WORLD BANK **EAST ASIA AND PACIFIC ECONOMIC UPDATE** 2011, VOLUME 2

Navigating Turbulence, Sustaining Growth

THE WORLD BANK

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Navigating Turbulence, Sustaining Growth

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PREFACE AND ACKNOWLEDGMENTS

The *East Asia and Pacific Economic Update* was prepared by a team led by Ekaterina Vostroknutova with guidance from Bert Hofman (East Asia and Pacific Regional Chief Economist) and Ahmad Ahsan (Acting Sector Director, Poverty Reduction and Economic Management, East Asia and Pacific Department). Team members were Antonio Ollero, Douglas Addison, Marek Hanusch, Tehmina Khan, Manohar Sharma, Juan Feng, Trang Van Nguyen, and Chul Ju Kim. Inputs were also provided by Ivailo Izvorski, Ashley Taylor, Frederico Gil Sander, Aira Maria Htenas, and Hironori Kawauchi. World Bank country economists throughout East Asia and Pacific region provided country write-ups and data, and assisted with the analysis.

Developing East Asia as used in this report includes China, Indonesia, Malaysia, Philippines, Thailand, Cambodia, Lao People's Democratic Republic, Mongolia, Papua New Guinea, Timor-Leste, Vietnam, and the island economies in the Pacific. The Newly-Industrialized Economies (NIEs) include Hong Kong SAR, China; the Republic of Korea; Singapore; and Taiwan, China. Middle-income countries, as used in this report, refer to China, Indonesia, Malaysia, Philippines, and Thailand. Low-income countries as used in this report include Cambodia and Lao PDR. The ASEAN member countries are Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.

CONTENTS

Preface and Acknowledgments....iii

Abbreviations.... vi

Summary 1

I. Weak External Demand Slows Growth 3

Growth moderated, driven by weak external demand, especially in manufacturing 4
Manufacturing employment followed output.... 8
Poverty is expected to decline further 9
East Asian exports were supported by China's domestic demand.... 9
Foreign investors sold regional equities and bonds as market volatility was rising globally.... 12

II. Policies Refocus on Sustaining Growth 15

Monetary policy: waiting to ease? 16
Currencies under pressure, central banks losing reserves.... 20
Fiscal policy: fine-tuning needed? 21

III. New Risks Add to Old Challenges 25

A challenging global environment 26
Increased uncertainty highlights vulnerabilities.... 27
Poverty reduction efforts could be hampered by food price shocks if incomes stagnate 33
Focusing on long-term growth.... 37

Country Pages and Key Indicators.... 42

Cambodia 42
China 45
Fiji.... 48
Indonesia.... 51
Lao PDR 55
Malaysia 58
Mongolia 61
Papua New Guinea.... 64
Philippines 67
Small Pacific Islands.... 70
Solomon Islands.... 73
Thailand 77
Timor-Leste 80
Vietnam 82

Appendix Tables 85

Appendix Table 1. Real GDP Growth 85
Appendix Table 2. Real GDP and Components of Aggregate Demand 86
Appendix Table 3. East Asia: Merchandise Export Growth 87

Appendix Table 4. East Asia and the Pacific: GDP Growth Projections 87
Appendix Table 5. Regional Aggregates for Poverty Measures in East Asia 88
Appendix Table 6. East Asia: Exchange Rates 89
Appendix Table 7. East Asia: Foreign Exchange Reserves Excluding Gold 90
Appendix Table 8a. East Asia: Balance of Payments 91
Appendix Table 8b. East Asia: Capital Account Components 91
Appendix Table 9. East Asia: Nonperforming Loans 92
Appendix Table 10. East Asia: Financial Market Indicators 93

Appendix Charts 94
Appendix Chart 1. East Asia: Stock Market Price Indices 94
Appendix Chart 2. East Asia: Local-Currency 10-Year Government Bond Yields 95
Appendix Chart 3. East Asia: Foreign-Currency Government Bond Spreads 96
Appendix Chart 4. East Asia: Sovereign Credit Default Swap (CDS) Spreads 97
Appendix Chart 5. East Asia: Foreign Exchange Reserves and Exchange Rates 98
Appendix Chart 6. East Asia: Real and Nominal Exchange Rates* 99

ABBREVIATIONS

APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
ASEAN+3	Association of Southeast Asian Nations plus China, Japan, and Republic of Korea
BAAC	Bank for Agriculture and Agricultural Cooperatives (Thailand)
BI	Bank Indonesia
BIS	Bank for International Settlements
BOP	Balance of payments
CBOE	Chicago Board of Options Exchange
CEIC	CEIC Data Company Ltd.
CPI	Consumer price index
DOTS	Direction of Trade Statistics
EAP	East Asia and Pacific Region, World Bank classification
ECA	Eastern Europe and Central Asia Region, World Bank classification
EFSF	European Financial Stability Facility
EPFR	Emerging Portfolio Funds Research
ETFs	Exchange traded funds
FDI	Foreign direct investment
GDP	Gross domestic product
GFSR	Global Financial Stability Report
IDR	Indonesian Rupiah
IMF	International Monetary Fund
KSEI	Indonesian Central Securities Depository
LAC	Latin America and the Caribbean Region, World Bank classification
LICs	Low-income Countries
MENA	Middle East and North Africa Region, World Bank classification
MICs	Middle-income countries
MSCI	Morgan Stanley Capital International
NIEs	Newly-industrialized economies
OECD	Organization for Economic Cooperation and Development
PMI	Purchasing manager indices
SAS	South Asia Region, World Bank classification
SBIs	Indonesia central bank bills
SOE	State-owned enterprise
SSA	Sub-Saharan Africa Region, World Bank classification
SUNs	Indonesia local currency bonds
TFP	Total factor productivity
UN COMTRADE	United Nations Commodity Trade statistics
WB	World Bank
WDI	World Development Indicators
WEO	World Economic Outlook
Y-o-y	Year-on-year changes are changes in levels expressed over the corresponding period (month or quarter in relation to the frequency of the data) of the previous year

Countries

CHN	China
HKG	Hong Kong SAR, China
IDN	Indonesia
KHM	Cambodia
KOR	Republic of Korea
LAO	Lao People's Democratic Republic (PDR)
MNG	Mongolia
MYS	Malaysia
PHL	The Philippines
PNG	Papua New Guinea
SLB	Solomon Islands
SGP	Singapore
THA	Thailand
TMP	Timor Leste
TWN	Taiwan, China
VNM	Vietnam

SUMMARY

Growth in developing East Asia in the first half of 2011 remained strong, but continued to moderate, mainly due to weakening external demand. Global growth was also affected by supply shocks from geopolitical disturbances in the Middle East, supply chain disruptions following the earthquake and tsunami in Japan, and a slower-than-expected recovery of private demand in crisis-affected countries. More recently, uncertainties over fiscal sustainability in the U.S. and sovereign debt in the Eurozone fed financial volatility and affected investor and consumer sentiment. Domestic demand in East Asian economies has also been softening, driven by the normalization of fiscal and monetary policy, although it remained robust and the largest contributor to growth. We project that real GDP in developing East Asia will increase by 8.2 percent in 2011 (4.7 percent excluding China), while growth will slow to 7.8 percent in 2012. Risks are on the downside, however.

Based on the still robust current growth projections, the proportion of people living on less than US$2 a day in developing East Asia is expected to decrease to about 24 percent in 2011, down two percentage points from 2010, and an estimated 38 million people are projected to move out of poverty. However, poverty reduction efforts would be hampered in the event of another sudden increase in food prices against a backdrop of slowing income growth.

The growth slowdown was particularly pronounced in industrial production. Exports of major regional industrial supply chains, especially electronics, have started to decline. Demand for commodities and raw materials remained strong, helping resource-rich economies maintain high levels of export and GDP growth. East Asia, and China in particular, is gaining importance as a source of global demand, while rising consumer goods imports in China are benefiting the region's manufacturing exporters.

In the short- to medium-term, East Asia's growth prospects are constrained by global uncertainty and by the impact of natural disasters. The slow progress towards resolution of debt problems in the Eurozone intensified investors' concerns over global growth and stability. As capital flowed out of emerging markets into relatively safer havens, portfolio investments reversed and stock markets lost value in East Asia. Markets remain jittery, even after the Eurozone countries agreed on a solution for the sovereign debt and banking problems. Fiscal and financial consolidation in the Eurozone is likely to reduce growth in Europe, and could lead to renewed financial outflows from East Asia as banks shore up their capital coverage. Credit outstanding from European banks to developing East Asia amounts to US$427 billion, or six percent of GDP. But high reserves and current account surpluses protect most East Asian countries against the impact of possible renewed financial stress.

The effects of flooding in several countries are likely to take a toll on growth this year. Because of widespread flooding, Thailand's GDP growth for 2011 was revised down to 2.4 percent, although the final tally of the damage done is yet to be made. Losses in production are being felt in the entire region, as the impact of the disaster is spreading through the industrial supply chains. While reconstruction after the flood in 2012 is likely to contribute to growth, the resilience of East Asia's production networks is being tested once more. Earlier in the year, after the March 11 earthquake and tsunami in Japan, East Asian countries suffered production losses from disrupted supply chains in electronics and automotive industries. However, these returned to their pre-disaster growth rates and production levels shortly after Japanese industry recovered in June. This time, recovery of production to pre-disaster levels in the region will also depend on the strength of global demand for electronics and cars.

With growing recognition that the current global economic slowdown could continue into the long-term, policymakers in East Asia are rethinking their policy options. With a few exceptions, notably Vietnam and Mongolia, the emphasis

has shifted from fighting inflation and dealing with excess capital inflows to sustaining growth, now the dominant concern.

In the short-term, striking a balance between stimulating growth and fighting the effects of global uncertainty is the primary challenge. Policymakers are likely to hold off further policy tightening and stand ready to act should further negative shocks to growth occur or in the extreme case of a disorderly resolution of the Eurozone debt problem. Monetary policy normalization has already been on hold in most countries in recent months and some central banks have started to cut official interest rates. In countries where the recent financial turbulence resulted in significant pressures on exchange rates, policymakers have also intervened in the currency markets. In this scenario it will also be important to take precautionary steps against financial risks arising from sudden downward movements in asset prices. Fiscal positions, while not as strong as before the 2008 crisis, leave sufficient space for fiscal stimulus in most middle-income countries should this become necessary.

Stimulus alone will not be enough to address the likely prolonged weakness in the global economy. Slow global growth presents an opportunity for East Asian governments to refocus on reforms that will enhance growth in the medium- and long-term. Increasing productivity and moving toward higher value-added production can be achieved through higher investment, including in productive infrastructure, education, and in building social security systems in most countries. Where levels of investments are already high, increasing the quality and efficiency of these investments should be the first priority alongside rebalancing growth towards domestic consumption. Improvements in public investment programs and regulatory frameworks will improve the quality of investments and increase investment rates. Further investment in disaster management and prevention is also becoming increasingly important for the region. Any fiscal stimulus should promote these structural reforms that support rebalancing and domestic sources of growth.

Once volatility in global financial markets recedes, capital flows are likely to return to East Asia. When that happens, a concerted effort in the region to use exchange rate flexibility to gain more independence in monetary policy, as well as to shift demand towards domestic sources, could become an option yet again. Efforts to deepen regional integration through existing regional initiatives can boost regional trade and demand and help establish the East Asia and Pacific region's new role in leading the global economy.

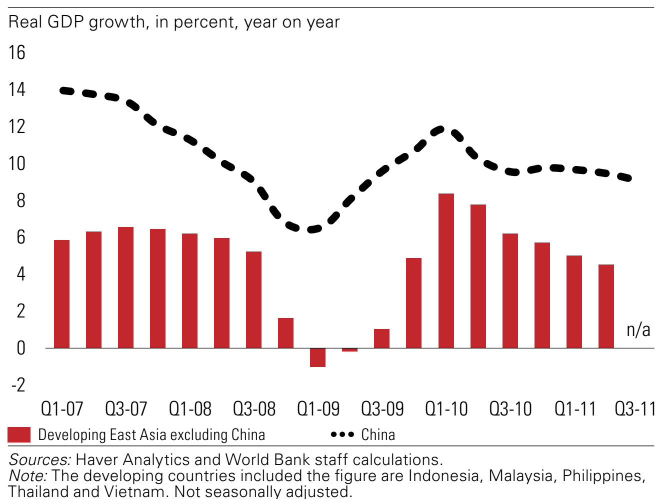
I. Weak External Demand Slows Growth

Developing East Asia continued to grow strongly, but economic growth slowed in 2011 due to lower demand for its exports from the developed economies, and fiscal retrenchment and monetary tightening in the East Asian Economies. Industrial production, notably in the electronics sector of the middle-income countries, has been affected more severely than other sectors, and manufacturing employment growth has slowed too. The slow progress towards resolution of the debt situation in Europe intensified investors' concerns over growth and stability, while recent market volatility triggered capital outflows as investors flocked to safer havens, including U.S. treasury bonds. Portfolio investments in East Asia have started to reverse and stock markets have lost value. Bank flows kept up well, but could yet turn lower as European banks will need to absorb losses and increase capital coverage in the wake of any definitive Eurozone settlement. At this critical juncture, China's robust domestic demand is supporting growth in the region, particularly through imports of manufactured goods as well as commodities. China is also importing more consumer goods, which presents a new opportunity for the region's exporters.

Growth moderated, driven by weak external demand, especially in manufacturing

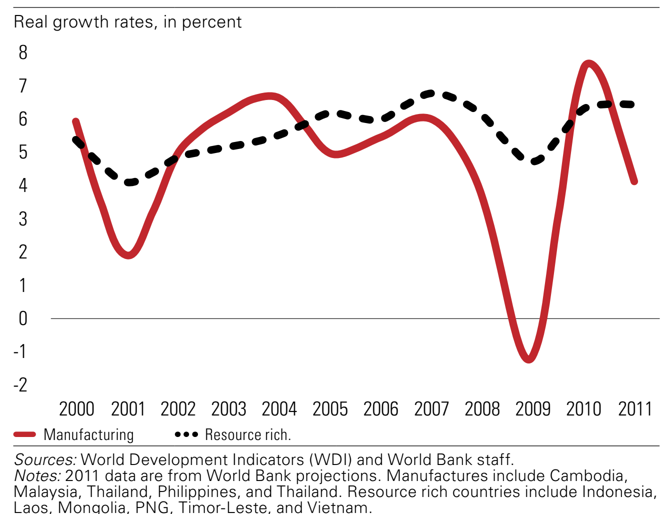
Slower expansion in demand in developed countries, the withdrawal of fiscal stimulus in the region, and tighter monetary policy combined to put a brake on growth in developing East Asia in 2011. Real GDP growth in the developing economies in the region, excluding China, slowed to 4.5 percent in the second quarter of 2011, from 5.7 percent in the fourth quarter of 2010 (Figure 1). For developing East Asia as a whole, growth fell from 9.1 percent in the last quarter of 2010 to 8.5 percent in the second quarter of 2011. Where third quarter data became available, the same trend as in the first half of 2011 persisted. In China, growth slowed to 9.6 percent in the first half and even further to 9.1 percent in the third quarter of 2011, down from 9.8 percent in the last quarter of 2010. In Indonesia, the year-on-year growth rate in the third quarter was the same as in the first half of 2011. Growth in resource-rich economies was more robust than in those that export manufacturing products (Figure 2).

Figure 1. Real GDP growth moderated in most of developing East Asia...



Sources: Haver Analytics and World Bank staff calculations.
Note: The developing countries included the figure are Indonesia, Malaysia, Philippines, Thailand and Vietnam. Not seasonally adjusted.

Figure 2. ...especially, among manufacturing exporters



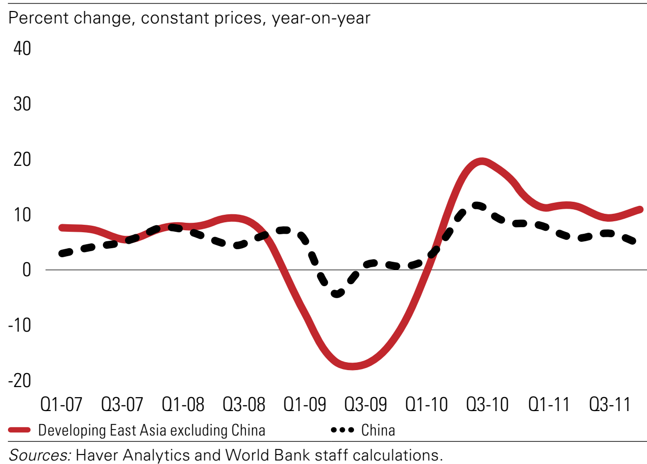
Sources: World Development Indicators (WDI) and World Bank staff.
Notes: 2011 data are from World Bank projections. Manufactures include Cambodia, Malaysia, Thailand, Philippines, and Thailand. Resource rich countries include Indonesia, Laos, Mongolia, PNG, Timor-Leste, and Vietnam.

Slower growth reflects weakening external demand. Growth in the Association of Southeast Asian Nations (ASEAN) countries was constrained by weak external demand (Figure 3). For China, external demand growth slowed down from nearly 40 percent in early 2010 to 10 percent in the third quarter of 2011 (Figure 4). Driven by the same factors, Hong Kong SAR, China, has narrowly missed a recession in the third quarter, contracting in the second and barely growing in the third quarter.

While weakening recently, domestic demand in the middle-income countries was still the largest contributor to growth. Growth in domestic demand also slowed, but remained more robust than external demand in 2011. This was especially true in China, where domestic demand grew by 10.7 percent in the third quarter, slightly higher than 9.7 percent growth in the same quarter of 2010 (Figure 4, Figure 5).[1] China's investment growth has returned to its pre-crisis level, as stimulus was withdrawn. Real consumption growth also was waning, most notably in 2011, reaching pre-2008 crisis growth rates (Figure 5). Domestic demand in ASEAN has been slowing gradually after reaching a peak of 12 percent in first quarter of 2010, easing to just under five percent in the second quarter of 2011.

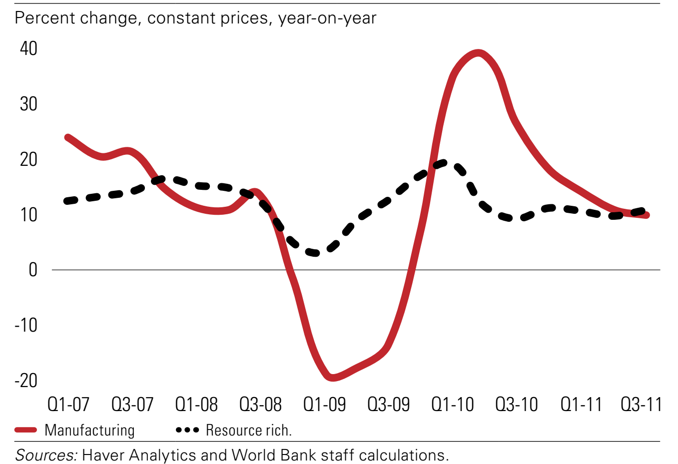
1 Domestic demand was calculated as GDP less net trade and is deflated by the GDP deflator.

Figure 3. Domestic and external demand in ASEAN moderated after peaking in 2010...



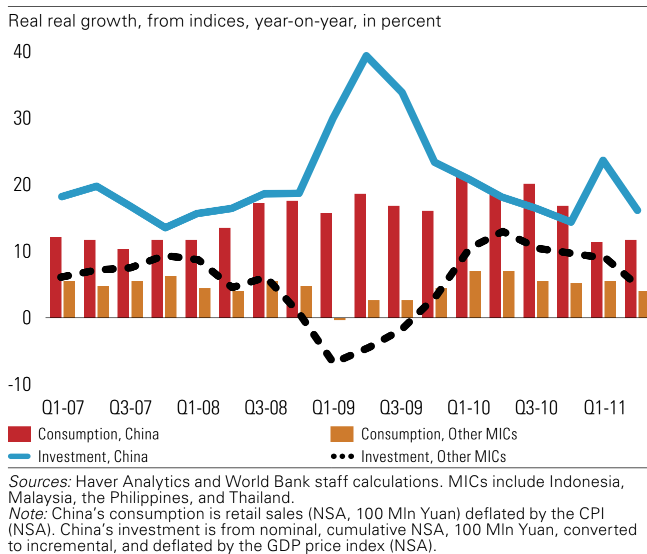
Sources: Haver Analytics and World Bank staff calculations.

Figure 4. ...but growth in external demand for China's exports has slowed even faster



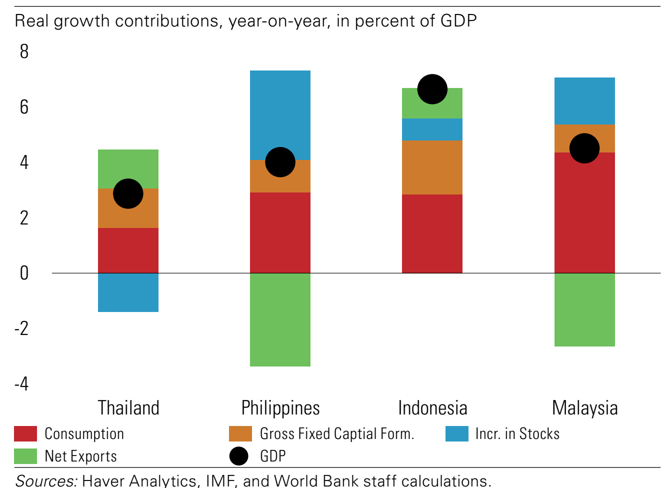
Sources: Haver Analytics and World Bank staff calculations.

Figure 5. Real growth in consumption and investment has been slowing in the middle-income countries...



Sources: Haver Analytics and World Bank staff calculations. MICs include Indonesia, Malaysia, the Philippines, and Thailand.
Note: China's consumption is retail sales (NSA, 100 Mln Yuan) deflated by the CPI (NSA). China's investment is from nominal, cumulative NSA, 100 Mln Yuan, converted to incremental, and deflated by the GDP price index (NSA).

Figure 6. ...but still drove growth in the first half of 2011

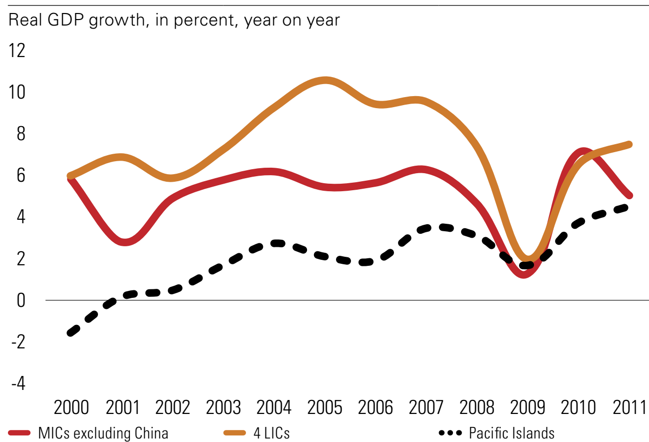


Sources: Haver Analytics, IMF, and World Bank staff calculations.

Nevertheless, domestic demand was the key driver of growth, more than offsetting the negative contribution from net exports in Malaysia and the Philippines in the first half of 2011 (Figure 6).

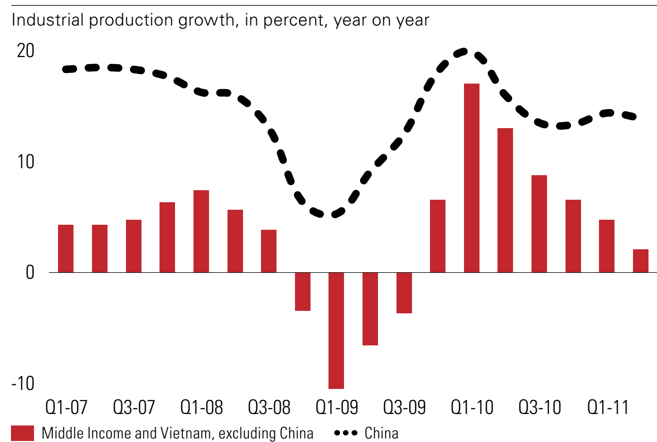
The growth slowdown was more pronounced in the industrial sector of the middle-income countries, excluding China. Output among the low-income countries is responding to the global malaise with a lag (Figure 7). Real growth in industrial value-added goods produced by the middle-income countries in East Asia (excluding China), slowed by 1.9 percentage points in the first quarter of 2011, and by another 2.7 percentage points in the second quarter (Figure 8). Some of this softening was due to supply chain disruption after the devastating earthquake and tsunami that hit Japan in March. For example, production of small cars fell by seven percent between April and August 2011 due to these disruptions (see Box 1). Industry growth remained relatively stable in China during the first half of this year.

Figure 7. The slowdown in the middle-income countries, excluding China, is more pronounced...



Sources: Haver Analytics and World Bank staff calculations.
Note: Low-income countries are: Cambodia, Laos, Mongolia, and East Timor. Middle Income countries are: Indonesia, Malaysia, Philippines, Thailand and Vietnam.

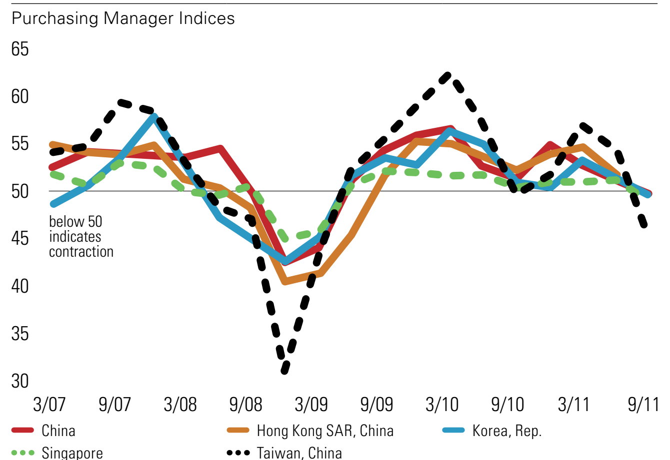
Figure 8. ...because of weakening industrial production



Sources: Haver Analytics and World Bank staff calculations.
Note: The developing countries included the figure are Indonesia, Malaysia, Philippines, Thailand and Vietnam. For China, gross industrial value added index is used, 2005=100.

Growth in the second half of 2011 is expected to be more modest than earlier in the year, especially in the manufacturing sector. Manufacturers' sentiment remains weak and reflects lingering uncertainty about financial problems and slow economic recovery in the developed economies, and the impact of natural disasters on economic prospects domestically. Output in the Eurozone contracted by 2 percent in September, and the purchasing manager indices (PMI) declined in October indicating that a stronger contraction could follow in the fourth quarter. PMIs in China, newly-industrialized economies, and the U.S. (each major export markets for East Asia countries), dropped through the 50 percent threshold in the third quarter, indicating that a contraction in the near future is possible (Figure 9).[2] In addition, capacity utilization was close to its pre-crisis peak in most middle-income countries, and may act as a brake on expansion as well. As predicted in the previous issue[3] of the Regional Update, the economic impacts of the Tohoku earthquake in Japan have mostly dissipated (see Box 1) but the lingering effects of flooding will take a toll on growth this year. In Thailand, exceptionally strong flooding is expected to reduce growth by one percent of GDP in 2011 (see Box 1). However, reconstruction in 2012 is likely to contribute to growth (see Chapter III for growth projections).

Figure 9. Manufacturers' sentiment deteriorated in the third quarter



Source: Markit.

2 Preliminary monthly data indicate that in October 2011 China's PMI has increased to just above 50.

3 Securing the Present, Shaping the Future, EAP Economic Update, March 2011, World Bank, Washington DC.

Box 1. Natural disasters are affecting growth and regional production networks

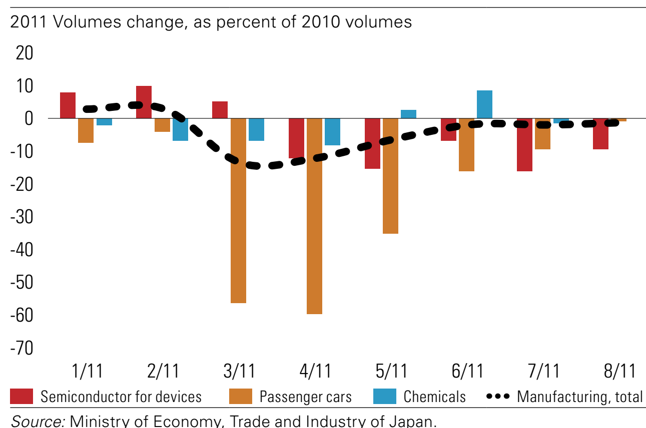
In Thailand, widespread flooding has reached Bangkok and surrounding provinces, which together produce close to 40 percent of Thailand's GDP. As a result of the flood, GDP growth in 2011 was revised down from an earlier forecast of 3.4 percent to 2.4 percent. The damages are estimated to be up to four percent of GDP, including two percent in industrial estates that are part of the regional supply chains, 0.4 percent in agriculture, and 0.6 percent in retail industry and tourism.

As this report is going to print in mid-November, the flooding has affected over 1,000 manufacturing plants in six industrial estates. Several international firms have warned that they will have to increase prices as a result of anticipated shortages. Several factories have closed, and Western Digital Corporation (a major producer of hard drives, with 60 percent of its production situated in Thailand) has warned that current supplies will last for only one month. The flood is also affecting automotive supply chains. Plant shutdowns had already cut carmaker Honda's world output by five percent and halted its production in Malaysia, due to lack of parts.

It is not the first time this year that the resilience of East Asian supply chains has been tested by natural disaster. Japan was struck by a magnitude 9.0 undersea earthquake on March 11, 2011. It was the most powerful earthquake to have hit Japan, and one of the five most powerful earthquakes in history. The earthquake was accompanied by extremely powerful tsunami waves that devastated many low-lying areas in Japan and resulted in tremendous human loss (15,824 dead and 3,824 missing, as of October 18, 2011). Many adverse economic consequences followed, including the loss of some power generating capacity and concern over nuclear contamination. Consumer confidence and several sectors of production have suffered as a consequence. The automotive industry was hit particularly hard when the Renesas plant in Tohoku, which produced 40 percent of the world's microcontrollers, was destroyed, halting car production around the world. Other East Asian countries suffered economic loss from the disrupted supply chains in electronics and automotive industries. In Thailand, for example, small car manufacturing swung from growth at 46 percent in February 2011 to a 40 percent decline in April. Some other industries were similarly affected, such as the manufacture of galvanized metal sheets.

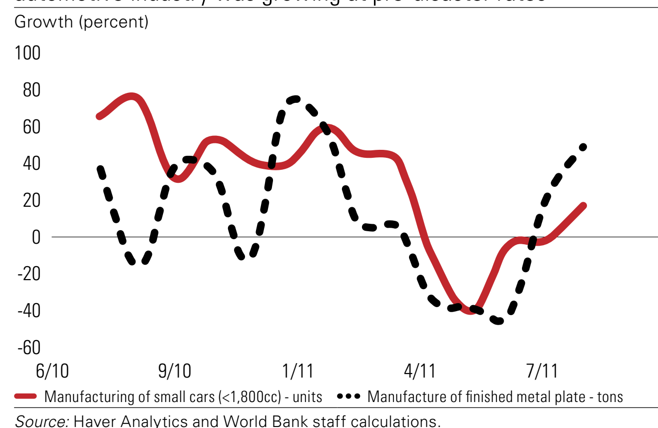
By June 2011, however, the affected industries in Japan had recovered to their pre-disaster levels of output (Box Figure 1). Shortly after that, the affected sectors in other countries returned to their pre-disaster growth rates and production levels (Box Figure 2). Whether the levels of production in Thailand can recover in the coming months remains to be seen, and will depend on demand for electronics and cars, which in turn is linked the global growth. Like in the case of Tohoku, reconstruction after the Thai flood is likely to be beneficial for growth in 2012.

Box Figure 1. Production recovered in Japan



Source: Ministry of Economy, Trade and Industry of Japan.

Box Figure 2. Six months after the Japan disaster, Thai automotive industry was growing at pre-disaster rates



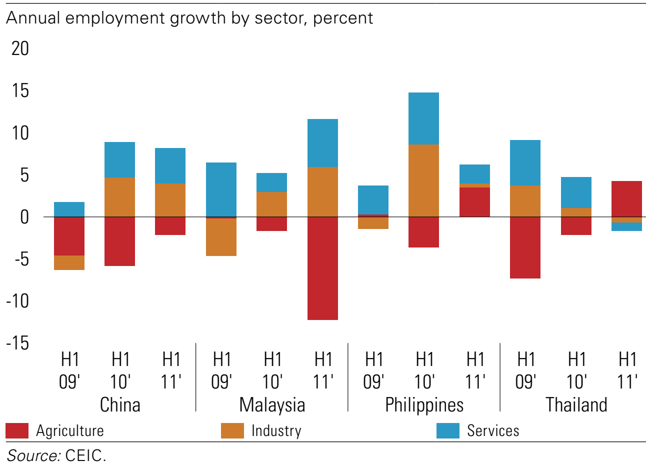
Source: Haver Analytics and World Bank staff calculations.

Production networks are serving the region well, as they reduce costs of production through diversification and specialization. But their resilience has been tested by a series of natural disasters, exposing the vulnerability of these complex production processes to external shocks. As the reconstruction after the Tohoku earthquake is ongoing, international companies are developing strategies to make their operations more resilient to catastrophes. They are planning to increase inventories, develop technologies that are easier to substitute in case of a disaster, and—most importantly—intensify their connections to other economies in the region to diversify supplies.

Manufacturing employment followed output

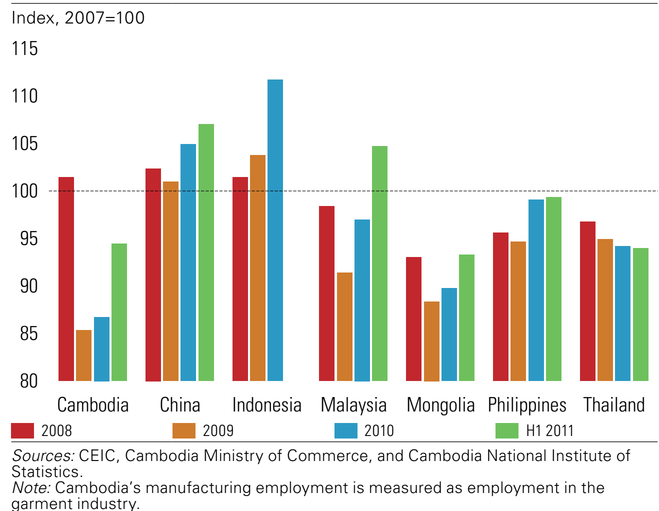
Growth in manufacturing employment began slowing, following dissipation of stimulus effects and global easing of manufacturing trade.[4] Excepting Malaysia, growth in manufacturing employment has started to slow, which is also a natural consequence of capacity utilization that is reaching pre-crisis levels. However, employment growth remained below pre-crisis levels in the low-income countries (Figure 10, Figure 11). In the Philippines, this was due to the fact that the electronics sector, which contributes over a half of gross exports, has not recovered from the recent crisis, and workers moved into service sector jobs, which serve as a safety net during downturns.[5] Contraction in manufacturing employment in Thailand was due to a shift of unskilled workers toward the agriculture

Figure 10. Manufacturing employment growth is slowing, and was negative in Thailand in the first half of 2011...



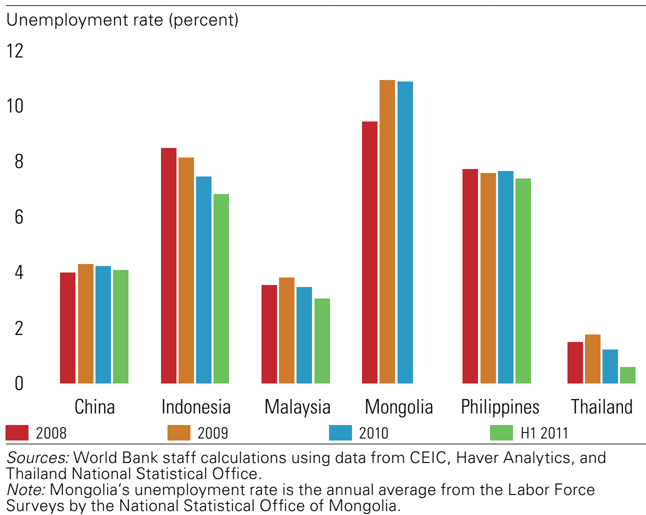
Source: CEIC.

Figure 11. ...and is still below pre-2008 crisis levels in many countries



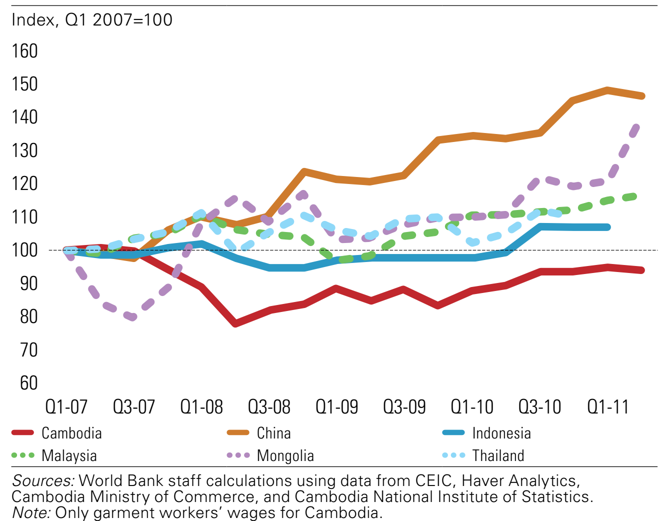
Sources: CEIC, Cambodia Ministry of Commerce, and Cambodia National Institute of Statistics.
Note: Cambodia's manufacturing employment is measured as employment in the garment industry.

Figure 12. Unemployment rates continued to decline across the middle-income countries...



Sources: World Bank staff calculations using data from CEIC, Haver Analytics, and Thailand National Statistical Office.
Note: Mongolia's unemployment rate is the annual average from the Labor Force Surveys by the National Statistical Office of Mongolia.

Figure 13. ...while real wages continued to trend up



Sources: World Bank staff calculations using data from CEIC, Haver Analytics, Cambodia Ministry of Commerce, and Cambodia National Institute of Statistics.
Note: Only garment workers' wages for Cambodia.

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4 See Chapter II for fiscal policy analysis.

5 See Securing the Present, Shaping the Future, EAP Economic Update, April 2011, World Bank, Washington DC.

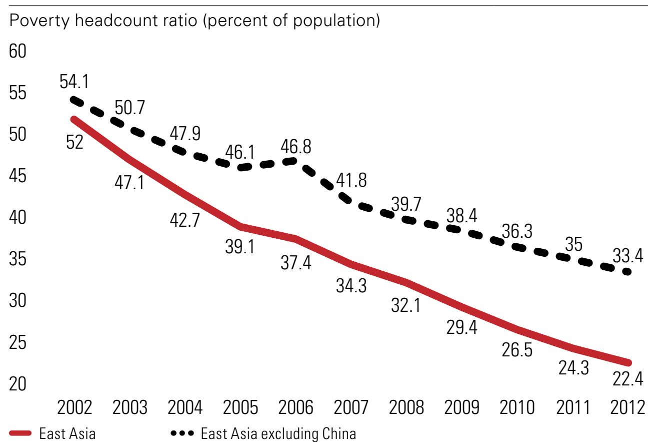
sector, which has been experiencing strong growth after the crisis. Total employment continued to grow, however, performing best in Indonesia, Malaysia, and Thailand (Figure 12).

Real manufacturing wages kept growing, albeit at slower rates than in 2010. Wages in most countries in the region have recovered to their pre-crisis levels and have continued on an upward trend (Figure 13). In China, real manufacturing wages trended up, although there was some cyclical slowdown in the second quarter of 2011. In Mongolia, however, surveys of informal sector workers show that their real wages stagnated after the crisis, so that earnings were insufficient to meet basic needs.

Poverty is expected to decline further

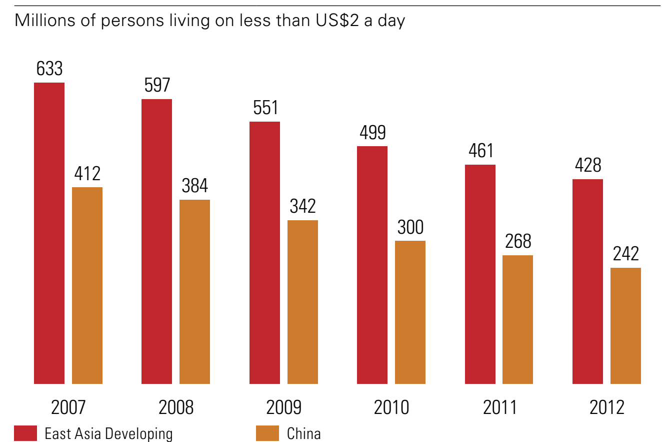
Based on the projected GDP growth, the proportion of the population living on less than US$2 a day in developing East Asia in 2011 is expected to decrease by 2.2 percentage points to 24.3 percent from 26.5 percent in 2010. Based on current growth forecasts (see Chapter III), it is estimated that 38 million people in developing East Asia will emerge out of poverty by the end of 2011 (Figure 14, Figure 15). However, poverty reduction efforts would be hampered in the event of another increase in food prices, if incomes stagnate.

Figure 14. Poverty is projected to further decline, despite slowing growth...



Source: PovcalNet and World Bank staff calculations.

Figure 15. ...and 38 million people will escape poverty in 2011

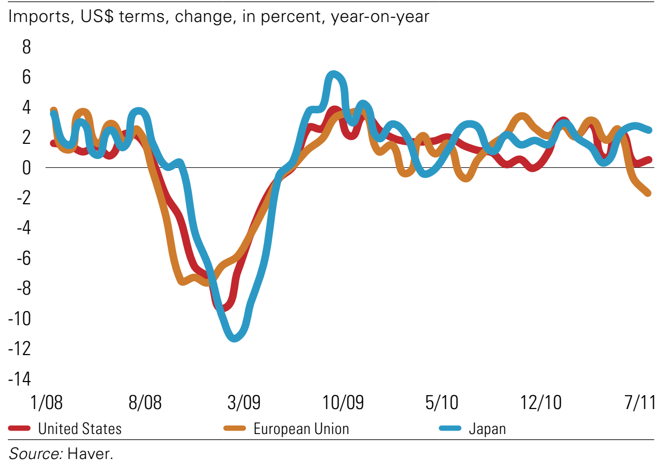


Source: PovcalNet and World Bank staff calculations.

East Asian exports were supported by China's domestic demand

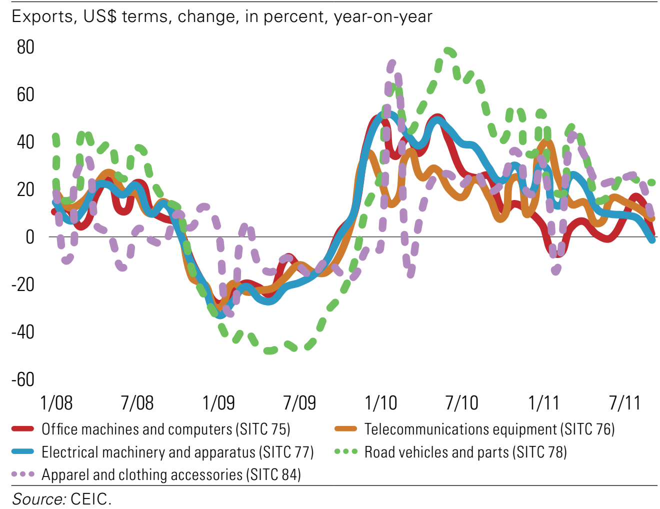
As a result of sluggish external demand for their final products, exports of the three major regional industrial supply chains, especially electronics, have experienced a severe slowdown. Advanced economies' imports have grown by just two-to-four percent a year, while European imports contracted in the third quarter of 2011 (Figure 16). As these major sources of global demand are slowing, they particularly affect exports of the main production networks in East Asia, most importantly electronics exports which fell in September, following contractions in apparel and office machines earlier in the year (Figure 17). Monthly exports of electronics from the Philippines contracted by 40 percent on average (compared to a year earlier) since the start of 2011; exports of telecommunications equipment from Thailand fell by 30 percent in September, and exports of office machines and computers in Malaysia and Indonesia contracted by over 20 percent during some months in 2011 compared to a year earlier.

Figure 16. External demand is barely growing...



Source: Haver.

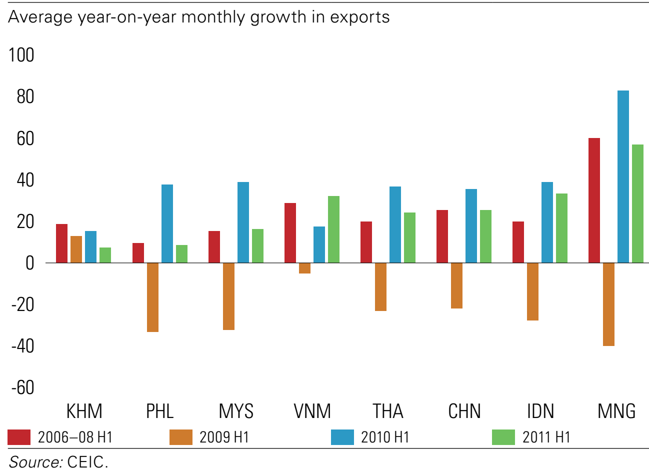
Figure 17. ...and it is dragging down exports of electronics



Source: CEIC.

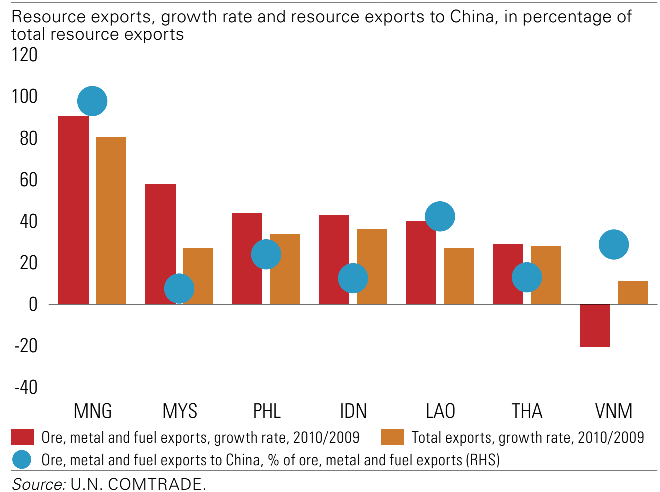
Demand for commodities and raw materials remained strong, however, helping resource-rich economies achieve high levels of export growth. While combined East Asian exports grew on average by 20 percent in 2010, there has been variation across countries (Figure 18). Commodity exporters registered higher export growth rates than other countries, most notably Mongolia which exports nearly all its commodities to China (mostly coal and copper, Figure 19).

Figure 18. Commodity exporters recovered faster to their pre-crisis export growth rates than other countries...



Source: CEIC.

Figure 19. ...driven by strong performance in the ore, metal, and energy sectors

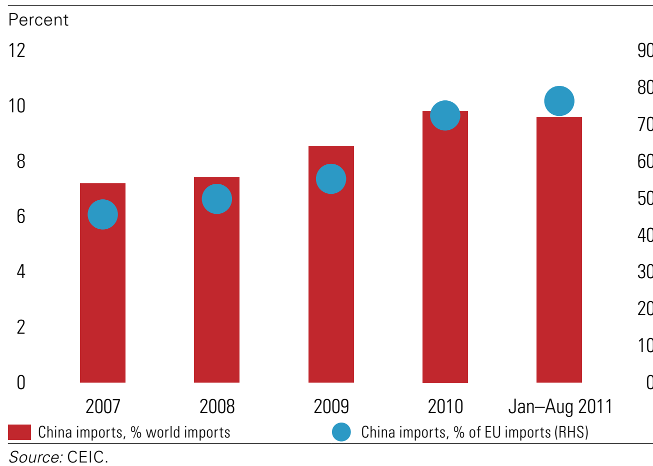


Source: U.N. COMTRADE.

East Asia, and China in particular, continued to grow in importance as a source of global demand. Since the financial crisis battered developed economies, China's share in world imports has consistently grown, approaching its share of 10 percent in global GDP (Figure 20). It now imports almost as much as the European Union, the world's largest single market. China's trade surplus also dropped by about 30 percent between 2007 and 2010 (Figure 21).

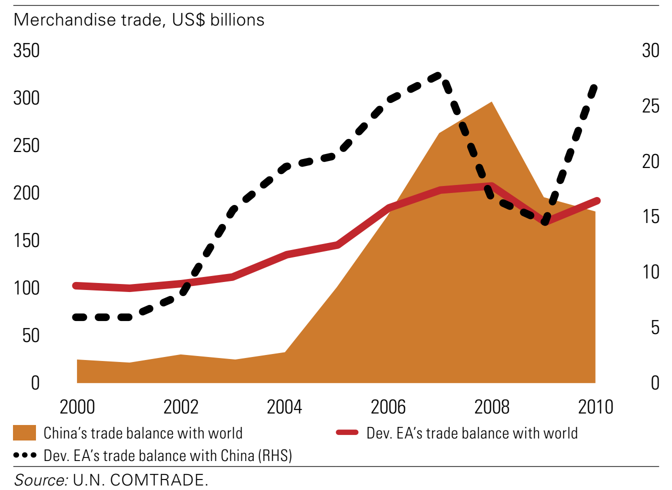
China's growing demand for imports, especially of consumer goods, presents a new opportunity for the region's exporters. As its trade surplus declined, China's imports for domestic needs grew faster than imports

Figure 20. China's rising share in world's imports puts it on course to surpass Europe as the second largest importer...



Source: CEIC.

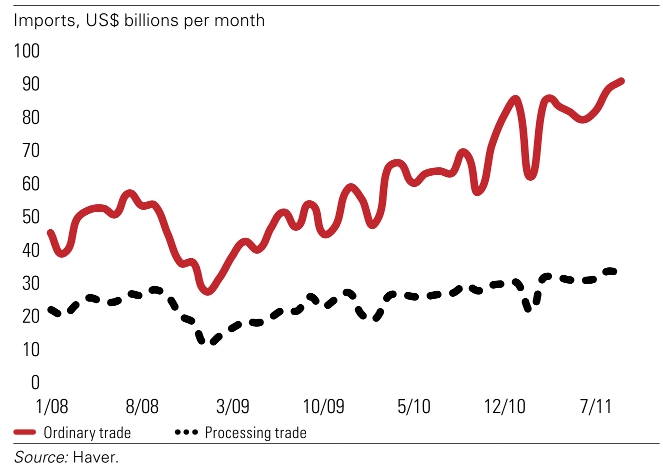
Figure 21. ...and China's imports from developing East Asia have almost recovered to pre-crisis levels



Source: U.N. COMTRADE.

for processing and re-export (Figure 22). Its imports of consumer goods have also been growing rapidly, with emerging East Asian countries currently holding 18 percent of this market (Figure 23, Figure 24). China's growing consumer goods market represents a potentially significant new opportunity for East Asian exporters, if it continues to expand from its low base of just two percent of the world consumer goods market. Raising China's private consumption by five percentage points of GDP is estimated to be associated with an improvement in the trade balance of China's regional trading partners by between 0.1 percentage points of GDP (in Indonesia) and 0.5 percentage points (in Malaysia).[6] Highlighting China's importance to the region, its trade balance with developing East Asia improved in East Asia's favor during the recovery (Figure 21).

Figure 22. China's imports for domestic needs grew faster than those for processing and re-export



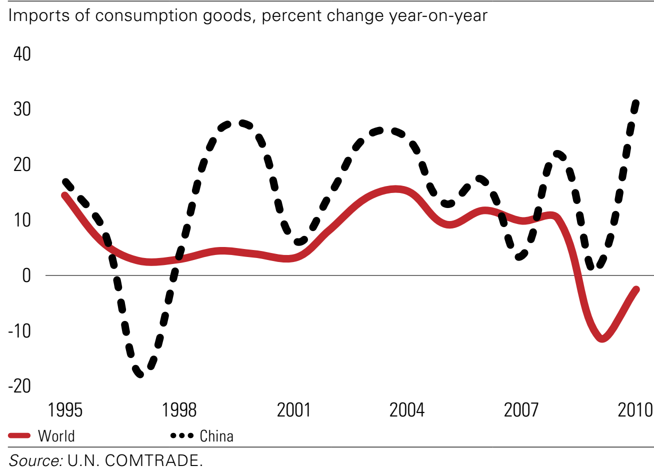
Source: Haver.

Regional domestic demand is expected to support export growth going forward, but it cannot fully compensate for the effects of global slowdown and uncertainty. Even though broad trade indicators have been upbeat in the first half of 2011, some worrisome signs have emerged. In September, exports from Hong Kong SAR to mainland China contracted by 7.3 percent, compared to a year earlier. Due to its position at the center of production chains, this could be an indication of rockier times ahead for regional trade.

Remittances into developing East Asia have remained resilient at mid-year, helping recipient countries maintain current account surpluses. However, economic weakness in the U.S. and in the Eurozone, which are

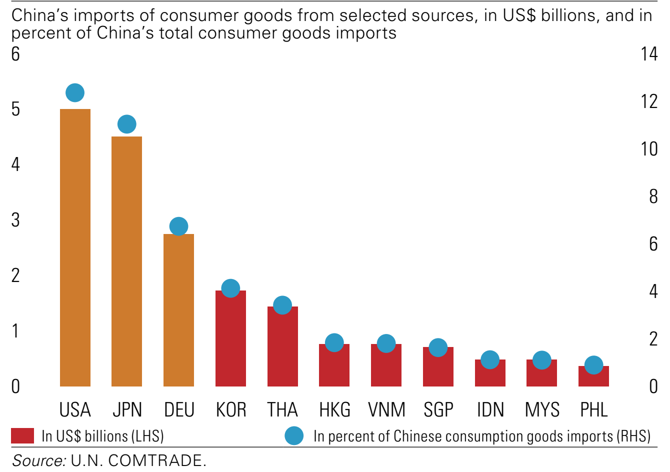
6 IMF, 2011, "China: Spillover Report for the 2011 Article IV Consultation and Selected Issues", Washington DC.

Figure 23. China's imports of consumption goods grew at an average annual rate of 14 percent in the past 15 years, compared with the world average of 6 percent...



Source: U.N. COMTRADE.

Figure 24. ...and most countries in the region have at least a one percent share of this market



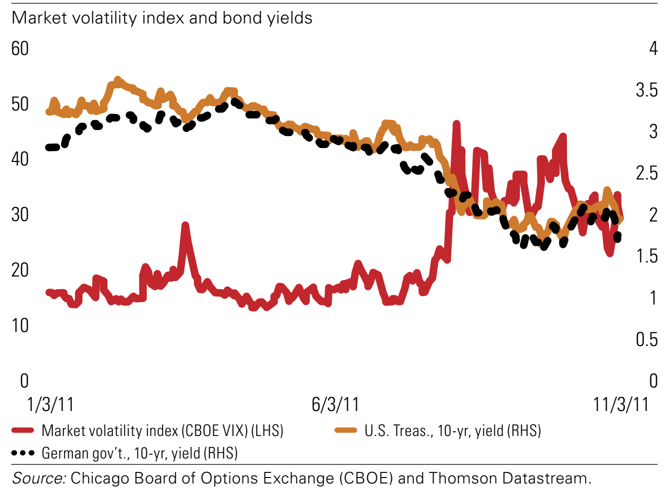
Source: U.N. COMTRADE.

the biggest hosts to migrant workers from developing economies, may depress remittance flows this year. In the Philippines, the world's fourth-largest remittance recipient after India, China, and Mexico, remittances stood at US$13 billion through August, growing by 6.9 percent compared to a year earlier. Healthier flows from Asia and the core Eurozone countries compensated for weaker flows from the U.S. However, remittances growth in the region is projected to settle at around six-to-seven percent this year, below its historical average, with lower flows from the Middle East also playing a part.

Foreign investors sold regional equities and bonds as market volatility was rising globally

Portfolio investment in East Asia continued to grow through the first half of 2011, but in August and September, international equity and bond funds sold off an estimated three percent of their portfolio positions in emerging East Asia. Risk aversion grew, driven by the debt crisis in the Eurozone, and the stock market slide in September triggered a rush by investors to relatively safe assets, notably U.S. government bonds (Figure 25). East Asian markets were recently dealing with high inflows of "hot" capital (Figure 26). But they also were among the most affected by this flight to safety, and the subsequent outflow of these short-term funds highlighted the vulnerability of the region to the events in Europe. During August and September, international mutual funds and exchange traded funds (ETFs) unloaded around US$13.1 billion of their holdings of emerging East Asian equities and bonds, equal to about three percent of their holdings in the region (Figure 27). Fund flows from mutual and ETFs represent, on average, about one-third of equity flows and one-fifth of bond flows reported on balance of payments basis.

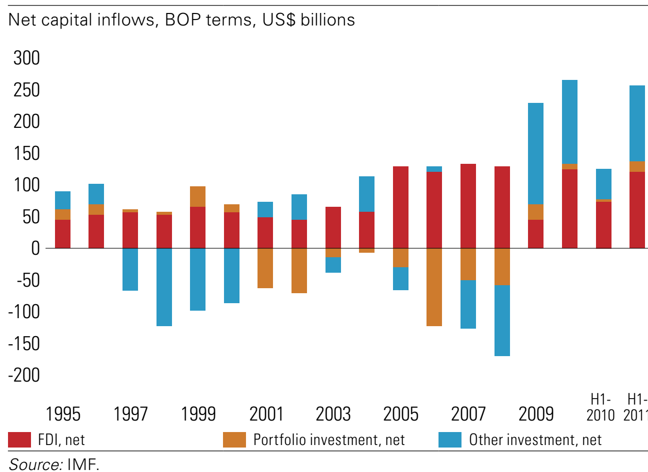
Figure 25. As market volatility increased after an escalation of the Greek debt crisis in May, investors rushed to the relative safety of U.S.Treasury bonds



Source: Chicago Board of Options Exchange (CBOE) and Thomson Datastream.

Figure 26. After buoyant portfolio inflows during the first half of the year...

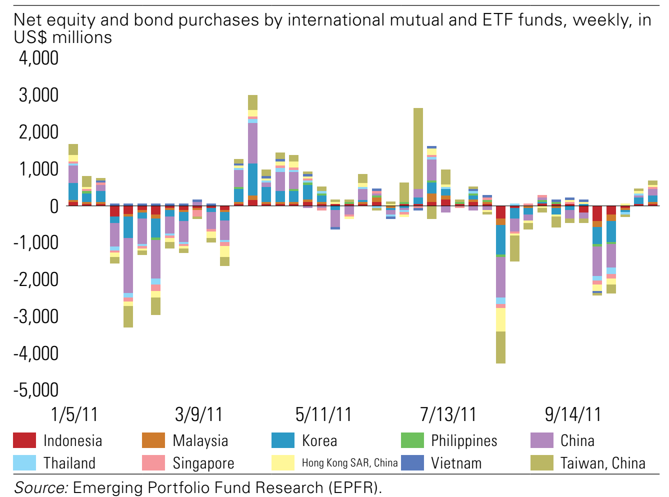
Net capital inflows, BOP terms, US$ billions



Source: IMF.

Figure 27. ...foreign investors withdrew at least 3 percent of total portfolio investment in August and September

Net equity and bond purchases by international mutual and ETF funds, weekly, in US$ millions

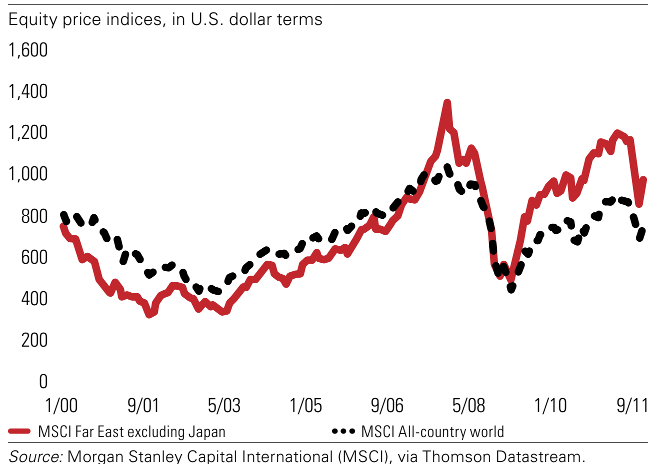


Source: Emerging Portfolio Fund Research (EPFR).

Capital market indices in the region dropped sharply. While capital flows to the region had helped deepen and broaden some of the local equity markets, they also increased the sensitivity of the region's equities to global events (see Chapter III). Share prices have become more volatile, and some East Asian markets fell more sharply than those in the advanced economies (Figure 28, Figure 29). Since the Greek crisis intensified in May this year, the losses in the region varied, falling by between 21 percent (Hang Seng in Hong Kong SAR, China) and three percent (Philippine PSEi) between May and November.

Figure 28. The region's equity prices dropped by more than a quarter from their May high...

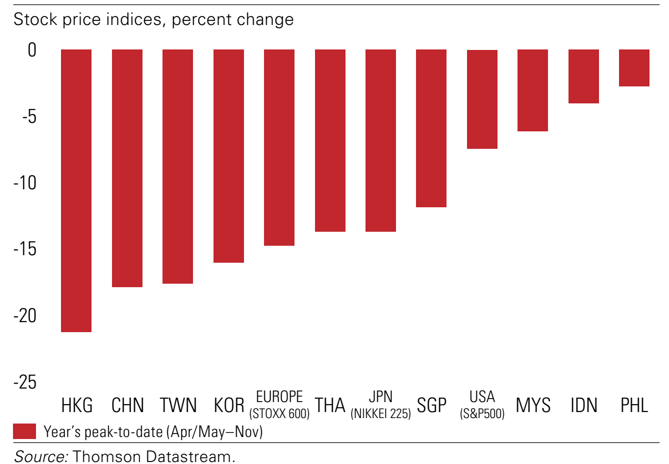
Equity price indices, in U.S. dollar terms



Source: Morgan Stanley Capital International (MSCI), via Thomson Datastream.

Figure 29. ...as more volatile emerging markets fell sharper than those in the advanced economies

Stock price indices, percent change



Source: Thomson Datastream.

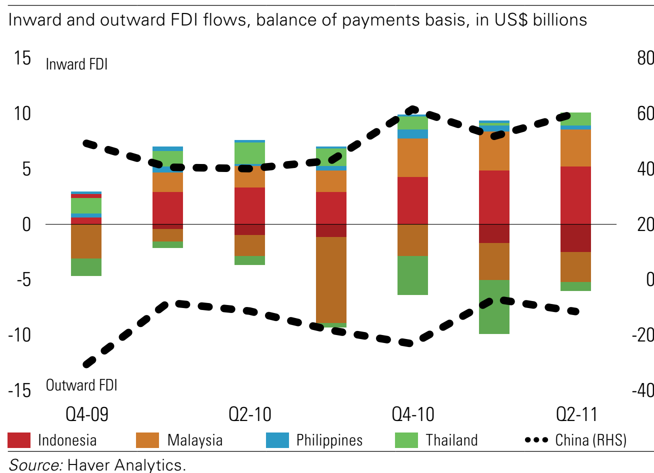
Foreign direct investments (FDI) remained strong in the first half of the year. These are driven by structural, rather than cyclical, factors and are therefore the least volatile of all investment flows. FDI inflows increased in the second quarter and outward FDI flows have also held relatively steady as residents in Malaysia, Thailand, and Indonesia invested abroad earlier in the year. China's outward investments are still remarkably small relative to its

GDP and are concentrated in the natural resource sector.[7] However, the projected US$8 billion of outflows in 2011 include investments in high-tech firms in Europe, most recently in Sweden's Volvo Group.

Bank credit flows remained stable through the first half of 2011 but represent an important risk, should European banks start deleveraging. As discussed in Chapter III, even if a definitive Eurozone settlement is implemented successfully, European banks would likely need to deleverage and could reduce exposure to emerging markets. During the 2008 crisis, international banks reduced their exposure to developing East Asia's non-bank private sector by US$36 billion between mid-2008 and the first quarter of 2009 (Figure 31). An impact of similar proportions now could mean that over US$30 billion dollars flow out, constraining credit available to the private sector.

Figure 30. Inward FDI flows were robust in the first half of 2011

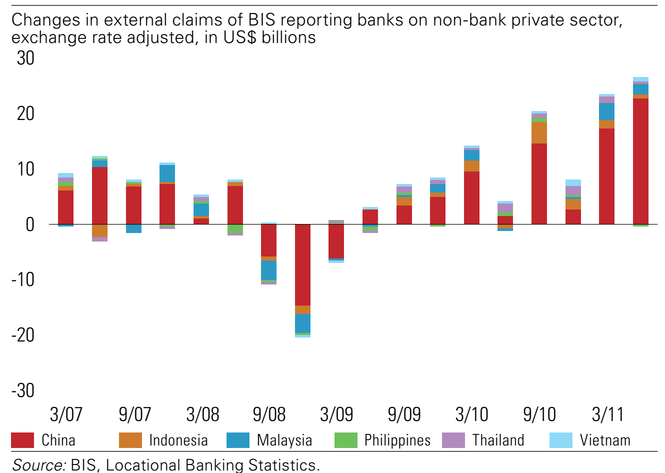
Inward and outward FDI flows, balance of payments basis, in US$ billions



Source: Haver Analytics.

Figure 31. International bank flows to East Asia are vulnerable to potential reversals should European banks start deleveraging

Changes in external claims of BIS reporting banks on non-bank private sector, exchange rate adjusted, in US$ billions



Source: BIS, Locational Banking Statistics.

7 See Robust Recovery, Rising Risks, East Asia and Pacific Economic Update, November 2010, World Bank, Washington DC.

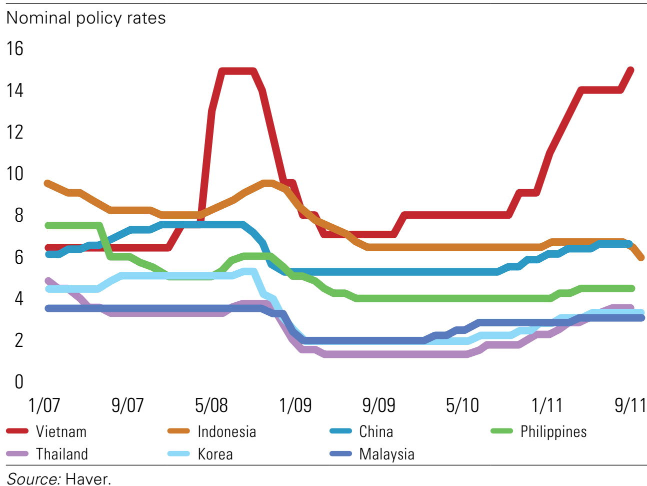
II. Policies Refocus on Sustaining Growth

The global economic malaise has led policymakers to rethink their policies during the last six months. Fighting inflation and dealing with excess capital inflows that drove currency appreciation was a key priority before. Now the emphasis is on supporting growth. Monetary tightening is on hold, and currencies have weakened in nominal terms. A tapering in capital inflows will initially help central banks manage inflation. While real interest rates are negative in nearly all East Asian countries, some are preparing for a round of monetary easing to cushion the impact of global weakness. Others will likely balance global risks against those from easing too soon and will be reluctant to cut interest rates unless there is an abrupt deterioration in growth. When capital flows return, however, a concerted effort in the region to use exchange rate flexibility to gain more independence in monetary policy and shift demand more towards domestic sources could be an option of choice. The current global slowdown could continue into the long- term, and as such, the case for a stimulus is weaker this time around. Should the need arise, however, fiscal space is available to promote the structural transformation needed to sustain more domestically-driven growth. With or without the stimulus, policymakers will need to sharpen their focus on addressing the challenges of long-term growth.

Monetary policy: waiting to ease?

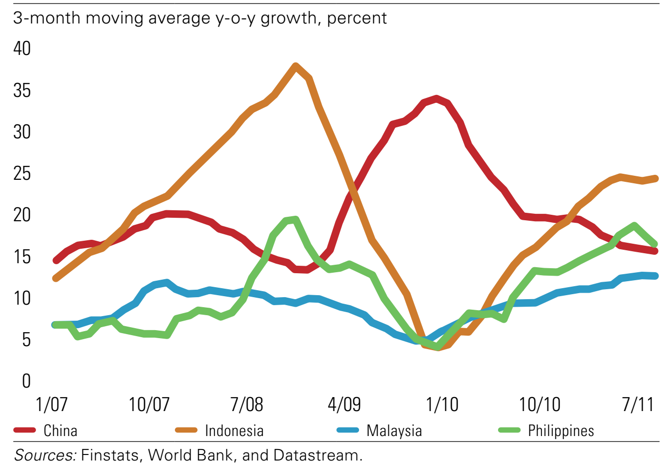
After months of tightening, central banks in the region have halted interest rate hikes. During the last six months, inflation was accelerating rapidly, forcing authorities to raise interest rates and cash reserve requirements (Figure 32, Figure 34). Curbing credit growth, an effective instrument of monetary policy in many countries, has also been employed to ease inflationary pressures (Figure 33). Some space for monetary tightening still remains, as nominal rates are below their peaks and real rates are negative (Figure 35). But sustaining growth seems to be the dominant concern among policy makers at this time.

Figure 32. Monetary tightening has not reached pre-crisis levels (except in Vietnam)...



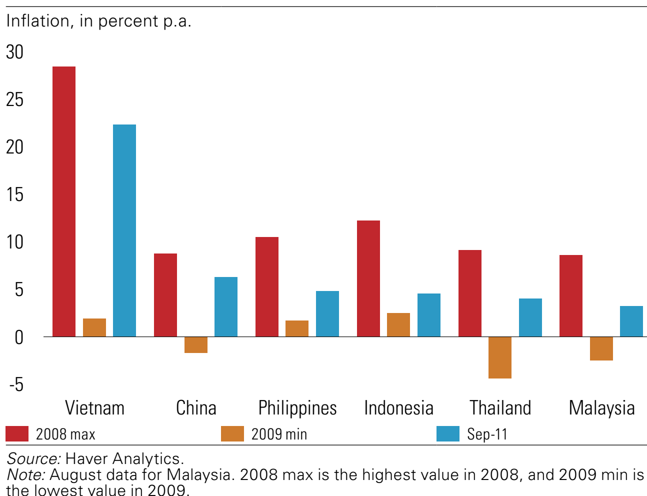
Source: Haver.

Figure 33. ...but authorities were able to slow credit growth, a key instrument in controlling inflation



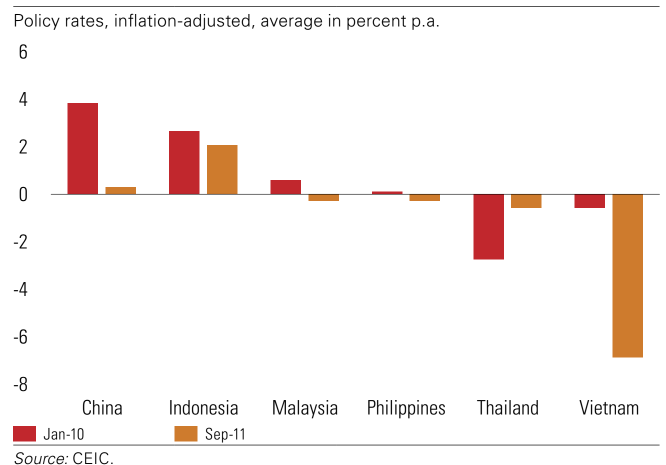
Sources: Finstats, World Bank, and Datastream.

Figure 34. Inflation is rebounding...



Source: Haver Analytics.
Note: August data for Malaysia. 2008 max is the highest value in 2008, and 2009 min is the lowest value in 2009.

Figure 35. ...and real policy rates dropped and became negative in most countries



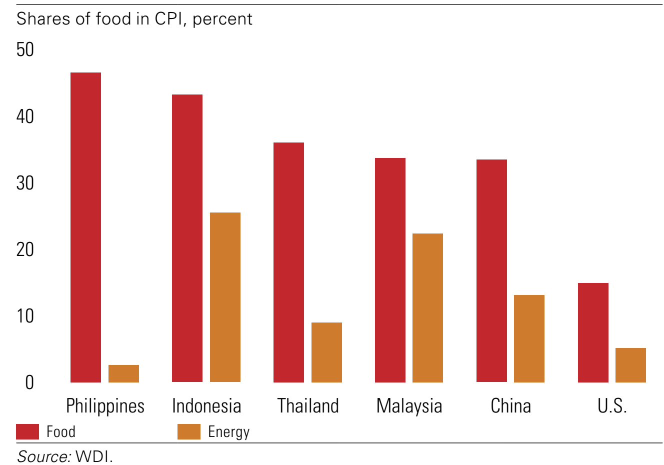
Source: CEIC.

Indonesia was the first country to cut interest rates as it moved to protect growth in the face of a weakening external environment. The authorities cut interest rates both in October and November, by 75 basis points in total, to six percent. The move was somewhat ahead of market expectations, especially because Indonesia was affected by outflows of portfolio investments in August and September (see Chapter I), but inflation has been trending

downwards and Indonesia has the highest real policy rates among the middle-income countries in the region (Figure 35). Although inflation appears to have peaked in the region, negative real interest rates mean some countries will likely remain reluctant to use interest rate cuts to pre-empt the impact of a global slowdown (Figure 34, Figure 35). In Mongolia, which grew by 20.8 percent in the third quarter compared to a year earlier, overheating concerns still dominate, with the central bank increasing interest rates in October, the third hike this year.

Food prices were the main driver of inflation in many countries, and remain a risk. International food prices were stuck near their 2008 peaks this year, and rice prices were a particular concern earlier in the year. Domestically-produced foods, such as meat and vegetables, were also increasingly strong drivers of inflation due to supply disruptions from floods and animal disease. In China, monthly pork price inflation grew from 20 percent to nearly 60 percent compared to a year earlier since January 2011, due to the above factors, as well as because of temporary deficits resulting from a supply-demand mismatch and high prices of feed (Figure 36). Chapter III of this report takes an in-depth look at food prices and their impact on the poor during the 2008 crisis.

Figure 36. Food prices are a large part of CPI

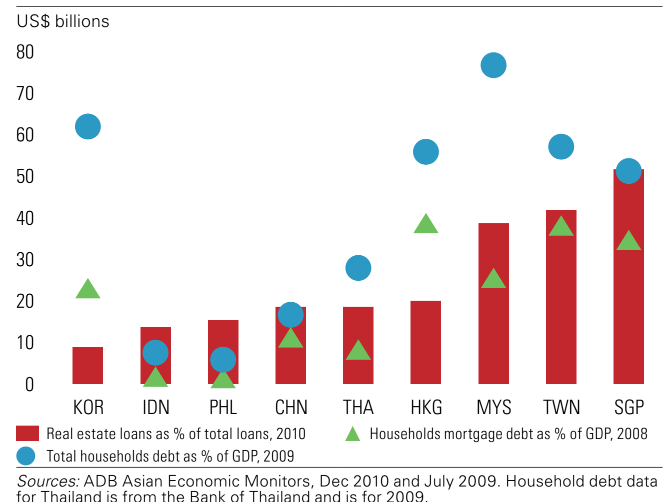


Source: WDI.

New risks have emerged as capital flows adjust to continuing uncertainty in Europe. These include increased risks of capital flow reversals, more volatility in the equity and bond markets, as well as a possible reversal in bank flows, should the European banking sector start deleveraging. These potential risks are discussed in more detail in Chapter III. So far, measures to reduce liquidity included raising reserve requirements (often to their pre-crisis levels, like in Malaysia) and emphasizing the use of macro-prudential measures. For example, Indonesia earlier in the year extended the holding period on short-term Central Bank debt instruments. It also introduced mechanisms to support the domestic government bond market in case of a shock and in September reduced the lower band of the interest rate corridor for monetary operations to stimulate transactions in the domestic money market (see Box 2). Countries have also allowed their currencies to depreciate somewhat.

A slowing or reversal in capital inflows will initially help central banks manage monetary policy. Earlier this year, authorities faced a challenge of maintaining stability without losing competitiveness. With capital inflows surging, high asset prices and credit growth raised overheating concerns in some countries. In the open economies, the reversal in flows will help. In China, housing markets have already cooled somewhat, driven by decisive policy interventions. But the share of real estate loans in total bank lending is high (especially if informal lending is included) and a sharp fall in house

Figure 37. Banks in Indonesia and the Philippines have limited exposure to the housing markets



Sources: ADB Asian Economic Monitors, Dec 2010 and July 2009. Household debt data for Thailand is from the Bank of Thailand and is for 2009.

Box 2. Capital outflows during periods of international market turbulence: Indonesia's recent experience

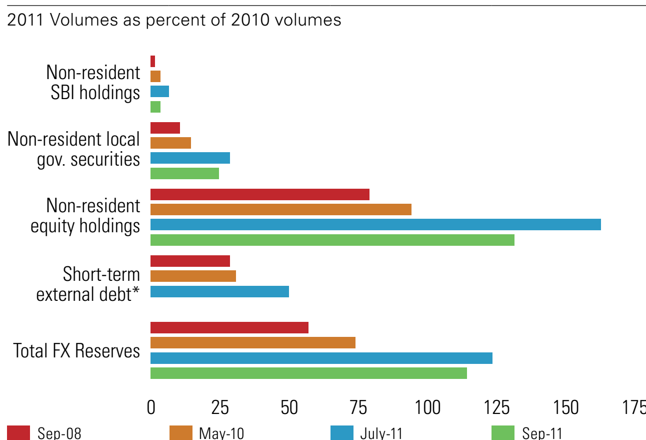
As has been the case for many emerging economies, Indonesia's exposure to global risk sentiment has risen in recent years as foreign investors have taken on increasing holdings of domestic portfolio assets (Box Figure 1). Non-resident investors hold roughly one-third of Rupiah government bonds (SUNs) and central bank bills (SBIs), compared to just 10 percent and 25 percent in Thailand and Malaysia respectively. While reserves have been boosted by these inflows, the increased asset holdings of foreign investors also leave the economy vulnerable to outflows due to changes in sentiment, as seen in late 2008 and May 2010.

This vulnerability was again highlighted during August and September 2011 when international market turbulence, associated with the debt crisis in the Eurozone and a downgrade in global growth expectations, triggered a sharp selloff by foreign investors (Box Figure 2). In total, foreign investors reduced their holdings of SUNs by US$3.3 billion over September and of SBIs, on which there is a minimum six-month holding period, by US$1.6 billion. Overall, net portfolio outflows amounted to US$4.7 billion, prompting intervention by Bank Indonesia in the currency market and in the domestic government bond market. This intervention drained foreign reserves by US$10 billion, or eight percent, over September to US$114.5 billion. This decline in reserves compares with a drop of 10 percent to US$50.6 billion during the market turmoil of October 2008.

While equity markets fell sharply (by 15 percent from end-August to early October), the central bank's intervention helped limit the Rupiah's depreciation against the U.S. dollar to 4.3 percent to IDR 8,960 over this period. In contrast, although one-year domestic currency government bond yields rose by over 100 basis points over the period, longer-dated bond yields remained relatively stable and well below the levels seen in other recent periods of market stress. For example, five- and ten-year yields in late September reached 6.7 percent and 7.5 percent respectively. By comparison, in late 2008 the exchange rate reached IDR 12 thousand per U.S. dollar and five-year government bond yields peaked at just over 20 percent.

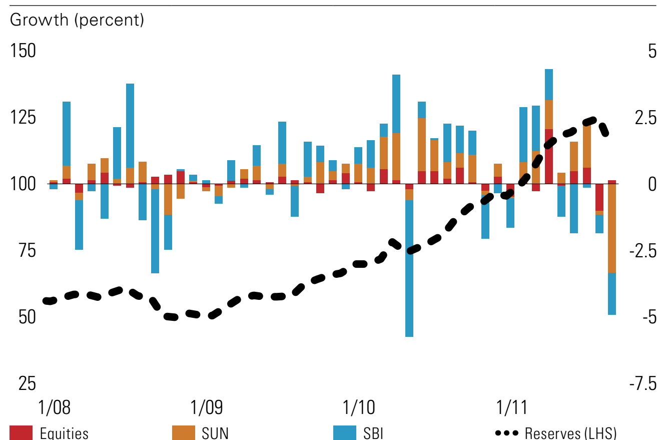
Indonesia's recent experience highlights a dilemma for countries that intervene to support domestic bond markets during periods of foreign investor outflows. This could smooth excess volatility in financial markets, which can inject uncertainty and raise the costs of borrowing for the economy. But it could also implicitly put a floor on potential losses for investors, creating stronger incentives for short-term inflows. Continued flexibility in the exchange rate can minimize any perceptions of "one-way bets". Over the medium- to long-term, a further deepening in domestic capital markets and a widening of the domestic investor base can help to further diversify funding sources for both governments and local corporations. It can also, in addition to structural reforms and investments that attract further FDI, play a role in reducing dependence on short-term portfolio inflows.

Box Figure 1. Reserves have increased in parallel with the rise in non-resident portfolio holdings



Sources: BI, KSEI, CEIC and World Bank.
Note: Short-term external debt by remaining maturity.

Box Figure 2. Non-resident portfolio outflows rose sharply in September



Sources: BI, CEIC and World Bank.
Note: "Flows" for SUN (local currency government securities) and SBI (BI certificates) indicate changes in holdings.

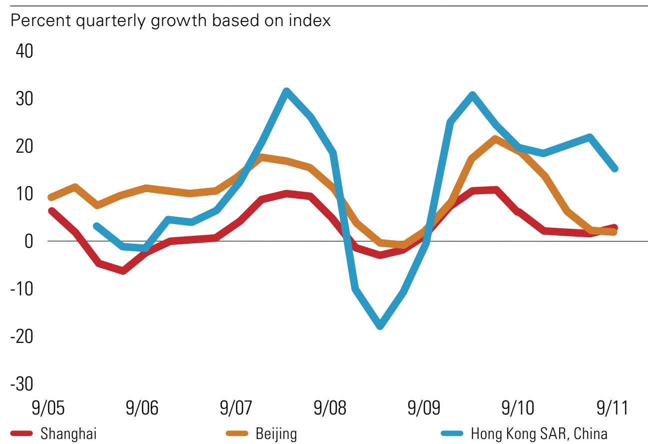
prices could undermine bank balance sheets, construction and associated sectors, and household spending (see Figure 37 for official lending only). If these risks were to materialize, China's growth could slow substantially. However, with the fiscal and monetary space available and given that markets have been cooling gradually, its impacts can be mitigated (Box 3). The deterioration in the global environment is not helping authorities in Vietnam who have been trying to stabilize the economy. They have slowed credit growth, tightened public spending, and raised interest rates above any other country's in the region, yet inflationary pressures eased only slightly (Figure 35).

Box 3. What kind of landing for China?

As the industrialized countries fear dipping into another recession, much of the prospects for inter-dependent East Asia continue to rest on China's resilience. Concerns have been resurfacing that this engine of regional growth might be heading towards a sudden slowdown—often called a hard landing—that might result in a large negative growth shock for the region and the world.

The expansionary policies that supported strong growth in the aftermath of the financial crisis also have fed a real estate boom. Rapid credit growth may also have undermined the portfolio quality of banks.

Box Figure. Housing prices cooled in large cities



Source: Haver.

More recently, successful attempts have been made to cool parts of the economy: interest rates were raised several times, statutory reserve ratios for commercial banks were raised, off-balance-sheet lending was included for determining capital and reserve requirements, and—most importantly—growth in formal bank lending has been constrained. As a result, broad money growth slowed sharply, and real estate prices have started to ease in some markets. Because real estate is usually used by formal and informal lenders as collateral or as an investment, it is a growing risk for the banking system and for informal creditors. Moreover, local governments may be put under pressure given their revenues rely to a considerable extent on selling land leases for real estate development. Weakening of land revenues could also impact local government borrowing. Reportedly, over 30 percent of GDP has been borrowed by local governments through special purpose vehicles, with most of it guaranteed by land and invested in infrastructure. Because Chinese households tend to put more money down and have smaller mortgages, a deleveraging of the magnitude seen in the U.S. is unlikely. Even so, real estate price corrections would still have a strong impact on domestic demand and consumer sentiment. As of mid-November 2011, real estate prices had already started declining in Wenzhou province.

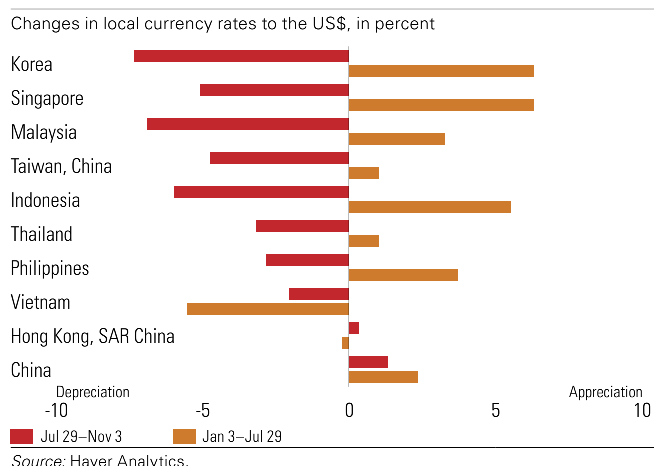
Across China, residential properties are about five-times households' annual earnings, which is comparable to the U.S. In Beijing and Shanghai, property prices exceed annual earnings thirteen- to seventeen-fold, although these markets have cooled recently (Box Figure). The government would be reluctant to ease monetary policy to support growth while inflation is high. Nonetheless, markets have been worried that, should monetary conditions be tightened further, or growth slow more than expected, falling housing prices would result in a decline in construction activity, and a deleveraging by formal and informal banking system and local governments.

Some relief could come in the planned social housing construction. Additionally, central and local governments are working to increase land supply, and new construction starts data remains strong. China's economy is projected to grow by above eight percent in 2011. The government also has ample fiscal space and room for monetary policy normalization should such a need arise, more so now that inflation seems to be on the wane again. As such, while adjustments in the property markets may well happen, there could still be a soft landing for China.

Currencies under pressure, central banks losing reserves

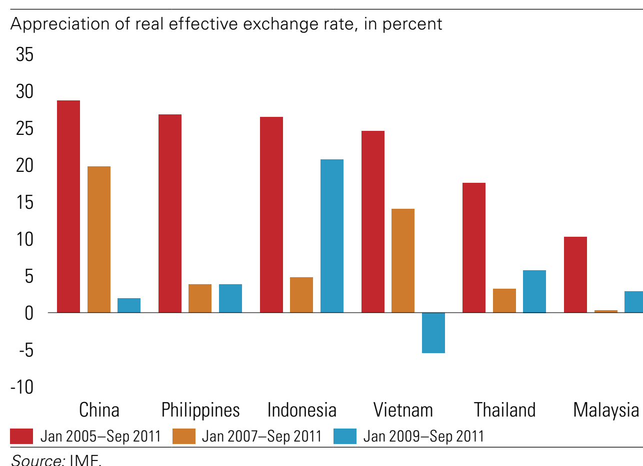
After the European debt crisis intensified in May, currencies depreciated quickly against the U.S. dollar, easing concerns about competitiveness. Exchange rates in East Asia depreciated in nominal terms, effectively erasing the appreciation that took place during first half of the year (Figure 38). Most middle-income countries' currencies appreciated in comparison to their trading partners since before the most recent crisis (Figure 39). China's exchange rate appreciated by 6.1 percent in nominal terms against the dollar, and by five percent in real effective terms between January 2010 and August 2011.

Figure 38. Most currencies have depreciated against the US$ since mid-year



Source: Haver Analytics.

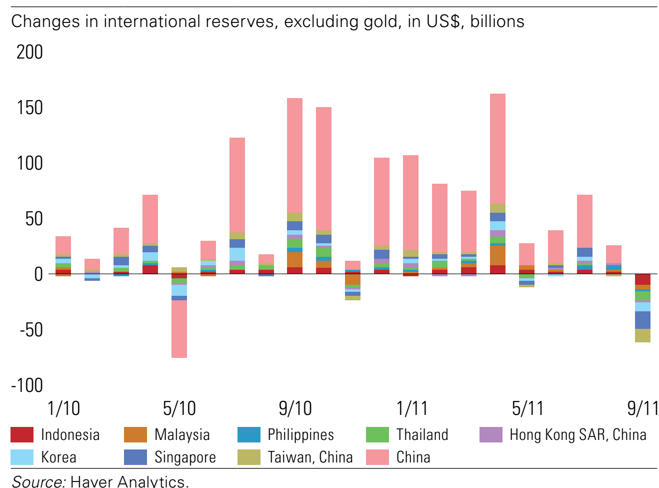
Figure 39. Middle-income countries' real exchange rates had appreciated relative to their trading partners since before the 2008 crisis



Source: IMF.

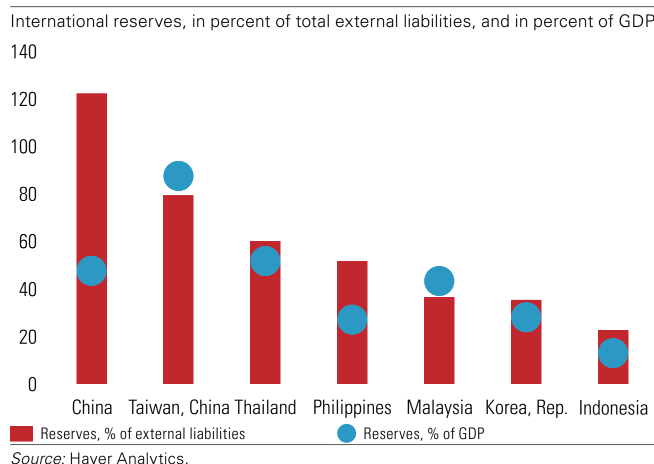
Foreign exchange reserves declined in September, but are still very substantial. As capital flows started reversing and valuation adjustments took place, reserves declined (Figure 40). For example, in Indonesia, reserves fell by 8 percent or US$10.1 billion over September as authorities intervened in support of local currency and bond markets (see Box 2). Reserves in the region remain substantial, however, and should be sufficient to withstand

Figure 40. Reserves declined in September in all countries, including China...



Source: Haver Analytics.

Figure 41. ...but levels of reserves still provide a strong buffer in case of a sudden stop



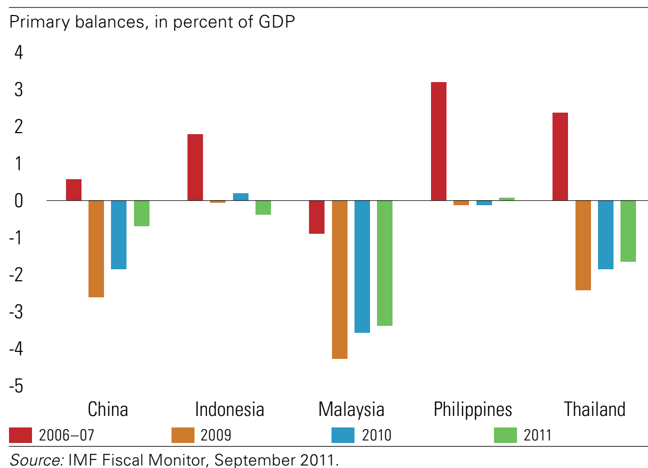
Source: Haver Analytics.

further shocks. For the median economy in mid-2011, they were equivalent to 50.4 percent of GDP, 8.9 months of imports, and 35.9 percent of external liabilities as measured at end-2010 (Figure 41).

Fiscal policy: fine-tuning needed?

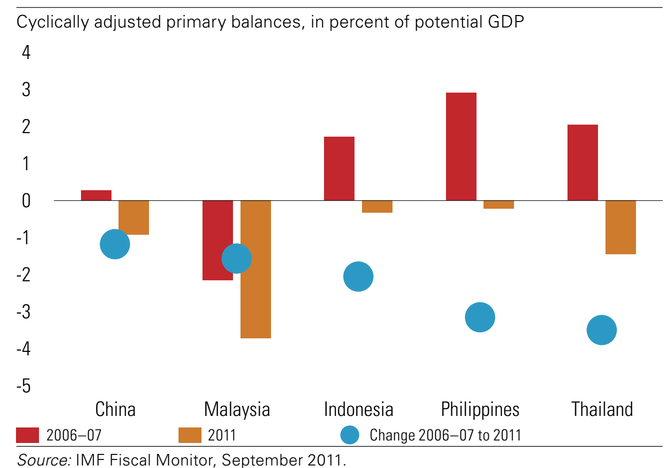
Even though policy continued to normalize, fiscal balances have not yet returned to their pre-crisis levels. As countries implemented stimulus packages, primary balances fell sharply between 2006-07 and 2009. In the middle-income countries, these declines ranged from 1.9 percentage points in Indonesia to 4.8 percentage points in Thailand (Figure 42). Fiscal balances improved as the stimuli were withdrawn between 2009 and 2011, but cyclically-adjusted fiscal deficits[8] still remain at levels higher than before the crisis (Figure 43).

Figure 42. Fiscal policy continued to normalize as the stimuli were slowly withdrawn...



Source: IMF Fiscal Monitor, September 2011.

Figure 43. ...but cyclically adjusted fiscal deficits are still higher than before the crisis



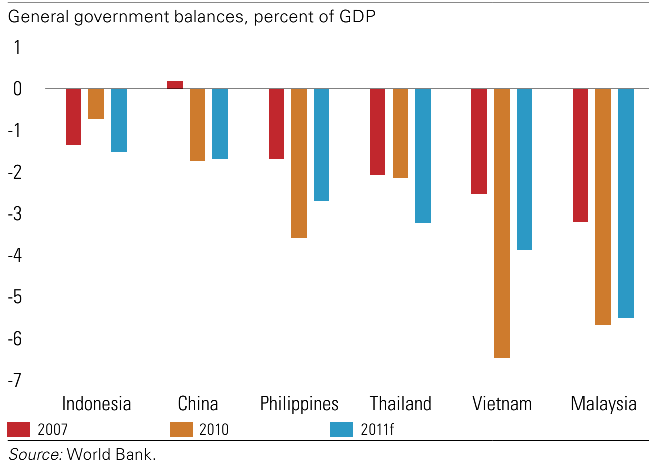
Source: IMF Fiscal Monitor, September 2011.

Should the need arise, there is space for a new fiscal stimulus in most middle-income countries. General government balances are mostly expected to improve in 2011 (Figure 44). The fiscal stance in the Philippines is improving due to better tax compliance, but also due to under-spending. Vietnam is pursuing fiscal consolidation as a part of macroeconomic stabilization program. Indonesia's expected deficit for 2011 has been revised upwards mainly due to higher energy subsidies, but with other spending likely to fall below target, the movement will likely be moderate. The Thai government deficit is also forecast to worsen, due to the impact from the flooding and because of higher-than-expected fuel subsidies (see also Box 1). The Mongolian fiscal balance is set to weaken largely due to the introduction of universal cash transfers. Debt burdens also came down in Indonesia and the Philippines between 2007 and 2011. In the Philippines, however, the debt service-to-revenue ratio remains high at 26 percent (Figure 45). Public debt burdens in Malaysia, Mongolia, and Vietnam are high and rising. In Malaysia, this reflected increases in the wage and subsidy bills that went unmatched by non-oil revenue growth, but measures have been recently taken to address the situation. While off-budget borrowing by subnational authorities complicates the measurement of overall (central and subnational) public debt in China, statistics are beginning to include subnational debt which increased by 10 percentage points of GDP to 26 percent of GDP in 2010 from 17 percent in 2007; a conservative

8 Cyclically adjusted primary balances (CAPB) are general government primary balances adjusted to filter out cyclical movements associated with changes in output, thus allowing a focus on the underlying fiscal stance and the impact of discretionary policy.

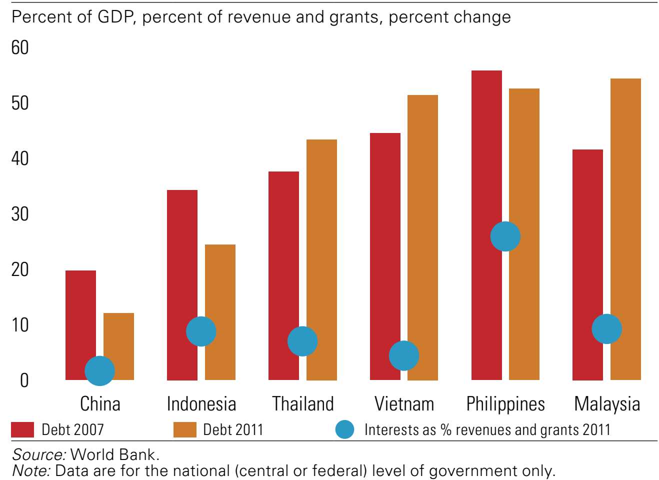
estimate of the central and local government debt was therefore at around 44 percent of GDP in 2010. In the low-income countries, there is less fiscal space for renewed interventions. Especially small countries, like the Pacific islands, are not fiscally well-placed to deal with new external shocks.[9] Overall, fiscal risks appear to be lower than in other regions (Figure 46).

Figure 44. General government balances are mostly expected to improve



Source: World Bank.

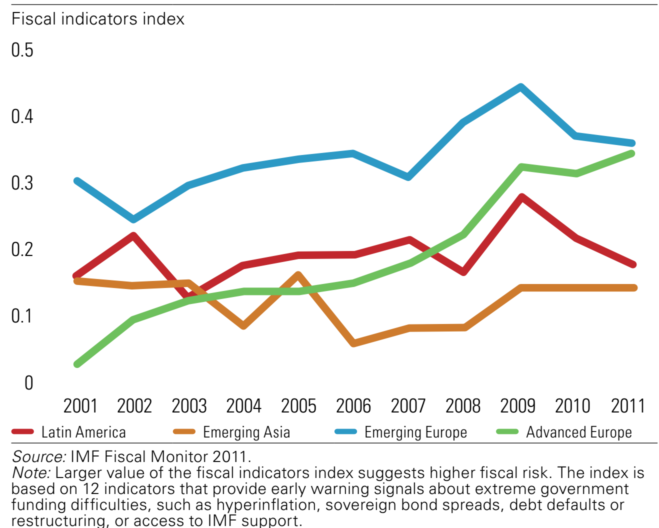
Figure 45. Debt burdens are manageable in most middle-income countries



Source: World Bank.
Note: Data are for the national (central or federal) level of government only.

Growing costs of external borrowing could, however, add to fiscal pressures in the future. The European debt crisis is negatively impacting emerging markets spreads (Figure 47). As perceptions of risk changed, spreads have grown, as have the costs of insuring against default (Figure 48). While spreads on East Asian bonds are still lower than in other emerging markets (for example, in Latin America), sovereign issuers with lower credit ratings—such as Vietnam and Mongolia—could experience problems in obtaining external financing going forward. These risks need to be kept in mind in designing any stimulus programs.

Figure 46. Fiscal risks in Emerging Asia grew compared to 2006, but are the lowest in the world



Source: IMF Fiscal Monitor 2011.
Note: Larger value of the fiscal indicators index suggests higher fiscal risk. The index is based on 12 indicators that provide early warning signals about extreme government funding difficulties, such as hyperinflation, sovereign bond spreads, debt defaults or restructuring, or access to IMF support.

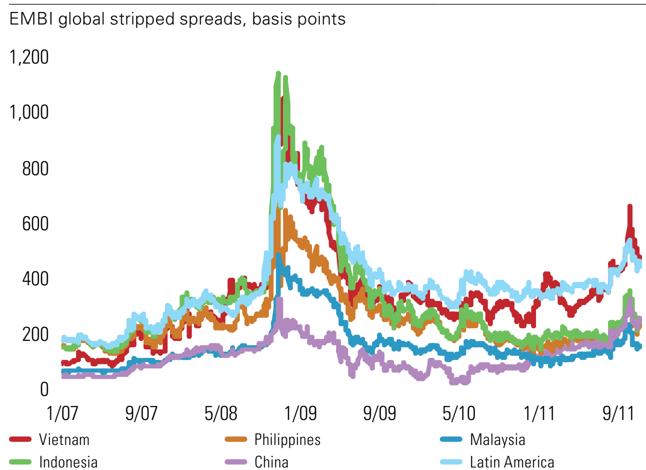
The slowdown in East Asia's growth has already prompted some governments to adjust their fiscal strategies. Indonesia has introduced some flexibility into its 2012 budget and allocated contingent funds to facilitate responses to any potential slowdown. Leveraging on improved revenue collection, the Philippines announced a US$1.7 billion disbursement acceleration plan which is speeding up existing programs and projects, after falling short on programmed spending in the first three quarters of the year. Malaysia is considering increasing social cash transfers and boosting transportation spending within the existing fiscal envelope. Thailand increased

9 See specific country pages at the end of this report for more detail.

minimum wages, lowered corporate income taxes, and introduced a rice mortgage scheme to support farmers (see Box 4). The devastating flood that has reached Bangkok would increase government spending through recovery and reconstruction programs, raising the fiscal deficit in 2012 to 4.5 percent of GDP. Should food or energy prices increase, consumer subsidies—where they are in place—could lead to wider increases in the fiscal deficit.

Figure 47. Sovereign borrowing costs in Asia are rising...

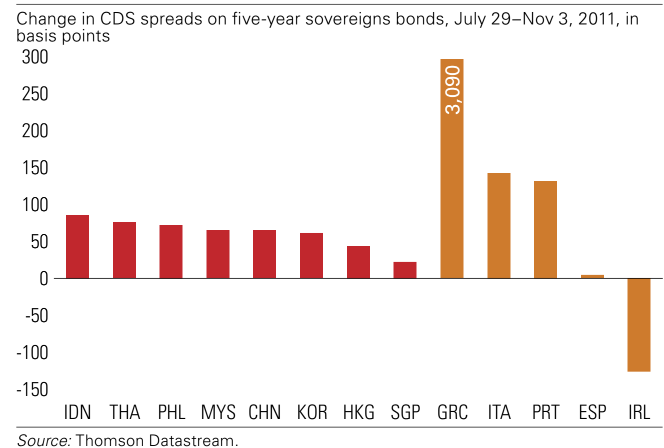
EMBI global stripped spreads, basis points



Source: JPMorgan, via Thomson Datastream.

Figure 48. ...as is sovereign risk and thus the costs of insuring against default

Change in CDS spreads on five-year sovereigns bonds, July 29–Nov 3, 2011, in basis points



Source: Thomson Datastream.

But any possible stimulus needs to be more long-term and structurally oriented. Even presuming an orderly resolution of the crisis in Europe, the weaknesses in the global economy are likely to continue into the medium- to long-term. In this case, it is timely to rethink whether new stimulus is the answer. Given the outlook for protracted low global growth, should the authorities decide in favor of a new round of stimulus programs they should be fiscally sustainable, well-targeted, and directed at promoting the structural transformation needed to sustain stronger, domestically-driven growth.

Much of the emphasis should be on stimulating investment. In low-income countries that were less affected by the global economic weakness, programs for poverty reduction and growth should take priority over the short-term considerations of stimulating demand. Higher investments are particularly important for the middle-income countries where investment shares have yet to recover to pre-Asian crisis levels and particularly where the quality or quantity of infrastructure lags behind middle-income averages (see discussion in Chapter III). Improving the investment climate, including through more or better public investment in productive infrastructure, would attract private investment. This would be a priority for the Philippines, for example, where the quality of infrastructure had been lagging other middle-income countries in the region.

Encouraging higher consumption spending might be a more appropriate target for other countries where investment levels are already high. Better targeted, and more productive, investment for long-term growth will mean increasing the efficiency of public investment programs in China, Vietnam, and Mongolia. Continued and closer attention to pension and social security systems is also a useful way to increase consumption, fight poverty, and prepare for future crises. Further improvements in the covered share of the labor force and the ratio of retirement to pre-retirement income will be especially important in China, Indonesia, Thailand, and Vietnam.[10]

10 Park, Donghyun, 2009. Ageing Asia's Looming Pension Crisis, Working Paper Series No. 165, Asian Development Bank.

Box 4. Revival of the rice mortgage scheme in Thailand

In early October 2011, the newly-elected Thai government reintroduced a mortgage scheme, mostly for rice farmers. The scheme, which has been used intermittently since 1981, is meant to smooth farmers' incomes, and to eliminate oversupply at harvest time that can depress prices. Most small farmers in Thailand lack adequate storage facilities and have limited savings. The mortgage scheme provides for storage and allows farmers to use their produce as collateral for loans from the Bank for Agriculture and Agricultural Cooperatives (BAAC). The collateral is valued at government-set prices, and loans are provided up to the full value of the collateral. When market prices are higher than the government-guaranteed price, farmers repay their loans, redeem the rice, and sell it in the market.

In recent years, however, the scheme has been used to provide a price floor, as the guaranteed price was higher than market prices. In this case, farmers use collateral to repay the loan, and therefore the government effectively acquired the rice. In 2011, the guaranteed prices were between 40 percent and 60 percent above the prevailing market prices before the scheme was announced.

The scheme also has some redistributive, as well as fiscal, consequences. Farmers are likely to earn higher incomes. Rice millers will benefit from payments from the government to mill and store the rice. Some Thai consumers may see their food bills rise, although the government is likely to subsidize rice for low-income households. Since Thailand is a key exporter of rice, export prices of Thai rice (generally considered the benchmark for international prices) may also increase. The government will likely need a sizeable budget to compensate the BAAC for the difference between the market value of the collateral and the loans given out. If subsidization of domestic prices is needed, it would become a fiscal liability as well.

Even though the scheme is intended to mainly benefit small farmers, critics of its earlier implementation raised concerns that large farmers, millers, and even smugglers from neighboring countries have benefited disproportionately. The scheme has also been saddled with allegations of corruption, as well as concerns about its impact on Thailand's standing as the leading rice exporter. The government has pledged to address these concerns, but the litmus test will lie in whether the benefits eventually accrue to the poorest farmers. Additional concern in relation to the floods, however, is that the scheme does not provide support to the farmers who lost their harvest.

When market prices are below the guaranteed price, the scheme would have fiscal consequences if the government does not pass the price difference to the international buyers. This would add to the burden of financing reconstruction and limit the government's options for further emergency fiscal policy, should the need arise.

Reforms need to focus on increasing fiscal space in the low-income countries and on effectiveness of fiscal spending in the middle-income countries. In Cambodia, a new Budget Law aims to broaden the tax base, streamline revenue collection, and limit non-essential expenditures, while increasing social spending. In Indonesia, spending on infrastructure is generally below budget plans and is back-loaded toward the end of the year. Although progress has been made on reforms to address the bottlenecks to spending, there remain long-standing issues such as a complex land acquisition process for infrastructure projects and lengthy budget procurement procedures. In the Philippines, some agencies have little capacity to spend their budget while others have slower spending rates due to added checks in procurement and financial management to improve budget transparency and effectiveness.

III. New Risks Add to Old Challenges

Developed economies are settling into a low growth scenario, and the possibility of a disorderly adjustment in the Eurozone cannot be ruled out. In East Asia, the region's middle-income countries enter this period of heightened uncertainty in a relatively strong position: holding sizeable reserves, relatively low debt, and experiencing comparatively robust domestic demand. However, they remain vulnerable to trade and capital flows reversals, and to commodity price shocks. Reversals of portfolio flows, as well as a possible sudden stop in banking sector credit from Europe are the two largest risks. Short-term worries, however, should not distract East Asian policymakers from their long-term agendas to increase investment, develop human capital, boost productivity, and reduce poverty.

A challenging global environment

Developed economies are adjusting to the "new normal" with growth rates over the medium-term projected to be—at most—half of what they experienced before the crisis. Limited fiscal space in these economies makes it unlikely that a public sector stimulus will be implemented. Among those developed economies that do have the fiscal space, some lack the political consensus to use it as part of a strategy that would include future fiscal consolidation. Assuming that authorities in advanced economies manage the adjustments needed to calm market sentiment and problems in the peripheral Eurozone countries are resolved, growth in the advanced economies could amount to 1-2 percent a year in 2012 and 2013. Monetary accommodation should help keep interest rates low and, given ample unused capacity, inflation in advanced countries should moderate, resulting in low long-term rates in the most credit-worthy borrowers.

Table 1. Growth in developing East Asia is projected to slow in 2011 and 2012

Annual growth, percent

	2009	2010	Forecast 2011	Forecast 2012
East Asia	**4.9**	**9.3**	**7.1**	**6.7**
Developing East Asia	**7.5**	**9.7**	**8.2**	**7.8**
China	9.2	10.4	9.1	8.4
Indonesia	4.6	6.1	6.4	6.3
Malaysia	-1.6	7.2	4.3	4.9
Philippines	1.1	7.6	4.2	4.8
Thailand	-2.3	7.8	2.4	4.0
Vietnam	5.3	6.8	5.8	6.1
Cambodia	0.1	6.0	6.0	6.5
Fiji	-1.3	0.3	1.4	1.5
Lao PDR	7.6	8.5	8.0	7.5
Mongolia	-1.3	6.4	14.9	15.1
Papua New Guinea	5.5	7.5	10.0	6.0
Developing EAP excl. China	**1.3**	**7.0**	**4.7**	**5.3**
Assumptions about the external environment:				
World	-2.4	4.0	2.7	2.8
High-income countries	-3.8	2.9	1.6	1.7
Other developing countries	-1.0	6.0	4.7	4.9

Source: World Bank.

Risks, however, are on the downside, even with a deal reached on the Greek debt in Europe at the end of October. Although there have been improvements in the stock markets, investors still do not fully discount the possibility of a disorderly sovereign debt restructuring in the advanced economies. Should such an event occur, it may well trigger another recession in Europe. Spillovers to developing East Asia will be substantial, through trade, financial flows, remittances, and consumer and investor sentiment. The ongoing European debt crisis will negatively impact countries in East Asia in any case, especially if European banks start deleveraging to adjust their balance sheets for a lower value of Greek bonds and the higher capital cover required by mid-next year. Although European banks have a modest exposure to East Asia, any liquidity shock would have a substantial effect and result in larger outflows of capital by investors trying to cover losses or meet margin calls.

In October 2011, European leaders agreed on a plan to resolve the region's debt crisis. However, the deal did not help Europe to completely regain the confidence of markets (see Box 5). As part of the plan to increase capital in the European Financial Stability Facility (EFSF), China and Japan, that have already purchased EFSF bonds, were asked to contribute additional resources.

Despite this uncertainty and a global growth slowdown, we still project that real GDP in developing East Asia will increase by 8.2 percent in 2011 and by 7.8 percent in 2012. China is expected to grow by 9.1 percent and 8.4 percent in 2011 and 2012 respectively, less than its average of 10.5 percent during 2000-2007 (Table 1). East Asia excluding China is expected to grow by 4.7 percent and 5.3 percent in these two years respectively. Slower growth reflects weaker demand from advanced economies, which will be only partially offset by higher domestic demand. Resource-rich countries are expected to grow faster than average.

Box 5. The European debt and banking crisis better?

The resolution to the debt crisis in Europe hinges on the successful implementation of the recently-achieved deal between European leaders and the private sector. The agreement proposes to expand the European Financial Stability Facility (EFSF) bailout fund to around US$1.4 trillion, and to write down 50 percent of the value of the Greek bonds on private sector balance sheets. The larger bailout fund can then be used to recapitalize European banks with (US$146 billion). The banks will also be required to establish a minimum core Tier 1 capital ratio of 9 percent, an increase from the current requirements. The fund would finance the Greek bailout to the tune of US$146 billion in 2012, as well as provide support for other distressed countries if the need arises.

This scheme is an improvement over the two previous deals, but concerns have been raised about the lack of details regarding how exactly it will be implemented, and whether it will support long-term growth in Europe. In particular, these concerns relate to the sources of expansion for the EFSF and whether the expanded fund would be able to perform its bailout function should other European countries experience debt problems. The spread on Italian sovereign bonds increased after the deal was reached and continued to rise, at least partly reflecting these concerns. The absence of a long-term growth plan for Europe, and the deal's uncertain impact on the Euro, are adding to uncertainty. A further factor is the "voluntary" nature of the debt restructuring, which may still be contested, and could lead to calls on credit default swaps. Finally, as market reaction to the short-lived idea of a Greek referendum on the bailout plan starkly illustrated, the political feasibility of the adjustments needed as part of the agreement is yet to be proven.

On the financial sector side, there is some anxiety that the 50 percent reduction in the value of bonds in bank balance sheets and the subsequent recapitalization might not succeed in maintaining a stable flow of credit to the private sector. Moreover, the banks are likely to shrink their balance sheets and deleverage given the increased capital requirement, combined with a reduction in assets and a possible inability to borrow without government guarantees. Trade finance, loans to small- and medium-sized enterprises, as well as emerging markets bank lending will be among the first activities to be affected. Should this happen, it would deprive the European business sector of credit, reduce economic growth, and have negative spillovers to the emerging markets through reduced bank flows. Credit default swaps guaranteed by sovereign bonds and held by banks are an additional risk to the successful outcome of the Eurozone agreement.

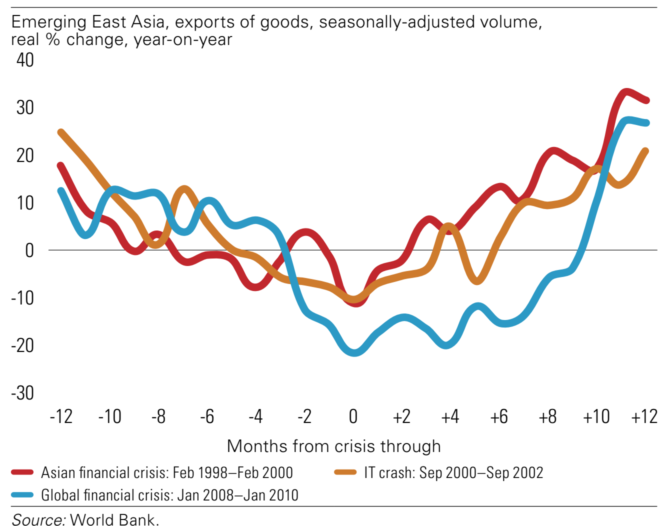
Last but not least, there are problems with financing for the EFSF, as it is unclear whether the special purpose vehicles would be bought by China, Japan or other potential investors. The jury is out therefore on whether the proposed deal can resolve uncertainty in the long-term and it has contributed little to calming markets shortly after its announcement.

The region's middle-income countries enter this period of increased uncertainty in a relatively strong position. They are holding sizeable reserves, relatively low debt, and are seeing strong domestic demand. But they remain vulnerable to trade and capital flow reversals, and to commodity price shocks. Low-income countries, especially the Pacific islands, are less prepared in terms of their fiscal position, but are less exposed in terms of direct impacts through financial sector flows.

Increased uncertainty highlights vulnerabilities

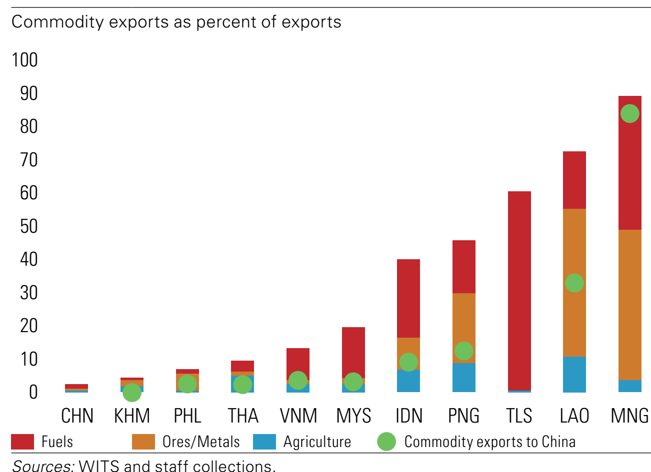
Should Eurozone problems result in a sharp negative growth shock in the industrialized countries, exports of developing East Asia will fall. Direct exports to the developed countries' markets are between five percent of total exports in Mongolia and 52 percent in Cambodia, with an average East Asia country exporting about 30 percent of their total exports to Europe, and the U.S. (Table 2). During the last three crises, the combined export volume of East Asia fell by a maximum of 20 percent, and took as long as two years to recover to pre-crisis levels (Figure 49). Commodity exporters, which sailed through the 2008 crisis on buoyant growth (with the exception of Mongolia), are also vulnerable to a negative commodity price shock. Low-income countries with their undiversified exports

Figure 49. Exports could decline by up to 20 percent, based on experience during past crises



Source: World Bank.

Figure 50. Low-income commodity exporters are especially vulnerable to a negative price shock



Sources: WITS and staff collections.

and greater reliance on European markets are perhaps most vulnerable (Figure 50).

Rebalancing economies towards more domestic-driven growth will reduce vulnerability to external shocks. Participation in the regional production networks increases vulnerability through trade channels, especially in the middle-income countries that export parts and components to China. Although its relative importance is declining, processing activities still account for nearly half of all Chinese trade. One-third of Chinese exports represent foreign value-added, including 80 percent in processing trade and 12 percent in other trade; East Asian suppliers account for the bulk of that amount (Figure 51).[11] The share of production networks-related trade in total electronics exports is around 15 percent in developing East Asia on average, and around 25 percent in the NIEs. By comparison, this number averages five percent in other regions.[12] Consumer goods constitute a large part of exports to the U.S. and Europe. For example, more than 60 percent of Malaysia's exports to the U.S. are in consumer electronics (Figure 52). This increases

Table 2. Direct trade exposures are high, especially for the low income countries

Exports by destination, percent of total exports

To: / From:	China	Japan	U.S.	EU-27
China	-	7.6	17.9	19.7
Thailand	11	10.5	10.4	11
Malaysia	12.6	10.4	9.5	10.8
Indonesia	9.9	16.3	9.1	10.9
Philippines	11	15.2	14.7	14.4
Vietnam	10.5	11.1	20.4	16.3
Cambodia	1.2	1.6	34.2	16.7
Laos	23.3	1.6	2.6	9.3
Mongolia	81.8	0.8	0.4	3.9
PNG	7.2	9.2	0.9	7.3
Singapore	10.3	4.6	6.5	10
Korea, Rep.	24.8	6	10.6	11.4
Japan	19.4	-	15.6	11.3
U.S.	7.2	4.7	-	18.8
EU-27	4.2	1.5	-2.6	55.7

0–5% 5–10% 10–20% Above 20%

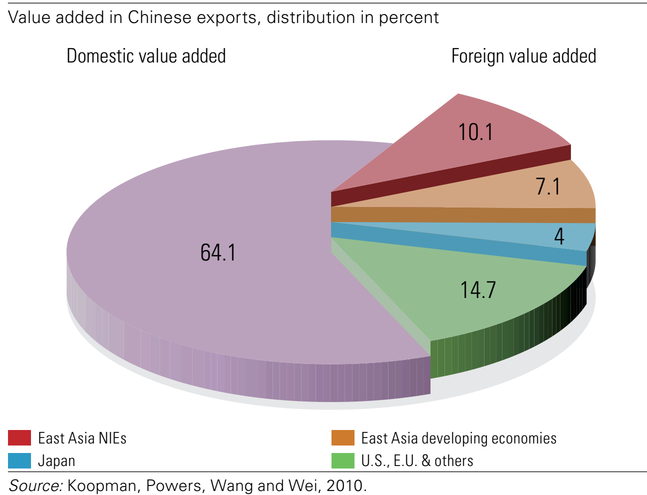
Sources: DOTS and World Bank staff.

11 Based on OECD Economic Surveys: China 2010, Koopman, Powers, Wang and Wei, 2010, "Give Credit Where Credit Is Due: Tracing Value Added in Global Production Chains", NBER Working Paper 16426, and IMF, "China: Spillover Report for the 2011 Article IV Consultation and Selected Issues", (2011).

12 Emerging Stronger from the Crisis, March 2010, East Asia and Pacific Economic Update, World Bank, Washington DC (page 36).

Figure 51. East Asia accounts for over a half of foreign value added in Chinese exports

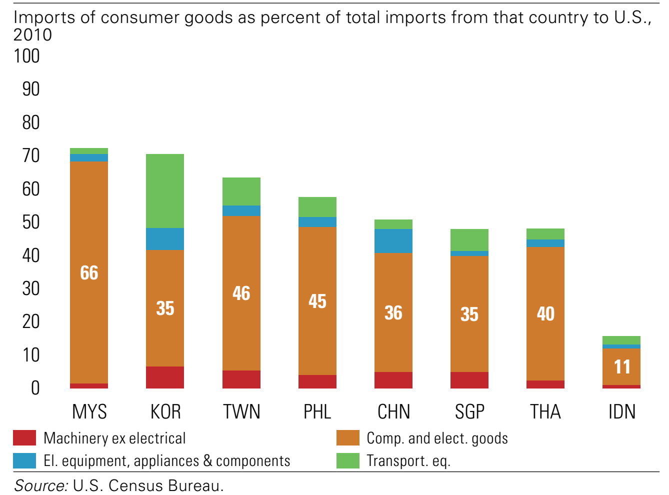
Value added in Chinese exports, distribution in percent



Source: Koopman, Powers, Wang and Wei, 2010.

Figure 52. Export base focused on consumer electronics goods leaves many vulnerable to consumer sentiment in advanced economies

Imports of consumer goods as percent of total imports from that country to U.S., 2010



Source: U.S. Census Bureau.

the vulnerability of the participating countries, especially the middle-income countries, to a fall in demand in the industrialized countries. The rebalancing of trade towards regional and domestic demand, including the pursuit of the opportunities offered by the growing demand for consumer goods by China, will reduce transmission of external shocks through trade (see also Chapter I).

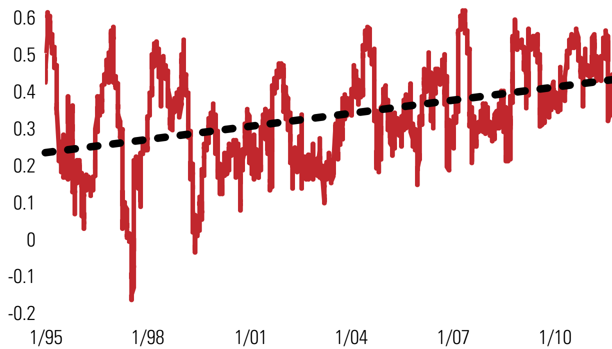
Deterioration in the Eurozone economies would impact East Asia through weaker financial flows, including in the banking sector and in regional stock markets. As discussed in the previous chapters, authorities have been implementing policies to counter sudden reversals of capital flows, but vulnerabilities remain. A reduction in the positions of foreign investors in East Asia economies and markets could result in abrupt outflows, including in equity and bond markets. With cross-border banking flows mostly comprising inter-bank lending, East Asia is also vulnerable to a potential deleveraging by European banks. Finally, contagion could spread to currency and derivatives markets.

Foreign participation in the financial markets in East Asia increased sharply after the last crisis. Since 2003, regional markets grew in size, depth, and efficiency. Market capitalization reached 170 percent of regional GDP in 2007, and recovered to 120 percent in 2010 while concentration and liquidity also improved. However, so did correlation with other markets, indicating greater vulnerability to contagion from elsewhere (Figure 53). Non-residents' holdings of local currency government bonds doubled between 2007 and 2011 in Indonesia and Malaysia (Figure 54). China attracted most of the portfolio inflows and issued most equity, with stocks of foreign capital equivalent to US$2 trillion in end-2010 (Figure 55). Other economies tried to keep pace, and stocks of foreign capital as a share of GDP are the highest in Malaysia and Thailand (Figure 56).

The increased exposure to foreign capital creates additional vulnerability during a crisis, even though these inflows have led to higher international reserves. In 2008, the region's markets collectively lost more than two-thirds of their U.S. dollar value between the market peak in November 2007 and the market trough in March 2009 (Figure 57). Liquidity tightened, with turnover in 2008 dropping more than 30 percent year-on-year in China, Malaysia, and the Philippines and as much as 60 percent in Vietnam. Equity issuances by Asian corporations virtually dried up, while international portfolio flows weakened substantially or completely reversed. Given the increased foreign

Figure 53. Inter-dependence with global markets has increased over time

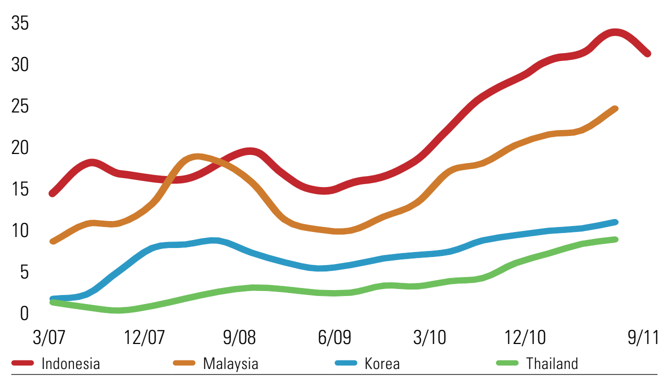
Correlations of daily returns, MSCI All-Country Far East excluding Japan and MSCI G-7, 90-day rolling window



Source: MSCI, via Datastream.

Figure 54. In June 2011, non-residents held more than one-third of local currency government bonds in Indonesia, and one quarter in Malaysia

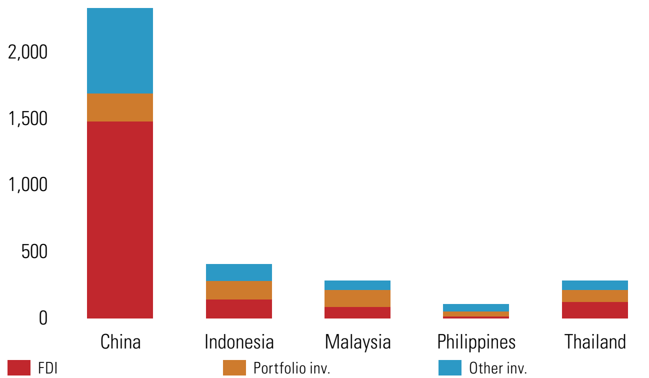
Non-resident portfolio holdings of local currency government bonds, in percent of local currency government bonds outstanding



Source: ADB and staff calculations.

Figure 55. The stocks of foreign capital are low in middle-income countries in comparison to China...

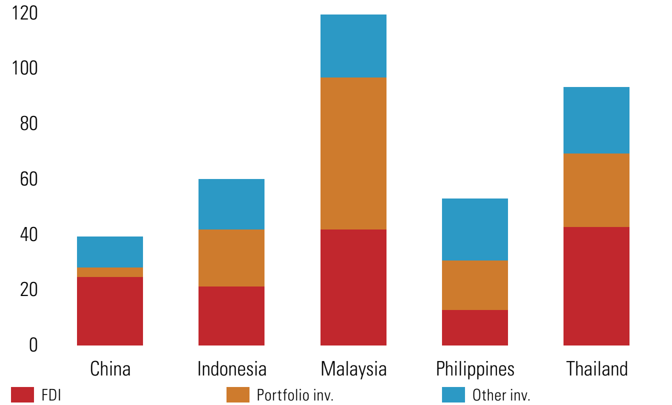
Stocks, end-2010, US$ billions



Source: IMF.

Figure 56. ...but they are much higher as a share of GDP

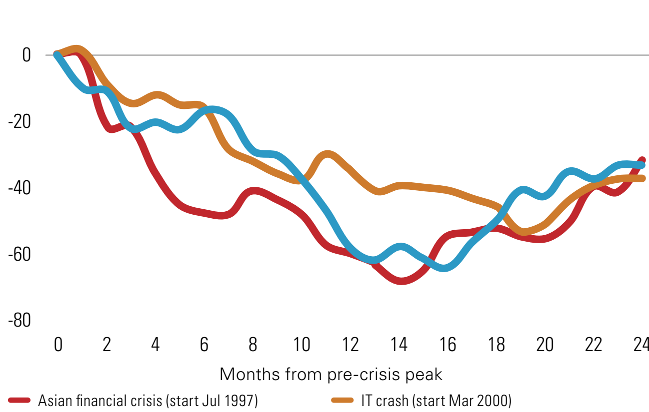
Stocks, end-2010, in percent of GDP



Source: IMF.

Figure 57. The markets declined at rates not seen since the Asian financial crisis

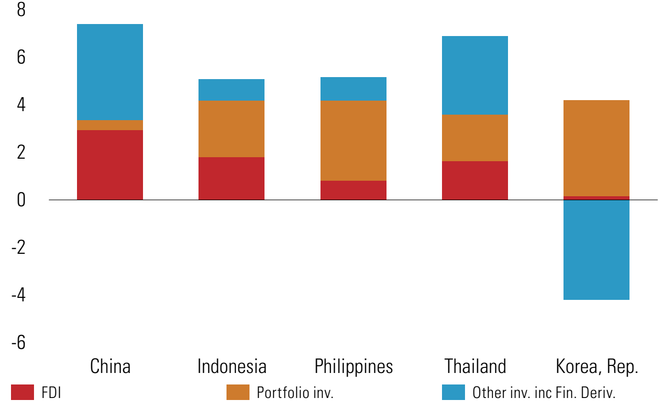
Cumulative change in the index value from pre-crisis peak, MSCI All-Country Far East excluding Japan, in percent



Source: MSCI, via Datastream.

Figure 58. Portfolio flows remain the principal driver of financial risk in many countries

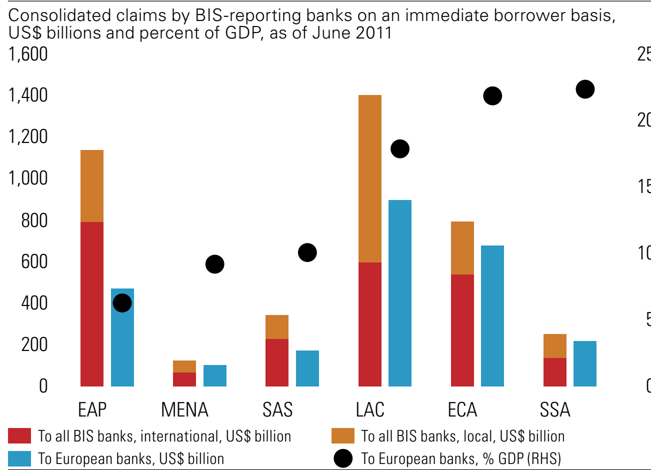
Net capital inflows, Balance of Payments basis, 3Q 2009–2Q 2011, in percent of GDP



Source: Haver Analytics.

Figure 59. Developing East Asia is the least exposed to European banks as share of GDP, but total claims by European banks are almost US$430 billion...

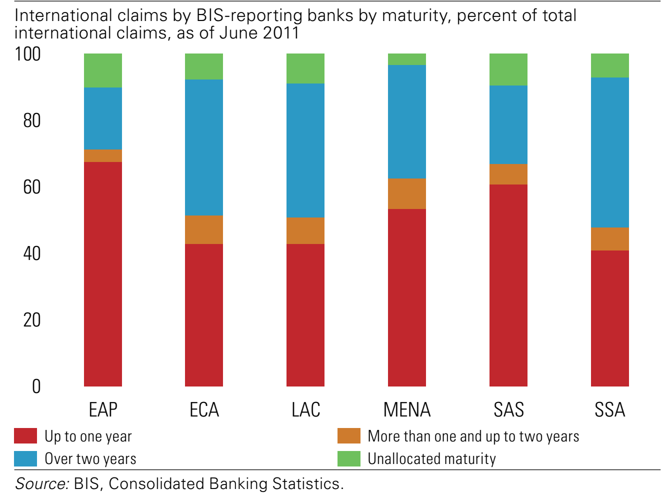
Consolidated claims by BIS-reporting banks on an immediate borrower basis, US$ billions and percent of GDP, as of June 2011



Source: BIS, Consolidated Banking Statistics.
Note: International exposure is cross-border claims of BIS banks in all currencies plus local claims of foreign affiliates in foreign currency on residents in each region. Local exposure is local claims of foreign affiliates in local currency.

Figure 60. ...and the maturity of debts to foreign banks is shorter in EAP than in other regions

International claims by BIS-reporting banks by maturity, percent of total international claims, as of June 2011



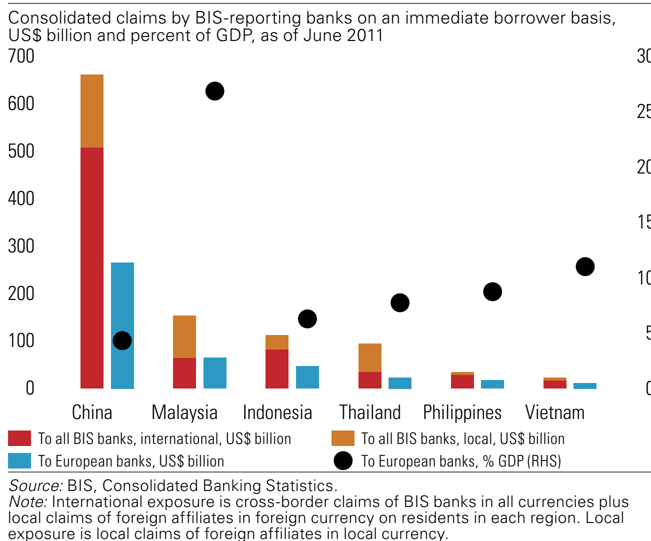
Source: BIS, Consolidated Banking Statistics.

participation, a fall could be steeper this time. Volatile portfolio inflows have built up in the aftermath of the crisis in many countries (Figure 58), but, as discussed in Chapter II, increased inflows are also reflected in higher levels of international reserves, which mitigate some of these risks.

A deeper banking crisis in Europe could affect bank credit to East Asia. As part of the Eurozone debt solution, the banks holding Greek sovereign bonds have agreed to write down 50 percent of their claims, and all European banks have to raise Tier 1 capital adequacy ratios to nine percent. These measures are likely to result in reduced lending, even if banks are subsequently recapitalized by the EFSF (see Box 5). Even though developing East Asia is the least-exposed to European bank lending among all regions, consolidated claims by these banks still amounted to

Figure 61. China accounts for over half of the claims on developing East Asia, while Malaysia's exposure to European banks is over 25 percent of GDP

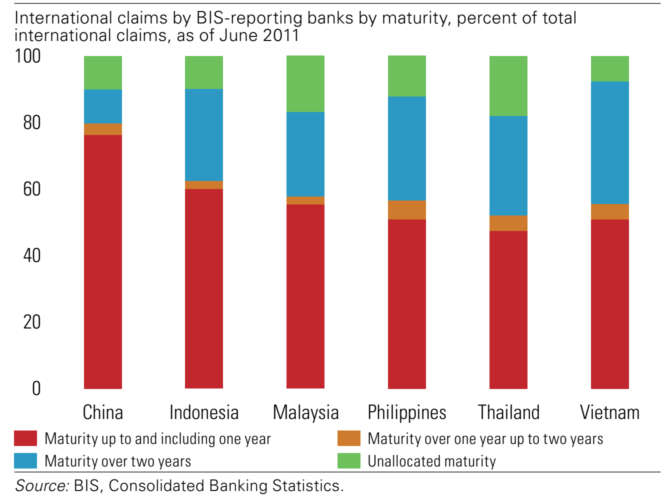
Consolidated claims by BIS-reporting banks on an immediate borrower basis, US$ billion and percent of GDP, as of June 2011



Source: BIS, Consolidated Banking Statistics.
Note: International exposure is cross-border claims of BIS banks in all currencies plus local claims of foreign affiliates in foreign currency on residents in each region. Local exposure is local claims of foreign affiliates in local currency.

Figure 62. Liabilities to BIS-reporting banks are mostly short-term

International claims by BIS-reporting banks by maturity, percent of total international claims, as of June 2011

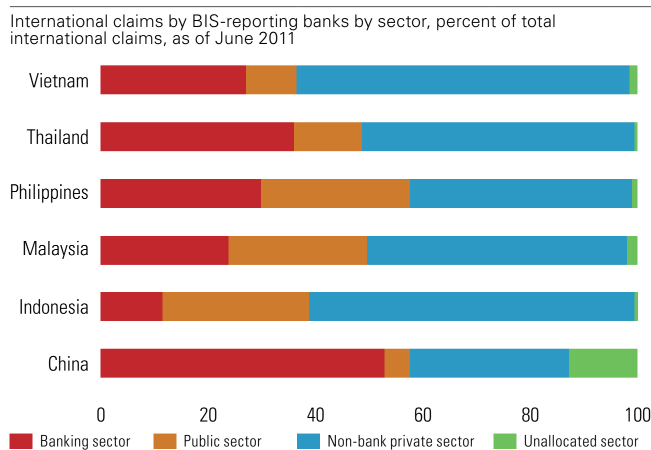


Source: BIS, Consolidated Banking Statistics.

six percent of GDP in June 2011 (Figure 59). Nearly 70 percent of the loans from all BIS-reporting banks to East Asia are short-term. This reflects in part their nature—many of these loans finance trade—but their short-term maturities increase the risk of sudden withdrawal (Figure 60). Almost 80 percent of the short-term borrowings by China's banks will mature in one year or less, with liabilities to European banks comprising US$268 billion or five percent of GDP (Figure 61, Figure 62). Among other middle-income countries, Malaysia stands out with loans from European banks representing more than 25 percent of GDP (US$ 64 billion). Half of the country's total liabilities mature in one year or less, and are mostly held by the non-bank private sector and the government (Figure 61, Figure 62, Figure 63). Other middle-income countries have exposures of between seven percent and 11 percent of GDP, mostly in the non-bank private sector (e.g. between around 40 percent in the Philippines and 60 percent in Indonesia and Vietnam, see Figure 63). During the 2008 crisis, this type of credit fell by 13 percent (Figure 64). It is possible that other banks, including banks from East Asia, could potentially step into any financing gap left by European banks, reducing the possible impact of any deleveraging by these lenders.

Figure 63. International bank credit in middle-income countries excluding China is mostly to the non-bank private sector...

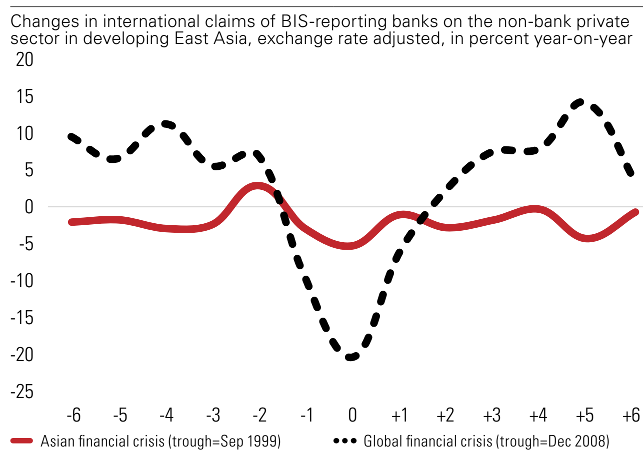
International claims by BIS-reporting banks by sector, percent of total international claims, as of June 2011



Source: BIS, Consolidated Banking Statistics.
Note: International exposure is cross-border claims of BIS banks in all currencies plus local claims of foreign affiliates in foreign currency on residents in each region. Local exposure is local claims of foreign affiliates in local currency.

Figure 64. ...and could fall sharply during a crisis

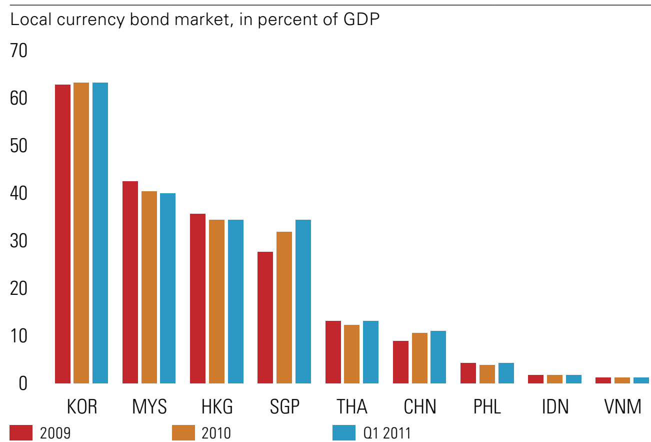
Changes in international claims of BIS-reporting banks on the non-bank private sector in developing East Asia, exchange rate adjusted, in percent year-on-year



Source: BIS, Consolidated Banking Statistics.

Figure 65. Corporate bond stock is high in Malaysia compared to other MICs...

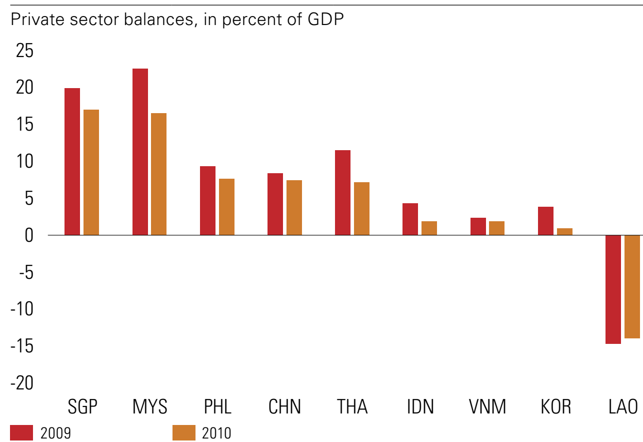
Local currency bond market, in percent of GDP



Source: IMF GFSR.

Figure 66. ...but private sector balances are mostly healthy

Private sector balances, in percent of GDP



Source: WEO.
Note: Private sector (including households) balances are calculated as current account balance minus fiscal balance. Positive balance indicates surplus in the private sector (value added minus consumption and investment).

Companies are more vulnerable now to volatility in the bond market, although aggregated private sector balances remain healthy. Private sector companies are increasingly reliant on bond financing for their activities and growth (Figure 65). Local currency- and dollar-denominated bond issuance in East Asia increased considerably after the crisis, with buyers attracted by relatively high yields. High private sector debt financed by foreign lenders can add to fiscal strain through a potentially higher sovereign cost of borrowing and contingent liabilities associated with the banking sector. For example, Standard & Poor's downgraded Spain's credit rating recently due to high levels of private sector debt, despite its healthy public finances. In East Asia, private sector and households' balances remain mostly in surplus, however (Figure 66).

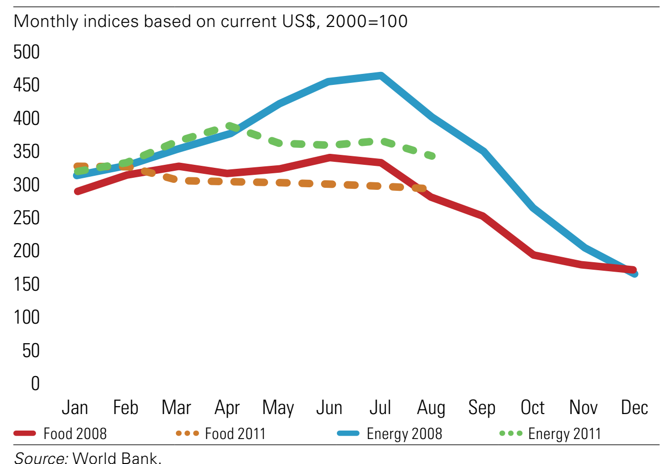
Capital flows will return. But now is an opportune time to pursue reforms that would help match growing investment needs in the future. With current growth differentials, East Asia is likely to continue to be among the most attractive destinations for capital flows. To make sure the markets are sufficiently deep and efficient, countries across the region are facing different challenges. In the longer-term, securities and corporate bond markets need to be further developed to match growing investment needs; priority areas include institutional and regulatory frameworks, information disclosure, transaction cost, and investor base. In China, the government is reducing the dominance of state-owned enterprises (SOEs) in the stock markets, improving corporate governance, and streamlining regulatory and supervisory practices. Middle-income countries need to deepen and broaden their markets; for example, Malaysia plans to triple the size of its stock exchange. Low-income countries with stock markets suffer from an insufficient number of traded companies and their priorities should include the deepening of the financial sector to provide financing to private businesses, a decrease in transaction costs, and the acceleration of SOE reforms.

Poverty reduction efforts could be hampered by food price shocks if incomes stagnate

International food prices this year have been near their 2008 peaks (Figure 67). Countries in the region are more vulnerable to higher food and energy prices than advanced economies given higher weights of food and energy in their consumer price inflation baskets (see Chapter II). But shocks in international prices are not transmitted directly to domestic prices: it is estimated that a median long-term pass-through of a one-percent food price shock to domestic food prices is only 0.34 percent in developing countries on average.[13]

Figure 67. International food prices are close to their 2008 levels

Monthly indices based on current US$, 2000=100



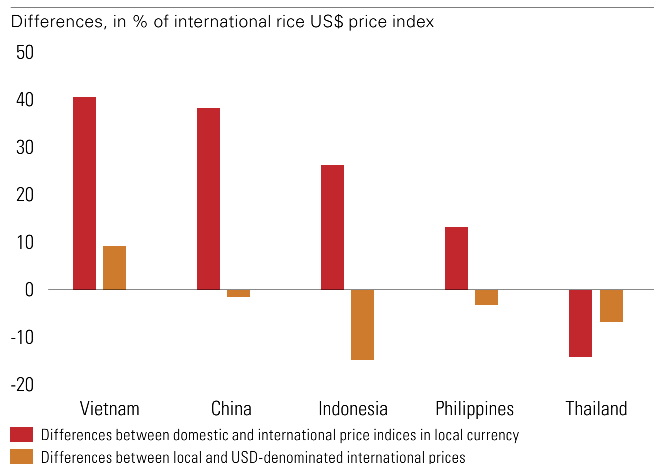
Source: World Bank.

The pass-through from international prices to domestic markets is influenced by policy interventions and exchange rate dynamics, but domestic shocks have also increased in importance. Although international rice prices have more than doubled in U.S. dollar terms since 2000 (excepting Vietnam, where currency depreciated), the pass-through from international prices has been muted. But domestic food price inflation has also differed from international price increases: in Thailand rice price inflation was lower

13 IMF World Economic Outlook September 2011.

Figure 68. Exchange rate appreciation helped food importers, but domestic rice price inflation tended to be higher than international

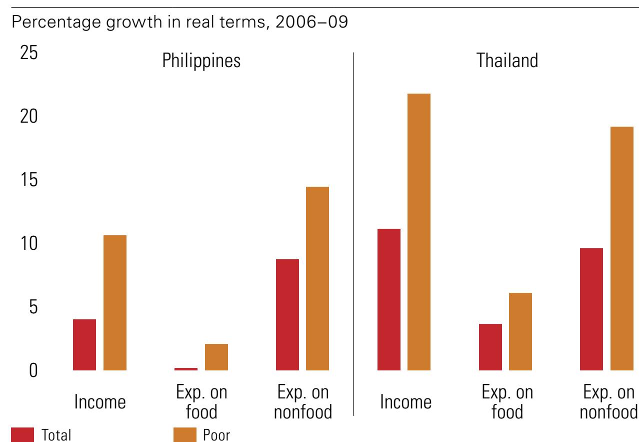
Differences, in % of international rice US$ price index



Sources: Haver, CEIC, and World Bank staff calculations.
Note: Percentage difference between indices of international rice prices in local currency and US dollars; and between domestic and international prices in US dollars. Averages 2009-2011. International Prices for Thai rice (5 percent broken). Domestic prices: wholesale for Thailand, retail for all others.

Figure 69. Income and consumption expenditure have increased, especially among the poorest 20 percent of the population

Percentage growth in real terms, 2006–09



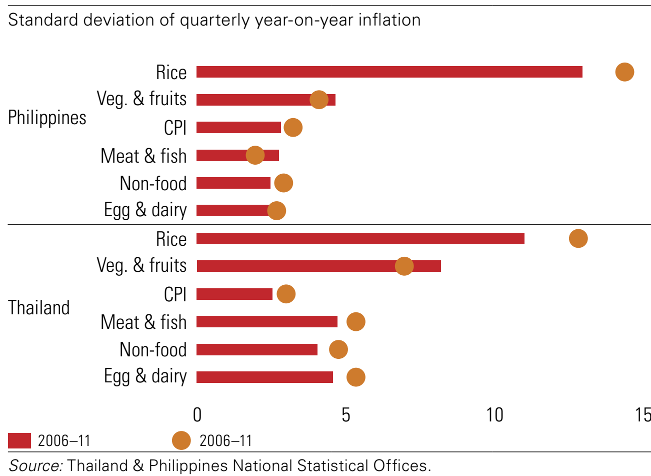
Source: World Bank staff calculations using data from household income and expenditure surveys.
Note: Food and drink consumption expenditure is deflated using CPI by commodity or group of commodities; non-food consumption expenditure is deflated by aggregated nonfood CPI. The poorest are defined as individuals in the bottom household consumption expenditure quintile.

than that of the international rice prices, while in other countries it was higher (Figure 68). Policy interventions that can dampen the effect of international inflation on domestic price movements include consumer and production subsidies, price supports, tariffs, and import quotas, as well as the use of reserves. Some of the shocks affecting prices are increasingly domestic in nature, highlighting the importance of perishable foods—such as vegetables, meats, and dairy products—for inflation, incomes, and poverty reduction. For example, while rice price inflation was the highest among food items in the Philippines, in Thailand other foods, such as vegetables, fruits, and meats, were also important (see Figure 70). Production shocks can quickly translate into price hikes, and changes in pre-harvest weather conditions have the tendency to quickly unsettle markets. For example, the combined effects of the recent move by the Thai government to buy paddies at higher prices from farmers, and the loss of 5-6 million tons of rice due to flooding, have added to upward pressure on prices (see Box 1 and 4).

Between 2006 and 2009, as real incomes increased, people spent more on food, although food expenditures grew much slower than incomes. In the Philippines and Thailand, incomes grew for the population at large, but especially for the poorest 20 percent of their populations[14] (Figure 69). These households saw their incomes increase by 22 percent in Thailand and 10 percent in the Philippines. Incomes increased in the rural areas in particular. In the Philippines, rural incomes grew by nine percent while urban incomes stagnated. In Thailand, urban and rural incomes increased by seven percent and 13 percent respectively. One factor playing out in this increase is higher agricultural prices that have likely translated into higher incomes for farmers. Consumption expenditure in the Philippines also rose; by 6.5 percent for the poor and by 5.1 percent for the population at large. In Thailand, consumer spending grew by 12.4 percent among the poor and by 7.6 percent for the overall population. At the same time, only modest increases in real expenditure on food items were observed among the poor. A disproportionate increase in food prices in comparison to CPI inflation contributed to this outcome (Figure 70).

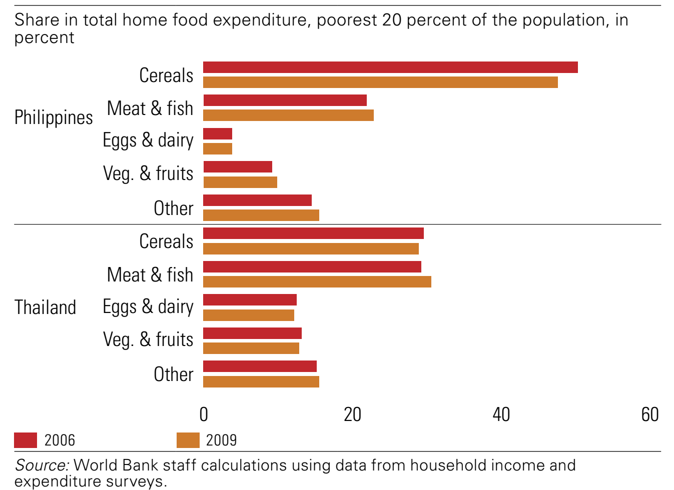
14 To avoid using country-specific poverty lines, hereafter in this document, we refer to the group of people in the lowest expenditure quintile as "poor" or "the poorest", interchangeably.

Figure 70. Price spikes were particularly pronounced in rice...



Source: Thailand & Philippines National Statistical Offices.

Figure 71. ...as a result, the poorest in Thailand and the Philippines consumed less starch and more protein

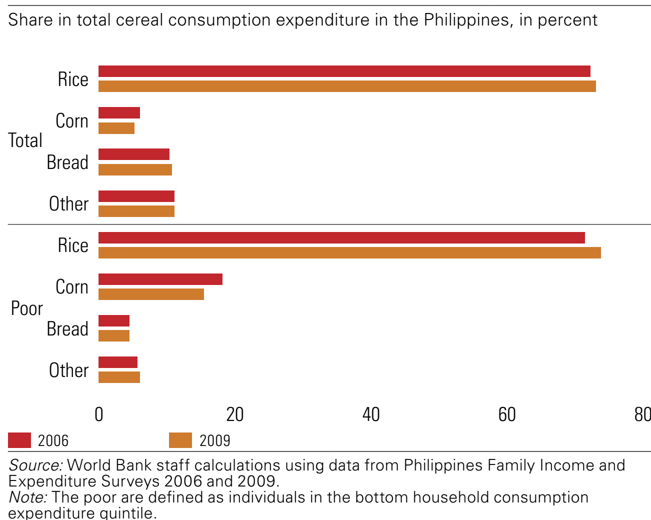


Source: World Bank staff calculations using data from household income and expenditure surveys.

Responding mainly to higher incomes, consumers shifted from cereals to more protein-rich foods. Rice prices had the highest increases among food items, while meat and fish prices have been more stable (Figure 70). As a result, the poor in the Philippines and Thailand have substituted other foods for cereals (Figure 71). Higher incomes also usually allow people to increase their intake of expensive, protein-rich food.

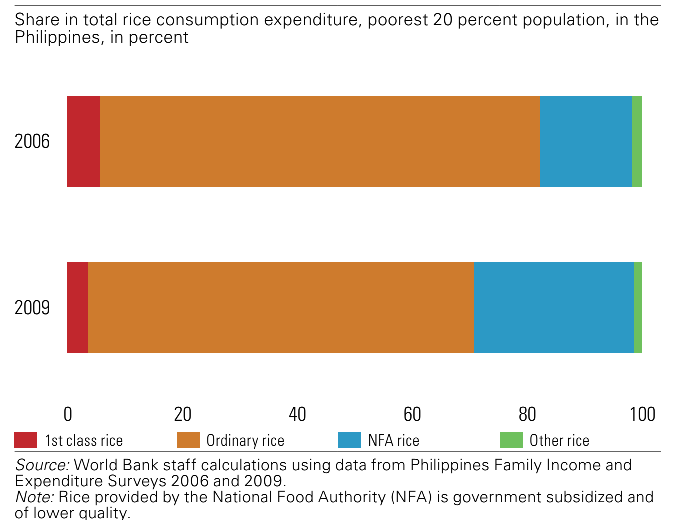
Consumers had to switch to cheaper rice, the region's dominant staple food, and reduced consumption of other cereals. Consumption of cereals decreased overall, but the share of rice in real expenditures increased relative to other cereals as income levels increased (Figure 72). Filipinos reduced their consumption expenditure on corn, an inferior staple food. The substitution between rice and corn is particularly pronounced for the poor in the Philippines. In addition, they also substituted high quality rice with subsidized but lower quality rice, as the price of unsubsidized rice rose. The substitution was most significant for the poor (Figure 73). They, in effect, stabilized overall rice consumption expenditure, even though the quality of the rice they consumed declined.

Figure 72. Within cereals, rice consumption rose while corn consumption declined...



Source: World Bank staff calculations using data from Philippines Family Income and Expenditure Surveys 2006 and 2009.
Note: The poor are defined as individuals in the bottom household consumption expenditure quintile.

Figure 73. ...but the poor also switched to cheaper varieties of rice

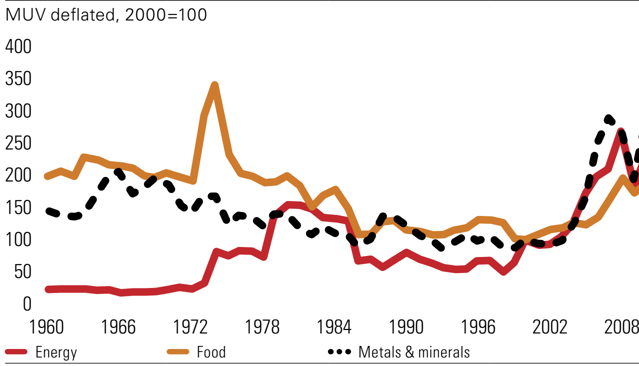


Source: World Bank staff calculations using data from Philippines Family Income and Expenditure Surveys 2006 and 2009.
Note: Rice provided by the National Food Authority (NFA) is government subsidized and of lower quality.

Box 6. High food prices are likely here to stay

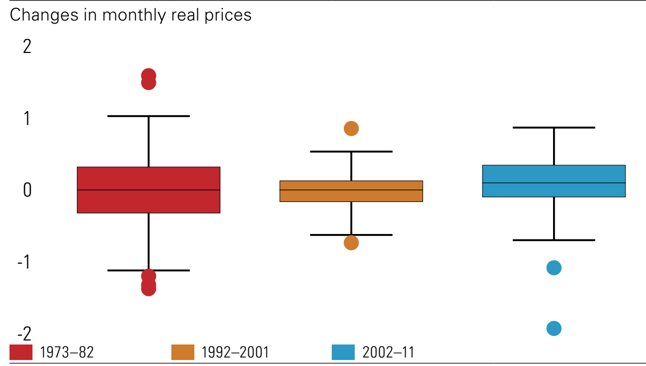
Food prices remain high and their volatility has increased. The spike in 2008 compares to previous commodity hikes during the Korean War in 1950/1951 and the oil crisis of 1973, interrupting otherwise largely declining trends in commodity prices (Box Figure 1). Volatility in food prices is higher than before 2002 and is comparable to volatility following the previous commodity boom following the oil crisis of 1973 (Box Figure 2).

Box Figure 1. Commodity prices rallied in the 2000s and remain high



Source: World Bank.

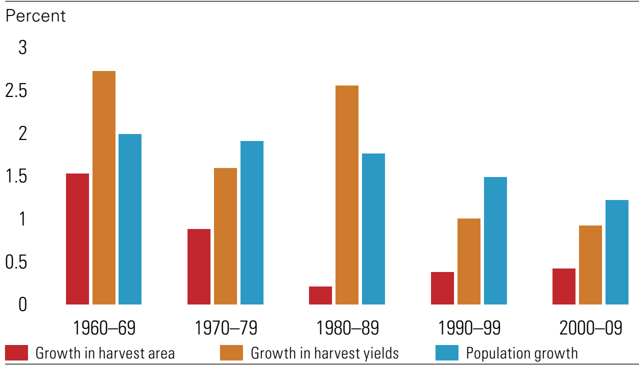
Box Figure 2. Volatility in food prices has increased since 2002 but compares to the last price shock



Source: World Bank.

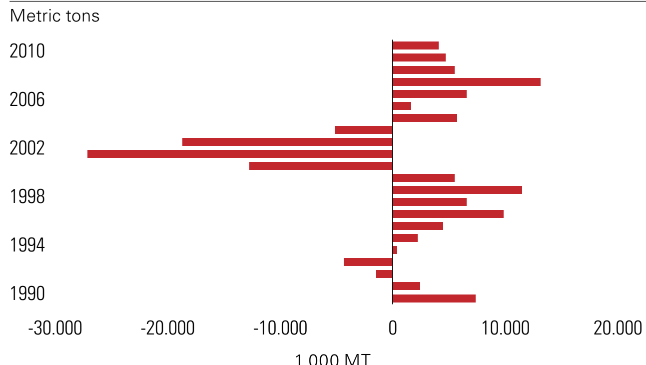
Stronger demand for food that is unmatched by higher production is often cited as the main reason for high food prices, which has been compounded by increases in demand for biofuels. For rice, Box Figure 3 shows that harvest area has been expanding less rapidly since the 1980s compared to the earlier period. Similarly, growth in rice yields has gone down since the Green Revolution. In the 1990s and 2000s, growth in the world's population exceeded both the growth in yields and harvest area (Box Figure 4). One reason explaining the decrease in yields is lower investment in research and development devoted to agriculture. Since the Green Revolution, technological innovation in agricultural production has been sluggish.

Box Figure 3. Since the 1990s population growth has exceeded growth in rice harvest yields and area



Source: USAID and World Bank staff calculations.
Note: Data for global harvest and population growth.

Box Figure 4. In the early 2000s rice consumption exceeded rice production



Source: USAID and World Bank staff calculations.
Note: Rice production subtracted by rice consumption.

Other pressures on food prices come from increasing transportation and production costs and shocks. Demand for commodities in general has trickled into food prices. Strong demand for energy has caused a notable shift of crop production for food consumption to production of bio-fuels. This has added to upward pressures from oil and other commodities used as inputs in food production. Adverse supply shocks have also aggravated shortages. The weather was particularly hostile to agricultural production in 2008, for example, and bad harvests translated into higher food prices.

Overall, food prices are likely to remain high. As long as demand and supply fundamentals in the world economy remain unaltered it is unlikely that food prices will decline significantly in the near future.

A combination of food price increases and sluggish income growth would pose a significant risk. When food price increases take place over a period of sufficient income growth, households' can still experience overall welfare gains in terms of total consumption, and thereby protect their food consumption. However, if their incomes do not increase, it would be more costly for poor households', for whom protecting basic food consumption will be increasingly difficult.

There have been policy interventions to address high and volatile food prices. Several countries have used agricultural subsidies to boost local food production in place (for example, China). The Indonesian government allowed the State Logistics Agency to import rice, and Indonesia, the Philippines and Thailand also temporarily reduced tariffs on selected food imports. Authorities in rice-importing countries often use stock reserves to manage price volatility (in China and the Philippines, for example). Rice-exporting countries, such as Thailand, and Vietnam, maintain smaller emergency stocks to be used for humanitarian relief during natural disasters or other temporary supply shortages. Rice-exporting countries also have various farmer support schemes in place (see Box 4 for Thailand). Some ongoing initiatives provide a promising start for regional cooperation in responding to food price shocks. The ASEAN+3 East Asia Emergency Rice Reserve, for example, while not sizeable enough to mitigate large shocks, could work as an emergency response vehicle. However, international food prices are high largely because of the structural issues in underlying demand and supply (see Box 6). Increasing investment in research and development and in technology in the agricultural sector would help take advantage of potential economies of scale, and boost agricultural productivity and farmers' incomes.

Focusing on long-term growth

Given that global economic growth is projected to remain sluggish, it is important to refocus on long-term reforms that will enhance growth and reorient it towards domestic sources where possible. As stressed in our previous Update,[15] maintaining a more buoyant growth path in the middle-income countries in the region remains a key priority for the authorities. Fiscal spending will need to be increasingly more efficient, better targeted, and long-term oriented, including enhancements in social security and education. Increasing productivity and moving towards higher value-added production will be an important part of the growth strategy. In some countries, this will mean a higher level of investment in key sectors such as in productive infrastructure, and education. In others, increasing the quality and efficiency of investments will be the first priority. Investments in disaster management and prevention are also becoming increasingly important for the region, as borne out by the dramatic flooding in Thailand.

Increasing productivity will need to remain a priority if high growth rates are to be maintained. While initially not very high, total factor productivity (TFP) improvements have strongly contributed to growth in the years after the Asian crisis. When capital accumulation fell after the crisis, countries that were able to increase total factor productivity grew faster. If the middle-income countries were accumulating capital at the average historical rate, they would need to facilitate even faster improvements in total factor productivity to achieve growth rates of around seven percent.[16]

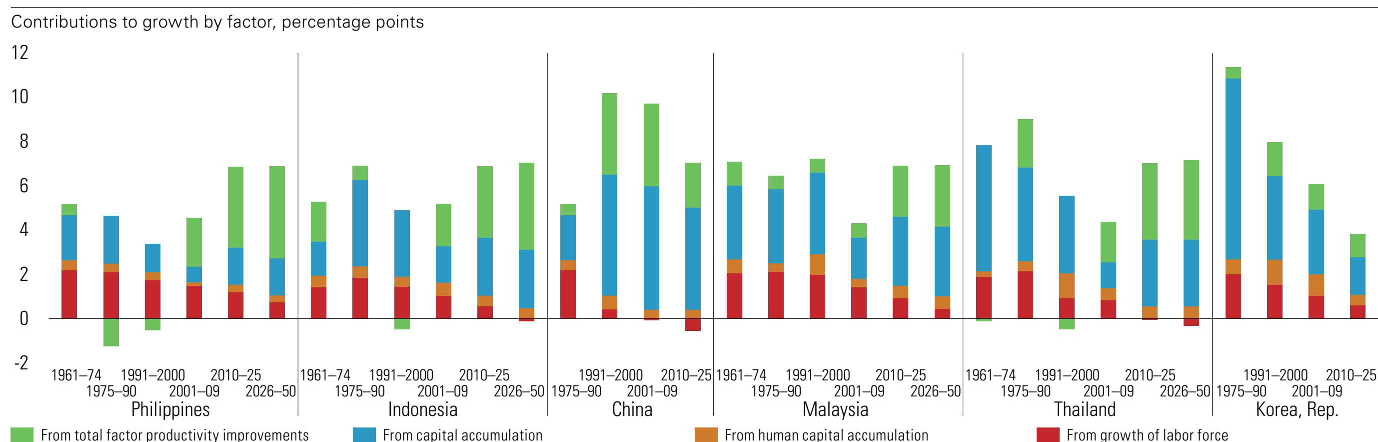
15 Securing the Present, Shaping the Future, EAP Update, April 2011, World Bank, Washington DC.

16 Average historical rates of capital accumulation are calculated for 1980–2009. Note that 7 percent growth in real GDP would be higher than average growth rates in 1980–2009 for most MICs.

	Thailand	Malaysia	Philippines	Indonesia	China
Average growth rate	6.3	6.0	3.1	5.4	9.8
Median growth rate, excluding crisis years	7.1	6.9	4.2	6.4	10.1

In some countries, these improvements would need to make up for the declining labor force and for the naturally slowing growth in capital stocks (Figure 74). For Indonesia and Thailand to grow at their median non-crisis growth rates[17], they would need to bring capital accumulation back to the historical average and double TFP contributions. For

Figure 74. Increases in productivity will be crucial if targeting high real growth rates



Source: WB staff calculations.
Note: Seven percent growth rate is targeted for all countries, for illustration purposes.

Malaysia, an increase in capital accumulation would be required, along with more than triple the TFP contribution to growth. In the Philippines, TFP improvements will be necessary if the country is to grow at rates above five percent. In China, we assume a gradual easing in capital accumulation following its medium-term plan aimed at rebalancing the economy.[18] As a result, if TFP growth remains at its current levels, the loss of the demographic benefit would mean a decline in overall growth in 2010–2025.

Improving both the quantity and quality of investment will be an important component of the strategies for increasing productivity. As discussed in the previous Update,[19] the shares of investment in GDP in the middle-income countries in the region are not sufficient to escape the middle-income trap, and some are not even at their pre-Asian crisis levels (Figure 75).[20] Korea and Japan invested as much as 31 percent of GDP to escape the middle-income trap, and investment rates of 25 percent of GDP or more are usually needed for robust and high growth.[21] At present, only China, Mongolia, and Vietnam are investing at such high rates, which may or may not be sustainable. Increased spending alone, however, is not likely to be an effective solution. A new index of public investment management practices[22] suggests that the quality of planning, appraisal, selection, implementation, and evaluation for projects within government investment portfolios could be improved in most countries within the region (Figure 76). While relative country rankings may be debatable, it is clear that only a few developing East Asian countries have met or exceeded the middle-income average for the quality of public investment management.

17 Their median growth rate during non-crisis years between 1980 and 2009, see Table in the previous footnote.

18 See He, J. and L. Kuijs. 2007. Rebalancing China's Economy – Modeling a Policy Package, World Bank China Research Paper No. 7. Also see Kuijs, L. 2009. China through 2020—A Macroeconomic Scenario. World Bank China Research Working paper No.9.

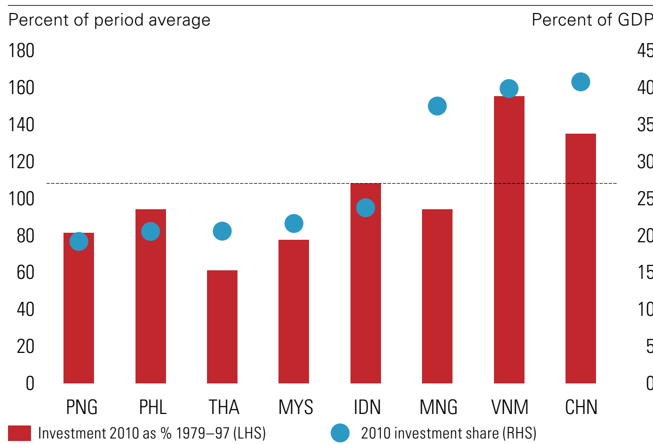
19 Securing the Present, Shaping the Future, EAP Update, April 2011, World Bank, Washington DC.

20 Calculated as a 20 year average from 1978 to 1997.

21 Growth Commission, 2008, The Growth Report: Strategies for Sustained Growth and Inclusive Development, p. 34, www.growthcommission.org.

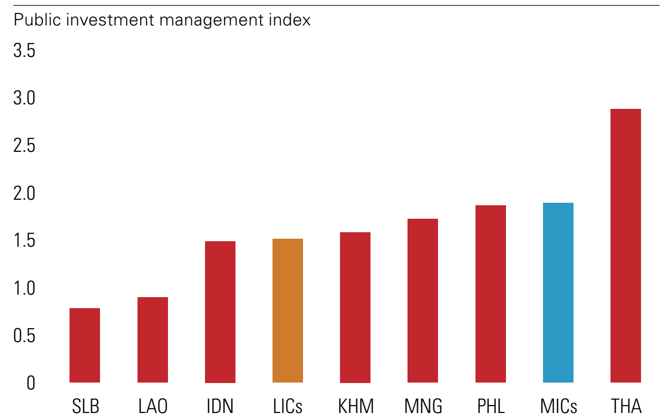
22 Dabla-Norris et al, 2011. Investing in Public Investment: An Index of Public Investment Efficiency. Primary sources used to construct the indices are from the period 2007 to 2010.

Figure 75. Investment shares of GDP have not uniformly recovered after the Asian crisis



Source: World Development Indicators.
Note: Data after 1995 only are used for Vietnam.

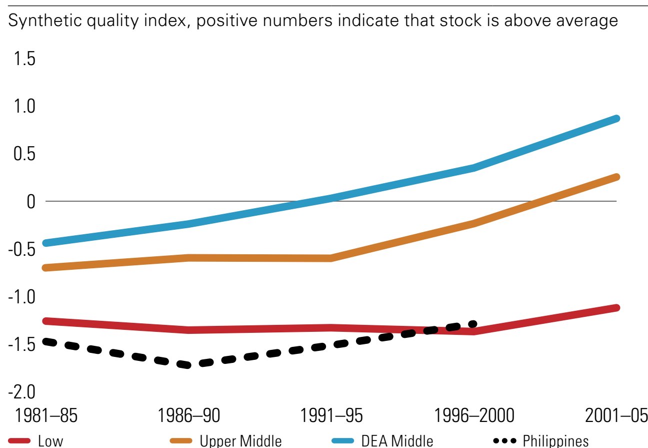
Figure 76. Quality of public investment planning and implementation needs to improve in many countries



Source: Dabla-Norris et al (2011).
Note: Higher values indicate better investment planning and implementation.

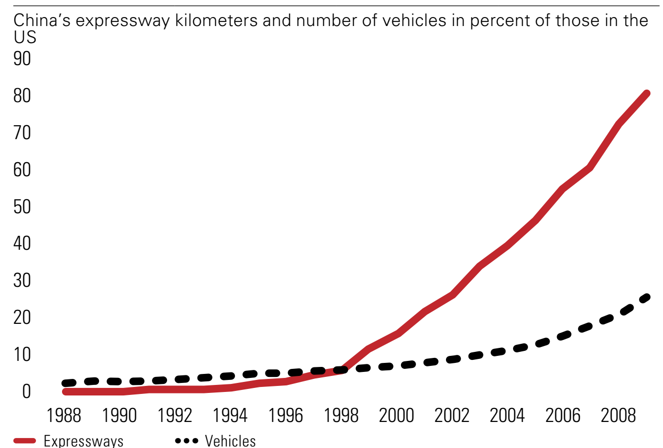
More infrastructure investments are needed to ensure high growth rates in the future. These include investment in transportation, as well as in innovation-enhancing technologies, such as telecommunications. While stocks of infrastructure per capita in East Asia exceeded world average in 2000, they are still below lower- to middle-income country averages.[23] But returns to infrastructure investments are not always adequate (Figure 77). In the Philippines, the quality of urban infrastructure is a major constraint, including roads, ports, and airports; high electricity costs and blackouts, by themselves, cause manufacturers to lose as much as six percent of their sales.[24] In Indonesia, firms identified a large infrastructure gap, including in roads, as one of the greatest obstacles to private investment.[25] Some infrastructure in China has been built well ahead of demand, raising questions about the returns on such investments,

Figure 77. The quality of most regional infrastructure is very good but some countries lag far behind...



Source: Serven and Calderon (2010).

Figure 78. ...while some may be leading demand, creating the risk of low returns



Source: National Bureaus of Statistics.
Note: Vehicle data from China are for civil vehicles owned, data from US are for vehicles in use.

23 Serven and Calderon, 2010. Infrastructure in Latin America. The synthetic quality index focuses on telecommunications, electricity, and roads. The underlying data include the waiting period for telephone installation, electric power transmission and distribution losses, and the percent of roads that are paved.

24 World Bank, 2006. Philippines Investment Climate Assessment and World Bank, 2008. Philippines Enterprise Survey.

25 World Bank, 2010. Indonesia Rising: Policy Priorities for 2010 and Beyond.

as in the case of the rapid expansion of their expressways (Figure 78). In Thailand, the quality of infrastructure is better than in most of its neighbors, but large variances in the quality of infrastructure services across provinces may need continued attention (Figure 76).[26] Ensuring a high quality of information technology infrastructure, together with affordable access, should also be a priority for Thailand.

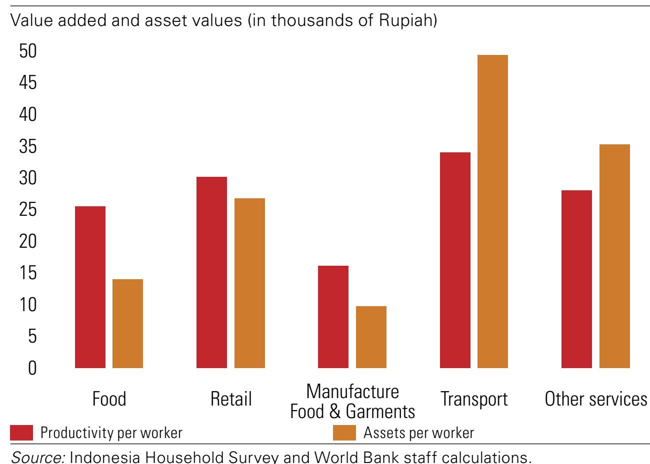
Faster growth in productivity can be driven by facilitating innovation and by greater investments in human capital. Economy-wide productivity improvements come from two main sources: technology and capital accumulation that improve productivity within sectors, and the movement of labor from less productive to more productive sectors. To increase productivity, low-income countries will need to educate more workers, and continue adopting existing technologies. Middle-income countries have successfully exploited a model of high volume, low value-added assembly operations, mainly through adoption of existing technologies. For these countries, sustaining rapid growth will depend more on the ability of the private sector to innovate closer to the frontier and to move up the value chains. To innovate, firms need access to adequately educated and skilled workers who can absorb and apply new knowledge and processes. Better education is the key: without educated workers, ideas would not emerge, get transmitted, adopted, or implemented. The share of unskilled workers can be as high as 85 percent in Thailand and 65 percent in Malaysia, compared to only 25 percent in OECD countries. Workers with tertiary education tend to get hired by innovating firms and they often earn more than those with less education.[27] More than half of the manufacturing firms in Thailand, Cambodia, and Malaysia offer formal training for their workforce, suggesting that education systems do not adequately train their workers. Restrictions on the movement of labor to productive sectors, where they are precluding productivity growth, should also be relaxed.

Reducing gender bias will also help improve productivity. In East Asia, within-industry productivity differentials are quite large (in some industries, total factor productivity of the top firms is 20 times higher than that of the least productive firms).[28] Reducing distortions and leveling the playing field would help reduce these differentials and increase overall productivity. Equal participation and opportunities for all is one way to move in the right direction. East Asia has made significant advances in reducing gender-based inequities in education and labor force participation.

Figure 79. Women in most of East Asia and Pacific continue to earn less than men

Source: WB estimates using country level household data.

Figure 80. In Indonesia, female-led enterprises are clustered in lower productivity and capital intensive industries



Source: Indonesia Household Survey and World Bank staff calculations.

26 World Bank, 2008. Thailand Investment Climate Assessment.

27 Putting Higher Education to Work: Skills and Research for Growth in East Asia, October 2011, World Bank, Washington DC.

28 See Productivity and Innovation in East Asia and Pacific: A Stocktaking, Eye on East Asia and Pacific #11, World Bank, Washington DC.

Even so, persistent employment segregation by gender traps women in low-productivity, lower-paying jobs, often in smaller, less efficient firms (Figure 79 and Figure 80). Such labor market sorting by gender is not only fundamentally unfair, but it also prevents the full utilization of women's skills and talents. Likewise, women's productivity is also impaired when distribution of a key asset—such as land—is skewed, when women have to bear the double burden of combing household work with market roles, or when women-owned businesses receive less than equal access to services. Policy action to reduce remaining gender biases in skills acquisition, jobs and wages, ownership of capital, and access to services is urgently needed—not only to uphold fundamental values of justice and fairness, but also to improve overall productivity so that everyone is better off as a result.

Investments are also needed to reduce the impact and costs of natural disasters. East Asia and Pacific region represents 85 percent of all people affected by natural disasters since 2007. That exposure is likely to double by 2050 due to climate change and rapid urbanization that concentrates the lives and assets in ways that can, but need not always, leave them vulnerable to the effects of climate change and other natural hazards. Moreover, when those urban areas host international manufacturing and trading hubs, local disasters can have global impacts—as has been clearly demonstrated by the recent earthquake and tsunami in Japan and by the flooding in Thailand (see also Box 1).

While it is not possible to control natural hazards, it is possible to reduce their costs through proactive policies and investments aimed at disaster management and prevention. Sometimes the required policy changes can be simple.[29] Well-maintained roads are essential for disaster management, allowing people to be evacuated to safety and relief supplies to be brought to devastated areas. Another important option is to use regulation to coordinate commercial and public investment decisions. For example, commercial investments in rural land clearing often result in downstream flooding of urban areas, thus requiring heavy public expenditures in flood control systems. Yet, thoughtful regulation can balance these commercial and public interests. Investing in information systems for easy access by firms and households would also help. Information about where flood plains and earthquake zones are located can usefully inform decisions about where to locate factories and homes, how to build-in resiliency against disasters, how to value property, and how to insure that property. This process works best when markets, while regulated, are not distorted through excessive taxation, subsidies or controls.

29 World Bank, 2010. *Natural Hazards, Unnatural Disasters*, World Bank, Washington DC.

COUNTRY PAGES AND KEY INDICATORS

Population	14.7 million
Population growth	1.7 percent
Surface area	181,040 sq. km.
Capital	Phnom Penh

Source: World Development Indicators.

Cambodia continued its strong recovery from the 2009 crisis and the growth momentum is expected to continue. The recent floods and the slowdown in the EU and U.S. economies have slowed growth over the second half of the year, but the Cambodian economy is still expected to end 2011 with 6.0 percent annual growth. This growth momentum is expected to further increase to 6.5 percent annually for the next two years, on the assumption that the international environment does not deteriorate.

The expected 6.0 percent GDP growth in 2011 is being driven by strong exports of goods and services, private investment, and a solid macroeconomic position. The impressive growth in the manufacturing sector (concentrated in the garment and footwear industries), the continued strong recovery in the tourism sector, and the moderate growth of the agricultural sector has offset the negative growth in the construction and real estate sectors over the first half of 2011. Growth in the second half of 2011 is expected to slow due to the recent destructive floods and the anticipated slowdown in external demand.

In the first half of 2011, the construction and real estate sectors remained subdued after experiencing negative growth last year (the real estate sector fell by 15.8 percent and construction dropped by 25.5 percent in 2010). In contrast, exports of garment products, the country's main foreign exchange earner, have continued to see an impressive expansion in the U.S. and EU markets (Cambodia's main export destination), despite the global slowdown. The main reason behind the acceleration of growth in the garment and footwear sectors was the relaxing of the EU's rule of origin on preferential tariffs for least-developed countries' exports to the EU markets (effective January 1, 2011). Garment exports to the EU market shot up 61 percent in the first half of 2011, the biggest growth recorded since Cambodia penetrated this market. Exports of services are expected to continue growing this year led by tourist arrivals, which registered a 13.5 percent gain in the first half of 2011 (to some 1.4 million) compared to 2010. The Asia and Pacific Region is the country's most important market, accounting for 68 percent of total tourist arrivals. The strong regional economic growth plays a crucial factor for Cambodia's tourism industry.

Cambodia's GDP growth has been downgraded from an estimated growth of about 6.8 percent to 6.0 percent as a result of the destructive flood impact and the expected slowdown of the EU and U.S. economies in the second half of 2011. The agriculture sector, which accounts for a third of the economy, experienced strong growth over the past five years (averaging 5.1 percent per year). This growth is expected to be interrupted by the recent floods in September and October, which are the highest floods in a decade. The floods damaged hundreds of thousands of hectares of rice seedlings, paddy rice plantations, and other agricultural crops. Furthermore, over 240 people lost their lives and over a thousand livestock perished. The agricultural sector was previously expected to grow by nearly 4.0 percent, but is now projected to grow by a mere 1.5 percent for 2011 on the assumption that floods will recede fast enough to allow some flooded areas to be replanted quickly. According to authorities' reports, some 390,000 hectares of rice seedlings and paddy rice plantations are inundated, threatening some 13.5 percent of the country's total paddy rice production. The impact on

production depends on how long the water takes to recede.

The external sector continues to grow, with merchandise exports estimated at 17 percent growth in 2011. As a result, the current account deficit will edge down slightly to 13.0 percent of GDP (down from 13.5 percent of GDP in 2010). FDI inflows are forecasted to increase by 15 percent in 2011 to nearly $900 million or 7.1 percent of GDP (up from 6.7 percent of GDP in 2010). The gross foreign reserves are projected to grow by 22 percent to $3.2 billion or 4.4 months of imports by the end of 2011. The reserves amount to 54.4 percent relative to the stock of broad money, and 75 percent relative to gross external debt (as of June 2011). Net capital inflows increased by 25 percent to $1.3 billion in 2010 and by 8 percent to $368 million in the first quarter of 2011—reflecting the continued pick-up of FDI inflows and loans from foreign banks. The nominal exchange rate has been very stable for nearly a decade. The National Bank of Cambodia (the Central Bank) has continued to stabilize the exchange rate: some $120 million has been injected into the market during the first half of 2011.

In the meantime, consumer price inflation rose 6.7 percent in September 2011 from a year earlier, with nearly half of the increases attributable to food prices alone. The inflation rate actually fell slightly from 7.1 percent in June 2011; it is projected to reach 7.5 percent by the end of 2011. The price of rice, the main diet staple of Cambodians, remained relatively stable despite recent price hikes in the international market (up 26 percent in September 2011 over the same period last year for the 5 percent broken rice). The local markets' rice price may increase in the second half of this year because of flood interruption and purchase competition from neighboring countries. The Government's rice production and export policy—adopted in July 2010—has started to produce positive outcomes with milled rice exports for the first 6 months of 2011 already passing the entire exports of 2010.

The financial sector is recovering with a growing number of banks entering the Cambodian market, despite the tripling of capital requirements (effective January 1, 2011), which were introduced in order to strengthen the country's banking sector and to keep it well capitalized in the emerging risk environment. Bank lending started to gain momentum after a slowdown in 2009 and 2010, reflecting the recovery of private sector vibrancy (credit to the private sector rose 30 percent compared to June 2010). Bank liquidity surged, as deposits—including those financed from remittances—rose to a high of $4.6 billion by June 2011. At the same time, the loan-to-deposits-ratio increased to 75 percent (up from 71 percent in June 2010). The Cambodian Securities Exchange (CSX) was officially launched on July 11, 2011, but is yet to have its first listed company.

Fiscal management has improved, reflected in the preliminary fiscal outturn of 2010. Revenue collection increased markedly from 11.5 percent of GDP in 2009 to 13.1 percent in 2010, expanding 1.5 percentage points of GDP. Tax revenues increased, reflecting the authorities' continued efforts to strengthen revenue administration, to enhance public financial management reform, to use the banking system for tax collections, and to expand the customs automation system. Meanwhile, overall expenditures were contained in 2010 at 20.1 percent of GDP with the fiscal deficit standing at 7.0 percent of GDP in 2010 (down from 8.1 percent of GDP in 2009). Capital spending grew but the wage bill was reduced. The deficit was mostly offset by foreign financing. The fiscal deficit for 2011 is projected to decline to 6.1 percent.

A new budget law for 2012 has been under preparation to enhance fiscal space. The Prime Minister's Instruction Circular, dated June 13, 2011, aims to improve fiscal space through strengthening capacity, and governance of revenue administration agencies (especially the Tax and Customs Departments), broadening tax-base policy, collecting tax in arrears, and limiting non-essential current expenditures (mainly government agency utility bills, gasoline consumption, and luxury furniture). The new Budget for 2012 also plans to increase spending in both the social and economic sectors. The Budget targets for the 2012 fiscal deficit at around 6 percent of GDP.

The growth prospects for 2012 and 2013 remain strong – projected at 6.5 percent per year. Exports are expected to promote growth because of greater market access granted by the relaxing of the EU's rules of origin and the assumption that the global uncertainty subsides. The associated downside risk is a fall in domestic demand in the U.S. and EU economies, which would hurt Cambodia's garments and footwear exports.

Cambodia Key Indicators

	2007 Year	2008 Year	2009 Year	2010e Year	2011f Year	2012f Year
Output, Employment and Prices						
Real GDP (% change y-y)	10.2	6.7	0.1	6.0	6.0	6.5
Domestic demand (% change y-y)	17.3	18.3	2.7	10.7	14.5	15.0
Industrial production index (2000=100)	246	256	231	263	280	298
(% change y-y)	8.4	4.0	-9.5	13.5	6.5	6.5
Unemployment (%)	0.9	1.7	..	..	..	..
Consumer price index (% change y-y)	14.0	12.5	5.3	3.1	7.5	5.0
Public Sector						
Government revenues (% GDP)	11.9	12.0	11.5	13.1	13.3	13.4
Government expenditures (% GDP)	14.7	14.8	19.6	20.1	19.4	19.3
Government balance (% GDP)	-2.9	-2.8	-8.1	-7.0	-6.1	-5.9
Foreign Trade, BOP and External Debt						
Trade balance (millions US$)	-1,343	-1,801	-1,634	-1,698	-1,859	-1,935
Exports of goods (millions US$)	4,089	4,708	4,196	4,687	5,483	6,141
(% change y-y)	10.7	15.2	-10.9	11.7	17.0	12.0
Key export (% change y-y) 1/	8.1	3.3	-19.0	24.4	25.0	15.0
Imports of goods (millions US$)	5,432	6,509	5,831	6,384	7,342	8,076
(% change y-y)	13.8	19.8	-10.4	9.5	15.0	10.0
Current account balance (millions US$) 2/	-705	-1,280	-1,203	-1,570	-1,631	-1,607
(% GDP)	-8.1	-12.4	-11.6	-13.5	-13.0	-11.6
Foreign direct investment (millions US$)	866	795	520	774	890	1,006
External debt (millions US$) 3/	2,555	2,808	3,054	3,514	3,813	4,176
(% GDP)	29	27	30	30	30	30
Short-term debt (millions US$)	218	218	218	218	218	218
Debt service ratio (% exports of g&s)	1.0	1.0	1.1	1.1	1.1	1.2
Foreign exchange reserves, gross (millions US$)	1,616	2,164	2,367	2,653	3,237	3,884
(months of imports of g&s)	3.1	3.4	4.1	4.3	4.4	4.4
Financial Markets						
Domestic credit (% change y-y)	70.7	51.1	19.9	35.3	35.0	25.0
Short-term interest rate (% p.a.) 4/	16.0	15.8	15.0	15.0	15.0	15.0
Exchange rate (Riel/US$, eop)	4,003	4,081	4,169	4,053	4,100	..
Real effective exchange rate (2000=100)	95.1	111.7	111.3	108.0	..	..
(% change y-y)	3.0	17.4	-0.4	-2.9	..	..
Memo: Nominal GDP (millions US$)	8,754	10,284	10,328	11,608	12,576	13,795

Sources: National data sources, IMF, and World Bank staff estimates
e = estimate
p = projection
1/ Garments
2/ Excludes official transfers
3 / IMF figures for 2010 onward
4/ One-year US$ loans

CHINA

Population	1,325.6 million
Population growth	0.6 percent
Surface area	9,598,088 sq. km.
Capital	Beijing

Source: World Development Indicators.

The Chinese economy registered a moderate slowdown over the course of 2011. During the first nine months of 2011, growth slowed from 10.6 percent in 2010 to 9.4 percent. On the production side, some two-thirds of the slowdown can be traced back to weaker activity in construction and manufacturing. On the expenditure side, investment and net exports contributed 1.4 and 0.7 percentage points to the slowdown, whereas consumption offset the decline by 0.7 percentage points.[30]

The slowdown occurred on the back of domestic tightening and external weakening. The renormalization of the macro policy stance constrained public investment as large-scale stimulus-related support was withdrawn. Private investment growth was affected by less accommodative monetary and credit policy, with the benchmark policy rate raised, reserve requirements lifted, and prudential controls tightened. The more difficult external environment in turn slowed the growth of trade, where the impact of slower export growth outweighed that of slower import growth—resulting in a lower trade surplus at USD13.7 billion in September.

Inflation reached high levels in 2011, but has now passed its peak. Consumer price inflation rose from 2 percent to over 6 percent, with the latest reading at 6.1 percent for September. On a seasonally adjusted basis, inflation has started to decelerate since July. Two-thirds of consumer price inflation is associated with food—the result of high food price inflation (13.4 percent in September) and food's weight in the consumption basket (31 percent in January). Pork prices were a key contributor to food price inflation following cyclical effects (the 'hog cycle') and a local disease outbreak. Pass-through of international commodity prices also played a role.

Leading indicators project further softening, with consumption offering resilience. Newly started construction and purchasing manager's orders suggest additional slowing in the next 6–12 months, but do not signal an immediate hard landing. OECD leading indicators suggest a similar pattern. Consumer demand is expected to remain resilient. The consumer expectations index of the National Bureau of Statistics has recently reached a two-year high and the business climate index remained buoyant for retail and wholesale trade.

Growth is expected at 9.1 percent in 2011, 8.4 percent in 2012 and roughly similar rates thereafter. This pattern reflects a combination of two forces: the continued cyclical adjustment to the internal and external factors responsible for the current slowdown and the structural adjustment to a more balanced growth model that is less reliant on investment-led, export-oriented and manufacturing-based growth.

Inflation is likely to recede but will remain elevated—at 5.3 percent in 2011 and 4.1 percent in 2012. Asides from base effects, inflation will be affected by weakening of growth, the fading of earlier food price impulses and the policy-induced cooling of the property market. Cost-push factors will likely play a leading role in mitigating inflationary pressure. Demand-pull factors are expected to recede somewhat in the near term, but will feed inflationary pressure again as growth differentials with the rest of the world attract capital inflows.

30 This write up is based on data for the first half of 2011 only.

The current account surplus will likely narrow from 5.2 percent of GDP in 2010 to 3.5 and 3.0 percent in 2011 and 2012. This reflects the anticipated decline in the trade balance—even though commodity price adjustment is expected to work to China's favor—as well as a smooth appreciation in the exchange rate. Foreign direct investment inflows should remain relatively robust (given ongoing growth differentials), whereas outflows will be on the rise given policy support and China's longer-term needs for raw materials. Foreign reserves will continue accumulating with a positive trade balance, valuation gains, and capital inflows.

While the central projection is for a gradual deceleration of growth, the risks are tilted to the downside. The global outlook has become increasingly precarious as advanced economies growth turned more sluggish than previously anticipated and uncertainties continued to loom over euro area sovereign debt. Domestically, concerns have heightened about the impact of the massive fiscal stimulus which boosted local government debt and led to a surge in fixed investment. Potential overheating in the property market provides an additional source of concern—even though the market has cooled somewhat in recent months as home purchase limits were expanded.

Policymakers will need to walk a fine line guarding against the short-term risks to growth and the lingering vulnerabilities associated with a still buoyant, if not overheated, economy. Given that monetary conditions remain accommodative, the projected reduction in inflation should introduce a welcome degree of passive tightening at current nominal rates. The fiscal balance—expected at 2.1 percent for 2011—leaves space for further stimulus should the need arise. To mitigate the vulnerabilities of continued low real interest rates, an easing of fiscal policy appears the most appropriate line of defense before the monetary policy stance is eased.

In line with the 12th Five-Year Plan, the overriding objective for the medium to longer term will be to transform the growth model. As factor accumulation-led growth hits diminishing returns, the challenge is to transition smoothly to sustained growth anchored on productivity gains. Internal cost pressures are triggering a reconfiguration of China's production networks. This will create opportunities for low-cost manufacturing further inland and abroad but also adds urgency for coastal areas to move up the value chain. While this process of structural adjustment is likely to reduce headline growth over the medium term, it is at the same time also placing China's longer term prospects on a more solid footing.

Policy actions to support this process would focus on completing the transition to the market-based economy and strengthening the national innovation system. By redefining the role of government, developing the private sector, promoting competition, and deepening reforms in the land, labor and financial markets, China can strengthen the market mechanism—which will in turn assist in correcting internal and external imbalances. Concerted efforts to strengthen the innovation capabilities of Chinese firms by strengthening the quality of research and development and leveraging on domestic and international knowledge networks would lay the foundation for sustained innovation-led growth.

China Key Indicators

	2008	2009	2010e	2011f	2012f	2010		2011			2011				
	Year	Year	Year	Year	Year	Q3	Q4	Q1	Q2	Q3	May	Jun	Jul	Aug	Sep
Output, Employment and Prices															
Real GDP (% change y-y)	9.6	9.2	10.4	9.1	8.4	9.6	9.8	9.7	9.5	9.1	..	..	..	..	..
Industrial production index /1	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
(% change y-y)	9.9	8.7	12.1	..	..	13.5	13.3	14.3	13.9	13.8	13.3	15.1	14	13.5	13.9
Unemployment (%) 2/	4.2	4.3	4.1	..	..	4.1	4.1	4.1	4.1	..	..	..	..	..	..
Real wages (% change y-y)	10.4	12.4	9.7	..	..	..	..	..	..	..	..	..	..	..	..
Consumer price index (% change y-y)	5.9	-0.7	3.3	5.3	4.1	4.5	5.7	7.1	6.9	..	5.5	6.4	6.5	6.2	6.1
Public Sector															
Government revenues (% GDP)	19.5	20.1	20.7	21.0	20.5	..	..	..	..	..	..	..	..	..	..
Government expenditures (% GDP)	19.9	22.4	22.4	22.7	22.6	..	..	..	..	..	..	..	..	..	..
Government balance (% GDP)	-0.8	-2.8	-1.7	-1.7	-2.1	..	..	..	..	..	..	..	..	..	..
Domestic public sector debt (% GDP) /3	17.0	17.7	16.8	..	..	..	..	..	..	..	..	..	..	..	..
Foreign Trade, BOP and External Debt															
Trade balance (billions US$)	297.3	198.2	184.5	176.0	156.8	65.6	63.1	-0.7	46.7	62.9	13.0	22.3	31.5	17.8	14.5
Exports of goods (billions US$)	1,429.2	1,202	1,578.4	1,958.9	2,307.5	429.8	443.5	399.7	474.8	518.3	157.2	162.0	175.1	173.3	169.7
(% change y-y) 4/	17.3	-15.9	31.3	24.1	17.8	32.2	24.9	26.4	22.0	20.7	19.3	17.9	20.3	24.4	17.1
Key export (% change y-y) 5/	16.8	-15.7	31.4	..	..	32.5	25.2	26.1	21.9	..	19.2	17.7	20.4	24.4	..
Imports of goods (billions US$)	1,131.8	1,003.9	1,393.9	1,781.4	2,148.4	364.2	380.3	400.4	428.1	455.4	144.1	139.7	143.6	155.6	155.2
(% change y-y) 4/	18.4	-11.3	38.9	27.8	20.6	27.4	29.5	32.8	23.1	24.9	28.4	19.0	23.0	30.4	20.9
Current account balance (billions US$)	436.1	297.1	305.4	250.0	246.0	..	..	..	..	..	..	..	..	..	..
(% GDP)	9.6	6.0	5.2	3.5	3.0	..	..	..	..	..	..	..	..	..	..
Foreign direct investment (billions US$) /6	108.3	94.1	105.7	..	..	198.7	31.4	30.3	30.6	..	9.2	12.9	8.3	8.4	..
External debt (billions US$)	390.2	428.6	548.9	..	..	..	..	..	..	..	..	..	..	..	..
(% GDP)	8.6	8.6	9.3	..	..	..	..	..	..	..	..	..	..	..	..
Short-term debt (billions US$)	226.3	259.3	375.7	..	..	..	..	..	..	..	..	..	..	..	..
Debt service ratio (% exports of g&s)	1.8	2.87	1.6	..	..	..	..	..	..	..	..	..	..	..	..
Foreign exchange reserves, gross (billions US$)	1,952.5	2,405.7	2,853.8	3,356.0	3,797.0	2,654.9	2,853.9	3,051.3	3,204.1	..	3,172.6	3,204.1	..	..	..
(months of imports of g&s)	13.2	18.1	15.6	19.2	18.4	87.5	90.0	91.5	89.8	..	22.0	22.9	..	..	..
Financial Markets															
Domestic credit (% change y-y)	15.9	31.7	19.9	..	..	18.5	19.9	17.9	16.9	..	17.1	16.9	16.6	16.4	..
Short-term interest rate (% p.a.) 7/	2.8	2.8	3.3	..	..	2.8	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Exchange rate (RMB/US$, eop)	6.84	6.83	6.65	..	..	6.75	6.65	6.57	6.48	..	6.50	6.48	6.46	6.41	..
Real effective exchange rate (2000=100)	110.3	104.7	109.1	..	..	108.9	109.1	107.0	106.7	..	107.6	106.7	107.1	109.5	..
(% change y-y)	12.9	-5.0	4.2	..	..	2.4	4.2	1.7	-1.5	..	-3.7	-4.6	-3.3	-1.4	..
Stock market index (Dec. 19, 1990=100)/8	1,821	3,277	2,808.1	..	..	2,656	2,808.1	2,928.1	..	..	2,743.5	2,762.1	2,701.7	2,567.3	2,359.2
Memo: Nominal GDP (billions US$)	4,521.8	4,990.5	6,031.8	7,068.0	8,230.0	..	..	..	..	..	..	..	..	..	..

Source: National data sources

f = forecast

1/ Annual data are not comparable with the quarterly and monthly data. Annual data cover all industrial enterprises while the quarterly and monthly ones only refer to those enterprises with sales value above RMB 5.0 million.

2/ Official urban unemployment only, not including laid-off workers

3/ Includes treasury bonds, policy financial bonds and other financial bonds (end-period outstanding)

4/ Nominal growth rate

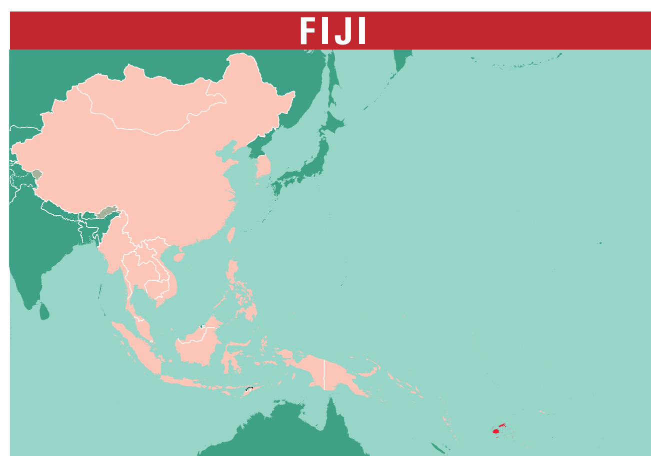
5/ Manufactured exports

6/ Gross FDI utilized

7/ Central Bank loans to financial institutions, less than 20 days

8/ Shanghai Stock Exchange A-Share Price Composite

FIJI



Population	838,700
Population growth	0.5 percent
Surface area	18,270 sq. km.
Capital	Suva

Source: World Development Indicators.

The economy of Fiji has remained weak in the last five years, with real GDP growth averaging 0.2 percent. A fragile domestic investment environment resulting from prolonged economic and political uncertainties, unfavourable weather events, and continued weakness of the sugar industry contributed to the lacklustre economic performance. Current projections are for Fiji's economy to grow by 2.0 to 2.5 percent in 2011 compared to 0.3 percent in 2010. The relatively ambitious growth target hinges on the continued strength of the tourism sector, as well as stronger performance of the manufacturing and forestry industries.

The sugar industry may experience limited improvements in 2011, both in terms of production and mill efficiency. Production of sugar cane is expected to rise as a result of the recovery from the 2010 cyclone, while mill efficiency may rise with attention being given to maintenance and upgrading as reflected in the FJD20 million set aside for this purpose in the budget. Tourism is expected to continue its solid performance in 2011. Following a 16.5 percent rise in 2010, visitor arrivals to June 2011 recorded a further 9.0 percent increase year-on-year. Estimated tourism earnings grew at a similar pace, though heavy price discounting offset some of the positive impact of the devaluation of the Fijian dollar.

Inflation rose steadily from 1.2 percent in August 2010 to 10.4 percent in August 2011. The upward trend is driven by international price developments (rising food and oil prices), an increase in the Value Added Tax (VAT) rate from 12.5 to 15.0 percent effective January 2011, and an upward revision of the electricity tariff. According to official projections inflation is expected to moderate to 7.0 percent by the end of 2011. Given that around two-thirds of Fijian inflation is imported, the economy remains vulnerable to adverse international price developments. The government recently removed five items from the price control list, the subsequent impact of which is unclear at this stage.

On the external front, export earnings recovered in 2010. Decline in sugar receipts were offset by rises in gold, timber, and fishing receipts. Imports also recovered from a low in 2009, with rising international fuel price being an important contributing factor. The trade deficit widened slightly in 2010 while the surplus on the services account rose further, owing to the solid performance of the tourism industry. Net income and transfers both worsened in 2010, due to a rise in profit repatriation, fall in remittances and no EU sugar transfers being received due to reforms in EU's preferential pricing scheme. Overall, the current account deficit widened from 7.6 percent of GDP in 2009, to 11.2 percent of GDP in 2010.

Data for 2011 indicate continued growth in export sectors, while import growth is expected to be weak given subdued consumption. Total export earnings rose by 2.5 percent cumulative to May from the same period in 2010. Merchandise imports, however, fell by 6.6 percent in the same period, largely on account of a drop in imports of mineral fuels. Foreign reserves improved from under 4 months of imports at the beginning of the year to 4.8 months of imports in August. In August, Standard & Poor's (S&P) raised Fiji's foreign currency long-term sovereign rating from 'B-' to 'B' with outlook revised to 'stable' from 'positive', citing continued improvements to the country's external position as the main reason behind the upgrade. The real effective exchange rate (REER) for July rose by 8.0 percent compared to a year earlier. The rise in REER indicates

a loss in competitiveness, and is mainly attributable to increase in domestic inflation rate.

Consumption indicators have displayed a mixed performance in 2011. The increase in remittances (9.6 percent to June 2011) has been supportive of consumption activity. However, a decline in new lending for consumption purposes (by 40.2 percent to July 2011), and the marginal growth in consumption imports (1.8 percent to May 2011) reflect cautious consumer spending.

Indicators of investment activity in Fiji have remained weak. Uncertainty of the political situation in Fiji is likely to continue to constrain investment in the near term. In 2011, small increases were noted in the value of work put-in-place (1.8 percent to March 2011), imports of investment goods (2.7 percent to May 2011), and new lending for investment purposes (6.0 percent to June 2011). Although higher allocations for capital expenditure in the 2011 budget and potential mining-related projects may provide some support to investment activity. Overall, private sector credit growth has remained low, recording 4.2 percent to June 2011 compared with the same period in 2010.

National poverty headcount ratio declined from 39.8 percent in 2002/03 to 35.2 percent in 2008/09. While there has been considerable improvement in urban areas over the six years (a decline from 35 percent to 26 percent), rural areas showed no decline in poverty, with a poverty headcount remaining at 44 percent. The trend was consistent with the sectoral pattern of economic growth: most of the decline in poverty was driven by the growth of non-agricultural sectors in urban areas. The national poverty levels disguise a large sub-national variation in poverty, between 54 percent headcount in the Northern division and 23 percent in the Central division, while the overwhelming majority of the poor reside in Ba, the most populous province of the country.

The government is budgeting for a deficit equivalent to around 3.3 percent of GDP for 2011, after an estimated deficit of 3.6 percent in 2010. A number of revenue measures have been introduced, and are reflected in an increase in the budgeted revenue by around 1.5 percent of GDP, compared to estimated actuals for 2010. On the expenditure side, the government is continuing its efforts to reduce the proportion of the budget going to the civil service wage bill. The dominant item in the 2011 capital budget is a 110 million Fiji dollar (FJD) allocation equivalent to around 20 percent of capital expenditure for the restructuring of the Fiji Sugar Corporation (FSC), recently taken over by the government. Government's fiscal performance to April 2011 has highlighted some risks to achieving budget targets, including revenue losses from customs duty concessions, slow progress in implementation of revenue measures, emergence of additional funding requests from various ministries, and slow implementation of capital projects.

Persistent fiscal deficits in recent years have caused a steady increase in Fiji's public debt, around three-quarters of which is held domestically, mostly by the Fiji National Provident Fund. Fiji's public debt is projected to increase by around FJD200 million in 2011 to around 57.5 percent of GDP (compared to 49.9 percent in 2007). Contingent liabilities stemming primarily from the Fiji Electricity Authority and FSC are estimated to have been 33.5 percent of GDP in 2010 (compared to 24.8 percent in 2006).

Fiji Key Indicators

	2007 Year	2008 Year	2009 Year	2010e Year	2011f Year	2012f Year
Output, Employment and Prices						
GDP (% change y-y)	-0.9	1.0	-1.3	0.3	1.4	1.5
Tourist arrivals (thousands)	540	585	542	632	..	..
(% change y-y)	-1.6	8.4	-7.3	16.5	..	..
Unemployment rate (%)	8.6	7.7	9.4	..	..	..
Consumer price index (% change y-y)	4.3	6.6	6.8	5.0	7.0	4.5
Public Sector						
Government revenues (% GDP)	25.4	25.5	25.0	25.1	26.7	26.5
Government expenditures (% GDP)	27.4	25.3	29.6	28.7	30.3	28.9
Government balance (% GDP) 1/	-1.1	-0.1	-3.9	-3.6	-3.6	-3.1
Domestic public sector debt (% GDP)	42.6	42.1	46.2	46.3	43.5	41.7
Foreign Trade, BOP and External Debt						
Trade balance (millions US$)	-939	-1,177	-676	-749	-770	-788
Exports of goods (millions US$)	395	497	393	470	484	507
(% change y-y)	10.9	25.8	-21.0	19.6	3.1	4.8
Key export (% change y-y) 2/	-7.5	35.5	-38.6	-62.9	50.7	5.8
Imports of goods (millions US$)	1,571	1,980	1,241	1,495	1,599	1,627
(% change y-y)	1.0	26.1	-37.3	20.5	7.0	1.8
Current account balance millions US$)	-434	-649	-219	-347	-287	-296
(% GDP)	-12.8	-18.1	-7.6	-11.2	-8.8	-8.6
Foreign direct investment (millions US$)	382	362	134	183	214	231
Total external debt (millions US$) 3/	461	450	430	478	574	621
(% GDP)	13.0	13.9	14.7	14.5	17.7	18.1
Short-term debt (millions US$)	..	..	..	..	..	..
Debt service ratio (% exports of g&s) 4/	4.0	3.8	6.1	5.0	14.3	6.4
Foreign exchange reserves, gross (millions US$) 5/	519	317	566	703	..	..
(months of imports g&s)	2.9	1.6	3.9	4.0	..	..
Financial Markets						
Domestic credit (% change y-y) 6/	2.8	11.2	0.2	3.1	..	..
Short-term interest rate % p.a.)	4.5	0.3	7.1	3.6	..	..
Exchange rate (FJ$/US$, eop)	1.6	1.8	1.9	1.9	..	..
Real effective exchange rate (2000=100)	99.4	102	90.5	87.9	..	..
(% change y-y)	1.7	2.6	-11.3	-2.9	..	..
Memo: Nominal GDP (millions US$)	3,405	3,590	2,879	3,090	3,266	3,458

Source: National data sources.
e = estimate
f = forecast
1/ Government balance below the line.
2/ Sugar.
3/ External debt inclusive of external debt by statutory bodies. Rise in extnal debt reflects drawdown of the US$250 million global bond.
4/ Rise in debt service ratio in 2011 reflects the maturity of the US$150 million global bond.
5/ Includes foreign assets of non-bank financial institutions.
6/ Domestic credit to the private sector.

Population	228.2 million
Population growth	1.2 percent
Surface area	1,904,570 sq. km.
Capital	Jakarta

Source: World Development Indicators.

Indonesia has seen strong domestic real sector performance in 2011, but the risks are rising around the economic outlook. In the first half of 2011 the main risks were associated primarily with increasing domestic and international commodity prices. More recently, the focus turned to the deterioration in the global outlook and rising international risk aversion, which contributed to domestic asset price falls and portfolio outflows in August and September.

Indonesia entered this period of heightened uncertainty in a relatively strong position, with sizeable reserves, low government debt, strong domestic demand and comparatively limited direct trade exposure to developed markets. The authorities set up mechanisms to support domestic bond markets if needed, funded by reserves or accumulated fiscal balances. The holding periods on short-term instruments were extended earlier in the year. However, as seen over August and September, the economy still remains vulnerable to capital flow reversals given the high level of foreign ownership of portfolio capital assets. Ensuring well-coordinated policy responses that are supportive of investor confidence can play an important stabilizing role to prevent any domestic amplification of the shock, along with policies to enhance monitoring and crisis preparedness. Maintaining progress on the medium-term reform agenda can also send a positive signal to investors, as well as promote growth in the medium-term.

Indonesia's robust growth in the first half of 2011 was supported by private demand. Year-on-year growth in the first two quarters of 2011 was 6.5 percent, higher than the 6.1 percent growth in 2010. Seasonally adjusted quarterly growth was 1.6 percent in the second quarter, up from 1 percent in the first quarter. Private consumption was aided by buoyant consumer sentiment and lower inflation, while construction drove investment. Net exports also contributed strongly to seasonally-adjusted quarterly growth in the second quarter. Retail and wholesale trade and transport and communications continue to be two key sectors driving growth but manufacturing performance has also been robust, moving above 6 percent growth in the second quarter for the first time in six years, despite supply disruptions associated with the Japan earthquake and tsunami.

Strong balance of payments inflows continued in the first half of 2011, after the record levels of 2010. Overall inflows were record high at US$19.5 billion in the first half of 2011, after US$30.2 billion in 2010. This has been driven by net financial account inflows of US$26 billion in 2010 and US$19 billion in the first half of 2011. In addition to portfolio inflows, FDI has been on an upward trend, moving above pre-crisis levels, although many regional peers receive more relative to GDP. The current account surplus has been narrowing and fell to US$0.2 billion in second quarter of 2012, primarily reflecting a widening income deficit. Monthly trade surpluses have come down somewhat recently, reflecting the relative strength of domestic versus external demand, but remain up on those of a year earlier.

Inflation has continued to fall, as the impact of previous food price shocks has unwound. Rice and food prices declined over the first half of 2011 due to the domestic harvest and the distribution of rice imported by the National Logistics Agency, BULOG. Domestic rice prices have since moved up but, with the high base

effects, food price inflation has continued to fall. This contributed to the decline in headline inflation from 7 percent in December 2010 to 4.4 percent in October 2011. Core inflation moved up gradually to just over 5 percent in August before falling back to 4.4 percent in October. Notwithstanding the adverse impact of higher food prices on net food consumers, the strength of the domestic economy contributed to a decline in the national poverty rate to 12.5 percent in March 2011 from 13.3 percent a year earlier.

Bank Indonesia (BI) has employed a range of policy measures to address the challenges of capital flow volatility and the inflationary pressures of early 2011. After raising the policy rate by 25 basis points in February, BI emphasized its usage of macro prudential measures to manage domestic liquidity and capital inflows. These include raising reserve requirements on foreign currency deposits and, as mentioned above, extending the minimum holding period on SBIs from one to six months in May. BI also indicated it would allow exchange rate appreciation in line with its regional neighbors. In September, recognizing the potential spillovers from the deterioration in the global outlook to Indonesia and the lower outlook for inflation, Bank Indonesia reduced the lower band of the interest rate corridor for monetary operations to stimulate transactions in the domestic money market. This was followed by a cut in the policy rate by 25 basis points to 6.5 percent in early October.

As in other regional markets, Indonesia's financial markets have seen increased volatility and portfolio capital outflows since August amidst the heightened uncertainty over the outlook for the Euro zone and the US. After seeing significant increases over the past two years, Indonesia's equity index dropped 22 percent from August 1st to October 4th (although recovered strongly in October). Portfolio outflows from non-residents (defined as their net equity sales plus the reduction in their holdings of domestic currency government bonds, SUNs, and of BI certificates, SBIs) reached US$4.7 billion in September after US$1.8 billion in outflows in August. These figures compare with monthly outflows of US$5.7 billion in May 2010 and US$3 billion and US$2 billion in September and October 2008 respectively. These outflows contributed to downward pressure on the currency which was countered by intervention by Bank Indonesia. However, some depreciation was seen from mid-September with the currency moving up to around 8,950 Indonesian rupiah per US dollar in the first week of October from 8,500 in early August. BI has also intervened to support domestic currency government bond prices. Five-year yields have been broadly unchanged although one-year yields moved up just over one percentage point in September. As in the case of equities, it is important to note that these movements follow substantial asset price gains since 2009.

With BI intervening to support the rupiah, foreign reserves fell by US$10 billion, or 8 percent, over September 2011 to US$114.5 billion. In comparison, reserves fell by US$6.5 billion, or 11 percent, over October 2008 and dropped by US$4 billion in May 2010 (a 5 percent fall). Reserves at end-September 2011 remained double their level in late 2008 and were equal to 6.5 months of imports and government external debt service or around 2.5 times short-term external debt by remaining maturity.

Fiscal policy remains conservative but higher oil prices contributed to an upward revision to the 2011 budget deficit to 2.1 percent of GDP. The rise from 1.8 percent in the original budget is driven mainly by a higher, though still relatively low, oil price assumption. Along with the delays in planned reforms, this contributed to a sizeable rise in energy subsidy spending. Disbursement rates remain weak; social, capital and materials expenditures in the first eight months of 2011 were only 31 percent of their full year revised budget allocations. The 2012 budget targets a deficit of 1.5 percent of GDP with higher tax revenues more than offsetting additional increases in capital expenditures. Further increases in electricity tariffs are planned from April 2012 but progress on fuel subsidy reform remains uncertain. Fiscal financing appears well-positioned to weather market volatility, after over-financing in 2010 and pre-financing of the deficit in 2011. Room for fiscal stimulus is available if required, but, as in 2009, disbursement

problems could hamper the effectiveness of additional spending allocations.

In a baseline scenario of continued international financial market turbulence, we project Indonesia's growth at 6.4 percent in 2011 before moderating to 6.3 percent in 2012. This baseline is predicated on continued strong domestic and consumption and a coordinated policy response to any adverse spillovers from international market turbulence, for example, to the domestic financial sector. Real sector spillovers from the EU and US are relatively limited directly but there could be more serious spillovers in scenarios in which there is an intensification of global financial difficulties and a decline in global commodity prices and demand from major emerging economies. Risks from commodity price volatility, which were more prominent in the first half of 2011, do remain for the fiscal position due to fuel subsidies and for inflation given its sensitivity to domestic food (particularly rice) price shocks.

In the medium-term it is likely that capital inflows to Indonesia, and other emerging economies, will return, given their higher growth and relative yields. The challenge of managing those flows will come back into focus. To date BI's policy response has focused on macro-prudential measures and managed appreciation. Structural reforms can also help to shift these inflows into more stable and longer-term forms such as FDI and increase domestic competitiveness to meet the challenge of any real appreciation. These reforms can also support the ambitious growth and investment targets set out in the Government's Master Plan for the Acceleration and Expansion of Indonesia's Economic Development 2011-2025 whose successful implementation will require the identification of policy and investment priorities along with the political commitment and coordination to address them.

Indonesia Key Indicators

	2008	2009	2010	2011f	2012f	2010		2011			2011				
	Year	Year	Year	Year	Year	Q3	Q4	Q1	Q2	Q3	May	Jun	Jul	Aug	Sep
Output, Employment and Prices															
Real GDP (% change y-y)	6.0	4.6	6.1	6.4	6.3	5.8	6.9	6.5	6.5	6.5	..	..	..	..	..
Domestic demand (% change y-y)	7.5	5.4	5.2	6.2	6.5	6.2	5.9	5.1	5.8	5.3	..	..	..	..	..
Industrial production index (2000=100) 1/	127.2	128.9	134.6	..	..	135.8	139.6	137.2	139.5	143.5	139.7	142.1	145.7	141.2	143.5
(% change y-y)	3.0	1.3	4.4	..	..	3.7	5.5	5.7	4.9	5.6	5.3	5.0	5.4	1.6	10.1
Unemployment (%) 2/	9.1	8.4	7.9	..	..	..	..	..	..		..	..	..	..	..
Real wages (% change y-y) 2/	-0.4	11.2	4.7	..	..	..	..	..	..		..	..	..	..	..
Consumer price index (% change y-y) 1/	9.8	4.8	5.1	5.6	5.5	6.2	6.3	6.8	5.9	4.6	6.0	5.5	4.6	4.8	4.6
Public Sector															
Government revenues (% GDP)	19.8	15.1	15.5	16.0	15.5	..	..	..	..	..	..	..	..	..	..
Government expenditures (% GDP)	19.9	16.7	16.2	17.5	16.5	..	..	..	..	..	..	..	..	..	..
Government balance (% GDP)	-0.1	-1.6	-0.7	-1.5	-1.0	..	..	..	..	..	..	..	..	..	..
Domestic public sector debt (% GDP)	12.5	14.5	11.4	..	..	..	..	..	..	..	..	..	..	..	..
Government debt (% GDP)	29.2	31.4	26.5	24.3	21.8	..	..	..	..	..	..	..	..	..	..
Foreign Trade, BOP and External Debt															
Trade balance (billions US$) 4/	9.9	21.2	21.3	21.7	19.7	5.4	6.4	6.4	6.1	..	..	..	..	..	..
Exports of goods (billions US$) 5/	139.6	119.6	158.1	..	..	39.7	45.8	45.8	51.5	..	18.3	18.4	17.4	18.6	17.8
(% change y-y)	18.3	-14.3	32.1	..	..	26.9	27.3	30.6	37.4	..	44.9	49.1	39.5	35.9	46.3
Key export (% change y-y) 6/	27.5	-35.0	39.0	..	..	22.2	16.4	32.7	32.5	..					..
Imports of goods (billions US$) 5/	116.7	88.7	127.4	..	..	32.1	36.6	37.1	41.7	..	14.8	15.1	16.2	15.1	15.1
(% change y-y)	36.9	-24.0	43.7	..	..	31.9	43.2	32.0	36.4	..	48.6	28.2	28.4	23.9	56.4
Current account balance (billions US$)	0.1	10.6	5.6	2.3	0.3	1.2	1.1	2.1	0.2	..	..	..	..	..	..
(% GDP)	0.0	2.0	0.8	0.3	0.0	0.6	0.6	1.1	0.1	..	..	..	..	..	..
Inward FDI (billions US$)	9.3	4.9	13.4	..	..	2.9	4.3	4.8	5.2	..	..	..	..	..	..
External debt (billions US$)	155.1	172.9	202.4	..	..	194.4	202.4	210.1	216.8	..	220.1	216.8	..	..	..
(% GDP)	30.4	32.1	28.6	..	..	28.8	28.6	28.3	27.8	..	..	..	..	..	..
Foreign exchange reserves, gross (billions US$) 2/	51.6	66.1	96.2	..	..	86.6	96.2	105.7	119.7	114.5	118.1	119.7	122.7	124.6	114.5
(months of imports of g&s)	4.3	7.1	7.5	..	..	7.3	7.5	7.8	8.4	..	..	..	..	..	
Financial Markets															
Domestic credit (% change y-y)	30.5	10.0	22.8	..	..	21.5	22.8	24.6	23.0	..	23.4	23.0	23.5	..	..
Short-term interest rate (% p.a.) 7/	8.7	7.1	6.5	..	..	6.5	6.5	6.7	6.8	6.8	6.8	6.8	6.8	6.8	6.8
Exchange rate (Rupiah/US$, ave)	9757	10354	9078	..	..	8,972.3	8,977.3	8,863.0	8,569.3	8,636.3	8,537.0	8,597.0	8,508.0	8,578.0	8,823.0
Real effective exchange rate (2000=100)	163.3	163.3	184.0	..	..	186.5	182.1	182.0	184.6	185.3	161.6	161.3	161.5	..	..
(% change y-y)	8.8	0.0	12.7	..	..	10.9	4.9	0.6	-1.0	-0.7	-0.3	-1.7	-0.8	..	..
Stock market index (Aug. 1982=100) 8/	1,355.4	2,534.4	3,703.5	..	..	3,501.3	3,703.5	3,678.7	3,888.6	3,549.0	3,837.0	3,888.6	4,130.8	3,841.7	3,549.0
Memo: Nominal GDP (billions US$)	510.2	539.4	706.6	..	..	185.9	186.1	196.1	211.9	222.7	..	..	..	..	..

Source: National data sources.
f = forecast
1/ Average.
2/ Data as of August. Real wage data is based on median nominal wage deflated by CPI.
3/ Central government data. World Bank forecasts for 2011 and 2012.
4/ Balance on goods and servcies.
5/ Goods trade on BOP basis from Bank Indonesia with exception of monthly figures from BPS.
6/ Crude oil and gas exports.
7/ Bank Indonesia policy rate.
8/ Jakarta Composite, end of period.

LAO PDR

Population	6.2 million
Population growth	1.8 percent
Surface area	236,800 sq. km.
Capital	Vientiane

Source: World Development Indicators.

The Lao economy continues to grow strongly at 8 percent this year despite the impact of typhoons. This growth estimate has been revised slightly downwards from an earlier estimate of 8.6 percent to account for (i) the adverse impact on agriculture by the recent typhoons Haima and Nock Ten during the second half of the year; and (ii) an upward revision of 2010 GDP due to a higher than anticipated output of electricity generation. The mining sector contribution to growth in 2011 is expected to slow this year according to company production plans. The manufacturing sector is projected to grow at 15 percent driven by garment and food and beverages production. The garment industry is shifting production towards higher value-added products and started benefiting this year from a relaxation of material sourcing regulations from the European Union. The services sector is benefitting from higher domestic demand, particularly for wholesale and retail trading and for telecommunications.

Headline inflation has decreased in the past few months due to slower growth in food prices, dropping from a peak of 9.8 percent in May to 6.4 percent (y-o-y) in September. Food inflation dropped to 6.9 percent in September (y-o-y) from the peak of 14 percent in May. The rate of increase in energy prices remained high in September reaching 30.4 percent (y-o-y), following international trends. Core inflation increased to 4.8 percent (y-o-y) driven by strong domestic demand, in particular for housing, water and electricity, and tourism. With growing uncertainty in the global market, inflationary pressure is likely to come from international energy prices and the impact of the typhoons and related flooding that affect food supply.

The government targets a budget deficit of below 3 percent and is phasing out off-budget expenditures initiated during the global crisis. Favorable external factors and tightened fiscal policy resulted in a lower fiscal deficit of 2 percent of GDP in FY10/11 compared to 4.6 percent of GDP in FY09/10. Total domestic revenue is estimated to have exceeded initial targets this fiscal year by increasing from 14.2 percent of GDP to 15.2 percent in FY10/11 partly due to higher commodity prices, as well as incremental contributions from the VAT, excise tax and dividend payments from the resource sector. Government spending is estimated to decline from 23.3 percent of GDP to 21.4 percent in FY10/11 following the phasing out of quasi-fiscal expenditures. As a result of the latter, government investment is estimated to account for 10.5 percent of GDP in this fiscal year compared to 12.3 percent in FY09/10. As a response to natural disaster (flooding and typhoons), the government has drawn down on its state accumulation fund to address immediate needs. The non-mining and non-resource deficits will decline from respectively 6.3 percent and 11.1 percent in FY09/10 to 5.6 percent to 10.4 percent in FY10/11, following the consolidation of public expenditures. The FY11/12 budget plan has recently been approved and targets a deficit below 3 percent. The stock of external public and publicly guaranteed debt declined to 51.8 percent of GDP from 82 percent in 2005 supported by strong economic growth, appreciation of the kip and favorable external conditions. The risk of debt distress remains high according to the latest June 2011 Debt Sustainability Assessment, stemming from a relatively high level of debt outstanding, against the back drop of a high level of concessionality and low debt service ratios.

Exports are estimated to have grown substantially, driven by regional demand while imports were fueled by FDI inflows in hydropower projects and dynamic internal demand. Exports are estimated to have grown by about 27 percent, driven by electricity generation and mineral exports. Non-resource exports particularly from the manufacturing sector also are projected to grow by 36 percent in 2011. Agriculture exports are likely to slow down following the flooding. Overall, imports are estimated to have grown faster than exports, driven by a strong demand for capital fueled by higher FDI in the resource sector, by a rise in fuel prices, and by faster growth in non-fuel, non-resource imports compared to last year. These developments in net trade, combined with profit and dividend repatriation from the resource sector, will lead to a deterioration of the current account deficit from 7.1 percent of GDP in 2010 to 11.1 percent of GDP in 2011. Foreign investment continued flowing into the economy: four new hydro projects made substantial contributions this year. Portfolio investment contributed US$100 million through the Lao Stock Exchange, launched in January this year. Overall, the balance of payments is expected to report a surplus with official reserves reaching US$719 million (from US$633 million at end 2010). After the impacts of expansionary macroeconomic policies on the external position during the global crisis period, net foreign assets have generally improved since September 2010. Net foreign assets have increased by 46 percent (y-o-y) in June 2011 to US$911 million.

In order to curb inflationary pressure, the Bank of the Lao PDR (BOL) increased its policy rate to commercials banks in September 2010 from 4 percent to 5 percent for less-than-one-week loans, from 5 to 6.25 percent for more-than-one-week loans, and from 10 to 12.5 percent for 14 days-to-one-year loans. Credit growth has gradually decelerated to 33.2 percent (y-o-y) in June 2011 compared to almost 63 percent in June 2010. This can be attributed to the slowing of BOL direct lending to investment projects, from 104 percent (y-o-y) in June 2010 to 33 percent (y-o-y) in June 2011, and slower credit growth to the private sector from 56 percent (y-o-y) to 35 percent (y-o-y) in the same period. The latter slowdown may be explained partly by a base effect as credit has been growing fast, and partly as a response to the BOL tightening measures described above. Reserve requirements were left unchanged while about US$340 million worth of BOL securities were sold to absorb excess liquidity. Broad money (M2) growth was 40 percent (y-o-y) in June 2011 from 27 percent in June 2010. Non-performing loans were reported about the same level of 3 percent of total loans as of June 2011 compared to end 2010.

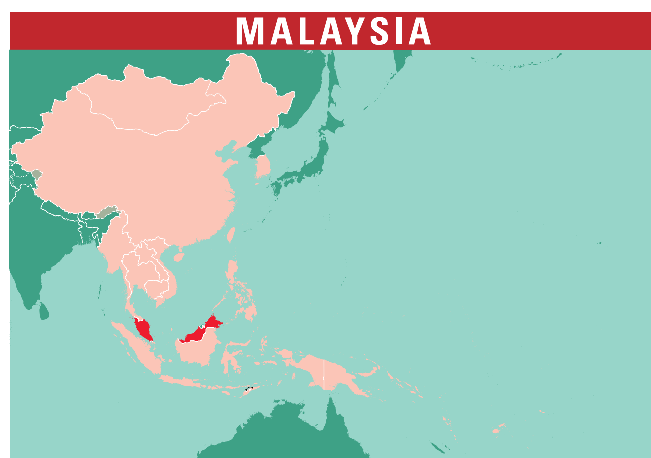
The 7th National Socio-Economic Development Plan was approved in June 2011 by the National Assembly, following the 9th Party Congress in March 2011. A new government structure was announced at the same time, including among other details, the creation of a new Ministry of Natural Resources and Environment. Structural reforms have witnessed some progress. The General Tax Law approved in June 2011 introduces a simplified presumptive tax regime, abolishes the minimum turnover tax, establishes a uniform corporate tax rate of 26 percent in line with regional practice and creates levels a playing field for foreign and domestic businesses. The continued implementation of Treasury centralization reforms and the Government Financial Information System has improved budget monitoring and controls in FY10/11. With regard to regional and global integration, the Trade Facilitation Strategy and Action Plan approved in March 2011 envisages improved coordination among concerned agencies and proposes a strengthened institutional set up for trade facilitation issues. The government has also commenced work to launch an electronic trade portal as part of efforts to improve transparency in the provision of trade related information. The Customs Law is being revised to allow for the introduction of more modern processes and procedures and revised, simplified declaration processing procedures have been put in place as part of ASYCUDA pilot. In October, the government launched one-stop service for investment registration in order to reduce time and procedures for business registration. Under this new service business licenses procedures are streamlined and simplified.

Lao PDR Key Indicators

	2007 Year	2008 Year	2009 Year	2010e Year	2011f Year	2012f Year
Output, Employment and Prices						
Real GDP (% change y-y)	7.5	7.5	7.5	8.5	8.0	7.5
Consumer price index (% change y-y)	4.5	7.6	0.1	6.0	7.5	6.0
Public Sector 1/						
Government balance (% GDP) 2/	-2.7	-2.7	-6.8	-4.8	-2.0	-2.5
Foreign Trade, BOP and External Debt						
Trade balance (millions US$)	-821	-1,039	-904	-632	-881	-1,049
Exports of goods (millions US$)	1,215	1,451	1,489	2,203	2,859	3,319
(% change y-y)	12.5	19.4	2.6	48.0	29.8	16.1
Key export (% change y-y)	2.6	12.0	8.8	58.1	26.4	20.3
Imports of goods (millions US$)	2,044	2,458	2,393	2,835	3,740	4,368
(% change y-y)	36.7	22.2	-2.6	18.4	31.9	16.8
Current account balance (millions US$)	-711	-917	-655	-520	-934	-1.323
(% GDP)	-16.7	-16.7	-11.1	-7.1	-11.1	-13.6
Foreign direct investment (millions US$)	838	933	845	793	1,136	1,656
External debt (millions US$)	4,377	5,363	6,050	6,574	7,420	8,612
(% GDP)	100	97	102	92	86	90
Debt service ratio (% exports of g&s)	6.3	11.0	11.8	13.4	12.8	10.8
Foreign exchange reserves, gross (millions US$) 3/	523	626	633	730	911	1,101
(months of imports of g&s)	2.9	2.9	3.0	2.9	2.8	2.9
Financial Markets						
Domestic credit (% change y-y) 4/	21.0	84.6	90.7	46.0	26.2	21.5
Short-term interest rate (% p.a.) 5/	13.0	10.5	7.0	7.0	7.0	
Exchange rate (Kip/US$, ave)	9,603	8,635	8,516	8,235	8,052	7,932
Real effective exchange rate (2000=100)	105.3	124.7	116.6	..	..	..
(% change y-y)	-0.8	18.4	-6.5	..	..	..
Memo: Nominal GDP (millions US$)	4,260	5,478	5,903	7,291	8,421	9,733

Source: National data sources
e = estimate
f = forecast
1/ Fiscal year basis
2/ After grants
3/ Excluding gold
4/ Excluding government lending funds
5/ Treasury bill rate

MALAYSIA



Population	27 million
Population growth	1.7 percent
Surface area	329,740 sq. km.
Capital	Kuala Lumpur

Source: World Development Indicators.

The Malaysian economy decelerated over the first half of 2011. After growing at a solid 9.2 percent in the final quarter of 2010, real GDP growth slowed to 6.0 and 2.5 percent in the first two quarters of 2011, respectively.[31] This led to a 4.4 percent year-on-year growth in the first half of the year, below the revised official 5.0–5.5 percent government growth forecast for the whole 2011.

The output expansion was generally driven by robust domestic demand, especially resilient private consumption. Favorable rubber and palm oil prices drove up incomes of smallholders while strong employment and wage growth supported incomes of urban consumers. Higher incomes and comfortable access to credit (due to banks' willingness to lend and low interest rates) boosted consumer spending. In contrast, fixed investment has been much more volatile on a sequential basis. Indicators, such as foreign direct investment (FDI), approved manufacturing projects, and federal government development expenditures, point to improving private investment and declining public investment in real terms.

31 All figures reflect changes from the previous quarter, adjusted for seasonal fluctuations, unless otherwise indicated.

After growing robustly in the first quarter, real exports of goods and services stalled in the second quarter, partly due to Japan-related supply chain disruptions but also due to the weakening global economic environment. Net exports however contributed positively to GDP growth, as imports (particularly machinery and transport equipment) contracted much more sharply than exports amid weak manufacturing activity, supply chain disruptions and sluggish new orders for durable goods. Within exports, electronics shipments remained subdued in the past several quarters, while non-electronics exports expanded steadily.

On the supply side, performance was mixed. Real agricultural output jumped in the first half of 2011 on a sequential basis mainly on higher palm oil production, while nearly all service sub-sectors grew steadily on robust consumer spending. In contrast, mining output plunged by 4.8 percent in the second quarter, the steepest quarterly decline in at least two decades due to temporary production problems and maintenances in some oil fields. Weak electronics sector and supply chain disruptions also led to a 1.5 percent decline in manufacturing output.

High-frequency indicators suggest that weakness has continued into the third quarter. The industrial production index in July 2011 dropped 3.4 percent from the June level (seasonally adjusted). As in the past months, the manufacturing and mining sub-indices mainly drove the contraction.

Fiscal policy has been a drag to growth as disbursements of public investments (which comprise half of overall gross fixed capital formation) have been slow. This is often the case during the first year of a new five-year plan, and disbursements have already started to accelerate as of July. Gasoline subsidies and electricity tariffs were adjusted earlier this year, but it is unlikely that new subsidy adjustments will be implemented before elections, which may come at any time over the next 18 months.

Inflationary pressures appear to have peaked at mid-year. Year-on-year consumer inflation reached 3.5 percent in

June 2011, the highest level since April 2009, before slowing down to 3.3–3.4 percent in July and August. On a sequential basis, the inflation rate registered flat growth in August for the first time since June 2010. Prices of food eased in recent months, while transport prices retreated. Core inflation continued to advance, however, suggesting demand-driven price increases fuelled by healthy consumer spending. The average CPI inflation in the first eight months of 2011 was 3.1 percent, which is still within the range of the 2.5–3.5 percent target.

Monetary policy normalization paused as growth prospects deteriorated and inflationary pressure gradually subsided. After a 25 basis points increase in the overnight policy rate (OPR) in May 2011 (to 3 percent relative to 3.5 percent pre-crisis), it has remained unchanged since. This is in line with the regional trend. To reduce ample liquidity in the financial markets without adjusting OPR may further attract capital inflows, the statutory reserve requirement (SRR) ratio was raised by 300 basis points between March and July 2011. The current level of 4 percent returned to the pre-crisis level.

The banking system remained healthy during the first half of 2011, despite challenging financial conditions globally. Risk-weighted and core capital ratios remained at prudent levels of 14.3 percent and 12.5 percent respectively. Ample liquidity and a robust banking system supported bank loans, which grew at an average monthly rate of over 10 percent in the first half of 2011. Net financing raised by the private sector also grew comfortably. Market interest in the debt market has appeared to increase relative to equity market, given European sovereign debt issues and US debt ceiling negotiations that added greater volatility to local equity markets.

Malaysia's overall balance of payments recorded a larger surplus of RM77.5 billion in the first half of 2011 (second half of 2010: RM18.9 billion). The improvements reflected widening current account surplus and substantial net financial inflows. The larger current account surplus benefitted from favorable commodity exports which continued to outweigh weakness in manufacturing exports. Improvements in the financial account largely reflected further increase in net inflows of portfolio funds and stronger recovery of FDI, which together more than offset the continued net outflow of direct investment abroad by Malaysian companies. Net FDI in the first six months of this year was almost double the value in the first half of 2010. Meanwhile, surging net portfolio inflows were mainly in the form of debt securities, particularly government and central bank securities. As of mid-October 2011, Malaysia's external reserves stood at $134.4 billion, or 10 months of retained imports and 4.6 times the short-external debt.

Malaysia's highly open economy is expected to slow further during the remainder of 2011 and into the first quarter of 2012 due to the deterioration in the outlook for external demand. While the dissipation of supply chain disruptions will support higher auto sales and possibly electrical and electronic exports, inventory levels have returned to pre-crisis levels, hence inventory restocking is unlikely to provide an outlet for additional growth in industrial production. Domestic demand is expected to remain resilient, but the weakening global environment is also likely to put pressure on oil and agricultural commodity prices, which would have a negative effect on consumer spending. Nevertheless, the weak global outlook prevails, and GDP is now expected to expand by 4.3 percent in 2011 and 4.9 percent in 2012. Risks are clearly to the downside, however, as the situation in Europe could lead to another significant shock to global trade.

Malaysia Key Indicators

	2008	2009	2010	2011f	2012f	2010		2011			2011				
	Year	Year	Year	Year	Year	Q3	Q4	Q1	Q2	Q3	May	Jun	Jul	Aug	Sep
Output, Employment and Prices															
Real GDP (% change y-y)	4.7	-1.7	7.2	4.3	4.9	5.3	4.8	4.9	4.0	..	..	..	..	..	..
Industrial production index (2000=100)	108.1	99.9	107.1	..	..	107.4	108.1	107.7	106.1	109.4	104.3	108.2	107.5	111.3	109.2
(% change y-y)	0.7	-7.5	7.2	..	..	4.2	3.7	2.4	-1.5	1.9	-5.6	1.3	-0.6	3.6	2.5
Unemployment (%)	3.3	3.7	3.3	..	..	3.2	3.2	3.1	3.0	..	3.0	3.2	3.0	3.1	..
Consumer price index (% change y-y)	5.4	0.6	1.7	3.2	2.7	1.9	2.0	2.8	3.3	3.4	3.3	3.5	3.4	3.3	3.4
Public Sector															
Government balance (% GDP) /1	-4.8	-7.0	-5.6	-5.5	-5.0	-4.0	-8.9	-2.6	0.4	..	..	..	..	..	..
Domestic public sector debt (% GDP) 1/	38.5	51.3	51.0	55.0	56.0	49.3	51.0	50.9	50.3	..	..	..	..	..	..
Foreign Trade, BOP and External Debt															
Trade balance (billions US$)	43.0	33.4	34.1	..	..	7.0	8.2	10.4	9.1	10.0	2.8	2.6	3.2	3.7	3.1
Exports of goods (billions US$)	198.9	156.8	198.3	..	..	50.2	52.9	54.6	56.6	58.5	18.3	19.1	19.8	19.6	19.0
(% change y-y)	13.1	-21.2	26.5	..	..	21.6	12.8	16.1	16.8	16.4	13.8	18.1	14.7	17.2	17.3
Key export (% change y-y) 2/	-3.7	-10.1	8.9	..	..	2.7	-7.8	-6.4	-4.1	..	-4.1	-5.5	-6.4	..	..
Imports of goods (billions US$)	155.9	123.3	164.2	..	..	43.2	44.7	44.2	47.5	48.5	15.5	16.5	16.6	16.0	15.9
(% change y-y)	6.8	-20.9	33.1	..	..	29.8	20.3	24.5	15.3	12.2	14.1	15.2	10.2	12.9	13.6
Current account balance (billions US$)	39.4	31.8	27.3	..	..	6.4	7.6	8.5	7.8	..	..	..	..	..	..
(% GDP)	13.8	19.3	14.6	12.1	10.0	10.5	11.7	12.7	11.2	..	..	..	..	..	..
Foreign direct investment (billions US$)	7.2	1.4	9.1	..	..	2.1	3.4	3.6	3.4	..	..	..	..	..	..
External debt (billions US$)	70.9	66.0	70.5	..	..	72.0	72.9	76.6	80.1	..	..	..	..	..	..
(% GDP)	31.8	34.2	29.6	..	..	29.4	27.9	28.7	28.9	..	..	..	..	..	..
Short-term debt (billions US$)	23.9	22.0	24.7	..	..	25.6	25.5	29.9	30.5	..	..	..	..	..	..
Debt service ratio (% exports of g&s)	2.6	6.5	7.4	..	..	7.5	6.9	10.0	8.2	..	..	..	..	..	..
Foreign exchange reserves, gross (billions US$)	92.4	94.6	84.5	..	..	100.7	84.5	115.9	137.5	..	132.9	137.5	137.4	138.3	..
(months of imports of g&s) 3/	7.1	9.2	6.2	..	..	9.3	7.6	10.5	11.6	..	8.6	8.3	8.3	..	..
Financial Markets															
Domestic credit (% change y-y)	4.1	4.8	10.0	..	..	11.8	12.7	13.2	13.5	..	13.8	13.5	12.9	13.4	..
Short-term interest rate (% p.a.) 4/	3.5	2.2	2.6	..	..	2.8	2.8	2.8	3.1	..	3.0	3.1	3.1	3.1	..
Exchange rate (Ringgit/US$, eop)	3.46	3.42	3.08	..	..	3.09	3.08	3.03	3.02	3.19	3.01	3.02	2.96	2.98	..
Real effective exchange rate (2000=100) 5/	105.6	102.8	109.3	..	..	111.1	109.3	111.2	110.4	..	110.5	110.1	111.1	..	..
(% change y-y)	-0.3	-2.0	6.6	..	..	10.4	6.6	4.4	-0.3	..	0.2	-0.3	0.6	..	..
Stock market index (Apr. 4, 1986=100) 6/	511	741	884	..	..	852	884	900	919	..	907	919	902	843	..
Memo: Nominal GDP (billions US$)	222.7	192.9	237.8	..	..	61.3	65.3	66.7	69.4	..	..	..	..	..	..

Sources: National data sources, World Bank staff estimates.

f = forecast

1/ Federal government only

2/ Electronics

3/ Excludes services imports

4/ One-month interbank rate

5/ World Bank staff estimate

6/ KLSE Composite

MONGOLIA

Population	2.6 million
Population growth	0.9 percent
Surface area	1,566,500 sq. km.
Capital	Ulaanbaatar

Source: World Development Indicators.

The economic rebound in recent quarters has been stronger than expected and the economy is showing signs of overheating. GDP growth reached 20.8 percent year-on-year (y-o-y) in the third quarter, following an outturn of 17.3 percent in the second quarter. Growth for the year as a whole will likely increase to 15 percent, up from 6.4 percent in 2010, as it is being pushed by infrastructure spending as Mongolia develops its vast mineral wealth. Expansionary fiscal policies are also contributing to overheating pressures.

Mining and manufacturing output are both rising at a healthy rate but there are growing fears of another construction bubble similar to the previous boom in 2004-08. Unemployment is trending down, but overall levels remain high at around 9 percent and October survey results from selected informal labor markets indicate that, on average, real wages have fallen (due to inflation) since the July survey.

Inflation continues its upward trend. Headline inflation in Ulaanbaatar accelerated to 11.9 percent y-o-y in September from 9.9 percent in August. Core inflation, which excludes all food and energy, has now continuously kept rising throughout the year, reflecting generalized wage and price pressures from a booming economy and large government cash handouts. With food prices rising and the government expected to ramp up spending sharply, inflation will likely rise further.

The trade deficit is close to record levels (US$1.4 billion in September) driven by a huge surge in mining-related equipment and fuel imports. Exports are growing strongly too, driven by large coal shipments to China. Nevertheless, copper exports are barely growing in volume terms, and cashmere exports are doing even worse. The togrog has depreciated against the US dollar since August in line with other currencies in the region due to rising global risk aversion, but this has been relatively small (about 4.8 percent) as FDI inflows have remained strong.

In the meantime, high lending growth is fuelling concerns about asset quality in the banking system. Credit growth of 52 percent y-o-y in real terms in September is much higher than warranted by underlying real growth in the economy and is also highly concentrated, while the volume of non-performing loans remains high. Although deposits in the banking system are hitting new peaks, the loan to deposit ratio (excluding government deposits) has risen to about a 100 percent implying growing liquidity risks.

The Bank of Mongolia raised its interest rate by 50 basis points to 12.25 percent in October. This is the third rate increase this year, complemented by two increases in the reserve requirement ratio, in response to the rising trend in core inflation. But given long policy lags, and with inflation continuing to rise, more action will be needed. The effectiveness of monetary policy in fighting inflation has been undermined, however, by the expansionary fiscal policy. Ensuring financial stability will require close monitoring and pro-active implementation of macro-prudential norms and regulations.

With government revenues boosted by mining sector receipts and a booming economy, public sector finances are in relatively good shape and the government has been running a small surplus since October of last year. But spending is also at its highest level (35.6 percent of GDP on a 12-months rolling basis) in almost two years spurred by rising expenditures on cash handouts.

In September, the government submitted to Parliament an amended 2011 Budget Law for consideration alongside the 2012 budget. The original 2011 budget planned to raise expenditures by 32 percent of 2010 outturns, and the amendments seek to raise spending by another 20 percent on top of original 2011 plans, with an unchanged deficit target of 9.8 percent of GDP. The higher spending would be funded from above-trend non-mineral revenues: while excess mineral revenues are saved in a stabilization fund as required by the Fiscal Stability Law (FSL), this is not required for windfall non-mineral revenues and it is these that the government is proposing to spend.

The 2012 Budget continues this fiscal expansion further and targets a 74 percent increase in expenditures (mostly on wages and social transfers) on top of the original 2011 budget. In absolute terms, the proposed fiscal expenditure in the 2012 budget is double of total expenditures in 2010 and is only slightly lower than total GDP in 2010. At the same time, based on optimistic revenue and GDP projections, the 2012 budget deficit is estimated at 4.1 percent of GDP.

Increased spending on wages and transfers creates the risk of setting in motion a wage price spiral, if higher inflation expectations become entrenched. Aside from the negative impact on the poor, this will undermine the competitiveness of exporting (agriculture) and the import-competing businesses (mostly small and medium size enterprises). The draft 2012 budget plans for the introduction of proxy means tested benefits targeted to the poorest in the second half of next year, replacing the current universal cash transfers.

Revenue, expenditure and GDP forecasts underlying the 2012 budget proposal are optimistic. They are based on i) a continuation of the strong growth in revenues seen in 2011, coupled with additional taxes on coal exports; ii) large investments in housing construction and roads, mainly by disbursements by the Development Bank of Mongolia; and iii) bringing forward the production schedule of a large project in the mining sector. There are risks that these optimistic forecasts would not materialize. For instance, revenues could discontinue or reverse their current trends if the global economy deteriorates or coal exports run into transport capacity constraints. Mining production could be affected by delays in obtaining power.

If there is another global recession, Mongolia's small, open economy will be affected. With the government intending to spend any budgetary windfalls before the Fiscal Stability Law comes into effect, and there would be little room for a fiscal stimulus in case of a downturn. Much will depend on the growth in China and its continuing demand for coal and copper. A pro-active, prudent and risk-averse economic management is now needed, as the economy shows signs of overheating against a backdrop of rising global risks.

Mongolia Key Indicators

	2007 Year	2008 Year	2009 Year	2010e Year	2011f Year	2012f Year
Output, Employment and Prices						
Real GDP (% change y-y)	10.2	8.9	-1.3	6.4	14.9	15.1
Industrial production index	110.4	113.0	109.6	120.5	130.1	140.6
(% change y-y)	10.4	2.7	-3.3	10.0	8.0	8.0
Consumer price index (% change y-y)	14.1	23.2	1.9	14.3	17.0	17.0
Public Sector						
Government expenditures (% GDP) 1/	35.3	37.6	35.2	36.6	52.1	39.4
Government revenues (% GDP) 1/	37.9	33.1	30.2	36.6	42.2	35.3
Government balance (% GDP) 1/	2.7	-4.5	-5.0	0.0	-9.9	-4.1
Non-mineral government balance (% GDP)	-13.4	-14.1	-12.2	-9.9	-13.3	-28.7
Total public sector debt (% GDP) 2/	36.5	31.0	49.4	42.2	38.6	37.1
Foreign Trade, BOP and External Debt						
Trade balance (millions US$)	-52	-613	-195	-278	-1,049	-1,107
Exports of goods (millions US$)	1,949	2,535	1,876	2,899	3,825	4,083,0
(% change y-y)	26.1	30.0	-26.0	54.5	31.9	6.7
Imports of goods (millions US$)	2,003	3,147	2,070	3,177	4,874	5,190
(% change y-y)	32.2	57.1	-34.2	53.5	53.4	6.5
Current account balance (millions US$)	265	-722	-410	-931	-1,301	-1,438
(% GDP)	6.3	-12.9	-9.0	-5.8	-15.1	-13.6
Foreign direct investment (millions US$)	360	836	496	1,574	3,400	1,000
External debt (% GDP) 3/	36.1	31.0	43.3	30.3	22.8	19.8
Foreign exchange reserves, gross (millions US$) 4/	1,001	637	1,145	2,091	2,407	..
(month of imports of g&s)	3.8	3.7	4.3	5.1	5.6	..
Financial Markets						
Domestic credit (% change y-y)	78.4	52.5	-7.6	42.2	42.9	33.9
Short-term interest rate (% p.a.) 5/	8.4	9.8	10.0	11.0	12.3	..
Exchange rate (Tugrik/US$, eop)	1,170	1,169	1,441	1,348	1,294	..
Real effective exchange rate (% change y-y) 6/	-5.5	13.7	-15.5	26.9	-0.4	..
Stock market index (Dec. 2000=100) 7/	2,048	1,182	1,229	2,931	3,984	..
Memo: Nominal GDP (millions US$)	4,235	5,607	4,574	6,243	8,575	..

Sources: Bank of Mongolia, National Statistical Office, Ministry of Finance, IMF and World Bank staff estimates
e = estimate
f = forecast
1/ Estimates for 2011 are from the approved budget and estimate for 2012 is from the 2012 budget proposal.
2/ Total public sector debt.
3/ On public and publicly guaranteed debt.
4/ Figure for 2011 are for end-September.
5/ Base policy rate, end-of-period. Figure for 2011 is the policy rate since October.
6/ Figure for 2011 is the year-to-date change for June.
7/ Figure for 2011 is the index value for end-June.

PAPUA NEW GUINEA

Population	6.4 million
Population growth	2.0 percent
Surface area	462,840 sq. km.
Capital	Port Moresby

Source: World Development Indicators.

Papua New Guinea's economy strengthened further over the first half of 2011, buoyed by a sequence of positive external developments adding to the momentum in the domestic economy. Expectations for GDP growth in 2011 have been raised to near 10 percent. This will be the eighth consecutive year of expansion, the longest period of economic growth in PNG's history as an independent nation.

Papua New Guinea's government changed in August 2011. The new government's public presentation has focused on improving the quality of governance and use of public resources, raising the government's effectiveness at providing public services and ensuring all Papua New Guineans benefit from the country's current resources boom. The new government's headline policy announcement was tuition-fee free education through to year 10, starting in 2012. The government has also affirmed its commitment to maintaining macro-fiscal stability, including through the introduction of an Organic Law (constitutional amendment) establishing a sovereign wealth fund to manage the government's growing natural resource revenues.

Three factors underlie the strength of PNG's economy: foreign-investment funded construction projects; record prices for PNG's exports, and strong government spending financed by higher-than-expected revenues. The current FDI-funded construction projects are approaching their peak of activity, although others are in the pipeline. These investment projects are adding to the country's supply capacity, in sectors ranging from accommodation, through IT and transport and telecommunications to catering. Meanwhile, up to Q3 2011, prices of PNG's cash crop exports (particularly coffee, copra and palm oil) returned to or exceeded the highs of mid-2008. Exceptional global gold and copper prices lifted the value of PNG's minerals exports, with the strength in prices enough to make up for ongoing delays or production problems at various mines.

The sectors of the economy most directly impacted by these factors—particularly construction, road, air and sea transport, storage and communications—are expected to expand by as much as 20 percent in 2011. This strength is spilling into other sectors in the economy (e.g., retail trade), thus creating a broader dynamic. Even agriculture and fishery production are expected to grow by over 4 percent in 2011 as producers respond to higher cash crop prices. It is also raising demand for workers, with growth in employment in the formal sector accelerating to over 7 in the year to Q2 2011 according to the Bank of PNG's (BPNG) Business Liaison Survey.

The strength in export values and turnover in the economy has raised government revenues. Government revenues are anticipated to exceed the budgeted amount by around 6.5 percent, which would imply an increase of about 20 percent over the estimated actuals for 2010. Most of the unexpected strength, in fact, reflects the conservative assumptions for minerals prices in the 2011 budget, which have been exceeded.

The new government has used its additional revenues to fund the Papua New Guinea kina (PGK) Supplementary Budget for 2011. The largest new spending item was funding for the tuition-fee free education commitment. More resources were also allocated to road reconstruction and health.

As the expansion in PNG's economy outpaces growth in supply, inflation has risen to concerning levels, although the rate stabilized between the second and the third quarter. PNG's urban consumer price inflation rate approached 10 percent in the year to Q2 (after adjusting for some measurement issues) before slowing slightly to 8.3 percent in the year to the third quarter (largely due to base effects). Core inflation measures have also continued to rise, reaching between 7 and 8 percent for the year to the second quarter and remained near that level through the third quarter, BPNG's surveys are finding that the length of PNG's current boom is raising inflation expectations, which are increasingly a factor in price-setting and wage negotiations. The resurgence in global food prices early in the year directly explains about one-third of this acceleration in prices. In contrast, food prices contributed to 60 percent of PNG's overall inflation between March 2008 and June 2009.

Policymakers responded to the economy's strength and the building inflation by tightening monetary conditions. Over three moves, BPNG raised the policy rate from 7.0 percent to 7.75 percent by September 2011, and tightened banks' reserve requirements. It also increased its issuance of Central Bank Bills, to PGK 157.2 million in Q1, towards absorbing excess liquidity in the banking system. Money growth remained modest and banking lending continued to slow in Q1 2011. BPNG's most direct means of reducing inflationary pressures and tightening monetary conditions has been by allowing a 15 percent appreciation of the kina against the US dollar between March and September, to 2.6 to 2.2 PGK per US dollar, although the appreciation has been smaller against the Australian dollar. At the same time as the PGK has been appreciating, earnings from natural resource exports lifted foreign exchange reserves to above $3.6 billion in June 2011, according to unpublished data.

PNG's economic outlook remains strong, though not without risks. The central driver is the stream of new investments in the country's productive capacity. Residential property constraints in the main urban areas, and the associated very high rental rates, are also being addressed with a large increase in the supply of new housing units and hotel rooms expected to enter the market from Q4 2011 and through 2012. Efforts are also being made to improve the efficiency with which business and government operate, although PNG's ranking in the 2012 Doing Business survey declined by four positions to 101 out of 183 economies as other countries reform efforts moved ahead of PNG's. The government is also investing in measures to strength its public financial management systems, but the current management of the various financial accounts has not helped remove excess liquidity from the financial system.

Concerns are growing around both external and domestic developments. The deteriorating and more uncertain global outlook creates risks that the prices of PNG's exports may retreat significantly from recent levels. A reversal in commodity prices may reduce the likelihood of potential future resource projects reaching final approval. Supply constraints, particularly for skilled labor and where land is an important input, are likely to keep inflationary pressures high. Demands for the new government to distribute the benefits of PNG's current prosperity creates spending pressures and risks adding to these inflationary trends. The quality and effectiveness of government spending will also be at risk if expenditures are scaled-up too rapidly.

The deepest challenge to Papua New Guinea's policy makers is to translate the economy's substantial growth into sustainable and broad-based improvements in living standards. Progress against the modified Millennium Development Goals adopted by the PNG government is generally off track. Crime rates may well rise further, exacerbating a major operational cost for businesses, if there is continued failure to address mounting inequality, limited opportunities for low-skilled workers, and poor provision of security and other public services. The government has formulated ambitious plans to tackle these issues. Now, before revenues from new natural resource projects start to flow, is the time to develop the systems and lay the groundwork for the improvements in governance needed to achieve those goals.

Papua New Guinea Key Indicators

	2007 Year	2008 Year	2009 Year	2010e Year	2011f Year	2012f Year
Output, Employment and Prices						
Real GDP (% change y-y)	7.2	6.7	5.5	7.5	10.0	6.0
Tourist arrivals (thousands)	104.1	115.0	123.0	..	..	..
(% change y-y)	34.0	10.4	7.0	..	..	..
Consumer price index (% change y-y)	0.9	10.7	6.9	6.0	8.5	9.0
Public Sector						
Government revenues (% GDP)	36.9	32.6	27.5	32.5	33.8	34.0
Government expenditures (% GDP)	28.4	30.1	37.1	32.8	33.5	34.0
Government balance (% GDP)	8.8	3.8	-5.6	0.6	0.3	0.0
Domestic public sector debt (% GDP)	33.6	31.7	32.1	26.5	21.9	18.3
Foreign Trade, BOP and External Debt						
Trade balance (millions US$)	2,193	2,675	1,187	83	-2,098	-1,441
Exports of goods (millions US$)	4,822	5,823	4,617	5,742	6,391	6,199
(% change y-y)	11.5	20.8	-20.7	24.4	11.0	-3.0
Key export (% change y-y) 1/	4.8	16.0	-17.5	30.4	13.5	0.0
Imports of goods (millions US$)	2,629	3,148	3,430	5,660	8,489	7,640
(% change y-y)	32.0	19.7	9.0	65.0	50.0	-10.0
Current account balance (millions US$)	208	805	-649	-2,255	-2,420	-1,868
(% GDP)	3.3	10.0	-8.1	-23.7	-21.2	-14.9
Foreign direct investment (millions US$)	462.7	-31.0	764.0	1,803.0	1,935.0	1,800.0
External debt (millions US$)	1,978	2,047	2,144	2,275	2,605	2,991
(% GDP)	31.2	25.6	26.6	23.9	22.8	23.8
Short-term debt (millions of US$) 2/	48	44	72	93	..	
Debt service ratio (% exports of g&s)	8.3	5.1	7.0	5.7	5.2	5.0
Foreign exchange reserves, gross (millions US$)	2,087	1,988	2,571	3,092	3,450	3,500
(months of imports of g&s)	4.2	4.4	5.6	3.8	4.5	5.1
Financial Markets						
Domestic credit (% change y-y)	5.5	31.3	30.2	25.2	15.0	15.0
Short-term interest rate (% p.a.)	4.36	5.91	7.18	7.00	7.75	7.75
Exchange rate (Kina/US$, eop)	2.84	2.68	2.70	2.60	2.20	2.30
Real effective exchange rate (2000=100)	96.5	109.4	118.0	111.7	125.0	122.0
(% change y-y)	-4.4	13.4	7.8	-5.3	11.9	-2.4
Memo: Nominal GDP (millions US$)	6,339	7,997	8,060	9,520	11,424	12,566

Sources: National data sources, IMF, and World Bank staff estimates.
e = estimate
f = forecast
1/ Gold
2/ Banking system short-term external debt only

PHILIPPINES

Population	90.3 million
Population growth	1.8 percent
Surface area	300,000 sq. km.
Capital	Manila

Source: World Development Indicators.

The Philippine economy grew by 4 percent in the first half of 2011—a respectable rate given the high base effect in 2010. The slowdown in the second quarter to 3.4 percent (from the revised first quarter growth of 4.6 percent)[32] was largely on account of a significant contraction in net exports and investment. In the second quarter, growth was led by robust private consumption, registering a 5.4 percent increase during the first half. Public construction continued to contract for the four consecutive quarters, by 51.2 percent in the second quarter, from last year, as the implementation of government projects stalled. On the supply side, the services sector posted 5 percent growth, outpacing industry. Agricultural activity expanded for the third consecutive quarter, owing to good weather conditions. Growth for the remainder of 2011 is expected to be domestically driven—through sustained private consumption for the rest of the year.

The self-rated poverty and hunger incidences improved in June even though the labor market remains structurally weak. The expansion of the conditional cash transfer program has translated into a large drop in overall hunger incidence. In Metro Manila and Luzon, hunger incidence registered a decline of 7-15 percentage points, equivalent to a combined 1.6 million households. In all areas except Mindanao, severe hunger rates fell by 2-4 percentage points. Meanwhile, Luzon (net of Metro Manila) witnessed the largest improvement in self-rated poverty incidence, which dropped by 16 percentage points to 38 percent, the lowest since 1987. Job creation improved this year: 20 percent more jobs (year-on-year) were added, providing employment to 90 percent of the 968,000 new entrants to the labor force. Unemployment and underemployment rates, however, remained structurally high at 7.1 and 19.1 percent, respectively.

The external position and macro-fundamentals remain strong, with the capital and financial account surplus expanding, which was recognized in recent credit rating upgrades. Amid greater volatility in the advanced economies, capital and financial inflows to the Philippines remained robust. Net foreign portfolio investments through August registered $3.1 billion, more than triple the amount of last year. On the other hand, net foreign direct investments (FDI) in the first half reached $838 million (just about 1 percent of GDP), lagging behind its neighbors. Foreign reserves have been rising rapidly thanks to sustained inflow of remittances, foreign portfolio investments, income from investments abroad, and the revaluation of the the Bangko Sentral ng Pilipinas (BSP)'s gold holdings. In contrast, the trade balance deteriorated sharply in the first half with electronics exports contracting by more than 20 percent since May due to the compounded effects of supply chain disruptions in Japan and weaker export demand from key international markets. The peso had appreciated modestly against the US dollar during the first half of the year.

The Philippines is well-positioned to absorb any new financial shock that might evolve from the current turmoil. The country is well insulated from the global financial crisis owing to a significant improvement of macroeconomic fundamentals and to some extent regulatory reforms already in place following the Asian Financial Crisis of 1997-98. Overseas Filipino workers' large remittance inflows show a counter-cyclical

32 First quarter GDP growth was revised downward from 4.9 to 4.6 percent.

pattern. The financial sector's conservative stance throughout the preceding decade helped to ensure a healthy balance sheet. The corporate sector, for the same reason, also exhibited no systemic vulnerabilities. Official reserves were the equivalent of 10 months of imports at the end of the second quarter of 2011.

Monetary policy remains accommodative, while the fiscal deficit is likely to be lower than expectations. Following two consecutive hikes earlier in the year, the BSP left policy rates unchanged between June and October. Instead, the BSP's Monetary Board raised the regular reserve requirement twice by 1 percentage point each, to bring the requirement back to the pre-crisis level of 21 percent. Inflation reached a four-month high in October, bringing year-to-date inflation to 4.8 percent, on the high end of the BSP target range.

The fiscal deficit improved sharply to 0.6 percent of GDP through September. This is largely the result of under-spending, with expenditures declining by 11.4 percent (year-on-year). Although under-spending had improved the fiscal balance and may lead to higher quality public spending in the future, large deficiencies in infrastructure are yet to be addressed. Meanwhile, revenue mobilization has recorded promising signs of growth, rising by 13.7 percent through September (15.1 percent growth during the first half of the year – ahead of nominal GDP growth), indicating that the thrust to improve tax compliance is starting to bear fruits.

Prospects are weaker for Philippine growth: we have revised our growth forecast downward from 5.0 to 4.2 percent for 2011 and from 5.4 to 4.8 percent for 2012. The Philippines is benefitting from relative political stability and an improved fiscal position, but key downside risks to growth remain - increased global uncertainties and a slowdown in investments. Portfolio investment inflows are expected to remain strong, but FDI is projected to moderate as foreign investors have become more cautious. As before, private consumption is expected to be buoyed by remittances. The current account surplus is projected to remain in healthy surplus, driven by sustained remittance inflows amid a larger trade deficit as imports pick up.

Over the medium-term, the challenge for policymakers is to ensure that the Philippines continue to improve competitiveness, while cushioning the economy from adverse external shocks. To strengthen the country's resiliency to external shocks, the government needs to accelerate public spending. Raising more revenues through improved tax administration and policy reforms will enable the government to meet its priority spending targets, especially in infrastructure and human capital investment.

Philippines Key Indicators

	2008	2009	2010	2011f	2012f	2010		2011			2011				
	Year	Year	Year	Year	Year	Q3	Q4	Q1	Q2	Q3	May	Jun	Jul	Aug	Sep
Output, Employment and Prices															
Real GDP (% change y-y) 1/	4.2	1.1	7.6	4.2	4.8	7.3	6.1	4.6	3.4	..	..	..	..	..	..
Industrial production index (1994 = 100)	84.8	74.7	92.1	..	..	94.2	102.2	90.6	92.8	..	95.2	93.7	99.2	..	..
(% change y-y)	0.3	-11.9	23.2	..	..	21.0	16.5	10.7	1.3	..	2.3	0.1	..	..	..
Unemployment (%) 2/	7.4	7.5	7.4	..	..	6.9	7.1	7.2	7.1	..	..	..	..	..	..
Nominal wages (% change y-y) 3/	5.3	2.2	3.8	..	..	5.8	5.8	5.8	1.8	5.4	0.0	0.0	5.4	5.4	5.4
Real wages (% change y-y) 3/	-1.6	0.7	-0.1	..	..	1.6	2.6	1.5	-2.2	1.1	-4.0	-4.4	1.1	1.6	0.7
Consumer price index (% change y-y)	8.3	4.1	3.8	4.8	4.0	3.9	3.5	4.5	5.0	4.8	5.1	5.2	5.1	4.7	4.8
Public Sector															
Government balance (% GDP) 4/	-1.5	-3.9	-3.6	-2.7	-3.0	-0.7	-0.6	-0.3	0.1	-0.4	..	..	..	..	..
Domestic public sector debt (% GDP) 5/	30.2	33.5	41.4	..	..	35.2	41.4	..	..	..	..	..	..	..	..
Foreign Trade, BOP and External Debt															
Trade balance (billions US$) 6/	-12.9	-8.8	-10.4	..	..	-1.5	-3.2	-3.9	-3.3	..	-1.0	-0.9	..	..	..
Exports of goods (billions US$) 6/	48.3	37.6	50.7	..	..	14.4	12.9	12.0	12.3	..	4.0	4.1	..	..	..
(% change y-y)	-2.5	-22.1	34.8	..	..	41.4	22.4	8.1	1.0	..	-3.2	-9.5	..	..	..
Key export (% change y-y) 7/	-7.2	-21.2	38.9	..	..	46.7	20.0	-1.6	-20.1	..	-25.9	-23.9	-20.1	-29.4	..
Imports of goods (billions US$) 6/	61.1	46.5	61.1	..	..	15.9	16.1	15.9	15.6	..	5.0	5.0	..	..	..
(% change y-y)	5.6	-24.0	31.5	..	..	30.1	28.2	13.6	2.4	..	-6.0	3.4	..	..	..
Current account balance (billions US$) 8/	3.6	9.4	8.5	7.2	6.1	3.3	2.2	1.0	2.1	..	0.9	0.9	..	..	..
(% GDP)	2.1	5.6	4.2	3.1	2.3	6.9	3.7	1.9	3.7	..	..	..	..	..	..
Foreign direct investment (billions US$)	1.3	1.6	1.2	1.2	1.5	0.3	0.6	0.4	0.4	..	0.3	0.1	0.0	..	..
External debt (billions US$) 9/	54.3	54.9	60.0	..	..	59.8	60.0	60.9	61.4	..	..	..	..	..	..
(% GDP)	31.3	32.6	30.1	..	..	30.1	29.1	27.1	27.0	..	..	..	..	..	..
Short-term debt (billions US$) 9/	7.0	4.0	6.3	..	..	5.7	6.3	6.8	7.2	..	..	..	..	..	..
Debt service ratio (% exports of g&s)	9.7	10.4	8.6	..	..	9.6	8.8	8.3	7.9	..	..	..	..	..	..
Foreign exchange reserves, gross (billions US$) 9/	37.6	44.2	62.4	76.6	78.8	53.8	62.4	66.0	69.0	75.2	68.9	69.0	71.9	75.9	75.2
(months of imports of g&s) 10/	6.0	8.7	9.6	11.1	10.6	8.7	9.6	9.9	10.3	11.16	10.3	10.3	10.8	11.1	11.16
Financial Markets															
Domestic credit (% change y-y) 11/	16.8	7.4	8.7	..	..	9.4	8.7	7.2	8.1	..	7.7	8.1	7.2	8.9	..
Short-term interest rate (% p.a.) 12/	5.5	4.5	4.2	..	..	4.2	4.2	4.2	4.6	4.7	4.7	4.7	4.7	4.7	4.7
Exchange rate (Peso/US$, ave)	44.5	47.7	45.1	..	..	45.3	43.6	43.8	43.2	42.8	43.1	43.1	43.2	42.4	43
Real effective exchange rate (2000=100)	124.5	121.2	126.8	..	..	..	127.4	127.3	126.7	..	..	125.8	126.4	126.5	..
(% change y-y) 13/	4.1	-2.6	4.6	..	..	..	..	..	..	..	..	..	..	..	..
Stock market index (Jan. 2, 1985=100) 14/	2,631	2,468	3,524	,,	,,	3,627	4,180	3,921	4,255	4,334	4,277	4,241	4,440	4,369	4,194.4
Memo: Nominal GDP (billions US$)	173.6	168.5	199.6	234.1	261.4	48.1	58.0	51.2	56.2	..	..	..	..	..	..

Source: National data sources
f = forecast
1/ The GDP series has a break in 2000.
2/ New methodology. Figures are based on the 2000 census.
3/ Non-agriculture minimum wage, National Capital Region
4/ IMF Government Financial Statistics (GFS) basis
5/ Total public sector domestic debt
6/ Central bank data, Balance-of-payments basis
7/ Electronics and other electronics
8/ Estimates
9/ Central bank data, % of annual GDP for quarterly figures
10/ Based on end-of-period gross international reserves
11/ Based on Depository Corporations Survey
12/ Interbank call rate
13/ World Bank staff estimates
14/ PSEi Composite, period average for annual figures

SMALL PACIFIC ISLANDS

Most of the small Pacific islands (Vanuatu, Samoa, Tonga, Kiribati, and Tuvalu) are now recovering and experiencing positive growth after being impacted in different ways by the global economic crisis. The islands face unique challenges of small size, remoteness, and vulnerability to external shocks. Recent gains remain precarious and vulnerable to further shocks. In the event of any substantial deterioration in economic conditions in key partner countries, donors will need to play a vital role in providing financing in the Small Pacific Islands to maintain public spending, which remains a critical source of employment, demand, and growth.

The economy of **Vanuatu** is expected to grow by 3.8 percent in 2011, but faces significant downside risks. Vanuatu performed strongly among the Small Pacific Islands in weathering the global economic crisis. The economy grew by 3.5 percent in 2009 and by 2.2 percent in 2010, benefiting from large donor-financed infrastructure investments and a short-term peak in tourism arrivals during the onset of the crisis driven by Australian holiday-makers choosing nearby Vanuatu over more expensive long-haul destinations. Growth moderated towards the end of 2010, as visitor arrivals and infrastructure spending declined, and copra prices fell. Throughout 2011, Vanuatu has benefited from resurgent copra prices, but continues to face risks from a slower-than-expected recovery in tourism arrivals, reductions in government recurrent expenditure, lower donor-financed infrastructure spending. Tourism arrivals declined by 5 percent during the first five months of the year, while low bookings and the cancellation of a key tourist air service from Sydney suggest continued weak performance. Government efforts to improve the fiscal position by curbing the wage bill have curtailed domestic demand in a context where Government remains a key source of formal sector employment. Donor capital investment remains below previous year highs following the completion of a major Millennium Challenge Account-financed road project, and it remains unclear whether other donor projects scheduled for 2011 will proceed as planned.

With sound macroeconomic fundamentals, Vanuatu remains relatively well-placed to deal with future shocks. Inflation is expected to remain moderate, reaching 4 percent in 2011, driven by increased food prices, and expansions of private sector credit to both businesses and households in the context of accommodative monetary conditions. The government ran a deficit of 3.9 percent of GDP in 2010, and was projecting a small deficit of around 1 percent of GDP in 2011, although recent political instability has put pressure on expenditure with a substantial supplementary budget tabled in parliament in September 2011. External debt is expected to remain steady at around 20 percent of GDP. Foreign exchange reserves remain at comfortable levels, equal to around 6 months of import cover.

Samoa was hit hard by the combined impacts of a food and fuel crisis, the global economic crisis and a major tsunami in 2009. Recovery is now underway, with the economy estimated to have grown by 2.8 percent in FY2011 (ended June 2011), with growth of 2.5 percent projected for FY2012. Resurgent growth has been highly reliant on government and donor-financed fiscal-stimulus, in the form of a major tsunami reconstruction project targeted towards rehabilitation of the damaged housing and tourism infrastructure. Production from the Yazaki automotive plant, the largest private-sector employer, which closed down during the global economic crisis, recently resumed and is expected to further increase. The economy has also benefited from moderate growth in international remittances—which rebounded in 2010 in response to the tsunami—and a recovery in tourism arrivals. However, recovery has been uneven and remittance and tourism growth have recently lost momentum. Merchandise exports remain sluggish, reflecting weak demand in key markets such as Japan and New Zealand. As of the third quarter of FY2011, tourism arrivals and earnings remained at similar levels to the previous year, while remittances had increased by around 2 percent. Both remained well below 2008 levels, reflecting slow growth in the economies of major remittance-sending countries and tourism markets (including New Zealand and the United States).

Recent challenges have curtailed Samoa's capacity to respond to future shocks. Reductions in remittances or tourism arrivals following a worsening of global economic conditions would have an immediate and potentially severe impact on incomes and government revenues. Inflationary pressures are projected to decline, given an expected easing of oil prices and expansion in agricultural production for domestic consumption. Foreign exchange reserves—at 6.7 months of imports—are at comfortable levels. But Samoa financed its much-needed stimulus program by running substantial fiscal deficits (11.1 percent of GDP in FY2010 and 8.1 percent of GDP in FY2011). The deficit is expected to be close to 6.5 percent of GDP in FY2012 and remain above 6 percent of GDP to at least FY2014. External debt is expected to increase gradually over this period, reaching 55 percent of GDP by FY2014. Future fiscal stimulus would be difficult without endangering debt sustainability unless substantially financed by donors on grant terms.

Tonga is now also showing signs of recovery from the combined impacts of the global economic crisis, the global food and fuel crisis, and several natural disasters, but the outlook for modest growth is subject to substantial downside risks. The economy contracted by 0.5 percent in FY2010 (ended June 2010) and is estimated to have achieved only modest growth of 1.3 percent in FY2011 as remittances and tourism earnings fell, weather events disrupted already-declining agricultural exports, and private sector credit contracted as banks tightened lending conditions in response to a sharp increase in non-performing loans. Fiscal expansion played a vital role in preventing a deeper contraction with government expenditure growing by 18 percent in FY2011 over FY2010 levels. This expansion reflected concessional loan-financed capital projects and increased budget support grants in the face of declining tax revenues. Growth for FY2012 is projected to reach 1.8 percent with concessional loan-financed capital projects being implemented and a modest projected recovery in tourism arrivals. The domestic impact of some donor capital expenditure will continue to be minimal, relying largely on imported labor and materials and having limited effect on employment or incomes. Private sector credit continues to decline, 9.4 percent lower in the third quarter of 2011 than during the same period in 2010. Donor inflows have seen foreign exchange reserves remain at comfortable levels, despite a decline in exports of 19 percent in the third quarter of 2011, and a 13 percent increase in imports.

Tonga remains poorly placed to deal with future shocks, including further declines in remittances or increases in food and fuel prices. Revenue declines forced a fiscal deficit of 5.7 percent of GDP in FY2010, and 7.5 percent in FY2011 despite significant reductions in recurrent spending. The deficit for FY2012 is projected at 3.1 percent of GDP. Tonga is considered at high risk of debt distress under the joint IMF-World Bank debt sustainability framework. With debt repayments scheduled to increase sharply over coming years, there is no fiscal space for further stimulus. While the Ministry of Finance and National Planning is working with the World Bank to improve the quality of government spending, options for reducing recurrent expenditure are limited with wage payment comprising a large proportion of the budget and providing a vital source of employment and incomes and government procurement providing an important source of demand to the local private sector. In the event of future shocks, donor financing on grant terms will be relied upon to avert serious challenges to macroeconomic stability.

The economy of **Kiribati** is dominated by the public sector. Key sources of income are fishing license fees, remittances, and the Revenue Equalization Reserve Fund (RERF) established with proceeds from extraction of now-exhausted phosphate deposits. Following a slight contraction in 2009, the economy grew by 0.5 percent in 2010. Adverse impacts of the global food and fuel crisis and the global economic crisis, including an increased import bill and reduced remittance income, were partly counteracted by increases in donor expenditure. The economy is expected to grow by 3 percent in 2011 with growth over the medium-term heavily reliant on major donor-financed infrastructure projects. Kiribati experienced deflation in 2010 primarily due to the appreciation of

the Australian currency against import currencies, but inflation is expected to reach 6.7 percent in 2011, driven by increasing food prices.

Kiribati has been running consecutive budget deficits, averaging 12 percent of GDP for the past decade. These deficits have been financed through RERF draw-downs and concessional loans. The 2011 budget projected a deficit of 14 percent of GDP, up from 12.5 percent in 2010. Emerging revenue shortfalls, arising from lower-than-expected income from fishing license fees, and additional expenditure on pensions and copra subsidies in the context of upcoming elections may see the deficit further increase. Over the medium-term, the RERF provides a buffer against external shocks with the government able to provide fiscal stimulus and shield its population against some of the impacts of global commodity price movements through accelerated draw-downs. In the long-run, Kiribati's current reliance on draw-downs from the RERF is unsustainable. On current trends the RERF will be drawn down to a third of its current value by 2030.

Tuvalu, like Kiribati, relies heavily on remittance and trust fund income, and is yet to recover from the impacts of the global economic crisis. Reduced seafarer remittances and higher food and fuel prices drove the economy to contract during 2009 and 2010, with the impact moderated by increases in donor expenditure. Improved remittance income is likely to spur growth of around 1 percent in 2011. Tuvalu experienced deflation for the year up to the second quarter of 2011 due the appreciation of the Australian dollar against trading currencies. Tuvalu already faces very substantial fiscal challenges and has very limited capacity to respond to any future shocks. While the Tuvalu Trust Fund remains relatively well-capitalized, revenues accessible to government from this source are expected to be completely exhausted this year and the cash position is precarious. Options exist to consolidate expenditure and strengthen revenue collection over the short- to medium-term, but donor support is likely to be required to close the current financing gap both under existing economic conditions and in the context of further negative shocks.

SOLOMON ISLANDS

Population	506,967
Population growth	2.3 percent
Surface area	28,900 sq. km.
Capital	Honiara

Source: World Development Indicators.

In the second half of 2011, Solomon Islands enjoyed a markedly more secure macroeconomic footing relative to most of the preceding decade. A surge in logging, support from the government's development partners, and gains in macroeconomic management lifted growth rates, and built foreign exchange and government cash reserves. Nevertheless, recent growth has been concentrated in natural resource exploitation, raising concerns about its sustainability. At the same time, the government's capacity to translate this growth into improved delivery of public services and investment in its citizens' health and education remains challenged. Progress against the MDGs has at best been mixed, with Solomon Islands assessed to be off-track on four of the seven goals, and to have regressed against the health-related goals.

The Solomon Islands economy is likely to grow by around 9 percent in 2011 based on data through to August, several percentage points stronger than earlier expected. This strength follows an estimated 7 percent expansion in 2010, following a 4¾ percent contraction induced by the global economic downturn in 2009. Logging activity is expected to contribute 2¼ percentage points of this year's growth—the Solomon Islands Government now expects log exports of 1.75 million m3 in 2011, compared with 1.43 million m3 in 2010. The start of production at the Goldridge gold mine is estimated to contribute another 2 percentage points. Fishing, cocoa and copra production have also all performed strongly this year, buoyed by good production conditions and high international prices. But it is greater government spending (including through donor-funded projects) that explains most of the expansion in the Solomon Islands' non-forestry, non-mining economy in 2011.

The same factors have allowed Solomon Islands to rebuild its external buffers. High global prices and increased production of Solomon Islands' commodity exports helped the country record a trade surplus in Q2, of a little over $10 million, its first since Q4 2004. Imports declined through the first half of 2011, following a surge in late 2010 of one-off capital equipment imports for specific investment projects: much of an 83 percent increase in 'machinery and transport equipment' in Q4 2010 was destined for Goldridge, with the remainder largely directed to mobile phone providers and logging companies. Foreign visitor arrivals also grew strongly (visitor nights in Q2 2011 were one-third greater than a year earlier), although tourist numbers remain modest (1,400 in Q2). Foreign direct investment inflows rose slightly in the first half of 2011 to $260 million, after doubling between 2009 and 2010. These factors together with ongoing donor inflows allowed the Central Bank to raise its foreign exchange reserves from 7 months to 8.5 months of import cover (as at end of September 2011, compared with a year earlier).

The Solomon Islands Government (SIG) continued to strengthen its fiscal position through to Q3 2011, following a significant turnaround in 2010. The government's revenues have exceed expectations in 2011, attributed to improvements in tax administration and the unexpected strength of logging activities and prices, while SIG-funded development spending in particular was below budget. By July, the government's deposits had increased to SBD 645 million ($87 million). Recurrent expenditure has generally been in-line with budgeted levels, with gains in the administration and control of payroll expenditure particularly notable. The government budget ended 2010 with a sizable surplus and with all short-term obligations met—contrasting

with the severe cash shortages at the start of 2009. The 2010 surplus totaled SBD 390 million. Below-budget expenditure, in part due to spending reservations at the start of the year, contributed to the surplus.

Government debt continued to decline, resulting in an improvement of the country's debt sustainability risk rating to 'yellow light' status (moderate risk of debt distress) from 'red light' status (high risk). Government debt fell to SBD 1,376 million, around 24 percent of GDP, at the end of 2010, and to SBD 1,271 million in Q2 of 2011. With adherence to the conditions of the Honiara Club Agreement (including no new borrowing), fully-funded recurrent budgets, and growth in the nominal economy, public debt is expected to fall towards 20 percent of GDP by the end of 2011. SIG has also eliminated its external arrears following a payment of SBD 14.6 million to the European Investment Bank (EIB) coupled with the EIB's decision to write-off the SBD 5.4 million arrears balance.

Increases in global energy prices passed into Solomon Islands' urban consumer prices in the first half of 2011, but this pressure waned in Q3 as international prices stabilized. CPI inflation rose to 8.6 percent over the year to August 2011. But this high year-on-year number is, in part, due to a 'base period effect' as consumer prices had fallen in mid-2010. Though CPI data are not yet available, momentum indicators suggest that inflation has come down to an annualized rate near 2¼ percent in Q3 2011. The earlier uptick in inflation appears to also have been influenced by idiosyncratic price movements – a 37 percent increase in chicken wing prices made the greatest contribution to the food index's 4.7 percent monthly inflation rate in April 2011. Higher fuel prices, which usually impact on the Solomon Islands with a lag of one to two quarters (the time it takes to ship and distribute the refined products from Singapore), fed into other prices. Further, the country's dispersed population suggests that higher fuel prices have a larger impact on remoter and typically poorer households. The rise in many global grains prices around the turn of 2011 has had little impact on the Solomon Islands, even among urban consumers who are the most dependent on imported food items. Rice is the principle imported staple, and movements in its retail price have been kept in check by the entry of new wholesalers sourcing rice from a wider range of producers, followed by renewed consolidation in the market.

On balance, monetary conditions eased in the 18 months to mid-2011. Bank lending rates fell as did those paid on short-term central bank and government paper. Deposit rates increased, leading to a narrowing in interest margins. Money supply increased by 23 percent due largely to the accretion of foreign reserves. However, credit growth to the private sector from banks and credit societies has remained stagnant. On the exchange rate front, a 7 percent upward revaluation of the SBD against the US dollar in June 2011 did not offset a weakening across other currencies, as the SBD followed the dollar's depreciation against the strong Australian dollar (a major source of Solomon Islands' imports and financial flows).

Excess liquidity in the banking system expanded further through the first half of 2011, although the rate of growth slowed from 2010. Like other countries in the region, excess liquidity appears to be a structural, rather than a temporary, feature of the Solomon Islands banking system. In recent months an important driver of excess liquidity has been the increase in government deposits with commercial banks. These deposits increased to 82 million Solomon Island dollars (SBD) by the end of June 2011, compared with SBD 55 million at the start of the year and SBD 32 million a year earlier. The authorities have absorbed some of this liquidity through issuing short-term paper.

With the Solomon Islands authorities to be commended for taking advantage of supportive external conditions to stabilize the economy, the imperative has shifted to broadening the sources of growth and improving the delivery of social services to the population. Conditions in the formal private sector remain difficult, despite the boom in Solomon Islands' resource industries, and this is hampering the creation of quality jobs and sustainable growth in incomes. Poor transport infrastructure, high cost of utilities (electricity, water, gas and telecommunications), limited human capital,

and high reservation wages detract from the investment climate. A recent report by the Asian Development Bank (ADB) commented that decades of poor governance led to chronic underperformance by Solomon Islands' state-owned enterprises (SOEs). But that the situation is improving. Recent reforms in relation to SOE board appointments and greater financial disclosures will help strengthen their governance. And the latest World Bank Group 'Ease of Doing Business' assessment (2012) ranked Solomon Islands 74th out of 183 countries, a large improvement from its ranking of 106 as recently as 2010.

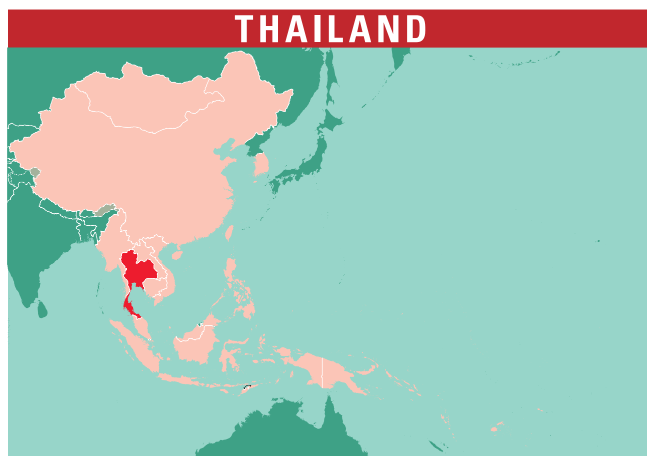
Solomon Islands' immediate economic outlook is linked to external demand and prices for its natural resource products, and to recent flows of aid and FDI continuing. The outlook for the country's export prices is, however, uncertain, both through 2012 and into the longer-term. While the baseline is for average prices to remain above the levels of the first half of the 2000s, they are also expected to be unstable. Managing this instability is particularly difficult in a context such as the Solomon Islands, where the exchange rate acts as a nominal anchor for consumer prices, and therefore has limited capacity to offset the movements in the country's terms of trade. This emphasizes the importance of maintaining the recently built buffers against external shocks, and to avoiding domestic policy decisions that may undermine these buffers or add to the sovereign risk perceived by external investors. Into the longer-term, the development of nickel deposits on Choiseul and Isabel islands offers an alternative to logging. Subject to reaching agreement with local land owners and various regulatory clearances, production may begin mid-decade, with operations expected to span 30 years. Ongoing surveying for a proposed hydroelectric plant on Tina River in Guadalcanal, and a pilot temporary migrant labor scheme with Australia, also present longer-term opportunities for improvements in Solomon Islanders' quality of life.

Solomon Islands Key Indicators

	2007 Year	2008 Year	2009 Year	2010e Year	2011f Year	2012f Year
Output, Employment and Prices						
GDP (% change y-y)	10.7	7.1	-4.7	7.0	9.0	6.0
Tourist arrivals	13,748	16,264	18,260	20,521	21,248	22,001
(% change y-y)	48.3	18.3	12.3	12.4	3.5	3.5
Consumer price index (% change y-y)	11.0	18.3	1.8	0.7	9.0	4.0
Public Sector						
Government revenues (% GDP)	42.1	45.2	49.8	59.3	61.5	58.0
Government expenditures (% GDP)	40.8	45.5	48.2	53.4	55.0	54.0
Government balance (% GDP)	1.3	-0.3	2.2	5.9	6.5	4.0
Public and publically-guaranteed debt (% GDP)	36.8	35.0	33.2	28.1	21.3	18.5
Foreign Trade, BOP and External Debt						
Trade balance (millions US$)	-116	-132	-109	-215	-63	-84
Exports of goods (millions US$)	160	193	165	227	351	351
(% change y-y)	41.6	21.1	-14.7	37.4	55.0	0.0
Key export (% change y-y) 1/	27.1	10.1	-20.1	41.5	20.0	-10.0
Imports of goods (millions US$)	235	262	239	360	414	435
(% change y-y)	33.7	11.7	-8.7	50.6	15.0	5.0
Current account balance millions US$)	-48	-106	-128	-200	-231	-161
(% GDP)	-8.2	-16.4	-19.5	-26.9	-25.0	-15.0
Foreign direct investment, net (millions US$)	57	97	128	259	171	118
Total external debt (millions US$)	188	207	213	239.1	229.8	243.2
(% GDP)	32.1	32.1	32.4	32.2	24.9	22.6
Debt service ratio (% exports of g&s)	5.8	4.2	3.6	3.0	2.0	1.5
Foreign exchange reserves, gross (millions US$) 2/	121	90	146	266	350	350
(months of imports g&s)	3.9	3.5	4.2	5.8	6.8	6.6
Financial Markets						
Domestic credit (% change y-y) 3/	53.3	26.5	-4.2	-12.4	8.4	10.0
Exchange rate (SBD$/US$, eop)	7.20	7.54	7.90	7.80	7.40	7.40
Real effective exchange rate (2005=100)	112.8	120.6	112.1	109.8	109.8	109.8
(% change y-y)	7.7	6.9	-7.0	-2.0	0.0	0.0
Memo: Nominal GDP (millions US$)	586	646	657	743	923	1076

Source: National data sources and IMF.
e = estimate
f = forecast
n.i. = no issues
1/ Logs
2/ Includes foreign assets of non-bank financial institutions
3/ Domestic credit to the private sector

THAILAND



Population	67.4 million
Population growth	0.6 percent
Surface area	513,120 sq. km.
Capital	Bangkok

Source: World Development Indicators.

After expanding by a strong 8.1 percent in the first quarter, Thailand's economy shrunk by 0.8 percent in the second quarter 2011.[33] For the first half of 2011, the economy expanded by 2.9 percent from the previous year. While the expansion in the first quarter was driven by strength in the agricultural sector, much of the contraction in the second quarter can be attributed to the impact of the Tohoku earthquake and tsunami in Japan on auto supply chains, but lower levels of government construction also weighed down the economy.

The impact of supply chain disruptions caused by the Tohoku earthquake can be noted in three areas: exports, household consumption and manufacturing output. Merchandise exports expanded 4 percent (impressive considering the headwinds during the quarter and following a 47 percent commodity-led surge in the previous quarter), but at the expense of inventory draw-downs and lower imports. Household consumption overall expanded by 1 percent, following a disappointing 2.4 percent in the first quarter, driven by lower auto sales. Excluding autos, consumption expanded nearly 9 percent, in fact accelerating from a contraction in the first quarter. Although some of the contraction in auto sales is likely due to rising interest rates and a cyclical decline following several quarters of rising sales, there were reports that supply chain disruptions disrupted deliveries. Finally, manufacturing output contracted 1.4 percent, reflecting the sharp reduction in domestic car sales and exports caused by the supply chain disruptions. The reduction in the energy-intensive auto manufacturing may also have contributed to the decline in output from the utilities sector.

The other key development was the sharp decline in government construction investment (down 30 percent), which dragged down the construction sector. Government construction registered its lowest overall levels for the April-June quarter since 1993. The contraction in construction investment more than offset a small increase in equipment investment and public investment overall registered a year-on-year contraction for the fifth consecutive quarter. Notwithstanding the election, government consumption contracted by 3 percent.

On the positive side, tourist receipts picked up and commodity-related exports remained robust, leading to a positive contribution of external demand to overall growth. Moreover, private investment was healthy and, notwithstanding the contraction in government construction, gross fixed capital formation was up by 2.8 percent overall, a solid outcome considering investment had expanded by 32 percent the previous quarter. Although it could not match the exceptional performance of the first quarter, the agriculture sector continued to perform well, along with firm agricultural prices that supported farm incomes and domestic consumption. Labor markets remain tight, with the unemployment rate in June below 0.5 percent and the rate of under-employment at 1.1 percent.

Consumer price inflation accelerated slightly to 4.2 percent in October, near a 35-month high, reversing the trend of stabilizing headline inflation. The difference between core and headline inflation moved higher between March and April, as a spike in

33 All figures reflect changes from the previous quarter, adjusted for seasonal fluctuations, unless otherwise indicated.

commodity prices (linked to the spike in oil prices in the first quarter) fed relatively quickly to headline inflation through fuel and raw food prices. Transmission of the spike to core inflation was partly ameliorated as the government negotiated with producers to delay passing along higher input costs of processed food items to consumer prices. Producers appear to have started passing on cost increases in earnest in May, when the acceleration in core inflation exceeded that of headline prices, which had started stabilizing by that time. The pattern of stable and slowly declining headline inflation with modestly increasing core inflation was reversed in August, when increases in food prices - both raw and processed - picked up pace. Domestic rice prices continued to decelerate through September for 13 consecutive months despite increasing producer and export prices.

The new Thai government installed in August has promised to implement a number of policies that will likely provide a boost to domestic demand going forward. The four most prominent are (1) increase the minimum wage to 300 baht (US$10) per day; (2) increase the minimum wage for holders of bachelor degrees to 15,000 baht (US$500) per month; (3) lower corporate income taxes from 30 to 23 percent; and (4) re-introduce a rice mortgage policy that effectively sets an intervention price between 40 and 60 percent above current market prices. In some instances, the government appears to be considering these policies as a part of broader reforms, for example in the case of taxes and civil service wages (as most civil servants have bachelors' degrees and would be eligible for the new minimum wage). Given the reconstruction needs, a deficit of around 4.5 percent of GDP is expected for FY2012 (which includes additional spending for recovery and rehabilitation programs post floods), compared to the projected 2 percent for fiscal year 2011.

Monetary policy has been on a normalization course since the beginning of the year. The Bank of Thailand has raised interest rates six times this year (by a total of 1.5 percentage points), but at 3.5 percent the real policy interest rate remains negative. The real effective exchange rate depreciated by less than 1 percent since the beginning of the year, as inflows in the current account were offset by higher reserve accumulation (especially in the first quarter) and more balanced outflows in the financial account.

The economy is expected to slow down during the remainder of 2011 and into the first quarter of 2012 due to the slowdown in the global economy and the impact of the devastating floods. The impact of the floods will be most severely felt in the last quarter of 2011, coming mainly from the production loses of the industrial estates in the vicinity of Bangkok, which could reduce GDP growth by around 1 percent. Factors supporting growth include the reconstruction and rehabilitation by both the public and private sectors after the floods, dissipation of supply chain disruptions (which will lead to inventory restocking, higher domestic sales and exports of autos and electronics), a momentum in household consumption supported by the stability of commodity prices and expansionary fiscal policies (including for rehabilitiation), and likely solid performance of private investment following the improved political stability. Moreover, inflation is likely to slow as commodity prices appear to have lost their upward momentum. The significantly worsened global outlook is likely to lead to a deceleration of both merchandise and service exports, and the dismal performance of public investment is likely to continue given delays in approving the FY 2012 budget although reconstruction efforts are likely to lead to a pick-up in 2012. Moreover, while weakness in commodity prices will support a decline in inflation, it could also dampen rural incomes. These factors weigh on the outlook, and GDP is now expected to expand by 2.4 percent in 2011 and 4.0 percent in 2012. Risks are clearly to the downside as a new major shock to the global economy would have a large impact on Thailand's export-oriented economy.

Thailand Key Indicators

	2008	2009	2010	2011f	2012f	2010		2011							2011
	Year	Year	Year	Year	Year	Q3	Q4	Q1	Q2	Q3	May	Jun	Jul	Aug	Sep
Output, Employment and Prices															
Real GDP (% change y-y)	2.5	-2.3	7.8	2.4	4.0	6.6	3.8	3.2	2.6	..	..	..	..	..	..
Domestic demand (% change y-y)	4.3	-6.9	10.3	2.1	8.8	11.6	3.4	0.7	3.2	..	..	..	..	..	..
Industrial production index (2000=100)	178.9	166.1	190.0	..	..	191.8	190.0	187.7	181.7	195.1	178.1	201.6	188.9	196.1	200.4
(% change y-y)	3.9	-7.2	14.4	..	..	9.8	2.6	-2.1	-2.5	1.8	-3.7	3.8	-0.7	6.8	-0.5
Unemployment (%)	1.4	1.5	1.0	1.0	1.0	0.9	0.8	0.8	0.6	..	0.5	0.4	0.5	0.7	..
Real wages (% change y-y) 1/	4.8	-1.6	3.3	..	..	4.1	6.2	4.4	1.6	..	..	..	..	..	..
Consumer price index (% change y-y)	5.5	-0.8	3.3	3.5	3.0	3.3	2.9	3.0	4.1	4.1	4.2	4.1	4.1	4.3	4.0
Public Sector															
Government revenues (% GDP)	16.5	16.4	17.2	17.4	17.4	17.9	15.3	14.0	23.1	18.7	..	..	..	..	..
Government expenditures (% GDP)	17.6	20.9	20.3	20.5	20.8	19.2	23.8	21.3	21.2	17.9	..	..	..	..	..
Government balance (% GDP) 2/	-1.4	-3.0	-2.1	-3.0	-3.1	1.3	-7.2	-10.3	5.2	4.3	..	..	..	..	..
Domestic public sector debt (% GDP) 3/	33.7	39.4	38.8	40.0	40.1	39.0	38.8	37.9	37.4	..	36.4	36.6	33.0	32.9	..
Foreign Trade, BOP and External Debt															
Trade balance (billions US$)	-0.4	19.4	14.1	8.4	-5.3	3.3	4.1	3.3	1.7	7.7	0.3	1.9	4.6	0.7	2.4
Exports of goods (billions US$)	175.2	150.7	193.7	220.3	227.9	49.7	51.8	56.0	57.3	63.3	19.3	20.8	21.1	20.9	21.3
(% change y-y)	15.9	-14.0	28.5	13.7	3.5	22.2	21.1	27.3	19.2	27.3	17.3	16.4	36.4	28.4	18.4
Key export (% change y-y) 4/	7.6	-15.2	27.0	..	..	21.4	11.0	0.8	10.3	10.0	8.5	3.0	10.2	9.1	10.9
Imports of goods (billions US$)	175.6	131.4	179.6	211.9	233.1	46.4	47.7	52.7	55.7	55.6	19.0	18.9	16.5	20.2	18.8
(% change y-y)	26.8	-25.2	36.7	18.0	10.0	30.6	18.7	25.6	28.0	19.9	36.4	35.8	29.7	35.7	44.6
Current account balance (billions US$)	2.1	21.9	14.8	10.4	-3.7	2.1	5.5	6.8	1.8	7.8	-0.5	2.5	4.6	0.7	2.4
(% GDP)	0.8	8.3	4.7	2.9	-1.0	2.6	6.4	7.6	2.1	8.8	..	..	..	..	..
Foreign direct investment (billions US$) 5/	7.5	4.5	4.4	6.2	7.9	1.5	1.0	0.2	1.3	..	0.3	0.6	..	..	..
External debt (billions US$) 6/	76.1	75.3	100.6	..	..	92.8	100.6	108.2	..	..	..	..	..	..	..
(% GDP)	28.0	28.6	31.6	..	..	29.5	29.2	30.1	..	..	..	..	..	..	..
Short-term debt (billions US$) 6/	33.6	33.1	50.7	..	..	45.2	50.7	55.7	..	..	..	..	..	..	..
Debt service ratio (% exports of g&s)	8.3	7.6	4.7	..	..	4.6	3.7	4.1	..	..	..	..	..	..	..
Foreign exchange reserves, gross (billions US$)	111.0	138.4	172.1	182.2	184.0	163.2	172.1	181.6	184.9	180.1	185.5	184.9	187.6	188.3	180.1
(months of imports of g&s)	6.5	10.7	10.0	9.0	8.3	9.2	9.3	9.1	8.8	8.6	..	..	..	..	..
Financial Markets															
Domestic credit (% change y-y) 7/	9.3	3.1	12.6	..	..	10.8	12.6	14.9	16.1	17.3	15.6	16.1	16.3	17.2	17.3
Short-term interest rate (% p.a.) 8/	3.4	1.4	1.5	..	..	1.7	1.8	2.3	2.8	3.4	2.8	3.0	3.3	3.5	3.5
Exchange rate (Baht/US$, ave)	33.4	34.3	31.7	30.0	30.0	31.6	30.0	30.5	30.3	30.1	30.2	30.5	30.1	29.9	30.5
Real effective exchange rate (2000=100) 9/	112.8	108.8	114.4	..	..	115.0	116.8	114.0	113.9	113.5	113.7	112.7	113.8	113.7	112.9
(% change y-y)	0.5	-3.6	5.2	..	..	6.1	8.3	2.6	-0.9	-1.3	-4.1	-5.5	-3.2	-3.6	-5.5
Stock market index (Dec. 1996=100) 10/	450	735	1,033	..	..	975	1,033	1,047	1,041	916	1,074	1,041	1,134	1,070	916.2
Memo: Nominal GDP (billions US$)	272.2	263.4	318.7	356.8	384.3	78.7	86.2	89.9	87.5	88.9	..	..	..	..	..

Source: National data sources, World Bank staff estimates
f = forecast
1/ Average wage of employed person, using the National Statistical Office Labor Force Survey, deflated by CPI inflation
2/ Cash balance of central government
3/ Includes domestic central government (CG) debt, domestic debt of non-financial state enterprises, and the Financial institutions Development Fund (FIDF) debt. Series was revised by adding the Village Fund (VF) and the Energy Fund Public Organization (EFPO).
4/ Machinery and mechanical appliances
5/ Non-bank FDI
6/ Bank of Thailand figures
7/ Private credits from domestically registered commercial banks, branches of foreign banks, international banking facilities, finance companies, specialized banks, thrift and credit cooperatives, and money market mutual funds
8/ One-day repurchase rate, average
9/ World Bank staff estimates
10/ Bangkok SET

TIMOR-LESTE

Population	1.1 million
Population growth	3.2 percent
Surface area	14,870 sq. km.
Capital	Dili

Source: World Development Indicators.

Real non-oil GDP (excluding the UN mission) is estimated to have grown by 8.5 percent in 2010. This follows two consecutive years of more than 12 percent expansion in this measure of economic activity. Petroleum receipts grew by 25 percent in 2010 and amounted to 350 percent of non-oil GDP. The slower, albeit still robust, economic growth in 2010 is explained by a weaker performance of the agriculture sector stemming from weather-related events, with both rice and coffee being adversely impacted. Public sector spending has been the key driver of growth in recent years. Elevated government spending has spurred growth in the local private construction sector, which in turn is creating opportunities for suppliers of locally sourced materials and labor. In 2011, with public spending remaining strong and agriculture set to recover, growth is expected to return to double digits. Petroleum receipts are projected to continue rising in 2011 mainly on account of higher prices. Beyond 2011, production from oil fields with approved development plans is expected to decline before ceasing in 2024.

Inflation in 2011, as measured by movements in the CPI for Dili, has been in the double digits and recorded 13.1 percent year-on-year in August. Increases in the international prices of food and fuel, combined with the depreciation of the US dollar, explain much of the uptick in inflation. Rice prices, which account for a large share of the CPI, moved higher on account of unfavorable weather conditions impacting domestic production, as well as due to a reduction in the subsidy on imported rice. The stimulus to aggregate demand through higher government spending is also having an impact on inflation, for example, through prices of locally sourced building materials. With public spending likely to be elevated in the coming years, it will remain a potential source of inflationary pressure.

In 2011 the government released its Strategic Development Plan (SDP) which aims to transform Timor-Leste to an "upper middle income country, with a healthy, well educated and safe population by 2030." The Budget for 2012 and accompanying medium-term expenditure plans are aimed at implementing the SDP, with a significant scaling-up of capital spending to address pressing infrastructure constraints. The overall size of the 2012 budget (excluding development partner commitments) shows an increase of 35 percent over the 2011 level, with capital expenditure rising by around 50 percent to constitute 60 percent of total expenditure. The budgeted level of capital expenditure in 2012 is more than four times the actual spending for 2010. In 2010, capital expenditure amounted to nearly 40 percent of non-oil GDP while total expenditure amounted to around 115 percent.

The bulk of the capital expenditure will be routed through the Infrastructure Fund (IF) which was set up in 2010 as part of the State Budget to finance multi-year projects with a value of more than one million dollars. Key areas of investment include electricity, transport, and education. The government is also aiming to develop infrastructure on the South Coast to attract investment in the downstream petroleum sector as envisaged in the SDP. Seed capital for the newly established Timor-Leste Investment Corporation (TLIC) is another major area of expenditure. The TLIC will have a commercial orientation and will aim to invest in strategic projects such as the undersea cable and projects that will help diversify the economy away from the oil sector.

Mindful of the importance of ensuring the quality of ramped-up expenditure, the government is strengthening its institutional setup for public investment management. The Secretariat of Major Projects will review all projects submitted for financing to the IF by line ministries. A newly established board of the IF will take the decision on financing, and a National Development Agency will be responsible for supervising project implementation and for quality control. A Procurement Commission will be responsible for procuring large projects. These new institutions will likely face a large workload in the coming months, and will need to strike a balance between speed and quality in executing their mandates.

Non-oil revenues are expected to finance about 8 percent of the budget in 2012, with withdrawals from the Petroleum Fund (PF) continuing to provide bulk of the financing. In the 2012 budget, the government will for the first time, undertake debt financing as a way to diversify its funding sources. This debt financing, about 3 percent of the 2011 Budget, is to be on concessional terms and will be directed towards selected infrastructure projects. Given the size of financing needs, withdrawals from the PF will exceed the Estimated Sustainable Income (ESI) for the third year running, and under current investment plans will continue to do so for the next five years. According to government projections, the ESI itself, based on fields with approved development plans, is expected to decline from 734 million dollars in 2011 to 577 million dollars in 2016.

Aided by high oil prices, the PF balance rose from 6.9 billion dollars at end-2010 to 8.3 billion dollars at the end of the second quarter of 2011 (more than 8 times non-oil GDP). The return on investments was 3.8 percent in 2010 (2.3 in real terms), with the annualized return on the fund since its inception in 2005 being 4.2 percent (2.2 in real terms). In a move to raise the long term rate of return, the PF Law was amended in 2011 to allow for a maximum of 50 percent of the Fund to be invested in equities. Earlier, the Law required at least 90 percent of the investments to be in US dollar denominated bonds issued or guaranteed by governments and cash deposits.

The currently unsettled global financial outlook poses some complexities for the government in diversifying towards equities. The governance of the PF is based on the "Santiago principles" and incorporates a high degree of transparency and disclosure of information.

VIETNAM

Population	86.2 million
Population growth	1.2 percent
Surface area	329,310 sq.km.
Capital	Hanoi

Source: World Development Indicators.

Vietnam's growth slowed in the first half of 2011, as the government's priority turned to containing inflation and maintaining macroeconomic stability. In early February the government introduced a stabilization package called Resolution 11, which includes a wide range of monetary, fiscal and structural policy reforms intended to fight inflation, stabilize the economy and ensure social safety. Following its implementation, both deposit and lending rates have increased, and credit growth has slowed as commercial banks have curtailed new loans, mainly to real estate and securities trading. Fiscal policy has been tightened by reducing non-wage recurrent spending by 10 percent and cancelling or postponing less urgent capital expenditure, amounting to an estimated 80 trillion dong or about 3 percent of GDP. Activities in the construction sector have slowed down considerably as a result of this, containing the real estate bubble and reducing the high cost of inputs. The Manufacturing Production Index rose 10.7 percent year on year (y-o-y) in August 2011, but over the same period, the inventory of manufacturing products increased by 17.8 percent. The real GDP growth rate was 5.6 percent in the first half of 2011, and is expected to be about 5.8 percent for the whole year, compared with 6.8 percent in 2010.

The trade deficit is expected to improve in 2011. Import growth has slowed as a result of stabilization policies, whereas export growth has remained robust helped by high commodity prices. Export earnings grew 33.7 percent and the import bill increased 25.4 percent in the first 8 months of 2011. High commodity prices have helped the export value of key agricultural commodities (rice, coffee, cashew, pepper, tea, vegetable, rubber, etc.) to grow by nearly 40 percent in the first 8 months of 2011. At the same time, crude oil exports have surged by 52 percent in value despite a volume increase of only 5 percent. Performance of Vietnam's labor-intensive, low value-added manufacturing exports such as garments, footwear and electronic goods has also been strong, rising by 25 percent in combined value. A narrowing of the trade deficit and significant purchase of foreign currencies by the State Bank of Vietnam (SBV) have enabled a buildup of foreign reserves to around two months of imports by the end of July, which could help to reduce the risk of any immediate balance of payments difficulties as well as ease depreciation pressures of the Vietnam dong. The current account deficit is estimated to be less than 4 percent of GDP in 2011, about the same level as 2010.

Headline inflation accelerated to 23 percent (y-o-y) in August 2011 – the highest level since November 2008, and compared to 11.7 percent (y-o-y) at end 2010. High inflation was driven by a steep jump in food prices; expansionary monetary and fiscal policy in 2009-2010; major price adjustments of key inputs (power and fuel); and exchange rate devaluation. The price of food and foodstuffs, which account for nearly 40 percent of the CPI basket, has soared by 34 percent since August 2010. Monthly inflation slowed to around 1 percent since June 2011, as stabilization measures began to take effect. However, inflation is unlikely to decline substantially in the near future because of factors such as high commodity prices, minimum wage adjustments, possible hike in electricity tariffs and market expectation of a more accommodating credit policy during the last quarter of 2011. Persistently high inflation motivated two hikes in minimum wages in the corporate sector in less than twelve months (in January and October 2011). The government also increased

civil service wages by 13.7 percent in January 2011, and announced an exemption to personal income tax for employees in the lowest income threshold for the period from August to December 2011.

The tightening of monetary policy is starting to put pressure on the banking sector. In response to stricter liquidity conditions since late 2010, smaller commercial banks have offered high deposit rates (up to 18 percent) to gain liquidity despite the SBV guidance to keep deposit rate at 14 percent or below – triggering fierce competition among the banks. However, as there are no prescribed limits on lending rates, banks have raised them to as much as 22–27 percent. With economy slowing down, the pressure on the borrowers is expected to grow in the coming months, resulting in some deterioration of the quality of bank sector assets in 2011-12. While the State Bank of Vietnam has supported weaker banks through greater liquidity, it has hinted that some consolidation may be needed if the weaker banks do not perform up to industry standards. However, given the tenuous macroeconomic environment, bank regulators are reluctant to force consolidation or allow bankruptcy to occur in the banking sector. The unresolved problems in the banking sector are likely to remain a source of concern for Vietnam in the coming years.

Fiscal tightening was a combination of a reduction in spending and an increase in revenues. Resolution 11 proposed to cut about 80 trillion dong (3.2 percent of GDP) in state capital investment; off-budget investment (government's development bond); and investment by SOEs and other public entities. The Ministry of Finance reported that total revenues increased nearly 23 percent in first half of 2011 compared to the same period in 2010. The Budget deficit this year is expected to fall to 5 percent of GDP from 5.6 percent in 2010 (based on the government's definition of budget deficit). The slower than expected fiscal consolidation and lack of a medium-term fiscal outlook that is consistent with a sustainable public debt remain a key source of concern for the investors.

Slower than expected growth and renewed signs of macroeconomic risks will test the confidence of investors and the commitment of authorities to macroeconomic stability. In a recent meeting with selected development partners, the Prime Minister of Vietnam reaffirmed the government's commitment to continue to implement Resolution 11. He noted that controlling inflation will remain the government's top priority, and that Vietnam would not "chase after" high growth. A target of single-digit inflation and moderate growth of 6.5 percent have been set for 2012. The Prime Minister highlighted a number of priorities for the remainder of 2011, including: (i) continued tight monetary and credit policy; (ii) a prudent fiscal stance; (iii) accelerating the restructuring of the SOE and banking sectors; and (iv) ensuring social security and welfare to maintain political stability for the country.

Vietnam's stabilization gains remain fragile and any premature loosening of policy will risk repeating the recent pattern of recurring instability. Vigorous implementation of fiscal consolidation and structural elements of Resolution 11, including restructuring and reform of the state enterprise sector and the financial sector should help Vietnam return to a more sustainable macroeconomic environment while laying the foundations for greater efficiency and productivity to drive medium and longer term growth. But undertaking these deep, structural reforms will require strong leadership, careful implementation, support from development partners and foreign investors, and some short-term pains.

Vietnam Key Indicators

	2007 Year	2008 Year	2009 Year	2010e Year	2011f Year	2012f Year
Output, Employment and Prices						
Real GDP (% change y-y)	8.5	6.2	5.3	6.8	5.8	6.1
Industrial production index						
(% change y-y)	16.7	13.9	7.6	14.0	11.0	12.0
Unemployment (%) 1/	4.6	4.7	4.6	4.4	4.0	4.0
Consumer price index (% change y-y)	8.3	23.1	6.7	9.2	19.0	10.5
Public Sector						
Government balance, official (% GDP) 2/	-0.7	1.2	-5.1	-2.0	-1.1	-1.2
Government balance, general (% GDP) 3/	-2.5	-1.2	-9.0	-6.4	-3.9	-3.8
Public sector debt (% GDP) 4/	45.6	44.0	52.6	56.7	58.7	59.0
Foreign Trade, BOP and External Debt						
Trade balance (billions US$)	-10.4	-12.8	-8.3	-7.1	-7.0	-8.0
Exports of goods (billions US$)	48.6	62.7	57.1	72.2	90.6	105.4
(% change y-y)	21.9	29.1	-8.9	26.4	25.5	16.3
Key export (% change y-y) 4/	2.7	23.1	-40.2	-23.0	45.0	5.0
Imports of goods (billions US$)	58.9	75.5	65.4	79.3	97.6	113.3
(% change y-y)	38.3	28.1	-13.3	21.2	23.1	16.1
Current account balance (billions US$)	-7.0	-10.8	-6.1	-4.0	-4.5	-4.6
(% GDP)	-9.8	-11.9	-6.6	-3.9	-3.8	-3.5
Foreign direct investment (billions US$)	6.6	9.3	6.9	6.1	6.8	7.3
External debt (billions US$)	23.1	28.4	36.3	43.7	49.1	52.2
(% GDP)	32.5	31.4	39.0	42.2	41.0	39.4
Debt service ratio (% exports of g&s)	2.8	2.6	4.5	3.2	3.0	3.3
Foreign exchange reserves, gross (billions US$) 6/	21.0	23.0	14.1	12.4	..	..
(months of imports of g&s)	3.0	3.8	1.9	1.4	..	..
Financial Markets						
Domestic credit (% change y-y)	53.9	25.4	39.6	32.4	14.0	15.0
Short-term interest rate (% p.a.) 7/	7.8	8.1	10.7	14.0	14.0	..
Exchange rate (Dong/US$, eop) 8/	16,017	17,483	18,479	19,498	20,803	..
Real effective exchange rate (2000=100)	106.0	125.8	115.9	114.0	..	..
(% change y-y)	9.5	18.7	-7.9	-1.6	..	..
Stock market index (Jul. 2000=100) 9/	927	316	495	485	..	..
Memo: Nominal GDP (billions US$)	71	90	93	104	120	132

Sources: Vietnam Government Statistics Office, State Bank of Vietnam, IMF, and World Bank staff estimates.
e = estimate
f = forecast
1/ Urban areas
2/ Excludes off-budgetary items
3/ Includes off-budgetary items
4/ Public and publicly-guaranteed debt
5/ Crude oil
6/ Based on IMF International Financial Statistics (IFS) as of September 2010
7/ Three-month deposit, end-of-period
8/ Ho Chi Minh Stock Index

APPENDIX TABLES

Appendix Table 1. Real GDP Growth

percent change from a year earlier

	China	Indonesia	Malaysia	Philippines	Thailand	Vietnam	Hong Kong SAR, China	Korea, Rep.	Singapore	Taiwan, China	East Asia and Pacific
Q1-2002	8.9	3.5	2.7	4.2	4.5	..	-1.0	6.6	-0.8	1.6	..
Q2-2002	8.0	4.2	4.7	4.6	5.0	..	0.5	7.0	4.6	6.5	..
Q3-2002	8.1	5.6	7.1	3.3	5.8	..	2.8	6.8	6.8	6.8	..
Q4-2002	8.1	4.7	6.9	5.5	6.0	..	4.8	8.1	6.5	6.0	..
Q1-2003	10.8	4.9	6.3	4.8	6.9	..	4.1	3.5	4.3	4.7	..
Q2-2003	7.9	5.0	5.9	4.3	6.6	..	-0.9	1.8	-0.6	-1.3	..
Q3-2003	9.6	4.6	4.6	5.4	6.7	..	3.8	2.0	5.4	4.6	..
Q4-2003	9.9	4.6	6.5	5.1	8.3	..	4.7	3.9	9.2	6.4	..
Q1-2004	10.4	4.1	8.2	7.2	6.7	..	7.7	5.2	10.0	6.1	..
Q2-2004	9.6	4.4	7.9	7.1	6.6	..	12.0	5.9	12.9	9.7	..
Q3-2004	9.1	4.5	6.4	5.6	6.3	..	6.6	4.8	7.7	6.7	..
Q4-2004	9.5	7.2	4.9	5.8	5.9	..	7.9	2.7	6.7	2.9	..
Q1-2005	10.5	6.0	5.6	4.5	3.6	7.4	6.2	2.7	4.7	2.7	7.0
Q2-2005	10.1	5.9	4.3	5.1	4.7	7.8	7.1	3.4	6.2	4.0	7.2
Q3-2005	9.8	5.8	5.6	4.7	5.5	8.3	8.1	4.5	8.7	4.8	7.5
Q4-2005	9.9	5.1	5.9	5.4	4.7	8.4	6.9	5.1	9.7	7.0	7.8
Q1-2006	12.4	5.1	6.0	5.5	6.1	7.3	9.0	6.1	10.7	5.8	9.4
Q2-2006	11.5	4.9	6.1	5.3	5.1	7.4	6.1	5.1	8.6	5.8	8.5
Q3-2006	10.6	5.9	5.8	5.2	4.8	7.9	6.4	5.0	8.0	6.5	8.1
Q4-2006	10.4	6.1	5.4	5.4	4.4	8.2	6.7	4.6	7.6	3.8	7.7
Q1-2007	14.0	6.1	5.7	6.8	4.6	7.7	5.6	4.5	7.9	4.5	9.6
Q2-2007	13.8	6.7	5.9	8.3	4.6	7.8	6.1	5.3	9.8	5.7	9.9
Q3-2007	13.4	6.7	6.8	6.8	5.5	8.2	6.8	4.9	11.0	7.1	9.9
Q4-2007	12.1	5.8	7.5	6.5	5.4	8.5	6.9	5.7	6.5	6.5	9.2
Q1-2008	11.3	6.2	7.5	3.9	6.3	7.5	7.2	5.5	7.6	7.5	8.9
Q2-2008	10.1	6.3	6.7	5.7	5.2	6.5	4.2	4.4	2.7	5.7	7.6
Q3-2008	9.0	6.3	5.1	6.4	3.1	6.3	1.2	3.3	-0.5	-1.2	5.9
Q4-2008	6.8	5.3	0.2	2.8	-4.1	6.2	-2.6	-3.3	-3.4	-7.5	2.4
Q1-2009	6.5	4.6	-6.2	1.0	-7.0	3.1	-7.9	-4.2	-8.4	-8.6	1.4
Q2-2009	8.1	4.2	-3.9	1.6	-5.2	3.9	-3.4	-2.1	-1.3	-7.2	3.2
Q3-2009	9.6	4.2	-1.2	0.5	-2.8	4.6	-2.1	1.0	2.1	-1.2	5.3
Q4-2009	10.7	5.4	4.6	1.4	5.9	5.5	2.5	6.3	4.6	9.2	8.4
Q1-2010	11.9	5.6	10.1	8.4	12.0	5.9	8.0	8.5	16.4	13.6	11.0
Q2-2010	10.3	6.1	9.0	8.9	9.2	6.2	6.7	7.5	19.4	12.9	9.8
Q3-2010	9.6	5.8	5.3	7.3	6.6	6.6	6.9	4.4	10.5	10.7	8.3
Q4-2010	9.8	6.9	4.8	6.1	3.8	6.8	6.4	4.7	12.0	7.1	8.1
Q1-2011	9.7	6.5	4.9	4.6	3.2	5.4	7.5	4.2	9.3	6.2	7.8
Q2-2011	9.5	6.5	4.0	3.4	2.6	5.6	5.1	3.4	1.0	5.0	7.1
Q3-2011	9.1	6.5				5.8	4.3	3.4	5.9	3.4	

Sources: Haver Analytics and national sources. Data for China uses annual production side GDP.

Appendix Table 2. Real GDP and Components of Aggregate Demand

percent change from a year earlier

		Indonesia	Malaysia	Philippines	Thailand	Hong Kong SAR, China	Korea, Rep.	Singapore	Taiwan, China	S.E. Asia	NIEs
GDP	2005	5.7	5.3	5.0	4.6	7.1	4.0	7.4	4.7	5.2	4.9
	2006	5.5	5.8	5.3	5.1	7.0	5.2	8.7	5.4	5.4	5.8
	2007	6.3	6.5	7.1	5.0	6.4	5.1	8.8	6.0	6.1	5.9
	2008	6.0	4.8	4.6	2.5	2.3	2.3	1.5	0.7	4.6	1.8
	2009	4.6	-1.6	1.1	-2.3	-2.7	0.3	-0.8	-1.9	1.0	-0.8
	2010	6.1	7.2	7.6	7.8	7.0	6.2	14.5	10.9	7.0	8.3
	2011 Q1	6.5	4.9	4.6	3.2	7.5	4.2	9.3	6.2	5.0	5.7
	2011 Q2	6.5	4.0	3.4	2.6	5.1	3.4	0.9	5.0	4.5	3.9
Private Consumption	2005	4.0	9.1	4.8	4.6	3.0	4.6	3.6	2.9	5.3	3.8
	2006	3.2	6.8	5.5	3.2	5.9	4.7	3.5	1.5	4.3	3.9
	2007	5.0	10.5	5.8	1.8	8.5	5.1	6.4	2.1	5.4	4.9
	2008	5.3	8.7	2.7	2.9	2.4	1.3	3.2	-0.9	5.0	1.0
	2009	4.9	0.7	2.3	-1.1	0.7	0.0	0.2	1.1	2.1	0.4
	2010	4.6	6.5	3.4	4.8	6.2	4.1	4.2	3.7	4.8	4.3
	2011 Q1	4.5	6.7	5.3	3.3	8.0	2.8	6.1	4.4	4.8	4.3
	2011 Q2	4.6	6.4	5.4	2.8	9.2	3.0	6.6	3.1	4.6	4.3
Fixed Investment	2005	10.9	5.0	-6.6	10.5	4.1	1.9	-1.7	2.7	6.7	2.1
	2006	2.6	7.5	3.9	3.9	7.1	3.4	17.0	0.1	4.2	4.2
	2007	9.3	9.4	10.9	1.5	3.4	4.2	19.6	0.6	7.5	4.4
	2008	11.9	1.1	-0.9	1.2	1.0	-1.9	13.5	-12.4	4.7	-2.9
	2009	3.3	-5.6	-2.0	-9.2	-3.9	-1.0	-2.9	-11.0	-2.6	-4.3
	2010	8.5	9.8	19.5	9.4	7.8	7.0	5.1	23.4	10.8	11.4
	2011 Q1	7.3	6.5	14.8	9.3	-0.3	-2.2	-7.8	8.6	8.9	0.5
	2011 Q2	9.2	3.2	-4.1	4.1	8.1	-1.1	10.0	1.6	4.5	2.1
Exports of Goods & Services	2005	16.6	8.3	4.8	4.2	10.6	7.8	20.7	7.8	9.6	9.3
	2006	9.4	6.6	13.4	9.1	9.4	11.4	9.7	11.4	9.4	10.9
	2007	8.5	4.1	5.5	7.8	8.3	12.6	20.1	9.6	6.9	11.8
	2008	9.5	1.7	-8.4	5.1	2.5	6.6	-29.7	0.9	3.8	1.2
	2009	-9.7	-10.5	-7.8	-12.5	-10.3	-1.2	20.4	-8.7	-10.3	-2.7
	2010	14.9	9.9	21.0	14.7	16.8	14.5	38.0	25.7	14.9	20.1
	2011 Q1	12.3	1.4	2.0	16.0	15.1	16.8	25.7	11.2	-4.4	15.8
	2011 Q2	17.4	4.1	-0.3	11.8	1.7	9.6	-4.3	4.4	-0.5	5.7

Sources: Haver Analytics, national data sources, and World Bank staff estimates. Regional averages are 2000 US$ GDP weighted.

Appendix Table 3. East Asia: Merchandise Export Growth

in U.S. dollars, percent change from a year earlier

	2008	2009	2010	Q4 2010	Q1 2011	Q2 2011	Q3 2011	Jun-11	Jul-11	Aug-11	Sep-11
East Asia and Pacific (10)	13.6	-16.2	29.8	22.5	25.3	19.6	17.4	16.9	20.4	20.6	15.0
China	17.4	-15.9	31.3	24.9	26.4	22.1	20.6	17.9	20.5	24.5	17.1
S.E. Asia	15.0	-16.6	29.7	23.9	25.4	22.6	19.9	23.9	29.8	25.0	21.2
Indonesia	20.1	-15.0	35.5	28.9	27.7	43.8	40.3	49.1	39.5	35.9	46.3
Malaysia	13.4	-21.2	26.3	12.8	15.9	16.8	16.4	18.2	14.6	17.2	17.3
Philippines	-2.7	-21.7	33.9	21.7	7.8	1.0	0.0	-9.4	-1.7	-13.7	-27.4
Thailand	14.3	-13.6	28.6	20.8	28.1	19.4	29.0	16.8	38.3	31.1	19.1
Vietnam	29.2	-10.1	26.9	34.2	34.1	28.8	39.7	33.9	54.6	34.9	30.3
NIEs	9.3	-16.2	28.3	20.2	25.1	15.2	13.4	12.6	16.2	14.4	9.8
Hong Kong SAR, China	5.3	-12.2	22.5	14.2	24.2	7.9	4.0	9.3	9.1	6.5	-3.4
Korea, Rep.	13.6	-13.9	28.3	23.8	29.6	18.7	21.7	11.2	21.1	25.5	18.8
Singapore	12.9	-20.2	30.5	22.5	24.6	19.8	15.8	20.1	16.7	16.7	13.9
Taiwan, China	3.7	-20.5	35.0	20.2	19.1	13.7	11.0	10.4	17.2	6.4	9.4

Source: Haver Analytics.

Appendix Table 4. East Asia and the Pacific: GDP Growth Projections

percent change form a year earlier

	2002	2003	2004	2005	2006	2007	2008	2009	2010	Forecast 2011	Forecast 2012
East Asia and Pacific	7.0	6.7	7.9	8.0	9.1	10.1	6.3	4.9	9.3	7.1	6.7
Developing East Asia	7.9	8.8	9.0	9.8	10.9	12.3	8.5	7.5	9.7	8.2	7.8
China	9.1	10.0	10.1	11.3	12.7	14.2	9.6	9.2	10.4	9.1	8.4
Indonesia	4.5	4.8	5.0	5.7	5.5	6.3	6.0	4.6	6.1	6.4	6.3
Malaysia	5.4	5.8	6.8	5.3	5.8	6.5	4.8	-1.6	7.2	4.3	4.9
Philippines	3.6	5.0	6.7	4.8	5.2	6.6	4.2	1.1	7.6	4.2	4.8
Thailand	5.3	7.1	6.3	4.6	5.1	5.0	2.5	-2.3	7.8	2.4	4.0
Vietnam	7.1	7.3	7.8	8.4	8.2	8.5	6.3	5.3	6.8	5.8	6.1
Cambodia	6.6	8.5	10.3	13.3	10.8	10.2	6.7	0.1	6.0	6.0	6.5
Fiji	3.2	1.0	5.3	0.7	1.8	-0.9	1.0	-1.3	0.3	1.4	1.5
Lao PDR	5.9	6.1	6.4	7.1	8.5	7.5	7.5	7.6	8.5	8.0	7.5
Mongolia	4.2	6.1	10.8	7.3	8.6	10.2	8.9	-1.3	6.4	14.9	15.1
Papua New Guinea	-0.2	2.2	2.7	3.4	2.3	7.2	6.7	5.5	7.5	10.0	6.0
Solomon Islands	-2.8	6.5	8.0	5.0	6.9	10.7	7.1	-4.7	7.0	9.0	6.0
Timor-Leste	2.4	0.1	4.2	6.2	-5.8	8.4	12.8	12.9	..	..	..
East Asia NIEs	5.6	3.2	6.0	4.9	5.8	5.9	1.8	-0.8	8.3	4.3	3.9

Sources: World Bank data and staff estimates.

Appendix Table 5. Regional Aggregates for Poverty Measures in East Asia

		$1.25-a-day		$2-a-day		
	Mean Consumption (2005 PPP$/month)	Headcount Index (%)	Number of Poor (million)	Headcount Index (%)	Number of Poor (million)	Population (million)
East Asia and Pacific						
1990	49.16	54.7	873.3	79.8	1,273.7	1,595.9
1993	54.55	50.8	845.3	75.8	1,262.1	1,664.9
1996	67.01	36.0	622.3	64.1	1,108.1	1,728.7
1999	70.76	35.5	635.1	61.8	1,104.9	1,788.4
2002	85.65	27.6	506.8	51.9	954.1	1,837.0
2005	106.85	16.8	316.2	38.7	728.7	1,884.4
East Asia and Pacific excluding China						
1990	72.98	39.2	180.5	66.0	304.4	460.8
1993	73.84	42.6	207.3	68.0	330.9	486.4
1996	85.81	35.0	178.8	61.5	314.2	511.2
1999	82.96	35.2	188.1	62.7	335.2	534.7
2002	89.76	25.5	142.1	54.0	300.8	556.6
2005	100.98	19.0	110.2	44.8	259.5	579.9
South East Asia (Indonesia, Malaysia, Philippines, Thailand)						
1990	77.05	38.6	120.3	65.1	202.9	311.8
1993	82.24	37.8	124.2	63.8	209.8	328.7
1996	96.46	29.5	101.6	56.2	193.9	344.9
1999	91.12	31.8	114.8	59.2	213.6	361.1
2002	97.84	21.3	80.3	49.9	188.4	377.3
2005	107.30	17.0	66.8	42.2	166.0	393.8
Lower-Income East Asia (Cambodia, Lao PDR, PNG, Vietnam)						
1990	58.57	41.2	34.6	69.5	58.4	84.1
1993	43.53	60.5	54.4	83.6	75.2	90.0
1996	47.82	55.1	52.7	80.6	77.1	95.7
1999	54.43	47.3	47.4	75.3	75.6	100.3
2002	60.87	41.0	42.6	69.1	71.9	104.1
2005	79.14	26.1	28.4	53.8	58.6	108.8

Source: World Bank PovcalNet.

Appendix Table 6. East Asia: Exchange Rates

local currency per U.S. dollar, end-of-period

	China	Indonesia	Malaysia	Philippines	Thailand	Vietnam	Hong Kong SAR, China	Korea, Rep.	Singapore	Taiwan, China	Japan
Jan-2008	7.19	9,291	3.24	40.65	33.19	15,971	7.80	943.9	1.42	32.20	106.36
Feb-2008	7.11	9,051	3.19	40.36	32.61	15,931	7.78	937.3	1.39	30.95	104.73
Mar-2008	7.02	9,217	3.19	41.87	31.46	16,105	7.79	991.7	1.38	30.41	100.10
Apr-2008	7.00	9,234	3.16	42.19	31.59	16,116	7.80	999.7	1.36	30.45	104.08
May-2008	6.95	9,318	3.24	43.88	32.11	16,246	7.80	1031.4	1.37	30.41	105.66
Jun-2008	6.86	9,225	3.27	44.76	33.20	16,842	7.80	1043.4	1.36	30.35	106.40
Jul-2008	6.86	9,118	3.26	44.14	33.50	16,755	7.80	1008.5	1.37	30.59	107.99
Aug-2008	6.85	9,157	3.39	45.69	33.86	16,525	7.80	1081.8	1.42	31.52	109.10
Sep-2008	6.85	9,378	3.46	46.92	34.29	16,575	7.77	1187.7	1.43	32.13	104.30
Oct-2008	6.86	10,995	3.56	48.75	34.43	16,813	7.75	1291.4	1.48	33.00	98.30
Nov-2008	6.87	12,151	3.62	48.88	35.09	16,974	7.75	1482.7	1.51	33.30	95.25
Dec-2008	6.86	10,950	3.46	47.49	35.04	17,433	7.75	1257.5	1.44	32.86	90.75
Jan-2009	6.86	11,355	3.61	47.08	34.92	17,475	7.75	1368.5	1.51	33.80	89.60
Feb-2009	6.84	11,980	3.69	48.24	35.33	17,475	7.75	1516.4	1.54	34.95	97.55
Mar-2009	6.84	11,575	3.65	48.42	35.78	17,756	7.75	1377.1	1.52	33.92	98.10
Apr-2009	6.85	10,713	3.56	48.70	35.46	17,784	7.75	1348.0	1.48	33.23	97.60
May-2009	6.82	10,340	3.51	47.55	34.57	17,784	7.75	1272.9	1.45	32.65	96.50
Jun-2009	6.81	10,225	3.52	48.31	34.14	17,801	7.75	1284.7	1.45	32.82	95.95
Jul-2009	6.82	9,920	3.52	48.12	34.05	17,815	7.75	1240.5	1.44	32.82	95.33
Aug-2009	6.82	10,060	3.53	48.91	34.02	17,823	7.75	1244.9	1.44	32.92	92.70
Sep-2009	6.83	9,681	3.47	47.59	33.83	17,841	7.75	1188.7	1.41	32.20	89.77
Oct-2009	6.82	9,545	3.41	47.73	33.41	17,862	7.75	1200.6	1.40	32.54	91.38
Nov-2009	6.83	9,480	3.39	46.75	33.28	18,485	7.75	1167.4	1.38	32.19	86.75
Dec-2009	6.83	9,400	3.42	46.36	33.23	18,472	7.76	1167.6	1.40	32.03	92.06
Jan-2010	6.82	9,365	3.41	46.74	33.04	18,472	7.76	1156.5	1.40	31.99	89.85
Feb-2010	6.84	9,335	3.41	46.26	33.15	18,925	7.76	1158.4	1.41	32.09	89.25
Mar-2010	6.83	9,115	3.27	45.22	32.51	19,080	7.77	1130.8	1.40	31.82	93.25
Apr-2010	6.83	9,012	3.19	44.64	32.29	18,960	7.77	1115.5	1.37	31.42	94.06
May-2010	6.83	9,180	3.25	46.21	32.40	18,980	7.79	1200.2	1.40	32.23	91.30
Jun-2010	6.84	9,083	3.26	46.42	32.47	19,065	7.79	1210.3	1.40	32.28	88.60
Jul-2010	6.85	8,952	3.19	45.81	32.33	19,095	7.77	1187.2	1.36	32.05	86.50
Aug-2010	6.86	9,041	3.14	45.18	31.74	19,485	7.78	1189.1	1.36	32.10	84.25
Sep-2010	6.85	8,924	3.09	43.90	30.83	19,485	7.76	1142.0	1.32	31.33	83.40
Oct-2010	6.86	8,928	3.11	43.18	29.97	19,495	7.75	1126.6	1.30	30.78	80.58
Nov-2010	6.86	9,013	3.16	44.26	29.89	19,498	7.77	1157.3	1.32	30.85	84.15
Dec-2010	6.86	8,991	3.08	43.89	30.12	19,498	7.78	1138.9	1.29	30.37	81.45
Jan-2011	6.87	9,057	3.06	44.09	30.58	19,498	7.80	1114.3	1.29	29.30	82.05
Feb-2011	6.86	8,823	3.05	43.84	30.72	20,875	7.79	1127.9	1.27	29.75	81.70
Mar-2011	6.86	8,709	3.03	43.43	30.37	20,908	7.78	1107.2	1.26	29.42	83.13
Apr-2011	6.87	8,574	2.97	43.02	30.05	20,625	7.77	1072.3	1.23	28.76	82.06
May-2011	6.87	8,537	3.01	43.29	30.25	20,535	7.78	1080.6	1.23	28.77	80.85
Jun-2011	6.86	8,597	3.02	43.49	30.52	20,565	7.78	1078.1	1.23	28.80	80.72
Jul-2011	6.86	8,508	2.96	42.23	30.07	20,555	7.79	1052.6	1.20	28.89	77.55
Aug-2011	6.85	8,578	2.98	42.51	29.88	20,822	7.80	1071.7	1.20	29.02	76.59
Sep-2011	6.84	8,823	3.19	43.64	31.23	20,822	7.79	1179.5	1.30	30.51	76.63
Oct-2011	6.85	8,835	3.07	43.03	30.71	20,999	7.77	1104.5	1.25	29.93	78.21

Sources: Haver Analytics, Datastream.

Appendix Table 7. East Asia: Foreign Exchange Reserves Excluding Gold

in billions of U.S. dollars

	China	Indonesia	Malaysia	Philippines	Thailand	Hong Kong SAR, China	Korea, Rep.	Singapore	Taiwan, China	Total
Dec-1997	142.8	17.4	20.8	7.3	26.3	92.8	20.4	71.3	83.5	482.5
Dec-1998	149.2	23.5	25.6	9.3	28.8	89.7	52.0	75.1	90.3	543.4
Dec-1999	157.7	27.3	30.6	13.3	34.1	96.2	74.0	77.0	106.2	616.4
Dec-2000	168.3	29.4	28.4	13.1	32.0	107.5	96.1	80.2	106.7	661.8
Dec-2001	215.6	28.0	29.6	13.5	32.4	111.2	102.8	75.7	122.2	730.9
Dec-2002	291.1	32.0	33.4	13.3	38.1	111.9	121.3	82.2	161.7	885.1
Dec-2003	408.2	36.3	44.6	13.7	41.1	118.4	155.3	96.2	206.6	1,120.3
Dec-2004	614.5	36.3	66.4	13.1	48.7	123.5	199.0	112.6	241.7	1,455.9
Dec-2005	821.5	34.7	70.2	15.9	50.7	124.2	210.3	116.2	253.3	1,697.1
Dec-2006	1,068.5	42.6	82.2	20.0	65.3	133.2	238.9	136.3	266.1	2,053.0
Dec-2007	1,530.3	56.9	101.1	30.2	85.2	152.6	262.1	163.0	270.3	2,651.7
Dec-2008	1,949.3	51.6	91.2	33.2	108.7	182.5	201.1	174.2	291.7	3,083.4
Dec-2009	2,416.0	66.1	96.4	38.8	135.5	255.8	269.9	187.8	348.2	3,814.5
Jan-2010	2,432.0	69.6	95.7	40.2	139.5	257.0	273.6	189.6	350.7	3,847.8
Feb-2010	2,441.2	69.7	95.6	40.2	138.8	258.2	270.6	187.6	352.7	3,854.6
Mar-2010	2,463.5	71.8	94.0	39.6	141.1	258.8	272.3	196.9	355.0	3,893.0
Apr-2010	2,506.9	78.6	94.7	40.6	144.4	259.2	278.8	203.2	357.6	3,963.9
May-2010	2,456.2	74.6	96.2	41.0	140.2	256.1	270.1	198.1	360.1	3,892.7
Jun-2010	2,471.2	76.3	93.3	41.8	143.4	256.7	274.1	199.7	362.4	3,919.1
Jul-2010	2,556.4	78.8	93.6	42.4	147.7	260.6	285.9	206.7	370.1	4,042.2
Aug-2010	2,565.3	81.3	93.8	42.8	151.2	261.3	285.3	206.2	372.1	4,059.2
Sep-2010	2,666.9	86.6	107.5	46.4	159.0	266.0	289.7	214.5	380.5	4,216.9
Oct-2010	2,779.8	91.8	114.1	50.3	166.7	267.0	293.3	221.2	383.8	4,368.0
Nov-2010	2,786.1	92.8	104.3	53.7	163.5	266.0	290.2	217.4	379.3	4,353.0
Dec-2010	2,866.1	96.2	104.9	55.4	167.5	268.6	291.5	225.5	382.0	4,457.7
Jan-2011	2,952.4	95.3	106.5	57.0	169.7	273.1	295.9	226.9	387.1	4,563.8
Feb-2011	3,012.2	99.6	108.1	56.9	174.9	272.6	297.6	230.7	390.7	4,643.3
Mar-2011	3,067.2	105.7	112.2	58.9	176.5	272.5	298.5	234.0	392.6	4,718.2
Apr-2011	3,168.5	113.8	128.3	60.9	184.4	276.8	307.1	242.3	399.5	4,881.7
May-2011	3,188.3	118.1	131.1	61.3	180.1	275.8	305.0	239.7	398.7	4,898.0
Jun-2011	3,219.8	119.7	132.6	61.4	178.8	277.1	304.4	242.1	400.3	4,936.1
Jul-2011	3,267.4	122.7	133.7	64.2	181.0	278.7	309.7	248.9	400.8	5,007.0
Aug-2011	3,284.4	124.6	134.5	68.4	180.3	279.4	310.9	249.0	400.3	5,031.8
Sep-2011	3,223.0	114.5	129.1	67.7	172.1	277.7	302.1	233.4	389.2	4,908.8
Oct-2011		114.0	134.6	67.9			309.7	245.2	393.3	

Sources: Haver Analytics, Thomson Datastream, and IMF International Financial Statistics.

Appendix Table 8a. East Asia: Balance of Payments

in percent of GDP

	Overall Balance					Current Account					Capital Account 1/				
	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010
East Asia and Pacific	7.1	8.9	6.8	8.2	7.1	7.0	8.4	7.1	5.8	4.9	0.1	0.4	-0.2	2.4	2.2
China	10.2	13.2	10.6	8.0	7.9	8.3	10.1	9.1	5.2	5.1	1.9	3.1	1.5	2.8	2.8
S.E. Asia	4.7	5.1	1.6	3.9	5.4	5.3	6.2	3.8	6.4	2.0	-0.6	-1.1	-2.2	-2.5	3.4
Indonesia	4.1	2.9	-0.4	2.3	4.3	3.0	2.4	0.0	2.0	0.8	1.1	0.5	-0.4	0.3	3.5
Malaysia	4.4	7.0	-1.6	2.0	0.0	16.7	15.9	17.5	16.5	0.0	-12.3	-8.9	-19.0	-14.5	0.0
Philippines	4.5	6.0	0.1	2.7	8.8	4.5	4.9	2.2	5.8	4.5	-0.1	1.1	-2.1	-3.1	4.4
Thailand	6.1	6.9	9.0	9.2	9.8	1.1	6.3	0.8	8.3	4.6	5.0	0.6	8.2	0.9	5.2
NIEs	3.1	2.5	1.0	12.8	6.3	6.0	7.2	5.1	8.0	6.9	-2.9	-4.7	-4.1	4.8	-0.7
Hong Kong SAR, China	3.2	7.1	15.8	33.9	4.1	12.1	12.3	13.7	8.6	6.2	-8.9	-5.2	2.1	25.3	-2.1
Korea, Rep.	2.3	1.4	-6.1	8.2	2.7	1.5	2.1	0.3	3.9	2.8	0.8	-0.6	-6.4	4.3	-0.1
Singapore	11.7	11.1	6.9	6.4	19.0	24.8	27.3	14.7	19.2	22.3	-13.1	-16.2	-7.8	-12.8	-3.3
Taiwan, China	1.6	-1.0	6.6	14.3	9.3	7.0	8.9	6.9	11.3	9.2	-5.4	-10.0	-0.3	3.0	0.1
Median	4.4	6.9	6.6	8.0	7.9	7.0	8.9	6.9	8.3	4.6	-0.1	-0.6	-0.4	0.9	0.1

Sources: IMF, Haver Analytics, national sources.

1/ Capital Account + Financial Account + Errors and Omissions.

Appendix Table 8b. East Asia: Capital Account Components

in percent of GDP

	Net FDI					Net Portfolio					Net Other Capital 2/				
	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010
East Asia and Pacific	2.3	2.1	1.7	0.6	1.3	-2.3	-0.8	-0.8	0.3	0.1	-2.3	-0.8	-0.8	0.3	0.1
China	3.7	4.1	2.7	1.4	2.1	-2.4	0.5	0.9	0.8	0.4	-2.4	0.5	0.9	0.8	0.4
S.E. Asia	1.6	0.7	0.1	-0.1	0.6	2.0	0.9	-2.4	0.3	3.1	2.0	0.9	-2.4	0.3	3.1
Indonesia	0.6	0.5	0.7	0.5	1.5	1.2	1.3	0.3	1.9	1.9	1.2	1.3	0.3	1.9	1.9
Malaysia	0.0	-1.5	-3.5	-3.4	-1.8	2.2	2.9	-10.8	-0.2	6.2	2.2	2.9	-10.8	-0.2	6.2
Philippines	2.4	-0.4	0.8	1.0	0.6	3.9	3.3	-2.2	-0.4	3.3	3.9	3.3	-2.2	-0.4	3.3
Thailand	4.1	3.4	1.6	0.3	0.3	2.1	-2.7	-0.8	-2.3	3.2	2.1	-2.7	-0.8	-2.3	3.2
NIEs	0.2	-1.3	-0.2	-2.0	-0.9	-4.4	-4.6	-4.1	-1.2	-3.4	-4.4	-4.6	-4.1	-1.2	-3.4
Hong Kong SAR, China	0.0	-3.3	4.2	-5.5	-3.2	-14.1	-1.3	-17.7	-20.5	-27.1	-14.1	-1.3	-17.7	-20.5	-27.1
Korea, Rep.	-0.8	-1.7	-1.8	-1.8	-1.9	-2.4	-2.5	-0.3	6.0	3.8	-2.4	-2.5	-0.3	6.0	3.8
Singapore	7.3	2.4	4.7	-1.7	8.5	-2.7	-8.8	-9.5	-8.5	-9.8	-2.7	-8.8	-9.5	-8.5	-9.8
Taiwan, China	0.0	-0.8	-1.2	-0.8	-2.1	-5.0	-10.2	-3.1	-2.7	-4.8	-5.0	-10.2	-3.1	-2.7	-4.8
Median	0.6	-0.4	0.8	-0.8	0.3	-2.4	-1.3	-2.2	-0.4	1.9	-2.4	-1.3	-2.2	-0.4	1.9

Sources: IMF, Haver Analytics, national sources.

3/ Net Other Investment + Net Financial Derivatives

Appendix Table 9. East Asia: Nonperforming Loans

in percent of total loans

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	
	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Mar	Jun
China 1/	..	..	..	..	..	23.6	17.9	13.2	8.6	7.1	6.2	2.4	1.6	1.1	1.1	1.0
Indonesia 2/	7.2	48.6	32.9	18.8	12.1	7.5	6.8	4.5	7.6	6.1	4.1	3.2	3.3	2.6	2.9	2.8
Malaysia 3/	..	10.6	11.0	9.7	11.5	10.2	9.0	7.5	5.8	4.8	3.2	2.2	1.8	2.3	2.2	2.0
Philippines 4/	..	11.0	12.7	14.9	16.9	14.6	13.8	12.5	8.6	6.1	4.9	4.1	3.7	3.6	4.3	..
Thailand 5/	..	45.0	38.9	17.7	10.4	15.7	12.7	10.7	8.2	7.5	7.3	5.3	4.9	3.6	3.2	3.0
Korea, Rep. 6/	6.0	7.3	13.6	8.8	3.3	2.4	2.2	2.0	1.3	0.9	0.7	1.1	1.2	1.9	2.0	1.7

Source: National data sources.

1/ Covers only the major commercial banks for 2002-04, and all commercial banks for 2005-10.

2/ Excludes IBRA's AMC. Data for 1997 to 2002 excludes state banks; the data source is the Monetary Division of Bank Indonesia. Data from 2003 covers all commercial banks including state banks; the data source is the Banking Supervision Division of Bank Indonesia

3/ Excludes Danaharta. This series, used by Bank Negara Malaysia, is net of provisions and excludes interest in suspense.

4/ Includes interbank loans.

5/ Excludes transfers to AMCs. The jump in headline NPLs in December 2002 was a one-off increase, reflecting a change in definition and did not affect provisioning.

6/ Excludes KAMCO/KDIC.

Appendix Table 10. East Asia: Financial Market Indicators

Stock Market Index, end-of-period, Dec. 31, 2007 = 100

	Jun-07	Dec-07	Jun-08	Dec-08	Jun-09	Dec-09	Jun-10	Dec-10	Jun-11	Oct-11
China	72.6	100.0	52.0	34.6	56.3	62.3	45.5	53.3	52.4	46.8
Indonesia	77.9	100.0	85.6	49.4	73.8	92.3	106.1	134.9	141.6	138.1
Malaysia	93.7	100.0	82.1	60.7	74.4	88.1	90.9	105.1	109.3	103.2
Philippines	101.1	100.0	67.9	51.7	67.3	84.3	93.1	116.0	118.5	119.7
Thailand	90.5	100.0	89.6	52.4	69.6	85.6	92.9	120.4	121.4	113.6
Vietnam	110.5	100.0	43.1	34.0	48.4	53.4	54.7	52.3	46.7	45.4
Hong Kong SAR, China	78.3	100.0	79.5	51.7	66.1	78.6	72.4	82.8	80.5	71.4
Korea, Rep.	91.9	100.0	88.3	59.3	73.3	88.7	89.5	108.1	110.7	100.6
Singapore	100.3	100.0	85.1	50.8	67.3	83.6	81.8	92.0	90.0	82.4
Taiwan, China	104.4	100.0	88.4	54.0	75.6	96.3	86.2	105.5	101.7	89.2

Source: Thomson Datastream.

Yields, 10-year local-currency government bonds, end-of-period, in percent

	Jun-07	Dec-07	Jun-08	Dec-08	Jun-09	Dec-09	Jun-10	Dec-10	Jun-11	Oct-11
China	4.4	4.5	4.5	2.8	3.2	3.6	3.3	3.9	3.9	3.9
Indonesia	9.0	10.0	13.4	11.9	11.1	10.1	8.4	7.6	7.5	6.9
Malaysia	5.0	4.1	4.9	3.2	4.4	4.3	4.0	4.0	3.9	3.7
Philippines	7.4	6.6	9.4	7.4	8.1	8.1	7.9	6.1	6.6	6.2
Thailand	4.5	5.0	5.9	2.7	3.7	4.2	3.1	3.7	3.9	3.7
Vietnam	7.8	9.1	16.0	10.2	9.7	11.5	11.5	11.8	12.5	12.7
Hong Kong SAR, China	4.8	3.4	3.5	1.9	2.6	2.6	2.3	2.9	2.3	1.3
Korea, Rep.	5.5	5.7	6.0	4.2	5.2	5.4	5.0	4.5	4.3	4.0
Singapore	2.9	2.7	3.6	2.1	2.6	2.7	2.4	2.7	2.3	1.6
Taiwan, China	2.5	2.6	2.7	1.4	1.6	1.5	1.4	1.6	1.6	1.3

Source: Bloomberg.

Foreign-Currency Government Bond Spreads (EMBIG), end-of-period, in basis points over U.S. Treasuries

	Jun-07	Dec-07	Jun-08	Dec-08	Jun-09	Dec-09	Jun-10	Dec-10	Jun-11	Oct-11
China	54	120	137	228	122	104	86	126	155	293
Indonesia	165	275	381	762	433	230	274	183	178	332
Malaysia	75	119	153	119	167	136	171	117	131	233
Philippines	155	172	303	546	324	206	266	163	160	289
Vietnam	122	203	368	747	379	314	338	323	329	549

Source: JP Morgan, Bloomberg.

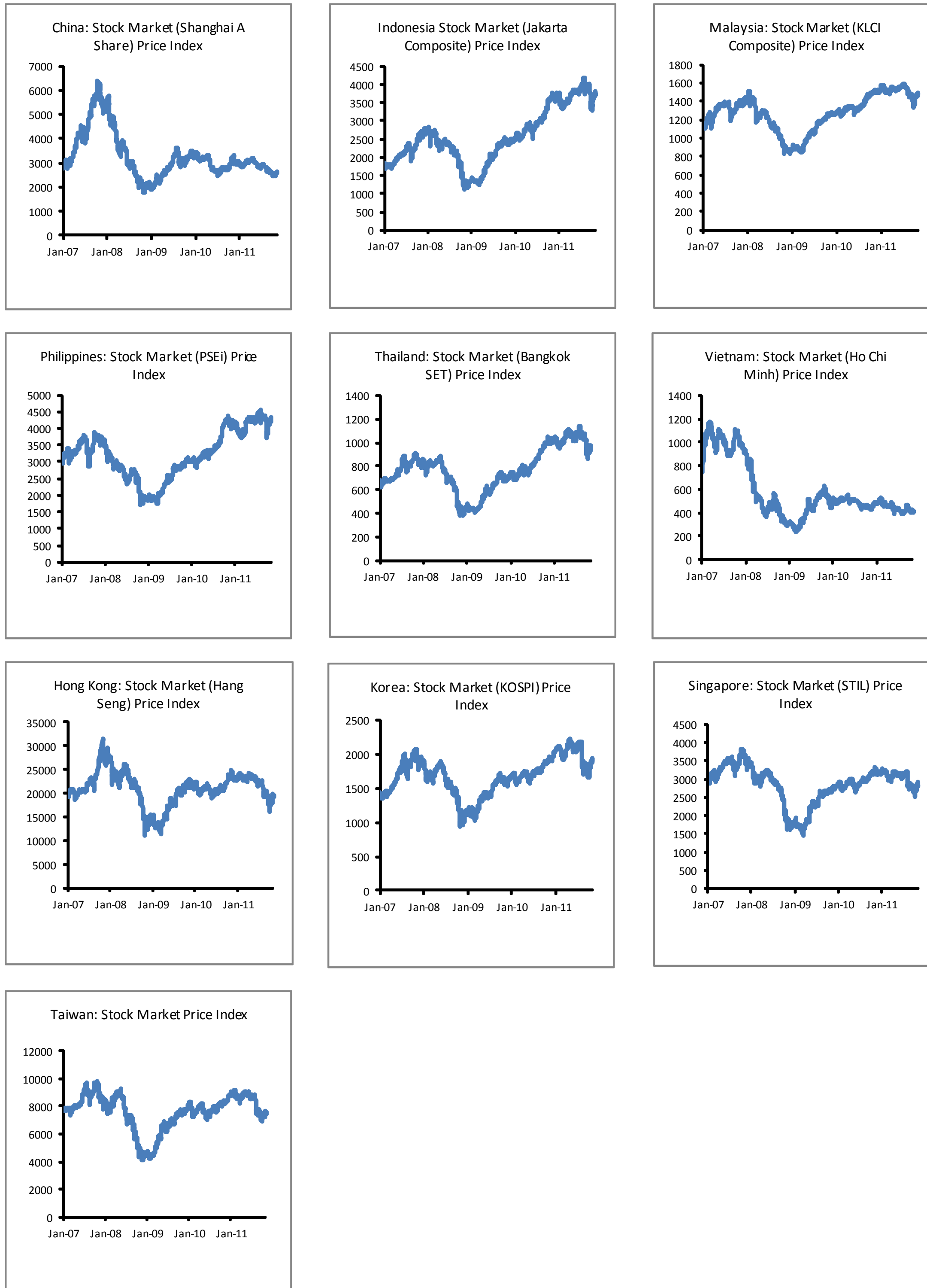
Credit Default Swap (CDS) Spreads on Foreign-Currency Government Bonds, 5-year, end-of-period, in basis points

	Jun-07	Dec-07	Jun-08	Dec-08	Jun-09	Dec-09	Jun-10	Dec-10	Jun-11	Oct-11
China	13	29	75	188	75	73	91	68	85	120
Indonesia	110	154	286	638	317	188	186	133	141	177
Malaysia	16	44	116	225	105	90	102	74	93	127
Philippines	111	153	266	384	217	168	174	130	138	164
Thailand	39	55	135	256	110	96	134	99	136	158
Hong Kong SAR, China	5	18	42	104	68	48	57	46	54	75
Korea, Rep.	17	47	107	319	182	85	131	98	103	131
Singapore	..	..	..	45	45	35	45	45	90	83

Source: Thomson Datastream.

APPENDIX CHARTS

Appendix Chart 1. East Asia: Stock Market Price Indices

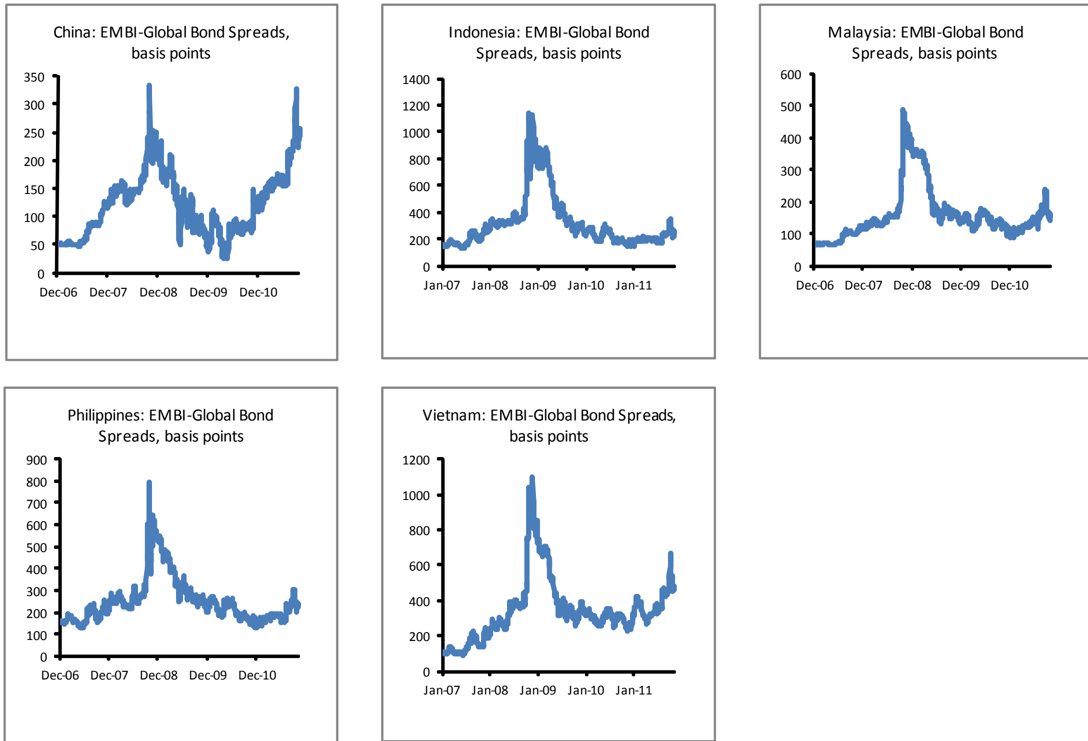


Sources: Thomson Datastream.

Appendix Chart 2. East Asia: Local-Currency 10-Year Government Bond Yields

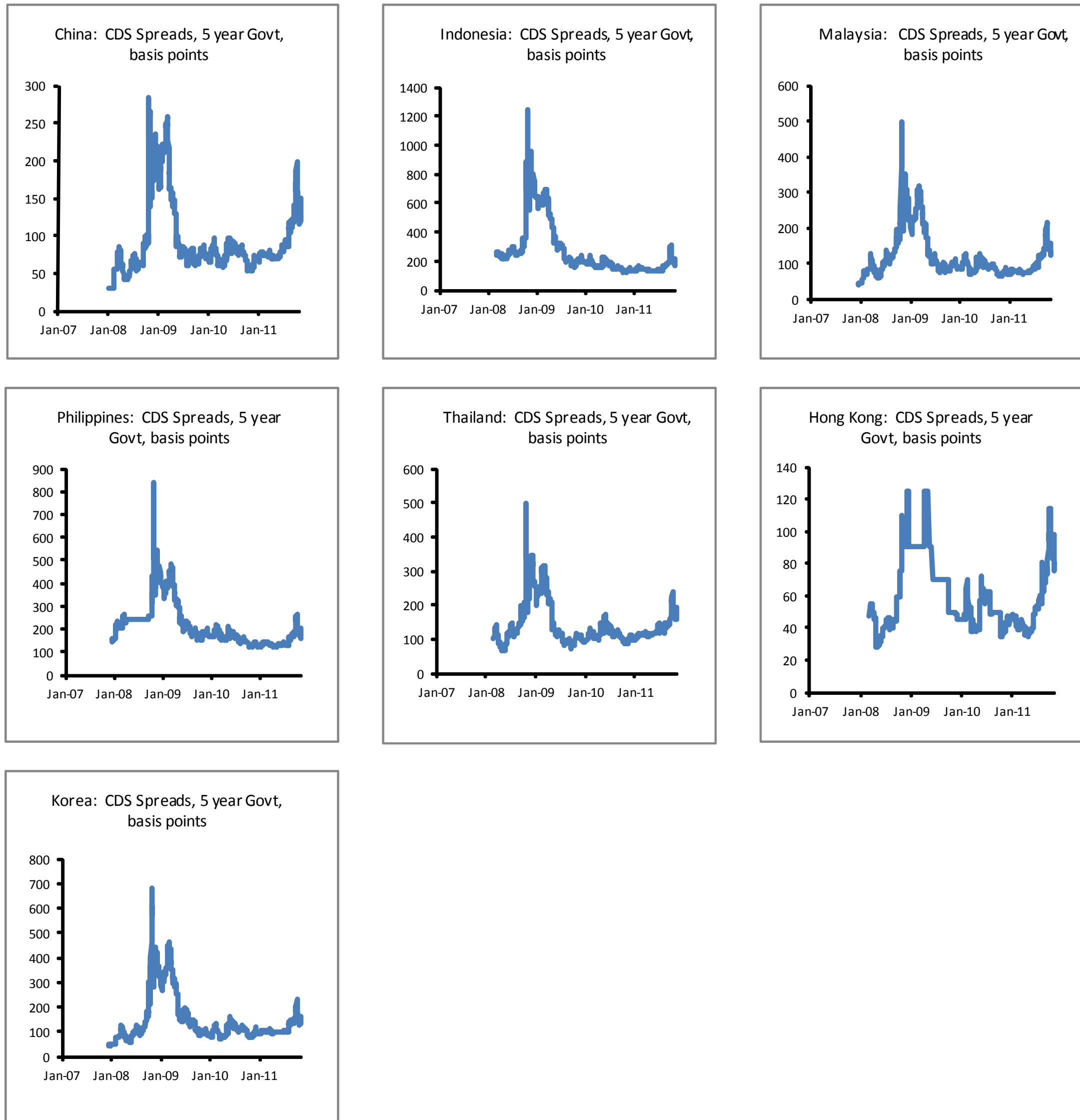
Source: Bloomberg.

Appendix Chart 3. East Asia: Foreign-Currency Government Bond Spreads



Source: JPMorgan Emerging Markets Bond Index Global (EMBIG), via Bloomberg.

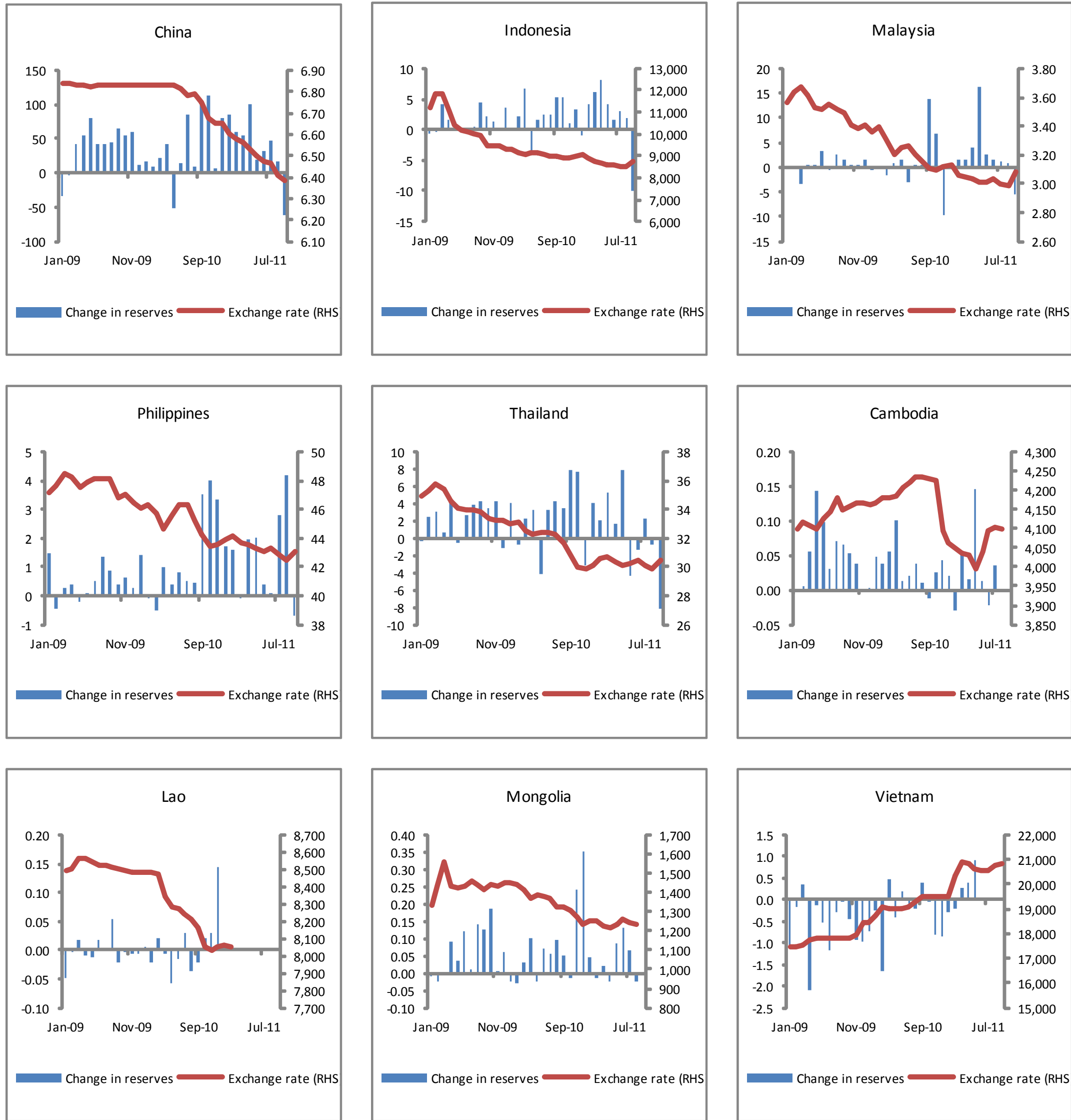
Appendix Chart 4. East Asia: Sovereign Credit Default Swap (CDS) Spreads



Source: Thomson Reuters, via Datastream.

Appendix Chart 5. East Asia: Foreign Exchange Reserves and Exchange Rates

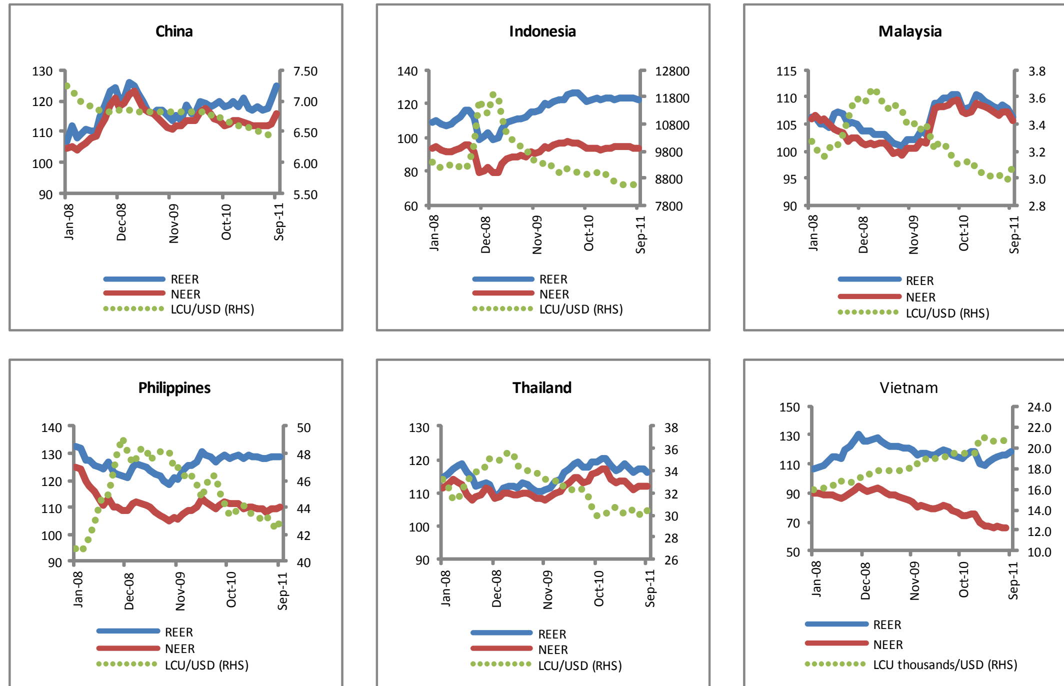
in billions of U.S. dollars and in local currency unit per U.S. dollar



Source: Haver Analytics and IMF.

Appendix Chart 6. East Asia: Real and Nominal Exchange Rates*

indices, 2005 = 100, and in local currency unit per U.S. dollar



Source: BIS, IMF and Haver Analytics.
**REER* = real effective exchange rate; NEER = nominal effective exchange rate; LCU = local currency units.

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