South-East Asia

GDP growth performance

Garment production in Cambodia is expected to grow as safeguards are imposed

Economic growth in Cambodia was projected to fall slightly, from 7.7 per cent in 2004 to 6.3 per cent in 2005 (see figure II.41). Although growth in the agricultural sector was estimated to be higher in 2005 because of increased paddy production, growth in the industrial and service sectors was expected to be moderate. Growth in the service sector was a result of the expansion in tourism and increased domestic activities including construction. Tourism arrivals were expected to rise by one third in 2005. Growth in garment production was expected to continue as safeguards were imposed by the United States and the European Union. Forty new investment projects were approved in 2004, and garment orders increased in 2005.

Figure II.41. GDP and sectoral growth in selected least developed countries in South-East Asia, 2003-2005[a]

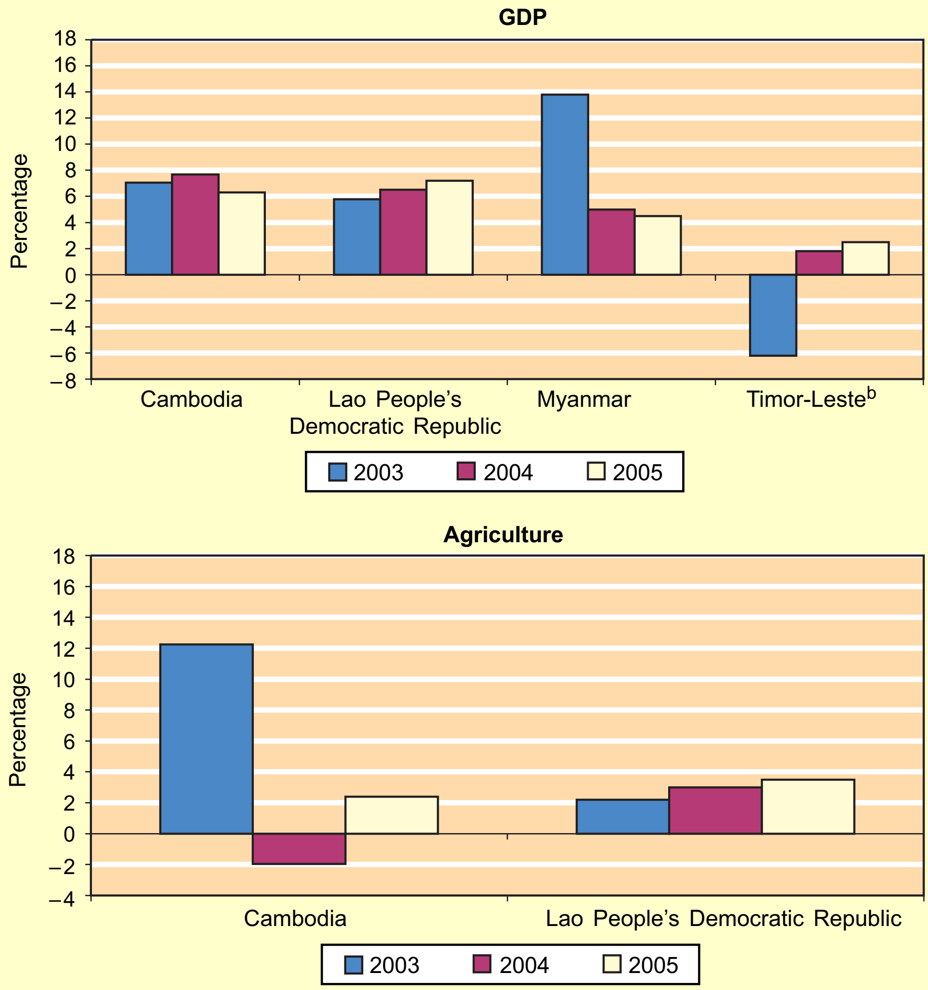

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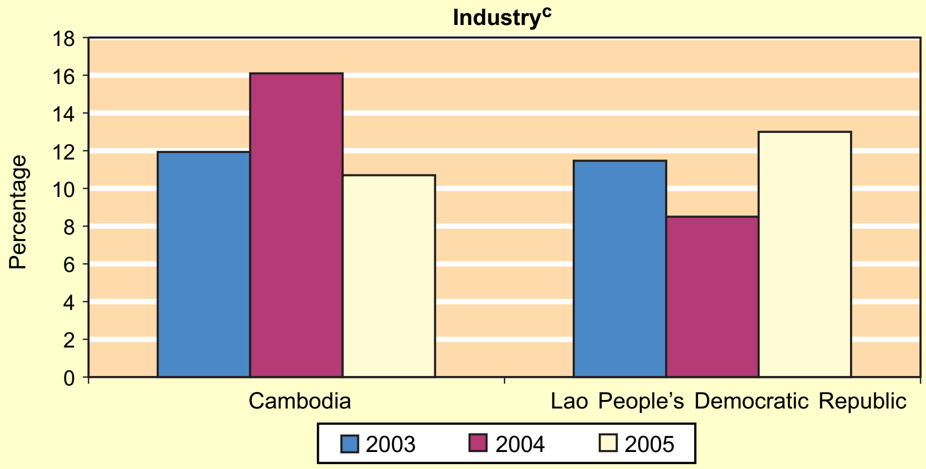
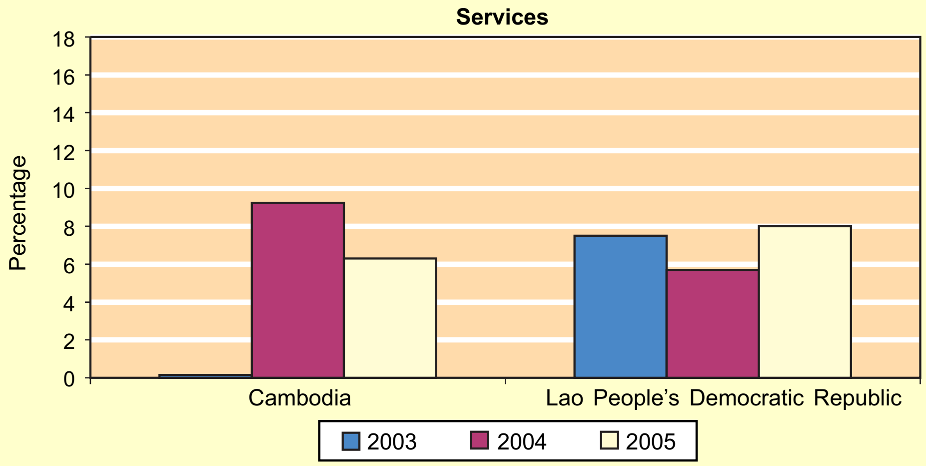
Figure II.41 *(continued)*





Sources: United Nations Economic and Social Commission for Asia and the Pacific, based on national sources; Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2005* (Manila, ADB, 2005); and International Monetary Fund, *Democratic Republic of Timor Leste: 2005 Article IV Consultation, IMF Country Report No. 05/245* (2005), "Cambodia: Statistical Appendix", IMF Country Report No. 05/245 (2005).

[a] Growth rates for 2005 are estimates.
[b] Real non-oil GDP growth.
[c] Comprising mining and quarrying; manufacturing; electricity-generation, gas and power; and construction.

Inflation in Cambodia was projected at 5.5 per cent in 2005, marginally lower than in 2004. In view of the country's large agricultural base, fluctuations in the prices of goods and services are seasonal. Drought in the first half of the year affected the production of crops and led to higher than expected food prices. Owing to the tax structure on oil imports and market oligopoly, inflation does not necessarily move in line with the prices of petrol and diesel. Because the United States dollar is widely used in the economy, domestic inflation is affected by changes in the exchange rate. In the first half of 2005, the riel depreciated against the dollar but strengthened against the baht.

Rising oil prices and declining paddy production are expected to boost consumer prices in the Lao People's Democratic Republic

In the Lao People's Democratic Republic, GDP was projected to rise from 6.5 per cent in 2004 to 7.2 per cent in 2005, led primarily by growth in mining and hydropower. Flooding in the central and southern paddy-producing areas of the country was expected to adversely affect the agricultural sector. Although growth was expected in the livestock and fisheries sectors, expansion in forestry was projected to slow as a result of the Government's policy to limit logging. Growth in the industrial sector was expected to rise considerably as production of gold nearly doubled and a new copper smelting plant came into operation. The service sector, led by tourism and wholesale and retail trade, was also projected to grow strongly.

Inflation was projected to fall from 10.5 per cent in 2004 to 8.0 per cent in 2005, but rising global oil prices and the decline in paddy production caused by flooding were expected to push consumer prices upward towards the end of the year. The exchange rate remained generally stable as the central bank maintained a spread of less than 1 per cent between the official rate and the market rate.

The informal sector remains large in Myanmar

In fiscal year 2003, GDP in Myanmar rose by 13.8 per cent, led by growth in agriculture, livestock and fisheries, manufacturing and processing, and services. In addition to increased rice production to meet domestic needs and to earn foreign exchange, the production of wheat, maize, pulses, groundnuts and sunflower seeds increased. Since the agricultural sector accounts for more than half of GDP, agricultural reform is expected to have a large impact on much of the population. The construction and transport sectors also grew substantially in fiscal year 2003 as a consequence of a significant rise in public investment in infrastructure. The informal sector remains large in Myanmar.

Central bank financing of the fiscal deficit fueled inflation in Myanmar. New administrative controls on credit creation, rice exports and increases in public and private wages, however, effectively lowered inflation from 54 per cent in fiscal year 2002 to 8 per cent in fiscal year 2003. By reducing the price of rice, however, these measures lowered agricultural income in favour of domestic rice consumers. Private investment was also curbed, and employees experienced an erosion of real wages.

Economic activity in Timor-Leste is dependent on government expenditure and subsistence agriculture

In Timor-Leste, economic growth, as measured by the change in real non-oil GDP, was projected to rise from an estimated 1.8 per cent in 2004 to 2.5 per cent in 2005, as a result of the post-drought recovery in agriculture and expansion of the banking sector. The economic structure is skewed towards government activity, including donor-funded projects, and subsistence agriculture. Social indicators are poor, and human capital remains underdeveloped, leading to inadequate administrative capacity in both the private and public sectors. Targeted public investment in infrastructure, education and health, coupled with increased private investment in labour-intensive sectors, was intended to increase productivity. Revenue from off-shore oil and gas production was expected to contribute to non-oil domestic activity and employment through the fiscal channel. Long-term economic growth may depend largely on the Government's ability to manage its oil and gas wealth and to establish an environment conducive to investment and growth in the non-oil sector.

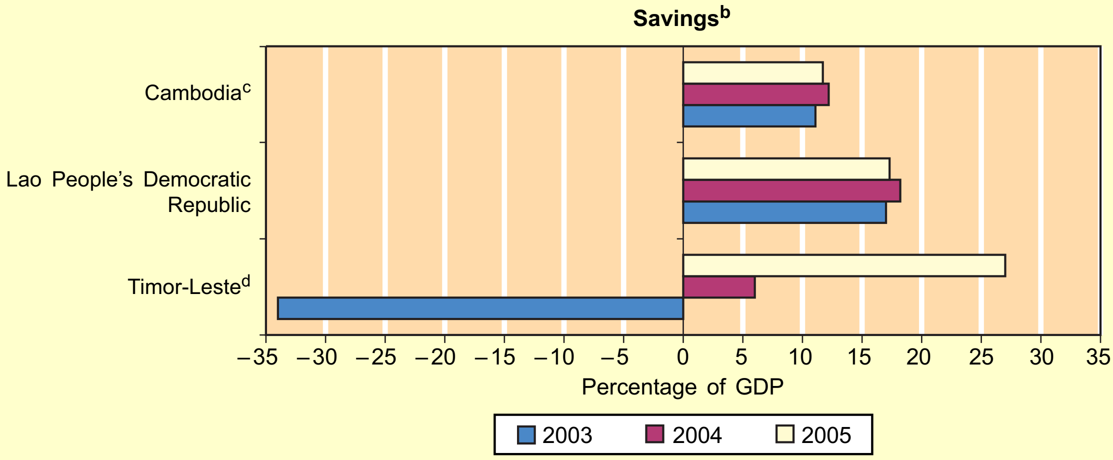
Inflation rose from an estimated 1.8 per cent in 2004 to a projected 2.5 per cent in 2005, as the official dollar-based monetary and exchange regime reined in inflation. Both domestic demand and non-oil import prices remained stable.

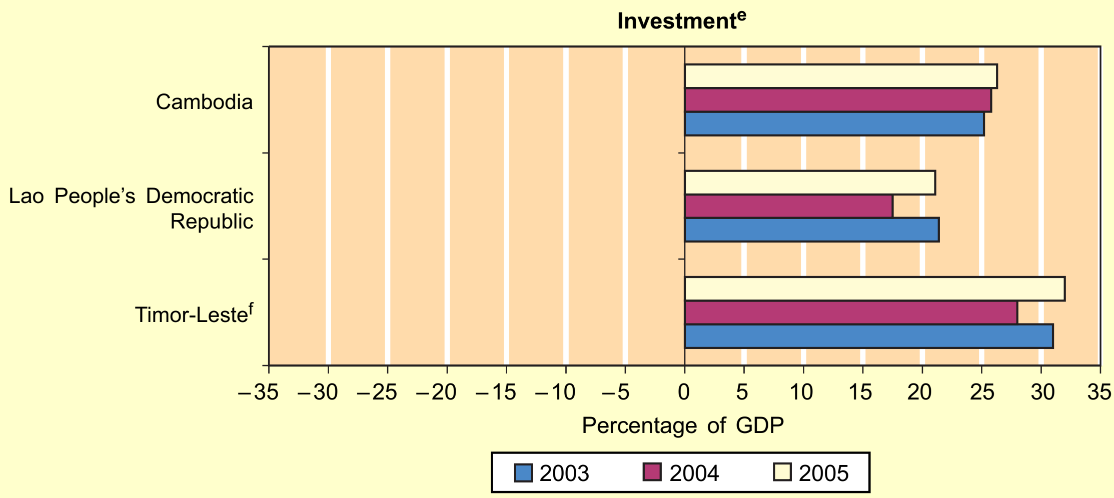
Key macroeconomic policy developments

Cambodia places priority on civil service reform and an overhaul of the infrastructure

Government revenue in Cambodia was projected to reach 11.3 per cent of GDP in 2005, and expenditure to reach 16.8 per cent of GDP. As with all least developed countries, savings remain low as a ratio of GDP (see figure II.42). Tax revenue increased considerably with the implementation of the public financial management programme and increased tax compliance. Although customs and excise revenue also rose, value added tax collection on petroleum products fell one fifth in the first half of 2005 because of fuel smuggling. The government budget for 2005 has placed priority on civil service reform and overhaul of the physical infra-

Figure II.42. Savings and investment in selected least developed countries in South-East Asia, 2003-2005[a]





Sources: United Nations Economic and Social Commission for Asia and the Pacific, based on national sources; Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2005* (Manila, ADB, 2005); International Monetary Fund, *Democratic Republic of Timor-Leste: 2005 Article IV Consultation,* IMF Country Report No. 05/245 (2005).

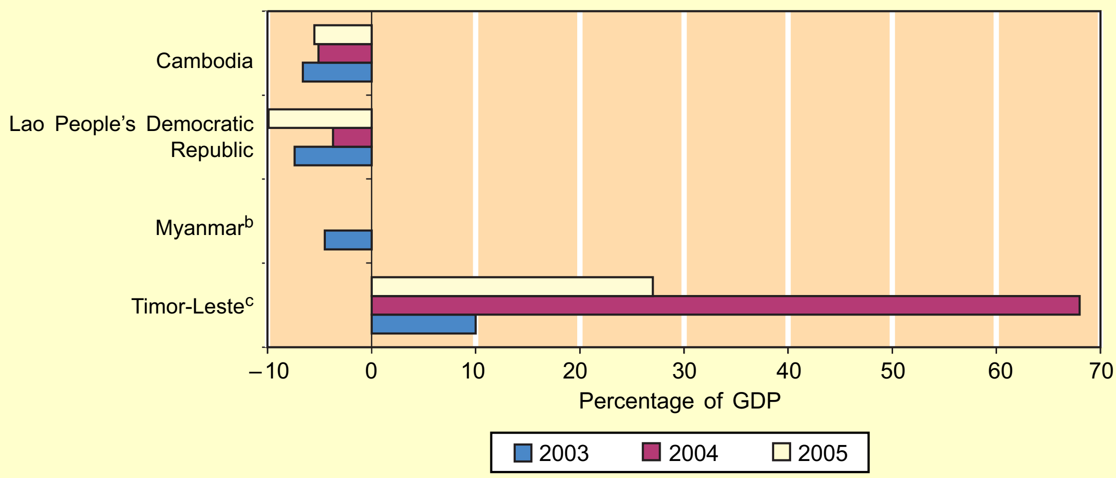
[a] Data for 2005 are estimates.
[b] Gross domestic savings.
[c] Excluding transfers.
[d] Gross national savings.
[e] Gross domestic investment.
[f] Excludes investment relating to the oil and gas sector.

structure. Wages constitute 40 per cent of current expenditure. With completion of the bank relicensing programme in 2004, greater emphasis is being placed on strengthening the supervisory capacity of the National Bank of Cambodia and promoting a competitive banking sector. With privatization of the Foreign Trade Bank of Cambodia, the country is expected to complete its transition to a two-tier banking system in 2006. The central bank has also licensed rural finance operators as formal microfinance institutions under its legal and supervisory framework. Efforts were also made to establish an insurance sector as well as a capital market.

Stable price levels and exchange rates led to positive real interest rates in the Lao People's Democratic Republic

In the Lao People's Democratic Republic, government revenue, including grants, was estimated at 13.6 per cent of GDP in 2005, slightly less than its revised target, while expenditure was estimated to have slightly exceeded its revised target, to reach 19.9 per cent of GDP (see figure II.43). Although the fiscal deficit, including grants, was estimated to have nearly doubled during 2005, capital inflows were expected to offset most of the increase. The main sources of tax revenues were the turnover tax, excise tax and import duties, while non-tax revenues consisted mainly of overflight fees, dividends and depreciation, and administration fees. To ensure macroeconomic stability, the central bank has aimed at controlling growth in the money supply (see figure II.44). The monetary base was projected to increase by nearly one fifth between the end of 2004 and the end of 2005. As a result of the stable price level and exchange rate, interest rates at commercial banks and the real interest rate for domestic currency deposits were positive. Private savings as a share of

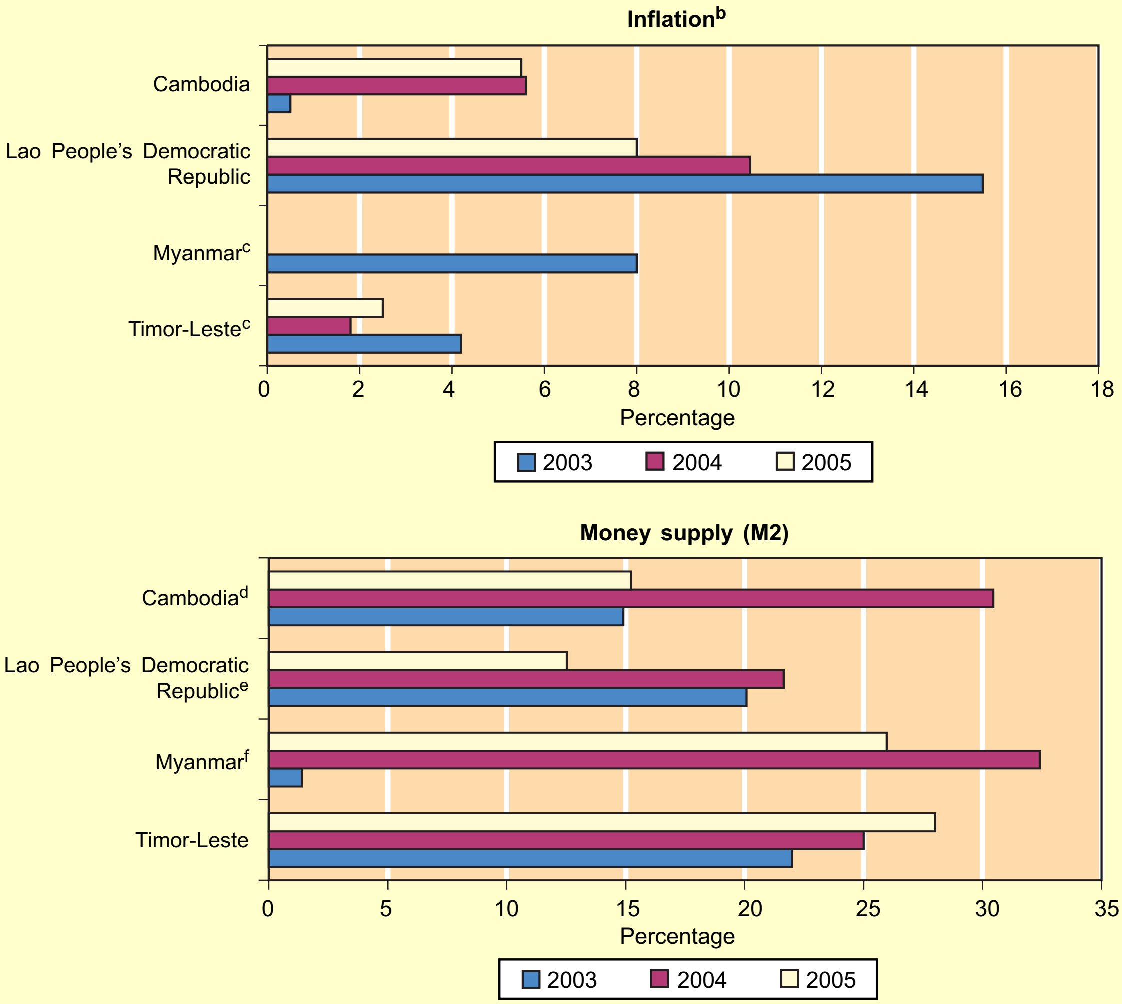
Figure II.43. Budget balance in least developed countries in South-East Asia, 2003-2005[a]



Sources: United Nations Economic and Social Commission for Asia and the Pacific, based on national sources; Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2005* (Manila, ADB, 2005) and *Asian Development Outlook 2005 Update* (Manila, ADB, 2005); Economist Intelligence Unit, *Country Reports* (London, EIU, 2005), various issues; and International Monetary Fund, *Democratic Republic of Timor-Leste: 2005 Article IV Consultation,* IMF Country Report No. 05/245 (2005).

[a] Data for 2005 are estimates.
[b] Includes grants.
[c] Calculated as a percentage of non-oil GDP and based on July-June fiscal year.

Figure II.44. Inflation and money supply growth in least developed countries in South-East Asia, 2003-2005[a]



Sources: United Nations Economic and Social Commission for Asia and the Pacific, based on national sources; Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2005* (Manila, ADB, 2005); International Monetary Fund, *International Financial Statistics* (CD-ROM) (Washington, D.C., IMF, 2005) and *Democratic Republic of Timor Leste: Selected Issues and Statistical Appendix*, IMF Country Report No. 05/250 (2005).

[a] Data for 2005 are estimates.
[b] Inflation refers to changes in the consumer price index.
[c] Inflation rate for 2005 refers to data at the end of period.
[d] Money supply for 2005 refers to the period January-October.
[e] Money supply for 2005 refers to the period January-February.
[f] Money supply for 2005 refers to the period of January-September.

GDP were projected to rise slightly to 17.5 per cent of GDP in 2005, with foreign currency deposits constituting slightly more than three fifths of the total outstanding deposits. Total credit to the economy was expected to decrease slightly to 10.2 per cent of GDP in 2005, with industry and handicrafts taking the largest share, followed by commerce.

The official exchange rate used for tariff evaluation in Myanmar was adjusted upward

As a result of economic sanctions and a complete halt to financial assistance from multilateral institutions, Myanmar has been forced to rely largely on its own resources for more than two decades. As the country's budget deficit continued to widen in 2003, reducing its fiscal deficit through improved tax collection. Expenditure consolidation became essential in Myanmar. A motor vehicle registration fee was introduced to expand the tax base, combat tax evasion and increase tax revenues. Further improvements in tax revenues are expected based on the replacement of ad hoc exemptions with a more transparent set of rules, and the possible introduction of excise taxes on alcohol, tobacco and luxury goods as well as a value added tax. The official exchange rate used in import evaluation for tariff purposes was also recently adjusted upward. Since a large proportion of economic activities remain in the informal sector, efforts are needed to bring income from such sources into the tax net. Central government capital expenditure rose from 3.8 per cent of GDP in fiscal year 2002 to 5.8 per cent in 2003. Greater fiscal consolidation, reform of State enterprises and banking institutions, agricultural liberalization and exchange rate unification are expected to create the conditions necessary for more sustained economic growth. Confidence in the domestic financial system and the domestic currency is improving as a result of measures to enhance the liquidity and capital adequacy of the country's financial institutions. The banking sector has recovered from the crisis in 2003, and emergency liquidity supports from the central bank have been fully repaid. Earlier capital flight appears to be reversing, and the demand for domestic currency deposits are rising. Regulation and supervision of the banking sector are being strengthened to allow greater competition.

The petroleum fund of Timor-Leste is expected to be operational by early 2006

Despite large inflows of oil and gas revenues fiscal policy in Timor-Leste has remained cautious. Commencement of oil production in 2004 resulted in a large fiscal surplus, an increase in the external current account surplus and accumulation of international reserves equivalent to 15 months of imports. Efforts to ensure productive use of oil and gas revenue are needed. The petroleum fund was expected to be operational by the beginning of 2006. The rise in domestic revenue also reflects improved tax administration. Since Timor-Leste has avoided both domestic and international borrowings, it has no debt. Nevertheless, the implementation of public investment projects has been poor. Bank lending to the private sector increased threefold to 21 per cent of non-oil GDP by the end of 2004, with most funds being used for construction and small transport-related businesses. Gross investment in Timor-Leste was projected to rise to 32 per cent of GDP and gross national savings to 27 per cent.

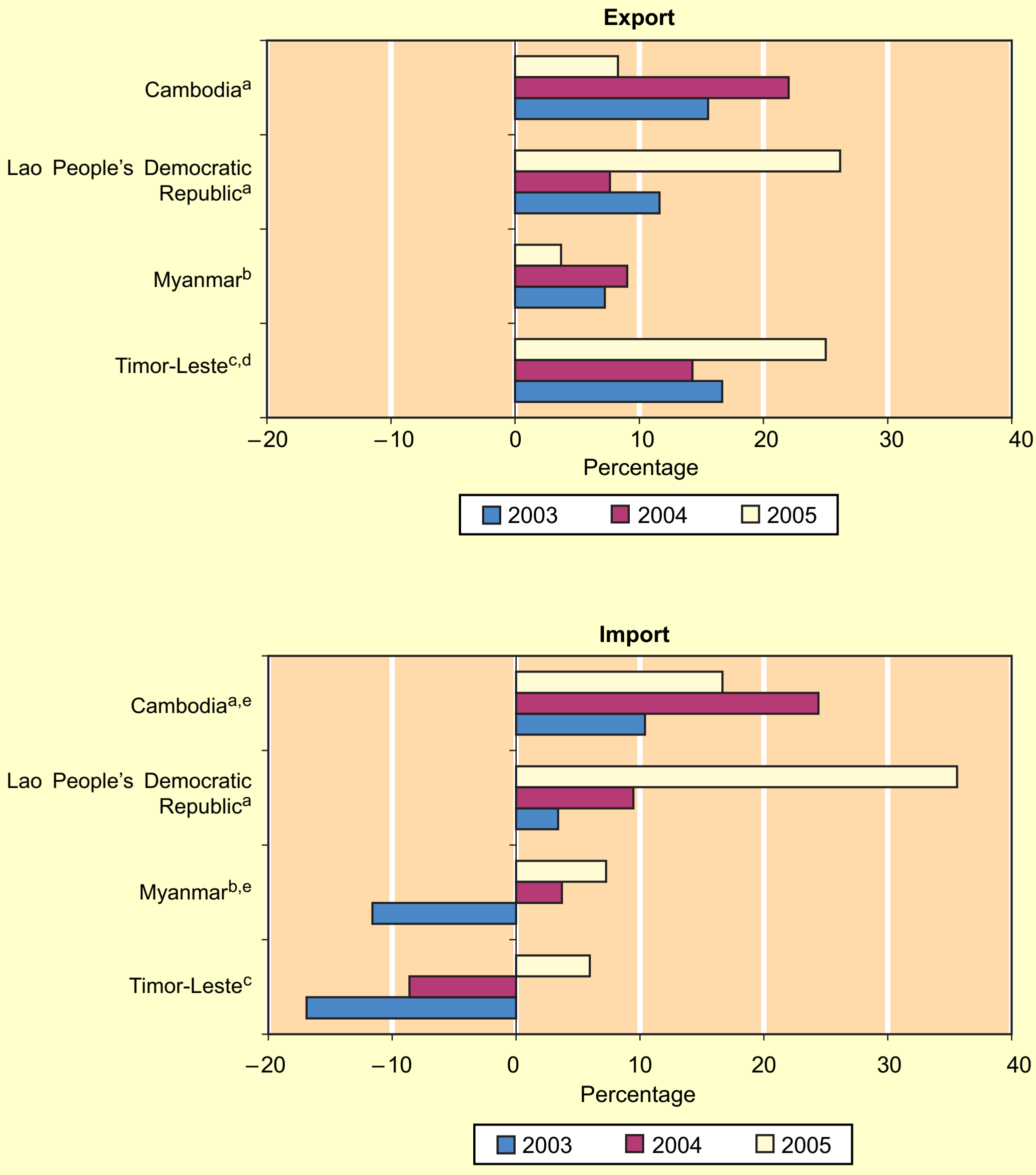
Developments in the external sector

Under the Multilateral Debt Relief Initiative, the International Monetary Fund has extended 100 per cent debt relief to Cambodia

Cambodia registered a surplus in its balance of payments in the first half of 2005, but its current account deficit widened because of the increased costs of petroleum, which constituted a quarter of domestic imports (see figures II.45 and II.46). Garment exports under the Generalized System of Preferences, which made up more than four fifths of exports, were expected to face increasing competition in the medium term. Other exports, such as lumber and fishery products, have declined in recent years. The surplus in the services account increased significantly owing to improvements in tourism and air freight. FDI rose with the strengthening of the banking sector and expansion in the garment sector and in tourism.

Repayment of external debts incurred prior to 1993 is being negotiated with the Russian Federation and the United States. Under the terms negotiated with the Russian Federation, the debt service ratio of Cambodia is expected to be the equivalent of 2 per cent of exports over the next decade. Debt rescheduling is expected to reduce amortization payments but could increase interest obligations. Under the Multilateral Debt Relief Initiative, IMF extended 100 per cent debt relief to Cambodia in late 2005.

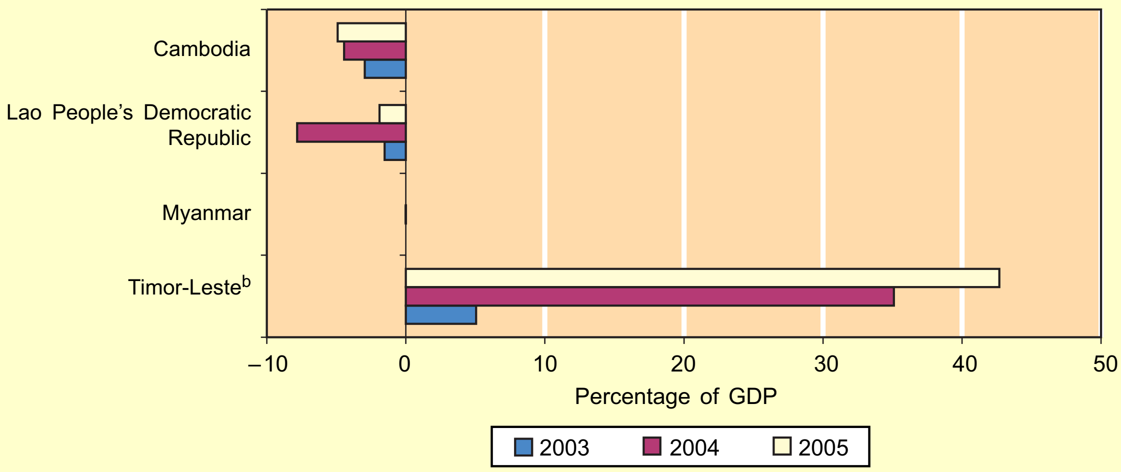
Figure II.45. Growth rates in merchandise export earnings and import spending in least developed countries in South-East Asia, 2003-2005



Sources: Economist Intelligence Unit, *Country Reports*, various issues; International Monetary Fund, *Country Report* No. 05/245 (2005); and national sources.

[a] Data for 2005 are estimates.
[b] Data for 2005 are Economist Intelligence Unit estimates.
[c] Data for 2004 are estimates and for 2005 are projections.
[d] Excludes oil and gas.
[e] Import value free on board (f.o.b.).

Figure II.46. Current account balance in least developed countries in South-East Asia, 2003-2005[a]



Sources: United Nations Economic and Social Commission for Asia and the Pacific, based on national sources; Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2005* (Manila, ADB, 2005) and *Asian Development Outlook 2005 Update* (Manila, ADB, 2005); Economist Intelligence Unit, *Country Reports* (London, EIU, 2005), various issues; and International Monetary Fund, *Democratic Republic of Timor-Leste: 2005 Article IV Consultation – Staff Report,* IMF Country Report No. 05/245 (2005).

[a] Data for 2005 are estimates.
[b] Based on percentage of non-oil GDP; includes international assistance.

Grants constitute one fifth of capital inflows to the Lao People's Democratic Republic

Exports from the Lao People's Democratic Republic, comprising textiles, electricity, wood products, gold, copper and coffee, and imports were projected to increase significantly in 2005. Although imports of consumer goods have declined in recent years, imports of capital equipment and electricity have risen; those imports are to be used in the country's gold and copper mining investments and large infrastructure projects such as the Nam Theun 2 Hydropower Project. Total capital inflows rose in 2005, with grants constituting nearly one fifth of the total. Inflows of commercial bank credits increased only marginally, however. As the country has no stock exchange, there were no portfolio investment inflows. The value of total approved FDI more than doubled, and more than a quarter of it was realized. Inflows of FDI through the banking system rose by more than 50 per cent in 2005.

Gross official foreign exchange reserves were estimated to be equivalent to 4.2 months of imports. The total external debt stock of the Lao People's Democratic Republic was estimated to have risen by more than one tenth, to 81.8 per cent of GDP in 2005. Debt stock to multilateral creditors accounted for nearly three quarters of this debt. External debt servicing was estimated to have risen to the equivalent of 10.9 per cent of exports. Although the Lao People's Democratic Republic is on the list of heavily indebted poor countries, in an effort to maintain creditworthiness for project-related external commercial loans, the Government has not submitted a request for debt forgiveness. Although no official statistical data are available on portfolio investment by nationals of the country in banks outside the country, a significant amount is believed to have been deposited in order to conduct payments for cross-border trade.

Myanmar remains committed to the Common Effective Preferential Tariff Scheme of the ASEAN Free Trade Area

Exports, especially of garments, from Myanmar have been adversely affected by international sanctions, while the services account has been eroded by larger profit repatriation and a decline in tourism receipts. In line with the commitments of the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area, Myanmar has made progress on tariff reductions. Bilateral and regional engagements have not compromised Myanmar's commitment to multilateral trade negotiations. In 2003, the current account surplus, excluding grants, declined to nearly one fifth of the surplus in 2002. The capital account has deteriorated with higher debt service payments falling due, while disbursements have remained largely static and FDI has declined. The issue of faster accumulation of international arrears over international reserves was addressed in bilateral negotiations. The recourse to commercial loans and suppliers' credit instead of concessional assistance is expected to be temporary in view of the higher cost and shorter repayment periods for such credit. To enhance regional trade, Myanmar conducted negotiations with neighbouring countries, and this resulted in agreements on road and rail network construction.

Coffee exports from Timor-Leste rise

The external current account surplus, including international assistance, of Timor-Leste was projected to increase to 43 per cent of non-oil GDP in 2005, owing to the country's large oil and gas tax and royalty income. Merchandise imports, at 61 per cent of non-oil GDP, were projected to be significantly greater than merchandise exports, excluding oil and gas revenues, leading to a trade deficit of 58 per cent of GDP. Coffee exports, which constitute more than four fifths of all non-oil exports, rose in response to higher global prices. Since overall external price competitiveness deteriorated with the depreciation of the country's trading partners' currencies against the dollar, cautious fiscal and wage policies will be the key to preserving the competitiveness of Timor-Leste (see figure II.47).

Medium-term prospects and key policy issues

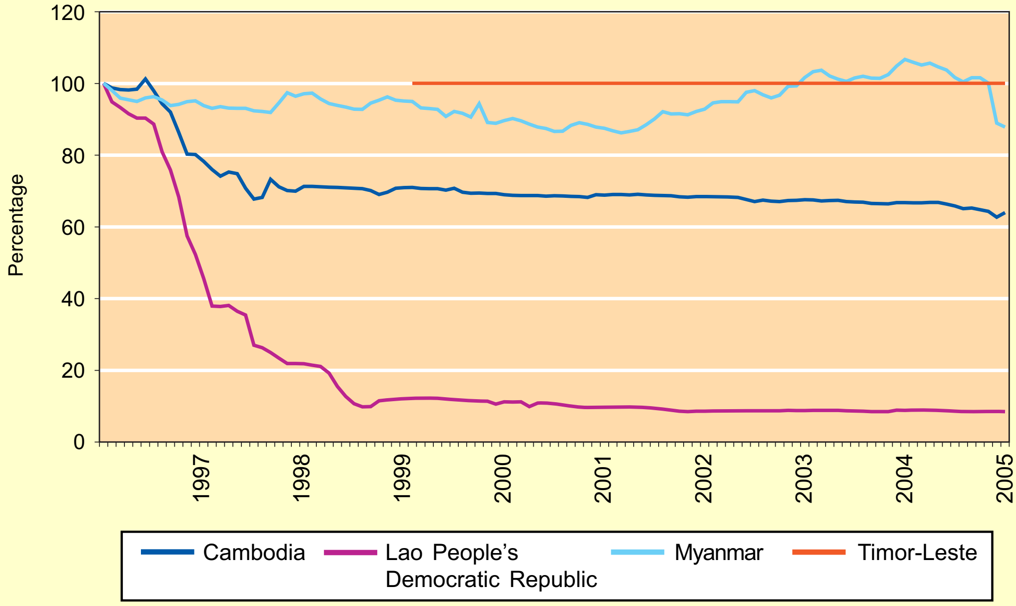
The least developed countries need to establish a sustainable growth mechanism that supports a rapid improvement in household living standards. Experience suggests that a sustainable growth process requires mutually reinforcing interactions between investment growth and export growth. Although external finance, usually aid, is vitally important in the initial stages of building an investment-export nexus, sustainability is best ensured when domestic savings start to grow along with investment and exports, and they increasingly begin to drive the process.

Sound macroeconomic policies are an essential element of long-term development strategies. However, macroeconomic objectives should be pursued through means that are consistent with long-term development objectives and that do not squeeze investment to levels that compromise future growth. A growth-oriented approach includes competitive exchange rates and the setting of low and stable interest rates in order to finance productive investment. Fiscal measures can also be used to increase corporate profitability and encourage the retention of earnings to accelerate capital accumulation.

Investment in rural roads and irrigation enables Cambodia to improve market access

Economic growth in Cambodia is expected to grow by an annual average of 6 per cent during the period 2006-2008, led largely by garment exports and oil and gas exploration. In the agricultural sector, current investment in rural roads and irrigation is expected to improve market access and productivity (see box II.6). Improved seed varieties, more diversified crops and community fisheries should also boost rural income. Growth in the garment industry is expected to be restrained, but recent reductions in operating costs should enable the industry to maintain its competitiveness. If political stability and security continue to be maintained, both construction and tourism are expected to grow. Inflation in the medium term is projected at an average annual rate of 3 per cent. Cambodia intends to reduce its primary budgetary deficit to less than 3 per cent of GDP, increase spending

Figure II.47. Index of exchange rates against the United States dollar in least developed countries in South-East Asia, 1996-2005[a]



Sources: International Monetary Fund, *International Financial Statistics* (CD-ROM) (Washington, D.C., 2005); and *The Economist,* various issues.

[a] Data for 2005 are estimates.

Box II.6. Duty-free and quota-free market access for products originating from least developed countries

The Ministerial Declaration of the Sixth WTO Ministerial Conference, held in Hong Kong, China, from 13 to 18 December 2005, reaffirmed the commitment to effectively integrate the least developed countries into the multilateral trading system. Building on the commitment of the Doha Ministerial Declaration, developed and developing countries agreed to implement duty-free and quota-free market access for products originating from least developed countries by 2008. Countries also agreed to take additional measures to provide effective market access, both at the border and otherwise, including simplified and transparent rules of origin, and to give priority to sectors and modes of supply of export interest to least developed countries. Least developed countries, for their part, will be required to undertake commitments and concessions only to the extent consistent with their individual development, financial and trade needs and their administrative and institutional capabilities.

To facilitate accession of the least developed countries to WTO, priority will be given to concluding ongoing accession proceedings. To assist these countries in expanding their limited human and institutional trade-related capacities, the Declaration reaffirmed a commitment to enhance effective trade-related technical assistance and capacity-building on a priority basis. To ensure coherency, donors, multilateral agencies and international financial institutions were also requested to coordinate their work so that least developed countries are not subjected to conditionalities on loans, grants and official development assistance that are inconsistent with their rights and obligations under WTO agreements.

in the social sectors and on infrastructure development in rural areas, and raise civil service salaries by 2008. Such expenditures would require an increase in government revenues to 13.1 per cent of GDP. The current account deficit is projected to decline to 7 per cent of GDP by the end of 2008 owing to increased competitiveness and tourism. A projected external financing gap of $119 million is expected to be covered with assistance from international financial institutions.

Foreign direct investment in the Lao People's Democratic Republic will increase with the elimination of duties

In the Lao People's Democratic Republic, GDP growth is projected to range between 7.5 to 8.1 per cent during the period 2006-2008. Although growth in the agricultural sector is expected to continue, its share in GDP may decline. Both the industrial and the service sectors are projected to grow more rapidly, led by mining and quarrying and tourism. Private savings in the banking system are projected to grow, with foreign currency deposits expected to drop to half the total outstanding deposits by 2008. Private investment is forecast to rise in line with private savings. Inflation is estimated at an annual average rate of 7 per cent in the medium term. The central bank is expected to absorb any excess liquidity while the Government aims at balancing the budget. The volume to imports of capital equipment for infrastructure projects is likely to mean that imports will keep growing faster than exports. FDI is expected to increase with the elimination of import duties on production machinery, equipment and raw materials and of export duties on finished products. Other factors expected to increase FDI are the right to employ expatriates and the provision of profit tax incentives tailored to specific activities, the establishment of investment areas and the size of investments.

Myanmar recognizes need for structural reforms to promote private investment

Barring unforeseen economic shocks, Myanmar is expected to maintain its economic growth rate, given its location in one of the world's most dynamic regions and its abundant natural resources. Myanmar recognizes the need to continue making structural reforms in order to promote a more conducive environment for private investment and productivity growth. To ensure better governance and transparency, the Government has introduced measures to promote improved accounting practices and greater disclosure and to enforce financial and non-financial rules and regulations. Implementation of international best practices and recommendations is expected to require substantial resources over time.

Large fiscal surpluses averaging nearly a third of GDP are expected in Timor-Leste

The economic growth rate in Timor-Leste is expected to double to 5 per cent in 2006 as a result of increased investment spending. Assuming normal weather conditions, the expansion of technical extension services to subsistence farmers, the development of agro-businesses and the licensing of fishing are expected to accelerate growth in the agricultural sector. Higher public spending would also increase private sector activity, especially in the construction and service sectors. The higher economic growth necessary to absorb the expanding labour force requires improved budget execution and strengthening of the legislative and regulatory framework to attract private investment. Inflation is expected to be moderate in view of the current exchange and monetary regime. Based on anticipated oil and gas production, large fiscal surpluses averaging nearly a third of GDP are expected in the medium term. Enactment of pending economic legislation, finalization of bankruptcy legislation and development of a strong and independent judiciary and a comprehensive land-titling system are measures essential to ensure sustainable growth and higher employment in Timor-Leste.

DEVELOPED COUNTRIES

Australia, Japan and New Zealand

Overview

Growth slackens but remains strong in all three developed countries in the region

GDP growth in Australia and New Zealand lost some momentum in 2005. Australia and New Zealand are primarily commodity-producing