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2001 APEC Economic Outlook

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LIST OF ABBREVIATIONS

The following is a list of abbreviations for the APEC member economies.

AUS	Australia
BD	Brunei Darussalam
CDA	Canada
CHL	Chile
PRC	China
HKC	Hong Kong, China
INA	Indonesia
JPN	Japan
ROK	Korea
MAS	Malaysia
MEX	Mexico
NZ	New Zealand
PNG	Papua New Guinea
PE	Peru
RP	The Philippines
RUS	The Russian Federation
SIN	Singapore
CT	Chinese Taipei
THA	Thailand
USA	United States of America
VN	Viet Nam

Foreword

The *APEC Economic Outlook* is an annual publication of the Economic Committee that was started in 1995. It reviews recent economic developments in the region as well as the economic performance of APEC member economies and their prospects. It also discusses a specific topical structural issue of particular interest at the time the report was written.

The *2001 APEC Economic Outlook* is the seventh in this series. This year's report is prepared amidst a cyclical slowdown of the world economy. Prospects for the year remain weak, as the negative impact of the global cyclical downturn rippled through and dampened business and consumer confidence. There are lingering concerns about the on-going inventory adjustment in the IT sector, more difficult financing conditions in some emerging economies, weakening corporate profitability and accompanying downward adjustment in equity prices, slower than expected recovery in the US economy and continued slow growth in the euro area, and a possible slip back of the Japanese economy in the near future.

Nevertheless, underlying inflationary pressures have been relatively subdued in the APEC region, giving room for more macroeconomic policies to counter the slowdown. Monetary easing and more expansionary fiscal policies in many APEC member economies should help revitalize demand in due course. Unfortunately the recent terrorist attack on the United States has overcast our near-term prospects, leading to added uncertainty about the timing and strength of the global economic recovery.

For its topical structural issue, this year's *Outlook* report takes a look into the nexus between financial development, financial efficiency and economic growth. The study is timely in face of the current global economic slowdown and envisaged volatility in the global market in the near term. A prominent task before us is how to strengthen our macroeconomic foundation, of which the financial infrastructure is an important constituent. The study affirms the significance of financial efficiency in ensuring stability and promoting long-run growth and prosperity. Empirical experience proves that size is not everything and efficiency matters. A key message from the study is that financial policies should aim at boosting financial efficiency through promoting competition, increasing private initiatives, reducing barriers to entry, relaxing restrictions on bank activities, improving risk management, enhancing transparency and tightening governance.

The *Outlook* is produced through the collaborative efforts of all member economies, with one member economy taking on the role of coordinator for the preparation of the report. Hong Kong, China is the coordinator for the *2001 Outlook*. It bore the heavy responsibility of preparing the initial drafts of the report and collating the individual economy reports submitted by member economies. All other economies assisted by providing comments and suggestions on the analyses as well as updated information on their own economies. As an integral part of the preparation of the *Outlook*, Hong Kong, China hosted the 2001 APEC Economic Outlook Symposium in June to gather views and inputs from the academia, government, business sector and international organizations.

Particular thanks are due to Ms Elley Mao of Hong Kong, China's Financial Services Bureau for taking on the difficult task of coordinating the work in producing this *Outlook*, and for her relentless editing of drafts and redrafts of the report. Thanks are also due to Dr Alan Siu, Dr Yim-fai Luk, Dr Kam-hon Chu and Dr Chor-yu Sin for their research input, and to the staff of the Financial Services Bureau, Mr Adolf Leung, Ms Frances Cheung and Ms Joyce Cheung for their technical assistance, and to Ms Stella Yip and Ms Anissa Hor for their patience in producing numerous transcripts of the report. Last but not least, I would like to express my appreciation of Mr Charles Jose, Director (Program) at the APEC Secretariat, for seeing this report through to publication.

Kyung Tae Lee
Chair, APEC Economic Committee
Seoul, October 2001

CHAPTER 1

Economic Performance and Prospects in the APEC Region

1.1 Overview

The global economy continued its growth momentum in 1999, and accelerated to an impressive growth rate of 4.7 percent in 2000. The APEC region shared this fruitful year and enjoyed a growth of 4.1 percent—the highest over the past decade. This was however overtaken by a downward drift towards the latter part of the year.

Most of the APEC member economies that suffered contraction during the Asian financial crisis continued to show a strong rebound in 2000. By comparison, the non-Asian member economies generally recorded more moderate growth. The *United States*, being the largest APEC member economy, helped drive the Asian member economies out of the trough. The strong growth in the US economy, at 4.1 percent in 2000, created a high demand for exports from Asia. As shown in Table 1.6, the United States was a major market for the Asian member economies, buying more than one-fifth of their exports. In particular, the dramatic expansion of the information technology (IT) sector in the United States induced a strong demand for electronic products and electronic components and parts from Asia. As shown in Table 1.7, these products constituted more than one-quarter of the total exports for many Asian member economies, and even more than half of the total exports for the *Philippines*, *Singapore* and *Malaysia*.

Although 2000 marked a very good year for the world economy, there was a significant downshift in the latter half of the year. The US economy began a cyclical slowdown. Its domestic demand moderated after several years of strong growth. This slowdown extended into the first half of 2001, although growth is expected to rebound in the second half of the year. In Asia, *Japan* is still unable to climb out of the trap created by the burst of the bubble economy in the late 1980s and the subsequent banking crisis in the 1990s, notwithstanding the zero-interest rate policy adopted by the Bank of Japan and the numerous stimulus packages initiated by the Japanese government. Reflecting the impact of a downturn in an increasingly globalised world, the European economies also recorded slowing growth. Against this backdrop, most member economies have eased back since the second half of 2000 and are expected to slacken further in 2001. The export-oriented member economies, especially those with a heavy reliance on electronic products, will probably be the hardest hit. *China* nevertheless has been able to maintain its growth momentum. The slowdown in its exports was largely offset by the rise in domestic demand. Economic reform and restructuring, reorientation of resource allocation to narrow income disparity and to achieve more balanced development between the eastern and western parts of the country, and the uplift of infrastructure to keep in step with the overall pace of economic growth have all contributed to supporting domestic demand in this economy.

High oil prices were a major concern among the regional economies in late 2000. The International Monetary Fund (IMF) simulation indicates that a US$5 per barrel increase in oil prices, if sustained, would lower growth in the major industrial economies in 2001 by 0.2-0.3 percent, and raise consumer prices by 0.3–0.4 percent. The same increase in oil prices would reduce growth in the Asian developing economies, including the net oil-exporters, by 0.3-0.4 percent in 2001. Yet the concern seems to have receded somewhat following the subsequent stabilisation of oil prices from early 2001. The efforts of the APEC economies to reduce oil dependency over the past decade or so have also rendered these economies less vulnerable to the recent volatilities in oil prices (Appendix AI).

World economic prospects for 2001 have weakened further, as the negative impact of the global cyclical downturn rippled through and dampened business and consumer confidence. There are lingering concerns about the on-going inventory adjustment in the IT sector, more difficult financing conditions in some emerging economies, weakening corporate profitability and accompanying downward adjustment in equity prices, and possible slip back of the Japanese economy in the near term. In cognisance of these factors, almost all individual APEC economies expect a general economic slowdown in 2001 (Table 1.8). Most have revised their forecasts further down in recent months to reflect the impact of a faster than expected downturn in global demand on their economies. IMF recently has also adjusted down its global growth forecast for 2001 to 2.6 percent, 0.6 percentage points lower than its May forecast.

Against the background of a general economic slowdown, underlying inflationary pressures have been relatively subdued giving room for more accommodative policies to counter the slowdown. Monetary easing in many of the APEC economies, and in particular in the United States since the beginning of 2001, is going to help reactivate demand in due course. Meanwhile, the more expansionary fiscal policy in some economies, the gradual abatement of the oil price shock and the general easing in world commodity prices together should give further support. It is thus believed that there is a reasonably good prospect for an early rebound in growth momentum. Growth in most APEC economies is forecast to pick up in 2002, supported by a revival in global activity and in the electronics cycle. IMF, in its latest review, expects global economic growth to recover to 3.5 percent in 2002, albeit somewhat slower than the May forecast of 3.9 percent. *(These forecasts were prepared before the tragic terrorist-attack on the United States, meaning that there is even more uncertainty around the estimates than is usually the case. In spite of the attack, most analysts continued to call for a rebound in economic activity. The precise timing of the rebound is subject to considerable uncertainty.)*

The baseline forecast is underscored by downside risks. As it now appears, the global economic outlook is heavily dependent on developments in the major industrial economies. So far, economic indicators still point to slackening growth in the United States, Europe and Japan. The unwinding of IT over-investment is still continuing. Should productivity growth in the major industrial economies stay weaker and the over-investment more pronounced than presently believed, the global downturn would be more prolonged making it much harder for the emerging markets and developing economies to recover. Continued slow growth can be expected to add further pressure on corporate performance and financial stability. While structural weakness and lagging reforms will be a hindrance to economic recovery, substantial progress in corporate and financial restructuring has been pushed through in several member economies since the last financial crisis. However, the process still needs to be accelerated in face of intensified competition along with globalisation.

1.2 Recent Economic Trends in the APEC Region

1.2.1 Continued economic rebound in 2000

The world economy expanded by 4.7 percent in 2000, up from 3.6 percent in 1999 (IMF 2001). Economic growth in the APEC region as a whole accelerated from 3.6 percent in 1999 to 4.1 percent in 2000 (Figure 1.1 and Table 1.1), with the majority of members enjoying higher growth. Those member economies that were badly hit by the Asian financial crisis enjoyed particularly sharp acceleration in growth. *Chile*, which was the only member with negative growth in 1999, turned around to record a positive growth.

The *United States* grew by 4.1 percent in 2000, the same as in 1999, and marked the ninth consecutive year of positive growth. The high growth rate was induced by the robust 4.8 percent growth in personal consumption and 9.9 percent growth in business fixed investment. Strong growth in the United States was a key factor supporting the overall favourable growth performance in the APEC region in 2000.

Japan, the second largest economy in APEC, managed to stay on the path of slow recovery in 2000, assisted by fiscal and financial policies. Its real GDP growth inched up from 0.8 percent in 1999 to 1.5 percent in 2000, attributable to the faster growth in exports and a turnaround in investment. Along with the accelerated economic growth, Japan's import absorption from the region expanded significantly. This to some extent also helped recovery in the Asian member economies. However, there were renewed signs of slackening towards the end of 2000. In the fourth quarter of 2000, although real GDP recorded a growth of 0.6 percent over the previous quarter, both private consumption and fixed asset investment registered a decrease of 0.6 percent.

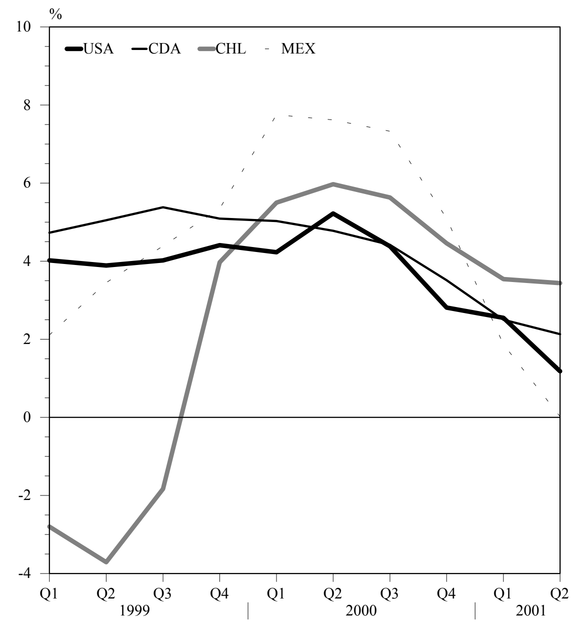
Strong external demand was the major factor behind the improved economic performance of most Asian member economies in 2000. In Northeast Asia, *China's* economic growth accelerated from 7.1 percent in 1999 to 8.0 percent in 2000. In addition to the strong growth in exports, robust domestic demand driven by rising disposable income on the one hand and proactive fiscal policy on the other also contributed to the stellar economic performance. *Hong Kong, China* recorded the highest real GDP growth amongst all the APEC economies, at 10.5 percent in 2000. This was a substantial jump from the 3.0 percent growth in 1999. Again, the strong growth was underpinned by a surge in exports, which helped raise both private consumption and fixed asset investment.

Chinese Taipei grew by 6.0 percent in 2000, slightly faster than the 5.4 percent growth in 1999. Meanwhile, *Korea's* economic growth moderated to 8.8 percent in 2000, from 10.9 percent in 1999. Exports of both economies grew vigorously on the back of the global IT boom and the recovery of the Asian markets, although manufacturers in Chinese Taipei reportedly are stepping up outsourcing to lower cost economies to maintain competitiveness. Domestic demand in the two economies was however not as robust, with noticeable moderation in the second half of the year. Reflecting this, both economies experienced a marked slowdown in the fourth quarter.

Members in Southeast Asia also showed improved economic performance in 2000, although their growth was generally more moderate than that of members in Northeast Asia. Real GDP growth in *Indonesia* bounced from a meagre 0.3 percent in 1999 to 4.8 percent in 2000, helped by a strong rebound in exports. *Malaysia* and *Singapore* recorded rapid real GDP growth in 2000, at 8.5 percent and 9.9 percent respectively, faster than the growth of 5.8 percent and 5.9 percent in 1999. Along with the acceleration in export growth, domestic demand, especially fixed asset investment, in the two economies rebounded strongly.

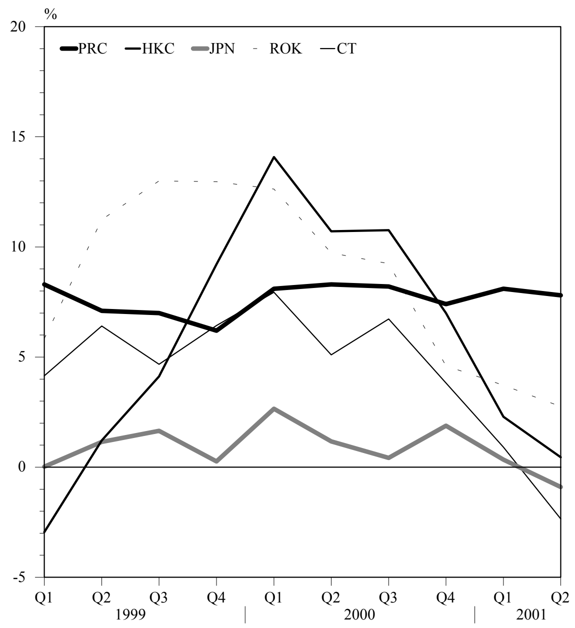
Figure 1.1: Gross Domestic Product
(year-on-year % growth in real terms)

(a) Western Hemisphere



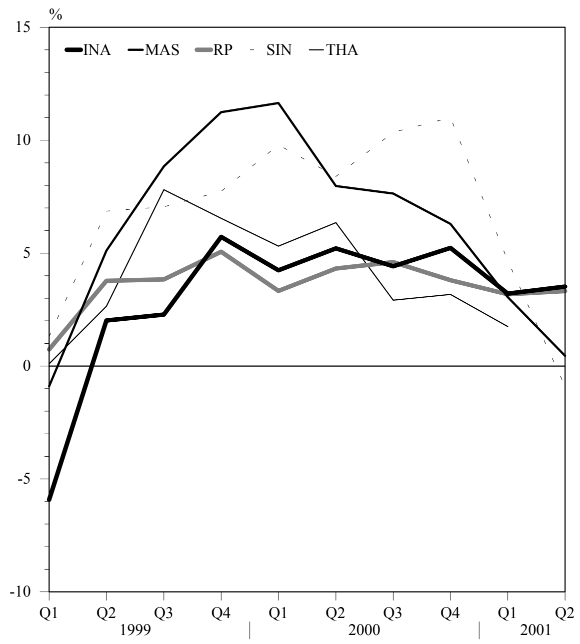
Note: For USA and CDA, annualised seasonally adjusted figures.
Source: Datastream.

(b) Northeast Asia



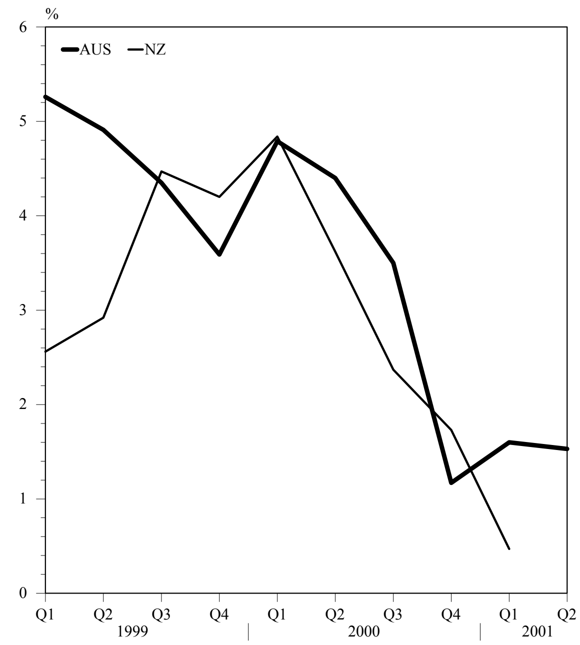
Source: CEIC.

(c) Southeast Asia



Source: CEIC.

(d) Oceania



Source: Datastream.

Table 1.1
Real GDP Growth in the APEC Region
(percent)

	1995	1996	1997	1998	1999	2000
Western Hemisphere	**2.3**	**3.5**	**4.5**	**4.2**	**4.1**	**4.3**
Canada	2.8	1.6	4.3	3.9	5.1	4.4
Chile	10.6	7.4	7.4	3.9	-1.1	5.4
Mexico	-6.2	5.2	6.8	5.0	3.8	6.9
Peru	8.6	2.5	6.7	-0.5	0.9	3.1
The United States	2.7	3.6	4.4	4.3	4.1	4.1
Northeast Asia	**3.1**	**4.5**	**3.2**	**-0.1**	**2.7**	**3.5**
China	10.5	9.6	8.8	7.8	7.1	8.0
Hong Kong, China	3.9	4.5	5.0	-5.3	3.0	10.5
Japan	1.6	3.5	1.8	-1.1	0.8	1.5
Korea	8.9	6.8	5.0	-6.7	10.9	8.8
Chinese Taipei	6.4	6.1	6.7	4.6	5.4	6.0
Southeast Asia	**8.1**	**7.4**	**4.1**	**-7.7**	**3.9**	**5.9**
Brunei Darussalam	3.0	1.0	3.6	-4.0	2.5	3.0
Indonesia	8.2	7.8	4.9	-13.7	0.3	4.8
Malaysia	9.8	10.0	7.3	-7.4	5.8	8.5
The Philippines	4.7	5.8	5.2	-0.6	3.3	4.0
Singapore	8.0	7.6	8.5	0.1	5.9	9.9
Thailand	8.6	5.9	-1.4	-10.8	4.2	4.4
Viet Nam [a]	9.5	9.3	8.2	3.5	4.2	5.5
Oceania	**4.3**	**3.7**	**3.5**	**4.7**	**4.6**	**3.7**
Australia	4.4	3.7	3.8	5.6	4.7	3.8
New Zealand	4.3	3.6	2.2	-0.1	3.9	3.6
Papua New Guinea [a]	-3.3	7.7	-3.9	-3.8	3.1	0.3
Russia	**-4.0**	**-3.4**	**0.9**	**-4.9**	**5.1**	**8.3**
APEC	**2.8**	**3.9**	**3.9**	**2.0**	**3.6**	**4.1**
WORLD [a]	**3.6**	**4.0**	**4.2**	**2.8**	**3.6**	**4.7**

Note: The APEC-wide and sub-regional averages were calculated using the previous year's nominal GDP levels as weights.
Sources: Individual Economy Reports at Appendix AII.
[a] *World Economic Outlook,* October 2001, International Monetary Fund.

Growth in *the Philippines* accelerated from 3.3 percent in 1999 to 4.0 percent in 2000, supported by a surge in exports, a turnaround in fixed asset investment and an accelerated growth in private consumption. Growth in *Thailand* also picked up, albeit marginally, from 4.2 percent to 4.4 percent. Meanwhile, *Viet Nam* grew by 5.5 percent in 2000, higher than the 4.2 percent growth in 1999. There was a notable rebound in private consumption, supported by the rise in public sector wages and the government's stimulus measures. As a net oil exporter, *Brunei Darussalam* benefited from the rise in crude oil prices, and saw its economic growth accelerate from 2.5 percent in 1999 to 3.0 percent in 2000.

Similar to the Asian economies, *Russia* continued on its recovery path in the past two years after the financial crisis in 1998. Real GDP growth accelerated from 5.1 percent in 1999 to 8.3 percent in 2000. The robust growth was fuelled by rapid growth in private consumption and increase in total investment.

All member economies in the Americas recorded strong growth in 2000. *Canada's* growth remained robust at 4.4 percent in 2000 after recording a 5.1 percent growth in 1999. Going down to Latin America, *Mexico* grew strongly by 6.9 percent in 2000, almost doubling the 3.8 percent growth in 1999. Growth was underpinned by the surge in exports and also strong growth in domestic demand. *Peru* picked up further from a 0.9 percent growth in 1999 to 3.1 percent in 2000. While private consumption showed a strong rebound, exports also accelerated in growth. *Chile*, the only APEC economy that suffered a 1.1 percent contraction in 1999 due to a combination of factors such as the El Niño weather phenomenon and sharp drop in commodity prices, also turned around to record a 5.4 percent growth in 2000.

All the three economies in Oceania, however, grew more slowly in 2000. Real GDP growth in *Australia* slowed from 4.7 percent in 1999 to 3.8 percent in 2000. Notwithstanding the strong exports, economic growth was hindered by transitional factors associated with the introduction of The New Tax System and the unwinding of the Sydney Olympics stimulus. Adversely affected by the oil price hike and softening business and consumer confidence, real GDP growth in *New Zealand* eased from 3.9 percent in 1999 to 3.6 percent in 2000. The sharp depreciation of the NZ dollar also weighed down domestic demand with higher import costs. *Papua New Guinea* grew by a meagre 0.3 percent in 2000, following a 3.2 percent growth in 1999.

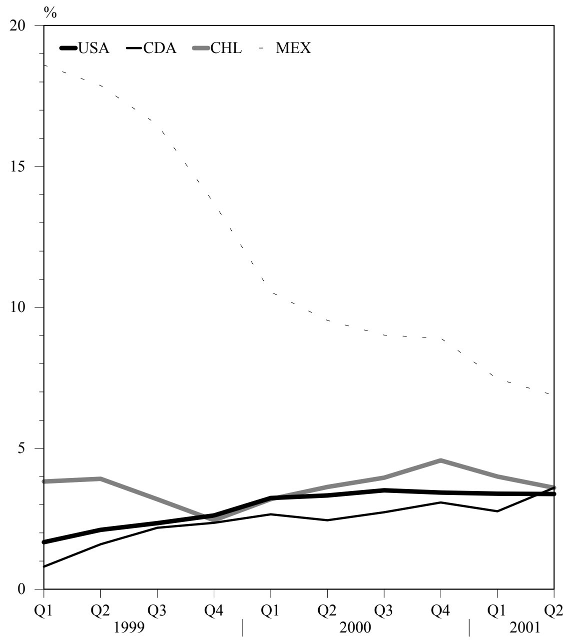
1.2.2 Subdued inflation

Strong economic growth has resulted in faster increases in prices in many APEC economies in 2000. The surge in oil prices, from an average of US$17.98 per barrel in 1999 to US$28.21 in 2000, also tended to push prices higher, particularly in the second half of the year. Nevertheless, inflation in most APEC economies in 2000 remained generally mild and did not pose much threat to economic growth or stability (Figure 1.2 and Table 1.2).

In Northeast Asia, Korea and Chinese Taipei recorded a moderate rise in inflation. Higher oil prices and public utility charges in the second half of 2000 have contributed to higher prices in *Korea*. Inflation picked up from 0.8 percent in 1999 to 2.3 percent in 2000. In *Chinese Taipei*, while rising international oil prices generated upward pressure on prices, the appreciation of the New Taiwan dollar produced an opposite effect. Consumer prices, though higher than the 0.2 percent increase in 1999, rose by only 1.3 percent in 2000. In *China*, strong domestic demand, partly driven by the government's proactive fiscal policy, has pushed consumer price inflation back to positive. An inflation rate of 0.4 percent was recorded in 2000, after two years of deflation. In *Hong Kong, China*, despite the on-going cost/price adjustment, the decline in overall consumer prices narrowed to 3.8 percent in 2000 from 4.0 percent in 1999. Strong domestic demand has resulted in some easing in disinflation, notwithstanding fierce competition in the retail sector. *Japan* was the only economy in Northeast Asia to see widening deflation,

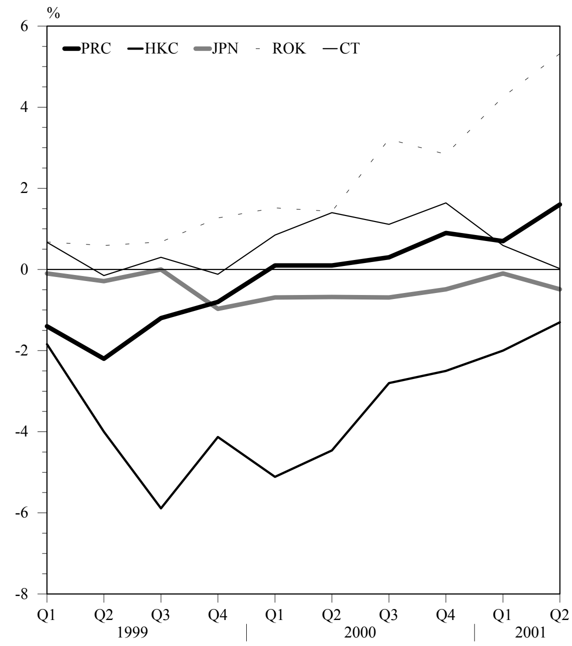
Figure 1.2: Consumer Price Inflation
(Percentage)

(a) Western Hemisphere



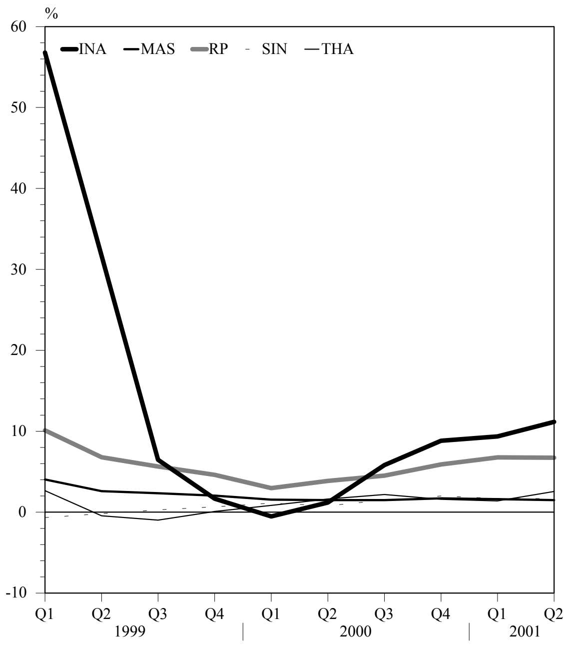
Source: Datastream.

(b) Northeast Asia



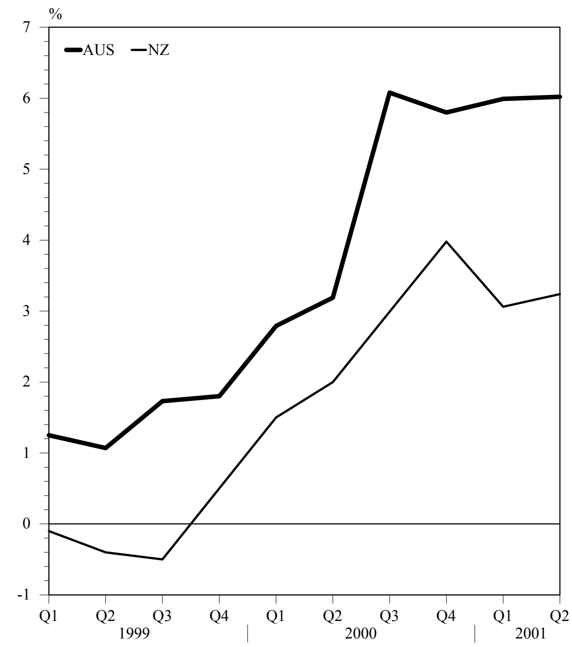
Sources: CEIC.
Official statistics.

(c) Southeast Asia



Source: CEIC.

(d) Oceania



Source: Datastream.

Table 1.2
Consumer Price Inflation in the APEC Region
(percent)

	1995	1996	1997	1998	1999	2000
Western Hemisphere						
Canada	2.2	1.6	1.6	0.9	1.7	2.7
Chile	8.2	6.6	6.0	4.7	2.3	4.5
Mexico	52.0	27.7	15.7	18.6	12.3	9.0
Peru [#]	10.2	11.8	6.5	6.0	3.7	3.7
The United States	2.8	2.9	2.3	1.5	2.2	3.4
Northeast Asia						
China	17.1	8.3	2.8	-0.8	-1.4	0.4
Hong Kong, China	9.1	6.3	5.8	2.8	-4.0	-3.8
Japan	-0.1	0.1	1.8	0.6	-0.3	-0.7
Korea	4.5	4.9	4.5	7.5	0.8	2.3
Chinese Taipei	3.7	3.1	0.9	1.7	0.2	1.3
Southeast Asia						
Brunei Darussalam	6.0	2.0	1.7	-0.4	-0.1	1.2
Indonesia	8.6	6.5	10.3	77.6	20.7	3.8
Malaysia	3.4	3.5	2.7	5.3	2.8	1.6
The Philippines	8.0	9.1	6.0	9.8	6.6	4.4
Singapore	1.7	1.4	2.0	-0.3	0.0	1.3
Thailand	5.8	5.9	5.6	8.1	0.3	1.6
Viet Nam [a]	16.9	5.6	3.1	7.9	4.1	-1.7
Oceania						
Australia	4.6	2.6	0.3	0.9	1.5	4.5
New Zealand	3.8	2.3	1.2	1.3	-0.1	2.6
Papua New Guinea [a]	17.3	11.6	3.9	13.6	14.9	15.6
Russia	231.3	121.8	111.0	184.4	136.5	120.2

Note: [#] End of periods figures.
Sources: Individual Economy Reports at Appendix AII.
[a] *World Economic Outlook*, October 2001, International Monetary Fund.

from -0.3 percent to -0.7 percent. Weak domestic demand and economic deregulation were the major factors underlying the continued fall in prices.

The situation in Southeast Asia was more diverse. While the inflation rates in *Brunei Darussalam*, *Singapore* and *Thailand* rose, they were still mild at below 2 percent in 2000. The appreciation of the Brunei dollar against its neighbouring economies helped keep inflation in check, although the impact was partly offset by the depreciation of its currency against the US dollar, the yen and the major European currencies. The small rise in inflation in Singapore was primarily due to the strong economic recovery and the effects of rising world oil prices on housing and transportation costs. In Thailand, inflation was driven up mainly by the rise in world oil prices and the continued depreciation of the Thai baht.

Meanwhile, inflation in *Indonesia* moderated distinctly from 20.7 percent in 1999 to 3.8 percent in 2000. Inflation in *the Philippines* also fell to its lowest level in a decade. The easing in inflation reflected the slower money supply growth as well as weaker food prices resulting from higher agricultural production and large stockpile of grains despite increases in petroleum prices and electricity charges, and the depreciation of the peso. Inflation also fell in *Malaysia*, attributable to the relatively stable exchange rate as well as excess capacity in several sectors of the economy. *Viet Nam* recorded negative inflation in 2000. Being an agricultural economy, the drop in world prices of agricultural commodities, particularly rice, led to a big decline in food prices in Viet Nam.

Most member economies in the Americas recorded higher inflation. The *United States* saw a rise in inflation, from 2.2 percent in 1999 to 3.4 percent in 2000, largely due to a dramatic increase in energy prices. The core inflation, which excludes food and energy prices, rose only slightly from 2.1 percent to 2.4 percent. *Canada* and *Chile* also recorded various degree of rise in inflation. Inflation was stable at 3.7 percent in *Peru*. On the other hand, *Mexico* recorded a fall in inflation, thanks to a restrictive monetary policy and the commitment to sound public finances.

Inflation rose in all Oceania member economies in 2000. The introduction of The New Tax System, coupled with the temporary effect of higher world oil prices on domestic petrol prices, saw inflation in *Australia* accelerate to 4.5 percent in 2000 from 1.5 percent in 1999. The oil price hike also led to a rise in inflation in *New Zealand*. Inflation in *Papua New Guinea* increased to 15.6 percent in 2000.

Finally, inflation in *Russia* was still high at 120.2 percent in 2000. But this already represented an improvement from the 136.5 percent in 1999.

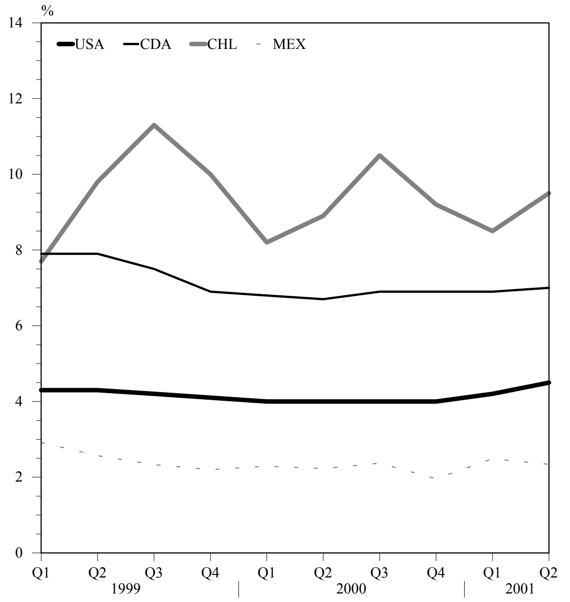
1.2.3 Diverse labour market conditions

Labour market conditions in the APEC region were rather diverse in 2000. The unemployment rates in several member economies in the western hemisphere have fallen for a few years, and have now reached the lowest level in recent decades. On the other hand, the unemployment rates in many Asian member economies stayed high, although for some of them there were already some easing from the high levels reached during the Asian financial crisis (Figures 1.3 and Table 1.3).

The unemployment rate in the *United States*, averaging at 4.0 percent in 2000, was the lowest since 1969. At the same time, the labour force participation rate–the percentage of the population over age 16 that is either employed or looking for work–reached an all-time high of 67.2 percent. As a result of the rapid growth in employment over the past few years, the unemployment rate in *Canada* was brought down to 6.8 percent in 2000, the lowest level in 25 years. The vigourous growth of the economy in *Mexico* drove its unemployment rate to 2.2

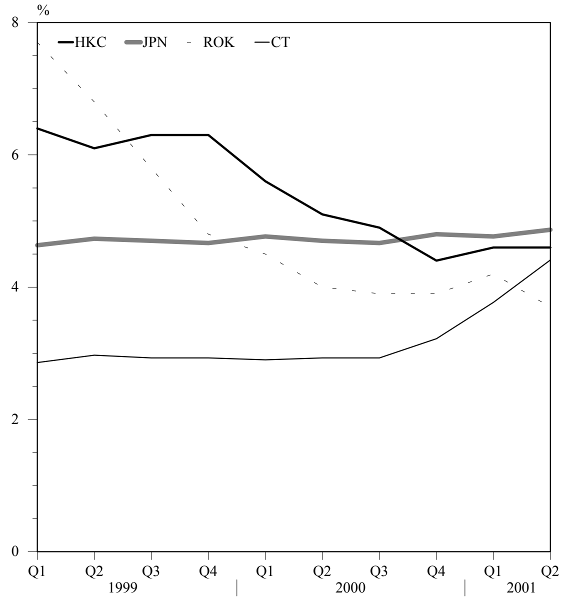
Figure 1.3: Unemployment Rates
(Percentage)

(a) Western Hemisphere



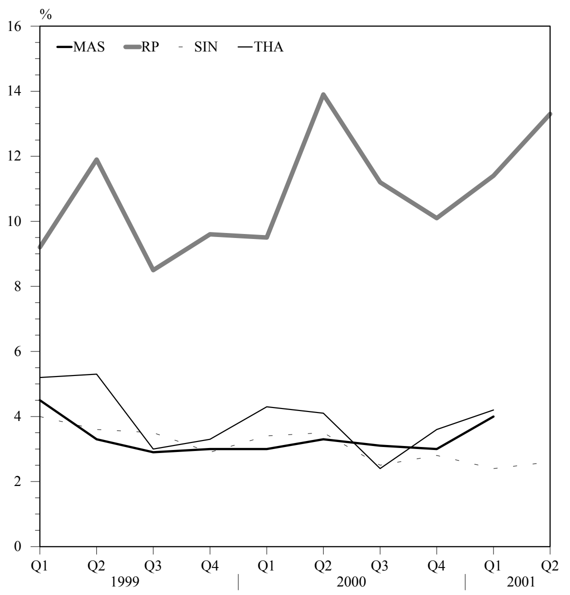
Note: For USA and CDA, seasonally adjusted figures.
Source: Datastream.

(b) Northeast Asia



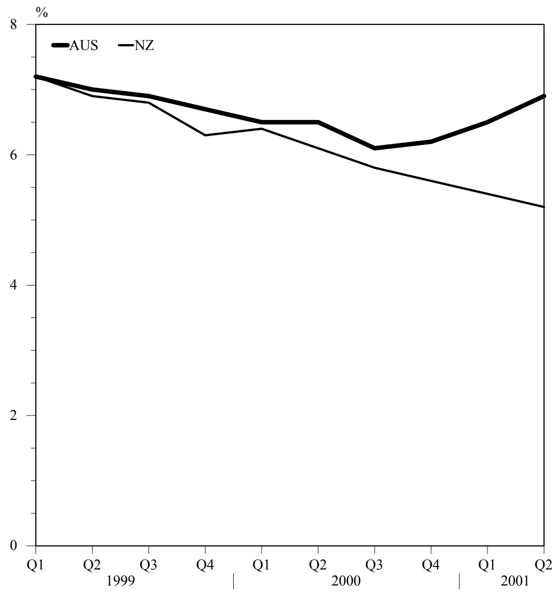
Note: Seasonally adjusted figures.
Sources: CEIC.
Official statistics.

(c) Southeast Asia



Notes: MAS, quarter-end figures.
RP, quarter-start figures.
SIN, quarter-end and seasonally adjusted figures.
Source: CEIC.

(d) Oceania



Note: Seasonally adjusted figures.
Source: Datastream.

Table 1.3
Unemployment Rates in the APEC Region
(percent)

	1995	1996	1997	1998	1999	2000
Western Hemisphere						
Canada	9.4	9.6	9.1	8.3	7.6	6.8
Chile	7.4	6.5	6.1	6.2	9.7	9.2
Mexico	6.3	5.5	3.7	3.2	2.5	2.2
Peru [a]	7.1	7.0	7.7	7.8	8.0	7.4
The United States	5.6	5.4	5.0	4.5	4.2	4.0
Northeast Asia						
China	2.9	3.0	3.1	3.1	3.1	3.1
Hong Kong, China	3.2	2.8	2.2	4.7	6.3	5.0
Japan	3.2	3.4	3.4	4.1	4.7	4.7
Korea	2.0	2.0	2.6	6.8	6.3	4.1
Chinese Taipei	1.8	2.6	2.7	2.7	2.9	3.0
Southeast Asia						
Brunei Darussalam	4.9	3.9	4.2	4.7	3.8	4.3
Indonesia	7.2	4.9	4.3	5.1	6.4	6.1
Malaysia	3.1	2.5	2.4	3.2	3.4	3.1
The Philippines	9.5	8.6	8.7	10.1	9.8	11.2
Singapore	2.0	2.0	1.8	3.2	3.5	3.1
Thailand	1.7	1.5	1.2	4.4	4.2	3.6
Viet Nam	N.A.	N.A.	N.A.	6.6	7.4	N.A.
Oceania						
Australia	8.2	8.2	8.2	7.7	7.0	6.3
New Zealand	6.3	6.1	6.6	7.5	6.8	6.0
Papua New Guinea	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Russia	9.0	10.0	11.2	13.3	13.3	12.0

Note: N.A. Not available.
Sources: Individual Economy Reports at Appendix AII.
[a] *Peru: Selected Issues, IMF Country Report No. 01/51,* International Monetary Fund.

percent in 2000, the lowest level registered since this indicator was first compiled in 1985. The unemployment rates in *Chile* and *Peru* also declined in 2000.

The situation in Asia was less bright. Notwithstanding the slightly faster economic growth, continued downsizing of Japanese corporations amidst accelerating economic restructuring kept *Japan's* unemployment rate high at 4.7 percent in 2000. While the registered urban unemployment rate in *China* remained stable at a low of 3.1 percent, the large and increasing pool of retrenched workers from the state-owned enterprises had not yet been included in the unemployment statistics. The unemployment rate in *Chinese Taipei* edged up in 2000, as industries cut hiring as a result of changes in comparative advantage, management reorganisation and production automation. Although the unemployment rates in *Hong Kong, China* and *Korea* declined, the improvement took place mostly in the early part of 2000. The labour markets in these two economies saw renewed weaknesses in the latter part of the year. The Korean government's expenditure on public projects is however expected to create new jobs and help lower unemployment in due course.

The Philippines did not see any improvement in the labour market after the Asian financial crisis, despite a turnaround in economic growth. The unemployment rate rose to a high of 11.2 percent in 2000. Employment in both agriculture and manufacturing fell. The unemployment rate in *Brunei Darussalam* also edged up. On the other hand, *Singapore's* labour market benefited from the strong expansion in most of its key industries, especially in the manufacturing sector. In consequence, unemployment recorded a small decline. Similarly, the strong growth in the *Malaysian* economy continued to create more jobs and reduce retrenchment, leading to a slight easing in unemployment. In *Thailand*, a rebound of the economy, together with the government's social relief programmes, served to lower the unemployment rate slightly. Both agricultural and non-agricultural employment increased. The unemployment rate in *Indonesia* also declined.

The unemployment rate in *Australia* went down in 2000. The unemployment rate in *New Zealand* also dropped, reflecting partly a decline in the labour force participation rate. In *Russia*, strong economic growth also led to a fall in the unemployment rate during 2000.

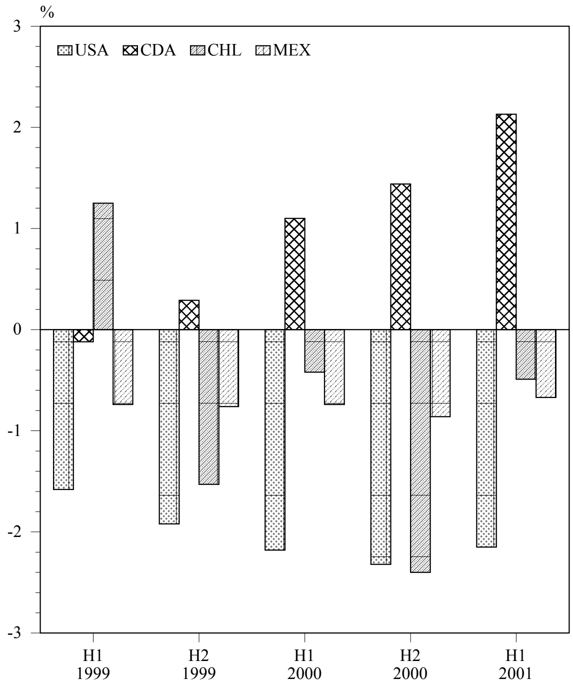
1.2.4 External transactions

Following the Asian financial crisis, the current accounts of most Asian member economies turned from deficits into surpluses, first due to a sharp fall in imports and then a strong surge in exports. In many of these Asian economies, the accumulation of current account surplus is essential to compensate for the capital account deficit partly due to mounting external debt repayment obligation and partly due to reduced capital inflow. By contrast, most member economies in the Western Hemisphere and Oceania continued to record current account deficits, which in turn were financed by net capital inflow.

The *United States* continued to have the largest current account deficit in the region in absolute terms, reaching US$445 billion, and equivalent to 4.5 percent of its GDP in 2000 (Figure 1.4 and Table 1.4). This was attributable mainly to its strong domestic demand for imported goods brought about by the rapid increase in economic activity. On the capital account (Table 1.5), the United States remained both an important source of and a favoured destination for foreign direct investment (FDI). In 2000, the US$288 billion inflow outweighed the US$152 billion outflow.

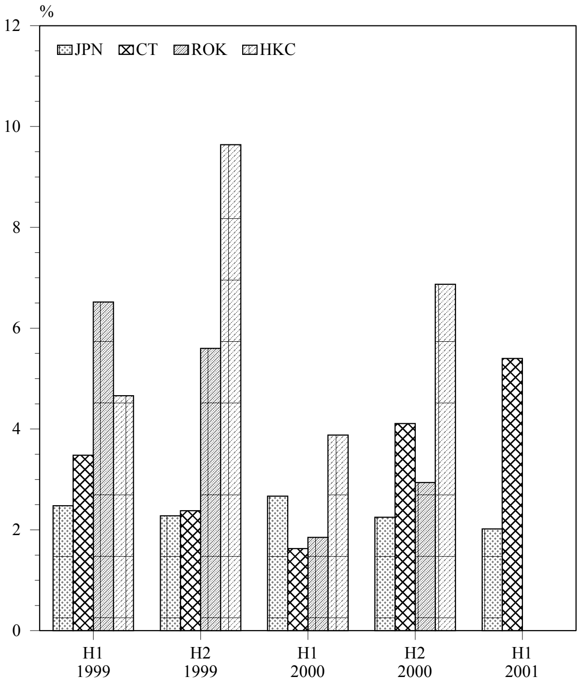
Figure 1.4 Current Account Balances
(As percent of GDP)

(a) Western Hemisphere



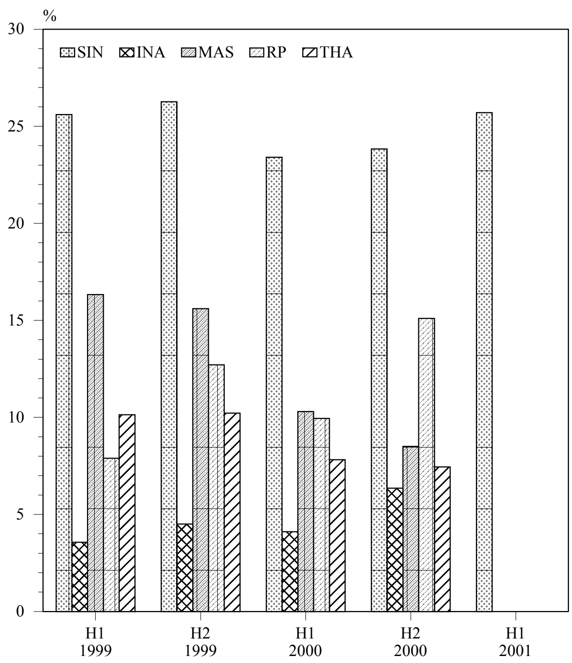
Source: Datastream.

(b) Northeast Asia



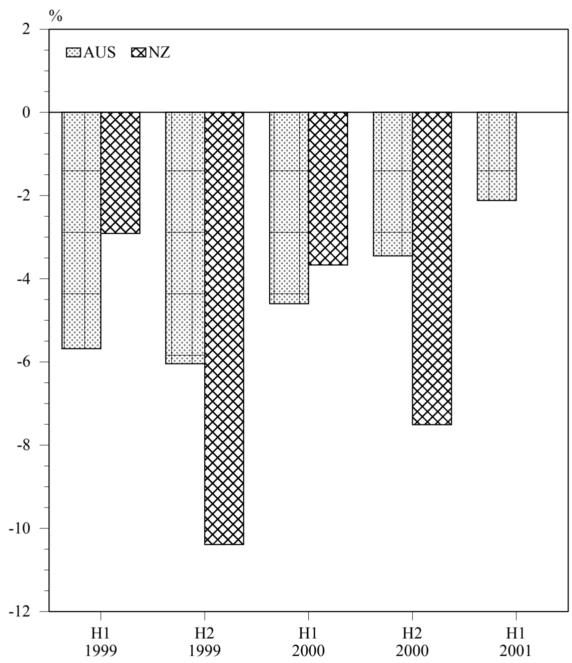
Source: CEIC.

(c) Southeast Asia



Source: CEIC.

(d) Oceania



Source: Datastream.

Table 1.4
Current Account Balance in the APEC Region
(percent of GDP)

	1995	1996	1997	1998	1999	2000
Western Hemisphere						
Canada	-0.7	0.5	-1.3	-1.3	0.2	2.5
Chile	-2.1	-5.1	-5.0	-5.7	-0.1	-1.4
Mexico	-0.6	-0.7	-1.9	-3.8	-3.0	-3.1
Peru [a]	-7.7	-6.1	-5.2	-6.4	-3.7	-3.0
The United States	-1.5	-1.5	-1.7	-2.5	-3.5	-4.5
Northeast Asia						
China	0.2	0.9	3.3	3.0	1.1	1.9
Hong Kong, China	N.A.	N.A.	-3.6	2.4	7.3	5.4
Japan	2.1	1.4	2.2	3.1	2.4	2.5
Korea	-1.7	-4.4	-1.7	12.7	6.0	2.4
Chinese Taipei	2.1	3.9	2.4	1.3	2.9	2.9
Southeast Asia						
Brunei Darussalam	47.3	54.2	51.7	50.0	58.8	86.4
Indonesia	-3.4	-3.5	-2.3	4.2	3.9	5.3
Malaysia	-9.7	-4.4	-5.9	13.1	15.9	9.2
The Philippines	-4.4	-4.8	-5.3	2.4	9.4	10.1*
Singapore	17.4	15.3	19.0	24.8	25.9	23.6
Thailand	-8.1	-14.4	-3.1	14.3	12.5	7.5
Viet Nam [b]	-11.0	-10.3	-6.5	-4.3	4.5	2.1
Oceania						
Australia	-5.4	-3.9	-3.1	-5.0	-5.8	-4.0
New Zealand	-5.1	-5.9	-6.6	-4.1	-6.7	-5.6
Papua New Guinea [c]	13.6	5.9	-5.0	1.6	4.0	11.7
Russia	2.2	2.8	0.5	0.2	13.1	18.3

Note: * The figure covers the period from January to November only.
N.A. Not available.

Sources: Individual Economy Reports at Appendix AII.
[a] *International Financial Statistics*, Vol LIV, Number 8, August 2001, International Monetary Fund.
[b] For 1995-1998, *2000 APEC Economic Outlook*; for 1999-2000, *World Economic Outlook*, October 2001, International Monetary Fund.
[c] For 1995-1997, *2000 APEC Economic Outlook*; for 1998-2000, *Asian Economic Outlook 2001,* Asian Development Bank.

Table 1.5
Capital Account Balance in the APEC Region
(percent of GDP)

	1995	1996	1997	1998	1999	2000
Western Hemisphere						
Canada [#]	0.2	-1.5	1.8	0.5	-1.2	-1.4
Chile	3.5	7.8	9.8	4.5	-1.1	-1.7
Mexico	5.4	1.2	3.9	4.2	3.0	3.1
Peru [a]	9.4	9.7	8.2	4.6	2.2	2.7
The United States [#]	1.5	2.2	3.3	1.6	4.1	4.5
Northeast Asia						
China	4.7	4.9	2.5	0.0	0.0	0.2
Hong Kong, China [#]	N.A.	N.A.	10.8	-6.7	-0.4	1.4
Japan	-1.3	-0.7	-2.8	-3.4	-1.1	-1.8
Korea	3.4	4.5	0.3	-1.0	0.5	2.6
Chinese Taipei	-0.3	-0.2	-0.1	-0.1	-0.1	-0.1
Southeast Asia						
Brunei Darussalam	-47.1	-43.5	-42.2	-48.7	-45.5	-45.8
Indonesia [b]	5.3	4.9	1.5	-4.1	-3.2	N.A.
Malaysia	8.6	9.4	2.2	-3.5	-8.4	-7.2
The Philippines	4.6	13.4	8.0	0.7	-2.4	-9.2
Singapore [#]	-5.8	-5.9	-11.8	-26.8	-22.0	-12.5
Thailand	13.0	19.5	-4.3	-9.8	-7.9	-9.5
Viet Nam [c]	N.A.	10.7	8.2	9.1	N.A.	N.A.
Oceania						
Australia	0.2	0.2	0.2	0.2	0.2	0.2
New Zealand	2.0	2.0	0.4	-0.3	-0.4	-0.4
Papua New Guinea						
Russia	-0.1	-0.1	-0.2	-0.1	-0.2	-0.0

Notes: [#] Total of Capital Account and Financial Account Balance.
N.A. Not available.

Sources: Individual Economy Reports at Appendix AII.
[a] *Peru: Selected Issues*, IMF Country Report No. 01/51, International Monetary Fund.
[b] For 1995-1999, *2000 APEC Economic Outlook.*
[c] *Key Indicators of Developing Asian and Pacific Countries,* Asian Development Bank.

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As in the case of the United States, *Mexico* and *Peru* also experienced current account deficits and capital account surpluses in 2000. In 2000, the current account deficit of *Mexico* amounted to US$17.7 billion (3.1 percent of GDP), which was financed mostly by foreign direct investment (US$13.2 billion or 74.6 percent of the current account deficit) and to a much smaller extent by portfolio investment (US$0.5 billion or 2.8 percent of the current account deficit). In *Peru*, faster export growth led to slightly smaller merchandise trade account and current account deficits in 2000. On the other hand, the capital account surplus increased. In *Chile*, both the current account and capital account were in deficit in 2000. Resulting from a faster increase in exports than in imports, *Canada* was the only member economy in the Americas that enjoyed a current account surplus, amounting to 2.5 percent of GDP in 2000. Yet its capital account recorded a deficit equivalent to 1.4 percent of GDP.

In Asia, *Japan* continued to record a current account surplus in 2000 that exceeded its capital account deficit. Similarly, both *Singapore* and *Malaysia* had current account surpluses larger than their capital account deficits. Buoyed by continuous robust growth in the region's main export market–the United States–strong global demand for electronic goods, particularly semiconductors for which sales grew by over 30 percent worldwide in 2000, and ongoing recovery in Asia, both domestic exports and re-exports of *Singapore* grew markedly in 2000. Exports of *Malaysia* showed a similar upward trend, though its higher repayment of external debts and higher overseas investment led to a sizeable capital account deficit.

Brunei Darussalam recorded the largest current account surplus among all the APEC members in relative terms, equivalent to 86.4 percent of GDP in 2000. This was partially offset by a sizeable capital account deficit, equivalent to 45.8 percent of GDP, resulting from huge long-term capital outflow. *The Philippines* recorded a sizeable current account surplus in 2000 due to a dip in imports against a moderate increase in exports. But the capital account deficit rose to 9.2 percent of GDP in 2000. *Indonesia's* current account surplus was maintained at a high level, underpinned by strong growth in exports amidst the sharp depreciation of the Indonesian rupiah. However, the capital account saw continued capital flight, reflecting both negative foreign direct investment (FDI) as well as continued outflow of portfolio capital.

In *Thailand*, the current account surplus as a percentage of GDP decreased in 2000. While the value of exports rose by 19.6 percent in 2000, it slowed down in the second half of the year due to the slowdown in the US economy. The value of imports however increased at a faster rate of 31.3 percent due to a sharp increase in net oil imports, raw materials and capital goods. Meanwhile, the capital account deficit widened, due to the private sector's external debt prepayment. In *Viet Nam*, the current account surplus narrowed substantially in 2000, reflecting the recovery of imports (including refined oil products).

China; Hong Kong, China; and Korea were the economies having surpluses on both the current account and the capital account. Notwithstanding a more rapid increase in imports than in exports, *China* still recorded a current account surplus equivalent to 1.9 percent of GDP in 2000. An influx of inward direct investment in anticipation of China's pending accession to WTO led to a small capital account surplus equivalent to 0.2 percent of GDP. The visible trade deficit of *Hong Kong, China* worsened in 2000, attributable to the surge in imports of goods. Yet thanks to the strong growth in exports of services, including inbound tourism and trade-related services, Hong Kong, China was able to maintain a sizeable current account surplus. The capital account was also in surplus. *Korea's* current account was in surplus for the third consecutive year, but the surplus narrowed significantly in 2000. The major factor behind the shrinkage was the rapid growth in imports in line with the economic recovery. The capital account was in surplus throughout the first three-quarters of 2000 but turned into deficit in the fourth quarter as investor confidence slipped. Meanwhile, *Chinese Taipei* also recorded a large current account surplus in 2000, supported by the surge in exports, particularly those of hi-tech products, amidst the global IT boom, as well as the rapid growth in exports of trade-related services. But the capital account recorded a small deficit, as outflow was spurred by a widening spread between domestic and foreign interest rates and an expectation of devaluation of the domestic currency.

On the back of strong exports, *Australia's* current account deficit narrowed in 2000. Both the current account and the capital account of *New Zealand* remained in deficit, but its merchandise trade balance turned to a surplus in 2000.

It is worthy of note that intra-APEC trade accounted for the bulk of trade of the APEC members. The United States, as the largest economy in the world and in APEC, provides a major destination for the exports of other APEC member economies, absorbing on average some 20 percent of the total exports of individual members (Table 1.6). Japan is another important destination for APEC exports, purchasing on average over 10 percent of the total. The United States and Japan, together with other APEC economies, make up over 80 percent of the total external demand for APEC goods and services.

As regards the product mix of exports, Table 1.7 shows that electrical and electronic products account for a high percentage of the total exports of most APEC economies. This is particularly the case for Malaysia, the Philippines, and Singapore, where their respective shares were well over 50 percent in 1998. The global demand for these kinds of products, and especially by the United States, has tremendous implications for the economic performance of these member economies.

1.3 Economic Prospects for the APEC Region[1]

1.3.1 Global economic slowdown

The *global economy* has started to slow down since the second half of 2000, and is expected to slow down further in 2001. According to IMF, global economic growth will moderate from 4.7 percent in 2000 to 2.6 percent in 2001. A faster-than-expected slackening of the US economy is the major factor behind the global slowdown. Following the rapid expansion in the IT sector in the past few years, partly driven by the keen shift to Internet usage, a consolidation seems inevitable. As an indication, growth in the US personal computer (PC) market slowed sharply from 13 percent in the third quarter of 2000 to 1.5 percent in the fourth quarter and further to -3.5 percent in the first quarter of 2001. The real GDP growth of the *United States* moderated distinctly from an annualised 5.7 percent in the second quarter of 2000 to 1.3 percent and 0.2 percent in the first and second quarters of 2001. Over the past several months, the *European economies* also weakened sharply. While the direct impact of the global slowdown through trade channels has been modest, activity is likely to have been affected by spillovers through corporate and financial linkages. In Asia, *Japan* was still haunted by problems consequential to the bursting of the bubble economy in the 1990s. While the acceleration in economic reform may benefit the economy in the longer term, it may be contractionary in the near term.

[1] The various forecasts were prepared before the tragic terrorist attack on the United States on 11 September 2001. Thus, the possible impact of the attack is not reflected in these forecasts.

Table 1.6
Direction of Exports, 2000
(percent of total exports)

From	To: US	Japan	Other APEC economies	EU
Western Hemisphere				
Canada	87.4	2.2	3.8	4.5
Chile	16.8	14.0	22.8	25.3
Mexico	83.5	1.4	7.2	3.3
Peru	29.6	4.8	20.2	19.8
The United States		8.4	56.3	21.4
Northeast Asia				
China	26.5	14.3	36.4	14.6
Hong Kong, China	22.3	5.6	48.1	15.2
Japan	29.7		45.5	16.4
Korea	22.3	11.2	38.9	13.0
Chinese Taipei	23.5	11.2	42.6	14.9
Southeast Asia				
Brunei Darussalam	14.3	41.4	41.8	2.0
Indonesia	15.0	21.7	40.5	14.1
Malaysia	21.7	12.5	45.6	13.6
The Philippines	30.2	14.6	35.6	16.5
Singapore	17.2	7.4	51.1	13.3
Thailand	22.5	15.7	39.3	16.7
Viet Nam	6.1	18.3	37.3	26.2
Oceania				
Australia	9.8	19.8	44.1	11.4
New Zealand	14.8	13.7	44.6	14.6
Papua New Guinea	1.2	11.1	46.2	7.0
Russia	7.7	2.7	8.8	35.8

Sources: *Direction of Trade*, June 2001, United Nations.
Ministry of Economic Affairs, Chinese Taipei.

Table 1.7: Exports of Electrical and Electronic Products, 1998
(percent of total exports)

	Electrical and electronic products	**Office machines, automatic data processing equipment**	Automatic data processing equipment	Parts for office machines and automatic data processing equipment	**Tele-communications, sound equipment**	Tele-communications equipment	**Electrical machinery**	Switch gear etc.	Transistor, valves, etc.	Electrical machinery
SITC	75+76+77	75	752	759	76	764	77	772	776	778
Western Hemisphere										
Canada	8.0	2.4	0.8	1.5	2.3	2.2	3.4	0.6	1.4	0.6
Chile	0.4	0.0	0.0	0.0	0.0	0.0	0.4	0.0	0.0	0.0
Mexico	32.2	6.4	3.8	2.3	10.3	4.6	15.5	2.6	1.8	3.8
Peru	0.6	0.0	0.0	0.0	0.0	0.0	0.6	0.0	0.0	0.0
The United States	22.1	7.0	3.8	3.0	3.8	3.3	11.3	1.6	5.9	1.6
Northeast Asia										
China	20.4	6.4	3.8	1.9	6.0	3.4	7.9	1.2	1.3	1.9
Hong Kong, China	28.4	7.5	2.1	4.6	8.9	5.7	12.0	1.6	4.5	1.7
Japan	29.6	8.6	4.0	3.8	6.0	3.3	15.0	2.5	7.3	3.5
Korea	27.9	4.1	3.4	0.5	5.3	3.4	18.5	0.7	14.7	0.9
Chinese Taipei	41.9	20.0	10.5	9.2	4.1	3.4	17.8	N.A.	9.8	N.A.
Southeast Asia										
Brunei Darussalam	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Indonesia	6.6	1.6	0.2	1.4	2.8	1.3	2.2	0.0	0.4	0.8
Malaysia	53.0	15.9	7.4	8.4	12.3	5.1	24.8	3.4	19.0	1.1
The Philippines	69.2	15.4	8.2	7.1	4.0	3.1	49.9	3.7	43.8	0.3
Singapore	58.2	27.9	18.5	9.0	6.8	4.3	23.5	2.1	17.7	2.2
Thailand	30.3	12.8	4.8	7.5	5.7	2.6	11.9	1.9	5.8	1.0
Viet Nam	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Oceania										
Australia	4.1	1.8	0.4	1.3	1.0	0.9	1.4	0.4	0.0	0.3
New Zealand	4.4	0.8	0.0	0.6	1.0	1.0	2.6	0.6	0.0	0.4
Papua New Guinea	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Russia	1.0	0.0	0.0	0.0	0.3	0.2	0.7	0.0	0.0	0.0

Sources: *International Trade Statistics,* 1998, United Nations.
Monthly Statistics of Exports and Imports, June 2001, Ministry of Finance, Chinese Taipei.

Most of the APEC economies are likely to feel the pinch of the global slowdown. However, the severity of the impact tends to depend on a number of factors, and differs from economy to economy. Intuitively, export-oriented economies will be more adversely affected than economies having a large domestic sector. Economies that rely heavily on exports of electronic and IT products to the United States will be particularly hard hit. Reflecting this, *Malaysia*, *Korea*, *Singapore*, *Chinese Taipei* and *Mexico* all slowed down sharply in the first half of 2001. On the other hand, *China* maintained strong growth in the same period, as the surge in domestic demand in China more than offset the slowdown in its exports.

According to official forecasts (Table 1.8), all APEC member economies except *Brunei Darussalam* and *Japan* are expecting slower growth in 2001. Reflecting a deteriorating environment, most forecasters, both in the public sector and in the private sector, have trimmed their forecasts significantly over the past few months.

Nevertheless, there remains a reasonable prospect of an early rebound in global growth, although at a slower pace than earlier envisaged. Since the beginning of 2001, macroeconomic policies have been eased in most industrial economies, and in the United States in particular. The gradual abatement of oil prices and the general easing in commodity prices should give added supporting effect. According to IMF, GDP growth in the United States and the euro area is projected to recover during the second half of the year, although the pace will be dampened by the lagged impact of past wealth losses on consumption as well as the continued unwinding of IT over-investment. Growth in Japan is also expected to begin to recover, but remain very modest given its continued structural difficulties. Putting these considerations together, global growth in 2002 is projected to rebound to 3.5 percent.

The outlook for the APEC economies will hinge on developments in the global economy. It is generally expected that they will recover gradually along with the global upturn in 2002. But, there are downside risks. For instance, if over-investment during the recent boom turned out to be more extensive and widespread than presently believed, equity markets in the major industrial economies could weaken further accompanied by sharp falls in fixed asset investment and private consumption. Slowing growth is also likely to add pressures on corporate sectors and financial systems, and hence further dampen business and consumer confidence. This could result in a much deeper and more protracted global downturn, especially if it is also associated with lingering structural weaknesses in Japan and some economies in the euro area. Also the scope for counter-cyclical policies will become increasingly constrained by the lately deepening current account and fiscal imbalances in some member economies.

1.3.2 Fiscal policy

Expansionary fiscal policy is among the measures governments can use to counter economic slowdown. During the Asian financial crisis, the governments of all the affected economies adopted expansionary fiscal policies to pull their economies out of the lull. This time round, many governments in the APEC economies have either announced or are contemplating the use of fiscal tools to support their weakening economies. To quote a few examples, in the *United States* the new government has introduced tax cuts amounting to US$39 billion. In *Korea*, the government has proposed to spend an additional 10 trillion won in the rest of 2001. In *Chinese Taipei*, a notable increase in public investment is planned for. In *Singapore*, the government announced a package of off-budget stimulus measures in late July, following the dismal economic performance in the second quarter of 2001. The *Malaysian* government announced an additional budget allocation to mitigate the economic slowdown in March 2001. In *the Philippines*, the government spent more money than planned to help improve the deteriorating economic conditions despite the fall in fiscal revenue. In *Thailand*, the new government upon taking office has introduced several fiscal measures to support the economy, including raising the budget deficit in fiscal year 2002 and establishing the Village and Urban Revolving Fund.

Table 1.8
GDP Growth Forecasts in the APEC Region
(percent)

	2000	Forecast 2001			2002		
	Actual out-turn	Official[@]	IMF[*a]	Private sector consensus[*c]	Official[@]	IMF[*a]	Private sector consensus[*c]
Western Hemisphere							
Canada	4.4	2.4[b]	2.0	1.8	3.4[b]	2.2	2.7
Chile	5.4	4.3	4.0	3.5	5.0	4.7	4.5
Mexico	6.9	2.0	0.8	0.6	N.A.	4.0	3.5
Peru	3.1	0.9	0.5	0.6	5.5	4.0	4.0
The United States	4.1	1.7	1.3	1.6	3.2	2.2	2.7
Northeast Asia							
China	8.0	7.0	7.5	7.6	N.A.	7.1	7.9
Hong Kong, China	10.5	1.0	0.6	0.8	N.A.	4.0	3.6
Japan	1.5	1.7[#]	-0.5	-0.1	N.A.	0.2	0.5
Korea	8.8	2-3[##]	2.5	2.9	N.A.	4.5	4.7
Chinese Taipei	6.0	-0.4	-1.0	-1.3	4.2	4.0	3.3
Southeast Asia							
Brunei Darussalam	3.0	3.5-4.5	N.A.	N.A.	4.0	N.A.	N.A.
Indonesia	4.8	3.0-4.0	3.0	3.0	4.0-5.0	4.3	3.9
Malaysia	8.5	5.0-6.0	1.0	0.7	N.A.	4.8	4.5
The Philippines	4.0	3.3-3.8	2.5	2.5	4.3-4.8	3.5	3.4
Singapore	9.9	0.5-1.5	-0.2	-0.6	N.A.	4.0	4.7
Thailand	4.4	2.0-3.0	2.0	1.9	4.0	4.0	3.4
Viet Nam	5.5 [a]	N.A.	4.5	5.9	N.A.	6.0	6.1
Oceania							
Australia	3.8	2.0[#]	2.3	2.5	3.25[#]	3.8	4.0
New Zealand	3.6	2.2	1.8	1.7	3.1	2.9	2.9
Papua New Guinea	0.3[a]	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Russia	**8.3**	**5.0-5.5**	**4.0**	N.A.	**N.A.**	**4.0**	**N.A.**
European Union	**3.4**[a]	**N.A.**	**1.8**	N.A.	**N.A.**	**2.2**	**N.A.**
World	**4.7**[a]	**N.A.**	**2.6**	N.A.	**N.A.**	**3.5**	**N.A.**

Notes: [@] These official forecasts were prepared by member economies before end-August 2001 and may not reflect the latest developments in their economies. There are indications that many member economies will revise their forecasts down in view of the likely impact of the terrorist-attack on the United States on 11 September 2001.

[*] The IMF and the private sector consensus forecasts were both released in September and should reflect more closely the latest developments in the global economy. But both have not been able to take into account the likely impact of the terrorist-attack on the United States on 11 September 2001.

[#] Fiscal year figures.

[##] Forecast of private economic institutes, not official government data.

N.A. Not available.

Sources: Individual Economy Reports at Appendix AII.

[a] *World Economic Outlook*, October 2001, International Monetary Fund.

[b] Average private-sector outlook (March 2001).

[c] Private Sector Consensus Forecasts, Consensus Economics Inc.

However, in many economies the extent to which the governments can implement expansionary fiscal policy to counter the current cyclical downturn is going to become increasingly constrained by their deteriorating financial positions. While the fiscal balances of some member economies like the United States have turned from deficit to surplus in recent times, those of many others (10 out of 21) are still in deficit (Table 1.9). The fiscal deficits in some member economies have even widened over the past two years as their government resorted to fiscal stimulus to jump-start their economies after the Asian financial crises. In 2000, among the Asian member economies, only *Brunei Darussalam*, *Singapore* and *Korea* recorded fiscal surplus, while *Indonesia* and *Thailand* experienced a small narrowing in fiscal deficit. All the other Asian member economies either recorded a larger fiscal deficit or had their fiscal balance switching from surplus to deficit. In North America, *Canada* and *the United States* both enjoyed large fiscal surplus. All the Latin American members except Chile still sustained fiscal deficits. In Oceania, both *New Zealand* and *Australia* continued to record budget surpluses. While the surplus in New Zealand narrowed somewhat, that in Australia widened. For *Russia*, a budget surplus was recorded in 2000, after continuous effort in trimming down its budget deficit since 1997.

1.3.3 Monetary policy

Monetary policy is directed by most APEC economies towards maintaining price stability. The global slowdown has depressed inflation, giving scope for an easing of monetary policy. In the *United States*, facing a sharp slowdown of the economy, the Federal Reserve reverted the earlier rising trend and lowered interest rates seven times in a row by a total of 3 percentage points in the first eight months of 2001.[2] The cut in US interest rates was transmitted immediately to interest rates in *Hong Kong, China* due to the linked exchange rate system. The *Bank of Japan* restored the zero interest rate policy in March and contemplated further quantitative monetary easing in August in face of a much weaker-than-expected economy. In most of the other Asian member economies, modest inflation and willingness to accept a weaker local currency have allowed the central banks to steer their interest rates lower (Figure 1.5 and Table 1.10). During the first eight months of 2001, short-term interest rates in all the Asian member economies except Indonesia fell. The fall in *the Philippines* was the sharpest, by 4.1 percentage points. In *Indonesia*, political uncertainty and capital outflow caused interest rates to rise. Interest rates in all the *non-Asian member economies* also declined during the first eight months of 2001.

In many APEC economies, another policy response to the economic slowdown is currency depreciation. There have been changes in exchange rate policy in some economies. For example, the Monetary Authority of Singapore have recently announced the change from a gradual appreciation of the Singapore dollar against a basket of currency to a neutral stance. Currencies of most Asian members depreciated against the US dollar in the latter part of 2000 and the first seven months of 2001, before showing some rebound in August due to the US dollar's weakness. Comparing end-August 2001 with end-June 2000, the Philippine peso depreciated the most amongst the East Asian currencies, by 18.0 percent against the US dollar to P51.99 per US$, mainly because of political uncertainty. *Malaysia*, *China* and *Hong Kong, China* are the exceptions, holding their currencies steady against the US dollar. The depreciation of some Asian currencies has at some point raised concern about another Asian financial crisis brewing. Yet, with the significant improvement in foreign debt position and the rapid build-up of foreign exchange reserves in many Asian economies over the past couple of years, the willingness to accept a weaker currency should reduce rather than increase the risk of another financial crisis. Outside Asia, the currencies of all member economies depreciated, except that of *Peru* which remained stable and that of *Mexico* which even appreciated slightly (Table 1.11).

[2] The Federal Reserve cut interest rates by another 0.5 percentage point on 17 September, following the terrorist attack on the United States earlier in the month.

Table 1.9
Budget Balance in the APEC Region
(percent of GDP)

	1995	1996	1997	1998	1999	2000
Western Hemisphere						
Canada	-5.3	-2.8	0.2	0.5	1.6	3.2
Chile	2.6	2.3	2.0	0.4	-1.5	0.1
Mexico	0.0	0.0	-0.8	-1.2	-1.1	-1.1
Peru	-3.1	-1.0	0.2	-0.8	-3.1	-3.2
The United States	-2.6	-1.8	-0.6	0.6	1.3	2.5
Northeast Asia						
China	-1.0	-0.7	-0.8	-1.5	-2.1	-2.8
Hong Kong, China	-0.3	2.2	6.6	-1.8	0.8	-0.6
Japan	-6.3	-6.2	-5.4	-7.2	-8.2	N.A.
Korea [a]	0.4	0.0	0.0	-3.0	-2.7	1.1
Chinese Taipei [b]	-2.9	-1.7	-2.4	1.2	0.5	-1.2
Southeast Asia						
Brunei Darussalam	-16.3	-9.7	-15.1	-28.2	-20.8	11.9
Indonesia	1.0	1.0	0.4	-1.7	-7.9	-5.1
Malaysia	0.8	0.7	2.4	-1.8	-3.2	-5.8
The Philippines	0.6	0.3	0.1	-1.9	-3.7	-4.1
Singapore	6.2	6.1	1.1	2.4	2.5	3.5
Thailand	2.7	2.3	-0.7	-2.5	-2.9	-2.4
Viet Nam [a]	-4.1	-3.0	-4.1	-3.3	-2.8	-3.0
Oceania						
Australia*	-2.8	-2.0	-1.0	0.2	0.7	2.0
New Zealand #	3.0	3.5	1.9	2.6	1.7	1.4
Papua New Guinea	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Russia	-5.4	-8.1	-7.7	-5.9	-1.1	2.5

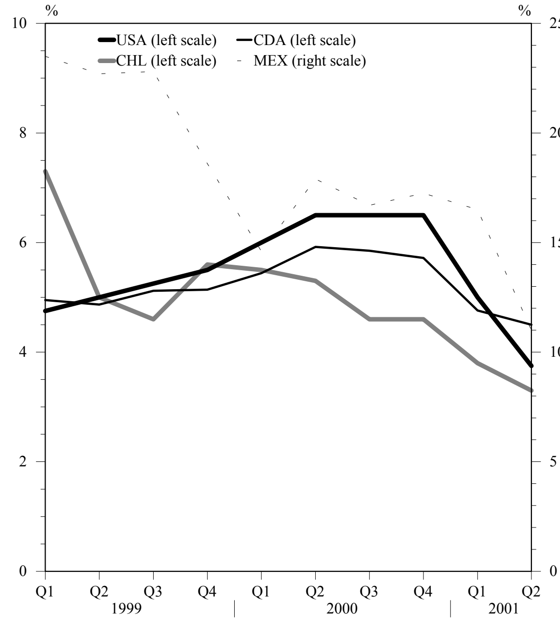
Notes: # Fiscal year figures.
* Percentage of GNP.
N.A. Not available.

Sources: Individual Economy Reports at Appendix AII.
[a] For 1995-1999, *2000 APEC Economic Outlook*; for 2000, *Asian Development Outlook 2001*, Asian Development Bank.

Figure 1.5: Short-term Interest Rates

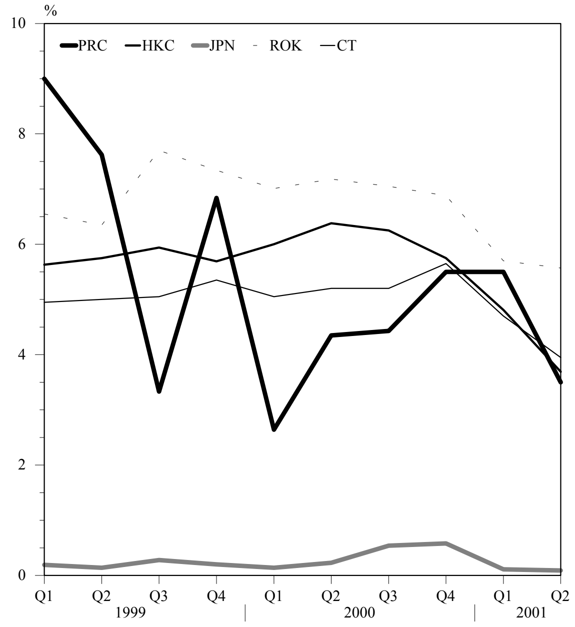
(Percent per annum)

(a) Western Hemisphere



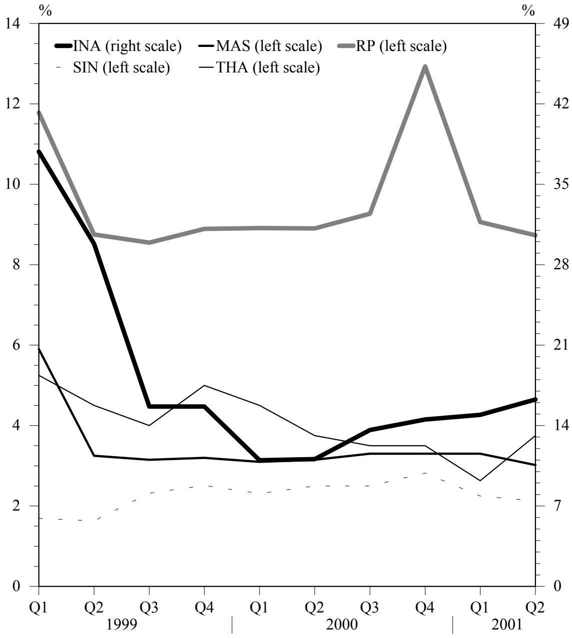
Source: Datastream.

(b) Northeast Asia



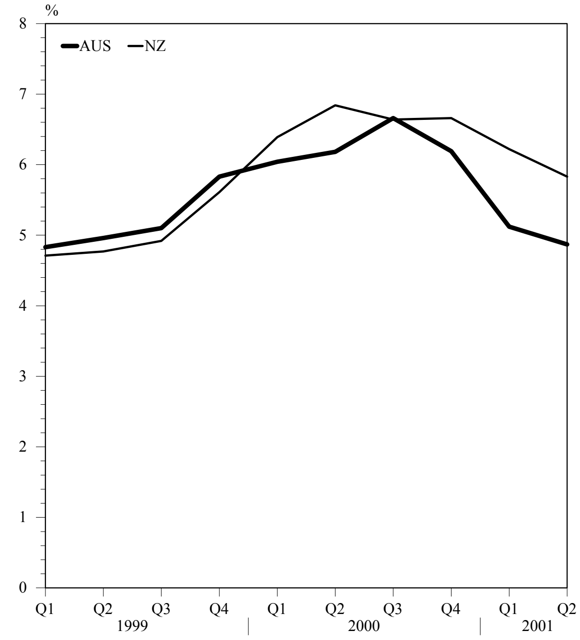
Sources: Datastream.
CEIC.
Official statistics.

(c) Southeast Asia



Source: Datastream.

(d) Oceania



Source: Datastream.

Table 1.10
Short-term Interest Rates
(percent per annum)

	Dec 2000	Mar 2001	Jun 2001	Aug 2001
Western Hemisphere				
Canada	5.72	4.76	4.50	3.96
Chile	4.60	3.80	3.30	N.A.
Mexico	17.25	16.50	11.00	10.95
Peru	N.A.	N.A.	N.A.	N.A.
The United States	6.50	5.00	3.75	3.50
Northeast Asia				
China	5.50	5.50	3.50	4.20
Hong Kong, China	5.75	4.81	3.69	3.25
Japan	0.58	0.11	0.09	0.07
Korea	6.88	5.70	5.57	4.81
Chinese Taipei	5.65	4.70	3.95	3.60
Southeast Asia				
Brunei Darussalam	N.A.	N.A.	N.A.	N.A.
Indonesia	14.53	14.94	16.28	17.03
Malaysia	3.30	3.30	3.02	2.88
The Philippines	13.6	9.7	8.8	9.5
Singapore	2.82	2.25	2.13	2.09
Thailand	3.50	2.63	3.75	3.25
Viet Nam	N.A.	N.A.	N.A.	N.A.
Oceania				
Australia	6.19	5.12	4.87	4.68
New Zealand	6.66	6.22	5.83	5.83
Papua New Guinea	N.A.	N.A.	N.A.	N.A.
Russia	17.71	14.12	15.27	14.12

Notes: The interest rates are end-of-month figures.
N.A. Not available.
Sources: Datastream.
CEIC.
Official statistics.

Table 1.11
Exchange Rates
(domestic currency units per US dollar)

	Jun 2000	Dec 2000	Jun 2001	Aug 2001
Western Hemisphere				
Canada	1.48	1.50	1.52	1.55
Chile	540	574	632	665
Mexico	9.92	9.62	9.04	9.21
Peru	3.49	3.53	3.51	3.48
Northeast Asia				
China	8.28	8.28	8.28	8.28
Hong Kong, China	7.79	7.80	7.80	7.80
Japan	106.02	114.36	124.62	118.77
Korea	1115	1265	1301	1280
Chinese Taipei	30.81	33.15	34.45	34.55
Southeast Asia				
Brunei Darussalam	N.A.	N.A.	N.A.	N.A.
Indonesia	8760	9675	11390	8863
Malaysia	3.80	3.80	3.80	3.80
The Philippines	42.65	49.90	51.49	51.99
Singapore	1.73	1.73	1.82	1.74
Thailand	39.19	43.40	45.23	44.05
Viet Nam	14083	14514	14845	14993
Oceania				
Australia	1.68	1.79	1.96	1.89
New Zealand	2.13	2.25	2.45	2.27
Papua New Guinea	2.45	3.07	3.33	N.A.
Russia	28.07	28.16	29.11	29.37

Notes: The exchange rates are end-of-month figures.
N.A. Not available.
Sources: Datastream.
International financial statistics, International Monetary Fund.
Official Statistics.

The effects of lower interest rates and weaker currency, though rather inconspicuous so far, may surface in due course. But again the effect may vary from economy to economy. While monetary easing may help to boost demand and reduce the cost of doing business, it may be more effective in economies with a larger domestic sector. On the other hand, currency depreciation may help enhance price competitiveness in the international market, and hence may be more useful to economies with a larger export sector. But there is always concern that the effectiveness of currency depreciation may diminish when many economies depreciate their currencies at the same time. Competitive devaluation can be detrimental to financial stability, so that in the end no one can benefit from the race to devalue one's currency.

1.3.4 Oil prices

In late 2000, the hike in international crude oil prices was a major uncertainty surrounding the APEC economies. Due to rising demand and falling supply, the Brent crude oil price rose from an average of US$17.7 per barrel in 1999 to US$28.3 per barrel in 2000. It even surged to about US$38 per barrel in late 2000. The upsurge in oil prices was expected to have negative effects on economic growth, inflation and external trade balance of the net oil importers. According to IMF, an increase of US$5 per barrel in crude oil prices, if sustained, would lower growth in the major industrial economies by 0.2–0.3 percentage point, and raise consumer prices by 0.3–0.4 percentage point. The same increase in oil prices would reduce growth in the Asian developing economies by 0.3–0.4 percentage point.

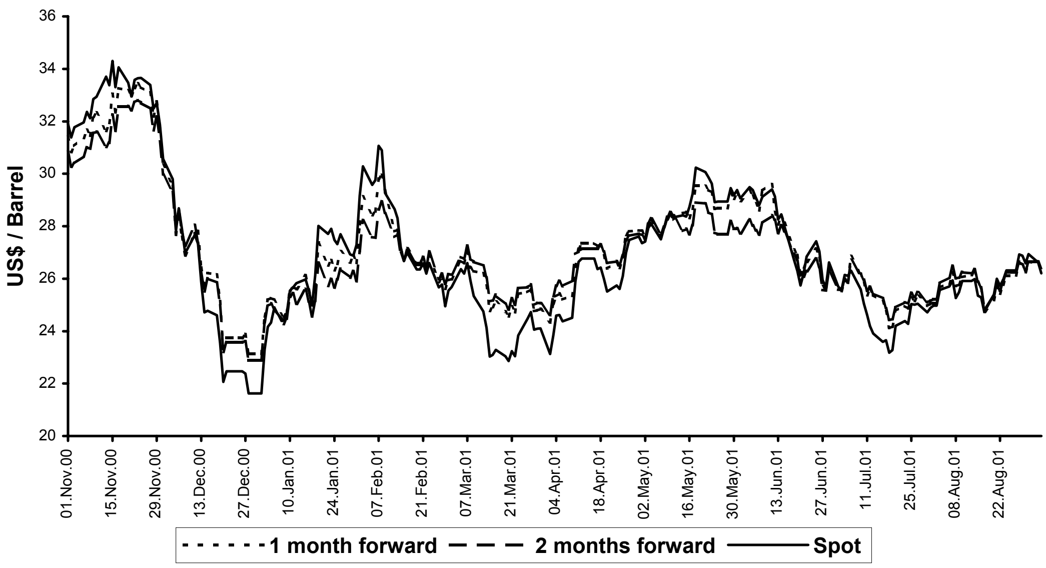
Fortunately, the surge in crude oil prices in the latter part of 2000 proved to be short-lived. In the first half of 2001, the Brent crude oil price fluctuated in the range of US$22.4–30.0 per barrel, and averaged at US$26.9 per barrel.[3] Crude oil prices remained stable during July and August, although the cut of oil production by one million barrels per day by OPEC led to a rebound in early September. Beside international oil prices, currency movements also play a role in determining domestic oil prices. For example, the weakening of the Thai baht since the beginning of the year has contributed to the domestic oil price hike. Since May 2001, the Thai government has intervened in the domestic oil market to subsidise oil prices for about three months for sectors that are considered to be crucial to the economy. The government has also urged a major local distributor to cut down on some marketing costs. The moral suasion succeeded in reducing domestic oil prices by a small amount.

The International Energy Agency forecast that global demand for crude oil would edge down by 0.2 percent in the third quarter of 2001 over a year earlier, before reverting to a 0.7 percent increase in the fourth quarter. Global oil demand was expected to rise by 1 percent to 76.4 million barrels per day in 2002. Barring any unforeseen development, oil prices are unlikely to make a sharp upturn in the near future, although forecasts by different parties vary significantly. The Energy Information Administration of the US Department of Energy forecast that crude oil price would rise from US$28 per barrel in April 2001 to US$30 per barrel in October 2001, and fluctuate around that level until the end of 2002. On the contrary, *Australia* expected the international oil price to decline to US$23 per barrel in 2001 and US$22 per barrel in 2002, while *Chile* expected it to go down to US$25 per barrel in 2001 and further to US$23 per barrel in 2002. In *New Zealand*, international oil prices were expected to rise slightly to US$25 per barrel and stabilise at that level in 2001. *Thailand* expected crude oil prices to remain at U$26 per barrel. Other economies, like *Mexico* and *Chinese Taipei* expected prices to remain stable at the 2000

[3] Following the terrorist incident, there are concerns that oil prices may become more volatile in the near future. Nevertheless, in the few days immediately following the incident, the Brent crude oil price rose from US$27.6 per barrel on 10 September (the day before the attack) to US$29.5 per barrel on 14 September, before easing back to US$27.2 per barrel on 18 September.

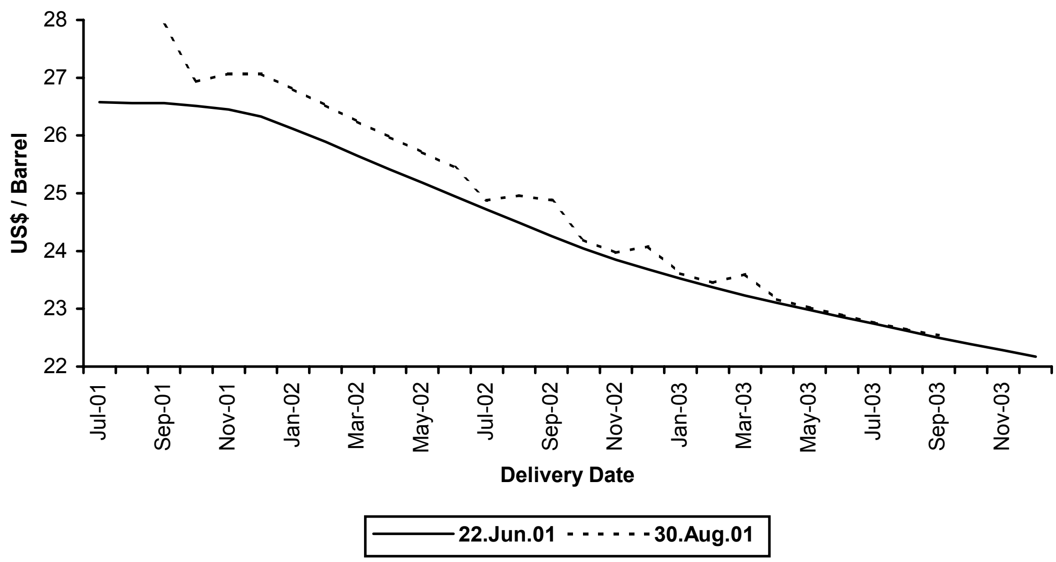
level, around US$28 per barrel.[4] The future prices of light sweet crude oil traded on the New York Mercantile Exchange may shed some light on the market's expectation. At end-August 2001, the forward price curve was downward sloping, falling from US$27.9 for September delivery to US$22.3 for delivery in December 2003. As such, crude oil prices should not have very significant impact on the short-term outlook for the APEC economies. Moreover, over the years most APEC economies have adopted measures to enhance energy efficiency and lower dependence on oil (see Appendix AI).

Figure 1.6: Brent Crude Oil - Spot and Futures Prices
1 Nov 2000 - 4 Sept 2001



Source: Datastream.

Figure 1.7: Light Sweet Crude Oil Futures



Source: New York Mercantile Exchange.

4 Forecasts of crude oil prices by different economies may not be directly comparable, due to variation in the definition of crude oil measure.

1.3.5 Benign inflation

The slowdown of the global economy and the stabilisation of crude oil prices should help contain inflation in 2001 and 2002 for most APEC member economies. The member economies in the Western Hemisphere and Oceania are expected to see a drop in inflation rate. In Northeast Asia, inflation will probably remain mild. In Southeast Asia, inflation will probably rise slightly in 2001 before easing back in 2002 despite the depreciation of most Southeast Asian currencies (Table 1.12).

1.3.6 Forecasts analysed by individual member economy[5]

The *US* economy has been slowing down faster than expected since the second half of 2000. Real GDP growth touched a low of 0.2 percent in the second quarter of 2001 on a quarter-to-quarter annualised basis. So far the main culprit for the slowdown was the plunge in investment amidst consolidation in the IT sector. While the successive cuts in interest rate by the Federal Reserve will help support the economy, the US government forecasts economic growth to moderate to 1.7 percent in 2001 before picking up to 3.2 percent in 2002. Private sector forecasters expect growth of 1.6 percent in 2001, picking up to 2.7 percent in 2002. As for prices, the government expects the inflation rate to ease from 3.4 percent in 2000 to 3.3 percent in 2001 and 2.7 percent in 2002.

In the first quarter of 2001, *Japan's* real GDP grew by a mere 0.3 percent. Exports dropped in US dollar terms in both the first and second quarters. Business investment slackened, and private sector investment showed no signs of recovery. The new government's heavy emphasis on economic reform should help revitalise the economy in the longer term, but the streamlining of corporate structure and consolidation of the banking sector, together with the associated rise in unemployment, will be contractionary in the near term. *Japan* is expected to achieve a low growth rate well below the official estimate (1.7 percent) which was initially forecast in December 2000. Business/private sector forecasters expect a 0.1 percent contraction in 2001, reverting to a 0.5 percent growth in 2002. The government forecasts deflation to improve from -0.7 percent in 2000 to -0.2 percent in 2001.

Hong Kong, China; *Korea*; and *Chinese Taipei* all slowed down sharply in the first half of 2001, registering growths of only 1.4 percent, 3.2 percent and -0.7 percent respectively. Exports of the three economies fell by 1.6 percent, 4.9 and 10.8 percent in US dollar terms in the first half of 2001, hit by the plunge in external demand. *Chinese Taipei* was the first to record a fall due to its heavy reliance on exports of IT products to *the United States*. Domestic demand was also weak in *Korea* and *Chinese Taipei* with both consumer and investor confidence sapping amidst the economic slowdown. Notwithstanding the general easing in monetary policy, vigorous resort to fiscal stimulus, and currency depreciation in the cases of *Korea* and *Chinese Taipei*, these three economies are expected to remain subdued in the remainder of 2001. According to official forecasts, *Hong Kong, China* will grow by 1 percent in 2001, whereas private economic institutes expect Korea to grow by 2–3 percent. *Chinese Taipei* recently revised down its forecast to -0.4 percent. As for prices, *Hong Kong, China* will probably continue to record negative inflation in 2001, at -1.3 percent. Inflation in *Korea* and *Chinese Taipei* is expected to remain modest in 2001, at 4.4 percent and 0.4 percent respectively.

[5] Individual Economy Reports as contributed by APEC member economies are at Appendix AII.

Table 1.12
Inflation Forecasts in the APEC Region
(percent)

	2000	Forecast 2001			Forecast 2002		
	Actual outurn	**Official[@]**	**IMF[*a]**	**Private sector consensus[*b]**	**Official[@]**	**IMF[*a]**	**Private sector consensus[*b]**
Western Hemisphere							
Canada	2.7	2.4	3.1	2.8	2.0	2.3	2.0
Chile	4.5	3.2 [#]	3.4	3.6	2.8 [#]	3.3	3.5
Mexico	9.0	6.5	6.3	5.3	N.A.	4.8	5.2
Peru	3.7	2.5-3.5	3.1	1.9	1.0-3.0	2.6	2.7
The United States	3.4	3.3	3.2	3.1	2.7	2.2	2.3
Northeast Asia							
China	0.4	1.0-2.0	1.0	1.4	N.A.	1.5	2.3
Hong Kong, China	-3.8	-1.3	-1.4	-1.0	N.A.	0.6	0.7
Japan	-0.7	-0.2[##]	-0.7	-0.5	N.A.	-0.7	-0.6
Korea	2.3	4.4	4.4	4.3	N.A.	3.4	2.9
Chinese Taipei	1.3	0.4	0.1	0.4	1.1	0.8	1.2
Southeast Asia							
Brunei Darussalam	1.2	1.0-2.0	N.A.	N.A.	1.5	N.A.	N.A.
Indonesia	3.8	9.0-11.0	10.8	10.9	7.0-9.0	7.0	9.6
Malaysia	1.6	1.5-2.0	1.5	1.6	N.A.	2.0	2.2
The Philippines	4.4	6.0-7.0	6.5	6.5	5.0-6.0	5.7	6.0
Singapore	1.3	1-2	1.5	1.5	N.A.	1.7	1.7
Thailand	1.6	2.2	2.5	1.9	2.6	2.7	2.3
Viet Nam	-1.7[a]	N.A.	0.6	1.0	N.A.	4.3	3.8
Oceania							
Australia	4.5	6.0[##]	4.2	4.4	2.0[##]	2.0	2.3
New Zealand	2.6	2.5	2.7	2.6	1.9	2.2	2.1
Papua New Guinea	15.6[a]	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Russia	120.2	17-18	22.1	N.A.	N.A.	12.9	N.A.

Notes: [@] These official forecasts were prepared by member economies before end-August 2001 and may not reflect the latest developments in their economies. There are indications that many member economies will revise their forecasts in view of the likely impact of the terrorist-attack on the United States on 11 September 2001.
[*] The IMF and the private sector consensus forecasts were both released in September and should reflect more closely the latest developments in the global economy. But both have not been able to take into account the likely impact of the terrorist-attack on the United States on 11 September 2001.
[#] December figures.
[##] Fiscal year figures.
N.A. Not available.

Sources: Individual Economy Reports at Appendix AII.
[a] *World Economic Outlook*, October 2001, International Monetary Fund.
[b] Private Sector Consensus Forecasts, Consensus Economics Inc.

Performance of member economies in Southeast Asia was equally subdued. Exports of *Malaysia* and *Singapore* were hard hit by the downturn of the global electronics market, and fell by 3.6 percent and 0.4 percent in the first half of 2001. In consequence, real GDP growth was markedly slower, at 1.7 percent in *Malaysia* and 1.8 percent in *Singapore* in the first half of 2001. The Malaysian government has introduced pre-emptive measures in its 2001 budget to mitigate the economic slowdown, and announced an additional budget allocation amounting to RM3 billion in March 2001. It is expected that with the higher fiscal expenditure and low interest rate, the economy will be able to achieve a 5.0–6.0 percent growth in 2001. Meanwhile, excess capacity in the domestic economy and benign global inflation should continue to check inflationary pressure. The Malaysian government expects inflation to stay at a low of 1.5–2.0 percent in 2001. In Singapore, the slowdown in its electronics exports has trickle-down effects on other industries like precision engineering and transportation. A slowing regional economy also affected Singapore's hub services. Following the dismal performance in the second quarter, the Singapore government introduced a stimulus package in late July. It also revised down the official forecast for real GDP growth in 2001 to 0.5–1.5 percent, while keeping the inflation forecast at 1–2 percent.

For similar reasons, real GDP growth of *Thailand* fell to 1.8 percent in the first quarter of 2001. A number of stimulus measures, including the postponing of a rise in VAT and the 3-year farmers' debt suspension programme, should help support the economy. Recent efforts of the government to clear up non-performing loans in the banking sector, including the setting up of the state-owned asset management company, would facilitate credit expansion, although monetary easing is constrained by the weak Thai baht. Balancing all the factors, the government forecasts the Thai economy to grow by 2–3 percent in 2001 and 4.0 percent in 2002. On inflation, the official is slightly higher than 2 percent. A marginal acceleration is expected in 2002. Likewise, real GDP in *the Philippines* grew by only 3.3 percent in the first half of 2001. In addition to the fall in exports, the continued contraction of the construction sector is also responsible for the modest performance. The Philippine government forecasts real GDP growth to decelerate to 3.3–3.8 percent in 2001 before rebounding to 4.3–4.8 percent in 2002. However, the lagged effect of the rise in fuel prices and spending associated with the May elections are expected to push inflation higher, to 6–7 percent in 2001 before easing back to 5–6 percent in 2002.

In *Indonesia*, the smooth transition to a new government and reaffirmed IMF support have helped restore market confidence. The economy is expected to grow by 3.5 percent in 2001. Whether the economy can pick up in 2002 or not depends very much on how well the new government can manage the economic problems. In the first half of 2001, real GDP grew by a decent 3.4 percent, although exports showed clear signs of slowing. As for prices, the depreciation of the Indonesian rupiah and the removal of government price subsidies are likely to lead to high inflation, at 9–11 percent in 2001. In *Viet Nam* growth will be led by manufacturing. Inflation is projected at 0.6 percent in 2001 and 5.0 percent in 2002.

China is the only economy in Asia that maintains strong growth in 2001. Despite the weakening in exports in the first half of 2001, the slowdown was less severe compared to the other Asian economies. Moreover, fixed asset investment surged upon the government's proactive fiscal policy and a sharp increase in foreign direct investment. Consumption remained robust, supported by the rise in disposable income of the people, an improved social security system and to a lesser extent increased availability of consumer credit. Real GDP grew by 7.9 percent in the first half of 2001, and will probably grow faster than the official target of 7 percent for the whole year. Along with the robust domestic demand, consumer price inflation is expected to rise to 1–2 percent in 2001. In the medium-term, economic growth is projected at about 7 percent per annum between 2000 and 2005.

Member economies in the Americas are also expected to slow down in 2001, although the pace of slowing down is likely to be more moderate than in Asia. The economic growth of *Canada* decelerated to 2.0 percent in the first quarter of 2001 and further to 0.4 percent in the second quarter on a quarter-to-quarter annualised basis. Growth for the whole year is expected to moderate to 2.4 percent, with the slowdown concentrated in the manufacturing sector, particularly in the automobile and IT industries. Inflationary pressure is widely expected to remain below 3 percent. Currently, it seems unlikely that *Mexico* will be able to reach the official 4.5 percent GDP growth target established in the 2001 economic program, because of the stronger than expected economic slowdown in the United States, as well as the sharp decrease in oil prices. In the first quarter of the year, GDP annual real growth rate was 1.9 percent, while in the second quarter no growth was recorded. A rebound is expected for the last quarter of the year, depending on the evolution of the U.S. economy. However, despite this economic slowdown the Mexican economy is expected to benefit from the comprehensive package of tax, financial and budgetary reforms submitted for Congress approval in the first quarter of 2001. This latest revised growth forecast for the year is below 2 percent. Additionally, inflation has steadily dropped and it is likely that the annual rate in 2001 will be below the 6.5 percent target set by Banco de Mexico.

In *Chile*, the sharp rebound of the economy in 2000 was fueled by rising exports and investment. However, both industrial production and exports have weakened recently, and unemployment remained high. In the first half of 2001, real GDP growth moderated to 3.5 percent, affected by the decline in exports. Economic growth is expected to decline to 4.3 percent in 2001, before picking up to 5.0 percent in 2002. Along with the slower economic growth, inflation rate is expected to fall to 3.2 percent in 2001 and further to 2.8 percent in 2002. Similarly, the economy of *Peru* is also expected to slow down, to a 0.9 percent growth in 2001. Inflation is expected to moderate to 2.5–3.5 percent in 2001.

The official Australian forecast for 2000-01 predicts economic growth to be around 2.0 percent in year-average terms. In the first half of 2001, growth already moderated to 1.6 percent. Looking ahead at 2001–02, it is expected that there will be strong growth in residential construction, with moderate growth in household consumption, business investment and net exports, leading to 3.25 percent economic growth in that year. The unemployment rate is expected to climb slightly higher. Inflation is forecast to decline to around 2 percent in 2001/02. The abolition of Financial Institutions Duty and other elements of The New Tax System and an anticipated slight easing in petrol prices will help keep inflation mild. In *New Zealand*, real GDP grew by only 0.5 percent in the first quarter of 2001, and is expected to grow by about 2 percent for the whole year. Owing to an uncertain economic outlook amidst slowdown in the global economy, firms will become more cautious about hiring new staff and undertaking new investment, and households will become more cautious about their spending. Nevertheless, the recent interest rate reductions and the historically competitive exchange rate may provide some support, leading to a faster growth of about 3 percent in 2002. On the price front, inflation is expected to move back to the top of the Reserve Bank's 0–3 percent target band in the third quarter of 2001, and then track back toward the middle of the band in the remainder of the year.

In *Russia*, the rise in world energy prices and the depreciated currency spurred growth and generated exceptionally large current account and fiscal surpluses in 2000. Lower oil prices, the global slowdown, and the real appreciation of the ruble during 2000 are expected to reduce growth in *Russia* to 5.0–5.5 percent in 2001. Inflation is expected to moderate sharply.

1.4 Conclusion

The world economy is in a cyclical slowdown in 2001, contrary to the strong rebound in 2000. With *the United States* being a key engine of global economic growth, the downturn in this economy since the second half of last year has far-reaching effects. In a more globalised and inter-related world, the European Union undergoes similar slowdown and the Japanese economy meets with renewed downward pressure. Most of the other APEC economies feel the pinch as well.

It is worth noting that the rebound in the Asian member economies in 2000 was largely driven by external trade, helped by strong demand in the industrial economies. Hence, in the current round of cyclical adjustment, the export-oriented economies are more adversely affected than those with a relatively larger domestic sector. Furthermore, economies with a large content of electronic and IT products in their total exports will be hardest hit. The examples are Chinese Taipei, Singapore, Malaysia, Thailand and the Philippines. China nevertheless has been able to maintain its growth momentum. The slowdown in its exports was largely offset by the rise in domestic demand.

Against the background of a global cyclical slowdown, inflation in the APEC economies remains generally subdued. While there was some pick-up in inflation in 2000, partly driven by the strong economic rebound, and partly attributable to the oil price hike towards the latter part of the year, inflation was still relatively mild. The current slowdown further relieves pressure on prices. Moreover, the oil price hike towards the end of last year has stabilised in recent months. Based on feedback by APEC member economies, and barring unforeseen developments, another hike seems unlikely. The economic slowdown should also mean slower demand for oil.

In face of the generally benign inflation, there should be room for more accommodative policies to counter the economic slowdown. In many of the APEC economies, a monetary easing is noticed, i.e. consecutive cuts in interest rates and currency depreciation to boost demand. In the first eight months of this year, the United States dropped its interest rates by 300 bps in 7 consecutive cuts.[6] Many Asian member economies have also let their currencies depreciate. Another policy response is through fiscal expansion either by cutting taxes or raising government expenditure, or both. But some economies are already sustaining budget deficits after the last financial crisis as they resorted to deficit financing to jump start the economy. This could constrain further loosening of fiscal policy to revitalise economic activities. This dilemma is keenly felt in some economies like Japan.

As for the external balance, many member economies have re-built trade surpluses after the previous crisis. Also many of them have replenished their foreign exchange reserves as well. In other words, these economies should be more resilient compared with the last financial crisis, and should have some spare capacity to absorb the deterioration in external environment. Meanwhile, the last financial crisis has driven unemployment to high levels in many Asian economies. Notwithstanding some easing in 2000, unemployment is picking up again this year. A common concern is how to create more demand to absorb the relatively abundant manpower.

Nevertheless, the general expectation is that while all APEC economies will see slower growth in 2001, there will be partial regaining of growth momentum in 2002. The general easing in macro-economic policies since the beginning of the year, especially in the United States, and the gradual abatement of oil prices should help support some pick-up in activity in the latter part of the year or early next year. Yet there are still some downside risks. For instance, the financial markets have remained volatile and corporate profitability weak. Both may continue to suppress business investment and consumer confidence. The persistent weakness of Japan's economy, and possible protracted inventory adjustment in the United States may slow the process of global recovery. Adding to these downsides is the recent terrorist attack on the United States. The repercussions of the attack have added to the uncertainty surrounding the timing and the strength of the global economic rebound.

[6] See footnote 2.

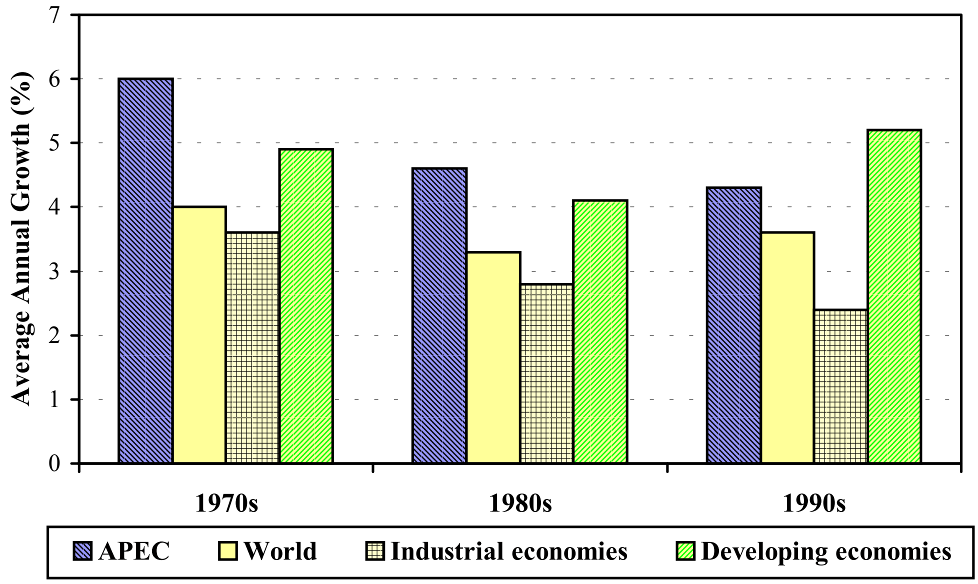
CHAPTER 2

Financial Development and Efficiency: Relations with Economic Growth in APEC Economies

2.1 Introduction

APEC economies as a group are one of the fastest growing regions in the world (Figure 2.1). Over the past three decades, they have been growing at more than 4 percent a year on average. This compares favourably with the growth rates of the world economy, the 22 industrial economies, and the developing economies taken as a whole.[1] At the same time, these APEC economies have experienced substantial growth and development in their financial sectors, notably the banking industries and the stock markets. In particular, the banking sectors in APEC economies have all shown material growth in asset size in real terms.[2]

Figure 2.1: Rapid Economic Growth of APEC



Sources: *International Financial Statistics*, International Monetary Fund.
Reports of Asian Development Bank and Asia-Pacific Economic Cooperation.

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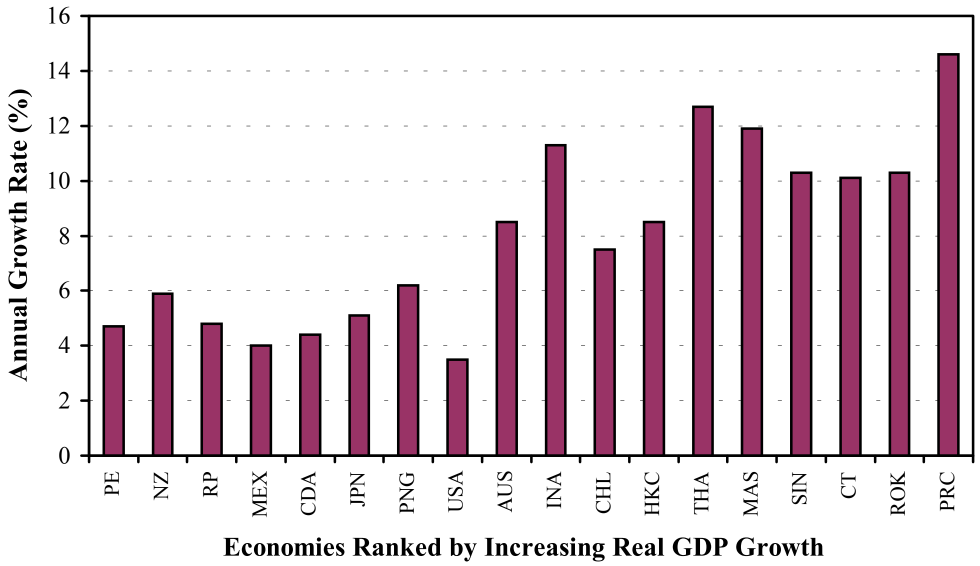
[1] The growth rates of APEC economies for the 1970s and the 1980s do not include Brunei Darussalam, Russia and Viet Nam because data on real GDP growth rates for these three economies are not available.

[2] For most APEC economies, the sum of the major aggregates of the accounts on the assets side of deposit money banks or banking institutions, as published in *International Financial Statistics*, is used as a proxy for the size of the banking sector. For Hong Kong, China and Chinese Taipei, data published by their monetary authorities are used. Brunei Darussalam, Russia and Viet Nam are not included because of lack of sufficient data.

The average annual growth rates of the size of the banking sectors in selected APEC economies are depicted in Figure 2.2. The growth rates range from a low of 3.5 percent a year for the United States to a high of 14.6 percent for China.[3] On ranking these economies in ascending order of real gross domestic product (GDP) growth over the period 1980-99, a pattern emerges. The banking sectors of economies with higher overall economic growth are growing faster. This suggests a positive relationship between banking sector development and long-run economic growth.

Figure 2.2: Real Growth in Banking Sector, 1980-99



Sources: *International Financial Statistics*, International Monetary Fund.
Official statistics from Hong Kong, China and Chinese Taipei.

Meanwhile, the stock markets in APEC economies have registered even faster growth and development, despite volatilities and a few major setbacks such as the global stock market crash in October 1987 and the Asian financial crisis 10 years later. The stock markets in the United States and in Japan have continued to grow and maintain their positions as the two largest bourses in the world in terms of market capitalisation. At the same time, the international capital market has witnessed the rise of emerging stock markets since the mid- and late 1980s. In terms of market capitalisation, value traded, and number of listed companies, many of the fastest-growing markets are in the APEC region. For instance, the stock market in Indonesia, which by 1994 had become an astonishing 403 times as large as it was in 1985, led the world in terms of growth in market capitalisation. Other APEC stock markets that registered phenomenal growth over the same period include the Philippines (an increase of 82 times), Thailand (70 times), Mexico, Chile (both 33 times), Chinese Taipei (23 times), Malaysia, Singapore (both 11 times) and Peru (10 times).[4]

The above observations suggest a positive relationship between economic growth and financial development, although it is not clear whether financial development drives economic growth or

[3] In general, the sampling period covers 1980 up to 1998 or 1999, depending on data availability. The exceptions are China (1985-99), where banking data before 1985 is not available, and New Zealand (1988-99), for which the time series on the banking variables before and after 1988 may not be strictly comparable owing to changes in definitions.

[4] The information on the stock market capitalisation comes from *Pocket World in Figures*, 1997 edition, *The Economist*.

vice versa. The causality could also be bilateral, with financial development inducing economic growth, which in turn feeds back on development of the financial sector.

2.2 Objectives

In the last decade many studies, both theoretical and empirical, have been done on the relationship between financial development and economic growth. So far, a large number of the empirical studies are conducted on the premise that a relationship does exist between financial development and economic growth. Most of the studies use different measures of the size of the financial sector as proxies of financial development, but the significance of financial efficiency seems to have been less explored.

"Size" and "efficiency" are essentially two distinctive concepts. An efficient but small financial sector may have more bearing on economic growth than a large but inefficient system. A distinction between financial development and financial efficiency in empirical analysis could lead to fruitful findings and useful insights into the relationship between financial development and economic growth. Hence, in addition to examining the relationship between financial development (as proxied by the size of the financial sector) and long-run economic growth in APEC economies, this study also explores the relationship between efficiency in the financial sector and long-run economic growth. As explained in Section 2.4, the focus of this study is on efficiency in the banking sector alone rather than on efficiency of the entire financial system.

This chapter gives a brief survey of the literature, a discussion of the importance of banking efficiency, and a comparative review of the institutional arrangements of the banking systems in APEC economies. An outline of the empirical framework and methodology used follows. The final sections discuss the empirical findings and their implications. The regression results are summarised in Appendix B.

2.3 Literature Survey

As the literature on the topic is vast, the coverage here is by no means exhaustive. Moreover, since this study is essentially empirical in nature, the review focuses mainly on the empirical studies. The major concepts, issues and findings that are most relevant to the study are emphasised. Excellent and more comprehensive surveys on this topic can be found in Pagano (1993), Levine (1997), Tsuru (2000), and Leahy *et al*. (2001).

Broadly speaking, there are several ways by which the financial system can affect the rate of economic growth. The first is by enhancing the efficiency of capital allocation. Financial intermediaries and stock markets enable funds to be pooled and channelled to high return projects. The financial system facilitates risk-sharing and risk-reduction through diversification and prevention of premature liquidation of profitable projects. In particular, a well-functioning financial system should be able to identify prospective entrepreneurs, effectively evaluate their projects with respect to potential returns and risk, mobilise resources to the more promising ones, and at the same time diversify the underlying risk associated with innovative activities. Channelling funds to finance such activities will help improve productivity and spur economic growth (Schumpeter, 1912).

The second way is by efficiently channelling savings into investment. Real resources have to be spent in directing savings to the ultimate users of funds. Such costs include those of screening and monitoring, accounting and legal services, as well as expected losses from loans. These are most prominently expressed as the spread between bank deposit and loan rates, commissions and other transaction costs. To the extent that financial development could help render the system more efficient and lower these costs, there would be more funds for investment and thus higher economic growth.

The third way is through the saving rate, but the effects are theoretically ambiguous. Firstly, as the financial market becomes more developed, it tends to offer greater investment opportunities, thereby raising marginal returns on savings and possibly increasing propensity to save. On the other hand, a more developed financial market could also mean easier access to liquidity as well as greater diversification and sharing of risks. People may choose to save less and consume more as a result. The net effect of financial development on the aggregate saving rate would be inconclusive *a priori*. Secondly, to the extent that financial development leads to more market-determined and eventual liberalisation of interest rates, the consequential interest rate changes will have both income and substitution effects which may offset each other, again leaving the net effect on savings ambiguous.

Historically, the debate on the link between finance and development can be traced back at least to the work of Bagehot (1873) and Schumpeter (1912). The former argues that the financial system played a critical role in igniting industrialization in England, and the latter further asserts that a well-functioning banking system spurred technological innovation by identifying entrepreneurs for funding support. Both authors emphasised the importance of the banking system in promoting growth.

The modern literature on financial development and economic growth can be broadly divided into two phases. The first phase emerged about three decades ago with the empirical work of Goldsmith (1969), McKinnon (1973) and Shaw (1973), followed by Fry (1978, 1988) and many others. These studies use the size of the financial system to gauge financial development. The results of these empirical studies point to a strong and positive contemporaneous correlation between financial development and economic growth. In other words, periods of rapid economic growth are usually accompanied by higher-than-average rates of financial development.

There are, however, a number of major weaknesses in the early empirical work. First of all, the size of the financial sector may not accurately measure the efficiency aspects of financial development such as the functioning of the financial system. Secondly, other variables influencing economic growth were not systematically controlled for in most of these empirical exercises. Thirdly, the sources of growth-enhancing effects of financial development, such as productivity growth, capital accumulation, improvement in the efficiency of the financial system, and so forth, were not examined.

The increasing popularity and importance of endogenous growth models, such as Lucas (1988) and Romer (1986), in the late 1980s led to a resurgence of interest in the link between financial development and economic growth. With the availability of more comprehensive and better-quality data than could be obtained before, two studies by King and Levine (1993a, 1993b) made major contributions on the empirical side. Using the cross-country regression approach, these studies reveal that a higher level of financial development is significantly correlated with faster current and future economic growth, physical capital accumulation and economic efficiency improvements (1993a, pp. 717-8). More recently, Levine and his collaborators have extended their empirical work to demonstrate that financial development leads economic growth in the long run (see Beck, Levine and Loayza, 2000; and Levine, Loayza and Beck, 2000 for details).

Pagano (1993) uses a simple endogenous growth AK model to demonstrate the effect of financial development on growth through three channels. These include raising the efficiency of the financial system, increasing the marginal productivity of capital, and influencing the private saving rate. He argued that the higher the efficiency of the financial system, the lower the proportion of savings lost or consumed in the process of financial intermediation.

Other economists like Fernandez and Galetovic (1994) show that the positive correlation between financial development and economic growth, as revealed by the series of empirical tests conducted by King and Levine, does not hold for OECD countries. However, by dividing the countries into three different groups according to their initial per capita income, Degregorio and Guidotti (1992) demonstrate that the positive correlation is higher and more significant for the lower per capita income group. Haslag and Koo (1999) find that there is no longer a coherent relationship between the different measures of financial development and economic growth once the reserve ratio is added in the growth regressions. Roubini and Sala-I-Martin (1995) further note that the activity of financial intermediaries is usually burdened by taxation, reserve requirements, and restrictive regulations, leading to higher costs at the margin. Chant (2001) also points out that the presence of financial institutions or their scale does not by itself indicate which functions they fulfil and how well they perform them. It is more important to look into the different functions and the types of infrastructure needed to support the effective operation of the financial sector.

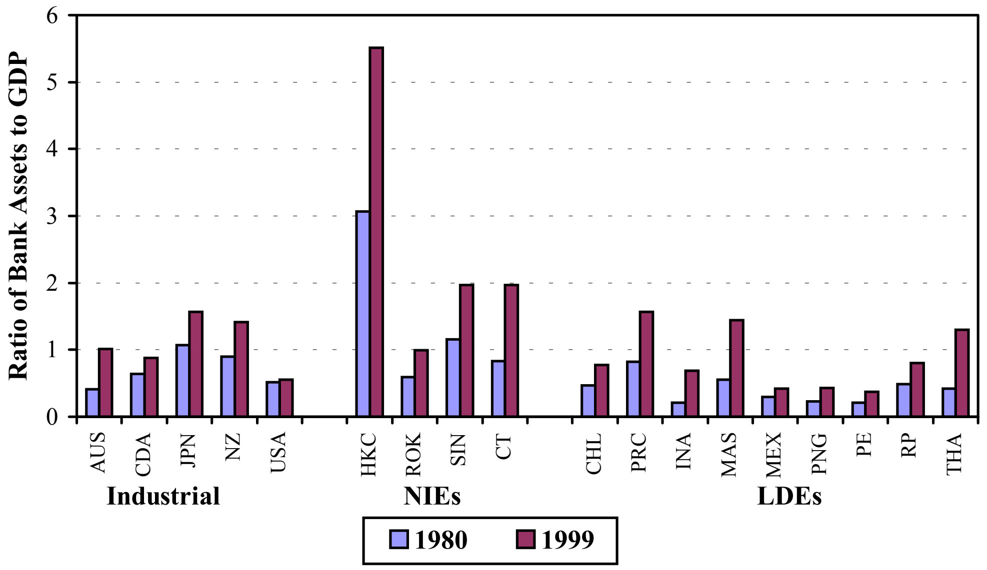
It thus appears from the more recent studies that apart from the size of financial sector, there should be other aspects relevant to the analysis of the finance-growth nexus. From this perspective, the use of efficiency indicators may supplement the existing literature. This is one of the major issues this study addresses.

2.4 Why Banking Efficiency

Most early studies of the relationship between finance and growth fail to address the possible impact of financial sector efficiency on overall economic growth. Only recently has more attention been directed to the importance of efficiency as a contributor to growth.

Conceptually, it is the overall efficiency of the financial system that matters. However, a number of measures tend to show that banks remain one of the most important types of financial intermediaries in both industrial and less-developed economies. In the United States, commercial banks' total assets account for about one-fourth of the total assets held by private financial institutions. Although this is down from 40 percent about 30 years ago, the ratio of commercial bank assets to GDP climbed to about 55 percent in 1999, from 52 percent in 1980 and 48 percent in 1970. Boyd and Gertler (1994) further demonstrate that the share of US commercial banks in intermediated assets should have remained fairly stable after adjusting for off-balance-sheet activities. Similar observations are noted for the other APEC economies; the ratios of their bank assets to GDP were generally on the rise over the period 1980–1999 (Figure 2.3). In particular, the substantially higher ratio experienced by Hong Kong, China reflects its role as a regional financial centre.

Figure 2.3: Importance of Banking



Sources: *International Financial Statistics*, International Monetary Fund.
Official statistics from Hong Kong, China and Chinese Taipei.

Over the years, the securities market has expanded rapidly to become a significant alternative source of corporate finance. Recent statistics provided by Barth and Levine (2001) show that world equity market capitalisation and bond market capitalisation were about 120 percent and 100 percent of world GDP in 1999, up from 40 percent and 60 percent in 1990. On the other hand, world bank assets as a percentage of world GDP remained relatively flat, rising only from 100 percent to 120 percent over the same period. Yet banks are still an important source of external finance for business, even in economies with well-developed securities markets such as the United States and Japan.

According to Hubbard (2000), internal funds accounted for three-fourths of the total funds raised by business in the United States over the period 1946–1998. Of the remaining one-fourth raised externally, about half came from financial intermediaries. The corresponding figure for the period up to the end of 1985 was approximately 60 percent. Notwithstanding the shift to marketable securities in recent years, financial intermediaries, especially commercial banks, still have a significant role to play in financing business firms.

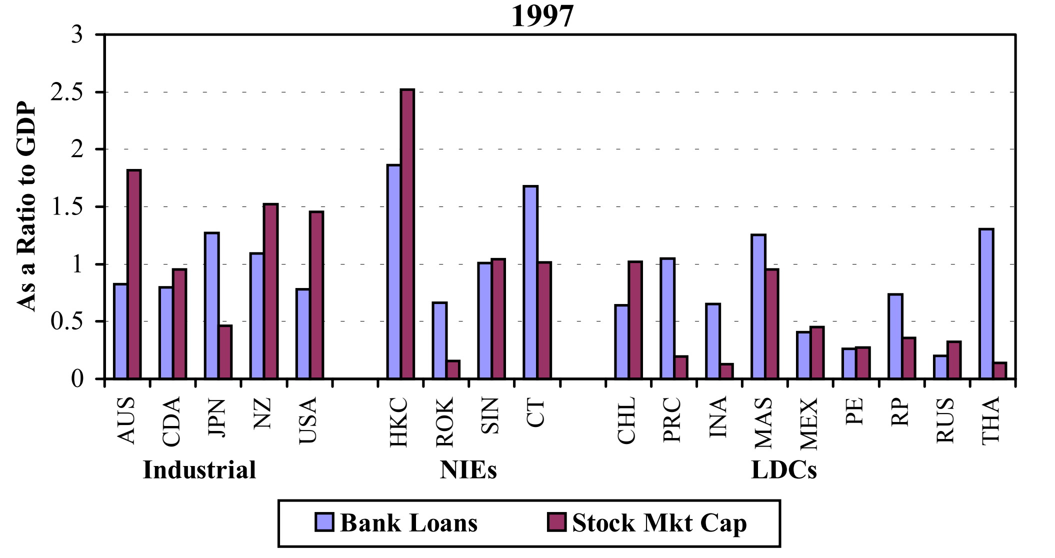
The other two industrial APEC economies where similar statistics are available are Canada and Japan. In Canada (Mayer, 1990), internal funds accounted for 54 percent of the total funds raised by business over the period 1975–85. Of the remaining funds raised externally, more than half came from financial intermediaries. As for Japan, despite the fact that its stock market is the second largest in the world in terms of market capitalisation and its bond market is one of the largest in the world, bank loans remain overwhelming. While internal funds satisfied 34 percent of its total funding needs, bank loans took up 59 percent and marketable securities only 7 percent.

Corresponding statistics for the other APEC economies are not available for comparison. Nevertheless, comparing the ratio of claims by banks on the private sector to GDP with the ratio of stock market capitalisation to GDP may shed some light on the relative importance of the banking sector as a source of private sector finance (Figure 2.4). In many of the APEC economies, the value of their equity market capitalisation is lower than the value of their bank loans outstanding. Furthermore, the absence of a significant correlation between the ratio of commercial bank assets to equity market capitalisation plus bonds outstanding and per capita

GDP suggests that banks and capital markets are not substitutes (Barth, Nolle, Root and Yago, 2000).

Hence, it is reasonable to infer that, while financial development shifts and changes over time, banking continues to play a vital role in financial flows in both industrial and developing economies. In view of this consideration as well as resource and time constraints, this study is confined to investigating banking efficiency and its relationship with economic growth, as a first step towards highlighting the significance of efficiency of the financial system.

Figure 2.4 Bank Loans vs. Stock Market Capitalization, 1997



Sources: *International Financial Statistics*, International Monetary Fund.
The Economist.

2.5 Institutional Arrangements

As different economies have different financial histories and have reached various stages of financial development, their financial structures are quite different naturally. The general characterisation of a financial system as either bank-based or capital-market-based highlights a major distinguishing feature of the system but necessarily overlooks a lot of details.

Among the various major channels of finance, bank credit tends to play a prominent role in almost all economies. In fact, banks serve the unique function of acting as delegated monitors, especially for small investors. Given banks' prevalence and relative significance, the relationship between banking efficiency and economic growth is a major focus of investigation in this chapter. More detailed justification of the focus on banking is provided in the preceding section. Here some comparative aspects of banking arrangements in APEC economies are highlighted.

The APEC economies’ banking systems have followed different development paths in the past decades and are currently exhibiting a certain degree of diversity in their institutional arrangements. Yet, as financial activities become more globalised, different banking systems are moving in certain common directions.

As institutions evolve and regulations change over time, information on institutional set-ups in all 21 APEC economies tends to be scattered and incomplete. The following discussion is based on information submitted by members of the APEC Economic Committee as well as on a recent database established by the World Bank (Barth, Caprio, and Levine, 2001), and is supplemented by publicly available statistics. Additional information on deposit insurance is taken from Demirgüc-Kunt and Sobaci (2000).

The World Bank database is the result of a survey in the late 1990s to which economies took different periods of time to submit replies. Nevertheless, since banking institutions usually do not change drastically in just one or two years, the figures are to a large extent comparable. They at least represent the general situation of banking in APEC economies towards the end of the last century. The database does not include three APEC economies, namely, Brunei Darussalam, Hong Kong, China, and Papua New Guinea, and those included do not necessarily provide answers to all the questions in the survey.

Table 2.1 summarises some institutional features of banking arrangement in APEC economies. Column 2 shows one measure of the relative size of the banking sector, that is the ratio of total bank assets to GDP. The ratio varies across APEC economies, from a low of 16 percent for Russia to a high of 716 percent for Hong Kong, China. The latter reflects the role of Hong Kong, China as a regional banking centre and the significance of its offshore banking. The United States has a relatively low ratio of 66 percent, which lends support to the general characterisation that its financial system is more capital-market based.

As banking is pervasive in all modern economies and as government authorities give it the most prominent supervisory attention, banking practices in APEC economies can be compared at various levels of detail. The following discussion looks at certain major concerns and highlights some salient features of banking in APEC economies. On the whole, current institutional arrangements in banking among APEC economies are diverse. This, however, does not preclude the potential tendency for them to be reformed and developed in some common directions. The more prominent trends are (1) more private initiatives in banking, (2) the lowering of barriers to foreign participation, and (3) the move towards a common nominal set of criteria in capital adequacy regulation.

2.5.1 Government ownership

APEC economies diverge considerably in terms of government ownership of bank assets. Governments in about one-third of the economies do not own any bank assets, while in other economies, such as Russia, government ownership reaches 68 percent. Column 3 of Table 2.1 shows the percentages of government-owned bank assets to total bank assets (referring only to the government-owned bank assets in banks with government ownership of 50 percent or above). In Table 2.1, there are no entries for China and Viet Nam in column 3, but it is safe to assume that the percentages for these economies are also high. The percentages for other economies range from 3 percent for Peru to 44 percent for Indonesia.

Table 2.1: Some Institutional Features of Banking in APEC Economies

	Ratio of total bank assets to GDP (%)	Percent of total bank assets government owned	Percent of total bank assets foreign owned	Percent of deposits accounted for by the five largest banks	Overall bank activities and ownership restriction index	Required capital adequacy ratio (%)	Actual average capital adequacy ratio (%)	Explicit deposit insurance scheme
Australia	281	0	17	73	2.0	8-15	9.8	No
Brunei Darussalam	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Canada	154	0	4	76	1.8	8	11.8	Yes
Chile	91	12	32	59	2.8	8	11.1	Yes
China	150	N.A.	N.A.	66	3.5	8	N.A.	No
Hong Kong, China	716	0	72	59	N.A.	8-12	17.9	No
Indonesia	41	44	7	53	3.5	8	4.8	No
Japan	148	1	6	31	3.3	8[1]	11.7	Yes
Korea	121	30	6.4	48	2.3	8	10.5	Yes
Malaysia	146	0	18	30	2.5	8	12.8	No
Mexico	101	25	20	80	3.0	8	14.2	Yes
New Zealand	180	0	99	91	1.0	8	11.1	No
Papua New Guinea	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	No
Peru	41	3	40	81	2.0	9.1	12.7	Yes
Philippines	116	12	13	46	1.8	10	15.8	Yes
Russia	16	68	9	80	2.0	12	N.A.	No
Singapore	216	0	77	N.A.	2.0	12	19.4	No
Chinese Taipei	245	25.6[2]	9.1[2]	38	3.0	8	10.8[3]	Yes
Thailand	140	31	7	75	2.3	8.5	12	No
United States	66	0	5	21	3.0	8	12	Yes
Viet Nam	N.A.	N.A.	N.A.	65	3.5	8	N.A.	No

Notes: [1] Eight percent for foreign and internationally active Japanese banks, 4 percent for domestic Japanese banks.
[2] Offshore banking units of foreign banks and foreign branches of domestic banks not included.
[3] Domestic banks only.
N.A. Not available.

Despite the fact that the degree of current government ownership in bank assets varies widely, there are indications that government-owned banks gradually assume a less prominent role. With state-owned banks being defined as those in which government ownership exceeds 50 percent, according to information submitted by member economies, state-owned banks have diminished in significance. Australia, for example, used to have four state-owned banks as recently as 1990, but they have all been privatised since then. In New Zealand, a state-owned bank accounted for 26.4 percent of total deposits and 22.3 percent of total loans in 1990, but it has since ceased to exist. There were 18 state-owned banks in Chinese Taipei in 1980, holding about two-thirds of total deposits and making a similar share of total loans. By 2000, there were only five state-owned banks with only about one-fourth of total deposits and making only about one-fourth of total loans. In China, the 100 percent state-owned People's Bank of China was the only bank in operation in 1980. Since then, a series of banking reforms has taken place, giving rise to quite a number of national and regional commercial banks. Although the state still holds majority shares in practically all these banks, private interests have at least started to emerge in the banking industry. In Peru, the 12 state-owned banks had shares of 41 percent and 61 percent in total deposits and loans respectively in 1980. The figures dropped to 33 percent and 57 percent in 1990 and further to zero by 2000, as a result of privatisation and restructuring of the banking sector. In the Philippines the role of state-owned banks has also dwindled. State-owned banks held 6.3 percent of total deposits in 1980 but only 1.5 percent in 1990, while the loans they made were 13.9 and 3.6 percent respectively of the total in these two years.

There are, however, exceptions to the diminishing role of state-owned banks in APEC economies. Thailand had only one state-owned bank in 1990 with negligible shares in both deposits and bank loans, but by 2000 there were four state-owned banks accounting for about 30 percent of deposits and loans. This is basically the result of failed banks being taken over by the government during the recent financial crisis. Similarly, there was no state-owned bank in Japan in 1980 or 1990, but two emerged in 2000 as the government took over two failed banks. Other members with problem banks during the financial crisis face largely the same situation. Yet, the experience of these economies represents more of a cyclical adjustment than a long-term development trend.

2.5.2 Foreign participation

Banks in APEC economies are also very different in terms of foreign ownership. Column 4 of Table 2.1 shows the percentages of foreign-owned bank assets to total bank assets (referring only to the foreign-owned bank assets in banks with foreign ownership of 50 percent or above). The figures range from a low of 4-6 percent for Canada, the United States and Japan to a high of 99 percent for New Zealand. Nevertheless, over the years there has been a rising presence of foreign banks across APEC economies.

In Australia, banks were predominantly locally owned and controlled in 1980. There were only two foreign banks and both had negligible shares in the banking system. However, foreign banks have since become more prominent. Their number rose from 17 in 1990 to 37 in 2000, and their shares in total deposits rose from 8.8 percent of all banks to 18 percent of all depository institutions over the same period. This growth is particularly impressive if one takes into consideration the rule that foreign bank branches are not allowed to accept deposits less than A$250,000. In Canada, the first 11 foreign bank subsidiaries were given bank charters in August 1981 following the 1980 revision of the *Bank Act*. The number of foreign banks stood at 56 in 1990 and 39 in 2000. By now, foreign banks have actually outnumbered local banks, although they account for only about 6–7 percent of both total loans and total deposits. In Chile, the number of foreign banks has not changed much over the past couple of decades. There were 13 in 1980 and 17 in 2000. However, their shares in total deposits and total loans have risen from about 4 percent to about 45 percent over the past two decades. In Korea, the number of foreign banks rose from seven in 1970 to 30 in 1980, 54 in 1990 and 43 in 2000. Moreover, foreign ownership of domestic banks can be up to 100 percent since April 1999, although this will be subject to additional review by the Financial Supervisory Commission.

Foreigners have also been allowed to become directors of bank boards since May 1998.

China had no foreign bank in 1980 but there were 72 by early 2001, although foreign banks are generally restricted from doing domestic currency business there. Chinese Taipei also experienced a large increase in the number of foreign banks, from six in 1970 to 39 in 2000, although their market shares in both deposits and loans are only 3-4 percent. The shares of foreign banks in deposits and loans in Peru were quite small in 1990, standing at 2.6 and 3.0 percent respectively. These shares had soared to 33.3 and 38.1 percent respectively by 2000. The number of foreign banks and their branches also rose sharply over the same period from three and six to 10 and 532 respectively.

2.5.3 Market concentration

Regarding market concentration, most APEC banking systems are dominated by large banks, with the largest five banks accounting for over 50 percent of total deposits in many economies. This is true even for some economies with a large number of banks. Russia, for example, has 1,309 banks, but the largest five hold 80 percent of the deposits.

2.5.4 Regulation and supervision

As for regulation and supervision, most APEC economies have only one supervisory body of banks, but in Australia, Korea, Chinese Taipei, Thailand and the United States more than one government agency are responsible for bank supervision. In Chinese Taipei and Thailand, both the central banks and the ministries of finance are vested with supervisory authority. In the United States, banks are usually under the supervision of the Office of the Comptroller of Currency and the Federal Reserve, but some are also subject to supervision by the Federal Deposit Insurance Corporation and the Securities and Exchange Commission.

Most APEC economies have either reserve requirements or liquidity requirements for the prudential supervision of banks. Some members, including Korea, Peru, the Philippines, Chinese Taipei and Singapore, have both kinds of requirements. On the other hand, Canada and New Zealand have no such requirements at all. Australia abolished its reserve requirement in 1988 and replaced it with a liquidity standard. Japan used to have a liquidity ratio but chose to eliminate it in 1998. Mexico abolished its legal reserve requirement in 1989, and its current liquidity requirement applies only to banks' foreign currency liabilities.

While APEC member economies take different approaches in terms of liquidity and reserve requirements to maintain bank stability, they are quite similar in recognising the importance of capital requirements. The Basle Capital Accord in 1988 set common minimum capital standards in banking, to be achieved by the end of 1992. The most prominent standard is the 8 percent capital adequacy ratio, calculated on a risk-adjusted basis. Columns 7 and 8 of Table 2.1 show the minimum required and actual capital adequacy ratios in APEC economies in around 1999 and 2000. It can be seen that all members follow the Basle guideline in minimum requirements, while almost all of them have higher-than-required actual capital adequacy ratios. However, care has to be taken in interpreting and comparing these figures, as the definitions of capital and the calculation of loan loss provisions differ.

2.5.5 Restriction on bank operation

Another major category of regulations on banks is that of restrictions on financial activities such as securities, insurance and real estates, as well as cross-ownership between banks and non-financial firms. Such restrictions, or the lack of, define the landscape of banking activities in different economies. To facilitate simple comparison across economies, Barth, Caprio, and Levine (2001) construct an index summarising restrictions in bank activities. They look at four possible areas of bank involvement: (1) securities underwriting, brokering, dealing, and mutual funds managing or marketing, (2) insurance underwriting and selling, (3) real estate investment, development, and management, and (4) ownership of non-financial firms. They then classify the ability of banks to engage in these activities into unrestricted, permitted, restricted, and prohibited and assign the degree of restriction values of 1 to 4 respectively. An overall index with values between 1 and 4 thus summarises the degree of restriction of bank activities in an economy, with a lower value indicating more permissive regulation. The results for APEC economies are given in column 6 of Table 2.1. APEC banking systems on the whole are quite restrictive in this regard, though there is again a certain degree of variation across economies. New Zealand has an index value of 1 and is the least restrictive of all APEC economies. This is consistent with its overall liberal approach to banking, which is also reflected in the size of its foreign banks. Other member economies like China, Indonesia, and Viet Nam take more stringent approaches. Both Japan and the United States are also on the restrictive end.[5]

As for interest rate determination, almost no APEC economies intervene in the setting of deposit rates, loan rates, and interbank rates. However, in Thailand, deposit rates on savings and fixed deposits cannot exceed the respective reference rates by 2 and 3 percent respectively. The reference rates are the average rates of the five largest banks.

2.5.6 Restriction on bank loans

In terms of making bank loans, most member economies have no tax or subsidy policy. In addition, the government normally does not act as guarantor of loans, although there may be exceptions. Canadian banks have a small amount of loan substitute securities on their books. These are restructured loans to enterprises in difficulty, which bank could consider securities. The interest payments the banks received would then be considered dividends and would be tax exempt, allowing the banks to charge borrowers lower rates. In Mexico, the government has some trust funds guaranteeing a given percentage of loans to specific sectors such as agriculture and housing. In Chinese Taipei, there are tax exemptions to interest derived from loans offered by international organisations or foreign financial institutions for economic development and specific export loans approved by the Ministry of Finance. In Hong Kong, China, deposit interest income received by corporations and individuals is tax exempt. In 1998 the government also committed HK$5 billion to guarantee bank loans to small and medium-size enterprises after the Asian financial crisis.

Another aspect of bank loan regulations is the limit on exposure to single parties. Most APEC member economies have some limits to various degrees, expressed as percentages of either the consolidated capital base or the total liabilities of banks. The exposure limit in Canada is 25 percent of total capital. For banks in Chinese Taipei, credit extended to a person or a corporation should not exceed 3 percent or 15 percent respectively of the bank's net worth. Corresponding figures for uncollateralised loans are 1 percent and 5 percent. In some cases, the limits can be surpassed with approval of the supervisory authorities. For example, depository institutions in Australia face no loan quota to particular sectors. They are expected to establish their own internal limits on exposures. However, when they intend to enter into an exposure in excess of 10 percent of their consolidated capital base, they must consult the Australian Prudential Regulation Authority.

2.5.7 Depositor protection

Finally, APEC economies are currently quite divided on whether they institute a deposit insurance scheme for depositor protection. Nine member economies have an explicit deposit insurance scheme. For *de facto* protection, however, one has to add cases with some kind of implicit deposit protection, especially for economies with state banks occupying a large market share in the banking system. Of

[5] However, while the restriction index is a good overall summary of the permissiveness of bank activities, it is highly aggregative. More work has to be done to better reveal the differences and similarities in the regulatory environment of banking in APEC.

the nine explicit deposit insurance schemes in APEC, the one in the United States is the oldest, having been enacted in 1934. The Philippines, Canada, and Japan set up their deposit insurance schemes in 1963, 1967 and 1971 respectively. Beginning the mid-1980s, Chinese Taipei, Chile, Mexico, Peru and Korea took turn in instituting deposit insurance schemes. As for Peru, the *Fondo de Seguros de Depósitos* (the Peruvian explicit deposit insurance scheme) was created in 1991. For one reason or another, for example, to protect small depositors, a global trend for instituting explicit deposit insurance schemes, notably among emerging markets, appears to have started in the last decade. Hong Kong, China, which has a sound banking system, is also planning to introduce deposit insurance.

There are naturally some variations in the features of the nine existing deposit insurance schemes in APEC. Four economies (Canada, Japan, Korea, and Chinese Taipei) do not cover foreign currency deposits, while five (Chile, Japan, Korea, Peru, and Chinese Taipei) do not cover interbank deposits. Except for Peru and the United States, the deposit insurance premiums are not risk-adjusted.

Based on the experiences of Canada and the United States, Carr (2001) argues that non-risk rated deposit insurance coupled with financial deregulation could be destabilising, as this might result in misallocation of deposit savings to high risk institutions. Based on a larger sample of economies ranging from less-developed to industrial economies, Demirgüc-Kunt and Detragiache (2000) conclude that the adoption of explicit deposit insurance on average has lowered banking stability and that it tends to encourage excessive risk-taking in institutionally weak economies, although deposit insurance in economies with a strong institutional environment has no significant destabilising effect.

2.6 Empirical Framework and Methodology

The empirical framework adopted here is essentially similar to that used by King and Levine (1993a, 1993b), as well as that deployed by Haslag and Koo (1999). This study is based on cross-country regressions. Averages of real GDP growth, and proxies for financial development, banking efficiency, and other control variables are computed for the sample period covering 1980 to 1999. Average economic growth is regressed on the level of financial development, and/or the level of banking efficiency at the initial year of the sample period, while controlling for the impact of other variables on growth.

The use of level estimates in the initial year for both the financial development and banking efficiency indicators is an attempt to deal with the endogeneity or reverse causality problem. By including them as predetermined variables, they are assumed to be orthogonal to the disturbance terms.[6] More recent studies by Beck *et al.* (2000) and Levine *et al.* (2000) apply the technique of dynamic generalised method of moments (GMM) panel estimators to tackle the endogeneity problem. The same technique, however, may not be appropriate for small sample size studies.

The data for this study come from various sources, mainly *International Financial Statistics* and statistics compiled by Beck, Demirgüc-Kunt, and Levine (1999). The entire sample is then divided into two subperiods—the 1980s and the 1990s—for the purpose of examining the finance-growth relationships. Comparing the results of the different sets of regressions, inferences can be made about the inter-relationships between financial development, banking efficiency and economic growth over the last two decades.

[6] In Appendix B, only the regression results using this technique to control for the endogeneity problem are reported. Growth is also regressed on financial development and banking efficiency respectively to examine their contemporaneous correlations without corrections for the endogeneity problem. For brevity, these OLS regression results for the various sample periods are not reported here, but they are available upon request.

2.6.1 Key variables

Growth indicators

In the modern empirical literature, King and Levine (1993a) introduce three growth indicators, namely real per capita GDP growth, real per capita capital growth, and total factor productivity growth. These variables measure growth in economic output, capital accumulation and productivity, respectively. The latter two serve to shed light on the transmission mechanisms through which financial development affects economic growth. More recent empirical studies further explore the various possible transmission mechanisms by making use of other indicators, such as patent applications, spending on research and development (Bassanini, Scarpetta and Hemmings, 2001), venture capital investment (Leahy *et al.,* 2001), and private savings (Bandiera, Caprio, Honohan and Schiantarelli, 2000). For the purpose of this study, the rate of increase in real per capita GDP is deployed as a broad measure of economic growth.

Financial development indicators

One standard indicator of financial development is the ratio of M2 to nominal GDP. The higher the value of this ratio, the higher is the level of financial development. This indicator is widely used in many studies, notably Goldsmith (1969) and McKinnon (1973), and is also known as DEPTH in King and Levine (1993a). An alternative indicator is the ratio of liquid liabilities of the financial system to GDP, also known as LLY. It measures the overall size of financial intermediaries in terms of currency plus demand and interest-bearing liabilities of banks and non-bank depository institutions. This is the broadest available indicator of financial intermediation. It reflects the degree of monetisation of an economy and also the importance of banks and similar depository institutions.

In addition to the liquidity measures mentioned above, there are other size indicators. The absolute size indicators measure the size of the financial sectors in relation to GDP, for example, central bank assets, deposit money bank assets, and other financial institution assets. The relative size indicators measure the relative importance of the banking sector to total financial assets, as in the ratio of deposit money bank assets to its value plus central bank assets, or the ratio of bank credit to the sum of bank credit and central bank domestic assets. In addition, to address the issue of credit allocation, there are the ratio of credit allocated to private enterprises to total domestic credit (PRIVATE), and the ratio of gross credit to private enterprises to GDP (PRIVY). A refinement to PRIVY, known as Private Credit in Beck *et al*. (2000) and Levine *et al*. (2000), is the ratio of credit issued by financial intermediaries to GDP.

Constrained by the availability of data, this study concentrates on using LLY as an indicator of financial development in the empirical work. LLY, the ratio of liquid liabilities of depository institutions to GDP, is a measure of the depth of the banking sector, and is a commonly used indicator in the literature.[7]

Banking efficiency indicators

From a macroeconomic perspective, banking efficiency cannot be completely and accurately measured by a single dimension. Banking efficiency encompasses several closely related concepts of efficient financial intermediation. Firstly, greater efficiency means more financial resources going into profitable and less risky projects. Secondly, it means savings is transformed into investment in a less costly way. Finally, efficiency also means lower transaction and information

[7] In some of the empirical work in this study, other financial development indicators, such as Private Credit, are used. The results are qualitatively similar to those using LLY.

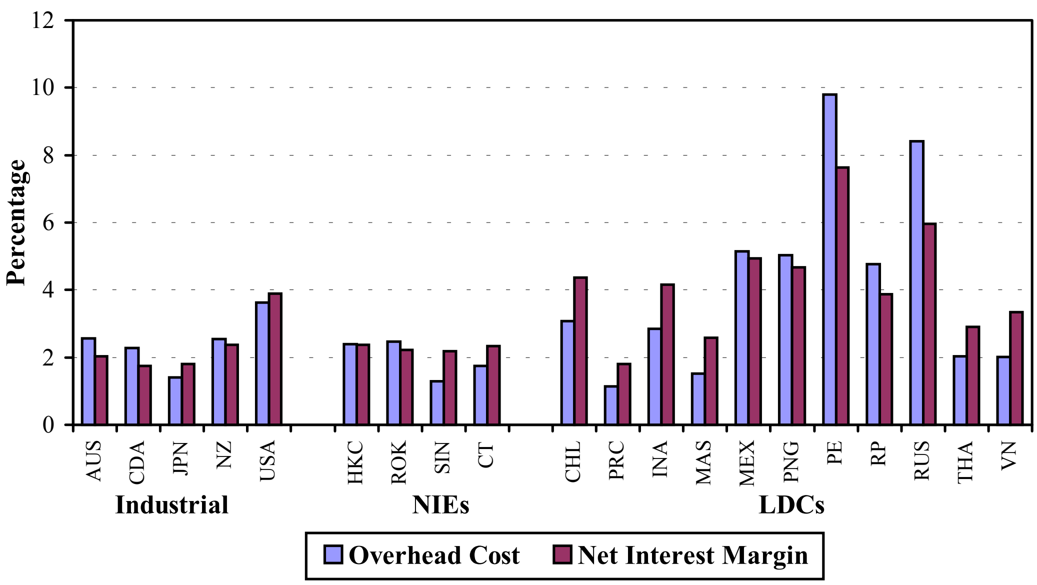
costs. These notions of banking or financial efficiency are not mutually exclusive. For this reason, this study tries to assess banking efficiency using different proxies.

As Leahy, Schich, Wehinger, Pelgrin and Thorgeirsson (2001) point out, it would be most desirable to measure directly the efficiency with which the financial system provides the financial services that affect growth, and to link the provision of these services backward to the conditions of the regulatory and institutional framework and forward to investment and growth. Unfortunately, this approach is practically infeasible because it requires a tremendous amount of data on financial sector activities at the firm level.

Beck, Demirgüc-Kunt and Levine (2000) have recently suggested two indicators to measure banking efficiency. These are the overhead cost and net interest margin. The former is the accounting value of a bank's overhead cost to its total assets, whereas the latter is the accounting value of a bank's net interest revenue to its total assets. All other things being equal, a lower overhead cost implies that the banking system absorbs fewer resources in channelling savings into investment. Thus, the lower the overhead cost the more efficient is the banking system operationally. Alternatively, net interest margin is another proxy for banking efficiency. Higher banking competition is expected to drive net interest margins down and to give rise to greater banking efficiency.

Data from income statements and balance sheets of commercial banks are used to compile overhead costs and net interest margins. The original commercial bank data are from the Bank Scope Database provided by IBCA. Such data are available for 137 economies, including 20 APEC economies (not including Brunei Darussalam). Unfortunately, they are only available for the period 1990–97.

Figure 2.5: Overhead Cost and Net Interest Margin, 1990-97



Source: Bank Scope Database.

The average overhead cost and net interest margin during 1990-97 for 20 APEC economies are shown in Figure 2.5. As can be seen, the two variables are closely correlated with each other. It is observed that the industrial economies and NIEs tend to have lower overhead costs and net interest margins than the less-developed economies. While economies of scale and scope help lower overhead costs, it is through competition that banks are driven not only to keep their operation costs low but also to maintain their pricing (that is, lending and deposit rates) competitive for survival.

A third proxy for banking efficiency is the interest rate spread (SPREAD), which is defined as the difference between the best lending rate and the key deposit rate of a commercial bank in the economy. The more competitive the banking industry, the narrower is SPREAD. At the macro-level, Besci and Wang (1997) develop a simple endogenous growth model to show that the steady-state economic growth rate is negatively correlated with the loan spread. This model can also serve as a theoretical basis to justify the use of SPREAD in this empirical study.

The above indicators, however, do not take into account banks' ability in appraising investment opportunities and screening out non-performing or bad loans. Chant (2001), among many others, believes that the way in which effective banks can promote growth is closely related to how efficient the financial/banking system is in channelling the economy's resources for investment to the use that gives the highest return. In this respect, the percentage of non-performing loans to total bank loans can be used as another proxy. Yet, in view of the unavailability of data on NPLs among APEC economies, the bank profitability indicator is used as a proxy for banks' overall operating efficiency.[8] To measure bank profitability, the rates of return on total assets and on capital are computed from data available at various issues of *The Banker*, which publishes annually the rankings of the top 1,000 banks (or top 300 or 500 banks in previous years) in the world.

2.7 Empirical Findings

To begin with, the relationship between real per capita GDP growth and the ratio of liquid liabilities of financial intermediaries to GDP (LLY) for the period 1980-99 among all 21 APEC member economies is estimated by simple regression. As expected, the scatter diagram in Figure 2.6 indicates a positive relationship between these two variables. This simple contemporaneous relationship is for illustration only, as the impact of other variables on growth has not been controlled for.[9]

In the next step, following the practice in the literature, other important factors are controlled for.[10] The regression results, as shown in Table B.1.1, affirm the positive relationship between financial development and growth over the period 1980-99 and the F-ratio is also statistically significant. On average, the higher the initial level of financial development, the higher is the real per capita GDP growth. This finding is in line with the empirical results achieved by other researchers (King and Levine, 1993; Benhabib and Spiegel 2000; and Spiegel, 2001). The study conducted by Levine and his associates is based on a larger sample of 80 economies over a sample period spanning 1969-89. Spiegel, based on a sample of 13 APEC economies covering the

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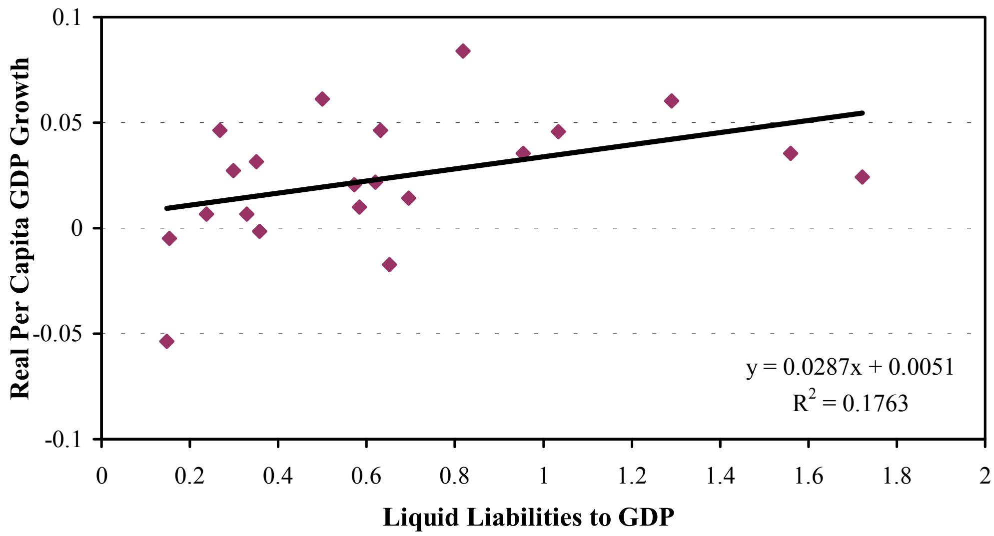
[8] Note that a higher spread does not necessarily mean higher profits. High interest rates may lead to self-selection, as those who are likely to default are more likely to borrow. A high spread still means inefficiency in this case, as banks fail to screen borrowers.

[9] The simple regression and scatter diagram shown in Figure 2.7, and all subsequent scatter plots, are presented as pedagogical devices and are not the main focus of this study. They are reported here to give the reader an idea of the relationship between growth and finance before controlling for the impacts of other variables on growth.

[10] To deal with the simultaneity bias caused by the potential endogeneity of financial development and banking efficiency, regressors at the start of the estimation period are used, which are maintained to be pre-determined variables.

period 1965-85, also finds that financial development is positively correlated with total factor productivity growth and investment.

Figure 2.6: Economic Growth vs. Financial Development, 1980-99

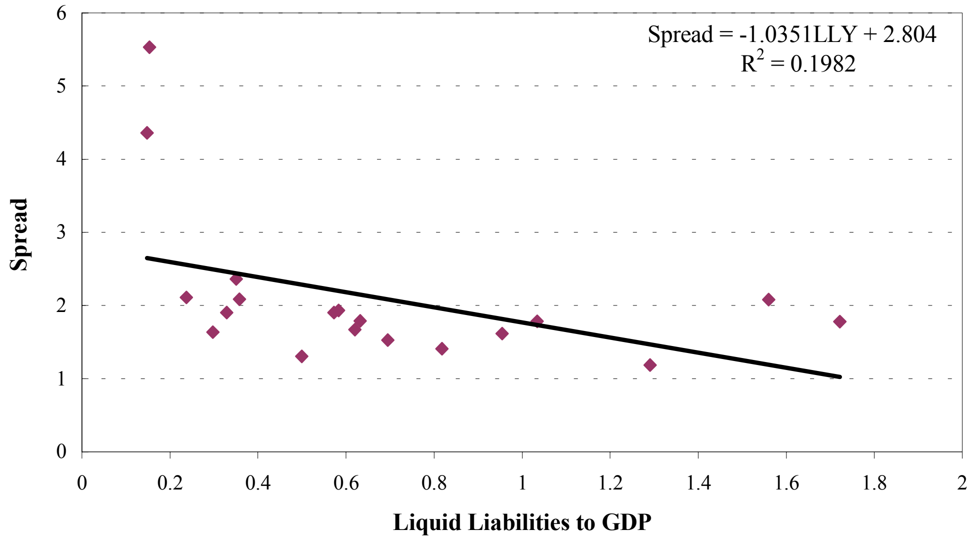


Besides financial development, the relationship between growth and SPREAD is also estimated for the same period, 1980-99. The latter is used as a proxy for banking efficiency because data on other proxies such as overhead cost and net interest rate margin are only available for the period 1990-99. The regression results as reported in Table B.1.1 indicate that a smaller SPREAD in 1980 is related to higher real per capita GDP growth in the following two decades. In other words, a higher degree of banking efficiency is associated with a higher growth rate.

Although this study highlights banking efficiency in addition to financial development as a factor affecting economic growth, it does not pretend that the two are separate from each other. As a matter of fact, financial development and banking efficiency are found to be interrelated. However, as indicated by the R^2 of the simple regression equation in Figure 2.7, a relatively large proportion of the variations in banking efficiency remains unexplained. This finding also generalises to the case between LLY and overhead cost as well as between LLY and net interest margin. Government regulations, the structure of the banking sector, the level of technology, and even payment habits are likely to be among the many other factors affecting banking efficiency. Some of these institutional features in APEC have already been discussed in Section 2.5.

The finding of a positive and yet imperfect correlation between the financial development and banking efficiency indicators means that the use of either indicator in the regression analysis is likely to omit the impact of the other variable on growth. In addressing this omission, both indicators are included as explanatory variables for growth in the same regression and their relationships estimated for the period 1980-99. From the results as summarised in Table B.1.2, it can be seen that both SPREAD and LLY are significant, and the explanatory power of the regression also enhanced. Both contribute to promoting economic growth. This lends some support to the notion that financial development is not exactly the same as banking efficiency and that both are important determinants of long-run growth. Moreover, the coefficient of SPREAD is statistically more significant than that of LLY in explaining the relationship between finance and growth over time.[11]

Figure 2.7: Banking Efficiency vs. Financial Development, 1980-99 Averages



It is worth trying to understand more about the change that has occurred in the finance-growth relationship over the past two decades. In this regard, the regressions are replicated for two subperiods, the 1980s and the 1990s. The results are discussed below.[12]

Broadly speaking, as shown in Table B.2.1, both financial development (as proxied by LLY) and banking efficiency (as proxied by SPREAD) demonstrate significant positive relationship with economic growth during the subperiod 1980-1989. The statistical results are largely the same as those covering the entire period 1980-1999 in Table B.1.1. In Table B.2.2, again more or less the same findings are noted when compared with Table B.1.2. The statistical significance of both indicators is higher in the earlier subperiod, with banking efficiency statistically more significant than financial development in explaining growth.

By running the same regressions for the sub-period 1990-1999, it is found that the positive relationships of both financial development and banking efficiency (SPREAD) with growth have diminished as shown in Table B.3.1. Further examination of the data reveals two outliers, that is, Peru and Russia.[13] Table B.3.2 shows the results after excluding these two economies. The positive relationship between banking efficiency (SPREAD) and economic growth resumes

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[11] This means that SPREAD is more highly correlated with growth than LLY, after controlling for the other variables included in the regression.

[12] Most studies look into the long-run relationship between growth and finance over a period of 25-30 years. However, some studies such as Levine, Loayza, and Beck (2000) and Dowrick (1996) also consider subsample periods as short as five years. To some extent, the choice of time span depends on the objective of the study. The intention of this study is to examine the long-run relationship over the past two decades.

[13] For Peru, the interest rate spread in 1990 was 2,335 percent and that of Russia was 218 percent. These spreads are huge relative to the ones observed in other APEC economies.

significance. On the other hand, the relationship between financial development and economic growth in this sub-period remains insignificant.

For the subperiod 1990-99, overhead cost, net interest margin, return on assets, and return on capital are also used as alternative banking efficiency indicators. The results in Tables B.3.3 and B.3.4 further affirm the positive relationship between banking efficiency and economic growth from different perspectives. A lower overhead cost, lower net interest margin, higher return on assets, and higher return on capital are each associated with a higher degree of economic growth in the sub-period 1990-99.[14] Even though the significance of the SPREAD variable diminished in the 1990s (Table B.3.1) compared with the 1980s (Table B.2.1), the results of the alternative banking efficiency indicators still demonstrate that the positive relationship between efficiency and growth remained in the 1990s.

2.8 Discussion

On the whole, the results in this study are in line with economic intuition and the results of other studies. However, the 21 members of APEC constitute only a relatively small sample for cross-sectional regression analysis, and the concepts of financial development and banking efficiency have to be proxied by available indicators. It would be prudent to interpret the empirical findings in this study with care, and in a broader context, drawing on empirical findings in other research work as well.

2.8.1 Financial development and economic growth

The regression results reveal that both financial development and banking efficiency are conducive to long-run economic growth. The results further reveal that while the positive relationship between banking efficiency and economic growth persisted in the last decade, the link between growth and financial development, as measured in terms of the size of the banking sector, has become less prominent over time. This is consistent with the law of diminishing returns, with finance being taken as a factor of production similar to the other input factors such as capital and labour.[15]

After attaining quantity development beyond a certain point, quality improvement in terms of gains in efficiency could become a more important aspect than sheer size expansion. In recent years, financial innovations such as the introduction of new banking products and the increased use of technology in communications and information should have helped lower transaction cost, enhance efficiency and raise productivity, thereby contributing positively to economic growth. However, these effects may not be adequately captured due to limitations of the traditional quantity indicators. Furthermore, the importance of capital markets as alternative sources of finance is growing. This trend is observed not only in the industrial economies. Capital markets in the less-developed economies also see rapid expansion in the late 1980s and early 1990s, and many of these are in APEC. As mentioned in Caprio and Honohan (2001), the scale, activity, and efficiency of organised stock and bond markets all increase relative to the banking sector as economies get richer. Separately, the initial expansion in money supply in many of the emerging economies was partly related to monetisation. As they develop and mature, such growth generally moderates.

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[14] As return on assets tends to fluctuate more significantly from year to year, the average level in the preceding decade is used instead of the level in the initial year. The same applies to return on capital.

[15] See for example the reviews by Clark (1988) and also Saunders and Thomas (1997).

2.8.2 Banks and capital markets

Banks are certainly not the only important source of funds, and financial channels other than banks have considerable impact on economic growth. Studies by Demirgüc-Kunt and Levine (1996) and Singh (1997), among others, suggest that the role of stock markets in the relationship between finance and growth could be substantial. The development of bank loans therefore should not be promoted at the expense of capital markets (Barth *et al.,* 2000). While this study points out that banks remain important in APEC and that banking efficiency induces growth, policymakers should consider the comparative advantages of the market-based versus the bank-based financial system in promoting economic growth and in coping with financial crises (Tsuru, 2001; and Park, 2001).

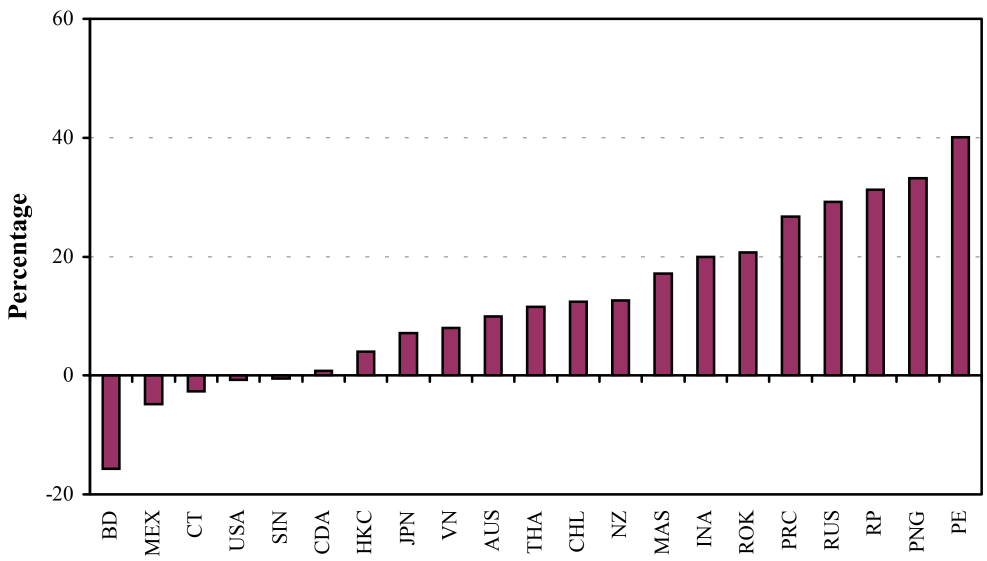
Based on a sample of 34 economies, including some APEC economies, Barth, Nolle, Root and Yago (2000) argue that banks and capital markets are complements and not substitutes in promoting economic development. As a result, one can safely conclude that economic growth cannot be entirely captured and explained by the size of the banking sector or by bank-based financial development indicators as used in this study and many other empirical studies in the literature.

2.8.3 The delusion of size

Figure 2.8 shows the percentage change in LLY in all APEC economies from 1994 to 1997 ranked in ascending order. The rankings remain similar when other financial-development indicators are used. On the surface, an increase in LLY means financial deepening, and hence subsequent economic growth can be expected. Yet contrary to such expectation, the economies that recorded substantial increases in their LLY ratios over this three-year period tended to be those most heavily hit by the Asian financial crisis and mounting NPLs. The truth is that many of these loans just went sour. A similar point is also raised in a recent study by Caprio and Honohan (2001), in which the authors caution against using credit as a way of achieving finance-driven growth.

Indeed, a rapid increase in the value of the financial development indicator within a short period of time is perhaps better treated as a warning of the imminence of a financial crisis, as the increase may simply be accompanied by the inefficient allocation of bank loans. The Asian financial crisis demonstrates that size is not everything and that efficiency matters.

Figure 2.8: Changes in LLY, 1994-97



Source: *International Financial Statistics*, International Monetary Fund.

2.8.4 Non-performing loans

The Asian financial crisis also reveals how inefficiency in banking could give rise to mounting non-performing loans (NPLs) and hence could have an adverse impact on growth. Table 2.2 shows the shares of NPLs in total loans and post-crisis growth rates in selected APEC economies. Subsequent to the Asian financial crisis, the percentages of NPLs in 1998 increased across the board when compared with their 1995 levels. At the same time, many APEC economies contracted, as indicated by real GDP growth in 1998. The two economies with the highest ratios of NPLs, namely, Thailand and Indonesia, recorded the sharpest decline in real GDP. High ratios of NPLs seem to have hindered their recovery rates after the crisis. Another illustrative example is Japan's experience. The burst of the property market bubble in the early 1990s left Japanese banks with massive bad loans. Since then, mounting bad loans have not only reduced bank profits but have also led to the dysfunction of finance (Taniuchi, 2001).

Admittedly, an economy’s economic performance depends on many factors. These include efficiency of the real sector, openness of the current and capital accounts, policy response of the government, and so forth. In the case of Japan, the gross inefficiency of the service sectors and the rigidity of the labour market are perhaps just as relevant, although banks’ failure to funnel funds to productive use is widely regarded as the main culprit for Japan’s stagnant growth for almost a decade.

Table 2.2: Non-performing Loans and Economic Growth

	NPL as a % of total loans		Real GDP growth (%)		Cumulative growth of real GDP, 1995-1999(%)
	1995	1998	1995	1998	
Chile	1	1	3.4	-1.1	17.9
China	20	25	7.8	7.1	37.7
Hong Kong, China	3	5	-5.1	3	7.2
Indonesia	10	36	-13.2	0.2	-1.8
Japan	6*	6	-2.9	0.2	3.5
Korea	5	7	-6.7	10.7	15.8
Malaysia	6	9	-7.4	5.6	15.5
Mexico	7	11	4.8	3.7	22
Peru	5	7	0.3	-0.5	9.9
Philippines	N.A.	11	-0.5	3.2	14.3
Russia	3	11	-4.9	3.2	N.A.
Singapore	N.A.	8	0.4	5.4	23.3
Chinese Taipei	2	4	4.6	5.4	24
Thailand	7	48	-10.2	3.3	-2.5

Notes: * Figure for 1996.
N.A. Not available.

Sources: Hawkins and Turner (1999).
International Financial Statistics, International Monetary Fund.
Official statistics.

2.8.5 The importance of institutional framework

APEC economies' experience, especially during the Asian financial crisis, demonstrates that a well-developed and healthy institutional framework is the foundation of financial efficiency and stability. Park (2001), among others, has recently examined the extent to which the fragility of East Asia's financial systems was responsible for the Asian financial crisis. The commonly accepted views are that the structural fragility of the East Asia financial systems has increased the susceptibility of the East Asian economies to financial crisis and that financial reforms are needed to improve the efficiency of the financial systems in allocating resources.

One reason for banks' failure in channelling funds to productive use is undue government policies affecting the banking system. As an example, the above-mentioned mounting NPLs were to some extent the legacy of state-directed credit to underperforming state enterprises and industries or specific ethnic groups and borrowers (see for example Skully 2001). Such government interventions distort the trade-off between expected return and risk. As a result, the financial system fails to allocate funds efficiently and is exposed to excessive risk.

The question of whether deposit insurance is a culprit or cure for financial systemic risk remains controversial. Much research has been done on this issue since the U.S. savings and loan debacle emerged more than a decade ago. While a consensus view is still lacking, one point is clear. The success of deposit insurance in promoting systemic stability depends heavily on a strong institutional environment (Demirgüc-Kunt and Detragiache, 2000).

2.8.6 Institutional set-up and banking efficiency

Given the importance of a strong institutional environment, it is worth attempting to find out whether any systematic relationships between institutional arrangements and banking efficiency exist in APEC economies. While there is no single measure of either institutional arrangement or banking efficiency, it may be instructive to study their relationships based on some indicators used in the previous sections of this chapter. The exercises here are only explorative, but they should shed some light on directions for future research as well as on possible financial reforms.

To begin with, Figure 2.9(a) shows the correlation between the concentration index and three banking efficiency indicators, namely, overhead cost, net interest margin and interest rate spread.[16] The three scatter plots indicate that a more concentrated banking sector is associated with a higher overhead cost, a higher net interest margin and a larger interest rate spread, representing lower efficiency. However, this finding is sensitive to the presence of Peru and Russia in the sample. Based on a larger sample, Barth, Nolle, Root and Yago (2000) have found a negative but statistically insignificant correlation between GDP per capita and bank concentration. The evidence is thus at best mixed. While traditional theory predicts that a more competitive banking industry will increase efficiency, the concentration index may not accurately reflect the level of competition. High concentration can be the outcome of the successes of a few efficient firms in gaining market shares (Demsetz 1973), and this should not be regarded as undesirable as long as there are few barriers to entry. Other factors, such as the size of the market and economies of scale, may also affect the degree of concentration. Hence, it is more important to promote policies to enhance competition in the banking sector than to focus attention on concentration *per se*.

Another analysis suggests that government ownership is not conducive to banking efficiency. Figure 2.9(b) shows that the percentage of government-owned bank assets is associated with a higher overhead cost, a higher net interest margin and a larger interest rate spread. More interestingly, the cluster of observations near the origin in the scatter plots indicates that banking systems with full private ownership tend to have distinctly higher efficiency. The study by Barth *et al.* also shows that the degree of private ownership positively affects GDP per capita.

The impact of foreign ownership on banking efficiency is less apparent in terms of the correlation between the percentage of foreign-owned bank assets and the three indicators of banking efficiency. This may be the result of the current restrictions on the scope of activities open to foreign banks. Also, it is the openness to foreign entry rather than the share of foreign owned bank assets that is more important in improving banking efficiency. It is generally believed that foreign banks can improve the efficiency of the domestic banking sector through greater competition; the injection of capital; and the importation of modern banking technology, know-how, and management skills. In this respect, restrictions on foreign participation should be relaxed to encourage entry of foreign banks. Australia and Hong Kong, China have experienced success in opening their domestic banking markets, and New Zealand has basically outsourced its banking system. Some governments may still have concerns about the possible negative consequences of foreign bank entry. Such concerns might include fear of market domination by foreign banks, lack of local commitment, capital flight, and the like. However, Ngiam (2001) points out that based on Singapore's experience with financial liberalisation, there is no evidence that local financial institutions have lost their market shares to foreign competitors.

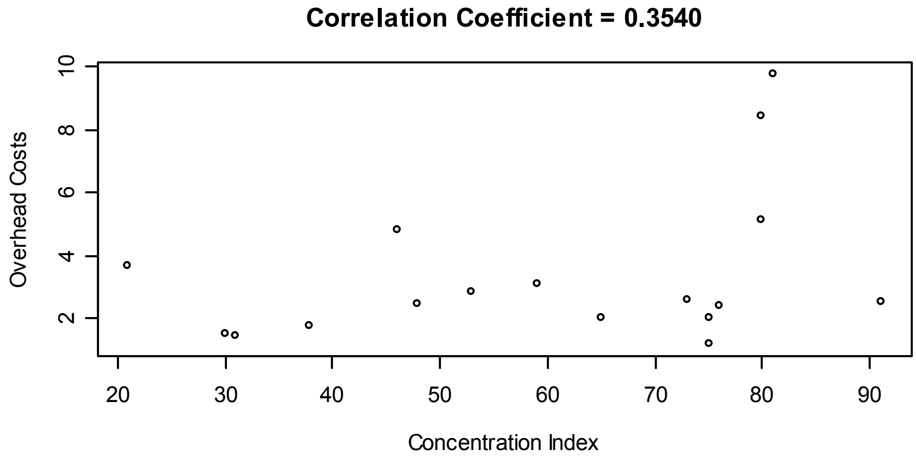
As in the case of foreign bank ownership, the correlation between the restriction index and the banking efficiency indicators is rather weak. Based on the same restriction index but on a larger sample, Barth, Caprio and Levine (2000) find that economies that impose more restriction on banks' securities activities are more likely to suffer a banking crisis. Yet, they fail to find a

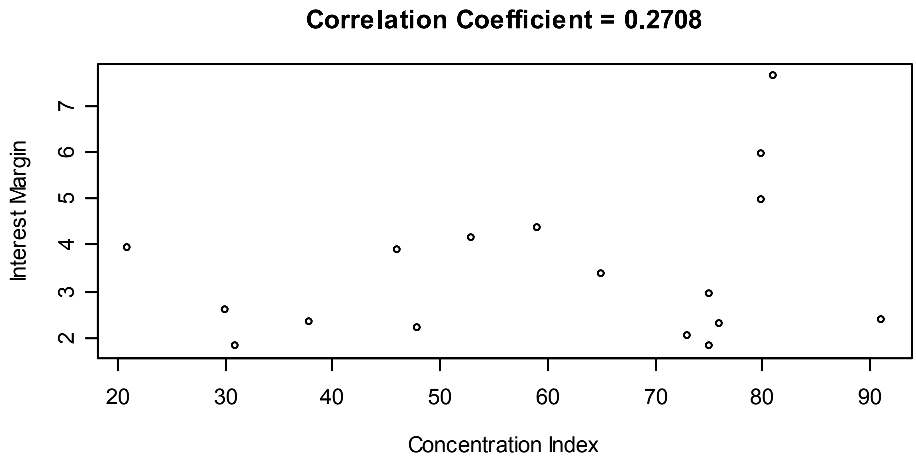
[16] Note that interest rate spreads in the figures are log-transformed. The transformation is necessary because some economies have a very large spread.

reliable statistical relationship showing that more restrictive regulations are associated with poorly functioning banking systems. In fact, the restriction index is unlikely to capture fully the huge cross-country differences in restrictions on banking activities. More importantly, what matters for banking development and performance is the soundness of the regulatory and supervisory framework, which is difficult to measure using any single index.

To summarise, the above results suggest that banking efficiency can potentially be raised through such reform measures as the promotion of competition, privatisation of state-owned banks, removal of restrictions on foreign banks, and relaxation of restrictions on bank activities. These policy implications are in line with those advocated by the World Bank (Caprio and Honohan, 2001). Yet, in view of the complexity and controversies regarding institutional arrangements, more in-depth research needs to be done to further unravel the relationships between institutional features and banking efficiency.

Figure 2.9(a):
Concentration Index vs. Banking Efficiency Indicators





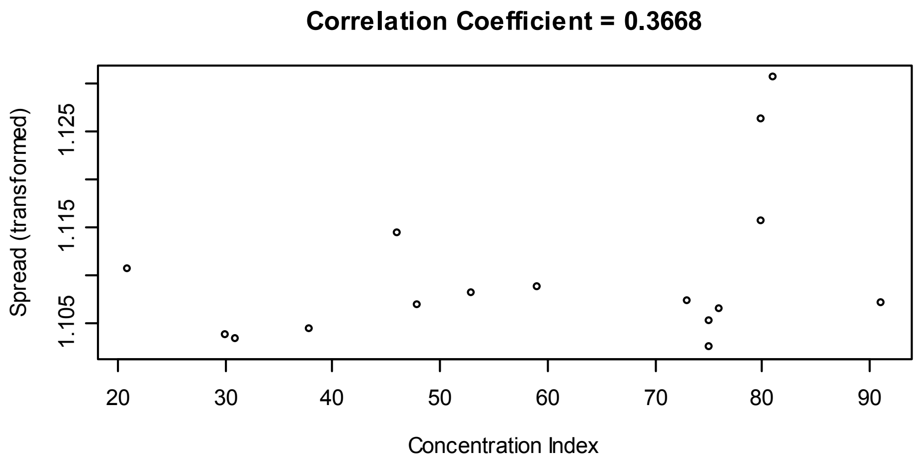
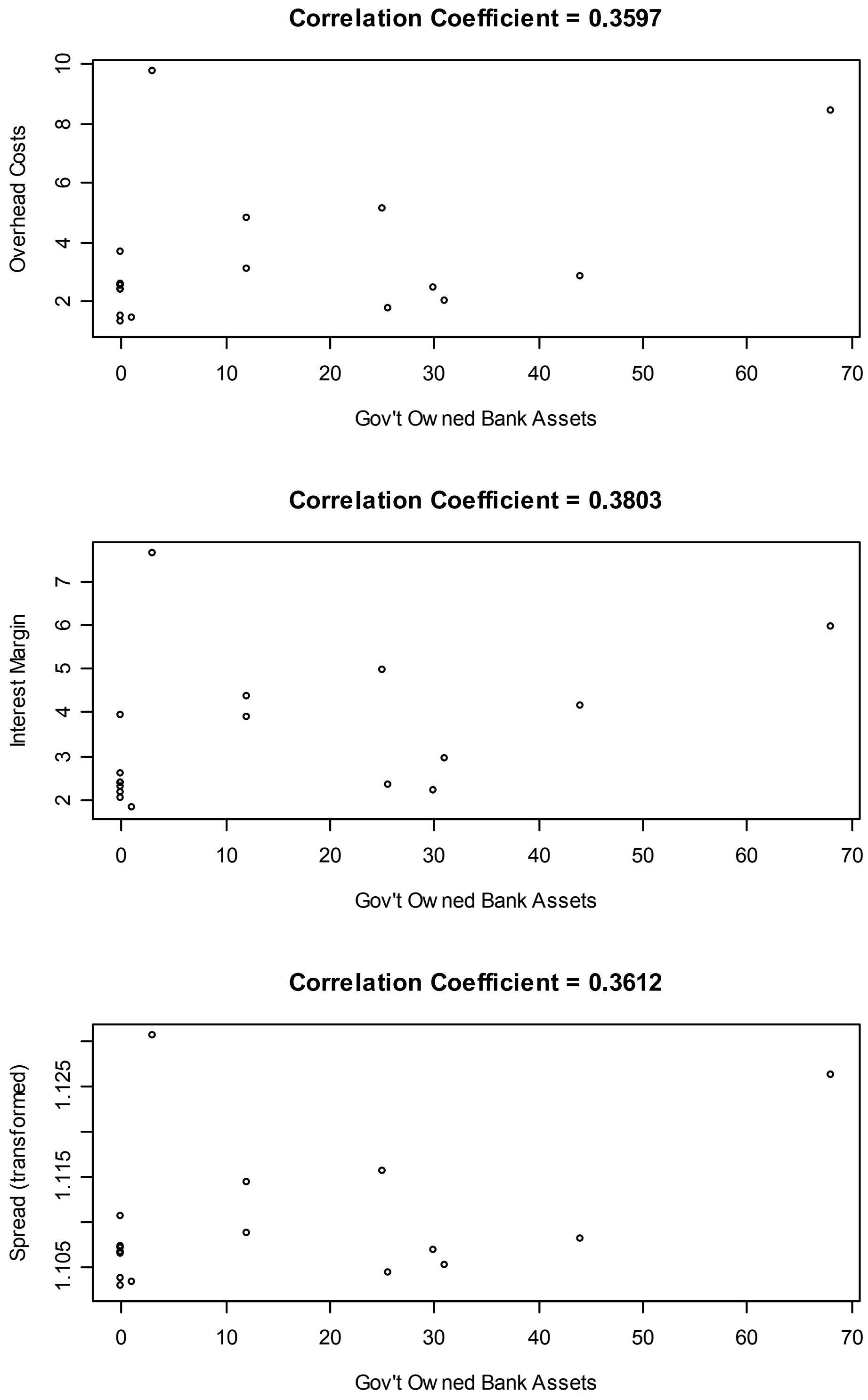


Figure 2.9(b):
Government-owned Bank Assets vs. Banking Efficiency Indicators



2.9 Conclusion

Financial development has been shown by numerous empirical studies to promote growth through various channels. Within the confinement of data availability, this study has confirmed a positive relationship between financial development and economic growth for APEC economies. The empirical results indicate that a higher level of financial development has been conducive to growth in APEC economies over the last two decades.

However, the positive finance-growth relationship seems to have become less prominent in the 1990s. This is consistent with the law of diminishing returns, with finance being taken as a factor of production similar to the other factor inputs like labour and capital. It may also reflect the limitations of the traditional quantity indicators in adequately capturing the impact of financial development on economic growth. Another plausible explanation is the growing importance of capital markets as alternative sources of finance. Policymakers should look into the comparative advantages of the market-based versus the bank-based financial system in promoting economic growth and in coping with financial crises.

More interestingly, this study established the importance of financial efficiency in promoting growth in APEC economies. This is an aspect less explored in the literature. The study findings suggest that upon attaining quantity development beyond a certain point, quality improvement in terms of efficiency gains will surpass size expansion to become a more prominent explanatory factor of economic growth. A few other studies have cautioned against the use of credit expansion to achieve finance-driven growth. The Asian financial crisis demonstrates that size is not all and that efficiency matters.

Furthermore, APEC economies' experiences during the last financial crisis demonstrate that a well-developed and healthy institutional framework is the foundation of financial efficiency and stability. In this connection, this study reviews the current institutional arrangements in banking in APEC economies. Though the review shows a great diversity among APEC economies, recent development points to a potential tendency for reforms and developments in some common directions, like greater private initiatives in banking, lower barriers to foreign participation, and movement towards a common nominal set of criteria in capital adequacy regulation.

This study then proceeds to explore further the relationship between institutional arrangements and banking efficiency. Although most of the results are suggestive and need affirmation by further empirical research, a broad policy implication of the findings is that financial policies or reforms should aim at boosting banking or financial efficiency for long-run prosperity. These policies may strive to promote competition, increase private initiatives, reduce barriers to entry, relax restrictions on bank activities, improve risk management, enhance transparency and tighten governance. In brief, government's role should be in providing a sound regulatory and supervisory framework for the financial sector to function effectively and efficiently. However, given the diversity in APEC economies in terms of their levels of financial development and infrastructures, there is no one-size-fits-all policy.

Last but not least, sustainable economic growth does not depend on finance alone. Other sound economic policies are indispensable ingredients of long-run prosperity. The results of this study and many other empirical studies in the literature suggest that other economic variables, notably the initial level of human capital and the general price level, are also significant in determining real per capita GDP growth. This means that government should introduce programmes to raise labour productivity and the central bank should implement monetary policy to maintain macroeconomic stability in the long-run. Otherwise, the gains in real output by an improvement in banking efficiency or financial development might be completely offset by an inappropriate policy in another area. Sustainable long-run growth is the outcome of successful co-ordination of sound policies.

APPENDIX AI

Oil Dependency in APEC Economies

A1 Oil Dependency

Over the years, most of developed economies in the world have significantly reduced their oil dependency. For the OECD member countries, the volume of net oil imports per unit of output was halved from 0.11 in 1971 to 0.06 in 1998. A downward trend is also found among the APEC economies. This lowering of oil dependency can be attributable to the lowering of energy intensity of the goods produced. As illustrated in Table A.1, most APEC economies, with the notable exception of Korea and Thailand, have managed to raise the amount of output produced per kilogram of oil consumed during the period 1990-97.

Table A.1: GDP Per Unit of Energy Use
(PPP$ Per kilogram of Oil Equivalent)

	1990	1997
Australia	3.2	4.0
Canada	2.6	3.0
Chile	4.5	5.7
China	1.8	3.3
Hong Kong, China	8.7	10.6
Indonesia	3.5	4.5
Japan	5.4	6.0
Korea	4.0	3.9
Malaysia	4.0	4.0
Mexico	4.2	5.1
New Zealand	3.4	4.0
Peru	5.3	7.3
Philippines	6.8	7.2
Russia	1.6	1.7
Singapore	2.8	2.9
Thailand	4.9	4.7
United States	2.9	3.6
Viet Nam	2.7	3.2

Source: World Development Report 2000, World Bank (2000)

To measure oil dependency, net oil imports as a share of GDP is often used for oil importing economies. This ratio shows the vulnerability of the economy to a hike in oil prices. An oil dependency ratio of 3 percent means that a doubling of oil prices, ignoring any adjustments induced by the higher prices, will cost the economy an extra 3 percent of its GDP to pay for the same volume of oil import. This oil dependency ratio in respect of most APEC economies has decreased over the past two decades.

In the United States and Japan, the ratios of net oil imports to GDP have declined from over 3 percent and 5 percent in 1980 to around 0.5 percent and 1.0 percent respectively in 1999. While the oil price hike in 2000 pushed US oil dependency ratio up to 1 percent, Japan’s ratio stayed below 1 percent.

For Australia, the oil dependency ratio also fell from 1.4 percent in 1981–83 to below 1 percent by 1983-84 and remained at the 0.1–0.4 percent level for the last fifteen years. The shifts within the economy towards less energy-intensive industries help to bring down both the energy intensity and the oil dependency ratio over the period. If there were no reduction in energy intensity, Australia should have used around 110 percent more energy in 1997–98 than that in 1974, but it actually used only 84 percent more.

Similarly in Chinese Taipei, total energy intensity declined from 11.01 litres oil equivalent (LOE) per NT$1 000 GDP to 9.50 LOE per NT$1 000 GDP during the period 1982–2000. At the same time, the oil dependency ratio declined gradually from a very high level of 10.65 percent in 1981 to around 2 percent in 2000.

The lowering of oil dependency ratios were also seen in Thailand and Chile. Thailand's oil dependency ratio fell from 8.9 percent in 1980 to 2.8 percent in 1998 though it jerked up again to 3.6 percent in 1999 and further to 5.6 percent in 2000 due to the hike in world oil prices during the period.

However, the ratio of net oil imports to GDP may not be universally applicable to all economies. For instance in Singapore, the fluctuation of oil prices has rendered this ratio rather erratic. Under such circumstances, other measure of oil dependency, such as oil consumption per unit of output, can be used. The latter measure clearly shows that Singapore is now much less dependent on oil, with oil consumption per unit of real GDP declining steadily over the 1990s. The same pattern is also apparent in the United States, where 19 000 BTUs of energy was consumed per dollar of GDP in 1970. This figure dropped to 10 600 BTUs in 2000, which is close to a 50 percent drop in 30 years.

The same measure can also be applied in the case of New Zealand. New Zealand's net oil imports hinge heavily on its self-sufficiency in oil, which in turn is dependent on the indigenous oil production and domestic demand for oil. Over the period 1974–1986, self-sufficiency rate increased dramatically from under 5 percent to over 50 percent. By 1995, with demand increasing faster than production, the self-sufficiency rate declined to 36 percent. But with the production of new domestic oil fields coming on stream, self-sufficiency in oil rose again to 43 percent in September 1999 before declining to 33 percent in September 2000.

In respect of the oil-exporting economies, such as Mexico and Indonesia, oil dependency can be measured by the the size of oil exports relative to total exports or to GDP, or by the importance of oil revenue in the fiscal budget. A drop of oil dependency implies that the economy does not rely as much on oil revenue both in the trade account and the government budget. Though the impact of the change in oil price is totally different for oil-exporting economies and oil-importing economies, they showed a similar downward trend in oil dependency.

In the case of Mexico, exports of oil products generate huge foreign exchange earnings and revenue for the government. In other words, both its export revenue and government income are highly susceptible to volatility in oil demand and fluctuation in oil prices. Since the 1980s, Mexico has undertaken conscious effort to reduce its oil dependency by raising the share of non-oil exports in total exports. By 1998, oil exports contributed less than 8 percent of total exports or 3 percent of GDP, showing significant improvement compared to a 25 percent share of total exports in late 1980s. The share of oil revenue in total fiscal revenue also dropped, from 37.1 percent in 1996 to 30.4 percent in 2000. For Chile, its oil exports as a percentage of GDP had been decreasing in the last decade until 2000 when the ratio shot up to around 3 percent.

As a summary, most APEC economies, including both oil-importing economies and oil-exporting economies, have shown a lowering of oil dependency and energy intensity over the last two decades.

A2 Policies Adopted

The common policies adopted by the APEC economies with a view to lowering oil dependency and raising efficiency in oil/energy utilisation are discussed below. Broadly speaking, these policies can be divided into tax-measures and non-tax measures.

A2.1 Taxes on oil-related products

Taxes on oil and oil-related products are measures commonly adopted to reduce oil consumption. They can be in the form of excise tax or import duties. While total gasoline tax in the United States has declined in recent years, gasoline tax in Chinese Taipei increased from 17.5 percent in 1979 to 90.0 percent in 1994 as government targeted to control the number of cars on the road. Tax rates among different petroleum-related products, such as gasoline, diesel and aviation fuel also vary significantly. Tax on aviation fuel is often much lower than on other items, presumably due to the competitive threats of neighboring international airports.

As emphasized by the IMF, any adjustment of taxes on gasoline and other petroleum products in response to higher oil prices would need to be considered in the context of the overall fiscal and macroeconomic situation. If the increase in oil price appears to be temporary, there would be no point in adjusting taxes. If oil prices are expected to remain high, and ad valorem taxes will generate windfall fiscal surplus, then some rethinking of the best use of the additional revenue is called for. The appropriate strategy depends largely on the tax structure of the economy.

A2.2 Non-tax measures

The APEC economies have also adopted non-tax measures to promote energy efficiency and conservation, and to encourage the development of alternative or renewable energy sources. For example, in order to cut down the amount of energy consumed, New Zealand introduced the Draft National Energy Efficiency and Conservation Strategy in 2001. The goals are to improve economy-wide energy efficiency by at least 20 percent and to increase renewable energy supply by a defined quantity by 2012. Steps will be taken to ensure that consumers receive price signals that encourage energy efficient responses. Meanwhile, according to China's Tenth Five-year Plan, China will close down inefficient production plants; and raise efficiency in the utilization of the power generating industry. A series of energy innovation measures were introduced in Korea in 2000. The measures aimed at reducing energy in-take in both production and consumption in Korea.

The common measures to conserve energy and to promote energy efficiency as adopted in the APEC economies are described as follows.

Energy efficiency standards

Imposing energy efficiency standards is one of the frequently adopted strategies among APEC member economies to encourage conservation and rational use of energy. For example, the Mexican government published the Mexican Official Standards (NOM) of energy efficiency, which outlined the mandatory technical specifications developed in consensus with the private, social and public sectors. Currently, 18 NOMs have been published and are in force, 14 related to electricity consumption and 4 related to thermal energy consumption. It is expected that annual savings derived from the application of these NOMs would result in 7,547 GWh of annual energy-consumption savings and 1,271 MW of power capacity conserved at the end of 2001.

Also, sector specific energy conservation measures are often used. For instance, in Singapore building codes are tailored to promote more efficient use of energy. It imposes upper limit on overall thermal transfer value for building envelop, establishes zoning for temperature control, and mandates the installation of automatic control device for the air-conditioning of hotel guest room and installation of data logging facilities for energy auditing.

Sensors and controls can be installed in buildings and factories to ensure efficient energy utilisation. Energy audit system can be put in place to identify excessive energy use. For example, 1,800 major energy users who accounted for 30 percent of total energy consumption in Chinese Taipei are required to report energy usage every year. Users identified as having low energy efficiency will be required to improve efficiency within a specified period. Heavy energy users are encouraged to pursue voluntary efforts to enhance energy efficiency and lower production cost. Singapore government also provides energy audit service to industrial and commercial consumers at no cost to assist users to identify opportunities for improving energy efficiency.

Fuel economy

Motor vehicles account for a lion share of oil consumption in most industrialized economies. Imposing standards for maintaining fuel efficiency in vehicle usage is expected to have the most significant impact. In the United States, the federal government has set up the Corporate Average Fuel Economy standards for motor vehicles to raise the fuel efficiency of cars.[1] The gas mileage of the average car on the road in the United States increased by 27 percent from 13.4 miles per gallon in 1973 to 17 miles per gallon in 1983 and further up to 21.6 miles per gallon, in 2000. As the average miles traveled per car fell by 8 percent to 9,118 miles in 1983 from 1973, fuel consumed per year for an average car fell by 27.5 percent from 737 gallons in 1973 to 534 gallons in 1983. While the average miles traveled per car rose sharply by 30 percent to 11,870 miles in 2000 from that in 1983, fuel consumption of an average car went up by only 2.8 percent in the same period.

However, the explosive growth of low fuel-economy pickup trucks, vans and sport-utility vehicles in the United States in recent years have brought the average vehicle fuel economy to its 20 year low. To alleviate the problem, a number of new efficiency technologies are introduced to improve fuel economy. For example, hybrid vehicles, using power electronics and battery storage to enhance gas mileage are currently marketed. Advanced lightweight materials are introduced. This can offer up to 6 percent improvement in mileage for each 10 percent reduction in body weight. It is noted that increase in the average fuel economy by three miles per gallon would save one million barrels of oil per day.

Some economies encourage the use of public transportation and other measures to reduce private car usage. For instance, Korea has implemented a scheme of a “10-day rotational suspension of vehicle usage”. New Zealand plans to promote teleworking and ride-sharing, and encourage the use of energy efficient and eco-efficient vehicles through proposing energy standards for new and used imported vehicles. Trials of new technologies such as hybrid vehicles and fuel cells are also conducted.

Chinese Taipei plans to toughen the requirement for energy efficiency of passenger vehicles in stages. It will also promote the use of electric vehicle and LPG fueled cars, introduce hybrid-fuel buses and advocate the development of high-speed railway and mass rapid transit systems. Australia has introduced a requirement that all new cars sold in Australia carry a fuel consumption label.

[1] Close to two-thirds of the petroleum consumption in the United States can be accounted for by motor vehicles.

Daylight savings time

Though daylight savings time schemes are less common nowadays, it can be very effective in reducing electricity consumption. When Mexico first implemented Daylight Savings Time (DST) in 1996, it helped bring about the optimal use of power infrastructure by reducing the use of fossil fuels for electricity generation. It is estimated that DST has accounted for a substantial decrease in electricity consumption by 1,000 million kilowatt-hours per year. The accumulated reduction in electricity consumption during the first four years of the application of DST (1996–1999) is equivalent to seven weeks of electricity consumption by 19.6 million households. The total saving for residential users from 1996 to 2000 is more than 2,600 million pesos. DST thus helped defer investment in electricity plants which is estimated to amount to more than 6,000 million pesos, equivalent to the cost of building a new generating plant with capacity to power 10.2 million 60-watt light bulbs.

Co-generation

Co-generation of electricity and heat allows for the productive use of much of the waste heat from electricity production which is about two-thirds of the energy used to produce electricity. For example, in New Zealand, the use of wood and wood waste as renewable fuels for industrial heat and co-generation has increased. In Chinese Taipei, energy users whose steam production reaches a given quantity must install co-generation facilities for steam and electrical power. Financial incentives, tax deduction and favorable power and natural gas prices are provided to encourage the installation of co-generation system. The conversion of waste heat into power will be Chinese Taipei's major focus in the near future.

In 1994/95, the Mexican National Commission for Energy Conservation (CONAE) conducted a national cogeneration feasibility study to identify cogeneration opportunities for the private sector as well as for the petrochemical branches of the national oil company PEMEX. This study identified a national cogeneration potential of 8,369 up to 15,698 MW. In 1996, CONAE created a sub-commission to promote cogeneration projects. Until mid-1999, the *Energy Regulatory Commission (CRE)* granted over 30 co-generation permits to private industrial enterprises with an installed capacity near 1,340 MW. Nowadays, 17 projects are in operation, with an installed capacity of 850 MW and an annual generation of 3,409 GWH, bringing energy savings of around 18 petajoules, equivalent to around 510 million m^3 of natural gas.

Alternative sources of energy

Other sources of energy, in particular renewable energy, can be used as an alternative to oil to reduce oil dependency. Australia has established grants to encourage research, development, commercialization of renewable energy technologies. It has also set out the requirements for the wholesale purchase of electricity to raise the ratio of renewable energy in the total energy consumed. Similarly, Thailand also promoted research and development in areas related to energy technology and energy conservation, including the application of research and development work to factories, buildings, and households. Renewable energy currently accounts for about 9 percent of US energy production, with non-hydro renewables growing rapidly. Research, development and early deployment of these technologies reduced their prices by as much as 90 percent over the past two decades, making them increasingly competitive in the energy market. In recent years, technology breakthroughs in fuel cells and photovolarics have significantly shortened the expected time for reaching market potential.

Demand management

Careful management of energy use can also help reduce energy consumption. Equipment and lights can be automatically turned off when they are not in use. Also, peak load can be reduced through price incentives. In Korea, street-lights, except for traffic lights, are cut down by 50 percent; extravagant neon lights are required to be turned off after 11:00pm.

Education and training

Provision of education and training programs on energy efficiency and conservation are also popular among the APEC economies. For example, in Singapore, training courses, seminars, and workshops on energy management are run regularly for personnel who operate energy consuming machines and equipment. The government also publicizes the ways to save energy by issuing leaflets and brochures or through the website. Regular energy conservation courses are also conducted for school children to inculcate in them the importance of using energy efficiently. In Chinese Taipei, awareness of energy conservation is promoted in schools at all levels. Training programs in energy conservation technology are organized for architects, air conditioning technicians, illumination designers and energy management personnel. Energy conservation methods for industrial electricity facilities and general household electric appliances are widely disseminated.

Technical assistance

Governments may also have a role to play. In Chinese Taipei, government provides consultation, diagnosis and testing services to assist energy users to improve utilization efficiency in air-conditioning, illumination, electricity, co-generation, and combustion and fabrication systems. A laboratory verification system was set up to promote the use of high-efficiency facilities.

In Mexico, government offers technical assistance to help energy users to identify energy efficiency opportunities, and evaluate and analyze technical and economic feasibility of energy efficiency projects for industrial, commercial, and services installations.

Financial incentives

Financial incentives may also be provided. In Chinese Taipei, companies using highly energy-efficient equipment and facilities are entitled to raise depreciation, investment tax credit, and low-interest loans. Industries are assisted to upgrade or replace equipment through medium and long-term loans, with energy efficiency as a condition.

In Mexico, the National Commission for Energy Conservation (CONAE) and the Trust Fund for Energy Conservation in the power sector (FIDE) promote the development of specific projects in energy-intensive installations.

In Korea, the government commenced a scheme that allow tax deduction for industries investing in energy saving facilities and equipment with the ultimate aim to reach 10 percent. Government aids are also provided to industries to assist them to implement energy-saving measures, and the amount of such aids has been increased by 50 percent since the recent hike in oil price. In Australia, A$1.6 million compressed natural gas infrastructure program and a A$75 million program to sweeten the use of compressed natural gas or liquefied petroleum gas by heavy commercial vehicles and bus fleets are launched.

Summary

Very often, the various measures on conserving energy, promoting energy efficiency and developing alternative renewable energy are targeted at combating pollution and reducing the adverse effect of global warming. The consequential lowering in oil dependency is only a useful by-products of these efforts.

A3 Shift in Economic Structure

Besides the above tax and non-tax measures, economic restructuring could also affect oil consumption and oil dependency.

As an economy shifts away from the more energy-intensive activities, energy consumption will come down given the same level of economic activities. In the last 30 years, the share of manufacturing in total output in the United States declined considerably from 31 percent in 1970 to 22 percent in 1999. Services sector rose from 50 percent to 65 percent over the same period. Most of the rise in share came from business, personal, and banking services. Services are substantially less energy-intensive. While manufacturing relies on petroleum for 25 percent of its energy needs, services require less than five percent. In 1995, the services sector used 1,157 BTUs per dollar of production, while the industrial sector used nearly 22,000 BTUs per dollar of production. The decline in the share of industrial production in total output and the corresponding rise in the share of services is thus an important factor underlying the decline in energy consumption in the United States in recent years.

The same trend is observed in some other APEC economies. In Japan, the share of the relatively more energy-intensive secondary industries in total GDP declined from 35.5 percent in 1990 to 28.1 percent in 1999 whereas the less energy-intensive tertiary industries increased its share from 62.1 percent in 1990 to 70.5 percent in 1999. Similarly, in Chinese Taipei, the share of the industrial sector in total GDP declined steadily from 45.8 percent in 1980 to 32.4 percent in 2000, and the share of energy-intensive industries in GDP also declined from around 6 percent in 1980 to around 5.5 percent in 2000. Furthermore, in Australia, the share of the industrial sector in GDO dropped from 36 percent in 1980 to 26 percent in 1998, while in Hong Kong, China, the corresponding share declined from 31 percent in 1980 to 15 percent in 1999. Apparently these economies become less oil dependent over time, ceteris paribus.

The above trend, however, is not a universal phenomenon in APEC. For the developing economies, demand for motor vehicles and other electrical appliances usually increases as income rises. The envisaged increase in demand for oil will lead to higher oil dependency in the near future, if there are no sufficient offsets from the increase in energy efficiency, industrialization, and the use of alternative sources of energy.

As shown in Table A.2, in Thailand the share of its industrial sector in GDP in fact rose from 29 percent in 1980 to 40 percent in 1999. The industrialization that accompanied, nevertheless, helped lower GDP per unit of energy use from 4.9 in 1990 to 4.7 in 1997. For some other APEC members, their industrial sectors have been growing in step with total output between 1980 and 1999. The share of their industrial sector in GDP has thus remained unchanged and hence, their oil dependency.

Table A.2: Industry Structure
(Percent of GDP)

	Primary				Secondary (Manufacturing)				Tertiary			
	1965	**1980**	**1990**	**1999**	**1965**	**1980**	**1990**	**1999**	**1965**	**1980**	**1990**	**1999**
Australia	9	5	3	3[1]	39(26)	36(19)	29(15)	26(14)	51	58	67	71
China	38	30	27	17	35(28)	49(41)	42(33)	50(24)	27	21	31	33
Chile	9		8	8	40(24)		39(19)	33(16)	52		53	59
Hong Kong, China	2	1	0	0	40(24)	31(23)	25(18)	15(6)	58	68	74	85
Indonesia	51	24	19	20	13(8)	42(13)	39(21)	45(25)	36	34	41	35
Japan	10	4	3	2	44(34)	42(29)	41(28)	37(24)	46	54	56	61
Malaysia	28	22	19	14	25(9)	38(21)	40(26)	44(35)	47	40	41	43
Mexico	14	9	7	5	27(20)	30(23)	26(19)	27(21)	59	61	67	68
New Zealand		11	7			31(22)	26(18)			58	67	
Peru	18	17	7	8	30(17)	37(27)	38(27)	39(24)	53	57	55	54
Philippines	26	25	22	17	27(20)	39(26)	34(25)	31(21)	47	36	44	52
Singapore	3	1	0	0	24(15)	38(29)	35(27)	36(26)	74	61	65	64
Korea	38	15	9	5	25(18)	40(29)	43(29)	44(32)	37	45	48	51
Chinese Taipei	24	8	3	3	30 (22)	46 (36)	35 (28)	33	47	47	62	64
Thailand	32	23	12	13	23(14)	29(22)	37(27)	40(32)	45	48	50	49
Viet Nam			37	26			23(19)	33			40	42
United States	3	3	2	2	38(28)	34(22)	28(19)	26(18)	59	64	70	72

Note: [1] Data for 1998.
Source: World Bank: *World Development Report*, various issues.

APPENDIX A2
Individual Economy Reports

AUSTRALIA

The Australian economy continued to perform strongly in the first half of 2000, before slowing in the second half of the year, with the downturn flowing somewhat on to employment later in the year. Ongoing inflation has remained low and within the Reserve Bank of Australia's target range over 2000.

REAL GROSS DOMESTIC PRODUCT

Real Gross Domestic Product (GDP) increased 3.8 percent in 2000 following growth of 4.7 percent in 1999. The slowing in the rate of growth was due to the weakness experienced in the second half of the year, arising, in part, from the negative impact of higher world oil prices, a decline in the world economy and the past effects of higher interest rates. The profile of growth through 2000 was heavily influenced by transitory factors such as the Sydney Olympics stimulus and the introduction of *The New Tax System* (TNTS). Following the abatement of these one-off factors the Australian economy is expected to continue its strong record of growth over the next 12 months.

- Household consumption rose by 3.4 percent in 2000, following growth of 5.2 percent in 1999. The moderate growth in household consumption in 2000 is likely to have reflected the effect of higher fuel prices, subdued employment growth, and less-rapid growth in household wealth.

- Following three years of solid growth, dwelling investment experienced slow growth in 2000. During the first half of the year dwelling investment rose strongly as a result of consumers bringing forward construction ahead of the introduction of *The New Tax System* (TNTS). This build-up in activity was subsequently unwound in the second half of 2000.

- Total business investment rose slightly in 2000. This result is due to a decline in non-residential construction following the completion of Olympics-related construction projects, which largely offset growth in machinery and equipment investment.

- Underlying public final demand (i.e., after adjusting for second hand asset sales) rose by 3.5 percent in 2000 after rising 6 percent in 1999. Slower growth in public final demand in 2000 reflects the unwinding of strong increases in both public consumption and public investment in 1999.

- The external sector had a positive impact on growth over the course of 2000. Net exports contributed 0.3 percentage points to GDP growth in 2000, after detracting 1.1 percentage points from GDP growth in 1999.

INFLATION

The 5.8 percent increase in the Australian Consumer Price Index (CPI) through the year to the December quarter 2000 includes the one-off impact from the introduction of TNTS (which is likely to have contributed a little less than 3 percentage points in the September quarter 2000) and the temporary effect of higher world oil prices on domestic fuel prices.

Abstracting from these influences, the CPI is estimated to have increased by around 2 percent through the year to the December quarter 2000, placing it at the lower end of the Reserve Bank of Australia's inflation target band. Moderate wage outcomes and intense competitive pressures contributed to the low outcome, which occurred despite a fall in the value of the Australian dollar.

EMPLOYMENT

Employment grew by 3.0 percent in 2000, with the unemployment rate falling to 6 percent in September and October 2000 before rising slightly to 6.3 percent in December 2000.

Wages, as measured by average weekly ordinary-time earnings for full-time adults and average weekly earnings (all employees), rose 5.1 percent through the year to the December quarter 2000. In contrast, the wage cost index rose by 3.4 percent through the year to the December quarter 2000.

CURRENT ACCOUNT

The current account deficit fell to A$26.5 billion or 4 percent of GDP in 2000, down from A$35.7 billion or 5.8 percent of GDP in 1999.

Exports in current prices increased 24.9 percent in 2000, while export volumes increased 10.2 percent in 2000. Imports increased 14.8 percent in current prices in 2000, while import volumes increased 7.3 percent in 2000. The terms of trade increased 5.9 percent in 2000, following a 0.4 percent fall in 1999. Overall, the trade deficit fell A$9.0 billion in 2000 to A$7.7 billion.

FOREIGN INVESTMENT

Net foreign debt was 44.6 percent of GDP (or US$162.2 billion) at the end of December 2000. Gross foreign debt was 69.6 percent of GDP (or US$252.0 billion) at the end of December 2000, and the public sector accounted for approximately 15 percent of this total, with the remaining 85 percent of Australia's gross foreign debt owed by private sector borrowers. Net foreign liabilities were 56.4 percent of GDP (or US$205.2 billion) at the end of December 2000. Foreign direct investment in Australia was 31.2 percent of GDP (or US$113.6 billion) at the end of December 2000.

EXCHANGE RATE

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

During 2000, the Australian dollar depreciated (in nominal terms) by 15.3 percent against the U.S. dollar and 5.0 percent against the Japanese yen. These depreciations contributed to a 8.5 percent fall in the trade-weighted index, despite rises in the Australian dollar against many Asian currencies.

FISCAL POLICY

Total general government net lending returned to surplus in financial year 1997–98 on a cash basis and has remained in surplus since then. (Data are not available on a calendar year basis.) This improvement has been mainly due to the elimination of the large Commonwealth Government fiscal deficits recorded in the first half of the 1990s.

In financial year 2001–02, the Commonwealth Government is expecting to achieve a fiscal surplus of 0.2 percent of GDP on a cash basis (or a deficit of 0.1 percent of GDP on an accrual basis). This is lower than the fiscal surplus of 0.5 percent of GDP (or 0.2 percent of GDP on an accrual basis) forecast in the 2000–01 Budget, reflecting the downward revision to the economic growth forecasts for 2000–01 and 2001–02, and new policy decisions.

MONETARY POLICY

The Reserve Bank of Australia has the primary responsibility for the conduct of monetary policy. The formal objectives of monetary policy require the Reserve Bank Board to conduct monetary policy in a way that will best contribute to currency stability, the maintenance of full employment, and the economic prosperity and welfare of the people of Australia. Price stability is regarded as a critical element in achieving these objectives. In pursuing the goal of medium-term price stability, the Reserve Bank of Australia has adopted, with agreement from the Treasurer, the objective of keeping underlying inflation between 2 and 3 percent, on average, over the cycle.

In pursuit of this objective, the Reserve Bank of Australia targets a publicly announced overnight cash rate that is determined by the Reserve Bank Board. The Reserve Bank Board does not target intermediate financial aggregates.

In response to emerging inflationary pressures, the Reserve Bank of Australia tightened monetary policy by 125 basis points—taking the target cash rate to 6 percent—between February and August 2000. The Reserve Bank of Australia had earlier increased the cash rate by 25 basis points in November 1999. By the end of April 2001, the Reserve Bank of Australia had reduced the cash rate by 125 basis points.

MEDIUM-TERM OUTLOOK

Economic growth in Australia in 2001–02[1] is forecast to rebound quite strongly, having slowed sharply in the second half of 2000, driven by a turnaround in residential construction. The stronger growth in 2001–02 is expected to be accompanied by declining inflation.

In 2001–02, economic growth in Australia is forecast to be around 3.25 percent in year-average terms and a strong 4 percent through the year to the June quarter 2002. Residential construction is expected to contribute strongly to growth in 2001–02, with moderate growth in household consumption, business investment, and net exports. Average unemployment rates are forecast to be slightly higher than recent levels, with inflation declining and the current account deficit well below its average of the 1990s.

Given the weakness in the second half of 2000 and subdued growth expected in the first half of 2001, economic growth is now expected to be around 2 percent in 2000-01 in year-average terms, and around 1 percent in through-the-year terms.

Despite the slower world growth expected in 2001, net exports are estimated to contribute strongly to overall economic growth in Australia in 2000–01, with a further modest positive contribution expected in 2001–02. The exchange rate has helped boost the competitiveness of many of Australia's export and import competing industries. Australia's current account deficit (CAD) is forecast to be around 3 percent of GDP in both 2000–01 and 2001–02. At these forecast levels, the CAD will be down markedly from 5.3 percent of GDP in 1999–2000 and well below its 1990s average. In addition to reflecting the stronger balance of trade, the lower CAD also reflects a decline in the net income deficit in response to lower world and domestic interest rates and reduced margins between Australian and world investment returns.

Domestic demand is forecast to grow at a moderate rate of around 3 percent in 2001–02, compared with less than 1 percent in 2000–01. Residential construction is expected to grow by

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

around 5 percent in year-average terms in 2001–02, following a marked decline of around 25 percent in 2000–01, with the turnaround supported by recent reductions in interest rates and the Government's more generous First Home Owners Scheme. The recovery in this sector is expected to gather strength as 2001–02 proceeds, with through-the-year growth of around 14 percent. Modest growth is also expected to resume in non-residential construction, particularly in engineering construction, following several years of decline since the recent peak in 1998–99.

Household consumption expenditure is forecast to increase by around 3 percent in 2001–02, a little faster than in 2000–01 but well below the very rapid growth experienced in the latter part of the 1990s (which was buoyed by strong growth in asset prices and household wealth). Household consumption will be supported by lower interest rates and a forecast gradual easing in fuel prices.

Employment growth in 2001–02 is expected to be slower than in recent years but to grow at around 1 percent in year-average terms, and around 1.5 percent through the year. This largely reflects the lagged effects of slower overall economic growth in 2000–01, particularly the downturn in the labour-intensive construction sector. The unemployment rate is expected to increase slightly, to average around 7 percent in 2001–02. This follows a period of declining unemployment which reduced the unemployment rate to near-decade lows. Prospects are sound for a resumption in the downward trend in unemployment over the medium term as the construction sector recovers and overall economic growth strengthens.

Inflation is forecast to decline in 2001–02, with the headline CPI rising by around 2 percent in both year-average and through-the-year terms. The abolition of Financial Institutions Duty and other elements of TNTS will put downward pressure on consumer prices in 2001–02 of between 0.25 and 0.5 percentage points. The forecasts also incorporate an allowance for a slight easing in fuel prices in line with an expected downward trend in world oil prices. Wages growth is expected to remain moderate, at around 3.75 percent, helping to ensure that growth in labour costs remains well contained. The inflation forecasts also make an allowance for some impact on consumer prices of the decline in the Australian dollar over recent quarters. Ongoing inflation, that is, inflation excluding the impact of TNTS, is expected to be around 2.25 percent in the year to the June quarter 2002.

POLICIES, STRATEGIES AND ADJUSTMENT MEASURES

One of the major reforms undertaken in 2000 was the re-structuring of Australia's taxation system. On 1 July 2000 *The New Tax System* came into effect. This package reformed income tax, indirect tax, family assistance, business tax and Commonwealth-State financial relations. Key elements of TNTS included the abolition of a multi-rate wholesale sales tax (WST) and the introduction of a broad-based 10 percent goods and services tax (GST). Australia has entered the 21st Century with an efficient and modern taxation system that will aid long-term economic growth.

Prior to tax reform WST was a 'hidden tax' applied at a number of rates to a narrow range of goods, thereby creating distortions and inefficiencies within the economy. Unlike the WST, which was a cascading tax, the GST is only applied to goods and services entering final consumption. Because it is only levied once and at a uniform rate across most goods and services, it removes unwarranted distortions of relative prices that were a feature of previous indirect taxes. As such it will promote the efficient allocation of resources within the economy.

All revenues collected from the GST are transferred to the States and Territories to aid them in funding their own expenditures. As the GST is a broad-based tax with a secure revenue base, it will provide a growing source of revenue to State and Territory governments. This will go some way toward addressing vertical fiscal imbalance and should reduce State and Territory reliance upon revenues from inefficient, narrowly based indirect taxes.

The increased indirect tax burden that results from the GST has been more than offset by substantial reductions in personal income tax. Personal income tax cuts worth $12 billion per annum have been implemented; this constitutes around one-fifth of the Commonwealth's individual income tax revenues prior to the reforms. These measures are expected to more than compensate taxpayers for the introduction of the GST; consequently they will experience a reduced tax burden.

Further, those in receipt of government income assistance have had their benefits increased to take into account the GST price effects. All pensions and allowances were increased by 4 percent; this includes a real increase of 2 percent.

Other elements of TNTS include improvements to the administration of the taxation system, which will make the collection of taxes simpler and less costly. A comprehensive Pay-As-You-Go system, which replaces a number of separate payment systems, was introduced for income tax instalments. In addition, the reforms introduced the Australian Business Number system, which will facilitate the collection of tax and reduce the capacity to evade tax.

The company tax rate is also being progressively reduced to make Australia a more attractive place to invest and conduct business. A cut in the company tax rate from 36 percent to 34 percent has been instituted, and a further cut to 30 percent took effect from 1 July 2001.

In addition to tax reform the Federal Government has made a strong commitment to developing Australia's research and development capacity. On 29 January 2001 the Prime Minister launched the Government's Innovation Action Plan — *Backing Australia's Ability*. Over the next five years this programme will commit $3.0 billion of Government resources to aid research and development through the provision of tax concessions, research grants, investment in research infrastructure, and additional university places. The broader economic reforms that have taken place in recent years will facilitate the effectiveness of these programmes.

Annex I

AUSTRALIA: OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000
GDP and Major Components (percent change from previous year, except as noted)						
Nominal GDP (level in billion US$)	363.7	407.4	407.1	364.2	395.3	381.0
Real GDP	4.4	3.7	3.8	5.6	4.7	3.8
Consumption	4.6	3.1	3.4	4.5	5.1	3.8
Private Consumption	5.0	3.3	3.9	4.6	5.2	3.4
Government Consumption	3.6	2.6	1.6	4.0	4.8	4.9
Investment	4.0	5.1	10.8	6.6	6.2	1.3
Private Investment	4.8	6.5	13.8	10.6	5.1	0.5
Government Investment	1.2	0.3	0.4	-8.1	14.5	4.6
Exports of Goods and Services	5.1	10.6	11.5	-0.3	4.5	10.2
Imports of Goods and Services	8.1	8.2	10.3	5.9	9.3	7.3
Fiscal and External Balances (percent of GDP)						
Budget Balance (financial year)	-2.8	-2.0	-1.0	0.2	0.7	2.0
Merchandise Trade Balance	-1.0	-0.6	0.4	-1.8	-2.6	-2.5
Current Account Balance	-5.4	-3.9	-3.1	-5.0	-5.8	-4.0
Capital Account Balance	0.2	0.2	0.2	0.2	0.2	0.2
Economic Indicators (percent change from previous year, except as noted)						
GDP Deflator	1.8	2.1	1.3	0.3	0.9	3.2
CPI	4.6	2.6	0.3	0.9	1.5	4.5
M3	7.4	9.1	9.0	6.3	9.1	7.1
90-Day Bank Accepted Bill	7.7	7.2	5.4	5.0	5.0	6.2
Real Effective Exchange Rate (level, 1997=100)*	92.3	101.0	100.0	91.5	91.8	87.3
Unemployment Rate (percent)	8.2	8.2	8.2	7.7	7.0	6.3
Population (millions)	18.1	18.3	18.6	18.8	19.0	19.2

* Source: OECD Main Economic Indicators.

Annex II

AUSTRALIA: FORECAST SUMMARY (percent change from previous year)

	2001				2002			
	Official*	IMF	Link	OECD	Official*	IMF	Link	OECD
Real GDP	2	2.3	0.8	2.0	3¼	3.8	2.8	3.8
Exports	6	N.A.	2.0	7.0	5	N.A.	5.0	7.1
Imports	0	N.A.	2.8	3.7	4	N.A.	4.1	7.5
CPI	6	4.2	4.6**	3.0**	2	2.0	3.6**	2.3**

Notes: * Official forecasts are given on a financial year basis (i.e., July to June).
** Private consumption deflator.
N.A. Not available.

Sources: IMF forecasts, *The World Economic Outlook Database* (September 2001).
LINK forecasts, *Project LINK World Economic Outlook* (April 2001).
OECD forecasts, *OECD Economic Outlook* (June 2001).

Annex III

AUSTRALIA: MEDIUM-TERM TREND FORECAST (percent)

	2002–03
Real GDP	3.5
CPI*	2.5

Note: * The Consumer Price Index (CPI) projections are set as the mid-point of the medium-term inflation target and as such make no allowance for any further impact of *The New Tax System*.

BRUNEI DARUSSALAM

REAL GROSS DOMESTIC PRODUCT

In 2000, Brunei Darussalam's economy improved and grew at 3 percent, compared to 2.5 percent in the previous year. Gross domestic product (GDP) growth, especially from the second half of 2000 onwards, was mainly attributable to the oil price hike. The crude oil price reached the highest levels seen in a decade; this increase was fostered by the fact that production levels rose in response to the high oil prices.

The mining, manufacturing, and quarrying sector, which consists mainly of oil and gas, contributes about 50 percent of total output. The number and production of non-oil-manufacturing activities increased somewhat during 2000. The service sector consists primarily of government activities, while contributions from other private sector activities such as the retail and wholesale trade, ownership of dwellings, and finance were adversely affected as a result of government spending cuts.

The construction sector was adversely affected by a sharp decrease in the number of government infrastructure projects and building projects in commercial and residential properties, which occurred as a result of the already excessive supply and very low demand, coupled with difficulty in obtaining finance.

Despite some improvements, as in the previous years, the contribution of the primary sector, comprising agriculture, forestry, and fisheries, is still insignificant at less than 4 percent of the GDP.

INFLATION

Inflation in Brunei Darussalam is measured by changes in the Consumer Price Index (CPI), caused by supply disruptions, changes in administered prices, price developments in the non-traded sector, and the composition of imports. In 2000, average annual CPI inflation in Brunei Darussalam was 1.2 percent, an increase from -0.1 percent in 1999. For the most part, price developments reflected the combination of declines in the U.S. dollar import prices of food, manufactured products, and machinery and transport equipment, and fluctuations in the bilateral exchange rates of import source economies. In particular, the appreciation of Brunei dollars against the currencies of neighbouring countries helped moderate imported inflationary pressures. This was offset by depreciation of the currency against the U.S. dollar, pound sterling, yen, and the major European currencies. The United States, Japan, and Europe together account for 39 percent of its total imports, while the Association of Southeast Asian Nations (ASEAN) economies account for 45 percent of Brunei's total imports.

EXTERNAL TRADE ACCOUNTS

Hydrocarbon exports and the steady accumulation of long-term foreign assets over many years have provided Brunei Darussalam with a comfortable external position, facilitating the maintenance of a liberal exchange and trade system. Oil prices decreased significantly in 1998, causing revenue from hydrocarbon to decrease to BND 1,344.8 million from BND 2,128.7 million the year before. However, with the recovery of the price of oil from mid-1999 onwards, peaking in mid-2000, revenue from hydrocarbon increased to BND 2,029.3 million and BND 4,221.1 million, respectively. In recent years, the trade balance (in terms of GDP) has improved, as exports have risen sharply while imports have remained stagnant. Japan and Korea are the major export markets, while imports largely come from the ASEAN economies.

The current account remained in substantial surplus throughout the period. The surplus showed an increasing trend, from 47.3 percent of GDP in 1995 to 65.9 percent in 2000 following increased earnings from petroleum. In 2000, the trade surplus improved by twice the previous year's level, mainly owing to the effects of increases in production and in the prices of oil and gas.

Portfolio and direct investment inflows have risen in recent years. Recorded inflows, however, are dwarfed by long-term capital outflows, which are derived as a residual in the balance of payments compilation, combining direct placements and reinvested earnings. Short-term capital provided net financing for many years. In placing their structural excess liquidity abroad, commercial banks in Brunei contributed significantly to both outward portfolio investment and short-term lending in most years. Direct and portfolio investments are estimated to have decreased 10.7 percent in 2000.

EMPLOYMENT

The total population of Brunei Darussalam in 2000 stood at 338,400, 2.4 percent higher than in 1999. The labour force stood at about 146,500, growing by 2.5 percent compared to 1999. A significant proportion of the labour force were migrant workers, but that number has notably decreased as a consequence of the fiscal consolidation measures adopted by the government in recent years and also as a result of industrial restructuring. However, the labour force participation rate for women has increased significantly, from 45 percent in 1995 to 55 percent in 2000. Of growing concern is the fact that over 7,000 individuals, many of them youths, are actively seeking jobs. To address this concern, the government continues to set up technical and vocational training institutions, cottage industries for local handicrafts, and resource centres for budding entrepreneurs, and also continues to enjoy support from the private sector.

FISCAL POLICY

The government has continued to tighten its fiscal outlay following the fall in revenue from hydrocarbon exports since 1997 as well as the slowdown in the non-oil private sector performance. Overall public expenditure in 2000 fell about 10 percent from the previous year's level. The increase in revenue from hydrocarbon exports and prudent public expenditures had resulted in a government budget surplus of BND 953 million in 2000, up from a deficit of BND 1,585 million in the previous year. In spite of the improvement in its fiscal position, the government will continue to be fiscally prudent with a view toward attaining a balanced budget.

MONETARY POLICY

The movement of the Brunei dollar was quite stable on average at around US$1=BND 1.7. Aggregate bank lending as of September 2000 increased by about 11 percent from the previous year's level, reflecting some degree of recovery in domestic non-oil and gas activities. The prime lending rate throughout the period was quite low, at 5.5 percent (a reduction from 6.25 percent in the previous year). Currency in circulation (M1 and quasi-money) as of September 2000 was around US$5,304 million, up 17.2 percent from the previous year's level. Brunei Darussalam has no central bank. Thus, the trend of interest rates follows that of Singapore because the two countries' currencies are at par.

MEDIUM-TERM OUTLOOK

The performance of Brunei Darussalam's economy during the next couple of years, particularly in 2001, depends very much on the development of the hydrocarbon sector and on the government's implementation of various projects and programmes of the 8th National Development Plan covering the period 2001–05. Recent trends in production, prices, and exports for both oil and gas have shown improvements, and additional revenues are expected as a result. Nevertheless, the tight fiscal situation is expected to remain because the government seeks to balance the budget. In 2001, GDP growth is forecast to be around 3.5–4.5 percent, while inflation is expected to remain at around 1–2 percent.

Some important factors that would significantly influence the macroeconomic performance of Brunei Darussalam in the medium term are as follows:

- The implementation of the 8th National Development Plan covering the period 2001–05.
- The impact of commercialisation, corporatisation, and privatisation of some government activities.
- The improvement of the business and investment climate to encourage foreign direct investment.
- The impact of the Brunei Visit Year 2001.
- The establishment of Brunei Darussalam as an international financial centre.
- Production, price levels, and exports of oil and gas, with emphasis on maintaining stable oil prices.

Annex I

BRUNEI DARUSSALAM: OVERALL ECONOMIC PERFORMANCE

	1993	1994	1995	1996	1997	1998	1999	2000
GDP and major components (percent change from previous year)								
Nominal GDP (US$billion)	4.1	4.5	5.2	5.3	4.5	4.2	4.5	4.6
Real GDP	0.5	1.8	3.0	1.0	3.6	-4.0	2.5	3.0
Total Consumption	-10.6	37.8	13.8	11.6	-4.7	-0.3	-10.1	-56.8
Investment	31.7	-26.8	3.9	-8.4	18.6	-5.0	-10.3	4.5
Government	35.4	-5.3	13.2	-19.2	40.4	-17.7	-13.1	13.7
Private	29.9	-37.5	-3.1	1.1	3.1	7.1	-8.2	-1.9
Export of Goods and Services	-8.6	-10.2	24.2	8.3	3.3	-21.6	32.6	51.1
Import of Goods and Services	4.3	-12.1	24.8	16.7	3.7	-13.2	-3.1	-1.5
Fiscal and External Balances (percent of GDP)								
Budget Balance	-17.1	-17.0	-16.3	-9.7	-15.1	-28.2	-20.8	11.9
Merchandise Trade Balance	11.2	10.1	7.9	4.7	12.9	13.9	28.8	61.6
Current Account Balance	47.8	63.7	47.3	54.2	51.7	50.0	58.8	86.4
Capital Account Balance	-47.8	-63.4	-47.1	-43.5	-42.2	-48.7	-45.5	-45.8
Economic Indicators (percent change from previous year)								
GDP Deflator	-0.2	-0.2	7.3	-0.8	-0.6	-4.0	5.7	1.9
CPI (1990=100)	4.3	2.4	6.0	2.0	1.7	-0.4	-0.1	1.2
M2	10.8	39.5	6.7	-2.3	-4.6	-1.3	3.1	17.2
Short-Term Interest Rate (percent)	5.8	5.8	6.5	6.5	6.5	6.9	5.5	5.5
Exchange Rate (BND/US$)	1.61	1.47	1.42	1.41	1.68	1.67	1.68	1.74
Unemployment Rate (percent)	4.1	3.6	4.9	3.9	4.2	4.7	3.8	4.3
Population (millions)	0.27	0.28	0.29	0.30	0.31	0.32	0.33	0.34

Annex II

BRUNEI DARUSSALAM: FORECAST SUMMARY (percent change from previous year)

	2001	2002
	Official	**Official**
Real GDP	3.5	4
Exports	20	25
Imports	4	5
CPI	1.2	1.5

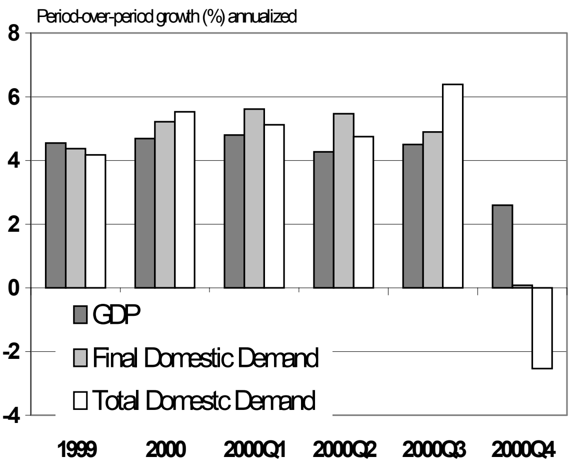
CANADA

REAL GROSS DOMESTIC PRODUCT

For Canada, 2000 marked the ninth consecutive year of economic growth, continuing one of the longest and most stable expansions of the postwar era. Growth in real gross domestic product (GDP) continued to be strong at 4.4 percent in 2000. This increase was boosted by an acceleration in domestic demand, combined with continued robust gains in foreign demand.

However, growth slowed noticeably in the fourth quarter of 2000, to 2.6 percent. Furthermore, initial indications suggest that growth may have slowed further early in 2001 owing to declines in North American auto and Information and Communications Technologies (ICT) demand.

Chart 1
Real GDP and Domestic Demand Growth



Total domestic demand equals final domestic demand plus investment in inventories.

A pickup in total domestic demand growth from 4.2 percent in 1999 to 5.5 percent in 2000 was led by rapid increases in business investment. Despite a downturn at the end of the year, machinery and equipment investment rose 18.9 percent in 2000 owing to surging investment growth in telecommunications, computers, and other office equipment. Non-residential investment also accelerated from 2 percent in 1999 to 4.8 percent. Residential investment, on the other hand, slowed after strong gains in 1999. While continued inventory investment contributed modestly to growth on average in 2000, a sharp slowing in investment at the end of the year contributed significantly to the slower growth in the fourth quarter.

Consumer expenditure also increased by 4 percent in 2000, compared with a 3.5 percent gain in 1999. This growth over the year was widespread among goods and services spending. However, growth of spending on durable goods fell at the end of the year, largely because of a noticeable decline in motor vehicle spending.

INFLATION

Underlying price and cost pressures remained subdued in Canada in 2000, with consumer price inflation averaging at 2.7 percent. CPI inflation has fluctuated at around 3 percent since the beginning of 2001, owing in large part to the impact of volatile energy and food prices. Core CPI inflation, which excludes food, energy, and the effects of changes in indirect taxes, meanwhile, reached 2 percent in January 2001, but eased back to 1.7 percent in March 2001. For 2001 and 2002, private/business sector forecasts for CPI inflation would average near the midpoint of the inflation target bands of 1–3 percent set jointly by the government and the Bank of Canada.

EMPLOYMENT

Following four consecutive years of robust gains, Canadian employment growth slowed in early 2001. Over 1997–2000, the employment rate increased at an average rate of 2.6 percent, bringing the unemployment rate to 6.8 percent in 2000 — its lowest level in 25 years. However, beginning in December the increase in the employment fell to an annual rate of 0.9 percent, as sharp declines in automotive and ITC industries partially offset continued strong gains in the rest of the economy. Consequently, the unemployment rate edged up slightly, to 7 percent in April 2001. Private sector forecasts suggest that this rate will remain largely unchanged in 2001.

TRADE

International trade continued to play an important role in Canadian economic activity in 2000. Exports of goods and services increased by 14.9 percent to reach Cdn $473.9 billion, equivalent to 45.6 percent of GDP (see Table 1). Imports of goods and services increased 10.7 percent to reach Cdn $426 billion or around 41 percent of GDP. In real terms, 2000 exports and imports rose 9.6 percent and 12 percent respectively, with the merchandise trade balance representing 1.5 percent of GDP in 2000, a decrease from 2.2 percent of GDP in 1999.

Table 1: Trade as a percent of GDP, 1990–2000

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Total exports	25.7	25.0	27.0	30.1	34.0	37.3	38.4	39.3	41.2	43.0	45.6
Goods	22.4	21.6	23.4	26.2	29.7	32.9	33.6	34.3	35.8	37.6	40.2
Services	3.3	3.4	3.6	3.9	4.3	4.4	4.8	5.0	5.4	5.4	5.4
Total imports	25.7	25.7	27.4	30.2	32.9	34.2	34.4	37.7	39.8	40.2	41.0
Goods	20.8	20.6	22.1	24.4	27.1	28.5	28.5	31.6	33.6	34.1	35.0
Services	4.9	5.1	5.3	5.8	5.8	5.7	5.9	6.0	6.2	6.0	6.0

Source: *National Income and Expenditure Accounts*, *Catalogue no. 13-001-PPB, Fourth Quarter 2000,* Statistics Canada.

The current account improved dramatically from a deficit of 1.3 percent of GDP in 1998 to a surplus of 0.2 percent of GDP in 1999 and a surplus of 2.5 percent of GDP in 2000. The main factor underpinning this improvement was an increase in the merchandise trade surplus from $19.1 billion in 1998 to $54.5 billion in 2000.

On a regional basis, export growth was widespread in 2000. Exports to the United States grew strongly as the expansion in that economy continued unabated in the first half of the year. The share of Canada's merchandise exports going to the United States rose from 83.6 percent in 1998 to 85.8 percent in 1999, and further to 86.1 percent in 2000. Exports to Japan rebounded modestly in 2000 but remained well below peak levels following four annual declines. Sales to the European Union, on the other hand, surged as growth in the major Western European economies firmed up.

Exports to most other major markets were, for the most part, up during the year as economic growth rebounded in several regions. Exports to East Asia rebounded sharply, with the bright spots including China, Korea, Indonesia, and the Philippines. Exports to Latin American destinations rebounded modestly in 2000 following a sharp drop in 1999, as that region began to recover from its economic troubles. Growth was notable with Mexico, one of Canada's partners in NAFTA, and with several South American economies such as Chile, Peru, Venezuela, and Columbia. Overall growth in exports to that region, however, was constrained by modest gains in Brazil and declines in many other economies.

On a sectoral basis, the highlight of 2000 was the steep growth in "machinery and equipment" exports. Boosted by exports of high-technology products, this sector experienced rising international sales of 22.8 percent, increasing its share in total Canadian merchandise exports to 25.3 percent to reclaim the top spot as Canada's leading major export sector. Export growth in the automotive sector, which has historically held the top spot, was modest, as sales dropped sharply in the United States in the second half of 2000. Energy sector trade surged, largely owing to rising oil prices, while higher metal prices in 2000 relative to the previous year's prices helped to boost the value of industrial goods and materials trade.

With regard to service trade, the strongest growth was recorded in transportation and commercial services, where expansion continued to be driven by key knowledge-based commercial services. Travel to Canada also expanded sharply in 2000, driven by the lower value of the Canadian dollar.

The rapid expansion of imports allowed the economy to maintain its capacity to meet growing demand and to continue the retooling needed to remain competitive in the "e-age". On a sectoral basis, import growth was led by purchases of "machinery and equipment" and industrial products, while growth of automotive products slowed sharply. The sharp rebound of international oil prices, which was beneficial to Canada on the whole since it is a net energy exporter, led to a steep rise in the oil import bill for Canadian net importing provinces. In regional terms, Canada's import growth in 2000 was broadly based, with robust growth in imports from Europe, especially the United Kingdom. Import growth from the United States was similar to that in 1999.

EXCHANGE RATE

The Canadian dollar is a freely floating currency that has experienced some volatility over the past year. After appreciating at the beginning of last year, peaking at US$0.697 in late January 2000, the Canadian dollar lost some ground during the year, in part because of the decline in world commodity prices. It closed at about US$0.670 at the end of 2000.

Yield spreads between Canadian and U.S. government securities turned positive for maturities of 2 to 30 years at the end of 2000, and widened out after that. This reflects in part an increased preference for U.S. assets on the part of global investors who have sought the safety and liquidity of U.S. financial markets at a time of market uncertainty. Because of this change in investor sentiment, the Canadian dollar has declined from about US$0.670 at the turn of 2001 to around US$0.640 in mid-April of this year. Compared to other major currencies, however, the Canadian dollar has remained quite firm.

FISCAL POLICY

The current fiscal strategy of the Government of Canada was last presented in the October 2000 *Economic Statement and Budget Update.* The central themes underlying the plan included investing in Canada's social fabric, particularly in health care and the environment; strengthening education, research, and innovation; paying down debts; and reducing taxes. Measures related to health care and early childhood development and the tax measures have all been implemented. The government is committed to balanced budgets or better in 2001–02 and 2002–03. This would mark six consecutive years of balanced budgets or better. By accounting standards used in most other countries, the Government of Canada will post a financial surplus for the fifth consecutive year in 2000–01, the only Group of Seven country to do so.

The reduction of the debt-to-GDP ratio remains a key objective of the government's fiscal policy. The Debt Repayment Plan, combined with sustained economic growth, has put the debt-to-GDP ratio on a permanent downward track. Based on the average private sector economic projections and assuming a minimum annual debt paydown of $3 billion per year (equal to the Contingency Reserve), the debt-to-GDP ratio is projected to fall from about 54 percent in 2000–01 to about 40 percent by 2005–06. This would put the ratio back to where it was in 1983–84.

The fiscal position of provincial-territorial governments has improved continuously since 1992–93. In 1999–2000, the provincial-territorial sector recorded a surplus of $2.8 billion, the first in 30 years. Current estimates suggest that the sector recorded a significantly higher surplus in 2000–01. Based on current plans and commitments, the provincial-territorial level should achieve balanced budgets in the medium term.

MONETARY POLICY

Since 1991, the federal government and the Bank of Canada have jointly announced an official target range for the inflation rate. This target range has been gradually lowered since it was first announced and currently stands at 1–3 percent. In February 1998, the commitment to maintain inflation within the 1–3 percent target range was renewed until December 2001. The appropriate long-run target for monetary policy will be determined by the end of 2001. The bank is of the view that the commitment to a low and stable inflation environment enables policy to best contribute to a sustained economic expansion in Canada, thereby leading to the likelihood of lower unemployment and improved productivity.

Between November 1999 and May 2000, the Bank of Canada raised its target for the overnight interest rate (its policy instrument) on four occasions for a cumulative increase of 1.25 percent (or 125 basis points). In the May 2000 Monetary Policy Report, the Bank of Canada took note of the strength of demand in Canada from both international and domestic sources, some early signs of pressures on capacity limits, and the need to lean against these trends in order to preserve the low and stable inflation environment that has been benefiting the Canadian economy.

Since the end of last year, however, there has been accumulating evidence that global economic growth has begun to slow. In light of this slowdown and movements towards a position of excess supply, monetary policy began to ease in the United States and Canada at the beginning of this year. At the end of April 2001, the Bank of Canada had reduced its target for the overnight rate on three occasions for a cumulative reduction of 100 basis points, while the U.S. Federal Reserve had dropped its Fed Funds rate by 200 basis points. In early May, market participants also expected further drops in the official rates in the near future.

It is also interesting to note that at the end of 2000 the Bank of Canada adopted a system of eight “fixed” or pre-specified dates each year for announcing changes to the Bank Rate and the target for the overnight rate. This system replaced the previous approach in which the Bank Rate can be adjusted on any business day. According to the bank, fixed dates will increase its transparency, accountability, and dialogue with the public.

MEDIUM-TERM OUTLOOK

After outperforming expectations in 2000 by posting 4.4 percent growth, the Canadian economy is expected to slow in 2001. The observed slowdown is primarily concentrated in the manufacturing sector (particularly automobile and ICT sectors) and results mainly from the slowing of the U.S. economy and a realignment of inventories in certain sectors. Canadian private-sector forecasters expect, however, that this slowdown will be short-lived, with economic activity picking up in the latter part of the year. For the year as a whole, they expect real GDP growth to average 2.4 percent, roughly in line with projections made by the Organization for Economic Cooperation and Development and the International Monetary Fund. Real GDP growth is expected to average a healthy 3.4 percent in 2002.

The recrudescence in growth is expected to stem mainly from the anticipated rebound in U.S. growth and the lagged effects of past and expected declines in interest rates. Since the beginning of the year, administered rates have been reduced by a full percentage point, and current market expectations suggest an additional 50-point decline in administered rates by early fall. Inflationary pressures are widely expected to remain well within the inflation target bands of 1–3 percent over the next two years. This reflects the increased credibility of Canadian monetary authorities as well as indications that Canada's capacity to sustain non-inflationary growth has increased as a result of structural reforms, sound fiscal management, and technological advancements.

Annex I

CANADA: OVERALL ECONOMIC PERFORMANCE

	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDP and Major Components (percent change, year-over-year, except as noted)									
Nominal GDP (billion US$)	581	566	566	592	615	639	617	656	711
Real GDP	0.86	2.39	4.72	2.81	1.57	4.28	3.93	5.07	4.43
Total Consumption	1.36	1.31	1.81	1.34	1.49	3.22	2.71	3.23	3.28
Private Consumption	1.56	1.82	3.02	2.06	2.56	4.63	3.02	3.43	3.62
Government Consumption	0.87	0.04	-1.27	-0.56	-1.41	-0.76	1.78	2.63	2.23
Total Investment	-2.74	-2.02	7.48	-2.12	4.39	15.22	2.37	7.32	6.71
Private Investment	-2.96	-2.14	7.50	-1.94	5.91	18.14	2.80	6.69	6.60
Government Investment	-1.50	-1.33	7.35	-3.15	-4.30	-3.22	-0.93	12.32	7.57
Exports of Goods and Services	7.17	10.84	12.71	8.49	5.60	8.33	8.87	9.90	7.60
Imports of Goods and Services	4.67	7.35	8.05	5.74	5.11	14.24	4.87	7.35	8.10
Fiscal and External Balances (percent of GDP)									
Budget Balance	-9.1	-8.7	-6.7	-5.3	-2.8	0.2	0.5	1.6	3.2
Merchandise Trade Balance	2.6	3.4	4.1	4.8	4.9	2.9	3.8	4.8	4.6
Current Account Balance	-3.6	-3.9	-2.3	-0.7	0.5	-1.3	-1.3	0.2	2.5
Capital and Financial Account Balance	3.1	4.7	2.3	0.2	-1.5	1.8	0.5	-1.2	-1.4
Economic Indicators (percent change, year-over-year, except as noted)									
GDP Deflators (% change)	1.4	1.5	1.1	2.3	1.7	1.2	-0.4	1.4	3.7
CPI (% change) 1994 = 100	1.5	1.8	0.2	2.2	1.6	1.6	0.9	1.7	2.7
M2 (% change)	3.6	2.9	2.1	4.3	3.1	-0.1	0.0	2.7	5.9
90 Corporate Paper Rate	6.74	4.97	5.66	7.22	4.35	3.61	5.05	4.94	5.71
Exchange Rate (P/US$)	1.209	1.290	1.366	1.372	1.364	1.385	1.484	1.486	1.485
Unemployment Rate(%)	11.2	11.4	10.4	9.4	9.6	9.1	8.3	7.6	6.8
Population (millions)	28.33	28.67	29.00	29.32	29.63	29.94	30.21	30.46	30.71

Annex II

CANADA: FORECAST SUMMARY (percent change from previous year)

	2001			2002		
	Official*	**IMF**	**OECD**	**Official***	**IMF**	**OECD**
Real GDP	2.4	2.3	2.3	3.4	2.4	3.2
Exports	1.9	N.A.	4.0	5.2	N.A.	6.8
Imports	1.9	N.A.	4.7	5.5	N.A.	7.0
CPI	2.4	3.0	2.4**	2.0	2.3	2.0**

Notes: N.A. Not available.
* Average private-sector outlook (March 2001)
** Private consumption deflator

Sources: IMF forecasts, *The World Economic Outlook Database* (September 2001).
OECD forecasts, *OECD Economic Outlook* (June 2001).

Annex III

CANADA: MEDIUM-TERM TREND FORECAST (percent)

	2003–06
Real GDP	3.2
CPI	2.0

CHILE

REAL GROSS DOMESTIC PRODUCT

After growing 5.4 percent in 2000, economic activity rose by 3.4 percent and 3.5 percent during the first and second quarters of 2001 respectively. This was somewhat lower than expected, but better than in other Latin American economies. Contributing factors include the larger-than-expected slowdown of world economic activity and still-weak domestic demand. By sector, the reduction in total output growth was associated with poor performances in manufacturing and mining.

Domestic demand growth averaged 6.6 percent during 2000, slowing significantly throughout the second half. This weakness carried over into the first half of 2001, revealing less promising conditions than forecast previously. This was apparent in the performance of several partial indicators of private consumption and fixed investment, which held steady or fell in recent months. At the root of weak consumption lies families' more prudent behaviour, which is probably due to uncertainty regarding their future job situation or high unemployment, along with their precarious financial situation.

The prospects for growth in consumer spending in coming months are more favourable than they have been to date, although only the passing of time will reveal if there is a real change in trend. In this sense, trends in unemployment and indicators for the financing of private consumption will be particularly important.

Gross formation of fixed capital (GFFC) was the most dynamic component of aggregate demand in late 2000 and in the first half of 2001. During the first and second quarters of 2001, it rose by 9.9 percent and 3.4 percent over the same quarters of the previous year respectively. Regarding individual components, investment in machinery and equipment has shown the strongest and most stable growth within GFFC, while the construction component has been more moderate.

INFLATION

At the end of August, the Consumer Price Index (CPI) inflation reached 3.8 percent year-on-year. After falling noticeably early in the year, prices of perishables followed their usual weather-related and seasonal patterns during the winter. On the other hand, the fall of fuel prices in the first quarter was offset during the second quarter. By the end of the third quarter inflation should drop again, in line with lower fuel prices and the stability of other prices and the usual pattern of perishables during the winter. In the short term, durable prices will probably hold steady, because margins will stop shrinking. Despite a temporary increase in inflation due to the recent depreciation of the peso, CPI inflation is expected to remain within the 2–4 percent target range.

EMPLOYMENT

In the first half of 2001, labour market conditions deteriorated. Compared to the first half of 2000, employment fell by about 60,000 posts on average, which amounts to a 1.1 percent reduction in employment. Lower job creation led the national unemployment rate to rise during the first quarter to 8.8 percent and to 9.7 percent in the second quarter.

Lower job creation during the first half of 2001 is associated with important sectors of the economy. In agriculture, manufacturing and the retail sector for example, employment fell (2.7 percent, 3.8 percent and -1.15 percent, respectively), while there was a significant rise in employment in construction (8.2 percent) and in financial services (4.5 percent).

Along with problems specific to the labour market, prospects for the recovery of employment in the coming months will also depend on the performance of relevant sectors, such as manufacturing and commerce. One element that could strengthen the future performance of some of these sectors is the possibility of renegotiating debts; the government is encouraging this in favour of labour-intensive firms, particularly small- and medium-sized operations.

BALANCE OF PAYMENTS

External Sector and the Current Account

Results for the first half of 2001 show less growth in both exports and imports compared to the last quarters of 2000. This was mainly due to an external demand that has shown signs of weakening due to deceleration of the world economy, particularly in important trading partners, such as Japan and the United States. During this period, the main impact has been in export prices, which fell by 5.3 percent and 5.6 percent in the first and second quarters respectively over the same period of the previous year. However, export volumes rose by 4.7 percent in the first quarter and a noticeable 13.9 percent in the second quarter. During the first quarter, the value of Chile's main exports, copper, fell by 0.7 percent, while non-copper exports fell by 0.9 percent. However, during the second quarter, these values recovered considerably, growing by 5.9 percent and 8.6 percent respectively.

On the other hand, imports rose by 8.2 percent in the first quarter before dropping by 3 percent in the second quarter, in line with the performance of domestic demand.

Current account projections for 2001 suggest a US$1.5 billion deficit, that is, 2.2 percent of GDP. This deficit will mainly be the result of eroding terms of trade, particularly the lower price of copper for this year compared to the average 82 cents per pound last year, which adds up to over one percentage point of GDP. This situation is projected to turn around in 2002, when the current account deficit should fall somewhat.

Capital Account

During the first half of 2001 there were significant inflows of direct investment from abroad. In effect, net foreign direct investment rose significantly, reaching US$1.4 billion in this period completely offsetting the negative value registered in 2000.

It is important to mention that the structure of financing has changed. In fact, inflows of medium-term, non-investment capital, mainly credits from abroad, were positive in the first half of the year. In contrast, short-term capital fell, due to outflows associated with foreign trade, the result of a seasonal increase in pending export returns.

Projections for 2001 indicate that the capital account balance will remain positive, due to net income from medium- and short-term credits, particularly those associated with foreign trade, along with positive direct investment inflows. By the end of 2001, the capital account balance is expected to be about 42 percent higher than last year, due to the recovery in foreign investment, which is projected to rise by about 55 percent over 2000. Direct investment abroad by Chileans should rise. Although for the rest of the year net portfolio investment flows are expected to be positive, estimates for the year indicate a net outflow due to the significant outflow already observed. This will occur despite new bonds likely to be issued abroad.

Finally, the measures taken in April by the Central Bank to suppress exchange restrictions affecting a series of financial operations should also influence the future behaviour of the capital account, as they make access to international capital markets more fluid.

EXCHANGE RATE

So far this year, the nominal exchange rate has depreciated by nearly 17.2 percent. The dollar rose from 571 Chilean pesos in January to over 670 pesos in recent weeks. This depreciation was partly due to economic instability in the other economies in the region. Considering this, the Central Bank decided in mid-August to increase the issue of dollar-linked notes and use part of its international reserves (up to US$2 billion until end-December) to intervene in the foreign exchange market, to provide an increased supply of hedging instruments and foreign exchange liquidity.

In multilateral terms, the peso has depreciated less, because of weakness against the dollar of currencies such as the euro, the yen and the real. The real exchange rate index rose by 10.1 percent between December and August.

FISCAL POLICY

Based on the implementation of the national budget during the fourth quarter of last year, public spending with macroeconomic impact rose by 2.1 percent over the same period of the previous year, totalling 3.1 percent for 2000. Tax revenues rose by 9.7 percent during 2000. Altogether, this brought the general fiscal surplus for 2000 to 0.1 percent of GDP, clearly a much more favourable result than the 1.5 percent overall deficit posted at the end of 1999.

The national budget proposal for 2001 was developed assuming potential GDP would rise by 5.7 percent, inflation by 3.0 percent, and an average copper price of 88 cents per pound. To guarantee a structural fiscal surplus of 1 percent of GDP based on these assumptions, real public absorption (public expenditure with macroeconomic impact) was expected to increase by 5.0 percent.

In practice, tax revenues will be less than assumed in the 2001 budget due to the downward correction of the GDP growth projection. This would set the stage for a fiscal deficit of about 0.5 percent of GDP, up from the –0.1 percent projection included in the 2001 budget.

The lower tax revenue scenario will translate into a greater fiscal impulse to the economy. In any case, employment programmes, subsidies to hiring labour, and moving public investment programs up to the first half of 2001 do not represent spending and, according to Finance Ministry authorities, will be financed through reallocations beyond what was committed within the budget. The other factor that will weaken the fiscal position is the lower-than-expected price of copper, which will lead to larger withdrawals from the Copper Stabilisation Fund to compensate the difference.

MONETARY POLICY

Since the beginning of the year, the Central Bank has steadily reduced the monetary policy interest rate, which today stands at 6.5 percent (nominal rate), its lowest point since the end of the 1980s. These policy decisions are the result of consolidation of a scenario involving less inflationary pressure in the medium term.

The use of nominal interest rates is a very recent phenomenon. In fact only in August 2001, the Central Bank shifted its monetary instrument from an indexed interest rate to a nominal interest rate target. The current nominal rate is in line with the 3.5 percent real rate set in June and 3 percent expected inflation (the Central Bank's medium-term inflation target). The use of nominal interest rates instead of indexed ones is part of a process towards a more modern monetary policy framework. This change in the monetary policy framework allows a reduction in the volatility of nominal interest rates, the exchange rate and monetary aggregates. It also simplifies international financial integration, expedites risk management and gives more transparency to the interest rate itself. Also, this change is consistent with the current macroeconomic conditions, in particular, low and stable inflation, high credibility of the Central Bank inflation target and a more developed nominal financial market.

Currency and private money (M1A), once adjusted for seasonal and interest rate effects, are linked to consumers' and companies' transaction needs. These variables have shown a tendency to expand in the February–July period, which suggests that expenditure could pick up in the coming months. The behaviour of the broader aggregates, M2 and M3, has followed M1A's performance.

ECONOMIC OUTLOOK

The current macroeconomic policy stance and external economic environment is consistent with a rate of economic growth below the one observed last year, of around 4 percent in 2001 and 5 percent in 2002. In the main scenario, CPI-measured inflation is projected at somewhat above 3 percent by the end of this year, as well as at the end of next year.

However, it is important to stress the conditional nature of these projections. Currently, there are some risk factors that could change the future path of the Chilean economy, but it is hard to weigh their influence using available information. In fact, there are three main areas worth considering: first, the performance of the Chilean economy, particularly consumption and employment; second, developments in the world economy and main export prices; and finally, conditions in international financial markets, particularly for emerging economies.

Annex I

CHILE: OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in million US$)	65,216	68,568	75,284	73,063	67,658	70,019
Real GDP (percent Var.)	10.6	7.4	7.4	3.9	-1.1	5.4
Consumption (Real) (percent Var.)	9.2	8.8	7.9	4.3	-2.5	4.1
Private Consumption	9.8	9.4	8.2	4.3	-3.1	4.1
Government Consumption	4.2	4.0	5.0	3.8	2.5	3.5
Investment (Real) (percent Var.)	23.5	8.9	11.5	4.1	-17.4	4.3
Investment (Nominal) (percent Var.)	24.0	14.0	14.3	8.7		
Private Investment (Nominal)	23.4	12.6	14.2	8.6		
Government Investment (Nominal)	29.5	26.1	14.6	9.2		
Exports of Goods and Services (Real) (percent Var.)	11.0	11.8	9.4	5.9	6.9	7.5
Imports of Goods and Services (Real) (percent Var.)	25.0	11.8	12.9	5.4	-14.3	10.1
Fiscal and External Balance (percent of GDP)						
Budget Balance	2.6	2.3	2.0	0.4	-1.5	0.1
Merchandise Trade Balance	1.8	-2.3	-2.7	-4.2	1.8	1.1
Current Account Balance (Déf.Cta.Cte./GDP)	2.1	5.1	5.0	5.7	0.1	1.4
Capital Account Balance	3.5	7.8	9.8	4.5	-1.1	1.7
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	380.5	387.0	402.4	412.5	427.1	444.8
GDP Deflator (percent Var.)	9.3	1.7	4.0	2.5	3.5	4.1
CPI (percent Var. Respecto Diciembre)	8.2	6.6	6.0	4.7	2.3	4.5
M2A (Monthly Average December) (MIs.Mill de $)[#]	8,453.62	10,582.61	12,936.42	14,501.04	16,031.42	17,374.28
M2A (percent Var.)[#]	25.9	25.2	22.2	12.1	10.6	8.4
Short-Term Interest Rate (percent)[+]	1.08	1.06	0.95	1.16	0.68	0.73
Real Effective Exchange Rate (level, 1997=100)	120.6	113.7	108.3	100	99.8	105.3
Unemployment Rate (percent)	7.4	6.5	6.1	6.2	9.7	9.2
Population (Millions)	14.2	14.4	14.6	14.8	15.0	15.2

Notes : * For 1999 and 2000 the National Accounts figures are provisional.

\# It correspns to the nonindexed nominal monthly deposit rate from 30 to 89 days.

\+ M2=M2A= Currency + demand deposits in checking accounts of the nonfinancial private sector net of float + demand deposits not included in checking accounts + demand saving deposits + time deposits of the private sector.

Annex II

CHILE: FORECAST SUMMARY (percent change from previous year)

	2001			2002		
	Official	**IMF**	**LINK**	**Official**	**IMF**	**LINK**
Real GDP	4.3	4.0	5.1	5.0	4.7	5.7
Exports (goods and services)	4.6	N.A.	5.0	4.8	N.A.	6.3
Imports	5.6	N.A.	8.3	5.6	N.A.	8.0
CPI	3.2 (dec)	3.4	5.0*	2.8 (dec)	3.3	5.2*

Note: * Private consumption deflator.
N.A. Not available.

Sources: IMF forecasts, *The World Economic Outlook Database* (September 2001).
LINK forecasts, *Project LINK World Economic Outlook* (April 2001).

Annex III

CHILE: MEDIUM-TERM TREND FORECAST (percent)

Real GDP	N.A.
CPI	3 (target)

THE PEOPLE'S REPUBLIC OF CHINA

In 2000, China's domestic economy continued to perform well, with improvement in the quality of growth.

REAL GROSS DOMESTIC PRODUCT

China's economic growth accelerated, and its comprehensive strength was enhanced in 2000. The gross domestic product (GDP) for the year was US$1,079.7 billion, representing an 8 percent growth in real terms. Growth in 2000 was 0.9 percent higher than in 1999. Growth of the primary secondary and tertiary sectors were 2.4 percent, 9.6 percent and 7.8 percent respectively. At the current exchange rate, China's GDP exceeded US$1,000 billion in 2000—the highest ever recorded.

The restructuring of China's agricultural production continued. In 2000, the product mix was further optimised, with grain outputs dropping sharply. With bumper harvests occurring each year from 1996 to 1999, supply of agricultural products exceeded demand, leading to a surplus of products. The regional governments strove to adjust the structure of local cultivation according to market needs. The sown area of cash crops was expanded, accounting for over 30 percent of the total sown area of farm crops for the first time. However, because of severe drought and decreased sown areas, the total output of grain for the year as a whole fell by 9 percent to 462.51 million tons in 2000.

Industrial production grew rapidly. In 2000, the total value added for the industrial sector as a whole was US$477.9 billion, 9.9 percent higher than in 1999. Significant progress was made in industrial structural adjustment. Production of high-technology and high-value-added products increased sharply. The electronic and telecommunications equipment manufacturing industry became the mainstay of the country's industrial sector. The targets of reforming state-owned enterprises (SOEs) and helping those in difficulty to recover within three years was basically realized**.** By the end of 2000, 12 out of 14 major industries under the supervision of the state were not making losses or were making profits.

Investment in fixed assets increased steadily in China during 2000. Investment in fixed assets reached US$393.9 billion in 2000, 9.3 percent higher than in the previous year. Investment in capital construction in the electronics industry and in scientific research as well as in technical services rose by 48.9 percent and 19.2 percent respectively. Investment in technical transformation rose by 13.2 percent. Analysed by region, investment in the western region increased by 14.4 percent, 6.1 percentage points and 0.6 percentage points higher than in the eastern and central regions respectively.

Consumption demand went up steadily, along with continued improvement in the standard of living. The total retail sales of consumer commodities was US$412.5 billion in 2000, with a real growth of 11.4 percent. New consumption hot spots such as housing and travel came into being gradually. Expenditures on commercial residential houses purchased by individuals rose by 50.6 percent, accounting for 84.8 percent of all commercial residential buildings sales. Annual per capita disposable income for urban residents was US$758.5, and for farmers was US$272.1. Real growth stood at 6.4 percent and 2.1 percent, respectively, after discounting for price effects.

Use of foreign capital was stable in 2000. Actual utilized foreign direct investment (FDI) in 2000 was US$40.7 billion, US$4 million higher than in the previous year. The trade surplus narrowed, by US$5.1 billion to US$24.1 billion in 2000.

INFLATION

The central government continued to implement a series of policies for expanding domestic demand. Market prices were targeted to remain stable. The consumer price index (CPI) was up by 0.4 percent in 2000, reversing the two-year declining trend since 1998. Calculated by category of commodities, prices for service items rose by 14.1 percent, and for housing by 4.8 percent. Except for the prices of aquatic products and vegetables that rose, food prices continued to decline. On the other hand, influenced by the rise in crude oil prices on the international market, the ex-factory price for industrial products increased by 2.8 percent, and the prices for energy, raw materials, and power by 5.1 percent.

EMPLOYMENT

The unemployment rate continued to fall. At the end of 2000, it stood at 3.1 percent. A total of 711.50 million people were employed in China, 5.64 million more than in 1999. Of this total, 212.74 million people were employed in urban areas, an increase of 2.60 million over the preceding year. Progress was made in the implementation of the re-employment project. By the end of 2000, the number of workers laid off in SOEs was 6.57 million, 47,000 more than in 1999. During 2000, about 3.61 million workers laid off found new jobs.

The social security system was further consolidated and improved in 2000. By the end of the year, 104.08 billion people were enrolled in the unemployment insurance programme, and a total of 1.37 million people received their unemployment insurance on a monthly basis. Nearly 103.67 million workers and 31.73 million retired people participated in the basic retirement security programme, and about 43.32 million people took part in the basic health care programme.

BALANCE OF PAYMENT

Driven by the fast growth of economy within and outside the economy, and by a series of policies on expanding exports, the country's foreign trade continued to grow well in 2000. Total trade reached US$474.3 billion, 31.5 percent higher than in the previous year. The value of exports amounted to US$249.2 billion, up 27.8 percent, and the value of imports was US$225.1 billion, up 35.8 percent, with a trade surplus of US$24.1 billion. Exports of machinery and electronic products stood at US$105.3 billion, up 36.9 percent. Exports of new and hi-tech products stood at US$37 billion, up 50 percent. As for imports, faster growth was seen in resource-type products, machinery and electronic products as well as new and hi-tech products, representing increases of 32.6 and 39.7 percent respectively.

Utilization of FDI improved in 2000. A total of 22,347 new foreign-invested projects were approved, up 32.1 percent over the previous year. The contractual investment value amounted to US$62.4 billion, and was higher by 51.3 percent. The utilised value of FDI was US$40.7 billion, up by only 1 percent.

Overseas construction projects, labour projects, and design and consulting services were all on the rise in 2000. Contracts with overseas partners involved US$14.9 billion, up 15 percent over the previous year, and the accomplished business revenue was US$11.3 billion, up 1 percent. Its contribution to total exports was US$900 million, up 35 percent.

International tourism developed steadily. 83.44 million overseas tourists visited China in 2000, 14.6 percent more than in 1999. Of the total, 10.61 million were foreigners and 713.21 million were Chinese compatriots from Hong Kong, Macao, and Taiwan. These represented increases of 20.5 percent and 13.9 percent respectively. Foreign exchange income from international tourism reached US$16.2 billion, up 15.1 percent. A total of 10.47 million Chinese went abroad in 2000, up 13.4 percent over the previous year, and 5.63 million went on personal travel, up 32 percent.

National foreign exchange reserves continued to increase. By the end of 2000, the total amount of foreign exchange reserves reached US$165.6 billion, US$10.9 billion more than a year earlier.

EXCHANGE RATE

The exchange rate of the RMB was stable in 2000. By the end of the year, US$1 equalled 8.2781 RMB, with an appreciation of 12 basis points.

FOREIGN DEBT

By the end of 2000, with the exception of debt to Hong Kong, Macao, and Taiwan, China's outstanding foreign debt amounted to US$145.73 billion, US$6.1 billion or 4 percent less than at the end of 1999. By the end of 2000, outstanding medium- and long-term foreign debt was at US$132.65, US$4 billion less than a year earlier. Outstanding short-term foreign debt was US$13.08 billion, US$2.1 billion lower than in the previous year. In 2000, newly borrowed foreign debt totalled US$14.92 billion. Repayment amounted to US$29.11 billion.

Of China's total of US$145.73 billion in foreign loans, foreign loans with sovereignty borrowed by the state departments reached US$48.96 billion, up 3.5 percent over end-1999. Foreign debt borrowed by domestic financial institutions reached US$35.56 billion, down 13.1 percent from the previous year. Debt borrowed by foreign invested enterprises was US$46.53 billion, down 1.6 percent. Debt for domestic enterprises was US$13.52 billion, down 8.1 percent. Other debt was US$1.16, down 28.4 percent.

FISCAL POLICES

The actual amount of fiscal deficit for the central government was less than the budgeted deficit for 2000. In 2000, total fiscal revenue reached US$161.6 billion, US$12.6 billion more than the fiscal budget. Total fiscal expenditure amounted to US$191.8 billion, US$9 billion more than the year's budget. The increase in fiscal revenue was attributable to rapid economic growth, enhancement of economic proficiency, and more effective tax collection.

In 2001, China's total fiscal revenue is expected to attain US$178.3 billion, US$16.7 billion or 10.3 percent higher than in 2000. Total fiscal expenditure will reach US$209.6 billion, US$17.9 billion or 9.3 percent higher than a year earlier.

MONETARY POLICY

In 2000, China's money supply increased by a moderate amount that helped enhance the liquidity of the banking system. The central bank continued to implement robust monetary policies, using various monetary policy tools to increase money supply. By the end of 2000, the balance of M2, M1 and M0 reached US$1,630.4 billion, US$640.1 billion and US$177.5 billion, 12.3 percent, 16 percent and 8.9 percent respectively higher than a year earlier. The amount of savings deposits and loans increased steadily. By the end of 2000, savings deposits in various forms in all banking institutions totalled US$1,495.2 billion, up 13.8 percent, a growth rate slightly higher than the end-1999 rate. Urban and rural residents' savings deposits reached US$776.6 billion, up 7.9 percent. Outstanding loans by all the financial setups amounted to US$1,200.5 billion, representing an increase of 13.4 percent. The amount of medium- and long-term loans rose to US$45.8 billion, US$3.7 billion higher than in the previous year. The central bank tried to use monetary policies, such as reducing the interest rates for savings and loans, enlarging consumer credit, and raising the re-financing limits allowed to small and medium-size financial bodies by the central bank to adjust currency in circulation and moderately increase the money supply. In these ways, the central bank stimulated domestic demand and economic development.

MEDIUM-TERM TREND FORECAST

In 2001, China will continue to stimulate domestic demand by adopting various macro-economic measures, and to carry out proactive financial policies and prudent monetary policies for the purpose of consolidating and enhancing economic growth.

In 2001, the central fiscal authority will distribute US$18.1 billion long-term national construction loans to commercial banks. The national budgeted revenue for the entire year will be US$178.3 billion, while the budgeted expenditure will amount to US$209.6 billion. The central government financial deficits will be limited to US$31.3 billion. The balance of revenue and expenditure of regional governments will be achieved. The positive effects of the financial policies and government investment will help fuel the growth of social investment and consumption expenditure. With the exception of the portion used to develop the western region, newly increased national loans will be used on national projects under construction.

The prudent monetary policies will remain in effect. In 2001, M1 is expected to increase by 13–14 percent, while M2 is expected to increase by 15–16 percent. The net cash supply will not exceed US$18.1 billion.

The government aims at:

- Improving the strategic adjustment of the economic structure on the basis of systematic and scientific innovation, and making use of information technology to stimulate industrialization.

- Further strengthening agriculture as the foundation of the economy, by increasing agriculture support and protection and raising farmers' income.

- Promoting the transformation of enterprises' operating mechanism, through the strengthening of the management of enterprises, consolidating and enlarging the results of reform and of rescuing SOEs.

- Accelerating the development of hi-tech industries, by stimulating the development of venture capital, and creating a favourable market environment for the development of hi-tech industries.

- Stepping up efforts to promote the efficient use of information in the national economy. This will include extensively promoting the application of information technology in various industries, developing electronic government and e-commerce, encouraging the use of information technology in enterprises, building information network infrastructure, expanding the software and integrated circuit industries, and enhancing the capacity of system integration and electronic equipment manufacturing.

- Accelerating the restructuring and technological transformation of traditional industries. This can be achieved by promoting production of products in short supply such as chemicals, steel and metallurgy, and mechanisms for saving energy and reducing waste. Various efforts will be made to develop new building materials, to accelerate the process of restructuring the automobile industry to economise on water and oil usage, to promote the use of alternative less-polluting fuels such as alcohol fuels, to develop new types of recycled energy and restructure the energy industry, and finally to eliminate outdated equipment, skills, and crafts, and close down enterprises that cannot ensure safe and efficient production while keeping wastage and pollution to the minimum.

- Actively restructuring and developing service industries, especially tourism, information, accounting, consulting, and legal services, to increase the value-added contribution to GDP and to employment.

- Preparing for entry into the World Trade Organization by opening further to the outside world.

- Increasing employment, improving the social security system, and raising the standard of living.

- Regulating the order of the market-based economy, and creating a better macroeconomic environment.

In 2001, the major guidance targets for the national economic and social development areas are as follows:

- Economic growth rate of 7 percent;
- Increase in total fixed asset investment of around 10 percent;
- Rise in consumer price level of 1 to 2 percent;
- Rise in total trade of around 8 percent;
- Central government deficit under US$31.4 billion;
- Total volume of currency issued not more than US$18.1 billion; and
- Maximum registered urban unemployment rate of 4 percent.

During 2001–2005, China will aim at maintaining a fairly rapid growth, while achieving notable improvement in the strategic restructuring of the economy to improve the quality of economic growth to lay a solid foundation for doubling GDP by 2010. The major macro-economic targets are as follows:

- Average yearly economic growth rate of about 7 percent;
- Maximum registered urban unemployment rate of about 5 percent;
- Price stability; and
- Basic balance in international payments.

Annex I

CHINA: OVERALL ECONOMIC PERFORMANCE

	1992	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**
GDP and Major Components (percent change from previous year, excepted as noted)									
Nominal GDP (US$ billion)	483	601.1	540.9	697.65	816.9	903.0	960.9	991.1	1,080
Real GDP	14.2	13.5	12.6	10.5	9.6	8.8	7.8	7.1	8.0
Total Consumption	14.2	9.3	8.0	9.2	9.3	6.1	6.8	7.9	10.4
Private	14.3	9.4	7.7	10.1	9.6	5.8	6.1	6.8	9.5
Government	13.6	9.1	9.1	5.9	8.4	7.2	8.9	12.0	13.8
Total Investment	12.9	24.9	15.6	15.5	10.4	7.1	14.4[1]	5.2	9.3[1]
Merchandise Exports	18.2	8.0	31.9	22.9	1.5	20.9	0.5[2]	6.1	27.8
Merchandise Imports	26.3	29.0	11.2	14.2	5.1	2.5	-1.5[3]	18.2	35.8
Fiscal and External Balances (percent of GDP)									
Budget Balance	-0.97	-0.85	-1.23	-1.00	-0.78	-0.78	-1.5	-2.1	-2.8
Merchandise Trade Balance (fob)	0.87	-2.03	0.99	2.41	1.51	4.46	5.48	2.9	2.23
Current Account Balance	1.33	-1.98	1.42	0.23	0.89	3.29	3.03	1.07	1.90
Capital Account Balance	-0.05	3.91	4.68	4.74	4.89	2.54	0.00	0.01	0.18
Economic Indicators (percent change from previous year, except as noted)									
GDP Deflator	7.9	14.6	19.5	13.1	6.1	1.5	-1.3	-3.0	0.9
CPI	6.4	14.7	24.1	17.1	8.3	2.8	-0.8	-1.4	0.4
M2	31.3	32.4	34.5	29.5	25.3	19.58	15.3	14.7	12.3
Short-Term Interest Rate (percent)	8.1	8.8	9.0	9.0	9.72	7.65	6.34[4]	5.58	5.58
Exchange Rate (RMB/US$)	5.5	5.76	8.62	8.35	8.31	8.28	8.28	8.28	8.28
Unemployment Rate (percent)	2.3	2.6	2.8	2.9	3.0	3.1	3.1	3.1	3.1
Population (millions)	1,171.7	1,185.2	1,198.5	1,211.2	1,223.9	1,236.7	1,248.1	1,259.1	1,265.8

Notes: [1] Real Investment in Fixed Assets Growth.
[2] Current price.
[3] Current price.
[4] Three-month interbank rate.

Annex II

CHINA: FORECAST SUMMARY (percent change from previous year)

	2001					2002			
	Official	**IMF**	**LINK**	**ADB**	**OECD**	**IMF**	**LINK**	**ADB**	**OECD**
Real GDP	7 (approx.)	7.5	7.3	7.3	7.5	7.1	7.2	7.5	7.8
Exports	N.A.	N.A.	6.7	10.0*	N.A.	N.A.	9.6	15.0*	N.A.
Imports	N.A.	N.A.	8.4	20.0*	N.A.	N.A.	9.3	15.0*	N.A.
CPI	1-2	1.0	N.A.	2.0	0.8	1.5	N.A.	2.5	1.2

Note: * Merchandise trade in US$ terms.
N.A. Not available.

Sources: IMF forecasts, *The World Economic Outlook Database* (September 2001).
LINK forecasts, *Project LINK World Economic Outlook* (April 2001).
ADB forecasts, *Asian Development Outlook* 2001.
OECD forecasts, *OECD Economic Outlook* (June 2001).

Annex III

CHINA: MEDIUM-TERM TREND FORECAST (percent)

	2001–05
Real GDP	7
CPI	3.5

HONG KONG, CHINA

REAL GROSS DOMESTIC OUTPUT

The Hong Kong, China economy saw a broad-based recovery in 2000, driven by a strong upturn on both the external and domestic fronts. The pace of economic growth was the strongest in the first quarter of 2000, at 14.1 percent in real terms over a year earlier, and remained at double-digit level in the ensuing two quarters, at 10.7 percent and 10.8 percent respectively. Upon a distinctly higher base of comparison, the economy settled to a 7.0 percent growth in the fourth quarter of 2000. For 2000 as a whole, the Gross Domestic Product (GDP) attained a double-digit growth of 10.5 percent in real terms in 2000, much more rapid than the 3.0 percent growth recorded in 1999.

Yet the fall-off in global demand triggered by a distinct setback in the US economy began to impinge on the Hong Kong, China economy towards the end of last year, and more visibly so in recent quarters. Total exports of goods slowed down sharply to a 1.9 percent decline in real terms in the second quarter of 2001 over a year earlier, having already moderated to a 4.2 percent growth in the first quarter. Exports of services nevertheless held up relatively better, on the back of a notable rise in both offshore trade and inbound tourism, with a further growth of 5.3 percent in the second quarter of 2001, following a 6.2 percent rise in the first quarter.

In the domestic economy, consumer spending remained on the rise, with growth picking up from 3.5 percent in the first quarter of 2001 to 4.0 percent in the second quarter. But investment spending eased back sharply to a meagre 0.4 percent growth in real terms in the second quarter of 2001 upon the subdued business climate, after recording double-digit growth for three consecutive quarters and an 11.5 percent growth in the first quarter.

With export performance being badly hit by the slump in global demand and with a distinct slackening in local investment, Hong Kong, China's GDP growth slowed to only 0.5 percent in real terms in the second quarter of 2001 over a year earlier, further moderated from 2.3 percent in the first quarter.

INFLATION

Continuing the trend in 2000, the decline in overall consumer prices narrowed further in the first eight months of 2001. On the domestic front, there was a modest resurrection in business costs, and the prices of some locally produced goods and services had tended to edge up. While overall property rentals held broadly stable, labour earnings and wages had risen moderately. In addition, certain Government fees and public utility charges were adjusted upward. Yet on the external front, the prices of retained imports showed a renewed decline, as the US dollar had strengthened earlier against the currencies of most of the major supplier economies, and as world commodity prices receded amidst a weak global demand. In line with these developments, the prices of those commodities having a larger degree of local cost content as against import content tended to show a relatively greater tendency for firming up in the local market.

Comparing the first eight months of 2001 with a year earlier, the Composite Consumer Price Index (Composite CPI) fell by 1.5 percent, further reduced from the 4.3 percent decrease in the same period in 2000. For 2001 as a whole, the Composite CPI is forecast to decline by 1.3 percent.

EMPLOYMENT

The labour market showed a slight easing in the first eight months of 2001, concurrent with the moderation in overall economic activity. The seasonally adjusted unemployment rate, having declined distinctly from 5.6 percent to 4.4 percent during 2000, edged up to 4.9 percent in June–August 2001. The recent rise in unemployment rate occurred more visibly in the import/export trade, affected by the marked slackening in external trade. Concurrently, the unemployment rate also moved higher in insurance, the wholesale/retail trade, and communications.

Comparing the first half of 2001 with a year earlier, total employment went up by 2.5 percent, considerably slower than the 3.9 percent growth in the second half of 2000. Yet total labour supply growth picked up, from 1.7 percent to 2.1 percent over the same periods. The differential between these growth rates thus narrowed distinctly. On a quarter-to-quarter comparison, total labour force grew at a slightly faster pace than total employment in the second quarter of 2001, having shown similar increase in the first quarter.

Statistics show that employment has tended to moderate further in recent months, upon the slowdown in overall economic activity. While fresh graduates and school leavers continue to enter the labour market, there have also been more incidents of corporate lay-offs as business consolidates. As the economic slowdown impinges, unemployment seems likely to move up further in the near term.

TRADE ACCOUNT

On the back of brisk import absorption in all the major markets and improved price competitiveness, total exports of goods grew markedly by 17 percent in value terms to HK$1,573 billion (US$201.9 billion) in 2000. Imports of goods also surged along with the strong growth in domestic demand as induced by the sustained economic revival, by 19 percent in value terms to HK$1,658 billion (US$212.8 billion) in 2000. Taken together, the visible trade deficit widened to HK$85 billion (US$10.9 billion) in 2000. This was nevertheless entirely offset by the appreciable invisible trade surplus of HK$149 billion (US$19.1 billion) in the year, thereby still yielding a sizeable surplus of HK$60 billion (US$7.7 billion) in the combined visible and invisible trade account in 2000.

Upon a distinct slackening in merchandise exports, the visible trade deficit increased to HK$58 billion (US$7.5 billion) in the first half of 2001, from HK$49 billion (US$6.3 billion) in the first half of 2000. But with the further surge in offshore trade and with inbound tourism also maintaining solid growth, the invisible trade surplus expanded further to HK$71 billion (US$9.1 billion) in the first half of 2001, from HK$65 billion (US$8.3 billion) in the first half of 2000. Taken together, the combined visible and invisible trade surplus remained sizeable, at HK$11 billion (US$1.5 billion) in the first half of 2001, albeit smaller than that of HK$15 billion (US$1.9 billion) in the first half of 2000.

EXTERNAL BALANCE OF PAYMENTS

The current account recorded a sustained surplus of HK$69 billion (US$8.8 billion) in 2000, or at 5.4 percent of GDP in that year. Concurrently, there was a considerable net inflow of financial non-reserve assets totalling HK$29 billion (US$3.8 billion) in 2000, or at 2.3 percent of GDP in that year, with the inflow of portfolio investment being particularly substantial. Taken together, there was an overall balance of payments surplus of HK$77 billion (US$9.9 billion) in 2000, equivalent to 6.1 percent of GDP in that year. This was on par with the sizeable balance of payments surplus of HK$78 billion (US$10.0 billion) or at 6.3 percent of GDP in 1999.

The balance of payments position continued to be favourable in the first quarter of 2001, with an overall surplus of HK$61 billion (US$7.8 billion), or at 20.1 percent of GDP in that quarter. While the current account remained in surplus, there was a further substantial net inflow of financial non-reserve assets during that quarter.

EXCHANGE RATE

The spot exchange rate of the Hong Kong dollar against the U.S. dollar remained stable during the first half of 2001 and moved within a narrow range of 7.7985 to 7.7999. Along with strengthening of the U.S. dollar, the trade-weighted Nominal Effective Exchange Rate Index of the Hong Kong dollar was on a general up-trend during the first half of 2001, rising from 136 at end-2000 to 140.7 at end-June 2001.

FISCAL POLICY

The financial results for 2000–01 (ending on March 31) showed a deficit of HK$7.8 billion or 0.6 percent of the forecast GDP for 2000 as compared with the original budget deficit of HK$6.2 billion. The fiscal reserves stood at HK$430.3 billion at end-March 2001, representing a decrease of HK$13.9 billion from the balance of HK$444.2 billion at end-March 2000. The decrease comprised the deficit of HK$7.8 billion for the year and a provision of HK$6.1 billion for the fall in the market value of the investments of the fiscal reserves. The fiscal reserves at end-March 2001 represented 23 months of government expenditure in 2000–01.

The 2001–02 budget forecasts a small deficit of HK$3 billion, equivalent to 0.2 percent of the forecast GDP for 2001. The budgeted government expenditure represents a growth of some 11 percent over the revised estimated expenditure in 2000–01.

In the remaining years of the Medium Range Forecast to 2004–05, expenditure is planned to grow at a rate broadly in line with the trend GDP growth rate of 4 percent a year in real terms over the period 2001–02 to 2004–05.

MONETARY POLICY

In line with the U.S. rate cuts, the best lending rate offered by the major commercial banks was reduced by a total of 275 basis point to 6.75 percent during the first half of 2001. Largely following their US dollar counterparts, Hong Kong dollar interbank interest rates have been on a down-trend, with three-month rates falling from 5.81 percent at end-2000 to 3.75 percent at end-June 2001. During the same period, the spreads between Hong Kong dollar and U.S. dollar interest rates mostly stayed in the negative territory. In terms of three-month rates the spread closed at –14 basis points at end-June.

Monetary aggregates increased in the second quarter of 2001. Reflecting increases in both currency held by the public and demand deposits, narrow money supply, M1 rose by 5.3 percent during the second quarter after a decline in the first quarter (on a seasonally adjusted basis). Concurrently, reflecting the decline in Hong Kong dollar time deposits during the first quarter of 2001, both M2 and M3 increased by 0.2 percent and 0.3 percent respectively in the June quarter contributed mainly by an increase in savings deposits.

Domestic credit contracted marginally by 0.4 percent in the second quarter of 2001 amid a slowdown economic activity. The overall quality of the loan portfolio of banks in Hong Kong, China continued to improve. For local banks, overdue and rescheduled loans stood at 5.4 percent of total loans, and classified loans[1] at 7.1 percent at end-March 2001, down from 6.3 percent and 7.7 percent respectively at end-September 2000. Local banks remained well capitalised, with a consolidated capital adequacy ratio of 18.3 percent at end-March 2001, well above the standard set by the Bank for International Settlements.

ECONOMIC OUTLOOK

In view of the further worsened external economic environment impinging on merchandise exports and the sharp ease-back in local investment, the forecast of Hong Kong, China's GDP growth for 2001 as a whole is recently trimmed further, to just 1 percent in real terms. Increased pessimism for the US economy is the key factor dimming Hong Kong, China's imminent economic outlook. Compounding this are the more distinct weakening in the European economies, continued sluggishness in the Japanese economy, and further scale-back in current-year forecasts in many of the other East Asian economies amidst the electronic products slump. Recent volatilities in exchange rate movements and jitters in stock markets overseas are likewise disturbing. These adverse influences will continue to feed into the local economy to dampen performance in the near term.

Yet the outlook for the Hong Kong, China economy beyond the short term should remain good, underpinned by further economic reform and development and continued market liberalisation in Mainland China. China's accession to WTO will open up more opportunities for trade and investment. Hong Kong, China will remain an important foothold and conduit for business between Mainland China and the rest of the world. As and when the global economic situation improves, hopefully by 2002, the Hong Kong, China economy with its sound fundamentals should be able to readily revive. Hong Kong, China's trend GDP growth rate in real terms is projected at 4 percent per annum over the next few years.

[1] Loans that are classified as substandard, doubtful, or loss under the Hong Kong Monetary Authroity's loan classifification system.

Annex I

HONG KONG, CHINA: OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (US$ billion)	139	154	171	163	158	163
Real GDP	3.9	4.5	5.0	-5.3	3.0	10.5
Consumption	1.7	4.6	5.8	-6.5	1.0	5.0
Private Consumption	1.6	4.7	6.2	-7.4	0.7	5.5
Government Consumption	3.2	4.0	2.4	0.8	3.3	2.1
Investment	10.7	10.8	12.7	-7.6	-17.5	9.8
Private Investment	8.8	9.6	16.6	-7.1	-20.4	14.0
Government Investment	22.0	17.1	-5.7	-10.4	0.4	-10.3
Exports of Goods and Services	11.0	5.5	5.3	-4.0	3.9	16.7
Imports of Goods and Services	12.7	4.4	6.9	-6.3	-0.2	16.7
Fiscal and External Balance (percent of GDP)						
Budget Balance	-0.3	2.2	6.6	-1.8	0.8	-0.6
Merchandise Trade Balance	-13.6	-11.6	-12	-6.5	-3.6	-6.7
Current Account Balance	N.A.	N.A.	-3.6	2.4	7.3	5.4
Capital and Financial Non-reserve Assets Balance*	N.A.	N.A.	10.8	-6.7	-0.4	1.4
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	2.5	5.9	5.8	0.4	-5.4	-6.6
CPI	9.1	6.3	5.8	2.8	-4.0	-3.8
M2	14.6	10.9	8.3	11.8	8.1	8.8
Short-term Interest Rate (percent)+	6.1660	5.4603	7.1235	8.0605	5.8402	6.1146
Real Effective Exchange Rate (level, 1997=100)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Unemployment Rate (percent)#	3.2	2.8	2.2	4.7	6.2	4.9
Population (millions)#	6.2	6.4	6.5	6.5	6.6	6.7

Notes : N.A. Not available.

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

+ Three-month HIBOR.

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

Annex II

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

	2001				2002		
	Official	**IMF**	**Link**	**ADB**	**IMF**	**Link**	**ADB**
Real GDP	1	0.6	3.7	4.0	4.0	4.6	5.5
Exports	-1.1	N.A.	6.0	5.3#	N.A.	8.9	8.5#
Imports	-0.4	N.A.	6.4	4.7#	N.A.	9.0	9.0#
CPI	-1.3	-1.4	-0.2*	1.0	0.6	1.2*	4.0

Notes : The Link and ADB forecasts on the Hong Kong economy, as are currently known, are all earlier produced forecasts which by now may not accord fully with the latest economic situation and outlook for the year.
* Private consumption deflator.
\# Merchandise trade in US$ terms.
N.A. Not available.

Sources: IMF forecasts, *The World Economic Outlook Database* (September 2001).
LINK forecasts, *Project LINK World Economic Outlook* (April 2001).
ADB forecasts, *Asian Development Outlook* 2001.

Annex III

HONG KONG: MEDIUM-TERM TREND FORECAST (percent)

	2001–04
Real GDP	4
GDP Deflator	2.5

INDONESIA

REAL GROSS DEOMSTIC PRODUCT

Indonesia's economic development during the first half of 2001 hinged on the impact of rising political tension that led to increasing uncertainty. This tension was reflected by the weakening of the rupiah, expectations of rising inflation, and decelerating economic activities. It appears that rising uncertainty, along with a slowdown in the growth of the world economy, has contributed to a slower-than-expected economic recovery in Indonesia during the first half of 2001, although the momentum for recovery was in place, as indicated by a relatively high level of growth (4.8 percent) in 2000 and progress in banking reform as well as corporate debt restructuring during the year.

It is commonly assumed that the restoration of market confidence in the economy will largely rely on the smooth resolution of political tension. Because the special session of the People's Consultative Assembly, which took place in July, went smoothly, it would appear that Indonesia is poised to regain its recovery momentum. During the session, a new government led by Mrs. Megawati Soekarnoputri was installed. Early signs of positive development, most notably the sharp appreciation of the rupiah, have been observed. Moreover, the economy is boosted by the prospect of the establishment of a new cabinet, which is widely believed to be highly capable of dealing with issues crucial to the recovery. It is hoped that the new cabinet will restore confidence of overseas investors, as Indonesia needs foreign investment to recover fully.

Another positive development for Indonesia was the reaffirmed IMF support for the economy, as reflected by the agreement of both parties on the draft of the upcoming Letter of Intent, and the upgrading of Indonesia's rating on outlook from "negative" to "stable" by Standard & Poor. These positive developments illustrate the international community's increasing confidence in the Indonesian economy. In light of the developments, there is room for the rupiah to appreciate further and to stabilise at a level favourable for the economy. For 2001, the rupiah exchange rate is assumed to average at around 9,800/US$ level. However, amidst the rupiah-appreciating trend, some risks are still associated with the demand for foreign currency for debt repayments and the impact of the weakening of currencies in the region. As domestic political concerns have subsided, issues affecting the rupiah's outlook would be solely economic fundamentals. Those issues relate to the monetary stance, the government's fiscal policy, the implementation of regional autonomy, banking development, and debt resolution.

In spite of emerging positive signs following the special session of the People's Consultative Assembly, the central question remains of whether the economy will be able to reap the full benefits of the positive developments so as to boost the pace of recovery this year. After depreciating considerably by around 20 percent (from 9,503/US$ at the beginning of 2001), the rupiah bounced back to the current level of 8,500/US$ recently, reflecting the strong competitiveness of Indonesia's exports amidst lacklustre exports for this year. It should also be noted that these developments could lessen inflationary expectations as well as create stabler economic conditions, thereby reducing inflationary pressures that have been on the rise recently.

At present, Indonesian economic growth in 2001 is projected to reach 3–4 percent, or 3.5 percent as a midpoint, which is lower than the 4.8 percent economic growth in 2000. It is expected that domestic demand will weaken slightly along with lower real income, which have fallen as a result of rising price levels and which have led to many delayed economic transactions. For 2001, consumption is expected to increase at a rate of 2.3–3.3 percent, while investments are expected to record a 5.6–6.6 percent growth. On the supply side, a decelerating growth is expected to occur in all sectors, except for agriculture, fisheries, and forestry. Rising retail prices and lower real income will result in a modest growth in the trade and services sector. On the external side, the slower growth can be attributed to poorer external-sector performance, as reflected by the less robust growth in exports and imports, in line with the global economic slowdown, which has particularly affected Indonesia's major trading partners. Therefore, although the current account will remain in surplus, exports for 2001 are expected to increase by 7.7–8.7 percent. This is lower than the import growth, which stands at around 13–14 percent. The status of the capital account will improve slightly, thanks to net official capital inflows. However, net capital flows are expected to remain in deficit owing to large debts that need to be paid.

INFLATION

As stated earlier, during the first half of 2001, the general price level continued its increasing trend, leaving the inflation rate at 5.46 percent for the year to date. Price increase in the first half can be attributed in particular to the weakening rupiah; the impact of government policy on prices of fuel, electricity and transportation, and telephone tariffs; and public expectation of heightened inflation in the future. The expectation of higher inflation, the impact of government policy on prices, and the implementation of regional autonomy, especially if regions impose local taxes, could cause inflationary pressure in the second half of 2001. However, the pressure is expected to moderate owing to the strengthening of the rupiah and improving expectations regarding inflation. Given the latest development as well as the inflation in the first half of 2001, the inflation rate of 2001 is expected to reach 12–14 percent year-on-year.

MONETARY POLICY

Bank Indonesia will remain watchful of inflationary pressures for the rest of 2001. In this respect, the bank will continue to implement its tight monetary policy while observing various developments in the economy, particularly those affecting risk factors and uncertainty. Although the appreciation of the rupiah is important to allay inflationary pressures, particularly from tradable goods, it is worth observing whether the effect will manifest itself in less pressure and in the expectation of lower prices at the general level. This is a key element for Bank Indonesia to take into account when considering relaxing its monetary stance. Furthermore, given the significant depreciation seen in the past, it is important that the rupiah stabilise at a level favourable to the economy, including exports.

In particular, Bank Indonesia will closely monitor the development of base money as its main indicative operating target. Owing to the sharp appreciation of the rupiah, developments of the exchange rate and of prices during the rest of 2001 will be critical in assessing the base scenario for monetary developments. The growth of base money remains above Bank Indonesia's target of 11–12 percent set for the end of this year. In implementing its policy, however, the bank remains aware of developments affecting the interest rate so as not to hamper recovery. Therefore, Bank Indonesia will employ a policy mix approach in conducting monetary operations through its main instruments: SBI (Bank Indonesia certificates), rupiah intervention, and sterilisation of the domestic foreign exchange market.

FISCAL POLICY

On the fiscal side, the government has revised the 2001 budget to reflect current developments and assumptions affecting fiscal policy. Together with Parliament, the government revised the budget to maintain a targeted budget deficit of 3.7 percent of GDP. The budget deficit is directed towards supporting economic recovery through limited fiscal stimuli, given that the private sector is still in the rehabilitation and consolidation stage. With regard to the deficit, various measures will be carried out to ensure fiscal sustainability through fiscal adjustments of both expenditures and financing. To increase revenue, the government will adopt tax policies through broadening the tax base, improving tax collection and administration, eliminating tax facilities, and increasing non-tax revenues by 0.1 per cent of GDP. For 2001, it is estimated that government consumption will grow at around 4.5 percent.

ECONOMIC OUTLOOK FOR 2002

The stable political and domestic situation is expected to solidify the foundation for further and sustainable recovery. In 2002, the economy is expected to post a 4–5 percent growth; growth will be supported by consumption and investment growth of 3–4 percent and 8.5–9.5 percent respectively. On the external side, it is expected that the improving global economic condition will contribute to higher export and import growth at 9.5–10.5 percent, and 14–15 percent respectively. The inflation rate is expected to reach 7–9 percent, mainly because of the expectation that the rupiah exchange rate will be stable at a level favourable for the economy.

The progress made in banking reform and corporate debt restructuring will facilitate higher economic growth in 2002. It is expected that banks will have more incentives to increase lending to finance a higher volume of business activities in line with improving domestic socio-political conditions.

Domestic demand in 2002 is expected to increase at a more rapid pace supported by higher real income and lower domestic interest rates. Meanwhile, increasing investment activities in 2001 will be stimulated by improved political and social stability as well as by the stable rupiah exchange rate.

Annex I

INDONESIA: OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000
GDP and Major Components (percent change from previous year, expected as noted)						
Nominal GDP (US$ billion)	202.2	227.3	218	103.1	144.2	151.0
Real GDP	8.2	7.8	4.9	-13.7	0.31	4.8
Total Consumption	11.2	8.9	5.9	-4.1	3.4	3.9
Private Consumption	12.6	9.7	6.6	-2.9	3.7	3.6
Government Consumption	1.3	6.6	0.1	-14.4	0.7	6.5
Total Investment (GFCF)*	14.0	14.5	8.6	-33.0	-19.4	17.9
Private Investment						
Government Investment						
Export of Goods and Services	7.7	7.6	7.8	10.6	31,6	16.1
Import of Goods and Services	20.9	6.9	14.7	-5,4	40.7	18.2
Fiscal and External Balances (percent of GDP)						
Budget Balance	1	1	0.4	-1,7	-7.9	-5.1
Merchandise Trade Balance (f.o.b)	2.8	1.5	4.4	17.8	14	16.8
Current Account Balance	-3.4	-3.5	-2.3	4.2	3.9	5.3
Capital Account Balance	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Economic Indicators (percent change from previous year, except as noted)						
GDP Deflator	9.9	8.7	12.6	81.2	12.8	10.9
CPI	9.4	7.9	6.2	58.0	20.7	3.8
M2	27.6	29.6	23.2	62.4	11.9	15.6
Short-Term Interest Rate (%)	14.3	13.8	18.0	35.6	15.7	14.5
Exchange Rate (Local Currency/US$)	2,308	2,383	4,650	8,025	7,085	9,595
Unemployment Rate (%)	7.24	4.89	4.68	5.46	6.36	6.14
Population (millions)	194.8	198.2	200.4	204	206.5	209.5

Notes: N.A. Not available.
* Gross fixed asset formation.

Annex II

INDONESIA: FORECAST SUMMARY (percent change from previous year)

	2001				2002			
	Official	**IMF**	**LINK**	**ADB**	**Official**	**IMF**	**LINK**	**ADB**
Real GDP	3-4	3.0	4.2	4.2	4-5	4.3	4.8	4.5
Real Exports	8-9	N.A.	7.7	8.1#	9.5-10.5	N.A.	10.5	11.2#
Real Imports	13-14	N.A.	8.9	15.4#	14-15	N.A.	12.1	17.3#
CPI	9-11	10.8	9.3*	9.0	7-9	7.0	8.2*	6.0

Notes : * Private consumption deflator.
Merchandise trade in US$ terms.
N.A. Not available.

Sources: IMF forecasts, *The World Economic Outlook Database* (September 2001).
LINK forecasts, *Project LINK World Economic Outlook* (April 2001).
ADB forecasts, *Asian Development Outlook* 2001.

JAPAN

REAL GROSS DOMESTIC PRODUCT

The Japanese economy was on a gradual recovery from the trough of the business cycle in April 1999, helped by both fiscal and financial policy efforts. In the course of this recovery, production and corporate profits had recovered, and business investment had also started to rebound. Real GDP increased by 1.0 percent in fiscal 2000, following the 1.4 percent increase in fiscal 1999 and the negative growth (-0.6 percent) in fiscal 1998[1].

However, exports and production have been on a decline, affected by the slowdown of the world economy. The economy is deteriorating again. Real GDP grew by only 0.1 percent in the January–March quarter of 2001 compared to the previous quarter, mainly because of the negative growth of non-residential investment, residential investment and net exports of goods and services. The short-term prospects are further suppressed by the rise in business inventory.

To counter these negative trends, the “Basic Policy for Economic Reform of the Japanese Economy: Basic Policies for Macroeconomic Management” was advocated first by the Council on Economic and Fiscal Policy and then adopted by the Japanese government on 26 June. The underlying philosophy is that “there can be no growth for Japan without structural reform.” According to these new policies, the government is to carry out bold and persistent structural reform to revitalise the economy, which include drastic resolution of the non-performing loans and implementation of a package of proactive structural reforms.

Under such policy response, the adjustment pressure of structural reforms is likely to emerge in the short run, to offset any positive effect of the reform measures on GDP growth. For that reason, the growth prospect for fiscal 2001 will be well below the official estimate (1.7 percent: fiscal year) that was initially forecast in December 2000.

INFLATION

Prices have been continuously dropping, mainly because of weak domestic demand further compounded by the effects of deregulation. A mild deflationary trend emerged, with domestic wholesale prices dropping slightly by 1.0 percent in fiscal 1999 and staying almost unchanged in fiscal 2000 (an increase of 0.1 percent in calendar year 2000). Since the beginning of 2001, renewed downward pressure was felt, as the prices of electric machinery and steel softened.

Consumer prices have been declining slightly since the fall of 2000 due to the fall in the prices of textile products and food services. They declined by 0.5 percent in fiscal 2000 (a decline of 0.7 percent in calendar year 2000).

EMPLOYMENT

The employment situation remains severe, with the unemployment rate hitting an all-time high. The number of job offers and overtime hours worked are edging downward. Unemployment for fiscal 2000 was 4.7 percent. Though the rate declined slightly from 4.9 percent in December 2000 and January 2001 to 4.7 percent in February and March, it rose back to 4.9 percent in May and June, and further to 5.0 percent in July.

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[1] Fiscal year refers to the period from April 1 to March 31 of the next year.

New job offers increased by 20.0 percent in fiscal 2000. Compared to the same month of the previous year, they decreased in June 2001 by 1.1 percent after consecutive increases up to May 2001, and increased by 3.1 percent in July. Compared to the previous quarter, they increased by 1.1 percent in the April–June quarter after decreasing by 6.3 percent in the January–March quarter.

In addition, the number of employees remained unchanged. The number of people in the workforce has decreased due to a decline in the number of self-employed and family workers.

EXTERNAL TRADE ACCOUNTS

Exports, especially of electrical devices such as semiconductors, are decreasing against the backdrop of the global economic slowdown. Export volume increased by 9.4 percent in calendar year 2000. However, it then decreased by 3.1 percent in the January–March quarter of 2001 compared to the previous quarter (a decrease of 4.4 percent compared to the same quarter of the previous year), and it significantly decreased by 6.2 percent in the April–June quarter of 2001 compared to the previous quarter (a decrease of 11.1 percent compared to the same quarter in the previous year).

Imports, especially of IT-related goods such as semiconductors, have also been declining, reflecting slower demand for IT-related goods. Import volume increased by 11.0 percent in calendar year 2000. However, after dropping by 2.0 percent in the January–March quarter of 2001 compared to the previous quarter (an increase of 6.3 percent compared to the same quarter of the previous year), it decreased by 2.9 percent in the April–June quarter compared to the previous quarter (a decrease of 0.3 percent compared to the same quarter of the previous year).

The surplus in the trade and services account is decreasing. It was 336.5 billion yen (preliminary figure) in April, although it reached 64.8 billion yen in May, as exports decreased faster than imports. In fiscal 2001, the surplus in trade and services as well as the current account surplus is projected to decline somewhat. The current account surplus will amount to 2.3 percent of GDP.

GROSS EXTERNAL DEBT

Despite a continuous current account surplus, the net external assets decreased to 84.7 trillion yen at the end of 1999, a figure far below the 133.3 trillion yen at the end of 1998, as a result of the appreciation of the yen and the increase in the appraised values of shares held by foreigners (debts). In addition, gross external assets amounted to 308 trillion yen while gross external debt registered at 223 trillion yen at the end of 1999.

EXCHANGE RATE

The exchange rate of the yen against the U.S. dollar fell from the beginning of 1999 and reached 124 yen in May, then rose to 102 yen in December. The yen moved broadly in a range between 105 yen and 111 yen in 2000. The yen began to fall in December 2000 and reached a low of 126 yen in early April 2001. After that the yen moved broadly in a range between 119 yen and 125 yen.

FISCAL POLICY

Fiscal policy played a major role in supporting economic activities. In October 2000, the government launched “The Policy Package for New Economic Development Toward the Rebirth of Japan” to avoid a sharp drop in public demand, to reinforce the advance of the Japanese economy toward a self-sustained recovery path, and to build an economy and society that match the needs of the 21st century.

In accordance with the new policy package, a supplementary budget of 3.9 trillion yen was compiled in fall 2000 to cover the cost of measures to develop infrastructures for 1) the IT revolution, 2) a recycling society, 3) the ageing of society, and 4) urban development. It also aims at financing small and medium-sized enterprises, housing loans and employment plans.

The fiscal 2000 supplementary budget amounted to 89.8 trillion yen, an increase of 0.8 percent over the supplementary budget of the previous fiscal year (the initial budget was an increase of 3.8 percent from the fiscal 1999 initial budget.) The amount of issue of bonds in fiscal 2000 was about 33.0 trillion yen, with the percentage of government bond issues to total government expenditures being about 36.9 percent (42.1 percent in fiscal 1999) and the outstanding government bonds reaching 367.6 trillion yen (about 72 percent of GDP.)

The fiscal 2001 budget was passed in March 2001. Efforts were made to maintain the same overall size of public works as in the initial budget for fiscal 2000, and steps would be taken for the appropriate implementation of the fiscal 2001 budget while considering the fiscal situation of local governments.

On 26 June, based on the current cabinet's philosophy that "there can be no growth for Japan without structural reform," the cabinet decided the "Basic Policy for Economic Reform of the Japanese Economy: Basic Policies for Macroeconomic Management"(Basic Policy). Basic Policy has set a medium-term goal of achieving primary balance to balance benefits and burdens among generations and to restore medium- to long-term sustainability of fiscal conditions. As for fiscal 2002 budget, Basic Policy calls for the first step in medium-term fiscal consolidation, where the goal of containing JGB issues to no more than 30 trillion yen is established.

MONETARY POLICY

In March 2001, the Bank of Japan (BOJ) made a decision to shift to a monetary operation that targets monetary aggregates until the ongoing decline in prices ends. As a consequence, it is anticipated that the uncollateralised overnight call rate will significantly decline from the current target level of 0.15 percent and stay close to zero percent under normal circumstances. Henceforth, while maintaining consistency with the basic principles of the government's economic policies, it is necessary for the Bank of Japan to take appropriate flexible monetary policies.

As for the short-term interest rate, the uncollateralised overnight call rate had stayed around the level of the target rate (0.25 percent) since the termination of the zero-interest-rate policy by BOJ in August 2000, but around the level of 0.15 percent until the middle of March 2001 due to the target rate cut (from 0.25 percent to 0.15 percent) at the end of February 2001. Subsequently, it further declined and stayed at the level of 0.01 percent in August as a result of the measures for further monetary easing taken by BOJ in March 2001.

The long-term interest rate, partly due to the market view of concerns over economic prospects, has been on a downward trend since the fall of 2000. Having significantly declined in March 2001 as a result of the measures for monetary easing taken by BOJ, it increased at the end of that month.

MEDIUM-TERM OUTLOOK

The Cabinet adopted an economic plan in July 1999 that outlined the long-term perspective of the Japanese economy and society up to 2010. In the annex to that plan, the prospects of the main economic indicators up to 2010 are given as follows:

- Real growth rate: approximately 2 percent
- Inflation rate and CPI: approximately 2 percent
- Unemployment rate: 3.5 percent to 4.5 percent

As a result of progress in structural reforms, the disposal of non-performing loans will cause low growth for the next two or three years, but, after that, in the medium run, the Japanese economy is expected to show a gradual recovery led by private demand.

Annex I

JAPAN: OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in US$ billion)	5,297	4,692	4,310	3,965	4,522	4,748
Real GDP	1.6	3.5	1.8	-1.1	0.8	1.5
Consumption	2.0	2.5	0.9	0.5	1.8	1.2
Private Consumption	1.4	2.4	0.8	0.1	1.2	0.5
Government Consumption	4.3	2.8	1.3	1.9	4.0	3.6
Investment	2.4	7.6	0.8	-6.0	-1.6	1.0
Private Investment	3.3	7.8	5.2	-7.3	-4.0	4.4
Government Investment	0.4	7.3	-9.6	-2.6	4.9	-7.0
Exports of Goods and Services	4.1	6.5	11.2	-2.3	1.4	12.1
Imports of Goods and Services	12.8	13.2	1.2	-6.8	3.0	9.9
Fiscal and External Balance (percent of GDP)						
Budget Balance*#	-6.3	-6.2	-5.4	-7.2	-8.2	N.A.
Merchandise Trade Balance	2.5	1.8	2.4	3.1	2.7	2.5
Current Account Balance	2.1	1.4	2.2	3.1	2.4	2.5
Capital Account Balance	-1.3	-0.7	-2.8	-3.4	-1.1	-1.8
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	-0.4	-0.8	0.4	-0.1	-1.4	-1.6
CPI 1995=100	-0.1	0.1	1.8	0.6	-0.3	-0.7
M2	3.0	3.3	3.1	4.0	3.6	2.1
Short-term Interest Rate (percent)+	1.2	0.6	0.6	0.7	0.2	0.2
Real Effective Exchange Rate (level, 1997=100)	124.3	105.6	100.0	99.7	108.8	114.8
Unemployment Rate (percent)	3.2	3.4	3.4	4.1	4.7	4.7
Population (millions)	125.6	125.9	126.2	126.5	126.7	126.9

Notes : N.A. Not available.

In 2000, the System of National Accounts was changed from the 68SNA to 93SNA, and the benchmark year was also changed from 1990 to 1995.

* Budget balance refers to general government. It excludes the social security.

\# The 1998 Budget Balance is -12.3 percent if including fiscal deficit resulting from the General Account's assumption of the debts of the Japan National Railway Settlement Corporation and the National Forest Service.

\+ Short-term interest rate refers to 3-months certificates of deposits (CDs).

Annex II

JAPAN: FORECAST SUMMARY (percent change from previous year)

	2001				2002			
	Official	**IMF**	**Link**	**OECD**	**Official**	**IMF**	**Link**	**OECD**
Real GDP	1.7	-0.5	0.7	1.0	N.A.	0.2	1.1	1.1
Exports	4.0	N.A.	1.5	3.4	N.A.	N.A.	2.8	8.3
Imports	5.3	N.A.	3.2	5.7	N.A.	N.A.	3.1	5.3
CPI	-0.2	-0.7	-0.7*	-0.7*	N.A.	-0.7	-0.5*	-0.5*

Notes : As at 30 August 2001.
* Private consumption deflator.
N.A. Not available.

Sources: IMF forecasts, *The World Economic Outlook Database* (September 2001).
LINK forecasts, *Project LINK World Economic Outlook* (April 2001).
OECD forecasts, *OECD Economic Outlook* (June 2001).

Annex III

JAPAN: MEDIUM-TERM TREND FORECAST (percent)

	2010
Real GDP	2.0
CPI	2.0

Source: *Ideal Socioeconomy and Policies for Economic Rebirth*, Government of Japan (1999).

REPUBLIC OF KOREA

OVERALL

After a serious economic downturn resulting from the financial crisis in 1997, Korea achieved a fast recovery. Korean government repaid US$700 million to the IMF and worked to reform the economic structure. However, Korea has suffered another economic downturn due to the slowdown in the growth of the world economy and the lack of substantial progress in economic restructuring.

As a result, from late 2000, the Korean economy has shown a downward trend. The GDP growth rate, after surging by 10.9 percent in 1999, was 8.8 percent last year and 3.7 percent in the first quarter of this year.

REAL GROSS DOMESTIC PRODUCT

In 2000, due to a sharp slowdown in domestic consumption and investment, real GDP growth rate recorded a moderate 4.6 percent increase year-on-year in the fourth quarter, compared to 9.2 percent in the third quarter. The poor performance in the fourth quarter dragged down GDP growth to 8.8 percent for the year, lower than the 9.5 percent growth rate expected at the end of 1999.

The Korean economic growth continued its downward trend into this year. During the first quarter, real GDP grew by 3.7 percent year-on-year basis, led by sluggish domestic demand and lower export growth. The slowdown has continued for the second quarter as well, with substantial decreases in exports and investment of machinery and equipment.

INFLATION

Consumer prices increased considerably this year, with a 4.7 increase rate for the first half of this year, a sharp increase from last year's 1.7 percent. This rise can be attributed to high oil prices and rise in public utility charges in the second half of last year. An increase in some of the public utility fares and the substantial rise in the won exchange rate also lead to such inflation.

Due to the sluggish domestic economy, there is less pressure on inflation and with the oil price expected to stabilize, the increase in consumer prices is expected to decline. Accordingly, we expect the rate of consumer prices to settle down at around 4 percent.

EMPLOYMENT

Employment conditions were bleak since last year's fourth quarter and the trend prevailed until the first quarter of this year. However, employment conditions picked up in the second quarter. As a result of a slowdown in the economy, the unemployment rate rose to 4.8 percent in the first quarter but rebounded to 3.5 percent in the second quarter.

This visible improvement in labor market conditions in the second quarter was due to an expansion in public projects which in turn created a lot of jobs, and an increased seasonal hiring in the agriculture and construction sectors as well.

However, there are still fears that the current favorable job market condition is not yet fully secure, as other unemployed are to be produced in the forthcoming restructuring procedures in industries. The completion of a more flexible labor market will be the fundamental solution for deterring the creation of unemployed.

EXTERNAL TRADE ACCOUNT

The current account registered a US$6.9billion surplus in the first half of the year due largely to an expansion of goods. Exports during the first half fell by 4.9 percent year-on-year basis, while imports declined by 7.8 percent.

The continuing decline in exports was led by a slump in overseas demand and decreased export unit prices in major export products, including IT-related products. The current economic downturn in the U.S. could be one major factor that reduced exports of semiconductors, computers, and steel. However, exports of ships, cars, and machinery products grew continuously based on the currency depreciation.

A sharp drop in imports was influenced by several factors, including the stabilization of commodity and oil prices, sluggish facility investment caused by the uncertainty in the domestic and foreign economy, and the depreciation of the won against the U.S. dollar.

Meanwhile, in spite of the gradual increase in exports for the second half of this year, the current account surplus is expected to decrease as a result of increase in imports arising from increased demand.

GROSS EXTERNAL DEBT

Korea’s total external liabilities stood at US$127.0 billion as of the end of June 2001. The figure has declined for the eleventh consecutive month since August last year and was the record low since the onset of the financial crisis. This decreasing trend of total external liabilities was mainly attributed to the early repayment of IMF loans and financial institutions’ repayment of overseas borrowings.

Korea’s external assets totaled US$ 161.8 billion as of the end of June 2001. As a result, Korea’s net external assets reached US$ 34.8 billion, maintaining its net creditor position since September 1999.

EXCHANGE RATE

The won broke through the 1,200 per U.S. dollar level in November 2000, and the upward trend continued. The dollar has traded at higher than 1,250 won since December 2000, and traded at 1,300 won in September this year. The weakening of the won against the dollar has been caused by the weakness of the yen and falling demand for Korean exports.

FISCAL POLICY

To mitigate the impact of the slowing economy, the government approved a 5.05 trillion won supplementary budget bill during a cabinet meeting on June 19. The additional budget measure, aimed at cutting back on local governments' liabilities, stabilizing the national health insurance fund and preparing for natural disasters, would bring the total national budget for 2001 to 105.3 trillion won, 5.3 percent more than a year earlier. The target budget deficit of this year is expected to total less than 1 percent of GDP.

In addition, to maintain a stable stance on the budget balance and to react to the short-term economic downturn, the government will utilize tax revenues and welfare payments as stabilizers. More tax collections and welfare payments are expected to compensate for the scheduled government spending in the second quarter to provide a sufficient boosting effect.

MONETARY POLICY

Consumer prices, having been stable in July, registered an increase of 0.2 percent month-on-month. And core inflation posted an increase of 0.1 percent month-on-month, a decline from the previous months 3 percent, due to the stable prices of industrial products as well as of public and individual services. The Korea government will endeavor to remove the uncertainties surrounding the internal and external economic environments and to conduct flexibly the monetary policy.

MEDIUM-TERM OUTLOOK

Korea's sluggish economy is expected to recover gradually in the latter half of this year. However, because of the Korean economy's high external dependency, the slowdown could last longer than expected in the event that U.S. economy's recovery is delayed.

Economic growth of 2001 is expected to decline to around 2–3 percent led by the deterioration of exports and investment along with the global downturn.[1]

The current account surplus, which registered a surplus of US$6.9 billion in the first half of this year, will be narrowed in the second half of the year, in response to a sharp fall in exports. Consumer price inflation is expected to rise to around 4 percent this year, driven by the persistent effects of high oil prices and rises in public service charges during the second half of last year.

Because of continued deterioration of world trading environment, it does not seem that the economy will recover from recession in the near future. It is estimated that Korean economy will grow at around 2 percent by mid-2002. But economic growth will recover slowly in the second half of 2002, and quicken toward the end of the year with the increase of exports.

[1] It should be noted that the forecast figures for 2001 are estimates of private economic institutes, not official government data.

Annex I

KOREA : OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000
GDP and Major Components (percent change from previous year, except as noted)						
Nominal GDP (level in billion US$)	489.4	520.0	476.6	317.7	405.8	457.4
Real GDP	8.90	6.80	5.00	-6.70	10.90	8.80
Consumption						
Private Consumption	9.60	7.10	3.50	-11.70	11.00	7.10
Government Consumption	0.80	8.20	1.50	-0.40	-0.60	1.30
Investment						
Private Investment	29.70	9.1	-5.9	-57.6	51.7	23.8
Government Investment	14.20	44.70	7.60	-21.40	-30.90	-8.80
Exports of Goods and Services	24.60	11.20	21.40	14.10	15.80	21.60
Imports of Goods and Services	22.40	14.20	3.20	-22.10	28.80	20.00
Fiscal and External Balances (percent of GDP)						
Budget Balance (financial year)						
Merchandise Trade Balance						
Current Account Balance	-1.74	-4.42	-1.71	12.70	6.03	2.41
Capital Account Balance	3.4	4.5	0.3	-1.0	0.5	2.6
Economic Indicators (percent change from previous year, except as noted)						
GDP Deflator	7.20	3.90	3.20	5.00	-2.00	-1.50
CPI	4.50	4.90	4.50	7.50	0.80	2.30
M2	15.50	16.20	19.20	19.00	27.90	30.20
Short-term Interest Rate	11.73	13.53	18.55	7.70	7.16	6.89
Real Effective Exchange Rate (level, 1997=100)*						
Unemployment Rate (percent)	2.00	2.00	2.60	6.80	6.30	4.10
Population (millions)	45.09	45.54	45.99	46.43	46.86	47.28

Source: * Bank of Korea. National Statistical Office, Ministry of Finance and Economy, Wharton Econometric Forecasting Associates.

Annex II

KOREA: FORECAST SUMMARY (percent change from previous year)

	2001					2002				
	KIEP[2]	**IMF**	**Link**	**ADB**	**OECD**	**Official**	**IMF**	**Link**	**ADB**	**OECD**
Real GDP	2-3	2.5	4.1	3.9	4.2	N.A.	4.5	5.2	5.5	5.5
Exports	11.0	N.A.	8.2	9.0*	11.0#	N.A.	N.A.	8.7	10.5*	12.0#
Imports	9.1	N.A.	10.1	8.0*	9.8#	N.A.	N.A.	11.8	13.0*	12.0#
CPI	4.4	4.4	3.1	3.0	3.5	N.A.	3.4	2.8	2.5	2.5

Notes: N.A. Not available.
* Merchandise trade in US$ terms.
# Goods and services in real terms.

Sources: IMF forecasts, *The World Economic Outlook Database* (September 2001).
LINK forecasts, *Project LINK Word Economic Outlook* (April 2001).
ADB forecasts, *Asian Development Outlook* 2001.
OECD forecasts, *OECD Economic Outlook* (June 2001).

[2] See footnote 1.

MALAYSIA

REAL GROSS DOMESTIC PRODUCT

Economic activity in Malaysia expanded strongly in 2000 under the stimulus of strong export growth as well as rising domestic expenditure. As a result of mutually reinforcing factors—strengthening external demand, stronger fiscal impulse, and a low-interest-rate environment—private sector activities strengthened significantly. Real gross domestic product (GDP) increased 8.5 percent in 2000, a faster rate of expansion than the earlier forecast and above the growth of 5.8 percent achieved in 1999. On the supply side, growth in output was supported by further expansion in the manufacturing and service sectors.

The outlook for 2001 will be influenced by the global economy. The slowdown in economic activity in the major industrial countries will also impact growth. While economic activity in Malaysia will moderate, the momentum of growth built up over the last two years, the preemptive measures introduced in the 2001 budget in October 2000, and the more recent package announced on 27 March 2001 are expected to mitigate the extent of the slowdown. Real output in the Malaysian economy is expected to expand 5 to 6 percent in 2001.

Public sector expenditure is projected to expand 10.4 percent to cushion the slowdown in external demand and provide the impetus for the continued growth in domestic consumption and investment. Public investment spending is projected to increase 8.9 percent. The higher fiscal expenditure, specific incentives introduced in the 2001 budget, and the low interest rate environment is expected to contain the moderation in growth in private sector expenditure to 7.5 percent, from 15.7 percent in 2000. Private consumption is forecast to increase 7 percent, while private investment is projected to grow 9.2 percent.

On the supply side, growth will continue to be broad-based. Value added in the manufacturing and service sectors is expected to increase 8.5 percent and 3.6 percent, respectively. Meanwhile, the construction sector is expected to benefit from the government's fiscal stimulus programme and incentives introduced by both the government and the banking sector to promote home ownership. The agriculture sector is also expected to record a positive growth owing mainly to higher production of crude palm oil following an expansion in mature areas. Value added in the mining sector is expected to turn around to record a positive growth of 14 percent, owing to the higher production of natural gas.

INFLATION

Inflation remained subdued in 2000. Annual growth of the consumer price index (CPI) was only 1.6 percent, mainly because of the relative stability of the exchange rate, the low rate of inflation abroad, lower prices for many commodities, and excess capacity in several sectors of the domestic economy. The increase in bus fares and in retail prices of several petroleum products, as well as the higher sales tax on alcoholic beverages and cigarette and tobacco products announced during the year, has had the effect of pushing up the CPI, but the increase has not been significant. This trend continued into the first quarter of 2001. The CPI rose by only 1.4 percent during the first half of 2001 (it was 1.5 percent during the corresponding period in 2000). The larger increase in prices of beverages and tobacco, transport and communication, and gross rent and fuels was more than offset by a decline in prices of clothing and footwear and a smaller increase in prices of other subgroups. For the whole of 2001, inflation is expected to remain low. Continued excess capacity in some sectors and capacity-expansion programmes being undertaken in other sectors as well as lower inflation abroad are expected to mitigate any build-up of inflationary pressures.

EMPLOYMENT

The labour market situation improved significantly in 2000. Strong economic growth led to the creation of an increased number of jobs and a decline in retrenchments. Consequently, the unemployment rate declined to 3.1 percent (1999: 3.4 percent), well below the full employment rate of 4 percent. As productivity improvements were generally higher than the growth in wages, inflationary pressures from wage increases were contained during the year.

Following the regional crisis in 1997, companies have undertaken rationalisation exercises, and hence most companies are operating with optimal labour/capital levels. There has been an increase in retrenchment during the first half of 2001, by 26.9 percent to 16,091 compared to the same period in 2000, largely on account of layoffs in the electronics sub-sector. Nevertheless, Malaysia still faces a labour shortage as in other sectors of the economy demand for labour continues to remain strong. The number of job vacancies has increased by 1.9 percent to 58,299 over the first half of this year, mainly for production and related workers, transport, equipment operators and labourers. As such, the unemployment rate is expected to remain the same in 2001 at 3.1 percent as in the previous year. In enhancing labour mobility, the Ministry of Human Resources had placed workers under its programme to increase the mobility of workers with appropriate skills from surplus to deficit areas. The shift to a knowledge-based economy is also envisaged to generate new employment prospects.

EXTERNAL TRADE ACCOUNTS

In 2000, the trade account registered a surplus of RM60.9 billion (US$16 billion). The merchandise account registered a surplus of RM79.5 billion — enough to offset the deficit in the services account. Consequently, the current account is estimated to have recorded a large surplus of RM31.2 billion, or 10 percent of gross national product (GNP). The large surplus in the current account and sustained long-term capital inflows provided a buffer to outflows for repayment of debt and overseas investment by Malaysia. As at end-2000, the net international reserves of Bank Negara Malaysia amounted to US$29.9 billion, sufficient to finance four and a half months of retained imports.

For 2001, the projected slowdown in U.S. economic growth will lead to moderation in exports and investment spending in Malaysia. Nevertheless, Malaysia's current account position is expected to remain in surplus in 2001; it is projected at RM22.1 billion (US$5.8 billion) or 6.2 percent of GDP (6.8 percent of GNP). Weaker export demand will reduce demand for intermediate inputs for both goods and services.

EXTERNAL DEBT

Malaysia's external debt position improved in 2000 on account of further reduction in the short-term debt level and continued of end-December 2000. Short-term debt declined significantly by 23 percent, to US$4.6 billion, equivalent to 11 percent of total external debt and 15.4 percent of international reserves. The improvement in the debt situation was also reflected in the ratio of external debt to GDP, which declined to 46 percent in 2000 from 54 percent in 1999 (1997: 61 percent).

The total external debt outstanding is expected to increase moderately (4 percent) to RM163.2 billion (US$43 billion) in 2001, equivalent to 46 percent of GDP. The increase reflects mainly the higher borrowing by the federal government to finance the fiscal deficit. The net external borrowing of NFPEs and the private sector are expected to be relatively small in 2001. There are a total of 37 NFPEs, with the main ones being Petroliam Nasional Berhad (PETRONAS), Telekom Nasional Berhad (TMB), Tenaga Nasional Berhad (TNB), Sarawak Electricity Supply

Corporation and Perwaja Terengganu Sdn. Bhd. The debt service ratio is expected to stabilise at 5 percent.

EXCHANGE RATE

The ringgit exchange rate remained pegged to the U.S. dollar at the rate of RM3.80 per U.S. dollar in 2000 — an arrangement that has been effective since 2 September 1998. In terms of its trade-weighted nominal effective exchange rate, the ringgit appreciated 6.8 percent during the year, in line with the appreciation of the U.S. dollar. During the first half of 2001, the ringgit continued to appreciate against all major currencies, including regional currencies in tandem with the strong U.S. dollar. The pegged exchange rate regime continues to be supported by the strong fundamentals of the economy as reflected by the strong current account surplus, the low rate of inflation, and the high level of reserves.

FISCAL POLICY

Prior to the financial crisis in 1997, the federal government achieved five consecutive years (1993–97) of budgetary surplus. From 1998 to 2000, the federal government budgetary position incurred deficit, largely because of expansionary fiscal policy designed to support economic recovery. For 2001, there were downside risks associated with external developments that could pose a threat to Malaysia's economic recovery process. In view of this development, the focus of the 2001 budget was to continue the recovery process to a level consistent with Malaysia's growth potential. The three main thrusts of the 2001 budget as presented to parliament in October 2000 were directed at stimulating the nation's economic growth, implementing strategic initiatives to enhance the nation's competitiveness, and continuing the agenda of a caring society.

The budgetary operations of the government continued to be expansionary to stimulate economic activities through higher allocations for both operating and development expenditures. In addition, the annual budgets contained both tax and non-tax fiscal incentives focused on expanding domestic demand while strengthening the nation's competitiveness and resilience through promoting new sources of growth, developing skilled manpower and technological competence, and expediting the restructuring of the financial and corporate sectors. Besides providing incentives, the government also established several funds to support high-technology projects and venture capital companies as well as small- and medium-scale industries. Regarding tax policy, the government continued with its tax reform programme aimed at improving tax buoyancy and tax collection.

Although fiscal policy has been expansionary since 1998, Malaysia still enjoys fiscal flexibility, and the continued expansionary budget in 2001 will not create risks in the economy. This is because public sector debt remains manageable, with total federal government debt over GDP of less than 40 percent. Debt servicing of the federal government is also low, with interest payments accounting for about 16 percent of operating expenditure. The level of expenditure will be managed by taking into consideration the need to stimulate economic activities, maintain a surplus position in the current account, avoid excessive reliance on external borrowings, and avoid crowding out the private sector in terms of borrowings from the domestic financial system.

Emoluments constituted the largest component of operating expenditure. As for development expenditure, education, transport infrastructure, and trade and industry were the biggest components.

MONETARY POLICY

Monetary policy in 2000 and the first quarter of 2001 was directed at supporting economic growth and maintaining financial stability. The low and stable inflation environment enabled the conduct of monetary policy to remain accommodative. With the absence of inflationary pressures, Bank Negara Malaysia's three-month Intervention Rate was maintained at 5.5 percent (it peaked at 11 percent in 1998). The accommodative monetary policy stance was able to provide the foundation for strengthening economic fundamentals.

In 2000, the money supply continued to expand broadly, in line with economic recovery, with M1, M2, and M3 expanding by 6.5 percent, 5.2 percent, and 5 percent, respectively. The overall performance of the monetary aggregates were consistent with the policy stance of ensuring sufficient liquidity to finance real output expansion while ensuring price stability.

In tandem with the stronger economic growth in 2000, lending activities of the banking system improved significantly. Total loans have been on the uptrend since February 2000, driven by higher credit growth in both the household and business sectors.

To ensure that vital sectors and small- and medium-scale enterprises have access to financing at reasonable costs, the size and scope of several special-purpose funds were enhanced, while their lending rates were reduced.

MEDIUM-TERM OUTLOOK

Going forward, the expectations are for higher world growth for 2002. With an improved external environment, export demand for Malaysia is expected to strengthen in 2002. Meanwhile, policy efforts will continue to be directed at promoting domestic sources of growth.

The policies and strategies for 2001 and beyond are contained in the Eighth Malaysia Plan, 2001–05, and the Third Outline Perspective Plan, 2001–10, unveiled in April 2001. It is projected that during the period 2001–05, the Malaysian economy will grow at an average annual rate of 7.5 percent per annum. The thrusts of the Eighth Plan will be to shift the growth strategy from input-driven to knowledge-driven in order to enhance potential output growth. Efforts will be made to strengthen indigenous capabilities in innovation and technology development as well as in human capital in order to build a strong base for endogenously-driven growth. Towards this end, measures will be taken to strengthen human resource development.

Annex 1

MALAYSIA: OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in billion US$)	88.7	100.9	100.2	72.5	79.0	89.3
Real GDP	9.8	10.0	7.3	-7.4	5.8	8.5
Consumption	10.5	5.6	4.6	-10.0	5.8	10.0
Private Consumption	11.7	6.9	4.3	-10.8	3.1	12.4
Government Consumption	6.1	0.7	5.7	-6.6	16.3	1.7
Investment	22.8	8.2	9.2	-43.0	-5.9	24.1
Private Investment	28.1	11.3	9.4	-55.2	-21.8	26.7
Government Investment	11.3	0.5	8.4	-8.4	15.9	21.7
Exports of Goods and Services	19.0	9.2	5.5	0.5	13.4	16.3
Imports of Goods and Services	23.7	4.9	5.8	-18.8	10.8	23.6
Fiscal and External Balances (percent of GDP)						
Budget Balance	0.8	0.7	2.4	-1.8	-3.2	-5.8
Merchandise Trade Balance	0.04	4.0	3.6	24.3	28.8	23.4
Current Account Balance	-9.7	-4.4	-5.9	13.1	15.9	9.2
Capital Account Balance	8.6	9.4	2.2	-3.5	-8.4	-7.2
Economic Indicators (percent change, year over year, except as noted)						
GDP Deflator	3.6	3.7	3.5	9.0	-0.2	4.1
CPI	3.4	3.5	2.7	5.3	2.8	1.6
M2	24	19.8	22.7	1.5	13.7	5.2
Three-Month Interbank Rate (percent p.a., end-period)	6.76	7.39	8.7	6.46	3.18	3.25
Real Effective Exchange Rate (level, 1997=100)						
Unemployment Rate (percent)	3.1	2.5	2.4	3.2	3.4	3.1
Population (millions)	20.8	21.3	21.8	22.1	22.7	23.3

Annex II

MALAYSIA: FORECAST SUMMARY (percent change from previous year)

	2001					2002			
	Official	**IMF**	**LINK**	**ADB**	**OECD**	**IMF**	**LINK**	**ADB**	**OECD**
Real GDP	5.0–6.0	1.0	5.0	4.9	4.6	4.8	6.2	6.0	6.0
Exports	4.9	N.A.	7.2	11.8#	N.A.	N.A.	8.9	14.8#	N.A.
Imports	8.4	N.A.	7.2	23.7#	N.A.	N.A.	9.2	27.5#	N.A.
CPI	1.5–2.0	1.5	2.1*	2.6	N.A.	2.0	2.0*	2.8	N.A.

Note: * Private consumption deflator.
Merchandise trade in US$ terms.
N.A. Not available.

Sources: IMF forecasts, *The World Economic Outlook Database* (September 2001).
LINK forecasts, *Project LINK World Economic Outlook* (April 2001).
ADB forecasts, *Asian Development Outlook* 2001.
OECD forecasts, *OECD Economic Outlook* (June 2001).

Annex III

MALAYSIA: MEDIUM-TERM TREND FORECAST (percent)

	Average for 2001–05
Real GDP	7.5
CPI	1.5–2.0 (for 2001)

MEXICO

During the last quarter of 2000, the Mexican economy grew at an annual rate of 5.1 percent. Although more moderate than in the first three quarters, this marked the twentieth consecutive quarter of economic growth. For the entire year, GDP increased by 6.9 percent, the second highest growth rate in two decades. Indeed, the implementation of sound fiscal and monetary policies during 2000 enabled Mexico to achieve, and in most cases outperform, the main economic targets established at the beginning of the year.

REAL GROSS DOMESTIC PRODUCT

During 2000, gross domestic product (GDP) grew by 6.9 percent in real terms, 2.4 percentage points higher than the original target of 4.5 percent. In current prices, GDP amounted to 5,432.3 billion pesos (approximately US$574.8 billion).

This increase in GDP was led by a 10 percent expansion in gross fixed capital formation (which in turn was supported mostly by a 10.2 percent increase in private investment), and by an 8.7 percent growth in private consumption. Public spending, on the other hand, registered only a moderate 3.5 percent increase during the year. The most vigorous component of aggregate demand, however, was the export sector, which expanded at an annual growth rate of 16.0 percent. For 2000 as a whole, the value of exports totalled US$166.4 billion.

In terms of sector performance, the primary sector (agriculture, livestock, fishing and forestry) expanded at a real rate of 3.4 percent in 2000, while the industrial sector (mining, manufacturing, construction and electricity), and the services sector (commerce, transportation, communication and financial services) grew, in real terms, by 6.6 and 7.4 percent respectively.

INFLATION

On the inflation front, the good news continued during 2000. In particular, the Accumulated Consumer Price Index rose by 8.96 percent during the year, 1.04 percentage points below the official target of 10 percent established by Banco de México (the Mexican Central Bank) at the beginning of the year. The inflation rate for 2000 was in fact the lowest registered since 1994. A restrictive monetary policy, the stability in international financial markets, and the commitment to sound public finances are among the main factors contributing to the remarkable outcome.

EMPLOYMENT

The favorable evolution of the economy drove the open unemployment rate to 2.2 percent in 2000, the lowest level registered since this indicator was first adopted in 1985. During the year, 680,000 workers joined the Mexican Institute of Social Security (IMSS), of which 553,000 (81.3 percent) were permanent members, representing an increase of 4.7 percent over 1999.[1]

The economic expansion and the consequent rise in the level of employment, along with stable prices, translated also into an increase in real wages. A clear indicator of such an improvement is the 5.3 percent growth in the index of real average wages in manufacturing activities.

[1] The number of workers joining the IMSS is a frequently-used indicator of the size of the formal labor market in Mexico.

EXTERNAL SECTOR

Despite the strong economic activity, growth rates did not result in external imbalances that could have undermined the confidence achieved in recent years. In particular, during 2000 the current account deficit amounted to US$17.7 billion (3.1 percent of GDP), just slightly higher than the US$14.3 billion (3.0 percent of GDP) deficit registered in 1999. It is worth mentioning that this deficit was financed mostly by foreign direct investment (US$13.2 billion, or 74.6 percent of the current account deficit), since portfolio investment during 2000 amounted only to US$0.5 billion (2.8 percent of the current account deficit).

The capital account, on the other hand, registered a surplus of US$17.9 billion (3.1 percent of GDP), 25 percent higher than the surplus registered in 1999.

The trade balance, on the other hand, posted a deficit of US$8.0 billion (42.9 percent higher than the US$5.6 billion deficit registered in 1999), equivalent to 1.4 percent of GDP, and only 0.2 percentage points of GDP above the trade deficit recorded in 1999. This imbalance is mainly explained by a 22.9 percent growth rate in total imports for the year. The latter, in turn, reflected a 48.8 percent increase in imports of consumer goods, an 18.1 percent growth in imports of capital goods, and a 22.2 percent growth in imports of intermediate goods.

EXTERNAL DEBT

In 2000, total net public debt decreased 1.9 percent relative to the end of 1999, explained primarily by the 3.3 percentage points of GDP drop in external net public sector debt over the period, which went from 15.8 percent of GDP down to 12.5 percent. The external net public sector debt totaled US$76.0 billion, representing a reduction of US$7.4 billion (8.9 percent) compared to the end of 1999.

Reduced external debt has substantially improved the solvency indicators of public sector external liabilities. For instance, the ratio of external debt to GDP reached its lowest level in nearly 30 years (13.8 percent), while the ratio of external debt to exports reached its lowest level in the last 50 years (45.3 percent).

The ratio of the stock of total net public debt (internal and external) to GDP has also fallen significantly. In particular, year-end total net public debt as a proportion of GDP, which in 1988 amounted to 67.4 percent, and 37.6 percent in 1994, went down to 22.9 percent in 2000, the lowest level registered since 1971.

Total debt payments (market and non-market), on the other hand, amounted to US$21.8 billion, with nearly 50 percent of that figure corresponding to debt pre-payments. For 2001, Mexican authorities have foreseen the liquidation of liabilities worth US$1.6 billion in international capital markets, equivalent to 16.0 percent of total programmed debt payments. The remaining payments will be financed by foreign exchange operations, or with resources provided by creditors.

It should be added that in 2000, long-term Mexican external debt was granted, for the first time, the grade of “investment rating” by an international agency (Moody’s). Additionally, responsible management of external indebtedness led to successful Brady bonds buyback operations for US$7.0 billion, which freed resources for pre-payment of additional external liabilities for a total of US$2.8 billion. All of these elements keep reinforcing the Mexican position to face its external obligations.

EXCHANGE RATE

The flexible exchange rate system adopted by Mexico in December 1994 has become a significant factor in preserving stability in the current volatility in international financial markets. In particular, the floating exchange rate has allowed for gradual adjustments to external shocks instead of infrequent but large changes. Additionally, it has modified the composition of capital flow towards longer terms, and has reduced the possibility of speculative attacks and contagion effects from third countries financial turmoil.

In this context, although at the end of 2000, the interbank spot exchange rate showed a depreciation of 15 cents compared to 31 December 1999, for the year as a whole the exchange rate averaged 9.46 pesos per US dollar, indicating an appreciation of 9 cents relative to the 1999 average.

MONETARY POLICY

The monetary program for 2000 emphasized the control of inflation through the avoidance of excess money supply and the provision of necessary monetary policy flexibility.

During the year, monetary authorities identified several internal and external factors that may have had disruptive effects on the achievement of the inflation goal and on the overall performance of the Mexican economy. Among the internal factors, the most important was the higher-than-expected growth rate of aggregate demand that resulted in a rise in inflationary expectations. Additionally, there were concerns resulting from the deceleration of the US economy, and from some turbulence affecting international capital markets. As a response to these events, Banco de México increased the "short" (or "corto", the mechanism that this institution uses to tighten the monetary conditions of the economy in accordance to inflation targets, and to restore orderly conditions in money and exchange markets) six times during the year.

The monetary policy actions carried out by the Mexican Central Bank during 2000 affected inflationary expectations and contributed to the achievement of the 8.96 percent inflation rate for the year. Such actions were also accompanied by a widening spread between domestic and foreign interest rates[2], an event that helped offset the inflationary impacts stemming from the materialization of some of the risks mentioned above, and that has contributed to lessen the risk of a deviation from the 3.0 percent inflation rate goal set for 2003.

By the end of 2000, the monetary base stood at 208.9 billion pesos, a figure fairly close to the 205.9 billion pesos forecast by the monetary program for the year, and with a deviation of only 1.5 percent (within the projected range +/-3.07 percent admitted by Banco de México) with respect to the anticipated path. However, given that when the inflation rate falls below certain low levels, the relationship between the growth rates of the monetary aggregates and prices starts to blur[3], Mexican monetary authorities in recent years have granted less attention to the evolution of monetary aggregates for the analysis and evaluation of inflationary pressures. Instead, they have chosen to rely on a monetary scheme based upon inflation targets. Hence, the surveillance of monetary aggregates is currently undertaken only as a complementary reference when examining the variables that affect inflation performance.

FISCAL POLICY[4]

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[2] *Informe Trimestral de Inflación: Octubre-Diciembre 2000* (Quarterly Inflation Report October-December 2000), http://www.banxico.org.mx.

[3] See *Monetary Program for 2000,* and the *Quarterly Inflation Reports*, http://www.banxico.org.mx.

[4] Estimated figures expressed in US dollars were calculated considering the average of the 48 hrs. spot exchange rate. For 2000, that was 9.4611 pesos per US dollar.

The favorable evolution of international oil prices and the strength of domestic economic activity determined the behavior of public finances throughout 2000. As a result, at the end of the year the public sector recorded an overall deficit of 60.5 billion pesos. This amounted to 1.1 percent of GDP, and was identical (in terms of GDP) to the deficit posted in 1999.

However, the fiscal deficit was higher than the 1.0 percent of GDP target set at the beginning of the year. Such deviation is mainly explained by: (1) the allocation of 10.0 billion pesos towards a reserve for extraordinary tax refunds; (2) higher-than-authorized expenditures by public entities, (3) higher extraordinary expenditures and lower deferred payments; and, (4) the increase in the subsidy to electricity rates as a result of higher energy prices. Excluding those factors, the public deficit would have amounted to 0.7 percent of GDP.

The overall primary balance, defined as total income minus expenditures other than interest payments, registered a surplus of 143.4 billion pesos (approximately US$15.2 billion) in the January-December period, an increase of 13.7 percent in real terms when compared with the same period of 1999. During the year, public sector budgetary revenues increased by 13.1 percent in real terms, while net public budgetary expenditures went up by 12.8 percent, also in real terms.

MEDIUM-TERM OUTLOOK

The Mexican government's main economic objectives are to attain annual growth rates of at least 7.0 percent per annum by the end of the current administration, bring inflation down to the level of our main trading and investment partners, and reduce the economy's vulnerability to external shocks. Certainly, the achievement of such goals requires strict economic policy discipline as well as the procurement of higher efficiency and competitiveness.

Hence, the 2001 economic program considers the proposal of a comprehensive fiscal reform (aimed to increase tax revenues and achieve a more efficient and transparent budgetary expenditure), as well as the promotion of additional reforms that seek to enhance participation of private investment in sectors such as energy, ports and airports, telecommunications, etc.

Financial sector reform is also in this year's agenda, and is being oriented towards increasing the capacity of government authorities to supervise and regulate financial intermediaries, introduce new operation mechanisms and provide correct incentives for financial institutions (risk assumption according to capitalization requirements, reducing risks of moral hazard, etc.). These measures are reinforced by the commitment of the new Administration to fully apply the Basic Core Principles for effective banking supervision, as well as other internationally accepted codes and standards for banking operation.

At the present time, and despite the good economic performance observed during the first quarter of 2001, it seems difficult for Mexico to maintain a growth pace similar to the one observed during 2000, mostly because of the anticipated deceleration of the US economy. It is expected that the growth rate for 2001 will be somewhat lower than 2 percent.

In line with the inflation targets set by Banco de México, the economic program remains focused on reducing the growth rate of prices to a level not higher than 6.5 percent, about 2.4 percentage points less than the inflation rate recorded in 2000. The figure is also consistent with the goal of converging to an inflation rate of 3.0 percent by 2003. Achievement of the inflation target seems feasible since, by March 2001, the cumulated inflation rate during the year stood at 1.72 percent, with the inflation during the first half of April (0.15 percent) being the lowest for a similar period since 1988.

For 2001, the estimated current account deficit is expected to be around 3.8 percent of GDP, 0.7 percentage points higher than that of the previous year. This rise in the current account deficit is anticipated to result from a drop in the average price of the Mexican oil mix (from US$24.61 per barrel in 2000, to US$18.0 per barrel in 2001) and the deceleration of the US economy. However, the financing of such a deficit will be contingent on the availability of long-term foreign savings.

The public sector deficit forecast is 0.5 percent of GDP for 2001, while the primary fiscal surplus is expected to increase to 2.9 percent of GDP. Net foreign debt, in turn, is expected to remain stable at 25.2 percent of GDP.

Annex I

MEXICO: OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000
GDP and Components (percent change, year over year, except as noted)						
Nominal GDP (US$ billion)	286.2	332.3	400.9	421.2	479.4	574.5
Real GDP	-6.2	5.2	6.8	5.0	3.8	6.9
Total Consumption	-8.4	1.8	6.0	5.0	4.2	8.7
Private Consumption	-9.5	2.2	6.5	5.4	4.3	9.5
Government Consumption	-1.3	-0.7	2.9	2.3	3.9	3.5
Total Investment	-29.0	16.4	21.0	10.3	7.7	10.0
Exports of Goods and Services	30.2	18.2	10.7	12.1	12.4	16.0
Imports of Goods and Services	-15.0	22.9	22.7	16.6	13.8	21.4
Fiscal and External Balances (percent of GDP)						
Budget Balance	0.0	0.0	-0.8	-1.2	-1.1	-1.1
Merchandise Trade Balance	2.5	2.0	0.2	-1.9	-1.2	-1.4
Current Account Balance	-0.6	-0.7	-1.9	-3.8	-3.0	-3.1
Capital Account Balance	5.4	1.2	3.9	4.2	3.0	3.1
Economic Indicators (percent change year over year earlier period, except as noted)						
GDP Deflator (percent change)	37.9	30.7	17.7	15.4	14.9	10.7
CPI (percent change) 1994=100	52.0	27.7	15.7	18.6	12.3	9.0
M2 (percent change)	98.3	-11.2	-5.5	-7.5	-24.0	-20.0
Short-term Interest Rate (percent)	48.4	31.4	19.8	24.8	21.4	15.2
Exchange Rate (P/US$)	6.4	7.6	7.9	9.1	9.6	9.5
Unemployment Rate (percent)	6.3	5.5	3.7	3.2	2.5	2.2
Population (millions)	91.2	92.8	94.3	95.8	97.6	97.0

Sources: System of National Accounts Statistics, INEGI; Banco de México and Ministry of Finance and Public Credit.
Exchange Rate figures refer to the rate for operations nominated in foreign currency.

Annex II

MEXICO: FORECAST SUMMARY (percent change from previous year)

	2001				2002		
	Official	**IMF**	**LINK**	**OECD**	**IMF**	**LINK**	**OECD**
Real GDP	2.0	0.8	3.5	3.7	4.0	4.9	4.7
Exports	12.5	N.A.	8.0	8.2	N.A.	12.8	9.0
Imports	10.5	N.A.	11.8	9.0	N.A.	14.0	10.4
CPI	6.5	6.3	12.1	7.8	4.8	9.8	5.8

Notes : N.A. Not available.
Sources: IMF forecasts, *The World Economic Outlook Database* (September 2001).
LINK forecasts, *Project LINK World Economic Outlook* (April 2001).
OECD forecasts, *OECD Economic Outlook* (June 2001).

NEW ZEALAND

REAL GROSS DOMESTIC PRODUCT

After growing well above trend in 1999, New Zealand's economy slowed over 2000. In particular, over the second half of the year the economy was buffeted by a significant rise in crude oil prices, a substantial softening in business and consumer confidence, and a sharp depreciation in the value of the NZ dollar. However, despite a relatively soft domestic demand picture, those firms with some export exposure reaped significant benefits from the weakness in the currency.

Not only did exporters benefit from the low NZ dollar, but those in the agricultural sectors also experienced a generally good growing season and robust world prices. Increased export income flowed through to spending, on investment by firms and in retail sales by households, in regions where that income was being generated. However, somewhat offsetting these gains, the sharp depreciation in the NZ dollar weighed on the domestic sector in terms of higher import costs. For instance, in industries and regions less directly exposed to the external sector, higher costs squeezed firm profitability without any offset from increased revenues, and retail spending did not benefit as much from higher farm incomes.

More recently, GDP growth over the March 2001 quarter was surprisingly weak. On a production basis, nearly all primary and goods producing industries experienced falls over the March quarter. Furthermore, the construction and manufacturing sectors recorded notable declines. In contrast, countering these falls were increases across most of the services industries. Measured on the expenditure basis, GDP recorded a modest +0.2 percent quarterly increase. Within the total, domestic demand was marginally down over the quarter, with a sharp decline in investment partly countered by an increase in stock building. When the decline in domestic demand is combined with a modest increase in exports and a fall in imports, the level of economic activity recorded only a modest increase over the quarter.

Despite the recent softness in GDP growth, partial indicators suggest that June 2001 quarter GDP growth looks more promising, with signs of some consolidation in housing market activity, underlying strength in employment data, positive consumer and business confidence, reasonably robust retail sales, a recent increase in exporter optimism, together with a sharp rise in export receipts.

Since the beginning of 2001, the prospects for the global economy have weakened considerably. In particular, using country forecasts from *Consensus Economics*, projections of NZ's top-20 trading partners growth for 2001 have fallen from 3.7 percent in October of last year to 2.1 percent now. Developments in the international environment together with a decline that was sharper than previously expected in consumer price index (CPI) inflation moving back down from its December 2000 quarter peak have been instrumental factors in the Reserve Bank of New Zealand (RBNZ) sanctioning recent reductions in the official cash rate (OCR).

Looking ahead, we expect some recovery in domestic demand over the second half of 2001. However, offshore economic developments continue to remain the dominant issue for the NZ economy going forward, with potential weakness in our trading partners' economies remaining the most serious risk to NZ's growth outlook.

INFLATION

Inflationary pressures picked up over the second half of 2000, largely reflecting the impact of a sharp rise in international oil prices and tax-related increases in cigarettes and tobacco products. Assuming that these items had remained unchanged, the annual increase for the December 2000 quarter would have been a more modest 2.5 percent rather than the actual increase of 4 percent.

Since the December 2000 quarter spike, the inflation outlook has improved. In particular, the annual CPI recorded a 3.2 percent increase in the year to June 2001, up slightly from a 3.1 percent increase in the year to March 2001. The latest annual increase was strongly influenced by increases in petrol prices over the June quarter, together with a sharp decrease in housing rental costs following the introduction of income-related rents over the March quarter.

Looking further ahead, inflation is expected to move back below the top of RBNZ's 0–3 percent inflation band in the September 2001 quarter and then to track back towards the middle of the band over the remainder of 2001–02. An unwinding of some of the forces that drove inflation up in 2000 (oil prices and the exchange rate fall), one-off events, and the lower growth mean that inflation pressures have dissipated somewhat more than previously anticipated.

EMPLOYMENT

Labour market outturns over the second half of 2000 represented a marked turnaround on the first half of the year, when employment growth was flat or negative. The latter coincided with weak business confidence as well as some unwinding of the very strong GDP and employment growth in the second half of 1999. Nevertheless, the unemployment rate has been on a declining trend for the past two years and is 1.8 percentage points below the rate observed in the March 1999 quarter.

Furthermore, recent labour-market developments have generally surprised on the upside over recent quarters, and a number of indicators point to the labour market remaining reasonably tight over the short term. Over the March 2001 quarter the unemployment rate fell to 5.4 percent, from 5.6 percent in the December 2000 quarter, reflecting a fall in the numbers of unemployed and a decline in labour force participation; this is the lowest unemployment rate since June 1998.

While firms are likely to be more cautious in the light of uncertainty over global activity, continued reporting by firms regarding the difficulty of finding skilled labour suggests that employment levels are likely to remain largely unchanged over the year ahead. With employment levels static, the participation rate is expected to ease back slightly. The unemployment rate is expected to remain close to current levels at around 5.5 percent over 2001–02. On the wages front, we expect annual wage growth to increase from around 2.5 percent now to around 3.5 percent in March 2002.

CURRENT ACCOUNT

The current account balance for the year to March 2001 recorded a better than expected deficit of 4.8 percent of GDP. This represented a significant improvement on the 7.1 percent deficit recorded for the year ended March 2000. While the improvement in the deficit in part reflects a frigate purchased the previous year falling out of the annual total, underlying improvements in the goods and services balances have also been important in the recent narrowing of the deficit.

Reflecting the better than expected outturns for the first half of the 2001, combined with quarterly outturns over the remainder of this year in line with our earlier forecasts, we would now expect the current account deficit to narrow to a level closer to 4 percent of GDP by March 2002 rather than the 4.7 percent previously projected.

EXCHANGE RATE

The exchange rate weakened sharply over 2000. On a trade-weighted basis, the exchange rate ended the year at around the 49.5 level, down by around 10 percent from where it stood at the start of the year. Against the U.S. dollar, the NZ dollar lost about 9 US cents in 2000 to stand at just under 43 US cents at the end of the year (this compares with a peak of just under 70 US cents in early 1997). While the precise factors behind the NZ dollar weakness remain unclear, they have been seen in part as a reflection of the unilateral strength of the U.S. dollar.

Since the start of 2001, the exchange rate has shown some signs of consolidation. By the end of July, the exchange rate, on a trade-weighted basis, was trading around the 49.5 level — largely unchanged from that at the end of last year. Over the same period, the NZ dollar lost around 2 US cents, to be around the 41 US cents mark.

GROSS EXTERNAL DEBT

New Zealand's total gross external debt remained little changed, at $86.5 billion (78 percent of GDP) in the year to March 2001, down by 0.6 percent from March 2000. Within the total, both the stock of foreign investment in NZ and NZ assets abroad increased in NZD terms. After generally increasing since the beginning of the series in 1989, the net liability position has remained relatively steady in level terms more recently. The steady net liability level combined with strong economic growth over 1999 has led to a fall in New Zealand's net liabilities as a proportion of GDP.

FISCAL POLICY

Following a prolonged period of fiscal deficits, New Zealand has consistently achieved operating surpluses since the fiscal year ending June 1994. The initial improvement in the fiscal balance over the mid-1990s period reflected a growing economy and firm control over expenditure. Government operating expenses were reduced as a percentage of GDP from 44 percent in 1992–93 to 34.4 percent in 1999–00.

Over recent years the fiscal surplus has fallen back from above 3 percent of GDP in fiscal years 1995 and 1996 to 1.2 percent of GDP in 2000. Slower economic growth as well as tax reduction packages help explain the reduction in the fiscal surplus.

Net crown debt has fallen from 51 percent of GDP in 1992–93 to 20 percent in 1999–00. Debt repayments have been financed from operating surpluses and asset sales proceeds. From 2001–02 onwards it is assumed that surpluses will contribute to building up financial assets to save towards future superannuation costs as well as paying off debt.

MONETARY POLICY

RBNZ is an independent central bank and by the Reserve Bank Act 1989 is charged with maintaining price stability in New Zealand. The act requires the bank to maintain inflation in the range of 0–3 percent over any 12-month period. The current Policy Targets Agreement, signed with the new Labour/Alliance Coalition Government in December 1999, also clarifies that in pursuing its price stability objective the bank shall seek to avoid unnecessary instability in output, interest rates, and the exchange rate.

In making its assessment of economic conditions, RBNZ, in its May projections, shows annual CPI inflation decreasing reasonably rapidly over the near term, as the influence of one-off price increases "drop out" and the exchange rate shows a gradual appreciation. This together with the sharp slowing in global growth prospects dampening domestic inflationary pressures has led

RBNZ to undertake three 25-basis points interest rate cuts, lowering the OCR to 5.75 percent. Despite the RBNZ keeping interest rates unchanged at their July OCR review, Governor Brash noted that the slightly weaker-than-expected March quarter GDP data, together with signs that the global slowdown may be having more impact on exports than previously thought, suggests a downward bias to the Bank's assessment of the risks going forward.

Looking out over the forecast horizon, a modest tightening in monetary conditions is expected in order to keep inflationary pressures in check. RBNZ is forecast to begin reversing out recent cuts in the official cash rate midway through 2002 via 25 basis-point increments. The modest tightening in monetary policy is forecast to keep inflationary pressures in check over the medium term, with annual CPI inflation remaining near the mid-point of RBNZ's 0–3 percent inflation target for most of the forecast horizon.

OUTLOOK

Looking ahead, GDP growth of around 2 percent is expected in 2001. Slower export volume growth and uncertainty in the world outlook is expected to lead firms to be more cautious about hiring new staff and undertaking new investment. In this environment, households are also likely to be more cautious about their consumption expenditure. However, recent interest rate reductions and the historically competitive exchange rate provide important offsets to lower demand from the rest of the world. Over the near-term, we expect some recovery in activity, with a reversal of the recent sharp decline in investment expenditure, together with continuing consumer spending and export growth.

On the pricing front, CPI inflation is expected to move back to below the top of RNBZ's 0-3 percent target band in the September 2001 quarter and then to track back towards the middle of the band over the remainder of 2001–02. The reasonably sharp fall in projected inflation largely reflects the unwinding of some of the forces that drove inflation up over last year (oil prices and exchange rate fall), one-off events, and weaker global growth that has been dampening domestic growth and pricing pressures.

The substantial easing of monetary policy in many countries overseas is expected to underpin a recovery in growth in key trading partners towards 2002. New Zealand GDP growth is expected to recover to around 3 percent in 2002 on the back of a rebound in export growth and an acceleration in domestic spending following the removal of uncertainty regarding the global outlook.

As GDP growth accelerates in 2002 the labour market is expected to tighten further, with the unemployment rate projected to fall to near 5 percent. On the external front, the increase in government saving serves to support a projected narrowing in the current account deficit to around 3.5 percent of GDP by the end of the forecast horizon.

Annex I

NEW ZEALAND: OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000
GDP and Components (percent change, year over year, except as noted)						
Nominal GDP (US$ billion)	59,889	66,332	65,918	53,656	54,688	49,874
Real GDP	4.3	3.6	2.2	-0.1	3.9	3.6
Total Consumption	4.1	4.0	3.2	1.0	3.9	0.5
Private Consumption	4.1	4.4	2.2	1.5	3.4	1.5
Government Consumption	4.4	2.6	6.8	-0.9	5.4	-2.9
Total Investment	12.1	8.7	0.8	-4.7	2.8	6.7
Private Investment	11.1	8.7	-2.5	-4.1	4.4	7.1
Government Investment	18.9	8.2	21.9	-7.4	-5.7	4.1
Exports of Goods and Services	3.7	3.7	3.7	1.1	7.2	7.4
Imports of Goods and Services	8.8	7.7	2.4	1.4	11.8	1.0
Fiscal and External Balances (percent of GDP)						
Budget Balance (June Fiscal Years)	3.0	3.5	1.9	2.6	1.7	1.4
Merchandise Trade Balance	1.5	0.8	1.3	1.7	-0.8	1.2
Current Account Balance	-5.1	-5.9	-6.6	-4.1	-6.7	-5.6
Capital Account Balance	2.0	2.0	0.4	-0.3	-0.4	-0.4
Economic Indicators (percent change year over year earlier period, except as noted)						
GDP Deflator	2.3	2.7	0.7	1.1	0.5	0.9
CPI	3.8	2.3	1.2	1.3	-0.1	2.6
M2	10.5	9.8	6	2.4	14.5	0.8
Short-term Interest Rate (percent) – 90 day bank bills	9	9.3	7.7	7.4	4.8	6.5
Real Effective Exchange Rate (level, 1997=100)						
Unemployment Rate (percent)	6.3	6.1	6.6	7.5	6.8	6
Population (millions)	3.67	3.72	3.77	3.8	3.82	3.84

Annex II

NEW ZEALAND: FORECASTING SUMMARY (percent change from previous year)

	2001				2002			
	Official	**IMF**	**Link**	**OECD**	**Official**	**IMF**	**Link**	**OECD**
Real GDP	2.2	1.8	2.2	2.2	3.1	2.9	3.2	3.0
Real Exports	N.A.	N.A.	5.8	3.9	N.A.	N.A.	5.2	7.4
Real Imports	N.A.	N.A.	4.5	3.5	N.A.	N.A.	6.0	5.0
CPI	2.5	2.7	2.9*	3.2*	1.9	2.2	2.6*	2.0*

Notes : * Private consumption deflator.
N.A. Not available.

Sources: IMF forecasts, *The World Economic Outlook Database* (September 2001).
LINK forecasts, *Project LINK World Economic Outlook* (April 2001).
OECD forecasts, *OECD Economic Outlook* (June 2001).

Annex III

NEW ZEALAND: MEDIUM-TERM TREND FORECAST (percent)

	Average for 2001/02 – 2004/05
Real GDP	2.9
CPI	1.8

Note : Refers financial year, ending end-March.

PAPUA NEW GUINEA

REAL GROSS DOMESTIC PRODUCT

Preliminary estimates of economic activity in Papua New Guinea (PNG) indicate that total real GDP increased marginally in 2000. The latest estimates are for economic activity to remain subdued in 2001, with real GDP growth revised downwards from the projected 3.1 percent. The revision was mainly due to lower activity than expected in the agriculture/forestry/fisheries and mineral sectors. The relatively large coffee industry has been adversely affected by depressed international prices, rising costs, deteriorated infrastructure, and the lack of bank credit due to a weakening in debt service capacity. In addition, the decline in the agriculture/forestry/fisheries sector reflected lower copra and copra oil production, while in the mineral sector, the decline is due to projected lower crude oil, gold and silver production.

INFLATION

a) Headline Inflation

During the March quarter of 2001, headline inflation, as measured by the Consumer Price Index (CPI), increased by 1.6 percent compared with the December quarter of 2000, and by 8.9 percent over the year. This compared to 0.9 percent in the December quarter of 2000 and 10.0 percent over the year to December 2000. The lower increase in inflation was attributed to:

- **Imported inflation**: The movement in the exchange rate is the most influential factor impacting on headline and underlying inflation. From March 2000 to March 2001 the kina depreciated by 9.3 percent against the US dollar, while it appreciated by 7.8 percent against the Australian dollar (A$). The appreciation of the kina against the A$ contributed significantly to the lower rate of inflation, due to the relatively high level of imports from Australia.

- **Domestic Inflation**: The main factor that affected domestic inflation was the 2 percent increase in wages and salaries of public servants in January 2001, as well as increases in prices of some price-controlled items, including petrol.

b) Underlying Inflation

The underlying inflation, which excludes effects of excise duties and fluctuations in the price of betelnut and fruits and vegetables on consumer prices, increased by 1.7 percent in the March quarter of 2001, from December 2000 and by 6.0 percent over the year. This compared to 1.0 percent in the December quarter of 2000 and 11.0 percent over the year to December 2000.

c) Inflation Forecast

In line with previous expectations, inflation is forecast to trend downwards during the remainder of 2001. The projected year-on-year and year-over-year headline inflation rates are 9.1 and 9.7 percent, respectively. The lower inflation forecasts are a result of a lower-than-expected March quarterly inflation rate, which was partly attributed to reductions in price-cost margins by businesses, reflecting the depressed domestic aggregate demand. Inflation in the latter half of the year is expected to be lower as support of the kina from export receipts and extraordinary financing boost private sector confidence and lead to more stable consumer prices.

The projected year on year and over the year underlying inflation rates for 2001 are 8.4 percent and 8.3 percent, respectively.

EMPLOYMENT

The level of employment in the formal private sector declined in 2000, following an increase in 1999, with lower employment in the non-mineral sector more than offsetting an increase in the mineral sector. The decline reflected a contraction in the building and construction sector following the completion of several major construction projects, lower demand in the transportation sector due to higher prices, lower activity in the security and financial services sector, and a down-turn in the coffee industry reflecting lower production and international prices, combined with depressed international prices for log, cocoa and copra export commodities.

According to the Banks' employment index, employment in the formal private sector, excluding mining and petroleum, declined over the year to December 2000 by 0.1 percent, compared to a revised decline of 0.7 percent over the year to December 1999. All regions recorded declines in employment with the exception of the Lae, Madang/Wewak and the Other Outlying regions. By industry, declines in the wholesale, building and construction, transportation, agriculture/forestry/fisheries and finance/business service sectors more than offset increases in the other sectors.

BALANCE OF PAYMENTS

Preliminary outcome of the balance of payments for the first six months of 2001, show an overall surplus of K183 million. This resulted from a surplus in the current account of K599 million, which more than offset a deficit of K470 million in the capital account. The current account surplus was attributed to higher values of merchandise exports, mainly crude oil, copper and forestry products, which more than offset the decline in most agricultural exports, higher imports and net service payments. The deficit in the capital account was due to loan repayments by the Government, net purchases of short-term money market instruments by the mineral companies combined with an increase in net foreign assets of the non-official monetary sector.

The level of gross foreign exchange reserves at the end of June 2001 was US$328 (K1,092) million, sufficient for 4.6 months of total and 6.8 months of non-mineral import cover.

The balance of payments for 2001, which includes extraordinary financing associated with the Structural Adjustment Program (SAP), but excludes balance of payments support from the International Monetary Fund (IMF) is projected to show a surplus of K200 million, compared to a surplus of K359 million in 2000. This outcome is attributed to a lower surplus in the current account, which more than offset a lower deficit in the capital account. The current account is projected to record a surplus of K352 million, compared to a surplus of K974 million in 2000, and reflects higher net service payments and a lower trade surplus. The capital account, including the external extraordinary financing, is projected to record a deficit of K332 million in 2001, compared to a deficit of K651 million in 2000, reflecting lower loan repayments by resident companies and higher loan draw downs by the Government.

EXCHANGE RATE

From the end of December 2000 to the end of June 2001, the kina appreciated by 0.6 percent against the Australian dollar, while it depreciated by 7.8 percent against the US dollar during the same period. The Central Bank intervened in the foreign exchange market to smooth out short-term volatility in the exchange rate. The real effective exchange rate (REER) has depreciated since September 2000, reflecting an increase in the international competitiveness of the export sector. The downward movements in the REER can be explained by the decline in the nominal exchange rate (Import Weighted Index), which more than offset relative price differentials between PNG and its partner trading countries. However, the benefits to the export sector of the increase in competitiveness were offset by the lower level of supply in response to the fall in international prices, coupled with other structural impediments.

FISCAL OPERATIONS OF THE GOVERNMENT

The fiscal operations of the Central Government over the six months to June 2001 showed an overall surplus of K13 million, compared to a deficit of K25 million in the corresponding period in 2000. Total revenue receipts and grants amounted to K1116 million, K138 million lower than in the corresponding period in 2000, and represents 35 percent of the budget amount. Total expenditure over the first six months of 2001 amounted to K1103 million, K176 million lower than in the corresponding period in 2000, and represents 33 percent of the budgeted expenditure in 2001.

Total tax collections were lower over the six months to June 2001, compared to the corresponding period in 2000, reflecting a downturn in economic activity. This, combined with lower foreign grants, tighter control on recurrent and lower development expenditure resulted in a surplus over the six months to June 2001.

The budget surplus, combined with a positive total domestic financing of K81 million, resulted in a net repayment to external sources of K94 million. Domestic financing of K112 million from other domestic sources reflecting increased holdings of Government securities, more than offset a negative financing of K31 million from the banking system. On 12 April 2001, the Government endorsed the new issuance of K35 million in Inscribed Stocks with maturities of 1–3 years to lengthen its domestic debt structure. From this issuance, K26 million has already been sold to the public. From September 2001, the Government is planning to issue new Inscribed Stocks of K105 million in substitution for the ame amount of Treasury Bills.

FISCAL POLICY

The fiscal strategy for the 2001 National Budget continues to aim at a balanced budget and the Government remains committed to macroeconomic stabilisation and economic reform. To achieve this objective would mean instilling fiscal discipline amongst institutions of the State in order to finance priority areas including health, education, law and order, agriculture and livestock, transport and works, civil aviation and revenue-raising measures. The Government is also determined to persevere with program implementation under the SAP to help solidify confidence and create the conditions for an economic recovery. Consequently, it will adhere to the fiscal path agreed under the SAP and will work to meet multilateral conditionality on a timely basis. This is expected to facilitate the release of external assistance, including that envisaged for the remainder of 2001 to be disbursed by the World Bank, the Asian Development Bank, Japan, the European Union, and China.

Further delays in the disbursement of external extraordinary funding and the privatisation programme poses a potential risk of not achieving the objectives of the 2001 Budget, as shortfalls in external financing and privatisation receipts would exert pressure on the Government's cash-flow. Under such circumstances, the Government is likely to resort to domestic financing, which in previous experiences led to higher inflationary pressures. Increase in domestic borrowing not only makes monetary management difficult, but also jeopardises the current improvement in monetary conditions and prospects for economic recovery.

Notwithstanding the difficult economic environment, the Government's financial policy objectives remain broadly unchanged. Policies continue to be aimed at reducing the rate of inflation to 8 percent by end-December 2001, and at further strengthening the international reserve position of the country. However, due to the weaker activity projected for 2001 and its adverse effect on the government finances, the fiscal deficit will now be slightly higher, as full compensation for revenue under-performance will not be feasible. This will also involve cuts in non-priority expenditure of K80 million as announced by the Prime Minister and Treasurer. In line with the government's commitment, any net privatisation proceeds will be used to reduce net domestic government debt.

MONETARY AND INTEREST RATE DEVELOPMENTS

The Central Bank relaxed its tight monetary policy stance in the first half of 2001, following a downward trend in inflation as anticipated and stability in exchange rates. The lower-than-expected increase in inflation in the December quarter of 2000 and March quarter of 2001 was a major contributing factor that led the Central Bank to reducing its benchmark rate, the Kina Facility Rate (KFR) by 2.5 percentage points in aggregate from 15.5 percent in February to 13.0 percent in July 2001.

Consistent with the decline in the KFR all market interest rates declined, with the 182-days Treasury bill rate falling from 14.9 percent in December 2000 to 12.3 percent at the end of June 2001. The weighted average 28-day term deposit rate and the Indicative Lending Rates (ILR) of the commercial banks also declined during the period. Although the KFR was initially below the 28-day Treasury bill rate, these two interest rates have since converged. However, spreads between the weighted average lending and deposit rates have widened, reflecting a slower adjustment in the cost of borrowing and lending rates by commercial banks. If the Government reduces the stock of Treasury bill issues, crowding-out of credit to the private sector would diminish and lending to this sector should grow. However, the retirement of Treasury bills by the Government depends on the success of the privatisation program in 2001.

The level of broad money (M3*) increased by 2 percent between December 2000 and June 2001 as a result of higher net foreign assets of the banking system, which more than offset a decline in net credit extended by the banking system. Credit by commercial banks to the private sector remained dismal.

The Central Bank continued to utilise its open market instruments in implementing monetary policy in the first half of 2001, with no changes made to both the Cash Reserve Requirement (CRR) and Minimum Liquid Asset Ratio (MLAR).

MONETARY POLICY

a) Objective of Monetary Policy

The Bank of Papua New Guinea has opted to target price stability, compared to the previous broad goal of monetary stability. The main reason for setting price stability as the primary goal for monetary policy is the experience in both developing and industrialized economies that low inflation helps to promote economic efficiency and growth in the long run, while the adverse impact of high inflation on the economy has been recognised. Maintaining price stability in a small open economy like Papua New Guinea requires amongst other things, relative stability in the exchange rate.

b) Monetary Policy Stance

In addition to the favourable outcome of inflation in the March quarter of 2001 and the expectations for a further downward trend in the remaining months of the year, other developments which have influenced the Bank's decision to gradually ease its stance of monetary policy are:

- The overall level of economic activity remains flat with few signs of any major recovery in the immediate future;
- Growth in money supply and credit aggregates are moderate;
- Domestic real interest rates remain positive;
- As overseas official interest rates fell sharply, following the actions by major central banks to ease monetary policy in order to stimulate economic activity, interest rate differentials between PNG and its key trading partners continue to widen;
- Reasonable progress continues to be made on the Government's reform program, despite some notable delays in implementation, in what now appears to have been an ambitious program; and
- Continued tight control on expenditures by Government, in light of lower tax revenue and delays in draw-down of external extraordinary financing.

Whilst inflation is projected to trend downwards in the second half of 2001, the BPNG will be mindful of any adverse developments in the key macroeconomic conditions underpinning inflationary projections and monetary developments. The Central Bank, therefore will take a cautious approach to any further easing of the monetary policy stance. However, the pace and extent of further adjustments to the stance of monetary policy in the second half of 2001 will also depend on the following factors and their combined influence on the underlying inflation rate and price stability:

- A gradual, rather than rapid, pick-up in private sector credit implicit in recent falls in interest rates, with further cuts in bank lending rates expected as commercial banks' average cost of funds continues to decline. This depends on the responsiveness of commercial banks to the competitive opportunities offered by the lower cost of funds;
- Fiscal consolidation and prioritisation of expenditure by Government as necessary. A cautious approach by Government is needed to ensure new domestic borrowing does not raise possible conflict with the direction of monetary policy. The progress on domestic debt reduction depends on realisation of the Government's privatisation program;
- An improvement in the balance of payments through a recovery in the prices of PNG's key exports and draw-down of external extraordinary financing. A continuation of the rebuilding of PNG's foreign reserves should provide added support to confidence;
- Continued moderation in supply-side cost pressures, especially wages and salaries, and price increases for price-controlled goods; and
- On-going progress on structural reform and funding assistance from bilateral sources and multilateral institutions.

Consistent with the Bank of Papua New Guinea's objective of achieving and maintaining price stability, the conduct of monetary policy will be operated within a reserve money framework. Reserve money is defined as currency in circulation and deposits of commercial banks with the Central Bank and, along with the level of liquid assets in relation to statutory requirements, is an indicator of the capacity of the banking system to finance new lending. During 2001, the revised reserve money is expected to increase by 2 percent following a decrease of 19 percent in 2000. The decrease in 2000 was a result of the tight stance of monetary policy pursued by the Central Bank. The expected growth in reserve money is likely to have minimal impact on inflation, and the Central Bank will continue to use its open market instruments to sterilise any excess reserve money in the banking system.

STRUCTURAL REFORM AT THE BANK OF PAPUA NEW GUINEA

As part of the financial sector reform of the Government in 2000, structural reforms of the Bank of Papua New Guinea were considered necessary to achieve stability of the economy in the medium term. A new Central Banking Act (CBA 2000) was passed by Parliament and became effective on 16 June 2000, while the revised Banks and Financial Institutions Act (BFIA 2000) was passed by Parliament in April 2000. In addition, new Life Insurance and Superannuation Acts were passed by Parliament in November/December 2000, which enables the Central Bank to regulate and supervise the life and superannuation industries. These new responsibilities will be initially taken over by the Central Bank with a view to delegate them in the future.

Under the CBA 2000, significant changes were made in the relationship between the Bank and the Government, which include: introducing price stability as the monetary policy objective; separating debt management from the conduct of monetary policy; limiting Central Bank credit to the Government to an operating overdraft of up to K100 million; and appointment of the Governor for a fixed term of five to seven years.

The greater independence and stronger powers of the Central Bank and the Governor demand greater accountability and transparency to Parliament and the public. The Central Bank is therefore required to publish semi-annual monetary policy statements, outlining developments, projections and the policy stance, which will enhance the effectiveness of the transmission of monetary policy. The first statement was released in July 2000, the second in January 2001 and the third in July 2001. The new Board of the Central Bank, comprising the Governor, two Deputy Governors, the PNG Trade Union Congress, PNG Council of Churches, Securities Commission, PNG Chamber of Commerce and Institute of Accountants, as well as two appointees by the Minister, is responsible for advising and reviewing the performance of the Governor. The Governor is now responsible for Monetary Policy and the Regulation of Banks and Financial Institutions. Besides an annual audit, the Minister for Finance and Treasury may at any time call for an external managerial or financial audit of the Bank. Conditions relating to the dismissal of the Governor and the Deputy Governors are more streamlined, but with any removal transparent and open.

The BFIA 2000 aims to broaden the scope and improve the effectiveness of financial sector regulation, drawing on international best practices. The Act:

- Gives full responsibility to the Central Bank for licensing and supervising banks and other authorised deposit-taking institutions;
- Strengthens information gathering and investigative powers;
- Enables vetting of directors and senior managers of authorised financial institutions;
- Effectively prohibits pyramid schemes which have been a major problem in recent times; and
- Introduces stronger and more credible penalties.

In August 2000, the Central Bank used the new Act to remove the Board of the PNG Banking Corporation, Nambawan Finance, Village Finance and Rural Development Bank over concerns of their weak governance, breach of exposure limits and short-comings in their management structure and capabilities. The Central Bank also undertook legal action against several fast-money schemes, but could not prevent many people being deceived by them, despite an intensive campaign. Two such schemes were liquidated in 2000. In 2000, the Central Bank, through a liquidator, liquidated 76 dormant savings and loan societies as part of its revitalisation programme.

Problems have also emerged in the pension industry. The National Provident Fund is currently under review by a Commission of Enquiry appointed by Government. The new Superannuation legislation creates a licensing, prudential and supervisory regime for superannuation funds, trustees, investment managers and fund administrators operating in the industry. The new Act:

- Requires authorised superannuation funds or licence holders to provide the Central Bank with information including financial statements and details of the officers of the corporate entity;
- Ensures compliance with prudential standards issued by the Central Bank;
- The Central Bank may appoint a competent person to investigate a licence holder;

- The Central Bank can issue directions to regulate activities of a licence holder if it has contravened a prudential standard or condition of its licence; and
- The Central Bank may appoint a statutory manager to take control of a licence holder.

The new Life Insurance Act establishes a framework for the regulation of the life insurance industry and entities operating as life insurance companies or brokers. The Act:

- Imposes conditions on any licence holder;
- Ensures compliance with prudential standards issued by the Central Bank;
- Requires a licence holder to provide information to the Central Bank;
- The Central Bank may appoints a competent person to investigate a licence holder;
- The Central Bank can issue directions to regulate the activities of a licence holder; and
- The Central Bank can appoint a statutory manager to take control of a licence holder.

OTHER STRUCTURAL REFORM OF THE GOVERNMENT

The National Executive Committee (NEC) has approved a medium-term plan of action for public sector reform and a Public Sector Reform Management Unit (PSRMU) has been established. The reforms are proceeding in two phases: (1) review and formulation, and (2) implementation.

Implementation of the measures contained in the Public Sector Reform Management Program will take place over a three-- year period. However, where possible and where clear advantages are demonstrated, incremental change is being made. Importantly, these reforms flow from an overhaul of the processes and procedures associated with the operation of NEC. A systematic approach has been implemented in the receipt of submissions, their consideration and implementation of decisions.

A number of preliminary functional and expenditure reviews of selected departments have already been completed in 2000. Assistance for the reviews was obtained from AusAID, the World Bank and the Asian Development Bank. Each department's human resource requirements and administrative performance are evaluated. Areas identified are: (1) for positive change in roles and functions; (2) for possible financial savings; (3) where more resources are needed; and (4) where functions can be better performed by agents other than government departments and agencies.

Preliminary reviews of the Department of Defence, Fisheries Authority, Office of Civil Aviation, Department of Foreign Affairs and Department of Finance and Treasury have already been carried out.

Preliminary reviews are currently being carried out in the Department of Personnel Management, the Department of the Prime Minister and NEC.

Terms of reference have been developed and approved for the reviews of the Attorney-General's Department, the Royal Papua New Guinea Constabulary, the Corrective Institutional Services and the Department of National Planning and Monitoring.

The recommendations flowing from these functional and expenditure reviews have been incorporated in the 2001 Budget.

Through the 2001 Budget formulation process, 1,380 public servants have been identified for retrenchment by the end of 2000. This have been carefully planned and will be accompanied by a moratorium on the hiring of new staff, except in extraordinary circumstances, as determined by a sub-committee of the Central Agency Co-ordinating Committee (CACC).

In 2001, further progress will be made in the implementation of the "Plan of Action for Public Sector Reform." This will include approval of a training program for public servants being retrenched (to be developed by the Public Sector Reform Management Unit and the Department of Personnel Management) and commencement of implementation by the end of 2001.

In addition to those departments with terms of reference in place, the Public Sector Reform Management Unit will oversee further functional and expenditure reviews of the Department of Works, Department of Agriculture and Livestock and related statutory authorities, the Department of Lands and Physical Planning, the Department of Health and the Department of Education.

Those recommendations of the functional and expenditure Reviews that gain NEC approval will be incorporated in the 2002 Budget.

PRIVATISATION OF PUBLIC ENTERPRISES

There is strong evidence that privatisation attracts new investment and increases the efficiency of many businesses. It also reduces the demands of the Government sector for debt capital. However, privatisation is less likely to offer significant public benefits if appropriate structural reforms are not carried out before or alongside privatisation, in order to encourage competition. The proceeds from privatisation will be used by Government to retire domestic debt.

In late 1999, the Government established the Privatisation Commission, and appointed an International Advisory Group, consisting of internationally-reputed economists to provide advice and assistance to the Privatisation Commission.

The NEC has approved a program for privatisation, the necessary amendments to the Privatisation Commission legislation have been made and funding provided from the Budget for the Commission.

Up-to-date audits for Elcom, Telikom, Harbours Board and Air Niugini have also either been produced or are in the process of being finalised. In the coming year the Privatisation Commission will aim to complete the due diligence exercises for Elcom, Telikom, Harbours Board, Post PNG and Air Niugini in 2001, sale PNGBC and Air Niugini in 2001.

ECONOMIC OUTLOOK

As a small open economy, characterised by a large subsistence sector, with primary exports of raw agricultural and mineral export commodities, PNG is a price-taker and is susceptible to external shocks, as experienced in 1997. The shocks include: (i) a prolonged and severe drought, which disrupted mining as well as agriculture production; and (ii) the Asian crisis, which caused steep declines in the world prices of PNG's principle mineral export.

The macroeconomic impact of these shocks were exacerbated by lax monetary policy and by poor governance of public institutions, which further undermined private sector confidence. In recognition of the serious economic and governance problems facing PNG, a new government was formed in July 1999 with a mandate to restore financial viability, improve transparency, and restore normal relations with traditional bilateral partners and international financial institutions. Financial markets reacted positively to these actions, as well as to the restoration of a productive dialogue with the International Monetary Fund, the World Bank, and other donors.

The Government believes that its commitment to adjust and reform, together with the recent improvement in the external environment and the prospect for enhanced donor support provides a window of opportunity to achieve rapid stabilization and growth.

Under the impact of macroeconomic stabilization, structural reforms, and the initiation of some large new projects in the energy and mining sectors (a PNG-Queensland gas pipeline, Napanapa Oil Refinary and Ramu Nickle Mine), foreign and domestic investment is projected to pick up significantly over the medium term. With the growth of investment outstripping that of savings, the external current account deficit would increase with the rise in imports of machinery and equipment during the construction phase of these large projects. However, with increasing exports coming on stream, a gradual decline in the debt-service ratio is expected to take place. With new investment leading to increases in both the revenue base and the general level of economic activity, strong sustainable growth within the environment of a balanced budget is expected over the medium term.

PERU

REAL GROSS DOMESTIC PRODUCT

In 2000 the rate of growth of the Peruvian economy was 3.1 percent — higher than the 0.9 percent rate of growth achieved in 1999 — thanks to the expansion of fisheries, primary manufacturing, and agriculture. However, gross domestic product (GDP) growth showed a declining trend during the year, owing to the uncertainty generated by the electoral process and the political crisis that occurred in the last quarter of the year.

The expansion registered in the primary sectors (5.6 percent) was mainly due to the favourable weather conditions, while the non-primary sector grew 2.6 percent.

Concerning aggregate supply and demand, GDP growth responded to the expansion in exports of goods and services (7.9 percent), while domestic demand grew only 2.4 percent. This was associated with the effect of the domestic political crisis on investors' expectations, as well as with the fiscal policy restrictions implemented to meet fiscal targets.

INFLATION

The 3.7 percent rate of inflation registered in 2000 — the same as in 1999 — was the lowest since 1960 and the second lowest in the last 60 years. This rate fell within the inflation target range (3.5 to 4 percent) established in the Monetary Program for 2000.

EMPLOYMENT

In 2000, unemployment in the urban areas (7.4 percent) was slightly lower than in the previous year.

CURRENT ACCOUNT

The current account deficit amounted to US$1,627 million (3 percent of GDP) in 2000, down from US$1,919 million in 1999 (3.7 percent of GDP). The smaller current account deficit reflected a US$310 million drop in the trade deficit caused by higher export growth (14.9 percent) relative to imports (8.9 percent).

The expansion of exports was mainly due to the increase in traditional exports (16.3 percent) such as petroleum and derivatives, fisheries, and cooper, which grew 60.1 percent, 58.8 percent, and 19.9 percent, respectively. Exports of cooper and petroleum and derivatives reflected higher international prices (18 and 77 percent over the previous year's levels, respectively). The increase in fishing exports was due to the fact that a higher share of fishing output was oriented to the foreign market.

CAPITAL INFLOWS

Net capital inflows in 2000 amounted to US$1,108 million (2.1 percent of GDP), similar to the level registered the previous year. Net short-run capital outflows dropped dramatically in 2000 (to US$368 million, from US$1,676 million in 1999). However, the fall was compensated by the reduction in long-term private capital inflow (from US$2,399 million in 1999 to US$1,199 million in 2000). In particular, political uncertainty implied that the total amount of direct investment and long-term loans to the private sector dropped from US$2,479 million in 1999 to US$1,244 million in 2000. However, it still represented 76 percent of the current account deficit.

EXCHANGE RATE

Peru maintains a floating exchange rate regime. In 2000, average depreciation of the Peruvian currency (Nuevo Sol) was 3.1 percent in nominal terms (a 1.1 percent average appreciation in real terms).

FISCAL POLICY

In 2000 the overall public sector deficit was 3.2 percent of GDP, slightly higher than the 1999 deficit (3.1 percent of GDP). This fact was associated with the shortfall in central government tax revenues (0.4 percent of GDP), but was compensated by the reduction in central government non-financial expenditures (0.4 percent of GDP). During the second half of the year, a fiscal adjustment program was launched to avoid a higher deficit. Even though it was not possible to meet the fiscal deficit limit established by the Fiscal Responsibility and Transparency Law (2 percent of GDP), the limit for general government non-financial expenditures (2 percent in real terms) was accomplished.

Concerning the privatisation and concession process, the Camisea Natural Gas project and the Lima International Airport concessions were completed. The concession of the Camisea Natural Gas project was accomplished in two stages and involved investment commitments amounting to US$1,600 million and US$1,449 million for the development and transportation and distribution stages respectively. In the case of the Lima International Airport, investment commitments amount to US$1,214 million, which will be used to improve the airport's category from IATA E to IATA B by the beginning of the 8^{th} year, and to add a second landing strip by the 11^{th} year.

MONETARY POLICY

In order to increase the transparency of monetary policy, the central bank published the Annual Monetary Program for the first time in January 2000. This report includes the inflation target range, the intermediate and operational target ranges, and the macroeconomic projections that would guide monetary policy during the year.

The monetary program for 2000 established an end-of-year inflation target range of 3.5–4 percent (the actual rate was 3.7 percent). Additionally, an 8–10 percent range was established for the monetary base growth rate, subject to a 9 percent increase in nominal GDP, a 1.5 percent decrease in domestic-currency broad-money velocity, and a 1.5 percent rise in the money multiplier. However, political uncertainty during the year made it necessary to review the intermediate target, which resulted in an adjustment of the monetary base growth rate to 6 percent. This forecast would be associated with a 6.9 percent increase in nominal GDP, a 0.8 percent rise in domestic-currency broad-money velocity and a null variation in the money multiplier.

During the year the following measures were adopted:

- The minimum reserve requirement was reduced from 7 percent to 6 percent, and a 1 percent minimum reserve requirement was introduced in the form of demand deposits kept at the central bank. The latter was intended to reduce the volatility of demand deposits held at the central bank and of domestic-currency interbank interest rates (September).

- A domestic-currency overnight deposit facility for commercial banks was established to reduce the volatility of the operating target and of domestic-currency interbank interest rates (September).

- Maturities of central bank certificates of deposit (CDBCRP) were increased and diversified to provide a benchmark for longer terms interest rates and to meet the seasonal pattern of monetary aggregates and public finances, thus reducing the volatility of the commercial banks' liquidity held at the central bank.

- The average reserve requirement rate for foreign-currency commercial bank's liabilities was reduced from 37.1 percent to 34.1 percent in order to favour financial intermediation (September).

In 2000, total banking system credit declined by 1 percent in nominal terms owing to the cautious behaviour of the commercial banks, which was associated with the delay in the recovery of economic activity.

Net international reserves declined by US$224 million, from US$8,404 million to US$8,180 million. However, the international liquidity position is still at an adequate level. The stock of international reserves is equivalent to 5 times the monetary base, 2 times the domestic liquidity, 60 percent of total liquidity, 13 months of imports of goods, 2 times the short-term foreign debt, and 1.3 times the foreign debt due in the next 12 months.

2001 AND MEDIUM-TERM OUTLOOK

In March, Peru signed a one-year Stand-By Arrangement with the International Monetary Fund, which included quantitative targets for the first half of the year and indicator targets for the rest of the year. The targets for the first quarter were met, and it is expected that the targets for the first half of the year will be fulfilled.

The medium-term outlook has been described in the Multiannual Macroeconomic Framework 2002–2004. The economy is forecast to grow by 0.9 percent in real terms in 2001 and by 5.7 percent in the medium term. The inflation target range for 2001 is 2.5–3.5 percent, and the inflation rate is expected to be in the 1–3 percent range in the coming years.

A current account deficit equivalent to 2.6 percent of GDP is expected in 2001. In the following years it is expected to fall to levels below 3 percent of GDP, and it will continue to be financed mainly by long-term capital inflows. Central bank international reserves are expected to grow around US$220 million in 2001 and will accumulate about US$600 million over the next three years.

The current fiscal target aims at reducing the deficit to 2.3 percent of GDP in 2001 and to attaining equilibrium.

Annex I

PERU: OVERALL ECONOMIC PERFORMANCE

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDP and Components (percent change, year over year, except as noted)										
Nominal GDP (Billions of US$)	34.1	36.3	34.7	44.9	53.6	55.8	58.9	56.9	51.6	53.5
Nominal GDP (Billions of nuevos soles)	26.7	45.0	69.3	98.6	120.9	136.9	157.3	166.5	174.7	186.8
Real GDP	2.2	-0.4	4.8	12.8	8.6	2.5	6.7	-0.5	0.9	3.1
Domestic Demand	3.5	0.2	4.8	14.0	11.8	1.3	6.9	-0.8	-3.1	2.4
Private Consumption	3.4	-0.3	3.4	9.8	9.7	3.1	4.3	-0.8	-0.4	3.9
Gross Domestic Investment	1.5	0.9	11.1	33.7	21.9	-2.9	15.3	-1.4	-11.1	-5.0
Fiscal and External Balances (percent of GDP, except as noted)										
Current Revenues	12.0	13.5	13.6	14.6	15.2	15.7	15.9	15.7	14.5	14.7
Non-financial Expenditure of Central Government	-10.6	-13.0	-13.0	-14.5	-15.4	-15.1	-15.1	-15.2	-15.9	-15.5
Primary Balance of Public Sector	1.8	1.2	1.5	1.0	0.4	1.5	2.0	1.2	-1.0	-0.9
Overall Balance of Public Sector	-2.8	-3.9	-3.1	-2.8	-3.1	-1.0	0.2	-0.8	-3.1	-3.2
Current Account (Billions of US$)	-1.5	-2.1	-2.3	-2.6	-4.1	-3.4	-3.1	-3.6	-1.9	-1.6
Trade Balance (Billions of US$)	-0.2	-0.3	-0.6	-1.0	-2.2	-2.0	-1.7	-2.5	-0.6	-0.3
Private Sector long-term capital flows* (Billions of US$)	0.1	0.2	1.1	1.6	2.0	2.4	2.3	2.1	2.2	1.0
Short-term capital flows (Billions of US$)	-0.1	1.0	0.1	0.4	0.6	-0.2	2.6	-0.2	-1.7	-0.4
Privatisation (Billions of US$)	0.0	0.0	0.2	2.2	0.5	1.7	0.1	0.1	0.2	0.2
Net international reserve flows (Billions of US$)	0.8	0.7	0.7	3.0	0.9	1.9	1.7	-1.0	-0.8	-0.2
Economic Indicators (percent change year over year, except as noted)										
CPI (end of period)	139.2	56.7	39.5	15.4	10.2	11.8	6.5	6.0	3.7	3.7
Real devaluation (average)	-31.1	-3.3	10.4	-6.2	0.4	-1.9	-1.0	0.4	10.9	-1.1
Exchange Rate	0.78	1.25	1.99	2.20	2.26	2.45	2.66	2.93	3.38	3.49
Savings-Investment (percent of GDP)										
External Savings	-4.4	-5.8	-6.6	-5.7	-7.7	-6.1	-5.2	-6.4	-3.7	-3.0
Domestic Savings	12.9	11.5	12.7	16.5	17.1	16.7	18.8	17.2	17.8	17.1
Domestic Investment	17.3	17.3	19.3	22.2	24.8	22.8	24.0	23.6	21.5	20.1
Overall Balance of Public Sector	-2.7	-3.4	-2.5	-1.8	-2.4	-0.4	0.8	-0.5	-3.0	-3.2
Overall Balance of Private Sector	-1.7	-2.4	-4.1	-3.9	-5.3	-5.7	-6.0	-5.9	-0.7	0.2
Private Savings	12.1	10.8	10.5	13.5	14.8	12.8	13.6	13.2	16.0	16.3
Private Investment	13.8	13.2	14.6	17.4	20.1	18.5	19.6	19.1	16.7	16.1
Monetary Indicators (percent of GDP)										
Total Liquidity	8.6	11.2	13.9	15.1	16.6	19.7	21.4	23.2	25.2	24.9
Private Sector Domestic Credit	5.5	7.8	9.9	11.3	14.0	18.0	21.3	25.8	27.9	26.0
Monetary Base (percentage change)	342.5	68.9	50.0	39.8	40.7	15.3	13.7	12.5	6.7	6.0

Note: * Excluding privatisation.

PHILIPPINES

REAL GROSS DOMESTIC PRODUCT

Gross domestic product (GDP) grew by 4 percent in 2000 despite political instability, an interest rate hike, high oil prices, and a global slowdown. The growth was 0.6 percentage points higher than in 1999 and approximated the government's growth target of 4 percent for the year.

Sectoral growths were fairly balanced. Favorable weather conditions complemented by agricultural productivity-enhancement programs contributed to the 3.3 percent expansion in agricultural output. The coconut industry finally shook the ill effects of the past El Niño–induced drought, while palay production benefited from the aggressive distribution of good-quality paddy rice seeds to farmers and the rehabilitation of major irrigation systems in the country.

Higher manufacturing output boosted expansion of the industrial sector, which grew 3.9 percent in 2000. The manufacturing subsector grew more than 6 percent during the first three quarters before leveling off during the fourth quarter to average a 5.6 percent increase during the year, compared to only a 1.6 percent increase in 1999. The expansion in manufacturing output was largely attributed to the rapid expansion of the electronics sector, which was buoyed by strong demand overseas and a gradual move by local firms in the design process, particularly during the first three quarters. Mining and quarrying and the utilities subsectors also showed some gains, but construction continued to fall as both public and private construction weakened further. The public sector has to cut back on capital expenditures to arrest its growing budget deficit.

The service sector continued its steady growth in 2000, posting a 4.4 percent increase, relative to a 4 percent gain in 1999. The sector remained the major source of growth, contributing 45.6 percent of total GDP growth. The upsurge in the transport, communication, and storage subsector — largely attributed to the phenomenal growth of subscribers and the increasing accessibility of internet and cable services — was the main catalyst for this growth. But real estate and financial services grew minimally during the year.

Personal consumption expenditures increased 3.5 percent in 2000 compared to 2.6 percent in 1999. The unexpectedly positive performance of the agriculture sector coupled with the increases in salaries and wages and the modest inflation rate contributed to an increase in household spending. The continued increase in overseas Filipino workers' remittances and the surge in property inflow in the fourth quarter further strengthened the purchasing power of households. On the other hand, government consumption fell by 1.1 percent, which was attributed to the government's prudent fiscal spending, which centred on expenditures focusing on basic social services. Real investment recovered from a 2 percent contraction in 1999 to a 2.3 percent expansion in 2000. This was largely driven by the 3.6 percent increase in durable equipment arising from significant investments in machineries for specialized industries, office machines, and data-processing and other miscellaneous durable equipment.

The combined effects of improved agricultural output, strong demand for electronics, and the peso depreciation spurred export performance (real terms), which grew 17.7 percent during the year. Real merchandise exports expanded 22.7 percent, from 8.7 percent in 1999, propelled by higher exports of agricultural and fishery products such as crude coconut oil, copra meal cake, banana and plantains, and prepared tuna, as well as petroleum naphtha, garments, and semiconductor and electronic microcircuits. Imports of goods and services recovered from a negative 2.8 growth in 1999 to a 4 percent increase in 2000, largely accounted for by the increase in merchandise imports, in particular mineral fuels and lubricants, electrical machinery, apparatus and appliances, and machinery other than electrical machinery.

INFLATION

The country's inflation rate was kept at a single-digit level despite increases in petroleum prices and electricity charges and the depreciation of the peso. The inflation rate averaged 4.4 percent in 2000 vis-à-vis 6.7 percent in 1999. Government efforts to keep a steady supply of food items, including the expansion of agriculture production, reduced food inflation from 5.1 percent to 1.9 percent, effectively offsetting the 6.9 percent non-food inflation in 2000.

EMPLOYMENT

The employment level fell by 1.04 percent in 2000—289,000 jobs less than in 1999. Employment in the agriculture sector declined 5.5 percent, a far cry from the 1999 level, when it posted a sharp recovery from the effects of the previous year's drought. The industrial sector remained in a slump at 1.3 percent, making services the only source of employment growth for the year, at 2.9 percent. This has brought the unemployment rate to a double-digit level of 11.2 percent, from 9.8 percent in 1999. About 3.46 million workers were unemployed in 2000.

There were some improvements in the quality of employment, as full-time waged employment managed to grow 1.9 percent. The number of wage and salary workers also went up 1.2 percent, while own account declined 0.2 percent. The number of unpaid workers also fell 11.4 percent.

TRADE ACCOUNT

Exports of goods and services (in nominal dollar terms) grew by 6.3 percent in 2000. Merchandise export growth slowed down sharply, from 19.1 percent in 1999 to 9 percent in 2000, marked by a weakening of the global electronics market, particularly during the second semester. On the other hand, total imports dipped 0.8 percent. Tepid investments and the peso depreciation slowed down import demand. As a result, the trade balance further improved, from US$4.96 billion in 1999 to US$6.92 billion in 2000.

EXTERNAL BALANCE OF PAYMENTS

Following the improvement in the trade balance, the current account position also improved. However, net capital outflows led to a balance of payments deficit of US$512 million in 2000. Net investments declined by 78.8 percent, with portfolio investments falling sharply from last year's level, as higher U.S. interest rates and the political uncertainty took their toll. Net foreign direct investments increased 11 percent. To encourage capital inflows, the government issued US$1.6 billion worth of bonds during the year.

At the end of 2000, net international reserves stood at US$11.35 billion, slightly lower than the US$11.76 level at end-1999.

EXCHANGE RATE

The Philippine currency (peso) was affected by both external and internal factors. The steady depreciation of the peso up to early October 2000 was a reflection of a strong U.S. dollar against some major regional currencies. The heightened political risks arising from the corruption allegations against the former president and the subsequent impeachment trial further pulled down the local currency. By end-2000, the peso almost reached the P50/US$ level. The peso averaged P44.19/US$ during the year, a depreciation of 13 percent.

In order to stabilize the currency market, the Bangko Sentral ng Pilipinas (BSP) (Philippine Central Bank) expanded the coverage of the Currency Risk Protection Program to help manage the strain on the spot market that resulted from demand pressures from borrowers covering for their immature foreign currency obligations.

The BSP also implemented the gradual unwinding of engineered swap holdings of banks to contain the pressures in the foreign exchange market. Furthermore, the BSP tightened oversight on foreign exchange corporations by instituting a P50 million capitalization requirement to curb excessive risk-taking of small foreign exchange players and by requiring these corporations to list, on a daily basis, the names of counter parties and other details on their purchases/sales worth US$250,000 and above for monitoring and correct record keeping, among other things. In addition, the BSP required a 90-day holding period for investments in time deposits, to curb speculation. To guard against money laundering, banks were required to report unusually large transactions and unusual transactions with no observable and lawful purpose.

FISCAL POLICY

Shortfalls in revenue generation and slight expenditure overrun widened the budget deficit to 4.1 percent of GDP in 2000, from 3.75 percent in 1999, exceeding government and the International Monetary Fund program target for the year. Revenue collections rose by 7.58 percent in 2000, compared to 3.4 percent in 1999, but fell below the government's program target of P566.95 billion for the year. Failure to meet revenue collection targets by the Bureau of Internal Revenue (BIR) and privatization targets was the primary cause of the shortfall. Proceeds from BIR reached only P360.8 billion, as against the targeted revenue collections of P397.76 billion. Likewise, proceeds from the privatization of the PSB, Philphos, and the International Broadcasting Corporation reached only P4.7 billion, as against the targeted revenue of P21.95 billion. Unfavourable market prices also hindered the government from disposing of its other assets.

The revenue performance was also affected by the slowdown in the financial and real estate activities, which resulted in a reduction in revenue collections from bank deposits, capital gains, and the documentary stamp tax. But corporate income tax collections and non-tax revenues improved compared to 1999 levels. Customs collections also exceeded targets as a result of intensified customs collection, anti-smuggling operations, and computerization of the Bureau of Customs.

Meanwhile, despite an excess of 3 percent over the programmed budgetary expenditure level, capital outlays declined by 4.8 percent, as can be gleaned from reduced public construction spending. Net lending likewise decreased by 17.5 percent.

MONETARY POLICY

Low levels of inflation enabled monetary authorities to reduce interest rates during the early part of 2000. Monetary policy, however, was tightened during most of the year in response to the increase in U.S. interest rates, the peso depreciation, a widening fiscal deficit, and emerging inflationary pressure. In the last quarter of 2000, the BSP raised its overnight borrowing and lending rates by a maximum of 400 basis points to 15 percent and 17.25 percent respectively, to arrest the volatility in the foreign exchange market and its possible impact on inflation. Following the relative calm in the foreign exchange market and more benign price pressures, the BSP gradually reduced its policy rates to the pre-political crisis levels of 10 percent and 12.25 percent. Meanwhile, the 91-day T-bill rate remained at less than 10 percent, although the differential between the short-term and longer-term maturities is wider because of inflationary expectations and anticipation of more domestic borrowing by the government to finance the fiscal deficit.

ECONOMIC OUTLOOK

In the first quarter of 2001, real GDP grew by 2.5 percent, slowing down from the 3.3 percent growth rate in the same quarter in 2000. Unfavourable political conditions and external factors continue to weigh down the economy. However, substantial net factor income inflows enabled the GNP to grow by 3.6 percent in the first quarter of 2001. The service sector remained a major source of growth, growing by 4.5 percent during the first quarter versus 4 percent in the same quarter last year.

Agriculture grew by 2.3 percent, boosted by increased production of crops, fishery, livestock, and poultry, while industry was hard hit by the slowdown in the United States and Japan, inching up by only 0.1 percent compared to the 4.4 percent rise in the first quarter of 2000.

Strong domestic demand offset the fall in net exports owing to the slowdown in the U.S. economy. GNP-boosted personal consumption was evident from the continued increased purchase of non-basic commodities such as cell phone services and household furnishings. Government spending also contributed to growth, proof that the responsible fiscal deficit-reduction program is working. As of the first semester of 2001, the fiscal deficit reached P79.6 billion, well within the programmed level. Investments grew minimally, while construction fell anew.

The modest growth in GNP in the first quarter appears more promising in the light of the employment performance. There was positive and significant job creation across all sectors, and unemployment in the first quarter of the year decreased by 0.6 percentage points versus unemployment during the same period in 2000. Consumer prices remain fairly stable, with the inflation rate averaging 6.7 percent during the first half of 2001.

The current account continued to be in surplus at US$1.01 billion in the first four months of 2001. This was brought about by the positive trade balance of US$902 million following a drop in merchandise exports and imports by 4.1 percent. The slowdown in the U.S. and Japanese economies as well as the downturn in the electronics business cycle continued to affect Philippine exports. Net outflows offset net inflows on account of higher repayment for maturing bonds and notes and lower reflows of currencies and deposits of residents with banks abroad. The balance of payments, as a result, yielded a deficit of $755 million for the first four months of the year, a reversal from last year's surplus position. As of end-May, the country's net international reserves stood at US$10.6 billion, while the local currency was pegged at 49.2 per the U.S. dollar.

In view of the first quarter performance and of the continued weakness in exports, GDP growth is conservatively projected at 3.3–3.8 percent. Merchandise exports are expected to grow at 0.1–0.6 percent. Total imports are expected to expand 3.0–3.5 percent. Industry is projected to grow only 1.8–2.3 percent owing to weaker growth in manufacturing and construction. A 2.5–3.3 percent growth in agriculture is expected given better prospects for certain crops. The service sector is projected to grow 4.8–5.2 percent on account of strong growth in transport, communication and storage, and private services. The inflation rate is expected to remain stable at between 6–7 percent during the year.

GOVERNMENT THRUSTS FOR 2001–04

Faced with domestic and external challenges, the government set out four major thrusts under the Draft Medium-Term Philippine Development Plan for 2001–04. These are stability and equitable growth, poverty alleviation and sustainable human development, agricultural modernization, and good and effective governance. In the pursuit of these goals, a number of strategies and policies have been identified.

Fiscal policy will focus on responsible budget-deficit reduction, while monetary policy will aim for price stability. A flexible exchange rate policy will ensure that competitiveness and capital mobility is encouraged toward financial market development. Policies will also be directed to strengthen commercial banking, equity, and bond market systems and to encourage provision of micro-finance and credit to self-employed and relatively small enterprises.

Stable economic growth will also entail the following: promotion of full, decent, and productive employment; continued implementation of market-oriented reforms including trade and investment liberalization; product and market diversification; acceleration of the development of information and communication technology; and development of human resources, promotion of tourism, and development of infrastructure.

Addressing the poverty problem will involve enhancement of capacities through health, education and housing; protection of vulnerable groups; reduction of regional disparities; and promotion of sustained peace and development in Mindanao.

Agricultural modernization will be promoted to increase the productivity and income of rural households. This should benefit, in particular, subsistence farmers and fishermen through research and development, full implementation of the Agriculture and Fisheries Modernization Act, and infrastructure development (like irrigation and farm-to-market roads). Strong support services to agrarian reform beneficiaries is also vital in attaining such objectives.

The government is also committed to helping reduce the cost of doing business through the implementation of simple, fair, transparent, and predictable rules, and to ensure consumer welfare through the institution of regulatory reforms. Decentralization of the national government will be pursued, while multisectoral partnerships with business and civil societies will be sustained to help facilitate the delivery of public goods and services.

Furthermore, the government recognizes the importance of international cooperation and will abide by its commitments reached in summits held under the auspices of the United Nations. In the area of regional and international economic cooperation, the government will uphold its commitments under the Association of Southeast Asian Nations (ASEAN) Free Trade Area-Comprehensive Effective Preferential Tariff (AFTA-CEPT), the Asia-Pacific Economic Cooperation (APEC), and the World Trade Organization (WTO).

Peace and order, and security against terrorists and external aggressors, are prerequisites to growth and development. In this regard, the government has restarted the peace process with the Moro Islamic Liberation Front and continues to implement the Government of the Republic of the Philippines–Moro National Liberation Front Final Peace Agreement. It has also initiated peace talks with the National Democratic Front. The administration is firmly committed to the acceleration of the professionalisation and modernisation of the Philippine National Police and the Armed Forces of the Philippines.

ANNEX 1

PHILIPPINES: OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000
GDP AND MAJOR COMPONENTS (percent change, year over year, except as noted)						
Nominal GDP (US$ million)	74,120	82,848	82,344	65,171	76,157	74,730
Real GDP	4.68	5.85	5.19	-0.59	3.4	4.01
Total Consumption						
Private Consumption	3.81	4.62	4.99	3.45	2.64	3.51
Government Consumption	5.56	4.13	4.63	-1.95	6.73	-1.13
Total Investment	3.50	12.46	11.70	-16.28	-1.98	2.26
Exports of Goods and Services	12.04	15.40	17.15	-21.03	3.62	17.68
Imports of Goods and Services	16.02	16.74	13.49	-14.70	-2.80	4.00
FISCAL AND EXTERNAL BALANCES (percent of GDP)						
Budget Balance	0.58	0.29	0.06	-1.88	-3.73	-4.06
Merchandise Trade Balance	-12.07	-13.69	-13.51	-0.04	6.51	9.25
Current Account Balance	-4.45	-4.77	-5.28	2.37	10.04	12.51
Capital Account Balance	4.58	13.37	8.01	0.73	-2.38	-9.16
ECONOMIC INDICATORS (percent change year over year, except as noted)						
GDP Deflator (percent change)	7.6	7.7	6.0	10.7	8.0	6.7
CPI (percent change) 1994=100	8.0	9.1	5.9	9.7	6.7	4.4
M2 (percent change)	25.2	15.8	20.5	8.0	19.3	4.8
Short-term Interest Rate (percent)	11.3	12.4	13.1	15.3	10.2	9.9
Exchange Rate (P/US$)	25.7	26.2	29.5	40.9	39.1	44.2
Unemployment Rate (percent)	9.5	8.6	8.7	10.1	9.8	11.2
Population (millions)	70.3	71.9	73.5	75.2	76.8	78.4

Annex II

PHILIPPINES: FORECASTING SUMMARY (percent change from previous year)

	2001				2002			
	Official	**IMF**	**Link**	**ADB**	**Official**	**IMF**	**Link**	**ADB**
Real GDP	3.3-3.8	2.5	2.9	3.1	4.3-4.8	3.5	4.0	4.2
Exports#	0.1-0.6	N.A.	-2.0	3.0	4.7-5.2	N.A.	3.5	8.0
Imports#	3.0-3.5	N.A.	4.0	5.0	6.2-6.7	N.A.	4.3	10.0
CPI	6.0-7.0	6.5	6.4*	7.0	5.0-6.0	5.7	5.5*	6.0

Notes: * Private consumption deflator.
Merchandise trade only.
N.A. Not available.

Sources: IMF forecasts, *The World Economic Outlook Database* (September 2001).
LINK forecasts, *Project LINK World Economic Outlook* (April 2001).
ADB forecasts, *Asian Development Outlook* 2001.

Annex III

PHILIPPINES: MEDIUM-TERM TREND FORECAST (percent)

	2001		2002		2003		2004		2005		2006		AVERAGE	
	Low	**High**	**Low**	**High**	**Low**	**High**	**Low**	**High**	**Low**	**High**	**Low**	**High**	**Low**	**High**
Real GDP	3.3	3.8	4.3	4.8	5.4	6.0	5.7	6.3	6.1	6.7	6.3	6.9	5.2	5.8
CPI	6.0	7.0	5.0	6.0	4.5	5.5	4.5	5.5	4.5	5.5	4.5	5.5	4.8	5.8

RUSSIA

2000 was the best year in a decade for the Russian economy. Almost all macroeconomic indicators marked significant economic growth: GDP, industrial production, fixed capital investment, external trade and real income per capita.

REAL GROSS DOMESTIC PRODUCT

GDP grew by 8.3 percent in 2000, with industry and construction as the main contributors to growth. The volume of industrial production in comparison with that in the previous year increased by 11.9 percent, agricultural production by 5 percent, construction by 11.5 percent, and transport by 10.6 percent. In 2000, total consumption and private consumption increased by 7 percent and 8.9 percent respectively.

INFLATION

In 2000, consumer price inflation declined in comparison with the previous year. In 2000, the inflation rate was 120.2 percent.

Prices in industry increased at a faster rate than consumer price inflation. In 2000, the rate of increase in prices in industry was 1.6 times that of consumer price inflation. The faster increase in prices in industry was influenced by increase in demand for domestic products, higher energy prices, and rising import prices.

EMPLOYMENT

Growth in the economy resulted in the improvement of the labour market situation. In the sphere of employment the main trend is the increase of the number of employed. The number increased from 63.8 to 65.0 million (or by 1.8 percent).

The number of unemployed people (calculated in accordance with the International Labour Organisation's methodology) fell from 12 percent of the economically active population in the beginning of 2000 to 9.6 percent by the end of the year.

The rate of officially registered unemployed decreased from 1.7 percent of the economically active population in the beginning of 2000 to 1.4 percent by the end of the year.

TRADE ACCOUNTS

The trade balance amounted to US$60.6 billion in 2000. Russia's foreign trade turnover was on a rising trend. In 2000, Russia's exports exceeded the previous year by 39.5 percent, and the growth of exports to distant foreign countries (42.8 percent) exceeded growth of exports to CIS countries (21.8 percent). Russia's imports increased by 13.5 percent. Import deliveries from distant foreign countries increased by 7.8 percent, while deliveries from CIS countries increased by 29.4 percent.

In 2000, inward foreign investments amounted to US$11 billion, 14.6 percent higher than in 1999. Of this total, the volume of foreign direct investment was US$4.4 billion in 2000, representing a 4 percent growth over 1999. The volume of foreign portfolio investments was US$145 million, marking an increase of 4.7 times over the level in 1999. The volume of other foreign investments was US$6.4 billion, 21 percent higher than the 1999 level.

GROSS EXTERNAL DEBT

In 2000, Russia's external debts totalled US$144.4 billion, which is less than the US$158.4 billion registered in 1999. The debt includes credits (US$90.8 billion) and securities (US$53.6 billion). The main part of the debt amounted to US$94.5 billion (65.4 percent of the gross external debt), which is the former Soviet Union debt.

According to the Paris Club Protocol, the bilateral agreements between Russia and its creditors (the Paris Club member countries) on the Russian external debt restructuring were signed. In 2000, Russia signed an agreement with its creditors — the London Club members. Under the conditions of the agreement, the restructured credits (PRINs) totalling US$22 billion with maturity in 2002–20, and bonds (IANs) totalling US$6.8 billion with maturity in 2002–15, were exchanged for external bonds totalling US$18.2 billion with maturity in 2030.

EXCHANGE RATE

In 2000, Russia pursued a floating ruble exchange rate policy. During the year the ruble exchange rate was stable.

Throughout 2000, the official exchange rate of the US dollar to the ruble fixed by the Bank of Russia increase by 4.3 percent, from 27 rubles per US$ to 28.16 rubles per US$. The index of the real exchange rate of the ruble to the US dollar (factoring the increase in prices for consumer goods) went up by 2.3 percent in the middle of the year.

FISCAL POLICY

Federal budget revenues in 2000 amounted to 16.2 percent of GDP. The major factors that determined the dynamics of the federal budget revenues were (1) an increase in industrial production and investments in fixed capital, (2) an enhancement in enterprises' financial conditions, (3) a favourable external economic conjuncture, (4) the absence of current debt on federal expenditures, and (5) an improvement increase in the overall performance of tax authorities. Federal budget expenditures totalled 13.7 percent of GDP in 2000. Primary profit amounted to 2.4 percent of GDP.

MONETARY POLICY

In 2000 monetary policy corresponded to the current tasks of economic growth. The gross international reserves increased, the outflow of capital fell, the stability of the national currency was ensured, and the interest rate decreased. The high positive foreign trade balance strongly influenced the money supply in 2000. As a whole, gross international reserves in 2000 increased by 124.4 percent, as compared with a mere 1.9 percent growth in 1999.

During 2000, the Bank of Russia lowered the refinancing rate five times, from 55 to 25 percent. In 2000, the money supply (M2) increased by 62.4 percent. The situation in the financial securities market remained stable. The interest rates of long-term government securities decreased from 70 percent at the beginning of the year to 25 percent in August. The rise in prices was substantiated by capital turnover, which stabilised at a high level.

MEDIUM-TERM OUTLOOK

The main goals of economic policy for the period up to the end of 2001 and 2002 are (1) the step-by-step recovery of the real income of the people and (2) the realisation of measures directed to reduce inflation and increase investment flows.

It is estimated that GDP will grow by 5 to 5.5 percent in 2001, industrial production by 5 percent, agricultural production by 3.5 percent, and investment in fixed capital by 6 percent. The rate of inflation will be at 17–18 percent.

Annex I

RUSSIAN FEDERATION: OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000
GDP and Major Components (percent change from previous year, except as noted)						
Nominal GDP (US$ billion)	338.3	418.8	428.5	282.4	193.2	251.1
Real GDP	-4.0	-3.4	0.9	-4.9	5.1	8.3
Total Consumption	-2.7	-3.1	3.0	-1.5	-2.4	7.0
Private Consumption	-2.8	-4.7	5.4	- 2.4	-4.4	8.9
Government Consumption	1.1	0.8	-2.4	0.6	3.0	1.6
Total Investment	-10.8	-20.6	-3.6	-28.7	8.5	17.3
Exports of Goods and Services	7.2	0.6	1.1	1.9	9.5	8.7
Imports of Goods and Services	8.1	-2.3	3.1	-13.6	-9.6	12.7
Fiscal and External Balances (percent of GDP)						
Budget Balance (federal)	- 5.4	- 8.1	- 7.7	-5.9	-1.1	2.5
Merchandise Trade Balance (f.o.b)	6.0	5.4	4.0	6.0	18.7	24.2
Current Account Balance	2.2	2.8	0.5	0.2	13.1	18.3
Capital Account Balance	- 0.1	- 0.1	- 0.2	-0.1	-0.2	-0.01
Economic Indicators (percent from previous year)						
GDP deflator	178.2	44.1	14.5	16.2	64.6	37.1
CPI	231.3	121.8	111.0	184.4	136.5	120.2
M2	225.5	130.7	129.8	119.8	157.2	162.4
Short-Term Interest Rate (percent)	168.0	85.8	31.5	39.9	31.3	-
Exchange Rate (rubles/US$)	4.563	5.129	5.787	9.705	24.620	28.128
Unemployment Rate (percent)	9.0	10.0	11.2	13.3	13.3	12.0
Population (millions)	148.3	148.0	147.5	147.1	146.7	144.8

SINGAPORE

REAL GROSS DOMESTIC PRODUCT

The Singapore economy grew a strong 9.9 percent in 2000, up from 5.9 percent in 1999. External demand remained the key locomotive of growth. Riding on the strong global demand, overseas demand for Singapore's goods and services surged 15 percent, more than doubling the 6.9 percent rise in 1999. Merchandise exports were propelled by electronics products, notably integrated circuits, capacitors, parts of office and data processing machines, and telecommunications equipment. The regional economic revival underpinned demand for Singapore's services exports, especially transportation, travel, and insurance services.

Domestic demand was also robust, rising 11 percent in 2000, extending the 5.3 percent expansion of a year earlier. Boosted by positive consumer sentiments and the rise in disposable incomes, private consumption expenditure rose 9.4 percent, up from 5 percent in 1999. The rebound in gross fixed capital formation, from -3.9 percent in the preceding year to a growth of 5.9 percent in 2000, was largely private-sector led, as private sector spending on construction projects emerged from the slump in the previous two years to post an increase of 3.6 percent. In addition, bolstered by the strong expansion in industrial and business activity, overall investment in machinery and equipment, notably office machines, telecommunications equipment, and machinery and tools used in production processes, surged 30 percent.

From the sectoral perspective, all key economic sectors saw higher growth compared to the previous year (see Annex III). The expansion was particularly strong in the export-oriented sectors of manufacturing and in wholesale and retail trade, with both expanding 15 percent in 2000. Although the construction sector continued to contract, the rate of decline was slower than in 1999.

INFLATION

Consumer prices rose somewhat in 2000 but remained modest. The consumer price index (CPI) increased 1.3 percent, after registering flat growth in 1999. Prices of most categories picked up, in line with the strong economic recovery and surging oil prices. Higher costs of housing, transport and communications, health, education, and miscellaneous items were responsible for the rise in the overall CPI in 2000. Producer prices also surged, in line with rising oil prices.

EMPLOYMENT

Singapore's labour market benefited from the strong economic growth in 2000. Rapid output expansion in most of the key industries, especially the manufacturing sector, contributed to the surge in employment creation. Employment is estimated to have expanded by 108,500, a sharp improvement over the gain of 39,900 in 1999. Retrenchments also fell significantly; 11,600 workers were displaced in 2000, representing a 60 percent drop over the record 29,100 retrenched in 1998, which was close to the level of displacement experienced just before the economic crisis in 1997–98. Consequently, the unemployment rate fell to 3.1 percent in 2000, from 3.5 percent in the year earlier. However, this was still higher than pre-crisis average of 2 percent.

EXTERNAL TRADE

Singapore's total external trade chalked up a sterling performance in 2000. Total trade soared by 23 percent, sharply higher than the 8.1 percent increase in 1999. This brought the level of total trade to a record high of $470 billion in 2000. The robust performance was largely driven by the strong global demand for semiconductors, as well as by buoyant demand from the major Asian countries. Total trade in volume terms exhibited a similar sharp rebound, expanding 16 percent in 2000 compared to 7.4 percent in 1999. Export volume rose 17 percent, with domestic exports and re-exports rising 10 percent and 27 percent respectively. Reflecting the healthy growth in domestic consumption and a continued surge in industrial activity, import volume expanded 15 percent in 2000.

GROSS EXTERNAL DEBT

As at end-December 2000, the Singapore government does not have any external debt.[1]

FISCAL POLICY

Fiscal policy seeks to create an environment that promotes a dynamic private sector, generates robust growth and employment, and advances the development of Singapore.

The focus of government expenditure is on the delivery of essential public goods and services, particularly in the key areas of education, housing, economic infrastructure, basic health care, and national security. As in previous years, the bulk of expenditure in 2000 was allocated to security (37 percent), and social and community services (35 percent). Economic services accounted for 23 percent of total expenditure.

On the revenue side, the taxation policy in 2000 continued to focus on enhancing our internationally competitive tax structure to encourage corporate and individual entrepreneurship. Supported by robust economic growth, the revenue raised was more than sufficient to finance both operating and development expenditure.

The budget surplus for fiscal year 2000 (1 April 1999–31 March 2000) is expected to come up to $3.5 billion, largely on the back of the strong rebound in the economy in 2000.

MONETARY POLICY

Monetary policy remained focused on price stability as a sound basis for sustained economic growth. After maintaining a neutral policy stance throughout 1999, the Monetary Authority of Singapore signalled a shift in monetary policy stance in July 2000, towards allowing a gradual and modest appreciation of the Singapore dollar on a trade-weighted basis.

EXCHANGE RATE

The Singapore dollar depreciated against the U.S. dollar and the yen but strengthened against the Euro and most of the regional currencies in 2000.

In the first half of 2000, the Singapore dollar's weakness against the greenback stemmed from a number of cross-border merger and acquisition activities, which led to large U.S. dollar purchases against the Singapore dollar. The weaknesses in regional currencies also played a role in dragging the Singapore dollar down in subsequent months. Nevertheless, the Singapore dollar strengthened towards the end of 2000, partly owing to the squaring of long U.S. dollar positions.

Overall, the Singapore dollar weakened 1.7 percent against the U.S. dollar in 2000, following a 1.3 percent depreciation in 1999. The Singapore dollar also fell 6.6 percent against the yen in 2000, following a depreciation of 14 percent the year before. In contrast, it strengthened 14 percent against the Euro and 4.9 percent against the sterling.

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[1] Further details can be found in the Singapore Department of Statistics' Information Paper, "Singapore's External Debt: Definition and 1998 Assessment" (January 2000).

The Singapore dollar strengthened against most of the regional currencies, with the exception of the ringgit and the Hong Kong dollar. The weakness in regional currencies was exacerbated by tensions in the Philippines and Indonesia. As a result, the Singapore dollar appreciated 5.2 percent against the rupiah, 4.2 percent against the baht, and 11 percent against the peso. In contrast, the Singapore dollar weakened 4.9 percent against the New Taiwan dollar and 6.6 percent against the Korean won.

INTEREST RATES

Domestic interest rates remained relatively stable throughout 2000, although they edged up slightly towards year-end. Singapore's three-month interbank rate rose from 2.5 percent at end-January to 2.75 percent in May as interest rates in the United States increased. It subsequently eased back to 2.5 percent in June but climbed steadily to 2.69 percent in October and to 2.81 percent in December, as money market participants sought longer-term funding to tide themselves over the end of the year. The differential between the domestic benchmark rate and the three-month US$ SIBOR reached close to historical highs as it widened to above 400 basis points during the period between May and October 2000. This large interest rate differential reflected the tightening monetary policy stance adopted by the U.S. Federal Reserve, coupled with expectations that domestic interest rates would remain low. Nevertheless, since October, the differential had narrowed to 358 basis points at the end of December 2000, as the US$ SIBOR rate eased to 6.39 percent at year-end.

MONEY SUPPLY

Growth of narrow money slowed sharply in 2000, while broad monetary aggregates registered declines. Narrow money, M1, saw a moderated growth of 7 percent in 2000, compared with 14 percent in the previous year. This was due to a slower increase in demand deposits, as well as to a 0.1 percent decline in currency in circulation at the end of the year. Broad money aggregates, M2 and M3, had also been on the decline since August, falling by 2.1 percent and 1.8 percent respectively, reflecting shrinkage in both fixed and savings deposits.

The decline in broad monetary aggregates was rather unusual in view of the brisk economic expansion. This could reflect the declining role of banks in intermediation and increased consumption, rather than tighter monetary conditions.[2] Monetary conditions in Singapore had not altered significantly since mid-1999, with interest rates and levels of reserve money remaining basically unchanged. However, funds that flowed into bank deposits during 1997–98 had reversed as the improved economic outlook and lower deposit rates encouraged residents to turn to other investments such as unit trusts and investment-linked insurance products.

OUTLOOK FOR THE SINGAPORE ECONOMY

After the strong expansion of 4.8 percent in 2000, global economic growth is expected to moderate to 3.2 percent in 2001. The major economies have decelerated sharply in the first half of 2001. The global electronics industry is also in a severe downturn. Semiconductor demand this year is expected to drop significantly. A slump in electronics demand will dampen Asia's growth in 2001, given the high share of electronics output in some Asian countries.

The United States economy has slipped further from the 1.3 percent in the first quarter of 2001 to 0.7 percent in the second quarter, as companies continue to run down inventories. The Japanese economy is near recession, having contracted by 0.2 percent in the first quarter of 2001 and

[2] Please refer to Monetary Authority of Singapore's Quarterly Bulletin for December 2000 on the MAS website for further details.

consumer and business sentiments remain weak. The EU economies have also weakened considerably, led by the slowdown in Germany. The EU is now expected to grow by 2.5 percent this year, down from the earlier projection of 2.8 percent. The slowdown in the major economies will have an impact on the regional countries and indirectly dampen our exports to these economies. Our hub services, which are more regionally oriented, will also be affected.

Taking the above factors into account, the 2001 growth is expected to be in the range of 0.5 to 1.5 percent. The final outcome will depend on how soon and how strongly the United States economy and the electronics industry rebound in the second half of the year.

STRATEGIES AND STRUCTURAL CHANGES UNDERTAKEN TO STRENGTHEN MARKETS

Free Trade Agreements

Singapore is one of the strongest supporters of the multilateral trading system under the World Trade Organization (WTO). It is hoped that a New Round can be launched at the fourth WTO Ministerial Conference in Qatar at the end of the year. In the meantime, Singapore will push the envelope of free trade through bilateral Free Trade Agreements (FTAs). Singapore is a member of AFTA and recently concluded an FTA with New Zealand. It is now negotiating with the United States, Japan, Mexico, EFTA and Australia. We have also begun exploratory talks on a possible FTA with Canada.

Technopreneurship

To build a conducive environment in Singapore for engaging in technology-intensive activities and supporting the creation of knowledge enterprises, the Technopreneurship 21 (T21) initiative was launched in April 1999. Various funds were established to create a vibrant network of venture funds and to cultivate talent to assess intellectual property, manage risks, and provide industry contacts. Some regulations, like bankruptcy provisions, were revised to create a business environment that is more tolerant to failure. A science hub, close to the universities and research institutes, was conceived to be a technoprenuerial hotbed where talents can congregate.

Science and Technology

In 2000, the Science & Technology (S&T) 2005 Plan for the next five years was launched. A key thrust of the S&T plan is to support industry research and development (R&D). For every dollar spent by the government on R&D, three dollars from the industry partners were attracted. For example, from 1996 to February 2001, while the government invested some S$1.3 billion for industry R&D, the private sector invested S$3.7billion. This is an important market discipline to ensure that public R&D funds go into economically relevant pursuits. Going forward, more than S$2 billion of the S&T 2005 Plan will be allocated for this purpose. The target is for private sector research to account for two-thirds of Singapore's overall expenditure on R&D by 2005.

Life Sciences

Singapore is pushing on with its life sciences effort as a long-term undertaking. Although the life sciences industry has a long gestation period, and success cannot be guaranteed, the industry holds tremendous potential. The industry will be developed through three key thrusts: the development of manpower capabilities, R&D, and industry development (by establishing world-class infrastructure and building a vibrant start-up environment).

Liberalisation of the Electricity and Gas Industries

The new competitive electricity and gas markets, which allow competition in the generation and retail sectors and full customer choice, will open by the end of 2001. There will be no foreign ownership restriction imposed on the divestment of the generation companies. The electricity and gas grids, which are natural monopolies, will be tightly regulated. The Energy Market Authority of Singapore (EMA) is the authority responsible for regulating the electricity and gas industries. The EMA will also regulate the monopoly providers of district cooling services.

Annex I

SINGAPORE: OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000
GDP and Components (percent change, year over year, except as noted)						
Nominal GDP (US$ million)	83,088	90,916	94,442	82,137	83,846	92,257
Real GDP	8.0	7.6	8.5	0.1	5.9	9.9
Total Consumption	4.4	9.7	6.2	-0.8	5.2	10.3
Private Consumption	3.0	7.6	6.0	-2.9	5.3	9.4
Government Consumption	11.7	19.3	7.1	8.0	5.0	13.7
Total Investment	11.8	23.1	9.6	-6.4	-3.9	5.9
Private Investment	14.6	27.3	7.0	-9.9	-6.1	8.6
Government Investment	1.7	5.7	22.3	8.4	4.1	-2.9
Fiscal and External Balances (percent of GDP)						
Budget Balance	6.2	6.1	1.1	2.4	2.5	3.5
Merchandise Trade Balance	1.2	2.4	1.2	18.0	13.3	12.4
Current Account Balance	17.4	15.3	19.0	24.8	25.9	23.6
Capital and Financial Account Balance	-5.8	-5.9	-11.8	-26.8	-22.0	-12.5
Capital Account Balance	-0.1	-0.2	-0.2	-0.3	-0.2	-0.2
Finance Account Balance	-5.7	-5.7	-11.6	-26.6	-21.8	-12.4
Economic Indicators (percent change year over year earlier period, except as noted)						
GDP Deflator	2.2	1.1	0.8	-2.0	-2.4	1.8
CPI	1.7	1.4	2.0	-0.3	0.0	1.3
M2	8.5	9.8	10.3	30.2	8.5	-2.1
Short-term Interest Rate	3.41	3.41	4.10	1.72	1.68	1.70
Exchange Rate (S$/US$)	1.42	1.41	1.48	1.67	1.69	1.72
Unemployment Rate (percent)	2.0	2.0	1.8	3.2	3.5	3.1
Population (millions)	3.5	3.7	3.8	3.9	4.0	4.0

Annex II

SINGAPORE: FORECASTING SUMMARY (percent change from previous year)

	2001				2002		
	Official	**IMF**	**ADB**	**Asia-Pacific Consensus**	**IMF**	**ADB**	**Asia-Pacific Consensus**
Real GDP	0.5-1.5	-0.2	5.0	-0.3	4.0	6.0	4.9
CPI	1-2	1.5	1.5	1.6	1.7	2.0	1.7

Sources: IMF forecasts, *The World Economic Outlook Database* (September 2001).
ADB forecasts, *Asian Development Outlook* 2001.
Asia-Pacific Consensus, *Asia-Pacific Consensus Forecasts* (13 August 2001).

Annex III

SINGAPORE: SECTORAL GROWTH (year-on-year; percent)

Sector	**1999**	**1Q00**	**2Q00**	**3Q00**	**4Q00**	**2000**
Total	**5.9**	**9.8**	**8.4**	**10.3**	**11.0**	**9.9**
Goods-Producing Industries	7.1	6.5	8.9	11.0	13.7	10.1
Manufacturing	13.6	13.2	13.2	15.2	18.8	15.2
Construction	-8.8	-10.9	-3.9	-1.1	-1.9	-4.6
Services-Producing Industries	4.5	10.4	7.2	9.2	8.7	8.9
Wholesale and Retail Trade	7.1	17.3	15.3	15.4	13.1	15.2
Hotels and Restaurants	4.0	10.7	6.8	9.9	5.6	8.2
Transport & Communication	7.1	9.9	9.7	9.5	6.8	9.0
Financial Services	0.8	11.6	-4.0	3.1	7.5	4.1
Business Services	1.5	5.2	6.5	7.4	7.1	6.6

Source: Singapore Department of Statistics

CHINESE TAIPEI

REAL GROSS DOMESTIC PRODUCT

The Chinese Taipei economy grew strongly during the first three quarters of 2000, thanks largely to robust foreign demand. However, as the global economic expansion moderated in the fourth quarter, foreign demand turned weak and the continued sliding of the domestic stock market and its negative effect on equity wealth discouraged domestic demand. Despite the slowdown in the fourth quarter, real gross domestic product (GDP) growth registered 6 percent for the whole year, with gross national product (GNP) and per capita GNP registering at US$314.4 billion and US$14,216 respectively.

Private consumption, private investment, and foreign demand were the major forces driving the Chinese Taipei economy in 2000, contributing 3.4 percentage points, 2.1 percentage points, and 1.7 percentage points respectively to the overall growth. Private consumption rose by 5.6 percent, boosted by optimistic expectations about the presidential election, the launch of new telecommunications and Internet products, and an upsurge in local tourism. Private investment grew by 13.7 percent, reflecting vigorous expansion in the semiconductor and opto-electric industries.

In real terms, exports of goods and services registered a 17.3 percent growth, led by a worldwide boom in information technology, the continued expansion of the U.S. economy, and the strengthening recovery of the European and Asian economies. Imports increased by 14.9 percent, fuelled by strong domestic investment and increased demand for raw materials for export production.

INFLATION

Although rising international oil prices and the booming world economy generated upward pressure on domestic prices, the rising exchange value of the domestic currency produced an opposite effect and helped keep the increase in wholesale prices to a modest 1.8 percent. Consumer prices rose by only 1.3 percent, kept down by the stability of food prices, building rentals, and service-sector wages.

EMPLOYMENT

The labour market has seen rising unemployment in recent years as industries cut hiring as a result of changes in comparative advantage, management reorganization, and production automation. In the first three quarters of 2000, the labour market generally reflected the overall expansion of the economy, and the unemployment rate was down from the previous year. But as the economy lost momentum in the fourth quarter, the unemployment rate rose again to reach an average of 3 percent for the whole year. The manufacturing industry and the wholesale, retail, and restaurant sector saw the largest gains in new jobs, while construction posted a decline in employment.

Monthly earnings of labour increased by 2.5 percent, the lowest level ever recorded. Labour-management disputes heightened as the number of factory closures increased. Most affected were low-skilled workers, such as machine and equipment operators and manual labourers. Workers with a junior-high-school education or less accounted for 34.6 percent of the unemployed, and those in the 45-to-64-year-old age group accounted for 15.1 percent.

EXTERNAL TRADE ACCOUNT

Driven by the global upswing and strong demand for information technology products in the international market, Chinese Taipei's exports rose by 22 percent in 2000. This was the highest growth rate in 13 years, and an all-time high for the customs-tallied aggregate export value of US$148.3 billion. High-tech products accounted for 55.8 percent of total exports, up from 52.6 percent in 1999. Imports in value terms increased by 26.5 percent to US$140.0 billion, driven by a surge in the purchase of capital equipment and higher international prices of oil and certain industrial raw materials and finished goods. Exports and investment expansion induced demand for imported raw materials and capital goods. The goods trade balance showed a surplus of US$8.3 billion for the year.

Trade in services grew steadily in the 1990s. In 2000, it accounted for 14.4 percent of trade in goods and services, down a little from 15.5 percent in 1999 as trade in services expanded less rapidly than trade in goods. Services exports in 2000 increased by 17.8 percent to US$20.3 billion, with exports of trade-related services growing by 33.3 percent. Trade-related services have become the key component of services exports since 1997, as global logistics activities by domestic industries have gained increasing importance. Services imports grew by 10 percent, to US$26.9 billion, with travel services accounting for the lion's share of the total. For the year, trade in services posted a deficit of US$6.5 billion.

The current account balance recorded a surplus of US$8.9 billion and the capital account a deficit of US$0.29 billion. The current account surplus as a percentage of GNP increased slightly to 2.9 percent. The financial account in the fourth quarter recorded a net outflow at the highest quarterly level in history, spurred by a widening spread between domestic and foreign interest rates and an expectation of devaluation of the domestic currency. For the year, the financial account displayed a net outflow of US$8.02 billion. The overall balance of payments posted a surplus of US$2.48 billion thanks to a sizable current account surplus. The overall balance of payments surplus was much smaller than the previous year's.

For the first quarter of 2001, the current account registered a surplus of US$3.9 billion, up from US$1.4 billion a year earlier. The widening surplus was attributable to an increase in merchandise trade surplus and a decrease in services deficit. The capital account exhibited a deficit of US$0.06 billion. The financial account reversed the trend of the last three quarters to record a net inflow of US$2.1 billion, mainly due to net inflows of foreign direct investment and portfolio investment.

EXCHANGE RATE

The exchange rate of the New Taiwan (NT) dollar against the U.S. dollar strengthened to NT$30.302 in April 2000. It then weakened to over NT$33, first because of a strengthening U.S. dollar, then owing to negative reports on several domestic economic events. The devaluating pressure continued as deposits in foreign currencies mounted as a result of the widening spread between domestic and foreign interest rates. To contain the pressure and maintain adequate foreign currency liquidity in the banking system, the central bank imposed a 5 percent reserve requirement on newly-taken foreign currency deposits with the domestic banking units of financial institutions in early December and this was further raised to 10 percent in late December. The currency then rebounded slightly to NT$32.992 at the end of the year, a depreciation of 4.8 percent from a year earlier.

In the first half of 2001, the NT dollar first rose to NT$32.271 against the US dollar then weakened amid the depreciation of the Japanese yen and the slowdown of the domestic economy. At the end of June, it fell to NT$34.435 against the US dollar, depreciating by 4.19 percent from the end of 2000.

FISCAL POLICY

Government revenues totalled NT$1,854 billion in 2000, marginally down by 0.3 percent from the previous year. Government expenditure fell by 4.3 percent to NT$2,313.2 billion. As a result, the fiscal deficit fell by 17.7 percent to NT$459.2 billion.

Tax revenues fell for the second consecutive year owing to a series of tax cut measures, including a reduction in the business tax rate for financial and insurance services. Tax revenues as a percentage of GNP stood at 13.8 percent, the lowest level on record. The ratio of tax revenue to government expenditure shrank gradually in the 1990s, reaching 59 percent in 2000, with a corresponding lessening of the tax burden.

Government revenues were expected to be boosted with the planned acceleration of government stock sales as part of the privatisation process of public enterprises. However, the process was delayed repeatedly owing to resistance to privatisation. The budget deficit then was met with public debt, resulting in higher dependency of government expenditure on debt. To avoid further worsening of the fiscal deficit, the government has laid out plans to improve the tax system and public property management, step up government reorganization, and encourage private participation in public projects.

MONETARY POLICY

Upward pressure on prices continued in the first half of 2000 as economic expansion accelerated and as international prices of energy and raw materials kept climbing. To prevent further buildup of inflationary pressure, the central bank twice raised the rediscount rate by 0.125 percentage points, once in March and once in June. However, indications of deceleration of economic expansion emerged in the second half of the year, after several quarters of recession in real estate and downshifts in the stock market. Meanwhile, some traditional industries encountered internal financial difficulties and tightening credit conditions. In a move to encourage bank lending and stimulate traditional industries, the central bank began paying an extra 0.8 percentage point interest on bank's required reserves. To further ease lending, the bank lowered reserve ratios of checking deposits and time deposits by 1.5 percentage points and 0.75 percentage points, respectively, in October, and raised the reserve ratio of savings deposits by 1 percentage point. The weighted average required reserve ratio declined to 6.29 percent at the end of the year. As signs of recovery did not appear with the year-end approaching, the bank then cut the rediscount rate by 0.125 percentage points to keep the money supply at ease.

Interest rates moved little and remained low in 2000. The one-year time deposit rate remained at around 5 percent throughout the year, while the basic lending rate stayed at around 7.2 percent. Both rates represent the lowest level since 1986.

The money market remained at ease through the first four months of the year but began to tighten in May as interest rates rose in the United States and bank lending tended towards conservatism in response to a flurry of financial scandals and ongoing instability in the stock and foreign exchange markets. As a result, the overnight call-loan rate moved upward from 4.61 percent early in the year to 4.80 percent in September before settling back slightly to 4.72 percent in December.

The overdue loan ratio continued to hit record levels in 2000. Several factors contributed to the rise from 5.86 percent in the first quarter to 6.20 percent in the fourth quarter, in particular 1) financial unease in some business sectors, 2) increasing difficulty in liquidating collateral owing to the continued decline in the real estate market, and 3) weakening debt-repaying ability owing to the business slide throughout the economy.

The annual growth of broad money supply M2, measured on a daily average basis, was 7.04 percent in 2000, lower than the preceding year's 8.33 percent. The expansion is largely attributable to an increase in net foreign assets, followed by financial institutions' claims on government and those claims on public and private enterprises. The M1B narrow measure of money supply posted a growth rate of 10.58 percent, the highest in three years. The increase was driven by a surge in stock market transactions in the first quarter. Subsequently, M1B growth declined month by month in tandem with the falling stock market index, to just 0.37 percent at the end of the year.

With inflationary pressure remaining subdued through the first half of 2001, the central bank continued an easy monetary policy to boost the domestic economy amid a global slowdown. The discount rate was reduced six times to a record low of 3.5 percent by the end of June. Both long-term and short-term interest rates have come down accordingly, further reducing cost of funds for businesses.

MEDIUM-TERM OUTLOOK

A deceleration of the economy is expected in 2001. The moderation of global economic expansion will lead to softened foreign demand for Chinese Taipei exports, in particular for information technology products. At the same time, imports will increase much more slowly, owing to the combined effect of falling private purchase of capital equipment, already past its peak; weakening performance of the domestic economy; and slackening export-induced demand. Both exports and imports of goods are forecast to see a marked decrease by 14.9 percent and 19.1 percent respectively, from 22 percent and 26.5 percent in 2000. Exports of goods and services in real terms will shrink 6.2 percent and imports 9.8 percent.

The effects of reductions in equity wealth and widening structural unemployment on consumer confidence will lead to slower growth of private consumption, estimated to be 1.7 percent in 2001. Despite large-scale investment in several ongoing projects such as the high-speed railway, fixed-line networks, and independent power plants, private investment will be dampened by the waning vigour of the global economy. In real terms, it is expected to decline by 14.6 percent.

As the government cuts back outlays for general purchase and military development, government consumption will shrink 1.9 percent in 2001. Though plans were made to step up government investment as part of the effort to create employment opportunities and stimulate the domestic economy, implementation has been slower than expected. Consequently, public investment slipped by 2.7 percent in the first half of 2001, while its growth for the year is forecast at 3.1 percent in real terms. Investment by public enterprises will increase by 0.9 percent, with a major contribution from electric power infrastructure development.

In sum, the economy is forecast to contract by 0.4 percent in 2001. The global and domestic economic slowdown, together with tariff reductions under Chinese Taipei's WTO accession commitments, will help keep prices stable. Moreover, as the real estate sector has yet to show any signs of recovery, rent increases will be limited and the price levels of services held steady. Consumer prices and wholesale prices are expected to increase 0.4 percent and decrease 0.4 percent, respectively. The continued rise of oil prices will not have a significant, direct impact on the domestic economy, but it may be affected indirectly, however, if oil prices continue to climb to a level that will significantly depress the world economy.

Annex I

CHINESE TAIPEI: OVERALL ECONOMIC PERFORMANCE

	1995	1996	1997	1998	1999	2000
GDP and Major Components (percent change, year over year — earlier period, except as noted)						
Nominal GDP (level in US$ billion)	264.90	279.60	290.20	267.15	287.88	310.13
Real GDP	6.42	6.10	6.68	4.57	5.42	5.98
Consumption	5.14	6.56	6.99	6.06	3.13	4.92
Private Consumption	5.63	6.53	7.26	6.52	5.37	5.55
Government Consumption	3.15	6.66	5.87	4.12	-6.49	1.87
Investment	7.31	1.66	10.65	8.01	1.78	7.75
Private Investment	11.37	3.44	18.56	11.80	-0.68	13.68
Government Investment	3.21	-0.31	0.48	0.09	3.64	-3.49
Exports of Goods and Services	12.34	6.74	9.08	2.41	11.90	17.33
Imports of Goods and Services	9.78	6.03	13.74	6.34	4.41	14.86
Fiscal and External Balances (percent of GDP)						
Budget Balance (percent of GNP)	-2.90	-1.70	-2.40	1.20	0.50	-1.20
Merchandise Trade Balance	5.00	6.27	4.78	3.86	5.23	4.52
Current Account Balance	2.07	3.91	2.43	1.29	2.91	2.87
Capital Account Balance	-0.25	-0.23	-0.11	-0.07	-0.06	-0.09
Economic Indicators (percent change, year over year — earlier period, except as noted)						
GDP Deflator	2.02	3.11	1.68	2.64	-1.42	-1.61
CPI	3.68	3.07	0.90	1.68	0.18	1.26
M2	11.60	9.20	8.30	8.80	8.30	7.00
Short-Term Interest Rate (percent) Money Market Rate	7.03	5.94	6.84	6.89	5.12	5.06
Real Effective Exchange Rate (level, 1997=100)	101.65	98.57	100.00	93.10	89.33	92.38
Unemployment Rate (percent)	1.79	2.60	2.72	2.69	2.92	2.99
Population (millions)	21.22	21.39	21.58	21.78	21.95	22.13

Annex II

CHINESE TAIPEI: FORECAST SUMMARY (percentage change from previous year)

	2001				2002			
	Official	**IMF**	**Link**	**ADB**	**Official**	**IMF**	**Link**	**ADB**
Real GDP	-0.37	-1.0	4.9	5.1	4.16	4.0	5.8	5.8
Exports of Goods and Services — Real	-6.2	N.A.	5.1	N.A.	N.A.	N.A.	8.1	N.A.
Imports of Goods and Services — Real	-9.8	N.A.	4.0	N.A.	N.A.	N.A.	5.9	N.A.
CPI	0.4	0.1	1.6*	1.7	1.1	0.8	1.6*	1.8

Note * Private consumption deflator.
N.A. Not available.

Sources: IMF forecasts, *The World Economic Outlook Database* (September 2001).
LINK forecasts, *Project LINK World Economic Outlook* (April 2001).
ADB forecasts, *Asian Development Outlook* 2001.

Annex III

CHINESE TAIPEI: MEDIUM-TERM TREND FORECAST (percent)

	2001–04 average
Real GDP	6
CPI	<2.0

THAILAND

ECONOMIC OUTLOOK IN 2001

The Thai economy is expected to grow at 2–3 percent in 2001, more slowly than it did in 2000. There are several threats to the Thai economy, including the slowdown in the world economy, which has grown at a rate of 2.2–3.2 percent in 2001, down from a 4.7 percent growth rate in 2000. The slowdown in the world economy is due to the downturn of the US business cycle and to the fragility of the Japanese economy. Other factors contributing to the slowdown are higher oil prices in the first half of 2001 and the lingering bear stock market. The deteriorating external environment has been an obstacle to Thai exports since the beginning of the year.

However, on the bright side, the Thai economy is experiencing a relatively low level of inflation. It will be possible to maintain the inflation rate in target range of 0–3.5 percent, as set by the Bank of Thailand. The low interest rate may also persist through next year because the liquidity in the money market is still high, and there is no pressure from the relatively low inflation rate. The existing low interest rate is at a comfortable level, since the Federal Reserve Bank may reduce the Fed funds rate further to prevent the US economy from experiencing a hard landing.

Other positive factors for Thailand are the implementation of stimulus packages by the new government, and the progress that has been made in the area of debt restructuring, which has reduced the amount of non-performing loans since 2000. The transfer of debts from banks to asset-management companies will allow financial institutions to expand credits better next year. Given the improved trend for agricultural products, the agricultural cycle will start to be on the upswing in 2001.

REAL GROSS DOMESTIC PRODUCT

In the first quarter of 2001, the Thai economy grew at the rate of 1.8 percent. This slow growth was attributed largely to a slowdown of the world economy which caused their real exports to decrease 2 percent. In addition, domestic demand was relative weak. Total consumption increased 2.7 percent only, whereas total investment decreased 5 percent. As the external environment deteriorates, the real gross domestic product (GDP) is expected to grow at the rate of 2-3 percent in 2001, lower than the growth rate in 2000. External demand will be limited by a slowdown in the world economy. The pressure of surging oil prices on production costs will become more pronounced.

Private consumption will increase 3.5–3.7 percent in 2001 because of the lack of a strong supporting factor. The government will need to implement an expansionary fiscal policy to boost the economy in the future. Government consumption and government investment at constant prices are expected to grow at the rate of 4.8 percent and 2.6 percent respectively.

However, the economy is expected to pick up as the fiscal stimulus packages become effective in the remaining of this year. Private investment is expected to expand at the rate of 5.1–9.4 percent.

INFLATION

In the first quarter of 2001, headline inflation recorded 1.4 percent, amid increases in retail oil prices, cooking gas prices, and electricity charges. Core inflation, excluding raw food and energy items, was 1.0 percent, which remained within the inflation target range of 0.-3.5 percent.

Headline inflation in 2001 is expected to be 2.2 percent, slightly higher than it was in 2000 as a result of increasing agricultural prices, electricity costs, capacity utilisation, and the average exchange rate.

However, owing to the decreasing pressure of volatile oil prices combined with the economic slowdown, it is now less likely that core inflation will move out of the target range of 0–3.5 percent in 2001-02.

Core inflation for 2001 is estimated to be 1.5-2 percent with 79 percent probability, increasing from 50 percent in the October forecast. In 2002, core inflation is projected to be 1.5–3 percent with 86 percent probability.

EMPLOYMENT

In the first quarter of 2001, the labour force expanded 1.1 percent whereas the number of persons employed increased by 0.9 percent, reflecting the inability of the labour market to absorb new labour entries. Thus, the unemployment rate rose to 4.8 percent. However, the unemployment rate is expected to fall as the government policies at the grass-roots level become effective in the second half of the year.

EXTERNAL TRADE ACCOUNT

Thailand's exports continued to grow in 2001, but more slowly than in 2000. A slowdown in the world economy will result in increased worldwide competition in 2001, while the implementation of non-tariff barriers (for example, health standards and environment standards) will be more pronounced.

Because it appears that imports will grow faster than exports, Thailand's trade surplus in 2001 is expected to be reduced to US$2.1 billion. The current account in 2001 will have a surplus of US$4.2 billion, or 3.7 percent of GDP, down from 6.7 percent in 2000.

GROSS EXTERNAL DEBT

Total external debt continued to decline as a result of an increase in private external debt repayment. External debt at the end of the first quarter of 2001 declined to US$75.6 billion, Private external debt declined to US$43.8 billion, whereas public external debt declined to US$31.8 billion.

EXCHANGE RATE

The average currency exchange rates of the baht were 37.96 and 40.30 baht per US dollar in 1999 and 2000 respectively. The exchange rate continued to depreciate in the first half of this year. In 2001 the baht is expected to further depreciate for the following reasons:

- The Thai economy in 2001 has shown signs of recession; the growth rate of the GDP is expected to be at 3.5–4 percent, slower than the 4.7 percent growth in 2000. This is because expansion in domestic consumption has been sluggish.

- Financial intermediaries are in a paradox of high liquidity, although there are still restrictions on loanable funds since their non-performing loans are still worrisome.

- The reduction in Thai exports resulting from the downturn in the US economy affected the volume of trade surplus. In addition, trade barriers in the European Union and fierce competition are other factors. Meanwhile, the value of imports has been increasing.

However, because of the economic slowdown in the United States the Federal Reserve will tend to implement a more relaxed monetary policy. Consequently, US investors might transfer capital to invest in the Thai securities market, and this would somewhat defend the depreciation of the baht.

FISCAL POLICY

The government has used the stimulus fiscal policy continuously from 1999, and since then it has been become the main tool running the economy. In 2001, fiscal policy is expected to take on an even more important role. The government has announced that it will implement an intensive stimulus fiscal policy on the following projects:

- Reallocating government budgets of fiscal year 2001 to projects that generate more income in the economy.
- Increasing the budget expenditure of fiscal year 2002 to help boost the economy.
- Maintaining the VAT rate of 7 percent until September 2003 to keep people's purchasing power.
- Establishing the Village and Urban Revolving Fund, for people to borrow for local investment and supplementary vocations.
- Establishing a 3-year farmers' debt suspension scheme to relieve farmers' debt burden.
- Promoting exports by searching for new markets and facilitating trade negotiation via newly appointed Thai Trade representatives.
- Launching measures to promote tourism
- Increasing the excise tax on luxury goods such as alcoholic beverages and tobacco products.

MONETARY POLICY

The Thai government has successfully brought inflation down and has sought to move the currency exchange rate in a direction that coincides with the concurrent economic fundamentals basis. The government has also helped commercial banks reduce their operating costs, enabling them to reduce the interest rate.

Subdued inflation allow the Bank of Thailand to use an accommodative monetary policy to support economic recovery. Recently, the Bank of Thailand raised the 14-day repurchase rate from 1.5 percent to 2.5 percent to correct for the distortion in the interest rate structure. Moreover, in order to reduce the excess liquidity in the banking system, the government has implemented measures to promote banks' lending as follows:

- Accelerating NPLs restructuring and debt restructuring through the centralized Thai Asset Management Corporation (TAMC).

- Establishing the Peoples Bank Scheme to improve access to banking facilities for low-income citizens.
- Establishing the Bank for SMEs to promote banking facilities for SMEs.
- Accelerating public financial institutions to expand credits to SMEs.
- Improving the operation of the Credit Insurance Corporation for Small Enterprises to support banks' lending.

MEDIUM-TERM ECONOMIC OUTLOOK

The government continues its prudent macroeconomic policy to revive the economy and lays down a firm foundation for sustainable growth and economic stability. The objective is to achieve a moderate growth rate of 5.0–6.0 percent per annum. The inflation rate is expected to be around 2.6 percent, well within the target set by the Bank of Thailand. The current account surplus is estimated at 1–2 percent of GDP.

	2002	**2003**	**2004**	**2005**	**2006**
GDP Growth (percent)	4.0	5.3	5.6	6.0	6.0
GDP (billion baht) at current price	5,454	5,879	6,361	6.908	7,502
Inflation (percent)	2.6	2.6	2.6	2.6	2.6
Current account (percent of GDP)	1.9	1.6	1.3	0.8	0.4
Export (Target) (percent)	6.5	7.2	8.0	8.7	8.7
Export (Trend) (percent)	3.9	4.7	4.7	4.7	4.7

The government will command a smaller share of the economy as a result of smaller increases in its general expenditures and investment expenditures. These smaller increases represent the government's need to curb its expenditures in order to maintain fiscal discipline amidst rising public debt.

The target case projection also showed a continuous increase in public debt through the Ninth Economic and Social Development Plan. Two factors are responsible for this rise: first, the government has to bear the FIDF losses, which will ultimately show up the government debt; and second, government consumption expenditure and investment expenditure are increasing at a rate of 7 percent annually, which is only slightly lower than the average increase in GDP at constant prices (less than 8 percent). If government revenue and GDP increase by the same percentage (elasticity of revenue close or equal to 1), the government will have limited ability to pay interest, especially when outstanding debt rises with the fiscalisation of the FIDF loss. Therefore, in order to achieve the government expenditure levels projected, other sources of revenue must be sought, and debt must be cautiously managed.

BUSINESS AND FINANCIAL STRUCTURE REFORM

Progress and Corporate Debt Restructuring

Considerable progress has been seen in corporate debt restructuring which resulted in a reduction of non-performing loans (NPLs) from the peak of 47 percent of total outstanding loans in May 1998 to 17.8 percent in May 2001. Yet, as cases in which multiple creditors were involved made negotiations difficult, a standstill of NPLs and low credit expansion by banks was seen in the first half of 2001. To facilitate and accelerate the corporate debt restructuring, NPLs with multiple creditors and worth more than 50 million baht will be transferred to the TAMC. The resolution of NPLs by the TAMC are as follows:

- TAMC must purchase default loans from the commercial banks at Net Book Value with no discount.
- The entire bank's debt of state-owned commercial banks will be transferred to TAMC, whereas a private bank's debt that would be transferred to TAMC includes the amount of overdue debts in the balance sheet and also the default debts that are under the ongoing process of a court conviction.
- Default loans will be classified according to their loss incurred.
- The payment for those default debts will be in the form of the issuance of bonds or notes with a 10-year maturity but will allow the issuer to call back. Each call back will not be over 10 percent of actual value, and it can be done after the three-year deferment period. The securities will be backed and secured by FIDF.

Privatization of state-owned enterprises

Privatization is one of the priority policies announced by the present Government. The objectives are to improve operational efficiency of state-owned enterprises, to ease burden on the government budget and to create a conducive environment for private sector participation through public selling of shares in the stock market. In early 2001, the government approved a draft bill establishing the National Enterprise Corporation to act as the state holding company. The National Enterprise Corporation is empowered to finalize privatization plans, especially on the timing and listing of privatized companies' shares in the stock market. The first four state enterprises whose shares are to be offered in the Thai stock market are Internet Thailand Company, Thai Airways International, the Petroleum Authority of Thailand, and the Krung Thai Bank Public Company Limited.

Annex I

THAILAND: OVERALL ECONOMIC PERFORMANCE

	1995	**1996**	**1997**	**1998**	**1999**	**2000**
GDP and Major Components (percent change, year over year, except as noted)						
Nominal GDP (level in US$ billion)	164.8	183.26	150.23	112.22	121.92	124.44
Real GDP	8.6	5.9	-1.4	-10.8	4.2	4.4
Consumption						
Private Consumption	7.9	6.8	-1.1	-12.3	2.4	4.5
Government Consumption	15.41	11.04	7.89	-0.18	12.82	8.44
Investment						
Private Investment	10.3	3.4	-31.7	-52.4	-6.5	14.2
Government Investment	19.18	28.93	16.12	26.52	-16.37	-7
Exports of Goods and Services	23.6	-0.2	29.8	21.9	-1.4	27.1
Imports of Goods and Services	30.5	2.3	4.3	-10.5	7.3	39.6
Fiscal and External Balances (percent of GDP)						
Budget Balance	2.7	2.3	-0.7	-2.5	-2.9	-2.4
Merchandise Trade Balance	-4.9	-9.1	-1.8	10.9	7.6	4.4
Current Account Balance	-8.1	-14.4	-3.1	14.3	12.5	7.5
Capital Account Balance	12.97	19.5	-4.3	-9.8	-7.9	-9.5
Economic Indicators (percent change, year over year, except as noted)						
GDP deflator	6.3	4.8	5.5	9.4	-4.3	2.6(Jan-Sep)
CPI	5.8	5.9	5.6	8.1	0.3	1.6
M2		12.7	16.3	9.5	2.1	3.6
Short-Term Interest Rate (Repurchase rate)			22.36	13.59	1.48	1.28
Real Effective Exchange Rate (level, 1997=100)		109.2	102.4	90	93.5	86.9
Unemployment Rate (percent)	1.7	1.5	1.2	4.4	4.2	3.6
Population (millions)	59.1	60.1	60.8	61.5	61.7	61.9

Sources: 1. Bank of Thailand.
2. The Ministry of Labour and Social Welfare.

Annex II

THAILAND: FORECAST SUMMARY (percent change from previous year)

	2001			2002		
	Official	**IMF**	**ADB**	**Official**	**IMF**	**ADB**
Real GDP	2.0-3.0	2.0	3.5	4.0	4.0	4.5
Exports	-2 - -0.5	N.A.	7.0	N.A.	N.A.	11.0
Imports	3.2-5.5	N.A.	13.0	N.A.	N.A.	14.0
CPI	2.2	2.5	2.0	2.6	2.7	2.6

Notes : N.A. Not available.

Sources: IMF forecasts, *The World Economic Outlook Database* (September 2001).
LINK forecasts, *Project LINK World Economic Outlook* (April 2001).
ADB forecasts, *Asian Development Outlook* 2001.

Annex III

THAILAND: MEDIUM-TERM TREND FORECAST (percent)

	2002
Real GDP	4.0
CPI	1.9

UNITED STATES OF AMERICA

The United States enjoyed rapid growth in the first half of 2000, but a dramatic slowdown began in the second half of the year. Inflation rose moderately, while the budget surplus continued to grow.

REAL GROSS DOMESTIC PRODUCT

Real gross domestic product (GDP) grew 4.1 percent from 1999 to 2000, marking the ninth consecutive year of positive output growth. However, after reaching 5.7 percent (annual rate) in the second quarter, real GDP growth declined to 1.3 and 1.9 percent in the third and fourth quarters, respectively. Growth remained low in the first half of 2001, as preliminary numbers indicate that real GDP grew 1.3 percent and 0.2 percent at an annual rate in the first and second quarters respectively.

Real personal consumption expenditures grew a robust 4.8 percent in 2000, matching 1999's growth rate, and accounted for nearly three-fourths of real GDP growth. Favourable economic performance and rising real disposable personal income helped fuel strong household spending. While measures of consumer confidence remained high through most of the year, they began to decline rapidly in the fourth quarter through April 2001. Consumer confidence edged up in May and June. Real personal consumption expenditures posted a modest 3.0 and 2.5 percent increase (annual rate) in the first and second quarters of 2001.

The stock market tumbled from highs set in the first half of the year. The S&P 500 ended the year down 10.1 percent, while the tech-heavy NASDAQ fell 39.3 percent and was down about 51 percent from its 10 March peak. Despite a rebound in January, stocks have continued to decline this year, with the S&P 500 and the NASDAQ dropping 7.3 and 12.5 percent, respectively, through the first six months of 2001.

Real investment grew 6.8 percent in 2000, well below the double-digit growth rates recorded in 1997 and 1998, but in line with 1999's 6.6 percent increase. Real business fixed investment grew 9.9 percent over the year, fueled both by large increases in spending on computers and other information-processing equipment and by higher spending on business structures. Real residential investment slowed in 2000, due in part to rising interest rates in the first half of the year.

Real net exports continued to exert a drag on domestic GDP growth in 2000. With strong growth abroad, real exports rose 11 percent (annual rate) in the first three quarters of the year, before falling back in the last quarter of 2000. Imports rose even more rapidly over the first three quarters. Imports have fallen over the past three quarters—a development not seen in more than 25 years. The sharp decline of imports in the first quarter of 2001 led to the first increase in real net exports since the fourth quarter of 1996.

INFLATION

Broad price measures showed some pick-up in inflation in 2000 from 1999's moderate pace. The chain-weighted price indexes for GDP and PCE increased 2.3 percent and 2.7 percent respectively on a year-over-year basis, both up slightly from their year-earlier rates. The consumer price index (CPI) rose 3.4 percent in 2000, up from 2.2 percent in 1999. This acceleration was due mainly to dramatic increases in energy prices. The core CPI, which excludes volatile food and energy prices, rose 2.4 percent in 2000, which represents an acceleration of only 0.3 percentage points in the core rate of inflation. Core PCE inflation was 1.9 percent on a year-over-year basis in 2000, an acceleration of 0.4 percentage points from 1999.

EMPLOYMENT

The U.S. labour market remained strong in 2000 as over 2.3 million private non-farm jobs were created. Federal government payrolls rose slightly, for the first time since 1992. The private service sector was the source of 2.7 million new jobs in 2000, an increase of nearly 2.6 percent. In contrast, employment in the manufacturing sector continued to decline, losing 85,000 jobs. This has intensified in the first half of 2001 with another 190,000 and 302,000 jobs being lost in the manufacturing sector in the first and second quarters, respectively.

The annual unemployment rate fell to 4 percent in 2000, its lowest level since 1969. These labour market gains were widely shared as Hispanic and African-American unemployment rates both dropped to historic lows. However, by June 2001 the unemployment rate stood near 4.5 percent.

The participation rate — the percentage of the population over age 16 that is either employed or looking for work — stood just above the rate recorded in 1997–99, reaching a new all-time high of 67.2 percent in 2000.

Non-farm business sector productivity grew at the fastest rate in 2000 since 1983, helping to keep wage inflation in check despite the very low unemployment rate. Unit labour costs increased only 0.7 percent on a year-over-year basis in 2000, while real wages jumped 1.7 percent.

TRADE ACCOUNTS

The current account deficit grew to $445 billion in 2000, or 4.5 percent of GDP. The balance on goods and services was $376 billion, as a merchandise trade deficit of $452 billion was partially offset by a services surplus of $76 billion.

EXCHANGE RATE

The US dollar increased steadily in real terms against a broad trade-weighted worldwide average of other currencies in 2000. The exchange rate rose slightly over the first quarter but jumped up in the second and fourth quarters of 2000. With the dollar continuing to rise slowly and level off in the first few months of 2001, the real exchange rate has reached levels not seen since the mid-1980s.

FOREIGN DIRECT INVESTMENT

In 2000, U.S. direct investment abroad was $152 billion, while foreign direct investment into the United States was $288 billion.

FISCAL POLICY

The federal government ran a surplus (on a unified budget basis) for fiscal year 2000 of $236 billion, compared with $125 billion in 1999. This marked the first time in over 40 years that the federal government has recorded three consecutive budget surpluses. At 2.5 percent of GDP in 2000, the fiscal surplus was the largest relative to the size of the economy since 1948.

MONETARY POLICY

Over the first six months of 2000, the Federal Reserve raised the target federal funds rate three times, amid concern over the potential buildup of inflationary imbalances. After holding the rate constant through the end of 2000, the Fed began to reduce rates as signs of a slowdown began to accumulate. Through the first eight months of 2001, the Fed lowered rates by 300 basis points, citing concerns that the risks are weighted mainly towards conditions that may generate economic weakness in the foreseeable future.[1]

MEDIUM-TERM OUTLOOK

After torrid growth in the second quarter of 2000, the economy's performance has substantially deteriorated. Relatively high energy prices and unemployment rates, falling equity prices, and declining consumer confidence have raised fears that the U.S. economy is in or will soon be in a recession. Despite these concerns, the consensus of private forecasters as of July 2001 still expects a 1.6 percent annual real GDP growth rate. The administration projects a growth rate of 1.7 percent for 2001. In addition, private forecasters are predicting a return to a solid growth rate of 2.7 percent in 2002. This is slightly lower than the administration's forecast of 3.2 percent.

With slowing consumer and business demand in recent quarters, manufacturers have limited production and laid off workers. A substantial portion of the recent weakness in GDP growth can be traced to efforts to bring inventories in line with demand. However, inventories remain lean with respect to sales by historical standards. There is also some evidence that the inventory correction is already well advanced. For example, the automobile industry has substantially curtailed its inventory overhang, and production rebounded in the second quarter.

The U.S. administration projects U.S. long-run GDP growth at about 3.2 percent per year through 2011. This rate is consistent with growth for the 1990 business cycle as a whole and with labour-force growth of approximately 1 percent and labour productivity growth of approximately 2 percent.

[1] The Federal Reserve lowered the federal fund rate by another 50 basis points on 17 September, following the terrorist attack earlier in the month.

Annex I

UNITED STATES: OVERALL ECONOMIC PERFORMANCE

	1993	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**
GDP and Major Components (percent change, year over year, except as noted)								
Nominal GDP (level in US$ billion)	6642.3	7054.3	7400.6	7813.2	8318.4	8781.5	9268.6	9872.9
Real GDP	2.7	4.0	2.7	3.6	4.4	4.3	4.1	4.1
Consumption	2.6	3.1	2.4	2.7	3.2	4.2	4.5	4.5
Private Consumption	3.4	3.8	3.0	3.2	3.6	4.8	5.0	4.8
Government Consumption	-0.4	0.2	0.0	0.5	1.8	1.4	2.2	2.8
Investment	6.2	10.6	3.0	8.1	10.9	10.7	6.8	6.1
Private Investment	8.7	13.2	3.0	9.0	12.1	11.8	6.6	6.8
Government Investment	-2.9	-0.1	2.7	3.9	5.0	4.5	8.3	2.0
Exports of Goods and Services	3.3	8.9	10.3	8.2	12.3	2.1	3.2	9.5
Imports of Goods and Services	9.1	12.0	8.2	8.6	13.7	11.8	10.5	13.4
Fiscal and External Balances (percent of GDP)								
Budget Balance	-4.1	-3.0	-2.6	-1.8	-0.6	0.6	1.3	2.5
Merchandise Trade Balance	-2.0	-2.4	-2.4	-2.4	-2.4	-2.8	-3.7	-4.6
Current Account Balance	-1.2	-1.7	-1.5	-1.5	-1.7	-2.5	-3.5	-4.5
Capital & Financial Account Balance[1]	1.2	1.8	1.5	2.2	3.3	1.6	4.1	4.5
Economic Indicators (percent change, year over year, except as noted)								
GDP deflator	2.4	2.1	2.2	1.9	2.0	1.2	1.4	2.3
CPI	3.0	2.6	2.8	2.9	2.3	1.5	2.2	3.4
M2	1.1	1.4	2.1	4.8	4.9	7.3	7.6	6.1
Short-Term Interest Rate (%)[2]	3.1	4.4	5.7	5.1	5.2	4.9	4.8	6.0
Real Effective Exchange Rate (level, 1996=100)[3]	108.0	106.9	100.0	106.0	115.4	123.2	124.4	132.9
Unemployment Rate (percent)	6.9	6.1	5.6	5.4	5.0	4.5	4.2	4.0
Population (millions)	257.7	260.3	262.8	265.2	267.7	270.3	272.9	281.4

Notes: [1] Capital account balance excludes that statistical discrepancy
[2] Short-term interest rate refers to average 3-Month Treasury Bill Market Bid Yield at Constant Maturity (percent)
[3] Real effective exchange rate from IMF *International Financial Statistics*, August 2000, and IMF communication.

Annex II

UNITED STATES: FORECAST SUMMARY (percent change from previous year)

	2001				2002			
	Official	**IMF**	**LINK**	**OECD**	**Official**	**IMF**	**LINK**	**OECD**
Real GDP	1.7	1.3	1.5	1.7	3.2	2.2	3.0	3.1
Exports	N.A.	5.8	3.9	4.3	N.A.	6.7	7.1	7.6
Imports	N.A.	7.2	3.7	4.8	N.A.	7.1	3.7	6.7
CPI	3.3	3.2	1.9*	1.9*	2.7	2.2	1.8*	1.6*

Notes: * Private consumption deflator.
N.A. Not available.

Sources: IMF forecasts, *The World Economic Outlook Database* (September 2001).
LINK forecasts, *UN's Global Economic Outlook,* April 2001.
OECD forecasts, *OECD Economic Outlook* (June 2001).

Annex III

UNITED STATES: MEDIUM-TERM TREND FORECAST (percent)

	2002-2011
Real GDP	3.2
CPI	2.5

APPENDIX B

Regression Results

Table B.1.1: Average Growth Rates of Real GDP per capita, 1980-99

	Banking Efficiency		Financial Development	
	Coefficient	**T-Statistic**	**Coefficient**	**T-Statistic**
Intercept	0.107	2.22***	0.098	2.11***
Spread_80	-0.016	-1.67*		
LLY_80			0.035	2.10***
Y_80	-0.013	-1.39*	-0.019	-3.45***
SCH_80	0.012	0.80	0.015	1.15
TRD	0.006	1.00	0.006	1.06
GOV	0.006	0.05	0.111	0.94
GDPD	0.001	0.16	-0.005	-1.11
Adjusted R^2	0.402		0.356	
F-Statistic	3.017***		2.840***	
SSE	0.004		0.006	
Number of Observations	19		21	

Notes: 1.***, **, * denote respectively 5 percent, 10 percent and 20 percent significance levels, two-tailed test.
2.Spread_80: interest rate spread in 1980, LLY_80: liquid liabilities to GDP in 1980, Y_80: real GDP in 1980, SCH_80: number of years of schooling in 1980, TRD: ratio of trade to GDP, GOV: ratio of government spending to GDP, and GDPD: general price level. The Spread_80 and GDPD are log transformed.
3.Brunei and Viet Nam are not included in the Banking Efficiency regression due to insufficient data.

Table B.1.2: Average Growth Rates of Real GDP per capita, 1980-99
Banking efficiency and financial development

	Coefficient	**T-Statistic**
Intercept	0.123	2.641***
Spread_80	-0.018	-2.037**
LLY_80	0.033	1.578*
Y_80	-0.017	-1.850**
SCH_80	0.007	0.467
TRD	0.004	0.652
GOV	0.044	0.365
GDPD	0.009	0.924
Adjusted R^2	0.468	
F-Statistic	3.263***	
SSE	0.004	
Number of Observations	19	

Notes: 1.***, **, * denote respectively 5 per cent, 10 per cent and 20 per cent significance, two-tailed test.
2.Spread_80: interest rate spread in 1980, LLY_80: liquid liabilities to GDP in 1980, Y_80: real GDP in 1980, SCH_80: number of years of schooling in 1980, TRD: ratio of trade to GDP, GOV: ratio of government spending to GDP, and GDPD: general price level. The Spread_80 and GDPD are log transformed.

Table B.2.1: Average Growth Rates of Real GDP per capita, 1980-89

	Banking Efficiency		Financial Development	
	Coefficient	T-Statistic	Coefficient	T-Statistic
Intercept	0.041	0.57	0.021	0.25
Spread_80	-0.033	-2.80***		
LLY_80			0.047	2.02**
Y_80	0.012	0.95	-0.015	-1.36*
SCH_80	-0.014	-0.70	0.017	0.88
TRD	0.004	0.49	0.010	1.31
GOV	-0.223	-1.28	0.115	0.69
GDPD	0.011	0.71	0.005	0.59
Adjusted R^2	0.322		0.167	
F-Statistic	2.346*		1.601	
SSE	0.006		0.010	
Number of Observations	18		19	

Notes: 1.***, **, * denote respectively 5 per cent, 10 per cent and 20 per cent significance, two-tailed test.
2.Spread_80: interest rate spread in 1980, LLY_80: liquid liabilities to GDP in 1980, Y_80: real GDP in 1980, SCH_80: number of years of schooling in 1980, TRD: ratio of trade to GDP, GOV: ratio of government spending to GDP, and GDPD: general price level. The Spread_80 and GDPD are log transformed.
3.Brunei, Russia and Viet Nam are not included in the Banking Efficiency regression due to insufficient data, while Russia and Viet Nam are not included in the Financial Development regression.

Table B.2.2: Average Growth Rates of Real GDP per capita, 1980-89
Banking efficiency and financial development

	Coefficient	T-Statistic
Intercept	0.019	0.285
Spread_80	-0.036	-3.307***
LLY_80	0.059	1.908**
Y_80	0.001	0.080
SCH_80	-0.017	-0.945
TRD	0.002	0.272
GOV	-0.067	-0.380
GDPD	0.037	1.909**
Adjusted R^2	0.453	
F-Statistic	3.013**	
SSE	0.005	
Number of Observations	18	

Notes: 1.***, **, * denote respectively 5 per cent, 10 per cent and 20 per cent significance, two-tailed test.
2.Spread_80: interest rate spread in 1980, LLY_80: liquid liabilities to GDP in 1980, Y_80: real GDP in 1980, SCH_80: number of years of schooling in 1980, TRD: ratio of trade to GDP, GOV: ratio of government spending to GDP, and GDPD: general price level. The Spread_80 and GDPD are log transformed.

Table B.3.1: Average Growth Rates of Real GDP per capita, 1990-99

	Banking Efficiency		Financial Development	
	Coefficient	**T-Statistic**	**Coefficient**	**T-Statistic**
Intercept	0.054	0.81	0.043	0.79
Spread_90	-0.010	-0.82		
LLY_90			0.0004	0.02
Y_90	-0.022	-1.64*	-0.019	-2.43***
SCH_90	0.042	1.84**	0.043	2.45***
TRD	0.001	0.15	-0.0003	-0.03
GOV	-0.054	-0.36	-0.101	-0.87
GDPD	0.002	0.20	-0.007	-1.47*
Adjusted R^2	0.170		0.236	
F-Statistic	1.616		2.028*	
SSE	0.008		0.009	
Number of Observations	19		21	

Notes: 1.***, **, * denote respectively 5 per cent, 10 per cent and 20 per cent significance, two-tailed test.
2.Spread_90: interest rate spread in 1990, LLY_90: liquid liabilities to GDP in 1990, Y_90: real GDP in 1990, SCH_90: number of years of schooling in 1990, TRD: ratio of trade to GDP, GOV: ratio of government spending to GDP, and GDPD: general price level. The Spread_90 and GDPD are log transformed.
3.Brunei and Viet Nam are not included in the Banking Efficiency regression due to insufficient data.

Table B.3.2: Average Growth Rates of Real GDP per capita, 1990-99
(Peru and Russia excluded)

	Banking Efficiency		Financial Development	
	Coefficient	**T-Statistic**	**Coefficient**	**T-Statistic**
Intercept	0.041	0.376	0.075	0.785
Spread_90	-0.018	-1.478*		
LLY_90			-0.007	-0.383
Y_90	-0.018	-1.359*	-0.022	-2.357***
SCH_90	0.037	1.651*	0.049	2.617***
TRD	0.003	0.335	0.003	0.306
GOV	-0.031	-0.176	-0.102	-0.830
GDPD	0.007	0.288	-0.019	-0.918
Adjusted R^2	0.232		0.225	
F-Statistic	1.806*		1.871*	
SSE	0.006		0.008	
Number of Observations	17		19	

Notes: 1.***, **, * denote respectively 5 per cent, 10 per cent and 20 per cent significance, two-tailed test.
2.Spread_90: interest rate spread in 1990, LLY_90: liquid liabilities to GDP in 1990, Y_90: real GDP in 1990, SCH_90: number of years of schooling in 1990, TRD: ratio of trade to GDP, GOV: ratio of government spending to GDP, and GDPD: general price level. The Spread_90 and GDPD are log transformed.

Table B.3.3: Average Growth Rates of Real GDP per capita, 1990-99
Reciprocal transformation

	Banking Efficiency		Banking Efficiency	
	Coefficient	**T-Statistic**	**Coefficient**	**T-Statistic**
Intercept	-0.001	-0.017	0.016	0.289
1/Overhead_90	0.001	1.800**		
1/Net Interest_90			0.0005	1.341*
Y_90	-0.017	-2.357***	-0.018	-2.340***
SCH_90	0.037	2.188***	0.038	2.132***
TRD	-0.003	-0.393	-0.001	-0.089
GOV	0.003	0.019	-0.039	-0.286
GDPD	-0.001	-0.214	-0.003	-0.671
Adjusted R^2	0.328		0.263	
F-Statistic	2.546**		2.128*	
SSE	0.007		0.008	
Number of Observations	20		20	

Notes: 1.***, **, * denote respectively 5 per cent, 10 per cent and 20 per cent significance, two-tailed test.
2.Overhead_90: overhead cost in 1990, Net Interest_90: net interest margin in 1990, Y_90: real GDP in 1990, SCH_90: number of years of schooling in 1990, TRD: ratio of trade to GDP, GOV: ratio of government spending to GDP, GDPD: general price level. The GDPD is log transformed.
3.Brunei is not included in the regressions due to insufficient data.

Table B.3.4: Average Growth Rates of Real GDP per capita, 1990-99
Alternative efficiency indicators

	Return on Assets		Return on Capital	
	Coefficient	**T-Statistic**	**Coefficient**	**T-Statistic**
Intercept	0.142	1.58*	0.176	2.19**
RoA80s	3.60	2.11**		
RoK80s			0.183	2.54***
Y_90	-0.030	-2.81***	-0.041	-3.37***
SCH_90	0.032	1.24	0.044	1.66*
TRD	0.004	0.56	0.013	1.67*
GOV	-0.005	-0.27	0.016	0.89
GDPD	-0.242	-1.76*	-0.311	-2.31***
Adjusted R^2	0.2510		0.3464	
F-Statistic	1.838*		2.325*	
SSE	0.004		0.003	
Number of Observations	16		16	

Notes: 1.***, **, * denote respectively 5 percent, 10 percent and 20 percent significance levels, two-tailed test.
2.RoA80s: average return on assets in the 1980s, RoK80s: average return on capital in the 1980s, Y_90: real GDP in 1990, SCH_90: number of years of schooling in 1990, TRD: ratio of trade to GDP, GOV: ratio of government spending to GDP, GDPD: general price level. The GDPD is log transformed.
3.Brunei, Papua New Guinea, Peru, Russia and Viet Nam are not included in the regressions due to insufficient data.

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