As the first global economic contraction in modern times hit Asia and the Pacific late in 2008, economic growth among developing economies of the region decelerated sharply from a pre-crisis level of 9.1% in 2007 to 4.0% in 2009. That the growth rate remained positive was due to continuing rapid growth in China (8.7%) and India (7.2%). However, if those two powerhouses are excluded, growth of developing economies in the rest of the region contracted to 0.6%, much the same as in the rest of the world. The synchronized impact of the global crisis is shown in figure 30.

Comparison of crisis-period growth (2008 and 2009) with pre-crisis growth trends (that is, the five-year average annual growth from 2003 to 2007) reveals that almost all economies experienced various degrees of deceleration in growth from their pre-crisis performance (figure 31). Japan, Fiji, Palau and Samoa were the most severely hit, followed by Armenia, Cook Islands, Georgia, the Marshall Islands, New Zealand, the Russian Federation, Taiwan Province of China, Singapore and Turkey.
The grim performance notwithstanding, clear signs of a rebound emerged across the region towards the end of 2009. Central to such better-than-expected performance was the domestic demand response to aggressive pump-priming. Business should not simply resume as usual – Governments have helped prevent a meltdown, but they will find it much trickier to steer their economies back to their pre-crisis growth rate. They first need to address imbalances and shift to a more sustainable and inclusive development paradigm.

Central to such better-than-expected performance was the domestic demand response to aggressive pump-priming

As a basis for understanding the range of required policy responses, this chapter examines the patterns of crisis impact and recovery across five subregions of Asia and the Pacific. The extent of the impact in each economy hinged on a number of factors, including its initial conditions, the breadth and depth of its integration with the global economy, and the speed and intensity of the Government’s countercyclical measures.

EAST AND NORTH-EAST ASIA

The East and North-East Asian subregion spans diverse economic systems as well as the development spectrum: from the centrally planned Democratic People’s Republic of Korea to three economies in transition away from centrally planned systems, to market economies at advanced stages of development; and, at its eastern extreme, Asia’s only developed country, Japan.

The diversity enhances economic complementarity and generates a potential for expanding and deepening a wide range of economic relations: from the Japanese capital- and technology-intensive economy, to Chinese labour-intensiveness to Mongolian and Russian Federation resource-abundant economies. China is the subregional growth engine as well as one of the
Notes: Economies are categorized according to their degree of deviation from the trend growth rate, in percentages. Deviation from trend growth is measured by the difference between average annual growth rate during the crisis (2008 to 2009) and the pre-crisis rate (2003 to 2007). Positive deviation denotes acceleration in growth, whereas negative deviation denotes deceleration.

world’s fastest-growing economies – consistently so. While vertically and horizontally integrated production networks have deepened economic relations among China, Japan and the Republic of Korea, linkages with the other economies of the subregion are much less developed and harbour a huge potential for future growth. Importantly, perhaps as a sign of more to come, in October 2009 China and the Russian Federation signed a $4 billion trade and investment agreement that included oil, gas, raw materials and engineering. The two Governments envisage expanding Russian oil and gas exports to China and cooperation between them in extracting and processing raw materials. The Russian Federation is one of the main suppliers of hydrocarbons to China, while its technology and investment agreement with China will help modernize its own Far East region.

Monetary authorities have also enjoyed greater flexibility, since lower food and energy prices have helped reduce inflation. Japan, however, remained under greater pressure because its previous decade of recession has left it with high levels of accumulated debt.

**Rebound under way.** Between 2008 and 2009, growth in the subregion decelerated into negative territory, from 2.1% to -1.1% (table 8 and figure 32). Much of the slowdown took place in the first half of 2009, at the peak of the global financial crisis. A further dampener, in the second quarter of 2009, was the outbreak of H1N1 influenza, whose severity at that time was unknown. Figure 32 reveals the scale of the deceleration, with GDP growth declining rapidly during the first and second quarters of 2009.

In China, the deceleration brought the slowest growth since records of quarterly growth began in the 1990s. However, urban fixed-asset investment, which had increased by 26% during both 2007 and 2008, rose even more quickly – by 31% in 2009 – after the Government responded with its fiscal stimulus package. Household consumption also continued to grow, though retail sales growth decelerated from 22% in 2008 to 16% in 2009. The pronounced rebound of 80% in the stock market brought recovery of all the ground it had lost due to the crisis, spurring growth to reach 8.7% in 2009.

Other economies are likewise extending their links outside the subregion; for example, the Mongolian Government has agreed with the Ivanhoe Mines/Rio Tinto consortium a development scheme for the giant Oyu Tolgoi copper-gold deposit. The 2009 ASEAN-China Investment Agreement aims to promote investment flows and create a liberal, facilitative, transparent and competitive investment regime.

**Impact of the crisis**

After being hit by the global financial crisis, the developing economies in East and North-East Asia, led by China, recovered swiftly in the latter part of 2009. Their inherent resilience and their unprecedented expansionary macroeconomic policies are key. Although the export sector has continued to struggle, the downturn has largely been cushioned by domestic demand.

The four economies of Taiwan Province of China; Hong Kong, China; Macao, China; and the Republic of Korea also experienced their worst contraction since the Asian financial turmoil of 1998 (table 8). Nevertheless, by the second half of 2009, a rebound was clearly under way in their subregion. By the end of 2009, the Korea Composite Stock Price Index was 50% higher than a year earlier and 56% above its trough of November 2008, while much smaller declines were recorded than during the
### TABLE 8. Rate of economic growth and inflation in East and North-East Asian economies, 2008 to 2010

(Percentages)

<table>
<thead>
<tr>
<th>Real GDP growth</th>
<th>Inflation&lt;sup&gt;a&lt;/sup&gt;</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>2008</td>
</tr>
<tr>
<td>East and North-East Asia&lt;sup&gt;d&lt;/sup&gt;</td>
<td>2.1</td>
</tr>
<tr>
<td>China</td>
<td>9.0</td>
</tr>
<tr>
<td>Democratic People's Republic of Korea</td>
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<tr>
<td>Hong Kong, China</td>
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<tr>
<td>Japan</td>
<td>–1.2</td>
</tr>
<tr>
<td>Macao, China</td>
<td>12.9</td>
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<tr>
<td>Mongolia</td>
<td>8.9</td>
</tr>
<tr>
<td>Republic of Korea (the)</td>
<td>2.2</td>
</tr>
<tr>
<td>Russian Federation (the)</td>
<td>5.6</td>
</tr>
<tr>
<td>Taiwan Province of China</td>
<td>0.7</td>
</tr>
</tbody>
</table>

Notes: <sup>a</sup> Changes in the consumer price index. <sup>b</sup> Estimates. <sup>c</sup> Forecasts (as of 15 April 2010). <sup>d</sup> Subregional calculations based on GDP figures at market prices in United States dollars in 2007 (at 2000 prices), used as weights to calculate the subregional growth rates.


### FIGURE 32. Real GDP growth, year-on-year, of major East and North-East Asian economies, 2008 and 2009

previous year in both consumption and investment. Similarly, in Hong Kong, China, the fall in GDP was 7.5% during the first quarter but had narrowed down to 3.7% in the second quarter; by the third quarter it was down to 2.2%. In Macao, China, revenue from the gaming and entertainment sector fell by 10% within the first seven months of 2009, with a 15% year-on-year drop in GDP in the second quarter of 2009. By the third quarter however, a number of multibillion-dollar investment projects that had been put on hold, started to pick up slowly.

Although the economy of Mongolia is relatively less integrated with the rest of the subregion, it also experienced a sharp drop in economic growth, from a robust 8.9% to 0.5% between 2008 and 2009. Lower commodity prices for some of its principal exports contributed to the sharp deceleration.

Japan experienced average pre-crisis growth of 2.1% during the period 2003 to 2007; but growth started to fall as early as the second quarter of 2008, when it was 0.4% lower than in the previous year, and continued to slide in the first quarter of 2009, by 8.9% year-on-year. Over the whole of 2009, the economy shrank by 5.2%, with deterioration in almost all economic indicators – not only in exports, but also in private consumption, which makes up almost 60% of GDP. Already weak prior to the crisis, consumption fell steadily along with wage income and employment. Private investment contracted at an unprecedented pace.

**Deflationary pressures key concern.** Lack of inflationary pressure in the subregion going into the crisis permitted accommodative monetary policies as part of stimulus measures. Deflationary pressures were much more evident in this subregion than in others, following marked corrections in oil and food prices (table 8) and excess capacity. In February 2009, consumer prices in China fell to -1.6% from a year earlier, while over the whole year prices declined to -0.7%. Housing costs showed the greatest downward adjustment among major expenditure items, owing to the consolidation in the property market. In Hong Kong, China, deflation emerged in mid-2009, after months of downward price adjustments. More dramatically, in Japan, while consumer price inflation hovered around 0%, producer price inflation swung from 4.5% in 2008 to an estimated -5.2% in 2009, bringing back deflationary pressures that had plagued the Japanese economy for more than a decade. Mongolia exhibited a relatively high inflation rate, estimated at 7.0%, a significant deceleration in comparison with 28.0% of 2008.

The crisis largely impacted East and North-East Asia through trade channels, with plunges in import demand from developed countries amounting to over 25% for Japan and the United States, and the European Union. Furthermore, the Russian Federation and Mongolia were affected not only by the volume decreases but also by the sharp fall in international commodity prices (figures 33 and 34). The decline in exports was already evident by the end of 2008 and exports fell steeply in the first half of 2009. Year-on-year decreases in merchandise trade were around 20% in China, the Republic of Korea and Hong Kong, China; in Japan and Taiwan Province of China they reached over 30%; in Mongolia, 40%, and in Macao, China a notable 55%. The export of services also declined, evident in a slowing in the growth in tourist arrivals. The sharpest decline was in transport-related and other services that also reflected the drop in merchandise trade, since in the more advanced economies an important share of merchandise trade is captured by services.

The major products of East and North-East Asia were clearly sensitive to the slowdown in demand from developed countries, to a much greater extent than in economies in other subregions that weathered the export contractions better because of their exports of low-cost/low-technology manufactured goods, or because of windfall gains in commodity price rises. Cases in point are Bangladeshi garment exports and Uzbekistani gold
FIGURE 33. Export growth, year-on-year, of major East and North-East Asian economies, 2008 and 2009


FIGURE 34. Import growth, year-on-year, of major East and North-East Asian economies, 2008 and 2009

Note: Data of 2009 are estimates.
exports. East and North-East Asian specialization in medium- and high-technology manufactured goods as well as fuel and metal commodity products led to the initial severity of the negative export impact of the global crisis.

On the import side, in tandem with export declines, demand for raw materials and intermediates for export-oriented production saw sharp declines. Commodity prices fell at the same time, so current accounts were only moderately affected (figure 35). All economies remained in positive territory with the exception of Mongolia, because of the unfavourable world prices for its principal exports and import dependence. Some economies, notably the Republic of Korea, even improved while others experienced modest deterioration.

**Renewed inflows challenge policy.** The global crisis affected inward flows of foreign direct investment (FDI) in East and North-East Asia. China has exhibited the most dynamism, having seen robust FDI growth of 15% in 2007 and 30% in 2008. But in 2009, FDI declined by 13%. Thanks to the current account surplus, however, reserves built up even more rapidly; by the end of 2009, Chinese foreign assets surpassed $2.4 trillion, the highest in the world.

The Republic of Korea also received net capital inflows, attributable mainly to massive inflows of portfolio investment that more than offset the net outflows related to direct investment, derivatives and other investments. In 2008, the country had net portfolio outflows of $2.4 billion. In 2009 net portfolio inflows reached $51 billion, helping foreign reserve assets rise by over $65 billion, in conjunction with the current account surplus.

Other economies of the subregion are also faced with the challenge of how to maximize the benefits of capital inflows while reducing their destabilizing effects. In 2009, for example, Hong Kong, China recorded net capital inflows associated with financial derivatives and other investments that exceeded the net outflows in

![Figure 35. Current account balance as a percentage of GDP in major East and North-East Asian economies, 2007 to 2009](image)

**Note:** Data for 2009 are estimates.

direct and portfolio investment. Combined with its current account surplus, by 2009 foreign reserve assets had exceeded $250 billion.

Mongolia also witnessed capital inflows that enabled it to offset a current account deficit in the second quarter of 2009. By mid-2009, foreign reserves stood at about $650 million.

In the case of Taiwan Province of China, net capital inflows in the first half of 2009 came mainly from the net inflows of other investment and financial derivatives. They offset the net outflows of direct and portfolio investment that had resulted from increased investment overseas. Coupled with current account surplus, foreign reserve assets continued to accumulate to over $300 billion by mid-2009.

Mongolia also witnessed capital inflows that enabled it to offset a current account deficit in the second quarter of 2009. By mid-2009, foreign reserves stood at about $650 million.

**Appreciating currencies.** In China, in the first half of 2008, the Central Bank ceased floating the yuan within a band, that had led to notable appreciation. During 2009, however, despite the increase in capital inflows, the yuan remained largely stable at around 6.8 per United States dollar. Stability in the exchange rate, as the US dollar weakened, helped maintain export competitiveness in third markets. However, with continuing surpluses in capital and current accounts, China continues to face pressures for appreciation.

The Korean won, by contrast, regained value during 2009, rising by 18% – a consequence of surplus in the current account, inflows of portfolio capital and improved access to foreign credit markets. The Japanese yen appreciated by over 20% from its low in mid-2008. Both Japan and the Republic of Korea, however, became less competitive in the Chinese market and elsewhere because of the stability of the yuan. China takes a major share of exports of both of those countries, so exchange rate movements dampened intraregional trade in 2009. The New Taiwan dollar experienced mild appreciation of 3% over 2009 against the United States dollar. Under the Linked Exchange Rate system, the Hong Kong dollar remained stable. The largest appreciation – almost 20% during 2009 – was that of the Russian rouble, reflecting the Government's monetary policy which helped avoid uncontrolled currency depreciation.

On the other hand, towards the end of 2008, the Mongolian tugrik lost over 25% of its value against the United States dollar. The Bank of Mongolia responded with a rise in interest rates. By end-2009 the tugrik was 8% higher than its March trough.

**Policy responses**

Low inflation levels enabled Governments to support aggressive fiscal spending with accommodative monetary policies. At the end of 2008, Japan, for example, lowered the policy interest rate by 0.5% to a token 0.1%. From October 2008, the Bank of Korea cut its policy rate six times in a row, reducing it by 325 basis points to a record low of 2%. Similarly, Hong Kong, China and Taiwan Province of China kept interest rates at rock-bottom levels – at 0.5% and 0.1%, respectively (figure 36).

At such rates, little room remains for further cuts to support private lending. China is a special case – the Government could direct increases in bank lending. In general each country's capacity to undertake effective stimulus was due to the considerable fiscal space available before the crisis for Government spending. The subregion displayed some of the largest fiscal spending programmes in the world as a percentage of GDP, particularly those of China, the Republic of Korea and Japan.
The Republic of Korea and China have been notable for including significant initiatives to achieve the twin goals of promoting the emerging field of “green” technology as well as shifting domestic consumption and production patterns to a more environmentally sustainable path.

Stimulus policies across the subregion have displayed some positive signs of moving economies to a new growth trajectory based on new industrial sectors and more inclusive and sustainable demand. The Republic of Korea and China have been notable for including significant initiatives to achieve the twin goals of promoting the emerging field of “green” technology as well as shifting domestic consumption and production patterns to a more environmentally sustainable path. The Republic of Korea had the world’s largest component of a stimulus programme dedicated to environment-related projects, accounting for 79% of its total stimulus spending, China was second globally with 34%. Also in 2009 the Republic of Korea initiated a five-year plan to move its economy decisively towards a low-carbon, “green-growth” vision of development. Earlier China had incorporated significant environment-related spending into its 11th Five-Year Plan (2006 to 2010).

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Unwinding expansionary policies. While aggressive fiscal stimulus was possible because of the accumulated budget surpluses, the scale of spending has inevitably put pressure on budgets going forward (figure 37). During the recovery phase, Governments have begun to consider the timing and prioritization of their exit strategies to ensure fiscal probity without endangering renewed growth momentum. Other than the impact on Governmental budgets, delay in removing stimulus creates the risk of asset price bubbles across many economies in the subregion. Property markets in China, the Republic of Korea and Hong Kong, China have seen rapid price rises over 2009.

Tightening monetary policies across the subregion to reduce the build-up in asset prices would need coordination, since any mismatch between economies is likely to lead to significant fluctuations in exchange rates. If Governments raise interest rates ahead of their trading partners, particularly the United States, they would see their currencies continue to strengthen, possibly retarding exports and choking off recovery. On the other hand, coordination in tightening monetary policy is complicated by varied growth performance across the subregion. Resilient economies would face greater demand-side pressure for monetary tightening, whereas economies that have just begun to see growth recovery might need to maintain supportive monetary policies.

Policy coordination accelerates. East and North-East Asian countries were notable among other parts of the ESCAP region for taking the lead in policy cooperation to combat impacts of

FIGURE 37. Budget balance as a percentage of GDP of major East and North-East Asian economies, 2007 to 2009

Note: Budget balance for Mongolia and Russian Federation includes grants.
the crisis. Cooperation moved to new heights among the major economies of Japan, China, the Republic of Korea and the Russian Federation. The three first-named played a leading role in 2009 in the financial response of Asia and the Pacific to the crisis through the multilateralization of the ASEAN+3 Chiang Mai Initiative, as well as the expansion of bilateral currency swap arrangements between the Republic of Korea and the other two East Asian economies in late 2008. The Russian Federation and China have deepened their cooperation through the Shanghai Cooperation Organisation framework as well as on a bilateral basis. In October 2009, the two economies moved towards deeper integration in trade and investment related to the supply of energy from the Russian Federation to China, an area of enormous future potential in subregional cooperation. The two economies have also been at the forefront of proposals to expand the system of world reserve currencies and increase the use of IMF special drawing rights (SDRs).

Outlook and policy challenges

By mid-2009 all economies were showing signs of a rebound. Growth is forecast to rise from the setback of -1.1% in 2009 to 4.0% in 2010 (table 8). Yet risks remain – the recent rebound could quickly turn into a second dip if global financial weakness returns, or if Governments exit prematurely from expansionary macroeconomic policies, and the private sector does not fill the investment gap. The key question is how to turn the recent rebound into a sustained recovery.

From rebound to sustainable recovery. Developments in the East and North-East subregion remain strongly influenced by China. If China is taken out of the equation, the growth rate for the rest of the subregion is below that of other Asia-Pacific subregions. Stimulus spending by China has increased domestic investment and consumption and therefore increased the demand for imports from the subregion. For example, China in 2009 became the most important Japanese trading partner, overtaking the United States. Similarly, the increase in exports of the Republic of Korea to China in 2009 served to replace much of the loss in exports to developed countries. Such developments point to a possible trend in the medium term among neighbouring economies – that of supplying goods destined for final demand in China rather than for processing and export by China to supply final demand in developed countries.

China is expected to continue to lead growth, expanding by 9.5% in 2010, with investment in infrastructure helping to remove supply-side constraints and spur even faster growth beyond 2010. A brighter economic outlook should also encourage further investment by the private sector. China is likely to emerge in 2010 as the world’s second-largest economy.

Much depends on what happens in Japan. Even though Japan should benefit from a revival in external demand and achieve positive growth of 1.3% in 2010, domestic demand remains weak and business investment has yet to sustain recovery. Consequently, Japan and other developed countries appear to be converging in an equilibrium of slower growth. That would hinder the return of East and North-East Asian economies to high growth unless they can consume more, save less and integrate more quickly among themselves and with other rapidly growing Asian and Pacific economies, notably that of India. Much remains to be done in liberalizing trade and investment and removing regulatory bottlenecks while improving employment conditions in order to help boost private consumption.

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After two years of recession, the Democratic People’s Republic of Korea\(^a\) showed positive economic growth in 2008; yet growth remains constrained. The global financial crisis appears to have had limited, if any, impact on the economy, given the limited integration of the economy with the external world. The country has suffered its own financial difficulties: the complications arising from a revaluation of its currency in November 2009. Inflation has followed, causing severe difficulties for poorer sections of the population in purchasing necessary goods.

Trade flows remain small. It is estimated that imports continue to outpace exports resulting in a trade deficit of around $1.5 billion in 2008. Investment is hampered by foreign exchange constraints that limit the import of capital goods needed for technological upgrading. Other constraints such as outdated trade laws and the lack of comprehensive and coherent foreign investments policy remain to be addressed.

Insufficient availability of energy has been a major constraint for sustainable economic growth and social welfare. Considerable unexploited resources remain; only 30% of hydropower resources have been developed, representing nearly half of the electricity used by industry. No oil or natural gas is produced, requiring that they or their refined products be imported.

Difficulties in the agricultural sector and their impact on food security for the population have been of great concern. Food production fell sharply over the past decade. In addition to geographical and climatic constraints, production during both the agricultural seasons has been severely limited by input shortages of mechanized equipment; quality seeds, fertilizer, pesticides, fuel and plastic sheeting, as well as labour. In recent years food imports have been reduced in a disturbing trend to offset the cereal shortfall, presenting further challenges for vulnerable groups within the country. Safety-net programmes that improve access to basic food and other essentials are critical for households unable to meet their essential needs through their own production, purchase or traditional coping mechanisms.

On a more positive note, the major trading partners of Democratic People’s Republic of Korea are its neighbouring economies, namely those of the Republic of Korea, China and the Russian Federation. Being located between the well-established transport systems of those trading partners, the potential for transit of goods by rail and road is big, as is broader economic cooperation between Democratic People’s Republic of Korea and North-East Asia. It was also reported recently that the country has upgraded the status of a free trade zone near its border with China and Russian Federation, that potentially will boost foreign investment.

\(^a\) Despite the paucity of reliable information for some economies, the current survey endeavours to cover all members of ESCAP, including the Democratic People’s Republic of Korea. However, in the absence of comprehensive economic and social data, it is very difficult to present a complete and accurate macroeconomic picture. The information here was obtained from secondary sources.

Benefiting from strong growth in China, the Republic of Korea is expected to resume positive growth in 2010, at a rate of around 5.2%. Taiwan Province of China should also be able to take advantage of economic growth in the region and grow by around 4.5% in 2010, though this will depend on the performance of the all-important export sector. Hong Kong, China, given its closer integration with the Chinese economy, should benefit from a strong performance in China and be able to grow by 4.5% in 2010. Mongolia should benefit from the Oyu Tolgoi investment. Its economy should expand by 6.5% in 2010.

**NORTH AND CENTRAL ASIA**

North and Central Asia is the subregion worst affected by the global economic crisis. In 2008 its economy had grown by 5.8%; in 2009, following the crisis, its economy shrank by 5.8% (table 9). Millions of people who had recently moved out of poverty saw themselves slide quickly back while unemployment rose, real wages declined and prices of basic necessities shot up. Countries that depended on foreign-exchange remittances also came under pressure as a result of the shrinking economy in the two main migrant
most Central Asian countries, became a channel of instability and declined economic growth, unlike for the rest of Asia and the Pacific where workers’ remittances showed more resilience and support for domestic demand.

The five net fuel exporters suffered a steep decline in export revenue as a result of lower oil prices. All have since seen inflation fall, often because of lower prices for food and oil; nevertheless inflation rates remain stubbornly high in a number of countries and can be expected to continue to face upward pressures as demand picks up.

Overall, the crisis brought vulnerabilities to the fore that should be carefully tracked and for which remedial policy responses are essential. For workers and families, the recovery process will be long and slow.

In 2009 Governments faced two main tasks. The most immediate was to contain the worst of the socioeconomic fallout. As was the case in other subregions, North and Central Asian countries adopted expansionary fiscal and monetary policies, combined with measures to stabilize their banking sectors. Governments had little choice but to meet their pledges to increase social spending and finance ongoing infrastructure projects, leading to widened fiscal deficits.

The second task was to maintain their resolve in market reforms – just when some of the basic market-economy fundamentals were being questioned all over the world. Despite the temptation to turn their backs on previous policies, Governments on the whole did not waver and continued their market reforms. In fact, reforms in the financial and banking sectors, combined with cautious macroeconomic management policies over the past decade, improved their overall resilience to financial crisis. Many economies

### TABLE 9. Rate of economic growth and inflation in North and Central Asian economies, 2008 to 2010

(Percentages)

<table>
<thead>
<tr>
<th></th>
<th>Real GDP growth</th>
<th>Inflation&lt;sup&gt;a&lt;/sup&gt;</th>
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<tr>
<td></td>
<td>2008 2009&lt;sup&gt;b&lt;/sup&gt; 2010&lt;sup&gt;c&lt;/sup&gt;</td>
<td>2008 2009&lt;sup&gt;b&lt;/sup&gt; 2010&lt;sup&gt;c&lt;/sup&gt;</td>
</tr>
<tr>
<td>North and Central Asia&lt;sup&gt;d&lt;/sup&gt;</td>
<td>5.8 – 5.8 3.7</td>
<td>14.4 10.7 7.9</td>
</tr>
<tr>
<td>Armenia</td>
<td>6.8 – 14.4 1.5</td>
<td>9.0 3.4 4.0</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>10.8 9.3 7.0</td>
<td>20.8 1.5 6.0</td>
</tr>
<tr>
<td>Georgia</td>
<td>2.1 – 4.0 2.0</td>
<td>10.0 1.7 5.5</td>
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<tr>
<td>Kazakhstan</td>
<td>3.3 1.0 2.0</td>
<td>17.0 7.3 7.0</td>
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<td>Kyrgyzstan</td>
<td>7.6 2.3 3.0</td>
<td>24.5 6.8 8.6</td>
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<td>Russian Federation</td>
<td>5.6 – 7.9 3.5</td>
<td>14.1 11.7 8.1</td>
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<td>Tajikistan</td>
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<td>Turkmenistan</td>
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<tr>
<td>Uzbekistan</td>
<td>9.0 8.1 8.0</td>
<td>12.7 8.0 8.5</td>
</tr>
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</table>

<sup>a</sup> Refer to percentage changes in the consumer price index. <sup>b</sup> Estimates. <sup>c</sup> Forecasts (as of 15 April 2010). <sup>d</sup> Calculations are based on GDP figures at market prices in United States dollars in 2007 (at 2000 prices) used as weights to calculate the subregional growth rates.

from the subregion showed they were better prepared for a financial crisis than during the last one of 1997.

**Impact of the crisis**

Economic growth has been mixed. The crisis impacted the Russian Federation severely, where lack of access to international financing during the early part of the crisis was further exacerbated by the sharp declines in commodity prices. Furthermore, its deep economic and socio-political ties with the rest of the subregion left no country unaffected. Armenia, suffering a 14.4% decline in growth, was the worst affected economy, not only in the subregion but the entire Asia-Pacific region. The orientation of the Russian Federation to Europe and other developed markets had increased over time and left it vulnerable, as trade, investment and financial flows from developed countries plummeted. A sharp fall in remittances from Armenians working abroad caused much hardship, given that in 2008 remittances accounted for a 8.9% share of its GDP. Consequently, the remittance-fuelled construction boom halted sharply, with the sector contracting by more than 50% during the first three quarters of 2009.

**Reforms in the financial and banking sectors, combined with cautious macroeconomic management policies over the past decade, improved their overall resilience to financial crisis**

Kazakhstan is one of five net exporters of fuel in the subregion with an economy highly dependent on oil revenues. It was impacted heavily by the crisis as well as reduced oil and other commodity prices. GDP was expected to grow by 1% in 2009. From mid-2009, however, Kazakhstan experienced a deceleration in the pace of decline in industrial production, being the first sign that the Government’s stimulus package for industrial and infrastructure projects including small- and medium-scale enterprises was yielding a positive effect.

Georgia also featured among those countries of the subregion that experienced negative economic growth, due to its relatively high exposure to the crisis-hit developed countries and the collapse in demand for its foodstuffs and manufactured exports. Domestic instability further exacerbated lacklustre economic performance.

On a more positive note, Azerbaijan, Turkmenistan and Uzbekistan emerged as the fastest-growing economies in the subregion. They are relatively less open and thus rather more reliant on domestic demand for economic growth. They also have had the fiscal space to implement countercyclical measures. Uzbekistan is one of the fastest-growing economy of all, buoyed by increases in the price of gold and a good grain harvest. Industrial output has led the recent developments, growing by 9% in 2009, with gross fixed investment particularly in the construction sector growing by about 30%. Household consumption has remained strong, with a growth in retail trade of 16.6%. In fact, growth in private consumption could have been higher except for the decline in remittance inflows from workers in the Russian Federation and Kazakhstan. In Azerbaijan, expansion in the industrial sector has made a major contribution to economic growth.

Increased grain harvests over the year provided relief, particularly for those countries that experienced high unemployment, helping to ensure supplies for their own people and exporting to countries outside the subregion such as Afghanistan. For both the Russian Federation and Kazakhstan, exports of wheat and fuel continued to play a key role in subregional trade.

**Inflation decelerated.** After having experienced the highest inflation rates seen in recent years in 2008, inflation decelerated in 2009 across all countries owing to weakened domestic demand and reduced commodity prices, particularly for energy and food. Notwithstanding that trend, inflation is expected to remain stubbornly high, at or close to double digit-levels, particularly in the Russian Federation and Turkmenistan (table 9). In Kyrgyzstan, consumer price inflation decelerated from 24.5% in 2008 to 6.8% in 2009. However, continuing power shortages
Economic crisis resulted in a sharp decline in current account and foreign trade surpluses across the region (figure 38). The impacts varied among the more closed economies that were less affected. Stagnant real wage growth and limited access to credit brought a sharp drop in imports. However, continued import dependence on essential food products, as well as machinery and equipment to complete hydrocarbon projects and improve infrastructure, resulted in declines in imports that were less than those in exports. Trade deficits therefore widened across the entire subregion (table 10). Surpluses on the current transfers and income accounts also fell, as lower inflows of remittances and other private transfers further exacerbated balance of payment pressures.

The current-account surplus of Turkmenistan remained positive in 2009 (figure 38) despite disruptions in natural gas exports to the Russian Federation. Nevertheless, that surplus was

and a doubling in the cost of gas imports are expected to create significant upward pressure on inflation in 2010. The Government of Turkmenistan has tried to control inflation by reducing the amount of cash in circulation through a currency reform process, given its underdeveloped capital and money markets and the lack of alternative monetary policy tools at its disposal.

In contrast, inflation in Armenia, Azerbaijan and Georgia remained at modest levels (table 9). For Armenia and Georgia, it was symptomatic of the steep decline in economic activity. In contrast, Azerbaijan experienced high growth. Inflation there in 2008 peaked at 20.8%, its highest of the past decade. The 2009 rate of 1.5% was the result of weak growth in domestic demand and reduced international oil prices. Recent rises in fuel and basic utility prices and increased cost of imported goods could soon drive the inflation rate up again.
expected to account for 20.4% of GDP as gas exports resumed and tensions eased by year-end. Exports to China and the Islamic Republic of Iran increased. Similarly, in Uzbekistan, rising global prices on its principal exports of gold, gas, and cotton were expected to sustain the export revenues in 2009. Hydrocarbons also became a more important source of income than in the past. Uzbekistan benefited from a renegotiated agreement with the Russian Federation regarding natural gas exports, with the result that it was the only country that experienced slower declines in exports in 2009.

FDI inflows remained a key priority and continued to play a key role in developing and modernizing the economies of North and Central Asia in 2009. However, a more difficult international economic environment limited new FDI into the subregion. Tight credit conditions and the economic downturn adversely impacted FDI flows into the Russian Federation. FDI in non-financial sectors fell by more than 50% to $17.3 billion in the first half of 2009, compared with $39.6 billion received in the first six months of 2008. Similarly in Georgia, FDI declined from $1.5 billion in the first four months of 2008 to $972 million in the corresponding period of 2009.

Remittances made a major socio-economic contribution in low-income countries accounting for one third and one quarter of GDP in Tajikistan and Kyrgyzstan, respectively in 2008 (table 11).

Up to one third of Tajikistan migrants are estimated to have returned home in 2009 and remittance inflows could have fallen by 60%. A 30% fall in remittance inflows was expected in Kyrgyzstan in 2009.

Policy responses

Governments reacted quickly to the crisis by implementing expansionary monetary and fiscal policies, in line with expansionary policies implemented at the global level. As the crisis evolved and Governments assumed more active man-

\[\text{TABLE 10. Trade performance of North and Central Asian economies, in percentages, 2007 to 2009}\]

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Armenia</td>
<td>17.0</td>
<td>-8.3</td>
<td>-34.0</td>
<td>49.1</td>
<td>35.4</td>
<td>-25.3</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>63.4</td>
<td>43.8</td>
<td>-69.2</td>
<td>14.7</td>
<td>25.3</td>
<td>-14.6</td>
</tr>
<tr>
<td>Georgiaa</td>
<td>31.6</td>
<td>21.4</td>
<td>-35.3</td>
<td>41.8</td>
<td>20.9</td>
<td>-37.7</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>24.8</td>
<td>49.1</td>
<td>-39.3</td>
<td>38.3</td>
<td>15.7</td>
<td>-25.0</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>45.8</td>
<td>24.3</td>
<td>-22.4</td>
<td>55.6</td>
<td>46.1</td>
<td>-25.3</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>16.8</td>
<td>32.9</td>
<td>-35.5</td>
<td>45.0</td>
<td>33.7</td>
<td>-37.3</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>4.9</td>
<td>-4.2</td>
<td>-28.3</td>
<td>42.5</td>
<td>33.2</td>
<td>-21.5</td>
</tr>
<tr>
<td>Turkmenistanb,c</td>
<td>12.9</td>
<td>52.7</td>
<td>-46.6</td>
<td>41.5</td>
<td>54.8</td>
<td>-28.8</td>
</tr>
<tr>
<td>Uzbekistanb,c</td>
<td>42.9</td>
<td>29.2</td>
<td>-3.8</td>
<td>49.2</td>
<td>23.4</td>
<td>19.5</td>
</tr>
</tbody>
</table>

Notes: a 2009 data refer to first 2 quarters.
b Import value in f.o.b.
c Figures for 2008 and 2009 are EIU estimates for whole year.
agement of the economy, policy debate intensified on what that might mean for the role of the State in a market economy. How should Governments direct and regulate the economy in order to temper the excesses and instabilities to which unbridled capitalism was prone? – while also enhancing openness and transparency in governance and consultative processes among all stakeholders. The challenges were a reminder of the complex issues that will remain after the crisis subsides.

Most countries had to augment their funding of social assistance, social insurance and nutrition programmes while implementing additional measures to protect the delivery of essential social services.

The crisis exacerbated longstanding imbalances in public pension systems. Sharp declines in economic growth and high unemployment reduced revenue contributions at the same time that expenditures were increasing and values on the asset side of balance sheets were dropping rapidly. A concomitant challenge arose from the decline in commodity prices. In countries that are resource dependent, the flow of public revenues is closely associated with commodity prices. Even though oil-producing and exporting countries entered the crisis with significant fiscal space, fiscal deficits rose sharply in those countries. The Russian Federation, having accumulated relatively large reserves in stabilization funds during the period of high commodity prices that preceded the global crisis, implemented one of the largest countercyclical packages in the world (at 7.2% of 2008 GDP) and consequently saw fiscal deficits rise sharply for the first time since 2000.

Other countries entered the crisis with constrained fiscal space. In Armenia, the budget deficit rose from 1.2% of GDP in 2008 to 6.6% in 2009, as in other subregions, substantial increases in State spending were directed at countering the adverse impact of the crisis on the economic security and social wellbeing of the peoples of the subregion. Public investments in large infrastructure projects accelerated. However, the substantial declines in remittance inflows created serious difficulties for poor households that for years had come to depend on remittances as a way of coping with poverty.

Remittances made a major socio-economic contribution in low-income countries

In 2009, as in other subregions, substantial increases in State spending were directed at countering the adverse impact of the crisis on the economic security and social wellbeing of the peoples of the subregion. Public investments in large infrastructure projects accelerated. However, the substantial declines in remittance inflows created serious difficulties for poor households that for years had come to depend on remittances as a way of coping with poverty.

### TABLE 11. Receipts of workers’ remittancesa in major North and Central Asian economies, 2006 to 2008

<table>
<thead>
<tr>
<th>Country</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>Percentage of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Armenia</td>
<td>658.1</td>
<td>845.9</td>
<td>1,062.1</td>
<td>10.3, 9.2, 8.9</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>812.5</td>
<td>1,287.3</td>
<td>1,554.3</td>
<td>3.9, 4.1, 3.4</td>
</tr>
<tr>
<td>Georgia</td>
<td>485.3</td>
<td>695.7</td>
<td>732.1</td>
<td>6.3, 6.8, 5.7</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>187.5</td>
<td>223</td>
<td>191.5</td>
<td>0.2, 0.2, 0.1</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>481.2</td>
<td>714.8</td>
<td>1,232.4</td>
<td>17.0, 19.1, 24.4</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>1,018.8</td>
<td>1,690.8</td>
<td>1,750.0</td>
<td>36.2, 45.5, 34.1</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
</tr>
</tbody>
</table>

Note: a Including compensation of employees.
in 2009. The Government had to raise the legal maximum permitted budget deficit so that it could accommodate the spending increases for social and other support programmes (figure 39). The deficit in Georgia rose to 8.9% in 2009, compared with an already high deficit of 6.3% of GDP recorded in 2008. Despite higher revenues received from corporate profit tax linked to rising oil prices, Azerbaijan is expected to record one of the highest fiscal deficit of the subregion in 2009, because of continued expenditure increases on social spending and large infrastructure projects. Any shortfall in donor financial support, arising from the impact of the crisis and the deepening debt problems in some countries of the European Union, is of major concern to all of them.

**Accommodative monetary policy.** Governments in the subregion aimed at two key targets in monetary policy: curbing inflation and providing exchange-rate stability. Central banks had to reduce interest rates to alleviate the burdens of domestic businesses that ranged from wide interest-rate spreads from high crisis-related business risks, to low capitalization of businesses, to overall weak institutional capacity. At the same time, declining commodity prices, combined with weak demand, dampened inflationary pressures and allowed for monetary policy to focus on maintaining financial stability and supporting domestic economic activity.

As capital flows reversed, strong downward pressures on exchange rates emerged in most countries of the subregion (figure 40). In the Russian Federation, monetary policy in 2009 was aimed at avoiding a large, uncontrolled devaluation of the rouble and maintaining a nominally stable rate of exchange for the rouble against a dual-currency basket of a 55:45, dollar-to-euro proportion. As the rouble stabilized,

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**FIGURE 39. Budget balance as a percentage of GDP in North and Central Asian economies, 2007 to 2009**

![Graph showing budget balance as a percentage of GDP in North and Central Asian economies, 2007 to 2009.](image)

**Note:** Data for 2009 are estimates.  
**Sources:** ADB, *Key Indicators for Asia and the Pacific 2009*, available from www.adb.org/Documents/Books/Key_Indicators/2009/default.asp (accessed 3 Nov. 2009); and ESCAP estimates.
and more recently appreciated, the Russian central bank cut its refinancing rate by 425 basis points to 8.75% and reduced cash reserve requirements to improve liquidity in the domestic economy.

Similarly in Kazakhstan, falling inflation and weak domestic demand provided space to loosen monetary policy in 2009. The Government intervened quickly to stabilize liquidity shortages in the banking sector. Another concern was the possibility that tight credit markets could dampen growth in the non-oil economy, thereby jeopardizing diversification targets in the “Kazakhstan 2030” development strategy. Consequently, the National Bank of Kazakhstan cut the refinancing rate to 7% and reduced cash reserve requirements for commercial banks. Its decision to allow the trading band of the tenge to widen to a range of 127.5 to 165.0 beginning from 5 February 2010 is likely to lead to an appreciation of the domestic currency that will help offset local demand for foreign currency.

The Government intervened quickly to stabilize the slowdown in credit growth.

Reform agenda and integration. Much of the rapid economic development in the subregion prior to the global crisis has resulted from increased integration with other developing as well as developed countries – mainly through trade and investment, particularly in natural resources, as well as remittances. Foreign exchange earnings rose substantially, enabling the countries of the subregion to boost imports and achieve high GDP growth. During the crisis, despite rising protectionist pressures and the temptation to reverse externally oriented growth policies, countries generally maintained their commitment to keeping trade, investment, finance and labour markets open. Reforms to improve the business climate and to encourage FDI continued. Kyrgyzstan moved up the global ranking from 80 to 41 in ease of doing business, by having implemented reforms in 7 out
of the 10 areas measured in the report “Doing Business 2010”. Furthermore, countries in the process of accession to WTO continued their efforts, despite the complexities. The Russian Federation, notwithstanding an accession process almost 20 years long, remains committed to join, at the same time pursuing other trade agreements – for example, the Customs Union with Kazakhstan and Belarus (box 3). Attention has already focused on economies in Asia and the Pacific because of growing complementarities. In December 2009, the Russian Federation opened its Siberian oil export route which is expected to carry annually 80 million tons of oil eastwards. The Russian Federation has also emerged as an important supplier of liquefied natural gas to Asia.

Outlook and policy challenges

The growth prospects of the economies in North and Central Asia in 2010 depend on trends in global commodity prices and the performance of the Russian Federation and Kazakhstan, which are the largest trading partners, important investors and major sources of remittances for other economies in the subregion. A return to positive growth is expected in all countries and, for the subregion as a whole, the growth rate for 2010 is forecast at 3.7%.

Strong domestic demand and increased oil and gas production should enable the economy of the Russian Federation to continue its expan-
sion at 3.5% in 2010. However, inflationary pressures could persist, however, because of marked deterioration in fiscal deficits, rising capital inflows and stronger domestic demand. In Kazakhstan, positive economic growth of 2% is forecast in 2010 owing to continued strong investment in oil-sector projects and rising prices for hydrocarbons and metals. The fastest growing economies are expected to be those of Turkmenistan and Azerbaijan at 7%, and Uzbekistan at 8%. Kyrgyzstan and Tajikistan are expected to develop their energy resources and infrastructure and to increase energy self-sufficiency with technical and financial assistance from the Russian Federation. They will need additional international assistance to sustain economic development and solve problems of poverty, infrastructure repair and capacity-building. GDP growth of both economies is expected to accelerate to about 3.0% or more in 2010.

Looking beyond 2010, the subregion is expected to expand trade and investment cooperation with the rest of Asia and the Pacific. Complementarities between countries rich in natural resources and energy, and those experiencing a rapid demand for such resources, will drive the process. Cooperative agreements are expected to increase and could include science and technology aspects, with a particular focus on drawing from experience and expertise available in East Asia regarding adapting to and mitigating climate-change challenges. Improving environmental management in water, agriculture and energy resources, and building up a low-carbon infrastructure that is less resource-intensive are promising new growth areas of the future that should deepen relations with the rest of Asia and the Pacific.

OCEANIA

Many of the characteristics of Pacific island economies have always impeded their development: their geography, narrow resource bases, frequent natural disasters and fragile ecosystems that are vulnerable to rising sea levels. Those characteristics cannot be changed. Yet, signs are emerging that some of the givens are being reshaped to enable the subregion to sustain and diversify its pattern of growth.

The crisis was transmitted to Oceania through declining demand for exports, falls in tourism and remittance earnings, etc

Pacific countries have benefited increasingly from development of tourism and related transport services as well as remittances that provide resource for business investment and support to poor households. Some have benefited from windfall gains in high, albeit sharply fluctuating, commodity prices. But as they grow more dependent on those income sources, they become more vulnerable to global economic shocks.

In this crisis, the major economic and trade partners were the hardest hit. From within the subregion Australia and New Zealand which are key economic partners of Pacific economies, also experienced marked slowdowns. Not surprisingly, the crisis was transmitted to Oceania through declining demand for exports, falls in tourism and remittance earnings, and the changes in oil prices, since they have high transportation costs. For some Pacific island countries, incomes from off-shore trust funds were reduced as well. The challenge ahead is to find ways to continue diversifying their economies while managing any resulting instabilities.

Impact of the crisis

GDP growth in the subregion was 2.0% in 2008, but slowed to 1.0% in 2009 (table 12).
Excluding Australia and New Zealand, growth in 2009 was actually 1.9%. In line with experience in other subregions, inflation peaked in 2008, following a surge in commodity prices; but fell again in 2009 as international prices and aggregate demand dropped.

**Developed countries’ performances varied**

The extent and the magnitude of the impacts on the economies in Oceania varied (table 12). In comparison with other developed countries, Australia managed to weather the global economic crisis relatively well, maintaining positive although very low growth in its 19th year of economic expansion. The Australian performance in turn supported Pacific island economies through an early recovery of tourism. Australia’s positive performance is attributable to the significant easing of monetary policy and fiscal expansion as well as the healthy state of the financial sector. Export demand for resources from its major trading partners in Asia remained relatively strong with the result that Australian

| TABLE 12. Rate of economic growth and inflation in countries in Oceania, 2008 to 2010 |
|------------------------------------------|----------|----------|----------|
|                                        | 2008     | 2009     | 2010     | 2008     | 2009     | 2010     |
| **Real GDP growth**                     |          |          |          |          |          |          |
| Oceaniađ,e                              | 2.0      | 1.0      | 2.3      | 4.4      | 1.9      | 2.5      |
| Australia                               | 2.3      | 1.2      | 2.4      | 4.4      | 1.8      | 2.5      |
| Cook Islands                            | −1.2     | −0.1     | 0.8      | 7.8      | 6.5      | 6.3      |
| Fiji                                    | −0.1     | −2.5     | 1.9      | 7.7      | 3.7      | 3.4      |
| Kiribati                                 | 3.4      | 1.5      | 0.8      | 18.6     | 6.6      | 5.9      |
| Marshall Islands (the)                  | −2.0     | 0.5      | 0.5      | 17.5     | 9.6      | 5.9      |
| Micronesia (Federated States of)        | −1.0     | 0.5      | 0.5      | 6.8      | 2.9      | 7.4      |
| Nauru                                   | 1.0      | 1.0      | 2.0      | 4.5      | 1.8      | 2.3      |
| New Zealand                             | −0.5     | −0.5     | 1.8      | 4.0      | 2.1      | 2.0      |
| Palau                                   | −1.0     | −3.0     | −1.0     | 12.0     | 5.2      | 6.7      |
| Papua New Guinea                        | 6.7      | 4.5      | 8.5      | 10.6     | 6.9      | 7.1      |
| Samoa                                   | −4.9     | −0.8     | 0.5      | 11.5     | 6.1      | 6.9      |
| Solomon Islands                         | 6.9      | 0.4      | 2.4      | 17.2     | 8.0      | 7.0      |
| Tonga                                   | 1.2      | 0.4      | 0.4      | 10.4     | 1.6      | 1.9      |
| Tuvalu                                  | 1.5      | 1.0      | 1.6      | 5.3      | 3.8      | 3.5      |
| Vanuatu                                 | 6.6      | 3.0      | 4.6      | 4.8      | 4.5      | 5.0      |

exports remained unchanged in volume terms despite the sharp contraction of global trade.72 Domestic demand was buoyed by growth in public consumption and moderate growth in private consumption, offsetting the decline of fixed investment in the first half of 2009. Household consumption regained strength, helped by Government transfer payments as part of the stimulus package, and lower interest rates that reduced the burden of mortgages. As housing and equity prices strengthened, the increase in household wealth further encouraged private consumption.

The New Zealand performance was more dismal. The country experienced five consecutive quarters of contraction with marked deterioration in business investment and subdued wage growth, combined with marked reduction in working hours, resulting in a sharp decline in household earnings growth. The sharp fall in imports since the beginning of 2009 exceeded export declines, resulting in trade surplus for the first two quarters in 2009. Nevertheless, by the second quarter of 2009, the acute phase of the crisis appeared over as business and consumer sentiments started to improve. Other contributing factors were positive disposable income growth following a tax cut in April 2009, moderation of oil prices, a housing-market recovery supported by lower interest rates, and a long-term demand for housing in response to migration inflows.

**Varied growth among commodity exporters**

While the crisis affected all the Pacific island economies, Papua New Guinea suffered less than others, mainly owing to its healthy foreign exchange reserves and domestic bank liquidity resulting from the commodity boom years. Parallels can be drawn with other oil-exporting countries of Central Asia and South-East Asia. Even though growth decelerated to a more modest rate of 4.5% in 2009, Papua New Guinean’s economy was supported by Government spending on infrastructure as well as lending to the private sector, which rose by 41% in 2008 and 21.3% in 2009. The resulting increase in budget deficit was financed by trust funds the Government had accumulated during the commodity boom. Further support came from gold, which has remained at a record high in reaction to economic uncertainty. Another positive outcome of the commodity boom has been the gains in formal employment in recent years: 8.4% growth from March 2007 to March 2008 and 3.8% to June 2009.

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prices for phosphate and physical damage to its port halted sales of phosphate from Nauru to Australia. In 2010 the economy is expected to expand by 2%.

**Hit hard: tourism- and remittance-dependent economies**

In 2009, a combination of severe flooding at the beginning of the year, declining tourism arrivals and reduced earnings from sugar exports resulted in a contraction in economic growth of 2.5% in Fiji. The decline in the European Union (EU) preferential price for sugar and the continuing poor performance of the sugar mills, despite extensive refurbishment exacerbated the situation further. Under the terms of the new EU sugar policy agreed with the WTO, the EU sugar price declined by 36% over the past 3 years to October 2009. While it is true that the EU sugar price is still higher than the world market price, which is already at historical highs, those price changes contributed to the sizeable reduction of export earnings. The 20% devaluation of the Fijian dollar in April 2009 partly offset the decline in the EU sugar price, while the adoption of the new Cane Quality Payment system to replace payment on tonnage is expected to result in quality improvements.

The economy of Palau contracted by 1%, due to a 10.1% fall in tourist arrivals in 2008. The closure of a charter-flight operator from Taiwan Province of China, and the declining number of visitors from crisis-struck countries, notably Japan and the Republic of Korea, saw tourist arrivals contract by 11.3% in 2009, while GDP is expected to have contracted by 3%.

In contrast, Vanuatu grew at 3% in 2009 and has become one of the few countries that resisted the global economic downturn with strong growth in tourism. The services sector contributed approximately 77% of total GDP in 2007 and is estimated to have grown by 6.6% in 2008. This is partly attributable to the reform of its international air transport sector and more recently its telecommunications sector, which increased both fly-in tourists and visits by cruise liners. It is also believed that visitors to Vanuatu increased owing to security worries emanating from political conflict in other Pacific island countries.

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**Vanuatu weathered the global economic downturn thanks to strong growth in tourism**

Samoa and Tonga, the countries that rely most heavily on remittances among Pacific island countries (table 15), were struck by a devastating tsunami in September 2009 that decimated their income-earning capabilities.

While the real GDP of Samoa improved to -0.8% in 2009 after a 4.9% contraction in 2008, recovery of production will take much longer. Losses by the tsunami are estimated at around 20% of 2008 GDP. Reconstruction costs may rise to $154 million. Substantial aid will be needed for rehabilitation of the economic sectors and villages. Samoa was also affected by job losses due to the ongoing restructuring of the operation of a firm which assembles wire harnesses for automobile plants in Australia. About one third of workers of the firm were reported to have been laid off.

In Tonga, the economy grew at 0.4% in 2009, still struggling to recover from the sharp fall in commerce and tourism in 2006 as well as the tsunami which caused extensive damage and wiped out two remote villages. The difficulty in reaching those villages will make their rehabilitation very difficult, even though the reconstruction of Nuku’alofa is expected to stimulate the economy, with loans from China, Australia and New Zealand amounting to about 120 million pa’anga.

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Dependence on public sector in small atoll countries

In Kiribati, the economy is expected to grow at 1.5% in 2009, reflecting a slight expansion in fisheries and public administration. The public sector has been a dominant contributor to the economy of Kiribati, providing almost two thirds of all paid employment and contributing half of GDP. Almost half of the national income comes from external sources including fishing license fees, sea farers’ remittances, official development assistance and revenue from offshore investment, or the Revenue Equalization Reserve Fund (RERF). Fishing license revenue fees alone financed about 40% of Government revenue in 2008 (excluding RERF).

The economy of Tuvalu grew by 1% in 2009, with continued support from Government expenditure, a major player for an economy with a narrow economic base. The global crisis negatively affected the country’s fiscal position through the sharp fall of the Tuvalu Trust Fund, which is mostly invested in offshore markets, although the impact was somewhat mitigated by the provision of financial assistance from Australia and New Zealand.

Both the Marshall Islands and the Federated States of Micronesia barely managed to achieve any economic growth in 2009 (0.5%). Both countries continued to depend heavily on financial assistance from the United States under the Compact of Free Association Grants, amounting to about one quarter of the GDP of the Federated States of Micronesia and about 64% of projected revenue and grants of the Government budget in the Marshall Islands. In the latter, the opening of a new fish filleting factory was partly offset by reduced employment in the U.S. military base in Kwajelein.

Inflation lower, wide variation

As in other subregions, inflation rates decelerated in 2009 along with the fall in commodity prices and weak demand (table 12). In Australia and New Zealand, inflation moderated to around 2% (year on year) in 2009; producer (input) prices plunged from peaks of 2008. Further-

more, the sharp decline in wage inflation reduced labour costs of production in New Zealand.
the kina against major trading partners’ currencies (for example, the Australian dollar). Similarly, inflationary pressures remain in the Solomon Islands and Samoa, where the respective Governments have incurred large expenditure and currencies have depreciated.

In Nauru, the Australian inflation rate has been used as a proxy since the country uses the Australian dollar as its currency and Australia supplies about 60% of its imports. Recently the Nauru Bureau of Statistics started to compile its own consumer price index, which indicates much higher inflation than that in Australia. Particularly high levels were recorded for clothing (62.5%) and food (12.5%) from January to August 2009.

External sector affected by volatilities in commodity prices, tourism and remittances

While a handful of countries enjoy sizeable earnings from commodity exports, many island countries in Oceania are characterized by balance-of-payment deficits with disproportionately large imports compared to merchandise exports. Tourism earnings, remittances and income from trust funds are not enough to offset the structural trade imbalance fully. For instance, Samoan exports account for only a small share (4% to 5%) of imports; the huge deficit in merchandise trade is partly offset by tourism, and largely offset by remittances. Still, the current account remains in deficit (figure 41).

FIGURE 41. Current account balances as a percentage of GDP of the countries in Oceania, 2007 to 2009

Note: Data for 2009 are estimates.
Fuel and food account for a large share of the imports for many countries in Oceania. The recent volatility in commodity prices has significantly affected their imports and thus their trade balances. For example, Fijian merchandise imports increased by almost 25% due to higher costs for petroleum products in 2008, followed by a fall by 30% over the first 9 months of 2009, owing to lower prices of international commodities and fuels. Similar situations prevailed in many of the other island countries. Growth of Vanuatu imports in 2008 also reflected the increase of commodity prices as well as increase in imports of capital equipment in connection with major infrastructure projects.

On the other hand, some commodity exporters (Australia, New Zealand, Papua New Guinea, Solomon Islands and Vanuatu) benefited from high commodity prices during 2008. Declines in primary commodity prices towards the end of 2008 (table 13) slashed export revenues, albeit with variations. For instance, high prices for gold, Arabica coffee and cocoa benefited Papua New Guinea, offsetting declines in revenue from other primary exports such as petroleum and copper. Palm oil and copra exporters such as Solomon Islands and Vanuatu also benefited because of increases in prices for bio-fuels.

The recent growth in visitor numbers and revenue earnings from tourism has supported economic growth in the Cook Islands, the Federated States of Micronesia, Fiji, Palau, Samoa, Solomon Islands, Tonga and Vanuatu, turning tourism into one of their most important income-generating sectors (table 14). The extent of the tourism sectoral contribution hinged on a combination of factors including: (a) the economic health and pattern of consumer spending of mostly developed economies which account for the lion’s share of tourist arrivals in the Pacific; (b) price competitiveness including exchange rates against the visitors’ home currencies; (c) transportation links; (d) recent natural disasters; and (e) political stability of the host country.

The global crisis and the consequent reduction in consumer spending led to falling tourist arrivals in the Pacific. For instance, reduction of tourism income in the Federated States of Micronesia and Palau is largely due to the downturn in United States and Japanese consumer spending. Yet visitors from Australia and New Zealand, who account for one third of arrivals in major Pacific destinations,76 started to pick up in the latter half of 2009, supporting countries such as Fiji, Samoa and Vanuatu.

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**TABLE 13. Recent international primary commodity prices, 2007 to 2009**

<table>
<thead>
<tr>
<th>Commodity</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude oil ($ per barrel, average spot price)</td>
<td>71.12</td>
<td>96.99</td>
<td>61.76</td>
</tr>
<tr>
<td>Copper ($ per metric tonne)</td>
<td>7 118</td>
<td>6 956</td>
<td>5 150</td>
</tr>
<tr>
<td>Gold ($ per troy ounce)</td>
<td>697</td>
<td>872</td>
<td>973</td>
</tr>
<tr>
<td>Sawnwood Malaysian ($ per cubic metre)</td>
<td>806.3</td>
<td>889.1</td>
<td>805.5</td>
</tr>
<tr>
<td>Sugar; EC import price (US cents per kg)</td>
<td>68.09</td>
<td>69.69</td>
<td>52.44</td>
</tr>
<tr>
<td>Cocoa (US cents/kg)</td>
<td>195.2</td>
<td>257.7</td>
<td>288.9</td>
</tr>
<tr>
<td>Coffee, Arabica (US cents/kg)</td>
<td>272.4</td>
<td>308.2</td>
<td>317.1</td>
</tr>
<tr>
<td>Palm oil ($ per metric tonne)</td>
<td>780</td>
<td>949</td>
<td>683</td>
</tr>
</tbody>
</table>


Australia is also the main source of visitors for Papua New Guinea, Kiribati and Solomon Islands although the extent of the contribution of tourism to the economy is still limited.

Exchange rate movements have also had a differentiated impact on the tourism in the Pacific subregion. For instance, the 25% decline in tourist arrivals in Fiji at the start of 2009 was mainly due to a sharp appreciation of the Fijian dollar against the Australian dollar (14%) between June 2008 and the first quarter of 2009. A 20% devaluation of the Fijian dollar in April 2009 led to a rebound in tourist arrivals. The higher tourist arrivals in Samoa during the first seven months of 2009 likely reflect the depreciation of the Samoan Tala relative to the Australian and New Zealand dollars in the first half of 2009.

Restructuring of the Pacific airline industry and increased connections to major tourist source countries, accompanied by competitive airfares, have encouraged tourism in Samoa and Vanuatu in recent years. Papua New Guinea also followed suit by partly opening up its international airline services. The closure of a charter-flight operator from Taiwan Province of China to Palau led, however, to a significant reduction in visitors from the second largest source of visitors to Palau.

Similar to tourism, in recent years remittances have become a major source of income in Pacific island countries (table 15) with Australia, New Zealand and the United States absorbing the largest share of workers. For Tuvalu and Kiribati, remittances depend heavily on seafarers’ employment in merchant shipping; the sharp downturn in global trade flows in the first quarter of 2009 have adversely affected them. Although the Australian economy was less badly affected, higher unemployment may have depressed prospects for new migrant workers.

Samoa and Tonga, with GDP ratios of remittance inflows of 25.8 and 37.7% in 2008, respectively, are particularly exposed. The National Reserve Bank of Tonga estimates that remittances fell by 14% and tourist receipts by 5.9% in the year to June 2009. Tuvalu, Kiribati and Fiji are relatively less reliant on remittances. Samoan remittances continued to grow in the first half of 2009 and expected to continue further, with a considerable increase in funds sent home to families in the aftermath of the tsunami.
In 2007 New Zealand launched its Recognized Seasonal Employer scheme for temporary employment of up to 5,000 migrant workers in seasonal activities, particularly fruit picking. All Pacific countries (except Fiji) were to be eligible, with initial focus on five countries: Kiribati, Samoa, Tonga, Tuvalu and Vanuatu. While the scale was limited, the scheme benefited Pacific islands in terms of household and village-level savings and the acquisition of skills and a work ethic. Australia also announced the similar Pacific Seasonal Worker Pilot in 2008, involving temporary migrants from Kiribati, Papua New Guinea, Samoa, Tonga and Vanuatu, with an annual visa quota of 2,500. Again numbers were small, particularly for a larger country such as Papua New Guinea, but the positive impacts from the returning workers could be important with respect to business start-ups, work ethic and expectations about public services. The pilot programme was to be evaluated at the end of 2009 to determine whether the scheme would be renewed and/or expanded beyond the five countries.

Trust funds lose value

Small atoll countries (Kiribati, the Marshall Islands, the Federated States of Micronesia, Palau and Tuvalu) with trust funds that serve as a main source of Government revenue were affected by the crisis. For instance, the value of the Marshall Islands Compact Trust Fund and the Kiribati Revenue Equalization Reserve Fund declined by an estimated 20% during 2008. The losses combined with increased need for fiscal expenditure added to a weakening of the fiscal states in those countries.

Imports in Australia and New Zealand decline sharply

Australia and New Zealand are the major destinations of export products for many Pacific island countries. Around 45% of Papua New Guinean and Samoan exports were destined for Australia in 2007 even though their shares in its imports were negligible. A sharp fall of imports in 2009 in Australia and New Zealand had a significant, albeit varied, impact on many of the Pacific island countries. Australian imports from Samoa halved between 2008 and 2009, while those from Kiribati contracted by 10%.

Policy responses

Policy options and responses to the crisis varied significantly across Oceania. In struggling with rising food and fuel import costs, many Pacific island Governments had implemented measures aimed at providing relief to low-income households, such as reducing customs duties and value-added tax (VAT) on selected consumer goods, and reducing taxes on fuel for transport that in turn reduced public revenues and increased budget deficits. Most of the Governments therefore entered the crisis in weakened positions.
In contrast, the developed economies of Australia and New Zealand had room for large fiscal stimulus packages. Having enjoyed fiscal surpluses in the recent past, their fiscal positions were much better than those of many OECD countries. That in turn brought benefits to Pacific island economies as deep recession was pre-empted in their key trading and economic partners. Australia launched a large fiscal stimulus package that included a $21 billion cash handout to households and public investments in school buildings and public housing. Similarly, in New Zealand a large fiscal stimulus package brought a decade-long record of fiscal surplus to an end in 2009: tax revenues fell because of falling corporate profits as well as personal income tax cuts, while expenditures jumped because of fiscal stimulus and increases in payment of unemployment benefits.

**Australia and New Zealand had room for large fiscal stimulus packages**

Australia and New Zealand also responded to the economic downturn by easing monetary policy. The Reserve Bank of New Zealand drastically cut the official cash rate from the peak of 8.25% in June 2008 to 2.5% by April 2009. Similarly, the Reserve Bank of Australia (RBA) cut the cash rate from 7.25% in March 2008 to 3% by April 2009. However, as economic contraction started to recede, the RBA turned to monetary tightening in October to pre-empt excessive inflation, in the first example of monetary tightening among developed economies.

**Unique developments and constraints**

Following policy responses in the rest of the world, Pacific island Governments had four options for tackling the effects of the global crisis and its myriad ramifications, although not all of them were available for some countries: (a) fiscal stimulus to boost domestic demand; (b) monetary expansion to boost aggregate domestic demand as a substitute for the reduction in external demand; (c) targeted assistance to the most vulnerable population groups; and (d) competitive devaluations in countries that had their own currencies (Fiji, Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu). Pacific island economies were in unique situations, especially as regards the policy space to adopt any of the above options, either alone or in combination as crisis-mitigating packages. Complexities arose that consequently are unique as well.

Some countries employed fiscal stimulus to boost aggregate demand. For example, Samoa prepared for sharp increases in fiscal deficits in FY2008/09 and FY2009/10 with increases in capital expenditure, a stimulus package focused on infrastructure, relying on Asian Development Bank concessional lending and donor grants. However, as the need for financial resources for post-tsunami rehabilitation increased, priorities changed rapidly.

The ability to finance a fiscal stimulus depends on a country’s capacity to borrow, which in turn depends on the size of the existing public debt and its creditworthiness. Pacific island Governments, apart from Papua New Guinea and Vanuatu, are not in a very good position to borrow; hence their need to rely heavily on concessional lending from international development agencies and donor grants. Vanuatu had paid down its public debt through the period of strong economic growth and managed to be in budget balance in 2009. Fiji, by contrast, increased its budget deficit from a target level of 2% to 3%. Fiji had been trying to create room for more infrastructural spending by reducing the size of its public service. However, the reduction of revenue in the first half of 2009 had led to a cutback in expenditure. The Government’s ability to finance a stimulus package was limited because of the constraints on its ability to borrow and to access donor grant monies. Tonga was also in a poor position to fund a stimulus package, although to some extent its rehabilitation of the commercial area of Niku’alofa, which is funded by concessional loans from China and donor funding, has functioned as an infrastructural stimulus package.
As for the second policy option, several developing States in Oceania effectively do not have an independent monetary or exchange-rate policy, since they use the United States dollar (Palau, the Marshall Islands and the Federated States of Micronesia) or Australian dollar (Kiribati, Nauru and Tuvalu) as legal tender. In countries with their own currencies, some form of monetary policy action was taken to boost aggregate demand (except Papua New Guinea). Money markets are underdeveloped, however, so demand for credit is not very responsive to changes in interest rates. Consequently, central banks in the Pacific do not emphasize interest rates as a monetary policy instrument. Expansion of the money supply is used instead as the major instrument in, for example, Fiji, Samoa, the Solomon Islands and Vanuatu. Commercial banks are also encouraged to lend, as was the case with Fiji and Solomon Islands. Effectiveness of the latter instrument is limited, inasmuch as few profitable investment opportunities are on offer. Tonga in particular has not been able to engage in credit expansion, as it has been trying to bring under control a credit “bubble” that developed over recent years through rapid expansion of the money supply.

Devaluation of Fiji in April 2009 increased competitiveness and helped to offset the decline in the EU price paid for its sugar exports, while it increased the value of remittances in domestic currency and foreign reserves as well. Devaluation, however, increases the cost of imports in local currency terms and it stimulates inflation, as well as the local currency size of the external debt, and debt servicing costs. Consequently any increase in budget expenditure is eventually squeezed out.

**Outlook and policy challenges**

In 2010 economic growth of 2.4% and 1.8% is anticipated in Australia and New Zealand, respectively, that will in turn improve the growth prospects of many Pacific island economies through greater tourism receipts and remittance earnings. Strong growth is also expected in Papua New Guinea from rising commodity prices and growth in domestic demand. Altogether the economies of the Oceania region are expected to grow by 2.3% in 2010, up from 1.0% in 2009.

Risks nonetheless hover in the near term: rising commodity prices put upward pressure on inflation, while rising import bills run down foreign exchange reserves. Any slippage in the global economy would hit the region hard. Hence, considering the risks in tandem with the vulnerabilities unique to this subregion, not the least of which are the increasingly frequent, severe natural disasters, forecasting remains a highly inexact enterprise.

Looking beyond 2010, developments in information and communication technology are generating new sources of economic growth that will help bridge the geographical isolation that has for so long kept Oceania apart from the rest of Asia and the Pacific (Box 4).
South and South-West Asia

The global crisis affected South and South-West Asia less than other subregions. GDP growth remained generally positive although exports declined substantially and capital inflows were reduced (table 16). The national economies depend much more on domestic than on external demand. They rely for employment mostly on agriculture which has held up well overall and thus dampened the worst of the crisis fallout.

Of greater concern is the sharp increase in food and fuel prices in 2008 which created numerous hardships for the peoples of the subregion. As inflation impacts the poor disproportionately, it is a serious problem for countries with a high incidence of poverty. Even though inflation rates decelerated in 2009, food prices remained high and upward pressures are re-emerging.

Controlling inflation is and will remain the key macroeconomic challenge for the subregion. Another key challenge is the adverse impact of security problems ranging from internal conflicts to terrorist attacks linked with geopolitical tensions, all of which impinge on macroeconomic performance and poverty reduction.

Impact of the crisis

Both the global crisis and deteriorating security situation in some countries saw economic growth come under pressure in 2009, decelerating to 2.9% as compared to 4.7% in 2008 (table 16). Barring Afghanistan, a country highly dependent on foreign aid, India achieved the highest growth
rate at 7.2% in 2009. Growth contracted in only two countries: Maldives and Turkey.

**Economic growth slows but less than in other subregions**

In Afghanistan, economic activity is dominated by security considerations. The economy rests primarily on agriculture and is vulnerable to weather conditions. GDP growth in 2008 was 3.4% but is expected to have been 15.1% in 2009, owing to improved weather and a good harvest. The large fluctuations in GDP growth underline the inherent vulnerability of the economy to weather conditions. Growth will also benefit from investment in construction, much of it linked to donor-led development projects. The economy depends heavily on foreign aid, much of it outside the Government budget. If overseas development assistance could be delivered through the Government in greater amounts, programme coordination, ownership and accountability could be enhanced. For that purpose governance and the capacity of Government institutions would need to be improved to administer aid-funded projects.

In Bangladesh, GDP growth was 6.2% in 2008 and decelerated only slightly to 5.9% in 2009. Growth was underpinned by good performance in agriculture, which accounts directly for some 20% of GDP and employs more than half the labour force. The slowdown in industrial growth mainly resulted from export decline for most of the items other than apparels and textiles. The exports of apparels continued to grow despite the crisis because of the focus of Bangladesh on the lower ends of the market that were relatively less affected from the downturn. Growth in overseas workers’ remittances helped in sustaining domestic demand.

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**TABLE 16. Rate of economic growth and inflation in South and South-West Asian economies, 2008 to 2010**

(Percentages)

<table>
<thead>
<tr>
<th></th>
<th>Real GDP growth</th>
<th>Inflation*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008</td>
<td>2009b</td>
</tr>
<tr>
<td>South and South-West Asia\textsuperscript{d,e}</td>
<td>4.7</td>
<td>2.9</td>
</tr>
<tr>
<td>Afghanistan</td>
<td>3.4</td>
<td>15.1</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>6.2</td>
<td>5.9</td>
</tr>
<tr>
<td>Bhutan</td>
<td>5.0</td>
<td>5.7</td>
</tr>
<tr>
<td>India</td>
<td>6.7</td>
<td>7.2</td>
</tr>
<tr>
<td>Iran (Islamic Republic of)</td>
<td>3.3</td>
<td>2.0</td>
</tr>
<tr>
<td>Maldives</td>
<td>5.8</td>
<td>–2.6</td>
</tr>
<tr>
<td>Nepal</td>
<td>5.3</td>
<td>4.7</td>
</tr>
<tr>
<td>Pakistan</td>
<td>4.1</td>
<td>2.0</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>6.0</td>
<td>3.5</td>
</tr>
<tr>
<td>Turkey</td>
<td>0.9</td>
<td>–6.0</td>
</tr>
</tbody>
</table>

Notes: a Changes in the consumer price index. 
b Estimates. 
c Forecasts (as of 15 April 2010). 
d Calculations are based on GDP figures at market prices in United States dollars in 2007 (at 2000 prices) used as weights to calculate the subregional growth rates. 
e The estimates and forecasts for countries relate to fiscal years defined as follows: fiscal year 1 April 2008 to 31 March 2009 for India; 21 March 2008 to 20 March 2009 for the Islamic Republic of Iran; 1 July 2007 to 30 June 2008 for Bangladesh and Pakistan; 16 July 2007 to 15 July 2008 for Nepal are 2008.

GDP growth in Bhutan peaked at nearly 21.4% in 2007 with the completion of the Tala hydropower project in 2007, but returned to a more normal level of 5.0% in 2008 and 5.7% in 2009. In the coming years growth in the economy will be underpinned by three more hydropower projects.

India achieved one of the world’s highest growth rates

India felt the crisis after a period of high growth momentum that had reached an annual average of 8.8% over the previous five years. In 2008, growth was 7.7% during the first half of the fiscal year, but fell to 5.8% in the second half (October 2008 to March 2009). Even so, at 6.7% India achieved one of the world’s highest growth rates in 2008. While the economy largely sustained the momentum of the previous five years, both external and domestic demand were affected by the crisis. There was a slowdown in the services sector, in domestic private consumption, in investment demand and in manufacturing output.

By the beginning of the third quarter of 2009, despite the uncertain global macroeconomic scenario, domestic and external financing conditions showed signs of improving and the business outlook turned positive, signalling a revival of industrial activity. From August to November 2009 industrial output grew in double digits, while GDP growth during the second quarter of the fiscal year 2009 (July to September 2009) was 7.9%. According to the preliminary estimates, GDP grew by 7.2% for the full fiscal year 2009. This recovery is remarkable given the fact that the agriculture output declined by 0.2% due to poor weather conditions as a result of delayed and sub-normal monsoon. Both the industrial and services sectors grew by over 8%.

The Islamic Republic of Iran is the net oil exporter and the country remains highly dependent on oil revenues that provide over 80% of Government revenue. As a result of reduced oil prices and declining output, GDP growth plummeted from 3.3% in 2008 to 2.0% in 2009. That will impede the Government’s plans for an expansionary fiscal policy, which in turn will affect the rate of private consumption and investment. The hydrocarbons industry will continue to suffer from a lack of foreign investment, and as refining capacity remains underdeveloped, despite petrol rationing, the country will rely increasingly on fuel imports. A drought in early 2009 was expected to lead to a rise in imports of wheat and other agricultural produce. The new five-year development plan (2010 to 2015) sets an ambitious 8% target for annual GDP growth that will not be easy to achieve.

Having grown by 7.2% in 2007 and 5.8% in 2008, the economy of Maldives is expected to have contracted by 2.6% in 2009, largely because of a significant decline in tourist arrivals. In addition, problems with external financing have held up capital projects for resort development and other major projects, causing a sharp decline in construction.

Despite the recent political fragility in Nepal on top of the global economic crisis, the macroeconomic situation remains broadly stable. GDP growth was 5.3% in 2008 and fell only slightly in 2009 to 4.7%. Some of the fall reflects adverse weather, since agricultural output, which accounts for around one third of GDP and which had grown by 4.7% in 2008, grew by only 2.2% in 2009. The non-agricultural sector was constrained by severe electricity shortages and difficult industrial relations and strikes that delayed the movement of goods and prevented people from getting to work. In recent years the services sector has, however, grown steadily and accounts for around half of GDP.

In Pakistan, GDP growth fell from 4.1% in 2008 to 2.0% in 2009. The economy has been affected not just by the global economic crisis but also by the declining security situation and intensification of conflict linked to terrorism. Industry, especially large-scale manufacturing, suffered the worst of all sectors from the drop in international demand, while also having to cope with acute shortages of electricity. Improved performance of the service sector offset it to some
extent, growing 3.6% in 2009, as well as a rebound in agriculture which benefited from a bumper wheat crop. While consumer spending remained strong, gross fixed capital formation, which had expanded by 3.8% in 2008, contracted by 6.9% in 2009.

In India, consumer prices, particularly of food, remain stubbornly high and the consumer price index (for industrial workers) rose to about 9.0% in 2008 (table 16). Inflationary pressures continued into 2009, largely resulting from the poor monsoon with adverse impact on food supplies, firming up of global commodity prices and the Government expansionary fiscal stance. Inflation as measured by the consumer price index was around 12.0% in 2009. A faster increase in food prices has become a cause of concern.

In Pakistan, inflation rose sharply from 12% in 2008 to 20.8% in 2009 mainly because of food price increases. The Government increased the wheat support price by more than 50%, which pushed up retail prices of wheat and wheat flour across the country. It also phased out subsidies on petroleum products. To contain inflation, the Government has been cutting spending and attempting to improve the supply and distribution of essential commodities. Inflation is projected to decline in 2010 although it will remain in double digits. Upward pressures will remain high, particularly if higher oil prices, electricity tariff increases, higher wages, and fiscal expansion come to bear. A more active monetary policy might be needed to manage inflationary pressures.

The end of the internal conflict in Sri Lanka should raise confidence among consumers and businesses

GDP growth in Sri Lanka fell from 6.0% in 2008 to 3.5% in 2009, corresponding to slower growth in the industrial and services sectors and falling exports. The end of the internal conflict in May 2009 should raise confidence among consumers and businesses. Much of the economic impetus will come from developing areas affected by conflict and resettling internally displaced persons. A boost in agricultural output in the north and east of the country, higher rural incomes and increased private consumption can be expected.

Turkey is strongly linked with the crisis-hit economies of the developed world and thus felt the full force of the crisis as it contracted by 6.0% in 2009. GDP growth started to contract in the last quarter of 2008, which dampened growth at barely 0.9% in 2008. That reflected a sharp decline in exports which affected domestic production, as well as much greater difficulties in foreign financing. However, imports fell even more, owing to low energy prices and the slowdown in economic activity. As a result, the current account deficit shrank from around 6.0% of GDP in 2007 and 2008 to 2.1% in 2009 – which will help ease external financing pressure.

A more active monetary policy might be needed to manage inflationary pressures

Faster reduction in inflation occurred in Bangladesh and Sri Lanka. In Bangladesh, lower world food and fuel prices drove inflation down to 6.7% in 2009 from 9.9% in 2008. Food inflation decelerated even more sharply from 12.3% in 2008 to 7.2% in 2009 supported by higher rice and wheat harvests. Non-food inflation has been comparatively lower and remained relatively stable. Inflation in Sri Lanka, after reaching a high of 28% on a year-on-year basis in June 2008, decelerated sharply to less than 1.0% in September 2009, owing to restrictive monetary policy efforts, favourable domestic supply conditions and significantly lower global commodity prices.
prices. On average inflation in 2009 was estimated at 3.4%.

Inflation in Bhutan and Nepal is linked to inflation in India due to the fixed rates of exchange of their currencies with the Indian rupee. Inflation in Nepal reached 13.2% in 2009. It was driven by a 16.5% spike in the cost of food and beverages, which account for a 53.2% weight in the consumer price index.

In the Islamic Republic of Iran, annual inflation declined from 25.5% in 2008 to 16.0% in 2009, owing to a sharp drop in international oil and non-oil commodity prices. With fiscal policy likely to remain expansionary, albeit not to the extent it was in previous years, concerns over inflation will persist in the coming years. The adoption of a tighter financial policies stance, which has been expansionary and procyclical, will be needed. Even though expansionary fiscal and monetary policies have brought about some short-term gains in production and employment, the high and persistent inflation that they generate can undermine long-term growth and adversely affect the poor.

In India, the balance of payments came under pressure in 2008, when the current account deficit widened to 2.4% of GDP in 2008. Furthermore, net capital inflows fell to $9.1 billion in 2008 as compared with net capital inflows of $108 billion in 2007, reflecting the unstable nature of those flows. Both exports and imports fell in 2009 but workers remittances remained strong. The current account deficit further widened to 3.3% of GDP for the first nine months of fiscal year 2009.

Similarly, Pakistan endured a decline in exports of 6.0% in 2009, while imports contracted at a much faster rate of 11%. Combined with a strong growth momentum in workers’ remittances of 20%, reaching a total of $7.8 billion, the current account deficit in 2008 of 8.4% of GDP was reduced to 5.3% of GDP in 2009. The global economic slowdown and political and security uncertainties resulted, however, in slackening of capital inflows with reduced FDI inflows, higher portfolio outflows, lower disbursements of loan and higher amortization payments.

Given the sharp economic slowdown in Turkey and much lower international commodity prices, consumer price inflation decreased to 6.3% in 2009 from 10.4% in 2008. The decreasing inflationary pressure enabled the central bank to implement growth-supporting monetary policy without deviating from the main objective of price stability.

Trade declines sharply but workers’ remittances stay strong

Before the onset of global economic crisis, high oil prices had created severe problems for the balance of payments position of some countries. However, during the global crisis, both exports and imports slowed down and helped contain trade and current account deficits. Furthermore, workers’ remittances have been rising sharply. They account for a substantial share of GDP, particularly in least developed countries, and provide current account support. A major part of remittances inflows originates from oil-rich Gulf Cooperation Countries. While there were some concerns that large-scale layoffs could happen if the recent financial problems experienced in Dubai spread, past experience shows that remittances from those countries are resilient, even during volatile oil price periods. Many of those countries have heavily invested in developing their infrastructure as a long-term development strategy, for which funding is available from large reserves accumulated over the years. Therefore, large-scale lay off of migrant workers seems unlikely even though rate of growth of remittances has declined.

In Bangladesh, the balance of payments strengthened considerably in 2009 with a current account surplus of 1.0% of GDP. Imports growth decelerated markedly from 26.1% in 2008 to 4.1% in 2009 after the onset of the global financial crisis and lower demand for capital and intermediate goods. Lower food and fuel import prices and a good harvest also played a role. The apparel and textile industries continued to expand because Bangladesh largely produces for the lower end of the market which was less affected by the downturn.
Total exports grew at 15.8% in 2008 and 10.3% in 2009 which, when compared with the double-digit declines experienced by major exporting countries of the region, clearly shows that Bangladesh has become more competitive than other Asian and Pacific economies in the exports of those products. At the same time overseas workers’ remittances increased 22% in 2009, to $9.7 billion, being almost 11% of GDP and lending further support to the current account balance. The Bangladeshi taka remained relatively stable.

In Nepal, due to the continued growth of remittances, the current account and balance of payments remain in surplus despite large merchandise trade deficit. Workers’ remittances increased by 24.2% to $2.7 billion in 2009. Foreign exchange reserves also went up by 15.8% to $3.6 billion in mid-July 2009 as compared with reserves one year earlier.

In Sri Lanka, relatively lower oil prices, a sharp decline in imports, a steady flow of remittances, and continued flexibility in the exchange rate allowed the current account deficit to recover from 9.0% of GDP in 2008 to around 0.3% of GDP in 2009. Exports are estimated to have fallen by 12.2% and imports by 29.5%, while workers’ remittances increased by 14.1% in 2009. In contrast, in the Maldives, the current account deficit has become unsustainably high through a fall in tourism inflows and exports. A decrease in the current account deficit is estimated from 51.4% of GDP in 2008 to 25.1% of GDP in 2009 as the global outlook improves.
The Islamic Republic of Iran, being a net exporter of oil, suffered sharp contraction in its exports in 2009 owing to lower oil prices and demand. Imports also fell but at a slower rate as economic activity moderated in the country. As a result, the trade surplus fell in 2009 and the current account registered a small deficit, after a large surplus in the previous year.

In Turkey, imports declined more rapidly than exports. The contraction in imports stemmed partly from decline in energy prices and partly from the slowdown in economic activity. The current account deficit is expected to shrink to 2.1% of GDP in 2009 from just under 6.0% of GDP in 2007 and 2008. The smaller deficit will help to ease external financing pressure as the global credit squeeze has made international financing more difficult and more costly than in the recent past.

With regard to the exchange rate against the United States dollar in 2009, the Indian rupee depreciated in the beginning of the year but in subsequent months appreciated. The Sri Lankan rupee followed a similar course but could not regain lost ground and ended the year slightly lower. The Pakistani rupee consistently depreciated over the year. The Bangladeshi taka showed the greatest stability over the year.

**Policy responses**

As for all other subregions of Asia and the Pacific, Governments in this subregion used expansionary fiscal and monetary policies to counter the negative fallout of the global slowdown and moderate the decline in growth. On the fiscal side, although budget deficits were already high prior to the global crisis, Governments had little choice but to run up higher deficits as a means of countercyclical stabilization. Moving forward, it is important that governments in the subregion prepare a clear roadmap of fiscal consolidation to be implemented at the earliest. This is important to anchor long run expectations about interest rates and private sector investments.

Central banks showed much more willingness to implement a range of monetary-easing and liquidity-enhancing measures including reduction in the cash reserve ratio, the statutory liquidity ratio and key policy rates in support of expansionary fiscal policies. Looking ahead, and as inflationary pressures increase, there are signs that monetary policy has started to tighten. The Reserve Bank of India in January 2010 raised the cash reserve ratio by 0.75% to 5.75% and in March 2010 policy interest rates were raised by 25 basis points, pushing the repo rate up to 5%. It was part of a fine balancing act between containing inflationary pressures and supporting the domestic economy as the global recovery process remains weak.

**Acceleration in expansionary fiscal policy**

The Government of India introduced a large fiscal stimulus package to boost domestic demand and contain the adverse impact of the global economic crisis. Fiscal stimulus was in the form of tax relief to boost demand, and increased expenditure on public projects to create employment and public assets. The Government renewed its efforts to increase infrastructure investments in telecommunications, power generation, airports, ports, roads and railways, besides expansion of the National Rural Employment Guarantee Scheme (box 5) as a part of fiscal stimulus in 2009 budget. The fiscal stimulus also included write-off of agricultural loans, revision of salaries of Government staff (undertaken in 2008 and 2009). Fiscal stimulus spending over 2008 and 2009 is estimated at the equivalent of 7.1% of GDP. As a result, the budget deficit increased from 2.6% GDP in 2007 to 5.9% of GDP in 2008 and is estimated to rise to 6.5% of GDP in 2009 (figure 43). The budget for the fiscal year 2010 attempted to address the challenge of fiscal consolidation in the face of growing public debt by raising revenues and containing unproductive expenditure. As a result, budget deficit is expected to come down to 5.5% of GDP in 2010.
In 2005, through the National Rural Employment Act, the Government of India launched a bold, innovative scheme to provide employment to the rural poor: the National Rural Employment Guarantee Scheme. It provides guaranteed employment at minimum wage for 100 days each year to every rural household whose adult members volunteer to do unskilled manual work. At least one third of the beneficiaries must be women.

In any poverty reduction programme the most difficult task is to identify the poor. In this case the programme is self targeting since the non-poor are not usually attracted by hard manual work at minimum wages. People interested in the scheme are issued registration cards and can apply for a minimum of 14 days’ continuous work either to the local Government or the programme officer. They will be offered work, if possible within a 5-kilometre radius or, if farther away, are entitled to a transport allowance and some extra living expenses. If applicants are not offered work within 15 days they are paid an unemployment allowance.

The scheme operates on a huge scale. During fiscal year 2008/2009 it provided more than 1 billion person-days of employment for 45 million people. For fiscal year 2009/2010 the Government has allocated 391 billion rupees, being more than $8 billion. Most of the financial resources are provided by central Government, but implementation and management are largely through State and local Governments that identify public works projects. The Government has been providing training to all the functionaries involved. This decentralized participatory management system helps improve delivery and public accountability. It can also be monitored centrally since details on the progress and outcomes of the scheme are available on the Internet, allowing higher-level Government officials, if necessary, to take remedial action.

The scheme has many advantages. Besides providing employment to the rural poor, it also helps address the causes of chronic poverty like drought, deforestation and soil erosion, through public works projects in water conservation and harvesting, afforestation, rural connectivity, and construction and repair of embankments for flood control. It promotes an inclusive form of financial development since, in order to protect poor workers from being cheated, payments are made through bank or post office accounts. Long distance to available banks and post offices in some rural areas can be a serious problem; in such cases mobile counters of banks/post offices can be provided.

Initial evidence suggests that the programme is achieving its objectives in providing income security for the poor, achieving high participation of women and marginalized groups, stemming distress migration, increasing access to markets and services and regenerating national resources. Such a scheme could be replicated in many developing countries.

Notes:

the fiscal improvement in 2009 was largely based on reduction in oil subsidies and development spending which is likely to impinge on the medium-term growth rate. The Government needs to improve the tax base and raise the very low tax-to-GDP ratio in order to reduce the fiscal deficit to sustainable levels.\textsuperscript{77} The tax burden can be made more equitable by spreading it across different sectors of the economy, particularly services and agriculture.

In Bangladesh, the budget deficit was contained at 4.0% of GDP in 2009, partly due to under-implementation of its development budget. In Sri Lanka, with the return of peace to the country, the budget deficit is expected to continue to come down; in 2009, to 7% of GDP, from 7.8% of GDP in 2008. The Government signed a 20-month Stand-By Arrangement with IMF of about $2.6 billion to support the country’s economic reform programme and rebuild international reserves. To contain its budget deficit, the Government introduced several measures to enhance revenues and rationalize current expenditures. As revenue measures usually take time to yield results, the Government’s adjustment pro-

gramme in 2009 relied more on expenditure restraint, while ensuring protection of vulnerable groups. The highest priority is being given to the reconstruction and development of the previously war-torn areas and resettlement of internally displaced persons. Economic stimulus measures could lead to sustained long-term growth through appropriate economic reforms, including restructuring of public-sector enterprises. \(^78\)

The budget deficit in Maldives has remained high in recent years, rising to 26.1% of GDP in 2009 from 16.9% of GDP in 2008. In December 2009, IMF approved blended financing arrangements amounting to about $92.5 million spread over 3 years. The financing is designed to support the Government's policy programme aimed at addressing the adverse impact of the global economic crisis and restoring macroeconomic stability and fiscal sustainability.

In Nepal, the budget deficit fell to 3.8% of GDP in 2009 from 4.1% in 2008 owing to strong revenue growth and below-target spending. The ratio of revenue mobilization to GDP grew to 14.8% in 2009 in comparison with the ratio of 13.2% in 2008 because of encouraging growth in revenue collection.

Due to large oil revenues, the Government of the Islamic Republic of Iran has been following an expansionary fiscal policy. For sharing the benefits of oil revenues with the people, the fiscal system incorporates huge explicit and implicit subsidies. Energy prices including prices of petroleum products and electricity remain highly subsidized. The agricultural sector and food imports are also subsidized. Government is in the process of reforming and overhauling the subsidy system by gradually phasing it out in favour of a new targeted welfare system. Poor families are to receive cash grants and basic services such as healthcare.

In response to the crisis, the Government in Turkey cut some taxes and boosted certain expenditures, equivalent to 0.8% of GDP in 2008 and 1.6% in 2009. It also relaxed monetary policy to make credit cheaper and more available. As a consequence and with the loss of revenue from economic contraction, the budget deficit widened from 1.8% of GDP in 2008 to 5.4% of GDP in 2009. The financial sector remained relatively stable, having benefited from major restructuring and improved regulation and supervision following the 2001 financial crisis. Consumer price inflation fell in 2009, which enabled the central bank to implement a growth-supporting monetary policy while maintaining price stability. As aggregate demand recovers, however, inflation could rise.

**Outlook and policy challenges**

As the global outlook improves, the subregion should resume rapid economic growth. It is forecast to grow at 6.1% in 2010 with stronger linkages with other fast-growing Asian and Pacific developing economies supporting its growth. Some countries are already developing new partnerships for trade and investment relations that will combine into an Asian community of trading nations and a node of economic growth.

**Growth improves but downside risks persist**

Most countries are projecting stronger growth in 2010: for example, 8.3% in India and 6.0% in Sri Lanka and Bangladesh. In India, the structural growth impulses of the economy remain strong, given the high domestic savings rate, sound financial system and a macroeconomic policy environment supportive of growth. With a revival in investment and private consumption, growth in exports and strong expansion in industrial production in recent months, growth in GDP is projected to accelerate in 2010. The improved security situation in Sri Lanka should benefit all major sectors of the economy, particularly tourism and agriculture, while investment is likely to expand strongly in 2010 as companies prepare for a period of accelerated growth.

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growth in domestic demand. Renewed foreign investor interest in the tourism sector holds promise.

Higher growth in Pakistan is also projected, on the assumption of improved security situation, relaxation of fiscal policy and some respite from electricity shortages. The anticipated recovery is expected to be supported by the restocking of inventories and a small recovery in exports as the incipient recovery in major economies gather pace. Large-scale manufacturing sector which contracted in 2009 is projected to register positive growth in 2010.

In Bangladesh, as external demand picks up, growth in crisis-hit sectors of manufacturing may follow, while remittances will continue to support the economy and domestic demand.

In Nepal, the Government target of 5.5% GDP growth in 2010 will be supported by strong private consumption and an expansionary fiscal budget, but may be constrained due to delayed monsoon and poor weather conditions. GDP growth in 2010 is expected to be around 3.5%.

For Maldives, a positive GDP growth is forecast in 2010 along with some recovery in the world economy.

With projected increase in oil prices, the economy of Islamic Republic of Iran should also experience higher growth.

For Turkey, moderate growth of 3.0% is projected in 2010, driven by improved domestic demand as the main European export markets are expected to remain weak and no major boost from external demand is expected.

This growth outlook is subject to downside risks linked to uncertainties that the global economy faces. Rising oil prices could also push up inflation and lead to higher budget and current-account deficits. Bad weather could damage harvests; the subregion will always be prone to floods, earthquakes and other natural disasters. There are also security risks: internal conflicts and terrorist attacks can undermine consumer and investor confidence. Across the subregion, in the face of rising international food and fuel prices and the return of capital flows, Governments may struggle to manage price and exchange rate stability without compromising economic growth.

Looking beyond 2010, accelerating economic growth is crucial to bring down poverty levels. The challenge will be how to make growth more inclusive by spreading its benefits to larger segments of the population. More resources should be devoted to provision of basic services such as education, health, sanitation and housing particularly for those belonging to lower income groups. Targeted programmes for the benefit of the poor in the broader framework of social protection should also be a priority.

Finally, the inadequacies of physical infrastructure remain a key constraint holding back the potential of economic growth. Of particular concern is electricity shortage in Pakistan and Nepal, where disruptions in the supply of electricity are compromising growth. Huge investments are needed to enhance capacity of electricity generation. At the same time, renovation of transmission and distribution lines is necessary to minimize electricity losses. Potentials of trade in electricity among countries of the subregion should be explored and subregional cooperation in electricity generation and distribution should be promoted to overcome electricity shortages.79

79 Research and Information System for Developing Countries (RIS), South Asia Development and Cooperation Report 2008 (Oxford University Press, New Delhi, 2008).
Generally, the year 2010 presents complex issues for policymakers as they seek to manage price and exchange rate stability without compromising growth momentum, in the face of rising international food and fuel prices and return of capital flows.

SOUTH-EAST ASIA

In South-East Asia the global crisis overturned prevailing economic logic. Previously, the large export-driven industrial base had been seen almost entirely as a source of strength. But as the financial crisis cut export demand from major markets, the dependence on trade was revealed also as a source of vulnerability. Export dependence (defined as the ratio of exports to GDP) rose from less than 50% in the mid-1990s to over 70% by 2007. Openness (defined as the ratio of imports and exports to GDP) is also high with ratios for Singapore, Thailand, Malaysia, and Viet Nam reaching 362%, 161%, 130% and 160%, respectively. Those ratios are significantly higher than those for the two largest Asian developing economies: China at 60% and India at 40%.

Moreover, that trade is still highly concentrated. While the subregion has to some extent diversified its export destinations, its biggest markets are still the developed economies. And even when there has been a rise in intraregional trade, it is largely based on interlocking production networks whose output, channelled through China as a production hub, is ultimately destined for the developed countries.

The fall in external demand notwithstanding, the economies in the subregion have enough policy levers to weather the crisis. As the following section will point out, many economies in the region are poised for a faster recovery, than what was initially expected.

Impact of the crisis

In contrast to the 1997 Asian financial crisis, the genesis of the current global economic crisis occurred outside of South-East Asia. The subregion was largely spared the institutional failures that saddled the United States and European financial systems. Clearly, the lessons from the Asian crisis were not lost on policymakers as bank lending practices, regulations and supervision have been tightened over the years. Rather, the shock this time around was transmitted via the trade channel. South-East Asian economic growth thus slowed down significantly from 4% in 2008 to 0.6% in 2009, although there were differences among countries.

Economic contraction

The national economies of Malaysia, Singapore and Thailand all contracted in 2009. The Philippines managed to keep growth positive, but experienced a dramatic deceleration. The economies of Indonesia and Viet Nam, on the other hand, though also undergoing a slowdown, did not contract to the same extent. Two least developed countries, Timor-Leste and Lao People’s Democratic Republic, grew the fastest in the subregion (table 17).

The variations are due to many factors, including domestic problems of varying intensity. Nevertheless, overall, some patterns across countries emerge. The worst-affected countries all had shares of exports to GDP that exceeded 60%, with the European Union and United States accounting for relatively large shares of exports. The country most exposed to trade shock is Cambodia, with close to 80% of total exports bound for the United States or Europe. Singapore and Malaysia, with exports accounting for more than 100% of GDP, are quite exposed to trade shock as well (figure 44).

Another factor that played a role was the composition of exports. Countries with a high share of export products based on regional production networking and outsourcing arrangements, such as apparel, machinery, electronics and motor vehicles, were more exposed to perturbations in global trade. The extent of exposure is illustrated in figure 45. The highest concentration for those sectors is in the Philippines at around 70%; the proportions are also high in Singa-
TABLE 17. Rate of economic growth and inflation in South-East Asian economies, 2008 to 2010

(Percentages)

<table>
<thead>
<tr>
<th>Region</th>
<th>Real GDP growth</th>
<th>Inflation(^a)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008  2009(^b) 2010(^c)</td>
<td>2008  2009(^b) 2010(^c)</td>
</tr>
<tr>
<td>South-East Asia(^d)</td>
<td>4.0  0.6  5.1</td>
<td>8.6  2.1  4.1</td>
</tr>
<tr>
<td>Brunei Darussalam</td>
<td>–1.9 –0.5 0.6</td>
<td>2.7  1.2  1.2</td>
</tr>
<tr>
<td>Cambodia</td>
<td>6.7  0.0  4.0</td>
<td>25.0 –0.8 5.0</td>
</tr>
<tr>
<td>Indonesia</td>
<td>6.1  4.5  5.5</td>
<td>10.1  4.6  5.3</td>
</tr>
<tr>
<td>Lao People’s Democratic Republic (the)</td>
<td>7.9  5.4  6.0</td>
<td>7.6  0.2  5.0</td>
</tr>
<tr>
<td>Malaysia</td>
<td>4.6  –1.7 5.0</td>
<td>5.4  0.6  2.0</td>
</tr>
<tr>
<td>Myanmar</td>
<td>2.0  2.0  3.1</td>
<td>26.8  6.6  10.4</td>
</tr>
<tr>
<td>Philippines (the)</td>
<td>3.8  0.9  3.5</td>
<td>9.3  3.3  4.7</td>
</tr>
<tr>
<td>Singapore</td>
<td>1.1  –2.0 7.0</td>
<td>6.5  0.6  2.3</td>
</tr>
<tr>
<td>Thailand</td>
<td>2.5  –2.3 4.0</td>
<td>5.5  0.8  3.5</td>
</tr>
<tr>
<td>Timor-Leste(^e)</td>
<td>12.8  7.4  7.5</td>
<td>7.6  1.3  4.0</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>6.2  5.3  5.8</td>
<td>23.1  7.0  10.3</td>
</tr>
</tbody>
</table>

Notes:  
\(^a\) Changes in the consumer price index.  
\(^b\) Estimates.  
\(^c\) Forecasts (as of 15 April 2010).  
\(^d\) Subregional calculations based on GDP figures at market prices in United States dollars in 2007 (at 2000 prices) used as weights to calculate the subregional growth rates.  
\(^e\) Refer to real non-oil GDP growth (excluding locally paid compensation of United Nations peacekeeping mission staff).


FIGURE 44. Combined share of United States and European Union purchases of merchandise exports of selected South-East Asian economies, 2006 to 2007 and 2008

Note: Average 2006-2007 = average of (exports to US + EU15)/total exports for 2006 and (exports to US + EU15)/total exports for 2007. EU15 denotes the 15 original members of the European Union.

pore, Malaysia and Thailand. The main Indonesian exports, on the other hand, are oil and other primary goods. As figure 45 shows, in all those economies the proportion has been declining as a result of a drop in demand for such goods, particularly electronics.

**Rebound gathers momentum.** Tracking economic performance on a quarterly basis tells the most about the extent of the crisis, its evolution and adjustment processes that Governments put in place. After all, recessionary forces struck South-East Asia only in the middle of 2008. Annual averages thus mask the depth of the crisis. Table 18 indicates a general improvement towards the middle of 2009, with the prospects of a V-shaped recovery gaining ground.

To some extent such rebound appears quick because some economies were starting from a low base. In addition, events in some senses were working in the favour of the subregion. First, perhaps largely unappreciated, was the benefit of a credible and timely early warning. By being able to observe the implosion of the financial markets in the United States and Europe, in the wake of the subprime crisis in 2007 that triggered the banking crisis and the collapse of Lehman Brothers, a major investment bank in the United States, policymakers could anticipate a massive incoming trade shock. That gave them enough time to counteract the expected deflationary forces with appropriate expansionary macroeconomic policies. Unlike the 1997 Asian financial crisis, this crisis did not take the region by surprise.

Second, the subregion had, by and large, sound macroeconomic fundamentals. Until the second quarter of 2008 exports were still increasing and inflation, although high in the first half of

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**FIGURE 45. Export share of electronics, machinery, motor vehicles and apparel in total exports, selected South-East Asian economies, 2006 to 2008**

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*Notes: Consists of: HS 61, articles of apparel, accessories, knit or crochet; HS 84 nuclear reactors, boilers, machinery, etc; HS 85, electrical, electronic equipment; HS 87, vehicles other than railway, tramway.*

the year, subsequently fell. Again in contrast to the period prior to the Asian financial crisis of 2007, Governments had, in varying degree, maintained prudent public finances. They had kept external debt at manageable levels and built up sufficient reserves to cover contingent capital outflows. Hence, the economies in the subregion could stand up to the scrutiny of international speculators.

Third, as a result of reforms in the aftermath of the Asian crisis, many countries had stable financial systems. Banks were still reasonably profitable and most economies had relatively few non-performing loans. In 2008, non-performing loan ratios were under 6% in Indonesia, Malaysia, the Philippines and Thailand, compared with 1998 figures of 49% for Indonesia and 45% for Thailand. Bank capital adequacy ratios also exceeded the prudent threshold: in 2008; they were in double digits in Indonesia, Malaysia, the Philippines, Singapore and Thailand. So when Governments started to prime the fiscal pumps, the financial infrastructure was in place to support that.

Fourth, Governments that had not been running high deficits had the resources to support their responses. They could adopt vigorous countercyclical policies. Since inflation was moderate they also had room for expansionary monetary policies.

When the crisis came, the stage was set for Governments to design, prepare and execute the necessary policies. As they did so, and the crisis unfolded, the economic outlook in the subregion changed.

Performances vary widely

Indonesia has weathered the global slump better than its South-East Asian neighbours. With a population of 226 million, Indonesia has a large domestic market base. Exports account for only 27% of GDP, compared with 185% of GDP in Singapore at the other extreme. Also, the share of electronics, machineries and other manufactured exports, whose demand collapsed as the crisis unfolded in 2008, is rather small, while only one fifth of its exports go to the United States and European market. Furthermore the share in its exports of the combined markets of India and China, two of the fastest-growing economies in the region, in its exports is increasing.

The subregion is home to two small oil-producing States: Brunei Darussalam and Timor-Leste. Because 70% of its GDP comes from oil, the economy of Brunei Darussalam proved to be less exposed to the crisis via the non-oil trade

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**TABLE 18. Percentage changes of real GDP of major South-East Asian economies, year-on-year, 2007 to 2009**

<table>
<thead>
<tr>
<th></th>
<th>Indonesia</th>
<th>Malaysia</th>
<th>Philippines</th>
<th>Singapore</th>
<th>Thailand</th>
<th>Viet Nam</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q1</td>
<td>6.1</td>
<td>5.4</td>
<td>6.9</td>
<td>7.7</td>
<td>4.6</td>
<td>7.7</td>
</tr>
<tr>
<td>Q2</td>
<td>6.7</td>
<td>5.6</td>
<td>8.3</td>
<td>9.0</td>
<td>4.5</td>
<td>8.0</td>
</tr>
<tr>
<td>Q3</td>
<td>6.7</td>
<td>6.5</td>
<td>6.8</td>
<td>10.0</td>
<td>5.3</td>
<td>8.7</td>
</tr>
<tr>
<td>Q4</td>
<td>5.8</td>
<td>7.2</td>
<td>6.3</td>
<td>6.2</td>
<td>5.3</td>
<td>9.1</td>
</tr>
<tr>
<td>2008</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q1</td>
<td>6.2</td>
<td>7.4</td>
<td>3.9</td>
<td>7.3</td>
<td>6.4</td>
<td>7.5</td>
</tr>
<tr>
<td>Q2</td>
<td>6.3</td>
<td>6.6</td>
<td>4.2</td>
<td>2.8</td>
<td>5.2</td>
<td>5.8</td>
</tr>
<tr>
<td>Q3</td>
<td>6.2</td>
<td>4.8</td>
<td>4.6</td>
<td>0.1</td>
<td>2.9</td>
<td>6.5</td>
</tr>
<tr>
<td>Q4</td>
<td>5.3</td>
<td>0.1</td>
<td>2.9</td>
<td>-4.2</td>
<td>-4.2</td>
<td>5.4</td>
</tr>
<tr>
<td>2009</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q1</td>
<td>4.5</td>
<td>-6.2</td>
<td>0.6</td>
<td>-9.4</td>
<td>-7.1</td>
<td>3.1</td>
</tr>
<tr>
<td>Q2</td>
<td>4.1</td>
<td>-3.9</td>
<td>0.8</td>
<td>-3.1</td>
<td>-4.9</td>
<td>4.4</td>
</tr>
<tr>
<td>Q3</td>
<td>4.2</td>
<td>-1.2</td>
<td>0.4</td>
<td>0.6</td>
<td>-2.7</td>
<td>5.2</td>
</tr>
<tr>
<td>Q4</td>
<td>5.4</td>
<td>4.5</td>
<td>1.8</td>
<td>4.0</td>
<td>5.8</td>
<td>7.7</td>
</tr>
</tbody>
</table>

and investment channels. Nevertheless, export income fell with the global oil price late in 2008. Investment income from overseas assets is also likely to have declined. As a result the GDP contracted in 2008.

When Governments started to prime the fiscal pumps, the financial infrastructure was in place to support that

Similarly, most of the Timorese GDP is related to oil: its oil GDP is five times greater than its non-oil GDP, so much will depend on the oil price outlook for 2010. In 2008, the non-oil GDP grew by 13%, partly because it started from a low base.

The Philippines, despite a trade profile that is heavily vulnerable to shocks, has just barely been able to withstand the global downturn, partly as a result of services exports, such as business process outsourcing, and more importantly the large flows of foreign exchange through remittances, which in 2008 were $16.4 billion or 13% of GDP. Remittances grew by 5% in 2009, contrary to expectations. They account for around 10% of GDP and have reached a record level of $17 billion. Among the mitigating factors is the wide geographical dispersion of overseas Filipino workers, and the mix of skills and positions held in overseas jobs market, many of which are in health care, a crisis-neutral sector.

The large stimulus package introduced in Singapore, which includes a sizeable construction component, should contribute to future growth. Trade is also likely to resume faster than initially anticipated, given the recovery in the electronics trade, and estimates of growth have therefore been revised sharply upwards.

In Viet Nam, growth has exhibited a sharp V-shape. In 2008, it grew at a brisk 6.2%, with inflation hitting 23%; combined with a current account deficit running at 11.9% of GDP, fears of overheating were raised. In January of 2009, as a result of the crisis, exports fell by more than 20%. The Government responded with an aggressive fiscal and monetary policy, and growth in 2009 reached 5.3% year-on-year. The State Bank of Viet Nam devalued the dong by around 5% in late November 2009, and a further 3% in February 2010, given the strains in the balance of payment deficits.

Growth in 2009 in Lao People’s Democratic Republic proved brisk. This is partly as a result of higher metal prices, especially gold, which has attracted investment from China, Thailand and Viet Nam. The economy also received a boost as a result of pay increases for public servants as well as increased public investment on infrastructure for the 2009 South-East Asian Games. Lao People’s Democratic Republic should also expect a rise in exports to China, but the prospects for other major markets are less sanguine: demand from Thailand, for example, may fall, especially since some of this is for goods re-exported to third countries.

At the onset of the global crisis, Malaysia suffered a deep contraction in its export-oriented manufacturing sector combined with a significant outflow in portfolio capital. Confidence was undermined and weakened investment spending leading to a negative growth rate in 2009. To counteract the fall in external demand, the authorities mounted two fiscal stimulus packages, while monetary authorities supported pump-priming activities by easing the cash reserve requirement and lowering policy interest rates. As a result, consumption increased and stabilized a decelerating economy towards the second half of 2009.

Thai exports have a large share of crisis-sensitive manufactures like electronics and machineries. Its service sector depends significantly on tourism which is very income elastic and was hit hard by the global recession and continuing political tensions. In the first half of 2009, the Thai GDP fell by 6%, the largest drop in the subregion. To boost the anaemic demand, the Government delivered two stimulus packages supported by expansionary monetary policy. However, they were insufficient to offset the severe contraction in the first half of 2009, as GDP fell by 2.3% for the whole of 2009 although a turnaround in the fourth quarter of 2009 was observed.
Cambodia is the only least-developed country in the region whose economy is not expected to experience any economic growth in 2009. Trade accounts for around half of GDP and is heavily oriented to crisis-affected developed countries. In the first half of 2008, exports of garments dropped by as much as 25% and tourism receipts also fell. The authorities responded with fiscal loosening. The country could be faced with a fiscal deficit along with an upsurge in inflation. On the other hand, Cambodia tends to export garments to niche markets so if demand in these revives quicker than anticipated there could be a rapid turnaround in growth.

The GDP growth of Myanmar weakened in 2008 owing to feeble external demand and to the destruction caused by cyclone Nargis. The agricultural sector still felt the lingering effects of the cyclone in 2009, dampening domestic demand. The largest export item is natural gas whose price has fallen and, given the drop in both internal and external demand, growth in 2009 was likely to be flat. Myanmar was also affected by the downturn in its biggest export market, Thailand, although that was partially offset by the robust growth of its second biggest market, India.

Policy responses

With sufficient warning, the Governments of the subregion were able to proceed with timely and aggressive fiscal policies to boost domestic spending. The packages varied considerably – in terms of size, elements, targeted sectors and criteria – depending on national priorities, fiscal space and institutional structures of decision-making and disbursement. Indonesia, for example, utilized income tax cuts in its fiscal package. Singapore offered some support for consumption, but opted for spending more on investment and on training as well as offering guarantees on loans for working capital. Viet Nam also offered support for credit but did so through a temporary interest rate subsidy of around 4% on certain bank loans.

Some patterns can be discerned across countries. First, the more aggressive responses came from the countries hardest hit by the trade shock. Thailand introduced a package worth 17% of GDP. Malaysia offered one worth 9% of GDP. Both cases involved two tranches. The Singaporean package was also large: 8% of GDP. Indonesia and the Philippines, on the other hand, being less affected, had programmes worth less than 5% of GDP.

The more aggressive responses came from the countries hardest hit by the trade shock

Second, a number of Governments based their stimulus package on pragmatic considerations such as speed of disbursement. They often frontloaded budget items in the first half of the fiscal year while also producing supplemental budgets in order to disburse funds quickly. The Philippines, for instance, prioritized such easily implemented projects as road repairs, irrigation facilities and hospitals, while also planning more complex infrastructure programmes that would require longer lead times. Thailand, similarly, first embarked on a short-term stimulus package to support consumption spending with transfer payments and cash handouts, particularly to the poor and senior citizens, before unveiling a second package which involved major public investment.

Third, nearly every stimulus package involved some expenditure on infrastructure. Malaysia, for example, under its first, $2-billion package, combined small-scale infrastructure projects, such as upgrading roads, hospitals and schools with investment in strategic industries including broadband. The “Stronger Thailand for 2012” package, which spans 2010 to 2012, aims to bolster competitiveness and encourage private investment by investing in mass transit, energy, water resources, healthcare and housing. In the Lao People’s Democratic Republic, the Government spent on infrastructure in preparation of the South-East Asian Games, which helped stoke demand. Viet Nam and Indonesia also announced programmes that combined spending on infrastructure with programmes for pov-
Directing the fiscal stimulus packages at infrastructure has a number of advantages – not only stimulating demand for many supplying industries, but also generating employment. And since some economies are constrained by poor infrastructure this should in the longer term enhance competitiveness.

Fourth, unlike the United States, the countries in this subregion did not need to bail out many specific companies or financial institutions. The financial systems in South-East Asia have been relatively sound, and no systemically significant corporations needed rescuing.

More than half of the fiscal stimulus packages were implemented in the first half of 2009, but a number of economies embarked on a second round shortly thereafter. For example, Malaysia announced a package worth around 9% of GDP over two years. It includes increasing guarantee funds, tax incentives and other forms of assistance to the private sector. The second Thai package is spread over three years. The increased spending, coupled with lower tax revenues, will put pressure on fiscal balances. The projected 2009 budget positions across the subregion are shown in figure 46.

Across the subregion, most central banks, unencumbered by concerns about inflation, have pursued expansionary policies. For example, the Bank of Viet Nam, which had already made five policy rate cuts in the second half of 2008, cut the base rate again by 150 basis points in 2009 which, on a year-to-date basis, represented a cut of 700 basis points, from 14% in October 2008 to a low of 7%. Other countries in the subregion also cut their rates, though more slowly.

In some economies, despite the fall in central bank policy rates, there are concerns that bank lending rates may be “sticky” downwards. With inflation low, real interest rates thus become

![Figure 46: Budget balance as a percentage of GDP in selected South-East Asian economies, 2007 to 2009](image)

Notes: Data for 2009 are estimates. Budget balance excludes grants for Cambodia, Indonesia, Malaysia, Singapore and Thailand.
high. A further concern is that creating credit too rapidly will stoke inflation and create asset bubbles. In response, and in a departure from the overall monetary trend of the subregion, the State Bank of Viet Nam in late November 2009 increased its policy base rate from 7% to 8% and devalued the reference rate for its currency to the United States dollar by 5%. Viet Nam, as of January 2010, has an inflation rate of over 7%, which is high relative to the past six months. With the possible exception of Viet Nam, the inflation outlook for most of the subregion appears benign. A few economies such as Thailand and Cambodia, for instance, had a deflationary environment for most of 2009. Early in 2010, however, inflation started to pick up in Malaysia, Thailand and Viet Nam. Timor-Leste, on the other hand, has a firm inflation anchor due to its “dollarization”.

Early in March 2010, the Malaysian monetary authorities raised interest rates by 25 basis points, from 2.00% to 2.25%, marking Malaysia as one of the first economies to reign in an expansive monetary policy in 2010. The tightening was regarded as fairly mild, however, and not expected to threaten economic recovery.

**External sector**

For the economies of the subregion, the drop in exports could have put a strain on the current account balance had it not been accompanied by a sharp fall in imports. The decline in imports was due partly to a reduction in domestic consumption and investment but also reflected a drop in the demand for intermediate inputs for exported items – especially in parts and components for electronic goods that tend to respond more rapidly to perturbations in demand. As a consequence, current accounts generally remained positive and in some cases actually improved (figure 47). The exceptions were Cambodia and Viet Nam which are expected to have negative balances.

**FIGURE 47. Current account balance as a percentage of GDP in selected South-East Asian economies, 2007 to 2009**

Note: Data for 2009 are estimates.
A substantial proportion of imports comes from within the subregion – during the first three quarters of 2009, intraregional imports actually increased at the expense of those from the United States and Japan (tables 19 and 20). China, likewise, has become a more important source.

Periods of economic contraction often provoke protectionism. In South-East Asia some Governments have become involved in trade remedy cases and other forms of contingency protection, but generally they have shown restraint and did not systematically increase tariffs. On the contrary, they have locked in further liberalization commitments by negotiating preferential trade agreements – seven agreements involving South-East Asian economies came into force in 2008 and 2009.

A V-shaped pattern has followed in capital flows. In the latter part of 2008 there was some capital flight, mostly flows of portfolio investment. However, as Governments took measures to stabilize their economies, international investors became more confident in regional equity markets and the capital promptly returned.

Towards the second half of 2009, trade and capital flows combined to put upward pressure on exchange rates. Economies had performed better than expected, which bolstered investor confidence in the financial and equity markets – and in turn created additional expectations of currency appreciation (figure 48). Indeed, comparing average exchange rates between December 2009 and December 2008, the Indonesian rupiah appreciated against the dollar by close to 16%, while the Malaysian ringgit,

### Table 19. Import growth by ASEAN economies, by source, 2008 and 2009, in percentages

<table>
<thead>
<tr>
<th>Source</th>
<th>2008</th>
<th>2008 Q1-3</th>
<th>2009 Q1-3</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASEAN</td>
<td>22.7</td>
<td>35.1</td>
<td>-20.4</td>
</tr>
<tr>
<td>China</td>
<td>18.2</td>
<td>27.7</td>
<td>-17.7</td>
</tr>
<tr>
<td>EU</td>
<td>13.1</td>
<td>20.9</td>
<td>-22.5</td>
</tr>
<tr>
<td>Japan</td>
<td>14.3</td>
<td>21.7</td>
<td>-23.6</td>
</tr>
<tr>
<td>US</td>
<td>16.0</td>
<td>22.4</td>
<td>-28.9</td>
</tr>
<tr>
<td>Others</td>
<td>37.8</td>
<td>53.7</td>
<td>-30.1</td>
</tr>
<tr>
<td>World</td>
<td>24.1</td>
<td>35.4</td>
<td>-24.7</td>
</tr>
</tbody>
</table>


### Table 20. Percentage shares of imports by ASEAN economies, by source, 2004 to 2008, in percentages

<table>
<thead>
<tr>
<th>Year</th>
<th>2004</th>
<th>2007</th>
<th>2008</th>
<th>2008 Q1-3</th>
<th>2009 Q1-3</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASEAN</td>
<td>23.9</td>
<td>24.7</td>
<td>24.4</td>
<td>24.8</td>
<td>26.2</td>
</tr>
<tr>
<td>China</td>
<td>9.5</td>
<td>12.5</td>
<td>11.9</td>
<td>11.8</td>
<td>12.9</td>
</tr>
<tr>
<td>EU</td>
<td>11.2</td>
<td>10.8</td>
<td>9.8</td>
<td>9.8</td>
<td>10.1</td>
</tr>
<tr>
<td>Japan</td>
<td>15.1</td>
<td>11.7</td>
<td>10.8</td>
<td>10.5</td>
<td>10.7</td>
</tr>
<tr>
<td>US</td>
<td>11.2</td>
<td>9.6</td>
<td>9.0</td>
<td>8.8</td>
<td>8.3</td>
</tr>
<tr>
<td>Others</td>
<td>29.1</td>
<td>30.6</td>
<td>34.0</td>
<td>34.3</td>
<td>31.8</td>
</tr>
<tr>
<td>World</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Singaporean dollar and Thailand baht appreciated by around 5%.

Exports could become less competitive as a result, especially when the Chinese yuan has effectively been depreciating in tandem with the falling United States dollar. In these circumstances Governments could either let their currencies continue to rise, or allow international reserves to accumulate. Most have chosen the latter course and added to a growing pool of foreign reserves (table 21). An exception is the State Bank of Viet Nam which, in November 2009, in response to the strains on the balance of payments, devalued the dong by around 5%. In February 2010, the Vietnamese dong was further devalued by 3% in an effort to reduce a widening trade deficit and stabilize the foreign exchange market. The move puts additional competitive strain on the exports of other ASEAN economies and could increase pressures for competitive devaluation. However, the impact of the two rounds of devaluation of the Vietnamese dong on the competitiveness of other ASEAN exporters is not likely be very significant because headline inflation (a cost factor) in Viet Nam as of January 2010 at 7.62% is higher than the other economies in the subregion. In addition, most economies in the subregion have positive current account balances, which ameliorates pressures on currency devaluation. For those reasons, the devaluation of the dong is not expected to spark a round of massive competitive devaluation in the subregion.

**Prospects**

Despite facing the full force of the global financial crisis, the economies of South-East Asia were thus fairly resilient and policymakers were generally able to respond effectively. Nevertheless, the subregion remains structurally dependent on trade with the developed countries. The IMF, for example, projects a 5.8% growth in the volume of world trade in goods and services for
TABLE 21. Foreign exchange reserves minus gold, selected South-East Asian economies, 2009, in billions of United States dollars

<table>
<thead>
<tr>
<th></th>
<th>Indonesia</th>
<th>Malaysia</th>
<th>Philippines</th>
<th>Singapore</th>
<th>Thailand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec-07</td>
<td>55.0</td>
<td>101.0</td>
<td>30.2</td>
<td>163.0</td>
<td>85.2</td>
</tr>
<tr>
<td>Dec-08</td>
<td>49.6</td>
<td>91.1</td>
<td>33.2</td>
<td>174.2</td>
<td>108.7</td>
</tr>
<tr>
<td>Jan-09</td>
<td>48.8</td>
<td>90.9</td>
<td>34.7</td>
<td>167.1</td>
<td>108.2</td>
</tr>
<tr>
<td>Mar-09</td>
<td>52.7</td>
<td>87.4</td>
<td>34.5</td>
<td>166.3</td>
<td>113.7</td>
</tr>
<tr>
<td>Jun-09</td>
<td>55.4</td>
<td>91.2</td>
<td>34.8</td>
<td>173.2</td>
<td>118.3</td>
</tr>
<tr>
<td>Sep-09</td>
<td>60.0</td>
<td>94.8</td>
<td>37.5</td>
<td>182.0</td>
<td>129.1</td>
</tr>
<tr>
<td>Dec-09</td>
<td>63.1a</td>
<td>95.4</td>
<td>38.5a</td>
<td>188.9a</td>
<td>135.5</td>
</tr>
</tbody>
</table>

Note: a Data refer to November 2009.


2010. Moreover, global capital is again flowing to the subregion and equity markets are exceptionally buoyant. Malaysia and Thailand should also see benefits from succeeding tranches of their stimulus packages. The subregion is thus forecast to grow by 5.1% in 2010.

South-East Asia should therefore see a rebound towards the end of 2009. During 2010 some countries that depend heavily on trade should see positive growth: Malaysia, 5.0%; Singapore, 7.0%; and Thailand, 4.0%. Growth should be even stronger in Indonesia, at 5.5%, and Viet Nam, at 5.8%. With large domestic markets, those commodity-rich countries were able to weather the 2009 recessional forces and should lead the recovery in 2010.

Cambodia is expected to resume economic growth by 4.0% on the back of an improving market for its main exports, while the Lao People’s Democratic Republic should continue to grow quite rapidly, by 6%. The Philippines expects a boost in consumption demand during 2010 from election spending and continued remittance flows. Timorese non-oil GDP, on the other hand, is expected to expand by 7.5% in 2010. Brunei is expected to grow by 0.6%.

As spending from the stimulus programmes winds down, economic prospects will rely on resurgence of the private sector. Nevertheless, infrastructure projects can be expected to continue beyond 2010, with their largest impact in developing countries where they will not only provide employment but help address infrastructure weaknesses that impede growth.

South-East Asian economies will want to look elsewhere for fresh sources of economic growth

The increase in spending is inevitably putting a strain on public finances, so policymakers will want to induce more private spending on consumption and investment. They could use the opportunity to review the investment climate and introduce further reforms, particularly those linked to improving governance. With the recovery still tentative, careful judgement about the pace and timing of the exit strategy will be required.

Since traditional markets in the developed countries have softened, South-East Asian economies will want to look elsewhere for fresh sources of economic growth – especially to

exploit the potential for trade with the wider Asian and Pacific region. They need not decouple from traditional markets but rather accelerate regional integration and pursue more aggressive trade and investment liberalization policies. Within their economies, they will also want to make growth more inclusive. That will lead to more equitable development as well as develop stronger markets for high-value-added products.

**BOX 6. The changing direction of ASEAN trade**

Exports of the member countries of the Association of South East Asian Nations (ASEAN) contracted severely in the first three quarters of 2009. Intra-ASEAN trade was hit particularly hard, declining by 26.4%. ASEAN exports to China also fell, by 17%. Chinese import demand for ASEAN products fell by less than that of the rest of the world. (table 22). Will the crisis encourage a shift in the direction of trade? Table 23 shows that the shares of intra-ASEAN trade and ASEAN trade to China have risen at the expense of the traditional markets. The ASEAN-China Free Trade Agreement, which entered into effect on January 1, 2010, is expected to intensify trading relations further. The trade share analysis does not differentiate between effects of exchange rate movements and those of cost competitiveness. Although the trade situation is very fluid and the profile could easily change, the analysis highlights the emerging Chinese role as a trade partner in the subregion.

**TABLE 22. ASEAN export growth, 2008 and 2009, in percentages**

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2008 Q1-3</th>
<th>2009 Q1-3</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASEAN</td>
<td>16.0</td>
<td>28.7</td>
<td>–26.4</td>
</tr>
<tr>
<td>China</td>
<td>12.2</td>
<td>24.9</td>
<td>–17.1</td>
</tr>
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<td>EU</td>
<td>6.9</td>
<td>12.7</td>
<td>–27.3</td>
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<tr>
<td>Japan</td>
<td>20.5</td>
<td>25.9</td>
<td>–31.8</td>
</tr>
<tr>
<td>US</td>
<td>-1.9</td>
<td>1.8</td>
<td>–23.0</td>
</tr>
<tr>
<td>Others</td>
<td>21.8</td>
<td>32.3</td>
<td>–20.5</td>
</tr>
<tr>
<td>World</td>
<td>14.5</td>
<td>23.7</td>
<td>–24.0</td>
</tr>
</tbody>
</table>


**TABLE 23. Percentage shares of ASEAN exporters in destination markets, in selected years**

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2007</th>
<th>2008</th>
<th>2008Q1-3</th>
<th>2009Q1-3</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASEAN</td>
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<td>25.1</td>
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<tr>
<td>China</td>
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<td>9.2</td>
<td>9.0</td>
<td>9.2</td>
<td>10.1</td>
</tr>
<tr>
<td>EU</td>
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<td>12.6</td>
<td>11.7</td>
<td>11.7</td>
<td>11.2</td>
</tr>
<tr>
<td>Japan</td>
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<td>10.3</td>
<td>10.8</td>
<td>10.5</td>
<td>9.4</td>
</tr>
<tr>
<td>US</td>
<td>15.0</td>
<td>12.4</td>
<td>10.6</td>
<td>10.4</td>
<td>10.6</td>
</tr>
<tr>
<td>Others</td>
<td>27.3</td>
<td>30.3</td>
<td>32.2</td>
<td>32.2</td>
<td>33.7</td>
</tr>
<tr>
<td>World</td>
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<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
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