor arrivals, y/y percent change	April: - 65% May: - 68%
Indonesia	Visitors to Bali, y/y percent change[5]	March: -35%
Japan	Overseas travel sales at 13 major travel agencies, y/y percent change	April: -47.4% May: -59.3% June: -59.3%
Malaysia	Tourist arrivals, y/y percent change	April : -58.6%

[3] These direct costs have yet to be well documented.
[4] It should be noted, however, that while many economies report statistics on the reduction in travel and tourism, the bases of these statistics differ, making direct comparisons misleading. Moreover, the data reported must be considered to be preliminary, and thus rather than being definitive, should be considered to be indicative. We continue to await more comprehensive studies in the future.
[5] This datum might be complicated by other factors.

Economy	Travel or Tourism Data Cited	Impact
New Zealand	Short-term visitor arrivals, y/y percent change	May: -12%
Philippines	Visitor arrivals from East Asia, y/y percent change	Q2, 2003: -25.3%
Singapore	Visitor arrivals, y/y percent change	April: -67%
Chinese Taipei	Visitor arrivals, y/y percent change	May: -82% June: -67%
Thailand	Tourist arrivals, m/m percent change	March: -12% April: -35%
Viet Nam	Foreign tourist and business arrivals, y/y percent change	April: - 50% May: -75%

Source: Briefs submitted to APEC.

In addition to the reductions in travel and tourism, retail demand fell, and SARS also had a negative effect on consumer confidence. However, overall investment, industrial output and international trade seem to have been little affected by SARS. Table 3 gives some Asian Development Board (ADB) estimates of the reduction in annual GDP growth in several APEC economies. The surprisingly low number for China is likely due to the fact that tourism accounts for a very low share of GDP in that economy. However, Malaysia and Thailand show relatively high numbers even though the incidence of SARS in those economies was very low. This is due, at least in part, to the relatively high weight that tourism carries in those economies. In consideration of these aspects, we examine some of the harder-hit APEC economies more closely.

Table 3: ADB Estimates of the Impact of SARS on GDP Growth

Economy	Estimated Reduction in Annual 2003 GDP Growth due to SARS (percent)
China	0.2
Hong Kong, China	1.8
Singapore	1.1
Indonesia	0.5
Korea	0.2
Malaysia	0.6
Philippines	0.3
Chinese Taipei	0.9
Thailand	0.7

Source: Fan, Emma Xiaoqin (2003) SARS: Economic Impacts and Implications, Asian Development Bank. Note that this estimate assumes the SARS outbreak lasted one quarter.

Prior to the outbreak of SARS, China was experiencing very rapid growth. First quarter growth was 9.9 percent (y/y). The drivers were trade and investment, and these were little impacted by SARS. Moreover, the outbreak of SARS was not widespread in China, but mainly hit the Guangdong, Beijing and Inner Mongolia provinces. The major impacts in China (as with most others) were in the travel and tourism sectors. Second quarter growth dipped to 6.7 percent. Although this represents a significant decline in growth—greater than that suggested by the ADB and the lowest growth rate in ten years—the overall economic situation in China is still very robust.

At the height of the SARS outbreak the travel and hospitality sectors of Hong Kong, China's economy were very severely hit. In addition, consumer sentiment and retail sales were significantly impacted. Nevertheless, retail business has shown visible improvement lately, with the volume of sales bottoming out to virtually no change in July, from a decline of 12 percent in April. Compared with the previous quarter, the volume of retail sales made a gain of 1.7 percent in the three months ending in July, on a seasonally adjusted basis. Inbound tourism has also been reviving steadily, with the decline in the total number of incoming visitors narrowing distinctly to 6 percent in July, from 60 percent in April and May. Yet, given that the hospitality sector is relatively labour-intense, the earlier setback in these sectors has aggravated the employment situration.

Chinese Taipei has estimated that the SARS outbreak will reduce its annual growth rate for 2003 by 0.91 percent, which is very much in line with the ADB estimate. The travel and tourism industries were very hard hit. In addition, private consumption dipped in the second quarter, and industrial production and trade were also weak in the second quarter.

In Canada, GDP growth turned marginally negative in the second quarter. However, relatively little of that weakness can be directly attributed to SARS. It should also be noted that in Canada the SARS outbreak was concentrated in one (albeit the largest) city, Toronto, and the main impacts were on the travel and tourism sector.

Singapore's economy was also hard hit. The travel and tourism sectors were particularly hurt, and indications are that retail sales fell between 10 percent and 50 percent from the onset of SARS to its peak incidence. In addition, the business travel disruption raised concerns about future sales and exports. Moreover, the manufacturing growth rate fell.

Despite the negative economic impacts mentioned above, the rapid containment of the disease, the resilience of the Chinese economy and the growing strength of the US economy are likely to render these impacts short-term in nature.

3. The Policy Responses and Issues

The first and by far the most important policy action undertaken by the affected economies was the imposition of quarantine and other public health measures. Although the overall duration of the outbreak was eight to nine months, the spread of disease was contained within three to four months from 12 March 2003, which was the first official World Health Organisation (WHO) warning. Ultimately, it was the public health measures that defeated the disease. This result stands as a tribute to the effectiveness of the relevant health and government authorities, and hopefully they will be even better prepared for any possible future public health crisis that may arise.

In addition, some economies instituted policies to help those that were financially hurt by the SARS outbreak. Policies ranged from Canada's offering of temporary financial assistance to those in financial crisis as a result of a mandatory quarantine; to Hong Kong, China's reducing certain fees and taxes; to Singapore's direct support of businesses that were hit; and Chinese Taipei's engaging in public works programs.

Some have also suggested that information policies should be reviewed, as the economic impacts of this kind of shock are almost entirely based on public fears.[6] In the absence of full information, people often base their actions on the worst case scenario. Thus, if the public has any perception that the government is hiding any information (whether it is not) the public is likely to assume the worst, and this would exacerbate the negative economic impacts.

[6] See, for example, The World Bank, *East Asia Update*, April, 2003.

Moreover, transparency helps to facilitate public cooperation with public health measures, which underpins the success of such a campaign. Thus, an honest, transparent information policy is likely to lead to the lowest economic costs. It is during crises such as that associated with the SARS outbreak, that the credibility of public authorities is at a premium.

ECONOMIC EFFECTS OF SEVERE ACUTE RESPIRATORY SYNDROME (SARS) ON APEC ECONOMIES

REPORTS BY INDIVIDUAL ECONOMIES AND THE INVESTMENT EXPERTS GROUP (IEG)

AUSTRALIA

CANADA

CHINA

HONG KONG, CHINA

INDONESIA

JAPAN

MALAYSIA

NEW ZEALAND

PHILIPPINES

SINGAPORE

CHINESE TAIPEI

THAILAND

UNITED STATES

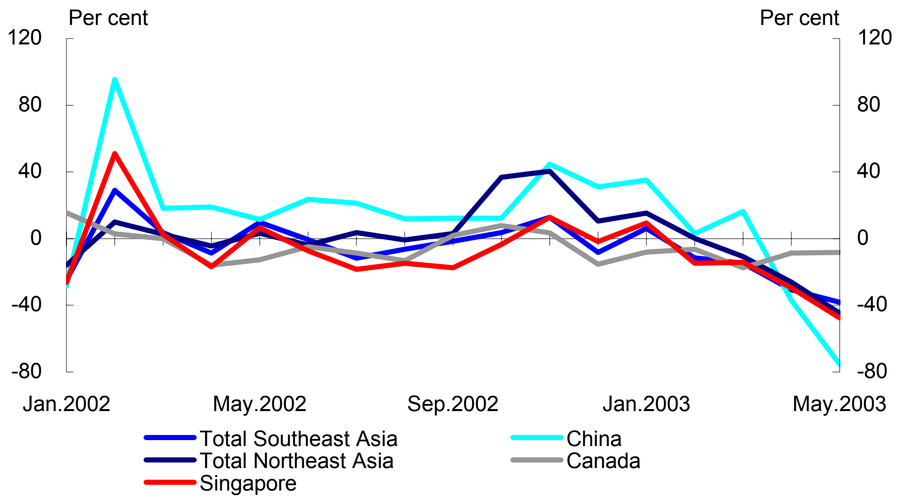
VIET NAM

INVESTMENT EXPERTS' GROUP (IEG)

IMPACT OFTHE SARS OUTBREAK ON THE AUSTRALIAN ECONOMY

The recent outbreak of SARS has had a mild and temporary impact on the Australian economy—primarily through weaker growth in East Asia that has slightly reduced some exports, disruptions to tourism, and possibly reduced business confidence.

Figure 1: Tourist Arrivals in Australia by Origin (percent change, through-the-year)



Source: Australia Bureau of Statistics Catalogue No. 3401.0.

Australia's tourism industry, which accounts for 4.5 percent of the economy, has seen a substantial decline in the number of inbound tourists. Short-term arrival data reported a month-on-month fall of 0.8 percent for May 2003, following an 8.5 percent fall in April. In particular short-term arrivals from SARS-affected East Asian economies, fell sharply in the year to May (see figure 1). There is little doubt that the war in Iraq and related geo-political tensions were major factors contributing to the overall decline in inbound tourists during this period, but a large proportion may be attributed to SARS. Initial evidence of a reversal of this trend was reported in the preliminary short-term arrival data, showing a month-on-month rise of 6.8 percent in June. The downturn in tourist arrivals has been offset somewhat as Australians have deferred or cancelled their overseas travel in favour of Australian destinations. Short-term month-on-month departures of Australian residents fell 0.7 percent in May, following a 5.9 percent decline in April.

Aside from travel, the SARS outbreak has had a broader economic, albeit minor, effect through its impact on Australia's major trading partner growth in East Asia, which slightly depressed Australia's overall export performance. However, the effect on exports is likely to dissipate quickly, as the SARS-induced economic shock to East Asia appears to have been relatively short lived.

IMPACT OF THE SARS OUTBREAK ON THE CANADIAN ECONOMY

PROGRESSION OF THE OUTBREAK

The first reported cases of severe acute respiratory syndrome (SARS) appeared in Canada in late February 2003, and by mid-March had gained considerable attention in the media in Canada and other economies. Most cases (and all deaths) were limited to the Greater Toronto Area (GTA).

The increase in new probable cases of SARS peaked in late March, with the great majority of these being health care professionals or family members of those already infected. At no time did a significant community outbreak occur. By mid-April, the number of new cases had tailed off, and Canadian health authorities were becoming increasingly confident that the outbreak had been brought under control. According to Health Canada, the number of active probable cases had fallen to 31 by 6 May, down from 42 a week earlier.

Anecdotal Reports of Economic Disruptions

As uncertainty over the progression of the outbreak rose, firms—particularly in industries closely affiliated with travel and tourism—began to report a decline in their business.

- Three major conventions scheduled for Toronto were cancelled, with a reported expected combined attendance of nearly 50,000 hotel "room-nights". Preliminary data suggest hotel occupancy rates fell significantly in March and anecdotal reports imply a further sharp drop in April. There have reportedly been 160,000 cancellations at hotels in the GTA for the second quarter, 75 percent of which were for SARS-related reasons.

- One-third of 739 firms responding to an Ontario Chamber of Commerce survey conducted in mid-April reported reduced business activity as a result of the outbreak. The most affected industries were tourism and hospitality, business services and retail.

- In March, Air Canada reported a year-on-year decline of 18 percent in air travel to Asia. Data from US carriers suggest this likely worsened in April.

These impacts were exacerbated by a travel advisory issued 23 April by the World Health Organization. Although the warning was lifted on 29 April, concerns were raised that there could be significant and potentially lasting negative impacts on tourism and business travel to Toronto (and, to a lesser extent, the rest of Canada).

Private Sector Assessment of Potential Economic Impact

Private sector economists have indicated it is difficult to be able to quantify the precise economic impact of the SARS outbreak at this time. However, most feel that its negative economic impact will be contained to the second quarter of 2003, with some or all of the slowdown in growth made up over the second half of the year.

Economists have focused on several sectors likely to be most affected: travel industries (mainly air travel), hotels, restaurants, and, to a lesser extent, retailers. The negative impacts are expected to be seen largely in the Greater Toronto Area (see box 2 for detail on the Toronto economy), although economists expect a modest negative impact on tourism-related industries

Canada-wide. In addition, slower growth in affected economies of Asia is expected to have a slight negative impact on Canadian exports.[7]

The range of private sector estimates is that Canadian growth in the second quarter could be reduced by anywhere between one-quarter of a percentage point and one and a half percentage points (at annual rates). However, even the most pessimistic forecasters do not expect Canadian real GDP growth to fall below one percent in the second quarter. Equally, forecasters expect growth to rebound in the third quarter and beyond, as activity in affected sectors returns to a more normal level in the second half of the year. As a result, the negative impact on Canadian growth for 2003 as a whole is expected to be modest, with most forecasters suggesting it will be less than one-quarter of one percentage point.

Box 1: Individual Private Sector Estimates:

- CIBC World Markets downgraded their outlook for Canadian growth in the second quarter of 2003 by 0.25 percentage point (<0.1 p.p. for 2003 as a whole).
- The University of Toronto (PEAP) reduced their second quarter growth outlook for Ontario by 0.7 percentage point, but expects little impact Canada-wide.
- The Conference Board of Canada lowered their outlook for the Greater Toronto Area by 0.5 percentage point for 2003. They expect an impact of 0.15 percentage point Canada-wide.
- Global Insight (formerly DRI-WEFA), expects the impact on 2003 growth to be "negligible" at "much less than 0.1 percentage point."
- Nesbitt Burns reduced expected second quarter growth by 0.5 percentage point in response to the WHO travel advisory on travel to Toronto, but expected no impact for the year as a whole.
- The Bank of Montreal suggests that the outbreak would likely reduce second quarter growth by 0.8 percentage point (0.25 p.p. for 2003).
- TD Economics also expects a reduction in Q2 growth of 1.0 to 1.5 percentage points due to the SARS outbreak, with growth boosted by 0.4 percentage point in each of Q3 and Q4 (0.2 p.p. for 2003).
- JP Morgan Canada anticipates a more negative impact on the Canadian economy, reducing growth in both the second and third quarter by 1.5 percentage points. Growth is expected to be boosted by approximately 1.0 percentage point in the fourth quarter and by 0.5 percentage point in both the first and second quarters of 2004. On balance, this would reduce 2003 growth by approximately 0.4 percentage point and boost 2004 growth by 0.1 percentage point.

[7] Although Canadian exports to China; Hong Kong, China; Singapore; Chinese Taipei; and Thailand constitute approximately 2 percent of total Canadian exports, Asia has been a relatively high-growth market for Canadian products. In addition, some private sector economists have suggested that a wider outbreak in China could have more significant implications for global growth, which could further hamper Canadian export growth.

Box 2: The Economic Importance of Toronto

- The Greater Toronto Area accounts for 18 percent of Canada's total employment, and almost 20 percent of Canada's GDP. Any economic impacts on Toronto are therefore going to have significant impacts on the Canadian economy as a whole.
- Within Toronto, the hospitality industry—hotels and restaurants—employ 150,000 workers, and the arts, entertainment and recreation industry—theatres, stadiums and cinemas—employs a further 50,000.
- These industries are clearly going to be affected by a decline in tourism spending.
- Some segments of the retail and wholesale trade sectors will also be affected.

Table 4 : Toronto Economic Indicators

				Toronto as a % of		
	Toronto	Ontario	Canada	Toronto	Ontario	Canada
Population (millions)	5.0	12.1	31.4	100.0%	41.7%	16.0%
GDP (2002.3 billions, 1997$)	186.6	413.5	983.8	100.0%	45.1%	19.0%
Employment ('000 workers annual, 2002)						
Total Employment	2742.9	6068.0	15411.8	100.0%	45.2%	17.8%
Services-Producing Sectors	2035.7	4432.5	11469.3	74.2%	33.5%	13.2%
Retail Trade	282.9	710.1	1837.1	10.3%	4.7%	1.8%
Arts, Entertainment and Recreation	49.5	117.0	294.0	1.8%	0.8%	0.3%
Professional, Scientific, and Technical Services	263.4	563.5	993.3	9.6%	4.3%	1.7%
Health Care and Social Assistance	207.2	288.3	1607.0	7.6%	3.4%	1.3%
Accommodation Services	28.8	61.6	195.3	1.0%	0.5%	0.2%
Food Services and Drinking Places	120.4	314.9	827.1	4.4%	2.0%	0.8%
Other Services	1203.9	2692.0	6542.6	43.9%	19.8%	7.8%

Source: Statistics Canada

IMPACT OF SARS ON THE CHINA ECONOMY

Economic Impact of SARS

On 16 August 2003, the last SARS patient in China was fully recovered and there have been no new SARS patients since then in China, the health ministry of China has announced.

However, the SARS outbreak did have some negative impact on the economy. The economic growth rate was 6.7 percent in the second quarter, 3.2 percent lower than in the first quarter of 2003, and the lowest growth rate in the second quarter since 1992. Some sectors are seriously impacted. The total amount of transportation (people) decreased 23.9 percent. The total sale of goods in the second quarter increased 6.7 percent, much lower than 9.2 percent in the first quarter.

Measures to Contain the SARS Outbreak

China has taken various measures to contain the disease:

1. China set up the National Headquarters for Prevention and Control of SARS to coordinate the work of local governments and departments, promptly and accurately report the changing situation and take effective measures against the disease. Chinese Vice Premier Wu Yi, was appointed to serve concurrently as Minister of Health, and is in charge of the headquarters.

2. Effective action has been taken across the board to strengthen prevention and to contain the spread of the disease, the SARS outbreak was declared a statutory epidemic under China's legislation, and an open and transparent system for epidemic reporting and news release was establish.

The Chinese government standardizes the clinics caring for fever patients so as to ensure proper layout of the clinics and to avoid possible cross-infection; implements strict isolation of the SARS patients; carries out close observation of people who have close contact with SARS patients, and improves work on epidemiological investigation; makes efforts to improve protection of migrant workers, to curb SARS spreading into rural areas, and try to set up a barrier to protect healthy people from infection.

3. At the same time, the Chinese government has been going all out to treat SARS patients and set up a SARS fund.

As an example, free treatment is given to SARS patients from poor families. The Ministry of Finance and Ministry of Health jointly issued a notice, promising that local authorities would pay medical charges for SARS patients from rural areas and impoverished urban families. The central government gives subsidies to local governments of economically-constrained western provinces and autonomous regions in an attempt to share the burden of SARS treatment costs

A SARS fund of RMB 2 billion (about US$24.17 million) was set up to explore the cause and treatment of SARS and curb its spread. The Chinese government also allocated RMB 10 million (about US$1.2 million) to set up a special fund for cooperative operations among the members of ASEAN.

4. China is making rapid progress in establishing an epidemic contingency mechanism and enhancing capacity for emergency management. China lost no time in establishing and improving a national public health contingency response mechanism, including a disease

monitoring and data collecting and sharing network, and a collaborative network of laboratories.

5. The Chinese government mobilized the entire society to fight the SARS outbreak, through administrative agencies at a whole range of levels. Especially important were the grassroots organizations such as community commissions, which played an important role in raising SARS awareness and implementing preventive measures and control tasks against SARS at community level.

6. China also promptly mobilized the production and supply of medicines, medical facilities and goods to defeat SARS.

7. China has been putting great efforts into stepping up critical SARS research and exploring effective methods of diagnosis and treatment.

8. China has also been trying hard to enhance cooperation with the international community, especially with the WHO, and to draw on others' successful experience.

9. New infectious diseases, with unknown causes, are common enemies of mankind. The cross-border spread of SARS was a challenge to the whole world, and to Asia in particular. China has proposed the following measures for international cooperation:

- Establishing a reporting mechanism with respect to epidemics and disease prevention and treatment;
- Carrying out exchanges of experience and go for cooperative SARS research;
- Accelerating the bilateral health cooperation process;
- Coordinating border exit and entry control measures; and,
- Doing everything possible to minimize the adverse effects of SARS, including the establishment of a China-ASEAN workshop to look into possible counter-measures.

10. The Chinese government has embarked on efforts to maintain steady economic growth and minimize the negative impact of the SARS outbreak on China’s economic development. A State Council executive meeting was convened on 7 May 2003, and presided over by Premier Wen Jia Bao. The meeting has highlighted the following measures to be taken:

- Ensure that first quarter planting and second quarter harvests are carried out to stabilize agricultural production. Speed up rural structural reform, and increase the incomes of farmers.
- Increase investment and foster new consumption and economic growth engines, such as the automobile, real estate, telecommunications industries, and Internet-related business.
- Secure an increase in trade and attract more overseas investment. Exported products should be effectively quarantined, and greater support should be given to electromechanical, high-tech and textile products.
- Adopt preferential policies for civil aviation, tourism, catering, commerce and other sectors heavily hit by the SARS outbreak;
- Increase revenue and cut spending. Expenditure should be tightly controlled except for the prevention and treatment of SARS; and
- Improve employment and social security. Enterprises in SARS-hit areas should not fire employees at will, while local governments should provide assistance to those whose living conditions have slipped below the minimum level due to the SARS outbreak.

IMPACT OF THE SPREAD OF SARS ON THE HONG KONG, CHINA (HKC) ECONOMY AND THE MORE RECENT REBOUND

Background

- The spread of severe acute respiratory syndrome (SARS) since mid-March 2003 has stalled the recovery process in the Hong Kong, China (HKC) economy seen earlier in the year, with a severe impact mostly in April and May. Yet with the SARS outbreak brought under control, its impact has progressively lessened since June and the economy has been picking up again in more recent months.

Specific Points

- The spread of SARS has hit inbound tourism badly. The number of incoming visitors came down abruptly by 10 percent year-on-year in the second half of March, followed by sharp declines of 65 percent in April and 68 percent in May. This was in stark contrast to a 29 percent surge in January and February combined, and a 19 percent leap in the first half of March.

- The slump in inbound tourism has dealt a direct blow to the travel and airline industries. The passenger load of Hong Kong's two airlines shrank by around 70 percent in April over a year earlier, and further by around 80 percent in May. The hotel, retail and restaurant sectors were also seriously hurt. The hotel room occupancy rate dropped to only 22 percent in April and 18 percent in May, far below that of over 80 percent under normal conditions in the same period.

- Outbound travel has likewise been drastically curbed, with local people avoiding visits to the affected places and also in face of the arrival restrictions and post-arrival quarantine being imposed by some neighbouring economies on HKC people. On a year-on-year comparison, the number of HKC residents travelling abroad plummeted by 14 percent in March, and further by 29 percent in April and 24 percent in May, in contrast to a 3 percent increase in January and February combined.

- The spread of SARS has also hit local sentiment severely, depressing consumers' inclination to spend and thus jeopardising the nascent improvement in local demand. The fall-off in local consumer spending was extensive in April, not just in durables and the more expensive items but even on some of the daily necessities, and also including, rather distinctly, eating out at restaurants and going for entertainment. The volume of retail sales, having already fallen back by 4 percent in March over a year earlier, slackened distinctly to a 12 percent decline in April.

- Nevertheless, the retail business has shown visible improvement more recently, with the volume of retail sales bottoming out to virtually no change in July, from declines of 12 percent in April, 7 percent in May and 3 percent in June. With local sentiment seen to be turning better, coupled with strong promotions by the affected trades and a relaunch by the government, local consumer spending is likely to pick up further in the coming months.

- Inbound tourism has been visibly reviving, with the year-on-year decline in the total number of incoming visitors narrowing distinctly to 38 percent in June and further to only 6.0 percent in July, from the plunge of over 60 percent in April and May. Within this total, the number of incoming visitors from China has rebounded sharply, to increases of 11 percent and 23 percent respectively in June and July over a year earlier, having plummeted by 39 percent and 43 percent respectively in April and May. This reflects the swift return Chinese visitors after the abrupt pause, notably those on group tours. Moreover, the launch of the "individual visit" scheme for Chinese visitors to Hong Kong, China since late July, starting with residents from several localities in Guangdong, is proving an added boost.

- Concurrently, the hotel and airline industries have been faring better. The passenger load of the two Hong Kong airlines had a distinctly lower decline of 17 percent in July compared with a year earlier, after having plummeted by almost 75 percent in April and May combined, and by nearly 60 percent in June. The average hotel room occupancy rate also increased, from only around 20 percent in April and May to 34 percent in June and then sharply further to 71 percent in July. It should lift even more in August.

- External trade has continued to perform strongly so far in the year, and thus is still providing the key driver for overall economic growth. Total exports of goods attained double-digit growth at 19 percent in real terms in the first quarter of 2003 over a year earlier, increasing further at 14 percent in the second quarter. Offshore trade has also continued to bode well.

- The latest weekly consultation on some 500 larger companies in selected sectors conducted by the Census and Statistics Department indicates that business receipts in the week ending 30 August were on average down by only slightly less than 1.0 percent from the normal level, much improved from a plunge of around 12 percent from the normal level in the week ending 3 May.

- Yet recognising that sectors like retail, restaurants and various consumer services are generally more labor-intensive, the earlier significant setback in these sectors has aggravated the employment situation. The seasonally adjusted unemployment rate rose to a new high of 8.7 percent in the three months ending July 2003, as against 7.5 percent in the first quarter.

- The government announced a package of relief measures, amounting to US$11.8 billion in April 2003, to help the community and the affected businesses to tide over the impact of the SARS outbreak. The relief measures include rates concessions, waiving of water and sewage charges, waiving of licence fees, salaries tax rebate, rent reductions at public sector commercial premises, job creation schemes, a bank loan guarantee plan for the hard-hit industries, etc. In June, the government put out an enhanced package of employment and training initiatives in a move to alleviate further the impact of the SARS outbreak on the labor market. This package will cost US$715 million and will create over 32,000 additional short-term jobs and training places.

- With the GDP outturn in the second quarter not as low as earlier thought coupled with a generally improved global economic environment, there has been a more distinct upturn most recently. The forecast growth rate in real terms of GDP for 2003 is revised to 2.0 percent in the August update, half of a percentage point up from the 1.5 percent growth forecast in the May round.

- There could be more upside potential if the growth momentum in exports of goods and offshore trade remains just as strong throughout the latter part of the year, and if inbound tourism surges even more. Yet, the recent resurgence of geo-political tension and terrorist attacks in some places casts a shadow on the global scene.

- On the price front, local costs and prices are expected to remain generally subdued in the coming months. Local retailers and service providers are likely to continue to exercise restraint on prices while overall demand in the economy is yet to return to normal. Wages and rentals are likely to come down further, as the slack conditions in the labor market and the property market have been exacerbated by the impact of the SARS outbreak. Some of the relief measures being rendered by the government carry a downward effect on the CPI. Together these will outweigh the effect of higher prices of retained imports brought about by the earlier weakening in the US dollar and the rise in world commodity prices. Thus the composite CPI for 2003 is now forecast to decline by 3.0 percent in 2003, half of a percentage point down from -2.5 percent as put out at the end of May.

Key Measures Taken by HKC

I. Macroeconomic Policy Response

1. Undoubtedly the SARS outbreak will adversely affect the domestic economy. On 23 April, the HKC government announced a package of relief measures to help tide the community over difficulties due to the outbreak of SARS and to revive the economy once the disease was under control. The total maximum cost of the proposed package was HK$11.8 billion (US$1.5 billion).

Table 5: Summary of the SARS relief package

	Measures
1.	Waiver of rates payment
2.	Reduction of water and sewage charges
3.	Reduction of trade effluent surcharges
4.	Waiver of licensing fees
5.	Salaries tax rebate
6.	Commercial rent concession by Housing Authority and for tenants managed by government departments
7.	Creation of new jobs and training places
8.	Relief Loan Guarantee Scheme
9.	Measures to further control the disease and revive the economy

2. In addition, a Task Force has been set up to propose further measures to revitalize the economy. HK$1 billion has been earmarked for this purpose.

II. Measures to Contain the Spread of the SARS Virus

3. To bring the epidemic under control, the government has put in place comprehensive public health measures centred around early detection, swift contact tracing, prompt isolation and quarantine, as well as effective containment. This approach has the effect of shortening the interval between onset of symptoms and admission to hospital, reducing the number of people exposed to each infectious case, and eventually breaking the chain of transmission from infected to healthy persons. Some of the major measures implemented are set out below.

Table 6: Key Measures to Contain the Spread of SARS

- Making SARS a statutory notifiable disease and conducting a comprehensive public education programme to heighten awareness of SARS symptoms so that potential SARS cases are presented to medical facilities as early as possible.

- Using modern technology, e.g., the online e-SARS database and the Major Incident Investigation and Disaster Support System, to improve the timeliness and capacity of contact tracing, and support identification of possible sources of infection in terms of time, place and person to guide further action.

- Requiring close contacts of suspected and confirmed SARS patients to undergo home confinement and medical surveillance for a maximum of 10 days to cut off the path by which the virus spreads in the community and thereby reduce the number of people exposed to the SARS virus.

- Establishing multi-disciplinary response teams to carry out immediate investigations and undertake prompt remedial actions in hot spots or buildings whenever one SARS case is reported, so as to minimize the chance of environmental transmission within the community.

- Heightening hospital infection control measures, e.g., providing infection control training to health care staff, equipping them with adequate protective gear, and offering advice on precautionary measures in caring for patients. In addition to allocating US$700 million for infectious disease prevention, public health education and treatment of disease, another US$200 million has been set aside for training and welfare of health care workers.

- Improving infection control facilities for handling suspected and confirmed SARS patients by carrying out enhancement works in 14 acute public hospitals at a cost of over US$400 million.

- Maintaining a high standard of personal and environmental hygiene through the launching of a territory-wide cleansing and disinfection campaign in late March to clean up public places and encourage all members of the community to clean their environment.

- Maintaining a close liaison with the WHO and other international authorities to contribute to global efforts in combating the SARS virus. HKC's transparency and openness in its handling of the SARS epidemic have been well recognized. Apart from daily press briefings, and meetings with consular corps and chambers of commerce, we also updated the WHO on our latest developments through video conferences and participation in international conferences.

- Improving the notification mechanism between Guangdong Province and HKC, and extending it to cover Macao since May, with a view to enhancing the information flow on infection control in hospitals, notification and data analysis on the epidemic situation and the clinical treatment of SARS, and enhancing co-operation in scientific research. The list of infectious diseases that must be notified to the authorities has been expanded to include SARS, AIDS, dengue fever, influenza, tuberculosis, cholera, malaria and Japanese encephalitis.
- In August, Guangdong, HKC and Macao further expanded the scope of the notification mechanism to include statutory notifiable infectious diseases in the three places. In addition, the three places could expand the list to cover other infectious diseases of concern as and when necessary. In case of the emergence of an unidentifiable disease with a tendency to spread, the respective health department would report to the relevant authority immediately and notify the health departments of the other two places at the same time so that they could get prepared.

▪ Stepping up health checks at border control points to prevent cross-border spread of SARS through international travel, e.g., requiring arriving passengers to complete a health declaration, setting up medical posts to watch for travellers displaying symptoms of SARS, implementing temperature screening at all border control points and barring close contacts of SARS patients from leaving HKC during their confinement period.
Schools Suspension and Measures Taken on Resumption of Classes: ▪ Classes in all schools including kindergartens, primary and secondary schools were suspended for three weeks from 29 March. Classes resumed for upper secondary students on 22 April and for lower secondary classes on 28 April. Classes resumed for students in primary four and above on 12 May and in primary three and below on 19 May. ▪ On returning to classes students need to ensure they have taken their body temperature and do not have a fever. For students who have not already done so, school authorities will assist in measuring their temperature before they are allowed into class. ▪ Since 19 April, if a staff member or student of a school is suspected of having contracted SARS, the school must suspend classes for 10 days. Also, if any family member or person in close contact with a staff member or student is suspected to have contracted the virus, the staff member or student must stay away from school for home confinement or home observation for 10 days.

III. International Collaboration/Cooperation with China

4. In view of HKC's role as a regional hub, it is important for HKC to attain tight international collaboration and step up cooperation with China to fight the SARS virus.

5. For this purpose, HKC maintained a dialogue with the WHO, and other economies, including China, in exchanging information on SARS and on best practices to contain the spread of the disease.

6. The WHO has praised the measures taken in HKC to stem the spread of SARS, some of which exceeded those recommended by the organization. The WHO was particularly impressed with the exit screening procedures at border checkpoints, publication of information on buildings where residents have developed SARS, procedures for isolation and quarantine, and aggressive contact tracing. The WHO also commended HKC officials for their level of transparency in reporting on the SARS situation in the territory, a degree of cooperation that would be valuable from all economies. The WHO removed HKC from the list of SARS-infected areas on 23 June 2003.

IV. Longer-Term Measures to Combat Infectious Disease

7. Learning from this experience, the HKC government is contemplating some longer-term measures to control and prevent the spread of infectious disease.

Table 7: Long-Term Measures

- A SARS Expert Committee, made up of international experts in epidemiology, hospital management and public health, has been set up to undertake a thorough review of SARS so that we will be better prepared for the future.
- HKC is studying the establishment of an organization similar to the Centers for Disease Control and Prevention (CDC) to fight and prevent infectious disease.
- HKC is studying various options, including the construction of purpose-built infectious disease hospital block(s), to further enhance the capacity and capability of the public hospital system in handling future outbreaks of infectious diseases.
- A task force, known as Team Clean, has been set up to promote a sustainable, cross-sectoral approach to improve environmental hygiene in HKC. Measures will include improving town planning, the design of buildings, their maintenance and management, and removing illegal structures.
- The SARS epidemic has witnessed the outstanding accomplishments of our experts in various areas, including identifying the causative agent and tracking the source of the virus. These are of paramount importance in the global effort to control SARS. The HKC government has earmarked US$500 million for financing research on controlling infectious diseases to encourage, facilitate and support research on the prevention, treatment and control of infectious diseases.
- Specifically, the HKC government considers it most important that the standard of personal and environmental hygiene in the community must be maintained and sustained. Together with other sectors in the community, the government has carried out ongoing public education programmes on this front. This is an integral part of the long-term strategy for fighting the SARS virus, and for that matter, any other infectious diseases that may emerge.

THE IMPACT OF SARS ON THE INDONESIAN ECONOMY

The Impact of SARS on Asian Economy

The severe acute respiratory syndrome (SARS) has been creating panic over the last month or so. The virus is still spreading, and unless the situation improves within the next few months, it will have an incomparable impact on public health, society, the environment and the economy. As far as the wider economy is concerned, the most significant near-term impact has been the disruption to business and consumer demand, and the subsequent rise in unemployment. Fear of SARS has kept people at home and tourists away. Public transportation, hotels and restaurants have been hit hard.

Meanwhile, international investors are no longer focusing on economies with a high number of infections and deaths. Attention is starting to shift to economic fallout in economies that are dependent on affected economies for growth. Firms have restricted travel to Asia, and companies have warned the outbreak could affect earnings and Asia-based output. Commodity traders are worried that if SARS disrupts trade and slows growth it would weaken the Asian economies demand for industrial imports. Many analysts' reports suggested that the impact of SARS would be neutral on sectors such as power, telecommunications, and construction. The major gainers would be manufacturers of masks and latex gloves, pharmaceuticals, and healthcare products. Most analysts warned that if the SARS outbreak were not contained, the impact would filter to other economy sectors like manufacturing and external trade.

Table 8: Trade Direction

% Total Exports in Period	Major Exports by Economy			Major Imports by Economy		
	Largest	Second	Third	Largest	Second	Third
China Jan-Mar	US 20.5	HKC 17.3	Japan 14.7	Japan 18	Chinese Taipei 11.8	Korea 10.5
HKC Jan-Feb	China 41.4	US 17.9	Japan 5.8	China 42.1	Japan 11.9	Chinese Taipei 6.8
Singapore Jan-Mar	Malaysia 15.2	US 13.4	HKC 10.6	Malaysia 16.7	US 15.2	Japan 11.5
Chinese Taipei Jan-Mar	HKC 22.5	US 18.5	China 10.5	Japan 25.6	US 13.2	China 7.9
Thailand Jan-Feb	US 16.9	Japan 14.9	China 7	Japan 23.3	US 10.4	China 7.5
Korea Jan-Feb	US 18	China 16.8	Japan 9.4	Japan 19.2	US 14.5	China 10.8
Indonesia Mar*	US 14.6	Japan 14.26	Singapore 10.42	Japan 16.85	US 8.8	China 6.75
Philippines Jan-Feb	US 20.9	Japan 15.5	Netherlands 10.1	US 20.2	Japan 19.2	Singapore 6.6

* BPS and Bloomberg

A bigger danger is trade disruption, especially exports to the three worse-hit economies (China; Hong Kong, China; and Singapore). The increasingly dense network of intra-regional trade ties in East Asia could be affected badly. The impact of the SARS outbreak on domestic demand in those economies is expected to lead to a reduction in import demand in economies most affected. Several of Asia's economies may, for now, actually see a net export improvement from the SARS outbreak, but this is unlikely to be sustained if SARS worsens globally. Global economic conditions, in particular the US recovery, will also play a crucial part as Asia's economies are heavily export-reliant.

The negative impact of SARS on domestic demand has been most evident in Hong Kong, China; Singapore; China and, to an increasing extent, in Chinese Taipei. The slowdown in domestic demand in those economies will also inevitably lead to a reduction in import demand, with economies that export to those most affected by SARS seeing a noticeable impact on exports (Table 8)

Whilst the length and depth of the impact from this will depend on how long the SARS outbreak/fear last, there is increasing evidence that the SARS affected economies are also being hit by cancellations or delays of orders from outside Asia. The other source of weakening pressure on exports, aside from the fall in demand in SARS affected economies, is falling orders from foreigners as they stop travel to Asia. The slowdown is also likely to feed through to economies including Japan and the US. Japan's exports to China; Hong Kong, China; Singapore; and Chinese Taipei account for around 28 percent of total exports. With the SARS outbreak now in its second month and still showing limited signs of stabilizing, the impact on production and external trade is likely to be most apparent in either April or May's data.

The Impact on the Indonesian Economy

Indonesia has contained its outbreak of severe acute respiratory syndrome, with a quick response and openness about the deadly disease’s spread. The Indonesian government in early April declared the SARS virus a major health threat, allowing the government to quarantine those who may have been infected. Its screening of visitors for the disease focused on flights from infected areas. The highest levels of the government acted quickly and in the right direction.

So far, we have succeeded in curbing the SARS outbreak by identifying new cases quickly and isolating patients before they spread the illness to others. The lessons to be learnt are a speedy response, a very high level of open support, and preparedness to accept help and public acknowledgement of the issues.

Given that the ultimate macroeconomic repercussions of the epidemic are difficult to ascertain at this stage, during the first quarter of 2003, Indonesia’s economy developed quite favorably as indicated by more stable macroeconomic conditions. Consistent monetary and fiscal policies supported by progress in several aspects of economic restructuring, helped to achieve economic and monetary stability. The exchange rate strengthened significantly with relatively little volatility and base money was under control and below its indicated target; and other monetary aggregates, M1 and M2, increased albeit at slower pace. These positive developments lowered inflation and improved inflation prospects, providing room for an easing monetary policy with a gradual but steady reduction of interest rate, thereby delivering positive signals regarding the economic recovery.

(i) The Impact on the Trade Account

We expect the Indonesian economy will maintain its recovery momentum despite the impact of the SARS outbreak on trade, tourism and transportation which cannot be overlooked. The SARS outbreak is disrupting trade and tourism in the Asian region, but the spread of the deadly virus may have less impact on Indonesian trade account compared to other Asian economies. Indonesia is not heavily exposed to the domestic demand weakness of SARS-affected economies.

Table 9: Value and Volume of Non-Oil/Gas Exports and Imports Q4–2002 to Q.1–2003 (value in US$ million; volume in thousand tons)

Period	Exports		Imports	
	Value	Volume	Value	Volume
Q.4–2002	**11,019**	**40,280**	**5,915**	**10,456**
Oct	3,973	13,676	2,234	3,760
Nov	3,804	12,766	2,059	3,733
Dec	3,242	13,838	1,621	2,963
Q.1–2003	**11,586**	**37,896**	**7,105**	**11,618**
Jan	3,936	12,954	2,322	4,791
Feb	3,723	11,460	2,632	3,847
Mar	3,927	13,482	2,150	2,980

Source: Bank Indonesia - open file

The US and Japan remained Indonesia's largest export markets. The new signs of US and Japan economic recovery are crucial to demand for Indonesia's exports. Indonesia's exports rose 5.14 percent in the first quarter of 2003 compared to the fourth quarter in 2002 before SARS outbreak, reflecting higher oil prices and a boost in overseas orders for manufactured goods (Table 9). In the same period, imports to Indonesia rose 20 percent, reflecting the increasing trend of domestic private investment.

(ii) The Impact on the Retail and Banking Sectors

Decline in consumption is one of the disease's direct impacts on the economy as fewer people go to department stores, which are often cited as crowded public places. In fact, the hypermarkets in Indonesia are not seeing any major drop in sales and do not expect any slowdown in business, and the impact of the SARS outbreak on Indonesian companies' earnings is not going to be as bad as in other Asian economies. Meanwhile, in the financial sector, the banking sector is seen as continuing to perform satisfactorily although loans growth is slowing. Nevertheless, banks exposed to the travel and tourism sectors may see some fluctuations in non-performing loans.

We estimate the economy grew 3.2 percent in the first quarter of 2003 year-on-year, against 3.8 percent growth in the last quarter of 2002. Domestic consumption increased to about 4.2 percent year-on-year in the first quarter of 2003, against an average first-quarter growth of 5.7 percent in 2002. Looking ahead, prospects for recovery of the Indonesian economy are expected to improve slightly with economic growth forecast to be around 3.5 percent to 4.0 percent.

(iii) The Impact on the Tourism Industry

Indonesia thus far appears to be relatively safe from the effects of the SARS outbreak with the exception of the tourism industry. We expect SARS to reduce total foreign tourist arrivals in Indonesia this year. Tourism revenue accounted for about 2.6 percent of Indonesian GDP in 2002. As a leading indicator, tourist arrivals to Indonesia's top tourist destination, Bali, dropped 35 percent in March as the war on Iraq and the new respiratory illness raised concerns about global travel. In March, Bali attracted 77,540 visitors, down from 118,957 in the same month a year ago.[8] Arrivals to Indonesia dropped off by one-fifth to 288,417 visitors in the same month. Last year, Indonesia's tourism industry earned US$4.3 billion in foreign exchange from 5.03 million tourists, 20 percent less revenue than in 2001.

Table 10: The Services Account Performance

Item	**Q4–2002** (US$ million)	**Q1–2003** (US$ million)	**%**	**Description**
Transportation (passenger transportation)	-482	-271	-43.80	Most of the destinations of Indonesian travelers are SARS-affected economies, therefore the number of Indonesian travelers sharply decreased. Furthermore, the SARS outbreaks reduced payments abroad as well as the deficit of transportation payments, since most Indonesian travelers used to travel by foreign-owned air transportation companies.
Freight on non-oil/gas imports	-532	-705	32.52	An increase in non-oil/gas imports was followed by an increase of transportation costs (shipping).
Tourism a. Tourism Income b. Number of tourists (thousand people)		1.008 1.037	-13.08 - 6.07	Foreign visitors from SARS-affected economies have been major contributors to Indonesian tourism. Therefore, SARS outbreaks in those economies reduced the number of tourists visiting Indonesia. Tourists from non-SARS-affected economies also avoided travel abroad. Consequently, tourism income was reduced. According to the Minister of Culture and Tourism, the outbreak of SARS caused the number of tourist visits to fall by 15% to 20% in April–May 2003.

Although tourist arrival numbers for April 2003 are not available yet, we expect a significant drop, as the number of visitors from SARS-affected economies may fall in

[8] The Indonesian Statistics Bureau (BPS)

April. While fear of SARS is undoubtedly having an impact on tourism, the extent of it is unclear.

(iv) The Impact on the Capital Account

The balance of payments positions in the SARS-affected economies are expected to worsen as more evidence emerges of foreign direct investment (FDI) falling. This will lead to more weakening pressure on the currency of the three worse-affected economies. Government fiscal and monetary stimulus will also remain expansionary in Asia to support the weakening of domestic demand.

With inflation risks in the region easing following the end of the war in Iraq and falling oil prices, slowing domestic and external demand is expected to keep fiscal, and in particular, monetary policy expansionary. We have seen several economies over the last month announce extra fiscal stimulus packages to support their economy, with the risk of more to emerge if the economic downturn intensifies. On the monetary policy front, we expect central banks in the region to remain on an easing stance given the easing bias of the Fed monetary policy.

The Central Bank of Indonesia also maintains its bias towards lower interest rates, but with a slower pace of decline to maintain stability in the economy and financial system. The fall in the interest rate, the improvement in risk premium, and the positive signal regarding economic recovery have recently turned global investors' eyes back to Indonesia's financial market. The rupiah is now viewed as high yielding domestic currency along with other emerging market currencies. We have witnessed large short-term capital inflows into our domestic financial system, which have led to a spectacular appreciation of the rupiah. Given the increasing international confidence on our domestic economy and based on the latest economic developments in early 2003, we strongly believe that the overall balance of payments will improve. Nevertheless, we should continue to monitor the SARS situation closely, as it could pose a major downside risk on our future economic development.

Finally, the magnitude of the ultimate economic impact of the SARS crisis depends on one critical variable–its duration. If the disease is contained in a relatively short time, its impact should be minimal. SARS outbreak are likely to materially impact the region's economies, as evidenced by the already significant disruptions to business and investment. We have seen that most Asian economies are now trying to deal more forcefully with SARS outbreak, to regain consumer and investor credibility. If the SARS virus is effectively contained, the impact on the economy should be minor.

THE IMPACT OF SARS ON THE JAPANESE ECONOMY

The severe acute respiratory syndrome (SARS) had very limited effects on the Japanese economy, in terms of the overall activities of consumption and production. However, the diminished number of overseas travelers, the reduced number of airline flights, and other factors significantly damaged the relevant sectors, such as the tourism and airline industries.

Effects on the Tourism Industry

- *Overseas travel sales at 13 major travel agencies showed a decline of 47.4 percent in April from last year, 59.3 percent in May and 59.3 percent in June. A particularly large decline was seen in the number of travelers to China and Southeast Asia.*

Effects on the Airline Industry

- *All Japanese airlines significantly reduced their flights to such destinations as Hong Kong, China and Guangzhou in China. One major airline in Japan cancelled 23 percent of its flights on international routes, largely those to and from China, and placed cabin crew on short-term furloughs in May.*

Japanese manufacturing companies that have located their production bases in Southern China were influenced by the SARS outbreak, especially through the cancellation of business trips. However, as the SARS threat in the region decreased, its effect on business has been mitigated.

Estimated Effects of the SARS Epidemic

- *There will be an effect on Japanese imports and exports due to the slowdown in Hong Kong China, China; and other Asian economies.*
- *There was a decline in travel overseas to SARS-infected regions with effects on related industries and effects on consumption and the balance of international tourist receipts and expenditures (current account).*

It is expected that a substitution effect in consumption and production has taken place in the form of increased domestic travel and an increase in the production of domestic bases.

THE IMPACT OF SARS ON THE MALAYSIAN ECONOMY

- The impact of the SARS outbreak was confined to the services sector, particularly tourism-related industries. Tourists arrivals plunged 58.6 percent on an annual basis in April 2003. However a slight recovery was registered in May and was further reinforced in June with increases of 17.7 percent and 32.7 percent respectively over preceding months. Hotel occupancy fell to 41.7 percent in April and inched up to 43.2 percent in May and rose to 55.3 percent in June. Air travel was affected during the period with Malaysian Airlines System's passenger volume contracting 20.6 percent in April and falling further by 29.5 percent in May.

- The short but severe effect on the tourism sub-sector is expected to moderate growth of the services sector during the first half of 2003. Strong growth in port activities and communication sub-sectors will help maintain positive growth.

- As there are indications of strong growth in the manufacturing and agricultural sectors plus the revival of tourism and business and consumer confidence as the impact of the Package of New Strategies filters through, the earlier GDP forecast of 4.5 percent is still relevant.

THE IMPACT OF SARS ON THE NEW ZEALAND ECONOMY

Executive Summary

- The outbreak of SARS is having a marked impact on short-term economic activity in the most affected economies–Hong Kong, China; and Singapore, and increasingly China. A significant contraction in activity in the second quarter is likely in Hong Kong, China; and Singapore.

- While SARS cases have been reported in a large number of economies, it is the 'fear' of SARS that is appreciably altering behaviour.

- Any assessment of the economic impact of SARS needs to take a view on the intensity and duration of the illness as well as attempt to quantify the 'fear' element of current behaviour. Such views are highly speculative, and subject to significant change as new information becomes available.

- Trade channels (of goods and services) represent the direct routes through which the outbreak will impact on the New Zealand economy (unless there were a material outbreak here). An impact via confidence is also possible.

- At this stage the economic impact on New Zealand, assuming it remains relatively SARS-free, is expected to be relatively small.

External Developments

The transmission channels through which SARS impacts are expected to feed through into regional economies are:

> **Demand:** reduced activity by consumers, through enforced quarantine, and out of fear of contracting the virus is likely to have the far greater economic impact. Shopping, travelling, eating out, and other forms of social and economic activity have been severely curtailed, particularly in Hong Kong, China; and Singapore.
>
> **Supply:** reduced production due to workdays lost through quarantines, sickness or death.

While some forecasters have produced different scenarios about the virus, most have assumed that it will have an effect on economic activity in only a single quarter, and are viewing it as a shock to aggregate demand. If the SARS outbreaks continue for longer then supply side issues are likely to become more important, including the effect of reduced business travel on willingness to invest.

A number of forecasters note that increased government spending (on health care among other things) is one offset to the fall in demand, and that activity is likely to rebound quickly, as travel rebounds and consumers step up spending to satisfy "pent up" demand.

While the SARS virus is largely confined to Asia, the WHO travel restrictions to Toronto (subsequently lifted) saw SARS cited as a risk to the growth outlook by the Bank of Canada, and SARS has been cited by the US Federal Reserve as affecting tourism to the US.

Impact on New Zealand

Trade channels (of goods and services) represent the direct routes through which the outbreak impacted on the New Zealand economy. An impact via confidence was also possible. Reduced numbers of New Zealanders travelling overseas and a boost to net migration (from non-resident New Zealanders returning) represent two possible offsets, although both are hard to quantify.

The table below summarizes the tourism and trade connections between New Zealand and some selected economies. The third column under visitor arrivals is the annual average decline/growth in visitor arrivals in 1998, immediately following the Asian financial crisis.

Table 11: Tourism and Trade Connections

	Visitor arrivals (year to March 2003)			Merchandise Trade Exports (year to December 2002)		Student Visas (year to June 2002)	
	Number	Share	% change in 1998	$ Billion	Share	Number	Share
China	79,766	3.9%	-6.5	4.6%	11.2	42,133	45.7%
Hong Kong	26,658	1.3%	-4.9	2.0%	3.5	1,734	1.9%
Singapore	33,752	1.6%	-2.8	1.2%	-2.2	242	0.3%
Japan	172,716	8.4%	-5.0	11.5%	-4	5,310	5.8%
Sth Korea	115,317	5.6%	-83.7	4.4%	-25.7	15,719	17.1%
Canada	39,699	1.9%	4.5	2.1%	-4.9	365	0.4%
Australia	638,354	31.0%	15.9	20.0%	7.8	n/a	
UK	240,029	11.7%	4.8	4.8%	-3.6	1,076	1.2%
US	205,796	10.0%	13.1	15.4%	30.4	1,777	1.9%

Note: Shares of total may not sum to 100% as not all countries are included in the table

Tourism

- Tourism is likely to be one of the principal transmission channels through to the New Zealand economy.
- Tourism is a sizeable part of the New Zealand economy. Tourism exports (more precisely, travel exports) were worth US$6.0 billion in the year ending September 2002, and the tourism sector employed around 95,000 people in 2000. Since 2000 tourism has grown strongly with strong growth in visitor arrivals (5.4 percent in March 2003) and an increase in the average length of stay.
- Asia as a whole is an important source of visitor arrivals, representing 25 percent of all arrivals in 2002. Australia accounts for around 30 percent of arrivals and the US and the UK around 10 percent each.

Events so far

- Short-term visitor arrivals fell sharply in the second half of March.
- Arrivals from Asia are down sharply in each of the 6 weeks to 20 April. The largest falls were in visitors from Japan and Korea, suggesting a broader driver than SARS.
- Overall, total visitor arrivals were running above the equivalent time period in 2001 and 2002 until mid-March and have since rebounded to above the 2001 and 2002 levels. The timing of Easter appears to be a significant driver of weekly arrivals.

- Seasonally adjusted short-term visitor arrivals fell 4.5 percent in May, to be 12 percent lower than one year ago. In April arrivals fell 8.8 percent. Falls in visitor arrivals from Asia were the main driver of the decline, with arrivals in May 47 percent lower than in May

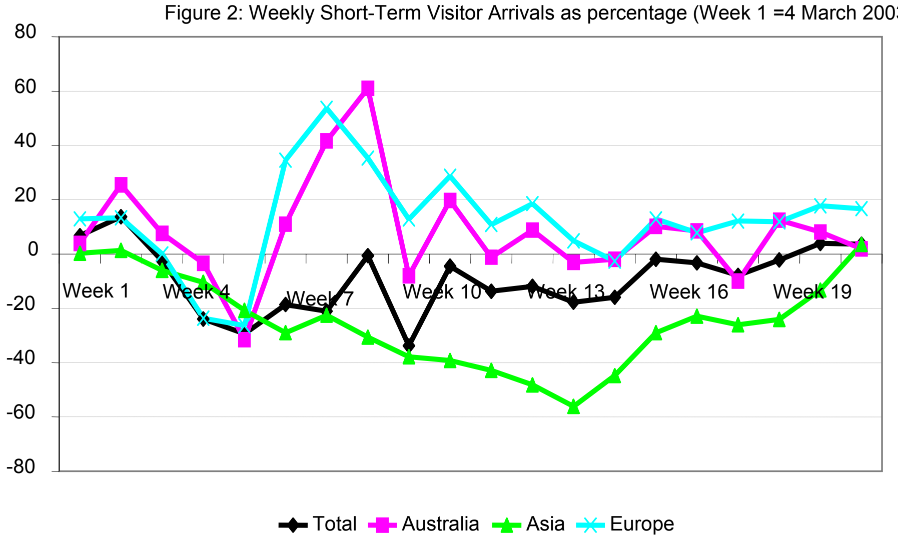
- 2002. Compared with a year ago, arrivals were up from Europe (13.2 percent), the US (1.5 percent) and Australia (2.7 percent).

- The month of June saw a lift in short-term arrivals of 6.9 percent. The first half of July has continued to see an increase in visitor arrivals, with total arrivals now slightly above the level recorded in 2002, compared with visitor numbers well below the equivalent week in 2002 for much of April and May.

- For the second quarter as a whole, short-term visitor arrivals were 8.3 percent lower than in March. This will have a negative impact on services exports and GDP in the second quarter.

- The graph below plots the annual percentage change in visitor arrivals between 2002 and 2003.

Figure 2: Weekly Short-Term Visitor Arrivals as percentage (Week 1 =4 March 2003)



Looking Forward

Factors relevant to future short-term visitor arrivals and the impact of SARS on New Zealand include:

- Duration. If the virus is contained quickly and fear of infection begins to subside then tourism flows may return toward "normal" levels. We have seen the beginning of this in June and the first half of July.

- Timing. The timing of the SARS outbreaks means that the effect on New Zealand is most likely to come during June and July. A continued negative impact into November and December and the peak tourist arrival season would have a larger impact. Recent data suggests that the chances of this are receding.

- The relative role of the SARS outbreak versus other drivers affecting international tourism in recent months–Iraq, overall weak global economic conditions. It is difficult to establish the impact of each factor.

- The broader economic impacts on Asian regional and global growth in general. The initial reduction in travel due to fear about the virus will be compounded if Asian economies are adversely affected and incomes fall.

Tourism

Tourism numbers from Asia may continue to be affected by the outbreak of SARS, with a fall in confidence and weakening economic activity reducing incomes. The SARS virus may also discourage some European travellers who would usually stopover in Asia and cannot move onto another route. There is a possible offset if tourists who were planning to go to Asia come to New Zealand instead.

Airlines cut capacity with Air New Zealand, reducing the number of flights both to and from Asia. For example, Air New Zealand cancelled its Monday flight to and from Hong Kong, China between 12 May and 30 June. Air NZ recently noted that Auckland-Hong Kong travel was down 15 percent to 20 percent and Auckland-Japan was down 10 percent to 15 percent.

However Cathay Pacific, Singapore Airlines and Air New Zealand have all recently announced an increase in flights to and from Asia. For example, Cathay Pacific is moving back to 90 percent of the normal number of flights in August and 100 percent in September after cutting flights to nearly 50 percent of the normal level in April and May.

Growth in the number of students from Asia, and particularly China, studying in New Zealand has provided a significant boost to both short-term and long-term visitor arrivals over the last few years. If SARS-related fears reduce education travel this could have a negative effect on New Zealand. As a broad measure of student arrivals, the visa application data provides an indication of the recent decline. Application numbers from China, and other parts of Asia fell sharply over March, April and May.

Migration

The nature of the impact of SARS on permanent and long-term migration is uncertain, with forces operating in both directions.

Arrivals may decrease if it is more difficult for people from affected economies to travel internationally. Total permanent and long-term arrivals remained at a high level over the June quarter, suggesting that any impact from SARS on arrival numbers may have been small. However, permanent and long-term arrivals from China were down on a year ago.

Conversely if New Zealand remains SARS free, there may be increased interest in moving here. Non-resident New Zealanders living in affected economies may be encouraged to return to New Zealand, although such an impact may only be short-lived. Departures from New Zealand may also fall with New Zealanders intending to move to affected areas likely to postpone or cancel their move.

Merchandise Trade

Asia is an important trading destination for many New Zealand exports, accounting for around a third of exports.

Prices and volumes of exports could both be affected by the impact of the spread of SARS on Asian economies. However, since most of New Zealand's exports to Asia are primary products the main channel may be via lower prices, as production is still likely to take place. Producers will tend to try and sell to other exports markets or domestically.

Merchandise trade data showed a decline in export values over the June quarter. However, the extent to which this is due to SARS is unclear, with the appreciation of the exchange rate also contributing. Seafood export volumes did fall in April (-8.6 percent) and may reflect a drop off in demand in some Asian economies during the outbreak of SARS.

Commodity prices have been relatively flat over the last couple of months with any impact from SARS small relative to total world demand for New Zealand commodities.

If growth in Asian economies weakens substantially then the impact on export volumes could be greater and could expand to include manufactured goods and forestry products, which are sensitive to income levels (and therefore demand).

At this stage we are not expecting a significant reduction in merchandise export volumes as a result of SARS. For agricultural products there are other factors, such as the influence of climate, that are likely to be more important than SARS.

Action by New Zealand to Prevent the Spread of SARS

Border control mechanisms in New Zealand include:

- Provision of SARS information pamphlets (which we have translated into four languages) to all incoming passengers;

- Requiring all incoming passengers to fill in a SARS declaration section on the New Zealand Passenger Arrival Card, which is a statutory declaration. On the basis of passenger response, immigration officials will direct higher risk passengers for nurse assessment at the New Zealand arrival airport. This system is being piloted at Auckland airport during the week of 5 May, and will be rolled out in a stepwise fashion in this and all other international airports (including those covered by Freedom Air) during May;

- Investigating the use of thermal imaging cameras at airports to identify passengers with a temperature of 38˚ Celsius or above for nurse assessment. At this point it seems that nurse interventions (described above) may be more reliable and cost-effective than thermal imaging camera identification;

- Stationing of nurses at four major international airports (Auckland, Christchurch, Wellington and Queenstown); and

- Systems to identify sick passengers and crew and possible contacts in flight, and ensure they are met for assessment on arrival.

The Ministry of Health currently advises that there are no reasons to isolate or quarantine any person returning to or visiting New Zealand from affected areas (or any other area) if that person is well.

However the Ministry of Health asks that people who are from or who have visited Level 1 and Level 2[9] affected areas take the following precautions:

- Stay at home and phone the doctor if they have symptoms suggestive of SARS;
- Do not donate blood for two weeks;
- Do not visit hospitals for ten days;
- Postpone any elective surgery and non-urgent dental work for ten days; and
- Hospital workers should defer returning to work for ten days.

[9] **Level 1 areas** are considered high risk. These are: China; Hong Kong, China; and Chinese Taipei. The New Zealand Ministry of Health advises that travelers to these areas **should postpone** non-essential travel.

Level 2 areas are those areas considered moderate risk. This applies to Singapore. The New Zealand Ministry of Health advises that travelers to this area should **consider postponing** non-essential travel.

THE IMPACT OF SARS ON THE PHILIPPINES ECONOMY

Growth

The Philippine economy grew slower in the second quarter of 2003 with GDP growing at 3.2 percent. The slowdown, however, was the result of the combined effects of the weak external environment, and uncontrollable factors such as the mild *El Niño* and the SARS outbreak.

Industry grew modestly at 1.7 percent in the second quarter of 2003. The impact of SARS was evident in the contraction of export-related sectors such as the electrical machinery sector (15.1 percent) which includes production of semiconductors, electronic microcircuits and finished electrical machineries. Exports of these products to China; Singapore; and Chinese Taipei fell, heightening the decline in exports to the United States and Japan. Notwithstanding the decline in the electrical machinery sector, manufacturing still held up unexpectedly well (4.1 percent) in the second quarter of 2003 as domestic-oriented industries such as food, base metal, chemicals and chemical products, and paper and paper products exhibited strong growths. One good development was the turnaround in the chemicals sector (5.1 percent) which is most likely due to higher spending for SARS-related products.

Table 12: Manufacturing by Industry Group at Constant 1985 prices
Growth Rate, in percent

Industry Group	2002					2003	
	Q1	Q2	Q3	Q4	**FY**	Q1	Q2
Export-oriented:	**4.7**	**11.7**	**14.0**	**7.8**	**9.8**	**-2.1**	**-2.3**
Textile manufactures	3.0	13.4	7.3	20.5	**11.2**	1.5	14.0
Footwear wearing apparel	4.5	-3.0	8.9	13.8	**6.9**	6.3	12.0
Wood and cork products	-12.2	-5.6	2.0	5.3	**-2.1**	12.4	51.3
Furniture and fixtures	-9.9	-6.9	-4.6	-8.2	**-7.4**	3.0	2.4
Leather and leather products	-12.9	-20.8	2.3	57.1	**4.7**	-4.9	13.1
Machinery except electrical	-23.6	-23.3	-26.8	1.5	**-18.4**	10.9	32.8
Electrical machinery	13.4	26.2	29.1	6.3	**18.9**	-7.1	-15.1
Domestic-oriented:	**1.7**	**2.7**	**-1.3**	**3.0**	**1.6**	**7.5**	**6.1**
Food manufactures	10.6	6.4	1.6	9.5	**7.2**	12.1	5.4
Beverage industries	-14.6	-1.4	7.8	-0.8	**-0.9**	6.6	-1.5
Tobacco manufactures	0.5	3.2	22.5	4.3	**8.3**	-47.1	-54.2
Paper and paper products	-19.5	-7.8	-10.5	3.7	**-9.7**	4.7	6.1
Publishing and printing	18.5	7.8	2.3	-5.4	**6.3**	5.1	4.0
Rubber products	-13.6	-3.1	-1.2	0.0	**-5.2**	3.3	-1.9
Chemicals & chemical prod.	6.2	-0.4	-7.8	-4.4	**-2.4**	-2.5	5.1
Products of petroleum & coal	-20.6	-9.0	-9.4	-11.0	**-12.3**	3.8	22.3
Non-metallic mineral prod.	3.8	15.4	13.4	5.4	**9.7**	-15.5	-5.6
Base metal industries	4.9	5.6	-6.0	-9.0	**-1.2**	93.0	63.8
Metal industries	13.8	21.2	8.5	26.9	**19.2**	0.8	-10.1
Transport equipment	3.3	19.1	-10.3	9.4	**4.1**	5.8	-14.1
Miscellaneous manufactures	14.6	2.4	-13.4	-9.4	**-2.7**	1.1	1.5
TOTAL	**2.4**	**4.8**	**2.7**	**4.0**	**3.5**	**5.3**	**4.1**

Source: National Statistical Coordination Board (NSCB)

Services remained the stronghold of the economy, expanding by 5.0 percent in the second quarter. The sector remained generally resilient, except for notable slowdown in the growths of tourism-related services sectors such as recreational, hotel and restaurant, airlines, and cruises, among others in the second quarter of 2003. The slowdown can be attributed to the decline in visitor arrivals from East Asian countries. Visitors from China; Hong Kong, China; Japan; Korea; and Chinese Taipei totaled 471,062 from January to July 2003, a decrease of 12.1 percent compared to the same period in 2002 and comprised about 46 percent of total visitor arrivals. While water transport was slightly affected, air transport suffered a considerable decline (16.7 percent) as the World Health Organization advised a high level of caution regarding air travel. The growth of trade services also slightly moderated to 5.3 percent in second quarter from 5.6 percent in first quarter.

Table 13: Services Sector at Constant 1985 Prices

	2002					2003	
	Q1	Q2	Q3	Q4	**FY**	Q1	Q2
SERVICES	**4.8**	**5.5**	**5.0**	**6.4**	**5.4**	**5.5**	**5.0**
Transport, Comm., Storage.	10.1	9.3	7.4	8.9	**8.9**	8.6	8.2
Tourism-related:	**3.9**	**5.4**	**3.1**	**6.2**	**4.7**	**3.2**	**-1.8**
Water transportation	**3.4**	**6.7**	**3.2**	**4.2**	**4.4**	**5.9**	**2.6**
Air transportation	**5.4**	**1.4**	**2.8**	**14.6**	**5.6**	**-5.2**	**-16.7**
Trade	5.5	6.4	4.6	6.4	**5.8**	5.6	5.3
Finance	-0.6	4.4	4.4	5.6	**3.4**	5.5	6.0
O. Dwellings & Real Estate	2.3	-0.2	2.1	2.8	**1.7**	3.2	3.8
Private Services	5.1	4.9	5.6	6.3	**5.5**	5.4	4.6
Tourism-related:	**2.7**	**2.8**	**-3.3**	**5.8**	**2.0**	**4.5**	**1.4**
Recreational	**3.0**	**3.5**	**-14.6**	**5.1**	**-1.0**	**7.7**	**4.4**
Hotel and restaurant	**2.6**	**2.1**	**4.7**	**6.7**	**4.1**	**2.2**	**-1.4**
Others	**2.7**	**3.5**	**3.0**	**4.0**	**3.3**	**4.6**	**3.1**
Government Services	2.2	4.1	5.3	7.2	**4.7**	3.3	0.1

Source: National Statistical Coordination Board

On the demand side, exports of non-factor services from the NIA data worsened to 9.5 percent, due to the significant decline of tourism travel receipts in the wake of regional concerns regarding the SARS virus.

Personal consumption maintained its momentum for the year, posting a strong 5.1 percent growth, though there were notable slowdowns in beverages, tobacco and utilities expenditures compared to Q1 2003 growth.

Table 14: Demand Side Expenditure Items at Constant 1985 prices
Growth Rate, in percent

Industry Group	2002 Q1	2002 Q2	2002 Q3	2002 Q4	2002 FY	2003 Q1	2003 Q2
Personal Consumption Expenditure:	3.5	3.8	4.3	4.6	**4.1**	4.9	5.1
Food	2.8	3.2	3.6	4.0	**3.4**	4.2	4.9
Beverages	3.0	2.3	2.8	4.0	**3.0**	3.9	1.3
Tobacco	1.7	1.4	2.0	1.7	**1.7**	2.5	0.9
Clothing and footwear	2.7	2.0	2.9	3.2	**2.7**	3.9	4.6
Fuel,light and water	-4.0	1.4	2.6	1.9	**0.6**	10.0	4.0
Household furnishings	2.3	6.0	4.0	6.8	**4.8**	2.8	5.7
Household operations	2.3	2.1	2.5	2.5	**2.3**	2.7	2.8
Transportation/communications.	15.7	12.1	13.2	13.8	**13.6**	11.8	12.0
Miscellaneous	4.9	5.3	5.5	5.4	**5.3**	5.7	5.6
Government Consumption	-1.9	5.1	3.6	2.2	**2.4**	-1.5	-8.7
Capital Formation	-11.1	-13.1	-4.0	14.7	**-3.5**	17.4	-0.4
Exports	-5.1	6.8	8.1	4.5	**3.6**	3.6	1.6
Imports	-5.1	4.6	5.0	14.9	**4.7**	24.0	6.5

Overseas Filipino Workers Remittances

Overseas Filipino Workers remittances for Q2 2003 slowed down to 6.3 percent (US$ 2.04 billion) after a 10.0 percent increase in Q1 2003 and the 30.6 percent expansion in the same quarter in 2002. The SARS outbreak had its most noticeable impact on the deployment of OFWs, with the number of persons deployed falling to 11.6 percent. This decline was partly compounded by the conflict in Iraq in the Middle East where a significant number of Filipino workers are usually deployed. Latest deployment data (July 2003) still registered a sluggish downturm of 6.3 percent, as the aftermath of the SARS outbreak continues to linger in the region.

Exports

Total nominal exports growth from January to July rose a slow 0.5 percent but this was due to the combined effect of the SARS outbreak and the weak growth in electronic exports. Exports from January to March 2003 grew by an average of 4.8 percent and decelerated to 2.4 percent from April to July of the same year. Exports to SARS-affected economies like Chinese Taipei and Singapore contracted by 15.5 percent and 8.5 percent respectively. However, the decline in earnings from these economies was offset by the ballooning rise of exports to Hong Kong, China; and China, which grew by 50.5 percent and 40.0 percent respectively.

Table 15: Selected Indicators Q1 2002 to Q2 2003
Levels and Growth Rates *(Updated: 10 September 2003)*

Indicator	2002		2003			Growth rate (2002)		Growth rate (2003)			Remarks
	Q1	Q2	Q1	Q2	Latest	Q1	Q2	Q1	Q2	Latest	
OFW remittance[1], (in US$ thousands)	1,670,760	1,919,898	1,838,565	2,041,111		17.5	30.6	10.0	6.3		
OFW Deployment[2] (No. of Persons)	231,826	252,343	236,291	222,969	70,588	0.5	8.0	1.9	-11.6	-6.3	Latest Data: July
MISSI Volume of Production Index (1994=100)[3]	106.033	111.700	109.300	112.467		-12.6	-3.0	3.1	0.7		
MISSI Value of Production Index (1994=100)[3]	175.767	188.100	199.400	204.223		-9.3	0.9	13.4	8.6		
MISSI Capacity Utilization (in percent)[3]	75.333	75.700	77.800	77.967		-4.6	-3.3	3.3	3.0		
Merchandise Imports (F.O.B. in US$ thousands)[3]	7,402,544	9,414,116	9,157,988	9,412,544		1.8	17.9	23.7	0.0		
Merchandise Exports (F.O.B. in US$ thousands)[3]	8,108,384	8,603,272	8,507,669	8,560,314	2,968,422	-5.3	15.9	4.9	-0.5	-7.9	Latest Data: July
Visitor Arrivals[4]	483,033	490,366	495,390	366,253	166,045	-3.6	4.0	2.6	-25.3	-2.8	Latest Data: July
Total Industry GVA,[5] (at Constant 1985 prices, in million P)	81,419	88,656	84,721	90,151		2.1	3.5	4.1	1.7		
Exports, Non-factor Services[5], (at constant 1985 prices, in million P)	15,279	15,472	15,454	14,007		-12.2	-9.1	1.1	-9.5		
PCE,[5] (at Constant 1985 prices, in million P)	185,680	200,278	194,840	210,420		3.5	3.8	4.9	5.1		

Sources:
[1] Bangko Sentral ng Pilipinas (BSP)
[2] Philippine Overseas Employment Administration
[3] National Statistics Office
[4] Department of Tourism
[5] National Statistical Coordination Board

THE IMPACT OF SARS ON THE SINGAPORE ECONOMY AND ACTION TAKEN IN RESPONSE

INTRODUCTION

- Singapore's economic outlook at the beginning of 2003 was clouded by the impending Iraqi war and its impact on oil prices. The war in Iraq has now ended, and oil prices have fallen, lifting some of these uncertainties. However, the outbreak of the severe acute respiratory syndrome (SARS) has created a new and greater uncertainty for the economy. It has caused fear and anxiety among Singaporeans and tourists, and inflicted a heavy toll on businesses.

- This paper examines the impact of SARS on the economy and our response to the outbreak.

IMPACT ON THE SINGAPORE ECONOMY

TOURISM AND TRANSPORT-RELATED SECTORS

- The tourism and transport-related industries–such as hotel, restaurant, retail, airline, cruise, travel agent and taxi services–have been most severely hit as a result of the sharp decline in visitor arrivals.

- Tourism and related industries contribute significantly to Singapore's economy. In 2002, tourism receipts[10] reached S$7.8 billion, which was about 5.0 percent of Singapore's GDP.

- *Visitor Arrivals*. Visitor arrivals in the fourth week of March have fallen by 57,400 or 30 percent from the corresponding period last year. This contributed to a 15 percent year-on-year decline in visitor arrivals for March. The situation worsened in April, with visitor arrivals dropping by 67 percent. All major markets registered double-digit falls in arrivals, with Japan (-75 percent), Malaysia (-72 percent), China (-64 percent) and Indonesia (-61 percent) recording the largest absolute declines.

- The outbreak of SARS has also resulted in the cancellation or postponement of a number of cruiseship calls, tourism events, conventions and exhibitions.

- *Hotel Occupancy*. The average hotel occupancy rate had fallen to 20 percent to 30 percent in April 2003, compared to 75 percent in February 2003 and 74 percent for the whole of 2002. Some hotels have reported occupancy rates as low as 10 percent.

- *Retail Sales*. Visitor expenditure on shopping accounts for around 10 percent of retail sales in Singapore. Retail sales have fallen 10 percent to 50 percent since the SARS outbreak as a result of the sharp drop in visitor arrivals and fewer domestic shoppers (see Table 16). Most acutely hit are retailers of tourist products, particularly in the Orchard Road shopping belt. Sales of discretionary items like apparel have also suffered, whereas sales of basic necessities like foodstuff are holding out well.

[10] Refers to "Exports of Travel" from Balance of Payments.

Table 16: Impact of SARS on Selected Tourism and Related Sectors in April 2003

	No. of establishments *	Employment of sector*	Percent fall in sales due to SARS**
Retail	18,372	85,589	10 to 50 percent
Catering Trade	3,356	48,202	Up to 50 percent
Hotels	196	26,096	Up to 70 percent
Taxi Drivers	-	34,000	30 to 40 percent
Tour operators	648	7,405	70 to 80 percent

** Sources: Economic Survey Series 2000, Singapore Department of Statistics*
*** Singapore Tourism Board; Various Industry Sources*

- *Restaurants, Travel Agents and Taxis*. Revenue at some restaurants has been down by as much as 50 percent. The National Association of Travel Agents Singapore (NATAS) estimates that inbound business has fallen by 70 percent, while outbound business has fallen by 80 percent since the SARS outbreak started. Comfort Cab Pte Ltd has also reported that taxi drivers' average daily take-home earnings have dipped from S$68.00 in late March to S$41.50 in mid April, before recovering slightly to S$48.75 for the week ending 4 May 2003. Average daily bookings at Comfort have also fallen, from 28,000 before SARS started to 18,600 in early April, recovering to 24,000 in the last week of April.

- *Flight Cutbacks*. A total of 34 airlines with landing rights at Changi Airport have announced temporary cutbacks in their services, commencing between March to June. The largest cuts are for services to China and Hong Kong, China. Changi Airport handled 2,296 fewer flights in April 2003, a 17 percent drop from March 2003. The airport's passenger movements fell by 50 percent in April 2003 compared to April 2002.

OTHER SERVICES SECTORS

- Regional headquarter services have been affected as many companies have imposed travel restrictions on their staff. The healthcare services sector has likewise been hit, with hospitals experiencing a large fall in the number of foreign patients coming to Singapore. Similarly, in the education services sector, schools have been receiving fewer enquiries from foreign students. Costs have increased as a result of the precautionary measures taken. Supporting industries like hostels have seen weaker earnings as the number of student exchange programmes has dropped. Other services industries have also been affected although to a smaller extent, as many industries are closely-interlinked in the value chain.

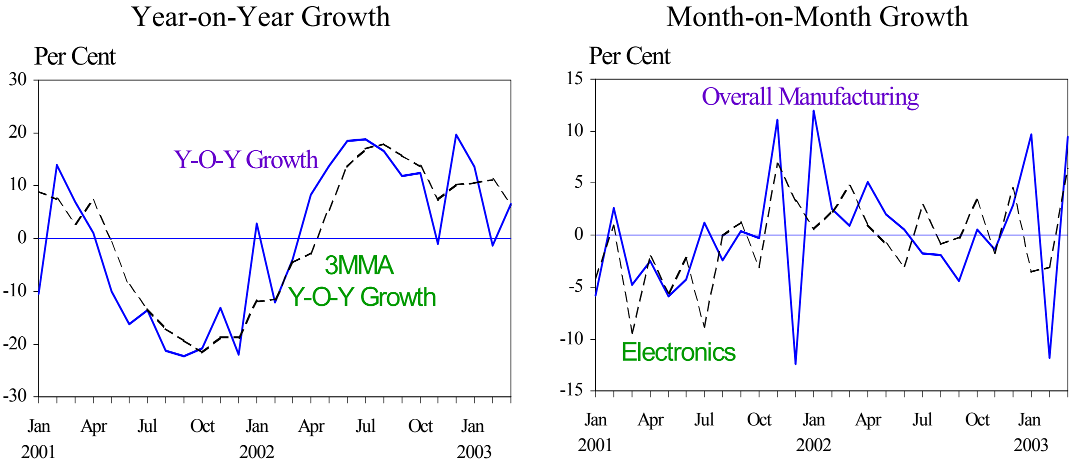
- The business expectations surveys conducted in March 2003 showed that business sentiments have generally worsened. The commerce sector was the most pessimistic, with a net balance of 41 percent of the firms expecting business to worsen in the next 6 months (April-September 2003). Firms in the real estate and business services like legal, accounting and business consultancy, secretarial and security services also expected poorer business conditions. Similarly, banks, finance companies and insurance companies anticipated business would decline further. However, stock brokering firms were hopeful of a recovery in the stock market following the end of the Iraq war.

MANUFACTURING SECTOR

- After recovering to double-digit growth throughout most of 2002, manufacturing output has slowed to 6.5 percent in March 2003 (Figure 3). Growth came mainly from the biomedicals

(BMS), chemicals and electronics clusters. On a seasonally-adjusted, month-on-month basis, output posted an increase of 9.5 percent in March compared to February.

Figure 3: Performance of Singapore's Manufacturing Sector



- On the back of geopolitical uncertainties and weak economic confidence, several leading indicators for Singapore's manufacturing sector have turned downwards. Although US consumer confidence improved in April 2003 after declining for the previous four months, US corporate profitability fell by 1.9 percent in the fourth quarter of 2002, the first time in five quarters, and this could result in a further tightening of corporate IT budgets. In addition, the US Purchasing Manufacturers' Index (PMI) at that time indicated that a sustained US recovery remains uncertain.

- All these factors have adversely affected the near-term outlook of the manufacturing sector. In the business expectations survey in March 2003, manufacturers expected the business environment to remain weak in the April-September period, due to the uncertainties arising from the outbreak of the SARS virus in Asia. The April reading for Singapore's PMI (compiled by the Singapore Institute of Purchasing and Materials Management) continued to stay below 50, indicating that the manufacturing sector was contracting.

- Nevertheless, there have been no major disruptions to production cycles and supply chain efficiencies. However, travel restrictions to/from SARS-affected countries have affected business development activities. Some trade and investment missions to Singapore's key export markets, and some startups here have been postponed or cancelled as a result of the travel restrictions. A plant closed one night shift for sanitation after one worker was suspected of having SARS. Additional costs were also incurred as companies took precautionary measures and developed business continuity plans.

A VIGOROUS AND COMPREHENSIVE RESPONSE

- Tackling the SARS virus calls for an effective and comprehensive plan, vigorously implemented, with the full support and cooperation of Singaporeans. The whole government machinery has been mobilized for this purpose. The Ministry of Health (MOH) and the hospitals are fully engaged in the medical measures to combat SARS. In addition, a Ministerial Committee has been set up to coordinate all the ministries and departments involved and direct the broader response.

- The following section describes the government's decisive actions in tackling the SARS outbreak during the period. As the SARS situation has been successfully contained in Singapore and elsewhere, some measures have been progressively lifted.[11] However, a new probable SARS case was detected and isolated on 3 September 2003. Singapore is treating it as a probable SARS case pending further tests, although the WHO has indicated that the case does not fulfil the case definition for SARS as per the new WHO guidelines in the post-outbreak period.

BATTLEFRONT 1 - PUBLIC HEALTH

- Besides medically treating those who have caught the disease, public health measures have been taken to stop the spread of the illness, and minimize the number of people who fall ill. Lines of defence have been set up around three groups of people:
  a. Those who are already infected or who might be infected,
  b. Those who are not infected, and
  c. Those entering and leaving Singapore.

Detect, Isolate and Contain

- For those who are already infected or who might be infected, Singapore's strategy is "detect, isolate and contain". This means contact tracing–to identify and locate those who have had contact with SARS patients, and issuing Home Quarantine Orders (HQOs) to those at risk. This is to break the cycle of infection and transmission, and bring the outbreak under control.

- The most stringent precautions have been taken at the hospitals. Health care workers are required to don protective gear and monitor their temperatures closely. Visits by family members and friends to patients in hospital are restricted. These measures have worked. Since 31 March, no patients in Tan Tock Seng Hospital have fallen ill from SARS as a result of being infected in the hospital.

- These public health measures to detect, isolate and contain the disease are all the more necessary because there has been no reliable diagnostic test for SARS. Scientists in Agency for Science, Technology and Applied Research institutes in Singapore have been working as part of a worldwide effort to identify and understand the SARS virus. They have successfully mapped the genome of the SARS virus, confirming and extending the results of mappings done elsewhere.

Protect and Monitor the Healthy

- Vigorous measures have also been taken to prevent the healthy from contracting SARS. Special attention is paid to public areas with heavy human traffic, and large institutions such as schools and military camps.

- The Ministry of Environment (ENV) has taken preventive actions to raise the overall standard of public health and hygiene, to minimize the risk of environmental transmission of SARS. It cleans and disinfects public areas, eliminates pests, ensures proper waste disposal and makes sure that sewerage systems are in working order. Food handlers in all food establishments are required to take their temperatures twice a day.

- The Ministry of National Development has instituted measures to improve the cleanliness of public housing estates. These include stepping up the general cleaning of common areas

[11] Since the last probable SARS case in Singapore was isolated on 11 May 2003, there were no new probable SARS cases here until the one in September 2003.

and responding promptly to complaints of sanitary pipe leaks within 24 hours. Management corporations of private buildings have been reminded to maintain the sanitary pipes in their buildings in good working condition.

- The Ministry of Education (MOE) has also introduced a series of measures. Schools are educating students about SARS, issuing every student with a personal thermometer, and teaching them to check their own temperatures daily. Students and staff are also required to regularly declare their travel history. The Institutes of Higher Learning have segmented their large campuses into smaller sections, to reduce movement across the campus and to facilitate contact tracing should a SARS case occur. The MOE and the Ministry of Community Development and Sports (MCDS) have implemented standard operating procedures for child-care centers and kindergartens, to screen and manage the children.

- Singaporeans have also been encouraged to take their own temperatures daily, and if they have a fever to stay away from work or school and see their doctor. Temperatures are taken at many workplaces and large gatherings. This will reduce the chances of SARS spreading from one person to many others, and thus help to bring the outbreak under control.

Safeguard Borders

- A third major concern has been to prevent fresh cases of SARS from being introduced into Singapore by travelers, and Singaporeans infected with SARS from going abroad and infecting other people.

- Singapore started screening all inbound air passengers from SARS-affected areas, including passengers on transit at Changi Airport, and later extended screening to inbound passengers from all areas. All travellers arriving in Singapore are issued with health advisories on SARS and are asked to fill in health declaration cards. Outbound passengers departing from Singapore are also screened.

- Like the airport, both land and sea border checkpoints have been equipped with thermal scanners. Newly arrived work pass holders coming from SARS-affected areas are required to undergo a 10-day observation period to minimize the risk of their bringing SARS to the workplace.

- ASEAN leaders have responded efficiently and decisively to the problem. ASEAN convened a meeting of the ASEAN health ministers and their counterparts from China, Japan and South Korea in Kuala Lumpur, Malaysia, on April 26. This was followed three days later by the Special ASEAN–China leaders' meeting in Bangkok, Thailand to discuss the outbreak. The Leaders issued a joint declaration on the need to coordinate efforts and respond to SARS collectively as a region. This includes pre-departure and arrival screening of travellers, and the sharing of information to facilitate contact tracing.

BATTLEFRONT 2: THE ECONOMY

- The second battlefront is the economy. The government is working with the Singapore Business Federation and business chambers to encourage businesses to adopt business continuity plans, so that they can continue to operate even if staff fall ill. Special attention has been placed on essential services, such as utilities, to ensure uninterrupted services. At the industry level, firms in the tourism trade are working with the Singapore Tourism Board to bring tourists back as the SARS situation stabilizes.

Relief Measures

- To mitigate the immediate economic hardship brought about by SARS, on 17 April the government announced a relief package worth S$230 million. The package's measures were targeted at the sectors most affected by the SARS outbreak, namely, the tourism and transport-related sectors. The measures would not fully offset the impact on these businesses, but would help tide them over the difficult period and save jobs, wherever possible.

- The government has also implemented a Home Quarantine Order Allowance Scheme, that would pay an allowance to self-employed persons who are served HQOs, to make up part of their income. An allowance would also be given to establishments whose employees have been affected by HQOs. This would defray part of their manpower costs for the duration of the HQO. It would be especially helpful to smaller businesses, which might otherwise be unable to survive.

- To deal with the economic problem, the National Trades Union Congress, the Singapore National Employers Federation, and the Ministry of Manpower have issued a joint statement recommending temporary cost reduction measures, including a shorter work week, layoffs and wage cuts. They have also acknowledged that, despite these measures, retrenchments would be unavoidable in the tourism and transport-related sectors, and advised employers to treat fairly workers who have to be retrenched. This realistic and constructive approach would help companies to stay afloat, and help as many workers as possible to keep their jobs.

BATTLEFRONT 3: THE SOCIETY

- The third battlefront against SARS is in mindset and society—the way each Singaporean responds to the problem, and cooperates with the measures which will help us to solve it. This is the most critical battlefront.

- To support the public health measures, Singaporeans have been urged to follow the precautions recommended by the MOH. The government has been emphasizing the need for each individual to be keenly aware of social responsibility to their families, friends and fellow citizens, in containing the spread of SARS. For instance, at a basic level, individuals should not only measure their own temperature, but also the temperatures of family members on a daily basis. They should see a doctor when they are unwell and heed medical advice seriously. Singaporeans have also been reminded to go to Tan Tock Seng Hospital if they suspect themselves of having contracted SARS, and abide by the quarantine orders.

- Government agencies have implemented schemes to boost the confidence of the public, to bring life back to normalcy. For example, SPRING Singapore has implemented a "COOL Singapore" scheme, which provides the assurance of stringent SARS preventive measures in places where people congregate, e.g., shopping malls, restaurants and supermarkets, schools and workplaces. All these establishments will have to meet a stringent set of criteria before being certified as "COOL". For instance, staff in these establishments will have to monitor their temperature daily. The programme would also give business travelers and tourists peace of mind while they are in Singapore.

- The STB has also launched a complementary campaign, "Step Out! Singapore", to encourage Singaporeans and residents to come out and have fun while exercising social responsibility by taking all necessary precautions.

- Spanning two months, it involved a festival of activities and events like the Great Singapore Sale, and special promotions held at hotels, tourist attractions, retail and food and beverages outlets.

- With these measures, life has returned to normalcy. Nevertheless, Singaporeans are urged to adopt sensible precautions and socially responsible habits, while carrying on with their normal day-to-day activities.

CONCLUSION

- The outbreak of the severe acute respiratory syndrome (SARS) has created public anxiety and taken a heavy toll on businesses. The tourism and transport-related industries, such as hotel, restaurant, retail, airline, cruise, travel agent and taxi services, have been most severely hit. Many supporting industries are also affected, as industries are closely inter-linked.

- The Singapore government has taken decisive actions to prevent the transmission of SARS in Singapore. Its transparent and decisive approach to acknowledging the problem and tackling the issues have won praise. For example, a few Chambers of Commerce have issued press releases recently, commending the robust strategy, transparency and groundbreaking use of technology such as the thermal imaging systems. As Singapore has remained vigilant, with strong and effective procedures in place, it is much better prepared should there be a recurrence of SARS during the coming months.

THE IMPACT OF SARS ON CHINESE TAIPEI ECONOMY AND ACTION TAKEN IN RESPONSE

The outbreak of SARS created new uncertainty for Chinese Taipei. It caused great anxiety among citizens and visitors, and took a heavy toll on business. This paper examines the impact of SARS on Chinese Taipei's economy, and describes the measures adopted to combat the epidemic and ameliorate its adverse effects.

Impact on the Chinese Taipei Economy

The impact of SARS is expected to reduce Chinese Taipei's economic growth rate by an estimated 0.91 percent in 2003. The areas of the economy most affected are as follows:

- The travel industry: The tourism and travel industries were severely affected by a drastic decline in visitor arrivals. The number of international flights was reduced by 45 percent and 44 percent in May and June respectively, with the number of visitor arrivals and departures down by 82 percent in May and 67 percent in June compared with the previous year. The average hotel occupancy rate stood at just 22 percent for the whole of May but rose to 51 percent for the last ten days of June.
- Consumption: The growth rate of private consumption turned negative in the second quarter.
- Production: Industrial production as a whole shrank by 2.8 percent in May, though the output of IC and communication products continued to grow.
- Trade: Export and import growth slowed to 3.7 percent and 5.0 percent, respectively, in the second quarter, though imports of machinery increased by 6.1 percent in June.

Chinese Taipei's Response to the SARS Epidemic

To combat the impact of SARS, assist those hardest hit by the epidemic, restore public confidence, and help return life to normalcy, Chinese Taipei implemented a broad range of measures on four main fronts.

- On the social front, Chinese Taipei launched a campaign to educate people on their individual social responsibilities, and encourage voluntary participation in community restoration work. It also implemented measures to provide special care for indigent, disadvantaged and vulnerable members of society.

- On the public health front, Chinese Taipei enforced stringent anti-epidemic measures, took steps to initiate reform in the public health and medical systems, put forward proposals for the improvement of hospital management, and launched a public information campaign to promote higher standards of personal and environmental hygiene and encourage the general public to take better care of their health.

- On the economic front, Chinese Taipei launched a NT$300 billion public works program, to be carried out over three years, aimed at providing economic stimulus and creating jobs. The government also introduced various financial assistance measures for businesses that bore the brunt of the impact of SARS.

- On the public relations front, the government drew up plans for a range of activities to promote Chinese Taipei's image and help it shake off negative associations resulting from the SARS outbreak. The plans include extending invitations for visits by high-profile foreign celebrities and providing support for the holding of various international conferences and events in Chinese Taipei.

THE IMPACT OF SARS ON THAILAND ECONOMY

- The Ministry of Finance has revised the GDP forecast downward due to the effect of the spreading of the severe acute respiratory syndrome (SARS). It previously forecasted that GDP would grow at a rate of 5.1 percent in 2003. However, due to the fact that SARS still cannot be controlled in the most affected economies (China; Hong Kong, China; Chinese Taipei; and Singapore), the GDP in 2003 would dropped by 0.4 percent.

- The major effect of SARS is on tourism. Tourist arrivals to Thailand have dropped by 12 percent in March as a result of both the war in Iraq and the outbreak of SARS. Moreover, SARS is likely to further reduce the number of tourists to 35 percent below the normal figure by the end of April 2003.

- Taking into account the similar fall in outbound tourism, and therefore a reduction in spending overseas by Thai residents, the net loss in foreign exchange earnings in 2003 will be around 26 billion baht (US$ 0.6 billion) or about half the inbound revenue loss.

- The Thai government and the Tourism Authority of Thailand have responded by providing additional fiscal stimulis and tourism promotions aiming at domestic travelers in order to compensate for the shortfall in international tourism revenue.

- However, if the SARS problem could be solved by the end of Q3 (high season in Thailand) we hope that tourism activity would increase quickly.

THE IMPACT OF SARS ON THE UNITED STATES ECONOMY

Severe acute respiratory syndrome (SARS) is a deadly respiratory disease whose impact has been felt most seriously in East Asian economies. The Asian Development Bank has estimated that the disease would cost the region US$28 billion.

If the SARS epidemic is contained mainly within the Asian economies currently afflicted by the disease, SARS will have only modest effects on the US economy. The countries now affected by SARS buy only 10 percent of US exported goods. Furthermore, most US exports are in the form of raw goods for manufacturing or large capital equipment (airplanes, heavy machinery, etc.), and the demand for these goods is unlikely to be affected dramatically by SARS. Given the current course of the outbreak, there does not seem to be a great risk to the affected economies' ability to continue to produce and export goods. Additionally, many large multi-national companies have prepared contingency plans in the event of a supply-chain crisis (although the cost of implementing such plans is unknown).

If the epidemic were to spread throughout Asia, however, Asian consumption concerns would be more pronounced, and production problems would emerge, with potentially serious consequences for the US economy.

THE IMPACT OF SARS ON VIET NAM'S ECONOMY

In the second quarter of 2003, the economy of Viet Nam has faced several difficulties such as natural disasters, the war in Iraq and, particularly problematic, severe acute respiratory syndrome (SARS). As in some other economies SARS has caused negative impacts on economic activities, especially tourism and aviation.

The tourism sector makes up about 3.4 percent of GDP in Viet Nam. In 2002, around 2.6 million foreign tourists and business arrivals were registered. In the first quarter of 2003 the figure was estimated at 712.5 thousand, an increase of 11.4 percent compared to the same period in 2002. However, the number of foreign tourists and business arrivals went down immediately in April because of the SARS alert. In April the number decreased about 50 percent and in May about 75 percent, compared to the same period in 2002. Most travel tours, international conferences and business arrivals were canceled and/or postponed in April and May. The occupation rate of hotels with three or more stars went down, to between 20 percent and 30 percent. Tourism industry in Viet Nam lost inbound tours from China; Chinese Taipei; Hong Kong, China; and Canada as well as from other economies. The tourism industry's turnover in the first six months of 2003 was 80 percent of that in the same period in 2002. The SARS alert has not only caused negative impacts on the tourism industry, but also on tourism-related services such as aviation, transportation, retail trade, restaurants, and hotels.

Apart from negative impacts on the tourism industry and tourism-related services, the SARS outbreak has also had some negative impacts on the economy as a whole through the interruption of commercial and trade contracts and reduced business confidence in economic prospects. However, in the case of Viet Nam, these impacts seem to be insignificant.[12]

Fortunately, after recognizing the SARS outbreak Viet Nam's government immediately set up a government committee to control the SARS alert. It isolated all SARS patients, set the right treatment for patients, and more importantly cooperated with the World Health Organization (WHO) to warn people about SARS. The WHO has highly appreciated Viet Nam because she has responded quickly and provided transparent information on SARS. Therefore, SARS has been controlled and stopped in Viet Nam. As a result, Viet Nam has managed to maintain rather high economic growth in the first seven months of 2003 compared to the same period of last year.

The economic outlook for Viet Nam in 2003 is expected to be bright compared to other economies in the region like Hong Kong, China; and Chinese Taipei. As in 2002, Viet Nam's GDP growth rate is driven by domestic consumption and investment, and a strong export performance.

The performance of economic sectors is expected to be as follows:

- Agriculture's performance should be maintained and damage caused by natural calamities should be repaired to ensure production continues. Gross output of autumn-paddy and winter-paddy is expected to increase by 25.5 percent and 2.0 percent respectively compared to the same period in 2002. Moreover, the fishery industry anticipates a record growth rate. It is estimated that fishery's gross output in 2003 will reach about 9 percent.
- Industry should show high growth rate compared to the same period in several previous years. Gross output of the sector for the first seven months of 2003 increased by 15.9 percent, of which the state-owned sector increased 12.1 percent, the domestic private

[12] Data about commercial and trade contracts are not available in Viet Nam.

sector 18.2 percent and the foreign invested sector 18.1 percent and is higher than that of previous periods (the same seven months' growth in 2001 was 14.2 percent and in 2002 was 13.9 percent) and higher than the target of (14 percent-14.5 percent).

- The services sector also, remarkably, develops. Retail sales during the first seven months of 2003 reached the growth rate of 10.5 percent compared to the same period in 2002. In the business services sector is only the tourism turnover decreased (from April to June) due to the SARS alert. It recovered in July after the SARS outbreak was controlled. However, is still lower than that of the same period in 2002. Viet Nam's tourism industry, together with Viet Nam Airlines has used new ways (e.g., reduction in prices, combination of tourist tours with airline travel, advertisement at the South East Asian Games) to attract foreign arrivals to Viet Nam. It has also paid more attention to local travelers. The number of foreign arrivals is estimated to be about 2.2 million for 2003, slightly lower than last year's.

The value of exports for seven months estimated at US$11.4 billion, increased 27.9 percent compared to the same period in 2002. This increase is mostly because of the high growth rates of main exported commodities in terms of volume as well as of prices.

The value of imports, estimated at US$14.1 billion, increased 34.4 percent compared to the same period in 2002. The high growth rate of imports is mainly a result of increasing imports of machinery, petroleum products, intermediate goods, and fertilizer–these products serve requirements of expending domestic production and of increasing exports.

GDP growth rate for the whole year is expected to be about 7.2 percent, in the planned target range of 7.0 percent to 7.5 percent and is higher than the rate of 7.04 percent in 2002.

INVESTMENT EXPERTS' GROUP III
Phuket, Thailand
14–15 August 2003

THE IMPACT OF SARS ON FDI IN CHINESE TAIPEI AND MEASURES TAKEN IN RESPONSE

1. Impact of the SARS Epidemic on Foreign Direct Investment

Statistics compiled by the Ministry of Economic Affairs reveal that since the SARS epidemic struck Chinese Taipei in late April, 2003, approved foreign investment during the second quarter of the year (April through June) amounted to a total of 309 cases with a value of US$531.68 million. This was a decline of 27.20 percent compared with the same period of 2002, and a drop of 10.4 percent compared with the first quarter of 2003. These figures show the possible impact of SARS on investment. However, decisions about FDI are made by investing companies based on long-term assessment and long-term considerations, while SARS was a short-term phenomenon. Furthermore, SARS was brought under control in Chinese Taipei in June and the WHO removed the island from the list of infected areas on 5 July 2003. For these reasons, SARS will have no substantial long-term impact on foreign investment in Chinese Taipei.

2. Measures Taken During the Period of the SARS Epidemic

(1) Provision of correct and timely disease control measures and epidemic information.
(2) Establishment of a SARS liaison window for foreign business people and provision of help to them in resolving problems resulting from the epidemic.
(3) Solicitation of the opinions of foreign chambers of commerce prior to the implementation of SARS-related control measures so as to lessen the impact on foreign companies.
(4) Provision of corporate relief measures including relief loans, financing services, promotion of export sales, offering of export insurance, etc.
(5) Holding of seminars for representatives of foreign economies, chambers of commerce, and investors in Chinese Taipei to explain to them the government's efforts to combat SARS and the measures it was undertaking to revitalize the economy.

3. Strengthened Investment Promotion Measures in the Post-SARS Period

(1) The minister of economic affairs sent a letter to major foreign companies and foreign chambers of commerce, conveying to them the information that Chinese Taipei had been removed from the WHO's travel advisory list.
(2) The Internet, domestic and international media, and publicity materials were used to convey timely information about the WHO's removal of Chinese Taipei from its travel advisory list and list of infected areas.
(3) Missions were sent to Europe, the United States, and Japan to hold investment seminars and visit companies in those areas with the aim of attracting foreign companies to invest in Chinese Taipei.
(4) An International Business Alliance Conference is being organized and prominent international companies as well as Chinese Taipei's enterprises at home and abroad will be invited to participate with the aim of encouraging foreign companies to come to invest.
(5) Foreign companies in Chinese Taipei were visited with the aim of gaining an understanding of their investment and helping them to resolve obstacles and problems encountered in their investments. Special personnel were sent to provide all possible

assistance to foreign investment cases currently in progress so that those cases could be carried out successfully.

(6) Talks were held with European, American, and Japanese chambers of commerce to gain an understanding of the operations of foreign companies, the problems they faced, and their advice about government administration, and subsequently to provide vigorous help in resolving obstacles to investment.

(7) The investment promotion work of overseas representative offices was strengthened. Those offices held investment seminars in their areas and paid visits to potential investors, set up channels of communication with foreign companies in their areas, and encouraged foreign companies to come to invest.

4. Conclusion

SARS began to affect Chinese Taipei in late April, causing a slump in the domestic catering, entertainment, travel services, and public transportation industries. The growth of domestic investment also slowed down because of the interruption of business activity, and there was an unfavorable impact on our economic growth in the first half of the year. The SARS outbreak has been brought under control, however, and our economy has experienced a substantial recovery; export orders received in June, for example, had a total value of US$13.83 billion, a 33-month high. Along with bringing the SARS outbreak under control and increasing signs of an international economic recovery, the holding of the International Business Alliance Conference in October and vigorous efforts to further improve the investment environment and strengthen the promotion of foreign investment will reduce the unfavorable impact of SARS on FDI in Chinese Taipei in the second half of the year.

MEASURES TAKEN IN RESPONSE TO SARS IN CANADA

Impact of SARS on Inward Foreign Investment to Canada

The effect of SARS on inward foreign investment flows to Canada is difficult to assess at this point. Concrete statistics are yet to be released, and will most likely be available closer to the end of 2003. Initial forecasting suggests that any effect on Canadian foreign investment inflows is expected to be minimal and temporary. While inflows are expected to be below-average, this is more likely attributed to geopolitical situations and a sluggish global economy, rather than the SARS epidemic.

Measures to Mitigate the Possible Effects of SARS

The Government of Canada had set aside $110 million to help in the fight against SARS. Of this, $10 million has been allocated to a worldwide marketing campaign to promote Toronto and Ontario as safe travel locations. A similar amount was matched by the Government of Ontario.

On 19 June 2003, the Government of Canada announced additional funding of $250 million, of which $150 million will go directly to Ontario in recognition of its efforts to control and contain the SARS epidemic.

More Information on Government of Canada Actions Related to SARS

Please visit the following website:
http://www.pm.gc.ca/default.asp?Language=E&Page=keyinitiatives&Sub=healthcare&Doc=sars_e.htm):

ACRONYMS

ACRONYMS

ADB	Asian Development Bank
AFTA	ASEAN Free Trade Agreement
AMT	Alternative Minimum Tax
AP	Atypical Pneumonia
ARMs	Adjustable Rate Mortgages
ASEAN	Association of South-East Asian Nations
BANSEFI	Banco del Ahorro Nacional y Servicios Financieros (Mexico)
BDC	Business Development Bank of Canada
BFIA	Banks Financial Institutions Act
BIR	Bureau of Internal Revenue
BIS	Bank for International Settlements
BKD	Bank Kredit Desa
BMS	Biomedicals
BOC	Bureau of Customs
BOJ	Bank of Japan
BOP	Balance of Payments
BoT	Bank of Thailand
BOT	Build-Operate-Transfer
BPNG	Bank of Papua New Guinea
BSP	Bank of South Pacific
BSP	Bangko Sentral ng Pilipinas
C.I.F	Cost-Insurance-Freight
CACC	Central Agencies Coordinating Committee
CAD	Current Account Deficit
CAR	Capital Adequacy Ratio
CBA	Central Banking Act
CCC	Canadian Commercial Corporation
CDC	Centers for Disease Control and Prevention
CDRC	Corporate Debt Restructuring Committee
CEPT	Common Effect Preferential Tariffs
CGPI	Corporate Goods Price Index
CMHC	Canadian Mortgage and Housing Corporation
CPI	Consumer Price Index
DBP	Development Bank of the Philippines
ECBs	Euro-Dollar Convertible Bonds
EDC	Export Development Corporation
EFIC	Export Finance and Insurance Corporation
EO	Executive Order
F.O.B	Free-On-Board
FCC	Farm Credit Corporation
FCDUs	Foreign Currency Deposit Units
FDI	Foreign Direct Investment
FERs	Functional and Expenditure Reviews

FIE	Foreign Invested Enterprise
FILP	Fiscal Investment and Loan Program
FMIP	Financial Management Improvement Project
FMIS	Financial Management Information Systems
FOMC	Federal Open Market Committee
GAAP	Generally Accepted Accounting Practice
GDP	Gross Domestic Product
GHB	Government Housing Bank
GIR	Gross International Reserves
GNS	Gross National Savings
GSB	Government Saving Bank
GTA	Greater Toronto Area
HKC	Hong Kong, China
HKECIC	Hong Kong Export Credit Insurance Corporation
HKMC	Hong Kong Mortgage Corporation
HQOs	Home Quarantine Orders
IAS	International Accounting Standard
IBRA	Indonesian Bank Restructuring Agency
ICCC	Independent Consumer and Competition Commission
ICT	Information and Telecommunication Technology
IFSB	Islamic Financial Services Board
IIFM	International Islamic Financial Market
IMSS	Mexican Institute of Social Security
IPBC	Independent Public Business Corporation
JETRO	Japan External Trade Organization
JSBs	Joint Stock Banks
KFR	Kina Facility Rate (Papua New Guinea)
KSLE	Kuala Lumpur Stock Exchange
L/C	Letter of Credit
LBP	Land Bank of the Philippines
LGUs	Local Government Units
LNG	Liquefied Natural Gas
LPS	Lembaga Penjamin Simpanan
M0	Cash in Circulation
M1	Narrow Money Supply
M2	Broad Money Supply
MAS	Monetary Authority of Singapore
MCB	Minimum Cash Balance
MOE	Ministry of Education
MSR	Mid-Session Review
MTDS	Medium Term Development Strategy
NAFIN	Nacional Financiera (Mexico)
NATAS	National Association of Travel Agents Singapore
NEER	Nominal Effective Exchange Rate
NESDB	National Economic and Social Development Board
NFPEs	Non-Financial Public Enterprises

NGOs	Non-Governmental Organizations
NID	Net Income Deficit
NIR	Net International Reserves
NPAs	Non-Performing Assets
NPL	Non Performing Loans
NSCB	National Statistical Coordination Board
NSSLAs	Non-Stock Savings and Loan Associations
OCR	Official Cash Rate
OFWs	Overseas Filipino Workers
OHQ	Operational Headquarters
OMO	Open Market Operations
P.A.	Per Annum
PAR	Public Administration Reform
PER	Public Expenditure Review
PMI	Purchasing Manufacturers' Index
PND	National Development Plan
PPI	Producer Price Index
PSBR	Public Sector Borrowing Requirements
PSC	Public Service Commission
PSE	Philippine Stock Exchange
PSRP	Public Sector Reform Program
QFII	Qualified Foreign Institutional Investors
RBNZ	Reserve Bank of New Zealand
RBs	Rural Banks (Philippines)
RFINL	Regular Foreign Investment Negative List
RMB	Renmimbi
RRP	Reserve Repurchase
S&L	Saving and Loan Societies
S&P	Standard and Poors
SAP	Structural Adjustment Program
SARS	Severe Acute Respiratory Syndrome
SBV	State Bank of Vietnam
SDA	Special Deposit Accounts
SET	Stock Exchange of Thailand
SFI	Specific Financial Institutions
SIPG	Service Improvement Support Group
SIPs	Service Improvement Plans
SME	Small and Medium Enterprises
SOCBs	State-Owned Commercial Banks
SOEs	State-Owned Enterprises
SRC	Securities Regulation Code
SRP	Structural Reform Program
SSM	Sistem Saraan Malaysia
TAMC	Thai Asset Management Corporation
TEM	Treasury Economic Monitor
UKM	Usaha Kecil dan Menengah

USBTA	Bilateral Trade Agreement with the United States
VAT	Value Added Tax
WHO	World Health Organisation
WTI	Western Texas Intermediate
YOY	Year-On-Year

DIRECCIÓN GENERAL

DG/008/2004

México, D. F., a 16 de febrero de 2004

Lic. Ricardo Ernesto Ochoa Rodríguez
Director General de Asuntos
Internacionales de Hacienda
Secretaría de Hacienda y Crédito Público

P r e s e n t e

Estimado Lic. Ochoa:

Me permito solicitar su apoyo, para que se envíe a los editores del Economic Outlook de 2003 publicado por APEC (*Asia-Pacific Economic Cooperation*), la fe de erratas anexa, con el fin de que pueda ser incluida en la siguiente edición de ese documento.

Lo anterior, debido a que el Comité Económico de APEC, líder de la integración del capítulo estructural del documento en cuestión, sintetizó de manera confusa la información que BANSEFI remitió por conducto de la Dirección General de Asuntos Internacionales de Hacienda, a través de un cuestionario elaborado en febrero del 2003 y que consideramos importante aclarar en beneficio de los lectores del documento, pues se le atribuye a BANSEFI una función que en ningún modo realiza: la de ser prestamista de última instancia ("*lender of last resort for popular banks*").

Se trata de una confusión en los términos utilizados, ya que BANSEFI está diseñado para ser un banco de cajas pero no es el prestamista de última instancia de éstas. De hecho, BANSEFI es un banco que no otorga créditos, como se manifestó en el cuestionario enviado a APEC.

Por otra parte, quisiera reiterar la disposición de BANSEFI a colaborar en los proyectos de APEC relacionados con las finanzas populares, ya que consideramos que constituye un foro que puede hacer aportaciones interesantes al proceso de institucionalización del sector de ahorro y crédito popular, pues en esa región se encuentran varios de los ejemplos más exitosos en esta materia.

Sin otro particular, aprovecho la ocasión para enviarle un cordial saludo.

Atentamente
El Director General

Javier Gavito Mohar

C.c.p. **LIC. VANESSA RUBIO MARQUEZ**, Directora General Adjunta de Asuntos Hacendarios Internacionales, SHCP.- P r e s e n t e
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MEXICO,
NATIONAL SAVINGS AND FINANCIAL SERVICES BANK

Corrigendum for the 2003 APEC Economic Outlook

SECTION II: OVERVIEW OF SPECIALIZED FINANCIAL INSTITUTIONS

3.6 Specialized Financial Institutions in Mexico

Page (p.)	***Where it says…***	***It should say…***	***Commentary***
p. 71	First, the banking sector consists of bank and non-bank institutions, development banks (or 'second floor' banks); **National Saving Patronage**; and Public Trusts.	First, the banking sector consists of bank and non-bank institutions, development banks (or 'second floor' banks); and Public Trusts.	In 2002, The National Savings Patronage (*Patronato del Ahorro Nacional*) transformed into BANSEFI, a development banking institution.
p.72	People's Saving and Credit Law	Popular Savings and Credit Law	
p.73	BANSEFI was established in April 2002. Prior to its transformation, it had operated as Patronato del Ahorro Nacional since 1950. This state-owned institution has a mandate of promoting both the culture of savings and the development of the **popular** banking sector in Mexico, **by offering high deposit rates, while charging low (or no) fees on some saving products. It offers saving products to low-income people and acts as a lender of last resort for popular banks. On the one hand, it offers deposit services, remittance services, portfolio investment and an advisory service to individuals, who constitute 99 percent of its customers. On the other hand, BANSEFI provides technological services and training to other popular banks**.	BANSEFI **(National Savings and Financial Services Bank)** was established in April 2002 **as a development bank**. Prior to its transformation, it had operated **as a governmental first tier financial institution,** *Patronato del Ahorro Nacional* **(National Savings Patronage)** since 1950. This state-owned bank has a mandate of promoting both the culture of savings and the development of the microbanking sector in Mexico. **On the one hand, BANSEFI through its branch network offers competitive saving products for individuals who normally do not have access to the financial sector, mainly low income people. The savings products offered have a low initial deposit (less than 5 US Dollars), and the highest deposit rates for this kind of products. BANSEFI also offers remittance payment services. On the other hand, BANSEFI provides technological services, portfolio investment, trust services, training and technical assistance to those microbanking entities willing to transform into regulated financial institutions according to the Popular Savings and Credit Law.**	Even though Bansefi is a banking institution, it does not offer credit products, and **it does not act as a lender of last resort** for microbanking institutions. BANSEFI promotes the financial health of the microbanking sector, through technological infrastructure, portfolio investment services and through technical assistance projects, but it does not rescue S&L institutions.

Page (p.)	***Where it says…***	***It should say…***	***Commentary***
p. 73	The authorities that supervise BANSEFI's operations (SHCP and BANXICO) have to make sure that this **instruction** follows prudential regulations **under the Basle Accord where applicable, applies the International Accounting Standard (IAS), and has an independent financial auditor.**	The authorities that supervise BANSEFI's operations (SHCP **through the National Banking and Securities Commission,** and BANXICO) have to make sure that this **institution** follows prudential regulations **and International Accounting and Auditing Standards, according to the Basle Committee Capital Accord and best practices standards.**	BANSEFI as a regulated Mexican credit institution, has to follow the same regulatory standards as any of the other Mexican development banks.