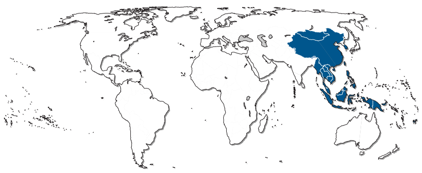
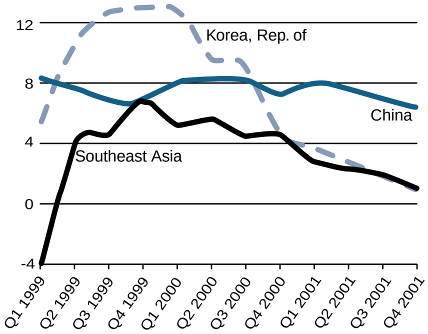


East Asia and Pacific

GNI per capita, 2000: $1,060

GDP growth in East Asia, 1999–2001

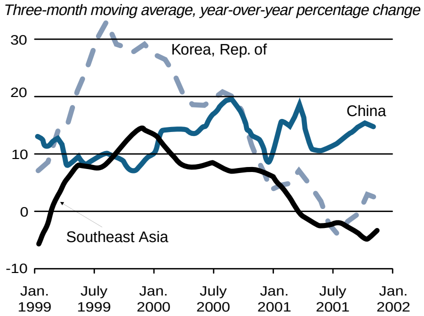
Year-over-year percentage change



Source: World Bank.

Industrial production in East Asia, 1999–2002

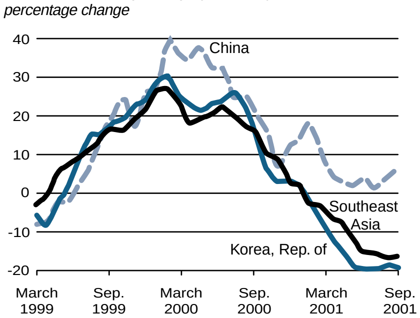
Three-month moving average, year-over-year percentage change



Source: Datastream and World Bank staff estimates.

Export in dollars, growth for East Asia, 1999–2001

Three-month moving average, year-over-year percentage change



Source: Datastream.

Recent developments

Growth in the East Asia and Pacific region slowed sharply in 2001, from 7.4 percent in 2000 to 4.6 percent. Excluding China, growth slowed more, from 7 percent in 2000 to 2.3 percent in 2001. The downturn in growth was concentrated in the high-tech exporting countries, which suffered disproportionately from the global recession in high-tech sectors.[1] Chinese growth was maintained at rates above 7 percent through substantial fiscal stimulus. And Vietnam grew by 5.5 percent by further increasing its share in export markets. But, partly related to its export success, the country suffered significant terms-of-trade losses.

Regional merchandise export volumes showed little to no growth in 2001, following an advance of 23 percent in 2000. And dollar export revenues fell (3.7 percent) for the first time since 1998. Moreover, loss of tourism revenue was significant in the wake of September 11, especially for Thailand and the Philippines. Worker remittances in the latter country were down sharply, a direct effect of the slowdown in world trade and tourism, because a significant portion of remittances come from Philippine seamen on cargo and cruise vessels.

Many countries in the region were able to use countercyclical monetary and fiscal policies to limit the adverse effects on growth caused by worsening external conditions. Rapidly falling international interest rates facilitated domestic interest rate declines in several countries. Over the course of 2001, policy rates fell 140 basis points in the Republic of Korea and 550 basis points in the Philippines. In both countries unemployment stabilized in the first half of 2001 and decreased in the second half of the year.

Across the region fiscal balances deteriorated, but the impact of this stimulus on domestic inflation and exchange rate levels was limited. For Thailand, Korea, and the Philippines, currency depreciation vis-à-vis the dollar ranged between 2 and 6.5 percent during 2001. The 9 percent depreciation of the rupiah, despite a 400 basis point increase in policy interest rates, made Indonesia an exception in the region.

Despite a decisive reduction in current account surpluses, the region saw a $50 billion increase in reserves during the year. The improved external positions since the East Asian crisis made an increase in reserves possible despite a fall in export revenues and domestic stimulus, and a decline in capital flows. Indonesia, struggling with a difficult political and social environment, was one of the few countries where reserves declined.

Capital market flows decline

Gross flows from the international capital markets fell dramatically during 2001. The aggregate of bond and equity issuance and bank lending dropped by $25.8 billion in the year (almost 40 percent) to reach a level of $40.9 billion—only moderately above the outturns of 1998, at the peak of the East Asian crisis. In contrast with conditions at that time—large-scale withdrawal of short-term banking debt—the 2001 downturn in flows reflects in part a decrease in demand for funds in the region, as well as limited investor supply of capital for high-tech ventures. The falloff in flows to East Asia amounted to one-half of the decline in flows to all emerging markets for the year.

Banking flows, which traditionally account for about 50 percent of market-based financing for the region, dropped by $10.7 billion, or 36 percent, with the decline in international bank credit broadly based across countries. This development likely reflects the confluence of several factors: increasing availability of preferred long-term capital through the international bond markets; decreasing demand for funds from a balance of payments perspective, against the background of continued (albeit diminishing) current account surpluses and record high reserve levels; and falling requirements for working capital and trade finance, with steep recession in high-tech manufacturing sectors across developing East Asia.

International equity placement fell from a record $23 billion in 2000 to $7.2 billion. China, which is the premier source of equity issuance among emerging markets ($21.9 billion placed in 2000, or 62 percent of total equity during that year), found international market conditions unfavorable for issuing larger share volumes (particularly for high-tech firms). And investor appetite for emerging market exposure was diminished during most of the year. Despite the less opportune environment, Korea and Thailand stepped up international placements, the former more substantially, from $1 billion in 2000 to $3.7 billion in 2001.

The shift from bank-sourced financing to the bond markets was of note during the year. Although bond issuance in East Asia advanced by about $1 billion over 2000 levels to $14.7 billion, a number of countries began to participate more fully in the market. China increased issuance by more than $1 billion to $2.5 billion, Malaysia by $750 million to $2.2 billion, and Thailand to $280 million. In contrast, Indonesia and the Philippines, under the weight of structural economic difficulties at present, were limited in their ability to expand use of the market, and issuance dropped by $200 million in the former and $625 million in the latter country during the year.

Bond market conditions were variable over the course of 2001. Spreads on East Asian secondary market debt increased moderately from an average 295 basis points in 2000 to 350 basis points in 2001—but these figures tend to mask the dynamics of financial market developments in the year. A narrowing of the regional spread by 50 basis points over the first half of 2001 was reversed by October as concerns regarding the Argentine situation and the health of the global economy mounted. By early January 2002, however, spreads fell quickly by 100 basis points, with the Philippines, a focus of some market concern, experiencing an easing of more than 200 basis points.

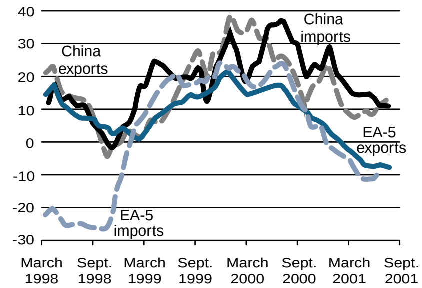
Foreign direct investment

Net inflows of foreign direct investment (FDI) to the region were $48.5 billion in 2001, a decline of $3.6 billion, or 6.9 percent, from 2000. At first glance, this amount must be considered a robust outturn in the context of global and East Asian regional recessions. Once more, such aggregates tend to mask a shifting distribution of investment flows across countries of the region.

The bulk of FDI flows continues to be directed to China, at $44 billion in 2001, a sharp $6 billion advance over the $38 billion recorded in 2000, returning flows to the record levels of 1997. But, with the exception of Vietnam, FDI flows into other large East Asian countries declined—in some cases precipitously—during the year. As an extreme case, for the fourth year in succession, FDI flowed out of Indonesia at an accelerated pace of $6 billion in 2001.[2] FDI dropped by $6

Export and import volume growth in East Asia, 1998–2001

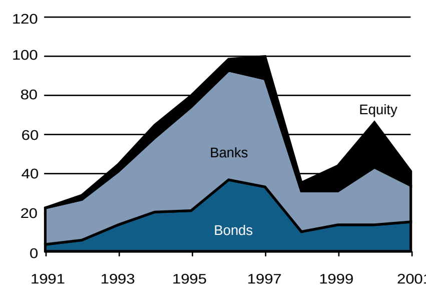
Three-month moving average, year-over-year percentage change



Note: EA-5 comprises Indonesia, the Republic of Korea, Malaysia, the Philippines, and Thailand.
Source: World Bank Economic Policy and Prospects Group.

Gross capital market flows to East Asia, 1991–2001

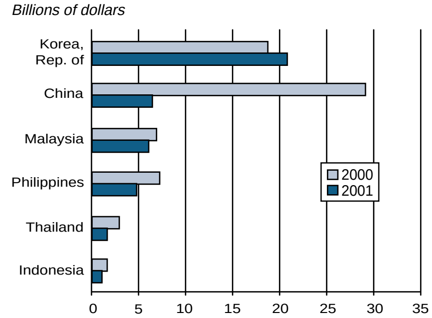
Billions of dollars



Source: Euromoney.

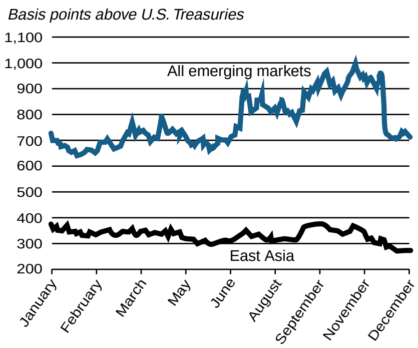
Capital market flows by country, 2000 and 2001

Billions of dollars



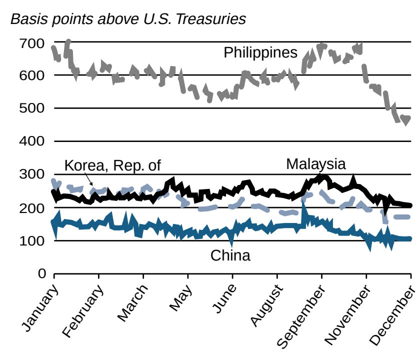
Source: World Bank Economic Policy and Prospects Group.

East Asian bond spreads, 2001

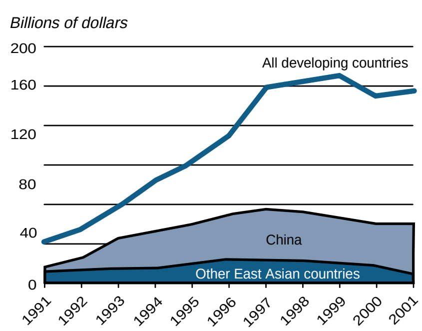


Source: J.P. Morgan Chase through Bloomberg.

Selected East Asian bond spreads, 2001



Foreign direct investment, 1991–2001



Source: World Bank.

billion, or two-thirds, in Korea; by $660 million, or 40 percent, in Malaysia; by 32 percent in Thailand; and by 20 percent in the Philippines.

The decline in FDI flows to these countries likely has its roots in the current downturn in the semiconductor and computer markets, where for several years overseas investment in new capacity had been buoyant. FDI flows to East Asia, excluding China, accumulated to $50 billion from 1998 to 2000, a good proportion of the accumulation occurring in the technology sectors.

Prospects and risks

Buoyed by the anticipated rebound in global high-tech markets (signs of which are now emerging in the United States), East Asia is expected to lead recovery in the developing world. During the fourth quarter of 2001, industrial production in high-tech East Asia, (Korea and Malaysia among middle-income countries, Singapore and Taiwan [China] among the newly industrialized economies) has turned the corner decisively, in line with an upturn in Asian semiconductor sales. However, recovery in GDP growth is likely to appear muted in annual figures for 2002, as regional output is expected to register 5.2 percent growth in the year, up from 4.6 percent in 2001. But in the absence of adverse surprises, the momentum underlying the current upswing could produce regional growth near 7 percent by 2003, growth similar to the robust outturns of 2000.

As most countries in the region have generally kept real exchange rate levels below their precrisis averages, they are expected to benefit fully from the turnaround in global trade, with export growth of nearly 10 percent in 2003 and 2004.

Yet, downside risks to this more encouraging view remain large. The recovery in global high-tech sectors may not be as robust as has been the case in past cycles. In particular, the unprecedented bursting of the high-tech bubble in financial markets may exert a larger drag on the availability of funds for high-tech firms than is assumed in the baseline. In broader scope, near-term revival of world demand continues to hinge on the spending behavior of the U.S. consumer. And abrupt changes in consumer confidence could serve to delay or protract recovery for some time.

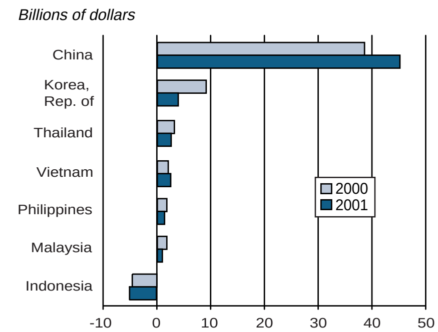
Within East Asia, the economic and political situation in Indonesia remains difficult, potentially dampening the recovery foreseen in the baseline. And the "war on terrorism" has increased global uncertainty, with several countries in the region potentially directly affected in future.

Notes

1. The most adversely affected were Korea and the newly industrialized economies (NIEs)—Hong Kong (China), Singapore, and Taiwan (China), which are not included in the aggregate for developing East Asia.

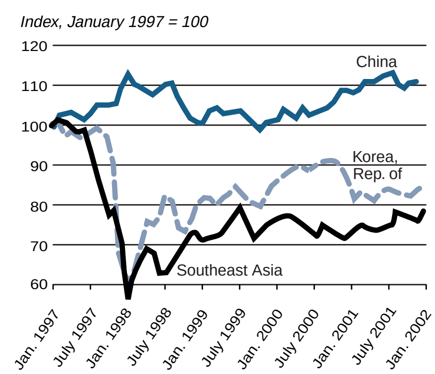
2. Negative net FDI in Indonesia is the result of repayments of intrafirm loans from foreign subsidiaries to their parents abroad.

Foreign direct investment by country, 2000 and 2001



Source: World Bank Economic Policy and Prospects Group.

Real effective exchange rates, 1997–2002



Source: J.P. Morgan Chase.

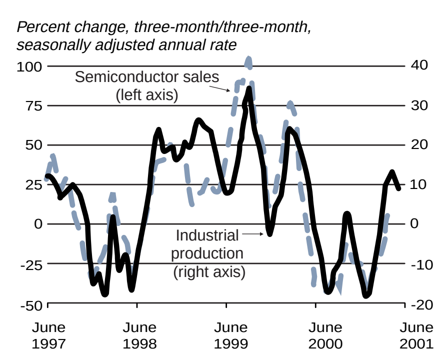
East Asia and Pacific forecast summary

(percent per year)

Growth rates/ratios	1991–2000	1999	2000	Estimate 2001	Baseline forecast 2002	2003	2004
Real GDP growth	7.2	7.0	7.4	4.6	5.2	6.9	6.5
Consumption per capita	5.4	6.3	6.4	4.9	5.5	5.6	5.9
GDP per capita	6.0	5.9	6.4	3.7	4.2	6.0	5.6
Population	1.2	1.1	1.0	0.9	0.9	0.9	0.8
Gross domestic investment/GDP[a]	30.3	28.9	29.9	30.8	31.4	31.2	31.0
Inflation[b]	5.4	0.1	3.4	4.2	6.8	6.4	6.3
Central government budget balance/GDP	–1.1	–2.5	–2.7	–2.9	–2.9	–2.9	–2.5
Export market growth[c]	8.3	7.3	14.2	–0.3	2.6	7.8	7.6
Export volume[d]	12.7	7.5	22.0	2.6	7.1	9.4	10.7
Terms of trade/GDP[e]	–0.3	0.1	–0.9	–1.2	0.2	–0.5	–0.3
Current account/GDP	0.5	4.6	3.5	1.9	2.3	1.8	1.2
Memo items							
GDP growth: East Asia excluding China	5.3	6.9	7.0	2.3	3.5	5.9	5.5

a. Fixed investment, measured in real terms
b. Local currency GDP deflator, median.
c. Weighted average growth of import demand in export markets.
d. Goods and nonfactor services
e. Change in terms of trade, measured as a proportion of GDP (percent).
Source: World Bank baseline forecast, February 2002.

High-tech emerging Asia:[a] Semiconductor dollar sales and industrial production, 1997–2001



Note: Through November 2001.
a. Republic of Korea, Malaysia, Singapore, and Taiwan (China).
Source: Datastream; World Bank staff estimates.