South-East Asia

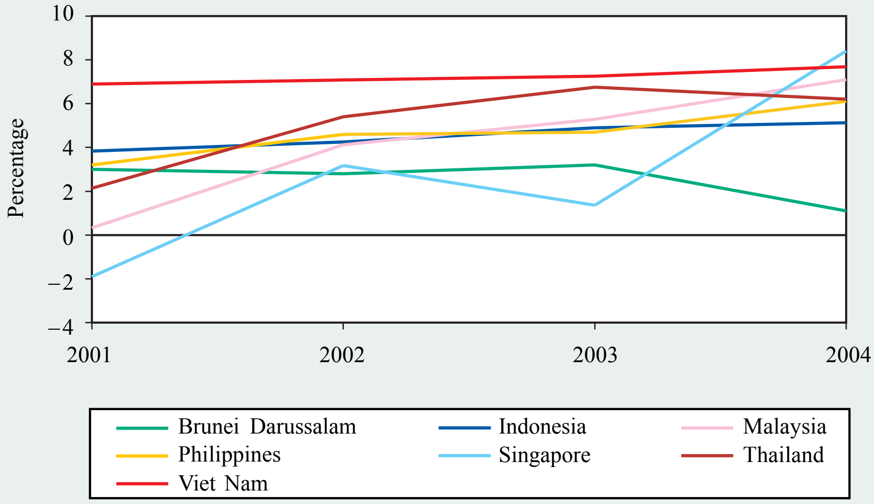
A. Developing countries in the subregion

Overview

Generally stronger growth in the subregion supported by domestic and external demand

GDP growth improved in most developing countries of South-East Asia in 2004 (figure II.24), the exceptions being Brunei Darussalam, where output in the crucial oil and gas sector was affected by maintenance, and Thailand, where economic growth in 2003 had been unusually vigorous. Growth was broadly based in most countries. Growth in the agricultural sector boosted GDP in Indonesia and the Philippines, despite some typhoon damage in the case of the latter. Drought, aggravated by a poor monsoon, lowered output in that sector in Thailand and Viet Nam. Several economies in the subregion were carried along by the strong upturn in the electronics cycle, which, however, appeared to have passed its peak in the second half of the year. Other manufacturing industries, such as vehicles, chemicals, plastics and biomedical products, also performed strongly. The service sectors benefited from increased trade, renewed consumer confidence and a sharp revival in tourism after the SARS scare of 2003.

Figure II.24. Rates of GDP growth in selected South-East Asian economies, 2001-2004



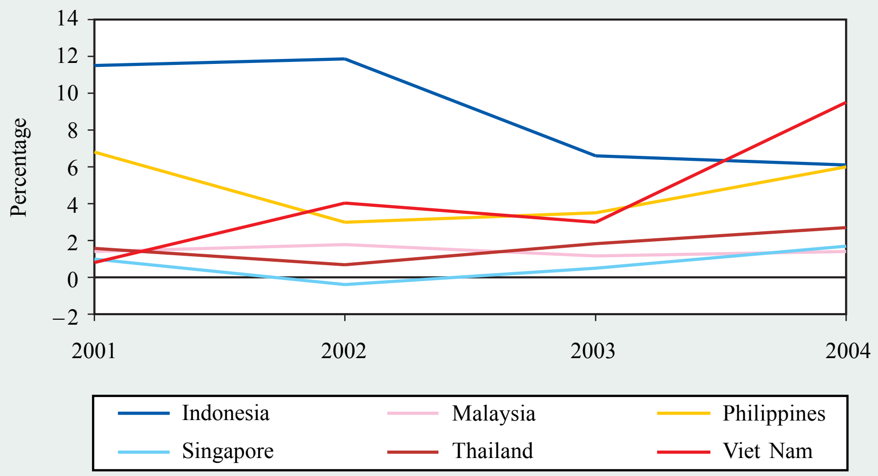
Sources: ESCAP, based on national sources; and ADB, *Key Indicators of Developing Asian and Pacific Countries 2004* (Manila, ADB, 2004).

Note: Growth rates for 2004 are estimates.

External demand played a very significant role in most South-East Asian economies, although Indonesia seemed to lag its neighbours to some extent. Many countries found their trading links with other economies in Asia and the Pacific strengthening and deepening owing to regional production networks and strong growth in China. Private consumption revived very strongly in Singapore as confidence returned and continued to be robust in Indonesia, Malaysia and Viet Nam, although it flagged somewhat in the Philippines and Thailand. One encouraging note is the strong growth of private investment in Indonesia, Malaysia, Singapore, Thailand and Viet Nam, although business confidence remained depressed in the Philippines and Brunei Darussalam. The outlook for growth in 2005 for most developing countries in the subregion is for a slowdown, as the external environment becomes less favourable. The effects of the tsunami of 26 December 2004 on tourism and fisheries in Thailand will slow growth further in that country. Despite the tsunami, strong investment is expected to continue boosting growth in Indonesia, as well as Viet Nam.

With the exception of Indonesia, rates of inflation picked up in developing countries in South-East Asia (figure II.25) generally owing to higher food and oil prices. Many countries resorted to fuel subsidies to

Figure II.25. Inflation[a] in selected South-East Asian economies, 2001-2004



Sources: ESCAP, based on national sources; ADB, *Key Indicators of Developing Asian and Pacific Countries 2004* (Manila, ADB, 2004); and EIU, *Country Forecasts* (London, EIU, 2004), various issues.

Note: Inflation rates for 2004 are estimates.

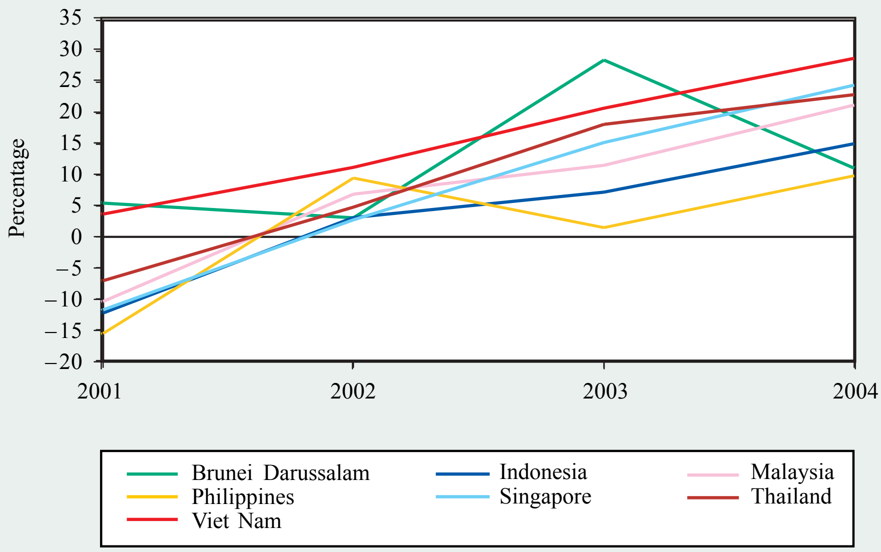
[a] Changes in the consumer price index.

contain inflation, but not Singapore. However, budgetary pressures prevented the Philippines from doing so to the same extent and led to subsidies being partially removed in Thailand and Viet Nam towards the end of the year. Monetary policy was tightened in response to the pickup in inflation in most countries of the subregion and the rising trend in global interest rates, although the Malaysian central bank maintained a prudent but accommodative stance. Fiscal policies also moved in a more prudent direction in 2004 and public debt continued to fall as a percentage of GDP.

High-tech products and commodities lift exports from the subregion and tourism revives

With the exception of Brunei Darussalam, all the developing countries of South-East Asia took advantage of the surge in external trade in 2004, with double-digit rates of growth of merchandise exports and imports in most cases (figures II.26 and II.27). Electronics, vehicles and other high-tech products as well commodities were the principal exports. Imports tended to be broadly based between consumer, intermediate and

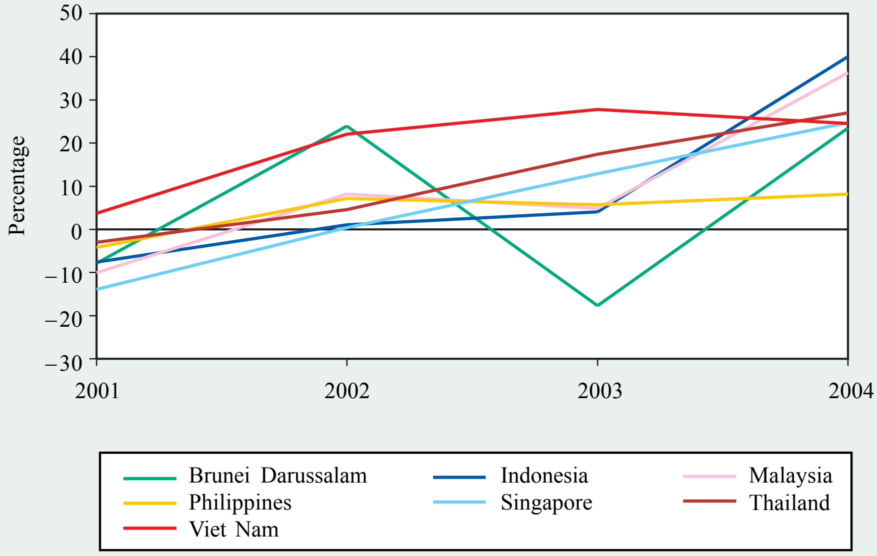
Figure II.26. Growth rates in merchandise export earnings of selected South-East Asian economies, 2001-2004



Sources: IMF, *Direction of Trade Statistics* (CD-ROM), February 2005; Bank Indonesia web site <http://www.bi.go.id>, 10 January 2005; Malaysia Economic Planning Unit web site <http://www.epu.jpm.my/>, 7 January 2005; Philippines National Statistics Office web site <http://www.census.gov.ph>, 11 January 2005; Bank of Thailand web site <http://www.bot.or.th>, 18 November 2004; and national sources.

Notes: Growth rate for 2004 compared with the corresponding period of 2003. Growth rate for 2004 refers to the whole year, except that for Indonesia it refers to January-October, Malaysia and the Philippines to January-November and Brunei Darussalam to January-September.

Figure II.27. Growth rates in merchandise import spending of selected South-East Asian economies, 2001-2004



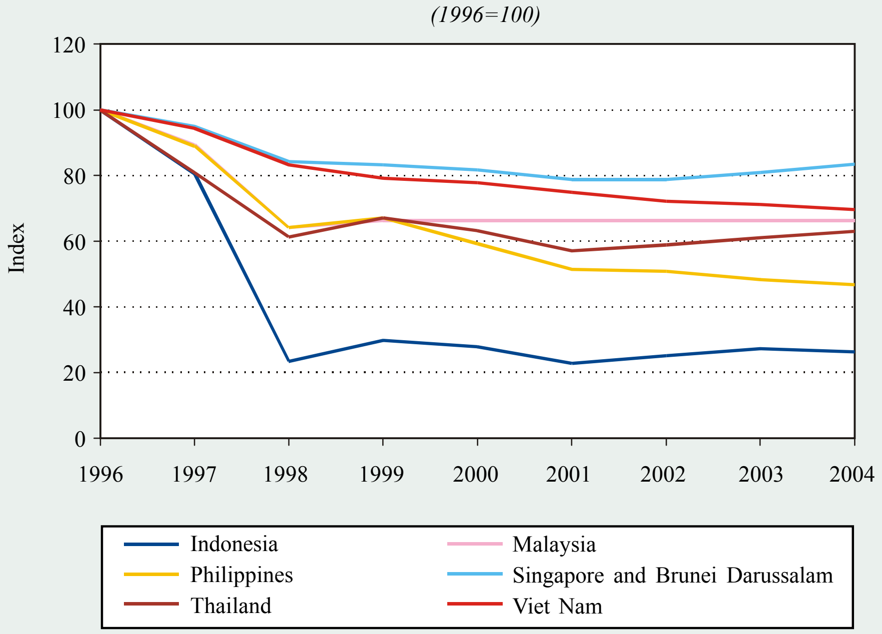
Sources: IMF, *Direction of Trade Statistics* (CD-ROM), February 2005; Statistics Indonesia web site <http://www.bps.go.id>, 7 January 2005; Malaysia Economic Planning Unit web site <http://www.epu.jpm.my/>, 7 January 2005; Philippines National Statistics Office web site <http://www.census.gov.ph>, 11 January 2005; Bank of Thailand web site <http://www.bot.or.th>, 18 November 2004; and national sources.

Notes: Growth rate for 2004 compared with the corresponding period of 2003. Growth rate for 2004 refers to the whole year except that for Indonesia it refers to January-October, Malaysia and the Philippines to January-November and Brunei Darussalam to January-September.

capital goods. Tourism also revived sharply after the SARS scare of the previous year. Current account surpluses narrowed as a percentage of GDP in most cases, except in the Philippines, where the surplus widened, and Viet Nam, where there was a smaller deficit. FDI inflows picked up in most countries in the subregion in 2004, except for the Philippines, but remained relatively low. Official reserves also increased in most countries, very substantially in Malaysia and Singapore, but declined in the Philippines despite heavy government borrowing. The exchange rate picture is mixed within the region (figure II.28).

Better job creation and faster income growth helped to reduce poverty incidence further in 2004 in many developing countries of South-East Asia but Indonesia and the Philippines face significant challenges in those areas. Increasing the competitiveness of domestic economies is another issue of concern to policy makers in the subregion.

Figure II.28. Index of exchange rates against the United States dollar of selected South-East Asian economies, 1996-2004



Sources: IMF, *International Financial Statistics,* vol. LVII, No. 10 (Washington, IMF, October 2004); and *The Economist,* various issues.

Notes: Figures for 2004 are estimates. The currency of Brunei Darussalam is set at par with the Singapore dollar.

GDP performance and outlook

Growth in Singapore comes surging back

Singapore was the fastest-growing economy in South-East Asia in 2004 (table II.28). GDP growth was 8.4 per cent for the year, a vast improvement over the modest 1.4 per cent growth in 2003 but substantially down from the 12.5 per cent year on year recorded in the second quarter. The economy decelerated in the second half of the year as manufacturers cut back on electronics production to clear inventories. A decline in biomedical output in the third quarter of 2004, following changes in the industry's production mix[1] also contributed to the deceleration, but growth in the sector improved in the last quarter. Transport engineering and chemicals continued to perform strongly. Construction

[1] Essentially, the withdrawal of the drug Vioxx by the Merck Corporation led to the company's production facilities going offline until they could be geared up to produce other drugs.

remained in the doldrums owing to lingering excess supply in the property market and cutbacks in public construction. Robust entrepôt trade and stronger retail sales, as well as the recovery in tourism following the SARS scare in 2003, boosted the service sector.

Table II.28. Selected South-East Asian economies: growth rates, 2001-2004

(Percentage)

		Rates of growth			
		Gross domestic product	*Agriculture*	*Industry*	*Services*
Brunei Darussalam	2001	3.0	..	..	..
	2002	2.8	..	..	..
	2003	3.2	..	..	..
	2004	1.1	..	..	..
Indonesia	2001	3.8	4.1	2.7	5.0
	2002	4.3	2.8	4.4	4.7
	2003	4.9	3.1	3.6	6.2
	2004	5.1	4.0	3.9	7.0
Malaysia	2001	0.3	−0.9	−3.8	6.1
	2002	4.1	3.0	3.9	4.2
	2003	5.3	5.5	7.0	3.9
	2004	7.1	2.6	8.6	4.9
Philippines	2001	3.2	3.7	1.3	4.4
	2002	4.6	3.5	4.1	5.4
	2003	4.7	3.8	3.8	5.8
	2004	6.1	4.9	5.3	7.3
Singapore[a]	2001	−1.9	−5.9	−9.1	2.4
	2002	3.2	−5.6	3.2	3.2
	2003	1.4	−0.7	0.5	1.8
	2004	8.4	11.4	9.9	7.8
Thailand	2001	2.2	3.2	1.7	2.4
	2002	5.3	1.0	6.9	4.8
	2003	6.9	8.7	9.4	4.0
	2004	6.1	−4.4	8.2	6.2
Viet Nam	2001	6.9	3.0	10.4	6.1
	2002	7.1	4.2	9.5	6.5
	2003	7.3	3.6	10.5	6.5
	2004	7.7	3.5	10.2	7.5

Sources: ESCAP, based on national sources; ADB, *Key Indicators of Developing Asian and Pacific Countries 2004* (Manila, ADB, 2004), and EIU, *Country Forecasts* and *Country Reports* (London, EIU, 2004), various issues.

Notes: Growth rates for 2004 are estimates. Industry comprises mining and quarrying; manufacturing; electricity, gas and power; and construction.

[a] Agriculture also includes quarrying.

External demand, which expanded at rates in excess of 20 per cent in the second and third quarters of 2004, fuelled by the upturn in the electronics cycle, was the driving force behind the improved growth performance in Singapore but domestic demand also played a role. Private consumption, which was depressed in 2001-2003 owing to the weak economy, revived strongly in 2004. Consumer confidence benefited from falling unemployment and better job creation, as well as rising real wages. Investment also picked up, especially in the private sector, after three successive years of contraction. The investment ratio rose to 15.3 per cent in 2004, almost 2 percentage points higher than in the previous year, but still relatively low for Singapore (table II.29). Looking ahead, real GDP growth is expected to moderate as growth in Singapore's main export markets softens along with demand for IT products. The Government expects GDP growth to be in the 3-5 per cent range in 2005. However, the accumulation of inventories has been much less in this electronics cycle than in the previous one and growth is not expected to be depressed for long.

Table II.29. Selected South-East Asian economies: ratios of gross domestic savings and investment to GDP, 2001-2004

(Percentage)

	2001	*2002*	*2003*	*2004*
Savings as a percentage of GDP				
Indonesia	26.4	24.7	23.5	22.4
Malaysia	42.3	41.9	42.9	45.0
Philippines	18.1	19.5	20.1	20.4
Singapore	44.0	43.9	46.7	47.4
Thailand	32.2	32.8	33.1	31.6
Viet Nam	28.8	28.7	27.4	28.3
Investment as a percentage of GDP				
Indonesia	21.5	20.2	19.8	19.5
Malaysia	24.0	23.6	21.8	22.5
Philippines	20.6	19.3	18.7	19.6
Singapore	24.9	21.2	13.4	15.3
Thailand	24.1	23.9	25.2	27.8
Viet Nam	31.2	33.2	33.8	35.5

Sources: ESCAP, based on national sources; and ADB, *Key Indicators of Developing Asian and Pacific Countries 2004* (Manila, ADB, 2004).

Note: Figures for 2004 are estimates.

High and steady growth in Viet Nam

Viet Nam was the second-fastest-growing nation in South-East Asia in 2004 with a GDP growth rate of 7.7 per cent, the first time that this rate has been within the 7.5-8.0 per cent range for annual growth targeted in the 2001-2005 five-year plan. The rate of growth averaged 7.1 per cent in 2001-2003. The marginal slowdown in the agricultural sector, to 3.5 per cent in 2004 from 3.6 per cent a year earlier, disguises a sharp fall in agriculture owing to the effects of a drought brought on by a weak monsoon, an unusually severe winter and avian influenza. Fisheries output increased strongly in 2004 as a result of the vigorous expansion of aquaculture and a greater number of harvests. Despite being hit by anti-dumping duties imposed by the United States on shrimp and catfish exports, which are being challenged, Vietnamese producers have responded by vigorously and successfully pursuing new markets. Value added in the industrial sector grew by a stellar 10.2 per cent in 2004, slightly slower than in 2003. Growth was dampened in manufacturing by the higher costs of imported inputs, particularly steel and oil, which also cooled activity in construction. The service sector performed very strongly, expanding by 7.5 per cent in 2004, 1 percentage point above the 2003 growth rate. Tourism, in particular, boomed with a 20 per cent increase in visitor numbers as compared with the previous year as Viet Nam benefited from being perceived as a safe destination and the Government reduced the time and costs associated with obtaining a visa. Wholesale and retail trade also expanded strongly.

Viet Nam's strong growth performance was sustained by both domestic and external demand. Household final consumption expenditure grew an average annual 7.5 per cent in 2002-2004. At the same time, the savings ratio rose from 27.4 per cent of GDP in 2003 to 28.3 per cent in 2004 largely as a result of increased household savings. A substantial portion of household savings remains outside the banking system. The investment ratio increased from 33.8 per cent in 2003 to 35.5 per cent in 2004. Around 56 per cent of all investment came from the State-invested sector in 2003-2004, with another 27 per cent representing private investment and 17 per cent FDI. Export performance was particularly strong in 2004, owing to the electronics revival as well as to higher international prices for oil and other commodities. The target for economic growth in 2005 has been set to accelerate to 8.5 per cent to meet the goals of the 2001-2005 five-year plan.

Strong external and domestic demand sustain Malaysian growth

Despite signs of a slowdown in the second half of the year in Malaysia, the growth in GDP is expected to be 7.1 per cent for the year as a whole, above the 6-6.5 per cent forecast earlier and well above the 5.3 per cent recorded in 2003. Strong private consumption expenditure, sustained by higher disposable incomes following robust export earnings as well as credit availability and low interest rates, was the principal driver of growth. A bonus for civil servants in the 2005 budget helped to boost consumption further. Public consumption was subdued as the Government focused on fiscal consolidation and net exports were negative as strong export growth was more than matched by imports. Private investment expenditure, on rebuilding inventories as well as on fixed capital, also made a significant contribution to growth in 2004. However, the increase in the savings ratio, from 42.9 per cent in 2003 to 45 per cent in 2004, outpaced that in the investment ratio, which increased to 22.5 per cent in 2004 from 21.8 per cent the previous year. Nevertheless, improved corporate profitability, capacity utilization rates in excess of 80 per cent and generally high levels of business confidence as well as favourable financing conditions suggest that the long-awaited revival in investment is under way.

Economic growth in Malaysia in 2004 was broad-based. Export-oriented manufacturing industries, in particular electronics and electrical products and chemical products such as plastics and resins, grew strongly while growth in domestic-oriented industries was lead by fabricated metal products, beverages and transport equipment. Strong consumer demand and a revival of trade and tourism sustained growth in both intermediate and final services. In agriculture, commodities such as palm oil, rubber and forestry products grew strongly in response to higher world prices, but production also expanded significantly in fisheries, vegetables and fruits. The mining sector was sustained by increased crude oil production but the construction sector declined as government spending on infrastructure slowed. Despite heightened external risks in 2005, the diversified nature of the Malaysian economy is expected to help the country to attain a respectable GDP growth rate of 6 per cent. Demand will continue to be driven by the private sector, particularly as interest rates are likely to remain low.

Some deceleration in growth in Thailand

The Thai economy continued to perform well in 2004 despite some deceleration in growth to 6.1 per cent from 6.9 per cent in 2003. Private consumption expenditure slowed owing to higher retail prices, especially for petrol, slower growth in farm incomes and diminished consumer confidence owing to the avian influenza outbreak and troubles in some provinces in the South. Private investment also slowed, despite rising capacity utilization, as investor confidence declined for similar reasons, but growth remained in double digits at around 15 per cent in the first 9 months of 2004. Public expenditure increased, in part owing to previous fiscal stimulus measures and higher public investment, and the investment ratio increased by over 2.5 percentage points between 2003 and 2004 to 27.8 per cent. Unanticipated expenditure, including compensation for farmers hit by the avian influenza outbreak and outlays for increased security and development in the violence-affected southern provinces, also added to government outlays. Robust external demand showed signs of slowing in the second half.

Agricultural production declined 4.4 per cent in 2004 in Thailand, a sharp fall from the nearly 9 per cent growth in 2003, as renewed outbreaks of avian influenza took their toll on poultry farming and shrimp production fell following the imposition of preliminary anti-dumping tariffs by the United States. In addition, a prolonged drought aggravated by a weak monsoon affected the output of rice and other grains. Growth in industrial production slowed to 8.2 per cent in 2004, down from the robust 9.4 per cent the previous year, as manufacturing output eased owing to slower growth in food processing, weakening exports of electronics and electrical appliances and excess inventories of steel and steel products. The construction sector was sustained by higher public construction while residential construction slowed. The service sector rebounded sharply as tourism recovered from the SARS scare and business and financial services registered robust growth.

Tsunami destroyed assets and livelihoods but growth outlook remains strong

The Indian Ocean tsunami disaster struck Thailand too late to affect 2004 performance but will certainly have an impact on GDP in 2005. Apart from the devastating human toll, preliminary estimates indicate that the tourism and fisheries industries lost around B 30.8 billion and B 2 billion in assets respectively. Damage to public utilities, roads and the power grid will add to overall losses. The Bank of Thailand (BOT) has estimated that tourism industry revenues will decline B 40 billion in 2005, as visitor arrivals are expected to fall by 1.2 million, and that the fishing industry will lose B 3.1 billion in income. Together, losses in those two sectors could shave 0.8 per cent off GDP growth in 2005. In compensation, the injection of State funds, soft loans and donations is expected to raise growth by 0.3 per cent, leaving a net 0.5 per cent reduction in GDP growth in 2005. An additional consideration is that the effect of higher world oil prices has not as yet been fully felt in Thailand owing to the Government's fuel price subsidies, which have now been removed from petrol but remain on diesel at least until early 2005. The current forecast is for GDP growth in the 5.5-6.5 per cent range in 2005.

Surprisingly strong growth in the Philippines

The economy of the Philippines proved to be remarkably resilient in 2004 with a performance that exceeded government expectations despite rising oil prices, slowing global demand, fragile investor confidence, political uncertainty and a series of typhoons that hit the country in the latter part of the year. GDP growth for the year as a whole at 6.1 per cent was well above the 4.7 per cent recorded in 2003 and higher than the Government's target range of 4.9-5.8 per cent. Strong external demand sustained growth, supported by domestic spending. Private consumption was particularly strong in the first half of the year, slowing somewhat thereafter as consumer prices rose but supported by an increased flow of remittances from overseas workers in the second half. The savings ratio also grew modestly to 20.4 per cent in 2004, continuing the slight upward trend of recent years. Public consumption was cut back in the second half of the year, following the election, in order to meet fiscal targets. Although there was a strong revival in investment in 2004, investment in durable equipment slowed to 4.4 per cent from 8.5 per cent the previous year. The investment ratio increased to 19.6 per cent in 2004 but it remains relatively low and the World Bank reports that the capital-labour ratio has fallen in the Philippines, unlike in other economies in the subregion.

Typhoons lower growth in the Philippines but call centres boost telecommunications

The service sector was a key factor in the strong performance of the Philippines, with growth accelerating to 7.3 per cent in 2004 from an average 5.6 per cent in 2002-2003. This can be attributed largely to the telecommunications sector, where investment related to call centre activity and other business process outsourcing, as well as software development, mushroomed. Agriculture benefited from extraordinarily productive harvests of the two food staples, rice and maize, although cash crops such as coconut and pineapple and forestry also performed well. However, losses estimated to be equivalent to 1.7 per cent of the sector's fourth quarter output resulting from four typhoons that hit Luzon in late-November to early-December pulled overall growth in agriculture down to 4.9 per cent in 2004, still an improvement on the average annual 3.7 per cent growth in 2002-2003. The typhoons shaved 0.35 percentage points off fourth-quarter GDP growth. Growth in the industrial sector surged in the first half of 2004, sustained by a strong recovery in construction from the contraction in 2003, but cutbacks in public construction led to a slowdown in the second half. Nevertheless, somewhat stronger growth in manufacturing and double-digit growth in mining, in response to higher commodity prices, led to an overall growth rate for the industrial sector of 5.3 per cent in 2004, well above the 4.0 per cent on average in 2002-2003. GDP growth is expected to slow to 5.3 per cent in 2005 as the external environment becomes less favourable.

Growth picks up in Indonesia but remains low

Robust private consumption and a strong revival in investment underpinned the pickup in GDP growth to 5.1 per cent in 2004 in Indonesia, matching the Government's forecast and continuing the modest upward trend observed since 2001. Consumers' expenditure was boosted by interest rates at six-year lows, as well as election-related spending. Demand for vehicles was particularly strong. Fixed investment grew 11.3 per cent year on year in the first 9 months of 2004, reflecting not only continued strong growth in housing investment but also increased spending on machinery and transport equipment. However, both the savings and investment rates continued to decline. In the first half of the year, export growth was modest, whereas imports soared, and Indonesia did not appear to benefit to the same extent as other countries from the surge in trade until the second half of the year. Public consumption was, however, constrained by budgetary pressures.

Growth was generally broad-based, with all sectors except mining expanding. The lack of investment in the mining sector, which has affected oil production negatively, was responsible for the poor performance. On a more positive note, transport and communications grew very strongly in 2004, as did construction and wholesale and retail trade. A revival in tourism along with strong private domestic consumption led to a recovery in the hotel and restaurant sector, and renewed strength in financial services was demonstrated by continued expansion, particularly in the second half of the year. Agriculture improved its performance through the year, helped by an import ban on rice, and in November 2004 the Ministry of Agriculture announced that Indonesia had regained self-sufficiency in rice production after nearly 10 years, taking a major step towards food security.

Aceh province hardest hit by the tsunami but GDP outlook still positive for Indonesia

The ending of political uncertainty in Indonesia following the elections in October 2004 boosted consumer and business confidence and GDP growth is expected to accelerate to 5.5 per cent in 2005 despite the destruction caused by the tsunami of 26 December 2004. The province of Aceh, which bore the brunt of the destruction, accounts for around 2 per cent of Indonesia's economic output. Although there has been a substantial loss of human and physical capital, other key economic assets in the province, such as coal and copper mines and oil and gas operations, appear to be largely intact. The economic aid and reconstruction following the disaster may also offset the disaster-related reduction in economic activity. Indonesia hopes to attain 7 per cent per annum growth, needed for a consistent reduction in unemployment and poverty, by 2009 but, in the opinion of the World Bank, this growth rate could be attained two years earlier given sufficient investment.

Repairs and upgrades to oil and gas sector slow growth in Brunei Darussalam

GDP growth has been moderate in Brunei Darussalam in recent years, averaging around 3 per cent per annum in 2001-2003. However, repairs and upgrades to oil and gas production facilities constrained growth in 2004. Output in the oil and gas sector, which accounts for around 40 per cent of GDP, is estimated to have declined by 5.4 per cent year on year in the first half. The non-oil and gas sector performed strongly, expanding at 3.9 per cent year on year in the second quarter of 2004, owing to a surge in forestry output, garments, roofing materials and switchboard production, as well as wholesale and retail trade. The restaurant and hotel sector, however, contracted quite sharply as hotel occupancy rates and restaurant sales both declined. Overall GDP growth for the year is estimated at 1.1 per cent but is expected to double to 2.2 per cent in 2005 and to rise further to 3 per cent in 2006.

Inflation and monetary policy

Fuel subsidies restrain inflation in Indonesia and Malaysia

The slowdown in inflation observed in 2003 in Indonesia continued into 2004 (table II.30) despite some acceleration in the second and third quarters, and the rate of inflation for the year was 6.1 per cent. An abundant rice harvest, fuel subsidies and a strengthening rupiah in the latter half of the year were all factors that helped to contain prices. Continuing low capacity utilization rates, of around 55-60 per cent, and declining wage demands were other contributing factors. Although lower oil prices could help to moderate inflation in 2005-2006, the Government has raised its inflation forecast for 2005 from 5.5 to 7 per cent because it expects transport costs to rise as fuel subsidies are reduced. Bank Indonesia raised reserve requirements for commercial banks at mid-year and announced that it would maintain a monetary policy with a tight bias, seeking to support the rupiah without major increases in interest rates so as to encourage economic growth and avoid adverse consequences for the Government's debt servicing. M2 growth between 2003 and 2004 is estimated at 10.5 per cent. The benchmark rate on one-month Bank Indonesia Certificates rose somewhat to 7.43 per cent in December but commercial bank lending rates were significantly higher despite abundant liquidity, reflecting continued risk aversion.

Table II.30. Selected South-East Asian economies: inflation and money supply growth (M2), 2001-2004

(Percentage)

	2001	*2002*	*2003*	*2004*
Inflation[a]				
Indonesia	11.5	11.9	6.6	6.1
Malaysia	1.4	1.8	1.2	1.4
Philippines	6.8	3.0	3.5	6.0
Singapore	1.0	–0.4	0.5	1.7
Thailand	1.6	0.7	1.8	2.7
Viet Nam	0.8	4.0	3.0	9.5
Money supply growth (M2)				
Indonesia	13.0	4.7	8.1	10.5
Malaysia	2.2	5.8	11.1	9.8
Philippines	3.6	10.4	3.6	4.0
Singapore	5.9	–0.3	8.1	6.2
Thailand	4.2	2.6	4.9	5.4
Viet Nam	25.5	17.6	24.9	..

Sources: ESCAP, based on national sources; ADB, *Key Indicators of Developing Asian and Pacific Countries 2004* (Manila, ADB, 2004); IMF, *International Financial Statistics,* vol. LVII, No. 6 (Washington, IMF, June 2004); and EIU, *Country Forecasts* (London, EIU, 2004), various issues.

Note: Figures for 2004 are estimates.

[a] Changes in the consumer price index.

Annual consumer price inflation edged up through 2004 in Malaysia to reach 1.4 per cent, compared with 1.2 per cent in 2003. Prices of food, beverages, tobacco, fuel and power all rose, largely owing to higher transport costs following two increases in the price of petroleum, in May and October, and to increased excise duties. Nevertheless, high prices for crude oil have had only a limited impact on inflation so far owing to the Government's fuel subsidies. Wage cost pressures were largely absent as labour productivity appears to have grown substantially faster than real wages per employee. The outlook for inflation in 2005 is for a further pickup to 2.2 per cent as the Government reduces fuel subsidies in line with its commitment to fiscal consolidation.

Bank Negara Malaysia continued with its accommodative but prudent monetary policy in 2004 and M2 growth was 9.8 per cent in 2004. In a step towards further interest rate liberalization, a new indicator rate, the overnight policy rate (OPR), was introduced in April 2004 and will be maintained close to the overnight interbank rate. The OPR was unchanged at 2.7 per cent during the rest of the year but banks and finance companies lowered lending rates owing to ample liquidity. The Bank has indicated that as the outlook for the Malaysian economy remains favourable, it intends to maintain the current stance of monetary policy and interest rates are unlikely to rise in the near future. The performance of the banking system remained sound with the risk-weighted capital ratio at 13.8 per cent and the net NPL ratio at 5.9 per cent, the lowest level since the 1997-1998 financial crisis, by December 2004.

Inflation accelerates on supply shocks in the Philippines

The rate of inflation in the Philippines slowed to an annual average of 3.2 per cent in 2002-2003. However, the inflation rate picked up significantly in 2004 to reach 6.0 per cent, above the central bank's target range, largely as a result of supply shocks to particular commodities, mainly food and energy items. Higher oil prices on world markets were reflected in higher domestic fuel, energy and transport charges as budget constraints prevented the Government from shielding consumers to the same extent as in neighbouring countries. Bango Sentral ng Filipinas (BSP) is in the process of finalizing inflation targets for 2005 and 2006. Indications are that the target range will be raised to 5-6 per cent using the 2000-based CPI but inflation may go even higher if oil prices continue to rise.

BSP had raised liquidity reserve requirements by 2 percentage points to 10 per cent in February 2004 in response to the upward trend in inflation. It did not, however, tighten monetary policy further in 2004, maintaining the overnight borrowing rate at 6.75 per cent, as it believed that any increase in key policy rates would have limited success in containing inflationary pressures that emanated largely from supply factors. However, if signs emerge of more generalized inflation, policy rates may then be increased. Some progress was made in 2004 in improving asset quality in the banking system in the Philippines. The NPL ratio has been on a downward trend and was reported to be 13.6 per cent in November. This is still high compared with economies that were more directly affected by the 1997 financial crisis as the Philippines has never had a centralized asset management corporation. Take-up under the special-purpose vehicle law, which provided incentives for the disposal of NPLs, has been weak and steps may be taken to extend the validity of the law beyond its scheduled expiry date in April 2005. The capital adequacy ratio of the commercial banking system was 17.8 per cent in September, well above the 10 per cent figure required by BSP, but credit demand is stagnant and bank profitability weak.

Higher food and energy prices in Singapore

The significant pickup in the rate of consumer price inflation in 2004 in Singapore, to 1.7 per cent from 0.5 per cent in 2003, was partly a reflection of higher international oil and other commodity prices as well strong economic growth above the long-term potential rate. Domestic prices of oil-related items such as electricity tariffs and petrol registered significant increases. Food prices also rose in the aftermath of a ban on poultry imports at the end of August owing to avian influenza concerns. There were also very substantial increases in the costs of education and health-care services. The outlook for inflation in 2005 is related to developments in commodity prices, particularly for oil. Currency appreciation and continued weakness in the housing market could moderate price pressures but retail prices may rise in response to improved consumer sentiment.

Singapore has a small, open economy, and its monetary policy is focused on managing the exchange rate, which is permitted to fluctuate within an undisclosed band. Against the background of more favourable economic growth and rising inflationary pressures, the Monetary Authority of Singapore tightened monetary policy somewhat in April 2004, shifting from a stance of 0 per cent appreciation of the trade-weighted nominal effective exchange rate to a policy of modest and gradual appreciation with no change in the slope or width of the policy band. The policy was reaffirmed in October for a further 6 months to reduce the risk of imported inflation while safeguarding the economy's competitiveness. Domestic interest rates have risen in tandem with the United States federal funds rate, the 3-month interbank rate rising from 0.75 per cent at the end of 2003 to 1.44 per cent by December 2004.

Fuel subsidies restrain inflation in Thailand but food prices rise

The rate of inflation accelerated in Thailand from 1.8 per cent in 2003 to 2.7 per cent in 2004 largely as a result of a sharp rise in food prices, reflecting higher demand and reduced agricultural output, and the increase in world oil prices. The Government's fuel subsidies, which will not be fully removed until March 2005, have prevented the full impact of the oil price hike from being reflected in the rate of inflation. Furthermore, an agreement between the Government and 80 suppliers of consumer products not to increase prices for 6 months from September 2004 has kept the price level in check. This suggests that there could be a further sharp pickup in consumer prices during the course of 2005.

The central bank moved to tighten monetary policy during 2004 in Thailand. After being maintained at an all-time low level of 1.25 per cent since June 2003, the benchmark 14-day repurchase rate was raised three times beginning in August 2004 in steps of 25 basis points to 2 per cent in December. BOT was concerned that growth momentum remained strong and that any reduction in inflationary pressures from currency appreciation or lower oil prices could be temporary. BOT has also expressed the view that continued negative real deposit rates discourage savings and lead to increased household debt and it would like to see interest rates return to neutral levels. M2 growth picked up somewhat to 5.4 per cent year on year in December 2004 from 4.9 per cent a year earlier. The overall health of the banking system continued to improve with the NPL ratio down to 11.6 per cent in September 2004 from 13.5 per cent in January and the capital adequacy ratio at around 12 per cent. The Thai Asset Management Corporation estimates that around 69 per cent of debt restructuring has been completed and BOT has introduced tighter provisioning rules against NPLs and moved decisively to curb excess lending by a large State-owned bank. Commercial banks are expected to comply with Basel II by 2008.

Sharp acceleration in the rate of inflation in Viet Nam

The rate of inflation more than tripled in Viet Nam in 2004, accelerating to 9.5 per cent from 3 per cent in 2003 as a result of successive supply shocks. Prices of food and foodstuffs, the largest item in the CPI, rose 15.6 per cent owing to problems in the agricultural sector and a 46 per cent increase in international fertilizer prices. Fuel subsidies were introduced by the Government earlier in 2004 to shield consumers from the effects of rising oil prices, but were withdrawn from petrol in September. At that time, prices of other fuels were capped, forcing suppliers to absorb higher costs. The authorities also lowered tariffs on petroleum and steel products to contain prices. The rate of inflation is expected to slow to 6-7 per cent in 2005 assuming lower oil and food prices. M2 growth has been rapid in recent years, in part reflecting the ongoing monetization, and credit growth accelerated in 2004, led by State-owned banks. In response to rising inflation, the State Bank of Viet Nam increased reserve requirements from 2 to 5 per cent on short-term deposits in July and doubled them on other types of deposits at the same time. However, it has kept the prime lending rate for dong loans unchanged at 7.5 per cent since May 2003. Other administrative measures are being taken to rein in lending, reduce public expenditure and lower production and distribution costs, while tightening enforcement of price controls.

Inflation has remained very subdued in Brunei Darussalam, with the CPI increasing by only 0.7 per cent year on year in the second quarter of 2004, reflecting higher prices for food and non-alcoholic beverages, transport and recreation and entertainment. Low inflation is likely to continue in the near future as commodity prices stabilize and the currency peg with the Singapore dollar is maintained. Although M2 is estimated to have expanded by nearly 10 per cent in the first half of 2004 as compared with a year earlier, private sector credit, principally in the form of personal loans, has expanded slowly. The prime lending rate has remained unchanged at 5.5 per cent since September 2000. NPLs in the banking system have fallen sharply, from 15.9 per cent at the end of June 2003 to 11.8 per cent at the end of the same month in 2004. The establishment of the Brunei Currency and Monetary Board in February 2004 will assist in greater financial market development and improve regulation in the banking sector.

Fiscal policy and public debt

Fuel subsidies weigh on Indonesia's budget

In Indonesia, the deficit target was revised upwards to 1.3 per cent in 2004 in the light of higher oil prices and projected expenditure, mainly on fuel subsidies and revenue-sharing with the regions, were raised. The actual deficit reached 1.4 per cent (table II.31) as fuel subsidy costs are

Table II.31. Selected South-East Asian economies: budget and current account balance as a percentage of GDP, 2001-2004

(Percentage)

	2001	*2002*	*2003*	*2004*
Budget balance as a percentage of GDP				
Indonesia	−2.8	−1.7	−1.9	−1.4
Malaysia	−5.5	−5.6	−5.3	−4.5
Philippines[a]	−4.0	−5.2	−4.6	−3.8
Singapore[b]	1.6	−1.1	−1.6	−0.6
Thailand[c]	−2.4	−1.4	0.4	0.1
Viet Nam[d]	−5.0	−4.5	−5.6	−4.9
Current account balance as a percentage of GDP				
Indonesia	4.8	4.5	3.7	2.8
Malaysia	8.3	8.5	13.0	10.2
Philippines	1.8	5.4	4.3	4.8
Singapore	16.8	17.7	29.2	26.1
Thailand	5.4	5.5	5.6	4.5
Viet Nam	2.1	−1.7	−4.8	−3.2

Sources: ESCAP, based on national sources; ADB, *Key Indicators of Developing Asian and Pacific Countries 2004* (Manila, ADB, 2004); EIU, *Country Forecasts* (London, EIU, 2004), various issues; and web site of the Ministry of Finance of Singapore <www.mof.gov.sg/budget_2004/fiscal_overview/>, 24 September 2004.

Note: Figures for 2004 are estimates.

[a] Including grants.

[b] Budget surplus/deficit computed from government operating revenue minus government operating expenditure minus government development expenditure.

[c] Referring to a government cash balance comprising the budgetary balance and non-budgetary balance.

[d] Including net lending.

estimated to have been nearly $7.5 billion in 2004. The Government plans to reduce the cost of subsidies in 2005 by raising petrol prices while retaining subsidies on diesel and kerosene, used as a cooking fuel by the poor. Fuel subsidies will be eliminated by 2010 as the domestic energy market is gradually liberalized. The Government hopes to continue the process of fiscal consolidation and reduce the deficit to 0.8 per cent of GDP in 2005, assuming that oil prices average $24 per barrel, and to balance the budget by 2007. Greater attention will also be given to spending on infrastructure and social programmes to stimulate employment and soften the effect of higher fuel prices on the poor. Government debt is now around 50 per cent of GDP, down from 67 per cent at the end of 2003. However, the impact of the tsunami disaster on the Government's budget has yet to be assessed. Debt relief will reduce interest payments in the short term and aid inflows will go some way towards meeting the costs of reconstruction. However, there may have to be a diversion of government expenditure from other programmes to rebuilding infrastructure in Aceh.

Slower fiscal consolidation in Malaysia

The process of fiscal consolidation that began in 2004 in Malaysia was reaffirmed in the 2005 budget, which seeks to reduce the budget deficit from 4.5 per cent of GDP in 2004 to 3.8 per cent of GDP in 2005. Much of the reduction is to be achieved by higher revenues but development spending will continue to fall as private investment revives. Spending will also be redirected towards boosting the agricultural sector to become the third growth pole while supporting smallholders. SMEs, new entrepreneurs and infrastructure are also to receive increased support. The goal of balancing the budget by 2006 now appears to be remote but the planned introduction of a VAT in 2007 gives credence to it being achieved soon thereafter. Slower fiscal consolidation will raise debt-service charges but federal government debt as a percentage of GDP is expected to be around 50 per cent in 2004, down from an average 53.6 per cent in 1998-2003.

Greater fiscal discipline in the Philippines

In the Philippines, the fiscal deficit narrowed to 4.6 per cent of GDP in 2003, from 5.2 per cent in 2002, as stronger growth led to higher tax revenues. The deficit target for 2004 was lowered to 4.2 per cent of GDP but fell even more sharply to 3.8 per cent. The better out-turn reflects greater fiscal control, stronger GDP growth and higher power charges, among other factors. Non-financial public sector debt in the Philippines is around 110 per cent of GDP and interest expense some 40 per cent of revenues, raising concerns about debt sustainability and vulnerability to external shocks. However, the Philippines medium-term development plan envisaged a very gradual reduction in the fiscal deficit with the budget balanced only in 2010. As interest rates are likely to rise in the future, there is pressure on the Government to frontload deficit reduction. Tax and customs revenues remain well below potential as tax evasion and corruption continue to be major problems. The Government had proposed eight legislative measures designed to increase tax revenues but only two of these measures, a specific excise levy on alcohol and tobacco and a measure to reward good performance by tax collectors, have been passed, although there has been some progress on two others. The National Power Corporation is to be privatized and one coal-fired facility was auctioned off in December 2004. The Government is forecasting a budget deficit equivalent to 3.5 per cent of GDP in 2005.

A return to fiscal prudence in Singapore

In its efforts to support economic activity in 2003, the Government of Singapore had introduced two off-budget packages to counter the effects of SARS and a reduction in employers' contributions to the Central Provident Fund, in addition to the budget for that year. As a result, the budget deficit rose to 1.6 per cent of GDP but is expected to fall to 0.6 per cent of GDP in 2004 as the Government has returned to a more prudent fiscal position, tightening operating expenditures in particular. Tax receipts have also been rising as a result of the improved economy but have still to recover from the drop in income in 2003. The budget is expected to return to a surplus in 2005 as growth continues although the corporate income tax rate is to be cut 2 per cent and individuals are to be offered tax exemptions on foreign-sourced and investment income.

Unexpected outlays reduce the budget surplus in Thailand

Strong economic growth in Thailand in 2003 led to a small budget surplus equivalent to 0.4 per cent of GDP in that year. Unexpected outlays as a result of avian influenza, the security situation in the South and the increased cost of fuel subsidies narrowed the surplus to 0.1 per cent of GDP in 2004. The Government had hoped for a balanced budget in the current fiscal year, earlier than the original target date of 2008, but the slowing economy, the rising cost of the universal health-care system and tsunami-related expenditure may push the budget into deficit. However, the partial reduction of fuel subsidies will reduce expenditures. Off-budget liabilities accumulated by the Government, mainly loans from State-owned banks to SMEs, continue to be of some concern. Total public sector debt has been on a declining trend and reached 47.8 per cent of GDP by the end of 2004, down from 48.9 per cent in December 2003.

Robust growth in budgetary revenues in Viet Nam

Budget revenues, particularly tax revenues, increased robustly in 2004 in Viet Nam, surpassing targets. This was despite a reduction in the enterprise income tax rate from 32 to 28 per cent. Profits of State-owned oil-producing companies added to non-tax revenue sources. Revenues from trade taxes decreased owing mainly to tariff reductions on oil and steel imports and only partly to Viet Nam's implementation of its AFTA commitments. Budgetary expenditure also increased strongly but there was a decrease in capital expenditure. The budget deficit decreased as a percentage of GDP from 5.6 per cent in 2003 to 4.9 per cent in 2004, in line with the Government's target of 5 per cent.

Helped by higher oil prices and expenditure restraint, the budget returned to a surplus in the second quarter of 2004 in Brunei Darussalam after recording a small deficit in the first quarter. Ensuring the long-term sustainability of public expenditure continues to be an important issue in Brunei Darussalam, where the oil and gas sector contributes around 80 per cent of government revenues. A related issue is the need to deal with fiscal deficits in a manner that does not compromise growth and diversification in the medium term. Under the eighth national development plan from 2001 to 2005, the Government is committed to spending B$ 1 billion annually on financing public investment in infrastructure. However, in 2002 and 2003 only 43 and 26 per cent respectively of the allocated amount were spent.

Foreign trade and external transactions

External trade

After the surge in the value of total exports in 2003 in Brunei Darussalam, due largely to increased revenues from exports of oil and gas, export growth in the first 9 months of 2004 was much slower at 11.1 per cent on an annual basis on diminished production (table II.32). Japan

Table II.32. Selected South-East Asian economies: merchandise exports and their rates of growth, 2001-2004

	Exports (f.o.b.)				
	Value (millions of US dollars)	*Annual rate of growth (percentage)*			
	2003	*2001*	*2002*	*2003*	*2004*
Brunei Darussalam[a]	4 422	5.5	3.1	28.6	11.1
Indonesia[b]	63 450	–12.3	3.1	7.2	15.1
Malaysia[c]	104 969	–10.4	6.9	11.6	21.3
Philippines[c]	35 750	–15.6	9.5	1.5	9.9
Singapore	144 126	–11.8	2.8	15.3	24.6
Thailand	78 105	–7.1	4.8	18.2	23.0
Viet Nam	20 176	3.7	11.2	20.8	28.9

Sources: IMF, *Direction of Trade Statistics* (CD-ROM), February 2005; Bank Indonesia web site <http://www.bi.go.id>, 10 January 2005; Malaysia Economic Planning Unit web site <http://www.epu.jpm.my/>, 7 January 2005; Philippines National Statistics Office web site <http://www.census.gov.ph>, 11 January 2005; Bank of Thailand web site <http://www.bot.or.th>, 18 November 2004; and other national sources.

[a] Growth rate for 2004 refers to January-September 2004 compared with the corresponding period of 2003.
[b] Growth rate for 2004 refers to January-October 2004 compared with the corresponding period of 2003.
[c] Growth rate for 2004 refers to January-November 2004 compared with the corresponding period of 2003.

remains the principal export market. Imports grew very strongly at 23.5 per cent in the first 9 months of 2004, reversing the decline registered in 2003 (table II.33). Other countries in ASEAN are the principal suppliers of imports to Brunei Darussalam.

Table II.33. Selected South-East Asian economies: merchandise imports and their rates of growth, 2001-2004

	Imports (c.i.f.)				
	Value (millions of US dollars)	*Annual rate of growth (percentage)*			
	2003	*2001*	*2002*	*2003*	*2004*
Brunei Darussalam[a]	1 341	−7.8	23.9	−17.7	23.5
Indonesia[b]	32 551	−7.6	1.1	4.0	40.0
Malaysia[b]	83 617	−10.0	8.2	4.8	36.3
Philippines[c]	37 448	−4.2	7.2	5.7	8.2
Singapore	131 335	−13.9	0.4	12.9	24.7
Thailand	74 346	−3.0	4.6	17.4	27.0
Viet Nam	25 227	3.7	22.1	27.8	24.5

Sources: IMF, *Direction of Trade Statistics* (CD-ROM), February 2005; Statistics Indonesia web site <http://www.bps.go.id>, 7 January 2005; Malaysia Economic Planning Unit web site <http://www.epu.jpm.my/>, 7 January 2005; Philippines National Statistics Office web site, <http://www.census.gov.ph>, 11 January 2005; Bank of Thailand web site <http://www.bot.or.th>, 18 November 2004; and other national sources.

[a] Growth rate for 2004 refers to January-September 2004 compared with the corresponding period of 2003.
[b] Growth rate for 2004 refers to January-November 2004 compared with the corresponding period of 2003.
[c] Growth rate for 2004 refers to January-October 2004 compared with the corresponding period of 2003.

Import growth outpaces exports in Indonesia

Export growth in the first half of 2004 in Indonesia was modest, particularly for non-oil and gas exports, but there was an apparent surge in exports in the second half of the year, in part owing to a switch to a computerized data collection system and in part to commodity exports to China and India. Exports are estimated to have increased over 15 per cent year on year in the first 10 months of 2004. Some two thirds of exports in 2003 were from the industrial sector, which has, however, been losing competitiveness as utility prices and wage rates have risen. Imports expanded very strongly, by 40 per cent year on year in January-November 2004. Nearly 80 per cent of imports were intermediate goods and only around 12 per cent were capital goods, half the share of the pre-crisis years. However, an encouraging sign of the revival of investment is that capital goods imports appear to have expanded very rapidly in 2004. The trade balance remained strongly positive in the first three quarters of 2004 but was some 20 per cent below its value in the same period in 2003. The deficit on the services account, which widened sharply in 2003 as tourism fell on fears of terrorism and SARS, narrowed somewhat in the first half of 2004 and tourist arrivals increased 28 per cent on an annual basis in the first 9 months of the year. The current account surplus as a percentage of GDP declined in 2004 to 2.8 per cent (table II.31).

Electronics and electrical products boost trade in Malaysia

The value of merchandise exports and imports soared, by 21.3 and 36.3 per cent respectively, in the first 11 months of 2004 in Malaysia but there were indications of a slowdown in export growth in the second half of the year, mainly of electronics and electrical products to China. Exports to other ASEAN nations, China, the EU, Hong Kong, China, Japan and the United States, which together absorb nearly 80 per cen of Malaysia's exports, all expanded sharply in 2004. Electronics and electrical products dominated total exports, with a share that hovered around 50 per cent. Chemicals and chemical products, crude petroleum and palm oil each contributed over 5 per cent to total exports. The strength of the growth in imports in 2004 was remarkable, as was its broad-based nature. Consumer, capital and intermediate goods imports all expanded at rates well in excess of 20 per cent, with the bulk of imports consisting of parts and components used in the manufacture of electronic and electrical goods. Despite the rapid import growth, the trade balance remained robust during the year. Although tourism revived, higher transport costs led to a widening of the deficit on services, which contributed to a projected narrowing in the current account deficit to 10.2 per cent of GDP in 2004 from 13 per cent in 2003.

Relatively slow export growth in the Philippines

The value of merchandise exports from the Philippines rebounded from low growth in 2003 to expand 9.9 per cent in January-November 2004, relatively slow compared with most of its neighbours. Around 67 per cent of exports are electronic products, mainly semiconductors, destined for Japan and exports of those products accounted for nearly three quarters of the increase as ICT companies built up inventories. Signs of a slowdown were emerging towards the end of the year, suggesting that export growth could be more modest in 2005. Earnings from garment exports declined for much of 2004 and, despite a sharp rebound in November, the trend is likely to continue as the MFA ends. Growth in the value of merchandise imports was slower than export growth, at 8.2 per cent in January-October 2004. Imports of consumer goods outpaced both capital and intermediate goods; the latter contracted towards the end of the year, particularly electronics products. High oil prices led to a sharp increase in imports of mineral fuels and lubricants. The trade deficit narrowed significantly from $1.3 billion in the first 11 months of 2003 to $924 million in the same period of 2004. Increased revenues from tourism and travel together with a bounce-back in migrant remittances in the second half of the year contributed to a surplus on the services and income account. The current account surplus as a percentage of GDP increased somewhat to 4.8 per cent in 2004 from 4.3 per cent in 2003.

Vigorous broad-based export growth in Singapore

The value of merchandise exports in Singapore grew a robust 24.6 per cent in 2004 fuelled by strong growth in non-oil domestic exports, particularly electronics products such as integrated circuits, telecommunications equipment and personal computer parts. Pharmaceuticals, petrochemicals and specialized machinery also performed strongly. The growth in non-oil domestic exports to the EU averaged around 30 per cent in the first half of 2004, much of it representing pharmaceutical exports from European multinationals based in Singapore. Exports to the United States were somewhat sluggish, picking up later in the year, but regional demand for Singapore's exports was very strong, particularly from China. Export growth to that country in each of the first three quarters of 2004 was in the 39-57 per cent range, with electronics exports expanding 60 per cent in the third quarter. The value of merchandise imports surged 24.7 per cent in 2004 as more inputs were needed for exports and retail sales picked up, helped by larger tourist numbers. The trade surplus narrowed in the first half of 2004 before widening again while the small surplus on the services account was rather volatile. The current account surplus had increased sharply as a percentage of GDP to 29.2 per cent in 2003 reflecting weak internal and strong external demand and it narrowed to 26.1 per cent in 2004 as domestic demand revived.

High-tech products lead export growth in Thailand but traditional exports also do well

External performance strengthened in 2004 in Thailand compared with 2003, as the value of merchandise exports increased 23 per cent, up from 18.2 per cent the previous year. High-tech manufactured goods expanded strongly, led by computers and parts, integrated circuits and parts and vehicles, parts and accessories. Exports of traditional labour-intensive products, such as textiles, and resource-based products, such as agricultural and petroleum products, also recorded robust growth, the latter benefiting from higher global commodity prices. The shares of traditional markets such as the United States and Japan in Thailand's exports continued to decrease as the shares of other countries in the Asian and Pacific region, such as fellow members of ASEAN and China, were on an upward trend, particularly in the case of the latter.

Merchandise imports expanded strongly in Thailand in 2004, growing 27 per cent and exceeding the 2003 rate by nearly 10 percentage points. All categories of imports registered robust growth, particularly capital goods. In line with the growth in exports, inputs for the electronics and electrical goods industries expanded strongly. Robust domestic consumption led to higher imports of durable and non-durable consumer goods, and imports of vehicles and parts expanded strongly. The value of fuel and lubricants rose on the back of higher oil prices. The trade surplus fell in 2004 and although the surplus on the services and transfers account surged with the recovery in earnings from tourism, the current account surplus narrowed to 4.5 per cent of GDP, down from the average 5.5 per cent in 2001-2003.

Foreign-invested enterprises major contributors to Viet Nam's export performance

The value of merchandise exports increased by a record 28.9 per cent in 2004, 8 percentage points higher than the growth in 2003. Exports from foreign-invested enterprises increased over 40 per cent year on year in 2004 and those enterprises have accounted for over 50 per cent of total exports in recent years. Exports of crude oil increased around 50 per cent on the back of high international oil prices, while exports of rubber increased 46 per cent. Electronics products and computers expanded over 57 per cent and wooden furniture products grew an astonishing 88 per cent. Exports of garments and textiles were hit by a reduction in the United States quota over a rules-of-origin discrepancy while exports of seafood faced anti-dumping tariffs in that country on shrimp and catfish, reducing export growth in the sector. The EU has now become Viet Nam's largest trading partner and exports to Japan and China have been growing fast while the United States has declined in importance. Non-traditional markets, such as in Africa, are also growing.

The value of merchandise imports grew at a somewhat slower rate than exports in 2004 in Viet Nam, expanding 24.5 per cent, down on the 27.8 per cent growth rate recorded in 2003. Refined oil, steel and steel ingots, plastic raw materials and electronic spare parts were the principle imports, reflecting export and investment growth. While the EU, the United States and Japan remained important sources of imports, China has become the third most important supplier.

The trade deficit widened to around $5.5 billion in 2004 in Viet Nam, an increase of roughly $0.5 billion over 2003. The services account benefited from a surge in tourism in the country. There has also been a steady expansion in overseas remittances to Viet Nam in recent years, which are estimated to have reached $3 billion in 2004. The current account deficit as a percentage of GDP declined from 4.8 per cent in 2003 to 3.2 per cent in 2004.

Capital flows and exchange rates

Higher FDI inflows into Brunei Darussalam

Between 2002 and 2003, FDI inflows into Brunei Darussalam doubled to $2 billion, making the country the ninth largest recipient of FDI among developing Asian nations. An increase in investment in the oil industry and in construction services contributed to the rise in FDI, as did improved economic conditions and a better investment climate. Official international reserves increased substantially in 2002-2003, reversing a decline in the previous two years, to reach $480 million. Brunei Darussalam also holds some $30 billion in foreign assets. The Brunei dollar is exchangeable at par with the Singapore dollar and, in line with the latter, has been appreciating against the United States dollar since 2002.

Net FDI outflows from Indonesia amounted to nearly $600 million in 2003, continuing the trend observed since the 1997-1998 crisis, but net inflows were over $460 million in the first half of 2004. However, FDI approvals contracted some 11 per cent year on year in January-October 2004. Foreign exchange reserves reached $35.8 billion in December 2004, somewhat higher than in the previous year. The ratio of external debt to GDP has fallen to around 53 per cent and IMF stated in September that the level was sustainable and further debt rescheduling was unlikely to be needed. However, Indonesia along with other tsunami-affected countries has been offered a debt moratorium by the Paris Club. The rupiah, which averaged Rp 8,577 to the dollar during 2003, was more volatile in 2004, ending the year at Rp 9,307.5 = $1. Nevertheless, greater confidence in the country was reflected in ratings upgrades by Standard and Poor's in December 2004 to B+ from B and by Fitch Ratings in January 2005 to BB- from B+ for long-term foreign currency sovereign debt.

Substantial net inflows of FDI into Malaysia but little new investment

The financial account surplus in Malaysia in 2004 was helped by a surge in net portfolio investments in the first quarter and by substantial net inward FDI, which totalled M$ 8.9 billion in the first half of the year. A large part of this inflow, however, consisted of unrepatriated profits of multinational corporations rather than new investment. Official reserve assets jumped from $44.2 billion at the end of December 2003 to $66.7 billion at 31 December 2004. Total external debt as a percentage of GDP is expected to decline to 44.3 per cent at the end of 2004 from 47.3 per cent a year earlier. Much of the decline was due to the reduction in medium- and long-term public sector debt. The ringgit's peg to the United States dollar ensured that the currency depreciated against the euro in 2004 but its performance was mixed against other regional currencies. The view of the central bank, endorsed by IMF, is that the value of the ringgit is in line with fundamentals and the peg is likely to remain given current global macroeconomic imbalances and oil price volatility. Greater international confidence in Malaysia was reflected in ratings upgrades for its sovereign long-term foreign currency debt by Moody's and Standard and Poor's to A3/A- with a stable outlook.

The peso comes under pressure in the Philippines

Net FDI and portfolio flows were -$56 million and -$524 million respectively in the first half of 2004 in the Philippines, reversing surpluses of $86 million and $221 million in the same period in 2003. Although the capital account was sustained by heavy government borrowing through bond issues, the overall balance of payments was in deficit and gross international reserves fell to $16.1 billion at the end of December 2004, down $813 million from a year earlier. The peso came under pressure during the year, despite the general weakness of the dollar, averaging P 56.04 to the dollar compared with P 54.20 in 2003. Total external debt, mostly medium- and long-term, amounted to $57.4 billion at the end of 2003, 72 per cent of GDP. The total had fallen to $55.6 billion by September 2004 owing largely to a reduction in the public debt stock, which accounted for two thirds of the total. Reflecting concerns over the prospects for fiscal policy adjustment, Fitch Ratings lowered the outlook on the Philippines' long-term sovereign debt to negative. Standard and Poor's downgraded the foreign currency rating to BB- from BB, three levels below investment grade while Moody's down-graded it two notches to B1 from Ba2, the lowest level since 1993. Nevertheless, the Philippine Government sold $1.5 billion in bonds in January 2005, its largest single bond issue. The size of the issue was increased 50 per cent in response to keen investor interest.

Singapore attracted S$ 8.3 billion in FDI in 2004 in manufacturing, of which S$ 4.6 billion was in electronics and another S$ 2.3 billion in services. While the United States, the EU and Japan continue to be the principal sources of investment, the country is also receiving increased flows of FDI from other economies in the Asian and Pacific region. There were significant inflows of net direct investment in the first half of 2004 before the direction was reversed in the third quarter. Net portfolio investment outflows were sustained in the first three quarters of the year, contributing to a narrowing in the overall balance-of-payments surplus. Official foreign exchange reserves soared to $112.8 billion by December 2004, an increase of $16.5 billion from the previous year. The improvement in the economy, which began in the second half of 2003, has led the Monetary Authority to permit a gradual appreciation of the Singapore dollar. Against the United States dollar, the currency has risen from S$ 1.70 = US$ 1.00 at the end of 2003 to S$ 1.63 = US$ 1.00 at the end of 2004.

Machinery and transport equipment attract most FDI in Thailand

In Thailand, net inflows of FDI dropped to $537 million in the first 7 months of 2004, down from $842 million a year earlier. FDI inflows in the same period were $4.2 billion, slightly higher than in 2003. There was a net inflow from Japan and a small net outflow with other members of ASEAN. The machinery and transport equipment sector attracted most inflows. Thailand's external debt continued to decline in 2004 to a projected 28.6 per cent of GDP from 36.2 per cent in 2003 mainly owing to the Government's efforts to reduce public external debt. Of total external debt outstanding, less than one quarter is short-term. The overall balance of payments was in surplus to the extent of $5.7 billion in 2004 and gross official reserves increased from around $42 billion at the end of 2003 to $49.8 billion at the end of 2004. The baht was in the B 38.87-41.70 range per dollar in 2004 and averaged 40.28, an appreciation of 3 per cent from the average in 2003.

Commitments of FDI have been growing in Viet Nam and are expected to reach $4 billion in 2004, an increase of one third from a year earlier. FDI disbursed is estimated to have been $2.9 billion in 2004, up from $2.4 billion in 2003. ODA commitments increased to $3.4 billion in 2004 from $2.8 billion the previous year. ODA disbursement, however, decreased from $1.7 billion in 2003 to $1.5 billion in 2004 owing to delays in the implementation of some large-scale projects. The overall balance-of-payments surplus amounted to just under 2 per cent of GDP in 2004, lower than the 5.4 per cent achieved in 2003. Viet Nam's international reserves amounted to $5.6 billion, equivalent to nine weeks of imports, at the end of 2003 and increased to $6.2 billion by April 2004. Total external debt is estimated at around 38 per cent of GDP in 2003-2004 but the debt-service ratio declined from 7.5 per cent in 2003 to 6.3 per cent in 2004. The Vietnamese dong depreciated against the United States dollar by 2.2 per cent in 2003 and by 2.0 per cent in 2004 as dollar weakness slowed the fall.

Policy issues and responses

Poverty and unemployment

Good progress in poverty reduction in Indonesia but challenges remain

The proportion of the population below the national poverty line is estimated to have fallen to 17.4 per cent in 2003 in Indonesia, finally below pre-crisis levels. It is likely to have fallen further in 2004 but is unlikely to have reached the Government's target of 14 per cent. However, vulnerability and regional disparities remain high. The Government is seeking to address these concerns and has decided to integrate its poverty reduction strategy paper into the medium-term development plan 2004-2009, which is a major step forward in bringing a poverty focus to all of the Government's work. According to ADB, poverty in Aceh province, which was severely damaged by the earthquake and tsunami disaster, was already rising in recent years and poverty incidence was estimated at 30 per cent in 2003. Nearly 12 per cent of the population of the province lives in coastal areas and civil conflict has led to a large number of displaced people. The disaster will add many more to their number. Although social infrastructure was thought to be good before the disaster, physical infrastructure was already in poor condition. Aid flowing in for relief and reconstruction provides the Government with an opportunity to make significant progress in poverty reduction in the province if the civil conflict can be kept at bay (box II.3).

Box II.3. Post-tsunami reconstruction in Aceh and North Sumatra

The 26 December 2004 earthquake and tsunami in the Indian Ocean, described as the worst natural disaster in living memory, struck the Indonesian provinces of Aceh and North Sumatra extremely hard. The Government of Indonesia has estimated that at least 94,000 people died and 132,000 are missing. Many thousands more were injured. About 11 per cent of the population in the affected areas, or 500,000 persons, have been displaced. Total damage from the tsunami is estimated at $4.5 billion, roughly equal to Aceh's GDP. Apart from the physical infrastructure, the tsunami swept away entire communities, taking with it local administrations, schools, hospitals and all other components of social infrastructure. Fortunately, the world was galvanized into action by the tsunami, responding to the challenge of providing immediate humanitarian relief with great generosity and speed. Funds are still being collected to help the tsunami victims but now the focus has to shift to longer-term recovery and reconstruction.

The Consultative Group on Indonesia, at its meeting in Jakarta on 19 and 20 January 2005, had before it two papers dealing with the tsunami and its aftermath prepared jointly by the Indonesian National Development Planning Agency (BAPPENAS) and the international donor community, one dealing with the task of assessing the damage and the second with issues related to reconstruction.[a] The document on reconstruction draws on international experience to make recommendations for the formulation of a "coherent, credible and comprehensive" reconstruction strategy for Aceh and North Sumatra. The Indonesian Government itself has set out six key principles for a national recovery and reconstruction strategy. First, it should be a people-centred and participative process; second, it should take a holistic approach; third, there should be effective coordination; fourth, there should be a distinction between rehabilitation, i.e. achieving minimum standards, and reconstruction, with a clear strategy for each; fifth, the focus should be on services and institutions rather than projects; and, sixth, it should incorporate fiscal transparency and effective monitoring. The need for effective coordination was particularly stressed as the scale and scope of the disaster were such that virtually all key ministries and State agencies are likely to be involved. In addition, a large number of official donor agencies, multilateral institutions and local and international NGOs, as well as private individuals, responded to the tragedy and many were present in Aceh. Furthermore, Aceh itself presents a challenging environment for reconstruction as it is a conflict zone. In addition, the destruction of local communities and dispersion of remaining members makes consultation that much more difficult, a process rendered even more complex by the ongoing decentralization in Indonesia.

The document points out that a balance has to be struck between rapid response and broad participation. For example, the need for people to get back to work and for children to return to school is more or less immediate, whereas people will need more time to think about rebuilding homes and businesses. Thus, the right balance has to be found based on needs assessments and strategies for specific sectors and programmes need to be appropriately phased in.

As set out in the document, a successful recovery strategy for Aceh should have five basic goals, which build one upon another:

- Restoring people's lives by providing them with clean water, roads to reach clinics, shelter and sources of income to support their families;
- Restoring the economy by creating jobs, rehabilitating markets for buying and selling daily necessities and providing credit and microfinance;

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[a] "Indonesia: preliminary damage and loss assessment, the December 26, 2004 natural disaster (January 2005) and Indonesia: notes on reconstruction, the December 26 natural disaster (January 2005).

- Rebuilding communities to give them social stability and a sense of orientation and to foster local solidarity;
- Restoring the system of local government to represent people's aspirations and guide development;
- Re-establishing the province as politically stable and economically vibrant so that it can become a growth pole for the country and become resilient and protected against other disasters.

To restore people's lives, labour-intensive public works would be a first step. Household microenterprises should be recapitalized with grants and communities need to be educated to know what aid is available to them. Credit and microfinance are also vital to restarting the economy, to meet demand from SMEs and larger firms. Apart from banks, non-commercial credit sources, such as cooperatives and microfinance institutions, will need to re-establish operations. Transport infrastructure has to be rehabilitated, focusing on infrastructure that is vital to improve access to markets and using labour-intensive methods where possible. Entrepreneurship needs to be encouraged. Rebuilding communities will involve repairing and reconstructing houses but as land has to be cleared and issues such as land titles have to be resolved, temporary shelter may initially be needed. This should be as close to the original community as possible and preferably community-built. Coastal communities need particular attention to rebuild sustainable livelihoods. Host communities that have taken in displaced persons also need support. For rebuilding local governance, local and village councils should coordinate and lead the next stage of assessing local needs and planning local reconstruction. Basic public administration and security functions have to be re-established and financial information should be shared with the public. Finally, a regional development plan for long-term growth in the province of Aceh should be formulated once the social and economic situation has been stabilized. Successful implementation of a reconstruction strategy for the province will require clear and well-designed mechanisms for channelling multiple financing sources, managing the extensive range of activities involved and governing the use of funds.

BAPPENAS in association with Government ministries and agencies as well as the donor community is working on an overall rehabilitation and reconstruction plan, which is to be completed in March 2005. It expects the relief phase, focusing on humanitarian relief including the construction of temporary shelter and emergency repair to infrastructure to last six months. Rehabilitation, focusing on restoring minimum levels of public services and economic facilities, such as banking and financial institutions, securing land rights and establishing law and order, as well as continued work on temporary shelter, is expected to last two years. Reconstruction, which will focus on rebuilding the region through investment in the economy, infrastructure, social and cultural systems, housing and institutional capacity could take at least five years.

Slow growth relative to potential in Indonesia has also resulted in inadequate job creation. According to ADB, some 2.5 million workers enter the labour force each year but in 2002-2003 only 1 million jobs were created annually. In June 2004, the national labour force survey carried out in 2003 was published and indicated that employment in manufacturing, construction, trade and the retail sector had contracted sharply, with displaced workers being pushed back into agriculture or the informal sector. Open unemployment rose to 9.5 per cent of the labour force in 2003, up from 9.1 per cent in 2002, with many more workers underemployed. Labour regulations and rising labour costs contributed to the rise. The outlook for employment is further clouded by Malaysia's intention to expel around 1 million illegal Indonesian workers and by the effect of ending the quotas on the Indonesian textile and garment industry, which could result in some 150,000 workers losing their jobs according to an employers' association. The proposed Jakarta minimum wage was increased 6 per cent in 2004 but still remains below the official cost of living.

The unemployment rate declined somewhat in Malaysia in 2004 to a projected 3.4 per cent of the labour force, from 3.5 per cent in 2003. Strong growth in manufacturing appears to have been the principal factor behind increased employment and rapid growth in wages and salaries in 2004 compared with 2003, although the pace slowed in the second half. Poverty incidence is relatively low in Malaysia and the share of the population with income below $2 per day was 4 per cent in 2002. Nevertheless, the Government is committed to reducing poverty further to 0.5 per cent and to eliminating hard-core poverty by 2009. Socio-economic development is an integral part of the 2005 budget and ensuring the well-being of the population through an improved quality of life is one of its four key strategies. Public expenditure will be directed towards smaller projects that benefit the grass roots.

High poverty incidence and low job growth in the Philippines

Poverty alleviation remains the overriding socio-economic concern in the Philippines. According to the National Statistical Coordination Board, poverty in the Philippines declined from 27.5 per cent in 2000 to 24.7 per cent in 2003 based on the family income and expenditure survey carried out in 2003. However, significant regional variations exist in the proportion of families living in poverty. Poverty incidence was highest in three regions in Mindanao, where the proportion ranged between 44.1 and 47.3 per cent, and lowest in three regions in Luzon, where the proportion was between 5 and 14.9 per cent. Measured in terms of the food poverty line, 1.7 million families in 2003 did not have enough income to provide for their basic food requirements, slightly less than the 1.8 million families in a similar situation in 2000.

The task of reducing poverty in the Philippines is hampered by economic growth that has failed to generate enough jobs for the growing labour force. According to the October 2004 labour force survey, the economy generated an estimated 976,000 jobs in 2004, a clear upturn from the 574,000 jobs added in 2003, but well short of the 1.29 million new entrants to the labour force in 2004, double the number that entered in 2003. The Government's target for annual job creation in the medium-term development plan 2004-2010 is 1.38-1.65 million jobs. Most of the jobs created were in the formal sector, with little change in self-employment and a substantial fall in unpaid family work. Nearly 68 per cent of the new jobs were in services and the balance was equally divided between agriculture and industry. Not surprisingly, the average unemployment rate in 2004 edged up to 11.8 per cent compared with 11.4 per cent in 2003. To generate more jobs, the Philippines clearly needs more pro-poor growth but both consumer and investor confidence have been falling, in part owing to the parlous state of public finances, political instability, corruption and poor infrastructure. High debt-service costs have prevented increased budget allocations for much-needed improvements in infrastructure and social services. As mentioned earlier, the Government exercised considerable fiscal discipline in 2004 and some of its proposed measures to increase revenues have been passed but it remains to be seen if these measures will be enough to lift the low growth path the economy has been on.

Clear improvement in the labour market in Singapore

In 2001-2003, the economy of Singapore lost 35,900 jobs but preliminary estimates indicate that it more than made up for the losses in 2004, adding 66,200 to total employment, principally in services and manufacturing. Construction continued to shed jobs. There have been clear signs of improvement in the labour market since the last quarter of 2003, when the unemployment rate started to decline, in part owing to a reduction in the labour force. The unemployment rate fell to 4 per cent in 2004 from 4.7 per cent the previous year. Average monthly nominal earnings grew over 4 per cent, faster than the rate of inflation, in the first half of 2004 helped also by overtime work, but earnings growth slowed in the second half. The Government believes that despite strong job creation the unemployment rate is not likely to return to the pre-crisis 2 per cent level as structural changes in the Singapore economy have shifted production to more capital-intensive industries. The structurally unemployed, defined as older and less educated workers, are estimated to have risen from 30 per cent of the unemployed before the 1997-1998 financial crisis to 35 per cent in 2003. To address these concerns, the Government has established various funds to promote retraining and skills upgrading as well as an agency to enhance the life-long employability and competitiveness of job seekers in Singapore. Steps are also being taken to increase flexibility in setting wages. The Government outlined some principles regarding social safety nets in the 2004 budget indicating that a balance has to be achieved between providing assistance to those in need and eroding the work ethic. Assistance schemes should be carefully targeted and means-testing will therefore be an important component in the provision of public services and social assistance. Demographic pressures resulting from Singapore's low birth rate and increased longevity may also lead to the retirement age being raised from 62 years as at present.

Higher commodity prices, especially for rice, boost farm incomes in Thailand

Farm incomes have risen sharply in Thailand since 2002, helped by higher world commodity prices. According to the World Bank, the agricultural terms of trade have improved, lifting consumption among rural farm households and reducing poverty. The proportion of the population living below the national poverty line was 9.8 per cent in 2002. One fifth of the poor are rice farmers, most of whom live in the North-East region, where two thirds of the poor reside, and they have benefited particularly from the 15 per cent increase in the price of rice in 2004, following a 3 per cent increase the previous year. In addition, the National Poverty

Eradication Centre announced new measures to assist poor people that had registered with it and caravans of experts and advisers were sent out in November 2004 to meet each registered family to assist in solving problems contributing to their poverty. Five State-owned financial institutions were requested to assist poor families with debt relief and other grass-roots financial schemes have been put in place, again with the support of some of these institutions. The Government's target is to reduce poverty incidence to less than 4 per cent by 2009. According to the labour force survey compiled by the National Statistical Office, total employment rose 4.7 per cent year on year in the second quarter of 2004 in Thailand. Unemployment fell to 2.3 per cent in the same quarter from 2.5 per cent a year earlier. Despite the problems in the agricultural sector, employment in that sector rose sharply and services employment also picked up, particularly in wholesale and retail trade. Employment in manufacturing was little changed. Real wages are reported to have risen 0.3 and 0.7 per cent in the first and second quarters of 2004 respectively.

Robust job creation in Viet Nam and reduced underemployment in rural areas

The rapid rates of GDP growth in Viet Nam in recent years have generated a substantial number of new jobs. An estimated 1.53 million jobs were created in 2003 and 1.56 million in 2004. The urban unemployment rate fell from 6.4 per cent in 2000 to 5.6 per cent in 2004 and underemployment in rural areas is also thought to have decreased sharply. The number of migrants going abroad in search of work decreased from 75,000 in 2003 to 67,500 in 2004. Nevertheless, the pressure to find jobs remains strong, especially among the young. Rising employment and incomes have contributed to falling poverty levels in the country. Viet Nam exited from a three-year Poverty Reduction and Growth Facility arrangement with IMF in April 2004, during which good progress was made on poverty reduction. The number of households falling below the national poverty line is estimated to have decreased from 17.2 per cent in 2000 to 11 per cent in 2003 and further to 8.3 per cent in 2004.

During the December 2004 meeting of the Consultative Group for Viet Nam, donors pledged a record $3.4 billion in ODA for 2005, in line with the Monterrey Consensus, whereby funds are channelled mainly to countries that formulate and follow a clear policy of economic growth accompanied by poverty reduction. Viet Nam received praise for its consistently high rates of growth, accompanied, by and large, by macroeconomic stability, high rates of investment, improved aid utilization and the pro-poor orientation of much public investment.

Maintaining competitiveness

Diversifying the economy through private sector development has been the long-standing aim of the Government of Brunei Darussalam. The Brunei Economic Development Board is pursuing a strategy of attracting

FDI through developing Sungai Liang into an industrial site meeting top international standards and constructing a deep-water port facility at Pulau Muara Besar. Progress has been made in developing the country into a hub for Islamic banking.

Insufficient investment erodes competitiveness in Indonesia

Indonesia's export performance has lagged that of its neighbours in South-East Asia. Much of the problem lies in the lack of investment in plant and equipment and in infrastructure in the country following the 1997-1998 financial crisis and in issues related to corruption. In a report released in December 2004, Transparency International ranked Indonesia as the tenth most corrupt country in the world. Corruption is also behind the low tax effort of Indonesia, reducing revenues available for economic and social development. Eradicating corruption is one of the main planks of the new Government with the announcement of the strengthening of the Corruption Eradication Commission.

The white paper adopted in September 2003 in Indonesia had three principal sections: macroeconomic stability; financial sector restructuring; and investments, exports and employment. Considerable progress was made in passing legislation under the first two headings and the last bank to remain in the hands of the Indonesian Bank Restructuring Agency was put up for sale in 2004. Indonesia's banks will be implementing the Basel II accord by 2008. Progress under the last heading has been somewhat slower. In this regard, greater flexibility and clarity in laws and regulations affecting the labour market will be necessary if investment and employment are to increase. The Government's intention to reorient public expenditures towards infrastructure and human development will require success in reducing politically sensitive fuel subsidies, which the Government has started to do.

Shifting to a higher value-added economy in Malaysia

Faced with increased competition in electronics markets as well as for FDI, the Government of Malaysia is seeking to boost overall competitiveness further to ensure medium- and long-term growth. Domestic private sector-led growth is being promoted while FDI is being sought to develop sectors such as services so as to diversify the economy. Three key strategies outlined in the 2005 budget were enhancing effectiveness and efficiency of financial management and service delivery in the public sector, accelerating the shift towards a higher value-added economy and developing human capital as a catalyst of growth by addressing skills shortages. As a result of earlier reforms, the performance of the corporate and banking sectors has greatly improved. Steps are also being taken under the financial sector master plan to continue strengthening and deepening the financial sector while moving towards greater liberalization.

Three quarters of the 40 government-linked companies in Malaysia are to be restructured and all such companies are to adopt programmes to monitor performance indicators by 2005 and to link executive compensation to them. Malaysia reduced import duties on vehicles and parts made in other ASEAN nations with effect from 1 January 2005 in line with its commitment under AFTA. Tariffs on vehicles and parts made in non-ASEAN countries will also be reduced to a lesser extent. However, excise duties will be increased on vehicles and local manufacturers are to be offered fiscal incentives. The net effect will be to reduce the pricing gap between locally manufactured cars and parts and those imported from other ASEAN countries in particular, which will increase pressure on local manufacturers such as Proton Holdings and Perodua. Malaysia has completed feasibility studies for possible FTAs with Australia and New Zealand and has started negotiations for bilateral FTAs with India, Japan and the United States.

Philippines' comparative advantage under threat

An issue the Philippine economy will have to address in the medium term is the high concentration of exports in a limited number of commodities and services. While this is not in itself a matter of concern, the nature of the economy's comparative advantage in those activities makes it so. Semiconductors and electronics account for over 70 per cent of total merchandise exports from the Philippines and the country's comparative advantage has been in its competitive wages. Here, the emergence of China with its large labour supply poses a distinct threat. A similar situation exists in business outsourcing, where proficiency in the English language provides Filipinos with a comparative advantage that can easily be eroded by India and even by China as it continues to develop. A crucial issue in this context is the friendliness of the business climate in the Philippines to companies seeking to lower costs by locating abroad or outsourcing.

In this regard, the disinterest shown by foreign investors in the Philippines recently is worrying. The Government is seeking to improve the economy's competitiveness by keeping the costs of wage goods low through greater productivity and by reducing transport and distribution costs through improved infrastructure and logistics. Reform of the power sector should also reduce power rates. Upgrading knowledge in the labour force, simplifying procedures and fighting corruption are other actions that the Government is hoping to take. Agreement was reached in November 2004 on the overall terms of a bilateral free trade agreement with Japan, the second-most important market for the Philippines, which is due to be finalized and come into effect in 2005. An important aspect of this agreement is that Filipino caregivers and nurses have been given access to the Japanese market, under certain conditions.

To reduce its vulnerability to both economic and non-economic shocks and carve out a niche for itself in a regional landscape increasingly overshadowed by the emergence of China and India, Singapore embarked some time ago on a multipronged strategy to diversify its economy and enhance competitiveness. Part of this strategy involves strengthening

Singapore's external linkages to position the country as an essential part of regional production networks and as the ideal platform from which to do business with the rest of the region and the world. Several FTAs have been concluded and negotiations are ongoing for several other agreements, the most important involving the Republic of Korea and India.

Singapore focuses on reducing the costs of doing business

The Government is also focused on improving Singapore's ability to attract FDI through reducing the costs of doing business. In 2004, 3,664 new high-tech businesses, of which 624 were foreign, were set up in Singapore. The corporate income tax rate will be cut from 22 to 20 per cent effective 2005 and various tax rebates and concessions will be offered to sectors seen as having the potential to accelerate growth in high value-added items and to foster entrepreneurship. The top marginal personal income tax rate is targeted for reduction in two steps from 22 to 20 per cent by 2006. Government red tape is also to be cut and fees and charges set at cost. Singapore's economy is heavily reliant on manufactured exports and the Government is trying to increase the contribution of the service sector through market liberalization in banking, telecommunications and legal services. Steps are also being taken to boost tourism with a package introduced in December to boost stopovers by transit passengers as visitor numbers topped a record 8 million in 2004. To meet competition from other regional ports and support the transport engineering and tourism sectors, the Maritime and Port Authority slashed port fees from 1 January 2005 for vessels undergoing ship repairs, bunkering and cruises. It will also reduce rates for car carrier operators to encourage trans-shipment of cars through Singapore.

Public investment in infrastructure set to expand in Thailand

Private investment, particularly net FDI, slowed in Thailand in 2004 and one quarter of the investment that took place was in residential construction. There are signs that capacity constraints may be appearing in some manufacturing industries. This is a matter of some concern as Thailand may find itself losing competitiveness in traditional, labour-intensive products such as textiles in the post-MFA world and exports of foods such as chicken and shrimp are facing health-related and other non-tariff barriers. The country's export success in the post-crisis period has been dependant on private investment that has enabled it to shift towards high value-added export items such as machinery and vehicles and parts for them. Trade liberalization helped this trend and Thailand's interest in pursuing FTAs both bilaterally and through ASEAN testifies to this. The Government hopes to improve competitiveness through investment in infrastructure and for the first time since the 1997-1998 crisis, public investment by both central and local governments and SOEs began to expand in 2004 as large infrastructure projects were initiated. The Government has announced ambitious plans for a five-year programme of infrastructure development, which could total B 1-1.5 trillion over the next four years. Full details are still to be worked out. Several other measures were taken in 2004 to enhance competitiveness. These include steps taken by the National Competitiveness Committee to develop business clusters, improve logistics, enhance skills and promote “green productivity”. The Ministry of Finance has provided tax incentives to promote the competitiveness of SMEs, encourage investments abroad, support industrial estates and promote long-term savings and investment. The National Economic and Social Development Board has proposed an infrastructure strategy to increase competitiveness, including developing Bangkok as a regional business hub, improving the transport and communications systems and increasing energy and water security.

WTO accession critical to long-term growth and poverty reduction in Viet Nam

Sustaining strong growth and poverty reduction in Viet Nam in the longer term requires structural reforms as well as the maintenance of macroeconomic stability. The reforms hinge on restructuring SOEs and banks, further development of the private sector and securing accession to WTO. While progress on trade liberalization has been impressive and talks on WTO accession are moving forward, progress on the other issues has been somewhat slower. During 2003-2005, around 3,000 SOEs were scheduled for restructuring but by September 2004, only 1,560 had been restructured, of which 1,098 were equitized. The State-owned banking sector remains fragile with weak supervision and continues to favour SOEs. Although steps have been taken to improve the business environment, obstacles such as the lack of a transparent legal system, complex legislation governing taxation and investment, highly regulated imports and corruption remain. To improve the business climate, the Government cut the corporate tax rate levied on newly established enterprises in industrial zones to 10-20 per cent, from 28 per cent, with effect from August 2004. The Government has also commenced work on preparing a unified law for all types of enterprises as well as a unified investment law so as to enhance transparency and simplify procedures, as well as to improve corporate governance. Attempts have been made to lower business costs, particularly in telecommunications.

Viet Nam has fulfilled nearly all its commitments under AFTA but has agreed to compensate Thailand for delaying tariff reduction on motorcycles and parts until 2008. As Viet Nam is not a member of WTO, it will face intense competition in the post-MFA world since it will continue to be subject to quotas. The Government has set itself the target of end-2005 for completing the accession process and in the meanwhile it has been seeking to negotiate increases in garment quotas with the EU and the United States. The former removed quotas on garment and textile exports from Viet Nam with effect from 1 January 2005. Viet Nam successfully completed the ninth round of negotiations for entry into WTO in December 2004, during which the first draft report of the working group on Viet Nam’s accession was discussed. Agreements have been reached with the EU and with Argentina, Brazil, Cuba, Chile and Singapore as part of the entry process.

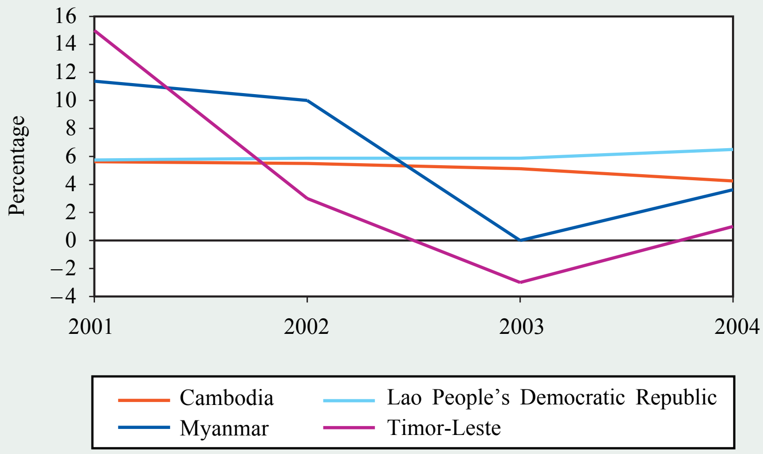
B. Least developed countries in the subregion

Overview

Economic growth generally higher in 2004

With the exception of Cambodia, the least developed countries of South-East Asia achieved economic growth in 2004 that was generally higher than in 2003 (figure II.29) Growth rates were low in most cases, although the Lao People's Democratic Republic continued its comparatively strong performance, helped by strong investment and exports and a recovery in tourism. For other countries, regional and global factors such as the prevalence of bird flu adversely affected both agriculture and tourism, while the anticipated expiration of the MFA had a substantial impact on both the manufacture and export of garments. Greater emphasis is being placed on agricultural development to ensure that these countries achieve sustained economic growth and meet internationally agreed development goals. This requires not only greater investment in the sector but also in transport infrastructure, private sector development, financial services and the social sector.

Figure II.29. Rates of GDP growth in the least developed countries in South-East Asia, 2001-2004

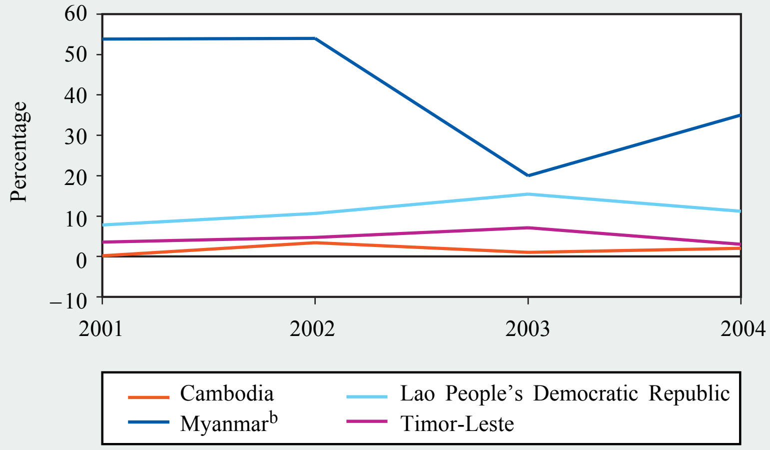


Sources: ESCAP, based on national sources; ADB, *Key Indicators of Developing Asian and Pacific Countries 2004* (Manila, ADB, 2004); IMF, *Democratic Republic of Timor-Leste: 2004 Article IV Consultation,* IMF Country Report No. 04/321 (October 2004) and *Cambodia: Statistical Appendix,* IMF Country Report No. 04/330 (October 2004); and other international sources.

Notes: Growth rates for 2004 are estimates. Fiscal year for Myanmar.

Inflation declined or remained low in three of the four least developed countries in the subregion, with the exception of Myanmar (figure II.30). This was partly due to the implementation of prudent fiscal

Figure II.30. Inflation[a] in the least developed countries in South-East Asia, 2001-2004



Sources: ESCAP, based on national sources; ADB, *Key Indicators of Developing Asian and Pacific Countries 2004* (Manila, ADB, 2004); IMF, *Democratic Republic of Timor-Leste: 2004 Article IV Consultation,* IMF Country Report No. 04/321 (October 2004); and other international sources.

Note: Inflation rates for 2004 are estimates.

[a] Changes in the consumer price index in main urban areas.
[b] Inflation at the end of the period.

and monetary policies and partly to low rates of inflation in trading-partner nations. Stable exchange rates also contributed greatly to the fall in inflationary pressures.

Measures to increase revenue from domestic sources through broadening of the tax base and improved revenue collection were recently introduced in least developed countries of the subregion. The expected resolution of debt arrears in Cambodia and the Lao People's Democratic Republic was expected to facilitate long-term economic growth in these two countries.

Growth performance

Growth in the agricultural and industrial sectors falls in Cambodia

Economic growth in Cambodia has been slowing in recent years. Despite slower growth in the non-agricultural sectors owing to the SARS-related drop in tourism and election year uncertainties in 2003, real GDP grew by 5.2 per cent, down from an average 5.6 per cent in 2001-2002, owing to a strong rebound in agricultural production (table II.34). Growth in real GDP was projected to decline further to 4.3 per cent in 2004, owing to a weaker performance in agriculture, and to less than 2 per cent in 2005 owing to weaker growth in the industrial sector following the expiry of the MFA.

Table II.34. Least developed countries in South-East Asia: growth rates, 2001-2004

(Percentage)

		Rates of growth			
		Gross domestic product	*Agriculture*	*Industry*	*Services*
Cambodia	2001	5.7	2.2	12.9	4.2
	2002	5.5	−2.7	17.7	4.5
	2003	5.2	9.2	6.7	1.6
	2004	4.3	0.4	..	..
Lao People's Democratic Republic	2001	5.7	3.8	10.1	5.7
	2002	5.9	4.0	10.3	5.7
	2003	5.9	2.6	11.1	7.1
	2004	6.5	3.5	11.4	7.4
Myanmar	2001	11.3	8.7	21.8	12.9
	2002	10.0	4.2	32.8	12.5
	2003	0.0	3.0	−3.4	-3.4
	2004	3.6	4.0	3.0	3.0
Timor-Leste	2001	15.0	..	..	..
	2002	3.0	..	..	..
	2003	−3.0	..	..	..
	2004	1.0	..	..	..

Sources: ESCAP, based on national sources; ADB, *Key Indicators of Developing Asian and Pacific Countries 2004* (Manila, ADB, 2004); IMF, *Democratic Republic of Timor-Leste: 2004 Article IV Consultation,* IMF Country Report No. 04/321 (October 2004) and *Cambodia: Statistical Appendix,* IMF Country Report No. 04/330 (October 2004); and other international sources.

Notes: Growth rates for 2004 are estimates. Industry comprises mining and quarrying; manufacturing; electricity, gas and power; and construction. Fiscal year for Myanmar.

The output of the agricultural, fisheries and forestry sector, which accounted for a third of GDP, rose by a robust 9.2 per cent in 2003 as reduced rainfall exposed a larger area of arable land along the Mekong. Growth in the sector was estimated to be a more modest 0.4 per cent in 2004 as a result of the bird flu outbreak, a smaller fish catch and lower crop production. The agricultural sector, focused mainly on paddy production, is constrained by the limited land available for cultivation and lack of property rights. Permanent cropland comprises only 1 per cent of the land area and only 7 per cent of this is irrigated. Most farmers are hesitant to engage in long-term investment, especially in irrigation, as only one tenth have formal titles to agricultural land and they have no access to collateralized lending. Inadequate rural roads, weak marketing systems, lack of modern farming techniques, limited access to formal financial services and barriers to public health also contribute to the limited growth in the agricultural sector. Community-based forestry is being considered as a means to safeguard livelihoods in rural areas as unsustainable logging has destroyed a source of income and contributed to soil erosion.

Output from the industrial sector, which had exhibited double-digit growth during the previous four years, rose by a more moderate 6.7 per cent in 2003, as rudimentary infrastructure and high wages have kept operating costs high. Manufacture of textiles, apparels and footwear accounted for approximately half of industrial output while construction accounted for another quarter. In anticipation of the expiration of the MFA in January 2005, growth in the garment sector slowed over the past two years and output was expected to contract substantially in 2005 (see box II.4). The quota removal is, however, expected to have a modest impact on the balance of payments as most inputs are imported and profit remittances are expected to fall. Depreciation of the currency is likely to have a limited impact in the industrial sector since most costs, including wages, are denominated in dollars. The high minimum wage, relative to average wages, applied to all industries in the formal sector has reduced employment further. Administrative impediments to investment as well as informal fees need to be addressed in order to stimulate the industrial sector, which accounts for a quarter of GDP, and to promote export diversification. The service sector, which accounts for more than a third of GDP, grew by a marginal 1.6 per cent in 2003 owing to the SARS-related drop in tourism and election-related uncertainties.

Real GDP in the Lao People's Democratic Republic rose from 5.9 per cent in 2003 to an estimated 6.5 per cent in 2004 as higher private and public investment, a recovery in tourism and a robust export performance fuelled by growth in China, Thailand and Viet Nam mitigated the adverse impact of higher crude oil prices on domestic production. Real GDP was targeted to grow between 6.5 and 7 per cent in 2005, as large investment projects in mining and tourism are completed.

Rice cultivation in the Lao People's Democratic Republic expected to increase with effective use of irrigation

The share of GDP held by the agricultural sector decreased to less than half while the shares of the industrial and service sectors each increased to more than a quarter of GDP in 2004. Growth in the agricultural sector, which employs more than three quarters of the population, rose from the drought-affected 2.6 per cent in 2003 to an estimated 3.5 per cent in 2004, despite the bird flu outbreak, which inflicted losses on poultry farmers. Owing to problems with irrigation systems and difficulties in obtaining fertilizer, the harvest of dry-season rice was expected to fall, as cultivation was possible on only three quarters of the available land. With more effective use of existing irrigation infrastructure, rice cultivation should increase over time. Non-rice crops, such as corn, beans and eggplants, for which production costs are lower, are increasingly being produced during the dry season. Cash crop production is being expanded to include rubber and cashew nuts, as well as coffee, in the northern and southern regions, and cassava in the central plains. Production in the industrial sector rose marginally from 11.1 per cent in 2003 to an estimated 11.4 per cent in 2004 as a result of strong hydropower and mining exports. As in Cambodia, the phasing out

Box II.4. Phase-out of the Multifibre Arrangement and least developed countries in the Asian and Pacific region

Trade in textiles and clothing (T&C) is one of the earliest forms of trade, with a long history of protectionism based to a large extent on a bilateral quota system – the so-called Multifibre Arrangement. With the abolition of the MFA on 31 December 2004, T&C trade is now free from all quantitative restrictions and is governed by prevailing WTO rules.

Several of the smaller and poorer countries in the Asian and Pacific region, including a number of least developed countries, built up their T&C export-oriented sectors relying on exports guaranteed under the MFA quota system. The underutilization of quotas in those countries attracted FDI, which played a major role in the development of their T&C industries. As can be seen from the table below, T&C today constitute an important portion of the total exports of several least developed countries in Asia.

Exports of textiles and clothing of selected least developed countries in Asia as a percentage of total exports, 2003

Bangladesh	84.4
Cambodia	87.1
Lao People's Democratic Republic	48.3
Maldives	32.0
Myanmar	25.9
Nepal	50.6

Source: Secretariat calculations based on the World Integrated Trade Solution.

Notes: "Textiles and clothing" defined as HS 50-63. Partner country import data used where export data not available.

While providing opportunities to smaller suppliers which had consistently underutilized quotas, the MFA system also artificially repressed the exports of highly competitive countries that had the capacity to supply T&C in larger quantities than quotas permitted. With the removal of quotas, market forces will determine T&C trade to a much larger extent. This will work to the advantage of a small number of major suppliers that can withstand competitive pressures. These suppliers are located mainly in China but also in India and a few other countries where low wage rates and integrated industries lend a comparative advantage. However, least developed countries and other smaller exporters of T&C, such as Sri Lanka, will face severe difficulties competing in this new trading environment. With women forming an important part of the largely low-skill workforce in the T&C sector in developing countries, the social costs of job losses and factory closures could be high.

Action will certainly be required at the national level to provide social safety nets and introduce training and labour readjustment programmes but, at the same time, many countries in the region, particularly the least developed, will have difficulty coping with long-term structural unemployment without assistance from the international community.

In April 2004, the IMF Executive Board approved the so-called Trade Integration Mechanism (TIM), designed to assist countries in overcoming balance-of-payments problems arising from trade liberalization, including the abolition of MFA, and Bangladesh became the first country to activate the Mechanism in July 2004. While there are

(Continued over-leaf)

(Continued from preceding page)

concerns, inter alia, with regard to the fact that it is a lending facility and could increase debt burdens, the Mechanism nevertheless represents a collective recognition that trade liberalization can expose countries to adverse impacts, which if not addressed in a timely and comprehensive manner can result in escalating adjustment costs. Other financial mechanisms to assist countries experiencing adjustment challenges arising from trade liberalization should also be considered.

Some member countries of WTO have further argued that an additional solution to the problem could be found within the organization itself. The pace, depth and scope of additional market access negotiated in the Doha Round will play a key role. The time seems ripe for least developed countries to be given the bound duty- and quota-free market access that has been on the agenda since 1996. In a submission[a] by a number of countries to the WTO membership, it has been proposed that the WTO secretariat undertake a study identifying adjustment-related issues and costs, paying particular attention to the impact on least developed countries and other small and vulnerable economies that will lose from quota elimination, and that a work programme be established in WTO to discuss and find solutions to problems identified by concerned parties. Turkey, a major T&C exporter, made a similar proposal.[b]

These initiatives raise an interesting question regarding negotiating strategies: should least developed countries continue to seek compensation through increased market access or should they be seeking compensation through direct forms of financial assistance? While WTO has traditionally eschewed any possible linkage to financial compensation, such linkages do exist and they appear to be increasing in regional trade agreements and bilateral trade agreements.[c]

Entering into free trade agreements with neighbouring countries is, indeed, one possible option open to least developed countries to help them to maintain at least some segments of their T&C industries. More specifically, the larger developing countries in the region, China and India in particular, could do much to strengthen South-South solidarity by assisting the least developed countries, inter alia, through providing full and free market access to those countries. The issue of financial compensation should also be given further thought at the regional level by exploring the feasibility of establishing a regional financial facility to assist countries adversely affected by the elimination of quotas, particularly the least developed among them.

Mitigating factors

Finally, some mitigating factors could come into play that may prevent, or at least slow down, the domination of the global T&C industry by China and other large suppliers. Given the long history of protectionism in this sector, it is highly possible that developed countries will increasingly resort to new forms of barriers, such as safeguard duties, anti-dumping duties and more stringent labour standards to undercut the competitive edge of developing countries and thus protect their less efficient domestic T&C industries. It is also worth noting that as part of the terms of China's accession to WTO, members of WTO have the right to impose safeguard measures under certain conditions specifically against imports from China until 2008. This being said, the potential hardships that could be faced by several countries in the region, especially the least developed, remain of great concern and continued support and attention from the international community will be required to cushion the negative effects of quota elimination and find an appropriate solution to the problem.

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[a] "Post-ATC adjustment-related issues" (G/C/W/496/Rev.1).

[b] "Turkey's contribution to the debate on post-ATC related issues" (G/C/W/497).

[c] A more detailed discussion can be found in the theme study for the sixty-first session of ESCAP.

of the MFA is expected to undermine garment exports, but the granting of normal trading relations status by the United States, as well as tax concessions by China for imports of more than 200 items produced in the Lao People's Democratic Republic, are expected to ameliorate the adverse impact. Growth in the service sector rose from 7.1 per cent in 2003 to an estimated 7.4 per cent as foreign tourist arrivals, especially from China, Singapore and Viet Nam, increased dramatically despite the outbreak of bird flu and heightened security concerns. Telecommunications and trade-related services rose but weaknesses in the banking sector hampered growth in financial services.

Constraints on imported inputs, structural rigidities and sanctions continue to affect Myanmar adversely

In Myanmar, growth in real GDP in 2002[2] was estimated at 10.0 per cent, owing to the substantial expansion of industrial production reflected in increased electricity consumption, cement production and the number of licensed motor vehicles. Although the Government expected growth of real GDP to continue at a similar rate in 2003, it is generally projected to have been flat, owing to a decline in industrial production, services and trade. Constraints on imported inputs, structural rigidities as well as the delayed effects of earlier sanctions and the banking crisis continue to affect economic growth adversely. Real GDP was expected grow 3.6 per cent in 2004, led by steady growth in the agricultural sector following the implementation of the revised rice trade regime. Agricultural output consists primarily of paddy, sugar cane, pulses, groundnuts, maize and sesame. Agriculture, manufacturing and processing, livestock and fisheries, and construction accounted for more than two thirds of GDP in 2002. Industrial development is being encouraged with the establishment of 18 industrial zones.

Income from oil and gas in Timor-Leste projected to rise

After contracting by an estimated 3 per cent in 2003 as the presence of international staff and peacekeepers was reduced and agricultural production fell owing to a drought, Timor–Leste's real GDP is projected to grow by 1 per cent in 2004. Agricultural production is expected to recover with the return of normal weather conditions. In order to achieve the 5 per cent annual real GDP growth envisaged in the national development plan, the agricultural sector needs to be developed further through improved productivity and expansion of cash crop production. Agriculture, forestry and fisheries accounted for a quarter of total GDP in 2003, while the industrial sector accounted for another 18 per cent. Income from the exploitation of oil and gas resources in the Timor Sea was projected to rise from 9 per cent of GDP in 2003 to nearly 13 per cent of GDP in 2004. The service sector accounted for 57 per cent of total GDP in 2003, with public administration and defence accounting for nearly two thirds of the subtotal.

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[2] National account statistics are available only annually in Myanmar and revised after the start of the following year. A large informal sector, including much of the border trade, is not captured in official statistics while the use of official exchange rates for conversion purposes results in understatement of external trade and foreign exchange.

Enactment of legislation to establish a framework for business activity, development of an independent judiciary and completion and implementation of sector investment programmes to improve infrastructure are necessary for the further development of the private sector. A commercial code and a company law were enacted as initial steps to establish a legal and regulatory framework for business activity. A policy paper on private investment was prepared for public consultation and draft domestic and foreign investment laws were submitted to the Council of Ministers. Following the enactment of a basic law on land ownership in 2003, the Council of Ministers is reviewing draft laws on the leasing of private and public land and land and property dispute mediation.

Inflation and exchange rates

Inflation wanes in 2004

Helped by low inflation in its trading partners, inflation in Cambodia rose by only 1.1 per cent in 2003 (table II.35). Prudent monetary and fiscal policies also contributed to this relative price stability, as M2 growth slowed to 14.9 per cent from 31.1 per cent in 2002 and the budget deficit was held at 7 per cent of GDP in 2003, close to the average of 6.5 per cent in 2001 and 2002 (table II.36). Higher prices for

Table II.35. Least developed countries in South-East Asia: inflation and money supply growth (M2), 2001-2004

(Percentage)

	2001	*2002*	*2003*	*2004*
Inflation[a]				
Cambodia	0.2	3.4	1.1	2.0
Lao People’s Democratic Republic	7.8	10.6	15.5	11.2
Myanmar[b]	53.8	54.0	20.0	35.0
Timor-Leste	3.6	4.8	7.1	3.0
Money supply growth (M2)				
Cambodia	20.4	31.1	14.9	14.1
Lao People’s Democratic Republic	13.7	37.6	20.1	18.1
Myanmar	43.9	34.6	1.4	11.0[c]
Timor-Leste	155.5	6.8	32.4	37.9[c]

Sources: ESCAP, based on national sources; ADB, *Key Indicators of Developing Asian and Pacific Countries 2004* (Manila, ADB, 2004); IMF, *International Financial Statistics,* vol. LVII, No. 8 (Washington, IMF, August 2004) and *Democratic Republic of Timor-Leste: 2004 Article IV Consultation,* IMF Country Report No. 04/321 (October 2004); and other international sources.

Note: Figures for 2004 are estimates.

[a] Changes in the consumer price index in main urban areas.
[b] End of period.
[c] January-March.

Table II.36. Least developed countries in South-East Asia: budget and current account balance as a percentage of GDP, 2001-2004

(Percentage)

	2001	2002	2003	2004
Budget balance as a percentage of GDP				
Cambodia	−6.4	−6.5	−7.0	−6.1
Lao People’s Democratic Republic[a]	−7.6	−8.3	−7.8	−9.2
Myanmar[b]	−5.9	−4.1	−4.5	−5.9
Timor-Leste[c]	−5.5	−6.1	−4.4	−2.4
Current account balance as a percentage of GDP				
Cambodia	−1.2	−1.2	−2.4	−3.3
Lao People’s Democratic Republic	−4.7	−1.7	−3.1	−3.8
Myanmar	..	..	..	..
Timor-Leste[d]	13.9	11.6	12.6	12.0

Sources: ESCAP, based on national sources; ADB, *Key Indicators of Developing Asian and Pacific Countries 2004* (Manila, ADB, 2004) and *Asian Development Outlook 2004 Update* (Manila, ADB, 2004); EIU, *Country Reports* (London, EIU, 2004), various issues; IMF, *Democratic Republic of Timor-Leste: 2004 Article IV Consultation,* IMF Country Report No. 04/321 (October 2004); and other international sources.

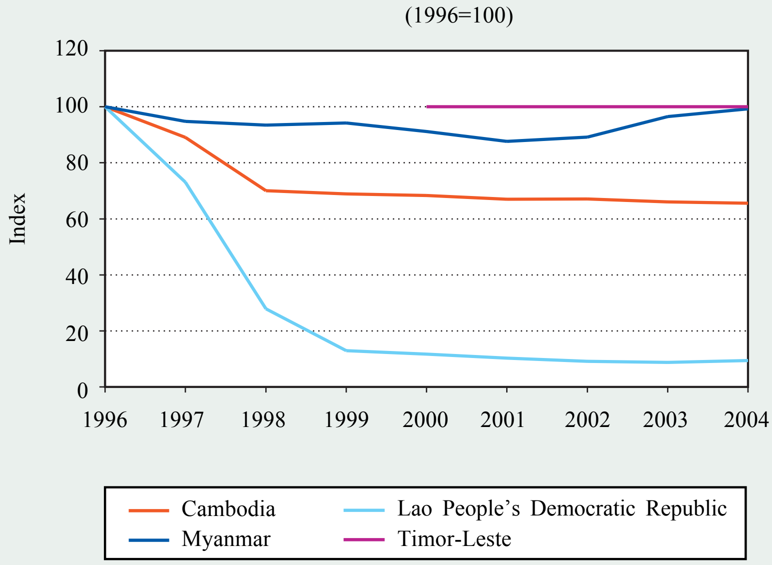
Note: Figures for 2004 are estimates.

[a] Fiscal year.
[b] Including grants.
[c] On the basis of fiscal year (July-June); for example, 2000 relates to FY2000/01.
[d] Including official transfers.

transport, communications and housing were offset by a decline in the prices of clothing, recreation and medical care. Price developments in its trading partners were, however, expected to increase inflationary pressures in 2004. Since the foreign exchange market is shallow and exchange rate policy has a limited effect on competitiveness, Cambodia stabilizes inflation at a low level by maintaining a broadly stable exchange rate (figure II.31). The official exchange rate, which applies to all external transactions conducted by the Government and State enterprises, is adjusted daily to maintain a spread of less than 1 per cent against the market rate, which applies to all other transactions.

Inflation in the Lao People’s Democratic Republic in 2004 has been kept reasonably well under control and exchange rates have been relatively stable. Annual average inflation declined from 15.5 per cent in 2003 to an estimated 11.2 per cent in 2004 as most CPI categories registered smaller increases. Declining food prices, which comprise nearly half of the total CPI basket, as a result of improved rice and other crop production during the second half of 2004 offset the increase in the cost of construction materials, including steel bars and cement, as well as higher petroleum prices, which exerted upward pressure on housing, transport and production and distribu-

Figure II.31. Index of exchange rates against the United States dollar of least developed countries in South-East Asia, 1996-2004



Sources: IMF, *International Financial Statistics,* vol. LVII, No. 10 (Washington, IMF, October 2004); and *The Economist,* various issues.

Notes: Figures for 2004 are estimates. In the case of Timor-Leste, base year 2000=100.

tion costs. The exchange rate of the kip against the dollar remained relatively stable throughout 2004. As in Cambodia, the Lao People's Democratic Republic has adopted a policy of maintaining a spread of less than 1.5 per cent between the parallel market and official exchange rates to reduce the volume of transactions occurring outside the banking sector. Steady fiscal and monetary policies to ensure macroeconomic stability have also contributed to exchange rate stability, although the projected budget deficit, excluding grants, is expected to widen to 9.2 per cent of GDP in 2004.

In Myanmar, the rate of inflation averaged 54 per cent in 2001 and 2002 as the fiscal deficit was monetized and private sector lending rose sharply. Nevertheless, low nominal interest rates and high inflation kept the domestic debt burden fairly stable. The rate of inflation is estimated to have fallen to 20 per cent in 2003, but is projected to have accelerated again to 35 per cent in 2004. The CPI for urban areas comprises 135 consumption items using new weights from a 1997 survey and includes a wider coverage of items at market prices as well as imported goods. The kyat has been losing its value in the parallel exchange rate market broadly in line with inflation. The dual exchange rate regime distorts relative prices, affects investment and production decisions adversely and imposes additional costs on the economy. A gradual move towards a flexible, unified exchange rate regime would improve the allocation of resources.

Inflationary pressures in Timor-Leste have been waning in recent months, with CPI inflation declining to 3 per cent in 2004 from 7.1 per cent the previous year, when drought created a scarcity of agricultural goods. The commodity basket and weighting scheme for the CPI were revised in 2003 to reflect household expenditure more closely. Looser monetary and fiscal policies may affect the outlook for inflation in coming years.

Foreign trade and other external transactions

Garment exports accounted for four fifths of Cambodia's merchandise exports in 2003

The value of Cambodia's merchandise exports is projected to expand by 7.4 per cent in 2004, substantially slower than the 18.7 per cent growth in 2003, to reach $2.2 billion (table II.37). Retained merchandise imports are projected to slow somewhat from the rapid 12.9 per cent growth registered in 2003 to 11.8 per cent in 2004, when the value of those exports could total $2.9 billion (table II.38). Garment exports accounted for more than four fifths of all merchandise exports in 2003. After the inclusion of official transfers, the current account deficit is projected at 3.3 per cent of GDP in 2004 (table II.36). However, high petroleum prices are expected to add another 0.5 per cent to this estimate. Official gross international reserves are expected to have increased to $782 million, slightly less than 2.8 months of imports of goods and services, by

Table II.37. Least developed countries in South-East Asia: merchandise exports and their rates of growth, 2001-2004

	Exports (f.o.b.)				
	Value (millions of US dollars)	*Annual rate of growth (percentage)*			
	2003	*2001*	*2002*	*2003*	*2004*
Cambodia[a]	2 076	12.1	11.3	18.7	7.4
Lao People's Democratic Republic[b]	359	0.3	−10.1	20.7	19.9
Myanmar[c]	2 127	39.4	24.1	−26.0	−0.3
Timor-Leste[d]	7	−20.0	50.0	16.7	14.3

Sources: IMF, *IMF Concludes 2004 Article IV Consultation with the Democratic Republic of Timor-Leste,* Public Information Notice (PIN) No. 04/118 (12 October 2004) and *Cambodia: 2004 Article IV Consultation,* IMF Country Report, No. 04/328 (October 2004); and EIU, *Country Reports* (London, EIU, 2004), various issues.

[a] Figure for 2004 is a projection.
[b] Figure for 2004 is an EIU estimate.
[c] Figures for 2002, 2003 and 2004 are EIU estimates.
[d] All figures are estimates.

Table II.38. Least developed countries in South-East Asia: merchandise imports and their rates of growth, 2001-2004

	Imports (c.i.f.)				
	Value (millions of US dollars)	*Annual rate of growth (percentage)*			
	2003	*2001*	*2002*	*2003*	*2004*
Cambodia[a]	2 613	8.0	10.5	12.9	11.8
Lao People's Democratic Republic[b]	482	−1.4	−18.3	11.8	18.0
Myanmar[c]	1 880	19.5	−19.6	−9.6	4.5
Timor-Leste[d]	203	11.7	−6.3	−19.1	−17.7

Sources: IMF, *IMF Concludes 2004 Article IV Consultation with the Democratic Republic of Timor-Leste,* Public Information Notice (PIN) No. 04/118 (12 October 2004) and *Cambodia: 2004 Article IV Consultation,* IMF Country Report, No. 04/328 (October 2004); and EIU, *Country Reports* (London, EIU, 2004), various issues.

[a] Import value in f.o.b.; figure for 2004 is a projection.
[b] Figure for 2004 is an EIU estimate.
[c] Imports value f.o.b.; figures for 2002, 2003 and 2004 are EIU estimates.
[d] All figures are estimates.

the end of 2004. Cambodia is seeking preferential duty treatment from the United States on the same terms as applied to African countries under the African Growth and Opportunity Act. Following the adoption of the WTO accession package by the National Assembly, Cambodia is required to strengthen its legal and judicial system. Accession requires the adoption and implementation of 46 pieces of legislation ranging from judicial reform to trade-related property rights over the next several years. In accordance with its commitment under ASEAN, Cambodia reclassified tariff lines to the ASEAN Harmonized Tariff Nomenclature, with the unweighted average tariff remaining unchanged at 15 per cent.

Technical assistance and food aid comprise bulk of aid flows to Cambodia

Large aid inflows have financed domestic investment and spurred construction activities. In view of the weak administrative capacity, technical assistance and investment comprised 45 and 39 per cent respectively of total aid flows in 1999-2003. Budgetary support and food aid comprised only 8 and 7 per cent respectively during the same period. A review of the current allocation of aid is under way and should ensure that poverty alleviation and long-term growth, especially in the agricultural sector, are addressed. After an initial increase from 34 per cent of GDP in 2004 to 35 per cent of GDP in 2006, Cambodia's stock of public debt is projected to decline to 16 per cent by 2023 on the assumption that the ratio of revenues to GDP expands from the current 11 per cent so as to maintain a sustainable debt-to-revenue ratio. Cambodia's total external public debt of $3 billion, or 71 per cent of GDP, at the end of 2003 was considered to be sustainable. A dialogue is being conducted with both the Russian Federation and the United States, which together account for 64 per cent of total external debt, to reach agreements on debt rescheduling. The proposal by the Russian Federation involves cash payments up front and substantial debt cancellation.

In the Lao People's Democratic Republic, merchandise exports totalled $359 million while merchandise imports totalled $482 million, leading to a trade deficit of $123 million in 2003. Exports are forecast to expand just under 20 per cent in 2004, slightly less than in 2003, as improved weather conditions contributed to a substantial increase in exports of agricultural and forest products as well as electricity. The growth in imports is forecast to accelerate to 18 per cent in 2004 from 11.8 per cent the previous year owing to increased imports of equipment and machinery for large mining-related investment projects, raw materials for manufacturing, including garments, and oil and gas. In 2004, the external current account, including ODA grants, is expected to show a deficit of 3.8 per cent of GDP, owing to an increase in investment-related imports. Official gross international reserves are expected to increase to $224 million, close to four months of imports, by the end of 2004.

Lao People's Democratic Republic meets its external debt-service obligation

The total external debt stock, of which about 89 per cent is public debt, is projected to rise from $2.17 billion in 2003 to $2.27 billion in 2004. In addition to concessional borrowings from multilateral donors, the stock of public debt reflects borrowings from the Russian Federation. Public debt service, both amortization and interest payments, rose from 7.2 per cent of exports of goods and services in 2003 to 13.4 per cent in 2004, but is expected to fall gradually as mining and hydropower exports rise. Despite the high level of external public debt, the Lao People's Democratic Republic has met its external debt-service obligations without arrears and has not sought debt relief under the enhanced Highly Indebted Poor Countries (HIPC) initiative. The expected rescheduling of the Russian debt on concessional terms will reduce external debt further to below the HIPC eligibility criteria.

Myanmar's balance of payments strengthens owing to gas exports

After a significant rise in exports in 2002 owing to gas-exporting facilities coming on stream, Myanmar's merchandise exports were projected to fall substantially by 26 per cent in 2003 to $2.1 billion. An earlier ban imposed by the United States on imports from Myanmar resulted in substantial employment losses in the garment industry, while the provision of financial services to Myanmar, including trade facilitation, banking services and money transfers, was prohibited. Merchandise imports were also projected to fall by 9.6 per cent to $1.9 billion in 2003, leading to a small trade surplus. The current account deficit at the official exchange rate was a negligible percentage of GDP in that year. While positive growth is expected for imports in 2004, little change is expected in exports. Thailand, China and India accounted for more than 60 per cent of Myanmar's exports while Singapore, China, Malaysia and Japan accounted for a similar share of imports. Although tariff reforms have been undertaken, non-tariff barriers such as the priority import list and administrative requirements continue to hamper trade. Furthermore, import licences were granted only to exporters against a portion of their export earnings. The balance of payments strengthened owing to gas exports and continued import compression. Official gross international reserves, including a $200 million renewable loan from Malaysia, were estimated to be $783.6 million, equivalent to four months of imports, in 2003.

Myanmar has not received aid in recent years. In the absence of donor support, there are limits to the economic adjustments that can be made without undermining social stability. At $128.7 million, actual FDI disbursed in 2002 was less than a fifth of the level registered in 1998. Four fifths of this amount went to the oil and gas sector. Of total external debt outstanding, amounting to $5.9 billion in 2002, $4 billion consisted of concessional loans, three quarters of which were from bilateral sources; half of the outstanding external debt is estimated to be in arrears.

International assistance to Timor-Leste falls by half from an estimated peak in 2001

In Timor-Leste, exports of goods, excluding border trade and oil and gas revenues, which are recorded as royalties and tax revenues, are projected to rise from $7 million in 2003 to $8 million in 2004, with coffee accounting for the bulk of exports in both years. Merchandise imports, excluding border trade, are projected to decline from $203 million in 2003 to $167 million in 2004 as imports related to international assistance declined from $104 million to $84 million during the period. Despite technical problems, the Bayu-Undan oil and gas project came on stream, contributing an additional $19 million in royalties and interest as well as $24 million in tax revenues in 2004 and paving the way for increased revenues over the coming years. The external current account (excluding official transfers) remains substantially in deficit, but the deficit is narrowing owing to a further reduction in donor-assisted reconstruction activities. International assistance fell from an estimated peak of $347 million in 2001 to a projected $181 million in 2004. Timor-Leste has not tapped concessional loans to fund essential capital investments.

Policy issues and responses

Rural poverty incidence in Cambodia more than double the urban rate

Poverty reduction in least developed countries requires strengthening of the agricultural sector and rural development. As small economies with unused arable land and a large unskilled labour force, their comparative advantage lies in agriculture. Large aid inflows and the boom in the garments and tourism sectors have, however, strengthened the formal sector in urban areas, while rural subsistence farmers have been left behind. Since the income gap between the urban and rural areas remains wide, many young people migrate to urban areas to seek employment in the industrial and service sectors. Poverty in rural areas of Cambodia, where more than fourth fifths of the population lives, was more than double the rate in urban areas, with average household expenditure in 2002 in rural areas estimated to be less than a quarter of the expenditure of households in Phnom Penh. Cambodia has recognized the need for agricultural reforms to improve land use and for redirection of aid to build irrigation and road infrastructure to promote agricultural growth.

Rural sector development in the Lao People's Democratic Republic is constrained by remoteness, mountainous terrain and lack of necessary services, including transport infrastructure. To narrow the disparities in employment opportunities between urban and rural areas, the Lao People's Democratic Republic has provided tax incentives to attract investment projects to rural areas and has allocated greater public investment to rural social development. A village development fund was also established to finance projects for building small-scale infrastructure, creating new employment opportunities for farmers and introducing new techniques to people in rural areas. The country's national growth and poverty eradication strategy stresses fostering economic growth with equity, modernizing social and economic infrastructure and enhancing human resources development. Although defence spending has been declining in both Cambodia and Myanmar, greater resources need to be allocated to social services. Furthermore, to alleviate poverty and safeguard human capital, such expenditure adjustment needs to rely on improved budgetary controls. Reduction in the incidence of poverty in Timor-Leste requires the development of a dynamic private sector, strengthened institutions and capacity to deliver government services in rural areas, as well as effective use of oil and gas wealth and continued international assistance.

To achieve fiscal objectives, revenue from domestic sources needs to rise

In order to achieve their fiscal objectives, all four least developed countries in South-East Asia need to increase revenues from domestic sources. Fiscal revenue collection in Cambodia was lower than expected in 2003 partly owing to delayed payment of taxes. Broadening of the tax base through reduction of exemptions, strengthened enforcement through computerization of revenue departments, passage of the customs law and good management of natural resources are seen as critical to the achievement of the 2004 revenue target of 11.9 per cent of GDP. To attain the targeted revenue of 12.8 per cent of GDP in 2005, the Lao People's Democratic Republic planned to improve the State budget law, strengthen the national revenue administration by centralizing revenues and prepare for the introduction of VAT at a single 10 per cent rate in January 2007. Since persistent fiscal deficits have led to macroeconomic instability in Myanmar, transparent and fair revenue collection through strengthening tax compliance, limiting exemptions and loopholes, assessing import duties based on the market exchange rate and restoring excise and user charges, whose value has been erased by inflation, was expected to increase revenue by 1 to 2 per cent of GDP. Timor-Leste was expected to use part of its oil and gas wealth to meet pressing investment needs for infrastructure and human capital development, with the majority of the wealth saved in financial assets for future generations. Following the commencement of oil and gas production in the Bayu-Undan field, establishment of a petroleum fund, based on a Norwegian model to ensure transparency and accountability in the management of oil and gas savings, was expected by mid-2005. Timor-Leste has avoided external borrowing and lacks access to domestic borrowing under the dollar-based monetary and exchange rate arrangement. Broadening the non-oil tax base is, however, necessary in order to avoid excessive reliance on oil and gas revenues.

Promoting the use of national currencies

The high degree of dollarization in Cambodia, the Lao People's Democratic Republic and Timor-Leste limits the conduct of domestic monetary policies. In addition to the loss of seigniorage, the lack of monetary independence and the central banks' inability to act as lenders of last resort could threaten financial stability. Increased deposits denominated in national currencies, however, reflect greater public confidence as exchange rates and prices stabilize. To address the challenges posed by the circulation of several currencies outside of the banking system, both Cambodia and the Lao People's Democratic Republic have noted the importance of promoting the national currency as a means of payment for all trade in goods and services domestically, while liberalizing currency exchange for all current account payments. In Cambodia, demand for the riel was expanding in rural areas as well as for government transactions, and currency in circulation reached over 5 per cent of GDP in 2003. It is, however, essential that administrative measures be implemented carefully to avoid capital flight. Given the country's institutional and financial constraints, the dollar-based monetary and exchange rate regime is seen as being appropriate for Timor-Leste, but prudent fiscal and wage policies are essential to avoid erosion in its external competitiveness.

Steps to combat money laundering and financing of terrorism

In view of the inherent weakness of the financial sector in many least developed countries, any hint of money laundering or financing of terrorism would be detrimental to the banking sector. In Cambodia, an inter-ministerial working group, headed by the central bank, was charged with preparing a draft anti-money-laundering law while the Lao People's Democratic Republic was in the process of establishing the legal framework to combat money laundering and terrorist financing. Myanmar's efforts to be in compliance with international norms include the introduction of anti-money-laundering legislation in 2003 and collaboration with regional organizations on these issues. Enactment of legislation on money laundering and combating the financing of terrorism is also expected in Timor-Leste.

Restructuring of State-owned enterprises focused on tariff reform

As in other least developed countries in transition to a market economy, restructuring of SOEs is considered an essential complement to the banking reform agenda, since such enterprises account for a large share of credit and non-performing loans. In the Lao People's Democratic Republic and Timor-Leste, restructuring has focused on tariff reform to commercialize large utilities. The installation of prepayment meters and improvement in billing at the power authority in Timor-Leste and gradual upward adjustment of fees for electricity usage in the Lao People's Democratic Republic are aimed at making the companies concerned more commercially viable. Restructuring programmes for three other major enterprises as well as Lao Airlines have been launched in the country with completion expected by the end of 2005. In Myanmar, SOEs, which account for the majority of production in the communications, power, energy and financial sectors, need to operate commercially in order to reduce budgetary costs and free resources for the private sector. This will require exchange rate unification to make the tax and subsidies provided to these enterprises explicit.